NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Analysis of the Slovak Financial Sector for the Year 2009

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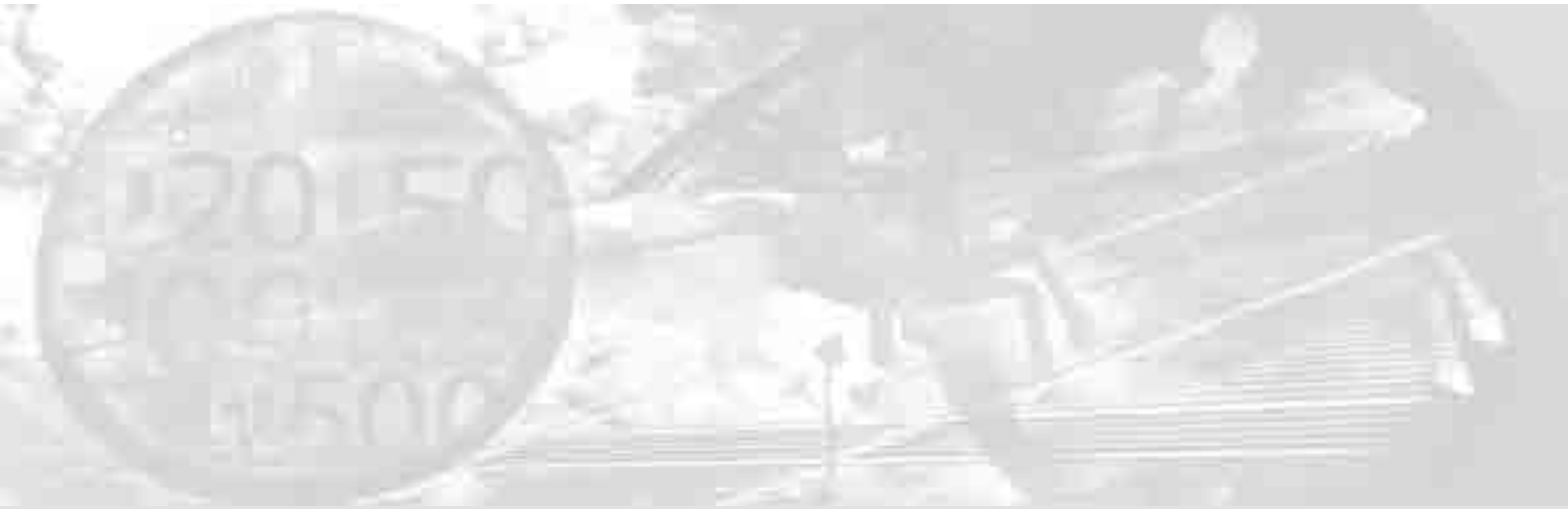

FOREWORD

Foreword

Národná banka Slovenska produces the Analysis of the Slovak Financial Sector for the purposes of the NBS Banking Board as well as for professionals and the wider public. The object of this analysis is to analyse the current situation and developments in the financial market, to warn of potential risks and threats to its stability, and thereby to support efforts to pre-empt potential crisis situations.

This analysis evaluates the overall condition of the financial sector, focusing on the analysis of the system's resilience to possible negative developments. The analysis is based on the evaluations of individual institutions and of the sector as a whole. It also aims to elucidate a deeper link between the developments in the financial sector, on one hand, and the development of macroeconomic and microeconomic indicators, on the other hand. Its macro-prudential nature is reflected especially in the use of stress testing, through which the sector's sensitivity in various scenarios may be assessed.

As in the previous analyses, financial information on particular institutions is primarily obtained from Národná banka Slovenska's internal sources. Additional sources included the Statistical Office of the Slovak Republic (SO SR), the Real Estate Price Map, Eurostat, the European Central Bank (ECB), and other external sources and commercial information systems. The analysis does not take into account activities concerning the exercise of supervision over particular institutions.

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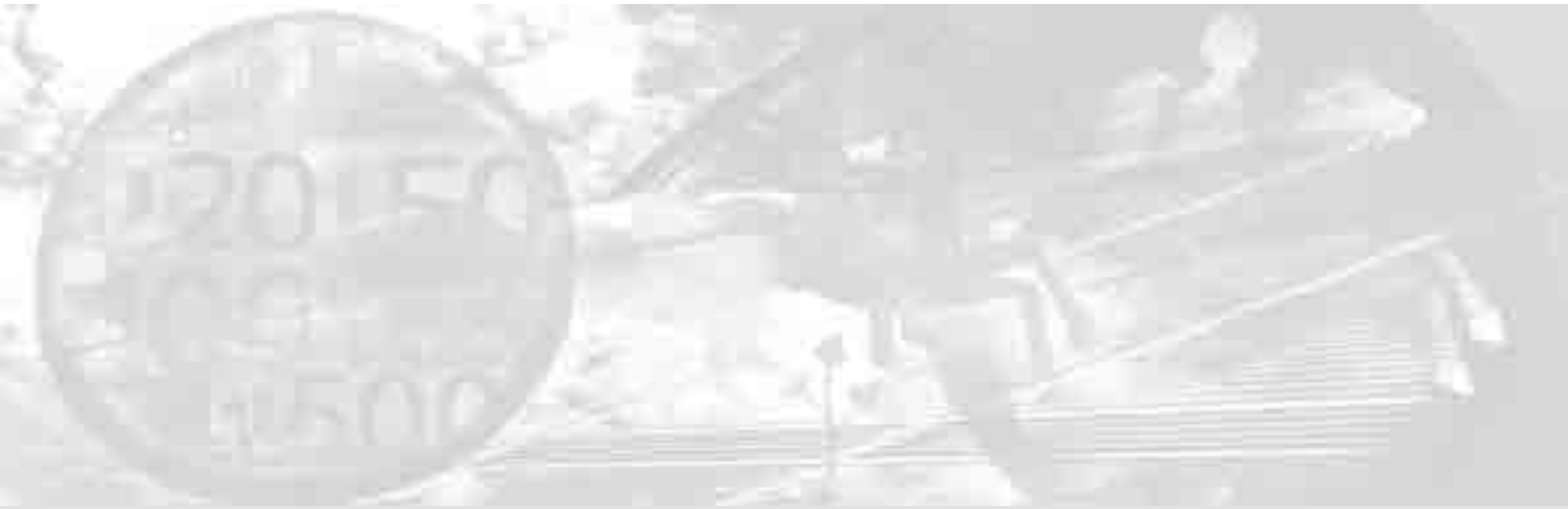


ANALYSIS SUMMARY

Analysis Summary

The accumulation of global imbalances and a loss of confidence led to the financial and economic crisis

The stability of the Slovak financial sector in 2009 was marked by the deepening global financial and economic crisis. The crisis had started to show up in the financial market in 2008, and in 2009 it was already assuming the nature of an economic crisis. Although there were several causes of the crisis situation, the primary one could be identified as the accumulation of global imbalances and the loss of confidence in external financial markets that ensued as a result. The crisis also indicated certain structural problems that economies and financial markets will face in the years ahead. The contraction in global demand (which before the crisis was dominated by one country) is set to increase pressure on export-oriented countries and will probably affect Slovakia, too. In the medium-term and long-term horizons, this may be reflected also in the corporate sector, particularly in the form of pressure on existing production capacity.

Fragile stabilisation of the global economy in the second half of 2009

Economic developments in 2009 were not uniform. After a deep slump in the first half of the year, a very fragile stabilisation emerged over the remaining six months, when financial markets and economies felt the positive effects of stimulus measures taken by central banks and governments. In the near-term, however, there is no prospect of a return to the growth levels seen before the crisis. From a medium to long term perspective, the main problem is the high debt ratios of enterprises and households, whose activities are crucial to kick-starting sustainable economic growth. Meanwhile, weak confidence in the corporate sector is reflected in the slow pace of job creation. Unemployment at the global level has risen sharply and there is little likelihood of this situation turning around in the near future.

In banking sectors, too, uncertainty about the economic recovery is prevalent and is reflected mainly in the ongoing credit crunch. At the same time, in Slovakia and most other European countries, lending activities are crucial to the financing of the real economy.

In the near term, financial markets will face a relatively new type of risk in the form of rising sovereign debts. The liquidity of the European banking sector may also be affected by the ECB's gradual tightening of monetary policy through exit strategies. This may also feed through to a reduction in the Slovak banking sector's liquidity as its funds flow out to the external environment.

In 2009, the global crisis began to have a relatively significant impact also in Slovakia

The global downturn in 2009 was felt also in Slovakia. The vulnerability of the Slovak economy was exacerbated by its high openness and the structure of the domestic industry, which is dominated by sectors sensitive to the business cycle. As a consequence, the economic downturn was relatively severe. After recording growth of 6.2% in 2008, the Slovak economy contracted by 4.7% in 2009. That the Slovak economy performed below the euro area average was largely due to its strong dependence on exports; in other countries, by contrast, domestic consumption accounts for a more significant share of the GDP structure. The adverse developments were reflected with a lag in sectors of the economy focused on domestic consumption, particularly in the real estate market, construction sector, and selected services. The economic downturn showed up relatively quickly in an unemployment rise that was among the highest in the euro area.

Profits plunged in the domestic banking sector

The banking sector in Slovakia typically has relatively close links with the domestic economy. This was to the sector's advantage particularly in the first stage of the crisis, when the effects were largely confined to external financial markets. As the crisis gradually spilled over into the domestic real economy, it began to be felt also by domestic banks. In 2009, these negative repercussions on the banking sector were compounded by the adoption of the euro and were reflected mainly in banks' profits and in interbank market developments.

Overall profits in the banking sector plunged by more than 50% year-on-year. The aforemen-

tioned impact of the euro changeover on foreign exchange income contributed to this slump, and so did the rising cost of covering credit losses. Several banks recorded a drop in interest income, especially from the banking and corporate sectors.

As for capital adequacy, its development in 2009 can largely be judged as positive, which indicates that banks have the ability to cope with an unexpected increase in losses. During the course of the year, several banks increased their own funds, predominantly out of profits generated in 2008. It should be noted, however, that this positive trend was not seen in all banks.

Banks behaved more conservatively in 2009

The behaviour of banks in 2009 can be described as conservative, and this was particularly true in the case of asset-side operations. In their lending activities, banks focused mainly on loans that had a higher probability of repayment, and, in comparison with the pre-crisis period, they switched their sights to the actual repayment of loans. In the area of corporate financing, banks therefore concentrated on less risky sectors and entities. Financing conditions were also tightened by other financial intermediaries, such as leasing companies and hire purchase companies, which had been harder hit by the crisis. Another major factor in the restriction of corporate lending was the decline in demand from enterprises, which in turn reflected the dwindling number of investment opportunities.

By contrast, the proportion of more conservative, i.e. relatively safer, investments increased. In particular, the share of government bonds rose more sharply than the share of external government bonds for the first time ever. Banks maintained lending to households, which they see as less risky than enterprises, and therefore this area of lending recorded relatively strong growth even in 2009.

In the interbank market, banks' activities underwent a marked change in comparison with 2008. In that year, banks mainly received deposits from foreign banks and then conducted liquidity-absorbing operations with Národná banka Slovenska. In 2009, however, after the euro changeover, these operations lost their previous significance, and the banks' interbank market activities centred primarily on liquidity-providing operations with the ECB/NBS. Several banks borrowed mainly at one-year maturities. The funds borrowed were invested predominantly in government bonds, and, in some cases, in the interbank market.

Differences between banks were exposed in 2009

In crisis years, facts that are hard to detect at times of strong growth are to a large extent revealed. In 2009, the banking sector saw differences between banks become more apparent than they had been in the past, and this happened in several areas. These differences stemmed largely from activities undertaken in previous periods. By the same token, the condition in which banks found themselves when the crisis arose will very probably influence their behaviour in subsequent years.

These differences can be seen, for example, in the quality of banks' credit portfolios, in particular in terms of the loan default ratio as well as the financial condition of the enterprises to which banks are exposed. As for interest income, differences emerged between large banks and other banks. Whereas most banks recorded a drop in interest income from the corporate and banking sectors, large banks, in particular, maintained their level of interest income from the household sector. Overall, therefore, the banking sector's profits in 2009 included sizeable differences between individual banks.

There were also differences in lending activities. In contrast to previous years, the abovementioned increase in loans to households was concentrated in only certain banks, as other banks substantially restricted their lending to this segment. Again in 2009, in line with the trend of previous years, certain banks faced greater difficulty in finding a market niche.

Credit risk in certain economic sectors rose more sharply in 2009

The slump in the domestic and external economies was relatively quickly felt in the corporate sector. Enterprises were adversely affected mainly in the first half of 2009. Thereafter, the situation stabilised, but like the economy's development, the stabilization is still judged to be relatively fragile due to the weakened financial position of the corporate sector. Industrial output remains at a low level, with output for 2009 being at around the same as the 2005 level. This shows up in the relatively large extent of idle production capacity.

In 2009, the ability of enterprises to repay their bank loans was limited. The beginning of the year saw a rise in credit risk mainly in export-oriented sectors and in the transportation sector. Over the course of the year, banks' exposure to the property market emerged as a significant risk, as the drop in demand, prices and occupancy rates made it more difficult for property developers to repay loans. Even more than before, the effect of market developments on individual projects varied according to their quality and location. We assume that the differences between these projects will be reflected in how non-performing bank loans develop in 2010. This sector poses a greater risk to banks also because of the relatively high concentration of these loans in terms of their size.

The situation in the household sector was similar to that in the corporate sector, although the impact was more moderate. The rise in unemployment was sharp in the first and second quarters, and then stabilised slightly. Even so, households remain exposed to a relatively high level of uncertainty, which in turn is related to the slow and fragile recovery in the corporate sector. Lower-income groups have been hardest hit. The exposure of banks to these groups is predominantly concentrated in consumer loans and current account overdrafts, and it is these loans that recorded the highest rise in the default ratio. Although lower-income groups take out a smaller proportion of house purchase loans, their share in this regard has been rising in recent years.

The banking sector's exposure to market risks hardly changed in 2009

As regards market risks, the banking sector was exposed mainly to interest rate risk. Banks would be particularly vulnerable to the scenario of a parallel rise in interest rates. Under the scenario of a rise in interest rates on shorter maturities and the stagnation of interest rates on longer maturities, the adverse effect on banks would not be as severe.

The amount of exposure to interest rate risk remained largely unchanged in 2009. The rise in longer-term retail deposits in the last quarter of 2009 was related to the extending of the bond portfolio's duration.

Stable development in banking sector liquidity

The banking sector's stability in the area of liquidity was confirmed again in 2009. From a long-term perspective, it is important that a majority of banks are still covering their lending activities with stable deposits from customers. It was mainly branches of foreign banks that reported a higher proportion of volatile funds in the financing of loans. The short-term liquidity situation was stable, with almost all banks meeting the prescribed short-term liquidity ratio.

There were, however, differences between banks in the sector. Certain banks reported higher sensitivity to liquidity risk, whether short-term or long-term.

Despite the adverse economic situation in 2009, the banking sector is stable

Despite the deteriorating economic situation and rise in banks' risk exposures in 2009, the banking sector as a whole can be said to be stable. We assume that the sector, and particularly the systemically important institutions, should be able to cope not only with anticipated developments, but also with any worsening of the situation which is greater than expected.

The banking sector's strong resilience to adverse developments was demonstrated under stress testing. The simulated scenario involved a recurring deterioration in economic development, both at home and in the external environment, and escalating uncertainty in financial markets. Even in the event of a substantial negative development in the domestic economy and a higher rise in non-performing loans, most banks would satisfy the capital adequacy requirement.

Given the structure of banks' activities, losses made by banks in the event of negative developments would arise mainly from their corporate loan portfolios. Selected banks also reported high sensitivity to household lending. In certain banks, the simulated credit losses should be mitigated by expected profits, especially from interest income. A key factor in the banking sector's stability over the next two years remains the relatively sound footing in which it found itself at the onset of the crisis.

Insurers recorded a decline in premiums

The insurance sector was marked by two major developments in 2009. Firstly, the amount of premiums in the sector recorded its largest ever decline, mainly due to the unfavourable economic situa-

tion. Secondly, profits increased by almost 30% in comparison with 2008, the principal reason being an increase in earnings on financial operations.

A sharper drop in premiums was recorded in life insurance. Premiums for unit-linked insurance policies, which for a long time had reported the highest growth among all lines of business, fell by more than 15%. In non-life insurance, prolonged contracts increased as a share of all insurance contracts, indicating a stabilisation of insurance portfolios in almost all lines of business. In the motor insurance segment, premiums for motor vehicle insurance exceeded premiums for motor third-party liability insurance for the first time since 2002.

As for the investment structure of technical provisions, the share of government bonds increased at the expense of bank bonds and term deposits.

The stabilisation in financial markets had a positive effect on the pension saving and collective investment sectors

In the pension saving sector, the portfolio composition of all pension funds underwent a radical change in 2009. Pension fund management companies sold practically the entire equity component of their fund portfolios and substantially reduced the volume and share of the bond component. The funds released in this way were re-invested in Treasury bills. In raising the size of the government bond component, the companies purchased debt securities with a shorter residual maturity. At present, the assets of these funds are exposed to concentration risk owing to the low diversification of bank deposits in different banks. They are also to some extent exposed to the risk that the securities purchased will drop in value. The risk of an issuer's credit rating being downgraded is greater than in the past, especially given the increase in the share of investments in debt securities issued by countries with a higher debt ratio.

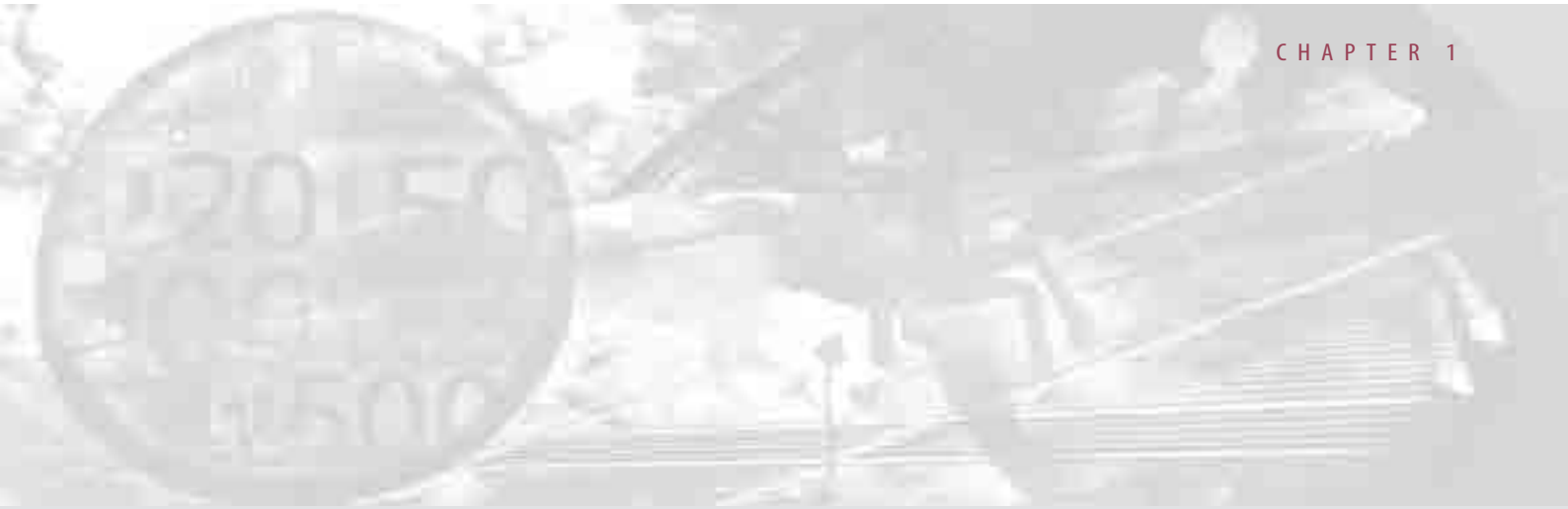
The net asset value of funds in Pillar II of the pension saving system continued to grow. It can be seen as a good sign that the year-on-year performance of balanced and growth funds entered positive territory for the first time since the outbreak of the global financial crisis. Once again, though, savers with conservative funds enjoyed the highest yields.

As for the collective investment sector, in the first quarter of 2009 it was still reeling from the negative developments that arose in 2008, largely as a result of the financial crisis. This was a quarter marked by plunging prices of certain assets and increased redemptions. Over the next period of 2009 – with growth in stock markets bringing the first signs of improved expectations for economic development and stabilisation in other asset prices – investor interest in mutual funds gradually began to pick up and the collective investment sector started to stabilise. The growth in net sales was supported also by the low level of interest rates on bank deposits, the principal alternative to investments in mutual funds. Overall, in 2009, mutual fund asset prices and the sector's net asset value rose in comparison with the end of 2008, but they still fell short of the levels recorded before the onset of the huge financial turbulences in the second half of 2008.

As financial markets stabilised, the significance of market risks declined

As regards the principal market risks that Slovak financial institutions are exposed to, the most significant development in 2009 was the decline, during the second half of the year, in the volatility of equity index prices and in interest rates and credit spreads. In most sectors, the high exposure to risks remained largely unchanged during 2009. The most significant change occurred in the fund portfolios of pension fund management companies, which became far less risky during the second quarter of 2009 following modifications of the portfolio structures. Nevertheless, the retirement pension saving system was exposed mostly to the sovereign risk of countries that have a high general government debt, though only through bonds with a short residual maturity. In addition, the equity component of mutual fund portfolios increased, reflecting the upturn in share prices as well as the positive net sales of equity and mixed funds at the end of 2009.

Clearly, the highest risk in the short-term is in insurance companies' portfolios of assets invested in the name of insured persons ("unit-linked insurance"). These portfolios reported a high share of investments in equity shares and mutual fund shares, as well as a long duration in their bond component.



CHAPTER 1

MACROECONOMIC DEVELOPMENTS AS THEY AFFECT FINANCIAL STABILITY

1

1 Macroeconomic Developments As They Affect Financial Sector Stability

Economic recession in 2009 had a global nature

In 2009, the global economy faced its deepest recession of the post-war era – the result of a sequence of events that began in 2007 with the US subprime mortgage crisis and then snowballed into a global financial crisis in the second half of 2008. World gross domestic product fell by 1.1% year-on-year, with the heaviest slump in output coming in the first quarter. Later in the 2009, the situation began to stabilise under the effect of a wide range of anti-crisis measures, and in the third quarter of the year a modest recovery began to take place. By the end of the year, however, economic activity had still not returned to its pre-recession level. Industry recorded a relatively deeper cyclical downturn, though it also made a quicker return to recovery. Exports of industrial goods were hit particularly hard, while the situation in services was somewhat more stable.

Although the economic downturn touched almost all parts of the world, it differed sharply in extent from country to country and from region to region. In a departure from their historical development, advanced countries recorded a deeper slump. By contrast, the emerging market countries of South America and Asia – led by Brazil, India and, above all, China – made a quick return to rapid growth following the initial negative shock, and they thereby contributed significantly to a partial improvement in the situation in other parts of the world. The severe negative developments were felt also in central and eastern Europe.

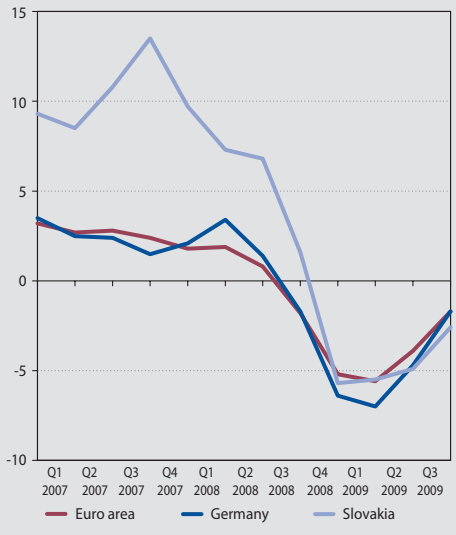
Slovakia, too, suffered sharp economic contraction

In Slovakia, too, the economic situation deteriorated. In 2008, the domestic economy posted growth of 6.2%, but in 2009 it contracted by a severe 4.7 %. Largely because it was heavily dependent on exports at a time of plunging external demand, the Slovak economy recorded below-average growth in the euro area, most of whose countries report domestic consumption as a larger share of their GDP structure. Slovakia's negative position in this regard was compounded by its substantial exposure to the crisis-hit motor industry. But as the situation began to turn for the better, especially in the euro area, demand for Slovak exports also started to pick up, and in the third quarter of the year the domestic economy's quarter-on-quarter growth was among the highest recorded among euro area countries.

Changes in global economic relations will probably lead to restructuring of the corporate sector in both Slovakia and the euro area as a whole

The current economic crisis was triggered by a collapse in global demand, which in turn was a reaction to the general decline in confidence caused by the initial financial crisis. The key factor in this regard was a slump in consumption, primarily consumption in the United States, whose credit-fuelled growth had previously been the main driver of global economic growth. The impact on investment demand was relatively stronger still, as firms facing a drop-off in interest for their products and services, as well as heightened uncertainty, slashed investment in their future development. In addition, there

Chart 1 Quarterly development of GDP in selected countries (year-on-year changes in %)



Source: Eurostat.

was extensive destocking, which was negatively reflected in the drop in GDP.

The trends outlined above signal one very important change that will affect the development of the world economy in the long term. The change in question concerns the structure of global economic relations that existed before the crisis. In simplified terms, these relations had hitherto been based on strong consumption in the United States combined with the export orientation of other major economies. With the bursting of the bubble in the United States, however, the export-oriented economies in particular have come under pressure and therefore need to seek alternative sources of demand. Despite widespread assumptions that China will manage to replace the demand lost in the United States, we do not expect that this will happen. Our view is more or less confirmed by recent developments in the Chinese economy. The more likely scenario, especially in euro area countries, is that pressure will build up for corporate restructuring and a greater focus on domestic demand. This trend is likely to put substantial pressure also on the corporate sector in Slovakia, notwithstanding its specific competitive advantages.

Interventions by governments and central banks restored confidence in financial markets

In response to the negative developments, governments and central banks around the world undertook a radical loosening of fiscal and monetary policies. The primary effect of these government and central bank interventions was to restore confidence in the global economy and thereby lay the basis for the current optimism. From a short-term perspective, the stimulation of economies through government spending and injections of new money proved to be relatively successful, with many countries reporting stronger than expected growth, especially towards the end of the year.

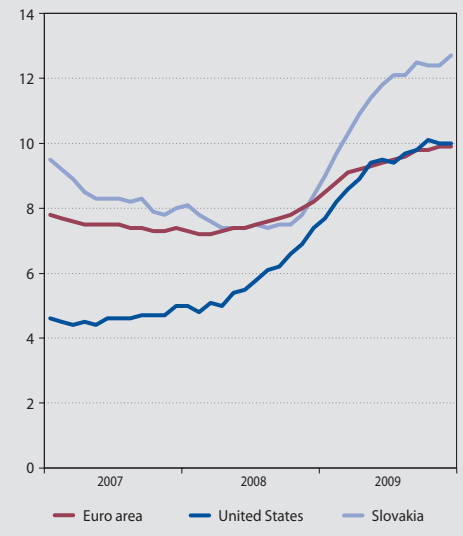
But for sustainable growth to be entrenched over the long term, it is essential that the focus of demand shifts back from the public to the private sector, i.e. to household final consumption and to corporate investment. A return to strong consumption growth faces, however, the obstacle of high household debt ratios in advanced countries, which prevents the further accumulation of debt that is a necessary corollary of such development. In fact, it is the opposite tendency that currently prevails among households, as they show a propensity to save and seek to deleverage balance sheets. The situation is further complicated by the tight lending conditions that face any entities interested in using bank loans to increase their consumption. Consumption has also been dampened by the decline in value of household assets, whether financial or in the form of real estate.

Developments in the employment rate – a key indicator of business sector confidence – do not yet show any sign of improvement

The financial position of households is coming under pressure also from rising unemployment. In the United States and the euro area, the rate of unemployment in 2009 reached around 10%, though there were disparities in labour market developments in these two regions. In the United States, the year began with a relatively sharp rise in the unemployment rate, as firms responded to reduced demand by cutting costs. In Europe, by contrast, redundancies were carried out at a slower pace thanks to government measures for maintaining employment. The difference in approach is reflected in the fact that labour productivity is rising in the United States and falling in the European Union. While it is therefore expected that US unemployment could begin to fall during the course of next year, the prospect of a further rise in EU unemployment is not inconsiderable. If the macroeconomic situation fails to improve substantially, firms will have to lay off staff as they adjust to a new reality in which employment support measures have already run their course. Even if the euro area's unemployment were to end 2010 at below its level of 12 months earlier, its decline would probably be only gradually paced; the same applies to the United States. A negative aspect of the unemployment structure is the rise in its long-term component.

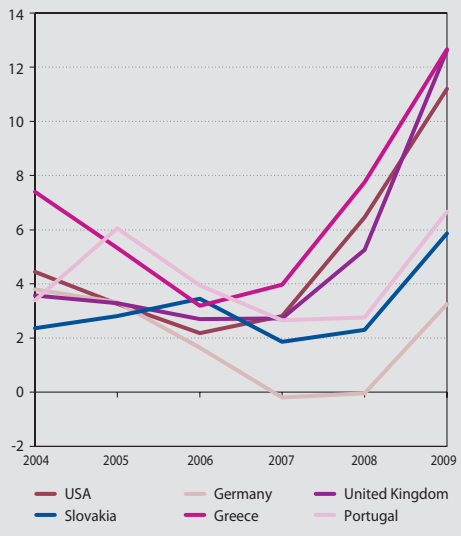
Unemployment in Slovakia recorded a similar development. The unemployment rate, as measured by the Labour Force Sample Survey, rose from 9.7% to 13.6% over the course of the year, which represented a steeper increase than that seen in other economies. Given the employment trends in the euro area, we expect that unemployment will continue to climb in 2010.

Chart 2 The unemployment rate in selected countries (%)



Source: SO SR, Eurostat, other sources.

Chart 3 General government deficits in selected countries (percentage share of GDP)



Source: OECD.

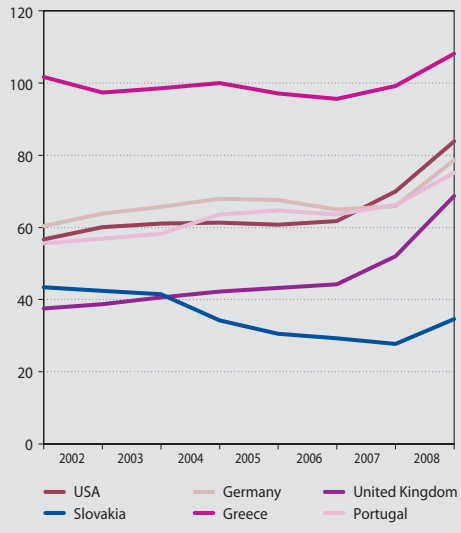
As to whether the economy is headed on the path to strong and long-term growth, we assume that a turnaround in the employment rate will represent a highly important indicator of such development.

Sovereign risk emerged in 2009 after previously being insignificant

The combination of massive fiscal stimulus measures and a drop in tax revenues caused by the slowdown in economic activity resulted in ballooning budget deficits in many countries around the world. The median deficit increase in the euro area was 4.8 percentage points. In order to cover these deficits, government bonds were issued on a scale never seen before. Furthermore, the volume of government bonds issued in 2010 is expected to be even higher than in the previous year. The large deficits are rapidly amplifying government debt levels, which are now already relatively high in several countries. The risk is emerging that financial markets will accept such an increase only at the price of higher government bond yields. This would give rise, on one hand, to a further escalation of budget interest costs and, on the other hand, to an increase at the longer-end of the yield curve, thereby pushing up borrowing costs and thus undermining the fragile economic recovery. Such a scenario may also be made more likely by central banks ending the monetary loosening that ensured low rates in 2009.

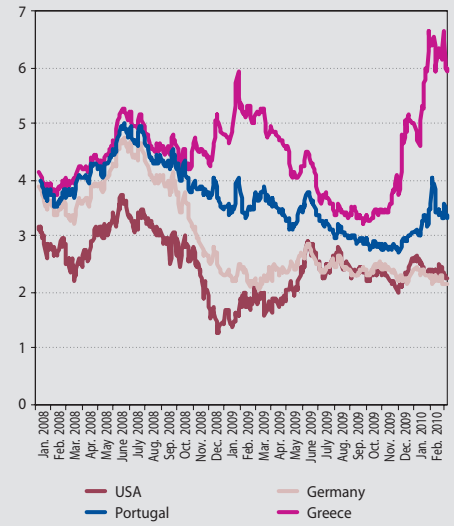
That such a development cannot be discounted is confirmed by the cases of Spain, Portugal and, above all, Greece, which since the end of 2009 have faced an increase in the risk premium on their government bonds. In the first two months of 2010, the credit risk situation in the peripheral countries of the euro area continued to escalate. Speculation intensified about the prospect of

Chart 4 General government gross debt in selected countries (percentage share of GDP)



Source: Eurostat, other sources.

Chart 5 Yields of on 5-year government bonds of selected countries (%)



Source: Reuters.

Chart 6 Interbank rates and bank CDS spreads

Source: Reuters.

Greece suffering a sovereign bankruptcy or at least having to be bailed out by the EU or IMF. Besides having a direct impact on investors in Greek government assets, such a scenario would likely lead to a collapse in confidence in government-issued securities in general, and thus it would adversely affect interest rates and the nascent economic recovery.

Slovakia, too, could be affected by such developments. Although Slovakia's government debt is basically low at present, any general rise in investor aversion to government debt in the so-called peripheral euro area countries – triggered by the situation in the above-mentioned economies – could bring the said negative effects to Slovakia as well.

After initial uncertainty, the situation in financial markets gradually stabilised over the course of 2009

A global stabilisation of financial markets was seen in 2009. Although all segments were still dominated by high uncertainty and tight liquidity until around March 2009, the situation began gradually to improve, largely as a result of the broad range of measures taken by central banks. These included, in particular, the cutting of official interest rates to all-time low levels, the purchase of various kinds of securities, and non-standard injections of liquidity into the banking sector.

The ECB cut its main refinancing rate to 1%, the lowest level since the establishment of the euro area. This, however, was still less aggressive than rate reductions in the United States, where the key rate went down to 0.25%. Among the most important non-standard measures taken by the ECB were the implementation of a covered bonds purchase programme and a full allotment procedure for banks seeking liquidity at longer maturities of up to one year. Confidence thus returned to most financial markets, including the crucial interbank market, and this was seen in the fall in several indicators of liquidity and credit risk to levels not recorded since before the collapse of Lehman Brothers.

The situation in euro area banking sectors stabilised

The asset side of the euro area banking sector's balance sheet was dominated in 2008 by the decline in value of structured securities, but in 2009 the focus of negative pressures on the balance sheet shifted to the deteriorating quality of the credit portfolio. In other words, prices of asset-backed securities ceased falling as property markets in Europe and the United States stabilised; at the same time, however, default rates began to increase on household loans and, even more so, on corporate loans. As for the banking sector's liabilities, the situation improved as a result

of the ECB supplying ample liquidity. However, those banks that were heavily dependent on central bank financing throughout the year may again face difficulties in 2010, given that the ECB plans to gradually phase out its non-standard liquidity support measures.

Flow of bank loans remained restricted

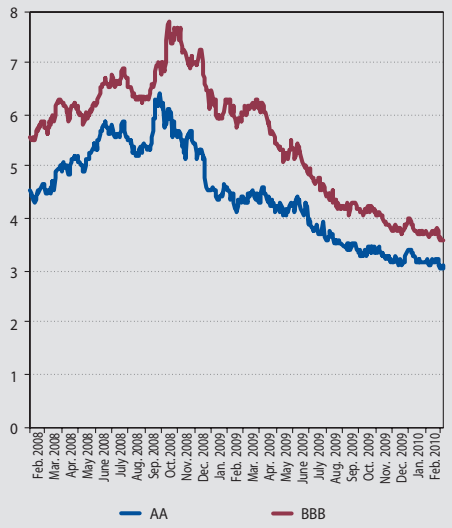
Besides supplying markets with liquidity, the central bank's measures were also intended to boost lending as a catalyst for economic activity. This second objective, however, remained largely unfulfilled in 2009. The total amount of corporate lending even began to decline toward the end of the year, while lending to households recorded only a slight rise. This state of affairs reflected a combination of low demand from economic entities and the tightening of bank lending standards. Although standards were tightened throughout 2009, the slowdown of this process towards the year-end represented a moderately positive sign.

The segment of house purchase loans offers relatively the best prospects for lending growth since it has so far reported the lowest degree of risk, according to a survey conducted among banks. As for consumer loans and loans to enterprises, no significant turnaround is expected in the short-term horizon. The unwillingness to lend is largely related to the rise in credit risk posed by enterprises and households, the general escalation of risk aversion during the crisis, and efforts to deleverage balance sheets. What matters even more in the decision to restrict lending is the anticipated tightening of regulation in the liquidity and capital position field.

As bank lending tightened, firms resorted to market financing to a substantially greater degree

Amid straitened lending conditions, enterprises in the euro area increasingly resorted to the capital markets in order to meet their financing needs. The issuance of corporate debt securities in 2009 reached record levels, especially during the second half of the year. Despite the wave of new issues, the yields to maturity on corporate bonds began falling from the second quarter of the year. The high level of investor interest reflected the decline in investors' aversion to these bonds combined with investors' search for yield at a time of generally low interest rates. This demand was not just for issues with the best credit rating, but also extended to non-investment grade issues.

Chart 7 Yields to maturity on corporate bonds (%)



Source: Reuters.
Note: Data in percent on the left-hand scale represent an index of the yield to maturity on corporate bonds of the respective rating grade.

Since mid-January 2010, activity in the corporate bond market has begun to show signs of cooling, owing to uncertainty about peripheral euro area countries. This uncertainty has been partly reflected in a rise in the required yield to maturity on corporate bonds. In general, the risk remains that the high interest rates under which government debts will be serviced will squeeze the ability of firms to obtain financing from the market, given the high price they would have to offer to make their securities as attractive as government paper.

In obtaining market financing, enterprises are not just seeking funds necessary for their operations; they also want to take advantage of the chance to obtain cheap finance before the expected tightening of monetary policy and the consequent rise in other interest rates. Some enterprises have in this way refinanced bank loans and extended the maturity of borrowed funds, which can be seen as a positive move in terms of the stability of their balance sheets. It should be noted, however, that access to capital markets is confined mainly to large corporates and that

access to financing for small and medium-sized enterprises remains restricted.

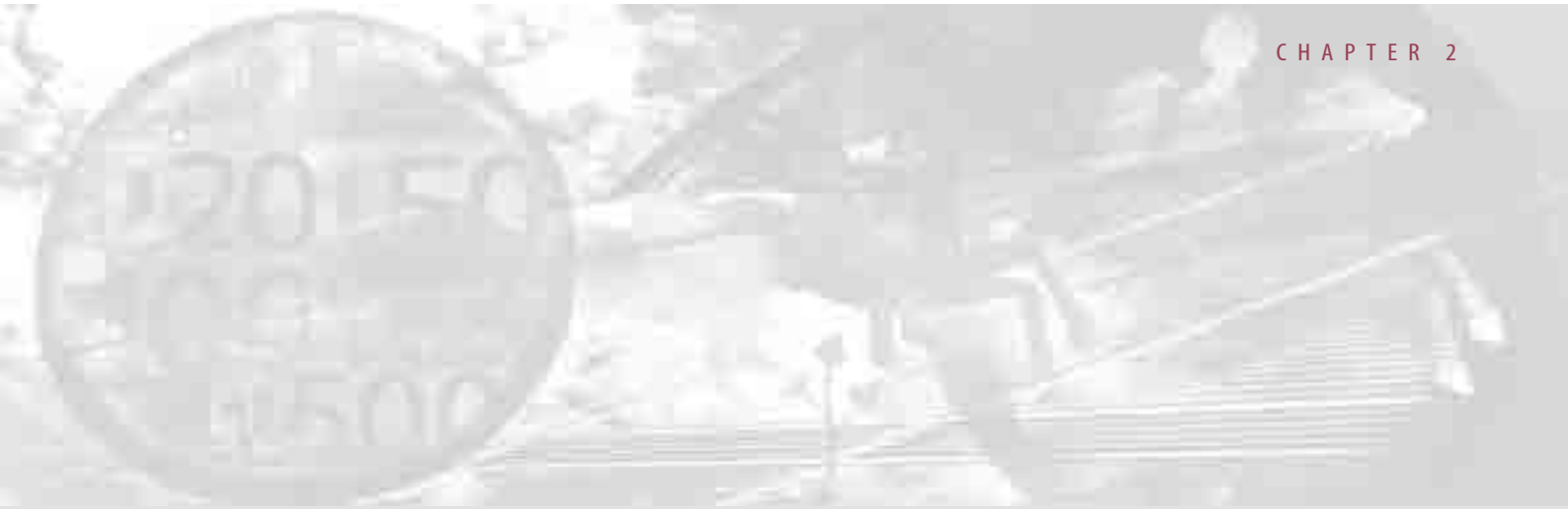
Financial market developments were affected to a large extent by carry trade strategies

In conditions of low interest rates, particularly for the US dollar, the implementation of carry trade strategies became more marked during the course of 2009. Such trades involve investing cheap funds in higher-yielding, and therefore riskier, assets. With US interest rates practically at zero, the dollar made an ideal means for effecting this strategy. The adoption of such positions on a large scale was the fundamental cause of the soaring prices of a wide range of riskier assets around the world, such as shares, corporate bonds and commodities.

