Podgorica, 1 December 2023

Information on review of the structural systemic risk buffer

Pursuant to Article 151 paragraph 5 of the Law on Credit Institutions, the Central Bank is obliged to review the obligation of maintaining the structural systemic risk buffer at least every two years. Based on the review, the Central Bank has decided that the buffer rate and other aspects of the structural systemic risk buffer shall remain unchanged, i.e. that the Decision on Applying the Structural Systemic Risk Buffer (OGM 139/21), which has been applied as of 1 January 2022, shall remain in effect without any modifications.

The buffer rate of 1.5% of the total exposure shall apply to all credit institutions in Montenegro, equally to exposures in Montenegro and in another country where these credit institutions have exposure. Due to the equal treatment of exposure, pursuant to Article 165 of the Law on Credit Institutions, where a credit institution is subject to both the O-SICI buffer and the structural systemic risk buffer requirements, it shall maintain whichever the buffer is higher.

The key segments of the analytical basis used to decide on maintaining the structural systemic risk buffer at the same level are presented below.

Most structural systemic risks come from the real economy and/or from various macroeconomic imbalances rather than from the financial system. In the period preceding the adoption of the Decision on Applying the Structural Systemic Risk Buffer, there were threats that the pandemic-induced crisis from the real economy would spill over to the financial system and undermine its stability. With prompt and targeted measures, the Central Bank has managed to minimize the negative impact of the crisis on the financial system, which has seen very positive developments over the last two years.

However, certain structural imbalances of the Montenegrin economy remain present. The economy is poorly diversified, being primarily service-based and with a strong share of tourism-related activities.

Montenegro`s economy has been continuously recording extremely high current account deficit (annex, graph 1), which has been partly financed by foreign borrowing, both private and public, resulting in a perpetuating high external debt.

The public debt to GDP ratio had been on a long-term upward trend, which has been reversed in the last three years. The position of public finances is now improved compared to the period of the pandemic outbreak. Nevertheless, as budget balances continue to be negative, public finance challenges are undoubtedly present both in terms of the amount of debt and due liabilities (annex, graph 2).

The Q2 2023 Labour Force Survey showed that the unemployment rate stood at 12.9% and the activity rate was 64.2%, thus indicating improvements on the labour market compared to the previous period. On the other hand, unemployment parameters are worse compared to the reference group of developing and emerging European countries (appendix, graph 3).

Growing indebtedness of the population towards banks over the last few years, coupled with high inflation in the last two years, can represent a burden on household finances and thus indirectly on the asset quality of the banks (annex, graph 4). At the same time, indebtedness of the non-financial sector towards banks has also been on an uptrend, albeit milder than that of the population. (Compared to the GDP, the indicators of indebtness have slightly decreased.) Liquidity of the real sector remains a matter of concern, having in mind the growth in the number of blocked economic entities within the enforced collection system as well as the growth in debt due to the blocking.

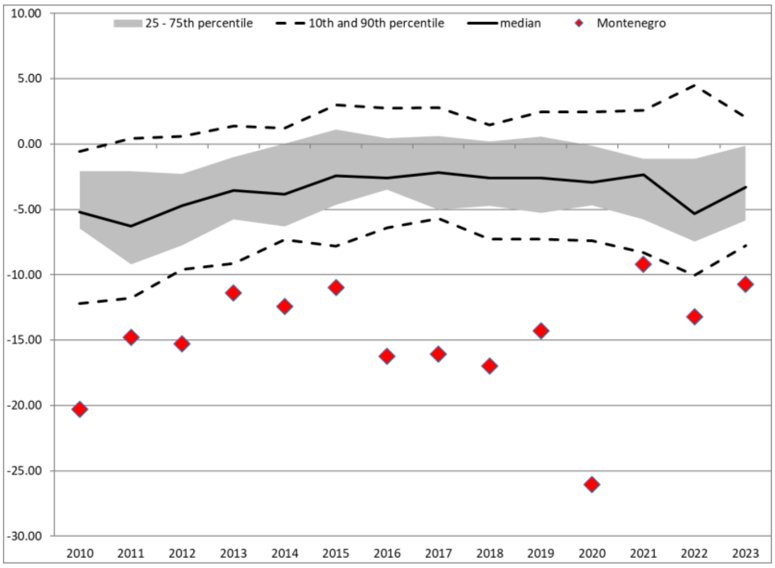
In addition, macroprudential measures which have been adopted with the aim of solving temporary disturbances in the market caused by the coronavirus pandemic and the situation in Ukraine, and addressing vulnerabilities caused by the excessive approval of unsecured cash loans, do not resolve any disturbances of a more permanent nature that could arise from the systemic risks discussed above. Also, it has been assessed that the existing measures prescribed under the law and other applicable regulations would not be sufficient to address the mentioned financial system vulnerabilities.

In view of the above, the CBCG has decided that the structural systemic risk buffer rate (1.5%) and other aspects of the buffer shall remain unchanged, which, taking into account basic and other capital requirements, will further strengthen the capital position of credit institutions. In accordance with its macroprudential powers, the CBCG will continue to monitor the development of structural systemic risks on an ongoing basis, ensuring a formal review of the structural systemic risk buffer rate at least every two years.

