

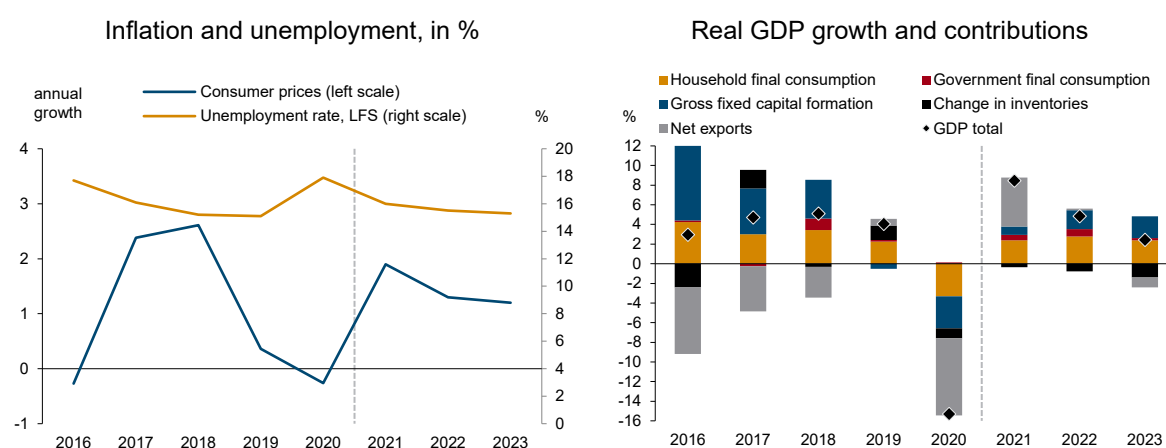


MONTENEGRO: Tourism pushes GDP up

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From Q2 2021, the economy has been enjoying a big increase in industrial production, retail sales, exports of goods and tourism. Accordingly, a high rate of GDP growth is expected in 2021. All the same, the huge contraction in 2020 means that the pre-crisis level will not be reached this year. Public debt and the budget deficit are falling but are still high, limiting fiscal space in the coming years. Despite improvements in economic activity, the unemployment rate remains high.

Figure 4.14 / Montenegro: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Since August, the country has been in the grip of a fourth wave of the COVID-19 pandemic. There has been a steep rise in the number of people infected, as a result of the increase in tourism and public gatherings. People are still reluctant to get vaccinated, though: mass vaccination started in May, but as of 10 October, just 40% of the adult population had been vaccinated (36% fully). Some minor restrictions remain in place, but they do not appear to affect the economy.

After a significant decline in 2020, there have been signs of economic recovery in Q2 and Q3 2021. In 2020, Montenegro suffered the biggest decline in GDP in Europe (-15.3%). This came as a result of the collapse of consumption and a slump in the tourism sector, which was hit hard by the pandemic and the associated containment measures, such as the tough travel restrictions. GDP growth was still negative in Q1 2021 (-6.4% year on year), but in Q2 it grew by 19%, year on year – just 2 percentage points (pp) less than the previous year's decline. This growth came about due to a strong revival in exports and consumption. The tourist season seems to have been a good one, so that GDP is

likely to grow strongly in Q3 as well. Visitor nights in July and August 2021 were four times up on 2020, and were just 13% below the 2019 level, meaning that tourism has recovered almost completely from the pandemic-induced decline. Accordingly, we are revising our forecast for GDP growth upwards by 1.9 pp (to 8.5%) in 2021, but slightly downwards (by 0.2 pp) to 4.8% in 2022. GDP will not reach its pre-pandemic level before the start of 2023.

Inflation is on the rise. In July and August 2021, annual consumer price inflation amounted to 3.1%, due to the increases in energy prices. Average inflation over the first eight months was 1.65%. Given the economic recovery witnessed in 2021, and the rise in prices globally, we expect inflation to increase in 2021 to 1.9% (an upwards revision of 1 pp since our last forecast).

