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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

MONTENEGRO
(2025-2027)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

Montenegro's economic growth moderated in 2024, but recently adopted policy measures are expected to provide a boost to GDP growth in 2025. Strong private consumption and recovering investment were the key drivers of economic growth in 2024, estimated at 3%. The performance of exports was disappointing due to a contraction in goods exports, while the growth in tourism-related services decelerated after strong increases in previous years. The baseline scenario set out in Montenegro's economic reform programme (ERP) projects real GDP growth to accelerate to 4.8% in 2025 on the back of surging private consumption and investment, which are set to be supported by the implementation of 'Europe Now 2.0' programme. Demand stimulus and GDP growth are projected to moderate in 2026-2027. Despite the projected expansion of tourism services, the ERP forecasts net exports to subtract from GDP growth in this period. Overall, the risks to the outlook are mostly negative. The recent inflow of migrants, which followed the outbreak of Russia's war of aggression against Ukraine and boosted consumption in the past years, might reverse. Tourism's muted growth might continue beyond 2024 amid a challenging and highly uncertain global outlook. The temporary closure of a major power plant could drag GDP growth down more than expected in the ERP.

The ERP's fiscal scenario projects a deterioration of the budget balance in 2025 and a gradual adjustment in the following two years, while public debt is set to remain above 60% of GDP for the whole period. The 2024 general government budget performed close to the revised target and recorded a 3.2% of GDP deficit, compared to a small surplus in 2023. The 2025 budget targets a 3.5% deficit due to the full-year effect of 'Europe Now 2.0' implementation including a large cut in pension contributions, accelerated capital investment, and some offsetting measures from raising indirect taxes. Budgetary adjustment plans in 2026-2027 assume a gradual drop in the primary deficit, mainly relying on a deceleration in current spending that is projected to lead to a 2.5 percentage points (pps) drop in the spending ratio. However, the envisaged spending restraint appears overly optimistic and is not underpinned by concrete measures. The public debt ratio, which has fallen very substantially in recent years due partly to strong nominal GDP growth, is projected to decline to 60.2% of GDP in 2025 and increase to 64.6% in 2027, thereby staying above the fiscal rule's limit. Debt refinancing needs remain large, close to 14% of GDP in 2025 and 2027.

The main challenges facing Montenegro are the following.

- **High mandatory spending and a limited revenue base, together with high debt repayment needs call for more prudent fiscal policies.** Recent measures, including efforts to substantially reduce the labour tax wedge and permanent increases in social transfers, increased the structural gap between revenue and spending. Debt repayment needs are set to increase sharply, first in 2025 and later in 2027. Given Montenegro's monetary framework, fiscal policy is the main tool for ensuring macroeconomic stability. This calls for more ambitious consolidation measures, ideally aimed at achieving a primary surplus and bringing the debt ratio below 60% of GDP as prescribed by the fiscal rule. Fiscal space could be gained by broadening the tax base, streamlining tax exemptions, adopting new revenue measures and by reviewing and reforming mandatory spending on public-sector wages as well as on social transfers. In addition to international credit markets, tapping the domestic market with retail bonds would help to diversify financing sources and gradually smoothen the repayment profile of public debt.

- **Strengthening fiscal governance, budgetary planning and the management of public investment are needed to secure the long-term sustainability of public finances.** A stronger implementation of the existing fiscal rules, which could also include additional rules and an adequate enforcement mechanism, would better underpin stability-oriented fiscal policies. Moving ahead with the plan to set up an independent fiscal institution by appointing its members would also be an important step in this respect. Addressing fiscal risks, including those stemming from state-owned enterprises (SOEs), could provide extra fiscal space for implementing ambitious capital projects. Proper cost-benefit analyses of infrastructure projects would better ensure productive capital investment.
- **Montenegro's structural challenges relate to improving the business environment, fostering private sector development, advancing the green and digital transitions, and strengthening human capital.** The business environment remains affected by weaknesses in the regulatory framework, a large size of the informal economy, limited access to finance, and shortcomings in the oversight and governance of state-owned enterprises. Montenegro's energy transition plans align with the EU energy policy, aiming to further develop the energy sector through investments in green energy and decarbonisation. Digitalisation efforts focus on expanding digital services and enhancing cybersecurity. Structural labour market challenges, such as regional disparities and high unemployment among women, youth, and low-skilled workers, continue to hinder potential growth and improvements in living standards. These challenges are being addressed through key structural reforms outlined in the country's Reform Agenda under the Growth Plan for the Western Balkans.

The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2024 has been partial. In 2024, the fiscal outcome was very close to the target. The government adopted the 'Europe Now 2.0' reform package, which leads to continued non-compliance with the fiscal rules and an increasing debt ratio as projected in the new medium-term fiscal strategy. Little progress has been made on the review of tax expenditures and preparing concrete budgetary recommendations, while the work on public investment management is still at an early stage and requires further technical assistance from the IFIs. The call for appointing Fiscal Council members was launched in November. Initial work was carried out for the SOE reform, and the risk statement.

2. ECONOMIC OUTLOOK AND RISKS

Montenegro's economy slowed down but continued to grow in 2024. Based on quarterly data, full-year real GDP growth is estimated at 3% in 2024, down from 6.3% in 2023. Economic expansion was driven by strong increase in private consumption and recovering investment. Growth in private consumption was supported by rising wages and pensions (the latter boosted by a large increase in minimum pensions), while easing monetary conditions and higher public capital spending fostered investment. The main headwind came from contracting exports of goods and weak tourism-related services following an extraordinary performance in 2022-2023. The ERP estimates annual growth 3.8% in 2024 is in line with the projection of last year's ERP¹ while the contribution to growth of demand components has changed. The main divergence comes from the performance of exports and imports whose growth rates have both been revised downwards. Labour market conditions continued to improve with the unemployment rate² falling to a new historical low of 11.6% in 2024, down from 13.4% in the previous year.

The ERP's baseline scenario projects GDP growth to surge to 4.8% in 2025 and moderate in the subsequent years. Average GDP growth is set at 3.7% in 2025-2027. The implementation of the 'Europe Now 2.0' measures, which started in October 2024, is projected to provide a strong impulse for domestic demand. These measures include halving pension contributions³ and significantly raising the minimum wage. The resulting large increase in net wages⁴ is expected to boost the growth of private consumption to 7.2% in 2025, which would peter out in 2026 and 2027. The start of a new investment cycle, including two major infrastructure projects (the construction of the second section of the Bar-Boljare highway and the reconstruction of railway infrastructure), is set to maintain investment growth at 6.5% in 2025 before it moderates in 2026-2027. Despite a projected reacceleration of tourism exports, net exports are expected to subtract from GDP growth over the ERP period. In 2025, the exports of goods are set to be constrained by the planned reconstruction of the power plant Pljevlja and its temporary closure, resulting in lower exports of electricity. The growth of exports is expected to recover in 2026-2027. In contrast, imports are projected to surge in 2025 due to higher consumption and investment and higher energy (replacement) imports, and to slow down in the two subsequent years. The unemployment rate is projected to continue falling to 9.2% in 2027. The ERP estimates a significant positive output gap of 4.7% in 2025-2026 and 4.8% in 2027, which results from higher consumption and

¹ Macroeconomic and fiscal estimates and forecasts covering 2024-2027 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2024 have been taken from the relevant national sources (statistical office of Montenegro (MONSTAT), Ministry of Finance, central bank of Montenegro).