This trend was particularly apparent in large emerging economies, and the levels reached in some cases raise questions about whether price bubbles are developing. From the end of the first quarter of 2009, the dollar's position as the funding currency of carry trades brought about a decline in its exchange rate against the euro as well as other currencies, mainly those of emerging countries. By the time this trend came to an end at the beginning of November, the euro had strengthened by 20% against the dollar, from its lowest position recorded in March. The weak dollar could have been an advantage for both the US economy and China (which kept its own currency pegged to the dollar), while the strong euro, by contrast, partially undermined the competitiveness of euro area exports. From the beginning of December, however, the fiscal problems of certain euro area countries resulted in a sharp turnaround in the euro/dollar currency pair to the detriment of the single European currency. This strengthening of the US dollar may lead to the end of these carry trade strategies, which in turn will probably feed through to another decline in financial asset prices.

Realistic threat of high inflation in the medium-term horizon

Both the ECB and Fed increased the money supply in an effort, inter alia, to avert the threat of long-lasting deflation, which in the first half of 2009 represented the greatest risk to economic recovery for the euro area and the United States. This aim can be said to have been achieved, since inflation, following a short period of falling prices, began to rise towards the year-end (though inflation in the euro area still remained relatively far below the target level of close to two percent). At least in the medium-term horizon, however, a threat of high inflation is emerging, given the influx of new money over the past two years and the need for refinancing of rising government debts.



DEVELOPMENTS IN THE SLOVAK FINANCIAL SECTOR

2

2 DEVELOPMENTS IN THE SLOVAK FINANCIAL SECTOR

AMOUNT OF ASSETS SLUMPED AT THE BEGINNING OF 2009, THEN ROSE SLIGHTLY IN THE SECOND HALF OF THE YEAR

For the Slovak financial sector, 2009 was not a straightforward year. Whereas the sector had been less affected by the first wave of the crisis – in the second half of 2007 and the first half of 2008 – than had the United States and western European countries, the second half of 2008 saw the crisis gradually spread to Slovakia's real economy. The customers of financial institutions reflected this development by their change in behaviour, and the impact on these institutions was more substantial. Meanwhile, the introduction of the euro currency represented a second, one-off effect.

These effects were most pronounced in the banking sector, where the amount of assets fell firstly as a consequence of the euro changeover and related cessation of NBS's liquidity-absorbing operations. Although the withdrawal of foreign banks' deposits was mitigated by an increase in household deposits, the total amount of assets in the sector dropped by €9.9 billion. Given the inflow of foreign banks' deposits during previous years, this turnaround should be seen as unavoidable. The drop-off in interbank activities contributed to the lower volatility of the banking sector's balance sheet.

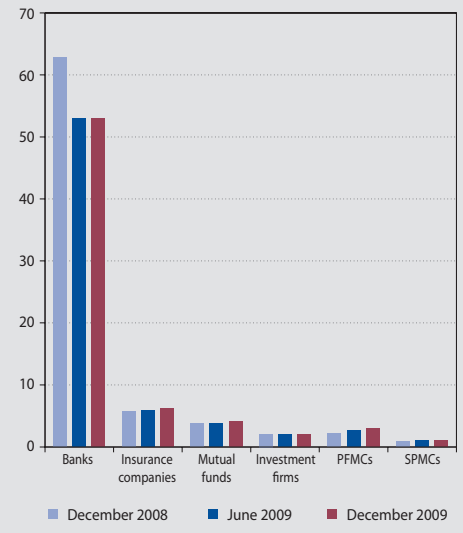
Amid weaker confidence in financial markets in the first half of 2009, the assets of collective investment funds and investment firms declined by, respectively, €84 million and €49 million. The fall in assets was largely attributable to fund redemptions. Even towards the end of 2008, some of the money invested in such funds was being shifted into bank deposits.

By contrast, the assets of pension funds and insurance companies rose in value over the first half of 2009. As the situation in world financial markets improved in the second half of the year, collective investment funds reported a return to growth and banks' assets also rose in value.

SLOWDOWN IN LENDING TO THE REAL ECONOMY

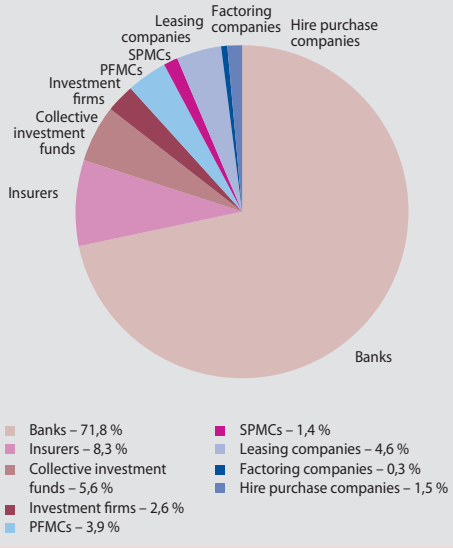
The activities of entities not subject to supervision by NBS also declined year-on-year. By the end of 2009, the assets of leasing companies,

Chart 8 Amounts of assets or assets under management by financial market segment (EUR billions)



Source: NBS.

Chart 9 Share of assets and assets under management of financial entities



Source: NBS.

Table 1 Selected financial flows (EUR millions)

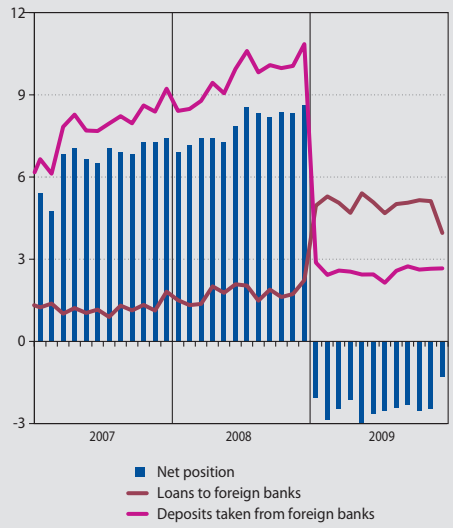
	NBS	Domestic financial sector						Domestic non-financial sector			External environment			
		Domestic banks	Insurers	PFMCss	SPMCs	Asset manage-ment companies	Other financial companies	Households	Enterprises	General government	Foreign banks	Foreign asset management companies	Foreign general government and international institutions	Other
NBS		70 – 1,423	0 – 0	0 – 0	0 – 0	0 – 0	0 – 0	10 – 10	3.3 – 3.6		5,245 – 8,935		6,373 – 3,762	258 – 969
Domestic banks	15,767 – 1,203	1,819 – 1,768		1 – 0.4		0 – 0	1,892 – 1,603	11,850 – 12,495	15,203 – 15,120	8,796 – 11,003	2,689 – 5,575		43 – 594	1,660 – 1,459
Insurers	0 – 0	1,427 – 1,639				193 – 202								
PFMCs and SPMCs	0 – 0													
Asset management companies	0 – 0	1,039 – 1,290												
Other financial companies	1 – 2.9	1,195 – 1,343				252 – 250								
Households	40 – 39	21,676 – 21,310	2,372 – 2,417	2,224 – 2,609	929 – 980	2,556 – 2,266								
Enterprises	0 – 0	10,888 – 8,258				33 – 58						498 – 571		
General government	0.3 – 3.9	3,751 – 3,552				1 – 0.2								
Foreign banks	432 – 638	13,185 – 3,297				33 – 36								
Foreign asset management companies														
Foreign general government and international institutions	12 – 7													
Other														

A direct creditor-debtor relationship does not exist.

Data are not available.

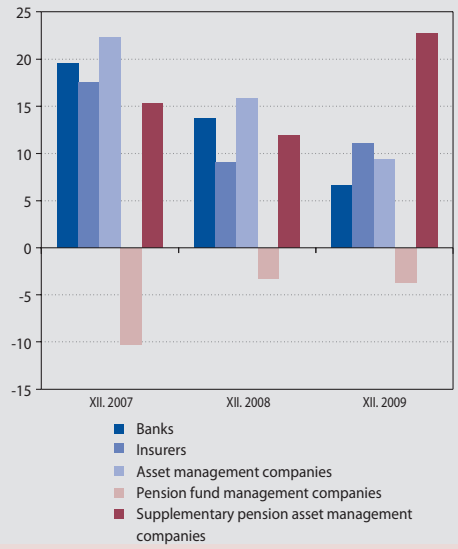
Source: NBS.
Note: Structure of data in cell: December 2008 – December 2009; rows: overview of financial assets (loans and securities) invested in the institutions named in the columns; columns: overview of liabilities (deposits and loans received) to institutions named in the rows; the figure for insurers represents technical provisions for life insurance.

Chart 10 Position vis-à-vis foreign banks (EUR billions)



Source: NBS.
Note: The net position is the difference between deposits taken from foreign banks and loans provided to foreign banks.

Chart 11 Average ROE by segment (%)



Source: NBS.

hire purchase companies and factoring companies had fallen by, respectively, €563 million, €15 million, and €80 million.

The slower rise in the banking sector's assets and the declines reported by leasing and hire purchase companies were related to an overall downturn in lending activity, which in turn reflected the greater caution being exercised by these financial institutions and their customers. The financial position of both households and enterprises was coming under increasing pressure in 2009. Their willingness, ability and, in the case of enterprises, reasons for taking on debt were weaker than they had been in 2008. In the case of households, borrowing from banks in 2009 was lower than in 2008, and the amount of loans taken out with hire purchase companies even declined. As for lending to enterprises, the impact was even more severe, with declines recorded in both the overall amount of lending and in leasing arrangements.

The leasing sector was particularly hard hit in 2009 with the result that all leasing companies reported losses. One of the main reasons for this was the deteriorating position of transport companies.

In the case of hire purchase companies, the decline in assets stemmed largely from the impaired financial condition of customers. Given that borrowing from banks through current account overdrafts and consumer loans continued to rise in 2009, we assume that the crisis had a greater effect on customers of hire purchase than on banks' customers.

Lending to general government intensified

In the banking sector's balance sheet, the reduced lending to households and enterprises was to a large extent offset by lending to general government. Holdings of domestic and, to a lesser extent, external government bonds rose sharply during 2009.

A relatively new trend is to finance the purchase of such bonds through central bank refinancing operations, the process being known as a carry trade.

Change of position vis-à-vis foreign banks

Another substantial change in 2009 came in the relationship of the Slovak banking sector to foreign banks, mostly parent companies. The abolition of the Slovak koruna and the related investment opportunities led to a change of position vis-à-vis foreign banks.

At the beginning of 2009, parent banks not only withdrew deposits placed through their sub-

sidiaries in liquidity-absorbing operations with Národná banka Slovenska; they also borrowed additional funds (Chart 10). Consequently the net position of the Slovak banking sector changed to a creditor position.

Financial sector profits continued to decline

The relatively weaker activity in 2009 was reflected also in the generation of profits. The worst affected in this regard was the banking sector, with 11 banks reporting a loss for the year. Return on equity in the banking sector plummeted. Profits were achieved by insurance companies and supplementary pension asset management, but pension fund management companies remained loss-making. As for collective investment undertakings, the decline in their profitability is understandable given its close correlation with the amount of assets under management.

2.1 THE BANKING SECTOR

2.1.1 TRENDS IN THE BANKING SECTOR BALANCE SHEET

In terms of balance sheet position, the year 2009 can be considered with certainty to be a turning point for the banking sector. While the previous years had seen dynamic growth, the year under review can be characterised as one of disappointment. The economic crisis hit Slovakia with full force. Its adverse effects were also felt in sectors to which domestic banks have significant credit exposures. Banks reacted by restricting their investment activities in sectors with a worsening financial position, while investing more in conservative assets.

Lending to the corporate sector was restricted to a relatively significant extent. Reduced financing was observed in almost all of the sectors. Banks completely redefined the parameters of a recoverable loan. Credit standards were tightened throughout 2009, mainly because of the worsening economic situation and the negative outlook for economic growth. On the other hand, the economic crisis also squeezed demand in the corporate sector, mainly for investment loans.

Compared with the corporate sector, lending to households was affected by the financial and economic crisis with a certain lag. Household loans, unlike corporate loans, still showed relatively strong growth in 2009. The supply of and demand for loans in this sector was influenced by numerous factors. The most crucial were uncertainty in the labour market, the rising unemployment, the tightening of credit standards accompanied by a fall in interest rates, the declining property prices and, to some extent, the adoption of the single currency. The aforementioned strong growth in loans continued in some of the banks only, while other banks were more cautious in their lending activities.

In the interbank market, banks' activities underwent a marked change in comparison with 2008. In 2008, banks mostly received deposits from foreign banks and then conducted sterilization operations with NBS. In 2009, however, after the euro changeover, these operations lost their previous significance. Developments in 2009 were influenced first and foremost by refinancing operations with the Eurosystem. Banks borrowed mainly at one-year maturities. The funds borrowed were invested predominantly in government bonds, and, in some cases, in the interbank market, mainly in transactions with parent banks.

The year under review saw a marked increase in investment in government bonds on a year-on-year basis. Compared with the previous periods, numerous banks made increased investments in foreign government bonds, mainly from neighbouring countries. In the case of certain banks, the growth in refinancing operations was directly connected with investment in securities, as funds from the ECB were used for investment in government bonds.

In 2009, the crisis was also mirrored in the decreasing amount of mortgage bond issues. This was caused partly by the lower amount of new mortgage loans and partly by the unfavourable situation in financial markets at the beginning of 2009.

2.1.1.1. CUSTOMERS

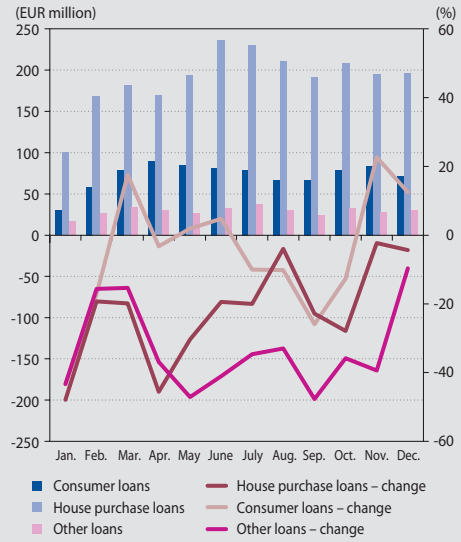
THE RETAIL SECTOR

Lending to households slowed in 2009, but there were some signs of revival at the end of the year

The volume of new loans provided to households in 2009 was 10.2% (€1.1 billion) smaller than in the previous year. The sharpest drop was recorded in January, owing to the unfavourable economic situation and the 'accumulation' of loans in connection with the change of currency and systems, on the part of both households and banks. Some signs of revival in bank lending were observed in the second half of 2009. In that period, larger amounts of loans were recorded in all categories under review, compared with the first half of the year.

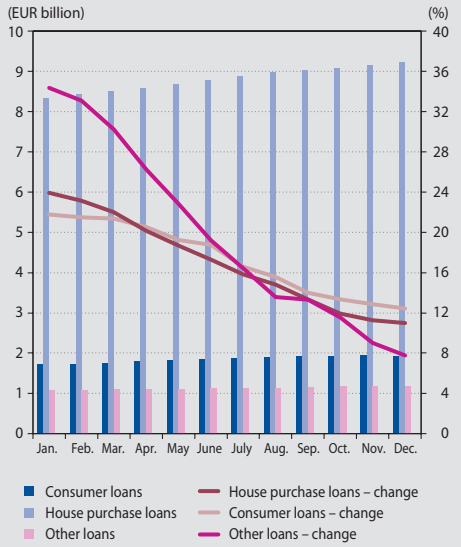
The situation in the second half of 2009 seemed to be better mainly in comparison with the marked deterioration in the lending market at the turn of 2008 and 2009, when fears of unemployment caused a dramatic plunge in demand for new loans. Uncertainty was heightened by the

Chart 12 New loans to households in 2009



Source: NBS.
Note: Right-hand scale: year-on-year changes in the amount of loans.

Chart 13 Outstanding amounts of household loans in 2009



Source: NBS.
Note: Right-hand scale: year-on-year changes in the amount of loans.

complicated labour market situation resulting in mass redundancies and by order cancellations of business orders. Demand for loans was further reduced by the decline in residential property prices, which was expected to continue. This was mainly apparent in demand for house purchase loans for investment purposes. The above factors were more and more taken into account by potential borrowers, who also began considering the various aspects of a house purchase, which led to differentiation between better and poorer projects in terms of locality or layout (e.g. number of rooms vs residential space). Residential property prices were pushed down by the abundant supply and low demand in the market.

Consumer loans were affected by the slowdown to a lesser extent than loans for house purchases were. These loans maintained their seasonal nature and showed stronger growth in year-on-year terms in certain months. Consumer lending received a boost from the government's introduction of subsidies for the purchase of new cars (the car-scrapping scheme).

The pace of loan portfolio growth also slowed

Owing to the smaller volume of loans provided in 2009, the household loan portfolio also showed decelerated growth. Slowdown was recorded in all categories under review, except in current account overdrafts. In January 2009, household loans grew in volume by 24.5% year-on-year, but December 2009 saw an increase of only 10.9%. Overall, this means that the household loan portfolio increased during 2009 by only €1.3 billion, compared with €2.2 billion in 2008. This trend could not even be stopped by an increase in new loans in the second half of 2009, mainly because the volume of repaid loans (including loans repaid early through a loan from another bank) also increased in that period.

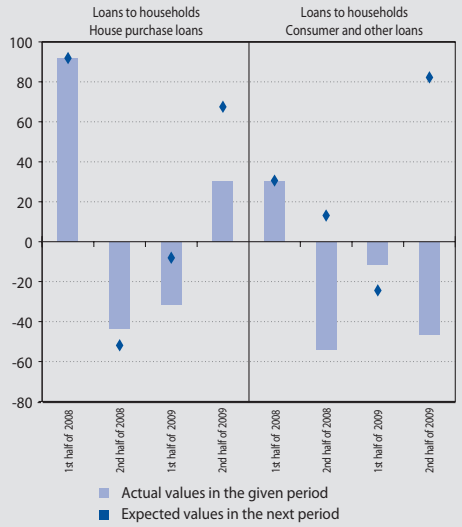
A slight increase was recorded only in current account overdrafts, probably as a result of increased pressures on the financial situation of households. On the other hand, households were more conservative in the use of credit cards. Despite the large number of credit cards issued to customers, their utilisation was at a relatively low level.

There was a shift towards interest rate fixation for longer periods

The approach of customers to interest rate fixation for loans changed during the year. In the first three quarters, customers gave preference to loans with an interest rate fixation period of up to one year, mainly because these rates were

lower. On the other hand, the advantage of a lower short-term rate exposed customers to the risk of higher volatility in monthly repayments in the case of changes in interbank market rates. Such approach may have consequences at a time of increased uncertainty in the financial markets.
In the last quarter of 2009, customers changed their approach, and the amount of new loans with an interest rate fixation period of over one and up to five years exceeded the amount of new loans with the shortest fixation period. This was mainly connected with the decreasing difference between the rates for these types of loans. Another factor was the intention of households to fix the costs of loan repayment at exceptionally low rates.

Chart 14 Demand for loans from households



Source: NBS.
Note: Data are given as a net percentage share of banks, as the difference in the weighted percentage share of banks that reported an increase and banks that reported a decrease in demand. Banks reporting no change have not been taken into account in the calculation. Expectations in the given half-year period express values expected in the next half-year period.
Changes in demand express the subjective view of banks.

Loan restructuring

The beginning of 2009 saw a rise in the loan default rate, which was mainly the result of a fall in employment. In response to the increasing loan default risk, banks introduced various loan restructuring programmes. The instruments employed included loan maturity extension, principal payment deferment or loan repayment deferment for a period of six months, as a rule.

Demand for house purchase loans showed signs of revival

Demand for house purchase loans changed over the course of 2009. The first half of the year, marked by a deep economic decline, witnessed a sharp fall in demand for loans, whereas the second half saw a slight increase in demand. The main factors behind the change in the behaviour of households were developments in customer interest rates on loans and in real estate prices. Both variables recorded a fall in 2009, which, together with the calming economic situation in the second half of 2009, caused an increase in demand.

Credit standards continued to be tightened, albeit at a slower pace

Banks were tightening their credit standards and lending conditions for households throughout 2009. In response to the increasing risks, they reassessed certain products and tightened the standards used in assessing incomes, employment (length and form), and property pledged as collateral. This trend was most apparent in the case of other loans, which are usually non-specific house purchase loans (so-called American mortgage loans) that are highly sensitive to the labour market situation. In general, the loan-to-value (LTV) ratio remained below 100% for all types of house purchase loans. Banks returned to the more conservative limit of around 70% of the value of the real estate collateral.

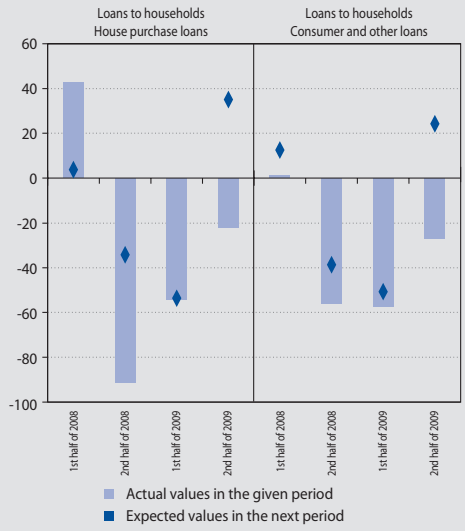
The degree of tightening moderated during the year, i.e. more and more banks decided to abandon this trend. As the situation stabilised in the market, some of the banks eased their lending conditions in the second half of the year.

Interest rates fell, but spreads increased

The measures taken by central banks to stabilise the financial markets were relatively quickly mirrored in the interest rates on household loans. Lending rates for house purchases had fallen since the beginning of 2009 by 0.8 of a percentage point, while interest rates on consumer loans were more volatile.

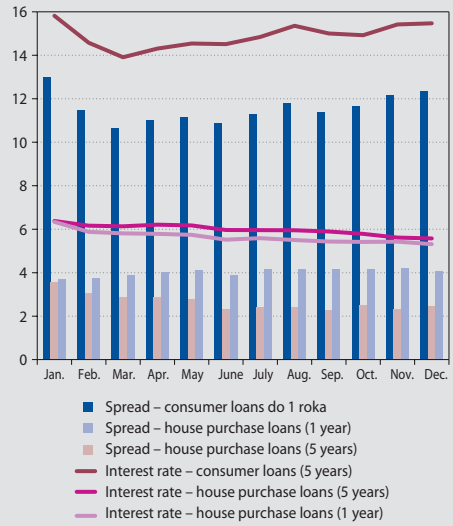
The smaller fall in lending rates compared with the market rates were accompanied by a steeper increase in interest rate spreads. The spreads

Chart 15 Credit standards for loans to households



Source: NBS.
Note: Data are given as a net percentage share of banks, as the difference in the weighted percentage share of banks that reported an easing and banks that reported a tightening of credit standards. Banks reporting no change have not been taken into account in the calculation.
Expectations in the given half-year period express values expected in the next half-year period.

Chart 16 Interest rates and spreads on new loans to households (p.p.; %)



Source: NBS, ECB.
Note: Spreads on loans with an interest rate fixation period of up to 1 year represent the difference between retail rates and the 12-month EURIBOR. Spreads on loans with an interest rate fixation period of up to 5 years represent the difference between retail rates and the 5-year EUR swap rate.

increased for both house purchase loans and consumer loans. This can be explained to some extent by the increased liquidity and risk margins (as a reaction to the financial crisis) and the increased credit risk posed by households. Banks also attempted to mitigate the negative effect of reduced lending on the amount of interest income.

Differences in spreads can also be observed between the individual banks. In the long term, the largest spreads are recorded by the largest banks. Medium-sized banks more or less follow the interest rate policy of large banks, while recording smaller spreads.

Interest rate spreads on household loans increased in all euro area countries, with the steepest increase recorded in Slovakia (on house purchase loans).

Lending to sole traders was restricted but the financing of non-profit organisations continued

Retail segments that are less significant in terms of volume (sole traders and non-profit organisations) reacted to the 2009 developments differently.

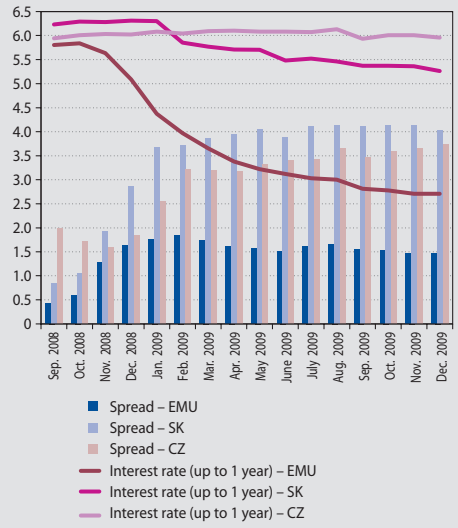
Lending to sole traders fell in volume by 3.8% year-on-year, confirming that sole traders are highly sensitive to changes in the business cycle and are therefore perceived by banks as a risky segment. The cautiousness of banks in relation to sole traders is mainly connected with the lack of data on such entities for a longer period of the business cycle.

The economic crisis produced the weakest effect on the segment of non-profit organisations serving households (e.g. associations of flat owners). This segment has relatively good prospects, owing to the growing legal and proprietary awareness of flat owners and their willingness to contribute to the maintenance and repair fund. The amount of non-performing loans is relatively small in this segment.

The withdrawal of funds from banks in connection with the euro changeover continued

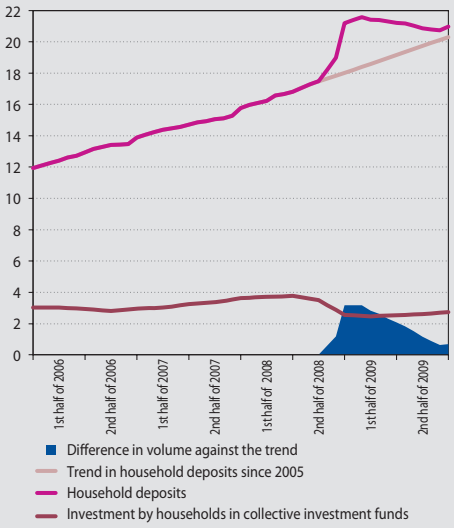
In the last quarter of 2008, households placed a significant amount of deposits with banks.

Chart 17 Comparison of interest rates and spreads on house purchase loans (up to one year) in selected countries (p.p.; %)



Source: NBS, ECB, ČNB.
Note: Spreads express the difference between retail rates and the 12-month EURIBOR or PRIBOR.

Chart 18 Developments in household deposits (EUR billions)



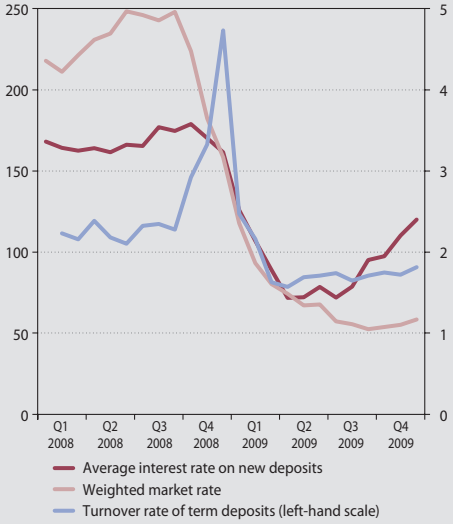
Source: NBS.

Compared with the trend observed since 2005, the largest difference in the volume of deposits was recorded in December 2008 (almost €3.2 billion). During 2009, this amount was withdrawn from the banking sector almost in full (Chart 18).

In this case, the decisions of households (deposit or withdrawal) were not motivated by interest rate changes. In December 2008, when interest rates offered by banks for new deposits had already reacted to the drop in market rates, households placed a record amount of deposits (Chart 18), which is also indicated by the high turnover rate of maturing deposits – 237% (Chart 19). At the end of 2009, banks were unable to avert the continuing withdrawal of deposits (Chart 18), not even by offering much high interest rates, which in the second half of 2009, unlike in 2008, attained a positive spread compared with the market rates (Chart 19).

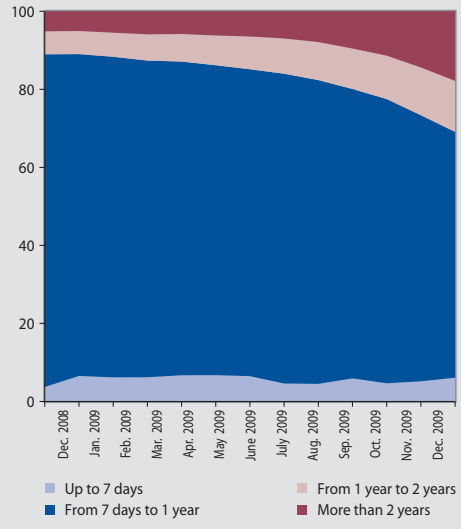
Since the volume of deposits fell at the end of 2009 to the level of the long-term trend (Chart 18), banks had little time to benefit from the increased liquidity resulting from the inflow of deposits at the end of 2008. In addition, the rise in deposit rates at the end of 2009 was negatively reflected in the interest costs of banks and did not contribute to the growth in deposits.

Chart 19 Reaction of term deposits to interest rate changes (%)



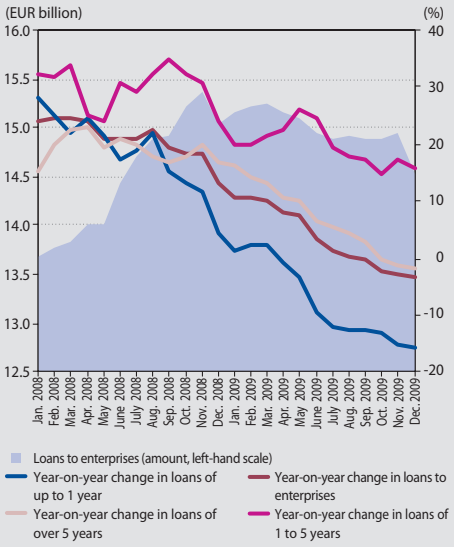
Source: NBS.
Note: Weighted market rate is the average of market rates weighted according to the volume of household deposits by maturity.

Chart 20 Changes in the time structure of household deposits (shares in %)



Source: NBS.

Chart 21 Bank lending to enterprises



Source: NBS.

The behaviour of households was influenced by various factors. It is likely that some of the deposits were transferred to mutual funds, which at the end of 2008 had seen an increase in redemptions in connection with the negative situation in global financial markets. This would give an explanation for only a smaller part of the total decrease (Chart 18). Another explanation is that natural persons tended to exchange korunas for the new currency. After conversion, these funds returned from the banking sector to where they had come from. A less probable explanation is that the decrease in deposits was a consequence of the crisis, which forced households to use their own financial assets, as their current account balances increased in 2009.

Households shifted their funds into longer-term deposits

Term deposits decreased during 2009 and their time structure changed. The relatively low interest rates and the steep yield curve motivated households to use longer-term deposit products for saving purposes.

On the other hand, this enabled banks to fix the prices of household deposits at historically low rates. Thus, banks could profit from a possible rise in interest rates in the future.

THE CORPORATE SECTOR

Bank lending to enterprises declined

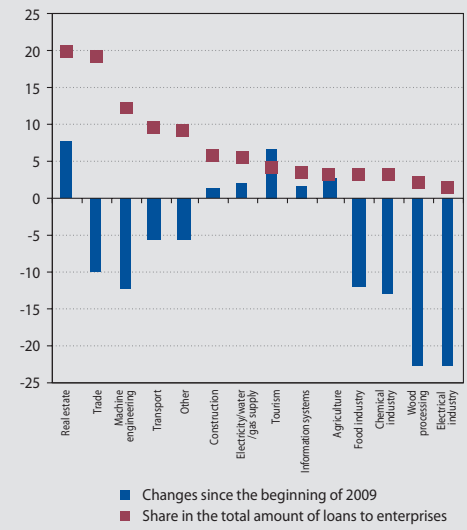
The financial crisis affected bank lending to the corporate sector to a relatively significant extent. After increasing in 2008, the outstanding amount of loans provided to enterprises gradually decreased in 2009. From the beginning of the year, the total amount of loans to enterprises fell by 3.3%. Financing was restricted in almost all categories of loans, in particular in operating loans. Longer-term loans continued to grow at a moderate pace.

A declining trend in lending to enterprises was observed throughout the sector. Numerous banks recorded a year-on-year decline or slight growth in loans. Significant increases in loans to enterprises were recorded only exceptionally.

The prudential policy of banks led to restricted financing in almost all segments

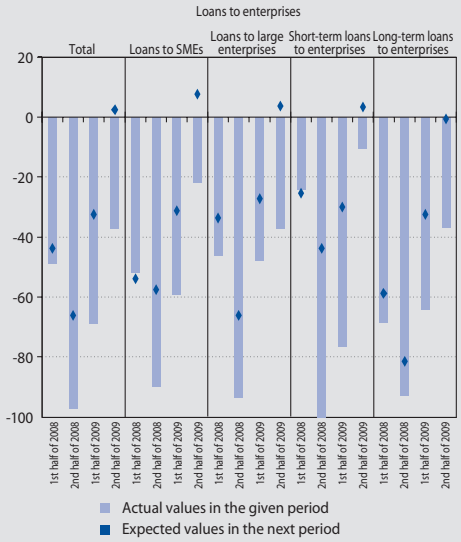
Financing declined in almost all segments of the corporate sector, owing to the cautious approach of banks. Most affected were the export-oriented sectors and sectors recording a sharp fall in revenues. Financing was most significantly restricted in trade, machine engineering and transport.

Chart 22 Changes in the amounts of loans to enterprises since the beginning of 2009 (by sector; %)



Source: NBS.

Chart 23 Credit standards for loans to enterprises



Source: NBS.
Note: Data are given as a net percentage share of banks, as the difference in the weighted percentage share of banks that reported an easing and banks that reported a tightening of credit standards. Banks reporting no change have not been taken into account in the calculation.
Expectations in the given half-year period express values expected in the next half-year period.

On the other hand, financing continued to grow in the real estate sector, by 8% on a year-on-year basis. This increase, however, was not a sign of confidence in this sector; it was a consequence of additional financing provided for projects under construction. Lending to the construction sector was growing for a similar reason. The prudential approach of banks was most apparent in the case of new projects, for which banks provided loans with shorter maturities and in smaller amounts.
Banks continued to tighten their credit standards, though more and more banks abandoned this policy

In 2009, the lending market was, as we have already mentioned, severely affected by the financial and economic crisis. This was reflected in the behaviour of banks as well as enterprises.

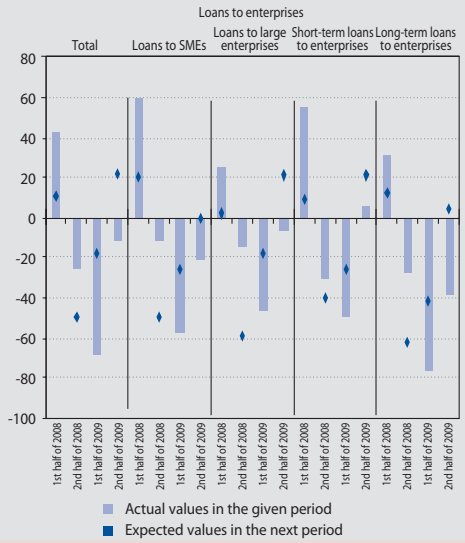
In view of the worsening economic situation, banks were tightening their credit standards throughout 2009. They stopped providing loans to sectors with seriously increased risks. The tightened lending conditions resulted in increased interest margins, stricter collateral requirements and other credit standards.

The tightening of credit standards showed moderating dynamics over the course of the year, meaning that more and more banks abandoned this policy in 2009. In the second half of the year, only six banks tightened their standards. This may be a sign of a change in the lending cycle in the banking sector. According to the majority of banks, credit standards should remain unchanged in the next six months; further tightening is unnecessary. On the other hand, credit standards are not expected to be eased in the near future.

Demand for loans stabilised in the corporate sector

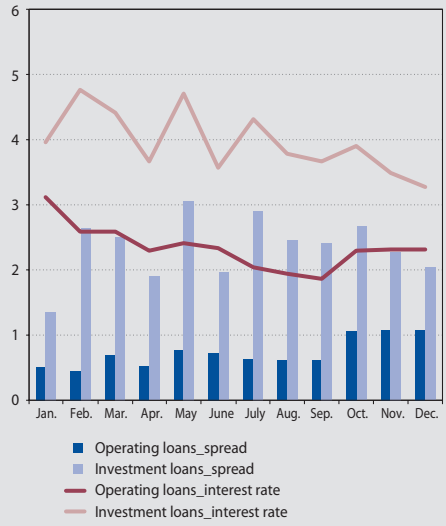
The decline in lending was also supported by a relatively significant fall in demand for new loans among enterprises. As in the case of credit standards, the pace of decline in demand for loans moderated during the year. This may be a sign of improvement in the situation of enterprises. The fall in demand can be ascribed to the shrinking investment opportunities in the sector. This trend continued throughout 2009. Demand for long-term loans remained negative in the second half of the year. Demand for operating loans increased gradually.

Chart 24 Demand for corporate loans



Source: NBS.
Note: Data are given as a net percentage share of banks, as the difference in the weighted percentage share of banks that reported an increase and banks that reported a decrease in demand. Banks reporting no change have not been taken into account in the calculation. Expectations in the given half-year period express values expected in the next half-year period.
Changes express the subjective view of banks.

Chart 25 Interest rates and spreads on new loans to enterprises in 2009 (p.p.; %)



Source: NBS.
Note: Spreads were calculated as the difference between the rate for the given type of loans and the 12-month EURIBOR.

The fall in lending rates for enterprises came to a halt at the end of the year

Interest rates on new loans to enterprises were falling from the beginning of the year, as a result of developments in interbank market rates. This trend came to a halt in October and November 2009, indicating that the transmission of changes in the key ECB rates to customer interest rates had come to an end. Interest rates were therefore at very low levels in the last few months of 2009, and they are not expected to fall further.

In contrast with the retail sector, changes in interbank market rates are directly transmitted to customer rates for new loans to enterprises, though not always to the same extent. This is reflected in the interest income of banks. The spreads of banks did not increase to a significant extent. They recorded a certain increase compared with the beginning of the year, which was an indication of higher credit risk.

Corporate deposits continued to fall slightly

The interest rate policy of banks concerning corporate deposits reflected the trends in interbank market rates. From the beginning of 2009, interest rates on term and current account deposits dropped substantially (Chart 26).

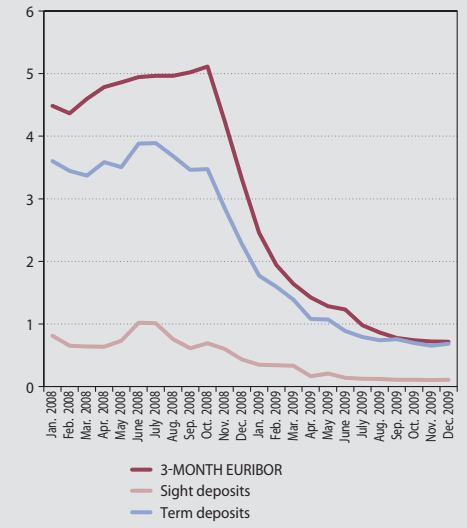
On the other hand, the volume of funds on corporate accounts did not seem to be sensitive to the interest rate policy of banks. A slight fall in the volume of term deposits had occurred before the rates were reduced, but current accounts did not react to interest rate changes at all (Chart 27).

The most obvious explanation is the weakening activity in the corporate sector, which exerted downward pressure on liquidity and the volume of financial assets. As a result, current account deposits ceased to grow and term deposits declined.

Other sectors

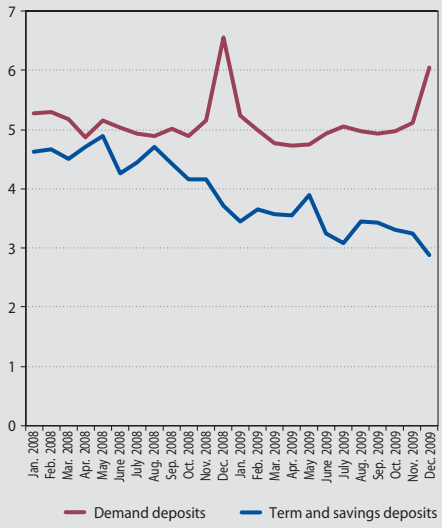
The declining trend in bank lending was also reflected in other sectors. The most significant decreases were recorded in loans to financial intermediaries (27%) and non-residents (14%). In the case of financial intermediaries, the decrease took place in lending to leasing companies and hire purchase companies (non-banks). Although some of the banks recorded increases in such

Chart 26 Average interest rates on corporate deposits (%)



Source: NBS.

Chart 27 Developments in corporate deposits (EUR billions)



Source: NBS.

loans, the total volume of lending to this sector had begun to fall as early as the middle of 2008.

A year-on-year increase in loans, mainly in the second half of 2009, was recorded in the general government sector (11%). This year-on-year increase was more or less caused by negative developments in the same period of 2008.

2.1.1.2 SECURITIES

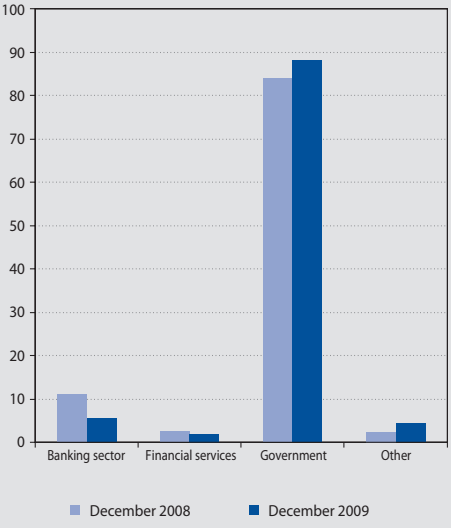
BANKS INVESTED MUCH MORE HEAVILY IN GOVERNMENT BONDS IN 2009

The total volume of securities held by banks continued to increase in 2009. At the end of the year, securities accounted for almost one quarter of the sector's total assets.

