

The World Bank in Montenegro Country Snapshot



An overview of the World Bank's work in Montenegro

April 2020

MONTENEGRO	2019
Population, million	0.6
GDP, current US\$ billion	5.5
GDP per capita, current US\$	8,828
Life Expectancy at birth, years (2017)	76.7

At a Glance

- The World Bank is actively engaged with Montenegro's Government in support of its fiscal consolidation program, which was launched to respond to macro and fiscal challenges, tame fiscal risks, and prevent the further accumulation of debt.
- The World Bank is working with the Government to help reduce vulnerabilities to the COVID-19 pandemic, climate change, and natural disasters.
- Montenegro's economy is highly dependent on tourism. Although this has underpinned high growth rates, it also creates vulnerabilities to external shocks such as the COVID-19 pandemic.
- To be competitive within the European Union, Montenegro needs to create better conditions for private sector growth and job creation and to invest in the skills required in modern labor markets.

Country Context

Montenegro is a small Western Balkan country, aspiring to join the European Union (EU) by 2025. The economy is open and service-oriented, with a narrow production base and high import content of consumption and investment, which results in a large structural deficit on the trade balance for goods.

By unilaterally adopting the euro, the country abandoned an independent monetary policy. These factors, combined with high debt levels and dependence on foreign capital inflows, make the economy highly vulnerable to external shocks.

Because of its size, the already high cost of developing and running national institutions is compounded by a limited capacity to exploit economies of scale in the provision of public goods and services. An EU-compatible legal framework and regulatory bodies, as well as the ability to absorb EU funds, all require substantial capacity building.

At the same time, the transition to a market economy requires a reduction in the state's footprint in the economy. Creating a favorable environment for private sector development requires intensified efforts to strengthen the rule of law, a leveled playing field for businesses, and improved efficiency in the public sector.

The EU accession process has been an important anchor for reform momentum. Montenegro started negotiations with the EU in June 2012. Of the 35 negotiations chapters, three have been provisionally closed and 32 have been opened. In the last European Commission Progress Report on Montenegro, the importance of maintaining macroeconomic stability was stressed, noting that the rapidly rising public debt and high fiscal deficits, together with high external imbalances and high unemployment, are of particular concern.

The World Bank and Montenegro

The overarching objective of the World Bank Group's Country Partnership Framework (CPF) covering the period FY16–20 is to support Montenegro on the path to more sustainable and inclusive growth.

The new framework selectively supports Montenegro's development agenda, with a particular focus on creating employment and economic opportunities and restoring fiscal balance in order to accelerate long-term inclusive growth.

Montenegro faces the significant challenge of creating good jobs for its people. Solving this problem requires action to strengthen the supply of labor and increase the demand for labor from potential employers.

Young job seekers need to be equipped with relevant skills, while less-skilled and more vulnerable segments of the population need access to opportunities and jobs.

Maintaining macroeconomic and fiscal sustainability and strengthening the financial sector will be critical to ensuring a stable macro environment that stimulates private investment and job creation in the long term.

Implementing these measures will also be an opportunity to improve the quality of public spending for more inclusive social and employment services for poor and vulnerable populations so that all Montenegrin citizens benefit from future development.

WORLD BANK PORTFOLIO

No. of Projects: 4

IBRD Lending: \$124.78 Million

Key Engagement

During the current CPF period, the World Bank has supported: the development of the agriculture sector; the retrofitting of 49 buildings within 25 schools and hospitals with better insulation, lighting, and heating; the cleanup of various industrial sites from hazardous waste, which is ongoing; and improvements in higher education and innovation.

The World Bank is also working alongside the Government to improve the stability of the economy by ensuring that government spending is lower and more effective.

Moving forward, the Bank will continue to work with the Government to support macroeconomic stability and the implementation of the structural reforms needed to create more and better jobs and improve the country's competitiveness.

The Bank will also work together with the Government to improve watershed management in the Lim and Grncar River Basins of Montenegro, as well as flood protection, drainage, and irrigation measures within the Lim River Basin.

Recent Economic Developments

Following robust expansion of 5.1 percent in 2018, growth softened to 3.6 percent in 2019, reflecting lower domestic demand. Private consumption was the backbone of growth dynamics in 2019, while investment decelerated partly due to an under-execution in highway spending.

The lower investments translated into lower imports of construction material and machinery equipment, which, combined with the strong growth of exports, resulted in a positive contribution of net exports to growth. After 19 quarters of consecutive growth, the construction sector fell by 7 percent year-on-year in the last quarter of 2019. In 2019, industrial production contracted by 6.3 percent, as growth in the mining sector did not offset steep declines in manufacturing and energy production.

Tourist arrivals and overnight stays, on the other hand, grew by 10.3 and 7.2 percent, respectively, while retail trade increased by 5.2 percent in 2019.

