

## Banking activity review

### 2<sup>nd</sup> Quarter of 2015

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info@lb.lt15 September 2015<sup>1</sup>

## Banking activity review

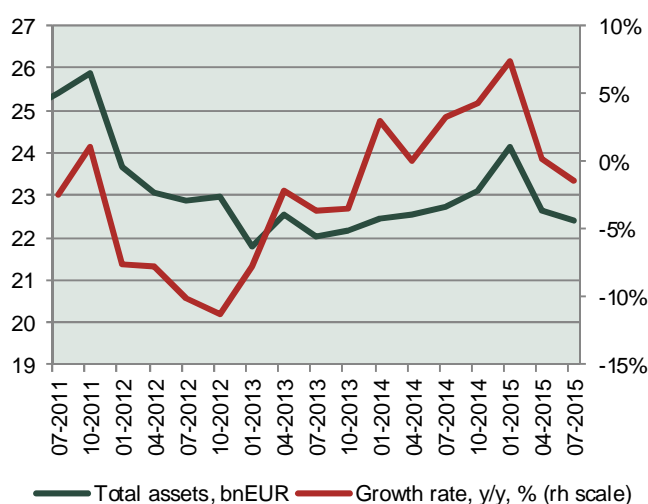
*The assets of banks operating in Lithuania in Q2 2015 were slightly less quarter of quarter. As in Q1, liabilities to parent institutions decreased. The amount of deposits held by customers in banks in Q2 2015 continues to grow moderately and no unexpected changes have occurred. The housing loan market recorded the strongest growth, with crediting over the quarter increasing since late 2008. Recovery was felt not only in the segments of housing loans, but also company loans and other loans to natural persons; this allows us to state that the reserve loan market is recovering. The banking system in the first six months of 2015 was profitable, but the low interest rate environment and decreasing income from fees and commissions resulted in a drop in bank profits and worsening profitability ratios.*

## Assets and liabilities

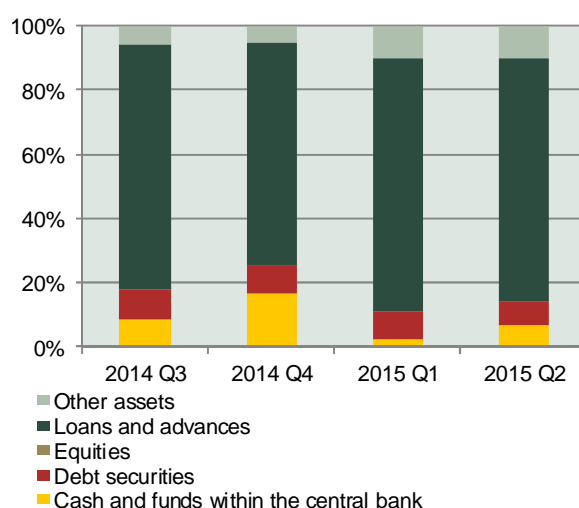
**Changes in the structure of banking assets were impacted by redistribution of funds from parent institutions and low yields of debt securities.** In Q2 2015, 7 banks and 8 foreign bank branches operated in Lithuania. Bank assets amounted to EUR 22.4 billion at the end of the period, and over the quarter declined by EUR 211 million (–0.9%). Year on year the assets of the banking system decreased by EUR 331 million (–1.5%). In Q2 2015, the amount of loans and advance payments decreased the most (by 4.9% — to EUR 16.9 billion) and, with the decrease in yields, the amount of debt securities dropped as well (by 11.8% — to EUR 16,9 billion). The decrease in the amount of loans and advance payments was a result of decreasing bank deposits in parent credit institutions, while the amount of loans issued to customers grew over the quarter. The amount of funds held in accounts at the Bank of Lithuania increased by 1.0 billion — to EUR 1.2 billion. In part this was a result of the circumstance, that the yield of high quality debt securities was particularly low, but, primarily it was the fact that a share of funds, held at parent banks, was redirected to accounts at the central bank.

<sup>1</sup> 14 September 2015 update: due to technical issues the changes in the financial reporting of one system participant occurred. The changes had no substantial influence for banking system analysis and inference. The report released on 14 September 2015 was updated as a result of the financial report data of one system participant changing due to technical reasons; these changes had no impact on the system analysis and conclusions as a whole.

