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MONTENEGRO

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ABBREVIATIONS

ARIMA	Autoregressive Integrated Moving Average
GDP	Gross Domestic Product
CBCG	Central Bank of Montenegro
CPI	Consumer Price Index
ECB	European Central Bank
EMU	Economic and Monetary Union
EU	European Union
FAO	Food and Agriculture Organization
HICP	Harmonised index of consumer prices
IMF	International Monetary Fund
MONSTAT	Statistical Office of Montenegro
OPEC	Organization of the Petroleum Exporting Countries
USA	United States of America
FDI	Foreign Direct Investments
UN	United Nations
USD	US dollar

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1. INFLATION INDICATORS

1.1. Inflation trend in Montenegro

Inflation slowed down in a large number of countries around the world during 2023 under the impact of the manifold reference interest rates increase by the leading central banks, stabilisation in the energy market, and a reduction in disruptions in global supply chains. The downward trend in international food prices has continued since mid-2022, while oil prices have dropped below the level recorded before the conflict in Ukraine, but are still above pre-pandemic level. The January IMF report¹ forecasts average crude oil prices to decline by some 16% relative to 2022. According to the Food and Agriculture Organization (FAO) data, the food price index, which tracks changes in international prices of basic food products, recorded decline of 13.7% relative to the comparative period. Nevertheless, global inflation is still above the average recorded in the period 2010–2019 and the target of central banks. According to the aforementioned IMF forecasts, global inflation in 2023 amounted to 6.8% (compared to 8.7% in 2022), while according to the February forecasts of the European Commission², inflation in the EU amounted to 6.3% (from 9.2%).

After the highest inflation recorded in the previous year in Montenegro since gaining independence (in 2006), there was a gradual slowdown in the growth of consumer prices this year. According to MONSTAT data, consumer prices were 8.6% higher on average in the period January - December 2023, compared to same period of the previous year. The main contributors to the annual inflation growth were the prices in the category *food and non-alcoholic beverages* (3.84 pp), *housing, water, electricity gas and other fuels* (1.38 pp), and *clothing and footwear* (0.82 pp). Since December of the previous year, the annual growth rate of consumer prices had a downward trend until the end of 2023 (with the exception of August, when, under the impact of price growth in the categories food and non-alcoholic beverages, transport and housing, water, electricity, gas and other fuels, the highest monthly growth of 1.7% was recorded).

Annual inflation in December of the current year, measured by consumer prices was 4.3%, while it was 4.9% measured by the harmonized index of consumer prices. The main contributors to the annual inflation growth were the prices in the category *clothing and footwear* (1.03 pp), *housing, water, electricity gas and other fuels* (0.76 pp), and *food and non-alcoholic beverages* (0.63 pp) (table 2). Observing the movement of prices by months, the highest growth of consumer prices was seen in August (1.7%), whereas the lowest growth was recorded in March (0.7%) (graph 1).

¹ IMF: *World Economic Outlook Update, Moderating Inflation and Steady Growth Open Path to Soft Landing*, January 2024.

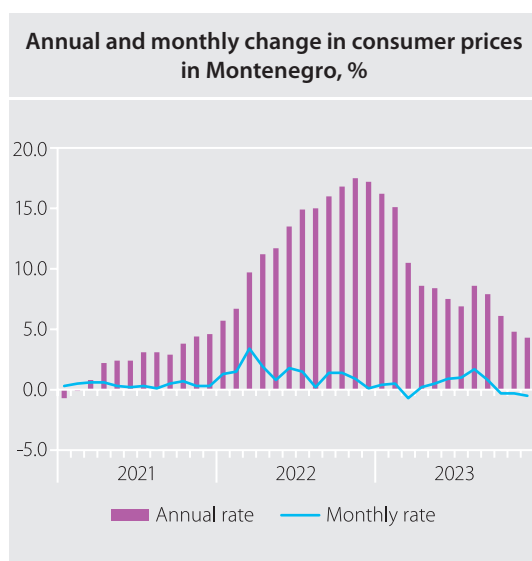
² Source: *European Economic Forecast, Winter 2024*, February 2024.

Table 1

Inflation in Montenegro in the period 2022 – 2023, in %								
	2022				2023			
	III	VI	IX	XII	III	VI	IX	XII
Change in relation to to the previous year-end	6.3	11.1	14.5	17.2	0.2	1.9	5.4	4.3
Annual change	9.7	13.5	16.0	17.2	10.5	7.5	7.9	4.3

Source: MONSTAT

Graph 1



Source: MONSTAT

prices in this category is the result of an increase in food prices, namely: fish and seafood 9.4%, meat 9.0%, sugar, jam, honey, chocolate and sweets 5.9%, bread and cereals 2.8% and vegetables by 1.8%, while the prices of oils and fats decreased by 17.5%, fruit by 4.6% and milk, cheese and eggs by 3.9%. After the anti-inflationary measures adopted by the Government in the previous year, which related to the reduction of key tax rates on basic food products, production inputs (excise duties on fuel), and the price caps of certain products in supermarkets, the actions called “Stop inflation” and “Stop Inflation+” were launched during this year. The Ministry of Economic Development and Tourism, in cooperation with representatives of the largest retail chains in the country, carried out these two actions in the period from the end of March to the end of June and the beginning of October to the end of the year. In this period two so-called “anti-inflation baskets” were formed. They contained initially 25, and then 100+ types of agreed products, the largest part of which is from the category *food and non-alcoholic beverages*. The prices were formed respecting the rule of 5% limit on trading margins in retail and wholesale.

Consumer prices also increased in the following categories: *hotels and restaurants* 13.2% (mostly as a result of an increase in prices for accommodation services of 15.0%), *other goods and services* 5.7%, *alcoholic beverages and tobacco* 5.6%, *health* 5.5%, *furnishing, household equipment and routine household maintenance* 4.6%, *recreation and culture* 3.8%, *education* 2.7% and *transportation* 1.6%, while consumer prices in December decreased on an annual basis only in category of *communication* by 0.3%.

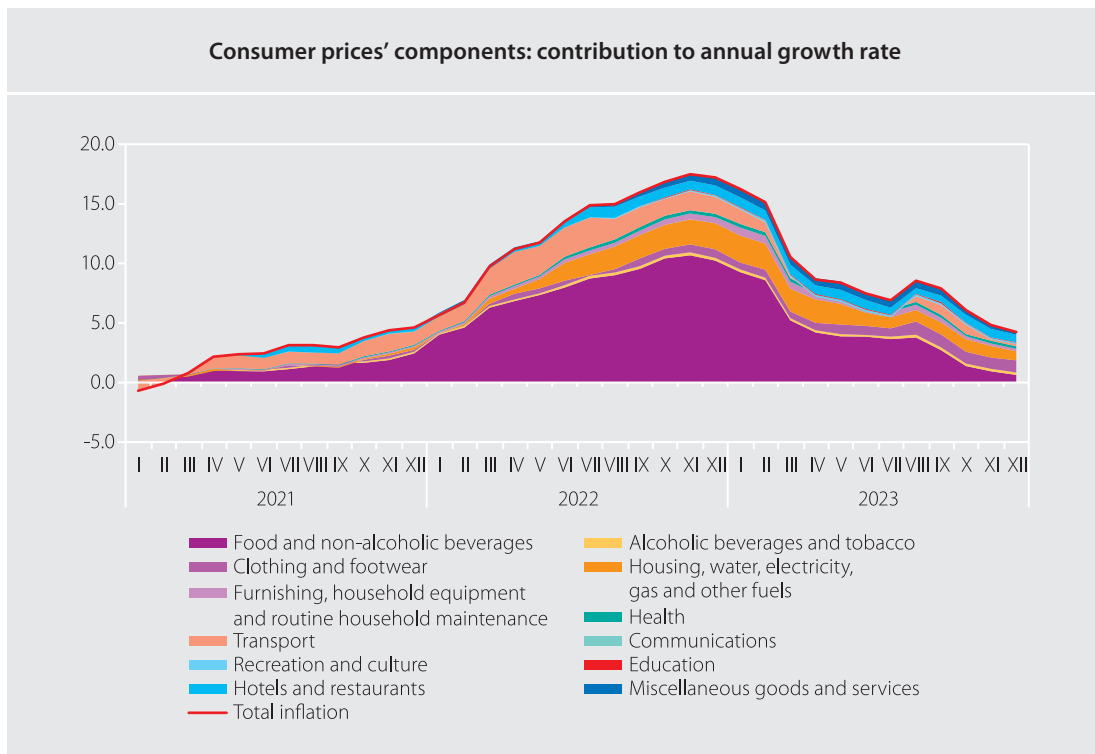
The biggest contribution to the growth of the annual inflation rate in December was made by prices from the *clothing and footwear* category (1.03 pp) with a growth of 12.8% (table 2), mostly as a result of a 20.0% increase in footwear prices. A significant contributor to the annual inflation (with 0.76 pp) were prices under the *housing, water, electricity gas and other fuels* category that rose 5.6%. Growth in solid fuel prices of 9.3% (the largest part of which refers to the increase in beech firewood prices of 10.2%) which is significant considering the high base from December of the previous year when the annual growth was 55.2%), and real rents paid by tenants for primary residence of 10.4% (due to the increased demand for apartments by non-residents) had the highest impact on the growth of the aforementioned category. Also, prices growth in the category *food and non-alcoholic beverages* of 1.7% contributed to total inflation growth with 0.63 pp. The increase in

