

Abbreviations

CCyB	countercyclical capital buffer
ESRB	European Systemic Risk Board
EU	European Union
GDP	gross domestic product
HPI	housing price index, calculated by Statistics Lithuania
MFI	monetary financial institution (bank or credit union)
RE	real estate

The publication was 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, the cut-off date for data used in the publication is 30 June 2018.

Periods indicated in charts include data for the respective year, quarter, etc.

Decision basis for setting the countercyclical capital buffer rate

On 25 September 2018, the Board of the Bank of Lithuania took a decision* to leave the CCyB rate unchanged at 1.0%, as set in June 2018. It will come into effect on 30 June 2019**. Such a decision was taken in view of the recent financial and economic trends, as well as core and additional indicators for setting the CCyB. The analysis of the credit and RE markets points to no significant imbalances in the financial system. In a period of moderate systemic risk, when credit and RE market activity is relatively high, the domestic economy is expanding and the corporate financial health is strong, the Bank of Lithuania seeks to ensure that banks accumulate a 1% CCyB.

The portfolio of loans to the non-financial private sector has been growing. On June 2018 its annual growth rate stood at 8.8%. The faster growth of the portfolio of loans to the non-financial private sector in Q2 2018 was largely determined by the increase in lending to non-financial corporations, which was especially robust in May and June. The annual growth rate of the portfolio of loans to households has been fluctuating around 7.4% for the last six months. Lending continued to be driven by low interest rates, growth in household income, declining unemployment and the improving business and household sentiment regarding future prospects. Banks expect that the growth rate of the loan portfolio in 2018 will not exceed the projected nominal economic growth.

In Q2 2018, activity in the housing market was slightly stronger. According to the Centre of Registers, on a year-on-year basis 3.7% more housing was assigned across Lithuania in Q2 2018. The main contribution to growth in housing transactions came from the significant increase (24.1%) in the number of transactions concluded in Vilnius. In the rest of the country, housing market activity somewhat scaled down in Q2 2018, with 2.4% less housing assigned year on year. In Q1 2018, the annual growth rate of house prices was 7.8%, a quarter-on-quarter increase of 0.9 percentage point. Over the same period house prices in Vilnius decelerated and stood at 3.5%, while in the remaining part of the country they picked up steam, to reach 11.7%. Preliminary RE market assessments show that the price gap between Vilnius and the remainder of the country should prevail in Q2 2018.

With no significant imbalances, the level of cyclical systemic risk remains average. The 1% CCyB rate set by the Bank of Lithuania is justified in terms of the current state of the domestic financial system. The gap between the credit-to-GDP ratio and its long-term trend (calculated using the forecast-augmented method) continues to be negative (in Q4 2017 – -11.5 and -3.6 percentage points respectively). The loan-to-deposit ratio is sustainable, fluctuating at 100%, while the current account balance is positive. The gap between the house price-to-household income ratio and its long-term trend remains negative, which means that wages are outpacing house prices, whereas RE prices are sufficiently well-founded in terms of other fundamental factors. Thus it might be stated that the likelihood of a systemic crisis in Lithuania is low. In case of any signs of imbalances, the Bank of Lithuania is ready to increase the CCyB rate; in the event of significant economic or financial market shocks, the CCyB rate could be instantly lowered.

* Resolution No 03–169 of the Board of the Bank of Lithuania of 2018 September 25 on the application of the countercyclical capital buffer.

** The 0.5% CCyB rate will come into effect on 31 December 2018, the 1% CCyB rate – on 30 June 2019.

DEVELOPMENTS IN CREDIT AND REAL ESTATE MARKETS

According to Bank of Lithuania assessment, in Q2 2018 lending in Lithuania picked up steam, yet this was mainly spurred by individual large-scale transactions in the non-financial sector rather than acceleration in overall economic activity. In June 2018, the portfolio of loans to the non-financial private sector was up by 8.8% year on year. Having been negative for four consecutive quarters, credit impulse, which shows the momentum of loan portfolio growth, increased by 1.8 percentage points in Q2 2018, to reach 0.9. Such rapid developments were largely influenced by lending to non-financial corporations – the annual growth rate of the portfolio of loans granted to them accounted for 10.2% in June 2018. Nevertheless, the pick-up in lending to non-financial corporations in May and June was driven by several one-off large-scale transactions, thus recent trends should not be seen as long-term. Lending to households remained stable, with the annual growth rate standing at 7.4% (unchanged from the start of 2018).

