

Vladimir Gligorov

Montenegro: is it sustainable?

Growth has been strong since the declaration of independence in May 2006. It has mostly been driven by consumption. Investments have also increased. Foreign investments have poured into real estate, especially on the coast. Significant investments have gone into tourism and into financial services. That has spurred growth of services, which accounts for most of the growth of production. Industrial output has continued to stagnate with no signs of a turnaround. Agriculture is not showing signs of improvement either.

The most impressive has been the growth of foreign direct investment: it has doubled within the past two years. In 2007 the FDI inflow was roughly as large as the current account deficit, i.e., around 40% of GDP. Similarly, imports of goods have doubled, while exports have increased only modestly. Exports of services, however, have also almost doubled in the past two years. This puts the huge increase of the current account deficit in perspective. The latter is mainly the consequence of the large inflows of foreign investments. Montenegro uses the euro and has no recourse to monetary and exchange rate policies. Thus, a surplus on the financial and capital account translates immediately into a deficit on the current account.

The large current account deficit has raised the issue of sustainability. However, in a country that is using a foreign currency as legal tender, sustainability is not an issue of the exchange rate but of growth, and that means of consumption and investment. If inflows decline, imports will decline as well, and that will mean that consumption will have to decline too. Thus, in this policy context, the issue is whether growth is sustainable. Looking at the sources of growth, it seems that the prospects for further expansion of services are quite positive. Investments in tourism and in related activities, particularly in infrastructure, can be sustained for quite some time.

In view of the strong growth and also strong inflow of foreign investments, the fiscal policy has faced few challenges. Indeed, Montenegro reported a fiscal surplus in 2007 and there is no reason why this should not be the case this year as well. Given strong growth of demand, it may be necessary to plan for large fiscal surpluses, especially in view of accelerated inflation. Though growth of prices should moderate this year due to the stabilization of food and energy prices, there is some pressure on prices that is being generated by the growth of wages. In 2007, average wage rose by 15% and that has certainly contributed to the prices increases. Montenegro needs to pay attention to inflation if it does not want to face worsening competitiveness. Fiscal policy is clearly the only policy instrument that it can use.

Though it started late, Montenegro was able to sign the Stabilization and Association agreement with the European Union already in the autumn of 2007. Further steps in the process of EU integration depend on the development of appropriate administrative capacity. As a small state, Montenegro has shortages of bureaucratic personnel and that impedes the speed of institutional harmonization with the EU. On the positive side, it is politically stable and will present few if any problems once it joins the EU.

Short-term prospects are positive with GDP set to grow by 6% in 2008. In the medium run, there are risks to growth connected with the sustainability of foreign finances. However, the scope for improvement in the services sector is large enough for strong growth to be quite attainable. There is some residual risk to political stability due to slow democratization, but EU integration should help in that respect.

