

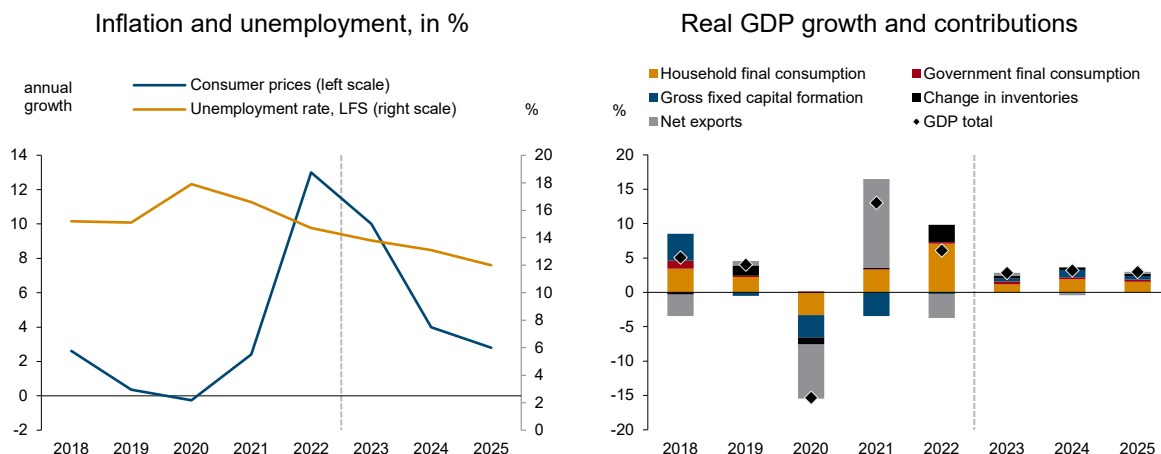


MONTENEGRO: A new era ahead

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Private consumption flourished in 2022, following a tax reform that resulted in very high GDP growth of 6.1%. Against all the odds, fiscal policy is still expansionary and fiscal risks are thus rising. A further rebound in tourism and expansion of the energy sector will be the main drivers of economic growth in 2023, which is projected to be 2.9%. The recent presidential election witnessed the triumph of the new ‘Europe Now’ party, which will likely win a significant share in the June parliamentary election, too, and could be a game changer in contemporary Montenegrin (geo)politics.

Figure 5.14 / Montenegro: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Montenegro's economy witnessed growth in 2022 of 6.1%, thanks to a record surge in private consumption. Household spending flourished (9.7% growth) despite high inflation, as a tax reform boosted net salaries by 18.4% in real terms. At about 9% annually, the increase in household credit matched the rise in private consumption. Growth was also supported by earnings from tourism, which rose by 35% annually (though still 17% short of pre-pandemic levels). There is likely to be a full rebound in revenue from tourism in 2023: tourist arrivals in January and February were already up 57% on 2022, while improved airline connectivity to the EU countries should boost the summer season. The energy sector will be another growth driver: in 2022, it achieved solid exports at record prices, and in the medium term it is expected to expand its solar and wind farm infrastructure, helped along by the European Bank for Reconstruction and Development. These projects are part of the plan to ‘green’ the energy sector and could have important economic implications, if they are implemented successfully.

Private consumption growth will slowly subside this year, but tourism and the energy sector will drive GDP growth to 2.9% in 2023 – and in the medium term to around 3%.

Inflation will continue in double digits in 2023. In February 2023, inflation stood at 15.1% – down from 17.2% in December 2022. However, it will take longer to get it into single digits. Higher excise duties are expected to be introduced in July on certain items (e.g. food, tobacco and plastic products). That – combined with a lack of monetary and fresh fiscal tools to combat inflation – could result in inflation averaging 10% in 2023.

The surge in real estate prices is another cause for concern. Despite a boom in supply, over the past two years the rise in real estate prices has been in double digits: in December 2022, the cost of new dwellings was 20% greater than a year previously. Several factors have contributed to this phenomenon: foreign direct investment (FDI) in real estate amounted to 38.9% of total FDI last year – its biggest share for nine years and slightly above the figure for 2008 (37.8%), the year preceding the real estate bust in Montenegro. The demand for real estate has been boosted by Russians and Ukrainians: the war has prompted them to attempt to safeguard their savings by purchasing property in Montenegro or even relocating there. Another factor is that higher incomes following the tax reform have brought about increased demand for housing, which has similarly pushed prices up. However, as inflation continues to erode purchasing power and as interest rates continue to rise, real estate prices could start falling soon. On a positive note, the Central Bank of Montenegro has put in place the macroprudential tools necessary to minimise the potential risk from a real estate boom.