Low interest rates, increasing wages, declining unemployment and improving household sentiment continued to support household lending. The annual growth rate of the housing loan portfolio has remained basically unchanged since the beginning of 2017. In June 2018, it reached 8.0%, a year-on-year increase of 0.2 percentage point. The net flow of new housing loans followed an upward trajectory: over the first half of 2018 it amounted to €612 million, a year-on-year increase of 4.4%. As usual, such trends were mainly underpinned by fundamental factors – the persistently low interest rates, rising household income and declining unemployment. In June 2018, the average interest rates on new housing loans stood at 2.3% and were 0.2 percentage point higher year on year. Despite the step-up, the cost of borrowing remained relatively low. The improving financial health of households (rising wages, falling unemployment) was also a contributing factor to the lift in their future expectations and the rise in the number of

households that are planning to make larger-value purchases in the near future. At the end of Q1 2018, the average wage (gross) saw a year-on-year increase of 9.8% (unemployment, respectively, amounted to 7.2%, decreasing 0.8 percentage point over the year). This contributed to improving household expectations: although in July 2018 the consumer confidence indicator¹ was still negative (-3 percentage points), it remained the highest since September 2007.

Midyear lending to non-financial corporations accelerated, yet this was mainly driven by one-off factors. In June 2018 the annual growth rate of the portfolio of MFI loans to non-financial corporations reached 10.2%, even though in April it only stood at 6.1%. The major shift occurred in May and June 2018, when the annual growth rate shot up due to several large-scale transactions in the energy and trade sectors. It is likely that over the upcoming quarter growth will not lose steam since at the start of Q3 another transaction valued at more than €100 million will be made. Lending should be also underpinned by growing investment, a quarter of which was financed with bank loans in 2017. In Q1 2018, investments were up by 6.5% year on year, exceeding the average² recorded over the past decade by almost a third. Corporate expectations have been also improving: in July 2018 the economic sentiment indicator stood at 10 percentage points, i.e. the highest level since September 2007. All this makes it more likely that the corporate loan portfolio will continue expanding.

At the beginning of 2018, house prices in Lithuania continued growing at a robust pace, while the most significant price changes were recorded outside the country's capital. According to the latest data of Statistics Lithuania, in Q1 2018 house prices in the country were 7.8% higher year on year. Quarter on quarter, house prices rose 0.9 percentage point. House price trends in Vilnius differed markedly compared to the rest of the country. In Q1, growth in house prices in the capital city decelerated by 0.4 percentage point, to 3.5%. In the rest of the country house prices rose 11.7%, a quarter-on-quarter increase of 2.1 percentage points. RE market participant data for Q2 shows that in the nearest future such contrasting trends will prevail. According to the data of UAB Ober-Haus, in Q2 2018 apartment prices in Vilnius saw a year-on-year increase of 2.3%, while in other biggest cities³ apartment prices grew by 2.9-5.9% over the same period.

In Q2 2018 activity in Lithuania's housing market slightly accelerated, remaining at historical highs. According to the Centre of Registers, in Q2 2018, 11.7 thousand apartments and private houses were sold in Lithuania (a year-on-year increase of 3.7%). The main contribution to growth in housing transactions came from the significant increase (24.1%) in the number of transactions concluded in Vilnius. Yet such dynamics in Vilnius market do not reflect the trends that were observed in Q2 2018 and are mainly linked with new-build apartment transactions that were previously concluded in the primary market and registered in the Centre of Registers after the constructions had been finished. To compare, in Q2 2018 the number of old-construction apartment transactions – which better reflect the general RE market trends – in Vilnius increased by 5.5% year on year. In the rest of the country, housing market activity somewhat scaled down in Q2 2018, with 2.4% less housing assigned year on year. Activity in Vilnius primary apartment market – the largest one in Lithuania – has remained largely unchanged: according to UAB Eika, in Q2 2018 the number of new-build apartments sold in Vilnius shrank by 0.8% year on year.

