Macroprudential Commentary

September 2024

NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Summary

- After one and a half years of stable development, the mortgage market is showing signs of picking up, with a slight increase in new mortgage lending. Consumer credit continues to grow, while retail interest rates have remained largely unchanged.
- Lending to non-financial corporations remains lower year-on-year, though it has stopped declining in recent months on the back of a recovery in lending to smaller firms. Lending to the commercial real estate sector continues to be subdued. Overall, non-performing loan ratios remain at historically low levels.
- Average asking prices for flats have increased slightly, and the situation is similar in the new-build segment. Housing supply remains constrained, and housing affordability is improving only gradually.
- Bank profitability is still high, though earnings have been dented by the bank levy. Banks' solvency has increased slightly.
- The financial cycle is nearing its low point, with signs of recovery now evident in certain segments. At present, no component of the financial cycle indicator is having any significant downward impact. The countercyclical capital buffer (CCyB) rate remains unchanged.

Also in this edition:

No change in the CCyB rate

The financial cycle is no longer contracting significantly. After a year and a half of a strong downward trend, the financial cycle has stabilised. The economy and property market are showing moderate growth. As for new mortgage lending, signs of recovery have appeared. While lending to non-financial corporations (NFCs) is still lower in year-on-year terms, it has been picking up in certain segments in recent months. Although lending rates are no longer rising, their elevated level continues to dampen loan demand. The private sector debt-to-GDP ratio is falling, though the rate of decline is now moderating. Current financial cycle developments are therefore not creating increased risks of excessive growth.

The good news is that the financial cycle's deceleration has been gradual and smooth, without significant changes or downturns. Non-performing loan ratios remain low, and banks are not having to increase their loan loss provisioning rates. The banking sector's net provisioning in the first six months of 2024 was lower than the average level for the previous ten years. On the other hand, the most recent stress test results confirm that financial cycle–related risks, as well as risks related to CRE lending, remain accumulated in banks' loan portfolios. In this light, it is appropriate to keep the countercyclical capital buffer rate at its current level.

Expectations for the CCyB rate in the next quarter

Národná banka Slovenska (NBS) does not foresee an adjustment to the countercyclical capital buffer rate in the next quarter.

According to the current outlook, the financial cycle should gradually turn upwards in the period ahead. However, the recovery is expected to be moderate and should not necessitate an increase in the CCyB rate..

On the other hand, risks previously accumulated in banks' portfolios will dissipate only gradually. Hence, for now, it is deemed prudent not to release the countercyclical capital buffer. This stance is in accord with recommendations of international institutions[1].

CCyB rate:
1.50 %

[1] ECB, Governing Council Statement; IMF, Global Financial Stability Report, April 2024, page 43; ESRB, Press release from the 53rd regular meeting of the General Board of the European Systemic Risk Board, March 2024.

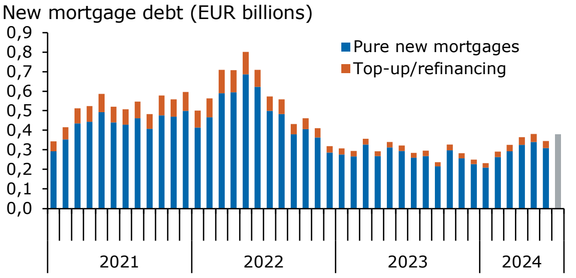
Mortgage market showing signs of recovery

After a period of stabilisation, new mortgage lending increased moderately in the second quarter of 2024. This was seen mainly in a higher number of mortgage originations – their first increase since the start of monetary policy tightening in 2022 – across all banks in the market.[2] Even so, new mortgage lending in the second quarter of 2024 was still 30% below its long-term average. There was virtually no change in either the structure of new mortgages or the credit standards on them. In terms of mortgage growth, Slovakia is at the median among EU countries, while among central and eastern European EU countries, it is actually the second lowest.

