

MONTENEGRO

Key conditions and challenges

Table 1 **2021**

Population, million	0.6
GDP, current US\$ billion	5.6
GDP per capita, current US\$	9011.0
Upper middle-income poverty rate (\$5.5) ^a	16.9
Gini index ^a	36.9
School enrollment, primary (% gross) ^b	101.7
Life expectancy at birth, years ^b	76.9
Total GHG Emissions (mtCO ₂ e)	3.6

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2011 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2019).

Montenegro's economic recovery in 2021 was robust, supported by tourism revival. The labor market also responded to economic recovery and the fiscal position significantly improved. Montenegro adopted a landmark reform program "Europe Now" which carries many opportunities, but also significant fiscal risks. The outbreak of war in Ukraine is worsening the otherwise positive outlook. This together with rising inflation risks will impact living standards and poverty.

Montenegro's small, open, and tourism-dependent economy suffered the largest contraction in Europe of -15.3 percent in 2020, reversing several years of poverty reduction and exposing Montenegro's acute vulnerabilities to external shocks.

From 2015-19, growth averaged 4 percent, driven by large public investments and strong growth in consumption. Over two-thirds of Montenegro's jobs are in services, which account for over 70 percent of value added. The current account balance shows a large structural deficit and averaged 15 percent of GDP over 2015-19, financed by net FDI and external debt. Montenegro's net international investment position at negative 170 percent of GDP in 2019 is amongst the largest in the world. Due to weaker adherence to fiscal plans and debt-financed highway construction, public debt peaked at 105 percent of GDP in 2020. Montenegro aspires to join the EU, but significant rule of law challenges have slowed progress towards this goal and reflect a key development constraint.

The economic rebound in 2021 was robust, supported by invigorating tourism. The fiscal macro-fiscal stability has been preserved as both the fiscal deficit and public debt were significantly reduced. Montenegro adopted a reform program "Europe Now", which abolishes healthcare contributions, introduces personal income tax allowance, progressive personal and corporate income

taxation, and increases the net monthly minimum wage from €250 to €450. The program has the potential to reduce inequalities and increase formal employment and growth over the medium-term, especially if complemented by additional structural reforms, but also poses fiscal risks. The Parliament rejected several revenue measures, which will likely result in a wider-than-planned fiscal deficit in 2022 and the following years.

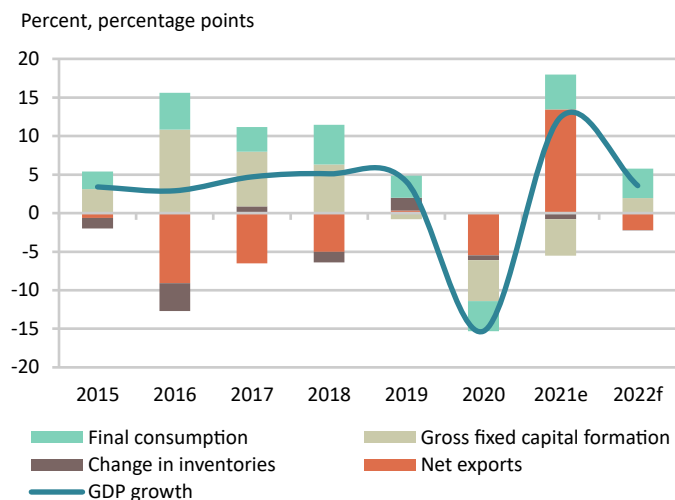
In February 2022, there was a vote of no confidence in the government. A turbulent political environment is adding to already high uncertainty. Accelerating structural reforms and fiscal prudence are needed to mitigate increasing risks.

Recent developments

Montenegro's economy posted a strong recovery in 2021, estimated at 12.4 percent, driven primarily by a rebound in international tourism receipts recovering to 70 percent of their 2019 level from just 13 percent in 2020. Tourism, employment growth, and household lending supported the strong private consumption rebound. Investments lingered driven by a slowdown in public investments.

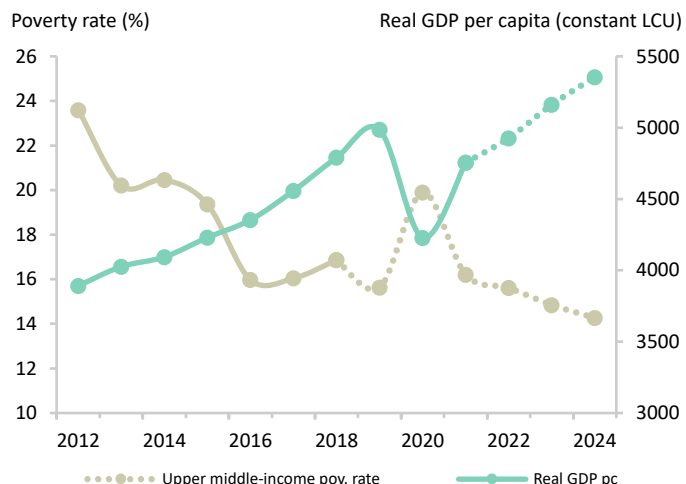
The labor market recovered as economic activity picked up. LFS data show an increase in employment in the fourth quarter by 20 percent compared to the first quarter. Poverty (income below \$5.5/day in 2011 PPP) is projected to decline from around 19.9 percent in 2020 to 16.2 percent in 2021.