## Assets of the banking sector



## Asset composition



Source: The Bank of Lithuania

Bank liabilities decreased by EUR 264 million (–1.3%) in Q2 2015 — to EUR 20.0 billion. The largest share of this decrease was a result of the continuing drop in the amount of liabilities to parent institutions. On the other hand, the amount of customer deposits over the quarter increased.

## Key performance indicators of banks<sup>2</sup>

(EUR)

No.	Indicator	01/07/2014	01/04/2015	01/07/2015	Change in Q1	Change over year
		Amount, EUR millions				
1.	Assets	22,743.9	22,623.1	22,412.5	0.9	-1.5
2.	Debt securities	2,210.2	1,920.5	1,693.9	-11.8	-23.4
3.	Leasing	1,005.9	992.0	978.5	-1.4	-2.7
4.	Loans granted to customers	14,781.3	14,830.2	15,205.7	2.5	2.9
4.1.	Private enterprises*	6,817.2	6,587.5	6,808.3	3.4	–
4.2.	Financial institutions*	171.7	132.2	161.6	22.2	–
4.3.	Natural persons*	6,639.7	6,970.9	7,121.7	2.2	–
4.4.	General government institutions*	1,152.7	1,139.6	1,114.1	-2.2	–
4.3.1.	Housing loans*	5,662.9	5,743.4	5,829.3	1.5	–
5.	Loan impairment	572.1	497.6	470.8	-5.4	-17.7
5.1.	Loan impairment to granted loans ratio, %	3.7	3.3	3.0	-9.1	-18.9
6.	Deposits	14,155.6	15,912.3	15,941.7	0.2	12.6
6.1.	Private enterprises*	4,418.6	4,832.0	4,610.3	-4.6	–
6.2.	Financial institutions*	344.4	364.6	376.2	3.2	–
6.3.	Natural persons*	8,256.3	9,652.8	9,853.8	2.1	–
6.4.	General government institutions*	1,152.7	1,062.9	1,101.4	3.6	–
7.	Shareholders' equity	2,392.7	2,405.6	2,458.6	2.2	2.8
8.	Profit (loss) of the current year	131.7	56.8	109.2	–	-17.1
9.	Net interest margin, %	1.5	1.5	1.5	–	–

\* As of 1 October 2014, the principles of classification of customer categories were subjected to changes, thus the loan and deposit data by customer group are not directly comparable to the data of previous periods.

Source: The Bank of Lithuania.

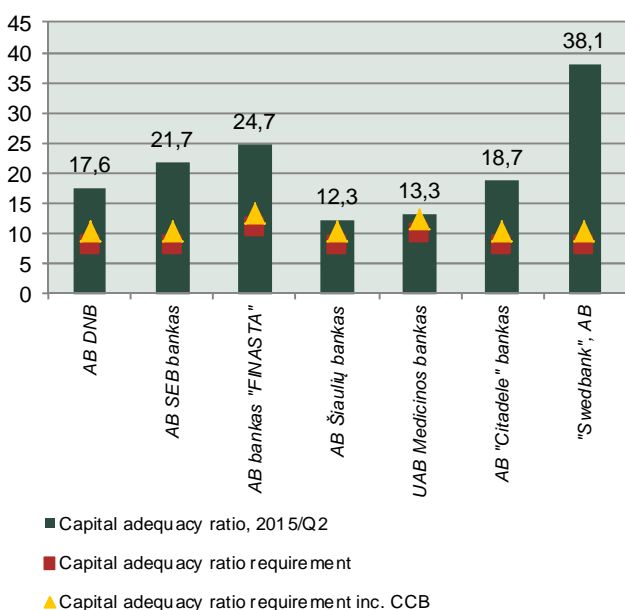
<sup>2</sup> The following data for Q2 2015 was updated on 15 September 2015: assets from EUR 22,419.3 million to EUR 22,412.5 million (difference — EUR 6.8 million); loans granted to customers from EUR 15,206.7 million to EUR 15,205.7 million (difference — EUR 1.0 million), of which — loans to financial institutions from EUR 162.6 million to EUR 161.6 million (difference — EUR 1.0 million); assets from EUR 15,952.6 million to EUR 15,941.7 million (difference — EUR 10.9 million), of which deposits of financial institutions from EUR 387.1 million to EUR 376.2 million (difference — EUR 10.9 million); shareholders' equity from EUR 2,465.4 million to EUR 2,458.6 million (difference — EUR 6.8 million).

