31. MONTENEGRO

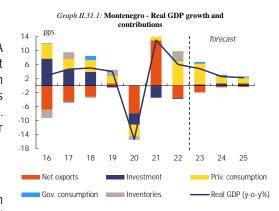
Montenegro's economy has continued to grow fast in 2023, driven by private consumption and a good tourism season. A deceleration is projected for 2024-2025 as high inflation and increasing borrowing costs are set to weigh on household consumption and private investment. Weaker external demand is likely to affect tourism. A good fiscal performance in 2023 was supported by high growth of revenue from consumption taxes and one-off items while capital spending remained under-executed. However, the budget deficit is set to widen amid tightening financing conditions and rising interest costs.

Economic growth remained strong in the first half of 2023

Real GDP expanded by 6.6% y-o-y in the first half of 2023, driven by strong private consumption, as a result of increasing real wages, employment and household borrowing, and a very successful tourism season. The rise in exports of goods and services outpaced the growth in imports and added to real GDP growth. Gross fixed capital formation and government consumption expanded moderately. The main headwinds came from high inflation and political uncertainty.

The political situation remains complex

Snap parliamentary elections took place in June. A new political party, Europe Now, won the most seats and formed a broad coalition government in early November. The political landscape is complex with risks of enacting populist policies. The present forecast doesn't assume any major reforms over the forecast horizon.



Deceleration in the coming years

Economic growth is projected to remain strong in 2023, underpinned by private consumption and

export of services. In 2024-2025 GDP growth is set to moderate amid headwinds from still elevated inflation, tighter financing conditions, domestic political fragmentation, and weak external demand. These factors are expected to weigh on real disposable income, private consumption, recovery of investment and tourism exports.

The current account deficit is set to narrow in 2023 due to the healthy growth of exports, notwithstanding somewhat lower surpluses of the primary and secondary income balance in line with the slowdown in the EU and lower remittances. The current account deficit is expected to decrease further slightly over 2024-2025 due to lower growth of imports resulting from moderating consumption.

The balance of risks is tilted to the downside due to the subdued growth outlook in the main trading partners, high financing costs and national political uncertainty. Montenegro's narrow export base makes it vulnerable to fluctuations in international demand, and elevated prices might reduce external demand for tourism services in Montenegro.

Montenegro's banking sector has solid capital levels and ample liquidity. However, the rising cost of lending is set to cool down domestic demand for loans over the forecast horizon.

Improving but still high unemployment rates

The rebound of tourism and measures adopted in late 2021, such as abolishing a mandatory health contribution and increasing the non-taxable share of wages, had a positive impact on job creation in 2022, which continued into 2023 with the unemployment rate declining to a record low

of 13.5% in the second quarter. However, employment growth is expected to decelerate in 2024-2025, as domestic and external demand weakens.

Inflation set to ease

Inflation started to decelerate in 2023, declining to 7.8% y-o-y in July before bouncing back to 9.1% y-o-y in August due to higher food prices. Large increases in wages and social transfers also generate upward price pressures. Inflation is expected to moderate in 2024-2025, on the back of lower imported inflation and moderating domestic demand.

Narrowing budget deficit in 2023, but risks ahead

In the first eight months, the budget execution performed significantly better than expected in the revised 2023 budget adopted in May, which targeted a deficit of 3% of GDP. The January-August budget outcome was a surplus amounting to 3% of GDP, driven by a combination of lower-than-expected spending, in particular on capital investment, and higher-than-projected revenue, especially from VAT and excise taxes, as well as several one-off measures such as the economic citizenship programme and the EU energy support grant. Going forward, the deficit is projected to widen due to slower revenue growth in line with decelerating consumption and the absence of one-off items. Due to narrowing budget deficit and strong nominal GDP growth, the public debt-to-GDP ratio is set to decline in 2023. Absent any fiscal consolidation strategy, public debt is expected to increase in 2024, but decrease in 2025.

Overall, the balance of risks to the fiscal outlook remains tilted to the downside due to high borrowing costs and upcoming large rollover needs.

Table II.31.1:

Main features of country forecast - MONTENEGRO

	2022				Annual percentage change						
	mio EUR	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025	
GDP		5796.8	100.0	3.3	-15.3	13.0	6.1	4.9	2.7	2.3	
Private Consumption		4423.6	76.3	:	-4.6	4.0	9.7	7.7	2.7	2.2	
Public Consumption		1034.3	17.8	:	0.8	0.5	1.2	2.9	2.2	2.0	
Gross fixed capital formation		1274.5	22.0	:	-11.9	-12.3	-1.1	1.7	3.2	3.1	
Exports (goods and services)		3053.8	52.7	:	-47.6	81.9	22.7	10.7	6.8	4.5	
Imports (goods and services)		4403.8	76.0	:	-20.1	13.7	21.3	9.9	5.5	3.8	
GNI (GDP deflator)		5913.3	102.0	:	-14.9	13.6	6.0	4.4	0.6	2.0	
Contribution to GDP growth:	[Domestic demand	I	4.6	-6.4	0.0	7.6	6.8	3.1	2.7	
	li	nventories		-0.3	-1.0	0.2	2.5	0.0	0.0	0.0	
	1	Net exports		-1.5	-7.8	12.9	-3.5	-1.9	-0.5	-0.4	
Employment				:	-10.1	-2.4	17.2	5.4	2.2	0.8	
Unemployment rate (a)				18.1	18.3	16.8	15.0	13.6	13.2	13.0	
Compensation of employees / head				:	:	:	:	:	:	:	
Unit labour costs whole economy				:	:	:	:	:	:	:	
Saving rate of households (b)				:	:	:	:	:	:	:	
GDP deflator				:	:	:	:	:	:	:	
Consumer price index				2.7	-0.8	2.5	11.9	9.0	5.7	3.8	
Terms of trade goods				:	:	:	:	:	:	:	
Trade balance (goods) (c)				-43.0	-39.2	-38.7	-46.2	-46.4	-47.1	-46.9	
Current-account balance (c)				-14.9	-26.1	-9.2	-13.3	-12.6	-12.3	-12.1	
General government balance (c)				-3.0	-11.1	-1.9	-5.2	-2.3	-3.4	-3.5	
Structural budget balance (d)				:	:	:		:	:	:	
General government gross debt (c)				50.5	105.3	82.5	69.5	61.0	63.5	61.2	

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.