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## RATING OF THE SLOVAK BANKING SECTOR

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**Abstract:** The article deals with the rating appreciation of the banking sector in Slovakia. It discusses the rating assignments beginnings for the Slovak banking. It is associated with the year 1994 when the first valuation was assigned by two major rating agencies, namely Standard & Poor's Rating and Investment Information. The article brings individual assessments based on positive and negative aspects that influenced them. The next section deals with the contribution of the further development of the rating to the present. It brings evaluations of the three top global agencies for each year that is generally reviewed in tabular and pictorial form with the appropriate commentary. The conclusion is devoted to the current situation in the banking segment in Slovakia with estimates of future development in this field.

**Keywords:** Rating, banking sector, rating agency, positive outlook, stable outlook

### INTRODUCTION

Rating means, as it is stated in [4], "an independent assessment of the entity's ability and willingness to meet its future obligations." Objective factors belong to the ability and subjective ones to the willingness. It is basically a standard product of capital and financial market bearing the information on the risk profile of the entity. It should be noted that rating also represents the risk to which potential partners enter through the performance of their all operations. The credit rating assessment thus objectifies and classifies risks. Risk related to the subject, emission, transaction or project is included in the allocated rating level via harmonized rating scale. Rating agencies therefore provide mutually comparable valuation. Minimal differences can arise only on the basis of "local rating." Harmonization is accordingly subject to the "requirements of the EU framework directives and national legislation"[2].

### BEGINNINGS OF THE SLOVAK BANKING SECTOR RATING ASSESSMENT

Rating classification is used worldwide for almost a century. The origins of the Slovak banking segment rating are dated to 1994, one year after the establishment of the Slovak Republic, when as a sovereign state received ratings from the two leading rating agencies.

Agency Standard & Poor's S&P (1941 is the year of the company establishment, namely by the merger of Standard Statistics Company and Poor's Publishing Company with a focus on services in the finance domain - it is largely devoted to the rating evaluation, economic surveys, the S&P's indexes creation and it is a significant provider of independent investment information worldwide) assigned to the Slovakia rating BB-. It corresponds to a speculative investment with the difficult development forecast to the future. Its appreciation relied on

» low gross debt ratio,

» stable foreign exchange reserves increase of the National Bank of Slovakia and the overall banking sector,  
» declining inflation,  
» milder gross domestic product downturn in comparison with the expected trend in development.

On the contrary, negatively were perceived in particular the following weaknesses:

» short existence of the newly created State,  
» unstable political environment,  
» deterioration of the current account balance,  
» poor investment inflows from abroad,  
» insufficient statistics.

Japanese agency Rating and Investment Information R&I (the agency was named Japan Bond Research Institute JBRI before the establishment of Rating and Investment Information) gave to Slovakia in mid 1994 initial rating at the investment grade BBB. This fact made Slovakia available to the capital market of Japan. Factors classified as positives of the mentioned evaluation were:

» low rate of foreign debt,  
» cheap labor,  
» convenient location from geographical point of view according to the European Union area (significant both for export as well as foreign investments).

For the negative were considered the following characteristics by which the Slovak Republic was defined:

» instability of the political system,  
» low level of foreign reserves,  
» dependence in the context of electricity production,  
» situation of the heavy and just as the armaments industry.

**FURTHER DEVELOPMENT OF THE EVALUATION OF BANKING SECTOR IN SLOVAKIA BY GLOBAL CREDIT RATING AGENCIES**

The positive direction of the economy development, compliance with the set targets in the fiscal policy questions and the uniform euro currency adoption plan were by [7] rewarded in 2005 by the rise of the rating. It can be seen in "Table 1" which provides an overview of the ratings assigned by three major rating agencies as their name [5].

**Table 1.** The rating levels assigned in the years 1995-2005 with the addition of each rating agency outlook

Year	Moody's	S&P	Fitch Ratings
1995	Baa3	BB+stable	x
1996	Baa3	BBB-stable	BBB-
1997	Baa3	BBB-stable	BBB-
1998	Ba1	BBB-negative	BB+
1999	Ba1stable	BB+stable	BB+
2000	Ba1positive	BB+positive	BB+stable
2001	Baa3stable	BBB-positive	BB+positive
2002	A3stable	BBBpositive	BBB-positive
2003	A3stable	BBBpositive	BBBpositive
2004	A3positive	BBB+positive	BBB+positive
2005	A2stable	Astable	Astable

Source: own adaptation from [1]

Assessing the whole period of the previous year 2005<sup>1</sup> pursuant given ratings by individual agencies is obvious that this year was a breakthrough. Slovakia was videlicet ranked among the countries having positive and healthy economic background. The ratings scaled up on the degree of investment nature. For all three agencies belonging to the most important players on the market in a sector, it was a so-called stable outlook and a strong ability to fulfill the obligations.

The phase 2006-2008 can be considered, based on [8], as a total expansion in the economy. There was a slowdown in inflation rate, employment growth, increasing the investment volume and improvement of other macroeconomic indicators. Last but not least, the year 2009 should be mentioned. An important step was realized - not only in the banking field itself, but also the entire economy. It was transition to the euro. Ratings summary after the 2005 provides "Table 2".