Table 2

Annual rate of growth (%) and contribution of individual categories to total inflation ³ in Montenegro				
	Weights	XII 2023 XII 2022	Growth rate	Contribution
Total	1,000.0	104.3	4.3	4.3
Food and non-alcoholic beverages	360.3	101.7	1.7	0.6
Alcoholic beverages and tobacco	37.3	105.6	5.6	0.2
Clothing and footwear	80.8	112.8	12.8	1.0
Housing, water, electricity gas and other fuels	136.6	105.6	5.6	0.8
Furnishing, household equipment and routine household maintenance	44.2	104.6	4.6	0.2
Health	39.1	105.5	5.5	0.2
Transport	118.3	101.6	1.6	0.2
Communication	45.1	99.7	-0.3	0.0
Recreation and culture	31.4	103.8	3.8	0.1
Education	18.4	102.7	2.7	0.0
Restaurants and hotels	47.1	113.2	13.2	0.6
Miscellaneous goods and services	41.5	105.7	5.7	0.2

Source: MONSTAT

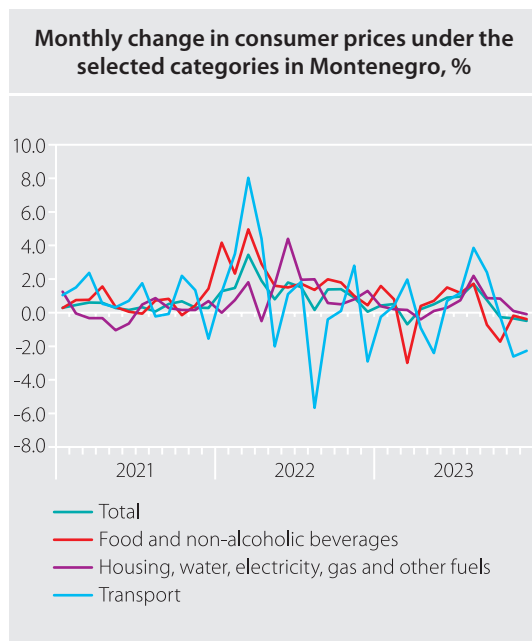
Graph 2



Source: MONSTAT

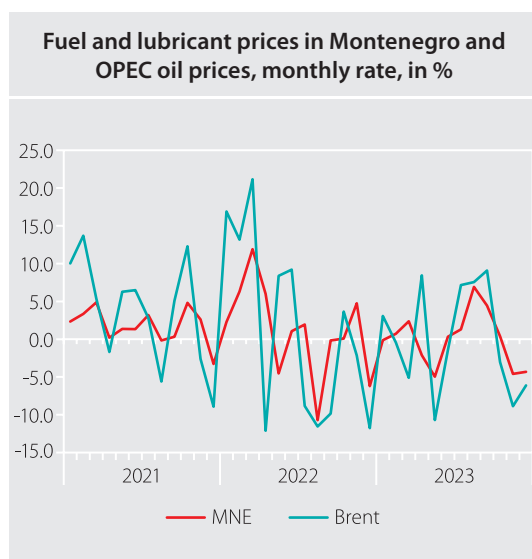
³ It should be noted that, regardless of the index changes, the contribution of the share of certain categories is not recorded before the second and/or third decimal due to the weight structure.

Graph 3



Source: MONSTAT

Graph 4



Source: MONSTAT and OPEC Monthly Oil Market Reports (*North Sea Dated)

The average price of oil recorded the year-on-year decline in 2023. The drop-in oil prices were caused by concerns over the increase in global oil stocks and the slowdown in demand growth. Oil prices experienced short-term jumps⁴ during the year. In the first half of the year, crude oil prices fluctuated following a ban on Russian crude oil imports into the EU, several interest rates increase by global central banks and concerns about inflation and recession. However, crude oil prices in the observed period were significantly less volatile than in 2022, when prices reached multi-year tops as a result of the Russian-Ukrainian conflict. In the second half of this year, geopolitical tensions and concerns about crude oil demand led to more price fluctuations (rise in the third quarter and decrease during the last quarter). As uncertainty from the wider conflict between Israel and Hamas and further disruption to oil supplies receded, concerns about crude oil demand once again sent prices down. In December, the markets were faced with the unexpected exit of Angola from the OPEC and the conflict between Israel and Hamas on ships in the Red Sea, which had the effect of creating a new disruption in transport communications in the area.

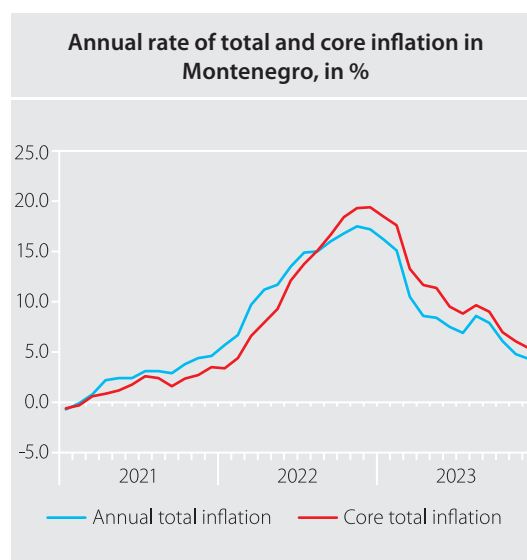
The price of the OPEC reference basket averaged 82.98 USD/barrel in this period, being 16.94% lower than the average recorded a year ago. The average price of Brent oil in the observed period stood at 82.62 USD/barrel or 18.14% less. Observed on a monthly basis, the lowest level of the average Brent price was recorded in June (74.73 USD/barrel), which is also the lowest price since December 2021 (when it was 74.10 USD/barrel). The IMF⁵ January 2024 report forecasts crude oil price to average at 79.10 USD/barrel in 2024 and 75.31 USD/barrel in 2025.

⁴ <https://www.eia.gov/todayinenergy/detail.php?id=61142>

⁵ IMF: *World Economic Outlook Update, Moderating Inflation and Steady Growth Open Path to Soft Landing*, January 2024.

