Macroprudential Commentary

June 2021

Summary

- Národná banka Slovenska (NBS) is keeping the countercyclical capital buffer (CCyB) rate at 1%.
- Housing loan growth has accelerated. At the same time, housing prices notably increased. Despite these trends, the Bank considers the current calibration of its main regulatory lending limits to be appropriate.
- Consumer credit is on a long-term declining trend that became even more pronounced during the height of the pandemic crisis. With the easing of pandemic containment measures, this trend began to moderate from February 2021.
- Demand for loans from large enterprises has declined, possibly because firms had previously been frontloading loans to a sufficient extent. The take-up of government-guaranteed loans also slowed.
- As regards the gradual phasing-out of statutory loan moratoria, most households and firms are managing to return to their previous repayment schedule without difficulty.
- The banking sector's profit is gradually returning to its pre-pandemic level, though remains under downward pressure from margin compression. Banks have sufficient available capital.

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The CCyB rate remains unchanged

The Bank is keeping the countercyclical capital buffer (CCyB) rate at its current level of 1%. The first point to note is that there are no obvious reasons for reducing the rate. The main indicator of whether or not a reduction is necessary is net loan loss provisioning, which returned to its pre-pandemic level and therefore did not imply the need for a rate cut. Another indicator, the amount and share of non-performing loans in the loan book was also broadly stable. This favourable situation reflects mainly the successful phasing-out of loan moratoria granted to firms and households under the "Lex Corona" pandemic relief legislation ('statutory moratoria'). Another important factor is that banks have sufficient available capital to maintain lending to firms and households.

The second point to note is that there are reasons for keeping the buffer at its current rate level. This concerns mainly the imbalances that have built up in several areas and potential loan risks which remain present in banks' loan books. Furthermore, some of the imbalances and risks may become more pronounced over the medium term. Examples may include rapid housing loan growth and related uptrends in household indebtedness and housing prices, or the risks associated with the commercial real estate (CRE) sector.

Expectations for the CCyB rate in the next quarter

The uncertainty surrounding the pandemic crisis has still not ended and several risks remain present. In the event of a sharp rise in loan delinquencies, the Bank stands ready to reduce the CCyB rate.

A CCyB rate cut would also be possible if banks' credit risk exposure gradually declined.

In recent months we have seen an upturn in business and financial cycles across the EU, including in Slovakia. If the next period saw excessive loan growth and housing price growth, these would be grounds for keeping the CCyB rate at its current level.

CCyB rate:

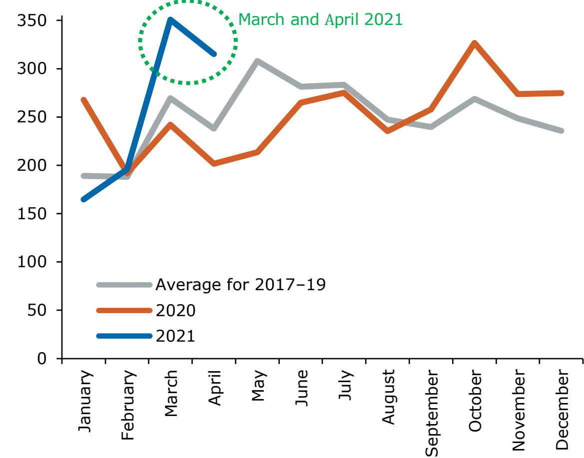
1.0%

Household loan growth has started accelerating again

After months of slowing, the annual growth rate of loans to households has started accelerating again. In other words, the pandemic's second wave has not had a major impact on the household credit market. In April 2021 household loan growth stood at 6.4%, year on year, which was up from 6.0% in the previous month and was the eighth highest rate in the EU.[1]

The acceleration of household loan growth stems mainly from an increase in the provision of housing loans. Demand for these loans is being nourished by stable low interest rates and by the situation in the housing market, which did not deteriorate even during the height of the pandemic crisis. This year has seen some of the highest ever absolute month-on-month increases in housing loans. There has also been an uptrend in the refinancing of housing loans,[2] as borrowers shop around between banks, seeking mainly lower interest rates or a principal increase. Refinancings often also include an extension of the loan maturity.

Chart 1 Acceleration of housing loan growth (month-on-month increases in EUR millions)



Source: NBS.

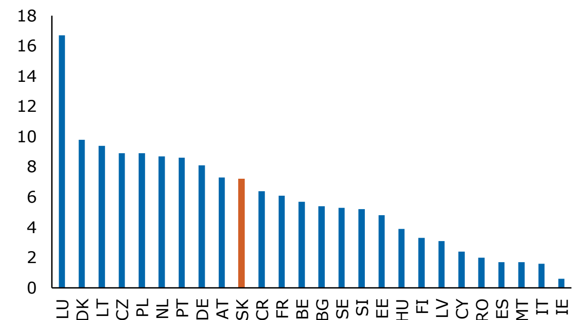
At the same time, the trend decline in consumer credit began to moderate as pandemic containment measures were eased.

