MONTENEGRO BOND

PROSPECTUS

(domestic issuance)

February 2014.

OVERVIEW OF THE TERMS AND CONDITIONS OF THE BOND

I. Issuer: Montenegro (Ministry of Finace)

II. Issue date: 03.03.2014.

III. Nond offered: EUR 100.000.000,00 due March 2018

IV. Type: Amortising bond with semianual equal payments

V. Value of single bond: EUR 10.000,00

VI. Year interest rate: 5%

VII. Total quantity 10.000

VIII. Amortisation plan:

	Date	Amortisation Amount per single bond	Interest per single bond	Amount of principal in amortisation amount	Outstanding principal amount
1	03.09.2014.	1.392,8608	246,95	1.145,91	8.854,09
2	03.03.2015.	1.392,8608	218,65	1.174,21	7.679,88
3	03.09.2015.	1.392,8608	189,66	1.203,21	6.476,68
4	03.03.2016.	1.392,8608	159,94	1.232,92	5.243,76
5	03.09.2016.	1.392,8608	129,49	1.263,37	3.980,39
6	03.03.2017.	1.392,8608	98,30	1.294,56	2.685,83
7	03.09.2017.	1.392,8608	66,33	1.326,53	1.359,29
8	03.03.2018.	1.392,8608	33,57	1.359,29	0,00

IX. On date by plan, a bond repays part of the principal along with the coupon payments;

X. Trading will be done in accordance to Law on securities and Rules of Montenegro Stock Exchnage.

XI. Fulfillment of the obligations under this bond has the same treatment as the settlement of liabilities incurred by signing the international credit arrangements or by issuing the international bonds.

PUBLIC FINANCE

Overview

In 2013 the Government was 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 the Government does not have a wide range of monetary tools which can be used and (ii) Montenegro is a small, developing and not fully diversified economy.

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

In 2012, public finances were adversely affected by challenging economic environments in the Euro-zone and in Montenegro, adverse weather conditions in Montenegro at the beginning of the year and payments under state guarantees in relation to financial obligations of the aluminium producer KAP. As a result of these and other factors, actual central Government revenues were lower than budgeted and than in 2011. The preliminary data indicates that the central budget has recorded the lowest nominal level of collections since 2008. Even though, despite numerous pressures, central Government expenditures remained generally stable in 2012 as compared to 2011 (although 4.5 per cent. higher than budgeted), the budget deficit reached 6.2 per cent. of GDP in 2012. In light of these developments, the Government's current priorities are to increase Government revenues and to reduce Government expenditures in order to stabilise and eventually reduce the deficit, which would also reduce the need for Government borrowing.

To increase Government revenues, following Parliamentary elections in 2012 and the formation of a new Government, a set of interim fiscal measures was introduced at the beginning of 2013, which increase income during the 2013.. Part of those measures stays in 2014. Furthermore, an increase in the upper VAT rate from 17 per cent. to 19 per cent. took effect from 1 July 2013. According to the results of an analysis prepared by the World Bank, this increase is not expected to have long-term adverse effects on the economy of Montenegro or its investment environment, particularly in light of the fact that the VAT rate of 19 per cent. is still competitive as compared to other European countries.

The Government's main medium term fiscal policy objectives are to create conditions for sustainable economic growth and to develop a more stable and sustainable public finances system. To achieve these objectives, the Government has adopted a policy based on the following principles and targets for the 2013-2016 period:

1. to continue the implementation of austerity measures with a view to reduce central Government expenditures from 41.8 per cent. of GDP in 2012 to 33.9 per cent. of GDP in 2016 and to direct the resulting savings to large capital projects in order to foster economic growth and development, while providing adequate protection to more vulnerable categories of population;

2. to implement, on an expedited basis, structural reforms in order to reduce the pressure on Government spending over the long term;

3. to attract investments that will contribute to the growth of the economy, with a focus on implementation of strategic investments;

4. to continue implementation of measures aimed at reducing the size of the "grey economy", while developing legislative framework with a view to improve the business environment and to sanction and adopt penalties for illegal market practices;

5. to increase the upper VAT rate from 17 per cent. to 19 per cent. from 1 July 2013, which is expected to generate additional funds to cover budget deficit;

6. to discontinue issuing state guarantees, except for infrastructure projects;

7. to reduce the central Government budget deficit from 6.2 per cent. of GDP in 2012 and to generate budget surplus 0.4 per cent.of GDP in 2016;

8. to generate a surplus in the primary budget (total budget without the interest payments component) over a medium term; and

9. to harmonise the public finances legislation with the EU *acquis communautaire*.