This increase took place almost exclusively in investment in government securities, with a marked increase being recorded in domestic government bonds. At the sectoral level, they grew year-on-year by more than €3 billion, representing an increase of almost 50%. In contrast with the previous years, investment grew not only in Slovak government bonds but also in foreign government bonds, in which approximately €730 million was invested. Almost half of this amount was invested in Hungarian bonds. Bonds from Poland and the Czech Republic also constituted a significant share.

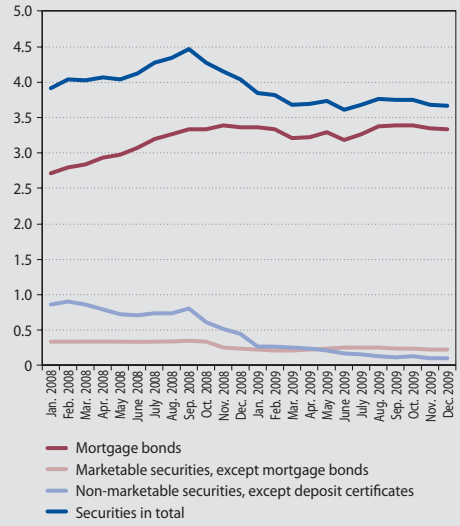
One of the reasons that certain banks reported strong growth in investment in government bonds was the existence of a relatively attractive interest rate differential between government bonds and ECB/NBS funds. Funds obtained from

Chart 28 Debt securities portfolio structure by sector (%)



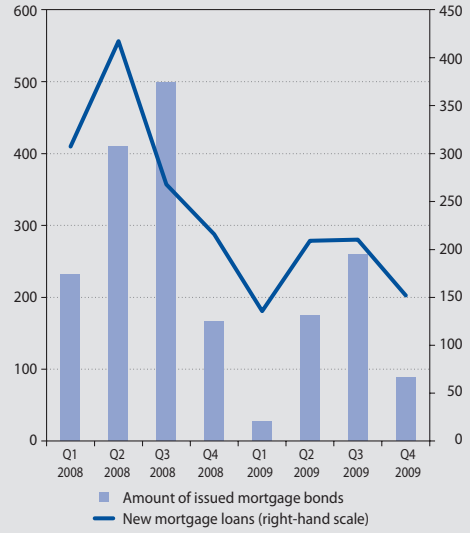
Source: NBS.

Chart 29 Amounts of securities issued (EUR billions)



Source: NBS.
Note: The data express the total value of instruments reported at the end of each month.

Chart 30 Mortgage bond issues and new mortgage loans (EUR billions)



Source: NBS.

the ECB/NBS, particularly those with a maturity of one year, were used for the purchase of government bonds. A similar strategy was pursued by banks in foreign banking sectors. However, it is reasonable to assume that banks will sell part of these securities after the maturity of refinancing operations expires.

Securities issuance stagnated in 2009

After growing in the previous years, the total amount of issued securities was stagnant in 2009. With the total amount of non-marketable securities declining, mortgage bonds as a share of the total amount of issued securities rose from the beginning of 2008 and continued to rise in 2009 (from 83% at 31 December 2008 to 91% at 31 December 2009).

The amount of mortgage bonds issued was less than in previous years

The total nominal value of mortgage bonds issued in 2009 reached €550 million, which was considerably less than in previous years. The fall in the amount of bond issues was caused by several factors. At the turn of 2008 and 2009, bond issuance was restricted owing to the worsened financial market conditions. At the same time, fewer mortgage loans were provided, and hence the need for new issues decreased. The reduced required ratio of mortgage loan coverage from 90% to 70% also led to lower mortgage bond issues in case of some of the banks. In year-on-year terms, the overall mortgage loan coverage ratio decreased from 91.2% to 87.6% at end-December 2009.

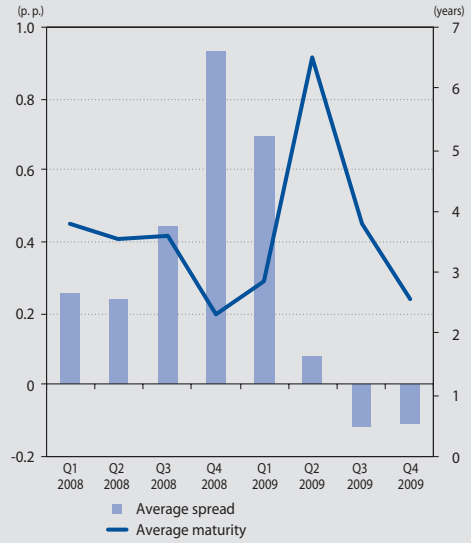
Another reason for new issues was the maturing of mortgage bonds in 2009. Some of the banks replenished their portfolios with new issues in order to meet the mortgage loan coverage requirement. In some cases, banks already replaced issues with a maturity of one year and a relatively high coupon rate launched in the last quarter of 2008.

The longer average maturities and smaller average spreads of mortgage bonds from the last three quarters of 2009 indicate that the situation in the primary market for mortgage bonds improved in comparison with the turn of 2008 and 2009. Owing to the relatively large amount of mortgage bonds maturing in 2010, new mortgage bonds are expected to be issued this year even in the case of stagnation in mortgage lending.

Changes in the structure of mortgage bond placements in the market

The distribution of mortgage bonds in the individual financial institutions changed somewhat

Chart 31 Average mortgage bond spreads and maturities



Source: NBS.
Note: Spreads and maturities are weighted by the nominal value of issued mortgage bonds. The spreads were calculated as the difference between the coupon rate for the given mortgage bond and the yield on a government bond with the same maturity at the time of issuance. In the absence of a government bond with the same maturity, the yield was calculated by linear interpolation.

during the year under review. At the end of 2008, 57% of the total nominal value of issued mortgage bonds was held in the portfolios of banks, retirement pension and supplementary pension funds, collective investment funds and insurance companies. By the end of 2009, this share had decreased to 47%. Mortgage bonds that were not held in the portfolios of these companies were held mostly abroad; part of them was sold to retail customers.

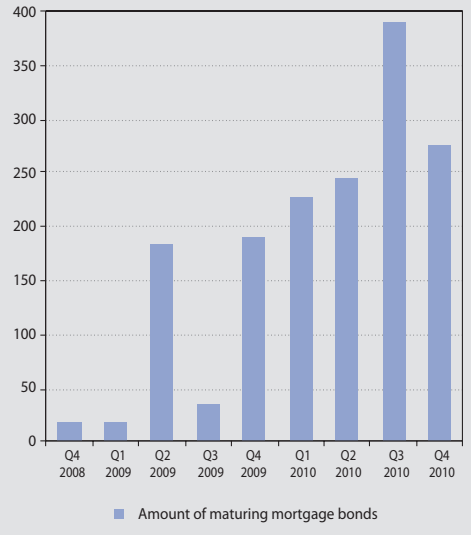
2.1.1.3 BANKS

AFTER THE CESSATION OF TWO-WEEK STERILIZATION OPERATIONS WITH NBS AND THE OUTFLOW OF FUNDS FROM FOREIGN BANKS, THE VOLUME OF REFINANCING OPERATIONS WITH THE ECB/NBS INCREASED DURING 2009

By the end of 2009, the total volume of interbank assets had fallen by more than 60%, and accounted for only 13% of the sector's total balance sheet. The largest part of interbank assets, over 50%, comprised transactions with foreign banks. Interbank liabilities decreased in year-on-year terms by more than 50% and accounted for 10% of the total balance sheet. As a share of these transactions as at end-2009, funds from foreign banks represented 48% and funds from the ECB 38%.

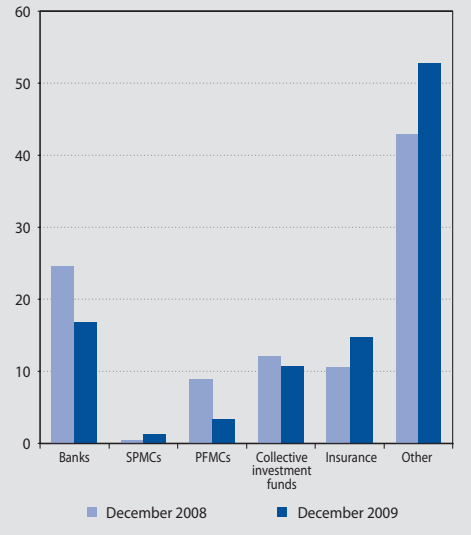
These changes were substantially influenced by the adoption of the single currency. This brought

Chart 32 Total nominal amount of mortgage bonds maturing in 2009 and 2010 (EUR millions)



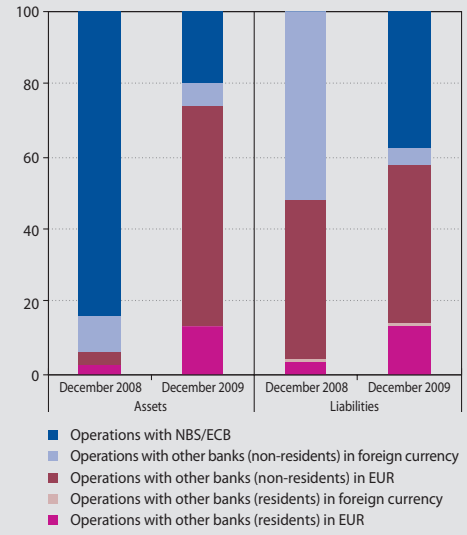
Source: NBS.

Chart 33 Distribution of mortgage bond issues across the financial sector by segment (%)



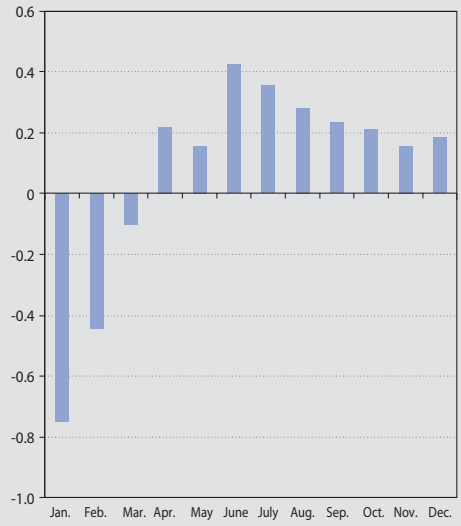
Source: NBS.

Chart 34 Structure of the interbank market (%)



Source: NBS.

Chart 35 Interbank market rate spread in 2009 (p.p.)



Source: NBS.
Note:The spread was calculated as the difference between interest rates on interbank transactions on the asset and liability sides. The calculation took into account only deposits with a maturity of up to 1 year in EUR.

about a reduction in funds provided to NBS (after the cessation of two-week sterilization operations) and deposits received from foreign financial institutions.

From the beginning of the year, however, more and more banks began to use refinancing operations with the ECB/NBS. In some cases, they gave preference to one-week refinancing operations (so-called main refinancing operations – MROs), then later in the year, they began to use more and more refinancing operations with longer maturities (long-term refinancing operations – LTROs), i.e. with a maturity of 3 to 6 months and, from 24 June, with a maturity of 12-months.

Funds obtained from the ECB/NBS were mainly invested in government bonds and in the interbank market

One of the factors behind the growth in the volume of refinancing operations with the ECB/NBS was the relatively low interest paid on this form of financing: 1% per annum for both MROs and LTROs (with effect from 13 May 2009). Thus, banks managed to achieve a relatively large margin by investing in less risky assets. Some of the funds thus obtained were invested in securities, mainly in Slovak government bonds and Treasury bills. Besides purchasing bonds, banks used these funds in certain cases to replace temporarily part of their more volatile liabilities, such as general government deposits and/or deposits from financial institutions, and on the asset side, to purchase deposits and to conduct interbank transactions.

The proportion of transactions with foreign banks remained significant

Apart from operations with the ECB/NBS, the largest part of interbank transactions reported as at the end of each month, on both the asset and liability sides, comprised deposits from and/or loans with foreign banks (65–75% on the liability side, 80–90% on the asset side). Most transactions with foreign banks were intra-group transactions, on both the asset and liability sides, often conducted directly with the parent company. Only a few banks undertook the majority of their transactions with foreign banks outside their group. In general, the transactions that banks undertook with foreign financial institutions had a maturity of up to one year.

The interbank market was dominated by transactions with the shortest maturities

In 2009, interbank transactions continued to be dominated by overnight transactions, on both the asset and liability sides. In terms of volume, these transactions accounted for 75–85% of all transactions over the span of a month, and banks probably used them to fine-tune their daily liquidity needs, and/or to meet the minimum reserve requirement. Deposits from foreign banks accounted for 38–50% of the overnight loans and/or deposits received. In the case of deposits and/or loans provided, transactions with foreign banks represented 40% to 60%. Since these overnight transactions were distributed relatively evenly over a month, the end-of-month reports contained only 7% to 30% of the total amount transacted.

The interest rate differential stabilized at a positive level

Reductions in the key ECB rates were mirrored in the interbank market rates, which were falling throughout 2009. A sharper fall in deposits rates than in lending rates brought about an increase in the interest rate spread between these rates, which stabilized at a level around 0.2 of a percentage point, after being in negative territory at the beginning of the year (-0.8 of a percentage point).

2.1.2 FINANCIAL POSITION OF THE BANKING SECTOR

The most important factors that affected the profits of banks in 2009 were the ongoing economic crisis and the adoption of the single currency. The banking sector's profitability fell by more than 50% on a year-on-year basis. Losses were recorded by five banks and seven branches of foreign banks.

Numerous components of profitability were adversely affected by the financial and economic crisis. The weaker activity of customers, mainly in comparison with 2008, brought about a fall in interest income, as well as in income from fees and commissions. A noticeable decrease was recorded in interest income, which constitutes a dominant part of banks' profits. Negative developments were recorded mainly in the segment of corporate customers. In the household segment, however, the continuing relatively strong growth in loans, combined with higher interest margins, ensured an increase in interest income for banks from this sector. In the area of interest income from households, however, there were considerable differences between banks. Positive trends were mainly recorded by large banks.

In 2009, the crisis was relatively strongly reflected in the quality of loans, necessitating an increase in the provisioning. Thus, provisioning costs significantly reduced the profits of numerous banks.

Apart from the global economic crisis, the profits of domestic banks were also affected by the euro cash changeover in 2009. Almost all banks recorded a decline in income from foreign exchange operations. Interest income was adversely affected by the interbank market changes. Although the banking sector as a whole was affected in both cases, the individual banks were dependent on these incomes to a different extent, so their profits were also affected differently.

Banks strengthened their capital position over the course of 2009, as part of a more general trend stemming from their efforts to be better prepared for an unexpected increase in losses. This was supported by an increase in own funds, mainly in Tier I capital. At the same time, however, the amount of risk-weighted assets decreased.

Despite the strengthening capital position of the sector, some of the banks recorded a fall in capital adequacy, and/or had a relatively low capital adequacy ratio in the long term. These banks were therefore more sensitive to negative developments.

2.1.2.1 PROFITABILITY

The sector's profitability fell by half on a year-on-year basis

In terms of profit generation, 2009 was much worse for the banking sector than previous years. The profitability of the sector as a whole fell by more than 50%, with the total profit reaching €250 million at the end of the year. This negative trend affected almost all banks in the sector. Only five banks and one branch of a foreign bank achieved a higher profit than a year earlier.

The sector's profitability plunged by more than 50%, and more banks ended the year with a financial loss. Overall, five banks and seven branches of foreign banks recorded losses in 2009, in the total amount of almost €92 million (Chart 37). Although the amount of the total loss decreased in comparison with 2008, the loss in 2008 was produced almost exclusively by one bank.

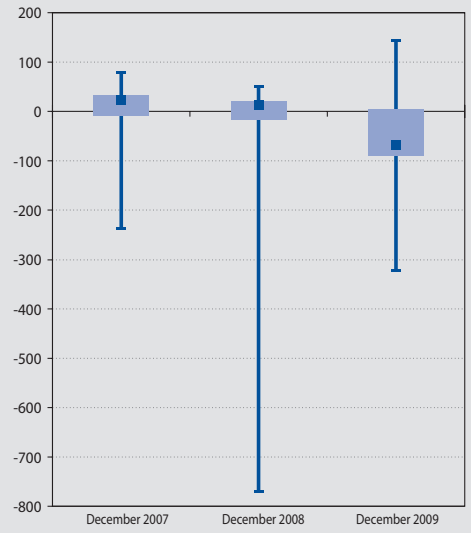
Not only did the number of banks in the red increase, the profits of other banks decreased, too. The lower ability of other banks to generate a profit was also indicated by the fact that almost half of the profit was achieved by one bank.

Bank profits were adversely affected by the economic crisis and the euro changeover

The negative trend in bank profits in 2009 was mainly influenced by two factors: the global economic crisis and the euro adoption.

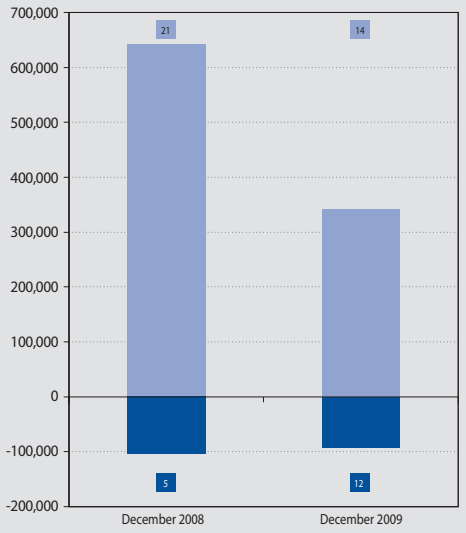
The financial and economic crisis was reflected mostly in interest income and banking charges, mainly as a result of a downturn in the activities of customers. A significant deterioration was recorded in the quality of loans, as a consequence of the worsening financial positions of enterpris-

Chart 36 Profitability: year-on-year changes in %



Source: NBS.
Notes: Left-hand scale: year-on-year changes in profitability as at end-December (minimum, lower quartile, median, upper quartile and the maximum).
The chart does not include branches of foreign banks.

Chart 37 Profit and loss in the banking sector (EUR thousands)



Source: NBS.
Note: The figures in the boxes represent the number of banks or branches of foreign banks that recorded a profit or loss.

es and households. A similar trend was recorded in other countries, too.

Owing to the slowdown in bank lending and/or the decrease in the outstanding amount of loans, there was only a slight rise in interest income – the most significant income component. The previous years saw double-digit increases as a result of strong growth in bank lending. A negative trend was recorded mainly in the case of enterprises. In the case of households, interest income increased because loans were still growing and banks had a wider range of interest policy options.

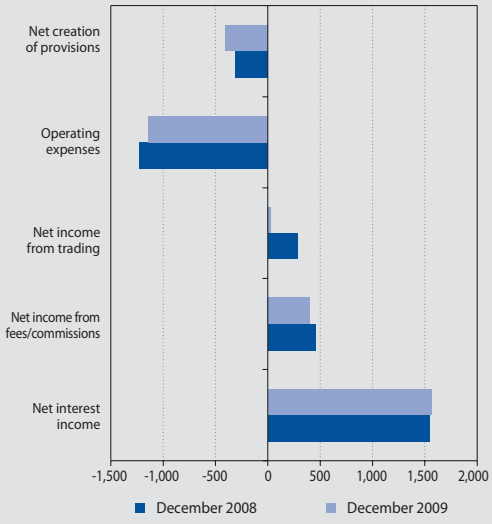
What distinguished the Slovak banking sector from foreign banking sectors in terms of profit generation was the adoption of the euro. This caused a sharp fall in income from foreign exchange transactions. The euro changeover also led to an outflow of funds from foreign banks and the cessation of asset-side operations with NBS, which resulted in a fall in interest income from transactions with banks.

In contrast with the past years, however, almost all banks reduced their operating expenses in year-on-year terms as a response to the crisis.

Interest income stagnated in the sector

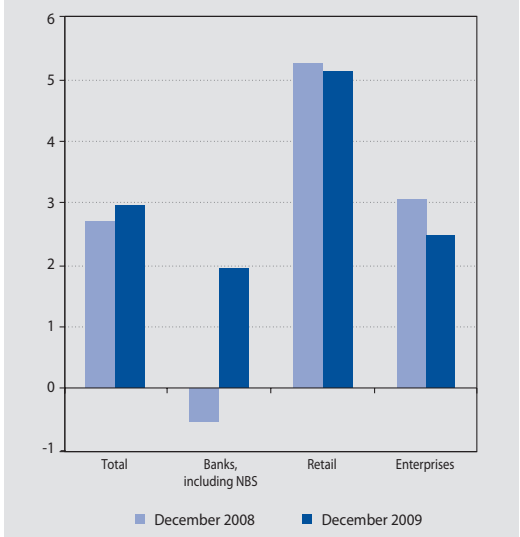
The banking sector's most significant gross income component increased by only 1% in 2009. This represents an important change compared with previous years, when the growing interest income

Chart 38 Main components of profitability (EUR millions)



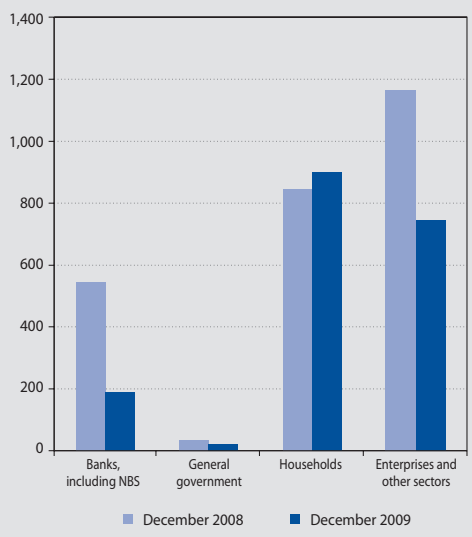
Source: NBS.

Chart 39 Net interest rate spread (p.p.)



Source: NBS.
Note: Net interest rate spread – represents the difference between the rate of return on loans (interest income from loans as a share of total loans) and the cost of deposits (interest expenses on deposits as a share of total deposits).

Chart 40 Interest income of banks by sector (EUR millions)



Source: NBS.

made the most significant contribution to the year-on-year growth in bank profits. The stagnation was caused by several factors. First of all, bank lending was badly hit by the economic crisis. Until 2008, banks had recorded double-digit growth rates in lending to both households and enterprises. In 2009, however, lending to households slowed down, while lending to enterprises declined.

The euro cash changeover affected the liability side, as household deposits had rapidly increased before the country's entry into the euro area and then decreased throughout the year.

These changes on the asset and liability sides, affecting both households and enterprises, and the general fall in interest levels were more effectively settled by banks in the case of households. The fall in yields was more or less offset by a cost reduction, which caused only a minimal decrease in the sector's interest spread. That the sector's total interest income did not fall was due in large part to an increase in interest income from the household sector. Interestingly, a positive trend in interest income from households was recorded mainly by large banks, as a result of the market's relatively high concentration.

In the case of enterprises, yields on loans recorded a relatively sharp fall, which was also reflected in the sector's total income.

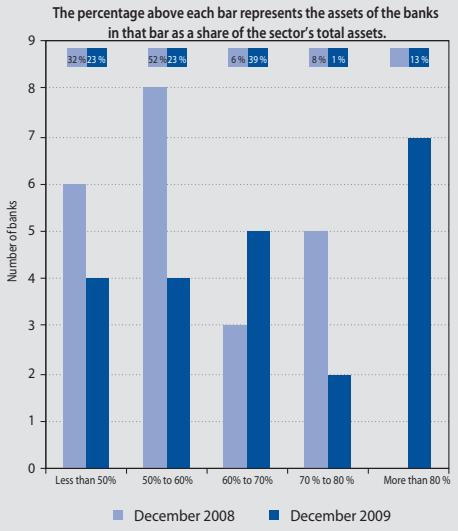
The euro changeover had a relatively significant effect on interest income from banks. The cessation of liquidity-absorbing operations with NBS on the asset side and the decrease in funds from foreign banks caused interest income to fall by approximately €350 million.

Despite a reduction in operating expenses, the sector's cost-to-income ratio decreased

A natural reaction of banks to a downturn in trading activities is to reduce the level of operating expenses. In 2009, operating expenses were cut in almost all banks. In the sector as a whole, they were reduced by an average of 7% year-on-year. Banks cut their expenses in all the main components, especially expenditure on purchased performances and staffing costs. Staff numbers in the sector were reduced by approximately 9% year-on-year.

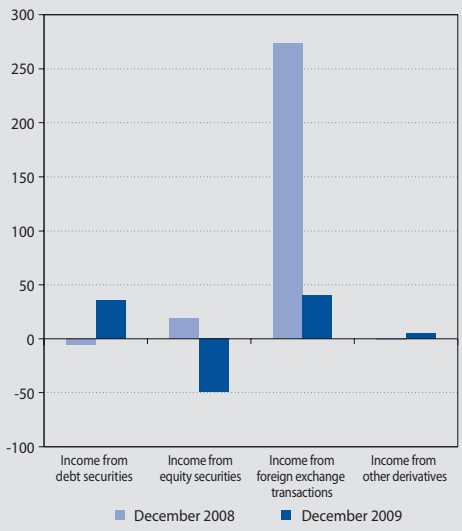
Despite the cost reduction, the sector's cost-to-income ratio worsened on a year-on-year basis, as a consequence of the sharp fall in income. In

Chart 41 Distribution of cost-to-income ratios across the banking sector



Source: NBS.
Note: Cost-to-income ratio is defined as the ratio of operating expenses to the gross income of banks.

Chart 42 Income from transactions in the banking sector (EUR millions)



Source: NBS.

2008, operating expenses corresponded to 55% of the income, and by the end of 2009, their share had increased to 60%.

Income from foreign exchange transactions fell considerably

Banks also recorded a sharp fall in non-interest income. The fall was caused by several factors.

The weaker economic activity of customers, in the corporate and household sectors, led to a fall in income from fees and commissions. This income fell by 11% compared with 2008, to approximately the level of 2007.

Compared with 2008, banks were increasingly selling loans in 2009, causing an increase in expenses. This trend was connected with the growing amount of non-performing loans. Some of the banks tackled this problem by selling non-performing loans – mostly retail loans – mainly in the last few months of 2009.

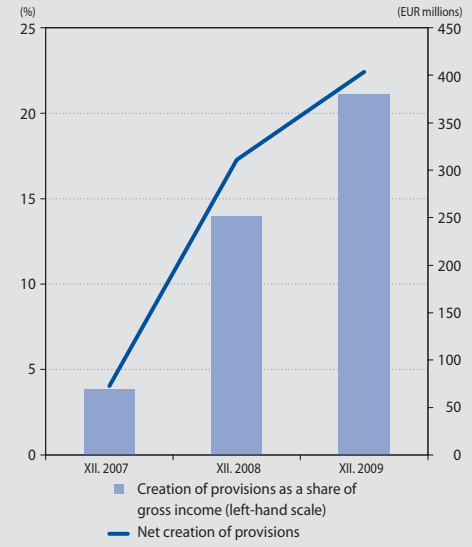
The marked year-on-year fall in non-interest income was caused mainly by a decrease in income from trading. Income from trading comes primarily from trading in securities, currencies, shares and derivatives.

These main income components followed different trends in 2009. The sharpest fall was recorded in income from foreign exchange transactions, which had been the largest trading income component before the country's entry into the euro area. This affected mostly banks whose total profits were dominated by such income. In general, the entire banking sector was negatively affected.

On the other hand, banks managed to increase their profits from securities trading. Compared with 2008, banks recorded higher gains from the revaluation of securities. This was mainly due to changes in the yield curves, with all rates for maturities of up to one year declining from the beginning of the year. This was automatically reflected in gains from the revaluation of securities.

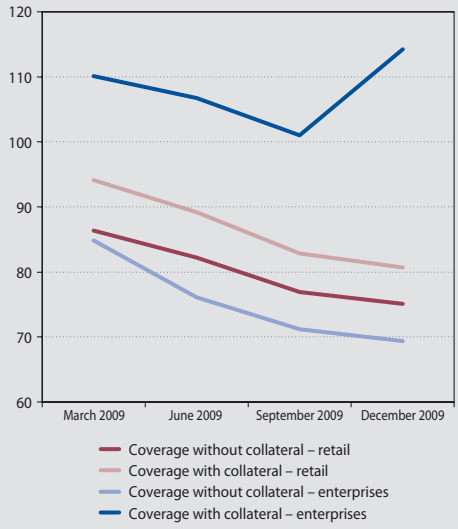
Income from equity securities followed a rather specific trend. At the sectoral level, losses from such transactions were produced by one bank that incurred a significant increase in expenses in connection with the sale of equity securities. Another bank – actively trading in shares since the end of the second quarter when the share market started growing – recorded a marked increase in income from such transactions.

Chart 43 Creation of provisions in the banking sector



Source: NBS.

Chart 44 Coverage of non-performing loans with provisions (%)



Source: NBS.
Note: The indicator is defined as the ratio of provisions to non-performing loans in the given sector.

Increased creation of provisions

The creation of provisions, which reflects the credit risk involved in the portfolios of banks, had a profound effect on profit generation in banks. Without taking the creation of provisions into of account, the total profit of banks would have fallen year-on-year by only 22%, instead of the reported 52%.

The net creation of provisions grew in volume by 30% in 2009, following a more than 300% increase in 2008.

The fact that the creation of provisions affected profitability so significantly in 2009 can be attributed to the growing amount of provisions and falling revenues of banks. At the end of 2009, the net creation of provisions accounted for more than 20% of the gross income of banks, compared with 4% in 2007.

The total amount of provisions as a share of total assets also increased, but this increase was not dramatic. In December, provisions accounted for 2.38% of the gross assets.

Non-performing loans grew more rapidly than provisions, thus their coverage decreased

The creation of provisions is one of the indicators of credit risk in banks, for banks usually create provisions when their receivables are depreciating. The increase in provisions over the course of 2009 indicates that more and more bank clients have problems with repayment of liabilities. For the stability of banks, an important requirement is that an adequate amount of provisions be created for the coverage of expected credit losses.

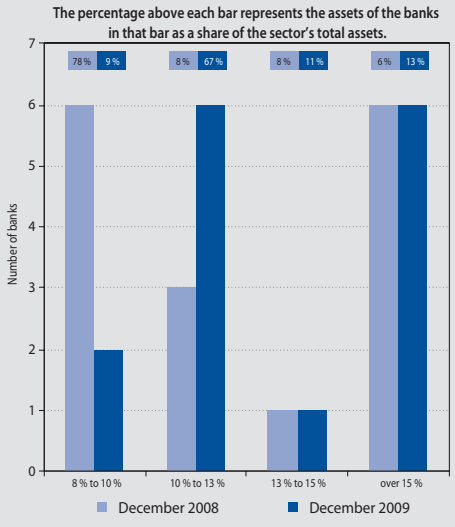
The outstanding amount of non-performing loans grew more rapidly in 2009 than the creation of provisions in banks. Hence, provisioning for non-performing loans fell considerably for both enterprises and households. Taking collateral into account, the coverage seemed to be adequate in the case of enterprises, but in the case of households it was only at the level of 81%, compared with 95% at the beginning of the year. In the case of enterprises, the coverage of defaulted loans (including collateral) did not fall below 100% during the year.

The coverage of non-performing loans with provisions showed a decreasing tendency in the majority of banks. In the case of enterprises, the coverage of defaulted loans was above 100%, except in three banks. Substantially lower coverage was ensured by banks for non-performing retail loans. In several cases, the coverage stood at 60%. In some of the banks, the ratio of cover-

Chart 45 Capital position of the banking sector

Source: NBS.
Left-hand scale: Tier 1, Tier 2 and Tier 3 capital in EUR billions.
Right-hand scale: capital adequacy ratio (CAR) and its minimum value of CAR for the banking sector.

Chart 46 Distribution of the capital adequacy ratio across the banking sector



Source: NBS.

age fell by a significant margin compared with the beginning of 2009.

2.1.2.2 CAPITAL REQUIREMENT

Banks were increasing their own funds during 2009

Banks continued to strengthen their capital position by increasing their own funds throughout 2009. This trend began in the middle of 2007, when the first signs of the crisis appeared. This was basically a defence mechanisms used by banks to prepare for a possible increase in future losses.

In December 2009, the own funds of the banking sector stood at €4.2 billion, representing a year-on-year increase of €351.1 million (9.2%). Eleven banks increased their own funds on a year-on-year basis, while four banks recorded a year-on-year decrease. A substantial increase in own funds was observed in the first half of 2009 (banks raised primarily the highest quality component of capital, i.e. Tier I), mainly from retained earnings from previous years.

On the other hand, the own funds of numerous banks were under pressure at the end of 2009, because the banks suffered a loss. At the same time, there was much less space for an increase in own funds for 2010 from retained earnings, because they had already decreased by more than 50% on a year-on-year basis.

Dominant share of Tier I capital

In terms of capital position, an advantage of domestic banks is the large share of Tier I capital. In December 2009, this top quality capital component accounted for more than 90% of banks' own funds, and recorded a relatively significant increase (10.9% year-on-year). The other components constituted a less significant part of the own funds, and their significance fell still further in 2009.

Slovakia's entry into the euro area and the resulting foreign exchange risk reduction led to a marked decrease in risk-weighted assets for market risks (by 60% year-on-year). This systemic change had a more or less positive influence on all banks in the sector.

The decrease in risk-weighted assets for the foreign exchange risk was also reflected in the total amount of risk-weighted assets, which fell year-on-year by almost 4%, despite an increase in risk-weighted assets in the banking book. Although

this significant component grew in year-on-year terms, its growth was much slower than in the previous periods. This was mainly caused by a slowdown in bank lending and/or its suspension in selected sectors.

At the sectoral level, the capital adequacy ratio rose

The increase in own funds and decrease in the amount of risk-weighted assets led to a rise in the capital adequacy ratio. At the end of December 2009, the ratio reached 12.6% at the sectoral level, representing a rise of 1.4% during the year. All banks exceeded the minimum ratio of 8%, and some of them by a considerable margin. Thus, numerous banks attempted to create an adequate capital cushion against unexpected losses.

On the other hand, two banks reported a significant fall in capital adequacy ratio, approaching to the 8% limit. According to their capital adequacy ratios, both banks show reduced ability to cover unexpected losses in the future.

The parent companies of local banks also strengthened their capital position

The increasing of capital adequacy ratios was a general trend in 2009 and was observed in almost all the banking sectors of the EU. The parent banks of most domestic banks strengthened their capital position, too. In the second half of the year, however, the capital increase in parent banks didn't take place through government support. Banks attempted to avoid such recapitalisation schemes and oriented towards market-based forms of capital acquisition. However, parent banks remained under pressure in most of the cases as a result of a fall in their annual profits.

Table 2 Capital positions of selected foreign banks groups

	Bank groups (consolidated data)					
	Tier I / RWA		Own funds / RWA		Year-on-year change in net profit	
	Q4 2009	Q2 2008	Q4 2009	Q2 2008	Q4 2009	Q2 2008
Raiffeisen	11.2 %	8.9 %	12.8 %	10.9 %	-78 %	-57.0 %
Erste Bank	8.6 %	8.4 %	10.9 %	11.1 %	-50.8 %[1)]	-23.0 %
UniCredit	7.6 %	7.7 %	12.1 %	11.3 %	-62.0 %[1)]	-69.0 %
Intesa Sanpaolo	8.0 %	7.7 %	11.6 %	11.0 %	-15.9 %	-49.0 %
KBC	10.8 %	10.8 %	–	–	-2,625 / 304[2)]	-43.0 %
Dexia	11.8 %	11.3 %	13.5 %	–	-1,542 /286[1), 2)]	-35.0 %
Volksbank	9.1 %	10.7 %	11.4 %	12.5 %	-1,700 %[1)]	loss
OTP	13.2 %	12.0 %	16.9 %	15.9 %	-57.0 %[1)]	-35.0 %

Source: Commercial banks.
1) Data for the 3rd quarter of 2009.
2) For the KBC and Dexia bank groups, the year-on-year changes in profitability are given in EUR millions. Data refer to profit 2008 / profit 2009.

2.2 THE INSURANCE SECTOR

The situation in the insurance sector in 2009 was notable for two key developments: firstly, the largest recorded drop in premiums, caused mainly by the unfavourable economic conditions, and, secondly, the sharp rise in profits compared with 2008, which stemmed from soaring gains on financial operations. Total premiums in the sector amounted to €1.985 billion, including €1.029 billion in life insurance and €0.956 billion in non-life insurance. Premiums in life insurance recorded a sharper fall, and even premiums for unit-linked insurance policies, long the fastest growing of all insurance lines, fell by more than 15%. In non-life insurance, prolonged contracts increased as a share of all insurance contracts, indicating a stabilisation of insurance portfolios in almost all lines of business. In the motor insurance segment, premiums for motor vehicle insurance exceeded premiums for motor third-party liability insurance for the first time since 2002. The profits of insurance companies amounted to €138.2 million in total, representing a rise of 28.4%. As for the investment structure of technical provisions, the share of government bonds increased at the expense of bank bonds and term deposits.

Premiums fell[1]

In 2009, the development of the insurance market in terms of premiums was largely shaped by the unfavourable economic situation. After reporting one of their strongest ever years of growth in 2008, premiums declined in 2009 for the first time since their monitoring began. The decline was sharper in the life insurance sector.

The drop in life insurance premiums was largely accounted for by the sharp reduction in premiums for the so-called "unit-linked" insurance products, where the investment risk is borne by the insured. These products feature a high degree of flexibility, especially in regard to partial withdrawals and the scope for the adjustment of the premium level.

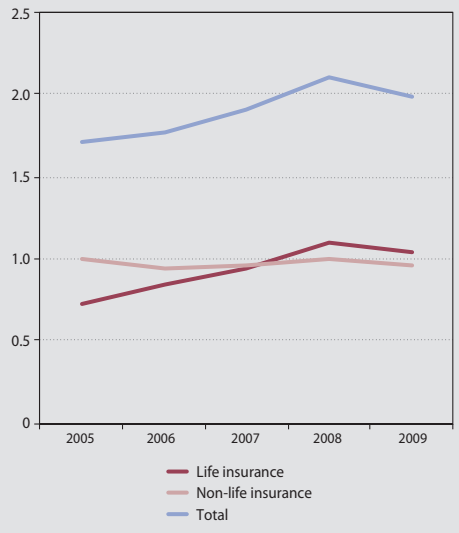
The second key reason for the downturn in life insurance was the reduction in the number of insurance policies for traditional life insurance (including assurance on death, assurance on survival to a stipulated age, mixed assurance, etc.). The decline in premiums in this line of insurance was caused mainly by contract surrenders and an increase in the number of maturing policies.

In general, the non-life insurance sector is less affected by the state of the real economy than is the life insurance sector. This is apparent also from the development of premiums during 2009. The decline in non-life insurance was largely due to a fall in premiums in the motor insurance line.[2]

Total premiums for 2009 amounted to €1.985 billion, representing a fall of 5.5% in comparison with the previous year. In life insurance, premiums fell by 6.4%, to €1.029 billion (representing the largest ever year-on-year drop), and in non-life insurance they decreased year-on-year by 4.5%, to €0.956 billion.

The figure for non-life insurance premiums does not, however, include data for two insurance companies which became branches of foreign insurance companies during the course of 2009 and therefore do not have a reporting obligation. Had these insurers been excluded from the 2008 data, the decline in non-life insurance premiums would have been only 2.6%.

Chart 47 Insurance premiums (EUR billions)



Source: NBS.

1 *Premiums can be defined as the price agreed in individual insurance contracts regardless of the method of their financial reporting.*

2 *The lower premiums in this insurance line may also relate partly to the arrival of a branch of insurer from other EU Member States to the Slovak market. However, since these insurers are not subject to a reporting obligation, their impact on the motor insurance sector cannot be assessed.*

The worsening economic conditions in 2009 were reflected mostly in reduced demand for insurance products. In a majority of life and non-life insurance lines, new production declined in terms of both the number of insurance contracts and the amount of premiums.

Lines of insurance

In the life insurance market, the situation in unit-linked insurance underwent a substantial change in 2009. After recording strong growth in previous years, premiums in this line slumped by 15.2% and reflected above all a sharp fall in new production in the second half of 2009. Here, too, the economic crisis led to a substantial rise in policy surrenders, and the frequency of policy surrenders in this insurance line was higher than in any other. Nevertheless, the rise in the number of insurance policies indicates that policy surrenders did not necessarily entail the termination of insurance contracts, but that they were applied as partial withdrawals from funds. Such a step is permitted under this type of insurance.

Premiums for traditional life insurance policies – the largest line of insurance – also showed high sensitivity to the economic downturn. Their amount fell by 3.5% year-on-year, the principal causes of this decline being payouts made in respect of surrenders or survival to a stipulated age. Like unit-linked products, traditional life insurance products recorded their largest ever drop in premiums.

As regards the number and frequency of policy surrenders in traditional life insurance, they declined in comparison with the previous year, but the amount of surrender payments rose year-on-year. This may indicate that the policies surrendered last year were mainly older ones covered by higher technical provisions, or high-benefit policies.

The only line of life insurance in which the amount of premiums rose in 2009 was supplementary insurance, though the increase of 3.5% was substantially lower than in the previous year. This may be partly related to the drop in new unit-linked production, given that insurers offer unit-linked products together with an option of supplementary insurance. As a share of total life insurance premiums, supplementary insurance rose moderately, to 11.9%.

Demand for supplementary pension insurance, the smallest line of life insurance, remains low. The number of insurance policies in this line again declined, and the amount of premiums fell by 9.2%.

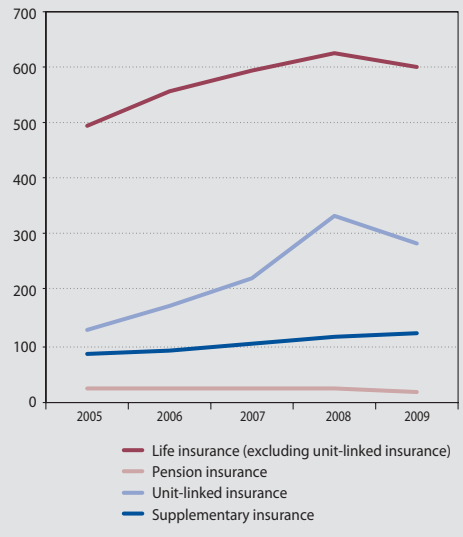
The situation in the non-life insurance market reflects mainly developments in the motor insurance line of business.[3] Premium prices in this line come under strong downward pressure from the conditions of persistently stiff competition. Thus the premium per contract declined in both motor third-party liability insurance (MTLP) and motor vehicle insurance.

