IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE LOCATED OUTSIDE OF THE UNITED STATES.

IMPORTANT: You must read the following before continuing. The following applies to the Prospectus following this page and you are therefore advised to read this page carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from the Issuer (as defined in the Prospectus), HSBC Bank plc or J.P. Morgan Securities Ltd. (together, the "**Joint Lead Managers**") or Erste Group Bank AG (together with the Joint Lead Managers, the "**Managers**") as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE NOTES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "**SECURITIES ACT**"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION, AND THE NOTES MAY NOT BE OFFERED OR SOLD, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER AND, IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THE PROSPECTUS IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS. IF YOU HAVE GAINED ACCESS TO THIS TRANSMISSION CONTRARY TO ANY OF THE FOREGOING RESTRICTIONS, YOU ARE NOT AUTHORISED AND WILL NOT BE ABLE TO PURCHASE ANY OF THE NOTES DESCRIBED IN THE ATTACHED PROSPECTUS.

Confirmation of your representation: In order to be eligible to view the attached Prospectus or make an investment decision with respect to the securities being offered, prospective investors must be located outside the United States. The Prospectus is being sent to you at your request, and by accessing the Prospectus you shall be deemed to have represented to the Issuer and each Manager that (1) you are purchasing the securities being offered in an offshore transaction (within the meaning of Regulation S under the Securities Act) and the electronic mail address that you gave us and to which this e-mail has been delivered is not located in the United States, its territories and possessions, any State of the United States or the District of Columbia and (2) you consent to delivery of the Prospectus by electronic transmission.

You are reminded that the Prospectus has been delivered to you on the basis that you are a person into whose possession the Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver the Prospectus to any other person.

The materials relating to this offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer, and a Manager or any affiliate of a Manager is a licensed broker or dealer in the relevant jurisdiction, the offering shall be deemed to be made by such Manager or such affiliate on behalf of the Issuer in such jurisdiction.

The Prospectus has been sent to you in electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Issuer and the Managers, any person who controls them or any director, officer, employee or agent of them or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from each of the Managers.

MONTENEGRO

acting through its Ministry of Finance

EUR 180,000,000
7.250 per cent Notes due 2016

Issue Price: 99.492 per cent

The issue price of the EUR 180,000,000 7.250 per cent Notes due 2016 (the "**Notes**") issued by Montenegro, acting through its Ministry of Finance (the "**Issuer**" or "**Montenegro**") is 99.492 per cent of their principal amount. The Notes will be redeemed at their principal amount on 8 April 2016. The Notes are not redeemable prior to maturity.

Interest on the Notes is payable annually in arrear on 8 April in each year.

All payments in respect of the Notes will be made by or on behalf of the Issuer without withholding or deduction for or on account of taxes imposed or levied by or within Montenegro or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. As at the date of this Prospectus, withholding tax of 9 per cent is applicable under Montenegrin law to payments of interest in respect of the Notes, except where any applicable double taxation treaty stipulates otherwise. If payments in respect of the Notes are subject to withholding or deduction for any such tax, pursuant to Condition 10 (*Taxation*) of the Terms and Conditions of the Notes, the Issuer has agreed to pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, subject only to the exceptions set out in that Condition. See "*Terms and Conditions of the Notes — Condition 10 (Taxation)*" and "*Taxation — Montenegrin Taxation*".

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "**UK Listing Authority**") for the Notes to be admitted to the official list of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for such Notes to be admitted to trading on the London Stock Exchange's regulated market (the "**Market**"). References in this Prospectus to Notes being "**listed**" (and all related references) shall mean that such Notes have been admitted to trading on the Market and have been admitted to the Official List. The Market is a regulated market for the purposes of the Markets in Financial Instruments Directive 2004/39/EC.

The Notes will be offered and sold in offshore transactions outside the United States in reliance on Regulation S ("**Regulation S**") under the U.S. Securities Act of 1933, as amended (the "**Securities Act**").

THE NOTES HAVE NOT BEEN NOR WILL BE REGISTERED UNDER THE SECURITIES ACT, OR ANY STATE SECURITIES LAW, AND THE NOTES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES, EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

The Notes will be rated Ba3 (with stable outlook) by Moody's Investors Service Ltd. ("**Moody's**") and BB (with negative outlook) by Standard & Poor's Credit Market Services Europe Ltd. ("**S&P**"). Moody's and S&P are established in the European Union and have applied to be registered under Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies although the result of such application has not yet been determined. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating agency.

The Notes will be issued in registered form in minimum denominations of EUR 100,000 and integral multiples of EUR 1,000 in excess thereof. The Notes will be represented by a global registered note certificate (the "**Global Note**") which will be registered in the name of a nominee of, and deposited with, a common depositary for Euroclear Bank S.A./N.V. ("**Euroclear**"), and Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**") on or around 8 April 2011 (the "**Closing Date**"). Individual note certificates (the "**Definitive Note Certificates**") evidencing holdings of Notes will be available only in certain limited circumstances. See "*Summary of Provisions Relating to the Notes in Global Form*".

INVESTING IN THE NOTES INVOLVES A HIGH DEGREE OF RISK. SEE "*RISK FACTORS*" BEGINNING ON PAGE 2.

Joint Lead Managers

HSBC **J.P. MORGAN**

Co-Lead Manager

ERSTE GROUP

The date of this Prospectus is 6 April 2011

This Prospectus constitutes a prospectus for the purpose of Article 5 of Directive 2003/71/EC (the "**Prospectus Directive**"). The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

None of the Managers and their directors, affiliates, advisers and agents has made any independent verification of the information contained in this Prospectus in connection with the issue or offering of the Notes and no representation or warranty, express or implied, is made by any of the Managers or their directors, affiliates, advisers or agents with respect to the accuracy or completeness of such information. Nothing contained in this Prospectus is, is to be construed as, or shall be relied upon as, a promise, warranty or representation, whether to the past or the future, by any of the Managers or their respective directors, affiliates, advisers or agents in any respect. The contents of this Prospectus are not, are not to be construed as, and should not be relied on as, legal, business or tax advice and each prospective investor should consult its own legal and other advisers for any such advice relevant to it.

No person is authorised to give any information or make any representation not contained in this Prospectus in connection with the issue and offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by any of the Issuer, the Managers or any of their directors, affiliates, advisers or agents. The delivery of this Prospectus does not imply that there has been no change in the affairs of the Issuer since the date hereof or that the information herein is correct as of any time subsequent to its date.

This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy the Notes by any person in any jurisdiction where it is unlawful to make such an offer or solicitation. The distribution of this Prospectus and the offer or sale of the Notes in certain jurisdictions is restricted by law. This Prospectus may not be used for, or in connection with, and does not constitute, any offer to, or solicitation by, anyone in any jurisdiction or under any circumstance in which such offer or solicitation is not authorised or is unlawful. Persons into whose possession this Prospectus may come are required by the Issuer and the Managers to inform themselves about and to observe such restrictions. Further information with regard to restrictions on offers, sales and deliveries of the Notes and the distribution of this Prospectus and other offering material relating to the Notes is set out under *"Subscription and Sale"*.

STABILISATION

In connection with the issue of the Notes, HSBC Bank plc (the "**Stabilising Manager**") (or any person acting on behalf of the Stabilising Manager) may over allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or any person acting on behalf of the Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or any person acting on behalf of the Stabilising Manager) in accordance with all applicable laws and rules.

ENFORCEMENT OF FOREIGN JUDGMENTS

The Issuer is a sovereign state. Consequently, it may be difficult for investors to obtain or realise upon judgments of courts in England against the Issuer without compliance with the Montenegrin enforcement procedure for foreign judgments. In addition, it may be difficult to enforce arbitral awards in Montenegro.

The Notes, the Fiscal Agency Agreement and the Deed of Covenant, including any non-contractual obligations arising out of or in connection with the Notes, the Fiscal Agency Agreement or the Deed of Covenant, are governed by English law and the Issuer has agreed that any claims or disputes arising thereunder shall be referred to and finally settled by arbitration in accordance with the rules of the London Court of International Arbitration. Montenegro is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

To the extent that the Issuer may in any jurisdiction claim or acquire for itself or its assets immunity from jurisdiction, suit, execution, attachment (whether in aid of execution of a judgment, before judgment or award or otherwise) or other legal process, including in relation to the enforcement of any arbitration award, and to the extent that in any such jurisdiction there may be attributed to itself or its assets such immunity (whether or not claimed), the

Issuer has irrevocably consented to the enforcement of any judgment or award, agreed not to claim and irrevocably waived such immunity to the fullest extent permitted by the laws of the jurisdiction (other than immunity in respect of (a) property used by diplomatic or consular mission of the Issuer or (b) property of a military character and under the control of a military authority or defence agency, which is expressly not waived).

PRESENTATION OF ECONOMIC AND OTHER INFORMATION

Unless otherwise specified or the context so requires, references to "**U.S. Dollars**" and "**US$**" are to United States dollars, references to "**euro**", "**EUR**" and "**€**" are to the currency introduced at the start of the third stage of European Economic and Monetary Union, and as defined in Article 2 of Council Regulation (EC) No. 974/98 of 3 May 1998 on the introduction of the euro, as amended, unless otherwise specified, references to a "**Member State**" are references to a Member State of the European Economic Area and references to "**SDR**" are to special drawing rights allocated by the International Monetary Fund ("**IMF**").

Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

Gross Domestic Product ("**GDP**") is a measure of the total value of final products and services produced in a country. "**Nominal GDP**" measures the total value of final production in current prices. "**Real GDP**" measures the total value of final production in constant prices, thus allowing historical GDP comparisons that exclude the effect of inflation. Unless otherwise stated, references in this Prospectus to "**GDP**" are to Nominal GDP figures.

References to laws, including the Budget, refer to such laws (and the Budget), as amended from time-to-time.

Unless otherwise stated, all annual information, including budgetary information for Montenegro, is based on calendar years. Unless otherwise stated, all budgetary and statistical information as at and for the year ended 31 December 2010 is preliminary and subject to revision and amendment. Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same item of information may vary reflecting such rounding, and figures which are totals may not be the arithmetical aggregate of their components.

Statistical data appearing in this Prospectus has, unless otherwise stated, been obtained from the Statistical Office of the Republic of Montenegro ("**Monstat**"), the Ministry of Finance, the Employment Agency and the Central Bank of Montenegro (the "**Central Bank**" or "**CBM**"). Similar statistics may be obtained from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source. Although every effort has been made to include in this Prospectus the most reliable and the most consistently presented data, no assurance can be given that such data was compiled or prepared on a basis consistent with international standards. However, as far as the Government is aware and is able to ascertain from the information published by these entities, the information has been accurately reproduced and no facts have been omitted which would render the reproduced information inaccurate or misleading.

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Prospectus, as well as written and oral statements that Montenegro and its representatives make from time to time in reports, filings, news releases, conferences, teleconferences, web postings or otherwise, are or may be deemed to be "forward-looking statements". Statements that are not historical facts, including, without limitation, statements about Montenegro's beliefs and expectations, are forward-looking statements. These statements are based on current plans, objectives, assumptions, estimates and projections. Therefore, undue reliance should not be placed on them. Forward-looking statements speak only as at the date on which they are made and Montenegro undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. Montenegro cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to: (i) plans with respect to the implementation of economic policies and the pace of economic and legal reforms; (ii) expectations about the behaviour of the economy if certain economic and fiscal policies are implemented; (iii) the outlook for inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts; and (iv) estimates of debt repayment and debt service.

In addition to the factors described in this Prospectus, including, but not limited to, those discussed under *"Risk Factors"*, the following factors, among others, could cause future results to differ materially from those expressed in any forward-looking statements made herein: (i) decisions of international organisations regarding the terms of their financial assistance to Montenegro and accordingly the net flow to or from such international organisations over the life of the Notes; (ii) adverse external factors, such as changes in the credit rating of Montenegro, higher international interest rates, low commodity prices or recession or low growth in Montenegro's trading partners or increases in world commodities prices, which could each decrease Montenegro's fiscal and foreign exchange revenues and could negatively affect the current account, balance of payments and international reserves and cause or contribute to recession or low growth in Montenegro; (iii) adverse domestic factors, such as recession, decline in foreign direct investment ("**FDI**") and portfolio investment, high domestic inflation, high domestic interest rates, difficulties in borrowing in the domestic and foreign markets, trade and political consensus, any of which could lead to lower growth in Montenegro and lower international currency reserves; (iv) relations with creditors; (v) decisions of international financial institutions such as the World Bank, the European Bank for Reconstruction and Development (the "**EBRD**") and the European Investment Bank (the "**EIB**") regarding the provision of funding for new or existing projects over the life of the Notes; and (vi) political factors in Montenegro, which may affect the timing and structure of economic reforms, the climate for FDI and the pace, scale and timing of privatisations.

CONTENTS

RISK FACTORS

The Issuer believes that the following factors may affect its ability to fulfil its obligations under the Notes. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which the Issuer believes are material for the purpose of assessing the market risks associated with the Notes are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Notes, but the Issuer may be unable to pay interest, principal or other amounts on or in connection with the Notes for other reasons and the Issuer does not represent that the statements below regarding the risks of holding the Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.

Risks associated with Emerging Markets

Investors in securities of sovereign or corporate issuers in emerging markets such as Montenegro should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. These greater risks include economic instability, caused by a variety of factors such as a narrow export base, reliance on imports, fiscal and current account deficits, reliance on foreign investment, high unemployment and changes in the political, economic, social, legal and regulatory environment. Actions of governments may be challenged by future governments. Investors should also note that emerging economies such as Montenegro's are subject to rapid change and that the information set out in this Prospectus may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in the light of those risks, their investment is appropriate. Generally, investment in emerging markets is suitable only for sophisticated investors who fully appreciate the significance of the risks involved. Investors are urged to consult with their own legal and financial advisers before making an investment in the Notes.

The disruptions recently experienced in the international and domestic capital markets have led to reduced liquidity and increased credit risk premiums for certain market participants and have resulted in a reduction of available financing. Any entity located in countries in the emerging markets may be particularly susceptible to these disruptions and reductions in the availability of credit or increases in financing costs, which could result in them experiencing financial difficulty.

In addition, the availability of credit to entities operating within the emerging markets is significantly influenced by levels of investor confidence in such markets as a whole and so any factors that impact market confidence (for example, a decrease in credit ratings or state or central bank intervention in one market) could affect the price or availability of funding for entities within any of these markets.

Factors that may affect the Issuer's ability to fulfil its obligations under the Notes

Progress towards EU Accession

Montenegro is in the process of applying for full membership of the EU. See "*Montenegro — International Relations — Montenegro's relationship with the international community — European Union*". The country's EU Stabilisation and Association Agreement became effective on 1 May 2010 and on 17 December 2010, the European Council recognised Montenegro's progress by granting it candidate country status. The timing of Montenegro attaining full membership of the EU will, however, depend on a number of economic and political factors relating to both Montenegro and the EU. As a result, there can be no assurance that Montenegro will be able become a full member of the EU within any given timescale.

Legal System

Montenegro has taken, and continues to take, steps to move towards a mature legal system which is comparable to the legal systems of the EU countries. New laws have been introduced and revisions have been made with respect to, amongst others, company, property, securities, labour and taxation laws in order to harmonise them with EU laws. However, such new laws and revisions remain untested in the courts and do not have a long history of interpretation. In some circumstances, therefore, it may not be possible to obtain swift enforcement of a judgment in Montenegro or predict the outcome of legal proceedings subject to these new laws.

Montenegro's economy remains vulnerable to external shocks, including the recent global financial and economic crisis, which could have an adverse effect on Montenegro's economic growth

Montenegro's economy remains vulnerable to external shocks such as the recent global financial and economic crisis. Although in recent years Montenegro had made significant progress in increasing its GDP and increasing real wages, the global financial and economic crisis negatively affected the Montenegrin economy. During the crisis, Montenegro experienced a decline in GDP and an increase in total debt. During 2009, GDP fell to €2,981 million, a decrease of approximately 5.7 per cent in real terms compared to 2008. During 2010 GDP recovered slightly to €3,025 million, an increase of 1.5 per cent over the previous year. As at 31 December 2010, total debt had increased to €1,270.7 million compared to €1,140.2 million at the end of 2009, which was an increase of 3.8 per cent of total GDP compared to 2009. Despite the fact that Montenegro's GDP growth averaged 8.7 per cent in real terms between 2006 and 2008, this growth pattern was reversed in 2009 and overall growth resumed only slowly in 2010, as described above. There can be no assurance that, in the short to medium-term, the economy of Montenegro will return to the growth levels experienced between 2006 and 2008.

The decrease in the lending activities of Montenegrin banks may continue to have an adverse effect on the overall economy, in particular small and medium-sized enterprises operating in the service sector

The impact of the recent global financial and economic crisis first became evident in the Montenegrin banking system in October 2008 and has led to a significant reduction in bank deposits, restrictions on banks' access to external sources of funding, reduction of inflow of funds by way of repayment of loans caused by the deterioration in the financial position of borrowers which in turn has led to an overall decline in the quality of assets (as described in detail in the following paragraph) and profitability and almost total discontinuance of banks' lending activities. This has resulted in severe liquidity problems for the many small businesses operating in the service sector of the Montenegrin economy which have no alternative means of financing and has in turn contributed to an increase in the overall level of tax arrears, particularly for the service sector. In 2010 there was a net increase in tax receivables of 1.7 per cent of GDP, giving a total increase of 4.1 per cent of GDP since the start of 2009. The difficulties with access to credit are likely to continue to affect growth prospects for the economy as a whole and the small and medium-sized service sector, in particular and growth in this sector is unlikely to resume until Montenegrin banks increase their lending activities.

Other risks associated with the banking sector

Since the end of 2008, the total amount of outstanding loans in the Montenegrin banking sector has gradually declined as banks restricted their lending activities by adopting more conservative policies in response to the global financial and economic crisis. At the end of December 2010, total loans were EUR 2,200.0 million, representing a decrease of 8.2 per cent compared to the total amount of loans of EUR 2,397.8 million at the end of 2009. As at 31 December 2010, the total amount of non performing loans stood at 21.0 per cent of total loans compared to 13.5 per cent at the end of 2009, with the ratio of provisions for losses to total non-performing loans standing at 0.3 as at 31 December 2010, down from 0.5 as at 31 December 2009. Expectations of further asset quality deterioration could prompt banks to be slower to restore their lending activities to previous levels and this may have an adverse effect on growth prospects for the economy as a whole and the small and medium-sized service sector, in particular, as described above.

As at 31 December 2010, foreign banks owned approximately 88.4 per cent of total banks' assets in the Montenegrin banking system. Foreign banks may rebalance their global loan portfolios in a manner adversely affecting Montenegro as a result of events related or unrelated to Montenegro. In addition, although the overall amount invested in the Montenegrin banking system by foreign banks is relatively small compared to their investments in the banking systems of certain other countries, foreign banks may decrease funding to their subsidiaries operating in Montenegro due to actual or perceived deterioration in asset quality of the relevant subsidiaries (particularly an increase in non-performing loans) or in the event of a weaker than expected economic performance. As a result of these or other factors, or other potential shocks, foreign banks may revise their business strategies in, or relating to, Montenegro and in particular their decision to continue to provide existing levels of funding to their subsidiaries in Montenegro. Resulting balance sheet mismatches may negatively affect the Montenegrin economy.

In addition, as a result of the adoption of the euro as the Montenegrin currency, the Central Bank's ability to regulate monetary policy and provide liquidity to the Montenegrin banking system is limited. See "Monetary and Financial System".

The CBM is not a member of the European System of Central Banks or the European Central Bank

Although Montenegro's legal tender is the euro, Montenegro is not yet a member of the EU or the Eurosystem. Unlike most other jurisdictions which use the euro, the CBM is not a member of the European System of Central Banks or the European Central Bank ("ECB"). As a result, the CBM has no involvement in ECB policy and neither Montenegro nor the CBM will benefit from any support programmes provided to EU member states or institutions located in EU member states, which could negatively affect Montenegro's economy relative to other Eurozone institutions which receive such support.

Montenegro depends on its tourism industry as a significant source of revenue and any deterioration in its tourism industry may adversely affect Montenegro's economy

The Government estimates that in 2009 approximately 20.8 per cent of total Montenegrin GDP was generated by tourism, whether directly or indirectly. Estimates are not yet available for the contribution of tourism to GDP in 2010, but in recent years tourism has been, and is expected by the Government to continue to be, a very important sector of the economy. Revenue generated by the tourism industry depends on various factors, including consumer spending power, which may be adversely affected by economic downturns, and public perception of the attractiveness and safety of a potential tourist destination.

Negative developments affecting these and other factors may adversely affect the tourism industry in Montenegro and have negative effects on the Montenegrin economy.

Statistical Information

A range of ministries and institutions, including Monstat, produce statistics relating to Montenegro and its economy. However, these statistics may be more limited in scope, less reliable and/or consistent in terms of basis of compilation between various ministries and institutions and published less frequently than is the case for the comparable statistics for other countries (particularly existing members of the EU), making adequate monitoring of key fiscal and economic indicators more difficult than for other countries. Statistical data appearing in this Prospectus has, unless otherwise stated, been obtained from public sources and documents. Similar statistics may be obtainable from other sources, but the underlying assumptions, methodology and, consequently, the resulting data may vary from source to source. In addition, statistics for the years prior to Montenegrin independence in 2006 may not be comparable to those compiled since 2007 as the methodology applied by Montenegro as an independent country has changed in a number of respects, including for example, the elimination of double-counting of goods for export and re-export. The existence of a substantial unofficial or unobserved economy in Montenegro may also affect the accuracy and reliability of statistical information. Prospective investors should be aware that none of the statistical information in this Prospectus has been independently verified.

Montenegro's credit rating

The long-term debt of Montenegro is currently rated Ba3 (with stable outlook) by Moody's and BB (with negative outlook) by S&P. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Any adverse change in an applicable credit rating could adversely affect the trading price of the Notes.

A claimant may not be able to enforce a court judgment or arbitral award against certain assets of Montenegro in certain jurisdictions

Montenegro is a sovereign state. There is a risk that, notwithstanding the waiver of sovereign immunity by Montenegro pursuant to the Terms and Conditions of the Notes, a claimant will not be able to enforce a court judgment or arbitral award against certain assets of Montenegro in certain jurisdictions (including the imposition of any arrest order or attachment or seizure of such assets and their subsequent sale) without Montenegro having specifically consented to such enforcement at the time when the enforcement is sought.

Factors which are material for the purpose of assessing the market risks associated with the Notes

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Prospectus or any applicable supplement;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes;

(iv) understand thoroughly the terms of the Notes; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Risks related to the Notes generally

Set out below is a brief description of certain risks relating to the Notes generally:

Collective Action

The Notes contain provisions regarding acceleration and voting on amendments, modifications, changes and waivers, which are commonly referred to as "collective action" clauses. Under these provisions, certain key provisions of the Notes may be amended, including the maturity date, interest rate and other payment terms, with the consent of the Issuer and defined majorities of Noteholders. Each such amendment will be binding on all Noteholders, whether or not they voted in favour of such amendment or at all. See "*Terms and Conditions of the Notes — Condition 14 (Meetings of Noteholders; Modification)*".

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate following the conclusion of certain other agreements relating to information exchange with certain other countries.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding measures) in relation to payments made by a person within their jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment is made or collected through a Member State that has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Agent (as defined in "*Terms and Conditions of the Notes*" below) nor any other person is obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Under the Terms and Conditions of the Notes, the Issuer is required to maintain an Agent in a Member State that would not be obliged to withhold or deduct tax pursuant to the EU Savings Directive.

Change of law

The Terms and Conditions of the Notes are based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus.

Risks related to the market generally

Set out below is a brief description of certain market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

The secondary market generally

The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Notes.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Notes in euro. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than euro. These include the risk that exchange rates may significantly change (including changes due to devaluation of euro or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to euro would decrease (1) the Investor's Currency equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Credit ratings may not reflect all risks

The credit rating(s) assigned to the Notes at any time may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk based capital or similar rules.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and conditions of the Notes which, subject to amendment and completion and except for the text in italics, will be endorsed on each Definitive Note Certificate (if issued):

The EUR 180,000,000 7.250 per cent Notes due 2016 (the "**Notes**", which expression includes any further notes issued pursuant to Condition 16 (*Further Issues*) and forming a single series therewith) of Montenegro (acting through its Ministry of Finance) (the "**Issuer**") (a) are subject to, and have the benefit of, a deed of covenant dated 8 April 2011 (as amended or supplemented from time to time, the "**Deed of Covenant**") of the Issuer, and (b) are the subject of a fiscal agency agreement dated 8 April 2011 (as amended or supplemented from time to time, the "**Fiscal Agency Agreement**") between the Issuer, Deutsche Bank AG, London Branch as fiscal agent (the "**Fiscal Agent**", which expression includes any successor fiscal agent appointed from time to time in connection with the Notes), the other paying and transfer agents named therein (together with the Fiscal Agent, the "**Agents**", which expression includes any successor or additional paying and transfer agents appointed from time to time in connection with the Notes) and Deutsche Bank Luxembourg S.A., in its capacity as Registrar (the "**Registrar**", which expression shall include any successor registrar appointed from time to time in connection with the Notes).

Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement and are subject to its detailed provisions. The Noteholders are bound by, and are deemed to have notice of all the provisions of the Fiscal Agency Agreement applicable to them. Copies of the Fiscal Agency Agreement are available for inspection during normal business hours at the Specified Offices (as defined in the Fiscal Agency Agreement) of the Agents. References to "Conditions" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

1. Form, Denomination and Title

(a) *Form and denomination*

The Notes are in registered form, serially numbered.

The Notes will be issued in minimum denominations of EUR 100,000 or any amount in excess thereof which is an integral multiple of EUR 1,000 (each an "**Authorised Holding**").