² Age group of 15-67 years.

³ Employee contributions to the Pension and Disability Insurance Fund were reduced from 15% to 10%, while employer contributions (5.5%) were abolished. The minimum wage increased from EUR 450 to EUR 600 or EUR 800, depending on the level of education.

⁴ The average net wage is expected to reach EUR 1 000 in 2025, up from EUR 823 in Q2-2024 and EUR 532 in 2021, i.e. the year before the authorities abolished health contributions under the 'Europe Now' programme. Montenegro sees such an aggressive increase necessary to stem labour outmigration. As net wages were boosted by subsequent measures aimed at reducing the labour tax wedge, the increase in the average gross wage is smaller in this period (from EUR 793 in 2021 to EUR 1 177 expected in 2025).

investment. Compared to the previous year, the ERP revises GDP growth upwards by 1.8 pps and 0.3 pps for 2025 and 2026, respectively. The ERP also contains an alternative downside scenario which assumes a weaker impulse to private consumption and investment, weaker growth of tourism sector and slower growth in the EU. This would result in significantly lower GDP growth of 3.2% in 2025, 2.4% in 2026 and 2.7% in 2027.

The baseline ERP scenario of a significant acceleration of GDP growth in 2025 growth is subject to sizeable domestic and external risks. The baseline growth scenario for 2025 is more positive than the Commission's autumn forecast while the divergence narrows in 2026. However, the Commission forecast did not yet take into account the economic impact of the temporary closure of the power plant, which could be significant⁵. Another key difference in 2025 stems from a higher growth of private consumption (7.2% in the ERP versus 4.5% in the autumn forecast), which is subject to a risk of reversal of the recent inflow of foreign nationals who made a sizeable contribution to private consumption growth in previous years. Another downside risk stems from the tourism sector, whose projected robust growth in 2025-2027 is at odds with the abrupt slowdown seen in 2024. At the same time, the construction of the Bar-Boljare highway might have positive impacts on connectivity and tourism. The ERP rightly refers to further downside risks related to the muted outlook for the EU economy, the slower implementation of investment projects and climate risks affecting tourism, agriculture and hydro-energy production. Domestic risks also stem from potentially higher inflation and a limited fiscal space, which constraints the response to unexpected adverse shocks to the economy. Positive risks relate to improvements in the domestic regulatory environment and progress on EU-related reforms, notably under the Reform Agenda.

Table 1:

Montenegro - comparison of macroeconomic developments and forecasts

	2023		2024		2025		2026		2027	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	6.3	6.3	3.9	3.8	4.2	4.8	3.0	3.2	n.a.	3.1
<i>Contributions:</i>										
- final domestic demand	6.8	6.8	4.6	4.7	5.1	7.0	3.6	2.8	n.a.	2.0
- change in inventories	-0.7	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	n.a.	0.0
- external balance of goods and services	0.2	0.2	-0.7	-1.0	-0.9	-2.2	-0.6	0.3	n.a.	1.2
Employment (% change)	10.5	10.8	2.9	2.0	3.5	4.6	2.6	4.9	n.a.	1.9
Unemployment rate (%)	13.4	13.1	11.5	11.7	10.8	10.7	10.5	10.0	n.a.	9.2
GDP deflator (% change)	n.a.	10.5	n.a.	2.7	n.a.	2.5	n.a.	1.9	n.a.	1.4
CPI inflation (%)	8.6	8.6	3.8	3.7	4.1	3.8	3.5	2.5	n.a.	2.3
Current account balance (% of GDP)	-11.2	-11.4	-12.5	-12.6	-12.4	-13.5	-12.1	-12.3	n.a.	-10.3
General government balance (% of GDP)	0.4	0.6	-2.9	-3.2	-3.9	-3.5	-3.5	-3.2	n.a.	-3.1
Government gross debt (% of GDP)	57.3	59.3	63.2	61.4	62.5	60.2	65.5	63.9	n.a.	64.6

Sources: *Economic Reform Programme (ERP) 2025, Commission Autumn 2024 forecast.*

Inflation declined in 2024 and is projected to increase just marginally despite the demand stimulus. The ERP estimates average inflation at 3.7% in 2024 which is above the 3.3% outturn released by the statistical office afterwards. Monthly inflation readings reached the lowest point of 1% y-o-y in September and recovered to 2.8% in February 2025. The deceleration of headline inflation in 2024 took place on the back of

⁵ The Pljevlja thermo power plant has an around 38% share in domestic electricity production.

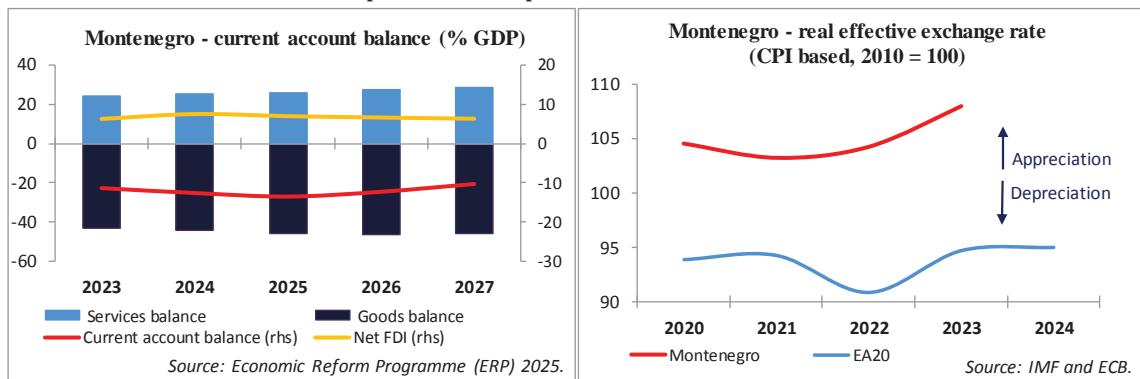
moderating prices for food, energy and transportation, while core inflation has remained stubbornly high, hovering around 5%. While import prices have a large influence on inflation in Montenegro's very small and open economy, domestic inflationary pressures might stem from high wage growth. The demand stimulus, resulting from the 'Europe Now 2.0' measures, is expected to raise inflation to 3.8% in 2025 before it eases to 2.5% and 2.3% in 2026 and 2027, respectively. Strong growth of gross and net wages took place in November 2024 (17.5% and 23% y-o-y, respectively), following the adoption of reform measures.⁶ The ERP projects gross wages to increase by 9% in 2025 and by 4% in 2026-2027.

