Slovakia

By Matej Bašták, Slovenská sporiteľňa

IN A NUTSHELL

- → GDP grew by 1.7%, while inflation peaked at 12.1%.
- → Real estate prices showed mild correction after exceptional growth.
- → Mortgage rates went up from 1% to 4% in just 1.5 year.
- → Asset quality remains solid despite economic turbulences.
- → Loan-to-deposit ratio of the sector above 100% is successfully mitigated by covered bonds.

MACROECONOMIC OVERVIEW

Household consumption remained strong supported by pandemic period excess savings. However, high inflation gradually started to affect real expenditures of households negatively, as potential of savings was seemingly fully utilized in the second half of 2022. In addition, investment activity in the private sector was dampened due to elevated uncertainty, weakening demand and rising costs. As a result, real GDP growth reached 1.7% in 2022.

The labour market remained in a good shape with the average unemployment rate falling to 6.1% in 2022, the lowest since the outbreak of the pandemic. Nominal wage growth also remained robust at almost 8% with even swifter growth expected in the coming year.

The pandemic and subsequent energy crisis resulting from the political crisis in the Ukraine were two external shocks taking inflation to 12.1%. Food together with energy and building materials prices, drove inflation up. In addition, inflationary pressures from energy spilled over into prices of a broad portfolio of other goods and services. Energy prices for households were capped at rather favourable levels with only slight increase.

The public debt ratio, consistently well below the Euro area average, declined due to the high inflation below the Maastricht limit of 60% to 58%.

Household indebtedness continued to increase, although only slightly. The growth of retail loans has been gradually slowing while nominal GDP increased at high single digit pace. The ratio of retail loans to GDP reached 46% for 2022, around 0.5 pps above the previous year but well above peer CEE countries. Stabilization or even some decline is expected in the coming quarters.

HOUSING MARKET

Slovakia has the second highest homeownership rate in Europe (behind Romania) with 91.7% of the population owning houses, exceeding by far the EU average of around 70%.

In the Bratislava region, which has the country's most expensive housing, residential property prices rose by 11.7% to EUR 3,342 per m2, after rising by 21.2% a year earlier. In the last quarter it declined by 3%. On an annual basis, prices in other regions increased at an even higher pace in 2022 despite significant deceleration in the second half:

- The most extreme growth was in Trnava region with 26% y-o-y inflation (to 1,938 per m2)
- Four regions (Presov, Banska Bystrica, Kosice, and Trencin) experienced growth above 20%
- Prices in the two remaining regions (Nitra and Zilina) went up by 16% and 13%, respectively

Price changes over the year were driven almost purely by the increasing interest rates on mortgages. Prices surged on the back of enormous demand caused by swift adjustment of mortgage rates to expected ECB hikes as clients wanted to fix their instalments at still favourable levels. Since the supply did not match the demand, prices grew rapidly. The quarterly changes in some regions reached double-digits in Q1 and Q2 2022 and annualised increases as of June 2022 ranged from 20% to almost 40% in the fastest growing region (in Presov).

The number of new building permits and housing starts as well as completions declined y-o-y. Housing starts fell by 16% compared to the peak of 2021, below the 5-year average. A similar drop was seen also in new permits, suggesting lagging supply in the years to come. The number of completions has been decreasing for three years already but decreased more slowly with just a single-digit drop.

To some extent this is due to the time-consuming and bureaucratic process of obtaining a building permit reducing the flexibility of developers to react to demand swings, to some extent it is due to developers being more cautious, anticipating a demand decline.

As a result, affordability of housing fell substantially after years of favourable conditions. Financing is now much more costly as interest rates on new mortgages went up significantly and real estate prices soared in the recent years. High inflation started to weigh on household budgets as real wages declined by more than 4% in 2022. The situation should improve relatively soon as growth of nominal wages sped up, real estate prices showed certain correction and ECB's tightening will probably not continue in 2024.

MORTGAGE MARKET

Although the annual growth in mortgages outstanding decelerated in 2022, it still increased by 10% over the year. The volume of new mortgages increased rapidly amid increasing rates and a pre-loading effect. Naturally, as mortgage rates reached the higher levels, demand fell significantly. For illustration, volume of new mortgages granted was two thirds lower in December than in March.

