NEW CORONAVIRUS AND BANKS

Banking System Answer to the Challenges of the COVID-19 Pandemic in Montenegro

Bratislav Pejaković, M.Sc.

Citat 1: “The banking system is in a better position to manage the situation than it was the case on some of earlier periods. However, an emergency situation, such as a pandemic, bears specific

Citat 2: “The Ministry of Finance of Montenegro indicated the necessity of timely activities and the expected contribution of the banking system, which will not remain without the support of the Government

Citat 3: “It is estimated that banks directly supported the liquidity of the economy and households by about 3.2% of Montenegro's GDP, which is a specific contribution to the amortisation of the first impact on the slowdown in economic activities.

Citat 4: “Immediately after the National Coordination Team had announced measures, the banks adjusted their business organisation to new circumstances

Citat 5: “The IMF said in its report that banks were better prepared for this economic shock thanks to the capital buffers established after the 2008 financial crisis

Citat 6: “The 2020 fall will definitely be vivid and interesting

Towards the end of his life, Sigmund Freud uttered his famous words "I am thankful that nothing was easy for me in life." It is about flexibility. In situations such as the new Coronavirus (COVID -19) pandemic, one must find its inner strength to turn in the direction that will guide him to "green branch". Although the statistical data of the Montenegrin economy at the end of March 2020 were positive, it is important to keep in mind that the economic effects of the Coronavirus pandemic will become much more noticeable in business results at the end of the second quarter of 2020.

In general, the banking system in Montenegro is stable, liquid, with a record profits at the end of 2019, low level of NPLs of some 3.85% at the system level, which have been constantly trending down. Important indicators are liquid assets, which made up about 20% of total assets, and the system solvency, which was at 17.8%. The banking system is in a better position to manage the situation than it was the case on some of earlier periods. However, an emergency situation, such as a pandemic, bears specific risks. Working from home, connecting to bank applications remotely, consequently greater reliance on technology, brought cyber risks that banks addressed successfully, and we did not have a single recorded case of this kind. Certainly, what has been done in the area of digitalisation in banks has received stronger application since the beginning of the pandemic than in the previous 3 years, both in the number of users and in the size of transactions.

The pandemic has brought a heavy workload to banks – they had to organise remote work and everyone expected that the banks would amortize the financial impact through their activities, not only by repaying the existing customers' obligations, but also financing the recovery of the economy, households and government projects. It is certainly a good fact that the banks, in addition to the burden of the moratorium, continued lending operations. Therefore, in the first quarter, the lending was at the level as if there were no pandemic, since the first cases of the new Coronavirus were discovered in the second half of March, and since 25 May, Montenegro became a Corona-free country.

In the period of the Coronavirus outbreak, previously visible problems of the economy or inadequate structuring of the economy was additionally exposed and intensified, which called a situation to be resolved, but atypically through the expected support from the state, because it was imposed by force majeure. As for banks' efforts, in addition to their lending expectations, they had to follow international standards, balance more loosen approval procedures and thus help companies. Banks had to find a balance between the rapid transfers of liquidity to companies and to protect at the same time the interests of the banks and the state in the future that would guarantee a significant amount of placements to companies, which is done by avoiding guarantees to cover loans with high default risk.

The Ministry of Finance of Montenegro indicated the necessity of timely activities and the expected contribution of the banking system, which will not remain without the support of the Government. The expected realisation of negotiations in providing additional funds to the system through the State has been announced. The funds would have adequate maturities and quality support in reducing interest rates towards vulnerable businesspersons from the aspect of liquidity, i.e. to those who are solvent and have comparative advantages on the market. The necessity of support to all who deserve it in accordance with the standards and priorities of banking practice, primarily support to SMEs, production, import substitution, tourism was emphasised. The economy and the population, but also successful athletes of Montenegro paid funds for the purchase of respirators and other hospital equipment on the new account of the National Coordination Team opened specially for these purposes, so that sufficient quantities of these items were provided, while two new clinics will be constructed using the remaining money together with the EU grant. Even in this activity, banks, as socially responsible institutions, have made a quality contribution through monetary and non-monetary donations.

Negotiations on funds for financing economy under favourable terms are underway with the EBRD, IFC, and EBA. The EBA emphasised that the value of placements must comply with the standards that do not jeopardise the long-term sustainability of the system, while the EBRD has committed credit support to Southeast Europe in the amount of 1 billion euros, in order to support entrepreneurs, the energy sector, small and medium enterprises, retailers, etc. In addition to these institutions, there is an announcement of quality cooperation between the Central Bank and the European Central Bank and the Bank for International Settlements.

The CBCG passed, through its activities and decisions, a set of measures, one of which among others, eased banks’ reserve requirements by 2%, which will contribute to additional funds for placements to customers and it will also reduce interest rates for banks by 50% if they use reserve requirements. The second quality measure relates to the flexible classification of loan restructuring in banks' balance sheets, where the banks are allowed to classify the loans of customers, who submit a documentation on the decline in their turnover caused by a pandemic, as new loans. The possibilities of an additional grace period after the moratorium are being considered. Third, banks are additionally allowed to increase their exposure to a single person or a group of connected persons, beyond the prescribed exposure limits of up to 25 percent of the bank's own funds, with the prior approval of the Central Bank.

