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February 16, 2022

**Statement by Mr. Nakunyada and Mr. Cham on Montenegro
(Preliminary)
Executive Board Meeting
February 18, 2022**

We thank staff for the comprehensive report as well as Mr. Dresse and Mr. Voinea for their useful Buff Statement.

We welcome the strong growth rebound in Montenegro following significant effects of the COVID-19 pandemic which triggered substantial contraction of GDP in 2020. We commend the authorities for implementing sound policies and taking swift measures, to mitigate the impact of the pandemic on vulnerable households and firms. Moreover, the notable vaccine progress, supported the rebound in tourism, and other contact intensive services sectors. Consequently, growth rebounded to 12 percent in 2021, but the outlook remains challenged by downside risks emanating from the uncertain evolution of the pandemic, deterioration in public finances, inflationary pressures, global financial tightening, and political uncertainty. Against this backdrop, policy efforts should focus on medium-term fiscal adjustment to restore fiscal and debt sustainability, strengthening financial supervision, and accelerating structural reforms to ensure stable and inclusive growth. We, therefore, share the staff's appraisal and provide the following comments for emphasis.

Targeted near-term fiscal support would be essential in the context of high unemployment, but medium-term consolidation efforts are required to place public finances on a sustainable footing. We, therefore, welcome the sizeable reduction in the fiscal deficit in 2021 following a significant widening in 2020 owing to elevated pandemic-related spending. An optimal mix of revenue and expenditure measures would, however, be important to help bring public debt on a sustainable downward path. In this regard, we view the revenue enhancing measures proposed for tabling in Parliament as important to offset permanent revenue losses and higher long-term spending commitments. *We, however, note divergent views on revenue and expenditure projections between staff and the authorities, and would urge continued technical discussions on this matter given the important fiscal policy implications.* That said, we welcome the authorities' commitment to fiscal consolidation to place debt on a declining path. Furthermore, we urge the authorities to implement large capital projects subject to adequate fiscal buffers and inflation

developments, while adhering to sound project selection practices in line with the PIMA recommendations.

The financial sector successfully weathered the pandemic shock, but the authorities should remain attentive to the remaining challenges. Considering attendant pockets of vulnerabilities, we call for further strengthening of the supervision and bank resolution frameworks. In this regard, we encourage The Central Bank (CBCG) to monitor closely and react swiftly to emerging vulnerabilities that are currently masked by pandemic support measures. We are, however, re-assured that the authorities do not expect a systemic rise in NPLs. That said, we welcome the new laws on credit institutions and on resolution of credit institutions and encourage the CBCG to strengthen governance, monitor bank practices and potential macroprudential indicators, while establishing adequate financial integrity safeguards. We are also encouraged by the completion of the Asset Quality Review (AQR) and the positive effects of the results on confidence in the financial system. Additional efforts are required to strengthen AML/CFT supervision of financial institutions, including through the development of a manual for risk-based supervision to avoid MONEYVAL enhanced follow-up measures. We, therefore, welcome the authorities' commitment to strengthen the AML/CFT framework, in line with EU Acquis and FATF standards.

Structural reforms should be advanced to tackle still high unemployment and informality and enhance the business climate to support a durable recovery. In this regard, we urge the authorities to adopt a phased approach in consultation with staff in the implementation of reforms under 'Europe Now' program. Nonetheless, we view this initiative as appropriately focused on the need to increase labor force participation to minimize structural unemployment and informality, while mitigating risks stemming from an increase in the minimum wage in formal employment to preserve competitiveness. Further, to enhance the business environment, we encourage the authorities to consider the use of active labor market policies (ALMPs) that facilitate better training and education of the workforce. While we welcome the establishment of 'Montenegro Works', we encourage its implementation and stress the need to establish solid institutional and legal frameworks and deep professional expertise. By the same token, we urge the authorities to strengthen the management and oversight of SOEs through reforms to help minimize contingent liabilities, reduce structural unemployment, and enhance inclusive growth.