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Privredne komore Crne Gore

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Očuvana finansijska stabilnost

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Mesopromet

Izvoz jagnjećeg mesa u Liban

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Unikatne gitare od crnogorskog drveta

The banking sector is well capitalized, solvent, liquid and ready to absorb the first effects of the crisis spillover from the real to the financial sector.

The banking system exhibited annual (October 2019/2020) growth of banks" capital of 3.44%, increase in loans and receivables by 7.32% accompanied by the decline in deposits of 5.31%. Non-performing loans recorded annual increase of 0.93 percentage points. The illiquidity of the real sector, as well as the rise in unemployment create a channel for the crisis to spill over into the financial sector and that is reflected in the increase of non-performing loans, which may, only partially and temporarily, be absorbed and delayed by the available instruments such as loan restructuring or moratoria. However, we are aware that challenges in the financial sector are yet to follow, in the form of additional capital needs of banks due to losses caused by non-payment of customer obligations and an increase in risk-weighted assets, says in the interview for Glasnik Mrs. **Zorica Kalezić**, the Vice Governor of the Central Bank of Montenegro.

Glasnik: What business trends have banks in Montenegro recorded in 2020? Please comment on the level of solvency, capital, asset quality, level of non-performing loans, banks" profits..., compared to the previous year. 8. How did the COVID-19 epidemic affect the banking sector operations in our country?

Z. Kalezić: Business trends recorded by Montenegro"s banking system are very similar to those recorded by the banking systems of other countries affected by the COVID-19 crisis. Unlike the 2008 crisis, the epicentre of the crisis caused by the coronavirus pandemic is in the real sector, with the potential to spill over into the financial sector. The banking system is solvent, with the solvency ratio of 19.34%, as well as liquid, with the share of liquid assets in total assets exceeding 20%. Therefore, it is ready to absorb the first effect of the crisis spillover from the real to the financial sector, and these effects are observed through a significant decline in profitability and a mild growth of non-performing loans.

Specifically, in the previous year, the banking system exhibited annual (October 2019/2020) growth of banks" capital of 3.44%, increase in loans and receivables by 7.32% accompanied by the decline in deposits of 5.31%. Non-performing loans recorded annual

Zorica Kalezić, Vice Governor of Central Bank of Montenegro

Financial stability preserved

increase of 0.93 percentage points, from 4.76% in October 2019 to 5.69% in October 2020, thus marking a discontinuation of the steady favourable downward trend that these loans have been recording from 2015 to 2020. The illiquidity of the real sector, as well as the rise in unemployment create a channel for the crisis to spill over into the financial sector and that is reflected in the increase of non-performing loans, which may, only partially and temporarily, be absorbed and delayed by the available instruments such as loan restructuring or moratoria.

In one year, banks' profits almost halved, from 53.9 million euros to 27.3 million euros, which is an annual decrease of 49.5%. The decrease in profitability resulted from pursuing responsible policy of allocating high additional value adjustments in anticipation of increased loan losses, in combination with a decline in fee income. Specifically, in their effort to adapt to the new circumstances and to meet the needs of their clients, the banks have reduced or suspended certain fees and provisions, which resulted in the decrease of net income from these sources.

In summary, banks' balance sheets are slowly beginning to become contaminated, but the system is well-capitalized and able to withstand the blow of this year"s deteriorated results.

Glasnik: The liquidity of banks expressed in previous years deserves respect. It was a time when the real sector was facing money shortages, which was hindering their operations, so that businessmen very often claimed that it was difficult to get bank loans. Bankers responded to this remarks that they could not adequately support the real sector, because it failed to offer high-quality projects. Now we must observe lending to the corporate sector through the prism of the Covid-19 pandemic?

Z. Kalezić: I would not agree with the assessment that banks did not adequately support the private sector, in particular during the COVID-19 pandemic. The banks are more than aware that in 2008 they were the centre of the problem, and that now they have a responsible role to be a part of the solution and response to the crisis. The perception that banks are institutions that are unaware of the fact that the performance of the banking sector is based exactly on the preservation and prosperity of its clients is very off-target.

On the contrary, since the beginning of the pandemic (15 March 2020), the banks have granted loans to legal persons in the amount of 398.75 million euros, which is a decrease of just 6.9% in relation to the same period of the previous year, when this amount stood at 428.44 million euros. Bearing in mind the drop in demand for loans, the active moratorium which now accounts for 9% of current portfolio, the disruption in clients" cash flows along with the unprecedented recession, the credit support to the real sector recorded in virtually the same amount as last year speaks of a considerable engagement of banks in the timely remediation of the real sector"s liquidity issue.

The banks are currently very active in restructuring loans to legal persons with regulatory treatment of new loans, in the effort to adjust reduced cash flows of their clients with the levels of their net financial and total liabilities, in the amount of over 133.8 million euros, whereas loans worth over 131.47 million euros are currently being treated under moratorium, including the mandatory one-year moratorium.

