Slovakia
Euro-related stabiliser effect protects households' finances from the crisis

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- The accumulation of household financial assets continued last year, driven by dynamic personal income growth and increasing employment. Rising penetration on the asset side was accompanied by even faster expansion in the level of household indebtedness, backed by the strong appetite of households for both consumption and real-estate investments. As a result, the net financial wealth of households remained stable at 36 % of GDP.
- The global financial crises have only had a minor impact on the Slovak economy so far. Some marginal impacts have, however, been noted in the performance of mutual and pension funds, while fundamental growth still remains lively.
- Despite some downside risks, the impact of the ongoing global crisis on Slovakian households is anticipated to have remained limited on the whole. However, some slowdown in the accumulation of both assets and liabilities might have materialised in the last quarters of 2008, with net financial wealth relative to GDP expected to have decreased marginally this year before stabilising around 34 % by 2010

Table 1: **Household Financial Indicators** (S. 14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	51 %	53 %	51 %	53 %	55 %
Financial Liabilities (% of GDP)	15 %	17 %	18 %	19 %	21 %
Net Wealth (% of GDP)	36 %	36 %	33 %	33 %	34 %
Corrected Net Wealth (% of GDP)	43 %	43 %	41 %	42 %	42 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomics & Market Analysis Dpt.

Spurred on by favourable macroeconomic conditions, the accumulation of household financial assets remained fairly strong last year, rising by a nominal 16 % yoy, in excess of economic growth, to reach 53 % of GDP. The fast expansion of investments into mutual funds and the introduction of the 2nd pension pillar made an important contribution to growth. Growth in assets was accompanied by an even faster increase in household indebtedness, which rose by almost 29 % yoy reaching 17 % of GDP at the end of 2007 (from just above 8.0 % in 2003). As a result, net financial wealth dropped slightly reaching 35.5 % of GDP in 2007.

The ongoing crises affecting the global financial markets only had a limited impact on the accumulation of household financial assets in H1 2008. However, both mutual and pension funds recorded a significant slowdown in growth, with sell-offs from investment funds starting to emerge in October. In terms of lending the dynamic growth continued in H1 too – despite the moderate increase in interest rates. Looking forward, further deceleration in the pace of lending growth should be mainly supply driven. However, some cooling on the demand side is also likely, especially in relation to housing loans, backed by the slower growth in house prices that is forecast following the rally observed in 2007 and H1 2008 in the run-up to euro adoption. Growth in the residential real estate market will remain relatively sound, although some signs of overheating are emerging, especially in specific segments such as buy-to-let properties in and around the capital city.

We still believe the global financial crises may only have a limited impact on the domestic real economy. However, risks are increasing as the global crises deepen and are prolonged (mainly in Eurozone countries). A potential slowdown in the real economy could thus lead to weaker growth in both household assets and liabilities too, bringing some stabilisation to the accumulation of net financial wealth to around 34 % of GDP by 2010.

In terms of asset allocation, Slovak households remain fairly conservative in their approach to investments, with the majority of their assets still kept in low-risk forms of savings – mainly currency and bank deposits. The sudden slump of the currency in 2008 is reflecting the announced adoption of the euro at the beginning of next year. People are putting their money into banks to ease the conversion process, thus stimulating growth in bank deposits (up by 14 % in the first 9 months). The growing trend toward bank deposits will also benefit from mounting risk aversion following the ongoing crisis on the global financial markets. Nonetheless, some of the new euro-driven deposits could melt into currency again in 2009.

Table 2: **Financial Wealth**

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Currency	4,217	14.6 %	8.0 %	–15.1 %	12.7 %	8.9 %
Bank deposit retail	12,654	43.7 %	14.6 %	13.8 %	11.1 %	8.8 %
LC currency	11,537	39.8 %	16.5 %	15.0 %	17.9 %	8.7 %
FX currency	1,117	3.9 %	–1.8 %	1.9 %	–67.5 %	12.0 %
Housing savings	1,694	5.8 %	3.6 %	1.0 %	1.3 %	1.5 %
Securities other than shares	–	–	–	–	–	–
Listed shares	–	–	–	–	–	–
Mutual funds	4,748	16.4 %	21.1 %	–8.6 %	5.0 %	11.4 %
Open-end	4,722	16.3 %	21.3 %	–8.6 %	5.2 %	11.8 %
Close-end	27	0.1 %	–3.7 %	–5.1 %	–35.3 %	–
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	3,374	11.6 %	9.2 %	13.1 %	9.7 %	9.7 %
Life insurance	2,516	8.7 %	12.0 %	13.8 %	9.1 %	8.9 %
Non-life insurance	857	3.0 %	1.7 %	11.1 %	11.7 %	12.0 %
Pension funds' assets	2,280	7.9 %	55.0 %	45.7 %	26.0 %	30.3 %
Total	**28,968**	**–**	**15.6 %**	**7.6 %**	**11.3 %**	**11.5 %**

Source: NBS, Association of Asset Management companies, Ministry of Labour, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomics & Market Analysis Dpt.

The deepening of the crises resulted in a sell-off of mutual fund shares, especially from August, following positive net flows recorded in the first part of the year. Looking ahead, the speed investments into open-end funds recover will very much depend on the revival in the financial markets, with livelier growth still expected for money and bond funds, whose share in total net assets will continue to grow (60 % as of September 2008).

Accumulation into pension fund assets has been the main driver for the observed increase in household financial assets over recent years, with participation in the 2nd pillar largely exceeding initial expectations.

