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Montenegro: chances and challenges

The declaration of independence of Montenegro has been met with positive response from the market. The stock exchange jumped 40% on the decision and the mood on the part of the business community was generally positive. Foreign investments were strong in the first quarter and overnight stays by tourists have risen by over 30% so far this year. If the interest by the investors is sustained and if the tourist season proves to be as good as it is expected to be, growth this year should come to about 5%, which is the fastest rate in a very long while.

Macroeconomic stability has been assured with a low inflation rate and shrinking budget deficit. The deficit for 2006 may turn out to be higher because of increased spending ahead of the referendum, but so far the data do not show that. As Montenegro is using the euro, the budget balance is the main anchor of stability. In the past couple of years the government has been able to contain the growth of expenditures and thus to implement quite significant fiscal consolidation. This has been supportive of the current account too, though the deficit has been growing. Its widening has to be expected given the speed of growth. Also, as in the region as a whole, the consolidation and privatization of the banking sector has led to a lending boom, which has put pressure on the trade deficit. This year imports are continuing to outrun exports, but the crucial services balance will depend on the strength of the tourism season.

Montenegro has inherited a relatively low level of foreign debt. It will also join the IMF and the World Bank with low obligations towards these institutions. It can be expected that Montenegro will request a programme with the IMF because the country can certainly use outside help in order to pursue a sound macroeconomic policy. It needs technical support more than money, though investments into infrastructure are a priority in order to improve the access to its coast as well as to its mountain resorts.

The regional dimension is important for this small economy. Its tourist sector depends on the tourists from the region, in particular from Serbia and Kosovo. Also, its coast is a natural extension of the Croatian coast and there are significant spillover effects between the Dubrovnik area and the Kotor Bay area. In the future, the connection with the Albanian coast to the south will also be quite important. This part of the Adriatic Sea has longer summers and there are also potentials for the development of winter tourism. Therefore, the tourist prospects are more regional than being contained within the respective states.

The strategy of transition in Montenegro has been a very liberal one, though the realization has been rather patchy. The guiding idea is that the structure of the Montenegrin economy

that will develop does not require strong state intervention, except in terms of investment in infrastructure and in human capital. Because of still significant regional differences and a rather old population, transfers have to take the bulk of public expenditures, but those could be financed by relatively low tax rates if significant inflows of foreign investments are attracted. Also, given that there is not so much to protect, except the aluminium plant and the steel-mill, tariffs can be quite low and the same goes for the non-tariff barriers. Finally, Montenegro has adopted the euro and does not intend to reintroduce its own currency, so price stability should not be a problem.

Thus, there are fair chances for success. There are also challenges. The first will come with the parliamentary elections next fall. After that, the process of EU integration should be restarted and Montenegro should be ready to sign a Stabilization and Association Agreement by the end of this or the beginning of the next year. The longer-term challenge is the process of democratization and the strengthening of the rule of law. Clearly, those will have to develop in parallel with the process of EU integration

Table Montenegro

Montenegro: Selected economic indicators

	2001	2002	2003	2004	2005 ¹⁾	2005 1st quarter	2006	2006 forecast	2007
Population th pers., mid-year ²⁾	612.9	615.9	620.1	625.0	630.0	.	.	.	.
Gross domestic product, EUR mn, nom. ³⁾	1244.8	1301.5	1433.0	1535.0	1642.0	.	.	1760	1900
annual change in % (real)	-0.2	1.7	2.3	3.7	4.1	.	.	5	5
GDP/capita (EUR at exchange rate)	2031	2113	2311	2456	2600	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4840	5030	5140	5460	5790	.	.	.	.
Gross industrial production ⁴⁾
annual change in % (real)	-0.7	0.6	2.4	13.8	-1.9	4.0	4.4	4	4
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	6.9	5.9	1.0	3.5	.	.	.	.	.
Construction output total	.	.	.	.	.	.	.	.	.
annual change in %	.	.	.	.	.	.	.	.	.
Gross fixed investment, EUR mn, nom. ⁵⁾	226	183	166	145	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
LFS - employed persons, th, Oct ⁶⁾	214.4	220.6	.	187.3	185.0	.	.	.	.
annual change in %	-6.9	2.9	.	.	-1.2	.	.	.	.
Reg. employees in industry, th pers., avg.	36.7	35.8	34.1	.	.	.	.	.	.
annual change in %	.	-2.3	-5.0	.	.	.	.	.	.
LFS - unemployed, th pers., average ⁶⁾	57.5	57.7	.	71.8	.	.	.	.	.
LFS - unemployment rate in %, average ⁶⁾	23.7	20.7	.	27.7	28.0	.	.	28	28
Reg. unemployment rate in %, end of period ⁷⁾	.	.	32.9	29.3	25.2	29.1	25.2	.	.
Average gross monthly wages, EUR ⁸⁾	176	251	271	303	326	297	343	.	.
annual change in % (real, net)	8.0	.	9.3	9.1	6.7	5.7	11.7	.	.
Consumer prices, % p.a.	21.8	16.0	6.7	2.4	2.3	1.2	2.9	3	3
Producer prices in industry, % p.a.	.	14.5	4.5	5.8	2.1	3.1	0.9	3	3
Central governm. budget, nat.def., % GDP ⁹⁾
Revenues	17.8	17.7	23.6	24.3	.	.	.	.	.
Expenditures	20.8	20.5	26.6	26.4	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.1	-2.8	-3.0	-2.1	.	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn	-195.4	-163.4	-102.0	-119.6	-140.7	-18.6	.	-160	-150
Current account in % of GDP	-15.7	-12.6	-7.1	-7.8	-8.6	.	.	-9.1	-7.9
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	.	.	438.8	502.4	513.4	.	.	.	.
FDI net, EUR mn	10.6	89.2	38.7	50.6	374.7	161.2	.	.	.
Exports of goods, BOP, EUR mn ¹⁰⁾	235.4	322.6	270.6	452.1	434.5	93.7	.	470	500
annual growth rate in %	.	37.1	-16.1	.	-3.9	-8.2	.	8	6
Imports of goods, BOP, EUR mn ¹⁰⁾	722.9	747.3	629.9	868.6	940.3	145.9	.	950	1000
annual growth rate in %	.	3.4	-15.7	.	8.3	-28.9	.	6	5
Exports of services, BOP, EUR mn	150.2	171.7	191.4	249.5	314.5	21.3	.	.	.
annual growth rate in %	.	14.3	11.5	30.4	26.0	26.7	.	.	.
Imports of services, BOP, EUR mn	53.4	71.7	79.7	101.4	123.5	22.6	.	.	.
annual growth rate in %	.	34.3	11.1	27.2	21.8	5.2	.	.	.
Average exchange rate EUR/USD	0.90	0.94	1.13	1.24	1.24	1.31	1.20	.	.
Purchasing power parity EUR/USD, wiiw ¹¹⁾	0.37	0.36	0.38	0.38	0.37	.	.	.	.
Purchasing power parity EUR/EUR, wiiw ¹¹⁾	0.42	0.42	0.45	0.45	0.45	.	.	.	.

Notes.: 1) Preliminary. - 2) From 2003 according to census November 2003. 2004, 2005: wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) 2003 excluding private sector. - 6) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 7) In % of unemployed plus employment (excluding individual farmers). - 8) From 2002 including various allowances and new personal income tax system. - 9) Revenues excluding grants, expenditures excluding net lendig. - 10) From 2004 incl. trade with Serbia and Kosovo. - 11) Estimate based on a 45% price level (EU-25=100) in 2003 and extrapolation with GDP deflator.

Source: wiiw Database incorporating national statistics; wiiw forecasts.