CENTRAL BANK OF MONTENEGRO

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Bulevar Svetog Petra Cetinjskog 6
81000 Podgorica
Telephone: +382 20 664 997, 664 269
Fax: +382 20 664 576

WEB SITE | http://www.cbcg.me

CENTRAL BANK COUNCIL | Irena Radović, PhD, Governor
Nikola Fabris, PhD, Vice-Governor
Zorica Kalezić, PhD, Vice-Governor
Milorad Jovović, PhD
Ruždija Tuzović

DESIGNED BY | Nikola Nikolić
Nikola Marđonović

TRANSLATED BY | Department for Financial Stability, Research and Statistics

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ABBREVIATIONS

CBCG	Central Bank of Montenegro
CSD&CC	Central Securities Depository and Clearing Company
DNS	Deferred Net Settlement
ECB	European Central Bank
€STR	Euro Short-term Rate
EU	European Union
EUREP	Eurosystem repo facility for central banks
EURIBOR	Euro Interbank Offered Rate
FDI	Foreign direct Investments
FED	Federal Reserve
FSIs	Financial Soundness Indicators
GDP	Gross domestic product
HH	Herfindahl–Hirschman Index
HP	Hodrick–Prescott
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
MONSTAT	Statistical Office of Montenegro
NPL	Non-performing loans
pp	percentage points
rhs	right-hand scale
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RTGS	Real Time Gross Settlement
SOFR	Secured Overnight Financing Rate
USA	United States of America
VIX	Volatility index
WALIR	Weighted Average Lending Interest Rate
WADIR	Weighted Average Deposit Interest Rate

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SUMMARY

As of the end of 2024, systemic risks were assessed as moderate. Four key systemic risks were identified: rising real estate prices and strong credit growth (low level, upward trend); the potential for a trade war among major industrialized countries and ongoing geopolitical tensions (medium level, upward trend); risks related to the level of public debt and debt servicing (medium level, stable trend); and the banking sector's exposure to the government (low level, downward trend).

The banking sector remained liquid, solvent, and profitable. Nevertheless, there has been a noticeable build-up of cyclical risks, primarily reflected in the surge in real estate prices and the intensification of credit activity. Property prices have reached record highs, showing signs of overvaluation, while annual credit growth rates exceeded double-digit levels. In response, the Central Bank of Montenegro raised the countercyclical capital buffer rate twice during 2024—first, from 0% to 0.5% at the end of March (effective as of 1 April 2025), and then from 0.5% to 1% at the end of December (effective as of 1 January 2026).

A potential escalation of the global tariff/trade war was a key factor behind the downward revision of the IMF's global growth forecasts in April 2025. Although Montenegro maintains relatively low levels of direct economic exposure to countries most likely to be affected, indirect effects could significantly influence domestic economic growth and price levels.

Risks related to the sustainability of public finances remain present despite public debt currently standing slightly above 60 percent of GDP. In late March 2025, the government issued Eurobonds, thereby securing, among other things, the necessary funds for the repayment of a 500 million euro Eurobond issue maturing in April 2025. This represents a moderate risk that requires close monitoring, particularly in light of the potential for geopolitical shocks.

The banking sector's exposure to the government has been declining, as banks have increasingly invested in securities issued by the euro area member states and have intensified lending to the private sector in recent years. Nevertheless, the ratio of sovereign exposure to total banking assets remains significant, warranting continued caution in this area.

INTRODUCTORY NOTES

The primary objective of the Central Bank of Montenegro (CBCG) remains the preservation of financial stability.

To foster and preserve financial stability, the CBCG primarily relies on microprudential regulation and supervision. However, since this approach focuses primarily on the stability of individual banks, the CBCG also undertakes macroprudential actions when necessary, utilizing instruments that address risks at the systemic level. This approach emphasizes the complex interconnections between banks and other economic agents, enabling a more comprehensive assessment of potential vulnerabilities within the financial system. The Financial Stability Report is one of the tools through which the CBCG contributes to financial stability—by raising awareness of the sources of risk to financial stability among economic and financial policymakers, in the financial system itself, and with the general public.

The Report analyses risk developments that are considered to be or may be systemic in nature. Systemic risk may stem from internal imbalances and vulnerabilities within the financial system or banking sector, as well as from external shocks that could affect the broader economy or directly impact the financial system.

The Report is structured into four main sections. The first section gives an overview and assessment of systemic risks. The second section outlines trends and expectations in the international economic and financial environment that are important for Montenegro given its connectivity with global economic and financial flows. The third section summarizes key domestic macroeconomic and balance of payments trends, offering an overview of Montenegro's economic interactions with the rest of the world, along with risks and vulnerabilities within the domestic private real sector and general government sector to which Montenegrin banks are exposed. The fourth section discusses trends and risks within the banking sector and other relevant segments of the financial system. This part uses a range of financial soundness indicators and other macroprudential tools to assess the stability of the banking sector, reflecting the influence of both domestic and international factors discussed in earlier sections, as well as internal sector-specific dynamics.

1. SYSTEMIC RISKS ANALYSIS AND ASSESSMENT

At the end of 2024, systemic risks were moderate.

Following strong economic growth in 2023 and a full recovery from the impacts of the COVID-19 pandemic, Montenegro's economic activity recorded a lower growth rate of approximately 3% in 2024. Somewhat weaker performance was observed in the tourism sector, primarily reflected in a 4.9% year-over-year decline in the number of overnight stays by both domestic and foreign visitors. Private consumption remained the key driver of economic growth. Continued wage growth, improved labour market conditions, and stable lending activity further supported economic expansion. Inflation, which had been elevated in the previous period, declined, with 2024 recording the lowest inflation rate since 2021.

When it comes to the non-financial segment of the economy, the debt of resident non-financial corporations and households to banks increased both in nominal terms and as a percentage of GDP, driven by strong credit growth.it should be noted that the debt of resident non-financial institutions and households to banks increased in nominal terms, as well as relative to GDP (due to a strong credit growth).

Debt of non-financial institutions to banks saw an increase of 18% during the reporting year, reaching 1.5 billion euros. In relation to GDP, the debt of non-financial institutions increased from 18.8% to 20.7% of GDP, thus ending the multi-year downward trend of this indicator. This rise was partly due to slower-than-expected GDP growth in 2024. Liquidity in the real sector remains a concern. In terms of value, frozen funds in corporate accounts reached 1.33 billion euros, which is 14.5% more than at the end of 2023. Business entities that were blocked at the end of 2024 accounted for over a quarter of active business entities (26.6%), and their number increased by 5.6% in one year.

Household indebtedness to banks increased by 16.6% during 2024 to 1.97 billion. euros, which continued the trend started in 2013 and reached the historically highest level of indebtedness in the nominal amount. In relation to GDP, household debt increased by 2.1 pp, reaching 26.4% of GDP. Real household income, as measured by average wages, indicates an improvement in the financial position of the household sector. Average net wages rose by 2.3% in 2023, followed by a 6.9% increase in 2024.

Public finances remained relatively stable, reflecting generally balanced spending during the 2023–2024 period, a manageable level of public debt, and a slight improvement in the country's credit rating to B+ in August 2024. This was the first credit rating upgrade since 2007, although the rating remains well below investment grade (BBB-). Public debt increased by 2.1 pp of GDP over the year, primarily due to new borrowing, most notably through the issuance of bonds on the international market. By the end of

2024, public debt amounted to 4.57 billion euros or 61.3% of GDP. The most prominent risks to public finances are related to the substantial repayments of outstanding debt amounts and the financing of the capital budget. The upcoming period may prove particularly challenging, especially in light of the current credit rating and the deterioration of borrowing conditions on international markets in early March 2025.

The banking sector remained solvent, liquid, and profitable. A stable growth in deposits continued, with banks increasingly allocating funds for lending rather than investing into liquid assets or securities. Although liquid assets, according to the CBCG`s highly conservative definition, declined slightly, they remained at a very high level. The stability of the banking system is largely reflected in the stability of deposits, which reached a record 5.84 billion euros, making up by far the largest part of banks' liabilities (80.5%). Compared to the end of 2023, deposits increased by 6.7% or 365.7 million euros.

The situation regarding non-performing loans (NPLs) significantly improved in 2024, with the NPL ratio declining from 5% to 3.5%. By the end of the year, all banks recorded a lower share of NPLs than in 2023, and the nominal amount of these loans also decreased.

Banks' exposure to the government decreased during 2024, amounting to 11.6% of total assets (841.7 million euros), which is 3.1 pp less than at the end of 2023. The government relied considerably less on bank borrowing compared to the previous year, resulting in a 28.1% reduction in general government debt arising from bank loans to 224.3 million euros.

Banks achieved record profitability, driven by strong lending activity at sustained interest margins and increasing non-interest income. Net profit in 2024 amounted to 157.6 million euros, up by 8% compared to the previous year. The four largest banks—each with over 10% market share in terms of assets—recorded a combined profit of €123.8 million. One bank in the system reported a loss. Reflecting the improved financial results, return on average assets (ROAA) stood at 2.3% in 2024 (compared to 2.2% in 2023), while return on average equity (ROAE) slightly decreased to 18.5%, from 20.1% in the previous year.

In order to preserve the banking sector resilience to the possible materialization of cyclical systemic risks, the CBCG increased the countercyclical capital buffer rate twice during 2024, first to 0.5% and then to 1%. Certain indicators pointed to the accumulation of cyclical risks, particularly in the domain of credit growth and further increases in real estate prices. Credit expansion was especially prominent in the household segment, partly due to wage increases in the preceding period. Cash and housing loans led the growth, with a record volume of newly approved loans also contributing to the expansion. Prices of newly built apartments reached an all-time high, adding to cyclical vulnerabilities. The leading factor in the growth of real estate prices were FDI in real estate, which in the period 2022-2024 amounted to 1.37 billion euros, or an average of 6.8% of nominal GDP per year, which is significantly more than in the multi-year period before that. In addition to FDI, the increase in housing loans also contributed to rising prices. For the last three years, new housing loans amounted to 400.8 million euros, of which 173.7 million euros in 2024.

Other financial intermediaries do not pose sources of systemic risk primarily due to their limited size and relevance in Montenegro's financial market, the nature of their operations (non-deposit institutions), as well as the solid financial position of key entities, particularly insurance companies.

On the Montenegro Stock Exchange, a turnover of 9.7 million euros was recorded (0.1% of GDP) in 2024, which is even less than in 2023, when the turnover was 12.3 million euros. The turnover mainly related to the trading with shares. The stock market indices MONEX and MNSE10 recorded growth of 5.5% and 2.1%, respectively, with MONEX still significantly lower compared to its maximum values from April 2007.

The CBCG`s payment system and the securities settlement system operated by the CSD&CC, as the key financial infrastructure components in Montenegro, continued working smoothly throughout 2024.

Scheme 1.1

Key financial stability risks as at 31 December 2024	
Accumulation of cyclical systemic risks, related to the real estate market and strong credit growth	↑
A possible trade war between the USA and certain industrialized countries, along with other geopolitical conflicts	↑
The level of public debt and future debt repayments, taking into account global trends	→
Exposure of banks to the government considering the challenges in government finances	↓

Explanation

- High systemic risk
- Moderate systemic risk
- Low systemic risk

Colours represent the level of risk as a combination of probability of materialisation and potential impact in case of materialisation during the next two years, based on the CBCG expert assessment. The arrow shows the direction of change in the level of risk relative to the previous Financial Stability Report.

2. INTERNATIONAL ECONOMIC AND FINANCIAL ENVIRONMENT

2.1. Global economic trends

The world economy recorded stable growth in 2024 (3.3%), and this slightly lower growth rate than in the previous year (3.5% in 2023) was mainly the result of below-expected economic results in the second half of the year in the largest economies of Europe and Asia. Strong economic growth in the USA, on the other hand, had the largest positive contribution to the growth rate of the world economy. According to the IMF estimates, advanced economies recorded a slightly higher growth rate compared to the previous year (1.8% versus 1.7%), but due to a significant increase in tariffs between the leading countries and increased uncertainty in the economic environment, the IMF expects a slowdown in the growth of economic activity in 2025 and 2026 to 1.4% and 1.5%, respectively. In developing and emerging markets, economic activity slowed down (4.3%) compared to the previous year (4.7%), and the IMF expects weaker dynamics in 2025 as well (table 2.1).

The decline in global inflation continued throughout 2024, supported by several contributing factors, most notably the earlier tightening of monetary policy by leading central banks, although the pace of tightening varied significantly across regions. Importantly, a wage-price spiral was avoided, and labour market recovery continued. Consumer price growth rates were significantly lower on average in advanced economies than in emerging and developing economies. Core inflation rates across the globe converged more closely toward central banks' target rates, particularly by the end of 2024.

The increase in oil prices was affected by the limited supply in the form of a smaller volume of production by the member countries of the OPEC+ group, and in the form of the establishment of a lower price limit; numerous tensions in the Middle East, as well as production and supply channel disruptions. The factors that brought down the price were the higher volume of production of countries that are not members of the OPEC+ group (led by the USA, Canada and Guyana), as well as the negative mood of investors due to expectations of weaker demand in China and an excess of oil supply in 2025, which was especially pronounced in the last quarter. The IMF predicts a drop-in oil prices by 15.5% in 2025. On the other hand, the prices of non-energy products increased by 3.7% in 2024, and the IMF expects them to increase by 4.4% in 2025.

The volume of global trade recorded significant growth compared to 2023, and its growth rate (3.8%) generally followed the growth rate of global GDP. The forecast for the next two years is significantly lower due to the uncertainty surrounding trade policies.

In January 2025, the global economic outlook for the year was slightly improved, as the IMF raised its growth forecast for the global economy to 3.3% in its January forecasts. Key risks to global growth were identified as ongoing adjustments in the energy sector in Europe and the real estate sector in China—challenges carried over from previous periods. Emerging risks were associated with the intensification of protectionist policies and corresponding countermeasures, which could disrupt trade flows and supply chains, reduce global investment, and undermine overall market efficiency. In the IMF`s April 2025 projections, these risks had intensified significantly. Effective tariff rates in the United States reached their highest level in over a century, underscoring the peak of protectionist trends. Trade growth may decline further, and combined with heightened policy uncertainty, this could negatively impact global financial flows and financial stability. The effects could be especially adverse for public finances in emerging and developing economies, particularly in low-income countries.

Table 2.1

Overview of selected global indicators, %

Indicator	2023	2024 estimate	Forecasts		Difference in relation to October 2024 projections, pp	
			2025	2026	2025	2026
Real growth of GDP						
World	**3.5**	**3.3**	**2.8**	**3.0**	**-0.4**	**-0.3**
Advanced economies	**1.7**	**1.8**	**1.4**	**1.5**	**-0.4**	**-0.3**
USA	2.9	2.8	1.8	1.7	-0.4	-0.3
Euro area	0.4	0.9	0.8	1.2	-0.4	-0.3
Japan	1.5	0.1	0.6	0.6	-0.5	-0.2
Emerging market and developing economies	**4.7**	**4.3**	**3.7**	**3.9**	**-0.5**	**-0.3**
China	5.4	5.0	4.0	4.0	-0.5	-0.1
India	9.2	6.5	6.2	6.3	-0.3	-0.2
Russia	4.1	4.1	1.5	0.9	0.2	-0.3
Emerging and developing Europe	3.6	3.4	2.1	2.1	-0.1	-0.4
World trade volume (goods and services)	**1.0**	**3.8**	**1.7**	**2.5**	**-1.7**	**-0.9**
Commodity prices, average rate						
Oil	-16.4	-1.8	-15.5	-6.8	-5.1	-3.2
Nonfuel	-5.7	3.7	4.4	0.2	4.6	-0.6
Consumer prices, average rate						
Advanced economies	4.6	2.6	2.5	2.2	0.5	0.2
Emerging market and developing economies	8.0	7.7	5.5	4.6	-0.4	-0.1

Source: IMF, April 2025

The stagnation of economic activity in the euro area was also evident in 2024 although the growth rate was higher (0.9%) than in the previous year (0.4%). The main contributing factors are structural in nature, reflected in a 1.7% decline in industrial production and low investment rates. Elevated energy prices also weighed on the region's economic position. The contraction in industrial output was particularly pronounced in the euro area's largest economy, Germany, where production levels remain significantly below the peak observed in 2017–2018. Despite these challenges, rising real wages and an overall improvement in labour market conditions supported a modest increase in personal consumption, which, according to the ECB, is expected to remain the key driver of GDP growth going forward. The ECB has repeatedly reduced its forecast for the growth of the euro area economy for 2025, which fell from 1.5% (March 2024) to 0.9% (March 2025). The weaker outlook is mainly a consequence of the revised outlook for exports and, to a lesser extent, for investments.

In January 2025, the IMF expected continued high demand in the United States to continue throughout the year, supported by more favourable financial conditions and a looser monetary policy stance. The projected growth rate for 2025 stood at 2.7%, a notable upward revision from the October 2024 forecast of 2.2%, driven by a stable labour market and increased investment activity. However, by April 2025, the IMF downgraded the forecast to 1.8%.

Preliminary data indicate that China's economy grew by 5% in 2024, surpassing market expectations. This performance was primarily attributed to stronger industrial output and increased trade activity, particularly ahead of anticipated import restrictions in the U.S. Despite this growth, consumer price inflation remained exceptionally low, and producer prices have been in negative territory for over two years. In response, the Central Bank of the People's Republic of China announced plans for further monetary easing, while the Chinese government had already introduced fiscal stimulus measures. Nevertheless, the IMF, in its April 2025 update, projected a significant slowdown in China's economic growth, with a forecasted rate of 4% for 2025.

2.2. Global financial trends

In mid-2024, major central banks in advanced economies began lowering their benchmark interest rates. However, in contrast to the previously synchronized monetary policy responses, there is now a noticeable divergence in both the direction and pace of monetary easing—particularly among emerging and developing economies, and even within the group of countries that have already started easing. The decline in interest rates has impacted global financial conditions, particularly benefiting emerging markets. Lower benchmark rates provide some fiscal relief by reducing public debt servicing costs, while the appreciation of emerging market currencies against the U.S. dollar helps ease imported inflationary pressures and facilitates disinflation in those economies. In the middle of 2024, the largest central banks in advanced economies started to reduce their reference interest rates. However, unlike the previous period of highly aligned monetary policies, there is currently some mismatch with developing and emerging countries in terms of the direction or speed of monetary policy easing, even among countries that have begun easing. The reduction in interest rates has affected global financial conditions, primarily in developing and emerging countries, given that the fall in reference interest rates provides some fiscal „relief" through the reduction of public debt financing costs, and that the currencies of developing and emerging countries strengthen against the dollar, reducing import inflationary pressures and easing the way to reducing inflation in those countries.