The annual core inflation rate stood at 5.4% in December and it was 1.1 pp higher than total annual inflation. This was due to the rise in the prices of almost all groups of food products that are not excluded from the calculation, as well as the prices of other product groups that determine core inflation on annual level. Annual core inflation was higher than the total inflation during 2023 (graph 5). The largest spread between total annual and core inflation was recorded in April due to price changes of certain products that are included in the annual inflation calculation, but not included in the core inflation calculation (e.g. prices of a large number of agricultural products, tobacco, fuel and lubricants, and the like). The higher level of core inflation indicates that there are still factors that can have an impact on medium-term price stability.

Graph 5



Source: MONSTAT and CBCG calculations

The UN report *World Economic Situation and Prospect 2023* from January 2024 indicates that inflation in advanced countries amounted to 4.8% in 2023, which represents a significant decrease compared to the previous year, when it amounted to 7.8%. In the transition countries, a slowdown in inflation was also recorded in most countries from the level of 13.2% in 2022 to 8.5% in 2023. A fall in inflation was also recorded in developing countries, from 8.2% in 2022 to 6.9% in 2023, due to a decrease in the level of inflation in the regions of East Asia, South Africa and Latin America and the Caribbean. As stated in the Report⁶, inflation in advanced countries could amount to 2.8% in 2024, 5.3% in transition countries, and 5.6% in developing countries.

Producer prices of export manufactured products⁷ recorded the year-over-year decrease of 1.0% in December 2023, while their average annual price decline was 8.5%. Prices in the manufacturing industry sector recorded an average decline of 10.5%, while in the mining and quarrying sector a price increase of 1.9% was recorded.

⁶ Detailed data on inflation trends for individual regions and countries are listed in the Report Annex *World Economic Situation and Prospect 2018*, in Tables A.5, A.6 and A.7.

⁷ The exports prices index represents monthly changes in the prices of manufactured products made by companies and sold at foreign markets. It is an important economic indicator that can be used as time series deflator, particularly for national account purposes.

Import prices of manufactured products⁸ recorded the year-on-year increase of 2.7%, and the average annual rate of growth amounted to 3.5%. Average annual price growths were recorded in both mining and quarrying sector and manufacturing industry of 9.9% and 3.5%, respectively.

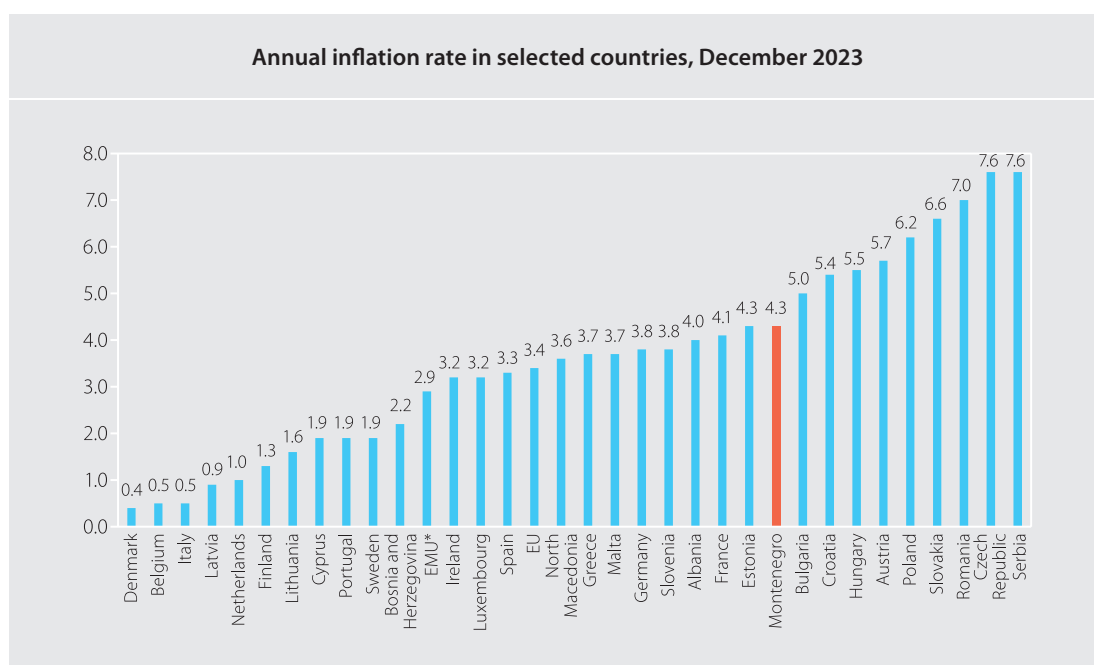
The trend in import and export prices has an impact on the price competitiveness of Montenegrin products and services, emphasizing still low competitiveness, evident in the current account deficit.

1.2. Inflation trends in the region and the EU

Inflation slowdown were recorded in majority countries in the region and the EU. The highest annual rate of consumer prices in December 2023 among the countries of the region was recorded in Serbia 7.6%, followed by Albania 4.0%, The Republic of North Macedonia 3.6%, while in Bosnia and Herzegovina it was 2.2%.

The annual HICP⁹ inflation recorded in the EU stood at 3.4% in December 2023. Of the EU member states, the highest annual rate was recorded in the Czech Republic 7.6% and Romania 7.0%, and the lowest in Denmark 0.4% (graph 6). The annual HICP inflation in the euro area amounted to 2.9%

Graph 6



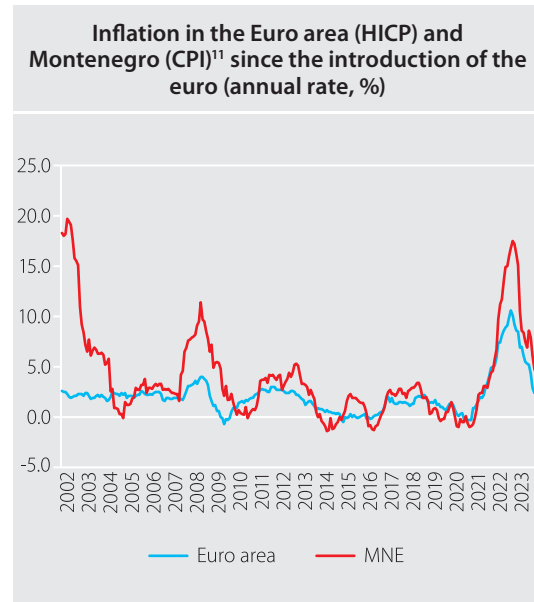
Source: National statistical offices and Eurostat

⁸ Import prices index refers to monthly changes of imported manufactured products. It can be used as a time series deflator, especially for the needs of national accounts and as a means of harmonizing prices at the conclusion of different sales contracts.

⁹ Harmonised Index of Consumer Prices (HICP) is the basis for a comparative measure of inflation in Europe and the assessment of stability of monetary value in the euro area. Every EU member state is obliged to produce the HICP index.

and it was 6.3 pp lower than the annual rate in December 2022, and the highest contribution of 1.74 pp and 1.21 pp was made by the annual growth of prices of services of 4.0%, i.e. food and non-alcoholic beverages 6.1%. The average annual rate in the euro area was 5.4% in 2023, but in its February report¹⁰ the European Commission forecasted an inflation rate of 2.7% in 2024 and 2.2% in 2025.

Graph 7



Source: MONSTAT and Eurostat

¹⁰ Source: *European Commission European Economic Forecast, Winter 2024*, February 2024.

¹¹ Cost of living had been used for measuring inflation in Montenegro until 2009, after which consumer prices were introduced.

