MONTENEGRO: Mired in uncertainty

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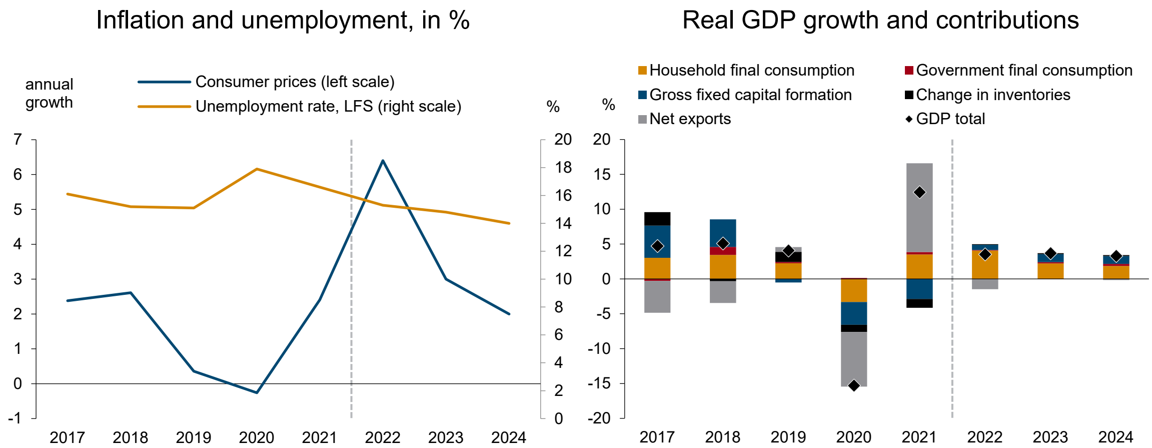
After the fall of the government at the beginning of the year, there is still no clear political solution in sight. Despite a growth rate of 12.4% in 2021, the pre-pandemic GDP level has not yet been reached, leaving further room for growth in 2022. There will be a decline in foreign direct investment, as a result of the sanctions against Russia. Despite rising inflation, household consumption will support growth in 2022, since the 'Europe Now' reform programme has led to an unprecedented increase in net earnings. The economy is expected to grow at a rate of 3.5% in 2022, 1 percentage point lower than initially expected.

Figure 4.14 / Montenegro: Main macroeconomic indicators



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

In economic terms, Montenegro forged ahead in 2021, thanks to the growth in tourism. The estimated GDP growth rate of 12.4% in 2021 was one of the highest in Europe, showing that the country can pick up rapidly, if the macroeconomic conditions allow it. Despite the fact that the number of tourists almost quadrupled between 2020 and 2021, still revenue from tourism fell short of the 2019 figure. The number of tourists was lower than before COVID-19 and the season was dominated by regional and local visitors (52% of all visitors), at the cost of the Western markets. Nor will the tourist sector reach its full potential in 2022, given the loss of the Ukrainian market (and part of the Russian market) when direct flights ceased in March 2022. Russian and Ukrainian tourists accounted for 12% of the tourist market last year. A solid summer season could be on the cards, given this year's successful winter season. Visitors from the EU and other foreign markets, encouraged by more frequent flights to Montenegro, may make up for the loss of Ukrainian tourists, while Russian visitors are expected to enter via Serbia, which maintains air transport links to Russia.

However, sanctions against Russia will significantly dampen foreign direct investment (FDI). After much agonising, the caretaker government supported sanctions, which will hit the Montenegrin economy hard, mainly because of the fall-off in FDI. Russian investments used to account for approximately 10% of total FDI inflows, but that share rose to 18% in 2021 – probably because the ousted government managed to steer a middle course between the EU and Russia. But only with political certainty is there any real hope of attracting FDI from other Western markets. The global financial crisis and the COVID-19 pandemic showed that FDI is very sensitive to global shocks, which is why FDI sentiment could suffer this year. We have lowered our projections by 1 percentage point (pp) to 3.5% of GDP in 2022, on the assumption that the Ukrainian-Russian crisis is settled by summer.