The ECB's restrictive policy, implemented in the last few years, had a strong effect on financial conditions and a reduction in demand, so inflation was successfully stopped, and then recorded a sharp decline. However, in June, the ECB, based on an assessment of the prospects and dynamics of inflation, and the effectiveness of the implementation of the monetary policy in the previous period, started easing the monetary policy[1]. Since June, four reductions in reference interest rates have been implemented, and at the end of the year, the rate on overnight deposits was 3%. In the first quarter of 2025,

[1] At the beginning of 2024, the ECB changed the operational framework for the implementation of monetary policy, shifting the focus to adjusting the interest rate on overnight deposits.

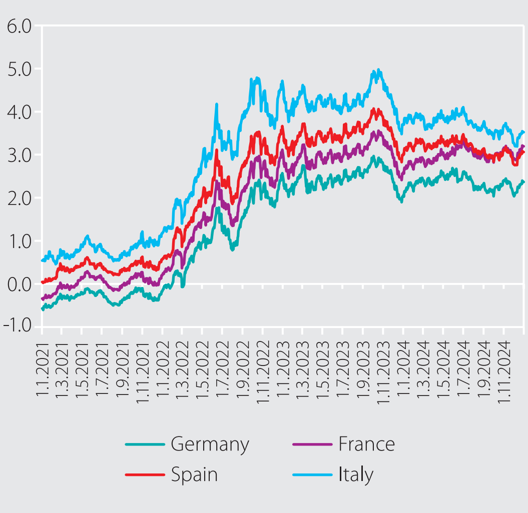
the ECB continued by reducing its reference rate two more times by 0.25 pp each. The fall in inflation was in line with the plan with certain oscillations, and gradual progress is also visible in terms of financing households and the economy. The inflation forecast is 2.3% for 2025 and 1.9% for 2026.[2] Most of the indicators used by the ECB indicate that inflation will reach the target level of 2% in the medium term, and interest rate decisions will be made on a continuous assessment of the situation, without determining the target path of interest rates.

According to the ECB's Survey of Professional Forecasters from the first quarter of 2025, the inflation rate expectations for the year 2025 have been revised upwards compared to the previous quarter from 1.9% to 2.1%; the GDP growth rate was revised downwards from 1.2% to 1%; and the unemployment rate remained at 6.5%. When it comes to the reference interest rate, forecasters expect it to fall to 2% by the third quarter of 2025, which is the level at which the rate will remain in 2026 and 2027.

During 2024, the FED implemented three reductions in the reference interest rate, which dropped it to the level of 4.25%–4.5%. According to the FED's analysis, the USA economy continued to grow at a solid pace, while the labour market and unemployment rate generally stabilized, and inflation was slightly elevated. The March 2025 forecasts indicate a slightly different position of the economy, considering that the GDP growth forecast for 2025 was lowered from 2.1% in December to 1.7%, the unemployment rate increased slightly from 4.3% to 4.4%, and the inflation projections (projections of personal consumption expenditures (PCE)) increased from 2.5% to 2.7%. The Fed is currently under pressure from the U.S. President to lower interest rates in order to stimulate economic growth. However, the Fed Chair has emphasized that any rate cuts will be postponed until the implications of the U.S. tariff policy become clearer.

Graph 2.1

10-year Government debt bond yields in the euro area, 2021–2024, %



Source: Bloomberg

Yields on 10-year German government securities rose slightly during 2024, while yields on 2-year and 3-month debt declined, making the relationship between shorter- and longer-maturity debt yields more common (graph 2.1). According to the latest available data, the securities markets have already reacted to the announced large-scale spending by the German government on infrastructure and defence projects (500 billion euros), which is why the current situation with elevated yields is expected to persist in the medium term, despite the lowering of the reference interest rate by the ECB. Given that yields on German debt represent the usual benchmark for yields on the debt of other euro area countries, the growth of yields on German debt was also reflected in other euro area countries.

Short-term market reference interest rates mostly mirrored the reference interest rates of the central banks (graph 2.2). Thus, the €STR rate fol-

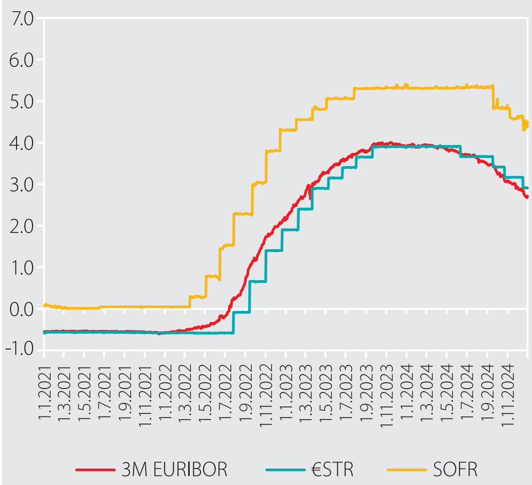
[2] The ECB forecasts, March 2025.

lowed every reduction in ECB interest rates, while the decline of the three-month *EURIBOR* started at the beginning of 2024. At the end of 2024, the three-month *EURIBOR* and *€STR*[3] amounted to 2.71% and 2.91%, respectively, and they were 105.4% and 83.3% higher on the annual basis. The *SOFR*[4] stood at 4.49% at the end of the year and it was 0.89 pp lower year-over-year.

Instability in financial markets, as measured by the expected volatility of U.S. stock prices through the VIX index[5], was lower than in 2023 and remained within historical averages. However, the price of gold, which serves as a specific indicator of stress and risk in the global economy and financial markets, followed an upward trajectory, reaching record levels. In 2024, the annual increase in the price of gold amounted to 27.2%, with the year-end price reaching $2,624/oz. At the beginning of 2025, the price of gold saw a sharp rise, mainly attributed to geopolitical developments and the announcement of new tariffs, surpassing $3,000/oz.

Graph 2.2

Short-term market interest rates, 2021–2024, %



Source: Bloomberg

[3] Euro Short-term Rate that reflects the cost of overnight borrowing in the euro area.

[4] SOFR is the reference rate on USD derivatives and loans that replaced LIBOR in June 2023 and it is based on overnight transactions secured by government securities.

[5] Index of expected volatility of stock prices based on options on the S&P 500 stock index, calculated by the Chicago Board Options Exchange.

3. DOMESTIC ECONOMIC ENVIRONMENT

3.1. General macroeconomic trends

After a strong economic growth in 2023, positive macroeconomic trends in the domestic environment continued in 2024, but with a lower intensity, which resulted in significantly slower GDP growth compared to the previous year (3%). Private consumption remained the key driver of growth, based on wage growth, an improved situation on the labour market and stable lending. In addition, gross investments in fixed assets also made a significant contribution, which indicates the recovery of investment activity and confidence in the country's economic stability.

When it comes to the contribution of individual sectors to the growth of economic activity in 2024, the transport and retail trade sectors had a significant positive impact (table 3.1). However, despite positive general economic trends, the tourism sector recorded a slight decline, given that the number of overnight stays by domestic and foreign guests in 2024 decreased by 4.9% compared to the previous year. Industrial production recorded a growth rate of only 0.2%, which indicates stagnation in this segment of the economy.

Table 3.1

Change rates in key industries, 2024/2023, %

Industry	Annual rate of change
Tourism, all accommodations, arrivals	-0.2
Tourism, all accommodations, overnights	-4.9
Passenger transport, road	11.6
Passenger transport, railways	1.3
Passenger transport, air	15.2
Retail trade, constant prices[6]	8.0
Industrial production	0.2
Construction, value of performed construction work	2.4
Construction, effective working hours	1.6
Forestry, produced assortments	-38.0

Source: MONSTAT

According to the CBCG forecast, GDP growth for 2025 will amount to 3.2%. As indicated in the 2025-2027 Economic Reform Program (ERP), the Ministry of Finance forecasts 4.8% and 3% GDP growth in 2025 and 2026, respectively, while the low-growth scenario forecasts growths of 3.2% and

[6] As an average of annual rates of change for quarterly turnover data.

2.4%. Macroeconomic projections for the period from 2025 to 2027 hint a growth of private consumption, which will continue to be one of the key drivers of the economic growth. This trend will be supported by the planned growth of minimum and average wages, as well as pensions, the implementation of comprehensive reforms in the area of tax and fiscal policies, and the improvement of the business environment. Medium-term macroeconomic forecasts of the Ministry of Finance predict the intensification of investment activity, especially in strategic sectors, with the continued growth of tourism sector.

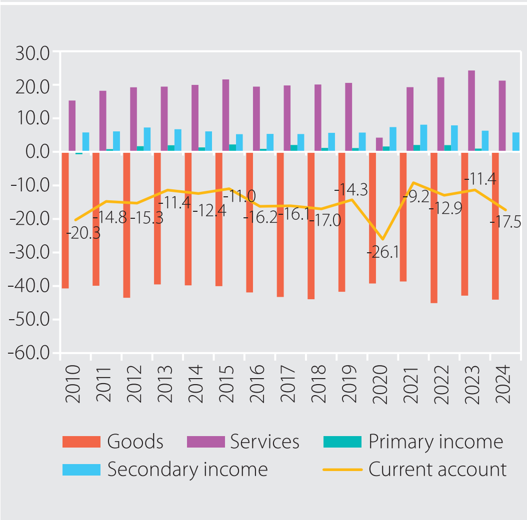
According to the forecasts of reference international institutions, a similar rate of economic growth in Montenegro to that in the previous year is expected in 2025. The IMF (April 2025) forecasts a real GDP growth rate of 3.2%, while the World Bank (April 2025) and the European Commission (May 2025) forecast growth of 3%.

Inflation in Montenegro slowed down significantly, with the annual inflation rate averaging at 3.4%, while it dropped to 2.1% at the end of 2024. Thus, after record double-digit values in the previous two years, it reached the lowest level since 2021. Based on model calculations, the CBCG expects inflation in 2025 to be 1.2%-3.3% with a probability of 90% and a central projection at 2.3%, with the CBCG's expert assessment indicating a similar expectations. According to forecasts specified in the 2025-2027 ERP, the Ministry of Finance predicts an average inflation rate of 2.9%, estimating that the trend of inflation in 2025 will largely depend on external factors such as geopolitical events, commodity prices and global financial conditions, but also on domestic demand, especially in the context of wage growth.

In 2024, the current account deficit was 1.3 billion euros or 17.5% of GDP and it was 6.2 pp higher year-on-year. As expected, the main cause of the increase in the deficit was the negative balance on the goods account, which increased further and reached 3.3 billion euros (44.3% of GDP). Visible imports continued to grow, with the largest contribution being made by the categories "machines and transport devices" and "food products". On the other hand, exports decreased due to significantly lower exports of electricity and non-ferrous metals.

Graph 3.1

Current account components, % of GDP, 2010–2024



Source: CBCG calculations

The surplus on the services account remained extremely high and amounted to 1.6 billion euros or 21.2% of GDP at end-2024. However, estimated revenues from travel-tourism amounted to 1.5 billion euros, which is 3.1% less than in 2023. This result is primarily a consequence of the decrease in the number of overnights by domestic and foreign tourists.

A deficit was recorded on the primary income account, while a decrease in surplus was recorded on the secondary income account compared to the previous year, due to an increase in expenditures (graph 3.1).

A net inflow of foreign direct investments amounted to 491.2 million euros or 6.6% of GDP, which represents an increase of 13.3% compared to 2023. Total FDI inflow increased by 3.3% due to a slight increase in investments in companies and banks, as well as the growth of intercompany debt. On the other hand, real estate investments recorded a slight decline for the first time in three years. At the same time, FDI outflow decreased by 6.7%.

3.2. Position of non-financial institutions[7]

Debt of non-financial institutions[8] to banks saw an increase of 18% during the reporting year, reaching 1.5 billion euros. In relation to GDP, the debt of non-financial institutions increased from 18.8% to 20.7%, thus ending the multi-year downward trend of this indicator. This growth is partly the result of a slower than expected GDP growth in 2024.

Throughout 2024, the banking sector supported economic activity by extending 974.3 million euros in new loans, representing a 29.3% increase. In terms of purpose, new borrowing mostly referred to liquidity loans for working capital (54.5% of total borrowings). For years, this type of loans has been the most common type of loans granted to non-financial institutions.[9] Refinancing of liabilities to other banks and the implementation of investment programs represented the next largest types of indebtedness, with the respective shares of 13% and 12.6% in new loans to this sector.

In 2024, the position of net creditors of the non-financial institutions sector declined due to an increase in loans, and at the end of the year it amounted to 2.6% of total assets.

Regarding the initial maturity of the debt of non-financial institutions to banks, debt with the agreed maturity exceeding three years accounted for the main share with 65.5% of the total debt at the end of 2024. Debt with the agreed maturity exceeding one year made up 84.1% of the debt. As for the currency structure, almost the entire debt of non-financial institutions was in euros (99.8%), and this trend has not changed significantly in recent years.

Judging by the quality of the debt of non-financial institutions to banks, credit risk continued to decline during 2024 as the share of bad debts in total debt of non-financial institutions fell to 6.2%. The total sum of non-performing loans fell by 23.9% relative to end-2023.

The average interest rate on the debt balance of non-financial institutions remained stable, amounting to 5.44% at end-2024, which is 0.04 pp less than at end-2023 (graph 3.2). At the same time, the average interest rate on new loans decreased from 5.64% in 2023 to 5.46% in 2024, registering a decrease of 0.19 pp.

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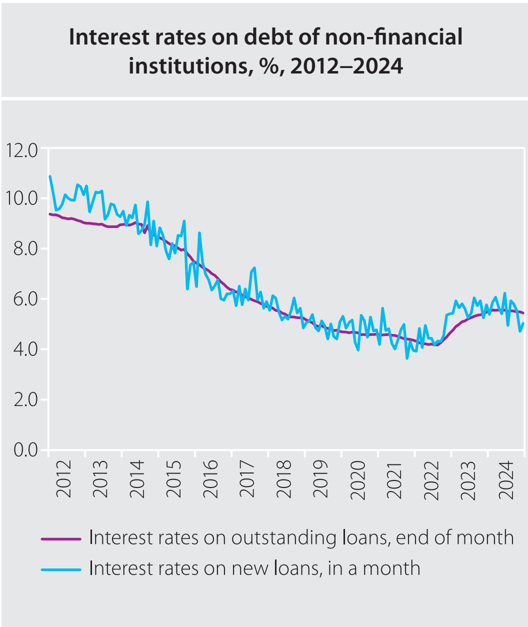
7 Since Montenegro does not have the financial account statistics. i.e. an overview of financial assets and liabilities by all institutional sectors of the economy, the position of non-financial institutions and households is primarily monitored through their relationship with Montenegrin banks via data that banks submit to the CBCG.

8 Non-financial institutions include resident private and state-owned companies.

9 This data refers to all legal persons but they are sufficiently representative as 86.5% of total debt of legal persons in 2024 referred to non-financial institutions.

Graph 3.2

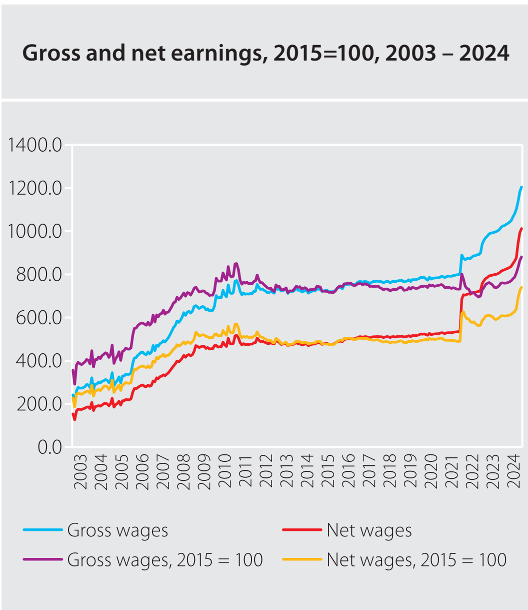


Source: CBCG

Data on blocked business entities can serve as an indicator of the financial position of the economy. At the end of 2024, business entities that were blocked through the enforced collection system of the CBCG accounted for over a quarter of active business entities (26.6%), and their number increased by 5.6% in one year. In terms of value, frozen funds on business entities' accounts reached 1.33 billion euros, which is 14.5% more than at the end of 2023. Some 90.2% of business entities were blocked over a year and the value of their debt accounted for 98.2% of total debt of blocked entities. For the most part, these are almost uncollectible liabilities from previous years. The growth of the debt of business entities which have been in a continuous blockade for over a year amounted to 15.3%, and the frozen amount was 173.3 million euros.

3.3. Position of households

Graph 3.3



Source: CBCG

The labour market has been recording positive trends driven by the growth of economic activity and the reduction of the informal economy. Real incomes of households, seen through average earnings, indicate an improvement in the financial position of this sector despite inflation pressures. Average net earnings increased by 2.3% in 2023, while in 2024 the growth was 6.9% (graph 3.3). The implementation of the "Europe Now 2: program in October 2024 additionally contributed to this growth through an increase in minimum wages, as well as a reduction in the pension and disability insurance contribution rates.

Decrease in unemployment additionally contributed to the improvement of the income position of the household sector. According to data from the Labour Force Survey, the unemployment rate in 2024 was 11.4%, which represents a decrease of 1.7 pp year-over-year. However, unemployment in Montenegro has had a pronounced structural character for years, which is reflected, among other things, in a relatively slow decline of the unemployment rate, which still remains high compared to other European countries. According to the projections of the Ministry of Finance indicated in the ERP, the unemployment rate is expected to decrease to 9.2% by the end of the forecast period (2027).

Household debt to banks increased by 16.6% during 2024 to 1.97 billion euros, which continued the trend started in 2013 and reached the historically highest level of indebtedness in the absolute amount. In relation to GDP, household debt increased by 2.1 pp, reaching 26.4%.

