1 MONITORING THE IMPACT OF THE MACROPRUDENTIAL INSTRUMENT GLTDF

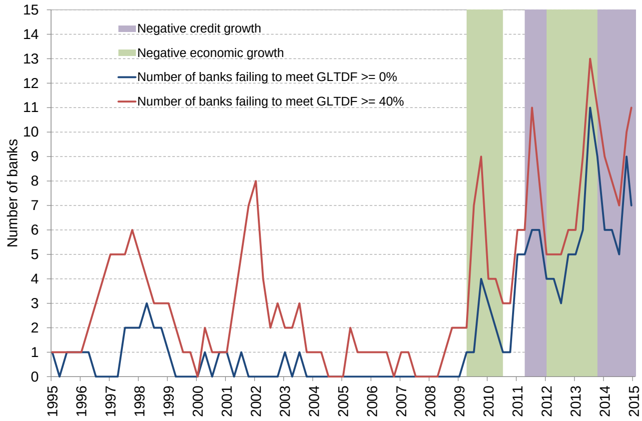
In June 2014 Bank of Slovenia introduced a macroprudential instrument GLTDF within the intermidiate objective of mitigating and preventing systemic risk from excessive maturity mismatch and illiquidity. GLTDF is the ratio of the annual change in the gross stock of loans to the non-banking sector before impairments (gross loans to the non-banking sector) to the annual change in the stock of deposits by the non-banking sector. The instrument gives a bank the choice of either meeting the GLTDF requirements, or increasing liquidity buffers.

For banks with a positive annual inflow of deposits by the non-banking sector, meeting the minimum requirements would entail them not reducing lending. The minimum requirements set the floor for the pace of the decline in the LTD ratio for the non-banking sector. The bank must apply corrective measures should it fail to meet the minimum requirements for GLTDF. The first corrective measure defines stricter requirements for GLTDFq at the quarterly level, i.e. for banks with a positive quarterly increase in deposits the expectation is that the quarterly increase in loans to the non-banking sector will reach at least 40% of the increase in deposits by the non-banking sector, i.e. GLTDFq >= 40%. In this manner the first corrective measure directs the bank towards meeting the minimum requirements for GLTDF. The three remaining corrective measures relate to higher requirements with regard to liquidity ratios, and directs the bank towards meeting the second-bucket liquidity ratio (KL2).[1] All the corrective measures cease to apply when the bank meets the minimum requirements for GLTDF. The banks first had to comply with the requirements of the regulation at the end of June 2014.

1.1.1 Meeting of minimum requirements in 2014

Six banks failed to meet the minimum requirements at the end of June, five banks at the end of September, and nine banks at the end of December. Although the number of banks with a positive increase in loans was up at the end of 2014, as a result of a positive increase in deposits the number of banks that failed to meet the minimum requirements for GLTDF also increased. By the end of March 2015 the number of banks failing to meet the minimum requirements had fallen from nine to five. Four banks had to meet corrective measures of higher liquidity ratios in the first quarter of 2015. Because one of these banks began meeting the minimum requirements for GLTDF at the end of the first quarter, and is also recording positive growth in loans in the wake of a positive annual increase in deposits, all the corrective measures ceased to apply to it.

Figure 1.1: Number of banks failing to meet GLTDF >= 0% or GLTDF >= 40% in the wake of a positive annual increase in deposits



Source: Bank of Slovenia

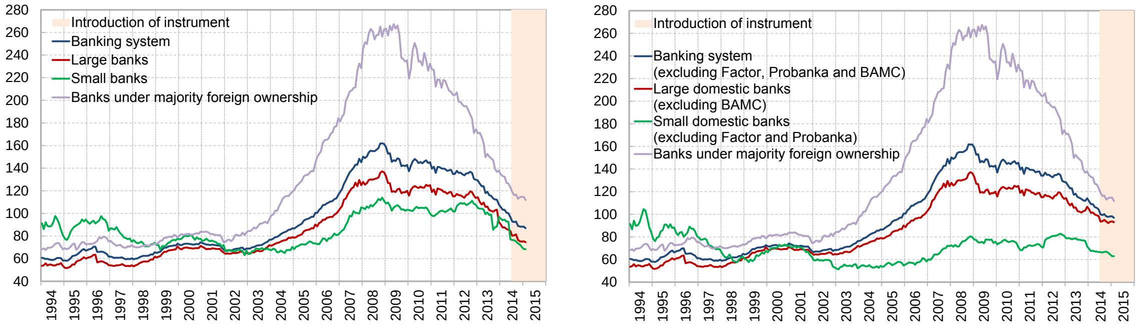
First objective: to slow the decline in the LTD ratio