The current account deficit narrowed in the first two quarters of 2021. As a result of the pandemic, exports of services declined significantly in 2020, so that Montenegro's current account deficit widened to 26% of GDP. The deficit then narrowed in the first two quarters of 2021, thanks to an increase in services revenues and secondary income. In Q2, exports of goods rose by 32.3% and exports of services by 43.6%, compared to Q2 2020. At the same time, imports of goods in Q2 increased by only 4.9%, while imports of services decreased by 2.7%; thus the current account deficit dropped to 20.4% of GDP. We have, therefore, revised our forecast for the current account deficit upwards by 2.7 pp, compared to our previous report, and we now project a current account deficit of 18.3% of GDP in 2021. We expect this deficit to continue to narrow thereafter. Remittances made up around 14% of GDP in 2020 (which was 2.5 pp up on 2019), and the figure continued to rise in the first two quarters of 2021. The increase in Q2 was 89.6%, compared to Q2 2020.

The budget deficit and public debt are both decreasing, although they are still high. In 2020, public debt and the general government budget deficit reached all-time highs of 105% and 11.1% of GDP, respectively. At the end of June 2021, public debt fell to 89% of GDP, thanks to the repayment of treasury bills, and the government budget was in surplus in June, July and August. However, public debt is still high and fiscal space in the coming years is seriously limited. Since China holds approximately a quarter of Montenegro's total debt, there are concerns about the country's dependence on its eastern partner. Repayment of the first tranche of the loan has been deferred to late 2022, and Montenegro has managed to secure a deal with three international banks to hedge against foreign exchange risk on the Chinese debt. The hedging will also reduce the interest rate it pays on the debt (it will pay interest of 0.88% in EUR, rather than the 2% it was paying in USD). The government measures to mitigate the COVID-19 economic downturn mean that the country is expected to post a budget deficit of 5.5% of GDP in 2021; that would still bring the debt-to-GDP ratio down, because of the higher nominal GDP growth. Over the medium term, debt will remain elevated, at around 90% of GDP – well above the pre-pandemic level of 77%. As a consequence of its high public debt, its government deficit and the sharp drop in GDP in 2020, Standard and Poor's has downgraded Montenegro's credit rating from B+ to B; that could result in a reduced inflow of foreign direct investment, which was a significant factor in the country's economic growth during the previous period.

On 28 September, the government announced a plan to raise the minimum wage and introduce tax reform. The plan, among other things, suggests the introduction of progressive income and profit tax, the abolition of healthcare contributions and an increase in non-taxable income; the outcome would be a significant reduction in the labour tax wedge. Essentially, it proposes a substantial rise in the minimum wage (to EUR 450 a month), which would maintain total labour costs at about the current level,

but would result in higher net wages and lower taxes. There is still not enough information for a concrete assessment of the effects of the plan, but – given the significant reduction in the labour tax – it poses the risk of a further rise in the budget deficit.

Despite the improvements in the economy, unemployment remains high. In the wake of the enormous contraction in GDP in 2020, unemployment in Montenegro soared – from 15.1% to 17.9%. This was the biggest rise in unemployment in the whole of Europe, and returned the country to its 2014 level. According to the Labour Force Survey, the unemployment rate increased further in Q1 2021, to 19.4% (although this is not directly comparable to previous figures, as the Labour Force Survey methodology changed). According to data on the registered jobless, unemployment rose in Q2 2021, compared to Q2 2020. As COVID-19 subsides, unemployment will decline; for 2021, we project that the rate will drop to 16%. It will continue to fall in coming years, but the pre-pandemic level will not be reached anytime soon.

Alongside the limited fiscal space mentioned above, political tension also poses a downside risk to growth. Violence erupted in the Montenegrin town of Cetinje at the beginning of September, as opposition parties and patriotic groups of protesters sought to prevent the enthronement of the new head of the Serbian Orthodox Church there. They viewed the event as an attempt to impose Serbian dominance on Montenegro. The heightened tension between citizens and the political instability it has engendered could potentially jeopardise the EU accession process.