During 2024, households borrowed a record 831.4 million euros worth of new loans. In terms of purpose, the largest part of new borrowings was related to cash (all-purpose) loans, which accounted for 59.1% of total new loans. This type of borrowing is still under the CBCG`s macroprudential measures due to the growing risks arising from the level of these loans and imbalances in their maturity. The measure resulted, among other things, in a drop in the average maturity of cash loans, given that starting as of 2020, banks have focused more on approving loans with maturities of less than 10 years, since only high-quality collateralized loans can be approved for maturities over 10 years.

Observed through the financing of demand on the real estate market, banks play an increasingly important role, since the second largest category of new loans to the household sector were loans for the purchase of apartments and apartment adaptation. If we look at loans for the construction of buildings and adaptations, these two categories, as in recent years, together accounted for nearly a quarter of the total new household loans. Also, the household sector shows increasing financial awareness, actively seeking more favourable conditions on the banking market. In this context, loans for the refinancing of liabilities to other banks are becoming more important, occupying the third place in terms of share in new loans.

The quality of household debt to banks continues to improve. The amount of bad debt of households decreased by 17.2% to 47.3 million euros in 2024, and the share of bad debt in total household debt dropped to 2.4%.

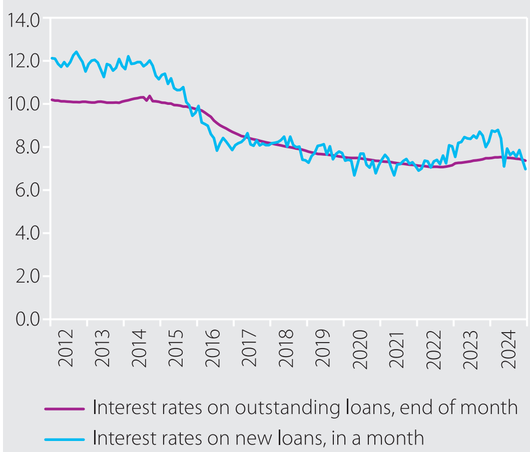
Due to the continuous growth of deposits, the household sector maintained its position as a net creditor, although it slightly decreased (2.6% of total bank assets). At the end of 2024, household deposits reached a historical maximum, amounting to 2.15 billion euros.

Regarding the initial maturity of the debt of households to banks, debt with the agreed maturity over three years dominated with 95.6% in the total debt at the end of 2024. This structure is primarily a consequence of indebtedness based on cash and housing loans. Debt with the agreed maturity of over one year made up 99.2% of the debt. The share of household loans denominated in other foreign currencies remained negligible, accounting for 0.1% of total household loans.

In general, borrowing by the household sector is "more expensive" compared to the corporate sector. At the end of 2024, the average interest rate on household total debt was 7.4% (graph 3.4),

Graph 3.4

Interest rates on households' debt, %, 2012–2024



Source: CBCG

with the interest rate on new borrowing slightly reduced from 8.32% in 2023 to 7.86% in 2024. This decrease is largely the result of the initiative from March 2024 when the CBCG recommended banks to lower interest rates on retail loans, but also a consequence of the drop in market reference rates. In parallel with the decrease in interest rates, the amount of new household debt continuously grew throughout the year, with the total rate of growth being no less than 40.1% compared to 2023.

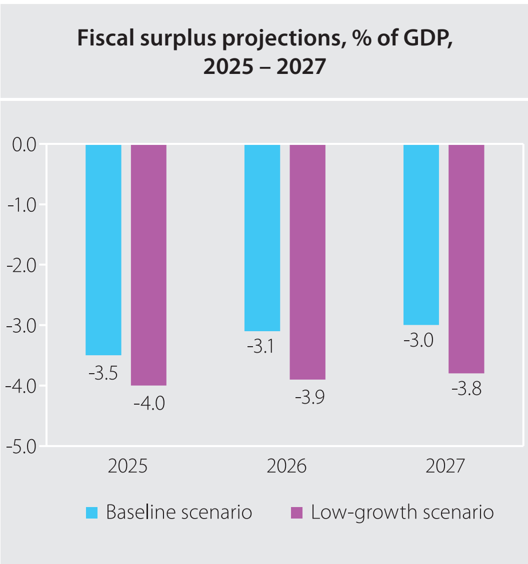
3.4. Government finances

The situation with government finances is relatively stable, bearing in mind mostly balanced expenditures in the period 2023-2024, the level of public debt, and a slight improvement in the credit rating to B+ at end-August 2024. This is the first increase in credit rating since 2007, although it is still far from the investment rating (BBB-).

Budget revenues were lower than planned (0.6%) but higher than last year's revenues (7.3%), and amounted to 2,755.1 million euros. The execution of the budget according to the key revenue items - taxes and contributions, mostly proceeded according to the plan. Total budget revenues amounted to 36.9% of GDP, which is generally within the ten-year average.

Budget expenditures were lower than planned (0.8%), but significantly higher than last year's expenditures (16.8%), and amounted to 2,986 million euros. The largest increase in expenditures compared to the plan was recorded in capital expenditures. In relation to GDP, budget expenditures amounted to 40%, and were lower compared to the ten-year average.

Graph 3.5



Source: Ministry of Finance

The government budget recorded a deficit in the amount of 230.9 million euros (3.1% of GDP). A budget deficit of 278.1 million euros or 3.5% of GDP[10] is projected for 2025 (graph 3.5).

During the year, public debt increased by 2.1 pp of GDP, and the reason for this is new debt, the largest of which is the issue of bonds on the international market[11]. Thus, the public debt as at 31 December 2024 amounted to 4.57 billion euros or 61.3% of GDP. Some 4.18 billion euros related to external debt, 331.3 million euros to domestic debt and 59.1 million euros on the local self-government's debt.

According to the baseline scenario in Montenegro`s 2025-2027 ERP, public debt will amount to 60.7% of GDP at the end of 2025, and it will reach 64.1% of GDP at end-2027.

[10] Economic Reform Program (ERP) for the period 2025-2027.

[11] 750 million dollars, i.e. 687.8 million euros after the conclusion of the hedging arrangement.

Public debt as at 31 December in 2024 it amounted to 4.51 billion euros or 60.5% of GDP (external 56.1% of GDP, domestic 4.4% of GDP). Within the external government debt, debt arising from Eurobonds accounted for the main share (58.3%). At the end of 2024, the current/outstanding Eurobond issues were those from 2018, 2019, 2020 and 2024. In March 2025, there was a new issue of Eurobonds in the amount of 850 million euros and with agreed maturity in 2032. Within the domestic debt, one Eurobond issue from 2019 maturing in 2026 was active on the Montenegro Stock Exchange.

During 2024, the principal of the debt repaid (to residents and non-residents, including liabilities for frozen foreign currency deposits and restitution) amounted to 495.7 million euros, as was the interest in the amount of 149.2 million euros.

According to the data from the ERP, public finances are facing a challenging period, given that debt repayment costs will amount to 836.5 million euros or 10.5% of GDP in 2025. In 2026, that amount will decrease to 368.6 million euros or 4.4% of GDP, while in 2027 it will increase to 986.4 million euros or 11.3% of GDP. The largest one-time repayments whose impact on the total amount of debt repayment is the most significant refer to Eurobonds due in 2025 in the amount of 500 million euros, domestic bonds maturing in 2026 in the amount of 50 million euros, as well as Eurobonds due in 2027 in the amount of 750 million euros.

Most of the government debt is repaid at a flat rate (83%), and the rest at a variable interest rate. Regarding the currency structure at the end of 2024, the situation changed significantly, given that almost the entire debt is effectively repaid in euros (99.2%).

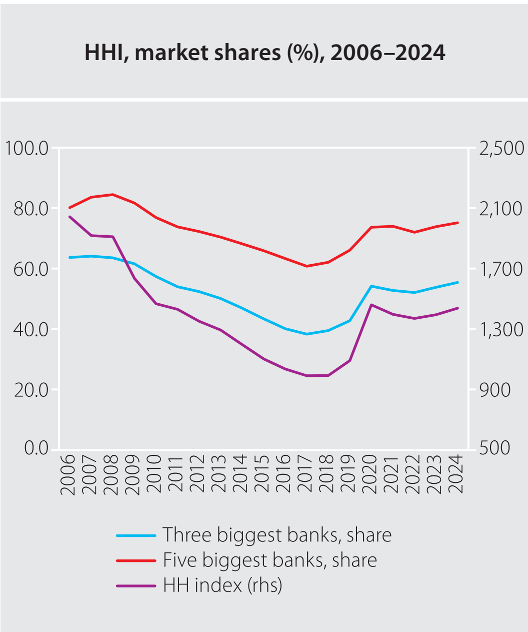
4. FINANCIAL SYSTEM

At the end of 2024, the value of financial sector assets amounted to 7.8 billion euros or 104.8% of GDP. Observed year-over-year, assets of the financial sector recorded a growth of 8.2%, primarily due to the growth of the assets of the banking sector, which still account for the main share in the financial sector assets (92.8%). The insurance sector remained the second most important group of institutions in terms of aSSETS(4.3%). The remaining segments of the financial sector - microcredit financial institutions (MFIs), leasing companies, factoring companies, companies for the purchase of receivables, and investment funds had a collective share of a mere 2.9% in the structure of the financial sector.

During 2024, eleven banks operated in the system, eight of which were majority foreign owned, with the share in assets of some 85%.

The banking sector concentration, according to the HH index (graph 4.1), increased from 1,395 to 1,438 points, still remaining in a zone of relatively low values. Measured by the same indicator, market concentration in loans was higher (1,691 points), while the aforementioned index in deposits stood at 1,412 points. Looking at assets, the market share of three and five largest banks reached 55.4% and 75.2%, respectively.

Graph 4.1



Source: CBCG

Nine insurance firms operated in the Montenegrin insurance market during 2024, of which four engaged in life insurance, and five in non-life insurance activities. Overall, the insurance market was characterized by low concentration in terms of assets, while in terms of gross premiums, market concentration was moderate. However, individually, both life[12] and non-life[13] insurance segments are characterized by high market concentration, especially the life insurance segment. The share of gross invoiced insurance premium in GDP was 1.8%.

In 2024, eleven microcredit financial institutions, one leasing company, two factoring companies and three receivables purchase companies were operating in Montenegro.

[12] The HHI value with regard to assets and gross premium amounted to 3,020 points and 3,200 points, respectively.

[13] The HHI value with regard to assets and gross premium amounted to 2,919 points and 2,830 points, respectively.

4.1. Banks' balance sheet structure

The trend of growth in the balance sheet of banks continued in 2024. The growth of the balance sheet amounted to 7.7% and was driven by the growth of deposits and capital (in liabilities), that is, loans (in assets).

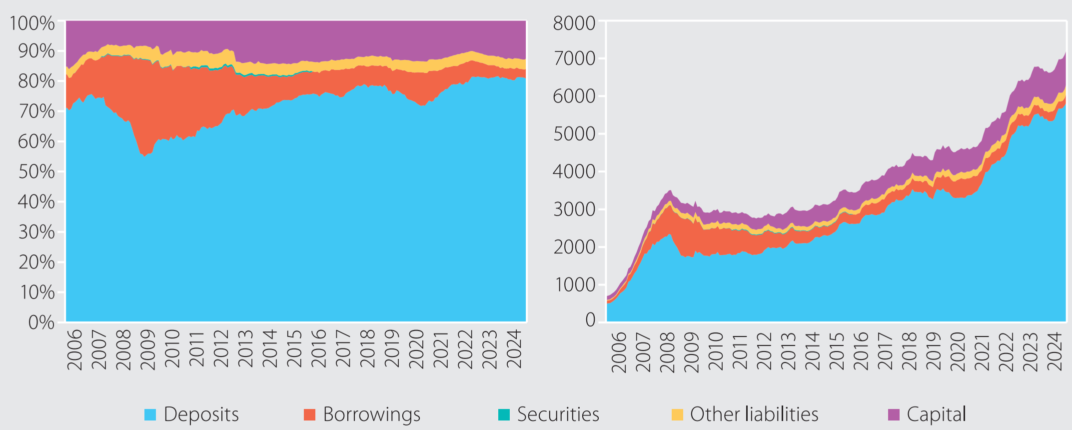
Deposits have been the primary source of bank funding for many years now and they accounted for 80.5% of total liabilities at end-2024, while their share in the balance sheet decreased by 0.7 pp annually (graph 4.2). Deposits grew every month during the reporting year, reaching the annual growth of 365.7 million euros or 6.7%. Thus, total deposits reached their record high of 5.8 billion euros, which undoubtedly points to a confidence in the banking sector.

Retail deposits amounted to 2.2 billion euros and they were 13.4% higher year-over-year. Deposits by the non-financial sector amounted to 1.7 billion euros or 1.4% less compared to 2023. Household deposits were at their all-time high at the end of the year, while non-financial sector deposits were at their all-time high in September. Deposits of non-residents accounted for a significant share of total deposits and they recorded a growth of 18.5 million euros or 1.4% at the end of 2024, while their share decreased from 23.6% in 2023 to 22.4% in 2024.

Borrowings recorded a decline during the reporting year, but at the end of the year they saw a significant growth of 24.9% or 53.9 million euros. However, their share in total liabilities and capital was 3.7% and it increased by 0.5 pp compared to the previous year. Borrowings from the Government of Montenegro accounted for the largest share in total loans, 29.4%. The share of borrowings from parent banks and members of the group amounted to 42.5%. At the end of the year, the share of short-term loans from parent banks in total loans amounted to 14.8%, while long-term loans from parent banks accounted for 1.9%.

Graph 4.2

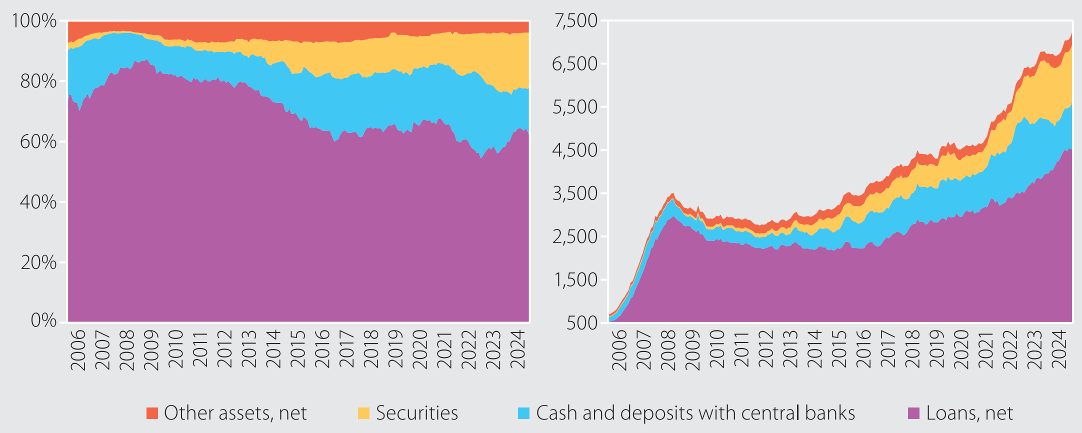
Liabilities and capital: structure (left) and amount in million euros (right), 2006–2024



Source: CBCG

Graph 4.3

Assets: structure (left) and amount in million euros (right), 2006–2024



Source: CBCG

The level of funds and deposits with central banks was in constant decline throughout the year, and at the end of December 2024 it amounted to 1.2 billion euros, which represents a decrease of 2.9% or 36.6 million euros compared to the end of the previous year. The share of cash and deposit accounts with central banks in total assets and liabilities amounted to 16.7%, which represents a decrease of 1.8 pp compared to the previous year (graph 4.3).

Securities were up 0.5% year-on-year and amounted to 1.3 billion euros or 18.2% of total assets and liabilities. Historically, the highest level (of 1.4 billion euros) and share (19.9%) of these instruments in total assets and liabilities was recorded in October 2023.

Most of the securities portfolio was directed abroad (714.5 million euros), mainly in short-term debt securities of investment credit rating, issued by the euro area member countries. The share of foreign securities compared to the previous year decreased by 4.7 pp, with the fact that in November foreign securities reached their historical maximum (730.4 million euros). Investments in domestic government securities are also attractive to banks, but in 2024, the portfolio of government securities of Montenegro was reduced to 617.4 million euros[14] or 8.9%. Banks generally consider these as investments with a favourable interest rate in relation to their risks, and this has been especially appealing to banks in recent years. In addition, regulatory risk weight for this type of investment is 0%, whereby banks make profit for this type of portfolio and do not have any related regulatory capital requirements.

At end-2024, total exposure of banks to the government stood at 11.6% of total assets or 3.1 pp in relation to end-2023 (graph 4.4). In absolute amount, this exposure reached 841.7 million euros[15]. In the

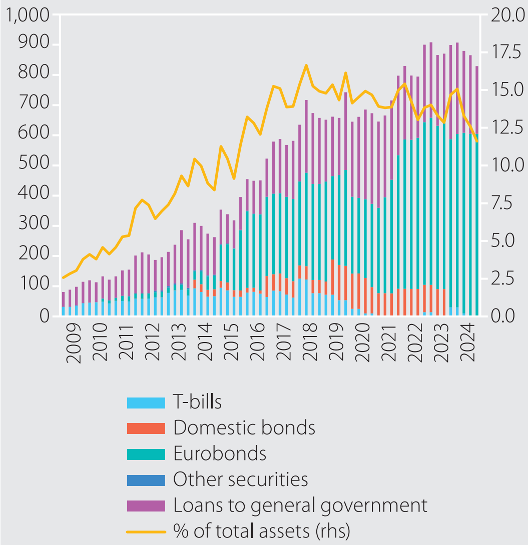
[14] Value expressed without discount/premium.

[15] The exposure relates to government securities and loans granted to the general government. General government includes central government, local governments (municipalities) and social security funds.

reporting year, the government used the possibility of new borrowings from banks (2 million euros), significantly less than it was the case the in the previous year (111.1 million euros), so the debt of General government arising from loans fell by 28.1% to 224.3 million euros. In 2024, the government again issued treasury bills, and at the end of the year, their value in the treasury bills portfolio of banks amounted to 40 million euros.

Graph 4.4

Banks' exposure to the general government, in million euros and % of assets, 2009–2024



Source: CBCG

At end-2024, banks' claims on non-residents for deposits were 20.8% higher than at the end of the previous year. These were mainly demand deposits with non-resident banks that amounted to 647.6 million euros.