New and continued reform processes are planned for the medium term, including the continued public administration reform, which seeks to increase the productivity and reduce costs of the public sector. Structural reforms in the areas of the pension system, healthcare, education and labour market are expected to provide a backdrop for developing a more stable public finances system and a competitive economic environment. Improving the competitiveness of the Montenegrin business environment is one of the key Government priorities and is also one of the requirements for the EU accession process. In light of the size and nature of the Montenegrin economy, the Government intends to continue to introduce measures aimed at attracting FDI.

The following table sets out a summary of the actual general Government budget revenues and expenditures (which consist of the revenues and expenditures of the central Government budget and the municipal budgets) for the year 2011, the budget execution figures for 2012 and those provided for in the Budget Laws for 2012 and 2013.

	2011		**2012 Budget Law(1)**		**2012 Budget Execution(2)**		**2013 Budget Law(3)**	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million)*	*(% GDP)*
Revenues	**1,285.07**	**39,74**	**1.282.23**	**38,41**	**1,299.91**	**41.28**	**1,294.10**	**39.08**
Tax revenues	1,148.10	35,50	1,155.90	34.63	1.148,24	36.46	1,157.44	34.95
Non-tax revenues	136.97	4.35	126.33	3.78	151.67	4.81	136.65	4.12
Expenditures	**(1,461.25)**	**(45.18)**	**(1,385.36)**	**(41.50)**	**(1,476.04)**	**(46.87)**	**(1,375.77)**	**(41.55)**
Non-capital expenditures	(1,342.67)	(41.52)	(1,271.72)	(38.10)	(1,368.98)	(43.47)	(1,280.13)	(38.66)
Capital expenditures	(118.58)	(3.67)	(113.65)	(3.40)	(107.05)	(3.40)	(95.64)	(2.89)
Financial balance	**(176.18)**	**(5.45)**	**(103.13)**	**(3.09)**	**(176.13)**	**(5.59)**	**(81.67)**	**(2.47)**

Source: Ministry of Finance

Notes:

(1) Takes into account the 2012 budget revision undertaken in April 2012.

(2) The figures for the 2012 Budget Execution are based on the 2012 Budget Execution Law.

(3) Does not take into account the impact of interim fiscal measures introduced at the beginning of 2013. See "—*2013 Budget*" for more details.

The following table sets out a summary of the budget execution figures for the first nine months of 2013.

	Nine months ended 30 September 2013 Budget Execution
	(€ million)
Revenues	**993.60**
Tax revenues	890.30
Non-tax revenues	103.30
Expenditures	**(1,103.98)**
Non-capital expenditures	(1,045.48)
Capital expenditures	(58.50)
Financial balance	**(110.38)**

Source: Ministry of Finance

The following table sets out a summary of the actual central Government budget revenues and expenditures for the year 2011, the budget execution figures for 2012 and those provided for in the Budget Laws for 2012 and 2013.

	2011		**2012 Budget Law[(1)]**		**2012 Budget Execution[(2)]**		**2013 Budget Law[(3)]**	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million))*	*(% GDP*	*(€ million)*	*(% GDP)*
Revenues	**1,129.14**	**34.91**	**1.150,06**	**36.74**	**1,121.02**	**35.60**	**1,161.80**	**35.09**
Tax revenues	1,057.65	32.70	1,077.61	34.72	1,049.69	33.33	1,084.65	34.44
Direct taxes..............	472.56	14.61	481.84	15.52	509.97	16.19	518.55	16.47
Personal income tax	81.64	2.52	81.50	2.45	82.26	2.61	90.88	2.74
Corporate income tax	36.10	1.12	46.87	1.41	64.02	2.03	41.93	1.27
Tax on property.....	1.24	0.04	1.47	0.04	1.44	0.05	1.52	0.05
Social security contributions	353.58	10.93	351.99	10.59	362.25	11.50	384.22	11.60
Indirect taxes	585.09	18.09	595.77	19.19	535.45	17.00	561.68	17.84
Valued added taxes	392.24	12.13	381.22	11.47	354.71	11.26	373.05	11.27
Excise tax.............	143.38	4.43	163.06	4.91	151.77	4.82	157.45	4.76
Customs duties	143.38	4.43	47.34	1.42	28.97	0.92	31.19	0.94
Other taxes...............	4.15	0.13	4.15	0.12	4.28	0.14	4.41	0.13
Non-tax revenues	71.49	2.21	72.45	2.33	71.32	2.26	77.15	2.45
Expenditures	**(1,318.22)**	**(40.78)**	**(1,260.18)**	**(37.91)**	**(1,316.57)**	**(41.81)**	**(1,257.12)**	**(37.97)**
Non-capital expenditures	(1,234.69)	(38.18)	(1,183.53)	(35.61)	(1,257.84)	(39.94)	(1,191.48)	(35.99)
Capital expenditures.....	(84.13)	(2.60)	(76.65)	(2.31)	(58.74)	(1.87)	(65.64)	(1.98)
Financial balance	**(189.67)**	**(5.86)**	**(110.13)**	**(3.31)**	**(195.56)**	**(6.21)**	**(95.32)**	**(2.88)**

Source: Ministry of Finance

Notes:

(1) Takes into account the 2012 budget revision undertaken in April 2012.