The fact is that the number of projects of sufficient quality for which the banks are actively competing is limited in Montenegro, that the life span of companies in Montenegro is many times shorter than that in the European Union, that companies in Montenegro invest significantly less in digitalization, development and research than the EU countries, that the mortality or disappearance of companies in the first year in Montenegro is above the EU practice, and that, on average, the financial statements of companies in Montenegro are not of satisfactory quality compared to those in EU countries. On the other hand, it is an indisputable fact that progress can be seen in all the mentioned areas, and that banks in Montenegro see that this market has potential for development. The fact that the banks, affected by the financial crisis, in the last ten years, ended four years with a loss at the aggregate level, and still continued to operate in Montenegro, signals that they are counting on the potential of this market in the long run and are willing to participate in its recovery and its development.

Glasnik: In several cycles the banks have provided moratorium on loan repayment in order to support the economy and citizens. How many loans have been restructured and in which sectors the most?

Z. Kalezić: Since the onset of the pandemic, banks have granted a total of four moratoria to citizens and businesses, and the CBCG has shaped measures and decisions in relation to the health and economic situation, respecting the instructions of international financial institutions and the guidelines of the European Banking Authority (EBA). The first moratorium on loan repayments, which was binding on banks, was aimed to temporarily provide quick liquidity to natural and legal persons in the amount of 155 million euros in the first three months of the pandemic, in order to support the real economy and aggregate demand. At that time, the moratorium covered about 47% of banks' loan portfolios, or about 1.3 billion euros.

The second moratorium was flexible and focused on targeting liquid position of those legal and natural persons whose cash flows suffered the effects of the COVID-19 pandemic. This moratorium was used by 1777 debtors i.e. liabilities in total amount of 99.3 million euros were postponed. The majority portion of loans in the second moratorium referred to the postponement of liabilities of businesses, namely, 59.5 million euros or 3.98 percent of total loans granted to the economy.

The third, one-year moratorium on loan repayment refers to the most vulnerable sectors, tourism and agriculture, as well as to loans for the preparation of the tourist season. According to the latest available data, since the end of September, loans in the amount of 32.1 million euros from these two sectors have been under the moratorium regime, for 127 debtors or 164 credit accounts, which accounts for about 11% of the total gross loan portfolio from these two sectors.

The fourth, six-month moratorium targets a socially vulnerable category – households and entrepreneurs who lost their jobs since the beginning of the pandemic in March 2020. According to preliminary data from the Tax Administration, from 15 March to the end of October, over 14,000 natural persons and entrepreneurs lost their jobs. With regard to the liquidity, banks can withstand this moratorium that, at the same time, temporarily maintains the access of these natural persons to the banking system, which would otherwise be limited.

Loans in the amount of 133.8 million euros have been restructured for 459 credit accounts since the onset of the pandemic i.e. in period from end of March to end of September 2020, which represents 4.6% of the total loan portfolio.

Cumulatively, as at end September 2020, the results showed that the measures of the CBCG affected the loan portfolio, which is best supported by the data that the portfolio of 265.3 million euros or 9.09% of total loan portfolio of the banking system of Montenegro is under the moratoria regime and loan restructuring.

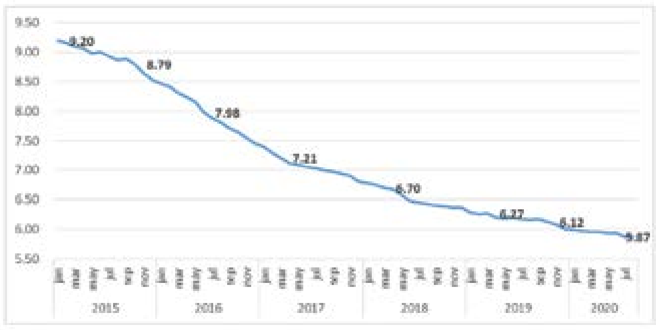
Glasnik: How much were citizens interested in using bank funds?

Z. Kalezić: A rise in unemployment and decrease in income observed since the start of the pandemic in March 2020 up to now have caused a significant decline in natural persons" demand for loans, especially in the segments of cash and housing loans. As per the results of a survey with banks, in terms of the number of submitted applications, the decrease trended around 35% in relation to the previous year, reaching as much as 70% during the April 2020 lockdown with some banks. The substantial contraction of demand for loans resulted in a considerable annual decline in new loans to natural persons.

Since the beginning of the pandemic on 15 March until 31 October 2020, natural persons have been granted new loans in the amount of 180.6 million euros for 26,137 clients, while in the same period of the previous year new loans were granted in the amount of 336.9 million euros for 41,458 clients. The decline of 46.4% in loan demand primarily points to the fact that the households" reaction to the uncertainty of their future cash flows has been rational, and that they have been delaying their planned spending or long-term investments. The rise in unemployment has also been one of the reasons for introducing the moratorium on loan repayment for persons who had lost their jobs. Among other things, through the introduction of this measure, the CBCG essentially aimed at preserving the access to the banking sector for most vulnerable segment of population.