(b) *Title*

Title to the Notes will pass by transfer and registration as described in Conditions 2 (*Registration*) and 3 (*Transfer of Notes*). The holder (as defined below) of any Note will (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as its absolute owner for all purposes whether or not it is overdue and regardless of any notice of ownership, trust or any other interest in it, any writing thereon by any person (as defined below) (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof; and no person will be liable for so treating the holder.

In these Conditions, "**Noteholder**" or "**holder**" means the person in whose name a Note is for the time being registered in the Register (as defined below) (or, in the case of joint holders, the first named thereof) and "**holders**" shall be construed accordingly. A Definitive Note Certificate (as defined below) will be issued to each Noteholder in respect of its registered holding.

*The Notes will be represented by a global note (the "**Global Note**"), interests in which will be exchangeable for notes in definitive form ("**Definitive Note Certificates**") in the circumstances specified in the Global Note. The Global Note will be deposited with, and registered in the name of a nominee for, a common depositary for Euroclear and Clearstream, Luxembourg.*

(c) *Third party rights*

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

2. Registration

The Issuer will cause a register (the "**Register**") to be kept at the Specified Office of the Registrar in which will be entered the names and addresses of the holders of the Notes and the particulars of the Notes held by them and all transfers and redemptions of the Notes.

3. Transfer of Notes

(a) *Transfer*

Each Note may, subject to the terms of the Fiscal Agency Agreement and to Conditions 3(b) (*Formalities Free of Charge*), 3(c) (*Closed Periods*) and 3(e) (*Regulations Concerning Transfer and Registration*), be transferred in whole or in part in an Authorised Holding by lodging the relevant Definitive Note Certificate (with the endorsed form of application for transfer in respect thereof duly executed and duly stamped where applicable) at the Specified Office of the Registrar or any Paying and Transfer Agent. A Note may be registered only in the name of, and transferred only to, a named person or persons. No transfer of a Note will be valid unless and until entered on the Register.

The Registrar will within five Business Days (as defined below) of any duly made application for the transfer of a Note, register the transfer and deliver a new Definitive Note Certificate to the transferee (and, in the case of a transfer of part only of a Note, deliver a Definitive Note Certificate for the untransferred balance to the transferor), at the Specified Office of the Registrar, or (at the risk and, if mailed at the request of the transferee or, as the case may be, the transferor otherwise than by ordinary mail, at the expense of the transferee or, as the case may be, the transferor) mail the Definitive Note Certificate by uninsured mail to such address as the transferee or, as the case may be, the transferor may request.

(b) *Formalities Free of Charge*

Such transfer will be effected without charge subject to (i) the person making such application for transfer paying or procuring the payment of any taxes, duties and other governmental charges in connection therewith, (ii) the Registrar being satisfied with the documents of title and/or identity of the person making the application and (iii) such reasonable regulations as the Issuer may from time to time agree with the Registrar.

(c) *Closed Periods*

Neither the Issuer nor the Registrar will be required to register the transfer of any Note (or part thereof) during the period of 15 days immediately prior to the due date for any payment of principal or interest in respect of the Notes.

(d) *Business Day*

In this Condition, "**Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the city in which the Specified Office of the Registrar or, as the case may be, the Principal Paying and Transfer Agent is located.

(e) *Regulations Concerning Transfer and Registration*

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes in Schedule 1 to the Fiscal Agency Agreement. The regulations may be changed by the Issuer with the approval of the Registrar.

(f) *Authorised Holdings*

No Note may be transferred unless each of the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred is an Authorised Holding.

4. Status

The Notes constitute direct, general, unconditional and (subject to Condition 5 (*Negative Pledge*)) unsecured obligations of the Issuer and the full faith and credit of the Issuer is pledged for the due and punctual payment of principal and interest on the Notes and for the performance of all obligations of the Issuer in respect of the Notes. The Notes will at all times rank *pari passu* among themselves and at least *pari passu* in right of payment with all other present and future unsecured and unsubordinated obligations of the Issuer.

5. Negative Pledge

So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement) the Issuer shall not create or permit to subsist any Security Interest other than a Permitted Security Interest upon the whole or any part of its present or future undertaking, assets or revenues to secure any of its Public Indebtedness or any Guarantee of any Public Indebtedness of any other person unless the Issuer shall, in the case of the creation of any Security Interest, at the same time or prior thereto, and in any other case, promptly, procure that all amounts payable in respect of the Notes are secured equally and rateably therewith or providing such other security or other arrangement for the Notes as may be approved by an Extraordinary Resolution (as defined in Condition 14(c) (*Modifications*)).

6. Definitions

For the purposes of these Conditions:

"**Guarantee**" means in relation to any indebtedness, any guarantee or indemnity given by the Issuer in respect of such indebtedness;

"**Permitted Security Interest**," means any Security Interest created as contemplated by the terms of the facility agreement dated 30 July 2009 between the Issuer, Credit Suisse International and Credit Suisse, London Branch and the conversion letter dated 30 July 2009 between the Issuer and Credit Suisse, London Branch and, the renewal or extension of any such Security Interest **provided that** (x) the principal amount of the Public Indebtedness secured thereby is not increased, (y) such renewal or extension shall be no more restrictive than the original Security Interest, and (z) the Security Interest has not been or is not extended to any additional assets;

"**Public Indebtedness**" means any indebtedness which (a) is in the form of or represented by any bond, note, debenture, debenture stock, loan stock, certificate or other instrument, (b) is, or was intended by the issuer thereof to be at the time such indebtedness was issued, listed, quoted or traded on any stock exchange or in any securities market (including, without limitation, any automated trading system or over-the-counter market) and (c) has a maturity date falling more than one year after its issue date; and

"**Security Interest**" means any mortgage, charge, pledge, lien or other security interest including, without limitation, anything having an equivalent effect to any of the foregoing under the laws of any jurisdiction.

7. Interest

(a) *Interest Accrual*

Each Note bears interest from 8 April 2011 (the "**Issue Date**") at the rate of 7.250 per cent per annum (the "**Rate of Interest**") payable annually in arrear on 8 April in each year (each, an "**Interest Payment Date**"), subject as provided in Condition 8 (*Payments*). Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date is herein called an "**Interest Period**".

(b) *Cessation of Interest*

Each Note will cease to bear interest from the due date for final redemption unless, upon due surrender of the relevant Note, payment of principal is improperly withheld or refused. In such case it will continue to bear interest at such rate (after as well as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment) in accordance with Condition 15 (*Notices*).

(c) *Calculation of Interest for an Interest Period*

The amount of interest payable in respect of each Note for any Interest Period shall be calculated by applying the Rate of Interest to the principal amount of such Note and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

(d) *Calculation of Interest for any other period*

Where interest is to be calculated in respect of a period other than an Interest Period, the day-count fraction applied to calculate the amount of interest payable in respect of each Note shall be the number of days in the relevant period, from (and including) the date from which interest begins to accrue, to (but excluding) the date on which it falls due, divided by the number of days in the Interest Period in which the relevant period falls (including the first such day but excluding the last) and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

The determination of the amount of interest payable under Conditions 7(c) (*Calculation of Interest for an Interest Period*) and 7(d) (*Calculation of Interest for any other period*) by the Fiscal Agent shall, in the absence of manifest and proven error, be binding on all parties.

8. Payments

(a) *Principal*

Payment of principal in respect of each Note and payment of interest due other than on an Interest Payment Date will be made to the person shown in the Register at the close of business on the Record Date (as defined below) and subject to the surrender (or, in the case of part payment only, endorsement) of the relevant Definitive Note Certificate at the Specified Office of the Registrar or of the Paying and Transfer Agents.

(b) *Interest*

Payments of interest due on an Interest Payment Date will be made to the persons shown in the Register at close of business on the Record Date.

(c) *Record Date*

"**Record Date**" means the fifteenth day before the due date for the relevant payment.

(d) *Payments*

Each payment in respect of the Notes pursuant to Conditions 8(a) (*Principal*) and (b) (Interest) will be made by euro cheque mailed to the holder of the relevant Note at his address appearing in the Register. However, upon application by the holder to the Specified Office of the Registrar or any Agent not less than 15 days before the due date for any payment in respect of a Note, such payment may be made by transfer to a euro account maintained by the payee with a bank in a city where banks have access to the TARGET System.

Where payment is to be made by cheque, the cheque will be mailed, on the business day preceding the due date for payment or, in the case of payments referred to in Condition 8(a) (*Principal*), if later, on the business day on which the relevant Definitive Note Certificate is surrendered (or endorsed as the case may be) as specified in Condition 8(a) (*Principal*) (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, expense of the holder).

Where payment is to be made by transfer to a euro account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated, in the case of principal, on the later of the due date for payment and the day on which the relevant Definitive Note Certificate is surrendered (or, in the case of part payment only, endorsed) and, in the case of interest on the due date for payment.

(e) *Agents*

The names of the initial Agents and Registrar and their Specified Offices are set out below. The Issuer reserves the right under the Fiscal Agency Agreement by giving to the relevant Agent concerned at least 60 days prior written notice, which notice shall expire at least 30 days before or after any due date for payment in respect of the Notes, to vary or terminate the appointment of any Agent or the Registrar and to appoint successor or additional Agents or another Registrar, **provided that** it will at all times maintain:

(i) a Fiscal Agent;

(ii) an Agent with a Specified Office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; and

(iii) a Registrar.

Notice of any such removal or appointment and of any change in the Specified Office of any Agent or Registrar will be given to Noteholders in accordance with the provisions of the Fiscal Agency Agreement and Condition 15 (*Notices*) as soon as practicable.

(f) *Payments subject to Fiscal Laws*

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 10 (*Taxation*). No commissions or expenses shall be charged to the Noteholders in respect of such payments.

(g) *Delay in Payment*

Noteholders will not be entitled to any interest or other payment in respect of any delay in payment resulting from (i) the due date for payment not being a business day, (ii) a cheque mailed in accordance with this Condition 8 (*Payments*) arriving after the due date for payment or being lost in the mail, or (iii) if the holder is late in surrendering (where so required) the relevant Definitive Note Certificate.

(h) *Business Days*

In this Condition 8 (*Payments*), "**business day**" means any day on which the TARGET System is open and, in the case of surrender of a Definitive Note Certificate, in the place of the Specified Office of the Registrar or relevant Agent, to whom the relevant Definitive Note Certificate is surrendered and "**TARGET System**" means the Trans-European Automated Real-Time Gross Settlement Express Transfer payment system which utilises a single shared platform and which was launched on 19 November 2007 or any successor thereto.

9. Redemption and Purchase

(a) *Scheduled redemption*

Unless previously purchased and cancelled as provided below, each Note will be redeemed at its principal amount on 8 April 2016, subject as provided in Condition 8 (*Payments*).

(b) *No other redemption*

The Issuer shall not be entitled to redeem the Notes otherwise than as provided in Condition 9(a) (*Scheduled redemption*).

(c) *Purchase*

The Issuer may at any time purchase or procure others to purchase for its account Notes in the open market or otherwise and at any price. The Notes so purchased may be held or resold (**provided that** such resale is in compliance with all applicable laws) or surrendered for cancellation at the option of the Issuer or otherwise, as the case may be in compliance with Condition 9(d) (*Cancellation of Notes*) below. The Notes so purchased, while held by or on behalf of the Issuer, shall not entitle the holder to vote at any meeting of the Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of the Noteholders or for the purposes of Condition 14(a) (*Meetings of Noteholders*).

(d) *Cancellation of Notes*

All Notes which are submitted for cancellation pursuant to Condition 9(c) (*Purchase*) will be cancelled and may not be reissued or resold.

10. Taxation

All payments of principal and interest in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by or within Montenegro or any political subdivision thereof or any authority therein having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note:

(a) *Other Connection*

held by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note by reason of his having some connection with Montenegro other than the mere holding of the Note;

(b) *Presentation more than 30 days after the Relevant Date*

where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder of it would have been entitled to such additional amounts on surrendering such Definitive Note Certificate for payment on the last day of such period of 30 days;

(c) *Payment to Individuals*

where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(d) *Payment by another Agent*

where (in the case of a payment of principal or interest on redemption) the relevant Definitive Note Certificate is surrendered for payment by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by surrendering the relevant Definitive Note Certificate to another Agent in a Member State of the European Union.

In these Conditions, "**Relevant Date**" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent on or prior to such due date, the date on which, the full amount plus any accrued interest having been so received, notice to that effect shall have been given to the Noteholders. Any reference in these Conditions to principal and/or interest shall be deemed to include any additional amounts which may be payable under this Condition.

11. Prescription

Claims in respect of principal and interest will become void unless made within a period of 10 years in the case of principal and five years in the case of interest from the appropriate Relevant Date.

12. Events of Default

If any of the following events (each an "**Event of Default**") occurs and is continuing:

(a) *Non payment*

The Issuer fails to pay any amount in respect of the Notes when the same becomes due and payable and such failure continues for a period of 15 days; or

(b) *Breach of other obligations*

The Issuer defaults in the performance or observance of any of its other obligations under the Notes and such default is incapable of remedy or, if capable of remedy, remains unremedied for 30 days after notice of such default has been given to the Issuer (with a copy to the Fiscal Agent at its Specified Office) by any holder of Notes; or

(c) *Cross-Default*

(i) The acceleration of the maturity (other than by optional or mandatory prepayment or redemption) of any Public Indebtedness of the Issuer, (ii) the Issuer defaults in the payment of any principal of or interest on any of its Public Indebtedness when and as the same shall become due and payable, and such default continues for more than the grace period, if any, originally applicable thereto or, in the case of interest where such grace period does not exceed 30 days, for more than 30 days or (iii) the Issuer defaults in the payment when due and called upon of any guarantee or indemnity of the Issuer in respect of any Public Indebtedness of any other person and such default continues for more than the grace period, if any, originally applicable thereto or, if such grace period does not exceed 30 days, for more than 30 days; **provided that** the aggregate amount of the relevant Public Indebtedness in respect of which one or more of the events mentioned in this sub-paragraph (c) have occurred (which, for the avoidance of doubt, shall exclude any Public Indebtedness of the Socialist Federal Republic of Yugoslavia, the Federal Republic of Yugoslavia and/or the State Union of Serbia and Montenegro which is allocated to the Issuer) equals or exceeds euro 20,000,000 or its equivalent; or

(d) *Unenforceability*

For any reason whatsoever, the obligations under the Notes are declared by a court of competent jurisdiction pursuant to a final non-appealable decision to be no longer binding or no longer enforceable against the Issuer; or

(e) *Moratorium*

Montenegro shall have declared a general moratorium on the payment of principal of, or interest on, all or any part of its Public Indebtedness; or

(f) *Validity*

Montenegro or any of its political sub-divisions (on its behalf) repudiates the validity of the Notes; or

(g) *IMF*

Montenegro ceases to be a member, or becomes ineligible to use the resources of, the International Monetary Fund,

then the holders of not less than 25 per cent in the aggregate principal amount of the Notes may, by written notice to the Issuer (with a copy to the Fiscal Agent at its Specified Office), declare the Notes due and payable immediately. Notice of any such declaration shall promptly be given to all other Noteholders by the Issuer. Upon any declaration of acceleration, the principal, interest and all additional amounts payable on the Notes will become immediately due and payable on the date the Issuer receives written notice of the declaration. No delay or omission of any Noteholder shall impair any such right or remedy or constitute a waiver of any such Event of Default.

If the Issuer receives notice in writing from holders of at least 50 per cent in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to any above-mentioned declaration of acceleration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn, the Issuer shall give notice thereof to the Noteholders (with a copy to the Fiscal Agent at its Specified Office), whereupon the relevant declaration shall be withdrawn and shall have no further effect. No such withdrawal shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto.

For the avoidance of doubt, no event of default shall occur if any event under paragraphs (a) to (g) above (inclusive) occurs in respect of any Public Indebtedness of the Socialist Federal Republic of Yugoslavia, the Federal Republic of Yugoslavia and/or the State Union of Serbia and Montenegro which is allocated to the Issuer.

13. Replacement of Notes

If any Definitive Note Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the Specified Office of the Registrar or any Agent subject to all applicable laws and stock exchange or other relevant authority requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may require (**provided that** the requirement is reasonable in the light of prevailing market practice). Mutilated or defaced Definitive Note Certificates must be surrendered before replacements will be issued.

14. Meetings of Noteholders; Modification

(a) *Meetings of Noteholders*

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider any matters relating to the Notes, including the modification of any provision of these Conditions or the Fiscal Agency Agreement. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer or by the Noteholders holding not less than one tenth in principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more persons holding or representing a clear majority of the aggregate principal amount of the Notes for the time being outstanding, or, at any adjourned meeting, one or more persons being or representing Noteholders whatever the principal amount of the Notes for the time being outstanding so held or represented; **provided, however, that** any proposals relating to any Reserved Matter (as defined below) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than three quarters or, at any adjourned meeting, one quarter of the principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present at the meeting(s) or not.

(b) *Reserved Matters*

In these Conditions, "**Reserved Matter**" means any proposal whereby:

(i) the principal amount of, or interest on, or other amounts in respect of the Notes is to be reduced or cancelled or the Rate of Interest on the Notes is to be reduced; or

(ii) the status of the Notes under Condition 4 (*Status*) is to be amended; or

(iii) the Events of Default set out in Condition 12 (*Events of Default*) are to be amended; or

(iv) the currency of payment of the Notes or the due date or date for any payment in respect of the Notes is to be changed; or

(v) the provisions contained in Schedule 3 (*Provisions for Meetings of Noteholders*) to the Fiscal Agency Agreement concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution or the definition of "**Extraordinary Resolution**" or the definition of "**outstanding**" is to be modified; or

(vi) this definition of Reserved Matter is to be amended; or

(vii) the Deed of Covenant is to be modified or cancelled.

(c) *Modifications*

Any modification of any provision of these Conditions may be made if approved by an Extraordinary Resolution or a Written Resolution (as defined below). In these Conditions, "**Extraordinary Resolution**" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least:

(i) in the case of a Reserved Matter, three-quarters of the aggregate principal amount of the outstanding Notes; or

(ii) in the case of a matter other than a Reserved Matter, two-thirds of the aggregate principal amount of the outstanding Notes which are represented at that meeting.

Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and whether they voted in favour or not.

(d) *Written resolutions*

A resolution in writing ("**Written Resolution**") will take effect as if it were an Extraordinary Resolution if it is signed (i) by or on behalf of all Noteholders who for the time being are entitled to receive notice of a meeting of Noteholders under the Fiscal Agency Agreement or (ii) if such Noteholders have been given at least 21 days' notice of such resolution, by or on behalf of persons holding three-quarters of the aggregate principal amount of the outstanding Notes in the case of a Reserved Matter, or two-thirds of the aggregate principal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. A Written Resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders, and the date of such resolution shall be the date of the latest such document. A Written Resolution shall be binding on all Noteholders, whether or not signed by them.

(e) *Modification without Noteholders' consent*

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of the Notes or the Fiscal Agency Agreement which is in the opinion of the Issuer of a formal, minor or technical nature or is made to correct a manifest error. Any such modification shall be binding on the Noteholders and, if the Fiscal Agent so requires, shall be notified to the Noteholders as soon as practicable thereafter.

(f) *Noteholders' Representative Committee*

(i) *Appointment*

The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least 50 per cent in aggregate principal amount of the Notes then outstanding, or by notice in writing to the Issuer (with a copy to the Fiscal Agent at its Specified Office) signed by or on behalf of the holders of at least 50 per cent in aggregate principal amount of the Notes then outstanding, appoint any person or persons as a committee (if appointed, a "**Noteholders' Representative Committee**") to represent the interests of the Noteholders if any of the following events shall have occurred:

(A) an Event of Default;

(B) any event or circumstance which would, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 12 (*Events of Default*) become an Event of Default;

(C) any official public announcement by the Issuer to the effect that the Issuer is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise);

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent of the aggregate principal amount of the outstanding Notes have either (I) objected to such appointment by notice in writing to the Issuer (with a copy to the Fiscal Agent at its Specified Office) during a specified period following notice of the appointment being given (if such notice of appointment is made by notice in writing to the Issuer) where such specified period shall be either 30 days or such other longer or shorter period as the Noteholders' Representative Committee may, acting in good faith, determine to be appropriate in the circumstances, or (II) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement. Such Noteholders' Representative Committee shall if appointed by notice in writing to the Issuer, give notice of its appointment to all Noteholders in accordance with Condition 15 (*Notices*) as soon as practicable after the notice is delivered to the Issuer.

(ii) *Powers*

Such Noteholders' Representative Committee in its discretion may, among other things, (A) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (B) adopt such rules as it considers appropriate regarding its proceedings and (C) enter into discussions with the Issuer and/or other creditors of the Issuer. The Issuer shall pay any reasonably incurred fees and expenses of such Noteholders' Representative Committee (including, without limitation, the reasonable fees and expenses of the Noteholders' Representative Committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Issuer of a reasonably detailed invoice and supporting documentation.

15. Notices

Notices to Noteholders will be sent to them by mail at their respective addresses on the Register. Any such notice shall be deemed to have been given on the fourth weekday (excluding Saturday and Sunday) after the date of mailing.

16. Further Issues

The Issuer may from time to time, without notice to or the consent of the Noteholders and in accordance with the Fiscal Agency Agreement, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the date for and amount of the first payment of interest) so as to be consolidated and form a single series with the Notes ("**Further Notes**").

17. Governing Law; Jurisdiction and Arbitration

(a) *Governing law*

The Notes, including any non-contractual obligations arising out of or in connection with the Notes, are governed by, and shall be construed in accordance with, English law.

(b) *Arbitration*

Subject to Condition 17(c) (*Noteholders' Option*), any claim, dispute or difference of whatever nature arising under, out of or in connection with the Notes (including a claim, dispute or difference regarding the existence, termination or validity of the Notes or any non-contractual obligations arising out of or in connection with the Notes) (a "**Dispute**"), shall be referred to and finally settled by arbitration in accordance with the rules of the London Court of International Arbitration ("**LCIA**") (the "**Rules**") as at present in force and as modified by this Condition, which Rules shall be deemed incorporated into this Condition. The number of arbitrators shall be three, one of whom shall be nominated by the claimant(s), one by the respondent(s) and the third of whom, who shall act as Chairman, shall be nominated by the two party-nominated arbitrators, **provided that** if the third arbitrator has not been nominated within 30 days of the nomination of the second party-nominated arbitrator, such third arbitrator shall be appointed by the LCIA court. The parties may nominate and the LCIA court may appoint arbitrators from among the nationals of any country, whether or not a party is a national of that country. The seat of arbitration shall be London, England and the language of arbitration shall be English. Sections 45 and 69 of the Arbitration Act 1996 shall not apply.

(c) *Noteholders' Option*

If a Noteholders' Representative Committee has been appointed in accordance with Condition 14(f) (*Noteholders' Representative Committee*), at any time before any Noteholder has nominated an arbitrator to resolve any Dispute(s) pursuant to Condition 17(b) (*Arbitration*) the Noteholders' Representative Committee may, at its sole option, elect by notice in writing to the Issuer that such Dispute(s) shall instead be heard by the courts of England or by any other court of competent jurisdiction, as more particularly described in Condition 17(d) (*Jurisdiction*). Following any such election, no arbitral tribunal shall have jurisdiction in respect of such Dispute(s).

If no Noteholders' Representative Committee has been appointed in accordance with Condition 14(f) (*Noteholders' Representative Committee*), at any time before a Noteholder has nominated an arbitrator to resolve any Dispute(s) pursuant to Condition 17(b) (*Arbitration*) such Noteholder may, at its sole option, elect by notice in writing to the Issuer that, as between itself and the Issuer, such Dispute(s) shall instead be heard by the courts of England or by any other court of competent jurisdiction, as more particularly described in Condition 17(d) (*Jurisdiction*). Following any such election, no arbitral tribunal shall have jurisdiction in respect of such Dispute(s) as between the electing Noteholder(s) and the Issuer. For the avoidance of doubt, any such election by one or more Noteholders shall not bind the other Noteholders, nor shall it affect the jurisdiction of any arbitral tribunal appointed in respect of any Dispute(s) between the Issuer and any Noteholders not making such an election.

(d) *Jurisdiction*

In the event that a Noteholders' Representative Committee or any one or more Noteholder(s) serves a written notice of election (an "**Election Notice**") in respect of any Dispute(s) pursuant to Condition 17(c) (*Noteholders' Option*), the Issuer agrees for the benefit of the Noteholders that the courts of England shall have exclusive jurisdiction to hear and determine any such Dispute(s) and, for such purposes, irrevocably submits to the jurisdiction of such courts.

(e) *Appropriate Forum*

For the purposes of Condition 17(d) (*Jurisdiction*), the Issuer irrevocably waives any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any proceedings ("**Proceedings**") and agrees not to claim that any such court is not a convenient or appropriate forum.

(f) *Service of Process*

The Issuer agrees that the process by which any Proceedings are commenced in England pursuant to Condition 17(d) (*Jurisdiction*) or by which any proceedings are commenced in the English courts in support of, or in connection with, an arbitration commenced pursuant to Condition 17(b) (*Arbitration*) may be served on it by being delivered to the Ambassador of Montenegro at 18 Callcott Street, London W8 7SU. If such person is not or ceases to be effectively appointed to accept service of process on behalf of the Issuer, the Issuer shall appoint a further person in England to accept service of process on its behalf. Nothing in this Condition shall affect the right of Noteholders to serve process in any other manner permitted by law.

