Montenegro

Highlights

- **Economic growth has remained strong.** After rapid real growth of 6.4 per cent in 2022 and 6.3 per cent in 2023, the economy expanded 3.4 per cent year on year in the first half of 2024, despite a high base in the first three months of 2023, driven by rising consumption and investment.
- **The government has developed a fiscal strategy for 2024-27.** The strategy envisages an increase in wages and pensions, a reduction in the tax burden on labour and the introduction of a single value-added tax (VAT) rate for hospitality services.
- **Significant infrastructure investments are under way.** The government is acquiring financing for several ambitious projects in the energy, railway and education sectors.

Key priorities for 2025

- **Structural fiscal reforms are essential for healthy public finances.** These include strengthening revenue administration, improving the targeting of social spending, containing the growth of the public wage bill and improving the oversight of state-owned enterprises (SOEs). A commitment to meeting the public debt target of 60 per cent of GDP by 2028, in line with the Law on Budget and Fiscal Responsibility, is necessary for a credible medium-term fiscal framework.
- **Preservation of the operational independence and institutional credibility of the Central Bank of Montenegro is vital.** Emerging pressures on the central bank to place an administrative cap on bank lending rates could lead to unintended consequences, such as curtailed European Central Bank policy transmission, adverse selection and credit rationing.
- **The authorities should continue to enhance the anti-money laundering and countering the financing of terrorism (AML/CFT) framework.** Large inflows into the real-estate sector mean cross-border money laundering risks need to be addressed. A rise in real-estate prices, fuelled by insufficiently vetted financial flows, indicates shortcomings in AML/CFT preventative measures among real-estate agents, as highlighted in a 2023 MONEYVAL report.[1]

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-15.3	13.0	6.4	6.3	3.8
Inflation (average)	-0.2	2.4	13.0	8.6	4.5
Government balance/GDP	-10.9	-1.7	-4.1	0.7	-3.2
Current account balance/GDP	-26.1	-9.2	-12.9	-11.4	-12.4
Net FDI/GDP [neg. sign = inflows]	-11.2	-11.7	-13.2	-6.3	-4.0
External debt/GDP	224.1	191.5	161.8	138.5	na
Gross reserves/GDP	43.5	31.7	31.1	19.3	na
Credit to private sector/GDP	60.0	52.3	47.3	43.8	na

CONTINUES >

[1] https://rm.coe.int/moneyval-2023-26-summ-montenegro/1680ae59a6

Macroeconomic developments and policy response

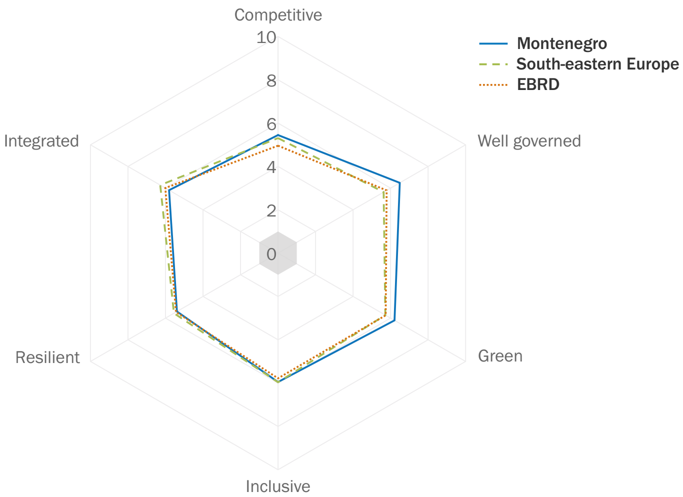
Robust economic growth continues. After 6.4 per cent real gross domestic product (GDP) growth in 2022 and 6.3 per cent growth in 2023, the economy expanded 3.4 per cent year on year in the first half of 2024, despite a high base in the first half of 2023. Growth was driven by services, predominantly trade and hospitality and professional and administrative services, while industrial production recorded a deep decline, caused mostly by a drop in electricity production. Tourism recorded sluggish growth of just 1.0 per cent year on year in the first eight months of the year, compared with record 2023 levels. On the expenditure side, growth in the first half of 2024 was driven by rising private consumption and investment. Private consumption increased by 8 per cent compared with the first half of 2023 due in part to the rise in pensions from the beginning of 2024 and an improvement in the labour market. Investment grew by 9.6 per cent on the year and is expected to maintain its momentum in the short run, with the completion of preparations for the launch of major construction projects such as the Matesevo-Andrijevica section of the Bar-Boljare highway. The net export contribution to GDP growth was negative in the first half of the year due to a double-digit decline in exports caused by lower electricity exports and tourism revenues. Consequently, the current account deficit expanded by €300 million on the year in the first half of 2024, reaching almost €900 million, or around 30 per cent of GDP. Net foreign direct investment inflows decreased by 5.0 per cent in the first half of 2024 from the same period in 2023.