**Table 2.** Ratings for the period 2006-2013 with a view of the agencies

Year	Moody's	S&P	Fitch Ratings
2006	A1stable	Astable	Astable
2007	x	x	Apositive
2008	A1positive	Apositive	A+stable
2009	A1stable	A+stable	A+stable
2010	x	A+stable	A+stable
2011	A1stable	A+positive	A+stable
2012	A2negative	Astable	A+stable
2013	A2stable	Astable	A+stable

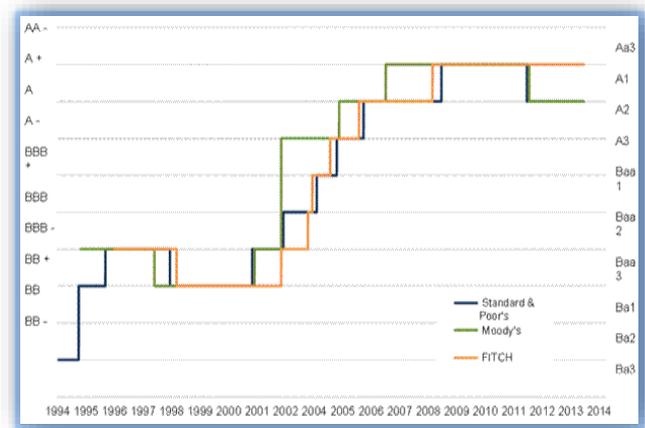
Source: own adaptation from [1]

All above referred aspects ensured to the Slovakia the retention of a rating assessment degree the so called safe investment with a positive or stable outlook. Although the change towards rating increasing was not registered, on the other hand, there were no adverse trends either. To the factors suppressing the impacts of the financial crisis on the banking sector may be ranked these points:

- » entrance to the euro area,
- » growth of the population savings deposition (primary related to the previous statement),
- » active government policy in terms of adopting the package of resolute anti-crisis measures.

The year 2012 brought with it certain transformations in the functioning of the Slovak financial sector. A several changes in laws, in accordance with [3], came into force. Among the most fundamental ones may be included a decision to enlarge contributions into the state bank stabilization fund what in a large extent helped out to escalate banking sector prosperity.

"Figure 1" presents a transparent summary of the rating assigned by globally reputable agencies through graphical representation for each year from the reporting start to the present. As can be seen, the credit rating has an upward trend in assessing the entire observation period. The figure shows for better comparison both kinds of rating scales which are the most commonly used and standardized. Individual agencies evaluations are color coded for better clarity.



**Figure 1.** Rating classification progress of Slovakia. Source: [1]

**THE CURRENT SITUATION IN THE BANKING SEGMENT IN SLOVAKIA**

Recent Moody's statements [6] discuss the perspective change from negative to stable towards the Slovak banking system. This reflects the current macroeconomic environment improvement which limits the risk of a decline in asset quality and profitability. Actual Agency report explains the stable outlook by combining mentioned risk reducing in relation to adverse trend, along with "healthy" capital reserves in the system, stable funding and adequate liquidity.

Press release by Moody's renders a view that the operating environment of Slovak banks will strengthen after the economic

<sup>1</sup> It means time interval since the Slovak Republic was established in 1993, respectively since first rating assignment was given in 1994, till the year 2005.

*growth projection in the broader recovery in the euro area. A key driver of economic growth in Slovakia will be export. This argument is justified by more intensive demand from the Slovak strategic trading partners' side in Europe. Despite high unemployment agency expects growth in domestic demand under the influence of existing support public policy, including an accommodating stance of the European Central Bank.*

*Favorable situation in terms of macroeconomic stability and stronger operational background ease the pressure on the quality of bank assets, resulting mainly in the retail, entrepreneurship and industrial production.*

*Solid credit expansion plus lower borrowing costs put the banking sector in a position with good profitability retention. Return on assets is estimated at about 1%. On the other hand, Moody's admits that moving towards profitability will be limited. Finally the cause is a bank tax enacted by the government since January 2012.*

*The credit rating agency concludes that Slovak banks capitalization will continue as salubrious with respect to expected losses. Its assertion is based on the Slovak Central Bank's capital rules containing detailed prudential requirements. The agency adds that funding and liquidity profiles will remain stable. Moody's believes that despite the increase lending, the Slovak banks will be able to fully finance lending to subjects through their stable deposit base - banks will keep a very low degree of dependence on wholesale funding sources.*

#### CONCLUSION

*Rating information beneficiaries are mostly the participants of financial and capital markets. These are therefore investors - companies carrying out investment activities, banks, retail investors, creditors, analysts etc. Basically it is everyone who has the transaction relationship with rated entity. Assigned rating level is for them a decisive indicator and relevant source for decision making process. However, rating is also important from the reporting subject perspective. It offers an independent assessment of its own position within the partial trade market. This is related to simplifying comparison with the competition. The credit rating is valid one calendar year precisely. During the mentioned period is allowed reconsideration and subsequent modification. The foundation is represented by conclusions resulting from the systemic supervision of entities, emissions or projects.*

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