Higher rates also caused lower refinancing activity. The market was well-known for popularity of both internal (renegotiation within a bank) and external (between two banks) refinancing. It makes less and less sense to do so with higher interest rates now.

After years of gradual declines, average interest rate on new mortgages rose abruptly: the average went from just below 1% in December 2021 to more than

3.5% in December 2022. The increase has continued in 2023 as well. While Slovaks enjoyed the third lowest rates in the Eurozone in 2021, they were near the middle of the ranking at the end of 2022.
The market has been dominated by relatively short interest rate fixed periods (3 to 5 years) for several years which usually made up approximately 90% of the new production. The share of longer fixings (above 5 years) increased, due to anticipated rates hikes, to almost one fifth of new production in 2021 and to 40% in the first months of 2022. Once the situation calmed, the market returned to usual setting with the vast majority of new mortgages with a fixed period of 3 to 5 years. Variable rate mortgages are virtually non-existent.

The average maturity of new mortgage contracts was around 26 years. More than a half of new housing loans (volume wise) in 2022 were provided with the maximum possible maturity of 30 years and around 16% chose a maturity of 20 years or less. The trend of stretching the maturity has been present already for several years.

The volume of NPLs declined further in 2022, although only slightly. Nevertheless, combined with the continuous growth of total lending, the NPL ratio fell from around 1.2% in 2021 to less than 1.1% in 2022. The asset quality deterioration has not materialized in 2023 despite the worsening economic situation.
A prominent feature of the Slovak mortgage market is a high share of new loans intermediated through financial advisors. In 2022, around 65% of total lending volume was via such external sales network. The share was similar to the value seen a year ago. The National Bank of Slovakia (NBS) considers intermediated loans as somewhat riskier and sees intermediaries as too aggressive, pushing clients to the maximum level of indebtedness allowed.

Due to the NBS's limits on maximum LTV, the average LTV ratio has stabilized in recent years at around 70% with a slightly declining trend. The share of new loans that can have an LTV ratio between 80% and 90% is set to 20% of new production and new loans with an LTV greater than 90% are not allowed. Other measures to fight increases in household indebtedness, which are currently in place, are limits on DTI and DSTI. The former was set at 8 times in mid-2018. The latter is defined as a minimum reserve which must be left aside out of monthly net income after deduction of debt repayments and minimum living costs. The reserve has to be at least 40% since mid-2020.

LOOKING AHEAD

The situation in the first half of 2023 was diametrically different compared to the previous years. Demand for mortgages was subdued, refinancing dried up and price competition does not dominate the market anymore. It is generally expected that the demand should pick up in coming quarters once interest rates stabilize or even start to decline and real estate prices recover.

MORTGAGE FUNDING

Deposits are, for banks, one main source and for the building societies, the only source of funding for their mortgage market activities. Short-term deposits and current accounts had offered a stable, low-cost source of funding for the banks and building societies for a long time. Retail deposits had virtually 0% interest rates for large commercial banks in 2022. The pandemic and subsequent economic revival as well as the political conflict in the Ukraine brought certain disruption to this. While the saving rate went up noticeably during the lockdowns, it fell to very low levels afterwards as household consumption caught up. In addition, uncertainty regarding the geopolitical situation seemingly caused a reduction of retail deposits as clients felt the need to hold cash. As a result, the annual growth of retail deposits in the banking sector came to a halt as of year-end and the loan-to-deposit ratio temporarily reached 110% in Q3.

Such high loan-to-deposit ratio is still seen as acceptable since banks can fund their lending by issuing covered bonds. Covered bonds are an attractive funding tool for Slovak banks as they are typically cheaper than senior unsecured bonds, as they are asset-backed, highly rated (triple A or slightly lower, depending on the actual over-collateralisation), therefore are perceived as lower risk by investors. TLTRO funding was successfully used by the largest banks, mostly due to positive effect on profitability rather than as a necessary source of funding. The stance was confirmed as they already repaid part of the facility after conditions changed and most probably will do so with the remaining outstanding volume at an accelerated pace.

lower, depending on the actual over-collateralisation), therefore are perceived as lower risk by investors. An updated covered bond law was introduced in January 2018 since when banks issued more than EUR 8 bn of the new covered bonds. In addition, EUR 1 bn of retained covered bonds were issued in 2020-2021 which were directly used as collateral in TLTRO transactions. TLTRO was utilised by four largest Slovak banks for a total amount of around EUR 11 bn as of year-end 2021.

