CENTRAL BANK OF MONTENEGRO

# INFLATION REPORT
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# 1. INFLATION INDICATORS

According to the June report of the World Bank[1], in the first months of 2024, many countries worldwide continued the previous-year trend of slowing inflation. Nevertheless, inflation is still above the target level in many countries, while the pace of consumer price disinflation slowed. This slowdown reflects a partial rise in energy prices, along with a slowdown in the reduction of the annual growth rate of core inflation and the impact of the rise in service prices. Oil prices on the international market, according to OPEC[2] data, increased 2.44% compared to the first quarter of the previous year. According to data from the Food and Agriculture Organization of the United Nations (FAO), after a seven-month decline, the food price index in March increased 1.1%, while compared to the same month of the previous year, there was a decrease of 7.7%. According to the IMF[3] forecasts from April 2024, global average inflation will amount to 5.9% this year (down from 6.8% in 2023), while according to ECB's[4] June forecasts, the annual average inflation rate in euro area will amount to 2.5% (down from 5.4% in 2023) and during 2025 it will further decrease to a level close to the target.

Observed year-over-year, consumer prices in Montenegro were 4.7% higher on average in the first three months of 2024, while the average price growth in March compared to the same month last year amounted to 5.5%. MONSTAT data indicate that consumer prices recorded an average growth of 1.5% in March this year in relation to December 2023. This was mostly due to the increase in prices in the categories of *food and non-alcoholic beverages* 1.8%, *transport* 2.7%, *housing, water, electricity, gas and other fuels* 1.8% and *communications* 5.4% (table 2). Observing by months, the highest growth of consumer prices was seen in January and March (0.5%, each) and February (0.4%) (graph 1).

**Table 1**

**Inflation in Montenegro, March 2023-March 2024, in %**

| | 2023 | | | | 2024 |
|---|---|---|---|---|---|
| | III | VI | IX | XII | III |
| Change in relation to the previous year-end | 0.2 | 1.9 | 5.4 | 4.3 | 1.5 |
| Annual change | 10.5 | 7.5 | 7.9 | 4.3 | 5.5 |

Source: MONSTAT

Compared to December 2023, prices increased in nine out of twelve categories that made up 85.29% of total consumer basket in March of the current year (table 2). The highest contribution to growth (0.64 pp) was the increase in prices in the category of food and non-alcoholic beverages of 1.8%, mostly as a result of the increase in the prices of vegetables 5.5%, oils and fats 2.9%, milk, cheese and eggs 2.4%, meat 1.5%. With a view to reducing inflation in certain categories and protect „vulnerable cat-

[1] World Bank - *Global Economic Prospects*, June 2024

[2] *OPEC Monthly Oil Market Reports* (North Sea Dated benchmark price), April 2024

[3] Source: IMF – *World Economic Outlook*, April 2024

[4] Source: *ECB - Eurosystem staff macroeconomic projections for the euro area*, June 2024

egories of customers, with lower incomes, while at the same time preserving the retail and wholesale trade", at the end of March, the Government of Montenegro adopted the *Decision Amending the Decision on Interim Measures for Limiting the Prices of Products of Special Importance for Human Life and Health and the List of Products*[5]. The Decision implies limiting the trade margin for 43 products to wholesalers and retailers from 5% to 15% (over 500 items, varying in terms of weight and manufacturer are considered, to be valid until 31 May 2024). This contributed to the monthly price drop in the food and non-alcoholic beverages category of 0.4% in April this year.

A significant contribution (0.31 pp) to price growth in March of the current year compared to December 2023 was made by a 2.7% increase in prices in the transportation category, mostly as a result of a 3.8% increase in the prices of fuels and lubricants for motor vehicles. On the international market, oil prices were higher if compared to December 2023, as a result of concerns about oil deliveries due to instability in the Middle East, as well as an increase in demand due to a slight acceleration of economic growth in developed countries. The geopolitical situation in the Middle East remains one of the risks for price growth, as an escalation of the conflict could affect the production and export of oil in that region and lead to certain instability in the energy market.

**Table 2**

**Growth rate and contribution of individual categories in total inflation[6] in Montenegro**

| | Weights | III 2024 / XII 2023 | Rate | Contribution |
|---|---|---|---|---|
| TOTAL | 1,000.0 | 101.5 | 1.5 | 1.5 |
| Food and non-alcoholic beverages | 360.6 | 101.8 | 1.8 | 0.6 |
| Alcoholic beverages and tobacco | 39.1 | 100.9 | 0.9 | 0.0 |
| Clothing and footwear | 76.8 | 96.6 | -3.4 | -0.3 |
| Housing, water, electricity gas and other fuels | 141.5 | 101.8 | 1.8 | 0.3 |
| Furnishing, household equipment and routine household maintenance | 44.2 | 102.9 | 2.9 | 0.1 |
| Health | 38.4 | 100.1 | 0.1 | 0.0 |
| Transport | 112.6 | 102.7 | 2.7 | 0.3 |
| Communication | 42.5 | 105.4 | 5.4 | 0.2 |
| Recreation and culture | 30.2 | 101.8 | 1.8 | 0.1 |
| Education | 17.7 | 100.0 | 0.0 | 0.0 |
| Restaurants and hotels | 52.5 | 98.9 | -1.1 | -0.1 |
| Miscellaneous goods and services | 43.8 | 102.8 | 2.8 | 0.1 |

Source: MONSTAT and CBCG calculations

Price growth in the category housing, water, electricity gas and other fuels of 1.8% contributed to total inflation increase with 0.26 pp, primarily as a result of growing prices of electricity of 2.9%. The increase was due to the decision that was adopted in mid-December of the previous year, which defined the increase in electricity prices for domestic consumers as of January of the current year. Price growth was also recorded in the following categories: communications 5.4%, furniture, household equipment and routine apartment maintenance 2.9%, other goods and services 2.8%, recreation and culture 1.8%,

[5] Source: OGM 026/24 as of 25 March 2024

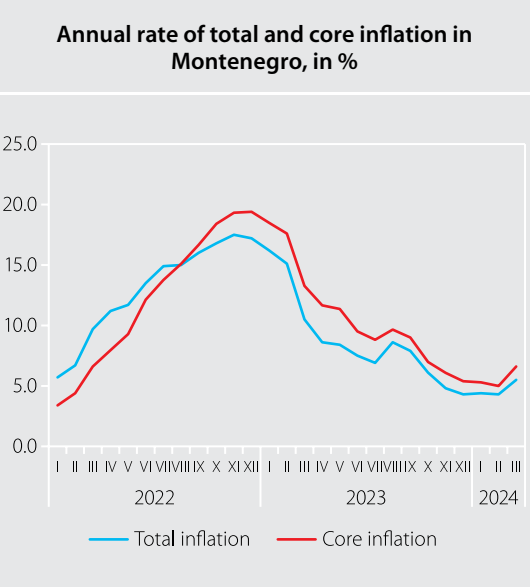
[6] It should be noted that, regardless of the index changes, the contribution of the share of certain categories is not recorded before the second and/or third decimal due to the weight structure.

alcoholic beverages and tobacco 0.9% and health 0.1%. A decrease in prices was recorded in the categories of clothing and footwear by 3.4% and restaurants and hotels by 1.1%, while in the category of education there were no price changes in March 2024 compared to December 2023.

The annual core inflation rate stood at 6.6% in March 2024 and it was 1.1 pp higher than total annual inflation[7]. 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 in all three months (graph 1). The largest spread between total annual and core inflation was recorded in March 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 certain agricultural products, electricity, tobacco, fuel and lubricants, and the like).

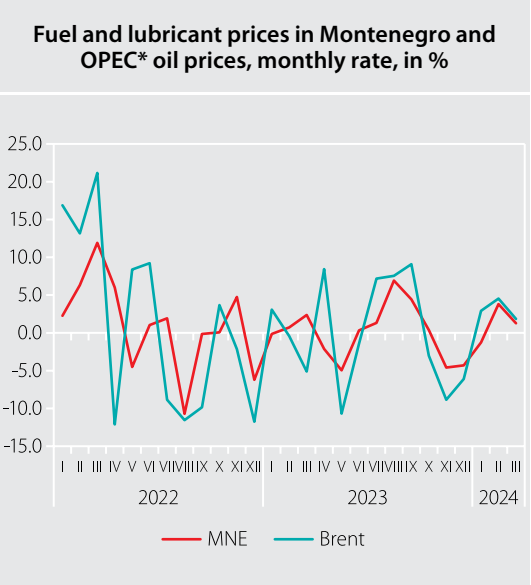
Oil prices in the first quarter of this year were slightly lower compared to the last quarter, and higher compared to the same quarter of the previous year. The price of the OPEC reference basket averaged at $81.83/bbl in this period, being 3.99% lower than the average recorded in the previous quarter and 1.46% higher y-o-y. In the same period, the average Brent price was $83.20/bbl, which is 1.01% lower compared to the last quarter, or 2.44% more compared to the first quarter of the previous year. The highest price ($85.44/bbl) since October 2023 was recorded in March this year. According to the World Bank's report from April 2024[8], a slight increase in the average price of crude oil is predicted (from $83/bbl to $84/bbl), while for 2025 it is predicted to drop to an average of $79/bbl.

