Macroprudential Commentary

March 2024

NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Summary

- Slovakia's financial cycle downswing continued in the last quarter of 2023.
- New mortgage lending has been stable for about a year now, while consumer credit growth has accelerated. Interest rates continue to dampen demand for loans.
- Growth in loans to non-financial corporations (NFCs) has slowed and is now around the EU median.
- With prices of flats not moving significantly for more than half a year, we can say the housing market has stabilised. However, housing affordability remains at subdued levels.
- Banks in Slovakia recorded healthy profits in 2023. Last year's historical results were driven by elevated interest rates, especially for the corporate sector. The banking sector's capital adequacy increased slightly during the year. Customer deposit inflows also improved banks' liquidity ratios. The fact that the special levy on business in regulated sectors has been extended to all entities authorised by NBS (as the so-called bank levy) is not expected to have a direct adverse impact on banks' financial stability.

Also in this edition:

No change in the CCyB rate

With interest rates at elevated levels, private sector demand for loans remains subdued. Growth in loans to firms has slowed, while growth in lending to households has been steady. Although lending is growing, it is not outpacing growth in economic fundamentals such as wages, corporate revenues, and GDP. Weak demand for loans in the private sector has been reflected in the financial cycle downswing, which has now lasted for six quarters. The build-up of risks related to financial cycle developments has slowed. The share of outstanding loans which are close to regulatory lending limits is no longer rising, as it was in the immediate wake of the upturn in interest rates. The share of loans with a debt service-to-income (DSTI) ratio of more than 55% has decreased, and there has been a stabilisation of both the share of loans with a high loan-to-value (LTV) and the share with long maturities, though they remain at high levels. In this environment, there is no need for a further increase in the countercyclical capital buffer (CCyB) rate, nor any need for its reduction. Risks accumulated during the financial cycle's strong expansionary phase remain present in banks' loan portfolios, but non-performing loan ratios are not currently increasing and banks are maintaining their capital strength.

Expectations for the CCyB rate in the next quarter

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

Banks currently have ample room for lending to the economy. And although banks' loan portfolios still harbour risks accumulated over the past decade, these risks are now building up at a much slower pace. Nor do non-performing loan trends indicate any need to increase loan loss provisioning.

In this environment, NBS does not anticipate a situation in the next quarter that would necessitate changing the CCyB rate.

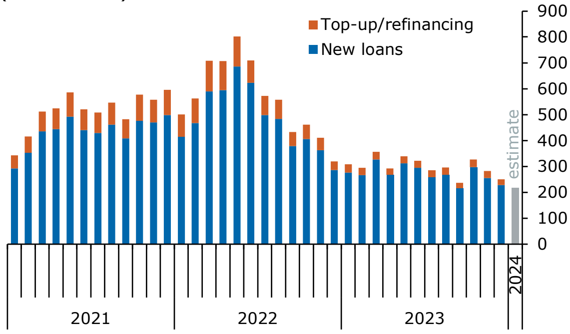
CCyB rate:
1.50%

Mortgage origination remains subdued, while consumer credit is recovering strongly

New mortgage lending has remained stable at around one-third below its 2019–2022 level. The mortgage portfolio's average annual growth rate declined gradually during 2023, down to 3.6%, slightly above the EU median. Looking at ongoing trends in the mortgage market, the current pace of decline in mortgage growth is not expected to continue.

Lower mortgage origination continues to be due mainly to fewer new loans, but their number is no longer falling. For all borrower age categories, the number of new mortgages was slightly higher in the fourth quarter of 2023 than in the third quarter. The average amount of new mortgages rose for a second successive quarter, while remaining below its previous peak.[1]

Chart 1 Demand for mortgages remains stable at lower levels
Pure new mortgages and mortgage top-ups/refinancing (EUR millions)

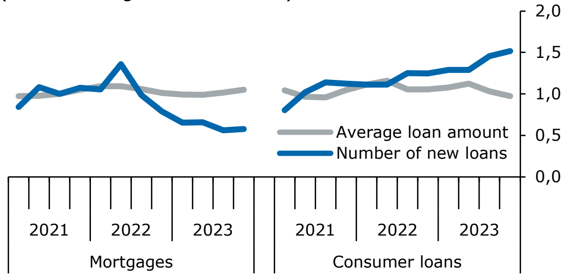


Source: NBS.

