

# MONTENEGRO

## Recent developments

**Table 1** 2018

Population, million	0.6
GDP, current US\$ billion	5.2
GDP per capita, current US\$	8365
Upper middle-income poverty rate (\$5.5) <sup>a</sup>	4.8
Gini index <sup>a</sup>	319
School enrollment, primary (% gross) <sup>b</sup>	96.0
Life expectancy at birth, years <sup>b</sup>	77.1

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2014), 2011 PPPs.

(b) Most recent WDI value (2016)

*Strong investment activity, another record-high tourism season, and increased industrial production drove GDP growth to an estimated 4.4 percent in 2018. Solid growth is reflected in improved labor market dynamics as the unemployment rate reached a historic low. Poverty is estimated to have declined since 2012. External imbalances remain high due to import-dependent investments. Gradual fiscal consolidation led to a reduced fiscal deficit, but higher than planned expenditures delayed reaching a balanced budget until next year.*

Montenegro's economic growth remains robust. In the first three quarters of 2018, the economy expanded by 4.9 percent, bringing the estimated annual GDP growth to 4.4 percent. Both private and public investments accelerated, and the tourism season recorded another strong year. Investment grew by an estimated 15 percent in 2018 led by investments in tourism and energy and supported by the motorway construction. Private consumption grew by an estimated 3 percent, supported by solid employment and credit growth. Given the high import-dependence of the investment projects, net exports were negative. On the production side, industrial production growth was led by energy production, supporting stronger electricity exports. By year-end, manufacturing strengthened, while the mining sector contracted. Construction growth of 25 percent and retail trade growth of 3.4 percent supported strong economic activity.

The strong economic performance is reflected in recent labor market dynamics. Employment grew by 4.3 percent in 2018, mostly in construction, tourism, services, and the public sector. The administrative employment data show that the total number of unemployed declined by 13.7 percent in 2018, resulting in a registered unemployment rate of 17.8 percent in December 2018 from 22.4 percent in December 2017. The survey-based unemployment rate, which better captures informal employment, declined to a historic low of

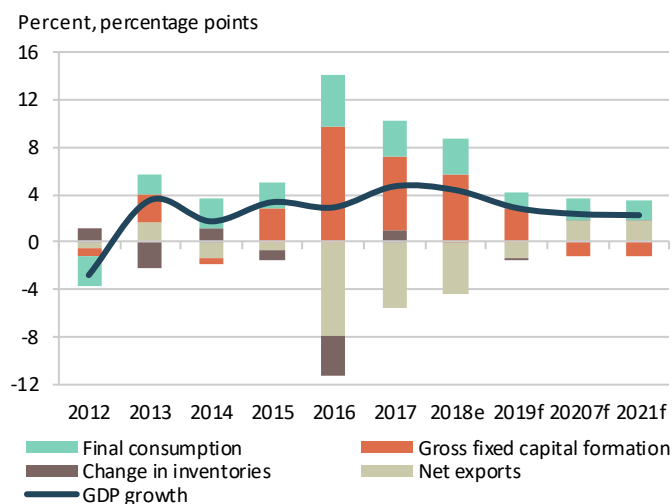
15.2 percent. At the same time, the survey-based participation and employment rates reached their record highs of 56 percent and 47.5 percent, respectively. Due to strong economic activity, the youth employment rate went up in 2018.

The external deficit further widened in 2018 to an estimated 17.1 percent of GDP. Solid growth of exports of goods and services was led by rising tourism, transport, electricity, and chemical products. Export growth, however, was outpaced by real import growth, largely driven by import-dependent investments. Specifically, the imports of machinery and equipment, oil, steel, iron, minerals, and furniture further increased in 2018. The primary income account surplus declined due to higher dividend and interest payments. In 2018, net FDI inflows declined to 7.1 percent of GDP, because of repayment of intercompany debt and government repurchases of shares of the power utility company. External debt is estimated at 168 percent of GDP in 2018.

In 2018, average annual CPI inflation stood at 2.6 percent, driven by increased prices of transport, alcohol, and tobacco. With nominal wages flat, inflation caused real gross wages to decline by more than 2 percent.

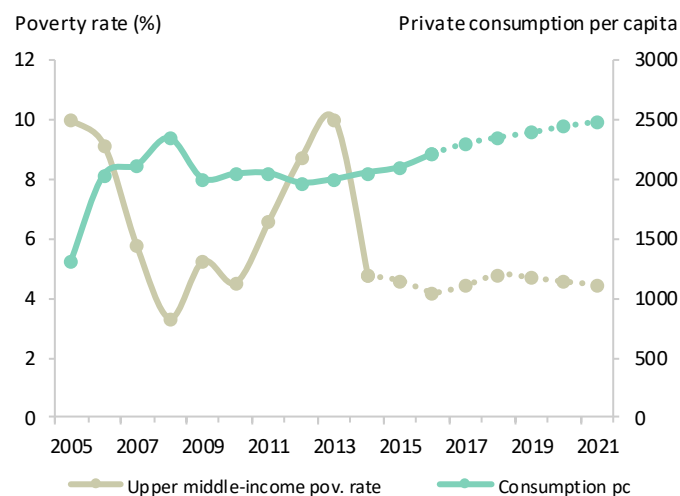
Solid growth and labor market improvements reduced poverty (measured as consumption below the standardized middle-income-country poverty line of \$5.5/day 2011PPP) from 8.7 percent in 2012 to an estimated 4.8 percent in 2018. In 2018, poverty reduction slowed down due to the mother's benefit withdrawal, real gross wages decline, and the rise in indirect taxes.