**Graph 1**




Source: MONSTAT and CBCG calculations

**Graph 2**



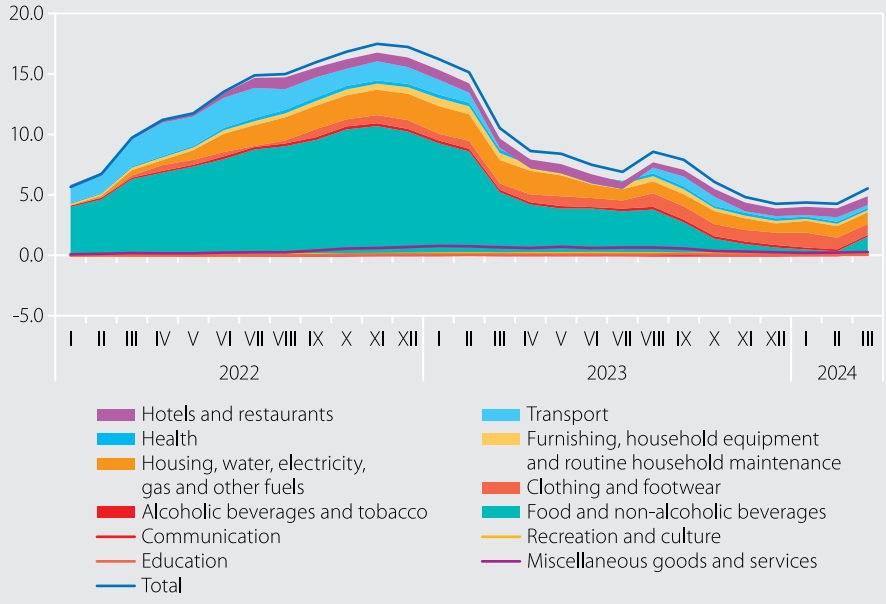

Source: MONSTAT and OPEC Monthly Oil Market Reports
(*North Sea Dated)

[7] Headline inflation is used as an indicator of the trend of a long-term rate or a future rate of inflation, i.e. it enables distinguishing between temporary price shocks and long-term inflation. Total annual inflation is an indicator of the average price change of all products and services used by households for consumption purposes. Read more on the methodology at: *https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_publikacije/radne_studije/obracun_bazicne_stope_inflacije_english.pdf*

[8] *Commodity Markets Outlook*, April 2024

**Graph 3**

**Consumer prices' components in Montenegro, contribution to annual growth rate**

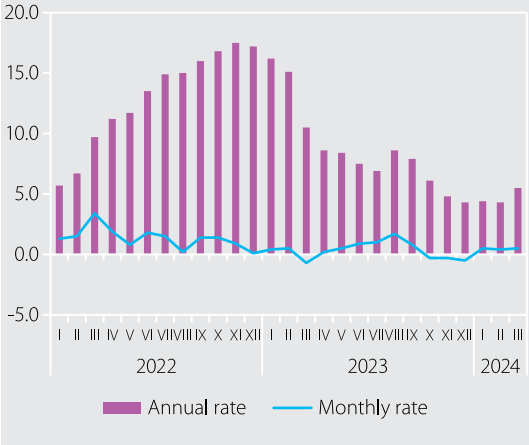



Source: MONSTAT

According to MONSTAT data, the annual price growth of 4.2% in the food and non-alcoholic beverages category in March was the main contributor (with 1.53 pp) to the increase in total annual inflation rate of 5.5% (graph 3). Annual price growth was also recorded in the following categories: *restaurants and hotels* (13.5%), *clothing and footwear* (11.9%), *housing, water, electricity, gas and other fuels* (6.7%), *other goods and services* ( 5.9%), *communications* (5.1%), *recreation and culture* (5.0%), *furniture, household equipment and routine apartment maintenance* (4.6%), *health* (4.3%), *alcoholic beverages and tobacco* (4.0%), *education* (2.7%) and *transport* (2.2%) (graph 4).

**Graph 4**

**Annual and monthly change in consumer prices in Montenegro, in %**




Source: MONSTAT

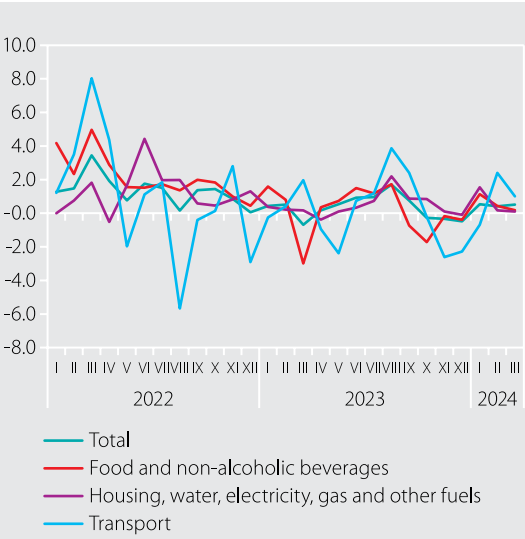
**Producers` prices of manufactured products** recorded minor fall of 0.2% in March this year compared to December 2023. Price decrease of 2.3% was recorded in mining and quarrying and manufacturing industry prices increased 0.4%. Prices in electricity, gas and steam supply prices remained unchanged. At the annual level, producers` prices of manufactured products increased by 1.8% in March.

A slowdown in inflation was recorded in most countries of the region and the EU. The highest consumer prices annual rate in March 2024 among the region countries was in Serbia 5.0%, followed by The Republic of North Macedonia 4.0%, Albania 2.3%, while in Bosnia and Herzegovina it was 2.0% (graph 6).

The annual HICP[9] inflation recorded in the EU stood at 2.6% in March 2024. Of the EU countries, the highest annual inflation rate was seen in Romania (6.7%), while the lowest rate was recorded in Lithuania (0.4%). The annual HICP inflation in the euro area amounted to 2.4% or 0.5 pp lower than the annual rate in December 2023, and the highest contribution of 1.76 pp and 0.53 pp was made by the annual growth of prices of services of 4.0%, i.e. food, alcohol and tobacco of 2.6%. In its June report[10], European Commission forecasted the euro area inflation rate of 2.5% in 2024 and 2.2% in 2025.

**Graph 5**

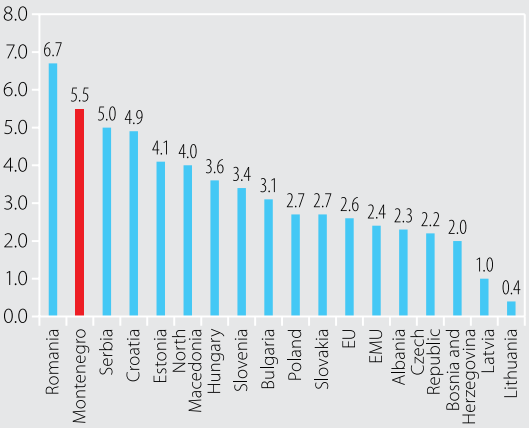
**Monthly change in consumer prices under the selected categories in Montenegro, in %**




Source: MONSTAT

**Graph 6**

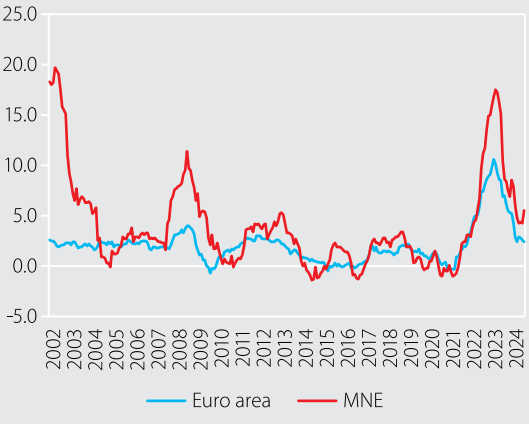
**Annual inflation rate in selected countries, March 2024, in %**




Source: National statistical offices and Eurostat

**Graph 7**

**Inflation in the Euro area (HICP) and Montenegro (CPI)[11] since the introduction of the euro (annual rate, in %)**




Source: MONSTAT and Eurostat

[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.

