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Montenegro economy briefing:

Trends in monetary sector: interest rate growth

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Trends in monetary sector: interest rate growth

Abstract

Instability in the global market was also reflected in the monetary sector. During the previous period, an increase in active interest rates was recorded, along with a simultaneous increase in loans and deposits. In January 2023, active interest rates increased by 0.4 percentage points in comparison to January 2022. On the other hand, the passive interest rate decreased in the observed period, with an increase in the interest rate on time deposits, especially deposits with a longer maturity. Unlike time deposits, which recorded a decline during the previous period, demand deposits recorded growth, which can be explained by uncertainty regarding future trends and the desire of households and companies to have readily available funds.

Introduction

Uncertainty on the international market, which was caused by the war in Ukraine, was reflected in the rise in prices. A high rate of inflation was also recorded in Montenegro, given its import dependence and strong economic connection with other countries. One of the measures taken by the states in order to curb inflation is the increase in interest rates.

Interest rates recorded growth[1]

During the previous period, interest rates recorded growth. In January 2023, the weighted average lending effective interest rates of banks amounted to 6.05%, which is 0.4 percentage points higher than the average effective interest rate in the same period in 2022. The nominal interest rate at the beginning of this year was at the level of 5.5%, recording growth compared to the previous year.

In terms of maturity, the 2023 weighted average lending effective interest rate amounted to 6.2% for the loans with a repayment term of over one year and 4.2% for short term lending.

[1] Source of data: Central Bank of Montenegro

In terms of residents of the sector, interest rates in January 2023 ranged from 2.8% for financial institutions to 7.2% for natural persons. The high interest rate at which natural persons borrow can affect their disposable income and consumption. On the other hand, the effective interest rate for companies in January 2023 was 4.8%. A further increase in interest rates will potentially affect the level of loans, and thus the investment activities of companies. A higher interest rate compared to other sectors was recorded for loans to the general government (5.7%), which was influenced by developments in public finances.

An important aspect of interest rates is the purpose, so interest rates related to the company's operations, such as liquidity for working capital and the realization of investment programs, amounted to 4.9% and 4.6% respectively. Also, the average effective interest rate for the purchase of fixed assets was 4.8%. A slightly higher amount of interest rates related to construction of buildings and adaptation and refinancing of liabilities to other banks (5.5% and 6.0%, respectively).

On the other hand, interest rates on loans for natural persons are at a significantly higher level. The highest interest rates were recorded for cash loans, which in January of this year amounted to 8.6%, but also for education loans (11.1%), although it does not represent a significant percentage of total loans.

Growth in the credit activity of banks[2]

The growth of interest rates during the previous period was simultaneously accompanied by the growth of banks' credit activity. In January 2023, total loans (end-period balance) were at the level of EUR 3,721.8 million, which is 1.6% more than at the end of 2022. Compared to the same period of the previous year, total loans were 10.0% higher. The largest number of approved loans refers to residents (84%), while the amount of approved loans to non-residents is 16%. Observed from the point of view of the sector, the most significant percentage of loans refers to households (42% of total loans) and privately owned companies (33%). Loans to households in the observed period amounted to EUR 1,558.7 million, which is 8.8% more than in January 2022. Throughout the previous year, loans to households grew. Similarly, loans to companies increased by 7.5%. In general, credit activity grew in all sectors, except for general government, when loans decreased by 2.7% in the comparative period.

[2] Ibid.

When it comes to newly approved loans, in January 2023 newly approved loans amounted to EUR 84,729 million, which is 2.2 times less compared to December of the previous year. However, compared to the same period in 2022, newly approved loans were 57% higher at the beginning of this year. The largest amount of loans, almost two-thirds, refers to loans over one year, while about one-third of loans are approved with a repayment term of less than one year.

According to the data of the Central Bank of Montenegro, companies (43.4%) and individuals (37.9%) have the largest share in newly approved loans. Additionally, almost two thirds of newly approved loans refer to a period longer than one year, while slightly more than a third of loans were approved for a period shorter than twelve months.

Deposits and passive interest rate[3]

Trends in the international market and the monetary sector were also reflected in the trends in passive interest rates. Contrary to the movement of the active interest rate, the passive interest rates recorded a decline in the previous period. Weighted average deposit effective interest rate in January 2023 was 0.27%. During 2022, the passive interest rate recorded a constant decline. Compared to January 2022, it was 0.07 percentage points lower at the beginning of this year (while the decrease compared to January 2021 was 0.13 percentage points).

Observed by maturity, the weighted average deposit effective interest rate recorded different trends. While, on the one hand, there was an increase in the deposit effective interest rate on deposits with maturity from 3 to 5 years and those with maturity from 1 to 3 years (0.65 percentage points and 0.21 percentage points, respectively), on the other hand, deposit interest rates for deposits with maturity up to three years (for 0.52 percentage points).

During the previous year, total deposits increased from EUR 4230.5 million in January 2022 to EUR 5204.7 million in January 2023 (which represents a growth of 23%). Observed by sector, the largest participation in deposits is held by companies (34.3%) and households (32.2%). Company deposits increased by 42.2% during the observed period, due to the growth of privately owned company deposits. Also, the growth of household deposits was recorded in the period January 2022 to January 2023 (17.9%). This growth in household deposits was driven by the growth of demand deposits, which increased by 32.7% in the observed period. On the

[3] Ibid.

other hand, term deposits decreased by 12.8%. Such a trend followed the movements of passive interest rates, which grew as the maturity increased. The reason for this trend of household deposits can be found in the uncertainty regarding future developments, and financial resources were withdrawn or transferred from term deposits to demand deposits in order to be quickly available. The trend of deposits is in line with the level of passive interest rates, which increased for term deposits, i.e. in the case of a longer term. The growth of passive interest rates for long-term time deposits is a reaction to the withdrawal of funds from bank accounts. The level of inflation has reduced the real value of money, which has influenced the decisions of the population and companies regarding investments in the purchase of durable goods and real estate, which may also represent an additional reason for the reduction of term deposits.

Future trends

In the coming period, the continuation of the growth of interest rates can be expected, which will be reflected in the trends in the monetary sector. At the beginning of February 2023, the European Central Bank (ECB) increased the interest rate by 0.5%, in order to curb further price growth.[4] During the previous year, the ECB already increased the interest rate, which also affected the trend rates in Montenegro.

The rise in interest rates will affect investments. Since the price of money is increasing, a decrease in investment activity can be expected. Further price growth is reflected in the real value of money, so investing in durable goods and real estate is one of the decisions that owners of cash can resort to, considering that buying real estate is a guardian of the value of money.

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The uncertainty that will be present during this year will be reflected in the trends on the financial market. An increase in interest rates in order to reduce or limit price growth can be expected in the coming period as well. This will be reflected in a decrease in demand and consequently in a decrease in production. The growth of indebtedness, that is, the increase in current consumption at the expense of future cash flows, can significantly limit the disposable income of the population, as well as companies. Taking into account the rise in prices that

[4] https://www.reuters.com/markets/rates-bonds/ecb-raise-rates-again-face-questions-about-future-path-2023-02-01/

affects purchasing power, but also the projected inflation during the next period, loan repayment may be more expensive if interest rates continue to rise.