NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Analysis of the Slovak Financial Sector for the First Half of 2010

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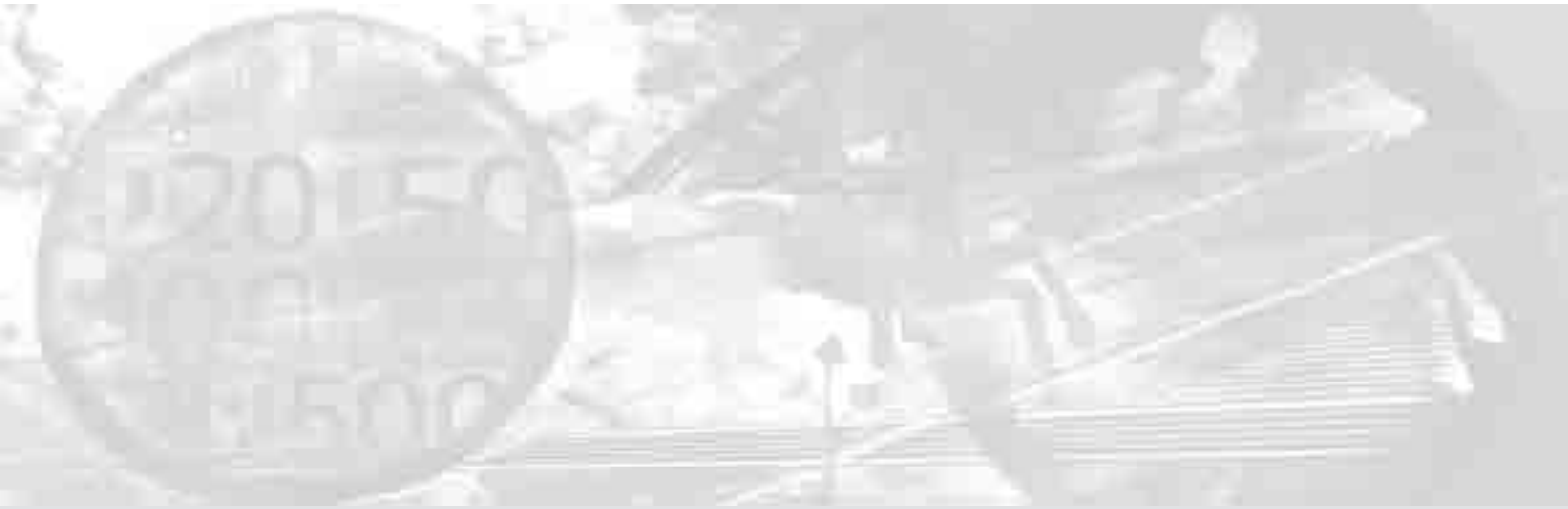

FOREWORD

FOREWORD

Národná banka Slovenska produces the Analysis of the Slovak Financial Sector for the purposes of the NBS Bank Board as well as for professionals and the wider public. The object of this analysis is to analyse the current situation and developments in the financial market, to warn of potential risks and threats to its stability, and thereby to support efforts to pre-empt potential crisis situations.

This analysis evaluates the overall condition of the financial sector as at 30 June 2010. It is based on data and information available as at 17 September 2010, the cut off date of the publication, and focuses on the analysis of the system's resilience to possible negative developments. The analysis is based on the evaluations of individual institutions and of the sector as a whole. It also aims to elucidate a deeper link between the developments in the financial sector, on one hand, and the development of macroeconomic and microeconomic indicators, on the other hand. Its macro-prudential nature is reflected especially in the use of stress testing, through which the sector's sensitivity in various scenarios may be assessed.

As in the previous analyses, financial information on particular institutions is primarily obtained from the banking supervision's information system „MIM", the STATUS system, STATUS DFT, RBUZ and from the basic documents prepared by Financial Market Supervision departments. Additional sources included the Statistical Office of the Slovak Republic, the Real Estate Price Map, Eurostat, the European Central Bank, and other external sources and commercial information systems. The analysis does not take into account activities concerning the exercise of supervision of particular institutions.

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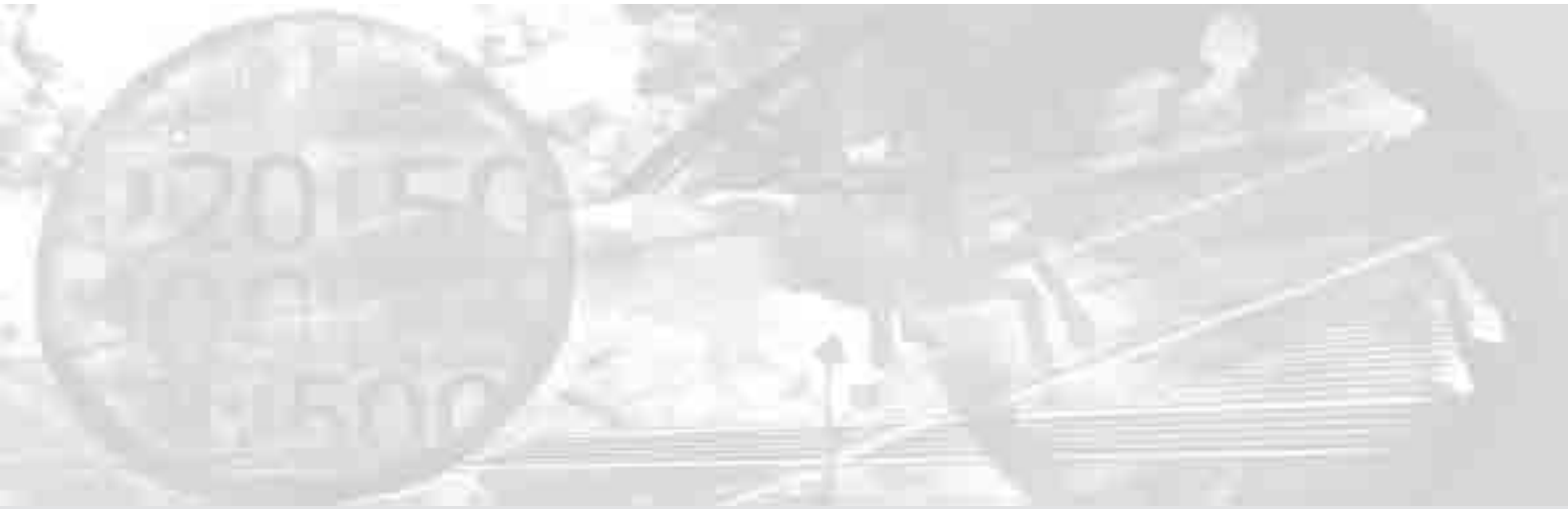


ANALYSIS SUMMARY

Analysis summary

Macroeconomic indicators continued to stabilise in the first half of 2010; financial markets were adversely affected by sovereign risk

The stability of the financial sector in the first half of 2010 was to a large extent affected by macroeconomic developments at home and abroad. The downturn in economic activity in the first half of 2009 was followed by a period of stabilisation, and these positive trends were maintained in the first six months of 2010. Above all, there has been a shift in the general sentiment in the world economy, with several indicators implying that optimism is rising in the principal economic blocs. The United States in particular recorded strong economic growth in the first quarter of 2010. Emerging countries continued to record sharp growth, and generally they felt no more than minimal repercussions from the global economic crisis. As far as Slovakia was concerned, developments in the EU were crucial. Although the EU economy as a whole recorded a positive trend, marked differences appeared between individual countries. In the first half of the year, the Slovak economy was one of the fastest growing in the EU, partly because of its strong links to economies that were themselves recovering.

The stabilisation in financial markets also continued at the beginning of 2010. Uncertainty gradually abated and liquidity improved, not least because central banks were taking measures that kept interest rates low. During this period, however, the sovereign debt crisis was becoming more severe and it came to a head in May 2010. Its effects were seen in several areas, including upward pressure on the sovereign bond yields of the crisis-hit countries and a negative impact on the health of the banking sector. The situation was calmed only after governments and central banks took a series of counter-measures.

Growth in the domestic financial sector was stronger among sectors centred on asset management

The upturn in several indicators of economic and financial-market developments, particularly in comparison with 2009, supported the stabilisation of the domestic financial sector. The differences between individual sectors were relatively marked in the first half of 2010. It was mainly sectors centred on asset management that recorded the largest increase in assets, since they were able to attract customers by offering higher returns in comparison with 2009. Sectors specialising in lending services reported only moderate growth. In the banking sector, this situation was reflected mainly in lending to enterprises. As for leasing, factoring and hire-purchase companies, their activities declined, though it is generally the case that the recovery of these sectors arrives after a certain lag. What is particularly important for such sectors is to have a stable and sustainable economic recovery.

The banking sector's financial position strengthened

In the first half of 2010, the banking sector continued to be the dominant component of the financial system in Slovakia. The stability of the whole system was closely tied to the stability of the banking sector, which in comparison with 2009 can be said to have strengthened. Amid improving economic conditions, banks managed to bolster their financial position – a key buffer against negative shocks. The overall profits of banks, after slumping in 2009, increased by more than one third year-on-year. It should be noted, however, that the profitability of banks remained lower than in 2008, and therefore that the profitability ratio, despite its improvement, had still not returned to the pre-crisis level. Interest income developed positively in the first half of 2010. The continuance of lending to households and the steepening of the yield curve drove up net interest income from the household and securities sectors. Banks created provisions to approximately the same extent as in 2009, and they also continued to cut operating expenses. We expect these trends to be maintained in the second half of 2010, too. As regards their profitability, banks will be affected mainly by the shape of the yield curve and further developments in non-performing loans.

The stability of banks was also increased by the strengthening of their capital adequacy ratio, which indicates the ability of banks to cope with unexpected losses. The principal cause of this

improvement in the first half of 2010 was a rise in own funds, with most banks using part of their 2009 profits to bolster these funds. Bank also benefited from the downturn in lending, particularly in lending to enterprises, since this reduced their risk-weighted assets.

Banks continued to behave conservatively

Banks did not significantly alter their behaviour in the first half of 2010. The majority of banks maintained the cautious approach that they had followed in 2009, focusing mainly on activities generally perceived as less risky. Several banks continued to invest in government securities, largely consisting of domestic government bonds. Some banks purchased government bonds whose prices proved highly volatile in the first half of the year. The total amount of bank lending rose by only one percent over the six months under review. The cautiousness of banks was strongly apparent in lending to enterprises. Firms themselves contributed significantly to the downturn in corporate lending; their demand for loans – particularly investment loans – was subdued due to production capacities still being underutilised. At the same time, the amount of corporate loans received from abroad increased and therefore partially replaced funding from domestic banks. Bank lending to leasing companies and hire-purchase companies decreased.

Bank lending to households increased; it can be said to be recovering to a certain extent given that the pace of this lending was faster than in the second half of 2009. Compared with the pre-crisis period, however, the rise in the stock of loans was substantially smaller. The mentioned recovery was driven mainly by demand. The increased willingness to take on debt reflected the upturn in the labour market and general improvement in household sentiment. A key factor in this regard is the period of relatively low interest rates and the decline in residential property prices. As for the banks, they did not ease lending standards to a significant extent, but rather they responded through marketing activities or by taking steps to streamline the lending process.

But while the overall stock of loans rose moderately, the amount of new bank loans increased far more sharply. This trend reflects mainly the fact that banks' existing customers are seeking to refinance their previously-arranged loans at relatively lower interest rates. The market shares of particular banks reflected this development, and, in this respect, the banks' differing approaches to lending were an important factor.

Although the overall amount of retail deposits stabilised, the structure of term deposits underwent a change, as bank customers sought higher remuneration by shifting their savings to longer-maturity deposits.

Economic recovery entails several risks

The Analysis for 2009 observed that banks were facing rising credit risk, but we can now say that this risk eased over the first half of 2010 due in large part to the improving economic environment at home and abroad.

As for the further development of credit risk in banks, the sustainability of current trends will be crucial. Although risks may be abating in the short-term horizon, the current economic development entails several risks in the medium term and long term. From a global perspective, critical issues include whether or not the US economy will suffer a double-dip recession and the expected cooling of economic growth in emerging countries. As regards developments in the European Union, they will probably be affected not only by the potential cooling of the global economy, but above all by the situation in certain peripheral countries. In the near term, economic growth may heavily reflect the programmes of savings implemented by national governments. Fears continue to surround the health of banking sectors in certain countries. On the whole, therefore, the current economic recovery raises a number of questions that may be a source of increasing risk in banks.

Credit risk mitigation in banks

The economic recovery in the first half of 2010 was reflected in the corporate sector, as firms – especially those in export-oriented sectors – improved their financial position. The upturn fed through to banks' portfolios, as the increase in non-performing loans slowed down. Nevertheless, credit risk continues to be the most significant risk that banks were facing. In addition to the mentioned uncertainty surrounding the economic recovery, certain business sectors continue to be a major source of potential losses. The property sector merits special attention since it

constitutes a substantial proportion of banks' portfolios and typically has a high concentration of loans. Particularly in the residential property sector, a large share of financed projects showed low marketability and little prospect of improvement in this respect. Most of these projects are unsuitable in terms of their quality or intended target group (especially in regard to price). These represent serious handicaps, particularly at the present time when demand is determining the market conditions and continues to be marked by strong caution.

The credit risk in household lending is also abating. The probability of loans being repaid is rising amid the improving situation in the labour market, the strengthening financial position of households, and the general rise in optimism. Increases in non-performing loan ratios slowed down during the first half of the year, indicating that banks have already put the largest increases in NPL ratios behind them. As with the assessment of corporate credit risk, a crucial factor in this regard will be the sustainability of the current economic upturn.

As for market risks in the banking sector, a particularly important development in the first half of 2010 was the escalation of the credit risk posed by certain EU countries, notably Greece. This put downward pressure on the valuation of debt securities issued by these countries. This type of risk affects only certain banks in the sector. In addition, certain banks would record an increase in banking book credit risk in the event of a rise in interest rates.

Firms and households have been relatively sensitive to a rise in interest rates, since a large part of loans were provided with short-term interest rate fixation. In the first half of 2010, the sensitivity of households showed a marginally decreasing trend. Concerning new housing loans, a shift towards longer interest-rate fixation has been observed.

Changes in banks' market shares in the first half of 2010 could lead to increased risk

Several trends that appeared in the banking sector in the first half of 2010 had the effect of changing market shares in the sector. On the asset side, this was reflected in the provision of new housing loans. The changes in market shares were more pronounced also in the area of term deposits of households. Although the changes per se need not necessarily be perceived as negative, their speed and structure could potentially result in a rise in riskiness.

The greater resilience of banks is indicated also by the results of stress testing

At the end of June 2010, the banking sector continued to report relatively strong resilience to adverse economic developments, and it may be described as more resilient in comparison with the results at the end of 2009. The main reason for this was the bolstering of the banking sector's capital buffers during the first half of 2010.

In the event of stress situations, banks would record greater losses mainly in corporate lending. Only a few banks would report higher losses from household lending and from market risks.

Banks reported a higher sensitivity only under the scenario of a substantial worsening in the economic environment. It was shown that in order to cope with the period of stress, banks need mainly an ability to generate profit and a relatively strong capital position. Interest income proved to be a key factor in improving profitability.

The insurance sector saw a continuation of the trends seen in 2009

Although the insurance sector showed certain signs of improvement in several areas, the negative condition that it found itself in 2009 continued in the first half of 2010. Notwithstanding a modest rise in demand for life insurance products, the sector is performing far below its pre-crisis level.

A combination of the fragile economic revival and uncertainty about future developments in general is keeping demand for insurance products at low levels. The risk of being unable to pay insurance premiums is rising, and insurance policy cancellations are also increasing, especially in life insurance. As a consequence of these trends, claims cost are rising.

The amount of new policies in the non-life insurance sector fell again, while strong competition continued to reduce premium prices in the sector's main lines. The loss ratio of the sector as a whole increased, driven partly by payouts related to natural disasters.

The main challenges that insurers faced during the period under review are still present to a considerable extent. The profitability of insurance companies during the first six months of this year was influenced by stagnant premiums, a persistently high amount of surrenders, an increasing incidence of natural disasters and modest growth in financial income. How these areas develop will have a major effect on the performance of insurers in the near term, too.

As regards the available solvency margin of insurance companies, all insurers were evaluated as meeting the prescribed level, and most of them did so relatively comfortably. Furthermore, the latest test of the adequacy of reserves demonstrated that insurance companies have a sufficient amount of reserves.

The amount of assets in collective investment vehicles increased mainly in the first quarter of 2010

The amount of assets in collective investment funds continued to rise in the first four months of 2010, driven up by both fund sales and the positive performance of funds. In May and July, the net asset value again declined, largely due to a deterioration in performance. Stronger asset growth was reported mainly among foreign collective investment undertakings. Most assets continue to be concentrated in money market funds. The composition of domestic investment fund portfolios underwent only moderate changes in the first half of 2010, although one new trend was the increase in the bond component of equity funds. A downturn in performance was recorded across almost the full range of fund categories in the first half of 2010, reflecting the fact that the upturn in asset prices seen in 2009 was not maintained during the period under review.

After undergoing substantial changes in 2009, the pension saving sector recorded stable development in the first half of 2010

Pillar II of the pension saving system did not undergo any substantial changes in the first half of 2010, particularly when compared with developments in previous years. In several respects, the situation during the six months continued on from where 2009 left off, with conditions stabilising in the wake of the major changes made to the system mainly in the first half of 2009. The asset structure of pension funds remained largely unaltered in the first half of 2010, and all funds made positive returns over the period. The performance of growth and balanced funds was more or less identical to that of conservative funds. This is largely a consequence of adjustments to the asset structure of funds made back in 2009.

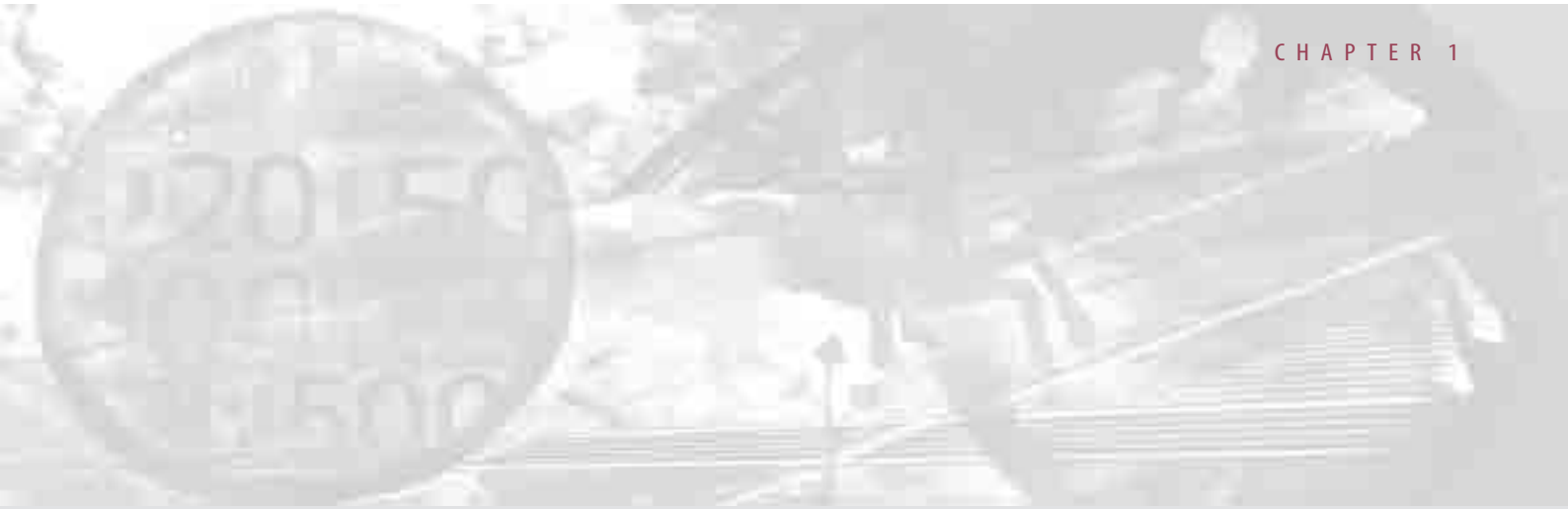
Assets in Pillar III of the pension saving system continued to increase, reflecting above all the rise in share purchases, which once again raised the equity component of equity funds. The average performance improved in comparison with 2009, and, overall, Pillar III funds outperformed Pillar II funds.

Equity risk represented the most significant market risk

One of the most significant changes in regard to market risk developments was the relatively sharp rise in the share of investments made in equity shares and in shares/units of funds managed by supplementary pension asset management companies (SPMCs). SPMC funds were therefore more substantially exposed to stock-market turbulences.

Equity risk is the prevailing risk also in investment funds. In certain funds, this risk is closely linked to foreign exchange risk due to the high proportion of shares denominated in foreign currency.

The exposure of retirement pension funds to market risk was relatively low as at the end of the first half of 2010. As for the risks that investments in PFMC funds are exposed to over a horizon of several months, the most severe include a fall in interest rates, a concentration of counterparties in the case of bank deposits, and a drop in bond prices, as well as the counterparty risk in other types of transactions stemming from certain sovereign credit risks.



CHAPTER 1

MACROECONOMIC DEVELOPMENTS AS THEY AFFECT FINANCIAL STABILITY

1

1 MACROECONOMIC DEVELOPMENTS AS THEY AFFECT FINANCIAL STABILITY

THE GLOBAL ECONOMY MADE PROGRESS, BUT UNCERTAINTY ABOUT ITS FUTURE DEVELOPMENT INCREASED

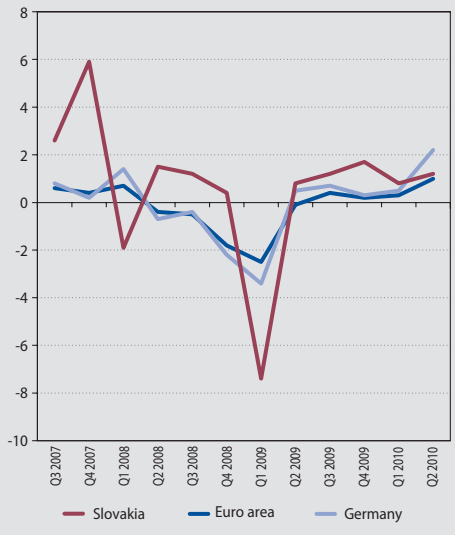
The global economy, despite its persisting difficulties, can be said to have performed relatively well in the first half of 2010 since it partially exceeded the original growth forecasts. Growth in some emerging countries even surpassed its pre-crisis level. The recovery in advanced economies was more moderate, albeit steady, and this was reflected in, among other things, revised forecasts for GDP.

From a historical perspective, however, the economy picked up at a slower pace than is usual for this phase of a recovery. Furthermore, uncertainty about the economic recovery escalated, largely due to sovereign crises in the euro area. Despite expectations that a W-shaped recovery has been definitively averted, a double-dip recession remains one of the possible scenarios, at least in certain regions.

FEARS ABOUT THE SUSTAINABILITY OF ECONOMIC RECOVERY IN THE UNITED STATES INCREASED TOWARDS THE END OF THE FIRST HALF OF 2010

Although the United States is no longer the engine of growth that it was throughout the decade before the crisis, it remains the largest economy in the world. Its health is in no small measure crucial to the course of economic developments in other parts of the world, not least in the euro area and therefore indirectly also in Slovakia. The first quarter of 2010 brought a relatively pleasant surprise, when the US economy grew in real terms by an annualised 3.7% in comparison with the final three months of 2009. This growth was largely driven by the US economy's traditional strength – household consumption. Since household disposable income increased slowly, it is possible that this consumption was being financed at the expense of household savings. Such behaviour, resembling that which preceded the crisis, would support a short-term boost to economic growth, but a situation in which expenditure rises faster than income is incompatible with sound and sustainable growth over the long term. The most significant source of growth in the first quarter was investments in inventories. The pace of the first-quarter growth proved, however, to be unsustainable (also because of its structure) and in the three months from April to June the US economy grew by an unexpectedly slow 1.6% in comparison with the previous period. The key causes of this turnaround were a pronounced slowdown in restocking (probably because firms were in the final phase of this process) and a sharp rise in imports. At the same time, however, the increase in imports of consumer and investment goods into the United States supported the recovery in other parts of the world.

Chart 1 Development of GDP in selected countries (quarterly changes in %)



Source: Eurostat.

The most favourable developments in the US economy occurred roughly during the months March to May, when it appeared that the country would be recovering at a fast pace. Not only did economic activity increase during this period, it was accompanied by a parallel rise in consumer confidence and in business confidence in the economy's progress. In addition, the property market situation improved and the number of new jobs created increased sharply.

The situation changed towards the end of the first half of 2010. Confidence among consumers and firms began to weaken, household consumption stagnated, and manufacturing output even declined slightly. This turnaround was brought about by several factors, most significantly the deteriorating labour market situation, the escalating uncertainty surrounding events in the euro area, and the overall drop-off in property market activity following the expiry of government support measures. The Federal Reserve also responded to this development; on one hand, it gave a more subdued assessment of the economic situation and, on the other hand, it decided to purchase government securities using the proceeds from maturing mortgage-backed securities. A fundamental problem in outlooks for the US economy continues to be the high level of unemployment, which – whether directly through the income channel or, indirectly, through the impact on sentiment – is to a large extent holding back an increase in household consumption. The economy's prospects are also undermined by the fact that the effects of fiscal stimulus measures taken in previous periods will gradually wane.

The rapid growth in emerging economies continued

Emerging economies are playing a key role in stimulating global economic growth in the wake of the recent crisis, and at the forefront of this development are countries from Asia and South America. Through export orientation and strong competitiveness in manufacturing, most of these countries managed to make a rapid return to pre-crisis levels of growth. Another advantage of these countries is their relatively low indebtedness, which allowed their governments to implement stimulus packages without delay. Furthermore, the lending process was able to continue in these countries because their banking sectors had remained in a relatively sound condition despite the financial crisis. Recent months, however, have seen the appearance of signs that the exceptional dynamism of emerging economies cannot be maintained and that their growth will cool down to a certain extent. Provided that such a slowdown is not too abrupt, it may be seen as a basically positive development, since it should prevent overheating and any consequent collapse in economic activity. In the short term, however, it would to some degree affect global demand and therefore also growth in advanced countries.

Economic activity in the euro area picked up in the second quarter of 2010

The situation in Europe and the euro area was among the weakest links in the process of reviving the global economy during the second half of 2009, i.e. from the point when the recession is roughly assumed to have ended. The beginning of 2010 continued in the same vein. In both these regions, gross domestic product for the first quarter rose by an annualised 0.8%, far below the growth reported by, for example, the United States or Japan for the same period. Economic stagnation or even contraction was prevented by government expenditure and, even more so, by the ending of the destocking process in the business sector. However, neither one of these factors can be called a driver of long-term sustainable growth. Despite hitherto unconvincing developments and the culminating crisis, the second quarter of the year saw an unexpected upturn, aided to a large extent by the euro having weakened substantially against all major world currencies during most of the second quarter and, to a lesser extent, from the beginning of 2010. In addition, the economic sentiment indicator (ESI) implies that economic outlooks included increased confidence in the private sector, as reflected in rising demand among both enterprises and households. In the second quarter, the ESI values stood at around their long-term average level.

Euro area economies reported marked differences in their economic developments

Despite the recovery in the euro area as a whole, the widening divergences between developments in different EU countries may be seen as negative. On the one side of the spectrum are the so-called central countries of the euro area, which managed to turn the nascent global recovery to their advantage because of their relatively greater export and manufacturing orientation. Having an economy set up in this way proved to be a strong competitive edge at this particular phase of the business cycle, since it allowed these countries to take advantage of the rising demand – predominantly from Asia – for manufactured goods. Germany occupies a special position among these euro area countries, and it recorded exceptionally strong GDP growth in the second quarter. Given the size of its economy, Germany therefore accounted for more than half of the euro area's total growth. In addition, Germany is the only country that has managed

to reduce unemployment since the onset of the crisis. Germany's strong position is largely attributable to its specialisation in high value added products that are not exposed to strong competition, while at the same time it has an exceptionally competitive workforce.

As regards the dynamics of post-crisis developments, the other side of the spectrum comprises countries on the geographical periphery of Europe, which recorded only minimal growth or, as in the case of Greece, remained in recession. The structure of their economies – centred on the services and construction industries – took shape during the economic boom and was highly successful, but it proved unsuited to the conditions of the new economic reality. All of these countries have a workforce that is overpriced, insufficiently flexible and therefore uncompetitive. Since these countries also show the characteristics associated with having a high fiscal deficit and overall debt, they found themselves at the epicentre of a new wave of financial market turbulences. In order to avert the threat of default, their governments committed themselves to substantial fiscal consolidation, which even during the first half of the year was resulting in reduced demand in the economy. Even so, the more severe repercussions of the budget cuts are not expected to be felt until the periods ahead. These countries, not having the option to devalue their currency, are therefore getting themselves into an especially difficult position by attempting to balance the need to generate sufficient growth and at the same time to stem the accumulation of general government debt.

GDP growth in Slovakia in the first half of 2010 was among the highest in the euro area

Slovakia was one of the euro area countries that experienced an economic recovery in the first half of 2010. The Slovak economy grew by 4.8% year-on-year in the first quarter of 2010 and by 4.7% in the second quarter, representing one of the strongest rates of growth in the euro area. A significant factor in this respect was the openness of the domestic economy, particularly to countries that themselves recorded growth in the first half of the year. This was reflected in the structure of economic growth in the first half of the year, with the recovery centred mainly on external demand. The Slovak economy's growth was boosted by the fact that exports exceeded imports over the six months. The contribution of domestic demand was more moderate, and household consumption even declined year-on-year in the second quarter of 2010. This is more or less confirmed also by developments in retail sales. As for general government consumption, it too recorded a year-on-year decline in the second quarter of the year.

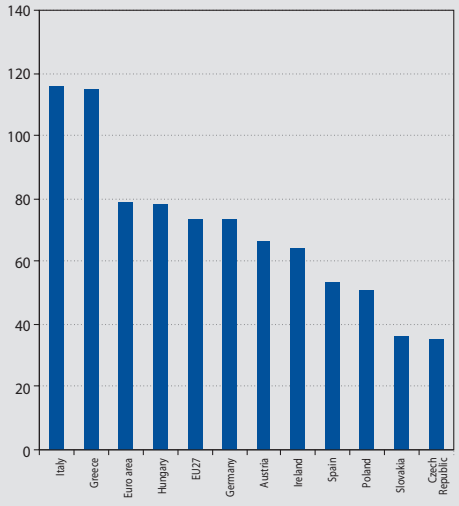
GDP growth was boosted by the behaviour of enterprises, particularly their decisions to restock amid the continuing rise in business optimism. Several business surveys confirm that firms have positive expectations for the near term.

The situation in the domestic economy over coming months will again be largely determined by the development of external demand and in particular by the situation in Germany.

The future economic development in the euro area will entail several risks

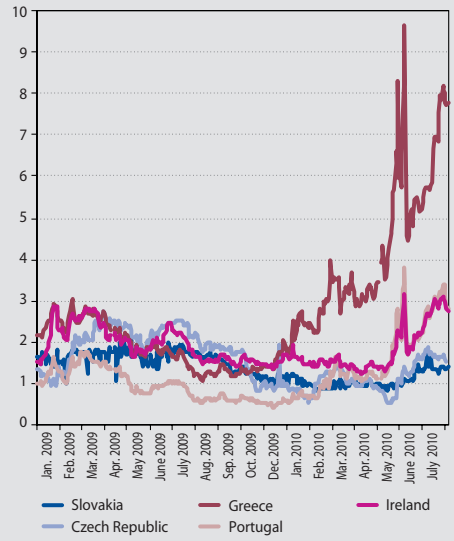
Many countries outside Europe's periphery have also run up higher budget deficits as a result of the crisis and they have been forced to announce programmes of savings as a preventative measure. The drop-off in demand in the euro area as a result of governments reining in spending will therefore be relatively widespread. In some cases, taxes will have to be raised to ensure budgetary

Chart 2 Gross debt to GDP ratio in selected countries in 2009 (%)



Source: Eurostat.

Chart 3 Ten-year government bond spreads between yields of selected countries and German bond yields (p.p.)



Source: Reuters, NBS calculations.

rehabilitation, which will probably be reflected in a decline in private sector consumption. Another risk for the entire euro area is the relatively strong export dependence of the central countries. Although this is an advantage at the present time, these countries are vulnerable to any decline in demand, mainly from Asia and in particular China. Crucial to the further progress of the euro area will be the extent to which the sovereign risk crisis affects the health of the banking sector. If the situation in the banking sector were again to deteriorate significantly, the euro area economy would probably slip back into recession.

Sharp increase in sovereign risk

Sovereign risk had an adverse effect on financial markets throughout the first half of 2010. The risk attached to sovereign government bonds – as measured by the spreads between the government bonds of the countries in question against German government bonds – peaked in May 2010. This period saw a sharp rise mainly in spreads on Greek government bonds. The situation was partially stabilised only after the approval of a €750 billion safety net. The ECB also played its part in steadying the situation by introducing a series of measures aimed at calming the markets.

In subsequent weeks, however, the sovereign risk of certain countries began to increase again. In contrast to the period before May 2010, however, the rise in spreads was caused not only by upward pressure on the yields required from the afflicted countries, but also by a decline in the yields on German bonds. This development indicates how, to an increasingly great extent, financial markets are discriminating between countries on the basis of their sovereign risk. Whereas the situation in Germany or France is generally viewed to be positive, developments in Greece, Spain, Portugal and Ireland are seen as negative – owing to fears about their ability to consolidate public finances (whether in the short- or long-term horizon), about their capacity to generate economic growth and about the health of their banking sectors.

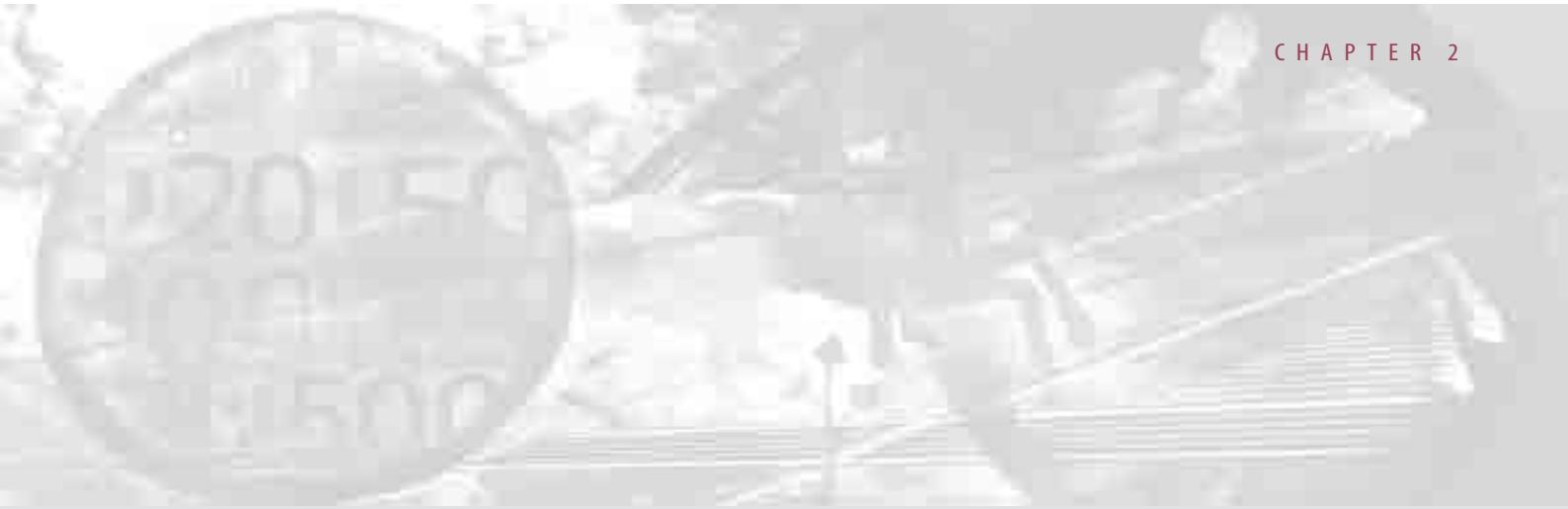
Slovakia's sovereign risk positively perceived

Owing to the mentioned discrimination between countries on the basis of sovereign risk, several countries recorded only a minimal rise in their country risk. Like countries such as Germany and the United States – which in the event of such turbulences mostly serve as save havens, Slovakia too recorded relatively stable development. Spreads on Slovak government bonds in most maturities did not record significant fluctuations. The moderate rise from May 2010 was caused largely by the decline in German bond yields, with the yields on Slovak government bonds remaining stable. Financial markets had a number of reasons for taking a positive view of Slovakia. Its public debt is one of the lowest in the EU and its budget deficit in 2009 did not stray far from the EU average. More important still is the financial markets' overall view of the Slovak economy. It is still perceived to be competitive, even during crisis periods. This view was partially confirmed by the relatively successful issues of new government bonds during the course of 2010.

Confidence lacking in the euro area interbank market

It was mainly in the second quarter of 2010 that the nervosity surrounding sovereign risks fed through to other parts of the euro area financial market in the form of high volatility. From April, the interbank market saw increases in interest rates and in spreads indicating credit risk or liquidity risk. What is particularly important, apart from the rise in the benchmark EURIBOR, is the disruption to the redistribution of interbank liquidity in the euro area. On one side are mainly the smal-

ler banks from the peripheral countries, but also certain other banks that are exposed to the private and public sectors of these, for now, economically vulnerable countries. These banks faced considerable difficulties in borrowing from other banks and they were to a large extent dependent on funds made available under the ECB's extraordinary support measures. It was the same banks that accounted for most of the higher demand in ECB liquidity tenders. Nevertheless, euro area banks are in relatively sound condition and even have a surplus of liquidity, although at the time of peak nervosity in the market they preferred to place it with the ECB through sterilization operations. Such disruption to interbank financial flows surfaced again at the beginning of July when – with more than €442 billion from an ECB one-year LTRO maturing – the amount of funds and the number of banks applying for refinancing fell far short of the levels seen a year earlier, while the average amount per bank rose by twofold. Overall liquidity in the system therefore fell, the effect of which was subsequently seen in rising interbank interest rates. The end to the EURIBOR's upward trajectory and the abatement of uncertainty were partly due to the publication of stress-test results and of the exposure to securities issued by peripheral countries at the end of July. Another factor was the announcement that planned regulatory measures would be moderated and their implementation would be deferred to a later time.



CHAPTER 2

DEVELOPMENTS IN THE SLOVAK FINANCIAL SECTOR

2

2 Developments in the Slovak financial sector

Financial sector assets began to rise again

Assets in the Slovak financial sector increased at a moderately fast pace in the first half of 2010. In the case of sectors regulated by Národná banka Slovenska, the year-on-year rise represented 5.8% and the total asset value of almost €72 billion. The situation in individual sectors of the financial market varied according to the focus of the given sector.