## Compliance with requirements

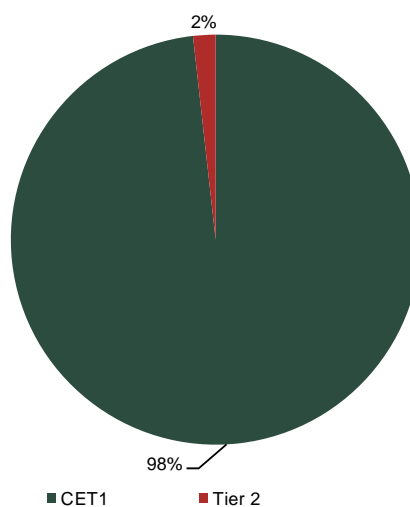
All banks operating in Lithuania with a surplus comply both with the minimum capital adequacy requirement and the new capital conservation buffer requirement. The overall capital adequacy ratio, as of 1 July 2015, was 23.8 per cent, an increase from the previous quarter (22.2%). All banks operating in Lithuania complied with both the minimum bank capital adequacy requirements (8%) and the requirement including the 2.5 per cent capital conservation buffer requirement (total of 10.5%), which came into effect on 30 June 2015. The capital of Lithuania's banking system is primarily (98%) comprised of the highest quality common equity tier 1 capital (CET1), its respective ratio in Q2 2015 amounted to 23.4 per cent (minimum requirement — 4.5%, including the capital conservation buffer — 7%). Despite the good state of the banking system's capital, for some banks the issue of capital adequacy is relevant; therefore the Bank of Lithuania continuously monitors the capacity to absorb bank losses, urges banks to further increase capital.

The reserve of liquid assets held by banks is in line with the established requirements. The liquidity position of banks in Q2 2015 was good — deposits at banks during this period grew at a stable rate, while attracted funds were invested in liquid facilities. From 2015 banks will have to ensure their compliance with the liquidity coverage (LCR) ratio. In monitoring the preparation of banks to implement the new liquidity coverage requirements and seeking to ensure their implementation, the Bank of Lithuania is currently calculating the preliminary LCR indicators. It is planned that the reports on the bank-calculated LCR indicators should be submitted from 1 November 2015. According to the Bank of Lithuania's data, the established indicators for banks having large liquid asset reserves were implemented in Q2 2015 with sufficient reserves.

Capital adequacy measures of banks (%)



Capital structure of banks (1 July 2015)



Source: The Bank of Lithuania

## The regulatory and economic environment

Processes, related to the acquisition of the shares of two banks, ended. The Bank of Lithuania, together with the European Central Bank (ECB) assessed the requests of buyers to acquire ownership of AB "Citadele" bankas and AB bankas FINASTA, it was decided to not to oppose the acquisition. On 7 July 2015 the indirect acquisition process for the shares of AB "Citadele" bankas, with which it was permitted to allow the US investor group, managed by Ripplewood Advisors, to acquire indirect ownership of the bank shares, ended. In April 2015 these investors were allowed to acquire 75% + 1 of the Latvian AS Citadele banka's shares, while the latter bank has 100 per cent of AB "Citadele" bankas' shares. On 17 July 2015 the AB Šiaulių bankas, in exchange for new shares, acquired AB bankas FINASTA and affiliated undertakings from

*AB Invalda INVL*. Currently, reorganisation of *AB bankas FINASTA* is taking place. Once it ends, *AB Šiauliy bankas* will take over the assets of *AB bankas FINASTA*, its rights and obligations, and will continue its activities, while *AB bankas FINASTA* will be removed from the Register of Legal Entities.

**The updated Responsible Lending Regulations will decrease the risk of the over-indebtedness of residents.** In May 2015 the Board of the Bank of Lithuania approved the updated Responsible Lending Regulations (RLR)<sup>3</sup>, which aim to decrease the risk of the over-indebtedness of residents. For the first time the provisions were prepared in autumn 2011, while the updated ones will enter into force on 1 November 2015. The latter were prepared taking into account the risks raised by the currently existing low interest rate environment, seeking to protect residents from possible interest rate shocks in the future. In the new RLR there remains the requirement that the maximum return on the interest contribution amount cannot exceed 40 per cent of the borrower's sustainable monthly income. However, additional requirements are raised to inspect the credit institution, whether the credit taking party will be financially able to withstand interest rate hikes. A requirement was adapted to ensure that the credit taking party should not designate more than 50 per cent of earned monthly income to pay credit contributions, when the lending rates rise to 5 per cent. In addition, it was established that the maximum maturity of a credit will not be able to exceed 30 years (previously, a 40 years maturity was in effect). An additional exception is provided in the provision, which seeks to provide the possibility for credit institutions to apply to some of their customers a 60 per cent sustainable monthly income.

