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MACROECONOMICAL ANALYSIS OF THE BANKING SECTOR AS KEY PART OF FINANCIAL SYSTEM OF MONTENEGRO DURING COVID CRYSIS 2020 - 2022

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ABSTRACT

Financial markets have a great influence on the functioning of the economy as a whole. During the last decade, the economic environment has become extremely dynamic and risky, and the financial institutions exposed to risk are constantly working on the application of mechanisms of protection and preservation of stability. The post-Covid period and the looming energy crisis have influenced main financial institutions to seriously deal with the protection of the financial system of Montenegro. The dominant part of the financial market, over 90%, is made up of banks, through which most of the financial intermediation takes place. In this paper, we will deal with the analysis of the importance of the role of the financial system of Montenegro, with a special focus on the banking sector.

***Keywords**: financial system, financial markets, banking system in Montenegro*

INTRODUCTION

The central bank has a significant role in preserving financial stability, which includes the healthy functioning of the financial system - financial intermediaries, financial markets and financial infrastructure, in order to facilitate not only the efficient allocation of financial resources and the normal functioning of the economy, but also special action in conditions of crises and imbalance in the market.

The development of the financial system has a great impact on economic activity, especially in the period of crisis, which requires greater control and regulation, strengthening of trust in the financial system, unhindered provision of financial services and risk protection. Therefore, it is important to continuously analyze and assess the impact of the macroeconomic environment on financial stability and analyze the functioning of key financial institutions, and act correctively and preventively by adjusting the financial framework, all with the aim of reducing the harmful consequences of crises.

Globalization is one of the most significant factors in the development of financial market and it has brought the integration and exchange of ideas, goods, capital, people, money, etc. Also, financial innovations and the appearance of new financial products have led to an increase in interest and a simpler way of accessing new markets, supported by the development of information technologies. The two most recent crises, Covid-19 and the Ukrainian crisis, hit Montenegro as a small economy

and reminded us that we must always be ready for new challenges in international markets. The global crisis of 2008-2009 (started on the US mortgage market), the public debt crisis in certain EU countries in 2010-2011 (Greece, Ireland, Portugal, Italy, Spain), as well as the latest crisis from the first half of 2020 caused by the pandemic of the Covid-19 virus, warn us how modern the world is and how small disruptions in one market segment or part of the world can have a big impact and implications on all others. Therefore, the role of financial institutions is significant in terms of preventive action and preservation of financial stability.

According to world's reports, EMDE growth is projected to roughly halve this year, slowing from 6.6 percent in 2021 to 3.4 percent in 2022—well below its annual average of 4.8 percent over 2011-19, despite a partial recovery from the

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pandemic1. The slowdown in part reflects the spillovers from the war in Ukraine, which have led to commodity price volatility, higher input costs, trade disruptions, and weaker confidence.

Financial stress could spread across countries. The production and shipping of food and fertilizer could be further disrupted, leading to widespread food shortages, pushing millions of people into food insecurity and extreme poverty. The pandemic could worsen due to the appearance of new, more virulent variants and lead to the reintroduction of disruptive control measures2.

External disturbances, such as the pandemic caused by the corona virus, have affected the measures taken by European leaders. In July 2020 EU announced that they had approved a €750 billion(about $859 billion) pandemic relief package and a multi-year EU budget, referred to as the Multiannual Financial Framework (MFF), with a combined value of over €2 trillion. The pandemic plan was developed to direct funding to post-pandemic economic recovery efforts with the European Commission set to borrow an unprecedented amount of funds on European capital markets3. A central bank's main objective during a financial crisis is to contain the damage and limit the impact on the real economy. The first imperative is to restore calm in financial markets. Market panics create the equivalent of a financial heart attack by cutting off the flow of credit even to healthy institutions. This amplifies the damage in the financial system and is one of the main transmission channels through which a panic affects the real economy. Central banks must therefore reduce uncertainty, ensure that markets for short-term credit function properly, and prevent the collapse of financial institutions due to liquidity restrictions4.

The impact of economic crises influenced policy makers to focus on the resistance of the financial and banking system to external shocks and to be as stable and secure as possible. More stable financial systems can assure better market competitiveness of banks. More competitive banking systems have a positive effect on the creation of companies. (addopted according to Dell'Ariccia, Giovanni and Emilia Bonaccorsi di Patti, 2004)

Deposit Protection Fund of Montenegro plays a significant role in preserving financial stability and improving depositors' trust in the Montenegrin banking system. The Fund's mission is to ensure the security of deposits in banks and thus contribute to the stability of the financial system, based on trust and protection of depositors.

