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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

MONTENEGRO
(2026-2028)

COMMISSION ASSESSMENT

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ANNEX: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2025ERROR! BOOKMARK NOT DEFINED.

1. EXECUTIVE SUMMARY

Montenegro's economic growth decelerated somewhat in 2025 and the economic reform programme (ERP) expects it to continue at some 3% in 2026-2028.[1] Strong private consumption and investment were the key drivers of GDP growth in 2025, estimated at 2.7%. Exports contracted due to the temporary closure of a thermal power plant and muted tourism performance. The baseline scenario set out in Montenegro's ERP projects real GDP growth to remain stable at around 3% in 2026-2028. In terms of growth drivers, domestic demand is set to decelerate, while the contribution of net exports is projected to improve markedly and turn slightly positive in 2028, with a tourism pickup supported by new accommodation facilities and low-cost flights to Montenegro. Uncertainty is very high, with downside risks related, apart from energy prices, to high wage growth hindering price competitiveness and alignment with EU visa policies potentially affecting tourism flows.

The ERP projects a gradual reduction in general government deficits in 2026-2028, though public debt will remain above 60% of GDP throughout this period. In 2025, the general government deficit exceeded the 3.5% target by nearly 0.8 percentage points (pps), mainly due to overspending, particularly on social security, health, and subsidies. The 2026 budget targets a 3.3% deficit without major policy changes, which might be challenging to achieve given the worst-than-expected budget outcome in 2025. Plans for budgetary adjustments in 2027-2028 anticipate a gradual drop in the primary deficit, relying mainly on GDP growth and a slowdown in current spending. It is expected that this will result in a 1.5 pps reduction in the spending ratio, with major savings from a decrease in both the public wage bill and transfers to the health fund as a share of GDP. Public debt is projected to rise to 69.4% of GDP in 2026 and gradually fall to 63.8% in 2028, remaining above the fiscal rule's limit. Debt refinancing needs remain significant, at close to 11% of GDP in 2027.

The main challenges facing Montenegro are the following:

- **High mandatory spending, a limited revenue base and high debt repayments remain a challenge for fiscal policy.** Recent measures, including the expansion of consumption taxes and the abolition of some tax exemptions, have only partially mitigated the revenue loss stemming from reduced pension contributions. However, spending pressures stemming from mandatory and age-related spending together with defence commitments call for the careful management of public finances, especially given the country's unilateral euroisation, which makes fiscal policy the main macroeconomic stabilisation tool. Debt repayment needs are set to increase sharply, first in 2027 and later in 2029. Moving towards a primary surplus and bringing the debt ratio below 60% of GDP as prescribed by the fiscal rule would help address these challenges. Fiscal space could be gained by broadening the tax base and by reviewing and reforming mandatory spending on social transfers, health and public sector wages.

- **Strengthening fiscal governance and budgetary planning, including better monitoring of age-related spending pressures, would secure the long-term sustainability of public finances.** Better adherence to fiscal rules, which could also include additional rules and an adequate enforcement mechanism, would better underpin stability-oriented fiscal policies.

[1] The assessment is based on the ERP submitted on 14 January 2026, prior to the escalation of the conflict in the Middle East. The war may significantly affect economic growth, inflation, and the external balance, depending on its duration and severity. However, detailed information on these effects was not available when the assessment was prepared, as the cut-off date was mid-March.

Moving ahead with the plan to set up a long-overdue independent fiscal institution by appointing its members would also be an important step in improving fiscal governance. Addressing fiscal risks, including those stemming from state-owned enterprises (SOEs) and improving SOE governance could provide extra fiscal space for implementing ambitious investment projects.

- **Montenegro's Reform Agenda under the Growth Plan for the Western Balkans aims to tackle key structural challenges**. These include improving the overall business environment, strengthening private sector development, accelerating the green and digital transitions, and enhancing human capital. The business environment is still affected by weaknesses in the regulatory framework, a large informal economy, limited access to finance, and deficiencies in SOEs oversight and governance. Montenegro's energy transition strategy focuses on investments in renewable energy and decarbonisation, in line with EU energy policy. Efforts to advance digitalisation centre on expanding digital public services and strengthening cybersecurity systems. The structural issues of the labour market, such as regional disparities and high unemployment among women, young people, and low-skilled workers, continue to weigh on potential growth and limit improvements in living standards.

Implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2025 has been partial. In 2025, the fiscal deficit was substantially above the target. The 2026 budget projects the general government deficit and debt to be non-compliant with the limits prescribed by the fiscal rules. The review of existing fiscal rules is yet to be produced with the assisstance of the IMF. Some progress has been made on the review of tax expenditures and the preparation of concrete budgetary recommendations, while the work on public investment management is advancing, supported by technical assistance from the International Financial Institutions The call to appoint Fiscal Council members has failed. Preparatory work was carried out for the SOE reform, including the SOE risk statement and the law on SOE governance adopted by the government.

2. ECONOMIC OUTLOOK AND RISKS

Montenegro's economy continued to expand in 2025, but at a significantly lower growth rate. Based on quarterly data, full-year real GDP growth is estimated at 2.7% in 2025, down from 3.2% in 2024. Economic growth was driven by strong domestic demand. Growth in private consumption benefited from higher disposable income supported by fiscal measures under the 'Europe Now 2.0' programme[2], while rapid credit growth and higher public capital spending fostered investment. The main headwind came from contracting exports of goods, mainly reflecting lower electricity exports due to the maintenance-related temporary shutdown of the Pljevlja power plant. Tourism performance was mixed, with a higher number of arrivals but fewer overnight stays. The ERP's 2025 GDP growth estimate of 3.3% is significantly below the projection of last year's ERP[3] (4.8%). This is mainly due to the revision of private consumption growth to 5.6% in the current ERP from 7.2% last year, and export growth to -0.8% from 2.7%. Labour

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

[3] Macroeconomic and fiscal estimates and forecasts covering 2025-2028 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2025 have been taken from the relevant national sources (statistical office of Montenegro (MONSTAT), Ministry of Finance, central bank of Montenegro).

market conditions continued to improve, with the unemployment rate[4] falling to a historical low of 10.5% in 2025, down from 11.5% in the previous year.