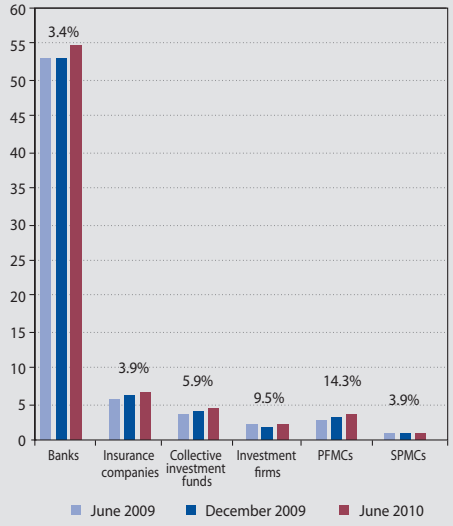
After declining and then stagnating in 2009, assets in the banking sector began to rise. This largely reflected increasing investments in domestic and foreign government bonds, with banks funding these purchases from the rise in household current account holdings and in short-term general government deposits.

Assets continued to increase smoothly mainly in those financial market sectors not engaged in the lending business, but rather focused on the management of customer assets. Households continued to accumulate their financial assets in pension funds and in collective investment funds – where asset growth was also a result of positive fund performance. Similarly in the insurance sector, the increase in assets was maintained largely due to the growth in life insurance and in household investments in unit-linked products. The amount of assets under the management of investment firms also rose (Chart 4).

An important fact for the Slovak economy is that the financial sector upturn was largely underpinned by the accumulation of domestic funds, mainly from households and enterprises. (Chart 5).

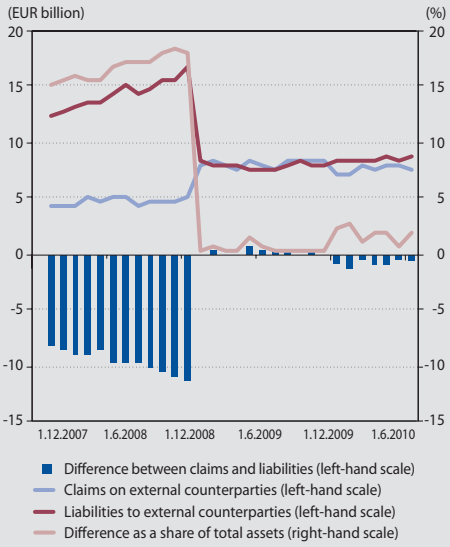
This is a positive development, particularly when compared with the situation in certain new EU Member States, where the increase in the banking sector's assets and in the overall indebtedness of its customers was to a large extent caused by the inflow of foreign funds and could be a factor in making the economy more vulnerable. It is also beneficial for the banking sector that the factors behind its growth in 2010 do not include the supply of liquidity from the Eurosystem through refinancing operations.

Chart 4 Amount of assets or assets under management by segment of the Slovak financial market (EUR billions)



Source: NBS.
Note: The percentage represents the relative change over the previous 6 months.

Chart 5 Claims and liabilities of the Slovak banking sector vis-à-vis the external environment



Source: NBS.

Table 1 Selected financial flows (EUR billions)

	NBS	Domestic financial sector					Domestic non-financial sector			External environment			
		Domestic banks	Insurers	Pillar II and Pillar III funds	Investment funds	Other financial companies	Households	Enterprises	General government	Foreign banks	Foreign investment funds	Foreign general government and international institutions	Other
NBS		2,127 – 2,164	0 – 0	0 – 0	0 – 0	0 – 0	11 – 11	3.6 – 3.6		11,004 – 11,201		1,434 – 2,441	1,349 – 1,343
Domestic banks	1,208 – 1,120	1,365 – 1,157	0.05 – 0.03		0 – 0	1,372 – 1,083	13,147 – 13,892	14,703 – 14,599	12,182 – 13,630	4,407 – 3,852		773 – 1,728	1,464 – 1,471
Insurers	0 – 0												
Pillar II and Pillar III funds	0 – 0	1,223 – 2,074			222 – 249								
Investment funds	0 – 0	1,374 – 1,461											
Other financial companies	26 – 47	1,254 – 1,420			276 – 299								
Households	40 – 39	21,468 – 22,082	3,156 – 3,288	3,947 – 4,401	2,734 – 2,798								
Enterprises	0 – 0	9,208 – 8,622			87 – 112						700 – 782		
General government	0.07 – 0.6	1,981 – 2,789			0.5 – 0.4								
External environment	15,309 – 15,307	8,261 –8,581			46 – 52			10,527 – 12,355					

A direct relationship is not assumed

Data are not available

Source: NBS.
Notes: Structure of data in cell: December 2009 – June 2010.
Rows: overview of financial assets (loans and securities) invested in the institutions named in the columns.
Columns: overview of liabilities (deposits and loans received) to institutions named in the rows.
The figure for insurers represents technical provisions for life insurance.

Changes in the lending market stemmed from weaker demand for loans

While household financial assets were rising at an accelerated pace – supporting an upturn in certain sectors of the financial market – the lending business was still feeling the adverse effects of the economic and financial crisis. The business sector reduced its liabilities to the domestic financial sector and began to make greater use of funding from abroad. In the banking sector, firms' lower demand for financing drove up investments in securities, but in the leasing and factoring sectors it was reflected in a substantial drop-off in activity. Hire-purchase companies also recorded a decline in activity, as households focused more on housing loans than on consumer loans. In addition to a contraction of lending activity, these segments faced a cut in bank financing.

These changes had basically no impact on the share of total assets in the financial market held by the largest sectors (banking, insurance, and collective investment) and the supplementary pension saving sector. The retirement pension saving sector recorded the most marked increase in asset share (0.4 of a percentage point). Since its establishment, this sector has in relative terms been the fastest growing segment of the domestic financial market. The amount of assets managed by investment firms rose more moderately (increasing the sector's share by 0.2 p.p.). The combined share of leasing, factoring, and hire-purchase companies dropped by 0.7 p.p. over the six months under review (Chart 6).

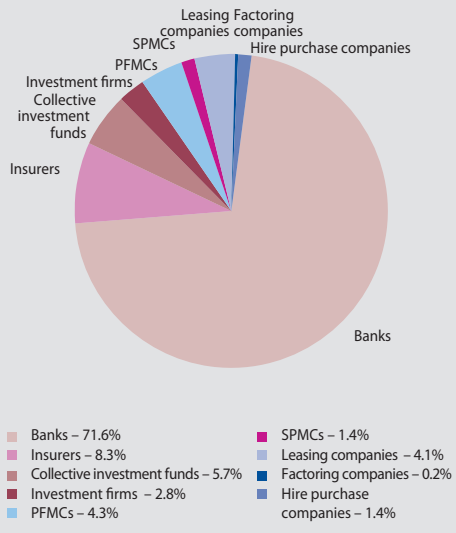
Some financial market sectors increased their profitability

Banking sector profits – which slumped in 2009 due to the decline in foreign exchange operations that followed Slovakia's entry into euro area and to higher provisioning costs – are rebounding, but still remain below their 2008 level. This increase is driven mainly by lower interest expenses. During the first six months of 2010, banks made an overall profit equivalent to 96% of their profit for 2009. The profits of asset management companies (correlated with the amount of assets under management) reflected new purchases of investment fund shares/units.

Households remain crucial to the financial sector

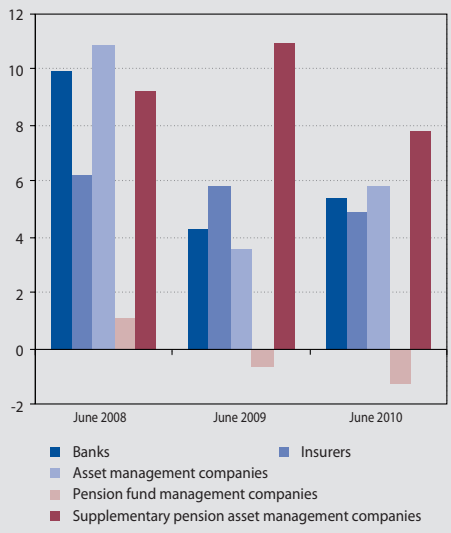
The financial sector is affected to a large extent by the behaviour of households. The growth of several sectors is directly dependent on the accumulation of household financial assets, while lending to the household sector appears to be more profitable and to some extent has better prospects than lending to the business sector. Furthermore, the domestic financial sector is more strongly

Chart 6 Shares of financial entities in total assets and managed assets as at 30 June 2009



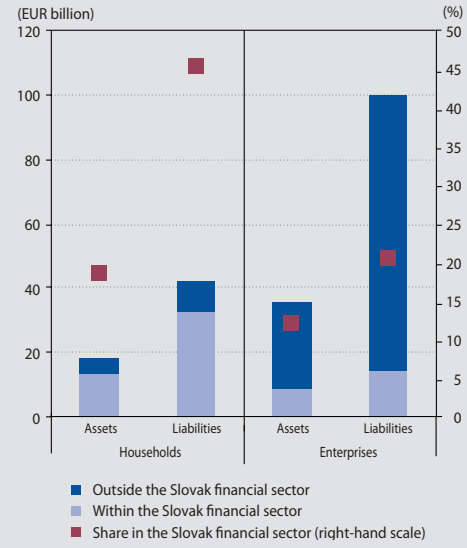
Source: NBS.

Chart 7 Average ROE by segment (%)



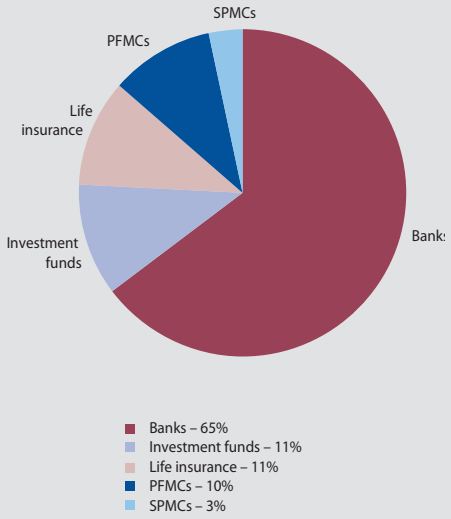
Source: NBS.
Note: Return on equity (ROE) represents net profit as a percentage of equity capital.

Chart 8 Financial assets and liabilities of enterprises and households



Source: NBS.
Note: Data on the right-hand scale represent the percentage share of assets/liabilities in the Slovak financial sector.

Chart 9 Household financial assets by financial market segment



Source: NBS.

linked to households than it is to the business sector (Chart 8).

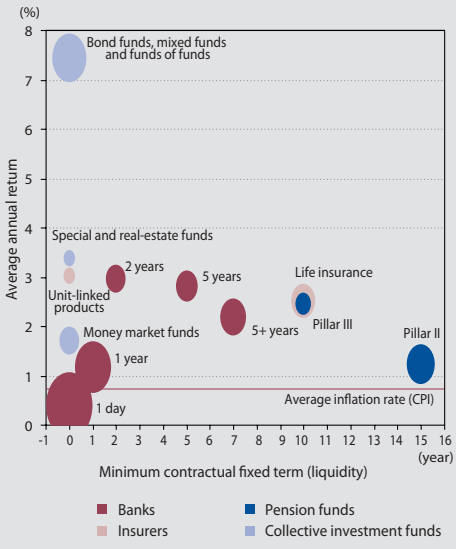
Although household liabilities are mostly owed to banks, they include also liabilities to general government, which are the most volatile item. The bulk of household financial assets are invested in bank deposits, while the proportion placed in Pillar II pension funds is recording the fastest growth.

As for enterprises, their financial liabilities comprise mainly equity capital, while the amount of their loans from abroad is approximately the same as their loans from domestic banks. Owing to an increase in own funds, the extent of corporate borrowing from domestic and foreign lenders has been falling since 2009. This also means that the corporate sector is less dependent on the domestic financial sector and also that its behaviour has a diminished effect on domestic financial institutions. The moderate increase in corporate financial assets in the first quarter of 2010 reduced firms' financial liabilities as a share of financial assets, which is a positive development in terms of their financial position. Households continued to have an overall surplus of liquidity.

Return on household financial assets increased

In 2009, households suffered losses on their pension accounts in certain Pillar II and Pillar III funds and on their holdings in collective investment funds, but in the first half of 2010 their investment returns began to rise again. Pension

Chart 10 Distribution of financial assets by maturity and gross performance

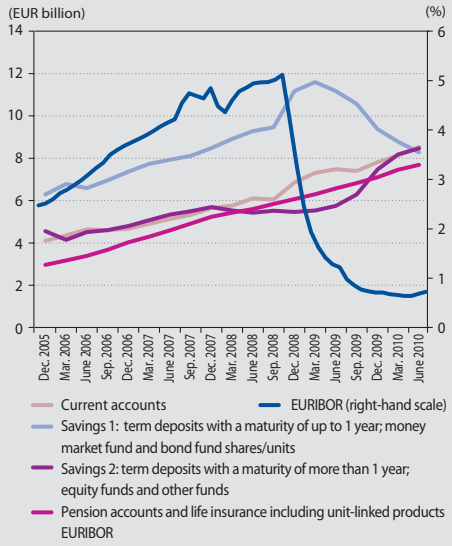


Source: NBS.
Notes: The size of the bubble represents the amount of assets. The composition of groups is determined by similarity of performance. For life insurance, the maximum technical interest rate is shown. The Chart does not include equity funds, which recorded a return of 26%.

funds, however, did not benefit from the recovery of financial markets to the same extent that investment funds did, possibly because of a legislative amendment that affected the investment strategy of pension funds.

In the first half of 2010, the performance of Pillar II pension funds was on the whole lagging behind the remuneration of long-term deposits in banks. The second quarter saw a positive turnaround, as households recorded a nominal return to profit in all the financial market aggregates under review (Chart 9). In what is now a long-term trend, the majority (67%) of household financial assets remained deposited with banks. Insurers and investments funds managed, respectively, 9% and 10%, of the financial assets (Chart 10). The largest rise in share of household financial assets was recorded by pension funds, leaving them with 14% of the total.

Chart 11 Distribution of household financial assets by type



Source: NBS.

The structure of household financial assets continues to change

Household financial assets underwent a change in their maturity structure in the first half of 2010, although bank deposits continue to be their main component. As interest rates fell, so too did the appeal of products whose returns are directly linked to money markets. Bank deposits with a maturity of up to one year fell sharply as a share of household financial assets, while deposits with longer maturities rose.

2.1 THE BANKING SECTOR

2.1.1 TRENDS IN THE BANKING SECTOR BALANCE SHEET

The main changes in the balance sheets of banks in the first half of 2010 resulted from the behaviour of households and enterprises. This was mainly attributable to the improving economic environment and the persistence of low interest rates.

Certain changes were recorded in household demand for loans. Overall, lending to households increased somewhat. The amount of loans provided to this sector in the first half of 2010 exceeded the total volume of household loans in 2009. However, it should be noted that the net increase in lending in the first half of 2010 was below the figures recorded before 2009. The lending market experienced a certain revival as households were recovering from the crisis in an environment where interest rates and residential property prices were lower than in previous years. At the same time, the amount of consumer loans provided remained below the level of 2009.

A new trend in the behaviour of households is an increase in early repayments of loans through new loans. Thus, households made use of the lower interest rates and the different credit standards at the individual banks operating in this sector. This trend led to a change in the market shares of banks.

In the long term, household deposits represented the most important source of funds for the banking sector. After a steep increase at end-2008 and a subsequent decrease in 2009, which took place in connection with the euro changeover, the long-term trend in the total amount of household deposits was restored. The new trend represented a shift to longer maturities, when households began to make use of the higher interest rates on products with longer maturities.

The banking sector also saw changes in the banks' market shares in deposits, when some of the banks managed to increase their market shares through new products or through their interest rate policy. Such increase was mainly achieved by smaller banks.

Demand for loans continued to stagnate in the corporate sector. This was the result of underutilised production capacities, which dampened the growth in demand for financing (though the activities of enterprises increased somewhat), combined with funds obtained by the Slovak corporate sector from abroad. Banks continued to pursue a cautious approach to lending and a policy of relatively strict credit standards.

Banks preferred to invest surplus liquidity in securities, mainly in government bonds, whose increase fully compensated for the decrease in loans to enterprises. Government bonds were dominated by domestic bonds. In some of the banks, the volume of investments in foreign government bonds also increased, mainly investments in Greek government bonds.

2.1.1.1 CUSTOMERS

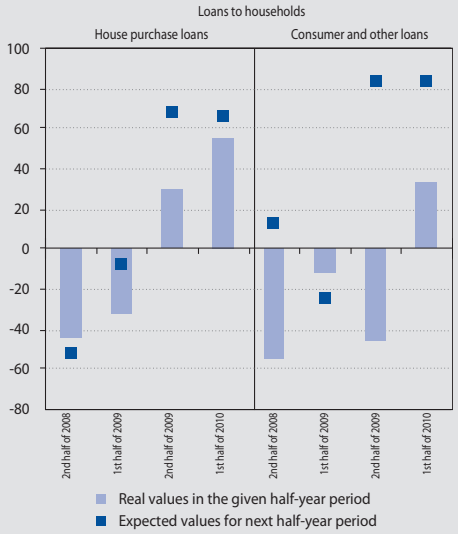
THE RETAIL SECTOR

Demand for housing loans increased in the first half of 2010

The gradual revival in lending for housing purposes, recorded mainly in the last few months of 2009, was previously described in the *Analysis of the Slovak Financial Sector for 2009*. This trend subsequently continued in the first few months of 2010. In this period, the outstanding amount of loans ceased to decrease in year-on-year terms and recorded a stable increase instead. This development was shaped by changes in both demand and supply.

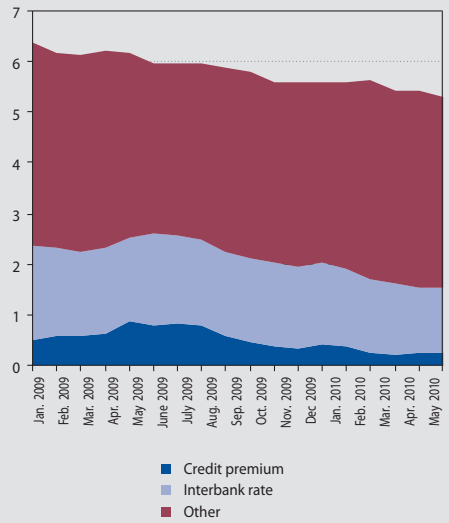
Demand was positively influenced by the stabilising labour market conditions, which took the form of smaller monthly increases in the number of unemployed. In addition, the number of mass redundancies decreased, and thus ceased to be such a burning issue in the media. This was positively reflected in the views of consumers. Expectations regarding the unemployment situation improved in comparison with the previous half-year period, and the negative consumer sentiment weakened. Households began to perceive the expected economic situation, as well as their own financial position, more positively. Overall consumer confidence improved, while the behaviour of households remained relatively cautious.

Chart 12 Demand for loans in the household sector (%)



Source: NBS.
Notes: The difference between the market share (expressed as a net percentage) of banks that reported an increase and banks that reported a decrease in demand. Banks reporting no change were not taken into account in the calculation.
Expectations in the given half-year period express values expected in the next half-year period.
Changes express the subjective views of banks.

Chart 13 Structure of interest rates on new housing loans with a fixation period of over 1 year and up to 5 years (%)



Source: NBS
Notes: Interest rates on new house purchase loans with a fixation period of over 1 year and up to 5 years were brought into equilibrium with the yields on 5-year government bonds.
Interbank rate represented by the discount rate with a maturity of 5 years (EUR zero coupon).
Credit premium approximated as the difference between the yield on 5-year government bonds and the corresponding interbank rate.
'Other' represents other factors that banks take into account in setting their interest rates, e.g. profit margin, random deviations, etc.

The growing demand was strongly supported by the relatively low lending rates. Interest rates on new loans continued to fall in the first half of 2010. This was mainly caused by a decrease in the credit premium, which takes into account the interbank rates and the risk inherent in the Slovak economy.

The decisions of customers were also influenced by the continuing fall in real property prices. Demand was concentrated on certain real property categories. Customers more and more distinguished between good and poor quality projects. The cautiousness of customers in taking on debt, combined with the maximum loan-to-value ratios set by banks, created a certain price limit that customers were largely unwilling to exceed. Hence, the majority of new contracts in the real estate market were concluded for older apartments or for affordably priced new houses/apartments.

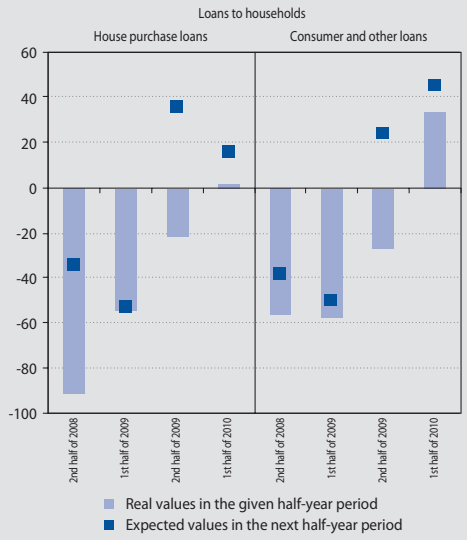
Unlike demand for house purchase loans, demand for consumer loans among households grew only slightly. A similar trend was recorded in short-term loans, i.e. current account overdrafts and credit cards, the outstanding amount of which continued to grow at a decelerating pace.

The behaviour of banks changed only slightly

In lending for housing purposes, the behaviour of banks, i.e. the setting of credit standards or lending conditions, remained virtually unchanged over the first half of 2010. This was also confirmed by the statements of banks implying that credit standards were not eased significantly in any of the banks. Banks tended to apply an individual approach to customers, instead of easing their lending conditions en masse. They also focused on increasing the effectiveness of the lending process.

In the second quarter of 2010, the increased activity of banks in providing loans for housing purposes surfaced in the form of various marketing techniques focusing largely on the price of loans.

Chart 14 Lending standards for loans to households (%)



Source: NBS.
Notes: The difference between the market share (expressed as a net percentage) of banks that reported an easing and banks that reported a tightening of credit standards. Banks reporting no change were not been taken into account in the calculation.
Expectations in the given half-year period express values expected in the next half-year period.

Changes in the structure of housing loans

Starting at the end of 2009, the growth in lending for house purchases began to stabilise. The year-on-year rate of growth fluctuated around the level of 11% during 2010.

An interesting change took place in the structure of growth in house purchase loans. In the first half of 2010, the tendency to replace mortgage loans with other housing loans was even more apparent. Such loans have grown since January by an average of 30% year-on-year, while the growth in classic mortgage loans (covered mortgage loans with a government bonus) slowed from 4% in January to 1% in June. As a result of this trend, the outstanding amount of other house purchase loans exceeded that of mortgage loans in March. This development indicates that the market has found its own path instead of that defined in the Banking Act. Banks give preference to this product because of its lower administrative costs and greater flexibility in meeting the individual needs of customers.

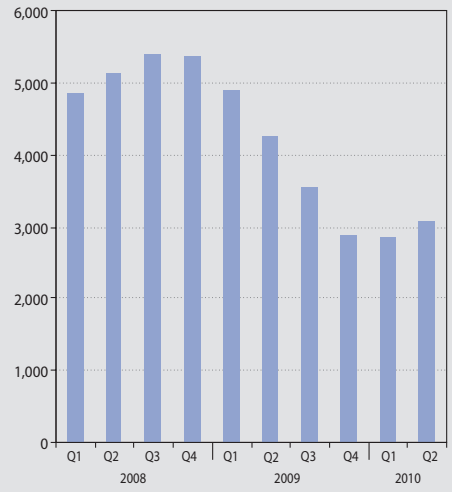
The marked increase in new loans was not reflected in the outstanding amount of house purchase loans

In contrast with the outstanding amount of housing loans, new housing loans recorded dynamic growth in the first half of 2010. In absolute terms, May and June exceeded even the months of 2008, which saw the largest loans in the history of bank lending for house purchases. In May

Chart 15 Outstanding amounts of housing loans by type (EUR billions)

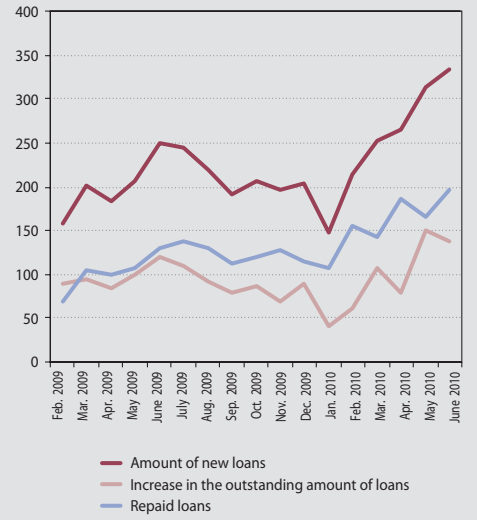
Source: NBS.

Chart 16 Quarterly increases in the outstanding amount of household loans (EUR millions)



Zdroj: NBS.

Chart 17 Increases in the outstanding amount of loans compared with the amounts of new loans in the household sector (EUR millions)



Source: NBS.
Notes: Home savings banks are not included in the data.
Repaid loans represent the difference between new loans and the increase in the outstanding amount of loans.

2010, new housing loans increased by 64% on a year-on-year basis.

The strong growth in new loans was not, however, reflected in the outstanding amount of loans, since their growth more or less stabilised over the course of 2010. Thus, despite the dynamic growth in new loans, the flow of loans in the economy remained broadly unchanged.

This trend was caused by several factors. Numerous borrowers attempted to make use of the periods of lower interest rates to refinance their old loans borrowed at higher interest rates under more advantageous conditions. Banks responded to this trend by offering new products that allow customers to obtain better lending conditions if they switch over from another bank. The refinanced old loans were subsequently registered as new loans. Such changes were enabled by the large share of loans with short fixation periods, where the borrower is allowed to make early repayment of the loan prematurely without incurring a penalty.

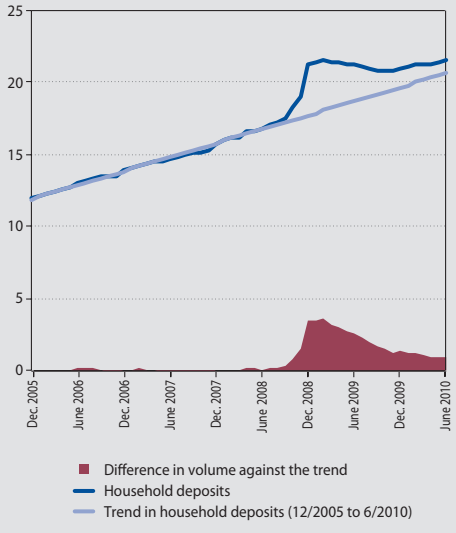
Regarding the different developments in new loans and in the outstanding amount of loans, changes in the share of individual banks in loans are very important, too. The first half of 2010 also brought changes in the share of banks in new loans as well as in the outstanding amount of loans. This can be attributed to the different approaches and attitudes of banks to the setting of risk parameters and other credit conditions. In 2010, similarly as in 2009, banks used different approaches to lending to customers. As a result of the different approaches, the growth in new loans was unevenly distributed across the banking sector. Approximately 75% of the new loans was provided by only three banks, while the shares of individual banks changed too. Like new loans, the month-on-month increases in the outstanding amount of loans were not distributed evenly across the banking sector. They were dominated by two banks, whose share reached 85% at the end of the first quarter of 2010.

The situation in lending to sole traders has improved somewhat since March 2010, when these loans recorded their sharpest decline in year-on-year terms (8%). Since March, the pace of decline has shown a decelerating trend.

Household deposits returned to their long-term trend

While 2009 was marked by the consequences of the euro changeover, the year 2010 saw a change in the area of deposits, which began to grow in both month-on-month and year-on-year terms. In the first half of 2010, developments in household deposits returned to their long-term trend.

Chart 18 Household deposits (EUR billions)



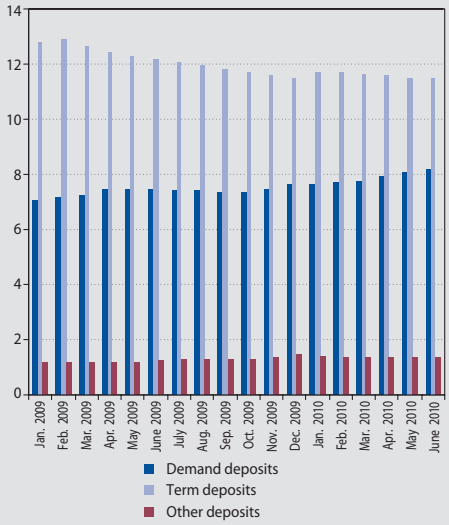
Source: NBS.

THE STRUCTURE OF TERM DEPOSITS CHANGED IN FAVOUR OF HIGHER-INTEREST-BEARING PRODUCTS

Although an overall view on household deposits indicates that the long-term trend will continue, the first half of 2010 saw several changes in the structure of deposits.

The relatively low deposit rates at banks were to a significant extent responsible for the falling volume of term deposits. The sharpest fall took place in the volume of term deposits with a maturity of up to one year, which ceased to pay interest at an attractive rate. The clients of banks mostly reacted by shifting their funds to longer maturity deposits. Thus, most banks recorded a decrease in one-year term deposits and an increase in deposits with a maturity of 2 to 5 years, especially in five-year deposits. Some of the banks responded to this situation by introducing new products. A proportion of the term deposits were converted into so-called daily deposits, which represent a certain hybrid product with some of the features of a current account but paying interest as a term deposit. Interest rates on such daily deposits reached the level of interest paid on term deposits with longer maturities.

Chart 19 Structure of deposits in the household sector (EUR billions)



Source: NBS.

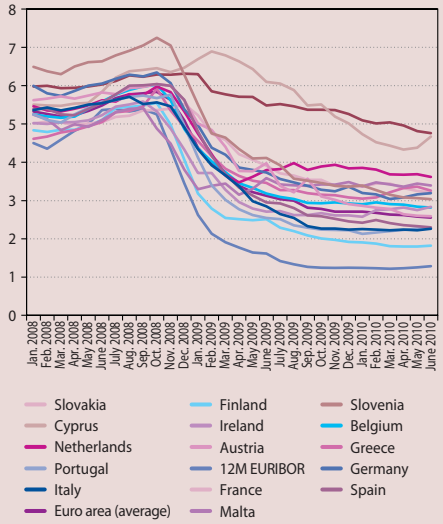
Box 1

ANALYSIS OF INTEREST RATES ON HOUSING LOANS

After the ECB had decided, amid the ongoing financial crisis, to reduce its key interest rates step by step and to conduct certain non-standard operations, the euro area interbank market rates fell to historical lows. As this means that banks may, if need be, obtain cheaper funds at the money markets, the fall in interbank market rates is expected to be reflected in their lending rates, too.

If banks really derive their interest rates for house purchase loans from the interbank rates and if the method of their setting and/or other market conditions do not change too much, there must be an apparent long-term relationship (cointegration) between retail interest rates and the interbank rates. While this long-term relationship between retail interest rates and the rates in the Slovak interbank market had been apparent until the end of 2008, such long-term relationship[1] could no longer be identified after the interbank rates were ex-

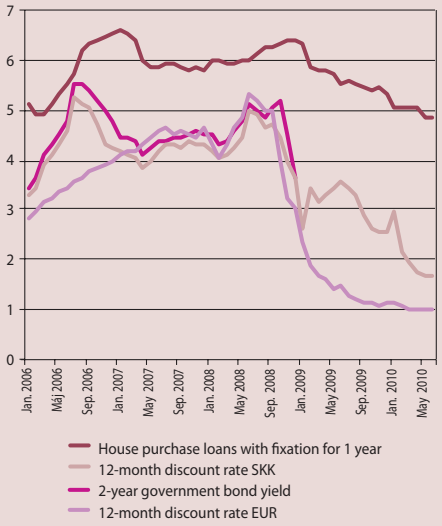
Chart A Interest rates on new house purchase loans with a fixation period of up to 1 year (%)



Source: ECB.

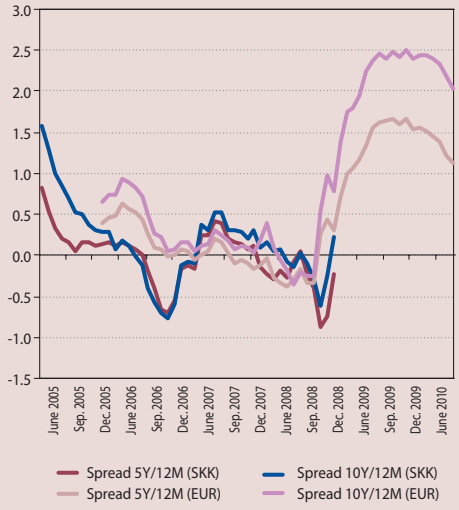
1 *Long-term relationships and other statements were tested using cointegration tests and EC equations. The methodology will be published in more detail in the October issue of BIATEC.*

Chart B Interest rates and government bond yields (%)



Source: NBS, ECB.

Chart C Differences between short- and long-term interbank rates (%)



Source: NBS, ECB.

tended to cover the years 2009 and 2010 using the EURIBOR rates.

Since there are differences between loan products of similar types in different countries (interest rate fixation period, loan maturity, etc.), as well as in the financing of these loans, it is natural that there are differences between interest rates in the individual Member States. Despite this, retail interest rates on house purchase loans in Slovakia are among the highest in the euro area. Over the course of 2009, they fell to a much lesser extent than those in other Member States. Hence, it is natural to ask what causes these differences. To answer this question, however, it is necessary to explain why these interest rates are higher in Slovakia.

However, a long-term relationship between retail interest rates and Slovak government bond yields also existed during the period extended until the end of the first half of 2010. This means that, while until the end of 2008 it had been difficult to find out whether banks set their interest rates according to the interbank rates or according to the yields on Slovak government bonds, the tests conducted in this regard showed that Slovak government bond yields were used as reference points. In setting their retail interest rates, banks probably take into account the sovereign risk of Slovakia, too. Furthermore, it is

Chart D Interest rate on retail loans for house purchases with a fixation period of up to 1 year – real and estimated values (%)

Source: NBS, NBS calculations.

possible to prove that the liquidity premium[2] is also taken into account when the retail rates are set, albeit to a much lesser extent than the credit risk associated with the state of the Slovak economy.

The hypothesis that the euro adoption or increased credit risk perception caused a general rise in the interest margin in the Slovak banking sector cannot be proved. It is also impossible to prove that a structural change occurs in the behaviour of banks when setting interest rates.

This probably means that both the sovereign risk of Slovakia and the increased liquidity premium are incorporated in the actual values of average interest rates on house purchase loans for households. This also means that, after the country's entry into the euro area and/or after the outbreak of the global financial crisis, the method of interest rate setting remained virtually unchanged and the differences in interest rates in Slovakia and other euro area countries are given by the differences in credit products and in the method of interest rate setting.

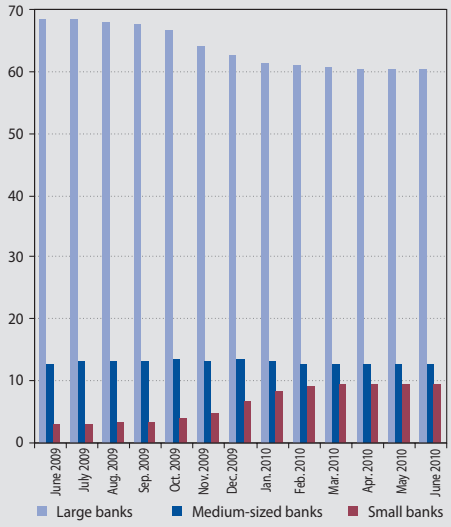
The volume of term deposits decreased, despite increased demand for deposits with longer maturities and the launch of new bank products offering higher yields. We assume that this decrease was caused by a shift of deposits to money market funds, which offered attractive yields at that time. On the other hand, demand deposits followed a growing trend over the first half of 2010. Stronger growth dynamics in the middle of the year were recorded by large banks.

Home savings also reflected the changing trend; the stock of these loans rose at an accelerated pace during the first half of 2010, and among loans with a maturity of more than five years, their share of total term deposits in the sector increased.

The market shares of banks in term deposits changed, too

The low interest rates on term deposits and the subsequent changes in their structure caused more intense competition among banks. This led to changes in the market shares of banks, too. Term deposits decreased mainly in large banks. At the same time, term deposits in some of the medium-sized and small banks increased throughout the period. Some of the banks recorded significant increases in deposits in year-on-year terms. These increases were mainly attributable to the introduction of new products and higher interest rates for all maturities.

Chart 20 Shares of selected banks in term deposits (%)



Source: NBS.

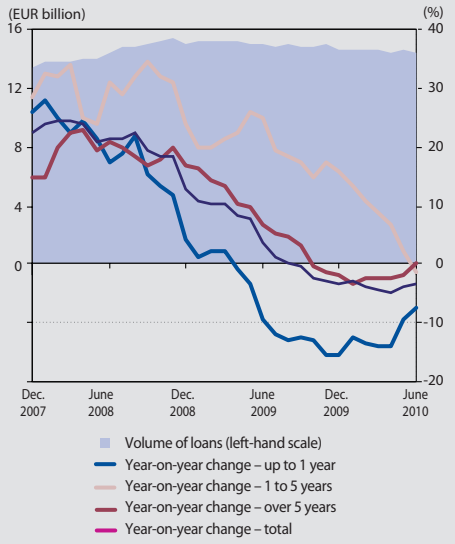
THE CORPORATE SECTOR

Continuing decline in the loan portfolio

The total amount of loans provided to the corporate sector continued to decline gradually in the first half of 2010 (Chart 21). The decline took place mostly in operating loans, the amount of which had halved since the end of 2008. Ten percent of this decline took place in the half-year period under review. The slowdown in the rate of growth gradually became a decline even in

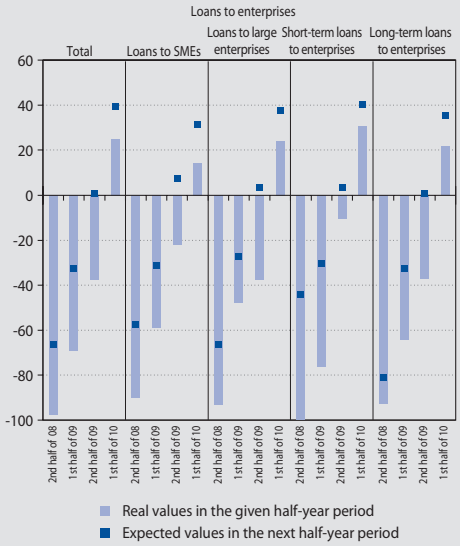
2 *The liquidity premium expresses the risk associated with the fact that, despite the shorter interest rate fixation periods, the maturity of household loans is relatively long as a rule and banks must ensure longer-term funds for the coverage of these loans, and/or they must create reserves to secure also the funds whose price in the future may be higher than the current price.*

Chart 21 Loans to enterprises



Source: NBS.

Chart 23 Credit standards for loans to enterprises (%)

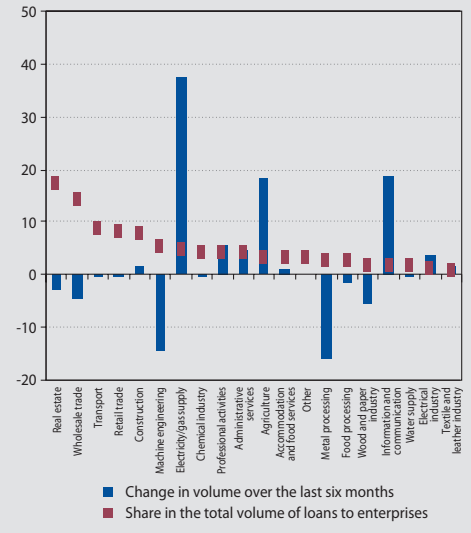


Source: NBS.
Notes: The difference between the market share (expressed as a net percentage) of banks that reported an easing and banks that reported a tightening of credit standards. Banks reporting no change have not been taken into account in the calculation. Expectations in the given half-year period express values expected in the next half-year period.

long-term investment loans. They have fallen by 3.7% over the last six months.

