

Abbreviations

CCB	countercyclical capital buffer
DSTI	debt service-to-income ratio
ECB	European Central Bank
EEA	European Economic Area
ESRB	European Systemic Risk Board
GDP	gross domestic product
MFI	monetary financial institutions (banks and credit unions)
RE	real estate
RLR	Responsible Lending Regulations

The publication has been prepared by the Economics and Financial Stability Service of the Bank of Lithuania. It is available in PDF format on the Bank of Lithuania [website](#).

Unless otherwise indicated, data up to 30 June 2017 was used.

Periods indicated in chart subtitles also include end-of-period (year, quarter, etc.) data.

Decision basis for setting the countercyclical capital buffer rate

On 28 September 2017, the Board of the Bank of Lithuania took a decision to set the CCB rate at 0 per cent. The decision was based on leading and additional indicators for setting the CCB, as well as the analysis of the lending and RE markets.

Overall growth of the portfolio of loans to the private non-financial sector decelerated in Q2 2017; however, the borrowing rate in the housing sector remains intense and is currently one of the highest in Europe. Favourable economic trends, long-lasting low interest rates, declining unemployment, increasing income and growing economy of the country further contribute to active borrowing for house purchases and high activity in the housing market. Housing credit standards are becoming more favourable as well. For example, although RLR exceptions applied by credit institutions are relatively few, the average ratio of new loans to mortgaged property has increased by 2 p.p. (up to 80%) since the beginning of 2016 and is approaching the 85 per cent limit set by the RLR. As the housing loan portfolio expands, the growth of the portfolio of loans to enterprises, which had increased by more than 8 per cent in April and June, slowed down in June and amounted to 5 per cent. However, the growth of this portfolio is characterised by large fluctuations and affected by large individual transactions.

Annual growth of housing prices has been accelerating for three consecutive quarters and reached 10.2 per cent in Q1 2017. Although some data representing more recent trends indicated that the price growth rate had slightly slowed down in Q2 2017, it remained significant. In 2017, the number of housing transactions in Lithuania remained high, yet it seems to be stabilising: in Q2 2017, the number of housing transactions dropped by 2.2 per cent year on year. Housing supply remained high and its main contributor has recently been the completion of construction of private houses and cottages. Over the quarter, the number of unsold flats¹ in the primary market in Vilnius grew by 5.6 per cent and amounted to 3,780 in Q2 2017.

Against the backdrop of credit growth, a boost in the country's GDP prevented significant changes in the gap between the credit-to-GDP ratio and its long-term trend over the quarter. The gap remained negative and other indicators did not show any signs of unsustainable situation in the credit market either. However, if the lending growth continues to be very rapid and the rate of increase in housing prices does not decelerate, cyclical risks may arise. As the country's economic growth intensifies, the economic activity exceeds its potential and the tension in the labour market continues to rise, the Bank of Lithuania will closely monitor the timely evaluation of possible imbalances and threats to the stability of the financial system and, if necessary, take preventive measures for mitigating these risks and their potential effects. If in H2 2017 the lending and RE market growth rate does not significantly decelerate or even accelerates, changing the CCB rate should be considered in order to strengthen the resilience of the financial system.

* Resolution No 03–158 of the Board of the Bank of Lithuania of 28 September 2017 on the application of the countercyclical capital buffer.

** The calculation of this rate is based on deviations of the credit-to-GDP ratio from its long-term trend, taking into account, *inter alia*, the domestic credit growth and the ESRB recommendations currently in effect. For more information, see the Bank of Lithuania Occasional Paper No 5, 'Application of the Countercyclical Capital Buffer in Lithuania'.

LENDING AND REAL ESTATE MARKET DYNAMICS

Lending remained highly active in Lithuania in Q2 2017 and, regardless of the slight slowdown of the overall loan portfolio growth rate, it remained rather high in individual segments. After almost two years of moderate increase, the portfolio of MFI loans to the private non-financial sector continues to grow. In June 2017, it was 6.6 per cent higher than a year ago, growing by 14.1 per cent from the beginning of 2015. However, although the portfolio continues to expand, trends of moderate deceleration have been observed over the last few months. For example, the credit impulse which shows the momentum of loan portfolio growth (amounting to 1.3 p.p. at the end of 2016) dropped to 0.02 p.p. in the first three months of 2017. The slowdown of the whole portfolio growth was predominantly determined by the decrease in the annual growth of the portfolio of loans to non-financial corporations (from 8.0% in March to 5.0% in June). On the other hand, the rate of credit market growth in Lithuania remained one of the highest in comparison with other European countries. In the household segment, Lithuania was among top five countries with the fastest growing loan portfolio, exceeding the European Union average by more than 5 p.p.

The main contributors to the growth of the loan portfolio were housing loans. At the same time, more and more house purchase transactions were financed by loans. At the end of Q2 2017, the portfolio of loans to households was 8.1 per cent higher year on year, while the portfolio of housing loans – 8.0 per cent higher. Similar growth rate was recorded throughout the first half of this year. In H1 2017, the value of transactions involving new flats and houses was 11.0 per cent higher than in the same period of the previous year (when the number of housing

¹ Unsold flats in the primary market include completed flats and those under construction.

transactions also grew by 2.5 per cent) and the number of new housing loans increased by 18.8 per cent. Faster growth of loans than the value of transactions shows the increasing importance of housing loans as a financing source in the housing market. Lately, signs of housing credit standards becoming more favourable have been observed. Although the scope of RLR exceptions in terms of the DSTI² remains narrow, the LTV³ ratio of housing loans has increased over the past quarters and reached the limit of 80.0 per cent.

In June, the expansion of the corporate loan portfolio, which is generally characterised by large fluctuations and dependence on large individual transactions, has significantly decreased. Annual growth of loans to enterprises, which stood at 8 per cent in March, dropped to 5 per cent in June. The corporate borrowing rate is also characterised by high volatility. For example, standard deviation of annual corporate portfolio growth amounted to 1.2 p.p. in the first half of this year, while standard deviation in the household segment amounted to a meagre 0.1 p.p. Such fluctuations are predominantly a result of large individual loans. For example, three largest loans granted to non-financial corporations in Q1 2017 accounted for one fifth of the total amount of new loans granted to enterprises.⁴ In terms of the type of economic activity, portfolios of loans to manufacturing and service as well as administration enterprises recorded most rapid growth in one year. At the end of Q2 2017, they grew by EUR 80.2 million and EUR 97.4 million respectively year on year. In contrast, real estate (including construction) and information and communication enterprises saw the largest decrease in the loan portfolio. It decreased by EUR 33.7 million and EUR 41.2 million respectively in a year.

The growth of housing prices accelerated in Lithuania; the number of housing transactions is starting to stabilise, yet remains high. According to the data of Statistics Lithuania, annual growth of housing prices in the country accelerated to 10.2 per cent in Q1 2017 and the acceleration of growth has been observed for three subsequent quarters. However, according to the data of UAB Ober-Haus, which represents more recent trends, in Q2 2017, the annual growth of flat prices in major cities of Lithuania decreased from 5.6 to 4.1 per cent over the quarter. Preliminary data presented by the Centre of Registers shows that the rate of annual growth of prices of flats sold in Lithuania in Q2 2017 decreased from 8.0 to 7.2 per cent over the quarter. There is a general tendency of delayed reaction of the housing price index presented by Statistics Lithuania to the growth of the number of housing transactions. Therefore, it is likely that current increase in prices reflects the rapid growth of the number of housing transactions in H1 2016, which began stabilising since the beginning of 2017. In Q2 2017, a total of 6,593 housing transactions were concluded in Lithuania, i.e. 2.2 per cent year on year. As the number of transactions is stabilising, there are increasingly more assumptions that the rate of housing price growth will decelerate in the upcoming quarters. However, it is likely that the number of transactions, which have grown over the last year, will remain high in the nearest future.

Signs of deceleration in price growth in the housing rental market were observed in Q2 2017. According to the data of Statistics Lithuania, in June 2017, the annual change of housing rental price was negative and stood at -1.1 per cent. Data from *Aruodas.lt* also shows a deceleration of the published annual rental prices. However, annual rental price growth remained positive and amounted to 3.3 per cent. The slowdown in the increase of rental prices was potentially a result of the increased supply of flats for rent. It is likely that active purchase of flats with own funds since 2015 contributed significantly to the rental market.