Banks' uncertainty related to the pandemic crisis has been diminishing, hence the pandemic's second wave did not trigger a retightening of credit standards. On the contrary, several banks indicated that their credit standards were already approaching pre-pandemic levels. Interest rates have also remained stable, with rates on household loans not changing significantly during the first quarter of 2021.

Increase in housing price growth

Housing prices have continued to rise in 2021, including high increases in April and May. The uptrend is relatively broad-based across regions and is seen in prices of both houses and flats, whether existing or new-build properties. Prices of houses have been rising faster than prices of flats, including in May 2021. Households' preferences may have been partly affected by their greater propensity to work from home as a result of the pandemic crisis. The main causes of rising property prices remain low interest rates and rigidities in the supply of new flats. A new factor may be the accelerating prices of building materials.[3] The rental market in the capital city has not changed significantly, with rental prices continuing to fall in year-on-year terms, largely owing to falling demand for rental housing amid the pandemic-induced drop in mobility.

Chart 2 Housing price growth in EU countries has not been slowed by the pandemic's impact (percentages)



Source: Eurostat (data for Q4 2020).

Housing price growth in Slovakia has been similar to that in most EU countries. The trends in Slovakia have closely corresponded to those in the broader central and eastern European (CEE) region. At the same time, housing price growth in the richest EU countries has been accelerating. Indeed, several of them are seeing housing prices rise more sharply than at any time in the past ten years. This is also one of the reasons why national authorities in these countries are drawing increasing attention to the build-up of risks.

As regards the main NBS limits on banks' credit standards for loans to households, we consider their overall calibration to be appropriate; nevertheless, we continue to assess whether they need to be adjusted in response to certain specific trends

The experience of past years has shown us that excessive growth in loans, household indebtedness and housing prices can result in several systemic risks. There is a particularly notable increase in households' sensitivity to adverse developments. An economic downturn may bring an increase in the amount of non-performing loans, while a sharp correction in the housing market could have a negative impact on the banking sector.

Despite the current growth in housing prices and housing loans, the Bank considers the current calibration of its main macroprudential measures to be appropriate. The Bank is closely monitoring developments in both the housing market and credit market and is assessing the risks that banks and borrowers are exposed to. Current trends do not as yet

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1 In March 2021 annual growth in household loans averaged 3.9% across the EU and 3.5% across central and eastern European EU countries.

2 In April 2021 as much as 1.16% of the current stock of housing loans was repaid before maturity. The only time a higher figure has been reported was in 2016, when a statutory cap on early repayment fees for housing loans was approved. The average for 2020 was 0.97%.

3 At the turn of this year building material prices were more than 1% lower year on year, but in March 2021 they were 3% higher compared with the same month in 2020.

pose a risk to the banking sector's stability, nor are they significantly weakening the financial situation and resilience of households.

Current regulatory limits on DSTI, LTV and DTI ratios are contributing significantly to increasing the resilience of borrowers and banks in crisis situations.[4] Furthermore, a detailed analysis of loans that have emerged from statutory moratoria indicates high resilience among those borrowers who at the outset of the crisis were compliant with the Bank's regulatory limits.[5]

On the other hand, the Bank is now assessing the appropriateness of the monetary policy settings in the light of certain trends. This refers in particular to the rising share of new housing loans that are due to mature after the borrower reaches retirement age,[5] as well as to a sizeable increase in the number of housing loan refinancings that include a maturity extension. Another trend is the ongoing decline in risk weights for the mortgage loan portfolio of banks that use an internal ratings-based (IRB) approach to assess credit risk ('IRB banks').[6] The Bank is therefore, in accordance with an IMF recommendation, weighing the benefits and drawbacks of introducing minimum risk weights on the housing loan exposures of IRB banks or activating a buffer to cover systemic risk resulting from risk developments associated with housing loans.