In 2009, insurance portfolios stabilised in all insurance lines other than legal protection and nowhere more so than in the motor insurance line. This is apparent from the share of prolonged contracts in the total number of insurance contracts.

Total premiums for motor third-party liability insurance declined by 11.2%, and premiums for motor vehicle insurance fell by 4.5%. Motor insurance premiums as a share of non-life insurance premiums again fell (to 60.5%), and premiums for motor vehicle insurance had the larger share of the premiums in this line of business for the first time since 2002.

Property insurance represents the third largest line of non-life insurance, accounting for almost

Chart 48 Life insurance premiums (EUR millions)



Zdroj: NBS.

3 *The motor insurance line includes motor third-party liability insurance (MTLP) and motor vehicle insurance.*

24% of premiums. The slight increase in the average premium for the whole of this line, even for prolonged contracts, indicates a certain shift towards a more realistic level of premium and insurance coverage in property insurance. Even so, the average premium for new contracts declined. The total amount of property insurance premiums increased by 3.5% year-on-year.

The only other lines of non-life insurance that recorded a rise in premiums were accident and sickness insurance (up by 0.2 %) and, most notably, the line of credit insurance, surety insurance and insurance of miscellaneous financial losses, with a rise of almost 13%. The importance of this insurance is rising at a time of uncertainty over future economic developments, as is confirmed by the sharp increase in the number of new contracts in this line.

All other lines of non-life insurance recorded a decline in premiums for the period under review.

Smaller rise in the claims cost[4]

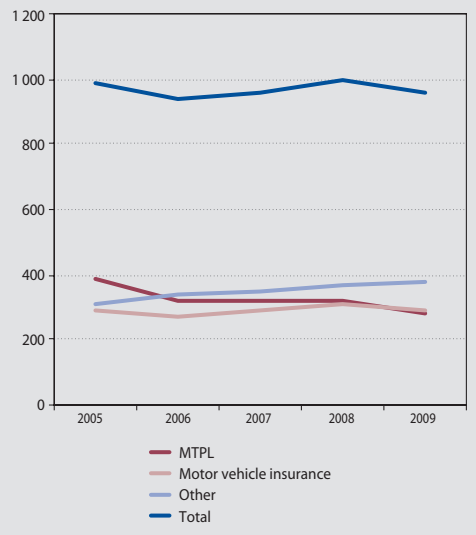
The total claims cost in 2009 amounted to €1.035 billion, representing a rise of 7.4% compared with the previous year. This increase, however, was lower than the one reported for 2008, largely because of the fall in the claims cost in non-life insurance. In life insurance, the claims cost rose by 19.3%, to €552.3 million, mostly due to the increase in payouts for survival to a stipulated age and surrenders.

In non-life insurance, the claims cost for 2009 reached €482.6 million, representing a fall of 3.6% year-on-year. This was caused mainly by the fall in claim payments in the property insurance line.

The loss ratio for non-life insurance as a whole rose by 2.7 percentage points year-on-year, to stand at 54.9%. The actual claims cost fell, but because of changes in provisions for claims, the overall technical claims cost increased. This, together with the decline in earned premiums, led to a rise in the loss ratio. At the level of insurance lines, the loss ratio increased in the majority of non-life insurance lines. But in two key lines – property insurance and motor vehicle insurance – the loss ratio fell (in each case mainly due to a decline in technical costs).

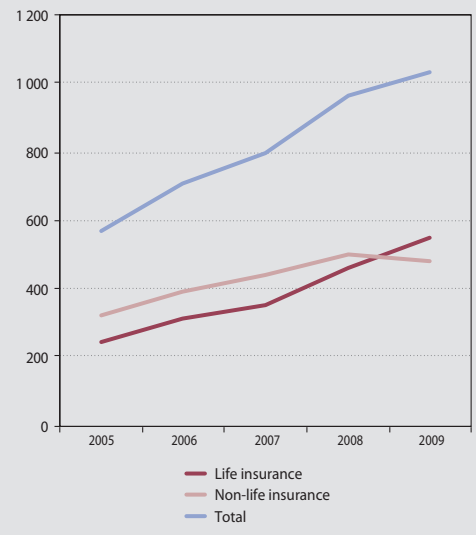
The combined ratio is also important for assessing the overall profitability of different insurance lines, since it takes into account not only technical costs, but also operating expenses. In 2009, only three insurance lines had a combined ratio of more than 100%, which means that they made a loss. The highest combined ratio of 198% was reported for the line of credit insurance, surety insurance and insurance of miscellaneous financial losses, which also had a loss ratio well in excess of 100% (the cost of claims increased almost threefold year-on-year). Here, too, it is apparent that the importance of insuring against this risk rose substantially in 2009.

Chart 49 Non-life insurance premiums (EUR millions)



Source: NBS.

Chart 50 Claims cost (EUR millions)



Source: NBS.

4 *NBS analysed the technical cost of claims as it did in the case of premiums. Hereinafter, the term "claims cost" means "technical claims cost".*

Table 3 The loss ratio, expense ratio, and combined ratio of non-life insurance lines for 2009 (%)

	Loss ratio	Expense ratio	Combined ratio
Supplementary insurance	20.57	22.92	43.48
Accident and sickness insurance	23.88	39.84	63.73
Motor third-party liability insurance	58.52	28.53	87.05
Motor vehicle insurance	67.84	28.85	96.70
Other motor insurance	31.29	24.12	55.41
Transport liability insurance	17.52	31.64	49.16
Property insurance	44.66	31.92	76.59
General liability insurance	5.23	31.57	36.80
Credit insurance, surety insurance and insurance of miscellaneous financial losses	161.61	36.70	198.31
Legal protection insurance	39.20	66.58	105.78
Assistance insurance	39.81	41.10	80.90
Active reinsurance	98.91	28.63	127.54
Total	54.86	30.52	85.38

Source: NBS.

The reinsurance share fell slightly

Insurance premiums ceded to reinsurers in 2009 amounted to €244.2 million, representing a rise of 8.3% year-on-year. Ceded premiums therefore further increased their share of total premiums, and they mostly comprised non-life insurance premiums. As a share of non-life insurance premiums and life insurance premiums, ceded premiums represented, respectively, almost 25% and just 0.8%.

Technical provisions and their investment

As at 31 December 2009, insurers reported technical provisions totalling €4.477 billion, representing an increase of 11.3% year-on-year. Provisions for life insurance made up the bulk of this rise and overall they totalled €3.455 billion. Provisions for non-life insurance ended the year at €1.022 billion.

The largest increase in 2009 was again recorded in provisions for unit-linked insurance. The highest provisions – provisions for life insurance – rose by 9.2%, to €2.589 billion. Their share of total life-insurance provisions is decreasing gradually, but still remains relatively high (75.0% as at the end of 2009).

The structure of technical provisions in non-life insurance remained largely unchanged from the previous year. Provisions rose by 4.0%, with the largest increase (5.7%) recorded by technical provisions for claims.

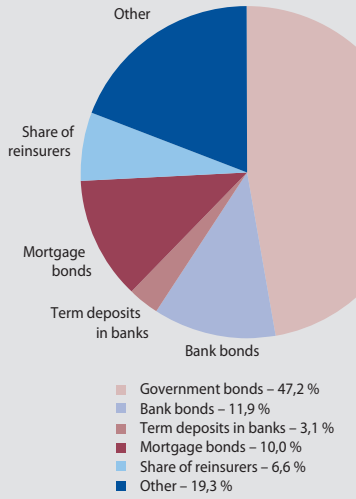
Technical provisions excluding provisions for unit-linked insurance liabilities totalled €3.785 billion as at the end of 2009. The asset coverage of technical provisions rose to 112%. Insurers increased mainly their holdings of government securities and reduced their exposure to bank bonds and term deposits. Thus these investments declined both in their amount and their share of total investments of technical provisions.

Table 4 Premiums ceded to reinsurers

	2009 (EUR million)	2008 (EUR million)	Change (%)	Share of premiums (%)
Total	244,2	266,3	-8,3	12,3
Life insurance	8,5	20,7	-59,0	0,8
Non-life insurance	235,7	245,6	-4,0	24,6

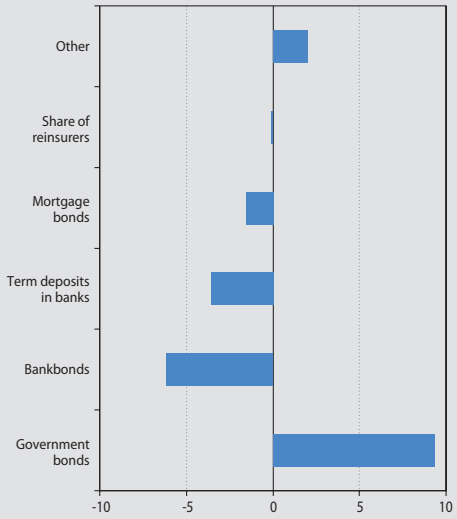
Source: NBS.

Chart 51 Investment of technical provisions in 2009 (%)



Source: NBS.

Chart 52 Investment of technical provisions as at the end of 2009 (year-on-year changes in %)



Source: NBS.

Financial position of the insurance sector

Despite the unfavourable situation in the insurance market in 2009 (which led to the lower technical result), the overall financial position of the insurance sector improved in comparison with the previous year, since the year-on-year drop in the technical account was outweighed by the rise in gains on financial operations.

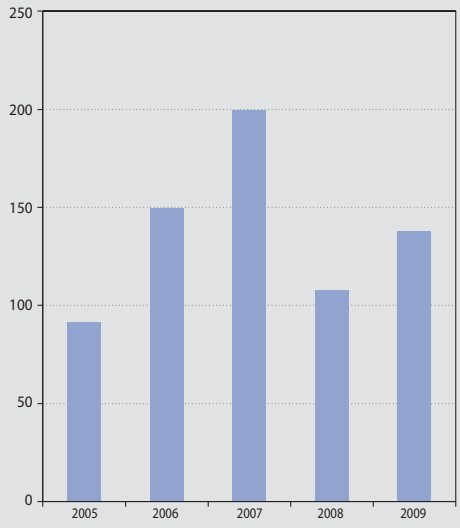
Nevertheless, most insurers reported a year-on-year deterioration in their overall financial result. The rise in profits reported by the sector as a whole was in fact largely attributable to the rise in profits of the three largest insurance companies.

The total profits of insurers increased by 28.4%, to stand at €138.2 million. There was also an improvement in the profitability indicators ROE, which climbed from 8.9% in 2008 to 10.4%, and ROA, with a rise from 1.9% to 2.3%. Like total profits, however, these values remained below the levels seen in 2006 and 2007.

The financial result of insurers increased year-on-year by €201.3 million, 78% of which was accounted for by gains on unit-linked products. This fact was reflected in the rise in technical provisions for unit-linked products, and thus in the decline in the technical result for life insurance as whole. The overall technical result for insurance companies fell by €173.9 million in comparison with 2008, which in addition to the abovementioned provisions for unit-linked products, reflected the fact that the cost of claims and other technical expenses rose more sharply than technical income.

Five insurance companies reported a loss for 2009, two fewer than did so for the previous year[5].

Chart 53 Total profits of insurance companies (EUR millions)



Source: NBS.

5 *Insurance companies which in 2009 were transformed into branches of foreign insurance companies were not taken into account. However, the merger of two insurance companies into one in 2009 was taken into account.*

2.3 INVESTMENT FIRMS

As a consequence of the financial crisis, derivatives trading in 2009 plunged by 76% year-on-year. At the same time, transactions in bonds, equities and other financial instruments soared by 40%. The amount of customer assets managed by licensed firms remained largely unchanged year-on-year. The capital adequacy ratios of investment firms comfortably met the statutory minimum requirement.

The total amount of transactions in bonds, shares, mutual funds and other equity securities in 2009 increased by 40% year-on-year, to €20 billion (compared with €14.4 billion as at 31 December 2008).

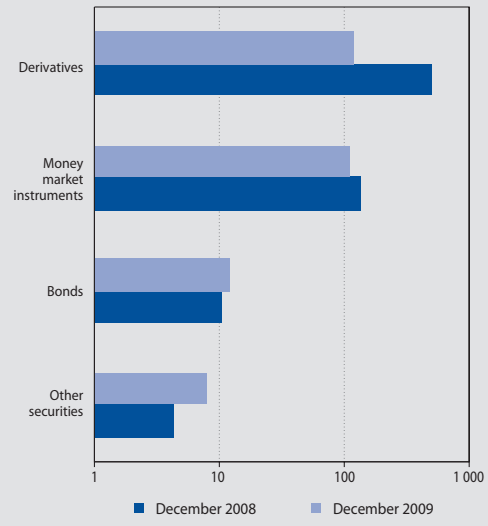
In 2009, the most traded instruments by nominal value were financial derivatives (€120 billion) and money market instruments (€110 billion). These figures, however, represent the amount of the underlying assets of the traded instrument; the actual amount of the financial flows generated by these transactions is far lower.

The financial crisis brought about a year-on-year slump in derivatives trading, which in 2008 had amounted to €508 billion. The amount of transactions in money market instruments also fell, by 18%.

The amount of customer assets managed by companies licensed to manage a customer portfolio (investment firms, banks, and certain asset management companies) declined by 7% year-on-year (from €2.09 billion to €1.95 billion).

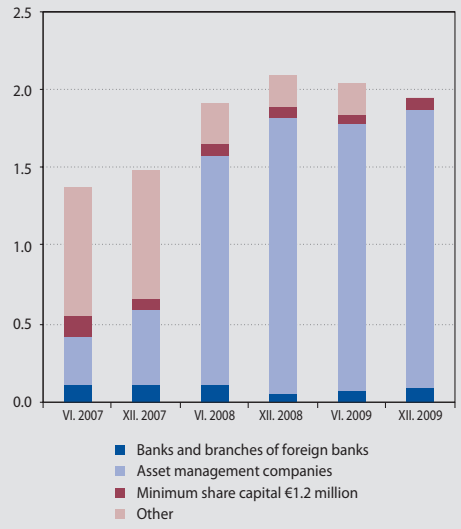
During 2009, the amount of own funds of every non-bank investment firm fluctuated well above the minimum required by law, and their level as at December 2009 was more than three times higher.

Chart 54 Transactions broken down by investment instrument (EUR billions)



Source: NBS.
Note: Data on the horizontal logarithmic axis are given in EUR billions.

Chart 55 Amount of customer assets managed by licensed entities (EUR billions)



Source: NBS.

2.4 COLLECTIVE INVESTMENT

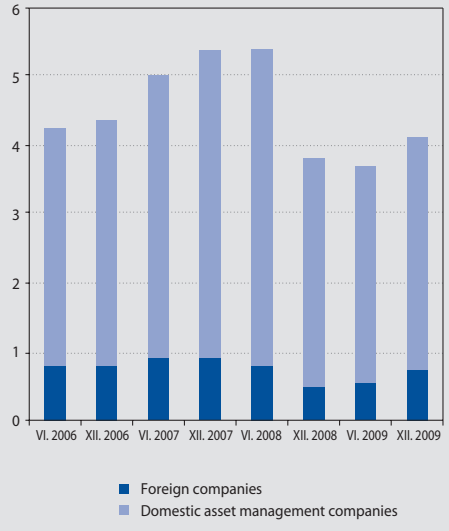
The collective investment sector in the first quarter of 2009 was still reeling from the negative developments in 2008 that were driven mainly by the financial and economic crisis. The crisis was reflected in plunging prices of certain assets managed by domestic and foreign collective investment undertakings, and it thus fuelled investor fears and led to a wave of redemptions. The main equity indexes bottomed out at the beginning of March 2009. In the period that followed, stock markets began to rebound (offering the first signs of improvement in expected economic developments) and prices of other assets stabilised, and it was in this context that investor demand for collective investment products gradually picked up and thus brought stability back to the collective investment sector. From the second quarter of 2009, the sector was reporting positive net sales, and their growth was supported also by the low level of interest rates on bank deposits, the principal alternative to investments in mutual funds. Overall, in 2009, the prices of assets managed by collective investment undertakings and the total net asset value in the sector rose in comparison with the end of 2008, but the figures still fell short of the levels recorded before the wave of mutual fund redemptions began in September 2008.

IN THE FIRST QUARTER OF 2009, NET ASSET VALUE (NAV) WAS STILL MARKED BY THE NEGATIVE TREND THAT DATED BACK TO THE PREVIOUS YEAR; IT BEGAN TO RECOVER FROM APRIL 2009

Having been hit by a series of negative trends and events in 2008, Slovakia's collective investment sector began to stabilise and then improve during 2009.

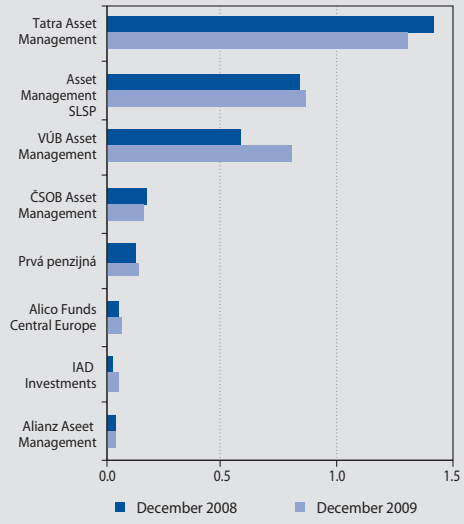
Developments in the first quarter of 2009 were in several ways still largely following on from the situation in the last three months of the previous year. Total net asset value as the sum of assets managed in Slovakia by domestic and foreign collective investment undertakings continued to decline relatively sharply. This stemmed largely from the turbulences in global financial markets, both in a direct way – through exposure to assets whose fair value was falling – and, to an even great extent, indirectly, as mutual fund shareholders became less confident in their investments and thus redeemed their mutual fund unit certificates. As financial markets began to rebound in April, so the trend in Slovakia's collective investment sector started to turn around, too. With asset prices rising and fund performances returning to positive territory, investors became increasingly ready to invest in domestic mutual funds and with foreign collective investment undertakings. As a result, the net asset value in the sector gradually returned to growth. Sometime in the third quarter of the year, the amount of assets under management reached the end-2008 level, and it continued rising until end of 2009, to total €4.12 billion as at the 31 December. As a result, the total net asset value managed in Slovakia by domestic and foreign collective investment undertakings increased by almost 9% year-on-year. Nevertheless, compared with the amount of assets that were under management before the wave of redemptions began in September 2008, the size of the sector in terms of net asset value was smaller by around one quarter. The rise in assets managed by foreign collective investment undertakings (40% year-on-year) was far higher than the increase recorded for domestic mutual funds (4 %), but at the same time it only made up for the greater slump that the

Chart 56 Net asset value of mutual funds sold in Slovakia (EUR billions)



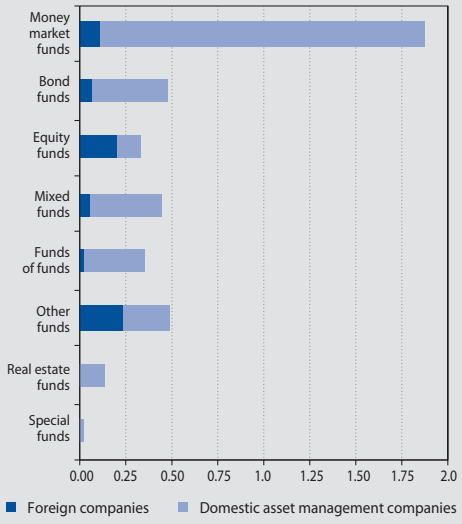
Source: NBS.

Chart 57 Net asset value of mutual funds managed by domestic asset management companies (as at December 2009; EUR billions)



Source: NBS.

Chart 58 Net asset value of funds by category, as at December 2009 (EUR billions)



Source: NBS.

foreign undertakings had recorded in the previous year. The share of domestic mutual funds in the sector's total assets therefore declined by 4 percentage points, to 83%.

Consolidation among domestic asset management companies and mutual funds

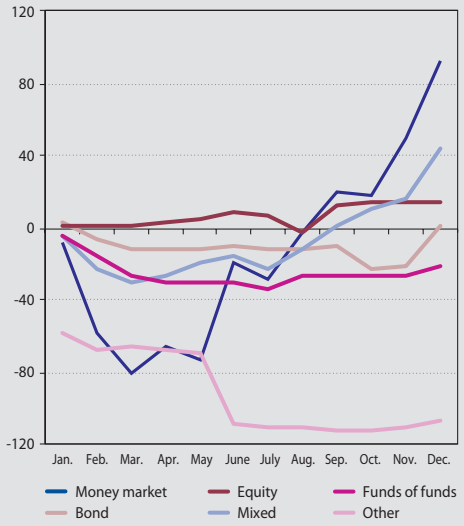
Another notable feature of the period under review was the partial consolidation among domestic asset management companies (AMCs) and mutual funds. The number of AMCs fell from ten at the beginning of 2009, to eight at the end of the year, as two asset management companies transferred their mutual funds to other AMCs. In one case, the AMC was wound up, with the management of its mutual funds being taken over by its parent undertaking. In the second case, the AMC was dissolved without winding up, by merging into another AMC. Since the dissolved AMCs were among the smaller market players in terms of the amount of assets under management, their respective mergers did not have a significant effect on relations and concentrations in the sector. The concentration remained high, with the three largest AMCs holding a combined market share of 87%, albeit slightly reduced by the relatively faster rise in mutual fund assets reported by smaller AMCs. Two companies reported a decline in assets under management.

There was also consolidation among domestic mutual funds. Several asset management companies opted to merge funds so as to make their management more efficient and also in order to meet the statutory requirement that closed-end funds be converted to open-end funds by the end of 2009. Consequently, there were 46 fewer funds at the end of December 2009 than there had been at the beginning of the year, and a total of 77 mutual funds were being managed by domestic companies at the year-end. The bulk of the decrease in funds was accounted for by one asset management company, which merged all 41 of its closed-end funds into four funds and then converted them into open-end mutual funds.

Assets under management in money-market, equity and mixed mutual funds increased

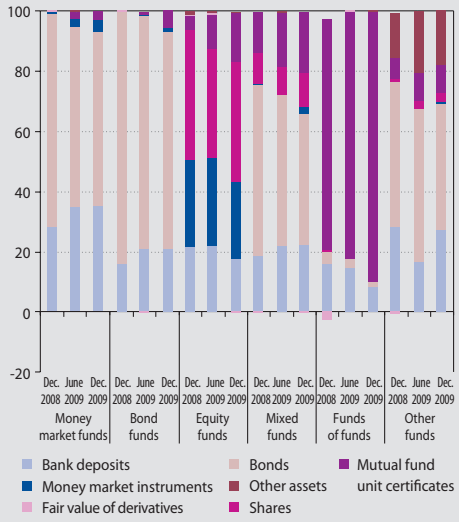
The distribution of net asset value across the different categories of mutual funds at the end of 2009 remained largely unchanged compared with the end of 2009. Money market funds maintained their long-standing position as the largest category, their share of the sector's assets remain-

Chart 59 Monthly cumulative net sales of open-end mutual funds in Slovakia for 2009 (EUR millions)



Source: NBS.

Chart 60 Comparison of the structure of assets in individual fund categories as at December 2008 and December 2009 (%)



Source: NBS.

ing unmoved at 46%. Among funds managed by domestic companies, their share even increased slightly, to 52%. Equity and mixed funds recorded the largest relative rise in assets, since they had largest positive sales in relative terms. However, December's growth in mixed fund assets reflected the conversion of closed-end funds into mixed funds. Particularly in the case of equity funds, and to a certain extent with mixed funds, the increase in asset value stemmed from the appreciation of assets in their portfolios. Negative cumulative net sales for 2009 brought about a drop in the amount of assets under management in funds of funds and, above all, in the category of other funds.

Households continued to be the main investors in mutual fund unit certificates

The position of households as the largest holders of mutual fund unit certificates remained virtually unchanged in 2009. Although their share in the total value of domestic mutual fund unit certificates fell by 2 percentage points, it still represented a dominant 80% as at December 2009. The second largest group of unit certicates holders are other financial institutions, such as banks, and their share rose slightly, to 15%. As for minority investors in collective investment funds, enterprises more than doubled their share of mutual fund assets.

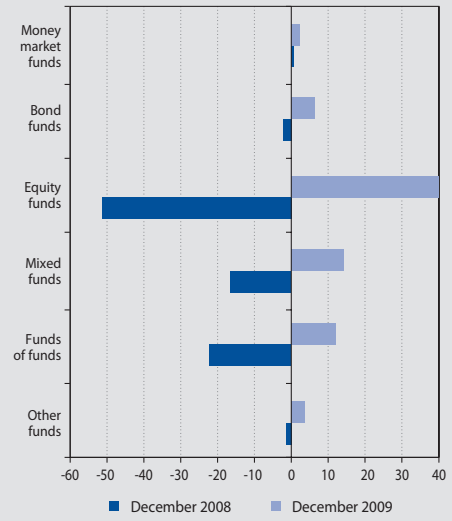
Changes in the portfolio structure of individual mutual fund categories

The portfolio structure of individual mutual fund categories underwent certain gradual changes during 2009. Money-market, bond and mixed funds increased their investments in bank deposits at the expense of bond investments, though bonds still remained the principal investment asset for these funds. A common trend in all fund categories during the period under review was the rise in the volume and proportion of investments in unit certificates of other mutual funds.

Return to positive performance

The performance of collective investment funds in 2009 was affected mostly by the rise in value of financial market assets – especially during the period from April to November – and in particular the upturn in share prices. As at 31 December 2009, all fund categories reported positive yields in the year-on-year comparison. There was a double-digit improvement in the performance of mixed funds, funds of funds and, in particular, equity funds – all of them categories in which equity securities make up a major share of assets.

Chart 61 Comparison of average annual performances of open-end mutual funds by category (in % p.a.)



Source: NBS.
Note: Funds are weighted by net asset value.

This stands in stark contrast to 2008, when all categories of funds except for money market funds recorded a nominal depreciation in investments amid the peaking financial crisis. From a longer-term perspective, it is clear that not even the favourable developments in 2009 were sufficient to erase fully the losses caused by the financial market turbulences during the ongoing crisis. In fact, the annualized yields of equity funds, mixed funds, and funds of funds for the years 2007 to 2009 are in the red.

The total profits of asset management companies in the collective investment sector plunged by 41% in 2009, to €5 million. This steep decline largely reflects the fact the average net asset value during 2009 was lower by around one quarter than in 2008 (the spate of redemptions occurred only towards the end of 2008). The fact is that the management fees of asset management companies are tied to the amount of assets under their management. Two asset management companies reported a loss for the year.

2.5 PENSION SAVING

The aggregate portfolio of retirement pension funds underwent a substantial change of composition in 2009. Pension fund management companies (PFMCs) sold practically the entire equity component of their fund portfolios and significantly reduced the volume and share of the bond component. The funds released in this way were re-invested in Treasury bills, which ended the year as the largest asset class in the portfolio of the Pillar II pension saving system, with a share of 35.3%. Within the debt securities component, the share of government securities increased to 80% by the year-end. At the same time, pension fund management companies purchased debt securities that had a shorter residual maturity. In changing their investment strategy, pension fund management companies were responding to the adoption of a new law. This legislation introduced a new type of fee related to fund performance and a requirement that PFMCs top up pension fund assets out of their own capital.

For the first half of the year, enrolment in Pillar II of the pension saving system was made voluntary by law. This allowed savers to join or leave the system and a proportion of them did so.

The net asset value of Pillar II funds rose by 30% over the course of the year, to €2.9 billion. It may be seen as a good sign that the performance of balanced and growth funds entered positive territory for the first time since the outbreak of the global financial crisis. Once again, though, savers with conservative funds enjoyed the highest yields.

As for Pillar III, the voluntary pension saving system, it mirrored Pillar II in that the net asset value of its funds increased year-on-year. As at the end of 2009, the NAV amounted to €1.047 billion. In contrast to Pillar II, however, the vast majority of assets in these supplementary pension funds were being invested in bonds, even towards the year-end, and more than half of those bond investments were in the form of government bonds. The equity component of the portfolio rose to 4.7%.

2.5.1 Retirement pension saving

In 2009, the composition and investment yields of assets in Pillar II funds were affected by certain legislative changes: firstly, an amendment to the Retirement Pension Savings Act that temporarily opened up the system so as to allow savers to join or leave it; secondly, a legal regulation concerning fees charged by pension fund management companies, required investment yields, and benchmarking.

Number of savers declined year-on-year

In the period from 15 November 2008 to 30 June 2009, savers were allowed to join or leave the Pillar II system on a voluntary basis. After the end of this period, the option to enter into a retirement pension saving contract was basically limited to people entering the workforce for the first time. The opportunity to opt out of Pillar II in 2009 was taken by around 66,000 existing savers.[6] Since the number of newly signed retirement pension saving contracts came to less than 14,000[7], the number of savers declined to 1,434,870 as at 31 December 2009, a relative drop of 3.3% year-on-year. Each of the six pension fund management companies recorded a fall at around the level of the sectoral average, and therefore their market shares by number of savers remained virtually unchanged.

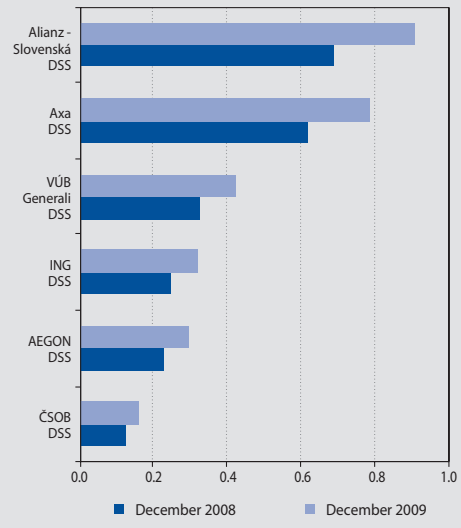
Of the retirement pension saving contracts newly signed in 2009, only around 30% (3838) were entered into with natural persons who were entering the workforce, i.e. taking out pension insurance for the first time.[8] This number is notable mainly in relation to the total number of young people who had the option to join the second pillar during this time (47,037). Depending on interpretation, the take-up rate of around 8% may indicate that the rest of the segment opted to take out pension insurance exclusively with the Social Insurance Agency or that young people are simply not engaged with the question of pension security. Assuming, however, that the numbers of young people who enter the workforce and join Pillar II do not change their trend, and that the state does not alter its position on the discretionary element of retirement pension saving (voluntary enrolment), the long-term sustainability of Pillar II – as the system that along with Pillar I is supposed to ensure, on one hand, a basic level of financial security for people in their old age and, on the other hand, a stable system of public pension provision – will be called into doubt.

6 *Source: the Social Insurance Agency. This figure includes applications to opt out of the Pillar II system that were submitted in 2008, since the Social Insurance Agency did not process them until 2009.*

7 *Source: the Social Insurance Agency.*

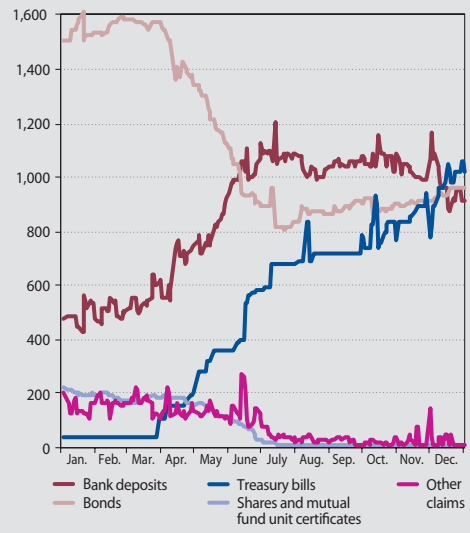
8 *Natural persons born after 31 December 1986 who opted in to the retirement pension saving system within six months after first taking out pension insurance in accordance with Act No. 461/2003 Coll. on Social Insurance as amended (employees, self-employed persons, persons insured on a voluntary basis).*

Chart 62 Net asset value of pension funds by pension fund management company (EUR billions)



Source: NBS.

Chart 63 Amount of major components of PFMC fund assets in 2009 (EUR millions)



Source: NBS.

Net asset value continued to rise sharply

The total net asset value of Pillar II funds rose in 2009 by €669 million, or 30% in relative terms. By the year-end, pension fund management companies were managing assets with a net value of €2.9 billion. Because of the transfer of assets from pension funds to the Social Insurance Agency in respect of those savers who opted out of Pillar II, the absolute increase of assets in 2009 was lower than in 2007; it was, though, higher than the figure for 2008, which, analogously, was affected by opt-outs. In 2009, the amount of assets transferred from the Pillar II system to the Social Insurance Agency in respect of savers opting out of the system represented €109 million[9].

The distribution of assets between the three types of fund remained unchanged. Approximately two thirds of the total assets were placed in growth funds, just under a third in balanced funds, and a small amount in conservative funds.

The new investment strategy of pension fund management companies led to changes in the portfolio's composition

The composition of the asset portfolio of Pillar II funds recorded a substantial change in 2009. Pension fund management companies undertook these changes primarily in response to a new law on PFMC fees. This introduced a new type of fee related to fund performance, and it requires PFMCs to top up a fund's assets out of their own capital if the fund in question fails to achieve the minimum performance required by law during a designated period. This period is defined as six months with each period following on from the previous one. In response to this regulation, every pension fund management company overhauled its investment strategy and optimised its portfolio so as to minimise the portfolio's volatility over the given time horizon and to eliminate, as far as possible, the risk of having to top up assets.

The close link between the new legislation and the strategic shifts within the aggregate portfolio is clear from the timing of the adjustments in the portfolio, which occurred between the approval of the amendment to the Retirement Pension Saving Act (March) and its entry into force (July). Outside of this period, the composition of the portfolio in 2009 remained relatively constant in terms of its breakdown into major asset classes.

The principal intervention made in the portfolio in order to reduce its volatility was the almost complete sale of equities and mutual fund units. The share of the equity component fell from 9.8% of the net asset value at the beginning of

9 *Source: the Social Insurance Agency.*

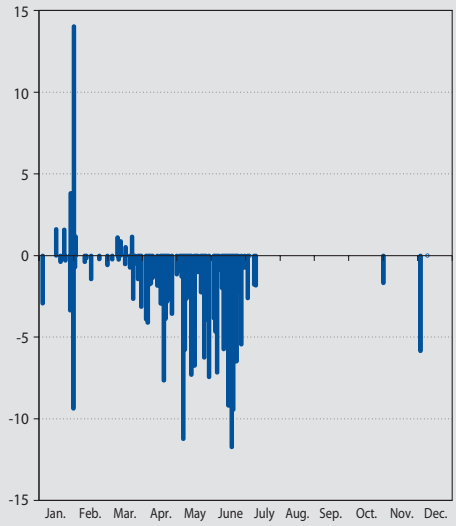
the year, to 0.9% as at 1 July 2009. Over the rest of the year, this share fell still further, and it ended the period at 0.1%. During the first quarter of 2009, net sales of shares were still at a moderately negative level, i.e. funds were net buyers of equities and mutual fund unit certificates. From April until the end of 2009, however, pension fund management companies were only selling shares and mutual fund units. In March of that year, stock markets had come to the end of their slump, and in the period up to October they recorded virtually uninterrupted growth in the tens of percent. Almost the entire sectoral exposure to equities remained concentrated in growth and balanced funds of one pension fund management company, and the share of equity component in the total assets of these funds was around 1% at the year-end.

Another way in which the portfolio was restructured was through the rapid reduction in the volume and proportion of the bond component. At the beginning of 2009, bonds made up the dominant share of the portfolio, accounting for around two thirds of the total net asset value, but during period from April to June that share was cut by half. For the rest of 2009, the bond component's share remained largely unchanged and it ended the year at 33.1%.

At the turn of the first and second quarters, pension fund management companies began to invest in Treasury bills using funds released from the sale of equities and bonds as well as funds from current Pillar II contributions. Whereas the share of Treasury bills in the portfolio's total assets had previously been a minimal 1.5 %, it soared to 23 % by June and kept rising up to 31 December 2009, when it stood at 35.3 %. Indeed, Treasury bills ended the year as the largest asset component of the Pillar II portfolio. Only Treasury bills from euro area countries were purchased for funds.

This tendency towards a more conservative investment strategy, as well as the relatively heavy selling of securities, was reflected in an accumulation of funds in bank current accounts and term deposits. As a share of the sector's net asset value, these funds peaked in July at around 42 %. A proportion of them were later invested in other assets, and thus bank account funds as a share of Pillar II assets declined to 31.5% at the year-end.

Chart 64 Volume of daily purchases and sales of shares and mutual fund unit certificates in PFMC funds in 2009 (EUR millions)



Source: NBS.
Note: Positive figures indicate the purchase of securities, negative figures the sale.

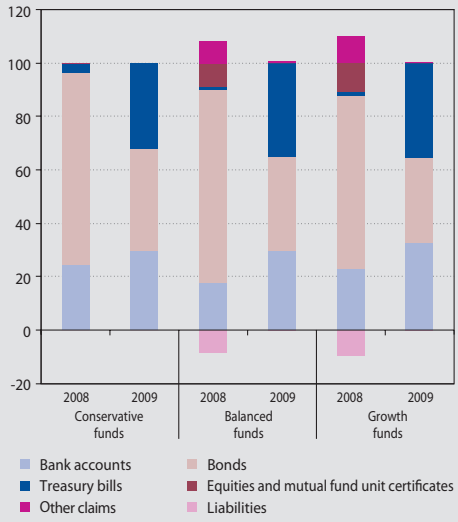
The other asset classes that make up the total net asset value comprise other claims and liabilities. The main component of both these assets and liabilities is currency derivative transactions. The share of assets denominated in foreign currencies also declined, to 0.1% of the total amount, largely owing to the substantial reduction in equity exposure. The need for hedge transactions therefore fell, which in turn led to a decrease in the share of fixed-term contracts in Pillar II assets, to around 1% of the net asset value.

As regards the asset structure of different types of fund, there was further convergence between all three types as the equity component of balanced and growth funds was almost entirely unloaded and replaced with bonds and Treasury bills. If the structure of the now substantially homogenised pension fund portfolios does not alter, it may give rise to justified doubts about the statutory requirement to establish and manage three types of pension fund.

The bond portfolio's internal structure also underwent changes

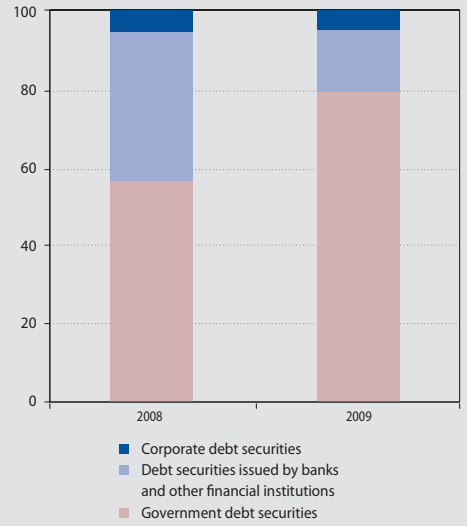
The portfolio restructuring not only reduced the bond component's share, it also brought about changes to the internal structure of this

Chart 65 Comparison of the asset structure in individual types of PFMC funds, as at December 2008 and December 2009 (%)



Source: NBS.

Chart 66 Structure of the aggregate debt securities portfolio of PFMC funds as at December 2008 and December 2009 (%)



Source: NBS.

component. Probably the most substantial of these changes was the decline in the volume-weighted residual maturity to 1.1 years as at end-December 2009, which is more than one and a half years less than in comparison with the year before. The selling and gradual maturing of bonds with relatively longer residual maturities and their substitution with shorter-dated issues was probably another of the targeted steps which was aimed at reducing the volatility of the aggregate portfolio and which also contributed to the reduction in its duration. The same motivation should be looked for in the accumulation of a large amount of Treasury bills, which typically have an original maturity of one year or six months.

The increased exposure to general government securities is expected to have a positive effect on limiting unexpected downturns in the prices of the portfolio's debt securities, this time caused by credit risk. As a share of the entire component of debt securities, debt securities labelled "government" – i.e. the sum of government bonds and Treasury bills – rose from 57% to 80% in 2009. Debt instruments issued by banks and other financial institutions declined in terms of both their share and amount. Corporate bonds remained with a low share of around 5%.

As for the breakdown of the Pillar II bond portfolio by coupon, it is zero-coupon debt securities (typically including government bonds and Treasury bills) that have the largest share, followed by fixed-coupon bonds. The share of floating-coupon bonds declined year-on-year.

The year-on-year performance of all fund types returned to positive territory

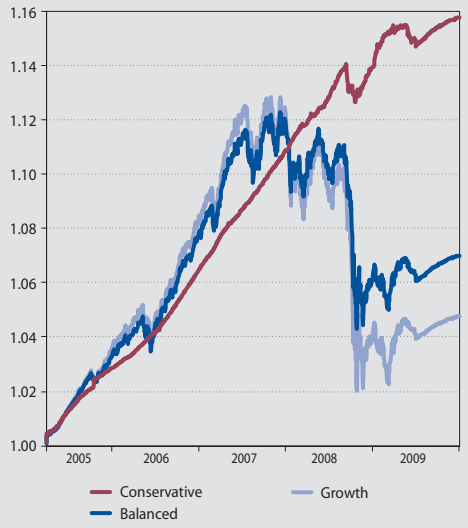
The first quarter of 2009 saw the weighted current values of pension units in balanced and growth funds, and to a lesser extent in conservative funds, continue the relatively volatile course that they had followed since the outbreak of the financial crisis. The trajectory of pension units' current values closely mirrored trends in global stock markets, although the amplitudes were smaller since the equity component at that time accounted for somewhat less than 10% of the portfolio. When funds subsequently undertook a gradual sale of their equity holdings, the portfolio's volatility began to diminish, as did the correlation with equity indexes. In the second half of the year, the fluctuations faded completely away and the current value of pension units drifted upwards in a basically linear fashion. The parallel development of pension units' current values for all three types of funds simply provides further evidence of their substantial similarity.

