Macroprudential Commentary

December 2024

Summary

- After two years of contraction, the financial cycle has turned upwards owing mainly to positive developments in the mortgage lending and housing markets. On the other hand, lending to non-financial corporations (NFCs) remains lower in year-on-year terms.
- While mortgage lending shows signs of recovery, the upturn is tentative, and the changes are very modest. Mortgage portfolio growth has been gathering pace since the third quarter of 2024. Since the start of the year, both the average mortgage size and the number of mortgage originations have increased. Mortgage rates are gradually starting to decline. The consumer credit portfolio has maintained stable growth.
- The NFC loan portfolio continues to decline year-on-year, although there are signs of stabilisation. Corporate lending rates have come down slightly.
- A recovery appears to be underway in the housing market. Prices of flats have increased moderately since the start of the year, across all Slovak regions and property size categories.
- Banks have maintained healthy profitability despite the introduction of the bank levy. Their profits remain driven by interest income. The sector's total capital ratio is near historical highs.

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No change in the CCyB rate

The financial cycle is gradually turning upwards. In the third quarter of 2024, the cycle was no longer contracting, while Národná banka Slovenska's composite indicator of the cycle increased slightly after two years of continuous decline. The turnaround is not yet broad-based, but a gradual recovery is evident in certain segments. Mortgage lending has accelerated moderately in recent months, while consumer credit is maintaining stable growth. Renewed growth in real incomes, gradually decreasing interest rates and sustained moderate economic growth are gradually reviving hitherto subdued loan demand. The housing market is also recovering, with housing prices increasing gradually since the summer. Lending to non-financial corporations (NFCs) is still declining year-on-year, although there is heterogeneity across portfolio segments.

From a financial stability perspective, it is important that credit portfolio quality did not deteriorate even during the financial cycle downturn and that non-performing loan (NPL) ratios are near historical lows. Banks have sufficient capacity to maintain lending to the economy and are not constrained by any regulatory requirements. In the context of a subdued financial cycle there is no immediate need to adjust the countercyclical capital buffer (CCyB) rate.

Expectations for the CCyB rate in the next quarter

Národná banka Slovenska (NBS) does not foresee any need to adjust the countercyclical capital buffer rate in the next quarter.

The financial cycle is expected to turn gradually upwards in the period ahead. So long as the upturn remains only gradual, there will be no need to increase the CCyB rate.

Conversely, if the current trend of steadily easing risks continues, there may be scope to consider reducing the CCyB rate in 2025. Any such decision will also depend on the evolution of geopolitical risks and the domestic economy.

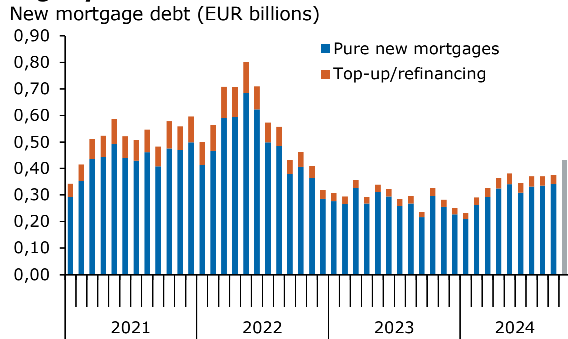
CCyB rate:
1.50%

Signs of mortgage market recovery remain tentative

The volume of new mortgage lending in the third quarter of 2024 remained similar to the level in the previous quarter, which, however, represented a slight increase compared with 2023. Signs of recovery were also observed in the October data, although mortgage growth remains below the levels reached before the upturn in interest rates. The growth is seen primarily in the increase in the average size of new mortgages, which is in line with housing market developments. The number of mortgages originated in the third quarter was the same as in second quarter, but it was slightly higher compared with 2023. Since reaching a low in July (2.9%), the annual growth in new mortgage lending has accelerated moderately (up to 3.4% in October). This trend aligns with the evolution of mortgage rates, which peaked in July (at 4.6%) and have since declined slightly (to 4.3% in October). The turnaround in the interest rate trend has been reflected in a shortening of the average interest rate fixation period. Approximately 80% of new mortgages have a rate fixed for three to four years, while the proportion with a rate fixed for five years or more has fallen sharply. Compared with other EU countries, Slovakia is at the median for mortgage growth, while among central and eastern European countries, it has the second-lowest rate.