Banks have been lowering mortgage rates, but only very cautiously. The average interest rate on mortgages originated between March and July 2024 was 4.6%, with rate declines limited to hundredths of a percent.[3] A partial change in this trend may only be expected from August 2024[4], when several banks – small and large – announced plans to lower rates. In the vast majority of euro area countries, mortgage rates started falling in late 2023/early 2023.

Chart 1 Despite rising slightly, new mortgage lending still lower than before interest rate upturn

New mortgage debt (EUR billions)

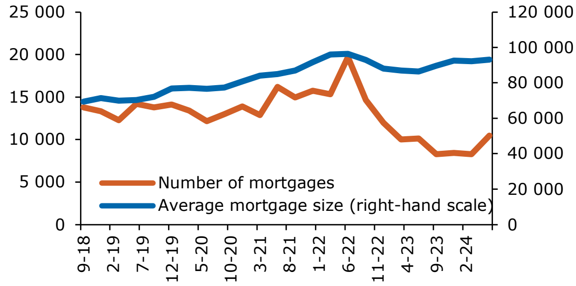


Source: NBS

Note: The value for July 2024 is estimated.

Chart 2 New mortgage lending grew due mainly to higher number of loan originations

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



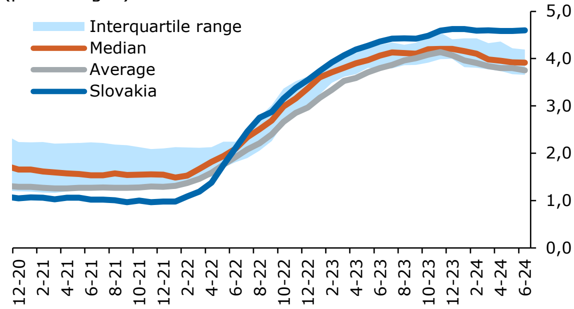
Source: NBS

Annual growth in consumer credit remains steady at around 8%,[5] therefore still above the EU median. Average interest rates on consumer credit remain just above 10.0%, maintaining their long-term position in the upper quartile of the dataset for euro area countries.

Mortgage default ratios reached historical lows in the second half of 2023. Although signs of slight deterioration appeared in the first half of 2024, mortgage lending in Slovakia is still experiencing its most favourable ever period.[6] Likewise, the overall non-performing loan (NPL) ratio for consumer credit remains close to its all-time low.[7]

Chart 3 Downturn in mortgage rates is slower in Slovakia than in other euro area countries

Average interest rate on pure new mortgages in the euro area (percentages)



Source: NBS

Transition to higher mortgage payments proceeding without major repayment problems[8]

This transition is proceeding gradually; by mid-2024 around a quarter of all mortgages had been fully repriced to higher interest rate levels. Mortgage payments went up by an average of €89, consistent with our previous expectations.

Most borrowers whose mortgages became more expensive have managed to keep up their payments without difficulty. There has been an increase in mortgage prepayments, and the uptake of mortgage top-ups has declined. These changes, however, concern only a relatively small proportion of mortgages. On the positive side, borrowers are generally coping with payment increases without having to extend their loan maturity.

The increase in mortgage payments has not so far resulted in significant repayment difficulties. So long as there is no deterioration in economic growth (particularly in the labour market situation), we do not expect this situation to worsen notably going forward. The impact of higher interest rates may also be partially mitigated by the new government subsidy towards the cost of higher mortgage payments. As of 31 July 2024, a total of 11,754 mortgage borrowers were receiving this subsidy, with their loans accounting for less than 7% of the mortgages repriced to higher interest rates**.**

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[2] In the period before the upturn in mortgage rates (for the purposes of this analysis from Q3 2018 to Q1 2022), the number of pure new mortgage originations per quarter averaged almost 14,000. From then until Q1 2024, their number dropped to around 60% of that average, while in Q2 2024 it increased to 75%. If that level were maintained for a period of four quarters, the annual growth rate for mortgages would increase by around 1.5 pp.

[3] Interest rate fixation periods of up to three years are particularly popular. When rates were rising, the strongest demand was for fixation periods of five years or longer.

[4] At the time of writing this analysis, data for August 2024 were not yet available.