It may seen partly as a good sign that the average annual yield[10] of balanced and growth funds returned to positive territory for the first time since September 2008. The year-on-year performance of these funds as at 31 December 2009 represented 0.8 % (balanced) and 0.7 % (growth). It should be noted, however, that the performance improvement is largely attributable to a base effect, i.e. the slump in the current value of pension units that followed the collapse of Lehman Brothers. In 2009, the highest yields were again enjoyed by savers with conservative funds, although December's figure of 1.6 % was lower than the average for the whole of 2008. With Slovakia recording consumer inflation of 0.9 % for 2009, only conservative funds, on average, managed to ensure a positive real yield.

In 2009, the principal sources of yields in balanced funds and growth funds were, approximately to the same degree, interest income from bank deposits (especially term deposits), on one hand, and coupon and capital yields on debt securities, on the other hand. Investments in bank accounts provided these two types of fund with a stable source of income throughout the year. By contrast, the contribution of debt securities to shifts in the current value of pension was relatively volatile, especially in the first half of the year. While gains from debt securities had a positive effect on fund performances in the first quarter of 2009, the revaluation of the securities to fair value in the second quarter resulted in losses. By mid-year, these instruments were showing a moderate cumulative loss (Chart 68).

Because of falling equity indexes, losses were recorded for the equity component of the balanced fund and growth fund portfolios in the first two months of the year, and these losses outweighed the gains on other types of instrument. As a consequence, the current values of pension units declined during this period. With global stock markets beginning to rebound from March 2009, the equity holdings of pension funds appreciated over the course of March to May and made up much of the ground they had lost earlier in the year. However, the substantial diminution of the equity component that took place from the end of June 2009, meant that this type of asset made only a marginal contribution to the overall profitability of the funds in the second half of the year.

Chart 67 Current value of pension units by type of fund



Source: NBS.

As for pension funds' total gains on conservative funds, around three quarters of the gains were made on debt securities, and the rest on income from bank deposits. Not even conservative funds avoided the May and June loss on bond investments, though in their case the loss was relatively smaller than that recorded in the other two types of pension fund.

The long-term performance of balanced and growth funds remains affected by the crisis development of the current value of the pension unit, which arose mainly in 2008. Consequently, their weighted averages at the end of December 2009 were at levels not recorded since 2006. The annualised weighted rise in the pension unit's current value, from when the system began operation up to the end of 2009, represented 1.0% for growth funds, 1.4% for balanced funds and 3.1% for conservative funds.

Table 5 Annual yield of pension funds as at December 2009

Fund types	Weighted average (%)
Conservative funds	1.6
Balanced funds	0.8
Growth funds	0.7

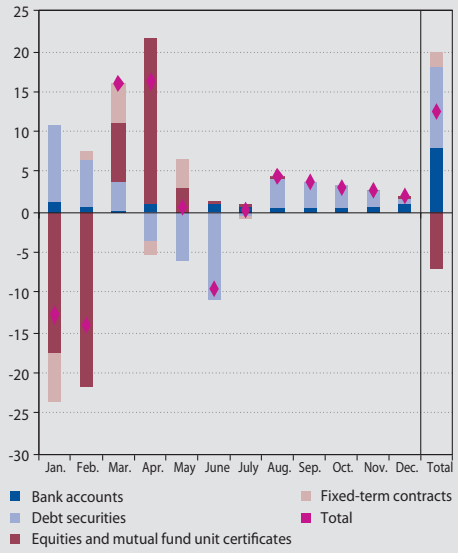
Source: NBS.

10 The average annual yield of the given type of pension fund is calculated as a weighted average of the year-on-year percentage changes in the daily values of pension fund units of the respective pension funds. The year-on-year percentage changes in the current values of pension units are calculated as at 31 December 2009 (PMZDHDJ31.12.2009) according to the following formula:

$$PMZDHDJ_{31.12.2009} = \left(\frac{DJ_{31.12.2009}}{DJ_{31.12.2008}} - 1\right) * 100\%$$

where DJ is the current value of a pension unit on the given day. The weight applied is the ratio of the respective fund's net asset value (NAV) to the sum of NAVs of funds of the same type.
The yield is given in nominal terms, which means that inflation is not deducted. When returns are calculated for various forms of investment, the nominal return is used as a rule, calculated according to the standard statutory methodology. This return, however, is not identical to the return in the saver's personal pension account, which is determined on an individual basis. The input data were the values of pension units from the individual pension funds reported to Národná banka Slovenska by pension fund management companies for the days 31 December 2008 and 31 December 2009, which are available on the website of Národná banka Slovenska.

Chart 68 Gains and losses of balanced and growth funds by type of instrument in 2009 (EUR millions)



Source: NBS.
Note: Data for each month give the gain/loss on specific instruments in that month; data in the column „Total" represent the cumulative gain/loss for the whole of 2009.

Chart 69 Gains and losses on the equity positions of balanced and growth funds as compared with the S&P 500 equity index

Source: NBS, REUTERS.

Companies of the Pillar II pension system made a total loss of €5,961,000 in 2009, which was €410,000 heavier than their loss for 2008. As in the previous two years, two of the pension fund management companies made a profit and the other four were loss-making. Profit generation slowed and losses deepened in the second half of the year, after the upper limit on the pension fund management fee was lowered.

2.5.2 Supplementary pension saving

Slight rise in participation in Pillar III of the pension saving system

Demand for participation in Pillar III of the pension saving system rose moderately in 2009, compared with the previous period under review. The number of participants in the Pillar III system increased by 1% over the second half of 2009, to end the year at 858,000. Nevertheless, two supplementary pension asset management companies' (SPMCs) funds that have 67% of the supplementary pension saving market recorded a drop in participants. Although the vast majority of participants (94.3%) remain enrolled in contributory supplementary pension funds, the number of beneficiaries under payout funds is gradually rising.

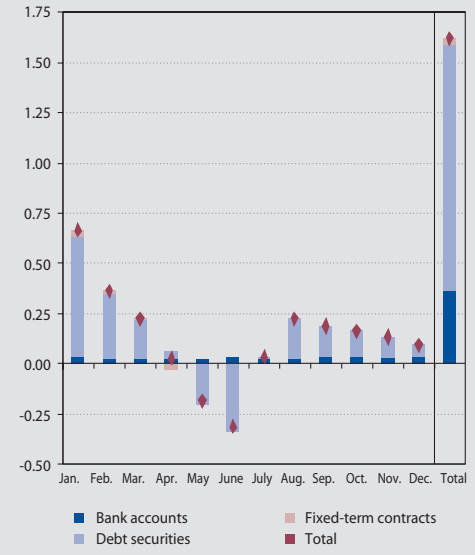
Stable annual rise in net asset value

The net asset value of Pillar III pension funds maintained its rising trend, reaching €1.047 billion as at December 2009 for an annual increase of 12% (or a half-yearly increase of 6.9%). All SPMCs reported a rise in net asset value.

Bond component of fund assets increased

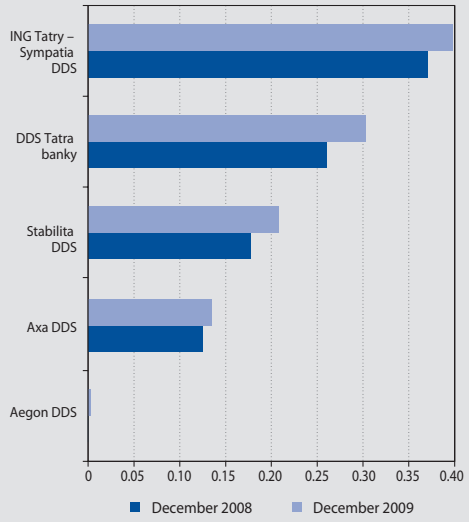
As at the end of 2009, the vast majority of the assets of supplementary pension funds (71.9% or €753.2 million) were invested in bonds, thus continuing the trend from 2008. This contrasts with their structure in the second half of 2007 (the global financial crisis then being in its initial stage), when participants' savings were invested in approximately equal proportions in bonds and bank accounts. By the end of the period under review, the bond component had risen sharply year-on-year, by 24.9%, at the expense of a decline in bank investments (down by 18%, at €247.3 million). The equity component climbed to €49.2 million as at December 2009, giving it a share of 4.7% in the funds' assets. The bulk of the assets under management

Chart 70 Gains and losses of conservative funds by type of instrument in 2009 (EUR millions)



Source: NBS.
Note: Data for each month give the gain/loss on specific instruments in that month; data in the column „Total" represent the cumulative gain/loss for the whole of 2009.

Chart 71 Net asset value of pension funds managed by supplementary pension asset management companies (EUR billions)



Source: NBS.
Note: The NAV reported by Aegon DDS was €999,000 as at 31 December 2008 and €2,283,000 as at 31 December 2009.

(94.6%) were placed in euro-denominated investments.

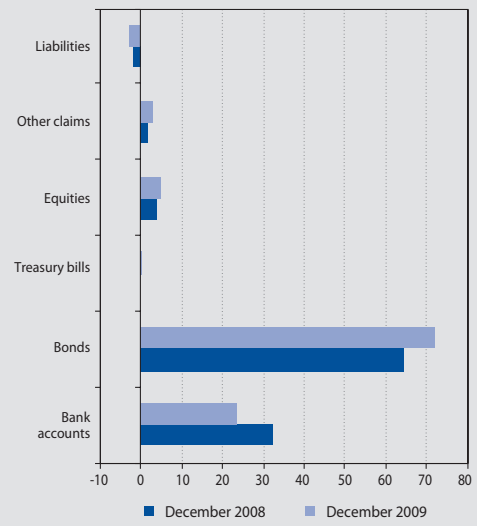
As in the previous period, the majority of assets under the management of SPMCs as at December 2009 (96.1%, representing €1.006 billion) were to be found in contributory funds. The asset structure of these funds mirrored that of the overall funds, with the portfolio dominated by the bond component (71.9%). As for the asset structure of SPMC payout funds as at December 2009, more than two thirds (73 %) of the assets were invested in bonds and the rest, in accordance with the strategy, were invested in conservative bonds. This contrasted with the structure as at June 2009, when the bond component had a share of 55%.

As regards contributory funds, each SPMC manages one fund that underpins the company's operation and is dominant in terms of the amount of assets under management. This fund is intended for the "ordinary" applicant for a supplementary pension scheme and it basically features a balanced investment strategy. These funds invest, on average, a quarter of the assets under management into bank accounts (fixed term accounts) and the remaining three quarters into bonds. The equity component represents less than two percent. From the view of risk, customers have the option to save, on one hand, with conservative funds (offered by two SPMCs) or, on the other hand, with any of three growth funds (i.e. equity funds). It is the second of these groups, in particular, whose risk/return profile represents a real alternative to the universal "large" funds. Their equity component fluctuates between 40% and 50%, depending on whether the fund in question predominantly contains either direct investments in the equities of particular companies, or exposures to equity mutual funds (overwhelmingly ETF funds[11]), or a combination of both. In addition, they are investing more heavily into debt securities. The composition of the growth fund portfolio is appropriate to the stated aim of these funds, notwithstanding that the amount of assets under their management is relatively low.

More than half of the bond investments of SPMC funds (51.9%, representing €391.1 million) were invested in government bonds, and almost one third (32.2%) in bank bonds. Nearly all of the

11 Exchange traded funds (ETF) are freely marketable equity funds intended to mirror the yields of a selected equity index.

Chart 72 Types of investment by share of total assets under management (%)



Source: NBS.
Note: The proportion of Treasury bills at the end of the period under review (31 December 2009) was insignificantly low (0.1 %).

bond investments (96.8%) were denominated in the euro currency.

Performance of Pillar III pension funds

Some SPMC funds reported a double-digit annual yield as at the end of 2009.[12] In the case of contributory funds, yields for individual funds ranged from -1.04% to 15.84% (the weighted average for all contributory funds as at 31 December 2009 was substantially higher, at 3.6%,[13] in comparison with the end-June 2009 and end-2008 figures of, respectively, -0,19 % and -2%). In general, it was contributory funds with a growth profile that offered the higher yields in 2009, but only a minority of all participants in the supplementary pension saving system are enrolled in these funds. As for payout funds of the Pillar III pension system, their performances ranged, except one fund in negative territory, in positive numbers to a highest yield of 2.33 %, with the weighted average for these funds representing 1.6% (compared with 0.74% as at June 2009 and 1.4% as at December 2008).

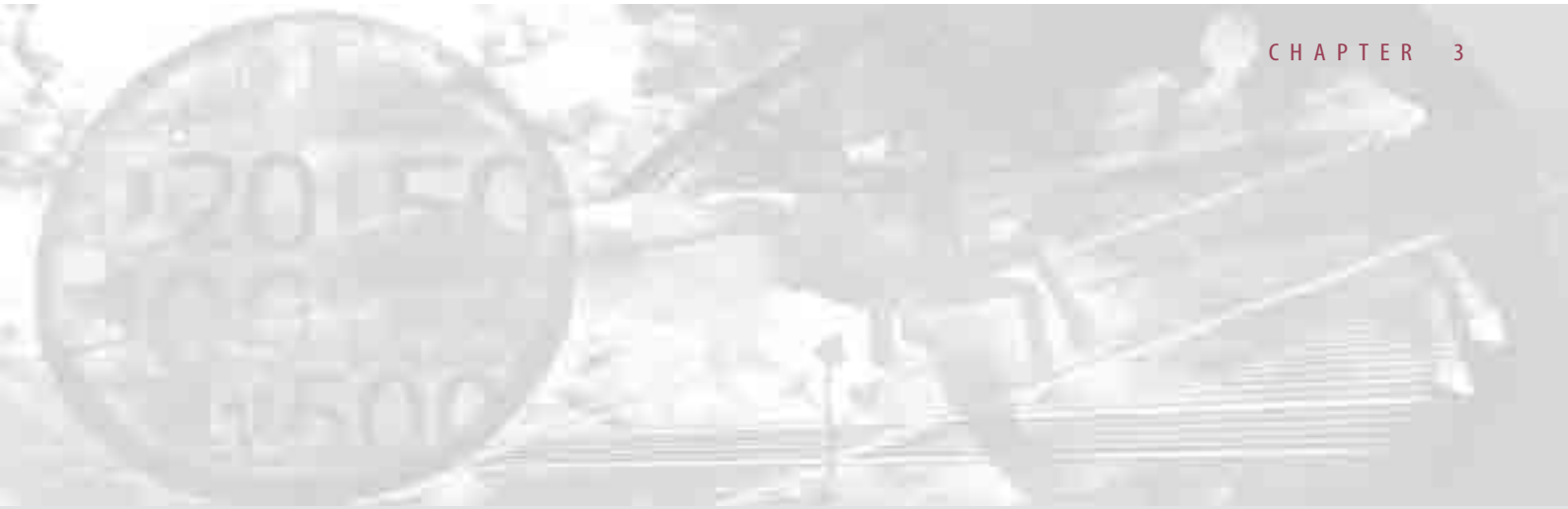
SPMCs report sharp rise in profits

The total profit of supplementary pension asset management companies for end-2009 amounted to €7.99 million. In the year-on-year comparison, this represents a more than twofold increase (up by 139%). The bulk of the profit increase was generated by the largest SPMC, and the rest by four other SPMCs to varying extents. One SPMC made a loss, though it was far lower than its loss of the previous year.

The sector's higher profit was attributable, on one hand, to a rise in net profit from fees and commissions, and, on the other hand, lower operational expenses, particularly wage costs.

Fees charged by SPMCs amounted to €26.7 million as at 31 December 2009 and as much as 83.9% of that figure consisted of supplementary pension fund management fees. Expenses and fees paid by Pillar III pension companies to third parties in connection with the supplementary pension saving system totalled €0.97 million at the end of the period under review. These comprised mostly fees for the performance of depository activities and charges paid to the central depository and to entities ensuring the settlement of securities transactions.

12 *Source: supplementary pension fund asset management companies.*
13 *The calculations did not include the performance figures for the conservative contributory fund of DDS Tatra banka, since the respective data were not available. The NAV of this fund represents 0.2% of the NAV of contributory funds in total.*



RISKS IN THE SLOVAK FINANCIAL SECTOR

3

3 Risks in the Slovak Financial Sector

Given how the banking sector is structured and, in particular, the nature of its activities, risk in the sector is closely related to developments in the real economy. The Slovak economy reached a turning point in 2009, suffering a sharp contraction after several years of rapid growth. The first signs of the economic downturn were already appearing in the third quarter of 2008, but it was in the first and second quarters of 2009 that the economy recorded its deepest slump. In the second half of the year, certain sectors saw a nascent recovery. As for the future development of risk in banks, especially in regard to credit risk, a key factor will be the pace and, above all, sustainability of the economic recovery.

Within a relatively short space of time, the 2009 economic downturn was reflected in an escalation of risk in the domestic banking sector.

The corporate sector was particularly hard hit by the crisis. Almost all business sectors suffered a deterioration in their financial position, which in turn reduced their ability to repay bank loans. The slump in the first half of 2009 was followed by a modest recovery, mainly in export-oriented sectors. This recovery, however, can still only be described as fragile. Although statistics showed some rebounding, our evaluation of output increases in absolute terms indicates that production and capacity utilisation remain at very low levels. The appetite to recruit, which can be seen as a key indicator of confidence in the corporate sector, remained very low at the end of 2009.

The effects of the crisis varied from one business sector to another, as well as from enterprise to enterprise. The moderate stabilisation in the second half of the year was seen mainly in export-oriented enterprises and industries. Even so, the loans-at- risk ratio – an indicator of the financial condition of firms to which banks are exposed – deteriorated slightly in the last quarter of the year. The state of this indicator also reveals growing differences between banks in terms of the quality of their credit portfolios. As for the situation in sectors oriented on domestic demand, it worsened during the course of 2009.

Banks face rising risks, particularly in their exposure to the commercial real estate sector, where the slump in demand, prices and occupancy rates has made it more difficult for the affected enterprises to repay their bank loans. To an increasing extent, the effect of market developments on individual projects varies according to their quality and location. We assume that the differences between these projects will be reflected in how non-performing bank loans develop in 2010. This sector poses a greater risk to banks also because of the relatively high concentration of these loans in terms of their size.

The situation in the household sector was similar to that in the corporate sector, although the impact was more moderate. The rise in unemployment was sharp in the first and second quarters, and then stabilised slightly. Nevertheless, households remain exposed to a relatively high level of uncertainty, which in turn is related to the stability of the recovery in the corporate sector. Lower-income groups have been the most affected. The exposure of banks to these groups is predominantly concentrated in consumer loans and current account overdrafts, and it is these loans that recorded the highest rise in the default ratio. Although lower-income groups take out a smaller proportion of house purchase loans, their share in this regard has been rising in recent years.

At the sectoral level, the ratio of non-performing loans rose by only one percentage point in 2009. However, this increase was mitigated by sales of non-performing loans in several banks, especially during the last quarter of the year, and in fact certain banks reported a relatively sharp rise in non-performing loans.

The banking sector's stability in the area of liquidity was confirmed again in 2009. From a long-term perspective, it is important that a majority of banks are still covering their lending activities with stable deposits from customers. It was mainly branches of foreign banks that reported a higher proportion of volatile funds in the financing of loans. The situation in regard to short-term liquidity remained unchanged, with almost all banks continuing to meet the prescribed short-term liquidity ratio. There were, however, differences between banks in the sector. Certain banks reported higher sensitivity to liquidity risk, whether short-term or long-term.

As well as the positive trends in the real economy, we can also see an upturn in financial markets. Regarding the risks that Slovak financial institutions are exposed to, the most significant development

in 2009 was the declining volatility of equity index prices, interest rates and credit spreads during the second half of the year.
In most sectors, the high exposure to risks remained largely unchanged during 2009. The most significant change occurred in the fund portfolios of pension fund management companies, which became less risky during the second quarter of 2009 following adjustments to the portfolio structures. Nevertheless, Pillar II of the retirement pension saving system was exposed mostly to the sovereign risk of countries that have a high general government debt, though only through bonds with a short residual maturity. In addition, the equity component of mutual fund portfolios increased, reflecting the upturn in share prices as well as the positive net sales of equity and mixed funds towards the end of 2009.
By far the highest risk was reported in insurance companies' portfolios of assets invested on behalf of insured persons ("unit-linked insurance"). These portfolios recorded a high share of investments in equity shares and mutual fund units, as well as a long duration in their bond component.
As regards market risks, the banking sector was exposed mainly to interest rate risk. Banks would be adversely affected by a parallel rise in interest rates. The more likely scenario at present, however, is that interest rates rise only on shorter maturities and remain flat on longer maturities. In that case, the adverse effect on banks would not be as severe. The level of exposure to interest rate risk remained substantially unchanged in 2009. Banks offset the rise in longer-term retail deposits recorded in the last quarter of 2009 by extending the duration of the bond portfolio.

3.1 CREDIT RISK OF HOUSEHOLDS IN THE BANKING SECTOR

Unemployment rose mainly in the first half of 2009

The ability of households to service their bank debts was under relatively severe pressure throughout 2009. The crisis situation had adverse repercussions on the real economy, especially in the first quarter of 2009. The slump in corporate sector performance fed through to the household sector, too. The rise in credit risk reflected mainly an increase in the unemployment rate, which soared from 9% in January to 11.4% in May. The rate rose more gradually over rest of 2009 and ended the year at 12.7%.

Households saw the sharpest rise in unemployment in the first quarter of 2009 – as a continuation of the negative trends from the end of 2008 – and in the second quarter. It was during this period that enterprises announced the largest number of mass redundancies. The unemployment rate rose at slower pace over the rest of the 2009, and the situation more or less stabilised in the second half of the year, except in September when school-leavers entered the labour market. Under plans for mass redundancies, a total of 45,600 people were due to be laid off between the last quarter of 2008 and January 2010, but the actual number of mass redundancies during this period was around 29,000. Therefore, more than 16,000 employees still face the threat of redundancy under plans already announced.

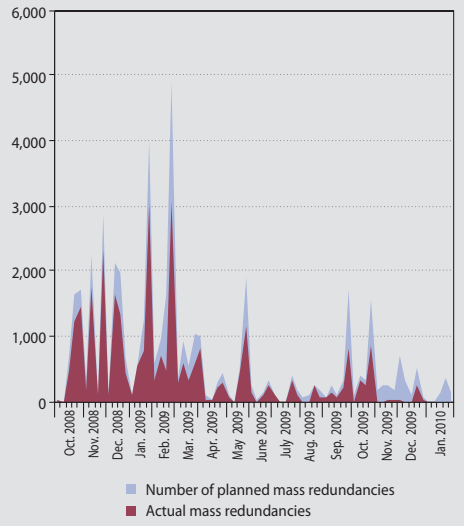
The growth in unemployment in the first and second quarters of 2009 was highest among lower-income groups of the population. Compared with higher income groups, the number of unemployed rose more sharply among lower-income groups. Further evidence of this development may be found in the ratio of non-performing loans, which recorded the highest rise in respect of loans taken out mainly by lower-income borrowers.

Employment rose modestly in the last quarter, but firms' expectation remain downbeat

Firms behaved cautiously also in regard to taking on staff. Employment fell particularly sharply in the first quarter of 2009, and it was only in the last quarter of the year that it began to rise slightly.

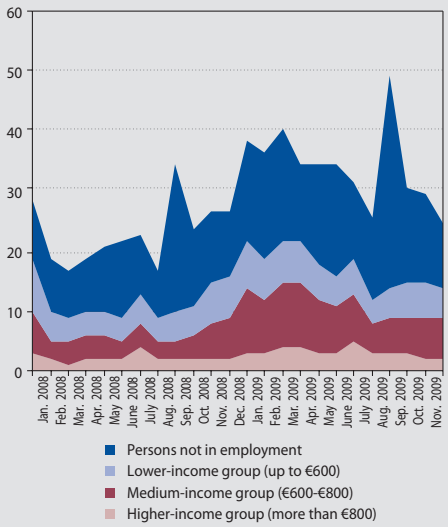
Firms' expectations regarding the further development of employment also showed an improvement; after deteriorating sharply in the first quarter of 2009, they became less negative. Even so, a majority of firms still expect employment to fall.

Chart 73 Planned mass redundancies and actual mass redundancies in the corporate sector (number of persons)



Source: Central Office of Labour Social Affairs and Family.

Chart 74 Number of unemployed by income group (thousands of persons)

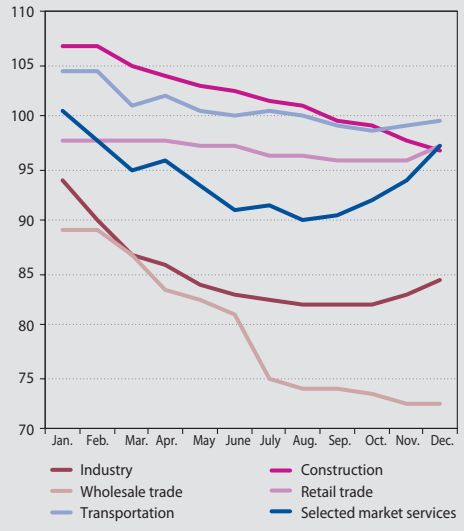


Source: SO SR, Trexima.

We do not expect unemployment to decline in the near term

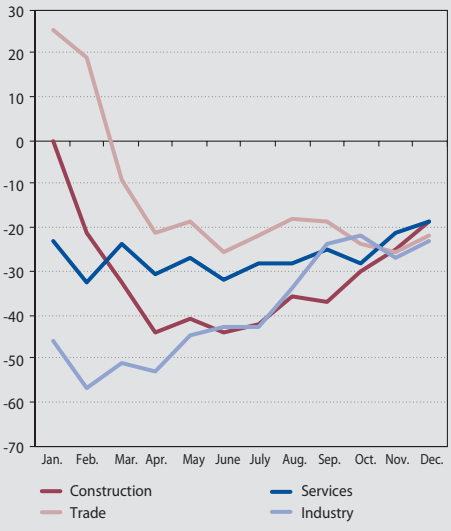
Expectations concerning the development of unemployment in the near term are more negative than positive. On one hand, certain positive changes were seen in the corporate sector in the second half of 2009 and they have already fed through to output figures and even to a modest rise in employment in selected sectors; on the other hand, the corporate sector has still not recovered to its pre-crisis position and it reports a relatively high level of idle production capacity.

Chart 75 Index of employment in selected business sectors



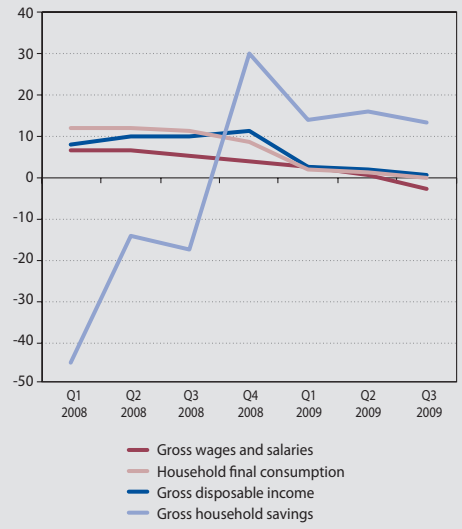
Source: SO SR.

Chart 76 Expectations for employment in selected business sectors in 2009



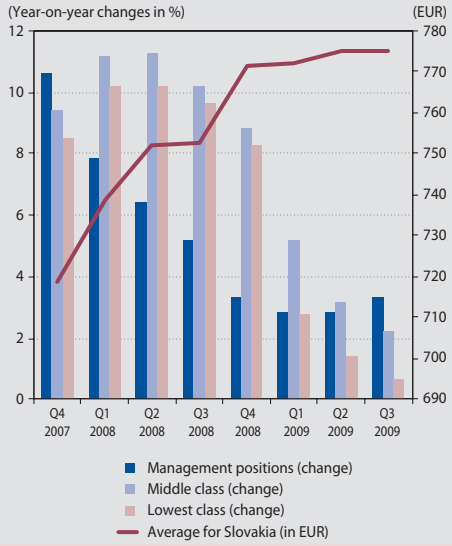
Source: Eurostat.
Note: Expectations are represented as a diference betwen responses indicating positive or negative expectations.

Chart 77 Income changes in the household sector on a year-on-year basis (%)



Source: SO SR.

Chart 78 Average gross monthly wage



Source: Trexima.

The appetite to recruit will certainly be affected also by the uncertainty about future economic developments. Notwithstanding some of the current positive trends, there are still quite a lot of questions concerning the sustainability of economic growth. In particular, it is being asked how growth will be sustained following withdrawal of the stimulus measures taken by governments and central banks. The willingness of enterprises to take on staff is a key indicator of the sustainability of economic growth, but a significant positive turnaround in this regard has not taken place.

Minimal rise in household income

The credit risk of households was adversely affected by income developments, too. A change in household behaviour began in the last quarter of 2008, when the importance of savings rose. In the third quarter of 2009, growth in disposable income slowed sharply year-on-year, to just 0.6 %, while in the same period of 2008 it had recorded 10%.

The average gross wage in Slovakia rose only minimally during 2009. According to the breakdown of households by income group, all groups saw a decline in wage growth, and the lowest income groups recorded the smallest wage growth on a year-on-year basis.

As for wage developments in business sectors, differences between sectors appeared. A drop in nominal monthly wages was recorded mainly in construction, wholesale trade, and transportation. Wage growth was maintained in industry, which is the largest sector by number of employees.

Amount of non-performing loans increased

During 2009, the worsening financial position caused largely by rising unemployment and the no more than minimal income growth was increasingly reflected in the quality of bank loans.

As a share of total household lending, non-performing loans climbed by around one percentage point during the course of 2009, to end the

Table 6 Ratio of non-performing loans by type of loan

	January 2009 (%)	December 2009 (%)
Overdrafts	7,3	9,1
Consumer loans	10,8	11,8
Mortgage loans	1,8	2,5
Intermediate loans	5,1	5,8
Other housing loans	2,6	3,4
Others	1,6	3,9

Source: NBS.

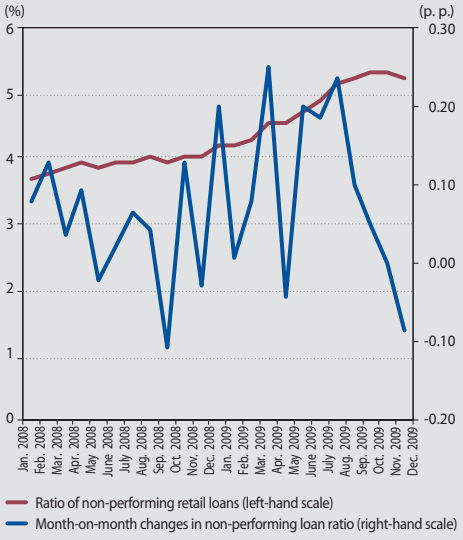
year at 5.2%. In terms of this ratio, the portfolios of all types of loans deteriorated in quality and the decline was particularly marked in the case of other loans, bank account overdrafts, and consumer loans.

The last quarter decline in non-performing loans was largely due to sales of these loans

As regards the development of the non-performing loan ratio over time, the quality of banks' credit portfolios deteriorated appreciably from the last quarter of 2008. The ratio of non-performing loans rose relative sharply, and it was only in the last quarter of 2009 that the pace of this increase stabilised. It should be noted, however, that slower rise in non-performing loans is not caused by any improvement in the position of households, but is mainly the result of certain banks selling off these loans.

A natural consequence of the mainly sale-related reduction in non-performing loans was that the ratio of loans that are not past due and loans that are past due by up to 90 days increased.

Chart 79 Ratio of non-performing retail loans



Source: NBS.
Left-hand scale: ratio of non-performing retail loans to total retail loans.
Right-hand scale: changes in the non-performing loan ratio on a month-on-month basis.

3.2 CREDIT RISK OF NON-FINANCIAL CORPORATIONS IN THE BANKING SECTOR

Fragile recovery of business activity continues

The recovery of financial markets and the related optimism for a recovery of the world economy was reflected also in Slovakia's corporate sector. In this context, however, two facts should be noted. Firstly, the main reason for the upturn in activity among Slovak enterprises was exports, which are not yet being driven by household consumption related to employment growth, but rather by other factors, such as government stimuli. Until there is a turnaround in employment (at home or abroad), the recovery should be seen as relatively fragile (Chart 80).

The second crucial fact is the persistently low output of Slovak enterprises. In industry, for example, the year-on-year figures for sales of output in 2009 are clearly on a par with those for 2005, and in comparison with December 2005 they were even weaker (Chart 81). It is also apparent from the Chart that the crisis had its greatest impact in the period from August 2008 to April 2009, when output failed to reach its seasonal potential.

The recovery of activity therefore has a relatively fragile footing, and in terms of output volume it does provide substantial grounds for optimism.

The situation differs from one sector to another

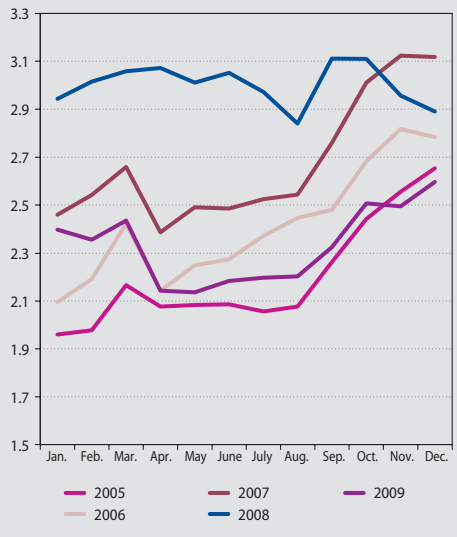
For a deeper interpretation of the growth in the Slovak corporate sector's activity, it is necessary to answer three questions. The first question is: to what extent may the slump in activity at the beginning of 2009 be explained by seasonal factors? In other words, how much of this decline is attributable to the economic crisis? Secondly, considering the credit risk that banks are facing, to what extent can we consider the growth in business sector activity in 2009 to be sufficient? And finally, it is necessary to ask the previous two questions in respect of each business sector, so as to identify which sectors were affected by the economic crisis to a greater or lesser extent.

The answer to the first question is relatively straightforward. In all the main sectors, the first-quarter drop in sales in 2009 was more substantial than the average seasonal change over the period from 2000 to 2008 (Chart 82). At the same time, however, activity in most sectors for the whole of 2009 rose at a slightly faster pace than the aver-

Chart 80 Index of markets weighted by the amount of bank lending, and the business confidence index (BCI)

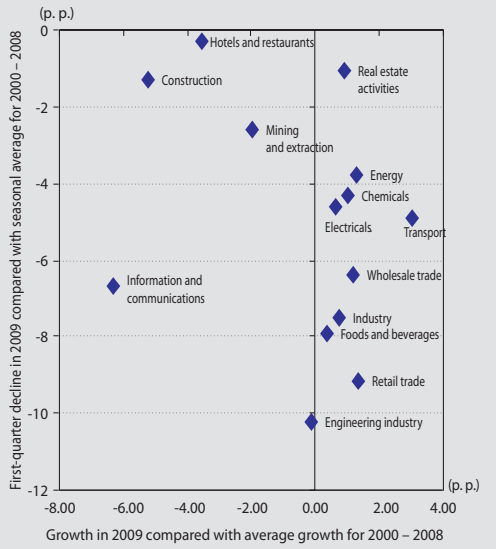
Source: SO SR, OECD.

Chart 81 Sales in industry for the years 2005 to 2009 (EUR billions)



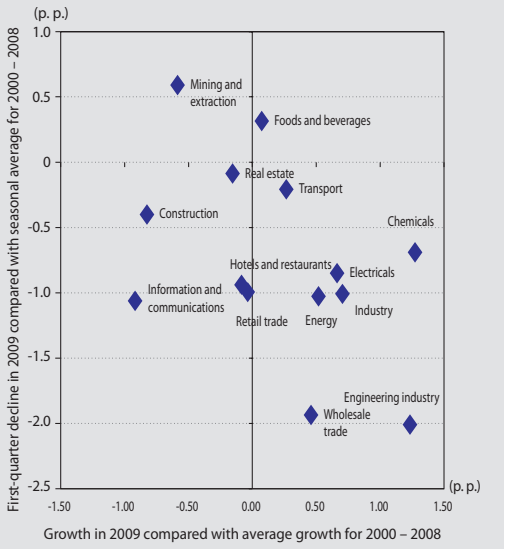
Source: SO SR.

Chart 82 Sales by sector



Source: SO SR.
Note: The percentage point values on the left-hand scale represent the difference between two values. The first is the change in the sales-to-assets ratio between 3Q2008 and 1Q2009; the second is its average change over the period 2000–2008 in the same quarter-year periods.
The percentage point values on the horizontal axis represent the difference between two values. The first is the change in the sales-to-assets ratio between 1Q2009 and 3Q2009 (not 4Q2009, since the data for this period were not available); the second its average change over the period 2000–2008 in the same quarter-year periods.

Chart 83 Profitability by sector



Source: SO SR.
Note: The percentage point values on the left-hand scale represent the difference between two values. The first is the change in the sales-to-assets ratio between 3Q2008 and 1Q2009; the second is its average change over the period 2000–2008 in the same quarter-year periods.
The percentage point values on the horizontal axis represent the difference between two values. The first is the change in the sales-to-assets ratio between 1Q2009 and 3Q2009 (not 4Q2009, since the data for this period were not available); the second its average change over the period 2000–2008 in the same quarter-year periods.

age increase for 2000–2008. The reason for this, of course, is the low volume of sales in 2009, i.e. the base effect. What is worse is that the slump in activity in certain sectors at the beginning of 2009 was steeper than the typical seasonal fall, and its growth was slower than the average for 2000–2008. The sectors most affected in this way were hotels and restaurants, construction, and the mining and extraction industry.

The situation was similar in regard to profit generation. In a majority of sectors, the decline in ROA in the first quarter of 2009 was greater than the average seasonal drop for the period 2000–2008. It was therefore the case in several sectors that the ROA increase for 2009 was higher than the average figure for 2000–2008 (Chart 83). In some sectors, however, the increase in profitability undershot the seasonal average, notwithstanding that it began at very low levels. The problems of activity and profit generation were clearly most acute in the construction industry and in accommodation and food service activities.

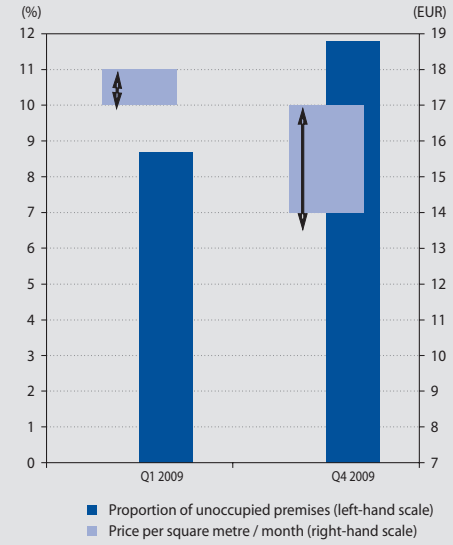
Thus the main effect of the economic crisis was not only the slump in activity at the beginning of the year, but also in its relatively weak growth.

Real estate sector came under increasing pressure

The previous charts (sales and profitability) indicate that business in the real estate sector was relatively stable. But to portray the state of real estate business, it is necessary to add details about markets in commercial property and residential property.

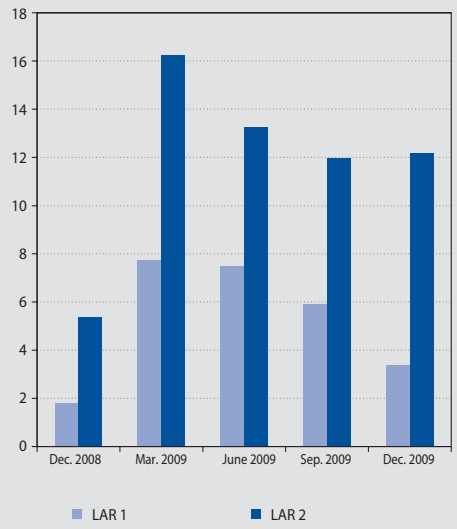
In the case of commercial property, developments in demand are particularly important, since they affect vacancy rates and prices. Demand plunged in 2009, with the area of office spaces handed over to customers falling by 46% in comparison with 2008. Even though supply responded to the reduced demand, the vacancy rates for commercial property rose. The proportion of premises sitting vacant rose from 8.7% to 11.8 %, which development was, of course, reflected in falling prices (Chart 84).

Chart 84 Price and occupancy rate changes for office spaces



Source: CB Richard Ellis.
The price is based on the „prime rate". The Chart shows the price interval in the given quarter.

Chart 85 Chart LAR 1 and LAR 2 ratios (%)



Source: NBS, SO SR.

The market in residential projects faces a similar problem in that falling demand is putting downward pressure on prices. In addition, property developers have limited scope for waiting until apartment sales improve in more benign market conditions, since they are under pressure to repay loans. In fact, bank loan debts are the main driver behind developers' efforts to sell newly-built flats quickly.

What was significant in this regard in 2009 was the amount of loans that were restructured, for example, by deferring repayment of the principal. The main risk factor in this case is the length of time during which these exceptional conditions obtain. From a bank's perspective, it is important that the developer manages to complete the project – i.e. to sell or lease the premises – during this time. If it fails to do so, the project may cause losses to both parties. In this regard, 2010 will be a decisive year for many projects.

The risk exposure of banks to this sector lies mainly in the amount of loans provided for such projects. Of the total number of corporate loans worth more than €10 billion, real estate loans account for approximately 25%. Moreover, the loans of this size that are provided to other sectors are in most cases either guaranteed by the state or arranged with large multinational corporations.