Banking sector as a key part of financial system of Montenegro

The financial system has been a key contributor to the overall macroeconomic stability of Montenegro for many years through its position as one of the most important factors of economic system. In this context, in addition to the inert capital market and the lack of a money market on the one hand, or the stable insurance sector on the other, the banking sector plays a dominant role in the multi-year stability of the financial system of Montenegro and it is therefore the subject of this analysis. Today, 11 banks are successfully operating in Montenegro, 9 of which are majority-owned by non-residents, while 12 banks were operating at the end of 2020. The most significant indicators at the sector level for the years 2018 - 2022 are as follows:5

	2018	2019	2020	2021	2022
Total assets					
In total, in 000 euro	4.407.089	4.603.933	4.586.507	5.328.584	6.404.252

[1] Global Economic Prospects, June 2022, available on: https://openknowledge.worldbank.org/bitstream/handle/10986/37224/Global-Economic-Prospects-June-2022-Global-Outlook.pdf
[2] Ibid
[3] Global Economic Effects Report, 2021, CRS, available on: https://sgp.fas.org/crs/row/R46270.pdf
[4] Vittorio Corbo, "Financial stability in a crisis: What is the role of the central bank?", available on: https://www.bis.org/publ/bppdf/bispap51f.pdf
[5] Council for Financial Stability, Annual Report for 2020, Annex 1: Overview of the financial market in Montenegro, p.1

Annual change in %	5,38	4,47	-0,39	16,18	20,19
Total credits					
In total, in 000 euro	2.929.239	3.061.751	3.159.161	3.360.303	3.660.118
Annual change in %	8,47	4,52	3,18	6,37	8,92
Total deposits					
In total, in 000 euro	3.459.222	3.475.778	3.372.852	4.201.242	5.224.315
Annual change in %	5,88	0,48	-2,96	24,56	24,35
Solvency ratio					
In total in %	15,63	17,73	18,52	18,50	19,32
Liquidity ratio (liquid assets / total bank assets)					
In total in %	22,57	20,79	22,15	26,36	31,04
Financial result					
Profit/loss, in 000 euros	24.809	48.654	22.335	27.500	83.305

Year 2020:

The structure of the balance sheet of banks during the crisis year of 2020 did not change significantly. Deposits have been the dominant source of bank financing for many years and made 73,5% of liabilities at the end of the year. Under the influence of the crisis, during 2020 deposits were the lowest in May, when their decline compared to the end of 2019 amounted to 5,1% or 176,6 million €, while at the end of 2020 they were lower compared to the end of 2019 by 3% or 102,9 million, amounting to 3,37 billion €.[6] Most of the new loans, which were one of the ways of improvement liquidity of banks, had a maturity of up to one year and were mostly loans from parent banks.

The credit activity of banks was, as expected, significantly lower in the first wave of the pandemic, but it recovered towards the end of the year, reaching its maximum value in November. The measures taken by Central Bank of Montenegro (CBCG) contributed to stability and confidence in the system and cash was at a satisfactory level throughout the year, so the banks were able to meet the needs of the population and the economy.

The largest part of the portfolio of securities consisted of government securities (79,1%). With a favorable interest rate, the regulatory risk weight for this form of investment is 0%, which means that banks generate income on that part of assets without a regulatory requirement to allocate capital on that basis.

[6] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.28

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The exposure of banks towards state decreased to 14,7% of total assets at the end of 2020, from 16,1% at the end of 2019. The total exposure of banks towards state amounted to 673,3 million €.7.

Credit growth had a slower pace compared to several previous years. Total loans increased by 3,2% on an annual basis and amounted to 3,16 billion € at the end of 2020.

The largest share of banks' loan portfolio refers to household loans (44,1%), while loans from resident non-financial institutions make up 35% of total loans, and they increased by 2,9% on an annual basis.

As maturity structure of loans is concerned, according to the initial maturity, long-term loans at the end of 2020 accounted for almost 90%.

At the end of 2020, nine banks had higher, while three banks had a lower share of non-performing loans compared to the end of the previous year. The share of non-performing loans was significant among certain banks with a larger market share. In the first three quarters of this year, banks recorded an increase in total non-performing loans, while that increase was slower in the last quarter. At the aggregate level, the share of non-performing loans in total loans increased by 0,8 p.p. compared to the end of the previous year, so at the end of 2020 it was 5,5%. The sum of non-performing loans increased by 19,6% on an annual basis and amounted to 172,9 million euros. At the end of 2020, the amount of loans overdue for more than 30 days (168.7 million euros, or 5.3% of total loans) was 45,5% higher than at the end of 20198.