## The loan portfolio

### *Developments in the loan portfolio*

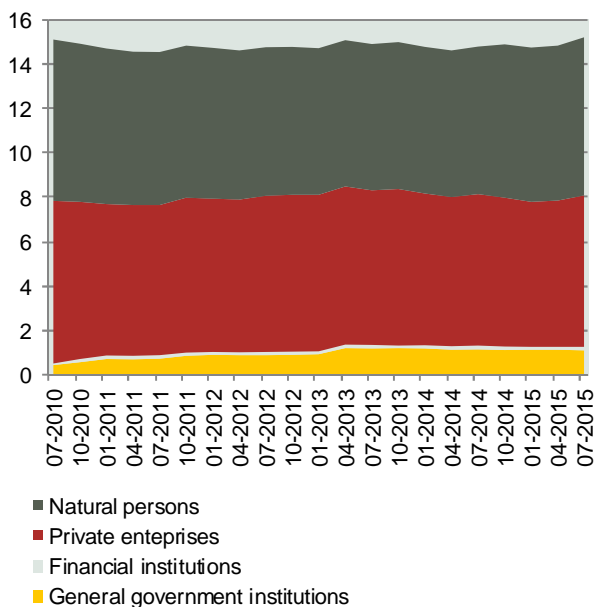
**The loan (on a net basis<sup>4</sup>) market continues to exhibit a recovery.** As of 1 July 2015, banks had granted to their customers EUR 375 million (2.5%) per cent more loans quarter on quarter, while their entire loan portfolio amounted to EUR 15.2 billion. Year on year the amount of loans boosted by EUR 424 million (2.9%). A greater than usual recovery was felt in the crediting market — both undertakings and households borrowed more. Loans to private undertakings increased the most over the quarter — by EUR 221 million (3.4%), but the portfolio of natural persons grew just as much — it increased by EUR 151 million (2.2%). Residential mortgage loans have grown most rapidly in Q2 2015 since Q4 2008: the portfolio of loans within this segment expanded by EUR 86 million (1.5%) to reach the highest levels since early 2010 — i.e. to EUR 5.8 billion. The growth rates for the loan portfolio of companies and natural persons were slightly skewed by the reclassification of one bank's loans, when part of a company's loans in Q2 2015 was assigned to the physical entities' non-housing loans segment. Excluding the impact of this reassignment, the growth of the loan portfolio of natural persons in the second quarter could have been smaller by about 0.7 p.p., while the rate of growth for company loans — larger by 0.8 p.p.; this reassignment did not impact the amount of housing loans.

The increase in the activity of the credit market can in part be related to the Responsible Lending Regulations amendments, coming into effect on 1 November 2015, which will be used to decrease the risk of over-indebtedness. According to the assessment of the Bank of Lithuania, the new amendments could have a neutral impact on the ability of residents to borrow their desired amount; however, news on these changes could have encouraged the reaction of the population to purchase housing right now, rather than postpone this decision. On the other hand, the fact that borrowing by enterprises also grew allows us to state that there is an improvement in the general situation of the loan market. Despite this, it is still too early to consider whether after the prolonged period of peace a significant breakthrough will take place. The low interest rate environment remains the motivating factor for traders to borrow; however the economic projections for Lithuanian and foreign markets are cautious. Despite this, the Bank of Lithuania is actively monitoring the situation in the bank lending market and is prepared to apply all the instruments provided for in legal acts (e.g. the countercyclical capital reserve), seeking to ensure sustainable and stable development of both the banking sector and lending.

