LIETUVOS BANKAS

Banking activity review

2013

ISSN 2335-8319 (ONLINE)

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BANK ASSETS AND LIABILITIES

In 2013 the operations of the banking sector[1] were profitable, banks were well capitalized and held a sufficient liquidity buffer. The year was distinguished for the dynamics of market participants: *AB Ūkio bankas* went bankrupt, *AS UniCredit Bank* Lithuania branch discontinued operations and *Pohjola Bank Plc* Lithuania branch began operating.

Dynamics of the key indicators of the banking sector[2]

Line No	Indicator	Amount as of 01/01/2013 LTL millions	Amount as of 01/10/2013 LTL millions	Amount as of 01/01/2014 LTL millions	Change in Q4 2013 %	Change in 2013, %
1.	Assets	75,323.0	76,468.1	77,578.1	1.5	3.0
2.	Debt securities	5,187.7	6,297.1	7,877.7	25.1	51.9
3.	Leasing	3,435.3	3,482.8	3,489.9	0.2	1.6
4.	Loans granted to customers	50,811.0	51,741.2	51,015.9	–1.4	0.4
4.1.	To private enterprises	24,333.0	24,304.6	23,575.0	–3.0	–3.1
4.2.	To financial institutions	404.5	421.1	481.0	14.2	18.9
4.3.	To natural persons	22,810.4	22,831.1	22,802.0	–0.1	0.0
4.3.1.	Housing loans	19,246.8.	19,309.3	19,375.5	0.3	0.7
5.	Loan impairment	2,994.3	2,419.4	2,212.4	–8.6	–26.1
5.1.	Loan impairment to granted loans ratio, %	5.6	4.5	4.2	–	–
6.	Deposits and letters of credit	43,586.0	46,108.5	47,604.5	3.2	9.2
6.1.	Of private enterprises	14,840.5	14,855.3	16,062.1	8.1	8.2
6.2.	Of financial institutions	1,041.0	792.7	803.6	1.4	–22.8
6.3.	Of natural persons	24,379.9	26,669.2	28,038.4	5.1	15.0
7.	Shareholders' equity	7,401.0	7,854.3	8,029.6	2.2	8.5
8.	Profit (loss) for current year	715.2	605.0	785.7	–	–

As of 1 January 2014, the assets of the banking system amounted to LTL 77.6 billion. Most of the assets (LTL 51 billion) consisted of loans granted to customers; however, as the assets did not grow significantly during the year, the volume of the banks' liquid assets expanded. In 2013, banks' funds with the Bank of Lithuania grew by 13 per cent — to LTL 5 billion, investment in the securities of the Government of the Republic of Lithuania increased by 34 per cent over a year — to LTL 4.5 billion. Investment in the debt securities of the governments of EU countries also increased by almost four times over the year — to LTL 0.8 billion. Investment in the debt securities of banks in the EU rose by 14 per cent over the year — to LTL 1.4 billion. As of 1 January 2014, total liquid assets accounted for as much as 27 per cent of the banking system's assets.

The bulk of bank liabilities (LTL 47.6 billion) consisted of customer deposits attracted by banks in Lithuania. Despite the prevailing low interest rate environment, the volumes of deposits with banks expanded in 2013. In 2014, additional preconditions for growth in deposits may arise: prior to the adoption of the euro, residents may be inclined to transfer their funds held at home to banks in order to avoid currency exchange related trouble.

With growth in deposits in 2013, banks reduced their indebtedness to parent banks: these liabilities contracted by almost LTL 1 billion over the year and as of 1 January 2014 stood at LTL 19.1 billion. As of 1 January 2014, the net indebtedness to parent banks (the differential between the liabilities to parent banks and funds with them) amounted to LTL 13.1 billion.

The structure of bank groups operating in Lithuania changed in 2013: at the beginning of the year, *Swedbank, AB* sold its life assurance undertaking to a bank within the *Swedbank* group operating in Estonia; in the fourth quarter, *AB SEB bankas* joined a subsidiary leasing company.