With activity in the housing market still solid, in Q2 2018 the supply of new-build apartments in Vilnius primary market somewhat increased, remaining to be one of the largest over the last couple of years. According to UAB Eika, at the end of Q2 2018 RE developers put 4.2 thousand apartments in Vilnius up for sale. The number of apartments for sale increased by 5.2% over the quarter, a year-on-year increase of 10.3%. The expected time frame for selling an apartment⁴ is 14 months. This liquidity indicator of Vilnius primary housing market did not change significantly during the quarter, however, it was higher than at the end of Q2 2017, when the expected time frame for selling new-build apartments was 13 months. According to UAB Ober-Haus projections, the supply of new-build housing in Vilnius should see a significant rise in 2018: the number of housing put up for sale by RE developers will increase by 14.1% compared to 2017.

With activity in the housing market stabilising and the number of unsold apartments remaining relatively high, expectations of banks regarding apartment prices in Lithuania continue to be moderate. According to the Banking Survey conducted by the Bank of Lithuania in Q2 2018, the majority of respondents expected the prices of new-build and old-construction apartments to remain unchanged in the next 12 months – respectively five and eight of the nine surveyed banks did not anticipate any apartment price changes. One bank indicated that prices of old-construction apartments will rise by up to 5% in the upcoming 12 months. Two banks expected that new-build apartment prices will increase by up to 5%, another two believed that they will drop by the same amount. Compared to the results of the Q1 2018 survey, the number of banks expecting a rise in new-build apartment prices decreased, while their expectations regarding older-construction housing prices remained basically unchanged. As previously, households remained optimistic about house price dynamics, with half of them anticipating a rise in house prices.

¹ The consumer confidence indicator is calculated as the difference between households with positive and negative future outlook.

² Investments made in Q1 were taken into account when calculating the average.

³ In Kaunas, Šiauliai and Panevėžys.

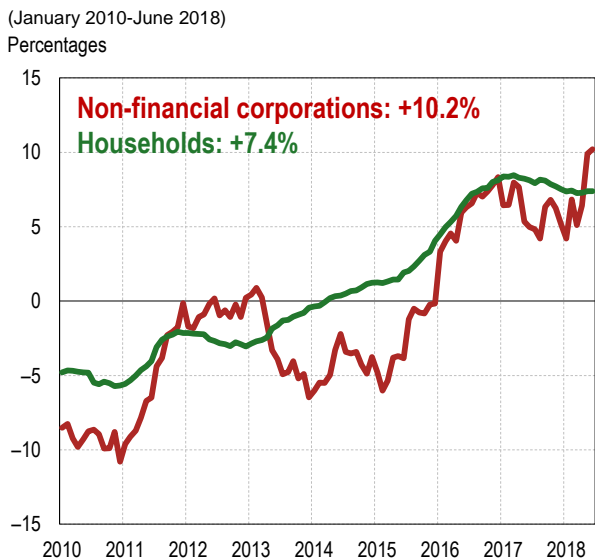
⁴ Calculated as the ratio between the number of housing for sale and the flow of current sales over a month.

Although in Q1 2018 credit outpaced GDP, most indicators that are used to assess the build-up of financial system imbalances did not signal excess risk. In Q1 2018, the annual growth rate of the portfolio of loans to the non-financial private sector stood at 8.8%, while nominal GDP expanded by 7.7%.⁵ As a result, the negative gap between the credit-to-GDP ratio and its long-term trend started to decrease. Subject to the method of assessment, at the end of Q1 2018 it reduced by 2.3 and 0.7 percentage points respectively compared to last year (-11.5 and -3.6 percentage points). Other indicators also suggest that there are no imbalances in the financial system and the level of cyclical systemic risk is moderate. For example, the loan-to-deposit ratio remained largely unchanged, fluctuating at 100%, the current account balance has been improving for the fourth consecutive quarter, while the gap between the house price-to-household income ratio and its long-term trend, although still reducing, remains negative. Given that trends in RE and credit markets in Q2 2018 remained basically unchanged, the CCyB rate was left at 1.0%.

