
IMF STAFF CONCLUDES VISIT TO MONTENEGRO

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An International Monetary Fund (IMF) mission, led by Martin Petri, visited Podgorica during May 31 – June 7, 2017, to continue discussions on the authorities fiscal consolidation strategy, initiated during the last Article IV mission (see Concluding Statement of February 28, 2017). At the conclusion of the visit, Mr. Petri made the following statement:

The economic outlook for 2017 appears favorable with growth expected around 3 percent and low inflation. Credit growth seems robust. The current account deficit is projected to be around 20 percent of GDP, mainly because of imports for investment activity. Steady export growth—particularly in tourism and energy—is expected to narrow the deficit in the future.

The authorities draft fiscal adjustment strategy published this week is in line with our recommendations. If approved and implemented by the government, it would put government finances on a strong footing to achieve fiscal sustainability. The announced fiscal adjustment, alongside the measures already contained in the 2017 budget, is necessary to deal with debt challenges and to sustainably address future financing needs.

The policies described in the draft strategy would enable the authorities to achieve a primary surplus of about 4½ percent of GDP by 2020 , a substantial improvement compared to a projected primary deficit of 4 percent of GDP in 2017. The strategy entails net fiscal adjustment measures amounting to 2½ percent of GDP in addition to the anticipated reduction in capital spending as the current phase of the highway project is completed.

The projected fiscal adjustment, if implemented, would put public debt on a sustainable path : after peaking in 2019 at 81 percent of GDP including guarantees (72 percent of GDP in the authorities debt definition without guarantees), the debt ratio is projected to decline to 67 percent of GDP including guarantees by 2022 (59 percent in the authorities debt definition).

The envisaged adjustment measures are of good quality and include policies to protect the most vulnerable. The increase in the standard VAT rate is broad based and excludes food products that are taxed at the lower VAT rate, which will not be changed. Excises on cigarettes, alcohol, sugary drinks, and coal [] with negative externalities [] increased to bring their prices closer to their true economic cost. The mission encourages the authorities to increase the coal excise even further to reduce the significant local pollution and global warming costs over time. Overall, these measures are expected to have a modest impact on economic growth.

The costly and badly-targeted mothers benefit is being transformed by increasing social assistance

and child allowances, which will benefit those truly in need. The original benefit was fiscally unaffordable and has been declared unconstitutional. The redesign will be compatible with stronger female labor participation and better child protection.

The proposed fiscal adjustment measures should be followed by reforms to gradually reduce wage and pensions spending, which is relatively high by international comparison. The authorities are already taking some steps to limit wage costs by reducing the wages of the senior officials and shrinking the public sector work force. They do not intend to reduce existing pensions but rather limit costly early retirement options. There is also a need to improve local government finances, service delivery, and fiscal accountability.

The authorities are aware that the fiscal adjustment strategy might impact the financial sector and are monitoring developments in this sector carefully. NPLs in the banking sector have continued to decline, and capital adequacy ratios have improved. Deposits have been growing steadily, and interest rates have declined. Some consolidation in the banking sector could be beneficial for credit provision and financial stability.

On the basis of this mission, staff will update the assessment initiated during the Article IV mission, and present it to the Executive Board for discussion.

The mission would like to thank the authorities for fruitful discussions and their warm hospitality. The mission wishes the authorities good luck with their difficult, but necessary, fiscal adjustment efforts.

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