Corporate loan growth has slowed, primarily in the segment of loans to large enterprises

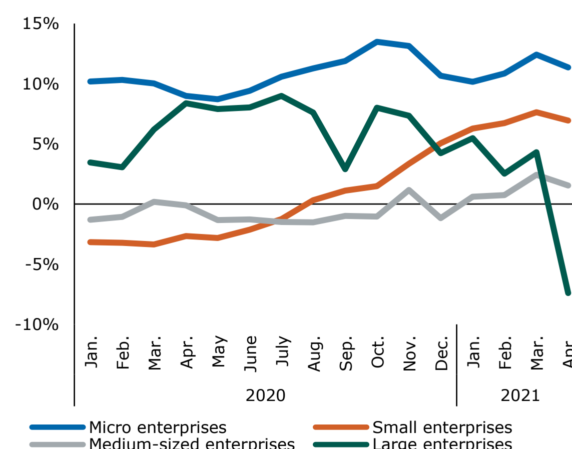
The corporate sector started to pick up in the second quarter of 2021. Optimism in the sector was reflected in the Economic Sentiment Indictor (ESI) for Slovakia, which in April[7] surged to levels not seen since the first half of 2018. The improvement was broad-based across all the ESI's components and was most marked in the services sector. Further evidence of recovery was provided by firms' revenues in March, which in several sectors increased quite sharply.[8] In some sectors, however, the situation remains difficult and recovery is proceeding only slowly. This is particularly true of those sectors hardest hit by the pandemic crisis; for example, accommodation and food service activities, or arts, entertainment and recreation.

At the same time, firms' liquidity was still higher in March 2021 than in normal, pre-crisis times, although it showed a slight downward correction compared with December 2020.[9] The liquidity of non-financial corporations (NFCs) has increased during the crisis thanks to operational savings, public support measures, and favourable borrowing conditions. A number of firms have in recent months been able to take advantage of the favourable credit market situation by frontloading borrowings.

The improvement in firms' liquidity has, as expected, been reflected in the credit market. There has been a decline in demand for new loans, especially from large enterprises (these, moreover, have already paid off some the loans they received earlier in the crisis).

Overall, the annual growth rate of loans to private firms fell by 3.6 percentage points between March and April, down to 0.7%. This decline, together with the continuing notable downtrend in loans to state-owned firms,[10] resulted in the annual growth rate of NFCs loans falling into negative territory (-1.7% in April).

Chart 3 The decline in NFC loan growth was primarily accounted for by loans to large enterprises (annual percentages changes in total loans)



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

This weakening of loan growth stems largely, however, from the portfolio of loans to large enterprises. The sharp slowdown in lending to large enterprises[11] is basically due to three factors. The first is the repayment of a large proportion of existing working capital loans. This trend has been further accentuated by a small number of the largest enterprises, which by the size of their exposures have a relatively significant impact on overall developments in the sector. After the gradual phasing-out of pandemic containment measures and stabilisation of the situation, a number of unnecessary bank loans may be paid off. A second factor is the decrease in firms' appetite for working capital finance, as evidenced by the lesser extent to which they are drawing down credit lines and short-term working capital loans. The third factor is the lower volume of new lending to large enterprises.

Lending to micro enterprises and SMEs has maintained solid growth. The growth rate of these loans slowed slightly in April 2021,[12] reflecting a softening of demand for new loans that was partly attributable to a gradual decline in the take-

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[4] See Jurča, P., Klacso, J., Tereanu, E., Forletta, M. and Gross, M., "The Effectiveness of Borrower-Based Macroprudential Measures: A Quantitative Analysis for Slovakia", *IMF Working Papers*, No 20/34, International Monetary Fund, July 2020.

[5] For more information, see the November 2020 edition of the NBS Financial Stability Report.

[6] Since 2017 the average risk weight on housing loans among IRB banks has decreased by 2.5 percentage points.

[7] Sentiment remained at similar levels in May, with the industry confidence indicator moderating slightly and the ESI's other components improving slightly.

[8] The most notable recoveries were in the industry, trade and transportation sectors.

[9] The median value of the liquidity ratio remained at 18.4%, while its pre-crisis average stood at 14%. The liquidity ratio is defined as the ratio of financial assets (cash and bank deposits) to liabilities. The median is based on a sample of around 5,000 firms.

[10] Total loans to state-owned firms recorded a year-on-year decline of 22% in April 2021.

[11] The annual growth rate of loans to large enterprises fell sharply in April 2021, by more than 12 percentage points compared with the previous month.

[12] The annual growth rate of loans to these firms was around one percentage point lower in April than in the previous month.

up of government-guaranteed loans.[13] In this segment there has been no significant repayment of existing loans, which might be indicative of firms getting rid of unnecessary borrowings.

Despite an improving situation in the corporate sector, fixed investment financing has not contributed to this year's loan growth. Annual growth in loans for fixed investment remained in negative territory in April 2021 (-2.5%). The moderate uptrend in fixed investment loans with a maturity of between one and five years continued in April, but its impact was outweighed by the ongoing decline in those with a maturity of more than five years.

