

Montenegro

Key developments and challenges

Power sector restructuring is a priority reform to improve the electricity supply and support economic activity. It is important, therefore, that the partial privatisation of the state-owned power utility, EPCG, to an international strategic investor brings about the much-needed restructuring of the company.

Several measures have been introduced to improve the business environment, but corruption and bureaucracy, especially regarding licences and permits, are still seen as the main obstacles affecting businesses. Further efforts are needed to tackle these problems to improve the investment climate and to continue attracting foreign direct investment (FDI).

The growth of credit slowed dramatically in the wake of the global economic crisis and banks' reduced appetite for risk. Maintaining the necessary supply of credit to the private sector, especially to small and medium-sized enterprises (SMEs), will continue to be crucial to the crisis response.

Country data

Population (in millions)	0.7
Area ('000 sq km)	13.8
GDP (in billion US\$, 2008)	4.8
Average transition score (scale: 1 to 4.33)	2.85

Progress in structural reform

Liberalisation and privatisation

Montenegro has made further progress with integrating into regional and global trading structures. Notably, the country formally applied for EU membership in December 2008. The European Commission is currently preparing an Opinion on Montenegro's application. In July 2009 the European Commission proposed that the Council of the European Union grant Montenegrin citizens (as well as those from FYR Macedonia and Serbia) visa-free access for the Schengen area from early 2010. Further progress has been made in the negotiations on membership of the World Trade Organization (WTO) over the past year and the country is close to achieving this goal.

A tender for the sale of a 54 per cent stake and a 30-year concession in the port operator, Marina Bar, was re-launched in June 2009. However, a previous privatisation is being reversed; in July 2009 in response to the economic crisis, the government approved the partial re-nationalisation of the financially troubled aluminium smelter KAP, the main Montenegrin industrial producer, and the related Niksic Bauxite mine. The private owner of the two companies, CEAC, is expected to transfer a 29 per cent stake in KAP and a 31 per cent stake in the bauxite mine to the state in exchange for financial support.

Business environment and competition

Montenegro has had some success in creating a favourable business climate and in attracting reputable foreign investors. During the first half of 2009 in spite of the global economic crisis, registration of new enterprises continued at a rate only slightly lower than in 2008. The Council for the Elimination of Business Barriers, established in mid-2008, adopted several measures to simplify procedures. These include allowing companies to register online with the commercial court, and record their taxes and contributions online. However, results from the latest round of the Business Environment and Enterprise Performance Survey (BEEPS IV) suggest that corruption and bureaucracy, especially in the area of licences and permits, are still perceived as among the main obstacles affecting businesses. Montenegro was ranked 71st (out of 183 economies) in the World Bank *Doing Business 2010* survey (up slightly from 77th the previous year).

Infrastructure

In December 2008 steps were taken to reduce the cross-subsidisation of electricity tariffs, with the energy regulator increasing electricity prices for households by 10.6 per cent. However, the Administrative Court overruled this decision in June 2009 so that the increase in electricity prices was reduced by 3 per cent and EPCG was requested to compensate customers for the over-payment (about €20 million). In September 2009 the tender for a minority stake in the state-owned power utility EPCG was successfully concluded. The winning bidder, Italian power company A2A, will acquire a 18.3 per cent stake in EPCG via a capital hike, with the government retaining 55 per cent. The unbundling of the sector started with the legal unbundling of EPCG's transmission unit into a separate company in March 2009.

Following a successful open tender, in June 2009 the Montenegrin government and a Croatian consortium signed a €2.7 billion concession agreement for the construction of the Bar-Boljare highway from the Adriatic coast to the Serbian border. The consortium will hold a 30-year concession for maintenance and management of the motorway, with construction expected to start by the end of 2009. In addition, the state-owned railways adopted a restructuring plan in line with EU directives (that is, vertical separation) in July 2008.

Financial sector

The banking sector continued to grow rapidly in 2008, but a slow-down became apparent in the last quarter of the year and accelerated dramatically in 2009 as a result of the global financial crisis. Credit growth decelerated and a sudden loss of confidence took place in October 2008 when households withdrew about 12 per cent of their deposits after Prva Banka, the second largest bank in the country, announced its troubled financial position. The authorities have taken steps to maintain the liquidity of the banking system, including the announcement of a full guarantee of all bank deposits and the removal of ceilings on credit growth. In addition, following the passage of a law in October 2008 authorising the government to provide support to banks, €44 million was subsequently lent to Prva Banka in December 2008. In June 2009 the rate of mandatory reserves on existing deposits was reduced to 10 per cent, with no reserve requirements for new deposits.