The supply of new housing in Lithuania continued to grow. In Q1 2017, 33 per cent more residential houses were completed year on year. The number of completed flats in one- and two-flat buildings continued to grow rapidly. On the other hand, the number of completed flats in apartment buildings, particularly in Vilnius, was significantly lower (27.8%). Therefore, in Q1 2017, the number of completed housing in Vilnius dropped to the level observed at the beginning of 2014 and stood at 584. However, the number of building permits continued to grow, thus it is likely that the supply of housing will recover in the near future. In general, a trend of building more and more one- or two-flat houses is observed, i.e. private houses and cottages. Just in the past four quarters, the number of such flats built in Lithuania was 70% higher than in apartment buildings, and the construction rate of the latter has been slowing down since H2 2016.

The number of commercial RE transactions decreased in H2 2017, but the demand for modern office space rental has increased. According to the data of the Centre of Registers, the amount of sale of commercial⁵ RE properties was 26.1 per cent lower year on year. The amount of transactions of administrative, trading, catering, service and hotel RE properties has significantly decreased (-32.6%), while the amount of transactions of manufacturing, industry and storage properties has increased (13.5%). However, according to the data of UAB Ober-Haus UAB, after a significant boost in the previous quarter, the vacancy rate of class A office space in Vilnius decreased from 6.4 to 5.8 per cent in Q1 2017, which represents an increase in demand of office space rental. Moreover, investment into office buildings is no longer concentrated in the capital: the participants of Kaunas market are expecting a significant increase in the supply of modern office space. However, with steady increase of supply of office space, significant changes in the price of office space rental were not registered in the last quarter.

² A bank may grant a housing loan after evaluating that the applicant will be solvent if up to 60 per cent of monthly income is allocated to repay all credits received. Such exception may be granted to a maximum of 5 per cent of the total amount of new housing loans granted in a year.

³ The ratio of the loan amount to the value of the mortgaged property.

⁴ This amount does not include the renewed loans, overdrafts and credit card limits.

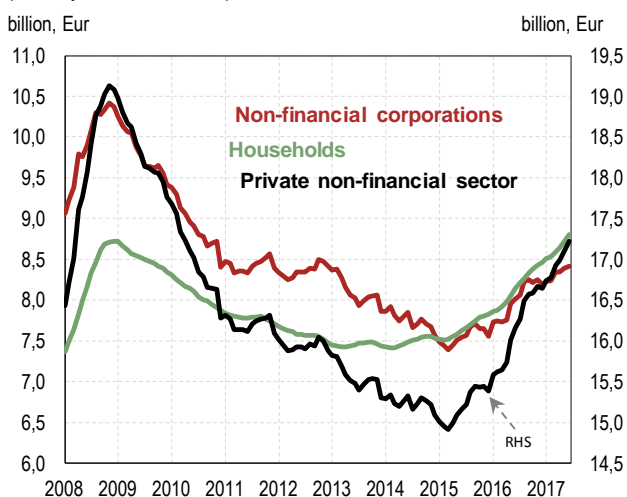
⁵ Administrative, trading, catering, services, hotels, manufacturing, industrial and storage.

Most indicators used for assessment of imbalances in the financial system do not show any warning signs. The gap between the credit-to-GDP ratio and its long-term trend at the end of Q1 2017 remained negative (–4.6 and –14.1 per cent⁶ respectively); however, it decreased over the quarter due to continued growth of borrowing (0.3 and 0.8 p.p. respectively).⁷ The country’s economic trends are positive: increasing employment, rising household income, improving financial situation of enterprises and accelerating growth of the country’s economy. This also contributes to more active borrowing and rising housing prices. So far, various early warning and other indicators suggest a low probability of a systemic crisis of banks and no credit and RE market imbalances. However, prolonged growth of housing prices and credit market would increase the likelihood of cyclical risk and, therefore, close monitoring is required so that as the country’s economic growth intensifies, the economic activity exceeds its potential and the tension in the labour market continues to rise, risks to the stability of the financial system would be evaluated in advance and, if necessary, preventive measures would be taken in order to mitigate these risks and their potential effects.