[5] In July 2024 it was 8.4%, and from January to July it ranged between 7.6% and 8.4%.

[6] The NPL ratio for mortgages remains close to 1.1%, with changes at the level of mere hundredths of a percent. The ratio is half of its level in the pre–global financial crisis period (2006–2008) and less than one-third of its level in the post-crisis period (2010–2014). From 2014 to 2023 the ratio was falling almost continuously.

[7] Podiel zlyhaných spotrebiteľských úverov sa s volatilitou udržuje okolo 7,0 %.

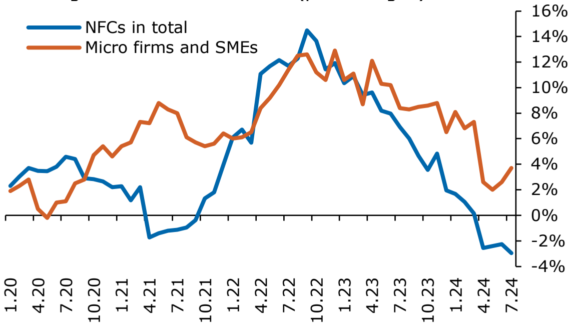
[8] This topic is examined more closely in NBS Discussion Note No 140, 'Vyššie splátky hypoték zatiaľ nespôsobujú výraznejšie problémy' (in Slovak only).

Corporate loan portfolio no longer contracting

Corporate revenues for the first half of 2024 were slightly weaker compared with the same period last year.[9] There were volatile developments in the industry sector, driven primarily by the automotive industry.[10] Revenues declined in the construction and wholesale trade sectors, while retail trade and selected market services performed relatively favourably.

Annual growth in loans to non-financial corporations (NFCs) remains in negative territory. The total volume of NFC loans in July 2024 was 3% lower than in the same month of the previous year. In terms of annual growth in NFC loans, Slovakia ranks in the bottom quartile among both EU countries and CEE countries. The negative year-on-year rate of change is, however, due largely to the weakening of lending in the period before April 2024.

Chart 4 Moderate rise in lending to micro, small and medium-sized enterprises
Annual growth in loans to NFCs (percentages)



Source: NBS

Note: SMEs – small and medium-sized enterprises.

Since April 2024, the corporate loan portfolio has been stable, owing mainly to a modest recovery in lending to smaller firms. The increases in lending to this segment in June and July even exceeded the long-term average.[11] A pick-up in lending to smaller firms has been seen in most of the significant economic sectors.[12] By contrast, lending to large firms and the commercial real estate (CRE) sector has continued to decline, reflecting weaker demand from firms.

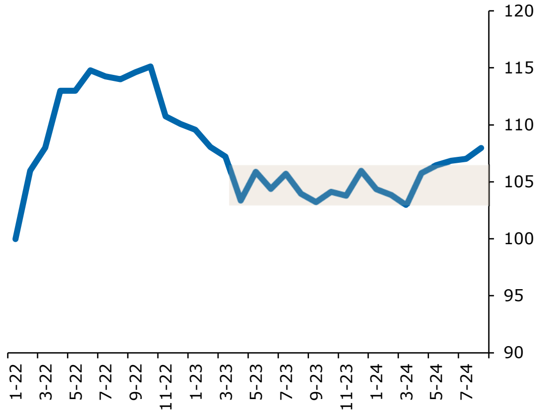
Slight upturn in prices of flats

After being stable for around a year, prices of flats have started to rise somewhat in recent months, in line with the mortgage market's nascent recovery. Although the average asking price for a flat has increased slightly, it remains more than 6% below its level of summer 2022, when housing prices in Slovakia peaked.

The moderate upturn in prices of flats is linked with changes in the composition of housing supply. As lower-priced flats have been selling more quickly, higher-priced flats now make up a larger share of the market, resulting in a higher average asking price.

In almost all Slovak regions, prices of flats were slightly higher in August 2024 than in March 2024. The situation was similar across all property size categories and for houses. It is still too soon, however, to speak about the emergence of a new trend.