In line with higher investment and consumption, the current account deficit is projected to remain elevated in 2025 and narrow in the following years. In 2024, the current account deficit is estimated to have widened significantly to 17.3% of GDP, which is way above the ERP projection of 12.6% of GDP, from 11.4% in 2023 due to a decline of services, in particular tourism, and merchandise exports. The latter was caused by unfavourable weather conditions and weak exports of electricity. In 2025, the ERP projects the current account deficit of 13.9% of GDP on the back of weak goods exports and growing imports, in line with the projected increase in private consumption and investment. Merchandise exports are set to contract by 10% due to the temporary closure of the thermal power plant Pljevlja while higher consumption and investment should drive up imports of goods by 8%, resulting in the deficit of goods trade increasing to 45.8% of GDP. In 2026-2027 exports of goods are assumed to grow by 3% per year while import growth is set to decelerate. Exports and imports of services are assumed to grow at more stable rates (some 8% and 4%, respectively) over this period. The secondary account surplus declined slightly to 6.1% of GDP in 2024 and is projected to stay stable in nominal terms but decline to 5% of GDP in 2027. Overall, the ERP projects the current account deficit to fall to 12.5% of GDP in 2027 from 13.9% in 2025. A high import dependency and limited diversification of the production base remain key structural weaknesses of the Montenegrin economy.

Foreign direct investment (FDI) inflows are set to moderate in 2025-2027 and finance around half of the current account deficit. Net FDI inflows increased by 18.8% y-o-y in January-September 2024, driven by a combination of higher inflows of equity investment and inter-company debt (by 5.5% y-o-y) and lower outflows (by 8% y-o-y). While there was an increase in equity investment going to banks and companies (44% y-o-y), the share of FDI going to real estate remained high at nearly 49% of all inflows. As a share of GDP, full-year net FDI inflows are estimated to have slightly increased to 6.6% in 2024 from 6.2% the previous year. Throughout the period they are projected to stay stable in nominal terms but decline as a share of GDP from 6.9% in 2025 and to 6.3% in 2027. This profile implies that around half of the current account deficit would be covered by FDI in 2025-2027. The ERP does not discuss the main drivers of the assumed path for FDIs. At the end of 2024, Montenegro's net international investment position was negative at 108% of GDP as compared to 106% at end-2023. External debt increased to 134% of GDP in 2024 from 130% in 2023, mainly due to increasing public borrowing from abroad.

⁶ MONSTAT data.

Graphs: external competitiveness and current account



The banking system is stable and profitable. The capital adequacy ratio of the banking sector (regulatory capital to risk-weighted assets) remained high at 19.8% in Q3-2024, although it was somewhat lower than in 2023. As a precautionary measure to ensure financial stability, the central bank requires banks to keep capital buffers ranging from 3.4% to 3.9% of total risk exposure amount. Given the recent increase in real estate prices and rapid growth of cash loans to physical persons, the ERP refers to the plan of introducing a countercyclical capital buffer of 0.5% from April 2025. Banks continued to fund themselves mainly through domestic deposits, although deposit growth decelerated significantly to 3.4% from 15.1% in 2023. At the same time, credit growth accelerated to 13.3% from 10.8% in the previous year. Borrowing costs increased with the nominal weighted average lending rate reaching 6.5% by the end of 2024 as compared to 6.1% at the beginning of the year. The nominal weighted average rate on deposits stood at only 0.25%. The wide spread between lending and deposit rates supported the profitability of the banking sector. The return on assets increased to 3% in Q3-2024 from 2.6% one year earlier, and the return on equity exceeded 20%. The non-performing loan ratio declined to 4.0% at the end of 2024, as compared to 5% in the previous year. Montenegro joined the Single Euro Payments Area (SEPA) in November 2024. Once operational, SEPA will reduce settlement time and cost for euro payments, and facilitate trade, remittances, and other cross-border activity.

Following the adoption of the Law on Development Bank in October, the Investment Development Fund of Montenegro was officially transformed into the Development Bank of Montenegro (DboM) in December. The law breaches several EU legal acts in the field of banking and regulation of credit institutions as well as on payments and raises strong concerns regarding the compliance with EU competition and State Aid rules. DboM's governance and risk management frameworks as well as its supervisory and oversight mechanisms do not comply with comprehensive EU rules and the EU-aligned legislation of Montenegro, which can negatively affect the integrity of the country's financial system. Capital adequacy requirements are lower than the benchmark prescribed by the EU banking legislation. The DboM is exempted from the laws regulating credit institutions, despite accepting deposits and granting business loans. This creates an uneven playing field vis-à-vis other commercial banks.

Table 2:

Montenegro - financial sector indicators

	2020	2021	2022	2023	2024
Total assets of the banking system (EUR million)	4 587	5 329	6 407	6 735	7 250
Foreign ownership of banking system (%)	80.3	80.0	82.0	83.7	n.a.
Credit growth (%, average)	5.0	6.6	6.1	10.8	13.3
Deposit growth (%, average)	-2.5	12.8	23.2	15.1	3.4
Loan-to-deposit ratio (end of period)	93.7	80.0	70.1	74.8	79.5
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	5.5	6.2	5.7	5.0	3.5
- regulatory capital to risk-weighted assets	18.5	18.5	19.3	20.3	19.4
- liquid assets to total assets	22.2	26.4	30.7	23.5	22.9
- return on equity	4.1	4.6	14.4	19.3	19.0
- foreign exchange loans to total loans	0.2	0.2	0.2	0.1	0.3

Source: Central Bank of Montenegro.

3. PUBLIC FINANCE⁷

The 2024 budget outcome was broadly in line with the target in the revised budget while it deteriorated compared to 2023. The ERP estimates the general government budget deficit at 3.2% of GDP, which is slightly better than the target of 3.3% adopted in the revised budget in September. The budget was nearly balanced in January – November, but a surge in current and capital spending in December led to a relatively sizeable deficit. In full-year terms, revenue and spending performed close to the plans for 2024. Tax revenue was slightly higher than planned while other (non-tax) revenue was lower, due mainly to the delay in disbursing the EU pre-financing under the Growth Plan and the lack of dividends by the electricity company in the context of the upcoming reconstruction of the thermo power plant Pljevlja. Tax revenue growth was supported by high consumer spending fuelled by increases in pensions and wages⁸. The fastest growing items were corporate and personal income tax revenue, which increased by 41% and 26% y-o-y respectively, while VAT revenue, which is by far the largest item making up 38% of general government revenue, rose by 15.4%. One-off revenue, which provided a substantial contribution in 2023⁹, decreased by 39.7% in 2024. Current expenditure increased by 11% y-o-y, driven by rising social transfers (22.7%) due to the large increase in minimum pensions, a higher public wage bill (5.6%) and growing interest costs (19.2%). In parallel, capital spending grew by 26.5%, recovering from a low base in 2023. Compared to the general government surplus of 0.6% of GDP in 2023, the budget balance deteriorated markedly. This is mainly explained by a large increase in public spending, including a 2 pps. rise in social transfers (to 13.9% of GDP), a 1.1 pps increase in capital spending (to 5.9% of GDP) and 0.8 pps higher transfers to institutions

⁷ The assessment of the fiscal framework is based on a revised fiscal scenario provided to the Commission after the official ERP submission, and not on the fiscal tables presented in the ERP. The revision is mainly explained by the budget outcome of 2024.

