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Information on the review of the countercyclical capital buffer rate carried out in Q1 2025

The countercyclical buffer rate of 1% that is to be applied as of 1 January 2026, as specified in the Decision on Raising the Countercyclical Capital Buffer Rate (Official Gazette of Montenegro 27/24 and 125/24), remains appropriate for ensuring the resilience of the banking system against potential systemic risk materialization or sudden shocks. Pursuant to the aforesaid decision, the countercyclical buffer rate of 0.5% will be applied from 1 April 2025 until 1 January 2026.

Below are the key findings of the countercyclical buffer rate review carried out in the first quarter of 2025.

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-Q4 2024, the credit-to-GDP ratio stood at 49.7%. Compared to its long-term trend, this is a deviation of -7.6 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. However, as of end-2023, the gap has been narrowing as a result of intense credit activity.

In addition to the buffer guide, the analysis includes other selected indicators that the Central Bank uses to monitor cyclical systemic risks in Montenegro, which signal a continued elevated accumulation of cyclical risks, primarily those related to credit growth and rising real estate prices.

During the fourth quarter of 2024, the annual growth rate for loans disbursed to residents reached its highest level of the year, standing at 13% in December. The growth was driven by the rise in retail loans, which increased by 16.6% year-on-year, partly due to the rise in nominal wages in the previous period. The non-financial sector also recorded a significant annual credit growth of 18%.

As for retail loans, growth was primarily driven by cash and housing loans, which accounted for approximately three-quarters of all retail loans. The annual growth rate of cash loans was 11.2% (as per the Credit Registry records). Additionally, both the number of loan agreements and the average amount of cash loans increased. New retail loans reached a record high in 2024, with cash loans comprising the largest share and the cumulative annual volume of new retail cash loans exceeding the pre-pandemic levels.

Retail housing loans recorded the annual rate of growth of 15.3% in December, and their cumulative increase since end-2020 reached 59.7% (the Credit Registry data). Given their inherently longer maturity, the growth of retail housing loans is also reflected in newly approved loans, and the cumulative annual volume of new loans had been accelerating since 2022, with a particularly sharp increase being recorded in 2024 (the annual growth rate of 49.8%). Housing loans reached a third of total retail loans and their growth has also been accompanied by an increase in the number of loan agreements and a higher average loan amount. Moreover, retail housing loans continue to increase their share in retail loans, total loans, and GDP.

The prices of dwellings in new residential buildings in Montenegro grew at a slower annual rate in the fourth quarter of 2024 compared to the previous period but still reached a new record high. The growth of real estate prices in real terms (nominal prices adjusted for the consumer price index) was naturally less pronounced. The ratio of new apartment prices to average nominal wages showed no significant deviations. Overall, the evaluation indicates that real estate prices remain somewhat overvalued.

The leading factor spurring the growth of real estate prices was foreign direct investments in real estate, which amounted to 1.37 billion euros in the period 2022-2024 or 6.8% of nominal GDP per year on average, which is substantially more than over several years prior to this period. Besides foreign direct investments, the aforementioned increase in housing loans also affected the growth in real estate prices. Over the past three years, newly approved housing loans totalled 400.8 million euros, of which 173.7 million euros was the value of loans disbursed in 2024 alone.

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 sector has remained solvent, liquid and profitable. The steady growth of deposits has continued, with banks increasingly redirecting these funds into loans rather than liquid assets or securities. As a result, liquid assets were generally on a decline, except in December, when they saw a significant increase before resuming their downward trend. On the other hand, it is important to consider the highly conservative definition of liquid assets established by the CBCG regulation governing liquidity risk management in credit institutions, as well as the fact that a significant portion of the securities held by banks remains highly tradable. Due to a significant lending activity, the loan to deposit ratio was on an increase since 2022, reaching 79.5% gross and 77.1% net at end-2024.

The capital adequacy ratio stood at 19.4% at the end of the fourth quarter and it was slightly lower than at the end of the third quarter of 2024. Non-performing loans further declined and this downward trend has been present since early 2022. At the end of 2024, their share in total loans amounted to 3.6%.

The growth cycle of the weighted average lending interest rate (for the entire credit portfolio of banks, i.e. on outstanding principal/debt), which began in mid-2022, came to a halt in mid-2024 and has since shown a slight decline. The aforesaid rate amounted to 6.5% in December 2024.

Banks recorded a record profit of 161.4 million euros in 2024, which is 10.6% more than in 2023.

Geopolitical circumstances are also relevant for assessing cyclical systemic risk, as tensions persist despite recent positive developments. Additionally, the tightening of trade policies by leading industrial nations has recently emerged as a significant factor.

Given the aforementioned factors related to credit growth, the real estate market, and global trends, the countercyclical buffer rate of 1% that is to be applied as of 1 January 2026, as specified in the Decision on Raising the Countercyclical Capital Buffer Rate (Official Gazette of Montenegro 27/24 and 125/24), remains appropriate for ensuring the resilience of the banking system against potential systemic risk materialization or sudden shocks. Pursuant to the aforesaid decision, the countercyclical buffer rate of 0.5% shall be applied from 1 April 2025 until 1 January 2026.

In accordance with its macroprudential responsibilities, the Central Bank of Montenegro will continue to regularly monitor potential imbalances in financing the needs of the non-financial sector and households, and publish the results of review of the countercyclical capital buffer rate on quarterly basis.