Total claims on non-residents stood at 1.8 billion euros, accounting for 24.8% of assets. Total liabilities to non-residents amounted to 1.5 billion euros or 21.2% of liabilities (foreign deposits made up the largest share of these liabilities and at the year-end they reached 1.3 billion euros, increasing by 1.4% annually). High exposure to the non-resident sector in terms of received deposits has implications for liquidity risk because regardless of this source being generally stable, it could cause instability in situations of potential significant drop/withdrawal of these deposits. Thus, net foreign assets stood at 3.6% of total assets and liabilities of banks at end-2024.

4.2. Credit growth and non-performing loans

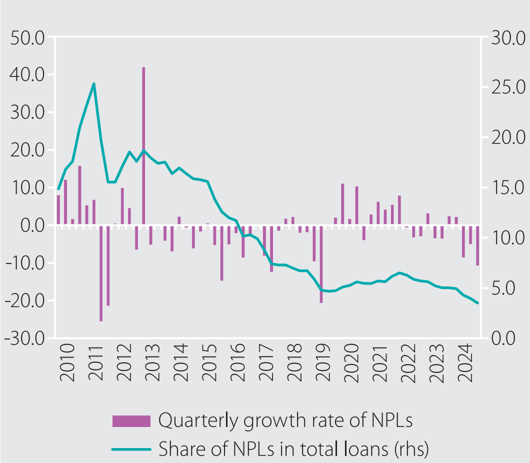
In general, 2024 was marked by a significant acceleration of credit activity. Total loans were at their historical maximum at the end of October 2024, while at the end of the year they amounted to 4.6 billion euros, achieving annual growth of 13.3%, while the share of net loans in assets increased during the year from 58.8% to 62.1%. The intensive credit activity is best reflected in the record volume of new loans, which amounted to 1.9 billion euros and were 23.4% higher than in 2023.

The largest share of the banks' loan portfolio refers to retail loans (42.5%), which have been recording positive growth rates since 2013 that have recently intensified, mainly due to the higher creditworthiness of households due to increased income. In 2024, this rate was 16.6%. The volume of new retail loans in 2024 was 43.8% higher year-over-year, amounting to 831.4 million euros. Individuals continue to use cash loans the most (59.1% of new retail loans), with the fact that the share of retail housing loans has recently become significant (20.9%).

Loans to resident non-financial institutions accounted for 33.3% of total loans at end-2024 and they increased by 18% at the annual level. Observed by new loans, this is still the sector that banks finance the most. The total amount of new loans to non-financial institutions was 974.3 million euros, which is 29.3% more than in 2023 and 24.9% more than in 2022. As in the previous years, the main share of new corporate loans referred to loans for liquidity (working capital). The share of liquidity loans in new corporate loans decreased from 63.4% in 2022 to 61.5% in 2023, additionally dropping down to 54.5% in 2024.

Graph 4.5

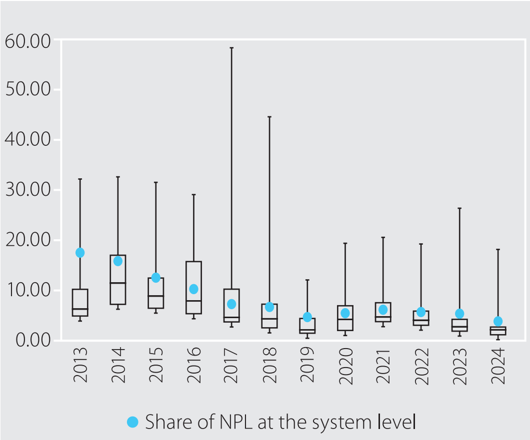
Quarterly growth rate and share of NPLs in total loans, %, 2010–2024



Source: CBCG

Graph 4.6

Distribution of the share of NPLs and their share at the system level, %, 2013–2024[16]



Source: CBCG

In terms of FX risk, i.e. currency-induced credit risk, the loans' currency structure is still very favourable. A negligible share of loans was approved in other foreign currencies, which has been characteristic of banks' loan portfolios for a longer period.

As for the maturity structure of loans according to the initial maturity, long-term loans accounted for 79.6% of loans at end-2024. If we look at gross loans, then long-term loans made up as much as 92.8%.

Looking at non-performing loans (NPLs), credit risk declined. At the aggregate level, NPLs` share in total loans fell by 1.5 pp year-on-year, down to 3.5% at the end of the reporting year (graph 4.6). At the end of 2024, all banks recorded a lower share of NPLs than at the end of 2023.

The sum of NPLs decreased by 20.7% and amounted to 163.1 million euros. The NPL to GDP ratio amounted to 2.2%, being lower compared to the end of the previous year (3%). Loans that were over 30 days past due decreased over the one-year period by 18.1% and accounted for 2% of total loans.

Distribution of the share of NLPs by banks at the end of 2024 indicates a somewhat different situation compared to end-2023 (graph 4.6). The range between the lowest and the highest share decreased, as did the range between the first and the third quartile, and the values recorded for the both were lower. The share of NPLs of all large banks was below the median value of NPLs of 3.9%.

[16] Reading from the bottom up, the graph's horizontal lines for each year mark the minimum, first quartile, second quartile (median), third quartile, and the maximum.

The change in the structure of loans by quality category was seen in the A loan category whose share increased from 80% to 80.8% during the year (graph 4.7). The share of B category loans increased from 15% to 15.7%, while their annual increase amounted to 18.4%. This category accounts for a significant portion of portfolios of one bank with a big market share and one bank with a small market share. The share of C category loans dropped to 2%, while the annual decline in the sum of C category loans amounted to 24.1%. D and E loan categories were much smaller in share and they accounted for 0.1% and 1.4% of total loans, respectively.

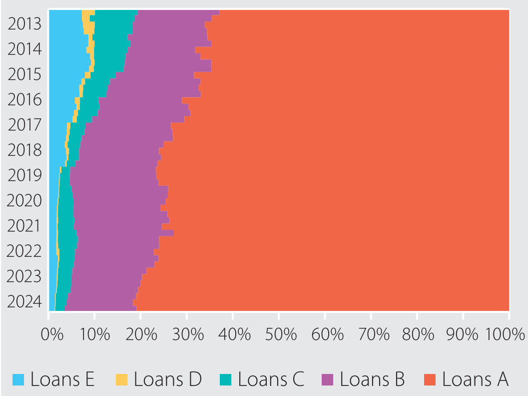
The condition of credit risk can also be viewed according to how banks perceived the risk trend on expected credit losses in accordance with the implementation of IFRS 9, which in this sense divides receivables into three levels/phases[17].

Phase 1 loans, which still represent the largest category, increased during every quarter, and their share in total loans reached 83.4% at the end of the reporting year. In 2024, banks "moved" loans from phase 1 to phase 2 less than in the previous year (graph 4.8). At end-2024, the annual decrease in phase 2 loans amounted to 0.2% and their share in total loans decreased from 14.6% to 13%. Loans in phase 3 registered the year-on-year decline during all quarters except the first one (3.6% at the end of 2024), and their share decreased from 5.1% to 3.6%.

The share of non-performing loans in total loans of non-financial institutions was 6.2% at end-2024, while it amounted to 9.6% at 2023. Credit risk was less pronounced in the retail sector. The sum of retail non-performing loans decreased by 17.2% and their share in total retail loans stood at 2.4% at end-2024. The share of retail loans that are more than 30 days past due was 2%.

Graph 4.7

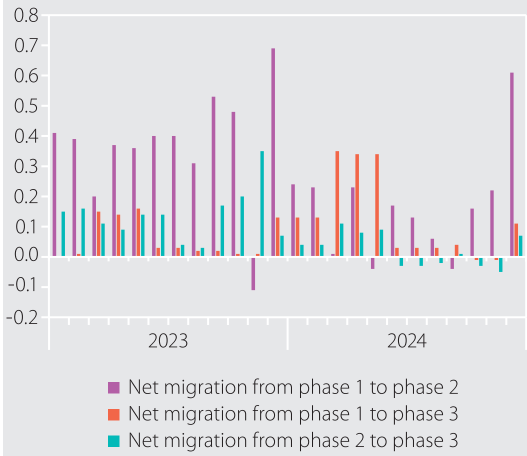
Trends of classified loans, %, 2013–2024



Source: CBCG

Graph 4.8

Monthly net loan migration per phases, % of total loans, 2023–2024

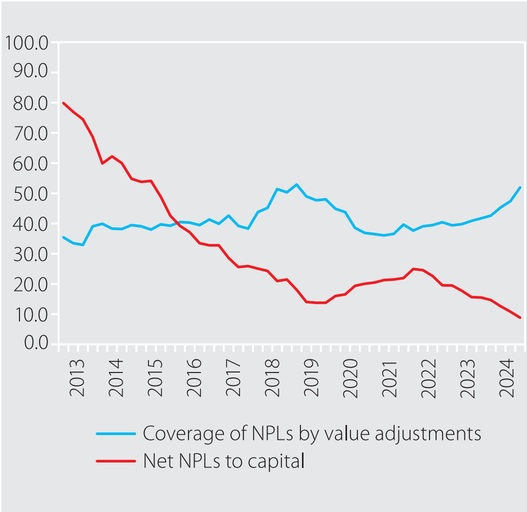


Source: CBCG

[17] Phase 1 includes financial instruments whose credit risk has not significantly deteriorated or which had low credit risk at the time of reporting. Phase 2 covers financial instruments where there was a significant increase in credit risk, but there was no objective evidence that loan losses had occurred. In phase 3, there are financial assets where there is objective evidence of the occurrence of credit losses, which essentially corresponds to non-performing loans, i.e. the sum of classification categories C, D and E.

Graph 4.9

Selected credit risk indicators, %, 2013–2024



Source: CBCG

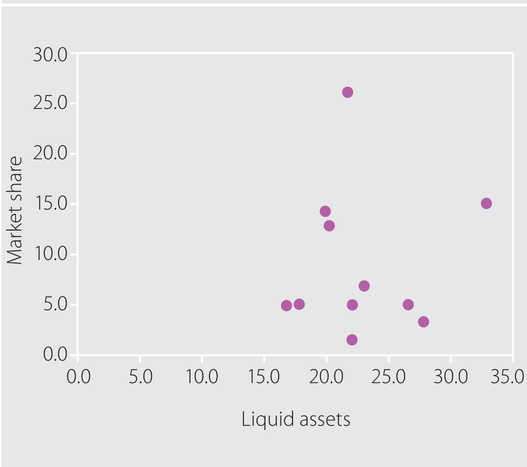
The coverage of non-performing loans by value adjustments for loan losses (only for non-performing loans) amounted to 51.9% at end-2024, while they stood at 44.4% at the previous year-end (graph 4.9). The ratio of net ("uncovered") non-performing loans and capital dropped from 13.9% to 8.8%.

During 2024, banks mostly continued to approve loans with a fixed interest rate, so the share of loans with a variable interest rate dropped to 7.6% (12.2% at the end of 2023). The downward trend in that share began in mid-2022, with the fact that in the second half of 2022 and during 2023, in addition to the transition to approving loans with a fixed interest rate, the decline in participation was also affected by the conversion of interest rates from variable to flat rates for previously approved loans (also as a result of the CBCG initiative, in the period when the ECB was planning to increase its reference interest rates).

4.3. Liquidity

Graph 4.10

Liquid assets of banks as per market share, %, 31/12/2024



Source: CBCG

Banks' liquid assets were in decline throughout the year, except in December 2024, when they amounted to 1.7 billion euros, recording the annual growth of 4.6%, only to decline again after December. Despite the decline, the level of liquid assets is still extremely high. At end-2024, liquid assets of banks accounted for 23.1% of total assets, which is 0.7 pp less year-on-year (graphs 4.10 and 4.11).

Throughout the year, banks maintained daily and ten-day liquidity indicators at a satisfactory level although these indicators generally tended to decline. Significant funds were available to banks for their liquidity needs on a very short notice, primarily deposits that banks hold in settlement accounts with the CBCG (besides reserves requirement), which amounted to 661.1 million euros or 39.6% of liquid assets at end-2024. Banks hold significant funds with foreign financial institutions and these are primarily demand deposits. They amounted to 593 million euros or 35.5% of liquid funds. Also, banks held cash in vaults in the amount of 238.9 million euros.

The loan to deposit ratio increased year-on-year and reached 79.5%, since the increase in loans (544.5 million euros) was about 50% higher than the increase in deposits (365.7 million euros).

Demand deposits accounted for the main share in the structure of deposits by maturity. At end-2024, they accounted for 85.3% of total deposits or 2.6 pp more than at the end of the previous year. For the purpose of comparison, this share was 42% at end-2013. This tendency can primarily be explained by the decline in passive interest rates, increased inflationary expectations in certain periods and more favourable return and risk ratios for alternative forms of investment. Thus, term deposits have become less attractive.

The ratio of liquid assets to financial liabilities up to one year stood at 28.7% and it was 1.1 pp lower year-on-year. If we observe the ratio of liquid assets to financial liabilities up to three months, then this ratio amounted to 31.1%.

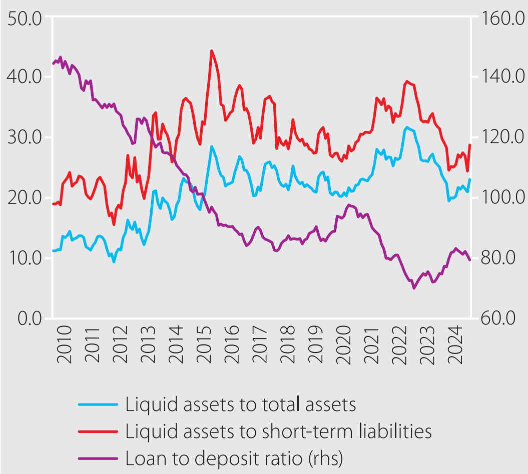
In January 2025, the ECB decided to extend the deadline for the CBCG for using the *EUREP* line until the end of January 2027. The extension of the credit line by the ECB represents additional safety for maintaining the stability of the country's financial system because in case of need, the *EUREP* facility allows Montenegro to access funds to support systemic liquidity in the amount of up to 250 million euros. So far, the CBCG has not used the *EUREP* line.

4.4. Solvency

Observed by capital indicators at the aggregate level, banks were adequately capitalized. At the system level, the total capital adequacy ratio stood at 19.4% at the end of the year, while the Tier 1 capital adequacy ratio was 18.6%. During the year, all banks in the system had capital ratios above the prescribed regulatory minimums, equal for all banks (4.5%, 6% and 8%).

Graph 4.11

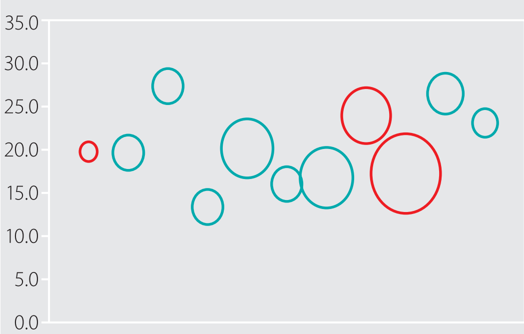
Liquid assets and loans to deposits ratio, %, 2010–2024



Source: CBCG

Graph 4.12

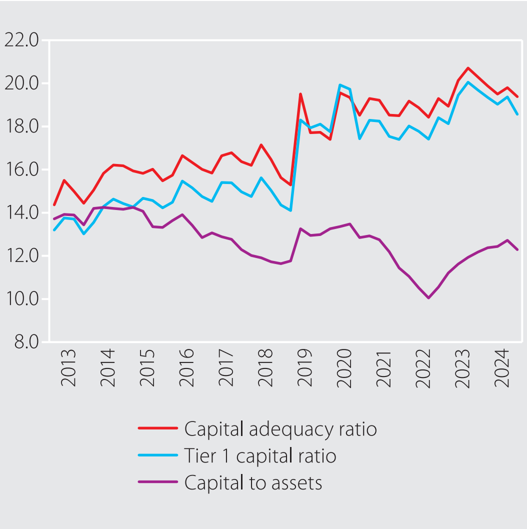
Capital adequacy ratio, %, 31/12/2024 (as per market share: bubble size and annual change: green - growth, red - decline)



Source: CBCG

Graph 4.13

Selected capital ratios, %, 2013–2024



Source: CBCG

At the four largest banks, the total capital adequacy ratio ranged from 16.8% to 23.9% (graph 4.12).

During 2024, one small bank carried out recapitalization through the issue of shares based on a public bid.

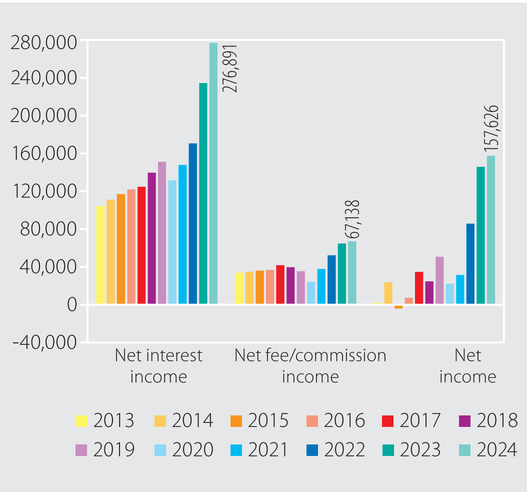
The total capital of banks recorded a growth of 8.6% and amounted to 890.9 million euros, primarily due to the banks' profit realized during the year. The share of total capital in total assets and liabilities of banks rose from 12.2% in 2023 to 12.3% in 2024, while the regulatory core capital/balance sheet ratio amounted to 9.3% (graph 4.13).

4.5. Profitability and interest rates

Banks recorded the highest profitability due to growing credit activity at a given interest margin, but also due to a growing non-interest income, thus, the growing profit trend started in the previous year continued. At the end of 2022 and during 2023, the difference between interest rates on loans and deposits recorded a significant increase, which was stopped in 2024.

Graph 4.14

Selected income statement components, in thousand euros, 2013 – 2024



Source: CBCG

Net profit of banks amounted to 157.6 million euros in 2024, which was 8% more than in the previous year. Four largest banks, which individually hold more than 10% of market share in terms of assets, recorded a profit of 123.8 million euros. One bank in the system operated with loss.

