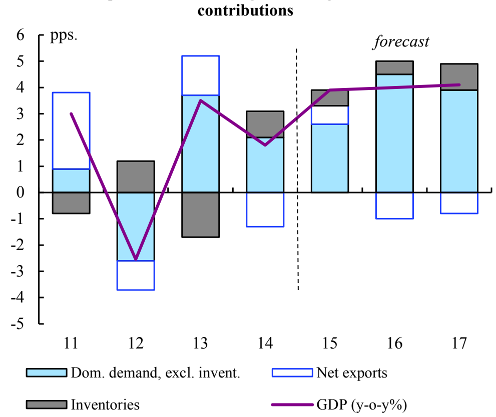
30. MONTENEGRO
Investment-driven growth

Surging public and private investments are set to drive economic growth in the next years. Private consumption is likely to benefit from the gradual improvement in the labour market. Meanwhile, public finances will remain strained by long-term commitments to finance a highway to Serbia and higher spending on wages, pensions and some social transfers.

Growth was stronger than expected

Strong growth in fixed capital investment and exports of services continued to support the economy in the third quarter of 2015, boosting GDP growth by 4.2% (y-o-y), up from 3.7% growth in the previous quarter. Yet, private consumption still remained subdued, presenting a negative contribution to economic growth due to stagnating wages and pensions in a low inflation context. By contrast, the contribution from government consumption and net exports turned positive in the third quarter, the latter driven by strong growth of services trade as a result of an excellent tourism season, and offsetting the also robust expansion of imports. Overall, considering past years' trends for the last quarter, GDP is expected to have increased by 3.9% in 2015.

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



Investment and tourism will continue to drive growth

Growth dynamics are expected to continue performing in a broadly similar way in 2016 and 2017. Thus, the substantial list of shovel-ready projects will sustain the strong performance of capital investments. Government fiscal space (and hence, its consumption) will remain constrained during the construction of the highway. Changes in inventories are envisaged to continue its strong seasonal pattern in line with retail traders' stocks and tourism-related consumption, while manufacturing stocks remain flat as the metal industry goes through restructuring. Yet, some recovery of private consumption may result from the government's plans to increase public sector wages, pensions, and some social benefits as foreseen in the 2016 budget. This will have an impact on the broader economy as the government is the major employer in the country, as well as by the example it sets for collective bargaining in the private sector.

The price factor

Falling global oil prices continue to weigh on Montenegrin inflation. Yet, the impact on growth from rising wages and pensions in 2016 could be dampened in case of higher inflationary pressures later on. This forecast considers two specific inflationary risks, affecting commodity prices: one related to the price of oil, projected to remain at low levels unless geopolitical risks in producing countries materialise, and the second one is related to food prices, in case unfavourable meteorological conditions affect future harvests.

Was 2015 tourism season a one-off effect?

The excellent results of the 2015 tourism season were the main factor for the narrowing of the external deficit. In the four quarters to September 2015, the current account deficit dropped to 12.6% of GDP, down from 15.8% a year before, in spite of further and simultaneous deepening of the merchandise trade deficit. As a result, the forecast revises upwards the positive contribution from service exports, expecting that significant investments on hotel capacities would sustain tourism-related income also in 2016 and 2017. Another technical factor recalibrated in this forecast is the lower than expected import elasticity of investments, allocating now more weight to construction equipment rather than to building materials.

Stronger labour supply dampens reduction in unemployment

The unemployment rate continued to decline in 2015, although at a slower pace than foreseen due to the simultaneous increase of the labour force. For 2016, the forecast expects that employment growth would continue at a similar pace as in 2015, to further accelerate in 2017 due to new investments, namely in new power generation plants.

Public spending to boost growth

The 2016 general government budget targets a deficit of 6.1% of GDP. The large deficit reflects the EUR 255 million (or 6.8% of GDP) spending to continue the construction of the priority section of a highway to Serbia. In addition, to stimulate the economy the government reduced as of 2016 the higher tax rate on personal income (paid by the employer) from 13% to 12%, and increased public sector wages, pensions and transfers. However, in the absence of new fiscal measures and structural reforms to counter these expenditure increases, this forecast reviews slightly upwards the deficit for 2016 and 2017.

Net financing needs remain substantial in 2016, but would decline in the following years. In 2016, the country will need to borrow EUR 688 million (or some 18% of GDP). Out of this amount, the main risk appears concentrated on the EUR 390 million to be rolled over in the capital markets in early 2016. Another EUR 205 million to finance the motorway in 2016 is secured by a USD denominated loan. In 2017 (in contrast with 2016 and 2015) there will be no need to refinance maturing Eurobonds, although a similar amount from the highway's loan should be withdrawn each year. Overall, Montenegro's public debt is set to further increase in 2016 and 2017 driven by further borrowing to finance capital spending.

According to Montenegro's fiscal rules, once the public debt reaches the limit of 60% of GDP - which is expected to happen soon - the government should present a plan to bring the debt below this threshold in the next five years. Yet, the new debt management plan could be challenged by cost overruns during the construction of the highway or by loosening fiscal discipline, in particular during the electoral year of 2016.

Table II.30.1:

Main features of country forecast - MONTENEGRO

	2014			Annual percentage change						
	mio EUR	Curr. prices	% GDP	96-11	2012	2013	2014	2015	2016	2017
GDP		3457.9	100.0	-	-2.7	3.5	1.8	**3.9**	**4.0**	**4.1**
Private Consumption		2774.9	80.2	-	-3.9	1.6	2.9	**0.0**	**1.5**	**3.3**
Public Consumption		669.9	19.4	-	3.0	1.3	1.4	**0.4**	**5.4**	**2.4**
Gross fixed capital formation		657.1	19.0	-	-2.4	10.7	-2.5	**13.5**	**11.5**	**4.5**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		1388.1	40.1	-	-0.3	-1.3	-0.7	**8.6**	**2.1**	**4.6**
Imports (goods and services)		2074.2	60.0	-	0.6	-3.1	1.6	**4.7**	**3.2**	**4.5**
GNI (GDP deflator)		-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth:	Domestic demand			-	-3.0	3.7	2.1	**2.6**	**4.5**	**3.9**
	Inventories			-	0.9	-1.7	1.0	**0.6**	**0.5**	**1.0**
	Net exports			-	-0.6	1.5	-1.3	**0.7**	**-1.0**	**-0.8**
Employment				-	2.2	1.1	3.1	**1.5**	**1.5**	**1.9**
Unemployment rate (a)				-	19.8	19.5	18.2	**17.6**	**17.2**	**16.8**
Compensation of employees / head				-	0.9	-2.0	-1.5	**0.0**	**3.5**	**2.6**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour cost				-	5.8	-6.2	-1.3	**-4.2**	**-1.1**	**-1.9**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	-	-	-	**-**	**-**	**-**
Consumer-price index				-	4.3	1.8	-0.5	**1.5**	**1.9**	**2.2**
Terms of trade of goods				-	-	-	-	**-**	**-**	**-**
Trade balance (goods) (c)				-	-43.7	-39.5	-39.8	**-40.3**	**-39.5**	**-38.8**
Current-account balance (c)				-	-18.5	-14.5	-15.2	**-12.9**	**-13.4**	**-13.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-6.0	-5.2	-2.8	**-7.0**	**-6.6**	**-6.1**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	53.4	57.5	54.8	**61.4**	**65.8**	**68.9**

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