



Macprudential Commentary

September 2021



NÁRODNÁ
BANKA
SLOVENSKA
EUROSYSTEM

Summary

- The financial cycle is gradually turning up, with acceleration particularly apparent in the credit and property markets. This may also entail a build-up of imbalances. Uncertainty about the future economic situation has diminished.
- The credit market has continued to recover, with notably stronger growth in loans to households for house purchase.
- Growth in loans to private non-financial corporations (NFCs) has also accelerated. The downtrend in loans for fixed investment has ended.
- Property price growth has picked up amid a firming of demand that reflects the broad availability of credit, rising household income and low interest rates. Imbalances are increasingly likely to build up.
- The banking sector's profit has rebounded to its pre-crisis level. Banks have been helped by no longer having to increase their loan loss provisioning. Banks remain well capitalised.



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The CCyB rate remains unchanged

The ongoing economic recovery and improving labour market situation is translating into a financial cycle upturn. Growth in loans to households, including housing prices, has been accelerating since the start of the year. A financial cycle upswing may, however, be coupled with a gradual build-up of imbalances. The buffer is currently at a level that sufficiently covers existing risks.

At the same time, uncertainty about the adverse effects of the coronavirus (COVID-19) pandemic on the financial sector have diminished. Thanks to the adoption of relief measures, the risks present have not had an upward impact on losses, hence the non-performing loan ratio has declined. The amount of loan loss provisions is appropriate for the currently perceived risks. Banks are no longer provisioning to an excessive degree. The banking sector's profit has rebounded to its pre-crisis level, while banks remain well capitalised and willing to lend to the real economy.

In the light of current developments, it appears justified to keep the countercyclical capital buffer (CCyB) rate at its current level.



Expectations for the CCyB rate in the next quarter

The probability of risks materialising as a result of the pandemic crisis has decreased. Národná banka Slovenska (NBS) does not expect the next period to see elevated loan delinquencies and a strong rise in credit risk losses. Were such a situation to arise, however, the Bank stands ready to reduce the CCyB rate to the necessary extent.

The recovery of economic growth is having an upward impact on both the credit market and the property market. This situation also entails a gradual build-up of imbalances. The buffer's current rate is, however, providing sufficient leeway to cover existing risks, so the Bank does not expect that a rate increase will be necessary in coming quarters.

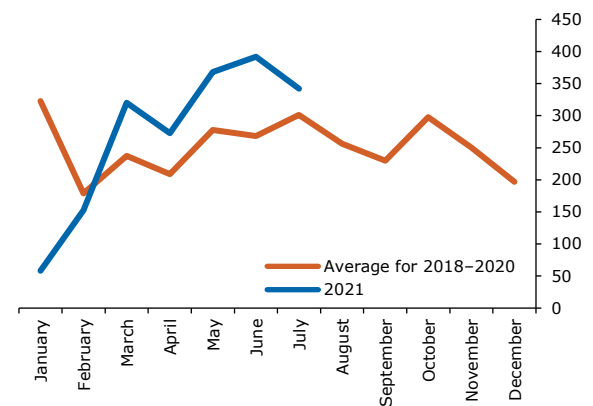
CCyB rate:
1.0%



Household loan growth has accelerated in 2021

Annual growth in loans to households remained strong in the second quarter of 2021. Compared with the first quarter, the growth rate accelerated by 1.6 percentage points, to 7.4%. This increase was, however, part of a Europe-wide trend,¹ with household loan growth in Slovakia being the ninth highest in the EU.² Growth remains notably robust in the housing loan portfolio, as rising household income, persisting low interest rates,³ strong interbank competition, and the property market situation are ensuring no cooling of demand for these types of loans. At the same time, banks' willingness to lend is increasing amid the improving economic situation. There is also an ongoing uptrend in household demand for loan refinancing (often involving a principal increase), hence the increasing share of prepaid loans.⁴ Another factor behind the expansion of loan books is the gradual easing of the decline in consumer loans⁵ which has been evident since around March of this year. This trend appears to have been supported by the relaxing of pandemic containment measures, given that consumer lending developments have in the past corresponded to the extent of economic lockdowns. Banks say they expect demand for loans to continue firming in the near term.