Chart 5 Slight increase in the average asking price for a flat
(index: January 2022 = 100)



Sources: NBS, United Classifieds

Note: The brown shaded area shows the extent to which to the average asking price for a flat has fluctuated over the past year.

A similar development has been seen in the new-build market. But although the average price of a new-build flat as at August 2024 was higher year-on-year, this was primarily due to the rising prices of flats in high-end property developments. Prices of other new-builds in Bratislava, have not increased significantly over the past year. The number of sales of new flats has remained subdued in 2024.

Although housing affordability in Bratislava has improved from its low point at the end of 2022, it remains subdued and far below its pre-pandemic level. In the last quarter, the positive impact of growth in household real wages was partially offset by the increase in average prices for flats.

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[9] Cumulative revenues for the first six months fell by 3% at current prices (by 0.5% at constant prices).

[10] Industry saw revenues decline throughout the first quarter. They returned to growth in April and May, before falling again in June. July's industrial production growth (5.4%) indicates that revenues will rise at the start of the second half of the year.

[11] The average for the last four years.

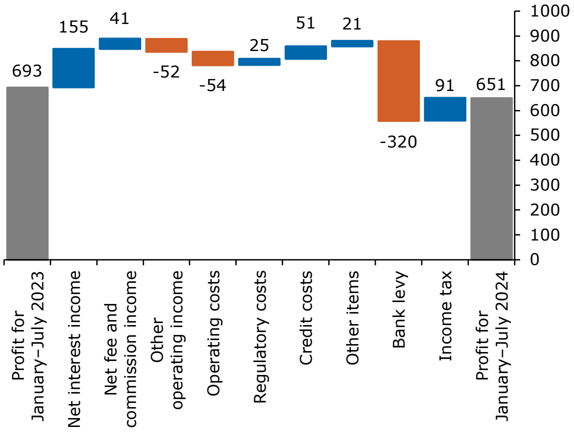
[12] In almost all significant economic sectors, month-on-month loan growth was above or close to its long-term average.

Slovak banks' resilience remains high

Since May 2024, the profitability of banks in Slovakia has started to fall below last year's performance. The banking sector's aggregate profit for the first seven months of 2024 was €651 million, representing a year-on-year decline of 6%. The main cause of the drop is the tax burden on banks, which has risen by 120% following the introduction of the 'bank levy'. The levy's impact could not be fully offset by an 8% increase in income from financial activities[13] and a 4% reduction in banks' costs[14].

Chart 6 Year-on-year drop in bank profits accounted for by bank levy

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



Source: NBS

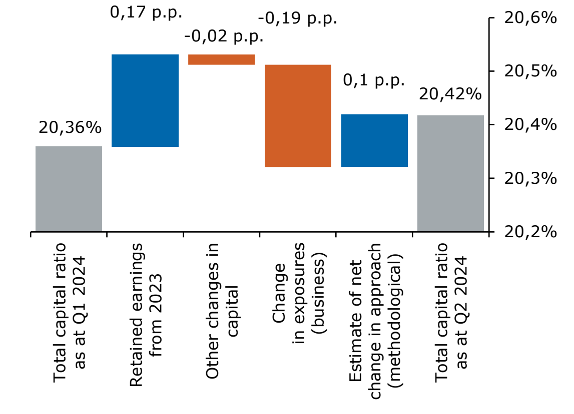
The retail[15] segment returned to being the largest contributor to banks' net interest income. When interest rates were rising, the corporate segment was the driver of interest income, owing to shorter interest rate fixations. After the monetary policy cycle turned, however, momentum shifted to the retail segment. In due course, cohorts of mortgages repriced from low-yielding levels and a slow upturn in mortgage originations have seen the retail segment's quarterly contribution to net interest income rise above the corporate segment's for the first time in a year.[16]

Credit quality developments have not deviated from their recent trends. The volume of impaired loans declined by more than one-fifth from September 2023 to July 2024. With the volume of non-performing loans remaining stable, the decline was accounted for entirely by the portfolio of Stage 2 loans, which contracted by almost a quarter in this short period.[17] A positive development is the gradual increase in the provisioning ratio. For Stage 2 loans, the ratio is rising because the volume of loans is falling faster than provisions, while for Stage 3 (non-performing) loans, the reason is an increase in provisioning.

