

# Domestic banks have liquidity under control, but new challenges are coming

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## Summary

- ✂ **Liquidity, which expresses the ability to handle the outflow of deposits, is one of the core pillars of bank stability, along with sufficient capital and sustainable profitability.** Only banks that adhere to these principles will gain the trust of creditors and investors.
- ✂ **The demands for a strong liquidity position are constantly increasing.** New payment methods and the speed of information dissemination increase the intensity of bank runs. Experience from the USA from spring 2023 showed that withdrawals are larger and occur faster than regulators assumed when creating the rules.
- ✂ **Slovak banks are slightly lagging the European median in meeting liquidity ratios.** The risk stems mainly from the high need for resources due to the volume and growth of the loan portfolio, and therefore we are among the countries with the highest value in the loan-to-deposit and issued bond ratio. The positive side is the long-term orientation of banks towards stable household deposits and the potential for further issues of covered bonds.
- ✂ **The liquidity of the banking sector is significantly affected by the situation in the economy.** The mortgage boom and a period of high inflation significantly reduced the liquidity reserves of Slovak banks. On the contrary, bank deposits grew when the pandemic in 2020 limited consumption and when wage growth accelerated in 2023 and 2024, which immediately responded to the previous period of price increases.
- ✂ **Besides the economic situation, banks will also have to consider new competition in liquidity management.** New payment methods bypassing traditional banking channels, such as digital euro or stablecoins, or the potential expansion of the scheme for citizens to invest in government bonds, may mean an additional channel for the outflow of deposits for banks.

## 1 Introduction

**Trust in the banking sector is a necessary condition for its effective functioning.** However, it cannot be built unless banks are sufficiently stable and resilient. The basic prerequisite for the stability of banks is to ensure their ability to bear losses (capital adequacy), the ability to generate profit (profitability) and to secure funding for providing loans while maintaining the ability to repay deposits (liquidity). The ability to withstand increased deposit outflows is vital to overcoming bank-specific and systemic stress situations. The combination of sufficient stable funding and sufficient liquid assets are crucial. Recent examples from Europe and the USA have also shown us this. The National Bank of Slovakia (NBS) regularly addresses the topic of liquidity when assessing its resilience of domestic banking sector. However, this publication offers a more detailed view of the issue, focusing on the following areas:

- **Why is liquidity in the banking sector important.**
- **What tools are used to monitor liquidity risk.**

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- **How the liquidity position of Slovak banks has developed.**
- **Current and expected challenges in banks' liquidity.**

## 2 The importance of liquidity for the banking sector

**Only a stable banking sector can effectively fulfil its functions.** Healthy banks are characterized by sustainable profitability and sufficient capital to provide new loans and absorb losses. At the same time, a strong liquidity position is an important prerequisite for gaining and maintaining the trust of creditors, thereby ensuring the stable funding of the bank in the long-term and its resilience in times of stress.

**Given the different business models of banks, liquidity risk can have different nature and intensity.** The overall liquidity position of a bank is determined by the relationship of its funding to its needs (e. g. for loan financing) and the stability of funding itself. A crucial factor is also the tolerance of a particular bank to the liquidity risk. This is best defined by the scope and level of quality of the internal liquidity management process. One of its components may be a voluntarily determined minimum excess of liquid assets over regulatory limits. The profitability of liquid assets is usually lower than the profitability of less liquid assets (loans). Therefore, a lower tolerance to liquidity risk (higher liquidity excess) reduces the overall profitability of the bank.

### Definition of liquidity in banking world

**In the banking world, the technical definition of the term liquidity is difficult.** In the narrow sense, it is the ability of banks to repay liabilities to their creditors properly and on time. Risk arises naturally within the fundamental function of banks, which is to provide long-term loans that are funded by short-term deposits. To manage a significant outflow of deposits banks must hold a certain volume of liquid assets that would immediately cover deposits upon their maturity. In a broader sense, it is necessary to look at bank liquidity in a more comprehensive way by considering the financing structure of a bank. The funding structure and volume should be sufficient to ensure sustainable financing of the bank's assets over the long term.

**From the source perspective, we can distinguish two basic risk components.** Market liquidity refers to the ability of a bank to conduct various operations with securities in the market in a short time and at minimal costs to obtain liquid funds for the repayment of deposits or for the provision of loans. Funding liquidity refers to the ability to borrow money under standard market conditions. In this case, for example, it may involve replacing a maturing deposit or issued bond with a new source of funding with similar parameters.

**Liquidity can be analysed at the systemic level or at the level of individual banks.** Systemic liquidity goes beyond the banking sector itself and considers broader contexts in relation to the domestic and global economy, geopolitics, monetary policy, and the development of the broader financial sector. The liquidity of an individual bank primarily reflects the structure of its own balance sheet, the bank's reputation and market confidence, or its position vis-à-vis its competitors.

**The need to cover the outflow of various funding sources is determined by their characteristics.** In addition to the contractual maturity itself, the basic characteristics of the funding sources also include the possibility of their withdrawal before maturity, the type of clients and their long-term behaviour, the amount and nature of the deposit. The combination of various characteristics of the funding sources determines their outflow rates in the short-term, and/or stable funding factors in the long-term.

**Massive outflows of deposits from banks (bank runs) are more intense due to technological progress, both in scope and duration.** Cashless payments, or even instant payments, and faster dissemination of information have caused larger withdrawals to be concentrated in a shorter period. The preventative rescue mechanisms used so far to alleviate the situation in the form of voluntary reserves of liquid assets, the existence of a deposit insurance scheme and standby liquidity lines of central banks can only alleviate the situation to a certain point. Bank runs, with their

speed and intensity, have recently surpassed the assumptions of regulatory stress testing.<sup>1</sup> Banks must place even more emphasis on consistent liquidity risk management. A comprehensive process of liquidity risk management is required, spanning from identification to mitigation and must evaluate the impact on the bank's business model. The requirements for the quality of this internal process grow with the size and importance of the bank (principle of proportionality). An increasingly important part of liquidity risk management is also the management of reputational risk, i.e. the risk of loss of trust of depositors and investors. Meeting various regulatory and ethical standards is only one aspect of managing this risk. A bank must be able to respond flexibly and decisively to changes in the perception of its brand by clients.

