1 Monetary policy implementation and investment portfolio management

1.1 Minimum reserve requirements

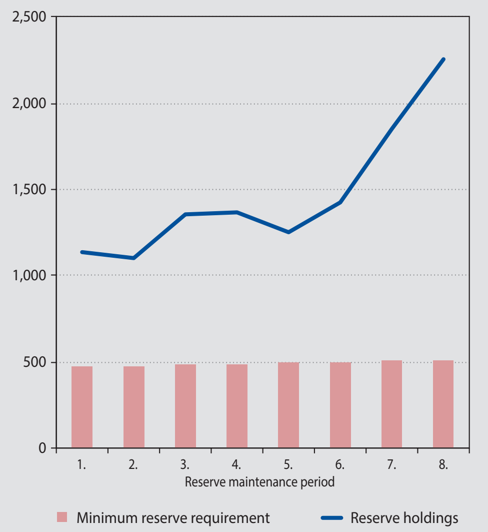
Under Eurosystem rules, all euro area credit institutions are required to hold a certain amount of funds as minimum reserves in their current accounts at their national central bank (NCB). Institutions currently have to hold a minimum of 1% of the sum of eligible balance sheet items that constitute the basis for calculating the reserve requirement ('the reserve base'). This requirement must be met on average over the maintenance period.

At the beginning of 2017 a total of 28 credit institutions in Slovakia were subject to minimum reserve requirements; they comprised 13 banks incorporated in Slovakia (including three home savings banks) and 15 branches of foreign credit institutions. The number of branches of foreign credit institutions fell to 14 in June 2017, when ZUNO BANK AG, pobočka zahraničnej banky ceased operations in Slovakia. With effect from 1 August 2017 Prima banka Slovensko a.s. acquired Sberbank Slovensko a.s., which was dissolved without liquidation on 31 July 2017. As a result of these developments, the number of banks fell to 12 and the total number of credit institutions fell to 26. This situation remained unchanged for the rest of the year. In June, the branch of one foreign credit institution underwent a name change: AKCENTA, spořitelní a úvěrní družstvo, pobočka Slovensko became Československé úvěrní družstvo, pobočka Slovensko.

Excess reserves continued to be remunerated at a negative rate in 2017, as they had been since 11 June 2014. That rate was maintained at -0.40% throughout 2017. None of the three key ECB interest rates were adjusted during the year.

Before 2015 the ECB's Governing Council held its monetary policy meetings on a monthly basis, but since then it has held them at six-week intervals. This change resulted in the reserve maintenance period being extended to either 42 or 49 days, and therefore the number of periods per year fell to eight. The calendar for reserve maintenance periods is aligned with the schedule for the Governing Council's monetary policy meetings so that the start of the period falls on the potential effective date of any change in the monetary policy settings.

Chart 12 Reserve holdings and minumum reserve requirements in 2017 (EUR millions)



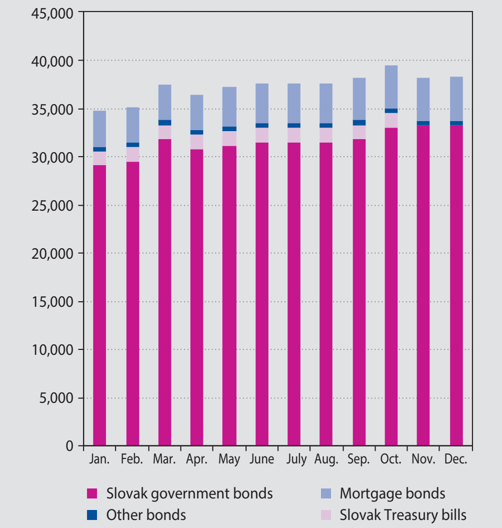
Source: NBS.

The average amount of reserves that banks were required to hold with Národná banka Slovenska in 2017 was €490.28 million, around 5.5% more than in 2016. In 2017 the amount of banks' actual reserve holdings at NBS was, on average, 199.1% higher than the reserve requirement, while in 2016 it had been 170.7% higher. The aggregate reserve holdings were highest in the eighth and seventh maintenance periods.