The ERP's baseline scenario projects GDP growth to average 3.2% in 2026-2028 and growth drivers to gradually shift towards net exports. Domestic demand is set to remain the key driver of economic growth, but with a gradually diminishing growth contribution, while the contribution of net exports is projected to improve markedly and turn slightly positive in 2028. After surging in the previous two years, private consumption growth is expected to moderate to 2.9% in 2026 and further to 2% in 2028. The start of a new investment cycle, including two major infrastructure projects (the construction of the second section of the Bar-Boljare highway and the reconstruction of railway infrastructure) together with investment projects in the tourism, energy and digitalisation sectors, is set to keep investment growth at close to 6% on average in 2026-2028. Exports of goods and services are set to rebound due to the recovery of electricity exports and improved tourism performance, which is expected to benefit from new hotel openings, diversification of tourist origin countries and new flight destinations served by low-cost airlines. These factors underpin the projected acceleration of export services growth from 3.1% in 2026 to 5.2% in 2028. Import growth is set at some 3% over the ERP period, implying a moderate import elasticity. The unemployment rate is projected to gradualy fall to 8.1% in 2028 thanks to new employment opportunities and further shrinking of the informal economy.

With moderate growth ahead, the ERP expects the positive output gap to narrow from 2.1% in 2025 to 0.9% in 2028. Compared to the previous year, the ERP's GDP growth projections are unchanged for 2026 and 2027. The ERP also contains an alternative downside scenario that assumes a weaker impulse of private consumption and capital investment, as well as slower growth in tourism revenue and lower investment inflows. This would result in significantly lower GDP growth (1.6% in 2026, 2.1% in 2027 and 2.0% in 2028), a higher rate of unemployment (around 10%) and lower public revenue from consumption taxes.

The ERP's baseline growth scenario is subject to significant downside risks. The ERP's growth projections for 2026-2027 are very close to the Commission's autumn forecast, but both may need to be revised given the heightened global uncertainties and the slowdown of growth in 2025. In terms of sources of growth, the Commission's forecast assumes stronger growth in private consumption (3.2% in 2026 and 2.5% in 2027 versus 2.9% and 2.2% in the ERP, respectively) and invesment (6.8% in 2026 and 6% in 2027 versus 6% and 5% in the ERP, respectively). In contrast, the ERP assumes a more dynamic recovery of exports in 2027 (3.9% versus 3.6% in the Commission forecast). Both outlooks are subject to downside risks stemming from an uncertain external environment, which could weigh on export recovery. The ERP's forecast of robust tourism growth faces a number of downside risks linked to high wage growth and increasing competition from neighbouring Albania, while expected changes to Montenegro's visa policy to align it with the EU's could affect tourism from major source countries such as Türkiye, Russia and Central Asian countries. Further (domestic) risks stem from potentially higher inflation and limited fiscal space, which, given Montenegro's unilateral euroisation, constrains the policy response to unexpected adverse shocks to the economy. Positive risks relate to gradual improvements in the domestic regulatory environment and some progress on EU-related reforms, notably under the Reform Agenda. Moreover, addressing electricity storage challenges in a timely manner could unlock foreign investnment in renewable energy.

[4] Age group of 15-67 years.

Table 1:
Montenegro - comparison of macroeconomic developments and forecasts

	2024		2025		2026		2027		2028	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	3.2	**3.2**	3.0	**3.3**	3.1	**3.2**	3.1	**3.1**	n.a.	**3.2**
Contributions:										
- final domestic demand	10.1	**10.1**	6.6	**6.4**	4.5	**4.0**	3.8	**3.3**	n.a.	**3.2**
- change in inventories	-1.1	**-1.1**	-0.4	**0.0**	-0.3	**0.0**	0.1	**0.0**	n.a.	**0.0**
- external balance of goods and services	-5.8	**-5.8**	-3.2	**-3.1**	-1.2	**-0.8**	-0.7	**-0.2**	n.a.	**0.1**
Employment (% change)	2.9	**1.5**	2.5	**2.6**	2.2	**2.1**	2.0	**2.0**	n.a.	**1.7**
Unemployment rate (%)	11.5	**11.5**	10.8	**10.5**	10.6	**9.8**	10.3	**9.0**	n.a.	**8.1**
GDP deflator (% change)	n.a.	**4.8**	n.a.	**2.9**	n.a.	**2.1**	n.a.	**1.7**	n.a.	**1.4**
CPI inflation (%)	3.3	**3.3**	3.8	**3.8**	3.2	**2.9**	2.8	**2.5**	n.a.	**2.0**
Current account balance (% of GDP)	-16.8	**-17.1**	-17.1	**-17.8**	-17.4	**-17.1**	-17.2	**-16.0**	n.a.	**-14.6**
General government balance (% of GDP)	-3.1	**-3.3**	-3.5	**-3.4**	-3.3	**-3.3**	-3.2	**-2.7**	n.a.	**-2.8**
Government gross debt (% of GDP)	59.6	**59.8**	60.6	**64.3**	62.5	**69.4**	64.4	**64.4**	n.a.	**63.8**

Sources: Economic Reform Programme (ERP) 2026, Commission Autumn 2025 forecast.