Chart 1 Loans to households increased more in the first half of 2021 than in the pre-crisis period (month-on-month increases in EUR millions)



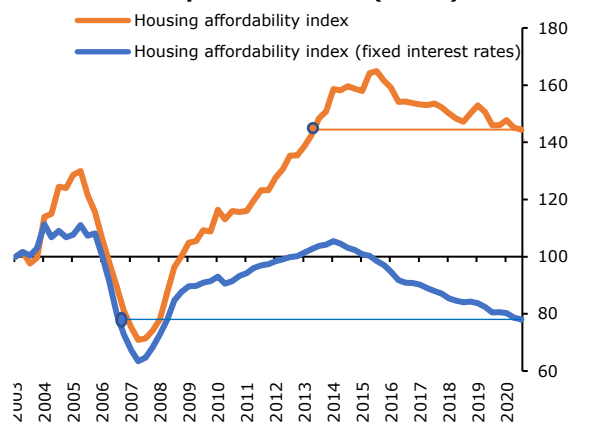
Source: NBS.



Housing prices continue to rise

The pandemic crisis has not dampened housing price growth. On the contrary, housing prices have been accelerating this year,⁶ not only in Slovakia, but also in a majority of European countries. In Slovakia, housing price growth has been most marked in the main regional towns and cities, and flats of all sizes have been rising in price. The housing price growth is being driven mainly by a situation in which household demand for flats and houses is strong and the supply of housing is relatively stable. The robust demand for flats reflects mainly their high affordability (the relationship between the average housing loan instalment and the average wage). In historical terms, housing affordability remains relatively favourable, largely because of rising household income and persisting low interest rates. These factors, however, are only partly offsetting the impact of housing price growth, and housing affordability is gradually decreasing. That prices of flats are rising faster than economic fundamentals may signal a build-up of imbalances in the housing market; this may also be indicated by the housing affordability index (in regard to fixed interest rates).

Chart 2 Housing affordability continued to fall in the second quarter of 2021 (index)



Sources: CMN, and NBS.



The availability of corporate loans appears favourable

Supported by the recovery in economic activity, firms' total revenues have rebounded to their 2019 level. The situation is, however, highly heterogeneous across economic sectors. With the economic situation improving, corporate sector revenues surged by 25%, year on year, in the second quarter of 2021. This high rate, however, reflected a base effect, since revenues fell sharply in the second quarter of 2020 following the onset of the pandemic's first wave. Total revenues for the second quarter of 2021 were on a par with those for the same period of 2019, just 0.4% lower. The situation,

¹ In Slovakia, annual growth in loans to households was 1.6 percentage points higher in the second quarter than in January, while in the EU as a whole it was 1.2 percentage points higher.

² In June 2021, the annual growth rate in loans to households was 4.0% in the euro area and 4.4% in the EU.

³ The average interest rate on housing loans has remained stable in 2021, at 1%.

⁴ The share of prepaid loans in the previous month's outstanding amount of loans has now been at a high level of 1.2% for around five months.

⁵ The annual rate of decrease in consumer loans moderated from 9.6% in February to 7.3% in July.

⁶ Compared with the first quarter, the annual growth in prices of existing flats increased by 4.9 percentage points in the second quarter, to 13.5%, and prices of houses accelerated by 6.6 percentage points, to 22%.

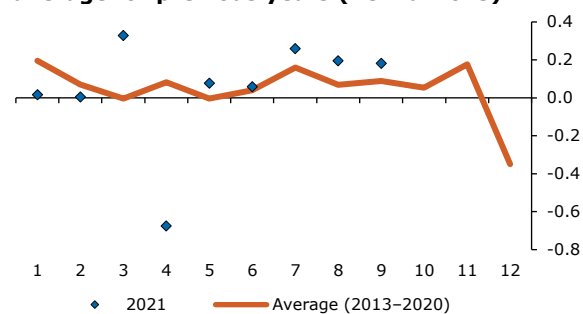
however, is highly heterogenous across economic sectors. Although all sectors showed an improvement on their 2020 performance, only the trade sector and information and communication sector outdid their 2019 results. In most economic sectors, revenues remain below their pre-pandemic level, and the largest difference is in the accommodation and food service activities sector. Furthermore, revenues for the second quarter of 2021 captured only the economic recovery that followed the fading of the pandemic's second wave; they did not yet reflect the uncertainty related to the incoming third wave.