Immediately after the introduction of the measures, the Government of Montenegro and the Central Bank determined a moratorium - a postponement of loan repayment at the request of citizens and businesses with all banks, micro-credit institutions and the Investment and Development Fund (IRF) for the period up to 90 days. Some 52% of customers used this opportunity, which amounted to approximately 48% of the size of the loan portfolio, where banks waived proportionately the inflow for that amount in period from April to June of this year. In Montenegro, a customer had a right to apply to moratorium, while in Serbia, if a customer did not want to use the moratorium, it had to contact the bank. I think that the approach in Montenegro has been much better set from the aspect of banks and liquidity, whereby the bankers have made a quality contribution to the solution through the Association of Banks.

With regard to banks and customers' behaviour, a special challenge in this period was the implementation of measures of the National Coordination Team on health standards, because the focus was on the use of banks' e-services: e-banking, and the increased loading of ATM networks and POS terminals, in order to ensure adequate social distance. In that sense, most banks have abolished fees for their customers in the case of money withdrawal from the ATMs, as well as fees in national payment system transactions when using e-banking applications. It is estimated that banks directly supported the liquidity of the economy and households by about 3.2% of Montenegro's GDP, which is a specific contribution to the amortisation of the first impact on the slowdown in economic activities.

At the beginning of the Coronavirus pandemic, we had a slightly more pronounced interest of customers in cash payments than usual, and it was agreed with the Central Bank of Montenegro that commercial banks, in addition to EUR, may take other currencies from the CBCG vault, primarily USD. The CBCG stated that they would not charge the banks for their engagement. The technical part of the amount, the structure of the denomination, is defined directly with the banks that have expressed the interest for other currencies. According to the CBCG, banks have also raised the issue of the development of electronic services in the area of online loan application and loan approvals, online account opening, including video identification. The issue of end-to-end service was emphasised, i.e. the application for loan approval, which would function without the need for the physical presence of the customer in the bank. The answer was obtained promptly.

With a quick reaction, the banks managed to provide the appropriate IT infrastructure and organise remote work for more than 80% of the employees in the head offices, while the employees in the branches worked from 8 am to 2 pm in the first weeks. During this period, the banks did not deny their customers any services, but they performed all activities with remote employees.

With a clear organisation, objectives and tasks, rules and the highest standard in information and security policy and practice, and using modern multimedia tools, working from home has proven to be fully efficient and functional in most segments. The changed working circumstances showed that all participants in the performance of their work, both providers and users of services, made certain improvements in the organisation of their daily activities, they came out of their daily routine, and using additional tools and new (often more functional and efficient) ways, met their needs in a new manner. This has opened up a new world of possibilities for everyone, so that the existing challenges can bring significant conclusions with regard to re-examining of the future organisation. Customers and employees have shown that they are ready for new challenges, and I believe that they will continue to improve processes and (personal) organisation even more in the future. Most work was done on enabling online applications for various products and services of the bank, the setting up of the so-called digital branches that contact customers remotely and prepare all the necessary steps so that customers' needs to come physically to the branch are reduced to a minimum, and the like. The intention is that customers do not feel the difference in the provision of services and product sales between the so-called "life as usual" situation and this crisis situation caused by the Coronavirus pandemic.

Immediately after the National Coordination Team had announced measures, the banks adjusted their business organisation to new circumstances. The system, work processes, all possibilities of the bank functioned fully and continuously. Business continuity plans of banks were set in motion in the middle of March 2020. Crisis Committees were formed by banks that met once a day and made conclusions and decisions that needed to be implemented efficiently and in a short period of time. All processes were organised to function in accordance with the established system of internal controls.

The biggest challenge in this period was the transformation related to the implementation of the moratorium, which required significant procedural and software settings, with mandatory remote application, i.e. through all available digital channels such as websites, call centres, text messages, etc.

During this period, no problems were felt when it comes to communication and exchange of information between the banks and the CBCG. Since the beginning of the Coronavirus pandemic, the CBCG has introduced several new daily and periodic reports necessary to monitor the situation in the banking market. These reports mainly refer to deposits (tends and balances of deposits, early termination of time deposits, etc.), as well as loans (loans in the moratorium, new payments, etc.).

As in the previous period, the entire set of reports and most of the communication flowed through IT, and knowing that the banks have fully adapted to the new circumstances and thus ensured continuity in conducting business activities, there were no problems in this interaction.

Montenegro is a predominantly import-oriented economy, characterised by significant exposure to tourism and related industries. Since tourism is a branch that has had significant losses due to the Coronavirus pandemic, special attention was paid to customers from this branch of the economy. Proactive approach and communication with customers required common models of bridging the current situation. The analysis of expected cash flows with each customer was performed and based on that, proposals were made for new amortisation plans, which included debt restructuring through a grace period, reduction of annuities, etc. The banks clearly communicated with customers that their role is not to finance losses, but to help bridge liquidity and provide financing to start a new business cycle. At the time of writing this article, available funding facilities in the international market, especially for the SMEs, are not favourable, thus the banks rely more on their own sources.