Inflation increased in 2025 due to a combination of external and domestic factors. Average inflation stood at 3.9% in 2025, which is above the 3.3% registered in 2024. Monthly inflation readings were on an increasing trend from 2.8% y-o-y in January to 4.9% in September before moderating to 2.6% in February 2026. While import prices, in particular of food, have a significant influence on inflation in Montenegro's very small and open economy, domestic inflationary pressures came from higher wage growth and demand stimulus, resulting from the 'Europe Now 2.0' measures. Core inflation averaged around 5% in 2025. In 2025 average gross wage rose by 11.4%.[5] The ERP projects inflation to moderate from 2.9% in 2026 to 2% in 2028, in line with the fading impact of 'Europe Now 2.0' measures and decelerating domestic demand. Upside risks to this benign outlook stem from rapid credit growth and increasing real estate prices.

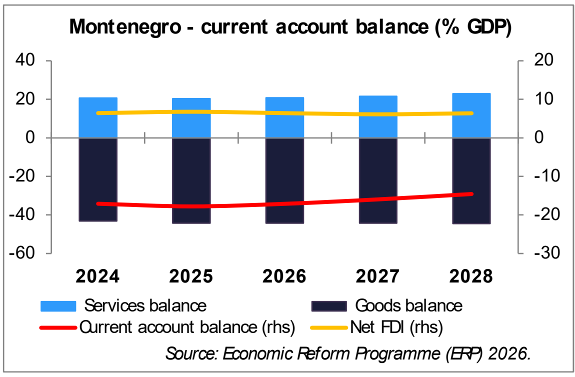
Driven by services exports, the ERP expects the very high current account deficit to narrow. Montenegro's small production base and consumption-led growth model has fueled a very large external deficit, which is a key macroeconomic vulnerability. In 2025, the current account deficit widened to 20.5% of GDP from 17.1% in 2024 due to the deterioration of the merchandise trade balance and moderate tourism performance. Merchandise exports contracted by 10.9% in nominal terms on the back of lower electricity production due to the temporary closure of the Pljevlja power plant and lower exports of non-ferrous metals, while goods imports increased by 9.4%. Services exports practically stagnated in 2025. The ERP projects the current account deficit to decrease significantly from 17.1% of GDP in 2026 to 14.6% in 2028, on the back of a 2.5 pps increase in the services trade surplus. This is optimistic given the balance of risks to tourism performance. Nominal growth of goods and services imports is set to remain stable at some 4% in 2026-2028 over the ERP period.

Foreign direct investment (FDI) inflows are set to remain moderate in 2026-2028 and finance around 40% of the current account deficit. Net FDI inflows declined by 1.7% y-o-y in January-September 2025, driven mainly by higher outflows (by 17.5% y-o-y). Around 76% of FDI outflows in the first nine months resulted from non-residents withdrawing their investments in Montenegro, while the remaining part was driven by Montenegrin residents investing abroad. The increase in equity investment inflows (6.6% y-o-y) was led by investment in real estate, which rose by nearly 13% y-o-y and accounted for around half of all inflows. The ERP projects net FDI

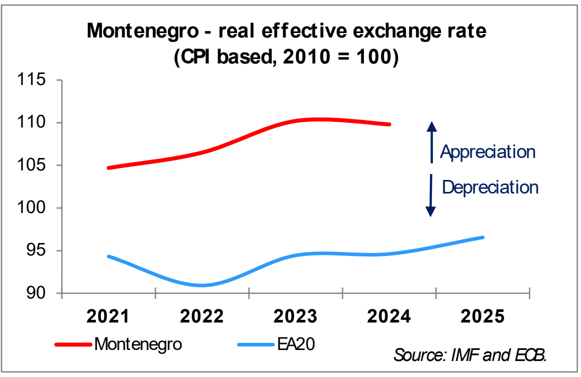
[5] MONSTAT data. Net wages increased by 15.5% over the same period.

inflows to stay stable in nominal terms in 2026-2027 and increase in 2028, staying above 6% of GDP. This profile implies that around 38% of the current account deficit would be covered by FDI in 2026-2027, while in 2028 this ratio would increase to 44%. The ERP does not discuss the main drivers of the assumed path for FDIs. At the end of 2025, Montenegro's net international investment position was negative at 111.5% of GDP as compared to 108% at end-2024. External debt declined to 126.3% from 134% of GDP in 2024.

External competitiveness and current account


Montenegro - current account balance (% GDP)

Source: Economic Reform Programme (ERP) 2026.


Montenegro - real effective exchange rate (CPI based, 2010 = 100)

Source: IMF and ECB.

The banking system is stable and profitable but strong credit growth requires supervisory vigilence. The capital adequacy ratio of the banking sector (regulatory capital to risk-weighted assets) increased to 20.2% in 2025, comfortably exceeding the regulatory minimum. As a precautionary measure to ensure financial stability, the central bank requires banks to keep capital buffers ranging from 4.4% to 5% of the total risk exposure amount. Given increasing real estate prices and the rapid growth of cash loans to physical persons, the central bank tightened macroprudential measures[6] and extended restrictions on unsecured cash loans. In addition, the central bank is closely monitoring the indebtedness of natural persons with a view to the possible introduction of borrower-based macroprudential measures. Banks continued to fund themselves mainly through domestic deposits, with deposit growth recovering to 6.1% from 3.4% in 2024. At the same time, credit growth accelerated to 15.3% from 13.3% in the previous year. Borrowing costs declined slightly, with the nominal weighted average lending rate falling to 6.2% at the end of 2025 from 6.5% one year earlier. The nominal weighted average rate on deposits stood at only 0.29%, pointing to structural factors. The wide spread between lending and deposit rates supported the profitability of the banking sector. The return on assets declined to 2.3% in Q3-2025 from 3% one year earlier, while the return on equity fell to 15.3% from 18.5% in 2024. The non-performing loan ratio declined to 2.7% in Q4-2025, as compared to 3.5% in the previous year.