Although the amount of corporate loans in some of the sectors increased in the first half of 2010 (Chart 22), this was the result of one-off changes or relatively volatile developments. Over the last six months, no increase has been recorded in the amount of loans even in commercial real estate financing, where loans increased last year as a result of financing provided for existing projects.

Chart 22 Changes in the amounts of corporate loans since the beginning of 2010 by sector



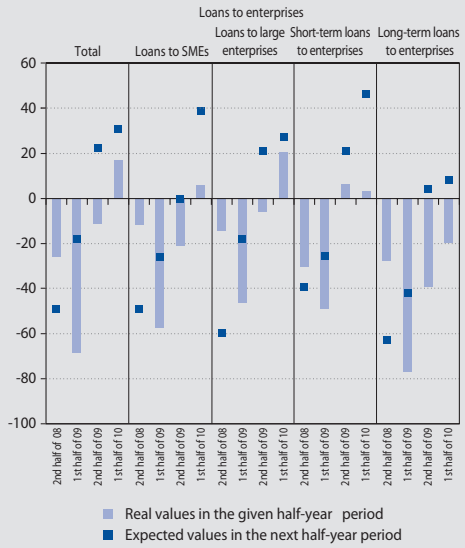
Source: NBS.

The number of new projects undertaken in this segment from the beginning of 2010 was minimal. The slowdown in the pace of lending to enterprises cannot be fully explained by interest rates, which remained unchanged at historically low levels. The main reason was the relatively weak demand for loans among enterprises and the strict lending conditions in the banking sector.

The settings of credit standards remained relatively strict

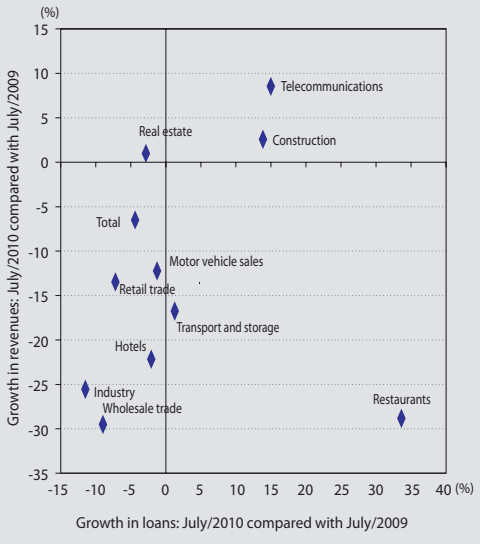
The years 2008 and 2009 witnessed the tightening of credit standards in banks, which was a natural reaction to the financial crisis. The pace of tightening gradually slowed after this period. In the first half of 2010, the majority of banks left their credit standards unchanged. Some of the banks eased their standards to some extent, causing a change in the current trend. The reason for easing the credit standards in these cases was competition and sufficient liquidity in the banks concerned, rather than expectations of positive

Chart 24 Demand for corporate loans (%)



Source: NBS.
Notes: The difference between the market share (expressed as a net percentage) of banks that reported an increase and banks that reported a decrease in demand Banks reporting no change have not been taken into account in the calculation.
Expectations in the given half-year period express values expected in the next half-year period.
Changes express the subjective view of banks.

Chart 25 Changes in corporate revenues in relation to the amount of loans provided



Source: NBS.

developments in the corporate sector. The future course of development in the corporate sector is still surrounded by relatively high uncertainty, which is also reflected in the cautious approach of banks to lending to this sector.

Demand for loans remained low

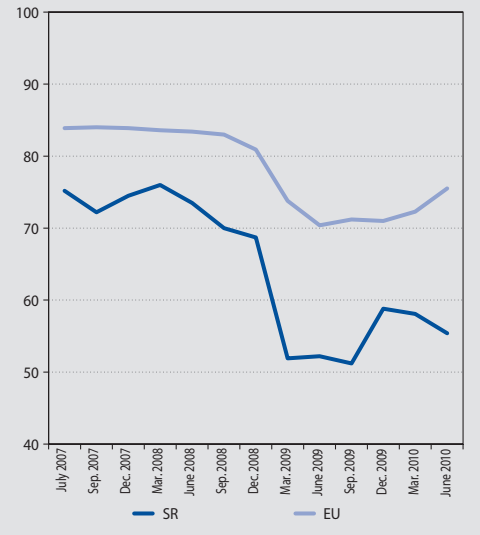
Uncertainty regarding the future trend is also reflected in the relatively weak demand for loans among enterprises. After falling gradually in the previous periods, demand for loans remained broadly unchanged in the first half of 2010. A certain positive aspect was that it continued to weaken for only long-term loans.

Lending supply and demand was influenced by the situation in the corporate sector

The stricter credit standards at banks and weak demand among enterprises broadly corresponded to the situation in the corporate sector. Despite a few positive data, most of the indicators were far from their pre-crisis values. The corporate sector still recorded a low ratio of production capacity utilisation. The utilisation of production capacities was determined by demand for investment loans (Chart 26). In this context, it was important to monitor the growth in corporate revenues in the most recent period, in relation to their decline in 2009. In many of the sectors, the greater fall in activity was recorded last year, the sharper decline in lending activity was experienced in the next period.

This relationship is logical since sectors recording the sharpest fall in revenues usually have

Chart 26 Ratio of production capacity utilisation in industry (%)



Source: Eurostat.

a higher degree of idle capacity that restricts their demand for loans; however, these sectors may seem to banks to have been more severely hit by the crisis, and this may influence banks in setting their credit standards.

Stable developments in corporate deposits

The first half of 2010 saw no substantial changes in corporate deposits. Interest rates, which usually have little influence on the amounts of corporate deposits, remained virtually unchanged over the first six months. The changes in deposits were caused almost exclusively by the activities of enterprises. The decline in term deposits came to a halt and current account balances increased somewhat as a result of increased liquidity in the corporate sector. Thus, corporate deposits remained an important source of finance for banking activities.

Among certain changes recorded in the banking sector in the first half of 2010, the concentration of corporate deposits increased slightly in the three largest banks.

OTHER SECTORS

Lending to other sectors declined, except to the general government sector

The declining trend in lending to other sectors continued in the first half of 2010. Despite modest improvements in certain indicators in other sectors (households and enterprises), lending to financial intermediaries did not reflect these positive developments and continued to follow a negative trend. In year-on-year terms, the amount of loans to financial intermediaries fell by 32.5%. In some of the banks, a modest increase was recorded in these loans, but in most of the cases only old credit lines continued to be drawn gradually. Loans to non-residents also showed an adverse trend, although they also showed some signs of stabilisation. The outstanding amount of loans grew only in the general government sector. The rate of growth stabilised at the level of 13% in the first quarter of 2010.

Deposits from other sectors remained broadly unchanged

Deposits from non-profit organisations rebounded from the bottom reached in September 2009 and began to grow at a gradually accelerating pace, to 10%. They followed their natural trend in both month-on-month and year-on-year terms. On the other hand, the rising outstanding amount of deposits in other sectors was significantly influenced by an increase in deposits in one financial intermediary and by an increase in non-resident deposits in three banks. After the effect of a one-off increase had waned, a negative change was recorded in both sectors at the end of the first half of 2010. In the case of financial intermediaries, the outstanding amount of deposits decreased.

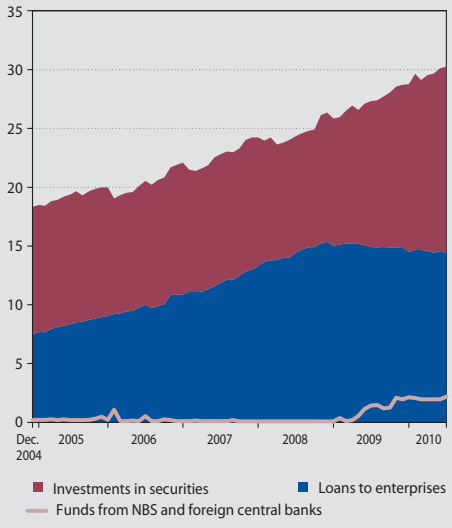
General government deposits increased, but their rise was influenced by growth in central government deposits and by liquidity management in the SR Treasury.

2.1.1.2 SECURITIES

Banks made increased investments in securities

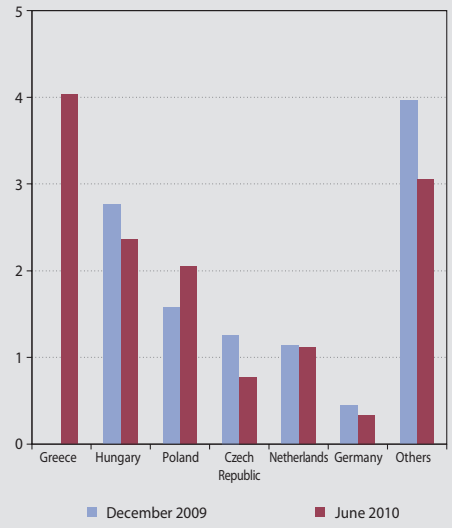
The investments of banks in securities increased by almost 16% year-on-year, to approximately one third of their total assets at the end of June. This trend began in 2009, when banks borrowed funds from the Eurosystem for the purchase of securities. Overall, however, the increased orientation of banks on securities was connected with the decline in corporate sector financing (Chart 27).

Chart 27 Investment in securities and lending to enterprises (EUR billions)



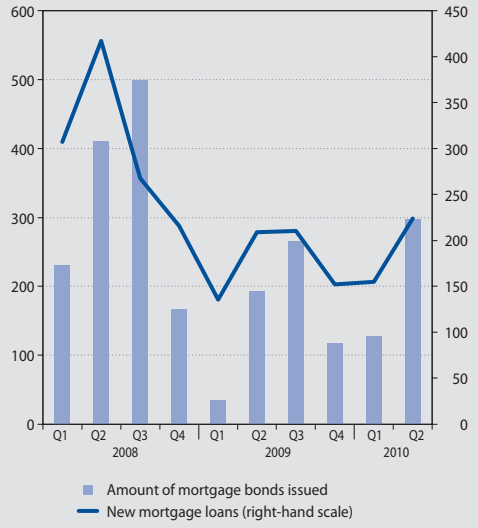
Source: NBS.

Chart 28 Share of foreign debt securities in the total amount of bonds by country



Source: NBS.
Note: The Chart does not include bonds issued in Slovakia representing roughly 86% of the total amount of bonds (at end-June 2010).

Chart 29 Amounts of mortgage bonds and new mortgage loans (EUR millions)



Source: NBS.

The increase was caused mainly by investments in domestic government bonds and Treasury bills. Compared with the beginning of the year, marked increases were also recorded in the amounts of foreign bonds, mainly government bonds. In the middle of the year, government bonds accounted for approximately 92% of the total amount of debt securities. The sectoral breakdown of securities shows that the share of bank bonds and bonds issued by financial institutions was also significant in some of the banks. The said increase in investments in foreign debt securities concerned only several banks. The breakdown of these investments by country shows that exposure to Greece increased to a significant extent. The risks involved in these investments were confirmed by the trend in the prices of Greek bonds in the first half of 2010.

Issuance of securities stagnated during the first half 2010

The total amount of securities issued during the first half of 2010 remained virtually unchanged, compared with the figure for end-2009. In the long term, mortgage bonds account for roughly 90% of the total amount of securities issued.

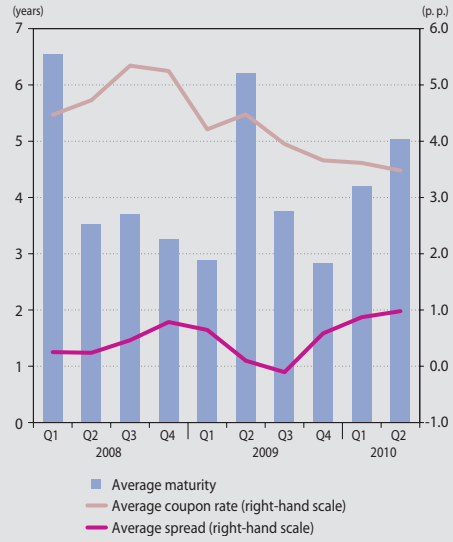
In the first half of 2010, the amount of newly issued mortgage bonds was determined by two factors: the amount of mortgage loans and the amount of outstanding mortgage bonds. Since mortgage loans grew only minimally during the first six months of 2010, the amount of new mortgage bond issues was influenced by the maturity and replacement of old issues. During the first half of 2010, mortgage bonds matured in the total nominal amount of €470 million and banks issued mortgage bonds with a total nominal value of €425 million.

Owing to the new issues made by banks to replace the maturing mortgage bonds, the coverage of mortgage loans with mortgage bonds exceeded the ratio prescribed by law (70%). The coverage ratio reached 87% at the end of June 2010.

The primary market conditions remained broadly unchanged over the first six months; a significant amount of mortgage bonds will fall due in 2010

The primary market conditions remained virtually unchanged in comparison with the previous half-year period, when the average maturities of issued mortgage bonds increased somewhat and the average coupon rates for bonds with fixed coupon rates fell (the average figures are weighted according to the nominal value of bonds).

Chart 30 Average spreads and maturities of mortgage bond issues



Source: NBS.
Notes: Spreads, coupon rates and maturities were weighted according to the nominal value of issued mortgage bonds. The spreads were calculated as the difference between the coupon rate for the given mortgage bond and the yield on a government bond with the same maturity at the time of issuance. In the absence of a government bond with the same maturity, the yield was calculated on the basis of a linear interpolation.
The average coupon rate and the spread were calculated on the basis of mortgage bonds with a fixed coupon rate.

Since government bond yields were falling at a faster pace than the coupon rates, the average spreads rose somewhat.

As a relatively large amount of mortgage bonds will fall due in the second half of 2010 (with a nominal value of over €660 million, representing roughly 20% of the total amount of issued mortgage bonds at end-June 2010), mortgage bonds are expected to be issued in a relatively large amount even if the total amount of mortgage loans is stagnant. Hence, it is still important for mortgage-lending banks to have stable primary market conditions, without any serious deterioration.

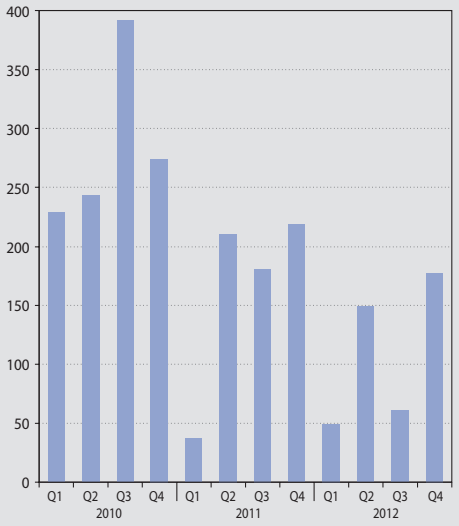
2.1.1.3 BANKS

THE STRUCTURE OF INTERBANK ASSETS AND LIABILITIES CHANGED SOMEWHAT; ONLY LOANS TO FOREIGN BANKS REPORTED A SHARPER FALL

The total amount of interbank assets changed to only a minimum extent during the first half of 2010. The change was minimal despite a relatively significant decrease in the largest asset item in December 2009 and January 2010 – operations with foreign banks. This decrease (by a total of €1.7 billion during the said two months) took place in four banks, mainly in loans provided to their own financial groups from interbank funds or from corporate or general government deposits.

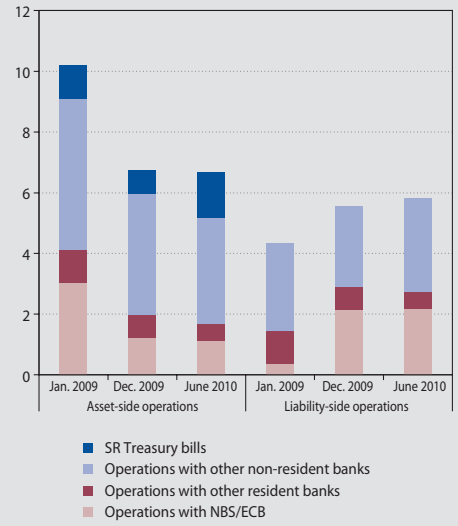
While loans to foreign banks fell to a significant extent, some of the banks made increased in-

Chart 31 Total nominal value of mortgage bonds maturing in 2010 to 2012 (EUR millions)



Source: NBS.

Chart 32 Interbank assets and liabilities (EUR billions)



Source: NBS.

vestments in Treasury bills, mainly in the first quarter of 2010.

In the first half-year period, the amount of funds that banks obtained from the interbank market increased slightly. Approximately a half of the funds comprised funds from foreign banks, which increased by more than 15% in the first half of the year. The largest share of interbank market funding in total liabilities was still recorded by branches of foreign banks. These were almost exclusively funds received from members of their own financial groups.

Banks obtained a significant part of their funds from the ECB. These funds increased mainly in the last quarter of 2009, while the first half of 2010 saw no further increase. The ECB gradually ceased to conduct 12-month and 6-month refinancing operations. As for 'non-standard' operations, banks may currently use only operations with a maturity corresponding to the length of the period. A substantial part of these funds was used for investments in securities or for interbank market deals. With these funds maturing gradually, changes can also be expected in these asset items.

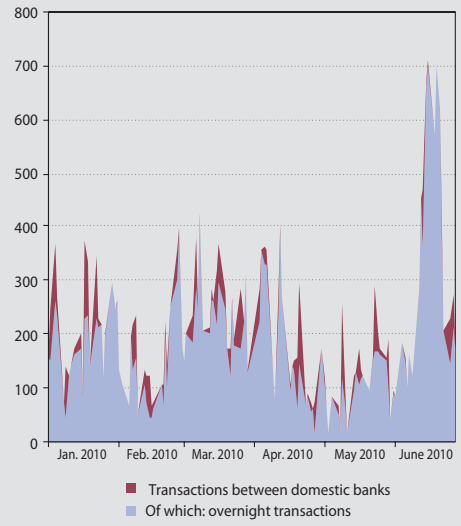
The negative financial market developments in May were also reflected in trading between domestic banks

Trading in the domestic interbank market in the first half of 2010 was to some extent influenced by nervosity in the global financial market. This was mainly apparent at the turn of April/May. The average volume of interbank transactions in this period reached less than 35% of the average for the first six months of 2010. The marked increase in overnight transactions in the domestic market during June was caused by a single bank, but the volume of transactions had fallen to the level of the long-term average by the end of the month.

Interest rates rose slightly after May as a result of concerns about the sovereign risk, while the EURIBOR rates remained at historically low levels

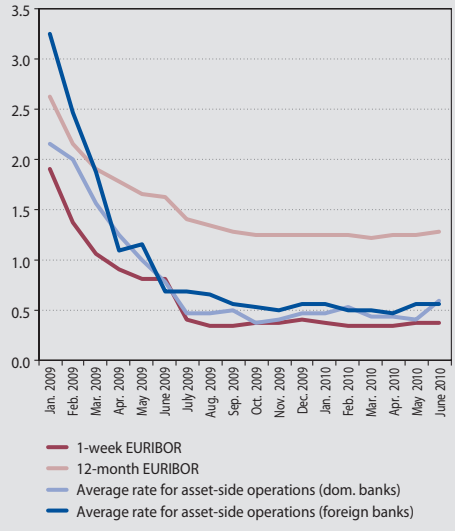
The average rates for asset-side interbank market operations conducted by domestic or foreign banks were at low but stable levels throughout the first half of 2010. They rose somewhat only in June. They approached the EURIBOR rates with shorter maturities, which indicate that the interbank market was dominated by operations with relatively short maturities.

Chart 33 Volume of overnight transactions between domestic banks (EUR millions)



Source: NBS.

Chart 34 Interbank market rates (%)



Source: NBS.
Note: Interest rates were calculated on the basis of short-term loans received and deposits with a maturity of up to 1 year in EUR as at the end of the individual months. The rates were calculated as average rates weighted according to the amounts of individual transactions.

2.1.2 FINANCIAL POSITION OF THE BANKING SECTOR

The profitability of the Slovak financial sector was still influenced by the waning crisis in the first half of 2010. Although the banking sector's net profit increased by 34% year-on-year, it was still much lower than before the crisis. This was in large part due to the loss of income from foreign exchange transactions after the euro adoption. Banks also recorded a further increase in the share of non-performing loans. Expenses related to the creation of provisions and reserves remained at approximately the same level as in the first half of 2009.
The increase in profits was influenced primarily by the steep yield curve. Interest rates for longer periods continued to exceed the rates for shorter periods to a relatively significant extent. In this environment, banks managed to increase their profits from operations with households, mainly through a reduction in deposit costs. This was connected with the gradually weakening of competition for household deposits, which had been very intense during the period preceding the euro introduction. In addition, banks made use of the interest rate differential between rates for short and long periods to purchase debt securities financed from relatively cheap sources, i.e. mostly from refinancing operations or from the interbank market.

2.1.2.1 PROFITABILITY

The banking sector's net profit increased

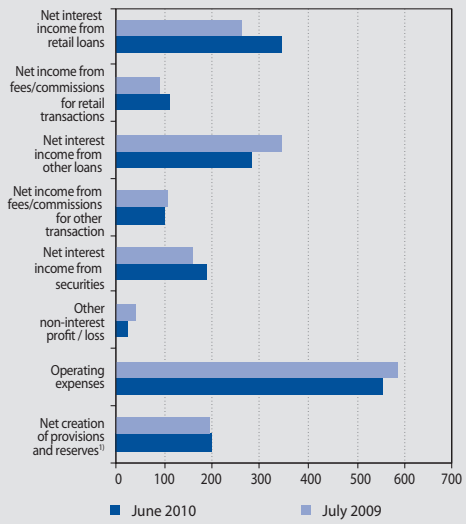
The banking sector's net profit for the first half of 2010 reached €240 million, representing a relatively significant year-on-year increase of 34%. However, its value was still lower than in the years 2006-2008. For example, the sector's net profit in 2008 was one third higher. On the other hand, the lower value of net profit recorded in the first half of 2010, compared with the pre-crisis period, was partly due to the loss of foreign exchange income as a result of the euro changeover. The loss of net income from foreign exchange operations in the first half of 2010, compared with the first half of 2007, was roughly equal to the difference in net profits in these periods.

Of fifteen banks operating in the Slovak banking sector, twelve banks achieved profits, the remaining three reported losses. Of eleven branches of foreign banks, seven branches recorded profits.

At the consolidated level (i.e. with the profits/losses of the banks' subsidiaries taken into account), the banking sector achieved a profit of €246 million. The year-on-year increase was somewhat higher than the increase in profits at the non-consolidated level.

The year-on-year increase in profits was unevenly distributed across the banking sector, and even within the group of large banks. This uneven distribution, however, was connected with the different developments seen in the individual banks' profits in 2009. Some of the banks, which had recorded a sharp decline in profits in the first half of 2009, reported a significant increase in the first half of 2010. For assessing the developments in bank profits, it is important to compare the profits/losses recorded in the first halves of 2010 and 2008 so that the effect of uneven developments in profits in 2009 is eliminated. Such

Chart 35 Changes in the structure of profits in the banking sector (EUR millions)



Source: NBS.
1) Net creation of provisions and reserves also includes net profit derived from receivables assigned to the third party clients, e.g. adjustment for incomes/costs in connection with the sale of non-performing receivables.

comparison provides a more homogeneous picture of the distribution of profits. Each of the four largest banks recorded a fall in profits ranging from 19% to 41%.

However, net profit shows a smaller year-on-year increase if we take into account the sector's comprehensive financial result.[3] This reached €207 million[4] for the first half of 2010, representing a year-on-year increase of 16%. The smaller year-on-year increase in the comprehensive financial result was caused mainly by a relatively sharp fall in equity (by approximately €33 million over the first half of 2010), which stemmed from a reduction in the real value of securities held in the portfolio of financial instruments available for sale, especially in three banks.

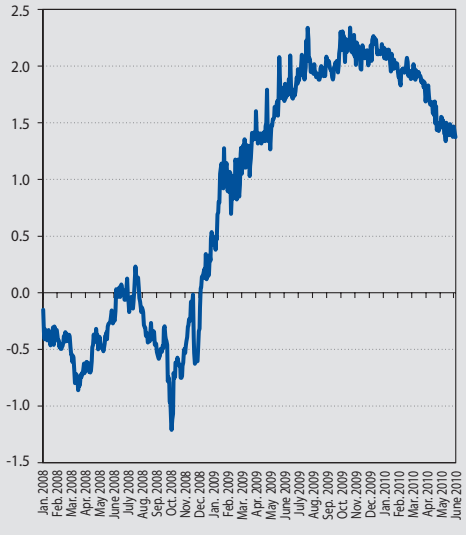
Growth in profits stimulated mainly by the retail sector

The aforementioned year-on-year increase in the banking sector's net profit was mainly the result of rising profits from retail operations, growing net interest income from securities, and continuing fall in operating expenses.

The growth in profits from retail operations and operations in securities was stimulated mainly by the ongoing period marked by a steep interest rate yield curve. Although the difference between five-year and three-month rates decreased from 2.2 to 1.4 percentage points during the first half of 2010, its value was still relatively significant.

As for the household sector, the persistent difference between short and long-term interest rates was reflected mainly in the interest rate spread. While the costs of household deposits were relatively low, banks managed to maintain relatively high rates for loans. Over the first half of 2010, the net interest rate spread widened in year-on-year terms. This was caused mainly by a fall in the costs of household deposits. Interest rates on deposits in the first half of 2010 were lower than in the first half of 2009 (they fell from 1.5% to 1.2%), when they were raised in an effort to obtain as much deposits from households as possible before the euro changeover. Thus, the interest costs of household deposits recorded a year-on-year fall of 39% (€84 million). This was the main factor in the growth of net interest income.

Chart 36 Spread between short- and long-term interest rates (p.p.)



Source: Reuters.
Note: The vertical scale shows the difference between 5-year and 3-month swap interest rates in percentage points.

Banks also recorded a slight fall in yields on loans, though they are still among the highest in the euro area. Therefore, despite the continuing growth in the lending to households (by 11% year-on-year), banks recorded a fall in interest revenues from household loans (10% year-on-year). Almost all retail banks reported a fall in interest revenues from this sector. Owing to their activities in the loan market, however, banks recorded increased revenues from charges for operations with households (23% year-on-year).

Banks used the interest rate differential between short and long-term rates to boost their profits by increasing the amount of purchased debt securities. These deals were largely financed from short-term interbank market operations.

The fall in net interest and non-interest revenues from other sectors was caused mainly by a decrease in the amount of loans. This was most apparent in the corporate sector.

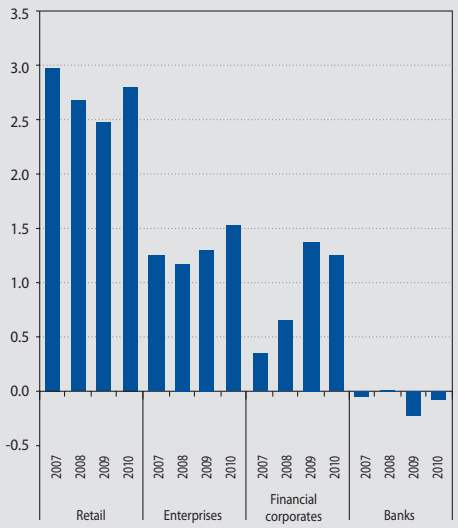
The amount of operating expenses remained at last year's level

In an effort to maintain its cost-to-income ratio, the banking sector cut its operating expenses to a relatively significant extent already in 2009 (by 7%). The number of employees was reduced by 9%. Over the first half of 2010, operating expenses

3 *'Comprehensive financial result' is defined as the net financial result less valuation differences adjusted for current taxes. Valuation differences express the changes in the real values of securities held in the portfolio of financial instruments available for sale, which led to changes in equity in the period under review, without affecting the reported financial result. Although valuation differences would affect the financial result at the time when the securities are sold, it is appropriate, given the possibility of their sale in the near future, to monitor their potential impact on the financial result.*

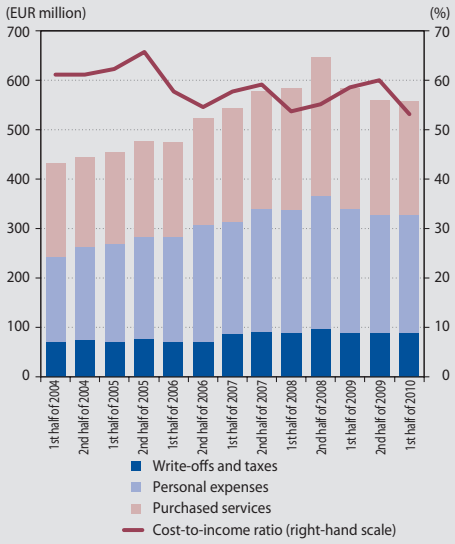
4 *This is only an approximate figure, since the precise calculation of tax adjustments is not yet available.*

Chart 37 Net interest rate spreads in the individual sectors (%)



Source: NBS.
Note: Net interest rate spread represents the difference between yield on loans (the ratio of interest revenues from loans to total loans) and the cost of deposits (the ratio of interest expenses on deposits to total deposits).

Chart 38 Operating expenses and the cost-to-income ratio



Source: NBS.
Notes: Left-hand scale data are in EUR millions; they express the amount of operating expenses in the given half-year period. Data on the right-hand scale express the cost-to-income ratio, defined as the ratio of operating expenses to the gross income of banks.

remained at the level of the second half of 2009, which represented a year-on-year decrease of 5% compared with the first half of 2009. This decrease took place in almost all the banks. During the first half of 2010, banks continued to reduce the number of employees, by a further 2.4%.

Owing to the year-on-year fall in operating expenses accompanied by gross income growth, the cost-to-income ratios of banks increased. The ratio of operating expenses to income from banking activities reached 53% in June 2010, which was the lowest value for the last few years (monitored at six-month intervals).

THE NET CREATION OF PROVISIONS AND RESERVES REMAINED VIRTUALLY UNCHANGED IN YEAR-ON-YEAR TERMS

Over the first half of 2010, the waning economic crisis was still reflected in the banking sector, in the increased creation of provisions. In year-on-year terms, the overall net creation of provisions and reserves (including losses from the write-off and sale of defaulted loans) increased only slightly, from €196 million to €202 million. The net creation of provisions as a share of own funds reached 4.6%. A relatively significant change, however, was recorded in the creation of provisions broken down by sector. While the net creation of provisions for household loans accounted for 37% of the overall net creation of provisions in the first half of 2009, this ratio increased to 51% in the first half of 2010.

The amount of non-performing loans has in recent years risen at a faster pace than provisions for these loans, thereby causing a reduction in their coverage. In banks using the internal rating-based approach for calculating the required amount of capital, this trend has been counteracted by the requirement to deduct the difference between the expected loss and the provisions created from the banks' own funds. In banks using the standardised approach, the said trend should be alleviated by reducing the banks' own funds by the surplus of expected losses over the identified depreciation.[5]

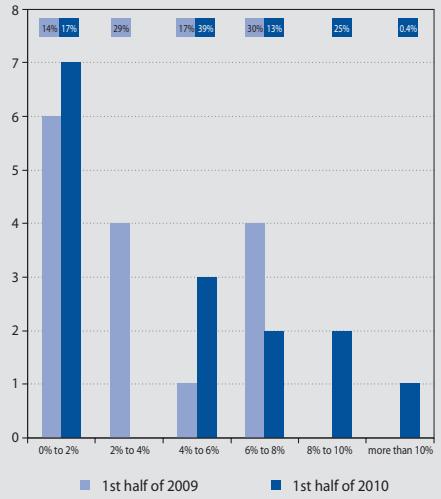
2.1.2.2 CAPITAL ADEQUACY

THE CAPITAL ADEQUACY RATIO OF THE BANKING SECTOR ROSE IN THE FIRST HALF OF 2010

During the first half of 2010, banks continued to strengthen their capital position in order to

5 *This change will become effective on 1 January 2011 and will be implemented by Decree No. 11/2010 of Národná banka Slovenska of 8 June 2010 stipulating methods of valuing banking book positions and details of the valuation of banking book positions, including the frequency of such valuations, and by Decree No. 12/2010 of Národná banka Slovenska of 8 June 2010, amending Decree No. 4/2007 of Národná banka Slovenska on banks' own funds and banks' capital requirements and on investment firms' own funds and investment firms' capital requirements.*

Chart 39 Creation of provisions and reserves as a share of own funds (%)



Source: NBS.
Notes: The vertical scale shows the net creation of provisions and reserves in the given half-year period as a share of own funds. The percentage above each bar represents the assets of the banks in that bar as a share of the sector's total assets.

create a stronger capital cushion for the case of unexpected losses in the future. The increase in own funds and decrease in the amount of risk-weighted assets led to a rise in the capital adequacy ratio. At the sectoral level, this ratio reached 13.2% in June 2010, compared with 12.3% a year earlier. All banks of the Slovak banking sector met the minimum ratio of 8%, by a sufficient margin. The lowest capital adequacy ratio recorded in the banking sector in June 2010 was 10.3%.

A similar trend was recorded in the share of Tier 1 capital, which reached 12% in June 2010.

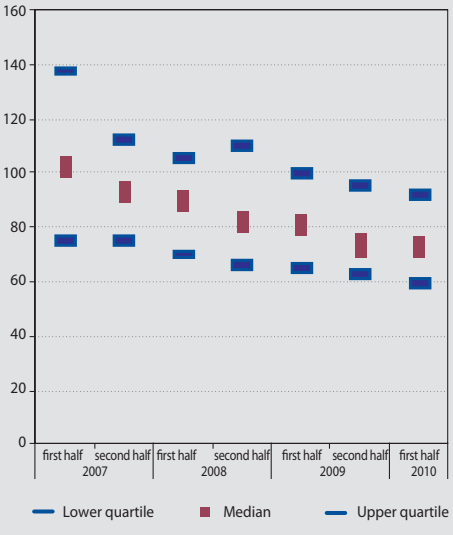
Capital adequacy was bolstered by the increase in own funds; risk-weighted assets fell somewhat

By the end of June 2010, the total amount of own funds in the banking sector had increased by 6.3% year-on-year, with the bulk of this rise occurring in the first half of 2010. Although the rate of growth in own funds was slower than in 2009, eleven banks increased their own funds in the period under review. Only four banks recorded a year-on-year decrease in their own funds. The slowdown in the rate of growth in own funds was connected with the fall in bank profits in 2009, as well as with the more moderate risk perception in the banking sector.

The structure of the capital increase can be evaluated as positive, since the dominant component was the highest-quality capital (Tier 1). In June 2010, Tier I capital accounted for 91.4% of the banks' own funds. Banks increased the share of Tier 1 capital mainly from their retained earnings from previous years. Approximately 42% of the sector's profits earned in 2009 remained in own funds. Retained earnings from previous years fell during the period under review in two banks, which recorded a loss in 2010.

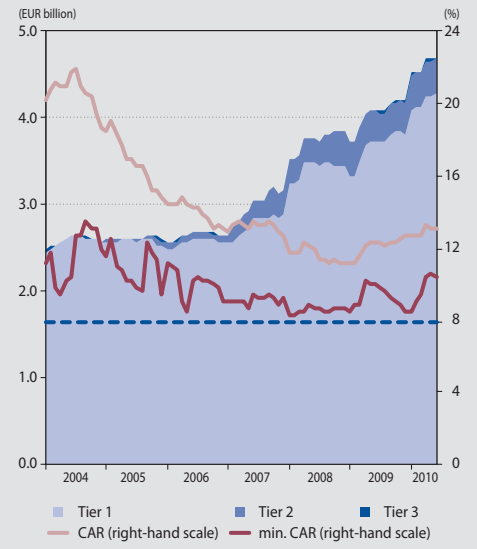
Developments in risk-weighted assets in 2010 differed from the trends observed in the last few years. While the year 2008 saw a relatively steep increase in the banking sector's risk-weighted assets, 2009 witnessed a decrease at the beginning of the year followed by a slight rise as a result of the country's entry into the euro area and a subsequent fall in the exchange rate risk. As from October 2009, we can see the opposite trend, i.e. a decrease in the total amount of risk-weighted assets in the banking sector, mainly in risk-weighted assets in the banking book. The decrease was mainly caused by the weakening of bank lending activity in relation to enterprises, with the capital requirements for credit risk coverage for exposures to enterprises falling in year-on-year terms.

Chart 40 Coverage of non-performing loans with provisions (%)



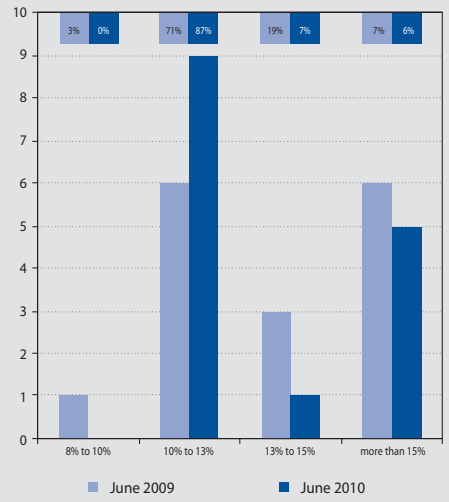
Source: NBS.

Chart 41 Capital position of the banking sector



Source: NBS.
Note: The right-hand scale shows the capital adequacy ratio (CAR) and its minimum value for the banking sector.

Chart 42 Distribution of the capital adequacy ratio across the banking sector



Source: NBS.
Notes: Left-hand scale: number of banks.
The percentage above each bar represents the assets of the banks in that bar as a share of the sector's total assets.

2.2 THE INSURANCE SECTOR

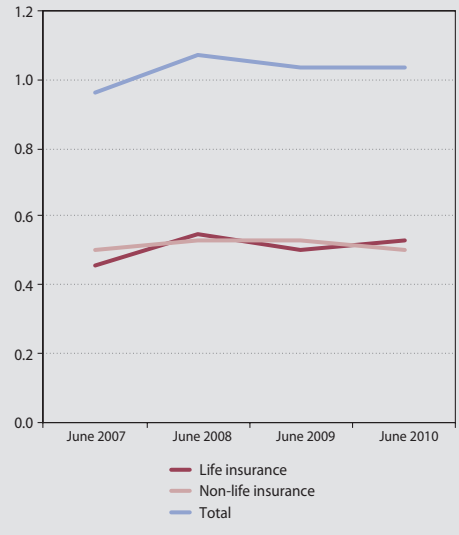
The insurance market did not recover significantly in the first half of 2010. Despite certain signs of improvement, the situation in several areas remained the same as in the previous year. The overall situation in the insurance sector was largely determined by the slow pace of recovery in the real economy. Notwithstanding a modest rise in demand for life insurance products, the sector overall is performing far below its pre-crisis levels. Partial withdrawals and contract cancellations continued to increase. Therefore the cost of claims rose too, albeit at a slower pace than before. In non-life insurance, the amount of new policies fell again, while strong competition continued to reduce premium prices in the sector's main lines of business. The loss ratio of the sector as a whole increased, driven partly by payouts related to natural disasters. As a consequence of these developments, the profitability of the insurance sector declined during the period under review.