FIGURE 1 Montenegro / Real GDP growth and contributions to real GDP growth



Sources: MONSTAT, World Bank.

FIGURE 2 Montenegro / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

In 2021, inflation averaged 2.4 percent, and peaked at 6.7 percent in February 2022, led by food and oil prices, which constrains purchasing power particularly for the poor. The financial sector has remained robust with outstanding loans and deposits reaching highs in 2021. The capital adequacy was at 18.5 percent, while non-performing loans increased to 6.8 percent of total loans from 5.9 percent in 2020.

In 2021, the current account deficit narrowed to 9.2 percent of GDP, the lowest since 2004. Growing by 95 percent, exports of goods and services outpaced import growth, narrowing the trade deficit to 19.5 percent of GDP. Strong net exports were supported by the tourism recovery, metals and electricity exports, and lower imports growth. Net remittances increased by 35 percent further reducing the current account deficit which was entirely financed by net FDI accounting for 11.2 percent of GDP. In January 2022, international reserves covered 8 months of merchandise imports.

The fiscal deficit fell to 2 percent of GDP in 2021 from 11 percent of GDP in 2020, driven by a rebound in revenues, capital budget underspending, and lower current spending. Public debt declined to 86 percent of GDP.

Outlook

The outlook is fragile in an environment of increasing uncertainties. The outbreak of the war in Ukraine and the associated developments have significantly worsened the outlook for Montenegro, reducing the GDP growth rate to 3.6 percent in 2022. The main direct transmission channel of the war to Montenegro's economy is tourism. The expected decline in tourism due to the war slows down exports and private consumption, which is expected to remain strong, however, due to the positive effects of higher disposable incomes and the employment recovery.

The war decelerates household income growth particularly for those working in the tourism and hospitality sector. Rising energy and food prices will disproportionately hurt the poor. Poverty in 2022 is projected at 15.6 percent, though the outlook is uncertain depending on the economic impacts of the conflict.

Investments are expected to pick up as the highway is being completed and other capital spending increases, while private investments in tourism and energy sectors continue, but at a slower pace. As investments resume, so will imports, which are expected to remain at similar levels during 2022-24. The current account deficit is thus expected to widen and remain at around 12 percent of GDP over the medium term. The global inflationary pressures and, to a lesser extent, domestic pressures from an increase in wages will push inflation to an estimated 5 percent in 2022. Utmost fiscal prudence is needed to return public debt towards Montenegro's fiscal rule of 60 percent of GDP.

TABLE 2 Montenegro / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	4.1	-15.3	12.4	3.6	4.7	3.7
Private Consumption	3.1	-4.6	4.3	3.9	3.6	2.8
Government Consumption	1.0	0.8	1.5	1.4	0.3	0.6
Gross Fixed Capital Investment	-1.7	-12.0	-10.3	5.3	6.8	7.5
Exports, Goods and Services	5.8	-47.6	81.1	2.2	7.4	5.8
Imports, Goods and Services	2.7	-20.1	13.7	3.8	5.5	5.2
Real GDP growth, at constant factor prices	4.2	-14.4	12.4	3.6	4.7	3.7
Agriculture	-2.2	1.1	-5.0	0.1	0.5	0.5
Industry	5.6	-12.0	1.0	4.0	6.0	4.0
Services	4.5	-16.9	19.0	3.8	4.7	4.0
Inflation (Consumer Price Index)	0.4	-0.3	2.4	5.0	2.3	1.6
Current Account Balance (% of GDP)	-14.3	-26.1	-9.2	-12.6	-12.1	-12.0
Net Foreign Direct Investment (% of GDP)	6.2	11.2	11.2	8.1	8.7	8.7
Fiscal Balance (% of GDP)	-2.7	-11.0	-2.0	-5.2	-3.0	-1.7
Debt (% of GDP)	76.5	105.3	84.9	77.4	75.2	73.1
Primary Balance (% of GDP)	-0.5	-8.3	0.4	-3.4	-1.4	-0.2
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	15.6	19.9	16.2	15.6	14.8	14.3
GHG emissions growth (mtCO₂e)	5.3	-22.0	15.2	2.1	0.0	1.3
Energy related GHG emissions (% of total)	70.7	65.9	69.8	70.6	70.8	71.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

a/ Calculations based on ECAPOV harmonization, using 2012-SILC-C, 2015-SILC-C, and 2018-SILC-C. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.

b/ Projection using point-to-point elasticity (2012-2015) with pass-through = 0.87 and, for 2022 onward, 0.5 based on GDP per capita in constant LCU, reflecting impacts of rising prices.