Chart 1 New mortgage lending accelerated slightly

New mortgage debt (EUR billions)

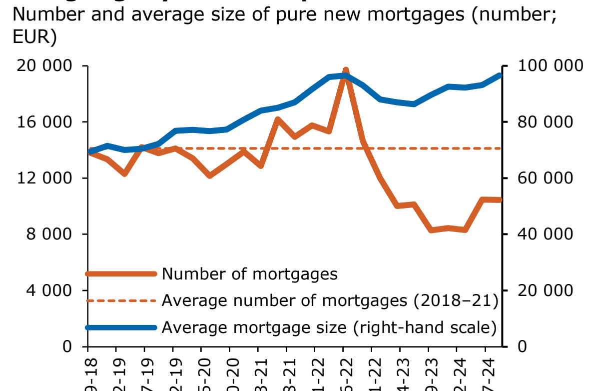


Source: NBS

Note: The figure for October 2024 (marked in grey) is estimated.

Chart 2 Number and average size of mortgages rising slightly in recent quarters

Number and average size of pure new mortgages (number; EUR)



Source: NBS

The situation in the consumer credit market remains stable. Annual credit growth is still running at 8%, while the average consumer credit interest rate remains steady (at 9.8%).

Neither the mortgage portfolio nor consumer credit portfolio has deteriorated in terms of credit quality.

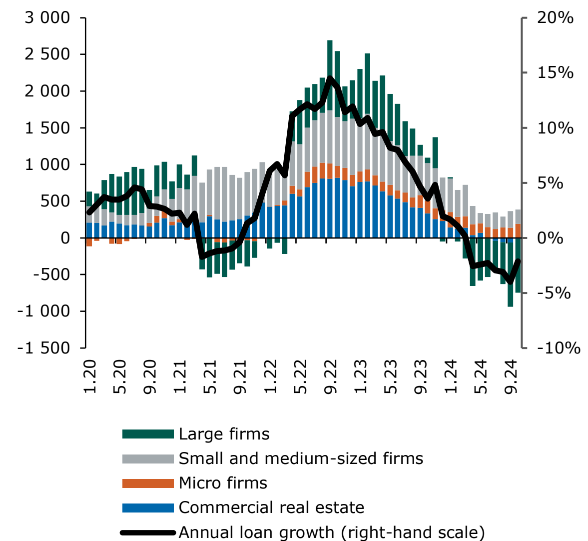
Corporate lending is lower year-on-year but showing signs of stabilisation

The flow of loans to non-financial corporations (NFCs) turned positive in the third quarter of 2024. After a series of negative quarters, the NFC portfolio thus increased in the third quarter. Nevertheless, the positive flow was below the average for recent years. Annual growth in NFC loans remained in negative territory due in part to a high comparison base. October saw a further improvement, with the flow of loans reaching the recent years' average and the negative annual growth rate moderating to -2.12% (from -3.99% in September). In terms of NFC loan growth, however, Slovakia remains below most other EU countries.[1]

Sluggish economic activity is curbing firms' appetite for borrowing. Total corporate revenues for the first nine months of 2024 were slightly lower compared with the same period in 2023.[2] Overall activity growth was primarily driven by services, while activity in the industry, construction and trade sectors did not have a significant impact. The Economic Sentiment Indicator is also pointing to uncertainty, with sentiment deteriorating among both managers[3] and consumers.[4] The uncertain economic outlook and still relatively elevated interest rates are the main factors preventing stronger credit growth. The average interest rate on outstanding NFC loans has so far decreased

Chart 3 NFC loan growth stabilises

Contributions to annual growth in total NFC loans by type of firm, and annual growth in total NFC loans (EUR billions; percentages)



Source: NBS, and Register of Bank Loans and Guarantees (RBUZ).

1 Slovakia ranks in the first quartile of both EU countries and central and eastern European countries.

2 Cumulative revenues for the first nine months declined by 0.6 pp.

3 Firms are reporting declining demand, reflected in rising stocks of finished products and falling production expectations.

4 Consumer confidence declined sharply in October, registering its worst level in 15 months, and fell slightly further in November. The deterioration was broad-based across all the indicator components, while being most pronounced in expectations about the general economic situation and in unemployment expectations.

only slightly[5] and remains a limiting factor on the demand side.[6] For their part, banks are not restricting the supply of loans to any significant extent.[7]

Corporate loan growth in the third quarter was strongest in the micro enterprise portfolio, with its trend becoming more heterogeneous across larger firm categories. The flow of loans to micro enterprises[8] is near historical highs, while also being relatively stable over time. Lending to small firms[9] accelerated in the third quarter, while lending to medium-sized firms moderated. In October, lending to large firms[10] contributed positively to overall NFC loan growth.

