Slovakia

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IN A NUTSHELL

→ GDP expanded by 3%, as inflation increased noticeably by end year 2021.
→ Generally favourable conditions for mortgages drove annual growth to almost 13%.
→ Exceptional growth of real estate prices across all regions.
→ Interest rates on new mortgages continued to decline.
→ Changes in ECB's monetary policy will break long-term trends in 2022.

MACROECONOMIC OVERVIEW

The economy experienced periods of both expansion and contraction mainly due to the pandemic. Both the first and the last quarter were affected by restrictions the disrupted global supply chains effected the economy during the second half of the year. Nevertheless, household consumption remained strong, driving the average GDP growth in 2021 to 3.0%.

Inflation, as elsewhere, became the main economic topic in Slovakia. Imbalances in the global demand revival, rapidly rising energy prices and change in consumer preferences from services to goods due to lockdowns caused prices (measured by HICP) to grow by 5.1% year-on-year at year end 2021. A further acceleration to double-digits is expected in 2022. Average inflation in 2021 was 2.8%. The most significant increases were in food, fuel, and construction materials prices while base effects, namely the decrease of regulated energy prices decrease in 2020 and the cancellation of subsidies for schoolchildren, also played a role.

Despite this the labour market remained resilient, partly due to significant government support. The average unemployment rate increased only slightly to 6.8% while nominal wages grew at 6.8%.

The public debt ratio, consistently well below the Euro area average, rose further as a result of pandemic-related spending and exceeded the Maastricht limit of 60% by 3 pps. Although the return below this limit is not expected until 2024, the ratio should not deteriorate in the coming two years.

Household indebtedness continued to increase as the growth of retail loans returned to high levels. The ratio of retail loans to GDP reached 47% for 2021, 1.5 pps above the previous year and well above peer CEE countries.

HOUSING MARKET

Slovakia has the second highest homeownership rate in Europe (behind Romania) with 92.3% 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 sharply by 21.2% to EUR 2,993 per m2 in 2021, after rising 15.8% a year earlier. Prices in other regions were catching up with even faster growth.

- The most extreme growth was in Presov region with almost 40% y-o-y inflation (to 1,715 per m^2).
- Three regions (Zilina, Kosice, and Banska Bystrica) had growth of around 35%.
- Prices in the three remaining regions located in the western part of Slovakia (Trnava, Trencin, Nitra) went up by 30%.

There were several factors, on both the supply and demand side, which contributed to these increases. Supply remained subdued due to increasing construction material prices, shortage of labour due to outbursts of COVID-19 infections, and lengthy approval process for new real estate projects. Although the number of newly started real estate projects increased by 26% y-o-y, the number of finished projects declined by 4% y-o-y.

Demand for mortgages did not weaken despite the economic uncertainty. Real estate is considered as a safe haven by Slovaks and the legal introduction of working from home schemes created a need for larger dwellings. The divergence of prices from fundamental economic indicators therefore grew wider and risks of a sudden correction was the highest since the real estate bubble of 2008.

Continued cheap mortgage availability also facilitated booming real estate prices. In addition, expectations of near term ECB rate hikes, and thus higher mortgage rates, forced many clients to accept higher prices in order to get favourable mortgage funding. This frontloading effect became even more prominent in early 2022.

MORTGAGE MARKET

The annual growth in mortgages outstanding accelerated to 13%. Although the pandemic seemingly affected the market only slightly, later developments proved that growth would have been noticeably faster otherwise. Growing real estate prices, still solid demand for flats and houses, together with a fairly robust labour market kept Slovakia among the top 5 fastest growing mortgage markets in the EU.

Due to continuing low interest rates and an expectation of upcoming increases refinancings remained a prominent feature of the local market. In 2021, as much as 29% of new loans were changes in contractual terms, with lower interest rates being by far the most common change. Similarly, high activity was seen in the number of clients switching banks for lower rates as breakage costs are low due to highly pro-client local laws.

The gradual decline of average interest rates on new mortgages continued, as it fell by 14 bps, from 1.12% to just below 1%. The main drivers were the ECB's extremely loose monetary policy and a high level of competition, mainly from smaller banks competing for market share. The market position of the largest banks deteriorated somewhat in 2021 while the challengers gained significantly.

The market has been dominated by relatively short interest rate fixed periods (3 to 5 years) for several years as rates fell. However, the share of longer fixings (above 5 years) increased in 2021 to almost one fifth of new production due to anticipated ECB rates hikes. For comparison, it was just 3% a year before. The development continued in the first months of 2022 when the share rose above 40% as of April. Variable rate mortgages are virtually non-existent.

The average maturity of new mortgage contracts was around 25 years. Approximately half of new housing loans (volume wise) in 2021 were provided with the maximum possible maturity of 30 years and less than 17% chose a maturity of 20 years or less.

The volume of non-performing loans declined further in 2021. Consequently, combined with the rapid growth of total lending, the NPL ratio fell from around 1.4% in 2020 to just 1.2% in 2021. After the statutory moratoria ended, the scenario was better than expected, asset quality deterioration did not materialise. The prominent feature of the Slovak mortgage market is a high share of new loans intermediated through financial advisors. In 2021, around 65% of total lending volume was via such external sales network. 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 Loan-to-Value (LTV), the average LTV ratio has stabilised in recent years at around 72%. 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 Debt-to-income ratio (DTI) and Debt service-to-income ratio (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 market situation has been changing significantly in the first half of 2022. Long term trends of declining interest rates, brisk annual growth in outstanding housing loans and high rates of refinancing – both within a bank and between banks – are expected to change in 2022. In the first months of 2022, signs of forthcoming tightening of ECB's monetary policy already caused an increase in the total volume of newly provided mortgages and a shift to longer fixed rates. Such development will probably not last long as it is generally expected that annual growth will slow to more moderate, mid-single-digit rate and the interest rates will stabilise around 2 to 3 pps above the level of 2021.

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 continue to offer a stable, low-cost source of funding for the banks and building societies. Retail deposits bear virtually 0% interest rates for large commercial banks. Despite this retail deposits had grown at around 7% y-o-y. As spending was catching up after the pandemic-related restrictions were lifted, growth slowed to just 4% in 2021, driving loan-to-deposit ratio of the banking sector above 104% as of December 2021.

Banks also 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. 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 2020	SLOVAKIA 2021	EU 27 2021
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-4.4	3.0	5.4
Unemployment Rate (LSF), annual average (%) (1)	6.7	6.8	7.0
HICP inflation (%) (1)	2.0	2.8	3.0
HOUSING MARKET			
Owner occupation rate (%) (1)	92.3	92.3	70.0
Gross Fixed Investment in Housing (annual change)(1)	9.7	3.4	6.6
Building Permits (2015=100) (2)	108.0	129.9	134.0
House Price Index – country (2015=100) (2)	142.1	175.8	145.2*
House Price Index – capital (2015=100) (2)	137.8	168.6	146.1*
Nominal house price growth (%) (2)	11.9	23.7	10.3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	33,787	37,677	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	7,613	8,502	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	56.9	62.2	62.8*
Gross residential lending, annual growth (%) (2)	15.5	32.3	12.2
Typical mortgage rate, annual average (%) (2)	1.1	1.0	2.0

* Please note that this value is the simple average of the available values in 2021.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2022, 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.
What is the market share of new mortgage issuances between these entities?	The majority of new mortgages is issued by commercial banks (around 95%), followed by building societies (with less than 5%). 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 societes of 6% and the state funds just 0.1%.
What is the typical LTV ratio on residential mortgage loans in your country?	In 2021, the average LTV for newly provided mortgages was slightly below 72%. Maximum LTV ratio of 90% is possible (up to 20% of all newly provided mortgage can have an LTV between 80% and 90%).
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 in 2021 were loans with rates fixed for period of 3 or 5 years, although the share of longer fixations has risen in 2022 due to increasing interest rates.
What is the typical/ average maturity for a mortgage in your country?	Average maturity of a new mortgage loan was about 25 years in 2021. Mortgage loans can have maturity of at least 4 years and maximum of 30 years, with certain exceptions where a loan with maturity of up to 40 years are possible.
What is/are the most common ways to fund mortgage lending in your country?	Deposits are for the banks 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. The legal reform from a couple of years ago covered made bonds even more attractive funding tool for banks.
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; • State Housing Development Fund - providing loans with lower interest rates (conditions apply).