In response to concerns expressed by the Commission, Montenegro adopted amendments to the Law on the Development Bank excluding deposit-taking and the provision of payment services from the scope of the Development Bank of Montenegro's (DboM) activities. Further by-laws were adopted on DboM governing minimum risk-management standards, large exposures, capital adequacy, and reporting requirements. While these are steps in the right direction, in order to comply with EU standards DboM should still be subject to full prudential oversight and the requirements applicable to financial institutions other than credit institutions, as is the case for all development institutions in the EU.

[6] The countercyclical capital buffer was raised to 0.5% in April 2025 and further to 1% in January 2026, and the capital conservation buffer to 2.5% in January 2025.

Table 2:
Montenegro - financial sector indicators

	2021	2022	2023	2024	2025
Total assets of the banking system (EUR million)	5 329	6 404	6 734	7 250	7 906
Foreign ownership of banking system (%)	80.0	82.0	83.8	85.1	85.5
Credit growth (%, average)	6.6	6.1	10.8	13.3	15.3
Deposit growth (%, average)	12.8	23.2	15.1	3.4	6.1
Loan-to-deposit ratio (end of period)	80.0	70.1	74.8	79.5	87.3
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	6.2	5.7	5.0	3.5	2.7
- regulatory capital to risk-weighted assets	18.5	19.3	20.3	19.4	20.2
- liquid assets to total assets	26.0	30.7	23.5	22.9	18.9
- return on equity	4.5	13.5	19.3	18.5	15.3
- foreign exchange loans to total loans	0.2	0.2	0.1	0.3	0.1

Source: Central Bank of Montenegro.

3. PUBLIC FINANCE

The 2025 budget deficit exceeded the target due to significantly higher spending on social security and health, along with somewhat lower revenue from pension contributions and grants. Preliminary results put the full-year general government deficit at 4.3% of GDP, well above both the ERP estimate of 3.4% and the 3.5% target set in the revised budget adopted in September. Helped by strong tax revenue, budget revenue was above the target (41.1% of GDP instead of 40.6%). However, this was more than offset by spending substantially exceeding the budget plan (45.4% instead of 44%). Tax revenue increased by 14.4% y-o-y and was 4.8% higher than planned, while other (non-tax) revenue was lower than budgeted due to underperformance in grants[7] and pension contributions. VAT revenue, which rose by 14.8% and accounted for 42% of general government revenue, was the largest contributor, alongside a 9% increase in corporate income tax revenue. VAT revenue growth was supported by rising private consumption and policy measures such as higher VAT rates on accommodation services and catering. Pension contributions were 11.1% below the plan, and their share in GDP dropped by 2.8 pps to 4.3% following a halving in contribution rates. Budget expenditure increased by 7.8% y-o-y and was 3.7% above the plan, driven by rising social transfers (up by 10% y-o-y and 3.9% above the plan), health-related spending (up by 12.3% and 12.2% above budget) and subsidies (29% above the plan). Conversely, the increase in the wage bill was contained at 1.8%. Capital spending grew by 14.9% and surpassed the 2025 plan by 11.3%. Compared to the general government deficit of 3.3% of GDP in 2024, the budget balance notably worsened.

Fiscal policy in 2026-2028 relies on controlled government spending and improving revenue collection. The ERP's declared objective is to improve the efficiency of public spending while increasing capital investment for infrastructure projects. On the revenue side, the ERP assumes an upward trend in nominal terms, while the revenue-to-GDP ratio is set to decrease by 0.9 pps between 2025 and 2028. Revenue from taxes and contributions is expected to be broadly stable as a percentage of GDP, while revenue from grants is projected to fall slightly in nominal terms and by 0.5 pps as a share of GDP between 2025 and 2028. The ERP projects public spending to decrease from 44% of GDP in 2025 to 42.5% in 2028, with major savings coming from a declining public wage bill (0.9 pps) and transfers to the health fund (0.3 pps), while social transfers and interest payments are expected to rise by 0.1 pps and 0.4 pps, respectively. The ERP

[7] The grant for the construction of the second section of the Bar-Boljare highway was postponed to early 2026.

refers to the goal of maintaining a current budget surplus, meaning that current revenue finances current spending, while borrowing is exclusively undertaken to finance capital investment, which is set to grow by 0.1 pps in 2025-2028. Careful public debt management is also a priority, given Montenegro's significant financing needs.

Table 3:

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

	2024	2025	2026	2027	2028	Change: 2025-28
Revenues	41.7	40.6	40.9	40.4	39.7	-0.9
- Taxes and social security contributions	36.7	35.4	35.7	35.4	35.1	-0.3
- Other (residual)	5.0	5.2	5.2	5.0	4.6	-0.6
Expenditure	45.0	44.0	44.2	43.1	42.5	-1.5
- Primary expenditure	43.0	42.1	42.1	41.0	40.2	-1.9
of which:						
Gross fixed capital formation	5.8	5.7	5.7	5.8	5.8	0.1
Consumption	12.6	12.9	12.6	12.1	11.6	-1.3
Transfers & subsidies	21.6	20.8	21.5	20.9	20.6	-0.2
Other (residual)	2.9	2.7	2.3	2.2	2.2	-0.5
- Interest payments	2.0	2.0	2.1	2.2	2.4	0.4
Budget balance	-3.3	-3.4	-3.3	-2.7	-2.8	0.6
- Cyclically adjusted	-5.6	-5.3	-4.6	-3.8	-3.6	1.7
Primary balance	-1.3	-1.4	-1.2	-0.5	-0.4	1.0
- Cyclically adjusted	-3.6	-3.3	-2.5	-1.6	-1.2	2.1
Gross debt level	59.8	64.3	69.4	64.4	63.8	-0.5

Sources: Economic Reform Programme (ERP) 2026, Commission calculations.