⁸ In 2024 there was the 52% hike in the minimum pension rate to EUR 450, a regular pension indexation and strong growth in wages.

⁹ In 2023 non-tax revenue was driven by three major items: the fees from the economic citizenship programme, the payoff from terminating a debt hedging arrangement, and the EU energy grant.

(7.5% of GDP) as well as the decrease in one-off revenue mentioned above (amounting to 1.6% of GDP).

The main element of the new fiscal strategy is the universal reduction of the labour tax wedge¹⁰, resulting in a sizeable revenue loss which is only partly offset by compensatory measures. This follows a number of measures implemented in previous years¹¹ that narrowed the tax base and resulted in higher mandatory spending. The ‘Europe Now 2.0’ programme, adopted in September and effective since October 2024, further reduced the tax wedge on labour by cutting employee’s pension contributions from 15% to 10% and abolishing employer contributions (5.5%). The resulting fiscal impact is expected to be mitigated by several offsetting factors such as the introduction of a third VAT rate (including for accommodation services and catering), higher minimum wages¹², rising employment, and an expected decline in ‘envelope’ wages due to the implementation of compliance measures. Still, the ERP expects the revenue-to-GDP ratio to decrease by 3.5 pps between 2024 and 2027, and the budget deficit is projected to be kept in check (somewhat above 3% of GDP on average in 2025-2027) only by a plan to contain spending, namely on public wages and social transfers. The ERP refers to the objective to maintain a current budget surplus, meaning that current revenue finances current spending while borrowing is exclusively undertaken to finance capital investment, which is set to grow by 8% on average in 2025-2027. Overall, compared to the 2024 revised budget, the ERP projects public spending to grow by 4.7% in 2025 and 3.3% in 2026-2027 (averaging to 3.8% over the period). Budget revenue is set to rise by 3.7% on average in this period. Following the shock of 2025 stemming from the decrease in pensions contributions, revenue from taxes and contributions are projected to grow by 3.7% and 6% in 2026 and 2027 respectively. This is set to be supported by economic and employment growth, an expansion in the range of excise goods, and by suppressing the grey economy including the illegal trade of tobacco products.

The ERP’s projected fiscal path would result in a widening of the headline deficit to 3.5% of GDP in 2025 and a gradual moderation to 3.1% in 2027. The primary balance is projected to stay negative but improve over the period. The debt ratio is assumed to fall from 61.4% of GDP in 2024 to 60.2% in 2025, before reversing the trend and increasing to 63.9% in 2026 and 64.6% in 2027, which is above the projections of the previous ERP. Overall, the projected fiscal path of a widening deficit in 2025 and a gradual adjustment in the subsequent years would result in exceeding the limits prescribed by the rules of fiscal responsibility¹³ in the whole period.

¹⁰ Following the earlier abolition of health contributions and the newly adopted reduction in pension contributions, the labour tax wedge on average wages will be 16.2%, which is far below the OECD average of 34.8%.

¹¹ These included abolishing the mandatory health contributions and introducing a non-taxable share of wages, introducing additional allowances for all children and for mothers of three or more children (all in 2022), large increases in minimum pensions (the latest of which was implemented in 2024) and wage increases in the public sector.

¹² Montenegro expects a positive net fiscal impact of the minimum wage increase via pension contributions and personal income tax (the tax-free threshold was left unchanged at EUR 700).

¹³ Numerical fiscal rules limit the general government deficit and debt to below 3% and 60% of GDP, respectively.

Table 3:

Montenegro - composition of the budgetary adjustment (% of GDP)

	2023	2024	2025	2026	2027	Change: 2024-27
Revenues	42.2	43.8	41.2	40.7	40.3	-3.5
- Taxes and social security contributions	35.4	38.5	36.0	35.7	35.5	-3.1
- Other (residual)	6.8	5.3	5.2	5.0	4.8	-0.5
Expenditure	41.6	47.0	44.7	44.0	43.4	-3.6
- Primary expenditure <i>of which:</i>	39.8	44.9	42.6	41.8	40.9	-4.0
Gross fixed capital formation	4.8	5.9	5.6	5.6	5.7	-0.2
Consumption	13.2	13.3	13.2	12.6	12.2	-1.2
Transfers & subsidies	19.7	22.7	21.2	21.0	20.6	-2.1
Other (residual)	2.1	3.1	2.6	2.6	2.5	-0.6
- Interest payments	1.8	2.1	2.0	2.3	2.5	0.4
Budget balance	0.6	-3.2	-3.5	-3.2	-3.1	0.1
- Cyclically adjusted	-3.8	-6.7	-8.5	-8.2	-8.2	-1.5
Primary balance	2.4	-1.1	-1.5	-0.9	-0.6	0.5
- Cyclically adjusted	-2.0	-4.6	-6.4	-5.9	-5.7	-1.0
Gross debt level	59.3	61.4	60.2	63.9	64.6	3.2

Sources: Economic Reform Programme (ERP) 2025, Commission calculations.

On the back of full-year implementation of the ‘Europe Now 2.0’ measures, the general government budget targets a deficit of 3.5% of GDP in 2025. Compared to the 2024 outturn, general government revenue is set to decrease by 2.6 pps. from 43.8% of GDP to 41.2% in 2025. The key reason for this is lower contributions to the Pension and Disability Fund, which are projected to decline from 7.3% to 5% of GDP. The main offsetting measure is the expected 0.4 pps. increase in VAT revenues (from 16.8% to 17.2% of GDP) on the back of higher private consumption and imports as well as the introduction of the intermediary 15% VAT rate that applies, among others, to accommodation and hotels and to hospitality services that had been subject to the 7% VAT rate before. Revenue from other taxes, duties and fees are projected to remain roughly stable as a share of GDP. Other revenue is set to decline by 0.7 pps., mainly due to the phasing out of the Economic Citizenship programme and the related fees, which will be partially offset by higher grants (0.6 pps.) related to the implementation of Montenegro’s Reform Agenda under the EU’s Growth Plan for the Western Balkans. Public spending at general government level is projected to decline by 2.3 pps. to 44.7% of GDP in 2025, with the main adjustment coming from public wages and social security transfers, which are set to increase nominally by 5% and 6%, respectively, but decline as a share of GDP by 0.4 pps. and 0.5 pps. respectively. Driven by the implementation of the second phase of the Bar-Boljare highway and the modernisation of railway infrastructure, the general government’s capital budget is set at 5.6% of GDP, which is above the 2024 revised target of 5.4% of GDP, but below the actual outturn.