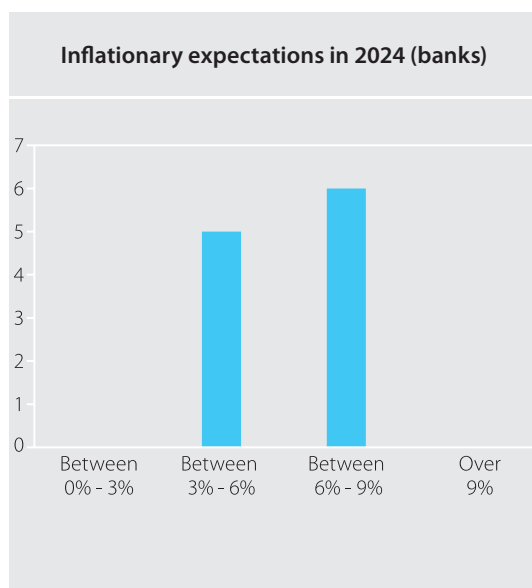
2. INFLATION EXPECTATIONS OF THE BANKING AND CORPORATE SECTOR

2.1. Banks' expectations

When it comes to banks' inflation expectations, based on a survey conducted in January and February 2024¹², six banks expect inflation to range between 6% and 9% in 2024, five banks between 3% and 6% (graph 8), No bank expects inflation between 0% and 3% and above 9%.

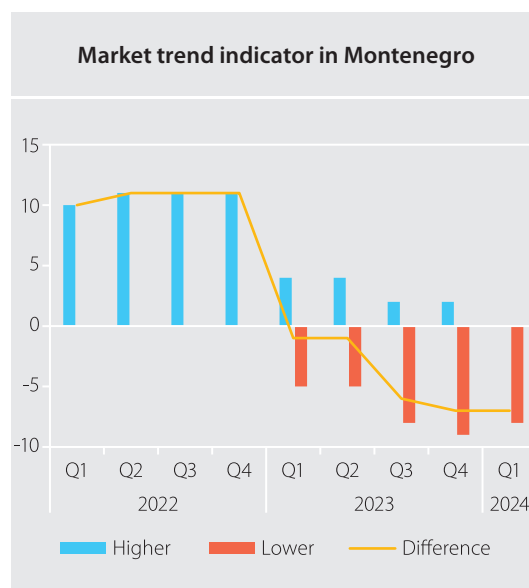
For the purpose of calculating inflation forecasts, we use the market trend indicator (line at graph 9) that is calculated as the difference between the number of banks expecting inflation growth and those expecting inflation decline. If the market trend indicator has a negative value, a decrease in inflation is expected in the upcoming period. However, if its value is positive, then an increase in the inflation rate can be expected. If it has a zero value, an unchanged inflation rate can be expected in the upcoming period. The more negative value of the market trend indicator, the lower the inflation expectations and vice versa, higher positive value means higher inflation level expectations. The surveys conducted in the first quarter indicate a decline in banks' inflation expectations in 2024.

Graph 8



Source: CBCG Survey

Graph 9



Source: CBCG Survey

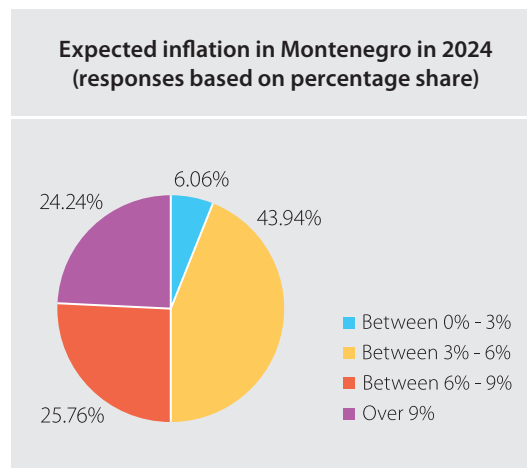
¹² Event after the reporting period of the Price Stability Report 2023.

2.2. Expectations of the corporate sector (banks excluded)

Inflation

Of the total number of the surveyed economic entities, most of them (43.94%) believe that the annual inflation rate in 2024 will be between 3% and 6% (graph 10), 25.76% forecast the annual inflation rate from 6% to 9%, while 24.24% of the respondents think that inflation will be above 9%, and only 6.06% expect inflation to range from 0% to 3%.

Graph 10



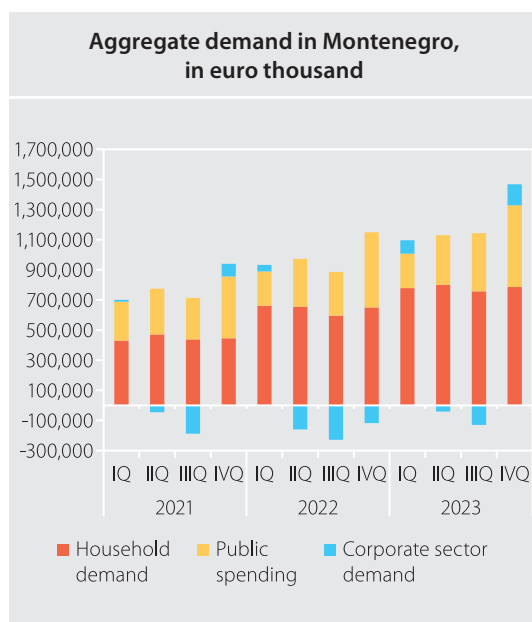
Source: CBCG Survey

3. INFLATION DETERMINANTS

3.1. Demand

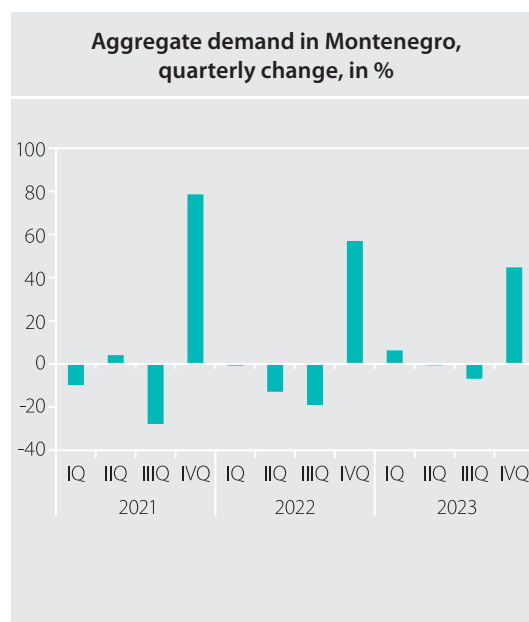
According to preliminary indicators, the total demand in the fourth quarter of 2023 was higher than in the other three quarters, as well as compared to the fourth quarter of the previous year. Observing the structure of total demand in Q4 2023, compared year-over-year, the share of household demand and public spending decreased, while the corporate demand component increased.

Graph 11



Source: CBCG calculations

Graph 12



Source: CBCG calculations

Box 1 – Aggregate demand calculation methodology

For the purpose of complete monitoring of aggregate demand as the inflation determinant, the CBCG has developed the aggregate demand calculation methodology. The starting point of this methodology states that the aggregate demand represents the sum of the demand of three sectors: personal spending (households), investment spending (corporate sector), and public spending. However, considering the lack of numerous data necessary for calculating the aggregate demand, the existing data should not be treated as the indicator of the exact amount of aggregate demand, but as an indicator showing the aggregate demand trend.