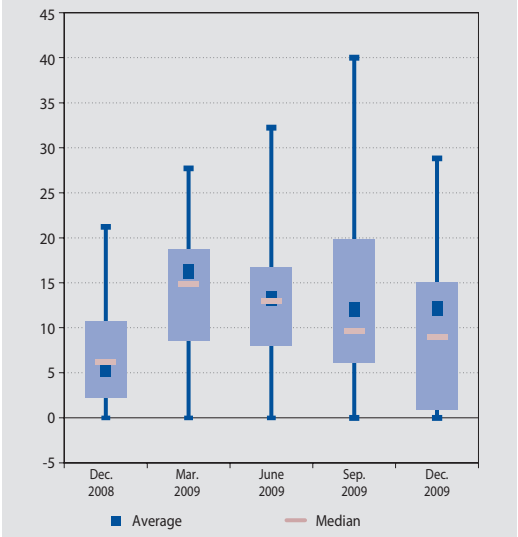
Significant exposure to enterprises whose financial condition has worsened

As the situation in the corporate sector deteriorated in 2009, so the proportion of loans at risk[14] increased. The first-quarter slump in activity (Chart 80) led to a rise in the LAR ratio (Chart 85). The situation improved slightly as the year wore on. Although the LAR 1 ratio declined, the LAR 2 ratio began to rise slightly in the final quarter (Chart 85). This means that slumps in sales of more than 50% were no longer as common as they had been in the first quarter. Nevertheless, the exposure to enterprises reporting declines in sales of between 30% and 50% still represented a significant risk to the banking sector.

In general, therefore, we cannot judge the developments towards the end of 2009 to be positive. Furthermore, the average value of the LAR 2 ratio weighted by the amount of loans was moving close to the upper quartile towards the year-end. This indicates a relative deterioration in the situation in those banks with the largest corporate loan portfolios (Chart 86).

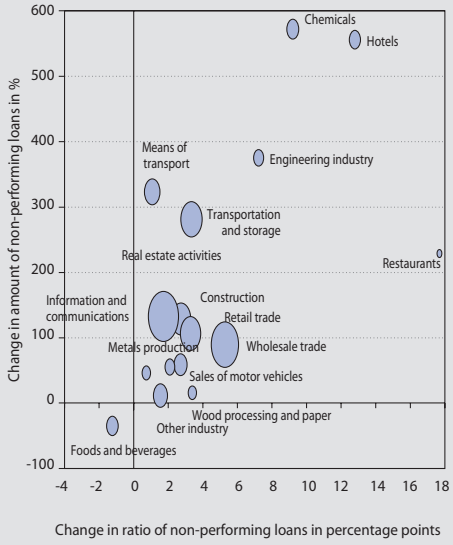
14 Loans at risk (LAR) – loans provided to enterprises that in the given quarter reported a loss and at the same time an annual drop in sales of more than 50% (for LAR 1) or more than 30% (for LAR 2). The LAR ratio expresses loans at risk as a share of total loans to those enterprises for which data on sales on profits are available.

Chart 86 Breakdown of the LAR 2 ratio (%)



Source: NBS, SO SR.
Note: The columns represent the upper and lower quartile.

Chart 87 Changes in non-performing loans in 2009 by ratio and amount



Source: NBS.
Note: The size of the bubble represents the banking sector's exposure to the respective sector as a share of its total exposure to the corporate sector.

The LAR ratio, however, includes only a sample of loans to domestic enterprises. The overall proportion of loans that report a worsening financial position may in fact be higher, especially in the case of banks that have significant exposure abroad.

Loan defaults continue in almost all sectors

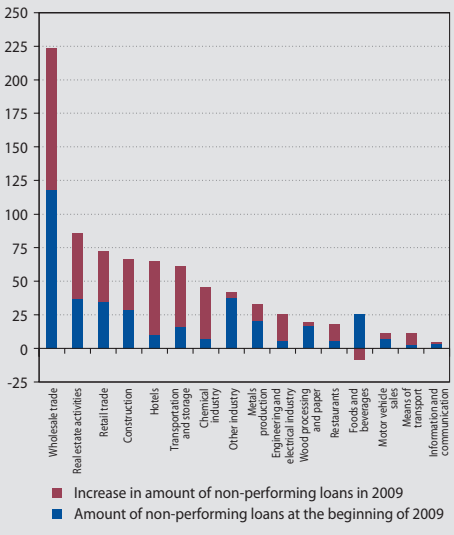
In general, corporate sector activity cannot, despite its growth, be said to be undergoing a clear and across-the-board recovery. That applies with varying intensity to all the main sectors.

Non-performing loans in most of the main sectors reflected this state of affairs, since in 2009 they increased in terms of both their amount and share of total loans. In relative terms, the most problematic situation is reported in accommodation and food service activities, the chemical industry, and metals production (Chart 87).

As regards credit risk, a key figure for the banking sector is the total amount of non-performing loans, since that amount represents a loss. In this comparison, the banking sector was affected most adversely by the wholesale trade sector, followed by the real estate, retail trade and construction sectors, with lending to these sectors recording the most pronounced rise in non-performing loans in 2009 (Chart 88).

A separate issue is the exposure of banking groups to leasing companies. Although these companies made substantial losses in 2009, the loans provided

Chart 88 Amounts of non-performing loans (EUR millions)



Source: NBS.

to them are not past due. Since, in fact, a majority of leasing companies are members of banking groups, the losses in question appear in the banking sector in the consolidation of profits.

Developments in 2010 will be crucial for the Slovak banking sector, since the intensity of the trends arising in the second half of 2009 still falls short of ensuring a decline in credit risk.

Box 1

THE FINANCIAL SECTOR'S EXPOSURE TO SELECTED COUNTRIES

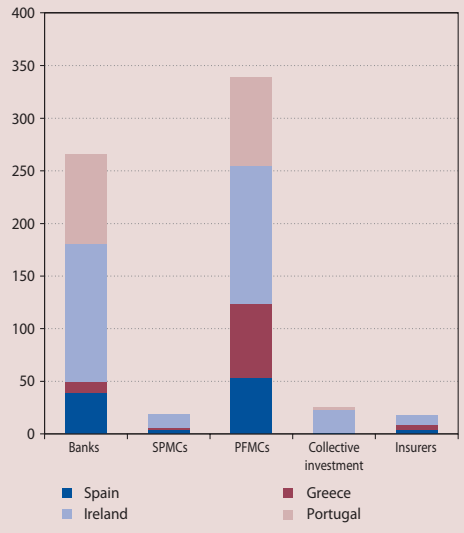
During 2009, a risk that had previously been perceived as minimal came to be mentioned with increasing frequency and urgency in financial markets. The risk in question is the ability of sovereign governments to meet their liabilities, otherwise known as "sovereign risk".

The significance of this risk began to mount following the outbreak of the financial crisis, when national governments bailed out financial sectors with massive support measures. Governments then became heavily engaged in supporting the real economy, too, as gaps in the corporate sector's investment activity and in household consumption were plugged with public money. As a result, several countries saw their fiscal deficit climb up to double figures in 2009.

On one hand, these measures helped put financial markets and economies back on a stable footing, but, on the other hand, the rapid rise in sovereign indebtedness raised questions about the sustainability of public finances in several countries. Concerns about debt-servicing ability were largely directed at countries that generally report a high debt ratio, i.e. not only as a result of crisis-related indebtedness. Other factors also played a part, including, for example, the debt structure, uncertainty over plans for reducing this high debt, and other macroeconomic imbalances.

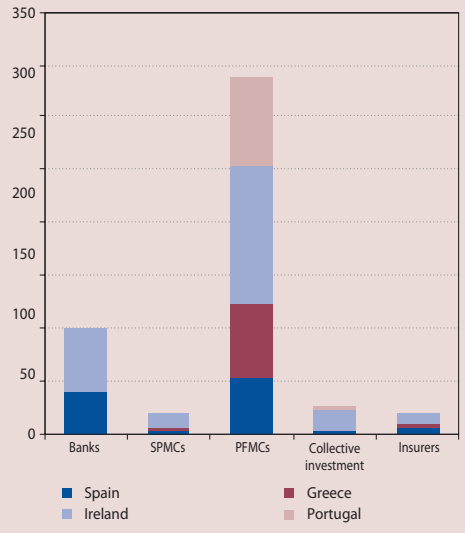
This type of risk had hitherto been seen as unimportant. What is therefore interesting is how domestic financial institutions are exposed to governments. Since country exposure is a relatively standard investment in the portfolios of financial institutions, the only countries taken into account for this purpose were those perceived as risky. Only direct exposure to these

Chart A Total direct exposure of financial institutions to selected countries (EUR millions)



Source: NBS.

Chart B Bond portfolio – composition by issuer (EUR millions)



Source: NBS.

countries is assessed. Naturally, Slovak institutions could be heavily affected by the default of any such country, even if they are not exposed to them directly.

Our analysis assesses the exposure to those countries that are currently seen as more risky (Greece, Spain, Portugal, and Ireland). This exposure is reflected mainly in the development of the spreads on their government bonds and also on CDS spreads. Also looked at was the exposure to the group of neighbouring countries that are perceived as emerging markets. Domestic financial institutions typically report a higher exposure to these countries.

The financial sector's exposure to selected countries of southern Europe

As at the end of 2009, the institutions reporting the largest amount of claims on the four countries under review were pension fund management companies (almost €340 million) and banks (€266 million). In the case of most banks, their total claims on the countries under review made up only a tiny part of their total assets, whereas in certain PFMC funds these bonds constituted up to 26% of their total net asset value.

The exposure of PFMC funds was exclusively in the form of bonds, the vast majority of which were government bonds.

Claims other than bonds were reported only by banks and they comprised mainly interbank loans. Because of the short-term character of interbank loans and deposits, this is a less risky exposure compared with bonds.

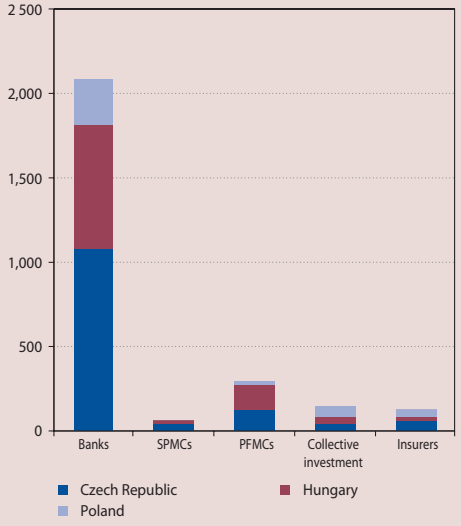
As for the bond portfolio's composition broken down by issuer, there are slight differences between different types of financial institution. Whereas PFMCs invested mainly in government bonds (93% of the portfolio), other institutions invested mainly in corporate bonds. In the case of banks, SPMCs and collective investment funds, a relatively large proportion of the issuers were either subsidiaries of large foreign corporations or else members of a large foreign group (in particular, British, German, Russian and Italian companies). In the event of an escalation in sovereign risk, it is highly likely that these bonds will lose less value compared with bonds whose issuers do not have a strong foreign background.

The financial sector's exposure to selected countries of central Europe

The banking sector has by a long way the largest share of claims on Poland, Hungary and the Czech Republic due to the high share of interbank loans. As mentioned above, this type of exposure is perceived as less risky owing to its short-term character. Of the banking sector's total exposure of €2.1 billion, interbank assets with Czech and Hungarian banks account for half.

As at December 2009, the total amount of bonds purchased by financial institutions represented €1.2 billion, of which banks owned the largest part, more than €770 million. The vast majority of bonds purchased by companies are government bonds, general government bonds or domestic corporate bonds.

Chart C Total direct exposure by type of financial institution (EUR billions)



Source: NBS.

3.3 LIQUIDITY RISK IN THE BANKING SECTOR

Liquidity risk should be seen at two levels. The first is the long-term outlook for the structure of a bank's balance sheet, including the nature of funds and the types of asset into which the bank has invested them. Viewed in this way, the maturity of assets and liabilities are less important than, for example, their internal liquidity or volatility. The second level is the short-term outlook (usually one month), which involves examining the extent to which banks are able to face adverse developments in regard to liquidity. What is particularly important in this case are the flows of cash accumulated within a defined time horizon.

Long-term liquidity shows a relatively stable development

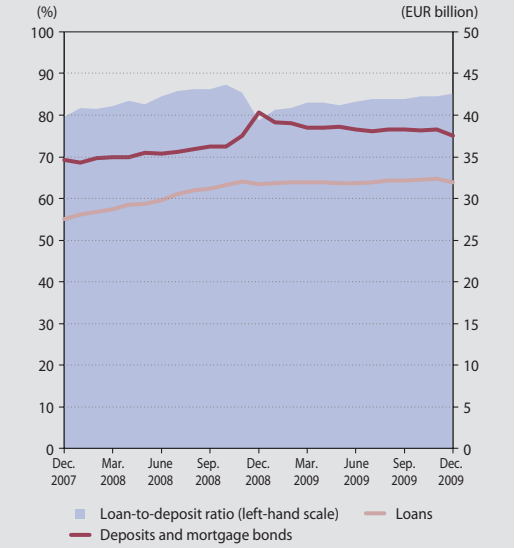
The ability of the banking sector to cover its illiquid assets (loans to customers) with relatively stable funds (deposits from customers and mortgage bonds) showed a marked deterioration during 2009. The year-on-year rise in the loan-to-deposit ratio, from 79% to 85%, must be seen in the context of the exceptional increase in deposits that occurred towards the end of 2008 in anticipation of the euro changeover (Chart 89). At the end of 2009, however, this ratio was higher than 100% in a total of nine banks, predominantly branches of foreign banks.

Moderate rise in pressure on liquid assets of up to 1 month

At the end of 2009, all but one of the banks complied with the liquid asset ratio.[15] The weighted average for the year fell from 1.44 to 1.32 (Chart 90).

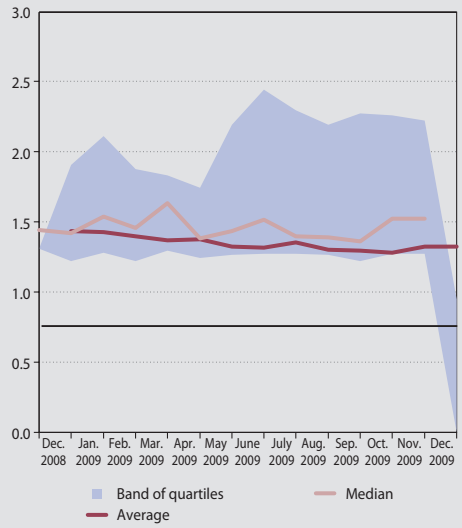
The cause of this decline was mainly the reduction in the amount of liquid assets, which was in turn the result of several movements. The first of these was the decline in interbank assets with a maturity of up to one month, including accounts held with NBS. The second was the drop in loans maturing within one month, which reflected a slump in the amount of operating loans provided to enterprises. Also contributing to the decline in liquid assets was the rise in the amount of pledged securities.

Chart 89 The loan-to-deposit ratio in 2009 (%)



Source: NBS

Chart 90 Liquid asset ratio



Source: NBS.

15 The liquid asset ratio is defined as the ratio of liquid assets to volatile liabilities over a horizon of one month. Its level should not fall below 1.

3.4 MARKET RISKS IN THE FINANCIAL SECTOR

3.4.1 EXPOSURE OF FINANCIAL MARKET PARTICIPANTS TO DIFFERENT TYPES OF MARKET RISKS

Decline in the net worth of banks in the event of a parallel rise in interest rates[16]

As previous analyses have pointed out, banks are sensitive to interest-rate movements particularly in the long-term horizon, where a change in rates would have a gradual impact on banks' interest income.

A parallel rise in interest rates would adversely affect a majority of banks.[17] With a parallel rise of 1 percentage point, the net worth of banks' portfolios would fall by 0.87% of their total asset value. If we exclude branches of foreign banks, then that figure rises to 0.92% of total asset value, or 10.8% of own funds. Thus, according to a simplified calculation (based on the contractual fixation of individual instruments and using average duration), if the yield curve recorded a parallel rise of 200 basis points, the net worth of some banks would plunge by more than 20% of the value of their own funds. Banks used only to a limited extent derivative transactions to hedge the interest rate risk. In 2009, the overall exposure to interest risk rose slightly in the second half of the year and then remained largely unchanged. At the same time, however, the structure of the interest rate risk exposure underwent a change, especially in the fourth quarter. As Chart 20 shows, banks reported a rise in the proportion of retail deposits with a longer interest rate fixation period, which in turn increased the average residual period until revaluation of the customer deposit interest rate, from 0.33 to 0.43. The final effect, however, was neutral, as banks also prolonged the duration of the securities portfolio, from 2.78 to 2.93.

The Slovak banking sector's banking book exposure to interest rate risk can be described as relatively substantial. But although net worth is predicted to decline sharply in the event of a rise in interest rates, it cannot be said that the banking sector will be significantly harmed by the rise in interest rates that can probably be expected in the future, and there are two reasons why not. First, the rates reduction in 2009 affected only short-term interest rates; there is no trend of declining rates on maturities of more than five years. It may therefore be expected that any future rise in rates will affect mainly the shortest maturities. If we assume that the interest curve for the shortest maturities rises by 2 percentage points and that the curve for maturities of more than five years remains unchanged, and if we estimate the curve growth for other maturities by linear interpolation, then the impact on banks' net worth will be around six times lower than in the case of a parallel rise of 1 percentage point. Secondly, even a rise in interest rates for shorter maturities will probably not be the same for each type of financial asset and liability. If historical trends are a guide, then such an increase can be expected to be fully reflected in the securities portfolio (which has a relatively higher duration), but may not necessarily be passed on in full to retail deposit rates (although their duration is lower, the slower reaction of banks may prolong it).[18]

Change in the risk structure of PFMC fund portfolios

As mentioned in the Analysis of the Slovak Financial Sector for the first half of 2009, the aggregate portfolio of PFMC funds underwent substantial changes in its composition during the first half of 2009 in response to legislative amendments. The risk profile of these funds fell sharply as shares and mutual fund units were sold and the duration of both the bond portfolio and net foreign exchange position was shortened. The exposure to equity, foreign exchange, and interest risk remained low also in the second half of 2009. The only increase was in the risk of a decline in the value of government bonds due to a widening of credit spreads for certain countries (i.e. sovereign risk – see Box 1 for more details). This was because the second half of 2009 saw a rise in the proportion of government bonds issued by certain euro area members whose credit risk has recently risen due to an escalation of government debt (in particular, Greece, Spain, Portugal and Ireland). By the end of 2009, government bonds issued by these countries constituted 12% of the aggregate net asset value in PFMC funds, and in some funds as much as 25%. At the

16 *Regarding the assessment of market risks, it should be noted that the market risks in banks and insurers are borne by the companies themselves, but that in the cases of unit-linked insurance, collective investment funds, pension funds and supplementary pension funds, the risks are borne by the customers of the respective companies, i.e. by investors in the funds.*

17 *The reason for assessing a parallel shift in the yield is contained in a provision of Act No. 483/2001 Coll. on banks and on amendments to certain laws as amended, according to which a bank's net asset value must not fall below a certain required level following a sudden and unexpected change in market interest rates. Under Decree No. 15/2006 of Národná banka Slovenska, a sudden and unexpected movement in interest rates means a parallel upward shift in the yield curve by 200 basis points.*

18 *The varying response of interest rates to a change in the ECB's base rate, or credit spreads, is modelled in more detail in the chapter "Macro stress testing".*

Table 7 Change in the share of equity, foreign-exchange and interest-rate positions (%; years)

		Banks	Insurers	PFMC funds	SPMC funds	Collective investment	Unit-linked[2)]
Shares and mutual fund units	XII.2008[1)]	0.1	2.6	9.6	2.3	13.7	–
	VI.2009	0.1	2.7	0.9	2.5	15.3	–
	XII.2009	0.2	2.6	0.1	2.2	17.6	80.8
Foreign-exch-ange positions	XII.2008[1)]	0.4	1.3	4.2	1.2	6.6	–
	VI.2009	0.7	1.2	0.5	1.9	7.7	–
	XII.2009	0.4	0.9	0.1	4.9	12.5	12.9
Share of debt securities	XII.2009	28.3	63.1	68.0	70.8	51.8	17.2
Durationof debt securities	XII.2009	2.7	5.7	0.5	2.1	1.1	5.9
Residual maturity of debt securities	XII.2009	2.8	7.8	0.8	3.0	1.8	6.2

Source: NBS.
Note: Values represent percentage shares of assets (or NAV) and express the asset-weighted average for the given group of institutions; durations are given in years. Foreign exchange positions are given as a percentage share of assets (or NAV) and were calculated as the sum of the absolute values of the positions for each institution. Equity positions are given as a percentage share of assets (or NAV) and do not include participating interests in subsidiaries and affiliates.
1) Positions in the euro were not included.
2) Assets invested by insurers under unit-linked insurance policies.

same time, however, the average residual maturity of these government bonds in PFMC funds is relatively short, at only 0.6 of a year. Thus the risk of these funds shedding value in the event of a rating downgrade is not expected to be too significant.[19]

Another risk that PFMC funds are exposed to is concentration risk stemming from the low diversification of bank deposits. Were any of the banks in which their deposits are held to fail, the effect on the funds could be severely adverse. Although the bulk of these deposits are held with Slovak banks or branches of foreign banks in Slovakia, funds are investing also with foreign banks. In the case of some funds, however, the pool of banks in which their deposits are placed is very small. Apart from this risk, the most significant risk for PFMC funds in 2009 was, given the low duration of their securities and bank deposit investments, the risk of interest income falling in the event of a cut in interest rates. This risk, however, is unlikely to materialise at the present time.

In the collective investment sector, equity investments rose

Another major change in the Slovak financial sector's exposure to particular risks was the rise in equity shares and mutual fund units as a proportion of the net asset value in mutual funds and in insurance companies. Although this may be partly ascribed to appreciation of equity investments amid the upturn in stock markets, another key factor was the growth in net sales of equity and mixed funds, especially during the fourth quarter of 2009. A substantial proportion of these equities and mutual fund units – 81% – comprise investments made by insurers under unit-linked insurance policies.

As regards foreign exchange risk exposure, movements in the exchange rate against the USD, CZK and PLN have the greatest effect

The Slovak financial sector does not have significant exposure to foreign exchange risk, except for the exposure of mutual funds or of insurers' assets invested under unit-linked insurance policies. A majority of institutions (with the exception of certain banks and a small number of mutual funds) have long open positions in individual currencies; in other words, strengthening of the euro against these currencies would have a negative effect. In the area of foreign exchange risk, a particular current risk for the Slovak market may be a general loss of confidence in currencies of the central European region, leading to a weakening of the Czech koruna, Polish zloty and Hungarian forint.

19 For example, in the case of a downgrade in rating from A to BBB, the average spread on a 5-year bond would rise by 0.8 p.p., but on a 1-year bond by only 0.3 p.p.

Table 8 Structure of foreign exchange positions by sector (%)

	Banks	Insurers	PFMC funds	SPMC funds	Mutual funds	Unit-linked[1)]
Share of FX position	0.4	0.9	0.1	4.9	12.5	12.9
USD	**43**	**55**	2	**51**	**67**	**24**
CZK	**23**	**18**	3	6	**10**	**73**
PLN	**18**	**16**	1	4	**11**	0
GBP	2	0	**66**	0	3	1
HUF	**12**	0	0	1	4	0
CHF	2	0	8	**19**	1	2
JPY	0	0	**17**	2	2	0
RON	0	0	0	**11**	0	0
TRY	0	0	0	6	1	0
HRK	0	9	0	0	0	0

Source: NBS.
Note: Values represent percentage shares of assets (or NAV) and express the asset-weighted average for the given group of institutions. Shares of more than 10% are marked in bold.
Foreign exchange positions were calculated as the sum of the absolute values of the positions for each institution.
1) Assets invested by insurers under unit-linked insurance policies.

3.4.2 RISK CHANGES IN DIFFERENT RISK FACTORS

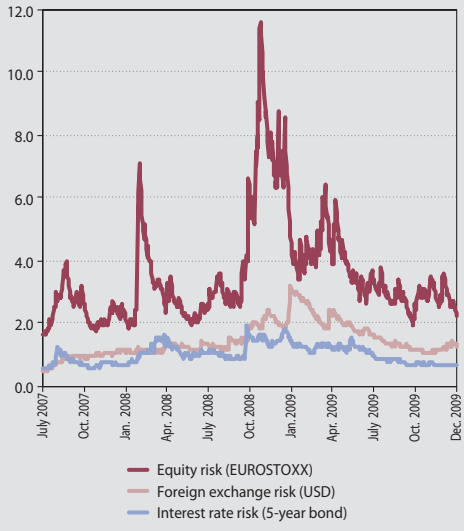
Decline in risk of equity indices and interest rate risk

The volatility of equity indexes, interest rates and credit spreads fell during 2009, particularly in the second half of the year, and thereby reduced the VaR in equity and bond positions (Chart 91).

In the case of interest rate risk, the decline was most pronounced in the short-term risk of a change in credit spreads – a risk that was particularly marked in the second half of 2008 and the first half of 2009. A slight drop was also seen, however, in the risk of discount rate changes (Chart 92).

Another factor behind the risk reduction, especially in certain mutual funds, was the increased correlation between daily movements in the USD/EUR exchange rate and stock market returns (Chart 93). This is because several mutual funds are investing in US shares denominated in US dollars. The increase in this correlation means that any fall in share prices was accompanied by a decline in the USD/EUR exchange rate (i.e. strengthening of the US dollar) and hence gains from the revaluation of these positions into euro.[20] Such partial coverage of the equity risk with currency risk contributed to a decrease in the overall risk, particularly in the collective investment sector and in investments made by insurers under unit-linked insurance policies (Chart 95).

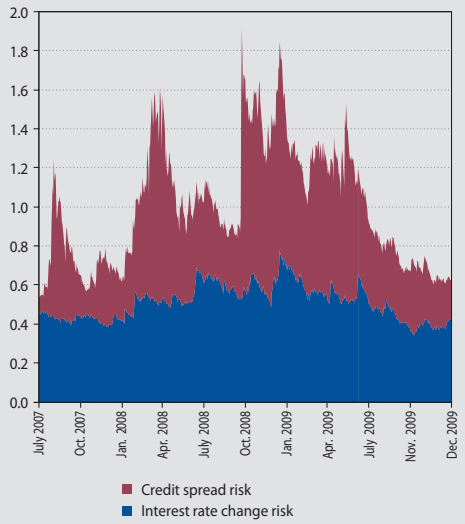
Chart 91 The 10-day VaR (at the 95% confidence level) as a share of investment value for particular types of risk (%)



Source: REUTERS, ECB.
Note: The VaR, calculated using a GARCH model (1,1), is given on the left-hand scale as a percentage of the investment value.

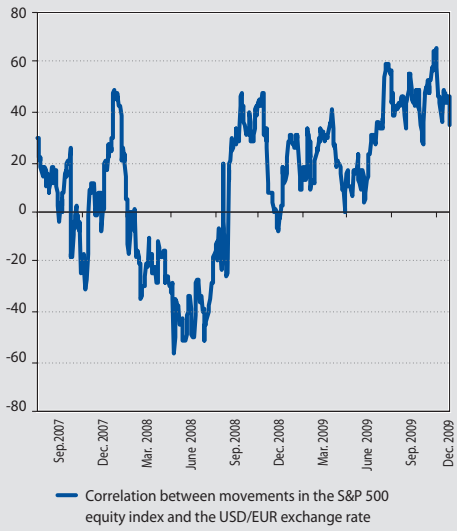
20 These developments may be related to carry trade strategies, where investors purchase riskier assets (e.g. shares) and unload less risky assets. This is described in more detail in the chapter "Macroeconomic developments as they affect financial sector stability".

Chart 92 Interest rate risk structure (%)



Source: REUTERS.
Note: The 10-day VaR (at the 95% confidence level) is given on the left-hand scale as a percentage of the value of the investment in the 5-year euro bond, and it is calculated using a GARCH (1,1) model. The interest rate change risk was calculated on the basis of movements in the 5-year discount rate for the euro. The credit spread risk was calculated on the basis of movements in the 5-year iTraxx Europe index.

Chart 93 Correlation between currency risk and equity risk (%)



Source: REUTERS, ECB.
Note: The correlation, given on the left-hand scale, was calculated using the Riskmetrics methodology (based on exponentially weighted moving averages).

3.4.3 MEASURING MARKET RISKS USING VALUE AT RISK

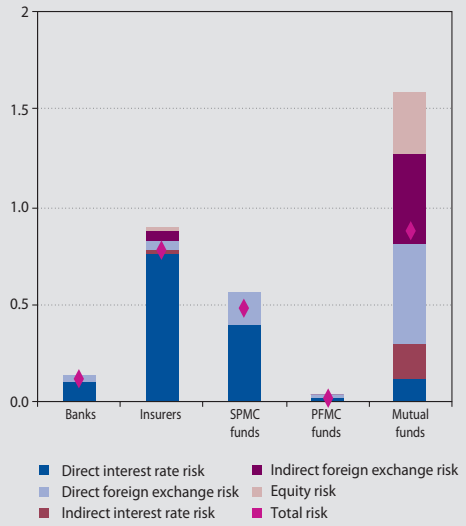
IN THE SHORT-TERM, SEVERAL SECTORS ARE EXPOSED MAINLY TO INTEREST RATE RISK

The estimate of risk over the short term is based on Value at Risk (VaR), which represents the potential loss that an institution would not exceed in 99% of cases over a period of 10 working days, assuming that the portfolio structure remains unchanged.[21] The VaR calculation is made using a multidimensional GARCH (1,1) model. For the assessment of interest rate risk, the only risk taken into account was the revaluation risk for debt securities valued at fair value.

In the short-term horizon, as Chart 94 indicates, the sectors of banks, insurance companies, and supplementary pension fund asset management companies are sensitive above all to interest rate risk. The highest sensitivity is reported by insurers, which have a large share of debt securities and at the same time an average duration that is the highest of any sector (Table 7). Since their securities have a relatively long residual maturity, insurers are more sensitive to revaluation in the event of a deterioration in the issuer's credit rating. This view, however, captures only the effect of a revaluation of assets, but, in the case of insurers, the liabilities side of insurance contracts is just as important as the assets side. Up to now, however, assessment of the liabilities side has not been possible due to insufficient data. The aim of insurers is to match the time structure of assets with the expected maturity of liabilities under insurance contracts. Provided that short-term movements in asset prices do not affect the match of assets and liabilities, there is no need to see this development in the insurance sector in negative terms, although it may have a short-term effect on the insurers' profitability or level of equity. SPMC funds are partially exposed also to foreign exchange risk, particularly to the US dollar and Swiss franc. This risk increased slightly during the second half of 2009, largely due to an increase in the net open position, but also partly because of the heightened volatility of exchange rates.

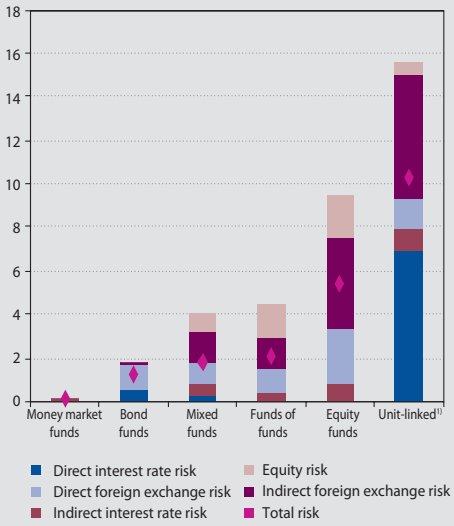
21 *The assessment of risk over the long term is based on stress testing, which is covered in the following chapter.*

Chart 94 VaR in individual sectors as at 31 December 2009 (%)



Source: NBS, Reuters, Bloomberg, internet.
Note: Data on the left-hand scale represent percentage shares of the value of assets (or NAV).
For insurers, assets covering unit-linked insurance policies are not included.
The VAR values were calculated as the potential loss that would not be exceeded in 99% of cases over a period of 10 working days. Indirect interest rate risk and foreign exchange risk constitute the risk to which individual institutions or funds are exposed through investments in mutual fund units.

Chart 95 VaR of mutual funds and of assets invested under unit-linked insurance policies, as at 31 December 2009 (%)



Source: NBS, Reuters, Bloomberg, internet.
Note: Data on the left-hand scale represent percentage shares of NAV.
The VAR values were calculated as the potential loss that would not be exceeded in 99% of cases over a period of 10 working days. Indirect interest rate risk and foreign exchange risk constitute the risk to which individual institutions or funds are exposed through investments in mutual fund units.
1) Unit-linked – insurers' assets invested on behalf of insured persons.

Mutual funds are exposed above all to the risk of price changes in the shares and mutual fund units that they have invested in. The direct interest rate risk is negligible. Investments in mutual fund units of other mutual funds are, however, associated with the indirect foreign exchange risk, as well as interest rate risk, which these mutual fund units are exposed to. As mentioned above, the different types of risk reflected relatively significant diversification effects, although these may be impaired at times of possible further turbulences in financial markets due to a change in correlation.

Assets invested by insurers under unit-linked policies are clearly exposed to the highest risk. These assets are exposed not only to the substantial risk of changes in the value of the mutual fund units which prevailingly they are invested in, but also to a relatively significant interest rate risk. This is because perhaps around a fifth of these assets are invested in debt securities with a high average duration

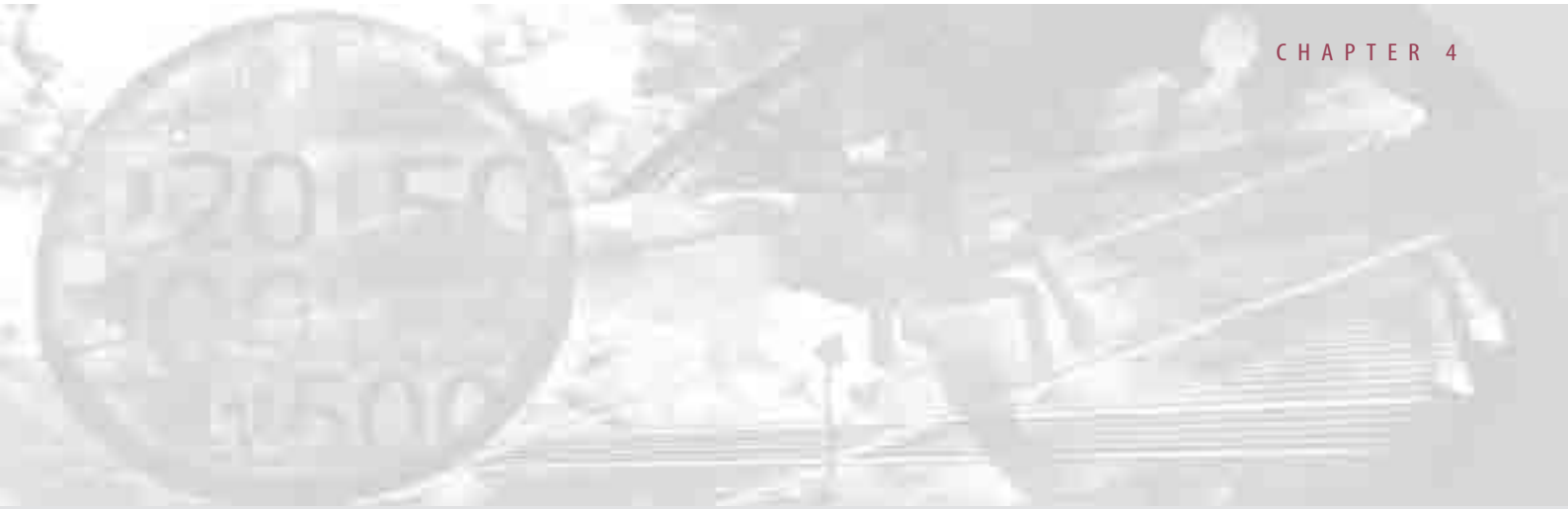
Table 9 Average VaR (AVaR) and AVaR in individual sectors (%)

	VaR (VI.2009)	VaR (XII.2009)	AVaR (XII.2009)
Insurers	0.9	0.8	0.9
Unit-linked	-	10.4	12.2
PFMC funds	0.2	0.0	0.0
balanced	0.2	0.0	0.0
growth	0.2	0.0	0.0
conservative	0.1	0.0	0.0
SPMC funds	0.7	0.5	0.5
payout	-	0.1	0.2
contributory	-	0.6	0.7
Mutual funds	1.1	0.9	1.0
money market	0.1	0.1	0.2
bond	0.5	1.3	1.4
mixed	2.2	1.8	2.1
funds of funds	5.4	2.1	2.4
equity	6.2	5.4	6.3

Source: NBS.
Note: Values represent percentage shares of assets (or NAV) and express the asset-weighted average for the given group of institutions. VaR was calculated for a period of 10 days at a 95% confidence level. VaR represents the maximum loss that can occur with the given level of probability. For cases where such loss would be exceeded, AVaR expresses the average expected loss.

(the average volume-weighted duration of assets invested in different securities represents up to 5.9 years).

As Table 9 shows, most sectors did not record substantial changes in their risk exposure during the second half of 2009.



CHAPTER 4

MACRO STRESS TESTING OF THE SLOVAK FINANCIAL SECTOR

4

4 Macro Stress Testing of the Slovak Financial Sector

Despite being beset by several adverse trends during 2009, the financial sector ended the year in a position to cope with even relatively stressful conditions. Support for this assertion may be found in the results of stress testing. For the purposes of stress scenarios, we assumed a recurring deterioration in economic development, both at home and in the external environment, and escalating uncertainty in financial markets.

The banking sector reported relatively strong resilience to negative developments. Even in the event of a substantial downturn in the domestic economy and a higher rise in non-performing loans, most banks would meet the required levels of capital. Indeed, all of the large systemically important banks would comply with the capital adequacy ratio.

Given the structure of banks' activities, losses made by banks in the event of negative developments would arise mainly from their corporate loan portfolios. Certain banks also reported high sensitivity to household lending. In some banks, the simulated credit losses would be mitigated by expected profits, especially from interest income. A key factor in the banking sector's stability over the next two years remains, however, the relatively sound footing on which it found itself at the outbreak of the crisis.

One scenario was designed specifically for other financial institutions that are exposed mainly to market risks. Given the current situation in financial markets, a simulation was carried out for an escalation of uncertainty in these markets which would be reflected, for example, in a decline in stock markets and rise in interest rates. The effect of such a scenario would vary between financial sectors, depending primarily on the structure of their portfolios.

Insurance companies in 2010 would be affected mainly by a decline in the real value of their securities investments. Over the horizon of two years, however, this scenario would not cause insurers significant losses. A far more adverse effect may be expected in regard to insurers' "unit-linked" products, meaning assets invested on behalf of insured persons. The main cause of the slump in these assets would be a decline in equity prices.

At the end of 2009, strong resilience to stressful conditions was reported by pension funds. The only moderate risk in certain funds would be the credit rating downgrade of some of the countries to which they have government bond exposure.

In the case of mutual funds, the negative effect of stressful conditions would be reflected mainly in equity investments.

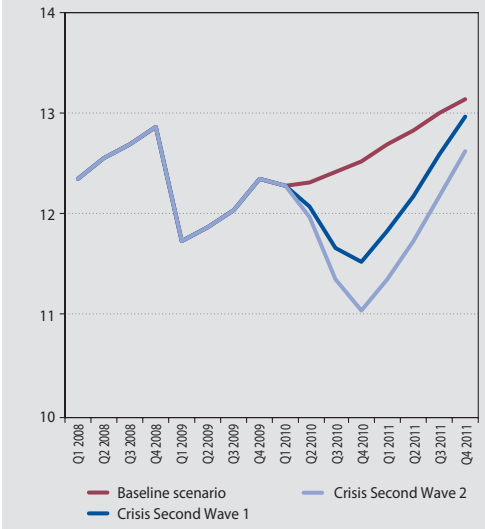
4.1 DESCRIPTION OF SCENARIOS USED

When measuring the risks that financial institutions are exposed to, it is crucial to look at their ability to cope with even extremely adverse conditions. In other words, it involves assessing the resilience of the financial sector, as well as the financial institutions themselves, to stress scenarios of economic conditions. The probability of such scenarios materialising may not necessarily be high, but each is based on a contemporary development and takes into account weaknesses in the current situation.

For assessing the financial sector's resilience on the basis of data as at December 2009, we use one scenario of expected developments – the "baseline scenario" – and two stress scenarios. The first stress scenario – "Crisis Second Wave" – describes the recurrence of an economic downturn in a second wave of the crisis; the second scenario – "Financial Market Uncertainty" – assumes that uncertainty in financial markets escalates in response to increasing sovereign risks. The stress scenarios are simulated for the two-year period 2010–2011.

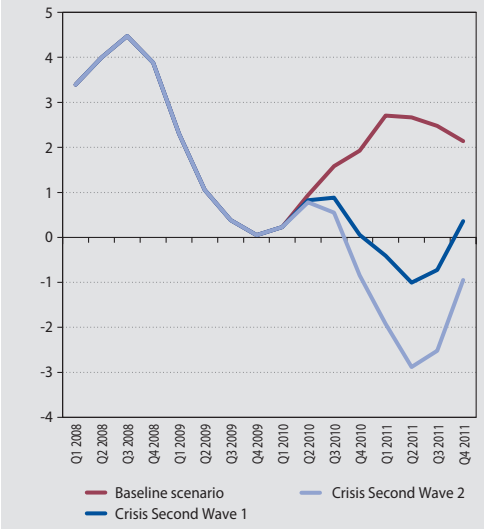
The scenarios were applied to all financial market institutions that are regulated by Národná banka Slovenska. The emphasis was on the significance of the scenarios in terms of the risk exposure of individual sectors. Therefore the key scenario for

Chart 96 Stress scenario „Crisis Second Wave" – development of GDP (EUR billions)



Source: NBS.
Note: The Chart shows the development of seasonally adjusted GDP, on a quarterly basis, for each stress scenario.

