The World Bank in Montenegro

Country Snapshot

An overview of the World Bank's work in Montenegro

April 2018

MONTENEGRO	2017
Population, million	0.6
GDP, current US$ billion	4.7
GDP per capita, current US$	7,528
Gini Coefficient (2013)	31.9
Life Expectancy at birth, years (2015)	76.9

At a Glance

- In response to macro and fiscal challenges, the Government has launched a fiscal consolidation program to tame fiscal risks and prevent further accumulation of debt. The World Bank is actively working with the Government in support of its fiscal consolidation agenda.
- To be competitive within the European Union (EU), Montenegro needs to create better conditions for private sector growth and job creation, and to invest in the skills required for modern labor markets.
- As Montenegro's remarkable natural endowments are a critical component of its long-term competitiveness and prosperity, they must be maintained and protected.
- The country is also highly vulnerable to climate change and natural disasters. The World Bank will continue working with the Government on this important agenda.

Country Context

Montenegro is a small, open economy aspiring to join the EU by 2025. It is also an economy vulnerable to external shocks, as it relies heavily on capital inflows from abroad to stimulate its growth.

Because of its size, the already high costs of developing and running national institutions are compounded by a limited capacity to exploit economies of scale in the provision of public goods and services. An EU-compatible legal framework and regulatory bodies, as well as the ability to absorb EU funds, all require substantial capacity building.

At the same time, the transition to a market economy requires a reduction in the state's footprint in the economy. Creating a favorable environment for private sector development requires restructuring state-owned enterprises (SOEs) and rationalization of public spending to reduce the cost of the state.

Montenegro started negotiations with the EU in June 2012 and strives to join by 2025, ahead of the other countries in the Western Balkans. Of the 35 negotiations chapters, three have been provisionally closed and 30 have been opened. In the latest European Commission (EC) Progress Report on Montenegro, the importance of maintaining macroeconomic stability was stressed, noting that the rapidly rising public debt and high fiscal deficits, together with high external imbalances and high unemployment are of particular concern.

The World Bank and Montenegro

The overarching objective of the World Bank Group's (WBG) new Country Partnership Framework covering the period FY16–20 is to support Montenegro on the path toward more sustainable and inclusive growth.

The new framework selectively supports Montenegro's development agenda, with a particular focus on creating employment and economic opportunities and restoring fiscal balance in order to accelerate long-term inclusive growth.

Montenegro faces the significant challenge of creating good jobs for its people; solving this problem requires action to strengthen the supply of labor as well as to increase the demand for labor from potential employers. Young job seekers need to be equipped with relevant skills, while less-skilled and more vulnerable segments of the population need access to opportunities and jobs.

Today, the growing public debt levels are making it more difficult to finance long-term private sector development at a pace needed for Montenegro to become a prosperous high-income country and move forward with EU accession.

Restoring macroeconomic and fiscal sustainability and strengthening the financial sector will be critical to ensuring a stable macro environment that stimulates private investment and job creation in the long term.

Key Engagement

Building on the successes of the original Montenegro Institutional Development and Agriculture Strengthening Project (MIDAS), in January 2018, the World Bank approved a EUR30.00 million loan for MIDAS 2 to help improve the competitiveness of agriculture and fisheries through enhanced delivery of government support in alignment with EU accession requirements.

WORLD BANK PORTFOLIO

No. of Projects: 5

IBRD Lending: $154.26 Million

Through a grant program, the project will increase economic activities in rural areas, generate jobs and leverage private investments through beneficiaries' contributions. This project will also provide much needed support to the fisheries sector. At the same time, the project will help Montenegrin producers to participate in the EU market and benefit from access to a larger demand for their products.

The original MIDAS project, which began in 2009, has achieved significant results. The most successful element of MIDAS has been the provision of grants modelled after the EU's pre-accession financial support scheme called IPARD to agricultural producers through Montenegro's public institutions. Around 660 farmers received IPARD-like grants to enhance their agricultural production.

MIDAS has also helped with strengthening institutions providing support and services in the areas of food safety, animal health, and rural development. Both MIDAS Projects are an example of excellent collaboration between the Ministry of Agriculture and Rural Development of Montenegro, European Union and the World Bank.

The MIDAS project has assisted Rasim Adzovic with greenhouse farming.

