



MONTENEGRO

2025 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

November 2025

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2025 Article IV consultation with Montenegro, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on September 26, 2025, with the officials of Montenegro on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 3, 2025.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2025 Article IV Consultation with Montenegro

FOR IMMEDIATE RELEASE

- The Montenegrin economy has demonstrated resilience to multiple shocks in recent years; Growth has moderated from an average of 9 percent during 2021–23 to 3.2 percent in 2024 and the first half of 2025.
- Following a substantial improvement from 2021–23, the fiscal position has begun to weaken once again. Over the short-term, this can be reversed with active fiscal management measures, but longer-term challenges related to aging, health, and defense expenditures will continue to mount, calling for deeper fiscal structural reforms.
- The external position is also weakening, partly driven by temporary factors. The economy needs to rebalance away from consumption through diversification which would attract higher foreign direct investment (FDI) to a broader range of sectors, reduce external imbalances, and make the economy more resilient to future economic shocks.
- Financial sector policies should continue to safeguard financial stability and integrity for which continuing operational independence of the central bank is essential.

Washington, DC – November 20, 2025: The Executive Board of the International Monetary Fund (IMF) completed the Article IV Consultation for Montenegro on November 18, 2025.¹ The authorities have consented to the publication of the Staff Report prepared for this consultation.²

After a severe economic contraction of over 15 percent in 2020, Montenegro's economy rebounded strongly, with growth averaging around 9 percent annually between 2021 and 2023. This robust performance was largely supported by favorable external factors, including the global recovery in tourism and substantial inflows of affluent migrants. Real GDP growth moderated to 3.2 percent in 2024, reflecting among other factors, a deceleration in international tourism. Meanwhile, inflationary pressures—as observed elsewhere in the region—have been rising, partly driven by increasing wages. Headline inflation, which fell sharply from a peak of 13 percent in 2022 to just 1 percent by September 2024, rose again to 4.9 percent by September 2025, while core inflation (excluding food and energy) reached 3.2

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² *Option 1:* Under the IMF's Articles of Agreement, publication of documents that pertain to member countries is voluntary and requires the member consent. The staff report will be shortly published on the www.imf.org/montenegro page.

percent. The policy landscape has been influenced by the government's *Europe Now* initiatives, which have helped to reduce labor market informality and enhance financial inclusion. However, their effects on revenue collection and future wage dynamics need to be carefully managed.

The sharp post-pandemic decline in public debt from end 2020-24—by approximately 48 percentage points of GDP—was largely driven both by strong growth and inflation. The general government deficit is currently projected to widen from 2.9 percent of GDP in 2024 to 3.6 percent in 2025. Without new measures to contain expenditures and mobilize additional revenues, the deficit is expected to exceed 4 percent of GDP by 2030 in baseline forecasts, as aging, health, and defense expenditures will rise. Consequently, the public debt-to-GDP ratio is projected to rise gradually to around 65 percent by 2030.

Real GDP growth is currently projected at 3.2 percent in 2025 and is expected to remain at similar levels over the forecast horizon. Average headline inflation is forecast to remain elevated at around 4 percent in 2025, before gradually converging toward 2 percent over the medium term. The current account balance is expected to weaken to some 18 percent of GDP in 2025 but improve partially as temporary factors subside. However, it is unlikely to return to the levels observed during 2021–2023, unless the economy diversifies and rebalances away from consumption.

Executive Board Assessment³

Executive Directors commended Montenegro's resilience in navigating a challenging external environment, underpinned by strong fundamentals and sound policy frameworks. However, they noted that the post-pandemic recovery has matured, and Montenegro must now adapt to meet future challenges. As a small, open economy, the country remains exposed to global shocks that affect tourism and relies on external financing to meet substantial public and external funding needs. Directors emphasized that strengthening the fiscal policy framework, alongside structural reforms aimed at diversifying the economy, would better equip Montenegro to address these vulnerabilities. They welcomed Montenegro's progress toward European Union (EU) membership, noting that the accession process can serve as the ideal anchor for reforms needed to meet the country's economic aspirations.

Directors underscored the importance of aligning the fiscal strategy with the economy's cyclical position as well as the requirements of the Fiscal Responsibility Law. They emphasized that this calls for a recalibration of fiscal policy toward targeting a balanced primary budget. Furthermore, Directors noted that long-term spending pressures due to population aging, health, climate, and defense will increase, which call for fiscal structural reforms. These reforms could include improving civil service and healthcare efficiency, better targeting of social benefits, linking retirement age to life expectancy, and enhancing public investment management. In this context, they recommended strengthening the Fiscal Responsibility Law and operationalizing the independent Fiscal Council to guide fiscal policy through this change.

³ At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

Directors noted that the banking system is in good health given strong capitalization, ample liquidity, and low non-performing loan (NPL) ratios. They welcomed Montenegro's integration into the Single European Payment Area (SEPA). In light of rapid growth in private-sector lending and rising real estate prices, they encouraged the authorities to continue close monitoring for early signs of stress—particularly in cash loans and the real estate sector—and to maintain robust supervision, including strong anti-money laundering (AML) enforcement. Directors also cautioned that the development bank should remain focused on its historical mandate of expanding credit access to underserved sectors and regions, avoiding new activities that could generate fiscal or financial stability risks. Finally, they emphasized the importance of safeguarding the operational independence of the central bank for continued financial stability. They underscored the importance of need for ensuring it is staffed with individuals with appropriate skills and experience, in accordance with central bank law.

Directors stressed the need for continued structural reforms to strengthen economic resilience and support higher-quality growth. Noting that the country's external position remains substantially weaker than levels consistent with underlying economic fundamentals and desirable policy settings, they called for a well-coordinated strategy to diversify the economy—both within and beyond tourism—and to develop a business climate conducive for small and large investors alike. Directors also emphasized the importance of firmly re-establishing the link between wage and productivity growth, whilst also aligning the country's climate policy objectives with those of the EU.

Montenegro: Selected Economic Indicators, 2020–30
(Under current policies; percent of GDP, unless otherwise noted)

	2020	2021	2022	2023	2024	Projections					
						2025	2026	2027	2028	2029	2030
Real economy											
Nominal GDP (millions of €)	4,145	4,923	5,944	7,069	7,645	8,280	8,771	9,233	9,700	10,207	10,720
Gross national saving	3.8	16.2	14.7	14.3	8.8	7.6	8.5	8.6	8.6	9.0	9.4
Gross investment	30.1	25.5	27.6	25.4	25.9	25.7	25.5	25.1	24.5	24.5	24.4
Unemployment rate (percent)	17.9	16.6	14.7	13.1	11.4	...	...	...	...	...	...
						(percent change)					
Real GDP growth	-15.0	13.0	7.7	6.5	3.2	3.2	3.2	3.0	3.0	3.0	3.0
Tourism											
Foreign Arrivals	-86.0	342.9	31.1	20.2	0.0	...	...	...	...	...	...
Foreign Nights	-84.0	323.3	25.9	33.0	-5.0	...	...	...	...	...	...
Consumer price inflation (period average)	-0.3	2.4	13.0	8.6	3.3	4.0	2.4	2.2	2.0	2.0	2.0
Consumer price inflation (end of period)	-0.9	4.6	17.2	4.3	2.1	4.9	2.2	2.1	2.0	1.9	2.0
GDP deflator	-0.3	5.1	12.1	11.7	4.8	5.0	2.6	2.2	2.0	2.2	2.0
Average net wage	1.7	1.5	33.8	11.2	10.6	...	...	...	...	...	...
Money and credit (end of period)						(percent change)					
Bank credit to private sector	3.4	3.2	8.2	6.9	15.5	19.3	8.8	6.6	8.5	8.0	7.3
Enterprises	4.2	3.8	7.9	5.2	14.5	...	...	...	...	...	...
Households	2.9	2.7	8.4	8.2	16.3	...	...	...	...	...	...
Private sector deposits	-2.0	15.7	23.0	8.9	8.0	10.3	5.9	5.3	5.1	5.6	4.7
General government finances 1/											
Revenue and grants	44.0	43.7	38.1	40.7	40.7	40.2	40.6	40.6	40.7	40.7	40.7
Expenditure	54.9	45.1	42.2	40.4	44.1	43.8	44.3	44.5	44.6	44.9	45.0
Overall fiscal balance	-10.9	-1.4	-4.0	0.4	-3.4	-3.6	-3.7	-3.8	-3.9	-4.1	-4.3
Cyclically adjusted overall fiscal balance	-3.2	1.2	-3.7	-0.5	-4.2	-4.2	-4.1	-4.1	-4.1	-4.2	-4.3
Primary balance	-8.2	1.0	-2.5	2.2	-1.5	-1.5	-1.4	-1.5	-1.3	-1.6	-1.8
General government gross debt	108.4	86.2	70.3	59.6	60.8	60.8	61.5	61.7	62.3	63.3	64.9
General government gross debt (authorities' definition) 2/	106.5	84.6	69.0	58.5	59.7	59.9	60.6	60.9	61.5	62.5	64.2
General government debt, including loan guarantees	113.7	90.2	73.4	62.1	63.1	63.0	63.6	63.7	64.2	65.0	66.6
General government net debt, including guarantees 3/	92.0	79.6	70.6	59.6	56.3	54.8	55.3	56.4	57.5	58.7	60.2
General government net debt, excluding guarantees 3/	86.7	75.7	67.6	57.0	54.0	52.6	53.2	54.4	55.6	56.9	58.5
Balance of payments											
Current account balance	-26.3	-9.3	-12.9	-11.2	-17.1	-18.1	-17.0	-16.5	-16.0	-15.5	-15.0
Foreign direct investment, net	11.4	11.8	13.2	6.1	6.4	6.9	7.4	7.4	7.4	7.4	7.4
External debt (end of period, stock)	223.5	193.5	158.1	128.2	126.6	142.0	149.9	156.8	163.2	168.9	174.6
REER (CPI-based; y-o-y avg. change, in percent) 4/	-0.5	-0.5	1.7	3.5	-0.4	...	...	...	...	...	...
Memorandum:											
GDP per capita (USD)	7,549	9,322	10,046	12,262	13,259	...	...	...	...	...	...
Nominal GDP Growth (in percent)	-15.4	18.8	20.7	18.9	8.1	8.3	5.9	5.3	5.1	5.2	5.0
Real output gap (percent of potential GDP)	-13.2	-4.9	-0.9	2.0	1.6	1.3	1.0	0.7	0.4	0.2	0.0
Gross international reserves in millions of USD	2,116	1,977	2,026	1,553	1,748	2,132	2,184	2,125	2,084	2,082	2,129

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 government deposits.

4/ A negative sign indicates depreciation a REER depreciation.



MONTENEGRO

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Following a robust post-pandemic recovery (9 percent average growth from 2021–23), growth decelerated to 3.2 percent in 2024 and the first half of 2025, driven partially by softening tourism. Inflation has risen from 1 percent in September 2024 to 4.9 percent as of September 2025, reflecting a combination of external, domestic demand, and wage pressures. The 2025 Article IV consultation aims to address emerging macro imbalances and help position the economy for accession to the European Union (EU), which the authorities are targeting by 2028.

Outlook and risks. With the output gap likely closed, medium-term growth in the baseline is forecast to hover around the estimated potential growth rate of around 3 percent. Inflation is projected to remain elevated in 2025, averaging 4 percent, before gradually converging toward 2 percent. Without fresh consolidation measures, the fiscal deficit is forecast to gradually widen beyond 4 percent of GDP by the end of the decade, as long-term spending pressures build. The widening current account deficit is projected to gradually improve from some 18 percent of GDP in 2025 as transitory exacerbating factors unwind but appears unlikely to return to 2021–23 levels.

Policy Recommendations

- **Fiscal policy.** Given the economy's cyclical position, fiscal policy needs to move toward balancing the primary budget. From a longer-term standpoint, maintaining this stance would also align fiscal outcomes with the existing fiscal responsibility legislation. Strengthening the medium-term fiscal framework and improving public investment management are essential for safeguarding macro-fiscal sustainability.
- **Financial sector.** The recent surge in bank lending and housing prices calls for careful monitoring of credit risk. Safeguarding the operational independence of the central bank is vital for financial stability. Ambiguities surrounding the mandate and operations of the new Development Bank should be clarified to ensure consistency with domestic legislation and EU standards.
- **Structural reforms.** Accelerating reforms aimed at diversifying the economy and boosting productivity would enhance economic resilience and help address external imbalances. Strengthening economic governance and addressing data gaps continue to be key priorities.

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Discussions were held in Podgorica from September 15–26, 2025. The team comprised S. Seshadri (head), S. Cevik, A. Kara, and J. Yao (all EUR). Mr. Susic (OED) participated in most of the meetings. The team met with the President, Prime Minister's office, Central Bank, Ministry of Finance, Ministry of Labor and Social Welfare, Ministry of Tourism, Ministry of Ecology, Ministry of Energy and Mining, Ministry of European Affairs, Parliamentary Committee on Economy, Finance and Budget, Statistical Office, Revenue Administration, and representatives of the private sector, academia, diplomatic community, and international agencies. L. Azoor, S. Dominguez, T. Zhang, and Z. Zhu (all EUR) provided support from headquarters.

CONTENTS

CONTEXT	4
RECENT DEVELOPMENTS	6
OUTLOOK AND RISKS	8
POLICY DISCUSSIONS	10
A. Fiscal Policy—Anchoring Accession and Sustainability	10
B. Financial Policies—Modernizing for Accession and Stability	13
C. Structural Policies—Reforming for Accession and Resilient Growth	15
D. Statistical Issues	18
E. Staff Appraisal	18
BOX	
1. EU Accession: Potential Gains and Challenges	5
FIGURES	
1. Real Sector	21
2. External Sector	22
3. Fiscal Sector	23
4. Financial Sector	24
5. Climate Indicators	25
TABLES	
1. Selected Economic Indicators, 2020–30	26
2a. Savings and Investment Balances, 2020–30	27
2b. Contribution to Real Gross Domestic Product, 2020–30	28

3a. Consolidated General Government Fiscal Operations, 2020–30 (Millions of euros, GFSM2014)	29
3b. Consolidated General Government Fiscal Operations, 2020–30 (In percent of GDP, GFSM2014)	30
4. Summary of Accounts of the Financial System, 2020–30	31
5. Balance of Payments, 2020–30	32
6. Financial Soundness Indicators of the Banking Sector, 2014–25	33

ANNEXES

I. Strengthening the Fiscal Policy Framework	34
II. Impact of ‘Europe Now’ Programs on Envelope Wage and Employment	38
III. Macro Fiscal Implications of Investing in Climate Change Adaptation Infrastructure in Montenegro	44
IV. Implementation of Past IMF Recommendations	50
V. External Sector Assessment	51
VI. Risk Assessment Matrix	56
VII. Sovereign Risk and Debt Sustainability Assessment	58
VIII. Data Issues	69

CONTEXT

1. A coalition government has been in power since 2023. This followed a period of instability that began in 2020, marked by short-lived caretaker governments. The current coalition has successfully weathered occasional differences among its constituent parties.

2. Montenegro experienced a robust post-pandemic recovery. After a severe economic contraction of over 15 percent in 2020, growth averaged about 9 percent annually between 2021 and 2023. This strong performance was largely driven by favorable external factors, including the global rebound in tourism and significant inflows of affluent migrants from Russia and Ukraine.¹ However, real GDP growth moderated to 3.2 percent in 2024, despite the continued *growth* of consumer spending, due to a slowdown in international tourism. The policy landscape has been strongly influenced by the government's ambitious *Europe Now* and *Europe Now 2* initiatives (see Text Table 1, paragraph 24, and Annex II).

Text Table 1. Europe Now Programs

Program	Europe Now	Europe Now 2
Effective date	January 2022	October 2024
Key policy changes	<ul style="list-style-type: none"> • Sharp minimum wage hike • Healthcare contribution removal • Introduction of progressive tax 	<ul style="list-style-type: none"> • Further minimum wage increase • Pension contribution reduction
Stated goals	Reducing informality (envelope wages—non-declared cash paid in addition to the official wage), boosting employment, and living standards	
Outcomes	From end-2021 to end-2024, registered employment increased by 22 percent; net wage increased by 88 percent; inflation averaged 7.7 percent annually initially driven by external factors and more recently due to domestic demand; The current account deficit has expanded with consumption, while the primary fiscal position is weakening.	
Overall assessment	Envelope wages have been reduced, and employment has been boosted moderately (Annex II), whilst enhancing financial inclusion. The weaknesses in fiscal revenues are yet to be fully offset.	

3. Accession to the European Union (EU) has the potential to anchor reforms and accelerate income convergence. EU accession enjoys broad social support. The government aims to complete the accession process by 2028. As of October 2025, Montenegro has provisionally closed seven of the 35 accession chapters (*inter alia*, those on Public Procurement, Intellectual Property Law, Information Society and Media, Enterprise and Industrial Policy, Science and Research). To meet the government's current timeline of accession, the remaining chapters—including those pertaining to rule of law—will need to be provisionally closed by end-2026. Montenegro's per capita income stands at 54 percent of the EU average in purchasing power parity (PPP) terms. Meaningful reforms associated with the remaining chapters, alongside the policies below would help position the country to reap the full benefits of EU accession.

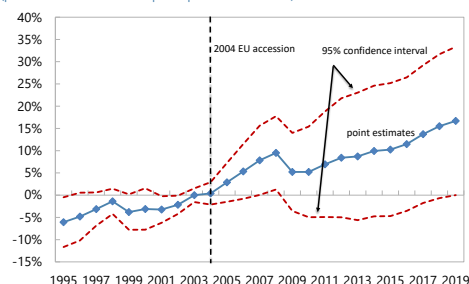
¹ The 2023 Census reports 122,744 immigrants in Montenegro, comprising 19.7 percent of the population. Immigrants from Russia and Ukraine make up only 14.5 percent of this group and 2.9 percent of the population.

Box 1. EU Accession: Potential Gains and Challenges

EU membership has generally brought sizable economic benefits. EU membership has raised per capita income significantly for accession countries on average.¹ Using a difference-in-differences approach that compares 2004 EU accession countries to a synthetic country that approximates what would have happened without EU accession, the GDP per capita gains are estimated at about 17 percent from 2004 to 2019.

GDP per capita Gains of 2004 EU Accession Countries

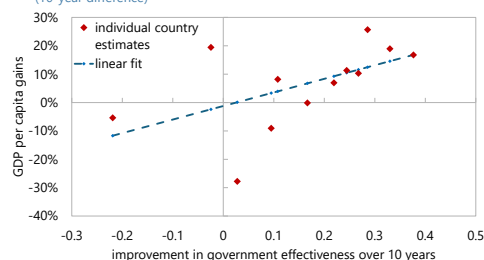
(percent deviation of GDP per capita from baseline)



Sources: Eurostat and IMF Staff calculations.

GDP per capita Gains and Government Effectiveness

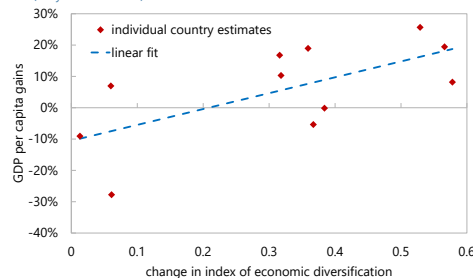
(10-year difference)



Sources: World Governance Indicators and IMF staff calculations.
Note: Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

GDP per capita Gains and Economic Diversification

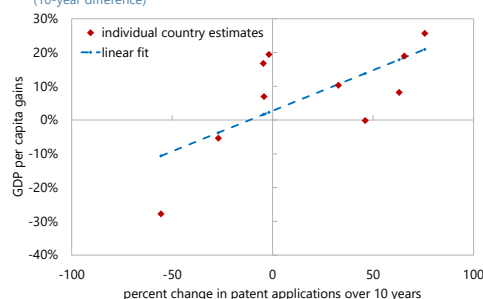
(10-year difference)



Sources: Eurostat, the Atlas of Economic Complexity, and IMF staff calculations.
Note: The index of economic diversification is measured by economic complexity, containing information about both the diversity and sophistication of a country's exports.

GDP per capita Gains and Innovation

(10-year difference)



Sources: World Bank; and IMF staff calculations.

However, there is considerable heterogeneity across countries. While EU accession brings about productivity increases, capital inflows, and trade integration, it also comes with heightened competition and the allure of outward labor migration. Countries with more economic diversification, focus on innovation, and strong governance tend to gain more from EU accession. Comparing the 75th percentile to the 25th percentile of EU accession countries in 2004 in terms of the change in economic diversification, the former has enjoyed 24 percent more gains in GDP per capita over 10 years. With respect to the change in government effectiveness and the change in innovation, those at the 75th percentile have reaped 10 percent and 16 percent more in GDP per capita gains, respectively, than those at the 25th percentile.

To reap the full benefits of EU accession, Montenegro must diversify its economy. Montenegro's economy is heavily dependent on tourism, while growth is increasingly consumption driven. With EU accession, the prospects of both brain and muscle drain loom large. Recent studies show that migration could lower potential output, if there are no offsetting improvements in productivity. More imports from the EU could further affect the already elevated trade deficit, while potential new visa requirements could affect tourism (currently dominated by Russia, Türkiye, and Serbia). Recent studies² on some Western Balkan countries show that lower migration costs following the EU accession could reduce potential output, and that productivity improvements are necessary to offset the negative impact. Montenegro should develop a clear strategy that improves productivity, bolsters the labor market, and attracts FDI into a wider range of sectors beyond tourism, construction, and real estate. Areas such as agriculture, clean energy, digital services, and niche tourism markets appear to hold significant promise.

¹ See, for example, Campos, Coricelli, and Moretti (2019), and Beyer, Li, and Weber (2025).

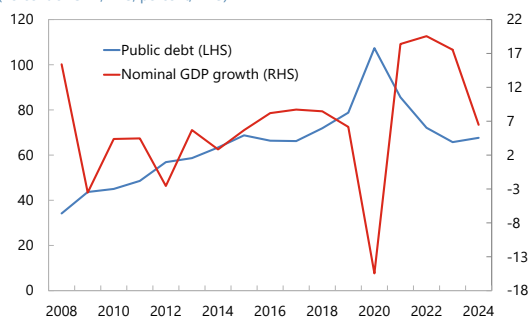
² Ayerst and Stefanova (2025), and Ayerst (2025).

RECENT DEVELOPMENTS

4. Growth is slowing, while inflationary pressures are re-emerging. Real GDP growth moderated to 3.2 percent in 2024, and into the first half of 2025. High-frequency indicators—including tourist arrivals, construction permits, and retail sales—signal this trend is likely to continue. Meanwhile, inflation, as observed elsewhere in the region, is trending upward, partly driven by rising wages. After falling sharply from a peak of 13 percent in 2022 to just 1 percent by September 2024, headline inflation increased to 4.9 percent as of September 2025, with core inflation (excluding food and energy) at 3.2 percent. The differential in headline inflation relative to the euro area has widened once again to 2.7 percentage points (after narrowing substantially from nearly 8 percentage points in 2022 to -0.8 percentage points in 2024).

Montenegro: Public Debt and Nominal GDP Growth

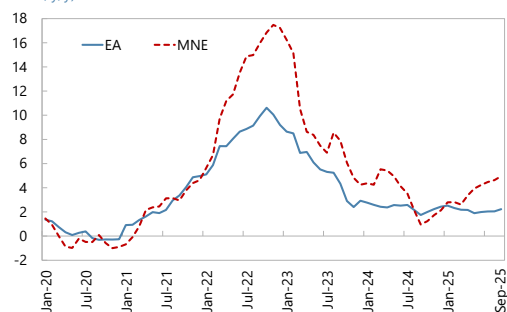
(Percent of GDP, LHS; percent, RHS)



Sources: Ministry of Finance, and IMF staff calculations.

Headline Inflation: Montenegro vs. Euro Area

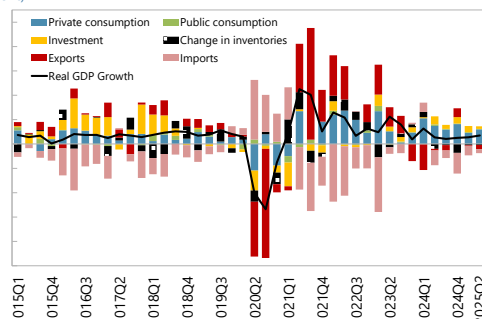
(Percent, y/y)



Sources: Haver Analytics and IMF staff calculations.

Montenegro: Contribution to Real GDP Growth

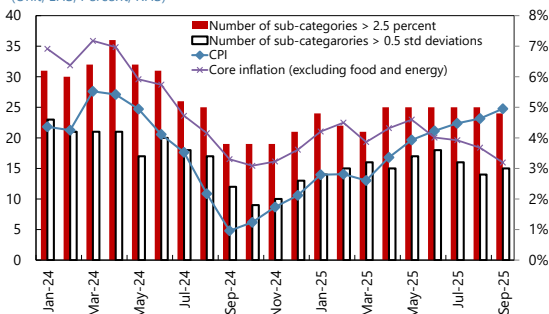
(Percent)



Sources: Haver Analytics from MONSTAT, and IMF staff calculations.

Montenegro: Inflation Components Deviation

(Unit, LHS, Percent, RHS)



Sources: Haver Analytics and IMF staff calculations.

5. The fiscal position has recently weakened, following a period of significant improvement. Between 2020 and 2023, the public debt-to-GDP ratio declined by some 48 percentage points, driven largely by strong nominal and real GDP growth. However, this trend has started to reverse. The consolidated general government budget balance shifted from a surplus of 0.4 percent of GDP in 2023 to a deficit of 3.4 percent in 2024. Preliminary data for the central government indicate weaker-than-expected revenue performance during the first eight months of 2025, relative to budgeted projections. This shortfall is primarily attributable to a reduction in pension contributions under the EN2 program, the fiscal impact of which was not fully anticipated in the 2025 budget.

Text Table 2. Montenegro: Central Government Budget, January-August 2025

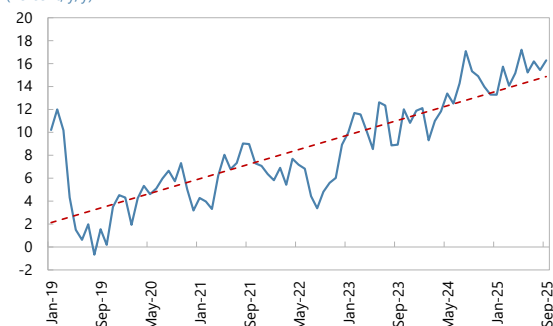
	EUR mn	y/y	% of Jan-Aug Budget
REVENUES	1,838	0.6%	98.5%
Taxes	1,482	12.0%	101.7%
Personal income tax	66	23.9%	101.3%
Corporate income tax	219	8.9%	106.7%
Property tax	0	-	-
VAT	880	12.6%	100.5%
Excise tax	261	9.4%	100.4%
Customs duties	46	17.1%	111.5%
Other	11	9.0%	102.2%
Contributions	256	-31.9%	91.9%
Other revenues	100	-22.3%	76.8%
EXPENDITURE	1,912	10.3%	93.9%
Current expenditure, o/w:	733	7.8%	91.5%
Personnel	455	2.0%	97.5%
Interest	88	29.5%	88.2%
Subsidies	38	4.7%	87.1%
Social transfers	731	11.3%	99.2%
Transfers to other government	269	10.2%	88.2%
Capital expenditure	155	40.4%	94.6%
Guarantees	4	-30.6%	99.1%
Repayment of obligations from previous years	15	-4.7%	82.8%

Source: Ministry of Finance.

6. Bank lending has been growing briskly. Credit expanded by a robust 13.3 percent in 2024 and accelerated further to 16.3 percent as of September 2025 (Figure 4). Both non-financial corporate and household lending exhibited strong growth, increasing by 23.6 percent and 21.2 percent, respectively, with household credit primarily driven by mortgage and unsecured cash loans. Bank lending started to recover in 2023 after a period of weak growth following the Covid-19 pandemic. The growth in mortgage lending has contributed to a strengthening of the housing market. However, despite the recovery in domestic mortgage lending, until recently, the main source of funding for housing has been from overseas. The average lending rate declined in line with easing euro area interest rates, while the average deposit rate remained close to zero. Elevated net interest margins have supported bank profitability. The non-performing loan (NPL) ratio improved significantly, falling to 2.9 percent in the second quarter of 2025, down from an average of 6.1 percent in 2022.