(2) The figures for the 2012 Budget Execution are based on the 2012 Budget Execution Law,.

(3) Does not take into account the impact of interim fiscal measures introduced at the beginning of 2013. See "—*2013 Budget*" for more details.

The following table sets out a summary of the budget execution figures for the first nine months of 2013.

	Nine months ended 30 September 2013 Budget Execution
	(€ million)
Revenues	**879.52**
Tax revenues	720.57
Direct taxes	364.98
Personal income tax	62.50
Corporate income tax	37.18
Tax on property	1.02
Social security contributions	264.29
Indirect taxes	455.53
Valued added taxes	317.84
Excise tax	120.63
Customs duties	17.06
Other taxes	3.87
Non-tax revenues	55.15
Expenditures	**(1,017.68)**
Non-capital expenditures	(985.29)
Capital expenditures	(32.39)
Financial balance	**(138.16)**

Source: Ministry of Finance

The following table sets out a summary of the actual municipal Government budget revenues and expenditures for the year 2011, the budget execution figures for 2012 and those provided for in the Budget Laws for 2012 and 2013.

	2011		2012 Approved Municipal Budget[(1)]		2012 Budget Execution[(2)]		2013 Approved Municipal Budget[(3)]	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million)*	*(% GDP)*	*(€ million)*	*(% GDP)*
Revenues	155.93	4.82	132.18	4.20	178.89	5.68	132.30	4.00
Tax revenues	90.45	2.80	78.30	2.49	98.55	3.13	72.79	2.20
Direct taxes	46.01	1.42	40.75	1.29	40.39	1.28	37.86	1.14
Personal income tax	31.59	0.98	29.75	0.95	27.42	0.87	24.16	0.73
Tax on property sales	14.42	0.45	11.00	0.35	12.97	0.41	13.70	0.41
Local taxes	44.45	1.37	37.55	1.19	50.96	1.62	34.94	1.06
Non-tax revenues	52.84	1.63	41.87	1.33	66.54	2.06	46.85	1.45
Other revenues	12.63	0.39	12.01	0.38	13.80	0.44	12.65	0.38
Expenditures	(148.35)	(4.59)	(126.65)	(4.02)	(160.31)	(5.09)	(118.90)	(3.59)
Non-capital expenditures	(96.88)	(3.00)	(89.65)	(2.85)	(111.99)	(3.56)	(88.90)	(2.68)
Capital expenditures	(51.47)	(1.59)	(37.00)	(1.18)	(48.32)	(1.53)	(30.00)	(0.91)
Transfers from central budget	1.07	0.03	0.85	0.03	0.85	0.03	0.25	0.01
Financial balance	**13.50**	**0.42**	**6.37**	**0.2**	**19.43**	**0.62**	**13.65**	**0.41**

Source: Ministry of Finance

Notes:

(1) Takes into account the 2012 budget revision undertaken in April 2012.

(2) The figures for the 2012 Budget Execution are based on the 2012 Budget Execution Law

(3) Does not take into account the impact of interim fiscal measures introduced at the beginning of 2013. See "—*2013 Budget*" for more details.

The following table sets out a summary of the budget execution figures for the first nine months of 2013.

	Nine months ended 30 September 2013 Budget Execution
	(€ million)
Revenues	**114.08**
Tax revenues	65.92
Direct taxes	29.56
Personal income tax	19.81
Tax on property	9.75
Local taxes	36.37
Non-tax revenues	39.97
Other revenues	8.18
Expenditures	**(86.33)**
Non-capital expenditures	(66.57)
Capital expenditures	(19.76)
Transfers from central budget	0.03
Financial balance	**27.78**

Source: Ministry of Finance

2012 Budget Execution

As discussed above, 2012 was one of the most challenging years for the country's public finances. A downturn in economic activity in the Euro-zone and in Montenegro and adverse weather conditions throughout the country at the beginning of the year resulted in the Montenegrin GDP contracting by 2.5 per cent. in 2012, which, in turn, had an adverse impact on central Government revenues. At the same time, payments under state guarantees in relation to financial obligations of the aluminium producer KAP resulted in higher central Government expenditures. As a result, the central Government budget deficit increased from €189.7 million in 2011 to €195.6 million in 2012.