**FIGURE 1 Montenegro / Real GDP growth and contributions to real GDP growth**



Sources: MONSTAT, World Bank.

**FIGURE 2 Montenegro / Actual and projected poverty rates and real private consumption per capita**



Source: World Bank. Notes: see table 2.

The financial sector has remained stable during the ongoing resolution of two smaller, non-systemic banks, one of which is in bankruptcy. But a rapid resolution focusing on the overall strength of the sector in observance of regulations is critical to maintain financial sector stability. The financial sector capital adequacy ratio of 16.5 percent as of October 2018 is above the 10 percent regulatory minimum. Overall credit grew by 8.5 percent y-o-y by December 2018, driven by household and general government lending. The loan-to-deposit ratio of 85 percent indicates plenty of liquidity in the system. Deposits grew by 5.9 percent y-o-y with both corporate and households deposits up. A recovery in credit growth helped to reduce non-performing loans to 6.9 percent of total loans.

The gradual fiscal consolidation program has reduced the fiscal deficit, but higher-than-planned public spending is delaying the Fiscal Strategy goal of balancing the budget. After reaching 5.6 percent in 2017, the fiscal deficit is estimated to have fallen to 3.8 percent of GDP in 2018. Revenue growth of 10.1 percent was supported by higher VAT, income tax, and non-tax revenues. Public spending went up by 5.5 percent due to higher capital spending and spending on wages and good and services. Public debt is projected to have peaked at 70.8 percent of GDP, and public

and publicly guaranteed debt at 75.4 percent in 2018.

## Outlook

The economy is expected to grow by an average of 2.5 percent in 2019-21. GDP growth is expected to slow down as private investment levels off after the strong increase in 2018 and the large public infrastructure investment projects gradually phase out. After a moderation in 2019, due to the fiscal consolidation and the implementation of the public administration staff reduction plan, private consumption and employment growth are expected to rebound in 2020. Increasing political and overall uncertainty will likely weigh on private consumption and investments. Inflation is projected at 1.9 percent over the medium term due to increasing excises and the announced electricity prices increase.

Current imbalances are expected to slowly moderate as investment-dependent infrastructure projects phase out.

Due to higher capital expenditures, the fiscal deficit will reach 3.0 percent in 2019 but is projected to turn into a surplus in 2020-2021 as the first phase of the motorway construction is completed.

The still large financing needs, which are estimated to average EUR 460 million over 2019-2021, again highlight the importance to fully commit to the implementation of planned fiscal consolidation.

Subject to improvements in private sector employment and earnings, poverty is expected to decline to an estimated 4.7 percent in 2019 as the fiscal consolidation phases out.

## Risks and challenges

Notwithstanding the positive outlook, there are significant downside risks. Apart from external factors, domestic risks are increasing due to increasing political uncertainty ahead of the elections in 2020, further cost overruns of the motorway project, and the vulnerability of some smaller banks. Mitigating these risks requires a firm commitment to the fiscal consolidation plan and an acceleration in implementing critical structural reforms in the labor market, social sectors, and the public administration. And it requires strengthening public institutions that enforce fair market competition to ensure that nobody benefits from special treatment and entrepreneurs are encouraged to compete by innovating.

**TABLE 2 Montenegro / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
<b>Real GDP growth, at constant market prices</b>	2.9	4.7	4.4	2.9	2.4	2.3
Private Consumption	5.4	3.9	3.0	2.1	2.4	2.0
Government Consumption	0.8	-1.4	2.9	-1.2	-0.3	-0.3
Gross Fixed Capital Investment	38.4	18.7	15.0	6.5	-2.8	-2.8
Exports, Goods and Services	5.9	1.8	6.6	3.7	4.6	4.8
Imports, Goods and Services	15.3	8.4	9.0	3.5	0.1	0.1
<b>Real GDP growth, at constant factor prices</b>	2.9	4.7	4.4	2.9	2.4	2.3
Agriculture	3.9	-3.1	0.0	0.1	0.5	1.0
Industry	22.7	18.9	5.0	3.4	2.9	2.5
Services	-22.9	-21.4	4.7	2.8	1.7	2.4
<b>Inflation (Consumer Price Index)</b>	-0.3	2.4	2.6	2.0	1.9	1.9
<b>Current Account Balance (% of GDP)</b>	-16.2	-16.1	-17.1	-17.1	-14.9	-11.4
<b>Net Foreign Direct Investment (% of GDP)</b>	9.4	11.3	7.1	8.7	8.4	7.9
<b>Fiscal Balance (% of GDP)</b>	-2.8	-5.6	-3.8	-3.0	0.2	2.2
<b>Debt (% of GDP)</b>	64.4	64.2	70.8	67.2	64.3	60.2
<b>Primary Balance (% of GDP)</b>	-0.7	-3.2	-1.8	-0.9	2.0	3.9
<b>Upper middle-income poverty rate (\$5.5 in 2011 PPP)<sup>a,b</sup></b>	4.2	4.4	4.8	4.7	4.6	4.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2009-HBS and 2014-HBS. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.

(b) Projection using point-to-point elasticity (2009-2014) with pass-through = 0.4 based on private consumption per capita in constant LCU, with estimated impact of fiscal consolidation.