The banking sector's resilience is supported by increasing capital ratios. On a consolidated basis, the sector's total capital ratio reached 20.4% as at June 2024, up by more than 0.1 pp quarter-on-quarter, and its leverage ratio stood at 8.1%, up by 0.3 pp. The total capital ratio is close to historical highs. These increases were largely driven by less significant banks' retained earnings from 2023.[18] Another notable change was one bank's switch from an internal rating-based approach to the standardised approach for the purpose of determining its regulatory capital requirement for credit risk. This move entailed significant capital replenishment given the greater capital burden of the simpler approach. Banks' overall capital headroom increased to an all-time high of 3.6% of risk-weighted assets or €1.6 billion.[19]

Chart 7 Total capital ratio developments reflected mainly methodological changes

Decomposition of the year-on-year change in the total capital ratio (percentage points)



Source: NBS

Note: 'Estimate of net change in approach' takes into account banks' capital replenishment.

The liquidity position of the Slovak banking sector did not change significantly over the second quarter.[20] However, developments in balance sheet items helped further strengthen stable funding. The ongoing decelerating

13 Net interest income increased by 12% year-on-year, though its growth rate was one-third lower compared with the first quarter of 2024 and more than half as much as in the last quarter of 2023. Fee and commission income rose by 9% year-on-year, maintaining the growth rate seen in first quarter of 2024.

14 Regulatory costs fell by 60% year-on-year, largely because of the resolution fund having been filled. The volume of provisioning is half of its 2023 level. Administrative costs recorded stable growth (6%), stemming mainly from increases in IT costs (12%) and wages (7%).

15 For the purpose of this analysis, the retail sector comprises households, sole traders and non-profit institutions serving mostly households.

16 The retail segment's contribution in the second quarter amounted to €265 million, while the corporate segment's contribution stood at €250 million. The retail contribution's share was steady at around 42% from the end of the second quarter of 2023, while the corporate contribution's share declined gradually, from 48% to 41%. The share of other segments increased from 10% to 16%.

17 The volume of non-performing loans stood at €1.7 billion from September, but owing to growth in the overall portfolio, their share edged down from 2.1% to 2%. The volume of Stage 2 loans fell over the given period, from €10 billion to €7.6 billion, with their share of total loans dropping from 12.3% to 9.3%.

18 The overall retention rate for 2023 earnings reached 46%, which was 3 pp above the average for the previous three years.

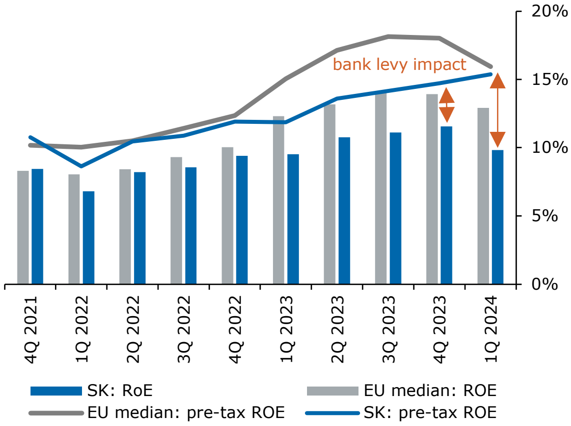
19 In quarter-on-quarter terms, it increased by 0.7 pp or €370 million. This indicator reflects the consolidated position of the banking sector and takes into account capital, leverage and MREL requirements (MREL being the minimum requirement for own funds and eligible liabilities).