Annex. Housing market and credit trends

Chart 1. Portfolio of MFI loans to the private non-financial sector

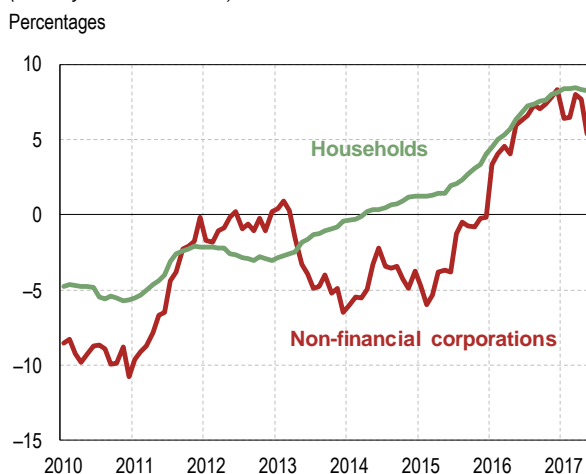
(January 2008–June 2017)



Source: Bank of Lithuania.

Chart 2. Annual growth of portfolio of loans to non-financial corporations and households

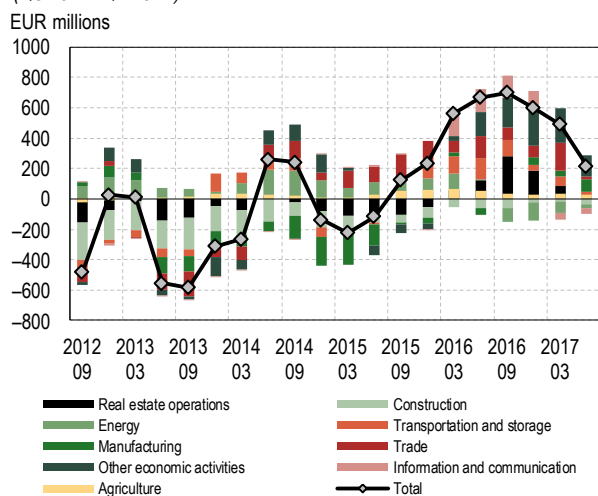
(January 2010–June 2017)



Source: Bank of Lithuania.

Chart 3. Annual developments of MFI loans to non-financial corporations

(Q3 2012–Q2 2017)

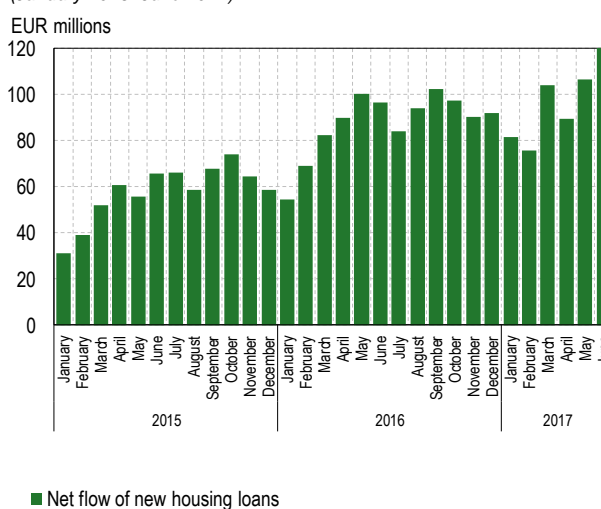


Source: Bank of Lithuania calculations.

Note: Names of some economic activities are abbreviated.

