

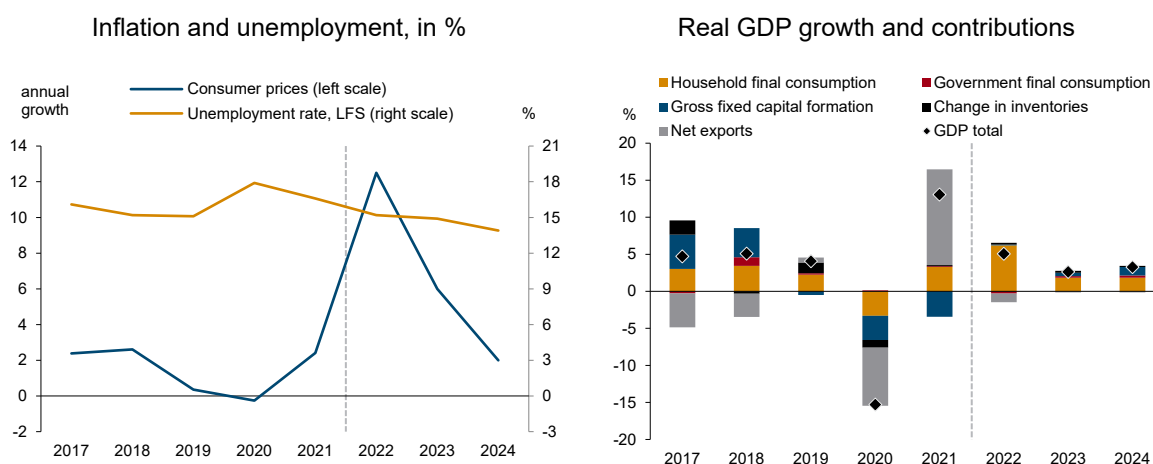


MONTENEGRO: Paralysed judicial system hampers EU integration progress

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Montenegro continued with its impressive growth in 2022, thanks to rising private consumption. This was a result of a tax reform that increased people's incomes, but which poses a serious threat to the state and the healthcare budget. The future will bring more inflation, which will act as a drag on consumption. Although not yet at pre-pandemic levels, tourism is on a solid path to recovery. The lack of political will to unblock the judiciary is extending the already lengthy road towards EU integration. Fresh parliamentary elections may be on the horizon.

Figure 6.14 / Montenegro: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Real GDP grew markedly in the first half of 2022 – by 7.2% in Q1 and 12.7% in Q2 – driven by a rise in household consumption. Increased spending resulted from a tax reform that put an end to compulsory health insurance, raised the minimum monthly wage to EUR 450 (from EUR 250) and introduced progressive personal income tax, with a zero rate for monthly earnings of below EUR 700. Altogether, these tax reforms raised average earnings by a nominal 30%, which is unprecedented in a country that has been dealing with stagnant wages for many years now. On top of that, the government introduced a phased increase in the minimum pension (of about 80%) this autumn, and that will also to some extent support consumption. Thanks to this cash influx, private consumption increased by over 12% in the first half of 2022. Household credit also rose, by 7% annually.

Migration from Ukraine has also contributed to the growth in private consumption. Consumption has been supported by Ukrainians who have fled the war and settled in Montenegro, and also by Russians who have bought property in Montenegro to safeguard their savings. For that reason, the first half of the year saw a big increase in foreign direct investment, due to an increase of 123% in real-estate investment. It is not unlikely that, with the migration of younger men from Russia to avoid mobilisation, the trend will continue to the end of this year. This increased investment has pushed up real-estate prices tremendously (in Q2 2022 they increased by 12% annually).

Given this, we project GDP growth to reach 5.1% in 2022, 1.5 percentage points higher than previously expected. At the same time, we have cut the growth projection for 2023 from 3.7% to 2.6%, on account of rising macroeconomic uncertainty.

However, high inflation is becoming a drag on consumption. Inflation picked up in summer to reach 15% in August, mainly on account of food and beverage prices (25.5%) and the cost of transport, housing, water and electricity (all with rises of over 14%). Montenegro is a big importer of food, and is thus at greater risk of inflation via this channel. As the scope for monetary policy is very limited, certain fiscal measures were taken to control prices – the excise duty on fuel was halved and value-added tax was scrapped on some basic food products. But this came too late: the higher food and energy prices had already spilled over into the tourism sector, and so the policies were rendered pretty much ineffective. Food prices will remain a key driver of inflation in the future, while energy prices will probably not rise so much in 2022. Over 55% of all electricity is produced from renewable energy sources (mostly hydropower plants), and the rest from coal. We expect a substantial rise in electricity prices only in the event of a lack of rainfall in 2022. All in all, we project average inflation to be 12.5% in 2022 and 6% in 2023.