Table 1

**Overview of large-scale deposit withdrawals of well-known banks over the last 20 years**

Bank	Country	Year	Deposit outflow as a share of total deposit volume	Duration of deposit outflow in days
Silicon Valley Bank	US	2023	85%	2
First Republic Bank	US	2023	40%	43
Silicon Valley Bank UK	GB	2023	30%	1
Signature Bank	US	2023	20%	1
Credit Suisse	CH	2023	25%	7
Banco Popular	ES	2017	25%	3
Banca Popolare di Vicenza	IT	2017	20%	7
Laiki Bank	CY	2013	30%	10
Dexia	BE, FR	2011	15%	5
Icesave	IS	2008	20%	75
Washington Mutual	US	2008	10%	10
IndyMac	US	2008	8%	14
Lehman Brothers	US	2008	40%	15
Bear Stearns	US	2008	20%	2
Northern Rock	GB	2007	20%	4

Sources: BIS, and Reuters.

## When bank liquidity turned worse

**Very recent history offers several cases of banks that collapsed after a combination of their internal problems and external events resulted in an inability to repay deposits.** During the small banking crisis in the US in March 2023, three medium-sized banks - First Republic Bank, Silicon Valley Bank and Signature Bank - got into trouble. Common features of the problems were long-term accumulated risks intensified during a period of increased market uncertainty, a fragile and one-sided business model, including a higher concentration of deposits with balances exceeding the deposit protection level, and less stringent regulation of smaller and medium-sized banks in the US, including risk management. The deteriorated reputation, combined with information about losses from their securities holdings, resulted in massive deposit outflows that exhausted liquidity reserves within a couple of days. In Europe, the most recent case is the collapse of the Credit Suisse in 2023. The bank paid its price for long-standing problems in risk management and anti-money laundering (AML), losses associated with the collapse of Archegos Capital and Greensill Capital, but also for a more sensitive perception of risk during the mini-banking crisis in the US. The loss of depositor confidence had gradually been evident since September 2022, when it lost more than half of its deposits in

<sup>1</sup> In the regulatory Liquidity coverage ratio deposit outflows vary from 3% to 40% (deposits of non-financial clients) for a 30-day horizon.

6 months. The situation was resolved by the takeover of the troubled bank by its competitor UBS. A different example dates to 2022, when within a couple of days of the start of Russian aggression in Ukraine, the Czech Sberbank CZ lost approximately 60% of its deposits due to concerns about its stability, which resulted in the withdrawal of its banking license.

### 3 Tools for liquidity risk monitoring

**A wide range of indicators and metrics are used to monitor liquidity risk.** Depending on the chosen definition of liquidity, regulatory performance obligation, time horizon, balance sheet stability assumption, assumption of whether the bank continues in business (going-concern) or is being liquidated (gone-concern), or the use of contractual or behavioural assumptions, there are a large number of them and in this section we will introduce the most commonly used ones.

**Regulatory and internationally defined indicators are the most widespread.** The Basel Committee on Banking Supervision within the Bank for International Settlements introduced proposals for common liquidity ratios in 2010. It was a response to the crisis in 2007-2008. As part of the so-called Basel III, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) were introduced. While the former is designed to measure the bank's ability to cover a significant outflow of deposits within a 30-day horizon, the latter determines a healthy model of financing long-term assets with sufficient stable funding. Both indicators have gradually become part of the pan-European banking legislation.<sup>2</sup>

**The NBS focuses, besides regulatory indicators, also on the balance sheet structure and the time mismatch of assets and liabilities when monitoring liquidity risk within financial stability.**<sup>3,4</sup> Balance sheet structure indicators are oriented towards the need of funding and the excess of funding. Key metrics include loan-to-deposit ratio (and ratio of loans to deposits and issued bonds) ratio, ratio of liquid assets to volatile deposits, the ratio of pledged bonds to the entire bond portfolio and the significance of issued bonds maturing in the short term. The time mismatch is analysed through liquidity gaps in different time bands and through the cumulative liquidity position for different time bands, considering both contractual and behavioural maturities. Within the cross-sectional area of moral hazard, an indicator of the concentration of covered deposits in the five largest banks has been introduced. Moreover, in concentration risk the share of received or provided intra-group financing on the balance sheet is monitored.

**In addition to publishing and analysing banking indicators time series, the NBS also performs reverse liquidity stress testing and survival period simulation.** The aim of reverse stress testing is to estimate the share of deposits that banks can cover with their liquid assets, supplemented with drawing additional funding from the central bank after issuing and pledging their own covered bonds. The survival period defines the period until which the bank can withstand the outflow of deposits (and other liabilities) with its liquid assets supplemented with incoming loan repayments. Technically, it is a combination of the net cumulative position of assets and liabilities (counter-balancing capacity) over a 1-year horizon, and LCR assumptions (deposit outflows, liquid asset haircuts).

**Banks use a comprehensive system of limits within the ILAAP<sup>5</sup> to measure and manage liquidity risk, based on the wide range of indicators.** In addition to meeting internal limits of regulatory indicators, banks have limits for various liquidity time bands, survival period, deposit concentration, or balance sheet structure (balance sheet items, pledged assets). Limits are usually monitored for different types of crises - market, bank-specific, or combined. Contingency liquidity planning is also an integral part of liquidity risk management, where massive deposits outflow and limited access to the interbank market is simulated.

