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Financial market developments

loan moratoria used by over 120,000 individuals and 5,200 firms

second highest housing loan growth in the EU

the banking sector's profit down by more than **one-quarter**

highest corporate loan growth among CEE EU countries

non-bank financial firms not so far unduly affected by the crisis

Financial market developments

In 2020 the coronavirus crisis did not significantly affect the financial market, but banks nevertheless began preparing for potential loan losses

In 2020 both the Slovak and global economies were seriously weakened by the fallout from the COVID-19 pandemic

In response to the global spread of the coronavirus (COVID-19) pandemic in 2020, necessarily stringent countermeasures were taken across the world. After growing over the previous decade, the global economy recorded its largest contraction in modern history. Governments and central banks were exceptionally swift in their response to the emerging situation and adopted extensive measures to protect their economies and labour markets. In the European Union, the steps taken succeeded in safeguarding millions of jobs. At the same time, however, the pandemic crisis resulted in rising debt levels in the private and public sectors. The world economy has been gradually recovering, but its nascent growth is highly fragile and is coupled with substantial risks. These stem from uncertainty about the pandemic's further progress and about economic developments following the ending of relief measures, from the newly elevated levels of public and private sector debt, and from the diminished capacity of many borrowers to service their bank loans.

A similar story was seen in export-oriented Slovakia, where GDP contracted to its lowest level since 2017. Despite the difficult period, however, household consumption showed resilience, with its rate of decline being among the most moderate in the EU. Although tens of thousands of people lost their jobs, the increase in unemployment was, thanks to relief measures, lower than the increase resulting from the 2008-09 crisis. On the other hand, some firms may find themselves on the verge of insolvency as a result of the crisis, particularly if the lockdown measures continue for an extended period of time. The economy is not expected to return to its pre-crisis level until 2022.

The pandemic crisis tested the banking sector's resilience

The Slovak banking sector's aggregate profit fell, year on year, by more than one-quarter in 2020. The drop was caused mainly by an increase in loan loss provisioning costs, as several banks sought to prepare in good time for a future increase in loan delinquencies. Such action is laudable from a financial stability perspective. For their part, borrowers have been benefiting from the crisis relief measures. More than 120,000 individuals and more than 5,200 firms have so far taken advantage of a pandemic-related loan moratorium, with their loans representing over one-tenth of the total outstanding amount of bank loans. The end of the relief measures may, however, result in an increase in loan delinquencies, as some borrowers may no longer be able to meet their loan repayments. In 2020 banks in Slovakia were also helped by the abolition of the bank levy as from July of that year. Had the levy been retained, the decline in their aggregate profit would probably have been one of the highest among Europe's national banking sectors.

Banks have for some time been under pressure from a prolonged decline in interest rates. They have tried to ease this pressure by stepping up their lending activity and by gradually increasing their operational efficiency, including through staff layoffs and branch closures. The fall in banks' profit margins has not been reflected in their fee income, which as a ratio to total loans and deposits actually declined last year.

On the positive side, domestic banks were well capitalised going into the pandemic crisis. The aggregate total capital ratio of the Slovak banking sector was one-third higher at the start of 2020 than on the eve of the previous crisis in 2008. This situation was due in part to most banks opting not to pay dividends for 2019. Banks are well placed to weather the expected crisis-induced increase in credit risk losses, while remaining stable and managing to maintain lending to the real economy.

Lending has not been notably affected by the pandemic crisis

Total bank loans maintained their pre-crisis growth trend even during the pandemic. As regards loans to households for house purchase, Slovakia recorded the second highest growth in Europe. Demand for these loans was supported by stable, low interest rates and an ongoing uptrend in property prices. In the case of consumer credit, however, its volume was stagnating even before the crisis and it recorded an accelerating downtrend as the cri-

sis wore on. Beside an increase in uncertainty, this decline reflected falling expenditure on consumption and an increase in interest rates. Another factor may have been the gradual tightening of debt service-to-income ratio limits during the first half of 2020, although several banks did not make full use of the permitted exemptions.

In 2020 growth in loans to non-financial corporations remained higher in Slovakia than in any other central and eastern European country. Banks responded to the outbreak of the crisis by tightening lending conditions and credit standards, but then gradually eased them. Demand for loans was also supported by the introduction of public loan guarantee schemes. Despite getting off to a slow and gradual start, government-guaranteed loans ended up accounting for more than half of the total amount of loans provided during the summer months of 2020.

The pandemic crisis affected non-banking segments of the financial market in 2020, but not to a significant extent

Although the crisis did have an impact on the insurance sector in 2020, insurers did not suffer heavy losses. The most notable negative effects of the crisis were declines in demand for life insurance products and in insurers' financial results. On the other hand, the reduction in mobility resulted in fewer claims paid on motor insurance policies. Several crisis-related risks have not yet fully materialised. Going forward, we can expect an increase in risk premia, an increase in surrenders due to the worsened financial situation of households, the downgrading of investment-grade ratings, and a rise in loss ratios in credit insurance and travel agency insurance.

Pension funds and investment funds suffered heavy losses at the outset of the pandemic crisis, but they had largely, or in some cases completely, recouped those losses by the end of 2020. What is positive from a financial stability perspective is that investors in domestic funds did not panic in response to financial market fluctuations and moved hardly any of their money out of the sector. The losses reported for the early part of 2020 were of a temporary nature, and subsequent months saw a rapid reduction in losses amid the recovery of financial markets.