

a policy rate cut, the EONIA remained negative with minimal intraday changes. Following the reduction in the deposit facility rate, the EOINIA fell to a historical low of -0.24%. Its declining trend was interrupted by temporary fluctuations at the ends of the reserve maintenance periods and/or at the month-ends and at the year-end.

## 2.2 EURO DEVELOPMENTS

The euro's exchange rate in 2015 was affected by different cyclical developments and by the monetary policy outlooks for major world economies. Early in the year, after the ECB announced the expansion of its asset purchase programme, the euro depreciated considerably against the US dollar, from 1.214 to 1.055 dollars per euro. The euro stabilised in the second quarter, except for occasional volatility related to political developments in Greece as well as to shifts in market expectations for an increase in monetary policy rates in the United States. At the start of the third quarter, the euro appreciated strongly against the dollar, to EUR/USD 1.15, reflecting global risk aversion and uncertainty about developments in China. The exchange rate weakened again towards the year-end, with the world's two largest

Chart 10 EUR/USD exchange rate in 2015



Source: Bloomberg.

central banks – the ECB and the Federal Reserve – expected to follow diverging monetary policy paths. In March 2015 the euro depreciated to a 13-year day-on-day low of EUR/USD 1.045, and by the year-end it was trading at USD 1.089, 10% weaker year-on-year.

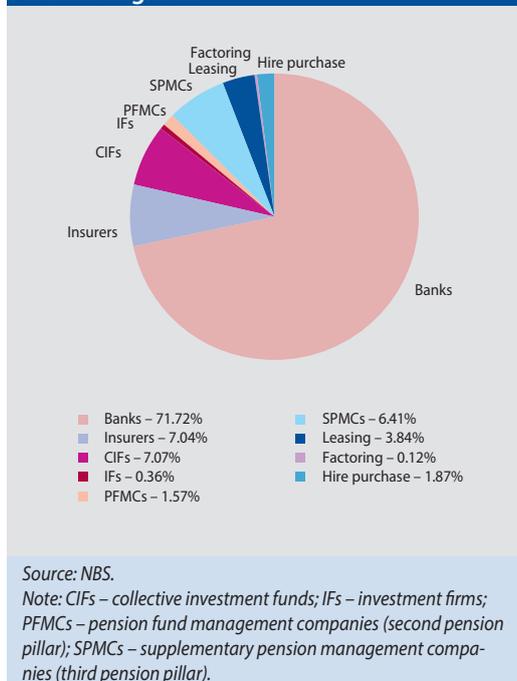
## 3 FINANCIAL MARKET DEVELOPMENTS

Since the situation in the domestic economy is conditioned to a large extent by the external environment, the developments in that environment have a significant bearing on the stability of the Slovak financial sector. Hence the slight pick-up of advanced economies in 2015 can be seen as beneficial for Slovakia, even though it should be noted this trend was driven largely by such factors as the expansion and subsequent extension of the ECB's asset purchase programme (APP), falling oil prices, and depreciation of the euro. The external environment is, however, subject to several risks. Globally, there are continuing downside risks to growth outlooks for emerging market economies (EMEs) in general and China in particular, with these risks being amplified by imbalances accumulated during previous years.

Owing to developments in China and Greece in 2015, global financial markets became increasingly volatile, and this in turn accentuated the risk of a sudden and simultaneous decline in prices of riskier assets (exacerbated by the continuing decline in market liquidity in financial markets). As for the fiscal sphere, a number of EU countries are failing to decrease debt levels despite efforts to consolidate public finances.

The Slovak economy's growth accelerated in 2015, while the composition of its growth underwent a change. Whereas net exports had been the main driver of growth in previous years, domestic demand came to the fore in 2015. In a low inflation environment, growth in employment and real wages had an upward impact

**Chart 11 Financial sector assets as at 31 December 2015 – broken down by market segment**



on household consumption. Economic growth was also supported by investments, which was boosted mainly by the public sector's effort to absorb outstanding EU funds from the finishing programming period. With the economy picking up, the financial position of both households and non-financial corporations improved.

The principal pillar of the Slovak financial sector – the banking sector – is on a sound footing in terms of solvency, profitability and access to funding, and on these measures ranks above average by international standards. The banking sector's aggregate profit for 2015 was €626 million, 12% higher than the profit for 2014. The profit growth was supported by a drop in credit risk costs, an increase in non-interest income and a reduction in the bank levy, from 4% to 2%. There was, however, a decline in the main source of banking profits – interest income – as the downward trend in interest rates continued. This reflected mainly decreases in interest income from non-financial corporations and from securities. The sector's average capital ratio remained largely unchanged, at 17.4%. The leverage ratio was more than 8%, significantly higher than the EU average.