**In 2023, the European Central Bank introduced liquidity composite indicators – both the market and the funding component.**<sup>6</sup> The aim is to evaluate the conditions and relative sentiment in both areas of liquidity and their

<sup>2</sup> Consolidated version of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>3</sup> [Macroprudential Commentary indicators \(NBS\)](#).

<sup>4</sup> [Financial sector analytical data \(NBS\)](#).

<sup>5</sup> ILAAP: Internal Liquidity Adequacy Assessment Process.

<sup>6</sup> [Financial Stability Review \(special feature „A“\)](#); ECB, May 2023.

interaction through almost fifty indicators. The market liquidity indicator has five basic dimensions - immediacy, breadth and depth, tightness, and resilience. The funding liquidity indicator includes three dimensions - rollover, redemption, and collateral (haircut and margin). The approach was further developed by the European Systemic Risk Board which added<sup>7</sup> the composite indicator for the area of risk of contagion and amplification with four dimensions - financing conditions, interconnectedness, volatility, and leverage. The advantage of the approach is its scalability to various sub-sectors of the financial market and individual EU countries.

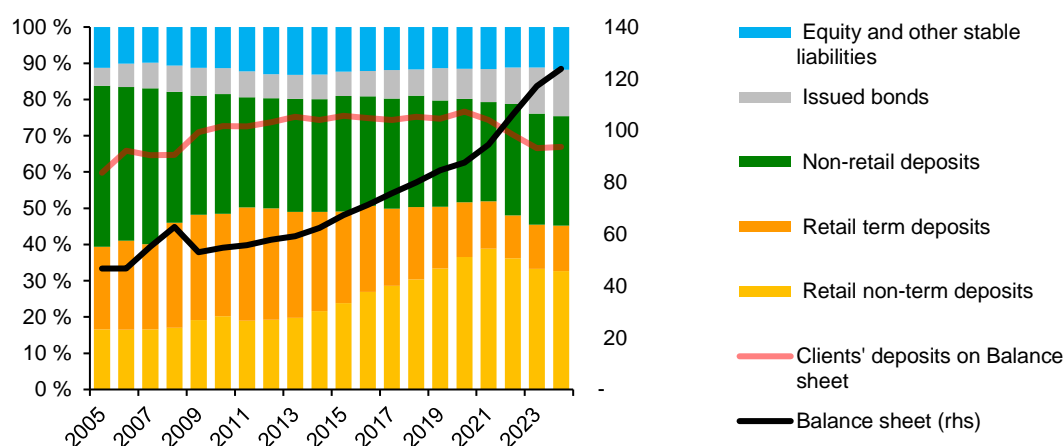
## 4 Liquidity in the Slovak banking sector

**Stable funding is an important pillar of the business model of domestic banks.** The volume of household deposits, especially sight deposits, has been growing for a long time. Deposits from corporations and funds obtained through security issuances (wholesale) grew slightly, but their inflow has significantly intensified in recent years due to both favourable economic and market conditions and the need to meet new legal obligations, such as minimum requirement for own funds and eligible liabilities (MREL). The interbank market has long been a place for domestic banks to store liquidity rather than a place to obtain it, except for the immediate liquidity shortage or the specific business model of some banks, which are dependent on intra-group financing.

Chart 1

### Funding structure of Slovak banks

Funding structure (%) and balance sheet volume (EUR bln.) and share of clients' deposits (%)



Source: NBS.

Notes: The balance sheet value is given without ECB's targeted longer-term refinancing operations (TLTRO 3). The reason for it is their neutral impact on the cash position of the banking sector (funds drawn from TLTRO 3 were placed on accounts within the NBS or within their own banking groups). The interbank market is presented in net value (assets less liabilities). Clients' deposits do not include deposits from monetary institutions.

**Deposits from clients, especially households and non-financial corporations, are crucial for banks in terms of both their volume and stability.** Given the business model and the focus of banks on the domestic market, the dynamics of deposit growth depends on the potential and behaviour of domestic entities in the real economy. Usually, the development of household and corporate deposits has a similar trend, which responds to the overall state of the economy and the credit market. In simple terms, it can be said that the long-term liquidity of banks is the result of the liquidity of corporates and households. This is also evidenced by recent developments. After the pandemic, when the pandemic-deferred consumption, Russian aggression in Ukraine and rising energy prices resulted in higher inflation, the opposite development was recorded in deposits for both segments. Corporations were able to pass on higher input prices to the prices of goods and services, and their deposits in banks grew dynamically. However, wage growth did not keep up with price growth. Households increased their consumption or started purchasing real estate, which resulted in a slowdown in the growth of new savings. In addition, changes also occurred in the structure, as higher

<sup>7</sup> [Systemic liquidity risk: a monitoring framework](#); ESRB, February 2025.