A different and possibly more realistic picture of the development of credit risk can be seen by observing how banks perceive the movement of risk according to expected credit losses, i.e. in accordance with the application of IFRS 9. Many banks reacted promptly by applying a conservative approach in assessing the newly created situation and its future development. Thus, in the credit portfolio, according to the so-called phases, it is very clear that throughout the year banks intensively moved loans to phase 2 and slightly less to phase 3. The annual growth of loans from phase 2 amounted to 126,4% and their share in total loans increased in one year from 6,8% to 14,9% at the end of 2020. The annual growth of loans from phase 3 was 24,7%. Finally, loans from phase 1 decreased during 2020, so their share in total loans at the end of the year was 78,3%. At the end of 2019, that share was 87,6%9. (phase 1 consists of financial instruments which show no significant deterioration of credit risk or have a low credit risk; phase 2 consists of financial instruments which show a significant increase in credit risk, but there is no evidence of credit losses; phase 3 consists of financial instruments with objectively proven existence of credit losses) At the same time, banks carried out value adjustments, which showed the biggest increase (over 100%) for loans in phase 2, similar to the above mentioned migrations. At the end of 2020, the coverage of non-performing loans by value adjustments was 36,9%, which is significantly less than at the end of the previous year, when it was 48%. A larger amount of capital was exposed to credit risk, given that the ratio of net non-performing loans ("uncovered") to capital increased annually from 13,8% to 20,2%10.

Banks successfully managed liquidity during the crisis year, which they entered with a high level of liquid assets. Measured by the ratio of liquid to total assets in the time frame 2015 - 2020, liquid assets amounted to over 20%. At the end of 2020, banks' liquid assets made up 22.2% of total assets, reaching the level of 1.016,1 million €. In absolute terms, it was higher by 6,2% compared to the end of 201911.

For liquidity needs, all banks were able to use the deposits they hold in settlement accounts with the CBCG (in addition to the mandatory reserve), which at the end of 2020 amounted to 505,6 million € or almost 50% of liquid assets. Banks could also use demand deposits with financial institutions abroad and at the end of 2020 those deposits amounted to 217,9 million € or 21,4% of liquid assets. Additionally, at the end of 2020, banks held a cash amount of 198,4 million. euros in their vaults.

[7] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.30
[8] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.33
[9] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.34
[10] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, pp. 36 and 37
[11] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.39

Demand deposits prevailed in the deposit structure this year as well, and for the sixth year in a row they were higher than term deposits. At the end of 2020, they made 71,4% of total deposits, as well as at the end of the previous year. For the sake of comparison, at the end of 2013 their participation was 42%. This can be primarily explained by the tendency of passive interest rates to fall, so term deposits have become less attractive[12].

Considered remaining contractual maturity, the ratio of liquid assets to short-term financial liabilities (up to one year) amounted to 29,45% and was higher than at the end of 2019. If we look at the ratio of liquid assets to short-term liabilities with terms up to three months, then the ratio is 35,1%. Both indicators were higher at the end of 2020 due to the growth of liquid assets, but also due to decrease of short-term financial obligations for both mentioned maturities.

To support the liquidity of the system, the CBCG reduced the mandatory reserve rates by two percentage points each, which contributed to the increase of banks' assets on giro accounts with the CBCG by around EUR 70 million. In addition, when calculating the liquidity ratio for liabilities due to payment, banks are allowed to include 20% instead of 30% of demand deposits, which, among other things, enables them to manage funds more efficiently[13].

In 2020, Deposit Protection Fund was a strong support to the stability of the financial system, guaranteeing deposits of Montenegrin citizens and businesses in the amount of up to €50,000 through the collection of regular premiums from banks. In addition, the Fund provided a stand-by arrangement with the European Bank for Reconstruction and Development, in the amount of 50 million euros. If a protected case were to occur, the Fund's assets at the end of 2020, increased by this potential €50 million, would be sufficient for the payment of guaranteed deposits at any of the 8 credit institutions[14]. (out of 12 that operated during most of 2020 in Montenegro)

The capital solvency ratio at the system level at the end of the year was 18,5% and was above the legal minimum for all banks. The ratio of core capital (Tier 1) to risk-weighted assets was 17,4%. The total capital of banks was higher throughout the year than at the end of 2019, but at the end of 2020 it was down by 1,9% and amounted to 586,7 million €. The drop in total capital was also influenced by a significantly lower profit this year[15].