Lending to the commercial real estate (CRE) sector remains subdued. A major factor weighing on this segment of the NFC portfolio is a downturn in investment activity. With a lack of borrowing for new investment projects, the volume of loans being repaid is greater than the volume being taken out, resulting in a moderately declining portfolio of project finance loans.[11]

Housing market also showing signs of recovery

After two years of downward correction, housing prices have gradually started rising again. Between the end of the first quarter of 2024 and the end of October, asking prices of flats increased by approximately 6%, reaching levels not seen since the start of 2023. The housing price growth since the first quarter has been broad-based, occurring in all Slovak regions and across all size categories of flats. Prices of houses have also risen, albeit more moderately.[12]

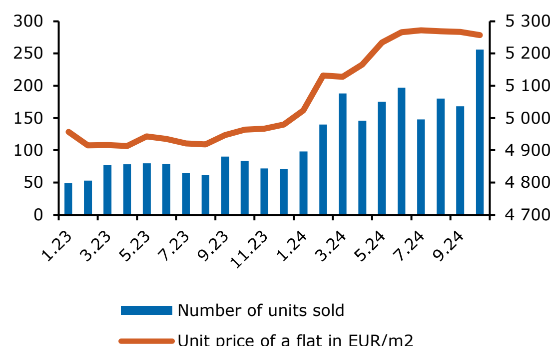
Housing prices are starting to rise because of strengthening demand. Their growth is also supported by the mortgage market's modest revival this year. On the other hand, the number of flats on the market has not changed significantly for approximately one year.

Changes can also be seen in the new-build market in the Slovak capital Bratislava. While asking prices of new-build flats have remained largely unchanged since the summer, the number of new flats sold in October 2024 was three times higher year-on-year. Even so, sales are still lower compared with the period before the upturn in interest rates. As regards the supply of flats, the number of flats under construction in the third quarter of 2024 was only slightly lower[13] than a year earlier. However, the number of construction starts declined more significantly, with the number of building permits issued for apartment buildings falling by more than 22% year-on-year.

Housing affordability is improving only very gradually and remains at low levels. The positive impact of real wage growth and a slight drop in interest rates has been largely cancelled out by rising housing prices.

Chart 4 While prices of new-build flats in Bratislava have remained largely unchanged, their sales velocity increased in October

Number of flats sold and the average price of a flat (number of units; EUR/m^2)



Source: NBS, and United Classifieds

5 Compared with its peak of April 2024, the average interest rate on outstanding NFC loans was 30 basis points lower as at October 2024.

6 Other significant factors on the demand side are weak demand for financing for fixed investment and a decline in demand for working capital financing, which are related to subdued revenues and the uncertain economic outlook.

7 Banks have not tightened credit standards, nor have they appeared to restrict lending to higher-risk firms to any significant extent.

8 Growth in loans to micro enterprises remained strong in October, with the portfolio's annual growth rate standing at 5.4%.

9 The flow of loans to small firms was negative in October.

10 The flow of loans to large firms was positive in October, after generally being negative during the previous 12 months.

11 While the portfolio's year-on-year change is negative, it is not lower than –1%.

12 Compared with the first quarter of 2024, their prices increased by 3.7%.

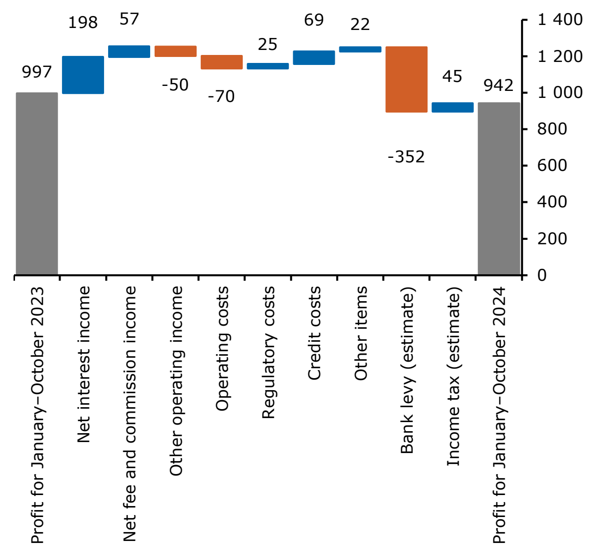
13 Compared with the third quarter of 2023, it was 3% lower, while compared with the pre-pandemic period 2015–19, it was 6% higher (source: Statistical Office of the Slovak Republic).