Interest income and similar revenues were 17.6% higher year-on-year at the system level. In recent years, income from fees and commissions have gained importance, and they amounted to 54.4% of interest income in 2024. After a decline in 2020, these incomes recorded a growth over the past four years and reached growth of 9%.

Net interest and similar income were 18.1% higher year-on-year, while net income from fees and commissions increased by 3.6% (graph 4.14).

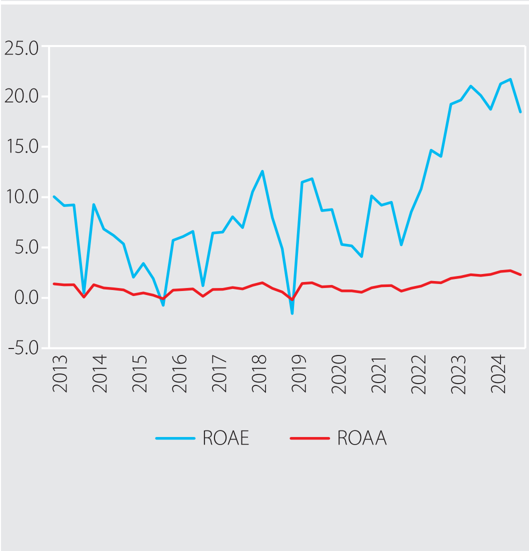
Impairment costs increased significantly (from -0.3 million euros in 2023 to 6.5 million euros), as well as provisioning costs (from -0.5 million euros in 2023 to 1.7 million euros), although their amount was not high enough to significantly affect banks' profitability in 2024.

In line with the improved financial performance, the ROAA was 2.3% in 2024, compared to 2.2% in 2023. On the other hand, the ROAE was lower and amounted to 18.5% as opposed to 20.1% in the previous year, due to the strong growth of average equity during the year (graph 4.15).

The breakdown of ROAE shows that net interest income had the largest positive contribution (graph 4.16). Regular expenses - employees' expenses and general and administrative expenses made up the largest part of banks' expenses. At the system level, banks` employee expenses increased by 13.7% year-on-year. Also, provisioning costs and impairment costs as part of other expenses made a negative contribution to the result in 2024, compared to the previous year when their contribution was positive.

Graph 4.15

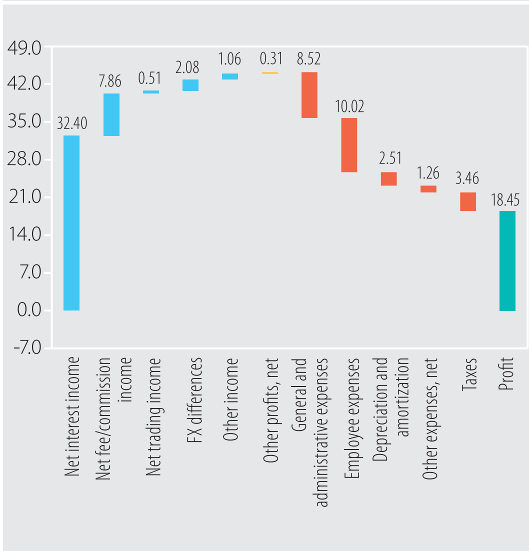
Selected profitability ratios, %, 2013–2024[18]



Source: CBCG

Graph 4.16

Components of banks' income statements in 2024, share in ROAE, percentage points[19]

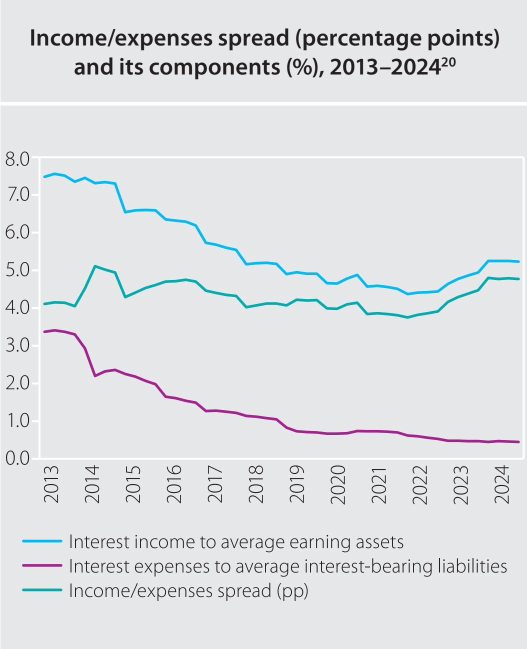


Source: CBCG

[18] Quarterly data for the first three quarters refers to cumulative amounts - first three months, first six months, and first nine months of the year, respectively, and for the annual level they were transferred by multiplying by 4, 2, and 4/3, respectively.

[19] From the graph above, net profit/loss: (1) due to derecognition of financial instruments that are not measured at fair value through income statement, (2) from financial instruments disclosed at fair value in income statement that are not held for trading, (3) from impairment of financial instruments that are not measured at fair value through income statement.

Graph 4.17

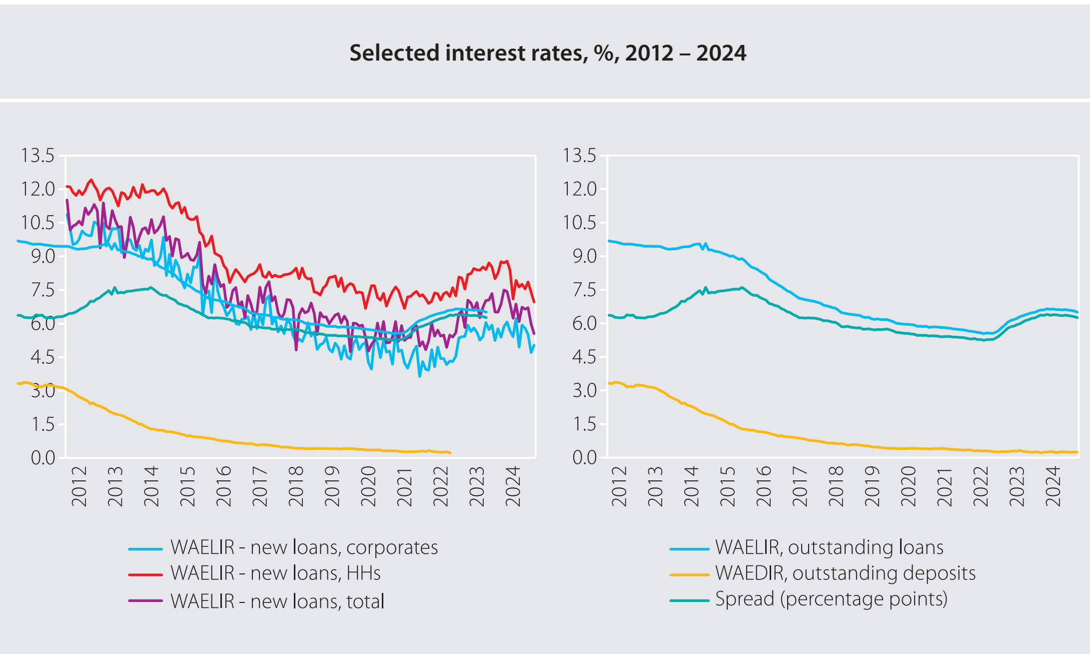


Source: CBCG

The difference between the interest income to average earning assets ratio and the interest expenses to average interest-bearing liabilities ratio was higher at end-2024 and amounted to 4.8 pp (graph 4.17). The spread per banks was very uneven, ranging from 2 pp to 6.6 pp. Average earning assets were 10.2% higher than in 2023, accounting for 83.7% of average assets.

The growth cycle of the WALIR (for the entire loan portfolio of banks, i.e. on outstanding principal/debt), which started in mid-2022, stopped in mid-2024 and has recorded a slight decline since then. During the year, the WALIR fell by 0.09 pp (graph 4.18). As for the WADIR, its annual growth was 0.03 pp. At end-2023, the WALIR was 6.50%, while the WADIR was 0.25%. Thus, the interest spread amounted to 6.25 pp at the year-end.

Graph 4.18



Source: CBCG

[20] Quarterly data for the first three quarters refers to cumulative amounts - first three months, first six months, and first nine months of the year, respectively, and for the annual level they were transferred by multiplying by 4, 2, and 4/3, respectively.

Lending interest rate on new loans was 0.17 pp lower compared to 2023 and it amounted to 6.52% in 2024. Its decline was driven more by the reduction of interest rates on new retail loans, where placements were 0.46 pp cheaper than the year before, while interest rates on new loans to the corporate sector were 0.19 pp lower.

4.6. Sensitivity analysis

Sensitivity testing using four credit risk tests showed a significant resilience of banks since all of them went through this testing (table 4.1)[21].

Table 4.1

Sensitivity analysis of credit and market risks, 31/12/2024

No.	Test	Solvency ratio after the test, %					Amount of lacking capital at the sector level, thousand euros	Number of banks that failed the test
		Minimum	Quartile 1	Quartile 3	Max	System		
		Solvency ratio before the test, %						
		13.4	17.0	23.5	27.4	19.4		
	Credit risk test							
1.	Negative reclassification of classified loans' structure[22]	11.3	15.3	22.0	24.1	17.4	0	0
2.	Increase in non-performing loans by 30% and value adjustments by 40%	11.0	16.6	23.0	26.5	18.8	0	0
3.	Large debtor bankruptcy[23]	11.7	16.1	22.7	25.2	18.3	0	0
4.	Largest debtor bankruptcy	11.0	14.9	21.8	22.9	16.9	0	0
	Market risks test							
1.	Interest rate increase by adding 2 pp to cumulative gap of interest rate sensitive positions with 181–365 days maturity	11.3	16.7	22.9	29.3	18.9	0	0
2.	Adjustment of net open FX position by 20%	13.5	17	23.5	27.4	19.4	0	0

Source: CBCG

As expected, the sensitivity to interest rate risk and the sensitivity to FX risk test showed minor negative impacts on the solvency ratio, which at the sector level in the first case decreased by 0.51 pp, to 18.9%, and in the latter case remained unchanged (table 4.1).

[21] Observed in relation to the statutory minimum for total regulatory capital that amounts to 8% of total exposure for all banks and it is equal for all banks.

[22] Reclassification of the structure of classified loans and receivables is implemented as follows: 1) category A – "pass" - calculated in the amount of 90%, and category B was increased by 10% of loans from category A, 2) category B – "special mention assets" – calculated in the amount of 95% of the increased category B, 3) category C – "substandard assets" – calculated in the amount of 5% from category B, whereby 95% of category C was kept, 4) category D – "doubtful assets" - calculated in the amount of 5% from category C assets, while 95% from category D was kept, and 5) category E - "loss" amount was increased by 5% of the amount from category D assets.

[23] Median value of the debt of banks' 20 top debtors.

Table 4.2

Sensitivity analysis of liquidity risk, 31/12/2024							
No.	Test	Coverage by immediately available liquid assets, thousand euros (899,580 as at 31 December 2024)			Coverage by available liquid assets, thousand euros (1,053,829 as at 31 December 2024)		
		Lacking amounts (-), sector, 000 euros	Number of banks that failed the test	Lacking amounts (-) for banks that failed the test	Lacking amounts (-), sector, 000 euros	Number of banks that failed the test	Lacking amounts (-) for banks that failed the test
1.	Withdrawal of 20% of deposits	-268.188	8	-328.246	-113.939	8	-209.590
2.	Withdrawal of 20% of demand deposits	-102.054	6	-211.177	52.195	6	-102.868
3.	Withdrawal of 10% of retail demand deposits and 30% of corporate demand deposits	-112.933	7	-220.071	41.316	5	-112.914
4.	Withdrawal of 20% of retail term deposits and 30% of corporate term deposits	703.510	0	0	857.759	0	0
5.	Withdrawal of deposits of the largest depositor	577.728	1	-1.867	731.977	0	0
6.	Withdrawal of 50% of deposits of 10 largest depositors	334.088	4	-78.545	488.337	4	-42.520
7.	Withdrawal of 30% of government deposits	662.686	0	0	816.935	0	0
8.	Withdrawal of 50% of government deposits	504.756	1	-1.602	659.005	0	0
9.	Withdrawal of 30% of non-resident deposits	506.992	3	-128.860	661.241	3	-100.303
10.	Withdrawal of 30% of deposits by non-residents from Russian Federation and Ukraine	807.625	0	0	961.874	0	0
11.	Withdrawal of 50% of deposits by non-residents from Russian Federation and Ukraine	746.322	1	-6.396	900.571	0	0

Source: CBCG

The sensitivity to liquidity risk test, actually tested as a risk of deposit run, was conducted through 11 extremely severe and less probable tests (table 4.2). In addition to the most liquid banks' funds in the country, the tests very conservatively assumed the possibility of using only 50% of the reserve requirement[24]. On the other hand, the possibility of using bank funds in the form of demand deposits held abroad, which amounted to 593 million euros at end-2023, was not assumed nor did the remaining 50% of the reserve requirement (154.2 million euros). Also, the options of selling non-cash assets (e.g. securities) or taking loans from parent banks, other participants in domestic or foreign markets or possibly from the CBCG or the government were not considered.

Even under these rigorous assumptions, testing expectedly indicated good liquidity of the banking sector as a whole although the most problematic was the first test where the sector as a whole could not respond to the withdrawal of deposits even after using 50% of the required reserve funds. In all other tests, inadequacy of liquid funds to cover deposit outflow would appear in some of the banks, and the most pronounced inadequacy even after the use of 50% of reserve requirement funds occurred after the conduct of the third test with five banks failing the test with the liquidity shortfall of 112.9 million euros.

However, with the use of deposits that banks have in foreign accounts and with the full amount of reserve requirement, every bank would pass all tests (with minor flaws in the first test). Again, it should

[24] Available liquid funds represent free liquid funds increased by 50% of reserve requirement. According to the Decision on reserve requirement of credit institutions at the Central Bank (OGM 19/22, 78/24), the bank can use up to 50% of the reserve requirement without the fee charged by the CBCG, if it returns taken funds by the end of the working day With the CBCG fee of 12% per year, the bank can use the funds of the reserve requirement even after the end of the working day.

be kept in mind that these conditions also exclude some of the abovementioned additional layers of liquidity in the form of sale of securities or potential borrowings from other entities.

4.7. Macro-stress testing

The results of the conducted stress testing indicate a satisfactory resilience of the banking system of Montenegro to the potential materialisation of unfavourable macroeconomic scenarios, due to the existence of a significant capital accumulation by credit institutions, which is primarily the result of the continuous prudential supervisory activities of the CBCG.

Using financial information with the balance as at 31 December 2023, the CBCG conducted regular annual stress resistance testing of all credit institutions during 2024 with the aim of determining additional capital needs. The process of stress testing is carried out through three stages:

Phase I – the trend of key macroeconomic variables is projected in the baseline scenario and the pessimistic scenario for 2024 and 2025 and the hypothetical scenario for 2024;

Phase II – the projection of the rate of non-performing loans is made for previously defined scenarios (three for 2024 and two for 2025);

Phase III – the simulation of the impact of the projected rate of non-performing loans on the capital adequacy ratios of credit institutions is carried out for each of the scenarios.

As a result of the first phase of macro stress testing, three scenarios were created - baseline, worst-case and hypothetical scenario of economic trends in 2024 and 2025. The scenarios describe the movement of key macroeconomic variables: GDP, unemployment rate, inflation, earnings, stock market index and real estate prices in the period 2024 - 2025. Table 4.3 gives an overview of trend assumptions for macroeconomic indicators in three scenarios in 2024 and two scenarios in 2025.

Table 4.3

Macroeconomic and financial variables assumptions, 2024-2025

Macro indicators - annual change	Three macro stress scenarios				
	Baseline		Worst-case		Hypothetical
	2024*	2025	2024	2025	2024
Real growth of GDP, %	3.60%	3.10%	2%	1.8%	-2.70%
Inflation, %	5%	3%	7.1%	4.50%	13.0%
Unemployment rate (in percentage points)	-2.2	-1	-1	-0.5	3%
Wages (% of change) **	7.6%	3%	4%	1.5%	-5%
MONEX20 (% of change)	2.1%	7.6%	1%	3.8%	-9%
Real estate prices (% of change)	7.7%	2%	2%	-7%	-15%

Notes:

* Model and expert projections of the CBCG, which are partially presented in the CBCG Annual Report for 2023, except for the MONEX20 projections, which are estimates of the Capital Market Authority of Montenegro.

** Nominal wage growth.

The baseline scenario is based on the projections of the CBCG of the trends of the given indicators in 2024, as well as on the CBCG estimates of the trends of these indicators in 2025.

The key feature of the worst/case scenario is higher and more persistent inflation, fuelled by the weaker transmission of lower prices in Europe through trade value chains, and a milder decline in food prices on the international market, as well as a potential increase in the prices of electricity on the domestic market. The aforementioned entails negative effects on private consumption. This scenario also predicts that some of the important infrastructure projects will not be implemented in 2024 and 2025, which will cause a more modest GDP growth of around 2% in both years.

The hypothetical scenario was created only for 2024 and, as the word itself implies, it is not realistic from the perspective of current macroeconomic and fiscal trends and forecasts. This scenario predicts an economic crisis caused by stagflation, i.e. the occurrence of negative growth and high inflation at the same time. This scenario was chosen because in the period after the Russian invasion of Ukraine there was a fear that high inflation would cause negative growth.

In addition to the above variables, the model for stress testing also includes a set of additional variables: banking competition index (HHI), FDI, the level of interest rates, as well as the level of credit activity of banks. All data were collected on a quarterly basis.

In this phase, by applying an adequate econometric model on a sample consisting of a set of macroeconomic and banking indicators (independent variables) and the share of non-performing loans in total loans - NPLs (dependent variable), we obtain the parameters that best describe the dependence of NPLs and macroeconomic/banking indicators.

The share of NPLs in total loans (NPL rate) is used as a dependent variable, that is, as a measure of credit risk. A separate model for each scenario was estimated for each of the eleven credit institutions. Several models were estimated, depending on the length of the time series, as well as the suitability of those series for the application of certain models. The econometric model used to estimate the rate of non-performing loans (NPL) in each of the eleven credit institutions is the error correction model (ECM), which is presented as model (2) in the text.