While mortgage lending remains subdued, consumer credit growth is accelerating. Consumer credit currently accounts for almost one-third of the growth in the retail portfolio. The annual growth rate of consumer credit reached 7.9% in January 2024, and the average amount of new lending since the start of 2023 has exceeded the pre-pandemic level. In the central and eastern European (CEE) region, however, such growth is not exceptional, and several countries have recorded even faster rates.

In the consumer credit portfolio, it is the number of new loans that is growing most strongly; the average loan size has remained largely unchanged. The increase in the number of new consumer loans is largely due to higher inflation. With prices rising, consumers are opting to make purchases sooner rather than later. Further supporting this trend are consumer income developments. After two years of growing more slowly than expenditure, wages are now growing faster, thus making purchases more affordable. The acceleration of consumer credit growth has been supported by an approximately one-third decline in the uptake of debt consolidation mortgages and, to a lesser extent, by a decrease in the amount of net write-downs and sales of bad loans.[2]

Chart 2 Changes in loan origination stem mainly from changes in the number of new loans
Number and average amount of pure new loans (index: average for 2021 = 1.0)



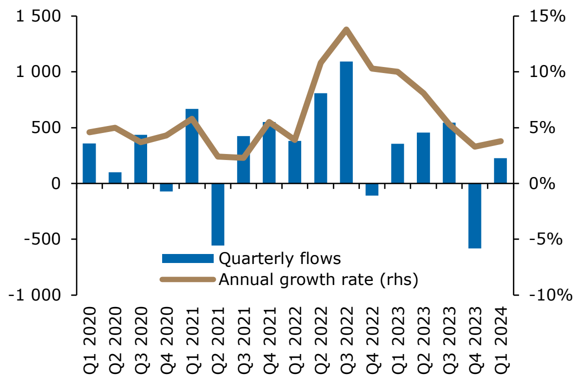
Source: NBS.
Note: The consumer loan data show the three-month moving average.

From a financial stability perspective, it matters that the recovery of consumer lending is not coupled with a deterioration in the credit quality of these loans. Rising interest rates have not so far had a significant upward impact on DSTI ratios, or on the percentage of borrowers that have lower income or fewer savings.

After slowing last year, corporate loan growth is showing signs of stabilising

Softening of demand, both domestic and foreign, continues to weigh on the revenues of non-financial corporations (NFCs). Firms' real revenues (adjusted for inflation) declined throughout 2023, including by 5.5% year-on-year in December and by a cumulative 4.8% over the year as a whole. Revenues were subdued in most economic sectors, including industry, trade and services.

Chart 3 NFC loan growth slowed towards the end of 2023
Quarterly flow of loans to NFCs (EUR millions) and annual rate of change in total NFC loans (percentages)



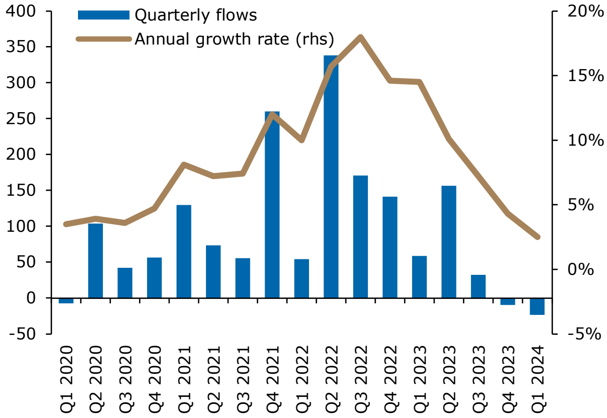
Sources: NBS, and Register of Bank Loans and Guarantees.
Note: The figure for Q1 2024 is an estimated quarterly flow based on the figure for January.

