

Montenegro



The Democratic Party of Socialists (DPS) remains the dominant political force in Montenegro, which it proved again with its convincing victory in the parliamentary elections of March 2009. Prior to this victory, Milo Djukanovic – considered for 15 years to be the dominant political figure in Montenegro, but absent from politics for some time – resumed his leading role within the DPS and accepted the role of prime minister. This highlighted the government's inability to make progress on planned reforms without his active involvement in the political process. The DPS candidate for president, Filip Vujanovic, was re-elected two months later. Despite its dominance, DPS required at least one coalition partner in the new government, and is now addressing a range of sensitive issues relating to the global economic crisis in partnership with the Social Democratic Party (SDP). The government has also set itself the ambitious goal of becoming a member of EU and NATO. In December 2008 Montenegro submitted a formal application to join the EU just 14 months after it had signed a Stabilisation and Association Agreement (SAA).

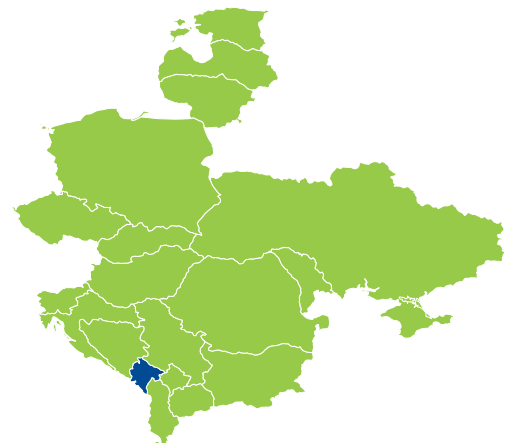
The 2003 census showed a slight rise in Montenegro's population, to 620,000 from about 615,000 in 1991. More significantly, it highlighted a substantial change in the country's ethnic structure with the number of people describing themselves as Montenegrin falling by about 113,000 to 268,000 and those identifying themselves as ethnic Serbs rising from 57,000 to almost 200,000.

As one of the smallest countries in the region, Montenegro's economy has a different structure from those of its neighbours.

Owing to its geographical position, it is more oriented towards service industries including tourism, which is one of the country's most important sectors. Montenegro also specialises in the manufacture of products including aluminium, which has historically been its major export item. According to EBRD estimates, service industry in Montenegro accounts for some 60% of GDP.

As with most of the former Yugoslav states, Montenegro's transition towards a market economy was sluggish in the 1990s, both during and in the years following the war. Notable reforms were evident in 1997, when the Montenegrin leadership distanced itself from the Milosevic regime in Serbia and invested great effort in achieving macroeconomic stabilisation and structural reforms.

While Montenegro was not at that time a member of the IMF (it joined this and other international organisations after it declared its independence from Serbia in 2007) and receiving the IMF guidance in this initiative.



Montenegro has managed its own public finances since 1998, when it ceased the transfer of federal taxes into the Yugoslav federal budget. Since then, the authorities have introduced a number of reforms to improve its tax collection. Fiscal reform has gathered pace since 2001, and the introduction of VAT in 2003 made public spending more transparent. As a result of such fiscal policies, the state budget deficit first fell to 1.7% of GDP in 2005, before recording a surplus in 2006 equivalent to 2.4% of GDP. This trend continued throughout 2007, surpassing all forecasts to deliver a surplus equivalent to some 8% of GDP.

In November 2000, the Montenegro Central Bank made the Deutschmark the sole valid currency in the republic, replacing it with the Euro in 2002. Adopting a foreign currency as its official currency brought some stability to Montenegro's monetary system, providing an anchor to control inflation and facilitate foreign trade. One disadvantage of this approach is that the Central Bank cannot influence money supply, imposing a heavy burden on fiscal policy in the event of a major economic crisis. One of the main monetary instruments of the Central Bank is to slow the rapid acceleration of bank lending. This has grown considerably in recent years (by some 130% year-on-year in 2008), raising doubts about the banks' appropriate assessment of the risks involved.

The adoption of a foreign currency as the sole legal tender reduced inflation considerably, from 67% in 1999 to 2.1% in 2006. However, inflationary pressures have risen again since 2007 because of high oil and food prices (as a consequence of drought in 2007), rising throughout 2008 to 8.2% in March 2009. Wage rises have also impacted on monetary stability in Montenegro. This acceleration was driven by public sector wage increases in October 2007, resulting in 20% growth in 2007 and a 25% year-on-year increase in March 2008. The largest growth was recorded in public administration, particular in the education sector which showed a 41% increase in 2008.