[1] The domestic banking sector consists of 7 commercial banks and 8 foreign bank branches currently operating in the country.
[2] Consolidated audited data, collected for the purpose of supervision, is presented for the first time this year. Seeking comparability of the data, the analysis of banking sector indicators excludes the data of AB Ūkio bankas.

BANKS' LOAN PORTFOLIO

The loan portfolio of banks operating in Lithuania did not change significantly in 2013. As of 1 January 2014, the loans granted by the banks amounted to LTL 51 billion. As compared to the beginning of 2013, the loan portfolio was larger by 0.4 per cent. It did not expand more, because the flow of new loans being granted was not significantly larger than the flow of earlier granted loans being repaid. The loan portfolio changes were due to several large single transactions; in the future, however, favourable conditions for the growth of the loan portfolio will be created by moderate growth of the domestic economy, the increasing use of enterprises' industrial capacities.

The loan portfolio of business undertakings contracted by 3.1 per cent over the year and amounted to LTL 23.6 billion at the end of the year. This was due to the business undertakings' decreased needs to finance their operations through credit lines as well as the fact that not all of the loans of *AS UniCredit Bank* Lithuania branch, which discontinued operations in 2013, were refinanced in other domestic banks (they were transferred to the *UniCredit* group's unit in Latvia).

Banks were more active in granting housing loans. In 2013 the housing loans portfolio recorded annual growth, for the first time since 2008. Housing loans increased by LTL 128.7 million over the year, to LTL 19.4 billion at the end of the year. Based on the Bank Lending Survey conducted by the Bank of Lithuania, we can assert that banks' expectations about the general economic situation, outlook for the housing market have been improving, competition among banks has been increasing and the borrowing conditions have been easing somewhat; it is therefore likely that, in the future, the demand for housing will be increasing and this segment's loan portfolio will begin expanding at a faster rate. However, this growth rate is likely to remain sustainable, as The Responsible Lending Regulations are applicable to banks that encourage more responsible lending by banks and the borrowing decisions of residents themselves.

In 2013, loans to public authorities and municipal enterprises grew from LTL 3.3 billion to LTL 4.2 billion. The increase in loans within this sector was due mainly to the issuance by one bank of a loan to the Ministry of Finance of the Republic of Lithuania in the first quarter of the year.

The improving financial standing of borrowers, completion of recovery procedures that were initiated as early as in the crisis years, write-off of non-performing loans and new crediting directed to clients with low risk profile led to an improvement in the loan portfolio quality indicators. The rate of specific provisions to the loan portfolio decreased by 1.4 percentage points over a year — to 4.2 per cent; the loan portfolio share of depreciated loans contracted by 2.9 percentage points — to 8.5 per cent, while the indicator of non-performing loans[3] declined by 2.6 percentage points — to 11 per cent. In 2010, when the indicators defining the quality of the loan portfolio had recorded the highest values, the indicator of non-performing loans was 19.4 per cent, while specific provisions accounted for 8.4 per cent of the loan portfolio.

The indicators defining the quality of loans granted to residents have been improving since mid-2012. The quality of the housing loan portfolio was better: non-performing loans accounted for 7 per cent, specific provisions formed — 2.6 per cent in 2013. The quality of the consumer loan portfolio was worse: at the end of 2013, non-performing loans accounted for 13.0 per cent, while the provisions for the formation of such loans — 7.9 per cent of the loan portfolio. The quality of the consumer loans portfolio has been improving at a faster rate than that of housing loans. The Regulations on the Assessment of Solvency of Recipients of Consumer Loans and Responsible Lending, which came into effect on 1 July 2013, should ensure further improvement of the consumer loan portfolio quality.