1 The average amount of a mortgage in the fourth quarter of 2023 was 4% below the peak recorded in mid-2022. The average amount of new mortgages is highest among borrowers aged up to 35.
2 A closer look at the factors behind the acceleration of consumer credit growth can be found in NBS Discussion Note No 136, '[Čo stojí za oživením spotrebiteľských Uvarov?]' (in Slovak only).

Firms were taking out fewer loans in the last quarter of 2023. During the last three months of the year, more corporate loans were repaid than were taken out. An uptick in loan repayment towards the year-end is largely normal in respect of firms' financing needs for working capital and occurs at the end of almost every year. Flows into the corporate loan portfolio were, however, already sluggish in October and November, reflecting firms' weaker demand for borrowing. There were year-on-year declines in both the amount of loans repaid and the amount of new borrowing, though the latter fell more sharply than the former. The corporate loan portfolio thus recorded its largest quarterly contraction of the year, resulting in its annual growth rate slowing to 3.3% in December 2023. The flow of NFC loans in January 2024 was above average for that month, and the annual growth rate edged up to 3.8%.

Chart 4 CRE lending also slowed towards the end of 2023

Quarterly flow of loans to CRE firms (EUR millions) and annual rate of change in total CRE loans (percentages)



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

Note: The figure for Q1 2024 is an estimated quarterly flow based on the figure for January.

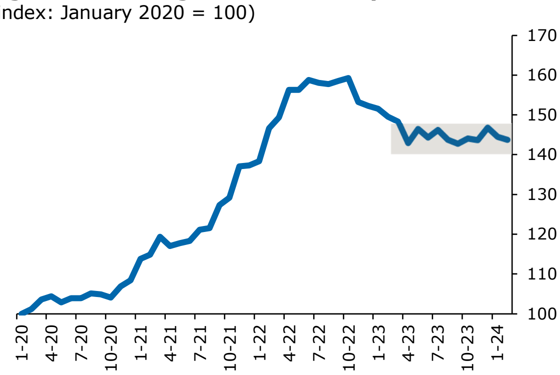
Lending slowed across multiple firm size categories in the fourth quarter of 2023. Lending to large firms accounted for the largest part of the corporate loan portfolio's negative quarterly growth.[3] There was also, however, a significant slowdown in lending to small and medium-sized firms. Growth in loans to micro firms remained strong.[4] In January, lending activity improved across all firm size categories. The economic sector that has seen the most notable credit cycle downturn is commercial real estate (CRE), and lending to the sector continued to slow in early 2024. Lending also remains subdued in the trade, construction, and selected services sectors, while lending to industrial firms has picked up.

Housing prices are no longer in significant decline

The housing market has stabilised in the recent period. Compared with their peak in October 2022, housing prices are, on average, around one-tenth lower; however, the majority of their decline occurred in the second half of 2022, since when they have been falling at a gradually slowing pace.

Chart 5 Average asking price for flats shows no significant change in the recent period

(index: January 2020 = 100)



Sources: United Classifieds, and NBS.

The average asking price for flats in Slovakia has stabilised since the second quarter of last year. Asking prices of flats were, on average, 4% lower in January 2024 than they were a year earlier. This trend is seen across all regions in Slovakia and across flats of all sizes. Prices of older and unrenovated flats have declined to a greater extent, in some segments by almost 20%. Prices of flats in newer apartment blocks have fallen only slightly or remained steady. Housing price stagnation can weaken the grounds for putting off the decision to buy a property. At the same time, housing affordability remains at lower levels and was prevented from improving in the latter part of 2023 by modest increases in interest rates, which cancelled out the positive impact of nominal wage growth.

Sales of new-build flats were already at record low levels in previous quarters and remained so during the period under review. Even so, they have not declined significantly in price, and they are currently in ample supply. Indeed, the number of flats newly issued with an occupancy permit in the fourth quarter of 2023 was the second highest of any quarter to date.[5] The low number of building permit issuances[6] implies a decline in the supply of new flats in the period ahead.

