Statement by Mr. Luc Dresse, Alternate Executive Director for Montenegro and Ms. Maja Ivanovic, Advisor to the Executive Director
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On behalf of the Montenegrin authorities, we would like to thank the team led by Mr. Seshadri, for their constructive exchange of views during the mission and the comprehensive staff report on the Article IV Consultation.

Following a rapid succession of governments, a stable administration is now in place, with a well-established program of economic stability and governance, centered on the strong aspiration of European accession. The unilateral euroization of the country symbolizes a steadfast commitment to economic stability and EU integration, harmonizing its monetary policies with those of its European counterparts. This commitment is underscored by ongoing reforms, notably aiming to meet the European Commission's Interim Benchmark Assessment Report (IBAR) for the rule of law by June 2024. This milestone is pivotal, enabling the provisional closure of a significant part of the negotiation chapters by year-end and reinforcing Montenegro's trajectory towards EU membership and enhanced regional and international relations. The timing of the Article IV consultation is particularly opportune, arriving at a crucial moment to discuss economic policy modalities, albeit after certain delay.

Recent Economic Developments, Outlook, and Risks

Over the past two years, the Montenegrin economy has shown remarkable resilience amidst significant geopolitical and global economic challenges. Activity achieved a robust growth of 6.0 percent and more in 2022-23, outperforming its regional peers. This strong expansion was driven by tax policy reforms, increases in minimum and average wages, and a significant influx of non-residents. Key sectors such as tourism, trade, and transport experienced notable growth, alongside a recovery in industrial production, particularly in power generation. Tourism receipts rebounded strongly (+44 percent), reaching record highs above pre-pandemic levels. On the demand side, exports of goods and services grew by 8.6 percent, private consumption by 5.4 percent, and gross investments in fixed assets by 4.8 percent. The labor market also recovered significantly in 2023, with the key indicators of employment and unemployment significantly better than their pre-pandemic levels.

Inflation has slowed down from its peak in 2022 but remains elevated due to both external factors and strong domestic demand, also fueled by the influx of non-residents. Inflation reached 5.5 percent year-on-year in March 2024, with food and non-alcoholic beverages contributing the most. Thereupon, to protect the living standards of the population, the government introduced temporary profit margin caps on some basic food items for large wholesalers and retailers, for a period of two months.

The current account deficit narrowed in 2023 due to the robust growth of exports of goods and services, notwithstanding somewhat lower surpluses of the primary and secondary income balance in line with the slowing growth in the EU and lower remittances. Traditionally a current account deficit in Montenegro is financed by FDI inflows. The surge of net errors and omissions in the balance of payments statistics, likely driven by the recovery of tourism as well as the large foreign influx, will be thoroughly explored within forthcoming IMF technical assistance (TA).

In March 2024, S&P upgraded Montenegro's outlook from stable to positive, based on strong growth and stronger fiscal performance.

Over the medium-term, private consumption is expected to moderate but continues to be one of the main drivers of economic growth, along with the start of a new investment cycle, and implementation of planned structural reforms in the economy. The medium-term economic growth prospects are underpinned by the priorities in implementing the European Union Agenda in Montenegro’s accession process. To that end, the new European Union initiative– the New Growth Plan for the Western Balkan, plays a special importance in accelerating the enlargement process and economic growth.

The authorities concur with staff assessments that risks are balanced, acknowledging that the country's narrow export base renders it susceptible to fluctuations in international demand. Furthermore, deterioration of financing conditions, postponement of planned structural reforms, and weaker dynamics in planned investments could pose additional challenges to achieving dynamic growth. On the other side, prospects for more dynamic growth in the medium-term could be bolstered by reinvigorating European integration efforts.

Fiscal policy

In 2023, the budget achieved a surplus of 0.6 percent of GDP, with record revenue collection of 43 percent of GDP, largely driven by increased tax revenues and the implementation of a progressive tax system and electronic fiscal reporting. Expenditures in 2023 amounted to 42.4 percent of GDP, mainly directed towards infrastructure projects and initiatives to enhance the social and business environment. The deficit will remain within the 3 percent of GDP limit by 2026, with new borrowings solely allocated to infrastructure projects.

The reform of the tax administration, particularly in improving compliance risk management, the use of third-party data, and greater digitalization hold a prominent position among the authorities' priorities. Recognizing the substantial potential of tax administration reform to yield gains in revenues, the authorities express their gratitude for the continuous TA provided by the IMF.