Based on 2012 Execution Law, general Government revenues in 2012 were €1,299.9 million, or 41.3 per cent. of GDP, which was 1.2 per cent. higher than in 2011 and 1.4 per cent. higher than budgeted. This was mainly due to higher municipal Government revenues than in 2011 and than budgeted for 2012, partially offset by lower central Government revenues. Higher municipal Government revenues principally reflected an increase in revenues from municipal taxes and from fees for municipal land development. The central Government revenues in 2012 recorded the lowest nominal level of collection since the onset of the global financial and economic crisis at the end of 2008. Adverse weather conditions at the beginning of 2012 resulted in weak economic performance in the first quarter and negatively impacted the economic activity for the rest of the year. As a result, Montenegrin GDP contracted by 2.5 per cent. in 2012. Reflecting these economic developments, actual central Government revenues in 2012 were €1,121.0 million, or 35.6 per cent. of GDP, which was 0.7 per cent. lower than in 2011, 7.5 per cent. less than was budgeted under the 2012 Budget Law and 2.6 per cent. lower than projected under the 2012 budget revision undertaken in April 2012 (the "**2012 Budget Revision**"). The foregoing trends were primarily due to almost a 10 per cent. decline in VAT revenues as compared to 2011 and a decrease in revenues from taxes on international trade and transactions due to the liberalisation of the international trade market and continued reduction of custom duty rates. This was partially offset by a 77.3 per cent. increase in corporate income tax revenues as compared to 2011 (mainly due to certain measures introduced under the 2012 Budget Revision) and higher excise tax revenues (primarily due to new fees being introduced).

Actual general Government expenditures in 2012 amounted to €1,493,3.0 million, or 47.4 per cent. of GDP, and were 2.2 per cent. higher than in 2011 and 7.5 per cent. higher than budgeted, which reflected higher central Government expenditures as well as higher expenditures by the municipal Governments. The central Government expenditures amounted to €1,333.9.6 million, or 42,4.8 per cent. of GDP, in 2012, which was higher for 1.1 per. cent compare to 2011 and 6.2 per cent. higher than projected under the 2012 Budget Law and 4.5 per cent. higher than forecasted under the 2012 Budget Revision. This was principally due to payments made under state guarantees in relation to financial obligations of the aluminium producer KAP as well as higher payments of interest and repayment of principal on Government debt (mainly due to repayment of principal to Montenegrin residents on internal debt), expenditures on social protection entitlements, expenditures on pension and disability insurance entitlements, subsidies and expenditures on materials and services. Adoption of 2012 Execution Law and suggestion given by State Audit Institutions, expenditures, in amount of 17 million euro, were record from Debt Repayment to Capital Budget. This change increase expenditures and deficit too. This was partially offset by lower public sector wages and severance payments, transfers to public institutions, other public sector related expenditures and capital budget expenditures.

As a result of the foregoing, the actual general Government deficit in 2012 was €193,4 million as compared to €176.2 million in 2011, while the actual central Government deficit in 2012 was €212,9 million as compared to €189.7 million in 2011.

2013 Budget

Two macroeconomic scenarios were developed under the Pre-Accession Economic Programme ("**PEP**") for 2012-2015. Both scenarios envisaged a GDP growth of 0.5 per cent. in 2012. However, as a result of the adverse economic developments that took place after the PEP was adopted, Montenegrin GDP contracted by 2.5 per cent. in 2012. For 2013, the base scenario under the PEP envisages GDP growth of 2.5 per cent. in Montenegro. The Government believes that the impact of the factors that caused the country's GDP to contract in 2012 was limited to that year. Available macroeconomic and fiscal indicators show that the Montenegrin economy has recorded a GDP growth of 2.4 per cent. in the first six months of 2013 on an annualised basis, which is in line with Government expectations. Based on the announced increases in the electricity generation capacities, data on bookings for the 2013 tourism season and announced commencements of investments, the Government projects that the economy will grow at a rate of 2.5 per cent. in 2013. Based on the assumptions that there will be a sizeable growth in the sectors of tourism, investments and electricity generation, the Ministry of Finance’s projections show that the economy is expected to grow over a medium term at an average rate of 3.6 per cent. per annum.

