MONTENEGRO

Highlights

- **Further progress has been made towards eventual EU membership.** The new European Commission (EC) Enlargement Strategy, published in February 2018, has set 2025 as the year when Montenegro could be ready for membership, provided it makes further progress in reforms.
- **The government has begun implementing a fiscal adjustment strategy.** The strategy is intended to boost the sustainability of the public finances, which have been put under severe pressure because of costs associated with the financing of major road infrastructure.
- **The main power utility is being brought back into almost full public ownership.** The government and Italian utility company A2A have agreed on the accelerated execution of the put option for the company's stake in the power utility EPCG.

Key priorities for 2019

- **Fiscal stabilisation is crucial for economic growth.** Having developed a credible fiscal strategy the government should stick to agreed targets, even if economic growth slows, in order to restore fiscal balance and reduce public debt.
- **Renewable energy projects should be further developed.** Montenegro has significant potential in this area and further development would help the country's green economy transition and improve its energy resilience.
- **Further improvements are needed on economic governance.** Areas of focus in the coming year should include the development of the government's e-governance programme and strengthening of the framework for competition policy.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.8	3.4	2.9	4.7	4.2
Inflation (average)	-0.7	1.5	-0.3	2.4	2.8
Government balance/GDP	-0.7	-6.2	-6.2	-7.0	-4.6
Current account balance/GDP	-12.4	-11.0	-16.2	-16.3	-16.8
Net FDI/GDP [neg. sign = inflows]	-10.2	-16.9	-9.4	-11.4	-11.4
External debt/GDP	163.1	161.8	158.8	160.2	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	54.1	52.6	51.6	51.4	n.a.

*Montenegro uses the euro as its legal tender.

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Macroeconomic performance

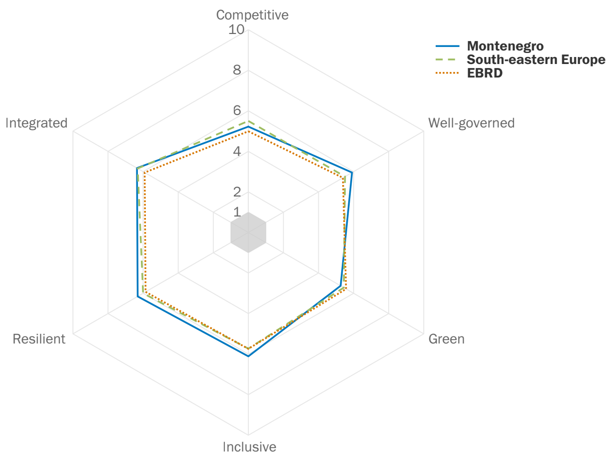
The economy out-performed expectations in 2017. GDP grew by 4.7 per cent, well above the 2.9 per cent growth rate recorded in the previous year. The key drivers of this growth were investment, particularly in the major highway project connecting the port of Bar with the Serbian border and in some flagship tourism developments on the coast; and private consumption, driven by the relatively high rate of lending. However, high imports, as a component of both investment and private consumption, fuelled a large current account deficit of more than 16 per cent of GDP and acted as a drag on growth. The Montenegrin economy depends heavily on tourism (one-fifth of annual GDP), and foreign tourist arrivals in 2017 were up by more than 10 per cent, boosted by new airline connections with EU countries. The unemployment rate as of the second quarter of 2018 was 14.4 per cent, while long-term unemployment is very high, at about 65 per cent of total unemployment. The economy has continued to power ahead in 2018, with growth in the first half of 2018 estimated at 4.8 per cent year-on-year, again with similar drivers as in 2017.

The government has begun implementing a medium-term fiscal adjustment strategy. The sustainability of the public finances is a significant concern, and is among the biggest risks the country is facing. To combat growing fiscal pressures, a new Fiscal Strategy (2017-20) was adopted in June 2017 containing a number of measures, including an increase of VAT and excise duties, a reduction in the salaries of senior public employees, improved tax collection, and the cancellation of benefits to mothers of three or more children introduced the year before by parliament. The main goal of the strategy is to achieve a primary budget surplus from 2019, and an overall budget surplus from 2020. This should put the public debt, which has been rising rapidly in recent years to over 70 per cent of GDP, on a downward trajectory.

In April 2018 the government placed a seven-year, €500 million Eurobond. The interest rate was 3.375 per cent, a record low for the country, implying a positive reaction from the financial markets for the recent fiscal consolidation measures. The country's credit rating, as of October 2018, is B+ by Standard & Poor's and B1 by Moody's, with a stable outlook in the former and a positive outlook in the latter. Further financing will be needed in the coming years to meet significant Eurobond redemptions in the period 2019-21.