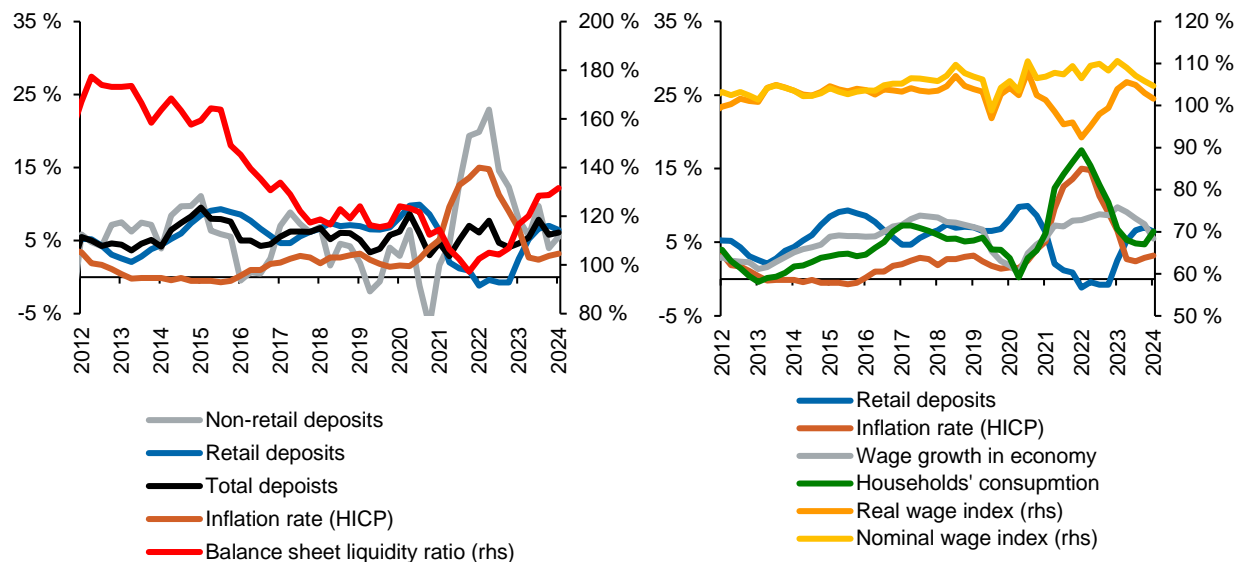
interest rates<sup>8</sup> caused a higher growth rate of term and savings deposits while the volume of current accounts stagnated.

Chart 2

### The impact of macroeconomic indicators on the volume of deposits

Left chart: Year-on-year change in retail and retail deposits and total deposits (%), inflation rate (%) and balance sheet liquidity ratio (%)

Right chart: Year-on-year change in retail deposits, inflation rate, wage growth in the economy, household consumption (%) and real and nominal wage growth index (%; index 100% = same period last year)



Sources: NBS, and Eurostat.

Notes: HICP: harmonised index of consumer prices. Balance sheet liquidity ratio: simplified proxy of the Liquidity Coverage Ratio (the use of the balance sheet liquidity ratio is related to the limited history of the Liquidity Coverage Ratio).

**Overall, the growth of deposits in banks in Slovakia has lagged the growth of loans in the long term. This was significantly influenced by two waves of mortgage booms between 2016 and 2022.<sup>9</sup>** Slovak banks were therefore forced to gradually start looking for alternative forms of funding, primarily through the issuance of covered bonds (Chart 4, left). However, since 2023, the situation has stabilized thanks to the slowdown in credit market and the acceleration of deposit inflows. In the euro area countries, the overall growth of deposits and bond issues has been higher than the loan growth in the long term, which helps its structural position (Chart 4, right).

<sup>8</sup> The effect of the ECB's restrictive monetary policy due to inflation well above the inflation target level.

<sup>9</sup> The increase in loans between 2016 and 2019 was due to low interest rates, intense competition between banks, especially in the mortgage market, triggered by the legislative reduction of the fee for early repayment of mortgage loans. In 2021 and 2022, bank clients used lending options before the increase in lending rates. This period was also marked by lower deposit inflows due to higher consumption (post-pandemic recovery and higher inflation).

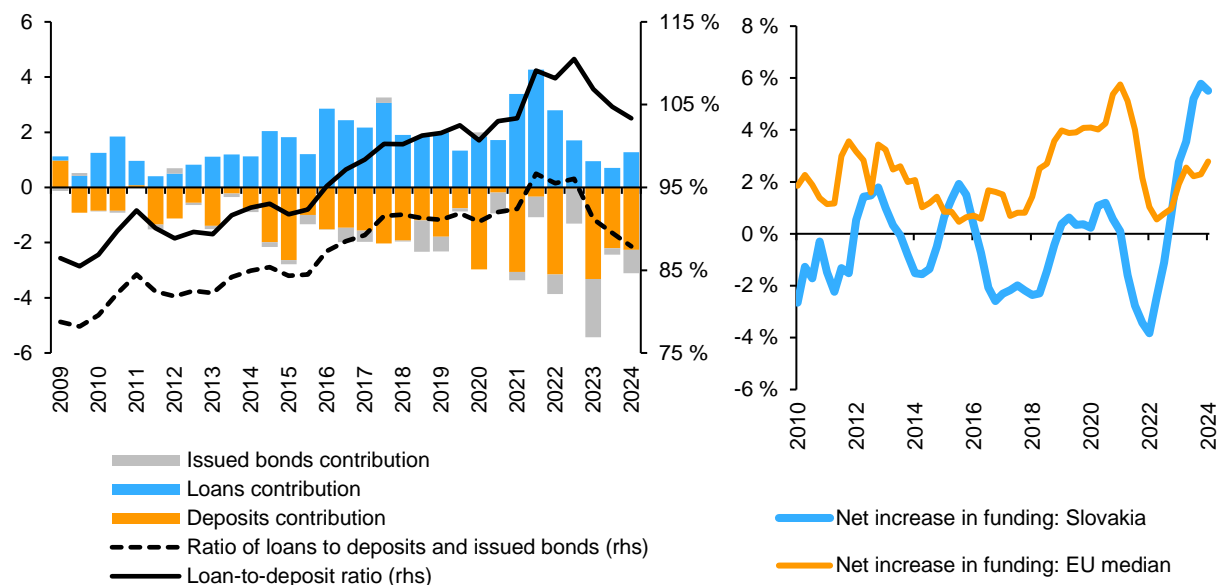


Chart 3

**Loan-to-deposit ratio and comparison of net increase of funding with euro area countries**

Left chart: Loan-to-deposit ratio, extended by bonds issued (%) and contributions of its components (EUR bln.)

Right chart: Comparison of the net increase in funding over loans in Slovakia and the median of euro area countries (%)



Source: NBS.

