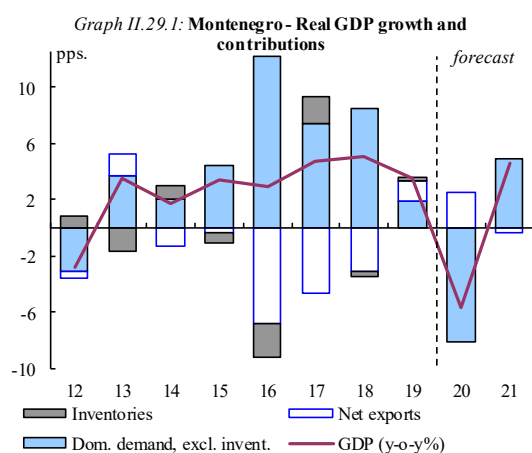


## 29. MONTENEGRO

The economy is set to contract substantially in 2020 due to the negative effects of the COVID-19 outbreak. Montenegro's economy is strongly dependent on tourism, a key source of GDP growth, foreign exchange, employment and fiscal revenues. However, the lock-down brought tourism and travel to a standstill at a time when these activities were about to enter the high season. Economic recovery in 2021 is dependent on the duration of the shock.

### Growth deceleration in 2019

As the maturing of the investment cycle had a dampening effect on economic output, GDP growth decelerated markedly to 3.6% y-o-y in 2019, down from the 5.1% expansion recorded a year earlier. The main growth contributions came from private consumption and net exports, both supported by an exceptionally good tourism season boosting net exports performance. Fiscal consolidation resulted in a modest (0.3 pps) contribution of government consumption to economic growth.



### Tourism shock

The COVID-19 pandemic is expected to push Montenegro into a deeper recession than the global financial crisis. The main transmission channel is the collapse in tourism arrivals due to the breakdown of international travel following the lockdown measures implemented in many countries. Travel and tourism accounts for some 25% of Montenegro's GDP in total. The large tourism shock will have knock-on effects on domestic consumption and investment, although the resulting fall in imports will absorb some of the negative impact. Conversely, the cost of the authorities' policy response would increase government consumption.

This forecast scenario assumes the tourism shock to last into the second quarter of 2020, followed by a very modest recovery in the third quarter, led by domestic tourists and travellers from neighbouring countries reaching Montenegro's coastal resorts by road once the movement restrictions end. Air connections would need more time to be re-established, while cruise ship tours might suffer an even longer-term damage. A swift recovery of the economy in 2021, while possible, is subject to very substantial uncertainties. The main risk for this scenario would be a revitalisation of the virus and delays to obtain a vaccine before the next tourism season.

### Trade and remittances downfall

The current account deficit is set to narrow for two consecutive years. First, in 2020, due to the contraction of domestic demand and imports, the latter outpacing in terms of volume the contraction of tourism exports. Then, in 2021, following the completion of the Bar-Boljare highway works, which was heavily reliant on construction materials, equipment, but also services imports. The plunge of oil prices would also contribute to narrowing the external gap, but this could be partially offset by an almost simultaneous decline in exports prices of electricity and aluminium. Remittances inflows are also set to contract as Montenegrins abroad are also confronted with lockdowns. A reversal of FDI flows is not expected considering the nature of investments, most of them in real estate, construction and intercompany debt. However, some important FDI projects could be delayed.

### Seasonal jobs to absorb partially the shock

Montenegro's labour market is characterised by strong seasonality and dependence on foreign temporary workers, particularly in construction, agriculture and tourism. This situation could facilitate a quick adjustment of the payroll for local businesses, dampening to some extent the negative impact on unemployment. Employment would

recover gradually in 2021, following the expected rebound of the economy.

### Inflation driven by domestic factors

In addition to the sharp decline of international oil prices, inflation pressures are set to stay low in 2020 due to the contraction of domestic demand. Some likely price increases in agro-food and medical products in 2020 could be offset by rebates in tourism packages and real estate. Some modest increase of inflation is forecast for 2021, in the wake of the projected recovery in consumption and employment.