[3] The amount of loans to large firms declined by more than €400 million in the last quarter of 2023, accounting for 60% of the total decline in corporate lending. The annual growth rate of loans to large firms turned negative in December 2023.

[4] Flows of loans to micro firms remained positive in the last three months of 2023, and this portfolio's annual growth rate gradually accelerated, up to 9.5% in December.

[5] A total of 6,870 flats were completed in Slovakia in the fourth quarter of 2023, representing a year-on-year increase of more than 14% and an increase of 13.8% over the average for the four quarters before the pandemic. Most of the new flats were located in Bratislava Region, where their number increased, year-on-year, by 50%. In Košice Region, by contrast, the number of flats for which an occupancy permit was issued in the fourth quarter declined by one-quarter. (Source: Statistical Office of the Slovak Republic.)

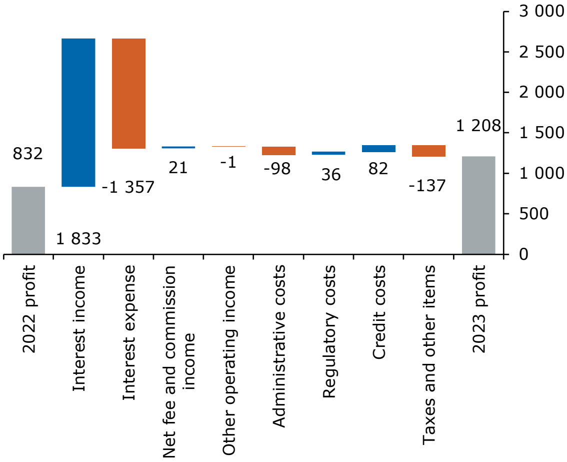
[6] The number of flats for which a building permit was issued in the fourth quarter of 2023 totalled 5,521, which was 12.6% more compared with a year earlier but also 8% fewer compared with the pre-pandemic average. (Source: Statistical Office of the Slovak Republic.)

Banks recorded healthy profits in 2023

Banks in Slovakia reported historically strong profits for 2023. The banking sector's net profit amounted to €1.21 billion, exceeding the previous year's record total by 45%.[7] The result was due entirely to interest income growth, stemming from the ECB's monetary policy tightening coupled with the uptrend in interest rates from mid-2022. The sector's net interest income increased by more than a quarter year-on-year,[8] thanks mainly to growth in returns on the corporate portfolio, as policy rates hikes passed through more quickly to lending rates for firms and than to lending rates for households. Looking at the breakdown of net interest income, interest expenses recorded a higher increase, but their contribution was smaller.[9] The growth in the sector's profit resulted in its corporate income tax rising more than twofold compared with the previous year.

Chart 6 Annual growth in bank profits was driven by higher interest income

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



Source: NBS.

In the profit and loss account, expense item developments were varied. On the one hand, the general increase in prices had an upward impact on operating costs,[10] while, on the other hand, banks reported year-on-year declines in regulatory costs and in provisioning.[11] Regulatory costs are expected to continue declining in subsequent years, given the phased-in fulfilment of target levels for the Resolution Fund and Deposit Protection Fund; by contrast, the decline in provisioning can be seen as an exception. For almost the whole of 2023, cumulative provisioning was higher than in any year since 2016 bar the pandemic year of 2020. The situation changed however, in the last two months of 2023, which saw certain banks start to become more realistic about the riskiness of their portfolios, to sell off and write down non-performing exposures, and to set about the complete reversal of accumulated credit costs, including pandemic-related provisions.