As a result of the actual 2012 GDP deviating from the PEP forecasts for that year, macroeconomic projections for 2013 and the medium term were revised, following which fiscal projections for 2013 and the medium term were revised as well. After the 2012 Budget Revision, budget projections in the PEP were revised in September 2012. However, actual 2012 budget revenues were lower than projected under the 2012 Budget Revision and, consequently, lower than estimated under the PEP. Lower budget revenues in 2012 prompted the revision of fiscal projections for 2013-2015, including the 2013 budget. As a result, at the beginning of 2013, the Ministry of Finance adopted a set of fiscal measures (the "**2013 Measures**") aimed at strengthening public finances, which include the following:

1. introduction of a "crisis" personal income tax, which increased the tax rate from 9 per cent. to 15 per cent. for wages in excess of an average gross monthly wage of €720;

2. implementation of measures to reduce the size of the "grey economy", while increasing penalties for breaches of related laws and regulations;

3. temporary suspension of annual pension adjustments starting from 2013;

4. introduction/extension of certain fees relating to SIM cards, smoking zones, electricity meters and cable television until the end of 2013;

5. an increase in the minimum wage from 30 per cent. to 40 per cent. of the average wage;

6. optimisation of the structure of managing boards in public enterprises, institutions, funds and other business organisations where the Government is a majority owner with a view to reduce expenditure. A review of compensation levels of such managing boards was performed and remuneration to chairpersons and members of managing boards was reduced, with ceiling levels imposed in certain cases;

7. optimisation of certain regulatory agencies, including the alignment of wages with those of civil servants and state employees and reduction in discretionary spending. Amendments to the relevant legislation enabled the excess revenues of the regulatory agencies to be transferred to the budget; and

8. reducing the number of the Government bodies and remuneration to their members.

The foregoing measures are intended to be of a temporary nature (for the most part, they are expected to remain in force until the end of 2013) but, after a detailed analysis, a possible extension of these measures may be considered.

The main objective of economic policy in 2013 was the stabilisation and consolidation of public finances with a view to reduce the budget deficit, public debt and the size of the "grey economy", while creating the conditions for an increase in foreign and domestic investments and the continuation of the financial sector stabilisation**.** In addition, the public administration reform seeks to reduce the number of public sector employees. The need for fiscal consolidation and increased competitiveness of the economy is also one of the priorities in the European integration process. The introduction of additional fiscal rules and the creation of an institutional framework for their consistent application with a view to ensure an efficient management of the public finances are also viewed as high priorities. Other priorities also include increasing the flexibility and mobility of the labour market and facilitating requirements for obtaining building permits, which is in line with the recommendations of international rating agencies. Improvement of the tax system is expected to continue through the harmonisation of the law on excise duties with EU *acquis communautaire*.

The main objective on the public revenue side is to improve revenue collection, including by reducing the size of the "grey economy". An action plan to combat the "grey economy" was drafted and fines and penalties for illegal business practices were increased, while a more developed legislative framework aimed at combating the "grey economy" is being prepared. Reducing the size of the "grey economy" is also expected to achieve more fair competition among market participants.

Although many neighbouring countries increased their tax rates, in particular income tax and VAT rates, in light of deteriorating economic indicators in 2011-2012, the Ministry of Finance of Montenegro did not raise taxes during that period and initially based its tax policy in 2012 and 2013 on the introduction of symbolic fees on products categorized as luxury. Despite the foregoing, as a result of deteriorating public finances in 2012, the Government made a decision to introduce a "crisis" personal income tax as part of the 2013 Measures, which increased the tax rate from 9 per cent. to 15 per cent. for wages in excess of an average gross monthly wage of €720. In addition to the 2013 Measures, the Government increased the VAT rate from 17 per cent. to 19 per cent. starting from 1 July 2013. The VAT rate increase was considered as a last resort measure. A set of analyses was undertaken prior to the increase based on the recommendations from various international financial institutions (including the IMF and WorldBank), the results of which showed that although the increase would lead to a reduction in disposable income and thus a reduction in consumption, it is expected that, as a result of the increase, Government VAT revenue would increase by approximately 8-9 per cent. per annum. The following estimates of the central and general Government budgets do not take into account the VAT increase.

Taking into account the effect of the 2013 Measures, central Government budget revenues in 2013 are estimated to be approximately €1,235.2 million, or 37.3 per cent. of GDP, which would represent a 10.2 per cent., or €114.1 million, increase as compared to the 2012 central Government revenues. Taking into account the impact of the 2013 Measures, general Government budget revenues in 2013 are estimated to be approximately €1,384.5 million, or 41.8 per cent. of GDP, which is 7 per cent. higher than the initially projected amount for 2013.