	SLOVAKIA 2021	SLOVAKIA 2022	EU 27 2022
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	4.9	1.7	3.5
Unemployment Rate (LSF), annual average (%) (1)	6.8	6.1	6.2
HICP inflation (%) (1)	2.8	12.1	9.2
HOUSING MARKET			
Owner occupation rate (%) (1)	92.9	93.0	69.1
Gross Fixed Investment in Housing (annual change)(1)	3.4	4.1	1.5
Building Permits (2015=100) (2)	129.9	108.8	125.8
House Price Index – country (2015=100) (2)	175.5	212.9	164.6*
House Price Index – capital (2015=100) (2)	166.9	198.2	163.8*
Nominal house price growth (%) (2)	23.7	21.3	10.6*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	37,677	41,602	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	8,502	9,450	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	62.2	59.7	71.5
Gross residential lending, annual growth (%) (2)	32.3	-14.6	-6.5
Typical mortgage rate, annual average (%) (2)	1.0	1.9	3.1

* Please note that this value is the simple average of the available values in 2022.

Sources:
(1) Eurostat
(2) European Mortgage Federation – Hypostat 2023, Statistical Tables.

SLOVAKIA FACT TABLE

Which entities can issue mortgage loans in your country?	Housing finance is raised from banks, building societies and State funds with only minimum volume provided.
What is the market share of new mortgage issuances between these entities?	Majority of new mortgages is issued by commercial banks (over 95%), followed by building societies (~3-4%) and state funds contributed with just marginal volumes.
Which entities hold what proportion of outstanding mortgage loans in your country?	Banks had a market share of 94%, building societies of 6% and the state funds just 0.1%.
What is the typical LTV ratio on residential mortgage loans in your country?	In 2022, the average LTV for newly provided mortgages was about 70%. Maximum LTV ratio of 90% is possible although only up to 20% of all newly provided mortgage can have an LTV between 80% and 90%. However, the share of mortgages with LTV between 80% and 90% is just 10% of the total new production.
How is the distinction made between loans for residential and non-residential purposes in your country?	NBS regulations define the purpose and eligible cover (i.e. residential property – flat, house, apartment house or land designed for housing construction) for residential loans. Non-residential loans cannot be included in the cover pools of the covered bonds.
What is/are the most common mortgage product(s) in your country?	Most mortgage loans taken out are loans with rates fixed for period of 3 or 5 years. First half of 2022 was specific due to increasing rates (clients wanted to have low rates guaranteed for longer periods) as popularity of rates fixation of 10+ years increased significantly. As soon as the rates started to stabilize, clients returned to the usual fixations of 3 to 5 years.
What is the typical/ average maturity for a mortgage in your country?	Average maturity of a new mortgage loan was about 26 years in 2022. Mortgage loans can have maturity of at least 4 years and maximum of 30 years. There are certain exceptions (e.g. for some Building societies' products the maximum maturity can be extended to 40 years) to these rules but these are applied only to a fraction of volumes provided.
What is/are the most common ways to fund mortgage lending in your country?	For banks, deposits are one main source and for the building societies the only source of funding for their mortgage market activities. Banks also fund their lending activities through issuance of covered bonds.
What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?	Relatively low. Legal, notarial and registration costs are in the order of hundreds to thousands of euro (depending on property value and specifics of the transaction). No special taxes are payable. Real estate agents' fees are typically 3% - 6%.
What is the level (if any) of government subsidies for house purchases in your country?	Subsidies are provided in two main forms: • Mortgage loan for young – tax break on 50% of interest costs, up to EUR 400 per annum, eligibility limited by income and age of debtor; • State Housing Development Fund - providing loans with lower interest rates. But the volume of state loans is low and conditions apply.