The net profit of banks in 2020 was 22,3 million €, which is around 50% less than the previous year. The four largest banks, which individually exceed 10% market share by assets, had a profit of 13,7 million €[16]. The decrease in profit for this year was mainly due to the increase in impairment costs, because some of the banks applied a conservative approach in assessing the newly created situation[17].

Year 2021:

The macroeconomic picture in Montenegro changed in 2021 compared to 2020, as a dominant pandemic year. There was a gradual recovery of economic growth (primarily in tourism) and real GDP growth was 12,4% according to preliminary data from Montstat. Considering this, we should consider the significant drop in GDP in the previous year (15,3%) due to the pandemic-induced slowdown in economic activity, primarily in tourism.

During 2021, banks are still the most significant part of the financial system of Montenegro, with high capitalization, liquidity and profitability achieved at the sector level. The high aggregate solvency ratio (18,5%) is noteworthy, which is particularly significant, bearing in mind that corrections during the Asset Quality Review (AQR) project are included in this ratio. During 2021, the issue of non-performing loans (NPLs) will become relevant again, and their share in total loans has increased to 6,2%[18]. The impact of this indicator on credit activity is lower than forecast, but it is undoubtedly negative.

[12] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, pp. 39 and 40
[13] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.40
[14] Deposit Protection Fund, Annual Report for 2020, p. 29 and 31
[15] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.41
[16] Central Bank of Montenegro, Report on the Stability of the Financial System 2020, p.41, www.bankar.me
[17] Council for Financial Stability, Annual Report for 2020, p.31
[18] Council for Financial Stability, Annual Report for 2021, p. 16

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Profit at the level of the banking system at the end of 2021 amounted to € 31,4 million, generated by higher income from interest and fees/commissions19. It should be noted that the increased provisioning costs had a limiting effect on the growth of net profit. Impairment costs increased slightly20, but far less than in 2020, when they were almost three times higher than in 2019 due to the emergency situation.

At the end of 2021, total assets of the financial sector were 5,7 billion €, or 116,3% of GDP, which is the result of a significant increase in bank 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%)21. The insurance sector is the second most important group of institutions (4,5%), as it was in previous period. The remaining segments of the financial sector - microcredit financial institutions (MFIs), leasing companies and factoring companies - have a collective participation of 2,2% in the structure of the financial system.

In the last few years, the number of banks on the Montenegrin banking market has been decreasing, as a result of bank mergers and the introduction of bankruptcy in two banks. At the end of 2021, the merger of Komercijalna banka AD Podgorica with NLB banka was completed, and accordingly eleven banks were operating in the system at the end of the year. The concentration of the banking sector, measured by the Hirschman-Herfindahl (HH) index22 according to assets, slightly decreased from 1.460 to 1.397 points. Measured by the same indicator, the market concentration of loans was significantly higher (1.720 points), while deposits at the end of this year were more evenly distributed, given that the mentioned index was 1.355 points. In terms of assets, the participation of the three largest banks in the market was 52,8%, while the participation of the five largest banks was 74%. Banks with majority foreign ownership have a share of around 80% in assets.

During 2021 nine insurance companies operated in Montenegro, four of them offered life insurance, and five companies offered non-life insurance. The insurance market is generally characterized by stability, but also by high market concentration23. Compulsory traffic insurance continues to have the most significant presence on the insurance market. This market has significant potential for further growth and development, which, among other things, is confirmed by the fact that in 2020 the insurance premium fell by only 1,1% and in 2021 achieved growth of 5,5%, exceeding pre-crisis premium level.

In 2021, there were eight microcredit financial institutions, two leasing companies, two factoring companies and two receivables redemption companies.

Similar to 2020, in 2021 changes in the balance sheet sum of banks were related to the method of financing. In this year, the share of loans in liabilities decreased, while the share of deposits increased, so at the end of the year deposits were at a historical maximum of €4,2 billion24. Part of the significant inflow of deposits was invested in securities. In the second half of the year, banks intensified investments in these instruments, whose annual position was 55,9% higher than the previous year and amounted to 734,4 million €, or 13,8% of the balance sheet. Historically, this is the highest level and share of these instruments in the balance sheet25. The largest part of these investments belongs to government securities, government bonds of Montenegro, which were very convenient for Montenegrin banks due to the security of placement and favorable interest rates. Likewise, since the regulatory weighting for these investments is 0%, banks generate income unencumbered by the regulatory requirement for allocation of capital on this basis.