The government announced further fiscal expansion and extended the list of products subject to retail and wholesale margin caps to tackle inflation. Annual inflation peaked at 17.5 per cent in November 2022 and has dropped steadily since then, reaching 1.2 per cent in October 2024. In July, profit margins on staple food products, such as wheat flour, sugar, salt and sunflower oil, were capped at 5 per cent for wholesalers and 7 per cent for retailers. The number of capped products was extended to 71, with different caps on wholesale and retail margins depending on product type. The caps will last until the end of January 2025. Wage increases of around 25 per cent, on average, were announced for October 2024 as part of the government's Europe Now 2.0 programme, along with a rise in the minimum wage to €700 per month. A 52 per cent increase in the minimum pension, affecting a third of Montenegrin retirees, has been in effect since January 2024 and a further increase is expected in January 2025. This fiscal expansion could stoke another round of inflationary pressures, depending on the pricing behaviour of firms facing increased demand.

Debt sustainability risks are elevated, but so far manageable. General government debt peaked at 107 per cent of GDP in 2020, but has since moderated, coming in at 60.3 per cent of GDP at the end of 2023 on the back of public debt repayments and strong economic growth. In the first quarter of 2024, public debt rose to 66.4 per cent of GDP, due to the issuance of a US$ 750 million (€678 million) seven-year international bond in March. The proceeds of the bond issue will be used to repay debt maturing this year (€519 million), so the net effect on public debt will be modest, at around 2.3 per cent of GDP.

Real GDP growth is projected to slow. After higher-than-expected real growth in 2023, a deceleration to 3.8 per cent is projected for 2024, due to the moderation of tourist inflows after a record season last year. A further slowdown to 2.9 per cent is forecast for 2025 due to the long rehabilitation of the Pljevlja thermal power plant, currently supplying around 40 per cent of the country's electricity, leading to a decline in electricity production and an increase in energy imports. In contrast, upside potential arises from the effects of the Europe Now 2.0 programme through elevated private and public consumption.

Assessment of transition qualities (1-10)



CONTINUES ›

Structural reform developments

The Western Balkans growth plan will support reforms in Montenegro. Under the European Union's growth plan, the country stands to gain €383.5 million, subject to the implementation of reforms proposed in the reform agenda. The focus areas of the agenda are: the rule of law and fundamental rights, the fight against corruption, secure digital infrastructure and an increase in the efficiency of public services, cybersecurity, decarbonisation policies, an improvement in the business environment and human capital development.

The justice system is undergoing extensive reform. The 2024-27 Judicial Reform Strategy was adopted in May 2024, alongside a suite of new legislation aimed at improving the independence, impartiality and accountability of the state prosecution service and the judiciary. High-level judicial officials have been appointed to fill most vacant positions in recent months. However, Montenegro's judicial institutions remain hindered by a lack of investment in human resources and information and communications technology (ICT) infrastructure.

Efforts to enhance the business environment have resumed. In March 2024, the Competitiveness Council approved an action plan targeting the removal of 11 major barriers to business by 2026. The operations of local and foreign companies are currently impeded by informality, inefficiencies, delays in administrative processes, an overly complex legal framework and the administrative burden of parafiscal charges, as well as the inadequate quality of e-services. Additional challenges include a lack of transparency in decision-making, arbitrary interpretation and enforcement of laws by public authorities, and limited access to finance for small and medium-sized enterprises.

The government approved the fiscal strategy for 2024-27 in September 2024. An integral part of the strategy is the Europe Now 2.0 programme, which foresees wage and pension increases, a reduced tax burden on labour and a single VAT rate for hospitality services. One of the biggest changes that should relieve the burden on employers is a proposal to reduce pension and disability insurance contributions from the current 20.5 per cent to 10 per cent. The general VAT rate will remain at 21 per cent, but the government proposes introducing a single, third VAT rate of 15 per cent for hospitality services from January 2025.

The informal economy is being tackled. The government's Programme and Action Plan for Suppressing the Informal Economy, 2024-26, is under way, having been adopted in December 2023. The plan contains actions focused on cooperation between central and local government, as well as prevention and repression of informal activities. The plan also includes analysis of the functionality of inspection services. However, it still lacks a monitoring mechanism for reviewing its implementation.

Consumer protection for credit products is being enhanced. In September 2024, the government adopted a new Consumer Credit Law, harmonising legislation with European Union standards and addressing growing needs for enhanced consumer protection, as an ever-greater number of entities are offering new credit products. For the first time, the law regulates the conditions under which credit intermediaries can operate with regard to housing loans and addresses the accountability of creditors for these intermediary actions. The measures are intended to protect consumers and enhance competition among creditors, which will positively influence loan repayment security and the stability of the financial market.