Table ME

Montenegro: Selected economic indicators

	2002	2003	2004	2005	2006	2007 ¹⁾	2008	2009	2010
							Forecast		
Population th pers., mid-year ²⁾	617.1	620.3	622.1	623.3	624.2	625	.	.	.
Gross domestic product, EUR mn, nom. ³⁾	1,302	1,392	1,651	1,785	1,970	2,200	2,400	2,600	2,800
annual change in % (real)	1.7	2.4	4.2	4.0	8.3	7	6	6	6
GDP/capita (EUR at exchange rate)	2,109	2,244	2,654	2,864	3,156	3,520	.	.	.
GDP/capita (EUR at PPP - wiiw)	5,740	5,860	6,240	6,620	7,470	8,180	.	.	.
Gross industrial production ⁴⁾									
annual change in % (real)	0.6	2.4	13.8	-1.9	1.0	0.1	3	4	5
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	5.9	1.0	3.8	-0.9	1.9	.	.	.	.
Construction industry	.	.	.	.	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Consumption of households, EUR mn, nom. ⁵⁾	1,067	1,025	1,213	1,275	1,440	.	.	.	.
real growth rate, % ⁵⁾	6.4	.	16.0	2.8	10	8	6	7	8
Gross fixed capital form., EUR mn, nom. ⁵⁾	199	201	286	326	360	.	.	.	.
real growth rate, % ⁵⁾	-16.1	.	36.7	12	8	10	8	8	8
LFS - employed persons, th, Oct ⁶⁾	220.6	.	187.3	178.8	178.4	175	.	.	.
annual change in %	2.9	.	.	-4.5	-0.3	-1.9	.	.	.
LFS - employed persons in industry, th, Oct. ⁶⁾	.	.	30.9	29.2	26.5	26	.	.	.
annual change in %	.	.	.	-5.5	-9.3	-1.7	.	.	.
LFS - unemployed, th pers., average ⁶⁾	57.7	.	71.8	77.8	74.8	74	.	.	.
LFS - unemployment rate in %, Oct. ⁶⁾	20.7	.	27.7	30.3	29.6	30	30	28	27
Reg. unemployment rate in %, end of period ⁷⁾	.	32.9	29.3	25.2	20.5	17	17	.	.
Average gross monthly wages, EUR ⁸⁾	251	271	303	326	377	497	.	.	.
annual change in % (real, net)	.	9.3	9.1	6.7	12.0	15.0	.	.	.
Consumer prices, % p.a.	16.0	6.7	2.4	2.3	3.0	4.2	3	3	3
Producer prices in industry, % p.a.	14.5	4.5	5.8	2.1	3.6	7	3	.	.
Central governm. budget, nat.def., % GDP ⁹⁾									
Revenues	17.7	24.2	22.6	24.1	28.8	35	.	.	.
Expenditures	20.5	27.4	24.6	25.8	27.0	30	.	.	.
Deficit (-) / surplus (+), % GDP	-2.8	-3.1	-2.0	-1.7	1.8	5	0	0	0
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn ¹⁰⁾	-163.4	-102.1	-119.6	-154.0	-511.9	-870	-720	-650	-700
Current account in % of GDP	-12.6	-7.3	-7.2	-8.6	-26.0	-40	-30	-25	-25
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	893.6	461.5	488.6	513.3	504.0	500.6 ^{I-X}	.	.	.
Gross external public debt in % of GDP	68.7	33.2	29.6	28.8	25.6	22.8 ^{I-X}	.	.	.
FDI inflow, EUR mn	.	43.8	52.7	392.7	644.3	800	800	.	.
FDI outflow, EUR mn	.	5.1	2.1	11.5	177.6	400	400	.	.
Exports of goods, BOP, EUR mn ¹¹⁾	322.6	270.6	452.1	460.6	648.3	680	750	860	990
annual growth rate in %	37.1	-16.1	.	1.9	40.7	5	10	15	15
Imports of goods, BOP, EUR mn ¹¹⁾	747.3	629.9	868.6	974.3	1,498	2,100	2,520	3,020	3,620
annual growth rate in %	3.4	-15.7	.	12.2	53.7	40	20	20	20
Exports of services, BOP, EUR mn	171.7	191.3	249.5	329.8	433.6	690	1,040	1,460	1,900
annual growth rate in %	14.3	11.4	30.4	32.2	31.5	60	50	40	30
Imports of services, BOP, EUR mn	71.7	79.7	101.4	134.3	217.1	230	250	280	310
annual growth rate in %	34.3	11.1	27.2	32.5	61.7	8	10	10	10
Average exchange rate USD/EUR	0.9456	1.1312	1.2439	1.2441	1.2556	1.3706	.	.	.
Purchasing power parity USD/EUR ¹²⁾	0.31	0.32	0.36	0.37	0.36	0.35	.	.	.
Purchasing power parity EUR/EUR ¹²⁾	0.37	0.38	0.43	0.43	0.42	0.43	.	.	.

Note: From 2002 the term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) From 2003 according to census November 2003; 2006 wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) Unrevised data; partly wiiw estimate. - 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) In 2007 wage data refer to employees who received wages (previously wages were divided by all registered employees in enterprises); comparable value for 2006 433. - 9) Revenues excluding grants, expenditures excluding net lendig. - 10) Including all transactions with Serbia. - 11) From 2004 trade with Serbia and Kosovo based on customs statistics (before on ITRS). - 12) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.