The gross financing gap will be financed by securing funds from domestic and international markets, issuing bonds, or entering into commercial agreements. In that regard, Montenegro successfully placed a $750 million Eurobond at a favorable effective rate of 5.88 percent in euros, following a cross-currency swap transaction. The issuance attracted significant interest, with demand reaching $4.75 billion from 250 investors, making it Montenegro's most successful offering to date. Furthermore, ongoing negotiations with the World Bank and other partners aim to secure a Development Policy Loan (DPL) arrangement totaling €180 million, which will provide additional funds for budget financing and fiscal reserves.

Fiscal consolidation is the key driver for a prudent and responsible evolution of Montenegro's debt, reducing it from 105 percent of GDP in 2020 to 60.3 percent in 2023, approaching Maastricht criteria. In addition, debt management operations aim at further containing risks. To this end, a hedging arrangement related to the dollar loan with the Exim China Bank was conducted, close to fully protecting Montenegro's public debt from currency risk. The share of debt in euro increased to 98.11 percent by 2023, while the share in US dollars subsided from 17.14 percent to 0.34 percent.

The authorities have a more optimistic view of the medium-term debt trajectory than staff but agree on the importance of a debt anchor to maintain a credible and effectively communicated fiscal strategy. The authorities intend to finalize the Fiscal Strategy, by the end of June. They also plan to implement a new medium-term debt management strategy for 2025-2027 by end-2024, which will be aligned with the Fiscal Strategy, and have already requested IMF TA. This strategy will prioritize reducing refinancing risk and achieving a more balanced maturity profile over the medium-term.

Financial sector

The banking system remained sound and stable despite geopolitical tensions and numerous external shocks. Capital adequacy, liquidity, and profitability indicators are strong, and NPLs have continued to decline despite the withdrawal of the COVID-19 support measures and the gradual application of stricter asset classification standards.

Developments in the housing market are closely monitored to avoid a build-up of domestic leverage in the system. At the end of March, the Central Bank of Montenegro (CBCG) adopted a decision to raise the countercyclical buffer rate from 0 percent to 0.5 percent, effective from April 1, 2025, mainly due to the dynamics in the real estate market.

The CBCG already followed up on the 2024 Article IV recommendation to compile statistics of macroprudential indicators. The CBCG developed a template to start collecting monthly data on ratios for borrower-based measures (LTV, LTI, LSTI, DTI, DSTI) and their components. The reporting period for all newly approved loans and receivables starts on May 15.

The CBCG significantly contributes to efforts to achieve the ambitious goal of successfully concluding the accession negotiations with the EU by aligning regulation and supervision practices with the current EU frameworks. In recent years, the alignment of Montenegrin legislation with EU regulations has been achieved, particularly in the key laws on credit institutions and the resolution of credit institutions, as well as their accompanying regulations. Furthermore, the CBCG recognizes the risks associated with digitalization and crypto assets and underscores the importance of aligning regulatory measures with evolving guidelines from leading standard setters, including the Basel Committee on Banking Supervision, FSB, ECB, and FATF.

The modernization of payment systems is underway, with Montenegro being the first country in the Western Balkans to submit a pre-application for the Single Euro Payments Area (SEPA). While awaiting approval from the European Commission (EC) to complete the procedure, the CBCG, supported by the World Bank, plans to enhance internal capacity and facilitate the transition of individual banks to the SEPA payment schemes. Additionally, the CBCG is actively working with the Bank of Italy on implementing fast payment systems.

The CBCG prioritizes close monitoring from an anti-money laundering (AML) perspective and the strengthening of the operational risk-based AML/CFT framework. Montenegro has successfully completed the evaluation by MONEYVAL, which requires regular reporting every two years.

The green agenda and climate change management rank high among the CBCG's priorities, as evidenced by the adoption of the Strategy Related to Climate Change Challenges and action plans. Additionally, the CBCG has joined the Network for Greening the Financial System (NGFS).

Structural reforms

The authorities agree with staff that economic diversification, both within and beyond the tourism sector, plays a crucial role in reducing Montenegro's vulnerability to economic shocks. To this end, their efforts include increasing infrastructure investment, particularly in the less developed northern regions, to expand tourism opportunities. They are also committed to promoting balanced and sustainable growth. The Economic Reform Program for the next two years will prioritize enhancing energy security through renewable energy sources and implementing climate change-related reforms to foster the green economy. Continued investments in renewable energy and infrastructure further will further consolidate Montenegro's position as a regional energy hub.

In addition, the Montenegrin authorities highly value staff's analysis of gender gaps and emphasize the need to increase female labor participation. They recognize significant childcare challenges and are open to learning from other countries' experiences in addressing them. They also consider it important to assess the gender impact of economic policies in advance, particularly to improve the targeting of social benefits and promote female labor participation.

The authorities look forward to continuing their close engagement with the Fund and highly appreciate the IMF's valuable technical assistance received so far.