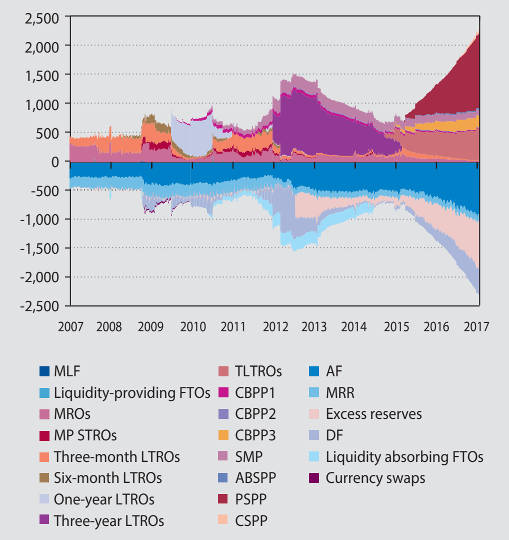
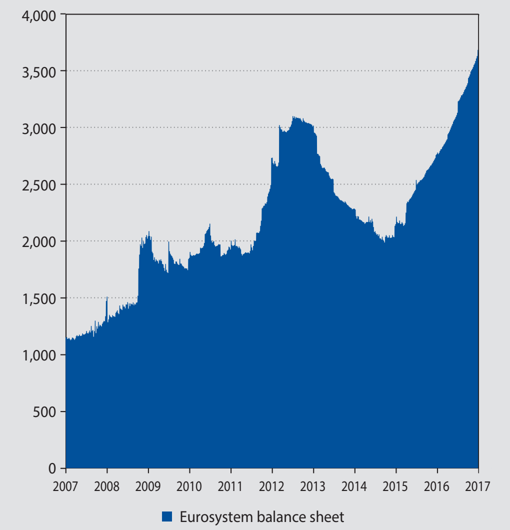
Chart 9 Liquidity position of the Eurosystem (EUR billions)



Sources: ECB, Bloomberg and NBS calculations.
Note: MLF – marginal lending facility; FTO – fine-tuning operation; MRO – main refinancing operation; MP STROs – special-term refinancing operation with a maturity of one maintenance period; LTRO – longer-term refinancing operation; TLTRO - targeted longer-term refinancing operation; CBPP – covered bond purchase programme; SMP – Securities Markets Programme; ABSPP – asset-backed securities purchase programme; PSPP – public sector purchase programme; CSPP – corporate sector purchase programme; AF – autonomous factors; MRR – minimum reserve requirement; DF – deposit facility.

Chart 10 Total assets of the Eurosystem (EUR billions)



Sources: Bloomberg and NBS calculations.

tors has also increased significantly, the largest such factor being government funds held with central banks.

Impact of monetary policy operations on the Eurosystem balance sheet

Since the crisis started in 2007, the ECB has been expanding the Eurosystem balance sheet and started using it to support monetary policy implementation. The balance sheet has been used to perform a variety of monetary policy interventions, with the extension in particular of balance-sheet tools on the asset side. Owing to the implementation of non-standard monetary policy measures, the total assets on the Eurosystem balance sheet increased from €1 trillion in 2007 to a historical high of €3.7 trillion in 2016. Monetary policy instruments increased to 60% of the assets side of the balance sheet at the end of 2016, while the size of the other financial assets remained relatively stable. On the liabilities side, counterparties' surplus reserve holdings increased significantly, by €1 trillion, and represented 35% of total liabilities at the end of 2016.

3 Financial market developments[5]

The euro area economy showed relatively strong resilience in 2016, with quarter-on-quarter GDP growth accelerating moderately in the second half of the year, despite headwinds such as the United Kingdom's vote to leave the EU, banking sector stress, and geopolitical events. Household consumption remained the mainstay of growth. Financial markets experienced bouts of highly elevated volatility and uncertainty, interspersed with periods of relative calm. From autumn 2016, however, the markets experienced a return of optimism grounded on improving macroeconomic conditions, the inflation rate's turnaround from a downward trend, and expectations for growth-friendly policies in the United States. Perceptions of risk related to the banking sector

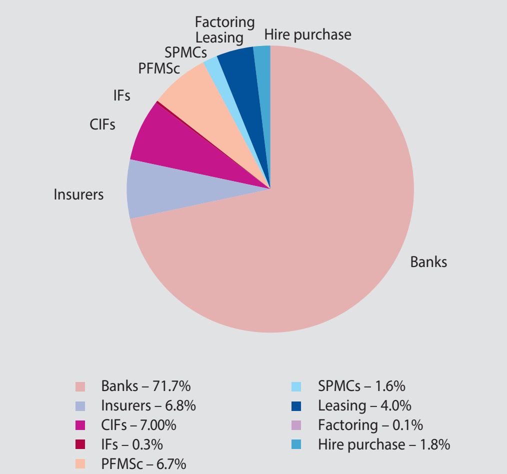
5 *The text on financial market developments in 2016 uses preliminary data as at 31 December 2016, where available. For the insurance sector, the only data available were older, as at 30 September 2016.*

became stronger in 2016. Additional, ongoing risks to financial stability in the euro area include increasing risk aversion in financial markets, concerns about the sustainability of public finances, and the rising importance of the shadow banking sector. Uncertainty about the future situation mounted towards the year-end, in response to the commencement of the new US administration and heightening of political risk.

Favourable labour market developments, together with real wage growth, had a positive impact on household consumption. The domestic economy's upswing supported household and business sentiment, as was evident from the increasing credit demand among both households and firms.

