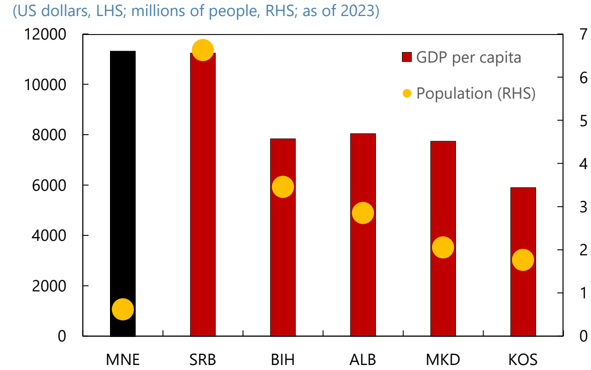
CONTEXT

1. **Montenegro is a strategically located, unilaterally euroized economy.** After gaining independence in 2006, the country was buffeted by the Global Financial Crisis. Following a period of tourism-driven growth averaging 4 percent in 2015-19, the economy was hit hard once again by COVID, contracting by over 15 percent in 2020. A strong recovery has taken root since 2021, and tourism has exceeded its pre-pandemic levels. The war in Ukraine has significantly impacted the economy through both real (via robust consumption growth due to migrants) and nominal (via inflation) channels, thereby improving its fiscal position. However, on current policies Montenegro's fiscal position is likely to gradually weaken once again over the medium term.

Montenegro vs. Peers: GDP Per Capita and Population

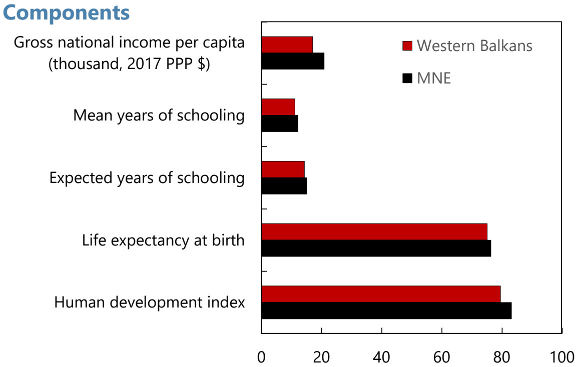
(US dollars, LHS; millions of people, RHS; as of 2023)



Source: IMF WEO Database.

2. **Fresh elections were held in 2023.** Since 2020, two minority governments and one caretaker administration were followed by presidential and parliamentary elections in March and June 2023 respectively. A new coalition government was formed in end-October 2023, and a new CBCG Governor took office in December 2023. Despite political fragmentation, there is strong social consensus regarding the goal of EU accession, targeted for 2028 by the authorities.

Montenegro vs. Peers: Human Development Index and its Components



Source: United Nations.

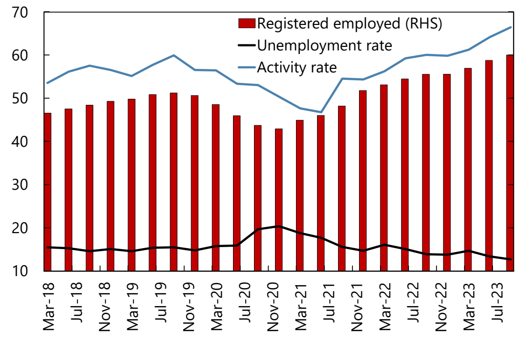
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

3. **Economic growth in 2023 was robust, at 6 percent.** In addition to a rebound in tourism, growth has been fueled by strong consumption of residents and by an inflow of affluent Russian and Ukrainian migrants since 2022 (estimated at around 10 percent of the country's population, see Annex I) who have not placed strains on the budget.[1] Following 6.4 percent growth in 2022, the economy grew at an estimated 6 percent 2023 driven primarily by private consumption in the first half and by net exports in the second half of the year. Unemployment fell below pre-pandemic

[1] In addition to Russians and Ukrainians, there has also been a more recent and steady inflow of affluent emigres from Turkey, currently estimated at around 2 percent of the country's pre-war population.

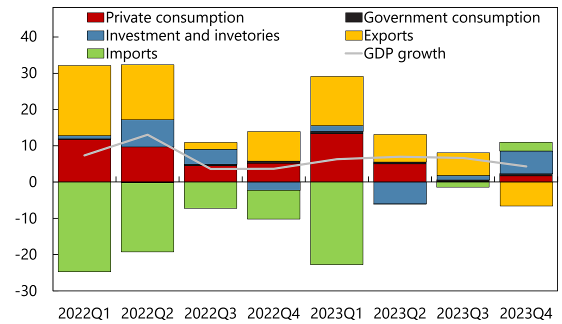
levels to 13.1 percent in 2023 while both labor force participation and the employment rate increased.

Montenegro: Labor Market Developments
(Percent, LHS; thousands, RHS)



Source: MonStat.

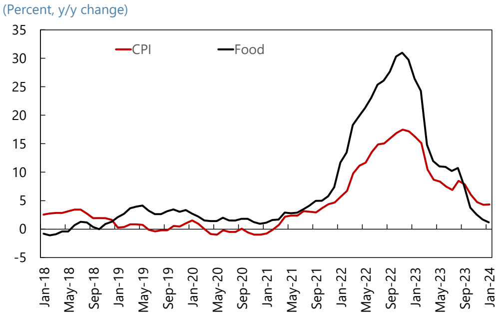
Montenegro: Real GDP Growth and Contributions
(Percent, y/y change)



Source: MonStat.

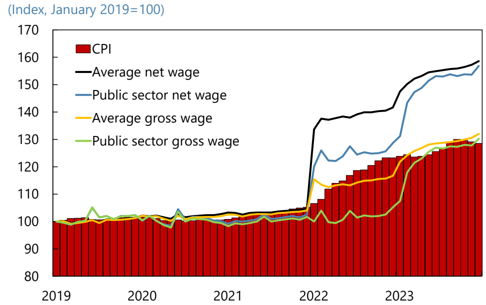
4. Inflation has come down from its 2022 peak, but upside risks persist over the medium-term. Driven by food and fuel prices, as well as large domestic policy-induced wage increases, inflation jumped to 17 percent y-o-y in 2022. Unlike in many peer countries, however, the government was not as pressed to help households cope with the higher cost of living. This was partly due to Montenegro's electricity self-sufficiency, and also because the near-doubling of the minimum wage within the 'Europe Now' reform package occurred just before commodity prices spiked.[2] Recently, wage growth, driven by public sector wage increases, has outpaced inflation and headline inflation has exceeded food price inflation unlike in recent years. February 2024 inflation was 4.3 percent y-o-y.[3] The differential with Euro Area inflation has reduced sharply from its peak of 8 percentage points in December 2022 to around 1.7 percentage points in February 2024, but continuing wage pressures risk keeping inflation elevated compared with the pre-COVID years.[4]

Montenegro: Headline and Food Price Inflation
(Percent, y/y change)



Sources: Haver Analytics and IMF staff calculations.

Montenegro: Wages and Inflation
(Index, January 2019=100)



Note: net wages exclude taxes and contributions.
Source: MonStat.

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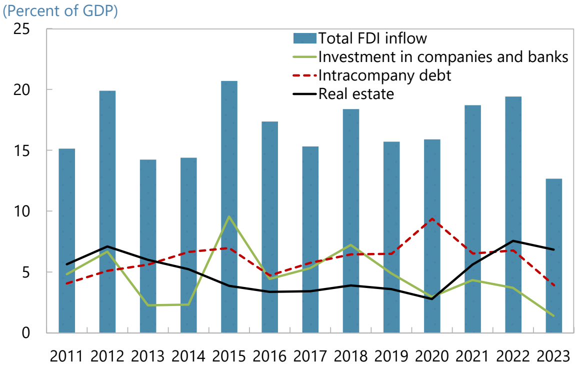
[2] The 'Europe Now' reform package, introduced in 2022, included a near-doubling the minimum wage, elimination of healthcare contributions and introduction of a generous non-taxable threshold for PIT. See 2021 Article IV Staff Report for more detail.

[3] In March 2024 the government introduced profit margin caps on some basic food items for large wholesalers and retailers for a period of 2 months. A similar measure was used in 2022 as well.

[4] See Annex II for a discussion of inflation dynamics in Montenegro.

5. **The current account deficit has narrowed significantly.** Falling from its peak of 26.1 percent of GDP in 2020, the current account deficit stood at 12.9 percent and 11.4 percent in 2022 and 2023, respectively. In 2023, tourism revenues exceeded their pre-pandemic levels by 38 percent, while import growth slowed in the second half of the year in line with the deceleration in the rate of consumption growth relative to previous quarters. As in previous years, the current account deficit was financed mostly by FDI inflows, but also by high positive errors and omissions.[5] While FDI into the real estate sector remained robust in 2023, intracompany FDI declined sharply, likely due to the comfortable cash position of the tourism sector companies. Equity investment also declined due to higher interest rates in advanced economies. The external position in 2023 was assessed to be substantially weaker than the level implied by fundamentals and desirable policies (Annex III).

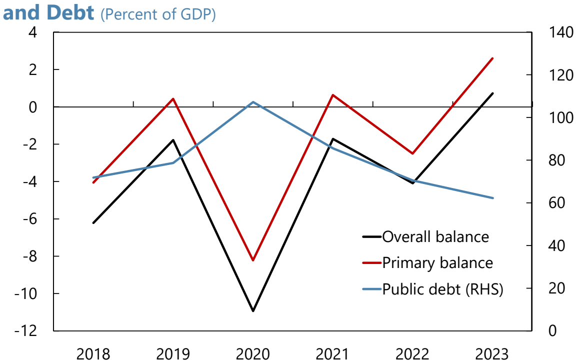
Montenegro: Gross FDI Inflows
(Percent of GDP)



Sources: Central Bank of Montenegro and IMF staff calculations.

6. **The general government budget recorded a surplus in 2023, following a bumpy path since COVID.** The fiscal deficit fell from its pandemic high of 10.9 percent of GDP in 2020 to 1.7 percent of GDP in 2021, then rose back to 4.1 percent in 2022, largely due to removal of healthcare contributions and the introduction of a generous non-taxable threshold as parts of the 'Europe Now' reform package. According to preliminary data, the budget recorded a surplus of ¾ percent of GDP in 2023 in contrast to an initially planned deficit of 5.6 percent of GDP. Alongside the effect of strong consumption growth on revenues, this strong fiscal performance in 2023 was driven in part by a few other factors: temporary increases in nontax revenues; fees from the citizenship program; payout from the termination of a 2021 currency hedging arrangement; and tax debt rescheduling. Public debt peaked in 2020 at 107 percent of GDP, fell back to 71 percent in 2022, and fell further to an estimated 61.5 percent of GDP in 2023 driven by the post-pandemic recovery, high inflation, as well as the use of deposits that were accumulated through large debt issuance in 2020. On March 6, 2024, Montenegro successfully placed a US$750 million Eurobond at a favorable effective rate of 5.9 percent in Euros (following a cross-currency swap transaction).

Montenegro: Dynamics of General Government Balance and Debt (Percent of GDP)

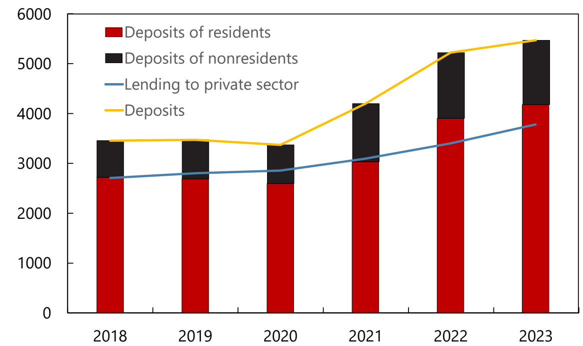


Sources: Ministry of Finance and IMF staff calculations.

[5] Errors and omissions were 10.7 percent of GDP in 2023 as compared to 9.6 percent in 2022 and 1.8 percent on average between 2012-2021. The surge in errors and omissions is likely due to the recovery of tourism as well as the large inflows of migrants as a result of the war in Ukraine.

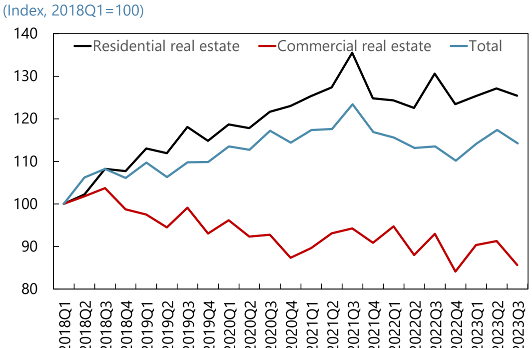
7. **The banking system, overall, appears to have weathered recent shocks well.** The withdrawal of COVID support measures and gradual application of stricter asset classification standards did not materially affect the NPL ratio (5.0 percent of total loans in Q4 2023, compared with the post-COVID peak of 6.5 percent in Q1 2022). The average capital adequacy ratio of the system is nearly twice the regulatory minimum. However, pockets of vulnerability remain, which are under close supervision and subject to tighter standards set by CBCG. Record-high deposit growth (62 percent since end-2020), driven by a sharp post-COVID recovery and large nonresident deposit inflows, resulted in ample liquidity.[6] As of February 2024, the average deposit and lending rates were respectively 0.1 percentage points lower, and 1.0 percentage points higher than they were in end-2021. Private sector credit growth has not kept pace with the growth in deposits, causing the loan-to-deposit ratio to fall. Banks have chosen to park additional deposits into their reserve balances at CBCG and, more recently, also switched into foreign securities investments. Despite growing real estate prices, rents, and a rapid increase in construction activity, the share of real estate loans to gross loans has remained stable at around 20 percent (see the Financial Sector Policies section).

Montenegro: Deposits and Lending
(Millions of Euros)



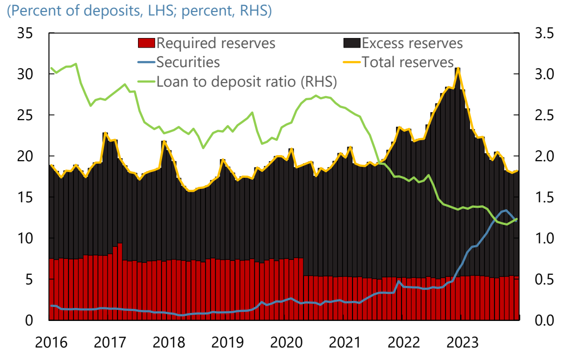
Source: Haver Analytics.

Montenegro: Loans Outstanding to the Real Estate Sector
(Index, 2018Q1=100)



Sources: Haver Analytics and IMF staff calculations.

Montenegro: Loans and Investments by the Banking Sector
(Percent of deposits, LHS; percent, RHS)



Sources: Haver Analytics and IMF staff calculations.

8. **Growth is expected to moderate to 3.7 percent in 2024, and the fiscal deficit is expected to rise.** After surpassing its pre-pandemic levels, tourism growth is expected to moderate. Staff's baseline assumes no further net migrant inflows or outflows; therefore, consumption growth is also expected to slow. Inflation is expected to continue to fall, although the differential with Euro

[6] Following an inflow of non-resident deposits into Montenegrin banks in 2021–22, non-resident deposit levels have stabilized. The share of non-resident deposits to total deposits stands at 24 percent in January 2024 which is broadly in line with the long run trend.

Area inflation in 2024 is still expected to be somewhat higher than its historical average. Absent structural reforms to raise national saving, the current account deficit is expected to rise to about 13.6 percent of GDP over the medium term, in line with its historical average. In staff's baseline the general government fiscal balance is set to weaken from 0.7 percent of GDP in 2023 to -3.2 percent of GDP in 2024, continuing over the medium term (due to growing interest payments and social security transfers). Public debt is expected to resume a gradual upward trajectory, reaching 66.1 percent of GDP in 2029.

9. Macroeconomic risks, on balance, rise over the medium term. The possibility that migration could reverse in the foreseeable future cannot be fully ruled out. This would negatively affect near-term growth and future growth prospects.[7] Downside risks to global growth, would negatively affect Montenegro primarily through tourism and FDI channels. Montenegro is also highly vulnerable to tightening of global financial conditions, given high sovereign refinancing needs (averaging 12 percent of GDP in the next five years) and projected deterioration of fiscal balances. Capital outflows, including of nonresident deposits, FDI into the real estate sector, and portfolio investment could occur, particularly if political uncertainty were to return. While inflation has been decelerating, the main upside risks stem from wage pressures as well as new shocks to commodity, especially food, prices (see Annex II). Although the fiscal outlook has improved substantially since the last Article IV Consultation, the fulfillment of all electoral promises would pose significant risks to the fiscal position (discussed in the Fiscal Policy section). For a fuller discussion of risks, see Annex IV.

Authorities' Views

10. The authorities broadly agreed with staff on the growth and inflation outlook. They highlighted the challenges in assessing the impact of migrants on growth and its economic implications. They also noted that broad measures of domestic policies in the last two years have supported economic growth. The CBCG thought that risks to banking sector stability from capital outflows were contained, given the ample liquidity in the banking sector which is largely driven by domestic deposits. On the recent surge in Errors and Omissions, the CBCG is seeking technical assistance from the IMF Statistics Department.

POLICY DISCUSSIONS

Fiscal policy discussions focused on the need to maintain a non-negative primary balance, anchored by a prudent debt ceiling of 60 percent of GDP by 2028. Longer-term structural fiscal reforms are important to support healthy public finances. Continued vigilance in the banking sector is essential as the landscape of risks changes. Staff emphasized that future growth prospects can be enhanced by supporting economic diversification, SME development, and female labor force participation. They do not hinge on ramping up infrastructure expenditures in a short period of time.

[7] See Annex I on the impact of migrants on growth over the near and medium term.

A. Fiscal Policy

11. The 2024 budget envisages a sharp rise in the fiscal deficit. On the expenditure side, the most notable feature of the 2024 budget is the 1.8 percent of GDP increase in social security transfers, mostly due to a more than 50 percent increase of the minimum pension to 450 euros per month. Capital expenditure and unallocated reserve fund spending are also expected to be higher compared to 2023. On the revenue side, the 2024 budget includes removal of COVID exemptions and preferential rates for VAT (estimated yield, 0.5 percent of GDP), increasing of excises on tobacco, plastics, and products containing sugar (estimated yield, 0.3 percent of GDP) and increasing fees on games of chance (estimated yield, 0.3 percent of GDP). These measures were originally planned under 'Europe Now' to partially compensate for the revenue loss caused by the abolition of health contributions (and were included in the World Bank Development Program Facility). An additional 0.2 percent of GDP of VAT revenues is expected from increased consumption due to higher social transfers. While not yet incorporated into the 2024 budget law, an agreement was reached in February 2024 to raise wages in the education sector with an estimated annual impact of 0.2 percent of GDP. In sum, combined with abating of one-off non-tax revenues of 2023, the overall general government balance is expected to fall from 0.7 to -3.2 percent of GDP in 2024. (Text Table 1). Both the higher spending and the revenue raising measures are expected to contribute moderately to inflation in 2024.

Text Table 1. General Government Budget
(In percent of GDP)

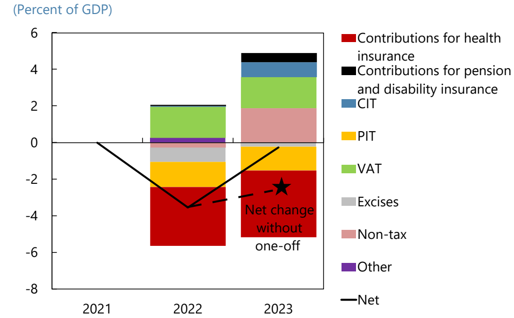
	2023 (est.)	2024 (proj.)
Total revenues and grants	41.8	41.0
Taxes	27.6	28.4
Personal income tax	2.2	2.2
Corporate income tax	2.2	2.2
Value added tax	15.5	16.2
Excises	4.7	5.0
Other taxes	3.0	2.9
Social security contributions	7.4	7.4
Nontax revenues	5.1	3.9
Grants	1.7	1.2
Total expenditures and net lending	41.1	44.2
Gross salaries	9.4	9.5
Other personal income	0.3	0.4
Other current spending	5.2	5.3
Interest payments	1.9	1.8
Social security transfers	12.1	13.9
Other transfers	6.9	7.0
Capital expenditure	5.1	5.6
Reserves	0.3	0.9
Overall Balance	0.7	-3.2
Primary Balance	2.6	-1.4

Source: IMF staff calcualtions.

12. Under current policies, public debt is set to resume a gradual upward trend. Debt is projected in the baseline to increase from 61.5 percent in 2023 to 66.1 percent by 2029 and continue growing further (Annex V). There are three main underlying drivers of the debt dynamics:

- *Revenue losses due to 'Europe Now' reforms:* The abolition of health contributions cost about 4 percent of GDP in revenues, and Personal Income Tax (PIT) revenues fell by about 1 percent of GDP due to the introduction of a generous tax-free allowance of 700 euros per month.[8] Partially offsetting these revenue losses, an increase in

Montenegro: Changes in Major Revenues Relative to 2021
(Percent of GDP)



Sources: MonStat and IMF staff calculations.

[8] 64 percent of the wage distribution was below a monthly income of 700 euros at the time.

Corporate Income Tax (CIT) revenue by 0.7 percent of GDP in 2023 coincided with the progressivity of CIT system coming into effect for 2023. Higher private consumption due to the 2022 reforms and the inflow of migrants have contributed to the increase of VAT revenues by up to 1.5 percent of GDP. However, the strong growth rates of CIT and VAT revenues are likely to taper off as economic growth moderates. The revenue measures introduced in the 2024 budget are expected to increase revenues by a combined 1.3 percent of GDP, still falling short of compensating for the losses in healthcare contributions and PIT.

- *Structural increases in social expenditures:* The main drivers are the 2024 increase in minimum pensions (around 2 percent of GDP), the 2021 introduction of quasi-universal child allowance (around 1 percent of GDP) and the 2022 re-introduction of mothers' benefit (some 0.8 percent of GDP).[9] However, the recent minimum pensions hike is expected to gradually lower the uptake of the mothers' benefit.

- *Rising interest costs:* Staff's baseline projects that interest costs will increase from 1.6 percent of GDP in 2022 to 2.8 percent in 2029, driven by the combined effect of higher interest rates relative to history on widening fiscal deficits. Financing needs in 2025 and 2027 are expected to near 14 and 16 percent of GDP respectively, when large Eurobond repayments come due.

13. A set of credible adjustment measures is necessary to counteract the recurrence of adverse fiscal dynamics. Starting 2024, the authorities are advised to reinvigorate the reform project of the Montenegro Revenues and Customs Administration, particularly in improving compliance risk management, the use of third-party data and greater digitalization. The IMF estimates that this reform will yield cumulative gains in revenues by 0.9 percent of GDP over four years. Starting 2025, limiting the growth of the public sector wage bill to CPI for two years will generate savings of 0.6 percent of GDP. Also starting 2025, implementing the fuel marking reform (which was

Text Table 2. Possible Fiscal Adjustment Measures and Their Impact

(In percent of GDP)

	2023	2024	2025	2026	2027	2028	2029
Revenue administration reforms		0.2	0.4	0.7	0.9	0.9	0.9
Fuel marking			0.3	0.3	0.3	0.3	0.3
Containing wage bill growth to CPI 2025-26			0.3	0.6	0.6	0.6	0.6
Annual impact, cumulative		**0.2**	**1.0**	**1.6**	**1.8**	**1.8**	**1.8**
Annual impact, additional		**0.2**	**0.8**	**0.6**	**0.2**	**0.0**	**0.0**
Primary balance, baseline		-1.4	-1.5	-1.5	-1.5	-1.5	-1.6
Overall balance, baseline		-3.2	-3.5	-3.7	-3.9	-4.2	-4.4
Public debt, baseline	61.5	62.3	61.4	62.2	63.2	64.8	66.1
Public debt net of deposits, baseline	*59.1*	*58.0*	*58.2*	*59.0*	*60.1*	*61.4*	*62.9*
Primary balance, after measures		-1.2	-0.5	0.1	0.3	0.3	0.2
Overall balance, after measures		-3.0	-2.5	-2.1	-2.0	-2.3	-2.3
Public debt, after measures	61.5	62.3	60.2	59.4	58.9	58.5	58.1
Public debt net of deposits, after measures	*59.1*	*57.8*	*57.0*	*56.2*	*55.5*	*55.1*	*54.8*

Source: IMF staff calcualtions.