Lending to households maintained solid growth in 2015, and in contrast to the previous year it was accompanied by a gradual increase in lending to non-financial corporations. The outstanding amount of retail loans increased in 2015 by 12.4% year-on-year, and that growth rate was far higher than the EU average. This growth was based mainly on housing loans, which grew by more than 13%. As for consumer loans, their annual growth rate remained strong, but slowed gradually, from more than 20% in March 2015 to 16.2% in December 2015. Demand for credit is being stoked mainly by increasing competition between banks and falling lending rates and margins in respect of new loans. On the other hand, credit standards have been tightened following the implementation of NBS Recommendation 1/2014 on risks related to market developments in retail lending. Falling interest rates are usually accompanied by an increase in refinancing, but in 2015 the share of refinancing loans in new loans dropped to 25%, due mainly to a drop in loan refinancings in which the principal is increased.

The annual growth rate for corporate loans reached 9% in December 2015. The pick-up in lending to non-financial corporations was supported by both demand and supply factors. On the supply side, credit standards were loosened slightly and the downward trend in lending rates continued. Demand for corporate loans, particularly among private firms, was greatly buoyed by favourable macroeconomic dynamics. Further evidence of the improving business climate was provided by the growth in loans to small and medium-sized enterprises and growth in loans for investment purposes.

The amount of the banking sector's securities investments increased slightly in 2015. Across the portfolio, the amount invested in Slovak government bonds remained flat, while a decrease in foreign banks' bonds was offset by an increase in domestic banks' bonds and a marked rise in foreign government securities.

Credit risk remains the most significant risk in the Slovak banking sector. In this context, the decrease in non-performing loan (NPL) ratios can be perceived positively. The NPL ratio for household loans decreased to 3.9%, from 4.3%, in 2014. The decline was not entirely a result of



an increase in lending, but also reflected a decrease in the outstanding amount of NPLs. It was a similar situation in the corporate credit portfolio, with the NPL ratio falling to 7.3%, from 8.6% in the previous year.

Total profits in the insurance sector declined by 20% in 2015, to just under €130 million. This deterioration was caused mainly by declines in both the financial result and technical result in life insurance. The technical result in non-life insurance remained largely unchanged. The principal risk in the insurance sector remains the low interest rate environment. Insurers are still struggling to achieve investment returns guaranteed in life insurance contracts. Insurers face a situation in which the higher-yielding bonds in their portfolios are maturing and can be replaced only with low-yielding investments, with potentially adverse implications going forward.

In the second pillar of the pension system – the old-age pension scheme operated by pension fund management companies (PFMCs) – the aggregate net asset value (NAV) of pension funds decreased in 2015 by just under 2%. The decline was caused by another ‘re-opening’ of the scheme, i.e. a temporary period in which it is permitted to withdraw from what is usually a mandatory scheme. The outflow of funds was substantially counterbalanced by the regular contributions of remaining savers. The distribution stage of the second pillar commenced in 2015, with the payment of the first pensions under scheme. This, however, had only a marginal impact on the NAV. The most notable change in the asset composition of second pillar pension funds was an increase in the equity component of equity pension funds. A combination of heightened uncertainty in global financial markets and the existing asset structure of pension funds resulted in the value of the funds’ pension points becoming more volatile in 2015 than at

any time since 2008. Index funds recorded the highest nominal return in 2015 (7.5% on average), followed by equity funds (2.8%) and mixed funds (2.7%). The average return on bond pension funds was 0.5%.

In the third pillar of the pension system – the supplementary pension scheme operated by supplementary pension management companies (SPMCs) – the NAV of pension funds increased in 2015 by 5% year-on-year. In supplementary pension funds (SPFs) with a balanced investment strategy (constituting the bulk of third pillar funds), the share of debt securities in their aggregate asset portfolio declined in 2015, while the share of equities increased. The opposite development was observed in SPFs with a growth-focused investment strategy, as the bond component of their asset portfolio increased at the expense of equities. Across the third pillar, only SPFs following a conservative investment strategy reported a positive average return in 2015 (0.4%). The worst performing funds were growth SPFs (-2.9%), behind balanced SPFs (-1.7%) and distribution SPFs (-0.2%).

The collective investment sector saw the total value of assets under management increase for a fourth successive year in 2015, by €669 million, which represents annual growth rate of 10.6%. This reflected mainly net sales in the sector, with domestic and foreign investment funds making similar positive contributions. In the case of domestic funds, the inflow was concentrated on mixed funds, while the NAV of bond funds declined. Net sales were also recorded by alternative investment funds and real estate funds. Households were the main source of the inflow to domestic investment funds in 2015. In terms of their average nominal returns, investment funds were less successful in 2015 than in the previous two years. Equity funds had the highest average return (3.7%), while mixed funds performed the most poorly (-1.7%).