Premiums[6] rose moderately, driven mainly by life insurance

The situation in regard to premiums began to improve moderately during the first half of 2010, following a year in which the economic crisis affected almost every area of the insurance market and which, in terms of premiums, was the worst since monitoring began. The upturn, however, occurred only in the life insurance sector. Premiums in most life insurance lines rose on a year-on-year basis, although their overall amount remained below the pre-crisis level. The positive turnaround in life insurance was reflected in demand for new policies, which, after weakening in the previous year, began to rise again.

As for the non-life insurance sector, the negative trend of the previous period continued in the first six months of 2010. Alongside the long-term adverse situation in the motor insurance line of business, another significant line of business – property insurance – reported a decline in premiums after several years of positive figures.

Chart 43 Insurance premiums (EUR billions; end of period)



Source: NBS.

In life insurance unit-linked products did particularly well

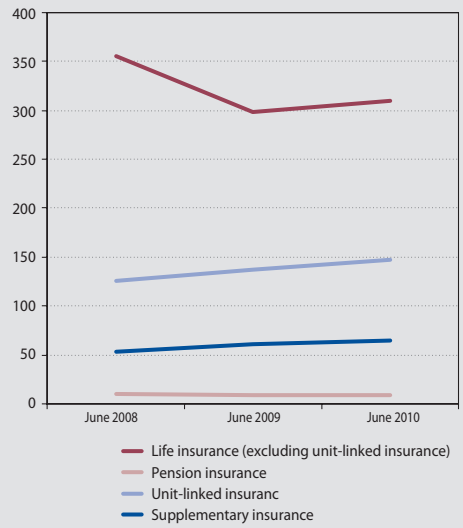
The best performance in the life-insurance sector in the first half of 2010 was recorded by investment insurance (unit-linked) products. The overall situation in this line of business was affected by several factors. At a time of adverse developments in financial markets, when the value of insurance policies are falling, people are preferring endowment insurance policies –with their offer of a guaranteed fixed payment – to the uncertain returns on investment insurance, which in turn may dampen demand for such insurance. However, unit-linked insurance products offer greater flexibility in comparison with traditional types of insurance – in particular by allowing partial withdrawals[7] and adjustment of the premium amount – which may result in lower overall premiums in this sector.

Following a slump in new policies, mainly during the second half of 2009, demand for this line of business rebounded moderately over the first six months of this year. The recovery was largely related to the gradual increase in economic activity. Premiums rose by 7.3% year-on-year, representing the highest increase among all life insurance lines.

But despite the gradual recovery in unit-linked insurance products, the situation in regard to surrenders indicates that policyholders are still facing difficult financial circumstances. The number of surrenders in this line of business rose by more than a quarter year-on-year and there was

6 *Premiums can be defined as the price agreed in individual insurance contracts regardless of the method of their financial reporting.*
7 *In 2009, partial withdrawals accounted for almost 20% of total costs related to the payment of surrender values.*

Chart 44 Life insurance premiums (EUR millions; end of period)



Source: NBS.

also a sharp increase in the claims cost related to surrenders (up by more than 30%).

The largest life insurance line of business– traditional life insurance[8] – performed positively according to several key indicators. Compared with the previous year, new policies increased, the surrender rate fell, and premiums rose by 3.6%. As with unit-linked insurance, however, surrenders in this line of business showed an adverse trend.[9] Both the number of surrenders and the claims cost related to them increased, albeit to a far lesser extent than in the unit-linked line of business.

Premiums in non-life insurance continued to decline

In the non-life insurance market, the only significant changes to occur in the first half of 2010 were in the property insurance line of business. After recording increasingly higher growth in recent years, premiums in this line of business declined by almost 6%, mainly because of the lower amount of new policies. Even so, demand cannot be described as subdued, since the number of new contracts rose by more than twofold year-on-year. The increase in insurance contracts was more pronounced in the second quarter, which may be explained as a response to the heavy flooding in Slovakia – this caused extensive property damage and may have motivated people to seek household insurance coverage. The overall decline in premiums may therefore have a number of causes. One of them is that the rise in the number of new contracts was concentrated in the household segment (the average value insured in the case of household property insurance is far lower than the value for corporate insurance). Another possible cause is that the majority of new contracts were entered into towards the end of the half year and therefore they were not reflected in the amount of premiums.

The claims cost in this line of business fell by almost 14%, but because insurance companies responded to flood damage claims (expected to be extensive) by increasing their liabilities, i.e. technical provisions, there was an overall increase in costs arising from existing insurance coverage. The loss ratio in the first half of 2010 rose by almost 16 p.p., reaching 76.3%.

It will be interesting to monitor the development of claim costs in this line of business, particularly in the second half of 2010 and 2011, when flood-related insurance claims are expected to increase.

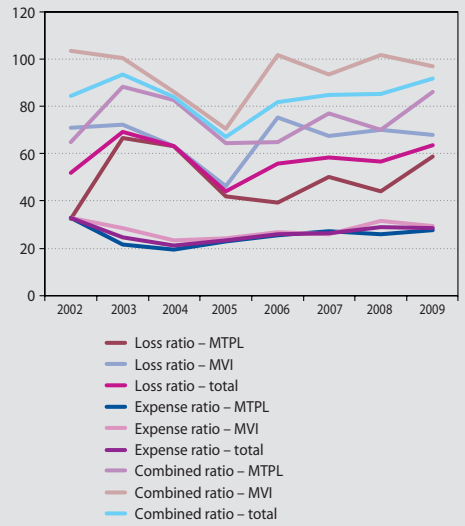
In the largest non-life insurance line of business – motor insurance – the situation during the first six months of the year remained the same as in previous periods. Strong competition, particularly in motor third-party liability insurance (MTPL), put downward pressure on premium prices and resulted in an overall decline in premiums, despite a higher number of insurance contracts. The average premium price per contract is decreasing mainly among prolonged contracts, which may be caused by no claims bonuses. Average premiums for new contracts increased slightly.

The long-term decline in premium prices is putting upward pressure on the basic performance indicators – loss ratio, expense ratio, and combined ratio – that are used to evaluate the profitability of existing non-life insurance policies. In the case of motor insurance, these indicators are important also due to the high concentration in this line of business.

The following Chart plots these ratios from 2002 for both segments of motor insurance. Motor vehicle insurance has been the less profitable over the long term and it even made a loss in several years (the combined ratio exceeded 100%). MTPL, by contrast, recorded its highest loss ratio for five years in 2009. As the Chart shows, these two motor insurance segments are interconnected. The

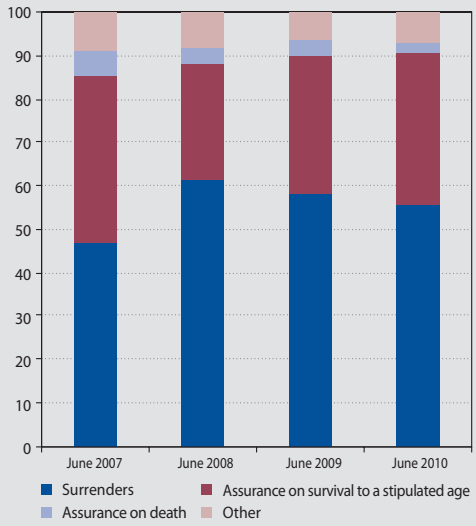
8 *Traditional life insurance includes assurance on death, assurance on survival to a stipulated age, mixed assurance, etc.*
9 *The surrender rate fell due to the higher rise in the number of insurance contracts in this line.*

Chart 45 The loss ratio, expense ratio, and combined ratio in the motor insurance line of business (%)



Source: NBS.
Note: MVI – motor vehicle insurance
MTPL – motor third-party liability insurance.

Chart 46 Structure of the claims cost in life insurance (%; end of period)



Source: NBS.

loss ratio, expense ratio and combined ratio of the motor insurance line of business as a whole did not record sharp fluctuations after 2005 and the mutual off-setting of losses is evident.

One insurance line of business that thrives even during adverse economic conditions is the credit insurance, surety insurance and miscellaneous financial loss insurance. During the first half of 2010, premiums under this line of business increased by more than 30% year-on-year. Demand for such insurance remains high, as reflected also in the sharp rise in the number of insurance contracts. Compared with their pre-crisis level, the number of contracts in this line of business rose by almost eight times.

Smaller rise in the claims cost[10]

The total claims cost in the first half of 2010 rose by 3.7% year-on-year, to stand at €530.1 million. In life insurance, the claims cost climbed by 11.4%, to €303.9 million, while the figure for non-life insurance fell by 5.1% to €226.3 million.

The claims cost in life insurance rose mainly due to an increase in payouts for survival to a stipulated age (up by more than 20% year-on-year) and surrenders. The overall rise in the claims cost is, however, gradually falling, largely due to a slower increase in the figure for surrenders.

It is worth looking at the structure of the claims cost according to the grounds of payouts, particularly the costs related to cancelled contracts. In the first half of 2007, surrenders accounted for less than a half of the total cost, but in the first half of 2008 the claim costs related to surrenders rose sharply and took their share up to 61%. Since then, this share has been gradually falling and by the end of the first half of 2010 it represented 56%. This development did not mean that surrender payouts were declining in absolute terms, but instead reflected an increase in payments under assurance on survival to a stipulated age, which in turn was due to the "ageing" of the insurance contract portfolio.

In non-life insurance, the claims cost is evaluated using the loss ratio, which compares the amount of losses to earned premiums. The loss ratio for non-life insurance as a whole rose by 3.7 p.p. in comparison with the previous period, to reach 61%. The overall increase was driven mainly by the worsening situation in the property insurance line of business, which, as has already been noted, saw a rise in insurance claims. Among the major lines of business, the loss ratio in MTPL rose by 3.7 p.p. while the figure for motor vehicle insurance declined by 7 p.p.

The combined ratio, which takes into account not only technical costs but also operating expenses

10 *NBS analysed the technical cost of claims as it did premiums. Hereinafter, the term "claims cost" means "technical claims cost".*

related to insurance activities, rose by 4.7%, to 91%. Like the loss ratio, the combined ratio recorded one of its highest levels over the last ten years. The combined ratio had long been hovering below 90% (with an average value of around 80%), and the loss ratio below 60% (with an average of 52%). This increase – caused by a combination of lower premiums and rising insurance claims (possibly related to a higher number of natural disasters) – is squeezing the profit margin on earned premiums.[11]

Three non-life insurance lines reported an overall loss for the period under review. Apart from property insurance, they included the credit insurance, surety insurance and miscellaneous financial loss insurance and the legal protection insurance.

The reinsurance share rose slightly

Insurance premiums ceded to reinsurers in the first half of 2010 amounted to €140.5 million, representing a moderate rise of 2.8% year-on-year. The bulk of ceded premiums were non-life insurance premiums, and the amount of ceded life insurance premiums again declined. As a share of non-life premiums and life premiums, ceded premiums represented, respectively, almost 27% and not even 1%.

Technical provisions and their investment

The technical provisions of insurance companies rose in both the life and non-life insurance sectors. Technical provisions, excluding provisions for unit-linked insurance liabilities, totalled €3.829 billion as at the end of 2009 and their asset coverage stayed at 112%. The investment structure of technical provisions remained largely unchanged. After rising in 2009, the amount and share of government bonds fell again, while the amount and share of bank bonds and term deposits began to rise. This is precisely the opposite of what happened in 2009. The share of reinsurers in overall technical provisions rose, after recording a falling trend in recent years. The reason probably lay in an increase in flood-related claims, the risk of which had been covered by reinsurers.

In non-life insurance, the largest rise was recorded for liabilities related to pending insurance claims.

The rising importance of unit-linked insurance is reflected also in liabilities related to investments made under unit-linked insurance policies. The technical provisions for such insurance rose by almost 31%, and in absolute terms they again recorded the sharpest increase among provisions for different insurance lines. Over the past ten years, their share of total provisions for life insurance has more than tripled, to stand at almost 22%.

Profits fell in the insurance sector

The overall financial position of the insurance sector in the first half of 2010 worsened in comparison with the same period of the previous

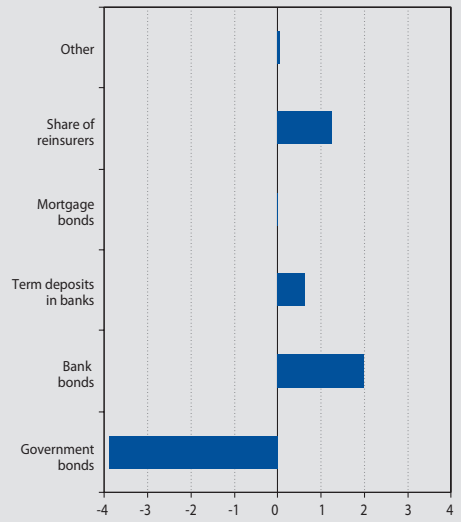
Table 2 The loss ratio, expense ratio, and combined ratio of non-life insurance lines for the first half of 2010

	Loss ratio (%)	Expense ratio (%)	Combined ratio (%)
Supplementary insurance	25.6	25.8	51.4
Accident and sickness insurance	30.7	37.4	68.1
Motor third-party liability insurance	57.5	27.3	84.8
Motor vehicle insurance	64.0	27.1	91.1
Other motor insurance	-39.4	26.4	-13.0
Transport liability insurance	60.7	32.5	93.1
Property insurance	76.3	32.0	108.3
General liability insurance	38.0	30.4	68.5
Credit insurance, surety insurance and miscellaneous financial loss insurance	80.9	48.1	129.0
Legal protection insurance	42.1	66.2	108.3
Assistance insurance	41.0	45.7	86.6
Active reinsurance	32.4	38.8	71.2
Total	61.0	29.9	90.9

Source: NBS.

11 ‚Earned premiums' means premiums used by insurers to cover the insurance risk and expenses during the period under review.

Chart 47 Changes in the investment of technical provisions as at the end of June 2010 (%)



Source: NBS.
Note: The Chart shows the year-on-year percentage changes in investments in given instruments

year. The profit on insurance activities fell and the profit on financial operations rose more moderately than in the previous year.

The total profits of insurers fell by 6.7% year-on-year, to €65.3 million, and the profitability ratios also declined. Although the sector as a whole reported a drop in profitability, exactly half of the constituent insurance companies improved their profits on a year-on-year basis. The divergence is explained by the fact that the sector's overall position is largely determined by the largest companies in the Slovak insurance market. As in the previous year, a total of six insurance companies reported a loss for the period under review.

In the non-life insurance sector, the deterioration in the technical result was attributable to a combination of a downturn in premiums and a rise in claims. Consequently, the profit on this sector's technical account fell by almost 40%.

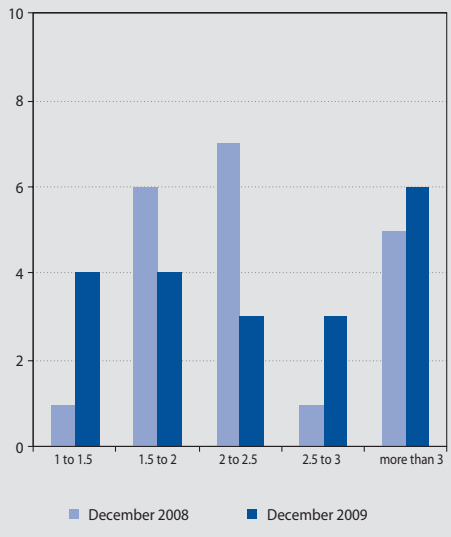
The life insurance sector reported a loss on insurance activities. This result had several causes, primarily the fact that the rise in premiums was lower than the increase in claim costs. Other factors included the drop in 'other technical provisions', which included, for example, commissions from reinsurers and a rise in liabilities to insured persons (the technical provision for life insurance). After taking into account expenses and income related to the financial investment of technical provisions, the life insurance sector recorded a profit that was almost one third lower on a year-on-year basis. In seeking to compensate for their worse results, insurance companies reduced operating expenses.

Rise in the available solvency margin for 2009[12]

As regards assessing the solvency of insurance companies, it is required that their available solvency margin (i.e. own funds) is higher than the required solvency margin and the value of the guarantee fund. As at the end of 2009, all insurance companies met these requirements.

The available solvency margin rose by 18.7% in comparison with the previous year, largely due to the rise in retained earnings from previous years. Its ratio to the higher value of the required solvency margin and guarantee fund stood at 3.3 (the solvency ratio), which represents a rise of 42 p.p. compared with the previous period. Insurance companies providing both life and non-life insurance had an overall solvency ratio of 3.3, while companies providing only life insurance or only non-life insurance had respective ratios of 2.7 and 1.7.

Chart 48 Distribution of the ratio between the available and required solvency margin



Source: NBS.
Note: Left-hand scale: number of entities.

12 Each insurance company once a year submits a report on its solvency to Národná banka Slovenska. The solvency assessment is therefore based on audited data as at 31 December 2009.

2.3 PENSION SAVING

The situation in Pillar II of the pension saving system in the first half of 2010 was marked by an absence of any substantial changes, particularly when compared with developments in previous years. In several respects, the situation during the six months continued on from where 2009 left off, with conditions stabilising in the wake of the major changes made to the system mainly in the first half of 2009. The asset structure of pension funds thus remained largely unaltered in the first half of 2010, while the performance of all funds stabilised at a similar level after improving in comparison with 2009.

Assets in Pillar III of the pension saving system continued to increase, which was reflected above all in the rise in share purchases, which once again raised the equity component of funds' assets. The average performance improved in comparison with 2009, and, overall, Pillar III funds outperformed Pillar II funds.

2.3.1 RETIREMENT PENSION SAVING

The number of savers stagnated

The number of savers enrolled in the retirement pension saving system barely changed during the first six months of 2010, rising by less than two thousand or 0.1%. By the end of June 2010, a total of 1,433,254 savers were registered in the Pillar II system. After taking into account the switching of savers between funds, both within and between individual pension fund management companies, the highest increase in savers was recorded by balanced funds. Conservative funds, too, attracted more savers, and in percentage terms the increase was even higher compared with balanced funds. Growth funds saw a decline in savers, mostly due to savers switching to either of the two types of funds mentioned above. Nevertheless, this shift towards more funds labelled 'conservative' did not involve a significant number of the total savers, and each type of fund's share of the total remained largely unchanged. Nor, in terms of saver numbers, did the market shares of individual pension fund management companies alter to any significant extent. Three PFMCs reported an increase in savers and the other three a decline, but in both cases the difference relative to the total number of savers in the given company was negligible.

Net asset value rose sharply

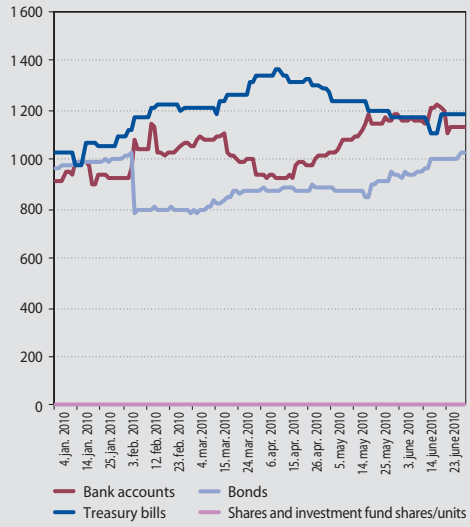
The total net asset value of Pillar II funds rose in the first half of 2010 by €413 million, or around 14%, to stand at €3.313 billion. The percentage rise recorded by individual pension fund management companies deviated from the aggregate figure to only a minimal degree. The distribution of managed assets between conservative, balanced and growth funds remained at the long-term ratio of 4.5% - 29% - 66%, respectively.

The asset structure of funds remained largely unchanged in the first half of 2010

The asset structure of pension funds did not undergo any significant changes during the period under review. The allocation of assets into major asset classes retained broadly the same structure that it had at the end of the previous year, corresponding with the new, more conservative investment strategy that PFMCs switched over to in mid-2009.

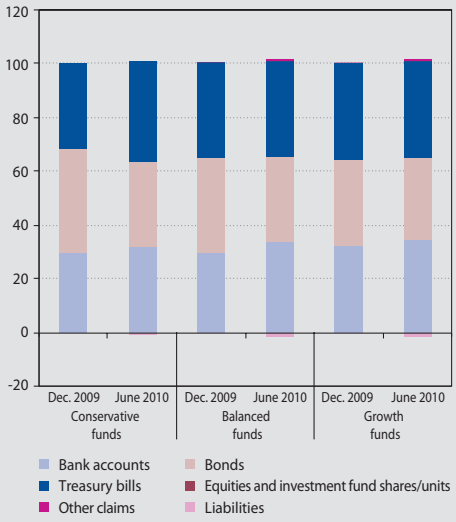
The conservative nature of PFMC investments is underlined by the share of funds' assets that are invested in current accounts and, even more so, in term accounts at banks – altogether a substantial 34% of the total assets as at the end of June 2010. Compared with the beginning of the year, this share recorded a further moderate increase of 2.5 percentage points. However, the rising amount and share of assets in the form of bank accounts also has a downside, namely the mounting concentration risk. In the case of individual funds, this is because their deposits are held in only a few banks, which means that a substantial proportion of the fund's total assets are exposed to individual institutions. The ratio between, on one hand, the amount that a fund deposits with the three banks that hold the largest proportion of its deposits and, on the other hand, the fund's total assets ranges

Chart 49 Amount of major components of PFMC fund assets (EUR millions)



Source: NBS.

Chart 50 Comparison of the asset structure in individual types of PFMC funds (%)



Source: NBS.

between 5% and 30%, depending on the specific fund in the sector; the median of these values is 23%.

Throughout the first half of 2010, the most significant asset class by amount was Treasury bills. Their share of total assets as at the end of the period under review remained practically the same as it had been at the beginning – at around 36% – although during the first three months it climbed to 43%. During the second quarter, in a reversal of the situation, both the share and amount of Treasury bills in the assets of funds recorded a gradual decline at the sectoral level, as the individual issues were continuously maturing and the uptake of new issues slowed down considerably.

The third major component of the pension fund asset structure is bonds. At the beginning of February, the amount of bonds in fund portfolios fell sharply upon the maturing of a single issue of Slovak government bonds that had accounted for a major share of several funds' bond investments. Thereafter, the amount of bond assets rose gradually, and by the end of June their value was at roughly the same level that it had been before the sudden drop. Amid a steady increase in the total assets of the pension fund sector's portfolio, the bond component's share declined by 2 p.p. during the first half of the year, to end the period at 31%.

Equity investments had in previous years constituted a significant component of fund portfolios in Pillar II of the pension saving system, but following heavy selling in the second quarter of 2009 they came to have very much a minority position. The aversion of pension fund management companies to this form of investment did not change in the first half of 2010 either. Throughout this period, equities as a share of the total assets in the system did not exceed 0.15% and the process of reducing the equity component through sales of shares continued. Thus by the end of June 2010, the proportion of total assets in the form of equities had fallen to a negligible 0.04%. It should be added that only three pension fund management companies had funds that included any equities in their asset structure.

Other claims, mostly consisting of hedging derivatives for currency risk, represented only a small part of the portfolio, with their share of the net asset value averaging less than one percent. The reason that such derivative transactions are not being utilised to the extent that they were in the past lies in the low share of fund assets denominated in foreign currency, which in turn reflects

the absence of a significant amount of equities. Indeed, the portfolio's only foreign currency assets are current account deposits in banks, but by the end of June 2010 they represented only a fraction of the total assets – in the region of a hundredth of a percent.

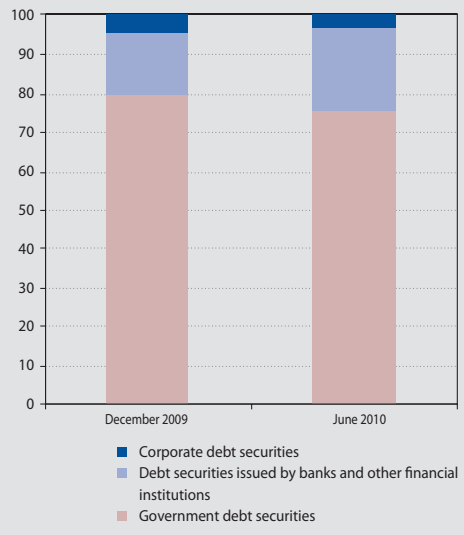
The asset structure of the different types of funds does not have to be separately described since, except for negligible divergences, it is identical to the aggregate structure for the whole of the Pillar II pension saving system. This similarity stems from the similarity between funds at the level of individual pension fund management companies. This means in practice, that although pension fund management companies are required by law to offer three types of fund, savers do not in fact have the option to choose a specific risk-reward profile according to their requirements.

The substantial concentration of sovereign debt instruments in the portfolio of debt securities – which in the context of this analysis includes bonds and Treasury bills – fell slightly during the first half of 2010. At the end of June, government paper accounted for 76% of all debt securities in the system, compared with 80% at the end of 2009. The share of debt securities issued by financial corporations increased by 5 p.p., to 21%. The amount of securities issued by non-financial corporations declined, and their share represented 3.4%. All the government bonds and Treasury bills in the system are issues of euro area countries. The crisis, which hit several euro area countries that have weaker fiscal positions, was partly reflected also in the investment decisions of pension fund management companies. Exposure to the five so-called "peripheral" euro-area countries fell by roughly a half during the first half of 2010 and at the mid-year point it represented 6% of total assets. This correction in the share of government securities of certain countries occurred mostly in a natural way, as equivalent positions were not restored following the maturity of existing instruments in the portfolios. It should be noted that also sales of the securities in question occurred, however, in a lesser extent.

The average maturity of the debt securities portfolio remained at the low level recorded at the end of December 2009. The for the sector as a whole, average maturity weighted by net assets value was approximately 0.8 of a year as at the end of June 2010, and in no fund did this indicator exceed 1.8 years.

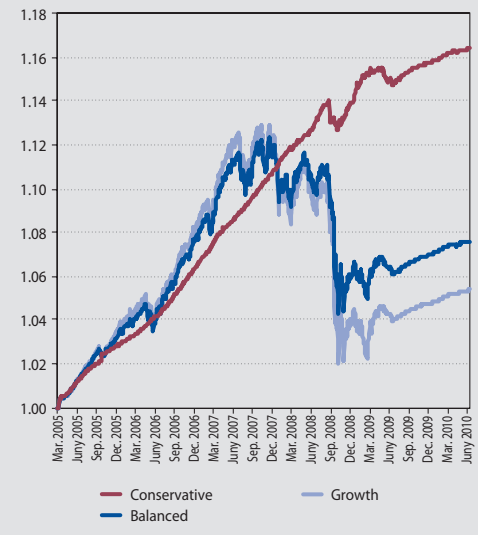
As much as two thirds of the total amount of debt securities held by pension funds at the end of the first half of 2010 were not paying any coupon over their life, i.e. they are zero-coupon se-

Chart 51 Structure of the aggregate debt securities portfolio of PFMC funds (%)



Source: NBS.

Chart 52 Current value of the pension unit by type of fund



Source: NBS.

curities. A further 22% of the funds' debt instruments provided a regular fixed coupon yield and the remaining 12% comprised floating-coupon issues.

The fund performance trend carried on from 2009

The current value of the pension unit in all three types of fund remained steady in the first half of 2010, simply maintaining the linear trend established in the second half of 2009. The all but zero volatility of pension fund units stemmed from the absence of the equity component and from the very low duration of portfolio debt instruments.

Higher volatility was seen in the weighted annual yield given as the annual percentage change in the current value of the pension unit.[13] Particularly in the case of growth and balanced funds, this value was rising until mid-March and later began to fall. These fluctuations in the average yield were not, however, related to events occurring during the period under review, but were a consequence of the volatility of pension unit values during the first six months of the previous year, which are included in the yield calculation. Annual returns on conservative, growth and balanced pension funds remained in positive territory throughout the first half of 2010. By the end of the first half of 2010, the annual returns on all three types of fund had converged to a considerable degree, with conservative and balanced funds offering savers 1.3% and growth funds a slightly lower 1.2%.

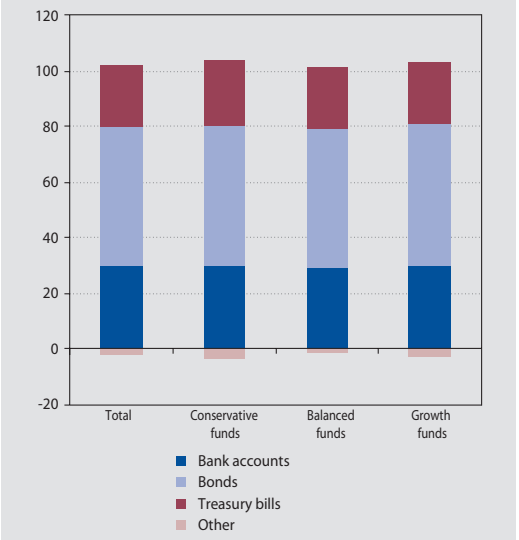
The highest increase in asset value over the long term has been recorded by conservative funds. The weighted average values of the pension unit in these funds represented 1.164 at the end of June 2010, which translates as a 16.4% nominal return on assets for the whole period since the introduction of the system and which is at the same time the historically highest value. By contrast, balanced and growth funds reported respective average values of 1.076 and 1.054, which, because of the financial crisis, are relatively far below their all-time high recorded at the end of 2007. Assuming that the current value of these pension units maintains its current trend, it would take several years for them to return to their historically highest values.

Table 3 Annual yield of pension funds as at June 2010

	Weighted average (%)
Conservative funds	1.3
Balanced funds	1.3
Growth funds	1.2

Source: NBS.

Chart 53 Gains and losses of balanced and growth funds by type of instrument (%)



Source: NBS.
Note: Left-hand scale: percentage share of each type of instrument in funds' gains and losses.

As regards the performance of funds over the first-half of 2010 in terms of the contribution of individual types of assets, probably half of the overall gains were accounted for by bonds. Some 30% of the returns comprise interest on bank accounts, and the remaining 20% represent income from Treasury bills. Equities and investment fund shares/units made a loss for the period under review, but given their small weight in the portfolio, this loss had a very limited effect on the overall performance.

The financial performance of pension fund management companies deteriorated year-on-year. For the period under review, the sector made a loss of €2.07 million, which is 80% higher than the loss reported for the first half of 2009. This was largely attributable to the

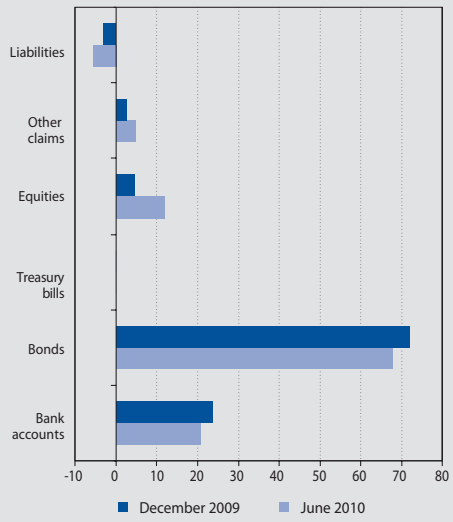
13 *The average annual yield of the given type of pension fund is calculated as a weighted average of the year-on-year percentage changes in the daily values of pension fund units of the respective pension funds. The year-on-year percentage changes in the daily values of pension units are calculated as at 30 June 2009 (PMZDHDJ31.12.2009) according to the following formula::*

$$PMZDHDJ_{30.06.2010} = \left(\frac{DJ_{30.06.2010}}{DJ_{30.06.2009}} - 1\right) * 100\%$$

where DJ is the value of a pension unit on the given day.
The weight applied is the ratio of the respective fund's net asset value (NAV) to the sum of NAVs of funds of the same type.
The yield is given in nominal terms, which means that inflation is not deducted. When yields are calculated for various forms of investment, the nominal yield is used as a rule, calculated according to the standard statutory methodology.
This yield, however, is not identical to the yield in the saver's personal pension account, which is determined on an individual basis.
The input data were the values of pension units from the individual pension funds reported to Národná banka Slovenska by pension fund management companies for the days 30 June 2009 and 30 June 2010, which are available on the website of Národná banka Slovenska.

fact that income from fees and commissions from savers – the dominant item on the income side – fell by almost one third, the main reason for which was probably the new fee limits that came into force at the beginning of July 2009. The new rules resulted in a lower cap on pension fund management fees and the introduction of a new fee linked to fund performance. The year-on-year loss would have been heavier still if pension fund management companies had not managed to make relatively substantial savings in their expenses related to, for example, fees and commissions (paid to depositories, intermediaries, etc.) and ordinary operations. Given the amendments to statutory rules, it is perhaps more meaningful to compare the results for the first half of 2010 with the second half of 2009, and this shows that pension fund management companies increased their income from fees and commissions. Thus the aggregate loss fell by more than a half, aided by the simultaneous further streamlining of operations.

Chart 54 Types of investment by share of total assets under management (%)



Source: NBS.
Note: The share of Treasury bills as at 30 June 2010 was a negligible 0.05%.

The trends observed for the sector as a whole were to a large extent mirrored in the individual pension fund management companies. Of the three PFMCs that made a profit for the first six months, one did so for the first time and the other two had been in the black for a longer period. The other three PFMCs reported a loss.

2.3.2 SUPPLEMENTARY PENSION SAVING

Net asset value continued to rise

The net asset value of funds managed by supplementary pension asset management companies had a rising trend in the first half of 2010, similar to that seen in the preceding periods. All SPMCs reported growth in fund assets. The number of participants in Pillar III of the pension saving system was 855,712 as at the end of June 2010, representing a slight decline of 0.2% in comparison with December 2009.

The aggregate net profit of SPMCs as at the end of the period under review amounted to €2.8 million, a drop of 16.4% year-on-year. As in previous periods, one SPMC reported a loss as at 30 June 2010.

The equity component of SPMC fund assets increased

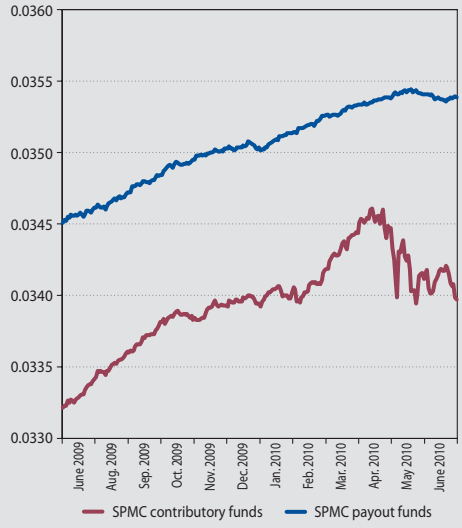
Although the bulk of supplementary pension fund assets were invested in bonds as at the end of the first half of 2010 (as was the case in the previous period), investments in equities and investment fund shares/units rose sharply year-on-year. The amount of equities climbed by approximately 165% in comparison with the end of 2009, to stand at almost 12% of the total assets. Most of this increase was driven by the purchase of these shares and it was largely recorded in two SPMC contributory funds. In all, eight of the nine SPMC funds reported a rise in the amount of equities and investment fund shares/units. By contrast, the share of investments in debt securities and bank deposits declined. More than half of the bond portfolio of SPMC funds is invested in government bonds – predominantly in Slovak government bonds and to a lesser extent in government bonds of Poland, the Czech Republic and Slovenia.

Performance of Pillar III pension funds

The annual performance of SPMC funds ranged from negative figures, to double-digit growth. In the case of contributory funds, the lowest return was -1.1% and the highest 10.71%. As

at the end of June 2010, the weighted average for all contributory funds represented 2.45%, and for all payout funds, 2.48%. In the first half of 2010, the current value of the pension unit (CVPU) in Pillar III contributory funds was largely determined by the CVPU in those Pillar III funds that include an equity component in their portfolio.

Chart 55 Current value of the pension unit in supplementary pension funds



Source: NBS.

2.4 COLLECTIVE INVESTMENT

The amount of assets in collective investment funds continued to rise in the first four months of 2010, driven up by both investment fund sales and the positive performance of funds. In May and July, the net asset value again declined, largely due to a deterioration in performance. Asset growth in foreign collective investment undertakings was almost twice as fast compared with domestic investment funds. Most assets continue to be concentrated in money market funds. The composition of domestic investment fund portfolios underwent only moderate changes in the first half of 2010, although one new trend was the increase in the bond component of equity funds. A downturn in performance was recorded across almost the full range of investment fund categories in the first half of 2010, reflecting the fact that the upturn in asset prices seen in 2009 was not maintained during the period under review.

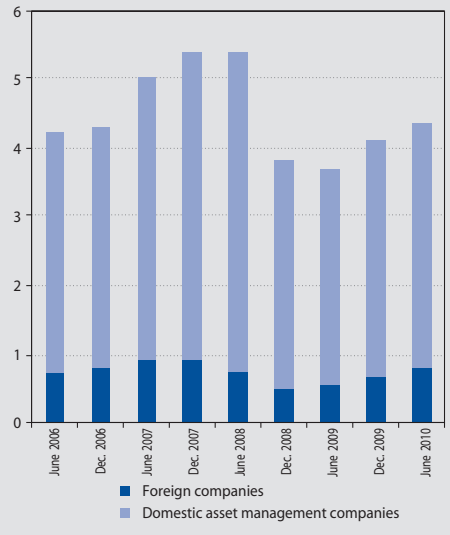
NET ASSET VALUE GROWTH SLOWED IN THE SECOND QUARTER OF 2010

Net asset value in the collective investment sector went through two phases in the first half of 2010. The first of them, lasting until April, continued the trend of a gradual return to asset growth that dated back to the second quarter of 2009. The accumulation of assets in domestic investment funds and in foreign collective investment undertakings was largely attributable to the positive net sales of investment fund shares/units during this period. These sales were strongest in the months of February and April.

Another relatively significant factor behind the asset growth was the increase in value of invested funds. Around a quarter of the asset growth recorded in the first four months of the year can be attributed to fund performance.

In a turnaround during May and June, however, net asset value began to decline. Net sales fell sharply, and, for a change, it was negative returns that caused the month-on-month movements in the amount of managed assets to tip into the red. For the whole of the first half of 2010, however, assets reported overall growth of 5.9%, which compared with the second half of 2009, represented an increase of roughly a half. At the same time, however, the sector's size is smaller by one billion euro than it was at its peak in the first half of 2008.

Chart 56 Net asset value of investment funds sold in Slovakia (EUR billions)

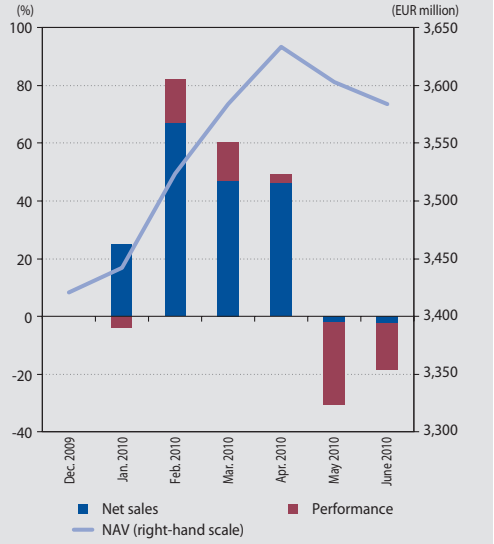


Source: NBS.

STRONGER GROWTH RECORDED BY FOREIGN COLLECTIVE INVESTMENT UNDERTAKINGS

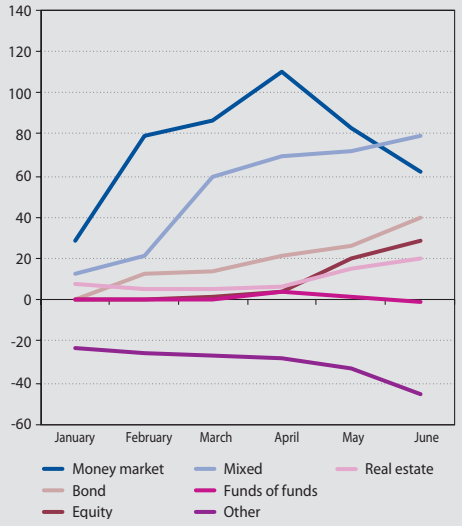
The amount of assets in terms of their distribution between domestic investment funds and foreign collective investment undertakings closely mirrored the aggregate described above. One difference was that foreign collective investment undertakings maintained moderately positive net sales even during the last two months of the first half of the year, whereas domestic investment funds recorded practically zero net sales. Assets in foreign collective investment undertakings during the first six months increased by around 12%, exceeding the growth in domestic investment funds by more than twofold. As a result, foreign collective investment undertakings increased their share of assets under management in the sector to 18%. This was the level that prevailed before the crisis of confidence, which resulted in an outflow of funds from the sector and saw the mentioned share decline to 13%. Given the regulations soon to be implemented under the UCITS IV Directive, the increase in the

Chart 57 Contributions of net sales and performance to changes in NAV in domestic investment funds



Source: NBS.

Chart 58 Cumulative net sales of open-end investment funds for the first half of 2010 (EUR millions)



Source: NBS.

share of foreign companies may prove to be a long-term trend.

Money market fund assets grew more slowly in the second quarter of 2010

In terms of amount of assets, money market funds have long been the most significant category of funds in the Slovak collective investment sector, with a share hovering around 45%. The net asset value of money market funds increased by 5% in the first half of 2010, representing a slightly slower pace of growth than that recorded by the sector as a whole. In the first four months of the year, all the indications were that the growth in the money market fund category could be even twofold, considering the favourable net sales and, to a lesser extent, the performance figures. The next two months, however, saw a certain retreat from domestic money market funds (the largest component of the category), with fund redemptions almost halving the positive balance in net sales recorded up to that point. One of the potential explanations for this relatively abrupt turnaround in sentiment towards money market funds may be related to the escalation in turbulences surrounding sovereign risk in the euro area, which may have induced some money market unit certificates holders – who typically are strongly risk averse – to pull their money out of these investment funds. To this may also be added the negative performance of domestic money market funds in May, which, in a category focused above all on protection of the principal, could also have been a factor behind the redemptions.

Among the investment funds under review, bond funds recorded one of the highest rises in assets for the first half of the year – close to 13%. Net sales of their unit certificates remained positive throughout the first six months and climbed still further towards the end of the period, albeit driven up by the strong sales of one particular investment fund (although this investment fund was not the only one in which the issue of new unit certificates surpassed redemptions in May and June). This development occurred even though bond funds on average made a slight loss over the two months in question.

Net sales of equity funds, particularly domestic ones, was relatively subdued until April. Up to that point, the value of investments in this category had been driven up by the rise in stock markets, especially during February and March. From May, domestic equity funds recorded a substantial inflow of funds from unit certificate holders, perhaps a somewhat paradoxical development given that stock markets were falling sharply at this time. These new investments in equity funds

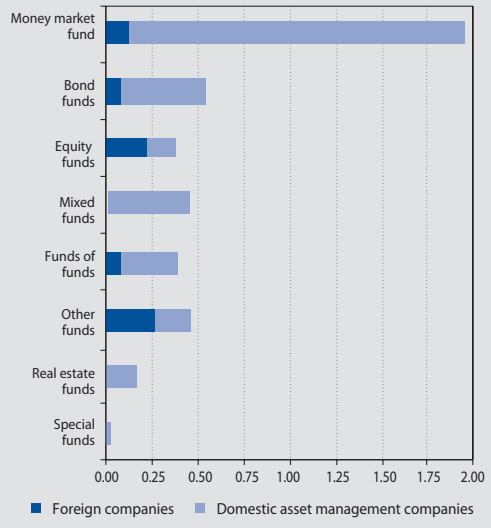
Table 4 Aggregate amount of investment fund unit certificates issued and redeemed during the first half of 2010 (EUR)

	Amount of unit certificates issued	Amount of unit certificates redeemed	Net sales of unit certificates
Money market funds	576,740,994	515,303,855	61,437,139
Bond funds	83,940,796	43,889,912	40,050,884
Equity funds	35,677,583	7,507,667	28,169,916
Mixed funds	131,023,383	51,693,902	79,329,481
Funds of funds	34,871,798	36,490,535	-1,618,737
Other funds	21,856,825	67,611,563	-45,754,739
Real estate funds	38,917,883	19,261,880	19,656,003

Source: NBS.

sufficed to ensure that net asset value growth in this category was above average at around 12%. The growth reported by funds of funds was just one percentage point lower than the equity fund figure, and it was entirely attributable to a threefold increase in the assets of the category's foreign investment undertakings. As for domestic funds of funds, their sales stagnated and their net asset value reflected mainly the negative returns on these investment funds. The situation in the case of mixed funds was basically the opposite. On one hand, the net sales of domestic mixed funds were steadily positive, but, on the other hand, the asset growth in foreign mixed funds slumped by 70%, and therefore the asset growth of mixed funds in total improved by a mere 3%. The smallest category of investment funds – real estate funds – reported the largest rise in assets in relative terms (17%).

Chart 59 Net asset value by category of investment fund (EUR billions)



Source: NBS.

Minimal changes in the asset structure of investment funds

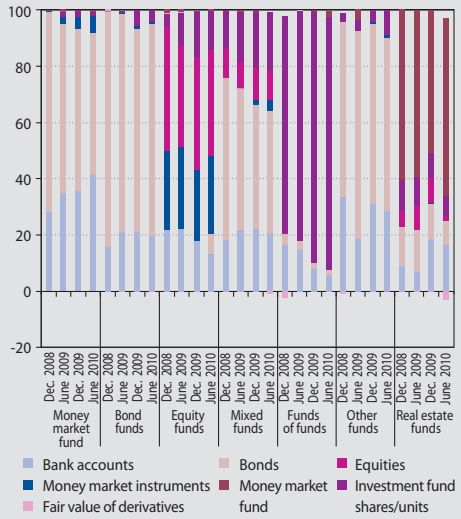
The composition of domestic investment fund portfolios did not undergo any significant changes in the first half of 2010.

In the portfolio of money market funds, the trend increase in the share of bank accounts, at the expense of bonds, continued. The long-term trend in the structure of funds of funds was also maintained, though in this case it consisted of an increase in the share of investments in other investment fund shares/units, which came to more than 90%. In equity funds, the bond component as at the end of June represented 7%, which contrasted with its absence from this portfolio in previous periods. Meanwhile, the share of equities and investment fund shares/units in the equity fund portfolio declined. Real estate funds reported a rise in the share of profile investments in participating interests in real estate companies.

The performance of most investment funds declined on a year-on-year basis

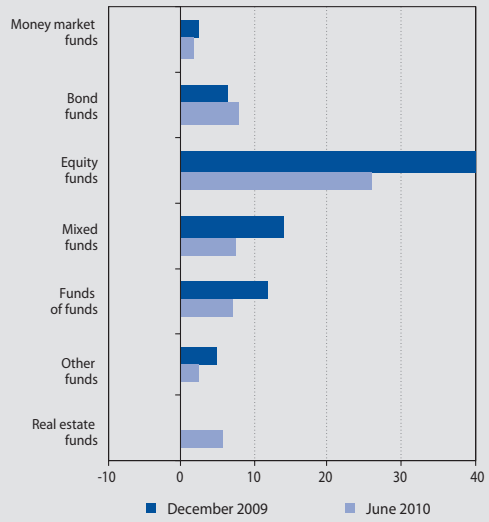
A downturn in performance was recorded across almost the full range of investment fund categories in the first half of 2010, reflecting the fact that the upturn in asset prices seen in 2009 was not maintained during the period under review. This was particularly true for equity prices, as

Chart 60 Comparison of the asset structure in individual investment fund categories (%)



Source: NBS.
Note: 'Other assets' include participations in real estate companies, cash, and other claims.

Chart 61 Comparison of annual average performance of open-end investment funds by category (%)



Source: NBS.
Note: Data on the horizontal axis are given as a percentage for the year. Funds are weighted by net asset value.

a result of which equity funds and mixed funds barely increased the value of their investments over the first six months and funds of funds even reported a slightly negative performance. The aggregate performance of money market funds improved by less than 0.5% over the half year.

The year-on-year performance of investment funds therefore combined the growth effects from the second half of 2009 with the relatively weak performance of the first half of 2010. As a consequence, all investment fund categories except for bond funds and real estate funds recorded an annual decline in performance as at 30 June 2010. In those categories that have the largest share of equity securities (equity funds, mixed funds, and funds of funds), the nominal increase in the value of investments over the previous twelve months fell sharply, but nevertheless remained at relatively high levels, notably the return of 26% on equity funds. The performance of money market funds fell year-on-year by approximately 0.7% of a percentage point, to 1.7%. The strongest improvement in performance from the beginning to the end of the first six months of 2010 was reported by real estate funds, which went from slightly negative territory to a 5.7% annual return.

The profitability of asset management companies increased

The aggregate profits of domestic asset management companies for the first half of 2010 rose by more than 50% in comparison with the same period of the previous year. Their profitability was also higher than in the second half of 2009, but not to the same extent as in the year-on-year comparison. The rise in profits was driven by an increase in net income from fees and commissions, which in turn reflected the upturn in the net value of assets under the management of domestic asset management companies. Another factor behind the higher profits was a year-on-year reduction in operating expenses. Compared with the second half of 2009, operating expenses remained unchanged. Seven of the eight asset management companies operating in the sector reported an annual increase in profits. One company, by contrast, made a slightly heavier loss than it did in the first half of 2009.

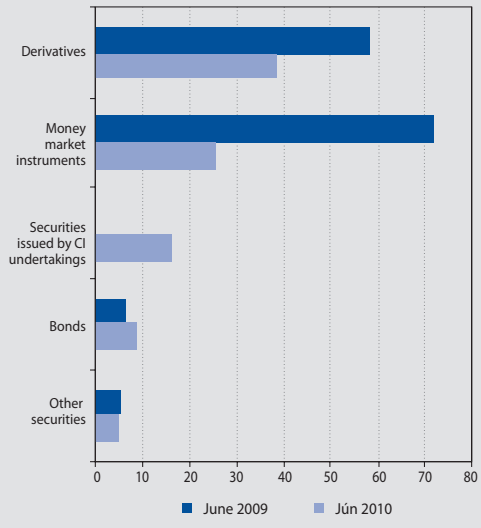
2.5 INVESTMENT FIRMS

The volume of securities trading in the first half of 2010 declined by an average of 33% in comparison with the same period of the previous year. The sharpest fall was recorded by transactions in financial derivatives and in money market instruments. The amount of customer assets managed by companies licensed to manage assets rose by 4.3% year-on-year, to € 2.13 billion.

The aggregate amount of transactions in equity securities (excluding derivatives) fell by 33% year-on-year. By contrast, trading in securities issued by foreign collective investment undertakings increased, and these transactions were conducted almost exclusively through banks. As for transactions in financial derivatives, their amount declined by 34%.

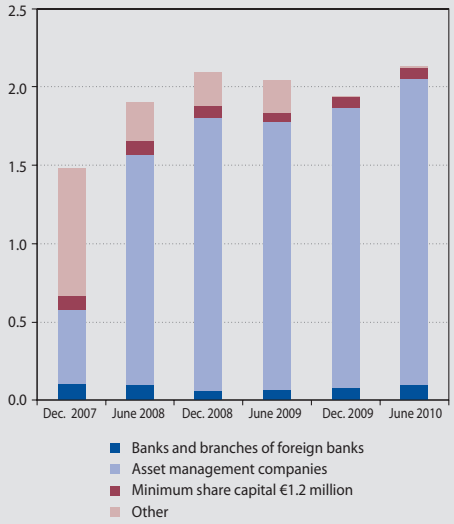
The amount of customer assets managed by companies licensed to manage a customer portfolio (investment firms, banks and certain asset management companies) rose by 4.3% year-on-year, to €2.13 billion.

Chart 62 Transactions broken down by investment instrument (EUR billions)

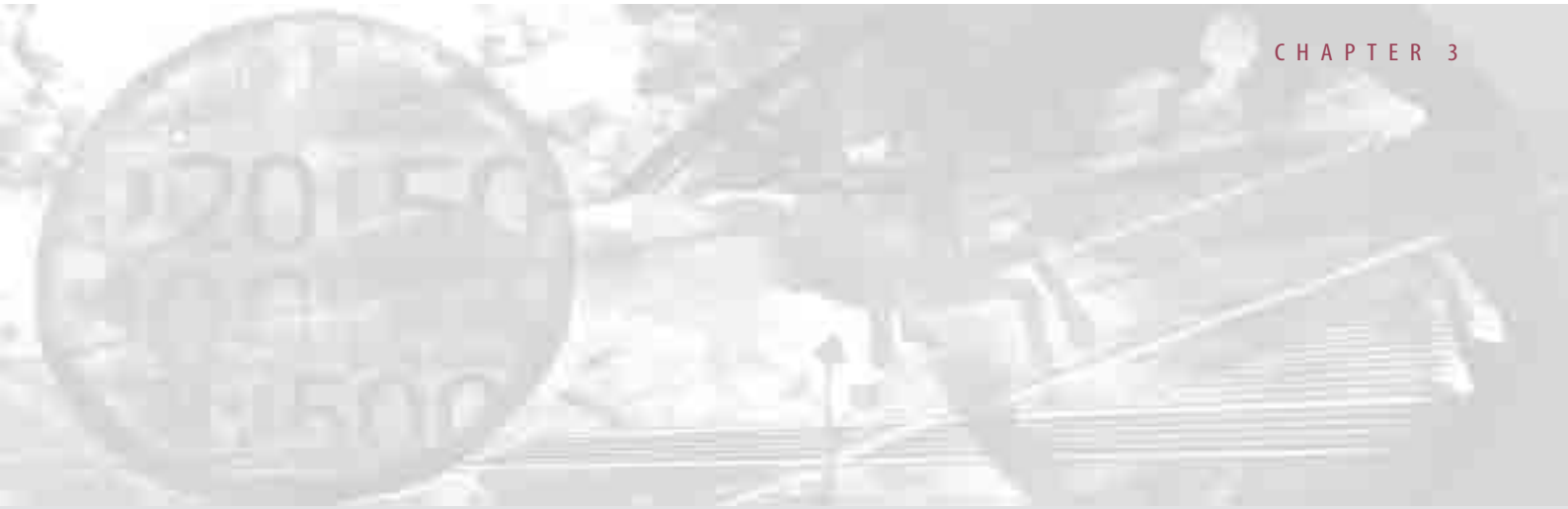


Source: NBS.

Chart 63 Amount of customer assets managed by licensed entities (EUR billions)



Source: NBS.



CHAPTER 3

RISKS IN THE SLOVAK FINANCIAL SECTOR

3

3 Risks in the Slovak financial sector

The financial strains of households eased somewhat in the first half of 2010, and this was reflected in improved expectations regarding credit risk. The main factor in this regard was the labour market situation. While the largest negative employment shocks occurred in 2009, the rise in unemployment slowed in the last months of the year. This lessening in financial tensions was accompanied by a slower rise in non-performing loans. The reaction of banks to this development was cautious, and lending standards remained at relatively tight levels.

A positive trend for the future degree of credit risk was that households increasingly gravitated towards longer interest rate fixation periods, in sharp contrast to the clear preference for short fixation periods that had prevailed until the end of 2009. Such behaviour is making households less sensitive to rises in interest rates, and, at the same time, it ensures that their repayments are fixed at historically low interest rates.

Looking ahead, the main risk is the overall macroeconomic situation, since it determines developments in the labour market. With lending standards having been tightened last year, any downturn in the economic situation would probably be felt to a lesser extent than in 2009. There remains, however, the risk of a rise in interest rates, since most household lending rates are determined by developments in the money market, notwithstanding the new trend towards longer interest rate fixation periods.

Changes in the market shares of banks that occurred in regard to loans and deposits could also prove to be a source of risk. Since the tightening of lending standards in 2009 differed from bank to bank, the increase in market concentration in favour of those banks that eased lending conditions to a lesser extent continued in the first half of 2010. We assume that, in the near term, certain banks will be attempting to reclaim their market share and that this may lead to an easing of lending standards throughout the banking sector. There is a risk that the new level of lending standards will reflect more the state of competition than economic fundamentals. In light of experiences from the previous years, the likelyhood of such scenario is higher.

Credit risk in the corporate sector remains one of the most serious risks in the banking sector, even though it has lessened in recent months. As in the household sector, increases in non-performing loans to enterprises have fallen gradually, which reflects the revival of activity in several sectors, particularly those oriented on exports (e.g. industry). At the same time, however, sectors dependent on domestic demand (e.g. construction or certain services) recovered more slowly.

The financing of commercial real estate represents a separate risk, and because of the high concentration of loans and gloomy situation in the commercial property market, this risk is very significant. With several residential projects remaining unsold, their fate will to a large extent depend on the pricing policy of the respective development company which will in turn affect the company's loan repayment capacity.

As for market risks, the first half of 2010 was marked above all by the rising sovereign credit risk of certain EU countries, notably Greece. The effect was to increase the risk of impairment in the value of debt securities issued by these countries, or by institutions established in these countries. Furthermore, the amount of the banking sector's investments in such securities increased during the first half of the year, although it was only in a few banks that these investments accounted for a significant part of the asset portfolio. Some banks also reported an increase in the risk of bank book assets falling in value in the event of a rise in interest rates.

Regarding the exposure of other sectors to market risks, one of the most significant changes was in the sector of SPMC funds, where the share of investments in equities and investment fund shares/units rose relatively sharply. Towards the end of the first half of 2010, the investment risk in stock markets also increased. As for PFMC funds, they currently have a low risk exposure.

Liquidity risk in the first half of 2010 remained largely unchanged. A positive trend was the greater extent of investments in government bonds, at the expense of corporate loans. Banks did not, however, increase the amount of their long-term funds in the form of mortgage bonds, given the stagnation in the mortgage portfolio.

3.1 CREDIT RISK OF HOUSEHOLDS IN THE BANKING SECTOR

Reduction of household credit risk in the near term; uncertainty persists in the medium-term horizon

The credit risk of households can be defined as the ability of households to service their bank debts. This ability depends on several factors whose importance changes over time. In the recent period, labour market developments have been particularly important owing to their effect on household income. The household debt ratio plays an important role here by indicating the ability of households to withstand negative developments. As lending increased, so did the sensitivity of households to interest rate movements, particularly in the case of short interest rate fixation periods.

All these factors changed during the first half of 2010, which also affected the aggregate exposure of banks to household credit risk. While the Analysis of the Slovak Financial Sector for 2009 observed that the ability of households to repay loans was coming under relatively strong pressure, the situation in the first half of 2010 saw this pressure ease to some extent.

Although labour market conditions remained difficult, some positive trends were recorded, concerning mainly the slower rise in unemployment and slower decline in employment. Firms began to be far more positive in their outlooks for the development of employment in the near term. This situation was also reflected in household income, which began to rise more sharply in comparison with 2009.

The dependence of households on short-term interest rate movements in financial markets also continued to decline, with several banks recording an increase in the share of loans that have longer interest rate fixation periods.

Bank lending conditions during the first half of 2010 did not indicate any substantial loosening of standards, which more or less remained at the relatively tight levels seen in 2009. This may imply that these loans are more resilient to future negative shocks.

The abatement of credit risk is further indicated by the situation with non-performing bank loans. In several banks, the rise in non-performing loans to households appears to have reached a ceiling, and it began to slow down in 2010, particularly in the second quarter of the year.

These improvements are, however, dampened mainly by the continuing uncertainty about the future economic situation. The expected progress in economic performance itself entails relatively many risks, which may quite quickly become manifested to a similar extent as happened at the beginning of 2009. It should also be noted that although certain indicators concerning the household sector improved in the first half of 2010, they are still far away from their pre-crisis levels.

Signs of positive trends in the labour market

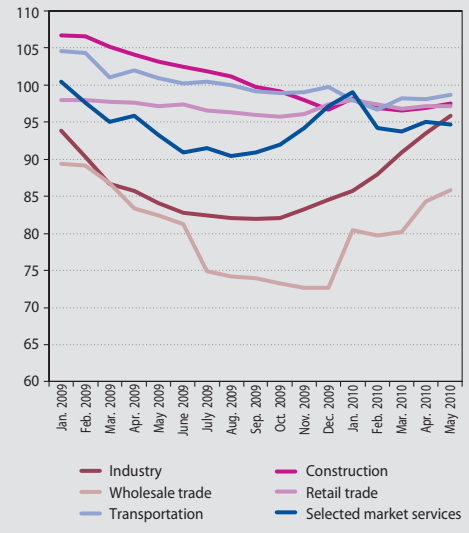
Certain positive trends in the corporate sector were gradually reflected in the labour market as well as in the financial position of households. The decline in employment slowed in almost all the major sectors in the first half of 2010, but, even so, some sectors still recorded a negative change in employment. During the six-month period, expectations for employment improved. In all the major sectors except for construction, a majority of employees believe employment is more likely to rise than to fall.

A number of indicators of unemployment also improved. The rate of recorded unemployment fell during the first half of the year, particularly in the second quarter. The rate of unemployment as measured by a sample survey showed the opposite trend. According to this indicator of unemployment, Slovakia even recorded one of the highest increases in comparison with surrounding countries. Another negative development is that the duration of registered unemployment is being extended.

Total hours worked increased and income stabilised

An important factor in the overall position of households was the fact that the Slovak economy, during the crisis, recorded one of the highest drops in the aggregate amount of hours worked. Year-on-year changes in hours worked moved into positive territory, especially in the second quarter of 2010. Nevertheless, the number of ho-

Chart 64 Employment in selected sectors (%)



Source: SO SR.

Chart 65 Average nominal wage (annual percentage changes)

Source: SO SR.

urs worked continues to fall short of the pre-crisis level, particularly so in the industry sector.

The situation in household income also began to change. In the second quarter of 2010, income in most of the major sectors rose year-on-year. At the level of the economy as a whole, the annual decline in income came to an end, and income levels stabilised in the most recent two quarters.

The banking sector did not loosen lending standards to any significant extent in the first half of the year; this trend may change as competition increases

Despite the relatively strong recovery of lending growth in the first half of 2010, banks did not loosen lending standards to any significant extent. This fact may be relatively significant to the riskiness of these loans, especially their capacity to overcome negative periods. It should be noted, however, that there are differences in approach between individual banks.

Some of the data for new loans also confirmed that lending standards were loosened only minimally in the first half of 2010. The average loan-to-value ratio remained largely unchanged. The share of loans with an LTV ratio of 80% to 100%, increased only slightly. Bank loans with an LTV ratio of more than 100% were provided only to a minimal extent. The maturity of loans did not change significantly, either.

As for the distribution of household loans by income, there has been a certain shift towards higher income groups, which are generally perceived as less risky in regard to loan repayment. This was confirmed not only by the amount of loans, but even more so by the number of loans. These data pertain to 2009, but we do not expect that banks will change their policy in this regard in 2010.

The rising competition between banks was not even reflected in interest margins to a significant extent. As regards interest rates on new loans, it is interesting to note the widening gap between rates with the shortest initial rate fixation period and those with an initial rate fixation of 1 to 5 years. At the same time, financial market interest rates with similar duration showed the opposite trend. Owing to this lending policy of banks, housing loans with an initial rate fixation of up to one year had a gradually declining share of total new loans, even though the interest margins on these loans fell. By contrast, loans with an initial rate fixation of 1 to 5 years – constituting the bulk of new housing loans – recorded a rise in interest margins.

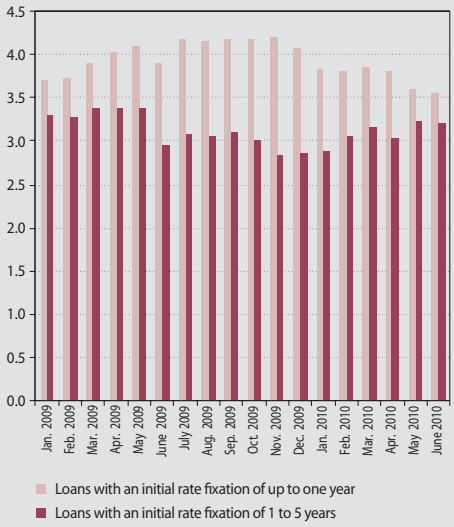
Household borrowers became less sensitive to interest rate rises

A trend seen in new bank loans since the beginning of 2009 has been the gradual shift from lo-

Chart 66 Distribution of housing loans by income group (%)

Source: SO SR, EU SILC 2009, NBS.
Note: The horizontal axis shows the distribution of the amount and number of household loans by amount of household annual income.

Chart 67 Interest margins on new housing loans



Source: NBS.
Note: Interest margins are defined as the difference between, on one hand, interest rates on new loans with the respective initial rate fixation and, on the other hand, interbank market rates with the corresponding maturity.

ans with an initial rate fixation of up to one year, to loans with longer initial rate fixation periods. In March 2009, the former group accounted for 61% of all new loans, but by the end of June 2010 its share had fallen to 30%. The main reason for this is a change in bank lending policies, which became increasingly attuned to the risk that an increase in interest rates poses for households. The predominant loans at present are those with an initial rate fixation of 1 to 5 years.

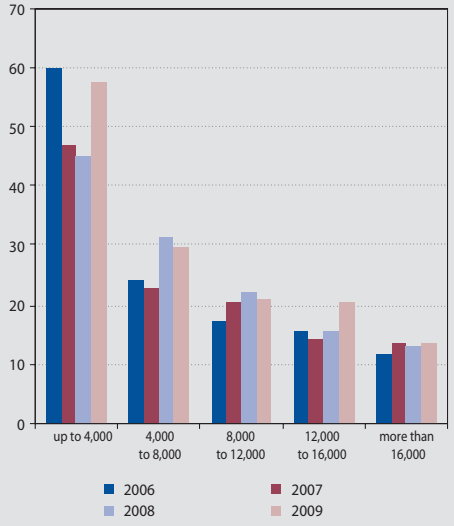
The loan repayment burden of households remained largely unchanged

The household debt ratio measured as the ratio between the loan repayment liabilities of household borrowers and the disposable income of these households remained largely unchanged. In 2009, this ratio averaged 26%. As for the breakdown of the ratio by household income group, the highest ratio was recorded by the lowest-income groups.

Non-performing loans increased at a slower pace

By the end of June 2010, non-performing loans as a share of total loans had risen by almost one percentage point year-on-year. The portfolios of all types of loan showed a drop in quality compared with the end of 2009. The sharpest rise in the NPL ratio was for consumer loans.

Chart 68 Household loan repayment burden by income group (%)



Source: SO SR, EU SILC 2009, NBS.
Note: The horizontal axis shows the distribution of households by amount of household annual income.

The improvement in the economic and financial position of the retail sector over the first half of 2010 was gradually reflected in the pace at which non-performing retail loans were rising.

The increase in the banking sector's non-performing retail loans peaked in the first months of 2010 and then stabilised. In some banks, the amount of non-performing loans even began to fall. A stabilising trend in NPL growth was seen in almost all banks and among the majority of credit products. This development in the first six months was to some extent driven by loan sales. But whereas loan sales were a substantial factor in the decline in NPLs in the last quarter of 2009, their effect was not significant in the first half of 2010. In general, however, banks were limited in the extent to which they could actively sell non-performing loans, mainly due to tax considerations (provisions for non-performing loans are tax deductible only if the bank has held the respective loans in its portfolio for more than three years).

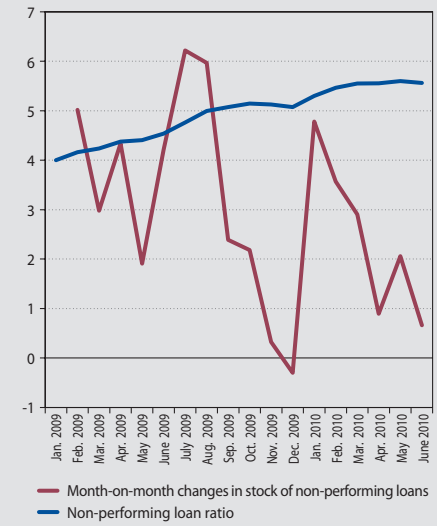
The amount of non-performing loans was also contained by banks pursuing an active policy in regard to the restructuring of distressed loans. Several banks gave borrowers the option of a temporary reduction in repayments, and this proved to be a relatively successful move.

Table 5 Ratio of non-performing retail loans (%)

	June 2009	December 2009	June 2010
Total loans	4.54	5.08	5.56
Current account overdrafts	8.77	9.05	9.70
Consumer loans	11.42	11.69	12.76
Mortgage loans	1.92	2.52	3.14
Construction loans	1.43	1.56	1.61
Intermediate loans	5.82	6.34	6.07
Other real estate loans	3.03	3.38	3.59

Source: NBS.

Chart 69 Non-performing retail loans (%)



Source: NBS.

3.2 CREDIT RISK OF NON-FINANCIAL CORPORATIONS IN THE BANKING SECTOR

The credit risk arising from banks' exposure to the non-financial corporations sector ranked among the most significant risks in the Slovak banking sector in the first half of 2010. Its importance stems from the relatively large amount of corporate loans – constituting on average 25% of bank assets – as well as the economic crisis, which has had a severe impact on this sector, particularly during last year.

The size of credit risk in the following period will depend mainly on the overall macroeconomic situation in Slovakia and economic developments in countries that import Slovak products. In this context, the current level of corporate indebtedness is a matter of importance, since it is one of the bases for coping with negative scenarios.

A separate issue is the financing of commercial real estate. This segment is turning into one of the highest risks facing the Slovak banking sector, owing to the large amount of loans and high concentration, but mainly to the several projects of questionable quality, and certain systemic factors.

Deterioration of the corporate loan portfolio is becoming more moderate

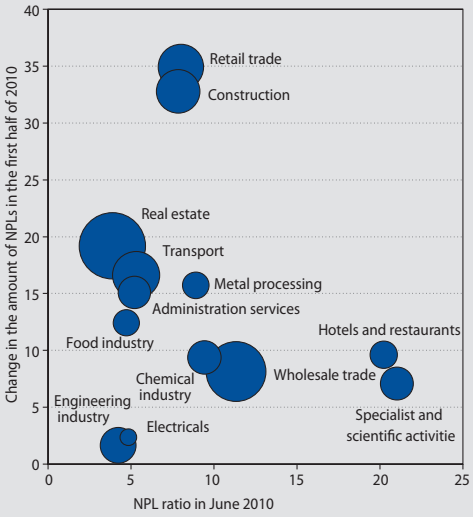
The bank lending portfolios for most sectors saw an increase in the amount and ratio of non-performing loans. The rate of impairment varied, however, between individual sectors. In terms of the amount of loans arranged and the stock and growth of non-performing loans, the portfolios for the retail trade and construction sectors recorded the worst deterioration in quality in the first half of 2010. In the real estate sector, too, the amount of non-performing loans rose sharply (Chart 70).

The quality of the lending portfolio was to a large extent affected by macroeconomic developments. As economic growth began to pick up during the first half of 2010, so the rising trend in non-performing loans came to an end (Chart 71). In several banks, the amount of NPLs grew at a slower pace, even though their share of total loans was still rising.

Financing of commercial property *faces mounting risk*

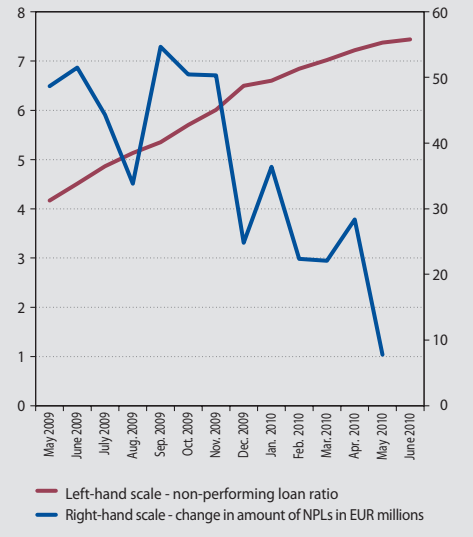
The improvement in certain indicators of economic development has not yet been significantly reflected in the commercial property sector. The amount of non-performing loans in the aggregate portfolio of loans to this sector climbed by 20% over the first six months of 2010. This was not only due to stagnating demand, but also

Chart 70 Non-performing loans by business sector



Source: NBS.
Note: The size of the bubbles represents the overall amount of loans in the given sector.

Chart 71 Non-performing corporate loans (%)



Source: NBS.

reflected to a substantial degree differences in quality between individual projects. The projects affected by problems were mainly those that were inappropriately conceived in terms of their layout as well as their overall economic plan.

Office space market shows signs of stabilising

Supply and demand in the office space market in Bratislava began to stabilise to some extent. This was reflected in the relatively steady development of prices and the vacancy rate, which even declined slightly in the most recent quarter. At the same time, however, differences within the city became more pronounced (Chart 72).

It is positive for the office space market that a relatively small number of projects are in progress. This means that the extent to which supply exceeds demand is not expected to rise substantially further. The risk of possible rental price movements is still present.

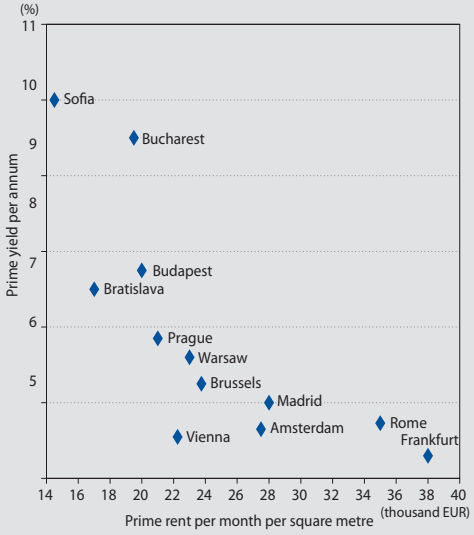
Compared at the international level, Bratislava has the lowest rental prices, which are lower both in absolute terms and from the view of prime yield. A further decline in this regard is not expected (Chart 73).

Increased risk in the residential segment

Disregarding the differences between individual projects, the residential segment appears to be slightly more problematical. This is largely due to the relatively high number of completed projects that are at present hampered by slow sales of apartments (Chart 74). As it seems, the situation deteriorated compared to 2009.

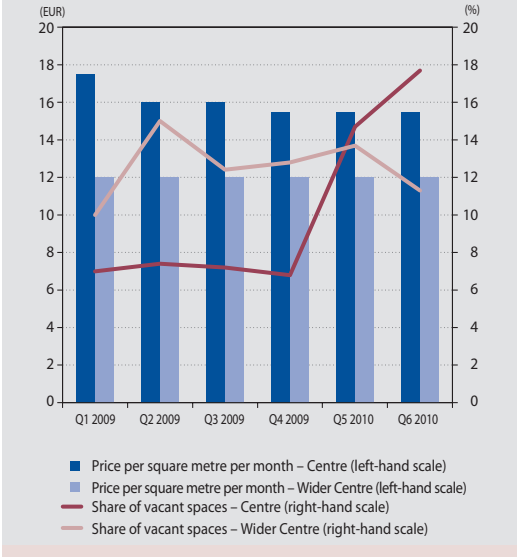
Unsold projects are gradually starting to be a problem for developers and for the financing banks. The

Chart 73 Comparison of office rental prices and return on investment in given properties



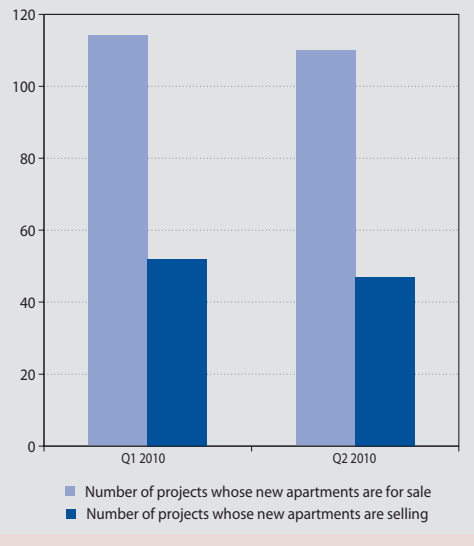
Source: CB Richard Ellis.
Note: Prime rent is the rental price for spaces of the highest quality. Prime yield is defined as the income from a property investment assuming that the property is fully let at the prime rent price.

Chart 72 Prices and occupancy rates of offices in Bratislava



Source: CB Richard Ellis.

Chart 74 Marketability of residential projects



Source: Lexxus, NBS calculations.

general strategy not to lower prices substantially and to wait for sales to take off with an upturn in the real estate market is coming up against the state of uncertainty about the pace of economic recovery and the ageing of unsold apartments.

At the same time, however, a certain paradox is emerging in the relationship between banks and developers. Where projects are facing weak sales, banks in general are tightening conditions for house purchase loans requested for the project's properties, and they usually allow financing for only a smaller part of the purchase price. The reason for the lower share is mainly the expectation that the developer will be forced to reduce apartment prices for the project in question, the result being a decline in the collateral coverage. With stricter conditions for the financing of such projects (through a lower LTV ratio), the sale of these properties is indirectly restricted because of the smaller amount of loans.

In general, the largest problem is the financing of land plots – which unlike complete projects do not create any cash flow – and this makes it more difficult for the developer and bank to wait for an upturn in the market. Their share in banks' portfolios is not very significant.

Improvement in certain assumptions for the mitigation of credit risk

The mentioned improvement in economic indicators at home and abroad in the first half of 2010 had a positive effect on overall sentiment in the business sector. This was the case not only for Slovakia, but also for its principal business partners whose economic situation is a determining factor in Slovak exports (Chart 75).

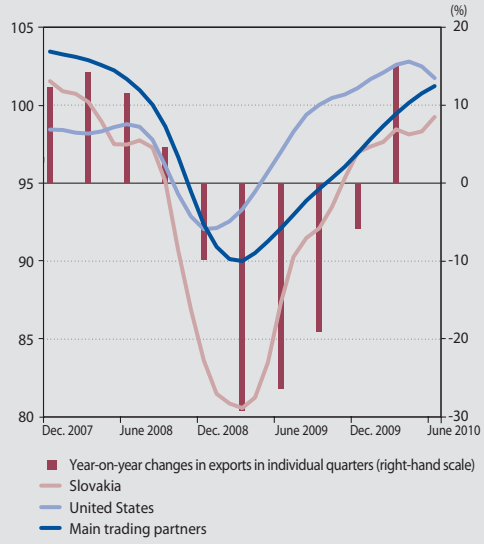
The upturn in confidence was not shared across all sectors, but was seen mainly in services and export-oriented industry. Construction, by contrast, being dependent on domestic demand, stagnated. In services, the growth in confidence was based on the perception of the overall situation and on expectations for future demand (Chart 76).

Activity growth in certain sectors

The improvement in business sector confidence was driven also by an overall upturn in the financial position of firms. Several sectors recorded an increase in both exports and sales. As with the changes recorded in business surveys, the positive developments in sales and exports were seen not across the board, but only in certain sectors. The positive trends in sales were most pronounced in export-oriented industry. In transportation and storage, sales rose more moderately, while in other sectors their decline slowed (Chart 77).

