INTERVIEW FOR THE “BANKAR” ZORICA KALEZIĆ, THE CBCG VICE-GOVERNOR

The CBCG, the Government and the banks will work together to deal with the consequences of the pandemic

Podnaslov: Giving estimates of the situation in the banking system of Montenegro by the end of the year would be a rather unenviable task, because the level of uncertainty is still too high. It is realistic to expect that the recession processes in the real economy will affect the level of non-performing loans, the growth of loan loss provisions and the weakening of the financial result. However, we are facing this crisis with a more liquid and better capitalized banking system compared to the one that was exposed to the crisis of 2008, the Vice Governor of the Central Bank of Montenegro says for the "Bankar" magazine.

We might say that COVID-19 belongs to the asymmetric information that cancel all economic projections made until its impact. How do you assess the systemic reaction, i.e. how ready have we been for such a challenge, previously unknown to us? What are your comments on the cooperation between the banks and the CBCG?

The extent of the shock that the COVID-19 pandemic exerted onto the global economy is immeasurable, presenting an exceptional challenge before the decision makers since it requires a coordinated, innovative, and aggressive approach in implementing monetary and fiscal instruments available, against the background of a public debt higher than ever, limited room for manoeuvring in reference rate adjustments, and radicalisation of quantitative easing measures and longer-term refinancing operations (FED and ECB). It remains to be seen to what extent will these measures induce the stabilisation of the market, more favourable terms of financing, and the private sector recovery. Montenegro belongs to a group of countries that will take a heavy blow from the effects of the COVID-19 pandemic, being a small developing country, with high public debt and tourism as a significant GDP contributor.

The response of the Government and the CBCG was synchronised and well-timed, with the efficient use of available fiscal space, and the range of monetary policy. Both sets of Government measures with more than 3% of GDP have been well targeted with remedial, developmental and social components. Although there is an opinion that the NCT measures slowed down the economic activity, a positive externality of these measures is that Montenegro remains one of the few countries that did not record a significant increase in budget expenses for the health sector.

The CBCG acted complementarily with the set of eight short-term and long-term measures, relying on the strong liquid position of the banking sector and its good capitalisation. While fully preserving the monetary independence, the CBCG communicated with banks frequently, which was noted by the international financial institutions as a welcome practice. I find that this cooperation proved to be an excellent platform for the exchange of experience and information, which have helped the CBCG to promptly define measures, and in return, helped the banks to implement them efficiently. Bearing in mind the level of uncertainty, a more frequent communication among the CBCG, the Association of Montenegrin Banks, banks and all necessary institutions will become a regular practice in the future.

Can you give us a summary of the CBCG measures relating to the mitigation of the consequences of Coronavirus on Montenegro's financial system?

In designing the measures relating to the mitigation of the consequences of the Coronavirus pandemic, the CBCG acted with eight measures implemented simultaneously on three fronts: 1) measures aimed at maintaining the liquidity of the banking sector, 2) measures for making the financial sector liquidity available to the real sector in the short term so that the first liquidity shock would be amortised, and finally 3) medium-term developmental and remedial measures aimed towards finding a systemic solution of the effects of a more permanent decrease in the creditworthiness of clients whose business had been affected by the COVID-19 consequences.

The first set of measures related to reducing the reserve requirement rate for banks by 2 percentage points, whereby the CBCG has released liquidity in the amount of cca. 70 million euros, by increasing the credit potential of banks. Next, the CBCG halved the prices for the withdrawal of reserve requirement liquidity, providing a more efficient and cost-effective access to additional sources of banks' liquidity if necessary. The CBCG doubled the bilateral repo line with the BIS from 50 to 100 million euros, thereby reinforcing the framework for providing fast liquidity to banks, if needed.

The second set of measures relates to interim measures of automatic and flexible moratoria on loan repayment. The moratorium on loan repayment, which was mandatory for banks, was aimed at providing temporary quick access to liquidity for natural and legal persons in the amount of 155 million euros in the first three months of the pandemic, with a view to supporting the real economy (aggregate demand) during the most critical period of induced freezing of a substantial portion of economic activity. The second moratorium is flexible, and focused on targeting the current liquid position of those legal and natural persons whose cash flows actually suffered the consequences of the COVID-19 pandemic.