Industrial production is already suffering after the closure of the country's largest industrial plant, the aluminium company Uniprom, in the wake of its failure to reach agreement with the national energy company on electricity subsidies. These subsidies had long been essential to profitable aluminium production. The closure will lead to a sharp decline in manufacturing and goods exports in 2022, and will further increase the country's dependence on services in the medium term, which will complicate the reforms being undertaken to restructure the economy. However, the growth of the energy sector may compensate for the loss of aluminium production, now that the Uniprom subsidies are no longer dragging profits down.

The substantial decline in the current account deficit from 2021 will not last long. Exports of services, driven mainly by tourism, increased by a nominal 135% and helped slash the current account deficit to an estimated 9.2% of GDP in 2021 – the lowest for 12 years. However, this upswing will be short-lived, on account of the supply-chain disruptions that have been further intensified by the war in Ukraine – and consequently by higher import and export prices. When war erupted in Ukraine, Serbia limited its exports of wheat, forcing Montenegro to import grain from Bulgaria for the time being. If the war drags on and if sanctions against Russia prevail, further such supply-chain disruptions are likely this year. Besides large external shocks to trade and prices, the closure of Uniprom, the most significant goods exporter, will further widen the current account deficit, which we forecast will be 12.5% of GDP in 2022.

Montenegro will experience its highest inflation for 14 years. The supply-chain disruption and the rising energy and food prices are having a severe impact on Montenegro, which is importing inflation from abroad, but has limited monetary policy tools to control it. Inflation in January and February 2022 was 5.7% and 6.7%, respectively. The government has suggested amendments to the law on excise duties, which would allow the duty on fuel to be cut by up to 20%. However, a lack of political will means that voting has not taken place yet in parliament. Our baseline projections are that inflation will be an average 6.4% in 2022.

The impact of inflation on households will be moderated by rising wages, following implementation of the 'Europe Now' reform package. 'Europe Now' is the most significant reform programme that the country has experienced since independence and has led to a sharp increase in average net earnings – from EUR 537 in December 2021 to EUR 706 in February 2022, or a nominal 31%. This rise in earnings comes about after the abolition of compulsory health insurance, a rise in the minimum wage (from EUR 250 to EUR 450 a month) and the introduction of a progressive personal income tax (no taxation on a monthly salary of under EUR 700). Altogether, we expect this to push household spending up, despite inflation. Retail trade already grew by 18.1% in February (which could partly be due to the low base and the good winter tourist season). Yet, this rise in net earnings comes at the cost of uncertain financing of the healthcare system and rising fiscal risks.

The fiscal risks remain the country's biggest weakness. The 'Europe Now' reform is being implemented without adequate analysis of its effects on the budget and fiscal risks. It is our assessment that, as a consequence of the reform, budget revenue will fall substantially, creating a budget deficit that will rise to 6% of GDP in 2022 and that will limit fiscal space in the years to come. Budget spending has been quite high in recent years, mainly due to the pandemic; for that reason, we do not expect to see a substantial rise in 2022. It is uncertain how the budget deficit will be financed this year, as parliament has limited its external financing through debt to a maximum of EUR 70m in 2022. Public debt fell substantially as a share of GDP in 2021 (by about 20 pp), but it remains the biggest source of systemic risk.

The political uncertainty in Montenegro is depressing growth. Ever since the formation of a new government in December 2020, the political situation in the country has been complicated. The disparate parties that went to make up that government proved a source of weakness that deepened the social divide and ultimately led to a vote of no confidence early this year. This has put the brakes on the country's progress towards EU accession, as the chances of any improvement in Montenegro's democratic capacity have completely vanished. The agreements on the formation of the minority government have been obscure, while its biggest supporter in terms of size (Democratic Party of Socialists) is not even actively participating in it. Thus, while the minority government is expected to contribute to the country's EU prospects, it is unlikely to continue in power beyond next year's presidential elections.