[10] Source: ECB - *Eurosystem staff macroeconomic projections for the euro area*, June 2024

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

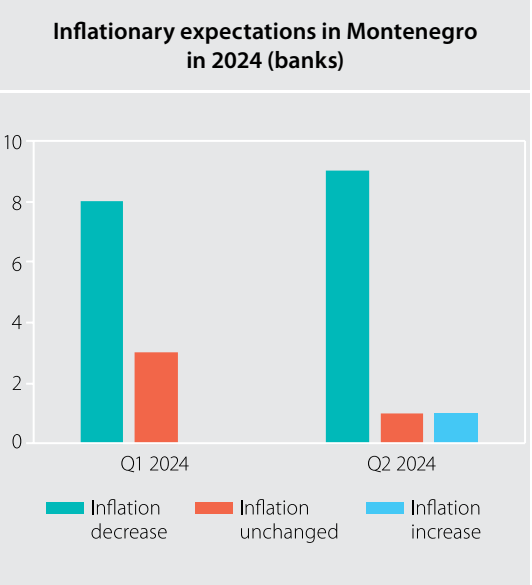
# 2. INFLATION EXPECTATIONS

## 2.1. Banks' expectations

As for inflation expectations of banks, based on the survey conducted in May this year, nine banks expect inflation decline, while one bank expects the same and one bank higher level of inflation compared to 2023 (graph 8).

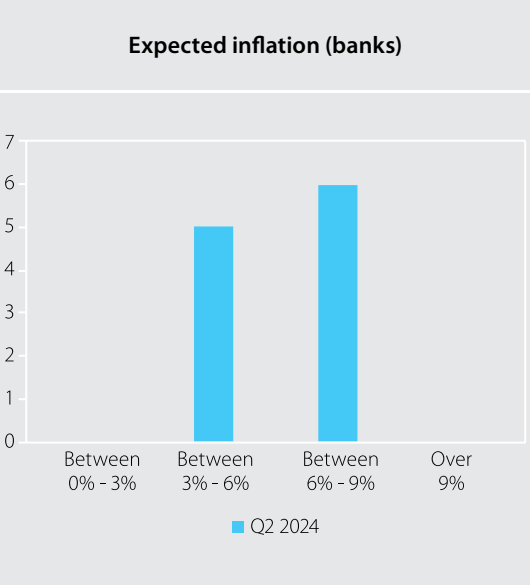
As for inflation, six banks expect an inflation level between 6% and 9%, five banks believe that inflation will range between 3% and 6%, while no bank expects inflation between 0% and 3% and higher than 9% (graph 9).

**Graph 8**




Source: Central Bank Survey

**Graph 9**

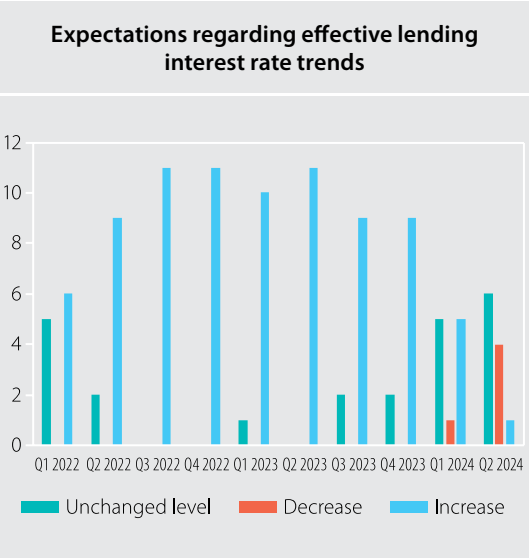



Source: Central Bank Survey

As for expectations regarding active nominal interest rates trends, seven banks expect them to remain at the same level, three banks expect a decline, and one believes that there will be an increase. With a view to effective active interest rates, six banks expect an unchanged level, four banks expect a decline, while one bank expects an increase compared to 2023 (graph 10).

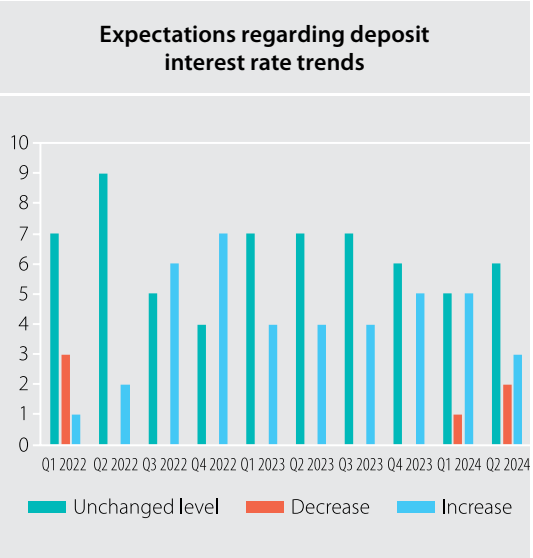
In reference to deposit interest rates` trends, six banks expect no change, three banks expect increase, while two banks expect a decline in deposit interest rates (graph 11).

**Graph 10**




Source: Central Bank Survey

**Graph 11**




Source: Central Bank Survey

For the purpose of calculating inflation forecasts, we use the market trend indicator (line in graph 12) 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 two quarters in 2024 indicate a decline in banks' inflation expectations in 2024.

**Graph 12**


Source: Central Bank Survey

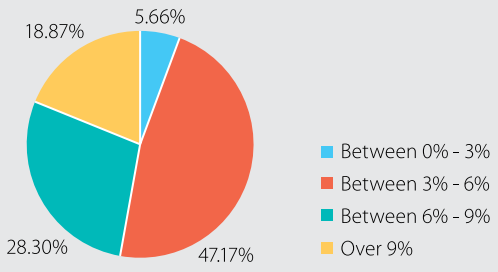
## 2.2. Expectations of economy (except banks)

### Inflation

Of the total number of surveyed companies, 47.17% expect the inflation to range between 3% and 6% in 2024. Some 28.30% of companies expects inflation between 6% and 9% by, while 18.87% of business entities expect inflation over 9%. Inflation between 0% and 3% is expected by 5.66% of respondents (graph 13).

**Graph 13**

**Expected annual inflation rate in Montenegro in 2024 (responses based on percentage share)**

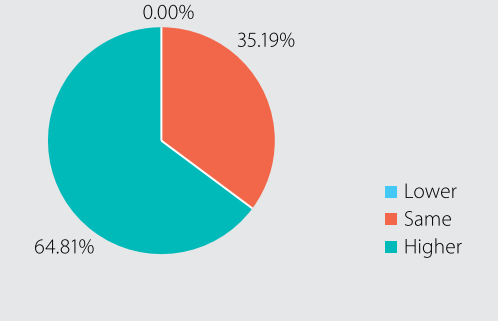



Source: Central Bank Survey

As much as 64.81% of the surveyed companies expect earnings to rise in 2024 in relation to the previous year, while the remaining 35.19% expect them to remain the same (graph 14). With regard to employment, 54.72% of the respondents expect it to remain the same, 41.51% expect this number to increase, and 3.77% expect it to decline in relation to the previous year (graph 15).

**Graph 14**

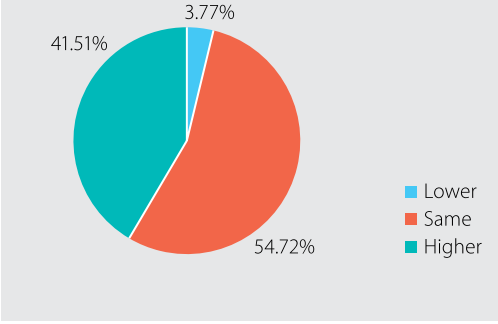
**Expected earnings in 2024 in relation to 2023**




Source: Central Bank Survey

**Graph 15**

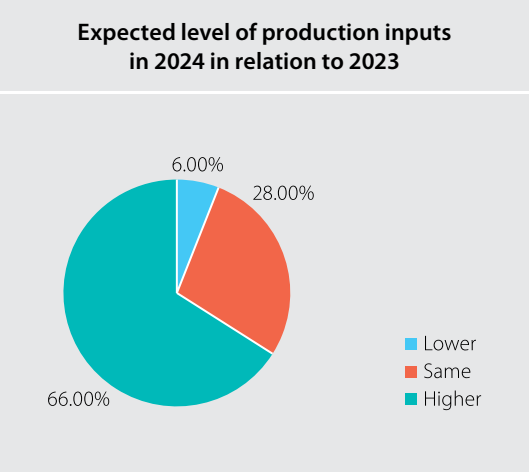
**Expected number of employed persons in 2024 in relation to 2023**




Source: Central Bank Survey

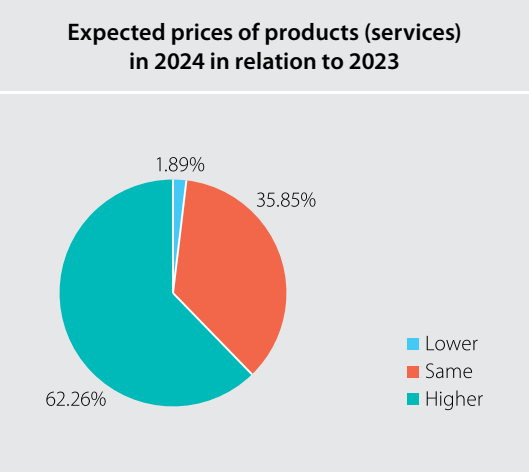
The majority of surveyed companies (66.00%) expect higher prices of production inputs they use (graph 16), and 62.26% plan to increase the prices of their products and/or services in 2024 (graph 17).