Banks have begun to recover after last year's slump in profits

From the perspective of their profitability, banks spent the second half of 2020 regaining ground lost in the first half of the year, while the start of 2021 already appears more optimistic, including in year-on-year terms. The banking sector's aggregate profit for the first four months of this year was approaching levels seen in the same period in pre-pandemic years. Compared with last year, the net after-tax profit for the period doubled, to €207 million.[14] The increase was largely due to the abolition of the bank levy as from July 2020, though its impact was partly dampened by an increase in the banking sector's contribution to the Deposit Protection Fund (DPF).[15]

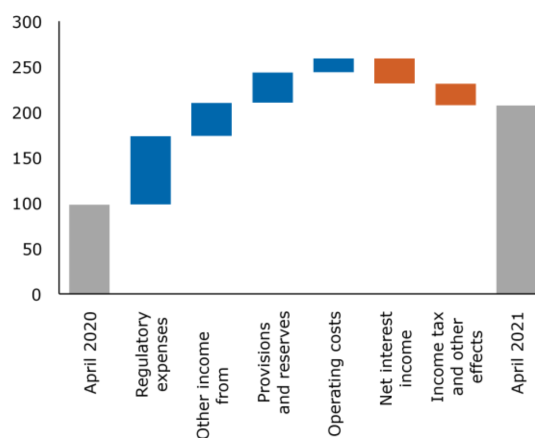
The year-on-year improvement in banks' financial performance was also supported by a lower need for loan loss provisioning. Banks had previously been concerned about a potential pandemic-induced increase in loan delinquencies, but as their concerns abated, they responded accordingly. In late 2020 banks' provisioning in response to the crisis was exceeding the pre-crisis norm,[16] while in early 2021 it was down to below that level. Although provisioning activity has varied from month to month in 2021, net provisioning was around one-tenth lower in the first four months than in the two years preceding the pandemic crisis.[17] Banks' eased mainly their provisioning for performing loans with increased credit risk.[18] This may imply that banks no longer see a need for further precautionary provisioning, especially in the area of retail business.[19] The non-performing loan coverage ratio (including provisions) fell slightly year on year.[20]

At the same time, however, the prevailing low interest rate environment continues to dent bank profits. Aggregate net interest income for the first four months of 2021 was 5% lower year on year. Nor was a moderate increase in fee and commission income able to offset that decline.

As regards banks' profitability, the greatest risk in subsequent months is the persisting uncertainty about credit costs. It is still not clear whether borrowers will be able to service their debts reliably over the long term, after the expiry of statutory moratoria and other forms of public support measures related to the pandemic crisis. The principal risk in the longer term is the decline in domestic banks' interest income, which is putting pressure on their traditional business model.

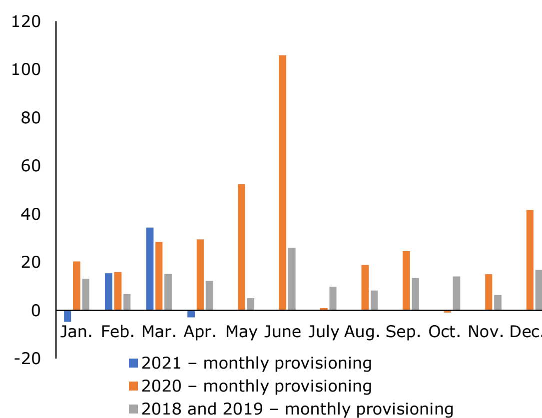
The sector's overall non-performing loan (NPL) ratio remains low. The NPL ratio for loans to households fell gradually during the height of the pandemic crisis and has continued to fall in 2021, reaching historically low levels.[21]

Chart 4 The banking sector's profit for the first four months of 2021 shows a marked year-on-year improvement (EUR millions)



Source: NBS

Chart 5 Banks' provisioning moderated in early 2021 (EUR millions)



Source: NBS.

[13] By the end of April 2021, the overall amount of guarantees made available under pandemic-related public guarantee schemes had reached €870 million. In April, the amount not drawn stood at just over €30 million, which was similar to the amount in January of this year. During the course of this year, however, the amount borrowed under guarantees approved in previous months is gradually decreasing.

[14] The profit for the first four months of 2020 was only €98 million. The sharp rise in profit will appear mainly in the first half of 2021, given that in the second half of 2020 banks were no longer paying the bank levy and they were reducing their loan loss provisioning.

[15] The sector's contribution to the DPF for the first four months of 2021 was eight times higher compared with the same period in the previous year, €26 million vis–à–vis €3.4 million. The abolition of the bank levy, set at 0.4% of external liabilities, was therefore partially offset by the contribution to the DPF being increased to 0.8% of covered deposits.

[16] The level of provisioning in the non-crisis period 2011–2019.

[17] Cumulative net provisioning for the first four months of 2021 amounted to just under €42 million, while in 2018 and 2019 it averaged €47 million.

[18] So-called Stage 2 loans (under IFRS 9).