Montenegro: Credit Growth

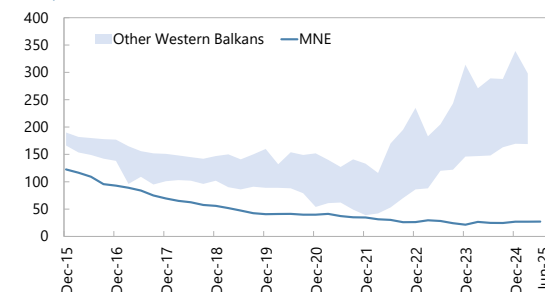
(Percent, y/y)



Sources: Haver Analytics and IMF staff calculations.

Montenegro: Deposit Rate

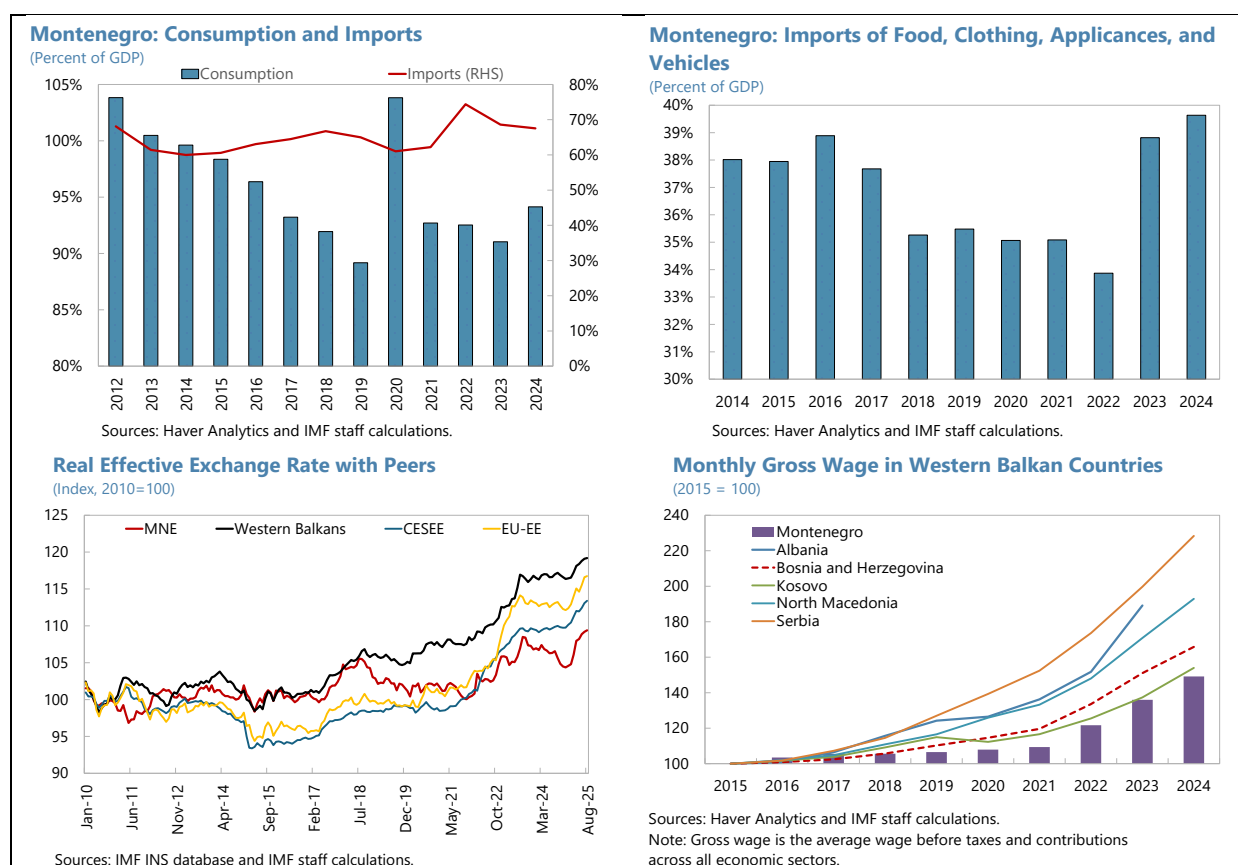
(Basis points)



Note: Swathe includes deposit rates of other Western Balkan countries (Albania, Bosnia Herzegovina, Kosovo, Serbia and North Macedonia).

Sources: Haver Analytics and IMF staff calculations.

7. The external position is also weakening. The current account deficit widened to above 17 percent of GDP in 2024, up from an average of some 12 percent during 2022–23. The growth of foreign tourist arrivals has softened following the initial post-COVID rebound.² Goods exports declined by 8 percent, driven mainly by decreases in electricity and aluminum exports. These declines were largely due to lower-than-normal rainfall reducing hydropower output, maintenance-related outages at the Pljevlja power plant, and the closure of an aluminum smelter. The first two of these factors are considered temporary. Goods imports grew by 7 percent, reflecting strong demand for household consumption goods such as food, clothing, appliances, and vehicles. The External Sector Assessment (Annex V) shows that Montenegro’s external position in 2024 was substantially weaker than levels consistent with underlying fundamentals and appropriate policy settings. Despite a recent appreciation of the real effective exchange rate (REER), the country’s competitiveness does not appear significantly impaired. Compared to peer economies—particularly other Western Balkan countries, Montenegro’s REER appreciation and labor costs remain relatively low.

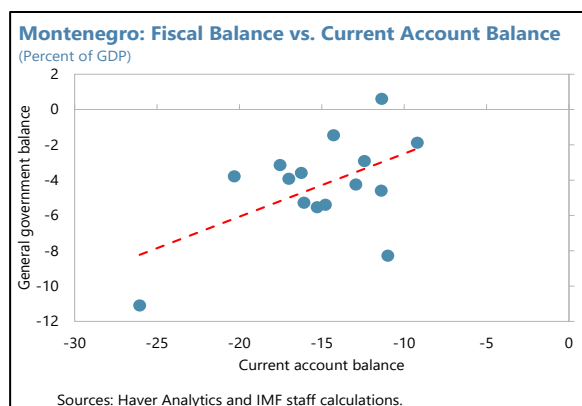


OUTLOOK AND RISKS

8. Growth is expected to moderate over the medium term, accompanied by a gradual disinflation process. Real GDP growth is projected at 3.2 percent in 2025 and is expected to hover

² While tourist arrivals rose by 3.8 percent year-on-year in the first eight months of 2025, the number of overnight stays fell by 1 percent relative to the same period in 2024, suggesting a structural shift in tourism patterns toward shorter stays and/or changing sources of visitors.

at similar levels over the forecast horizon. The output gap is expected to remain positive in the near term and to close over the medium term, although measurement uncertainties warrant caution in interpreting these estimates. Wage pressures continue to feed through, with average inflation forecast to remain elevated at around 4 percent in 2025, before gradually converging toward the ECB's 2 percent target over the medium term. The current account balance is anticipated to improve partially as temporary factors subside but is not expected to return to the levels observed during 2021–23. Fiscal balances are projected to weaken gradually in the absence of new consolidation measures.³



9. Risks to the baseline outlook are broadly balanced. The direct impact of global trade disruptions is expected to be limited, given that goods exports to the U.S. represent only about 1 percent of Montenegro's total exports. However, weak tourism growth—whether due to a slowdown in the global economy or other idiosyncratic factors—remains the primary downside risk. The dependence on external financing is also a point of vulnerability if a major global financial disruption were to occur—given high gross financing needs (GFN) of the public sector (averaging about 13 percent of GDP throughout the forecast period), as well as the need for sizable and more diverse sources of foreign direct investment (FDI) to fill the current account deficit. According to the downside scenario from the April World Economic Outlook (WEO), which factors in heightened trade tensions, increased uncertainty, and tighter financial conditions, real GDP growth is projected to be 0.4 percentage points below the baseline in 2026 and 0.25 percentage points lower in 2027.

Over the longer term, structural challenges such as population aging and climate change are likely to increase fiscal and economic pressures. Conversely, successful attraction of well-directed capital inflows (aided by a successful EU accession process) would brighten the outlook. In one such favorable scenario, real GDP growth is projected to exceed the baseline by 0.5 percentage points in both 2026 and 2027, and by 1 percentage point over the remainder of the forecast period.

Text Table 3. Montenegro: Alternative Scenarios

	2026	2027	2028
Baseline scenario			
Real GDP growth (percent)	3.2	3.0	3.0
Inflation (avg, percent)	2.4	2.2	2.0
Public debt (percent of GDP)	61.5	61.7	62.3
Current account balance (percent of GDP)	(17.0)	(16.5)	(16.0)
Downside scenario			
Real GDP growth (percent)	2.8	2.8	3.0
Inflation (avg, percent)	2.2	2.0	2.0
Public debt (percent of GDP)	62.0	62.5	63.0
Current account balance (percent of GDP)	(16.7)	(16.2)	(16.0)
Upside scenario			
Real GDP growth (percent)	3.7	3.5	4.0
Inflation (avg, percent)	2.7	2.7	3.0
Public debt (percent of GDP)	61.0	60.6	60.0
Current account balance (percent of GDP)	(17.2)	(17.4)	(17.6)

Source: IMF staff calculations.

³ The IMF has provided technical assistance on debt management strategies, covering more effective use of local markets (regular predictably timed auctions, initiating a local retail debt market—expected to have its inaugural issue before year-end). The authorities have also advanced significantly in terms of accessing international debt markets at competitive yields—in 2025, they have issued 800 million in long-term euro-denominated bonds at a yield of 4.875 percent, which is lower than might be expected for a BB rated borrower.

Authorities' Views

10. The authorities broadly concurred with staff on the outlook and key risks. Their growth and inflation forecasts over the remaining mandate of the current government are largely aligned with staff's. They believe the medium- to long-term prospects for growth will improve substantially with planned investments in road, air, and rail transport. They also expect investments in renewable energy will add permanently to export capacity. Finally, they also expect the range of tourism offerings to expand, including in currently less developed regions of the country.

POLICY DISCUSSIONS

Given the absence of monetary policy tools, fiscal discipline is essential for macroeconomic stability. The central bank should remain vigilant against the build-up of credit risks while continuing to strengthen anti-money laundering (AML) efforts. Maintaining operational independence is critical for the central bank to discharge its responsibilities effectively. Achieving sustainable income convergence will require structural policies that enhance both the quantity and productivity of inputs and diversify the economy. Montenegro's reliance on tourism also underscores the need for greater attention to climate change adaptation.

A. Fiscal Policy—Anchoring Accession and Sustainability

11. The budget deficit is projected to widen to 3.6 percent of GDP in 2025. This is mainly driven by the drop in projected pension contributions—from 6.6 percent of GDP in 2024 to 4.5 percent in 2025 according to staff estimates—due to the EN2 program. The authorities have introduced compensatory measures in the 2025 budget such as (i) excise taxes on alcoholic and sugary beverages; (ii) an increase in the VAT rate on tourism-related services from 7 to 15 percent; and (iii) the removal of the zero VAT rate on construction and equipment for high-end hospitality projects, major energy initiatives, and select food-processing activities. Staff expect these measures will boost overall tax revenues (excluding social security contributions) by 1.8 percentage points of GDP in 2025, which is still insufficient to fully offset the decline in social security contributions.

Text Table 4. Montenegro: Consolidated General Government (Percent of GDP)		
	2024	2025 (proj)
Total Revenues	40.7	40.2
Taxes	29.0	30.8
Personal income tax	2.5	2.9
Corporate income tax	2.8	3.0
Property tax	1.6	1.6
Value added tax	16.0	16.8
Excises	4.8	5.0
Taxes on international trade	0.8	0.8
Local government taxes	0.4	0.4
Other taxes	0.2	0.4
Social security contributions	6.6	4.5
Nontax revenues	3.6	3.5
Grants	1.4	1.4
Total Expenditures	38.5	38.2
Wages and other personal income	10.2	10.3
Goods and services	2.6	2.6
Interest payments	2.0	2.1
Subsidies to enterprises	1.2	1.2
Other current outflows	1.3	1.3
Social security transfers	13.2	13.2
Repayment of guarantees	0.1	0.0
Reserves	0.7	0.3
Capital Expenditure	5.6	5.6
Overall balance	-3.4	-3.6
Primary balance	-1.4	-1.5
Source: IMF staff calculations.		

12. The fiscal strategy needs align with the economy’s cyclical position, as well as the Fiscal Responsibility Law. Given the projected positive output gap in the near term, the optimal fiscal policy stance would be to aim for a balanced primary budget. Furthermore, baseline projections suggest that fiscal outcomes are likely to deviate from the requirements of Montenegro’s Law on Budget and Fiscal Responsibility—which mandates a budget deficit below 3 percent of GDP and a public debt ratio under 60 percent of GDP (also consistent with the Maastricht criteria). Maintaining a balanced current budget (the authorities’ stated preference) does not necessarily guarantee long-term fiscal sustainability. Accordingly, staff advocates for front-loaded fiscal consolidation aimed at lowering public debt below the 60 percent threshold, while simultaneously contributing to aggregate demand management. Some measures to help reach a balanced primary budget were proposed:

Text Table 5. Montenegro: Menu of Potential Fiscal Adjustment Measures
(Percent of GDP)

	2026	2027	2028
Confining Wage Bill to Inflation	0.3	0.6	0.9
Saving Airport Concession Revenue	1.1	0.0	0.0
Reducing Tax Expenditures	0.4	0.4	0.4
Total Annual Impact	1.8	1.0	1.3
Additional Annual Impact	1.8	-0.8	0.3
Primary Balance (baseline)	-1.4	-1.5	-1.3
Primary Balance (after measures)	0.4	-0.5	0.0
Public Debt (baseline)	61.5	61.7	62.3
Public Debt (after measures)	59.7	58.9	58.2
Additional Measures			
Revenue Admin Reforms	0.3	0.6	0.9
Fuel Marking	0.3	0.3	0.3
Total Annual Impact	0.6	0.9	1.2
Additional Annual Impact	0.6	0.3	0.3
Public Debt (after additional measures)	59.1	57.4	55.5

Source: IMF staff calculations.

- On the expenditure side, the key measure is to limit the public wage bill growth to the rate of inflation, generating estimated savings of 0.9 percent of GDP relative to the baseline by 2028.⁴ On the revenue side, completing the long-delayed airport concession and saving all temporary windfall revenues could yield about 1.1 percent of GDP.⁵ Additional gains could be achieved by reducing unproductive tax expenditures, conservatively estimated to generate 0.4 percent of GDP relative to the baseline in 2026–28.⁶ Furthermore, continued revenue administration reforms, consistent with ongoing IMF technical assistance recommendations,⁷ and the implementation of the fuel-marking system (originally planned for 2025 but not yet executed) would further strengthen revenues.

⁴ The wage bill amounted to an average of 11.4 percent of GDP and accounted for about 30 percent of total spending during the period 2020–2024. This is on the upper end relative to regional peers. Moreover, public sector wage increases in sensitive and relatively highly paid professions such as healthcare, education, and police, have been increasing at around twice the rate of inflation.

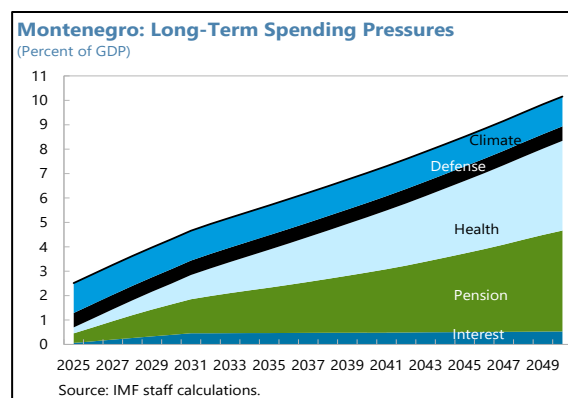
⁵ Montenegro launched the airport concession process in 2019, to award a 30-year concession for its two international airports—Podgorica and Tivat—that would transfer operational and investment responsibilities to a private partner, with the dual objective of generating upfront fiscal revenues and facilitating long-term infrastructure development.

⁶ Tax expenditures are currently estimated to amount to about 4.4 percent of GDP. The authorities are actively working with the IMF’s fiscal experts on this area. The IMF’s May 2025 tax policy TA report already identifies 2.7 percent of GDP in VAT-related tax expenditures that could be reconsidered.

⁷ The authorities are currently working with the IMF to strengthen tax administration, with the associated reforms expected to generate additional revenues of approximately 0.9 percent of GDP (see Annex VI in the 2024 Staff Report). Priority actions include advancing digitalization through an integrated tax system and real-time audits, enhancing risk-based compliance by leveraging data analytics, improving the exchange of international financial information, and recruiting more inspectors.

- Of these measures, containing wage bill growth to the rate of inflation may prove challenging, although its impact on economic growth is expected to be limited. Modernizing airports is growth-friendly given tourism dependence. These measures account for currently programmed additional military expenditures, estimated at about 0.2 percent of GDP annually.⁸

13. The overall risk of sovereign stress is assessed as moderate, but the debt sustainability analysis highlights the need to address long-term spending pressures (Annex VII). Over time, expenditure pressures are expected to intensify, driven primarily by rising healthcare costs and pension outlays. To ensure fiscal sustainability, Montenegro should advance structural fiscal reforms. Key areas include: (i) restoring prior plans to more strongly link the statutory retirement age to life expectancy;⁹ (ii) enhancing means-testing for social benefits, which the authorities have endorsed in principle but not yet legislated; (iii) implementing cost-containment measures in the health sector to achieve additional savings;¹⁰ (iv) comprehensive civil service reforms; (v) enhancing progressivity in the personal income tax (PIT) structure; and (vi) aligning excise tax rates with EU directives.¹¹



14. Improving public investment management (PIM) practices would enhance economic growth and increase efficiency of capital expenditures. Between 2012 and 2019, public investment averaged 6.8 percent of GDP annually, contributing to an increase of 4.4 percent of GDP in public capital stock. A substantial share of recent investment during this period was allocated to the second stage of the Bar–Boljare Highway—at a cost about €600 million (an estimated 7.3 percent of GDP as of 2025).¹² The government plans to maintain capital spending at around 5.5 percent of GDP over 2025–30. As Montenegro advances in its EU accession process, substantial new funding could become available.¹³ Historically, net EU budget transfers to accession countries have

⁸ As a NATO member, Montenegro will have to raise the national defense spending target from 2 percent of GDP to 5 percent by 2035, allocating 3.5 percent of GDP for core military capabilities. The Ministry of Defense has requested to increase military expenditures by 0.2 percent of GDP annually until 2028, which is incorporated into the baseline scenario.

⁹ Plans to reform pension eligibility policies were discussed in the pre-pandemic period but were subsequently shelved. Staff has previously recommended (SIP, 2018 Article IV Consultation) raising the retirement age for both men and women (currently 66 for men, and 64 for women) and limiting early retirement options.

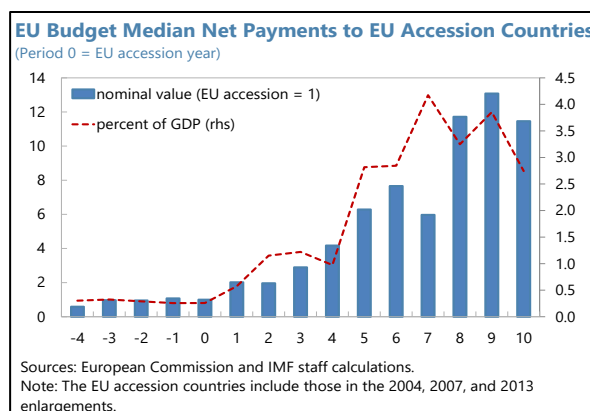
¹⁰ The World Bank has provided recommendations to reduce current costs of operating the healthcare system, including centralized bargaining and procurement of drugs, and expanding the use of generic drugs.

¹¹ The IMF has provided technical assistance in these areas and stands ready to explore further collaboration.

¹² Other highway projects that could deliver high economic returns and merit prioritization include improved connections from the capital to the coast, and roads connecting Montenegro to Croatia and Albania which could significantly increase tourism inflows.

¹³ Montenegro has been allocated €383.5 million in pre-accession grants and loans from the EU over the 2025–28 period.

increased from a median of 0.3 percent of GDP at the time of accession to roughly 2.8 percent within five years. In this context, implementing the recommendations of the IMF's June 2022 technical assistance would be prudent: (i) improving project preparation, appraisal, and selection; and (ii) strengthening portfolio monitoring. These measures would position Montenegro to fully leverage EU accession funds once they become available.



15. Strengthening the Fiscal Responsibility Law and operationalizing the independent Fiscal Council are immediate priorities. Although Montenegro's Fiscal Responsibility Law formally prescribes corrective action when fiscal targets are missed, its current design is largely symbolic (Annex I).¹⁴ Greater effectiveness and stronger compliance will require amendments that clearly and narrowly define the exceptional circumstances under which the law can be temporarily suspended. The law should also specify clear timelines for corrective action. In parallel, enhancing fiscal risk assessments would support more effective enforcement of fiscal discipline. Operationalizing the long-delayed independent Fiscal Council would further strengthen fiscal oversight, providing transparent advice and early warnings to ensure that fiscal outcomes remain on track.¹⁵

Authorities' Views

16. The authorities reaffirmed their commitment to prudent policies. They are confident that they are carefully assessing long-term budgetary pressures. They consider increasing the surplus on the current budget to be a good means by which to push economic growth by allocating more resources to public investment with lower borrowing. The authorities recognize that long-term spending pressures will necessitate structural fiscal reforms over the medium term. They have requested IMF technical assistance on long-term expenditure challenges including civil service reforms. The authorities also acknowledged the need to strengthen the Fiscal Responsibility Law and welcomed staff's recommendations in this regard. Subject to parliamentary action, they hope the Fiscal Council will become operational in early-2026.

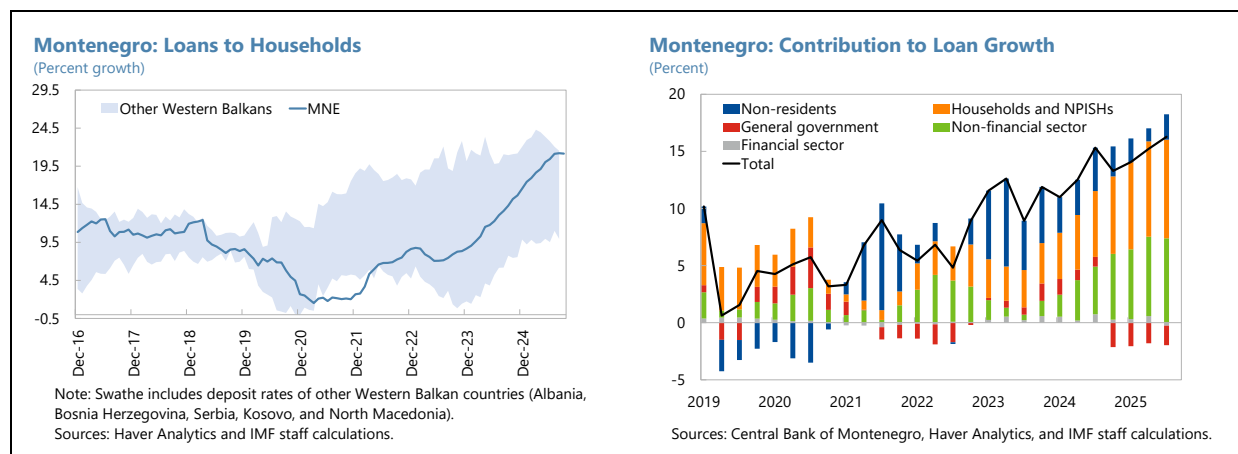
B. Financial Policies—Modernizing for Accession and Stability

17. The banking sector remains broadly healthy, but some risks require continued attention. As of Q2 2025, the average capital adequacy ratio was 19.5 percent—about twice the regulatory minimum—while profitability, measured by return on equity, remained robust at 15.2

¹⁴ The law states that "if the level of the deficit during the fiscal year exceeds the limit, the government shall, within 60 days, from the date of determination of the deviation, submit to the parliament a proposal for measures to remedy the deficit." This has not been enforced, resulting in persistent breaches of the 3 percent of GDP deficit threshold, and debt peaking at over 107 percent of GDP in 2020.

¹⁵ Three nominees—made by the President, the government, and parliament, respectively—require parliamentary confirmation to make the council operational.

percent. Although the decline in non-performing loan (NPL) ratios provides some comfort, the strong growth of credit calls for strong focus on forward-looking indicators (such as 30-day past-due loans). Breaches of Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regulations have prompted the CBCG to impose fines on several banks. To safeguard financial integrity and stability, staff reiterated the need to strengthen the AML/CFT framework. Montenegro's position as a regional transit corridor increases its exposure to illicit financial flows and organized crime. Mitigating these risks requires intensified risk-based supervision of high-risk sectors, enhanced transparency of beneficial ownership, and improved cross-border cooperation.¹⁶



18. Surging property prices in Montenegro call for enhanced monitoring and technical capabilities to analyze emerging risks. Nationwide, real estate prices have increased by 128 percent in real terms since 2020, with the largest gains concentrated in the capital and coastal regions. In response, the CBCG raised the countercyclical capital buffer (CCyB) to 0.5 percent in April 2025, with a further increase to 1 percent planned for January 2026. Nevertheless, if credit growth remains strong and property prices continue to rise, additional macroprudential tightening may be necessary. The CBCG is in the early stages of collecting borrower-based measures (BBM) data, such as debt-service-to-income (DSTI) and loan-to-value (LTV) ratios, from banks. To more effectively monitor risks arising from rapid growth in real estate lending, the CBCG should improve the quality of BBM data and strengthen its modeling and analytical capabilities.¹⁷

19. The new state-owned development bank requires rigorous governance and operational provisions. The Law on the Development Bank, adopted in October 2024, transformed the Investment and Development Fund into the Development Bank of Montenegro (RBCG). Per the law (as currently drafted), the RBCG is authorized to accept deposits—without clear language on the kind of deposits (e.g. retail, public sector, corporate) it can take. The RBCG's deposits, however, are not required to be covered under the Deposit Protection Law or the Deposit Protection Fund. Additionally, while the enacted law permits the RBCG to provide payment services, the EU's Payment

¹⁶ The IMF is collaborating with the CBCG to support its technical assistance needs in AML/CFT.

¹⁷ The CBCG is seeking technical assistance from the IMF on macro modeling, and technical assistance from the Austrian Central Bank is under consideration.

Services Directive (PSD2) does not allow institutions like the RBCG to do so (due to fair competition considerations). The RBCG has not yet produced a strategy or business plan, if its mandate were to fully expand to the extent permitted by the law. These gaps could introduce fiscal and financial stability risks. Parliament is currently considering amendments to mitigate such risks by more clearly contain the RBCG's scope of activities and ensure compliance with national and EU legal provisions.

20. Montenegro's integration into the Single Euro Payments Area (SEPA) is a welcome development. This lowers transaction costs and strengthens economic and financial integration. The CBCG stated that participation could generate significant benefits through channels such as lower transaction fees, higher remittances, faster payments, and digital advancements in tourism and services. However, the CBCG, which relies almost entirely on service fees from deposits and lacks seigniorage income, may face reduced fee income from domestic payment services following SEPA accession.

21. To continue delivering financial stability, the central bank's operational independence must be preserved. It is critical to staff the central bank with qualified, experienced personnel in accordance with the central bank law.¹⁸ Parliamentary confirmation of two vacant vice-governor positions is still pending, which places operational pressures on the institution. Appointment processes must disregard political affiliations and ensure that appointees meet fit-and-proper standards. Granting licenses to foreign banks must remain free of political interference and thoroughly scrutinize the AML credentials of all applicants—be they legal or natural persons. The CBCG is currently undergoing a peer assessment to identify and address gaps relative to Eurosystem central banks. As EU accession progresses, strengthening the CBCG's governance and modernizing its operational effectiveness will be essential to maintaining credibility.

Authorities' Views

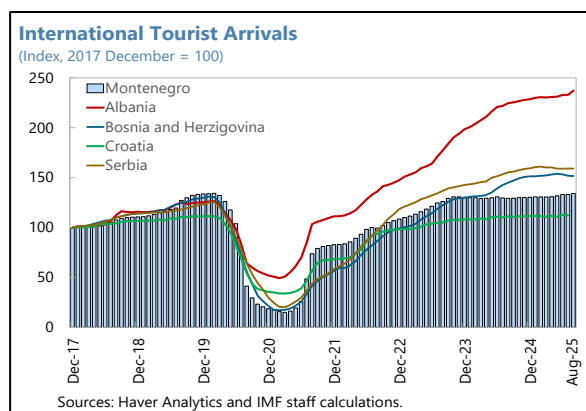
22. The authorities concur with staff's assessment of the financial sector. The authorities agreed with staff that the banking system remains well-capitalized and liquid. The CBCG acknowledged that the recent rapid expansion in credit warrants close monitoring of early warning indicators to mitigate potential risks. The central bank underscored the importance of maintaining supervisory pressure to ensure compliance with AML/CFT regulations. The authorities also concurred on the importance of the central bank's operational independence. Finally, they expect that legislative amendments under consideration for the RBCG will ensure that it that will operate in full compliance with domestic legislation and relevant EU standards.

C. Structural Policies—Reforming for Accession and Resilient Growth

23. Structural reforms would increase potential output, reduce external imbalances, and strengthen economic resilience. The recommendations of the 2024 Article IV consultation remain

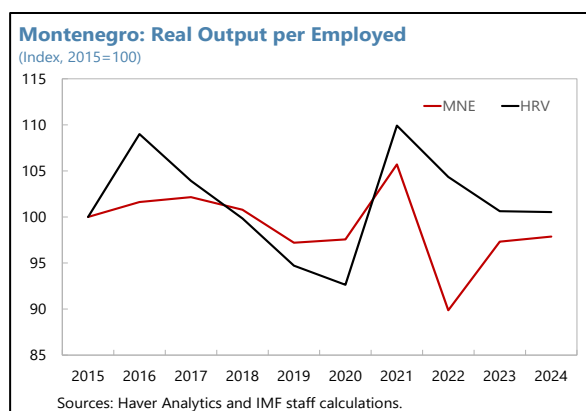
¹⁸ The law states that Parliament appoints the Vice Governors at the proposal of the Governor. The four council members that are not employed by the central bank are proposed by the working body of Parliament responsible for financial affairs and appointed by Parliament.

pertinent. To attain high-quality and sustainable growth, Montenegro should continue to (i) diversify the economy by tapping renewable energy resource endowments; (ii) raise female labor participation rates; and (iii) improve the business climate for SMEs to attract high-skill companies. Staff also urged the authorities to take steps to expand tourism offerings (e.g., extending the season, expanding niche markets like adventure tourism, cultivating “digital nomads”). Regionally, Montenegro’s tourism growth matches most of its neighboring Western Balkan countries. However, it lags the post-pandemic tourism rebound observed in Albania, which has wider flight connections and stronger tourism infrastructure. Closing this gap would also help to narrow external imbalances.



24. Staff’s analytical work sheds light on the effects of the “Europe Now” initiatives on informality and employment.

Using anonymized individual-level tax administration data (Annex II), staff’s analysis provides a range of estimates—differentiated by worker categories—for the reduction in so-called “envelope wages” (undeclared cash payments). While the estimated reduction in the envelope wage is moderate on average (€38/month and €21/month for EN1 and EN2 respectively), the variance is significant. Some workers earning the minimum wage officially may have experienced up to €217/month for EN1 and €290/month for EN2 in envelope wage reductions. Staff estimates that EN1 and EN2’s contributions to employment are moderate but sizeable. Roughly two thirds of the new employment created between 2021 and 2024 was due to broad favorable macro conditions, while some further employment gains were made due to formalization of employment. The main policy implication is that while the EN programs have successfully reduced the prevalence of “envelope wages” and contributed to formal employment gains, a more granular analysis—accounting for sectoral heterogeneity—suggests that further increases in the minimum wage could reintroduce informality through misreporting of full- and part-time work or, more concerning, a shift from “grey” employment practices (which EN1 and EN2 sought to curtail) to more opaque noncompliance. Such developments would further weaken the already fragile link between wages and productivity, which continues to lag behind regional peers. In this context, the possible introduction of a shortened workday could reduce labor supply and further constrain productivity growth.



25. Domestic electricity prices are expected to rise as the domestic carbon price aligns with the EU Emission Trading System (ETS) price. Electricity exports to the EU represent around 20 percent of Montenegro’s total exports. Starting January 1, 2026, EU importers of Montenegrin

electricity will incur Carbon Border Adjustment Mechanism (CBAM) related costs equal to the difference between the EU Emission Trading System (ETS) price (currently around EUR 80/tCO₂e) and the fixed Montenegrin carbon price of EUR 24/tCO₂e. These higher costs will affect Montenegro's electricity export competitiveness, given the high emission intensity of its electricity sector (coal accounts for around 30–40 percent of electricity production). To avoid immediate CBAM-related costs, Montenegro must reform its national ETS to align with the EU ETS. This will entail an increase in the domestic carbon price, and the establishment of an EU-compliant Monitoring, Reporting, Verification and Accreditation (MRVA) system.¹⁹ While raising the domestic carbon price will save on CBAM costs, it is likely to result in higher domestic energy costs. Montenegro should therefore continue prioritizing the expansion of its renewable energy generation and distribution capacity. This would help achieve its emission reduction targets and maintain export competitiveness.²⁰ Support to households impacted by higher energy prices must be targeted to those that are economically vulnerable.

26. Montenegro faces macro-fiscal risks from climate change, underscoring the need for proactive investment in adaptation infrastructure. Current adaptation efforts are not keeping pace with the growing intensity of climate hazards. Montenegro is vulnerable to floods and droughts, while relying heavily on rainfall for both water supply and hydroelectric power generation. Simulations using the IMF's DIGNAD model (Annex III) suggest that timely public investment in climate-resilient infrastructure can mitigate the adverse macroeconomic effects of extreme events, such as wildfires (which pose significant risks in a tourism-dependent economy where forests cover 60 percent of the country's territory). A calibrated scenario indicates that a major climate shock could result in immediate output losses of up to 8 percent of GDP and longer-term scarring of around 0.7 percent of GDP. However, investing an additional 0.6–0.9 percent of GDP annually, which is in line with World Bank's Country Climate and Development Report (CCDR) estimate, in climate-resilient infrastructure and improving public investment efficiency in line with recent C-PIMA recommendations can substantially reduce short-term losses and eliminate long-term scarring. In this context, Montenegro published its National Adaptation Plan in September 2025. According to the plan, the authorities are mainstreaming adaptation into all sectoral policies and planning, including legal reforms and institutional coordination through the National Council for Sustainable Development.

Authorities' Views

27. The authorities share staff's view that the economy needs to be more diversified and further formalized. The authorities noted that the Montenegrin economy could diversify into the agriculture and energy sectors. They agreed that heavy reliance on tourism makes the economy

¹⁹ The national ETS market is currently inactive. A new Climate Change Law will include legislation to better align the national ETS with the EU ETS. Meanwhile, the Ministry of Energy and Mining has launched an auction for 250MW of solar energy. This compares with Montenegro's total installed electricity generation capacity of 1,067 MW as of 2023

²⁰ Montenegro revised its Nationally Determined Contribution target in February 2025. In this submission, Montenegro is committed to reducing its national greenhouse gas emissions by 55 percent and 60 percent by 2030 and 2035 respectively relative to 1990 levels.

vulnerable to sudden stops and attracting FDI to help enhance the productive capacity of the economy is important. The authorities emphasized that the Europe Now programs formalized not only envelope wages, but informal jobs. They noted that EN1 had the largest impact on reducing informality, while the full effect of EN2 remains to be examined. They agree with staff that accelerated convergence would enhance energy sector competitiveness, albeit at the cost of potentially higher domestic energy prices. The authorities also concur with staff that timely investment in climate-resilient infrastructure will improve fiscal sustainability and economic resilience.

D. Statistical Issues

28. The data provided to the Fund have some shortcomings but are broadly adequate for surveillance (Annex VIII). The Statistical Office of Montenegro (MONSTAT) has recently revised national accounts for the period 2006–25, adopting the ESA 2010 methodology with a new base year (2020). Despite these improvements, MONSTAT continues to face resource constraints and capacity limitations. A key statistical challenge has emerged in the tourism sector, largely driven by rising inflows of foreigners. Currently, the CBCG estimates tourism revenues for balance-of-payments purposes in full compliance with the IMF’s BPM6 methodology. This process, however, relies on transforming primary data from various agencies, including the Ministry of Tourism, MONSTAT, and local tourism offices, which provide information on visitor numbers, lengths of stay, and types of accommodation. Recent developments underscore the need for more granular data and improved methodologies to accurately distinguish between tourists and migrants, ensuring that their respective expenditures are properly captured and allocated. Implementing these improvements will require time, strong interagency coordination, and sustained institutional commitment. Accordingly, the agencies responsible for primary data collection should prioritize these methodological enhancements and then assume full responsibility for the production of tourism statistics. In the interim, the timely resumption of detailed balance-of-payments data publication remains essential to ensure transparency and support robust economic analysis.

E. Staff Appraisal

29. The post-pandemic economic recovery has matured, and Montenegro must now adapt to meet future challenges. The robust 9 percent average growth from 2021–23 was aided by tailwinds—a sharp rebound in tourism, affluent migrant inflows—which are now fading. Growth in the baseline is expected to moderate over the foreseeable future to its potential rate of around 3 percent, while inflation is expected to gradually moderate as wage and potential energy price related pressures dissipate. As a small and open economy, Montenegro remains exposed to global shocks that affect tourism and depends on external financing to meet high public and external funding needs. Strengthening the fiscal policy framework alongside structural reforms to diversify the economy would enable the country to address these challenges. The EU accession process provides an ideal anchor for the reforms needed. The window of opportunity over the next 3–5 years is unique and must be fully utilized.

30. A recalibration of fiscal policy is essential. The policy landscape has been recently dominated by the government's *Europe Now* initiatives. These have had a measurable positive impact in reducing labor market informality and enhancing financial inclusion. However, the process of addressing their fiscal costs is still a work in progress. Both the cyclical position of the economy, and the longer-term need to prudently align fiscal outcomes with existing fiscal responsibility legislation call for a shift in fiscal policy to target a balanced primary budget. At the same time, there is a need to rebalance toward more investment rather than consumption. Over the next few years, these goals can be met through fiscal measures that are feasible to implement with a strong commitment from the authorities. By 2035, however, Montenegro will need an *additional* 5–6 percent of GDP to meet pressures from population aging, defense commitments, and climate change. This will require deeper and more challenging fiscal structural reforms such as civil service and healthcare efficiency improvements, better targeting of social benefits, linking retirement to life expectancy, and improving public investment management.

31. Strengthening the Fiscal Responsibility Law and operationalizing the independent Fiscal Council will help guide fiscal policy through this recalibration. Effective compliance will require amendments that clearly and narrowly define the exceptional circumstances under which the law can be temporarily suspended, along with well-specified timelines for corrective actions in such cases. Promptly finalizing the membership and operationalizing the long-delayed independent Fiscal Council would enhance monitoring of fiscal performance and support fiscal sustainability by providing transparent advice and early warnings if fiscal outcomes deviate from targets.

32. The banking sector remains broadly healthy, with strong capital, liquidity, and asset quality indicators. Rapid growth in private-sector lending and surging real estate prices prompted the CBCG to appropriately raise capital levels as a precaution. The CBCG should continue monitoring early signs of stress, particularly in cash loans and real estate, and maintain robust supervision, including in AML enforcement. Montenegro's integration into SEPA and TIPS Clone will strengthen financial integration with Europe and lower transactions costs. The Development Bank of Montenegro (RBCG) should maintain its focus on its historical mandate of expanding credit access to underserved sectors and regions and not undertake new activities that could create fiscal or stability risks.

33. Operational independence of the central bank is vital for continued financial stability. The CBCG's responsibilities range from banking supervision and macro prudential policies to AML supervision and contingency planning. As Montenegro joins the eurozone, it will also broaden into monetary policy. To keep the institution functioning smoothly, it must be staffed by individuals with the appropriate skills and experience, in accordance with central bank law. Staff hopes that the process of parliamentary confirmation for its vacant senior positions, as well as the remaining non-executive members of its governing council will be completed expeditiously.

34. Structural policies should aim to strengthen economic resilience and support higher-quality growth. The external position is substantially weaker than the level consistent with underlying economic fundamentals and desirable policy settings. Reducing external imbalances and boosting potential growth remain a priority. Tourism can be diversified into eco-friendly and

adventure segments, while overall reliance on it can be reduced by diversifying the economy. A well-organized strategy to enhance the predictability of the business climate would enhance Montenegro's attractiveness for small and medium sized businesses and larger foreign investors. This would reduce the current concentration of foreign investment in tourism, construction, and real estate, whilst raising growth without increasing debt.

35. The link between wage and productivity growth must be firmly re-established. In the wake of the *Europe Now* programs, future wage growth must be matched by productivity to preserve competitiveness and avoid wage-price spirals. Restraining the growth of the public wage bill is an important step in this direction, whereas policies to shorten working hours could adversely affect labor supply and employment costs.

36. Climate change has significant implications for Montenegro. The country needs to align its domestic carbon price to EU levels and expand its renewable energy capacity to maintain export competitiveness in the electricity sector. Support to households from likely higher energy costs must be targeted to the vulnerable. Appropriate investments in climate-resilient infrastructure can demonstrably reduce the costs of extreme climate events to which the country may be exposed.

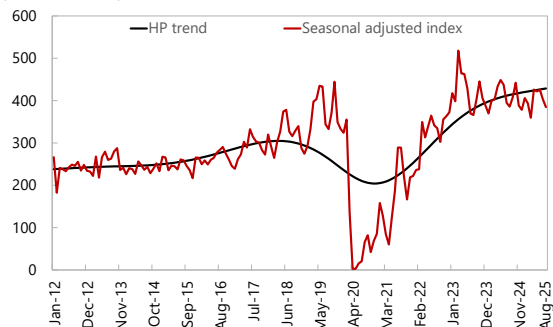
37. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Montenegro: Real Sector

The post-pandemic recovery in international tourism has begun to slow.

Montenegro: Foreign Overnight Stays

(Index, 2020=100)

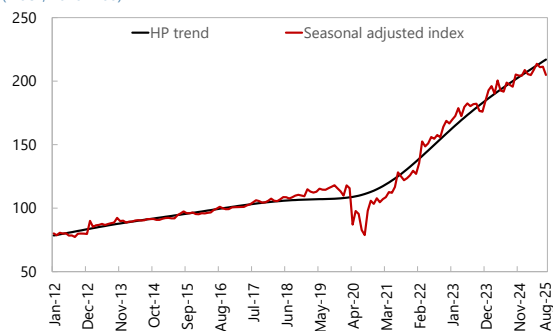


Sources: Haver Analytics and IMF staff calculations.

Retail trade remains on a robust trend, fueled by disposable income growth and the inflow of migrants.

Montenegro: Retail Trade

(Index, 2020=100)

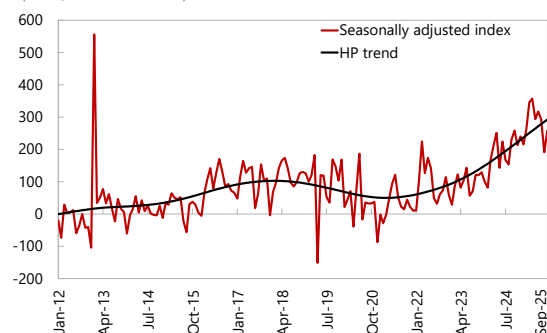


Sources: Haver Analytics and IMF staff calculations.

Bank lending to households continues to expand robustly in real terms...

Montenegro: New Credit to Households

(Index, deflated with CPI)

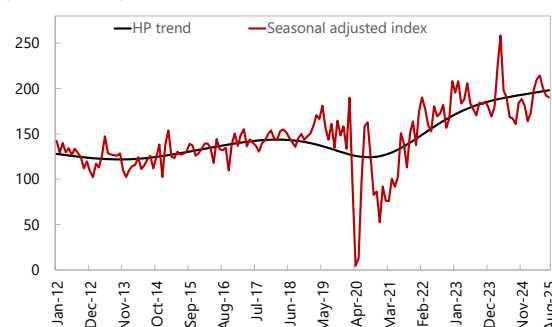


Sources: Haver Analytics and IMF staff calculations.

Domestic tourism has also followed a similar path of growth.

Montenegro: Domestic Overnight Stays

(Index, 2020=100)

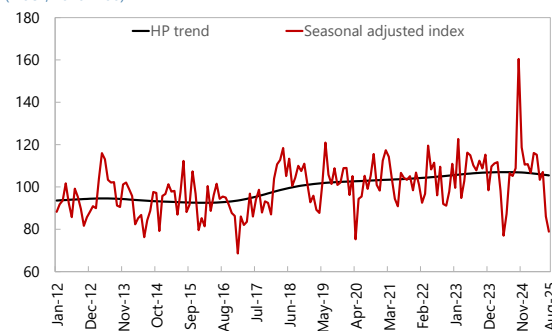


Sources: Haver Analytics and IMF staff calculations.

Industrial production continues to exhibit a volatile growth pattern, driven partly by weather-dependent hydro energy.

Montenegro: Industrial Production

(Index, 2020=100)

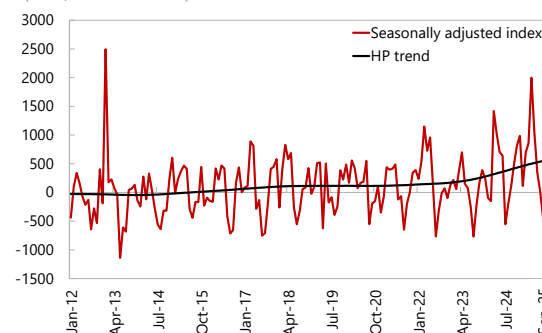


Sources: Haver Analytics and IMF staff calculations.

...and new credit to the corporate sector is likewise expanding swiftly.

Montenegro: New Credit to Corporates

(Index, deflated with CPI)



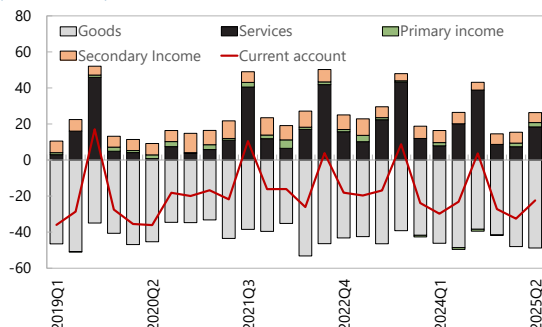
Sources: Haver Analytics and IMF staff calculations.

Figure 2. Montenegro: External Sector

The current account deficit has widened away from the historical norm...

Montenegro: Current Account Balance

(Percent of GDP)

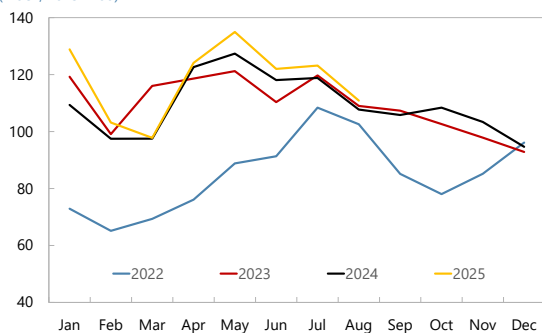


Source: Central Bank of Montenegro.

Tourist arrivals in 2025 so far have remained broadly in line with historical trends...

Montenegro: Tourist Arrivals

(Index, 2019=100)

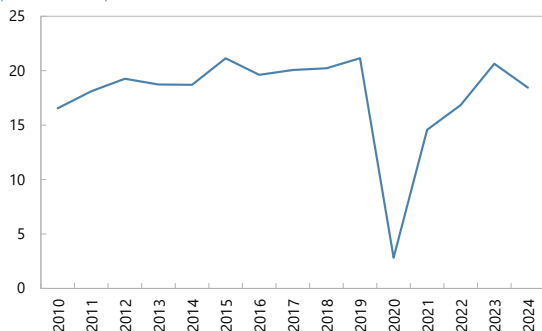


Sources: Haver Analytics and IMF staff calculations.

Tourism continues to support Montenegro's economy, albeit with slower momentum.

Montenegro: Net Export of Travel Services

(Percent of GDP)

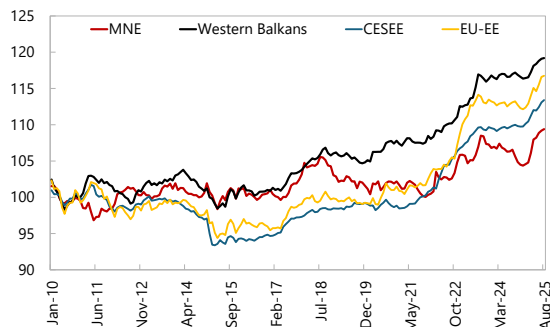


Sources: Haver Analytics and IMF staff calculations.

...because of an overvalued real exchange rate and booming domestic demand

Real Effective Exchange Rate with Peers

(Index, 2010=100)

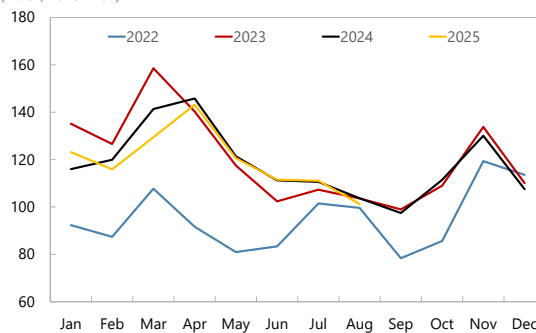


Sources: IMF INS database and IMF staff calculations.

...but overnight stays in 2025 are below the level observed in previous years.

Montenegro: Overnight Stays

(Index, 2019=100)

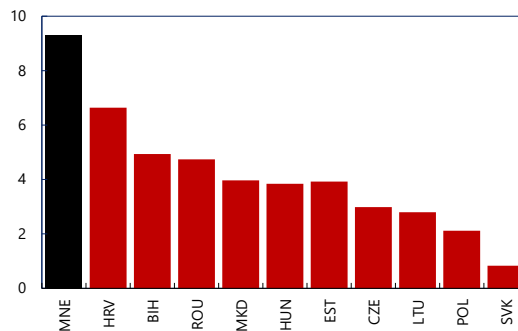


Sources: Haver Analytics and IMF staff calculations.

With tourism accounting for a large portion of jobs, Montenegro remains susceptible to sector-specific shocks.

CESEE: Employment in Accommodation and Food Services

(Percent of total employment in 2024)



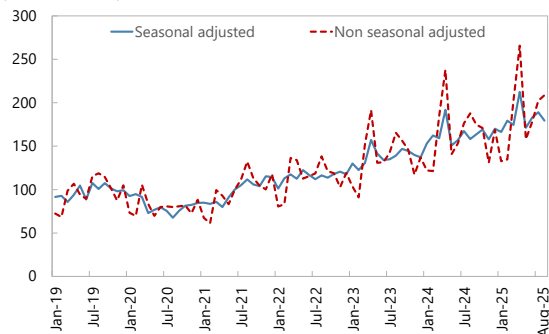
Sources: Haver Analytics and IMF staff calculations.

Figure 3. Montenegro: Fiscal Sector

Despite the cut in social security contributions, robust domestic demand continues to fuel strong tax revenues.

Montenegro: Central Government Tax Revenue

(Millions of Euros)

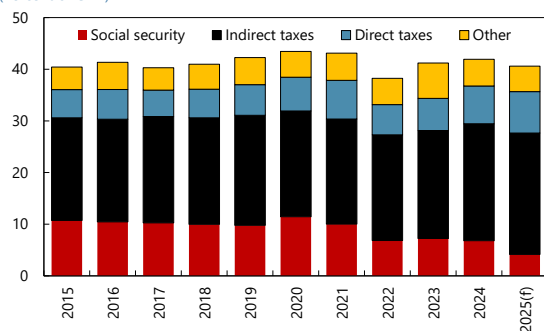


Sources: Haver Analytics and IMF staff calculations.

Indirect taxes have helped cushion the drop in social security contributions as a percentage of GDP.

Montenegro: Composition of Government Revenue

(Percent of GDP)

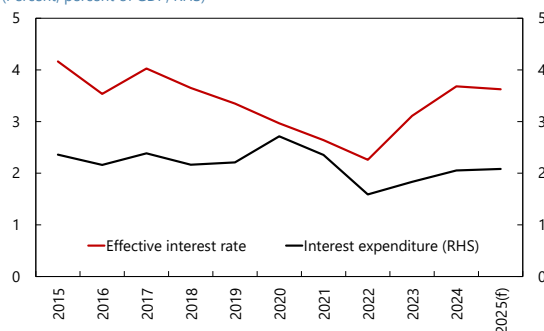


Source: IMF staff calculations.

With interest rates higher than historical norms, interest expenditures are beginning to rise.

Montenegro: Effective Interest Rate and Expenditure

(Percent; percent of GDP, RHS)

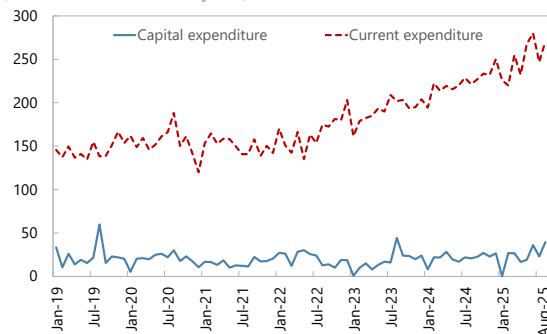


Source: IMF staff calculations.

The pace of current expenditure growth has outstripped that of capital investment in recent years.

Montenegro: Central Government Expenditure

(Millions of Euros; seasonal adjusted)

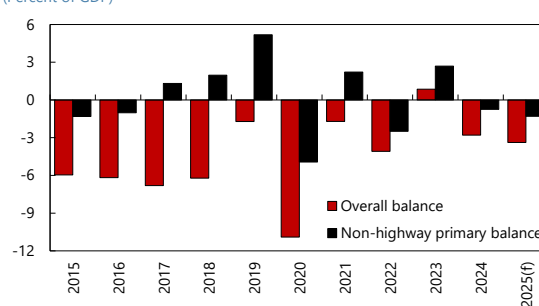


Sources: Haver Analytics and IMF staff calculations.

The fiscal stance has been marked by volatility, with the overall deficit continuing to expand.

Montenegro: Overall Fiscal Balance and Non-Highway Primary Balance

(Percent of GDP)

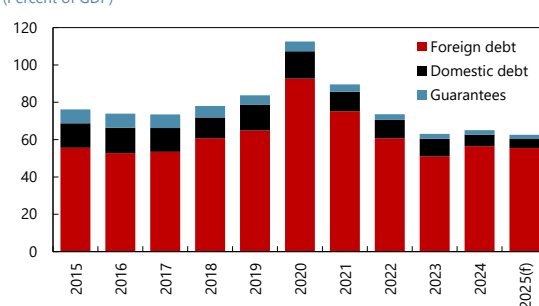


Source: IMF staff calculations.

The public debt-to-GDP ratio has fallen by 45 percentage points since the pandemic, but it is projected to rise again.

Montenegro: General Government Debt Including Guarantees

(Percent of GDP)



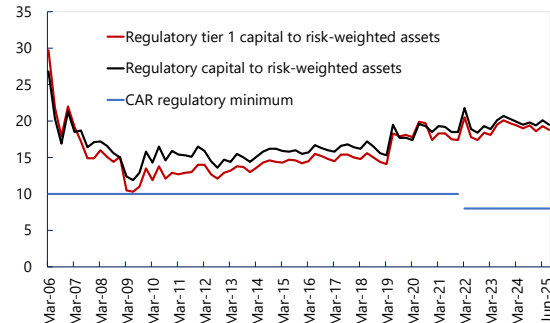
Source: IMF staff calculations.

Figure 4. Montenegro: Financial Sector

Capital buffers in the banking sector remain elevated and continue to reflect a healthy financial position.

Montenegro: Bank Capital

(Percent)

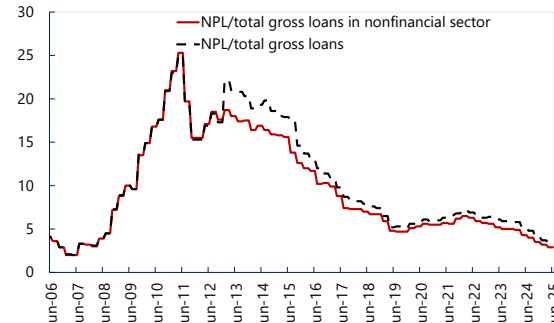


Sources: CBCG and Haver Analytics.

Asset quality remains sound with the NPL ratio falling close to record low levels.

Montenegro: Nonperforming Loans

(Percent)

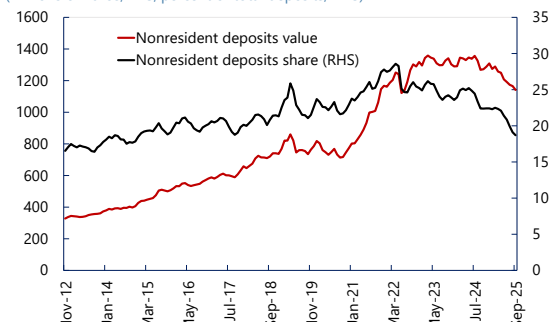


Sources: CBCG and Haver Analytics.

Nonresident deposits have eased from an elevated level

Montenegro: Nonresident Deposits

(Millions of Euros, LHS; percent of total deposits, RHS)

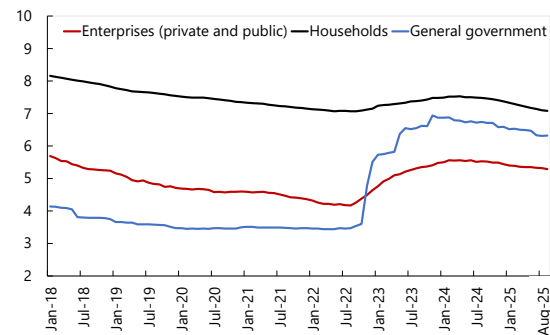


Sources: CBCG, Haver Analytics, and IMF staff calculations.

The lending rate to the government remains lower than that to households, but higher than the rate to firms.

Montenegro: Weighted Average Lending Rates of Banks

(Percent; outstanding amounts)

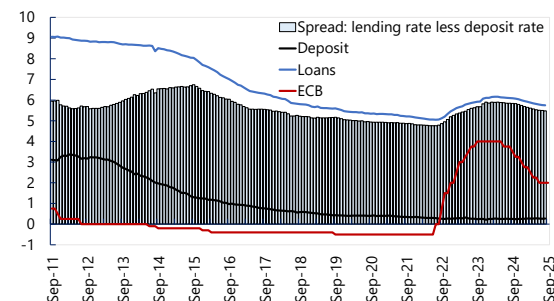


Source: CBCG.

Both average deposit and lending rates are declining, but the link with the ECB's monetary stance has been weak.

Montenegro: Bank Deposit and Lending Rates

(Percent)



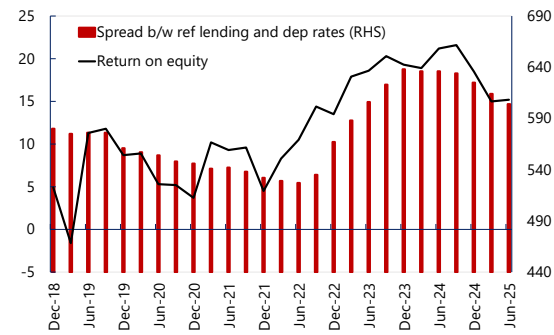
Sources: CBCG, Haver Analytics, and IMF staff calculations.

Note: Deposit rates refer to outstanding amounts.

The profitability of the banking sector has improved, largely due to the expansion of interest margins

Montenegro: Interest Rate Spread and Return on Equity

(Percent, LHS; basis points, RHS)

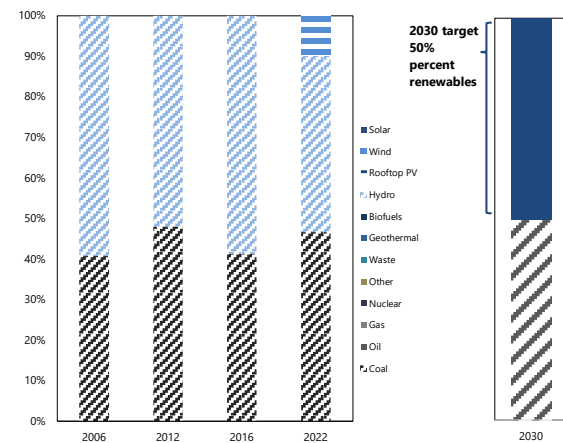


Sources: CBCG and Haver Analytics.

Figure 5. Montenegro: Climate Indicators

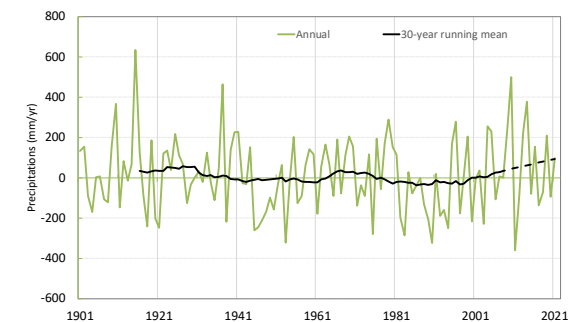
Montenegro aims to eliminate its dependence on coal by 2041

Montenegro: Electricity Generation Mix



Precipitation levels remain broadly unchanged

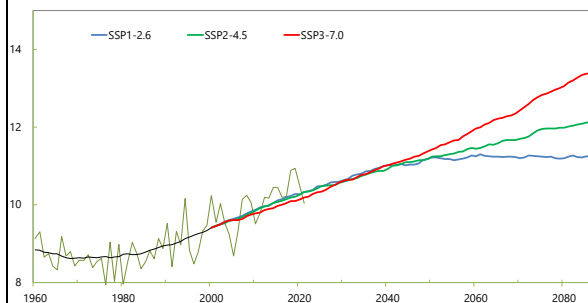
Montenegro: Total Annual Precipitations Anomaly (mm/year)



Source: FADCP Climate Dataset (v2).

However, the average temperature has risen and could rise to as high as 13 degrees centigrade by 2100 in an extreme scenario

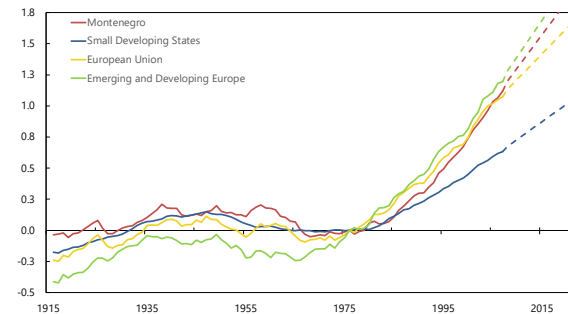
Montenegro: Historical and Simulated Annual Average Temperature (°C)



Source: FADCP Climate Dataset (v2).

Montenegro is more exposed to rising temperatures compared with other small developing states

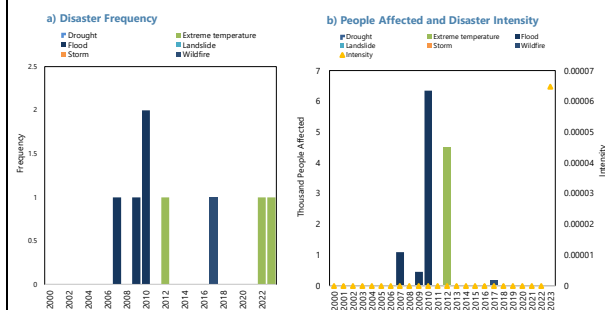
Montenegro: Temperature Anomalies Relative to 1961-1990 (°C)



Source: FADCP Climate Dataset (v2).

Montenegro is particularly exposed to wildfires and extreme temperatures

Montenegro: Key Natural Hazard Statistics

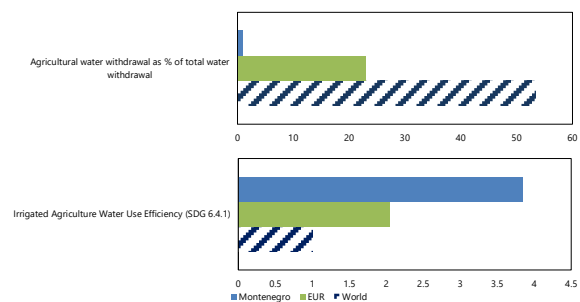


Sources: EMDAT and Staff calculations using Pondi and others (2023).

Note: Intensity is defined as (Total death+30% Total Affected)/Total population.

Water availability for agriculture is low, but efficiency is high compared with regional peers and the world average

Montenegro: Water Use Efficiency



Source: IMF staff estimates based on FAO Aquastat.

Table 1. Montenegro: Selected Economic Indicators, 2020–30
(Under current policies; percent of GDP, unless otherwise noted)

	2020	2021	2022	2023	2024	Projections					
						2025	2026	2027	2028	2029	2030
Real economy											
Nominal GDP (millions of €)	4,145	4,923	5,944	7,069	7,645	8,280	8,771	9,233	9,700	10,207	10,720
Gross national saving	3.8	16.2	14.7	14.3	8.8	7.6	8.5	8.6	8.6	9.0	9.4
Gross investment	30.1	25.5	27.6	25.4	25.9	25.7	25.5	25.1	24.5	24.5	24.4
Unemployment rate (percent)	17.9	16.6	14.7	13.1	11.4	...	...	...	...	...	...
	(percent change)										
Real GDP growth	-15.0	13.0	7.7	6.5	3.2	3.2	3.2	3.0	3.0	3.0	3.0
Tourism											
Foreign Arrivals	-86.0	342.9	31.1	20.2	0.0	...	...	...	...	...	...
Foreign Nights	-84.0	323.3	25.9	33.0	-5.0	...	...	...	...	...	...
Consumer price inflation (period average)	-0.3	2.4	13.0	8.6	3.3	4.0	2.4	2.2	2.0	2.0	2.0
Consumer price inflation (end of period)	-0.9	4.6	17.2	4.3	2.1	4.9	2.2	2.1	2.0	1.9	2.0
GDP deflator	-0.3	5.1	12.1	11.7	4.8	5.0	2.6	2.2	2.0	2.2	2.0
Average net wage	1.7	1.5	33.8	11.2	10.6	...	...	...	...	...	...
Money and credit (end of period)											
	(percent change)										
Bank credit to private sector	3.4	3.2	8.2	6.9	15.5	19.3	8.8	6.6	8.5	8.0	7.3
Enterprises	4.2	3.8	7.9	5.2	14.5	...	...	...	...	...	...
Households	2.9	2.7	8.4	8.2	16.3	...	...	...	...	...	...
Private sector deposits	-2.0	15.7	23.0	8.9	8.0	10.3	5.9	5.3	5.1	5.6	4.7
General government finances 1/											
Revenue and grants	44.0	43.7	38.1	40.7	40.7	40.2	40.6	40.6	40.7	40.7	40.7
Expenditure	54.9	45.1	42.2	40.4	44.1	43.8	44.3	44.5	44.6	44.9	45.0
Overall fiscal balance	-10.9	-1.4	-4.0	0.4	-3.4	-3.6	-3.7	-3.8	-3.9	-4.1	-4.3
Cyclically adjusted overall fiscal balance	-3.2	1.2	-3.7	-0.5	-4.2	-4.2	-4.1	-4.1	-4.1	-4.2	-4.3
Primary balance	-8.2	1.0	-2.5	2.2	-1.5	-1.5	-1.4	-1.5	-1.3	-1.6	-1.8
General government gross debt	108.4	86.2	70.3	59.6	60.8	60.8	61.5	61.7	62.3	63.3	64.9
General government gross debt (authorities' definition) 2/	106.5	84.6	69.0	58.5	59.7	59.9	60.6	60.9	61.5	62.5	64.2
General government debt, including loan guarantees	113.7	90.2	73.4	62.1	63.1	63.0	63.6	63.7	64.2	65.0	66.6
General government net debt, including guarantees 3/	92.0	79.6	70.6	59.6	56.3	54.8	55.3	56.4	57.5	58.7	60.2
General government net debt, excluding guarantees 3/	86.7	75.7	67.6	57.0	54.0	52.6	53.2	54.4	55.6	56.9	58.5
Balance of payments											
Current account balance	-26.3	-9.3	-12.9	-11.2	-17.1	-18.1	-17.0	-16.5	-16.0	-15.5	-15.0
Foreign direct investment, net	11.4	11.8	13.2	6.1	6.4	6.9	7.4	7.4	7.4	7.4	7.4
External debt (end of period, stock)	223.5	193.5	158.1	128.2	126.6	142.0	149.9	156.8	163.2	168.9	174.6
REER (CPI-based; y-o-y avg. change, in percent) 4/	-0.5	-0.5	1.7	3.5	-0.4	...	...	...	...	...	...
Memorandum:											
GDP per capita (USD)	7,549	9,322	10,046	12,262	13,259	...	...	...	...	...	...
Nominal GDP Growth (in percent)	-15.4	18.8	20.7	18.9	8.1	8.3	5.9	5.3	5.1	5.2	5.0
Real output gap (percent of potential GDP)	-13.2	-4.9	-0.9	2.0	1.6	1.3	1.0	0.7	0.4	0.2	0.0
Gross international reserves in millions of USD	2,116	1,977	2,026	1,553	1,748	2,132	2,184	2,125	2,084	2,082	2,129

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 government deposits

4/ A negative sign indicates depreciation a REER depreciation.

Table 2a. Montenegro: Savings and Investment Balances, 2020–30
(Under current policies; percent of GDP, unless otherwise noted)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Projections										
Gross national savings	3.8	16.2	14.7	14.3	8.8	7.6	8.5	8.6	8.6	9.0	9.4
Non-government	9.4	13.9	14.2	10.7	8.4	7.5	8.2	8.5	8.7	9.2	9.7
Government	-5.6	2.3	0.5	3.6	0.4	0.1	0.3	0.1	-0.2	-0.3	-0.4
Gross domestic investment	30.1	25.5	27.6	25.4	25.9	25.7	25.5	25.1	24.5	24.5	24.4
Non-government	22.5	19.7	21.6	20.7	20.3	20.1	19.6	19.1	18.5	18.3	18.1
Government	7.6	5.7	5.9	4.8	5.6	5.6	5.9	6.0	6.0	6.2	6.3
Savings - investment balance	-26.3	-9.3	-12.9	-11.2	-17.1	-18.1	-17.0	-16.5	-16.0	-15.5	-15.0
Non-government	-13.1	-5.8	-7.4	-10.0	-12.0	-12.6	-11.4	-10.6	-9.8	-9.0	-8.4
Government	-13.2	-3.5	-5.5	-1.2	-5.1	-5.5	-5.6	-5.9	-6.2	-6.5	-6.7
Current account balance	-26.3	-9.3	-12.9	-11.2	-17.1	-18.1	-17.0	-16.5	-16.0	-15.5	-15.0
Foreign direct investment (net)	11.4	11.8	13.2	6.1	6.4	6.9	7.4	7.4	7.4	7.4	7.4
External debt	223.5	193.5	158.1	128.2	126.6	142.0	149.9	156.8	163.2	168.9	174.6
Consumption	105.3	94.0	95.2	92.9	96.6	98.9	98.1	97.9	98.0	97.5	97.1
Non-government	80.1	72.6	75.8	73.6	77.5	81.8	81.0	81.0	81.2	80.7	80.4
Government	23.7	20.0	18.1	17.9	17.6	17.1	17.0	17.0	16.8	16.8	16.7

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

Table 2b. Montenegro: Contribution to Real Gross Domestic Product, 2020–30
(Contribution to real GDP growth)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Projections										
Gross domestic product	-15.0	13.0	7.7	6.5	3.2	3.2	3.2	3.0	3.0	3.0	3.0
Consumption	-4.3	5.3	13.8	7.9	10.5	20.2	2.4	2.4	2.7	2.0	1.7
Government	0.0	-0.5	0.4	0.5	0.6	0.2	0.5	0.5	0.4	0.6	0.4
Private	-4.3	5.8	13.4	7.3	9.9	20.0	1.9	1.9	2.3	1.4	1.3
Investment	-3.0	-9.4	-2.3	-0.2	0.9	-8.9	1.7	1.3	0.9	1.7	1.6
Gross fixed capital formation	-4.5	-5.1	0.3	3.3	1.5	-0.7	1.5	0.8	0.5	1.3	1.1
Government	-2.8	-1.1	0.7	-0.9	1.2	0.4	0.8	0.4	0.2	0.5	0.4
Private	-1.8	-4.0	-0.5	4.1	0.4	-1.1	0.7	0.4	0.2	0.7	0.8
Changes in inventories	1.5	-4.2	-2.6	-3.5	-0.6	-8.1	0.2	0.5	0.5	0.4	0.5
Net Exports	-7.8	17.1	-3.8	-1.2	-8.3	-8.2	-0.9	-0.7	-0.6	-0.7	-0.3
Exports	-25.1	26.0	16.1	5.2	-4.0	-0.7	2.4	0.8	0.7	0.6	0.6
Goods	-1.5	2.3	4.1	-1.5	-1.5	-0.9	1.9	0.5	0.3	0.3	0.3
Services	-23.7	23.7	12.0	6.6	-2.5	0.2	0.5	0.3	0.4	0.3	0.3
Imports	17.4	-8.9	-19.9	-6.3	-4.3	-7.4	-3.4	-1.5	-1.3	-1.3	-0.9
Goods	12.4	-5.0	-12.9	-5.2	-4.3	-6.3	-2.7	-1.0	-0.9	-0.9	-0.5
Services	5.0	-3.9	-7.0	-1.1	0.0	-1.2	-0.7	-0.4	-0.4	-0.4	-0.4

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

Table 3a. Montenegro: Consolidated General Government Fiscal Operations, 2020–30 1/
(Millions of euros, GFSM2014)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Projections										
1. Revenue	1,817	2,138	2,265	2,880	3,109	3,329	3,559	3,752	3,952	4,158	4,367
Taxes	1,128	1,379	1,558	1,890	2,220	2,550	2,701	2,849	3,003	3,160	3,319
Personal income tax	168	185	137	151	191	237	251	269	282	297	312
Corporate income tax	78	75	90	151	214	247	261	275	299	315	331
Property taxes	72	101	107	118	122	132	140	147	155	163	171
Value added tax	530	692	908	1,059	1,223	1,389	1,472	1,549	1,627	1,713	1,799
Excises	205	249	246	323	369	414	439	462	485	511	536
Taxes on international trade	23	28	40	52	60	65	69	73	77	81	85
Local government taxes	42	38	17	22	27	29	31	32	34	36	38
Other taxes	10	11	12	14	15	37	39	41	43	45	47
Social security contributions 2/	480	497	406	514	505	374	394	414	435	458	481
Nontax revenues	144	212	214	354	279	291	341	359	377	397	417
Grants	65	50	87	123	105	114	123	130	136	144	151
2. Expense	1,958	1,935	2,153	2,515	2,945	3,164	3,363	3,553	3,746	3,946	4,154
Gross salaries and other personal income	566	603	623	739	781	856	907	955	1,003	1,055	1,110
Use of goods and services	172	152	167	188	200	215	227	239	247	265	279
Interest payments	114	117	94	128	152	176	196	214	245	258	272
Subsidies to enterprises	38	52	73	79	95	99	105	110	116	122	123
Other current outflows	55	45	71	63	100	108	113	119	120	126	128
Social security transfers	559	568	668	825	1,013	1,096	1,165	1,231	1,297	1,365	1,450
Other transfers	335	317	428	469	546	589	624	656	688	723	759
Repayment of guarantees	0	8	1	3	6	0	0	0	0	0	0
Reserves	119	74	28	21	53	25	27	29	30	32	33
3. Gross operating balance (= 1 - 2)	-141	203	113	365	163	165	196	199	205	212	214
4. Net acquisition of nonfinancial assets	307	267	353	337	426	463	518	554	581	632	675
Capital revenue	-8	-15	0	0	0	0	0	0	0	0	0
Capital expenditure	315	282	353	337	426	463	518	554	581	632	675
5. Net lending (+) / borrowing (-) (= 3 - 4)	-448	-64	-241	28	-263	-298	-322	-355	-376	-420	-462
6. Net acquisition of financial assets	232	-339	-324	113	434	165	49	-39	-25	8	49
Domestic	232	-339	-324	113	434	165	49	-39	-25	8	49
Currency and deposits	247	-331	-327	119	441	182	68	-21	-6	26	68
Loans	5	4	0	1	0	0	0	0	0	0	0
Equity and investment fund shares	-19	-12	2	-7	-8	-18	-18	-18	-18	-18	-18
7. Net incurrence of liabilities	706	-130	-59	20	493	454	361	305	340	416	498
Domestic	-69	105	82	89	-110	131	-12	-28	-78	8	-10
Foreign	775	-235	-140	-69	603	324	373	332	417	408	508
Memorandum items:											
Primary balance	-334	53	-146	155	-110	-123	-126	-140	-131	-162	-190
Current balance	-206	153	25	242	59	51	73	69	69	68	63
Nominal general government debt	4,493	4,243	4,180	4,211	4,645	5,034	5,396	5,701	6,042	6,458	6,956
Nominal gen. gov. debt, with guarantees	4,712	4,438	4,361	4,392	4,826	5,215	5,577	5,883	6,223	6,639	7,138
Nominal GDP	4,145	4,923	5,944	7,069	7,645	8,280	8,771	9,233	9,700	10,207	10,720

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 General Government Fiscal Operations, 2020–30 1/
(In percent of GDP, GFSM2014)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Projections										
1. Revenue	43.8	43.4	38.1	40.7	40.7	40.2	40.6	40.6	40.7	40.7	40.7
Taxes	27.2	28.0	26.2	26.7	29.0	30.8	30.8	30.9	31.0	31.0	31.0
Personal income tax	4.1	3.7	2.3	2.1	2.5	2.9	2.9	2.9	2.9	2.9	2.9
Corporate income tax	1.9	1.5	1.5	2.1	2.8	3.0	3.0	3.0	3.1	3.1	3.1
Property taxes	1.7	2.0	1.8	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Value added tax	12.8	14.1	15.3	15.0	16.0	16.8	16.8	16.8	16.8	16.8	16.8
Excises	5.0	5.1	4.1	4.6	4.8	5.0	5.0	5.0	5.0	5.0	5.0
Taxes on international trade	0.5	0.6	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Local government taxes	1.0	0.8	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	0.2	0.2	0.2	0.2	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Social security contributions 2/	11.6	10.1	6.8	7.3	6.6	4.5	4.5	4.5	4.5	4.5	4.5
Nontax revenues	3.5	4.3	3.6	5.0	3.6	3.5	3.9	3.9	3.9	3.9	3.9
Grants	1.6	1.0	1.5	1.7	1.4	1.4	1.4	1.4	1.4	1.4	1.4
2. Expense	47.2	39.3	36.2	35.6	38.5	38.2	38.3	38.5	38.6	38.7	38.7
Gross salaries and other personal income	13.7	12.2	10.5	10.5	10.2	10.3	10.3	10.3	10.3	10.3	10.4
Use of goods and services	4.1	3.1	2.8	2.7	2.6	2.6	2.6	2.6	2.5	2.6	2.6
Interest payments	2.7	2.4	1.6	1.8	2.0	2.1	2.2	2.3	2.5	2.5	2.5
Subsidies to enterprises	0.9	1.1	1.2	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.1
Other current outflows	1.3	0.9	1.2	0.9	1.3	1.3	1.3	1.3	1.2	1.2	1.2
Social security transfers	13.5	11.5	11.2	11.7	13.2	13.2	13.3	13.3	13.4	13.4	13.5
Other transfers	8.1	6.4	7.2	6.6	7.1	7.1	7.1	7.1	7.1	7.1	7.1
Repayment of guarantees	0.0	0.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserves	2.9	1.5	0.5	0.3	0.7	0.3	0.3	0.3	0.3	0.3	0.3
3. Gross operating balance (= 1 - 2)	-3.4	4.1	1.9	5.2	2.1	2.0	2.2	2.2	2.1	2.1	2.0
4. Net acquisition of nonfinancial assets	7.4	5.4	5.9	4.8	5.6	5.6	5.9	6.0	6.0	6.2	6.3
Capital revenue	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	7.6	5.7	5.9	4.8	5.6	5.6	5.9	6.0	6.0	6.2	6.3
5. Net lending (+) / borrowing (-) (= 3 - 4)	-10.8	-1.3	-4.0	0.4	-3.4	-3.6	-3.7	-3.8	-3.9	-4.1	-4.3
6. Net acquisition of financial assets	5.6	-6.9	-5.5	1.6	5.7	2.0	0.6	-0.4	-0.3	0.1	0.5
Domestic	5.6	-6.9	-5.5	1.6	5.7	2.0	0.6	-0.4	-0.3	0.1	0.5
Currency and deposits	6.0	-6.7	-5.5	1.7	5.8	2.2	0.8	-0.2	-0.1	0.3	0.6
Loans	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	-0.5	-0.2	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
7. Net incurrence of liabilities	17.0	-2.6	-1.0	0.3	6.4	5.5	4.1	3.3	3.5	4.1	4.6
Domestic	-1.7	2.1	1.4	1.3	-1.4	1.6	-0.1	-0.3	-0.8	0.1	-0.1
Foreign	18.7	-4.8	-2.4	-1.0	7.9	3.9	4.3	3.6	4.3	4.0	4.7
Memorandum items:											
Primary balance	-8.1	1.1	-2.5	2.2	-1.4	-1.5	-1.4	-1.5	-1.3	-1.6	-1.8
Current balance	-5.0	3.1	0.4	3.4	0.8	0.6	0.8	0.8	0.7	0.7	0.6

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, 2020–30
(Millions of euros)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Projections										
I. Central Bank											
Net foreign assets	1637	1570	1733	1267	1544	1703	1749	1703	1670	1670	1712
Assets	1738	1749	1913	1424	1668	1827	1873	1827	1794	1794	1836
Liabilities	101	178	180	157	124	124	124	124	124	124	124
Net domestic assets	-1501	-1415	-1608	-1188	-1458	-1610	-1651	-1599	-1561	-1556	-1592
Net credit to the nonfinancial public sector	-845	-463	-109	-129	-158	-318	-363	-317	-285	-285	-326
Of which: general government	-845	-463	-109	-129	-158	-318	-363	-317	-285	-285	-326
Net credit to the banking system	-689	-985	-1533	-985	-1226	-1219	-1213	-1208	-1203	-1197	-1191
Required reserves	-179	-217	-263	-291	-308	-340	-360	-380	-399	-421	-441
Giro account	-509	-769	-1270	-694	-918	-879	-853	-829	-805	-777	-751
Claims on depository institutions	-1	1	1	1	1	1	1	1	1	1	1
Other assets net	32	34	33	-74	-74	-74	-74	-74	-74	-74	-74
Deposits included in broad money	56	78	95	11	12	13	14	15	15	16	17
Equity	80	78	30	68	74	80	85	89	94	98	103
II. Banking System											
Net foreign assets	-560	-537	-451	221	261	152	38	-81	-206	-336	-472
Assets	608	885	1,095	1,656	1,801	1,801	1,801	1,801	1,801	1,801	1,801
Liabilities	1,169	1,422	1,546	1,435	1,540	1,649	1,763	1,882	2,007	2,137	2,273
Net domestic assets	3,459	3,877	4,688	4,250	4,481	5,514	5,848	6,095	6,400	6,799	7,174
Net assets held in the central bank	685	981	1,523	979	970	1,219	1,214	1,209	1,203	1,198	1,192
Net credit to nonfinancial public sector	254	299	351	268	44	160	134	89	-7	-17	-45
Of which: general government	376	421	473	479	248	364	338	293	197	187	159
Credit to the private sector	2,511	2,591	2,804	2,997	3,462	4,130	4,495	4,793	5,198	5,613	6,022
Other domestic assets	11	9	13	13	13	9	5	5	5	5	5
Liabilities	2,893	3,340	4,237	4,471	4,585	5,666	5,886	6,014	6,194	6,463	6,703
Private sector deposits	2,211	2,559	3,149	3,430	3,704	4,086	4,328	4,557	4,787	5,056	5,295
Other items, net	682	781	1,088	1,042	881	1,581	1,557	1,457	1,407	1,407	1,407
o/w capital	589	606	675	820	891	1,065	1,106	1,130	1,164	1,214	1,259
III. Consolidated System											
Net foreign assets	1,077	1,033	1,282	1,488	1,805	1,855	1,787	1,621	1,464	1,334	1,240
Net domestic assets	1,960	2,462	3,080	3,062	3,023	3,904	4,197	4,496	4,839	5,244	5,583
Net credit to the nonfinancial public sector	-591	-164	243	139	-114	-157	-229	-228	-291	-301	-371
Of which: general government	-469	-43	365	350	90	46	-25	-24	-88	-98	-167
Credit to the private sector	2,511	2,591	2,804	2,997	3,462	4,130	4,495	4,793	5,198	5,613	6,022
Other net domestic assets	40	36	33	-73	-325	-68	-68	-68	-68	-68	-68
Liabilities	2,949	3,418	4,332	4,482	4,597	5,679	5,900	6,028	6,209	6,479	6,720
Equity capital of the central bank	80	78	30	68	74	80	85	89	94	98	103
IV. Ratios											
Net assets held in CBCG/Deposits	31.0	38.3	48.4	28.5	26.2	29.8	28.0	26.5	25.1	23.7	22.5
Effective required reserves ratio	8.1	8.5	8.4	8.5	8.3	8.3	8.3	8.3	8.3	8.3	8.3
Credit to private sector / GDP	60.6	52.6	47.2	42.4	45.3	49.9	51.2	51.9	53.6	55.0	56.2
Banks' capital / credit to private sector	23.5	23.4	24.1	27.4	25.7	25.8	24.6	23.6	22.4	21.6	20.9
CBCG reserves / bank deposits	78.6	68.3	60.8	41.5	45.0	44.7	43.3	40.1	37.5	35.5	34.7
Banks' foreign liabilities / credit to private sector	46.5	54.9	55.1	47.9	44.5	39.9	39.2	39.3	38.6	38.1	37.7
Memo item:											
Broad money	2,484.4	2,872.3	3,531.4	3,849.2	4,184.4	4,567.3	4,810.5	5,039.4	5,270.4	5,540.4	5,780.5
BM growth	-3.7	15.6	22.9	9.0	8.7	9.1	5.3	4.8	4.6	5.1	4.3

Sources: CBCG; and IMF staff estimates and projections.

Table 5. Montenegro: Balance of Payments, 2020–30
(Millions of euros)

	2020	2021	2022	2023	2024	Projections					
						2025	2026	2027	2028	2029	2030
	(Millions of euros)										
Current account balance	-1,090	-456	-766	-791	-1,307	-1,501	-1,491	-1,523	-1,550	-1,581	-1,612
Trade balance	-1,642	-1,915	-2,670	-2,986	-3,300	-3,607	-3,653	-3,745	-3,837	-3,931	-4,023
Exports	409	526	763	716	660	622	744	787	823	860	897
Imports	2,051	2,441	3,434	3,702	3,960	4,229	4,398	4,532	4,660	4,790	4,921
Services account	177	956	1,317	1,689	1,584	1,566	1,589	1,618	1,653	1,685	1,718
Receipts	679	1,597	2,289	2,764	2,684	2,750	2,830	2,911	2,997	3,082	3,170
Expenditures	503	641	972	1,075	1,101	1,183	1,242	1,293	1,343	1,397	1,451
Primary Income	67	102	119	67	-21	26	27	29	29	29	25
Compensation of employees, net	216	283	286	278	264	331	351	369	388	408	429
Investment income, net	-150	-180	-167	-211	-285	-305	-323	-341	-358	-379	-403
Secondary Income	308	401	469	438	431	513	546	575	604	636	668
Government, net	51	66	42	59	34	84	91	96	101	106	111
Other sectors, net	258	335	427	379	397	430	455	479	503	530	556
Capital account	0	0	0	0	-1	0	0	0	0	0	0
Financial account	-1367	-426	-830	-285	-1394	-1,660	-1,537	-1,476	-1,517	-1,581	-1,654
Foreign direct investment, net	-471	-582	-783	-434	-491	-571	-645	-680	-716	-753	-798
Portfolio investment, net	-394	548	175	446	-329	-29	340	358	376	146	-334
General government, net change in liabilities	424	-227	0	0	688	350	0	0	0	250	750
Eurobond	424	-227	0	0	688	350	0	0	0	250	750
Disbursements (increase in liabilities)	745	0	0	0	688	850	0	750	0	750	750
Amortization (reduction in liabilities)	-321	-227	0	0	0	-500	0	-750	0	-500	0
Derivatives, net	0	-4	-14	-66	-27	0	0	0	0	0	0
Other investment, net	-502	-388	-208	-231	-547	-1,060	-1,232	-1,154	-1,178	-974	-522
General government	-322	-19	174	110	66	26	-373	-332	-417	-158	242
Commercial banks	-69	-89	-10	319	-22	-109	-114	-119	-124	-130	-136
Other sectors	-111	-280	-371	-660	-591	-978	-744	-702	-636	-687	-628
Errors and omissions	98	38	101	23	156	0	0	0	0	0	0
Change in official reserves (+ denotes increase)	374	7	165	-483	243	159	46	-47	-32	0	42
Memorandum items	(Percent of GDP)										
Current account balance	-26.3	-9.3	-12.9	-11.2	-17.1	-18.1	-17.0	-16.5	-16.0	-15.5	-15.0
Trade balance	-39.6	-38.9	-44.9	-42.2	-43.2	-43.6	-41.7	-40.6	-39.6	-38.5	-37.5
Exports	9.9	10.7	12.8	10.1	8.6	7.5	8.5	8.5	8.5	8.4	8.4
Imports	49.5	49.6	57.8	52.4	51.8	51.1	50.1	49.1	48.0	46.9	45.9
Services account	4.3	19.4	22.2	23.9	20.7	18.9	18.1	17.5	17.0	16.5	16.0
Receipts	16.4	32.4	38.5	39.1	35.1	33.2	32.3	31.5	30.9	30.2	29.6
Payments	12.1	13.0	16.3	15.2	14.4	14.3	14.2	14.0	13.8	13.7	13.5
Income account	1.6	2.1	2.0	1.0	-0.3	0.3	0.3	0.3	0.3	0.3	0.2
Current transfers, net	7.4	8.1	7.9	6.2	5.6	6.2	6.2	6.2	6.2	6.2	6.2
Foreign direct investment, net	-11.4	-11.8	-13.2	-6.1	-6.4	-6.9	-7.4	-7.4	-7.4	-7.4	-7.4
Portfolio investment, net	-9.5	11.1	2.9	6.3	-4.3	-0.3	3.9	3.9	3.9	1.4	-3.1
Other investment, net	-12.1	-7.9	-3.5	-3.3	-7.2	-12.8	-14.0	-12.5	-12.1	-9.5	-4.9
General government	-7.8	-0.4	2.9	1.6	0.9	0.3	-4.3	-3.6	-4.3	-1.5	2.3
Other sectors	-2.7	-5.7	-6.2	-9.3	-7.7	-11.8	-8.5	-7.6	-6.6	-6.7	-5.9
Errors and omissions	2.4	0.8	1.7	0.3	2.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross external debt	223.5	193.5	158.1	128.2	126.6	142.0	149.9	156.8	163.2	168.9	174.6
of which: Government	92.5	74.9	60.5	50.4	54.8	53.7	55.0	55.8	57.5	58.6	60.5
Real goods import growth	-17.6	7.4	19.8	7.2	5.9	8.4	3.4	1.3	1.2	1.2	0.7
Real goods export growth	-11.4	17.3	29.7	-8.8	-10.3	-7.6	17.6	3.6	2.6	2.4	2.3
Real service export growth	-60.3	129.2	32.2	14.5	-5.1	0.4	1.1	0.8	0.9	0.8	0.8

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

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

Table 6. Montenegro: Financial Soundness Indicators of the Banking Sector, 2014–25
(In percent, unless otherwise indicated)

	2014 Dec	2015 Dec	2016 Dec	2017 Dec	2018 Dec	2019 Dec	2020 Dec	2021 Dec	2022 Dec	2023 Dec	2024 Dec	2025 Jun
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	20.3	19.4	19.5
Regulatory tier 1 capital as percent of risk weighted assets	14.4	14.2	14.8	15.0	14.4	18.1	17.4	17.4	18.4	19.7	18.6	18.8
Asset composition and quality												
Nonperforming loans in percent of gross loans	18.6	14.6	11.4	8.3	7.4	5.1	5.9	6.8	6.3	5.8	4.1	3.4
Nonperforming loans net of provision in percent of capital	68.9	52.5	38.3	28.9	21.0	14.9	21.2	22.6	21.4	18.4	11.2	8.7
Earnings and profitability												
Return on assets	0.8	-0.1	0.2	0.9	0.7	1.2	0.5	0.7	1.7	2.6	2.7	2.2
Return on equity	5.6	-0.9	1.2	6.9	4.9	8.7	3.7	4.5	13.5	19.3	18.5	15.2
Interest margin to gross income	60.2	58.5	58.3	54.5	56.1	56.6	60.8	55.6	54.0	55.9	57.6	60.7
Noninterest expenses to gross income	76.1	81.1	76.3	73.7	82.5	75.8	74.4	75.7	58.4	57.6	58.8	61.9
Liquidity												
Liquid assets to total assets	22.1	24.6	24.3	25.1	22.3	20.6	21.8	26.0	30.7	23.5	22.9	19.2
Liquid assets to short-term liabilities	66.8	87.0	51.4	49.2	35.4	31.1	35.1	39.7	42.9	32.2	31.1	26.8
Not open position in foreign exchange to capital	0.6	2.2	1.6	0.8	0.0	0.6	0.7	0.1	0.1	-0.3	0.3	0.5
Efficiency of operations												
Personnel expenses to noninterest expenses	41.1	37.3	39.0	37.8	32.3	36.9	35.0	30.2	37.3	31.7	30.7	32.9
Spread between reference lending and deposit rates (basis points)	736.0	730.0	652.0	612.0	580.0	561.0	546.0	532.0	567.0	638.0	625.0	604
Customer deposits to total (noninterbank) loans	110.1	123.0	126.6	131.9	123.1	116.1	108.3	131.0	151.9	147.2	136.5	119.6

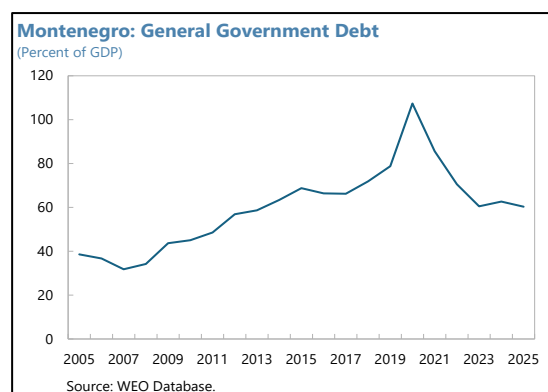
Source: CBCG

Annex I. Strengthening the Fiscal Policy Framework

Montenegro's fiscal policy framework can be usefully strengthened by (i) reinforcing the existing numerical rules in the current fiscal responsibility law by aiming for a balanced primary budget; (ii) clearly and narrowly specifying the exceptional circumstances under which the numerical targets can be held in abeyance; (iii) requiring more accountability to parliament regarding the duration for which these targets can be suspended; and (iv) operationalizing the independent fiscal council with a strong mandate from parliament and adequate resources to monitor that the fiscal responsibility law is fully and consistently observed in practice.

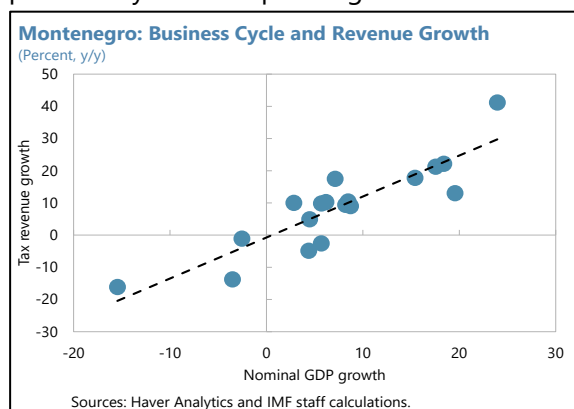
1. Montenegro's fiscal responsibility law has not been consistently observed in practice.

The Budget and Fiscal Responsibility Law, originally adopted in 2014 and amended in 2018 and 2023, establishes a set of numerical fiscal rules aimed at promoting long-term fiscal discipline. These include: (i) a ceiling on public debt at 60 percent of GDP; (ii) a limit on the general government deficit of 3 percent of GDP; and (iii) a cap on central government expenditure growth—excluding interest payments, donor-funded projects, and disaster-related spending—set at the rate of GDP growth. Additionally, current expenditure growth is restricted to the rate of real GDP growth, while capital expenditure is permitted to grow in line with nominal GDP. Despite the formal adoption of these rules, enforcement has not been adequate. While the law formally prescribes penalties for failing to meet fiscal targets, these sanctions are rarely enforced in practice. As a result, the general government budget deficit has surpassed the 3 percent threshold on multiple occasions, and public debt reached as high as 107.3 percent of GDP in 2020 (78.8 percent of GDP even before the pandemic).



2. The authorities are undertaking steps to enhance budgetary credibility, yet further efforts are needed.

Until recently, actual spending—particularly current spending—has often exceeded what was planned in the budget, while revenues have exceeded budgetary plans. Fiscal initiatives involving spending increases or revenue reductions have often not been accompanied by adequate offsetting measures, resulting in fiscal outcomes frequently becoming misaligned with the provisions of the fiscal responsibility law.¹ The authorities are committed to undertaking positive steps to enhance budget credibility including the formal publication of a medium-term fiscal



¹ Various Technical Assistance reports have identified improving medium-term budget credibility as a significant priority in Montenegro.

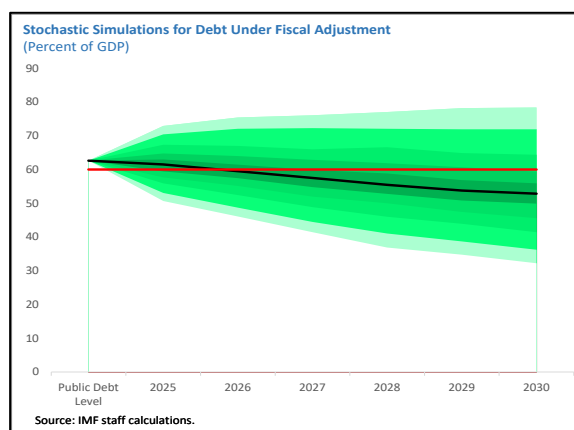
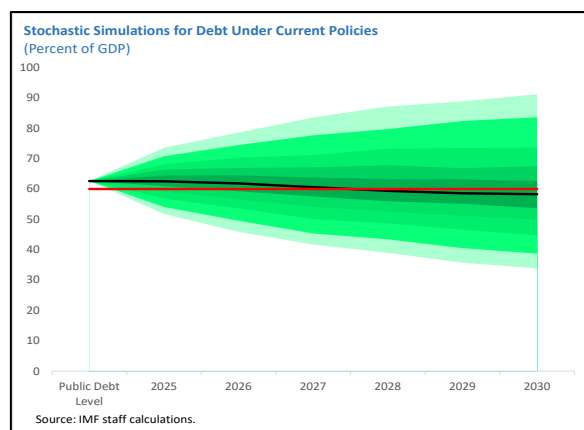
strategy, as well as articulating a fiscal risk statement. They are now using a balanced current budget as a guiding principle. These are encouraging first steps. However, a balanced current budget does not safely guarantee medium to long-term debt sustainability, nor does it necessarily ensure compliance with the Fiscal Responsibility Law.

3. While extensive research explores the concept of a “safe” debt level, there is no universally agreed threshold, as appropriate limits vary across countries and over time. Even accurately estimated thresholds can be rendered ineffective in the face of strong adverse shocks. The calibration of such a “safe” level of public debt can be achieved by assessing the probability that breaches might occur and setting the anchor to match a reasonable tolerance level for such risks. Key sources of uncertainty include future tax and spending decisions, as well as macroeconomic variables such as economic growth, demographic trends, and borrowing costs. Even under unchanged fiscal policy, these factors can shift the macro-financial environment, directly or indirectly affecting public finances. Given the potential for unexpected shocks, assessing a prudent debt level requires estimating the joint probability distribution of economic fundamentals and government debt.

4. A stochastic simulation can usefully indicate the likelihood of the debt trajectory under a wide range of macroeconomic conditions.² For stochastic simulations based on the joint distribution of key macroeconomic variables, the analysis draws on annual data from 2006 to 2024 to model the evolution of public debt in Montenegro. Each simulation projects macroeconomic variables over a medium-term horizon, incorporating shocks in each period. The impact of these shocks on public debt dynamics depends on the initial debt level—higher starting debt amplifies the effects of adverse shocks, such as declines in real GDP growth or shifts in interest and exchange rates. Debt trajectories are then derived from a system of simultaneous equations, grounded in the government’s budget constraint and a fiscal reaction function estimated over the same period.

5. The analysis examines the distribution of debt outcomes under alternative scenarios (baseline versus fiscal adjustment), drawing on the historical distribution of macroeconomic variables. The algorithm introduces numerous random shocks and computes the associated debt trajectories for each sequence. This approach depends on the robustness of the underlying statistical model and historical data covering the period 2006–24. The results are presented in a fan chart, which illustrates the uncertainty surrounding the baseline projection by displaying the 5th to 95th percentile range, with color gradients denoting varying likelihood levels. Assuming a maximum debt threshold of 60 percent of GDP and *the continuation of current policies*, the simulations over the next six years—starting from the end-2024 debt level and depicted in the left-hand panel—indicate a high probability of exceeding this threshold in the medium term. By contrast, stochastic simulations where *fiscal policy successfully targets a balanced primary budget*—demonstrate a substantial improvement. As shown in the right-hand panel, this strategy would reduce the probability of exceeding the debt target by about 40 percent by the end of the forecast horizon.

² The stochastic simulation model is described in the technical appendix.



6. More stringent provisions governing deviations from the Fiscal Responsibility Law, together with the establishment of an independent fiscal council to monitor compliance, are essential. The analysis shows that there is a risk of breaching the debt threshold even under a more conservative fiscal stance (i.e., a balanced primary budget), if an external shock encountered by the economy were to be very strong (as seen, for example, during the GFC or the pandemic). This highlights the importance of introducing well-defined escape clauses to the fiscal responsibility law, and including clear limits on their duration. The credibility of fiscal rules depends on the existence of predefined responses to such extraordinary shocks. Escape clauses should be guided by transparent criteria, subject to parliamentary approval, and complemented by automatic correction mechanisms that trigger fiscal adjustments once thresholds are breached. They must also specify a clearly articulated and time-bound path back to compliance. Without such built-in mechanisms, fiscal rules risk losing their intended disciplining effect. Accordingly, the Fiscal Responsibility Law should include robust enforcement provisions—such as mandatory public reporting to parliament—and establish a strict timeline for corrective action. An independent fiscal council would further enhance transparency, provide impartial macro-fiscal projections, and monitor adherence to fiscal rules. If granted a strong mandate and sufficient resources, such a council could significantly strengthen the credibility and effectiveness of Montenegro’s rule-based fiscal framework.

Technical Appendix. Stochastic Simulation Model

1. Projections of future government debt are inherently uncertain, influenced by both policy-related and exogenous factors. First, uncertainty surrounds future fiscal policy decisions. Second, even under the assumption of unchanged fiscal policies, macroeconomic uncertainty persists, owing to domestic and global developments. Key variables—such as economic growth, demographic trends, and borrowing costs—shape the macro-financial environment and significantly affect public debt dynamics. Given the susceptibility of this environment to external shocks, assessing a “safe level” of government debt requires estimating the joint probability distribution of macroeconomic fundamentals and debt outcomes.

2. The multivariate normal distribution of a k-dimensional vector of macroeconomic variables, including real GDP growth, the primary budget balance, interest rates, and the real effective exchange, can be written as:

$$x \sim N_k(\mu, \Sigma)$$

with the k-dimensional mean vector

$$\mu = (E[X_1], E[X_2], \dots, E[X_k])$$

and $k \times k$ covariance matrix

$$\Sigma = \left(\text{cov}(X_i, X_j) \right), \text{ for all } i=1,2, \dots, k; j=1,2, \dots, k$$

3. Subsequently, medium-term government debt trajectories consistent with each simulated path of macroeconomic variables are derived from a system of simultaneous equations. This system incorporates the debt accumulation equation—reflecting the government’s intertemporal budget constraint—and a fiscal reaction function, in which the primary balance responds to the level of public debt and macroeconomic conditions.

4. The simulation algorithm generates a large number of random shocks over the forecast period and computes the corresponding debt paths for each sequence. This enables a probabilistic assessment of debt sustainability. However, the reliability of this approach depends on the robustness of the underlying statistical model. To illustrate the uncertainty around the baseline projection, fan charts are used to display the distribution of outcomes, ranging from the 5th to the 95th percentile, with each color band representing a 5 percent probability interval.

Annex II. Impact of ‘Europe Now’ Programs on Envelope Wage and Employment

The two “Europe Now” programs (introduced in 2022, and 2024) were significantly motivated by the goals of reducing labor market informality (in the form of undeclared, or “envelope wages”) and increasing employment (by lowering the labor-tax wedge). Using monthly anonymized tax administration data, this annex attempts to analyze the impact of these policy initiatives on wage informality and employment. The evidence suggests that these initiatives have indeed successfully reduced the incentive for employers to formally understate the wages paid to workers. Available evidence also suggests a moderate but sizeable impact on employment. The specific sectors where employment growth is most evident are those closely tied to the uniquely favorable external conditions that prevailed between 2022–24.

1. Two Europe Now programs have been introduced in recent years, featuring prominent minimum wage increases and social security contribution cuts. The first Europe Now program (EN1), which came into effect in January 2022, raised the net minimum wage by 80 percent, eliminated health care contributions, and introduced progressive personal income tax and corporate income tax. The second Europe Now program (EN2), effective in October 2024, increased the net minimum wage further by 34 and 78 percent respectively for low- and high-skilled workers, and halved pension contributions.

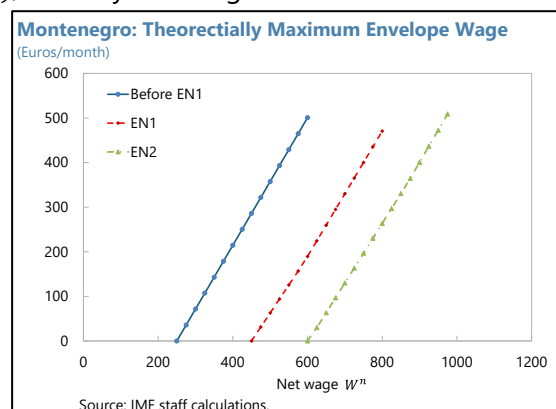
Annex II. Table 1. Key Elements of the Europe Now Programs		
Program	EN1	EN2
Effective Date	January 2022	October 2024
Key Policy Changes		
Minimum Wage Increases	€250/month to €450/month	€450/month to €600/month for low-skilled workers and to €800/month for high-skilled workers
Social Security Contribution Cuts	Elimination of the flat rate employee (8.5 percent) and employer (2.3 percent) healthcare contribution on earnings	Reduction of contributions for pension and disability insurance from 15 to 10 percent for employees and 5.5 to 0 percent for employers
Introduction of Progressive Tax	Introduction of a progressive personal income tax (PIT) and a progressive tax on corporate profits (CIT). PIT: 9 percent on earnings of €700–1,000 and 15 percent for earnings above €1,000. The existing regime has a flat rate of 9 percent with no allowance. CIT: 9 percent on profit below €100,000; 12 percent on €100,001–1,500,000; and 15 percent on above €1,500,000. The existing regime has a flat rate of 9 percent.	

2. These programs were significantly motivated by the goals of reducing wage informality and increasing employment. The underlying rationale, as noted by the authorities, was that a sharp reduction in the labor tax wedge would increase the incentives for employers to hire more workers, and reduce their incentive to understate formally reported wages of existing workers (by informally paying them separately in “envelopes”). Following the introduction of EN1, employment and wages did increase in 2022 and 2023. Encouraged by these initial responses, the authorities introduced EN2 in 2024. Still, it is noteworthy that these developments occurred when exceptionally favorable external conditions prevailed—including a sharp rebound in global tourism following the pandemic, and an influx of affluent migrants due to the war in Ukraine.

3. This annex attempts to shed light on the effects of these programs on “envelope wages” and employment. First, it presents the theoretically maximum envelope wage at various wage levels—these theoretical underpinnings are essential to ground the analysis because envelope wages are not directly observable. Next, using individual-level anonymized tax administration data, it employs two distinct approaches to develop estimates of the reduction in the envelope wage.¹ Finally, from a sectoral perspective and a spillover perspective, it estimates the change in employment that can be attributed to Europe Now programs.

A. Impact on Envelope Wage

4. In theory, the upper bound of the envelope wage depends on the minimum wage and is increasing in the net wage. In the presence of the envelope wage, an employee gets paid by an above-the-table official net wage, W^a , and a below-the-table envelope wage, W^b . The “above-the-table” official net wage, W^a , is typically smaller than the net wage that the employee would have otherwise received, W^n , based on individual productivity in the absence of the envelope wage. The cost to an employer includes the above-the-table official gross wage, $f(W^a)$, and the envelope wage, W^b . The scope for tax evasion is $f(W^n) - f(W^a)$, since by reducing the above-the-table official net wage, personal income tax and social security contributions can be evaded and used to pay the envelope wage. As a result, the maximum of the envelope wage is increasing in the net wage, W^n . The net minimum wage, W^m , sets a floor to W^a . As the minimum wage increases, the scope for tax evasion at a given level of net wage shrinks. The figure on the right maps out the maximum of the envelope wage at various “above-the-table” net wages.



5. In reality, however, the envelope wage is likely to plateau as the net wage increases. While the scope for tax evasion becomes larger at higher levels of net wage, exceedingly high

¹ A [recent ILO study](#) evaluated the impact of the EN1 reforms. It focuses on the impact on the distributional changes of official wages and employment but does not discuss the impact on wage informality. Furthermore, this analysis also covers the impact of EN2 to help provide a more comprehensive picture of the impacts of these policy initiatives.

envelope wages are more likely to draw the attention of the tax authorities and incur penalties. Additionally, high-paying jobs may be more concentrated in larger firms, which tend to be less involved in informal labor practices such as envelope wages. The relationship between the envelope wage and the officially paid net wage is therefore likely to flatten (or possibly even decline) as the above-the-table net wage increases pass a high enough threshold. The true size of the envelope wage is intrinsically “unobservable”, but its changes can be estimated empirically through the effects of large changes in minimum wages.

6. Two distinct empirical approaches are used to estimate the reduction in envelope wages.

- **The first** approach is a difference-in-differences approach. It differentiates wage earners into two groups— one wherein the prevalence of envelope wages is assessed, *ex-ante*, to be more likely than in the other. Such *ex-ante* separations can be done in various ways:
 - **Private vs. public sector wage.** The envelope wage is absent in the public sector while present in the private sector.
 - **Small and large firms.** Larger firms are less likely to engage in wage informality. Small firms are those whose number of employees is below 20 while large firms are those whose number of employees is above 50.
 - **Designation of sectors with envelope wage.** Based on the Statistical classification of economic activities in the European Community (NACE), 60 out of 84 two-digit sectors are designated as professions where employer incentives to underate wages may be higher. These are typically so-called “white collar” jobs, as opposed to so-called “blue collar” sectors such as basic retail and hospitality services, and construction.
- **The second approach** focuses on those that earn around/close to the minimum wage. As the wage distribution is highly concentrated around the minimum wage, the change in the wage of minimum wage workers is informative about the change in the envelope wage.
 - **Regression discontinuity around the new minimum wage.** When minimum wages increase, those workers with officially declared wages just below the new minimum wage before the increase, would be more directly affected relative to those who declared wages just above the new minimum wage. If both these kinds of workers were receiving envelope wages prior to the minimum wage increase, the group below the new minimum wage could see some of their envelope wages formalized, while there is no need from the employers’ perspective, from a purely legal standpoint, for the group above the new minimum wage to experience wage formalization since they are already paid above the new minimum wage. Therefore, the *differential* increase in their wages after the minimum wage increase comes into effect can be attributed to the reduction in the envelope wage. *This approach is likely to yield a lower bound of the reduction of the envelope wage*, given that workers who were paid above the new minimum envelope wage may have also been receiving envelope wages prior to the minimum wage increase.

- **Information revealed by those earning exactly at the minimum wage.** For workers who were officially earning exactly the old minimum wage, their new wage after the minimum wage increase reveals the extent of the reduction in the envelope wage. Following the minimum wage increase, If a worker is officially paid at *exactly* the new minimum wage, there are three cases: (i) for those whose productivity is below the old minimum wage, there is no envelope wage reduction; (ii) for those whose productivity is between the old and the new minimum wages, the reduction in envelope wages is smaller than the minimum wage increase; and (iii) for those whose productivity is above the new minimum wage, the envelope wage reduction is exactly the increase in the minimum wage. On the other hand, (iv) if the minimum wage hike results in a worker getting paid *above* the new minimum wage, it is likely he/she is now no longer receiving the envelope wage—the reduction in the envelope wage is therefore the difference between their new wage and the old minimum wage.

7. The reduction in the envelope wage was estimated to be modest for both EN1 and EN2, but large for certain groups.

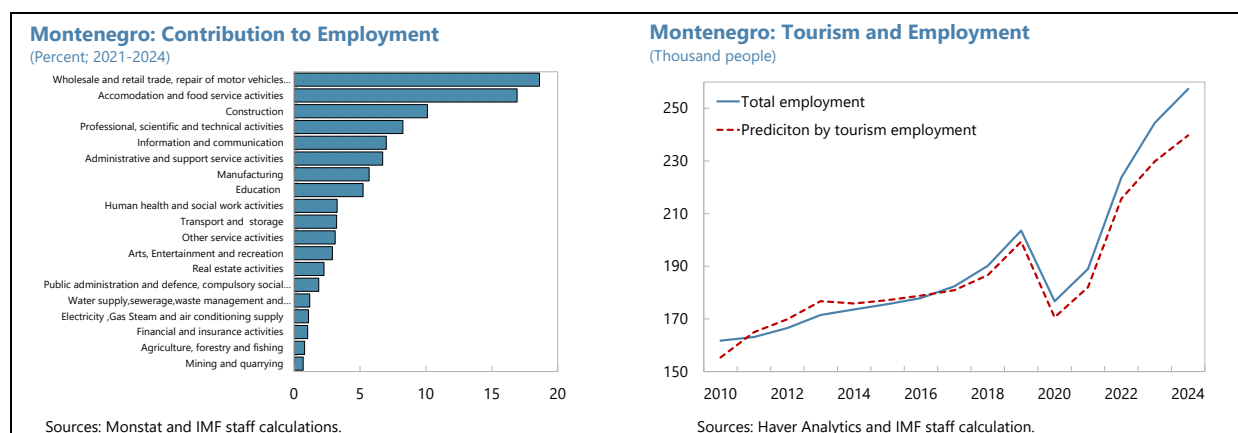
- Table 2 presents the results from the first approach (difference in differences) as well as the regression discontinuity approach. It shows that the reduction in the envelope wage is between €11–38 per month for EN1 on average and between €23–73 per month for EN2, based on different methods. *It is unsurprising that these average estimates of the reduction in the envelope wage appear modest*, because both these approaches rely on the comparison of two groups—if the envelope wage is reduced for both groups, only their differential is what is estimated. As such, they are likely to underestimate the reduction in the envelope wage. Nevertheless, they do help to set a *conceptual lower bound* for the reduction in envelope wages.
- Table 3 presents the results from tracking those who earned exactly at the old minimum wage, prior to the minimum wage increase. It shows that in both EN1 and EN2, the majority of old minimum wage earners are bunched at the new minimum wage after the increase in the minimum wages. For these workers, the *conceptual upper bound* of the reduction in the envelope wage is as large as the increase in the minimum wage (or up to €159 per month for EN1, and up to €138 per month for EN2) . For those who used to earn at the old minimum wage but are now paid above the new minimum wage (type IV), the reduction in the envelope wage is the largest (up to €217 per month for EN1 and €290 per month for EN2). These (type IV) workers account for 17 percent of the old minimum wage earners in EN1 and 23 percent in EN2.

Annex II. Table 2. Reduction of Envelope Wage Around the New Minimum Wage		
	EN1	EN2
Private vs. public	€38	€23
Small vs. large	€11	€24
Envelope wage sectors vs. others	€34	€73
Regression discontinuity	€25	€30

Annex II. Table 3. Reduction of Envelope Wage for Minimum Wage Earners				
Type of Min. Wage Earners	Type I	Type II	Type III	Type IV
Paid at the old min. wage (W^o) before the increase in min. wage	Yes	Yes	Yes	Yes
Paid at the new min. wage (W^n) after the increase in min. wage	Yes	Yes	Yes	No, paid above the new min. wage
Wage according to productivity (W^p)	$W^p < W^o$	$W^p \in [W^o, W^n]$	$W^p > W^n$	$W^p > W^n$
official wage increase	$W^n - W^o$	$W^n - W^o$	$W^n - W^o$	$W^p - W^o$
Reduction in envelope wage	0	$W^p - W^o$	$W^n - W^o$	$W^p - W^o$
EN1: Empirical Estimates				
Share of the type		83%		17%
Increase in gross wage (Dec 2021 to Jan 2022)	€159	€159	€159	€217
Reduction in envelope wage	€0	<€159	€159	€217
EN2: Empirical Estimates				
Share of the type		77%		23%
Increase in gross wage (Sep 2024 to Oct 2024)	€138	€138	€138	€290
Reduction in envelope wage	€0	<€138	€138	€290

B. Impact on Employment

8. The impact of Europe Now programs on employment is analyzed from a sectoral perspective and a spillover perspective. Other than the Europe Now programs, two factors have played an important role in driving up employment: the rebound of tourism and affluent migrants from Russia's war in Ukraine. Tourism directly impacts employment in accommodation and food service activities and indirectly impacts wholesale and retail trade. Affluent migrants mostly take jobs in sectors such as IT, professional activities, and education, and their consumption affects retail trade and the real estate market.



9. A purely sectoral approach suggests tourism and migration account for more than half of employment growth between 2022–24. Employment growth from 2021 to 2024 is added in the following five sectors: accommodation and food service activities, wholesale and retail trade, information and communication, professional activities, education, and real estate activities. *Together, they constitute 58 percent of total employment growth during this period.* However, employment growth in those sectors should have spillover effects on other sectors, making this a lower estimate than the actual impact of tourism and migration would be.

10. However, taking spillovers into account, favorable external factors explain at least 66 percent of employment growth over this period. As Montenegro's economy is heavily dependent on tourism, a close relationship exists between total employment and tourism employment. Between 2010–19, the elasticity between total employment and tourism employment is estimated to be 0.48, with a 95 percent confidence interval of [0.36, 0.61]. In other words, a 1 percent increase in tourism employment is associated with 0.48 percent of total employment increase. Since tourism employment grew by 56.6 percent from 2021 and 2024, the associated *predicted* increase in total employment increase would have been 27.1 percent based on this relationship, with a 95% confidence interval of [20.4, 34.5] percent. However, the *actual* total employment increase during this period was 30.9 percent. Taking the lower bound estimate of 20.4 percent, *the tourism rebound between 2021 and 2024 explains at least 66 percent of the observed total employment increase.*

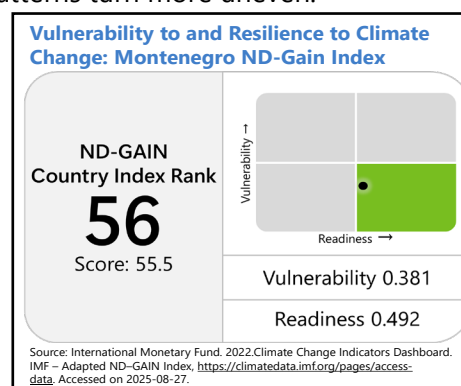
11. The implied employment impact of the Europe Now programs may be moderate, but is still sizeable. The sectoral accounting and the spillover analysis therefore suggest that roughly two thirds of the total employment increase was driven by tourism and migration. If the residual employment growth from the above approaches is entirely attributed to the Europe Now programs, the interpretation would be that the Europe Now programs could account for up to one third of employment growth between 2021 and 2024. There are uncertainties surrounding such quantitative estimates. Still, it can reasonably be inferred that the Europe Now programs account for a moderate but sizeable share of overall employment growth.

Annex III. Macro Fiscal Implications of Investing in Climate Change Adaptation Infrastructure in Montenegro¹

The IMF's Debt, Investment, Growth, and Natural Disaster (DIGNAD) model is used to assess Montenegro's vulnerability to climate change. Simulations from the model indicate that timely public investment in adaptive infrastructure could enhance Montenegro's resilience to climate-related shocks, benefiting both output growth and fiscal stability.

1. To protect Montenegro from extreme weather events, important public infrastructure investment choices need to be made. As Montenegro (MNE) is a mountainous country with over 60 percent of its land covered by forests, it faces several environmental challenges, including flooding, landslides, wildfires, and heatwaves. Exposure to climate-related extreme events are likely to increase over time as temperatures rise and precipitation patterns turn more uneven.

Montenegro is, however, relatively less exposed and better placed to adapt to the risks of climate change compared with other countries according to the IMF adapted ND-GAIN index, a measure of climate vulnerability. Even so, the World Bank estimates that Montenegro is required to spend on average 1.5–2.3 percent of GDP annually on infrastructure until 2050. Of this, 0.6 percentage points is estimated to be incremental, and that the required investment is front-loaded, at 0.9 percent of GDP until 2030.



2. An extreme weather event cannot be discounted and could result in large economic losses. Montenegro's economic structure, with tourism contributing approximately 30 percent of GDP, renders it particularly susceptible to climate-related shocks. Tourist activity is heavily concentrated along the coastal region during the summer months (June to September), amplifying the potential economic impact of seasonal disruptions. The possibility of low-frequency, high-impact occurrences—such as the wildfires experienced in Greece (2023) and Los Angeles (2025)—cannot be discounted. The World Bank estimates approximately 36 percent of Montenegro's forested areas are classified as being at 'very high' risk of wildfire. A severe wildfire coinciding with the peak tourist season could result in significant human and economic losses. To illustrate this risk, this annex presents a calibrated scenario in which a major wildfire disrupts tourism for one month during the summer season. Under this scenario, the estimated immediate output loss ranges between 7 and 8 percent of GDP. The medium-term macroeconomic consequences of such an extreme event are assessed using the IMF's DIGNAD model framework.

3. DIGNAD is a general equilibrium model designed to assess the impact of climate disasters and their investment implications for adaptation infrastructure. The model integrates the effects of climate-related shocks by quantifying damages to both public and private capital stocks, alongside temporary losses in productivity. It also accounts for reductions in the efficiency of

¹ The author would like to thank Azar Sultanov (RES) for helpful comments and feedback.

public investment and deteriorations in sovereign creditworthiness. Furthermore, the model evaluates the implications for debt sustainability and the potential benefits of proactive policy responses. These include the development of climate-resilient infrastructure, the strengthening of fiscal buffers, and enhancements in public investment management. The model comprises three interdependent analytical blocks, each capturing a distinct dimension of the macroeconomic transmission of climate shocks:

- **Private demand:** Comprises households that decide on the labor that they supply. They receive income for the labor that they supply. In addition, they may also receive remittances and government transfers. Regardless of whether households are liquidity constrained or savers, they consume domestic goods and imports.
- **Private supply:** Comprises tradable and non-tradable firms that choose the optimum level of capital and labor to maximize profits. Output also depends on total factor productivity which in turn depends on the stock of public infrastructure.
- **Policies:** Consists of various instruments employed by the government to fund both current and capital expenditures. This includes revenue generated from taxes, such as labor and consumption taxes, as well as different types of debt, including domestic, concessional, external commercial loans, and grants. The government plays a critical role in determining the level and type of public investments made, choosing between standard infrastructure and climate-resilient options.

4. The DIGNAD model distinguishes specifically between standard physical capital and climate-resilient capital. Standard capital is more susceptible to damage from natural disasters, whereas climate-resilient capital is designed to endure such shocks. This distinction allows the model to capture the differential economic impacts and policy trade-offs associated with each capital type. Standard capital is inherently more vulnerable to damage from natural disasters, whereas climate-resilient capital is specifically engineered to withstand such shocks. The latter is characterized by a lower depreciation rate and a higher rate of return, reflecting its enhanced durability and productivity. By minimizing the destruction of physical assets during extreme weather events, climate-resilient capital plays a critical role in mitigating output losses and strengthening economic resilience. However, the construction and maintenance of climate-resilient infrastructure entail higher upfront costs compared to standard capital, posing important trade-offs for policymakers in resource-constrained environments.

5. This analysis employs a scenario-based framework to assess the macroeconomic implications of alternative policy choices in the context of climate-related risks. *All scenarios assume that the government initiates a five-year public infrastructure investment program spanning 2025 to 2029, preceding the occurrence of a climate-induced natural disaster in 2030.* This setup enables a forward-looking evaluation of how different fiscal strategies and investment compositions influence economic resilience and recovery in the aftermath of a severe climate shock. The disaster shock is calibrated to induce a GDP contraction of 7–8 percent, consistent with a complete disruption of the tourism season for approximately one month during the peak summer period.

6. Two stylized fiscal response strategies are examined. In the first set of simulations, the government finances infrastructure investment through 2030 using domestic fiscal measures—namely, increased taxation and expenditure rationalization—without resorting to additional borrowing. In the second set, the government relies exclusively on commercial borrowing to fund both the infrastructure program and the fiscal gap that emerges following the disaster shock. These two scenarios represent “corner solutions” and are presented this way to bring the range of outcomes into clear relief. In reality, the government would be more likely to adopt an optimal fiscal mix that includes tax increases, spending cuts and new borrowing to fund the infrastructure spending and the post-shock fiscal gap. Within each of these two stylized fiscal responses, three investment variants are explored. The baseline scenario involves annual public investment of 0.9 percent of GDP in standard infrastructure from 2025 to 2029. The second scenario allocates the same investment envelope to climate-resilient infrastructure. The third scenario builds upon the second by incorporating measures to enhance public investment efficiency. These efficiency gains are assumed to stem from the implementation of recommendations outlined in the Climate-Public Investment Management Assessment (C-PIMA) technical assistance report. Key model parameters have been calibrated for Montenegro (Table 2).

Annex III. Table 1. Three Scenarios for Each of the Two Sets of Simulations ('No Borrowing' and 'With Borrowing')

Scenario 1	Scenario 2	Scenario 3
<ul style="list-style-type: none"> Standard Investment. Additional Investment of 0.9 percentage points of GDP in <i>standard</i> infrastructure from 2025 to 2029. 	<ul style="list-style-type: none"> Climate-resilient Investment. Additional Investment of 0.9 percentage points of GDP in <i>climate-resilient</i> infrastructure from 2025 to 2029. 	<ul style="list-style-type: none"> Climate-resilient + efficient public investment. Scenario 2 plus public investment efficiency (C-PIMA implemented).
<ul style="list-style-type: none"> A natural disaster occurs in 2030 as soon as the investment is completed. 		

Annex III. Table 2. Calibration of Key Parameters

Calibrated Parameters and Initial values (in percent)	
Definition	Value
Return to standard infrastructure	35.0
Return to adaptation infrastructure	45.0
Public investment to GDP ratio	5.7
Grants to GDP ratio	1.0
Consumption tax (VAT) rate	21.0
Labour income tax rate	9.0
Public domestic debt to GDP ratio	4.0
Public concessional debt to GDP ratio	10.0
Public external commercial debt to GDP ratio	46.0
Remittances to GDP ratio	10.7
Imports to GDP ratio	68.0
Real interest rate on public domestic debt	1.2
Real interest rate on public external commercial debt	2.0
Depreciation rate of standard public infrastructure	7.5
Depreciation rate of resilient public infrastructure	3.0
Public investment efficiency	41.0
Source: IMF staff calculations, Ministry of Finance	

7. Figure 1 illustrates that a climate disaster forces a stringent fiscal tightening, with significantly challenging macroeconomic effects. The government is compelled to raise taxes sharply and to lower spending to close the fiscal gap caused by the climate disaster particularly when the investment is directed towards standard infrastructure under a scenario where the government faces borrowing constraints. Our simulation results indicate that, in this scenario, consumption tax revenues must increase by 1.5 percentage points of GDP and income tax by 0.5 percentage points of GDP in 2031, compared with a scenario where the government invests in climate resilient infrastructure. In addition, current public expenditures must fall by 0.5 percentage points of GDP in 2031. GDP falls by an additional 4 percentage points in response to the climate disaster and the fiscal tightening when the investment is of standard quality. Investing in climate-resilient infrastructure and improving public investment efficiency—such as through measures recommended in the C-PIMA technical assistance report—not only results in smaller short-term GDP economic losses, it also effectively eliminates long term scarring effects on GDP

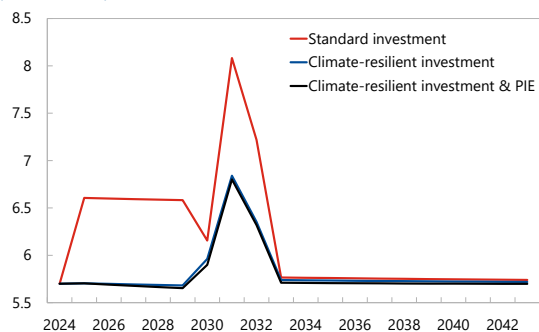
8. Figure 2 shows simulation results where the government is not borrowing-constrained. The macroeconomic trajectory of GDP in this scenario closely mirrors that of the no-borrowing case. However, *the simulations show that investing in climate-resilient infrastructure significantly mitigates the adverse effects of the climate shock and reduces long-term output scarring.* Moreover, the results underscore the positive contribution of enhanced public investment efficiency, consistent with findings from the no-borrowing simulations. Nonetheless, reliance on borrowing leads to a notable increase in public debt, ranging from 4 to 6 percentage points of GDP. The higher end of this range is associated with investments in standard infrastructure, reflecting its greater vulnerability to climate-related damage and lower returns relative to climate-resilient alternatives.

9. Climate risks are not restricted to the extreme events analyzed in this annex. Montenegro must also address the gradual, chronic impacts of climate change and the fiscal impact of mitigation efforts. Estimates from the IMF's Quantitative Climate Risk Assessment Fiscal Tool (Q-CRAFT) suggest that under extreme climate scenarios, the country could face long-run output losses of up to 8 percent of GDP and public debt surging to 180 percent of GDP by 2100. Even in more moderate scenarios, GDP losses and debt accumulation remain significant. Moreover, with 72 percent of Montenegro's energy currently sourced from fossil fuels and a heavy reliance on rain-dependent hydroelectric power, the costs of adapting infrastructure and transitioning to greener energy are substantial—potentially reaching 2.7 percent of GDP annually. These risks are amplified by external factors, such as the EU's Carbon Border Adjustment Mechanism, and underscore the need for Montenegro to build fiscal buffers, enhance analytical capacity, and incorporate long-term climate risk management into its fiscal planning.

Annex III. Figure 1. Macroeconomic Impact of Standard and Climate-Resilient Infrastructure Investment and Improvements to Public Investment Efficiency—'No Borrowing'

Public Infrastructure Investment

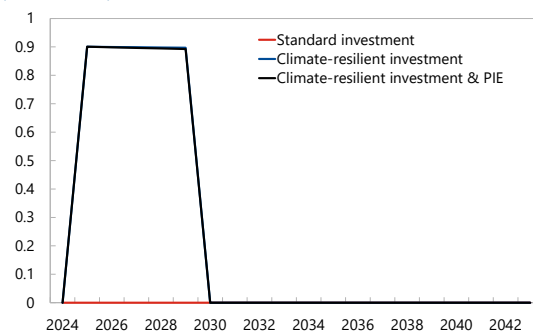
(Percent of GDP)



Source: IMF staff estimates.

Public Adaptation Investment

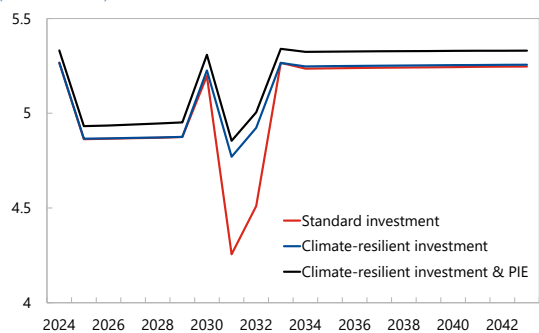
(Percent of GDP)



Source: IMF staff estimates.

Public Current Expenditures

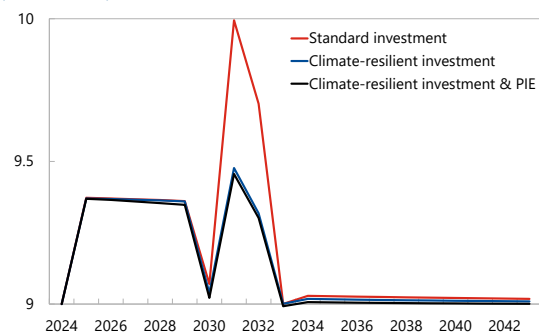
(Percent of GDP)



Source: IMF staff estimates.

Labor Income Tax

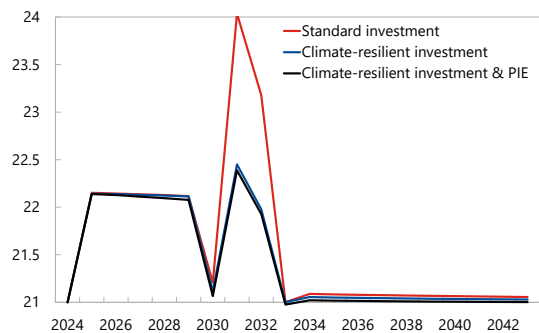
(Percent of GDP)



Source: IMF staff estimates.

Consumption Tax

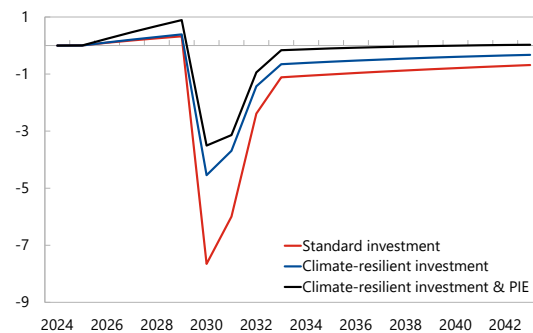
(Percent)



Source: IMF staff estimates.

Real GDP

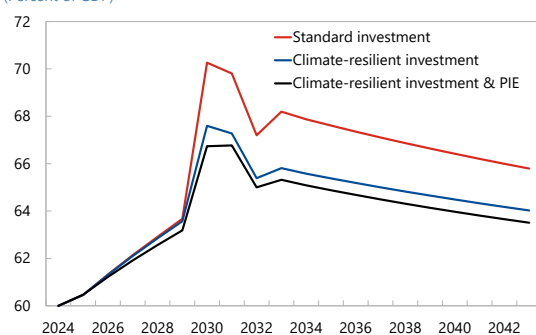
(Percent deviation from SS)



Source: IMF staff estimates.

Annex III. Figure 2. Macroeconomic Impact of Standard and Climate-Resilient Infrastructure Investment and Improvements to Public Investment Efficiency—‘With Borrowing’

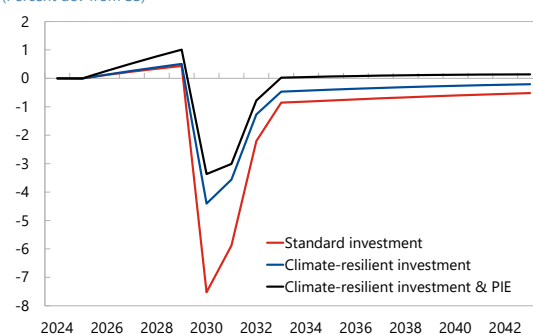
Total Public Debt
(Percent of GDP)



Source: IMF staff estimates.

Real GDP

(Percent dev from SS)



Source: IMF staff estimates.

Annex IV. Implementation of Past IMF Recommendations

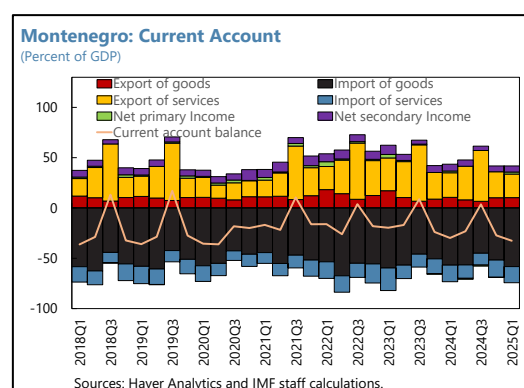
Key Recommendations	Status
Fiscal Policy	
Implement offsetting measures to close the fiscal gaps created by 'Europe Now'.	Some offsetting measures were introduced, but not adequate to cover the loss in revenues.
Replace the progressive CIT regime with a flat rate with a special SME regime.	Not implemented. 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, but it is yet to become operational.
Establish more robust investment management and PPP frameworks.	Progress has been made in line with IMF PIMA TA. C-PIMA recommendations need to be implemented.
Reform public sector employment and the pension system.	Both has stalled due to political constraints.
Review tax expenditures.	Authorities are in touch with FAD to identify suitable areas to eliminate.
Issue retail government bonds.	Authorities plan to have the inaugural issuance by end-2025.
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.	The shortcomings identified in the MONEYVAL report need to be addressed. This includes developing a risk-based AML supervision and enforcement framework.
Develop macroprudential indicators and modeling capability at CBCG to assess financial sector risks, and build a regulatory framework to implement BBM.	CBCG has been collecting data such as DTI, DSTI and LTV from banks. The data quality needs improvement. Technical assistance from the Austrian Central Bank is under consideration.
Structural Reforms	
Increase female labor force participation.	While parental policies are generous, the authorities can provide better childcare options.
For SOE sector reform, 'Montenegro Works' should be equipped with robust institutional and legal frameworks, and deep professional expertise.	'Montenegro Works' has not been operational.

Annex V. External Sector Assessment

Montenegro's external position in 2024 is assessed to be substantially weaker than the level consistent with underlying economic fundamentals and desirable policy settings, based on the IMF's EBA-lite model estimates and staff judgment. The current account deficit widened significantly in 2024 and is projected to remain elevated over the medium term. Addressing this imbalance will require a sustained policy effort, including maintaining fiscal discipline, prioritizing growth-enhancing capital expenditures, creating a business climate that diversifies sources of FDI, and advancing structural reforms to boost productivity. These measures are essential to strengthen external sustainability and reduce the economy's vulnerability to external shocks.

A. Current Account

1. The current account weakened significantly, as tourism plateaued and domestic demand remained strong. The current account deficit widened markedly from 11.2 percent of GDP in 2023 to 17.1 percent in 2024, reaching its highest level since the onset of the pandemic. While the tourism sector had fully rebounded by 2023, it experienced a loss of momentum in 2024, with foreign tourist arrivals plateauing and both overnight stays and tourism receipts declining. At the same time, robust domestic demand continued to drive strong import growth. Export performance weakened, reflecting declines in electricity, aluminum, and iron and steel exports—largely attributable to the underperformance of hydropower plants, maintenance-related outages at the Pljevlja thermal power plant, and the closure of the aluminum smelter. Looking ahead, the current account deficit is projected to remain elevated over the medium term, as the structural imbalance between domestic savings and investment persists.



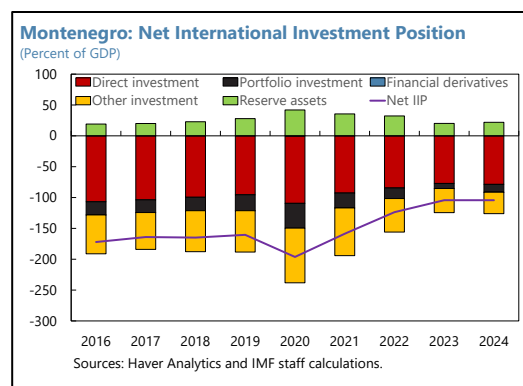
2. The deterioration in current account is partly a twin deficits problem. The substantial increase in the minimum wage under the "Europe Now" and "Europe Now 2" programs, coupled with reductions in healthcare and pension contributions, has not only weakened Montenegro's fiscal position but also contributed to a surge in domestic demand in recent years. While the share of consumption in GDP had been on a declining trajectory, this trend reversed following the pandemic. Reflecting this shift, imports have risen as a percentage of GDP, particularly in household consumption goods such as food, clothing, appliances, and vehicles—underscoring the strength of household demand since the launch of "Europe Now" in 2022. This pattern is indicative of a twin deficits dynamic, wherein simultaneous deterioration in the fiscal and current account balances has further entrenched structural saving-investment imbalances in the economy.

B. Financial Account

3. FDI inflows moderated, while portfolio and other investment flows played an increasingly important role in financing the widening current account deficit. Net FDI inflows declined from an average of 12.1 percent of GDP during 2020–22 to 6.1 percent in 2023 and 6.4 percent in 2024. Although FDI in the real estate sector remained resilient, investment in other sectors weakened, both in terms of equity participation and intra-company lending. As a result, the share of gross FDI directed toward real estate rose to 51 percent in 2024, indicating a growing sectoral concentration. Portfolio investment, supported by the issuance of a Eurobond, amounted to 4.3 percent of GDP and financed approximately 25 percent of the current account deficit. Other investment—primarily in the form of transfers from foreign parent banks to their domestic subsidiaries—accounted for 42 percent of the deficit financing. Net errors and omissions were recorded at 2.0 percent of GDP in 2024, a figure that declined significantly following technical assistance from the IMF, which improved the accuracy of recording foreign residents’ asset holdings.

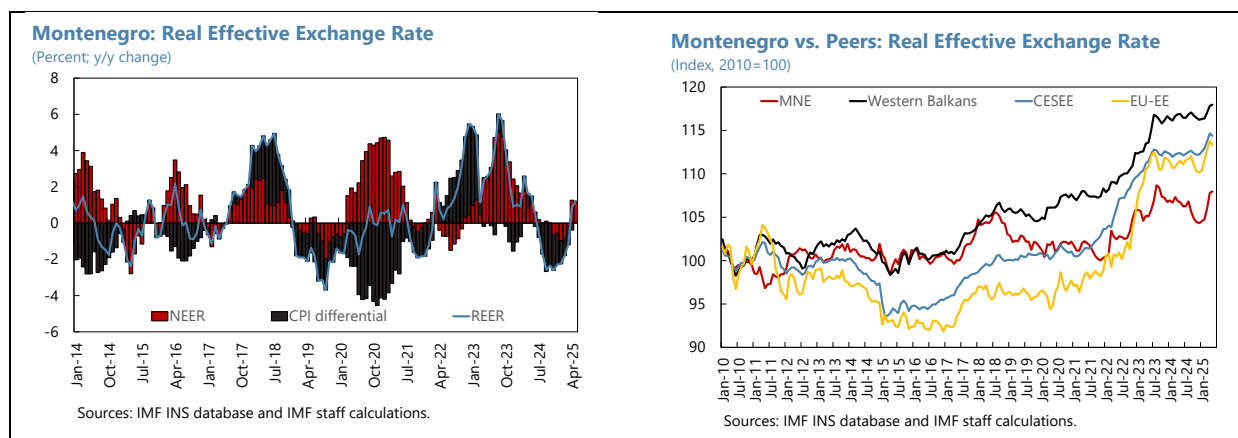
NIIP

4. The improvement in Montenegro’s net international investment position (NIIP) has stalled. Following a peak deterioration to almost -200 percent of GDP in 2020, the NIIP had improved as nominal GDP recovered from the pandemic-induced contraction. However, the resurgence of large current account deficits has impeded further progress, with the NIIP leveling at -104 percent of GDP in 2023 and 2024. The persistently large negative NIIP remains a key source of external vulnerability, heightening the risks of sudden stops in capital flows, increases in sovereign risk premia, and constrained access to international financial markets.



Real Exchange Rate

5. The appreciation of the REER has moderated in recent periods, reflecting the easing of inflationary pressures. In the aftermath of the pandemic, Montenegro experienced a sharper rise in inflation relative to its trading partners, driven by global supply chain disruptions and the economic fallout from the war in Ukraine. This divergence led to a notable appreciation of the REER. However, as inflation has receded, the pace of appreciation has slowed. Compared to peer economies—particularly other Western Balkan countries—Montenegro’s REER appreciation has been relatively moderate, suggesting a potential competitive advantage in regional trade and investment dynamics.



C. Assessment

6. The current account is assessed to be substantially weaker than the level justified by economic fundamentals and desirable policy settings. Two EBA-lite models were employed to evaluate Montenegro's external position. The current account (CA) model estimates a cyclically adjusted current account deficit of 16.7 percent of GDP in 2024, significantly exceeding the model-derived multilaterally consistent norm of 1.8 percent of GDP. Based on the estimated elasticity of the current account with respect to the REER, this gap of -14.9 percent implies an overvaluation of the REER by approximately 41.4 percent. The REER model also indicates overvaluation, though to a lesser extent, estimating a misalignment of 2.0 percent. In the staff's assessment, neither model provides a fully satisfactory quantitative estimate. While the CA model is marginally preferred, it is constrained by a limited data set. The REER model, on the other hand, is highly sensitive to assumptions regarding country fixed effects.¹ Compared to the CA model estimate in 2023, an improvement in the adjusted CA norm, driven by population growth, and a worsening savings-investment imbalance, mostly driven by the public sector, contributed to a widening REER gap.

Montenegro: EBA-lite Model Results, 2024		
	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	-17.1	
Cyclical contributions (from model) (-)	-0.3	
Additional temporary/statistical factors (-)		
Natural disasters and conflicts (-)	0.0	
Adjusted CA	-16.7	
CA Norm (from model) 2/	-1.8	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	-1.8	
CA Gap	-14.9	-0.7
o/w Relative policy gap	-0.1	
Elasticity	-0.4	
REER Gap (in percent)	41.4	2.0

1/ Based on the EBA-lite 3.0 methodology.

2/ Cyclically adjusted, including multilateral consistency adjustments.

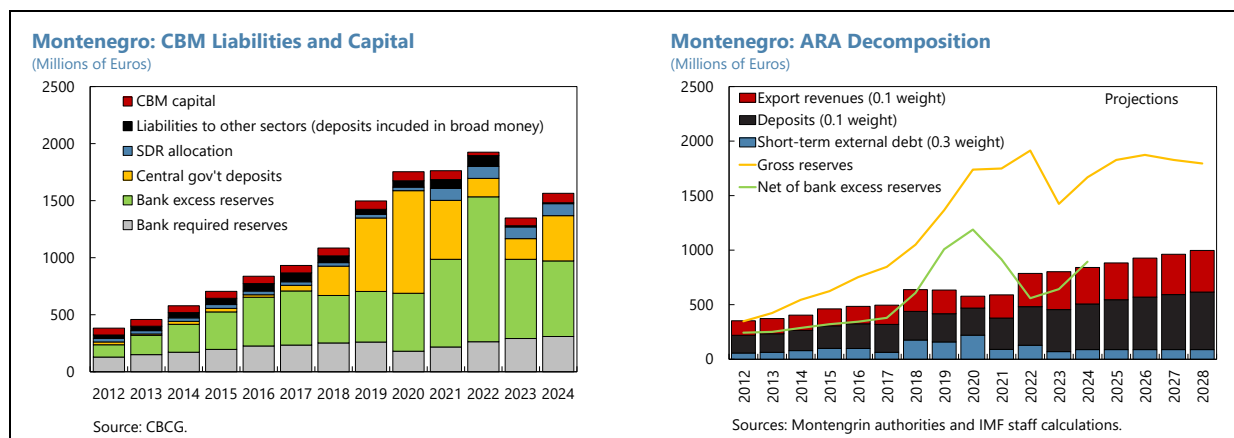
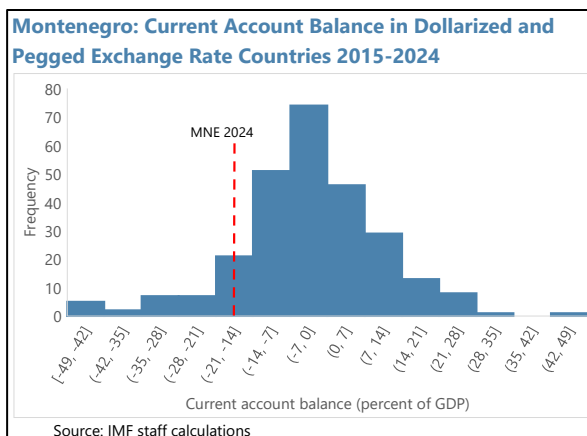
7. Montenegro's current account position remains weak relative to countries that operate under dollarized or fixed exchange rate regimes. A distinguishing feature of the Montenegrin economy is its unilateral euroization. Globally, economies with similar monetary arrangements—primarily small island states and tourism-dependent countries—share structural characteristics with Montenegro. They have experienced similar or even higher levels of current account deficit. When benchmarked against a group of 27 such countries over the past decade,

¹ 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.

Montenegro's current account deficit in 2024 ranks in the lowest decile. Compared to the EBA-lite CA model results of those countries, Montenegro's REER gap is in line with the range of REER gaps when they had elevated current account deficit.

D. Reserve Adequacy

8. Gross international reserves are assessed to be adequate. As a unilaterally euroized economy without an independent monetary authority or lender of last resort, Montenegro relies on its reserve holdings—comprising central government deposits and banks' required and excess reserves—not only to meet balance of payments needs but also to serve as fiscal and liquidity buffers. Reserve adequacy has been evaluated using two metrics: the IMF's standard metric for fixed exchange rate regimes and a modified version that assigns greater weight to bank deposits. Under both frameworks, reserve coverage exceeds 100 percent. While coverage appears less robust when bank excess reserves are excluded, this concern is mitigated by the fact that banks with Euro Area parent institutions can access liquidity through the European Central Bank via their parent banks. When deposits from these banks are excluded from the calculation, reserve adequacy improves significantly and remains within a comfortable range.



Annex VII. Montenegro: International Reserve Needs Estimate (2024, in percent of GDP unless otherwise noted)		
Potential sources of liquidity need	ARA Concept	Modified ARA Concept
Exports	4.4	4.4
Short-term external debt	1.2	1.2
Base money (bank deposits)	5.5	8.2
Portfolio investment liabilities	6.4	6.4
Target	17.4	20.1
Without deposits of euro area banks	7.4	8.3
Available resources:		
Gross international reserves	21.8	
<i>Percent of metric</i>	125%	108%
<i>Percent of metric, w/o euro area banks</i>	297%	264%
Net of bank excess reserves	13.2	
<i>Percent of metric</i>	76%	65%
<i>Percent of metric, w/o euro area banks</i>	179%	159%
Sources: Montenegrin authorities and IMF staff calculations		

Annex VI. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Geopolitical tensions. Intensification of conflicts, coupled with the weakening of multilateralism, may trigger commodity price volatility, increase migration pressures, reignite inflation, and weigh on growth by undermining confidence, investment, tourism, trade, and supply chains. Escalation of the war in Ukraine could lead to further migrant inflows, while better prospects of a resolution may lead to an outflow. Tourism flows from these countries would be affected in the opposite direction with an overall smaller impact on growth.	High	High. 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.
Escalating trade measures and prolonged uncertainty. Rising trade barriers and prolonged policy uncertainty could reduce trade, investment, and growth. Inflationary pressures may re-emerge—especially in countries imposing tariffs. These effects can be amplified by strategic complementarities or bottlenecks in global value chains or inventory overhang, which in turn negatively impacts tourism activity in Montenegro.	High	High. Reduction in tourism revenues will negatively affect growth.	Assuming a temporary slowdown, countercyclical policy without significant deviation from medium-term goals may be considered.
Fiscal vulnerabilities and higher long-term interest rates. Rising public debt and deficit levels may put upward pressure on long-term interest rates and increase the risk of sovereign bond market disruptions. These developments could amplify capital flow volatility, tighten financial conditions, threaten sovereign debt sustainability, and trigger global spillovers. To the extent that major economies are affected, market imbalances (such as reduced investor capacity to absorb sovereign debt) could emerge, exacerbating risks from a close sovereign-financial nexus.	High	High. 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.
Commodity price volatility. Shifts in supply and demand—driven by	High	Medium. Montenegro's inflation is sensitive to	Targeted and temporary measures to alleviate the cost

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
geopolitical tensions and conflicts, OPEC+ actions, or the green transition—may fuel commodity price swings, intensifying external and fiscal pressures, social unrest, and macroeconomic instability.		international food price increases, given the large share of imported food in the CPI basket.	of price increases of staple products may be considered.
Europe Now 2.0. The government's pledge for large increases in the minimum wage and elimination of pension contributions continues to have significant macro-fiscal effects.	High	High. These policies would undermine competitiveness and lead to a significant deterioration of the fiscal position.	Coherent fiscal policies, consistent with debt sustainability should be maintained.
Renewed domestic political uncertainty. Coherence of economic policies, investment, and consumer confidence may be negatively affected.	Medium	High. Political uncertainty could create new risks to the fiscal outlook. Growth would also be negatively affected.	Macroeconomic policies should be guided by credible medium-term objectives.
Fiscal vulnerabilities and higher long-term interest rates. Rising public debt and deficit levels may put upward pressure on long-term interest rates and increase the risk of sovereign bond market disruptions. These developments could amplify capital flow volatility, tighten financial conditions, threaten sovereign debt sustainability, and trigger global spillovers. To the extent that major economies are affected, market imbalances (such as reduced investor capacity to absorb sovereign debt) could emerge, exacerbating risks from a close sovereign-financial nexus.	High	High. 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.
Cyberthreats. Cyberattacks on physical or digital infrastructure, technical failures, or misuse of AI technologies could trigger financial and economic instability.	High	Medium. Montenegro has a recent history of a disruptive cyberattack on government websites.	Building resilience and robust supervision of the digital infrastructure is needed.
Climate change. Extreme climate events and rising temperatures could cause loss of life, damage to infrastructure, food insecurity, supply disruptions, and heighten economic and financial instability.	Medium	Medium. Montenegro is particularly exposed to wildfires and flooding. Wildfires along the coastal strip during the high season summer months could be particularly damaging to the economy.	Investing in climate-resilient public infrastructure.

Annex VII. Sovereign Risk and Debt Sustainability Assessment

Annex VII. Figure 1. Montenegro: Debt Coverage and Disclosures
Montenegro, Rep. of: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Moderate	The overall risk of sovereign stress is assessed as moderate. The substantial reduction in public debt following the COVID-19 pandemic, along with strong access to international capital markets at highly favorable borrowing rates, underscores the country's fiscal strengths.
Near term 1/			
Medium term	High	Moderate	While model-based results point to high medium-term risks, staff assesses these risks to be moderate. Although GFNs are expected to stay elevated, they are in line with historical levels and the country has consistently shown its ability to access international capital markets at competitive rates. Relatively high GFN/GDP ratios also reflect the small size of the economy. After having come down significantly since after the pandemic, public debt is expected to increase moderately over the medium term.
Fanchart	High	...	
GFN	High	...	
Stress test	Nat. Diast.	...	
Long term	...	High	Long term risks are assessed as high as aging and healthcare expenditures will increase fiscal pressures. Climate change related risks require effective adaptation to avert potentially further adverse debt dynamics.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA Summary Assessment

Montenegro has a moderate overall risk of debt distress. This assessment balances sharply improved fiscal indicators over the last five years against a mild worsening of debt dynamics over the medium term and stronger fiscal pressures over the longer term related to climate change and demographics.

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.

Annex VII. Figure 2. Montenegro: Debt Coverage and Disclosures

					Comments				
1. Debt coverage in the DSA: 1/									
1a. If central government, are non-central government entities insignificant?					n.a.				
2. Subsectors included in the chosen coverage in (1) above:									
Subsectors captured in the baseline					Inclusion				
CPS	NFPS	GG: expected	CG	1 Budgetary central government	Yes	Not applicable			
				2 Extra budgetary funds (EBFs)	No				
				3 Social security funds (SSFs)	Yes				
				4 State governments	No		Not applicable		
				5 Local governments	Yes				
				6 Public nonfinancial corporations	No				
				7 Central bank	No				
				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		

Color code: chosen coverage Missing from recommended coverage Not applicable

Reporting on Intra-Government Debt Holdings

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

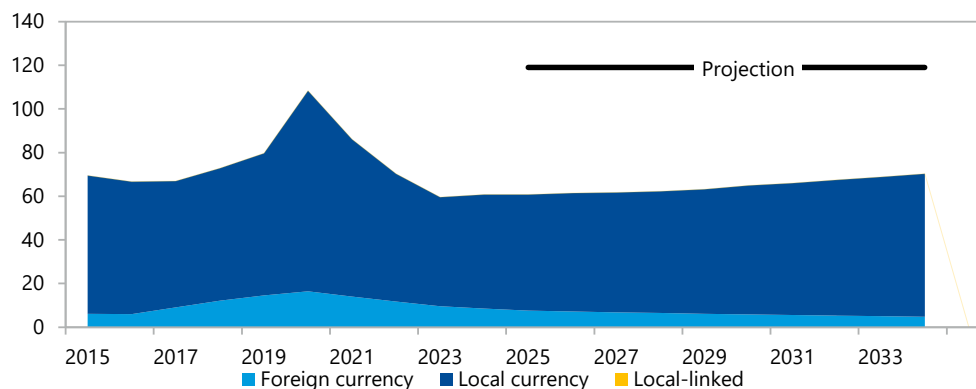
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

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.

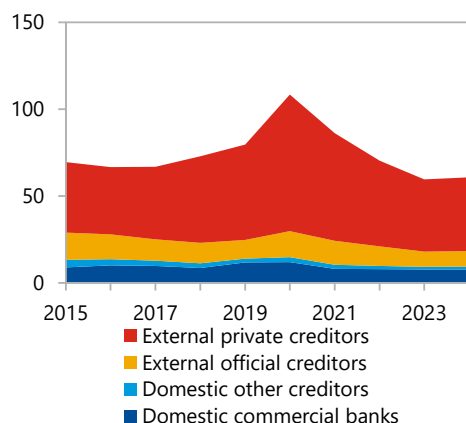
Commentary: The coverage of this SRDSA is for the general government, which includes central government, the social security fund, the health fund, and local governments.

Annex VII. Figure 3. Montenegro: Public Debt Structure Indicators
Debt by Currency (Percent of GDP)



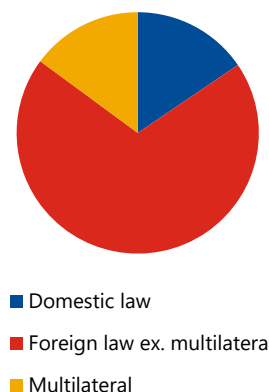
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



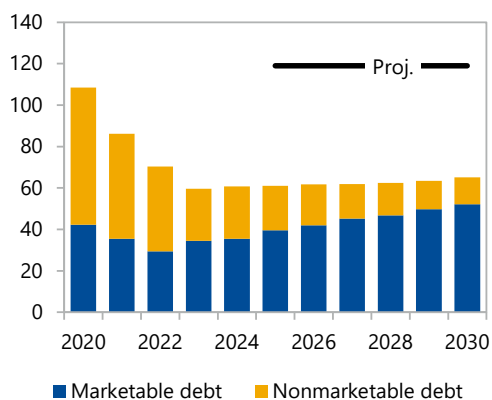
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2024 (percent)



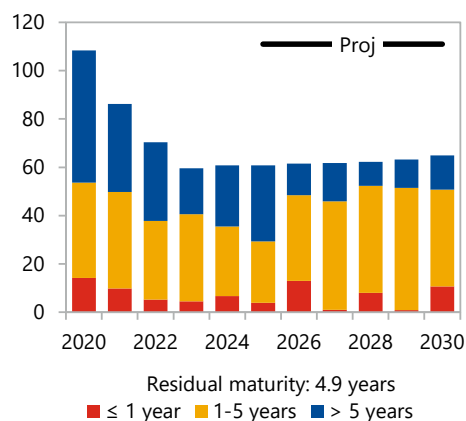
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



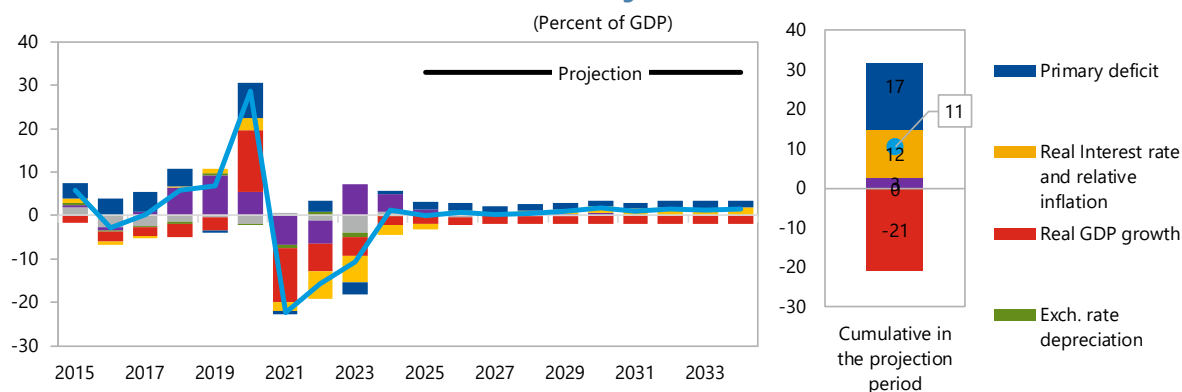
Note: The perimeter shown is general government.

Commentary: By end-2024, more than 70 percent of public debt was held by external private creditors, with China EXIM Bank's USD-denominated loans making up about 15 percent. Domestic financing sources remain limited, lacking a retail government debt market.

Annex VII. Table 1. Montenegro: Baseline Scenario
(Percent of GDP unless indicated otherwise)

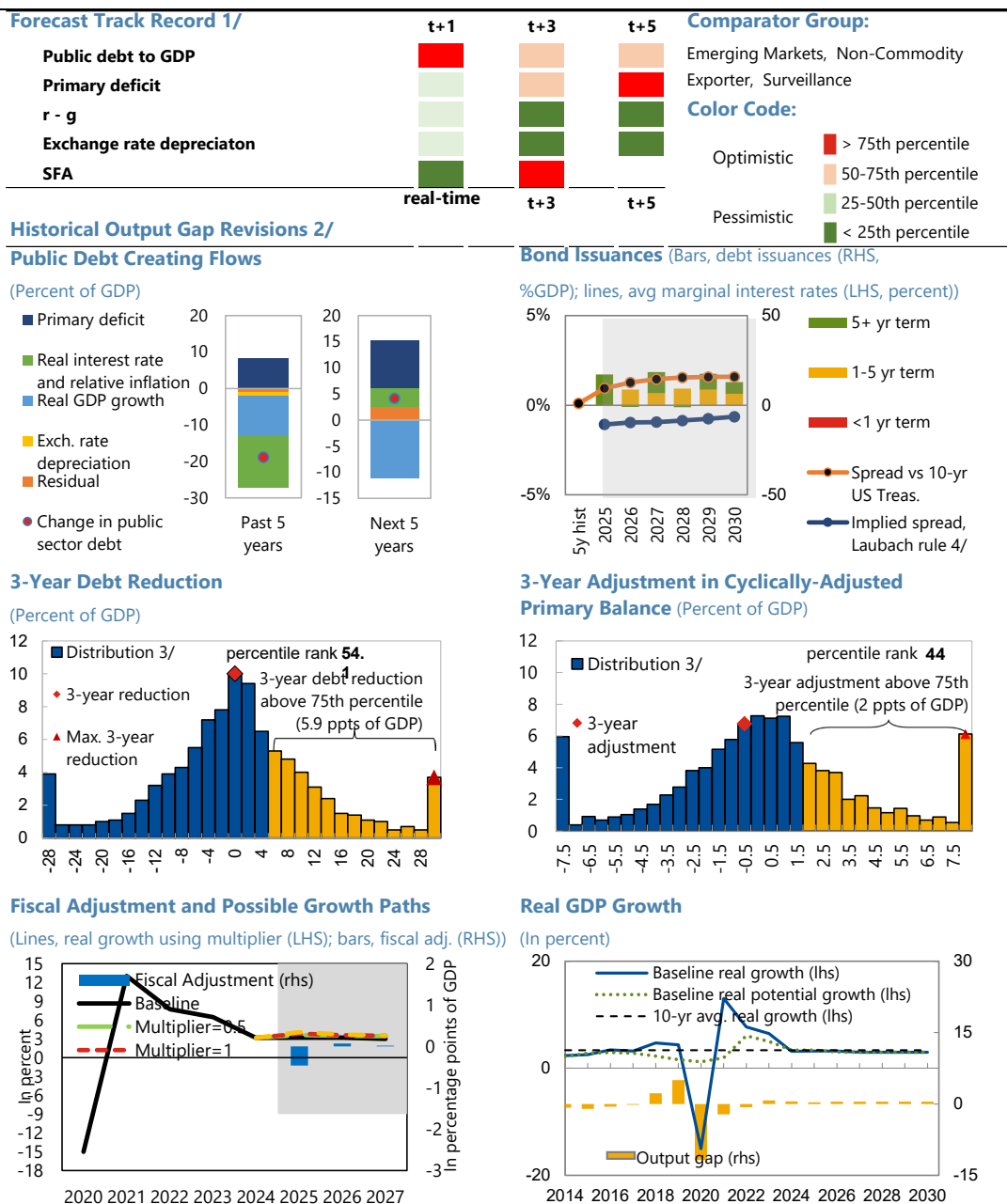
	Actual	Medium-term projection							Extended projection				
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	
Public debt	60.8	60.8	61.5	61.7	62.3	63.3	64.9	66.0	67.5	68.9	70.3	71.4	
Change in public debt	1.2	0.0	0.7	0.3	0.6	1.0	1.7	1.1	1.5	1.4	1.4	1.1	
Contribution of identified flows	0.2	-0.2	1.0	0.3	0.6	1.0	1.7	1.1	1.5	1.4	1.4	1.1	
Primary deficit	0.8	1.7	1.6	1.6	1.4	1.4	1.3	1.4	1.4	1.6	1.6	1.6	
Noninterest revenues	40.7	39.2	39.3	39.2	39.4	39.5	39.5	39.5	39.6	39.6	39.6	39.6	
Noninterest expenditures	41.5	40.9	40.9	40.8	40.8	40.9	40.8	40.9	41.0	41.2	41.2	41.2	
Automatic debt dynamics	-4.5	-3.1	-1.6	-1.1	-0.7	-0.7	-0.4	-0.3	0.1	-0.2	-0.2	-0.4	
Real interest rate and relative inflation	-2.4	-1.2	0.3	0.7	1.1	1.1	1.5	1.6	2.0	1.8	1.8	1.6	
Real interest rate	-2.7	-1.4	0.3	0.7	1.2	1.1	1.5	1.6	2.0	1.8	1.8	1.6	
Relative inflation	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Real growth rate	-1.8	-1.9	-1.9	-1.8	-1.8	-1.8	-1.8	-1.9	-1.9	-2.0	-2.0	-2.0	
Real exchange rate	-0.2	...	...	...	...	...	...	...	...	...	...	...
Other identified flows	3.9	1.1	0.9	-0.2	-0.2	0.3	0.7	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.1	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	0.0	
Other transactions	3.8	1.1	0.9	-0.2	-0.2	0.3	0.7	0.0	0.0	0.0	0.0	0.0	
Contribution of residual	1.0	0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Gross financing needs	7.6	15.3	7.1	18.6	8.3	17.3	12.2	20.6	13.8	16.2	15.9	13.7	
of which: debt service	6.7	13.5	5.5	17.1	6.9	15.9	10.8	19.2	12.3	14.7	14.3	12.2	
Local currency	6.0	13.4	5.3	17.0	6.8	15.8	10.8	19.1	12.3	14.6	14.3	12.1	
Foreign currency	0.8	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	
Memo:													
Real GDP growth (percent)	3.2	3.2	3.2	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	
Inflation (GDP deflator; percent)	4.8	5.0	2.6	2.2	2.0	2.2	2.0	2.0	2.0	2.0	2.0	2.0	
Nominal GDP growth (percent)	8.1	8.3	5.9	5.3	5.1	5.2	5.0	5.0	5.0	5.0	5.0	5.0	
Effective interest rate (percent)	0.0	2.5	3.1	3.3	4.0	4.0	4.4	4.5	5.2	4.7	4.8	4.4	

Contribution to Change in Public Debt



Commentary: Public debt dropped to 60.8 percent of GDP by 2024 after a 48-point decline post-pandemic, but is expected to rise in 2026 and beyond due to worsening fiscal performance. Aging costs and climate change will increasingly strain public finances.