**Graph 16**




Source: Central Bank Survey

**Graph 17**



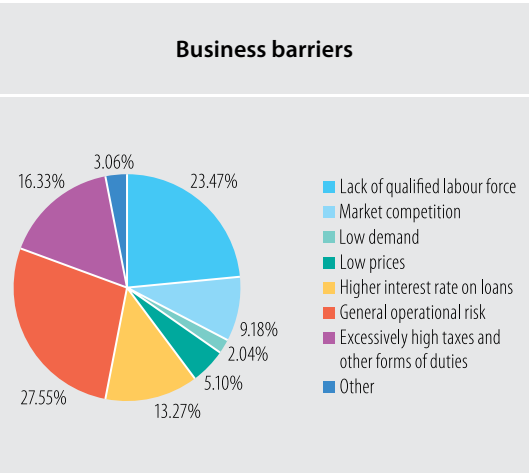

Source: Central Bank Survey

## Business Environment

The survey results show that the largest number of surveyed companies see general business risks (27.55%) in the lack of qualified labour force on the labour market (23.47%), followed by excessively high taxes and other duties (16.33%), high interest rates on loans (13.27%), market competition (9.18%), low prices (5.10%), other barriers (3.06%) and weak demand (2.04%) of respondent (graph 18).

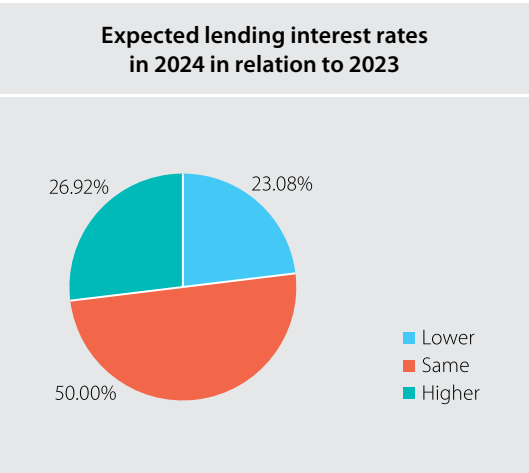
With regard to the lending interest rates, 50.00% of the respondents expect unchanged level, 26.92% expect higher levels, and 23.08% expect them to decline in the current year relative to 2023 (graph 19).

**Graph 18**




Source: Central Bank Survey

**Graph 19**

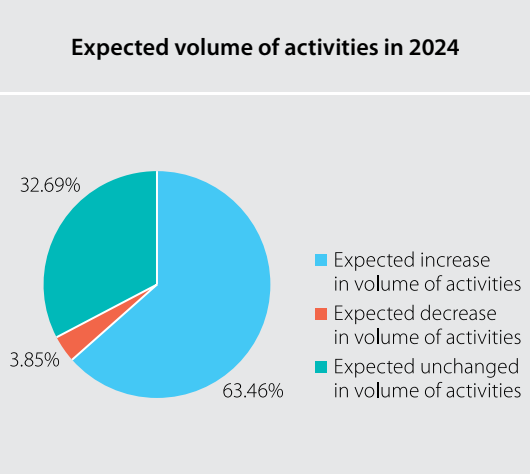



Source: Central Bank Survey

## Investments

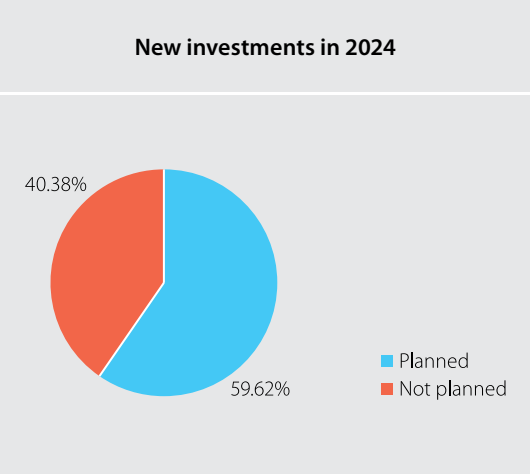
Out of the total number of companies surveyed, 63.46% plan to increase the volume of activities by the end of 2024, 32.69% expect an unchanged volume, while 3.85% of the respondents expect a reduced volume of activities (graph 20). The majority of those surveyed (59.62%) plan new investments (graph 21). Most investments (40.38%) will be towards the increase their fixed assets (graph 22). The surveyed entities highlighted insufficient exploitation of the existing capacities, high interest rates, and unfavourable conditions for capital borrowing and other barriers as the main barriers to new investments (graph 23).

**Graph 20**



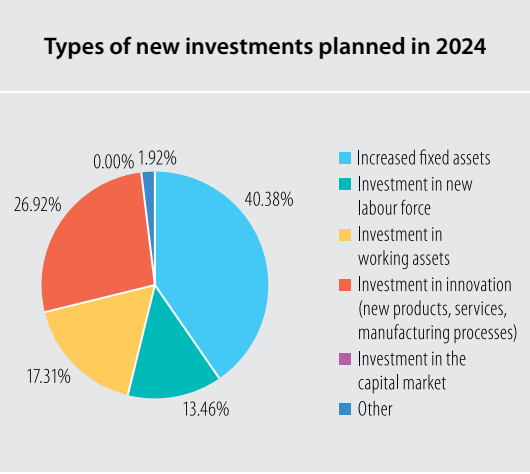

Source: Central Bank Survey

**Graph 21**



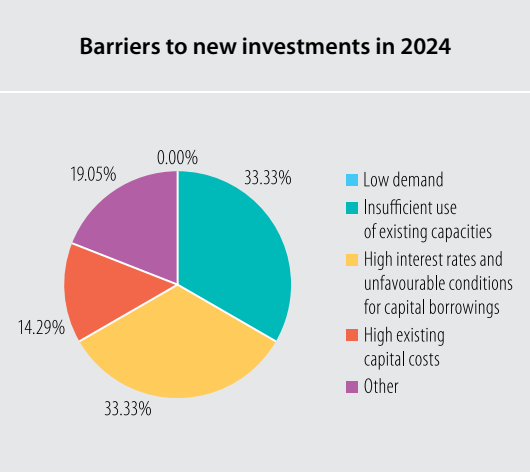

Source: Central Bank Survey

**Graph 22**




Source: Central Bank Survey

**Graph 23**



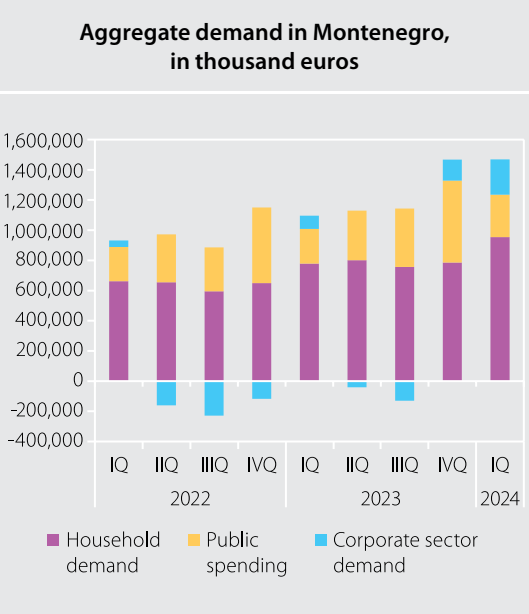

Source: Central Bank Survey

# 3. INFLATION DETERMINANTS

## 3.1. Demand

According to preliminary data, aggregate demand recorded both quarterly and the year-on-year growth in the first quarter of 2024. Observing the structure of total demand in the reporting period, the share of household and corporate sector demand increased compared to the previous quarter, while that of public spending declined (graph 24).