(g) *Waiver of Immunity*

To the extent that the Issuer may in respect of any Proceedings or Dispute be entitled to claim for itself or its assets immunity from jurisdiction, suit, execution, attachment (whether in aid of execution of a judgment, before judgment or award or otherwise) or other legal process, including in relation to the enforcement of any arbitration award, and to the extent that in any such jurisdiction there may be attributed to itself or its assets such immunity (whether or not claimed), the Issuer irrevocably consents to the enforcement of any judgment or award and agrees not to claim and irrevocably waived such immunity, subject to Condition 17(h) (*Exclusions — Waiver of Immunity*) to the fullest extent permitted by the laws of the jurisdiction.

(h) *Exclusions — Waiver of Immunity*

Notwithstanding any of the provisions of Condition 17(g) (*Waiver of Immunity*), the Issuer does not waive any immunity in respect of any present or future (i) "**premises of the mission**" as defined in the Vienna Convention on Diplomatic Relations signed in 1961, (ii) "**consular premises**" as defined in the Vienna Convention on Consular Relations signed in 1963 or (iii) military property or military assets or property or assets of Montenegro relating to any of the assets referred to in the foregoing sub-paragraphs (i) and (ii).

SUMMARY OF PROVISIONS RELATING TO THE NOTES IN GLOBAL FORM

1. Global Note

The Notes will be represented on issue by the Global Note (deposited with, and registered in the name of a nominee of, a common depositary for Euroclear and Clearstream, Luxembourg).

Interests in the Global Note may be held only through Euroclear or Clearstream, Luxembourg at any time. See "*— Book Entry Procedures*".

Except in the limited circumstances described below, owners of interests in the Global Note will not be entitled to receive physical delivery of certificated Notes in definitive form (the "**Definitive Note Certificates**").

2. Amendments to the Conditions

The Global Note contains provisions that apply to the Notes that it represents, some of which modify the effect of the above Conditions of the Notes. The following is a summary of those provisions:

Payments

Payments in respect of Notes evidenced by the Global Note will be made to the person who appears in the Register at the close of business on the Clearing System Business Day immediately prior to the due date for such payment against presentation for endorsement and, if no further payment falls to be made in respect of the relevant Notes, surrender of the Global Note to or to the order of the Fiscal Agent. A record of each payment of principal will be endorsed in the appropriate schedule to the Global Note, which endorsement will be *prima facie* evidence that such payment has been made in respect of the relevant Notes. For the purposes of this paragraph, "**Clearing System Business Day**" means Monday to Friday, inclusive except 25 December and 1 January.

Notices

So long as the Global Note is held on behalf of Euroclear and/or Clearstream, Luxembourg or any other clearing system (an "**Alternative Clearing System**"), notices to holders of Notes represented by the Global Note may be given by delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg or (as the case may be) such Alternative Clearing System.

Meetings

The holder of the Global Note will be treated as being two persons for the purposes of any quorum requirements of a meeting of Noteholders and having one vote in respect of each EUR 1,000 in principal amount of Notes for which the Global Note may be exchangeable.

Prescription

Claims against the Issuer in respect of principal and interest on the Notes while the Notes are represented by the Global Note will become void unless it is presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 10 (*Taxation*) of the Notes).

Purchase and Cancellation

Cancellation of any Note required by the Conditions to be cancelled following its purchase will be effected by reduction in the principal amount of the Global Note.

3. Exchange for Definitive Note Certificates

Exchange

The Global Note will become exchangeable in whole (but not in part) free of charge to the holder for duly authenticated and completed Definitive Note Certificates if any of the following events occurs:

(a) Euroclear and/or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or does in fact do so; or

(b) an Event of Default (as defined and set out in Condition 12 (*Events of Default*) of the Notes) occurs.

Such exchange shall be effected in accordance with paragraph 7 (*Delivery of Definitive Note Certificates*) of the Global Note. In such circumstances, such Definitive Note Certificates will be registered in such names as Euroclear and Clearstream, Luxembourg shall direct in writing and the Issuer will procure that the Registrar notify the holders as soon as practicable after the occurrence of any of the events specified in (a) and (b).

The Registrar will not register the transfer of any Notes or exchange of interests in a Global Note for Definitive Note Certificates for a period of 15 calendar days ending on the due date for any payment of principal or interest in respect of the Notes.

Delivery

In such circumstances, the Global Note shall be exchanged in full for Definitive Note Certificates and the Issuer will, without charge to the holder or holders thereof, but against such indemnity as the Registrar may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange, cause sufficient Definitive Note Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Noteholders. A person having an interest in the Global Note must provide the Registrar with a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Notes.

The holder of a Definitive Note Certificate may transfer the Notes evidenced thereby in whole or in part in the applicable minimum denomination by surrendering it at the specified office of the Registrar or the Paying and Transfer Agent, together with the completed form of transfer thereon.

Failure to deliver Definitive Note Certificates or to pay

If:

(a) Definitive Note Certificates have not been issued and delivered by 5.00 p.m. (London time) on the thirtieth day after the date on which the same are due to be issued and delivered in accordance with the terms of the Global Note; or

(b) any of the Notes evidenced by the Global Note has become due and payable in accordance with the Conditions or the date for final redemption of the Notes has occurred and, in either case, payment in full of the amount of principal falling due with all accrued interest thereon has not been made to the Holder of the Global Note on the due date for payment in accordance with the terms of the Global Note,

then, at 5.00 p.m. (London time) on such thirtieth day (in the case of (a) above) or at 5.00 p.m. (London time) on such due date (in the case of (b) above) the Registrar shall in respect of each person shown in the records of Euroclear and/or Clearstream, Luxembourg (or any other relevant clearing system) as being entitled to interest in the Notes (each an "**Accountholder**"), enter in the Register the name of such Accountholder as the holder of direct rights under the deed of covenant dated 8 April 2011 (the "**Deed of Covenant**") in respect of the Notes in an aggregate principal amount equal to the principal amount shown in the records of Euroclear and/or Clearstream, Luxembourg (or any other relevant clearing system) of such Accountholder's interest in the Notes. To the extent that the Registrar makes such entries in the Register, the holder will have no further rights under the Global Note, but without prejudice to the rights which the holder or Accountholders may have under the Deed of Covenant. Under the Deed of Covenant, Accountholders will acquire directly against the Issuer, subject to their rights being entered in the Register as described above and subject as provided in the Deed of Covenant, all those rights to which they would have been entitled if, immediately before the date on which the Registrar is required to enter in the Register the rights of the Accountholders, they had been the registered holders of Notes in an aggregate principal amount equal to the principal amount of Notes they were shown as holding in the records of Euroclear, Clearstream, Luxembourg or any other relevant clearing system (as the case may be).

4. Book Entry Procedures

Custodial and depository links are to be established between Euroclear and Clearstream, Luxembourg to facilitate the initial issue of the Notes and cross market transfers of the Notes associated with secondary market trading. See "*— Settlement and Transfer of Notes*" below.

Investors may hold their interests in a Global Note directly through Euroclear or Clearstream, Luxembourg if they are accountholders ("**Direct Participants**") or indirectly ("**Indirect Participants**" and together with Direct Participants, "**Participants**") through organisations which are accountholders therein.

5. Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodial relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations.

6. Relationship of Participants with Clearing Systems

Each of the persons shown in the records of Euroclear and Clearstream, Luxembourg as the holder of a Note evidenced by the Global Note must look solely to Euroclear or Clearstream, Luxembourg (as the case may be) for his share of each payment made by the Issuer to the holder of the Global Note and in relation to all other rights arising under the Global Note, subject to and in accordance with the respective rules and procedures of Euroclear or Clearstream, Luxembourg (as the case may be). The Issuer expects that, upon receipt of any payment in respect of Notes evidenced by the Global Note, the common depositary by whom such Note is held, or nominee in whose name it is registered, will immediately credit the relevant Participants or accountholders accounts in the relevant clearing system with payments in amounts proportionate to their respective interests in the principal amount of the Global Note as shown on the records of the relevant clearing system or its nominee. The Issuer also expects that payments by Direct Participants in any clearing system to owners of interests in the Global Note held through such Direct Participants in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are evidenced by the Global Note and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of the Global Note in respect of each amount so paid. None of the Issuer, the Paying and Transfer Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in the Global Note or for maintaining, supervising or reviewing any records relating to such ownership interests.

7. Settlement and Transfer of Notes

Subject to the rules and procedures of each applicable clearing system, purchases of Notes held within a clearing system must be made by or through Direct Participants, which will receive a credit for such Notes on the clearing system's records. The ownership interest of each actual purchaser of each such Note (the "**Beneficial Owner**") will in turn be recorded on the Direct and Indirect Participants records.

Beneficial Owners will not receive written confirmation from any clearing system of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction.

Transfers of ownership interests in Notes held within the clearing system will be affected by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in such Notes, unless and until interests in the Global Note held within a clearing system are exchanged for Definitive Note Certificates.

No clearing system has knowledge of the actual Beneficial Owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in the Global Note to such persons may be limited.

8. Trading between Euroclear and/or Clearstream, Luxembourg Participants

Secondary market sales of book entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book entry interests in the Notes held through Clearstream, Luxembourg or Euroclear will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

USE OF PROCEEDS

The net proceeds of the issue of the Notes will be used for general budgetary governmental purposes (including, without limitation, repayment of outstanding indebtedness and capital budget financing).

MONTENEGRO

Geography and Population

Montenegro is located in South-Eastern Europe and is bordered by Croatia to the West, Bosnia and Herzegovina to the North-West, Serbia to the North-East, Kosovo to the East and Albania to the South-East. To the South-West, Montenegro has 293 kilometres of coastline on the Adriatic Sea, on the other side of which lies Italy.

Montenegro covers an area of approximately 14,000 square kilometres. The capital and administrative centre of Montenegro is Podgorica where the Government of Montenegro (the "**Government**") and most of the other state institutions are located. The historic royal capital is Cetinje where certain of the country's governmental and cultural institutions and the office of the President are located.

The total population of Montenegro is approximately 642,000, with approximately 60 per cent of the population living in urban areas and the remainder in rural areas. The population density is approximately 46 persons per square kilometre. The highest population concentration is in the Podgorica municipality (which includes the municipalities of Tuzi and Golubovci), with a population of approximately 170,000, making up approximately 26 per cent of the national total.

Historical Background

The history of Montenegro dates back to the ninth century with the development of Duklja, which encompassed approximately the territories of present-day Montenegro. The medieval country had three reigning dynasties before it was annexed by the Ottoman Empire at end of the 15th century, but managed to preserve a level of autonomy throughout. Following constant rebellions by the Montenegrins against the Ottoman Empire, Montenegro became a theocracy until 1852, when Prince Danilo decided to renounce his ecclesiastical position and as a result, Montenegro became a principality.

Montenegro was the first Balkan country to achieve full independence in the Berlin Congress in 1878. In 1918, at the end of the First World War, it became part of the Kingdom of Yugoslavia ("**Yugoslavia**"), which was initially established as the union of the States of Slovenes, Croats and Serbs, and after the Second World War became a republic, one of six forming the Socialist Federal Republic of Yugoslavia. After the dissolution of Yugoslavia in 1992, Montenegro, together with Serbia, remained part of the Federal Republic of Yugoslavia. The status of the federation between Montenegro and Serbia was decided by the referendum on Montenegrin independence on 21 May 2006, and as a result Montenegro declared its independence on 3 June 2006.

Political System and Developments

Constitution

The current constitution of Montenegro (the "**Constitution**") was ratified and adopted by the Constitutional Parliament of Montenegro on 19 October 2007. The Constitution established a democratic republic with a multiparty political system. The Constitution is based on the separation of powers between the legislature, executive and judiciary.

Under the Constitution, the President of Montenegro (the "**President**") serves a five-year term and may only serve two terms. In order to be eligible for the position a person must be a citizen of Montenegro and must have lived in Montenegro for 10 of the 15 years prior to his candidature. The President proposes candidates for the role of Prime Minister of the Government (the "**Prime Minister**") who is then appointed by the Parliament and the Prime Minister, in turn, appoints Government Ministers.

Legislature

Montenegro has a single chamber Parliament, which consists of 81 elected members who are elected in a national general election for a four year term. The Parliament passes all laws of Montenegro, ratifies international treaties, appoints the Prime Minister, adopts the budget and performs all other duties specified for it in accordance with the Constitution. Laws are passed by majority vote, except that certain laws including those which deal with certain constitutional rights can only be passed by (in certain cases) a two thirds majority of all members or (in other cases) a majority of all members. The President promulgates laws validly enacted by the Parliament.

The Executive

The President is elected by universal suffrage. The current President, Filip Vujanovic, was first elected in 2003 and was then re-elected for a five-year term in 2008 with 51.9 per cent of the total vote. The next presidential election will be required to be held in 2013, at which a new candidate for President will be elected. The President promulgates laws, calls elections for the Parliament, proposes candidates for the role of Prime Minister, confers decorations and awards and performs all other duties specified for him in accordance with the constitution.

The national Government is organised into 16 ministries and is led by the Prime Minister. Milo Djukanovic was appointed Prime Minister following elections in 2009. Mr Djukanovic resigned in December 2010 and at its session held on 29 December 2010, the Parliament appointed a new Government led by Igor Luksic, the former Deputy Prime Minister and Minister of Finance. The Minister of Finance is now Milorad Katnic.

Following the parliamentary elections in March 2009, the Government is led by a coalition of the Democratic Party of Socialists ("**DPS**"), the Social Democratic Party ("**SDP**") and certain minority parties. The political stability of the coalition was confirmed in municipal elections held in May 2010.

The Judicial System

Montenegro's three tier judicial system is independent. The first level comprises the Basic courts, with the Superior courts making up the next level of the court system. The Supreme Court is the highest court in Montenegro. Other specialised courts exist to deal with commercial and administrative law matters. Judges are elected by the Judiciary Council of Montenegro (the "**Council**"). The Council is appointed for four years and consists of the President of the Supreme Court, four judges elected by the Conference of Judges, two are elected by members of the Parliament, two renowned lawyers elected by the President of Montenegro and the Minister of Justice. Newly appointed judges are appointed for a four year term and may be removed in accordance with the Constitution and the Law on Courts.

The Constitutional Court consists of seven judges who are elected for nine years by the Parliament. It has the authority to annul unconstitutional laws and regulations, and to decide on jurisdictional questions between the legislature, executive and judiciary. It also has the power to impeach the President. This Court's function includes protecting the constitutional freedom and rights of citizens.

Local Governments

Montenegro has 21 areas of local government, comprising 19 municipalities, one for the capital city, Podgorica and one for the historic royal capital city, Cetinje. The local government of Podgorica also encompasses two smaller nearby municipalities, Tuzi and Golubovci.

The following table sets out the size and population for each municipality (according to the last census which was undertaken in 2003):

Municipality	Area (in square km)	Population
Andrijevica	283	5,785
Bar	598	40,037
Berane	717	35,068
Bijelo Polje	924	50,284
Budva	122	15,909
Danilovgrad	501	16,523
Zabljak	445	4,204
Kolasin	897	9,949
Kotor	335	22,947
Mojkovac	367	10,066
Niksic	2,065	75,282
Plav	486	13,805
Pluzine	854	4,272
Pljevlja	1,346	35,806
Podgorica	1,441	169,132
Rozaje	432	22,693
Tivat	46	13,630
Ulcinj	255	20,290
Herceg Novi	235	33,034
Cetinje	910	18,482
Savnik	553	2,947
Total	13,812	620,145

Source: Monstat

A new census is scheduled to be conducted in April 2011.

Each municipality's powers are granted to it by the Law on Local Governance and the Law on Local Government Finance (the "**Local Government Laws**"). In accordance with the Montenegrin constitution and the Local Government Laws, each municipality may conduct the following activities:

- produce development plans;
- set up programmes for certain executive activities such as utility and transport infrastructure, land development, tourism and sport;
- produce spatial and other plans;
- provide and execute local government budgetary measures;
- set up plans for investment in local infrastructure; and
- perform any and other actions within its competencies.

Municipalities are also stakeholders in local utility companies providing water and waste services as well as public services such as fire fighting.

International Relations

Montenegro's relationship with the international community

European Union

Montenegro's full membership of the European Union ("**EU**") is a key strategic goal of the Government. The Government has overwhelming public support and cross party consensus on this issue. In July 2009 Montenegro received the Questionnaire of the European Commission (the "**Questionnaire**") as next step towards its full membership of the EU. After responding to the Commission's initial questions (673 in total), Montenegro subsequently answered 74 additional questions in the Questionnaire and submitted it to the Directorate General for Enlargement on 12 April 2010. The country's EU Stabilisation and Association Agreement became effective on 1 May 2010. A new institutional framework for co-operation between Montenegro and the EU is currently being put in place. This involves the establishment of a Stabilisation and Association Council, a Stabilisation and Association Committee, seven sub-committees and a Parliamentary Stabilisation and Association Committee. The first session of the Stabilisation and Association Council was held on 14 June 2010 in Luxembourg.

At its session held on 17 December 2010, the European Council recognised Montenegro's progress by granting it candidate country status, making Montenegro the first country in the Western Balkans to be granted candidate status in the last five years.

The Government is in the final stages of revising its National Plan for Integration of Montenegro in the European Union 2011 — 2015 (the "**NPI**"), the strategic document which sets out the steps to be taken for the EU integration process. In particular the NPI focuses on three key areas: political (i.e. compliance with the EU's so called "**Copenhagen criteria**"), economic and implementation of EU legislation.

When the European Council agrees to open negotiations, the screening process for Montenegro's membership will then begin. During this process the European Commission and Montenegro will review Montenegrin laws to determine what differences exist between them and existing EU directives. The process of harmonisation with the *acquis communautaire* will then need to take place prior to Montenegro's accession to the EU. The timing of Montenegro attaining full membership of the EU will, however, depend on a number of economic and political factors relating to both Montenegro and the EU.

North Atlantic Treaty Organisation

Membership of the North Atlantic Treaty Organisation ("**NATO**") is another important goal of Montenegro. In December 2006, Montenegro signed the Framework Document of the Partnership for Peace with NATO and after three years of being actively involved in this programme, in December 2009 Montenegro was invited to submit its Membership Action Plan ("**MAP**"). The Government believes that this invitation represents confirmation of its overall reform processes and achievements and is an important step on the path towards full membership of NATO.

At the meeting of the foreign ministers of the NATO members in Brussels, held on 3/4 December 2009, Montenegro was admitted to the MAP, on the basis of its progress with internal reforms and fulfilling its obligations under the various programmes and plans associated with its accession process. On 16 September 2010 the Government of Montenegro adopted the first Annual National Programme ("**ANP**") under the first cycle of its MAP, which was presented to NATO on 28 October 2010. At the Lisbon Summit held on 19/20 November 2010, NATO members recognised the "considerable progress" that Montenegro had made on its path to integration with NATO and its contribution to security in the region and beyond, including through its participation in NATO's International Security Assistance Force. NATO also recognised Montenegro's active engagement in the MAP process as demonstrating its firm commitment to join the Alliance and stated that it would continue, through the MAP, to support Montenegro's continuing reform efforts.

World Trade Organisation

Montenegro first submitted its request for membership of the World Trade Organisation ("**WTO**") in December 2004. Negotiations for membership are now in their final phase, Montenegro having concluded negotiations with all countries except for Ukraine. There have already been five rounds of negotiations with Ukraine with the most recent concluding on 5 May 2010 with good progress having been made. The Government does not believe that there are any remaining significant obstacles to resolving the negotiations with Ukraine. Ukraine is not, in any event, a significant trading partner of Montenegro with trade volumes with Ukraine comprising just 0.02 per cent of total foreign trade of Montenegro in 2009. The Government expects that it may achieve membership of the WTO before the end of 2011.

Other

Montenegro is also a member of various other international institutions and organisations. In 2006, Montenegro became a member of the United Nations and the Organisation for Security and Co-operation in Europe. In 2007, Montenegro became a member of the World Bank, the International Monetary Fund (the "**IMF**") and the Council of Europe. In 2007 Montenegro became a member of the European Bank for Reconstruction and Development (the "**EBRD**").

Montenegro and Regional Relationships

One of Montenegro's key foreign policies is to improve and maintain neighbourly relations and regional co-operation.

Italy is one of the most significant foreign-policy partners of Montenegro. Montenegro has entered into a number of bilateral economic initiatives with Italy, such as the Italian-Montenegrin Business Union in early 2009 and initiatives in the areas of energy and transport as well as the opening of the Office of the Italian Institute for Foreign Trade in Podgorica. In particular, both governments have attached significance to the co-operation projects in relation to ports, railways and road transport.

In June 2009, a Memorandum of Understanding between the Ministry of Economy of Montenegro, the Ministry of Economic Development of Italy and the Ministry of Infrastructure of Serbia was signed relating to the reconstruction and modernisation of the Bar-Belgrade railway, which is worth approximately EUR 1.5 billion and of strategic importance to the transport system of Montenegro and South Eastern European region.

There have also been Italian investments in the Montenegrin energy sector primarily through the participation by the Italian company, A2A S.p.A. in the capital increase of the Electric Enterprise of Montenegro and a project for underwater transmission cables between Italy and Montenegro worth approximately EUR 800 million.

Bilateral relations between Montenegro and Croatia are very good, with economic co-operation being of particular strategic significance. In 2008 investment from Croatia in Montenegro was ranked sixth and fifth in terms of volume of trade. A Council for Economic Co-operation was constituted on 1 July 2008 in Podgorica. A representation office of the Chamber of Commerce of Montenegro was opened in Zagreb in September 2008.

Montenegro's relationship with Serbia is a key priority for the Government, with 12 bilateral treaties and acts signed between Montenegro and Serbia since Montenegro's independence. In May 2009, agreements relating to legal aid between Montenegro and Serbia were signed in Podgorica. Further agreements on economic co-operation and the reciprocal promotion and protection of investment between Montenegro and Serbia will be required to facilitate the efficient economic co-operation between the two countries. Serbia is Montenegro's largest trading partner by volume.

Relations between Montenegro and Albania have historically been, and continue today to be, friendly. The first joint border crossing in the South Eastern European region — *Sukobin-Muriæani* (financed by the European Commission CARDS Funds and worth approximately EUR 1.1 million) was opened on 18 June 2009. The two countries have focused on co-operation in the energy field; the energy system of Montenegro is connected to the energy system of Albania through the 220 kW Podgorica-Skadar long-distance power line. The project for the construction of the long-distance power line of 400 kV between Podgorica and Tirana is also under way.

THE ECONOMY

Background

Comprehensive economic reforms in Montenegro and development based on the principles of private ownership, free markets, openness to trade, the free flow of capital and competitive tax policies contributed to an increase in the country's GDP of approximately 8.7 per cent in real terms between 2006 and 2008. The declaration of independence in June 2006 had a further positive impact on economic growth. Key challenges for Montenegro include further restructuring and reforms in the public sector and State administration, developing sustainable pension and health systems, reforms to the judicial system and legislation, labour market reforms and further improvements in the business environment.

The Government is dedicated to improving the business environment in Montenegro. It has set up a Council for Eliminating Business Barriers (the "**Council**"), in co-operation with the World Bank, with the aim of simplifying administrative procedures and reducing red tape. Representatives of the private sector are also members of the Council. The Government is also currently working on establishing a "one-stop-shop" to deal with property issues, licensing, tax administration and bankruptcy procedures in order to improve the environment for economic growth since these are all issues recognised by the business community as bottlenecks in the pursuit of growth.

The International Finance Corporation ("**IFC**") and the Government are also currently undertaking a "Regulatory Impact Assessment" project to assess the country's existing regulatory framework and make recommendations as to what aspects of regulation can be simplified and streamlined.

In conjunction with its efforts to improve the country's overall business climate, the Government is committed to fighting against corruption. According to the Council of Europe's Group of States Against Corruption (GRECO) report, since 2006 Montenegro has satisfactorily implemented 67 per cent of its recommendations, more than any other Balkan nation.

The following table shows Montenegro's ranking in the Corruption Perceptions Index 2010 as compared to other countries in the region:

Overall Rank	Regional Rank	Country/Territory	Corruption Perceptions Index 2010 Score
56	1	Turkey	4.4
62 (equal)	2 (equal)	Croatia	4.1
62 (equal)	2 (equal)	FYR Macedonia	4.1
68	4	Georgia	3.8
69	**5**	**Montenegro**	**3.7**
78	6	Serbia	3.5
87	7	Albania	3.3
91	8	Bosnia and Herzegovina	3.2

Source: Corruption Perception Index 2010

Reform efforts in the labour market, public administration and legislation are related to improvement of the overall business climate in Montenegro. For example, the protection of property rights and the execution of contracts by reducing backlogs in legal procedures are important priorities since they are also important aspects of the process towards EU membership. See "Montenegro — International Relations — Montenegro's relationship with the international community — European Union".

Recent Economic Developments and Trends

The effects of the recent global financial and economic crisis were first felt in Montenegro in October 2008 and intensified towards the end of that year and continuing to the end of the first quarter of 2009. During 2009, GDP is estimated to have fallen in real terms by 5.7 per cent.

The global economic and financial crisis led to a significant drop in confidence in the country's banking sector resulting in a large outflow of deposits in late 2008 of approximately EUR 350 million or 15.2 per cent of total deposits. This trend continued in 2009 with total deposits falling by a further 8.3 per cent at the end of 2009 compared to the end of 2008. This outflow, in turn, led to a marked decline in the credit activities of banks, with overall volumes decreasing by 14.3 per cent in 2009 compared with 2008. By the end of 2009, total assets of the banking sector had fallen by 8.6 per cent to EUR 3,025.2 million The Government reacted to the crisis by implementing a number of measures in relation to the banking sector, principally the adoption of the Law on the Banking System Safeguards in October 2008 thereby preventing a further outflow of deposits in 2009. See "Monetary and Financial System — Measures of economic, prudential and monetary policy in the banking system" and "Risk Factors — Montenegro's economy remains vulnerable to external shocks, including the recent global financial and economic crisis, which could have an adverse effect on Montenegro's economic growth and its ability to service its public debt".