Recent Economic Developments

The economy grew by 4.3 percent in 2017. Investment made the strongest contribution to growth at 5 percentage points (pp), as the construction of the Bar-Boljare highway and residential construction accelerated. Consumption also grew, contributing an additional 3.7 percentage points, supported by employment and wage growth. Net exports continued to contribute negatively to growth, but in 2017 subtracted less from growth due to a record tourism season and a pickup in goods exports from the metal industry, driven by improved EU demand. Due to high import content, the growth impact of the higher investment for highway construction is subdued.

Credit growth increased by close to 12 percent in 2017, as household lending surged, amid subdued corporate lending. NPLs declined to 7 percent of total loans, supported by relaxed voluntary financial restructuring rules. Current account deficit further widened to 18.9 percent of GDP in 2017 on the back of rising construction-related imports and despite rise in exports of metals, mineral ore sales, and tourism. Still, after a decline in 2016 to 160 percent, external debt increased again in 2017 to an estimated 162 percent of GDP and remains the highest in the region.

The Government launched an ambitious fiscal consolidation program in 2017 reducing the deficit by one pp of GDP in 2017, compared to a no-reform scenario. By December, tax revenues increased by over 9 percent y-o-y led by improved collection of VAT and excises. Spending increased by close to 12 percent on the back of tripled capital budget. On the other hand, wage reduction and abolishment of the mothers benefit from the second half of 2017 helped decelerate growth of the wage bill and social transfers. Consequently, general government deficit increased from 3.1 percent in 2016 to an estimated 5.2 percent of GDP in 2017.

Public debt including guarantees increased to 74 percent of GDP by end-2017. After initial fiscal consolidation efforts, the outlook on the credit rating of B+ improved to stable. This has allowed easier access to capital markets for regular refinancing of liabilities coming due in 2018 and 2019-2021.

Economic Outlook

The economy is expected to grow by an average of 2.5 percent annually in 2018-20, on the back of public investments and personal consumption. While growth of investment will slow down as the highway construction gets to its closure, its contribution to growth will remain strong in 2018. Current imbalances are likely to stay high given the import dependence of the current growth pattern.

Inflation is projected at 2.5 percent in the period 2018-19, as the VAT rate rise adds to the current inflation growth in 2018. Fiscal deficit is projected to be brought down to 3.2 percent in 2018, and slowly reaching surplus by 2020.

With the potential poverty impact of fiscal consolidation measures, in 2018, poverty is expected to slightly increase as mothers' benefits phase out. Poverty is likely to resume its decline in 2019-20 to an estimated 4.4 percent by 2020, subject to improvements in private sector employment and earnings.

The positive economic outlook faces high, but moderating risks. As the highway construction is completed in 2019, growth will slow unless productivity gains and new private sector investments realize. Large fiscal deficit and growing public debt call for the decisive implementation of the recently adopted fiscal consolidation program. The fiscal framework that aims to have a balanced budget by 2019, from over 5% deficit in 2017, will require credible spending consolidation in wage bill, social transfers, and operational costs to put public deficit and debt on a sustainable trajectory.

Reducing unemployment, especially for youth and mitigating short-term poverty and social impacts of fiscal consolidation and facilitating access to employment need to be an important part of the policy agenda.

Project Spotlight

The Montenegro Energy Efficiency Project (MEEP)

MEEP is investing in energy saving retrofits in about 27 schools and hospitals.

Through the Montenegro Energy Efficiency Project (MEEP), the World Bank has supported the Montenegrin Government's efforts to improve energy-efficiency performance in public sector buildings, energy-efficiency implementation practices and capacity in public institutions, and energy-efficiency service providers in the country.

MEEP is investing in energy saving retrofits in about 25 schools and hospitals. It is insulating roofs and buildings and upgrading heating systems, substations, and networks. Facilities were selected for retrofits based on their energy savings potential, geographic distribution, number of users, and social and demographic impact.

Social surveys of users show very high end-user satisfaction with the results as well as increased awareness of the importance of energy efficiency.

As a result, savings in heating energy have ranged between 30 and 67%, with an average of 46.7%.

CONTACTS

Podgorica
+382 20 665 353
Bulevar Svetog Petra Cetinjskog 6,
81000 Podgorica,
Montenegro.

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