**Graph 24**




Source: Central Bank calculations

**Graph 25**


Source: Central Bank calculations

### Box 1 – Aggregate demand calculation methodology

For the purpose of a more complete monitoring of aggregate demand as a determinant of inflation, the Central Bank 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:

$$AD = C + I + G$$

C = sum of paid salaries + sum of paid pensions + paid frozen foreign currency deposits + net compensations to households – net household savings (savings – loans granted)

I = -net savings of economy (deposits – loans)

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

AD – aggregate demand, C – personal spending, I – investment spending, G – public spending

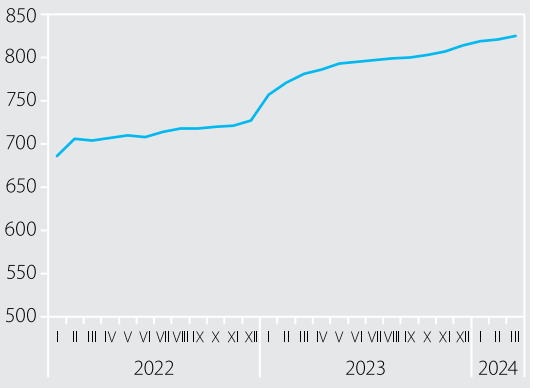
## 3.1.1. Earnings and other available demand determinants

Average gross earnings in Montenegro in Q1 2024 amounted to 1,027 euros, while average earnings without taxes and contributions amounted to 822 euros. In relation to the previous quarter (Q4 2023), the average gross and net earnings rose by 1.78% and 1.73%, respectively. Compared to Q1 2023, average earnings and average earnings without taxes and contributions rose by 7.43% and 6.75%, respectively.

Considering the consumer prices, i.e. trends in wages and salaries in real amounts, it can be concluded that real wages and salaries reported minor growth in January and March, and slight decline in February this year.

**Graph 26**

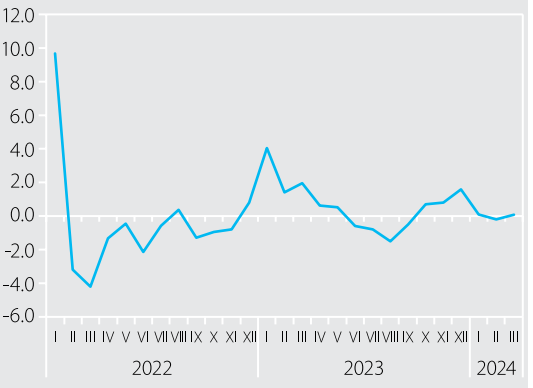
**Average earnings without taxes and contributions in Montenegro, in euros**




Source: MONSTAT

**Graph 27**

**Monthly change in real gross earnings in Montenegro, in %**




Source: MONSTAT

Retail loans[12] recorded positive trends in the first three months of the current year. Loans to this sector grew at a monthly average rate of 1.07% during the reporting period, while this rate was 0.57% in the comparative period of the previous year.

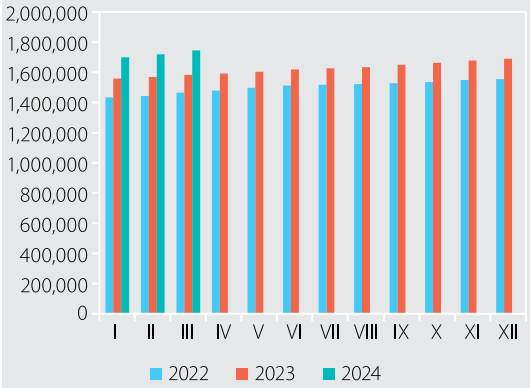
At end-March 2024, retail loans amounted to 1,744.50 million euros, which is 162.77 million euros or 10.29% more than in same period of the previous year, i.e. 54.65 million euros or 3.23% more than at the end of the previous year (graph 28).

*Per capita*[13] debt amounted to 2,828.80 euros at the end of the reporting period, recording an increase of 263.94 euros or 10.29% year-on-year and a 88.62 euros or 3.23% increase in relation to end-2023.

Total MFI loans granted to the retail sector amounted to 73.94 million euros, which is 3.89 million euros or 5.55% more than in same period of the previous year, and 1.14 million euros or 1.57% more than at end-2023.

**Graph 28**

**Retail loans, in thousand euros, January 2022 - March 2024, end-month balance**




Source: CBCG calculations

Retail deposits amounted to 1,860.03 million euros at end-March this year, being 163.74 million euros or 9.65% higher than at end-March 2023 but 40.80 million euros or 2.15% lower than at end-2023.

The loans to deposits ratio of the non-financial sector was 0.94 and it increased year-on-year when it was 0.93 and compared to the end of the previous year when it stood at 0.89.

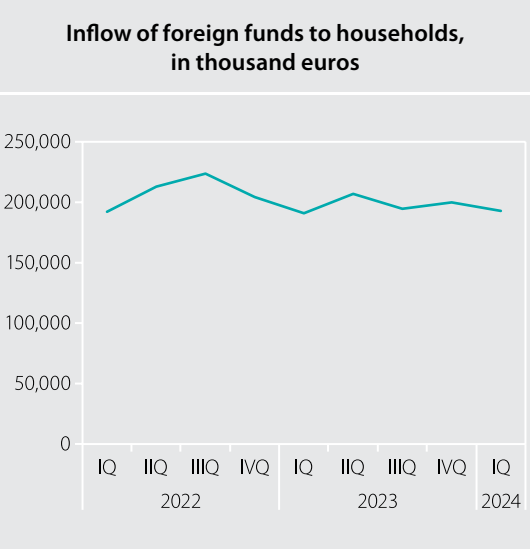
The retail sector had a net savings of 115.53 million euros, which is is an year-on-year increase when the retail sector net savings amounted to 114.55 million euros. At end-December 2023, the retail sector recorded net savings in the amount of 210.99 million euros.

During the first quarter of 2024, the balance of payments statistics records a slight increase in the inflow of funds based on employee compensation compared to the same period in 2023, while based on personal transfers from abroad, a decline is recorded for the observed period (graph 29).

[12] The retail sector includes resident natural persons and entrepreneurs.

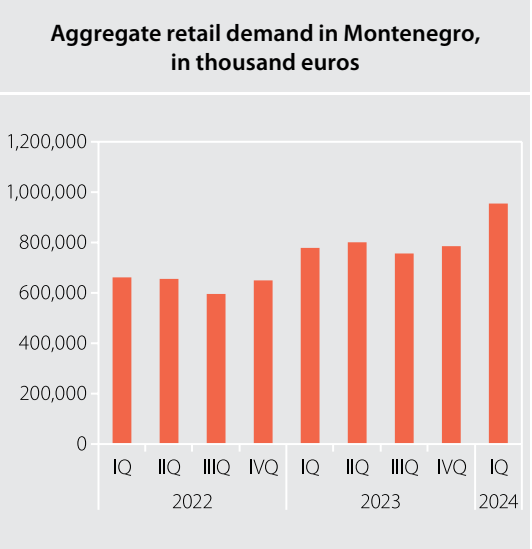
[13] Population estimate for 2022 as at 1 January 2022 amounts to 617,683, source: MONSTAT.

**Graph 29**




Source: Central Bank

**Graph 30**




Source: Central Bank calculations

Observation of the total retail sector demand by quarters shows that household demand in Q1 this year was higher both compared to the previous quarter and year-on-year (graph 30).

## 3.1.2. Budget analysis

**Budget of Montenegro**

According to the Ministry of Finance preliminary data, total revenues[14] of the Budget of Montenegro amounted to 1,276.91 million euro in Q1 2024.

*Source revenues* amounted to 578.59 million euros or 8.23% of the projected GDP[15], and compared to the plan they grew by 8.57%, and compared to the same period in 2023 they were 6.66%, which is the result of improved tax discipline and results of business entities in the previous year, as well as the dynamics of VAT refunds, which have been accelerated since the beginning of the year by the Tax Administration, bearing in mind the accumulated amounts of requests for refunds from the previous period. In the structure of current revenues, tax revenues accounted for the main share of 73.95%, followed by contributions 19.85%, other revenues 2.64%, fees 1.75%, donations 1.32%, and duties with 0.49%.

Tax revenues amounted to 427.88 million euros, recording a 8.67% increase relative to the plan and a 23.53% increase year-on-year. All taxes recorded an annual increase, with the largest (36.25 million euros) recorded by the corporate income tax.