The third set of measures, focussing on the medium term, relates to the targeted restructuring of loans that will be treated as new loans, so that the banks would be free of the additional burden of provisioning costs. This creates the conditions for loan restructuring under favourable terms. At the same time, the CBCG allowed the banks to temporarily increase exposure to one person or a group of connected persons above the prescribed exposure limits subject to prior authorisation of the Central Bank. This measure becomes meaningful in situations when the business of a legal person is largely directed towards one bank, and establishing a business relation and obtaining adequate credit support from another bank would be time-consuming. Finally, with a view to strengthening banks' capital buffers for the purpose of absorbing potential losses, the CBCG prohibited the banks from paying out dividends to shareholders, unless they are paid out in the form of bank shares.

What amount of funds may be expected from international institutions such as the EU, ECB, WB, and the IMF, or development funds, and have any arrangements already been made?

All key institutions of the system reacted promptly by requesting funds/recovery packages under more favourable conditions offered by international financial institutions. The Ministry of Finance and the CBCG are in talks with the IMF for obtaining the rapid financing instrument (RFI). At the same time, negotiations are in progress for receiving a 60 million euros loan under favourable conditions from the European Commission from the EU Microfinance support fund. In 2019, the Government successfully financed in advance its Eurobonds that became due in the first trimester of 2020, in the amount of 321 million euros, and a syndicated loan of 250 million euros was also secured supported by the World Bank guarantee. In addition, negotiation for a new World Bank Development Policy Loan (DPL) in process.

In coordination with the CBCG and the Ministry of Finance, the banks received a good response from the international financial institutions (EBRD, EIB, IFC, KFW, etc.), and negotiations are in progress for granting over 150 million euros for additional credit support to our real sector.

In addition, as mentioned above, the CBCG managed very quickly to arrange the doubling of the BIS liquidity line, which leads to a conclusion that compared to other dollarized and euroised economies, the CBCG has at its disposal one of the most advanced frameworks for providing quick access to liquidity for banks. Finally, the Government is currently in negotiations with international financial institutions to obtain credit lines under favourable conditions which would be placed to the corporate sector through the banking system, thus completing the third set of Government measures.

The public is often confused by different interpretations of the measures relating to the banking system. Sometimes they are poorly informed individuals, and sometimes it appears that attacking the banking system provides good media's attention. In that context, what is your comment on the "moratorium on loan repayment" and the attempt to marginalise a good solution to amortise the first blow of the pandemic to the economy and households in Montenegro vs the region?

There is not much professional motivation behind the populist statements on banks making "extra profits" during the moratorium on loan repayment, and the economy being "left to the mercy" of banks. Making the first moratorium (20 March – 20 June) mandatory is one of the most radical measures that the CBCG could have implemented. Only 12 central banks in the world have introduced the automatic moratorium on loan repayment, and the CBCG was among the first ones to decide to implement this short-term instrument, as is confirmed in the latest World Bank report.

The CBCG's Decision created a sustainable balance where the banks provide significant liquidity of approximately 3% of GDP to the real sector, while the creditworthiness of clients remains frozen. The calculation of the interest rate contracted for that period is in the function of maintaining the net present value of cash flows of credit indebtedness (in accordance with the EBA and WB recommendations) and it shall be distributed evenly over the remaining annuities. During that period, the banks recorded no profit from reinvesting turnover from the loan portfolio of 1.3 billion euros (45% of loan portfolio), while they regularly serviced the costs of sources of financing to which the moratorium did not apply, and which the banks had to service in accordance with initially contracted terms. The mere fact that 45% of the portfolio is under a moratorium speaks volumes about how much clients have found their interest in this measure. The magnitude of the current impact on the liquid position of banks is best illustrated by the fact that some of the banks have more than 70% of their own loan portfolio under the moratorium.

The flexible moratorium pertaining to the second phase was motivated by the gradual unfreezing of economic activity, and, more than anything, the need for a precise redirection of banks' funds towards clients that run sustainable businesses that were actually affected by the crisis.

