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Montenegro: the fruits of independence

The first year of independence has proved to be quite successful. The uncertainties that surrounded the May 2006 referendum were resolved with the results coming out in favour of independence and with the calm post-referendum political developments. The ruling coalition won the parliamentary elections in September 2006 and had no difficulties in forming the government. Surprisingly, the long-time prime minister and sometime president of Montenegro, Milo Djukanović, stepped down and was replaced by another prominent member of his Democratic Party of Socialists, Željko Sturanović. Altogether, the political transition went on quite smoothly.

The integration of Montenegro into the international community also went quite quickly and with no hiccups. Most importantly, the EU resumed the negotiations on the Stabilization and Association Agreement (SAA), which had been discontinued early in 2006 due to Serbia's non-cooperation with the Hague Tribunal. Once Montenegro had declared independence, the European Commission drafted a new mandate for negotiations, which should be concluded with the signing of the SAA in the first half of 2007.

The economy reacted favourably to independence, though the results of the referendum were in accordance with the expectations. The fears that there might be negative consequences for tourism or that there may be sudden capital flight due to increased uncertainty about the ability of Montenegro to govern itself, proved to be unfounded. Quite to the contrary, the stock exchange reported significant advances and foreign investments were at an all-time high. Also, the tourist season was very good, though the potential for growth is much greater. All in all, GDP growth was rather strong, historically speaking, at around 4.5%.

Data on consumption and investment are not available, so it is not easy to pin down the sources of growth. Fiscal data indicate improvements in revenue collection and a further narrowing of the fiscal deficit. Public expenditure did increase, ahead of the referendum and the elections that followed, so that has certainly contributed to growth. Private investments in services have also gone up, according to indirect evidence from real estate prices and the performance of the stock exchange. Private consumption must have also increased, though it is hard to say by how much precisely.

The sharp deterioration of the trade balance and the current account indicate that the increased inflow of foreign investments has gone into imports. Also, private transfers such as remittances might have increased, as has been true of the Balkan region as a whole. Finally, credit expansion by the increasingly more active and confident banks, which are mostly private and foreign-owned, has contributed to private consumption and investment.

These positive financial developments have been supported by price stability, with inflation being at a level that is quite comparable to that in the EU. Montenegro uses the euro, which has contributed positively to the expectations about inflation.

Unlike services, industrial production has continued to struggle. Growth has been 1% for the whole year. Given that de-industrialization has been rather severe in Montenegro, the continuing lack of vitality in this sector highlights problems with competitiveness. As in other economies in the Balkans with a large tourist sector, the emergence of the Dutch disease can be suspected. Data on wages and incomes do not necessarily confirm that, but it is questionable how reliable those are. It is also true that there are significant regional differences in this very small country, which are partly the consequence of its geography. Montenegro is very mountainous and its infrastructure is not developed enough for that not to be a problem for industrial development. Investments in roads and in the improvement of the railroads are being made, but that will take time.

The new government of Mr Sturanović is facing pressures to speed up reforms. As administrative capacity is not very high, both the design of reforms and their implementation are not easy tasks. Technical assistance from the USA has been helpful and it is to be expected that the EU will increase its presence too now that the country is nearing its first contractual relationship with the Union. For a number of years, the soundness of the fiscal sector was the main concern. With the aid and assistance of USAID, significant improvements have been achieved. The ministry of finance is confident that it will balance the general budget in the near future. Due to the fact that the country uses the euro, the main internal policy risks are associated with fiscal policy. With the elections over and with the prospects for growth improving, the risks to fiscal destabilization are very low indeed.

The prospects for growth in the short and medium run are quite good. Foreign investments should continue to flow into the country due to speeding up privatizations and the growth of tourism. The key challenge will be the turnaround in industrial production and an increase in employment. In the next couple of years, significant advances in administrative capacity have to be made in order to speed up the process of EU integration.