As a result of the implementation of the 2013 Measures as well as a more favourable economic environment and weather conditions, general Government revenues in the first nine months of 2013 amounted to €993.60 million and were 7.1 per cent. higher than in the same period of 2012. In the first nine months of 2013, central Government revenues amounted to €879.52 million and were 8.6 per cent. higher than in the same period of 2012 principally as a result of the implementation of anti-gray economy measures and the increase in the upper VAT rate to 19 per cent. An increase in the VAT collection was particularly pronounced, as the actual collected VAT exceeded the budgeted collection amount for September 2013 by 5.5 per cent. and, for the first nine months of 2013, was 19.5 per cent. higher than the same period of 2012. It is expected that, as a result of the 2013 Measures, based on estimates, general Government revenues in 2013 will be more than €90 million higher than initially planned and central Government revenues will be approximately 72.5 per cent. higher than initially planned.

Central Government expenditures in 2013, taking into account the impact of the 2013 Measures, are estimated to be 41.9 per cent. of GDP, of which current budget expenditures and capital expenditures account for 39.7 per cent. and 2.2 per cent. of GDP, respectively. As a result of the 2013 Measures and the payments made under the Government guarantees for KAP amounting to €103.1 million, central Government expenditures are projected to be €111.6 million, or 3.4 per cent. of GDP, higher than initially planned. Certain categories of expenditures are expected to be higher than estimated prior to the introduction of the 2013 Measures, primarily those relating to social protection entitlements in order to protect the most vulnerable categories of the population. A slight increase is also expected in capital expenditures, expenditures for materials and services, subsidies, and transfers to public institutions. Pension expenditures are expected to be lower than initially forecast due to the Government's decision (as part of the 2013 Measures) to temporarily suspend annual pension adjustments. As a result of this decision, in 2013 the expenditures on pensions and disability insurance is expected to be €10 million lower than originally planned, although compared to 2012, pension expenditures are expected to increase due to a higher number of pensioners. As a result of the implementation of the 2013 Measures, in the first nine months of 2013, central Government expenditures amounted to €1,017.7 million, thereby exceeding planned budgetary expenditures by 8.1 per cent. For the first nine months of 2013, central Government expenditures were 8.1 per cent. higher than in the same period of 2012.

Even though the 2013 Measures may result in a decrease in aggregate demand and disposable income, they are expected to improve the stability of public finances, while also supporting other sectors of the economy. It is planned that all savings achieved in the current expenditures line items during 2013 as a result of the 2013 Measures will be utilised for capital projects, resulting in the public sector further contributing to economic growth and development.

General Government expenditures, taking into account the impact of the 2013 Measures, are projected to be €1,517.1 million in 2013, or 45.8 per cent. of GDP, of which 42.6 per cent. of GDP relate to current expenditures and 3.2 per cent. of GDP relate to capital expenditures. In the first nine months of 2013, general Government expenditures amounted to €1,104.0 million. For the first nine months of 2013, general Government expenditures were 6.8 per cent. higher than in the same period of 2012.

Following the implementation of the 2013 Measures, the central Government budget deficit in 2013 is estimated to be €151.9 million, or 4.6 per cent. of GDP, which is approximately €56,6 million higher than the amount initially planned. The cumulative central Government budget deficit for the first nine months of 2013 amounted to €138.2 million, which was 4.6 per cent. higher than in the same period of 2012 as a result of the guarantees paid by the Government as a result of KAP's debt restructuring.

The general Government deficit was initially projected to be €81.7 million in 2013. However, as a result of the implementation of the 2013 Measures as positive input and activation of State guarantees for KAP as negative input, it is presently estimated to be €132.6 million, or 4.0 per cent. of GDP. It is expected that the budget will have a primary deficit in the amount of €63.2 million, or 1.49 per cent. of GDP, in 2013, and that debt repayments (including interest and principal) in 2013 will be approximately €274.3 million. The general Government deficit in 2013 is intended to be financed in part through issuances of sovereign bonds, including the issue of the Notes. In the first nine months of 2013, the general Government budget deficit amounted to €110.4 million, which was 4.7 per cent. higher than in the same period of 2012.

2014 Budget

According to the budget law for 2014, central Government budget revenues are projected to be approximately €1,268.1 million, or 36.1 per cent. of projected GDP, which would represent an 9.1 per cent. increase as compared to the planned 2013 central Government revenues. General Government budget revenues in 2014 are projected to be approximately €1,425.85 million, or 40.55 per cent. of projected GDP, which is 10,24 per cent. higher than the planned 2013 general Government revenues. The projections for Government revenues were made based on the projected rates of economic recovery and inflation.

