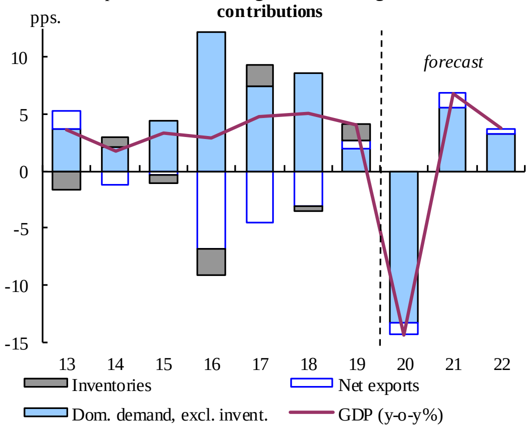
29. MONTENEGRO

After a relatively soft first wave of COVID-19 infections in spring, a much bigger and extended second wave followed soon after. The shock had widespread effects across the economy, depressing not only tourism and retail services, but also trade, investment employment and public finances. The baseline scenario is for a gradual recovery in 2021 and 2022, driven by planned investment in tourism and the energy sector as well as public and private construction activity. The revival of private consumption will be supported by rising employment, stronger remittances and credit growth.

Plunging into recession

The COVID-19 pandemic and the subsequent introduction of travel restrictions devastated Montenegro's large tourism sector, causing one of Europe's steepest declines in second-quarter GDP. After growing by 2.7% y-o-y in the first quarter of 2020, economic activity plunged by a preliminary 20.2% y-o-y in the second quarter, affected by a weakening of both external and domestic demand. The latter was pulled downwards by falling fixed investment and private consumption. On the external demand, exports of goods and services plummeted while imports also fell, even if at a much slower pace. In contrast, government consumption rose marginally, by 0.5% y-o-y. Overall, Montenegro's GDP fell by a preliminary 8.8% y-o-y in the first half of 2020.

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



Tourism shockwave

Travel and tourism accounts for more than 20% of Montenegro's GDP. In the first eight months of 2020, the number of tourist arrivals decreased by almost 80% y-o-y due to travel restrictions and virus-related concerns. Overall, the tourism shock is having deep knock-on effects on domestic consumption and investment. However, even if travel resumes in the next two years, it is forecast to remain significantly below pre-crisis levels as travellers' confidence recovers only gradually. The key condition for a fast recovery of the economy as of 2021 would be for COVID-19 outbreaks to remain limited to the upcoming winter and spring. Based on this assumption, Montenegro's economy could rebound thanks to investments supporting construction works and the revival of private consumption driven by growing employment, bank lending and remittances from abroad. On the contrary, new pandemic outbreaks and failing some degree of symmetric opening of borders and travel restrictions with key tourism markets in 2021 would represent major downside risks.

Moreover, the strength of the economic recovery may be put at risk in case of contagion from the corporate to the financial sector. So far, the banking sector has proved resilient in spite of the COVID-19 crisis, with banks' capital adequacy ratio comfortably above the regulatory minimum and the level of impaired loans stabilising thanks to payment deferrals and loan restructurings. However, the risk of default could rise in 2021, as a number of companies might be put at risk of insolvency once public support comes to an end.

The decline in imports and investment due to coronavirus-related disruptions and lower domestic demand is expected to help easing the trade deficit in 2020 and 2021. The completion of the first section of the Bar-Boljare highway in 2021, and a firmer recovery of tourism and remittances in 2022, will also support the containment of the current account deficit. Moreover, for 2021 and 2022, sizeable FDI inflows into energy, telecommunications (5G) and tourism projects (estimated at some 30% of GDP), have been announced by the foreign investors' council.

Energy prices and low demand hold back inflation

Low oil prices, combined with lower demand related to the coronavirus are key disinflationary factors dominating the forecast period. As a result, inflation is expected to remain subdued, coming into negative territory in 2020, before some modest growth in 2021 and 2022.

Labour market slack

The impact of the COVID-19 pandemic and the resulting contraction of economic activity on unemployment has –so far– been dampened by wage subsidies to avoid larger layoffs, but also by an increase of economically inactive people (mostly discouraged seasonal and temporary workers). As a result, 2020 unemployment figures are registering a mild deterioration, compared to the much faster decline in employment. The baseline scenario foresees a gradual recovery of employment, boosting private consumption and supporting the revitalisation of economic activity in 2021 and 2022. Yet, the speed of recovery will depend on the capacity to maintain borders opened to foreign seasonal workers and tourists.

Public finance under stress

Public finances are under significant pressure due to fast growing costs to finance the government's policy response to the pandemic, combined with a sharp decline in budget revenue due to lower economic activity. Thus, in the first eight months of 2020, the central government budget deficit already reached 6.7% of GDP. These same pressing factors are expected to continue well into 2021, before public finances stabilise once tax collection improves and health-related expenditure flattens. The completion of the debt-financed first section of the Bar-Boljare highway (now foreseen for mid-2021) will help easing the pressure on public finances in 2022.

Table II.29.1:

Main features of country forecast - MONTENEGRO

		2019			Annual percentage change						
	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	**-14.3**	**6.8**	**3.7**
Private Consumption		3533.6	71.4	-	3.9	4.6	3.1	**-12.9**	**5.1**	**2.4**
Public Consumption		881.1	17.8	-	-1.4	6.3	1.0	**2.2**	**1.2**	**0.9**
Gross fixed capital formation		1351.8	27.3	-	18.7	14.7	-1.7	**-16.7**	**5.3**	**4.4**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		2163.4	43.7	-	1.8	6.9	5.4	**-29.2**	**16.4**	**7.2**
Imports (goods and services)		3208.7	64.8	-	8.4	9.2	2.4	**-18.3**	**7.1**	**3.4**
GNI (GDP deflator)		-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth:	Domestic demand			-	7.4	8.5	1.9	**-13.4**	**5.3**	**3.0**
	Inventories			-	1.9	-0.3	1.4	**0.0**	**0.0**	**0.0**
	Net exports			-	-4.6	-3.1	0.7	**-0.9**	**1.5**	**0.7**
Employment				-	2.3	2.2	2.2	**-2.6**	**2.3**	**1.9**
Unemployment rate (a)				-	16.1	15.5	15.3	**18.1**	**16.6**	**15.9**
Compensation of employees / head				-	0.8	0.0	1.1	**0.3**	**1.8**	**2.2**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour cost				-	-	-	-	**-**	**-**	**-**
Saving rate of households (b)				-	-	-	-	**-**	**-**	**-**
GDP deflator				-	-	-	-	**-**	**-**	**-**
Consumer-price index				-	2.8	2.9	0.5	**-0.5**	**1.0**	**1.4**
Terms of trade of goods				-	-	-	-	**-**	**-**	**-**
Trade balance (goods) (c)				-39.9	-43.3	-43.9	-41.7	**-39.0**	**-38.5**	**-38.4**
Current-account balance (c)				-	-16.1	-17.0	-15.0	**-15.8**	**-14.3**	**-13.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-	-	-	**-**	**-**	**-**
General government balance (c)				-	-5.2	-3.7	-2.0	**-8.8**	**-4.7**	**-3.6**
Cyclically-adjusted budget balance (d)				-	-	-	-	**-**	**-**	**-**
Structural budget balance (d)				-	-	-	-	**-**	**-**	**-**
General government gross debt (c)				-	64.2	70.1	76.5	**87.3**	**85.6**	**83.0**

(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.