Chart 97 Stress scenario „Crisis Second Wave" – development of HICP (%)



Source: NBS.

the banking sector was the scenario directed at credit risk (*Crisis Second Wave*). Other financial sector institutions were tested mainly for their sensitivity to a change in market factors (Financial Market Uncertainty).

"Baseline scenario"

This scenario corresponds to the official prediction of the NBS as of December 2009 (P4Q-2009Q4).

"Crisis Second Wave"

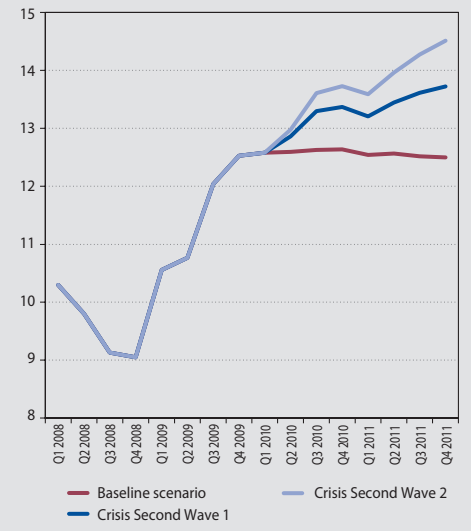
The basic triggering event for this scenario is a premature unwinding of the non-standard anti-crisis measures taken by governments and central banks. The ECB's base rate is assumed to remain unchanged during the period under review. Since it is quite difficult to estimate exactly how such an event would affect financial markets and the real economy, we designed two stress scenarios with which to test it. In the first scenario, *Crisis Second Wave 1*, the shock has a moderate impact, and in the second, Crisis Second Wave 2, it has a more severe impact. Since Slovakia's main export partners are Member States of the European Union that belong to the euro area, the potential effect of this event on the euro area's key macroeconomic indicators was examined and then its effect on the Slovak economy was calculated.

The abovementioned demand-side shock will bring about a worsening of the liquidity situation in financial markets and increasing uncertainty. These factors will result in an increase in both short-term and long-term interest rates (raising both the liquidity margin and credit margin), a decline in prices of shares and commodities, a drop in demand, and gradually falling inflation. The scenario assumes that the euro will depreciate against the US dollar and appreciate against currencies of neighbouring countries.

In the event of a decline in external demand and downturn in financial markets, the Slovak economy would react relatively quickly. The estimate of how external factors would affect the Slovak economy was made using a macroeconomic model, its output being the development of GDP, inflation and unemployment in Slovakia.

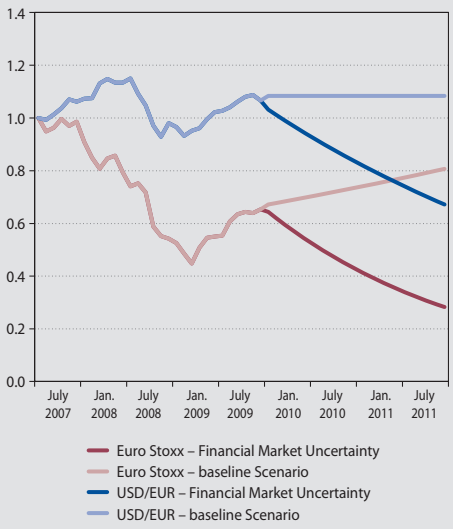
The greatest effect of the shock would occur during the second and third quarters of 2010. After the fourth quarter of 2010, the shock would gradually diminish. At the end of the two-year period under review, both GDP and inflation would gradually return to the baseline scenario. The recovery of the domestic economy would in large part be caused by the pick-up in external demand. By contrast, the unemployment rate would rise also during 2011.

Chart 98 Stress scenario „Crisis Second Wave" – development of unemployment (%)



Source: NBS.

Chart 99 Stress scenario „Financial Market Uncertainty" – development of the equity index and USD/EUR exchange rate



Source: ECB, Reuters.
Note: July 2007 = 1.

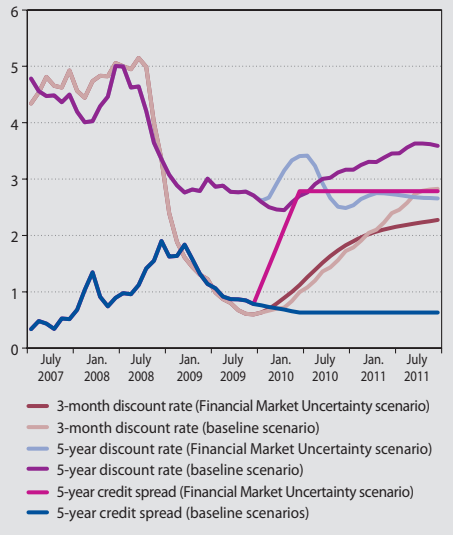
"Financial Market Uncertainty"

In response to the financial and economic crisis, many countries implemented strongly expansive fiscal policies, and, as a consequence, several countries saw a marked deepening of their government debt. This situation may in future raise doubts about the sustainability of public finances in certain countries. For a number of southern European countries in particular, borrowing costs have risen in recent months. Such a situation may trigger a general rise in credit spreads, a return to decline in stock markets, and depreciation of the euro against the dollar, or a still sharper weakening of the currencies of central and eastern European countries. These developments are captured in the stress scenario "Financial Market Uncertainty".

As with the scenario "Crisis Second Wave" there is a two-year timespan. During this period, stock markets are assumed to gradually decline by 70%. The euro, yen and certain other currencies that maintain a relatively stable exchange rate against the euro (Swiss franc, Danish krone, Latvian lats, Croatian kuna) lose 40% of their value against the dollar. All other currencies weaken by as much as 70% against the dollar over the same period.

Credit spreads will increase sharply, and the 5-year iTraxx index will rise, from 0.6 p.p. to 2.8 p p. We assume that the ECB will not put up its base rate, but that interest rates will gradu-

Chart 100 Stress scenario „Financial Market Uncertainty" – development of discount rates and the credit spread (%; p.p.)



Source: Reuters.
Note: Values on the left-hand scale are in percent (for the discount rates) or in percentage points) for the credit spread).

ally rise due to a lack of confidence in the financial market. The levels of individual interest rates for various maturities were modelled using several single-equation error correction models for the given development of the ECB's base rate and the iTraxx index.

Box 2

ASSUMPTIONS AND PARAMETERS FOR MACRO STRESS TESTING OF THE BANKING SECTOR

In comparison with previous versions, the stress testing system has undergone certain changes. Past versions focused solely on estimating losses arising from credit risk and market risk and the consequent effect on capital adequacy, but the actual picture is far more complex. As well as incurring losses over the defined period, banks continue to generate profits, too, and some of these profits are converted into capital. When assessing the overall ability of banks to cope with adverse developments, or a loss, it is thus necessary to simulate not just the losses of banks but also their total profit.

This new perspective is a feature of the stress testing version presented here. Therefore the calculation of the impact that macro stress scenarios have on the banking sector not only include the estimated losses from non-performing loans to customers, but also estimated interest rate gains /losses arising from the portfolio of client loans and deposits, from the revaluation of debt securities and interest rate derivatives, from the coupon yield on these securities, from foreign exchange operations, and from equities. The interest rate gain/loss was calculated using the econometric model described in the Annexes to the Analysis of the Slovak Financial Sector for 2009. Furthermore, we assumed that the values of operating expenses, fee income, and other operating income in 2010 and 2011 will be the same as their values at the end of 2009[1)]. The basic relationship between particular assumptions, econometric models and estimated parameters of macro stress testing are shown in Scheme 1.

For estimating the loss from non-performing client loans, we used the baseline scenario and the Crisis Second Wave scenario (1 and 2). Particular macroeconomic variables served as the input for the econometric models used to quantify the assumed loan default rates for corporate loans and the assumed amount of non-performing loans to households, housing loans to households and other loans to households (see Annexes to the Analysis of the Slovak Financial Sector for 2009). It was assumed that in the case of housing loans to households, the total loss will be 20% of the amount of non-performing loans and that for consumer loans it will be 80%, without taking into account the actual amount of the collateral (due to insufficient data).

For the calculation of credit losses arising from the corporate loan portfolio, the inputs included the loan default rates as well as a further two parameters: the collateral depreciation rate and LGD. The assumed collateral depreciation rate was also set according to the selected scenario. Based on an expert estimate, collaterals were divided into those for which the depreciation rate was assumed to be 0% under the baseline scenario, 30% under Crisis Second Wave 1, and 50% under Crisis Second Wave 2 (e.g. collateral in the form of real estate or a blank bill), and those for which no depreciation rate was assumed (mostly the collateral of third parties). For the calculation of losses, it was assumed that banks will create provisions for non-performing loans in the amount of 45% of the unsecured outstanding loan, meaning that the bank will, in subsequent bankruptcy proceedings, be able to satisfy its claim in the amount (100-45)% of the unsecured part of the loan.

The calculation of the interest-rate, foreign-exchange or equity gain/loss was made using the baseline scenario and the Financial Market Uncertainty scenario. The latter was directed

mainly at capturing the size of market risks in the portfolios of individual financial institutions (including non-bank corporations).

The effect of credit risk under the above scenarios and the effect of market risks under the Financial Market Uncertainty scenario could be combined, because although the trigger mechanisms vary from one scenario to another, their impact on market factors would be similar (a decline in share prices, depreciation of the euro against the dollar, a rise in credit and liquidity spreads, etc.).

Estimates were made for the years 2010 and 2011. The impacts of the shock were quantified using their effect on the capital adequacy of individual banks (branches of foreign banks were excluded from the calculation). At the same time, we assumed that the amount of risk-weighted assets during the period under review will not change and that 50% of the profits (the years 2009 to 2011) will be used to increase own funds. This assumption was based on the distribution of profits for 2008, when approximately 60% of the banking sector's profits were retained in the form of capital.
For the simplified calculation of the adequacy of own funds, no distinction was made between banks that use the IRB approach and other banks.

It is important to note that since the estimated development of particular macroeconomic factors is coupled with considerable uncertainty, and since that various assumptions need to be adopted for the calculation, stress testing serves rather to identify the most important risks in the financial system and to identify the companies with highest exposure to these risks, than to precisely quantify the size of the loss under particular scenarios.

1) www.nbs.sk/Publications/NBSPublications/Analysis of the Slovak Financial Sector.

Scheme 1

MACRO STRESS TESTING: ASSUMPTIONS, MODELS, SCENARIOS

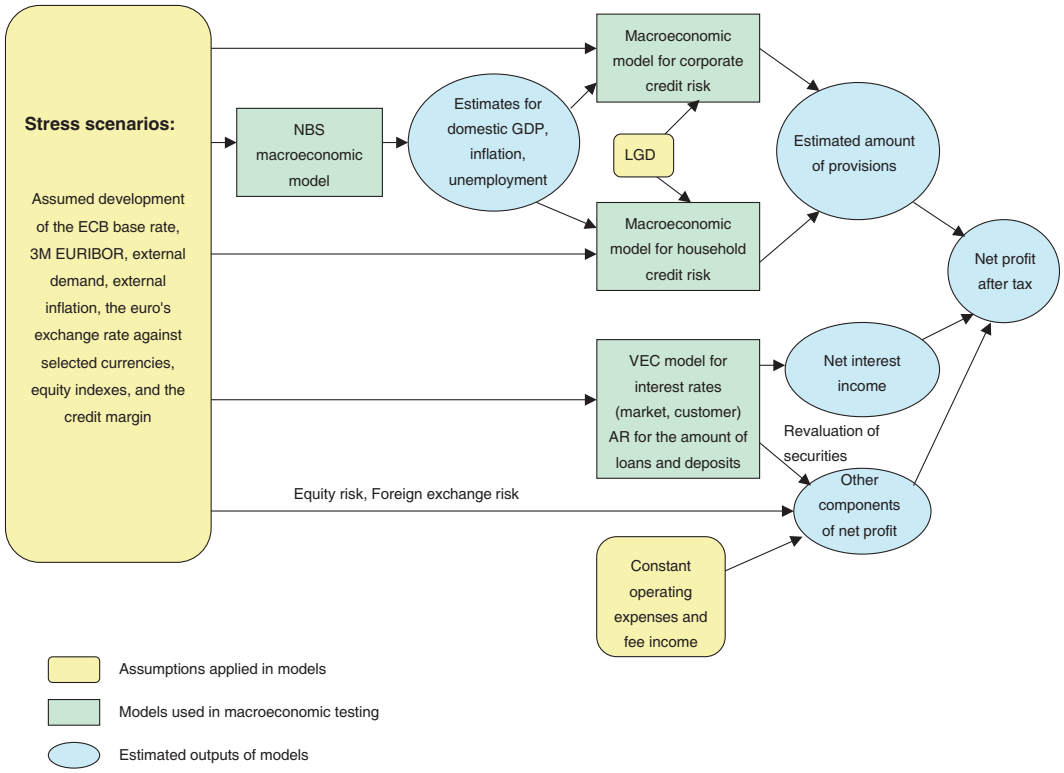


Table 10 Stress testing parameters

			Baseline scenario		Crisis Second Wave 1		Crisis Second Wave 2		Financial Market Uncertainty	
			Q4 2010	Q4 2011	Q4 2010	Q4 2011	Q4 2010	Q4 2011	Q4 2010	Q4 2011
Base assumptions	External demand (year-on-year change)		2.8%	3.8%	-10.0%	13.1%	-16.7%	14.1%		
	USD/EUR exchange rate (year-on-year change)		0.1%	0.0%	-7.0%	6.1%	-11.2%	6.4%	-20%	-40%
	Exchange rates of CHF, JPY, GBP, DKK, CAD, HRK, LVL against EUR (year-on-year change)		0%	0%					0%	0%
	Exchange rate of other currencies against EUR (year-on-year change)		0%	0%	7.0%	-5.0%	11.1%	-4.8%	15%	15%
	Share prices (year-on-year change)		10%	10%					-35%	-35%
	ECB base rate (year-on-year change)		75 b.b.	75 b.b.					0 b.b	0 b.b.
	3-month EURIBOR (year-on-year change)		100 b.b.	100 b.b.	100 b.b.	-30 b.b.	160 b.b.	-30 b.b.	120 b.b.	0 b.b.
	iTraxx index (year-on-year change)		-16 b.b.	0 b.b.					200 b.b.	0 b.b.
Macroeconomic variables estimated using a model	GDP growth (year-on-year)		3.1%	4.3%	-1.1%	4.1%	-3.1%	2.6%		
	Inflation (HICP)		1.9%	2.1%	0.1%	0.4%	-0.8%	-0.9%		
	Unemployment		12.6%	12.5%	13.4%	13.7%	13.7%	14.5%		
Variables for credit risk estimated using macr-oeconomic variables	Annual probability of default	Non-sensitive sectors	4.2%	2.2%	4.2%	4.7%	4.2%	7.9%		
		Less sensitive sectors	6.1%	6.2%	6.2%	11.0%	6.2%	15.5%		
		Sensitive sectors	9.5%	8.2%	9.7%	16.9%	9.6%	24.8%		
	Ratio of non-performing household loans		5.1%	5.2%	5.3%	6.7%	5.2%	7.6%		

Source: NBS, ECB.
Note: The highlighted values are directly entered into the estimate of losses for individual financial institutions.
In the case of the scenarios for credit risk, firstly the macroeconomic variables for Slovakia (GDP growth, inflation, unemployment) were estimated using base assumptions and the econometric model of Národná banka Slovenska. These variables then served as the basis for estimating the probability of default, or ratio of non-performing loans, using the models described in the Annexes to the Analysis of the Slovak Financial Sector.
Year-on-year GDP growth represents cumulative year-on-year growth (rise in overall gross domestic product in the given year, compared with the previous year).

4.2 SCENARIO IMPACTS

Table 11 Impact of macroeconomic scenarios (% of assets or NAV)

	Impacts of individual risks (average weighted by amount of individual asset types)					Overall impact			
	Credit risk	Direct interest rate risk	Direct foreign exchange risk	Equity risk	Indirect interest rate and foreign exchange risk	Asset--weighted average	Lower quartile	Median	Upper quartile
Banks (Crisis Second Wave 1)	-0.7	-0.3	-0.2	-0.2	-	-1.4	-1.7	-1.2	-0.7
Banks (Crisis Second Wave 2)	-1.4	-0.3	-0.2	-0.2	-	-2.1	-2.6	-2.1	-1.3
Insurers	-	-0.1	0.2	-0.5	-0.1	-0.5	-1.1	0.0	0.9
Insurer's assets – unit-linked	-	0.5	-0.7	-17.3	-1.7	-19.2	-13.8	-4.4	0.0
Pension funds	-	1.0	0.0	-0.1	-	0.9	0.6	0.8	1.2
of which: conservative	-	1.0		-	-	1.0	0.6	0.8	1.3
balanced	-	1.0	0.0	-0.1	-	0.9	0.6	0.7	1.1
growth	-	1.1	0.0	-0.1	-	0.9	0.6	0.8	1.1
Supplementary pension funds	-	1.4	0.5	-	-	1.9	1.2	1.5	2.0
Mutual funds	-	1.1	2.5	-9.0	-0.7	-6.2	-26.7	-3.7	1.2
of which: equity funds	-	0.2	22.8	-57.5	-3.4	-38.0	-80.8	-32.3	-3.6
money market funds	-	1.3	0.4	-0.2	0.0	1.5	0.9	1.3	1.7
bond funds	-	1.2	-3.2	-0.5	0.0	-2.6	-3.6	0.8	1.4
mixed funds	-	1.0	5.8	-27.0	-3.0	-23.1	-44.0	-14.0	-5.1
funds of funds	-	0.1	12.2	-41.4	-3.0	-32.2	-41.9	-29.4	-16.9

Source: NBS, Register of Bank Loans and Guarantees (RBUZ), ECB, Reuters, Bloomberg.
Note: The table shows quartiles of the profit/loss-to-asset ratio resulting from application of the stress scenario and gives the divergence from the baseline scenario over a time horizon of two years.
The risk of debt securities being revaluated due to the credit rating downgrade of the counterparty is not included.

Banking sector resilient to adverse scenarios

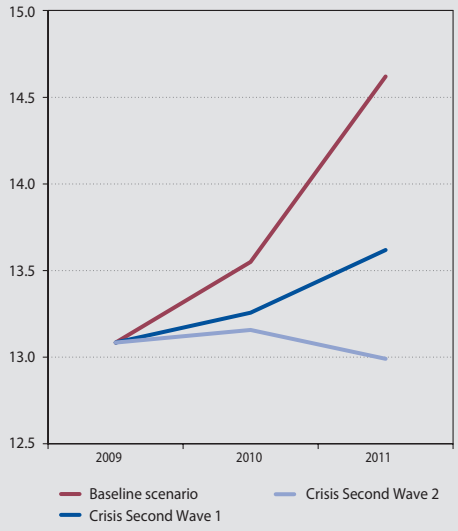
In general, after applying the different stress scenarios and having regard to the assumptions necessary for the calculation, the resilience of the Slovak banking sector to adverse events can be described as satisfactory as at the end of 2009.

Under the baseline scenario, not one bank would see its capital adequacy ratio (CAR) fall below 8%, while under the Crisis Second Wave scenario, two banks would struggle to comply with the 8% requirement under both the moderate and extreme versions of the scenario. Other banks would be able to maintain their CAR at above 8% due to having a relatively strong starting position (high CAR and/or relatively large profit reported as at the end of 2009). Several banks could maintain their CAR at the required level even if they failed to make a profit over the two-year period under review.

Losses from corporate loans would have a greater negative effect

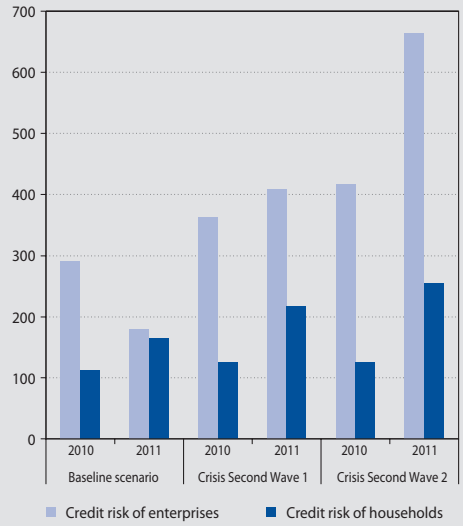
The largest risk to which banks are currently exposed continues to be credit risk. Because of

Chart 101 Capital adequacy ratio of the banking sector under stress scenarios (%)



Source: NBS.
Note: The calculations do not include branches of foreign banks.

Chart 102 Losses from non-performing loans to non-financial corporations and households (EUR billions)



Source: NBS.

the weakened financial position of non-financial corporations and households as at the end of 2009, the reaction of client loan portfolios to unfavourable economic developments would be relatively sensitive.

Under the baseline scenario, the total loss from customer loans in 2011 would be lower than in 2010, but under the other two scenarios this loss would peak in 2011. Since the unemployment rate would continue to rise, according to the estimates used in the stress scenarios, it may be assumed that the amount of non-performing loans to households would go up even after 2011.

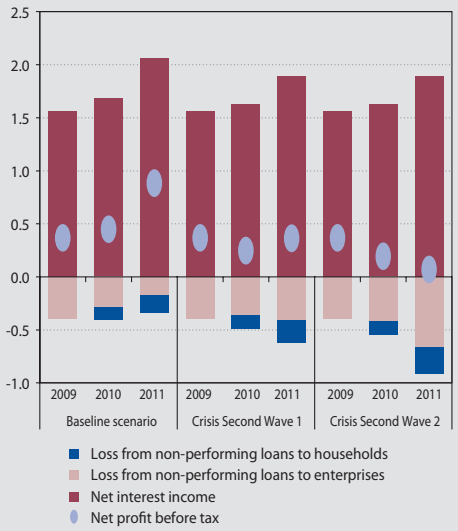
The banking sector would be affected to a greater degree by losses from non-performing loans to non-financial corporations (Chart 102). Only in certain banks would the losses from non-performing loans to households be similar or more substantial. Depending on the scenario and bank, the loss from non-performing loans in ratio to risk-weighted assets would range between 0.0% and -2.7%, while the corresponding ratio for corporate loans would in some cases be as much as -6.6%.

Market risks would pose a more moderate risk to banks. Losses from the revaluation of securities would be partially mitigated by interest rate derivatives, and only two banks would be at risk from heavier losses on foreign exchange transactions.

The impact of negative economic conditions on banks would be mitigated mainly through net interest income

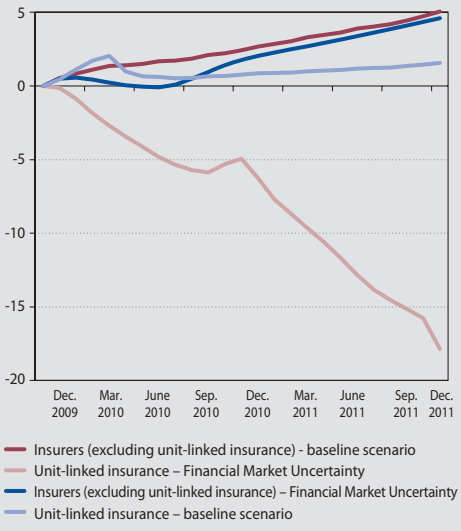
In the case of most banks, losses arising from credit risk and market risk would be mitigated by overall profitability. Even under the stress scenarios, the main source of income for the banking sector would be interest income. The principal components of gross income that would enable banks to reduce their loss from non-performing loans would be net interest income from the client loans and deposits portfolio and coupon yields from the securities portfolio (Chart 103). Given the assumed development of the ECB's base rate and interbank interest rates, banks would be able to increase their net interest income mainly in the second year of the period under review. As regards the capacity for covering losses from non-performing loans and other expenses, however, it is important that net interest income would not, under either of the stress scenarios, reach the level under the baseline scenario. This means that banks would be covering

Chart 103 Main estimated components of net profit before tax (EUR billions)



Source: NBS.
Note: For 2009, total provisioning expenses are stated.

Chart 104 Impact on the insurance sector of the stress scenario Financial Market Uncertainty (profit-to-asset ratio in %)



Source: NBS, ECB, Bloomberg, Reuters.

increasingly heavier losses out of a diminishing pool of funds.

This situation is reflected also in the stress test results, according to which four banks would end the period under review with a loss in case of the baseline scenario. Under the scenario Crisis Second Wave 1, the number of loss-making banks would rise to seven, and under Crisis Second Wave 2 it would be eight. Under the baseline scenario, despite the assumed negative developments in profitability and losses, the capital adequacy ratio of banks would not fall below 8%. This is largely because of the relatively strong capital position and profit reported at the end of 2009. Under the scenarios Crisis Second Wave 1 and 2, the capital adequacy ratio fell to below 8% in two banks.

In the insurance companies sector,[22] the stress scenario Financial Market Uncertainty would have a slightly negative impact

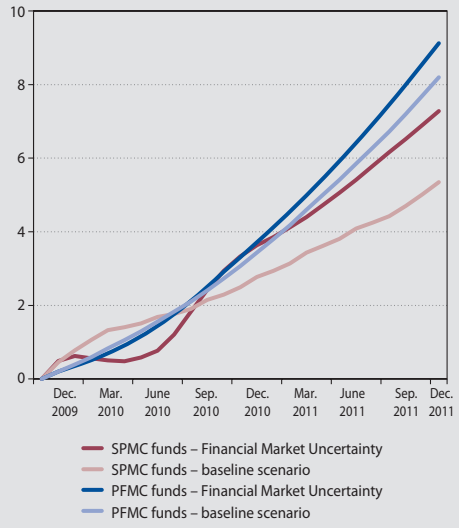
Under the scenario of rising uncertainty in financial markets, the insurance companies sector would record mainly a sharp decline in the fair value of securities in the available-for-sale and held-for-trading portfolios. Since these securities have a relatively long duration (Table 7), several insurance companies would, under the expected rise in interest rates, make a loss on these portfolios. Such loss would be most pronounced in the first half of 2010, but it would then gradually diminish and also be covered by rising interest income from coupons and bank deposits. From the view of interest rate risk, the effect of the scenario on the insurance companies sector should not be too adverse over the horizon of two years. Some insurance companies, however, would record losses from equity risk exposure due to the decline in prices of shares and mutual funds (around 0.6% of assets in the horizon of two years). These losses would be partially covered by gains on foreign exchange positions, since more than half of the total open position is denominated in US dollars and we assume that this currency will gradually strengthen against the euro.

Marked depreciation of assets invested under unit-linked insurance policies

Under this stress scenario, a far heavier loss would be recorded on assets invested under unit-linked insurance policies. The assets are to a considerable extent exposed to equity risk (through investments in shares and mutual funds), as well as to interest rate risk from a revaluation of debt

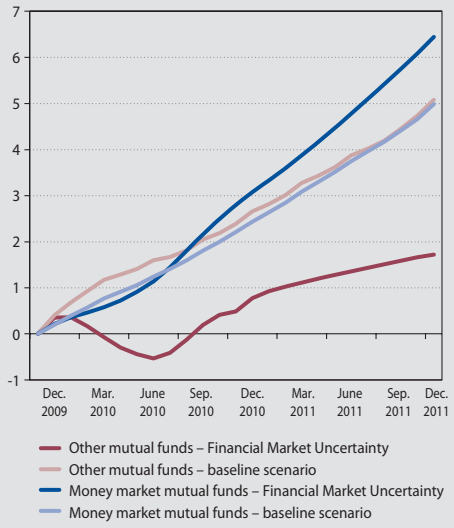
22 In addition to assets invested under unit-linked insurance policies, the stress testing included only the impact of market risks on the value of assets. However, this impact (especially in regard to credit risk) may vary if we also take into account the interest rate sensitivity of insurers' liabilities. Although NBS annually collects data on the interest rate sensitivity of insurers' liabilities, these data were not available as at the preparation date of this Analysis (19 march 2010). Furthermore, insurers are exposed to insurance risks that are not examined in this Analysis.

Chart 105 Impact on PFMC and SPMC funds of the stress scenario Financial Market Uncertainty (ratio of profit to net asset value in %)



Source: NBS, ECB, Bloomberg, Reuters.

Chart 106 Impact on the collective investment sector of the stress scenario Financial Market Uncertainty (ratio of profit to net asset value in %)



Source: NBS, ECB, Bloomberg, Reuters.

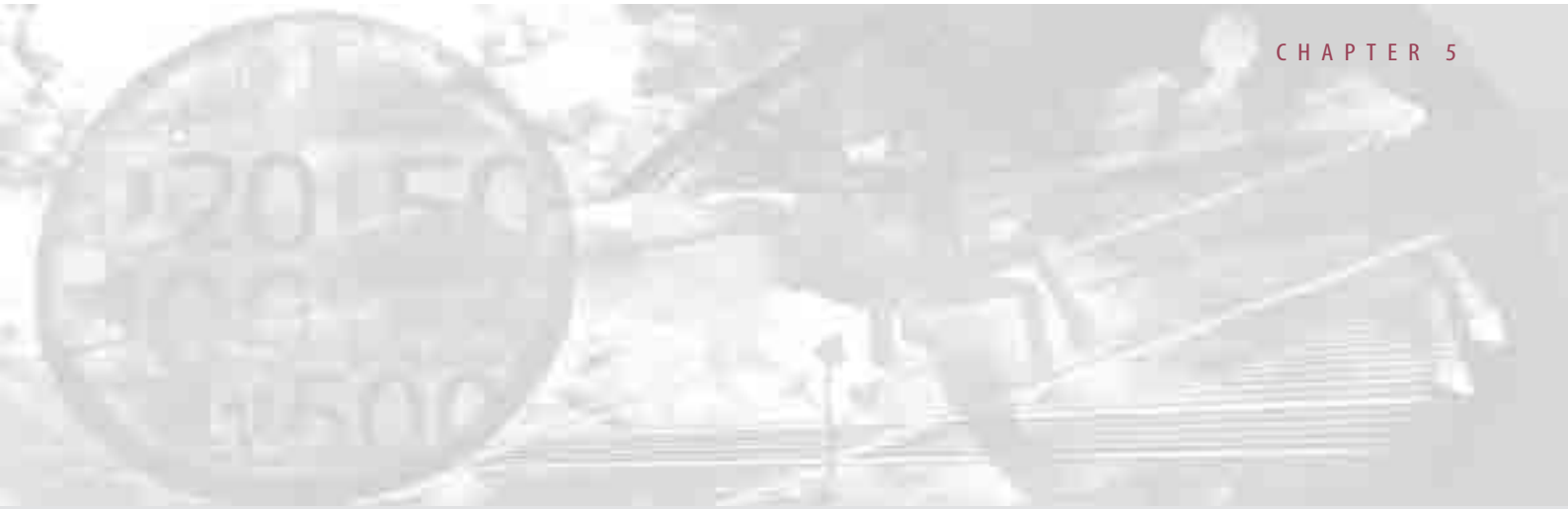
securities caused by a rise in interest rates, or by a credit rating downgrade of issuers of these securities. These investments would be profitable under the baseline scenario, but under the stress scenario they would shed one fifth of their value owing to the sharp decline in stock markets.

In the pension funds sector, the impact of the stress scenario would be less marked owing to the expected rise in interest income

Pension funds, especially those in Pillar II of the pension saving system, report a low duration for debt securities and bank deposits. The impact of a rise in interest rates on the revaluation of debt securities would therefore be relatively insignificant (except for its effect on certain SPMC funds during the first half of 2010). Over the two-year time horizon, gains would increase under both the baseline scenario and stress scenario because of the rise in interest rates.

This development faces the moderate risk of a possible credit rating downgrade of a country to which PFMC funds are exposed through investments in government debt securities. This risk, however, should be mitigated by the shorter residual maturity of these securities. In SPMC funds, by contrast, any rise in credit spreads may be reflected to a greater extent due to the higher average residual maturity of debt securities in these funds (3 years).

As for the collective investment sector, the baseline scenario is expected to produce a profit based on the rise in interest rates (with the debt securities portfolio having a relatively short duration) and the moderate growth in stock markets. Under the stress scenario, too, the positive profit is expected to be maintained, though it may be to a large extent decrease in all funds other than money market funds. The stress scenario's negative impact arising from the decline in stock markets would, however, be partially offset by the strengthened US dollar, since several mutual funds have exposure to this currency.



CHAPTER 5

FINANCIAL MARKET ANALYTICAL DATA (ANNEXES)

5

5 Financial Market Analytical Data (Annexes)

1 BANKS AND BRANCHES OF FOREIGN BANKS

1.1 Asset and liability structure of banks and branches of foreign banks

	Total volume (as at 31.12.2009) (EUR thousands)	Share denominated in a foreign currency (%)	Year-on-year change (%)	Share of total assets (%)	CR3 (%)	CR5 (%)	HHI
A SSETS – TOTAL (gross)	55,787,095	2%	-14%	100%	56%	72%	1,281
TOTAL LOANS TO CUSTOMERS	31,876,177	2%	1%	57%	54%	71%	1,203
Retail loans	13,999,701	0%	10%	25%	64%	85%	1,683
of which: Loans to households	13,147,288	0%	11%	24%	65%	85%	1,708
Loans to enterprises	14,530,392	2%	-3%	26%	47%	70%	1,121
Loans to non-bank financial corporations	1,371,801	1%	-28%	2%	52%	68%	1,174
Loans to general government	864,331	0%	12%	2%	90%	97%	6,326
Loans to non-residents	1,109,952	24%	-15%	2%	52%	76%	1,317
TOTAL INTERBANK MARKET OPERATIONS	7,434,851	6%	-63%	13%	52%	63%	1,286
of which: Operations with NBS and foreign issuing banks emisnými bankami (including NBS bills)	1,198,447	0%	-92%	2%	50%	69%	1,169
TOTAL SECURITIES	13,778,100	2%	30%	25%	64%	84%	1,694
Securities issued by non-residents	11,746,590	0%	33%	21%	68%	85%	1,841
Government bonds	10,282,532	0%	44%	18%	69%	86%	1,890
Corporate bonds	172,192	0%	-4%	0%	87%	97%	2,772
Bank bonds	575,872	0%	-32%	1%	58%	81%	1,488
Other debt securities	263,886	0%	-1%	0%	100%	100%	10,000
Equity securities	452,108	0%	12%	1%	74%	97%	2,189
Securities issued by non-residents	1,573,198	16%	86%	3%	62%	83%	1,655
Debt securities	1,493,771	14%	99%	3%	60%	82%	1,611
of which: issued by banks	429,867	9%	-1%	1%	60%	83%	1,697
of which: issued by general government	773,483	15%	1688%	1%	69%	91%	2,153
of which: other issuers	290,421	20%	6%	1%	59%	85%	1,777
Equity securities	79,427	45%	-17%	0%	92%	100%	3,669
of which: issued by banks	15,469	99%	-24%	0%	100%	100%	9,832
of which: other issuers	63,958	31%	-15%	0%	98%	100%	5,076
Derivatives – positive fair value	458,312	0%	-49%	1%	72%	93%	2,189

1.1 Asset and liability structure of banks and branches of foreign banks

	Total volume (as at 31.12.2009) (EUR thousands)	Share denominated in a foreign currency (%)	Year-on-year change (%)	Share of total assets (%)	CR3 (%)	CR5 (%)	HHI
TOTAL LIABILITIES	53,027,951	3%	-16%	100%	56%	72%	1,272
TOTAL DEPOSITS AND LOANS FROM CUSTOMERS	37,386,441	1%	-8%	71%	56%	72%	1,283
of which: deposits insured with the deposit protection fund	23,345,856	2%	-2%	44%	61%	77%	1,536
Deposits and loans received from retail customers	22,408,744	2%	-2%	42%	60%	75%	1,517
Deposits and loans received from households	20,983,389	2%	-1%	40%	60%	75%	1,516
Deposits and loans received from enterprises	8,924,233	4%	-13%	17%	57%	75%	1,490
Deposits and loans received from non-bank financial corps.	2,681,799	2%	10%	5%	54%	81%	1,386
Deposits and loans received from general government	1,980,931	0%	-47%	4%	64%	78%	1,861
Deposits and loans received from non-residents	1,390,734	6%	10%	3%	59%	77%	1,460
TOTAL FUNDS FROM BANKS	5,573,720	4%	-51%	11%	60%	70%	1,849
Funds from NBS and foreign issuing banks	2,126,406	0%	2928%	4%	87%	94%	3,783
Funds from non-resident banks	2,666,449	9%	-75%	5%	43%	59%	1,061
TOTAL SECURITIES ISSUED	4,197,587	2%	-16%	8%	72%	87%	2,123
Mortgage bonds	3,335,584	3%	-1%	6%	77%	90%	2,526
Bills of exchange	106,742	6%	-76%	0%	72%	97%	2,215
Other securities issued	227,721	0%	-6%	0%	93%	100%	3,715
Derivatives - negative fair value	527,540	0%	-43%	1%	70%	91%	2,129
Risk-weighted assets of the banking book	29,102,038		1%	55%	61%	78%	1,460
Risk-weighted assets of the trading book	1,050,079		-60%	2%	71%	91%	2,251
Other risk-weighted assets	3,147,850		-3%	6%	61%	78%	1,487
Own funds	4,185,974		9%	8%	53%	73%	1,261

Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 385 if the institutions numbered 26.
Assets are expressed in the gross value; equality with liabilities is achieved by deducting the value of depreciation charges and provisions.

1.2 Revenues and expenditure of banks and branches of foreign banks (EUR thousands)

	Value (as at 31.12.2009) (EUR thousands)	Value (as at 31. 12. 2008) (%)	CR3 (%)	CR5 (%)	HHI
(a) TOTAL OPERATING COSTS (b + e + f)	1,143,143	1,229,004	57%	73%	1,318
(b) Administrative costs (c + d)	961,896	1,041,698	56%	72%	1,282
(c) Purchased performances	474,068	526,619	54%	70%	1,262
(d) Staffing costs	487,828	515,079	58%	74%	1,331
(e) Depreciation/amortization of tangible and immovable assets	159,078	162,070	63%	76%	1,719
(f) Taxes and fees	22,169	25,237	83%	92%	3,511
(g) GROSS INCOME (h + l)	1,910,246	2,230,770	62%	77%	1,468
(h) Net interest income (j – i)	1,562,375	1,546,152	60%	76%	1,462
(i) Interest expenses	776,377	1,558,465	50%	68%	1,131
(j) Interest income	2,338,752	3,104,618	57%	72%	1,314
(k) of which: Interest income from securities	471,407	486,162	66%	85%	1,793
(l) Net non-interest income (m + n + o + p)	347,871	684,618	72%	82%	2,219
(m) Revenue from shares and ownership interests	27,368	22,396	95%	100%	6,170
(n) Net income from fees	403,798	455,277	66%	77%	1,683
(o) Net income from trading	31,308	289,912			
(p) Other net operating incomes	-114,603	-82,968			
(q) NET INCOME (g – a)	767,103	1,001,766			
(r) Net creation of provisons and income from depreciation of claims	403,481	289,072			
(s) Net creation of reserves	23,041	4,651			
(t) NET PRE-TAX PROFIT (q – r – s)	340,581	708,043			
(u) Extraordinary profit	0	0			
(v) Income tax	90,450	158,778			
w) NET PROFIT AFTER TAX (t + u – v)	250,131	549,266			

Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value of the given item.
In the case of all institutions having an equal share, the HHI value would be 385 if the institutions numbered 26.

1.3 Profitability indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (31.12.2009)	Denominator weighted average (31.12.2008)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum
ROA	0.47%	0.96%	0.48%	-13.70%	-0.55% (7%)	0.13% (38%)	0.84% (11%)	1.52% (44%)
ROE (excl. branches)	6.54%	14.73%	7.29%	-29.24%	-5.06% (10%)	1.63% (33%)	12.28% (7%)	22.01% (43%)
Cost-to-income ratio	59.84%	55.09%	68.00%	-341.67%	53.75% (28%)	65.24% (51%)	90.55% (12%)	2,632.84% (9%)
Relative significance of interest incomes	81.79%	69.31%	84.97%	0.00%	70.41% (27%)	83.58% (27%)	93.60% (12%)	490.56% (35%)
Net interest spread	2.86%	2.53%	2.87%	-2.01%	1.17% (5%)	1.89% (8%)	3.08% (29%)	13.39% (57%)
Retail	5.06%	5.19%	5.09%	-1.10%	2.57% (5%)	3.23% (19%)	5.33% (29%)	27.00% (45%)
corporates	2.69%	1.67%	2.41%	-2.87%	1.43% (27%)	2.74% (9%)	3.27% (44%)	5.55% (20%)
financial companies	3.06%	7.39%	2.99%	-3.65%	2.11% (42%)	2.70% (22%)	3.35% (14%)	10.67% (15%)
Banks including NBS and bills	-0.20%	-0.31%	0.79%	-4.38%	-1.42% (25%)	-0.34% (12%)	0.44% (6%)	5.44% (55%)
Net interest margin	2.85%	2.62%	2.91%	0.00%	1.21% (4%)	2.19% (14%)	3.01% (25%)	13.53% (57%)

Note: Figures in brackets below the quartile values represent the share of banks (measured by volume of net assets), for which the value of the indicator lies between the value of the given quartile and the previous quartile.