The Slovak banking sector made an aggregate profit of €750 million for 2016, which was 20% higher than its profit for 2015. The sector faced several adverse trends that weighed on its profitability, and the final result was only achieved by virtue of an exceptional one-off factor (a sale of shares in the company VISA Europe). The most significant adverse factor was a further decline in interest income, and that trend is expected to continue in the next period. Hence, in the current low interest rate environment, banks will find it increasingly difficult to maintain adequate profitability. The sector's aggregate total capital ratio increased to 18.0%. On the other hand, the measure of the level of the highest quality capital – the common equity Tier 1 ratio – fell from 16.0% to 15.7%. The leverage ratio fell slightly in 2016, to 8.1%.

Chart 11 Financial sector assets as at 31 December 2016 – broken down by market segment



Source: NBS.
Note: CIFs – collective investment funds; IFs – investment firms; PFMCs – pension fund management companies; SPMCs – supplementary pension management companies. The data for insurance undertakings are as at September 2016, the most recent available.

As regards lending activity, lending to households continued to show significant growth. The stock of retail loans maintained stable year-on-year growth of between 12% and 13%, which was among the highest in the European Union. Demand was stoked mainly by strong inter-bank competition, which was further heightened by the introduction of a statutory cap on early repayment fees for housing loans. Falling interest rates and margins on new loans also contributed substantially to the strengthening of demand for retail loans. In response to these trends, NBS issued Decree No 10/2016 laying down detailed provisions on the assessment of borrowers' ability to repay housing loans, which entered into force on 1 January 2017. This decree implements into law principles contained in NBS Recommendation No 1/2014.

Lending to non-financial corporations (NFCs) was relatively stable during 2016, with the annual growth rate in the stock of NFC loans slowing slightly to 5.3% but still remaining well above the EU average. Demand for loans was supported by robust macroeconomic trends that resulted in significant business expansion, particularly in the private sector. The improving situation in the corporate sector was also evident from the growth in loans to small and medium-sized enterprises and the growth in loans with a maturity of over five years, which are predominantly used for investment purposes. Lending conditions and credit standards eased slightly in 2016, mainly in the first half of the year.

In response to prolonged growth in lending to both the household and NFC sectors, the NBS Bank Board, under a decision issued on 26 July 2016, set a non-zero countercyclical capital buffer (CCB) rate of 0.5% with effect from 1 August 2017.

Banks' investments in securities maintained their downward trend in 2016. The share of domestic government bonds in the banking sector's total assets was the fourth highest in the EU, down from its previous ranking. At the same time, banks' increased their investments in bank bonds and foreign government bonds, although these continued to constitute only a small share of the aggregate securities portfolio.

With credit risk still the most significant risk in the Slovak banking sector, the fall in the non-performing loan (NPL) ratio in 2016 was a favourable development. The NPL ratio for household loans edged down from 3.9% to 3.7%, but whereas the ratio for housing loans fell, the ratio for consumer loans increased. The quality of the aggregate NFC loan book also improved, with the NPL ratio falling from 7.3% at the end of 2015 to 6.5% at the end of 2016, which was significantly lower than the post-crisis average.

Total profits in the insurance sector climbed by 64%, although that growth was largely caused by one-off effects. Adjusting for these effects, the year-on-year profit growth was a more modest 21% and most of that was attributable to a single undertaking. The overall profit of the other undertakings fell by 10%. The sector's profit growth reflected improvements in the technical result of both non-life insurance and life insurance. The insurance sector successfully managed the transition to the Solvency II regime, effective from the beginning of 2016. All insurance undertakings comfortably met the solvency capital requirement and minimum capital requirement. Among the principal risks to the insurance sector were the persisting low interest rate environment and competition for compulsory motor insurance business.

In the second pillar of the pension system, operated by pension fund management companies (PFMCs), the net asset value of pension funds increased in 2016 to an all-time high of €6.94 billion and the number of savers also reach a record level. Looking at the aggregate assets of bond pension funds, the share of securities increased at the expense of bank deposits, and there was also a slight increase in the duration of the securities component. The growth profile of equity pension funds was accentuated in 2016, as the share of equities in their total assets continued to rise. As for the breakdown of pension funds' assets by origin of counterparty, the share of Slovak counterparties decreased, mainly due to a falling share of domestic bank deposits. Index funds recorded the highest average annual nominal return in 2016, at 9%, ahead of equity funds (7.5%), mixed funds (5%) and bond funds (1.8%).

In the third pillar of the pension system, the net asset value of supplementary pension funds (SPFs) – managed by supplementary pension management companies (SPMCs) – increased in 2016 by a historically high 7%, year on year. The composition of SPFs' assets underwent further changes in 2016. Among SPFs with a growth-focused investment strategy, the equity and bond components of their assets increased at the expense of bank deposits. Balanced SPFs also saw the equity share of their assets increase, while conservative and distribution SPFs registered rising shares of bank deposits. The average nominal return on assets in 2016 was 4.7% for growth SPFs, 2.6% for balanced SPFs, 0.8% for conservative SPFs and 0.1% for distribution SPFs.

In the investment fund sector, the net value of assets under management increased more slowly than in previous years, by 3% or €341 million. Domestic investment funds accounted for €189 million of that increase, and foreign investment funds for €152. For domestic funds, 2016 was a weaker year, while for foreign funds it was third most successful since 2007. In contrast to the trend in previous years, the nominal return on assets accounted for most of the increase in net asset value, and net sales for less than half. Fund redemptions by financial institutions had a negative impact on the net asset value of investment funds at the beginning of the year. The main factor thereafter was the inflow of investment from households. Among domestic funds, the two biggest-selling types of fund were real estate funds and mixed funds, while among foreign funds they were equity funds and bond funds. The average annual nominal return on domestic and foreign funds in total was 2.7% in 2016.