1.2 Eligible assets

The collateral eligibility criteria for Eurosystem credit operations underwent several changes in 2017. One of the most significant changes concerned the eligible assets known as non-marketable debt instruments backed by eligible credit claims (DECCs). In 2017 this class was extended

Chart 13 Composition of Slovak eligible assets in 2017 (EUR millions)



Source: NBS.

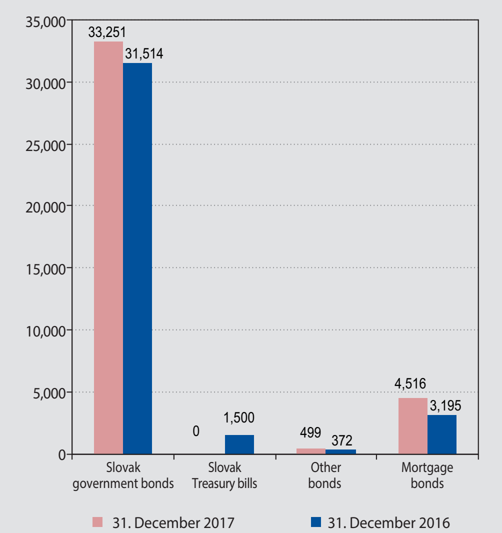
the updating of haircuts for marketable assets. In the case of eligible asset-backed securities, graduated haircuts based on their Weighted Average Life were introduced in 2017.

The value of Slovak marketable eligible assets was, on average, 3% higher in 2017 than in 2016. The total nominal value of these assets at the end of 2017 was €38,267 million, which compared to its level at the end of the previous year was higher by €1,111 million. Slovak government bonds constituted almost 84.4% of these eligible assets, and mortgage bonds 11%. No Slovak Treasury bills were included in the list of eligible assets at the end of 2017, following the maturity of the last outstanding issue of such bills in November 2017.

to include DECCs with negative cash flows for coupon payments. Marketable assets with negative cash flows were also included in the list of eligible assets. A second change was the introduction of minimum disclosure requirements for covered bond ratings issued by credit rating agencies accepted in the Eurosystem credit assessment framework (ECAF). A third change was

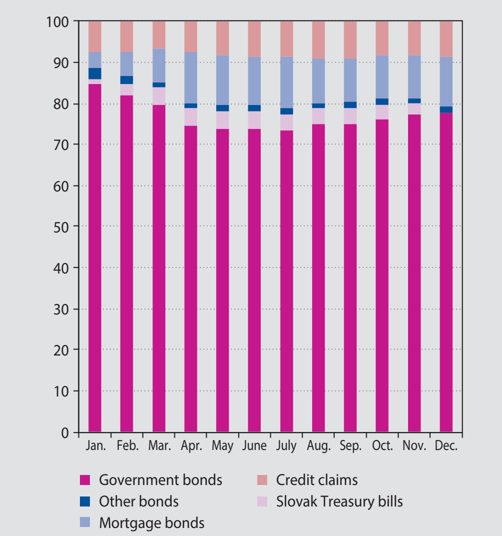
The value of collateral pledged by domestic banks in Eurosystem operations was the same at end-2017 as at end-2016 and the averages for these years also remained similar. The average share of government debt securities in the collateral pledged in 2017 was 80%, down from 91% in 2016. The decline in their share was the largest recorded by any component. The average share of mortgage bonds increased from 3% to 10%, and that of credit claims increased to around 8%, thus maintaining its upward trend. As a share of the total collateral pledged, collateral issued in the domestic market fell from 93%

Chart 14 Composition of Slovak eligible assets as at end-December 2017 and end-December 2016 on (EUR millions)