⁵ The last four-quarter moving sum.

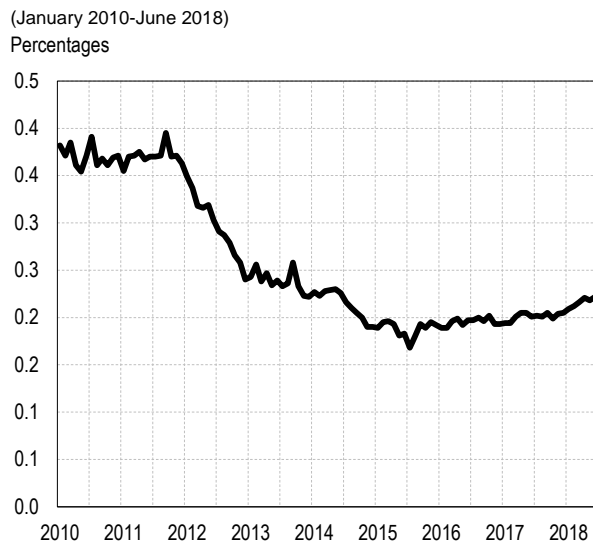
Annex 1. Credit and housing market trends

Chart 1. Annual growth of the portfolio of loans to non-financial corporations and households
(January 2010-June 2018)



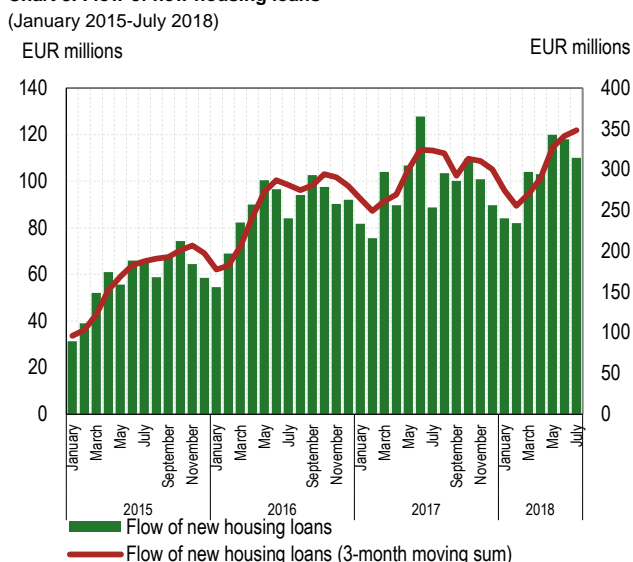
Source: Bank of Lithuania.

Chart 2. Average interest rates on new business of housing loans



Source: Bank of Lithuania.

Chart 3. Flow of new housing loans



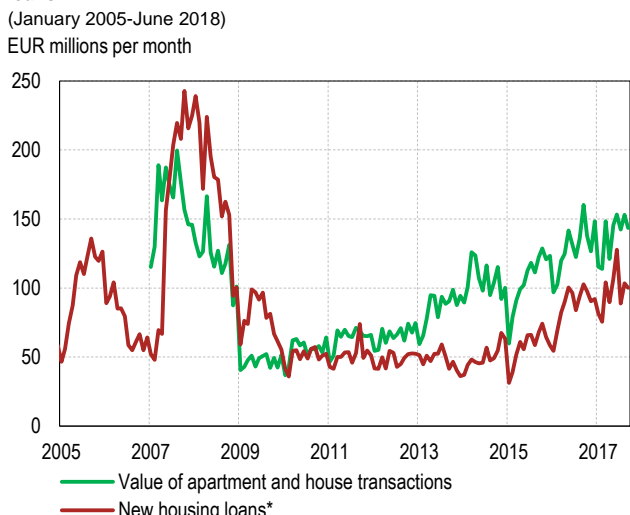
Source: Bank of Lithuania.