Glasnik: Did interest rates rise or fall this year?

Z. Kalezić: If we consider only the period of the last year, despite the coronavirus pandemic, and the increase in credit risk, the weighted average effective interest rate has been declining. Specifically, at the end of August 2019 weighted average effective interest rate at the system level amounted to 6.16%, while at the end of September 2020 this rate stood at 5.86%, recording a decline of 0.30 percentage points. There is an evident compression of the difference between the lending and deposit interest rates. It should be noted that between July 2015 and the end of August 2020, weighted average interest rates in Montenegro have been on a continuous downtrend, decreasing from 9.20% to 5.87%.



Graph 1: Weighted average effective interest rate trends, January 2015 – August 2020

Glasnik: How will the abolishment of reference interest rates LIBOR and EURIBOR reflect on borrowers?

Z. Kalezić: As at 31 October 2020, loans with variable interest rates in the system amounted to 813.4 million euros, which primarily included EURIBOR loans (810 million euros) and a small amount of LIBOR loans (3.4 million euros). This shows that the abolishment of LIBOR and transfer to new benchmark rates SONIA, S0FR, SARON, T0NAR at the end of 2021 could not have a significant impact on the system.

With regard to the loans with variable interest rates linked to EURIBOR, they are primarily offered by banks that are subsidiaries of foreign banks. EURIBOR is under the benchmark reform process and there is no firm date for its possible discontinuity. These banks in Montenegro, as well as in the region, have not yet received instructions from their parent banks to use this transformed, more transparent and more credible benchmark rate or to move to some other benchmark rate in the existing and new contracts. Therefore, it is rather too early to talk about the effects of this transition.

Glasnik: Will loans be more expensive or cheaper in the future?

Z. Kalezić: It is very difficult to estimate what will happen to the interest rate trend in the medium term. Namely, the cost of the funding sources is very significant variable to the interest rate trend on corporate loans, because it reacts much faster to its upward and downward change/oscillation than it is the case with interest rate on loans granted to natural persons.

On one hand, sources of funding in the international markets and from parent banks are relatively favourable and the decline in operating expenses of banks is also noted, which altogether have positive effects on interest rates. In parallel, the erosion of the volume and maturity structure of deposits in the system has not been noted so far, while banks are providing more favourable lines from international financial institutions like EIB and EBRD. In addition to that, there is an amount of 70 million euros with the Council of Europe Development Bank and the EIB guarantee of 50 million euros that was negotiated by the Government within the third package of measures, which the banks should place under favourable conditions.

On the other hand, it would be irresponsible to believe that the evaluation of bank margin to compensate for default risk, as determinant of interest rate of client, will decline in the year of the largest recorded recession. In parallel, it is very difficult to estimate what will happen to country credit rating, which potential decline may lead to the pressures on increase in costs of sources of funding.

This is just a segment of the most important variables that will affect the movement of interest rates in opposite directions in the coming period.

Glasnik: It is known that the core and key role of the Central Bank of Montenegro is to preserve financial stability. Has this task been accomplished? What areas the CBCG covered under its competence ? Are you satisfied with the results?

Z. Kalezić: As the ECB President Christine Lagarde said "extraordinary times require extraordinary measures". We believe that the CBCG, without compromising its independence and remaining consistent with its mandate, has decisively responded to the task of preparing measures aimed at maintaining liquidity in the banking sector, measures to provide liquidity from the financial sector to the real sector and, finally, medium-term development and rehabilitation measures to remediate the effects of long-term reduction of the clients" credit capacities. In eight months, the CBCG has prepared and adopted a total of 13 measures in five sets, while fully preserving financial stability. The fact that some of the proposed measures have been also proposed later by our colleagues in the region, supports the fact that we were guided by good practice in proposing them.

In addition to abovementioned four moratoria, I would like to emphasise the measure of reducing the reserve requirement rate of banks by 2 percentage points, which resulted in CBCG releasing liquidity in the amount of approximately 70 million euros and increasing the credit potential of banks, as well as a prohibition for banks to pay out dividends to shareholders, other than payments in the form of bank shares, in order to strengthen capital buffers of banks to absorb potential losses. We are particularly pleased that in May 2020, the CBCG doubled its bilateral repo line with the BIS, from 50 million euros to 100 million euros, and negotiated a temporary repo line of up to 250 million euros with the ECB, which significantly strengthened the framework for systemic liquidity in case of emergency.

All indicators point out that financial stability has been preserved. Banks are liquid and well-capitalised, and the stability of deposits does not indicate a systemic outflow. However, we are aware that challenges in the financial sector are yet to follow, in the form of additional capital needs of banks due to losses caused by non-payment of customer obligations and an increase in risk-weighted assets. At the same time, the complexity of the situation in public finances can create pressure on the cost of funding sources. At the same time, we are all waiting for the results of the asset quality review in April/May next year as a fundamental test of quality and, consequently, the resilience of banks' balance sheets to future challenges.