The analysis produced to determine the criteria for the second round of moratorium, showed that some of the moratorium users were legal and natural persons whose cash flows were not (significantly) compromised during the moratorium. Out of 1.3 billion euros of loans under moratorium, the main nominal amount of loans in moratorium within the banking sector was recorded in the trade sector, in the amount of 148 million euros, and in loans to natural persons with regular income, in the amount of over 420 million euros. At the same time, in the accommodation and food service activities sector (tourism) only 85 million euros of loans were treated. The moratorium also covered 2,926 small and medium-sized legal persons, to which moratorium was granted for 451 million euros. As regards the tourism sector and small and medium-sized enterprises, the CBCG Council gave the recommendation that special attention is paid to them during the implementation of the second part of the moratorium.

The flexible moratorium is present in many jurisdictions in Europe and Central Asia, and in none of them have we witnessed companies being "left to the mercy of banks". On the contrary, during the flexible moratorium, the banks were given the freedom to design solutions tailored to the client on a transparent basis of mutual interest, and to filter out the clients with short-term liquidity problems from those who are candidates for restructuring.

What else could be done that has not been done so far?

With the existing measures, the CBCG has provided a substantial medium-term framework for the process of providing short-term liquidity and loan restructuring for clients whose business had been compromised due to the COVID-19 pandemic. Implementation of new measures will depend on perceiving four main factors: the size of the impact of current measures on banks' balances, or whether this impact corresponds to the CBCG's scenario analysis, what will be the real economy trends in the third quarter (tourism revenues and employment), the amount, price, and structure of the sources of financing that the banks will be able to provide for new financing of the real sector in the next quarter, and the generosity of the third set of Government measures.

As the analysts' focus shifted to the moratorium, the view of the most important long-term CBCG measure was completely lost, and I would like to remind the public, primarily clients of banks of it. To wit, a recent Decision on Interim Measures to Reduce Adverse Effects of the New Coronavirus Outbreak on the Financial System enables the banks to restructure loans, the beneficiaries of which have proven to the bank that their financial position has deteriorated, or will deteriorate in the near future due to the negative impact of the new Coronavirus, and to treat such loans as a new loans in the process of assets classification and allocation of loan loss provisions. Loan restructuring implies the possibility of extending the repayment period for principal or interest; reduction of the interest rate on the approved loan; reduction in the amount of debt, principal or interest; replacing an existing loan with a new loan (loan renewal), or providing other similar benefits that facilitate the debtor's financial position. Despite the high uncertainty, the CBCG expects the highest standards of credit risk assessment from banks during the implementation of this measure, and will closely monitor the quality of restructuring, especially in terms of compliance of the repayment plan and restructured loan terms with new cash flows of the client.

I believe that, in addition to credit lines that banks contract with international financial institutions, the third set of measures, i.e. the role of the Government in the form of providing favourable long-term funding sources or partial guarantees to cover part of credit risk, would be a good component for successful implementation of this measure.

How would you assess the current situation in the banking system and what are your expectations by the end of the current year?

Significant improvement of supervisory regulations, favourable economic cycle and clearing of contaminated assets, created a resistant banking sector, which has a significant margin for absorbing shocks and the effects of CBCG measures that are currently being implemented.

Looking at the data from the end of April, the banking system is still solvent, liquid and profitable, while the first results of the impact of measures on banks' balance sheets are expected in the data from the second quarter. The analysis of high-frequency data is encouraging, showing that during the moratorium, banks managed liquid assets well (the level of liquid assets, which is still at over 20% of total assets), the temporary outflow of deposits was stabilized, and the levels of NPLs and loans over 90 days past due were low. What sends a positive signal is the fact that the banks, despite having 45% of loan portfolio under moratorium, continued their lending activity, and in the period March - end of May this year provided 161 million euros of new loans for 6,947 clients.

Giving estimates of the situation in the banking system of Montenegro by the end of the year would be a rather unenviable task, because the level of uncertainty is still too high. It is realistic to expect that the recession processes in the real economy will affect the level of non-performing loans, the growth of loan loss provisions and the weakening of the financial result. However, we are facing this crisis with a more liquid and better capitalized banking system compared to the one that was exposed to the crisis of 2008. Moreover, learning exactly from the financial crisis, despite having a liquid and well-capitalized banking system, the CBCG acted proactively by prohibiting banks from paying out dividends to shareholders, except in the form of bank shares, providing additional capital buffers to absorb potential losses.