Chart 4. Flow of new housing loans

(January 2015–June 2017)

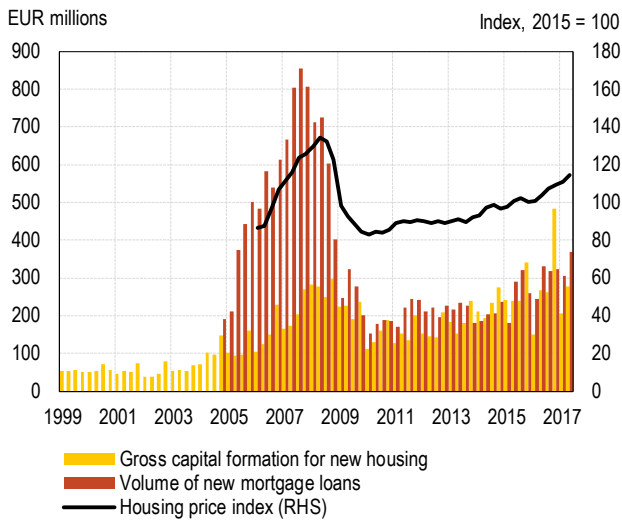


Sources: ECB and Bank of Lithuania calculations.

⁶ Depending on the valuation method.

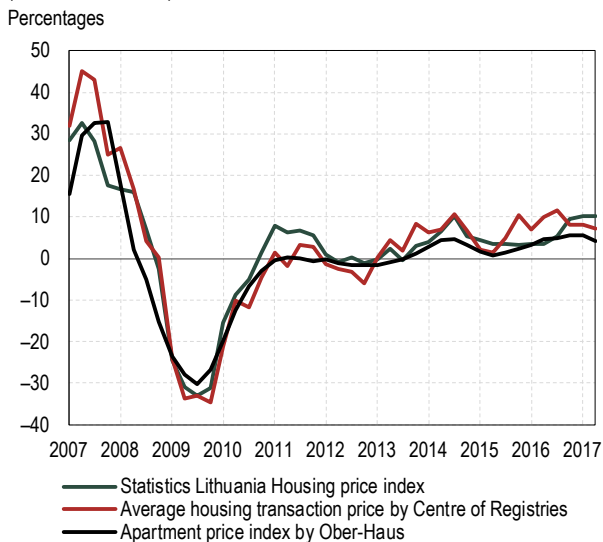
⁷ Decreased by 0.6 and 3.8 year on year.

Chart 5. Developments in housing prices, new housing loans (including renegotiations) and gross capital formation for new housing (Q1 1999–Q2 2017)



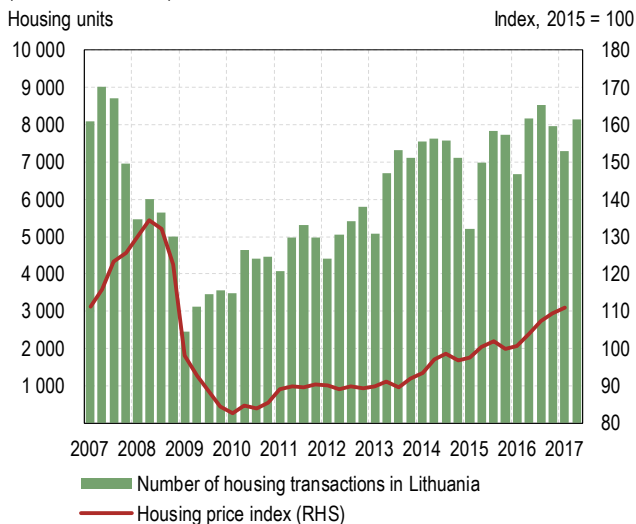
Source: Statistics Lithuania.

Chart 7. Annual growth in housing prices according to different sources (Q1 2007–Q2 2017)



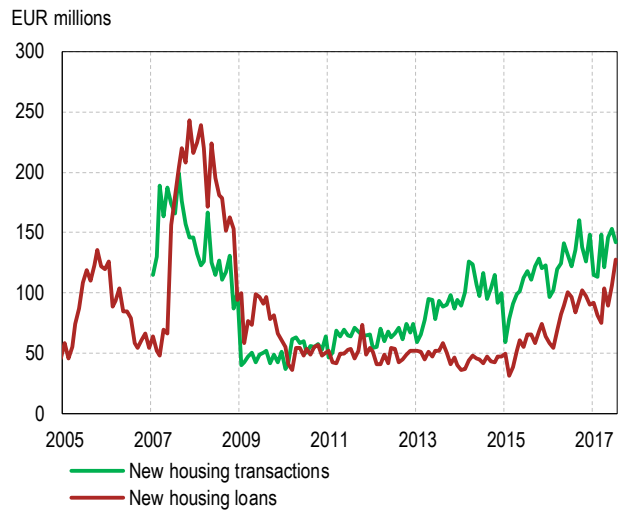
Sources: Statistics Lithuania, Centre of Registries and Ober-Haus.

