



Podgorica, 29 March 2024

### **Information on the countercyclical capital buffer rate for Montenegro in the second quarter of 2024**

In its Decision on the Countercyclical Capital Buffer Rate in Q2 2024 and in accordance with the Law on Credit Institutions (OGM 72/19, 82/20, 8/21), the Central Bank of Montenegro (CBCG) has set the countercyclical buffer rate for the second 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 CBCG is obliged to publish the decision on the countercyclical buffer rate and the announcement thereof on its website. 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-Q4 2023, the credit-to-GDP ratio stood at 46%. Compared to its long-term trend, this is a deviation of -13.4 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 five quarters, 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.



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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, points to a further increase in real estate prices. Additionally, the prices of dwellings in new residential buildings (data produced by MONSTAT) rose substantially in the fourth quarter of 2023 (an uptrend observed over the past two years), reaching their all-time highs. The growth of real estate prices in real terms was much less pronounced, but it has also intensified in the recent period, especially when it comes to dwellings in new residential buildings in Podgorica. Also, the price-to-income ratio (net earnings) has been on a mild uptrend, while some other indicators also 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 911.4 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. In addition, growth of nominal wages 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. Over the past few years there had been a noticeable growth in total housing loans, but it has slowed down significantly in the last year and a half.

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 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, and thus, in the case of a possible sharp drop in real estate prices, negatively affect both debtors and bank 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 had been negative in the last few months leading to December 2023, but the situation changed at the very end of



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the year, as a result of significantly higher lending to the non-financial sector and the government sector in the last month of the year.

The average interest rate on total new loans stood at 6.7% in 2023 and it was 1 pp higher than the average rate recorded in 2022, with interest rates on unpaid principal balance showing similar trends. The average increase in interest rates was higher for new wholesale loans and it amounted to 1.04 pp, while interest on retail loans rose 0.93 pp.

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. At end-2023, the share of liquid assets in total assets was significantly lower year-over-year and it came down to 23.7%, but remains very high. The loan-to-deposit ratio was higher compared to end-2022 and it reached 74.8% gross and 72.3% net.

Banks recorded a profit of 146 million euros in 2023 (75.3% more than in 2022). The capital adequacy ratio stood at 20.3% and it was slightly lower than at the end of the third quarter 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 5% at end-2023.

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 CBCG has set the countercyclical capital buffer rate at 0% for the second quarter of 2024.

Having regard to the aforesaid legal provision, the CBCG has passed another decision on increasing the buffer rate, with a delayed application of 12 months, and which has been announced under a separate information. In accordance with its macroprudential powers, the CBCG 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.