[19] Provisions for retail exposures fell by almost 80% year on year, to €12 million and are far below the pre-crisis levels of 2018 and 2019. By contrast, provisions for exposures to NFCs fell by less than half, to €35 million and remain above pre-crisis levels.

[20] Compared with April 2020, the NPL coverage ratio for April 2021 was 0.8 percentage point lower, at 66.3%.

[21] The NPL ratio stood at 2.4% in April 2021. For housing loans, the net annual default rate remained at zero; for consumer loans, it fell to 1.3%.

The NPL ratio for loans to non-financial corporations gradually turned up in summer 2020 and has also risen slightly in 2021; it too, however, remains at low levels.[22]

After falling sharply in 2020, the banking sector's profitability, measured by annualised return on equity (ROE), has improved significantly in 2021. The sector's ROE for the first four months of 2021 was 6.9%, approximately one-sixth below the pre-crisis level.[23] It should be noted that this difference owes more to an increase in the sector's solvency than to a decrease in its profitability.

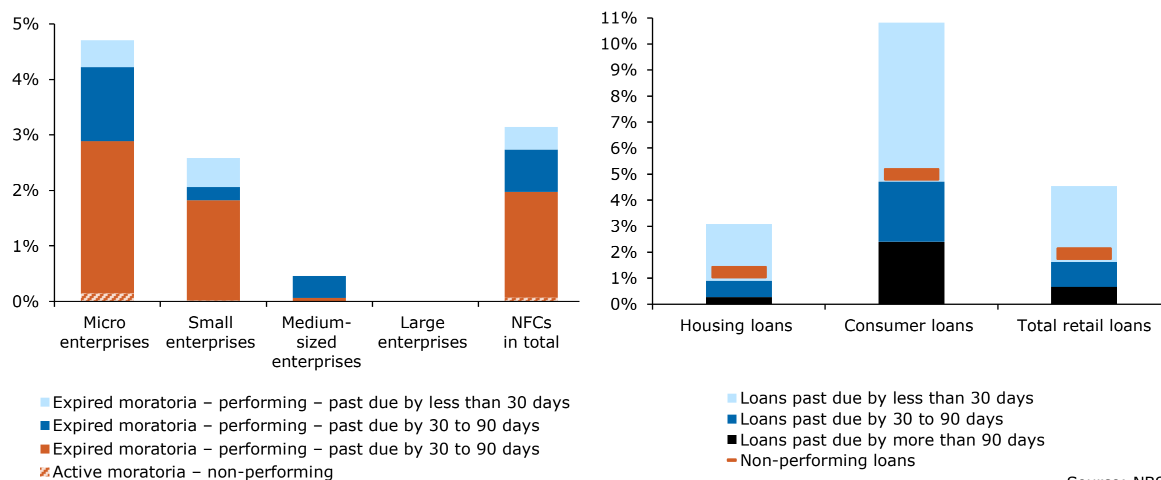
The sector continues to be sufficiently capitalised in 2021. Despite the serious repercussions of the pandemic crisis for economic growth, the banking sector has managed to strengthen its capital position. The aggregate total capital ratio was 20.4% at the end of the first quarter of 2021, with around 87% of the capital included in that figure consisting of highest quality Common Equity Tier 1 (CET1) capital. The improvement in the sector's capital position was supported by several banks deciding to follow the recommendations of regulatory authorities and retain their earnings for the previous year. The first-quarter increase in the total capital ratio also reflected a decline in the amount of risk-weighted assets. The sector currently has sufficient capital to continue lending to the real economy and to absorb potential future shocks.

The return of loans to their original repayment schedule following the expiry of statutory moratoria is not being accompanied by any significant surprises

As regards loans for which a statutory moratorium was granted during the pandemic crisis, most of the borrowers have managed to resume repayments according to the pre-moratorium repayment schedule.[24] By the end of April, the shares of distressed loans in the NFC loans and retail loans that were under a moratorium stood at 3.1% and 4.5% respectively. Compared with March, those figures showed a slight improvement. Worst affected by repayment difficulties have been consumer loans and loans to the information and communication sector and the administrative and support services activity sector, as more than 10% of them are now distressed.

If the levels of distress remained at these levels, then, by the end of April, distressed post-moratorium loans would constitute 0.5% of the retail loan portfolio and 0.4% of the NFC loan portfolio. In the case of NFC loans, however, we should add loans that defaulted during the crisis without having been under a statutory moratorium; they account for a further 0.6 percentage point.