Even though the Government responded swiftly with a range of measures, including the Supplemental Budget for 2009 adopted by the Parliament in July 2009 in order to reduce public expenditure the 2008 central budget surplus of 0.49 per cent of GDP was reversed in 2009 to a deficit of 4.4 per cent of GDP. Gross debt of 38 per cent and net debt of 31 per cent, respectively of GDP in 2009 contributed to this deficit, although the prudent fiscal policies adopted by the Government largely mitigated the negative impact of the crisis on Montenegro's public finances despite the fall in central budget revenues of 2.78 per cent of GDP compared to 2008 and the contraction of the economy by 5.7 per cent.

Preliminary economic indicators for 2010 show the beginning of a recovery, with almost all sectors of the economy (other than government-related services) growing. In particular, power production and tourism led the overall recovery and recorded significant growth above the rates of 0.5 per cent per annum originally forecast in the Budget Law for 2010. The latest Ministry of Finance estimates indicate overall real growth of 1.1 per cent for 2010. The same estimates indicate that the 2009 deficit of 5.7 per cent of GDP was almost halved to 3 per cent of GDP in 2010, while gross debt increased to 42 per cent of GDP (with net debt at 37.3 per cent) due to the level of deficit financing incurred in 2010.

At the end of December 2010, total net assets of the banking sector were EUR 2,943.7 million, a decrease of 2.7 per cent compared to the end of 2009 and a increase of 1.3 per cent compared to September 2010. In December 2010, liquid assets were EUR 562.7 million or 19.1 per cent of total banking sector assets. Total bank deposits were EUR 1,789.9 million at the end of December 2010, a decrease of 1.9 per cent compared to the end of 2009. Since the start of the global economic and financial crisis, bank deposits have shown a downward trend due to the impact of the crisis on household and corporate confidence in the banking sector, although from the middle of 2009, deposits started to flow into the banking sector once more. In December 2010, the credit/deposit coefficient was 1.23.

In 2010 the number of tourists increased by 4.5 per cent compared to 2009, while overnight stays increased to 7.964 million, 5.4 per cent more than in 2009. The Government expects that in 2011 the tourist sector will again perform strongly.

Montenegro's total industrial production grew by an estimated 9.3 per cent in 2010, with quarrying and power production growing by approximately 11.3 and 22.1 per cent, respectively, compared to 2009. Metal processing did not gain momentum, however, with production at the steel mill at Zeljezara (*Zeljezara Niksic a.d.*) (the "**Steel Mill**") remaining stalled. See "— Principal Sectors of the Economy — Industrial production". However, the growth in other non-metals sectors, which currently accounts for more than 50 per cent of overall industrial output, continued to show the increased diversification of this sector of the Montenegrin economy and the decreasing dependence on metal producers. Any increased output of the Podgorica Aluminium Plant (*Kombinat Aluminijuma Podgorica* or "**KAP**") and the Steel Mill, could contribute to GDP growth much more than further drop could hurt growth prospects, current potential contribution to growth is 0.5 per cent.

In the construction industry, even though there was a significant downturn during 2009 based on the value of completed projects, the overall level of activity remained at a higher level at the end of 2009 than at the end of 2007, while preliminary data indicates growth of 5.5 per cent in 2010, with particularly strong growth of 36 per cent in the last quarter of 2010. The recent growth in the construction industry is an indicator of the start of the overall recovery in the economy and the Government expects it to continue as the country's infrastructure continues to be upgraded, particularly to facilitate growth in the tourist industry. Growth in real estate, renting and associated activity was 8.5 per cent in 2010 (compared to 7.5 per cent in 2009) and since this and the construction sector had been particularly badly affected during the crisis, (with the latter declining by 19.2 per cent in 2009 but growing by 5.5 per cent in 2010), this provided further evidence of the overall recovery.

The performance of the transport sector varied between the different segments. Although passenger transport decreased further in 2010, railway cargo increased by almost 50 per cent, while airline transport grew by 26 per cent compared to 2009 and mobile telecommunications also recorded significant growth. The Government estimates (based on preliminary data for 2010) that overall the transport sector recorded a drop of 2.2 per cent between 2009 and 2010.

The labour market in Montenegro was largely unaffected by the global economic and financial crisis until the end of the third quarter of 2009. According to data from the Montenegrin Employment Office, the unemployment rate at the end of 2009 was 11.43 per cent or 1.17 per cent lower than in 2007, but 0.53 per cent higher than at the end of 2008. The unemployment rate started to increase during 2010 as the effects of the global economic and financial crisis came to be felt, and had increased to 12.4 per cent by the end of March 2010. It decreased somewhat during the main tourist season in the summer of 2010 and now stands at 12.3 per cent. The Ministry of Finance expects the rate of unemployment to decrease further during 2011 as the overall economy continues to recover.

Reduced economic activity in 2009 was accompanied by a significant fall in foreign trade which contracted by 35 per cent in 2009 compared to 2008. The recovery in the economy, particularly in the second half of 2010 led to exports increasing by 20.3 per cent, while imports increased by 0.2 per cent and overall total foreign trade increased by 3.2 per cent. Notably, export of services increased by 9.9 per cent, fuelled by increased domestic demand, particularly by growth in tourism.

Gross Domestic Product

In real terms, GDP grew by an annual average of 8.7 per cent from 2006 to 2008, after some years of much lower growth rates averaging only 2.8 per cent per annum. The overall size of the Montenegrin economy halved during the 1990's and the Government's forecasts for real growth rates for the foreseeable future would only succeed in restoring the economic potential of the late 1980's. The tourism and energy sectors having gained renewed momentum more recently and are now expected by the Government to be particularly relevant contributors to future overall growth in the economy.

The following table sets out GDP in current and constant (2000 prices) and includes nominal and real growth rates for the years 2006 to 2010:

	2006	2007	2008	2009	2010[1]
GDP at current prices (€ million)	2,149	2,680	3,086	2,981	3,025
Nominal growth rates (%)	18.4	30.7[2]	15.1	(3.4)	1.5
Per capita GDP at current prices (€)	3,443	4,281	4,908	4,741	4,802
GDP at constant 2000 prices (€ million)	1,329	1,404	1,502	1,416	1,487
Real growth rates (%)	8.6	10.7[2]	6.9	(5.7)	0.5

Source: Monstat

Notes:

(1) Estimate by the Ministry of Finance as per Budget Law 2010.

(2) A new method of compiling GDP based on international standards was introduced from 2007 and accordingly, real growth rates shown in this table are not calculated based on other data presented in the table. See "Risk Factors — Statistical Information".

The following table sets out the structure of GDP at current prices from the expenditure side for the years 2006 to 2009[1]:

	2006		2007		2008		2009[1]	
	GDP	GDP Structure	GDP	GDP Structure	GDP	GDP Structure	GDP	GDP Structure
	(€ thousand)	*(%)*	*(€ thousand)*	*(%)*	*(€ thousand)*	*(%)*	*(€ thousand)*	*(%)*
Final consumption expenditure	2,241,002	104.2	2,908,301	108.5	3,512,925	113.8	3,165,126	106.2
of which: Households final consumption expenditure (HFCE)	1,660,948	77.2	2,368,961	88.4	2,814,821	91.2	2,503,696	84.0
Government final consumption expenditure (GFCE)	580,054	27.0	539,340	20.1	698,103	22.6	661,430	22.2
Gross fixed capital formation (GFCF)	469,811	21.9	867,109	32.3	1,180,216	38.2	797,623	26.7
Changes in inventories	77,000	3.7	39,043	1.5	74,747	2.4	10,855	0.4
External balance of goods and services	(638,815)	(29.7)	(1,133,986)	(42.3)	(1,682,267)	(54.5)	(992,637)	(33.3)
of which: Exports of goods and services	1,061,008	49.4	1,189,952	44.4	1,218,193	39.5	957,498	32.1
Imports of goods and services	1,699,823	79.1	2,323,938	86.7	2,900,460	94.0	1,950,435	65.4
GDP	2,148,998	100.0	2,680,467	100.0	3,085,621	100.0	2,980,967	100.0

Source: Monstat

Note:

(1) Estimates for the structure of GDP for 2010 are not yet available.

Growth between 2007 and 2009 has mainly been due to growth of the service segments of the economy, principally tourism, transport, trade and construction and has been fuelled by high levels of FDI and lending activity in the banking sector (see also "Balance of Payments and Foreign Trade — Foreign Direct Investment"). Growth of FDI in the period 2007 to 2009 totalled 60 per cent of GDP, while net FDI over the same period totalled approximately 70 per cent of GDP. Average FDI per capita in those years was over EUR 1,000, giving Montenegro one of the highest levels of FDI per capita in the Central Eastern European and South Eastern European countries.

During 2009, GDP is estimated to have fallen in real terms by approximately 5.7 per cent. This downturn was partly caused by the effects of the global economic and financial crisis which led to a significant drop in confidence in the country's banking sector resulting in a large outflow of deposits in late 2008 of approximately EUR 350 million or 15.2 per cent of total deposits. This trend continued in 2009 with total deposits falling by a further 8.3 per cent at the end of 2009 compared to the end of 2008. This outflow, in turn, led to a marked decline in the credit activities of banks such as lending, with overall volumes decreasing by 14.3 per cent in 2009 compared to 2008. The Government reacted to the crisis by implementing a number of measures, principally the adoption of the Law on Banking System Safeguards in October 2008, thereby preventing a further outflow of deposits in 2009. See "Monetary and Financial System — Measures of economic, prudential and monetary policy in the banking system".

The contraction in the economy continued in the first quarter of 2010, but growth resumed in the second quarter of 2010 and continued throughout the remainder of 2010, to give overall growth of 1.1 per cent for the year. Tourism, trade and real estate all recovered well, while in the industrial sector, power production and quarrying recorded growth rates of 22.1 and 11.3 per cent, respectively. By contrast, metal processing and financial intermediation are still suffering from the economic downturn. As a result of reduced public expenditure, education, health and government services also declined in 2010. Overall the Government expects that its initial projection for the growth rate for 2010 of 0.5 per cent is likely to be surpassed, with the more important strategic sectors of Montenegrin economy having performed well given the turbulent overall economic environment, continued restricted access to finance and reduced activity in the banking sector.

The Montenegrin economy is predominately a service-oriented economy. It has many small and "micro" businesses that have either very few, or, in most cases, no, alternative means of financing apart from the banking sector and during the financial crisis these businesses have endured severe liquidity problems (even though the majority of businesses remain solvent and profitable). The difficulties with access to credit across the economy continued to affect growth in 2010 and are likely to continue to affect growth prospects during 2011. Many economic indicators, such as the overall level of employment in the private sector and net wages, have, however, remained on an upward trend and a significant number of new start-up businesses (for instance, in 2010, the total number of registered sale traders was over 3,600 higher than in 2009) demonstrate a relatively flexible and resilient economy which is well-placed to rebound once liquidity and lending resumes.

As a result of all these factors, along with the change in the structure of the economy as a result of which a more productive and value added private sector has been developing, the Government believes that there still remains potential for continued economic growth in Montenegro.

Principal Sectors of the Economy

In the past decade and, in particular, since Montenegro declared independence in 2006, the structure of its economy has changed drastically. Instead of industrial production, the main drivers of the economy have emerged from the service sector, principally tourism and related services, transport and retail sales and, to a lesser extent, construction. The number of small and medium-sized enterprises ("**SMEs**") has increased rapidly. For example, in 2010 the number of employees in companies which have 100 employees or less was 73,380, comprising approximately 60 per cent of the total private sector workforce. Despite the effects of the global financial and economic crisis the number of these SMEs has continued to grow.

The following tables set out the structure[(1)] of GDP from the production side and the contributions to nominal growth for each component of GDP for the years 2005 to 2009:

	2005			2006			2007[(2)]			2008			2009		
	€ million	*Structure (%)*	*Contribution to nominal growth (%)*	*€ million*	*Structure (%)*	*Contribution to nominal growth (%)*	*€ million*	*Structure (%)*	*Contribution to nominal growth (%)*	*€ million*	*Structure (%)*	*Contribution to nominal growth (%)*	*€ million*	*Structure (%)*	*Contribution to nominal growth (%)*
GDP in current prices															
Agriculture & forestry	159	8.8	0.3	178	8.3	1.1	194	7.2	0.7	230	7.5	1.4	247	8.3	0.5
Manufacturing & power	261	14.4	(0.4)	282	13.1	1.2	290	10.8	1.2	333	10.8	1.6	335	11.2	0.1
Construction	54	3.0	0.3	76	3.5	1.2	155	5.8	0.9	191	6.2	1.3	162	5.4	(1.0)
Trade	190	10.5	1.2	238	11.1	2.6	357	13.3	4.6	382	12.4	0.9	357	12.0	(0.8)
Hotels	54	3.0	0.3	64	3.0	0.6	118	4.4	1.3	133	4.3	0.6	152	5.1	0.6
Transport	171	9.4	0.5	208	9.7	2.0	239	8.9	3.5	289	9.4	1.9	284	9.5	(0.2)
Finance & real estate	255	14.0	0.5	309	14.4	3.0	359	13.4	7.3	371	12.0	0.5	372	12.5	0.0
Government services	378	20.8	3.4	401	18.6	1.2	420	15.7	4.4	547	17.7	4.7	565	18.9	0.6
Taxes — Subsidies	295	16.3	2.8	396	18.4	5.6	549	20.5	7.0	230	19.7	2.2	508	17.1	(3.3)
Total Production	**1,815**	**100.0**	**8.7**	**2,148**	**100.0**	**18.4**	**2,680**	**100.0**	**30.7**	**3,086**	**100.0**	**15.1**	**2,981**	**100.0**	**(3.4)**

Source: Monstat

Notes:

(1) The segments contained in this table are based on international categories which are different from the segments described below. For example, the "Tourism" segment described below includes contributions from, among others, the "Hotels", "Transport" and "Trade" segments in this table.

(2) A new method of compiling GDP based on international standards was introduced from 2007 and accordingly, real growth rates shown in this table are not calculated based on other data presented in the tables. See "Risk Factor — Statistical Information".

Tourism

Based on data collected by the World Travel and Tourism Council, the Government estimates that in 2009 approximately 20.8 per cent of total Montenegrin GDP was generated by tourism directly and indirectly, with a total of 29,000 employees engaged in the tourism industry. Total tourism revenues in 2010 were approximately EUR 635 million, approximately 6.4 per cent higher than in 2009.

The tourism sector emerged in 2000 and continued to grow year on year through 2009, with an increase in the number of arrivals and overnight stays of tourists and generated revenues. In 2008, the number of tourists increased by 4.8 per cent with an increase of 6.9 per cent in overnight stays compared to 2007.

In 2009 just over 1.2 million tourists visited Montenegro, an increase of 1.6 per cent over 2008, although the number of tourist overnight stays was 7.552 million, 3.1 per cent less than in 2008. Foreign tourists accounted for 88.7 per cent of total overnight stays. The origins of tourists are fairly diversified, with approximately 21 per cent of tourists coming from the European Union, 12 per cent from the Russian Federation and 37 per cent from Serbia.

Approximately 96 per cent of the total number of overnight tourist stays are on the Montenegrin coast, but the Government believes that there is also great potential for increases in tourist numbers visiting the mountain area of the country and Lake Skadar, the largest lake in the Balkans. The Government is focussing on infrastructure investment and marketing to try to promote inland tourism, while two mountain resorts (Kolasin and Zabljak) are becoming centres of regional winter tourism.

In 2010, the number of tourists increased by 4.5 per cent compared to 2009, while overnight stays increased to 7.964 million, 5.4 per cent more than in 2009. Foreign tourists accounted for 87.6 per cent of total overnight stays, with further increasing diversification in terms of the country of origin.

Once overall economic growth gathers momentum, the Government expects significant further investments in the tourism sector (see "Balance of Payments and Foreign Trade — Foreign Direct Investment") principally in a number of major developments on the coast and that, as a result, tourism will continue to grow at an even faster pace than previously. The World Travel and Tourism Council predicts that the "tourist" GDP of Montenegro will grow at annual rates of 5.7 per cent which ranks Montenegro in the first five countries out of 176 on this measure. As with the overall size of the economy, the Montenegrin tourist industry is still operating below the peak it enjoyed at the end of the 1980's when the country first established itself as an attractive tourist destination.

The Government recognises tourism as a very important sector of the economy and supports it through some important infrastructure projects, such as the coastline water supply and wastewater treatment projects, solid waste projects, and road infrastructure. All of these projects are co-financed with major international financial institutions such as the European Investment Bank (the "**EIB**"), the EBRD, the German Development Bank *Kreditanstalt fur Wiederaufbau* ("**KfW**") and the World Bank.

Industrial production

In the past industrial production has contributed significantly to the overall GDP of Montenegro, comprising 16 per cent of total GDP in 2004, and more recently, 11.2 per cent of total GDP in 2009. In particular, aluminium production by KAP and the production of steel at the Steel Mill contributed on average approximately 5 per cent of total GDP in the period between 2000 and 2005, although this decreased to 2.2 per cent of GDP in 2008 and further to 1.7 per cent of GDP in 2010. Going forward, the Government expects energy production to play an increasingly important role in this segment of the economy. Energy production currently comprises approximately 60 per cent of the country's total industrial production.

Energy production

The production of base metals and the generation of electricity are currently major components of industrial production in Montenegro. In the medium to long term, energy production (in particular, the production of renewable energy) is expected to be the biggest source of potential future growth in the Montenegrin economy, with the Government estimating, for example, that over 80 per cent of the country's potential hydro-power generating capacity currently remains untapped. The Government estimates that in 2010 power production grew by over 22 per cent compared to 2009. In July and August 2010, the Government signed contracts with Fersa Energia Renovables, S.A. and Mitsubishi Heavy Industries Ltd., respectively for the construction of windparks with the potential to produce a total of 96 mega-watts of energy. The partial privatisation of the national power company (Electric Power Company of Montenegro or "**EPCG**") and tenders for four large hydroelectric plants on the River Moraca, for an estimated total amount of EUR 540 million, as well as several smaller hydro-electric plants, in addition to a project for an underwater transmission cable between Montenegro and Italy, for an estimated total amount of EUR 700 million, will assure future growth.

KAP

KAP was established in 1969, with aluminium production beginning in 1971. In December 2005, KAP was privatised with 65.4 per cent of its shares being sold to Salomon Enterprises Limited (now renamed Central European Aluminium Company ("**CEAC**")). CEAC is wholly owned by the EN + Group, a Russian company, which focuses on businesses which extract raw materials for energy production, as well as the production and sales of electric energy and high energy consuming metals.

KAP's aluminium refinery and an aluminium plant (which consists of a carbon plant, smelter, a casthouse and secondary smelter) are situated on the outskirts of Podgorica close to the Podgorica airport and connected by railway to the bauxite mine near Niksic and the Port of Bar where KAP has its own dedicated installations. The refinery produces aluminium by extracting it from the bauxite shipped from the Niksic bauxite mine. It has a capacity of 280,000 metric tonnes a year and fully supplies the aluminium plant. The smelter consists of two potlines which produces 120,000 metric tonnes of molten aluminium each year. The casthouse casts molten aluminium into two products: standard ingots, which are re-melted for alloying in foundry plants and T-ingots, which are cast and sized according to customer requirements and range in quality from A6-A8. The secondary smelter recovers scrap aluminium and dross from the casthouse and potlines.

During 2008, KAP was affected by the worldwide decline in aluminium prices and high electricity costs which led to a drop in production. In recent years, KAP's trade union has also staged strikes demanding, among other things, increased severance payments.

After debt rescheduling and layoffs in 2009, KAP increased its production from 60,000 tonnes in 2009 to 81,800 tonnes in 2010. The agreement signed between the Government and KAP in connection with the restructuring contemplates a further increase in production to 100,000 tonnes for 2011 and 120,000 tonnes for 2012.

Steel Mill

The Steel Mill was established on 16 December 1950 and the first production mill began operations in December 1956 with liquid steel first cast in July 1957. As the originally installed machinery and production facilities were second-hand a major reconstruction of the plant took place between 1961 and 1966, which resulted in an increase in production of crude steel from 136,000 to 185,000 tonnes per year. Between 1975 and 1982 the production facilities were further modernised and extended resulting in an increase in production capacity of crude steel to 380,000 tonnes per year. Between 1989 and 1992 a new open die forging and ring rolling plant with a capacity of 10,000 tonnes per year was installed enhancing the range and quality of steel grades which could be produced. During the period of UN sanctions between 1992 and 1996, the Steel Mill's business was seriously affected and in order to survive it shifted its business from producing quality steel grades to rebar steel production.

In November 2006, the Steel Mill was privatised with 66.7 per cent of its shares being sold to MN Specialty Steels Limited ("**MN Specialty Steel**") for EUR 5.2 million and a pledge to invest a further EUR 118 million in the plant within five years. In February 2008 MN Specialty Steel transferred its shares to MNSS B.V., its current owners.

The Steel Mill has also been affected by the financial crisis with production being halted in October 2009, although it then resumed in 2010. In addition, during late 2010 and early 2011, production has been affected by the workforce striking as a result of non-payment of wages. The financial obligations and operations of the Steel Mill are currently being restructured as described below. A new electric arc furnace is currently being installed which is expected to increase production volumes as well as efficiency and a second phase of modernisation is planned during 2011 to boost further the production capacity.

Restructuring of KAP and the Steel Mill

Driven largely by the factors referred to above, in 2009 Montenegro's total industrial output fell over 30 per cent. Output has begun to recover again since December 2009, although manufacturing continued to decline, falling by 5.8 per cent in 2010, while power production and quarrying grew in 2010 leading to an increased combined share for these two sectors in overall industrial production from 56 per cent in 2009 to 62 per cent in 2010. In the manufacturing segment, the share of non-metal producers increased to over 50 per cent with a further decrease in the significance of production by KAP and the Steel Mill, which now together contribute just 1.7 per cent of total GDP.

The Government has provided guarantees for the debt restructuring and redundancy programmes for these two companies and subsidies for their power consumption, with the subsidies being scheduled to come to an end in 2012. The guarantees for KAP are in respect of a EUR 49.68 million loan from OTP Bank and EUR 22 million loan from Deutsche Bank AG, London Branch, each given in 2010. The guarantee for the Steel Mill, also given in 2010, was in respect of a EUR 26.3 million loan from Credit Suisse. The total amount of these guarantees amounted to approximately 6 per cent of GDP in the Budget Law for 2010. These measures are intended to improve the prospects of these two metal producers and the Government expects that these two entities combined will contribute to GDP growth of up to 0.5 per cent in 2011. See also "Indebtedness — Domestic Debt".

Construction

Even though the construction industry suffered a significant downturn during 2009 based on the value of completed projects, this value remained at a higher level at the end of 2009 than it was at the end of 2007. Extensive capital budget investments by both central and local governments, (see "- Public Finance") together with Public Private Partnership ("**PPP**") projects in road infrastructure, offset reductions in private sector investments in 2010. A major PPP motorway project to connect Bar to Belgrade was delayed in 2010 and is, currently being re-negotiated with Chinese investors, who have expressed a strong interest to invest in the project. A Government-sponsored housing project in co-operation with the Council of Europe Development Bank also assisted growth in the construction industry. According to the Ministry of Finance estimates, the construction sector recorded growth of 5.5 per cent in 2010, with particularly strong growth in the final quarter reversing the slower activity earlier in 2010.

Transportation

Between 2004 and 2008, transportation contributed on average 9.5 per cent of total GDP at current prices. Annual statistics for 2009 show that railway and air passenger transport declined by 20.6 per cent and 13.8 per cent, respectively, compared to 2008 but the transportation of goods by road grew by 3.1 per cent.

In 2010 passenger transport and road cargo transport volumes continued to decline, while railway cargo, airline transport and mobile telecommunications grew. The Government estimates that overall the transportation sector continued to fall by over 2.2 per cent in 2010 compared to 2009.

The privatisation process for Montecargo (the state railway cargo operator), Montenegro Airlines and the Port of Bar are underway and, together with significant investments in the country's road and railway infrastructure and the motorway project from Bar to Boljare (running from the Montenegrin coast to the Serbian border), are expected to contribute to further growth in the transportation sector.

Agriculture

Between 2004 and 2009, agriculture contributed on average 8 per cent of total GDP at current prices. The agricultural sector consists of, among other things, food processing and beverages (including wine and beer production). In 2010 agricultural contribution to GDP fell by almost 7 per cent compared to 2009, mainly due to bad weather and flooding in the first half of 2010, as well as in the autumn months.

State controlled wine producer, Plantaze, produces and distributes wine, table grapes, grape brandies and peaches. The company is also active in fish farming, catering and the retail trade.

Plantaze has approximately 2,310 hectares of vines and wine cellars, giving it the largest single vineyard site in Europe with an annual production of approximately 22 million kilos of grapes and annual sales of approximately 17 million bottles of wine. Approximately 60 per cent of its vineyeards produce its most famous wine branded "Vranac". Wine is exported to more than 25 countries, including Russia, China, Australia, USA and Canada, as well as countries in South East Europe.

Plantaze also has a 6,000 square metre fish pond on the Mareza river where it produces and sells around 100 tonnes of Californian trout annually and also breeds fish for the stocking of lakes and rivers.

For the year ended 31 December 2009, Plantaze's total revenue was EUR 32.3 million. For the nine months ended 30 September 2010, total revenue decreased to EUR 20.3 million, compared to EUR 21.3 million for the nine months ended 30 September 2009.

The food processing sector includes, among other things, processing plants, flour mills, diaries, bakeries, juice factories and fruit-processing factories.