Annex VII. Figure 4. Montenegro: Realism of Baseline Assumptions



Commentary: Montenegro's small, undiversified economy leads to significant volatility in macroeconomic variables and forecast revisions. The government's fiscal plans and outcomes have been similarly unstable, with large forecast errors over the medium term.

Source : IMF staff.

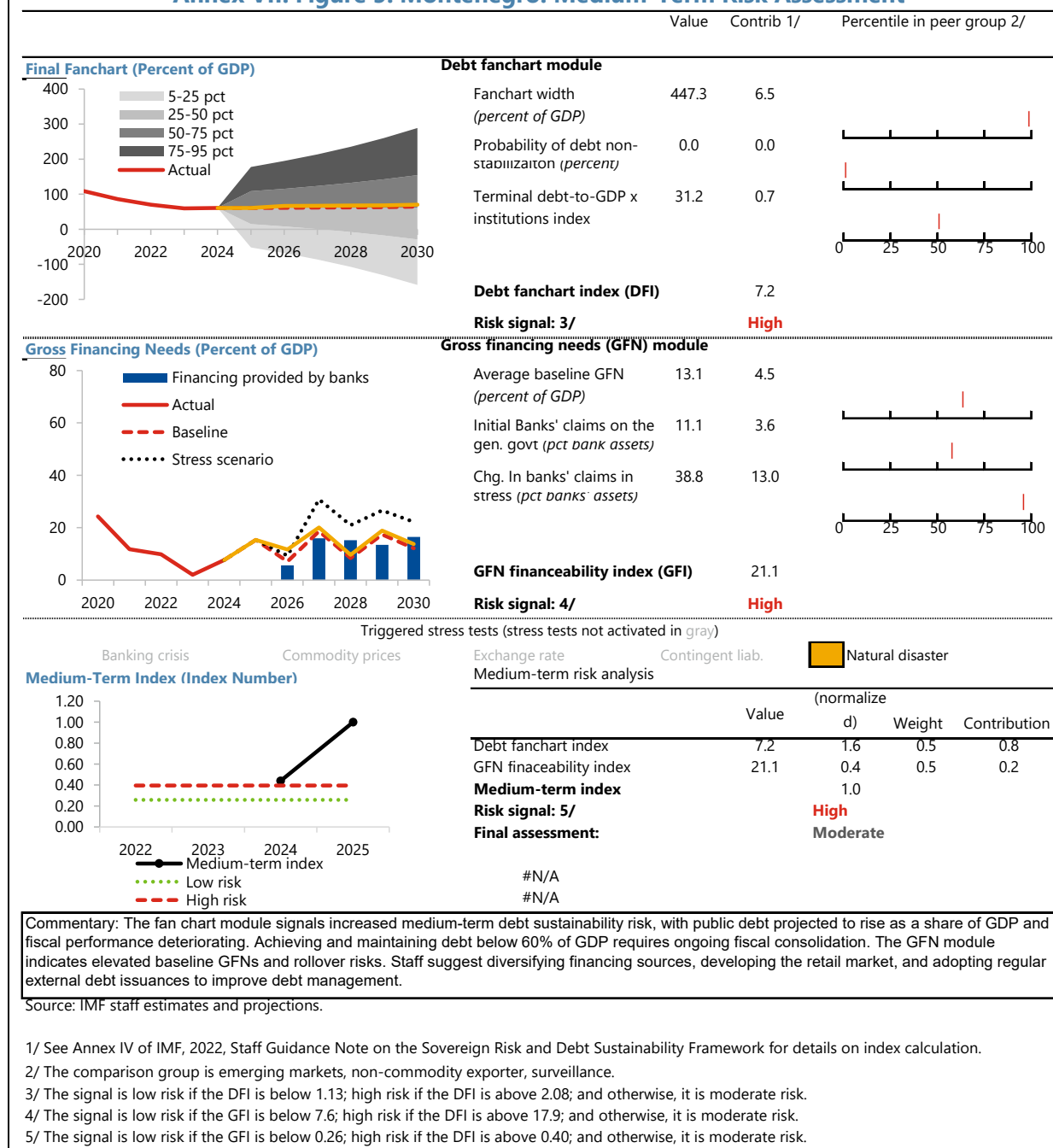
1/ Projections made in the October and April WEO vintage.

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

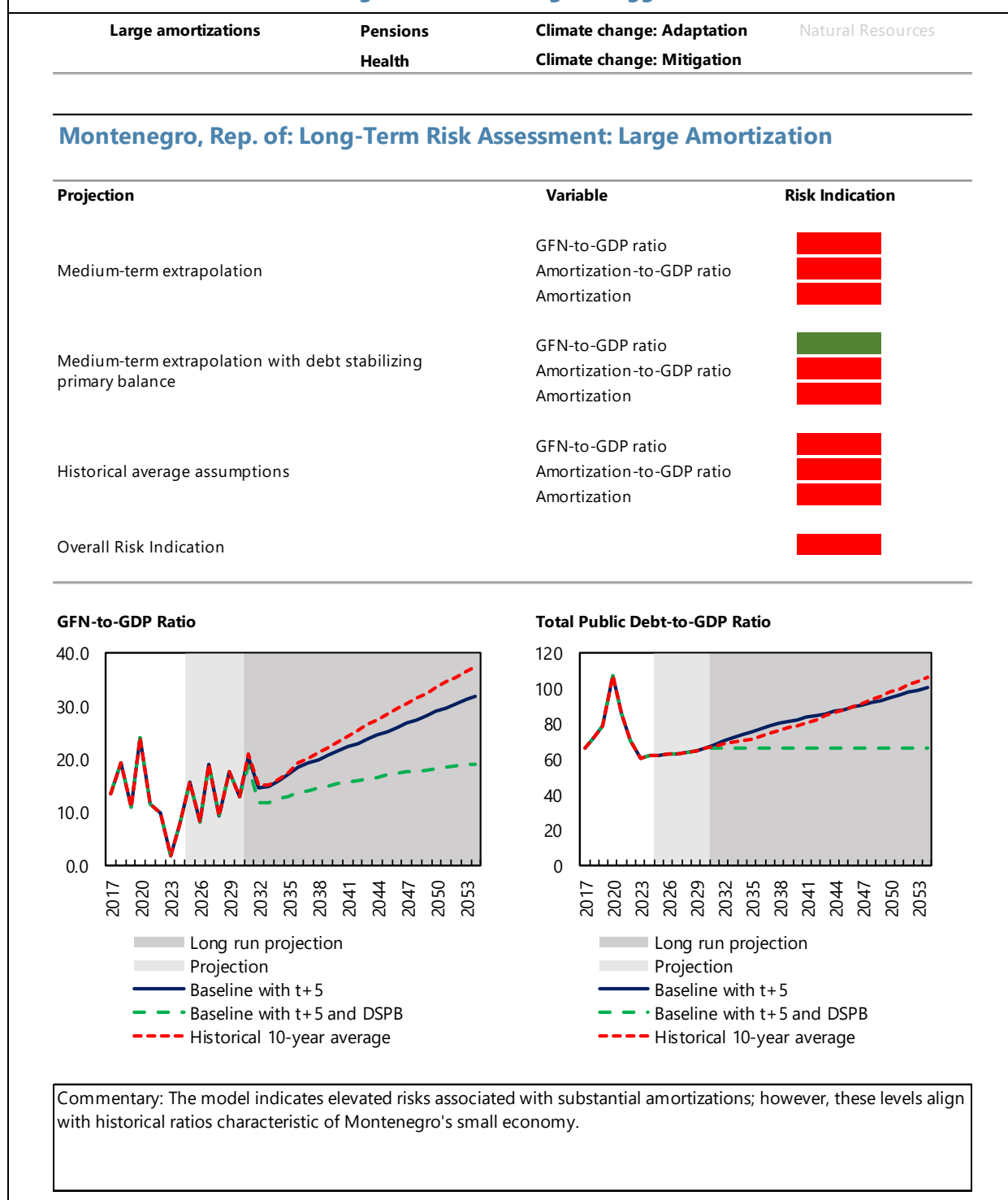
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

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.

Annex VII. Figure 5. Montenegro: Medium-Term Risk Assessment



Annex VII. Figure 6a. Montenegro: Triggered Modules

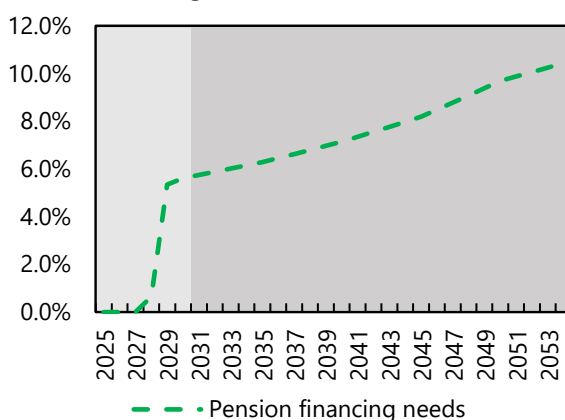


Annex VII. Figure 6b. Montenegro: Demographics: Pensions

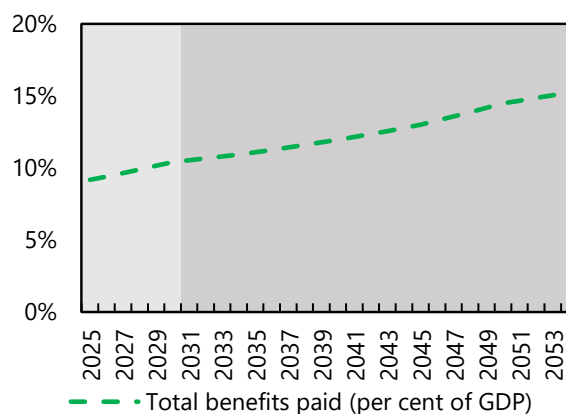
Permanent adjustment needed in the pension system to keep pension assets positive for:

	30 years	50 years	Until 2100
(pp of GDP per year)	6.7%	9.0%	10.8%

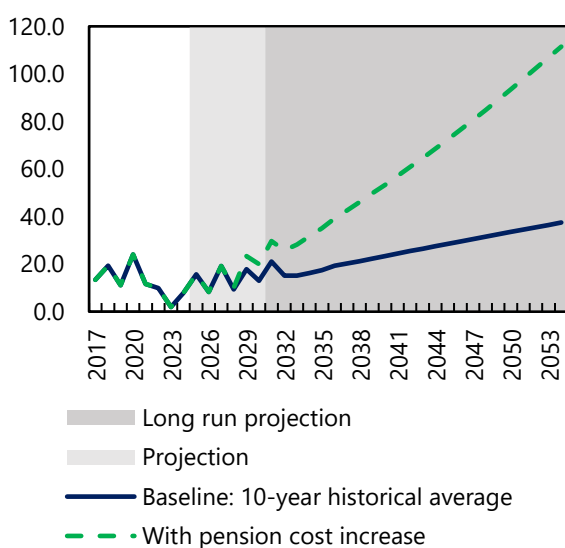
Pension Financing Needs



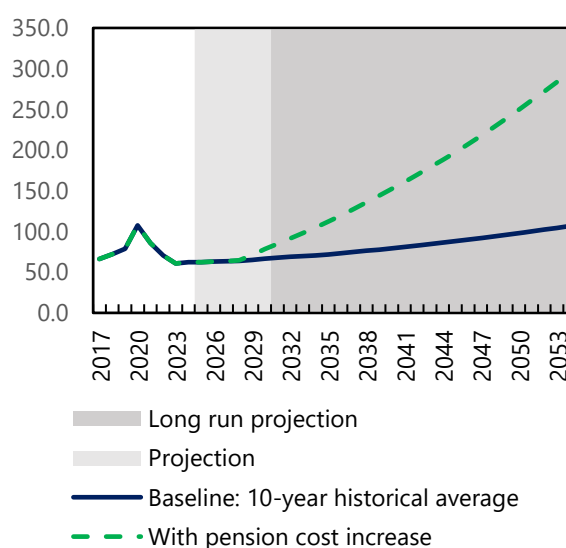
Total Benefits Paid



GFN-to-GDP Ratio



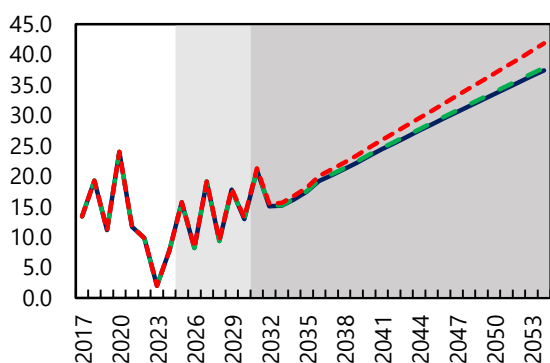
Total Public Debt-to-GDP Ratio



Commentary: Pension payouts now exceed contributions due to higher minimum pensions and lower contribution rates, increasing funding pressure. As the population ages, financial challenges for social security will intensify.

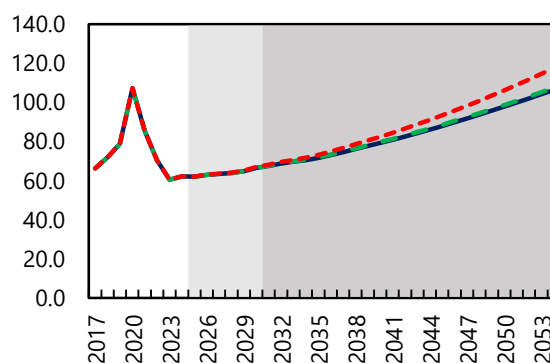
Annex VII. Figure 6c. Montenegro: Demographics: Health

GFN-to-GDP Ratio



— Baseline: 10-year historical average
 - - - Health (Demographics)
 - - - Health (Demographics + ECG)

Total Public Debt-to-GDP Ratio

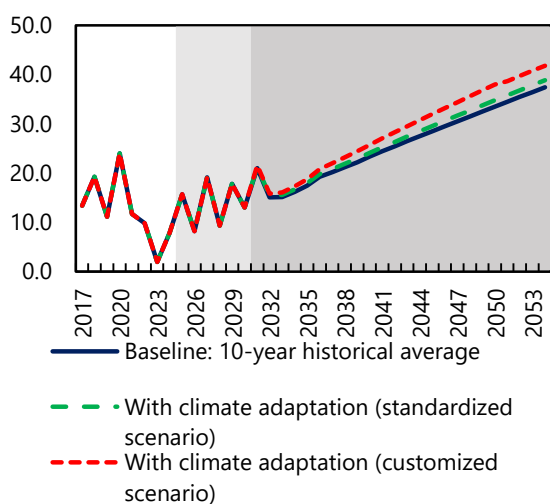


— Baseline: 10-year historical average
 - - - Health (Demographics)
 - - - Health (Demographics + ECG)

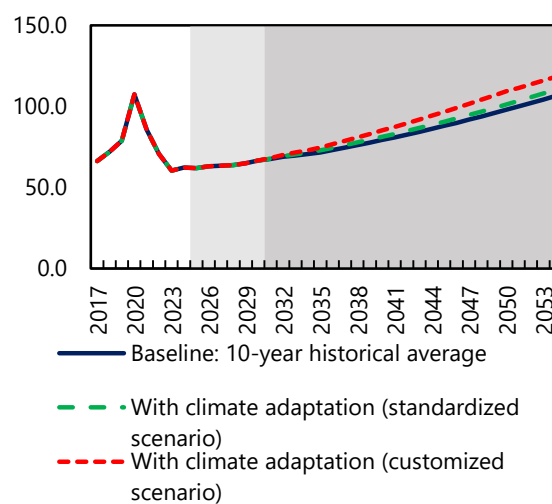
Commentary: Health spending may create long-term fiscal risks for Montenegro. Limited data by age group mean model results should be interpreted with caution.

Annex VII. Figure 6d. Montenegro: Climate Change: Adaptation

GFN-to-GDP Ratio



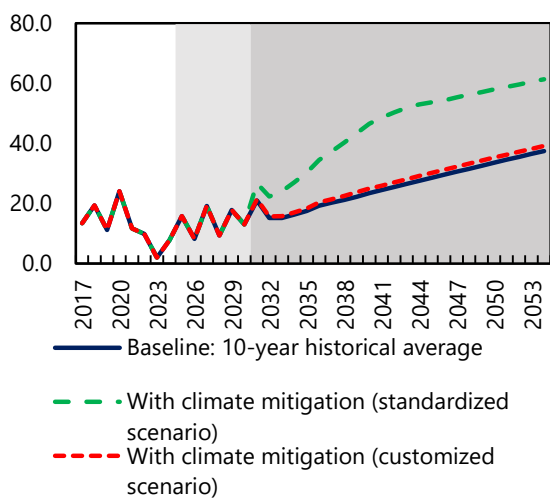
Total Public Debt-to-GDP Ratio



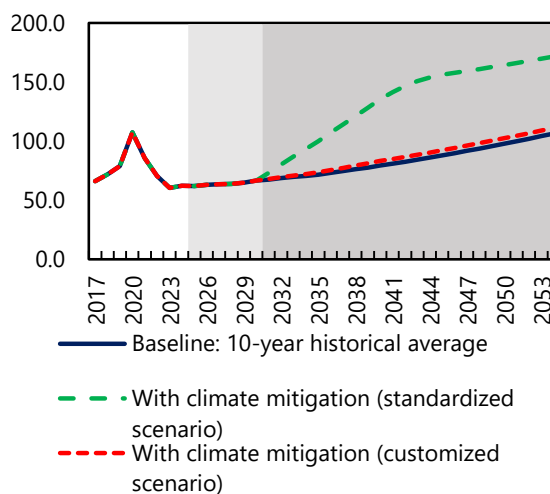
Commentary: Montenegro faces climate risks like flooding, drought, extreme heat, and wildfires, but performs well on the ND-GAIN climate risk index. According to the 2024 World Bank report, adaptation is expected to cost about 0.6 percent of GDP annually through 2050.

Annex VII. Figure 6e. Montenegro: Climate Change: Mitigation

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



Commentary: Montenegro's economy is carbon intensive because of its heavy reliance on coal for energy production. Montenegro is committed to reducing greenhouse gas emissions by 55 percent by 2030 and 60 percent by 2035 relative to 1990 levels, and ending its dependence on coal by 2041.

Annex VIII. Data Issues

Annex VIII. Table 1. Montenegro: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
B							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	B	B	B	B	B	B	B
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	C	C	B	B	B		
Granularity 3/	B		B	B	B		
			C		B		
Consistency			B	C		B	
Frequency and Timeliness	B	A	B	B	A		
<p>Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.</p> <p>1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.</p> <p>2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF <i>Review of the Framework for Data Adequacy Assessment for Surveillance</i>, January 2024, Appendix I).</p> <p>3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.</p>							
A	The data provided to the Fund are adequate for surveillance.						
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.						
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.						
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.						
<p>Rationale for staff assessment. Data provisions have some shortcomings, but are broadly adequate for surveillance. The most affected areas are national accounts, labor market indicators, price statistics (no measure of core inflation), and government finance statistics. The Statistical Office of Montenegro (MONSTAT) has recently revised national accounts for the period 2006–2025 using the ESA 2010 methodology with a new base year. Despite this, MONSTAT continues to face resource constraints and capacity limitations. With regards to external sector statistics, the main challenges are discrepancies in tourism statistics and the positive and persistent net errors and omissions, suggesting understated inflows, due to the compilation of data based on an international transaction reporting system from banks. On government finance statistics, there is no available data on enterprises owned by municipalities and the stock of local government arrears, and data on the government's stocks of financial assets and liabilities remain incomplete.</p>							
<p>Changes since the last Article IV consultation. MONSTAT has made progress in developing its capacity, but there is room for improvement in coverage and methodology.</p>							
<p>Corrective actions and capacity development priorities. The coverage of the PPI could be expanded to include services; information on foreign employment should be improved; compilation of the public sector fiscal balance requires significant further effort; and Montenegro should report GFSM 2001 based data to the IMF.</p>							
<p>Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. Staff does not use any data and/or estimates in the staff report in lieu of official statistics".</p>							
<p>Other data gaps. The Central Bank of Montenegro (CBCG) compiles the data for travel services solely for the balance of payments statistics for Montenegro based on the residency of the tourists following the international standard for compiling balance of payments statistics (i.e., BPM6). However, given the importance of the tourism sector in Montenegro, the data for tourism should be compiled comprehensively beyond balance of payments statistics by the government authority that is in charge of tourism policies and statistics. Once the data are compiled by the government authorities, relevant data should be provided to the CBCG to compile the balance of payments statistics for Montenegro. In the meantime, the CBCG should continue to publish detailed balance-of-payments data.</p>							

Annex VIII. Table 2. Montenegro: Data Standards Initiatives

Montenegro participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since September 2017.

Annex VIII. Table 3. Table of Common Indicators Required for Surveillance
(As of October 24, 2025)

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Expected Frequency ^{6,7}	Montenegro ⁸	Expected Timeliness ^{6,7}	Montenegro ⁸
Exchange Rates					D	M	...	7D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Sep-25	Oct-25	Monthly	Monthly	M	M	1M	1M
Reserve/Base Money	Sep-25	Oct-25	Monthly	Monthly	M	M	2M	1M
Broad Money	Sep-25	Oct-25	Monthly	Monthly	M	M	1Q	1M
Central Bank Balance Sheet	Sep-25	Oct-25	Monthly	Monthly	M	M	2M	1M
Consolidated Balance Sheet of the Banking System	Sep-25	Oct-25	Monthly	Monthly	M	M	1Q	1M
Interest Rates ²	Sep-25	Oct-25	Monthly	Monthly	M	M	...	1M
Consumer Price Index	Sep-25	Oct-25	Monthly	Monthly	M	M	2M	15D
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	2024	Jun-25	Annual	Annual	A	A	3Q	8M
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government	Aug-25	Oct-25	Monthly	Monthly	Q	M	1Q	30D
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Aug-25	Oct-25	Monthly	Monthly	Q	Q	2Q	50D
External Current Account Balance	2025Q2	Aug-25	Quarterly	Quarterly	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	2025Q2	Aug-25	Quarterly	Quarterly	M	M	12W	27D
GDP/GNP	2025Q2	Sep-25	Quarterly	Quarterly	Q	Q	1Q	1Q
Gross External Debt	2025Q2	Sep-25	Quarterly	Quarterly	Q	Q	2Q	2Q
International Investment Position	2025Q2	Sep-25	Quarterly	Quarterly	A	Q	3Q	1Q

¹ Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

² Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

⁷ Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

⁸ Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "...".



MONTENEGRO

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 3, 2025

Prepared By

European Department

CONTENTS

FUND RELATIONS _____ 2

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS _____ 4

FUND RELATIONS

(As of September 30, 2025)

Membership Status: Joined January 18, 2007; Article VIII.

General Resources Account:	SDR Million	% Quota
Quota	60.50	100.00
Fund Holdings of Currency	45.65	75.45
Reserve Tranche Position	14.85	24.55

SDR Department:	SDR Million	% Allocation
Net cumulative allocation	83.81	100.00
Holdings	69.15	82.51

Outstanding Purchases and Loans:	SDR Million	% Quota
Emergency Assistance	45.38	75.00

Latest Financial Arrangements:

Type	Date of Commitment	Date Drawn/Expired	Amount Approved	Amount Drawn
RFI	June 24, 2020	June 26, 2020	60.5	60.5

Projected Obligations to Fund (In millions of SDR):

	Forthcoming				
	2025	2026	2027	2028	2029
Principal					
Charges/Interest	0.11	0.41		0.41	0.41
Total	0.11	0.41	0.53	0.41	0.41

Implementation of HIPC Initiative: Not Applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable.

Implementation of Catastrophic Containment and Relief (CCR): Not Applicable.

Exchange Rate Arrangement: The de jure and de facto exchange rate arrangements are no separate legal tender. Montenegro unilaterally adopted the euro, which is the legal tender in Montenegro. Montenegro is not part of the euro area, and the CBCG is not part of the European System of Central Banks Montenegro has accepted the obligations under Article VIII, Sections 2, 3, and 4 of the IMF's Articles of Agreement. Montenegro maintains an exchange system free of multiple currency practices and of restrictions on payments and transfers for current international

transactions, except for restrictions in place for security reasons which have been notified to the Fund pursuant to Executive Board Decision No. 144(52/51).

Latest Article IV Consultation: May 1, 2024 (IMF Country Report No. 24/101).

FSAP Participation: A Financial Sector Assessment Program was initiated in August 2015, jointly with the World Bank, and concluded during the 2015 Article IV consultation. The Executive Board discussed the Financial System Stability Assessment in January 2016.

Recent Technical Assistance:

Department	Timing	Purpose
FAD	May 2025	C-PIMA
FAD	May 2025	Tax policy microsimulation
FAD	Multiple missions 2025	Fiscal risks
FAD	October 2024	PIMA follow-up
FAD	Multiple missions 2024-25	Revenue administration
FAD	2023	Legal review for establishing a fiscal council
FAD	Multiple missions 2022-25	SOE risk analysis and oversight
FAD	2021	PIMA
FAD	2021	Tax analysis and microsimulation modelling
LEG	Multiple missions 2021-23	Draft amendments to strengthen the central bank law
MCM	September-October 2025	Modernizing central bank communications
MCM	May 2025	Stress testing central bank balance sheet
MCM	September 2024	Debt portfolio advanced risk management framework and techniques
MCM	April 2024	Interest rate supervision (IRRBB) workshop
MCM	May 2023	FX risk management
MCM	February 2022	Medium-term debt management strategy (MTDS) follow-up
STA	July-August 2024	External sector statistics
STA	April-May 2021	Balance of payments statistics

In addition, technical assistance was available through regional advisors covering public financial management and revenue administration.

Resident Representative: Mr. Sebastian Sosa is the Regional Resident Representative for the Western Balkans.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

EBRD: <https://www.ebrd.com/where-we-are/montenegro/overview.html>

European Commission: https://ec.europa.eu/neighbourhood-enlargement/enlargement-policy/negotiations-status/montenegro_en

European Investment Bank: <https://www.eib.org/en/projects/regions/enlargement/the-western-balkans/montenegro/index.htm>

World Bank: <https://www.worldbank.org/en/country/montenegro>