While consumers are spending, the state and healthcare budgets are being squeezed. The tax reform was not properly planned, and its implementation was rushed and interrupted by the fall of one government early this year and of another in August. In the aftermath of the serious global health crisis, the healthcare system has lost an important source of financing because of this reform. The official state pharmaceutical supplier is still lacking basic medicines. It is not evident how the healthcare system will be financed in the long term, but it is already clear that it is at high risk. And so is the state budget. This reform and the fiscal measures taken to control inflation deprived the state of EUR 200m. The reduction in some public revenues and the pre-existing budget allocations mean that a new loan of EUR 450m will be taken out from local banks and in the form of a Eurobond placement. The budget deficit will probably reach 8.1% of GDP in 2022 and will stay at a similar level in 2023 and 2024. These are big deficits for the already highly indebted Montenegro.

The tourist industry recorded a good season, especially over the winter. Tourist arrivals rose substantially in the period January-July (by 79% annually), although they are still 10% down on pre-pandemic times. For the second year in a row, more tourists have come from the Balkan region, since there are currently fewer cheap air routes. Local and regional tourists accounted for 46% of total arrivals in the first seven months (compared to 30% before the pandemic). As the purchasing power of these tourists is lower, so are the revenues from the tourist sector. The winter season (Q4 2022) will likely be very successful, thanks to the inauguration this summer of the first highway leading to the ski centres. Overall, the sector is still the main driver of economic growth, while diversification toward other industries has not yet taken place.

A paralysed judiciary has become the 'new norm' for Montenegro. The EU has long stressed that the main obstacle to EU accession is the country's slow progress in the area of the rule of law. However, almost all the institutions in the judicial system have been pretty much paralysed for several years. The **Constitutional Court** has not functioned properly since January 2021: four of the seven judges of the Constitutional Court have retired (although, at different points in time), essentially disabling the court, as no decision can be taken without a majority. Three members of the **Supreme Court** council have been without a 'proper' mandate for six years now (i.e. their mandates have expired); the court also lacks a head, so that for the past two years it has been presided over by a deputy head. The country has also been without a **Supreme State Prosecutor** for about three years now. The key to unblocking the judicial system rests with parliament, but there has been no political majority to do anything. The EU had hoped that the institutions would be 'unblocked', so that reforms could start. That, however, has not happened.

Instead, agreement with the Serbian Orthodox Church was prioritised. Various elements of this agreement have sparked ethnic tension. The first is that the preamble ties the establishment of the Orthodox religion in Montenegro to the date of the establishment of the Serbian Orthodox Church. Given that Montenegro was a theocratic state until the nineteenth century, much of its historical heritage is (according to this agreement) linked to the Serbian Orthodox Church. Second, the preamble thus denies the existence of the Montenegrin Orthodox Church. Third, the agreement obliges the state to provide religious education for pupils whose parents demand such education, which makes the country more theocratic in nature and contravenes Montenegrin law. Fourth, the agreement grants possession rights to the Serbian Orthodox Church over property that, according to Montenegrin law, is a cultural heritage protected by the state.

EU accession is no longer a topic. After only a few months in power, the government lost its majority over the agreement with the Serbian Orthodox Church, thus opening a fresh chapter of political instability. Since the August 2020 election, two governments have fallen because of lack of consensus among the coalition parties. Reforms cannot be properly implemented with all the systemic changes. With this much uncertainty, the country risks its future with the EU. The political scene has been very heated for two years now and fresh general elections are being discussed.