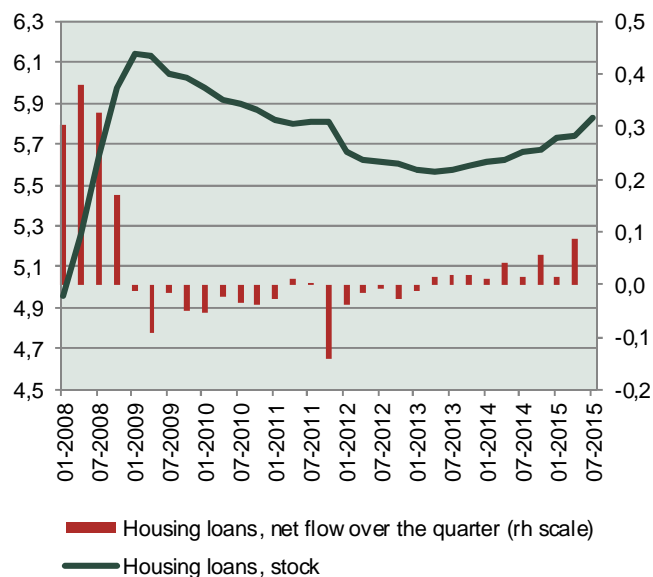
<sup>3</sup> The updated RLR are available at the [website](#) of the Bank of Lithuania.

<sup>4</sup> Loan portfolio (on a net basis) — loans that debtors have to return to the bank, including the accrued interest on the loans, minus the loan impairment. It should be noted that in various Bank of Lithuania statements several loan portfolio concepts, therefore the measurement of the loan portfolio changes, loan flows differs.

## The loan portfolio of banks (EUR billion)



## Housing loans (EUR billion)



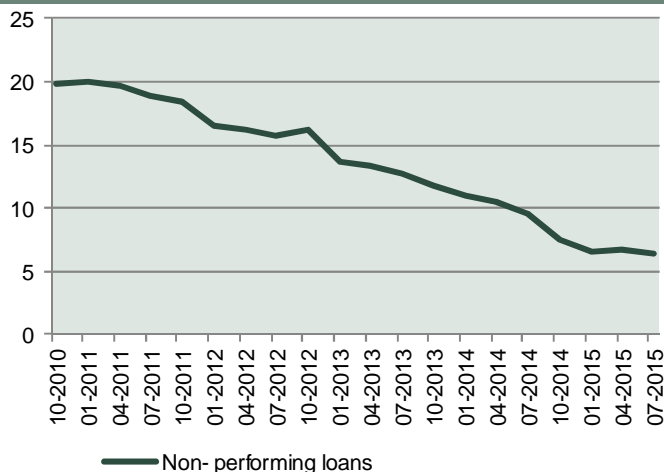
Note: As of 1 October 2014, housing loans also include loans granted to households designated for investment in one's house for one's own needs or rent, including construction and repair; therefore, the data are not fully comparable to the line of previous data.

Source: The Bank of Lithuania

### Quality of the loan portfolio

**The quality of loans slightly improved.** In Q2 2015 the ratio of non-performing loans (including funds in banks and debt securities) accounted for 6.4 per cent of the loan portfolio on a gross basis.<sup>5</sup> Over the quarter, the ratio of non-performing loans improved by 0.3 p.p. The greatest impact on this was had by the increase in funds at central banks and the most increased new loan amounts, affecting the loan portfolio growth. As in earlier periods, the writing off of bad loans also affected the ratio of non-performing loans.

### Bank non-performing loans (compared to the loan portfolio, %)



Note: from 2015 the European Union has begun applying a new definition for non-performing loans; the 1 October 2014 quality indicators for the loans of banks operating in Lithuania are announced in accordance with new requirements and their meanings are not entirely comparable to earlier ones.

Source: The Bank of Lithuania

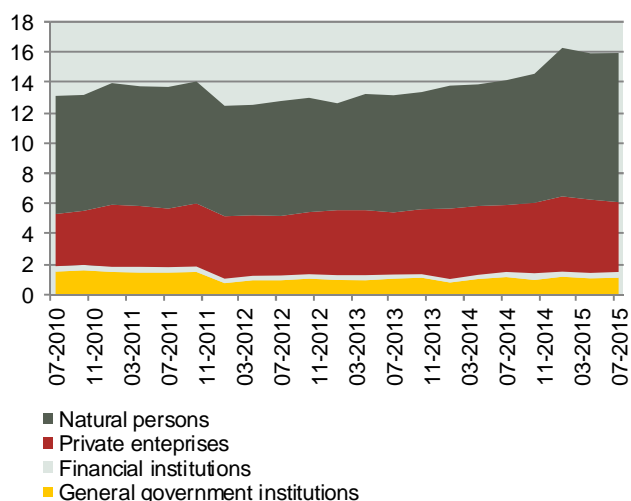
## Deposits with banks

**The deposit amounts with banks increased moderately in Q2 2015.** As of 1 July 2015, customers held with banks EUR 15.9 billion in deposits, which was a hike of EUR 29 million (0.2%) quarter on quarter. Deposits rose over the quarter across customer groups other than private undertakings. Deposits of natural