The budget for 2025

- * Following a significant delay, the Parliament of Montenegro adopted the 2025 Budget Law and related borrowing decisions on 7 February 2025. The budget targets a deficit of 3.5% of projected GDP, assuming real growth of 4.8% and inflation reaching 3.8%.

Table: **Main measures in the budget for 2025**

Revenue measures*	Expenditure measures**
<ul style="list-style-type: none"> • Halving pension contributions (<i>Estimated impact: -2.3 % of GDP</i>) • Introducing the 3rd VAT rate on accommodation and catering (<i>Estimated impact: 0.8%</i>) • Expansion of the coverage of excise duties (<i>Estimated impact: 0.1% of GDP</i>) • Implementation of the new Law on Games of Chance (<i>Estimated impact: 0.04% of GDP</i>) 	<ul style="list-style-type: none"> • Increasing the minimum wages to EUR 600 and 800 depending on the level of education (<i>Estimated impact: 0.1%</i>) • Regular adjustment of pensions (<i>Estimated impact: 0.5%</i>)

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.

Source: ERP

In the medium term, the ERP projects that the budget deficit will decline mildly as a result of GDP growth and spending restraint. Despite some offsetting measures, the ‘Europe Now 2.0’ reforms, aimed at reducing the labour tax wedge, significantly reduce the public revenue-to-GDP ratio, which is projected to remain on a declining trend in 2025-2027. Public revenue is projected to grow by 3.9% and 3.4% in 2026 and 2027, but decline as a share of GDP to 40.7% and 40.3%, respectively. In terms of components, tax revenue growth is set to decelerate (from 12% in 2025¹⁴ to 3.6% in 2027), while revenue from contributions is projected to recover somewhat from a 23% contraction in 2025 to a growth of some 6% in 2026-2027 on the back of increasing wages. Similarly, the ERP projects public spending to decelerate in nominal terms and decline as a share of GDP from 47% in 2024 to 43.4% in 2027. The share of social transfers is projected to remain stable at 30% of public spending, while their nominal growth should decelerate from some 6% in 2025 to 4% in 2027. The public wage bill is assumed to follow an even flatter profile with its growth declining from 3% in 2025 to 1% in 2027, which is below the assumed inflation rate. Transfers to institutions, which are primarily health-related, is also projected to decelerate from 5.7% in 2025 to 0.9% in 2027 and decline as a share of GDP from 6.8% to 6.4%. In contrast, capital spending and interest payments are expected to rise substantially. Investment spending is projected to surge by 12% in 2025 and moderate to 5% and 7% in the following years. Interest payments are expected to increase by 7% in 2025 before accelerating to double-digit growth (18% and 14%) in 2026 and 2027, with the share of interest costs in total spending increasing from 4.5% in 2025 to 5.8% in 2027. The assumption of moderate growth of some of these spending items is not backed up by concrete measures and therefore seems optimistic. Notably, the

¹⁴ Compared to the 2024 revised budget.

projection of an almost stable wage bill in nominal terms, leading to a 0.3-0.4% of GDP reduction per year is not in line with historical wage trends and the inflation outlook for 2026-2027. Pressure to raise social transfers might also re-emerge as it was the case in the recent past, which has led to large increases in pensions and social benefits and a rise in overall social transfers from 11.5% of GDP in 2021 to 13.8% in 2024.

After a moderate decline expected in 2025, the ERP projects the public debt ratio to rise to 64.6% of GDP in 2027, while financing needs are set to increase. The ERP estimates that total public debt increased to 61.4% of GDP at the end of 2024 from 59.3% in the previous year. Given the projected budget deficits, nominal GDP growth, debt repayment schedule and plans for the build-up and withdrawal of government deposits, the ERP projects public debt-to-GDP ratio to moderate slightly to 60.2% of GDP in 2025 and increase to 63.9% and 64.6% in 2026 and 2027, respectively. Debt rollover needs, including of Eurobonds, are especially large in 2025 and 2027, amounting to 10.3% and 11.1% of GDP, respectively¹⁵. Together with the projected deficits, financing needs are close to 14% of GDP in these years. The overall financing strategy is to secure sufficient financing for debt repayment and fiscal buffers for 2025 and 2026 by issuing bonds on foreign and domestic markets and obtaining a further policy-based lending or guarantee from the World Bank. Montenegro has made progress towards meeting financing needs by selling in March 2025 a record-high EUR 850 million Eurobond (around 10.7% of the 2025 projected GDP) with a seven-year maturity and an interest rate of 4.875%. The authorities have also secured an EUR 180 million loan facility provided by the World Bank, the French development agency (AFD) and the OPEC Development Fund. Montenegro also plans to issue a first retail bond of around EUR 50 million, tapping into the large deposit base held by banks and yielding very low interest rates. The diversification of the debt portfolio could help to lengthen and smoothen the debt repayment profile while offering households an alternative saving option.

At the end of 2024 the government of Montenegro adopted the Medium-Term Debt Management Strategy for 2025-2027. The strategy aims to manage risks, primarily those related to interest and exchange rate movements, diversify the international investor base and develop domestic sources of financing. A further aim is to extend the debt maturity, smoothen its repayment profile and avoid peaks in every two years¹⁶. The projections for general government budget and debt are the same as in the fiscal strategy, i.e. exceeding the fiscal rule limits. The strategy justifies this by referring to high investment needs to support long-term growth.

¹⁵ The surge in 2025 (EUR 821 million) is driven by a maturing Eurobond (EUR 500 million) while the peak in 2027 (EUR 972 million) is due to the repayment of Eurobond issued in 2020 (EUR 750 million).

¹⁶ Currently Montenegro has large debt repayments in 2025, 2027, 2029 and 2031.

Montenegro						Debt dynamics
Composition of changes in the debt ratio (% of GDP)						
	2023	2024	2025	2026	2027	
Gross debt ratio [1]	59.3	61.4	60.2	63.9	64.6	
Change in the ratio	-10.0	2.2	-1.2	3.7	0.7	
Contributions [2]:						
1. Primary balance	-2.4	1.1	1.5	0.9	0.6	
2. 'Snowball effect'	-8.1	-1.5	-2.1	-0.6	-0.3	
Of which:						
Interest expenditure	1.8	2.1	2.0	2.3	2.5	
Growth effect	-3.7	-2.1	-2.7	-1.8	-1.9	
Inflation effect	-6.2	-1.5	-1.4	-1.1	-0.9	
3. Stock-flow adjustment	0.6	2.6	-0.6	3.4	0.4	

[1] End of period.
[2] The 'snowball effect' captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).
The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets, and valuation and other effects.