The ERP's projected fiscal path would result in the headline deficit falling from 3.4% of GDP in 2025 to 2.8% in 2028. The primary balance is projected to stay negative but improve by 1 pp. over this period. The debt ratio is forecast to increase from 64.3% of GDP in 2025 to 69.4% in 2026 and then decline gradually to 63.8% in 2028. Compared to the previous ERP, the debt-to-GDP ratio is assumed to be higher in 2025-2026, but to remain slightly below the previous projection in 2027. Overall, the projected fiscal path would result in compliance with the limit on general government deficit in 2027-2028 but a breach of the cap on debt prescribed by the rules of fiscal responsibility[8].

Assuming the continuation of current policies, the general government budget targets a deficit of 3.3% of GDP in 2026. Considering the actual deficit in 2025, which significantly diverged from projections, the revenue and spending targets for 2026 likely need revision. The plan is for general government revenue to increase slightly by 0.3 pps, from 40.6% of GDP to 40.9% in 2026. However, compared to the actual revenue of 41.1% of GDP, this represents a decrease of 0.2 pps in 2026. Budget spending was projected to increase moderately by 0.2 pps, from 44% of GDP in 2025 to 44.2% in 2026. Given the overspending in 2025 (45.4% of GDP), achieving this would require substantial cuts in spending, which are not planned in the ERP.

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

BOX 1: THE BUDGET FOR 2026

The Parliament of Montenegro adopted the 2026 Budget Law and related borrowing decisions on 30 December 2025. The budget targets a deficit of 3.2% of projected GDP, assuming real growth of 3.2% and average inflation reaching 2.9%.

Table: **Main measures in the budget for 2026**

Revenue measures*	**Expenditure measures****
• Introduction of VAT on construction land (*estimated impact: 0.1% of GDP*) • Increased excise rates on tobacco *(estimated impact: 0.2%)* • Progressive taxation on game of chance winnings (Personal income tax law) *(estimated impact: 0.03% of GDP)* • Law on the Reprogramming of Tax Claims of Local Government Units (*estimated impact: 0.07% of GDP*) • Implementation of the new Law on Games of Chance *(estimated impact: 0.04% of GDP)* • Reducing informal economy (Excise Law, Law on Tax Administration, Personal Income Tax Law) *(estimated impact: 0.02% of GDP)* • Increase in grants *(estimated impact: 0.2% of GDP)*	• Increased nominal spending for pensions (1) increased base due to overruns in 2025 *(estimated impact 0.2% GDP)* and (2) regular adjustment of pensions *(estimated impact: 0.5%)* • Increased nominal spending for transfers for social protection (1) increased base due to overruns in 2025 *(estimated impact 0.3% GDP),* and (2) spending increase based on regular adjustments *(estimated impact: 0.1% of GDP)* • Gradual annual increase for defence spending (*estimated impact: 0.2% of GDP*) • Gradual nominal increase for CapEx (*estimated impact: 0.3% GDP*)

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

Source: ERP

In the medium term, the ERP projects the budget deficit to decline as a result of GDP growth and spending restraint. The nominal growth in both budget revenue and spending is set to decelerate in 2027-2028. After increasing by 6.4% in 2026, general government revenue is projected to rise by 3.4% in 2027 and 2.8% in 2028. Within the revenue categories, the relative share of consumption taxes is set to decline slightly, which would be partially compensated by higher contributions. The growth in VAT and excise revenues is set to decelerate to some 3% annually in 2027-2028, while the growth rate of pension contributions is expected to recover from

0.6% in 2026[9] to 4.8% in 2027 and further to 6.5% in 2028. Grants are expected to fall significantly in 2028, driven by the assumed profile of the highway construction and Reform Agenda implementation. The nominal growth of government spending is projected to slow from 5.9% in 2026 to 2.2% in 2027 and pick up somewhat to 3.1% in 2028. Despite the controlled growth of social transfers, which is set to decelerate from 8.2% in 2026 to below 4% in 2028, their share in public spending is projected to increase gradually from 30.6% to 31.3% over the same period. The public wage bill is assumed to follow a flat profile, with its growth declining from 5.2% in 2025 to some 1.5% in 2026-2028, which is below the assumed inflation rate. In contrast (and in line with new borrowing), the rise in interest payments is expected to pick up from 9.4% in 2026 to 14% in 2028. Investment spending is projected to surge by 6.8% in 2026 and moderate to 5.7% and 4.6% in the following years.

The assumption of moderate growth of some spending items is not backed up by concrete measures and therefore seems optimistic. For instance, the very low growth of the wage bill in nominal terms, leading to a 0.3-0.4 pps reduction per year is not in line with historical wage trends and the inflation outlook for 2026-2028. Pressure to raise social transfers might also re-emerge, as was the case in the recent past, which led to large ad hoc increases in pensions and social benefits.

