

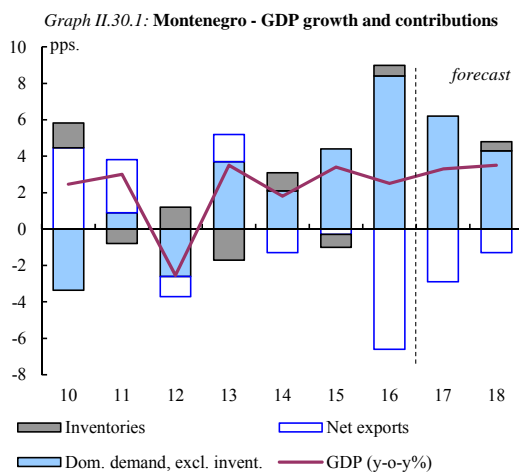
30. MONTENEGRO

Steady growth dampened by imports

The economy entered into a robust investment cycle. However, the growth profile is set to remain moderate due to the negative contribution of investment-related imports. Moreover, fiscal tightening to redress recent increases in public wages and social spending is also projected to be a drag on growth. At the same time, large public investment spending keeps budget deficits high and the public debt ratio on an upward trajectory.

After a weak start into the year, the economy accelerated in the second half of 2016

In the fourth quarter, real GDP recorded 3.4% (y-o-y), up from 2.4% in the third and 1.4% in the second quarter. In the last quarter of 2016, growth was driven by a robust expansion of private consumption supported by hikes in public sector wages and social benefits, and strong bank lending to households. Government consumption grew by 1.6% (y-o-y) in the fourth quarter; while gross fixed capital formation surged by 29% (y-o-y). However, net exports' contribution to growth remained largely negative and growing fast in the wake of investments, while exports increased at a substantially slower pace. Overall, real GDP grew by 2.5% in 2016, down from a 3.2% growth in 2015.

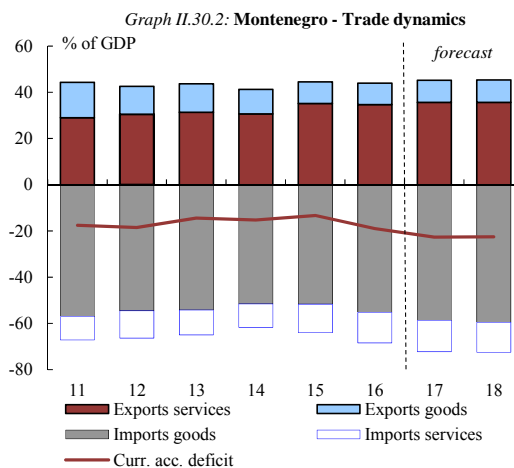


The investment-driven growth dynamic is expected to continue in 2017 and 2018, as the construction of a highway and some major tourism resorts will continue during this period. However, the need for fiscal consolidation to contain the rapid expansion of public debt is projected to slow down both private and public consumption in 2017. Concretely, the fiscal measures introduced at the end of 2016 (e.g. the increase of fuel excises, the reduction of social benefits for mothers and of public sector wages) will dampen consumption in

2017. Moreover, bank lending is expected to remain subdued during the forecast period as some credit institutions' balance sheets still remain burdened by non-performing loans.

Construction-related imports keep fuelling the trade deficit

In 2016, the current account deficit widened to 18.9% of GDP compared to 13.3% a year earlier. The deficit was driven by a broadening gap in merchandise trade as imports surged, including import of construction-related services which reduced – for the first time since 2008 – the surplus of the services balance. High trade deficits are expected to continue in 2017 and 2018. However, the completion of some new tourism, electricity and metal production facilities during this period could moderate the expansion of the external deficit by reducing the need for imports, and by increasing exports capacities.



Employment growth was dampened by the withdrawal of women from the labour market

Investment works boosted employment in construction, which accounted for one out five new jobs created in 2016. However, a substantial number of women left the labour force in 2016 after qualifying for a new lifetime benefit

(analogous to a pension), while others, previously inactive, registered for the first time in the employment agency as job seekers, increasing the active (but unemployed) active population ratio. As a result, unemployment recorded in 2016 a modest growth of 1.6% (y-o-y) while the unemployment rate increased marginally, to 17.8%. Job creation is forecast to accelerate in 2017 on the back of increasing construction activity and tourism, leading to some reduction in the unemployment rate. At the same time, the negative effect of the mothers benefit scheme on labour market participation of women is set to fade.