The current account deficit reached single digits in 2021 for the first time in a decade; however, this positive result has proved short lived. The deficit widened from 9.2% of GDP in 2021 to 13.3% in 2022, following a big surge in imports of goods at a time of higher food and energy prices and greater domestic demand. However, we forecast that the current account deficit will decline over the medium term (although it will remain in double digits), thanks to larger exports of energy and a possible diversification of the economy towards manufacturing (two food-processing companies have opened in the past year).

The fiscal risks are continuing to rise. In 2022, government debt was over 70% of GDP and the government deficit was above 5% of GDP – both figures well above the Maastricht criteria (60% and 3%, respectively). They were thus at approximately the level of pre-pandemic times – mainly on account of rising economic activity. However, the fiscal outlook may become gloomier, as public spending rises due to higher social benefits. The risks are also greater because of the 2022 populist tax reform, which abolished healthcare contributions, raised the minimum wage to EUR 450 and reduced budget revenues as a share of GDP by 5 percentage points. Earlier this year, the government borrowed EUR 100m from Deutsche Bank at the highest interest rate Montenegro has ever agreed to for a loan (5.9% plus a six-month Euribor rate, currently 3.3%). The government's strategy document (*Programme of Economic Reforms*) makes it plain that further loans are on the cards, and that the high debt and deficit levels are planned by the government itself.

A political novice and driving force behind the tax reform, Jakov Milatović won the presidential elections held in April 2023, putting an end to the three-decade dominance of the presidency by the Democratic Party of Socialists (DPS). The result showed clearly that a large majority (60%) wanted change and a better standard of living. The tax reform has contributed to this, despite the long-term

fiscal costs and risks. The 'Europe Now' movement, whose founding member is also the newly elected president, is now predicted to win a significant share of the vote in the parliamentary elections scheduled for June of this year.

While the change in the political elite looks likely to be more permanent, it will need to confront the elephant(s) in the room. First, whatever the government, it will have to set the country on a sounder fiscal track. The problem is compounded by the fact that the fragile healthcare system will no longer be financed by social contributions, and will thus require more fiscal spending. The second challenge will be to strengthen the institutions: the last two years have seen an unprecedented collapse of the institutional framework. The constitutional court is still incomplete, and last December the parliamentary majority passed amendments to the Law of the President, with the aim of further diminishing the already largely figurehead role of the president, despite warnings from the EU and the Venice Commission. The third challenge will be to form a stable government: Montenegro is a NATO member, but some potential coalition members side with Russia and oppose NATO – that is likely to prolong the political instability. The final challenge will be to return Montenegro to the EU path, from which it has deviated in recent years.

'Europe Now' may lead to 'Open Balkan'. The newly elected president is in favour of the Open Balkan initiative. This initiative has not been well communicated to the public, but some of its clear goals are to abolish border controls and allow the free movement of labour among the Western Balkan countries. To date, only Serbia, North Macedonia and Albania have decided to join the initiative. The advantages of Montenegro potentially joining it are spurious: for instance, a study by the Ministry of European Affairs has shown that the costs to Montenegro would be higher than the benefits it would receive. Yet, if the initiative leads to a lowering of non-tariff trade barriers, it could bring the country some economic benefits, beyond the benefits derived from CEFTA. The primary goal of the Western Balkan region via this initiative, however, should be to achieve greater embeddedness in European value chains and to encourage the export industries toward the higher value-added end of global value chains. This will remain a challenge for a service-based economy such as Montenegro's.