[9] This benefit was first introduced in 2015 for mothers of 3 or more children, at approximately 70 percent of the average net salary for women with 25 years of employment and 40 percent of salary for women with 15 years of unemployment. The benefit was deemed discriminatory by the courts and removed in 2017. However, in 2022, the government reintroduced a compensatory benefit for those eligible to receive the prior benefit.

one of the originally planned compensatory reforms under 'Europe Now') will increase excises revenues by 0.3 percent of GDP. Together, these tax policy, tax administration, and expenditure measures will help achieve a fiscal adjustment of 1.8 percent of GDP relative to baseline and stabilize debt at below 60 percent of GDP over the medium term (see Text Table 2 and Annex VI for more detail). Undertaking deficit reduction measures beginning in 2024 would also help bring inflation down faster and close the estimated small positive output gap sooner than in the baseline.

14. Commitment to the debt anchor is necessary for a credible medium-term fiscal framework. A 60 percent debt-to-GDP ceiling—in line with Montenegro's Law of Budget and Fiscal Responsibility—to be reached by 2028 would be an appropriate debt anchor.[10] This can be achieved by maintaining a non-negative primary balance from 2026 onwards, and would, in practice, keep the overall deficit below 3 percent of GDP (Text Table 2). In contrast, targeting the current balance (overall fiscal balance excluding capital spending) would not necessarily stabilize debt. A strong commitment to the debt anchor and the authorities' strategy for adherence to it should be included in the upcoming Macroeconomic and Fiscal Policy Guidelines of the government and reiterated in budget documentation in the coming years. Given high financing needs over the medium term, the adoption of a strong fiscal anchor would have important signaling effects.

15. Long-term structural fiscal reforms would further support healthy public finances. Social transfers need to be managed through better targeting of the eligibility of benefits to those who are most vulnerable. Growth in the public sector wage bill needs to be contained over the medium-term, including by introducing rules to limit the hiring of permanent and non-permanent staff, and review of non-salary compensations. Project selection, planning, and risk appraisal issues identified in the 2021 IMF Public Investment Management Assessment need to be addressed. In addition, the public investment planning processes should fully include as active participants, those agencies in charge of implementing capital projects, which would increase the efficiency of capital budgeting and implementation. Strengthening the capacity of the newly split Tax Administration and Customs Agency will be essential to raising fiscal revenues in the smoothest possible way. The establishment of a fully functional fiscal council,[11] and improved oversight of state-owned enterprises (SOEs) will usefully complement the fiscal efforts of the government. Finally, restarting the t-bill/bond auctions and extending the market to the retail investor base will help diversify the government's sources of funding.[12] The IMF has and will continue to support the Montenegrin authorities through the provision of capacity development in these and other areas.[13]

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[10] Montenegro's Law of Budget and Fiscal Responsibility stipulates that general government debt should not exceed 60 percent of GDP and deficit should not exceed 3 percent of GDP.

[11] See Annex VII on Implementation of Past IMF Recommendations.

[12] The recent rapid growth of deposits despite exceptionally low deposit rates presents an opportune moment for the government to access retail investors.

[13] See Annex VI for further detail.

16. Were all electoral promises to be fully honored, the ensuing fiscal deterioration would be markedly worse. Electoral promises that did not feature in the 2024 budget proposal or in the authorities' medium-term projections, include (i) partial to full elimination of pension contributions (up to 7.5 percent of GDP); (ii) increasing the net minimum wage from 450 to 700 euros per month. A scenario assuming this is fully implemented starting in 2025 projects public debt to surpass 100 percent of GDP in 2029 (summarized in Text Table 3).[14] Financing these policies through offsetting measures would be extremely challenging: for example, increasing the VAT rate by 6 percentage points would only yield about 4 percent of GDP extra revenue, as compared to nearly 9 percent adjustment needed to bring the primary balance to zero. Despite the authorities' preference to shift the tax burden from direct to indirect taxation, such a sizable increase in the VAT rate would be distortionary, regressive, and highly inflationary.

Text Table 3. Alternative Scenario: Elimination of Pension Contributions
(In percent of GDP)

	2023	2024	2025	2026	2027	2028	2029
General Government Revenue	41.8	41.0	32.8	32.8	32.8	32.8	32.8
General Government Expenditure	41.1	44.2	43.6	44.2	44.8	45.5	46.1
Interest expenditure	1.9	1.8	2.1	2.7	3.2	4.0	4.5
Primary balance	2.6	-1.4	-8.7	-8.7	-8.7	-8.8	-8.8
Overall balance	0.7	-3.2	-10.7	-11.4	-12.0	-12.7	-13.3
Public debt	61.5	62.3	67.9	75.9	84.5	93.5	102.5
Memo:							
Nominal GDP, EUR millions	6,847	7,428	8,035	8,470	8,912	9,374	9,860
Nominal GDP, EUR millions, baseline	6,847	7,428	7,888	8,315	8,749	9,203	9,680

Source: IMF staff calculations.

Authorities' Views

17. The authorities were more optimistic on the debt trajectory but broadly agreed on the importance of a debt anchor for a credible medium-term fiscal framework. They expressed confidence that public expenditures, and most notably, the public wage bill, will grow slower than nominal GDP over the medium term, leading to improving medium-term primary balances. They were optimistic on tapping the international markets at more favorable rates relative to staff's baseline projections (which has indeed been the case for the March 2024 bond issue). The Ministry of Finance expressed interest in new IMF TA to support the preparation of their medium-term debt strategy, building on previous TA in 2023. The authorities also mentioned their intention to move ahead with staffing of the Fiscal Council in the coming months. Both the Ministry of Finance and the Revenue administration stressed their strong commitment to improve tax administration and expressed appreciation for the Fund's support.

[14] If financed by full elimination of pension contributions, the net minimum wage increase would not lead to an increase in labor costs to employers, or to the public wage bill. However, the minimum wage increase will be inflationary (see Annex II). The scenario abstracts from the higher risk premia that would result from the proposed policies. Incorporating such effects would compound the negative implications.

B. Financial Sector Policies

18. Even as indicators of systemic financial sector risks are low, the CBCG should closely watch emerging risks. CBCG has encouraged the conversion of existing variable rate loans to fixed rate loans, causing the share of variable rate loans to decline from 29 percent (mid-2022) to 14 percent (Q4 2023). This has helped contain the riskiness of the loan portfolio. The real estate market is buoyant and is supported by increased demand from recent immigrants with financing mainly from inward FDI rather than the local banking system. More broadly, to better inform the formulation of macroprudential policies, the CBCG should lean on the banking sector to provide data regarding indicators such as loan-to-value, price-to-income, debt-to-income and debt service-to-income ratios across all sectors more systematically and frequently.[15] The CBCG's removal of its forbearance measure allowing banks to exclude from their calculation of regulatory capital unrealized losses from holdings of government securities, in line with the IMF-endorsed recommendation, has helped enhance market discipline. Going forward, it is important to consistently let supervisory data appropriately reflect market realities. The banking sector's growing exposure to foreign securities also requires close monitoring as it may create interest rate and potential maturity mismatch risks. The IMF is supporting CBCG with technical assistance on the supervision of interest rate risks.

19. As in other European countries, domestic deposit interest rates have been unresponsive to ECB monetary tightening. The strong post-COVID economic recovery and nonresident deposit inflows resulted in record-high deposit growth. Loan growth has not kept pace, resulting in a fall in the loan-to-deposit ratio. While lending rates have risen, deposit rates have remained flat, thereby driving strong banking sector profits. Factors contributing to low deposit rates include high levels of liquidity, high market concentration in the banking sector, limited opportunities for profitable lending, as well as challenges for local depositors to tap higher yields and "home bias". In this context, the CBCG should collaborate with the government to develop a retail government bond market, to diversify funding channels for the government whilst providing higher returns for savers.

20. Staff strongly emphasized the importance of preserving the operational independence and institutional credibility of the CBCG. Emerging pressures on the central bank to administratively cap bank lending rates should be resisted to avoid unintended consequences such as curtailed ECB policy transmission, adverse selection, and credit rationing.[16] Where pockets of vulnerabilities remain, CBCG should continue monitoring of asset quality and capitalization closely and stand ready to impose tighter management and prudential standards. Contingency planning—including the resolution strategies for all banks (developed in 2022)—must be kept up to date. Bolstering CBCG's buffers for ELA, the €250 million EUREP liquidity line with the ECB in 2020 has been renewed until January 2025, as has the €100 million liquidity line with the BIS set up in 2019.

[15] See Annex VII on Past IMF Recommendations.

[16] In March 2024, banks undertook a joint initiative to reduce interest rates on select cash and mortgage loans, as well as other loans to vulnerable groups such as pensioners.

The IMF's "Central Bank Transparency Code Assessment" will help reinforce the institutional strength of the CBCG.

21. Alignment of regulation and supervision practices with current EU frameworks and other international standards should continue. Significant synchronization of Montenegrin laws with EU regulations has been achieved in recent years.[17] It is also important that digitalization and the development of crypto assets and fintech initiatives are accompanied by (i) a legal framework that aligns with emerging guidelines from standard setters such as the Basel Committee on Banking Supervision, the FSB, and the Financial Action Task Force (FATF); and (ii) adequate supervision capacities to understand complex global risks associated with such innovations. Crypto activity is judged to be at modest levels in Montenegro according to the latest MONEYVAL evaluation report. However, inherent difficulties in tracing crypto transactions could raise risks for the financial sector, therefore requiring constant vigilance. Separately, progress has been made in implementing most recommendations in the 2015 Financial Sector Assessment Program.[18]

22. The authorities should continue strengthening the AML/CFT framework. Through proactive management, the country averted a "grey listing", in the most recent MONEYVAL plenary session, but more work is needed. Large inflows to the real-estate sector, while not posing immediate leverage-related risks to the banking system, require the internalization of cross border money laundering risks. Growth in real-estate prices arising from inadequately vetted financial flows point to ineffective AML/CFT preventive measures by real estate agents as assessed in a 2023 MONEYVAL report. While notaries reporting real-estate ownership-transfer transactions to the Financial Intelligence Unit is positive, additional measures could be considered, including stronger supervision of real-estate agents. A legal framework for the collection and verification of beneficial ownership information of real-estate at the time of property transfer and its public dissemination would also be welcome. The surge of net errors and omissions in the balance of payments statistics might also signal AML risks. IMF's technical assistance on improving BOP statistics is forthcoming and should help shed light on this issue as well.

23. The CBCG has made progress in addressing the 2021 safeguards assessment recommendations. The assessment found a strong operational control framework at the central bank and recommended legal amendments to further strengthen the independence and governance of the CBCG. The recent adopted amendments to the Central Bank of Montenegro Law incorporate some of these recommendations but certain issues related to governance remain outstanding. To preserve the credibility of the Central Bank, it is important to codify that the selection procedures for Vice-Governors are transparent and focused on candidates' technical competence, and free from political influence. Similarly, the Governing Council of the Central Bank needs to be balanced in its composition between executive and non-executive members.

[17] Notably, this includes the key laws on credit institutions and on resolution of credit institution with their accompanying regulations.

[18] Further progress is required in the implementation of Solvency II and BRRD1 and RTGS operations (Annex VIII).

Authorities' Views

24. The authorities view the banking sector as resilient and are confident that weak spots are being proactively addressed. They agreed that the growing exposure of banks to foreign securities may create risks and stressed that they are monitoring exposures to foreign securities. Developments in the housing market are also under close watch to avoid a build-up of leverage in the system. They recognize the risks associated with digitalization and crypto assets and the importance of moving in regulatory lock-step with the ECB in these areas.

C. Structural Policies

25. Economic diversification can help decrease the susceptibility to economic shocks. The presence of skilled migrant labor and capital can be utilized to boost knowledge-intensive businesses.[19] For this, it is essential to tackle high informality linked with insufficient enforcement capacity of the public authorities, corruption, and tax non-compliance—challenges that are especially detrimental for the development of a thriving legally operating SME sector. The tourism sector has potential to expand further by encouraging longer stays (as in Croatia) and off-season tourism (as in Serbia). This requires developing inland tourist destinations, particularly in the North, diversifying the markets of potential visitors (e.g., winter and adventure tourism, "digital nomads"),[20] and improving infrastructure. Montenegro's hydro, solar and wind energy production potential affords strong economic diversification opportunities while also helping to align climate policies with the EU climate acquis.[21] Better public investment management practices are central to delivering high social returns to public investments in physical and digital infrastructure, as well as investments in climate change adaptation and mitigation.

26. Higher labor force participation of women can significantly enhance economic prospects. The World Bank estimates that inequality of opportunity, including by gender and region, is the constraint on upward mobility.[22] Fully closing the 14-percentage point gap in labor force participation between men and women, in theory, could result in around 10 percentage points of GDP gain in potential output. More realistically, reducing the gap to the top decile of countries in the region would result in a 4 percentage points gain. The paucity of affordable childcare is a significant impediment. Enrolment in formal care in Montenegro is one of the lowest in Europe. The authorities should actively consider policy options to alleviate this situation. The introduction of progressivity of PIT in 2022 is likely to have had a positive impact on both female labor force

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[19] See Annex I.

[20] One of OECD's tourism competitiveness measures, tourism spending per visitor, suggests that Montenegro still ranks below similar tourist destinations in the Western Balkans (e.g., Serbia and Greece), in the Caribbeans (e.g., Barbados), and in Africa (e.g., Seychelles and Mauritius).

[21] Climate issues will be covered in more detail in the 2025 Article IV cycle, as the authorities are still formulating their climate strategy.

[22] The World Bank, 2022. Montenegro Country Economic Memorandum: Towards a Sustainable Growth Strategy

participation and reduce the earnings gap between men and women. The mothers' benefit, on the other hand, has negatively impacted incentives for female labor force participation.[23]

Authorities' Views

27. The authorities recognize the importance of diversification both within and away from tourism. They plan to increase investment in infrastructure—particularly in the country's relatively underdeveloped Northern regions—to open up new forms of tourism, and to increase economic growth, more broadly. Plans are underway to develop a national climate strategy which will facilitate a discussion on climate issues and renewable energy production prospects during the next Article IV cycle.

28. The authorities welcomed staff's analysis of gender disparities, and the importance placed on raising female labor participation. Discussions with the relevant ministries and the central bank highlighted the need to better understand deeper drivers of gender inequalities, including cultural factors. It was agreed that childcare challenges play a significant role, and that other countries can offer valuable lessons in overcoming them. The authorities also acknowledged the value of considering, ex-ante, the gender impacts of economic policies—particularly in improving the targeting of social benefits with a view to increasing female labor force participation.

STAFF APPRAISAL

29. Montenegro's economy today looks considerably healthier relative to the last Article IV Consultation in 2021. The economy is benefitting from strong tourism and increased consumption owing both to the 2022 reforms, and to migrants. Aided in part by these factors, the fiscal position has improved. The current account deficit also narrowed, however, the external position in 2023 was assessed to be substantially weaker than the level implied by fundamentals and desirable policies. The importance of harnessing the country's good fortune, by creating a thriving business environment to utilize the skills of the recent migrants cannot be overstated. Reducing external and internal imbalances requires increasing the level of public and private saving. Economic volatility can be mitigated by (i) diversifying the economy, particularly in renewable energy production; (ii) maintaining strong public finances underpinned by a credible medium-term fiscal strategy; (iii) bolstering oversight of the banking system whilst strengthening the AML/CFT framework; and (iv) fully utilizing the vast untapped potential of women in the labor force.

30. On current policies, debt is likely to rise gradually over the coming years. The fall of public debt from its 2020 peak has been sharp and a budget surplus was recorded in 2023. However, a return to deficits is expected from 2024 onwards and debt is expected to rise gradually. Since 2022 there have been permanent revenue losses due to the abolition of health contributions and introduction of the PIT tax-free allowance, as well as increases in social

[23] See Annex IX for a detailed analysis of the role of fiscal policies and institutions for gender equality.

expenditures. The revenue enhancing measures introduced in the 2024 budget are welcome. Still, additional measures are necessary to stabilize debt.

31. A credible and well-communicated medium-term fiscal strategy is essential. Committing to a debt-to-GDP ceiling of 60 percent is appropriate as it is aligned with Montenegro's Law on Budget and Fiscal Responsibility. This commitment can be achieved by 2028 (the authorities' target year for EU accession) with a cumulative primary balance adjustment of about 2 percent of GDP compared to staff's baseline over the next 4 years. However, further revenue losses and/or structural expenditure increases, would raise the required level of fiscal consolidation to reach this target. Given high financing needs over the next few years, the adoption and communication of a strong fiscal anchor would also signal that Montenegro has a credible framework to manage its public finances responsibly. The Fund stands ready to assist the Montenegrin authorities in their efforts to strengthen the fiscal framework.

32. Structural fiscal reforms would support healthy public finances. The main areas requiring attention are: (i) better targeting of social transfers; (ii) containing the growth in the public sector wage bill: (iii) improving public investment management practices; (iv) strengthening the capacities of tax revenue and customs administrations; (v) establishing a fully functioning fiscal council; (vi) improving the oversight of SOEs; (vii) strengthening the domestic debt market by extending it to the retail sector. The IMF has and will continue to support the Montenegrin authorities through the provision of capacity development in these and other areas.

33. Continued close supervision of the financial sector by a strong and independent central bank is essential. Systemwide financial stability indicators appear healthy amid ample liquidity, but lingering spots of weakness need to be addressed. The CBCG is taking the appropriate steps. Stronger and more systematic monitoring of domestic leverage would help improve the design of macroprudential policies. Staff strongly reiterates its support for the operational independence of the central bank and will continue to offer capacity development to enhance its institutional strength.

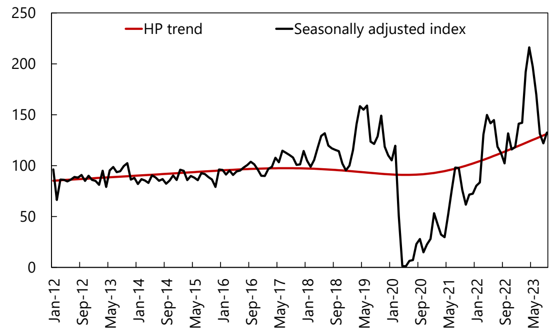
34. Strong progress in aligning Montenegrin regulation and supervision practices with international standards should continue. Digitalization and the development of crypto assets and fintech initiatives need to be accompanied by a legal framework that aligns with emerging guidelines from standard setters such as the Basel Committee on Banking Supervision, FSB, ECB, and the FATF. Supervision capacities need to be constantly updated to understand complex global risks associated with such financial innovations. Large inflows to the real estate sector need to be closely scrutinized from an AML perspective even if they do not pose immediate leverage related risks to the financial system. More broadly, the operationalization of an effective risk-based AML/CFT framework requires further efforts.

35. It is expected that the next Article IV consultation with Montenegro will be held on the standard 12-month cycle.

Figure 1. Montenegro: Real Sector

Robust growth has been driven by foreigners returning post-COVID...

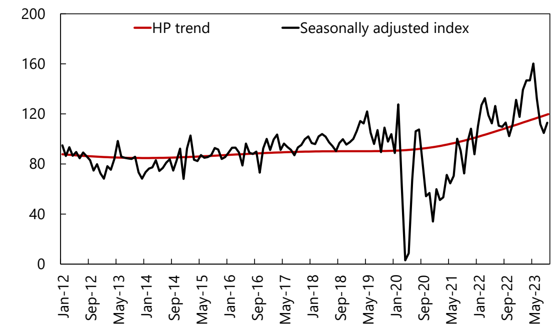
Montenegro: Foreign Overnight Stays
(Index)



Sources: Haver Analytics and IMF staff calculations.

...while domestic tourism also recovered strongly.

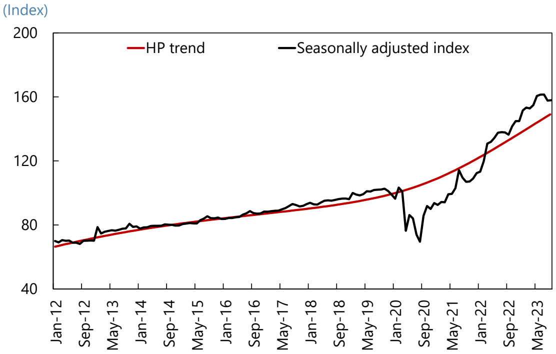
Montenegro: Domestic Overnight Stays
(Index)



Sources: Haver Analytics and IMF staff calculations.

Retail trade is above trend, fueled by the inflow of migrants.

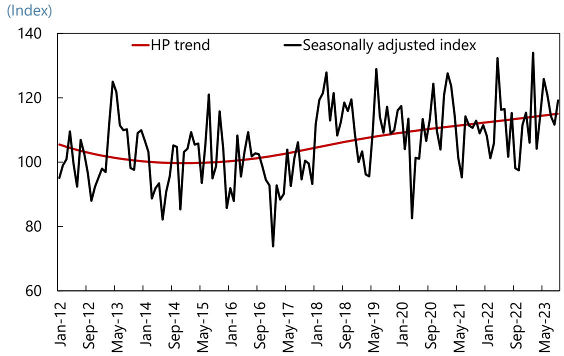
Montenegro: Retail Trade
(Index)



Sources: Haver Analytics and IMF staff calculations.

Volatile industrial production is largely driven by hydro energy.

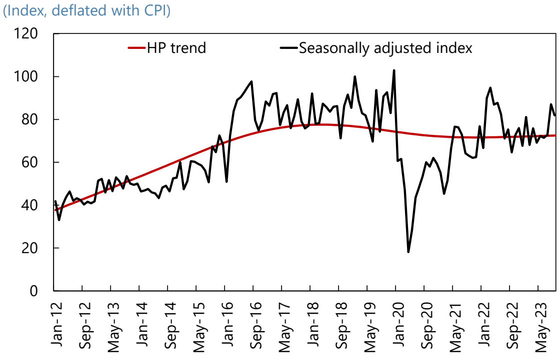
Montenegro: Industrial Production
(Index)



Sources: Haver Analytics and IMF staff calculations.

After recovering from COVID, credit to households has stabilized.

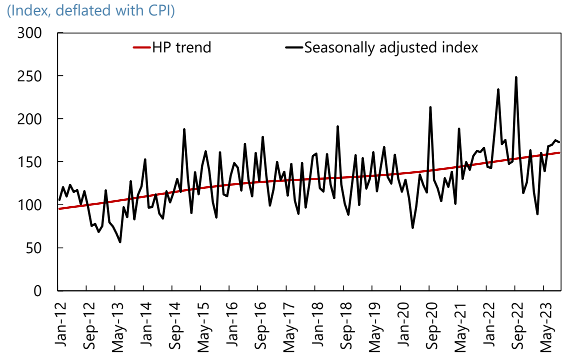
Montenegro: New Credit to Households
(Index, deflated with CPI)



Sources: Haver Analytics and IMF staff calculations.