Slovak banks still in good shape

The profitability of the Slovak banking sector as at October 2024 was still slightly lower compared with the previous year. The sector's aggregate profit for the first ten months amounted to €942 million, representing a year-on-year decline of 6%. The pre-tax profit increased significantly,[14] primarily due to growth in net interest income (+11 %) and net fee and commission income (+9%). However, their momentum is gradually slowing, except in respect of interest income from the retail segment.[15] Another significant factor behind the gross profit growth was a year-on-year decrease in net provisioning (-42%).

Chart 5 Bank levy impact mitigated by strengthening of traditional pillars of profitability

The banking sector's net after-tax profit and contributions to the profit's year-on-year change (EUR millions)



Source: NBS

Note: The decomposition of the tax liabilities into the bank levy and income tax is based on a weighted average of the effective bank levy rate of selected banks as at September 2024.

Non-performing loan (NPL) ratios remain low. The volume of non-performing loans has remained stable in 2024, as has the provisioning coverage ratio.[16] A slight deterioration has been observed in the Stage 2 loan portfolio, which in September and October 2024 increased by a total of €0.5 billion.[17] From a financial stability perspective, however, this increase does not represent a significant risk, since the it followed several months of substantial declines and affected only a few banks.

Banks in Slovakia remain well capitalised. As at the end of September 2024, the banking sector's total capital ratio on a consolidated basis stood at 20.3% and its leverage ratio reached 8.1%. The slight decrease in capital ratios[18] stemmed mainly from a decline in capital volume, which, however, was accompanied by a decline in risk-weighted assets.[19] The management buffer contracted more notably, with microprudential capital buffers increasing as a corollary.[20] The banking sector's capital headroom, after accounting for the minimum requirement for own funds and eligible liabilities (MREL), increased moderately, to 3.5% of risk-weighted assets.

The banking sector continues to have a robust liquidity position. The structural net stable funding ratio (NSFR) continued to be above its long-run average in the third quarter of 2024, despite declining slightly over the previous quarter.[21] The liquidity coverage ratio (LCR) also remains above its historical average. Despite declining significantly in September 2024, the LCR rebounded in October back to its normal level for this year.[22] The sector's overall liquidity position has strengthened since the end of the first half of 2024, largely because growth in stable sources of funding, specifically deposits and bond issuances, has been stronger than loan growth. This has contributed to the ongoing slow decline in the ratio of loans to deposit and bond liabilities.[23] Towards the end of the year, the liquidity position could be bolstered by inflows of deposits, especially retail deposits, which is typical for the banking sector in the latter part of the calendar year.[24]

Compared with banking sectors in other EU countries, the domestic sector is slightly underperforming. The second quarter of 2024 saw the capital adequacy and liquidity position of Slovak banks draw closer to the respective EU medians.[25] Nevertheless, the gap in profitability as measured by return on equity (ROE) became wider again, after narrowing slightly in the first quarter.[26]

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14 The pre-tax profit increased by 20% year-on-year, to €1.53 billion.

15 The quarterly contribution of the retail segment to net interest income increased by 16% over the previous quarter, while the contributions of other segments either declined or recorded a marginal increase. For the purpose of this report, the retail sector comprises households, sole traders and non-profit institutions serving mostly households.

16 The volume of non-performing loans has remained virtually unchanged this year, at €1.7 billion. The NPL ratio for the overall loan portfolio was 2% as at October 2024. The provisioning coverage ratio has remained steady in 2024 at between 58% and 60%.

17 The volume of Stage 2 loans stood at €8.1 billion in October 2024 (up from €7.6 billion in July). As at October 2024, Stage 2 loans constituted 9.8% of the overall loan portfolio (up from 9.3% in July) and the provisioning ratio for the Stage 2 portfolio stood at 5.3% (down from 5.5% in July).