Although model (1) is theoretically set as the basic specification of the ARDL model, in practical application, its reparameterization in the form of ECM was used, which enables the analysis of both short-term and long-term relationships between variables:

$$npl\_rate_t = \beta_0 + \beta_1 npl_{rate(t-1)} + \beta_2 X_{it} + \sum_{k=0}^{t} \beta_3 X_{it-k} + time\_dummy + e_i \tag{1}$$

In this model, npl_rate_t represents the percentage of non-performing loans in total loans; $time\_dummy$ is a vector of artificial time variables that control for structural breaks in the independent variable; X is the vector of independent variables that include macroeconomic and banking indicators, e is the standard error in the regression, while β are the parameters of the independent variables estimated by the model. All macroeconomic series and banking variables have their own theoretical and empirical background, which is the reason for their incorporation into the model.

The model uses available time series relating to the period 2006 q1 – 2023 q4. The model was able to calculate NPLs in all eleven banks in the system. All diagnostic tests are found to be valid. Gross earnings, inflation, and credit series have been adjusted to account for changing definitions of these variables. Given the nature of quarterly data, the series have been adjusted for seasonal variations.

The Autoregressive Distributed Leg (ARDL) model was used, which is particularly suitable for stress testing: a) ARDL modelling allows connecting microeconomic variables (non-performing loans) with macroeconomic variables under the assumption that they are exogenous, b) ARDL model allows taking into account all short-term and long-term relationships (co-integrating relationships) between these variables, c) ARDL modelling does not require prior testing of the presence of a unit root during testing co-integration, d) enables neutrality regarding the order of integration of all variables in the model, which can be I(0) or I(1), co-integrated or not. The ARDL model is a reparameterization of the ECM model (error correction model). The ARDL model can be viewed as an ECM model that can model short-term and/or long-term relationships between endogenous variables and a set of exogenous variables: X determines Y, but Y does not determine X.

The form of ECM is:

$$\Delta y_t = \alpha - \underbrace{\psi(1)\left(y_{t-1} - \sum_{j=1}^{k} \frac{\beta_j(1)}{\psi(1)} x_{j,t-1}\right)}_{Long\ term\ dynamics} + \underbrace{\tilde{\psi}^*(L)\Delta y_{t-1} + \sum_{j=1}^{k} \gamma_j(L)\Delta x_{j,t}}_{Short\ term\ dynamics} + \varepsilon_t \qquad (2)$$

Based on the parameters obtained by model (2) which was applied to each credit institution individually, and the given assumptions for 2024 and 2025, the NPL rates in 2024 and 2025 were projected. The most significant impact on the level of non-performing loans is the level of inflation, GDP and real estate prices. Variables of the MONEX20 stock market index and unemployment have a partial influence, depending on the credit institution.

It should be considered that the model cannot predict factors in the banking sector in 2024 and 2025 that cannot be quantitatively covered (for example, the sale of a part of non-performing assets, removing „E“ category loans from balance sheet to internal records), and which can influence the level of NPLs to a larger or a lesser extent. Nevertheless, the projections of the rates of non-performing loans in the past few years indicate that, in most cases, they are very similar to the actual rates of NPLs.

During the third phase of testing credit institutions' resilience to stress, a simulation of the impact of projected NPL growth on capital adequacy ratios (own funds, Tier 1, and total capital) for 2024 and 2025 was carried out. The parameters of credit institutions' operations on 31 December 2023 were taken as a starting point, assuming a static balance sheet and income statement. This means that when projecting the growth of value adjustment, missing reserves, i.e. the growth of the risk-weighted value, the assumption of a constant proportion of these parameters in total gross non-performing loans, i.e. risk-weighted assets for exposures that are in default status was taken.

In order to determine the effects of the projected level of gross non-performing loans on capital adequacy of credit institutions, the gross loan balance as of 31 December 2023 is taken as a starting point, followed by the amount of gross non-performing loans, their share in gross loans, the coverage of non-performing loans by value adjustments, as well as the missing reserves allocated for non-performing loans.

The simulation of the impact of NPL growth on capital adequacy ratios was performed in three steps. In the first step, the increase in the amount of value adjustments and missing reserves due to the projected increase in the amount of non-performing loans was simulated. Having in mind that the increase in value adjustments leads to an increase in impairment costs that reduce the operating result, the effect on the net profit of the tested credit institutions was quantified. At the same time, the impact of the growth of missing reserves on the amount of own funds, which was reduced by the increase in deductible items was quantified.

In the second step, a simulation of the growth of risk-weighted assets was carried out based on the migration of certain exposure categories to the exposure category with default status. Namely, by using the structure of exposures in the status of default, which are distributed according to the exposure categories in which they would be classified if they were not in the status of default (non-performing loans), the amount of exposures previously assigned a lower risk weight (0%, 20%, 35%, 50% and 75%) was determined, which, due to the increase in the amount of non-performing loans, will migrate to the exposure category assigned a risk weight of 100%, after which the effect of migration was quantified.

In the third step, the results of the simulations from the first two steps were sublimated and the capital adequacy ratios (own funds, Tier 1, and total capital) were calculated.

The results of the third phase of stress testing of credit institutions gave the expected results, that is, they confirmed the resilience of the banking sector to shocks that would manifest through the growth of non-performing loans of credit institutions. At this moment, it can be concluded that there is generally a significant capital accumulation of credit institutions as a result of the temporary measures introduced by the CBCG during the COVID-19 pandemic, including the ban on dividend payments. In addition, the CBCG's prudential supervisory dialogue with credit institutions, which is reflected in the expectation of credit institutions to lead a prudent dividend payment policy, is generating results so that credit institutions are obliged to demonstrate that after paying the intended amount of dividends, they are able to meet all prudential requirements in the next three years in the event of the realization of a stress resistance scenario, which is based on at least three scenarios of varying degrees of rigorousness specific to the credit institution's risk profile.

By adopting macroprudential measures and performing supervisory functions, the CBCG monitors operations of credit institutions, assesses the level of capital of credit institutions, the level of risk taken by credit institutions in their operations, observes trends in the financial markets and makes decisions within its competence in order to preserve financial stability and maintain confidence in the banking system as a whole.

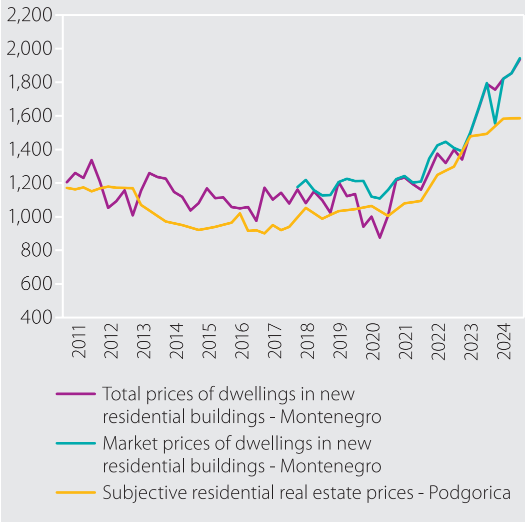
4.8. Real Estate Market

Real estate prices are important for assessing financial stability, considering the contribution of housing loans to the current upward credit cycle, and the fact that real estate is one of the most important forms of collateral, which secures both housing and mortgage loans. The imbalance in real estate prices increases the impact of sudden shocks that can directly or indirectly affect the balance sheets of banks. That is why monitoring the real estate market is necessary in order to try to prevent the development of cyclical risks by increasing the resilience of the banking system to sudden shocks. Also, the CBCG has the ability to impose measures in the form of borrowing conditions, which can prevent the accumulation of credit risk associated with the real estate market.

Newly built apartments reached a new historical high in 2024 although growth slowed down compared to the previous year. In Podgorica, the market value of newly built apartments reached 1,938 euros per square meter, which represents the annual growth of 8.2% (26.1% in 2023). The average market prices of newly built apartments throughout Montenegro had almost the same value (1,943 euros[25]) with the same annual growth rate. According to the results of the CBCG`s December 2024 survey on real estate prices, the average price of all residential real estates per square meter in Podgorica was 1,586 euros, which represents a growth of 6% compared to the results of the December 2023 survey[26] (graph 4.19). The prices obtained in this way follow the general growth trend, but due to certain shortcomings of the survey, i.e. untimely or inadequate information of the respondents, they are significantly lower than the transaction prices of newly built apartments (MONSTAT data).

Graph 4.19

Prices of residential buildings obtained using the Hedonic Index and prices of apartments in newly constructed buildings, in euros[27]



Source: CBCG and MONSTAT

The CBCG also conducted a survey among real estate agencies[28], which showed that 24% of agencies recorded an increase in turnover in 2024, while 48% of agencies saw a decline in turnover. Most of the real estate agencies (64%) believe that the real estate price per square meter increased. The majority of agencies (64%) expect prices to remain at the same level in 2025, and half of the agencies (52%) believe that overall demand in the next year will be the same. When asked about the growth of demand from abroad, which has been significant over the last three years and is generally the key[29] factor of the price growth, the agencies in this survey were optimistic, given that 36% of them expect this demand to grow, and 44% expect it to remain unchanged.

Housing loans are a significant determinant of demand on the real estate market, and the most important trends are presented in Table 4.4. Their growth rate in 2024 was 15.3%, and the cumulative growth compared to the end of 2020 was about 60% (according to data from the Credit Registry).

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25 It should be noted that the differences in the prices of newly built apartments mostly depend on the share of the Montenegrin Fund for Solidarity Housing Development, so the higher the share of these housing units, the lower the prices of newly built apartments and vice versa. In 2024, the average price of apartments of solidarity housing development was 589 euros for a square meter.

26 As per the Hedonic Index obtained from the CBCG survey where the prices do not reflect actual prices but essentially represent subjective prices of the real estate owners, i.e. the prices below which they would not be willing to sell their property.

27 The market price per square meter of an apartment in a new building includes apartments sold by companies, while the total price in a new building also includes apartments sold by institutions of solidarity housing development.

28 For the purpose of the analysis, 150 real estate agencies were surveyed, most of which have their activities in Podgorica and the coastal region of Montenegro. Answers were submitted by 25 agencies.

29 The leading factor in the growth of real estate prices were FDI in real estate, which in the period 2022-2024 amounted to 1.37 billion euros, or an average of 6.8% of nominal GDP per year, which is significantly more than in the multi-year period before that.

The growth of retail housing loans is also visible through new loans, so the annual cumulative of new loans has grown at an accelerated pace since 2022, and especially in 2024 (almost 50%). Retail housing loans show a growth trend in retail loans, total loans and GDP, and their growth is accompanied by a larger number of credit sub-accounts and a larger average amount of loans. The value in relation to the GDP was still significantly lower than the EU average (over third of the GDP value) which, observed historically, may be the result of lower solvency of citizens, but also less favourable lending conditions compared to the EU countries.

Table 4.4

Housing loans, 2019-2024					
Year	Stock at end-year, in thousand euros	Year-over-year growth, %	% of GDP	% of total loans	New housing loans, in thousand euros
2019	391,493	6.3	7.9	12.8	84,512
2020	415,154	6.0	9.9	13.1	67,214
2021	439,929	6.0	8.9	13.1	84,182
2022	535,123	21.6	9.0	14.6	111,209
2023	575,217	7.5	8.3	14.1	115,961
2024	663,203	15.3	8.9	14.3	173,659

Source: CBCG

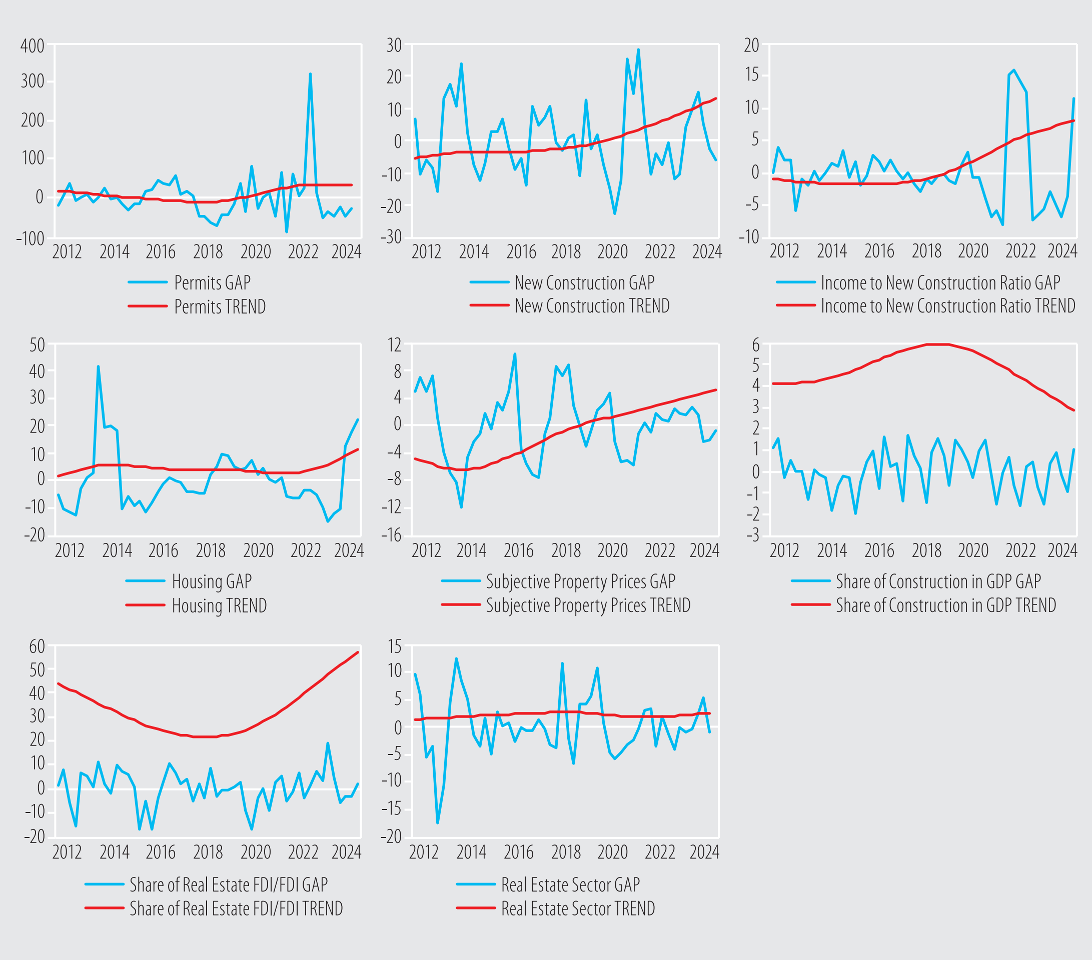
The survey on banks' lending activity assessed the retail demand for housing loans as growing, which was particularly obvious in the second half of 2024. Also, banks clearly expressed their willingness to finance the purchase of residential buildings. In all four surveys conducted in 2024, banks reported a decrease in rejected housing loan applications for the survey period. The explanation can be found in relaxed lending standards in all quarters of 2024, and the reasons were increased willingness to take risks, better risk perception (better general economic situation and prospects, lower credit risk, and the like) and significantly stronger competition among banks. In addition, the conditions for housing loans were more favourable, and the reasons cited were the interest rate margin, collateral requirements, mortgage and deposit values, maturity, commissions and fees.

Considering the importance of the real estate market for the business cycle and financial stability, a risk assessment of the market was performed. For this assessment, five indicators monitored in the period 2012-2024 were used to approximate the real (fundamental) value of real estate. Any major deviation from the calculated real estate value could signal increased risk in the real estate market which, as the financial crisis has shown, may affect financial stability. Considering the period of high inflation in 2022 and 2023, certain variables are deflationary in order to subtract the price effect.

Therefore, six series were used for this analysis, which describe the market value, domestic and foreign demand, and the offer on the real estate market. The prices of dwellings in newly built apartments in Montenegro approximate the market value of real estate. The ratio of net earnings and the price of newly built apartments as well as the percentage growth of housing loans in Montenegro approximate the domestic demand for real estate in Montenegro through the inclusion of the citizens` purchasing power and the demand for external sources of real estate financing. The share of foreign direct investments (FDI) in real estate in total FDIs approximates the foreign demand for real estate, which is very important considering that Montenegro is recognized as a tourist destination and has had a high influx of non-residents in the past period. The level of supply on the real estate market is described through the subjective assessment of real estate owners of the price of their real estate and through the share of construction in GDP. Also, in order to improve the analysis, two series were added: a) the number of issued construction permits and notifications of construction activities, and b) real estate business (one of the GDP aggregates).

Graph 4.20

Deviation from the real value of real estate during the period 2012-2024



Source: CBCG

These series are available for the period 2012-2024, on a quarterly basis. In order to assess the deviation from the real value of real estate, cyclical trends were calculated using the HP filter method. The given cyclical trends are presented in graph 4.20.

a) **Newly built apartments_GAP and Trend**: The prices of newly built apartments recorded short-term oscillations, with pronounced volatility during certain periods, but despite these fluctuations, the long-term trend is clear - as of 2020, a gradual and then accelerated growth can be observed. This upward trend may be a consequence of rising demand, rising construction costs, as well as inflationary pressures in the construction sector. This may indicate growth in demand, increased construction costs, as well as the effect of increased inflation in the construction sector. Although there are oscillations around the trend, the long-term trend suggests continued growth in real estate prices.

b) **Earnings/Newly constructed apartments_GAP and Trend ratio**: The ratio of net earnings/prices of newly constructed apartments shows oscillations during the analysed period, with the observed worsening of affordability in phases of pronounced growth in real estate prices. However, according to 2024 data, a partial improvement of this ratio was observed due to a significant growth of net wages primarily stimulated by the increase in wages within the „Europe Now 2" Program. At the same time, there was an increase in the prices of new construction, but with a slightly slower dynamics, which contributed to temporary mitigation of the unfavourable trend in the affordability of apartments.

The improvement in the ratio of earnings to prices of newly constructed apartments in the fourth quarter of 2024 (19.3%) contributed to the increased demand for housing space, which was additionally reflected in the growth of housing loans for natural persons of 18.3% during the same year. This development, along with the growth of activity in the construction sector - both in the value of completed works (+2.4%) and effective working hours (+1.6%) - is an indicator of positive short-term trends in the real estate market. However, from a long-term trend perspective, it remains important to monitor the sustainability of this improvement, given the potential volatility in price and income trends.

c) **Housing loans_GAP and Trend**: The trend in housing loans is characterized by oscillations, but the long-term trend clearly indicates gradual growth of lending activity. During 2024, a significant increase of 18.3% in housing loans of natural persons was recorded, which indicates a strong demand for external financing in the retail sector. This increase is partially related to the improvement of the ratio between net earnings and new construction prices, as well as favourable lending conditions.

