



MONTENEGRO

Highlights

- **The economy is recovering from a deep recession in 2020.** Gross domestic product (GDP) fell by more than 15 per cent in 2020 but data from the second quarter of 2021 show a strong recovery in foreign tourist overnight stays, retail sales and manufacturing output.
- **Progress has been made on the country's digital agenda.** The electronic monitoring of fiscal cash registers has begun and a new electronic platform is enabling the rapid establishment of new companies.
- **The country has announced a date for phasing out coal.** Montenegro has joined the Powering Past Coal Alliance and has committed to ending power generation from coal by 2035.

Key priorities for 2022

- **The government needs to step up fiscal consolidation once Covid-19 concerns recede.** To ensure fiscal sustainability, it is important not only to improve public investment management and tax collection, but also to adopt a comprehensive medium-term public debt management strategy and establish a fiscal council to strengthen the oversight of fiscal policy. Public investment projects should be assessed carefully and prioritised based on a cost-benefit analysis.
- **State-owned enterprise (SOE) governance should be enhanced.** Montenegro has a relatively large SOE sector and some important companies are run inefficiently. Adopting a government policy or law that defines the overall objectives of state ownership and its effective implementation would be desirable.
- **A "just transition" for the planned phase-out of coal should be ensured.** To mitigate the negative social and economic impacts of closing coal-fired power plants in the affected regions, it is important to work out in advance a strategy to address associated labour and regional development issues.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.7	5.1	4.1	-15.3	12.3
Inflation (average)	2.4	2.6	0.4	-0.3	2.0
Government balance/GDP	-6.8	-6.2	-1.8	-10.9	-5.0
Current account balance/GDP	-16.1	-17.0	-14.3	-26.0	-21.0
Net FDI/GDP [neg. sign = inflows]	-11.3	-6.9	-6.2	-11.2	-9.1
External debt/GDP	161.0	163.7	169.0	224.1	n.a.
Gross reserves/GDP	19.7	22.3	27.6	41.5	n.a.
Credit to private sector/GDP	48.9	49.6	49.0	59.9	n.a.

Covid-19: macroeconomic implications

After a major recession in 2020, the economy started to recover in the first half of 2021. In Montenegro, around one-fifth of GDP normally comes from tourism. Due to the Covid-19 pandemic and strict border policies, foreign tourist arrivals declined by 86 per cent in 2020. Consequently, GDP contracted sharply, by 15.3 per cent. The contraction came primarily on the back of falling services exports (mainly tourism-related) but investment and consumption also declined strongly. Although GDP fell again in the first quarter of 2021 on a year-on-year basis, it recovered strongly in the second quarter. In this quarter, retail sales picked up significantly (by almost 20 per cent year-on-year) and manufacturing output by 13 per cent year-on-year, while the number of foreign tourist overnight stays in July and August was around 85 per cent of the 2019 level.

Prices are trending up. The economy entered deflation in the second quarter of 2020, with the inflation rate averaging -0.2 per cent for the year as a whole. However, price growth became positive in the first nine months of 2021 (1.8 per cent year-on-year) on the back of higher transport (oil) and food and beverage prices.

Public debt reached a record high in 2020. The strong economic contraction and increased government expenditures to mitigate the negative effects of the Covid-19 pandemic resulted in public debt exceeding 100 per cent of GDP at the end of 2020. In light of the deteriorating fiscal and external positions, ratings agency Standard & Poor's downgraded Montenegro's sovereign ratings in March 2021 by one notch, to B. In July 2021 the government managed to hedge the Chinese Exim Bank loan for the Bar-Boljare highway through a swap deal which eliminated future exchange rate volatility risk and reduced the interest rate.

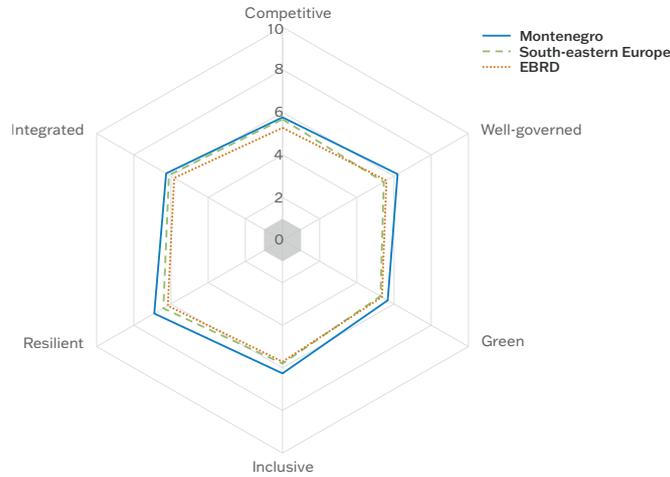
The short-term rebound is expected to continue. In 2021 GDP is forecast to increase by 12.3 per cent. A more relaxed border policy this year has boosted the tourism sector, while last year's positive base effect will contribute additionally to the relatively high growth rate. In 2022 a further recovery is expected, with the economy projected to expand by 5.7 per cent. Downside risks to the forecast are a possible weaker-than-expected recovery in tourism due to a prolonged impact of the Covid-19 pandemic, as well as limited fiscal space to accommodate further spending should such needs arise.