Growth of credit to corporates has been moderate.

Montenegro: New Credit to Corporates
(Index, deflated with CPI)

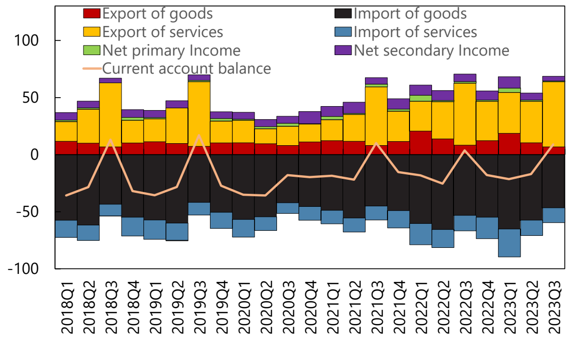


Sources: Haver Analytics and IMF staff calculations.

Figure 2. Montenegro: External Sector

The current account deficit has narrowed significantly, …

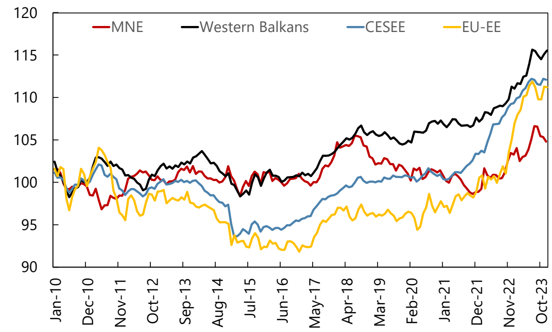
Montenegro: Current Account
(Percent of GDP)



Sources: Haver Analytics and IMF staff calculations.

… benefiting from a less appreciated real exchange rate…

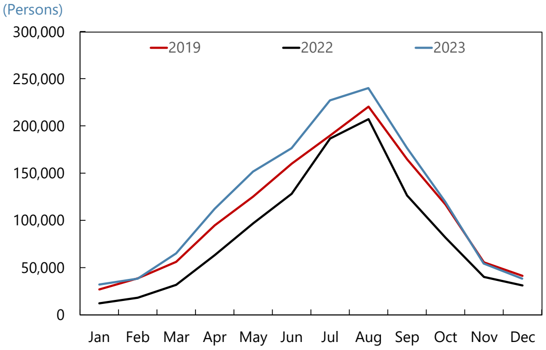
Montenegro vs. Peers: Real Effective Exchange Rate
(Index, 2010=100)



Sources: IMF INS database and IMF staff calculations.

…and a strong recovery of the tourism sector…

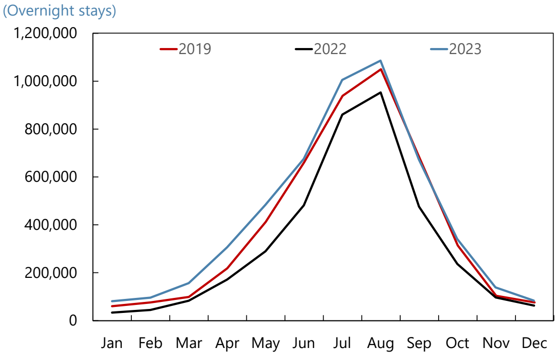
Montenegro: Tourism Arrivals
(Persons)



Source: MonStat.

… that surpassed pre-pandemic levels.

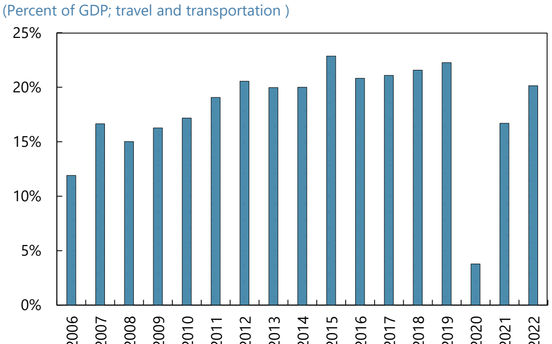
Montenegro: Tourism Overnight Stays
(Overnight stays)



Source: MonStat.

The tourism sector continues to drive the economy…

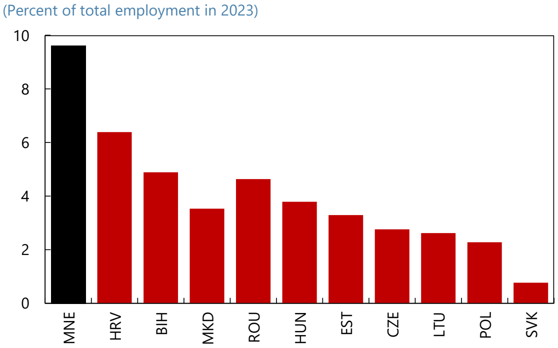
Montenegro: Net Service Exports
(Percent of GDP; travel and transportation)



Source: MonStat.

…and the need for diversification remains strong.

CESEE: Employment in Accommodation and Food Services
(Percent of total employment in 2023)

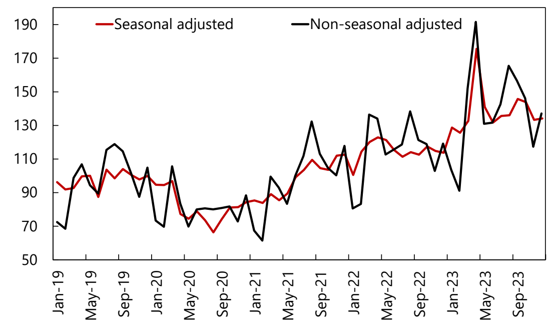


Note: MNE, MKD, CZE use 2022 data.
Sources: Central Bank of Montenegro, Haver Analytics, and IMF staff calculations.

Figure 3. Montenegro: Fiscal Sector

Strong domestic demand has been boosting tax revenues.

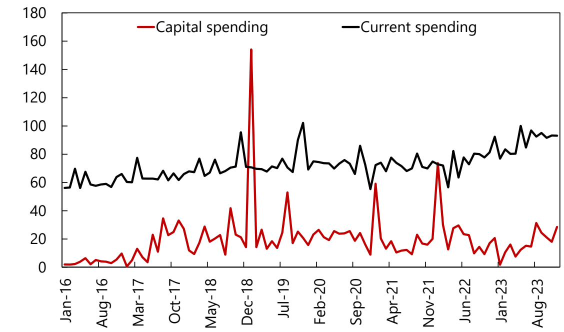
Montenegro: Central Government Tax Revenues
(Millions of Euros)



Sources: Haver Analytics and IMF staff calculations.

Current spending has trended up in recent years, unlike capital spending.

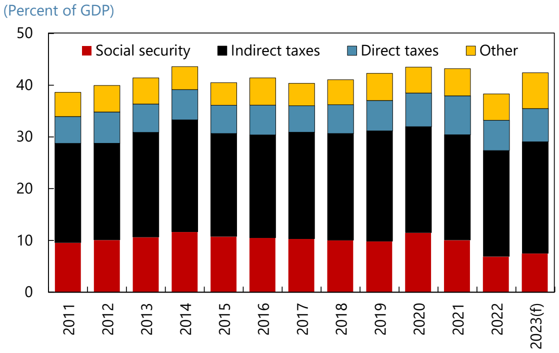
Montenegro: Central Government Expenditures
(Millions of Euros; seasonal adjusted)



Sources: Haver Analytics and IMF staff calculations.

Social security contributions declined as a share of GDP while non-tax revenues were highest in 2023.

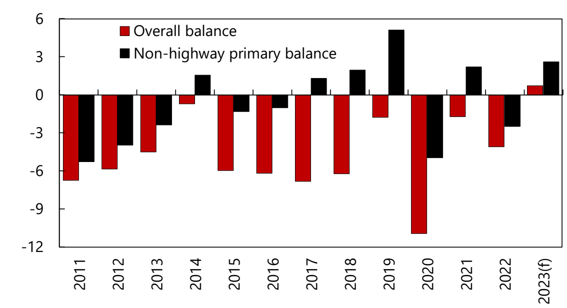
Montenegro: Composition of Government Revenue
(Percent of GDP)



Source: IMF staff calculations.

The fiscal balance has been volatile since COVID.

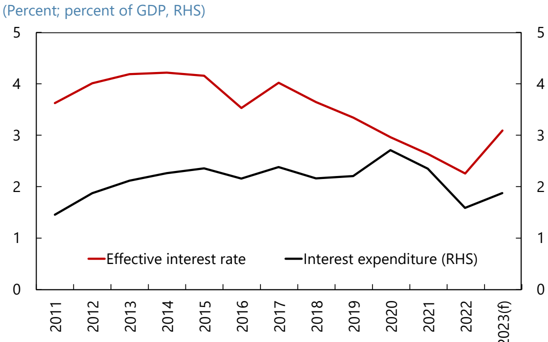
Montenegro: Overall Fiscal Balance and Non-Highway Primary Balance
(Percent of GDP)



Source: IMF staff calculations.

With higher global interest rates compared to history, interest expenditures are starting to pick up.

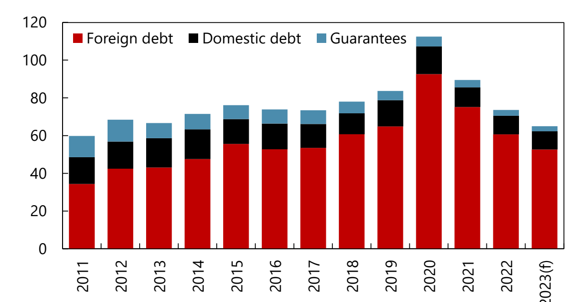
Montenegro: Effective Interest Rate and Expenditure
(Percent; percent of GDP, RHS)



Source: IMF staff calculations.

The share of domestic debt in total has been decreasing.

Montenegro: General Government Debt Including Guarantees
(Percent of GDP)

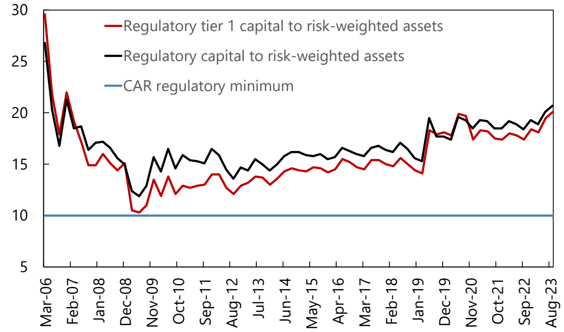


Source: IMF staff calculations.

Figure 4. Montenegro: Financial Sector

Capital buffers remain healthy

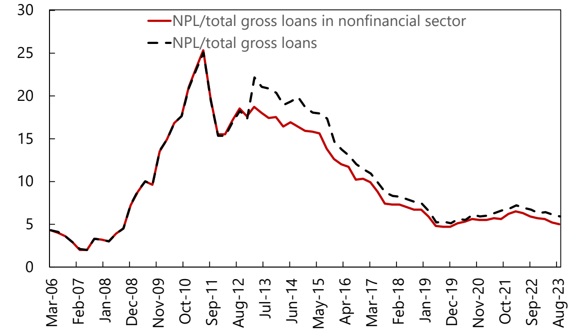
Montenegro: Bank Capital
(Percent)



Source: Haver Analytics.

NPL remains low despite stricter classification standards

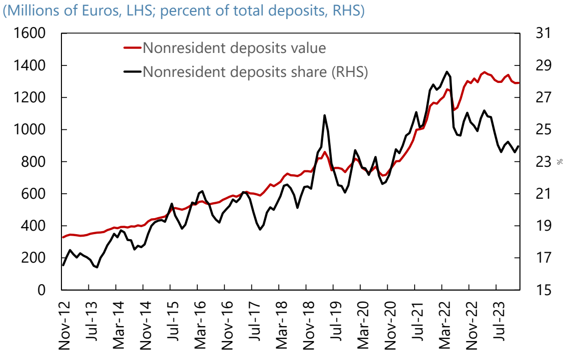
Montenegro: Nonperforming Loans
(Percent)



Source: Haver Analytics.

Nonresident deposits continue to rise in 2023 but not as fast as resident deposits.

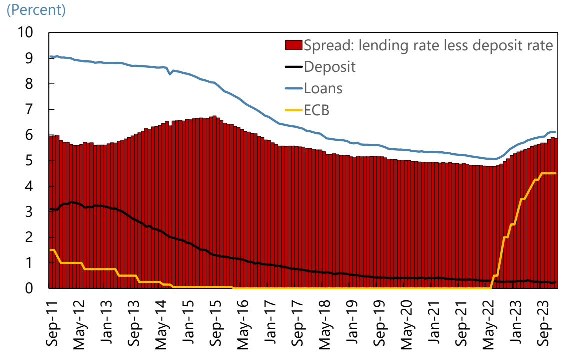
Montenegro: Nonresident Deposits
(Millions of Euros, LHS; percent of total deposits, RHS)



Sources: Haver Analytics and IMF staff calculations.

The deposit rate continues to fall even as the lending rate rises.

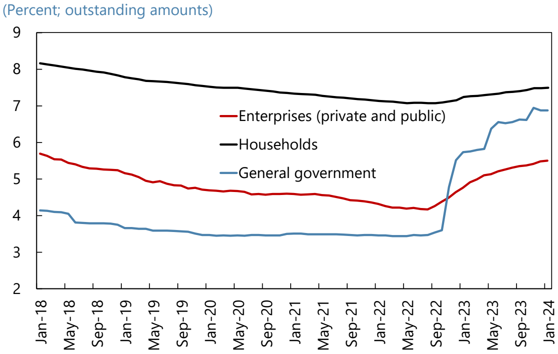
Montenegro: Bank Deposit and Lending Rates
(Percent)



Source: Haver Analytics.

The lending rate to the government jumps above the rate to Enterprises.

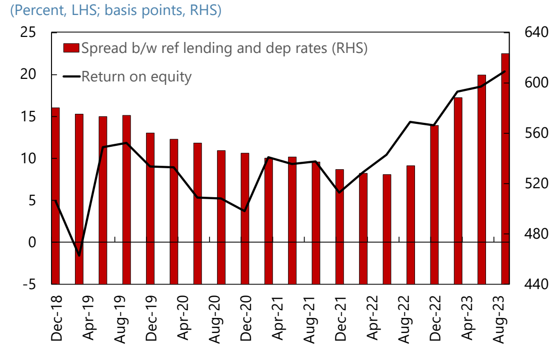
Montenegro: Weighted Average Lending Rates of Banks
(Percent; outstanding amounts)



Source: CBCG.

Banking sector profits are up on wider interest margins.

Montenegro: Interest Rate Spread and Return on Equity
(Percent, LHS; basis points, RHS)



Source: Haver Analytics.

Table 1. Montenegro: Selected Economic Indicators, 2019–29

(Under current policies; percent of GDP, unless otherwise noted)

					Projections						
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Real economy											
Nominal GDP (millions of €)	4,951	4,186	4,955	5,924	6,847	7,428	7,888	8,315	8,749	9,203	9,680
Gross national saving	17.7	5.1	17.4	17.4	15.5	13.9	11.5	11.2	10.7	10.5	10.3
Gross investment	32.0	31.2	26.7	30.3	26.9	26.2	25.0	24.5	24.2	24.0	23.8
Unemployment rate (percent)	15.1	17.9	16.7	14.7	13.1	...	...	...	...	...	...
					(percent change)						
Real GDP growth	4.1	-15.3	13.0	6.4	6.0	3.7	3.0	3.0	3.0	3.0	3.0
Tourism											
Arrivals	20.1	-79.2	171.7	59.6	23.2	...	...	...	...	...	...
Nights	11.2	-79.8	212.2	46.4	18.8	...	...	...	...	...	...
Consumer price inflation (period average)	0.4	-0.3	2.4	13.0	8.6	4.2	2.7	2.1	2.0	2.0	1.9
Consumer price inflation (end of period)	1.0	-0.9	4.6	17.2	4.3	4.2	2.1	2.0	1.9	1.9	1.9
GDP deflator	2.0	-0.3	4.7	12.4	9.0	4.6	3.1	2.3	2.2	2.2	2.1
Average net wage	0.8	1.7	1.5	33.8	11.2	...	...	...	...	...	...
Money and credit (end of period)					(percent change)						
Bank credit to private sector	5.0	3.4	3.2	8.2	6.9	5.6	5.5	5.5	5.1	5.2	5.1
Enterprises	1.5	4.2	3.8	7.9	5.2	...	...	...	...	...	...
Households	7.9	2.9	2.7	8.4	8.2	...	...	...	...	...	...
Private sector deposits	2.0	-2.0	15.7	23.0	8.9	6.8	5.2	5.4	5.2	5.2	5.2
General government finances 1/											
Revenue and grants	42.3	43.5	43.1	38.2	41.8	41.0	40.5	40.4	40.4	40.4	40.4
Expenditure	44.0	54.4	44.8	42.3	41.1	44.2	44.0	44.2	44.3	44.7	44.9
Overall fiscal balance	-1.7	-10.9	-1.7	-4.1	0.7	-3.2	-3.5	-3.7	-3.9	-4.2	-4.4
Cyclically adjusted overall fiscal balance	-4.7	-4.8	-1.1	-3.7	0.7	-3.4	-3.6	-3.7	-3.9	-4.3	-4.4
Primary balance	0.5	-8.2	0.6	-2.5	2.6	-1.4	-1.5	-1.5	-1.5	-1.5	-1.6
General government gross debt	78.8	107.3	85.6	70.6	61.5	62.3	61.4	62.2	63.2	64.8	66.1
General government gross debt (authorities' definition) 2/	77.4	105.5	84.0	69.2	60.4	61.3	60.5	61.3	62.3	64.0	65.3
General government debt, including loan guarantees	83.7	112.6	89.6	73.6	64.1	64.7	63.7	64.4	65.2	66.8	67.9
General government net debt, including guarantees 3/	70.7	91.1	79.1	70.9	61.8	60.4	60.5	61.2	62.1	63.4	64.8
General government net debt, excluding guarantees 3/	65.8	85.9	75.2	67.8	59.1	58.0	58.2	59.0	60.1	61.4	62.9
Balance of payments											
Current account balance	-14.3	-26.1	-9.2	-12.9	-11.4	-12.4	-13.5	-13.4	-13.5	-13.5	-13.6
Foreign direct investment, net	6.2	11.2	11.7	13.2	6.3	8.5	9.3	9.9	9.9	9.9	9.9
External debt (end of period, stock)	169.0	224.1	191.5	161.8	138.5	139.4	140.5	142.9	145.5	148.4	150.7
REER (CPI-based; y-o-y avg. change, in percent) 4/	-2.2	-1.0	-1.2	1.0	3.5	...	...	...	...	...	...
Memorandum:											
GDP per capita (USD)	8,925	7,690	9,439	9,860	11,696	...	...	...	...	...	...
Nominal GDP Growth (in percent)	6.2	-15.5	18.4	19.6	15.6	8.5	6.2	5.4	5.2	5.2	5.2
Real output gap (percent of potential GDP)	6.6	-10.8	-1.1	-0.8	0.1	0.5	0.1	0.0	0.0	0.0	0.0
Gross international reserves in millions of USD	1,519	2,116	1,977	2,026	1,553	1,704	1,627	1,638	1,642	1,681	1,671

Sources: Ministry of Finance; Central Bank of Montenegro; Statistical Office of Montenegro; and IMF staff estimates and projections.

1/ Includes central and local governments.

2/ The authorities do not include the arrears of local governments in their definition of general government gross debt.

3/ General government debt, including guarantees, net of central agovernment deposits

4/ A negative sign indicates a REER depreciation.

Table 2a. Montenegro: Savings and Investment Balances, 2019–29

(Under current policies; percent of GDP, unless otherwise noted)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections						
Gross national savings	17.7	5.1	17.4	17.4	15.5	13.9	11.5	11.2	10.7	10.5	10.3
Non-government	12.7	10.5	15.5	16.9	11.3	13.0	11.3	11.3	11.1	11.6	11.8
Government	5.0	-5.3	1.9	0.5	4.3	0.8	0.2	-0.2	-0.5	-1.1	-1.5
Gross domestic investment	32.0	31.2	26.7	30.3	26.9	26.2	25.0	24.5	24.2	24.0	23.8
Non-government	23.3	23.3	21.0	24.3	21.8	20.6	19.4	18.9	18.6	18.4	18.2
Government	8.7	7.9	5.7	6.0	5.1	5.6	5.6	5.6	5.6	5.6	5.6
Savings - investment balance	-14.3	-26.1	-9.2	-12.9	-11.4	-12.4	-13.5	-13.4	-13.5	-13.5	-13.6
Non-government	-10.6	-12.8	-5.4	-7.4	-10.6	-7.6	-8.1	-7.6	-7.4	-6.8	-6.5
Government	-3.7	-13.2	-3.8	-5.5	-0.9	-4.8	-5.4	-5.8	-6.1	-6.8	-7.1
Current account balance	-14.3	-26.1	-9.2	-12.9	-11.4	-12.4	-13.5	-13.4	-13.5	-13.5	-13.6
Foreign direct investment (net)	6.2	11.2	11.7	13.2	6.3	8.5	9.3	9.9	9.9	9.9	9.9
External debt	169.0	224.1	191.5	161.8	138.5	139.4	140.5	142.9	145.5	148.4	150.7
Consumption	89.2	103.8	92.7	92.5	91.9	93.8	96.1	96.4	96.8	96.9	97.0
Non-government	71.4	81.2	73.0	74.7	73.8	75.2	78.2	78.5	79.1	79.3	79.5
Government	17.8	22.6	19.7	17.9	18.1	18.6	18.0	17.8	17.7	17.6	17.5

Sources: Statistical Office of Montenegro; Ministry of Finance; and IMF staff estimates and projections.

Table 2b. Montenegro: Contribution to Real Gross Domestic Product, 2019–29
(Contribution to Real GDP growth)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections						
Gross domestic product	4.1	-15.3	13.0	6.4	6.0	3.7	3.0	3.0	3.0	3.0	3.0
Consumption	3.1	-4.1	4.3	9.6	5.9	4.5	3.1	3.3	3.3	3.3	3.3
Government	0.2	0.2	0.1	0.3	0.6	1.4	0.0	0.5	0.5	0.5	0.5
Private	2.9	-4.3	4.2	9.3	5.3	3.1	3.1	2.8	2.8	2.8	2.8
Investment	-0.6	-3.5	-8.2	0.5	-0.3	3.6	3.9	1.4	1.6	1.2	1.1
Gross fixed capital formation	-0.7	-4.5	-4.8	0.0	1.4	1.7	1.0	1.1	1.1	1.1	1.1
Government	-1.5	-2.4	-1.5	0.7	-0.6	0.8	0.1	0.3	0.3	0.2	0.2
Private	0.8	-2.1	-3.3	-0.7	2.0	0.9	0.9	0.8	0.9	0.9	0.8
Changes in inventories	0.0	0.9	-3.4	0.5	-1.7	1.9	2.9	0.4	0.4	0.1	0.1
Net Exports	1.6	-7.6	16.9	-3.7	0.4	-4.4	-4.0	-1.7	-1.9	-1.5	-1.4
Exports	3.8	-24.8	25.7	15.9	5.3	2.3	0.5	1.8	0.9	1.2	1.2
Goods	0.9	-1.4	2.3	4.1	-1.5	0.0	-0.8	0.8	0.0	0.3	0.3
Services	2.9	-23.3	23.4	11.9	6.8	2.3	1.3	1.0	0.9	0.9	0.9
Imports	-2.2	17.1	-8.8	-19.7	-4.9	-6.6	-4.5	-3.5	-2.8	-2.8	-2.6
Goods	-0.7	12.2	-5.0	-12.7	-5.5	-5.4	-3.7	-2.9	-2.2	-2.2	-2.1
Services	-1.5	4.9	-3.8	-6.9	0.5	-1.2	-0.8	-0.6	-0.5	-0.6	-0.6

Sources: Statistical Office of Montenegro; Ministry of Finance; and IMF staff estimates and projections.