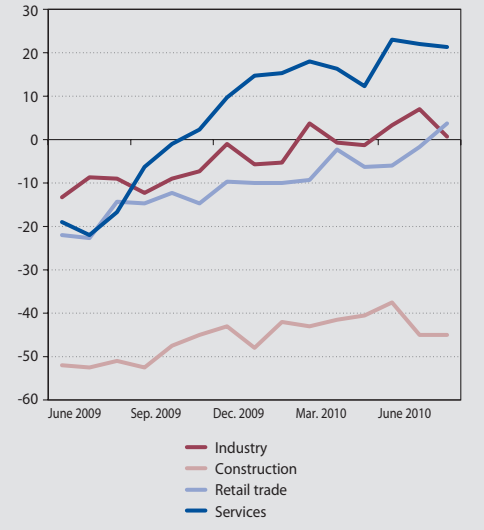
Despite their increase or slower decrease, sales remain at a low level in absolute terms. Sales for

Chart 75 Business confidence



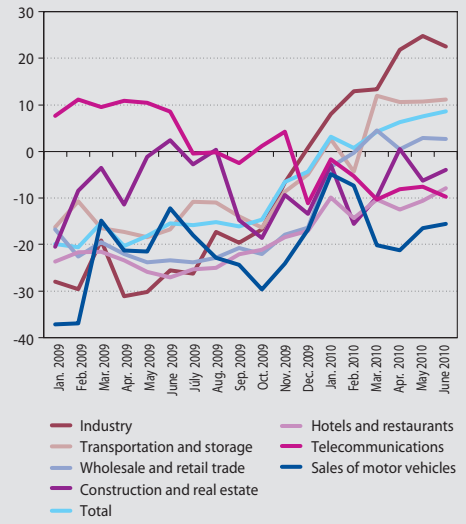
Source: OECD, SO SR.

Chart 76 Economic sentiment indicators in Slovakia



Source: SO SR.

Chart 77 Sales by sector of the domestic economy (year-on-year percentage changes)



Source: SO SR.

June 2010 were lower than those for June 2008 in all sectors bar telecommunications, therefore indicating that idle capacity remains high. Even in the case of industry, which recorded strong growth, sales for June 2010 stood at only 85% of the June 2008 figure (Chart 78).

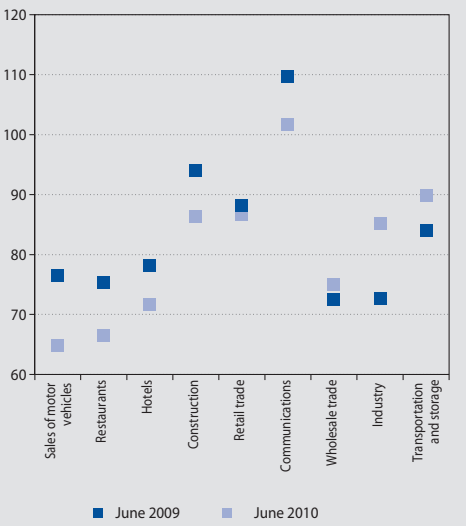
Further evidence of the differing developments across the business sector is provided by exports. The sharpest rise in exports was recorded by the car production industry, which was a significant factor in the aggregate export figure. The electronics industry, by contrast, has been maintaining stable growth for a long period (Chart 79).

Sensitivity to a rise in interest rates

We analysed how a possible rise in interest rates would affect the financial position of a sample of enterprises and found that the sensitivity of profitable enterprises to such a scenario was relatively low. On the other hand, one third of the sampled enterprises made a loss in the second half of 2010, thus increasing their sensitivity to any negative developments.

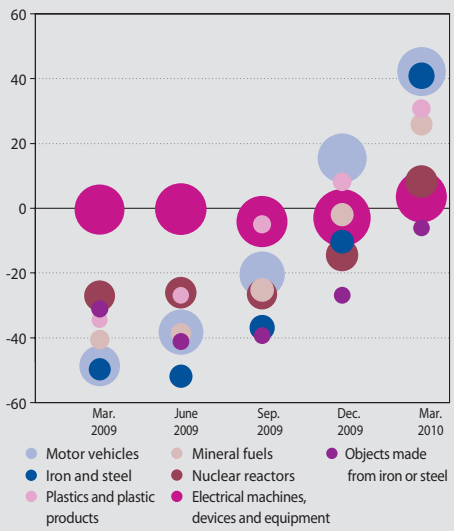
As for the extent of the negative impact of a rise in interest rates, it depends mainly on two factors. The first is loan maturity, which in the case of corporate loans has an average duration of 7 years. The effect of a rate change on repayments of such loans would be small compared with the effect on housing loans with a maturity of 30 years. The second factor, also related to the relatively short maturity period, is the actual relationship between the loan amount and the amount of the firm's profit, which in the case of shorter maturities generally means that a firm cannot borrow an amount that is several times greater than its financial capacity.

Chart 78 Sales by sector in comparison with 2008 (%)



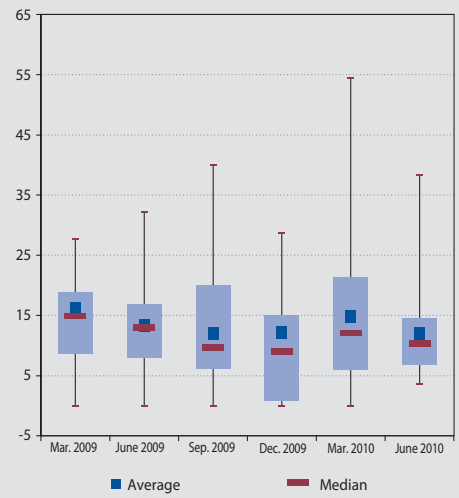
Source: SO SR.
Note: June 2008 = 100%.

Chart 79 Exports by business sector in terms of their year-on-year percentage change (%)



Source: SO SR.
Note: The size of the bubbles represents the size of exports.

Chart 80 Breakdown of the loans at risk ratio (%)



Source: NBS, SO SR, NBS calculations.
Note: Each bar shows the maximum and minimum ratios, the upper and lower quartile, and the median and average.

The situation in individual sectors is determined by these two factors to varying extents. The real estate sector can be considered the most vulnerable in this respect owing to its need for relatively longer-term financing.

As regards the financial position of enterprises, it is positive that the debt ratio in the period under review remained largely unchanged.

High exposure to enterprises whose financial condition has worsened

The low sales recorded by enterprises in comparison with 2008 was reflected also in the loans at risk (LAR) ratio,[14] which does not as yet indicate an improvement in the situation. Most of the enterprises that have bank loans report an activity level below that of the pre-crisis period.

14 Loans at risk (LAR) – loans to enterprises that recorded a loss in the given quarter as well as a 30% fall in sales in the given quarter of 2008. Loans at risk are expressed as the share of loans at risk in total loans to enterprises for which data on sales and profits are available.

3.3 LIQUIDITY RISK IN THE BANKING SECTOR

Loan-to-deposit ratio improved slightly

The longer term view of the liquidity of Slovak banks – which evaluates liquidity through the aggregate structure of banks' balance sheets – improved moderately during the first half of 2010. With deposits rising modestly and the corporate loan portfolio stagnating, the loan-to-deposit ratio fell marginally (Chart 81). Only three banks and seven of the smaller branches of foreign banks reported a higher amount of loans than deposits. Overall, the banking sector in Slovakia remains one of the few banking sectors in the EU which is able to fund loans with deposits.

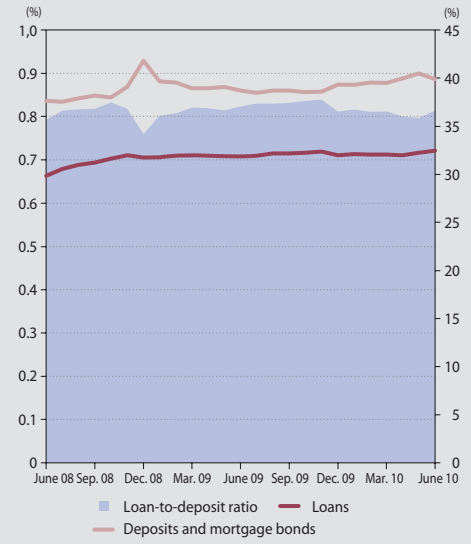
Since the mortgage portfolio stagnated, no further issues of mortgage bonds were needed. As for other housing loans, they continued to increase sharply, even though the steep rise in longer-maturity deposits exacerbated the maturity mismatch between assets and liabilities.

Liquidity asset ratio remained stable

Short-term liquidity, which indicates the ability of banks to cope with negative developments in liquidity in a one-month horizon, improved during the first half of 2010.[15] In June 2010, all banks in the sector met the regulatory minimum ratio. The aggregate ratio over the six-month period reflected a moderate increase in the liquidity of most Slovak banks, and in particular heavier investment in securities that replaced stagnating corporate loans (Chart 82).

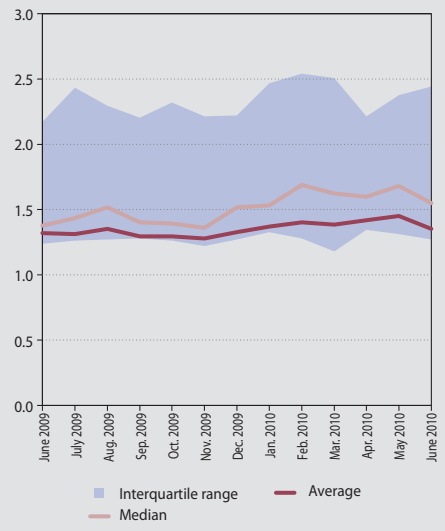
Banks invested mostly in Slovak government bonds, which are defined by regulation as highly liquid. Their liquidity is at present supported mainly by ECB monetary operations. From the view of liquidity management over the long-term horizon, however, it should be noted that the liquidity of Slovak government bonds is lessened by the absence of a secondary market in these securities.

Chart 81 The loan-to-deposit ratio in the banking sector



Source: NBS.

Chart 82 Liquid asset ratio in the banking sector



Source: NBS.

15 Short-term liquidity is monitored using the liquid asset ratio. This is defined as the ratio of liquid assets to volatile liabilities over a horizon of one month. Its level should not fall below 1.

3.4 MARKET RISKS IN THE FINANCIAL SECTOR

3.4.1 CHANGE IN RISKINESS OF MARKET FACTORS AND THE EXPOSURE OF FINANCIAL INSTITUTIONS TO PARTICULAR TYPES OF MARKET RISK[16]

Bank exposure to market risks remains at a low level

The proportion of banks' investments in equities and investment fund shares/units (not including investments in subsidiaries and affiliates) represented 0.3%. This risk, however, is concentrated in one bank, and in other banks the share did not exceed 0.3%. Of the total amount of equity investments, 62% are revalued through profit and loss. The remainder are revalued directly through equity and affect the reported profit only in the event of their sale.

The banking sector also did not record any substantial increase in its exposure to foreign exchange risk during the first half of 2010. The median ratio of the net open position to own funds has remained below 2% since the euro introduction. At the end of June 2010, the banking sector's highest exposure in this regard was to the Czech koruna and British pound.

The main source of banks' sensitivity to interest rates lies in the banking book. The majority of banks have negligible interest rate exposure in trading book financial instruments revalued through profit and loss. In the event of a parallel rise in interest rates, the decrease of the value of trading book financial instruments (including interest rate derivatives) in most banks would not exceed 2% of own funds. Trading book bonds are additionally exposed to the risk of movements in the credit spreads on debt issued by countries in the central European region. The majority of these securities comprise government bonds or Treasury bills issued by Slovakia (84%), Poland (11%) and the Czech Republic (4%). This risk is not at present perceived to be significant.

Interest rate risk in the banking book increased

During the first half of 2010, the exposure of certain banks to financial instrument price movements increased, especially in the case of two types of risk. The first is the general interest rate risk, where the risk of a decline in economic value rises in response to an increase in interest rates. The second risk is that the value of securities is impaired as a result of the issuer's credit rating being downgraded.

One indicator of the general interest rate risk that banks face is based on the change in a bank's economic value in the event of a parallel rise in interest rates of 200 basis points.[17] Although the adverse impact of a change in economic value would not immediately appear in banks' financial statements, it would negatively affect the amount of interest income in the long-term horizon. According to data as at 30 June 2010, such an interest rate movement would reduce the net worth of banks' portfolios (not including the portfolios of branches of foreign banks) by 25.6% of own funds (this figure as at 31 December 2009 represented 21.6%). Thus the exposure of banks to general interest rate risk can be said to have increased. The increase of this risk, however, was concentrated in a small number of banks.

Debt instrument risk rose sharply in response to certain sovereign risks within the EU

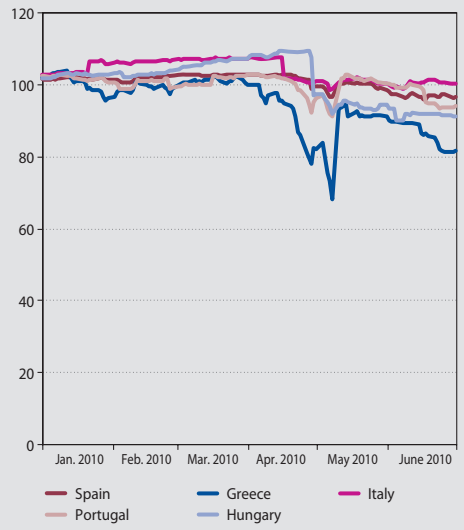
Banks' securities investments were also exposed to an increased credit risk spread in the first half of 2010. This was caused by a rise in the sovereign credit risk of certain so-called peripheral euro area countries and some other EU countries, such as Hungary (Chart 83), as well as by a rise in the amount of investments in securities issued by these countries (Chart 83). By the end of 2010, banks owned debt securities issued by Greece, Hungary, Spain, Portugal, Italy and Ireland in a total amount of €1.3 billion (representing an increase of €0.8 billion over the first half of the year).

Uncertainty regarding the credit quality of these countries was most apparent during the second quarter of 2010. Greek government bonds shed the most value, with the five-year maturities falling by approximately 20% and being downgraded to speculative grade. Banks, however, did not report the price impairment of these securities in their profit and loss accounts, since the majority

16 *Regarding the assessment of market risks, it should be noted that the market risks in banks and insurers are borne by the companies themselves, but that in the cases of unit-linked insurance, collective investment funds, pension funds and supplementary pension funds, the risks are borne by the customers of the respective companies, i.e. by investors in the funds.*

17 *The reason for assessing a parallel shift in the yield is contained in a provision of Act No. 483/2001 Coll. on banks and on amendments to certain laws as amended, according to which a bank's economic value must not fall below a certain required level following a sudden and unexpected change in market interest rates. Under Decree No. 15/2006 of Národná banka Slovenska, a sudden and unexpected movement in interest rates means a parallel upward shift in the yield curve of 200 basis points.*

Chart 83 Prices of five-year government bonds issued by selected countries (%)



Source: ECB.

of these securities are recorded in portfolios of financial instruments available for sale or held to maturity. However, where these securities are recorded in the portfolio of financial instruments available for sale, the reduction in their value is revalued through equity, a process which in certain banks had a relatively significant effect on their so-called comprehensive income.[18]

If we take account of the risk of all debt securities revalued at fair value (through profit and loss or through equity), then, in most banks, the reduction in fair value over a 10-day period, at a confidence level of 99%, should not exceed 2%–3% of the amount of these securities (Table 6). Only a small number of banks are exposed to the risk of a credit spread movement, which is at approximately the same level.

Certain institutions have a higher exposure to concentration risk

Certain institutions or funds have a relatively significant concentration of exposure to a single specific counterparty (exposure to sovereign counterparties was not taken into account). The sector with the highest aggregate risk in this regard is the PFMC fund sector. At the same time, however, no sector has a median value of more than 9%. The highest concentration of exposure to a single counterparty is recorded by certain insurance companies, investment funds and SPMC funds.

Slight increase in market factor risk during the second quarter of 2010

The development of market factor risk during the first half of 2010 was affected most of all by the uncertainty surrounding the credit quality of several EU countries, in particular Greece and Hungary. This uncertainty was manifested in the downgrading of these countries' credit ratings by rating agencies as well as in a rise in credit spreads, particularly in the months of May and June 2010. While this development directly affected mainly the market in bonds issued by these countries (or by institutions established in them), it also indirectly contributed to an escalation of risk in foreign exchange and equity markets (Chart 85). The volatility of the Eurostoxx 50 in-

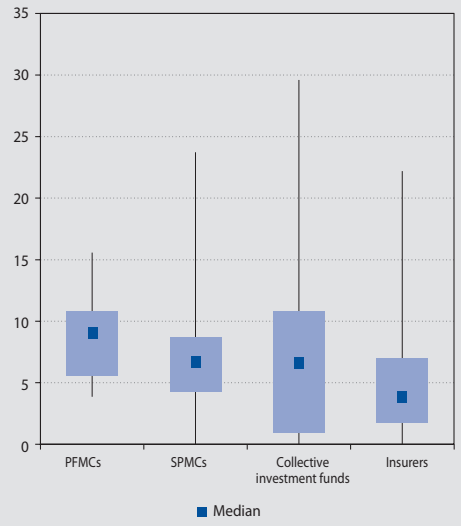
Table 6 Interest rate risk on banks' securities (%)

	VaR as a share of the amount of securities			VaR as a share of own funds
	Risk of an interest rate change	Risk of a credit spread change	Overall interest rate risk	
lower quartile	0.2	0.0	0.2	0.2
median	0.2	0.0	0.2	0.3
upper quartile	0.3	0.0	0.4	0.8
asset-weighted average	0.3	0.3	0.5	0.9

Source: NBS, Reuters, Bloomberg, NBS calculations.
Notes: VaR represents the potential loss on the investment that would not be exceeded in 99% of cases over a period of 10 working days.
The calculation included only securities revalued at fair value (through profit and loss or directly through equity). Securities held to maturity were excluded from the calculation on the ground that their fair value does not affect the bank's financial results.

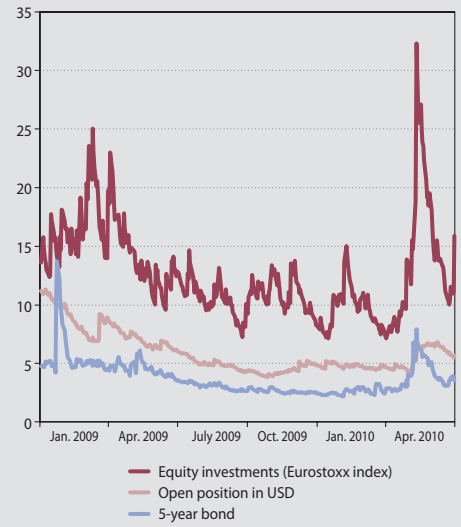
18 See the section „Financial Position of the Banking Sector".

Chart 84 Distribution of institutions by each institution's exposure to its most significant counterparty as a share of its overall exposure (%)



Source: NBS, NBS calculations.
Note: The Chart shows the distribution (minimum value, lower quartile, median, upper quartile, and maximum value) of each financial institution by its exposure to its most significant counterparty (through funds held in current accounts and term accounts, and through investments in securities, equities, and investment fund shares/units) as a share of its total assets or NAV. Only exposure to non-sovereign counterparties was taken into account.

Chart 85 Value at Risk for investments in various types of financial instruments (%)



Source: Reuters.
Notes: Data on the left-hand scale represent the loss (as a percentage of the given investment). The loss was calculated on the basis of risk factor volatility calculated using a GARCH (1,1) model.
The calculation of potential losses on the five-year bond took into account the five-year swap rate and value of the iTraxx Europe 5Y, an index indicating the risk of credit spread movements.

dex surged in May 2010. The USD/EUR exchange rate also recorded a slight rise in volatility.

Sovereign credit risk remains significant in other sectors too

The risk of impairment in the value of securities issued by selected EU countries may adversely affect also certain pension funds, collective investment funds, or insurance companies. During the first half year, the amount of investments in securities issued by the countries stated in Table 7, rose from €0.8 billion to €1.3 billion. It is positive, however, that the amount invested by these institutions in Greek bonds fell significantly, from €146 million to €21 million. PFMC funds did not record these securities in their portfolios as at the given date.

Table 7 Investments in debt securities of selected countries as a share of total assets (%)

	Greece	Hungary	Ireland	Italy	Spain	Portugal
Banks	1.1	0.7	0.1	0.1	0.1	0.0
SPMC funds	0.1	0.8	1.3	0.5	0.7	0.0
PFMC funds	0.0	0.9	1.4	1.6	0.2	4.5
Investment funds	0.3	1.6	0.8	0.6	0.0	0.0
Insurance companies	0.1	0.1	0.1	2.3	0.2	0.0

Source: NBS.
Notes: Values are given as percentages and represent debt securities issued by the respective country (or institutions established in that country) as a share of total assets or NAV.
0.0 in a cell means that the respective value is zero or negligible.

Table 8 The debt securities portfolio of different sectors broken down by credit rating (%)

	AAA	AA	A	BBB	BB	B	CCC and worse	un-rated	PD[1)]
Banks	0.3	1.1	88.2	5.1	4.3	-	-	1.0	0.12
Insurance companies	10.6	10.2	72.4	4.3	0.2	-	0.1	2.2	0.10
PFMC funds	20.2	20.2	54.4	2.8	-	-	-	2.3	0.08
Conservative	24.1	18.6	51.8	3.8	-	-	-	1.8	0.08
Balanced	2.1	36.7	38.1	15.5	-	-	-	7.6	0.09
Growth	20.4	2	55.0	2.4	-	-	-	2.2	0.07
SPMCs	19.9	20.3	55.2	2.7	-	-	-	2.0	0.08
Investment funds	6.3	15.2	67.6	8.6	0.3	0.4	-	1.7	0.11
Money market	6.6	3.0	75.9	9.5	1.0	0.1	-	3.9	0.11
Bond	4.7	2.5	80.9	8.8	0.2	-	-	2.8	0.12
Equity	2.5	3.0	78.5	12.0	0.2	-	-	3.9	0.02
Funds of funds	97.6	-	2.0	-	-	-	-	0.5	0.08
Mixed	-	40.9	50.1	6.7	-	-	-	2.3	0.15

Source: NBS, Reuters.
1) PD – annual probability of default, the values are given as percentages as set by credit rating agencies. The probability of default was calculated as weighted average for each credit rating, weighted by the amount of exposures under the respective credit rating.
Note: Values are given as percentages; they represent debt securities with the respective credit rating as a share of the total amount of debt securities.

On the whole, however, it may be said that the investments of individual sectors in debt securities are relatively conservative as regards their movements arising from credit risk. A-rated securities constitute the largest share of securities, and they include also Slovak government bonds. In banks in particular, these bonds constitute the largest such holding. In other sectors (mainly PFMC and SPMC funds), the average credit rating of debt securities is even higher. It is positive that only a small part of the investments comprise non-investment grade securities (rated lower than BBB). These securities mostly consist of Greek government bonds.

3.4.2 MEASURING MARKET RISKS USING VALUE AT RISK

The risk of decrease in the asset value of PFMC funds is relatively low

Over a horizon of several days, the risk of substantial impairment of the value of assets held in PFMC funds is low. The only risk factor in this time horizon is an increase in interest rates or credit spreads. However, the potential fall in value of such assets over a period of 10 working days, at a confidence level of 99%, would not exceed 0.07%.

Over a horizon of several months, the most significant risks to which investments in PFMC funds are exposed are the risk of a fall in interest rates, the risk of counterparty concentration in the case of bank deposits, and sovereign credit risks.

The risk of a fall in interest rates stems largely from the fact that a large part of the assets of PFMC funds consist of bank term deposits with a maturity of around half a year or investments in debt securities that have a relatively short duration and residual maturity (in both cases approximately 0.5–0.8 of a year). A reduction in interest rates would, over the course of several months, feed through to a decline in interest income on these securities. In the current situation of low market rates, however, the prevailing expectation is that interest rates will rise, which would benefit the performance of PFMC funds over a horizon of several months.

Table 9 VaR values in individual sectors (%)

	Lower quartile	Median	Upper quartile	Weighted average
Insurers	0.2	0.3	0.5	0.4
Unit-linked	4.0	7.5	9.3	6.4
PFMCs	0.0	0.1	0.1	0.1
balanced	0.0	0.1	0.1	0.1
growth	0.0	0.1	0.1	0.1
conservative	0.0	0.1	0.1	0.1
SPMCs	0.0	0.1	0.1	0.1
Payout	0.0	0.1	0.2	0.7
contributory	0.4	1.3	3.0	1.3
Investment funds	0.1	0.9	4.6	1.2
money market	0.0	0.1	0.1	0.1
bond	0.1	0.3	1.3	1.3
mixed	0.1	0.3	1.3	1.3
funds of funds	0.6	5.0	5.9	5.5
equity	3.1	8.4	11.0	5.1

Source: NBS, NBS calculations.
Note: The values are given as a percentage share of total assets (or NAV); they represent quartiles or the asset-weighted average for each group of institutions.

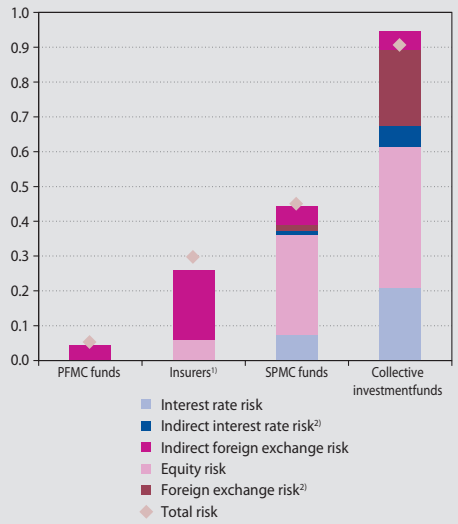
As for the risk of counterparty concentration in the case of bank deposits, certain PFMCs invest fund monies in current accounts or term deposits held with a relatively small number of banks. Although the probability of these banks becoming insolvent is extremely small, the funds are still exposed to relatively low diversification of the risk that any of them fail.

Table 10 Change in the share of equity, foreign-exchange and interest-rate positions (%)

		Banks	Insur-ers	PFMC funds	SPMC funds	Collective in-vestment	Unit-linked[1)]
Equities and invest-ment fund shares/units	XII.09	0.2	2.6	0.1	4.7	17.6	80.8
	VI.10	0.3	2.6	0.0	12.0	16.7	81.3
Foreign-exch-ange positions	XII.09	0.4	0.9	0.1	4.9	12.5	12.9
	VI.10	0.6	1.5	0.1	9.2	9.4	12.6
Share of debt securities	XII.09	28.3	63.1	68.0	70.8	51.8	17.2
	VI.10	27.3	60.0	66.9	66.6	50.4	16.9
Duration of debt securities	XII.09	2.7	5.7	0.5	2.1	1.1	5.9
	VI.10	3.0	6.0	0.6	2.6	1.3	5.6
Residual maturity of debt securities	XII.09	2.8	7.8	0.8	3.0	1.8	6.2
	VI.10	3.3	7.4	0.8	2.9	1.5	5.6

Source: NBS, Reuters, NBS calculations.
1) Assets invested by insurers under unit-linked insurance policies.
Notes: Values are given as a percentage share of total assets (or NAV) and they represent the asset-weighted average for the given group of institutions; durations are given in years.
Foreign exchange positions are given as a percentage share of assets (or NAV); they were calculated as the sum of the absolute values of the positions for each institution.
Equity positions are given as a percentage share of assets (or NAV); they do not include participating interests in subsidiaries and affiliates.
Durations and periods to maturity are given in years.

Chart 86 VaR in individual sectors (%)



Source: NBS, Reuters, Bloomberg, internet, NBS calculations.
Note: Values are as at 30 June 2010. Data on the left-hand scale represent percentage shares of total assets (or NAV).
1) The figure for insurers does not include assets covering unit-linked insurance policies and risks arising from the revaluation of reserves.
2) Indirect interest rate risk and foreign exchange risk constitute the risk to which individual institutions or funds are exposed through investments in investment fund shares/units.

The exposure of PFMCs to sovereign credit risk lies mainly in their investments in Hungarian government bonds. Certain PFMCs were investing part of their fund monies in bonds issued by Hungary or Hungarian institutions while the risk of a deterioration in Hungary's credit situation rose in the first six months of 2010. The amount of these investments doubled during this period, even though the attached risk was very small owing to the short residual maturity of these securities. By contrast, PFMC funds did not have any investments in Greek bonds as at 30 June 2010.

Equity risk in SPMC funds increased

In Pillar III of the pension saving system, the amount of investments in equities and investment fund shares/units surged by 165% in the first half of 2010. SPMC funds therefore became more exposed to stock market turbulences. In the case of several funds, their foreign exchange position became somewhat more open as a result of equity investments. In this regard, funds are exposed mainly to devaluation of the US dollar or Japanese Yen. In no fund, however, would the 10-day VaR, at a 99% confidence level, exceed 0.8% of the net asset value.

The investments of SPMC funds in debt securities are longer in duration and residual maturity than those of PFMC funds. This means that SPMC funds' securities are more exposed to any rise in interest rates or interest rate spreads, and that these funds would record any rise in interest income on bond coupons only at a later date.

Deposit investments of SPMC funds as at the end of June 2010 were held only with Slovak or Czech banks. In this sector too, however, some funds had deposits with a single banking institution which amounted to more than 15% of the fund's net asset value, meaning that they had a higher concentration risk.

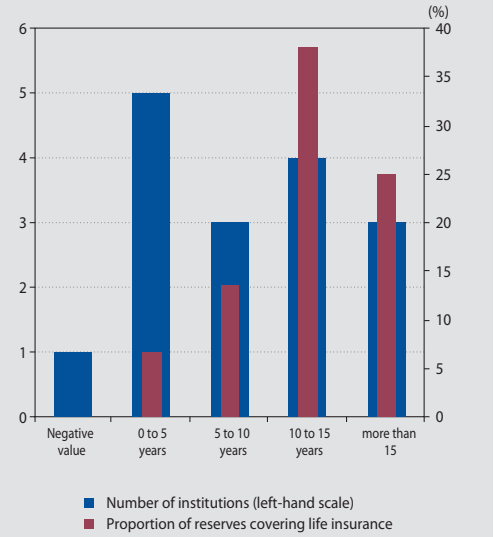
Investment funds are exposed mainly to the risk of impairment in the value of equity investments

The most significant risk for the value of assets in collective investment funds is the risk of a decline in prices of equities and investment fund shares/units. Given that a relatively large part of these investments are denominated in foreign currency and that, in several cases, the respective foreign exchange risk is not hedged, some of these funds face a relatively significant foreign exchange risk. The direct interest rate risk (the general interest rate risk or risk of credit spreads movements) is relatively low in most funds. Funds also, however, have indirect exposure to foreign exchange risk through investments in other investment fund shares/units. The majority of funds are not significantly exposed to sovereign risks arising from credit spreads movements.

Among insurers, the principal market risk is the risk of interest rate movements

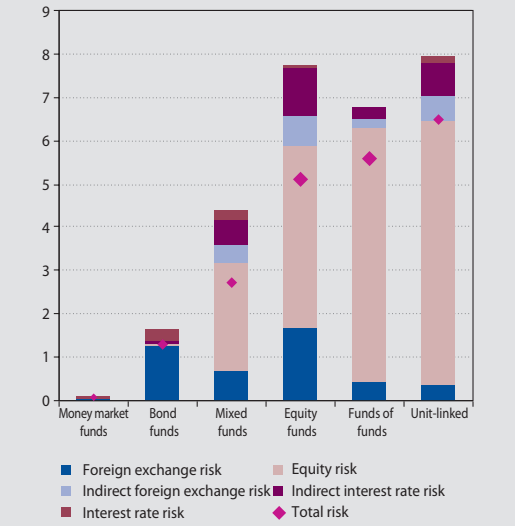
Among insurance companies, the structure of assets and liabilities is marked by long fixation periods for interest rates and interest yields. A large part of insurers' assets consist of investments in fixed coupon debt securities, with 60% of these securities (i.e. 40% of assets other than those invested under unit-linked insurance policies) comprising securities revalued at fair value. On the liabilities side, insurers report mainly life insurance provisions, which also typically have long interest rate fixation periods. If their fair value rises, it reduces the insurance company's financial result. Although it is diffi-

Chart 87 Distribution of the duration mismatch on life insurance provisions and the assets covering these provisions



Source: NBS.
Notes: Horizontal axis – difference between the average expected maturity period for life insurance provisions on the liabilities side and the average duration of assets that cover life insurance technical provisions on the assets side (a positive value indicates a higher value on the liabilities side).
Left-hand scale – number of institutions in the respective category.
Right-hand scale – institutions in the respective category by share of total provisions for life insurance.
The Chart does not show all insurance companies owing to insufficient quality in the data. Data on the average expected maturity of liabilities are given as at 31 December 2009.

Chart 88 VaR of investment funds and of assets invested under unit-linked insurance policies, as at the end of June 2010 (%)

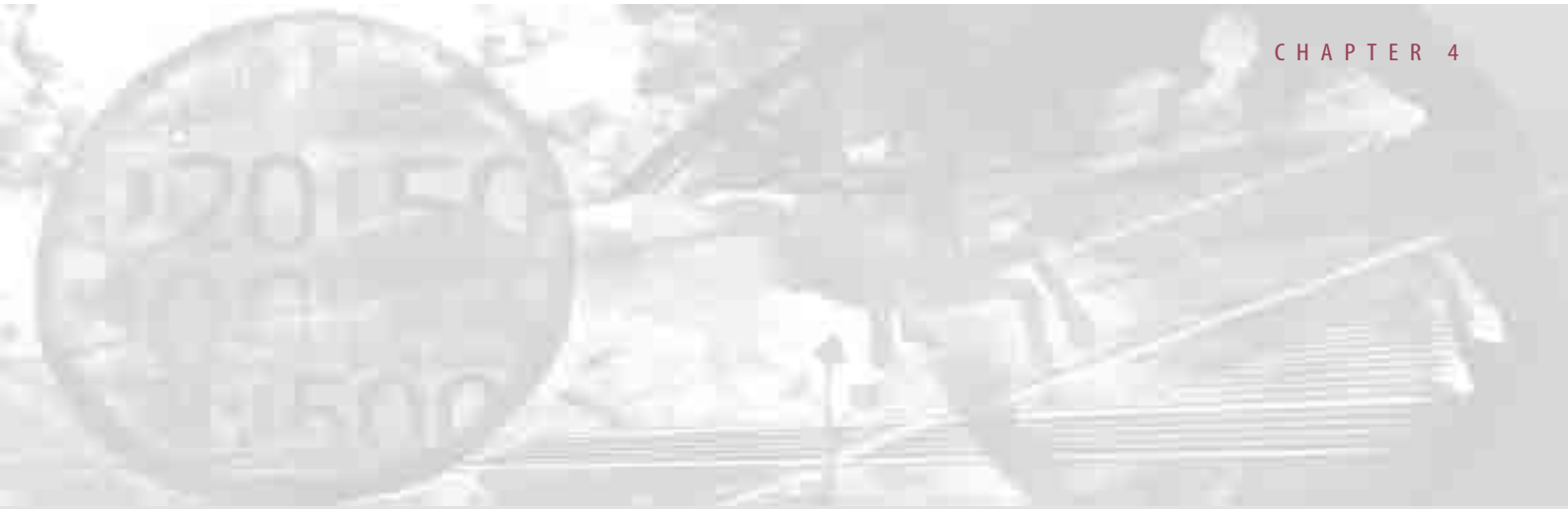


Source: NBS, Reuters, Bloomberg, internet, NBS calculations.
Note: Data on the left-hand scale represent percentage shares of NAV.

cult to determine precisely the average duration of insurers' liabilities (owing to uncertainty about the amount and distribution of cash flows and their specification in individual contractual relations), the estimated value based on projected financial flows indicates a relatively large mismatch between the interest rate fixation periods for assets and liabilities (Chart 87). This means that insurance companies should be adversely sensitive to a fall in interest rates. However, the income of insurance companies rose at a time of declining long-term interest rates in 2009 and 2010, partly aided by the relatively long duration of assets and the high share of assets revalued at fair value. Income from debt securities for the first half of 2010 increased by 50% compared with the first half of 2010.

Assets invested by insurance companies on behalf of the insured were exposed to the highest risk

In this case, the high risk exposure stems from the large equity component (more than 80% of the invested assets) and the long duration of the bond component (5.6 years). These assets are not significantly exposed to sovereign credit risk.



MACRO STRESS TESTING OF THE SLOVAK FINANCIAL SECTOR

4

4 Macro Stress Testing of The Slovak Financial Sector

At the end of June 2010, the banking sector continued to report relatively strong resilience to adverse economic developments, and it may be described as more resilient in comparison with the results at the end of 2009. The main reason for this was the bolstering of the banking sector's capital buffers during the first half of 2010.
In the event of stress situations, banks would record greater losses mainly in corporate lending. Only a few banks would report higher losses from household lending and from market risks.
It was shown that in order to cope with the stress period, banks need mainly an ability to generate profit and a relatively strong capital position. Interest income proved to be a key factor in improving profitability.
In the event of the expected, or baseline, scenario, we envisage that the position of banks will remain stable. Almost all banks in the sector would be able to increase their capital adequacy ratio. The banking sector is expected to show relatively strong resilience also in the case of a more moderate version of the stress scenario. A majority of banks in the sector would record a decline in their capital buffer.
If the economic environment worsened substantially, we would expect a more severe drop in capital adequacy ratios. But even in this case too, however, both the sector as a whole and the majority of banks should still be able to meet the capital adequacy requirement. Under this scenario, only two banks would fall short of the capital requirement.
In other sectors, the impact of macroeconomic scenarios would depend mainly on the length of the fixation periods for interest or coupon rates and on the percentage share of equity investments in the assets of individual institutions or funds. The insurance sector is marked by a relatively high share of long-term fixed coupon bonds revalued at fair value. The impact of the scenarios on the value of insurers' assets would therefore negatively reflect the revaluation of these securities. At the same time, however, it should be noted that the overall impact on insurance companies is affected also by the fixation period for liability costs, which in many insurance companies is longer than for assets.
In the sector of PFMC funds, the stress scenarios appeared only after several months, and their impact would be positive owing to rising interest income. During the second half of 2010, SPMC funds and investment funds would record an adverse impact owing to the decline in equity investment prices. By end of 2011, however, they would on average be achieving returns at the level of the baseline scenario.

4.1 DESCRIPTION OF SCENARIOS USED

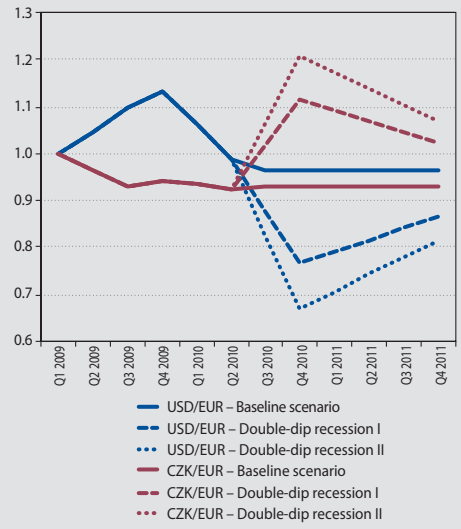
Stress testing represents a significant tool for measuring the risks that financial institutions are exposed to. It allows us to estimate the sensitivity of individual financial institutions, as well as the sector as a whole, to potential adverse developments. It should be noted, however, that this instrument does not make a prediction about the future situation and that, since it involves complex models, it is used in conjunction with several assumptions and simplifications.