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (31.12.2009)	Denominator-weighted average (31.12.2008)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CREDIT RISK									
Non-performing loans as a share of total amount of loans to customers	5,50%	3,21%	5,55%	0,00%	2,54% (5%)	4,46% (33%)	7,45% (44%)	14,75% (18%)	
Retail (share of loans to retail sector)	5,23%	4,03%	5,64%	0,00%	3,31% 14%)	4,70% (43%)	7,81% (24%)	82,14% (18%)	
Corporates (share in loans to enterprises)	6,71%	3,20%	6,36%	0,00%	0,00% (8%)	3,98% (21%)	8,37% (52%)	15,66% (19%)	
Financial companies (share of loans to financial companies)	0,25%	0,03%	0,32%	0,00%	0,00% (54%)	0,00% (0%)	0,00% (6%)	1,56% (32%)	
Provisions as a share of total amount of non-performing loans to customers	74,59%	91,36%	83,16%	8,41%	63,74% (16%)	74,06% (33%)	95,89% (27%)	648,86% (22%)	
Large asset exposure (weighted) / own funds (excl. branches)	119,66%	121,88%	133,91%	0,00%	23,99% (6%)	164,86% (66%)	259,52% (11%)	547,83% (10%)	0
Large asset exposure within groups (number of breaches)									
Claimable value of collateral as a share of total amount of non-performing loans to customers	40,65%	29,18%	42,70%	0,00%	11,06% (3%)	38,72% (45%)	54,82% (19%)	101,73% (29%)	
FOREIGN EXCHANGE RISK									
Forex open balance-sheet / own funds (excl. branches)	-0,89%	-49,61%	0,06%	-22,56%	-3,29% (47%)	0,00% (24%)	1,76% (8%)	93,61% (13%)	
Forex open off-balance-sheet position / own funds (excl. branches)	-0,04%	22,49%	-0,35%	-135,37%	-0,71% (28%)	0,00% (6%)	2,15% (24%)	37,02% (34%)	
Total forex open position / own funds (excl. branches)	-0,93%	-27,12%	-0,29%	-116,09%	-5,04% (32%)	0,00% (29%)	2,08% (6%)	37,02% (25%)	
Total forex open position / own funds (incl. branches)	2,10%	-58,92%							
INTEREST RATE RISK									
Change in economic value of the trading book not including interest rate derivatives / own funds (excl. branches)*	-0,75%		-0,68%	-4,79%	-0,12% (51%)	0,00% (36%)	0,00% (0%)	0,98% (6%)	
Change in economic value of the trading book including interest rate derivatives / own funds (excl. branches)*	-0,53%		-0,46%	-4,86%	-0,78% (21%)	-0,03% (42%)	0,00% (12%)	1,55% (18%)	

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (31.12.2009)	Denominator-weighted average (31.12.2008)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
Change in economic value of the total balance sheet not including interest rate derivatives / own funds (excl. branches)*	-11,41%		-11,67%	-27,49%	-16,33% (26%)	-9,58% (32%)	-5,93% (24%)	-1,17% (10%)	
Change in economic value of the total balance sheet including interest rate derivatives / own funds (excl. branches)*	-10,83%		-10,60%	-69,95%	-16,36% (26%)	-9,15% (32%)	-4,38% (26%)	8,86% (9%)	
Total interest-rate open position up to 1 month / own funds (excl. branches)	-111,12%	-99,21%	-126,43%	-780,26%	-321,14% (27%)	-167,06% (19%)	25,27% (7%)	155,10% (40%)	
Total interest-rate open position up to 1 year / own funds (excl. branches)	-104,54%	-87,72%	-107,42%	-426,60%	-81,78% (34%)	-67,11% (8%)	-28,44% (39%)	48,26% (10%)	
Total interest-rate open position up to 5 years / own funds (excl. branches)	-1,42%	-18,66%	-2,27%	-174,25%	-21,06% (26%)	15,35% (14%)	54,07% (32%)	437,11% (19%)	
LIQUIDITY RISK									
Liquid asset ratio as defined in Decree No. 18/2008 of Národná banka Slovenska (Section 13) as amended	132,43	145,67	137,42	93,11	128,58 (56)	152,92 (30)	227,13 (11)	1 521,54 (3)	1
Share of quick assets in highly volatile funds	12,04	17,55	3 461,31	0,19	3,66 (8)	6,35 (31)	22,65 (33)	432 400,00 (28)	
Share of liquid assets (incl. collateral from reverse repo trades) in volatile funds	24,14	41,56	24,41	-17,64	1,12 (11)	8,55 (6)	27,59 (31)	380,44 (52)	
Ratio of fixed and illiquid assets (excl. branches)	43,82	36,08	48,78	6,75	21,94 (3)	44,03 (35)	54,14 (40)	131,11 (15)	
Share of loans and issued securities	76,65	69,68	82,49	0,00	66,23 (9)	81,79 (68)	110,53 (20)	537,80 (4)	
Total liquidity position current up to 7 days / assets	-44,65	-35,81	-44,65	-85,54	-45,69 (53)	-27,50 (36)	1,18 (4)	73,71 (7)	
Total liquidity position estimated up to 7 days / assets	-3,25	-4,63	-3,25	-79,71	-16,77 (7)	-0,05 (54)	3,32 (14)	73,71 (25)	
Total liquidity position current up to 3 months / assets	-50,78	-42,39	-50,78	-67,18	-50,95 (57)	-30,44 (36)	-15,72 (3)	73,71 (5)	
Total liquidity position estimated up to 3 months / assets	-9,23	-10,65	-9,23	-77,96	-18,53 (29)	-9,29 (15)	1,68 (31)	73,71 (25)	

1.4 Risk and capital adequacy indicators of banks and branches of foreign banks and their distribution in the banking sector (%)

	Denominator-weighted average (31.12.2009)	Denominator-weighted average (31.12.2008)	Asset-weighted average	Minimum	Lower quartile	Median	Upper quartile	Maximum	Number of breaches
CAPITAL ADEQUACY									
Capital adequacy ratio (excl. branches)	12,57	11,44	12,25	8,43	11,12 (33)	12,77 (38)	17,88 (20)	53,89 (2)	0
Share of Tier I in own funds (excl. branches)	88,49	85,74	86,94	66,66	79,42 (8)	91,87 (52)	99,51 (28)	100,00 (5)	
Share of own funds in balance-sheet total (excl. branches)	8,50	6,61	8,50	5,24	7,10 (31)	8,65 (40)	12,16 (20)	59,39 (2)	
Potential loss as a share of own funds at a capital adequacy ratio of 8% (excl. branches)	36,36	30,08	30,98	5,07	28,08 (33)	37,34 (38)	55,13 (20)	85,15 (2)	

** The change in economic value is estimated using data on the contractual residual period until the next revision of interest rates, or maturity date, assuming a parallel rise in interest rates of 1 percentage point.*
Note: Figures in brackets below the quartile values represent the share of banks (measured by volume of net assets), for which the value of the indicator lies between the value of the given quartile and the previous quartile.

2 INSURANCE COMPANIES

2.1 Net profit and profitability indicators of insurance companies

	Value as at 30.6.2009 (EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change (%)	Share of total premiums (%)
Total net profit	138,167	107,606	28.40	6.96
ROA (%)	2.25	1.89	-	-
ROE (%)	10.43	8.90	-	-

2.2 Premiums

	Value as at (31.12.2009 EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change	Share of total premiums (%)	CR3 (%)	HHI 31.12.2009	HHI 31.12.2008
Total	1,984,843	2,100,114	-5.49	100.00	64.90	1,785	1,717
Life insurance	1,028,548	1,098,999	-6.41	51.82	54.78	1,376	1,408
Whole-life insurance, pure endowment insurance, or whole-life and endowment insurance (excl. unit-linked insurance)	603,258	624,951	-3.47	30.39	59.99	1,566	1,622
Unit-linked insurance	284,005	335,013	-15.23	14.31	66.73	1,740	1,658
Supplementary insurance	122,495	118,336	3.51	6.17	60.46	1,576	1,596
Other	18,790	20,699	-9.23	0.95	87.54	4,172	4,169
Non-life insurance	956,295	1,001,115	-4.48	48.18	78.50	2,513	2,373
Motor third-party liability insurance	284,543	320,611	-11.25	14.34	81.37	2,784	2,712
Other motor insurance	293,650	307,580	-4.53	14.79	79.04	2,452	2,425
Property insurance	227,333	219,562	3.54	11.45	81.20	2,896	2,628
Other	150,769	153,362	-1.69	7.60	68.02	2,132	1,972

Note: The calculation of CR 3 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 400 if the institutions numbered 25.

2.3 Premiums ceded to reinsurers

	Value as at 31.12.2009 (EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change (%)	Share of total premiums written (%)
Total	244,164	266,261	-8.30	12.30
Life insurance	8,477	20,681	-59.01	0.82
Non-life insurance	235,687	245,581	-4.03	24.65

2.4 Loss ratio in non-life insurance

	Value as at 31.12.2009 (%)	Value as at 31.12.2008 (%)
Total	54.86	52.15
Motor third-party liability insurance	58.52	43.90
Other motor insurance	67.84	69.85
Property insurance	44.66	49.87
Other	37.17	37.26

2.5 Cost of claims

	Value as at 31.12.2009 (EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change (%)	Share of total premiums (%)	CR3 (%)	HHI 31.12.2009	HHI 31.12.2008
Total	1,034,885	963,704	7.39	52.14	68.86	1,973	1,891
Life insurance	552,301	463,051	19.27	27.83	62.42	1,666	1,595
Whole-life insurance, pure endowment insurance, or whole-life and endowment insurance (excl. unit-linked insurance)	469,485	380,842	23.28	23.65	65.41	1,826	1,732
Unit-linked insurance	43,476	45,570	-4.59	2.19	83.19	2,938	3,810
Supplementary insurance	22,360	19,837	12.72	1.13	65.49	1,812	1,784
Other	16,980	16,803	1.05	0.86	88.11	6,315	5,829
Non-life insurance	482,584	500,653	-3.61	24.31	80.77	2,670	2,538
Motor third-party liability insurance	162,753	159,083	2.31	8.20	84.42	3,135	3,016
Other motor insurance	199,659	206,191	-3.17	10.06	79.81	2,530	2,481
Property insurance	66,021	96,752	-31.76	3.33	86.35	3,401	2,774
Other	54,151	38,627	40.19	2.73	80.07	2,672	2,801

Note: The calculation of CR 3 and HHI covers only those institutions reporting a positive value for the given item.
In the case of all institutions having an equal share, the HHI value would be 400 if the institutions numbered 25.

2.6 Structure of insurers' technical provisions

	Value as at 31.12.2009 (EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change (%)	Share of total reserves (%)
Total	4,476,564	4,021,220	11.30	100.00
Life insurance	2,762,782	2,499,288	10.54	61.72
Provisions for liabilities arising from financial investments made on behalf of insured persons	691,850	539,106	28.33	15.45
Non-life insurance	1,021,932	982,825	3.98	22.83

2.7 Investment of insurers' technical provisions excluding provisions for liabilities arising from financial investments made on behalf of insured persons

	Value as at 31.12.2009 (EUR thousands)	Value as at 31.12.2008 (EUR thousands)	Year-on-year change (%)	Share of total reserves (%)
Total	4,228,649	3,757,610	12.54	111.73
Government and central bank bonds of Slovakia and EU Member States, bonds guaranteed by Slovakia, and bonds of the EIB, EBRD and IBRD.	1,994,495	1,421,383	40.32	52.70
Bank bonds	502,248	677,709	-25.89	13.27
Term bank accounts	131,538	250,790	-47.55	3.48
Mortgage bonds	505,395	506,673	-0.25	13.35
Reinsurance	278,794	250,126	11.46	7.37
Other	816,179	650,930	25.39	21.57

3 RETIREMENT PENSION SAVING

3.1 Pension fund management companies as at 31.12.2009

	Market share[1] (%)	NAV of funds (EUR thousands)	Number of customers[2]
Allianz – Slovenská, d.s.s., a.s.	31	909,935	436,297
Axa, d.s.s., a.s.	27	788,320	374,897
VÚB Generali, d.s.s., a.s.	15	421,238	193,621
ING, d.s.s., a.s.	11	320,455	147,274
AEGON, d.s.s., a.s.	10	297,169	185,432
AEGON, d.s.s., a.s.	6	162,414	93,940

1) Market shares are calculated according to the aggregate net asset value (NAV) of funds managed by the given pension fund management company.
2) Data on the number of customers is received directly from the pension fund management companies; the sum of these data for the whole sector may differ from the data received from the Social Insurance Agency on the aggregate number of customers in the sector.
NAV – Net Asset Value.

3.2 Results of pension fund management companies as at 31.12.2009 (in EUR)

	Revenues (EUR thousands)	Expenditures (EUR thousands)	Profit/loss (EUR thousands)	ROA (%)	ROE (%)
Allianz – Slovenská, d.s.s., a.s.	7,140	8,144	-1,004	-2.3	-2.3
Axa, d.s.s., a.s.	5,929	10,200	-4,271	-6.2	-6.3
VÚB Generali, d.s.s., a.s.	3,289	2,300	989	8.4	8.8
ING, d.s.s., a.s.	2,505	4,506	-2,001	-13.2	-13.6
AEGON, d.s.s., a.s.	2,480	1,922	558	4.1	4.2
ČSOB, d.s.s., a.s.	1,288	1,520	-232	-1.8	-1.9

3.3 Pension funds

	NAV as at 31.12.2009 (EUR thousands)
Total	2,899,531
Conservative	126,450
Balanced	834,734
Growth	1,938,346

Note: NAV – Net Asset Value

3.4 Investment structure of pension funds

	Value as at 31.12.2009 (EUR thousands)
Total	2,899,531
Bank accounts	913,301
Bonds	960,400
Treasury bills	1,022,645
Shares and mutual fund units	3,744
Other claims	9,278
Payables	-9,838

3.5 Supplementary pension fund asset management companies as at 31.12.2009

	Market share[1] (%)	NAV of funds (EUR thousands)	Number of customers
ING Tatry – Sympatia, d. d. s., a. s.	38	397,957	318,987
Doplnková dôchodková spoločnosť Tatra banky, a. s.	29	303,970	202,738
Stabilita, d. d. s., a. s.	20	207,564	176,787
Axa d. d. s., a. s.	13	135,659	154,097
AEGON d. d. s., a. s.	0	2,283	4,956

1) Market shares are calculated according to the aggregate net asset value (NAV) of funds managed by the given supplementary pension fund asset management companies. .
Note: NAV – Net Asset Value.

3.6 Results of supplementary pension fund asset management companies as at 31.12.2009

	Revenues (EUR thousands)	Expenses (EUR thousands)	Profit/loss (EUR thousands)	ROA (%)	ROE (%)
ING Tatry – Sympatia, d. d. s., a. s.	12,481	8,068	4,413	27	37
Doplnková dôchodková spoločnosť Tatra banky, a. s.	6,822	4,481	2,341	25	31
Stabilita, d. d. s., a. s.	4,320	3,608	712	17	19
Axa d. d. s., a. s.	3,956	3,232	724	7	8
AEGON d. d. s., a. s.	73	273	-200	-8	-9

3.7 Supplementary pension funds

	NAV as at 31.12.2009 (EUR thousands)
Total	1,047,434
Contribution	1,015,257
Payroll	32,177

Note: NAV – Net Asset Value.

3.8 Investment structure of supplementary pension funds

	Value as at 31.12.2009 (EUR thousands)
Total	1,047,434
Bank accounts	247,275
Bonds	753,218
Treasury bills	819
Shares and mutual fund units	49,236
Other claims	28,387
Payables	-31,501

4 COLLECTIVE INVESTMENT

4.1 Asset management companies as at 31.12.2009

Asset management company	NAV of mutual funds (EUR thousand)	Market share (%)
Total	3,420,520	100.00
Tatra Asset Management	1,311,410	38.34
Asset Management SLSP	861,642	25.19
VÚB Asset Management	800,623	23.41
ČSOB Asset Management	157,803	4.61
Prvá penzijná	139,908	4.09
Alico Funds Central Europe	63,563	1.86
IAD Investments	46,021	1.35
Allianz Asset Management	39,552	1.16

Note: NAV – Net Asset Value.

4.2 Expenditures, revenues and profitability indicators of domestic asset management companies as at 31.12.2009

Asset management company	Revenues (EUR thousands)	Expenditures (EUR thousands)	Profit/loss (EUR thousands)	ROA (%)	ROE (%)
Total	35,974	30,993	4,981	8.3	9.4
Alico Funds Central Europe	2,417	1,961	456	12.5	16.0
Allianz Asset Management	448	983	-535	-14.7	-14.9
Asset Management SLSP	6,992	6,417	575	11.4	14.5
ČSOB Asset Management	5,780	5,392	388	3.7	5.2
IAD Investments	721	815	-94	-4.3	-4.4
Prvá Penzijná	2,248	1,703	545	14.5	17.7
Tatra Asset Management	12,828	10,020	2,808	10.3	10.8
VÚB Asset Management	4,540	3,702	838	19.1	21.8

4.3 Structure of mutual funds as at 31.12.2009 (EUR thousands)

Fund type	Market share (%)	Net asset value (EUR thousands)	Number of funds	CR3 (%)	CR5[1] (%)	HHI[1]	HHI on a uniform distribution
Total mutual funds	100	4,120,645	501	-	-	-	20
Domestic	83.01	3,420,520	77	34	44	554	130
Money market funds	42.84	1,765,196	13	67	83	1,715	769
Bond funds	9.96	410,257	8	89	96	3,095	1,250
Equity funds	3.13	129,021	8	87	98	3,099	1,250
Mixed funds	9.41	387,788	19	56	72	1,520	526
Funds of funds	7.84	323,162	16	60	80	1,588	625
Other funds	5.87	241,854	8	64	91	1,822	1,250
Special funds	0.58	23,828	1	100	100	10,000	10,000
Real estate funds	3.38	139,416	4	89	100	3,244	2,500
Foreign[2]	16.99	700,125	424	17	23	202	24
Money market funds	2.66	109,791	26	82	89	3,158	385
Bond funds	1.64	67,594	70	43	56	894	143
Equity funds	4.84	199,310	231	36	46	581	43
Mixed funds	1.38	56,794	31	75	90	3,006	323
Funds of funds	0.64	26,408	14	86	93	4,042	714
Other funds	5.83	240,228	52	20	31	370	192

1) Market concentrations are calculated only for open-end mutual fund (they exclude closed-end and special funds)
2) For foreign mutual funds the net asset value represents units sold in the Slovak Republic.
Note: The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item. In the column, „HHI on a uniform distribution", the HHI value is that which would express the concentration on a uniform distribution of the net asset value in the given group of funds.

4.4 Net sales of open-end mutual funds as at 31.12.2009

	12 months (EUR thousands)	Number of funds	HHI	HHI on a uniform distribution
Total open mutual funds	89,329	501	-	20
Domestic	46,374	77	1,293	130
Money market funds	92,570	13	3,719	769
Bond funds	841	8	8,566	1,250
Equity funds	15,143	8	3,805	1,250
Mixed funds	43,322	19	1,691	526
Funds of funds	-19,935	16	1,850	625
Other funds	-106,862	8	5,008	1,250
Special funds	21,295	5	3,596	2,000
Foreign	42,955	424	202	24
Money market funds	17,516	26	3,158	385
Bond funds	1,108	70	894	143
Equity funds	26,757	231	581	43
Mixed funds	2,129	31	3,006	323
Funds of funds	7,032	14	4,042	714
Other funds	-11,588	52	370	192

Note: The calculation of HHI covers only those institutions reporting a positive value for the given item. In the column, „HHI on a uniform distribution", the HHI value is that which would express the concentration on a uniform distribution of the net asset value in the given group of funds.

4.5 Average returns on open-end mutual funds as at 31.12.2009 (% p.a.)

	3 months			1 year			3 years		
Total open-end funds	-15.37	1.52	21.40	-8.36	8.30	168.31	-35.51	-2.69	9.46
Domestic	-4.04	1.19	13.10	-4.40	5.06	101.04	-25.82	0.09	9.46
Money market funds	-4.04	0.49	1.40	1.00	2.32	4.50	-0.73	2.42	3.30
Bond funds	-0.16	0.86	2.19	-0.76	2.23	7.00	-3.92	0.74	2.14
Equity funds	3.40	6.53	13.10	17.54	25.88	101.04	-25.82	-16.22	-12.82
Mixed funds	-0.50	1.78	5.33	-0.57	11.71	39.52	-16.90	-1.41	2.44
Funds of funds	0.54	3.08	5.00	3.44	11.77	21.15	-7.86	-4.51	1.61
Other funds	-0.31	0.27	1.00	2.03	3.09	4.46	1.99	1.99	1.99
Special funds	0.91	1.00	1.50	-4.40	0.30	5.64	1.00	4.24	9.46
Foreign	-15.37	3.14	21.40	-8.36	24.10	168.31	-35.51	-16.30	-1.96
Money market funds	-3.44	0.47	4.50	-2.27	2.98	15.48	-18.82	-11.40	-6.78
Bond funds	-1.33	1.97	9.52	-8.36	31.75	98.18	-30.29	-10.30	-2.82
Equity funds	-15.37	7.55	21.40	-6.67	49.32	168.31	-35.51	-22.45	-1.96
Mixed funds	-1.44	2.50	9.73	-3.11	30.06	52.61	-25.06	-21.44	-12.15
Funds of funds	-1.43	2.75	6.32	2.58	14.20	48.46	-20.72	-16.32	-10.23
Other funds	-4.00	1.01	16.52	-0.46	6.76	33.79	-17.48	-11.23	-7.70

4.6 Asset structure of domestic mutual funds as at 31.12.2009 (EUR thousands)

	Money market funds	Other funds
Total	1,768,483	1,664,239
Deposits in banks	632,448	333,671
Securities other than shares and mutual fund shares	1,093,414	699,158
Shares and mutual fund units	43,301	450,220
Shares and other participating interests	0	109,884
Financial derivatives[1)]	-682	-1,778
Other assets	3	73,084

1) Financial derivatives include derivatives with positive and negative fair value.

5 INVESTMENT FIRMS

5.1 Basic details of investment firms as at 31.12.2009

	Amount of transactions (EUR thousands)	Market share (%)	Amount of assets under management (EUR thousands)	Market share (%)
Banks and branches of foreign banks	111,326,009	44	82,862	4
Asset management companies	24,848	0	1,784,875	92
IFs with share capital of at least 35M	2,781,981	1	70,685	4
Others	138,081,282	55	7,288	0

Note: Non-bank investment firms are divided by the size of their share capital. Those with share capital of less than €1.162 million are not licensed to provide IS-3 investment services (receiving a customer's order to buy or sell an investment instrument and execution of the order on own account).

5.2 Market concentrations of investment firms by trading volume

	Number of traders	CR3 (%)	CR5 (%)	HHI
Total	45	81	94	3,381
Banks and branches of foreign banks	18	91	95	2,793
Asset management companies	7	100	100	10,000
IFs with a share capital of at least 35M	8	98	100	6,946
Others	12	99	100	9,388

Note: Market concentrations are calculated for the current quarter.
The calculation of CR 3, CR 5 and HHI covers only those institutions reporting a positive value for the given item.

5.3 Trading volume broken down by investment service as at 31.12.2009

	IS-1 (EUR thousands)	IS-2 (EUR thousands)	IS-3 (EUR thousands)
Total transactions	23,675,428	122,398,873	106,139,819
Shares	790,539	242,088	30,451
Bonds	422,951	5,384,708	6,306,779
Mutual fund units	662,155	1,812	0
Other transferable securities	57,545	29,353	5,826,408
Money market instruments	6,792,901	92,984,583	10,076,872
Securities issued by foreign CI undertakings	173,193	62,668	358
Derivatives – type A	12,809,271	23,693,661	83,777,460
Derivatives – type B	221,462	0	121,491
Derivatives – type C	1,127,290	0	0
Derivatives – type D	482,488	0	0
Derivative instruments for the transfer of credit risk	62,936	0	0
Financial contracts for differences	0	0	0
Derivatives – type E	72,697	0	0

Note: IS-1 – reception of a customer's order to acquire, sell or otherwise dispose of an investment instrument and subsequent transmission of the customer's order for the purpose of its execution.
IS-2 – reception of a customer's order to acquire or sell an investment instrument and its execution for an account other than the account of the service provider.
IS-3 – reception of a customer's order to acquire or sell an investment instrument and its execution for own account.
Derivatives – type A – as defined in Section 5(1)(d) of the Securities Act.
Derivatives – type B – as defined in Section 5(1)(e) of the Securities Act.
Derivatives – type C – as defined in Section 5(1)(f) of the Securities Act.
Derivatives – type D – as defined in Section 5(1)(g) of the Securities Act.
Derivatives – type E – as defined in Section 5(1)(j) of the Securities Act.

6 FINANCIAL MARKET STRUCTURE

6.1 Number of financial institutions

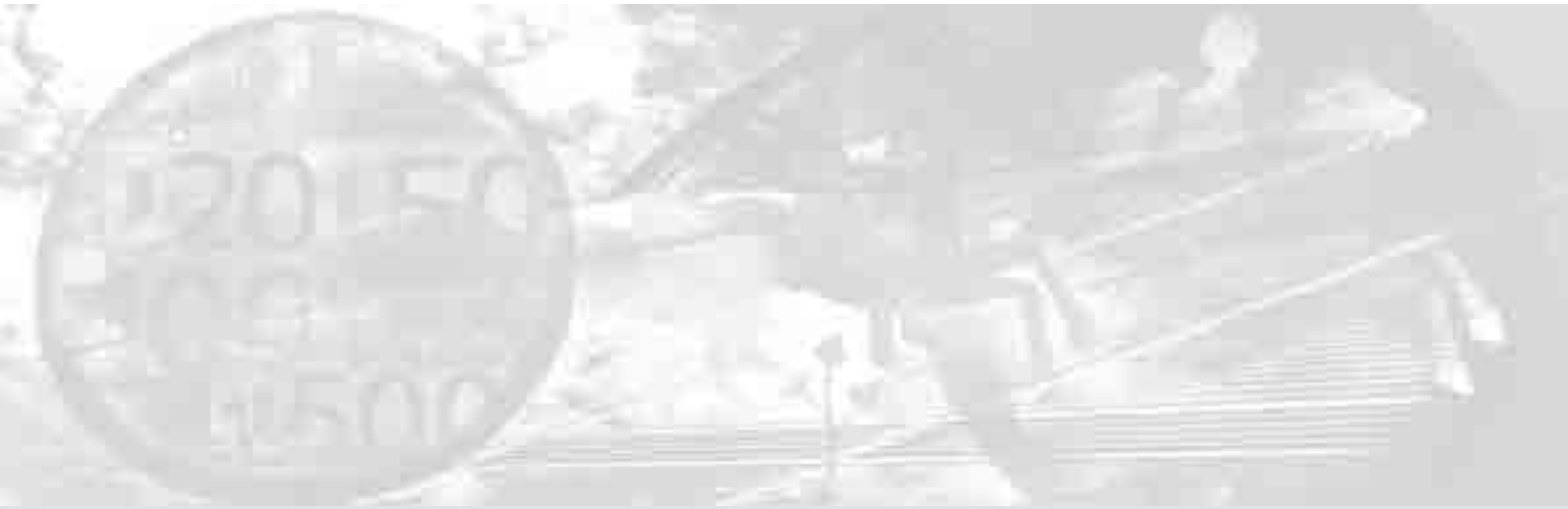
	Number of institutions as at 31.12.2009	Number of institutions as at 31.12.2008	Change
Banks in Slovakia	15	17	-2
home savings banks	3	3	0
mortgage banks	8	9	-1
other banks	4	5	-1
Branches of foreign banks in Slovakia	13[1]	11*	2
of which: NBS-authorised	0	0	0
on the single European passport principle	13	11	2
of which: branches of foreign mortgage banks	0	0	0
Branches of foreign banks contributing to the Deposit Protection Fund	1	0	1
Representative offices of foreign banks in Slovakia	4	7	-3
Branches (organisational units) of banks in Slovakia	1 04[2]	857	185
Lower organisational units in Slovakia	188	401	-213
Branches of Slovak banks in other countries	22	1	1
Representative offices of Slovak banks in other countries	1	1	0
Foreign entities freely providing cross-border banking services	274	252	22
of which: banks	251	231	20
electronic money institutions	13	12	1
foreign financial institutions	7	7	0
credit cooperatives	3	2	1
Slovak banks providing cross-border banking services abroad	2	2	0
of which: electronic money institutions	0	0	0
Number of staff in banks and branches of foreign banks	18 750	20 598	-1 848
Insurance companies in Slovakia	20	23	-3
of which: insurance companies providing only life insurance	5	5	0
insurance companies providing only non-life insurance	3	4	-1
insurance companies providing life and non-life insurance	12	14	-2
Insurance companies established in Slovakia and providing services abroad	14	14	0
Foreign insurance companies providing services on a freedom to provide services basis	447	419	28
Pension fund management companies	6	6	0
Supplementary pension fund asset management companies	5	5	0
Supplementary pension fund insurance companies			0
Domestic asset management companies in Slovakia	8	10	-2
of which: asset management companies with an extended licence under Section 3(3) of the Collective Investment Act (CIA)	6	6	0
Domestic mutual funds:	78	114	-36

6.1 Number of financial institutions

	Number of institutions as at 31.12.2009	Number of institutions as at 31.12.2008	Change
of which: open-end mutual funds	73	68	5
closed-end mutual funds	0	41	-41
special mutual funds	5	5	0
Foreign asset management companies and foreign collective investment undertakings operating in Slovakia and authorised under Section 75 of the CIA:	5	5	0
Foreign asset management companies and foreign collective investment undertakings operating in Slovakia on the single European passport principle:	57		
of which: a foreign asset management company branch established under Section 28 of the CIA	2		
a foreign management company (without a branch) established under Section 29 of the CIA	13		
European funds under Section 61 – foreign asset management companies (FAMCs)	16		
– foreign investment companies (FICs)	26		
under which: foreign mutual funds and sub-funds of FAMCs and FICs	874		
Foreign asset management companies conducting business under Section 3(3) of the CIA	13		
Investment firms as defined by the Securities Act	18	18	0
Banks conducting business under the Securities Act and NBS-licensed	11	13	-2
Branches of foreign banks – investment firms licensed by their home authority	7	6	1
Foreign entities operating in Slovakia as investment firms	1 029	890	139
Slovak investment firms providing services abroad without establishing a branch	9	7	2
Investment service intermediaries in Slovakia:	962	978	-16
of which: legal persons	85	73	12
natural persons	877	905	-28
Securities issuers whose securities are admitted to trading on a regulated market	125	144	-19
Other legal persons authorised by Národná banka Slovenska only to issue means of payment	2	1	1
Payment institution	1		
Electronic money institution	1		
Foreign payment institutions providing payment services in Slovakia on a cross-border basis	19		

1) As at 31.12.2009, the following branches of foreign credit institutions had not begun banking activities – AXA Bank Europe (a branch of a foreign bank) and UNIBON – spořitelní a úvěrní družstvo (an organisational unit of a foreign entity)
2) As at 31. 12. 2009 Poštová banka had not begun to conduct banking activities through its branch abroad.

**) Up to 31 December 2008, the following branch offices of foreign credit institutions did not commenced banking activities: UNIBON, spořitelní a úvěrní družstvo (organisational unit of a foreign entity), and Oberbank AG, branch office of a foreign bank.*



GLOSSARY AND ABBREVIATIONS

Glossary of Terms Used

Average annual return on pension funds – is calculated as a weighted average of the year-on-year percentage changes in the daily values of pension fund units of the respective pension funds. The year-on-year percentage changes in the daily values of pension units are calculated as at 30.6.2009 (PMZDHDJ30.6.2009) according to the following formula:

$$PMZDHDJ_{30.6.2009} = \left(\frac{DJ_{30.6.2009}}{DJ_{30.6.2008}} - 1 \right) * 100\%$$

where DJ is the value of a pension unit on the given day.

The weight applied is the ratio of the respective fund's net asset value (NAV) to the sum of NAVs of funds of the same type. The return is given in nominal terms, which means that inflation is not deducted. When returns are calculated for various forms of investment, the nominal return is used as a rule, calculated according to the standard statutory methodology.
This return, however, is not identical to the return in the saver's personal pension account, which is determined on an individual basis. The input data were the values of pension units from the individual pension funds reported to Národná banka Slovenska by pension fund management companies for the days 30.6.2008 and 30.6.2009, which are available on the website of Národná banka Slovenska.

Average return of market rivals – the arithmetic average of the moving averages of the percentage year-on-year changes in the daily pension unit values of the pension fund's market rivals, calculated for the previous 24 months and rounded up to 2 decimal places.

Average return on a pension fund of a pension fund management company – the moving average of the percentage year-on-year changes in the daily pension unit values of the pension fund calculated for the previous 24 months and rounded up to two decimal places.

Capital adequacy ratio – ratio of own funds and 12.5 times the capital adequacy requirement.

CLI index – an index of the weighted average of CLIs for selected countries, with each country weighted according to its share of Slovak exports; the CLI is a composite indicator of economic activity, and it is published by the OECD.

Combined ratio – a ratio representing the expense ratio and loss ratio relative to earned premiums.

Cost-to-income ratio – the ratio of total operating costs and net income from banking activity (purchased performances + staff costs + social costs + depreciation/amortisation of tangible and intangible assets + taxes and fees / revenues from shares and ownership interests + net income from fees and commissions + net income from securities transactions + net income from derivatives transactions + net income from foreign exchange transactions + net income from other transactions).

CR n index – the concentration of the n largest banks, i.e. the sum of their assets as a share of total assets.

Cumulative gap – the sum of open positions (long or short) in certain time bands.

Default rate – the percentage of loans defaulting over the period under review.

Emerging markets – developing markets undergoing rapid growth and industrialisation.

Enterprises – non-financial companies.

Expense ratio – the ratio of operating expenses to earned premiums.

Euro Libor/OIS spread – an indicator that takes account of how banks perceive the credit risk of inter-bank lending.

Financial intermediation – for the purpose of this analysis, financial intermediation means financial flows between entities and not the mediation of financial services.

General government – central and local government bodies.

Herfindahl index – an index representing the sum of the squares of the shares of individual banks' assets in total assets.

Households – the population, i.e. individuals' accounts.

Household disposable income – is calculated as the sum of the components of the gross personal income of all members of a household (gross financial income from employment and closely related income, gross non-financial income from employment, gross financial gains or losses from self-employment [including royalties and fees], unemployment benefits, old-age pension benefits, survivor's pension benefits, sickness benefits, invalidity benefits and contributions for education) plus components of the gross income at the household level (income from rented assets or land, family benefits and contributions paid to families with children, the social exclusion not classified elsewhere, housing benefits, financial transfers regularly received between households, interest, dividends, capital gains from a non-registered business, income of persons younger than 16 years of age less regular property taxes, regular paid financial transfers between households, income tax, and social insurance contributions).

Index of exports to selected countries – an index representing the change in the moving average of exports to the principal export countries; the selected countries' share of Slovak exports has fluctuated at around 80% since the beginning of 2006 (April 2006 = 100).

Interest rate spreads – the difference between lending rates/deposit rates and the respective inter-bank rates.

iTraxx index – an index of credit default swaps.

Liquidity up to 7 days and up to 3 months – the ratio of liquid assets and volatile funds, where liquid assets include cash, the bank's current accounts held with other banks, and all bills and government bonds not pledged as collateral (including those that the bank acquired in reverse repo trades), and all claims against customers and banks with a residual maturity of up to 7 days, or up to 3 months; and volatile funds are the sum of liabilities towards banks and customers maturing within 7 days or 3 months.

Liquidity cushion – the sum of cash, government bonds, Treasury bills and NBS bills, deposits with NBS and current accounts at other banks, after deducting banks' liabilities towards foreign banks (except long-term liabilities) and the Debt and Liquidity Management Agency (ARDAL), and assets pledged as collateral.

Loans at risk (LAR) – an indicator of corporate credit risk, measuring the share of corporate loans provided to enterprises whose financial position has sharply deteriorated. LAR 1 represents the share of corporate loans to total loans provided to enterprises that in the given quarter reported a loss and at

the same time a year-on-year drop in sales of more than 50%. LAR 2 represents the share of corporate loans to total loans provided to enterprises that in the given quarter reported a loss and at the same time a year-on-year drop in sales of more than 30%.

Loan-to-deposit ratio – the ratio of loans to customers and the sum of retail deposits, deposits from enterprises, deposits from financial companies, and issued mortgage bonds. It indicates the extent to which loans are financed with stable funds from customers. The lower the value, the greater the extent to which loans are financed with customer deposits, and therefore the lesser the extent to which they are financed through the more volatile financial markets.

Loan-to-value ratio – the ratio of a loan's amount to the value of the respective collateral.

Long position – a position in which assets are greater than liabilities.

Loss ratio – the percentage ratio of:
- the sum of the claims cost and the change in the gross technical provision for claims, to
- earned premiums, i.e. the gross premium after deducting the change in the gross technical provision for unearned premiums.

Net balance-sheet position – the difference between foreign exchange assets and liabilities in the balance sheet.

Net interest rate spread – the difference between the rate of return on loans (interest income on loans as a share of total loans) and the cost of deposits (interest expenses on deposits as a share of total deposits).

Net off-balance-sheet position – the difference between foreign exchange assets and liabilities in the off-balance sheet.

Net percentage share – used in the evaluation of responses to the Bank Lending Survey; it is calculated by taking the lending of banks that eased lending standards and those that tightened lending standards and finding the difference between the percentage share of each in total lending. The individual responses of banks are weighted by the average amount of loans of the respective type.

Non-bank financial corporations (NBFCs) – other financial companies, financial intermediaries, pension and mutual funds, insurance companies.

Non-performing loans – loans are non-performing when the bank finds that they have lost more than 50% of their value or that the borrower is in arrears with payment.

Open position for up to 3 months – the difference between, on one hand, the sum of claims against customers and debt securities issued by banks and enterprises which have a residual maturity of up to 3 months, and, on the other hand, the sum of liabilities towards customers and issued securities which have a residual maturity of up to 3 months.

Premium – the price agreed in individual insurance contracts regardless of the method of their financial reporting.

Quick liquidity ratio – immediately liquid assets / highly volatile funds.

Retail – households, sole traders and non-profit institutions serving households.

Short position – a position in which liabilities are greater than assets.

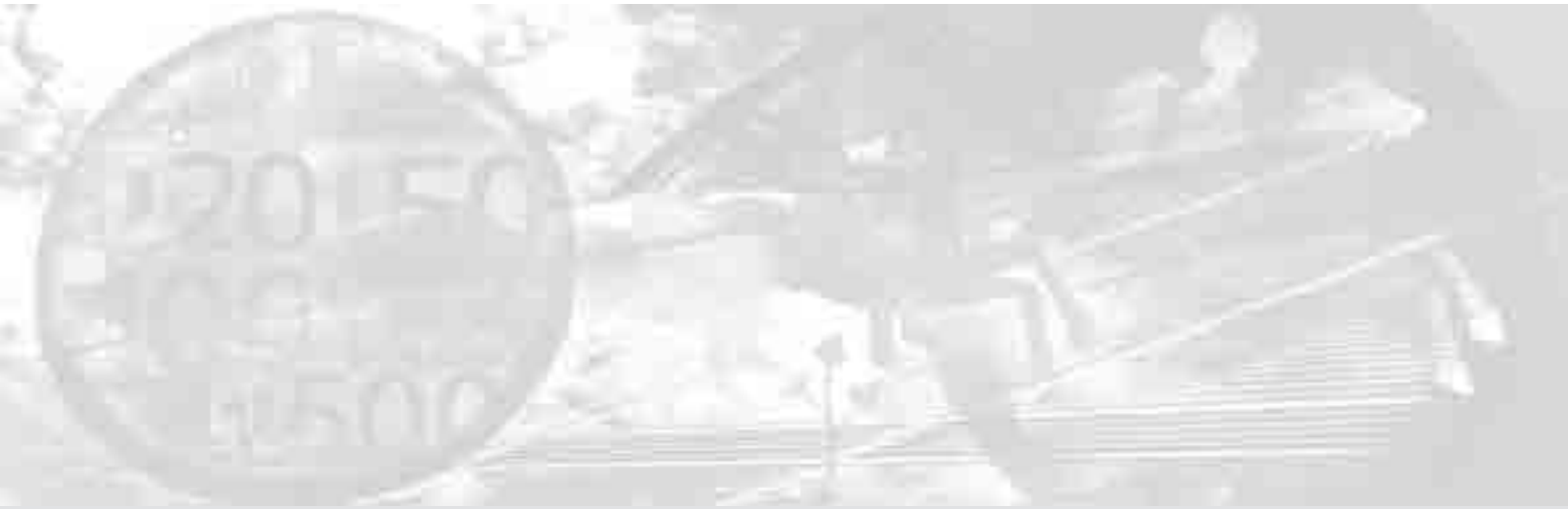
Total net position – the sum of the net balance-sheet position and net off-balance-sheet position.

Unit-linked provision – a technical provision that is created for life insurance linked with an investment fund in insurance branch A4.

VSTOXX – an indicator of implied volatility for the Dow Jones EURO STOXX 50 index, derived from options in this index. The higher the value, the higher the level of volatility.

Abbreviations

AFS	Available for Sale
AMC	asset management company
ASM	available solvency margin
BF	bond mutual funds
b.p.	basic points
BRIBOR	Bratislava Interbank Offered Rate
CDS	Credit Default Swap
CLI	Composite Leading Indicator
CR n	index of the concentration of leading banks
EBRD	European Bank for Reconstruction and Development
EC	Employment Classification
ECB	European Central Bank
EF	equity mutual funds
EIB	European Investment Bank
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FF	funds of funds
FV	fair value
GDP	gross domestic product
HFT	Held for Trading
HHI	Herfindahl index
HTM	Held to Maturity
IBRD	International Bank for Reconstruction and Development
IF	investment firm
IR	interest rate
IRB	Internal Rating Based (approach)
IS	investment service
LAR	loans at risk
LGD	Loss Given Default
MB	mortgage bond
MF	mutual funds
MMF	money market mutual funds
MTPL	motor third-party liability insurance
MXF	mixed mutual fund
NAV	net asset value
NBS	Národná banka Slovenska
OF	other mutual funds
OECD	Organisation for Economic Cooperation and Development
PFMC	pension fund management company
p.p.	percentage points
ROA	return on assets
ROE	return on equity
RSR	required solvency ratio
SPMC	supplementary pension asset management company
SR	Slovak Republic
SO SR	Statistical Office of the Slovak Republic
VaR	Value at Risk



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CHARTS IN BOXES

Box 1

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