Macroeconomic performance

Montenegro's economy continued to expand at a strong pace in 2008, with real GDP growth estimated at 7.5 per cent, owing to robust domestic demand fuelled by large FDI inflows and rapid credit growth. On the supply side, services, especially financial services and tourism, continued to drive growth. The current account deficit, largely financed by FDI inflows, was at 33.7 per cent of GDP in 2008 and the overall external debt at 59.4 per cent of GDP, mostly pertaining to the private sector. The general government balance recorded a surplus of 1.5 per cent of GDP in 2008, owing to larger than expected revenues.

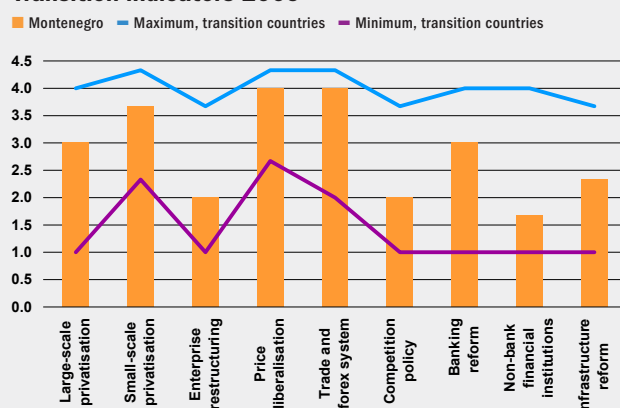
The impact of the crisis fully unfolded at the end of 2008 and during the first half of 2009, with credit growth slowing dramatically to 3 per cent year on year (compared with 95 per cent in 2008) and industrial production contracting by 20.2 per cent in the first half compared with the same period of the previous year. Following the contraction in the external demand for metals, the largest company, KAP, operated on a significantly reduced scale from October 2008 and the other main industrial producer, the Niksic Steelworks, halted its production for a month. In December 2008 the government approved a fiscal package estimated at €350 million (about 10 per cent of GDP) to stimulate the economy. The package included a significant increase in capital expenditure, a reduction in the rate of social contributions, the elimination of certain fees and subsidies for electricity payments for SMEs and households. The government also provided a guarantee for a €150 million loan to Montenegrin banks, negotiated with KfW and EIB, to be used to supply credit to SMEs.

Outlook and risks

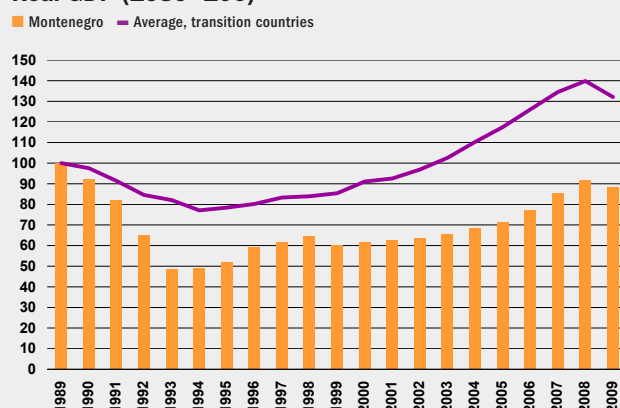
After years of strong economic growth, the near-term outlook is weak owing to the impact of the global economic crisis on the economy. Real GDP is expected to contract by 4 per cent in 2009, reflecting a much slower pace of consumption and investment due to lower FDI inflows, the slow-down in credit growth and the weakness of external demand. However, inflation is expected to significantly moderate below 2 per cent in 2009, as the demand-driven inflationary pressures ease. The downside risks to the outlook are significant, especially if tourism and FDI decline more sharply than anticipated.

However, the medium-term outlook for Montenegro remains bright. There should be a moderate rebound in growth once the global recession ends, reflecting the strong potential for growth in the tourism sector, for further FDI flows and the prospects for EU accession in the future. However, underlying external and domestic vulnerabilities still need to be addressed, especially the large external imbalances and the relative lack of diversification, if growth is to be sustained.