20 The sector's net stable funding ratio (NSFR) was 134% as at June 2024, and its liquidity coverage ratio amounted to 196% as at July 2024. Both ratios have maintained stable movement within a very narrow range sinke the end of 2023.

of loan growth coupled with stable and higher growth rates for deposits resulted in the aggregate loan-to-deposit ratio falling to below 103%.[21] Nevertheless, the level of this ratio in Slovakia remains, as it has long been, one of the highest in the euro area.[22]

When the first-quarter performance of banks in Slovakia and banks across the EU are compared, the picture is as expected. The return on equity (ROE) of domestic banks declined sharply following the introduction of the bank levy, falling further below the EU median.[23] Looking, however, at the pre-tax return on equity, domestic banks improved their position significantly, almost reaching the EU median. In terms of their total capital ratio[24] and liquidity ratios,[25] banks in Slovakia continue to rank near EU median levels.

Chart 8 Profitability convergence slowed by bank levy's introduction
Impact of tax burden on return on equity (percentage points)

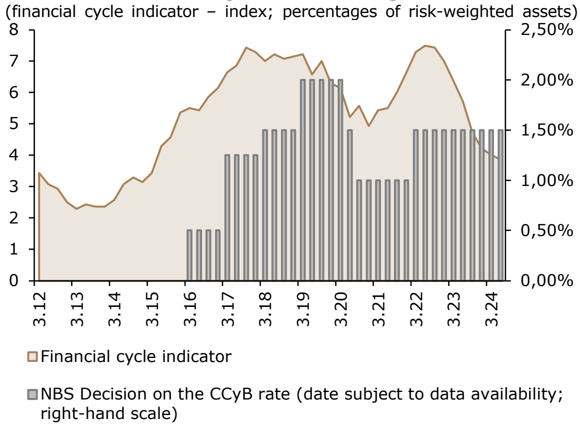


No significant change in the financial cycle

The financial cycle did not contract significantly in the second quarter of 2024. The negative annual growth in loans to NFCs continued to have a downward impact on the cycle; however, economic developments and the firming of housing prices contributed to its stabilisation. Although NBS's financial cycle indicator declined slightly, its rate of decrease was marginal. It nevertheless remains relatively low, below the levels seen during the pandemic. This implies no significant build-up of financial cycle–related risks, which is related to the cycle's subdued movement.

The outlook for future developments indicates that the financial cycle should stabilise, or even turn gradually upward, in coming quarters. This is expected to result from a gradual increase in economic growth, an easing of restrictive monetary policy, and the consequent gradual acceleration of loan growth.

Chart 9 Financial cycle stabilising at 2015 levels
(financial cycle indicator – index; percentages of risk-weighted assets)



Source: NBS

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

At present, there remain reasons for keeping the countercyclical capital buffer at its current rate. The subdued financial cycle indicates that the build-up of cycle-related risks is not significant and that no new risks are being added to banks' balance sheets. Although the financial cycle is still in a downturn phase, non-performing loan ratios remain close to historical lows. Banks are therefore not having to step up their loan loss provisioning, which currently does not exceed levels normal for a non-crisis period. At the same time, the volume of loans with increased credit risk (Stage 2 loans) is not rising, which implies that banks do not expect projected developments to result in an increase in loan defaults.

[21] The loan-to-deposit (LTD) ratio has decreased by almost 3 pp since the beginning of the year, down to end-2021 levels. If adjusted to include bond funding, the ratio would stand at 88%, on a par with levels last seen in the first quarter of 2017.

[22] The only euro area countries reporting a higher LTD ratio as at July 2024 were Finland (138%) and France (105%). The median for euro area countries was 80%. In terms of the LTD ratio adjusted to include bond funding, Slovakia ranks highest in the euro area (with the median standing at 71%).

[23] Between the end of 2023 and March 2024, the aggregate ROE of Slovak banks declined by almost 2 pp, to 9.8%, while the EU median dropped by 1 pp to 12.9%.

[24] The aggregate total capital ratio of Slovak banks was 20.4% as at March 2024, just below the EU median of 20.5%.

[25] As regards liquidity ratios for the Slovak banking sector, the liquidity coverage ratio reached 189% in March 2024 and the net stable funding ratio amounted to 132%. The EU median values for these ratios were 207% and 136%, respectively.

What’ s new in the world of macroprudential policy

What is the impact of population ageing on bank stability?