The ERP projects the public debt ratio to rise to 69.4% of GDP in 2026 and decline gradually in 2027-2028, mainly due to GDP growth. The ERP estimates that total public debt increased to 64.3% of GDP at the end of 2025 from 61.3% in the previous year, reflecting new net borrowing, partly to build fiscal buffers for 2026 and 2027. In 2025, Montenegro repaid large amounts of maturing debt (EUR 720 million in total or 8.9% of GDP), including a Eurobond (EUR 500 million). Following a record-high EUR 850 million Eurobond in March, Montenegro successfully issued retail bonds for the first time in November, raising EUR 50 million with a maturity of two years and an annual interest rate of 3.75%. In December, Montenegro concluded a syndicated loan arrangement (EUR 450 million) with several major international financial institutions. The agreed interest rate stands at six-month EURIBOR plus a 2.5 pps margin, resulting in an effective interest rate of around 4.5%. Montenegro also benefits from support under the EU's Reform and Growth Facility (total country envelope: EUR 383.5 million), from which EUR 210 million in loans at favourable rates were disbursed in 2025. Given the projected primary deficits, nominal GDP growth, interest costs and plans for the build-up and withdrawal of government deposits, the ERP projects the public debt-to-GDP ratio to increase to 69.4% in 2026 and then moderate to 64.4% and 63.8% in 2026 and 2027, respectively. The adjustment is mainly driven by the denominator effect, as the primary balance stays negative, albeit declining over the entire period. Debt rollover needs, including of Eurobonds, are moderate in 2026 (EUR 383.6 million), but peak again in 2027, amounting to EUR 750 million or 8.4% of GDP[10]. Together with the projected deficit, financing needs are close to 11% of GDP in 2027. The overall financing strategy is to secure sufficient financing for debt repayment and fiscal buffers for 2026 and 2027 by issuing bonds on foreign and domestic markets while trying to extend the debt maturity, smoothen its repayment profile and avoid peaks every two years.[11]

[9] Compared to the 2025 budget outturn, the projected growth of pension contributions stands at 12% in 2026.

[10] The surge in 2027 (EUR 972 million) is due to the repayment of Eurobond issued in 2020 (EUR 750 million).

[11] In 2029 Eurobonds (EUR 500 million) will mature. Further large debt repayment is due in 2031.

BOX 2: DEBT DYNAMICS

Montenegro

Composition of changes in the debt ratio (% of GDP)

	2024	2025	2026	2027	2028
Gross debt ratio [1]	59.8	64.3	69.4	64.4	63.8
Change in the ratio	1.5	4.5	5.1	-5.0	-0.6
Contributions [2]:					
1. Primary balance	**1.3**	**1.4**	**1.2**	**0.5**	**0.4**
2. 'Snowball effect'	**-2.3**	**-1.5**	**-1.2**	**-0.9**	**-0.4**
Of which:					
Interest expenditure	2.0	2.0	2.1	2.2	2.4
Growth effect	-1.7	-1.9	-2.0	-2.0	-2.0
Inflation effect	-2.6	-1.6	-1.3	-1.1	-0.8
3. Stock-flow adjustment	**2.5**	**4.5**	**5.1**	**-4.6**	**-0.6**

[1] End of period.

[2] The 'snowball effect' captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).

The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets, and valuation and other effects.

Source: Economic Reform Programme (ERP) 2026, Commission calculations.

The debt-reducing snowball effect is set to moderate in 2026-2028, in line with the projected lower nominal GDP growth and increasing interest costs. Building up government cash deposits in 2025-2026 and using them to repay maturing debt when debt redemptions peak (2027) is projected to generate large stock-flow adjustments. The negative primary balance remains a debt-increasing factor in 2026-2028, although its impact is set to wane as the budget balance improves. Overall, following an increase in 2026, the debt-to-GDP ratio is projected to decline in 2027 and 2028 but remain above the fiscal rule’s limit.

The ERP discusses positive and negative fiscal risks surrounding the baseline scenario, while the underperformance of the 2025 budget signals a need for stronger fiscal adjustment. Key downside risks relate to a potential overestimation of pension contributions, whose shortfall in 2025 was substantial, and stronger than assumed growth of mandatory current spending. The ERP refers to the implementation of tax policy reforms, but it remains vague on the exact measures which should broaden the tax base and reduce tax expenditure. Some positive effects are expected from introducing VAT on construction land, expanded use of excises on tobacco, PIT changes on second job income, but their impact is rather limited. Upside risks to revenues include: i) the reform of the tax administration with the introduction of the Integrated Revenue Management System from January 2026, which should support improving data quality and risk monitoring, and therefore the fight against the informal economy; ii) the ongoing tender process to grant a long-term concession for Montenegro’s two international airports which, if successful, will generate a one-off revenue windfall and a modest flow of annual revenue for local governments; and iii) fee income related to the legalisation of illegal structures. The ERP refers in general terms to the aim of rationalising current spending and implementing reforms to the pension, healthcare and social protection systems and the renumeration of public employees. Some ongoing or planned reforms of disability-related benefits, social service provision and medicine procurement, if implemented, would help contain social and health transfers. Spending pressures and risks not included in the ERP relate to the need to increase defence spending to meet NATO requirements, age-related spending on pensions and health, possible cost overruns of the highway project and contingent liabilities related to SOEs. On a positive note, the SOE risk assessment report has been updated and the government adopted the Law on SOE Governance of State-Owned Business Undertakings, which would set up continuous centralised monitoring of SOE performance and related fiscal risks and strengthen corporate governance.

BOX 3: SENSITIVITY ANALYSIS

The ERP includes a detailed analysis of the deficit, with a comparison between baseline and low growth scenarios as well as with the previous ERP. The comparison of scenarios includes a detailed risk matrix identifying potential positive and negative events (see above). However, a detailed impact of each single risk is not quantified; only their total effect on the budget balance, as reflected in the alternative scenario. Under the low-growth scenario, the general government deficit would widen from 3.3% of GDP in 2025 to 3.7% in 2026 and further to 4% in 2028. In addition, the public debt-to-GDP ratio would reach 66.3% of GDP by 2028, implying higher fiscal sustainability risks.