In accordance to 2014 Budget Law, Central Government expenditures in 2014 are projected to be approximately €1,337.61 million or 38.61. per cent. of projected GDP, which would represent a 6,4 per cent. increase as compared to the planned 2013 central Government expenditures. General Government expenditures are projected to be approximately €1,471.84 million, or 41.85 per cent. of projected GDP, which is 7 per cent. higher than the planned 2013 general Government expenditures principally as a result of. increase of 36 million of euro, in budgeted capital expenditures, as compared to the planned 2013 central Government capital expenditures, what is around 55 per cent of budget capital expenditures.

The central Government budget deficit in 2014 is planned to be ly €69.6 million, or 1,98 per cent. of projected GDPThe general Government budget deficit in 2014 is planned to be €46.0 million, or 1.3 per cent. of projected GDP.

Forecasts for 2015 and 2016

The following table sets out a summary of the forecast general Government budget revenues and expenditures (which consist of the revenues and expenditures of the central Government budget and the municipal budgets) for the years 2015 and 2016. These are based on a number of economic, fiscal and other assumptions. The actual results may differ materially from these projections.

	Forecast 2015[(1)]		**Forecast 2016[(1)]**	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*
Government budget revenues..	**1447.7**	**38.8**	**1502.2**	**37.9**
Tax revenues.......................	1313.0	37.3	1363.8	38.8
Non-tax revenues................	134.8	3.8	138.5	3.9
Government budget expenditures	**(1450.9)**	**(39.0)**	**(1475.9)**	**(37.2)**
Non capital expenditure.......	(1309.3)	(35.1)	(1330.1)	(33.5)
Capital expenditure.............	(141.6)	(3.8)	(145.8)	(3.7)
Financial balance	**(3.1)**	**(0.1)**	**26.4**	**0.7**

Source: Ministry of Finance

The following table sets out a summary of the forecast central Government budget revenues and expenditures for the years 2015 and 2016. The following figures are Government projections that are based on a number of economic, fiscal and other assumptions. The actual results may differ materially from these projections.

	Forecast 2015[1]		Forecast 2016[1]	
	(€ million)	*(% GDP)*	*(€ million)*	*(% GDP)*
Central Government budget revenue	**1285.8**	**34.5**	**1336.2**	**33.7**
Tax revenues	1219.9	32.7	844.4	21.3
Direct taxes	545.8	14.6	567.6	14.3
Personal income tax	91.1	2.4	94.8	2.4
Corporate income tax	45.5	1.2	47.3	1.2
Tax on property sales	1.6	0.0	1.6	0.0
Social security contribution	407.6	10.9	423.9	10.7
Indirect taxes	668.8	17.9	695.3	17.5
Valued added taxes	467.2	12.5	485.9	12.2
Excise tax	177.1	4.8	184.2	4.6
Customs duties	24.6	0.7	25.3	0.6
Other taxes	5.2	0.1	5.4	0.1
Non tax revenue	65.9	1.8	67.8	1.7
Central Government budget expenditure	**(1311.1)**	**(35.2)**	**(1,332.7)**	**(33.6)**
Non capital expenditure	(**1205.5**)	**32.3**	(**1223.9**)	(**30.8**)
Capital expenditure	(**105.6**)	(**2.8**)	(**108.8**)	(**2.7**)
Financial balance	**(25.3)**	**(0.7)**	**3.6**	**(0.1)**

Source: Ministry of Finance

The following table sets out a summary of the forecast municipal Government budget revenues and expenditures for the years 2015 and 2016. The following figures are Government projections that are based on a number of economic, fiscal and other assumptions. The actual results may differ materially from these projections.

	Forecast 2015[1]		Forecast 2016[1]	
	(€ million)	*(% of GDP)*	*(€ million)*	*(% of GDP)*
Municipal Government budget revenues	**162.0**	**4.3**	**166.0**	**4.2**
Tax revenues	93.1	2.5	95.4	2.4
Direct taxes	40.6	1.1	41.5	1.1
Personal income tax	25.9	0.7	26.5	0.7
Tax on property sales	14.7	0.4	15.0	0.4
Local taxes	52.5	1.4	53.8	1.4
Non tax revenue	54.1	1.4	55.6	1.4
Other revenues	14.8	0.4	15.1	0.4
Municipal Government budget expenditures	**(140.3)**	**(3.8)**	**(143.7)**	**(3.6)**
Non capital expenditure	(104.3)	(2.8)	(106.7)	(2.7)
Capital expenditure	(36.0)	(1.0)	(37.0)	(0.9)
Transfers from Central Budget	0.5	0.0	0.5	0.0
Financial balance	**22.2**	**0.6**	**22.8**	**0.6**

Source: Ministry of Finance

INDEBTEDNESS

Overview

As of 31 December 2013, the State Debt of Montenegro were in amounts of 1.873,2 million or 56,6% of the Gross Domestic Product (GDP).[1]

The 2013 Law on Budget provides for borrowings amounting to €250 million, so that borrowing in the current year is realized within the set limits despite the activated guarantees for credit arrangements between KAP and foreign creditors. The total paid guarantees for KAP amounted to €102.7 million. On the basis of better effects in revenue collection, the need for additional borrowings for the needs of financing of budget spending caused by the activation of guarantees has been reduced.