18 The total capital ratio declined by 0.2 pp quarter-on-quarter, and the leverage ratio declined by 0.05 pp.

19 The capital volume fell by €128 million quarter-on-quarter, primarily due to one bank's payment of an extraordinary dividend. Risk-weighted assets decreased by €285 million. The largest changes were in the corporate exposure classes, where the volume of exposures fell by €415 million, owing mainly to an almost 3 pp decline in the average risk weight at banks using the internal ratings-based approach.

20 The available management buffer decreased by 0.4 pp, to stand at 4% of risk-weighted assets as at September 2024. Microprudential buffers in the form of the Pillar 2 requirement (P2R) and the Pillar 2 guidance (P2G) increased by 0.2 pp quarter-on-quarter, to 2.9% of risk-weighted assets.

21 The NSFR amounted to 132% as at September 2024, down by 2 pp from its level in June.

22 Compared with June 2024, the LCR was 25 pp lower as at September 2024, at 178%, while in October it returned to 194%.

23 The volume of banks' deposit liabilities and bond liabilities increased between June and October 2024 by, respectively, €0.4 billion and €1 billion. while the outstanding amount of bank loans increased by €1.2 billion over the same period. The ratio of loans to deposit and bond liabilities rose by 0.2 pp over that period, to 88.2%. However, the narrower loan-to-deposit ratio increased by 0.9 pp, to 103.8%.

24 Since 2005, there have been 11 years where the highest inflow of deposits occurred in the last quarter, and in the case of retail deposits, as many as 15 years.

25 For banks in the EU, the median total capital ratio was 20.6% as at June 2024, while for banks in Slovakia it stood at 20.4%. For the LCR, the corresponding figures were 205% and 203%, and for the NSFR, 137% and 134%.

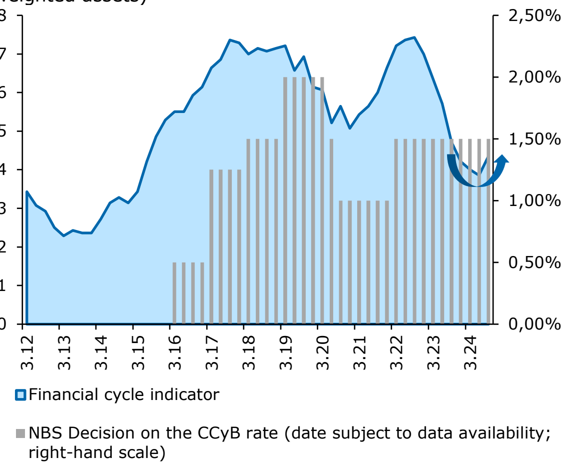
26 The median ROE for banks in the EU declined sharply in the first quarter of 2024, primarily because the capital increase was unusually concentrated in one quarter, instead of being spread over the first half of the year. In the case of Slovakia, the ROE decline was due mainly to the introduction of the bank levy. For banks in the EU, the median ROE as at June 2024 was 14.1%, while for banks in Slovakia it stood at 10%.

Financial cycle no longer contracting

After two years of continuous decline, NBS's indicator of the financial cycle has increased. This means that financial sector trends that would have a downward impact on the indicator are no longer prevailing. However, the upturn is only gradual and is still not present in all segments. Lending to households is accelerating gradually, with consumer credit maintaining steady growth and mortgage lending gaining momentum. At the same time, housing prices are starting slowly to rise. Non-performing loan ratios remain low, and improved economic sentiment has also contributed moderately to the rise in the financial cycle indicator. On the other hand, the corporate loan portfolio continues to record a year-on-year decline. Nor is macroeconomic growth yet adding any significant impetus to the financial cycle upturn. No new risks related to cyclical trends in the credit and financial markets are currently being generated. In the financial sector, however, there remain several risks accumulated during the previous expansionary period.

Chart 6 Slight upturn in the financial cycle for the first time in two years

(financial cycle indicator – index; percentages of risk-weighted assets)



Financial cycle indicator

NBS Decision on the CCyB rate (date subject to data availability; right-hand scale)

Source: NBS

Note: Higher financial cyclical indicator values imply a strong build-up of imbalances.

Going forward, the financial cycle uptrends are expected to continue. Nevertheless, the cycle's recovery should remain moderate, and it will be some time before it is broad-based across all segments. The anticipated gradual easing of the restrictive monetary policy stance could provide impetus for continued recovery of the financial cycle. On the other hand, the outlook for moderate growth implies that the cycle will not overheat.