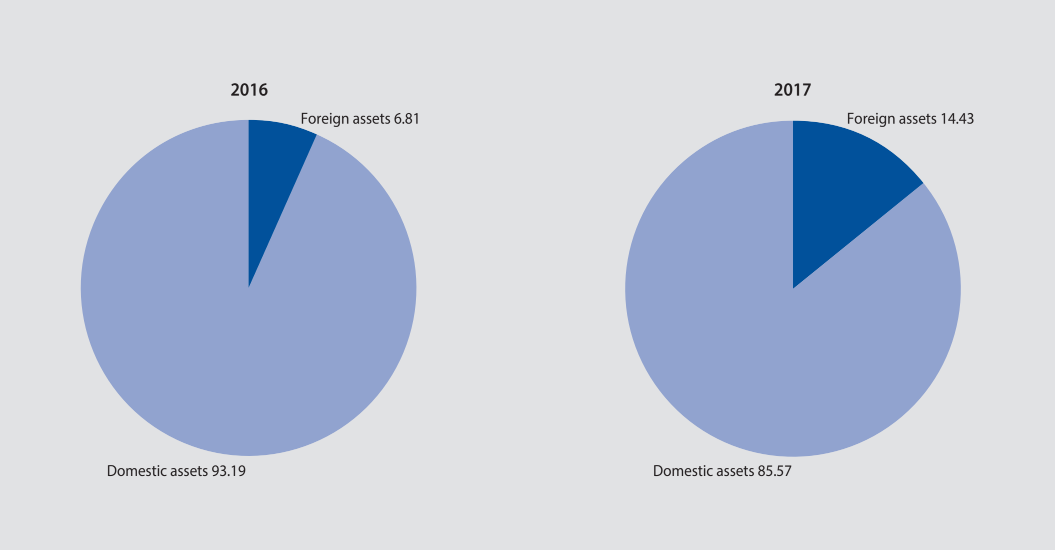
Source: NBS.

Chart 15 Use of eligible assets in 2016 (percentages)



Source: NBS.

Chart 16 Use of domestic and foreign eligible assets (percentages)



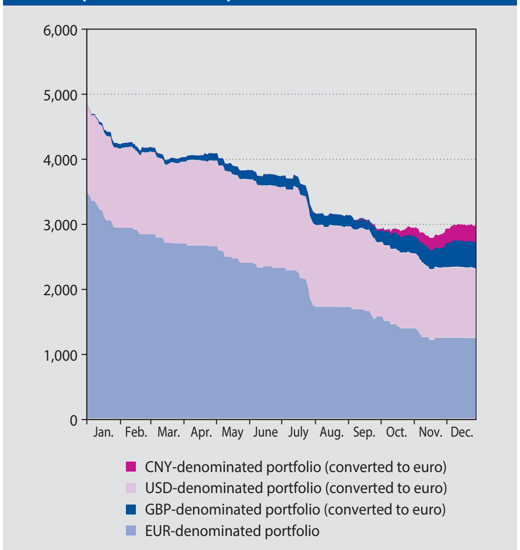
Source: NBS.

in 2016 to 86% in 2017. Slovak counterparties use a collateral pool to manage their collateral.

1.3 INVESTMENT PORTFOLIO MANAGEMENT

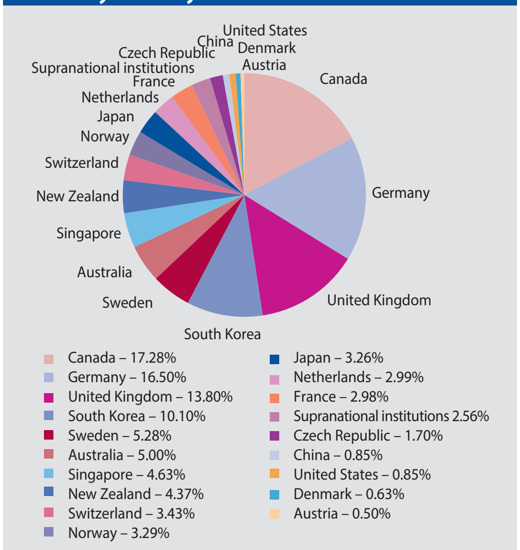
Národná banka Slovenska manages its investment portfolios with the aim of ensuring that the portfolios contribute positively to the bank's overall financial result. The total value of NBS's investment portfolios as at 31 December 2017 was €3 billion (at corresponding exchange rates and with securities at nominal value). Chart 17 shows how the total value of these portfolios changed during the year, while Chart 18 shows their geographical breakdown. In managing its portfolios, NBS applies the

Chart 17 Nominal value of securities holdings in NBS investment portfolios in 2017 (EUR millions)



Source: NBS.