What are the most important tasks of the CBCG in the upcoming period?

The crisis has expanded the room for the Central Bank of Montenegro to manoeuvre through balancing the three coordinates: encouraging and preserving the stability of the financial system (including encouraging and maintaining a healthy banking system), monitoring the implementation of measures to remedy the effects of the COVID-19 pandemic coordinated with the Government (while preserving its independence), and developing an exit strategy on withdrawing the measures when the crisis is over.

To quote Kristalina Georgieva, the IMF Managing Director: “Memories from the last global crisis still linger”. The global financial crisis has taught both banks and regulators the hard way how a weak financial system creates negative feedback with weak economic growth. I believe that the CBCG has so far carefully balanced its basic mandate - maintaining the stability of the financial system, with the activities aimed at counteracting the effects of the COVID-19 pandemic on the real sector liquidity and catalysing new sources of financing with international institutions, which will take up an important role in stabilising the market and offering new sources of financing.

Just as the Government's third set of measures focuses on preserving the productive capacity of the Montenegrin economy in the long run, the role of the CBCG is to preserve the vitality of the banking system that can keep up with this process. Therefore, in the forthcoming period, the CBCG will strengthen reporting and supervision over the implementation of measures, especially those related to the quality of loan restructuring in the medium term, in order to reduce the likelihood of erroneous assessments of banks' credit risk and jeopardizing the banks' credit potential in the medium term.

In parallel, the CBCG monitors the adjustment of guidelines, practices and standards through technical clarifications of the Basel Committee and the EBA, especially in the area of IFRS-9 implementation and the treatment of the moratorium during COVID-19.

In short, what are your views on the challenges of the new function you are covering?

After many years of working in international financial institutions, it is a pleasure to contribute to the system of the country I came from, especially during this challenging time. I would not give too much importance to my gender, because although the CBCG fosters gender equality, with over 50% of women in executive positions, the entire CBCG staff and management is there, primarily as part of the team recommended by work, order and discipline.

Boks

The AQR process will resume in September

Preparations for the most important business of our banks in 2020 were almost complete, and it concerned the AQR. What can be expected by the end of the year, and has a decision been reached regarding this process?

As you are aware, after the implementation of the IFRS-9 in 2018 and the resolution of the two non-systemic banks in 2019, the CBCG had planned the implementation of the AQR for 2020. In order to ensure the highest level of reputability and transparency, in January 2020, the CBCG chose the auditing company EY Serbia with project leaders from EY Germany as its consultant. The recommendation of the CBCG consultants is to continue with the process of asset quality review through the AQR this year, which is also the recommendation of the IMF, the World Bank and the European Commission. Unless there is a shock caused by the second wave of COVID-19, the plan is to resume with the AQR process in September, with an indicative deadline for the completion of the process set for March-April 2021. Guidelines for the selection of AQR consultants and appraisers will be distributed to banks in the first week of June.

The operational capacities of banks are ready for the implementation of the AQR, and the obtained results will give a precise picture of the level of resistance of the banking system and the ability of banks to absorb measures that have already been implemented as well as new ones. In addition, the AQR results will provide an excellent basis for stress testing through which the regulator can make a high-quality assessment of the effects of the COVID-19 pandemic shock on banks' capital in the long run.

Boks

Enabling regulations of new loans will be ready

Many systemic laws have been passed and enabling regulations have been pending, is the dynamics of consideration and adoption in line with previous plans, or is it being delayed more and more in the long run due to the new situation?

Despite the negative impact of COVID-19, the CBCG continued to work on enabling regulations and according to the current roadmap, we believe that there will be no postponement of deadlines for their adoption and implementation. With 25 enabling regulations that the CBCG is preparing for the operationalisation of the Law on Credit Institutions, as well as 16 enabling regulations related to the Law on

Resolution of Credit Institutions, whose adoption is planned for the closing quarter of 2020, next year, we can expect unhindered implementation of these two systemic laws, provided that there are no new unplanned shocks.