Table ME

Montenegro: Selected Economic Indicators

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ¹⁾ | 2007 forecast | 2008 forecast |
|--|--------|--------|--------|--------|--------|--------|--------------------|------------------|------------------|
| Population th pers., mid-year ²⁾ | 612.5 | 614.8 | 617.1 | 620.3 | 622.1 | 623.3 | 625 | . | . |
| Gross domestic product, EUR mn, nom. ³⁾ | 1022.2 | 1244.8 | 1301.5 | 1392.0 | 1565.1 | 1690.0 | 1759.0 | 2000 | 2000 |
| annual change in % (real) | . | -0.2 | 1.7 | 2.4 | 4.2 | 4.3 | 4.5 | 5 | 5 |
| GDP/capita (EUR at exchange rate) | 1669 | 2025 | 2109 | 2244 | 2516 | 2711 | 2814 | . | . |
| GDP/capita (EUR at PPP - wiiw) | 4640 | 4710 | 4910 | 4990 | 5350 | 5650 | 5990 | . | . |
| Gross industrial production ⁴⁾ | | | | | | | | | |
| annual change in % (real) | 4.2 | -0.7 | 0.6 | 2.4 | 13.8 | -1.9 | 1.0 | 3 | 3 |
| Net agricultural production | | | | | | | | . | . |
| annual change in % (real) | -5.0 | 6.9 | 5.9 | 1.0 | 3.8 | -0.9 | . | . | . |
| Construction industry | | | | | | | | . | . |
| annual change in % (real) | . | . | . | . | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 721.7 | 938.3 | 1067.3 | 1024.8 | 1137.3 | . | . | . | . |
| real growth rate, % | . | 4.7 | 6.4 | . | . | . | . | . | . |
| Gross fixed capital form., EUR mn, nom. | 179.8 | 226.7 | 198.9 | 200.8 | 286.1 | . | . | . | . |
| real growth rate, % | . | 16.7 | -16.1 | . | . | . | . | . | . |
| LFS - employed persons, th, Oct ⁵⁾ | 230.3 | 214.4 | 220.6 | . | 187.3 | 178.8 | 179.6 | . | . |
| annual change in % | . | -6.9 | 2.9 | . | . | -4.5 | 0.5 | . | . |
| Reg. employees in industry, th pers., avg. | . | 36.7 | 35.8 | 34.1 | . | . | . | . | . |
| annual change in % | . | . | -2.3 | -5.0 | . | . | . | . | . |
| LFS - unemployed, th pers., average ⁵⁾ | 54.9 | 57.5 | 57.7 | . | 71.8 | 77.8 | 77 | . | . |
| LFS - unemployment rate in %, Oct. ⁵⁾ | 19.3 | 23.7 | 20.7 | . | 27.7 | 30.3 | 30 | 30 | 30 |
| Reg. unemployment rate in %, end of period ⁶⁾ | . | . | . | 32.9 | 29.3 | 25.2 | 15 | 15 | 15 |
| Average gross monthly wages, EUR ⁷⁾ | 151 | 176 | 251 | 271 | 303 | 326 | 377 | . | . |
| annual change in % (real, net) | 1.0 | 8.0 | . | 9.3 | 9.1 | 6.7 | 12.0 | . | . |
| Consumer prices, % p.a. | 20.2 | 21.8 | 16.0 | 6.7 | 2.4 | 2.3 | 3.0 | 3 | 3 |
| Producer prices in industry, % p.a. | . | . | 14.5 | 4.5 | 5.8 | 2.1 | 2 | 3 | 3 |
| Central governm. budget, nat.def., % GDP ⁸⁾ | | | | | | | | | |
| Revenues | . | 17.8 | 17.7 | 24.2 | 23.8 | 25.4 | . | . | . |
| Expenditures | . | 20.8 | 20.5 | 27.4 | 25.9 | 27.2 | . | . | . |
| Deficit (-) / surplus (+), % GDP | -6.0 | -3.1 | -2.8 | -3.1 | -2.1 | -1.8 | -1.6 | -1 | -1. |
| Public debt in % of GDP | . | . | . | . | . | . | . | . | . |
| Discount rate, % p.a., end of period | . | . | . | . | . | . | . | . | . |
| Current account, EUR mn ⁹⁾ | . | -195.4 | -163.4 | -102.1 | -119.6 | -154.0 | -300 | -300 | -300 |
| Current account in % of GDP | . | -15.7 | -12.6 | -7.3 | -7.6 | -9.1 | -17.1 | -15.0 | -15.0 |
| Gross reserves of NB, excl. gold, EUR mn | . | . | . | . | . | . | . | . | . |
| Gross external public debt, EUR mn | . | . | 893.6 | 461.5 | 488.6 | 513.3 | 630 | . | . |
| Gross external public debt in % of GDP | . | . | 68.7 | 33.2 | 31.2 | 30.4 | 36 | . | . |
| FDI net, EUR mn | . | 10.6 | 89.2 | 38.7 | 50.6 | 381.2 | 350 | . | . |
| Exports of goods, BOP, EUR mn ¹⁰⁾ | . | 235.4 | 322.6 | 270.6 | 452.1 | 460.6 | 530 | 610 | 700 |
| annual growth rate in % | . | . | 37.1 | -16.1 | . | 1.9 | 15 | 15 | 15 |
| Imports of goods, BOP, EUR mn ¹⁰⁾ | . | 722.9 | 747.3 | 629.9 | 868.6 | 974.3 | 1220 | 1470 | 1760 |
| annual growth rate in % | . | . | 3.4 | -15.7 | . | 12.2 | 25 | 20 | 20 |
| Exports of services, BOP, EUR mn | . | 150.2 | 171.7 | 191.3 | 249.5 | 329.8 | 445 | . | . |
| annual growth rate in % | . | . | 14.3 | 11.4 | 30.4 | 32.2 | 35 | . | . |
| Imports of services, BOP, EUR mn | . | 53.4 | 71.7 | 79.7 | 101.4 | 134.3 | 201 | . | . |
| annual growth rate in % | . | . | 34.3 | 11.1 | 27.2 | 32.5 | 50 | . | . |
| Average exchange rate USD/EUR | 0.92 | 0.90 | 0.94 | 1.13 | 1.24 | 1.24 | 1.26 | . | . |
| Purchasing power parity USD/EUR, wiiw ¹¹⁾ | 0.32 | 0.38 | 0.37 | 0.38 | 0.40 | 0.40 | 0.38 | . | . |
| Purchasing power parity EUR/EUR, wiiw ¹¹⁾ | 0.36 | 0.43 | 0.43 | 0.45 | 0.47 | 0.48 | 0.47 | . | . |

Note: From 2002 the term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2003 according to census November 2003; 2006 wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 6) In % of unemployed plus employment (excluding individual farmers). - 7) From 2002 including various allowances and new personal income tax system. - 8) Revenues excluding grants, expenditures excluding net lending. - 9) Including all transactions with Serbia. - 10) From 2004 including trade with Serbia and Kosovo based on customs statistics (before on ITRS). - 11) Estimate based on a 45% price level (EU-25=100) in 2003 and extrapolation with GDP deflator.

Source: wiiw Database incorporating national statistics; wiiw forecasts.