The decline in the LTD ratio has slowed. The decline in the loan-to-deposit (LTD) ratio for the non-banking sector has slowed since the introduction of the instrument, having

[1] The latter is the ratio of financial assets to financial liabilities with a residual maturity up to 180 days, and must reach a value of at least 1 under the fourth corrective measure.

fluctuated around 88% over the fourth months to January, before falling to 87% in February. The banking system's LTD ratio declined by 19.7 percentage points in 2014, which was 90% of the decline in 2013. The LTD ratio declined by 5.3 percentage points over the six months to February 2015, 44% of the decline over the same period a year earlier. The decline in the LTD ratio slowed most at the banks under majority foreign ownership.

Figure 1.2: LTD ratio of banking system and bank groups (left) and excluding effects of recovery, i.e. excluding Factor banka and Probanka, and excluding the transfer of non-performing claims to the BAMC (right)



Source: Bank of Slovenia

Excluding the effects of bank recovery, the LTD ratio has stabilised. The recovery of the banking system (the transfer of non-performing claims from Abanka and Banka Celje to the BAMC and the orderly wind-down process at Factor banka and Probanka) again had a significant impact on developments in the LTD ratio in 2014. The exclusion of these effects reveals that the decline in the LTD ratio stopped entirely or slowed considerably after the introduction of the instrument, both at the level of the banking system and at individual bank groups.

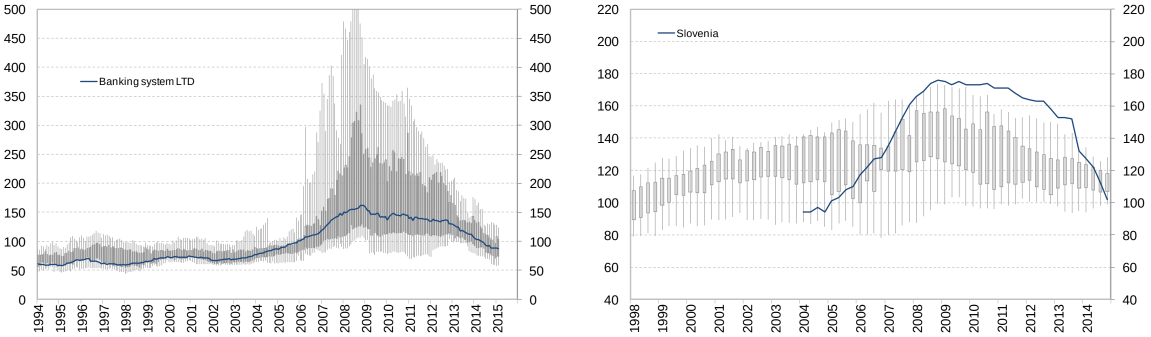
Table 1.1: Level and decline of LTD ratio of banking system and bank groups, basic indicator and excluding effects of recovery, i.e. excluding Factor banka and Probanka, and excluding the transfer of non-performing claims to the BAMC