The priority of every bank is to maintain a high level of liquidity and successfully service the financial needs of its customers. The overall focus is on these categories and all customer requirements are analysed with great care. The overall assessment of the banking sector is that we are witnessing the improvement of business that ranges from regulatory improvement to offering new services to customers every year. Therefore, we have a declining trend in interest rates, but also strengthening the system both through profit as well as through the adoption of FinTech solutions, digitalisation and HighTech, which are trends and conditions for survival in the market.

The experiences from the period of performing work in changed (social) circumstances, imposes active thinking on the improvement of certain processes. The most common challenges are getting out of habits that are built into our way of thinking and working. The current situation has provoked and made such an approach necessary. I believe that from the recent experience, we can all draw quality conclusions, define new rules in the organisation for the benefit of employee satisfaction and increase the quality of work of companies.

Situation in Montenegro in relation to trends in Europe

As a reminder, depending on the international institution that gave the forecast, decline and recovery of the economy from the Coronavirus pandemic for Montenegro are forecasted at the level of decline from 5.9% to 9% in 2020, and growth in 2021 of 4.5%, which is at the level of the forecast even for more developed economies of Europe. The current debt to GDP ratio in Montenegro is estimated at around 77%, and it is expected to rise to around 90%. The euro area economy is expected to shrink by 7.75 percent this year due to Coronavirus, an estimate of the contraction that has overshadowed the worst financial crisis in 2009. Unemployment in the EU could rise to 9 percent this year. Things could get worse depending on the development of the Coronavirus pandemic, the Brussels executive authorities said. The financial crisis reduced the euro area economy by 4.5 percent in 2009 and left about 10% of workers jobless.

Greece, Italy and Spain are facing the most severe shocks, where they are projected to lose 9.4% or more of gross domestic product. With regard to the forecast for Italy, it is expected that the public debt will rise from the current 136% to almost 186% of GDP, while Greece is in an even more unfavourable position. However, all EU countries are affected by the Coronavirus pandemic, which will cause a drop of at least 5.4%, which is forecasted for Luxembourg. The forecast for the German economy expects the fall of 6.5 percent, while the French economy expects the fall of 8.2 percent. The euro area economy should return to the growth trend next year, where the growth of gross domestic product is projected at 6.25 percent, something that we can read from the documents of the European Commission. Of course, both the decline and the recovery will vary between the Member States of the Single Euro Area. The Bloomberg recalls to the position of the European Banking Agency, which warned that lenders could face a shock of 315 billion euros on the level of their capital due to losses on loans and growth of risky assets in their balance sheets, which further indicates the reality of economic forecasts.

The depth of the recession and the strength of the recovery will be uneven, conditioned by the velocity in overcoming obstacles and the growth of services such as tourism, which is of particular importance in most economies, but the strength of the reaction depends on and will be in accordance with the financial resources of each country. The divergence like this poses a threat to Single Market and Euro area, and as such would worsen the north-south division in the EU that has begun after the crisis in the financial system and sovereign debts. "However, this can be mitigated by decisive, joint European action," Paolo Gentiloni, the Commission's economy chief, said in a statement, emphasising that "we must face this challenge."

In a gloomy context, due to uncertain economic forecasts, the meeting of Italian and German bankers discussed many topics: from implementing reforms in the health sector and providing financial assistance to companies and families affected by the economic crisis, to the role that efficient financial markets could play in recovery. The two delegations had the opportunity to discuss the recent banking package adopted by the European Commission on more flexible access to capital requirements rules for European banks affected by the Coronavirus, more flexible access to NPL treatment rules (provisions) and various EU banks' contributions to the European Resolution Fund for 2020 and 2021. Yet this is another, albeit atypical, crisis that has imposed challenges on both, the supply and demand, but can still be addressed through joint action.

However, the IMF said in its report that banks were better prepared for this economic shock thanks to the capital buffers established after the 2008 financial crisis; what is good for bank liquidity, but questionable for economic recovery is the information that bank deposits are increasing across Europe as a conditional response to the economic and social impact of the Coronavirus pandemic saving more, which fuels the fear among economists that consumers will not contribute to the recovery and growth of the economy on the Continent. Savings rates in four of Europe's five largest economies rose sharply to well above long-term averages in March, according to recently released data from the European Central Bank, published by the Financial Times. On the other hand, the European leaders may be united in the need to inject money into economies during the Coronavirus crisis, but they have yet to face how to pay for it all, Bloomberg writes. This reconsideration may force governments across the region to make difficult choices about where to place the burden among voters who are already dissatisfied with political institutions. Politicians are already asking questions about raising taxes on either wealth or income - even if it threatens to hurt growth. Public debt among euro area Member States rose to 103 percent of GDP from last year's level of 86 percent, due to measures to support the economy and citizens and falling tax revenues. CNBC says the EU is looking at taxing U.S. technical giants to further provide funding for the recovery. The 2020 fall will definitely be vivid and interesting.