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

As of 1 January 2014, all banks complied with prudential requirements for banking activities; moreover, according to preliminary estimates, they would also comply with new capital adequacy and liquidity ratios, the application of which is provided for in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

The banking sector was characterised by high capital adequacy levels. Based on 1 January 2014 data, capital adequacy in the banking system was 17.6 per cent, almost 2 p.p. higher than based on 1 January 2013 data. The improvement of this ratio was mainly due to the inclusion by banks of the audited profits for 2012 in the capital base. In spite of the high capitalization of the banking system, strengthening of the capital base remains relevant to smaller banks.

After declaring suspension of the operation of *AB Ūkio bankas* in early 2013, the domestic banking system, already for the second time in the last three years, had to prove its preparedness and capacity to withstand one of liquidity risk stress testing scenarios. As in late 2011 after declaring the suspension of the operations of *AB bankas SNORAS*, this incident in 2013 did not have a significant negative effect on liquidity in the banking system. The liquidity ratio as of 1

[3] Non-performing loans include impaired loans and loans overdue for more than 60 days (but unimpaired).

January 2014 was 41.2 per cent, 10 p. p. above the requirement. In addition, the banking sector had sufficient liquidity reserve to fill the financing gap (almost two times above the requirement).

As of 1 January 2014, the banking sector's maximum open position in foreign currencies and precious metals requirement was 0.4 per cent.

PROFITABILITY AND EFFICIENCY OF OPERATIONS

Last year, the profits earned by banks and foreign bank branches operating in the country amounted to LTL 785.7 million, LTL 70.5 million, or 9.9 per cent above the figure for 2012. Last year, the operations of six banks and six foreign bank branches were profitable, whereas one bank and two foreign bank branches operated at a loss.

Net interest income — the most significant income for banks — has been declining for several consecutive years already. Although in 2013 the decline in this income was not significant (LTL 16 million), one should take into account the fact that, with the banking system's loan portfolio basically unchanged in 2013, last year the banks' interest income from their loan portfolio declined by even LTL 406.2 million (16.7%). Thus banks only managed to avoid a somewhat greater decline in their net interest income by cutting interest income by LTL 390.3 million. As the banks' interest on liabilities in 2013 reached the historically lowest level (1.19%), the possibilities to cut the current interest expenditure still more (and to maintain net interest income stable) have been almost explored.

With the decrease in banks' net interest income, the share of banks' net services and commission income, relative to banks' total income, has been increasingly expanding. Net services and commission income of the banks in 2013, as compared to 2012, picked up by LTL 38.1 million (6.2%) — to LTL 651.7 million. The growth in net services and commission income is directly related to the activity of domestic economic entities: growth in the domestic economy entailed the increase in the demand for bank services and transaction volumes (except for the number of cash operations at bank branches), which entailed growth in net services and commission income at the same time.

Banks, in aiming to reduce operational expenditure, lately have encouraged the expansion of electronic banking, and part of banks are decreasing and are planning to decrease in the future the number of customer service units. However, last year banks' operational expenditure, as compared to 2012, grew by 7.3 per cent — to LTL 1.1 billion. Total and administrative expenses rose by 10.1 per cent, while staff costs grew by 4.9 per cent. In 2014, additional operational expenditure will be required by one of the major challenges awaiting the banking sector this year — preparations for the adoption of the euro in Lithuania. Banks are already planning in advance their actions, allocating additional financial and human resources that are to ensure the smooth process of migration to the euro.

In 2013, banks incurred asset impairment costs in the amount of LTL 34.4 million — twice as much as in 2012.

The indicators defining banks' operating efficiency, due to banks' higher profits, improved somewhat from 2012: the indicator of the banking sector's annual return on equity was 8.9 per cent and did not stand out on an EU scale. Banks' net interest margin, which shows the differential between the interest that banks receive on invested assets and the interest they pay to their creditors, in 2013 actually remained unchanged and, standing at 1.5 per cent, was lower than in 2011 and 2012. The expenses to income ratio defining banks' operating efficiency also remained unchanged and stood at 56.5 per cent.