Chart 9. Housing market activity and the housing price index (Q1 2007–Q2 2017)



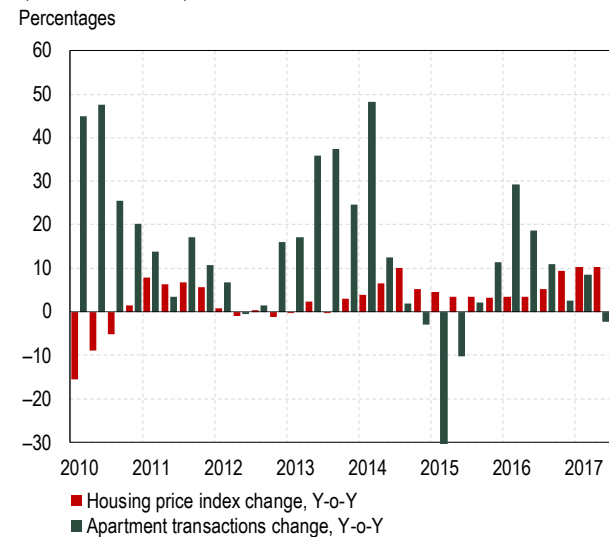
Sources: Statistics Lithuania and Centre of Registries.

Chart 6. Amount of new flat and house transactions and real new housing loans (January 2005 – June 2017)



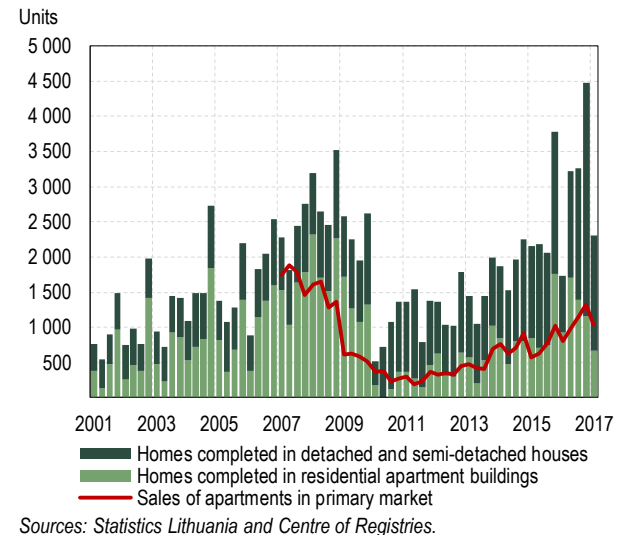
Sources: Center of registry and Bank of Lithuania.
 Note: *up to 2015 housing loans also include renegotiations.

Chart 8. Number of housing transactions and annual change in the housing price index (Q1 2010–Q2 2017)



Sources: Statistics Lithuania and Centre of Registries.

Chart 10. Finished housing by construction type and flat sales in the primary market (Q1 2001–Q1 2017)

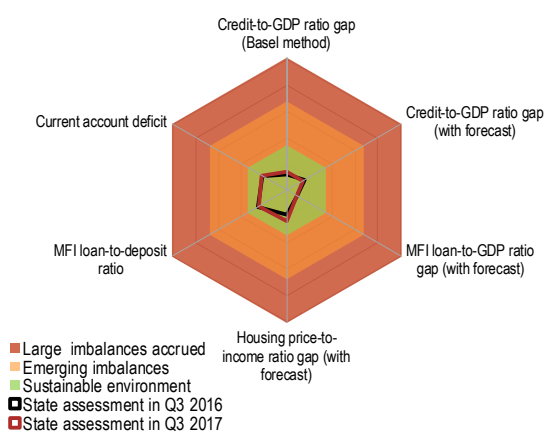


Sources: Statistics Lithuania and Centre of Registries.