Growth is likely to moderate in the short term. The fiscal austerity measures adopted in the past year are expected to bite further, while current construction activities are slowing, as the construction and financing of the remaining highway sections remain unclear. Therefore, GDP growth is projected at 4.2 per cent in 2018 and 3.0 per cent in 2019. The economy will continue to be mainly investment-driven and supported by public investment in transport and energy infrastructure (where construction of the highway continues to be the key project) and flagship foreign direct private investments, particularly in the tourism sector. The main risks include the high level of public debt and limited fiscal space.

Assessment of transition qualities (1-10)



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Major structural reform developments

Further progress has occurred on EU approximation. As of October 2018, Montenegro had opened 31 negotiating chapters (out of 33) of the EU's *acquis communautaire*, including two critical chapters related to the rule of law, and had provisionally closed three: Science and Research; Education and Culture; and External Relations. The chapters on Competition Policy and Environment still remain unopened. Montenegro launched EU accession negotiations in 2012. The new EC Enlargement Strategy, published in February 2018, has set 2025 as an indicative timeline for the country's EU membership, noting that Montenegro (and Serbia) could be ready for membership by 2025 provided it makes further progress in reforms.

Progress on privatisation has been minimal in the past year. The only concrete achievement was the agreement on the 30-year lease of Ulcinjska Rivijera with Karisma Hotels Adriatic Montenegro, the only bidder on the tender. Meanwhile the tender for the concession of the port of Bijela is in its final phase. A consortium comprising the Dutch company Damen and Adriatic Marinas, the company which operates the country's flagship investment Porto Montenegro, had expressed interest in obtaining the concession for the port for 30 years, aiming to convert it from a former shipyard into a place for yacht building and repair. At the same time, the process of renationalisation of EPCG, the country's state-owned power utility, has begun, as the minority shareholder Italian A2A has started its exit from the company. In August 2018 the government published a draft concession agreement for the two international airports. The plan is to offer a concession contract on the two airports for 25 to 30 years. The preparation and implementation of public tenders for the privatisation of the health institute in Igalo and the hotel group Budvanska Rivijera are part of the 2018 privatisation plan.

The government and Chinese construction company CRBC have signed a Memorandum of Understanding (MoU) on further motorway construction. The MoU was signed in March 2018 on the possible establishment of a public-private partnership to handle the construction of further sections of the Bar-Boljare highway, which connects the Adriatic port of Bar in Montenegro with the Serbian border. CRBC is already the lead contractor for the construction of the 42 km-long priority section of the highway, worth US$ 1.1 billion, set for completion by the end of 2019. However, in addition to this priority section, the highway includes another four sections – two northern and two southern – with an additional estimated total construction cost of approximately €1.7 billion. In parallel, in April 2018 the government appointed a team to negotiate with interested companies the construction of the two northern stretches of the motorway, leading to the Serbian border. The team's goal is to propose to the government a model for the construction of these stretches as well as to define criteria for tendering them. The team should also assess the gathered offers and start talks with the preferred company or consortium.

The power utility is being brought back into almost full public ownership. In April 2018 parliament approved the agreement on an accelerated execution of the put option that gives A2A the right to sell its 42 per cent stake in power utility EPCG for €250 million (the government has a 57 per cent stake, while the remainder belongs to smaller shareholders). Following parliament's approval, the put option should be executed within two years instead of the originally planned seven years. In line herewith, the government had adopted a budget revision in March 2018 allocating €70 million for the purchase of A2A's shares in EPCG. A2A is exiting EPCG mainly because it disagrees with the government's project to extend the capacity of the country's sole thermal power plant Pljevlja, which now has only one unit of 210 MW.

A second wind park is being developed. The 46 MW Mozura wind park on Montenegro's coast will start operations in the fourth quarter of 2018 after China's Shanghai Electric Power Company has completed the installation of 23 turbines. The project is being carried out by the Maltese state-owned company Enemalta and Shanghai Electric. This is the second wind park project to be developed in Montenegro, following the launch of the 72 MW EBRD co-funded Krnovo wind park last year.

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Financial sector legislation is being strengthened. To address remaining legislative shortcomings in the financial sector, a number of new laws and related directives have recently been introduced. These include a Central Bank Act, a Law on Financial Institutions, and an all-encompassing non-banking financial institutions law covering factoring, leasing, micro-crediting and credit guarantee operations, all adopted by parliament in October 2017. The Law on Voluntary Financial Restructuring adopted some years ago has been extended again, this time to May 2019. Also, the authorities are currently amending a number of pieces of legislation, including the Deposit Insurance Law, the Banking Law and the Law on Recovery and Resolution of Banks, to improve banking supervision and resolution frameworks and make them consistent with the Basel Core Principles for Effective Banking Supervision and the EU's Bank Recovery and Resolution Directive.