[14] Revenues include current revenues (direct and indirect taxes and non-tax revenues), borrowings and loans from domestic and foreign sources, as well as revenues from property sale and receipts from loan repayment.

[15] Source: Ministry of Finance; estimated GDP for 2024 amounts to 7,034.00 million euros.

Revenues arising from contributions amounted to 114.84 million euros or 9.55% more than planned and 15.09% more than in the same quarter in 2023.

*Consolidated budget expenditure* amounted to 583.42 million euros or 8.29% of GDP in the first quarter of the current year. Recorded expenditures were 11% lower than planned but also 21.73% higher year-on-year.

Current budget expenditures amounted to 233.64 million euros and they were 13.54% lower in relation to the plan and 12.20% higher year-on-year. The largest reduction compared to the plan was recorded in other current expenditures (12.22 million euros or 48%), while the increase compared to the same period of the previous year was determined by the growth of gross wages and contributions at the expense of the employer (13.45 million euros or 8 .80%), due to the increase in the wages of employees in the public sector in 2023.

Capital expenditures amounted to 28.57 million euros or 0.41% of GDP. Compared to the plan, they were 18.18% lower, while compared to the same period of the previous year, capital expenditures were 90.85% higher due to financing new infrastructure projects.

*Cash deficit* of the Budget of Montenegro was estimated to 4.83 million euros or 0.07% of GDP for the first three months of 2024.

## 3.1.3. Non-financial sector

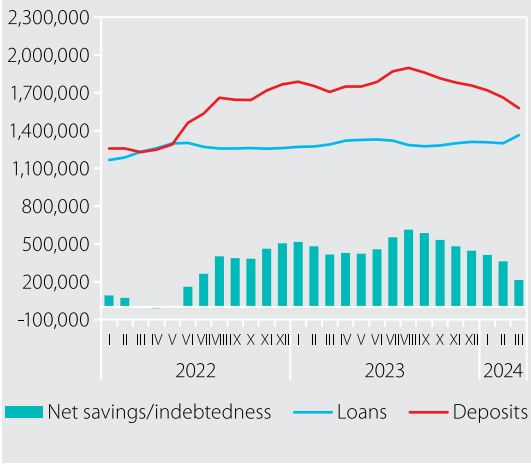
Lending to the non-financial sector[16] recorded positive trends in the first three months of the current year. Loans to this sector grew at a monthly average rate of 1.36% during the reporting period, while they increased 0.73% during the same period of the previous year.

At end-March 2024, total loans to the non-financial sector amounted to 1,363.58 million euros, which is 73.83 million euros or 5.72% more year-on-year and 52.97 million euros or 4.04% more compared to end-2023.

Long-term loans accounted for the main share in the structure of loans to the sector with 83.56%, which indicates that loans to the corporate sector were mainly used for increasing the volume of economic activity.

**Graph 31**

**Net savings/indebtedness of the non-financial sector, in thousand euros, 2022 - March 2024, end-month balance**




Source: CBCG calculations

[16] The non-financial sector includes state companies and private companies.

Deposits of the non-financial sector amounted to 1,577.51 million euros at end-March this year, recorded an increase of 128.37 million euros or 7.53% in relation to March 2023, while they were 179.58 million euros or 10.22% lower than in December 2023.

The loans to deposits ratio of the non-financial sector was 0.86 at end-March this year and it increased year-on-year when it was 0.76 and compared to the end of the previous year when it stood at 0.75.

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-March 2024, net savings of the non-financial sector amounted to 213.93 million euros, which is 202.21 million euros lower year-on-year and compared to end-December 2023 when it amounted to 446.47 million euros (graph 31).

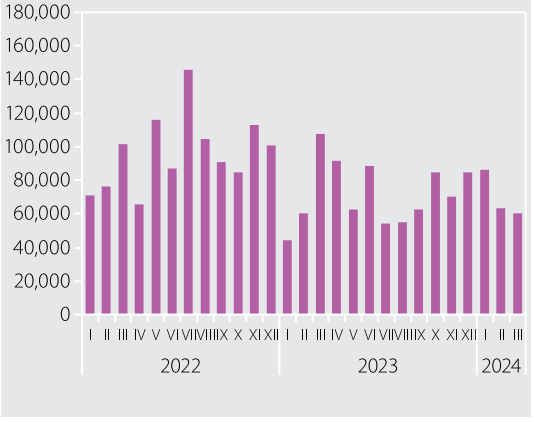
### 3.1.4. External demand and the current account

Preliminary data shows that the current account deficit amounted to 434.79 million euros in Q1 2024, which is the year-on-year increase of 64.26%. This increase is a result of an increase in deficit on the goods account and decreases of surpluses on the services, primary and secondary income accounts.

The goods account recorded a deficit of 677.76 million euros or 18.41% more than in the comparative period last year. Total visible exports amounted to 156.73 million euros, recording a decrease of 32.02%, whereas total visible imports amounted to 834.48 million euros, being 3.93% higher year-on-year. The services account recorded a surplus of 114.96 million euros, which is 16.21% less than in the same period last year. The primary income account registered a surplus of 28.75 million euros, which is a decline of 39.02% as a result of an increase in international investments expenditures of 68.66%. The secondary income account ran a surplus of 99.26 million euros, which is the year-on-year decrease of 19.53%.

**Graph 32**

**Monthly inflow of total FDI in Montenegro`s balance of payments, in thousand euros**




Source: Central Bank

Preliminary data suggests that net foreign direct investments (FDI) inflow for the period January - March 2024 amounted to 117.55 million euros, which is the year-on-year fall of 1.08%. Total FDI inflow reached 208.81 million euros and it dropped by 0.76% (graph 32). Equity investments amounted to 129.94 million euros (a 0.87% decrease), while the inflow in the form of intercompany debt added up to 75.39 million euros or 6.20% more y-o-y. In the structure of equity investments, investments in companies and banks amounted to 36.13 million euros (a 40.49% increase), while real estate investments reached 93.81 million euros (a 58.37% decrease). The inflow arising from the withdrawal of funds invested abroad amounted to 3.48 million euros.

In the structure of total FDI inflow, the share of real estate investments amounted to 44.93%, followed by intercompany debt with 36.10%, while 17.30% were investments in companies and banks. Total FDI outflow in the period January - March this year amounted to 91.26 million euros, which is approximately at the same level y-o-y. In the outflow structure, outflow from residents' investments abroad amounted to 23.62 million euros, while withdrawals of non-residents' funds invested in Montenegro amounted to 67.64 million euros.

The portfolio investments account recorded a net outflow of 678.88 million euros, while the net outflow from the other investments account amounted to 75.73 million euros.

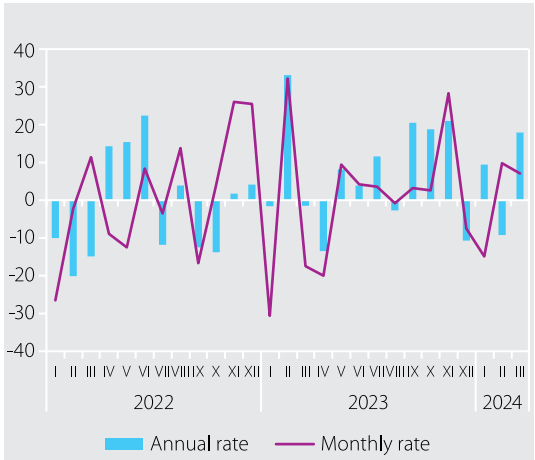
## 3.2. Supply and production

In Q1 2024, industrial output recorded the year-over-year increase of 4.9% due to an increase recorded in the *manufacturing industry* of 23.0% and *mining and quarrying* of 19.7%. Prices decline was recorded in *electricity, gas and steam supply* sector (10.5%). Monthly data on the industrial output trends (graph 33) shows that growth was recorded in February (9.8%) and March (7.1%), while industrial output declined in January (14.9%).

According to preliminary MONSTAT data, 192,215 tourists visited Montenegro in Q1 2024, which is 11.98% less compared to the same period of the previous year and 15.33% more in relation to the pre-crisis 2019. Tourist overnights reached 1.32 million, which is a decrease of 19.12%. Out of the total number of overnights, domestic tourists realized 76,951 overnights, which is 1.91% more, while foreign tourists realized 1.24 million overnights, which represents a drop of 20.14%. In comparison with the same period in 2019, the total number of overnights was 104.24% higher, whereby the number of domestic tourist overnights and foreign tourist overnights rose by 21.05% and 113.33%, respectively.