Table 4.14 / Montenegro: Selected economic indicators

	2018	2019	2020 ¹⁾	2020 January-June	2021	2021 Forecast	2022 Forecast	2023
Population, th pers., average	622	622	621	.	.	630	630	630
Gross domestic product, EUR m, nom.	4,663	4,951	4,186	1,817	2,004	4,600	4,900	5,100
annual change in % (real)	5.1	4.1	-15.3	-10.5	6.4	8.5	4.8	2.4
GDP/capita (EUR at PPP)	14,610	15,680	13,720	.	.	.	.	.
Consumption of households, EUR m, nom. ²⁾	3,425	3,534	3,400	1,574	1,636	.	.	.
annual change in % (real)	4.6	3.1	-4.6	-6.5	3.2	3.0	3.5	3.0
Gross fixed capital form., EUR m, nom.	1,364	1,352	1,166	563	537	.	.	.
annual change in % (real)	14.7	-1.7	-12.0	-14.5	3.2	3.0	7.0	8.0
Gross industrial production ³⁾								
annual change in % (real)	22.4	-6.3	-0.9	-0.8	10.6	8.0	3.0	2.5
Net agricultural production ⁴⁾								
annual change in % (real)	3.3	-2.2	1.1	.	.	.	.	.
Construction output ⁴⁾								
annual change in % (real)	24.9	10.7	-5.5	-6.9	-1.3	.	.	.
Employed persons, LFS, th, average ⁵⁾	237.4	243.8	219.4	.	.	224	228	233
annual change in %	3.5	2.7	-10.0	.	.	2.0	2.0	2.0
Unemployed persons, LFS, th, average ⁵⁾	42.5	43.4	47.8	.	.	40	40	40
Unemployment rate, LFS, in %, average ⁵⁾	15.2	15.1	17.9	.	.	16.0	15.5	15.3
Reg. unemployment rate, in %, eop	17.8	16.2	20.5	16.6	23.9	.	.	.
Average monthly gross wages, EUR	766	773	783	783	790	800	810	820
annual change in % (real, gross)	-2.4	0.6	1.6	1.6	-0.2	0.5	0.3	0.2
Average monthly net wages, EUR	511	515	524	523	529	540	550	560
annual change in % (real, net)	-2.3	0.4	2.0	1.9	0.0	0.4	0.2	0.2
Consumer prices, % p.a.	2.6	0.4	-0.3	0.1	1.2	1.9	1.3	1.2
Producer prices in industry, % p.a. ⁶⁾	1.7	2.4	-0.1	0.4	1.3	1.3	1.7	1.6
General governm.budget, nat.def., % of GDP								
Revenues	42.2	43.4	44.6	.	.	44.8	41.0	41.0
Expenditures	46.2	45.4	55.7	.	.	50.3	45.0	44.0
Deficit (-) / surplus (+)	-3.9	-2.0	-11.1	.	.	-5.5	-4.0	-3.0
General gov.gross debt, nat.def., % of GDP	70.1	76.5	105.3	.	.	91.0	90.0	85.0
Stock of loans of non-fin.private sector, % p.a.	9.1	6.6	2.9	7.0	2.3	.	.	.
Non-performing loans (NPL), in %, eop	6.7	4.7	5.5	5.3	5.7	.	.	.
Central bank policy rate, % p.a., eop ⁷⁾	5.75	5.46	5.84	5.93	5.78	5.9	5.5	5.4
Current account, EUR m	-793	-707	-1,090	-644	-409	-843	-830	-880
Current account, % of GDP	-17.0	-14.3	-26.1	-35.4	-20.4	-18.3	-16.9	-17.3
Exports of goods, BOP, EUR m	436	466	409	182	241	480	510	530
annual change in %	14.0	6.8	-12.2	-15.3	32.3	18.0	6.0	3.0
Imports of goods, BOP, EUR m	2,485	2,531	2,051	1,012	1,062	2,130	2,340	2,480
annual change in %	10.8	1.8	-19.0	-16.2	4.9	4.0	10.0	6.0
Exports of services, BOP, EUR m	1,563	1,705	679	296	424	920	1,200	1,310
annual change in %	13.1	9.1	-60.2	-45.1	43.6	35.5	30.0	9.0
Imports of services, BOP, EUR m	627	687	503	251	244	540	590	630
annual change in %	18.1	9.6	-26.8	-23.5	-2.7	7.0	10.0	6.0
FDI liabilities, EUR m	415	372	463	254	204	460	.	.
FDI assets, EUR m	92	67	-5	-5	-2	10	.	.
Gross reserves of CB excl. gold, EUR m ⁸⁾	1,050	1,367	1,739	1,212	1,372	.	.	.
Gross external debt, EUR m	7,631	8,369	9,381	.	.	9,020	9,460	9,690
Gross external debt, % of GDP	163.7	169.0	224.1	.	.	196.0	193.0	190.0

1) Preliminary. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on gross value added data. - 5) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 6) Domestic output prices. - 7) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 8) Data refer to reserve requirements of the Central Bank.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.