In 2019, employment increased by 2.3 percent, mostly in the construction, tourism, and retail sectors. The participation and employment rates reached record highs of 57.4 and 48.7 percent, respectively, while the unemployment rate was 15.1 percent. However, the employment rate remains lower for women, youth, and the Northern region.

Average annual inflation fell from 2.6 percent in 2018 to 0.4 percent in 2019, while real wages grew by 0.5 percent. Economic growth, rising employment, and low inflation reduced poverty (measured as income below the standardized middle-income-country poverty line of US\$5.5/day in 2011 purchasing power parity) from 20 percent in 2015 to an estimated 17.6 percent in 2019, though shocks may push vulnerable populations back into poverty.

Overall bank lending remained robust in 2019, growing by 4.5 percent, mainly driven by lending to households. After the liquidation of two banks earlier in the year, deposits slightly recovered and grew by 0.5 percent in 2019. In December, the number of nonperforming loans fell to 5.1 percent of total loans, while the capital adequacy ratio was at a healthy 17.7 percent.

The current account deficit (CAD) narrowed to 15.2 percent of GDP in 2019 from 17 percent in 2018, owing to the shrinking trade balance. The strong tourism and transport season boosted exports, while imports grew much slower due to the contraction in machinery imports.

The primary account shrunk over large interest payments, while remittance inflows remained stable at 5 percent of GDP. Almost half of the CAD was covered by net foreign direct investment, the rest by external debt. In December, foreign reserves covered 6.3 months of merchandise imports. The fiscal deficit fell to 3 percent of GDP.

Although capital spending was under-executed, current spending increased partly due to a one-off guarantee payment of 0.6 percent of GDP. Moreover, the country passed a law on the takeover of the debt and capital expenditures of Montenegro Airlines, with an estimated overall fiscal impact of around 1.5 percent of GDP over the next five years.

Supported by favorable global financial conditions, Montenegro issued a €500 million Eurobond in September 2019. Although this pushed public and publicly guaranteed debt to 81 percent of GDP in 2019, the proceedings will be used to repay debt due in 2020.

Economic Outlook

The COVID-19 pandemic exposes Montenegro's vulnerability to external shocks. The economy is likely to contract sharply due to the abrupt halt in tourism, a major sector of Montenegro's economy. The magnitude will depend on the duration of the pandemic and the measures undertaken to contain it.

Consequently, government revenue will fall, widening the fiscal deficit and public debt. The full extent of the impact is difficult to quantify given the evolving nature of the pandemic, but job losses and increases in poverty are expected.

Efforts toward fiscal consolidation have strengthened the country's ability to deal with this crisis; however, the fiscal space to react is very limited and further constrained by the high level of public debt and absence of a monetary policy.

Project Spotlight

How a Higher Education and Innovation Project is Supporting the COVID-19 Response

On March 17, 2020, Montenegro became the last European country to record a positive COVID-19 test. As is true of many developing countries, Montenegro is facing massive challenges in responding effectively and rapidly to the evolving pandemic, including in gaining access to the necessary diagnostic equipment and expertise. But there is some good news.

At the Institute for Public Health in the capital Podgorica, doctors are conducting sensitive tests to detect the coronavirus in patients. Like many colleagues around the world, they are relying on the highly specialized RT-PCR (real-time reverse transcription-polymerase chain reaction) machine, the most reliable method of virus detection available according to the International Atomic Energy Agency.

The Institute acquired the machine back in 2015 with support from the World Bank-funded Higher Education and Research for Innovation and Competitiveness (HERIC) Project, which is focused on strengthening higher education and research at universities across Montenegro. The investment is now paying off just as the nation needs such highly sophisticated technology.

As part of the project, Dr. Igor Pajovic of the University of Montenegro brought the RT-PCR machine to the Institute and provided training to the staff. Dr. Pajovic says that, "Now with the COVID-19 outbreak, the Institute is able to use this very sensitive test to quickly and efficiently detect infected patients and to develop appropriate measures to fight the COVID-19 pandemic."

The University of Donja Gorica (UDG) also received valuable equipment and knowledge as part of the HERIC project. The ProDe laboratory at UDG now has state-of-the-art equipment for 3D printing, scanning, and modeling, as well as for mechanical testing and materials. This technology is now being used extensively to produce protective visors that provide effective shields for medical staff who are treating COVID-19 patients across the country.

Apart from creating a more robust environment for the academic and scientific community, the project has also helped provide access to state-of-the-art training for the country's young researchers. That investment is bringing results today in the rapid deployment of local scientists and technology in the fight against COVID-19.

The Minister of Science, Sanja Damjanovic, notes: "Two out of eight HERIC project-funded academic centers are now directly contributing to the fight against COVID-19 in Montenegro." She adds, "All this is yet another great lesson to emphasize the importance of investing in science and research."



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The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at <http://www.worldbank.org/montenegro>