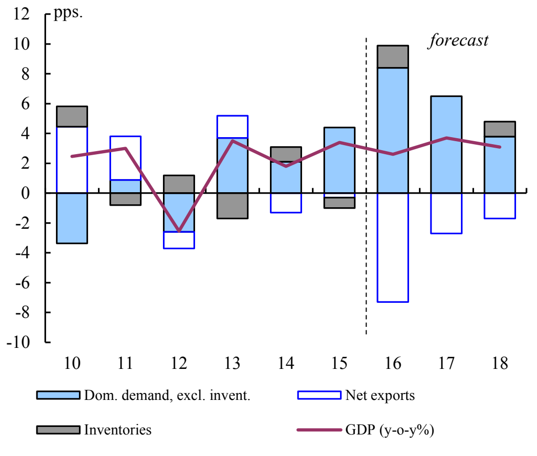
30. MONTENEGRO
High import content of investment drags on growth

Investment is set to remain the main driver of growth. However, the high import content of investment will likely lead to a moderation of growth too. Fiscal relaxation in 2016, with the increase in public sector wages, pensions and social benefits, is expected to be offset to some extent in 2017 with the implementation of the budget consolidation plan; but then again, the reprisal this year of extensive public works is expected to continue to feed higher budget deficits and debt beyond 2018.

Growth projections revised downwards

Data for the first three quarters of 2016 suggest a lower growth rate for the whole year than foreseen a few months ago. In particular, the outlook for private consumption is revised slightly downwards, with its growth expected to remain below the 3% annual rate for the whole year, as increases in public sector wages and pensions in 2016 were not followed by the private sector. Also, the government reduced its own pace of consumption. By contrast, the faster than expected surge in both public and private investments (by 30% y-o-y in the second and in third quarters), suggests a higher figure for the whole year. Hard data also confirmed the need to review upward the import elasticity ratio of investments, while exports projections appeared underestimated. Overall, these revised projections portray a stronger contribution of domestic demand to growth, offset by a more negative impact of net exports.

Graph II.30.1: **Montenegro - GDP growth and contributions**



A modest revival of industry

After a poor performance in 2016, industrial production is set to witness some recovery in 2017 driven by electricity output after the commissioning of the Krnovo windmill. The production of this new plant will account for 8% of the national electricity output, and will also support exports. With high electricity costs and low aluminium prices, the Montenegrin industry is turning to upstream production in an attempt to gain added value from the market. The production overhaul of aluminium alloy products is expected to commence in autumn 2017 and further develop in 2018.

Construction should remain strong, fuelled by investments

In particular, the completion of new hotels should continue improving the export of services, albeit at a slower pace due to high base-effect from the record-high number of visits registered in 2015 and 2016. Works will continue in 2017 and 2018 on the highway and the connection cable with Italy. On the transport sector, the conclusion of the ongoing privatisation of the port of Bar and the railway cargo company could bring efficiency gains, reinforcing the positive performance of services as of 2018. However, all these investments also present a high import component, exacerbating the already high volume of imports and the large external deficit.

Weak performance of the labour market

After the introduction in 2016 of a pension for mothers of three or more children, many working women opted out of the labour market while others, previously inactive, registered as unemployed, providing a distorted picture of longer-term trends in the labour market and hindering economic growth. Employment is expected to resume a faster pace in 2017 and 2018; firstly, in the construction sector, and after completion of the new facilities, on the tourism, transport and energy sectors.

Banks' deleveraging and consolidation

2017 could see the merge or acquisition of a few domestic banks, bringing some consolidation of the little Montenegrin market, and some further competition for market share. Meanwhile, the ongoing deleveraging of the financial sector hinders credit growth, except for households and foreign companies.

As a result of weak labour and credit growth, inflation pressures are expected to remain modest despite some increase in energy prices. During 2017 and 2018, the annual change in the consumer price index is expected to return gradually closer to the historical average of around 2%.

The return of high fiscal deficits

Delays in public works and some improvement on revenue collection resulted in a marked reduction of the general government deficit in 2016. However, as of 2017, budget deficits are set to increase to around 6% of GDP after resuming the financing of the highway. The 2017 fiscal consolidation plan offsets previous year's increase in current expenditure, namely in public sector wages and mothers' pensions introduced in 2016 before the elections. The main corrective measures include the reduction (up to 25%) in mothers' pensions, higher excises on fuel, an 8% cut in public sector wages as well as the suspension (until 2019) of the years of service bonuses. Yet, overall financing needs remain substantial (at 12% of GDP); half of which is expected to be covered by the Chinese loan to finance the Bar-Boljare highway. The projections for the 2018 budget performance are very similar to 2017, except for a further nominal increase in capital spending. However, some increase in VAT and fees revenue would contribute to contain the budget deficit at around 6% of GDP in 2018.

Main risks

Substantial financing needs, largely funded from foreign sources, will raise the stock of public debt above 70% of GDP until 2018. Although there will be no need to refinance Eurobonds in 2017 or in 2018, the refinancing risk will intensify soon afterwards in 2019, when bonds worth some 7% of GDP are coming to maturity. A possible increase in 2017 of the minimum wage (from current 30% of the average salary to 60%) is not scheduled in the baseline due to the customary no-policy-change assumption. However, such a step increase would have a negative impact on employment as well as on competitiveness and hence, on overall growth.

Table II.30.1:

Main features of country forecast - MONTENEGRO

		2015			Annual percentage change					
	mio EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		3624.7	100.0	-	3.5	1.8	3.4	**2.6**	**3.7**	**3.1**
Private Consumption		2871.9	79.2	-	1.6	2.9	2.2	**2.9**	**1.8**	**1.3**
Public Consumption		701.5	19.4	-	1.3	1.4	1.9	**2.4**	**1.4**	**1.1**
Gross fixed capital formation		736.3	20.3	-	10.7	-2.5	11.9	**27.4**	**19.0**	**9.0**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		1539.2	42.5	-	-1.3	-0.7	5.7	**4.3**	**3.1**	**3.2**
Imports (goods and services)		2213.6	61.1	-	-3.1	1.6	4.4	**15.0**	**6.1**	**4.5**
GNI (GDP deflator)		-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth:	Domestic demand			-	3.7	2.1	4.4	**8.4**	**6.5**	**3.8**
	Inventories			-	-1.7	1.0	-0.7	**1.5**	**0.0**	**1.0**
	Net exports			-	1.5	-1.3	-0.3	**-7.3**	**-2.7**	**-1.7**
Employment				-	1.1	7.1	2.4	**1.6**	**2.9**	**2.9**
Unemployment rate (a)				-	19.5	18.0	17.5	**17.9**	**17.4**	**17.1**
Compensation of employees / head				-	-2.0	6.1	0.9	**4.2**	**0.1**	**1.3**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour cost				-	-6.2	10.5	-1.4	**2.5**	**-1.9**	**-1.1**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	-	-	-	**-**	**-**	**-**
Consumer-price index				-	1.8	-0.5	1.4	**0.1**	**1.4**	**2.1**
Terms of trade of goods				-	-	-	-	**-**	**-**	**-**
Trade balance (goods) (c)				-	-39.5	-39.8	-40.4	**-46.1**	**-48.3**	**-49.0**
Current-account balance (c)				-	-14.5	-15.2	-13.3	**-19.5**	**-22.7**	**-23.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-4.6	-2.9	-8.4	**-3.8**	**-6.6**	**-6.0**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	57.6	54.8	61.2	**65.5**	**70.3**	**73.3**

(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.