Despite good performance of labour and corporate taxes, budget revenue remains reliant on indirect taxes and, combined with high mandatory spending, exposes public finances to the associated risks. While PIT and CIT revenue are expected to expand by 8% and 10.8% in 2026, a marked reliance on revenue from consumption taxes (VAT and excises, which accounted for 54% of total budget revenue in 2025) results in a narrow revenue base and high dependency on the business cycle. Measures such as recurrent property taxation, which is considered to be the least distortive, or environmental taxes, which take into account negative external effects and can help accelerate the green transition, are not considered in the ERP. Public spending is driven by high mandatory spending, with the public wage bill, social security and health transfers amounting to 68% of total general government expenditure in 2025. Steps have been taken to improve public investment management in line with the IMF's PIMA recommendations, and a Master Plan for infrastructure development is being finalised. This document will include all large-scale infrastructure projects over EUR 5 million, with a focus on the five most important areas (transportation, education, health, ecology and energy). High mandatory spending, an ambitious investment programme and increasing interest payments do not leave much room for fiscal support in case of adverse economic shocks, which can become a challenge given Montenegro's unilateral euroisation and the lack of monetary policy tools to manage aggregate demand.

Existing fiscal rules do not provide a strong anchor for fiscal policy. The current medium-term fiscal planning breaches the numerical rules for general government deficit (3% of GDP) for 2026 and debt (60% of GDP) for the entire period 2026-2028. Corrective action if the limits are breached is not enforced in practice, and therefore the fiscal rules are too weak to guide fiscal policy. Instead, the fiscal strategy aims to comply with the 'golden rule', targeting a non-negative current budget balance, which does not necessarily result in a primary balance consistent with public debt reduction. In order to strengthen responsible fiscal management, the ERP refers to plans to revise the existing fiscal rules with IMF assistance, by either introducing additional rules or reinforcing current processes of annual and medium-term planning. After several failed attempts[12], a further important step towards improving fiscal policymaking would be the long-overdue establishment of the Fiscal Council by appointing its members, in accordance with the Law on Budget and Fiscal Responsibility. Government finance statistics urgently need further improvements to align them with the European System of Accounts (ESA 2010) methodology. The Law on Budget and Fiscal Responsibility is being revised to strenghten public investment management, medium-term budgeting, debt management and accrual-based accounting, among others.

[12] The Parliament of Montenegro has so far launched three public calls to appoint members of the Fiscal Council. The third call resulted in three candidates, one of whom was rejected in the application phase, while the two remaining candidates did not receive enough votes in Parliament.

4. Addressing structural challenges – the Reform Agenda and its impact on the macro-fiscal framework

The Reform Agenda is meant to address structural challenges and foster real convergence with the EU. Agreed in October 2024, it includes socio-economic and fundamental reforms and financing under the Reform and Growth Facility,[13] which provides a total amount of EUR 383.5 million (EUR 110 million in grants and EUR 273.5 million in concessional loans) in 2024-27, subject to the implementation of these reforms. Of the total amount, EUR 178.5 million is to be allocated in the form of budget support, while the remaining EUR 205 million will be allocated for the financing of infrastructure projects and implemented through the Western Balkan Investment Framework (WBIF).

Montenegro's Reform Agenda covers four key policy areas: (1) business environment and private sector development, including the reforms related to SOE governance; (2) digital and green transition, i.e. aligning with EU standards on the electricity integration package and renewable energy and energy efficiency, digital public services, cybersecurity; (3) human capital development, i.e. addressing labour market mismatches, investing in all levels of education; and (4) rule of law and fundamental rights, including alignment with EU visa policy, judicial and anti-corruption reforms, development of anti-corruption strategy, etc.

The legal framework between the European Commission and Montenegro is fully in place. Montenegro ratified the Reform and Growth Facility in March, while the loan agreement entered into force in May. Subsequently, the pre-financing of EUR 26.8 million (7% of the total allocation) was approved in May 2025. Based on the implementation of further steps set out in the country's Reform Agenda, the European Commission approved the first regular release of funds (EUR 10.2 million in loans and grants) in July and the second regular release (EUR 8.1 million) in October 2025. As of March 2026, the European Commission had approved EUR 45.1 million[14] in favour of Montenegro.

Improving the business environment is vital for private sector development. The Reform Agenda aims to tackle key obstacles to doing business, including regulatory and administrative burdens, informality, weak legal certainty over property rights, and limited transparency in legislation. It also promotes research and innovation, strengthens business competitiveness, and enhances transparency and efficiency in public procurement and State aid. There are also reforms to simplify adminstrative processes, streamline debt restructuring, update state registers, and strengthen public consultations and regulatory impact assessments.

The Reform Agenda seeks to strengthen the governance, efficiency, and accountability of SOEs. Well-functioning SOEs would help to reduce fiscal risks and their reliance on budget support. Key measures include improving financial transparency, reinforcing state oversight, introducing merit-based management appointments, and increasing managerial accountability.

Montenegro's green transition is at an early stage but is aligned with EU energy policy and the Green Deal. The Reform Agenda aims to accelerate the shift to a sustainable, climate-neutral, and resilient economy by strengthening energy security, diversifying renewable energy beyond hydropower, and advancing decarbonisation in line with national climate and energy strategies. Key measures include implementing the Electricity Integration Package, expanding renewables,

[13] https://eur-lex.europa.eu/eli/reg/2024/1449/oj/eng

[14] In 2025 the Commission approved the release of EUR 45.1 million to Montenegro, of which EUR 21.0 million was disbursed as a loan to the treasury, while the remaining amount will be channelled through the WBIF.

developing carbon pricing and an EU-aligned Emissions Trading System by 2030, and supporting a just transition in the coal-dependent Pljevlja region. The Agenda also promotes improved energy efficiency in buildings and stronger sustainability criteria for biofuels and biomass.

The Reform Agenda's digital reforms aim to advance Montenegro's digital transition and to promote convergence with the EU. Key priorities include expanding secure broadband nationwide, digitalising and improving public services, strengthening cyber resilience, and developing interoperable digital solutions such as a cross-border digital wallet. Montenegro is also aligning with EU e-commerce, electronic communications, gigabit connectivity, and 5G cybersecurity legislation, while promoting digital skills, digital inclusion in rural areas, and safer digital infrastructure to support economic growth.