Although total loans to non-financial corporations (NFCs) have declined slightly in year-on-year terms,⁷ this decrease stems from substantial loan repayments by several large enterprises and state-owned enterprises,⁸ which in April repaid working capital loans to a greater than usual extent. The modest levels of annual growth in total NFC loans have therefore been due in large part to April's outlying decline in loans.

In May and June 2021, the month-on-month increases in NFC loans were already at or slightly above their pre-pandemic level. This upturn was caused largely by lending to private firms, with the annual growth rate of their loans gradually accelerating from 0.7% in April to 1.7%⁹ in July 2021. Looking at the breakdown of corporate loans by purpose, growth in fixed investment loans has continued to improve slowly,¹⁰ supported mainly by growth in those loans with a maturity of between one and five years.

Lending trends broken down by firm size categories show a favourable situation in the credit market. As mentioned above, the only negative developments have been in the portfolio of loans to large enterprises.¹¹ Loans to firms in other size categories, i.e. firms for whom bank loans are an important source of financing, have been growing quite strongly. Lending to micro enterprises and small enterprises has maintained high growth rates,¹² and lending to medium-sized firms has accelerated.¹³ In all of these categories, lending growth has remained favourable despite the ending of borrowing under public loan guarantee schemes.¹⁴

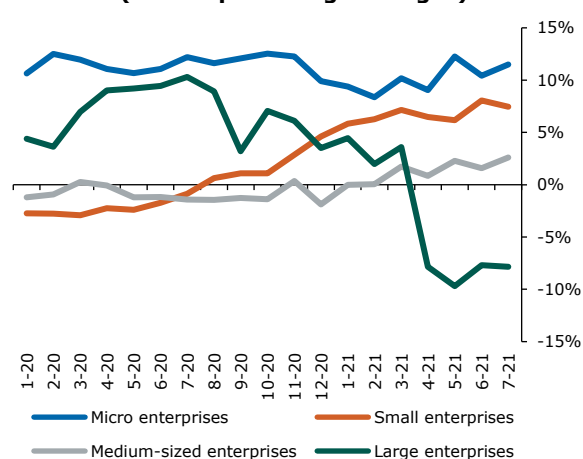
Chart 3 Month-on-month increases in loans to NFCs stabilised after April at just above their average for previous years (EUR billions)



Sources: NBS, and Register of Bank Loans and Guarantees.

Note: The numbers on the horizontal axis denote the months of the year.

Chart 4 In the breakdown of NFC loans by firm size, only loans to large enterprises have declined (annual percentage changes)



Source: Register of Bank Loans and Guarantees.

⁷ In July 2021 the annual rate of change in total NFC loans was -1.13%.

⁸ The annual growth rate of loans to state-owned enterprises decreased during the second quarter of 2021 by an average of almost 25%. This also contributed to the decline in loans to large enterprises.

⁹ The relatively low growth rate compared with that for loans to microenterprises and SMEs is caused by the previously mentioned category of large enterprises, some of which are privately owned.

¹⁰ The annual rate of decline in total fixed investment loans eased from -2.5% in April 2021 to -0.1% in July 2021.

¹¹ After falling sharply in April, the annual rate of growth in loans to large enterprises has been in the region of -8%.

¹² For loans to microenterprises, the annual growth rate in June 2021 was 11.5% for loans to small enterprises, 7.5%.

¹³ The annual growth rate accelerated from 1.2% in April 2021 to 3.2% in June 2021.

¹⁴ The scheme was supposed to end by the end of the first half of 2021. Less than €8 million worth of government-guaranteed loans were provided in July, and these may have been based on applications made in late June.



