LIETUVOS BANKAS

Banking Activity Review

1st Quarter of 2013

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In the first quarter of 2013, the results of the activities of the banking sector[1] show that the suspension of the operation on AB *Ūkio bankas* did not significantly influence the country's banking sector—it remained stable, was well capitalized, had sufficient liquidity buffers and reported profit.

Changes of the main indicators in the banking sector

Row. No.	Name of the indicator	Amount as of 04–01–2012, LTL millions (excl. *Ūkio bankas*)	Amount as of 01–01–2013, LTL millions (excl. *Ūkio bankas*)	Amount as of 04-01-2012, LTL millions (excl. *Ūkio bankas*)	Change Q1 2013, % (excl. *Ūkio bankas*)	Change Change year-on-year (%) (excl. *Ūkio bankas*)
1.	Assets	73,117.8	74,258.3	77,303.6	4.1	5.7
2.	Debt securities	4,899.2	5,180.5	6,133.1	18.4	25.2
3.	Loans to customers	51,532.1	52,870.1	54,310.1	2.7	5.4
3.1.	To private entities	23,345.2	24,000.7	24,244.8	1.0	3.9
3.2.	To financial institutions	1,902.5	2,843.9	3,172.1	11.5	66.7
3.3.	To natural persons	23,187.9	22,775.1	22,775.1	–0.3	–2.1
3.3.1.	Housing loans	19,392.1	19,246.8	19,206.2	–0.2	–1.0
4.	Loan impairment	3,673.8	2,986.9	2,926.2	–2.0	–20.4
4.1.	Relation between the loan amount impairment and granted loans, %	6.7	5.3	5.1	–	–
5.	Deposits and letters of credit	39,964.5	43,613.6	45,738.1	4.9	14.4
5.1.	Of private enterprises	13,141.2	14,840.5	14,793.9	–0.3	12.6
5.2.	Of financial institutions	881.5	1,068.6	1,195.1	11.8	35.6
5.3.	Of natural persons	22,871.3	24,379.9	26,521.3	8.8	16.0
6.	Shareholders' equity	6,506.1	7,070.4	7,265.1	2.8	11.7
7.	Profit (loss) for current year	189.2	721.7	372.8	–	–

In the first quarter of 2013 the assets of banks grew and on 1 April 2013 amounted to LTL 77.3 billion. The growth in assets was mostly due to the transfer of the assets, rights, transactions and liabilities of AB *Ūkio bankas* to AB *Šiaulių bankas*.

The loan portfolio, comprising the major part of assets, grew steadily for the fourth quarter in a row. In 2012, the bank loan portfolio increased by LTL 1.4 billion and on 1 January 2013 totalled LTL 54.3 billion (see more in section "Bank loan portfolio"). Excluding the increase of the loan portfolio of AB *Šiaulių bankas*, the lending growth would amount to LTL 0.8 billion.

In Q1 2013 the debt securities portfolio grew almost LTL 1 billion and on 1 April amounted to LTL 6.1 billion (the growth was due to conclusion of a trilateral agreement between state enterprise *Indėlių Ir Investicijų Draudimas*, AB *Šiaulių bankas* and AB *Ūkio bankas*. Investing in the government securities of the Republic of Lithuania during the reporting quarter amounted to LTLT 4 billion, and securities of the governments of other countries owned by the banks—LTL 0.2 billion. In addition, banks have invested significant portion of funds (LTL 1.2 billion) in the bank debt securities of the European Union countries.

Nearly all equity securities portfolio held by the banks (LTL 1 billion) is comprised of investment in subsidiaries. In Q1 2013, after one of the banks sold their company's life insurance block of shares, the existing equity portfolio decreased by 6 per cent. Other equity securities held by the banks (other than subsidiaries), according to data of

1 The banking sector is comprised of seven commercial banks and nine foreign bank branches (*Pohjola Bank Plc* Lithuanian branch began operations in March). In order for the data to be comparable, data of AB *Ūkio bankas* is eliminated from the analysis of the banking sector indicators.

01 April 2013, totalled merely LTL 5.1 million.

At the beginning of 2013, when the Bank of Lithuania decreased its reserve requirement ratio and having decided to no longer pay interest for held funds, bank assets at the Bank of Lithuania decreased by LTL 0.7 billion; however funds held with parent banks grew more (LTL 0.9 billion). In general, the bank assets—cash and funds held in the Bank of Lithuania and other banks—in Q1 increased by LTL 0.3 billion (to LTL 13.7 billion).

Deposits in Q1 grew LTL 2.1 billion and on 1 April amounted to LTL 45.7 billion; however, excluding the deposits taken over by AB *Šiaulių bankas*, the quarterly deposit growth rate would have been negative (deposits grew in only the financial institution and government and municipal institution segments*)* Banks, having a surplus of liquid funds, do not compete for financing in the local market, therefore deposit interest rates are still low. According to the data of 1 April 2013, non-resident deposits in the banking sector accounted for only 3.5 per cent of total deposits.

Debts to parent banks in Q1 increased LTL 0.3 billion—to LTL 19.7 billion, parent bank funds financed a quarter of bank assets. Net debt to parent banks (difference between liabilities to parent banks and funds in them) as of 1 April 2013 totalled LTL 12 billion litas.

The decline in the loan-to-deposit ratio, showing the increasing balance of the banking sector, on 1 April 2013 amounted to 119 per cent.

BANK LOAN PORTFOLIO

In Q1 of this year the working bank loan portfolio increased by 2.7 per cent and on 1 April 2013 amounted to LTL 54.3 billion. The growth of the banking sector loan portfolio was due to crediting of the government sector and financial institutions. Natural person housing and consumer loan portfolios slightly decreased, however, signs of recovery can be noticed (the liabilities of banks increased).