**Graph 33**

**Industrial production in Montenegro, in %**




Source: MONSTAT

In the first quarter of 2024, according to MONSTAT data, a total of 13,544 m³ of **forest assortments were produced in state forests**[17], which represents a growth of 0.7%[18] compared to the same period in 2023.

According to preliminary MONSTAT data, the total *value of executed* **construction works**

[17] The total 2024 production of forest assortments (from state and private forests) is to be published by MONSTAT at end-2025.

[18] Presented through weighted index.

amounted to 154.55 million euros in the reporting quarter, recording the year-over-year growth of 3.49%, while measured by the *effective working hours at constructions sights*, it grew 0.54% (to 4.36 million euros).

MONSTAT preliminary data also indicate that **transport** showed positive trends in the majority of its segments. In Q1 2024, road passenger transport recorded y-o-y increase of 3.20%[19], while road cargo transport increased 18.14%[20]. Railway transport saw a 6.80%[21] increase year-on-year in the number of passengers, while freight transport via railways increased 43.36%[22]. Air transport saw a 5.03% growth in passengers at airports, but cargo turnover at airports declined 2.17%. Total turnover of goods in ports amounted to 554.462 tonnes and it was 1.81% higher compared to the same three-month period in 2023. Of this amount, export accounted for 68.26% and import for the remaining 31.74%. In this period, the export of goods in Montenegrin ports in tons increased 19.59%, while the import of goods in Montenegrin ports in tons decreased by 22.85%.

## 3.3. Stock exchange indices

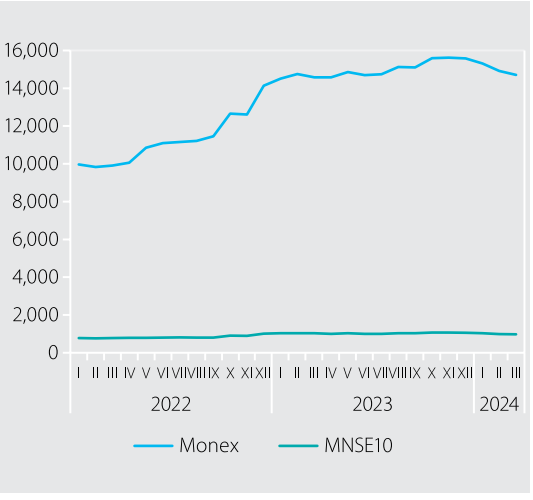
At the end of March 2024, the Monex[23] index grew, while the MNSE10[24] index recorded a decline compared y-o-y. Also, both indices declined compared to the end of the previous year (graph 34).

At end-March 2024, the SE index MONEX reached 14,701.86, recording a growth of 122.69 index points or 0.84% year-on-year, while compared to the end of the previous year it recorded decline of 881.27 index points or 5.66%.

At end-March 2024, the SE index MNSE10 reached 977.96, recording fall of 54.99 index points or 5.32% year-on-year, while compared to the end of the previous year it recorded decline of 85.36 index points or 8.03%.

**Graph 34**

**Movement of Montenegro Stock Exchange indices, in index points, 2022 - March 2024, end-month balance**




Source: Montenegro Stock Exchange calculations

[19] Presented in the number of passengers, while presented in passenger-kilometres, it increased by 17.63%.

[20] Presented in transported goods in thousand tonnes, while presented in ton-kilometres, it declined 0.33%.

[21] Presented in the number of passengers transported in thousands, while presented in passenger kilometres, it rose 6.67%.

[22] Presented in thousand tonnes, and when presented through tonne kilometres the increase was 33.28%.

[23] The MONEX is a *benchmark* Montenegro Stock Exchange index aimed at providing a more precise description of the share price trends in the official and in the free market of Montenegro Stock Exchange AD Podgorica. With the new Methodology, the successor of the MONEX20 index - MONEX index - contains more companies in its index basket.

[24] The MNSE10 is the *blue-chip* index at the Montenegro Stock Exchange and it is aimed at providing a more precise description of prices trends of the most representative shares in the official and free markets of the Montenegro Stock Exchange AD Podgorica. It includes the top ten companies in the Montenegrin market.

# 4. MONETARY POLICY

During the first three months of 2024, there were no changes to the existing monetary policy instruments nor were any new decisions passed regarding the Central Bank of Montenegro`s monetary policy instruments.

# 5. INFLATION FORECAST FOR THREE QUARTERS OF 2024 AND THE FIRST QUARTER OF 2025

## 5.1. Model assessment

Montenegro's inflation fan chart is a graphic presentation 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 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 three quarters of 2024 and the first quarter of 2025 is based on three estimated constituent parts:

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 for three quarters of 2024 and the first quarter of 2025***

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[25] was developed.

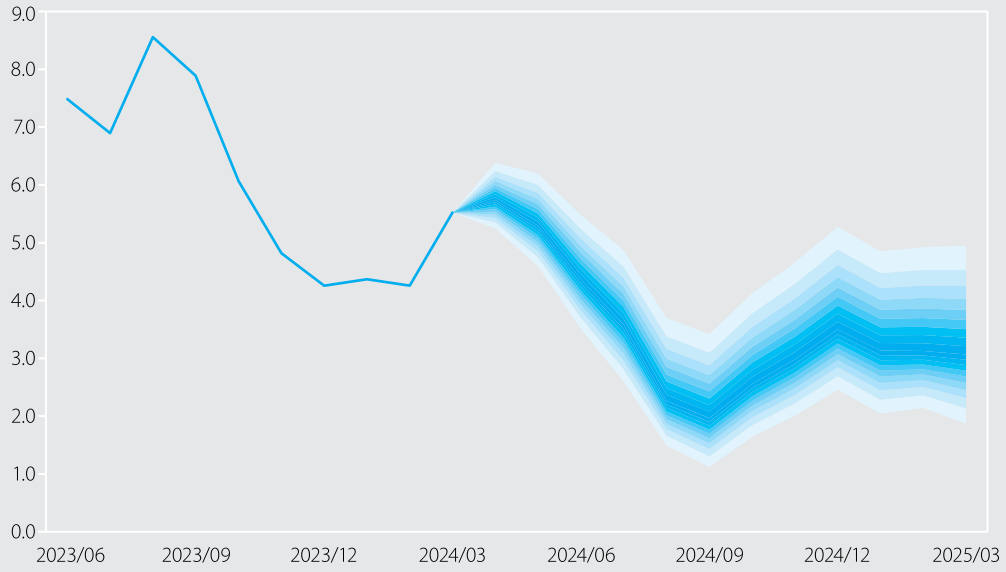
[25] A detailed explanation of the ARIMA model of Montenegro was presented in the working study of the Central Bank no. 11 *"Inflation forecasting: Empirical research on the retail price index trend of Montenegro for 2007 - applying the ARIMA model."*

The ARIMA model was used for near-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 (5,1,2)[26] has sufficient confidence level for forecasts.

Monthly forecast values were used as the value of central projection of the CPI graph for three quarters of 2024 and the first quarter of 2025. Obtained values represent the distribution mode, i.e. values with the highest frequency in the distribution of this time series.

**Graph 35**

**Montenegro's CPI projections for three quarters of 2024 and the first quarter of 2025**




Source: CBCG, 2024

The mean value of inflation (central projections) of the resulting model (April 2024–March 2025) is 3.5%. The value of the coefficient of asymmetry varies between 0.6 and 1.1, 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[27]. 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

[26] ARIMA model is generally referred to as an ARIMA (p, d, q) where p represents the number of autoregressive variables, d refers to the level of dependent variable that needs to be made stationary, and q is the number of variables, moving averages, in the certain model.

[27] The mode value (central projection) is, by construction, always in the deepest band shade, but in case of a heavily unbalanced risk, the central projection may not cover either of these values. (Britton, E. Fisher, P.D. and Whitley, J.D. (1998), 'The Inflation Report projections: Understanding the Fan Chart', Bank of England, Quarterly Bulletin, 38, pp. 30–37).

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 inflation *fan chart* in Montenegro, based on the ARIMA model assessment for three quarters of 2024 and the first quarter of 2025, indicates that there is a 90% probability that the CPI inflation will range between 1.1% and 6.4%, depending on the month, with the central projection at 3.5%.

**Table 3**

| Model inflation rate in Montenegro for three quarters of 2024 and the first quarter of 2025 | | |
|---|---|---|
| Lower inflation threshold | Central projection | Upper inflation threshold |
| 1.1% | 3.5% | 6.4% |

If we analyse the projected inflation for 2024, average inflation will range from 1.1% to 6.4%, with the central projection at 3.9%. Inflation projected for December 2024 ranges between 2.5% and 5.3%, with the central projection at 3.4%. The fan chart central projection (the darkest part) represents a 10% probability span (graph 35).