Stress scenarios are designed according to the current economic situation and condition of the financial sector; this process to a large extent takes into consideration weaknesses of the current and potential future developments. In order to test the resilience of the financial sector as at the end of the first half of 2010, we designed one baseline scenario and one stress scenario called "Double-dip recession". These scenarios more or less correspond to the scenarios that were examined at the end of 2009. The difference is that certain risks have now become pronounced. Since the resilience of all types of financial institutions regulated by NBS were tested, the stress scenario focuses on both credit and market risks. Both scenarios are simulated for the period from the second half of 2010 to the end of 2011.

"Baseline scenario"

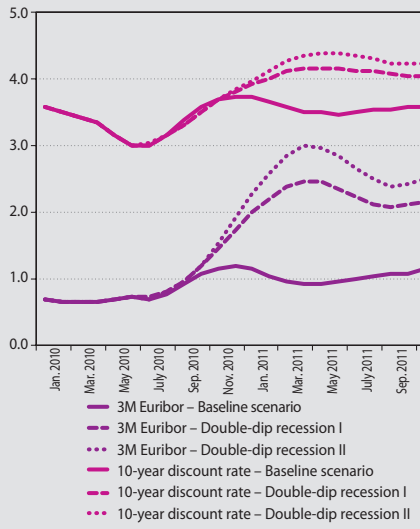
Developments in the baseline scenario correspond to the official medium-term forecast of NBS (P2Q 2010).

Chart 89 USD/EUR and CZK/EUR exchange rates – baseline and stress scenario



Note: Source: Reuters, NBS, NBS calculations.
31.3.2009 = 1.

Chart 90 Interest rates – baseline and stress scenario (%)



Data are in percent.
Source: Reuters, www.euriborg.org, NBS calculations.

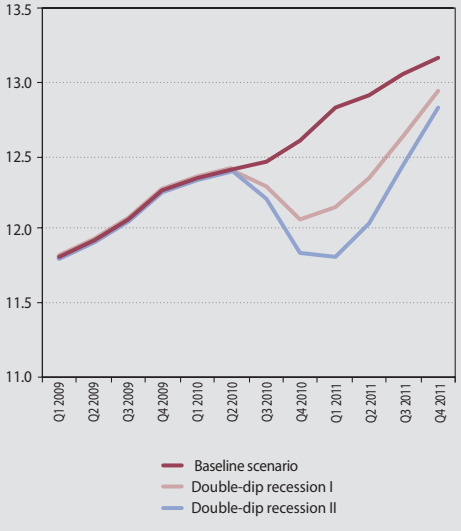
"Double-dip recession"

The scenario entitled "Double-dip recession" assumes that national government will wind down their anti-crisis and support measures. It is our assumption that the result of this action will be a slump in demand and worsening of liquidity in financial markets. This situation will lead to a global economic contraction, decline in commodity prices, rise in unemployment, and a gradual move into deflationary territory. As a consequence of heightened uncertainty in financial markets, credit premia will rise. Taken in conjunction with higher liquidity premia, this will put upward pressure on short- and long-term interest rates. The assumption is that equity prices will in general plunge. The flight to more secure investments will result in the euro weakening against the dollar and in the currencies of surrounding countries depreciating against both the dollar and the euro. At the same time, it is assumed that the sovereign risk of particular countries will rise, causing an increase in the spreads of government bonds issued by these countries. The scenario assumes that the downturn will continue until the end of 2010 and that the situation will gradually calm down during the course of 2011. A steady return to the baseline scenario is envisaged.

Since it is quite difficult to estimate precisely how such an event would affect financial markets and the real economy, we designed two versions of the scenario in order to test it. One version (Double-dip recession I) where the shock has a more moderate impact, and another (Double-dip recession II) where it has a more serious impact.

The Slovak economy would react relatively quickly to a downturn in external demand and a worsening situation in financial markets.[1] As regards the effect of the shock on GDP, it would be strongest in last quarter of 2010 or the first quarter of 2011, followed by a gradual return to the baseline

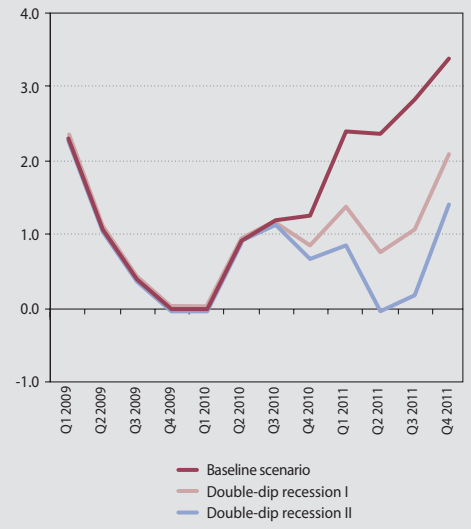
Chart 91 GDP – baseline and stress scenario (EUR billions)



Source: NBS, NBS calculations.

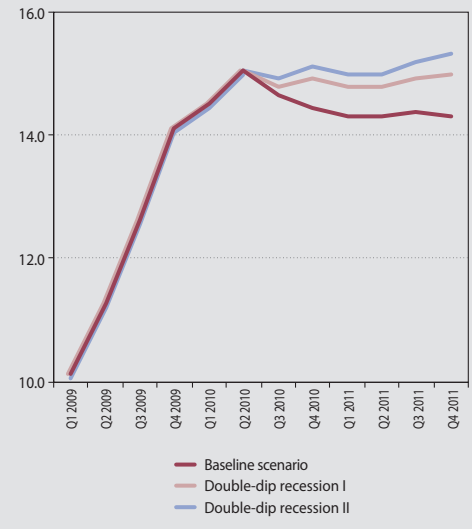
19 *The estimate of how external factors would affect the Slovak economy was made using a macroeconomic model, its output being the expected development of GDP, inflation and unemployment in Slovakia.*

Chart 92 Inflation (HICP) – baseline and stress scenario (%)



Source: NBS, NBS calculations.

Chart 93 Unemployment rate – baseline and stress scenario (%)



Source: NBS, NBS calculations.

scenario. The inflationary shock would not begin to fade away until the third quarter of 2011. Under the baseline scenario, the unemployment rate would gradually decline, but under the stress scenarios its level would be maintained or rise slightly during the whole period under review.

Table 11 Stress testing parameters (%)

			Baseline scenario		Double-dip recession I		Double-dip recession II	
			Q4 2010	Q4 2011	Q4 2010	Q4 2011	Q4 2010	Q4 2011
Base assumptions	External demand (year-on-year change)		2.67	4.36	-6.65	11.94	-11.16	16.52
	USD/EUR (year-on-year change)		0	0	-20	10	-30	20
	Exchange rates of CHF, JPY, GBP, DKK, CAD, HRK, LVL against EUR (year-on-year change)		0	0	10	-10	15	-10
	Exchange rates of other currencies against EUR (year-on-year change)		0	0	20	-10	30	-20
	Equity prices (year-on-year change)		5	10	-30	57[1)]	-50	115[2)]
	ECB base rate (year-on-year change)		0 b.p.	0 b.p.	0 b.p.	0 b.p.	0 b.p.	0 b.p.
	3-month Euribor (year-on-year change)		26 b.p.	28 b.p.	103 b.p.	50 b.p.	121 b.p.	72 b.p.
	iTraxx index (year-on-year change)		0 b.p.	0 b.p.	123 b.p.	0 b.p.	165 b.p.	0 b.p.
	Rise in credit spreads on debt issued by GR, IE, ES, IT and PT		0 b.p.	0 b.p.	150 b.p.	0 b.p.	200 b.p.	0 b.p.
Macroeconomic variables estimated using a model	GDP growth (year-on-year change)		1.60	4.51	-2.60	7.10	-4.59	8.47
	Inflation (GDP)		1.24	3.38	0.86	2.10	0.66	1.42
	Unemployment		14.43	14.29	14.90	15.00	15.13	15.34
Variables for credit risk estimated using macroeconomic variables	Annual probability of default	Non-sensitive sectors	3.13	2.26	7.13	8.14	10.13	12.12
		Less sensitive sectors	3.90	2.99	7.94	8.49	10.91	12.19
		Sensitive sectors	4.90	4.31	8.88	9.37	11.89	12.88
	Ratio of non-performing household loans		5.08	4.86	5.30	5.75	5.35	6.16

Source: NBS, ECB, NBS calculations.
For values in the fourth quarter of 2010, half-year changes are stated instead of annual changes; in the case of inflation, annual changes are stated.
1) Increase to the second-quarter of 2011 level under the baseline scenario.
2) Increase to the first-quarter of 2011 level under the baseline scenario.

Box 2

ASSUMPTIONS AND PARAMETERS OF MACRO STRESS TESTING OF THE FINANCIAL SECTOR

In this Report, as in the Analysis of the Slovak Financial Sector for 2009, the calculation of the impact that macro stress scenarios have on the banking sector include not only the estimated losses from non-performing retail loans to customers, but also the estimated gains/losses on the portfolio of customer loans, on the revaluation of debt securities and interest rate derivatives, on the coupon yield on these securities, on foreign exchange operations, and on equities. Furthermore, we assumed that the values of operating expenses, fee income, and other operating income in the second half of 2010 and in the first and second halves of 2011 will be the same as their values at the end of the first half of 2010. The basic relationship between particular assumptions, econometric models, and estimated parameters of macro stress testing are described in the Analysis of the Slovak Financial Sector for 2009.

The loss on non-performing customer loans was estimated using the baseline scenario and the Double-dip recession scenario (versions I and II). Particular macroeconomic variables served as input data for the econometric models used to quantify the assumed ratio of non-performing corporate loans and the amounts of distressed household loans, house purchase loans, and other loans to households. The methodology used in the previous version of stress testing was changed slightly in regard to the calculation of non-performing retail loans and the total amount of retail loans. In the previous stress testing, the total amount of retail loans was modelled using simple autoregressive processes, but in the current version the estimates are produced using various macroeconomic variables (domestic GDP, inflation, etc.). It was assumed that in the case of housing loans to households, the total loss will be 20% of the amount of non-performing loans and that for consumer loans it will be 80%, without taking into account the actual amount of the collateral.

For the calculation of credit losses arising from the corporate loan portfolio, the inputs included the loan default ratios as well as a further two parameters: the collateral depreciation rate and loss given default (LGD). The assumed collateral depreciation rate was also set according to the selected scenario. Based on an expert estimate, collaterals were divided into those for which the depreciation rate was assumed to be 0% under the baseline scenario, 30% under Double-dip recession I and 50% under Double-dip recession II (e.g. collateral in the form of real estate or a blank bill), and those for which no depreciation rate was assumed (mostly the collateral of third parties). For the calculation of losses, it was assumed that banks will create provisions for non-performing loans in the amount of 45% of the unsecured outstanding loan, meaning that the bank will, in subsequent bankruptcy proceedings, be able to satisfy its claim in the amount (100-45)% of the unsecured part of the loan.

Estimates were made for the second half of 2010 and the whole of 2011. The shock impacts were quantified through their effect on the capital adequacy ratios of individual banks (branches of foreign banks were excluded from the calculation). It was also assumed that the amount of risk-weighted assets during the period under review will not change and that 50% of the profits (for the years 2010 and 2011) will be used to increase own funds. For the simplified calculation of the adequacy of own funds, no distinction was made between banks that use the IRB approach and other banks.

It is important to note that since the estimated development of particular macroeconomic factors is coupled with considerable uncertainty, and since various assumptions need to be adopted for the calculation, stress testing serves rather to identify the most important risks in the financial system and to identify the companies with the highest exposure to these risks, than to precisely quantify the size of the loss under particular scenarios.

Table 12 Impact of macroeconomic scenarios on the financial sector as at the end of the first half of 2010 (%)

	Baseline scenario				Double-dip recession I				Double-dip recession II			
	Asset-weighted average	Lower quar-tile	Median	Upper quar-tile	Asset-weighted average	Lower quar-tile	Median	Upper quar-tile	Asset-weighted average	Lower quar-tile	Median	Upper quar-tile
Banks	0.3	0.0	0.2	0.3	0.2	0.1	0.2	0.4	0.2	0.0	0.2	0.4
Insurers	0.3	0.1	0.3	0.8	-0.4	-0.8	0.3	0.5	-0.8	-1.4	0.1	0.6
Insurers' assets – unit-linked	1.4	0.7	2.2	3.1	-19.0	-27.5	-19.1	-10.2	-28.7	-45.8	-31.1	-15.6
Pension funds	0.3	0.2	0.3	0.6	0.3	0.2	0.4	0.6	0.5	0.2	0.4	0.6
of which: conservative	0.3	0.2	0.3	0.5	0.3	0.2	0.4	0.5	0.6	0.2	0.4	0.5
balanced	0.3	0.2	0.4	0.5	0.3	0.2	0.4	0.5	0.5	0.2	0.4	0.5
growth	0.3	0.2	0.3	0.5	0.3	0.2	0.3	0.5	0.4	0.3	0.3	0.6
Supplementary pension funds	1.0	0.2	0.6	1.0	-1.0	-3.5	0.2	0.5	-1.9	-5.7	0.2	0.6
Investment funds	0.8	0.2	0.7	1.6	-1.8	-11.7	-1.1	0.4	-2.3	-17.9	-1.0	0.6
of which: equity funds	2.2	0.9	2.5	6.6	-3.8	-23.0	-13.3	-3.7	-3.2	-38.2	-22.1	-6.1
money market funds	0.3	0.3	0.3	0.6	0.4	0.2	0.4	0.6	0.7	0.2	0.4	0.6
bond funds	0.7	0.4	0.9	1.2	-1.6	-2.8	0.3	1.4	-2.1	-4.1	0.2	1.6
mixed fund	2.2	0.8	1.2	1.8	-4.1	-10.5	-2.3	0.3	-4.2	-16.3	-3.8	0.5
funds of funds	2.6	0.4	2.5	2.9	-15.0	-18.4	-16.8	-0.9	-22.1	-30.3	-27.6	-1.3

Source: NBS, RBUZ, ECB, Reuters, Bloomberg, NBS calculations.
Notes: The Table shows quartiles of the profit/loss-to-asset ratio resulting from the application of the respective scenarios as at 31 December 2010.
The data for insurance companies includes only the change in the fair value of assets, not the change in the fair value of liabilities.
Values are given as a percentage share of assets or NAV.

THE BANKING SECTOR AS A WHOLE REPORTED RESILIENCE TO ADVERSE SCENARIOS ALSO AT THE MIDPOINT OF 2010

The results of applying the individual stress scenarios as at the end of the first half of 2010 indicate that the banking sector's sensitivity to adverse economic development is not significant. The majority of banks in the sector would probably be able to cope with even a substantial worsening of the economic environment both at home and abroad. Compared with the results of the stress testing of banks at the end of 2009, the sector did not report any notable changes.

All banks in the sector would cope with the worsening of the external environment simulated in the baseline scenario and in the scenario "Double-dip recession I". Under such scenarios, not one bank in the sector would report a capital adequacy ratio below the minimum regulatory capital requirement.

In the case of the baseline scenario, all but two banks would increase their capital adequacy ratio. Under the moderate version of the stress scenario, six banks would experience a decline in the capital ratio. In both scenarios, banks would take advantage of a rise in profitability.

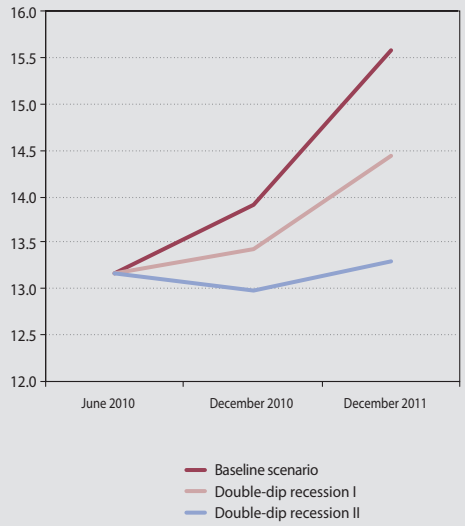
The banking sector reported higher sensitivity mainly in the case of a severe deterioration in the economic environment ("Double-dip recession II"). In this case, two banks would see their capital adequacy ratio drop to below 8%. Other banks would be able to maintain their CAR at above 8% thanks to the profit they made in 2010 or 2011 and/or the high initial level proportion of own funds.

LOSSES FROM CORPORATE LOANS REMAIN THE MOST SIGNIFICANT RISK TO BANKS

As under testing at the end of 2009, banks reported their highest sensitivity to potential losses on corporate loans. Firms reported a lower ability to service their bank debts, especially in the case of stress scenarios. Under the baseline scenario, we assume rather a gradual easing of credit risk. The gradual mitigation of credit risk is also assumed under the scenario "Double-dip recession I", but this scenario also envisages relatively high losses on these loans.

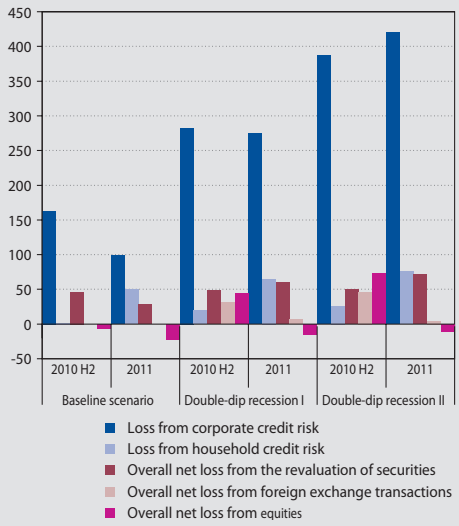
By comparison, loans to households reported a stronger resilience under stress testing. Not even a substantial worsening of the economic environment is likely to cause significant impairment of household loan portfolios. On the other hand, some banks reported a higher sensitivity to this segment.

Chart 94 Capital adequacy ratio of the banking sector under stress scenario (%)



Source: NBS, NBS calculations.
Note: The calculations do not include branches of foreign banks.

Chart 95 Losses from credit risk and market risks (EUR millions)



Source: NBS, NBS calculations.

The marked rise in securities investments during the recent time has left several banks more exposed to a revaluation of securities. It is, however, necessary to note that those losses caused by a rise in interest rates would be partially offset by the revaluation of interest rate derivatives as well as by the higher coupon yields on these securities. As for equity risk, only one bank showed any significant exposure to it.

Profit-making ability is a key precondition to coping with adverse economic developments

In the case of most banks, losses arising from credit risk and market risk were mitigated by overall profits. The ability to generate profits is a key precondition for coping with potential adverse future developments.

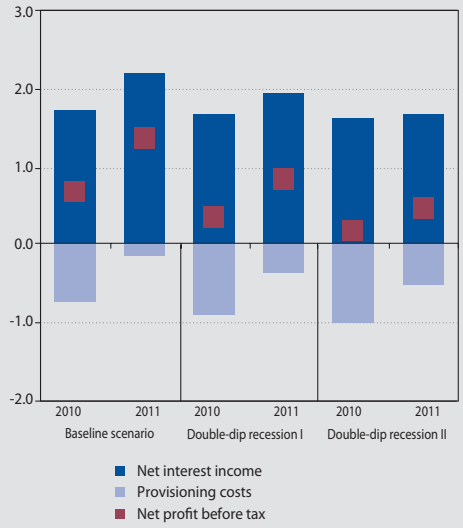
Under the baseline scenario, the profit-making ability of banks is expected to be sound. This scenario would see only three banks reporting a loss for 2010 or 2011. Profitability would be more heavily squeezed under the stress scenarios. In the case of the more moderate version, seven banks would report a loss for at least one of the two years under review, while under the more severe version at least eight banks would do so.

Interest income accounts for a substantial share of the rise in profitability, owing to the retail focus of domestic banks and the surge in securities investments. The main components of the gross income through which banks would be able to reduce their losses on non-performing loans would be net interest income from the customer loans and deposits portfolio and coupon yields from the securities portfolio. It is important to note, however, that net interest income rises at least moderately in each of the three scenarios, but in neither of the stress scenarios would it reach the level recorded under the baseline scenario. This means that banks would have an ever shrinking pool of funds from which to cover ever more substantial losses.

In PFMC funds, stress scenarios have a relatively positive impact

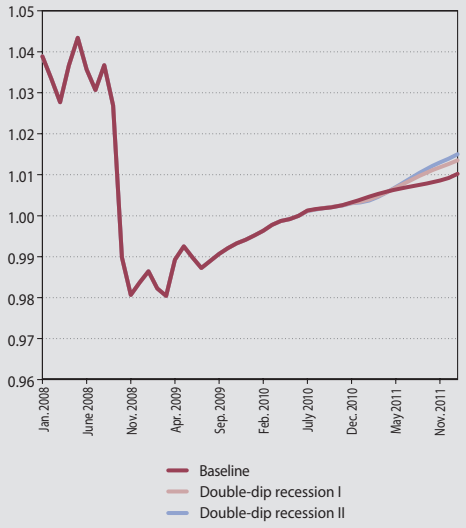
As mentioned earlier, in regard to analysis of main risks, investments in PFMC funds are not sensitive to falling share prices or to exchange rate movements. The interest rate fixation period for term deposits, as well as for coupon payments on bonds, is 0.5 of a year on average. Thus, during the first six months, the returns on the majority of PFMC funds would record practically no sensitivity to the stress scenarios.

Chart 96 Main estimated components of net profit before tax (EUR billions)



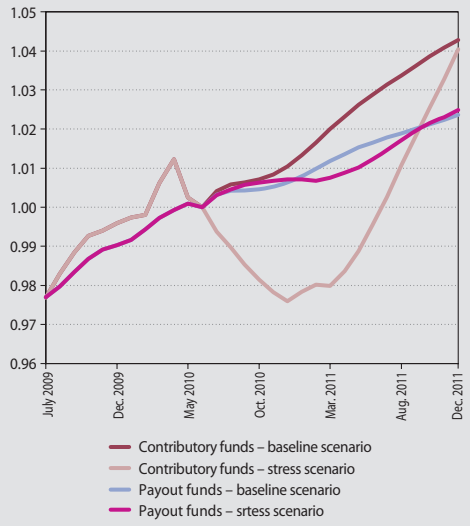
Source: NBS, NBS calculations.

Chart 97 Impact of the baseline scenario and stress scenarios on PFMC funds



Source: NBS, ECB, Bloomberg, Reuters, internet, NBS calculations.
Note: Left-hand scale: average current value of the pension unit weighted by the net asset value of individual funds (index value as at 30 June 2010 = 1.00).

Chart 98 Impact of the baseline scenario and stress scenario on SPMC funds



Source: NBS, ECB, Bloomberg, Reuters, internet, NBS calculations.
Notes: Left-hand scale: average current value of the pension unit weighted by the net asset value of individual funds (index value as at 30 June 2010 = 1.00).
The stress scenario applied is the Double-dip recession II scenario.

Looking beyond this horizon, their returns would even increase, as interest income is boosted by the rising interest rates assumed in the stress scenarios.

Investments in SPMC funds were affected mainly by equity price movements

The effect of stress scenarios in contributory funds is determined largely by assumptions for stock market movements. This is due to the relatively high share of investments in equities and in investment fund shares/units; this also applies to the four largest funds, where this share represents 15%. The asset value of payout funds would not be significantly affected by the stress scenarios.

In the case of investment funds, a relatively large proportion of their investments are conservative

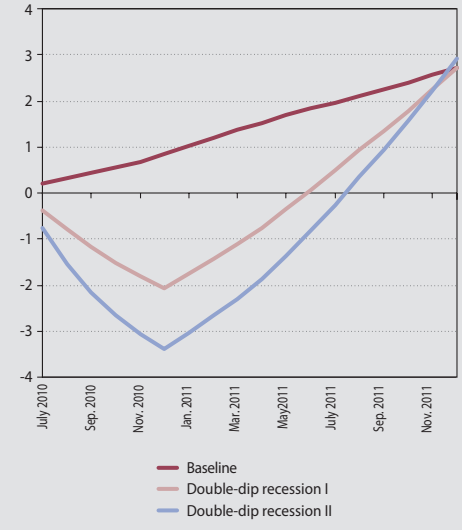
When assessing the impact of the stress scenarios on investment funds, it is apparent that a relatively largely proportion of their assets are invested on a fairly conservative basis.

Under stress scenarios, the funds would record a loss for the second half of the year representing, on average, 2.0% to 3.5% of the asset value (average weighted by the amount of the net asset value of individual funds). Under the Double-dip recession I scenario, the market share of funds that would record a loss of more than 5% of the asset value, would be 14%. The largest diversity in the impact of stress scenarios appears in equity funds, where the degree of the impact depends on the share of the equity component (Table 3). In these funds, investments in equities and investment fund shares/units account for around half of the assets. Furthermore, investments in US equities show a diversification effect, since the US dollar is assumed to strengthen against the euro. During 2011, however, the losses made in 2010 would be recovered, due partly to stock markets rebounding and partly to the rising net interest income from the coupons of debt securities (since the average duration of bond investments in collective investment funds is relatively short).

The assets of insurance companies are, under the stress scenarios, exposed mainly to the decline in the value of securities

Under the stress scenarios, the assets of insurance companies decline in value mainly as a result of interest rate risk, in contrast to the situation in the collective investment sector. During the second half of 2010, approximately a half of the total losses would be caused by falling equity prices, but in 2011 these losses would be gradu-

Chart 99 Impact of the baseline scenario and stress scenarios on collective investment funds (%)



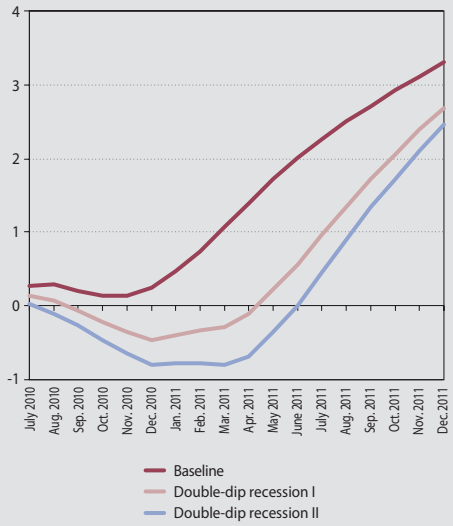
Source: NBS, ECB, Bloomberg, Reuters, Internet, NBS calculations.

Table 13 Breakdown of the impact of the Double-dip recession I scenario as at 31 December 2010 (%)

Type of investment fund	Gain	Loss from 0% to 5% of NAV	Loss from 5% to 10% of NAV	Loss from 10% to 20% of NAV	Loss from 20% to 30% of NAV	Loss from 30% to 40% of NAV	Loss of more than 40% of NAV
Money market funds	98	2	0	0	0	0	0
Bond funds	54	26	2	18	0	0	0
Funds of funds	6	1	2	71	20	0	0
Equity funds	31	38	0	19	1	7	4
Mixed funds	17	55	10	15	2	0	0
Funds –total	68	17	2	10	2	0	0

Source: NBS, ECB, Bloomberg, Reuters, internet, NBS calculations.
Note: In the table, the net asset value of funds that record a gain or loss in the stated range under the Double-dip recession I macro stress scenario is shown as a share of the total net asset value of investment funds in the respective category.

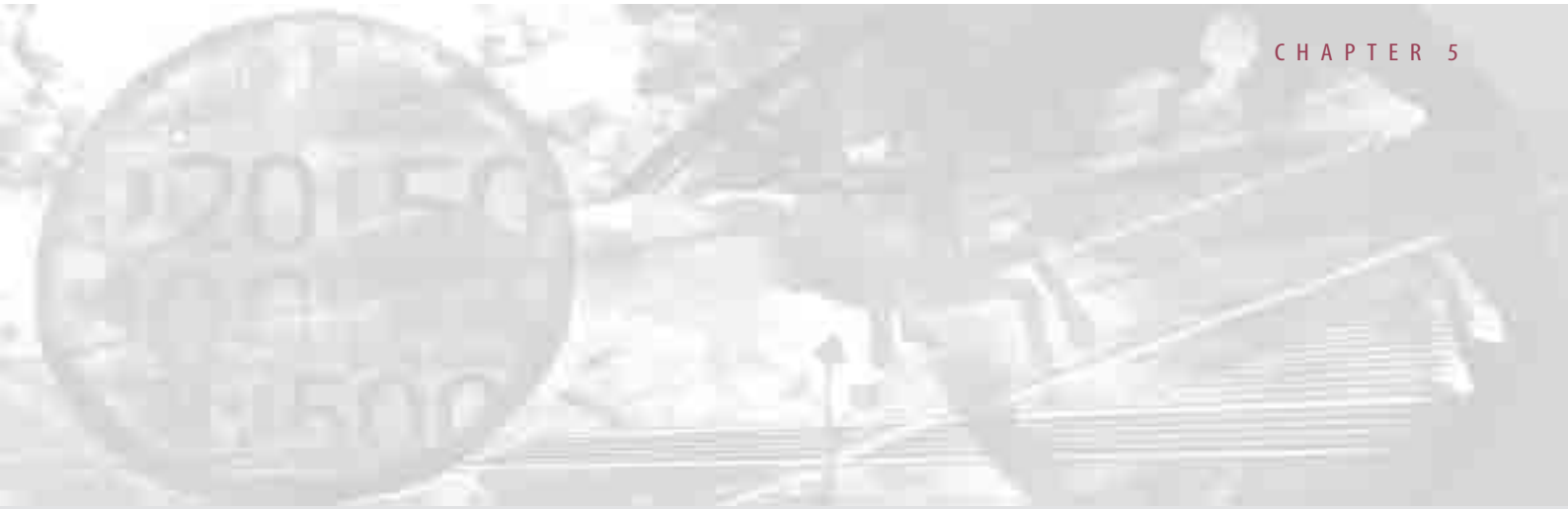
Chart 100 Impact of the baseline scenario and stress scenarios on the assets of insurance companies (%)



Source: NBS, ECB, Bloomberg, Reuters, internet, NBS calculations.
Note: Left-hand scale: the estimated gain/loss as a share of the net asset value weighted by the net asset value of individual insurance companies.

ally recovered when the prices rebound. Insurance companies would, however, still report losses from the impairment of debt securities, owing to the gradual rise in interest rates or credit spreads, since we assume that these do not return to their original levels. This situation is caused by the high share of securities revalued at fair value. Because of the long duration of these securities, their value would not manage to return to its original level within the stress scenarios horizon.

It should be noted, however, that this analysis does not take into account the overall impact on insurance companies since it does not cover any revaluation of liabilities.



CHAPTER 5

FINANCIAL MARKET ANALYTICAL DATA

5

5 Financial Market Analytical Data

1 BANKS AND BRANCHES OF FOREIGN BANKS

1.1 Asset and liability structure of banks and branches of foreign banks (EUR thousands)

	Total volume (EUR thousands) (as at 30.6.2010)	Share of a foreign currency (%)	Year-on-year change (%)	Share of total assets (%)	CR3 (%)	CR5 (%)	HHI
ASSETS TOTAL (gross)	57,767,681	3	4	100	56	73	1,284
TOTAL LOANS TO CUSTOMERS	32,291,432	2	2	56	54	70	1,200
Loans to retail	14,742,614	0	10	26	65	85	1,698
of which: Loans to households	13,891,887	0	11	24	65	85	1,727
Loans to enterprises	14,453,624	2	-3	25	46	69	1,101
Loans to non-banking financial companies	1,082,697	2	-32	2	51	69	1,174
Loans to general government	942,454	0	22	2	89	97	6,169
Loans to non-residents	1,070,043	29	-5	2	51	76	1,291
TOTAL INTERBANK MARKET OPERATIONS	7,388,491	7	-18	13	54	68	1,286
of which: Operations with NBS and foreign CB (incl. NBS bills)	1,100,484	0	-8	2	56	77	1,425
TOTAL SECURITIES	15,424,021	2	28	27	63	84	1,651
Securities issued by residents	12,390,388	0	23	21	67	86	1,849
Government bonds	10,938,046	0	27	19	68	87	1,889
Corporate bonds	145,200	0	-21	0	94	100	3,177
Bank bonds	578,151	0	-7	1	57	81	1,481
Other debt securities	263,318	0	0	0	100	100	10,000
Equity securities	465,673	0	18	1	75	97	2,237
Securities issued by non-residents	2,489,016	12	74	4	72	85	2,075
Debt securities	2,417,389	11	79	4	72	85	2,062
of which: issued by banks	359,221	5	-25	1	72	93	2,205
issued by general government	1,728,481	10	191	3	80	92	2,935
other issuers	329,687	23	19	1	58	82	1,620
Equity securities	71,627	46	-7	0	99	100	4,930
of which: issued by banks	196	0	-99	0	100	100	10,000
other issuers	71,431	46	22	0	99	100	4,957
Derivatives – positive fair value	544,617	0	-2	1	69	88	1,959

1.1 Asset and liability structure of banks and branches of foreign banks (EUR thousands)

	Total volume (EUR thousands) (as at 30.6.2010)	Share of a foreign currency (%)	Year-on-year change (%)	Share of total assets (%)	CR3 (%)	CR5 (%)	HHI
TOTAL LIABILITIES	54,823,887	3	3	100	56	73	1,275
TOTAL DEPOSITS AND LOANS FROM CUSTOMERS	38,480,375	1	1	70	57	72	1,305
of which: deposits insured with the Deposit Protection Fund	23,694,594	3	1	43	60	76	1,513
Deposits and loans received from the retail sector	23,063,509	2	2	42	60	74	1,487
Deposits and loans received from households	21,550,035	3	2	39	59	74	1,486
Deposits and loans received from enterprises	8,348,788	4	2	15	58	74	1,556
Deposits and loans received from non-bank financial corps.	2,916,483	3	2	5	56	84	1,490
Deposits and loans received from general government	2,788,614	0	-21	5	68	90	2,123
Deposits and loans received from non-residents	1,362,981	9	59	2	50	70	1,172
TOTAL FUNDS FROM BANKS	5,824,815	5	29	11	58	76	1,595
Funds from NBS and foreign issuing banks	2,163,710	0	52	4	90	97	4,629
Funds from non-resident banks	3,077,963	8	26	6	46	65	1,101
TOTAL SECURITIES ISSUED	4,293,442	3	2	8	71	86	2,152
Mortgage bonds	3,297,040	3	3	6	77	90	2,536
Bills of exchange	191,168	11	11	0	83	100	3,152
Other securities issued	171,393	0	-32	0	90	100	2,889
Derivatives – negative fair value	633,841	0	7	1	65	85	1,832
Risk-weighted assets of the banking book	28,853,739		-1	53	60	78	1,434
Risk-weighted assets of the trading book	1,073,299		10	2	74	91	2,503
Other risk-weighted assets	3,105,275		-7	6	60	77	1,461
Own funds	4,349,372		6	8	54	74	1,276

Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 385 if the institutions numbered 26.
Assets are expressed in the gross value; equality with liabilities is achieved by deducting the value of depreciation charges and provisions.

1.2 Revenues and expenditure of banks and branches of foreign banks (EUR thousands)

	Value (as at 30.6.2010)	Value (as at 30. 6. 2009)	CR3 (%)	CR5 (%)	HHI
(a) TOTAL OPERATING COSTS (b + e + f)	556,980	583,798	56	74	1,311
(b) Administrative costs (c + d)	467,513	492,763	55	73	1,278
(c) Purchased performances	229,086	245,077	53	71	1,268
(d) Staffing costs	238,427	247,686	57	75	1,328
(e) Depreciation/amortization of tangible and immovable assets	77,601	79,956	60	77	1,654
(f) Taxes and fees	11,866	11,079	86	92	4,044
(g) GROSS INCOME (h + l)	1,048,561	998,256	61	79	1,509
(h) Net interest income (j – i)	820,258	770,263	61	78	1,482
(i) Interest expenses	284,886	469,045	48	66	1,110
(j) Interest income	1,105,144	1,239,308	58	73	1,351
(k) of which: Interest income from securities	254,176	236,262	59	83	1,567
(l) Net non-interest income (m + n + o + p)	228,303	227,993	63	81	1,666
(m) Revenue from shares and ownership interests	9,828	6,641	96	100	3,271
(n) Net income from fees	217,239	198,426	65	78	1,639
(o) Net income from trading	35,419	49,020	59	77	1,455
(p) Other net operating incomes	-34,183	-26,094	,	,	,
(q) NET INCOME (g – a)	491,581	414,458	67	86	1,826
(r) Net creation of provisons and net income from depreciation of recievables	183,870	199,323	,	,	,
(s) Net creation of reserves	3,008	-8,098	,	,	,
(t) NET PRE-TAX PROFIT (q – r – s)	304,703	223,233	65	85	1,799
(u) Extraordinary profit	0	0	,	,	,
(v) Income tax	64,281	43,676	65	82	1,664
w) NET PROFIT AFTER TAX (t + u – v)	240,422	179,557	65	85	1,846

Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value of the given item.
In the case of all institutions having an equal share, the HHI value would be 385 if the institutions numbered 26.

1.3 Profitability indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (30.6.2010)	Denominator weighted average (30.6.2009)	Asset-weighted average	Mini-mum	Lower quartile	Median	Upper quartile	Maxi-mum
ROA	0.45	0.34	0.45	-22.43	0.02 (8)	0.29 (13)	0.59 (49)	1.64 (30)
ROE (excl. branches)	5.46	4.39	6.19	-14.85	0.81 (8)	3.76 (10)	6.43 (27)	21.65 (48)
Cost-to-income ratio	53.12	58.48	58.06	-1 150.00	43.29 (10)	57.65 (68)	79.59 (13)	581.16 (9)
Relative significance of interest incomes	78.23	77.16	79.59	0.00	71.67 (10)	78.58 (51)	84.27 (26)	311.02 (13)
Net interest spread	1.48	1.39	1.48	-0.36	0.70 (4)	0.91 (9)	1.50 (20)	6.99 (66)
retail	2.79	2.48	2.76	0.42	1.56 (4)	2.05 (26)	3.33 (41)	7.80 (27)
corporates	1.53	1.29	1.46	-1.01	0.95 (23)	1.33 (27)	1.58 (27)	6.25 (22)
financial companies	1.27	1.38	1.37	-0.35	0.75 (43)	1.22 (5)	1.89 (28)	9.12 (17)
banks including NBS and bills	-0.06	-0.20	-3.64	-284.93	-0.32 (13)	-0.07 (20)	0.17 (9)	0.63 (57)
Net interest margin	1.47	1.41	1.47	-0.07	0.69 (4)	0.97 (15)	1.50 (16)	6.88 (65)

Note: Figures in brackets below the quartile values represent the share of banks (measured by volume of net assets), for which the value of the indicator lies between the value of the given quartile and the previous quartile.