Chart 6 Impaired loans as a share of loans for which a statutory moratorium has been granted
Left-hand chart: NFC loans (as a percentage share of all loans for which a moratorium has been granted)
Right-hand chart: Retail loans (as a percentage share of loans that were under a moratorium)



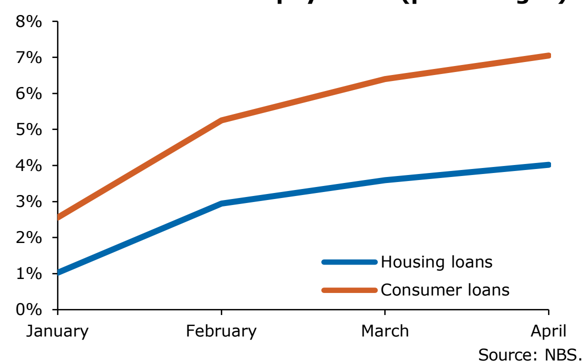
Source: NBS.

Notes: The cut-off date for moratoria expiry is the end of March 2021. The chart shows credit quality as at the end of April 2021.
The figures for retail loans comprise retail loan data for the four largest banks in the Slovak banking sector.

In the case of retail loans, however, the proportion of borrowers who received a statutory moratorium and, following its expiry, have had their repayments further deferred is gradually increasing. Unlike under the previous moratoria, banks in these cases typically require the borrowers to pay at least part (e.g. one-quarter) of their loan instalments; nevertheless, this may imply that a small proportion of loans could be affected by repayment difficulties at a later date. On the other hand, the fading of the pandemic's second wave is gradually reducing demand for new repayment deferrals, though even in early 2021 this demand was almost ten times lower than at the time of the pandemic's outbreak.

[22] The ratio was 0.3 percentage point higher in April 2021 than in September 2020, at 3.4%.
[23] The Slovak banking sector's average ROE for the first four months of 2019 was 8%. The ROE for April 2020 was 4.2%.
[24] The data are as at end-April 2021. The cut-off date for moratoria expiry is the end of March 2021.

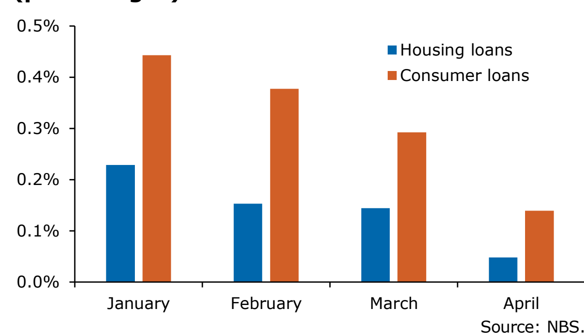
Chart 7 Share of post-moratorium loans subject to a new deferral of repayments (percentages)



Source: NBS.

Note: The figures for retail loans comprise retail loan data for the four largest banks in the Slovak banking sector.

Chart 8 Loans subject to a new deferral of repayments as a share of the total portfolio (percentages)



Source: NBS.

Note: The figures for retail loans comprise retail loan data for the four largest banks in the Slovak banking sector.

Why is consumer credit declining?

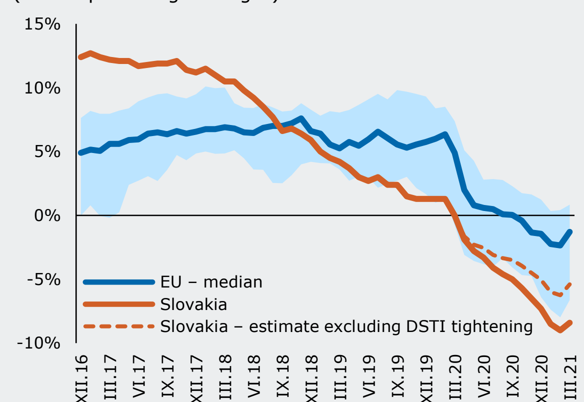
The annual growth rate of consumer credit is on a long-term downtrend. The rate started to slow back in 2017, when it was the second highest in the EU. Its downward path can be divided into two periods.

During the years 2017–19 consumer credit growth slowed more quickly in Slovakia than in most other EU countries, with the rate in Slovakia gradually falling into the lower quartile of the range. This slowdown was caused by the following factors:

- the partial refinancing of consumer loans by their consolidation into housing loans.[25] Borrowers who refinanced in this way were able to reduce the interest rate on the loan debt. The increase in housing loan refinancings occurred at the expense of demand for consumer credit;
- gradual saturation of the consumer credit market;
- a tightening of income verification requirements in regard to pre-approved consumer credit; this, however, did not occur until early 2019.[26]

Chart 9 Consumer credit growth slowed significantly from 2017 and is now in negative territory

(annual percentage changes)



Source: NBS.