Table 3a. Montenegro: Consolidated General Government Fiscal Operations, 2019–29 1/

(Millions of euros, GFSM2014)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Projections				
1. Revenue	**2,084**	**1,811**	**2,121**	**2,265**	**2,861**	**3,044**	**3,191**	**3,362**	**3,537**	**3,721**	**3,914**
Taxes	1,348	1,130	1,379	1,558	1,890	2,112	2,242	2,364	2,487	2,616	2,752
Personal income tax	180	168	185	137	151	160	170	179	189	199	209
Corporate income tax	73	78	75	90	151	164	174	184	193	203	214
Property taxes	27	17	101	107	118	119	127	134	141	148	156
Value added tax	696	530	692	908	1,059	1,201	1,276	1,345	1,415	1,488	1,565
Excises	236	205	249	246	323	373	396	417	439	462	486
Taxes on international trade	29	23	28	40	52	57	60	63	67	70	74
Local government taxes	95	99	38	17	22	22	24	25	26	28	29
Other taxes	13	10	11	12	14	15	16	17	18	18	19
Social security contributions 2/	485	480	497	406	504	550	586	620	653	687	722
Nontax revenues	208	136	196	214	351	292	264	272	286	301	316
Grants	43	65	49	87	116	91	98	106	112	117	123
2. Expense	**1,740**	**1,940**	**1,935**	**2,154**	**2,460**	**2,868**	**3,027**	**3,204**	**3,385**	**3,594**	**3,798**
Gross salaries and other personal income	483	515	545	565	667	733	787	829	873	918	966
Use of goods and services	159	181	173	188	191	211	222	234	246	259	272
Interest payments	109	114	117	94	127	136	165	188	208	248	275
Subsidies to enterprises	36	38	52	73	79	88	94	99	104	109	115
Other current outflows	57	60	59	85	75	81	85	89	94	98	103
Social security transfers	555	559	568	668	826	1,034	1,101	1,164	1,229	1,297	1,369
Other transfers	275	355	340	452	472	521	549	576	605	635	667
Repayment of guarantees	39	0	8	1	3	0	0	0	0	0	0
Reserves	27	119	74	28	21	64	24	26	28	29	30
3. Gross operating balance (= 1 - 2)	**344**	**-129**	**186**	**111**	**401**	**176**	**164**	**157**	**152**	**127**	**116**
4. Net acquisition of nonfinancial assets	**423**	**322**	**267**	**353**	**350**	**416**	**444**	**468**	**492**	**518**	**544**
Capital revenue	-8	-8	-15	0	0	0	0	0	0	0	0
Capital expenditure	431	330	282	353	350	416	444	468	492	518	544
5. Net lending (+) / borrowing (-) (= 3 - 4)	**-79**	**-452**	**-81**	**-242**	**51**	**-240**	**-280**	**-310**	**-340**	**-391**	**-428**
6. Net acquisition of financial assets	**454**	**232**	**-339**	**-324**	**48**	**168**	**-63**	**16**	**13**	**48**	**2**
Domestic	454	232	-339	-324	48	168	-63	16	13	48	2
Currency and deposits	409	247	-331	-327	54	183	-45	34	32	66	20
Loans	6	5	4	0	1	0	0	0	0	0	0
Equity and investment fund shares	40	-19	-12	2	-7	-16	-18	-18	-18	-18	-18
7. Net incurrence of liabilities	**479**	**706**	**-130**	**-59**	**-2**	**408**	**216**	**326**	**353**	**438**	**430**
Domestic	133	-69	105	82	67	-203	-27	-48	21	21	22
Foreign	346	775	-235	-140	-69	611	243	373	332	417	408
Memorandum items:											
Primary balance	30	-338	36	-148	178	-104	-115	-123	-132	-142	-154
Current balance	300	-195	137	24	285	85	66	51	40	9	-7
Nominal general government debt	3,901	4,493	4,243	4,180	4,211	4,628	4,846	5,173	5,527	5,966	6,396
Nominal gen. gov. debt, with guarantees	4,145	4,712	4,438	4,361	4,392	4,810	5,027	5,354	5,708	6,147	6,578
Nominal GDP	4,951	4,186	4,955	5,924	6,847	7,428	7,888	8,315	8,749	9,203	9,680

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Includes central government budget and local governments.

2/ Excludes social security contributions by government on behalf of employees.

Table 3b. Montenegro: Consolidated Government Fiscal Operations, 2019–29 1/

(In percent of GDP, GFSM2014)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections						
1. Revenue	**42.1**	**43.3**	**42.8**	**38.2**	**41.8**	**41.0**	**40.5**	**40.4**	**40.4**	**40.4**	**40.4**
Taxes	27.2	27.0	27.8	26.3	27.6	28.4	28.4	28.4	28.4	28.4	28.4
Personal income tax	3.6	4.0	3.7	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Corporate income tax	1.5	1.9	1.5	1.5	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Property taxes	0.5	0.4	2.0	1.8	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Value added tax	14.1	12.7	14.0	15.3	15.5	16.2	16.2	16.2	16.2	16.2	16.2
Excises	4.8	4.9	5.0	4.2	4.7	5.0	5.0	5.0	5.0	5.0	5.0
Taxes on international trade	0.6	0.5	0.6	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Local government taxes	1.9	2.4	0.8	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other taxes	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social security contributions 2/	9.8	11.5	10.0	6.8	7.4	7.4	7.4	7.5	7.5	7.5	7.5
Nontax revenues	4.2	3.3	4.0	3.6	5.1	3.9	3.3	3.3	3.3	3.3	3.3
Grants	0.9	1.6	1.0	1.5	1.7	1.2	1.2	1.3	1.3	1.3	1.3
2. Expense	**35.2**	**46.4**	**39.1**	**36.4**	**35.9**	**38.6**	**38.4**	**38.5**	**38.7**	**39.1**	**39.2**
Gross salaries and other personal income	9.8	12.3	11.0	9.5	9.7	9.9	10.0	10.0	10.0	10.0	10.0
Use of goods and services	3.2	4.3	3.5	3.2	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Interest payments	2.2	2.7	2.4	1.6	1.9	1.8	2.1	2.3	2.4	2.7	2.8
Subsidies to enterprises	0.7	0.9	1.0	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Other current outflows	1.2	1.4	1.2	1.4	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social security transfers	11.2	13.4	11.5	11.3	12.1	13.9	14.0	14.0	14.0	14.1	14.1
Other transfers	5.6	8.5	6.9	7.6	6.9	7.0	7.0	6.9	6.9	6.9	6.9
Repayment of guarantees	0.8	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserves	0.6	2.8	1.5	0.5	0.3	0.9	0.3	0.3	0.3	0.3	0.3
3. Gross operating balance (= 1 - 2)	**6.9**	**-3.1**	**3.8**	**1.9**	**5.9**	**2.4**	**2.1**	**1.9**	**1.7**	**1.4**	**1.2**
4. Net acquisition of nonfinancial assets	**8.5**	**7.7**	**5.4**	**6.0**	**5.1**	**5.6**	**5.6**	**5.6**	**5.6**	**5.6**	**5.6**
Capital revenue	-0.2	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	8.7	7.9	5.7	6.0	5.1	5.6	5.6	5.6	5.6	5.6	5.6
5. Net lending (+) / borrowing (-) (= 3 - 4)	**-1.6**	**-10.8**	**-1.6**	**-4.1**	**0.7**	**-3.2**	**-3.5**	**-3.7**	**-3.9**	**-4.2**	**-4.4**
6. Net acquisition of financial assets	**9.2**	**5.5**	**-6.8**	**-5.5**	**0.7**	**2.3**	**-0.8**	**0.2**	**0.2**	**0.5**	**0.0**
Domestic	9.2	5.5	-6.8	-5.5	0.7	2.3	-0.8	0.2	0.2	0.5	0.0
Currency and deposits	8.3	5.9	-6.7	-5.5	0.8	2.5	-0.6	0.4	0.4	0.7	0.2
Loans	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	0.8	-0.5	-0.2	0.0	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
7. Net incurrence of liabilities	**9.7**	**16.9**	**-2.6**	**-1.0**	**0.0**	**5.5**	**2.7**	**3.9**	**4.0**	**4.8**	**4.4**
Domestic	2.7	-1.6	2.1	1.4	1.0	-2.7	-0.3	-0.6	0.2	0.2	0.2
Foreign	7.0	18.5	-4.7	-2.4	-1.0	8.2	3.1	4.5	3.8	4.5	4.2
Memorandum items:											
Primary balance	0.6	-8.1	0.7	-2.5	2.6	-1.4	-1.5	-1.5	-1.5	-1.5	-1.6
Current balance	6.1	-4.7	2.8	0.4	4.2	1.1	0.8	0.6	0.5	0.1	-0.1

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Includes central government budget and local governments.

2/ Excludes social security contributions by government on behalf of employees.

Table 4. Montenegro: Summary of Accounts of the Financial System, 2019–29

(Millions of euros)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections						
					I. Central Bank						
Net foreign assets	1335	1637	1570	1733	1267	1428	1359	1372	1377	1417	1411
Assets	1367	1738	1749	1913	1424	1585	1516	1528	1534	1574	1567
Liabilities	32	101	178	180	157	157	157	157	157	157	157
Net domestic assets	-1217	-1501	-1415	-1608	-1188	-1342	-1268	-1275	-1276	-1310	-1299
Net credit to the nonfinancial public sector	-537	-845	-463	-109	-129	-290	-221	-233	-239	-279	-273
Of which: general government	-537	-845	-463	-109	-129	-290	-221	-233	-239	-279	-273
Net credit to the banking system	-705	-689	-985	-1533	-985	-978	-973	-968	-963	-957	-952
Required reserves	-260	-179	-217	-263	-291	-311	-327	-345	-363	-381	-401
Giro account	-444	-509	-769	-1270	-694	-668	-646	-624	-601	-577	-551
Claims on depository institutions	-1	-1	1	1	1	1	1	1	1	1	1
Other assets net	24	32	34	33	-74	-74	-74	-74	-74	-74	-74
Deposits included in broad money	44	56	78	95	11	12	13	13	14	15	16
Equity	74	80	78	30	68	74	79	83	87	92	96
					II. Banking System						
Net foreign assets	-504	-560	-537	-451	221	342	469	602	740	883	1,033
Assets	593	608	885	1,095	1,656	1,656	1,656	1,656	1,656	1,656	1,656
Liabilities	1,097	1,169	1,422	1,546	1,435	1,313	1,186	1,054	916	772	623
Net domestic assets	3,395	3,459	3,877	4,688	4,250	4,201	4,328	4,445	4,623	4,814	5,010
Net assets held in the central bank	695	685	981	1,523	979	979	973	968	963	958	953
Net credit to nonfinancial public sector	264	254	299	351	268	50	8	-53	-50	-47	-43
Of which: general government	423	376	421	473	479	262	220	159	162	165	169
Credit to the private sector	2,428	2,511	2,591	2,804	2,997	3,165	3,339	3,523	3,703	3,895	4,094
Other domestic assets	32	11	9	13	13	9	9	7	7	7	7
Liabilities	2,890	2,893	3,340	4,237	4,471	4,543	4,797	5,047	5,363	5,697	6,043
Private sector deposits	2,259	2,211	2,559	3,149	3,430	3,662	3,852	4,061	4,273	4,494	4,728
Other items, net	631	682	781	1,088	1,042	880	945	986	1,090	1,203	1,316
o/w capital	598	589	606	675	824	838	884	931	989	1,050	1,114
					III. Consolidated System						
Net foreign assets	831	1,077	1,033	1,282	1,488	1,770	1,829	1,973	2,117	2,300	2,444
Net domestic assets	2,201	1,960	2,462	3,080	3,062	2,859	3,060	3,170	3,347	3,503	3,712
Net credit to the nonfinancial public sector	-273	-591	-164	243	139	-240	-213	-286	-289	-326	-316
Of which: general government	-113	-469	-43	365	350	-28	-1	-75	-77	-114	-104
Credit to the private sector	2,428	2,511	2,591	2,804	2,997	3,165	3,339	3,523	3,703	3,895	4,094
Other net domestic assets	46	40	36	33	-73	-66	-66	-66	-66	-66	-66
Liabilities	2,934	2,949	3,418	4,332	4,482	4,555	4,810	5,061	5,377	5,712	6,059
Equity capital of the central bank	74	80	78	30	68	74	79	83	87	92	96
					IV. Ratios						
Net assets held in CBCG/Deposits	30.8	31.0	38.3	48.4	28.5	26.7	25.3	23.8	22.5	21.3	20.1
Effective required reserves ratio	11.5	8.1	8.5	8.4	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Credit to private sector / GDP	49.0	60.0	52.3	47.3	43.8	42.6	42.3	42.4	42.3	42.3	42.3
Banks' capital / credit to private sector	24.6	23.5	23.4	24.1	27.5	26.5	26.5	26.4	26.7	27.0	27.2
CBCG reserves / bank deposits	60.5	78.6	68.3	60.8	41.5	43.3	39.4	37.6	35.9	35.0	33.2
Banks' foreign liabilities / credit to private sector	45.2	46.5	54.9	55.1	47.9	41.5	35.5	29.9	24.7	19.8	15.2
Memo item:											
Broad money	2,581.2	2,484.4	2,872.3	3,531.4	3,849.2	4,083.1	4,273.6	4,482.9	4,695.5	4,917.9	5,151.9
BM growth	-1.7	-3.7	15.6	22.9	9.0	6.1	4.7	4.9	4.7	4.7	4.8

Sources: Central Bank of Montenegro; and IMF staff estimates and projections.

Table 5. Montenegro: Balance of Payments, 2019–29

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections						
					(Millions of euros)						
Current account balance	**-707**	**-1,090**	**-456**	**-766**	**-782**	**-918**	**-1,069**	**-1,113**	**-1,184**	**-1,245**	**-1,312**
Trade balance	-2,066	-1,642	-1,915	-2,670	-2,983	-3,293	-3,549	-3,688	-3,853	-4,009	-4,170
Exports	466	409	526	763	716	731	704	764	779	815	851
Imports	2,531	2,051	2,441	3,434	3,699	4,024	4,254	4,452	4,632	4,824	5,021
Services account	1,018	177	956	1,317	1,695	1,806	1,881	1,949	2,016	2,084	2,154
Receipts	1,705	679	1,597	2,289	2,769	2,974	3,118	3,246	3,373	3,503	3,638
Expenditures	687	503	641	972	1,074	1,167	1,236	1,298	1,357	1,419	1,484
Primary Income	56	67	102	118	67	89	89	87	85	82	76
Compensation of employees, net	216	216	283	286	278	314	333	352	370	389	409
Investment income, net	-160	-150	-180	-168	-211	-225	-244	-264	-285	-307	-334
Secondary Income	284	308	401	469	438	479	510	540	568	597	628
Government, net	49	51	66	42	59	67	73	79	83	88	92
Other sectors, net	236	258	335	427	379	412	437	461	485	510	536
Capital account	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Financial account	**-1,175**	**-1,372**	**-110**	**-347**	**503**	**-1,079**	**-1,000**	**-1,125**	**-1,190**	**-1,285**	**-1,305**
Foreign direct investment, net	-305	-471	-582	-783	-429	-634	-731	-820	-864	-909	-956
Portfolio investment, net	-337	-394	548	175	446	-471	-40	242	255	268	32
General government, net change in liabilities	319	424	-227	0	0	688	270	0	0	0	250
Eurobond	331	429	-227	0	0	688	270	0	0	0	250
Disbursements (increase in liabilities)	500	750	0	0	0	688	770	0	750	0	750
Amortization (reduction in liabilities)	-169	-321	-227	0	0	0	-500	0	-750	0	-500
Derivatives, net	64	71	28	-14	-40	-2	17	40	41	45	26
Other investment, net	-534	-507	-77	261	485	26	-229	-547	-581	-644	-381
General government	9	-322	-19	174	110	77	27	-373	-332	-417	-158
Commercial banks	-222	-69	-89	-10	319	121	127	132	138	144	150
Other sectors	-320	-116	31	98	56	-172	-383	-306	-387	-370	-373
Errors and omissions	-152	95	276	570	736	0	0	0	0	0	0
Change in official reserves (+ denotes increase)	316	374	7	165	-483	161	-68	12	6	40	-6
Memorandum items				(Percent of GDP)							
Current account balance	-14.3	-26.1	-9.2	-12.9	-11.4	-12.4	-13.5	-13.4	-13.5	-13.5	-13.6
Trade balance	-41.7	-39.2	-38.7	-45.1	-43.6	-44.3	-45.0	-44.4	-44.0	-43.6	-43.1
Exports	9.4	9.8	10.6	12.9	10.5	9.8	8.9	9.2	8.9	8.9	8.8
Imports	51.1	49.0	49.3	58.0	54.0	54.2	53.9	53.5	52.9	52.4	51.9
Services account	20.6	4.2	19.3	22.2	24.8	24.3	23.9	23.4	23.0	22.7	22.3
Receipts	34.4	16.2	32.2	38.6	40.4	40.0	39.5	39.0	38.5	38.1	37.6
Payments	13.9	12.0	12.9	16.4	15.7	15.7	15.7	15.6	15.5	15.4	15.3
Income account	1.1	1.6	2.1	2.0	1.0	1.2	1.1	1.1	1.0	0.9	0.8
Current transfers, net	5.7	7.4	8.1	7.9	6.4	6.4	6.5	6.5	6.5	6.5	6.5
Foreign direct investment, net	-6.2	-11.2	-11.7	-13.2	-6.3	-8.5	-9.3	-9.9	-9.9	-9.9	-9.9
Portfolio investment, net	-6.8	-9.4	11.1	3.0	6.5	-6.3	-0.5	2.9	2.9	2.9	0.3
Other investment, net	-10.8	-12.1	-1.6	4.4	7.1	0.4	-2.9	-6.6	-6.6	-7.0	-3.9
General government	0.2	-7.7	-0.4	2.9	1.6	1.0	0.3	-4.5	-3.8	-4.5	-1.6
Other sectors	-6.5	-2.8	0.6	1.6	0.8	-2.3	-4.9	-3.7	-4.4	-4.0	-3.9
Errors and omissions	-3.1	2.3	5.6	9.6	10.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross external debt	169.0	224.1	191.5	161.8	138.5	139.4	140.5	142.9	145.5	148.4	150.7
of which: Government	63.2	91.6	74.4	60.7	52.0	56.3	56.1	57.7	58.7	60.3	61.6
Real goods import growth	1.0	-17.6	7.4	19.8	7.6	7.4	4.9	3.7	2.9	2.8	2.7
Real goods export growth	7.3	-11.4	17.3	29.7	-8.9	-0.2	-6.0	6.0	-0.1	2.5	2.4
Real service export growth	7.8	-60.3	129.2	32.3	14.7	4.6	2.7	2.1	1.9	1.9	1.9

Sources: Central Bank of Montenegro; and IMF staff estimates and projections.

Table 6. Montenegro: Financial Soundness Indicators of the Banking Sector, 2014–23

	2014 Dec	2015 Dec	2016 Dec	2017 Dec	2018 Dec	2019 Dec	2020 Dec	2021 Dec	2022 Dec	2023 Sep
Capital adequacy										
Regulatory capital as percent of risk-weighted assets	16.2	15.5	16.0	16.4	15.6	17.7	18.5	18.5	19.3	20.7
Regulatory tier 1 capital as percent of risk-weighted assets	14.4	14.2	14.7	15.0	14.4	18.1	17.4	17.4	18.4	20.1
Asset composition and quality										
Nonperforming loans in percent of gross loans	15.9	12.6	10.3	7.3	6.7	4.7	5.5	6.2	5.7	5.0
Nonperforming loans net of provisions in percent of capital	68.8	52.5	38.3	28.9	21.0	14.9	21.2	22.6	21.4	18.3
Earnings and profitability										
Return on assets	0.8	-0.1	0.2	0.9	0.7	1.2	0.5	0.8	1.7	2.6
Return on equity	5.6	-0.9	1.2	6.9	4.9	9.0	3.7	5.9	13.9	20.3
Interest margin to gross income	60.2	58.5	58.3	54.5	56.1	56.6	60.8	55.6	54.0	55.3
Noninterest expenses to gross income	76.1	81.1	76.3	73.7	82.5	75.0	74.4	72.3	58.4	57.6
Liquidity										
Liquid assets to total assets	22.1	24.6	24.3	25.1	22.3	20.6	21.8	26.0	30.7	25.7
Liquid assets to short-term liabilities	66.8	87.0	51.4	49.2	35.4	31.1	35.1	39.7	42.9	35.3
Net open position in foreign exchange to capital	0.6	2.1	1.6	0.8	0.0	0.6	0.7	0.1	0.1	0.0
Efficiency of operations										
Personnel expenses to noninterest expenses	41.1	37.0	36.8	36.0	34.9	35.9	35.9	31.6	37.3	30.9
Spread between reference lending and deposit rates (basis points)	736	555	552	546	544	540	541	531	566	623
Customer deposits to total (noninterbank) loans	110	110	105	105	108	110	114	131	152	156

Source: Central Bank of Montenegro.

Annex I. The Impact of Migrants on Economic Growth[1]

The inflow of migrants from Russia and Ukraine is estimated to have contributed to growth in 2022 and throughout 2023. To the extent that migrants stay in Montenegro over the medium and long term, they would also support potential growth.

1. **The migrant inflow since early 2022 has been significant relative to Montenegro's population.** Various estimates of the number of Russian and Ukrainian migrants who arrived in Montenegro since the start of the war in Ukraine in February 2022 average around 10 percent of the country's pre-2022 population. While most of the arrivals occurred in 2022, the net inflow has likely been still positive in 2023.[2] The migrants appear to be relatively well-off (richer than the average Montenegrin resident according to anecdotal evidence) and have not created any material fiscal costs. There is also no evidence of the migrants putting pressure on the labor market, as the declining trend of the unemployment rate continued throughout 2022 and 2023.

2. **The main channels through which migrants have affected the economy are household consumption and the associated imports.** If indeed migrants constituted 10 percent of the 2021 population, assuming that an average migrant consumed as much as an average Montenegrin resident throughout 2022[3] and further assuming that this was true for ¾ of imports of goods,[4] the estimated contribution of migrants to 2022 growth of 6.4 percent would be 3.4 percentage points. From the production side, the impact of migrants appears most noticeable in the information and communication (IT) sector, which registered 30 percent real growth in 2022, contributing 1.5 percentage points to total growth in 2022 despite the still small share of the sector in GDP. The IT sector continued to grow at 3 percent yoy in the first 9 months of 2023. This is consistent with many of the new businesses established by the migrants in the IT sector and with the 36 percent yoy increase in employment registered in the sector according to administrative data in 2022.

3. **Beyond real growth effects migrants have also had other notable impacts.** These include: (i) inflation, through aggregate demand pressures, especially on some segments of consumer prices, e.g. rents increased by 31 percent yoy in 2022 and by another 10 percent in 2023[5] while real estate prices have also been increasing rapidly; (ii) strong tax revenue performance, especially of indirect taxes; (iii) financial inflows.

4. **The possible long term growth effects of migrants are best considered in the context of drivers of potential growth in Montenegro.** For this purpose, GDP growth can be decomposed

[1] Prepared by Gohar Minasyan (EUR).

[2] Visa-free travel by Russians complicates the task of estimating migrant flows and their timing. Turkish citizens are also known to be increasing in number, currently estimated at 2 percent of the country's pre-COVID population.