Annex 2. CCB reference rates and indicators warning of the need to raise the CCB rate

Chart A. Evaluation of credit market imbalances based on leading and additional indicators

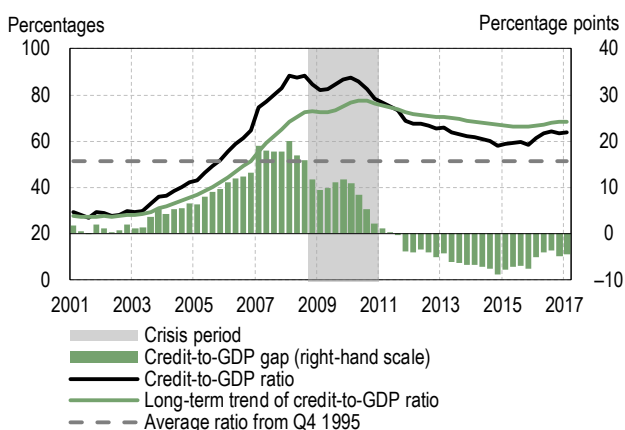
(evaluation carried out in Q3 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
 Note: axes are scaled according to the range of a particular indicator: from its minimal value up to the maximal value.

Chart C. Leading indicator II: Credit to the private non-financial sector-to-GDP gap (calculating using the forecast-augmented method)

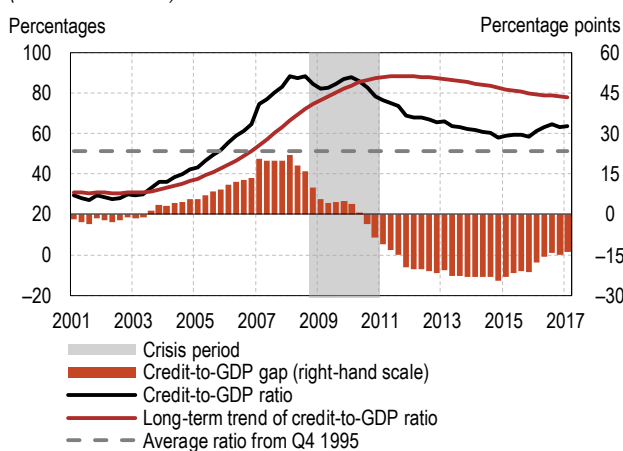
(Q1 2001–Q1 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
 Note: the long-term trend is computed by applying a one-sided HP filter with the smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart B. Leading indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method)

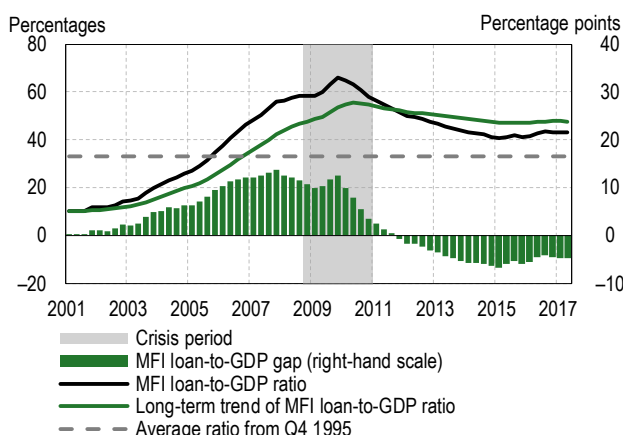
(Q1 2001–Q1 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
 Note: long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

Chart D. Additional indicator I: MFI lending to the private non-financial sector-to-GDP ratio gap (calculating using the forecast-augmented method)

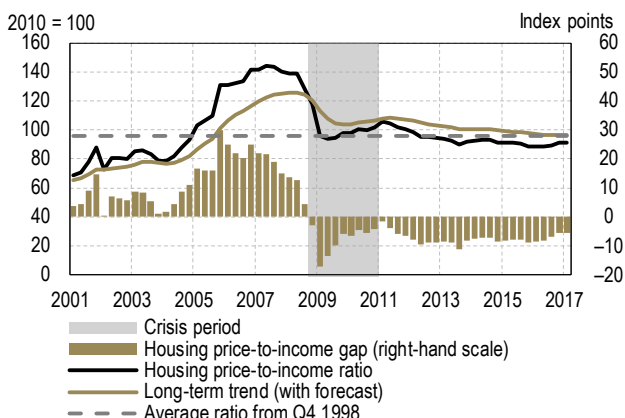
(Q1 2001–Q2 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
 Note: the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart E. Additional indicator II: Housing prices-to-household income ratio gap (calculated using the forecast-augmented method)