	Banking system		Large domestic banks		Small domestic banks		
	LTD	LTD ratio excluding Factor, Probanka and BAMC	LTD	LTD ratio excluding BAMC	LTD	LTD ratio excluding Factor, Probanka and BAMC	Banks under majority foreign ownership
1997	60,3	59,9	54,2	54,2	74,9	68,8	71,9
2004	86,9	86,6	79,0	79,0	70,4	54,5	119,2
2008	161,5	161,7	136,3	136,3	111,0	79,6	262,7
2012	129,8	128,7	113,6	113,6	107,7	81,2	174,4
2013	107,9	114,2	92,4	106,7	97,0	71,6	137,9
2014	88,2	98,3	75,0	93,4	70,4	64,5	114,8
febr. 2015	87,0	96,9	74,6	93,0	68,3	63,0	111,8
	Difference in percentage points						
2004-1997	26,5	26,8	24,8	24,8	-4,5	-14,3	47,2
2008-2004	74,6	75,1	57,3	57,3	40,6	25,1	143,5
2014-2008	-73,2	-63,5	-61,3	-43,0	-40,6	-15,1	-147,9
2013-2012	-21,9	-14,6	-21,2	-6,9	-10,7	-9,5	-36,5
2014-2013	-19,7	-15,9	-17,3	-13,3	-26,7	-7,1	-23,1
The percentage of the reduction compared to the same period of the previous year	90,2%	109,4%	81,8%	192,3%	249,4%	74,6%	63,2%
V zadnjem letu							
feb.14-feb.13	-23,1	-16,4	-22,6	-8,9	-10,2	-11,3	-38,3
feb.15-feb.14	-16,3	-12,1	-13,0	-8,3	-25,7	-4,4	-21,2
The percentage of the reduction compared to the same period of the previous year	70,3%	73,9%	57,7%	93,5%	251,2%	39,3%	55,5%
V zadnje pol leta							
feb.14-avg.13	-12,3	-5,6	-14,7	-1,0	-5,0	-10,2	-15,7
feb.15-avg.14	-5,3	-2,4	-6,0	-1,0	-8,0	-3,2	-4,3
The percentage of the reduction compared to the same period of the previous year	43,5%	44,0%	41,0%	96,2%	159,0%	31,4%	27,4%

Source: Bank of Slovenia

The distribution of the banks has narrowed. The differences between the banks in terms of the LTD ratio have diminished significantly, which has been reflected in a narrower distribution of banks, which has approached that of the pre-crisis period. The banking system's LTD ratio had also become low compared with other euro area countries.

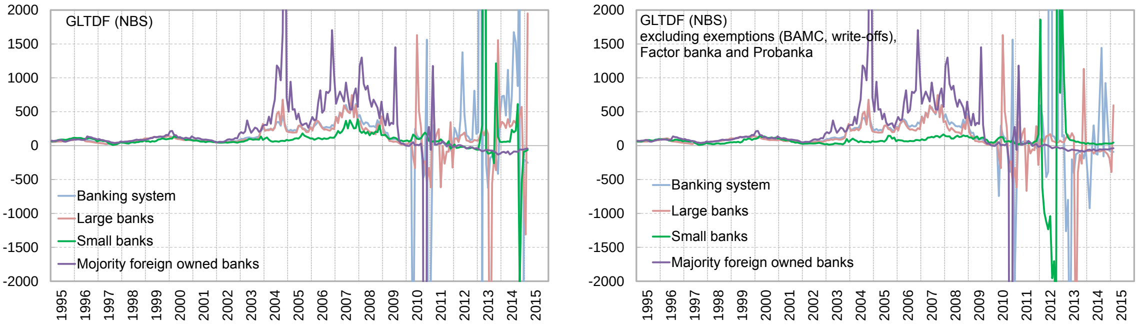
Figure 1.3: Distribution of LTD ratio of individual banks (left) and comparison of LTD ratio (loans before impairment excluding government sector) with distribution across other euro area countries (right) in terms of 20th/33rd/66th/80th percentile



Source: Bank of Slovenia

GLTDF is becoming more stable at the small domestic banks and the banks under majority foreign ownership. GLTDF is also showing signs of stabilisation. It is most pronounced at the banks under majority foreign ownership, where the trend has reversed. The indicator remains volatile at the small domestic banks and large domestic banks, although part of the volatility is attributable to measures related to bank recovery. At the small domestic banks excluding Factor banka and Probanka and excluding the exemptions related to the transfer of non-performing claims to the BAMC and write-offs, GLTDF has been increasing since August 2014. It reached 40% in February 2015. The indicator remains volatile at the large domestic banks, even excluding the exemptions.

Figure 1.4: GLTDF of banking system and bank groups (left) and excluding Factor banka and Probanka and exemptions related to the transfer of non-performing claims to the BAMC (right)



Source: Bank of Slovenia

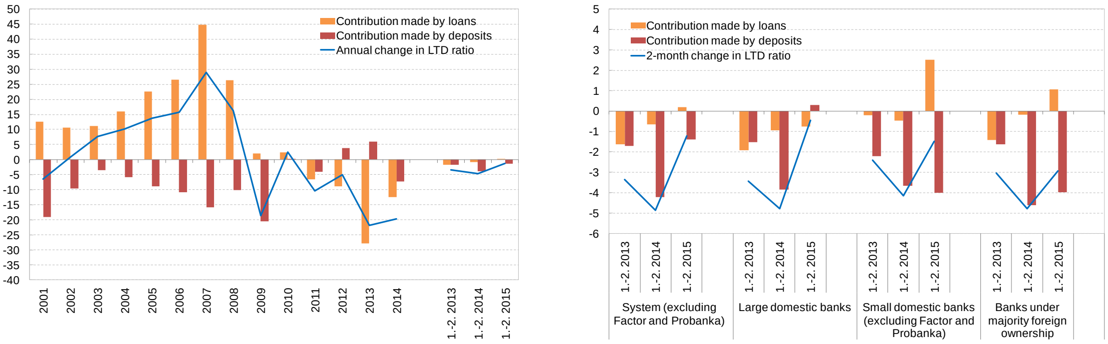
Sustainability of current level of LTD ratio and GLTDF

The purpose of the instrument was not to prevent a decline in the LTD ratio, but primarily to slow the pace of the decline. A declining LTD ratio contributes to the stability of bank performance, if it is indicative of reduced dependency on wholesale funding and a higher proportion of stable funding such as deposits by the non-banking sector, in particular household deposits. The decline in the LTD ratio should therefore be based on an increase in deposits, and not on a contraction in lending.

With the re-establishment of a functioning financial intermediation process, the contribution to the change in the LTD ratio made by loans has become positive, and the contribution made by deposits has become negative as the stock increases. After 2012 and 2013, when the banks lost deposits and reduced lending to the non-banking sector, the stock of deposits began increasing in 2014, although loans were still declining sharply as a result of the additional transfers to the BAMC. The contribution made by loans also began to increase over the first two months of 2015.

The contribution made by loans to development in the LTD ratio has become sharply positive at the small domestic banks, followed by the banks under majority foreign ownership. The small domestic banks and savings banks are recording significantly higher growth in loans to the non-banking sector than the other bank groups. At the large domestic banks a functioning financial intermediation process has not yet been re-established: this bank group has seen a decline in the stock of non-banking sector deposits and loans in early 2015.

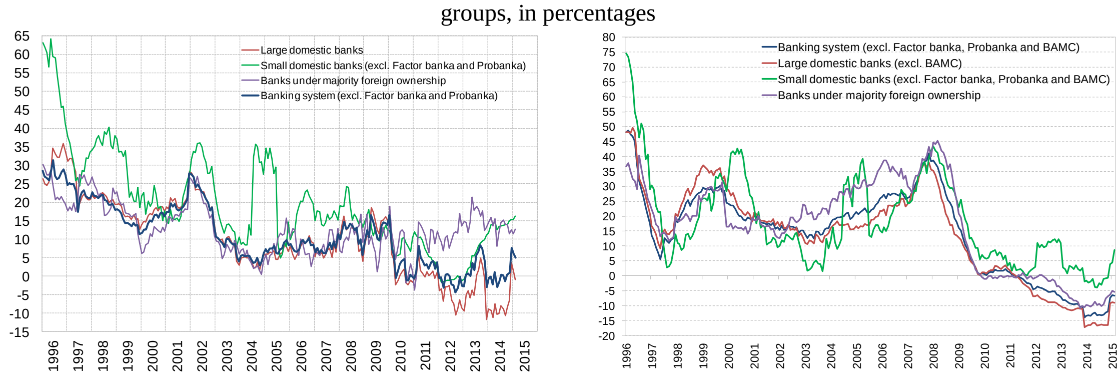
Figure 1.5: Annual changes in the LTD ratio (left) and changes in the first two months of the year (right) and contribution of individual components of loans to or deposits by the non-banking sector to the change in the LTD ratio for the banking system and the bank groups, in percentage points



Source: Bank of Slovenia

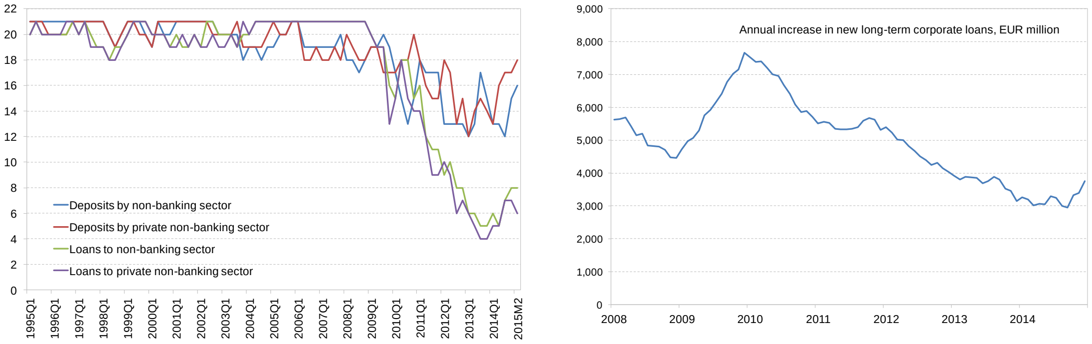
A reversal in the trends in bank performance is evident, which is reducing the need for the additional tightening of the minimum requirements for GLTDF. The number of banks with a positive increase in deposits by the non-banking sector rose in late 2014 and early 2015, as did the number of banks with a positive increase in loans. In addition to the contributions made by the components to developments in the LTD ratio, which are normalising, higher growth in loans and deposits, an increase in new long-term corporate loans and housing loans, according to surveys credit demand is also increasing, which is being confirmed by increased inflows of corporate funding from the rest of the world and from capital markets. The banks have begun to reduce their lending rates more sharply. These factors suggest that the business conditions of the banking system are improving, for which reason the additional tightening of the minimum requirements for GLTDF is not necessary, and the maintenance of the existing requirements is giving support to the current developments in the LTD ratio.

Figure 1.6: Deposits by the non-banking sector (left) and loans to the non-banking sector (right), year-on-year growth rates for the banking system and bank groups, in percentages



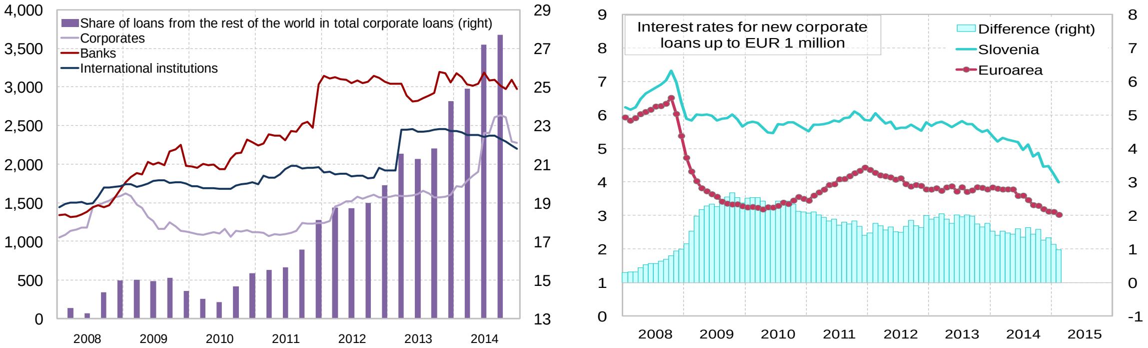
Source: Bank of Slovenia

Figure 1.7: Number of banks with a positive annual increase in loans to or deposits by the non-banking sector and loans to and deposits by the private non-banking sector (left) and annual increase in new long-term corporate loans (right)



Source: Bank of Slovenia

Figure 1.8: Corporate loans from the rest of the world in EUR million (left) and interest rates for new corporate loans (right)



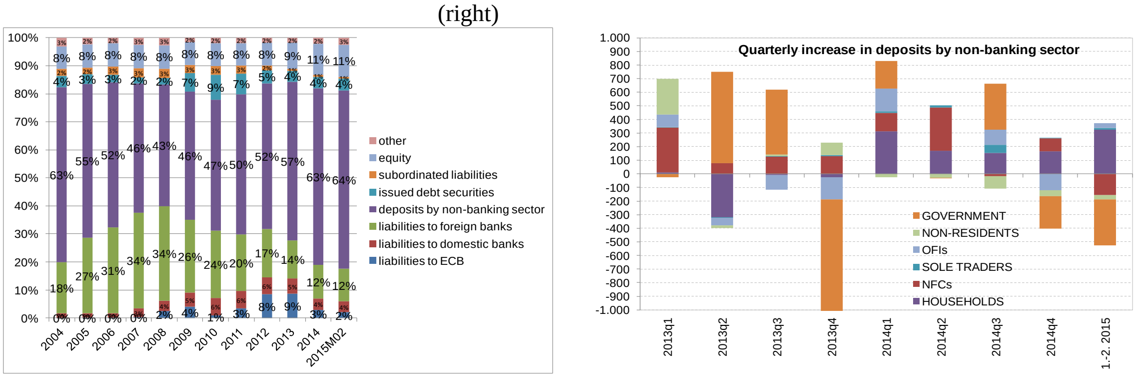
Source: Bank of Slovenia

Second objective: stabilisation of funding structure

The funding structure has not yet stabilised. During the period of financial crisis from 2008, the funding structure became very unstable. The proportion of total liabilities accounted for by deposits by the non-banking sector across the banking system increased by 20 percentage points over six years, while the proportion accounted for by wholesale liabilities declined by slightly more over the same period, 22 percentage points. Within deposits by the non-banking sector, which account for almost two-thirds of the banking system's total liabilities, the proportion accounted for by sight deposits, which account for half of all deposits by the non-banking sector, increased sharply.

It is however notable that the funding structure is moving in the direction of greater stability. In terms of the proportions of deposits and wholesale funding, the structure of the liability side of the balance sheet became comparable to the structure of the banking system's funding in 2004, i.e. at the time that Slovenia was just joining the EU, and the accumulation of the systemic risks of excessive credit growth and leverage was yet to take place. Compared with 2004, the banking system has a higher ratio of equity to total liabilities and a more diversified structure of wholesale funding (liabilities to domestic and foreign banks and to the ECB). The proportion of deposits by the non-banking sector accounted for by long-term deposits is double the figure during the pre-crisis period. The overall outflows of government deposits in the recent period have reflected the banks' diminishing dependence on government deposits. At the same time the quarterly increase in household deposits stabilised at around EUR 150 million in 2014, while the increase strengthened further to exceed EUR 300 million over the first two months of 2015.

Figure 1.9: Percentage breakdown of the banking system's liabilities (left) and breakdown of quarterly increase in deposits by sector in EUR million (right)

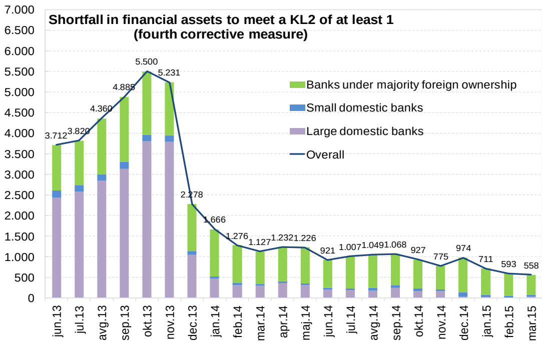


Source: Bank of Slovenia

Third objective Reduction in systemic funding liquidity risk (KL2[2])

The banks sharply reduced the shortfall in financial assets to meet the KL2. The KL2 improved throughout 2014 and early 2015. At the time of the definition of the instrument (October 2013), the shortfall in financial assets for all banks (excluding Factor banka and Probanka) to meet the second-bucket liquidity ratio (KL2) amounted to EUR 5.5 billion. After the restructuring measures in late 2013, the shortfall in liquid investments narrowed to EUR 2.3 billion. The banks were first notified of the introduction of the GLTDF in early December 2013, and by the time of the introduction of the instrument in June 2014 had reduced the shortfall in liquid investments to meet the KL2 by a further EUR 1.4 billion to EUR 921 million. The shortfall in liquid investments to meet the KL2 had further declined by just under EUR 400 million to EUR 560 million by March 2015.

Figure 1.10: Shortfall in liquid investments for each bank to meet the KL2 (fourth corrective measure) by bank group, EUR million

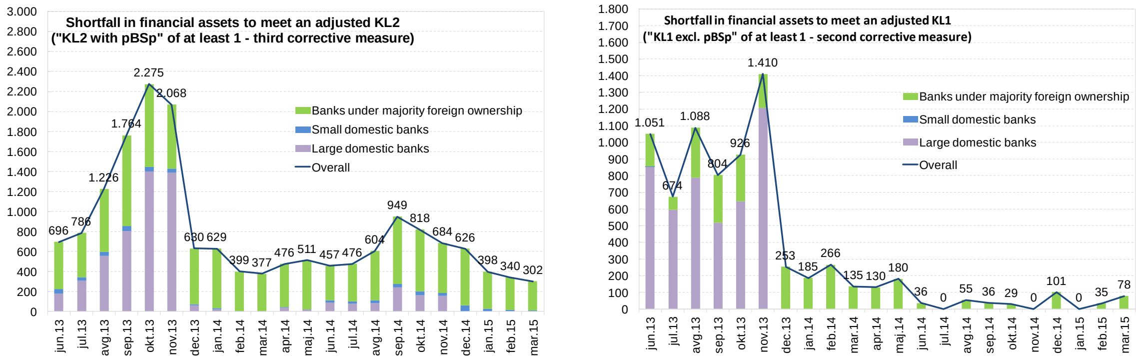


Source: Bank of Slovenia

The shortfall in liquid investments to meet the third corrective measure (adjusted KL2) declined to EUR 300 million, while the shortfall to meet the second corrective measure (adjusted KL1) is fluctuating around EUR 100 million. On account of the 3-year LTRO, the residual maturity of which fell below 180 days, in September 2014 the shortfall in liquid investments for all the banks to meet the second-bucket liquidity ratio taking account of the pledged amount of the pool of eligible collateral at the Bank of Slovenia (the adjusted KL2) within the framework of the third corrective measure increased to EUR 950 million. However, by making early repayments of the LTRO the banks had reduced the shortfall in liquid assets to meet the adjusted KL2 to the previous level by the end of the year, and had halved it to EUR 300 million by March 2015.

[2] KL2 is the ratio of financial assets to financial liabilities with a residual maturity up to 180 days, and must reach a value of at least 1 under the fourth corrective measure

Figure 1.11: Shortfall in liquid investments to meet the third corrective measure, the adjusted KL2 (left) and the second corrective measure, the adjusted KL1 (right) by bank group, EUR million



Source: Bank of Slovenia

1.1.2 Amendment of regulation

On the basis of an evaluation of the instrument's objectives realisation, it is assessed that it is important that the instrument remain in force in the future, while additional tightening of the minimum requirements for GLTDF is not necessary. The instrument is achieving the objectives set. The LTD ratio and funding structure are stabilising. At the same time the banks have sharply increased liquidity buffers (the second-bucket liquidity ratio), while the inflow of alternative financing has strengthened at corporates, which is reducing the systemic funding liquidity risk. A trend reversal is evident in the banks' lending activity, although credit growth remains negative at the level of the banking system.

Under the original version of the instrument, stricter minimum requirements for GLTDF would apply as of the second quarter of 2015, i.e. GLTDF >=40%, which means that banks would meet the minimum requirements if their annual increase in loans to the non-banking sector amounted to at least 40% of the increase in deposits by the non-banking sector. However, the Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks (hereinafter: the regulation) was amended at the end of April, and thus the minimum requirements have not been tightened and remain at their previous level. The condition remains that banks with a positive increase in deposits have to meet higher liquidity ratios if they do reduce lending.

The amendment to the regulation was adopted for the purpose of ensuring that stricter minimum requirements for GLTDF would not limit the effectiveness of the ECB's non-standard measures, and ensuring that interference between the instruments of the two institutions would not pressure banks into taking up excessive risks. Credit growth remains negative, but the trend is reversing. The maintenance of the previous level of the minimum requirements for GLTDF makes it easier for banks to meet them, reduces the need to maintain high liquidity ratios, and gives the opportunity to develop a more competitive offer on the deposit side. The circumstances in which the banks are doing business have altered significantly. As a result of the ECB's non-standard measures, liquidity could be accessible at a favourable price, and after the recovery of the banking system the banks have high capital adequacy and excess liquidity, while the economic recovery is improving creditworthiness and credit demand. Should the economic recovery and the credit cycle prove to be stable, it is likely that it will soon be necessary to set the cap for the GLTDF. Some banks are already recording high growth in loans, which is an additional reason for the minimum requirements for GLTDF not to be tightened.