Table 5.14 / Montenegro: Selected economic indicators

	2019	2020	2021	2022 ¹⁾	2023	2024 Forecast	2025
Population, th pers., average	622	621	619	618	619	618	618
Gross domestic product, EUR m, nom.	4,951	4,186	4,955	5,797	6,600	7,100	7,500
annual change in % (real)	4.1	-15.3	13.0	6.1	2.9	3.2	3.0
GDP/capita (EUR at PPP)	15,700	13,440	15,540	16,860	.	.	.
Consumption of households, EUR m, nom. ²⁾	3,534	3,400	3,617	4,417	.	.	.
annual change in % (real)	3.1	-4.6	4.0	9.7	1.5	2.5	2.0
Gross fixed capital form., EUR m, nom.	1,352	1,166	1,096	1,259	.	.	.
annual change in % (real)	-1.7	-12.0	-12.3	-1.1	2.0	5.0	2.5
Gross industrial production ³⁾							
annual change in % (real)	-6.3	-0.9	4.9	-3.3	8.0	4.0	3.0
Net agricultural production ⁴⁾							
annual change in % (real)	-2.2	1.1	-0.5	4.0	.	.	.
Construction output ¹⁾							
annual change in % (real)	10.7	-5.5	-4.8	-4.4	.	.	.
Employed persons, LFS, th, average ⁵⁾	243.8	219.4	212.6	251.2	257	265	273
annual change in %	2.7	-10.0	-3.1	18.2	2.5	3.0	3.0
Unemployed persons, LFS, th, average ⁵⁾	43.4	47.8	42.2	43.2	40	40	40
Unemployment rate, LFS, in %, average ⁵⁾	15.1	17.9	16.6	14.7	13.8	13.1	12.0
Reg. unemployment rate, in %, eop	16.2	20.1	24.7	20.1	.	.	.
Average monthly gross wages, EUR	773	783	793	883	960	1,020	1,070
annual change in % (real, gross)	0.6	1.6	-1.1	-1.5	-1.0	2.0	2.5
Average monthly net wages, EUR ⁶⁾	515	524	532	712	780	820	860
annual change in % (real, net)	0.4	2.1	-0.9	18.4	-1.0	1.5	2.5
Consumer prices, % p.a.	0.4	-0.3	2.4	13.0	10.0	4.0	2.8
Producer prices in industry, % p.a. ⁷⁾	2.4	-0.1	1.3	11.2	6.0	4.0	2.6
General governm. budget, nat. def., % of GDP							
Revenues	43.4	44.6	44.3	39.7	39.2	39.0	38.9
Expenditures	45.4	55.7	46.2	44.8	44.2	43.8	43.5
Deficit (-) / surplus (+)	-2.0	-11.1	-1.9	-5.2	-5.0	-4.8	-4.6
General gov. gross debt, nat. def., % of GDP	76.5	105.3	84.0	70.8	73.0	70.0	67.0
Stock of loans of non-fin. private sector, % p.a.	6.6	2.9	3.4	8.8	.	.	.
Non-performing loans (NPL), in %, eop	4.7	5.5	6.2	5.7	.	.	.
Central bank policy rate, % p.a., eop ⁸⁾	5.46	5.33	5.16	5.45	5.8	5.5	5.4
Current account, EUR m	-707	-1,090	-456	-773	-770	-760	-752
Current account, % of GDP	-14.3	-26.1	-9.2	-13.3	-11.7	-10.7	-10.0
Exports of goods, BOP, EUR m	466	409	526	763	990	1,070	1,120
annual change in %	6.8	-12.2	28.6	45.2	30.0	8.4	5.0
Imports of goods, BOP, EUR m	2,531	2,051	2,441	3,439	3,820	4,070	4,240
annual change in %	1.8	-19.0	19.0	40.9	11.1	6.6	4.1
Exports of services, BOP, EUR m	1,706	679	1,597	2,289	2,580	2,780	2,960
annual change in %	9.1	-60.2	135.2	43.3	12.9	7.8	6.4
Imports of services, BOP, EUR m	687	503	641	971	1,070	1,140	1,210
annual change in %	9.6	-26.8	27.5	51.5	10.2	7.0	6.5
FDI liabilities, EUR m	372	466	591	833	.	.	.
FDI assets, EUR m	67	-5	9	50	.	.	.
Gross reserves of CB excl. gold, EUR m ⁹⁾	1,367	1,739	1,749	1,915	.	.	.
Gross external debt, EUR m	8,287	9,275	9,501	9,421	10,560	11,290	11,850
Gross external debt, % of GDP	167.4	221.6	191.7	162.5	160.0	159.0	158.0

1) Preliminary and wiiw estimates. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on gross value added data. - 5) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 6) From 2022 net wages excluding health insurance contributions and including an impact of personal income tax reform. - 7) Domestic output prices. - 8) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 9) Data refer to reserve requirements of the Central Bank.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.