Inflation

The following table shows annual inflation rates (according to the cost of living index) for the years 2005 to 2008 and (according to the consumer price index) for 2009 and 2010:

	2005	2006	2007	2008	2009	2010
			(%)			
Inflation (annual 12-months average rate of change)	2.3	3.0	4.2	8.5	3.4	0.5

Source: Monstat

The increase in the inflation rate in the period from 2007 to 2008 corresponded with the significant growth rates in the overall economy in the same period. A high inflow of FDIs and the significant increase in lending activity in the banking sector caused a huge increase in aggregate demand, and further side effects were felt in the record-high current account deficit (50 per cent of GDP), as well as inflated property prices and stock-market values. These factors, in turn, led to even higher aggregate demand and a comparatively high inflation rate compared to other eurozone economies. The major contributor to the rise in prices was the increase in the prices of non-tradeable goods. In 2009 the inflation rate fell back to 3.4 per cent and in 2010 weak demand led to decreased inflation of 0.5 per cent on an annualised basis. The Government expects that inflation will increase during 2011, with it having already increased to 1.1 per cent for January 2011. For the purpose of its forecast budget revenues and expenditures for the years 2012-2014, the Government has assumed an inflation rate of 2.5 per cent per annum. See "Public Finance — Budget Law 2011".

Wages

The following table shows the average monthly gross and net wages in the public and private sectors along with their growth rates for each of the years 2006 to 2010:

	Average Gross Wages					Average Net Wages				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Public Sector (€)	456	455	605	641	652	301	312	412	461	463
Private Sector (€)	398	533	617	643	715	262	361	422	463	479
Public Sector — Growth Rate (%)	100	99.9	132.9	106.0	6.88	100	103.5	132.3	111.8	105.94
Private Sector — Growth Rate (%)	100	134.0	115.7	104.1	11.2	100	137.9	116.8	109.7	103.5

Source: Monstat

There has been a marked growth in wages in the last three years for a number of reasons, including cuts in income taxes and social insurance contribution rates and the expansion of the private sector (in particular, in the service industries). The growth of net wages in 2009, along with an increase in overall employment levels, demonstrated the resilience of the private sector since the increase in wage levels did not restrict overall growth.

By contrast, during 2009 the Government cut public sector wages by an average of 4 per cent in keeping with its current fiscal policy to reduce overall government expenditure and, in particular, the public sector wages bill. Wages in the public sector are recorded in official Monstat Statistics as having increased slightly during 2010 due to the taxation of previously non-taxable allowances, such as holiday and meal allowances, resulting in them being included in the overall amount of gross wages based on the methodology applied by Monstat, even though the average actual net income per public sector employee decreased by approximately 4 per cent. The recorded increase in private sector wages was also largely due to this methodology, as opposed to any actual increase in net income.

The Government has also imposed strict controls on the number of new public sector employees between 2010 and 2012. This factor, along with wage cuts and the cancellation of various bonuses for public sector employees, will make private sector employment far more attractive and is expected eventually to lead to increased overall productivity in the economy. Given that the growth in wages in the public sector has jeopardised reforms in the labour market to a certain extent and even threatened to restrict the ability of the private sector to employ workers, the Government's decision to cut wages has acted not merely as a fiscal measure but also as a structural economic reform.

Employment

The following table sets out the number of employed, unemployed and their respective participation rates for the years 2005 to 2010(6):

	2005	2006	2007	2008	2009	2010(6)
			(thousand)			
Total population (mid-year)	634.9	632.7	638.0	639.7	642.3	645.3
Labour force(1)	256.6	253.2	263.7	266.7	264.0	262.4
Persons in employment	178.8	178.4	212.7	221.9	213.6	211.9
Unemployed persons(2)	77.8	74.8	51.1	44.8	50.4	50.5
Inactive persons(3)	257.6	264.1	245.9	246.7	252.7	257.4
			(%)			
Employment rate(4)	34.8	34.5	41.7	43.2	41.3	40.8
Activity Rate(5)	49.9	48.9	51.7	51.9	51.1	50.4

Source: Monstat, Labour force survey 2005-2010

Notes:

(1) Labour force includes persons in employment and unemployed persons.

(2) The term "unemployed" refers to persons who in the reference week did not work (i.e. not in paid employment or self-employment and did not do any paid work); or in the past four weeks were actively seeking work (i.e. specific steps were taken to seek paid employment or self-employment); or were currently available for work (i.e. within two weeks). Persons who had found a job to start later are also included among unemployed persons.

(3) "Inactive persons" are those, aged 15 years and over, who are not classified as persons in employment or as unemployed persons

(4) "Employment rate" represents the percentage of persons in employment in the total population aged 15 and above.

(5) "Activity rate" represents the percentage of active population in the total population aged 15 and above.

(6) For 2010, the figures are for third quarter only.

The following table sets out the unemployment rate for the years 2005 to 2010:

	2005	2006	2007	2008	2009	2010
				(%)		
Unemployment rate(1)	18.5	14.5	12.6	11.3	11.6	12.1

Source: Employment Agency

Notes:

(1) "Unemployment rate" represents the percentage of unemployed persons in the total active population based on the International Labour Organisation Methodology.

The following table shows the proportion of the total number of employed people in Montenegro employed in each of the public and private sectors for each of the years 2006 to 2010:

	2006	2007	2008	2009	2010[(1)]
			(%)		
Public Sector	23.3	26.9	26.4	25.3	26.6
Private Sector	76.7	73.1	73.6	74.7	73.4

Source: Monstat

Note:

(1) As of March 2010 Monstat has been reporting the number of employed people based on a data received from the Tax Office, while prior to that Monstat had reported based on data from the Health Fund and the Pension Fund. Monstat has confirmed that the March data and the December data are not comparable due to the process of data transfer from the two Funds to the Tax Office. Even though these statistics show a decrease in the overall number of employed people between 2009 and 2010, the increase in the amount of personal income tax and social contributions collected in 2010 compared to 2009 (EUR 51 million) can only partially be explained by changes in taxation policies between the two years and the Government therefore believes that there has actually been an increase in the number of employed persons in 2010.

Since 2000, when unemployment in Montenegro reached its highest level ever (at almost 30 per cent of the labour force), the unemployment rate has fallen significantly to 12.1 per cent for 2010, a slight increase over 11.6 per cent in 2009.

Changes in the labour market have been influenced by two major factors: an increase in the flexibility of the labour market and a decrease in the fiscal burden imposed on labour. In addition, reforms of labour regulations in 2008 have made the Montenegrin labour market one of the most flexible labour markets in Europe, as measured by the EPL Index (Employment Protection by Legislation Index), whose value decreased from 4.1 to 1.7 from 2003 to 2008 (with the OECD average being 2.0). According to the World Bank's Doing Business Indicator — Employing Workers, Montenegro is ranked as the 46th country out of 183 on this measure.

The average tax burden on labour, calculated based on the average wage of the average production worker in the manufacturing industry (APW) in Montenegro as published by Monstat, has declined from 50.5 per cent in 2000 to 37.7 per cent in 2010, which is close to the current OECD average for such measure.

The labour market in Montenegro was largely unaffected by the global economic and financial crisis until the end of the third quarter of 2009. According to data from the Montenegrin Employment Office, the unemployment rate at the end of 2009 was 11.43 per cent or 1.17 per cent lower than in 2007, but 0.53 per cent higher than at the end of 2008. The negative effects of crises continued during 2010 with the unemployment rate increasing to 12.1 per cent by the end of December 2010, and the Government expects the unemployment rate will increase slightly in the first half of 2011 with recovery of the labour market and a resulting decrease in unemployment in the second half of 2011.

In 2009, the Law on the Employment and Work of Foreigners was passed giving non-resident employees equal rights and obligations to those of Montenegro residents in the labour force. To some extent this has made non-resident labour less attractive due to the removal of favourable tax rates for non-resident employees and has resulted in an increase in employment levels for the domestic labour force. Montenegro is one of the few countries in emerging Europe which employs a significant number of non-residents in its labour force. Since the beginning of 2009, over 17,000 work permits for non-residents have been issued, which has significantly influenced employment growth in the tourism and retail sectors.

The "structural" unemployment rate in Montenegro is currently approximately 10 per cent according to Ministry of Finance estimates, primarily due to the fact that the majority of unemployed persons have been claiming benefits for an extensive period and are essentially former employees of socialist manufacturing companies which were shut down during the transition phase of the economy. Nonetheless, the rate of "structural" unemployment is being reduced virtually every month through a natural outflow of those being classified as unemployed by virtue of them reaching retirement age.

Pension System

Since 2003, the Government has been implementing reforms to its pension system. As part of these changes the Law on Pension and Disability Insurance was adopted by the Parliament in December 2003 to provide for the implementation of reforms in the pension and disability insurance area, including the increase in the retirement age of men, from 60 to 65, and of women, from 55 to 60. Changes have been made to the Pension and Disability Insurance Fund to ensure that it operates more efficiently, including the introduction of a newly integrated information system and information technology system.

Pension and disability insurance in Montenegro is based on a multi-pillar system developed to ensure long term sustainability. The system comprises the following:

- compulsory pension and disability insurance based on current financing (Pillar I);
- compulsory pension and disability insurance based on individual capitalised savings (Pillar II); and
- voluntary pension insurance based on individual capitalised savings (Pillar III).

In accordance with the Social Security Minimum Standards Convention No. 102 of the International Labour Organisation, compulsory pension and disability insurance is available to all members of the economically active working population. For every employee in Montenegro, employers allocate 5.5 per cent of gross salary to the pension fund. Other contributions include those by insurers and any shortfall is covered out of total central government budget revenue. State pensions and disability benefits are index-linked rather than being linked to average earnings.

In light of certain negative demographic trends, the relatively low activity rate of the population in the workforce and the unpredictability of the likely overall pension expenditure for Pillar I described above, the Government introduced certain amendments to the Law on Pension and Disability Insurance, which were passed by the Parliament in December 2010. The main changes relate to:

- gradual increase over a period of years in the retirement age to 67 years for both males and females (currently 65 for males and 60 for females); and
- change in the pension adjustment formula from 50 per cent of growth in average wage in Montenegro and 50 per cent of growth in CPI to 75 per cent of CPI growth and 25 per cent of growth in average wage in Montenegro.

Pursuant to the Law on Voluntary Pension Funds, so far three companies have been issued with licences for the management of voluntary pension funds: Atlas Penzija a.d. Podgorica, Market Invest a.d. Bijelo Polje and NLB Penzija a.d., Podgorica.

Exchange Rates

The introduction of the euro as legal tender in Montenegro in 2002 was an important initial step in achieving macroeconomic stability. At the same time, the use of the euro as legal tender made it impossible for the Government to use most quantitative instruments of monetary policy during the global financial and economic crisis, leaving the mandatory reserve rate as the only means that could be used to control to some extent the money supply. See “Monetary and Financial System — Monetary Policy”.

The introduction of the euro generated numerous economic strengths for Montenegro and brought about the acceleration of economic growth. In a relatively short period of time, inflation was reduced and this contributed greatly to achieving macroeconomic stability and a reliable business environment. In the absence of foreign currency risk, foreign investors could be confident that no sudden devaluation or depreciation of the domestic currency would affect their investment. The adoption of the euro also required a tightening of fiscal policy in the absence of the ability to monetise the budget deficit and also eliminated commissions and information asymmetry in trading with EU countries, making the latter the most important foreign trade partners of Montenegro. The adoption of the euro also furthered the development of the country’s financial system, primarily the banking sector and the capital markets because, as a “hard” currency, the euro was not subject to effective devaluation by Government action.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

The following table sets out Montenegro's current, capital and financial accounts for the years 2005 to 2010 both in EUR million and as a percentage of GDP:

	2005	2006	2007	2008	2009	2010[1]
			(€ million)			
A. Current Account (1+2+3+4)	(311.4)	(686.8)	(1,077.5)	(1,583.7)	(896.3)	(774.6)
1. Goods	(673.5)	(1,010.3)	(1,607.2)	(2,101.9)	(1,371.7)	(1,314.7)
1.1. Export	369.3	462.0	483.4	450.4	296.3	356.6
1.2. Import	1,042.8	1,472.3	2,090.6	2,552.3	1,668.0	1,671.2
2. Services	195.5	197.1	439.0	399.4	384.6	446.4
2.1. Credit	329.8	418.0	673.0	750.6	680.5	747.0
2.2. Debit	134.2	220.9	234.0	351.2	295.9	300.6
3. Income	20.0	36.2	31.3	45.8	5.4	(20.8)
3.1. Credit	64.8	70.8	105.3	168.8	162.8	165.8
3.2. Debit	44.8	34.5	74.1	123.0	157.4	186.6
4. Current transfers	146.6	90.2	59.4	73.1	85.4	114.4
4.1. Credit	163.5	108.6	100.8	109.3	117.7	146.3
4.2. Debit	16.9	18.3	41.4	36.2	32.3	31.9
B. Capital & Financial Account	169.6	530.7	1,053.4	1,325.5	528.1	368.3
B1. Capital account	0.0	(14.0)	(1.4)	(0.5)	2.0	(0.5)
B2. Financial account	169.6	544.7	1,054.9	1,325.9	526.1	368.8
1. Direct investment — net	399.0	469.7	567.8	582.0	1,066.5	542.4
2. Portfolio investment — net	4.8	(9.9)	5.2	(15.5)	(41.9)	188.2
3. Other investment — net	(121.4)	222.0	632.7	604.2	(413.8)	(345.2)
4. Change in reserve assets (CBM)	(112.9)	(137.0)	(150.8)	155.3	(84.7)	(16.6)
C. Net Errors & Omissions (-A-B)	141.8	156.1	24.1	258.2	368.2	406.4

	2005	2006	2007	2008	2009	2010[1]
			(% of GDP)			
A. Current Account (1+2+3+4)	(17.2)	(32.0)	(40.2)	(51.3)	(30.1)	(25.6)
1. Goods	(37.1)	(47.0)	(60.0)	(68.1)	(46.0)	(43.5)
1.1. Export	20.3	21.5	18.0	14.6	9.9	11.8
1.2. Import	57.5	68.5	78.0	82.7	56.0	55.2
2. Services	10.8	9.2	16.4	12.9	12.9	14.8
2.1. Credit	18.2	19.5	25.1	24.3	22.8	24.7
2.2. Debit	7.4	10.3	8.7	11.4	9.9	9.9
3. Income	1.1	1.7	1.2	1.5	0.2	(0.7)
3.1. Credit	3.6	3.3	3.9	5.5	5.5	5.5
3.2. Debit	2.5	1.6	2.8	4.0	5.3	6.2
4. Current transfers	8.1	4.2	2.2	2.4	2.9	3.8
4.1. Credit	9.0	5.1	3.8	3.5	3.9	4.8
4.2. Debit	0.9	0.9	1.5	1.2	1.1	1.1
B. Capital & Financial Account	9.3	24.7	39.3	43.0	17.7	12.2
B1. Capital account	0.0	(0.7)	(0.1)	0.0	0.1	0.0
B2. Financial account	9.3	25.3	39.4	43.0	17.7	12.2
1. Direct investment — net	22.0	21.9	21.2	18.9	35.8	17.9
2. Portfolio investment — net	0.3	(0.5)	0.2	(0.5)	(1.4)	6.2
3. Other investment — net	(6.7)	10.3	23.6	19.6	(13.9)	(11.4)
4. Change in reserve assets (CBM)	(6.2)	(6.4)	(5.6)	5.0	(2.8)	(0.5)
C. Net Errors & Omissions (-A-B)	7.8	7.3	0.9	8.4	12.4	13.4

Source: Central Bank of Montenegro

Note:

(1) Preliminary data

During 2008-10, the emergence of significant positive net errors and omissions, increasing to 13.4 per cent of GDP in 2010, implies that there may be significant unrecorded transactions in the economy. The origin of these transactions is currently being investigated by Monstat but based on its assessment of the situation, the Government estimates that it may be accounted for by a number of different factors, including, the actual level of exports being higher than recorded, tourist payments being made in cash, various unrecorded remittances and high levels of FDIs (which tends to lead to higher overall errors). Based on the overall level of net errors and omissions, the Government estimates that the current account deficit (which is currently recorded at approximately 25.6 per cent of GDP) may be somewhat lower than that which is indicated in the table above.

Current Account

The current account deficit increased to 51.3 per cent of GDP in 2008 from 17.2 per cent of GDP in 2005. This increase was caused by the large inflow of FDIs and a significant increase in lending activity by the banking sector. Imports of goods increased by 25 per cent of GDP during this period, while exports of goods declined by 5.7 per cent of GDP and earnings from services increased as tourism grew.

The general economic downturn led to a significant change in 2009 and 2010, with the current account deficit falling to 30.1 per cent of GDP in 2009 and further to 25.6 per cent of GDP in 2010. Imports amounted to 55.2 per cent of GDP in 2010, while exports increased to 11.8 per cent of GDP, due to an increase in exports of aluminium. Net earnings from services, however, remained constant at approximately 13 per cent of GDP in 2008 and 2009 and increased to 14.8 per cent of GDP in 2010.

Capital and Financial Account

During 2005 to 2007, large inflows of foreign capital were able to fully fund the current account deficit and allowed a significant build up of reserves at the Central Bank. This trend was partly reversed by the deposit outflows from banks in 2008, but the Central Bank was again able to accumulate reserves during 2009 as the level of imports fell.

The level of FDIs rose to above 20 per cent of GDP between 2005 and 2007. It fell back only slightly in 2008 before recovering strongly to 35.8 per cent of GDP in 2009, partly buoyed by the sale of shares in EPCG which raised a total of EUR 436.1 million. There was a significant reversal in other financial flows in 2009 reflecting the significant contraction in the banking system. In 2010, the level of FDIs was EUR 542.4 million (17.9 per cent of GDP).

Foreign Trade

Foreign trade in goods

The global economic and financial crisis resulted in both a drop in world commodity prices and a general fall in worldwide demand. This in turn had a negative impact on Montenegro’s foreign trade. Total foreign trade in goods in 2009 fell by 35 per cent compared to 2008, with exports falling by 36 per cent and imports falling by 35 per cent. In 2010, however, the trend was reversed and according to preliminary data the total volume of foreign trade was EUR 1,984.9 million, 2.8 per cent higher than in 2009. Exports of goods increased by 19.2 per cent to EUR 330.3 million and imports of goods increased by 0.03 per cent to EUR 1,654.6 million.

The following tables illustrate the geographic distribution of Montenegrin exports and imports of goods for the years 2005 to 2010:

Exports

	2005		2006		2007		2008		2009		2010	
	(€ million)	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*
Serbia	158.18	34.34	172.02	27.42	106.73	21.91	107.81	24.89	77.27	27.90	74.92	22.68
Italy	146.26	31.75	239.23	38.13	145.29	29.83	130.56	30.14	32.95	11.90	48.83	14.78
Greece	50.19	10.90	68.36	10.90	60.46	12.41	53.23	12.29	47.80	17.26	56.39	17.07
Slovenia	26.37	5.72	23.05	3.67	28.56	5.86	37.35	8.62	24.28	8.77	20.57	6.23
Bosnia and Herzegovina	22.07	4.79	28.55	4.55	26.02	5.34	22.09	5.10	17.82	6.43	24.11	7.30
Croatia	6.34	1.38	8.80	1.40	10.99	2.26	6.62	1.53	9.12	3.29	4.04	1.22
Albania	4.62	1.00	10.25	1.63	11.58	2.38	5.91	1.36	6.08	2.19	8.22	2.49
Germany	1.35	0.29	5.68	0.91	9.19	1.89	16.22	3.75	2.58	0.93	3.12	0.94
Macedonia	1.54	0.34	2.04	0.32	0.79	0.16	0.90	0.21	1.36	0.49	1.09	0.33
United Kingdom	7.02	1.52	1.63	0.26	2.78	0.57	3.95	0.91	1.92	0.69	4.16	1.26
Hungary	10.09	2.19	44.25	7.05	63.34	13.00	9.25	2.13	11.66	4.21	29.96	9.07
Others	26.60	5.78	172.02	3.76	106.73	4.39	39.27	9.07	44.15	15.94	54.90	16.62
Total	460.65	100.00	627.46	100.00	487.12	100.00	433.16	100.00	276.98	100.00	330.31	100.00

Source: Monstat

Imports

	2005		2006		2007		2008		2009		2010	
	(€ million)	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*	*(€ million)*	*(%)*
Serbia	292.43	30.01	402.15	27.13	705.04	34.02	839.18	33.21	505.50	30.56	432.24	26.12
Italy	96.92	9.95	154.49	10.42	95.99	4.63	136.85	5.41	104.02	6.29	99.03	5.99
Greece	91.40	9.38	141.09	9.52	163.69	7.90	193.19	7.64	115.00	6.95	115.32	6.97
Slovenia	52.85	5.43	75.21	5.07	122.83	5.93	185.46	7.34	85.86	5.19	60.22	3.64
Bosnia and Herzegovina	48.19	4.95	51.43	3.47	110.80	5.35	120.52	4.77	58.94	3.56	123.51	7.46
Croatia	40.52	4.16	52.84	3.56	149.02	7.19	161.30	6.38	89.17	5.39	80.16	4.84
Albania	38.72	3.97	47.74	3.22	75.72	3.65	105.05	4.16	63.22	3.82	9.00	0.54
Germany	30.42	3.12	59.13	3.99	25.85	1.25	36.77	1.45	58.96	3.57	116.89	7.06
Macedonia	28.56	2.93	60.41	4.07	133.61	6.45	169.67	6.72	99.52	6.02	23.19	1.40
United Kingdom	23.74	2.44	40.94	2.76	117.17	5.65	164.81	6.52	100.88	6.10	13.28	0.80
Hungary	21.48	2.20	38.30	2.58	9.84	0.47	3.04	0.12	38.04	2.30	12.79	0.77
Others	209.07	21.46	358.96	24.21	362.94	17.51	411.32	16.28	334.93	20.25	568.93	34.39
Total	974.30	100.00	1,482.69	100.00	2,072.48	100.00	2,527.15	100.00	1,654.04	100.00	1,654.57	100.00

Source: Monstat

Foreign trade in services

The total volume of foreign trade in services was EUR 1,047.6 million in 2010, 7.3 per cent higher than in 2009. Exports of services increased by 9.8 per cent to EUR 747 million and the imports of services increased by 1.6 per cent to EUR 300.6 million.

Composition of Trade

The following tables illustrate the composition of Montenegro's exports of goods for the years 2005 to 2010:

	2005	2006	2007[1]	2008	2009	2010
			(€ thousand)			
Food and live animals	36,087	30,887	11,746	16,056	18,284	23,929
Beverages and tobacco	32,264	38,504	53,991	30,219	21,030	21,109
Crude materials, inedible, except fuels	35,097	41,604	37,839	32,362	23,820	44,713
Mineral fuels, lubricants and related materials	10,048	40,371	7,897	12,505	8,375	33,286
Animal and vegetables oils, fats and waxes	245	376	76	170	291	1,288
Chemicals and related products, not elsewhere specified	9,996	13,327	12,385	14,613	11,800	12,916
Manufactured goods classified chiefly by material[2]	290,252	390,503	327,946	284,033	153,182	157,106
Machinery and transport equipment	29,725	40,237	13,775	28,347	25,892	27,015
Miscellaneous manufactured articles	15,531	9,967	10,661	9,211	7,804	8,946
Commodities and transactions not classified elsewhere in the SITC	1,402	21,682	10,804	5,643	6,504	0
Total exports	460,647	627,460	487,119	433,158	276,982	330,308

Source: Monstat

Notes:

(1) Even though it did not achieve independence until 2006, since April 2003 Montenegro had already begun to keep an independent record of its foreign trade notwithstanding its federation with Serbia. Since 2007 the methodology applied by Montenegro as an independent country has changed in a number of respects, including the elimination of double-counting of goods for export and re-export.

(2) Manufactured goods includes metals (including aluminium and steel), timber, leather, fur, paper, minerals and textiles.

	2005	2006	2007[1]	2008	2009	2010
			(% of total)			
Food and live animals	7.8	4.9	2.4	3.7	6.6	7.2
Beverages and tobacco	7.0	6.1	11.1	7.0	7.6	6.4
Crude materials, inedible, except fuels	7.6	6.6	7.8	7.5	8.6	13.5
Mineral fuels, lubricants and related materials	2.2	6.4	1.6	2.9	3.0	10.1
Animal and vegetables oils, fats and waxes	0.1	0.1	0.0	0.0	0.1	0.4
Chemical and related products, not elsewhere specified	2.2	2.1	2.5	3.4	4.3	3.9
Manufactured goods classified chiefly by material[2]	63.0	62.2	67.3	65.6	55.3	47.6
Machinery and transport equipment	6.5	6.4	2.8	6.5	9.3	8.2
Miscellaneous manufactured articles	3.4	1.6	2.2	2.1	2.8	2.7
Commodities and transactions not classified elsewhere in the SITC	0.3	3.5	2.2	1.3	2.3	0.0
Total exports	100.0	100.0	100.0	100.0	100.0	100.0

Source: Monstat

Notes:

(1) Even though it did not achieve independence until 2006, since April 2003 Montenegro had already begun to keep an independent record of its foreign trade notwithstanding its federation with Serbia. Since 2007 the methodology applied by Montenegro as an independent country has changed in a number of respects, including the elimination of double-counting of goods for export and re-export.

(2) Manufactured goods includes metals (including aluminium and steel), timber, leather, fur, paper, minerals and textiles.