In the existing methodology, a number of substantial data were not available, such as: corporate investments, revenues from share sales, non-market income, non-observed economy revenues, and the like. Methodology of aggregate demand calculation is expressed by the following equation:

$$AD = C + I + G$$

AD – aggregate demand

C - personal spending = sum of paid salaries + sum of paid pensions + paid frozen foreign currency deposits + net compensations to households – retail sector net savings (savings – loans granted)

I - investment spending = - net corporate savings (deposits – loans)

G - public spending = public consumption – paid pensions – salaries paid from the budget – net Government savings (deposits – loans – Treasury bills)

3.1.1. Earnings and other available demand determinants

MONSTAT data show that average gross earnings in Montenegro was 987 euros in 2023 and it increased by 11.35 in relation to the average in the previous year. At the same time, the average salary without taxes and contributions amounted to 792 euros and it was 11.24% higher as a result of the “Europe Now!” program. The highest earnings without taxes and contributions were recorded in the *financial and insurance activities* (1,257 euros) and *electricity, gas, steam, and air conditioning supply* (1,218 euros), while the lowest earnings were recorded in *manufacturing industry* (625 euros) and *administrative and ancillary services sector* (636 euros). The highest increase in earnings without taxes

Graph 13

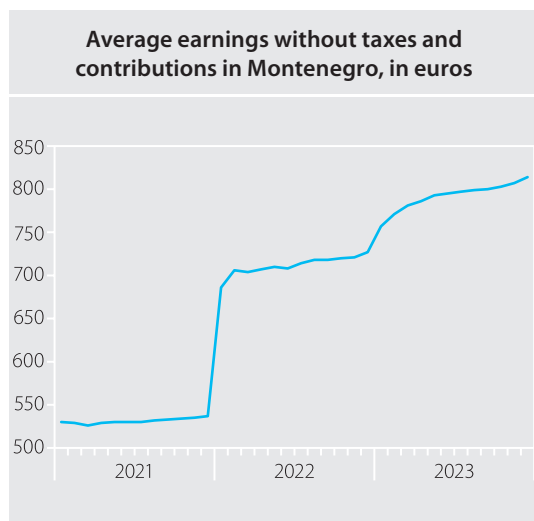


Source: MONSTAT

and contributions was recorded in the sector of *state administration and defence, mandatory social insurance* 20.5%, then in the *mining and quarrying* sector 17.2%, *information and communications* 15.6%, while earnings grew the least in the sector of *other service activities* 3.1% (graph 13).

Observed by months, nominal growth in earnings without taxes and contributions was recorded in all months, but the highest growth was in January - 4.13% (graph 14), while the lowest nominal growth of 0.13% was recorded in September.

Graph 14



Source: MONSTAT

If we consider consumer prices, i.e. trends in earnings in real terms, it can be concluded that real earnings recorded the highest growth in January, while the highest real decline was reported in August.

Retail loans¹³ recorded positive trends during 2023. Loans to this sector grew at a monthly average rate of 0.70% during the reporting year, while this rate was 0.69% in 2021.

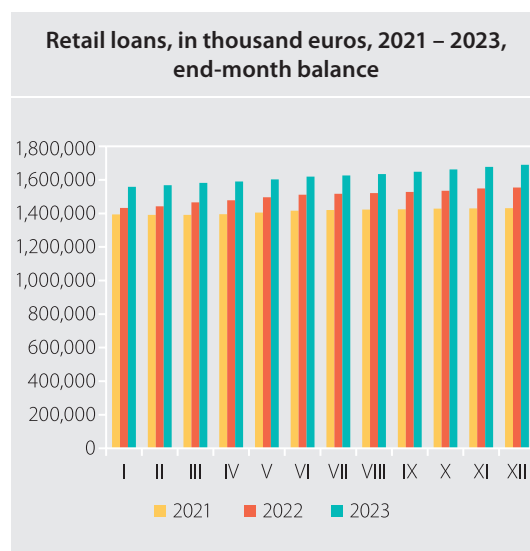
Total retail bank loans amounted to 1,689.85 million euros at end-2023, which is the year-over-year growth of 134.77 million euros or 8.67% (graph 16).

Graph 15



Source: MONSTAT

Graph 16



Source: CBCG calculations

¹³ The retail sector includes resident natural persons and entrepreneurs.

Per capita debt¹⁴ amounted to 2,668.92 euros at the end of the reporting period and it rose 151.32 euros of 6.01% year-over-year.

Total retail MFIs loans amounted to 72.80 million euros at end-2023 which was by 5.85 million euros or 8.73% more than at end-2022.

Retail deposits amounted to 1,900.84 million euros at end-2023, recording an intensive growth of 199.47 million euros or 11.72% y-o-y.

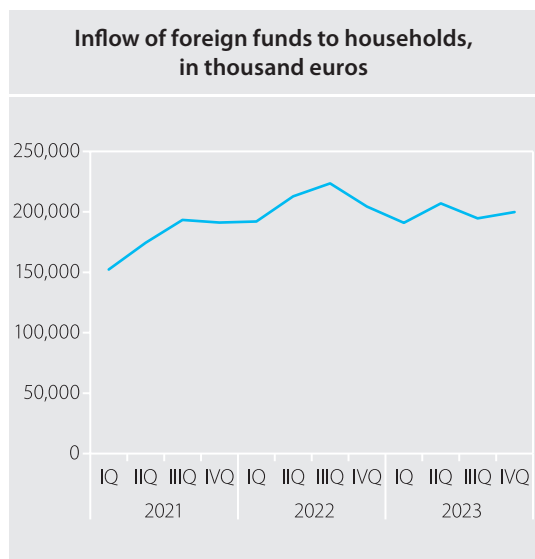
The loans to deposits ratio of the retail sector was 0.89 at end-2023 and it decreased year-on-year when it was 0.91.

At end-2023, the retail sector had a net savings of 210.99 million euros, which is was much more favourable year-on-year when the retail sector net savings amounted to 146.28 million euros.

In 2023, the balance of payments statistics recorded a slight increase in the inflow of funds based on employee compensation compared to 2022, while a decrease was recorded based on personal transfers from abroad.

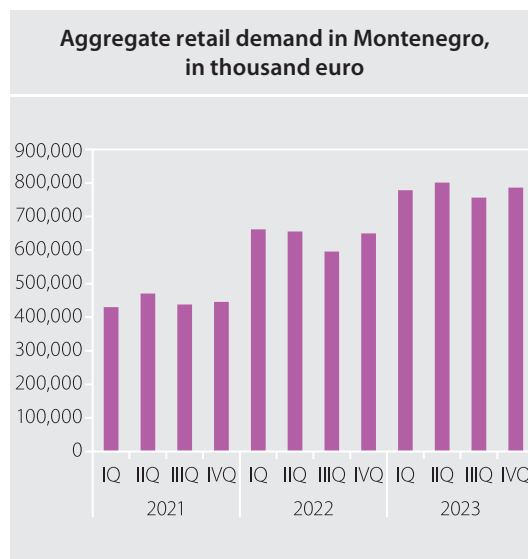
According to preliminary indicators, total retail demand in Q4 2023 was higher than in Q1 and Q3, as well as compared to Q4 2022, while it was lower in relation to Q2.

Graph 17



Source: CBCG

Graph 18



Source: CBCG calculations

¹⁴ Population in 2023, according to preliminary results of Census of Population, Households and Dwellings amounts to 633.158, source: MONSTAT.

3.1.2. Public sector demand

Montenegro's public finances¹⁵

According to the Ministry of Finance preliminary data, **public spending** reached 2,900.05 million euros or 42.35% of the estimated GDP¹⁶ for 2023. Compared to the plan, public spending was 63.53 million euros or 2.14% lower, and 326.04 million euros or 12.67% higher than in the previous year. The increase in consumption was mostly caused by an increase in expenditures based on gross earnings and contributions at the expense of the employer, that is, by an increase in the earnings of employees in the public sector.

The recorded level of public spending was financed from tax revenues (1,889.52 million euros), contributions (575.73 million euros), other revenues (198.18 million euros), fees (134.97 million euros), revenues from donations (122.59 million euros), and duties (20.31 million euros).

Current public spending (public spending reduced by capital expenditure) amounted to 2,563.01 million euros or 37.43% of GDP and it grew year-over-year by 15.39%, while capital expenditure amounted to 337.04 million euros or 4.92% of GDP.

According to individual economic classification, transfers accounted for the main share in the structure of public expenditures with 44.64%, followed by current public expenditures with 41.25%, capital expenditures 11.62%, while 2.49% referred to other expenditures - repayment of guarantees and liabilities from the previous period.

Preliminary public revenues were estimated at 2,941.30 million euros or 42.96% of estimated GDP, being 5.91% and 26.66% higher in relation to the 2022 plan and 26.66% relative to 2022. As for the structure of public revenues, tax revenues accounted for the main share of 64.24%, followed by contributions with 19.57%, whereas the other revenues accounted for the remaining 16.19%.