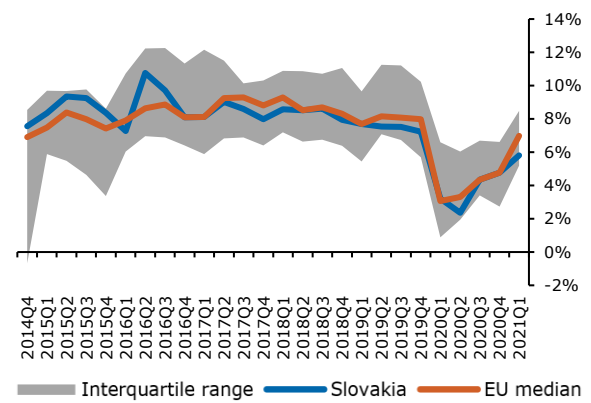
Banks' profitability has rebounded

After falling sharply in 2020, the banking sector's profit has rebounded to its pre-crisis level. The sector's profit for the first seven months was higher in 2021 than in any year since 2016. Compared with the same period of 2020, the profit more than doubled.¹⁵ This notable improvement was accounted for by two factors. First, loan loss provisioning in response to the onset of the pandemic crisis made a significant dent in banks' profits in 2020, while this year, with the pandemic situation improving, banks have scaled back their provisioning. Their net provisioning was approximately three times higher in 2020 than in the period before the crisis,¹⁶ while in the first seven months of 2021, it was only two-thirds of the pre-crisis level.¹⁷ Banks have eased mainly their provisioning for performing loans with increased credit risk,¹⁸ reflecting a decrease in banks' uncertainty perceptions. The second factor affecting the banking sector's profit is the abolition of the bank levy as from July 2020, since when the levy has no longer been a burden of banks' profits.

While the effects of these factors will moderate in coming months, banks remain in a long-term struggle with low interest rates, which continue to weigh on their business. Bank's interest income as at July 2021 was 2.5% lower year on year, although that drop was notably more moderate than its annual decline at the end of 2020 (-3.9%). This improvement is largely due to the impact of the ECB's third series of targeted longer-term refinancing operations (TLTRO III), which at least five Slovak banks had participated in as at July 2021.¹⁹ At the same time, banks' net fee and commission income as at July was 8.6% higher year on year. But despite its strong recovery, the Slovak banking sector's profitability is lower than that of most other European countries' banking sectors.²⁰

Slovak banks have retained their strong capital positions in 2021. Despite recording a lower profit in 2020, the banking sector has remained well capitalised thanks to prudent dividend policies supported by ECB and NBS Recommendations.²¹ The aggregate total capital ratio was 20.8% at the end of the second quarter (a quarter-on-quarter increase of 0.4 percentage points).²² The sector's capital has for a long time comprised mostly highest quality Common Equity Tier 1 (CET1) capital.²³ The capital ratio increase was also supported by a significant decline in the amount of risk-weighted assets in certain banks. At the current juncture, banks' lending to the real economy is not constrained by capital requirements.

Chart 5 Profitability measured by return on equity in Slovakia and in EU countries (percentages)



Sources: ECB, and NBS.

Note: The ROE is based on annualised figures.

¹⁵ The sector's net after-tax profit for the first seven months of 2021 was €447 million, up from €197 million for the same period in 2020.

¹⁶ In 2018 and 2019.

¹⁷ In 2018 and 2019 banks' cumulative net provisioning amounted to just over €100 million, while in the pandemic crisis year of 2020 it stood at just over €322 million. In the first seven months of 2021, cumulative net provisioning amounted to just over €50 million, while in the same period of 2018 and 2019 it averaged €78 million.

¹⁸ So-called Stage 2 loans (under IFRS 9).

¹⁹ Abstracting from the TLTRO III impact, the annual rate of decline in net interest income as at June 2021 was 5.1% (the decline inclusive of that impact was 2.5%). Banks have benefited from the ECB's decision to ease conditions for TLTRO III operations, enabling them to borrow at a rate as low as -1%, 50 basis points below the average interest rate on the deposit facility.

²⁰ For the first quarter of 2021, the ROE of the Slovak banking sector stood at 5.8%, while the median ROE for EU national banking sectors was 7% and the lower quartile level was at 5.2%.

²¹ Recommendation ECB/2020/35 (2020/C 437/01) of 15 December 2020 and NBS Recommendation No 1/2021 of 12 January 2021.

²² Besides business activities, another factor that affected the quarter-on-quarter change in the total capital ratio was the entry into force of Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019 (CRR 2), in particular changes in the measurement of credit risk, market risk and counterparty credit risk. These changes are described in more detail in the box entitled "What's new in banking regulation?"