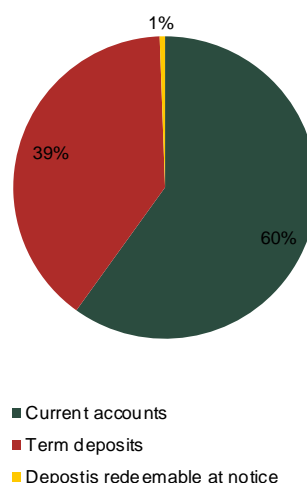
<sup>5</sup> The loan portfolio (excluding funds in banks and debt securities) ratio to non-performing loans amounted to 8.2 per cent.

persons increased the most — by EUR 201 million (2.1%), while the amount of enterprise deposits contracted by EUR 222 million (4.6%). Compared to Q2 2014, the customers' deposit amount with banks increased by EUR 1.8 billion (12.8%). Judging from the data, we can claim that the changes in deposits are currently moderate, while more dramatic annual changes were affected by the impact of the euro adoption, when the population brought in significant funds, part of which remained in the bank accounts. It seems that even though interest rates are low, bank deposits will continue to be the most popular financial instrument for keeping funds, although recently alternative financial products are becoming popular, such as pension funds, investment funds and life assurance. Nevertheless, it can be seen that in the absence of sufficient return, preference is given to current accounts, not fixed-term deposits.

**The amount of deposits**  
(EUR billion)



**Composition of deposits by term**  
(1 July 2015)



Source: The Bank of Lithuania

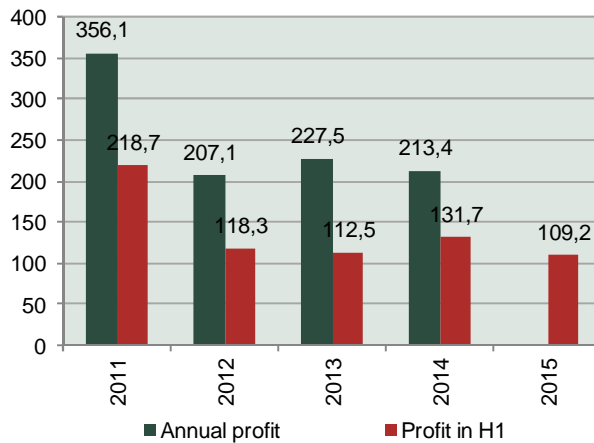
## Profitability and efficiency of operations

**In Q1 2015 the banking system operated at a profit; however, gross profit declined further.** The profits earned by banks and foreign bank branches operating in Lithuania over the first half-year of 2015 amounted to EUR 109.2 million, a year-on-year decrease of EUR 22.5 (17.0%). Profit was affected in a negative direction by both net interest income and net income from services and commissions. In Q1 2015, compared to the same period a year ago, 8 market participants increased their profits and 7 earned less. Over the first half year of 2015 only two market participants incurred losses, while the others operated at a profit.

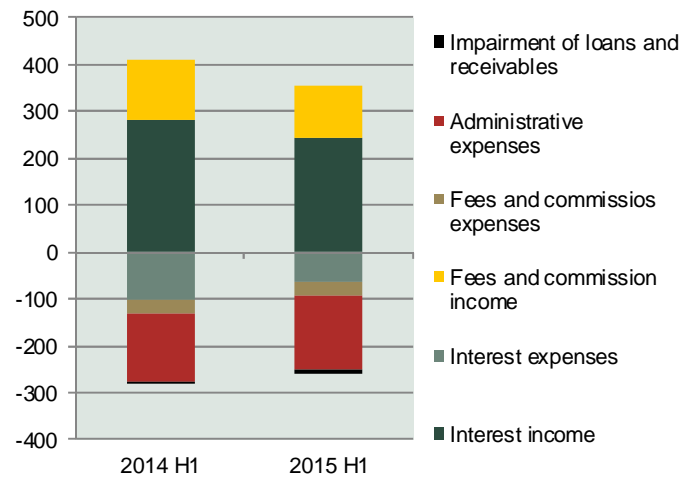
**The low interest rate environment was unfavourable for net interest income.** Bank interest income in Q1 2015, compared to the same period a year ago, decreased by EUR 41.7 million (−14.7%) and amounted to EUR 241.2 million, while expenses decreased by EUR 38.8 million (−37.3%) and amounted to EUR 65.2 million. The low interest rate environment remained unfavourable, since smaller expenses did not offset the decreased income from their assets: the net interest income contracted by EUR 2.9 million (−1.6%) and reached EUR 176.2 million.