Rebound of import and excise-driven inflation

A rebound in international oil prices at the end of 2016, followed by an increase of fuel excises in early 2017, drove a sharp acceleration of transport prices. Moreover, prices for fruit, vegetables and dairy products have also added to inflationary pressures, while in April 2017 there was a further increase of excises on cigarettes. As a result, the consumer price index for 2017 has been revised upwards in this forecast, and prices are expected to stabilise in 2018 as base-year effects fade.

Persistence of high budget deficits and debt

In 2016, the general government deficit was, at 3.6% of GDP, lower than the original target of 7.3% due to the fact that public capital spending turned out to be substantially lower than planned. However, higher expenditure on transfers, social spending, public sector wages, and some unplanned repayment of previous years' liabilities have kept fiscal pressure high. At the beginning of 2017, excise and corporate income tax collection recorded some improvement, but both budget revenue and expenditure remained below the plan.

So long as the highway works continue, the budget deficit is projected to be high and the public debt ratio is expected to increase further. Financing risks appear limited in the short-term since the funding for the highway is secured to a large extent by a loan to be repaid as of 2021, after a six-year grace period. The new government's fiscal strategy is still under preparation, and it is expected to include some new consolidation measures. However, under the no-policy-change assumption, these are not included in the present forecast.

Table II.30.1:

Main features of country forecast - MONTENEGRO

	2015		97-12	Annual percentage change					
	mio EUR	Curr. prices		% GDP	2013	2014	2015	2016	2017
GDP	3624.7	100.0	-	3.5	1.8	3.4	2.5	3.3	3.5
Private Consumption	2871.9	79.2	-	1.6	2.9	2.2	2.7	1.6	2.1
Public Consumption	701.5	19.4	-	1.3	1.4	1.9	1.0	-1.0	0.0
Gross fixed capital formation	736.3	20.3	-	10.7	-2.5	11.9	29.9	19.9	8.9
of which: equipment	-	-	-	-	-	-	-	-	-
Exports (goods and services)	1539.2	42.5	-	-1.3	-0.7	5.7	4.1	2.9	3.0
Imports (goods and services)	2213.6	61.1	-	-3.1	1.6	4.4	13.6	6.2	3.8
GNI (GDP deflator)	-	-	-	-	-	-	-	-	-
Contribution to GDP growth:	Domestic demand		-	3.7	2.1	4.4	8.4	6.2	4.3
	Inventories		-	-1.7	1.0	-0.7	0.6	0.0	0.5
	Net exports		-	1.5	-1.3	-0.3	-6.6	-2.9	-1.3
Employment			-	1.1	7.1	2.4	1.6	2.2	2.7
Unemployment rate (a)			-	19.5	17.9	17.6	17.8	17.5	17.3
Compensation of employees / head			-	-2.0	6.1	0.9	3.4	1.5	1.9
Unit labour costs whole economy			-	-	-	-	-	-	-
Real unit labour cost			-	-	-	-	-	-	-
Saving rate of households (b)			-	-	-	-	-	-	-
GDP deflator			-	-	-	-	-	-	-
Consumer-price index			-	1.8	-0.5	1.4	0.1	2.6	2.1
Terms of trade of goods			-	-	-	-	-	-	-
Trade balance (goods) (c)			-	-39.5	-39.8	-40.4	-44.6	-47.0	-47.1
Current-account balance (c)			-	-14.5	-15.2	-13.3	-18.9	-22.6	-22.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-	-	-	-	-	-	-
General government balance (c)			-	-4.6	-2.9	-8.4	-3.6	-5.8	-5.1
Cyclically-adjusted budget balance (d)			-	-	-	-	-	-	-
Structural budget balance (d)			-	-	-	-	-	-	-
General government gross debt (c)			-	57.6	54.8	61.2	67.4	71.1	75.8

(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.