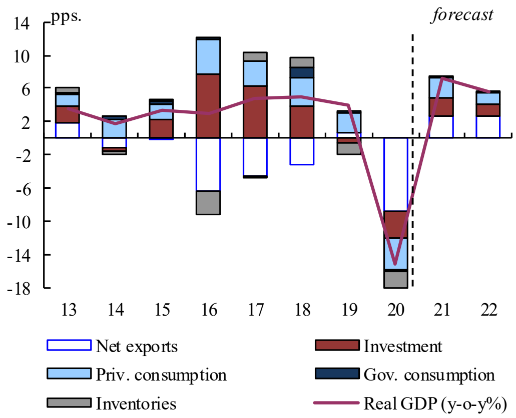
29. MONTENEGRO

Montenegro experienced a very deep recession in 2020 as the COVID-19 took a heavy toll on its tourism-dependent economy, weakening both external and domestic demand. A partial recovery of tourism and investment is projected for 2021 while households and firms will continue to benefit from public policies support. Notwithstanding the pandemic's enduring damage on domestic companies and labour, the economy could come closer to pre-pandemic levels in 2022, driven by the return of a regular tourism season with positive spill-over effects on private consumption, employment, external balances and budget revenue, the latter also supported by some rise of inflation due to growing domestic demand.

A deep and broad recession

Montenegro's income from tourism plunged to 3.5% of GDP in 2020, compared to 22.2% of GDP a year earlier. The collapse of tourism activity triggered a sharp recession of the economy, contracting by 15.2% in 2020. The fall in external demand not only exacerbated the current account deficit, but also had widespread effects across the economy, depressing retail services, employment, investment and public finances. To support citizens and the economy, authorities implemented several economic support packages, including wage subsidies and temporary tax reductions for businesses and individuals, which led to rising public debt and deficit ratios. Labour market conditions deteriorated despite the measures undertaken by the government to help companies retain jobs. The contraction of domestic demand combined with falling global commodity prices resulted in a protracted period of negative inflation in 2020.

Graph II.29.1: **Montenegro - Real GDP growth and contributions**



The recovery path

The persistent high rate of infections and slow progress with COVID-19 vaccination threaten the 2021 summer tourism season, which is vital for improving Montenegro's weak economic and fiscal outlooks. The baseline scenario is for a partial recovery of tourism in 2021, reaching a level of visitors close to historical averages in 2022. Under this premise, private consumption would rebound driven by a partial recovery in employment as well as the revival of retail trade boosted by tourists demand. Government consumption growth is expected to turn into positive territory as of 2021, but only moderately due to limited fiscal space. Fixed capital formation is set to recover partially in 2021 as planned public projects in transport and energy start materialising and private investments in tourism and telecommunication sectors kick in. However, some deceleration of investment growth is foreseen in 2022, following the finalisation of the first section of the Bar-Boljare highway. Some accumulation of inventories could be expected at the end of 2021, as lower tourists demand for goods might fell short compared to local stocks. Exports, in particular of services, are expected to rebound sharply in both 2021 and 2022, while imports would follow at a slower pace, in particular in 2022 as the end of the highway works reduces demand for construction material.

A precarious regain in labour activity

The reactivation of economic activity and removal of travel barriers should facilitate the return of workers, in particular to those sectors more affected by the crisis, like catering, retail trade and accommodation. However, given the strong seasonal character of these jobs and the liquidation of some businesses due to the crisis, employment growth would remain below 2019 level and register some volatility through the forecast period.

Moderate inflation pressure

With the recovery of global demand, international oil prices are set to bounce back to pre-crisis level. However, a weak demand due a partial recovery of employment would dampen to some extent inflationary pressures. Overall, inflation is expected to increase moderately in 2021 and 2022.

Outlook risks

The key specific risk would be a weak or delayed recovery of tourism activities given its far-reaching impact across the economy. Moreover, the reliance on other countries' travel restriction policies set a limit to Montenegro's own capacity of reaction. Notwithstanding the current high level of uncertainty, the balance of risks could also turn to the upside in case of a higher affluence of foreign tourists than foreseen in our baseline scenario.

Disentangling fiscal imbalances

The sharp contraction of the economy, combined with discretionary support measures, caused a sharp increase in the budget deficit to 11% of GDP in 2020. Budget revenue fell by 13.1% y-o-y, with nearly all revenue categories underperforming compared to 2019. Total expenditure grew by 4.8% y-o-y in spite of the government's efforts to reallocate spending into healthcare services and supplies while reducing capital spending.