Notes: Left chart: The half-year increase in deposits and issued bonds is shown with a negative sign. Data are up to December 2024. Right chart: The net increase in funding is the difference between the sum of the year-on-year increase in deposits and issued bonds and the year-on-year increase in loans. The net increase in funding for 12 months is expressed as a share of the sum of deposits and issued bonds at the beginning of the respective period. A negative net increase in funding means higher increase in loans in terms of volume than the sum of the increase in deposits and issued bonds (i.e. net drawdown of funding).

**The eurozone comparison shows higher vulnerability of the domestic banking sector, especially in long-term liquidity.**<sup>10</sup> In the ratio of loans to deposits and issued bonds, Slovakia is among the eurozone countries with the highest value at the end of 2024, 20 pp above eurozone median value. In 2014, it was only slightly above it. In particular, the boom in mortgage market in Slovakia in the period from 2016 to 2022 had contributed to a slight increase of this indicator comparing to its value in 2014. The structure of the funding, especially the composition of retail deposits (higher share of sight deposits) is a partial mitigating factor.<sup>11</sup> However, it should be said that the above also reflects to the overall low volume of savings that Slovak households have deposited in banks. This is also a consequence of the faster growth of Slovak households' indebtedness, primarily in favour of their own housing or real estate investments.<sup>12</sup>

<sup>10</sup> Data are as of December 2024. Data does not include branches of foreign banks in individual countries.

<sup>11</sup> Up to 40% of domestic banks' balance sheets are funded by retail deposits, with 56% in the form of current account balances. In the EU, the median values are 38% and 58%, respectively.

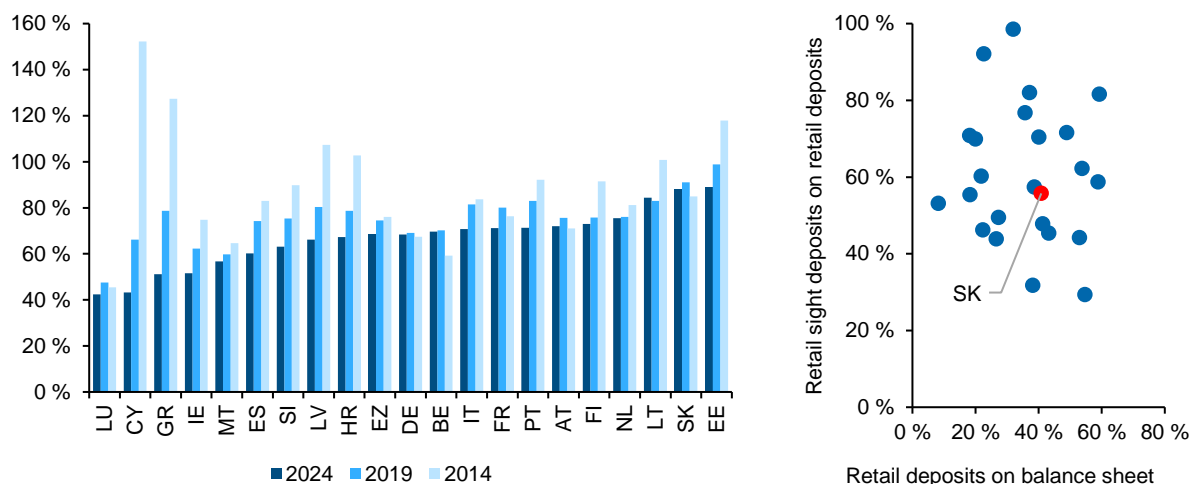
<sup>12</sup> The net financial assets of Slovak households reached only 44% of gross domestic product at the end of 2024. This is the lowest value within the EU countries (the median of EU countries is 113%). The share of financial assets on total household assets of Slovak households is at 92% (the median of EU countries is at 86%).

Chart 4

### Ratio of loans to deposits and issued bonds and the importance and structure of retail deposits on the balance sheet

Left chart: Ratio of loans to deposits and bonds issued in euro area countries (%)

Right chart: Share of retail deposits on the balance sheet (%) and share of retail current accounts on retail deposits (%) as of June 2024 in euro area countries



Source: ECB.

Notes: Left chart: Data for loans and deposits for individual banking sectors do not include loans and deposits with the counterparty of the central bank, commercial banks, and non-residents. Right chart: Data for retail deposits exclude deposits from non-residents.

**Due to the slower growth of the surplus of funding over loans, Slovak banks have been slightly below the EU countries median values for regulatory indicators for a long time.** From the perspective of the structure of the components of the liquidity coverage ratio, Slovakia is characterized by a lower net outflow rate<sup>13</sup> than the EU median. This results in a lower need for liquid assets, the share of which is also below the median in the EU.<sup>14</sup> Compared to 2019, Slovakia achieved the lowest increase in the share of liquid assets among EU member states (+1 pp, vs. median value +5 pp). The net outflow rate remained stable. Lower regulatory indicator values of Slovak banks compared to the EU can be partially explained by the nature of the domestic banking market. This market is primarily composed of subsidiaries of foreign banking groups. These groups do not have a significant need to hold liquidity surpluses on local markets, and they provide intra-group financing in case of sufficient liquidity at a higher consolidation level.

<sup>13</sup> In accordance with the Liquidity Coverage Ratio methodology (Consolidated version of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012; Article 420).

<sup>14</sup> The net outflow rate for Slovakia is at 12% and the share of liquid assets reached 19%. The median for EU countries is at 13% and 24%, respectively. Data are as of September 2024.



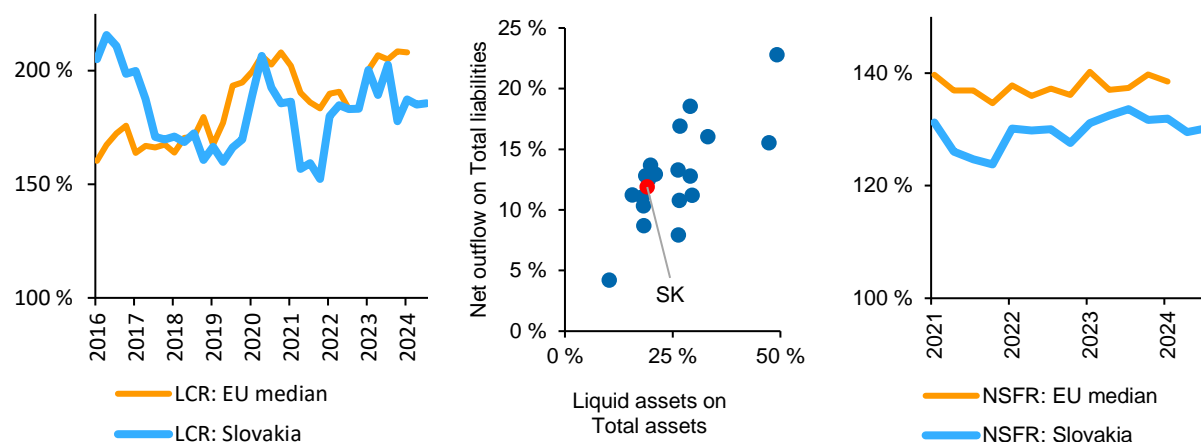
Chart 5

**Regulatory liquidity ratios and structure of the liquidity coverage ratio**

Left chart: Liquidity coverage ratio in Slovakia and the median value of EU countries (%)

Middle chart: Intensity of net outflow (%) and share of liquid assets (%)

Right chart: Net stable funding ratio in Slovakia and the median value of EU countries (%)



Sources: ECB, and NBS.

Notes: Left Chart: LCR - Liquidity Coverage Ratio. Middle Chart: Share indicators of the LCR components to the balance sheet items. Right Chart: NSFR - Net Stable Funding Ratio. All Charts: Data for EU countries are until December 2024, for Slovakia until June 2025. Branches of foreign banks are not included in data for respective countries.

**Additional metrics for liquidity resilience for the Slovak banking sector show a stable situation in the long term.** The increase in the balance sheet significantly contributed to the increase in the volume of the liquidity buffer and the prolonged potential survival period.<sup>15</sup> Looking at the counter-balancing capacity<sup>16</sup> of the domestic banking sector, we observe a significant increase in the liquid assets residuum over the entire period. The positive change is due to the increase of deposits and issued bonds, with up to half of this increase allocated into additional liquid assets. The reverse stress test, on the other hand, shows that the overall capacity to cover the deposit outflow remains stable in the long term. After taking into account the surplus of a liquidity buffer (level 1) over the minimum requirement for liquid assets (level 2) and the volume of additional funding from secured operations with the central bank (level 3), banks are able to cover a stable share of deposits (from 58% to 63%)<sup>17</sup> in the long term. Half of the capacity arises from drawing hypothetical funding from the central bank after pledging newly issued covered bonds from banks' own portfolios.

<sup>15</sup> The survival period is defined as the period during which a bank gradually pays off its liabilities and only provides loans from irrevocable loan commitments, using only its liquidity reserves, without access to additional funding.

<sup>16</sup> Counter-balancing capacity refers to the absolute level of liquid assets in individual time buckets after the gradual balancing of liabilities (e.g. withdrawal of deposits, repayment of issued bonds) and receipt of payments (e.g. collected instalments from loans). Counter-balancing capacity is defined for the baseline scenario (in accordance with the LCR methodology) and for the adverse scenario (stricter haircuts on liquid assets and deposit outflows).

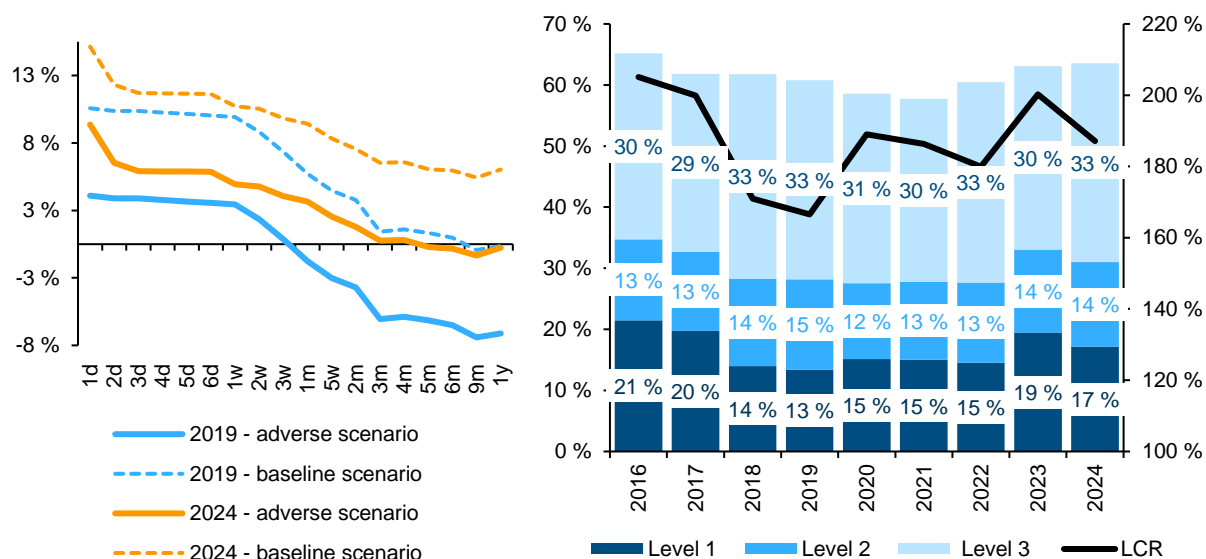
<sup>17</sup> This is a theoretical calculation that does not consider the obligations of the Deposit Insurance Scheme.

Chart 6

**The increase in the liquidity buffer on the balance sheet benefited from the increase in the balance sheet with faster growth in liquid assets, the potential to cover deposit outflows remains stable**

Left chart: Counter-balancing capacity as a share of the balance sheet (%)

Right chart: Ability to cover deposit outflows with available liquid assets and additional funding from refinancing operations with the central bank (%)



Sources: NBS, and own calculations.

Notes: LCR: Liquidity Coverage Ratio. Left Chart: Comparison of the banking sector's counter-balancing capacity as a share of the total balance sheet in the baseline scenario (outflow ratios for deposits without contractual maturity and liquid assets haircuts in accordance with the LCR methodology) and in the adverse scenario (increased outflow ratios for deposits without contractual maturity and increased liquid assets haircuts). Right Chart: Capacity to cover deposit outflows from liquid assets excess (level 1) over the minimum value of liquid assets (level 2) and additional funds obtained from secured operations with the central bank after pledging newly issued covered bonds (level 3).

## „Hidden“ liquidity reserves

**The mortgage boom drains liquidity, but it can also contribute to its re-creation.** The reason is the possibility of including loans secured by real estate properties into the cover pool for the purposes of issuing covered bonds.<sup>18</sup> From the issuer's point of view, this is long-term, stable, and relatively cheap sources of funding, which is demanded across the entire spectrum of institutional investors, both home and abroad. The higher demand stems from the lower risk of their non-repayment due to the existence of additional security in the form of a cover pool, and higher market liquidity. For banks as investors in covered bonds, there are additional advantages in the form of preferential risk weights in capital management<sup>19</sup>, and the possibility of using these bonds as collateral in the ECB monetary policy operations, or emergency liquidity facilities.

**However, banks do not have to use only the purchased covered bonds of other banks to obtain funds from the ECB.** If necessary, banks can flexibly<sup>20</sup> proceed to issue a new covered bond which can be used as collateral for ECB operations. These operations are usually part of the contingency liquidity plans of individual banks in case the banks do not have sufficient liquid assets at their disposal in times of stress.

<sup>18</sup> More information in Section 70 of Act No. 483/2001 Coll. on banks (in consolidated version).

<sup>19</sup> More information in Article 129 of Consolidated version of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>20</sup> Operations can be carried out within a few days (usually from 5 to 10) if the bank has a previously approved covered bond program with the relevant authority and enough eligible loans in the portfolio that can be used in the cover pool.

## 5 Are banks about to face tough times?

**At a time of declining household savings rates and a recovering credit market, banks are already replacing maturing bonds often on worse terms.** These trends are likely to persist in the near term. Funds obtained through bond issuance undoubtedly have many advantages (Box 3). Disadvantages include the concentrated maturity of a large volume of funds and the ties of the size of demand and the required yield by investors, with the overall risk of the country in which the issuer operates. By the end of 2026, banks will have to repay more than a third of issued bonds. Most of them had been issued in an environment of ultra-low interest rates, and their upcoming refinancing will therefore be associated with higher interest expenses. Another option is to replace them with other source of funding, but it cannot be assumed that these would be household deposits only. With the increase in the inflation rate and the slowdown in real wage growth, the household savings rate is falling. Its decline began at the end of 2023, although it should stabilize in 2025-2027, according to the NBS forecast.<sup>21</sup> Pressure on additional funding will also be created by increased credit demand, supported by falling interest rates, which will also further reduce the attractiveness of term and saving deposits.

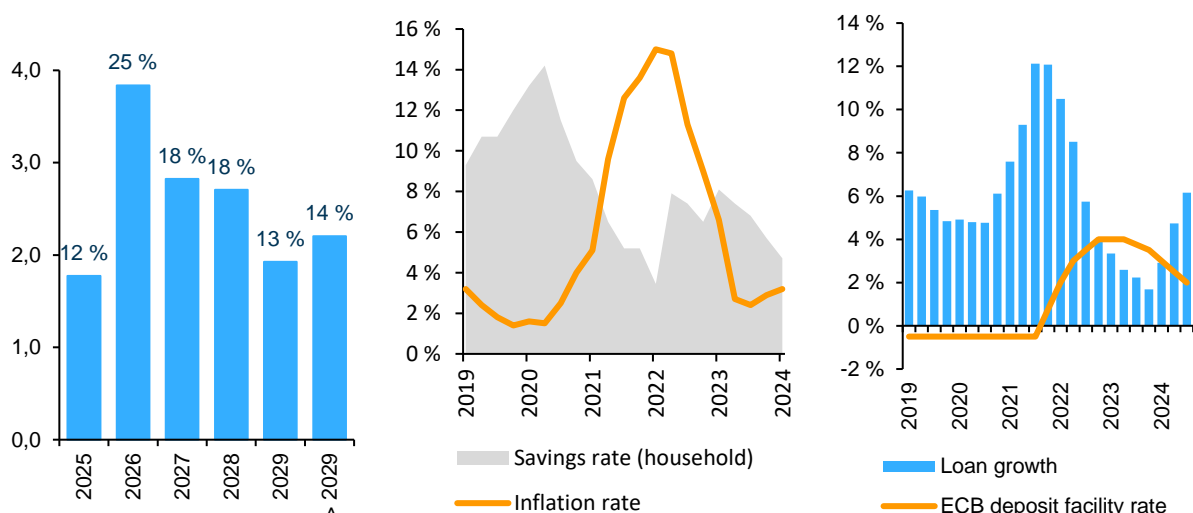
Chart 7

### Banks face a wave of bond refinancing amid low savings rates and a wakening loan market

Left chart: Volume of bonds issued by maturity (EUR bln.) and their share in the total volume of bank bonds issued (%)

Middle chart: Household savings rate (%) and inflation rate (%)

Right chart: Year-on-year loan growth (%) and ECB base rate (%)



Sources: NBS, and Statistical Office of Slovak republic.