Increased availability of loans, low interest rates and economic policy measures – including the increase in minimum wages – further boosted the demand for apartments, thus strengthening the upward trend in lending. Although this development can have a positive impact on economic growth and construction, , it requires careful monitoring of potential risks at the same time, especially in the case of a change in the interest rate environment or deterioration of macroeconomic conditions.

d) **Share of real estate FDI/FDI_GAP and Trend**: The share of FDI in real estates recorded certain oscillations during the observed period, while it is still maintained at a relatively high level. The long-term trend indicates the continued interest of foreign investors in the Montenegrin real estate market, which may be a consequence of the attractiveness of tourist destinations, favourable tax treatment and a stable investment environment.

However, according to the latest data, the FDI share in real estate in total FDI inflows has declined – from 53.7% in 2023 to 51.2% in 2024 – which may indicate a slight diversification of investment flows to other economy sectors. Although the overall level of investments in real estate remains high, short-term fluctuations confirm the sensitivity of the sector to changes in global economic and geopolitical factors.

e) **Subjective real estate prices_GAP and Trend**: Real estate owners' perception of the market value of their buildings varies, with sharp declines in crisis periods. However, the trend indicates a long-term positive trajectory, which suggests a stabilization of market expectations. A rise in the subjective assessment of real estate values may reflect increased demand, an improved economic situation, or an increase in optimism among real estate owners.

f) **Share of construction/GDP_GAP and Trend**: The deviation indicator (GAP) shows pronounced cyclical oscillations throughout the analysed period. Seasonal fluctuations are visible, with periods of increased construction activity followed by phases of decline. Oscillations have been particularly pronounced since 2014, which may indicate a high level of sensitivity of the construction sector to macroeconomic conditions, including investment cycles, changes in demand and availability of financing. In recent years, although the GAP is still subject to variations, there has been a slight recovery compared to previous periods of stagnation. The trend shows a gradual increase in the share of the construction sector in GDP from 2012 to 2019, reaching its peak in 2019 and 2020. After that, the trend begins to decline, which may signal a decrease in investment activity in the construction sector or a redistribution of the economic structure in favour of other sectors. This decline may be the result of the economic consequences of the COVID-19 pandemic, increased costs of construction materials, reduced foreign investment or changes in the regulatory framework. Although the trend is still above the initial level of 2012, a continuation of the negative trajectory may indicate long-term challenges for the sector.

g) **Construction permits_GAP and Trend**: The number of construction permits issued shows strong fluctuations, especially in periods of economic uncertainty. However, the long-term trend indicates a gradual increase in the number of construction permits issued, which may indicate increased investment activity and optimism in the real estate sector. This trend is a positive indicator of future growth of the construction industry, but it can also indicate a growing investment cycle that can be sensitive to external economic dynamics.

h) **Real estate sector_GAP and Trend**: Real estate business shows pronounced oscillations throughout the analysed period, with cyclical deviations depending on the economic situation. The long-term trend indicates gradual growth in the real estate sector, which may reflect increased economic activity, FDI growth and improved market dynamics. Nevertheless, the present oscillations point to the need for prudent risk management in order to ensure market stability.

Finally, adding trends enables a deeper analysis of long-term trends in the real estate market in Montenegro, providing a clearer insight into fundamental changes in the sector. Most of the analysed variables show a growing tendency, which suggests increased demand, more intense lending activity and strong investment interest, both from domestic and foreign market participants. Although short-term oscillations are present, long-term trends point to stabilization of the market, noting that the relationship between earnings and real estate prices improved moderately in 2024 - which positively affected demand and lending activity. However, from a sustainability point of view, it is important to continue monitoring this relationship in the medium and long term, given its key impact on affordability of real estate.

The increased role of construction and the real estate sector in the Montenegrin economy is clearly visible through the growing trend of investments, FDI and lending activities. However, certain indicators such as the share of construction in GDP and subjective estimates of real estate prices, show signs of slowing down after the peak recorded in previous years. This may indicate a phase of market maturity or a potential correction due to external economic factors such as rising financing costs, inflation or regulatory changes. Therefore, continuous monitoring of market indicators is essential for timely identification of potential risks.

Although the market demonstrates resilience and a growth trend, prudent macroeconomic policy is essential to maintain the balance between supply and demand, prevent speculative behaviour, and ensure the sector's long-term stability. In addition, it is important to observe structural changes in economic activity, such as the diversification of investments and the increase in the affordability of residential real estates. In this context, tracking trends through relevant indicators enables the implementation of timely and targeted economic policies that can contribute to the sustainable development of Montenegro's real estate market.

4.9. Capital Market

The Montenegro Stock Exchange recorded a turnover of 9.7 million euros (0.1% of GDP) in 2024, which is even less than in 2023 when it totalled 12.3 million euros.

Trading with shares made up 93.8% of the total turnover, of which trading with shares of companies other than investment funds amounted to 9.1 million euros and trading with shares of investment funds to a mere 23.5 thousand euros. Bonds were traded in the amount of 0.6 million euros, and it was almost entirely related to the corporate bonds trade. The rest of the total turnover related to the primary turnover on the stock exchange, which was realized in the amount of 0.7 million euros.

At end-2024, the SE indices MONEX and MNSE10 stood at 16,433.46 and 1,085.52 points, respectively, recording the respective year-on-year growths of 5.5% and 2.1%. Despite the growth recorded in the last few years, the value of the MONEX index is still significantly lower than in the period of strong expansion in 2007, which was followed by a sharp decline, and the index has never returned to those levels.

4.10. Payment Systems

The CBCG`s payment system, which consists of the RTGS system and the DNS system, worked almost without interruption and in accordance with the time schedule of the system during all 253 working days in 2024. During 2024, out of 137,885 minutes of production, there were 84 minutes of downtime (27 minutes in March, seven minutes in May, and 50 minutes in June), so the availability of the system was a high (99.94%).

A total of 14.6 million transactions worth 24.8 billion euros were effected, which is 7% and 12.9% more than in 2023, respectively. Of the total number of transactions, 38.7% were effected in the RTGS system, with the share in the total value of transactions of 94.2%. On the other hand, 61.3% of the total number of transactions were effected in the DNS system (5.8% of the total value of payments).

There was a relatively small number of rejected and pending transactions, which indicates that liquidity of participants in the system was excellent and that the reasons for putting payments on hold and/or refusing payments were primarily of technical and/or operational nature. Due to insufficient funds in the account, 48 payments (all in the RTGS system) were put on hold. Of these, 46 were executed following the inflow of funds during the day, one payment was not processed due to a continued lack of funds by the end of the day, and one was cancelled by the operator with the consent of the participant.

Observing the intraday liquidity of banks, it can be said that the initial balances in the RTGS accounts of banks were largely sufficient to cover their outgoing payments, with some variations by banks that had no impact on liquidity risk.

4.11. Macroprudential policy

The CBCG adopts macroprudential measures as part of the activities it carries out with a view to preserving financial stability and with which it targets the prevention or mitigation of certain systemic risks. First and foremost, the CBCG uses capital buffers as protective layers of capital. Capital buffers were introduced by the Law on Credit Institutions, which initially transposed the provisions of the CRD IV/CRR[30] package into the Montenegrin regulatory framework, and which provided for the Basel III implementation in the EU. As of 20 March 2025, the CRD V/CRR II[31] package was implemented in Montenegro and credit institutions have nine months to harmonize their operations with the provisions of the law implementing the package.

In accordance with its Macroprudential Policy Framework[32], the CBCG may deploy other available macroprudential measures. Additionally, besides macroprudential measures in the strict sense of the word, the CBCG may deploy other measures to preserve financial stability, as was the practice before the adoption of the Law on Credit Institutions, and it continues to do so.

During 2024, the CBCG actively used capital buffers (table 4.5). At the end of the year, the request for the combined buffer ranged from 3.375% to 3.875%, or up to 3.885%, considering countercyclical capital buffer specific rate.

Table 4.5

Current capital buffers, %, 31/12/2024	
Buffer	Buffer level
Capital conservation buffer[33]	1.875%
Structural systemic risk buffer[34]	1.5%
Buffer for other systemically important credit institutions[35]	1,25–2%
Countercyclical capital buffer[36]	0%

Source: CBCG

30 Directive 2013/36/EU and Regulation 2013/575

31 Directive 2019/878/EU and Regulation 2019/876

32 https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_naslovna/macroprudential_policy_framework.pdf

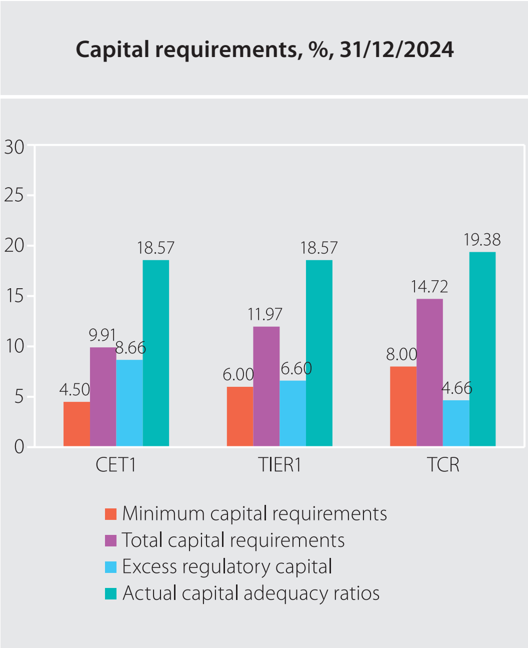
33 Article 138 of the Law on Credit Institutions (OGM 72/19, 82/20, 8/21, 24/25) https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_brzi_linkovi/propisi/laws/law_on_credit_institutions_unoff_consol_24-25.pdf

34 https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_fin_stabilnost/obavjestenje_bafer_strukturni_sistemski_rizik_01122023_eng.pdf

35 https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_fin_stabilnost/information_on_review_O-SICI_identification_and_determining_buffer_rates_for_O-SICIs_290324.pdf

36 https://www.cbcg.me/slike_i_fajlovi/eng/fajlovi/fajlovi_fin_stabilnost/information_on_countercyclical_capital_buffer_rate_in_q4-2024_300924.pdf

Graph 4.21



Source: CBCG

In addition to the macroprudential capital requirements, additional individual capital requirements within pillar II were also in force as well as minimum capital requirements that are the same for all banks. Thus, the minimum requirement for the Common Equity Tier 1 capital amounted to 9.91%[37] at the system level. Minimum requirements for Tier 1 capital amounted to 11.97%, and the minimum requirement for own funds amounted to 14.72% at the system level. However, many banks allocated excess capital, which resulted in the actual capital ratio of 18.57% for the Common Equity Tier 1 and Tier 1 capital, and 19.38% for total capital ratio (graph 4.21).

Capital conservation buffer is specified in the Law on Credit Institutions, which prescribes the gradual introduction, i.e. increasing this buffer.[38] In 2024, the capital conservation buffer rate was 1.875%. As of 1 January 2025, the buffer rate is 2.5% of the total amount of risk exposure, which is in line with Basel III.

Structural systemic risk buffer is reviewed every two years, and during the last review conducted at the end of 2023, it was estimated that the measures from the Law and other enabling regulations would not be sufficient to address the risk to the financial system. Structural systemic risks in Montenegro mostly come from the real economy, that is, from macroeconomic imbalances of various types, rather than from the financial system. Therefore, the CBCG prescribed the structural systemic risk buffer rate at the level of 1.5%, with equal implementation to all exposures. The latter stipulates that only one of the buffers is to be applied to a given credit institution and that is the higher of the structural systemic risk buffer or the O-SICI buffer. This provision was amended with the transposition of the CRD V / CRR II package into the Law on Credit Institutions[39] in 2025, according to which these buffers will be aggregated.

Buffer for other systemically important (OSI) credit institutions is reviewed annually.[40] The CBCG last determined the OSI buffer rates for the period starting from 31 March 2024, in the range of 1.25% – 2%, depending on the degree of systemic importance of the given credit institution. The procedure mainly used data submitted of credit institutions submitted to the CBCG in the regular reporting process for the fourth quarter of 2023. On this occasion, the CBCG identified eight other systemically important credit institutions.

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[37] Percentages in this and the following sentence refer to all capital requirements, including additional capital requirements within pillar II and capital buffers.

[38] Article 386 of the Law on Credit Institution.

[39] Article 138 of the Law on Credit Institutions, Article 131 of the Directive (EU) 2019/878.

[40] Decision on identifying other systemically important credit institutions (OGM 127/20, 17/25).

In general, OSI credit institutions are those institutions whose "whose disruption in business operations or termination of business operations can lead to a systemic risk in Montenegro". The CBCG determines these institutions on the basis of the Decision on Identifying Other Systemically Important Credit Institutions (OGM 127/20), i.e. the methodology that forms an integral part of that Decision. This methodology is fully compliant with the EBA Guidelines on O-SII Assessment (EBA/GL/2014/10) and it is based on the four criteria: 1) size of a credit institution; 2) importance for the economy of Montenegro; 3) complexity of cross-border activities; and 4) interconnectedness with the financial system.

Table 4.6

OSI credit institutions and buffer rates for OSI credit institutions determined as of 31 March 2024

OSI credit institution	Points	OSI buffer rate for credit institution, %
Crnogorska Komercijalna Bank AD Podgorica	2,162	2.00
NLB Bank AD Podgorica	1,876	2.00
Hipotekarna Bank AD Podgorica	1,369	2.00
ERSTE Bank AD Podgorica	945	2.00
Zapad Bank AD Podgorica	793	2.00
Adriatic Bank AD Podgorica	684	2.00
Lovćen Bank AD Podgorica	589	1.25
Prva Bank Crne Gore AD Podgorica	456	2.00

Source: CBCG

Countercyclical capital buffer - during the review of adequacy of the rate carried out in the first quarter of 2024, in order to preserve the resilience of the banking sector to the potential materialisation of cyclical systemic risks, the CBCG decided to increase this rate and thus for the first time introduced a non-zero countercyclical capital buffer rate (0.5%), which became effective as of 1 April 2025. In the last quarter of 2024, the CBCG once again increased the countercyclical capital buffer rate (1%) which will become effective as of 1 January 2026[41].

Namely, certain indicators pointed to the accumulation of cyclical risks, primarily in the domain of credit growth and further growth in real estate prices. Intensive credit growth was particularly pronounced in the household sector, which is partly the result of the increase in wages in the previous period. Cash and housing loans led the way, and loan expansion was also evident through the record volume of new loans. Prices of newly built apartments reached a new record high, thus contributing to cyclical vulnerabilities.

During 2024, the countercyclical buffer rate was maintained at the level of 0%, in accordance with the previous decisions of the CBCG. More precisely, the buffer rate for exposures in Montenegro was 0%, with the fact that in the case of foreign exposures, credit institutions are generally obliged to apply the buffer rates prescribed by the competent authorities for buffers in other countries, weight all buffer rates according to the proportion of exposures to each country in its total exposures, and thereby calculate the so-called institution-specific countercyclical capital buffer rate. During 2024, there was very

[41] Both increases were implemented in line with the Decision on increasing the countercyclical capital buffer rate (OGM 27/24, 125/24).

little allocation of capital for the countercyclical buffer based on the exposure of credit institutions abroad, i.e. the buffer rate specific to the credit institution was rarely above 0%.

In addition to capital buffers, macroprudential measures related to retail loans granted by credit institutions were also in place. The measures have been implemented since 2020 with the aim of establishing the sustainability of retail sector lending in the context of preserving financial stability by the CBCG. The measures limit the maturity of cash retail loans for private individuals that do not have a high-quality collateral up to 10 years and/or to 8 and/or 6 years, depending on the size and quality of the portfolio of those loans for each individual credit institution. Cash retail loans had a dynamic growth in 2024 as well, so the validity of the Decision on macroprudential measures related to retail loans granted by credit institutions was extended until the end of 2025. For example, according to the Credit Registry, a record amount of cash retail loans of 492.08 million euros was approved. It is 55.91% more compared to 2023, whereby 73.54% of them were loans with agreed maturity of five years or more.

4.12. Indebtedness indicators for retail debtors

During 2024, the CBCG started collecting data from credit institutions on the indebtedness indicators of retail debtors. Namely, according to the Decision on criteria and the manner of classification of assets and calculation of provisions for potential loan losses of a credit institutions (OGM 127/20, 140/21), credit institutions are required to calculate the ratio of LTI, DTI, LSTI, DSTI and LTV[42] for the purposes of assessing the indebtedness of a debtor who is a natural person, as well as to internally determine the acceptable level of indebtedness when approving retail loans based on these ratios. As of the middle of the year, banks began to report to the CBCG on a monthly basis the calculated ratios for all individual new claims, which in some cases also include claims based on leasing, overdrafts and credit cards. In the medium term, the CBCG plans to establish a structured way of reporting, most likely through the Credit Registry, which will include uniform and more detailed definitions of the constituent components of the aforementioned ratios. All this will form a high-quality statistical base for the CBCG to prescribe limits in the future, i.e. maximum levels of individual ratios, if necessary.

The existing reporting system enables the CBCG to monitor risks in the segment of retail loans to a reasonably good extent, including the possibility of eventual introducing limits for individual ratios. At the same time, the CBCG is planning to introduce a structured reporting system, which will entail a corresponding legal act - either a new decision or amendments to some of the existing CBCG decisions.

For example, in December 2024, banks reported 8,291 new claims for which they calculated at least one of the abovementioned ratios, in the total amount of 86.7 million euros[43]. It was mainly about loans (97.6% of the amount), while the rest related to credit cards, overdrafts and leasing. All loans

[42] LTI (*loan-to-income*), the ratio between the amount of the approved loan and the debtor's total annual income; DTI (*debt-to-income*), the ratio of the total debt based on the loan and the total annual income of the debtor; LSTI (*loan-service-to-income*), the ratio of the annual cost of repaying the loan and the debtor's total annual income; DSTI (*debt-service-to-income*), which represents the ratio of the annual cost of repayment of the total loan debt and the debtor's total annual income, and LTV (loan-to-value), the ratio of the amount of the approved loan to the estimated value of the collateral.