The countercyclical capital buffer rate does not need to be adjusted for now. Banks have sufficient capital space to maintain lending to the economy and are not constrained by any regulatory requirements. Non-performing loans ratios remain low. Moreover, the subdued financial cycle is not fostering conditions likely to lead to an excessive build-up of cyclical risks.

What´s new in the world of macroprudential policy

Why did Credit Suisse have liquidity problems during the 2023 banking turmoil?

This question was addressed in a report published by the Bank for International Settlements.[27] The report's authors argue that during the 2023 banking turmoil, deposit outflows were particularly widespread in Credit Suisse's international operations, specifically within its wealth management client balances, rather than in domestic business conducted in Swiss francs. Increased prepositioning requirements were imposed on the bank by payment agents, central counterparties and clearing institutions. Moreover, some counterparties also delayed payments to the bank. This, together with the bank's efforts to maintain normal outgoing payments to avoid negative signalling to counterparties, placed the bank in a position where it could no longer cope with deposit outflows. Although the bank had high-quality liquid assets (HQLAs), they were held primarily to meet domestic liquidity requirements and could not be transferred to other activities within the broader group. As other activities, such as global wealth management, experienced higher liquidity outflows, the bank was unable to use these 'trapped' HQLAs to cover the deposit outflows. The report notes that it is important for banks to fully understand the amount of HQLAs that are truly transferable within their group under stress.

How macroprudential measures impact the housing market and economy

This issue was explored in a paper recently published by the Bank of England.[28] The authors developed an extensive macroeconomic agent-based model to simulate the impact on the UK housing market and economy of the following: (i) an increase of total capital requirements; (ii) the introduction of a loan-to-income (LTI) cap on mortgages to owner-occupiers; and (iii) the joint introduction of both policy measures at the same time. Their results suggest that tightening capital requirements leads to a sharp decrease in mortgage and commercial real estate lending, and housing transactions. The house price-to-income ratio remains largely unchanged after the capital requirement increase, but when the LTI cap is in place, house prices fall sharply relative to income, and the homeownership rate decreases. When both policy instruments are combined, housing transactions and prices drop. Both policies have a positive impact on real GDP and unemployment due to a shift of resources from the housing sector to the goods-producing sector. There is no material impact on inflation and the real interest rate.

The financial stability impact of the introduction of central bank digital currencies (CBDCs)

The question of what changes and effects the introduction of CBDCs may have on financial stability was examined in a paper recently published by the IMF.[29] According to the authors, the extent of the impact depends on the size of the CBDC issuance, the initial conditions of the issuance, and the reactions of the banking sector and the central bank. The authors note that adverse effects become larger when the replacement of deposits is greater, commercial banks do not hold excess central bank reserves, and central banks are not willing to increase the supply of reserves beyond existing collateral requirements. The risk becomes particularly pronounced during stress times when there can be increasing conversion of deposits into CBDCs, because the latter are seen as a 'safe haven' asset. However, this can be mitigated by implementing limits designed to encourage the use of the CBDC as a means of payment, rather than as a store of value. Adverse effects on financial stability can arise mostly in scenarios where the central bank balance sheet expands significantly from the CBDC issuance, and commercial banks increase more costly or more volatile funding to help generate additional reserves. While macroprudential policy can increase banks' resilience, it cannot provide much relief if the CBDC puts pressure on bank liquidity or disrupts credit intermediation. Financial stability concerns arising from a greater role of non-bank financial institutions (NBFIs) in banks' funding underscore the need to make progress in their macroprudential regulation.

The December 2024 Macroprudential Commentary was discussed by the NBS Bank Board on 16 December 2024. The publication has not been copy-edited. Reproduction is permitted provided that the source is acknowledged.

[27] *The 2023 banking turmoil and liquidity risk: a progress report*, A report to G20 Finance Ministers and Central Bank Governors, Basel Committee on Banking Supervision, October 2024.

[28] Bardoscia, M., Carro, A., Hinterschweiger, M., Napoletano, M., Popoyan, L., Roventini, A. and Uluc, A., "The impact of prudential regulations on the UK housing market and economy: insights from an agent-based model", Staff Working Papers, No 1,066, Bank of England, March 2024.

[29] Bouis, R., Gelos, G., Miettinen, P., Nakamura, F., Nier, E. and Soderberg, G., "Central Bank Digital Currencies and Financial Stability: Balance Sheet Analysis and Policy Choices", *IMF Working Papers*, No 2024/226, International Monetary Fund, Washington DC, October 2024.