[3] While being wealthier than the average Montenegrin resident, the average migrant would have contributed more than proportionately to consumption, most migrants spent less than the full year of 2022 in Montenegro, making the proportionality assumption a reasonable starting point for analysis.

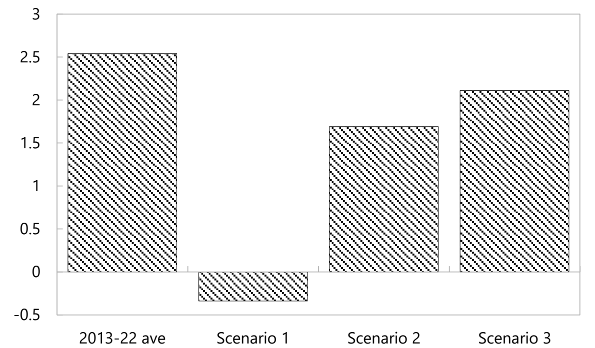
[4] Approximately ¼ of imports of goods can be classified as capital goods.

[5] Given the small weight of rents in the CPI basket (1.4 percent) the impact on CPI inflation has not been significant.

into labor input and labor productivity (output per unit of labor input). This approach is preferable to estimating a standard production function, given the data limitations on capital stock and the volatility of labor and capital shares in national income. In this formulation, the impact of capital accumulation is implicit in labor productivity. This exercise shows that GDP growth in Montenegro after the GFC was mostly driven by employment growth. For the past 10 years, employment growth contributed 2.5pp on average to annual growth while labor productivity growth contributed 0.6pp. Employment growth in turn was mostly due to increasing employment rates (calculated as persons in employment as a share of the 15–64 age group) while the 15–64 population growth was near zero (0.05 percent average annual change in the past 10 years). Three alternative scenarios for employment growth over the next 10 years are shown next to historical one in the text chart.

5. **The first, most pessimistic scenario uses the UN population projections and assumes no further gains in the employment rate.** According to UN population projections, the working age population (15–64 y.o.) will be declining at an average rate of 0.34 percent per year in the next 10 years. These projections appear overly pessimistic as they imply a sharp structural shift compared to recent history when there was, on average, zero change in the working age population for the past 10 years. Moreover, the preliminary results of the 2023 census available in the media suggest, contrary to UN population projections, that the population actually increased by 2.1 percent between 2011 and 2023. The concrete implications of this new information on employment trend projections will become clearer after population data by age group become available, as well as any historical employment data revisions.

Scenarios for Employment Growth
(Annual average percent change for 2023-32)



Source: IMF staff calculations.

6. **The second scenario assumes constant working age population and growing employment rate.** While the employment rate in 2022 was at the all-time high for Montenegro, at 59 percent, it is still quite low compared to peers. Scenario 2 assumes over the next 10 years Montenegro's employment rate (share of employed in the 15–64 y.o.) gradually converges to the EU average of 70 percent. Closing the female labor force participation gap will help achieve this.[6] This scenario implies an average annual employment growth of 1.7 percent.

7. **Finally, Scenario 3 assumes that a significant portion of the migrants choose to stay and work in Montenegro.** In this scenario, on top of the gradual convergence of employment rate to EU average, 12 thousand Russians and Ukrainians (5 percent compared to the total number of employed in 2022) are assumed to permanently join the labor force starting 2023 and in the next

[6] See Annex IX.

10 years. In this scenario, average annual employment growth is 2.1 percent, and the contribution of the migrants to potential growth is 0.4 percentage points.

8. **There are important policy implications to be drawn.** While the low starting level of labor force participation and employment may make it easier to achieve initial employment gains, policy initiatives that lead to lower labor input should be reconsidered. One example is an electoral promise to shorten the workday from 8 to 7 hours. While data on work hours is not available, according to the latest labor force survey, less than 5 percent of workers work part-time, which implies that reducing work hours would be potentially binding for a large share of the workforce. Taking an agnostic approach to the causal effects of work hours on productivity,[7] the impact of such a policy on potential growth can reasonably be posited to be negative.

9. **Achieving high potential GDP growth would require reinvigorating the growth of labor productivity.** It is notable that in all the above scenarios, achieving potential GDP growth of 3 percent or above would require increasing labor productivity growth from its historical average of 0.6 percent. While difficult to estimate quantitatively, factors that should help increase labor productivity include: (i) productive investment in physical and digital infrastructure, including FDI; (ii) improvements in human capital through better education; (iii) structural reforms to improve the business environment.[8] Migrants can also play a role in increasing the overall labor productivity of the economy, especially if they contribute to the development of knowledge intensive sectors. For example, labor productivity in the IT sector is about twice the average for the economy, and diversification of the economy towards higher productivity sectors would help achieve higher and sustainable potential growth.

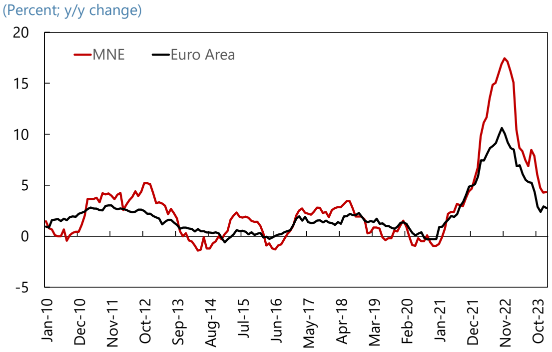
[7] The empirical evidence on casual effects of shorter work hours on productivity is inconclusive. E.g., Lee and Lim (2017) argue that the relationship is nonlinear because the "fatigue effect" becomes important as hours increase, while the "fixed cost effect" and "learning effect" work in the opposite direction and are more important when overall hours are shorter. They also find that the "fatigue effect" is less important in the services sector compared to manufacturing. See also: Delmez and Vandenberghe (2018)

[8] World Bank's recent Country Economic Memorandum for Montenegro contains specific policy recommendations.

Annex II. Inflation Dynamics in Montenegro and Upside Risks[1]

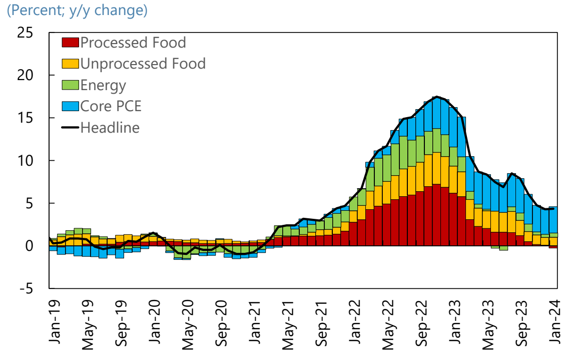
Inflation in Montenegro surged to an all-time high since independence in mid-2022, easing. significantly since then. Still, there are important upside risks, stemming from potential further policy induced wage increases and asymmetric pass-through form international food prices.

Montenegro vs. Euro Area: Headline Inflation
(Percent; y/y change)



Sources: Haver Analytics and IMF staff calcualtions.

Montenegro: Inflation Composition
(Percent; y/y change)



Sources: Haver Analytics and IMF staff calcualtions.

1. **Inflation dynamics in Montenegro can be described by an augmented Phillips curve model.** The model includes as explanatory variables, in addition to the output gap: (i) international food price inflation; (ii) lagged inflation; (iii) lagged wage growth; (iv) error correction term for deviations from long-term relationship between prices in Montenegro and the Euro Area. Given the unilateral euroization of Montenegro, a long-term relationship between price levels in Montenegro and Euro Area is reasonable to expect, while deviations from this long-term relationship can be caused by Montenegro-specific shocks. Results are presented in Tables 1–2 and show; (i) high persistence of inflation which is consistent with earlier studies on inflation dynamics in the Western Balkans (and, more generally, emerging market economies as compared to advanced economies); (ii) importance of international food price shocks;[2] (iii) a statistically significant role for lagged wages; (iv) error correction mechanism that corrects deviations from the long-term relationship. The coefficient for the output gap is not statistically significant, which can be attributed to the difficulty of accurately measuring the output gap.[3]

[1] Prepared by Gohar Minasyan (EUR).

[2] Minasyan, G., E. Ozturk, M. Pinat, M. Wang and Z. Zhu (2023) Inflation Dynamics in the Western Balkans, IMF WP Show that in the Western Balkans international food prices not only affect headline inflation directly due to a large share of food in the CPI baskets, but they also affect core inflation.

[3] Statistical significance of output gap in Phillips curve regressions for Western Balkans has been difficult to establish in general.

Table 1. Montenegro: Phillips Curve Regression

Variables	Model 1	Model 2
Lagged inflation	0.569*** (0.092)	0.487*** (0.093)
Lagged gross wage growth	0.103** (0.047)	
Lagged net wage growth		0.085*** (0.026)
Lagged error correction term	-32.812*** (9.489)	-30.044*** (9.108)
International food price inflation	0.045** (0.018)	0.035** (0.018)
Output gap	0.000 (0.000)	0.000 (0.000)
Constant	0.191 (0.126)	0.244* (0.116)
Observations	62	62
R-squared	0.59	0.628

Note: standard errors are in parentheses.
Source: IMF staff calculations.

Table 2. Montenegro: Long-Run CPI Regression

Variables	Log CPI
Euro Area Log CPI	1.322*** (0.018)
Constant	-1.491*** (0.085)
Observations	64
R-squared	0.988

Note: standard errors are in parentheses.
Source: IMF staff calculations.

2. **The surge in inflation in 2022 was a result of multiple concurrent shocks,** which included the rapid recovery from COVID, the minimum wage hike effective January 2022, global food and energy price increases, and a large inflow of migrants contributing to aggregate demand pressures. While the concurrent nature of the shocks complicates the task of disentangling the effects of the minimum wage increase from the other shocks, the following observations appear relevant.

- An out-of-sample forecast for inflation using data prior to 2022 is unfortunately not helpful because the low variation of wages in this period does not allow establishing an intuitive statistically significant relationship between wages and inflation.

- Almost all the average wage increase in the year of 2022 occurred in January, when the minimum wage increase became effective, and before the international commodity price shocks took effect in March 2022. Therefore, the average wage increase in 2022 was not a result of wage pressures in reaction to increased cost of living, but can be attributed fully to the minimum wage increase.

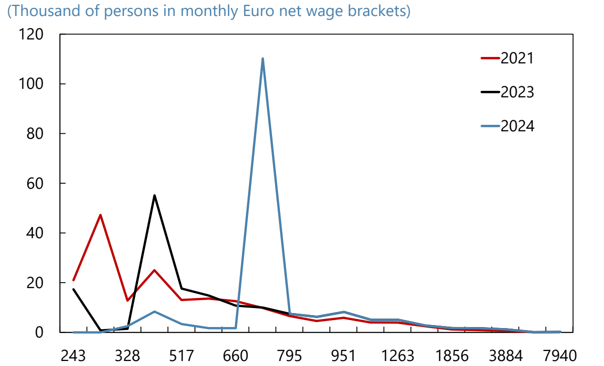
- At the same time, the minimum wage increase has likely prevented or delayed some demands for wage increases that would otherwise have materialized in response to the higher cost of living.[4] Separately, the minimum wage increase in January 2022 also meant that the government was not as pressed to increase spending to help households, which would have increased aggregate demand and therefore inflation.

- An important aspect of the 2022 reform was that the minimum wage increase was largely "financed" by the government through elimination of healthcare contributions. Therefore, the net wage increase was much higher than the gross wage increase (30 percent average net wage growth vs 10 percent average gross wage growth in Q1, 2022). This has implications for the channels through which wage growth can contribute to inflation: through higher consumption demand because of higher disposable income and through higher production costs for firms, part of which is passed on to prices. While a reduced form model (such the Phillips curve regressions in Table 1) would reflect both channels, it can be argued that the 2022 wage increase affected inflation mostly through the demand channel.

3. **Analyzing the relationship between wages and inflation in Montenegro is complicated by the presence of "envelope wages".** The key argument for the minimum wage increase in 2022 was that actual wages were much higher than the previous statutory minimum wage but all wages above the minimum were paid unofficially as "envelope" payments. To what extent the minimum wage increase resulted in reported wages converging to actual wages rather than in actual wages experiencing a genuine increase, is an important question and a subject of further research. However, even being agnostic about the size of the "envelope payments", it is safe to argue that they would be lower when the minimum wage is €450 than when the minimum wage was €250. Therefore, the average wage increase following the proposed new minimum wage hike to €700 will likely reflect less wage formalization and more actual wage increase than in 2022.

4. **Increasing the average monthly net wage from €450 to €700 is estimated to result in a 30 percent increase of the average net wage.** Currently, about ¾ of wage recipients earn less than €700 per month, with a significant bunching of about 33 percent of the wage distribution at the current minimum wage level of €450.[5] Notably, the previous minimum wage hike to 450 did not seem to have caused a shift in the distribution of wages beyond the new minimum wage. Assuming that increasing the minimum wage again does not result in second-round effects from higher wage pressure further up the income distribution but only a re-bunching of the distribution around the new minimum wage

Montenegro: Wage Distribution
(Thousand of persons in monthly Euro net wage brackets)



Sources: MRCA and IMF staff calculations.

[4] While some countries in the Western Balkans had minimum wage increases (much more modest than in Montenegro), average wages increased in all the countries.

[5] Wage distribution data are as of Q2, 2023.

(while recognizing the upside risks associated with this assumption) the average net wage would increase by about 30 percent. However, if simultaneously with the minimum wage increase, the pension contributions are eliminated in full, the average gross wage and therefore the average labor cost to employers will stay roughly the same. This is because the gain to employers from not paying the pension contributions would compensate for the loss due to having to pay higher minimum wages. Therefore, as in 2022, the new minimum wage hike is expected to affect inflation mostly through the demand channel.

5. According to the augmented Phillips curve model above, a 30 percent increase in the average net wage would cause a 2.2 percentage points higher annual average inflation compared to baseline. The calculations use the same assumptions on international food prices and euro area inflation in both scenarios, no wage increases in the baseline and a one-off 30 percent increase of the average net wage in Q2, 2024. While persistence of inflation causes the effect of the wage increase to linger, the error correction term works in the opposite direction, gradually pulling inflation back closer to the inflation in the Euro Area.

6. There are also upside risks to inflation in Montenegro due to asymmetric pass-through of international to local food prices. While international food prices are expected to moderate, risks to commodity price volatility remain. Further upside shocks to international food prices are possible due to supply disruptions related to conflicts, uncertainty, and export restrictions (Annex IV). At the same time, declining international food prices may not symmetrically lead to lower inflation. The impulse responses from a simple VAR show that responses of food price inflation to positive shocks to international food prices (left chart) tend to be larger, more often statistically significant, and more persistent as compared to negative socks (right chart) in Montenegro.[6] Empirical literature finds that the pass-through of commodity price shocks to domestic prices is often asymmetric, with higher pass-through of price increases than of price decreases.[7] This can be attributed to importer and retailer margins reacting asymmetrically to input cost shocks, i.e. increasing by more when input costs decline than they decrease when input costs rise.[8] Further research is needed to determine whether the apparent asymmetric pass-through from international to domestic food prices in Montenegro is linked with anti-competitive practices within the retail sector.[9] If confirmed, the presence of asymmetric pass-through would imply that policies

[6] The picture is similar in most other Western Balkan economies.

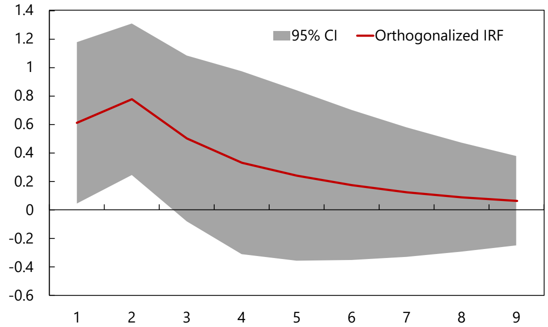
[7] Some references include: Ferrucci, G., R. Jiménez-Rodríguez, L. Onorante (2005) “Food price pass-through in the euro area: The role of asymmetries and non-linearities”, Vavra, P. and B. K. Goodwin (2005) "Analysis of Price Transmission Along the Food Chain", Andrew Glover, José Mustre-del-Río, and Alice von Ende-Becker, (2022) How Much Have Record Corporate Profits Contributed to Recent Inflation?

[8] There can also be other reasons such as asymmetric menu costs (in the presence of trend inflation, menu costs may lead to more resistance to lower prices than to increase them) or productivity shifts triggered by commodity price shocks.

[9] Staff is collaborating with the World Bank on analyzing company level data and expect to have more results in the staff report.

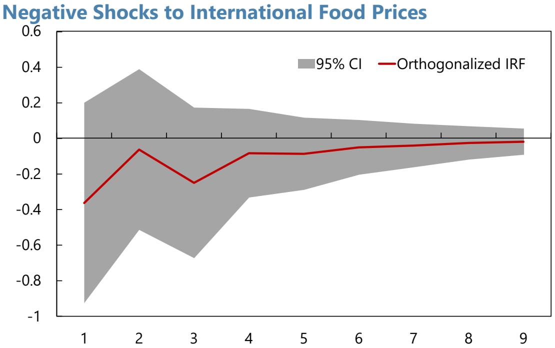
to enforce competition and limit margins of importers and retailers, if well designed, may have merit in ensuring low and stable inflation in the context of commodity price fluctuations.

Montenegro: Responses of Domestic Food Prices to Positive Shocks to International Food Prices



Source: IMF staff calculations.

Montenegro: Responses of Domestic Food Prices to Negative Shocks to International Food Prices



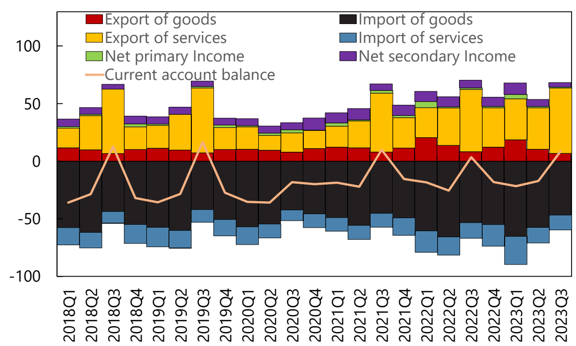
Sources: IMF staff calculations.

Annex III. External Sector Assessment[1]

Montenegro's external position in 2023 was assessed to be substantially weaker than the levels implied by fundamentals and desirable policy settings, based on the results of the IMF's EBA-lite current account model.[2] While the current account balance has narrowed significantly since the pandemic as tourism recovered, the imbalance between saving and investment remains large and can be alleviated by fiscal control and structural reforms to strengthen competitiveness and increase productivity.

1. The current account deficit has narrowed significantly since the height of the pandemic with the recovery of tourism. The current account deficit peaked at 26.1 percent of GDP in 2020 as tourism collapsed. Since then, foreign tourists have gradually returned, and the number of arrivals in 2023 has surpassed its pre-pandemic levels. The recovery of tourism has helped reduce the current account deficit while boosting GDP, improving the external balance significantly. However, imports have also expanded commensurate with the recovery of tourism and domestic consumption growth. Over the medium term, the current account deficit is expected to remain at its pre-pandemic levels. This reflects the imbalance between saving and investment in the Montenegrin economy, driven in part by loose fiscal policies and in part by structural issues that subdue the private saving rate, including low real interest rates.

Montenegro: Current Account
(Percent of GDP)



Sources: Haver Analytics and IMF staff calculations.

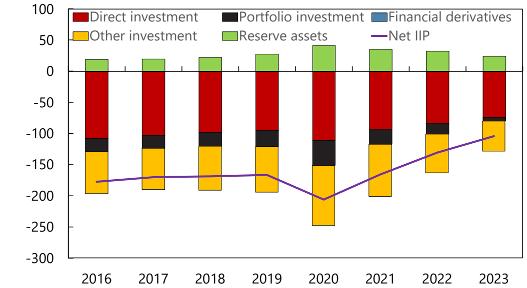
2. Continued FDI inflows have been supporting the financing of the current account deficit. Robust FDI inflows have been the main source of financing for Montenegro. Averaging at 11 percent of GDP in the past decade, FDI has accounted for ¾ of the current account deficit. Equity purchase and intracompany lending through debt instruments have both been important FDI components. At the same time, net errors and omissions have surged since the pandemic, reaching 10.7 percent of GDP in 2023 from 2.3 percent of GDP in 2020. This is likely due to the recovery of tourism as well as the BoP implications of the large inflows of migrants from Russia and Ukraine not being accurately reflected in BoP statistics.

[1] Prepared by Jiaxiong Yao (EUR).

[2] The external sector assessment is based on staff's estimates. This assessment should be interpreted with caution given that the EBA models' fit for Montenegro is poor, and the two approaches point to opposite results.

3. The net international investment position (IIP) remains deep in negative territory. After peaking at more than -200 percent of GDP in 2020, the net IIP has fallen largely because of the denominator effect as nominal GDP increased. Nevertheless, it remains highly negative as the economy continues to run large current account deficits. While the current account deficit has mostly been financed by FDI, external debt remains high, and vulnerabilities to sudden stops and rise in sovereign spreads remain.

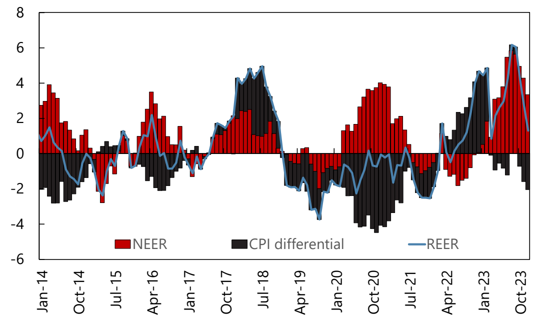
Montenegro: Net International Investment Position
(Percent of GDP)



Sources: Haver Analytics and IMF staff calculations.
Note: 2023 data are as of November.

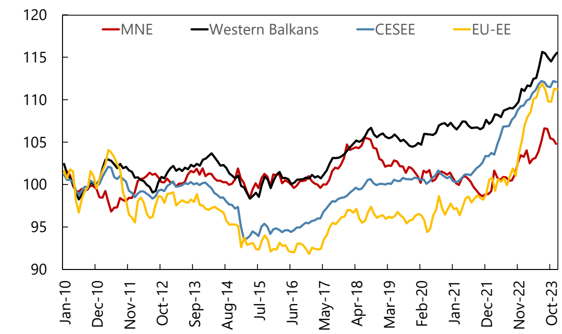
4. The real effective exchange rate has appreciated lately as inflation differentials with trading partners increased. Global supply chain disruptions during the pandemic and the war in Ukraine have catapulted inflation worldwide, but more so in Montenegro than in its trading partners. While Montenegro's real effective exchange has appreciated as a result, it did so less than in other Western Balkan countries. This may present Montenegro with a relative competitive advantage in the region.

Montenegro: Real Effective Exchange Rate
(Percent; y/y change)



Sources: IMF INS database and IMF staff calculations.

Montenegro vs. Peers: Real Effective Exchange Rate
(Index, 2010=100)



Sources: IMF INS database and IMF staff calculations.