[43] The data presented in this part of the text should be interpreted primarily in the sense of presenting the activities undertaken by the CBCG in that area, and bearing in mind that it is only about one part of the situation (receivables/loans that were approved only in December 2024), and in any case they should be interpreted with a certain reserve, because the CBCG did not collect them through official reporting.

were approved in euros, and were resident retail loans, with a fixed interest rate, monthly repayment method and mostly belonged to the „A" category. Of the total amount of approved loans, 93.2% related to cash (62.6%), housing (22.1%) and refinancing loans (8.4%). Regarding maturity, only 7.7% of the amount related to loans with a maturity up to three years, 67.1% to loans with agreed maturity from three to ten years, and 25.2% to loans with agreed maturity over ten years.

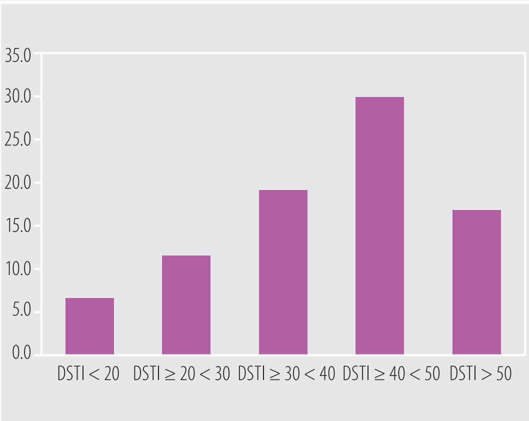
In the structure of loans according to DSTI (calculated by the banks for 6,908 loans amounting to 84.1 million euros)[44], 35.6% related to loans approved with DSTI in the range of 40% - 50%, which is an increased level of DSTI, and 44% of loans with DSTI lower than 40% (graph 4.22). With a DSTI of over 50%, 20% of the loan amount was approved, which can be problematic, even though it was a smaller number of loans (935 or 13.5%). The average DSTI was 37.1% and the average DSTI weighted by loan amounts was 40.3%.

A DSTI above 50% means that after debt servicing for all loans, including the loan in question, the debtor is left with less than 50% of income, which is especially controversial for debtors with a lower income level. In Montenegro, enforced collection against a debtor's funds cannot be carried out in the amount exceeding 50% of the salary, which usually constitutes the majority of the debtor's regular income, and could make the situation even more problematic. However, it may be that other forms of income were considered (besides salary) when approving some of the mentioned loans and, also, about half of the amount of loans approved with DSTI of over 50% related to housing loans secured by real estate, which makes the accumulation of risk lower than it seems.

In the structure of loans according to LTV (calculated by banks for 344 loans amounting to 25.4 million euros), 31.6% related to loans approved with LTV in the range of 80% - 90%, which is a slightly higher level of LTV, and 61.2% of loans with DSTI lower than 80% (graph 4.23). Some 7.3% of the loan amount was approved (30 loans or 8.7% of the number) with LTV of over 90%. The average LTV was 63.4%, and the average LTV weighted by loan amounts was 68.1%.

Graph 4.22

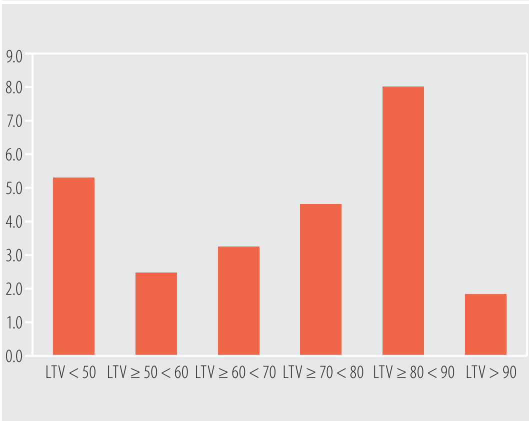
New loans in December 2024 according to DSTI, in millions euros



Source: Banks' monthly reports

Graph 4.23

New loans in December 2024 according to LTV, in million euros



Source: Banks' monthly reports

[44] Loans for which the banks did not report the calculated DSTI/LTV, as well as certain loans with excessively high and thus unreliable DSTI/LTV values, are excluded from the scope of data related to DSTI and LTV.

In the structure of the amount of housing loans according to DSTI and LTV, 34.1% of housing loans were approved with DSTI above 40% and LTV above 80%, which can be problematic, although only 2.3% of housing loans were approved with DSTI above 50% and LTV above 90%.

Table 4.7

New housing loans in December 2024 according to DSTI and LTV, %

	LTV < 50	LTV ≥ 50< 60	LTV ≥ 60< 70	LTV ≥ 70< 80	LTV ≥ 80< 90	LTV> 90	Total
DSTI> 50	2.4	4.2	5.0	7.9	14.8	2.3	**36.5**
DSTI ≥ 40< 50	2.4	2.2	3.8	3.2	11.5	5.5	**28.6**
DSTI ≥ 30< 40	1.1	1.5	2.7	5.4	11.3	0.4	**22.4**
DSTI ≥ 20< 30	3.1	0.3	1.2	1.4	2.1	0.5	**8.5**
DSTI < 20	1.8	0.7	0.0	0.8	0.9	0.0	**4.1**
Total	**10.7**	**8.8**	**12.7**	**18.7**	**40.5**	**8.6**	**100.0**

Source: Banks' monthly reports

As stated, this reporting represents the statistical base for the potential introduction of a limit, i.e. maximum levels of certain ratios, which belongs to the group of „borrower-based measures-BBMs", i.e. measures imposed on loan beneficiaries. These are macroprudential measures which directly affect the preservation of the debtor's financial position, by limiting the level of their indebtedness, and indirectly also the stability of banks as creditors, by reducing the possibility of losses. Usually, the measures are introduced for new loans (not for previously approved and outstanding loans), so it takes a certain amount of time to fully account for their impact.

In recent years, measures affecting loan beneficiaries have become quite prominent in macroprudential policy, especially in the EU member states where they are currently introduced in 24 out of 27 countries (they do not exist in Denmark, Italy and Spain)[45]. There are no measures of this type that are valid at the level of the entire EU, but individual member states are in charge of their introduction. Restrictions are sometimes set in the form of recommendations, which in some cases turn into measures over time. In addition to the ratios mentioned above, the measures aimed at loan beneficiaries also include those measures related to the maturity of loans or loan repayments, which are often combined with some of the ratios that are subject to limits. Usually, measures are adopted for debtors who are natural persons, and very rarely or legal persons as well.

In our environment, the most characteristic examples are Croatia, The Republic of North Macedonia and Slovenia. The Croatian National Bank introduced DSTI limits of 40% for non-residential loans and 45% for residential loans, as well as a 90% LTV limit for loans secured by real estate. In addition, the maturity for non-housing loans is limited to 10 years, and for housing loans to 30 years. Certain deviations from the mentioned limits on DSTI and LTV are allowed, which in the case of housing loans mainly refer to situations in which debtors solve their housing issue, i.e. finance the purchase of their first real estate. The Decision on the measures was adopted in mid-March 2025, and will enter into force as of 1 July 2025.

[45] The data sources for the text below are the European Systemic Risk Board (https://www.esrb.europa.eu/national_policy/html/index.en.html) and the mentioned central banks of the surrounding countries.

The National Bank of North Macedonia adopted measures limiting DSTI to 50% for foreign currency loans and loans with a currency clause, i.e. to 55% for loans approved in the local currency – Macedonian denar, while the LTV for loans secured by real estate is limited to 85%. Also, the maturity of non-residential mortgage loans is limited to 20 years, while the maturity of housing loans is limited to 30 years. The measures have been in effect as of 1 July 2023.

The Bank of Slovenia has longer track record with measures aimed at loan beneficiaries since it first introduced such measures in 2016, and the measures currently in force are the following: 1) a limit on DSTI of 50%, with the fact that after servicing the loan debt, the debtor must not have less than the amount necessary to cover basic living expenses, which is currently estimated at 745 euros, and 2) a limit on the maturity of cash loans that are not secured by residential real estate, at seven years. In addition to the measures, there is also a recommendation for a limit on LTV for housing loans of 70%, and 80% for those housing loans that finance the purchase of the borrower's primary real estates.

5. CONCLUSION

After a strong economic growth in 2023, Montenegro`s economic activity recorded a significantly lower growth rate of 3%. Lower parameters were recorded in the tourism sector. High inflation recorded in the previous period saw a decline and in 2024 we witnessed the inflation rate that was the lowest since 2021.

However, key indicators show that risks are still present, i.e. that the financial position of non-financial institutions and households, the two main groups of clients to which banks are exposed, has substantially improved but remains susceptible to challenges.

The situation in government finances is relatively stable, bearing in mind mostly balanced expenditures in the period 2023-2024, the level of public debt, and a slight improvement in the credit rating to B+ which is still far from the investment rating. New borrowings over the year increased public debt to 61.3% of GDP. The most pronounced risks in public finances relate to significant repayments of old debts and financing of the capital budget, so the next period may be particularly challenging, bearing in mind the associated rating and deterioration of lending conditions on the international market at the beginning of March 2025. Indirectly, the public debt level in the case of Montenegro points to a relatively weak international competitiveness, high spending relative to low accumulation, and dependence on foreign capital inflows. In the context of geopolitical turmoil and the tightening of financing conditions on the international market, a resolute continuation of responsible and well-balanced fiscal policy measures aimed at solving structural economic problems is necessary.

The fiscal situation is relevant for the preservation of financial stability given the banks' exposure to the government in the form of securities and loans, although this exposure was significantly reduced during 2024 and amounted to 11.6% of total assets or 3.1 pp less compared to the end of 2023. In 2024, the government relied far less on new borrowing from banks than it had in the previous year.

The banking sector remained solvent, liquid and profitable. Deposit growth remained stable, with banks increasingly channelling these funds into lending rather than into liquid assets or securities. The stability of the banking system is reflected to a significant extent in the stability of deposits, which at the end of 2024 amounted to a record 5.84 billion euros. Numerous risks that characterized banks in the previous period were at a low level at the end of the year. Banks recorded the highest profitability due to growing lending activity at a given interest margin, but also due to a growing non-interest income. Net profit of banks amounted to 157.6 million euros in 2024, which was 8% more than in the previous year.

In order to preserve the banking system resilience to potential materialisation of cyclical systemic risks, the CBCG increased the countercyclical capital buffer rate twice during 2024, first to 0.5% and then to 1%. Certain indicators pointed to the accumulation of cyclical risks, primarily in the domain of credit growth and further growth in real estate prices. In addition to capital buffers, macroprudential measures related to retail loans granted by credit institutions are also in place. The measures have been implemented since 2020 with the aim of establishing sustainability of retail lending as the lending activity and the average maturity of loans in the segment of cash loans are above the level that is optimal from the point of view of financial stability.

As for capital requirements, in addition to the main capital requirements prescribed by law and equal for all banks, additional individual capital requirements were also applied within Pillar II, as well as capital buffers. In addition, banks held excess regulatory capital so the capital adequacy ratio at the system level was 19.4%, thus indicating a high resilience of banks to potential further problems with non-performing loans or a decline in the value of other asset items

ANNEX

Table 1 – Financial Soundness Indicators (FSIs), 2019–2024

	2019	2020	2021	2022	2023	2024			
	XII	XII	XII	XII	XII	III	VI	IX	XII
Core FSIs for credit institutions									
Regulatory capital to risk weighted assets [1]	17.7	18.5	18.5	19.3	20.3	19.9	19.5	19.8	19.4
Tier 1 capital to risk weighted assets [1]	18.1	17.4	17.4	18.4	19.7	19.4	19.0	19.4	18.6
Nonperforming loans net of provisions to capital [2]	14.9	21.2	22.6	21.4	18.4	18.7	15.7	14.0	11.2
Common Equity Tier 1 capital to risk-weighted assets [1]	---	---	---	18.3	19.7	19.4	19.0	19.4	18.6
Tier 1 capital to assets	10.0	9.9	9.2	8.0	8.6	9.1	9.3	9.2	8.8
Nonperforming loans to total gross loans [3]	5.1	5.9	6.8	6.3	5.8	5.8	5.1	4.8	4.1
Nonperforming loans to total gross loans [4]	4.7	5.5	6.2	5.7	5.0	4.9	4.3	4.0	3.5
Loan concentration of loans by economic activity [5]	67.4	66.5	67.1	66.7	64.5	64.5	64.7	62.6	62.4
Provisions to non-performing loans	52.9	40.0	42.4	43.0	44.4	42.6	45.3	47.3	51.9
Return on assets [6]	1.2	0.5	0.7	1.7	2.6	2.6	2.9	3.0	2.7
Return on equity [7]	8.7	3.7	4.5	13.5	19.3	18.9	21.2	21.6	18.5
Interest margin to gross income [8]	56.6	60.8	55.6	54.0	55.9	60.9	58.1	56.8	57.6
Noninterest expenses to gross income	75.8	74.4	75.7	58.4	57.6	56.4	55.4	56.3	58.8
Liquid assets to total assets [9]	20.6	21.8	26.0	30.7	23.5	19.3	20.1	21.8	22.9
Liquid assets to short-term liabilities [10]	31.1	35.1	39.7	42.9	32.2	26.6	27.6	29.6	31.1
Liquidity coverage ratio [11]	---	---	---	317.7	310.7	323.3	281.3	324.1	315.7
Net stable funding ratio [11]	---	---	---	---	---	---	---	---	---
Net open position in foreign exchange to capital [12]	0.6	0.7	0.1	0.1	-0.3	-0.3	-0.1	0.4	0.3
Residential real estate prices (percentage change/last 12 months) [13]	3.4	-11.3	15.3	20.5	28.0	31.0	21.4	12.8	8.2
Additional financial soundness indicators									
Credit institutions									
Large exposures to capital [14]	97.4	96.8	118.1	131.5	121.1	109.4	114.9	116.4	125.5
Geographical distribution of loans to total loans [15]									
Domestic economy	96.7	97.2	95.7	94.7	94.9	95.3	95.1	95.1	95.4
Advanced economies	0.6	0.7	0.5	0.5	0.7	0.8	0.9	1.0	0.8
Emerging market and developing economies	2.6	2.1	3.8	4.8	4.5	3.9	4.0	3.9	3.8

Table 1 – Financial Soundness Indicators (FSIs), 2019–2024 – continued

	2019	2020	2021	2022	2023	2024			
	XII	XII	XII	XII	XII	III	VI	IX	XII
Emerging and developing Asia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Emerging and developing Europe, excluding Montenegro	1.7	1.2	1.6	2.6	2.5	1.9	2.1	2.1	2.0
Latin America and the Caribbean	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Middle East and Central Asia	0.9	1.0	2.3	2.2	2.0	2.0	1.9	1.9	1.8
Sub-Saharan Africa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross asset position in financial derivatives to capital [12]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross liability position in financial derivatives to capital [12]	0.1	0.0	0.0	0.0	0.4	0.3	0.2	0.4	0.4
Trading income to total income [16]	3.8	3.1	3.8	3.6	4.6	5.0	5.6	5.2	4.7
Personnel expenses to noninterest expenses	36.9	35.0	30.2	37.3	31.7	33.4	32.4	31.0	30.7
Spread between reference lending and deposit rates (basis points) [17]	561	546	532	567	638	636	636	634	625
Customer deposits to total (no interbank) loans [18]	116.1	108.3	131.0	151.9	147.2	138.3	133.6	139.8	136.5
Foreign-currency-denominated loans to total loans [19]	0.4	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.3
Foreign-currency-denominated liabilities to total liabilities [20]	6.4	4.8	5.3	4.8	4.8	5.0	5.2	4.8	4.6
Credit growth to private sector [21]	6.6	3.0	3.4	8.8	6.3	7.9	11.2	13.5	17.1
Real Estate Markets									
Residential real estate loans to total gross loans [22]	13.9	14.3	14.2	14.9	14.1	13.7	16.4	17.0	17.0
Commercial real estate loans to total gross loans [23]	6.1	5.5	5.6	5.5	5.9	5.9	5.9	5.9	6.2

The text of all footnotes can be found in the excel file available at https://www.cbcg.me/en/statistics/statistical/financial-soundness-indicators, and the most important footnotes are presented below.

3/ Non-performing loans refer only to the principal of loans, without interest and prepayments and accruals of interest and fees. On the other hand, total loans (in addition to the principal) include interest and prepayments and accruals of interest and fees for performing loans, while interest and prepayments and accruals of interest and fees for non-performing loans are excluded from the scope. Exceptionally, for the period before 2013, total loans in addition to the principal include only the mentioned interest rates, because data on prepayments and accruals of interest and fees were not available.
Prior to 2013, loans classified in category E (i.e. in the worst classification category - „loss“) were kept in off-balance sheet, so that the counter of this indicator (i.e. non-performing loans) contains loans classified as E, while the denominator of this indicator (i.e. total loans) does not contain the same.

4/ Internal definition, according to the methodology used in the CBCG.
By definition, interest and prepayments and accruals of interest and fees are completely excluded from both non-performing loans and total loans. Also, according to the IFRS 9 requirements (formerly IAS 39), the definition treats deposits of credit institutions deposited with other credit institutions as loans, which is particularly relevant for account no. 1009 (from the Decision on the accounting framework for credit institutions, (OGM 128/20). Prior to 2013, the definition of loans did not include the aforementioned deposits.

* 01 January * On 01 January 2018, IFRS 9 replaced IAS 39, with limited impact on the comparability of data series before and starting from 01 January 2018.
IAS 39 is introduced on January 2013 the introduction of IAS 39 resulted in incomparability of a significant number of data series before and starting from 1 January 2013 Most importantly, on 01 January 2013: non-performing loans increased, as well as accounting capital, then total loans to a lesser extent and to an even lesser extent asset. The comparability of loan loss provisions, and therefore the comparability of net profit, was also affected by the change. As a consequence, all indicators calculated using these data series are basically incomparable before and starting from 1 January 2013 the consistency of other data series or indicators, such as liquid assets or capital adequacy ratios, has been largely maintained.

Source: Quarterly and monthly reports of banks; MONSTAT

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