Table 6.14 / Montenegro: Selected economic indicators

	2019	2020	2021 ¹⁾	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average	622	621	619	.	.	619	619	618
Gross domestic product, EUR m, nom.	4,951	4,186	4,955	2,018	2,428	5,900	6,400	6,700
annual change in % (real)	4.1	-15.3	13.0	6.8	10.3	5.1	2.6	3.3
GDP/capita (EUR at PPP)	15,700	13,360	15,370	.	.	.	.	.
Consumption of households, EUR m, nom. ²⁾	3,534	3,400	3,617	1,655	1,996	.	.	.
annual change in % (real)	3.1	-4.6	4.0	4.4	12.6	8.4	2.5	2.5
Gross fixed capital form., EUR m, nom.	1,352	1,166	1,096	526	599	.	.	.
annual change in % (real)	-1.7	-12.0	-12.3	-10.6	12.6	0.5	2.0	5.0
Gross industrial production ³⁾								
annual change in % (real)	-6.3	-0.9	4.9	10.6	-2.3	2.0	7.0	9.0
Net agricultural production ⁴⁾								
annual change in % (real)	-2.2	1.1	-0.5	.	.	.	.	.
Construction output								
annual change in % (real)	10.7	-5.5	-4.8	-1.3	-1.8	.	.	.
Employed persons, LFS, th, average ⁵⁾	243.8	219.4	212.6	193.3	243.6	244	249	256
annual change in %	2.7	-10.0	.	.	26.0	15.0	2.0	3.0
Unemployed persons, LFS, th, average ⁵⁾	43.4	47.8	42.2	43.2	45.2	40	40	40
Unemployment rate, LFS, in %, average ⁵⁾	15.1	17.9	16.6	18.3	15.7	15.2	14.9	13.9
Reg. unemployment rate, in %, eop	16.2	20.1	24.7	23.6	21.5	.	.	.
Average monthly gross wages, EUR	773	783	793	790	876	880	940	980
annual change in % (real, gross)	0.6	1.6	-1.1	-0.2	1.0	-0.8	0.3	2.0
Average monthly net wages, EUR ⁶⁾	515	524	532	529	704	710	760	790
annual change in % (real, net)	0.4	2.1	-0.9	0.0	.	18.0	0.6	1.5
Consumer prices, % p.a.	0.4	-0.3	2.4	1.2	9.8	12.5	6.0	2.0
Producer prices in industry, % p.a. ⁷⁾	2.4	-0.1	1.3	1.3	8.8	12.0	5.1	1.8
General governm. budget, nat. def., % of GDP								
Revenues	43.4	44.6	43.3	.	.	33.9	35.5	37.0
Expenditures	45.4	55.7	45.1	.	.	42.0	43.0	44.1
Deficit (-) / surplus (+)	-2.0	-11.1	-1.8	.	.	-8.1	-7.5	-7.1
General gov.gross debt, nat.def., % of GDP	76.5	105.3	84.0	.	.	82.0	80.0	78.0
Stock of loans of non-fin. private sector, % p.a.	6.6	2.9	3.4	2.3	9.1	.	.	.
Non-performing loans (NPL), in %, eop	4.7	5.5	6.2	5.7	6.3	.	.	.
Central bank policy rate, % p.a., eop ⁸⁾	5.46	5.33	5.16	5.28	5.06	5.1	5.0	5.0
Current account, EUR m	-707	-1,090	-455	-412	-540	-690	-770	-720
Current account, % of GDP	-14.3	-26.1	-9.2	-20.4	-22.2	-11.7	-12.0	-10.7
Exports of goods, BOP, EUR m	466	409	526	242	413	740	780	820
annual change in %	6.8	-12.2	28.6	32.4	70.9	40.0	5.5	5.0
Imports of goods, BOP, EUR m	2,531	2,051	2,441	1,062	1,564	3,920	4,310	4,530
annual change in %	1.8	-19.0	19.0	5.0	47.2	60.5	10.0	5.0
Exports of services, BOP, EUR m	1,705	679	1,597	427	735	3,010	3,410	3,680
annual change in %	9.1	-60.2	135.1	44.4	72.2	88.3	13.2	8.0
Imports of services, BOP, EUR m	687	503	641	244	419	970	1,050	1,090
annual change in %	9.6	-26.8	27.5	-2.7	72.1	52.0	8.0	4.0
FDI liabilities, EUR m	372	466	590	204	368	506	.	.
FDI assets, EUR m	67	-5	9	-2	12	16	.	.
Gross reserves of CB excl. gold, EUR m ⁹⁾	1,367	1,739	1,749	1,372	1,657	1,790	1,800	1,810
Gross external debt, EUR m	8,287	9,275	9,488	9,159	9,317	10,920	11,460	11,590
Gross external debt, % of GDP	167.4	221.6	191.5	184.8	157.9	185.0	179.0	173.0

1) Preliminary. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on gross value added data. - 5) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 6) From 2022 net wages excluding health insurance contributions and including an impact of personal income tax reform. - 7) Domestic output prices. - 8) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 9) Data refer to reserve requirements of the Central Bank.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.