To some extent, Montenegro's economy still owes its underperformance to the period in the 1990s, when war and sanctions caused GDP to contract sharply. However, even between 2000 and 2005, by when Montenegro was running an independent fiscal and monetary policy, GDP only grew by the rather modest average of 2.5% – significantly below average growth for the Balkans. Growth subsequently strengthened, however, reaching 8.6% in 2006 and 7% in 2007, mainly driven by increased expenditure and inflows of foreign direct investment (FDI).

Despite this GDP growth, Montenegro's current account deficit remains large, raising questions as to its future sustainability. In 2008, it reached some 29% of GDP, rising from 25% of GDP in 2006. This increase was primarily caused by a large trade deficit, which expanded to 64% of GDP in 2007, followed by increases in domestic demand and a large inflow of FDI. The main challenge facing Montenegro economy is its ability to compete with other regional economies based on a somewhat narrow range of goods for export. Aluminium, fuel products and steel represent over 70% of its exports, aluminium alone accounting for 40%. On the other hand, imports are diversified, with machinery and motor vehicles featuring as significant items in the country's import structure. The most notable surplus in the Montenegrin economy is in the tourism industry, which accounts for approximately one third of the total service industry.

FDI inflows were modest until 2005, a direct consequence of inadequate privatisation, a lack of large scale opportunities and the relatively small overall size of the country's market. Since the full advent of privatisation, however, inflows have risen considerably, reaching close to EUR 1 billion in 2007. It is estimated that half of these are invested in real estate (amounting to some EUR 483 million according to central bank data). Foreign investments made by Montenegrin companies reached EUR 62.5 million in 2007. Other investments also increased considerably in 2007, reaching some EUR 358 million, as a direct consequence of credit inflow from abroad to Montenegrin banks and companies. With the help of these investments, Montenegro has managed to increase its foreign reserves despite its large current account deficit.

Industrial output contracted by 16.3% year-on-year in the fourth quarter of 2008 and by 12.5% year-on-year in January-February 2009, with the manufacturing sector hardest hit. This stemmed mainly from the severe problems encountered by Montenegro's key industry, basic metals and metal products, and was exacerbated by an acrimonious dispute over electricity prices between the state energy company, EPCG, and Montenegro's largest industrial producer, the Russian-owned Podgorica Aluminium Plant (KAP). As a result, the metals sector, which accounted for 43.4% of total industrial output in 2008 (down from 49% in 2007) contracted by 43.2% year-on-year in the fourth quarter of 2008. Two other large industries, manufacturing non-metal minerals and chemicals, also contracted significantly. Food processing, which accounted for 9.3% of industrial output in 2008, was the only sizeable industry that posted a positive growth rate (23.9% growth in the last quarter of 2008 and a 27.3% rise during January and February 2009).

Mining and quarrying reflected the downturn, contracting year-on-year by 9.4% in the fourth quarter of 2008. By contrast, the energy sector fared relatively well, falling by just 5.6% in the fourth quarter.

Retail trade decelerated in early 2009, reflecting slowing demand, from an average of 16% year-on-year growth in 2008 down to 9.9% in January and February 2009. However, the latest data indicate that retail is continuing to expand relatively rapidly in comparison with other countries in the Balkans.

Montenegro	2005/2007 Average Values	2007-2008	2008
	Change (%)	Change (%)	
Population (mil.)	-0.5	0.2	6.2
Average monthly gross wage (EUR)	19.5	17.5	651.0
EUR Exchange rate vis-à-vis	0.0	0.0	1.0
USD Exchange rate vis-à-vis	-1.8	4.4	0.7
	Real change (%)	Real change (%)	EUR mil.
GDP	7.8	8.1	3,339
Private consumption	n/a	n/a	2,566
Public consumption	n/a	n/a	923
Gross fixed capital investments	n/a	n/a	759
Exports (goods and services)	n/a	n/a	1,552
Imports (goods and services)	n/a	n/a	2,637
	Nominal change (EUR mil.)	Nominal change (EUR mil.)	EUR mil.
Trade balance	-215	-119	-1,032
Current account balance	-235	-151	-976
General government balance	74	-128	51
General government gross debt	2	310	1,082
External debt	-11	20	481
Foreign currency reserves	145	-160	335
	Percentage point change	Percentage point change	%
Economic activity rate	n/a	n/a	n/a
Unemployment rate	-3.5	-1.2	10.8
CPI rate (previous year = 100%)	0.7	0.6	6.9
Central bank interest rate	n/a	n/a	n/a
1-year yield on Treasury Bill	-2.8	0.0	0.5
10-year yield on Treasury Bond	n/a	n/a	n/a

Sources used: Reuters EcoWin Pro

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