**The change in the services and net commissions income decreased profit.** Despite taxes on certain services (e.g. for management of accounts) being applied more widely, the net income from fees and commissions of banks also dropped. Part of the income in this area was lost by banks with the loss of the need to convert litas to euro, while income from cross-border transfers also decreased. Bank income from services and commissions in Q1 2015, compared to the same period a year ago, decreased by EUR 15.4 million (12.0%) and amounted to EUR 112.7 million, while expenses, on the other hand, increased by EUR 1.8 million (6.5%) and amounted to EUR 29.4 million. With such developments taking place, net income from services and commissions decreased by 17.2 million (−17.1%) and amounted to EUR 83.3 million.

### Profit of the banking sector (EUR millions)



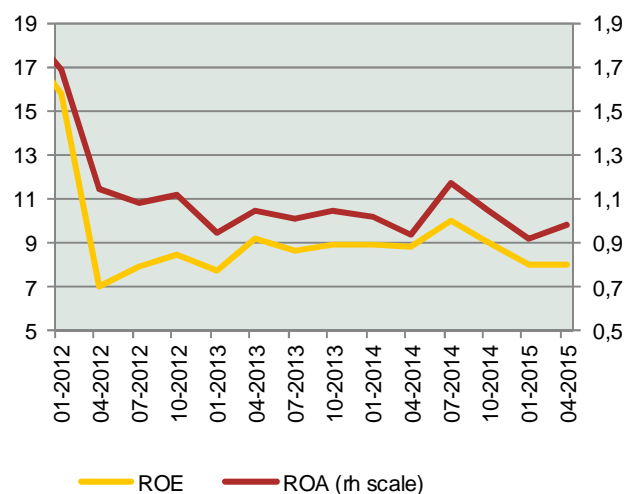
### Main items of income and expenses (EUR millions)



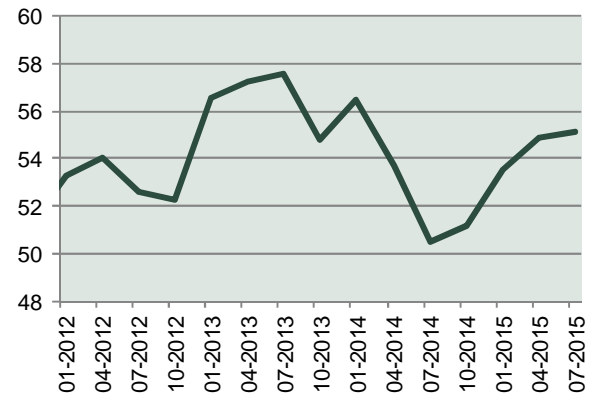
Source: The Bank of Lithuania

**Bank administrative expenses were also changing in a direction unfavourable for profit.** In the first half year of 2015, banks experienced EUR 155.4 million in administrative expenses. Compared to the first half year of 2014, it widened by EUR 10.6 million (7.3%). Receiving lower net profit from their primary activity, banks experience pressure due to administrative expenses; they most likely increase as a result of income expenses.

### Profitability indicators of banks (%)



### Cost-to-income ratio (%)



Source: The Bank of Lithuania.

**All of the aforementioned factors negatively affected the profitability ratios of banks.** The bank return on assets ratio over the year decreased from 1.17 to 0.95 per cent, while equity return worsened from 10.4 to 7.62 per cent. As a result of the increase in expenses exceeding income, in Q2 2015 the cost-to-income ratio of banks also worsened — over the past quarter it was 55.2 per cent (a year ago it reached 50.5%).

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