The domestic banking sector's profitability remains low by European standards. Although the return on equity (ROE) of Slovak banks has risen by one-third since the start of monetary policy tightening, the median of the corresponding metric for EU countries has increased by two-thirds over the same period.[12] The gap between Slovakia and the EU median in this regard has been increasing since interest rates started rising, which implies that Slovak banks have been slower to pass on policy rates to customers, in particular to households.[13]

The latter part of 2023 and January 2024 brought no signs of change in domestic banks' profitability trends. In this regard, we continue to observe a gradual increase in the sector's net interest margin,[14] even with both interest income and interest expenses increasing at a slower pace. Since this trend is expected to continue in 2024, net interest income should remain pivotal to banks' profitability.

A major change in 2024 is the previously mentioned increase in the taxation of banks from the beginning of this year. Although banks' profitability will be reduced by the higher tax burden, their absolute level of profitability is expected to remain above the levels of previous years. From this perspective, the increased taxation of banks does not represent a systemic risk to the sector, nor should it constrain banks' ability to lend to the economy. On the other hand, the generation of sufficient profit is a prerequisite for maintaining the banking sector's capital strength and soundness. The current assumption of a phased reduction in the special levy on business in regulated sectors should therefore be maintained.

The banking sector's total capital ratio continued to rise in 2023, ending the year at 20.5%.[15] The gap between significant banks and less significant banks in terms of their average total capital ratio continues to narrow.[16] The increase in capital adequacy is due largely to capital accumulation, which is outpacing the increase in risk-weighted exposures.[17] The sole source of capital growth in the last quarter of 2023 was that year's profit, so it is likely that capital growth will be slower in 2024.[18] The sector's capital headroom increased by 0.5 pp in the last quarter of 2023, to 4.05% of risk-weighted assets.[19] Banks remained compliant with the leverage ratio[20] as well as with the minimum requirement for own funds and eligible

7 When including the results of Slovak banks' organisational units in other countries, the profit amounted to €1.24 billion and was 47% higher year-on-year.

8 Net interest income increased by €476 million (27.2%) year-on-year.

9 Interest expenses increased by 400% (€1.4 billion) year-on-year, far outpacing the growth rate of interest income at 90% (€1.8 billion).

10 Annual growth in operating costs stood at 7% (€95 million), with banks' purchased goods and services costs rising faster than their wage costs (9% versus 7.5%).

11 Regulatory costs decreased by 45% (€36 million) year-on-year, and provisioning fell by 40% (€74 million).

12 The ROE of Slovak banks increased from 8.2% in June 2022 to 11.1% in September 2023, while the median ROE of all EU banking sectors climbed 8.4%, to 14%.

13 Further details can be found in Box 2 of NBS's November 2023 Financial Stability Report.

14 The net interest margin has increased gradually since August 2022 (when it stood at 1.56%), and in January 2024 it reached 1.93%.

15 On a consolidated basis, the total capital ratio stood at 20.1%.

16 While the total capital ratio of significant banks rose gradually, from 18.9% to 20%, between 2022 and 2023, that of less significant banks decreased from 22.7% to 22.5%.

17 In quarter-on-quarter terms, capital increased by 2.7% in the fourth quarter of 2023 while risk-weighted exposures rose by 0.3% (the year-on-year increases were, respectively, 8.6% and 4%).

18 Capital increased by €230 million, quarter-on-quarter, while retained earnings from the previous year amounted to €345 million. The impact of the retained earnings was significantly reduced by an extraordinary dividend payment amounting to €80 million.

19 This figure reflects only constraints from the perspective of capital adequacy and the position of banks on a standalone basis; banks' capital headroom on a consolidated basis stands at 3.7%.