The following tables illustrate the composition of Montenegro's imports of goods for the years 2005 to 2010:

	2005	2006	2007[(1)]	2008	2009	2010
			(€ thousand)			
Food and live animals	152,776	174,207	233,215	314,493	299,415	323,116
Beverages and tobacco	34,580	41,201	61,896	77,134	66,866	63,780
Crude materials, inedible, except fuels	21,026	33,070	45,449	55,510	32,748	70,246
Mineral fuels, lubricants and related materials	138,635	236,739	311,465	359,926	208,057	209,660
Animal and vegetables oils and fats	9,890	9,484	9,744	14,916	12,454	12,588
Chemical and related products, not elsewhere specified	87,152	122,146	148,085	185,475	163,260	162,978
Manufactured goods classified chiefly by material[(2)]	149,112	225,062	332,767	439,165	250,789	265,661
Machinery and transport equipment	217,664	304,125	484,197	612,736	295,356	340,159
Miscellaneous manufactured articles	105,234	159,248	217,039	288,002	191,518	206,380
Commodities and transactions not classified elsewhere in the SITC	58,231	177,406	228,623	179,793	133,580	0
Total imports	974,300	1,482,689	2,072,481	2,527,151	1,654,043	1,654,568

Source: Monstat

Notes:

(1) Even though it did not achieve independence until 2006, since April 2003 Montenegro had already begun to keep an independent record of its foreign trade notwithstanding its federation with Serbia. Since 2007 the methodology applied by Montenegro as an independent country has changed in a number of respects, including the elimination of double-counting of goods for export and re-export.

(2) Manufactured goods includes metals (including aluminium and steel), timber, leather, fur, paper, minerals and textiles.

	2005	2006	2007[(1)]	2008	2009	2010
			(€ thousand)			
Food and live animals	15.7	11.7	11.3	12.4	18.1	19.5
Beverages and tobacco	3.5	2.8	3.0	3.1	4.0	3.9
Crude materials, inedible, except fuels	2.2	2.2	2.2	2.2	2.0	4.2
Mineral fuels, lubricants and related materials	14.2	16.0	15.0	14.2	12.6	12.7
Animal and vegetables oils and fats	1.0	0.6	0.5	0.6	0.8	0.8
Chemical and related products, not elsewhere specified	8.9	8.2	7.1	7.3	9.9	9.9
Manufactured goods classified chiefly by material[(2)]	15.3	15.2	16.1	17.4	15.2	16.1
Machinery and transport equipment	22.3	20.5	23.4	24.2	17.9	20.6
Miscellaneous manufactured articles	10.8	10.7	10.5	11.4	11.6	12.5
Commodities and transactions not classified elsewhere in the SITC	6.0	12.0	11.0	7.1	8.1	0.0
Total imports	100.0	100.0	100.0	100.0	100.0	100.0

Source: Monstat

Notes:

(1) Even though it did not achieve independence until 2006, since April 2003 Montenegro had already begun to keep an independent record of its foreign trade notwithstanding its federation with Serbia. Since 2007 the methodology applied by Montenegro as an independent country has changed in a number of respects, including the elimination of double-counting of goods for export and re-export.

(2) Manufactured goods includes metals (including aluminium and steel), timber, leather, fur, paper, minerals and textiles.

The overall proportion of manufactured exports decreased substantially in 2009, due to the drop in prices of primary products and significant declines in output at KAP and the steel works at Niksic. By contrast, agricultural exports and exports of machinery have increased proportionately.

The Government believes that the significant decline in imports of machinery and transport equipment in 2009 was a strong indication that most of the boom in imports prior to the downturn was driven by investment and the high level of economic growth. At the same time, imports declined significantly in euro terms across all categories.

Foreign Direct Investment

In the five years from 2005 to 2009, Montenegro recorded consistent growth of net inflows of FDIs (growing from EUR 399 million in 2005 to EUR 1,066.5 million in 2009) and became the leading country in Europe in FDIs per capita. Net FDI inflow in 2010 decreased by 49 per cent to EUR 542.4 million, with the decrease largely being due to the absence of any privatisation activity in the year. At the same time, the number of foreign registered companies increased from 1,145 in 2005 to over 6,000 in 2010. Investment projects currently underway are significantly changing the local economy, from the construction of the first marina for mega yachts in the Mediterranean (Porto Montenegro) (see below) to luxury hotels like Aman Resort, Banyan Tree and Hilton, a prime real estate development by Orascom (see below) and fibre optic cable and fast internet services spread across the country.

Montenegro encourages foreign investment. It has a flat rate tax system and low tax rates with corporate and personal income taxes set at 9 per cent and allows overseas investors to remit profits, dividends and interest freely. Having adopted the euro as its currency and with stable macroeconomic policies, the Government expects to be able to continue to attract significant levels of FDIs.

The following major FDI projects are currently underway:

Luštica Peninsula

The Government, the municipality of Tivat and the Egyptian company Orascom have signed a contract to develop nearly seven million square metres of prime real estate on the Tivat Luštica Peninsula. The total planned investment is approximately EUR 1,100 million and the project envisages the construction of eight hotels, golf courses, moorings, and private residences. Preparatory work has begun at the site with the construction of access roads.

Porto Montenegro

The Canadian developer, PM Securities has begun a development project at Porto Montenegro, a marina and residential complex on the Montenegrin coast in the Bay of Kotor with a projected total investment of EUR 500 million. Porto Montenegro's marina is open and already enjoying high occupancy and visits from yachts of all sizes. Marina services include wireless internet, 24-hour security, laundry facilities and a crew club with tennis and squash courts, a fitness centre, bowling alley and internet cafe. Long-term berths are available to residential property owners and short-term, seasonal and annual berths are available for non-residents. The residential complex is being developed to international luxury standards with residences having private courtyards and pools.

Other

Major future projects include:

- the construction of 330 km of highways;
- the privatisation and expansion of the Port of Bar and the upgrading of the country's two airports and rail expansion;
- a large number of the greenfield investments in tourism and the hotel industry (such as Long Beach in Ulcinj, the islands of Ada Bojana, Sveti. Marko, Sveti. Nikola and the Island of Flowers and the development of the ski resort on Bjelasica Mountain at Kolasin);
- the construction of windparks with the potential to produce in aggregate 96 mega-watts of energy; and
- investments in communal infrastructure.

Privatisation

The privatisation process in Montenegro gained momentum after 2001 and more than 85 per cent of state-owned capital has now been privatised. In addition, the privatisation of a large number of companies, particularly in the tourism sector, has been achieved partially by sales of the relevant assets which are not reflected as a change in the ownership structure, as well as by the sale and free distribution of minority stakes in the relevant companies, thereby effectively increasing the overall level of private ownership in the sector.

Privatisation in Montenegro has mainly been implemented by the sale of shares and assets by public auction, public tenders or the sale of shares pursuant to the annual privatisation plan, adopted by the Government upon the recommendation of its Privatisation Council. On 20 January 2011, the Government appointed a new Privatisation and Capital Projects Council. This new Council is headed by the Prime Minister and includes 18 other members including the Deputy Prime Minister and six Ministers. The Council meets at least every month to make decisions relating to specific privatisations and is assisted by 12 committees. The annual privatisation plan sets out the main goals and other aspects of the privatisation process for the relevant year, and the methods and principles to be employed in the privatisation of relevant companies in that year.

The country's privatisation process is now in its final phase. The majority of companies that are still state-owned and have strategic importance in the Montenegrin economy, most notably in the transport and tourism sectors, are also in the privatisation pipeline. The Government expects that the privatisation of remaining state-owned companies will further enhance their growth prospects and improve the competitiveness and productivity of the economy and the Government is focused on completing the process.

Privatisation of the telecommunications and banking sectors was completed in 2005 while privatisation in the tourism industry was mainly carried out between 2001 and 2008. The privatisation of the State's Aluminium Plant at Podgorica, KAP and the bauxite mines in Niksic was completed in 2005, with contractual investments agreed by the new owners totalling EUR 79 million. In the following year the privatisation process for the Niksic Steelworks was completed with contractual investments agreed by the new owners totalling EUR 117.9 million. See also "The Economy — Principal Sectors of the Economy — Industrial Production".

In order to provide conditions for new construction and development and to facilitate the efficient operation of existing power generation and distribution facilities in Montenegro, the partial privatisation and capital increase of EPCG was completed in 2009. The Italian company, A2A S.p.A., purchased the State's shares as well as newly issued shares, shares owned by certain privatisation funds and most of the shares of other minority shareholders, acquiring a total stake of 43.7 per cent with a total investment of EUR 436.1 million. See also "Montenegro — International Relations — Montenegro and Regional Relationships".

Following the privatisation of several Montenegrin hotels in recent years, significant investment in the tourism industry is under way and this is expected to further improve existing capacity resulting in the continued expansion and renovation of the tourism infrastructure in Montenegro, especially the upgrading of hotel services. The Government estimates that, as a result of this privatisation process, total committed investment in the hotel industry is currently EUR 140 million, equivalent to an average of EUR 41.2 per bed.

In 2011 the privatisation process will focus on projects in the tourism and transportation sector. Planned projects include the privatisation of Montecargo, Montenegro Airlines and the Port of Bar.

MONETARY AND FINANCIAL SYSTEM

The Central Bank of Montenegro

The Central Bank is the main monetary authority in Montenegro. The Constitution specifies that the Central Bank is the institution responsible for (i) the monetary and financial stability and (ii) the functioning of the banking system. The Central Bank was established in November 2000 following the promulgation of the Law on Central Bank of Montenegro and began operations in March 2001 following the adoption by the Montenegrin Parliament of the Decision on Appointment of Members of Council of the Central Bank of Montenegro.

The main powers and responsibilities of the Central Bank are to:

- oversee the maintenance of stability of the financial system as a whole and implement measures to promote this;
- issue and withdraw licences and approvals to banks and financial institutions, and regulate and supervise their operations;
- grant loans to licensed banks in Montenegro, subject to legal requirements, to support their liquidity needs;
- act as banker, adviser and fiscal agent of the Montenegrin public authorities; and
- buy and sell on the secondary market securities issued by the Government, EU Member States, or any other states designated in the Central Bank regulations.

Monetary Policy

As a result of the adoption of the euro as the Montenegrin currency, the Central Bank's ability to regulate monetary policy is limited. The primary monetary policy instrument of the Central Bank is the mandatory reserve requirement. The Central Bank requires Montenegrin banks to hold mandatory reserves at the Central Bank's accounts (in the country and/or overseas) a proportion of which may be in the form of Treasury bills issued by the State.

The new Law on the Central Bank of Montenegro, which came into effect on 6 August 2010, states that the Central Bank may operate in financial markets by purchasing, selling and swapping securities and other readily-marketable financial instruments, and by purchasing and selling precious metals.

The Central Bank has also introduced a new set of regulations under which the Central Bank is able to use open market operations, intraday and overnight loans, as well as short term liquidity loans in order to preserve the liquidity of the banking system. In exceptional circumstances, the Central Bank may act as a lender of last resort to ensure the financial stability of Montenegro.

Foreign Assets

Foreign assets held by the Central Bank as at 31 December in each of the years 2007 to 2010 are set out in the table below:

	As at 31 December			
	2007	2008	2009	2010
		(€ thousand)		
Foreign Assets held by Central Bank	467,938	313,043	397,483	416,432

Source: CBM

Central Bank Interest Rates

The Central Bank does not have a reference interest rate. It does, however, publish weighted average lending and deposit interest rates of the banks in the Montenegrin Banking system.

The following table shows the weighted average aggregate lending and deposit rates for each of the years 2007 to 2010:

	2007	2008	2009	2010
		(% per annum)		
Weighted average lending rate	9.29	9.40	9.38	9.63
Weighted average deposit rate	3.35	4.10	3.87	3.26

Source: CBM

Measures of economic, prudential and monetary policy in the banking system

The impact of the global financial crisis on the Montenegrin banking system first became evident in October 2008, and escalated in the following months to the end of the first quarter of 2009. The impact of the crisis led to a significant reduction in bank deposits, restrictions on banks' access to external sources of funding, reduction of inflow of funds by way of repayment of loans caused by the deterioration in the financial position of borrowers which in turn led to an overall decline in the quality of assets and profitability, and almost total discontinuance of banks' lending activities.

In order to preserve the stability and safety of the banking sector, the Central Bank implemented, in cooperation with the Government, comprehensive measures to respond to the challenges of the global financial crisis. In October 2008 the "Law on the Banking System Safeguards" was adopted to prevent the escalation of the crisis and to maintain the stability, liquidity and solvency of the banking sector. The Law was temporary and was valid until the end of 2009.

In 2009, the Central Bank adopted a range of measures that significantly contributed to the liquidity of the country's banks. These included:

- lowering the single rate of the mandatory reserve from 11 per cent to 10 per cent and introducing a marginal mandatory reserve rate of zero per cent;
- allowing banks to hold up to 25 per cent of the mandatory reserve in the form of Treasury Bills issued by the State of Montenegro;
- extending the period of use for up to 50 per cent of allocated funds of the mandatory reserve from seven to 10 working days;
- lowering the interest rate from 5 per cent to 4 per cent per annum on the used amount of the mandatory reserve for liquidity purposes;
- lowering the interest rate from 9 per cent to 7 per cent per annum on the amount of funds of the mandatory reserve that a bank fails to repay on the same day; and
- harmonising the classification of banks' loan assets with the Basel standards in respect of days of arrears, so that non-performing loans are now classified as loans overdue by more than 90 days rather than the previous test of 60 days. In addition, loans are now required to be written off when 270 days' overdue, as opposed to 180 days' overdue.

At the end of December 2009, the Central Bank introduced new measures which reduced provisions for certain classification groups, allowed banks to exclude operating indicators for 2009 when estimating the creditworthiness of a debtor and enabled banks to classify credits approved for investments in development projects by analysis of project profitability, and not by assessing creditworthiness of the debtor. In addition, exemptions for credit restructuring could be applied where a loan was up to 180 days overdue (instead of 90 days).

In November 2010, the Central Bank adopted two new measures: Amendments to the Decision on Temporary Measures for Credit Risk Management in Banks and Amendments to the Decision on Minimum Standards for Bank investment in Immovable Property and Fixed Assets. These new measures include changes in the method of calculation and allocation of provisions for potential bank losses, which allow banks to improve their loan portfolio and consolidate liquidity within a reasonable time frame and are intended to provide for a gradual improvement in the conditions for credit growth.

In addition, the Central Bank conducted an on-site examination of all Montenegrin banks to assess the sustainability of the banking system and the requirements for capital and liquidity for each individual bank and for the system as a whole. Following its examination, the Central Bank was satisfied with the sustainability of the banking system and the requirements for capital and liquidity for each individual bank and for the system as a whole.

The new Law on the Central Bank introduced new monetary and other instruments for use by the Central Bank, including open market operations, loans for liquidity needs and a role as lender of last resort. The Law requires the Central Bank to prepare further regulations dealing with these new aspects of its role to be adopted no later than July 2011. The Law also gives the Central Bank the opportunity to participate in the adoption of a new banking law by submitting proposals and opinions directly to the Government, the power to dispose of its assets independently and grants the Central Bank immunity from suit in certain cases.

The Central Bank is required to act independently in pursuing its objectives and exercising functions under the new Law. In accordance with the new Law, on 14 October 2010 the Parliament of Montenegro, on the recommendation of the President, appointed Mr. Radoje Zugic as the new Governor of the Central Bank.

Three other new laws have been passed to assist with the regulation of the banking system. Law on Protection of Deposits, Law Amending the Banking Law and Law on the Financial Stability Council.

The new Law on Protection of Deposits has been further harmonised with relevant EU legislation: there will be a gradual increase in the amount of guaranteed deposits over time (EUR 20,000 in 2011, EUR 35,000 in 2012 and EUR 50,000 in 2013), payment techniques and procedures have been improved and the timeframe for proceedings related to the payment of guaranteed deposits have been shortened from 90 business days to 30 business days.

The Law Amending the Banking Law introduces measures to strengthen the role of the Central Bank in order to ensure greater stability in the banking system. It addresses corporate governance issues and expands the powers of a temporary bank administrator and also provides for certain powers which may be exercised by the Central Bank in regulating banks.

The new Law on the Financial Stability Council establishes a financial stability council, whose members include the Minister of Finance and the Governor of the Central Bank, to monitor conditions in the financial system and to provide non-binding recommendations to the Central Bank.

Banking Sector Development

The following table sets out the aggregate balance sheet of the Montenegrin banking sector for each of the years 2005 to 2010:

	As at 31 December					
	2005	2006	2007	2008	2009	2010
			(€ million)			
Total Assets	695.8	1,431.4	2,975.4	3,309.7	3,025.2	2,943.7
Cash and deposits accounts at depositary institutions	267.0	511.9	664.4	473.3	528.7	629.7
Cash	27.9	44.6	71.5	48.4	57.3	55.5
Cash equivalents and deposits accounts at depositary institutions[1]	239.1	467.3	592.9	424.9	471.4	574.3
Securities for Dealing Operations	0.1	0.2	2.5	5.7	21.6	27.2
Investment Securities	7.7	8.8	0.2	2.5	30.6	26.1
Net Loans	362.4	828.1	2,193.5	2,685.6	2,247.5	2,058.3
Accrued interest and Dividends Receivable						
Equity investments	9.7	20.2	32.0	29.5	30.2	27.6
Fixed Assets	25.0	33.7	40.6	48.8	47.6	46.3
Other Assets[2]	23.8	28.6	42.2	64.3	119.0	121,869.0
Total Liabilities and Equity	695.8	1,431.4	2,975.4	3,309.7	3,025.2	2,943.7
Total Liabilities	589.3	1,282.7	2,738.5	3,030.3	2,693.5	2,631.1
Total Deposits	487.9	1,075.8	2,091.1	1,990.6	1,824.7	1,789.9
Bank Deposits	18.0	34.2	58.8	147.8	80.2	6.7
Non-Bank Deposits	469.9	1,041.6	2,032.3	1,842.8	1,744.5	1,783.2
Demand Deposits	258.0	609.2	956.1	724.9	666.2	732.8
Term Deposits of Enterprises	49.3	134.3	344.9	390.9	314.6	203.4
Term Deposits of Individuals	82.2	205.0	553.3	553.9	577.3	637.1
Term Government Deposits	67.2	69.9	138.8	119.9	101.0	61.3
Term Other Deposits	13.2	23.2	39.1	53.1	85.5	152.3
Accrued Interest and Dividends Payable						
Borrowed Funds	80.3	172.4	536.2	908.2	734.8	697.4
Other Liabilities[2]	21.1	34.5	111.2	131.5	134.0	143.3
Equity	106.5	148.8	236.9	279.4	331.7	310.9
Paid-in capital	87.5	114.4	196.3	262.6	339.7	411.1
Capital Reserves	12.2	24.0	23.1	33.2	21.6	19.7
Retained Profits	6.7	10.3	17.6	(16.5)	(29.6)	(117.9)
Net Loans/Total Assets (%)	52.1	57.9	73.7	81.1	74.3	70.1
Liquid Assets/Total Assets (%)	38.4	37.8	22.4	11.2	15.3	19.1
Net Loans/Total Deposits (%)	74.3	77.0	104.9	134.9	123.2	115.0
Total Deposits/Total Liabilities (%)	82.8	83.9	76.4	65.7	67.7	67.5
Demand Deposits/Total Deposits (%)	53.4	56.8	46.0	36.5	36.6	40.9
Borrowed Funds/Total Liabilities (%)	13.6	13.4	19.6	30.0	27.3	26.5
Borrowed Funds/Total Assets (%)	11.5	12.0	18.0	27.4	24.3	23.7

Source: CBM

Notes:

(1) Deposits at Central Bank, deposits at banks and other financial institutions.

(2) Other assets and other liabilities include all items which are not covered in this classification, but which are specified in the Chart of Accounts of the Montenegrin banking sector.

The following table lists the banks in the Montenegrin banking system by market share by assets and indicates the ownership of each bank:

	Market share by assets (as at 31 December 2010)	**Ownership (as at 30 September 2010)**
	(%)	
Crnogorska Komercijalna Banka a.d	24.39	OTP Bank (100 per cent foreign ownership)
NLB Montenegro banka a.d	17.78	Foreign holders (97.0 per cent), Domestic holders (2.1 per cent), State-owned entities (0.9 per cent)
Hypo Alpe-Adria Bank	15.2	Hypo Alpe-Adria Bank International AG (100 per cent foreign ownership)
Prva Banka Crne Gore	10.64	Foreign holders (3.9 per cent), Domestic holders (77.6 per cent), State-owned entities (18.5 per cent)
Podgoricka banka Societe Generale	8.83	Foreign holders (92.1 per cent), Domestic holders (4.3 per cent), State-owned entities (3.6 per cent)
Erste Bank	8.15	Erste & Steiermarkische Bank (100 per cent foreign ownership)
Atlasmont Banka	6.21	Foreign holders (55.4 per cent), Domestic holders (44.6 per cent)
Hipotekarna banka	4.37	Foreign holders (91.9 per cent), Domestic holders (5.3 per cent), State-owned entities (2.8 per cent)
Komercijalna Banka a.d. Budva	2.8	Komercijalna banka a.d Beograd (100 per cent foreign ownership)
Invest Banka	0.95	Foreign holders (3.9 per cent), Domestic holders (92.0 per cent), State-owned entities (4.1 per cent)
First Financial Bank a.d	0.67	Foreign holders (99.7 per cent), Domestic holders (0.3 per cent)

Prva Banka Crne Gore ("**Prva Banka**"), a domestic bank established in 1901, was particularly affected by the global financial and economic crisis in 2008 and 2009. In 2008, Prva Banka was the only bank to make use of the credit support for liquidity introduced by the Law on the Banking System Safeguards, with a loan in the amount of EUR 44 million. See also "Monetary and Financial System — Measures of economic, prudential and monetary policy in the banking system". Although the loan has since been repaid, the Central Bank had restricted Prva Banka from making any new loans until it had conducted a further review of its situation. Following the review, the Central Bank has permitted Prva Banka to resume some limited lending activities but it continues to be subject to certain restrictions and will be required to increase its capital position in the short term.

The following tables show selected Montenegrin banking sector performance indicators:

	31 December 2010 compared to 31 December 2009	**31 December 2009 compared to 31 December 2008**
	(% change)	
Assets of banks	(2.7)	(8.6)
Total credits	(8.2)	(14.3)
Corporate credits	(11.1)	(18.1)
Households credits	(6.1)	(11.4)
Total deposits	(1.9)	(8.3)
Corporate deposits	(13.9)	(13.5)
Households deposits	12.8	(1.5)
Allocated mandatory reserve	(4.8)	(20.2)

Source: CBM

	2006	2007	2008	2009	2010	Change 2010-2009	Change 2010-2009
			(€ million)				%
Assets of banks	1,431.40	2,975.40	3,309.70	3,025.2	2,943.7	(81.6)	(2.7)
Total credits	847.2	2,245.70	2,797.50	2,397.8	2,199.9	(197.8)	(8.2)
Corporate credits	471.3	1,364.40	1,657.00	1,357.9	1,207.3	(150.6)	(11.1)
Households credits	311.2	794.1	1,037.60	919.3	863.6	(55.7)	(6.1)
Total deposits	1,075.80	2,091.10	1,990.60	1,824.7	1,789.9	(34.8)	(1.9)
Corporate deposits	321	663.5	589.5	510.1	439.1	(70.9)	(13.9)
Households deposits	499.4	1,019.40	856.5	843.9	951.9	107.9	12.8
Allocated mandatory reserve requirements	172.8	259	216.6	172.8	164.5	(8.3)	(4.8)

Source: CBM

The following table shows the average of available liquid funds and payments made by banks for the years 2006 to 2010:

	2006	2007	2008	2009[(1)]	2010
Available liquid bank funds (average)	267,724	472,216	438,619	438,339	547,276
Payments made	27,337	46,708	45,737	—	—
Surplus	240,387	425,508	392,882	—	—

Source: CBM

Note:

(1) As of 2009, the new methodology employed by the Central Bank does not include "payments made" and "surplus".

Prior to the start of the global financial crisis in October 2008, total assets of the Montenegrin banking sector stood at EUR 3,509.7 million at the end of September 2008. At the end of 2009, total assets of the sector had fallen by 13.8 per cent to EUR 3,025.2 million, with total deposits falling by 21.6 per cent total loans falling by 15.9 per cent and household deposits falling by 24.3 per cent. By the end of December 2010, total assets of the banking sector had fallen by a further 2.7 per cent compared to the end of 2009, with total loans falling by 8.2 per cent. During the same period, however, household deposits increased by 12.8 per cent although total deposits fell by a further 1.9 per cent.

Measures taken by the Central Bank for the purpose of reducing credit growth and reducing pressure on consumption and inflation were effective, and the total credits in 2008 increased by only 24.6 per cent significantly less than the rate of growth in 2007 when they increased over 2.5 times. See "— Measures of economic, prudential and monetary policy in the banking system". Loans to the household sector increased by 30.7 per cent and loans to the corporate sector by 21.4 per cent. However, in the last quarter of 2008, the global financial crisis had a significant impact.

At the end of 2008, liquid assets of the banks were EUR 370.7 million, a decrease of 31 per cent compared to the end of 2007 with liquid assets representing 11.2 per cent of the total, compared to 18 per cent at the end of 2007. Credit/deposit coefficient was 1.41 at the end of 2008, compared to 1.08 at the end of 2007. In the first three quarters of 2008, the Central Bank's mandatory reserve fund for liquidity was not used, whereas in the last quarter of 2008 two banks used the mandatory reserve fund provided by the Central Bank for liquidity. This continued in the first five months of 2009, when three banks used this fund for liquidity maintenance purposes, while in the period from June to September 2009 only one bank was depositing less than the amount prescribed by the Central Bank. Since September 2009, no bank has used the fund.

At the end of 2010, total assets of the banking sector were EUR 2,943.7 million, a decrease of 2.7 per cent compared to the end of 2009. In December 2010, liquid assets were EUR 562.7 million or 19.1 per cent of total banking sector assets. Total bank deposits were EUR 1,789.9 million at the end of 2010, a decrease of 1.9 per cent compared to the figure at the end of 2009. Since the start of the global economic and financial crisis, bank deposits have shown a downward trend due to the impact of the global economic and financial crisis on household and corporate confidence in the banking sector, but from the middle of 2009 deposits started to flow into the banking sector once more. In addition, the reduction in deposits was partially caused by banks using deposits as cash collateral to set off against their claims in respect of defaulted loan payments.