Source: *Economic Reform Programme (ERP) 2025, Commission calculations.*

set to wane as the budget balance improves. Overall, following a decline in 2025, the debt-to-GDP ratio is projected to increase in 2026 and 2027.

While the ERP presents a number of risks relevant to the baseline scenario, the key risk relates to the structural changes in government revenue and spending and the possible reversal of recent positive economic trends. The 'Europe Now 2.0' programme came on top of several budget balance-worsening measures (abolishing the mandatory health contributions, introducing a non-taxable share of wages, introducing additional allowances for all children and for mothers of three or more children, large increases in minimum pensions and wage increases in the public sector) which weakened the revenue base and structurally increased spending. The resulting negative fiscal impact was masked by a large inflow of migrants and the ensuing surge in consumption following Russia's war of aggression against Ukraine, as well as a strong post-Covid rebound of tourism. As a result, Montenegro's fiscal situation improved considerably, and the public debt ratio saw an exceptionally large decrease of some 45 percentage points between 2020 and 2023. However, these positive economic trends might come to a halt or even reverse, resulting in a sharply lower GDP and revenue growth. Spending projections signal consolidation attempts, but the underlying assumptions, such as a nearly stable nominal public wage bill, are not supported by concrete consolidation measures. The ERP refers only in general terms to envisaged reforms of the pension, healthcare and social protection system, the renumeration of public employees, and SOEs. While these reforms would be very important to safeguard stable public finances, improve public-sector efficiency and enhance social cohesion, at this stage they seem only efforts. Creating fiscal space is especially important given Montenegro's unilateral euroisation and the lack of monetary policy tools to manage aggregate demand. There are some upside risks to revenues, including from the reform of the Revenue and Customs Administration, strengthened measures against the informal economy, and the ongoing tender process to grant a long-term concession of Montenegro's airports. Negative risks, not included in the ERP, relate to possible cost overruns of the highway project and contingent liabilities related to SOEs. The SOE risk assessment report foresees further work and possibly correcting measures for loss-making SOEs, requiring them to produce medium-term recovery strategies, while in some cases a review of SOE pricing policy and governance is needed.

Sensitivity analysis

The ERP includes a detailed analysis of the deficit, with a comparison between baseline and low growth scenarios as well as with the previous ERP. The comparison of scenarios includes a detailed risk matrix identifying potential positive and negative events (see above). However, a detailed impact of each single risk is not quantified; only their total effect on the budget balance, as reflected in the alternative scenario. Under the low growth scenario, the general government deficit would widen from 3.2% of GDP in 2024 to 4% in 2025 and adjust to 3.8% in 2027. In addition, the public debt-to-GDP ratio would reach 68.7% of GDP by 2027 implying higher fiscal sustainability risks.

While aiming at higher competitiveness and sustainable growth in the medium term, recent measures increase the reliance on indirect taxes and expose public finances to the associated risks. As a result of the ‘Europe Now 2.0’ programme and previous reforms, the tax wedge on average wages has been lowered to only 16.2%. Following the large decrease in contributions, around 54% of Montenegro’s public revenue in 2025 is set to come from VAT and excises, with VAT, which is considered more growth-friendly but has a regressive distributive impact, alone amounting to 17.2% of GDP. The risk of high reliance on VAT revenue is increased pro-cyclicality and related volatility of public revenue. Measures such as recurrent property taxation, which is thought to be the least distortive, or environmental taxes which take into account negative external effects and can help accelerate the green transition, are not considered in the ERP. High public spending is dominated by mandatory current expenditure (87% of the total). Coupled with a weaker revenue base, the ambitious public investment programme will result in higher general government deficit and an increasing debt-to-GDP ratio. Mobilising revenue, including by reviewing tax expenditure, would allow for more productivity-enhancing investment (e.g. on education, infrastructure and digitalisation) without a negative impact on fiscal stability. Improving the frameworks for public investment management and public private partnerships would help to achieve higher returns from large public investments in physical and digital infrastructure. The IMF recommendations for strengthening the efficiency of expenditures on capital projects include issues related to the investment project selection, planning, and risk appraisal, including cost-benefit analysis.

Fiscal rules do not provide a strong anchor for fiscal policy, and they are not planned to be met during the ERP’s timeline. The current medium-term fiscal planning breaches the numerical rules for general government deficit (3% of GDP) and debt (60% of GDP) for the entire period. The fiscal strategy’s main focus on a ‘golden rule’ targeting a non-negative current budget balance does not necessarily ensure a primary balance consistent with public debt reduction. The ERP refers briefly to the intention to revise existing fiscal rules, as they are too weak to anchor fiscal policy, and possibly introducing additional rules or reinforcing the current budgetary planning process. A commitment to anchor public debt to 60% of GDP could be a useful tool in strengthening fiscal sustainability. Further support for improving fiscal policymaking could come from the Fiscal Council, tasked among others with evaluating new measures prior to their adoption, in accordance with the Law on budget and fiscal responsibility. Following a failed attempt in 2023, Montenegro relaunched the public call for Council members in late 2024 and aims to set up the Fiscal Council in 2025. Government finance statistics urgently need further improvements to align them with the European System of Accounts (ESA 2010) methodology, which would require reclassifying some operations of public companies into the general government sector, potentially increasing deficit and debt levels.

4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

The Commission approved the Reform Agenda of Montenegro in October 2024. In its Reform Agenda, Montenegro commits to socio-economic and fundamental reforms it will undertake to spur growth and convergence with the EU under the Growth Plan during the period of 2024 - 2027. Under the Reform and Growth Facility¹⁷, the allocation for Montenegro amounts to EUR 383.5 million with EUR 110 million planned in grants and EUR 273.5 million in concessional loans, subject to the implementation of these reforms. Of the total amount of support, EUR 178.5 million is to be allocated in the form of budget support, with the remaining EUR 205 million will be allocated for the financing of infrastructure projects and implemented through the Western Balkan Investment Framework. Montenegro's Reform Agenda is aligned with the structural reforms that are part of the 2023 ERP as well as the common Policy Guidance agreed upon at the Economic and Financial Dialogue of May 2023.