(Q1 2001–Q1 2017)



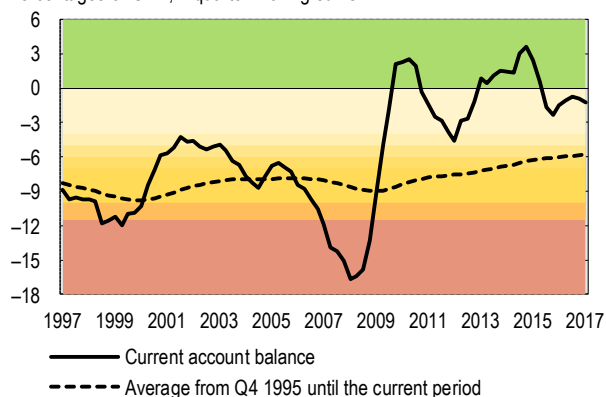
Sources: Statistics Lithuania and Bank of Lithuania calculations.

Notes: 1) income – household wages and salaries; 2) the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart G. Additional indicator IV: Current account balance (4-quarter moving sums)-to-GDP ratio

(Q1 1997–Q1 2017)

Percentages of GDP, 4-quarter moving sums

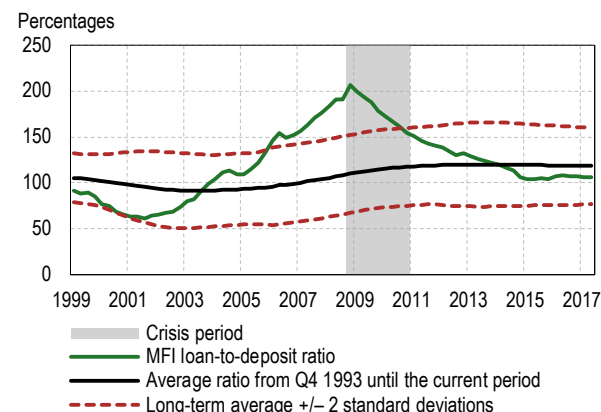


Sources: Statistics Lithuania and Bank of Lithuania calculations.

Note: colours indicate different levels of risk which have been set based on Reinhart S. M. and V. R. Reinhart (2008): "Capital flow bonanzas: An encompassing of the past and present", NBER working paper, 14321.

Chart F. Additional indicator III: MFI lending to the private sector-to-private sector deposits ratio (after eliminating seasonal effects)

(Q1 1999–Q2 2017)

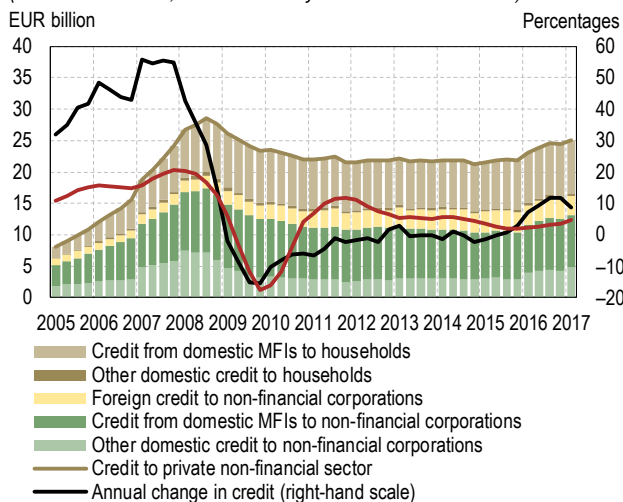


Source: Bank of Lithuania calculations.

Note: the ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding Q2 2016–Q4 2011 data

Chart H. Credit and nominal GDP moving dynamics

(Q1 2005–Q1 2017; nominal GDP dynamics — until Q1 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.