In 2023, according to preliminary data from the Ministry of Finance, a cash surplus of public expenditures was 41.25 million euros or 0.60% of GDP, while in 2022 a **cash deficit of public expenditures** amounted to 251.72 million euros or 4.25% of GDP.

Budget of Montenegro

According to Ministry of Finance preliminary data, total revenues¹⁷ of the Budget of Montenegro amounted to 2,901.21 million euros or 42.37% of GDP in 2023.

¹⁵ The structure of public finances of Montenegro consists of the Budget of Montenegro with state funds (Pension and Disability Insurance Fund, Health Insurance Fund, Compensation Fund, Employment Agency and Labor Fund) and budgets of local governments (Capital Cetinje, Capital Podgorica and 23 municipalities).

¹⁶ The estimated GDP for 2023 is 6,847.12 million euros.

¹⁷ According to the Law Amending the Law on Budget and Fiscal Responsibility (adopted at the end of February of the current year), receipts include current revenues (direct and indirect taxes and non-tax revenues), borrowings and loans from domestic and foreign sources, receipts from property sales and receipts from loan repayments. Revenues from loan repayments are excluded from source revenues and are now part of financing transactions.

Current revenues of the Budget amounted to 2,566.40 million euros and they accounted for 37.48% of the projected GDP. Compared to the plan, they were higher by 5.93%, and compared to 2022 higher by 28.62%, which is primarily the result of an increase in other revenues, i.e. termination of the hedging arrangement from 2021 and the transfer of funds collected from the implementation of the “Economic Citizenship” project. Also, a significant increase was recorded in value added tax, corporate income tax, excise duties and contributions for pension and disability insurance, which is conditioned by the growth of economic activity, improvement of tax discipline, successful summer tourist season, import and inflation growth, results of business entities in the previous year, implementation of progressive taxation rate profit, the increased basis for calculating contributions due to the increase in coefficients for the earnings of employees in the public sector, the successful implementation of the Law on the Reprogramming of Tax Claims, the cessation of the implementation of the Decision on the reduction of excise duty for the sale of unleaded gasoline and gas oils, the increase in excise duties on tobacco and tobacco products and the introduction of excise duty to sugar products, cocoa and ice cream.

In the structure of current revenues, tax revenues accounted for the main share of 64.92%, followed by contributions with 22.43%, other revenues with 7.08%, donations with 2.78%, fees with 2.17%, and duties with 0.62%.

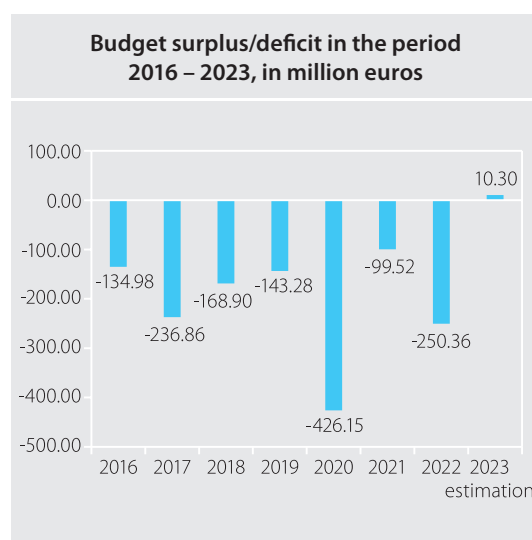
Tax revenues amounted to 1,666.02 million euros, recording a 5.36% increase relative to the plan and a 20.63% increase y-o-y. The biggest increase compared to the previous year was recorded in the collection of value added tax (151.22 million euros or 16.65%), dominantly due to the expenditures increase.

Revenues based on contributions amounted to 575.73 million euros and were higher by 12.40% compared to the planned, while at the annual level they recorded a growth of 24.40%, which is the result of the increased base for calculating contributions due to the increase in coefficients for earnings of employees in the public sector, as well as the successful implementation of the Law on reprogramming of tax liabilities.

Consolidated budget expenditures amounted to 2,556.10 million euros in 2023 and they accounted for 37.33% of GDP. Recorded expenditure was 3.14% lower than planned but 13.82% higher y-o-y. Current budget expenditures amounted to 1,073.05 million euros, being slightly lower than planned but 16.17% higher than in 2022. Social protection transfers amounted to 825.11 million euros or 12.05% of GDP. Capital expenditures amounted to 238.80 million euros or 3.49% of GDP.

The cash surplus of the Montenegrin budget was estimated at 10.30 million euros or 0.15% of GDP, while in the previous year a cash deficit was 250.36 million or 4.23% of GDP. Debt repayment amounted to 301.21 million euros.

Graph 19



Source: Ministry of Finance

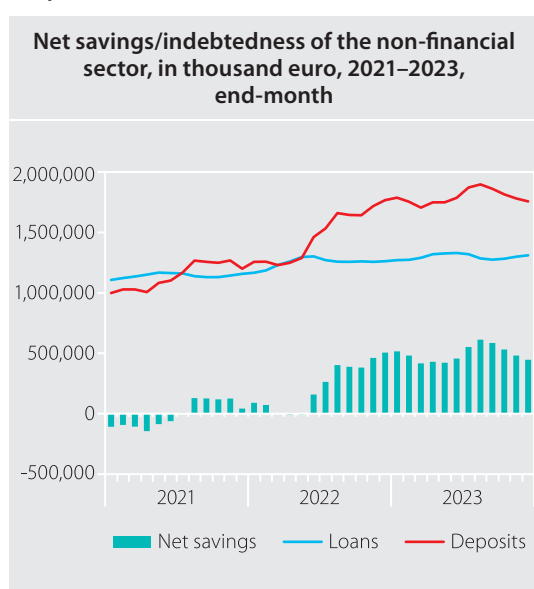
3.1.3. Non-financial sector

Lending to the non-financial sector¹⁸ recorded positive trends during 2023. Average monthly growth of loans to this sector recorded a growth rate of 0.33 during the observed period.

Total loans of the non-financial sector amounted to 1,275.70 million euros at end-2023, which is 49.04 million euros or 3.89% more than a year ago.

Long-term loans accounted for the main share in the structure of loans to the sector with 84.20%, which indicates that loans to the corporate sector were mainly used for increasing the volume of economic activity.

Graph 20



Source: CBCG calculations

Deposits of the non-financial sector amounted to 1,757.09 million euros at the end of the reporting year and they declined by 9.56 million euros or 0.54% compared to end-2022.

The loans to deposits ratio of the non-financial sector amounted to 0.69 at end-2023 and it decreased year-on-year when it was 0.71.

Due to the lack of data on the non-financial sector investments, we can use the sector's net savings/indebtedness as an approximation.

At end-2023, net savings of the non-financial sector was recorded in the amount of 446.47 million euros, which is lower compared to the previous year when net savings was recorded in the amount of 505.07 million euros (graph 20).

3.1.4. External demand and the current account

Preliminary data show that the current account deficit amounted to 782.24 million euros in 2023, which is the year-on-year increase of 2.11%. This deficit increase is a result of an increased deficit on the goods account and decrease in surpluses on the primary and secondary income accounts.

The goods account recorded a deficit of 2,983.09 million euros or 11.72% more than in the comparative period last year. Total visible exports amounted to 716.03 million euros, recording a decrease of 6.21%, whereas total visible imports amounted to 3,699.12 million euros, being 7.73% higher year-on-year. The services account recorded a surplus of 1,695 million euros, which is 28.66% more than in the same period last year. The primary income account registered a surplus of 67.43 million euros, which is a

¹⁸ The non-financial sector includes state companies and private companies.

decline of 42.87% that resulted from an increase in expenditure for international investments of 43.41%. The secondary income account ran a surplus of 438.43 million euros, 6.43% less in relation to the comparative period last year.