Reforms for human capital development focus on improving employment prospects and reforming social services, while advancing education, skills and innovation. Skills mismatches remain an important challenge, driven by gaps in education quality, relevance, and practical training, particularly in VET. Reforms aim to improve labour market alignment and to boost employability through expanded upskilling, reskilling, lifelong learning, work-based learning with employers, and stronger career guidance and counselling. Research and innovation are guided by the Smart Specialisation Strategy, through which Montenegro seeks to strengthen innovation across all levels and stakeholders, with particular emphasis on supporting the twin transitions. The Education System Digitalisation Strategy 2022–2027 prioritises the use of digital technologies in teaching, the full digitalisation of education system processes, the development of electronic services for students, teachers and parents, and the enhancement of digital skills and competencies.

In its 2024 and 2025 ERPs, Montenegro provided model-based simulations of the medium-term impact of investments contained in the Reform Agenda on macroeconomic variables. The economic and fiscal impacts have been included in the ERP's macro-fiscal framework. The impact assessment covers public investment of EUR 360 million, equally divided during the years 2025-2027, in the areas of education, energy, road infrastructure and ICT. A conservative approach is used, the model does not assume any spillovers of crowding-in private investment or higher productivity and competitiveness. The cumulative effect on the level of GDP is estimated at 0.9% by 2027 compared to the baseline scenario without implementation of the Reform Agenda. The impacts on the levels of public consumption and exports are estimated at 0.7% and 0.8% above the baseline, respectively, while an increase of imports is around 1% given the low manufacturing base of Montenegro. The impact assessment on employment is 0.4% above the baseline in 2027.

The Reform Agenda is estimated to have a positive fiscal impact. The ERP also presents the impact on the budgetary revenue in 2025-2027. A positive impact is assumed on the revenue from business and labour taxes, contributions and VAT. The overall fiscal impact of the Reform Agenda on budget revenues is around EUR 85 million during a three-year period, i.e. around 0.9% above the baseline revenue, peaking during the years of 2026 and 2027 when infrastructure projects and relevant disbursements are expected to intensify.

Annex: Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2025

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

The following table presents the Commission's assessment of the implementation of the 2025 policy guidance jointly adopted at the Economic and Financial Dialogue between the EU and Regional Partners at ministerial level on 13 May 2025.

Overall: Partial implementation (41.7)[15]	
2025 policy guidance (PG)	**Summary assessment**
PG 1: Contain current spending while using any revenue overperformance and savings from under-execution of capital spending for deficit reduction and accumulation of government deposits.	There was **no implementation** of PG 1: 1) **No implementation**: The central government deficit was significantly above the 2025 target. While tax revenue was above the plan, income from pension contributions fell short of the planned value. Driven by social transfers and health expenditure, public spending overshot the target. No additional savings were made.
Set up and operationalise the Fiscal Council in time for it to be able to review the 2026 budget proposal.	2) **No implementation**: Despite the third public call, the Fiscal Council members were not confirmed.
Review the functioning of the existing fiscal rules, and prepare and share with the Commission an options paper on their possible strengthening.	3) **No implementation**: The review is yet to be done. Cooperation with the IMF is planned in this regard.

[15] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's overview and country assessments of the 2017 economic reform programmes, available at:

PG 2: Based on the analysis of the economic and fiscal impact of all tax expenditures, implement budgetary measures to raise public revenue. Prepare and share with the Commission a comprehensive fiscal risk statement and strengthen further the analysis of SOE-related fiscal risks. Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space and ensuring cost-benefit analysis of investment projects, including PPPs.	There was **partial implementation** of PG2. 1) **Partial implementation**: In 2025 Montenegro adopted several measures, including VAT on construction land, higher excises on tobacco, and taxes on winnings from games of chances, which should support budget revenue. The 2025 tax expenditure report is based on improved methodology and is yet to be released. 2) **Substantial implementation:** The government has prepared the analysis of SOE financial operations in 2024, including the fiscal risks statement. The Law on the governance of state-owned enterprises has been adopted by the government. Once implemented, it will strenghten centralised monitoring of SOEs and the related fiscal risks and enhance the role of the Ministry of Finance as the competent authority.. 3) **Limited implementation:** The Master Plan for the Infrastructure Development of Montenegro is yet to be completed. The Ministry of Finance is working on the manual for capital budgeting and the methodological guidelines for project evaluation. The government adopted the decision on the preparation of the capital budget, aiming to improve the management of public investments.
PG 3: Continue to thoroughly assess price developments and possible second-round effects and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability.	There was **substantial implementation** of PG 3: 1) **Substantial implementation**: The central bank carefully monitored the changes in price dynamics and related factors and inflation expectations. The central bank raised the countercyclical capital buffer by 0.5% in April 2025 to 1%, effective from January 2026.

In line with the principles of central bank independence, ensure a transparent selection of council members, including vice governors, based on candidates' competence and following the process in compliance with the Central Bank Law.	2) **Full implementation**: Two vice-governors and four external members of the Council of the Central Bank were appointed.
Ensure that the Development Bank complies with best practices in terms of governance as well as appropriate supervision and regulation applicable to other deposit-taking institutions to ensure transparency, sound lending practices, adequate deposit protection, and a level playing field in the banking sector.	3) **Partial implementation**: The central bank prepared the amendments on the deposits taking and the provision of payment services, precisely to delete the exception whereby the Development Bank would provide payment services. These amendments were adopted. The by-laws governing minimum risk management standards, large exposures, capital adequacy and reporting requirements were also adopted. To comply with EU standards, the Development Bank still has to be subject to full prudential oversight and the requirements applicable to financial institutions.