### Enterprises liquidity support

Montenegro's Investment Development Fund, International Financial Institutions and the EU are providing credit lines and guarantees to domestic banks to facilitate liquidity to local companies. The financial sector appears stable, liquid and well capitalised, with capacity to provide liquidity to the real sector during the forecast period. However, risks remain on the demand side, in particular the capacity of small businesses to recover after the lockdown and reimburse debt.

### Public finance shudders

Public finances are confronted with a triple shock: the collapse of tax revenue due to the interruption of economic activity, a sudden surge of healthcare expenditure, and the need to finance support measures to preserve the economy. Only the more pressing medical needs to respond to the pandemic are estimated at 1.2% of GDP, while the first set of measures in support of the economy are estimated to cost some 3.5% of GDP. The contraction of tax revenue is extremely difficult to estimate, as it would depend on the duration of the lockdown and its effects, and on the amount of taxes deferred (and recovered). Overall, a historically high deficit of more than 7% of GDP is expected in 2020, instead of the initially planned balanced budget. In 2021, the rebound of the economy and a marked reduction in capital spending would facilitate a modest primary surplus, providing some relieve to public debt.

Public debt growth would be partially limited in 2020 thanks to the use of government reserves. These were built-up to pay maturing debt in 2020 and 2021. Instead, they would be used to cover urgent financing needs created by the pandemic.

Table II.29.1:

### Main features of country forecast - MONTENEGRO

	2018			Annual percentage change						
	mio EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	4663.1	100.0	-	-	2.9	4.7	5.1	3.6	-5.9	4.4
Private Consumption	3424.6	73.4	-	-	5.4	3.9	4.6	2.9	-9.1	10.9
Public Consumption	862.9	18.5	-	-	0.8	-1.4	6.3	1.5	2.5	-1.7
Gross fixed capital formation	1363.9	29.2	-	-	38.4	18.7	14.7	-1.5	-7.5	-8.4
of which: equipment	-	-	-	-	-	-	-	-	-	-
Exports (goods and services)	1999.3	42.9	-	-	5.9	1.8	6.9	6.4	-33.7	24.3
Imports (goods and services)	3111.9	66.7	-	-	15.3	8.4	9.2	2.1	-26.1	16.0
GNI (GDP deflator)	-	-	-	-	-	-	-	-	-	-
Contribution to GDP growth:										
Domestic demand			-	-	12.1	7.4	8.5	2.0	-8.1	4.9
Inventories			-	-	-2.4	1.9	-0.3	0.3	0.0	0.0
Net exports			-	-	-6.8	-4.6	-3.1	1.4	2.2	-0.5
Employment			-	-	1.1	2.3	2.2	2.1	-1.4	2.6
Unemployment rate (a)			-	-	17.7	16.1	15.5	15.4	17.0	16.2
Compensation of employees / head			-	-	0.9	0.8	0.0	0.8	-1.8	2.1
Unit labour costs whole economy			-	-	-	-	-	-	-	-
Real unit labour cost			-	-	-	-	-	-	-	-
Saving rate of households (b)			-	-	-	-	-	-	-	-
GDP deflator			-	-	-	-	-	-	-	-
Consumer-price index			-	-	0.1	2.8	2.9	0.5	0.8	1.3
Terms of trade of goods			-	-	-	-	-	-	-	-
Trade balance (goods) (c)			-	-	-38.7	-41.9	-43.3	-43.9	-42.1	-29.0
Current-account balance (c)			-	-	-16.2	-16.1	-17.0	-15.2	-13.8	-12.9
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-	-	-	-	-	-	-	-
General government balance (c)			-	-	-3.6	-5.2	-3.7	-2.0	-7.7	-1.5
Cyclically-adjusted budget balance (d)			-	-	-	-	-	-	-	-
Structural budget balance (d)			-	-	-	-	-	-	-	-
General government gross debt (c)			-	-	63.4	64.2	70.1	77.2	82.7	79.6

(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.