20 The leverage ratio came to 7.6%.

liabilities (MREL), ahead of its full implementation from January 2024.[21] Although the domestic banking sector's capital adequacy has been increasing, Slovakia remains below the EU median on this metric.[22]

The liquidity position of Slovak banks has improved significantly on the back of new deposit inflows. Subdued demand for new financing and the normal end-of-year inflow of retail deposits pushed up banks' liquidity ratios to levels last seen since in 2021.[23] In the period ahead, some banks will have to repay funds borrowed under targeted longer-term refinancing operations (TLTROs) and will later face costlier refinancing of their bond issues. None of this, however, is expected to dent the liquidity position of banks, only the profitability of some banks. Compared with other banking sectors in the EU, the Slovak sector was at the median level for the liquidity coverage ratio (LCR) and below the median for the net stable funding ratio (NSFR).[24]

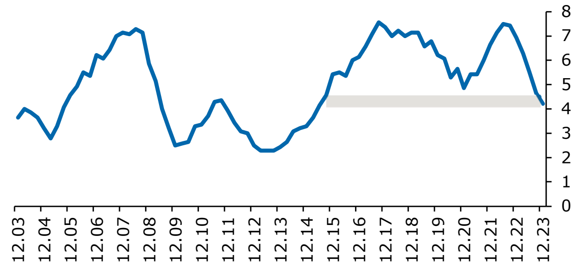
The financial cycle downswing persists but should gradually come to an end

The financial cycle in Slovakia has now been in a downswing for approximately a year and a half. The Cyclogram, NBS's composite indicator of the financial cycle, has fallen to a level last seen in 2015.[25] Most of the Cyclogram's components are now below their median level, implying a broad-based cooling of activity in the financial sector. In the fourth quarter of 2023, it was the slowdown in lending to firms that contributed most to the downswing.[26] The only component acting countercyclically in this period was economic sentiment, which showed a moderate improvement. All other components had either a neutral or downward impact on the Cyclogram.

The financial cycle downswing is expected to continue in the period ahead but without becoming any more pronounced. On the contrary, it should start to gradually come to an end, given that both the credit and housing markets are showing signs of stabilisation. Moreover, the economy is maintaining fragile growth with the prospect of its accelerating, which, against the backdrop of an anticipated gradual reduction in interest rates, may help to end the financial cycle downswing.

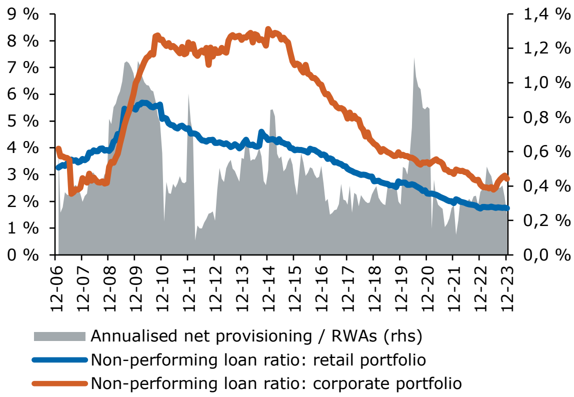
When setting the rate of the countercyclical capital buffer (CCyB), an important consideration is whether loans are not defaulting excessively and whether lending is at a stable level. The banking sector's provisioning rate is currently below the average normal level.[27] At the same time, banks are managing to generate profit, which is a key prerequisite for maintaining their capital strength. There is therefore, at present, no need to adjust the CCyB rate.

Chart 7 In the current downswing, the financial cycle indicator has fallen to its 2015 level
(index)



Source: NBS.
Note: Higher Cyclogram values imply a stronger build-up of imbalances.

Chart 8 Both non-performing loan ratios and the provisioning rate remain at low levels
(percentages of loans; percentages of risk-weighted assets)



Source: NBS.
Note: RWA – risk-weighted asset.

21 Taking into account the total capital ratio, leverage ratio and MREL, the capital headroom of banks on a consolidated basis increased to 3% of risk-weighted assets (up from 2.2% in the previous quarter).

22 The Slovak banking sector on a consolidated basis had a total capital ratio of 19.6% as at September 2023, while the median for EU banking sectors was 20.2%.

23 The net stable financing ratio (NSFR) increased to 131% at the end of 2023 (up by 3 pp over the third quarter). The liquidity coverage ratio (LCR) reached 204% in January 2024 (a quarter-on-quarter increase of 16 pp).

24 As at September 2023, the aggregate LCR of the Slovak banking sector was 183%, the same as the EU median; the NSFR stood at 127%, below the EU median of 136%.

