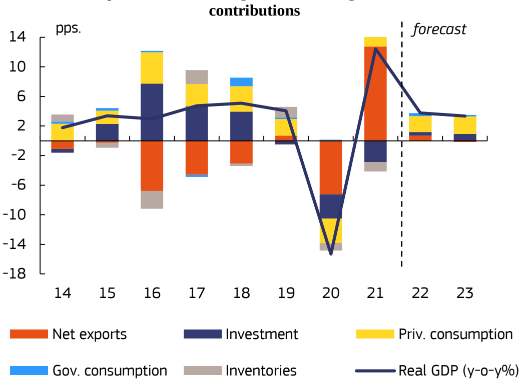
29. MONTENEGRO

A quicker than expected resumption of tourism resulted in a strong rebound of the economy in 2021. Tourism activity in Montenegro is however set to slow down in 2022 due to Russia's war of aggression against Ukraine, as Russians and Ukrainians constitute a significant share of visitors. At the same time, an ambitious economic reform programme adopted by the government at the end of 2021 is projected to boost households' purchasing power and investment. This stimulus is set to add further inflationary pressures and to increase external and budget deficits.

Strong rebound of the economy in 2021

Montenegro's economy recorded very strong growth in 2021, surging by 12.4% y-o-y, but did not fully recover to pre-pandemic levels. Net exports were the main driver of growth in 2021, led by a robust revival of tourism, which had positive spillover effects across the economy, boosting private consumption. Government consumption increased only moderately, as COVID-19-related support measures started to expire. Investment activity remained weak for a second year in a row, declining by 10% y-o-y.

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



Challenging circumstances in 2022

The optimistic autumn forecast baseline outlook has been upturned by a triple shock. In early 2022, food and energy price increases were exacerbated further by the fallout of Russia's war of aggression against Ukraine. The war is also expected to have a negative impact on Montenegro's tourism industry, as Russians and Ukrainians constitute 20% of total visitors. On top of this, a political crisis materialised on 4 February 2022, when the government lost a vote of confidence 14 months after being formed. A new minority government was established three months later, but political uncertainty persists.

An ambitious initiative not exempt from risks

At the end of 2021, the government adopted an ambitious plan (Europe Now) to boost economic recovery. This included the abolition of health contributions, an 80% increase in the minimum wage, the introduction of new social benefits and an ambitious public investment programme. This major fiscal stimulus is set to boost households' income, employment and investment. However, while the increase of salaries is projected to preserve households' purchasing power this year, it also risks nourishing inflationary pressures as well as increasing external and fiscal imbalances.

Overall, this scenario is subject to major downside risks in case the economy grows less than expected in an environment of global financial tightening, which would hinder investments and employment, and consequently, public finances.

Growth projections lowered

Montenegro's GDP growth projections for 2022 are revised downwards by some 2 pps. compared to the Autumn Forecast. Tourism in particular is expected to perform worse in 2022 than previously expected and to reduce exports of services, while the fiscal stimulus is set to support private consumption particularly in 2022, before the impulse runs out in 2023. Weaknesses in public investment management, a track record of low implementation rates, and delays in forming the new government are set to hinder the ambitious public investment plan for 2022, albeit some intensification of investment could be expected in 2023 as the preparation of several construction projects mature. The economy is expected to regain some momentum in 2023, as tourism is projected to fully recover or surpass pre-pandemic levels. The slower but sustained growth of the economy would be reflected in a gradual improvement of labour market conditions. Employment is expected to increase gradually and unemployment rates to fall below pre-pandemic levels in 2023 as the rebound of tourism supports economic activity. Inflation projections are revised significantly upwards. However, the surge in inflation is expected to be temporary. Consumer prices are assumed to decelerate gradually as from mid-2022 as energy and food prices are assumed to broadly flatten out, helping headline inflation to return to more moderate levels in 2023 after base effects phase out.

Following a large improvement in 2021, the current account deficit is expected to increase again in 2022 due to lower revenues from tourism. The merchandise trade deficit is set to widen in 2023, as import-dependent investment activity intensifies.

External financing is expected to continue relying on FDI inflows. However, the tightening of global financial conditions and Russian investors' difficulties to transfer capital (particularly towards real estate) may hinder capital flows into Montenegro.

Temporary surge of the budget deficit

The rebound in economic activity combined with a significant underspending of the capital budget resulted in a sharp reduction of the budget deficit in 2021. The economy is set to benefit from the strong fiscal stimulus provided by the 'Europe Now' programme, which is however expected to raise significantly the budget deficit this year. The gap is forecast to narrow in 2023 thanks to the stimulus carryover provided to the economy, and the subsequent windfall from indirect and personal income taxes, while public spending is expected to remain stable in nominal terms. The sizeable amount of government deposits relieves considerably Montenegro's budget financing needs, and therefore, borrowing operations are set to remain limited during the forecast horizon. The combination of high inflation, GDP growth and limited borrowing are set to reduce the public debt ratio in both 2022 and 2023.

Table II.29.1:

Main features of country forecast - MONTENEGRO

	2021		Annual percentage change						
	mio EUR Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP	4911.6	100.0	3.0	5.1	4.1	-15.3	**12.4**	**3.8**	**3.4**
Private Consumption	3628.8	73.9	:	4.6	3.1	-4.6	**4.3**	**2.9**	**3.3**
Public Consumption	990.8	20.2	:	6.3	1.0	0.8	**1.5**	**2.1**	**1.1**
Gross fixed capital formation	1116.4	22.7	:	14.7	-1.7	-11.9	**-10.3**	**2.2**	**4.2**
Exports (goods and services)	2114.2	43.0	:	7.0	5.8	-46.2	**81.1**	**3.8**	**6.3**
Imports (goods and services)	3080.0	62.7	:	9.2	2.7	-20.1	**13.7**	**1.4**	**4.8**
GNI (GDP deflator)	5023.1	102.3	:	4.2	3.2	-14.3	**13.2**	**-0.2**	**3.4**
Contribution to GDP growth: Domestic demand			4.5	8.5	1.9	-6.4	**1.0**	**3.1**	**3.6**
Inventories			-0.4	-0.3	1.5	-1.0	**-1.3**	**0.0**	**0.0**
Net exports			-1.2	-3.1	0.7	-7.2	**12.7**	**0.8**	**-0.2**
Employment			:	3.2	2.6	-10.1	**-2.4**	**2.1**	**2.3**
Unemployment rate (a)			18.7	15.5	15.4	18.3	**16.9**	**15.2**	**14.7**
Compensation of employees / head			:	:	:	:	**:**	**:**	**:**
Unit labour costs whole economy			:	:	:	:	**:**	**:**	**:**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			:	:	:	:	**:**	**:**	**:**
Consumer price index			3.0	2.9	0.5	-0.8	**2.5**	**6.5**	**2.9**
Terms of trade goods			:	:	:	:	**:**	**:**	**:**
Trade balance (goods) (c)			-45.0	-43.9	-41.7	-39.2	**-39.0**	**-38.8**	**-40.6**
Current-account balance (c)			-22.1	-17.0	-15.0	-26.1	**-9.2**	**-12.1**	**-12.5**
General government balance (c)			-3.0	-3.9	-1.9	-11.1	**-2.0**	**-4.4**	**-2.2**
Structural budget balance (d)			:	:	:	:	**:**	**:**	**:**
General government gross debt (c)			49.1	70.1	74.9	103.5	**80.6**	**76.7**	**72.7**

(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.