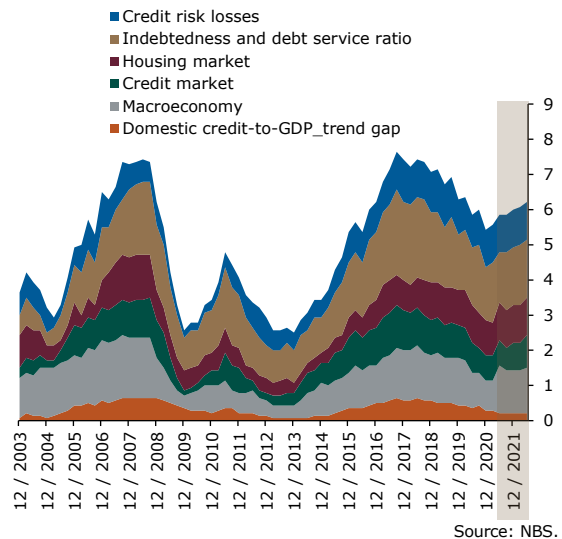
²³ The share of CET1 capital in total capital has for a long time been around the 87% level.



The economic recovery has been reflected in financial cycle developments

The financial cycle is gradually entering an upswing that may also be coupled with a build-up of imbalances. The economic recovery following the pandemic's second wave, together with the related strong upturn in economic sentiment, is starting to have an impact on the financial sector. Amid an improving labour market situation and the high availability of credit, household loan growth has been accelerating since the start of this year. Not even the pandemic crisis has seriously slowed housing price growth, so housing, although still highly affordable, is gradually becoming less affordable. Nor has the crisis had an upward impact on non-performing loan (NPL) ratios, which in 2021 have decreased further from already low levels. The financial cycle indicator is gradually increasing, implying a potential slow accumulation of cycle-related imbalances. These relate mainly to an increase in private sector indebtedness, a moderation of risk perceptions, a possible easing of credit standards, and lending to higher-risk borrowers. At present, the only curb on the indicator's uptrend is from lending to the corporate sector, which is maintaining modest stable growth. If the Bank's current projections²⁴ for economic developments materialise, the financial market's expansionary phase can be expected to continue.

Chart 6 The financial cycle turned up in the first half of 2021



Note: Higher index values imply an intensive build-up of imbalances.



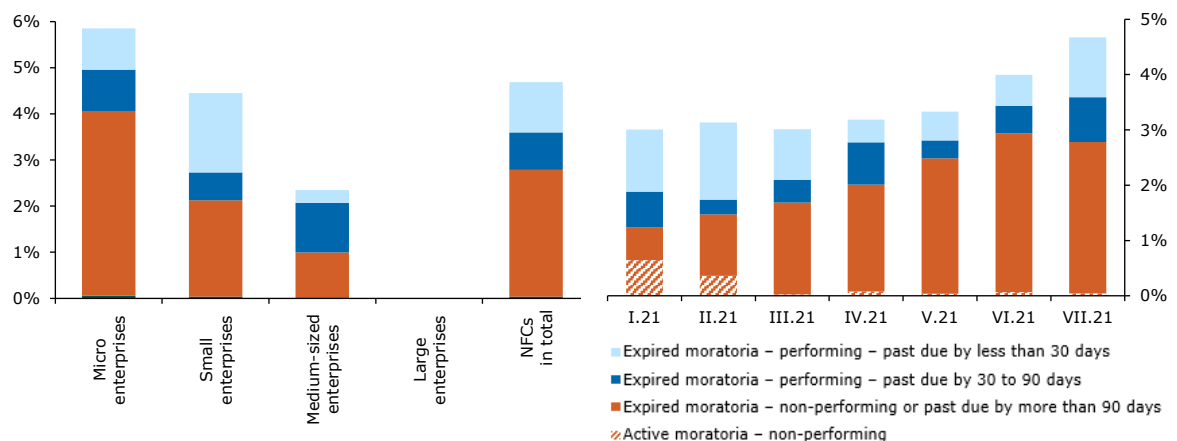
No upside surprise in loan delinquencies in 2021