Chart 18 Total value of NBS investment portfolios as at 29 December 2017 broken down by country of issuer



Source: NBS.

principles laid down in the NBS investment strategy approved in 2008 and updated in 2014 and 2016. In the case of the euro-, US dollar- and GBP-denominated portfolios, interest rate risk is managed in a standard way through interest rate swaps and futures contracts. After taking into account hedging costs and other costs and revenues on the liability side, the returns on the euro-, US dollar- and GBP-denominated portfolios in 2017 were 0.44%, 0.66%, and 1.24%, respectively. In late 2017 NBS established a strategic portfolio of Chinese government bonds unhedged against interest rate risk and exchange rate risk.

2 Financial stability and financial market supervision[5]

2.1 Financial stability

In 2017 Národná banka Slovenska (NBS) issued six macroprudential decisions concerning cyclical and structural systemic risk in the context of financial stability. Four of these decisions concerned the setting of the countercyclical capital buffer (CCyB) rate. They included NBS Decision No 8/2017, which was significant from a financial stability perspective in that it raised the CCyB rate to 1.25% with effect from 1 August 2018 (this was the second time that the rate had been raised). The reason for the hike was the continuing strong growth in credit to the domestic non-financial sector, which had reached an all-time high. That growth was spurred mainly by the upward impact of low interest rates on demand for loans among households and non-financial corporations (NFC). Signs of the financial cycle's expansionary phase began to appear in other areas, too. Property market pressures built up, private sector indebtedness increased and default rates fell for most types of loan.

Another two decisions concerned banks in Slovakia identified as 'other systemically important institutions' (O-SIIs). The list of O-SIIs is reassessed on an annual basis, and the 2017 assessment did not result in any changes to its composition. There were, however, changes to the settings of the O-SIIs' additional capital buffer requirements in the form of O-SII buffers and systemic risk buffers.

In response to rising credit demand, NBS has adopted two decrees that are significant in terms of macroprudential policy. Decree No 10/2016, which entered into force at the start of 2017, enabled the recalibration of certain parameters and established a legal framework for supervising compliance with prudential rules for the provision of housing loans. Decree 10/2017, which entered into force at the start of 2018, laid down conditions for the provision of consumer loans. Its purpose is to reduce risks to consumers (in particular the risk associated with rising household debt) and risks to firms providing consumer loans, as well as to stem the build-up of financial market imbalances. Through these decrees, the principles contained in a previous NBS Recommendation on risks related to market developments in retail lending became binding on all providers of the respective types of loan.

2.2 Financial market supervision

The banking sector

As at 31 December 2017 a total of 12 banks and 14 foreign bank branches were operating in Slovakia. Under the Single Supervision Mechanism (SSM), consisting of the ECB and the national competent authorities of participating Member States, all banks and foreign bank branches operating in Slovakia are categorised as either:

- significant, supervised directly by the European Central Bank in close cooperation with Národná banka Slovenska (they comprise: Tatra banka, a.s.; Všeobecná úverová banka, a.s.; Slovenská sporiteľňa, a.s.; Československá obchodná banka, a.s. and ČSOB stavebná sporiteľňa, a.s., both part of the KBC Group; UniCredit Bank Czech Republic and Slovakia, a.s., pobočka zahraničnej banky; Komerční

5 *For further details, see the Report on the Activities of the Financial Market Supervision Unit of Národná banka Slovenska in 2017, which is published (in Slovak only) on the NBS website at http://www.nbs.sk/sk/publikacie/publikacie-dohladu/sprava-o-cinnosti-udf*