[19] Council for Financial Stability, Annual Report for 2021, p. 16
[20] Council for Financial Stability, Annual Report for 2021, p. 23
[21] Council for Financial Stability, Annual Report for 2021, pages 19 and 20

[22] The Herfindahl-Hirschman Index (HHI) is used to determine market competitiveness. A market with an HHI of less than 1,500 is considered a competitive marketplace, an HHI of 1,500 to 2,500 is moderately concentrated, and an HHI of 2,500 or greater is highly concentrated.
[23] Council for Financial Stability, Annual Report for 2021, p.20
[24] Deposit Protection Fund, Annual Report for 2021, p.14
[25] Council for Financial Stability, Annual Report for 2021, p.20

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In 2021, the lending activity of banks increased slightly. Total loans were at an all-time high in August, 3,53 billion €, although by the end of the year they decreased to 3,36 billion €. Newly approved loans increased to 1,11 billion € and growth annualy by 22,6%. In general, credit activity was not at the level of the pre-crisis period, but in the circumstances of the ongoing pandemic, its volume was satisfactory26.

As for the loan portfolio, according to the so-called phases, which were discussed in the analysis of 2020, banks also moved loans to phase 2 in 2021. At the end of 2021, the annual growth of loans from phase 2 amounted to 9,2% and their share in total loans in one year period increased from 14,9% to 15,3%. The coverage of NPLs by value corrections has slightly increased compared to last year (amounts to slightly below 40%). Liquid assets have increased by 4,2% compared to 2020 and with the amount of €1,4 billion, they made 26,4% of total assets.27 This is also due to the fact that the banks showed satisfactory daily and decadal indicators of liquidity throughout the year. For cases of urgent need for liquidity, funds were available to banks in a very short period of time, in settlement accounts with the CBCG (in addition to mandatory reserves), as well as with financial institutions abroad. Banks kept significant funds (around €200 million) in their vaults.

As already mentioned, the solvency ratio at the level of the banking system was more than satisfactory and amounted to 18,5%, while the legal minimum is 10%. Also at the system level, the ratio of core capital (Tier 1) to risk-weighted assets was 17,4%.

The total capital of banks at the end of 2021 was higher by 3,4% than at the end of 2020 and amounted to 609,5 million. euros. The share of total capital in the balance sheet sum was 11,4%, while the share of basic capital in the balance sheet sum was 9,3%28.

The downward tendency of the average weighted active interest rate (for the entire credit portfolio of banks, i.e. on unpaid principal/debt) continued in 2021, and the decline amounted to -0,18 pp. Weighted average passive interest rate annualy declined by -0,05 pp. At the end of December this year, the average weighted active interest rate was 5,66%, while the average weighted passive interest rate was 0,35%. The interest spread thereby further decreased, and at the end of the year it amounted to 5.31 pp29.

Year 2022:

During 2022, there was a new wave of the Covid 19 pandemic, as well as an escalation of the war conflict caused by Russia's aggression against Ukraine. Disruptions in the supply chains caused by the pandemic were partially remedied at the end of 2021 and the beginning of 2022, but were compromised again in the rest of the year due to acts of war. As a consequence of these factors, there was a significant general increase in prices at the world level, mostly caused by the rapid increase in energy prices. The macroeconomic situation in Montenegro followed the European panorama and in such conditions there was a further gradual recovery of the economy and a real GDP growth of 6.4% according to Montstat data, accompanied by significant inflationary pressure - the annual inflation rate at the end of 2022 was 17 .2% (Montstat data).

The balance sheet of banks also grew in 2022 and the growth amounted to 20.2%, primarily due to a significant increase in deposits. During 2022, deposits achieved an annual growth of 1.02 billion. euros or 24.4% and at the end of 2022 reached a historical maximum of 5.22 billion. euros30. The net profit of banks in 2022 was 85.7 million. euros, which is almost three times more compared to the previous year, for the well-known reasons of the dominant impact of the pandemic. If we look at the four largest banks together, each of which individually exceeds 10% market share, we see that they had a profit of 77.8 million. euros. No bank reported a loss. The most significant factor that caused such a difference compared to the profit in 2021 was provisioning costs. In 2022, they amounted to -21.4