Following the expiry of pandemic-related statutory moratoria on loan repayments, most of the loans concerned are being repaid on schedule. The majority of these moratoria have already expired and hardly any new ones are being granted. As for what proportion of these loans have defaulted, it will still be several months before that question can be finally answered. As at August 2021, 4.7% of post-moratorium NFC loans and 5.6% of post-moratorium household loans were in some form of distress.²⁵ Consumer loans and, among NFC loans, loans to microenterprises continue to show the highest levels of distress. These distressed loans represent respectively around 0.6% of the total NFC loan book²⁶ and 0.7% of the household loan book. The NPL ratio for household loans remains on a long-term downtrend and fell to 2.2% in July 2021. In the aggregate NFC loan book, the NPL ratio has stabilised at 3.3% after a slight uptrend. In both the household and NFC loan portfolios, the share of non-performing or past due loans that were under a statutory moratorium²⁷ is increasing gradually and moderately.

Chart 7 Impaired loans as a share of NFC loans for which a statutory moratorium was granted

Left-hand chart: NFC loans as at August 2021 broken down by firm size (impaired loans as a percentage share of loans for which a statutory moratorium was granted)

Right-hand chart: Evolution of loans to all sizes of NFCs (impaired loans as a percentage share of loans that were under a statutory moratorium)



Source: NBS.

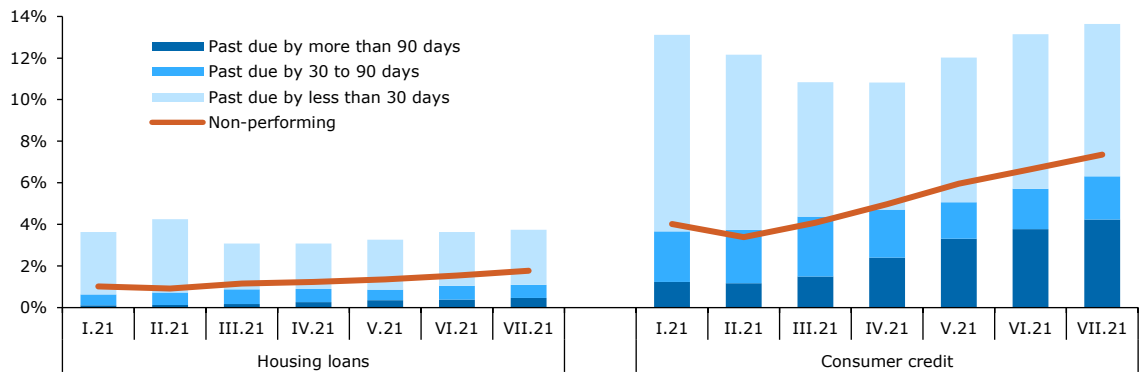
²⁴ As given in NBS's spring 2021 Medium-Term Forecast (MTF-2021Q2).

²⁵ In the case of a further 0.8% of loans, the borrowers had requested debt restructuring (for example in the form of a temporary reduction in repayments); however, the share of these loans has not been increasing in recent months.

²⁶ The figure for NFC loans should, however, be increased by a further 0.6 percentage points representing loans that have defaulted during the pandemic crisis without having been subject to a statutory moratorium.

²⁷ Statutory moratoria were granted for loans amounting to 12% of the total loan book.

Chart 8 Impaired loans as a share of retail loans that were under a statutory moratorium (percentages)



Source: NBS.

Note: The charts show data for the four largest banks in the Slovak banking sector.

The Bank is also closely monitoring credit quality developments in NFC loans that were granted a government guarantee under pandemic relief legislation. Any impairment of these loans affects not only banks, but also the state budget. Most of the loans concerned have a maturity of between three and six years. The credit quality of these loans has remained sound up to now,²⁸ although some signs of deterioration may have appeared in recent months.²⁹

²⁸ As at July 2021 the share of non-performing loans or loans past due by more than 90 days stood at 0.8%, a further 1% were past due by up to 90 days.

