Podgorica, 28 June 2024

Information on the countercyclical capital buffer rate for Montenegro

in the third quarter of 2024

In its Decision on the Countercyclical Capital Buffer Rate for Q3 2024 and in accordance with the Law on Credit Institutions (OGM 72/19, 82/20, 8/21), the Central Bank of Montenegro has set the countercyclical buffer rate for the third quarter of 2024. The rate shall be 0% of the total amount of risk exposure.

The 0% rate shall apply to the territory of Montenegro, that is, to relevant exposures of credit institutions in Montenegro. Pursuant to Article 147 of the Law on Credit Institutions, every credit institution is obliged to calculate the specific countercyclical buffer rate as the weighted average of the countercyclical buffer rates that apply in Montenegro and other countries where the relevant credit exposures of the credit institution are located.

Article 144 of the Law on Credit Institutions specifies that the Central Bank is obliged to publish the decision on the countercyclical buffer rate and the announcement thereof on its website, while the information to be contained in the announcement is specified under Articles 141 and 144 of the law.

The key findings of the analytical base used for the countercyclical buffer decision are presented below.

The starting point was the calculation of the buffer guide. The buffer guide was calculated using the so-called standardised credit-to-GDP gap in line with the Law on Credit Institutions and the Recommendation of the European Systemic Risk Board on guidance for setting countercyclical buffer rates (ESRB/2014/1).

At end-Q1 2024 the credit-to-GDP ratio stood at 46.8%. Compared to its long-term trend, this is a deviation of -12 pp, which is below the lower threshold of 2 pp, i.e. the minimum value that would indicate the need to introduce a non-zero countercyclical buffer rate, so the value of the buffer guide was 0%. Over the past year and a half, the credit-to-GDP ratio was particularly pronounced, showing negative deviations from the longstanding trend as a result of a stronger growth of GDP over credits. However, in the first quarter of the current year, lending activity was very pronounced so the gap was partially reduced.

In addition to the buffer guide, the analysis covers numerous other selected indicators that the CBCG uses to monitor cyclical systemic risks in Montenegro.

When it comes to the real estate market, the value of the hedonic real estate price index (data produced by the CBCG), as indicated in the latest survey as of end-2023, points to a further increase in real estate prices. On the other hand, the prices of dwellings in new residential buildings (data produced by MONSTAT) at the level of the state and the capital registered a slight decline in the first quarter of 2024 (an uptrend was seen over the past two years), while the corresponding prices in other regions continued to rise. Also, some other indicators point to a certain overvaluation of real estate. The growth of real estate prices in the last period was intensified especially in the segment of dwellings in new residential buildings in Podgorica, although real prices fell slightly in the first quarter, as did the ratio of real estate prices and income.

The leading factor spurring the growth of real estate prices was foreign direct investments in real estate, which amounted to 911.4 million euros in the period 2022-2023 or some 7% of nominal GDP per year, which is significantly more than over several years before that period. Moreover, data from the first quarter of 2024 indicate that investments in real estate have remained significant albeit being somewhat lower than in the comparative period last year. In addition, growth of nominal wages in Montenegro over the previous period has also contributed to the real estate prices growth to some extent. Finally, new housing loans granted to natural persons in the last two years amounted to 227.2 million euros, accounting for approximately 20% of total new retail loans, and this share has been on a mild uptrend in recent years. In the first quarter of 2024, new housing loans continued to grow in a similar volume as in the previous two years.

Overall, the assessment is that there is a certain accumulation of cyclical systemic risks connected to the real estate market. Real estate prices are important for the assessment of cyclical systemic risks because real estate is one of the most significant forms of collateral used to secure both housing and mortgage loans. Unrealistically high real estate prices can reinforce the upward phase of the financial cycle, thus spurring credit levels above the justified, whereas in the phase of a possible sudden drop in real estate prices they could negatively affect both borrowers and banks' balance sheets.

Geopolitical circumstances are also relevant for the assessment of cyclical systemic risk, primarily the conflicts in Ukraine and the Middle East, as well as other processes which point to the persistence and/or intensification of such risk factors in recent period.

Other than that, the banking business parameters are generally stable. Banking loans, observed through the definition of credit used to calculate the buffer

guide, maintained their steady growth on the annual level. The annual growth of the twelve-month cumulative of new loans was also significant, especially for the retail sector.

Starting from 2022 there has been a noticeable increase in the weighted average lending interest rate for the entire credit portfolio of banks (on outstanding principal/debt), which at the end of the first quarter of 2024 amounted to 6.63%. The interest rate on new loans reached 7.43% in March 2024, while in the period of the last twelve months it averaged at 6.85%.

The structure of assets changed in 2023 in favour of total loans (from 54.9% to 58.8%) and investments in securities (from 14.4% to 19.5%), with the latter recording a particular increase in investments in foreign securities. In the first quarter of 2024, the aforementioned positions further increased, so the share of loans in total assets rose to 62.3% and investment in securities increased to 20.4%. The share of liquid assets in total assets consequently decreased and dropped to 19.5% which is nevertheless still a relatively high share. Since lending activity was very intensive, the ratio of loans to deposits additionally increased and amounted to 79.9% (gross) and 77.3% (net).

Banks recorded a profit of 146 million euros in 2023 (75.3% more than in 2022). In the first quarter of the current year, banks` profit was almost one quarter higher than in the comparative period last year, reaching the amount of 38.7 million euros. The capital adequacy ratio stood at 19.9% and it was slightly lower than at the end of 2023. During the pandemic, the share of non-performing loans slightly increased but it has been on a decline since early 2022, falling down to 4.9% at end-Q1 2024.

In view of the above, primarily the circumstances surrounding the real estate market, the conditions have been met for increasing the countercyclical capital buffer rate to 0.5%. However, bearing in mind that the application date of any increase of the countercyclical buffer rate must be determined within 12 months following the date of the buffer rate publication and that, currently, it cannot be assessed whether any extraordinary circumstances exist due to which the application date of the higher buffer rate should be determined within a period shorter than 12 months, the Central Bank has set the countercyclical capital buffer rate at 0% for the third quarter of 2024. All credit institutions are obliged to apply this rate when calculating their individual countercyclical capital buffer rate. On the other hand, the Central Bank of Montenegro has already passed a decision on raising the countercyclical capital buffer rate to 0.5%, to be applied as of 1 April 2025 (OGM 27/24).

In accordance with its powers, the Central Bank of Montenegro will continue to regularly monitor the evolution of possible imbalances in financing the needs of the non-financial sector and households and to determine the countercyclical

capital buffer rate on quarterly basis, in accordance with the provisions of Article 144 paragraph 1 of the Law on Credit Institutions.