This question is addressed in a paper recently published by the Bank for International Settlements (BIS).[26] By analysing changes in banks' balance sheets across 28 advanced economies over the period 2000–2022, the authors concluded that population ageing has a bifurcated impact on bank stability. On the one hand, where the population is ageing, there is declining demand for new loans, which reduces banks' exposure to maturity transformation risk. Maturity transformation is the main source of income for banks, as they receive deposits (a short-term source of income) and transform them into long-term loans. On the other hand, as credit demand falls, banks may be incentivised to seek riskier investments in order to maintain their income and profitability levels. Hence, banks may increasingly invest in riskier, higher-yielding products or ventures, including in third countries beyond their own jurisdiction, potentially leaving them more highly exposed to tail risks that may only manifest during economic downturns or financial shocks. Policymakers and regulators must therefore turn their attention to ageing-related changes and their repercussions for financial stability, particularly those related to tail risks.

How the Bank Term Funding Program helped banks during the March 2023 banking turmoil

A study published by the US Federal Reserve[27] has examined the effectiveness of the Bank Term Funding Program (BTFP) during the March 2023 banking turmoil in the United States. By analysing bank-level, high-frequency datasets from the US banking sector, including data on banks' assets and liabilities at a weekly frequency, the authors found that banks with higher reliance on uninsured deposits suffered larger deposit outflows. The BTFP played an outsized role in meeting these outflows at banks with larger securities losses (banks at the 90th percentile in securities losses replaced 26 cents of every dollar of outflows with BTFP borrowing, compared to only 7 cents on average). This indicates that the instrument played an important role at a time of financial stress and was used specifically by troubled banks. In addition to funding loan growth and deposit outflows, banks used the BTFP to build cash holdings, indicating that the instrument enabled banks to position themselves against potential future funding needs. Overall, the BTFP enabled banks to meet funding needs and preserve liquidity during the period of stress.

Stablecoins' impact on banks' liquidity and capital ratios

In a recent ECB-published paper[28] on this topic, the author concludes that collecting deposits from stablecoin issuers transforms retail deposits that can serve as a stable source of funding for banks into volatile deposits that cannot. Unlike retail deposits, which are used to finance lending and therefore the broader economy, deposits from stablecoin issuers need to be kept by banks as central bank reserves or reinvested in low-risk assets, meaning that these deposits generally serve as a less efficient source of funding. Even if a bank reinvests all the deposits it collects from stablecoin issuers in high-quality liquid assets, its liquidity coverage ratio (LCR) will always be weakened by the 100% outflow rate that it must apply on these deposits. This is also the case where the bank itself is the issuer of the stablecoins. However, when a credit institution issues its own stablecoins and can identify the holder type, it can apply the appropriate outflow rate for that category, which will generally be beneficial when holders are retail. When retail customers of bank A buy stablecoins issued by a non-bank issuer that keeps reserves in bank B, both banks may see an unexpected decline in their LCR. Even though creating the stablecoins only shifts liquidity between banks without changing the amount of liquidity within the banking sector, bank A sees a reduction in its retail deposits (a stable deposit source) while bank B sees an increase in its wholesale funding (a non-stable source of funding). The fact that banks need to reinvest deposits from stablecoin issuers in low-risk assets to maintain their liquidity targets means that collecting such deposits should have little to no impact on their capital ratio but could weaken their leverage ratio.

The September 2024 Macroprudential Commentary was discussed by the NBS Bank Board on 23 September 2024. The publication has not been copy-edited.

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[26] Imam, P.A. and Schmieder, C., "Aging Gracefully: Steering the Banking Sector through Demographic Shifts", BIS Working Papers, No 1193, Bank for International Settlements, June 2024.

[27] Glancy, D., Ionescu, F., Klee, E., Kotidis, A., Siemer, M. and Zlate, A., 'The 2023 Banking Turmoil and the Bank Term Funding Program', Finance and Economics Discussion Series, No 2024-045, Board of Governors of the Federal Reserve System, Washington DC, June 2024.

[28] Coste, C.E., 'Toss a stablecoin to your banker', Occasional Paper Series, No 353, European Central Bank, Frankfurt am Main, July 2024.