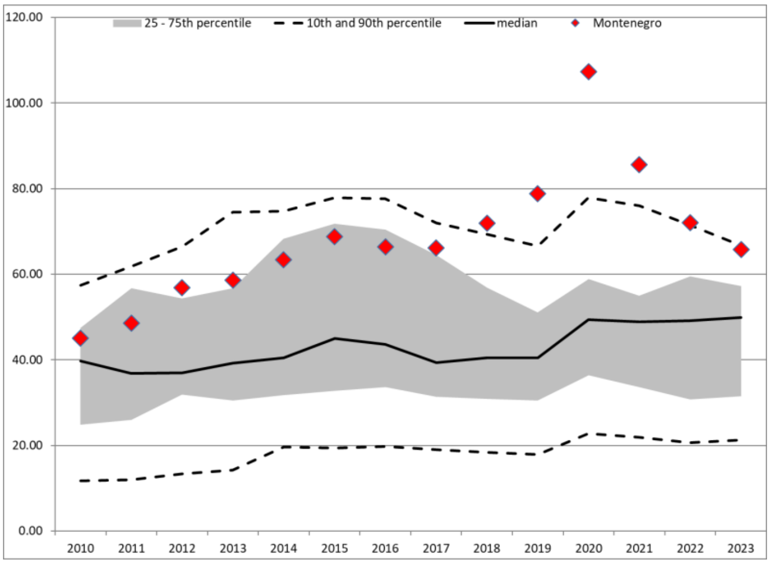
Credit institutions will continue to inform the Central Bank of Montenegro about the fulfilment of obligations set forth in this decision in accordance with the requirements established under the Decision on Reporting to the Central Bank of Montenegro (OGM 128/20).

ANNEX: Graphical presentation of selected indicators

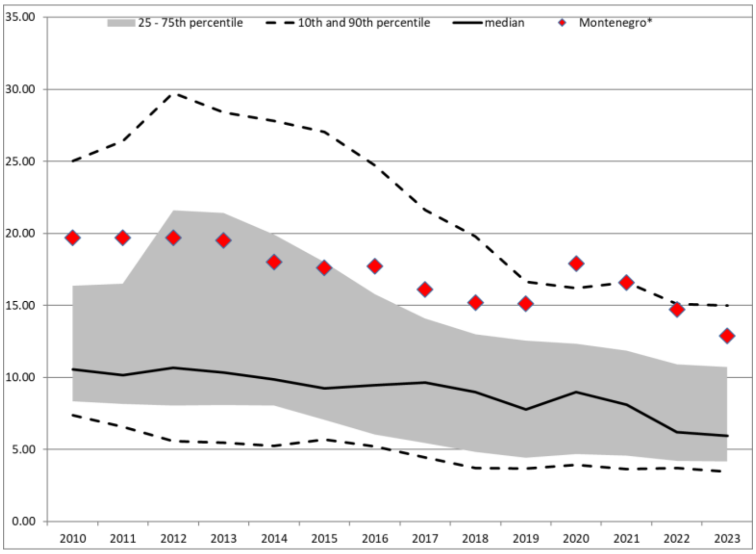
Graph 1 – Current account balance of Montenegro and comparative countries, % of GDP, 2010-2023



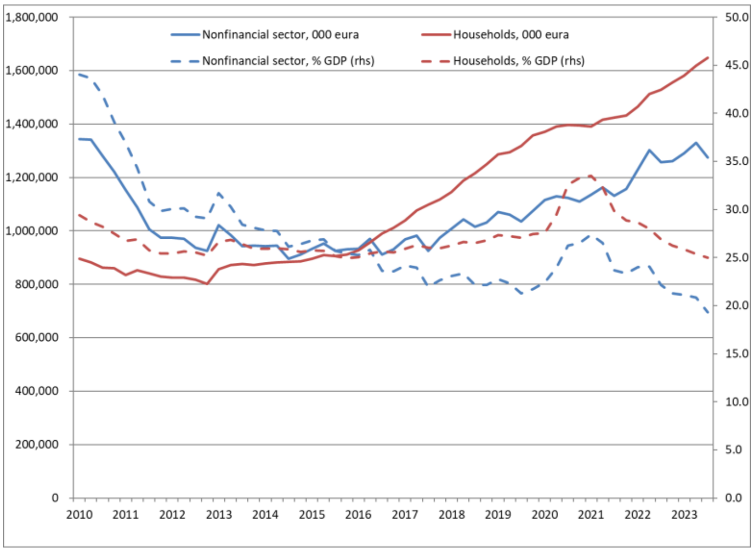
Graph 2 – Public debt of Montenegro and comparative countries, % of GDP, 2010-2023



Graph 3 – Unemployment rate in Montenegro and comparative countries, %, 2010-2023



Graph 4 – Debt of non-financial sector and households in Montenegro, Q1 2010 – Q3 2023



Information presented in the graphs:

Graph 1. Current account deficit as a percentage of GDP. Comparative countries are: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Hungary, Kosovo, Moldova, North Macedonia, Poland, Romania, Russia, Serbia, Turkey, Ukraine (which, together with Montenegro, form a group of “Emerging and Developing Europe", according to the IMF), and Croatia. Data source: IMF *(WEO Database, October 2023)*

Graph 2. Public debt as a percentage of GDP. Comparative countries are: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Hungary, Kosovo, Moldova, North Macedonia, Poland, Romania, Russia, Serbia, Turkey, Ukraine (which, together with Montenegro, form a group of “Emerging and Developing Europe", according to the IMF), and Croatia. Data source: IMF (*WEO Database, October 2023*)

Graph 3. Unemployment rate. Comparative countries are: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Hungary, Kosovo, Moldova, North Macedonia, Poland, Romania, Russia, Serbia, Turkey, Ukraine (which, together with Montenegro, form a group of "Emerging and Developing Europe", according to the IMF), and Croatia. Data source for Montenegro: MONSTAT; data source for other countries: the IMF (*WEO Database, October 2023*). Data for Q2 2023 is the latest available data.

Graph 4. Debt of non-financial sector and households in Montenegro, in euro thousand and as a percentage of GDP. GDP data are recalculated as annual cumulative sum of GDP values in a given quarter and the previous three quarters. Data sources: CBCG for loans to the non-financial sector and households; MONSTAT and CBCG calculations for GDP values.