During 2013, credit arrangements in amount of €248.5 million have been concluded and realized. Part of the funds was provided from the international market, through the issuance of bonds and signing of bilateral agreements, while part of the funds was provided from domestic sources.

In the period 2013-2017, repayment of a significant portion of liabilities for credit arrangements concluded in the last few years is foreseen, which will significantly reduce the burden in the form of payment of interest and principal. Bearing in mind the anticipated repayment a significant increase of obligations relating to the interest repayment is not expected.

The analysis of credit arrangements concluded in 2013 shows an evident decline in interest rates to 5.75% (margin) which represents an improvement in credit conditions compared to those that were concluded in the previous period, and it can be concluded that a certain progress has been made in providing better financing conditions as well as the improvement of the position on international market.

In addition to these measures, in the area of public debt management follow-up activities are planned which relate to obligations cost analysis and undertaking measures that would lead to a reduction of costs arising from debt servicing. The subject of special attention will be lending arrangements entered into in the previous period, with high interest expenditures, as well as for issued bonds. In this regard Ministry will consider possibility, in the course of 2014, of issuing bonds in a higher amount than the planned for the purpose of budget financing (€240 million), under favourable terms of repayment, in order to partially meet the obligations arising from previous bonds, which were issued in 2010 and 2011.

In particular, bonds would be issued in the amount to cover financing needs in 2014, and part would be used to reprogram part of the previously issued bonds. Bond issuance in a higher amount is aimed to provide more favorable terms of financing, that is lower interest rates, as well as placement of bonds that would be more liquid, that is, more interesting for investors. In this way, Montenegro will provide a better position in the international capital markets and, consequently, the easier and cheaper access to funding sources. Also, repayment of obligations in 2015 and 2016 would be reduced, because the debt repayment reprogramming, 50% of the existing debt repayment obligations would reduce by €100 million in 2015 and €90 million in 2016.

Based on the 2014 Budget Law, and the projected deficit and debt for the year 2014, borrowing in the amount of €240 million is planned, which will cause an increase in debt to the level of around €2,000 million or about 57% of the estimated GDP. Additional borrowing refers to the need of financing budget deficit, servicing obligations and creating fiscal reserves. Internal debt

[1] Date for State Debt on 31.12.2013. are preliminary, The changes can be made in municipality obligations, where the final date have not been yet finalized.

at the end of 2014 will be reduced by about €38 million, while the external debt will be increased by some €170 million.

Table 1 Government debt trend in the period 2013 - 2016 –base scenario[2]

Type of debt	30 September 2013	2013	2014	2015	2016
GDP	**3,311**	**3,311**	**3,516**	**3,730**	**3,968**
foreign debt	1,363.9	1,443.5	1,612.7	1,731.9	1,809
% GDP	**41.19**	**43.60**	**45.87**	**46.43**	**45.59**
domestic debt	480.9	426.9	388.6	332.1	282.6
% GDP	**14.52**	**12.89**	**11.05**	**8.90**	**7.12**
Total	1,844.8	1,870.4	2,001.3	2,064	2,091.6
% GDP	**55.72**	**56.49**	**56.92**	**55.34**	**52.71**

At the end of 2014, it is planned a slight increase of debt to 56.9% of GDP by around 0.5% of GDP is expected, after which their decline in projected. In nominal terms, debt will increase from €1,870.4 million in 2014 to €2,091.6 million in 2016 due to the need of financing the Budget. In particularly, withdrawal of almost €226 million is foreseen in 2014 for the financing of government spending, while the Budget Law for 2014 established the possibility of borrowing amounting to €240 million. In 2015, the necessary funds for financing debt and deficit repayment amount to approximately €450 million, while that amount for 2016 is foreseen to be around €380 million.

At the same time, in the abovementioned period of time withdrawal of funds under other financial arrangements is planned which will amount to approximately €30 million per year.

In the course of 2014 funds for budget financing will be provided, as already mentioned, through the bond issuance on international market, domestic market or concluding of bilateral agreements.

[2] Borrowing for highway is not calculate in projection