Moreover, despite the option given by the new government for all participants to exit the scheme in an effort to reduce the overall burden on public finances, the outflows recorded were not significant. As a result, the assets accumulated in pension funds have been rising steadily. Despite the uncertainty dominating the capital markets we see space for continual growth in pension fund assets in the coming years too, even taking the planned re-opening of the 2nd pillar this year into account.

In the years to come there is scope for a gradual recovery in the growth of household financial assets. Household financial assets should thus record average annual growth of about 11 %, reaching 55 % of GDP by 2010. The growth will be driven mainly by pension funds, still benefiting from the pension system reform. Some recovery is also expected in open-end funds provided that developments in global financial markets stabilise and confidence is restored.

Following the credit boom experienced in recent years, household indebtedness continued to rise in H1 2008. Economic growth remained lively and Slovak households have yet to feel the uncer-

Table 3: **Financial Liabilities**

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Housing loans	4,312	46.0 %	22.9 %	14.0 %	8.8 %	8.9 %
Consumer loans	2,000	21.3 %	23.6 %	12.8 %	9.5 %	4.2 %
Consumer loans of other MFIs	1,253	13.4 %	15.8 %	17.1 %	9.6 %	1.7 %
Consumer loans of OFIs	747	8.0 %	39.4 %	5.6 %	9.4 %	9.0 %
Overdraft	403	4.3 %	11.1 %	16.0 %	16.9 %	16.6 %
Other loans	2,324	24.8 %	52.3 %	38.3 %	21.4 %	27.5 %
Revolving credit cards	137	1.5 %	38.0 %	28.3 %	20.3 %	18.3 %
Financial leasing	205	2.2 %	10.9 %	12.0 %	10.4 %	9.4 %
Total	**9,380**	**–**	**28.5 %**	**20.0 %**	**13.1 %**	**14.2 %**

Source: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt.

tainty stemming from the global financial crises. The strong demand for improvement in living standards has continued to support growth in mortgages and other housing loans. Significant growth was also recorded in consumer financing. As a result, bank loans to the household sector went up by 13 % in H1 and further accelerated through October posting an increase of 22 % compared to the end of 2007.

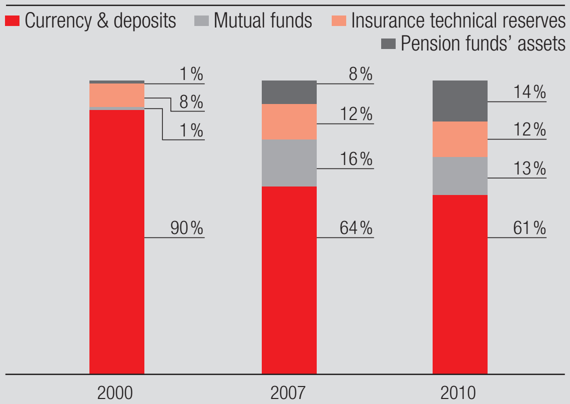
Despite the continued high growth in household indebtedness, the retail loan portfolios of banks remain relatively healthy. The share of non-performing loans increased only slightly, reaching 3.9 % as of September 2008 from 3.4 % in 2007.

Looking ahead, some deceleration is anticipated in the pace of growth in household loans. The real estate market is starting to show initial signs of cooling. Uncertainty and rising interest rates are decreasing demand for housing. Furthermore, banks are starting to be more prudent, e.g. in some regions they do not allow 100 % of real estate to be financed by loans. The demand for housing could recover modestly this year again, supported by the further relaxation of monetary conditions expected in the Eurozone.

House prices recorded dynamic growth at the end of 2007 and the beginning of 2008, also driven by euro speculation. Prices in the capital city went up by 30 % yoy, while in the regions growth was even higher – in some (Zilina, Nitra, Kosice and Banska Bystrica) it exceeded 50 % yoy. In Q3, the residential real estate market started to cool down. Demand decreased dramatically, hence prices corrected themselves – prices fell 1.4 % qoq in Bratislava. However, the correction of prices has only taken place in some of the regions so far (Trencin, Kosice and Banska Bystrica).

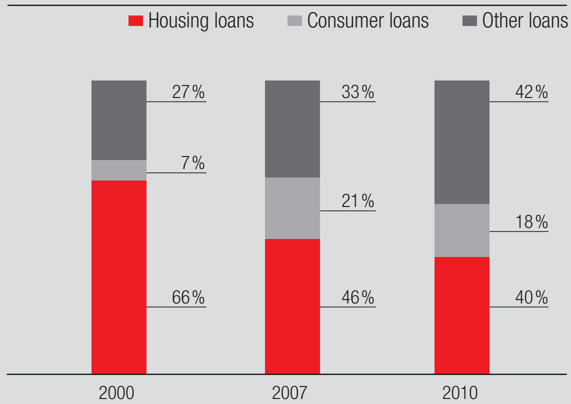
Overall, household financial liabilities are expected to reach around 21 % (relative to GDP) by 2010, recording average annual growth of around 14 % in the next two years. Mortgage as well as consumer loans will remain the key drivers. However, strong growth is also expected in the short-term financing of households, i.e. credit cards. Leasing (still dominated mainly by car leasing) and loans provided by consumer financing companies are expected to suffer the most in the coming years due to strong competition and the more flexible products offered by banks.

Household Financial Assets (% of total)*



*) Currency and deposits include savings kept in construction and savings banks
Sources: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt

Household Financial Liabilities (% of total)*



*) Other loans include overdrafts, other loans granted by banks, revolving credit cards and financial leasing
Sources: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt