



that euro area banks will have continuous access to yuan funding. The maximum size of the swap line is 350 billion yuan and €45 billion.

During the year the ECB continued with operations to absorb the liquidity injected through the Securities Markets Programme (SMP), thereby neutralising the SMP's impact on the monetary stance. The SMP programme for purchasing sovereign bonds of selected countries had run from 2010 until September 2012, when it was terminated concurrently with the announcement of the new programme of Outright Monetary Transactions (OMT). In essence, the OMT programme is a means of purchasing unlimited amounts of one-year to three-year government bonds issued by countries participating in an appropriate EFSF/ESM programme, with the ECB fully sterilising the OMTs (just as it absorbed liquidity injected by the SMP). A precondition for initiating OMT is that a euro area country applies for a loan from the EFSF. As at the end of 2013, no country had requested such assistance and therefore no OMTs had been activated. Nevertheless, the announcement of the programme has in itself helped significantly to reduce risk premia in periphery bond markets.

2.2 FOREIGN EXCHANGE OPERATIONS

The exchange rate of the euro against the US dollar was volatile during 2013. It reflected market expectations for euro area monetary policy, volatility in foreign exchange markets, and anticipation of the US Federal Reserve System's

Chart 9 USD/EUR exchange rate in 2013



Source: Bloomberg.

monetary policy decisions. The euro was positively affected by preparations for a euro area banking union, which the market sees as a stabilising move. In the second half of the year the exchange rate responded to capital flight from certain emerging economies, as well as to positive activity figures for the euro area. In 2013 the euro traded lowest against the dollar at the end of the first quarter, at 1.2772 USD/EUR, and strongest at the end of October, during the height of the US budget difficulties, when it reached a two-year high of 1.3805 USD/EUR. The euro's trading against the dollar was 4.5% stronger at the end of 2013 than at the end of 2012.

3 FINANCIAL MARKET DEVELOPMENTS⁴

Financial sector developments in Slovakia in 2013 reflected to some extent improvements in the external environment, stemming mainly from the euro area's emergence from recession. In Slovakia, too, economic growth accelerated moderately. This upturn was accompanied by partial stabilisation of the euro area debt crisis, which was largely the result of large-scale liquidity-supporting operations conducted by central

banks. As recent developments have indicated, however, the unwinding of support measures may pose an appreciable risk to the global financial system, particularly given the potential increase in risk premia. Despite the substantial efforts already made, the situation in Europe requires additional, relatively extensive, structural reforms and consolidation measures. In both Slovakia and the euro area as a whole, the labour

⁴ Preliminary data as at 31 December 2013.



FINANCIAL MARKET DEVELOPMENTS

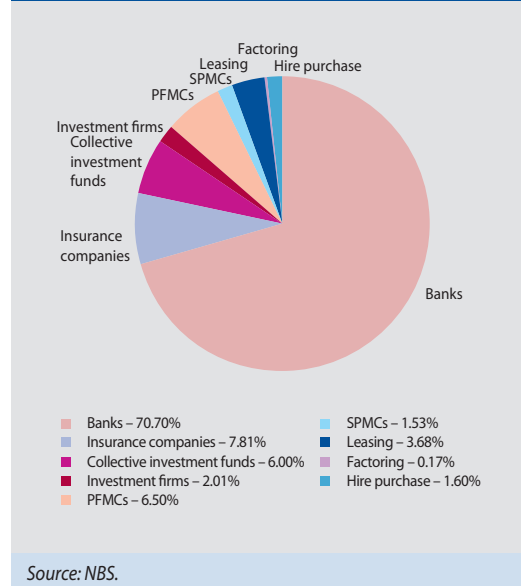
market situation shows no sign of significant improvement.

The potential for such adverse risks in the external environment and domestic economy to impinge on financial stability in Slovakia's financial sector is to a large degree mitigated by the strong resilience of domestic financial institutions in terms of solvency, profitability, and access to funding. In these respects the banking sector in Slovakia – the main pillar of the country's financial sector – reports better results than do the banking sectors of most other EU countries, and its position improved further during 2013. The aggregate profit of the banking sector increased by 12% in 2013, after falling in the previous year, while the aggregate capital adequacy ratio increased again, to an all-time high of 17.2% at end-2013. One of the main drivers of profit growth was the continuing increase in retail lending and its upward effect on net interest income. However, the higher capital adequacy ratio was due largely to equity capital again being raised by the retention of profits for the previous year as well as to a decline in the risk weights used to calculate capital requirements. The soundness of the banking sector as a whole is at present one of the most significant factors behind the Slovak economy's relatively strong resilience to external shocks.