Table 4.14 / Montenegro: Selected economic indicators

	2018	2019	2020	2021 [1)]	2022	2023	2024
						Forecast	
Population, th pers., average	622	622	621	621	621	621	621
Gross domestic product, EUR m, nom.	4,663	4,951	4,186	4,912	5,400	5,800	6,100
annual change in % (real)	5.1	4.1	-15.3	12.4	3.5	3.7	3.3
GDP/capita (EUR at PPP)	14,590	15,700	13,360	15,390	.	.	.
Consumption of households, EUR m, nom. [2)]	3,425	3,534	3,400	3,629	.	.	.
annual change in % (real)	4.6	3.1	-4.6	4.3	5.5	3.0	2.5
Gross fixed capital form., EUR m, nom.	1,364	1,352	1,166	1,116	.	.	.
annual change in % (real)	14.7	-1.7	-12.0	-10.3	3.3	5.0	5.0
Gross industrial production [3)]							
annual change in % (real)	22.4	-6.3	-0.9	4.9	-14.0	7.0	9.0
Net agricultural production [4)]							
annual change in % (real)	3.3	-2.2	1.1	4.0	.	.	.
Construction output							
annual change in % (real)	24.9	10.7	-5.5	-4.8	.	.	.
Employed persons, LFS, th, average [5)]	237.4	243.8	219.4	212.6	216	220	226
annual change in %	3.5	2.7	-10.0	.	1.8	2.0	2.5
Unemployed persons, LFS, th, average [5)]	42.5	43.4	47.8	42.2	40	40	40
Unemployment rate, LFS, in %, average [5)]	15.2	15.1	17.9	16.6	15.3	14.8	14.0
Reg. unemployment rate, in %, eop	17.8	16.2	20.1	24.7	.	.	.
Average monthly gross wages, EUR	766	773	783	793	890	930	970
annual change in % (real, gross)	-2.4	0.6	1.6	-1.1	5.0	1.0	2.0
Average monthly net wages, EUR [6)]	511	515	524	532	700	730	760
annual change in % (real, net)	-2.3	0.4	2.1	-0.9	22.8	1.0	1.5
Consumer prices, % p.a.	2.6	0.4	-0.3	2.4	6.4	3.0	2.0
Producer prices in industry, % p.a. [7)]	1.7	2.4	-0.1	1.3	6.0	2.0	1.8
General governm. budget, nat. def., % of GDP							
Revenues	42.2	43.4	44.6	43.7	38.0	39.0	40.0
Expenditures	46.2	45.4	55.7	45.5	44.0	43.5	44.0
Deficit (-) / surplus (+)	-3.9	-2.0	-11.1	-1.8	-6.0	-4.5	-4.0
General gov. gross debt, nat. def., % of GDP	70.1	76.5	105.3	85.0	85.5	83.0	82.0
Stock of loans of non-fin. private sector, % p.a.	9.1	6.6	2.9	3.4	.	.	.
Non-performing loans (NPL), in %, eop	6.7	4.7	5.5	6.2	.	.	.
Central bank policy rate, % p.a., eop [8)]	5.75	5.46	5.33	5.16	5.3	5.4	5.5
Current account, EUR m	-793	-707	-1,090	-453	-675	-740	-750
Current account, % of GDP	-17.0	-14.3	-26.1	-9.2	-12.5	-12.8	-12.3
Exports of goods, BOP, EUR m	436	466	409	526	440	460	490
annual change in %	14.0	6.8	-12.2	28.7	-17.0	5.0	6.0
Imports of goods, BOP, EUR m	2,485	2,531	2,051	2,440	2,640	2,800	2,940
annual change in %	10.8	1.8	-19.0	19.0	8.0	6.1	5.0
Exports of services, BOP, EUR m	1,563	1,705	679	1,597	1,760	1,880	2,020
annual change in %	13.1	9.1	-60.2	135.1	10.0	7.0	7.7
Imports of services, BOP, EUR m	627	687	503	641	670	690	720
annual change in %	18.1	9.6	-26.8	27.5	5.0	3.5	4.0
FDI liabilities, EUR m	415	372	463	561	.	.	.
FDI assets, EUR m	92	67	-5	9	.	.	.
Gross reserves of CB excl. gold, EUR m [9)]	1,050	1,367	1,739	1,749	.	.	.
Gross external debt, EUR m	7,631	8,369	9,381	9,234	10,260	10,730	10,980
Gross external debt, % of GDP	163.7	169.0	224.1	188.0	190.0	185.0	180.0

1) Preliminary and wiiw estimates. - 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) From 2022 net wages excluding health insurance contributions and including an impact of personal income tax reform. - 7) Domestic output prices. - 8) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 9) Data refer to reserve requirements of the Central Bank.

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