The increase of loans to the government sector (government institutions and state and municipal entities) over the quarter reached LTL 0.9 billion, or 29 per cent; this was mostly due to a loan to the Ministry of Finance of the Republic of Lithuania. Loans to financial institutions increased by LTL 328 million, or 11.5 per cent, due to the refinancing of subsidiary leasing companies. Loans to residents were still decreasing. In the analysed period loans to residents decreased LTL 75.2 million (0.3%), of which housing loans decreased LTL 34.6 million (0.2%). Loans to the private companies segment over the quarter increased 1 per cent or LTL 244 million; however, having eliminated the influence of the portfolio taken over by *Šiaulių bankas*, crediting of the business in Q1 decreased by more than LTL 250 million.

In Q1 the quality of the loan portfolio slightly increased. With the decrease of special provisions (2%), the ratio of special provisions to loan portfolios decreased by 0.2 percentage points and at the end of the quarter amounted to 5.1 per cent. The share of depreciated loans in the loan portfolio decreased by 0.4 percentage points and totalled 10.6 per cent, the indicators of non-performing loans[2] decreased by 0.2 percentage points—to 12.9 per cent. The ratio of loans overdue for longer than 60 days (but not impaired) to the loan portfolio increased slightly (0.15 percentage points) to 2.3 per cent.

The housing loan portfolio is still the highest quality, for which 3.1 per cent special provisions have been formed. Slightly improved was the consumer loan portfolio, although its quality is relatively poor—the special provisions indicator for consumer loans on 1 April 2013 amounted to 9.1 per cent.

In the previous year, residents and businesses began to actively borrow in litas, rather than euro, as was customary in the past. Such a tendency remained in the first quarter of this year: loans in litas increased by LTL 1.3 billion, while the loan portfolio in foreign currency—only LTL 163.3 million. During Q1, loans to non-residents grew by 4.6 per cent and amounted to LTL 383 million, or 0.7 per cent of the total loan portfolio.

[2] Non-performing loans include impaired loans and loans overdue for more than 60 days (but not impaired).

IMPLEMENTATION OF PRUDENTIAL REQUIREMENTS FOR BANKING ACTIVITIES

As of 1 April 2013, all banks other than AB *Ūkio bankas* complied with the prudential requirements for banking activities. The banking sector's capital adequacy ratio, according to the data of 1 April 2013, totalled 15.6 per cent, in Q1 2013the banking sector's capital adequacy ratio increased slightly by 1.2 percentage point. The improvement of the quality indicator was due to the banks including the 2012 audited profits in the capital base. The capital base, used in calculating the capital adequacy ratio, in 1 April 2013 amounted to LTL 6.7 billion. A large part of it (94%) was made of Tier I (highest quality) capital. The capital requirements of the banks over the quarter did not significantly change and amounted to LTL 3.4 billion. The greatest part of the capital requirement—LTL 2.7 billion—was made up of capital to amortise credit risk. Capital allocated for market risk and operational risk totalled LTL 0.5 billion and LTL 0.2 billion respectively.

The banking sector's maximum position in foreign currency and precious metals on 1 April 2013 amounted to 0.6 per cent.

The liquidity ratio as of 1 April 2013 totalled 40.7 per cent and was higher than by 10 percentage points than required. In addition, the banking sector had sufficient liquidity reserve to cover the financing gap: the liquidity reserve of the banks amounted to LTL 18.4 billion, while the net financing gap—LTL 7.6 billion. Therefore, the banks have accumulated almost 2.4 times higher liquid reserve funds than required.

PROFITABILITY

In Q1 2013, the profits of the banking sector amounted to LTL 372.8 million and were almost two times more than a year ago; however the increase of profits was mostly due to the profits of AB Swedbank, which was earned by selling their life insurance block of shares. Having eliminated the influence of the aforementioned transaction and the profits of other banks received from subsidiary companies, in Q1 the banking sector's profits, before taxes and provisions, compared to Q1 2012, decreased by 9.3 per cent—to LTL 186 million, mostly due to the decline of net interest income.

This year six banks and six branches of foreign banks operated profitably, and one bank and two foreign bank branches operated at a loss.

In Q1 2013, compared to previous year, the income structure of banks changed—net interest income decreased, and their decrease was in part compensated by the hike in net fee and commission income, as well as income from trading.

The net interest margin of banks, showing the difference between interest rates that banks receive for invested assets and interest that banks pay their creditors, at this time have significantly dropped and amount to 1.35 per cent, i.e. this is the lowest since the beginning of 2011. Therefore, the most important income of the banks—net interest income—in Q1, compared to previous year, decreased by LTLT 33.2 million (or 11.2%)—to LTL 262.9 million.

Net income from services and commissions for banks in the first quarter of this year, compared to previous year, grew by 12.4 per cent and amounted to LTL 157.6 million. However, it should be noted that bank customers, due to the recently increased non-bank institution (payment services providing payment institutions, credit unions) competition, in Q1 2013, for use of banking services they payed 5.2 per cent less commissions than in the last quarter of 2012.

As was mentioned, in Q1 the results of the banking activities improved also due to successful trading and other financial activities: compared to the corresponding period of the previous year, it grew by almost a quarter—to LTL 46 million.

The profits of Q1 were decreased by LTL 12.3 million larger than previous year asset value impairment costs, also, the operating expenses—in Q1, compared to previous year, they increased by 5.6 per cent and reached LTL 255 million, however, this growth was largely influenced by the operating costs experienced by one bank in installing a new information system.