5. The current account is assessed to be substantially weaker than the norm implied by fundamentals and desirable policies. Two EBA-lite models were used to assess Montenegro's external position. The current account model suggests that the cyclically adjusted current account deficit, at 11.2 percent of GDP for 2023, is higher than the model-derived multilaterally consistent cyclically adjusted norm of 4.5 percent of GDP. Using the estimated current account elasticity, the current account gap of -6.7 percent implies an overvaluation of REER by 18.6 percent. The REER model points to a different direction—that the REER is

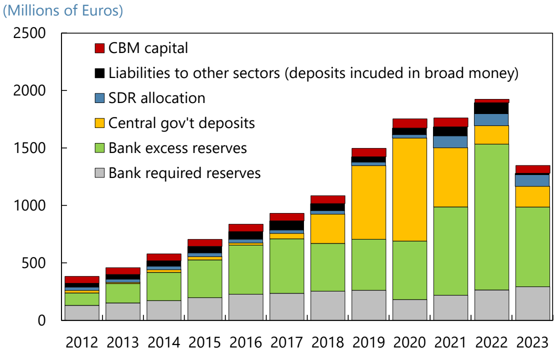
Montenegro: EBA-lite Model Results, 2023

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**-11.4**	
Cyclical contributions (from model) (-)	-0.2	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**-11.2**	
CA Norm (from model) 3/	**-4.5**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-4.5**	
CA Gap	**-6.7**	**2.7**
o/w Relative policy gap	5.0	
Elasticity	-0.4	
REER Gap (in percent)	**18.6**	**-7.5**

1/ Based on the EBA-lite 3.0 methodology undervalued—on account of better fiscal outcomes and lower private credit growth than implied by the fundamentals and desirable policies. Overall, in staff's view, the CA model is preferred as the REER model is sensitive to the assumption of country fixed effects.[3]

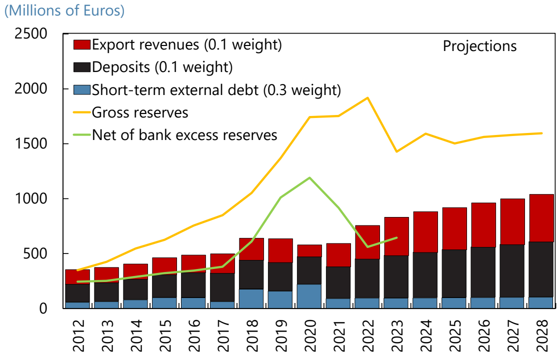
6. Gross international reserves are adequate when assessed against standard metrics. Montenegro's reserves fell to €1.4 billion or 21 percent of GDP in 2023 from the peak in 2022 as bank excessive reserves declined in search of higher yields. Over the medium term, reserves are expected to stay above 17 percent of GDP. End-2023 gross reserves were at 172 percent of the IMF metric for reserve adequacy and are expected to remain above 150 percent in the medium term. Because of Montenegro's unilateral euroization, gross reserves also serve the roles of fiscal and liquidity buffers. The Government's deposits at the central bank were less than one month's expenditure in 2023 and will increase in 2024 with the issuance of Eurobond. Regarding the bank emergency liquidity assistance needs, official buffers have declined from the peak of about 40 percent of short-term liabilities of the banks in 2020 to 13.2 percent and closer to the historical average.

Montenegro: CBM Liabilities and Capital
(Millions of Euros)



Source: CBCG.

Montenegro: ARA Decomposition
(Millions of Euros)



Sources: Montengrin authorities and IMF staff calculations.

[3] The REER model requires a country fixed effect but does not have one for Montenegro. Following previous practice, staff estimated the fixed effect as the average of its neighboring countries, including Serbia, Albania, and Croatia.

Annex IV. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Domestic			
'Europe Now 2.0'. The new government has pledged large increases of the minimum wage, and reduction/elimination of pension contributions.	High	High. These policies would lead to a significant deterioration of the fiscal position. Wage increases would also lead to higher inflation.	Coherent fiscal policies, consistent with debt sustainability should be maintained.
Renewed domestic political uncertainty. Coherence of economic policies would be undermined, consumer and investor sentiment could be negatively affected.	Medium	High. Political uncertainty could create new risks to the fiscal outlook. Growth would also be negatively affected through reduced consumer and investor confidence.	Macroeconomic policies should be guided by credible medium-term objectives.
External			
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	High	High. Russian and Ukrainian migrants have had a sizeable impact on aggregate demand. Whether or not migrant flows reverse would have implications for near- and medium-term growth.	Structural policies can help to better integrate migrants into the labor force.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.	Medium	High. Reduction in tourism revenues will negatively affect growth.	Assuming the slowdown is temporary, countercyclical fiscal policy without significant deviation from medium-term fiscal goals may be considered.
Sovereign debt distress. Domino effects from high global interest rates, a growth slowdown in AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, and loss of market access.	Medium	High. Montenegro's external financing needs are high, including large Eurobond rollovers due in 2025 and 2027. Prohibitively high interest rates would sharply worsen the fiscal situation.	Debt management should be planned actively. Additional fiscal tightening would be needed should borrowing costs rise.

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High**	**Medium**. Montenegro's inflation is sensitive to international food price increases, given the large share of imported food in the CPI basket.	Targeted and temporary measures to alleviate the cost of price increases of staple products may be considered.
Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	**Medium**	**Medium**. Montenegro has a recent history of a disruptive cyberattack on a number of government websites.	Building resilience and robust supervision of the digital infrastructure (including crypto asset ecosystems) is needed.

Annex V. Sovereign Risk and Debt Sustainability Assessment

Table 1. Montenegro: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	**Moderate**	The overall risk of sovereign stress is moderate given the combination of low vulnerability in the near term and moderate vulnerability in the medium term and long term. While Montenegro's fiscal position has improved significantly over the recent years, further fiscal adjustment is needed to stabilize debt.
Near term 1/			
Medium term	**High**	**Moderate**	While model-based results point to high medium-term risks, staff assesses these risks to be moderate. GFN are expected to stay elevated, however, in line with historical levels. Relatively high GFN/GDP ratios also reflect the small size of the economy. Debt is expected to increase gradually over the medium term after having come down significantly since after the pandemic. The undiversified sources of financing add to the risks of GFN financeability.
Fanchart	**High**	…	
GFN	**High**	…	
Stress test	Nat. Disast.	…	
Long term	…	**Moderate**	Long term risks to Montenegro's debt sustainability stem from projected large amortizations relative to GDP (in part reflecting the small size of the economy) and the projected increases in costs of pension, health, and climate-related spending. However, the model-based results of health and pension modules are likely to overstate the fiscal risks, as they embed population and aging assumptions that appear overly pessimistic (they imply a population decline, while preliminary results from the recent 2023 census show that population actually increased by 2.1% between 2011 and 2023). Based on staff's preliminary information, climate adaptation related fiscal risks are assessed to be moderate.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA summary assessment

Commentary: Following the sharp reduction of the debt-to-GDP ratio in the post-pandemic period, a slow upward trend is expected to resume in 2024 driven by projected primary deficits. Stabilizing debt at below 60 percent of GDP is feasible through a cumulative fiscal adjustment of 1.8 percent of GDP over the next 4 years, which is consistent with maintaining small fiscal surpluses from 2026 on.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Table 2. Montenegro: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

Sector grouping		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	Not applicable
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
5. Debt consolidation across sectors:		Consolidated		Non-consolidated	

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

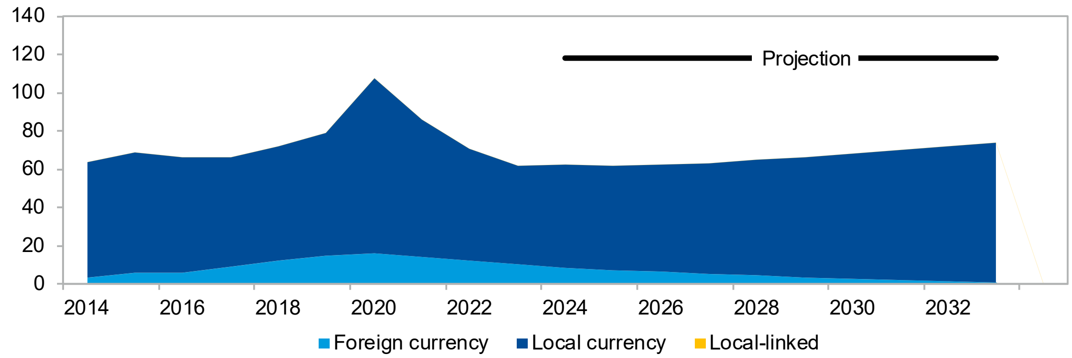
Sector grouping		Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The coverage of this SRDSA is for the general government, which includes central government, SSF, Health Fund, and local government. The authorities report consolidated accounts of GG including SSF and the Health Fund. Fiscal risks may stem from potential deterioration of the Health Fund and Social Security Fund balances if the elimination of healthcare contributions and, potentially, reduction of pension contributions are not fully compensated by the central government.

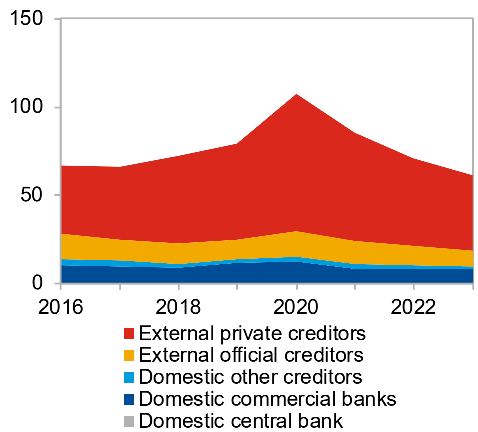
Table 3. Montenegro: Public Debt Structure Indicators

Debt by currency (percent of GDP)



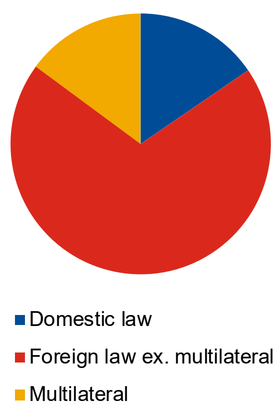
Note: The perimeter shown is general government.

Public debt by holder (percent of GDP)



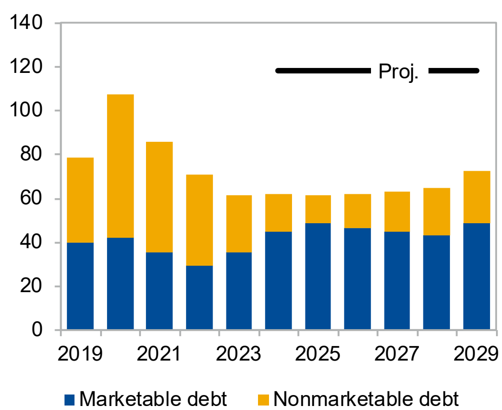
Note: The perimeter shown is general government.

Public debt by governing law, 2023 (percent)



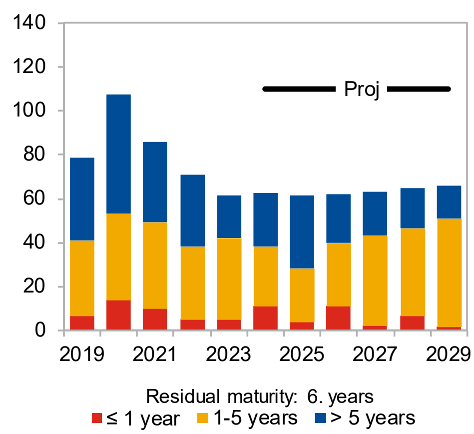
Note: The perimeter shown is general government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is general government.

Public debt by maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: 70 percent of debt as of end-2023 was held by external private creditors, including the China EXIM Bank debt, denominated in USD accounting for 16 percent. Domestic sources of financing remain undiversified with no retail market for government debt.

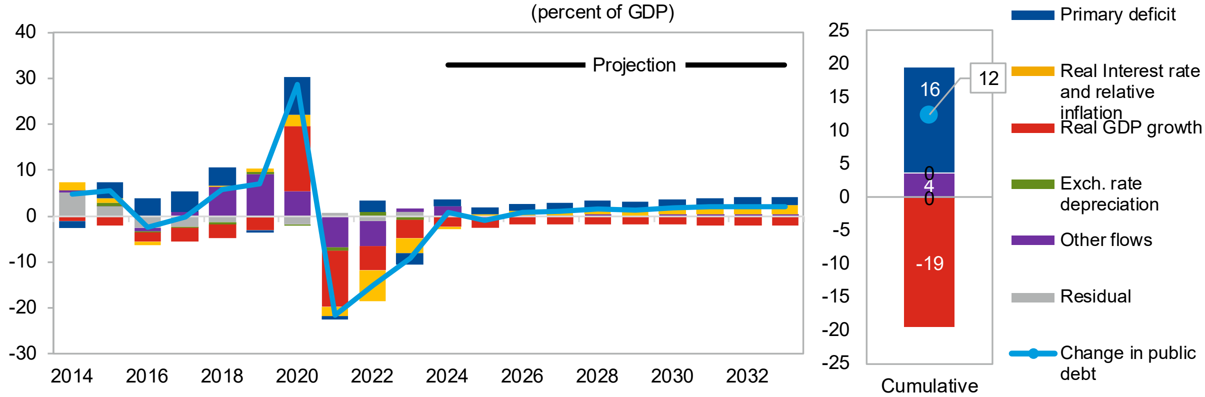
Table 4. Montenegro: Baseline Scenario
(Percent of GDP unless indicated otherwise)

(percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	61.5	62.3	61.4	62.2	63.2	64.8	66.1	67.9	69.8	71.8	73.9
Change in public debt	-9.1	0.8	-0.9	0.8	1.0	1.7	1.2	1.8	1.9	2.0	2.1
Contribution of identified flows	-9.9	0.9	-0.8	0.8	1.0	1.7	1.3	1.8	1.9	2.0	2.1
Primary deficit	-2.6	1.4	1.5	1.5	1.5	1.5	1.6	1.6	1.7	1.7	1.9
Noninterest revenues	41.8	41.0	40.5	40.4	40.4	40.4	40.4	40.4	40.4	40.4	40.4
Noninterest expenditures	39.2	42.4	41.9	41.9	41.9	42.0	42.0	42.1	42.1	42.1	42.3
Automatic debt dynamics	-8.1	-2.8	-1.5	-0.9	-0.7	-0.4	-0.4	-0.2	-0.1	-0.1	0.0
Real interest rate and relative inflation	-3.3	-0.6	0.4	0.9	1.1	1.4	1.5	1.7	1.9	2.0	2.1
Real interest rate	-3.8	-0.8	0.3	0.9	1.1	1.4	1.5	1.7	1.9	2.0	2.1
Relative inflation	0.5	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-4.0	-2.2	-1.8	-1.8	-1.8	-1.8	-1.9	-1.9	-2.0	-2.0	-2.1
Real exchange rate	-0.8	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.7	2.3	-0.8	0.2	0.2	0.5	0.0	0.4	0.3	0.3	0.3
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.7	2.3	-0.8	0.2	0.2	0.5	0.0	0.4	0.3	0.3	0.3
Contribution of residual	0.9	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	3.9	10.1	13.9	7.4	16.0	8.8	15.4	12.3	18.9	20.3	16.1
of which: debt service	6.4	8.7	12.5	5.9	14.5	7.3	13.8	10.7	17.2	18.5	14.2
Local currency	5.6	7.7	11.5	5.0	13.7	6.5	13.1	10.0	16.6	17.9	13.7
Foreign currency	0.8	1.0	0.9	0.9	0.8	0.8	0.7	0.7	0.6	0.6	0.6
Memo:											
Real GDP growth (percent)	6.0	3.7	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Inflation (GDP deflator; percent)	9.0	4.6	3.1	2.3	2.2	2.1	2.1	2.1	2.1	2.1	2.1
Nominal GDP growth (percent)	15.6	8.5	6.2	5.4	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Effective interest rate (percent)	2.8	3.2	3.6	3.9	4.0	4.5	4.6	4.9	5.0	5.1	5.2

Contribution to change in public debt

(percent of GDP)

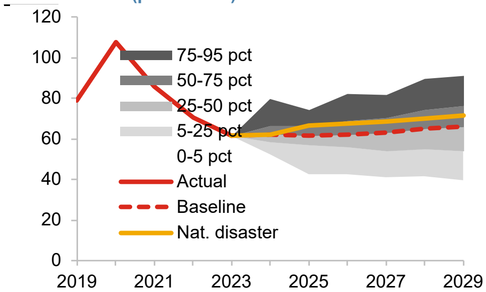


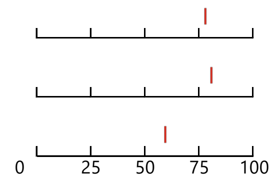
Commentary: Other flows mainly account for government deposits at the Central Bank, which are expected to be maintained at a level to cover 1 month of central government spending on average.

Table 5. Montenegro: Medium-Term Risk Assessment

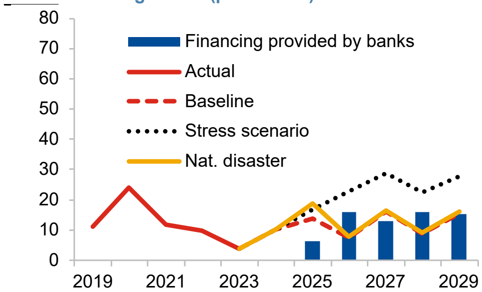
	Value	Contrib [1/]	Percentile in peer group [2/]
Debt fanchart module			
Fanchart width *(percent of GDP)*	51.4	0.7	
Probability of debt non-stabilization *(percent)*	82.0	0.7	
Terminal debt-to-GDP x institutions index	35.4	0.8	
Debt fanchart index (DFI)		2.2	
Risk signal: [3/]		**High**	
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	11.9	4.1	
Initial Banks' claims on the gen. govt *(pct bank assets)*	14.0	4.5	
Chg. In banks' claims in stress *(pct banks' assets)*	35.0	11.7	
GFN financeability index (GFI)		20.3	
Risk signal: [4/]		**High**	

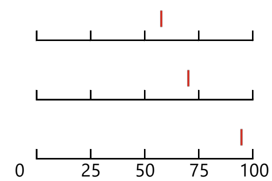
Final fanchart (pct of GDP)





Gross financing needs (pct of GDP)

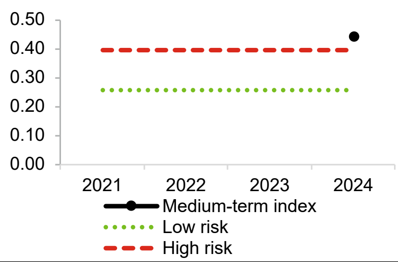




Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | **Natural disaster**

Medium-term index (index number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	2.2	0.5	0.5	0.2
GFN financeability index	20.3	0.4	0.5	0.2
Medium-term index		0.4		
Risk signal: 5/		**High**		
Final assessment:		**Moderate**		

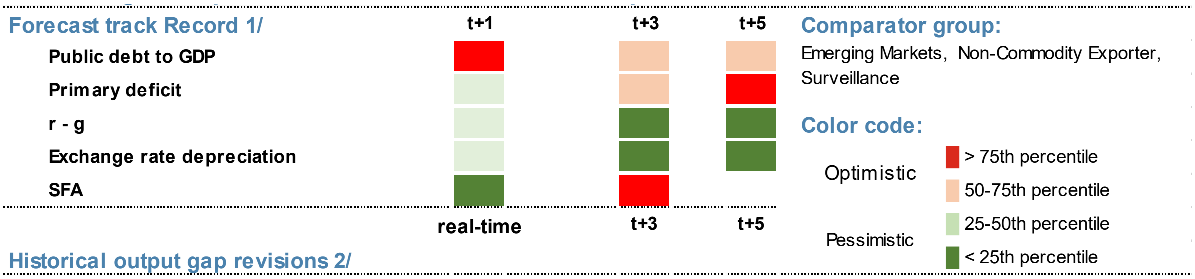
Prob. of missed crisis, 2024-2029, if stress not predicted: 54.5 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 6.8 pct.

Commentary: The mechanical signal of the Fanchart module points to high risk over the medium term. While in the baseline debt is expected to rise slowly, a fiscal effort of 1.8 percent of GDP over the next 4 years would stabilize debt at below 60 percent of GDP. The GFN module highlights high baseline GFNs and financeability risks. Montenegro is a small economy with historically similar GFN to GDP ratios: GFNs averaged 12.6% of GDP in 2013-23 and are projected in the baseline to average 11.9% of GDP over 2024-29. An important model element contributing to the high risk assessment is the potentially large increase in domestic banks' claims on the general government if other financing sources become unavailable. In a small economy like Montenegro, that also does not have a large banking sector, this is true by construction. Nevertheless, diversification of sources of sovereign financing is important, in particular by developing the retail market, and is one of staff's recommendations to improve the government's public debt management.

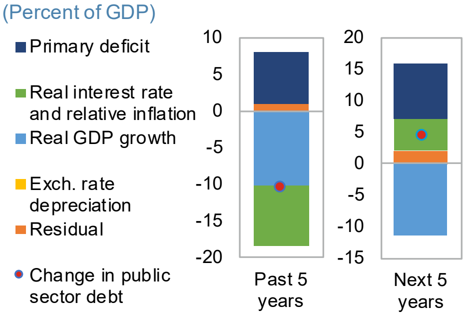
Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

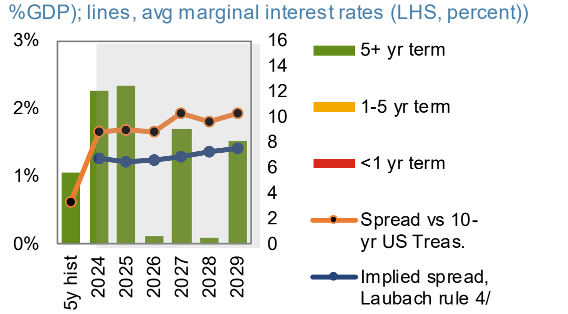
Table 6. Montenegro: Realism of Baseline Assumptions



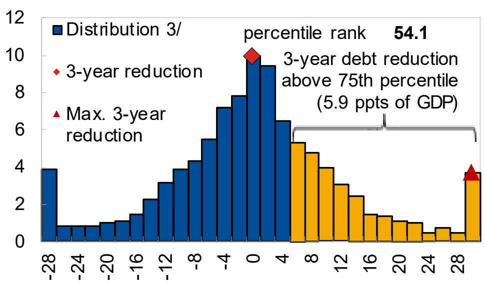
Public Debt Creating Flows
(Percent of GDP)



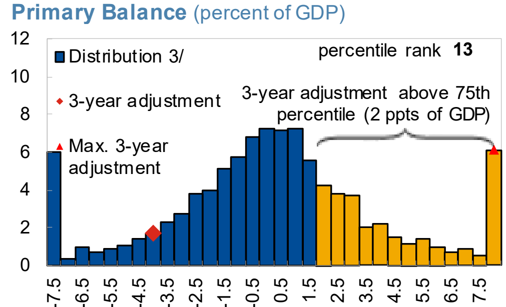
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



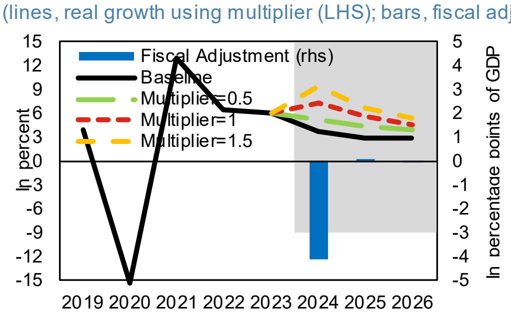
3-Year Debt Reduction
(Percent of GDP)



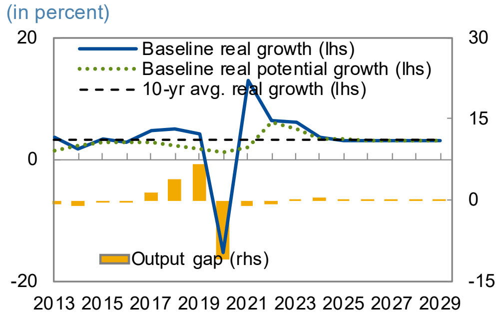
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth
(in percent)



Commentary: Being a small and undiversified economy, high volatility of macro variables as well as of forecast revisions is a characteristic of Montenegro. Government fiscal plans and outturns have also been highly volatile.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates).