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (30.6.2010)	Denominator-weighted average (30.6.2009)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CREDIT RISK									
Non-performing loans as a share of total amount of loans to customers	6.09	4.24	6.12	0.00	0.44 (5)	4.69 (34)	8.12 (47)	17.96 (14)	
Retail (share of loans to retail sector)	5.79	4.73	6.12	0.00	3.44 (15)	4.64 (28)	9.19 (38)	82.89 (18)	
Corporates (share in loans to enterprises)	7.40	4.51	7.09	0.00	0.00 (5)	3.47 (7)	9.38 (69)	23.23 (19)	
Financial companies (share of loans to financial companies)	0.66	0.05	1.14	0.00	0.00 (36)	0.00 (0)	0.00 (26)	9.56 (31)	
Provisions as a share of total amount of non-performing loans to customers	75.35	83.34	109.93	34.35	60.27 (13)	73.39 (31)	92.70 (30)	2 590.91 (23)	
Large asset exposure (weighted) / own funds (excl. branches)	114.72	97.02	123.59	0.00	38.24 (6)	138.55 (58)	244.59 (19)	453.54 (10)	
Large asset exposure within groups (number of breaches)									6
Claimable value of collateral as a share of total amount of non-performing loans to customers	38.95	32.46	39.73	0.00	16.27 (2)	40.89 (51)	57.79 (31)	88.81 (12)	
FOREIGN EXCHANGE RISK									
Forex open balance-sheet / own funds (excl. branches)	-5.05	7.26	-4.68	-47.17	-1.48 (34)	0.00 (22)	1.87 (9)	44.66 (28)	
Forex open off-balance-sheet position / own funds (excl. branches)	14.21	-12.82	14.35	-121.85	0.00 (12)	0.70 (21)	27.96 (38)	52.38 (23)	
Total forex open position / own funds (excl. branches)	9.16	-5.56	9.67	-122.91	0.00 (26)	0.45 (6)	10.10 (15)	44.38 (47)	
Total forex open position / own funds (incl. branches)	8.32	3.27							
INTEREST RATE RISK									
Change in economic value of the trading book not including interest rate derivatives / own funds (excl. branches)[1)]	0.71	0.92	0.69	-1.30	0.00 (16)	0.00 (0)	0.13 (25)	4.89 (52)	
Change in economic value of the trading book including interest rate derivatives / own funds (excl. branches)[1)]	0.50	0.44	0.51	-1.30	0.00 (31)	0.00 (0)	0.37 (40)	4.85 (22)	

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (30.6.2010)	Denominator-weighted average (30.6.2009)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
Change in economic value of the total balance sheet not including interest rate derivatives / own funds (excl. branches)[1)]	12.81	12.68	12.96	1.86	6.02 (6)	8.28 (28)	18.28 (33)	25.83 (26)	
Change in economic value of the total balance sheet including interest rate derivatives / own funds (excl. branches)[1)]	12.28	11.55	12.15	-1.64	4.60 (8)	9.72 (26)	18.25 (33)	48.23 (26)	
Total interest-rate open position up to 1 month / own funds (excl. branches)	-106.23	-155.81	-118.24	-746.96	-218.60 (26)	-66.97 (23)	18.63 (25)	155.17 (20)	
Total interest-rate open position up to 1 year / own funds (excl. branches)	-65.44	-109.07	-72.68	-638.88	-111.05 (17)	-42.59 (32)	38.71 (21)	171.74 (23)	
Total interest-rate open position up to 5 years / own funds (excl. branches)	-19.11	2.11	-22.74	-176.30	-79.01 (37)	0.38 (16)	47.64 (19)	392.01 (22)	
LIQUIDITY RISK									
Liquid asset ratio as defined in Decree No. 18/2008 of Národná banka Slovenska (Section 13) as amended	135.07	132.09	142.51	102.68	126.76 (18)	155.26 (71)	244.50 (8)	1 820.33 (3)	0
Share of quick assets in highly volatile funds	17.54	14.65	37 574.54	0.22	5.60 (14)	16.91 (44)	39.83 (35)	999 608.33 (7)	
Share of liquid assets (incl. collateral from reverse repo trades) in volatile funds	26.64	24.20	27.28	-9.49	4.19 (8)	12.77 (11)	33.47 (48)	728.13 (33)	
Ratio of fixed and illiquid assets (excl. branches)	42.59	43.80	45.72	0.00	24.11 (2)	43.08 (33)	55.76 (44)	119.98 (14)	
Share of loans in deposits and securities issued	75.49	75.05	80.92	0.00	66.02 (27)	81.26 (49)	134.23 (21)	445.40 (3)	
Total liquidity position current up to 7 days / assets	-13.16	-46.07	-13.16	-48.18	-7.31 (70)	-0.71 (20)	0.00 (7)	33.05 (3)	
Total liquidity position estimated up to 7 days / assets	-5.58	-10.90	-5.58	-48.18	-3.87 (46)	-0.23 (26)	0.00 (20)	33.66 (8)	
Total liquidity position current up to 3 months / assets	-14.08	-56.95	-14.08	-47.57	-14.44 (52)	-3.29 (34)	-0.08 (8)	33.05 (5)	
Total liquidity position estimated up to 3 months / assets	-6.99	-19.60	-6.99	-47.57	-7.89 (25)	-1.04 (62)	0.00 (2)	33.05 (10)	

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (30.6.2010)	Denominator-weighted average (30.6.2009)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CAPITAL ADEQUACY									
Capital adequacy ratio (excl. branches)	13.17	12.60	12.87	10.35	11.87 (14)	12.76 (57)	17.44 (20)	51.41 (2)	0
Share of Tier I in own funds (excl. branches)	88.64	88.33	87.44	65.77	79.02 (8)	92.55 (66)	99.83 (13)	100.00 (6)	
Share of own funds in balance-sheet total (excl. branches)	8.51	8.39	8.51	5.45	7.33 (29)	8.58 (49)	11.36 (13)	56.35 (2)	
Potential loss as a share of own funds at a capital adequacy ratio of 8% (excl. branches)	39.24	34.79	35.53	22.70	32.60 (14)	37.28 (57)	53.83 (20)	84.44 (2)	

1) The change in economic value is estimated using data on the contractual residual period until the next revision of interest rates, or maturity date, assuming a parallel rise in interest rates of 1 percentage point.
Note: Figures in brackets below the quartile values represent the share of banks (measured by volume of net assets), for which the value of the indicator lies between the value of the given quartile and the previous quartile.

2 INSURANCE COMPANIES

2.1 Net profit and profitability indicators of insurance companies (EUR thousands)

	Value as at 30.6.2010	Value as at 30.6.2009	Year-on-year change (%)	Share of total premiums written (%)
Total net profit	65,316	69,981	-6.7	6.3
ROA (%)	1.0	1.2		
ROE (%)	4.9	5.8		

2.2 Premiums (EUR thousands)

	Value as at 30.6.2010	Value as at 30.6.2009	Year-on-year change	Share of total premiums written (%)	CR3 (%)	HHI 30.6.2010	HHI 30.6.2009
Total	1,034,115	1,030,299	0.4	100	64.5	1,778	1,863
Life insurance	529,199	505,783	4.6	51.2	55.2	1,353	1,394
Whole-life insurance, pure endowment insurance, or whole-life and endowment insurance (excl. unit-linked insurance)	309,311	298,609	3.6	29.9	61.6	1,691	1,545
Unit-linked insurance	147,381	137,378	7.3	14.3	57.8	1,434	1,898
Supplementary insurance	64,224	60,450	6.2	6.2	60.4	1,578	1,584
Other	8,203	9,346	-12.2	0.8	87.8	4,100	4,181
Non-life insurance	504,996	524,517	-3.7	48.8	77.8	2,506	2,633
Motor third-party liability	159,942	165,919	-3.6	15.5	78.8	2,657	2,939
Land vehicles damage or loss insurance	140,597	150,351	-6.5	13.6	77.6	2,424,	2,473
Property insurance	118,065	125,525	-5.9	11.4	82.6	3,055	2,960
Other	86,391	82,720	4.4	8.4	69.8	2,170	2,297

Note: The calculation of CR 3 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 400 if the institutions numbered 25.

2.3 Premiums ceded to reinsurers (EUR thousands)

	Value as at 30.6.2010	Value as at 30.6.2009	Year-on-year change (%)	Share of total premiums written (%)
Total	140,463	136,640	2.8	13.6
Life insurance	4,421	9,623	-54.1	0.8
Non-life insurance	136,043	127,017	7.1	26.9

2.4 Loss ratio in non-life insurance

	Value as at 30.6.2010 (%)	Value as at 30.6.2009 (%)
Total	61.0	57.3
Motor third-party liability	57.5	53.8
Land vehicles damage or loss insurance	64.0	70.9
Property insurance	76.3	60.8
Other	39.5	30.9

2.5 Cost of claims (EUR thousands)

	Value as at 30.6.2010	Value as at 30.6.2009	Year-on-year change (%)	Share of total premiums written (%)	CR3 (%)	HHI 30.6.2010	HHI 30.6.2009
Total	530,122	511,226	3.7	51.26	66.4	1,852	1,971
Life insurance	303,856	272,805	11.4	29.4	61.2	1,600	1,639
Whole-life insurance, pure endowment insurance, or whole-life and endowment insurance (excl. unit-linked insurance)	255,130	233,870	9.1	24.7	64.7	1,804	1,796
Unit-linked insurance	26,758	20,270	32.0	2.6	79.5	2,700	3,198
Supplementary insurance	13,093	10,745	21.8	1.3	60.1	1,719	1,701
Other	8,875	7,920	12.1	0.9	89.1	6,310	6,332
Non-life insurance	226,266	238,421	-5.1	21.9	80.2	2,544	2,758
Motor third-party liability	78,895	83,055	-5.0	7.6	82.6	2,852	3,156
Land vehicles damage or loss insurance	96,210	103,035	-6.6	9.3	79.2	2,409	2,590
Property insurance	29,301	33,950	-13.7	2.8	84.5	3,313	3,473
Other	21,861	18,381	18.9	2.1	72.8	2,496	2,796

Note: The calculation of CR 3 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 400 if the institutions numbered 25.

2.6 Structure of insurers' technical provisions (EUR thousands)

	Value as at 30.6.2009	Value as at 30.6.2008	Year-on-year change (%)	Share of total reserves (%)
Total	4,584,063	4,210,894	8.9	100.0
Life insurance	3,455,602	3,155,978	9.5	75.4
Reserves for the coverage of liabilities from investments on behalf of the insured	754,645	576,650	30.9	16.5
Non-life insurance	1,128,461	1,054,916	7.0	24.6

2.7 Investment of insurers' technical provisions excluding provisions for liabilities arising from financial investments made on behalf of insured persons (EUR thousands)

	Value as at 30.6.2010	Value as at 30.6.2009	Year-on-year change (%)	Share of total reserves (%)
Total	4,298,122	4,021,861	6.9	112.2
Government and central bank bonds of Slovakia and EU Member States, bonds guaranteed by Slovakia, and bonds of the EIB, EBRD and IBRD	1,860,199	1,630,216,	14.1	48.6
Bank bonds	595,696	582,476	2.3	15.6
Term accounts at banks	160,265	155,083	3.3	4.2
Mortgage bonds	512,545	552,675	-7.3	13.4
Reinsurance	337,529	279,558	20.7	8.8
Other	831,888	821,854	1.2	21.7

3 RETIREMENT PENSION SAVING

3.1 Pension fund management companies as at 30.6.2010

	Market share[1] (%)	NAV of funds (EUR thousands)	Number of customers[2]
Allianz – Slovenská PFMC	32	1,045,018	439,629
Axa PFMC	27	896,624	373,242
VÚB Generali PFMC	14	479,717	194,420
ING PFMC	11	366,807	147,238
AEGON PFMC	10	339,500	184,975
CSOB PFMC	6	185,135	93,750

1) Market shares are calculated according to the aggregate net asset value (NAV) of funds managed by the given pension fund management company.
2) Data on the number of customers is received directly from the pension fund management companies; the sum of these data for the whole sector may differ from the data received from the Social Insurance Agency on the aggregate number of customers in the sector.
Note: NAV – Net Asset Value.

3.2 Results of pension fund management companies as at 30.6.2010 (EUR thousands)

	Revenues	Expenditures	Profit/loss	ROA (%)	ROE (%)
Allianz – Slovenská PFMC	3,057	2,819	238	0.5	0.5
Axa PFMC	2,549	4,694	-2,145	-3.2	-3.3
VÚB Generali PFMC	1,600	1,042	558	4.6	4.8
ING PFMC	1,118	1,986	-868	-6.1	-6.3
AEGON PFMC	1,184	761	423	3.0	3.0
CSOB PFMC	606	879	-273	-2.2	-2.2

3.3 Pension funds (EUR thousands)

	NAV as at 30.6.2010
Total	3,312,801
Conservative	147,551
Balanced	968,183
Growth	2,197,066

Note: NAV – Net Asset Value.

3.4 Investment structure of pension funds (EUR thousands)

	Value as at 30.6.2010
Total	3,312,801
Bank accounts	1,126,108
Bonds	1,032,187
Treasury bills	1,185,296
Shares and investment fund shares / units	1,302
Other claims	17,179
Payables	-49,271

3.5 Supplementary pension fund asset management companies as at 30.6.2010

	Market share[1] (%)	NAV of funds (EUR thousands)	Number of customers
ING Tatry – Sympatia, d. d. s., a. s.	37.5	408,181	329,904
Doplnková dôchodková spoločnosť Tatra banky, a. s.	29.3	318,956	199,045
Stabilita, d. d. s., a. s.	19.9	216,215	186,468
Axa d. d. s., a. s.	13.1	142,412	135,449
AEGON d. d. s., a. s.	0.2	2,707	4,846

1) Market shares are calculated according to the aggregate net asset value (NAV) of funds managed by the given supplementary pension fund asset management companies.
Note: NAV – Net Asset Value.

3.6 Results of supplementary pension fund asset management companies as at 30.6.2010 (EUR thousands)

	Revenues	Expenses	Profit/loss	ROA (%)	ROE (%)
ING Tatry – Sympatia, d. d. s., a. s.	5,528	3,253	1,350	7.3	10.2
Doplnková dôchodková spoločnosť Tatra banky, a. s.	3,374	2,731	506	6.7	8.8
Stabilita, d. d. s., a. s.	2,904	1,813	882	17.9	19.1
Axa d. d. s., a. s.	1,636	1,530	106	1.0	1.1
AEGON d. d. s., a. s.	78	126	-48	-2.1	-2.1

3.7 Supplementary pension funds (EUR thousands)

	NAV as at 30.6.2010
Total	1,088,470
Contribution	1,043,931
Payroll	44,539

Note: NAV – Net Asset Value.

3.8 Investment structure of supplementary pension funds (EUR thousands)

	Value as at 30.6.2010
Total	1,088,470
Bank accounts	227,314
Bonds	738,169
Treasury bills	539
Shares and investment fund shares / units	130,820
Other claims	53,808
Payables	-62,180

4 COLLECTIVE INVESTMENT

4.1 Asset management companies as at 30.6.2010

	NAV of investment funds (EUR thousand)	Market share (%)
Total	3,584,052	100.0
Tatra Asset Management	1,408,359	39.3
Asset Management SLSP	861,948	24.0
VÚB Asset Management	861,629	24.0
Prvá penzijná	153,141	4.3
ČSOB Asset Management	134,502	3.8
Alico Funds Central Europe	69,763	1.9
IAD Investments	53,319	1.5
Allianz Asset Management	41,389	1.2

Note: NAV – Net Asset Value

4.2 Expenditures, revenues and profitability indicators of domestic asset management companies as at 30.6.2010 (EUR thousands)

	Revenues	Expenses	Profit/loss	ROA (%)	ROE (%)
Total	23,293	20,080	3,213	5.2	5.8
Alico Funds Central Europe	1,422	1,084	338	8.4	11.2
Allianz Asset Management	258	536	-278	-8.2	-8.4
Asset Management SLSP	3,868	3,439	429	8.6	10.5
ČSOB Asset Management	3,512	3,267	245	2.6	3.1
IAD Investments	601	579	22	1.0	1.0
Prvá Penzijná	3,544	3,026	518	13.4	14.4
Tatra Asset Management	6,704	5,214	1,490	5.2	5.4
VÚB Asset Management	3,384	2,935	449	9.2	11.3

4.3 Structure of investment funds as at 30.6.2010 (EUR thousands)

Fund type	Market share (%)	Net asset value	Number of funds	CR3[1] (%)	CR5[1] (%)	HHI[1]	HHI if distribution uniform
Total investment funds	100.0	4,365,735	503				20
Domestic	82.1	3,584,052	77	37	47	604	130
Money market funds	42.0	1,835,373	13	72	86	1,891	769
Bond funds	10.5	457,589	8	90	96	3,173	1,250
Equity funds	3.5	154,780	7	81	95	2,615	1,429
Mixed funds	10.1	441,574	20	62	75	1,831	500
Funds of funds	7.1	309,525	16	59	78	1,538	625
Other funds	4.5	197,199	8	61	91	1,763	1,250
Special funds	0.6	24,155	1	100	100	10,000	10,000
Real estate funds	3.8	163,857	4	89	100	3,248	2,500
Foreign[2]	17.9	781,683	426	17	24	206	23
Money market funds	3.0	131,412	27	82	88	3,272	370
Bond funds	1.8	80,637	71	39	53	802	141
Equity funds	4.9	212,670	226	33	43	496	44
Mixed funds	0.4	16,869	27	82	91	3,029	370
Funds of funds	1.8	79,232	21	71	83	2,447	476
Other funds	6.0	260,862	54	21	31	371	185

1) Market concentrations are calculated only for open-end investment fund (they exclude closed-end and special funds)
2) For foreign investment funds the net asset value represents units sold in the Slovak Republic.
Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item. In the column, "HHI on a uniform distribution", the HHI value is that which would express the concentration on a uniform distribution of the net asset value in the given group of funds.

4.4 Net sales of open-end investment funds as at 30.6.2010 (EUR thousands)

	6 months	Number of funds	HHI	HHI if uniform distribution
Total open-end investment funds	269,611	503		20
Domestic	181,270	77	908	130
Money market funds	61,437	13	2,905	769
Bond funds	40,051	8	3,935	1,250
Equity funds	28,170	7	2,685	1,429
Mixed funds	79,329	20	2,637	500
Funds of funds	-1,619	16	3,716	625
Other funds	-45,755	8		1,250
Special funds	19,656	5	8,249	2,000
Foreign	88,341	426	455	23
Money market funds	20,350	27	3,391	370
Bond funds	8,273	71	1,898	141
Equity funds	13,136	226	375	44
Mixed funds	3,551	27	7,250	370
Funds of funds	4,863	21	2,217	476
Other funds	38,169	54	1,488	185

Note: The calculation of HHI covers only those institutions reporting a positive value for the given item. In the column, "HHI on a uniform distribution", the HHI value is that which would express the concentration on a uniform distribution of the net asset value in the given group of funds.

4.5 Average returns on open-end investment funds as at 31.6.2010 (% p.a.)

	3 months			1 year			3 years		
	Min	Priemer	Max	Min	Priemer	Max	Min	Priemer	Max
Total open-end funds	-53.6	-1.4	19.6	-49.7	6.0	67.3	-38.9	-2.6	16.3
Domestic	-11.7	-1.0	3.5	-4.8	4.3	51.6	-26.1	-0.3	6.7
Money market funds	-1.1	0.0	0.4	0.8	1.7	3.5	-0.9	1.9	2.9
Bond funds	-5.5	-0.7	1.0	2.0	5.2	21.2	-13.9	1.0	2.8
Equity funds	-11.7	-6.7	0.1	6.5	22.2	51.6	-26.1	-17.0	-12.9
Mixed funds	-5.6	-1.6	1.7	-1.2	7.5	28.5	-21.8	-1.4	3.6
Funds of funds	-11.6	-5.8	0.2	-4.8	6.3	19.4	-10.1	-6.7	1.5
Other funds	-1.3	-0.4	-0.2	0.1	2.2	3.5	0.9	1.1	1.2
Special funds	0.0	1.7	3.5	2.4	5.5	7.0	-2.2	1.1	6.7
Foreign	-53.6	-3.1	19.6	-49.7	14.2	67.3	-38.9	-12.8	16.3
Money market funds	-4.3	0.4	8.6	0.2	2.5	23.1	-13.7	-7.7	2.3
Bond funds	-9.6	0.6	12.7	0.0	22.4	58.1	-20.5	-4.4	16.3
Equity funds	-25.6	-8.8	19.6	-33.1	28.9	67.3	-38.9	-21.8	2.3
Mixed funds	-12.8	-5.3	5.8	-10.4	3.7	26.9	-19.9	-14.0	-9.6
Funds of funds	-8.7	-3.2	-0.1	-4.5	10.3	24.2	-20.0	-15.0	-8.5
Other funds	-53.6	-1.2	7.0	-49.7	2.8	16.3	-20.7	-8.8	3.2

4.6 Asset structure of domestic investment funds as at 30.6.2010 (EUR thousands)

	Money market funds	Other funds
Total	1,847,552	1,764,660
Deposits at banks	768,592	311,068
Securities other than shares and investment fund shares / units	1,050,998	773,023
Shares and investment fund shares / units	24,368	465,391
Shares and other ownership interests	0	107,907
Financial derivatives[1)]	-3,399	-11,325
Other assets	6,994	118,595

1) Financial derivatives include derivatives with positive and negative fair value.

4.7 SAX Index – movement in the first half of 2010

	Date	SAX
Opening level	04.01.2010	266.97
Closing level	30.06.2010	213.59
Annual maximum	04.01.2010	266.97
Annual minimum	27.05.2010	201.20

4.8 Summary of the performance of selected SDXGroup indices

	Typ dlhových cenných papierov	04.01.2010 (%)	30.06.2010 (%)	Zmena (%)
SDXG Overall	Government bonds	107,0124	108,9159	1.02
SDXG (<=5)	Government bonds with a maturity of up to 5 years	106,6483	109,3076	2.49
SDXG (> 5)	Government bonds with a maturity of more than 5 years	108,6409	109,1927	0.51
SDXG Overall	Corporate bonds	98,8499	94,8499	-4.05
SDXG Overall	Mortgage bonds	99,4721	99,4721	0.00

4.9 Transactions by type of securities – securities in total

	Price-setting transactions			Direct transactions			Total		
	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions
First half of 2009	465,464,151	35,590,193	672	5,301,124,245	271,197,735	1,102	5,766,588,397	306,787,928	1,774
First half of 2010	53,812,307	38,164,223	2,032	3,795,067,113	2,165,502,679	691	3,848,879,420	2,203,666,902	2,723

4.10 Transactions by type of securities – equities

	Price-setting transactions			Direct transactions			Total		
	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions
First half of 2009	1,691,002	35,528	497	8,298,278	153,901	341	9,989,280	189,429	838
First half of 2010	6,224,457	110,824	1,872	138,853,683	6,513,002	193	145,078,141	6,623,826	2,065

4.11 Transactions by type of securities – debt securities

	Price-setting transactions			Direct transactions			Total		
	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions	Amount in EUR	Number of securities	Number of transactions
First half of 2009	463,773,149	35,554,665	175	5,292,825,968	271,043,834	761	5,756,599,117	306,598,499	936
First half of 2010	47,587,850	38,053,399	160	3,656,213,429	2,158,989,677	498	3,703,801,279	2,197,043,076	658

5 INVESTMENT FIRMS

5.1 Basic details of investment firms as at 30.6.2009 (EUR thousands)

	Amount of transactions	Market share (%)	Amount of assets under management	Market share (%)
Banks and branches of foreign banks	57,462,257	61	97,779	5
Asset management companies	5,801	0	1,961,294	92
IFs with share capital of at least 35M	661,352	1	66,388	3
Others	36,352,112	38	5,989	0

Note: Non-bank investment firms are divided by the size of their share capital. Those with share capital of less than €1.162 million are not licensed to provide IS-3 investment services (receiving a customer's order to buy or sell an investment instrument and execution of the order on own account).

5.2 Market concentrations of investment firms by trading volume

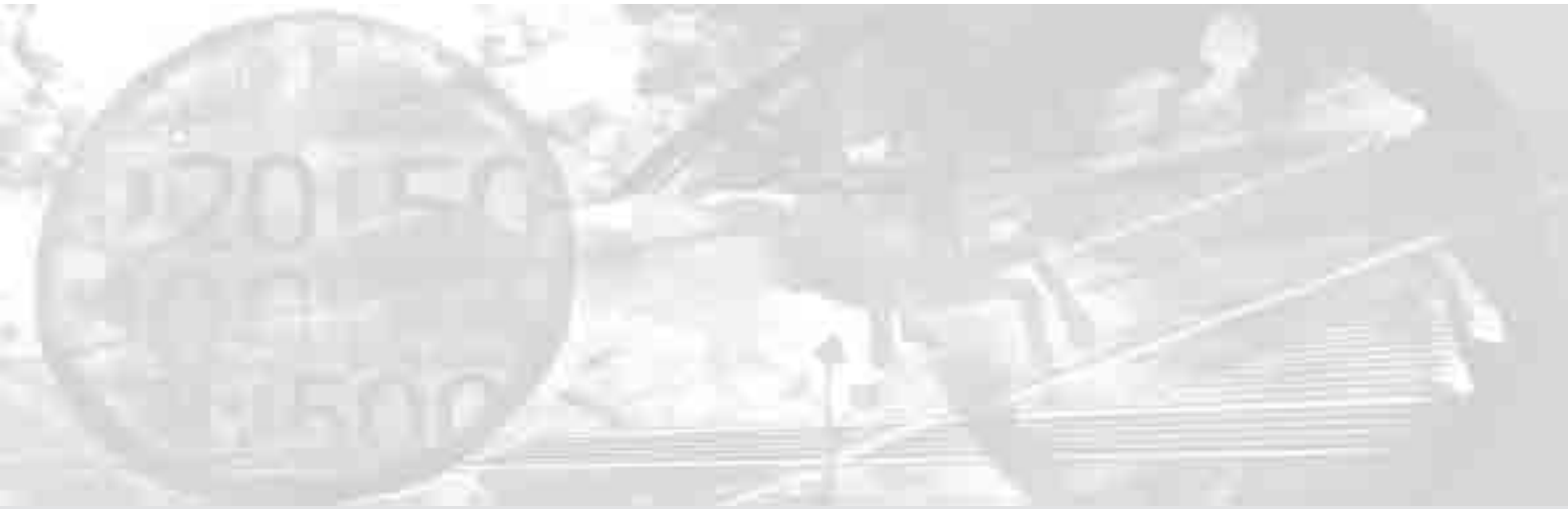
	Number of traders	CR3 (%)	CR5 (%)	HHI
Total	36	69	85	1,838
Banks and branches of foreign banks	16	77	95	2,229
Management companies	3	100	100	10,000
IFs with share capital of at least 35M	7	99	100	4,427
Others	10	88	97	4,414

Note: Market concentrations are calculated for the current quarter.
The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item.

5.3 Trading volume broken down by investment service as at 30.6.2009 (EUR thousands)

	IS-1	IS-2	IS-3
Total trades	13,473,908	31,329,912	49,677,702
Shares	456,952	330,411	237
Bonds	1,219,505	5,007,632	2,662,117
Investment fund shares / units	913,748	615	0
Fungible securities	35,528	6,355	319,805
Other non-capital securities	0	123,160	3,047,037
Money market instruments	106,059	25,318,174	169,002
Foreign securities	50,098	31,320	16,241,963
Derivatives – type A	9,944,795	512,245	27,227,530
Derivatives – type B	64,555	0	10,011
Derivatives – type C	599,692	0	0
Derivatives – type D	0	0	0
Derivative instruments for the transfer of credit risk	0	0	0
Financial contracts for differences	0	0	0
Derivatives – type E	82,976	0	0

Notes: IS-1 – reception of a customer's order to acquire, sell or otherwise dispose of an investment instrument and subsequent transmission of the customer's order for the purpose of its execution.
IS-2 – reception of a customer's order to acquire or sell an investment instrument and its execution for an account other than the account of the service provider.
IS-3 – reception of a customer's order to acquire or sell an investment instrument and its execution for own account.
Derivatives - type A – as defined in Section 5(1)(d) of the Securities Act.
Derivatives - type B – as defined in Section 5(1)(e) of the Securities Act.
Derivatives - type C – as defined in Section 5(1)(f) of the Securities Act.
Derivatives - type D – as defined in Section 5(1)(g) of the Securities Act.
Derivatives - type E – as defined in Section 5(1)(j) of the Securities Act.



GLOSSARY AND ABBREVIATIONS

GLOSSARY OF TERMS USED

Average annual yield of pension funds – this is calculated as a weighted average of the year-on-year percentage changes in the daily values of pension fund units of the respective pension funds. The year-on-year percentage changes in the daily values of pension units are calculated as at 30 June 2009 ($PMZDHDJ_{30.6.2009}$) according to the following formula:

$$PMZDHDJ_{30.6.2009} = \left(\frac{DJ_{30.6.2009}}{DJ_{30.6.2008}} - 1 \right) * 100\%$$

where DJ is the value of a pension unit on the given day.
The weight applied is the ratio of the respective fund's net asset value (NAV) to the sum of NAVs of funds of the same type. The yield is given in nominal terms, which means that inflation is not deducted. When yields are calculated for various forms of investment, the nominal yield is used as a rule, calculated according to the standard methodology.
This yield, however, is not identical to the yield in the saver's personal pension account, which is determined on an individual basis. The input data were the values of pension units from the individual pension funds reported to Národná banka Slovenska by pension fund management companies for the days 30 June 2008 and 30 June 2009, which are available on the website of Národná banka Slovenska.

Average yield of market rivals – the arithmetic average of the moving averages of the percentage year-on-year changes in the daily pension unit values of the pension fund's market rivals, calculated for the previous 24 months and rounded up to 2 decimal places.

Average yield of a pension fund of a pension fund management company – the moving average of the percentage year-on-year changes in the daily pension unit values of the pension fund calculated for the previous 24 months and rounded up to two decimal places.

Capital adequacy ratio – ratio of own funds and 12.5 times the capital adequacy requirement.

CLI index – an index of the weighted average of CLIs for selected countries, with each country weighted according to its share of Slovak exports; the CLI is a composite indicator of economic activity, and it is published by the OECD.

Combined ratio – a ratio representing the expense ratio and loss ratio relative to earned premiums.

Cost-to-income ratio – the ratio of total operating costs and net income from banking activity (purchased performances + staff costs + social costs + depreciation/amortization of tangible and intangible assets + taxes and fees / revenues from shares and ownership interests + net income from fees and commissions + net income from securities transactions + net income from derivatives transactions + net income from foreign exchange transactions + net income from other transactions).

CR n index – the concentration of the n largest banks, i.e. the sum of their assets as a share of total assets.

Cumulative gap – the sum of open positions (long or short) in certain time bands.

Default rate – the percentage of loans defaulting over the period monitored.

Emerging markets – developing markets undergoing rapid growth and industrialization.

Enterprises – non-financial institutions.

Expense ratio – ratio of operating expenses to earned premiums.

Euro Libor/OIS spread – an indicator that takes account of how banks perceive the credit risk of inter-bank lending.

Financial intermediation – for the purpose of this analysis, financial intermediation is understood as financial flows between entities and not the mediation of financial services.

General government – central and local government bodies.

Herfindahl index – defined as the sum of the squares of the shares of individual banks' assets in total assets.

Households – the population, i.e. individuals' accounts.

Household disposable income – is calculated as the sum of the components of the gross personal income of all members of a household (gross financial income from employment and closely related income, and gross non-financial income from employment, gross financial gains or losses from self-employment (including royalties and fees), unemployment benefits, old-age pension benefits, survivor's pension benefits, sickness benefits, invalidity benefits and contributions for education) plus components of the gross income at the household level (income from rented assets or land, family benefits and contributions paid to families with children, the social exclusion not classified elsewhere, housing benefits, financial transfers regularly received between households, interest, dividends, capital gains from a non-registered business, income of persons younger than 16 years of age less regular property taxes, regular paid financial transfers between households, income tax, and social insurance contributions).

Index of exports to selected countries – an index representing the change in the moving average of exports to the principal export countries; the selected countries' share of Slovak exports has fluctuated at around 80% since the beginning of 2006 (April 2006 = 100).

iTraxx index – an index of credit default swaps.

Interest rate spreads – the difference between lending rates/deposit rates and the respective inter-bank rates.

Liquidity up to 7 days and up to 3 months – the ratio of liquid assets and volatile funds, where liquid assets include cash, the bank's current accounts held with other banks, and all bills and government bonds not subject to pledge (including those that the bank acquired in reverse repo trades), and all claims against customers and banks with a residual maturity of up to 7 days, or up to 3 months; and volatile funds are the sum of liabilities towards banks and customers maturing within 7 days or 3 months.

Liquidity cushion – the sum of cash, government bonds, Treasury bills and NBS bills, deposits with NBS and current accounts at other banks, after deducting banks' liabilities towards foreign banks (except long-term liabilities) and the Debt and Liquidity Management Agency (ARDAL), and assets pledged as collateral.

Loans at risk (LAR) – an indicator of corporate credit risk, measuring the share of corporate loans provided to enterprises whose financial position has sharply deteriorated. LAR 1 represents the share of corporate loans to total corporate loans provided to enterprises that in the given quarter reported a loss and at the same time a year-on-year drop in sales of more than 50%. LAR 2 represents the share of corporate loans to total corporate loans provided to enterprises that

in the given quarter reported a loss and at the same time a year-on-year drop in sales of more than 30%.

Loan-to-deposit ratio – the ratio of loans to customers and the sum of retail deposits, deposits from enterprises, deposits from financial companies, and issued mortgage bonds. It indicates the extent to which loans are financed with stable funds from customers. The lower the value, the greater the extent to which loans are financed with customer deposits, and therefore the lesser the extent to which they are financed through the more volatile financial markets.

Loan-to-value ratio – defined as the proportion of the volume of a provided loan and the value of its security.

Long position – a position in which assets are greater than liabilities.

Loss ratio – the percentage ratio of:
- the sum of claims cost and the change in the gross technical provision for claims, to
- earned premiums, i.e. the gross premium after deducting the change in the gross technical provision for unearned premiums.

Net balance-sheet position – the difference between foreign exchange assets and liabilities in the balance sheet.

Net interest rate spread – the difference between the rate of return on loans (interest income on loans as a share of total loan) and the cost of deposits (interest expenses on deposits as a share of total deposits).

Net off-balance-sheet position – defined as the difference between foreign exchange assets and liabilities in the off-balance sheet.

Net percentage share – used in the evaluation of responses to the Bank Lending Survey; it is calculated by taking the lending of banks that relaxed lending standards and those that tightened lending standards and finding the difference between the percentage share of each in total lending. The individual responses of banks are weighted by the average amount of loans of the respective type.

Non-bank financial corporations (NBFCs) – other financial companies, financial intermediaries, pension and investment funds, insurance companies.

Non-performing loans – loans are non-performing when the bank finds that they have lost more than 50% of their value or that the borrower is in arrears with payment.

Open position for up to 3 months – the difference between, on the one hand, the sum of claims against customers and debt securities issued by banks and enterprises which have a residual maturity of up to 3 months, and, on the other hand, the sum of liabilities towards customers and issued securities which have a residual maturity of up to 3 months.

Quick liquidity ratio – immediately liquid assets / highly volatile funds.

Retail – households, sole traders and non-profit institutions serving households.

Short position – a position in which liabilities are greater than assets.

Premium – the price agreed in individual insurance contracts without regard to the method of their financial reporting.

Tier 1, 2, 3 – components of own funds, top quality capital (Tier 1), secondary capital (Tier 2), additional capital sources (Tier 3).

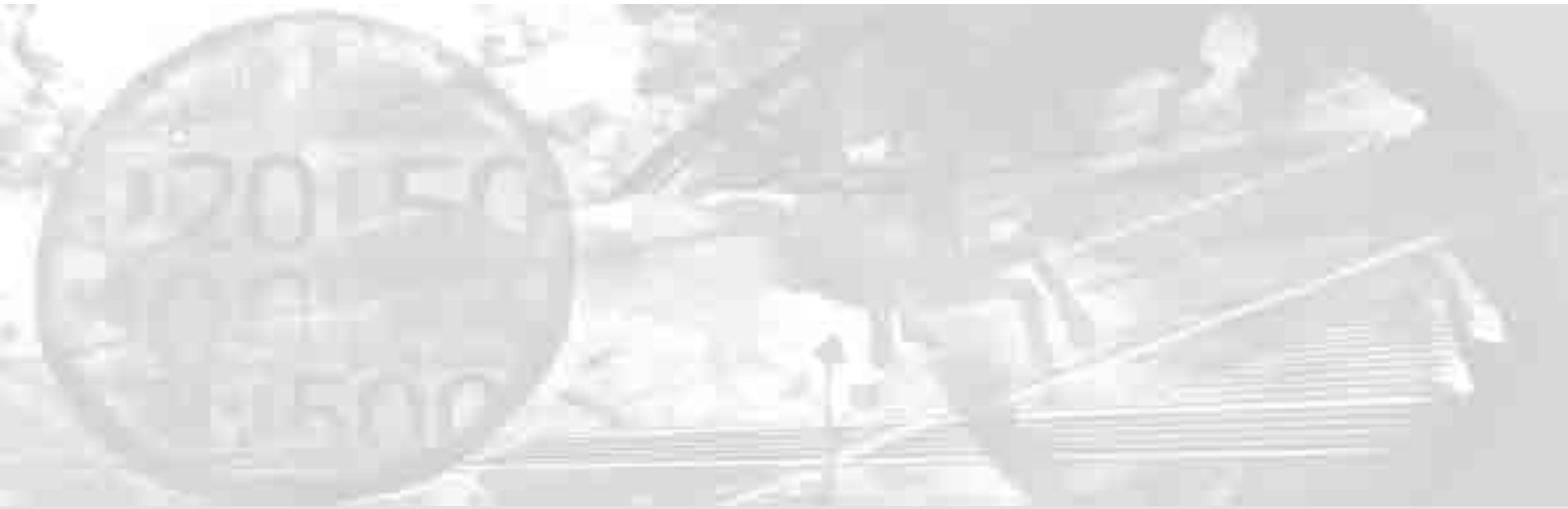
Total net position – the sum of the net balance-sheet position and net off-balance-sheet position.

Unit-linked reserve – technical provision that is created for life insurance linked with an investment fund in insurance branch A4.

VSTOXX – an indicator of implied volatility for the Dow Jones EURO STOXX 50 index, derived from options in this index. The higher the value, the higher the level of volatility.

Abbreviations

AFS	Available for Sale
AMC	asset management company
ASM	available solvency margin
BF	bond investment funds
b. p.	basic points
BRIBOR	Bratislava Interbank Offered Rate
CDS	Credit Default Swap
CLI	Composite Leading Indicator
CR n	index of the concentration of the largest banks
EBRD	European Bank for Reconstruction and Development
EC	Employment Classification
ECB	European Central Bank
EF	equity investment funds
EIB	European Investment Bank
EURIBOR	Euro Interbank Offered Rate
EU	European Union
FF	funds of funds
FV	fair value
GDP	gross domestic product
HFT	Held for Trading
HHI	Herfindahl index
HTM	Held to Maturity
IBRD	International Bank for Reconstruction and Development
IF	investment firm
IR	interest rate
IRB	Internal Rating Based Approach
IS	investment service
LAR	loans at risk
LGD	Loss Given Default
MB	mortgage bond
MF	investment funds
MMF	money market investment funds
MTPL	motor third-party liability
MXF	mixed investment funds
NAV	net asset value
NBS	Národná banka Slovenska
OF	other investment funds
OECD	Organization for Economic Cooperation and Development
PFMC	pension fund management company
p.p.	percentage point
ROA	return on assets
ROE	return on equity
RSR	required solvency ratio
SKK	Slovak koruna
SPMC	supplementary pension asset management company
SO SR	Statistical Office of the Slovak Republic
SR	Slovak Republic
VaR	Value at Risk



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