The high deficit, the contraction of the economy and massive borrowing swelled the public debt-to-GDP ratio. As a result, the public debt exceeded 100% of GDP at the end of 2020. However, the stock of gross public debt is set to decline rapidly as maturing debt would be repaid thanks to earlier accumulated government deposits. Thus, in March 2021 the government reimbursed maturing Eurobonds worth 5% of GDP, while additional debt of 2% and 6% of GDP will be repaid in 2021 and 2022, respectively.

Graph II.29.2: **Montenegro - General government budget balance and gross debt**

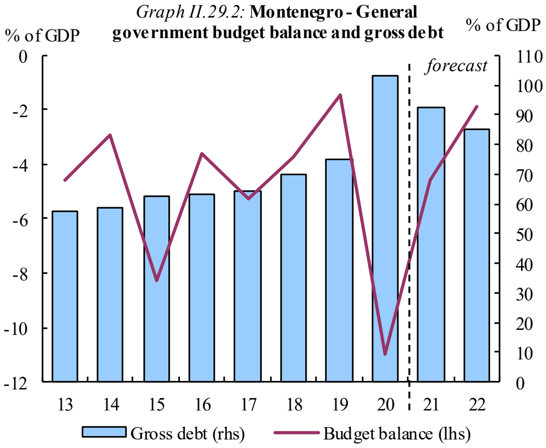


Table II.29.1:
Main features of country forecast - MONTENEGRO

	2019										
	mio EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		4950.7	100.0	2.8	4.7	5.1	4.1	**-15.2**	**7.1**	**6.5**
Private Consumption		3533.6	71.4	:	3.9	4.6	3.1	**-5.4**	**3.3**	**2.3**
Public Consumption		881.1	17.8	:	-1.4	6.3	1.0	**-0.9**	**1.1**	**0.6**
Gross fixed capital formation		1351.8	27.3	:	26.7	14.7	-1.7	**-12.3**	**7.8**	**3.4**
of which: equipment		:	:	:	:	:	:	**:**	**:**	**:**
Exports (goods and services)		2163.4	43.7	:	2.1	7.0	5.5	**-48.9**	**31.1**	**21.0**
Imports (goods and services)		3208.7	64.8	:	8.7	9.2	2.4	**-19.5**	**10.7**	**4.6**
GNI (GDP deflator)		4967.6	100.3	:	5.9	4.2	3.2	**-14.2**	**6.3**	**6.7**
Contribution to GDP growth:	Domestic demand			4.2	8.9	8.5	1.9	**-7.4**	**5.0**	**2.8**
	Inventories			-0.7	0.4	-0.3	1.4	**1.0**	**0.5**	**0.0**
	Net exports			-0.8	-4.6	-3.1	0.7	**-8.8**	**1.5**	**3.7**
Employment				:	2.1	3.2	2.6	**-10.5**	**7.1**	**2.3**
Unemployment rate (a)				20.6	16.1	15.2	15.1	**17.9**	**16.5**	**15.2**
Compensation of employees / head				:	:	:	:	**:**	**:**	**:**
Unit labour costs whole economy				:	:	:	:	**:**	**:**	**:**
Real unit labour cost				:	:	:	:	**:**	**:**	**:**
Saving rate of households (b)				:	:	:	:	**:**	**:**	**:**
GDP deflator				:	:	:	:	**:**	**:**	**:**
Harmonised index of consumer prices				:	2.8	2.9	0.5	**-0.8**	**1.3**	**1.8**
Terms of trade goods				:	:	:	:	**:**	**:**	**:**
Trade balance (goods) (c)				-45.2	-43.3	-43.9	-41.7	**-39.1**	**-40.3**	**-39.6**
Current-account balance (c)				-22.6	-16.1	-17.0	-15.0	**-26.0**	**-22.7**	**-16.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				:	:	:	:	**:**	**:**	**:**
General government balance (c)				-2.7	-5.7	-3.9	-1.9	**-11.0**	**-3.8**	**-1.4**
Cyclically-adjusted budget balance (d)				:	:	:	:	**:**	**:**	**:**
Structural budget balance (d)				:	:	:	:	**:**	**:**	**:**
General government gross debt (c)				48.0	64.2	70.1	74.9	**103.3**	**92.2**	**84.2**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.