Consumer credit developments during the pandemic crisis have been affected by two factors in particular. The first factor is the pandemic itself. Largely because of the decline in consumption expenditure, demand for consumer credit has fallen sharply during the pandemic. This reduction was partly forced by the effects of pandemic containment measures and was partly a result of consumers opting to compensate for income losses and, amid high uncertainty about the future situation, to increase their financial buffer in the form of savings. Banks, for their part, notably tightened credits standards for consumer credit during the pandemic's first wave, before subsequently easing them again. Unlike lending rates for housing loans, interest rates on consumer credit have increased sharply. All in all, the impact of the pandemic crisis on consumer credit growth has been about the same in Slovakia as in other EU countries.

The second major factor, albeit less significant than the first, has been the tightening of the regulatory limit on the debt-service-to-income (DSTI) ratio. Absent this tightening, we estimate that the decline in consumer credit would have been around three percentage points lower (-5% instead of -8%). This estimate is based on the fact that the total volume of new consumer credit (including refinancing loans that increase the principal) fell by 33% in the second half of 2020 in year-on-year terms and that new consumer credit with a DSTI ratio of up to 50%, which was not affected by the tightening, fell by 19%. Chart 9 shows that consumer credit would have declined even if the DSTI limit had not been tightened.

Although the tightening of the DSTI limit contributed to a decline in new production of consumer credit, it had a positive impact in terms of reducing the portfolio's riskiness. It was also seen during the pandemic crisis that the share of statutory moratoria in loans with a DSTI ratio of more than 60% was almost three-quarters higher than the share in loans with a DSTI ratio of up to 60%. Furthermore, it is those borrowers with a higher DSTI ratio who have had more difficulty in resuming repayments following the expiry of moratoria.

[25] We estimate that between 5% and 7% of consumer loans per year were refinanced in this way.
[26] Following this tightening the amount of lending in the form of pre-approved loans fell by more than one-third.

An increase in risks related to strong growth in loans and housing prices is being reported by several countries and institutions

The effects of the pandemic crisis on Slovakia and the rest of Europe are gradually easing, and several countries are starting to report steady risks of a cyclical nature or even an increase in such risks. The economic recovery and associated increase in risks is starting to be reflected in the housing market in particular, with some EU countries reporting an acceleration of housing prices in the recent period[27]. The growth in housing prices has been coupled with accelerating growth in housing loans and with an increase in household indebtedness. The heightened risks associated with such developments have already been pointed out by several international institutions (including the IMF[28] and ECB[29]). In response to rapid loan growth and rising household borrowing, the macroprudential authorities in a number of countries have announced their intention to, or have directly begun to, tighten regulatory requirements for the provision of housing loans. At the end of May the Czech central bank, Česká národní banka, decided to increase its countercyclical capital buffer rate by 0.5 percentage point, to 1%, with effect from July 2022.[30] Its reason for doing so was the increase in risks, particularly in the area of housing loans. Given also the low materialisation of previously accumulated risks and the decline in loan loss provisioning in early 2021, the level of overall risks on banks' balance sheets remains elevated. According to Česká národní banka, a further source of systemic risk is the cyclically reduced risk weights in the loan books of IRB banks. The Danish central bank[31] has announced it will be proceeding similarly, as well as taking additional measures,[32] in the near future in order to reduce the risks associated with high household indebtedness in Denmark. Likewise, Luxembourg's macroprudential authority, the Comité du Risque Systémique, has responded to significant increases in housing prices and household indebtedness by tightening regulatory lending requirements from January of this year.

The mounting risks in Slovakia's housing market have also been pointed out by the IMF.[33] This trend, together with strong growth in housing loans and the continuing uptrend in household indebtedness, may contribute to a deepening of imbalances. The IMF therefore suggests examining the possibility of activating a systemic risk buffer (SyRB) on housing loans or introducing a risk weight floor for IRB banks.

The risks related to rising household debt and rapid loan growth have also been noted in the S&P credit rating agency's rating report for Slovakia. It points out that Slovakia's household indebtedness, which is among the highest in the central and eastern European (CEE) region, and its housing loan growth, which has long been outpacing GDP growth, are clearly inviting a tightening of macroprudential measures with the purpose of mitigating risks arising from increasing debt.

In an April 2021 report on Slovakia, Moody's credit rating agency also highlighted the elevated uncertainty that could lead to a rising need for further provisioning. The uncertainty is also related to the share of loans that show a significant increase in credit risk (Stage 2 loans under IFRS 9), which in Slovakia is one of the highest in the EU. Moody's also notes risks in the housing financing market and that Slovakia has the highest level of household indebtedness in the CEE region. In other words there is, on the one hand, a risk of housing price overvaluation owing to constrained supply, and, on the other hand, a risk of rapid housing loan growth through which loan portfolios are being loaded with potentially higher-risk new loans. At the same time, banks' profitability and financial resilience remain under pressure from prolonged low interest rates, lax loan refinancing rules, and a high share of financial agents.