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

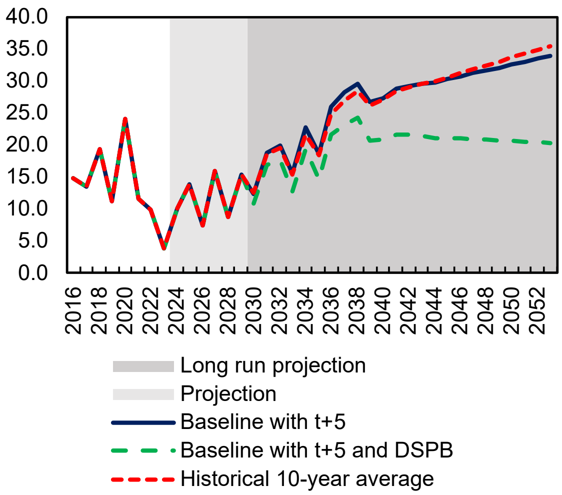
Table 7. Montenegro: Triggered Modules

Large amortizations	**Pensions**	**Climate change: Adaptation**	Natural Resources
	Health	Climate change: Mitigation	

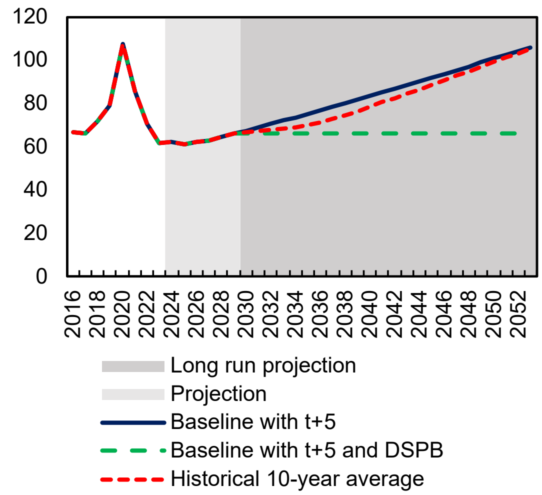
Montenegro: Long-term risk assessment: Large Amortizations

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP ratio



Total public debt-to-GDP ratio

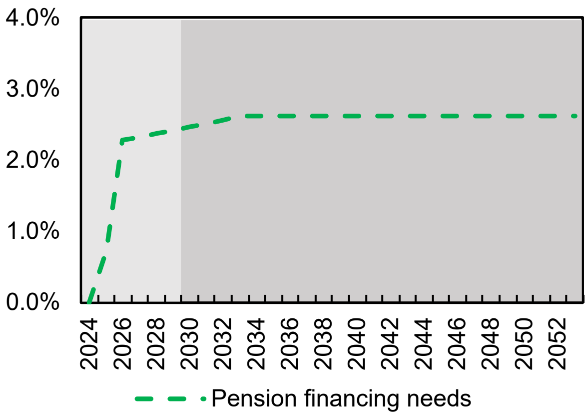


Commentary: The model points to high risks from large amortizations. However, Montenegro is a small economy with historically similar GFN to GDP ratios. Montenegro's GFNs averaged 12.6% of GDP in 2013-23 and are projected in the baseline to average 11.9% of GDP over 2024-29.

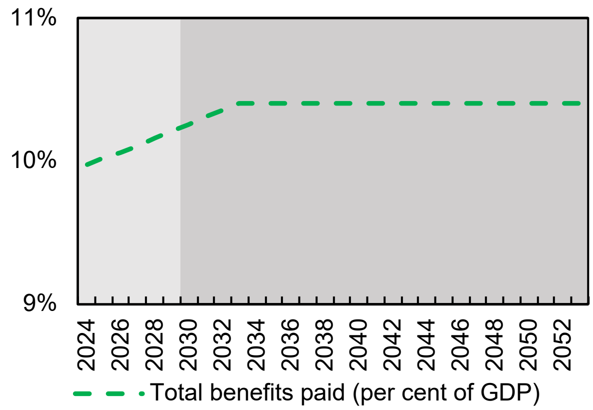
Table 8. Montenegro: Pensions

Permanent adjustment needed in the pension system to keep pension assets positive for:	30 years	50 years	Until 2100
(pp of GDP per year)	2.4%	2.5%	2.5%

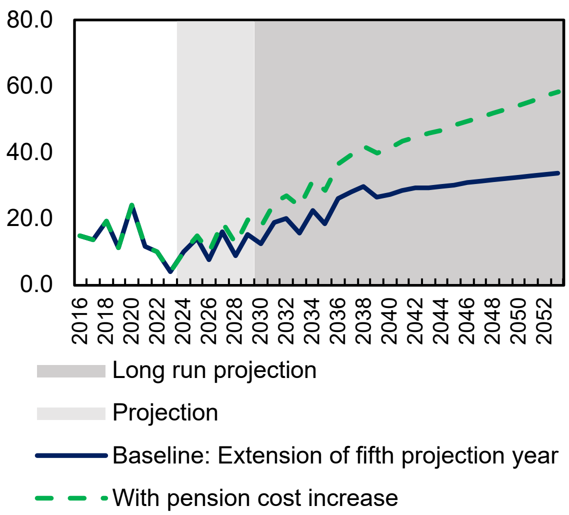
Pension Financing Needs



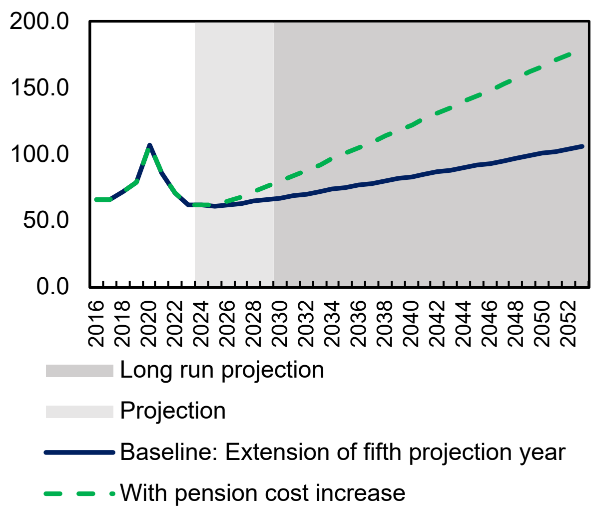
Total benefits paid



GFN-to-GDP ratio

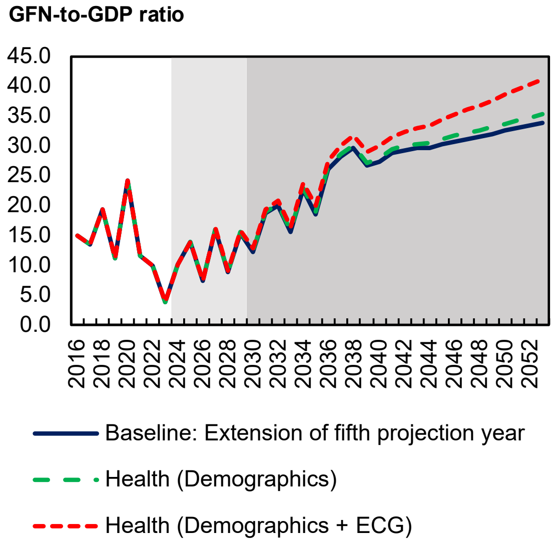


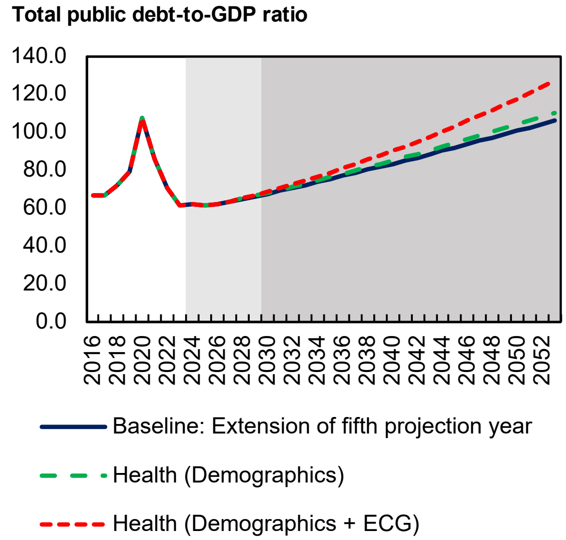
Total public debt-to-GDP ratio



Commentary: Total benefits paid by the pension system exceed pension contributions, and this difference has increased due to the recent hike of the minimum pension, resulting in higher pension financing needs. This module, however, may overstate long term fiscal risks because it embeds population projections that imply a population decline, while preliminary results from the recent 2023 census show that population actually increased by 2.1% between 2011 and 2023.

Table 9. Montenegro: Demographics Health





Commentary: Because of lack of data on health spending by age group in Montenegro, respective ratios for Serbia have been used as proxies. These data limitations imply that model results should be interpreted with caution. While health related spending is likely an important source of fiscal risk for Montenegro over the long term, this module may overstate such risks because it embeds population projections that imply a population decline, while preliminary results from the recent 2023 census show that population actually increased by 2.1% between 2011 and 2023.

Table 10. Montenegro: Climate Change Adaptation

Montenegro is exposed to climate risks such as flooding, drought, extreme heat, and wildfires. Still, the fiscal risks and costs of adaptation are currently understood to be relatively low. The IMF Climate-driven INFORM Risk Index aims to capture both a country's relative risk-exposure to climate-driven shocks, as well as its capacity to cope with those risks. Montenegro's overall index score is relatively low, mainly because its risk exposure is deemed low. Its overall index score (2.7 on a scale of 0-10) is comparable to those of France, Canada, and Germany. Nevertheless, extreme events do pose significant concerns regarding public safety, the economy and infrastructure. For example, droughts have a direct impact on hydro power (half of all electricity generation, therefore partially shielding the country from global energy shocks), and on electricity exports.

Montenegro has committed to lowering its greenhouse gas (GHG) emissions by 35 percent by 2030 relative to 1990 levels under its 2021 Nationally Determined Contribution submission. In addition, the Government of Montenegro has indicated its intention to align its GHG emission target with the EU's more ambitious target of a 55 percent reduction relative to 1990 levels by 2030. The authorities are still developing their national climate adaptation and mitigation strategy. As this strategy is intended to serve as the framework to reach these goals and meet other environmental challenges, climate-related discussions were deferred to the 2025 Article IV cycle.

Annex VI. Fiscal Measures[1]

1. Possible measures to improve the fiscal position, to support a stable primary balance over the medium term, include:

- *Completing reforms to the revenue administration* – the Reform Project of the Montenegro Revenues and Customs Administration should be reinvigorated. Focus should be on improving compliance risk management, the use of third-party data and greater digitalization. These can translate into significant and sustained tax revenues. Early indications from the IMF's Tax Administration – Assessment and Yield Tool (TA-AYT) show potential to increase the tax-to-GDP ratio by a cumulative 0.9 percent per year in four years if tax administration reforms are fully implemented in line with international good practice. Further Capacity Development assistance from the IMF could support the acceleration of these reforms.

- *Tax policy changes* - Implement the remaining revenue raising measures originally planned under 'Europe Now'. The proposed laws on fuel marking and should be implemented to raise approximately 0.2 percent of GDP. Raising VAT by one percentage point would raise collection by about 0.7 percent of GDP.

- *Containing the growth of the public wage bill* – limiting the wage bill growth to inflation for one year is estimated to generate savings of 0.3 percent of GDP.

2. Rationalizing and improving targeting of social expenditures will yield sizable dividends. The controversial mother's benefit is not well-targeted and was previously ruled unconstitutional in 2016 for being discriminatory. The mothers' benefit was reintroduced in 2022 and entitles mothers of three or more children to a benefit equivalent to between 40-70 percent of the previous year's average net wage in Montenegro. The benefit is expected to reduce incentives for female labor force participation. This is discussed further in the Annex IX on gender inequalities in Montenegro. As the increase of minimum pensions in 2024 is expected to gradually reduce the uptake of the mothers' benefit, its fiscal costs are expected to decline over time. Improving the targeting of the child allowance to families with low incomes could further reduce expenditures. In May 2021 the child allowance was introduced to children under the age of 6 and was expanded to all children under the age of 18 from the end of 2022. UNICEF estimates that less than 40 percent of the expanded child allowance is spent on the poorest quintile.

3. Other structural fiscal issues should be addressed.

- *Health care sector spending efficiency* – it will be important to constrain the growth of pharmaceutical expenditures, which have grown by an average of 18 percent since 2018, reaching 2.5 percent of GDP in 2022. Strengthened systematic monitoring of pharmaceutical expenditures and mandatory regular revaluation of clinical treatments for cost effectiveness should be implemented, as highlighted by the 2023 World Bank Development

[1] Prepared by Vincent Tang (FAD).

Policy Loan. The build-up of arrears in the health care sector should be monitored and addressed to avoid accumulation. In 2022, 1 percent of GDP was transferred to the Health Insurance Fund to clear arrears from previous years.

- *Public investment management* – the 2021 IMF Public Investment Management Assessment identified issues in project selection, planning, and risk appraisal that should be addressed to strengthen the efficiency of expenditures on capital projects.

4. Some important structural reforms are underway and should continue. In particular:

- *Creation of a fiscal council* – in March 2023, an amendment to the Law on Budget and Fiscal Responsibility provided for the establishment of a fiscal council, which will be obliged to provide opinions on fiscal strategy, the budget law and whether fiscal responsibility criteria have been respected. Once operational, the fiscal council should play an important role in strengthening fiscal policy making and credibility. However, to be effective, it will be important that information access requirements and relationships with government institutions are clearly defined, and that it is staffed with adequate technical capacity.

- *Gender budgeting* – additional information on gender impacts of budget programs is being included into the performance information system and included in a new gender budget statement. Progress to improve the quality and presentation of information should continue. Further IMF Capacity Development could support future reform steps.

- *Program budgeting* – reforms to classify the budget by program have supported the publication of a wider range of presentations of the budget. Efforts to use program classification in budget preparation, and to inform parliamentary and public debate should continue, with greater explanation, analysis and transparency.

Annex VII. Implementation of Past IMF Recommendations

Key Recommendations	Status
Fiscal policy	
Implement offsetting measures to close the fiscal gaps created by 'Europe Now'.	No offsetting measures were introduced.
Replace the progressive CIT regime with a flat rate with a special SME regime.	Not implemented. However, CIT revenue performance has been strong after the introduction of the progressive regime.
Strengthen fiscal institutions, including fiscal rules and budgetary processes.	A law was passed in March 2023 to establish a fiscal council, which is tasked with providing opinions on fiscal strategy, the budget law and on compliance with fiscal responsibility criteria.
Establish more robust investment management and PPP frameworks.	Structural fiscal reforms had stalled in part due to political stalemate.
Reform public sector employment and the pension system.	Structural fiscal reforms had stalled in part due to political stalemate.
Review tax expenditures.	Structural fiscal reforms had stalled in part due to political stalemate.
Financial Sector	
Continue the gradual and data-dependent unwinding of crisis response measures.	Implemented
Using the Asset Quality Review findings, take steps to strengthen financial sector supervision and contingency planning.	Implemented
Further improve the AML/CFT framework.	Montenegro averted a MONEYVAL gray listing. The shortcomings identified in the MONEYVAL report need to be addressed with a focus on AML/CFT preventive measures in the real estate sector to mitigate the risk of laundering ill-gotten proceeds in the sector.
Monitor bank practices and leverage ratios to inform potential macroprudential indicators.	While data is available to CBCG though individual bank supervision, it is not compiled and analyzed at the macro level.
Structural Reforms	
Risks to formal employment and competitiveness stemming from the minimum wage increase should be carefully managed.	These risks do not seem to have materialized, in part because of the inflation and growth effects of the war in Ukraine (commodity price spikes and influx of migrants).
For SOE sector reform, the holding company for unified oversight of all SOEs 'Montenegro Works' should be equipped with robust institutional and legal frameworks, and deep professional expertise.	'Montenegro Works' has not been operational, however, the authorities intend to restart efforts to move ahead with the initial plan.

Annex VIII. Implementation of 2015 FSAP Recommendations[1/ 2/]

Recommendations	Timing[1/]	Progress
Prepare and implement time-bound supervisory action plans for vulnerable banks (CBCG).	I	**Done.**
Conduct an Asset Quality Review (AQR) for all banks to determine adequacy of provisions (CBCG).	I	**Done.**
Introduce a macroprudential mandate taking into account the institutional setup and establish pertinent policies and a toolkit consistent with EU/ESRB framework (MOF/CBCG/FSC).	MT	**Done.**
Introduce effective consolidated supervision (CBCG). Improve the regulatory and supervisory framework for liquidity and credit risks (CBCG).	NT, I	**Done.**
Tighten prudential norms for identification, classification, and reclassification of nonperforming assets (CBCG).	NT	**Done.**
Adopt risk-based supervision (ISA).	I	**In progress.** ISA has been implementing a risk assessment framework for the annual supervisory review since 2016. The next step for Solvency II is the proposed 'Amendments to the Insurance Law' which will enable risk-based supervision in risk management (establishing key functions for the insurance undertakings).
Incrementally implement Solvency II (ISA).	NT	**In progress.** The 'Amendments to the Insurance Law' aims to gradually implement new elements of the Solvency II framework, particularly in key functions and prudent person principle in investments.
Implement risk mitigation measures to minimize liquidity risks in the RTGS system and to eliminate the possibility of partial unwinding in the DNS system (CBCG).	I	**In progress.** A new law on the CBCG was adopted in 2023 which allows for creating links to central securities depository and banks. A working group for the preparation of the new Decision on granting loans for liquidity to commercial banks is being established. The next phase will be creating IT solutions to operationalize the link to the central securities depository.

[1] Updates since the 2021 Article IV consultation Staff Report

[2] This table is based on information provided by the authorities.

Recommendations	Timing[1/]	Progress
Finalize national risk assessment and ensuing action plan and ensure that high money laundering/terrorist financing risks are adequately mitigated (CBCG).	NT	**Done.**
Set strict and objective criteria for determining the systemic importance of banks to determine eligibility for capital support (CBCG/MOF).	NT	**Done.**
Strengthen resolution-funding options (MOF).	NT	**Done.**
Organize a dedicated resolution unit within the CBM, and initiate bank-specific resolution planning, prioritizing the weakest CAMEL-rated banks (CBCG).	I	**Done, in progress.** Resolution unit has been organized. The Law on Resolution of Credit Institutions came into force on January 1, 2022. The CBCG has set MREL requirement for all banks. The Resolution Fund has started collecting contributions according to the Law. The CBCG is in the process of harmonizing the regulations with BRRD 2 Directive with the goal of full harmonization with EU regulation that relates to the resolution of credit institutions in 2024.
Implement risk-based contributions and shorten the pay-out term for DPF (DPF/MOF).	NT	**Done.**

1/ I-Immediate' is within one year; 'NT-near-term' is 1–3 years; 'MT-medium-term' is 3–5 years.

Annex IX. Fiscal Policies and Institutions for Gender Equality[1]

Overview

The gap between Male and Female Labor Force Participation (MLFP, FLFP), at 14 percentage points, is on par with emerging European countries. However, the wage gap between men and women is high relative to peers, and across most sectors, women are under-represented in employment and earn less. Montenegro has the potential to raise GDP by about 4 percentage points by reducing the LFP gender gap between men and women to the top decile of peer countries; closing the gap completely could add 14 percentage points to GDP. Raising FLFP could be an important engine of growth in the context of potentially sizeable demographic challenges in coming decades. Labor force gender gaps are in spite of girls outperforming boys in education, including at tertiary level, although women are less likely to enroll in STEM subjects.

*Unpaid care work p*resents a significant barrier to women's participation in the labor force. The share of inactive women not seeking employment due to care or personal reasons is one of the highest in Europe, while enrolment of children in formal childcare is one of the lowest. Less than 10 percent of the children under three years old are enrolled in formal childcare, compared to 36 percent in the EU. An assessment of how to improve access to affordable and accessible childcare services should be explored, also considering the context of the high proportion of families that live in multi-generational households with care needs for the elderly. Social protection programs may be improved to address imbalances in unpaid care and domestic work There are no significant explicit or implicit biases in the tax system. However, due to the greater concentration of women in lower earning jobs, recent reforms to increase progressivity of the tax system are likely to contribute to reducing employment gaps between men and women.

Montenegro has recently embarked upon gender budgeting reforms, adding gender into program performance information and reported in the 2023 Budget. These reforms are to be welcomed and built upon to further integrate gender budgeting practices into the Public Financial Management (PFM) system. The share of female workforce of the Montenegro Revenue and Customs Agency (MCRA) is high relative to peers, and its development of a new HR strategy provides opportunities for greater focus on gender.

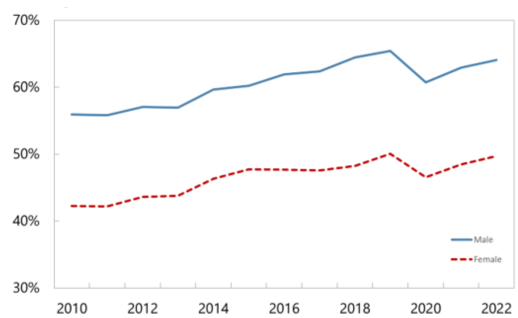
A. Labor Force Gender Inequalities

1. The gap in the participation in the labor force between men and women in Montenegro is 14 percent. Both Male and Female Labor Force Participation (MLFP, FLFP) have increased markedly over the past decade, rising by 9.5 percentage points and 7.8 percentage points respectively between 2010 and 2019 (Figure 1). The faster growth in MLFP over this period has led to a widening of the gender gap, with the gap narrowing since the onset of COVID-19 due to a

[1] Prepared by Vincent Tang (FAD), working with Qiaoe Chen, Céline Thévenot, Carolina Osorio, Duncan MacDonald, Marijn Verhoeven, Lauren Keating, Kezhou Miao, Frank van Brunschot (all FAD), Jorge Mondragon (SPR).

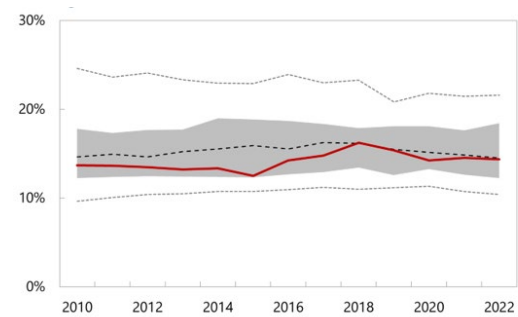
sharper drop off in MLFP. As the effect of COVID-19 recedes, it is possible that this gap may start to widen again.

Figure 1. Montenegro: Labor Force Participation Rate by Gender
(Percent)



Source: IMF Staff, World Development Indicators, National estimates

Figure 2. Montenegro: Labor Force Participation Rate Gender Gap 1/
(Percent rate difference, male minus female)



Source: IMF Staff, World Development Indicators, National estimates

1/ Middle dashed line is median of Emerging European countries, grey swathe represents the range of the 25th and 75th percentiles, upper and lower dashed lines represent 10th and 90th percentiles.