Preliminary data suggests that the net inflow of foreign direct investments (FDI) amounted to 428.67 million euros in the reporting year, which is the year-on-year fall of 45.23%. Total FDI inflow reached 856.99 million euros and it dropped by 25.59% (graph 21). Equity investments amounted to 558.44 million euros (a 16.36% decrease), while the inflow in the form of intercompany debt added up to 264.65 million euros or 34.09% less year-over-year. In the structure of equity investments, investments in companies and banks amounted to 95.26 million euros (a 56.58% decline), while real estate investments reached 463.18 million euros (a 3.33% increase). The inflow arising from the withdrawal of funds invested abroad amounted to 33.90 million euros. In the structure of total FDI inflow, the share of real estate investments amounted to 54.05%, followed by intercompany debt with 30.88%, while 11.12% were investments in companies and banks. Total FDI outflow amounted to 428.32 million euros or 16.06% more than in 2022. The outflow from residents' investments abroad amounted to 91.92 million euros, while the withdrawal of non-residents' funds invested in Montenegro amounted to 336.40 million euros.

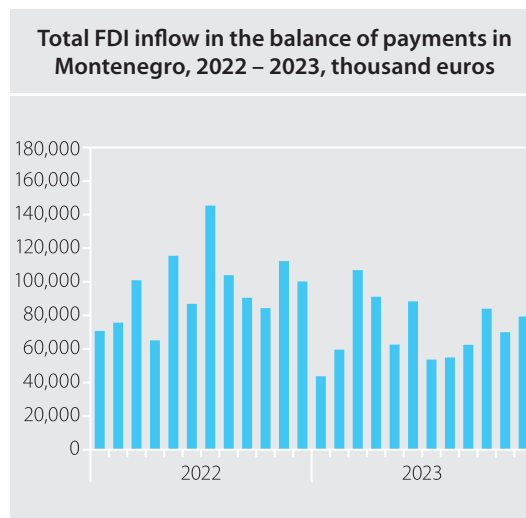
The portfolio investments account recorded a net outflow of 446.09 million euros, while the net outflow from the other investments account amounted to 485.38 million euros.

3.2. Supply and production

In 2023, industrial output recorded y-o-y increase of 6.4%, according to preliminary MONSTAT data. Output growth was recorded in *electricity, gas and steam supply* sector (26.2%), and in the *mining and quarrying* (3.9%), while the *manufacturing industry* recorded output decline (6.1%). Observing monthly data on industrial output (graph 22), the highest monthly growth was recorded in February (32.2%), while the highest decrease was recorded in January (30.6%).

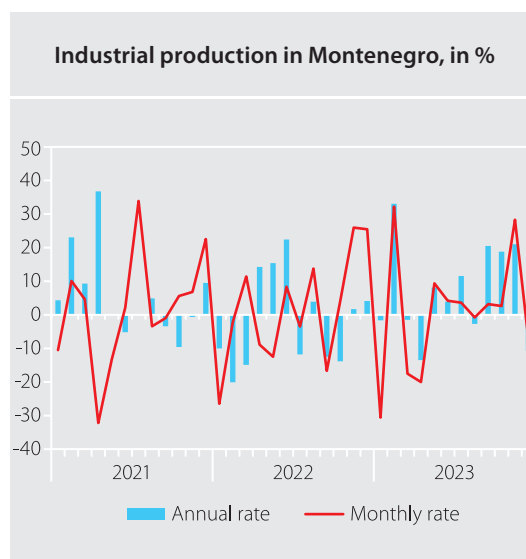
Preliminary MONSTAT data indicate that 2.61 million **tourists** visited Montenegro in 2023, which is 19.66 more than in the previous year, but 1.21% less than in the record pre-crisis year

Graph 21



Source: CBCG

Graph 22



Source: MONSTAT

2019. In the same period, 16.39 million overnights were recorded, which represents a growth of 31.87% compared to 2022, i.e. 13.37% more compared to the period before the pandemic.

MONSTAT data shows that a total of 344.018 m³ of **forest assortments from the national forests**¹⁹ were produced in 2023, which is the year-on-year increase of 28.1%²⁰.

Preliminary MONSTAT data show that the value of executed **construction works** amounted to 634.38 million euros in 2023, which is a 7.88% decline year-on-year. Measured by the effective working hours, construction activity amounted to 17.39 million euros and it dropped by 4.04%.

MONSTAT data also indicate that the results in **transport** showed positive trends in the majority of its segments. Thus, road passenger transport increased 8.4%²¹ year-over-year, while road freight transport increased by 9.8%²². Railway transport saw a 9.8%²³ increase in passenger transport, while freight transport declined by 17.2%²⁴. Air transport saw a 30.6% growth in passenger traffic at airports, and cargo traffic at airports increased by 45.3%. Total turnover of goods in ports amounted to 2.41 million tonnes and it was 17.7% lower compared to the previous year, with exports accounting for 58.5% and imports made up 41.5%. Exports in this period declined by 22.9% while imports decreased by 9.2%.

¹⁹ The total production of forest assortments is to be published by MONSTAT at end-2024.

²⁰ Presented through weighted index.

²¹ Presented through the number of transported passengers, while it increased by 1.0% when expressed in passenger kilometres

²² Presented through transported goods in thousand tonnes, and when presented in ton-kilometres it increased by 9.4%.

²³ Presented through the number of transported passengers, but when presented in passenger-kilometres, it increased by 30.9%.

²⁴ Presented in thousand tonnes, while presented in ton-kilometres, it decreased by 13.6%.

4. MONETARY POLICY

During 2023, there were no changes to the existing monetary policy instruments nor were any new decisions made regarding the Central Bank of Montenegro's monetary policy instruments.

By analysing the trend of the reserve requirement, as well as the overall macroeconomic situation in the country, it was concluded that it is not necessary to change the rate of the reserve requirement, neither the basis nor the other elements of the decision, but all elements of the existing decision are retained.

5. INFLATION FORECAST FOR 2024

5.1. Model assessment

Montenegro's inflation Fan Chart is a graphic representation of inflation forecast probability distribution presented by the consumer price index. In that respect, instead of determining specific points, the Fan Chart also considers potential risks and uncertainties through probability distribution that might influence the inflation trend in the following period. The very purpose of the Fan Chart is to indicate and consider the uncertainties in the real economy flows, which are consequently reflected in the inflation rate trend (increase in energy prices, increase/decrease in the foreign trade deficit, and the like).

Montenegro's Fan Chart for 2024 was based on the following three estimated components:

1. **Central projection value** – the value of the Fan Chart central projection derived from the ARIMA model;
2. **Degree of uncertainty** – determines the Fan Chart width. The uncertainty degree ratios are obtained through analytical assessment and calculation of the relative impact of potential internal and external shocks that are possible in the Montenegrin economy over the one-year period and which are reflected through the “thickness” of the band around the central projection.
3. **Fan Chart skewedness** – based on the level of skewedness of the distribution of inflation projection, the Fan Chart is adjusted to the forecast to show whether the values of the central projections have overestimated or underestimated inflation rates. The position of the mean value of inflation distribution will also depend on this.

Central projection of Fan chart - ARIMA model 2024

With a view to developing a Fan Chart, an ARIMA (Autoregressive Integrated Moving Average) model of time series of inflation of Montenegro presented via the Consumer Price Index was developed.

The ARIMA model was used for short term forecasts (12 months), whereby iteration of several ARIMA models was made, which were ranked based on their efficiency and diagnostics quality. The selected ARIMA model, ARIMA (10,1,27) has sufficient confidence level for forecasts.