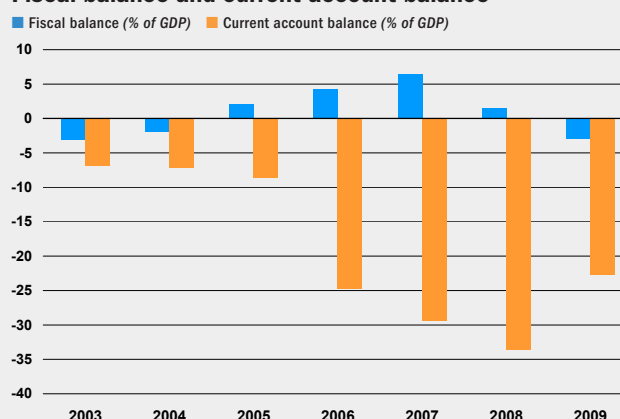
Transition indicators 2009



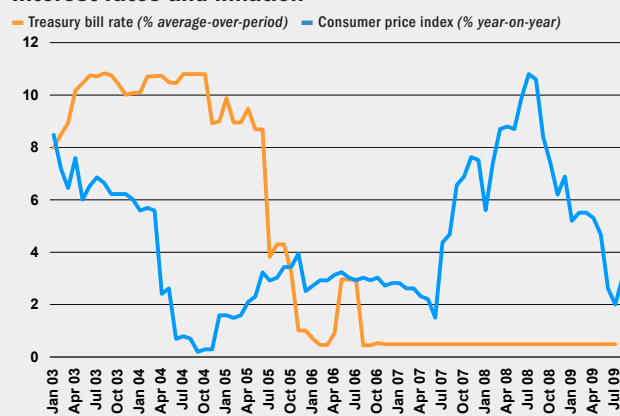
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility - full	Competition office - yes	Telecoms regulatory assessment compliance - medium	Capital adequacy ratio - 10 per cent	Share of population living in poverty - 8 per cent (2007)
Controls on inward direct investment - no	Quality of insolvency law - very high	Independence of the electricity regulator - partial	Deposit insurance system - yes	Government expenditure on health - 6.2 per cent of GDP (2005)
Interest rate liberalisation - full	Secured transactions law - modern/some defects	Separation of railway infrastructure from operations - full	Private pension funds - no	Government expenditure on education - 5.4 per cent of GDP (2004)
Exchange rate regime - unilateral euroisation		Independence of the road directorate - partial		Household expenditure on power and water - 11.7 per cent
Wage regulation - no				
Tradeability of land - limited de jure				

Structural and institutional change indicators

	2003	2004	2005	2006	2007	2008	2009
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	na	na	na	na	na	na	na
Private sector share in GDP (in per cent)	na	na	na	na	65.0	65.0	65.0
Private sector share in employment (in per cent)	na	na	na	na	50.0	52.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	na	na	na	na	na
Share of industry in total employment (in per cent)	na	na	na	na	na	na	na
Change in labour productivity in industry (in per cent)	na	na	na	na	na	na	na
Investment/GDP (in per cent)	na	na	na	na	na	na	na
<i>EBRD index of small-scale privatisation</i>	3.3	3.3	3.7	3.7	3.7	3.7	3.7
<i>EBRD index of large-scale privatisation</i>	2.7	2.7	3.3	3.3	3.3	3.3	3.0
<i>EBRD index of enterprise reform</i>	1.7	2.0	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	9.2	5.6	5.6	na
Number of goods with administered prices in EBRD-15 basket	na	na	na	2.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	na	na	na	na	na	na	na
Share of trade in GDP (in per cent)	59.7	79.1	79.0	100.0	94.7	85.8	na
Tariff revenues (in per cent of imports)	na	na	na	na	na	na	na
<i>EBRD index of price liberalisation</i>	4.0	4.0	4.0	4.0	4.0	4.0	4.0
<i>EBRD index of forex and trade liberalisation</i>	3.0	3.0	3.7	3.7	4.0	4.0	4.0
<i>EBRD index of competition policy</i>	1.0	1.0	1.0	1.0	1.7	1.7	2.0
Financial sector							
Number of banks (foreign-owned)	10 (3)	10 (3)	10 (7)	10 (8)	11 (8)	11 (9)	na
Asset share of state-owned banks (in per cent)	19.2	16.4	5.1	0.0	0.0	0.0	na
Asset share of foreign-owned banks (in per cent)	23.5	31.0	87.7	91.9	78.7	84.6	na
Non-performing loans (in per cent of total loans)	4.7	5.7	5.2	2.8	3.2	6.0	na
Domestic credit to private sector (in per cent of GDP)	13.3	16.8	20.7	39.4	83.0	87.2	na
Domestic credit to households (in per cent of GDP)	3.6	4.8	6.4	17.3	32.8	31.5	na
- Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	62.0	89.5	61.9	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	20.6	13.8	3.2	na
Eurobond issuance (in per cent of GDP)	na	na	na	na	na	na	na
<i>EBRD index of banking sector reform</i>	2.0	2.3	2.3	2.7	2.7	3.0	3.0
<i>EBRD index of reform of non-bank financial institutions</i>	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	na	46.0 (76.7)	55.9 (87.0)	56.9 (103.6)	56.9 (103.6)	56.9 (103.6)	na
Internet users (per 100 inhabitants)	na	25.4	38.9	42.8	45.1	45.1	na
Railway labour productivity (2000=100)	100.9	111.2	127.6	144.7	149.8	165.1	na
Residential electricity tariffs (USc kWh)	na	6.0	5.9	7.5	10.1	12.4	na
Average collection rate, electricity (in per cent)	na	na	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na
<i>EBRD index of infrastructure reform</i>	1.7	1.7	2.0	2.0	2.0	2.0	2.3
- Electric power	1.7	2.0	2.3	2.3	2.3	2.3	2.3
- Railways	1.0	1.0	1.0	1.0	1.0	1.7	2.0
- Roads	1.7	2.0	2.0	2.0	2.0	2.0	2.3
- Telecommunications	2.3	2.7	3.0	3.0	3.3	3.3	3.3
- Water and wastewater	2.0	2.0	2.0	2.0	2.0	2.0	2.0