25 The cycle downswing has also been reflected in private sector indebtedness, with the credit-to-GDP ratio declining by almost 6 pp over the past five quarters.

26 The Cyclogram was also, however, under downward pressure from indicators capturing indebtedness and debt service developments as well as credit losses.

27 Average provisioning as a ratio to risk-weighted exposures in the non-crisis years of 2011 to 2019.

What´s new in the world of macroprudential policy

Are stablecoins really stable currencies?

This is the question posed in a paper published by the Bank for International Settlements.[28] In their analysis, the authors covered the evolution of 68 cryptocurrencies that can be classed as a stablecoin. According to their findings, those stablecoins backed by traditional fiat currency, commodities or other crypto-assets have shown less price volatility than traditional crypto-assets; however, not one of them has been able to maintain parity with its peg at all times. This is irrespective of a coin's size or type of backing. Moreover, there is currently no guarantee that stablecoin issuers could redeem users' stablecoins in full and on demand. For these reasons, the stable coins in circulation today do not meet the key criteria for being a safe store of value and a trustworthy means of payment in the real economy. The analysis also highlights some significant data gaps. More data are required to better understand the uses of stablecoins and to quantify the risks associated with them.

What drives banks' credit standards

An ECB-published paper[29] addresses this issue using a quarterly dataset that covers banks and firms from ten euro area countries in the period from 2008 to 2020. The authors studied how banks decide which firms to lend to, looking at the situation and basic characteristics of firms and at bank-level information from the euro area bank lending survey (BLS). They find that weaker capitalised banks adjust their credit standards more than healthier banks, especially for firms with a higher default risk. They also show how credit standards change in reaction to an increase in bank funding costs and a sudden deterioration in banks' corporate loan portfolios. According to the authors, weaker banks respond more forcefully by tightening their credit standards more than better capitalised banks. This development is particularly pronounced when banks are linked to riskier firms. The stronger reaction of less well-capitalised banks to changes in funding costs may point to their potentially higher risk-taking behaviour in a lower interest rate environment. Conversely, when times are worse, these banks may restrict their lending policy more strongly.

Has housing affordability improved or worsened in recent decades?

An answer to this question is provided in a paper published by the Bank for International Settlements.[30] The authors construct a housing affordability index (HAI) for a total of 40 countries for the period between Q1 1970 and Q4 2021, incorporating data on the level of house prices, median household income, mortgage rates, loan-to-value (LTV) ratios, the average term-to-maturity of mortgage loans, the average property size and the average household size. For each country, the index measures the extent to which a median-income household can qualify for a mortgage loan to purchase an average-priced home. The authors find that, since the 1990s, the affordability of housing has improved, despite a setback suffered during the global financial crisis. Housing is generally more affordable in advanced than in emerging market economies. An important dimension to consider here is the development of mortgage markets and the mode with which households become owner-occupiers, namely with or without a mortgage. According to the authors, housing affordability improved in all countries during periods of lower interest rates and favourable economic conditions. However, it remains uncertain what the future holds in terms of affordability, particularly in a scenario where interest rates decline rapidly while incomes do not experience significant decreases. Another finding is that fiscal expenditure in the form of spending on housing benefits has a positive impact on housing affordability, while government spending on housing development has an insignificant impact for the sample of countries and for the time period considered in the analysis.

[28] Kosse, A., Glowka, M., Mattei, I. and Rice, T., "Will the real stablecoin please stand up?", *BIS Papers*, No 141, Bank for International Settlements, November 2023.

[29] Faccia, D., Hünnekes, F. and Köhler-Ulbrich, P. (2024), "What drives banks' credit standards? An analysis based on a large bank-firm panel", *Working Paper Series*, European Central Bank, Frankfurt am Main, February 2024.

[30] Biljanovska, N., Fu, C. and Igan, D., "Housing affordability: a new data set", *BIS Working Papers*, No 1149, Bank for International Settlements, November 2023.