Podgorica, 27 December 2024

Information on increasing the countercyclical capital buffer rate

with the effect as of 1 January 2026

In its Decision on Supplementing the Decision on Raising the Countercyclical Capital Buffer Rate and in accordance with Article 143 paragraphs 1 and 2 of the Law on Credit Institutions (OGM 72/19, 82/20 and 8/21), the Central Bank of Montenegro has increased the countercyclical buffer rate, setting the application date as of 1 January 2026. The rate shall be 1% of the total amount of risk exposure.

The 1% 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 being 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-Q3 2024, the credit-to-GDP ratio stood at 47.5%. Compared to its long-term trend, this is a deviation of -10,1 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 few years, 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. As the lending activity intensified over the past 12 months, the gap has partially narrowed.

In addition to the buffer guide, the analysis includes other selected indicators that help the Central Bank monitor cyclical systemic risks in Montenegro, which signal an increased accumulation of cyclical risks, primarily those related to credit growth and real estate price growth.

Credit growth has intensified, with resident loans reaching the annual growth of 14.9% in October this year. The growth was driven by the rise in retail loans, which increased by 15.2% on the annual basis, partly due to growing nominal wages in the previous period.

As for the structure of retail loans, cash loans rose 14.5% year-over-year (as per the Credit Registry records). Also, the twelve-month cumulative of newly approved retail cash loans has significantly exceeded the pre-pandemic level, with a growing number of loans. Retail housing loans recorded the annual rate of growth of 13.5% in October, and their cumulative increase since end-2020 reached 54.7% (the Credit Registry data). The growth of these loans is also visible through new loan disbursements, as the twelve-month cumulative of new loans has rather accelerated after 2022, in particular in 2024 (with the annual growth reaching 62.8% in October). Housing loans reached a third of total retail loans granted and their growth has also been accompanied by an increase in the number of loans.

The prices of dwellings in new residential buildings in Montenegro reached their new record highs in the third quarter of 2024. An increase in real prices of real estate (CPI-deflated nominal prices) was normally less pronounced, but it has intensified over the past period, resulting in the highest prices of dwellings in new residential buildings in Podgorica in the last 15 years. Due to a continuous growth in nominal wages, which increased further in October, the ratio of prices of dwellings in new residential buildings to average nominal wages has not changed to any meaningful extent. Overall, the aforesaid indicators point to a certain overvaluation of real estate.

The leading factor spurring the growth of real estate prices was foreign direct investments in real estate, which amounted to 911.6 million euros in the period 2022-2023 or 7.2% of nominal GDP per year on average, which is significantly more than over several years prior to that period. In the first ten months of 2024, foreign direct investments in real estate were still substantial, albeit slightly lower than in the comparative periods in the previous two years. Besides foreign direct investments, the aforementioned increase in housing loans also affected the growth in real estate prices.

Real estate prices are important for the assessment of cyclical systemic risks because real estate is one of the most important forms of collateral used to

secure both housing and mortgage loans. Unrealistically high real estate prices could amplify the upward phase of the financial cycle, driving loans to unjustifiable levels, yet in the phase of a possible sharp drop in real estate prices, they would negatively affect both debtors and bank balance sheets.

The banking business parameters are generally stable. Due to the aforementioned intensification of credit growth in the first ten months of 2024, the structure of assets additionally changed in favour of loans, considering that the share of net loans increased to 64.9% or 10 pp compared to end-2022. Another asset position that had recorded a high growth in the previous year, namely securities, continued with their increase in the first quarter of 2024 but they have been trendind down ever since, albeit moderately. Consequently, the share of liquid assets in total assets was on a decline, dropping down to 21.5% in October, which is still a relatively high share considering a very conservative Central Bank definition of liquidity. Due to a significant lending activity, the loan to deposit ratio was on an increase since 2022, reaching 82.3% gross and 79.9% net in October 2024.

The capital adequacy ratio stood at 19.8% at end-Q3 and it was slightly higher than at end-Q2 this year. Non-performing loans further declined and this downward trend has been present since early 2022. At the end of the October this year, their share in total loans amounted to 3.9%.

The growth cycle of the weighted average lending interest rate (for the entire credit portfolio of banks, i.e. on outstanding principal/debt), which had begun in mid-2022, was stopped in the spring of 2024 when a slight decline of this rate began and it dipped down to 6.57% at the end of October.

In the first ten months of 2024, banks made a profit of 150.3 million euros, which is almost one fifth of the amount more than in the same period last year.

What is also relevant for the assessment of cyclical systemic risk are geopolitical circumstances, primarily the conflicts in Ukraine and the Middle East, which point to continued uncertainty and potential intensification of such risk factors.

Considering the situation regarding credit growth, real estate market, and geopolitical circumstances indicated above, the Central Bank has set the countercyclical capital buffer rate of 1% to be applied as of 1 January 2026. In the meantime, pursuant to the Decision on raising the countercyclical capital buffer rate (OGM 27/24) the countercyclical capital buffer rate of 0.5% will be applied as of 1 April 2025.

In accordance with its macroprudential powers, the Central Bank of Montenegro will continue to regularly monitor the development of potential imbalances in financing the needs of the non-financial sector and households, and publish countercyclical capital buffer rates on quarterly level.