[26] Council for Financial Stability, Annual Report for 2021, p.21
[27] Council for Financial Stability, Annual Report for 2021, p.22
[28] Council for Financial Stability, Annual Report for 2021, p. 23
[29] Council for Financial Stability, Annual Report for 2021, p. 23
[30] Council for Financial Stability, Annual Report for 2022, p. 16

million. EUR (a negative cost has a positive effect on the result), and in 2021, 23.2 million. EUR, which makes a difference of close to 45 million. euros. Impairment costs decreased by 10.9% compared to 2021.31

Banks were adequately capitalized. At the system level, the total capital adequacy ratio was 19.3%, while the basic capital adequacy ratio was 18.4%. At the four largest banks, the total capital adequacy ratio was in the range of 13.2% to 28.7%. During the year, all banks in the system had capital ratios above the prescribed regulatory minimums. The banks' liquidity was at satisfactory daily and weekly levels throughout the year, and the banks' liquid assets amounted to two billion euros, achieving a strong annual growth of 41.5%. Liquid assets made up 31% of total assets, which is an increase of 4.7 pp compared to the end of the previous year.32

During 2022, three banks implemented recapitalization. At two banks, the share capital was increased by issuing shares, and one bank increased the share capital by converting subordinated debt into additional share capital.33

The total capital of banks amounted to 677.9 million. Euro and increased by almost 12% in relation to 2021. Its share in the balance sheet total was 10.6%, while the share of fixed capital in the balance sheet total was 8.3%.34

On the Montenegrin insurance market in 2022, nine companies performed insurance operations, of which four companies performed life insurance operations, and five companies performed non-life insurance operations. The insurance sector was characterized by moderate market concentration, however, individually considered, life and non-life insurance is characterized by high market concentration, especially in the life insurance segment. The share of gross invoiced insurance premiums in GDP at the end of 2022 was 1.9%, which is at a significantly lower level compared to developed European markets.35

In 2022, there were eight microcredit financial institutions operating in Montenegro, one leasing company, two factoring companies and three receivables purchase companies, 11 brokers/dealers and 6 investment funds.36

CONCLUSION

In conclusion, without diminishing the importance of other segments (insurance sector, microfinance institutions and capital market), we can firmly reiterate that the banking sector, led by the Central Bank of Montenegro, represents the dominant part of the financial system of Montenegro. Through a series of indicators and information mentioned above, it can be concluded that the banking system strongly contributes to the overall macroeconomic stability in Montenegro. Bankruptcy of two banks at the beginning of 2019 and the possible negative implications for overall trust in the banking system were successfully neutralized by the Deposit Protection Fund. Deposit Protection Fund timely undertaked all necessary actions and payment of guaranteed deposits began within the legally stipulated period. Already in the first few months, ending in July 2019, more than 80% of the obligation to the owners of guaranteed deposits in both banks was paid. This pace of payment strengthened the stability of the system and provided guarantees to clients, so that the so-called "bank run", which was one of the possible consequences of bankruptcy, was avoided.

The new international circumstances, strongly influented by war in Ukraine, impose the need for increased caution when it comes to macroeconomic issues in Europe, and thus in Montenegro, as a small and open economy, very susceptible to external influences. Growth of inflation, which in 2022 reached a double-digit level on an annual basis, as well as the reactions of key global and European central banks (FED, ECB) that raised reference interest rates, implied growth of reference interest rates on the Montenegrin market as well. Growth of Euribor also lead to the increase of interest rates for loans with a variable interest rate both in the EU and in Montenegro. In Montenegro, inflation was in large part imported, due to the rise in prices of imported goods, but there was also a strong influence

[31] Council for Financial Stability, Annual Report for 2022, p. 18
[32] Council for Financial Stability, Annual Report for 2022, p. 18
[33] Council for Financial Stability, Annual Report for 2022, p. 18
[34] Council for Financial Stability, Annual Report for 2022, p. 18
[35] Council for Financial Stability, Annual Report for 2022, p. 16
[36] Council for Financial Stability, Annual Report for 2022, p. 16

of the "domestic" component by inflatory expectations during last qurter of 2021. That was caused by the announcement of the introduction of new economic program, which predicted an increase in net earnings after abolition of health insurance contribution. Here we should also add certain number of unjustified increase in retail prices which further accelerated inflation.

With caution, always necessary when making forecasts for future periods, it can be stated that banking sector will continue to be a dominant factor in Montenegrin financial system in the years to come. The capitalization of banks will remain very good, with a high amount of liquid assets at the system level and total deposits at record levels. There are no indications of threats for the stability of individual banks, with Central Bank of Montenegro which continuosly keep monitoring the system.

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