Bank lending activity in 2013 continued to reflect a divergence in trends between the corporate and retail sectors. Corporate lending fell again in year-on-year terms, consistent with developments in the euro area, although in the second half of the year there was a slight moderation in the annual rate of decline. The situation in the corporate loan portfolio reflected continuing deterioration on both the supply and demand side, although not equally across segments. Indeed, lending to small- and medium-sized enterprises actually increased moderately.

As for retail lending, it increased by around 10% year-on-year, which was one of the highest growth rates observed in any EU country. Most of that increase was accounted for by housing loans, demand for which was boosted by relatively stable property prices as well as historically low interest rates. As a result, housing affordability is relatively high. Another driver of

Chart 10 Financial sector assets broken down by market segments as at 31 December 2013



the lending growth was refinancing, where the amount borrowed is larger than the original loan. As for new loans, they mostly had an initial rate fixation of between 1 and 5 years. Therefore the proportion of loans with up to one-year fixed rate declined, and so households became slightly less sensitive to a potential rise in interest rates.

A particularity of the Slovak banking sector, especially compared to foreign counterparts, is that investments in domestic (Slovak) government bonds constitute a high share of their banks' total assets. The size of this share is one of the highest in any national banking sector within the EU. It should be noted, however, that the bulk of the securities issued by domestic banks are mortgage bonds. Most mortgage bonds issued in 2013 had a fixed coupon, probably owing to low yields on Slovak government bonds.

Since the Slovak banking sector is heavily oriented to the domestic economy, the greatest risk to banks is that of a deterioration in credit portfolio quality in the event of adverse economic developments. Although non-performing loans (NPLs) in banks' corporate sector increased slightly in the first half of 2013, the rise was far lower than that observed dur-



ing the crisis period in 2009. The NPL ratio for corporate loans was 8.1% at the end of 2013, while for retail loans it was only 4.2%. Results of macro stress testing confirm that the Slovak banking sector is, owing to its currently high solvency, relatively resilient to adverse scenarios of significant economic headwinds as well as to increase in financial market uncertainty in the event of an escalation of the euro area debt crisis.

In other segments of the financial market there were some notable changes, particularly in the second pillar of the pension scheme. Legislative amendments in this sector resulted in significant switching of savers, as well as pension assets, between different types of pension fund. Consequently, from the beginning of May, more than 90% of savers found themselves enrolled in bond pension funds that alone remained guaranteed by law. Other pension funds catered for savers who sought higher investment risk, and therefore the range of portfolios in terms of risk-return profile became broader. Returns on pension funds and collective investment funds remained positive in 2013, albeit lower than in 2012. In the second pension pillar, however, owing to the above-mentioned changes, the variation in performance between different fund types increased considerably.

In the insurance sector, according to figures for the first three quarters of 2013, there was growth in traditional life insurance, supplementary insurance and, again, in unit-linked insurance. By contrast, non-life insurance saw a decline in premiums, caused mainly by falling premiums in motor third-party liability in-

surance and in comprehensive motor vehicle insurance.

In the third pension pillar, the supplementary pension scheme, the number of participants increased and the net asset value continued to grow. The asset composition of third-pillar funds remained largely unchanged. As regards their risk exposure, moderate increases of sensitivity to interest rate changes and growth in exposure to exchange risk were observed, especially in growth funds. Although the returns on third-pillar funds were positive, they fell short of their 2012 levels.

The collective investment sector experienced exceptional developments in 2013, particularly in regard to the amount of assets under management. Net asset value in the sector climbed by a fifth, its highest annual increase since the pre-crisis year of 2007. The main driver of this increase was positive net sales of investment funds to end investors. As in 2012, the largest inflows were observed in domestic special investment funds, specifically in special real estate funds and special securities funds. Special professional investor funds also recorded a marked rise in NAV through the issuance of unit certificates, although in this case the new investment came not from households, but banks. Investment in standard common funds also picked up in 2013, after falling in the previous year. Collective investment funds did not perform so well in 2013 as in 2012, with the average annual nominal return of 2.7% less than half of that of the previous year. A marked drop in performance was reported in all fund categories with the exception of equity funds.