Note: Left Chart: Year 2025 includes issues maturing from June 2025 to December 2025.

**New and attractive financial products offered by competing banks and fintechs may be challenging. If banks do not capture these trends in time, they may lose their position in the transaction account space.** In the area of new payment instruments, the area of stablecoins is developing rapidly.<sup>22</sup> They have been gaining popularity since 2021, especially in the USA, Asia and various developing countries. They are a potential sought-after alternative to traditional fiat currencies, as they enable fast and cheap transfers without the need to involve banks or other institutional intermediaries.<sup>23</sup> If the trends spread to Europe, the transfer of part of the payment system to stablecoins may cause a potential risk of further outflow of deposits from banks. However, today's motivation for the use of stablecoins in retail payments in the euro area is weaker than in other countries due to the existence of instant payments. The change in financial consumer preferences in favour of faster and easier online payments can also

<sup>21</sup> For more information: [Medium-term forecast for key macroeconomic indicators \(P2Q-2025, NBS\)](#).

<sup>22</sup> Stablecoins are cryptocurrencies pegged to a stable asset, most often the US dollar (99% in market capitalization). The main goal of stablecoins is to minimize the volatility of their price, which is common with original cryptocurrencies. The value of the tokens is backed by short-term assets such as government securities or bank deposits. The standardization of stablecoins among financial products has been enhanced by their regulatory grip in the EU (Markets in Crypto-Assets Regulation) and the US (Genius Act).

<sup>23</sup> They are also gaining popularity due to their use as a means of settlement for transactions with various cryptocurrencies, or, in the case of developing countries, as a protection against the depreciation of savings in the domestic, less stable currency.

boost the transfer of balance in transaction accounts between institutions in favour of more innovative ones. Moreover, if these can also offer additional services at competitive prices.

**In the medium term, banks may also face a certain level of competition in household deposits from public institutions, in the form of a digital euro or government-issued bonds targeted at citizens.** The issuance of digital euro may transfer part of the balances from clients' current accounts to their digital euro accounts. Preliminary estimates of the deposit outflows do not yet appear to be significant, but within the euro area, the local market will be among the most affected.<sup>24</sup> However, the increase in awareness of the advantages of the digital euro after fine-tuning its product and technical specifications could further dynamize the deposit outflow of current accounts from banks. Moreover, retail government bonds may serve as an alternative to term and savings deposits in banks. Their first two local issues have enjoyed great interest due to attractive financial conditions, although in overall they drained approximately 1% of total household deposits from banks, only. The expansion of this form of investment has the potential to drain another part of stable retail deposits. However, the extent will depend on the attractiveness of the investment (financial conditions of next issuances, bond subscription options and market liquidity on the secondary market).

## 6 Conclusion

**The Slovak banking sector has undergone dynamic development in its recent history.** The main milestones since the completion of the systemic restructuring and privatisation of banks at start of the millennium include the Great Financial Crisis, the adoption of the euro, the eurozone crisis, the covid-19 pandemic, or the change in the ECB's monetary policy stance due to the increase in inflation. Throughout this period, domestic banks were stable in capital and liquidity, constantly able to fully cover the demand for loans.<sup>25</sup>

**The balance sheet of banks changed significantly during this period. In 2004, client deposits in banks were almost double the volume of loans.** This resulted in a high, almost one-third, share of liquid assets to total assets.<sup>26</sup> By the end of 2024, after a 2.5-fold increase in the balance sheet, the volume of loans is exceeding the volume of deposits and the share of liquid assets on the balance sheet decreased by one-third.<sup>27</sup> While the share and composition of client deposits on the balance sheet remained stable during the period, favourable market conditions have allowed for a significant increase in the share of issued bonds.<sup>28</sup>

**The increase in the share of retail deposits and issued bonds on the balance sheet significantly dampened the impact of loan growth on liquidity.** Moreover, the loan growth is heavily oriented towards the residential real estate market and thus it is constantly generating loans that can be used into a cover pool for covered bonds. It is the large volume of unencumbered housing loans (and the potential for covered bond issuances) that forms a large part of the hypothetical liquidity buffer that banks could flexibly use in stress. Moreover, after the tightening of the ECB's monetary policy in 2022 and 2023, banks have increasingly purchased liquid assets, primarily in the form of government bonds.

**In addition to the impacts of the normal economic cycle and various shocks, managing some structural trends may also be challenging for banks.** The transfer of payments outside the infrastructure of commercial banks (digital euro, stablecoins), or new investment opportunities (retail government bonds) may drain some bank deposits. Based on experience or estimates of the deposit outflows, banks should be able to manage these challenges. However, slightly higher interest expenses or more concentrated alternative funding may be the price for the increased pressure.

<sup>24</sup> More information in [Discussion note of NBS No 141](#) (in Slovak only).

<sup>25</sup> The share of loans provided by banks to gross domestic product increased from 42 % to 65 % between 2004 and 2024. Domestic banks have covered approximately 60% of total loans received by all entities in Slovakia (excluding banks) in the long term since 2004. Total credit indebtedness of entities (excluding banks) in Slovakia increased from EUR 21 billion to EUR 143 billion in the given period, while financing from banks increased from EUR 12 billion to EUR 87 billion.

<sup>26</sup> The loan-to-deposit ratio reached 55% at the beginning of 2004 (or 53% after expanding the denominator to include issued bonds). Liquid assets reached a share of 30% on the balance sheet in the given period.

<sup>27</sup> The loan-to-deposit ratio reached 102% at the end of 2024 (or 87% after expanding the denominator to include issued bonds). Liquid assets reached a share of 19% of the balance sheet at the given period.

<sup>28</sup> Customer deposits on the balance sheet reached 70% at the beginning of 2004, respectively 67% at the end of 2024. The share of retail deposits in total deposits was 55%, respectively 60%. Issued securities reached a share of 2%, respectively 12% on the balance sheet.