Policy response to Covid-19

The government has adopted two more aid packages in 2021. The first package of measures, adopted in January 2021, included providing wage subsidies for businesses severely affected by the Covid-19 pandemic, as well as one-off assistance to the unemployed, pensioners and social welfare beneficiaries. Additional measures were also taken to support tourism and agriculture. The latest package, approved in April 2021, included credit support for the economy (aimed at providing the economy with at least €110 million of new loans in 2021) and support for tourism and the vulnerable.

The moratorium on loan repayments has been extended. In 2021 the Central Bank of Montenegro extended the right of loan beneficiaries to use the moratorium. Those who were given the right to a moratorium on loan repayment until 31 August 2021 included businesses performing activities threatened by the Covid-19 pandemic, providing accommodation and food services or preparing the tourist season, as well as those whose total revenue in 2020 was at least 50 per cent lower than in 2019. The moratorium was also extended until the end of 2021 for the repayment of loans granted to private persons who lost their job after 31 March 2020 or whose net salaries had not been paid to them for more than three months before submitting the application.

Assessment of transition qualities (1-10)



Structural reform developments

There is a renewed focus on closing European Union (EU) accession negotiating chapters. Having opened the last remaining chapter of the EU accession negotiating framework in 2020, the focus has now shifted to closing chapters. Only three chapters were provisionally closed since the opening of accession negotiations in June 2012 and there has been no progress on this over the past year. According to the European Council, further progress on negotiations will depend on meeting the interim benchmarks set out in the rule-of-law chapters (chapters 23 and 24) of the EU *acquis*.

The country has a new state-owned national carrier, while the future of the former one is unclear. In December 2020 the government announced the decision to shut down the troubled state-owned Montenegro Airlines and replace it with a new national carrier. Earlier, the company had received financial support from the government worth €43 million, which the Agency for Protection of Competition did not consider to be in line with state aid rules. In February 2021 a new state-owned national carrier, Air Montenegro, was established and it started operations in June. The future of the former national carrier, which is undergoing bankruptcy proceedings, remains unclear as it has restored some business operations and reopened sales offices in the country.

A new state-owned company has been established to supervise the management of other SOEs. In August 2021 the government decided to establish a company – Montenegro Works – whose task will be to oversee and analyse the financial performance of SOEs and to ensure that reforms to increase their efficiency are properly implemented. The company will provide strategic guidance to the government on establishing appropriate policies for managing SOEs. The effectiveness of the new company remains to be seen.

An infringement procedure has been launched against Montenegro over the thermal power plant (TPP) Pljevlja. In April 2021 the Secretariat of the Energy Community (the EU energy watchdog) initiated an infringement procedure against Montenegro for continuing to operate its only TPP after the opt-out period under the Large Combustion Plants Directives had expired. The authorities are planning an ecological reconstruction of TPP Pljevlja.

The country has set the date for the coal phase-out. In June 2021 Montenegro joined the Powering Past Coal Alliance, promoting the coal phase-out and the transition to clean energy. The country has announced it will end power generation from coal by 2035. Plans on how to meet this goal remain to be developed.

Feed-in tariffs have been abolished for renewables. In July 2021 the government announced that it would no longer provide incentives for renewable energy as the country had met its target of a 33 per cent share of renewable energy in final energy consumption (in 2018 and 2019 the share was 39.8 and 38.7 per cent, respectively). In recent years Montenegro has made progress on creating a relevant legislative framework for developing renewable energy and decarbonisation, including legislation to limit greenhouse gas emissions, as well as introducing an emissions trading scheme for large industrial emitters.

Electronic monitoring of fiscal cash registers (e-fiscalisation) has started. Application of the Law on Fiscalisation in the Trade in Goods and Services, which entered into force in mid-2019, began on 1 January 2021, although full application was delayed until 1 June 2021. Together with more efficient inspections, e-fiscalisation should contribute to reducing the grey economy and increasing tax revenues.

Electronic registration of new companies has been enabled. In July 2021 the eFirma platform was launched, making it possible to establish a new company electronically. This has significantly shortened the time required for registration and reduced costs, as there are fewer required procedures and documents. The process to set up a company now takes just three days.