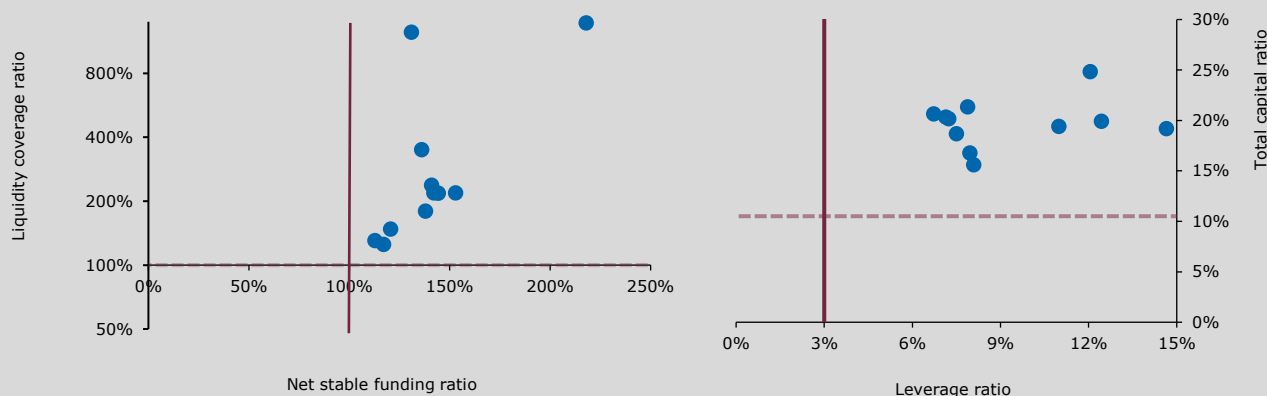
²⁹ From May to July 2021, the share of non-performing or past due loans increased from 0.5% to 1.8%. There was also an increase in the share of loans that show a significant increase in credit risk (Stage 2 loans under IFRS 9).

What's new in banking regulation

As part of a regulatory overhaul known as the “risk reduction package”,³⁰ a number of regulatory changes concerning banking business entered into force in June 2020. They were among changes approved at the EU level back in the first half of 2019, most of which had their entry into force deferred until December 2020 (those under CRD V)³¹ or June 2021 (those under CRR II).³²

The principal change is the introduction of a binding leverage ratio (LR) requirement, set at 3%, and a net stable funding ratio (NSFR) requirement, set at 100%. In view of its traditional business model, the Slovak banking sector is expected to meet the new requirements comfortably.

Chart 9 Compliance with regulatory requirements for the net stable funding ratio, liquidity coverage ratio, leverage ratio and total capital ratio
(percentage logarithmic scale; percentages)



Source: NBS.

Note: The horizontal axes show the newly introduced requirements for the net stable funding ratio and the financial leverage ratio. The total capital ratio requirement is set at 10.5% (comprising the minimum Pillar 1 requirement plus the capital conservation buffer).

Besides introducing ratio requirements, the new provisions also address eligible liabilities, the calculation of banking book credit risk and counterparty credit risk, and the tightening of exposure limits. Other changes under the new framework concern, for example, the management of market risk in the trading book in accordance with the revised Basel IV proposals – the *Fundamental Review of the Trading Book (FRTB)* – approved by the Basel Committee on Banking Supervision in January 2019. Questions, however, continue to surround long discussed changes concerning the measurement of credit risk of sovereign exposures and operational risk, as well as, for example, the introduction of a minimum level of risk-weighted assets (an output floor) for banks using advanced measurement approaches.

³⁰ In November 2016 the European Commission introduced amendments to the Capital Requirements Regulation (CRR) and to the fourth Capital Requirements Directive (CRD IV), as part of a financial system reform package. The purpose of the amendments was to finalise the implementation of the Basel III framework in the European Union and in the context of the prospective banking union and capital markets union.

³¹ Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 (transposed into Slovak law through amendments to the Banking Act (No 483/2001)).

³² Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019.



ECB decides not to extend recommendation on limiting dividends

Last year the ECB issued a recommendation³³ advising banks to exercise extreme prudence on dividends and share buy-backs until 30 September 2021. In the light of its latest macroeconomic projections, envisaging economic recovery and reduced uncertainty, the ECB has decided that this recommendation does not need to be extended.³⁴ According to the ECB, banks should remain prudent when deciding on dividends and share buy-backs, carefully considering the sustainability of their business model. They should also bear in mind the risk of additional losses following the expiry of pandemic support measures. Acting in step with the ECB, Národná banka Slovenska last year adopted a Recommendation on capital and profit distribution by banks during the COVID-19 pandemic³⁵ and set 30 September 2021 at its expiry date. No extension of that expiry date is currently envisaged. In the future, however, it cannot be ruled out that the recommendation will be reissued and possibly modified, depending on the evolution of the pandemic situation and the stability of the financial sector.