At the end of 2010, total loans were EUR 2,199.9 million, a decrease of 8.2 per cent compared to the end of 2009. During 2010, total bank loans outstanding recorded an average monthly fall of 0.7 per cent with three banks recording a fall in total loans and eight banks recording growth in lending activity. In December 2010, the credit/deposit coefficient was 1.23.

Loan exposure

The following table sets out certain statistics relating to total outstanding loans and non performing loans ("**NPLs**") of Montenegrin banks for each of the years 2006 to 2010:

	As at 31 December				
	2006	2007	2008	2009[(1)]	2010
NPLs (€ million)	24.2	71.0	201.4	324.3	461.3
Total outstanding loans (€ million)	847.2	2,245.7	2,797.5	2,397.8	2,200.0
NPLs/total loans (%)	2.9	3.2	7.2	13.5	21.0
Reserves for loan losses/Total loans (%)	2.3	2.3	4.0	6.3	6.4
NPL coverage ratio[(2)]	0.8	0.7	0.6	0.5	0.3
Equity/Net loans (%)	18.0	10.8	10.4	14.8	15.1

Source: CBM

Notes:

(1) During 2009 the Central Bank adopted certain measures aimed at improving liquidity in the banking sector including harmonising classification of banks' loan assets with the Basel standards. See "— Measures of economic, prudential and monetary policy in the banking system".

(2) NPL coverage ratio is the ratio of reserves for loan losses to NPLs.

Since the end of 2008, total outstanding loans have gradually declined as a consequence of decreased lending activities of Montenegrin banks as a result of the global financial and economic crisis and the adoption of more conservative credit policies by the banks. At the end of December 2010, although total loans were EUR 2,200.0 million, representing a decrease of 8.2 per cent compared to the figure at the end of 2009, the proportion of NPLs to total loans had risen to 21.0 per cent from 13.5 per cent at the end of 2009. The Government believes that even though the overall proportion of NPLs is continuing to rise, Montenegrin banks remain adequately capitalised. Significant capital support has been provided to the banks by their shareholders since the onset of the global financial crisis in late 2008 and particularly to those banks controlled by non-Montenegrin shareholders, with approximately EUR 71.4 million of additional capital having been injected in the past twelve months, of which approximately EUR 50 million was as a result of capital requirements imposed by the CBM. The CBM continues to monitor closely the level of overall NPLs in the Montenegrin banking system.

Stock Exchange

The NEX Montenegro and the Montenegro Stock Exchange A.D., were established in 2001 and 1993, respectively. The two exchanges merged on 31 December 2010 and with effect from 10 January 2011, a new united stock exchange has been operating in Montenegro (Montenegro Stock Exchange). Since 2006 trading on these exchanges has been cyclical. Trading reached its peak during the investment boom of 2007 but each market recorded a sharp fall during 2008, as a result of the onset of the global financial crisis and a decrease in the overall level of investment in the economy. During 2009, the volume increased again, with one key driver being the recapitalisation and sale of shares in EPCG, which accounted for approximately 61 per cent of the total annual volume of the stock exchanges.

	Year ended 31 December				
	2006	2007	2008	2009	2010
Volume (€ million)[(1)]	377	727	160.3	405.8	54.8
Number of Transactions	114,073	224,637	83,348	58,778	19,827

Source: Security Commission

Note:

(1) Total volume of both stock exchanges combined.

	Year ended 31 December				
	2006	2007	2008	2009	2010
			(€ million)		
Market capitalisation — NEX Montenegro	1,944.9	3,581.3	1,419.8	2,044.1	2,011.2
Market capitalisation — Montenegro Stock Exchange	1,661.1	3,698.8	2,256.0	2,947.5	2,672.7
Nex 20 Index	18,050.8	34,168.6	10,002.9	14,596.9	14,522.5
Nex PIF Index	17,763.6	39,229.2	5,844.6	7,020.7	6,777.8
Moste Index	918.9	1,627.7	469.5	639.0	523.7

Source: Montenegro Stock Exchange and NEX Montenegro.

	Year ended 31 December				
	2006	2007	2008	2009	2010
Monex 20	18,050.89	34,168.63	10,002.93	14,596.88	14,522.53
MonexPIX	17,763.63	39,229.17	5,844.64	1,020.66	6,777.76

Source: Montenegro Stock Exchange.

PUBLIC FINANCE

General

The Government has focused on the importance of conservative fiscal policies in order to foster the macroeconomic stability of the country given that (i) as a result of the adoption of the euro it does not have a wide range of monetary tools which it can use (see "Monetary and Financial System — Monetary Policy") and (ii) Montenegro is a small, developing and is not yet a fully diversified economy. The Government has therefore developed the following fiscal principles and targets which are set out in its Medium-Term Macroeconomic Guidelines and implemented through annual budget laws:

- reduction of current expenditure to less than 40 per cent of GDP in 2011 and general Government debt to below 40 per cent of GDP by 2012.
- balanced budget by 2012; structural revenues (after deduction of any cyclical components) should cover current expenditures and at least 50 per cent of the capital budget. In addition, once the economy recovers and grows at a sustainable rate of 3 per cent, which the Government currently expects to occur in 2012, the budget should be in surplus of approximately 1.67 per cent of GDP in 2013. As a result, the level of current public expenditure is expected to reach the Government's target level of approximately 30 per cent of GDP by 2015.
- strict public sector employment policy through the rationalisation of the number of employees, restrictions on the number of new employees and various other measures envisaged by the personnel policies adopted by the Government in April 2010. The process of centralising public sector wage payments is underway and will lead to the full control of the public sector wage bill by the Ministry of Finance. This control, together with a sustainable public pension system have been recognised by the Government as a key challenge to medium term fiscal consolidation.
- phasing out of subsidies to manufacturing industry by 2012 in accordance with the terms of the contracts with the relevant companies, and as of 2010 restricting the issuance of Government guarantees only to key infrastructure projects.
- maintain the capital budget at 5 per cent of GDP.
- establish a sustainable health and pension system in the medium to long term. The Pension Fund and the Health Insurance Fund were integrated into the Single Treasury Account in 2010 and their inflows and outflows are now recorded and processed through the State Treasury. The Government expects this to result in an improvement in transparency of the budget for, and control of, spending by the funds as well as their overall liquidity. The transformation of the Development Fund has been completed, and it has been established as a state investment fund with a primary role to boost the liquidity of SME-sector. The Pension Law has been amended with the retirement age increased to 67 for both men and women and the indexation formula has been amended. See "The Economy — Pension System".

In addition to focusing on the level of general Government debt and the deficit, the Government recognises the importance of controlling public expenditure. Total general Government expenditure has risen in recent years from EUR 1,162 million in 2007 to EUR 1,524 million in 2009. In 2010, however, public expenditure decreased to EUR 1,401 million, while consolidated expenditure (public expenditure reduced for inter-governmental costs) was EUR 1,361 million or 45 per cent of GDP.

Since the onset of the global financial crisis the Government has undertaken a number of measures in pursuit of its overall fiscal goals even though some of these had short-term negative effects by further reducing overall demand in the economy, in particular at the end of 2009 when public expenditure was the main contributor to GDP growth. Even in the rapid growth years of 2007 and 2008, a moderate relaxation of fiscal rules by central and local governments still did not outweigh countercyclical fiscal policies, as demonstrated by a reduction in the general Government net debt by almost 10 per cent of GDP. This included an early debt repayment to the International Bank for Reconstruction and Development, the buy-back of domestic debt with an outstanding amount of approximately 4 per cent of GDP, and accumulating cash reserves which stood at more than 8 per cent of GDP in the third quarter of 2008. These cash reserves helped the Government stabilise the banking sector through a credit facility for banks and early debt repayment operations conducted at the end of 2008 when the outflow of deposits was at its highest. See "Monetary and Financial System — Measures of economic, prudential and monetary policy in the banking system".

In 2007, the consolidated public finances of Montenegro, comprising the central Government budget and 21 municipal budgets, were marked by a significant increase in public revenues and surplus of public finances of approximately 6.5 per cent of GDP. As a result of the global financial crisis, the public finances of Montenegro were adversely affected during 2008 when the deficit was 0.39 per cent of GDP and even more so in 2009 when the deficit rose to 5.7 per cent of GDP.

The effects of the global financial crisis on the Montenegrin economy first began to be reflected in the fourth quarter of 2008 and continued throughout 2009. Even though the Government responded swiftly with a range of measures, including the Supplemental Budget for 2009 adopted by the Parliament in July 2009 in order to reduce public expenditures, the 2008 central Government budget surplus of 0.49 per cent of GDP was reversed to a deficit of 4.4 per cent of GDP in 2009. Gross debt of 38 per cent and net debt of 31 per cent, respectively, of GDP in 2009 contributed to this deficit, although the Government's prudent fiscal policies largely mitigated the negative impact of the crisis on Montenegro's public finances despite the fall in central Government budget revenues of 4.66 per cent of GDP compared to 2008 and the contraction of the economy by 5.7 per cent.

The Supplemental Budget for 2009, additional saving measures implemented in 2009 and the Budget Law for 2010 have led to a significant reduction in the overall level of Government expenditure by a total of 8.8 per cent of GDP. The reduction in total expenditure was accompanied by significant changes in its structure. Although there was an increase in transfers for social care as part of the Government's counter-crisis measures and improvement of the social safety net, discretionary spending was significantly reduced. In particular, in the area of current expenditure, significant reductions were made in bonuses in the public sector and public expenditure for goods and services.

The following table sets out the total expected impact of the Government's main discretionary fiscal measures in 2009 and 2010:

	2009	2010
	(% of GDP)	
Main revenue measures		
Decrease of PIT rate in two stages to 9 per cent	(1.0)	(1.0)
Decrease in contribution rates	(0.6)	0.0
Increase in contribution rates	0.0	0.5
Increase of excise tax on cigarettes and oil	0.7	0.3
Elimination of certain tax exemptions	0.0	0.3
Total revenue measures	**(0.9)**	**0.1**
Main expenditure measures		
Reduction in capital budget	4.0	0.0
Reduction in capital expenditures	1.0	0.0
Reduction in public sector wage bill	0.9	0.2
Reduction in materials and supplies expenditures	2.0	1.0
Application of new contribution rates	0.0	0.5
Project "Job for you"	(0.6)	0.0
Social programme for KAP restructuring	(0.1)	(0.1)
Total expenditure measures	**7.2**	**1.6**
Total impact	6.3	1.7

Source: Ministry of Finance

Conservative fiscal policies and fiscal consolidation have continued with the adoption of the Budget Law for 2011. This provides for consolidated public expenditure to be reduced by an extra 2 per cent to 43 per cent of GDP. In addition the Law provides that the public deficit should be reduced further from 3 per cent of GDP in 2010 to 2.42 per cent of GDP in 2011 and that the primary deficit should be reduced from 2 per cent of GDP in 2010 to 0.9 per cent of GDP in 2011.

The following table sets out a summary of the actual general Government budget revenues and expenditures for the years 2008 and 2009, the preliminary execution figures for 2010 and those provided for in the Budget Laws for 2010 and 2011:

	2008		2009		Budget Law 2010		Budget Execution 2010[1]		Budget Law 2011	
	(€ million)	*(in % GDP)*	*(€ million)*	*(in % GDP)*	*(€ million)*	*(in % GDP)*	*(€ million)*	*(in % GDP)*	*(€ million)*	*(in % GDP)*
General Government revenues	1,544.44	50.05	1,352.96	45.39	1,341.02	44.33	1,310.01	43.31	1,331.90	42.02
Tax revenues	1,266.31	41.04	1,103.20	37.01	1,144.40	37.83	1,134.85	37.52	1,170.75	36.93
Non-tax revenues	278.13	9.01	249.76	8.38	196.62	6.50	175.17	5.79	161.15	5.08
General Government expenditures	1,556.55	50.45	1,524.04	51.13	1,479.97	48.92	1,401.62	46.33	1,408.64	44.44
Non capital expenditure	1,245.67	40.37	1,272.83	42.70	1,246.81	41.22	1,238.09	40.93	1,247.33	39.35
Capital expenditure	310.89	10.08	251.21	8.43	233.16	7.71	163.54	5.41	161.32	5.09
Financial balance	(12.12)	(0.39)	(171.07)	(5.74)	(138.96)	(4.59)	(91.61)	(3.03)	(76.74)	(2.42)

Source: Ministry of Finance

Note:

(1) The figures for the 2010 Budget Execution are yet to be confirmed through adoption of the Budget Execution Law for 2010, which is expected to be approved by the Parliament in the third quarter of 2011. The deficit figure is calculated on a cash basis and will require adjustment for net increase or decrease of budget arrears in accordance with the provisions of the general budget legislation which sets out the method for deficit calculation.

The following table sets out a summary of the actual central Government budget revenues and expenditures for the years 2008 and 2009, the preliminary execution figures for 2010 and those provided for in the Budget Laws for 2010 and 2011:

	2008		2009		Budget Law 2010		Budget Execution 2010(1)		Budget Law 2011	
	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)
Central Government budget revenues	1,287.20	41.72	1,169.27	39.22	1,164.89	38.51	1,138.62	37.64	1,170.74	36.93
Tax revenues	1,167.89	37.85	1,019.98	34.22	1,070.20	35.38	1,055.56	34.89	1,088.32	34.33
Direct taxes	526.06	17.05	462.48	15.51	462.79	15.30	494.72	16.35	482.89	15.23
Personal income tax	111.92	3.63	94.99	3.19	83.63	2.76	89.75	2.97	88.59	2.79
Corporate income tax	62.80	2.04	54.74	1.84	49.58	1.64	20.27	0.67	32.90	1.04
Tax on property	11.43	0.37	5.21	0.17	5.65	0.19	4.94	0.16	1.79	0.06
Social security contribution	339.91	11.02	307.54	10.32	323.93	10.71	379.76	12.55	359.61	11.34
Indirect taxes	641.82	20.80	557.50	18.70	607.41	20.08	560.84	18.54	605.43	19.10
Valued added taxes	440.06	14.26	370.78	12.44	398.86	13.19	364.18	12.04	401.26	12.66
Excise tax	120.30	3.90	128.68	4.32	149.89	4.96	134.26	4.44	147.48	4.65
Customs duties	72.93	2.36	49.12	1.65	48.87	1.62	50.81	1.68	53.53	1.69
Other taxes	8.53	0.28	8.92	0.30	9.79	0.32	11.59	0.38	3.16	0.10
Non tax revenue	119.31	3.87	149.28	5.01	94.69	3.13	83.07	2.75	82.42	2.60
Central Government budget expenditures	1,272.03	41.22	1,301.36	43.66	1,298.10	42.91	1,223.20	40.44	1,253.77	39.55
Non capital expenditure	1,123.49	36.41	1,188.99	39.89	1,177.11	38.91	1,159.95	38.35	1,172.55	36.99
Capital expenditure	148.54	4.81	112.36	3.77	121.00	4.00	63.25	2.09	81.21	2.56
Financial balance	15.17	0.49	(132.09)	(4.43)	(133.22)	(4.40)	(84.57)	(2.80)	(83.02)	(2.62)

Source: Ministry of Finance

Note:

(1) The figures for the 2010 Budget Execution are to be confirmed through adoption of the Budget Execution Law for 2010, which is expected to be approved by the Parliament in the third quarter of 2011. The deficit figure is calculated on a cash basis and will require adjustment for net increase or decrease of budget arrears in accordance with the provisions of the general budget legislation which sets out the method for deficit calculation.

The following table sets out a summary of the actual local government budget revenues and expenditures for the years 2008 and 2009, the preliminary local governmental budget execution figures for 2010 and those provided for in the approved budgets of local governments for 2010 and 2011:

	2008		2009		Approved Local Budgets for 2010(1)		Budget Execution 2010(1)		Approved Local Budget for 2011(1)	
	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)	(€ million)	(% GDP)
Local government budget revenue	257.24	8.34	183.7	6.16	176.13	5.82	171.39	5.67	161.16	5.08
Tax revenues	98.42	3.19	83.22	2.79	7.42	0.25	79.29	2.62	82.43	2.60
Direct taxes	56.42	1.83	40.97	1.37	35.41	1.17	36.84	1.22	41.10	1.30
Personal income tax	29.75	0.96	26.38	0.88	22.23	0.73	25.32	0.84	24.99	0.79
Tax on property	26.67	0.86	14.59	0.49	13.18	0.44	11.52	0.38	16.11	0.51
Non tax revenue	42	1.36	42.25	1.42	38.79	1.28	92.10	3.04	78.73	2.48
Other revenues	158.82	5.15	100.48	3.37	101.93	3.37	42.45	1.40	41.33	1.30
Local government budget expenditure	286.76	9.29	222.68	7.47	183.56	6.07	179.33	5.93	155.78	4.91
Non capital expenditure	124.41	4.03	110.34	3.70	92.34	3.05	98.44	3.25	92.78	2.93
Capital expenditure	162.35	5.26	112.34	3,77	91.22	3.02	80.89	2.67	63.00	1.99
Transfers from Central Budget	2.28	0.07	2.57	0.09	0.75	0.02	0.90	0.03	0.90	0.03
Financial balance	(27.24)	(0.88)	(36.41)	(1.22)	(6.68)	(0.22)	(7.04)	(0.23)	6.28	0.20

Source: Ministry of Finance

Note:

(1) The figures for the 2010 Budget Execution are to be confirmed through adoption of the Budget Execution Law for 2010, which is expected to be approved by the Parliament in the third quarter of 2011. The deficit figure is calculated on a cash basis and will require adjustment for net increase or decrease of budget arrears in accordance with the provisions of the general budget legislation which sets out the method for deficit calculation.

As of 1 January 2011 the Government increased excise rates on tobacco and alcohol in order to align them with European standards and expects this to increase overall revenues by approximately 0.5 per cent of GDP. The Government did not, however, increase tax rates in Montenegro, even though the existing tax rates in Montenegro are comparably low, with value added tax ("**VAT**") at 17 per cent and personal income tax ("**PIT**") and corporate income tax ("**CIT**") rates each at 9 per cent, because an increase in tax rates could have had the effect of further contracting the economy. A future increase in the tax rates remains, however, a measure available to the Government in the case of greater than expected funding needs or if it requires to make additional adjustments to its fiscal policies.

2010 Budget Execution

Public expenditure was reduced from 51.1 per cent of GDP in 2009 to 46.3 per cent in 2010 and from 50.1 per cent of GDP to 45 per cent in terms of consolidated public expenditure. The budget deficit was reduced to just over 3 per cent of GDP, as opposed to 5.7 per cent of GDP in 2009. In spite of the overall recovery of economy, total revenues were 1 per cent less than had been provided for in the 2010 Budget Law. The main reasons for this shortfall were:

- amendments to the CIT regime which came into effect in 2010 and allowed companies to settle CIT at the end of the fiscal year, whereas the previous law had required payment of CIT in advance. In 2010 most companies opted for payment at the year end. Going forward, however, the Ministry of Finance expects that CIT collection in 2011 will exceed that in 2010;
- increase of tax arrears. According to the Tax Office the net increase of arrears was EUR 51 million or 1.7 per cent of GDP during 2010, while as of January 2011 total tax receivables amounted to EUR 157 million or 5 per cent of GDP. The reason for this increase in arrears is the general illiquidity in the real sector of the economy. The Government expects that an improvement in the volume of lending activity of the banks in 2011 will improve liquidity in the real sector in 2011, with projected growth of the banks' credit portfolio of 4.6 per cent in 2011; and
- low inflation, averaging only 0.5 per cent per annum in 2010.

The main challenges on the expenditure side related to expenditure on pensions and social benefits, which increased by 3 and 18 per cent, respectively, over the 2010 Budget Law allocations, giving a total increase of 0.6 per cent of GDP in expenditure for these benefits. Through improved control of public procurement costs, strict control of the public sector wage bill and a wide range of public cost-saving policies the Government managed to reduce total public expenditure by EUR 78 million or 2.6 per cent of GDP.

In respect of certain key fiscal parameters, the Budget Execution for 2010 out-performed the relevant amounts allocated in the Budget Law for 2010. Actual public expenditure was 2.6 per cent lower and the deficit was 1.6 per cent lower, respectively, compared to the amounts provided in the 2010 Budget Law. The Government's commitment to fiscal prudence led to a net increase in general Government debt of just 3.8 per cent, while the capital budget, although reduced compared to previous years, was almost twice as high as the deficit figure at 5.41 per cent compared to a deficit of 3.03 per cent of GDP.

The structure of budget revenues changed in 2009 and 2010. The growth in the share of direct taxes (PIT and social contributions) in the total central Government tax revenues grew to 43 per cent of total tax revenues. The simultaneous effect of lower rates of PIT and CIT and the continued effect of the removal of barriers to doing business in the Montenegrin economy have led to an increase in direct revenues, reflecting growth in employment and wages, as well as the reduction of the "informal" economy. In the Government's view the rise in revenues from direct taxes demonstrates that consumption-led growth is still the main driving force of the Montenegrin economy, although this has been partially off-set and supplemented by production and investment. Revenues from VAT have decreased significantly as the economy has slowed and the ratio of import VAT to domestic VAT fell from 75 per cent/25 per cent to 60 per cent/40 per cent between 2007 and 2010.

Budget Law 2011

The Budget Law for 2011 envisages a deficit of 2.42 per cent of GDP. The Law assumes estimated growth in the economy of 2.5 per cent, while revenue growth is projected to grow by only 0.7 per cent of 2010 collected revenues, just below the revenue performance in 2007 and less (by EUR 213 million or 16 per cent) than the revenue figure achieved in 2008. Even though signs of recovery are now evident (see "Economy — Gross Domestic Product") growth has not been strong across all sectors of the economy, mainly due to the persistent illiquidity of the economy, which in 2010 led to a net increase in tax receivables of 1.7 per cent of GDP and a total increase in tax receivables of 5 per cent of GDP since the start of 2009. The latest estimates received by the Government from the Tax Office indicate that up to EUR 50 million of the outstanding total tax receivables can be expected to be collected in the short to medium-term. In addition, revenue from CIT is expected to increase by 60 per cent in 2011 compared to 2010, but even at that level it will still remain 60 per cent lower than the amount of revenue collected from CIT in 2009. Overall, given that the increase in excise rates could contribute to increased tax collection revenue of up to 0.5 per cent of GDP, the Government's view is that the total revenue figure in the Budget Law for 2011 is likely to prove to be conservative.

Public expenditure is planned to be EUR 7 million above the level of Budget Execution for 2010, but EUR 71 million or 2.4 per cent of GDP below that approved in the Budget Law for 2010. Given the fact that certain categories of expenditure such as interest payments (54 per cent higher than 2010), pensions (4 per cent higher than 2010), social benefits (increased due to an increase in the number of claimants) and costs related to the new national census, had to be increased, actual reduction of public expenditure envisaged in the Budget Law for 2011 is EUR 129 million (4.3 per cent of GDP), lower than that provided in the Budget Law for 2010 or EUR 29 million (0.9 per cent of GDP) lower than the level of the Budget Execution for 2010.

Consolidated Government expenditure (total public expenditures reduced by tax charges to the State as an employer and fees charged by local government to central Government) in 2011 has been reduced to 43 per cent of GDP, which is 2 per cent of GDP less than in 2010. The public deficit in 2011 is budgeted to be 0.6 per cent of GDP less than in 2010, while the primary deficit is budgeted to be 0.9 per cent of 2011 GDP or 1.1 per cent of GDP lower than 2010 figure.

As in past years, capital expenditure has been reduced (for 2011 the figure is 2.13 per cent of GDP), while debt repayments are budgeted at EUR 174 million or 5.5 per cent of GDP, higher than the actual borrowing requirements of the Government. Budgeted privatisation receipts are 0.7 per cent of GDP, but given the Government's current plans for privatisation in 2011 (See "Balance of Payments and Foreign Trade — Privatisation") total receipts may in fact exceed this amount.

In the medium-term, the Government intends to use the following economic and fiscal policy instruments (which are set out in its Medium-Term Macroeconomic Guidelines) in order to further adjust and strengthen public finances of Montenegro:

- create conditions to allow the Government to be more flexible in developing its budgetary policy, primarily through the reduction of mandatory commitments in favour of discretionary spending. Currently mandatory expenditure commitments account for over 75 per cent of total spending and two-thirds of the public spending increase in the period 2006 to 2009 was caused by increases in public sector wages and pensions. The Government intends to cap, and, to a certain extent, reduce, this expenditure while also seeking to reduce non-capital discretionary spending by 1.5 per cent of GDP by 2013;

- strict public sector employment policy through the rationalisation of the number of employees and wage restraint;

- social transfers will be shown by economic classification (broken down into wages, goods and services and "other") in order to improve control and transparency in public resources spending;

- improve the methodology and procedures for defining basic macroeconomic and fiscal indicators, for example the current and capital consumption levels, deficit and public debt;

- apply the proceeds of one-off budget revenues (such as privatisation proceeds) generated in 2011 and 2012 in early repayment of government debt and, in some cases, in making severance payments to affected public sector employees;

- make efficient use of the EU Pre-accession Funds — IPA funds to which Montenegro as an EU member candidate country will be entitled. These are expected to amount to approximately EUR 33 million in the period from 2011 to 2013;

- increases in current consumption will be confined to development projects, with the reduction of certain "non-productive" programmes and a "like-for-like" spending principle applied to new expenditure as a result of which the new expenditure will only be permitted if some other equivalent amount of expenditure on another programme is reduced; and

- completion of tax reforms, including the gradual increase of excise taxes on tobacco and the introduction of excise duty on certain goods.