An improved business-oriented institutional and regulatory environment is essential for private sector and business development. The Reform Agenda aims to address critical challenges to doing business, including regulatory and administrative barriers, the informal economy, and the need for legal certainty regarding property rights ownership. The agenda also focuses on enhancing research and innovation, improving the competitiveness of businesses, strengthening governance and financial performance of SOEs, and increasing transparency, efficiency, and integrity in public procurement and State aid processes. Key issues impacting the business environment in Montenegro include inefficiencies and delays in administrative decision-making, inconsistent law enforcement, and poor interpretation of laws by public authorities. Additionally, a lack of transparency and predictability in the adoption of business-related legislation is a significant concern. Businesses also face liquidity constraints due to small debts and blocked accounts caused by administrative procedures. The Reform Agenda addresses these issues by promoting the simplification and digitalisation of essential services, such as company registration, tax and customs payments. It also aims to resolve the problem of small debts through simplified restructuring procedures, update state company registers, and make the legislative process more inclusive and transparent through public consultations and regulatory impact assessments.

The Reform Agenda aims to enhance the governance, efficiency, and accountability of SOEs. Insufficient performance of SOEs translates into fiscal risks and a potential increase in public spending within limited fiscal space. For improving financial performance of Montenegro's SOEs and reducing their dependence on budget support, the Reform Agenda foresees a broad range of actions, including improving financial transparency, strengthening state oversight, implementing a more rigorous approach to managerial appointments based on open, independent, and merit-based selection processes, and increasing managerial accountability. With the assistance of the IMF Montenegro undertook the preparatory work on analysing the legal and regulatory framework of SOE reform and assessing the SOE-related fiscal risks.

The informal economy continues to obstruct the inclusive, sustainable growth and the competitiveness in Montenegro. The informal economy is widespread and continues to be a significant barrier to developing a robust business sector and establishing a functioning market economy. The informality is fuelled by deficiencies in the institutional and regulatory environment, labour market weaknesses, insufficient

¹⁷ <https://eur-lex.europa.eu/eli/reg/2024/1449/oj/eng>

enforcement capacity of the public authorities, corruption and tax non-compliance. The impact of the informal economy is particularly harmful for SMEs that operate legally and microenterprises in the services sector, which dominate the economy. The Reform Agenda tackles this issue horizontally through various reform measures, and specifically, by introducing a series of changes to the legal framework aimed at reducing informality. It also focuses on enhancing the integrity and efficiency of inspection services and implementing risk-based approaches to improve enforcement.

While at an early stage, Montenegro's green transition is aligning with the EU energy policy and the Green Deal. Montenegro's Reform Agenda aims to accelerate the transition to a green, sustainable, climate-neutral, climate-resilient, and inclusive economy. The Agenda seeks to enhance energy security by integrating markets and diversifying energy generation sources, with a focus on renewable energy options beyond hydro power. The Agenda includes the implementation of climate and energy policies aligned with the draft National Energy and Climate Plan, the enhanced Nationally Determined Contribution, and the Long-term Strategy for Climate Action and its Action Plan, thereby advancing decarbonisation and supporting transition in Pljevlja region, which is heavily reliant on coal mining and coal power production. Key measures include the transposition and implementation of the Electricity Integration Package, the deployment of renewable energy, work towards carbon pricing (including full implementation of Monitoring, Reporting, Verification, and Accreditation), aiming to have an EU-aligned Emissions Trading System by 2030. The main challenges lie in the small number of participating installations, the grandfathering of allowances and insufficient fines for non-compliance. Additionally, steps are planned to improve energy performance in buildings, including the implementation of a long-term renovation plan. Aspects related to the sustainability and greenhouse gas emissions saving criteria for biofuels, bioliquids and biomass fuels are to be further addressed.

The aim of the digital reforms in the Reform Agenda is to enhance Montenegro's digital transition and to promote convergence with the EU including the EU's Digital Compass. Montenegro has put forward ambitious digital reforms that are expected to extend the country-wide coverage of broadband¹⁸ and increase the security of digital networks, to create an interoperable, cross-border digital wallet, to further digitalise public services and make them more user-friendly and to increase cyber resilience. The country is implementing the Consumer Protection Programme 2022–2024, which aims to improve the alignment with EU e-commerce regulations. Montenegro has committed to adopt a national plan for the development of broadband infrastructure, secure this infrastructure and expand its broadband network to ensure that rural communities have access to the same services as the rest of the country thus ensuring robust economic growth. Further commitment was made to adopt and implement legislation in line with 1) the European Electronic Communications Code which promotes connectivity and access to, and take-up of, very high-capacity networks and 2) the EU's new Gigabit Infrastructure Act, which aims to ensure faster, cheaper, and simpler rollout of Gigabit network installation. Other reforms areas relate to developing new digital public services to benefit both businesses and citizens, while enhancing digital skills and literacy, and adopting and implementing legislation to fully transpose the EU's 5G Cybersecurity Toolbox, mitigating risks to critical infrastructure.

¹⁸ At end of 2023, around 85.4% of the population of Montenegro was covered by the 5G network signal.

Labour market indicators continued to improve, but structural challenges remain.

According to the labour force survey (LFS), the average unemployment rate fell to 11.6% in 2024, down from 13.2% a year earlier, while the employment rate also increased to 62.9% up from 61.1%, the previous year. Despite these improvements, the 2024 LFS results once again confirmed large regional disparities, with the unemployment rate standing at 2% in the tourism-heavy coastal region, at 8.4% in the central region, and at 25.7% in the poorer northern region. The gender gap narrowed somewhat, but the activity rate of women (64.8%) remained significantly below that of men (77.2%). Remaining major structural challenges are youth unemployment, standing at 26% for the population aged 15-24, and long-term unemployment, as 74.4% of all unemployed have been looking for a job for more than 12 months. The most vulnerable groups on the labour market remain women, young people, Roma and low-skilled workers, with Roma and people with disabilities facing particular challenges in accessing the labour market. Measures are planned to increase female labour force participation and the development of a new gender targeting methodology in line with EU cohesion policy requirements, notably the European Social Fund+. Moreover, to address structural barriers hindering women's active participation in the labour market, Montenegro plans to increase capacities for publicly funded quality early childhood education and care, both in terms of infrastructure and trained personnel employed.

A mismatch of skills represents a significant challenge. The quality and relevance of the entire education system and the lack of practical experience of vocational education and training (VET) are long-standing challenges. Reform steps to address labour market mismatches and to increase the employability of higher education graduates are expected to provide for additional upskilling and reskilling. This will include expanding lifelong learning options for adults and creating more opportunities for work-based practical learning with employers, both for VET students and higher education graduates. In addition, the proposed reform of the career guidance and counselling system and related capacity building could provide significant help for graduates to make better informed career choices.

5. CONSISTENCY OF THE REFORM AGENDA WITH THE ERP'S MACRO-FISCAL FRAMEWORK

The ERP provides model-based simulations of the medium-term impact of investments contained in the EU Growth Plan on macroeconomic variables. The Growth Plan impact assessment covers the public investment of EUR 200 million, without making any specific assumptions on distribution by sector. The assumed timeline of disbursement is not clear, the model focuses on the cumulative results in 2027. A conservative approach is used, the model does not assume any spillovers of crowding-in private investment or higher productivity and competitiveness. The cumulative effect on the level of GDP is estimated at 0.7% by 2027 compared to the baseline scenario without implementation of the Growth Plan investment. The impacts on the levels of public consumption and exports are estimated at 0.5% and 1.6% above the baseline, respectively, while an increase of imports is around 1.6% given a low manufacturing base of Montenegro. The impact assessment on employment 0.3% above the baseline in 2027.