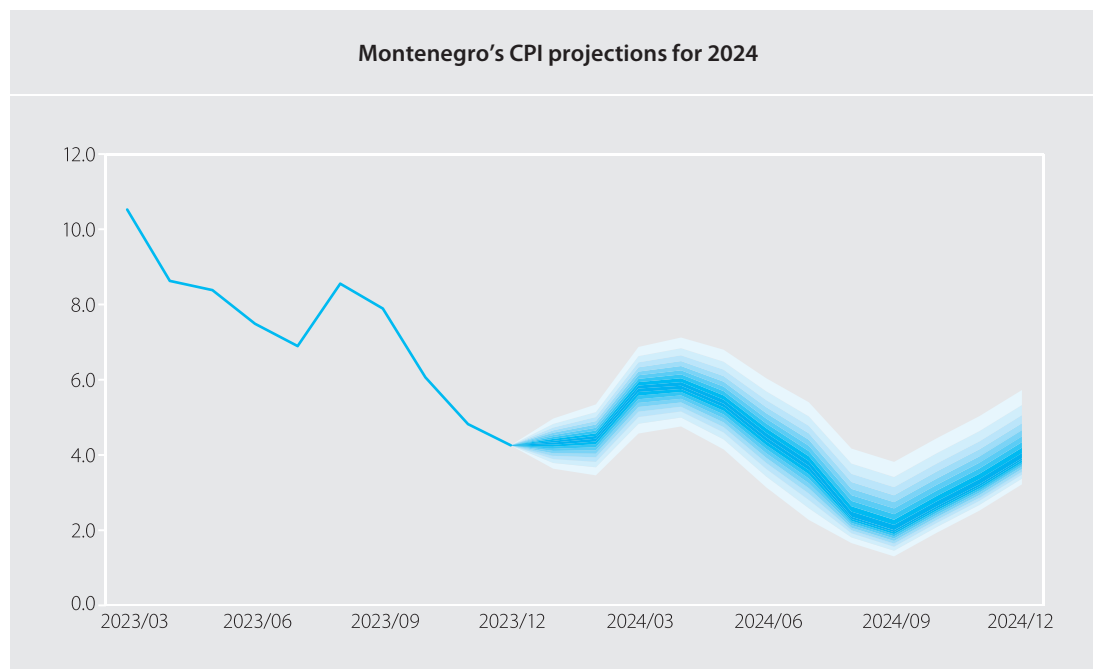
Monthly forecast values were used as the value of central projection in the CPI graph for 2024. Obtained values represent the distribution mode, i.e. values with the highest frequency in the distribution of this time series.

Mean value of the obtained model is 4%. The value of the coefficient of asymmetry varies between 0.5 and 1.4, and the relative standard deviation is 0.3. Model projection of inflation is located in the central span of the distribution. This indicates that the corresponding range of uncertainty of future inflation is set towards higher levels. The Fan Chart explains a 90% probability of inflation distribution. The central projection is usually in the deepest shade of the Fan Chart, i.e. in the central 10% of probability. The Fan Chart has an equal number of bands (eight) on either side of the central band whereby every band of the same colour, both above and below the central band, cumulatively describe the next 10% of inflation trend probability. As the degree of uncertainty grows over time, so the Fan Chart spreads.

The Fan Chart of inflation in Montenegro, based on the ARIMA model assessment for 2024, indicates that there is a 90% probability that the CPI inflation will range between 1.3% and 7.1%, depending on the month, with the central projection at 4%. In December 2024,

Inflation projected ranges between 3.2% and 5.7%, with the central projection at 3.9%. The Fan Chart central projection (the darkest part) represents a 10% probability span (graph 23).

Graph 23



Source: Central Bank of Montenegro, 2024

Projection is based on the following assumptions:

1. Stabilisation of inflation in countries that are the main foreign trade partners, mostly driven by the prices of energy generating products, raw materials and food, previously fuelled by the war in Ukraine. Their stabilisation is the main reason for the inflation stabilisation, because it encourages price stability in many other sectors.

According to the ECB²⁵ forecasts from December 2023, the average inflation in the euro area will amount to 2.7% this year. As the ECB points out, inflation in the euro area continued to decline due to the drop-in energy prices, the impact of the tightening of monetary policy and the ongoing easing of pressure on the gas pipeline and supply bottlenecks. The underlying disinflationary process is expected to continue, despite strong increases in labour costs, which are increasingly the dominant driver of HICP²⁶ inflation, excluding energy and food costs. Also, a slowdown in earnings growth in the euro area is expected. Banks' profits increased significantly in 2022 and 2023, but will weaken over the projection horizon. Next, prices for the other HICP components are expected to begin to decline with the easing of producer cost pressures, especially those related to food prices inflation. Given the medium-term inflation expectations, which are estimated to remain "anchored" at the ECB's inflation target of 2%, headline HICP inflation is expected to decline from 5.4% in 2023 to an average of 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026.

2. The ECB started with the normalization of its monetary policy in 2022, which implied an increase in the reference interest rates. The rate for main refinancing operations increased to 4.5% in September 2023. Based on the revised assumptions, the ECB announces lower short-term interest rates, lower energy prices and depreciation of the euro in the second half of 2024. Available data and market expectations have begun to signal that inflation is on a downward trend leading to a target inflation rate of around 2%. Although there is significant uncertainty about the timing of the start of effectuation and the magnitude of the impact of monetary policy and credit supply conditions on the real economy, based on market expectations about the future movement of interest rates, it is expected that its impact on economic growth will begin to decline after 2024.
3. Food prices on the international market are decreasing. However, as the world's two largest exporters of wheat and other key crops enter their third year of war, many vulnerable countries continue to face increased uncertainty in their food supply. Food prices, according to data from the Food and Agriculture Organization of the United Nations (FAO), recorded a 13.4% drop in 2023 compared to 2022, due to the drop in the price of meat, vegetable oils, dairy products and cereals, although sugar prices increased. Also, world exporters of wheat and other key crops tend to reduce their stock holdings and thus reduce speculative activities on the commodity futures markets, which puts pressure on food prices in the coming period.
4. Investors continue to monitor the development of events in the Middle East, which directly affects their expectations, and consequently the price of oil and other raw materials on world markets. Conflicts in the Middle East, low expectations of an immediate interest rate cut by the US Federal Reserve and continued uncertainty over China's economic recovery have also put weighed on the outlook for global demand.

²⁵ Source: ECB (2023): *ECB staff macroeconomic projections for the euro area*, December 2023.

²⁶ HICP – Harmonised index of consumer prices.

Finally, the situations in Ukraine and the Middle East could trigger new inflationary trends that this projection does not currently include. Changes of any of the above-mentioned parameters would require the forecast revision.

5.2. Expert assessment

The previous year was still marked by a high rate of inflation, both globally and in Montenegro. It is certainly encouraging that in the second half of the year there was a slowdown in the growth of inflation, and this trend is expected to continue in 2024.

The expectations of the economy and the banks are that even during 2024, inflation will be at a level higher than the target inflation rate of the European Central Bank, which Montenegro also strives for.

It is evident that during the year there will be factors that will affect inflation in the opposite direction. Still expressed geopolitical tensions, high level of aggregate demand in Montenegro, high level of fluctuations in the prices of oil derivatives, expected normalization of ECB monetary policy and difficult maritime transport are factors that will negatively affect the inflation trend. On the other hand, the expected growth of economic activity, the slowdown in the growth of food product prices, the slowdown of inflation in the countries of the main foreign trade partners are factors that will have a positive effect on the trend of inflation.

Having in mind all of the above, we expect that the trend of slowing inflation will continue in 2024, but that it will remain above the level of 2% during 2024 as well.

The Fan Chart of inflation indicates that, with a 90% probability, the inflation, as measured by the consumer price index, will range from 3.2% to 5.7% in 2024, with a central tendency of 3.9%. Our expert assessment is slightly higher and it indicates the risk of inflation growth.

Table 3

Expected inflation rate in Montenegro at end-2024		
Lower inflation threshold	Central projection	Upper inflation threshold
3%	5%	7%

The expert assessment is based on the same assumptions as the model assessment, and a deviation from any of the assumptions would require the forecast revision.

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