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June 23, 2020

Statement by Mr. Beblawi and Ms. Al-Riffai on Montenegro
(Preliminary)
Executive Board Meeting 20/72
June 24, 2020

We thank staff for their report and Messrs. De Lannoy and Voinea for their informative Buff statement. We commend the authorities on their swift and decisive action to contain the spread of the pandemic and mitigate its impacts. We are pleased to hear that as of June 8, Montenegro had no active cases and that a phased resumption of economic activity has been underway since May 4. Heavily dependent on tourism and facing reduced tourism revenue, as well as depressed capital inflows, Montenegro's economy has been negatively impacted resulting in an urgent balance of payments, need that if unaddressed, can lead to severe economic disruption. We support the authorities' request for disbursement of 100 percent of quota under the Rapid Financing Instrument. Staff and the authorities project a significant decline in GDP and a deterioration in the fiscal balance in 2020. However, the authorities' recovery projections are more optimistic based on an assumption of a stronger recovery in tourism.

Lost revenue streams and increasing spending outlays to combat the crisis and mitigate its impacts have necessitated that the authorities suspend their fiscal consolidation policies. As a result, the headline fiscal deficit is increasing, constraining an already limited fiscal space. We commend the authorities on their stated commitment to rationalize expenditures, including halting all non-priority spending as well as new and large capital expenditures until the outlook for public finances improves and risks to debt sustainability are decisively mitigated. We also welcome the progress made in furthering public administration reform and the authorities' plan to improve the medium-term budget framework to enhance spending efficiency. Once the crisis subsides, it will be important to return to fiscal consolidation to bring debt back on a downward trajectory.

Montenegro’s banking sector is healthy, well-capitalized, and liquid. In response to the crisis, the monetary authorities provided additional liquidity to the sector and worked to ease liquidity constraints on borrowers. Nonetheless, should weakened aggregate demand continue, businesses can be negatively impacted and liquidity shortages and loan repayment difficulties can surface. We note that should the economic slowdown intensify, the vulnerabilities of the smaller, less profitable local banks can be exacerbated. *To what extent are these smaller less profitable banks a risk to the sector?* We positively note that the authorities are enhancing supervision of the banking system, and welcome the Central Bank’s plans to proceed with a system-wide asset quality review later this year and look forward to its completion in 2021. We note that the central bank’s policy options to provide Emergency Liquidity Assistance are constrained by Montenegro’s unilateral euroization and therefore welcome their efforts to expand buffers by doubling the existing liquidity line at the BIS and expanding their EBRD credit line to strengthen their deposit insurance scheme. We positively note the adoption of the new AML/CFT law with new guidelines for banks on AML/CFT. Once the crisis is overcome, we see merit in reversing the temporary measures taken to mitigate the impact of the pandemic on the sector.