Several authorities in Europe have increased the CCyB rate

A number of European countries are witnessing a gradual upswing of the financial cycle coupled with a build-up of imbalances. Relatively strong growth in loans to households, particularly in housing loans, can be seen occurring in several European countries amid rising property prices. These trends are a source of concern that private sector borrowing will rise sharply and that the banking sector's risk exposures may increase in the event of adverse future developments. In response to this situation, several macroprudential authorities decided in recent quarters to raise the CCyB rate by 50 basis points. Česká národní banka then in August 2021 decided to increase the rate by a further 50 basis points, to 1.5%, with effect from October 2022.³⁶ Similarly, the Bulgarian central bank decided in September 2021³⁷ to hike the CCyB rate to 1% with effect from October next year, and Norway's finance ministry decided back in June to raise the CCyB rate to 1.5% with effect from June of next year.³⁸

Macroprudential policy measures and their leakage effects

The tightening of macroprudential policy may lead to unwanted effects in the form of increasing higher-risk lending to other sectors of the economy. According to an IMF paper³⁹ based on a sample of 29 economies, unexpected tightening of household-specific macroprudential policy measures, such as loan-to-value (LTV), debt service-to-income (DSTI) and debt-to-income (DTI) limits, is accompanied by an increase in riskiness of corporate credit. This probably reflects banks' efforts to maintain their profitability. According to the authors, their results support early policy tightening, i.e. during the early phase of the credit cycle, when risks are growing but still relatively low and therefore the significance of the measures' unwanted effects is also relatively small.

Do macroprudential policy measures exacerbate inequality?

According to an ECB paper,⁴⁰ the answer depends on the time horizon and the economic scenario. While such measures as LTV and DSTI limits can increase wealth inequality at introduction, their benefits increase significantly during a time of crisis and adverse developments. This is because, during a crisis, rising unemployment and recession usually have a greater impact on low-income households. Macroprudential policy measures introduced at such a time help dampen the adverse effects of the crisis on households. This prevents an increase in bankruptcies, so there is a lower increase in income inequality compared to the counterfactual where these measures are not in place.

Can financial indicators predict banking crises?

According to an IMF paper⁴¹ using data from 59 advanced and emerging market economies, financial overheating can be detected in real time. In advanced economies, the best leading indicators are equity prices and output gap; in emerging markets, equity prices, property prices and credit gap indicators. Moreover, aggregating this information flags financial crisis many years before the crisis. According to the authors, financial cycles are shorter than is generally believed and their length is on a par with, or even shorter than, that of business cycles (typically 5–6 years). This should be kept in mind when calibrating countercyclical macroprudential policy instruments. Equity cycles are shortest, with a length of approximately 3–4 years, and they have the largest amplitude. Credit cycles are typically 5–6 years in length. Cycles in emerging market economies are usually shorter than those in advanced economies and also have a larger amplitude.



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³³ Recommendation ECB/2020/35 of 15 December 2020.

³⁴ ECB [press release](#) of 23 July 2021.

³⁵ Recommendation No 1/2021 of Národná banka Slovenska of 12 January 2021.

³⁶ Provision of a general nature No III/2021 of Česká národní banka of 26 August 2021.

³⁷ Decision of the Bulgarian National Bank of 16 September 2021.

³⁸ See the [press release](#) of 17 June 2021.

³⁹ Bhargava, A., Górnicka, L. and Xie, P., "Leakages from Macroprudential Regulations: The Case of Household-Specific Tools and Corporate Credit", *IMF Working Papers*, No 21/113, International Monetary Fund, August 2021.

⁴⁰ Georgescu, O. and Martin, D.V., "Do macroprudential measures increase inequality? Evidence from the euro area household survey", *Working Paper Series*, No 2567, European Central Bank, Frankfurt am Main, June 2021.

⁴¹ Chen, S. and Sviryzdenka, K., "Financial Cycles – Early Warning Indicators of Banking Crises?", *IMF Working Papers*, No 21/116, International Monetary Fund, April 2021.