**Table 4**

| Model inflation rate in Montenegro at end-2024 | | |
|---|---|---|
| Lower inflation threshold | Central projection | Upper inflation threshold |
| 2.5% | 3.4% | 5.3% |

A gradual decrease in the prices of energy industrial goods and other raw materials on the world market is expected in 2024 and, consequently, a decrease in headline inflation. Food prices are expected to continue downward trend, although not to the level of prices that prevailed before the war in Ukraine. Risks related to the projected inflation rate shown on the fan chart are set asymmetrically. Inflation could be higher in case of an increase in energy prices at the world market, the spill over of energy prices on the prices of other products and services, and the beginning of easing of the monetary policy of the leading central banks. Possibility of further wage growth in 2024 represents an additional risk. On the other hand, lower prices of energy industrial goods and other raw materials on the world market, a slowdown in global economic growth, which has a modest but direct impacts raw material prices, and maintaining the status quo or, which is less certain, an additional tightening of monetary policy, and lower-than-expected inflation with major foreign trade partners could contribute to the weakening of inflationary pressures.

***Projection is based on the following assumptions:***

Inflation in Montenegro, as in every country, is affected by various domestic and international factors. When making assumptions about future inflation rates in Montenegro, it is important to consider both historical data and current economic conditions.

**1. Global economic conditions:**

- **Goods' prices:** Oscillations in world prices of goods such as oil and food can have a significant impact on inflation in Montenegro, given the high level of imports of these goods.

- **Economic growth in key trade partner countries:** The Montenegrin economy is affected by the economic results of the European Union, especially neighbouring countries and main trading partners. Economic slowdown or growth in these areas can impact inflation through trade and investment channels.

  According to the ECB's[28] scenario forecasts from June 2024, the average inflation in the euro area will amount to 2.5% this year. On 06 June 2024, the Governing Council of the ECB decided to lower three key interest rates of the ECB by 25 basis points. Based on the updated assessment of the inflation outlook, the dynamics of headline inflation and the strength of monetary policy transmission, it was assessed that it is appropriate to ease the degree of monetary policy restrictions after nine months of holding rates at a stable level. As explained by the ECB, inflation in the euro area continued to decline due to the fall in energy industrial goods price inflation, the impact of the tightening of monetary policy and the continued easing of pipeline pressures and supply bottlenecks. The underlying disinflationary process is expected to continue, despite strong growth in labour costs, which are increasingly the dominant driver of HICP[29] inflation, excluding energy and food costs. Also, due to the current tight labour market, nominal wage growth is expected to remain high.

  Easing pressures on labour costs should be supported by a revival in productivity growth. Productivity growth should ease labour cost pressures. Furthermore, prices for the other HICP components are expected to decline with the easing of producer cost pressures, especially those related to food prices increase. With medium-term inflation expectations estimated to remain „anchored" at the ECB's 2% inflation target, headline HICP inflation is expected to ease from 5.4% in 2023 to an average of 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026. Given the uncertain outlook for energy inflation, headline inflation is expected to remain below HICP inflation excluding energy and food throughout the projection horizon. Compared to the December 2023 projections, HICP inflation is revised downward for 2024 and 2025, mainly due to the direct and indirect effects of lower energy industrial goods' prices assumptions and lower labour cost pressures, and is not revised for 2026.

**2. Monetary policy:**

- **Central Bank of Montenegro policy:** Although Montenegro does not have its own currency (it uses the euro), the policy of the European Central Bank (ECB) will affect inflation. Changes

[28] Source: ECB (2024): *ECB staff macroeconomic projections for the euro area*, June 2024

[29] HICP-Harmonised Index of Consumer Prices

in interest rates or monetary policy of the ECB will affect inflation expectations and actual inflation. Compared to December 2023 projections, assumptions include lower ECB interest rates, lower energy prices and a slight depreciation of euro.

- **Exchange rate stability:** Since Montenegro uses the euro, there is no risk of exchange rate volatility directly affecting inflation, but changes in the value of the euro against other major currencies can have indirect effects.

  Based on the revised assumptions, the ECB announces lower near-term interest rates in the euro area, lower energy prices and depreciation of 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%. The interest rates on the main refinancing operations and the interest rates on the marginal credit line and the deposit line have been reduced to 4.25%, 4.50% and 3.75%, respectively, as of 12 June 2024. On 06 June 2024, the Governing Council of the ECB also confirmed that it will reduce the volume of Eurosystem securities under the Pandemic Emergency Purchase Program (PEPP) by 7.5 billion euros per month on average, in the second half of the year.

**3. Fiscal policy:**

- **Government spending and budget deficits:** Government fiscal policies, including spending levels and budget deficits, can affect inflation. Expansionary fiscal policies can lead to higher inflation, while restrictive policies can reduce inflationary pressures.

- **Tax policy:** Changes in tax rates, especially VAT and excise duties, can have a direct impact on consumer prices, and thus on inflation.

**4. Supply chain dynamics:**

- **Dependence on imports:** Montenegro's reliance on imports of many goods means that disruptions in global supply chains can lead to inflationary pressures.

- **Domestic production:** The capacity and efficiency of domestic production, especially in agriculture and manufacturing, will affect the inflation rate. Productivity improvements can moderate inflation, while inefficiency or underproduction can exacerbate it.

**5. Labour market conditions:**

- **Growth of salaries:** An increase in salaries can lead to higher consumer spending, which can result in an increase in prices. Monitoring salaries' trends is important for the inflation forecasts.

- **Unemployment rate:** Low unemployment can put pressure on salaries and increase consumer spending, contributing to inflation. High unemployment may have the opposite effect.

**6. External shocks:**

- **Climate change and political instability:** Unexpected events such as natural disasters, political instability or geopolitical tensions can affect inflation by disrupting supply chains or by suddenly changing economic conditions.

  Disturbances in the Red Sea observed so far may affect the global economy through higher transport costs, higher oil prices and lower trade, but the effects are still likely to be limited. About 12% of global crude oil shipments and 10% of total global maritime trade by volume pass through the Suez Canal. Delivery interruptions can have multiple side effects. First, delays in oil deliveries could lead to higher oil prices due to tighter global oil supply. Since the start of the Houthi attack, shipping costs for shipping containers have risen significantly along certain routes, but are still below the highest levels seen in 2021 and 2022.

  Delivery delays can disrupt production due to reduced availability of raw materials and intermediate inputs, especially in industries that rely on "just-in-time" supply chains.

**7. Expectations of consumers and enterprises:**

- **Inflation expectations:** If enterprises and consumers expect higher inflation in the future, they may act in way that contributes to actual inflation (for example, enterprises can rise prices, employees can demand higher salaries).

**8. Structural factors:**

- **Economic diversification:** The degree to which the Montenegrin economy is diversified will affect its vulnerability to sector-specific shocks that could have impact on inflation.

- **Technological progress:** The adoption of new technologies can improve productivity and moderate inflationary pressures over time.

Contrary to these assumptions, the escalation of the situation in Ukraine and Israel could cause new inflationary trends that this projection does not currently include. Changes of any of the aforementioned parameters would require the forecast revision.

# 6. EXPECTED INFLATION IN 2024

Inflation showed its „persistence“ in the first quarter of this year. However, we believe that inflation growth will slow down in the coming quarters. This is why we reduced our expert estimate by 0.5 percentage points.

When it comes to inflation expectations, nine banks expect lower inflation rate compared to the previous year, one bank expects growth while one expects unchanged level of inflation. Similar are the expectations of the majority of surveyed companies (almost 50%), expecting inflation between 3% and 6%.

The financial markets have similar expectations when it comes to the trends in global inflation, thus, in accordance with such expectations, the ECB also started lowering interest rates.

However, it should not be ignored that there are still many challenges, both external and internal, that can affect the inflation growth. First of all, there are still present conflicts at the global level, political tensions, high level of fluctuations in food and energy prices, threatened distribution channels, too sudden „monetary policy relaxation“ by some key central banks, salaries growth higher than productivity growth and the like.

The model inflation projection for December 2024 projects inflation in the range of 2.5% to 5.3%, with a 90% probability, with a central tendency of 3.4%. Our expert assessment is somewhat higher, which indicates that when it comes to inflation assessment risks are concentrated towards higher inflation levels.

**Table 5**

| Expected inflation rate in Montenegro at end-2024 | | |
|---|---|---|
| Lower inflation threshold | Central projection | Upper inflation threshold |
| 2.5% | 4.5% | 6.5% |

The expert assessment is based on the same assumptions as the model assessment. Deviation of any of the mentioned parameters from the expected values would also require revision of the estimation.