

Montenegro

The reduced impact of the pandemic and the re-opening of borders contributed to the economic rebound in 2021. The revival of tourism and related activities had an effect on the return of economic activity to the zone of renewed growth i.e., the real GDP grew at a double-digit rate of 12.4%.

The level of public debt continues to represent a key systemic risk in Montenegro. Namely, after a certain reduction of public debt in relation to GDP during 2016 and 2017, public debt increased from 64.2% to 105.3% of GDP in period 2018-2020, mainly due to indebtedness under the loan for the construction of the priority section of the highway and due to the coronavirus pandemic. In 2021, the debt reduced to 84.8% of GDP due to the economic rebound and the repayment of the matured debt arising from the issued Eurobonds.

When it comes to the banking sector, very good capitalization was preserved, since the solvency ratio decreased slightly during the year, as a result of the application of measures from the Asset Quality Review, but it was still at a significantly higher level than the statutory prescribed minimum. In addition, the liquidity of banks was still high, with additional growth during the year. The following vulnerabilities stand out among the main structural vulnerabilities of banks: the share of bad loans in total loans, exposure of banks to the state, exposure of banks to the household sector (especially in the case of cash loans), as well as an increase in the maturity mismatch between sources and funds (due to the general increase in the share of demand deposits from one side and long-term loans on the other side). The real picture of the situation regarding non-performing loans and the solvency ratio was additionally confirmed after the completion of the Asset Quality Review (AQR) process, as well as after the expiry of most of the interim measures of the Central Bank, which provided a significant relief for the regulatory treatment of loans.

Banks are the most stable segment of the economic system, which is reflected to a significant extent in the stability of deposits in the banking sector. At the end of 2021, they amounted to a record € 4.2 billion, making up by far the largest part of banks' liabilities (78.8%). The growth of deposits led to the growth of bank assets, whereby the banks diverted received funds much more into the liquid assets and less into loans. During 2021, total liquid assets of banks increased by 38.3% to € 1.4 billion, their share in relation to assets and to deposits increased also to 26.4% and 33.4% (from 22.2% and 30.1%), respectively. With regard to the structural limitations to the growth of the Montenegrin economy, these liquid assets are currently the best safety reserve for banks against the risk of asset quality deterioration and/or deposit outflows.

At the end of 2021, financial sector assets amounted to € 5.7 billion or 116.3% of GDP, which is the result of a significant increase in banks' assets, as well as an incomplete recovery of GDP compared to the pre-crisis level. The banking sector continues to be the backbone of financial intermediation in Montenegro and occupies a dominant position in the assets of the financial system (93.3%).

Deposits have been the dominant source of funding for banks for many years and accounted for 78.8% of liabilities at the end of 2021. Their share in the balance sheet total increased by 5.3 percentage points on an annual basis. Due to the coronavirus pandemic, at the end of 2020, deposits recorded their first annual decline since 2010. Nevertheless, from September 2020 to the end of 2021, deposits increased every month, which during 2021 amounted to € 828.4 million or 24.6%. Thus, total deposits were at a historical

maximum of € 4.2 billion, and such an inflow of deposits undoubtedly indicates the confidence in the banking sector.

In 2021, banks' lending activity has slightly intensified. Total loans were at a historical maximum in August and amounted to € 3.53 billion, although they decreased to € 3.36 billion by the end of the year. Observed in terms of new loans, lending activity amounted to € 1.11 billion, which is an annual growth of 22.6%. In general, lending activity was not at the level of the pre-crisis period, but in the circumstances of the ongoing coronavirus pandemic, it was of a satisfactory volume.

Banks' liquid assets amounted to € 1.4 billion, and its annual growth was 38.3%. Liquid assets accounted for 26.4% of total assets, which is an increase of 4.2 percentage points compared to the end of the previous year.

At the end of 2021, total capital of banks was higher by 3.4% compared to end 2020 and it amounted to € 609.5 million. The share of total capital in the balance sheet total was 11.4%, while the share of initial capital in the balance sheet total was 9.3%.