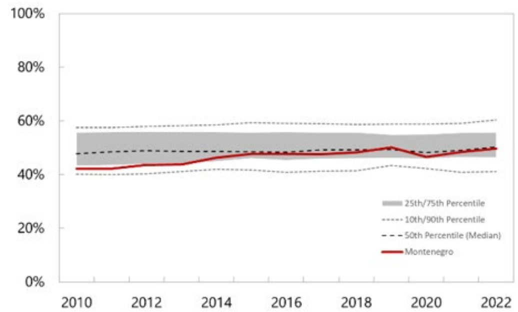
2. The gap between FLFP and MLFP is in line with the median of regional peers (Figure 2). Similarly, the level of FLFP in Montenegro, at 50 percent, has caught up to other emerging economies of Europe over the past decade (Figure 3, Figure 4).[2] However, the gender wage gap is more pronounced in Montenegro than in surrounding countries.[3] Within Montenegro, women are under-represented in employment and are paid less across most sectors. In the main sectors in which women are over-represented – trade, health and social work, and education – women are paid less than men on average (Figure 5). Labor force analysis also shows that women in Montenegro earn on average less than men, even after controlling for the same level of education, hours worked, occupation, and industry.[4]

[2] Comparator group countries are Emerging Market economies (EME) in Europe. These countries are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, Montenegro, North Macedonia, Poland, Romania, Serbia, Turkey, Turkmenistan

[3] Source: [Policy-Brief-EN.pdf (fren.org.rs).](Policy-Brief-EN.pdf) The unadjusted gender pay gap is a percentage difference between average gross hourly earnings of male and female employees, expressed as a percentage of male gross earnings, unadjusted (Eurostat, 2010).

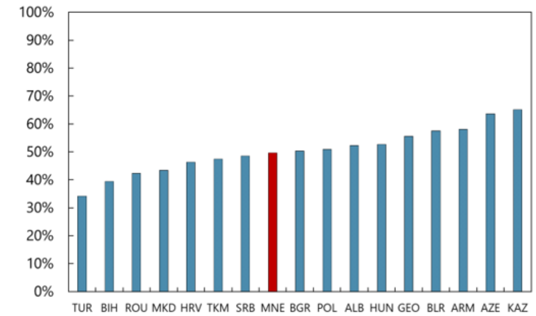
[4] World Bank Country Gender Assessment for Montenegro, 2022

Figure 3. Montenegro: Female Labor Force Participation Rate Regional Comparison
(Percent)



Source: IMF Staff, World Development Indicators, National estimates

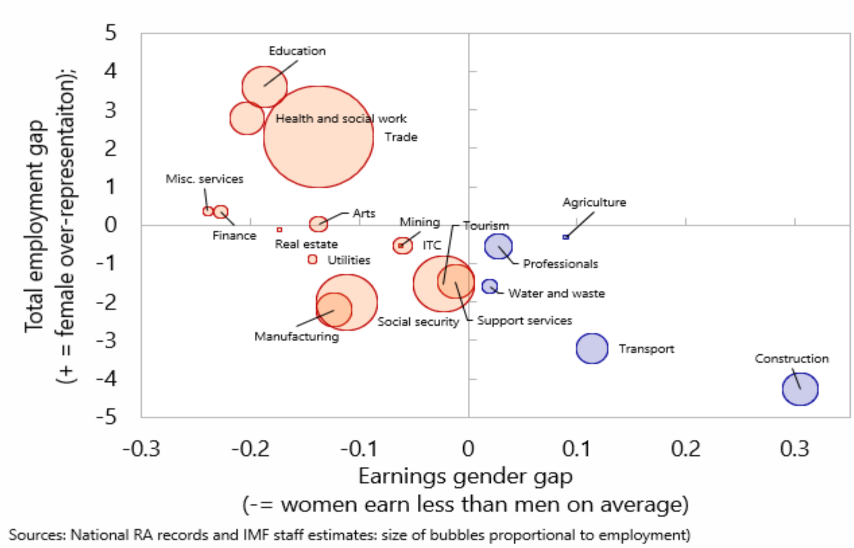
Figure 4. Montenegro: Female Labor Force Participation Regional Comparison
(Percent)



Source: IMF Staff, World Development Indicators, National estimates

3. **There are significant economic gains from reducing the LFP gender gap.** Using the framework developed by Ostry et. al (2018), entirely closing the LFP gender gap by increasing FLFP to the level of men would lead to an estimated increase in GDP by 13.8 percentage points (Figure 6).[5] By reducing the LFP gap to the top decile of peer countries (closing the gap to 10.4 percentage points, by raising FLFP by 4 percentage points), the output gain could be 4 percent of GDP. Increasing FLFP to the third quartile of neighboring countries would entail increasing FLFP by 6 percentage points, and could increase GDP by 5.9 percentage points.

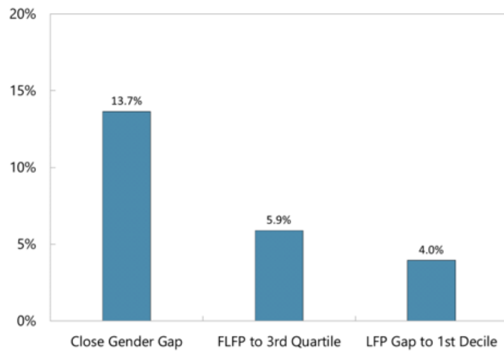
Figure 5. Montenegro: Earnings and Employment Gaps by Sector
(Percent)



Source: IMF Staff, MCRA

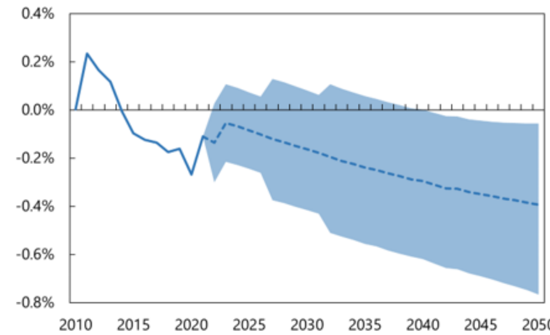
[5] See IMF Staff Discussion Note: Economic Gains From Gender Inclusion: New Mechanisms, New Evidence (2018), J. D. Ostry, J. Alvarez, R. Espinoza, and C. Papageorgiou

Figure 6. Montenegro: Potential Output Gains from Closing Gender Gaps
(Percent of GDP)



Source: IMF Staff

Figure 7. Montenegro: Population Growth Projections to 2050 1/
(Percent)



Source: United Nations – World Population Prospects 2022

1/ Swathe represents 95 percent confidence intervals.

4. Raising female labor force participation could be an important engine of growth to offset projected demographic challenges. Demographics are projected to act as a drag on economic growth over the coming decades. The central demographic scenario of the United Nations projects that Montenegro's population may shrink by an average of 0.3 percentage points per year over the coming 25 years, with the working age population shrinking at an even faster rate (Figure 7), acting as a drag on GDP growth. By contrast, should the FLFP gap be close to the top decile of comparator countries, for example over a 10-year period, this would raise annual GDP growth by an average of about 0.4 percentage points.

B. Expenditure Policies and Gender

5. Women have higher rates of educational attainment than men.[6] A higher share of women hold tertiary qualifications than men, and this set to further increase as women have higher rates of current enrolment in bachelors, specialist diplomas, master's degrees as well as PhDs. Across the whole population, there are a disproportionate number of women with only primary and lower secondary education, although this is likely due to historically lower enrolment rates among older generations. The lag in boys' educational enrolment is therefore set to increase. To address the issue of boys underperforming academically compared to girls, countries can adopt a multifaceted approach. This includes early intervention and support for struggling students, gender-neutral education environments, teacher training to accommodate different learning styles, promoting male role models and mentors, fostering emotional and social learning, and ensuring equal access to educational resources and opportunities for both genders. Public awareness campaigns and policy

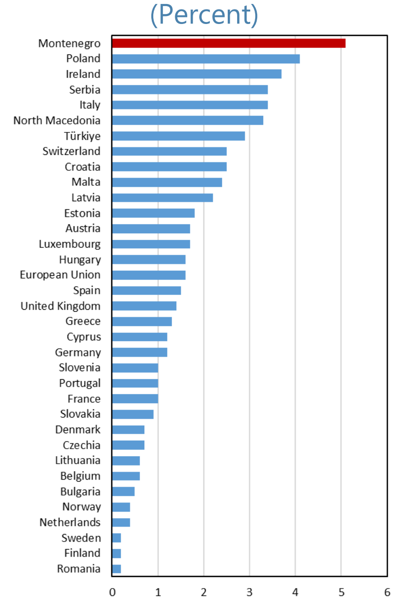
[6] Women are overrepresented in the segments of the population that had no education at all, or that had incomplete primary school. However, this is due to a generational effect, with older generation having less access to education than current generations.

initiatives can further challenge traditional stereotypes and provide a comprehensive solution to close the gender gap in educational performance.

6. Despite outperformance of women, there is a noticeable gender gap in STEM fields, with fewer women enrolling and graduating in these areas. However, the differences are less pronounced than in the EU. Women report lower levels of digital skills, especially among those in the prime working age group, highlighting a notable gender gap in digital proficiency.[7] To enhance women's representation in STEM, a multifaceted approach is required. This includes nurturing early interest through educational programs and role models, eliminating gender biases in curricula and teacher training, establishing mentorship and support networks, offering reskilling programs to adapt to evolving demands, and highlighting the societal impact of STEM, which often motivates girls to pursue careers in these fields. A dual secondary education, where students alternate between classroom and employers, was launched in Montenegro two years ago. 30 percent of girls are enrolled in this scheme.

7. Unpaid care work presents a significant barrier to women's participation in the labor force. The proportion of inactive women not seeking employment due to care and other family reasons is one of the highest in Europe. 43 percent of women spend time caring for children, the elderly, disabled, relatives, compared to 24 percent of men. Also, 68 percent of women spend at least one hour doing housework every day, while the same is true for only 10 percent of men.[8] The share of inactive women not seeking employment due to care or personal reasons is one of the highest in Europe (Figure 8).[9] It is possible that the gender pay gap is partially due to women seeking jobs with flexibility, given their disproportionate burden of unpaid care relative to men. In turn, jobs that offer flexibility can often pay less.

Figure 8. Montenegro: Inactive Women Not Seeking Employment Because of Care or Personal Reasons 1/
(Percent)



Source: Eurostat, 2019

1/ Inactive women not seeking employment because of care of adults with disabilities or children and other family or personal reasons.

[7] Source: Gender Equality Profile of Montenegro Report, Government of Montenegro, UNDP.

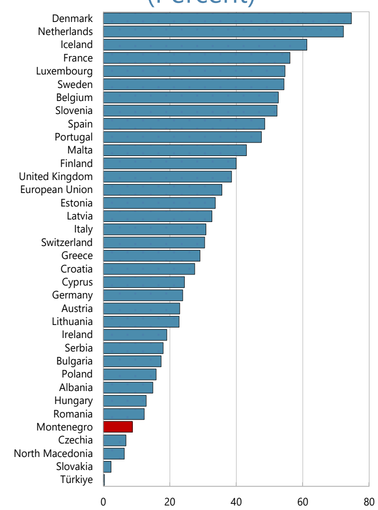
[8] National Gender Equality Index for Montenegro quoted by Gender Equality Profile of Montenegro report.

[9] OECD 2021 – Competitiveness in South East Europe 2021: "At present, there is no strategy to expand the career choices of young women or to encourage enrolment in non-traditional vocational programs and university studies, nor are there any specific guidelines for women returning to the labor market after childcare breaks, or programs to empower young women to climb the career ladder."

8. Many households are multigenerational in Montenegro, which has specific implications for care. 17 percent of the population live in a household with three adults or more. This is slightly below Greece or Serbia (20 percent) but much higher than the EU average. The implications for women are that young parents can rely on other generations to care about young children. Possibly related to this, less than 10 percent of the children under 3 were enrolled in formal childcare, compared to 36 percent in the EU (Figure 9). This can be a matter of concern for future outcomes, given that quality and affordable education and care helps to improve children's performance in the long run, especially those with a disadvantaged background. Women often have a care duty towards the elderly, and 77 percent of the population lives in a household where elderly care is needed.[10] Social protection programs may be improved to address imbalances in unpaid care and domestic work, including strengthening participation in paternity leave and improve access to childcare service. A fiscal (and welfare) impact assessment of improving access to affordable and accessible high-quality childcare services could be conducted in order to identify the best options to prioritize in terms of type of service and public.

Figure 9. Montenegro: Enrollment in Formal Care

(Percent)



Source: Eurostat, latest available data to 2022.

9. The reintroduction of the so-called Mother's Benefit may have created disincentives for some women to engage with the labor force, although the impact will reduce over time. In 2015, government introduced a benefit for mothers of three or more children, with an amount of 70 percent of the average net salary for women with 25 years of employment and 40 percent of salary for women with 15 years of unemployment. This created some disincentives to participate in the labor market, with some 22,000 women enrolled, approximately 7 percent of the female population. This benefit was removed after 2017 after it was deemed discriminatory by a constitutional court but was reinstated in 2022 for previously eligible non-working beneficiaries. While the overall impact of the mother's benefit on the female labor force is likely to be marginal now (beneficiaries have reduced to around 15,000 and will continue to fall with many approaching retirement age or migrating to the state pension), it would be valuable in future for Montenegro to assess the impact of the design of social benefits to create positive incentives for women's labor force participation.

C. Tax Policies and Gender

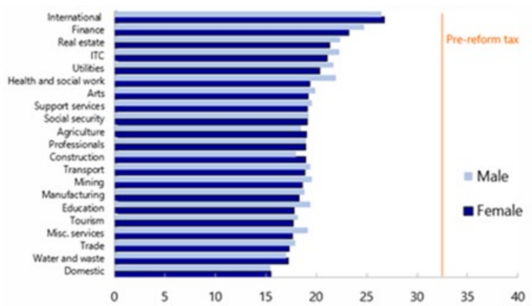
10. The tax system in Montenegro does not have explicit gender-biases, and recent reforms may have supported the reduction in gender gaps in the labor force. There is no

[10] LFTSIII survey (WB).

explicit bias against women: in particular, personal taxation does not create biases against second earners. Moreover, recent reforms have increased the progressivity of the tax system. Montenegro had a flat-rate income tax and social security system, with rates of 9 percent and 8.5 percent respectively. In 2021, the government introduced a progressive income tax system, with a tax-free allowance for income up to 700 euros a month and two rates, 9 and 15 percent. In addition, social security contributions were also reduced from 33 percent to 16 percent. The changes to income tax and social security liabilities of each taxpayer can be assessed (Figure 10, Figure 11).

Figure 10. Montenegro: Average Personal Income Tax and Social Contribution Rates Pre and Post Reform

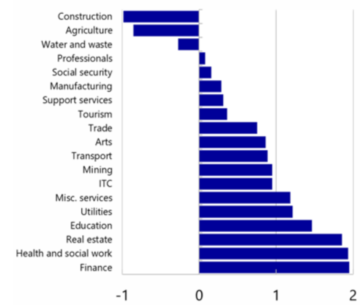
(Percent)



Source: IMF Staff, MCRA

Figure 11. Montenegro: Change in Net Earnings Gap

(Percent points. Positive is a narrowing net earnings gap in favor of women)



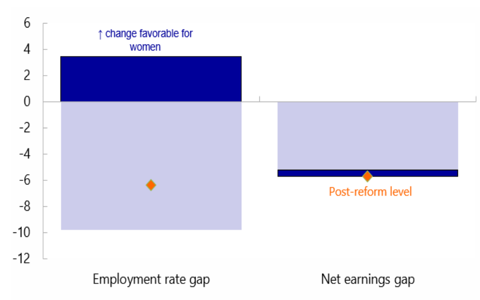
Source: IMF Staff, MCRA

11. Given the concentration of women in lower paid jobs, the increased progressivity could have acted to reduce employment gender gaps. An IMF simulation shows that the reform considerably reduces the tax burden on women relative to men, due to the increased progressivity. However, when social security contributions are considered, the improvements in progressivity are less evident. This reflects that the upper threshold at which social security contributions are capped. This cap, in combination with the flat rate structure makes social security contributions regressive. Due to data limitations, behavioral responses to the effects relied on estimates available for similar countries. The revenue administration data is available only for 2017, precluding the empirical analysis of the effects of the reform on labor market outcomes. Subject to these limitations, labor supply elasticities from a study assessing

Figure 12. Montenegro: Simulated Changes in Gender Gaps Due to Tax Reforms

Change in Gender Gaps

(Percentage points; + = narrowing of gap in favor of women)



Source: IMF Staff, MCRA

similar reforms in other eastern European countries, were used to predict outcome effects.[11]

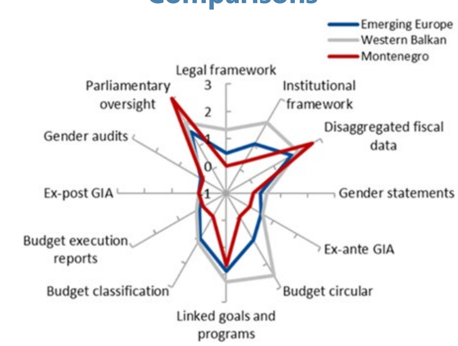
12. The results indicate that gender labor force participation gaps are poised to narrow, despite the small effect on net income gaps. The reform of the income tax and social security system could help narrow the gender gaps in all the sectors where women are currently under-represented (Figure 12). At the country-level, the increase in take-home pay is not sufficient to reduce gender gaps in net income, because higher-earning-individuals, which have a larger male representation, also benefit from the relon inthe rate of social security contributions. Yet given their labor supply elasticity, women are predicted to increase their labor supply more than men, which could narrow the differential in labor force participation rates between women and men by over three percentage points.

D. Gender Budgeting

13. Montenegro has started to integrate gender-responsive budgeting in Budget 2023 as part of the broader program budget reform process. The objective is to enable equality in the use of public resources, improve access to goods and services provided by the public sector for all, and ensure priorities and development directions are contributing to greater equality. In Budget 2023, budget submissions were asked to include information about gender goals and indicators through the budget management information system and explain how the budget programs (subprograms and/or activities/projects) contribute to the reduction of gender gaps. The introduction of gender-responsive budgeting is a promising start and the involvement of the Ministry of Finance in further developing capacity and guidance is encouraging. These reforms are to be welcomed and built upon to further integrate gender budgeting practices into the Public Financial Management (PFM) system.

14. Montenegro performs relatively well in several Gender Budgeting practices. The IMF Gender Budgeting Survey, which covers over 100 countries worldwide, shows that Montenegro performs relatively well on Parliamentary oversight and Disaggregated fiscal data (Figure 13).[12] Regarding Parliamentary oversight, Montenegro has conducted hearings on gender equality issues, established a committee on gender issues, reviewed information in annual reports or financial statements on the performance of gender equality initiatives. Regarding disaggregated fiscal data, Montenegro collects and publishes data disaggregated by gender in most sectors.

Figure 13. Montenegro: Gender Budgeting Index International Comparisons



Source: IMF Gender Budgeting Survey

15. Montenegro lacks a legal framework for gender budgeting. A legal framework for GB provides a consistent

[11] Senaj et al. 2016

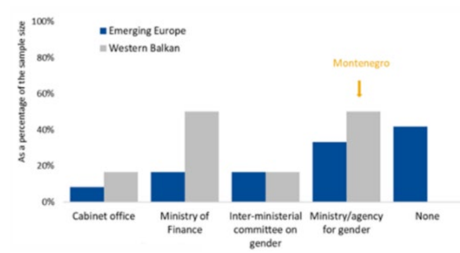
[12] The IMF Survey on Gender Budgeting is based on self-reported information by country authorities.

and articulate basis to develop and prioritize gender policies, helps to progress discussion of gender-related policies in a systematic way rather than an ad-hoc fashion and ensures continuity over political administrations. While only a few countries choose the option of enshrining Gender Budgeting in the constitution, many do so in lower-ranked laws. In Montenegro, the Ministry of Human and Minority Rights coordinates gender discussions, but there is no legal provision for gender budgeting.

Figure 14. Montenegro: Gender Budgeting Legal Provisions

Source: IMF Gender Budgeting Survey

Figure 15. Montenegro: Organization Coordinating Gender Discussions During Budget Preparation



Source: IMF Gender Budgeting Survey

E. Gender and Revenue Administration

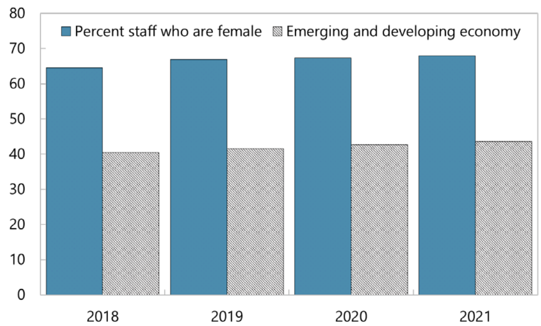
16. The share of female workforce of the Montenegro Tax Administration (MTA) is high.[13] The share of female workforce is growing year-on-year and is currently approximately 70 percent of the total workforce (Figure 16). There is more volatility in female executives where a declining trend during 2018 – 2021 has recently changed with more than 50 percent female executives in 2023, higher than the average in Montenegro's public sector (Figure 17).[14,15] The female workforce is evenly spread among all functions. In particular, the audit function, which has internationally the tendency to be more male dominated, shows a high participation of female auditors.

[13] As of January 1, 2024, the Montenegro Revenue and Customs Administration (MCRA) is split into the MTA and the Montenegro Customs Administration.

[14] https://www.gov.me/upravaprihoda

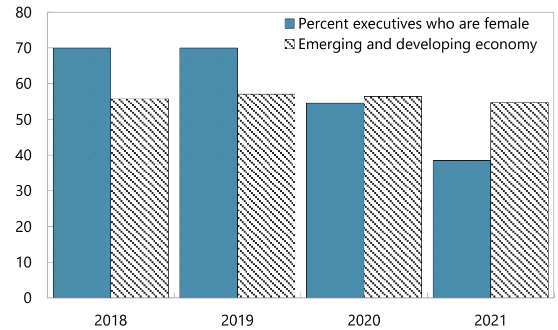
[15] European Commission 2022 - Montenegro 2022 Report: "Women make up only a quarter of the total management in the public administration, often due to explicit or implicit bias in hiring, training and promotion practices."

Figure 16. Montenegro: Representation of Women in Revenue Administration Workforce
(Percent)



Source: International Survey on Revenue Administration (ISORA)

Figure 17. Montenegro: Representation of Women in Revenue Administration Executive Position
(Percent)



Source: International Survey on Revenue Administration (ISORA).

Source: International Survey on Revenue Administration (ISORA)

17. Gender related employee satisfaction surveys are foreseen in 2025. MRCA's Revenue Administration Reform Project (RARP)[16] foresees in an employee satisfaction survey and a taxpayer satisfaction survey, classified by gender, in the first year of project implementation in 2025. Currently, the MTA does not have an HR strategy. When developing the HR strategy, initiatives to help build a gender-balanced and inclusive workforce should be taken into consideration. This can include implementing flexible working arrangements, providing for continuing career development during career breaks, encouraging women to develop broader networks, and spotlighting women leaders as role models.[17]

18. A new strategic plan will create options for the MTA to address gender related compliance activities. A strategic plan is currently not in place and developing a new plan provides options for improved focus on gender issues, such as lowering barriers restricting women, tailoring services and products for women taxpayers, and reducing gender related compliance and enforcement bias.

[16] Objective of the RARP is to improve the effectiveness of MRCA's operational functions and to reduce taxpayers' compliance costs through institutional development, business process redesign, and enhancing taxpayer services. This project, funded by the World Bank, had an original scheduled completion date of March 2023, but was delayed, and is now expected to be fully implemented by September 2025. (World Bank – 2017 – Revenue Administration Reform Project (P149743))

[17] IMF Technical Note: Gender and Revenue Administrations, 2023.