The following table sets out a summary of the forecast general Government budget revenues and expenditures for the years 2012 to 2014:

	Forecast 2012		Forecast 2013		Forecast 2014	
	(€ million)	*(% of GDP)*	*(€ million)*	*(% of GDP)*	*(€ million)*	*(% of GDP)*
Government budget revenues	1,417.53	42.15	1,506.33	42.02	1,574.75	41.20
Tax revenues	1,246.48	37.06	1,326.64	37.01	1,386.96	36.29
Non-tax revenues	171.05	5.09	179.69	5.01	187.79	4.91
Government budget expenditures	1,420.03	42.23	1,446.47	40.35	1,474.43	38.58
Non capital expenditure	1,251.13	37.20	1,264.80	35.28	1,275.74	33.38
Capital expenditure	168.90	5.02	181.67	5.07	198.69	5.20
Financial balance	(2.50)	(0.07)	59.86	1.67	100.32	2.62

Source: Ministry of Finance

Note:

(1) The data used in this table is based on assumptions used by the Government in October 2010 in formulating the Medium-Term Macroeconomic Guidelines which form an integral part of the Budget Law for 2011 presented to Parliament, namely: (i) real growth rate in GDP of 3.5 per cent per annum in 2012 and 4.0 per cent per annum in each of 2013 and 2014 and (ii) inflation rate of 2.5 per cent per annum for each of the relevant years.

The following table sets out a summary of the forecast central Government budget revenues and expenditures for the years 2012 to 2014:

	Forecast 2012		Forecast 2013		Forecast 2014	
	(€ million)	*(% of GDP)*	*(€ million)*	*(% of GDP)*	*(€ million)*	*(% of GDP)*
Central Government budget revenue	1,249.98	37.17	1,328.23	37.05	1,388.31	36.32
Tax revenues	1,160.54	34.51	1,234.48	34.43	1,288.86	33.72
Direct taxes	514.15	15.29	546.07	15.23	574.43	15.03
Personal income tax	93.68	2.79	99.77	2.78	105.50	2.76
Corporate income tax	38.20	1.14	40.69	1.13	43.02	1.13
Tax on property	1.89	0.06	2.02	0.06	2.13	0.06
Social security contribution	380.37	11.31	403.60	11.26	423.77	11.09
Indirect taxes	646.39	19.22	688.41	19.20	714.44	18.69
Valued added taxes	429.32	12.77	457.22	12.75	474.48	12.41
Excise tax	155.96	4.64	166.09	4.63	172.63	4.52
Customs duties	57.28	1.70	61.00	1.70	62.97	1,65
Other taxes	3.84	0.11	4.09	0.11	4.36	0.11
Non tax revenue	89.44	2.66	93.75	2.62	99.45	2.60
Central Government budget expenditure	1,259.57	37.45	1,278.69	35.67	1,302.62	34.08
Non capital expenditure	1,174.33	34.92	1,182.59	32.99	1,191.48	31.17
Capital expenditure	85.24	2.53	96.09	2.68	111.14	2.91
Financial balance	(9.59)	(0.29)	49.55	1.38	8.69	2.24

Source: Ministry of Finance

Note:

(1) The data used in this table is based on assumptions used by the Government in October 2010 in formulating the Medium-Term Macroeconomic Guidelines which form an integral part of the Budget Law for 2011 presented to Parliament, namely: (i) real growth rate in GDP of 3.5 per cent per annum in 2012 and 4.0 per cent per annum in each of 2013 and 2014 and (ii) inflation rate of 2.5 per cent per annum for each of the relevant years.

The following table sets out a summary of the forecast local Government budget revenues and expenditures for the years 2012 to 2014:

	Forecast 2012		Forecast 2013		Forecast 2014	
	(€ million)	*(% of GDP)*	*(€ million)*	*(% of GDP)*	*(€ million)*	*(% of GDP)*
Local Government budget revenues	167.54	4.98	178.09	2.57	186.44	4.88
Tax revenues	85.93	2.56	92.16	1.29	98.10	2.57
Direct taxes	43.46	1.29	46.28	1.29	48.94	1.28
Personal income tax	26.42	0.79	28.14	0.78	29.76	0.78
Tax on property	17.04	0.51	18.14	0.51	19.18	0.50
Non tax revenue	81.61	2.43	85.84	2.40	88.34	2.31
Other revenues	42.48	1.26	45.87	1.28	49.16	1.29
Local Government budget expenditures	161.36	4.80	168.69	4.71	172.72	4.52
Non capital expenditure	97.36	2.90	102.77	2.87	104.82	2.74
Capital expenditure	64.00	1.90	65.92	1.84	67.90	1.78
Transfers from Central Budget	0.91	0.03	0.91	0.03	0.91	0.02
Financial balance	7.09	0.21	10.32	0.29	14.62	0.38

Source: Ministry of Finance

Note:

(1) The data used in this table is based on assumptions used by the Government in October 2010 in formulating the Medium-Term Macroeconomic Guidelines which form an integral part of the Budget Law for 2011 presented to Parliament, namely: (i) real growth rate in GDP of 3.5 per cent per annum in 2012 and 4.0 per cent per annum in each of 2013 and 2014 and (ii) inflation rate of 2.5 per cent per annum for each of the relevant years.

The following table sets out an overview of consolidated general Government figures for the period 2009 to 2011 which demonstrates the size of the fiscal adjustment since the beginning of the crisis:

	2009		Budget Execution 2010		Budget Law 2011	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million)*	*(% GDP)*
Consolidated general Government budget revenues	1,322.23	44.36	1,269.96	41.98	1,288.65	40.65
Tax revenues	1,072.46	35.98	1,098.40	36.31	1,127.50	35.57
Non tax revenue	249.76	8.38	171.57	5.67	161.15	5.08
Consolidated general Government budget expenditures	1,493.30	50.09	1,361.58	45.01	1,365.39	43.07
Non capital expenditure	1,493.30	41.67	1,217.44	40.25	1,202.64	37.94
Capital expenditure	251.21	8.43	144.14	4.76	162.75	5.13
Financial balance	(171.07)	(5.74)	(91.61)	(3.03)	(76.74)	(2.42)

Government Reserves

The following table sets out the Government's reserves at the end of each of the years 2007 to 2010:

	2007	2008	2009	2010
			(€)	
Government Reserves	91,103,158.44	101,099,661.60	183,067,787.63	141,812,204

Source: Ministry of Finance

Budget process and Local Governments

Montenegro's public finances consist of (i) the central government budget, which includes four state funds (Fund for Pension and Disability Insurance, Fund for Health Insurance, Employment Office and Compensation Fund) and (ii) municipal budgets.

The Budget Law regulates, among other things, adoption of the budget, budget management, preparation and planning of the budget, execution of the central and municipal budgets and execution of loans and guarantees. The Budget Law for each fiscal year starting on 1 January and ending on 31 December is adopted by the Parliament. Each municipal budget is adopted by the relevant municipal council or assembly. Planning of the central budget is based on the economic growth projections, macroeconomic stability, economic policies, laws and other regulations.

Based on the Government's Medium-Term Macroeconomic Guidelines, the Ministry of Finance issues instructions for preparation of the budgets of the various government departments and budgets of local governments for the forthcoming fiscal year. If, during the process of negotiating of the draft budget law, any disagreement arises between the Ministry of Finance and the various government departments, the Ministry of Finance prepares the final draft for consideration by the Government. The relevant competent body of each municipality prepares the draft of the municipal budget and submits it for consideration and comment by the Ministry of Finance prior to sending it to the local municipal assembly.

The draft Budget Law is required to be submitted to the Parliament and the draft municipal budget is required to be submitted to the local municipal assembly, in each case by the end of November in each year. At the same time as it receives the draft Budget Law, the Parliament is presented with the proposed financial plans and activities of the certain independent regulatory bodies, including, among other things, the Central Bank, telecommunications agencies, air traffic agencies and pharmaceutical agencies.

The rights and obligations of the municipalities are set out in the Local Government Laws. The Law on Local Government Finance regulates the rights and obligations of the local governments regarding financing. This law defines sources of financing of the units of local self-government and sets out the structure of the distribution of common revenues between the central budget and the local government. In addition this law determines the conditions for use of the Equalisation Fund, as well as the conditional subsidies from the budget. According to the law, municipalities are prohibited from borrowing to the extent their overall debt service would exceed 10 per cent of their current revenues in the previous fiscal year and they are obliged to obtain central government approval for each new borrowing even if within this limit.

INDEBTEDNESS

The following table sets out Montenegro's outstanding general government debt at the end of each of the years 2005 to 2010:

	2005	2006	2007	2008	2009	2010
Total debt *(€ million)*	700.4	701.1	737.2	894.7	1,140.2	1,270.7
External *(€ million)*	513.3	504	462.1	481.7	699.9	912.4
Domestic *(€ million)*	187.1	197.1	275.1	413.0	440.3	358.3
Total debt *(% of GDP)*	38.6	32.6	27.5	29.0	38.2	42.0
External *(% of GDP)*	28.3	23.5	17.2	15.6	23.5	30.2
Domestic *(% of GDP)*	10.3	9.2	10.3	13.4	14.7	11.8
GDP *(€ million)*	1,815.0	2,148.9	2,680.5	3,085.6	2,981.0	3,025.0

Source: Ministry of Finance

Between 2007 and 2009, half of the nominal debt increase was incurred to finance infrastructure projects predominantly between 2007 and 2008, and the other half was used for deficit financing in 2009. In 2010, the nominal debt increased as a result of the issue of EUR 200 million of Eurobonds.

The following table sets out the total projected public debt service for the years 2011 to 2015[(1)]:

	2011	2012	2013	2014	2015
			(€ million)		
Internal Public Debt service	70.24	97.27	66.15	61.54	61.29
Principal	67.50	95.56	65.91	61.35	61.19
of which: principal on T-bills	20.00	29.59	—	—	—
Interest	2.74	1.70	0.23	0.19	0.09
of which: interest on T-bills	1.48	1.48	—	—	—
External Public Debt service	96.78	105.30	115.32	127.71	304.91
Principal	52.74	57.65	63.34	75.81	256.11
Interest	44.04	47.65	51.98	51.90	48.8
Total Public Debt service	167.02	202.56	181.70	188.73	366.19[(2)]
Principal	120.24	153.21	129.49	136.64	317.3
Interest	46.78	49.35	52.21	52.09	48.89

Source: Ministry of Finance

Notes:

(1) The data used in this table assumes that the forecast budget deficit (see "Public Finance — Budget Law 2011 — table setting out a summary of the forecast general Government budget revenues and expenditures for the years 2012 to 2014" on page 59) will be financed by borrowings and that Montenegro will drawdown under pre-existing agreements with International Financial Institutions

(2) Includes repayment at maturity of EUR 200 million in respect of the Eurobonds issued on 14 September 2010.

The following tables set out a breakdown of Montenegro's outstanding external and domestic general government debt (excluding guarantees) as at 31 December 2010:

External Debt

Creditor	Amount	% of Foreign Debt
	(€ million)	
International Bank for Reconstruction and Development (IBRD)	176.6	19.4
International Financial Corporation (IFC)	5.7	0.6
Paris Club	124.3	13.6
International Development Association (IDA)	59.9	6.6
European Investment Bank (EIB)	71.8	7.9
European Bank for Reconstruction and Development (EBRD)	19.8	2.2
Council of Europe Development Bank	0.5	0.1
European Community	5.5	0.6
German Development Bank (KFW)	12.2	1.3
Soft Loans	134.3	14.7
Credit Suisse Bank	75.5	8.3
Erste Bank	26.3	2.9
EUR 200,000,000 7.875 per cent Notes due 2015	200.0	21.9
Total	912.4	100.0

Source: Ministry of Finance

Domestic Debt

Creditor	Amount	% of Domestic Debt
	(€ million)	
Frozen currency savings(1)	99.2	27.7
Municipalities	46.2	12.9
Restitution(2)	78.5	21.9
Loans from commercial banks	17.6	4.9
Loans from non-financial institutions	50.0	14.0
Pension arrears	17.2	4.8
Treasury bills(3)	49.6	13.8
Total	358.3	100.0

Source: Ministry of Finance

Notes:

(1) Pursuant to the Law on Foreign Currency Savings Deposited with Non Resident Banks passed in 2009 and the Law on Settlement on Claims and Obligations on Foreign Debt and Foreign Currency Savings passed in 2003, zero coupon bonds in the amount of EUR 107.9 million were issued to depositors who had previously held foreign currency savings with former socialist banks which became bankrupt in the 1990s.

(2) Restitution bonds each with a 20 year maturity. Restitution bonds have been issued to citizens of Montenegro to compensate them for property which has been previously appropriated.

(3) T-bills are issued with six month maturities, but since they are funded by application of the banks' non interest-bearing mandatory reserves, it is beneficial for the banks to roll-over the amounts at maturity.

At 31 December 2010, total general government debt amounted to EUR 1,270.7 million or 42.0 per cent of GDP, of which domestic debt made up EUR 358.3 million or 11.8 per cent of GDP and external debt EUR 912.4 million or 30.2 per cent of GDP.

At the same date, the total amount of outstanding guarantees issued by the Government was EUR 313.38 million or approximately 10.4 per cent of GDP. Guarantees are usually issued only in favour of international financial institutions such as EIB, EBRD and KfW in respect of the obligations of state-owned companies for key infrastructure projects such as power sector rehabilitation, water supply and transport infrastructure. The Government has, however, also issued guarantees to EIB and KfW for certain banks as part of its efforts to support the banking sector during the recent global financial crisis. See "The Economy — Principal Sectors of the Economy". In addition during 2010, the Government issued certain guarantees in respect of the debt repayment obligations of KAP and the Steel Mill. See "The Economy — Industrial Production — Restructuring of KAP and the Steel Mill".

At the end of December 2010 the Government had EUR 141.8 million of reserves. As a result its net general debt was at 37.3 per cent of GDP, 6.3 per cent of GDP higher than at the end of 2009.

The average maturity of the general Government debt is 6.4 years, with an average interest cost of 3.64 per cent per annum. Approximately 83 per cent of external debt, and all domestic debt, is denominated in euro. The interest rate on 70 per cent of total Government debt is fixed as opposed to floating.

Approximately 52.2 per cent of total external debt is owed to International Financial Institutions ("**IFIs**") and comprises essentially rescheduled debt from the time when Montenegro was part of the former Yugoslavia. An additional 14.7 per cent of total external debt is in the form of "soft" bilateral loans with even more favourable conditions than those provided by IFIs (mainly Spanish, Polish, Austrian, Hungarian and French official development assistance).

Domestic debt predominantly relates to arrears incurred during the former Yugoslavia era, such as frozen assets bonds (issued to compensate holders of saving deposits held in state-owned banks) and restitution bonds, both of which are in the form of non-interest bearing instruments.

Multilateral and Bilateral Development Organisations

International Monetary Fund

After gaining independence, Montenegro became a member of the IMF on 18 January 2007. Prior to its independence, Montenegro, as part of the Federal Republic of Yugoslavia and later the State Union of Serbia and Montenegro, had entered into various agreements with the IMF for a total amount of SDR 850 million. However, since its independence Montenegro has not entered into any new formal agreements with the IMF.

World Bank

Montenegro became a member of the World Bank on 18 January 2007. In 2007, Montenegro entered into an agreement with the World Bank and the Republic of Serbia in relation to the assumption of certain liabilities entered into by Montenegrin entities prior to Montenegro's independence. As part of this agreement, Montenegro assumed the following liabilities: approximately EUR 270 million to the IBRD, approximately SDR 46 million to the International Development Association ("**IDA**") and donations to various government institutions of approximately U.S.$ 1.46 million.

In addition, as part of the World Bank Country Partnership Strategy for Montenegro for the period 2007 to 2010, loans totalling approximately U.S.$ 67.5 million have been agreed between the World Bank and various ministries. As at 31 December 2009, the total amount owed to the World Bank was EUR 242 million. An additional EUR 35.9 million of funding from the World Bank has not yet been disbursed.

Standard terms for World Bank loans may be up to 30 years maturity with interest rates calculated at LIBOR plus a variable or fixed rate spread (variable spreads may be up to 0.48 per cent per annum and fixed rate spreads up to 1.15 per cent per annum).

European Bank for Reconstruction and Development

After gaining independence, Montenegro became a member of the EBRD on 3 June 2006.

On 25 April 2007, Montenegro signed a protocol with the EBRD setting out the basis for the implementation of two key projects relating to railway infrastructure and regional water supply systems. As part of the protocol, Montenegro has guaranteed loans of up to EUR 18 million entered into by the Railways of Montenegro, JSC relating to the railway infrastructure project and EUR 15 million entered into by PE "Regionalni vodovod crnogorsko primorje" (PEW) relating to construction of a regional water supply network to municipalities along the Montenegrin coast. In 2010 the EBRD signed a guarantee agreement in the amount of EUR 13.5 million with the Government for the obligations of the Montenegrin passenger railway company and with the Deposit Protection Fund of Montenegro, in the amount of EUR 30 million. In 2011 projects are expected to be implemented for water supply and waste water treatment, heating and the Port of Bar, in a total amount of EUR 17.8 million.

European Investment Bank

In May 2007, a Framework Agreement was signed between Montenegro and the EIB pursuant to which the parties agreed terms relating to, among other things, the tax treatment of EIB, the treatment of projects financed by the EIB, public tendering procedures and any privileges and immunities awarded to the EIB in relation to the financing of loans, guarantees and other instruments by the EIB for investments projects in Montenegro.

In addition on 8 December 2009, Montenegro and the EIB signed a memorandum of understanding relating to the financing of projects for the following five year period worth approximately EUR 200 million. The projects include the construction of railway infrastructure worth EUR 34 million (with EUR 7 million of financing already agreed), the treatment of the waste water worth EUR 54 million (with EUR 5 million of financing already agreed), solid waste disposal worth EUR 30 million (with EUR 27 million of financing already agreed) and the construction of by-passes in Montenegrin towns worth EUR 60 million. The memorandum of understanding also allows for additional projects to be included, as well as the possibility to increase the amount of funding depending on the development needs of Montenegro.

Kreditanstalt für Wiederaufbau

After gaining independence, Montenegro and KfW signed a memorandum of understanding in April 2007 relating to the financing of certain projects.

The projects include the supply of water and waste water treatment in the coastal area (EUR 57.5 million), establishing substations in Ribarevina and Podgorica (EUR 8.5 million), the rehabilitation and modernisation of the hydro power plant in Piva (EUR 16 million plus a donation of EUR 1 million to EPCG) and the replacement of filters at the thermal power plant in Pljevlja and the extension of the substations in Ribarevina and Podgorica (EUR 15 million).

In addition in September 2009, Montenegro and KfW signed another memorandum of understanding relating to projects involving renewable energy sources and water supply totalling EUR 91 million. In accordance with this memorandum, during 2011 KfW and the Government are expected to sign a financing agreement for a total amount of EUR 11.5 million

Council of Europe Development Bank

Montenegro became a member of the Council of Europe on 11 May 2007 and a member of the Council of Europe Development Bank (the "**CEDB**") on 19 November 2007.

Montenegro is currently working with the CEDB on financing for a project relating to housing for people on low income, amounting to EUR 30 million, the first tranche of which for EUR 15 million was signed in 2010, with the second tranche due to be signed in 2011.

TAXATION

The following is a general description of certain tax considerations relating to the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes. Prospective purchasers of Notes should consult their tax advisers as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Montenegro of acquiring, holding and disposing of Notes and receiving payments of interest, principal and/or other amounts under the Notes. This summary is based upon the law in effect on the date of this Prospectus and is subject to any change in law that may take effect after such date.

Montenegrin Taxation

Under the Montenegrin Corporate Profit Tax Law (Official Gazzette of Montenegro No 65/2001, 12/2002, 80/2004, 40/2008 and 86/2009), withholding tax of 9 per cent is applicable to payments of interest in respect of the Notes except where any applicable double taxation treaty stipulates otherwise. In the event payment of interest in respect of the Notes is subject to withholding or deduction for any such tax pursuant to Condition 10 (*Taxation*), the Issuer has agreed to pay such additional amounts as will result in the receipt by Noteholders of such amounts as would have been received by them if no such withholding or reduction had been required, subject only to the exceptions set out in that Condition.

Under Montenegrin law, there is no requirement for any Noteholder or Accountholder to provide any identification to demonstrate, or certification to the effect, that it is not resident in Montenegro in order to be entitled to receive any such additional amounts.

Residents of Montenegro investing in Notes may be subject to capital gain tax upon sale of the Notes.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate following the conclusion of certain other agreements relating to information exchange with certain other countries.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding measures) in relation to payments made by a person within their jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

SUBSCRIPTION AND SALE

HSBC Bank plc, J.P. Morgan Securities Ltd. and Erste Group Bank AG (together, the "**Managers**") have, pursuant to a subscription agreement dated 6 April 2011 (the "**Subscription Agreement**"), jointly and severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe for the Notes at 99.492 per cent of their principal amount. The Subscription Agreement entitles the Managers to terminate it in certain circumstances prior to payment being made to the Issuer.

The Managers and their respective affiliates may have engaged in transactions with the Issuer in the ordinary course of their banking business and the Managers may have performed various investment banking, financial advisory and other services for the Issuer, for which they receive customary fees, and the Managers and their respective affiliates may provide such services in the future.

United States

The Notes have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States.

The Notes are being offered and sold outside of the United States in reliance on Regulation S.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented, warranted and agreed that it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Montenegro

Each Manager has represented, warranted and agreed that it will not, as part of its initial distribution of the Notes, offer or sell any Notes to residents of Montenegro or legal entities incorporated in Montenegro unless such residents or legal entities are authorised or licensed under Montenegrin law to acquire, hold, manage or dispose of the Notes on the date of the relevant offer or sale.

General

No action has been or will be taken in any jurisdiction by the Issuer or any Manager that would permit a public offering of the Notes, or possession or distribution of this Prospectus or any other offering or publicity material relating to the Notes, in any country or jurisdiction where action for that purpose is required. Each Manager has represented, warranted and agreed that it has, to the best of its knowledge and belief, complied and will comply with all applicable laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Notes or possesses, distributes or publishes this Prospectus or any other offering material relating to the Notes. Persons into whose hands this Prospectus comes are required by the Issuer and each Manager to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or possess, distribute or publish this Prospectus or any other offering material relating to the Notes, in all cases at their own expense.

GENERAL INFORMATION

1. Clearing Systems

The Notes have been accepted for clearance through the Clearstream, Luxembourg and Euroclear systems with a Common Code of 061470042. The International Securities Identification Number for the Notes is XS0614700424.

The address of Euroclear is 1 Boulevard du Roi Albert 11, B 1210 Brussels, Belgium, and the address of Clearstream, Luxembourg is 42 Avenue J.F. Kennedy, L 1855, Luxembourg.

2. Admission to Trading

The admission of the Notes to the Official List will be expressed as a percentage of their principal amount (exclusive of accrued interest). It is expected that admission of the Notes to the Official List and to trading on the Market will be granted on or around 8 April 2011, subject only to the issue of the Global Note. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for settlement in euro and for delivery on the third working day after the day of the transaction. The expenses in connection with the admission of the Notes to the Official List and trading on the Market are expected to amount to approximately £7,175.

3. Authorisations

The Issuer has obtained all necessary consents, approvals and authorisations in Montenegro in connection with the issue and performance of the Notes. The issue of the Notes was authorised pursuant to the Budget Law of 2011 and the Decision of the Government passed on 24 March 2011.

4. Significant Change

There has been no significant change in the Issuer's (i) tax and budgetary systems, (ii) gross public debt, (iii) foreign trade and balance of payment figures, (iv) foreign exchange reserves, (v) financial position and resources and (vi) income and expenditures figures since 31 December 2010.

5. Litigation

The Issuer is, from time to time, subject to a variety of legal proceedings and claims. The Issuer is not, however, involved in any legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) which may have, or have had during the 12 months preceding the date of this Prospectus, a significant effect on the financial position of the Issuer.

6. Yield

The yield of the Notes is 7.375 per cent on an annual basis. The yield is calculated as at the Closing Date on the basis of the issue price. It is not an indication of future yield.

7. Documents on Display

For the period of 12 months starting on the date on which this Prospectus is made available to the public, copies (and English translations where the documents in question are not in English) of the following documents may be inspected at the specified office of the Paying and Transfer Agent during normal business hours:

(a) the Fiscal Agency Agreement;

(b) the Deed of Covenant;

(c) this Prospectus and any supplements thereto; and

(d) the Budget Law of Montenegro for the current fiscal year.

INDEX OF DEFINED TERMS

The Issuer

Montenegro
acting through its Ministry of Finance
Stanka Dragojevica 2
81000 Podgorica
Montenegro

Joint Lead Managers

HSBC Bank plc
8 Canada Square
London E14 5HQ
United Kingdom

J.P. Morgan Securities Ltd.
125 London Wall
London EC2Y 5AJ
United Kingdom

Co-Lead Manager

Erste Group Bank AG
Graben 21
1010 Wien
Austria

Registrar

Deutsche Bank Luxembourg S.A.
2 Boulevard Konrad Adenauer
L-1115 Luxembourg
Grand Duchy of Luxembourg

Fiscal Agent, Principal Paying Agent and Transfer Agent

Deutsche Bank AG, London Branch
Winchester House
1 Great Winchester Street
London EC2N 2DB
United Kingdom

Legal Advisers
to the Issuer

as to English law

Linklaters LLP
One Silk Street
London EC2Y 8HQ
United Kingdom

as to Montenegrin law

Protector of the Property-Legal Interests of Montenegro
Stanka Dragojevica 2
81000 Podgorica
Montenegro

to the Managers

as to English law

Clifford Chance LLP
10 Upper Bank Street
London E14 5JJ
United Kingdom

as to Montenegrin law

Harrisons Solicitors
Terazije 34
11000 Belgrade
Serbia