Macroeconomic indicators

	2003	2004	2005	2006	2007	2008 Estimate	2009 Projection
Output and expenditure	<i>(Percentage change in real terms)</i>						
GDP	2.5	4.4	4.2	8.6	10.7	7.5	-4.1
Industrial gross output	2.4	13.8	-1.9	1.0	0.4	-2.0	na
Agricultural gross output	na	na	na	na	na	na	na
Employment	<i>(Percentage change)</i>						
Labour force (end-year)	-6.1	13.0	-3.6	-2.3	0.7	4.7	na
Employment (end-year)	-3.3	29.9	2.0	3.7	5.5	3.8	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year)	38.5	29.3	25.2	20.6	16.8	17.5	na
Prices and wages	<i>(Percentage change)</i>						
Consumer prices (annual average)	6.7	2.4	2.3	3.0	4.2	7.4	1.8
Consumer prices (end-year)	6.2	1.5	2.4	2.8	7.7	7.0	1.7
Producer prices (annual average)	4.5	5.8	2.1	3.0	8.5	7.5	na
Gross average monthly earnings in economy (annual average)	17.8	12.2	7.6	15.3	14.1	16.3	na
Government sector	<i>(In per cent of GDP)</i>						
General government balance	-3.1	-1.9	2.1	4.2	6.4	1.5	-3.0
General government expenditure	46.6	40.5	39.1	42.5	39.0	42.9	na
Monetary sector	<i>(Percentage change)</i>						
Broad money (M2, end-year)	na	16.3	49.6	87.9	72.9	28.5	na
Domestic credit (end-year)	na	42.4	10.6	142.3	175.5	25.8	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	30.5	32.1	44.2	70.1	92.7	101.8	na
Interest and exchange rates	<i>(In per cent per annum, end-year)</i>						
Discount rate	na	na	na	na	na	na	na
Money market rate	na	na	na	na	na	na	na
Deposit rate	4.9	4.8	5.0	5.4	4.8	na	na
Lending rate (long-term)	na	na	12.1	9.9	9.2	na	na
	<i>(Euros per US dollar)</i>						
Exchange rate (official, end-year)	0.8	0.7	0.8	0.8	0.7	0.7	na
Exchange rate (official, annual average)	0.9	0.8	0.8	0.8	0.7	0.7	na
External sector	<i>(In millions of US dollars)</i>						
Current account	-116.3	-149.0	-197.3	-667.0	-1,129.6	-1,617.3	-999.4
Trade balance	-405.3	-517.9	-650.1	-1,066.4	-1,836.0	-2,252.4	-1,738.7
– Merchandise exports	305.9	561.4	581.8	813.9	903.0	939.6	762.6
– Merchandise imports	711.2	1,079.3	1,231.9	1,880.3	2,739.0	3,192.1	2,501.2
Foreign direct investment, net	44.0	63.3	481.9	585.3	717.4	805.0	638.3
Gross reserves, excluding gold (end-year)	63.7	82.0	204.0	432.7	732.4	478.4	na
External debt stock	462.1	488.8	524.5	939.0	1,841.0	2,541.0	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	1.0	0.8	1.7	2.4	2.9	1.5	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	4.8	3.4	2.8	2.4	2.6	2.4	na
Memorandum items	<i>(Denominations as indicated)</i>						
Population (end-year, million)	0.7	0.7	0.7	0.7	0.7	0.7	na
GDP (in millions of euros)	1,510.0	1,670.0	1,815.0	2,149.0	2,810.0	3,292.0	3,213.9
GDP per capita (in US dollars)	2,582.8	3,142.8	3,478.3	4,084.2	5,827.2	7,300.1	na
Share of industry in GDP (in per cent)	na	na	na	na	na	na	na
Share of agriculture in GDP (in per cent)	na	na	na	na	na	na	na
Current account/GDP (in per cent)	-6.8	-7.2	-8.6	-24.7	-29.4	-33.6	-22.8
External debt - reserves (in US\$ million)	398.4	406.8	320.5	506.3	1,108.6	2,062.6	na
External debt/GDP (in per cent)	27.1	23.6	22.8	34.8	47.9	52.7	na
External debt/exports of goods and services (in per cent)	88.6	56.1	52.6	70.1	100.9	122.6	na