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[27] For further details, see this commentary's section on the housing market.
[28] https://www.imf.org/en/Publications/GFSR
[29] https://www.ecb.europa.eu/pub/financial-stability/fsr/html/index.en.html
[30] https://www.cnb.cz/cs/financni-stabilita/makroobezretnostni-politika/proticyklicka-kapitalova-rezerva/opatreni-obecne-povahy-ke-stanoveni-sazby-proticyklicke-kapitalove-rezervy/Opatreni-obecne-povahy-II-2021/
[31] https://www.nationalbanken.dk/en/publications/Documents/2021/05/ANALYSIS_No.%2012_Financial%20Stability_1st%20half%202021.pdf
[32] Tighter LTV limits and stricter loan repayment rules.
[33] See the IMF's June2021 Country Report for Slovakia.

What´s new in the world of macroprudential policy

Slovak banks' resilience independently confirmed by the IMF

The IMF recently subjected the Slovak banking sector to a relatively wide range of stress tests. Based on the results, it concludes that the sector has sufficient capital to cope with the stresses. In the scenario of a gradual unwinding of pandemic support measures coupled with a housing loan market shock, the banking sector's CET1 ratio is estimated to fall by 2.8 percentage points. Its level, however, remains above the regulatory minimum (including capital buffers), and banks remain stable and can continue lending to the real economy. The highest risk in the loan portfolio lies in new mortgage loans provided just before the outbreak of the crisis, which are around three times riskier than the rest of the portfolio. According to the IMF, this risk could be reduced by tightening LTV or DSTI limits.

Appropriately calibrated macroprudential policy accelerates economic growth

That is the conclusion of a recent paper published by the Bank of England.[34] Using a DSGE model and data for 24 advanced economies, the authors find that appropriate macroprudential policy can prevent more than half of the permanent output losses in response to financial shocks. Such a policy thus prevents asset price loss and increases household welfare. According to the authors, however, macroprudential policy must focus not only on short-term targets, but also medium-term targets, so as to be able to meet the twin objectives of supporting financial stability and bolster economic growth. In this way, macroeconomic policy also reduces the probability of the monetary policy rate reaching the zero lower bound.

Is macroprudential policy effective as a tool for supporting loan growth?

Macroprudential policy tools are relatively effective in reducing excessive household loan growth and systemic risk. This effect is, however, asymmetric; policy easing does not have such an upward impact on loan growth. So says a recent paper published by the Bank for International Settlements.[35] Using supervisory bank-level data for five Asia-Pacific countries, the authors evaluated the effectiveness of macroprudential policies. At the same time, the authors found that large banks and banks with high liquidity are less sensitive to macroprudential policy change since they are better able to raise additional funds.

How can it be that the pandemic crisis has not affected the housing market?

The question of how housing markets in many advanced economies have remained buoyant through the severe pandemic-induced economic downturn was recently addressed in a speech by Sir Jon Cunliffe, the Bank of England's Deputy Governor for Financial Stability.[36] A pandemic-driven structural shift in which there is increasing demand for housing away from urban areas may, in his view, support a return of housing price growth to its pre-2008 trend. Unlike then, however, prices outside major urban areas may converge more quickly towards those in such areas.

Risks related to fiscal debt are affecting the banking sector

A 2021 paper from the South African Reserve Bank[37] looks at the impact of fiscal policy on capital buffers in the banking sector. According to the authors, their results show a positive relationship between the sovereign risk premium and capital buffers. This suggests that fiscal policy decisions need to take into account the adverse impacts of negative fiscal shocks on the financial sector. At the same time, financial market regulators need to review the role of government debt as a low-risk asset in the regulatory framework, while bank exposure to sovereign debt instruments should be reduced as a precaution against a sudden increase in fiscal risks.

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[34] Bonciani, D., Gauthier, D. and Kanngiesser, D., "Slow recoveries, endogenous growth and macroprudential policy", *Staff Working Papers*, No 917, Bank of England, April 2021.

[35] Cantú, C., Gambacorta, L. and Shim, I., "How effective are macroprudential policies in Asia-Pacific? Evidence from a meta-analysis", *BIS Papers*, No 110, Bank for International Settlements, 2020.

[36] See the speech entitled "Housing – The Quiet Decade" given by Sir Jon Cunliffe, the Bank of England's Deputy Governor for Financial Stability, at The Law Society Property Section Convention, London, 20 May 2021.

[37] Makrelov, K., Pillay, N. and Morule, B., "Fiscal risks and their impact on banks' capital buffers in South Africa", *Working Paper Series*, No 21/08, South African Reserve Bank, May 2021.