The ERP also presents the impact on the budgetary revenue in 2025-2027. Positive impact is assumed on the revenue from business and labour taxes, contributions, taxes on international trade and VAT. The overall fiscal impact of the Growth Plan on budget revenues is around EUR 80 million during a three-year period, i.e. around 0.9% above the baseline revenue, peaking during the years of 2026 and 2027 when infrastructure

projects and relevant disbursements are expected to intensify. The economic and fiscal impacts have been included in the ERP's macro-fiscal framework.

ANNEX 1: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2024

Every year since 2015, the Economic and Financial Dialogue between the EU and enlargement partners has adopted targeted policy guidance for all partners. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the guidance is evaluated by the Commission in the following year's ERP assessments.

The following table presents the Commission's assessment of the implementation of the 2024 policy guidance jointly adopted at the Economic and Financial Dialogue on 14 May 2024.

Overall: Partial implementation (47.2) ¹⁹	
2024 policy guidance (PG)	Summary assessment
<p>PG 1:</p> <p>Adopt an appropriately tight fiscal stance in 2024 to comply with the budget target and support further disinflation, and use revenue overperformance for deficit reduction and accumulation of government deposits.</p> <p>Adopt a medium-term fiscal strategy, including concrete consolidation measures supporting the achievement of a non-negative primary balance and the public debt ratio not exceeding 60% of GDP by 2026.</p> <p>Elect and appoint members of the Fiscal Council, and ensure and make publicly available a proper costing of new fiscal initiatives</p>	<p>There was limited implementation of PG 1:</p> <p>1) Partial implementation: The general government deficit was in line with the revised target and was slightly lower than projected in the 2024 ERP. However, the measures adopted in September, such as halving pension contributions, result in weakening the revenue base and loosening fiscal policy. Inflation declined, but high net wage increases might generate inflationary pressures in 2025.</p> <p>2) Limited implementation: A medium-term fiscal strategy, including the large decrease in pension contributions partly offset by some consolidation measures, has been adopted. It projects negative primary balances and a debt-to-GDP ratio which will increase in 2026-2027 and exceed 60%.</p> <p>3) Limited implementation: A new public call for the fiscal council members was launched in November. Previous ones failed due to a lack of qualified applicants.</p>

¹⁹ For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's overview and country assessments of the 2017 economic reform programmes, available at: https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en

<p>PG 2:</p> <p>Based on an analysis of the economic and fiscal impact of all tax expenditures to be shared with the Commission, prepare concrete budgetary recommendations to reduce tax expenditure (such as exemptions, deductions, credits, deferrals).</p> <p>Improve SOE oversight by producing and publishing the related fiscal risk assessments.</p> <p>Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space while avoiding exceptions regarding project selection.</p>	<p>There was limited implementation of PG2.</p> <p>1) Limited implementation: A tax expenditure report was adopted by the government in December, but concrete budgetary recommendations on reducing tax expenditure are yet to be developed and shared with the Commission.</p> <p>2) Partial implementation: SOE financial analysis and risk statement was adopted by the government in late December 2024. The risk statement indicates further steps to improve the performance of loss-making SOEs.</p> <p>3) Limited implementation: The Ministry of Finance set up the Department for management of public investment and public procurement policies. There was some improvement in the selection process of mature projects which are financed from the capital budget. Further work is planned with IMF assistance.</p>
<p>PG 3:</p> <p>Continue to thoroughly assess price developments and possible second-round effects, and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability</p> <p>Progress with the implementation of secondary legislation for the Law on Credit Institutions and the Law on Resolution of Credit Institutions and transpose the Bank Recovery and Resolution Directive II.</p> <p>Further enhance risk-based supervision in line with best international and European practices, including by improving data collection to enable a comprehensive assessment of financial sector</p>	<p>There was substantial implementation of PG 3:</p> <p>1) Substantial implementation: The central bank carefully monitored the changes in price dynamics and related factors and inflation expectations. The central bank employs macroprudential tools, which are among the few tools it has at its disposal to influence lending activity and thereby also inflation, for instance by raising countercyclical buffers in March 2024 (effective: April 2025). Fiscal policy contributed to underlying inflationary pressures, including via large net wage increases, even if second-round effects have remained limited so far.</p> <p>2) Substantial implementation: Progress was made in key legislations that further aligned Montenegro's regulation and supervision with the current EU framework, which is pending approval in parliament. However, concerns exist regarding the law on establishing a new state development bank, which raises questions about adequate depositor protection, compliance with best practices in terms of governance as well as being subject to appropriate supervision and regulation applicable to other deposit-taking institutions in order to ensure transparency, sound lending practices and a level playing field.</p> <p>3) Substantial implementation: The central bank has continued to closely monitor bank liquidity, including monitoring deposits on a weekly basis (with a split between residents and non-residents), and put in place rules favouring</p>

risks.

the preservation of capital, for instance the need for a positive opinion from the central bank to distribute dividends. Employing a range of capital buffers, the central bank decided to increase the countercyclical capital buffer in March 2024 from 0% to 0.5% with effect from 1 April 2025 and it stands ready to increase buffers further or deploy other instruments, if needed, to curb excessive lending or house price growth. However, on the real estate sector some data gaps remain.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government of Montenegro submitted its 2025-2027 economic reform programme (ERP) to the Commission on 13 January 2025.

Inter-ministerial coordination

The Ministry of Finance coordinated the work to prepare the 2025 ERP. An inter-ministerial working group involved all relevant ministries.

Stakeholder consultation

The process of preparation of the ERP 2025-2027 started in September 2024, when the government adopted the briefing note on the preparation. Public consultation on the draft ERP took place in December 2024, and included a roundtable discussion with members of the public.

Macro framework

The programme presents a clear and concise picture of past economic developments and covers relevant data available at the time of submission. The information provided is coherent, concise and well structured. The macroeconomic framework is coherent, consistent and sufficiently comprehensive and provides a good basis for policy evaluation and discussions. Statistical tables were not complete in the first submission and were subsequently revised.

Fiscal framework

The fiscal framework is well detailed, in line with stated policy objectives and consistent with the ERP macroeconomic framework. However, fiscal projections were revised due to missing data on the execution of 2024 budget at local and general government level. The main measures of the 2025 budget are quantified for the revenue side, while estimates for the spending side were not provided. Montenegro's fiscal reporting does not follow ESA2010 standards, and therefore does not meet the Commission's fiscal notification requirements.