Chart 4. Tangible investment and average wage



Source: Bank of Lithuania.

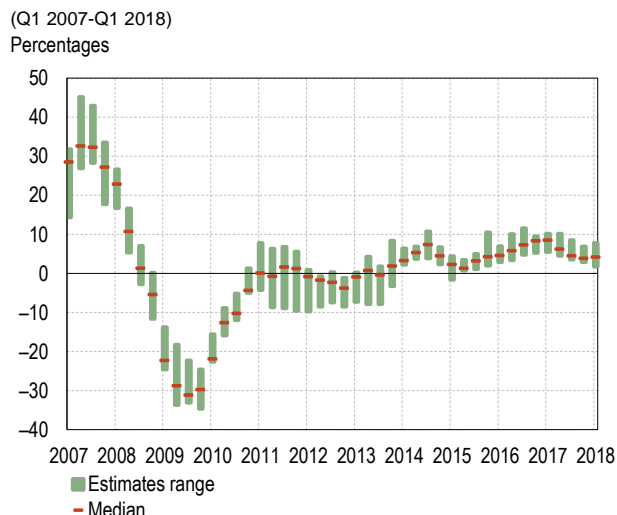
Chart 5. Amount of apartment and house transactions and new housing loans



Sources: Centre of Registers and Bank of Lithuania.

* From 2015 housing loans do not include renegotiations.

Chart 6. Annual growth in house prices according to different sources



Sources: Centre of Registers, Statistics Lithuania, UAB OberHaus, Aruodas.lt and Bank of Lithuania calculations.

Chart 7. Number of housing transactions and annual change in the house price index

(Q1 2010-Q2 2018)

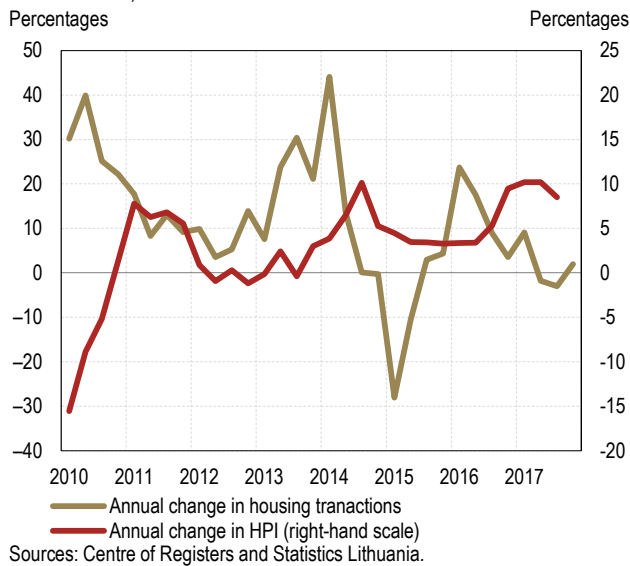
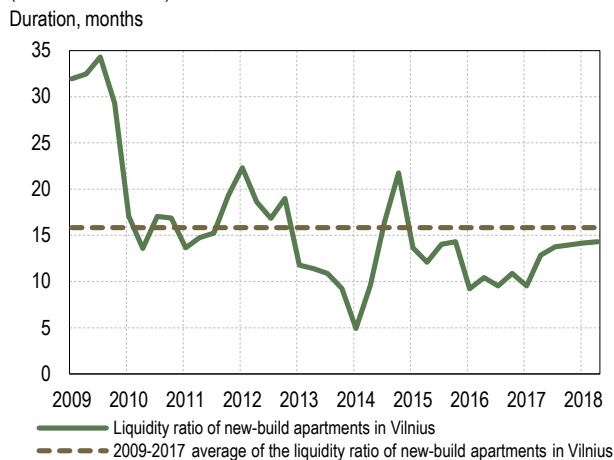


Chart 8. Liquidity within the new-build apartment market in Vilnius

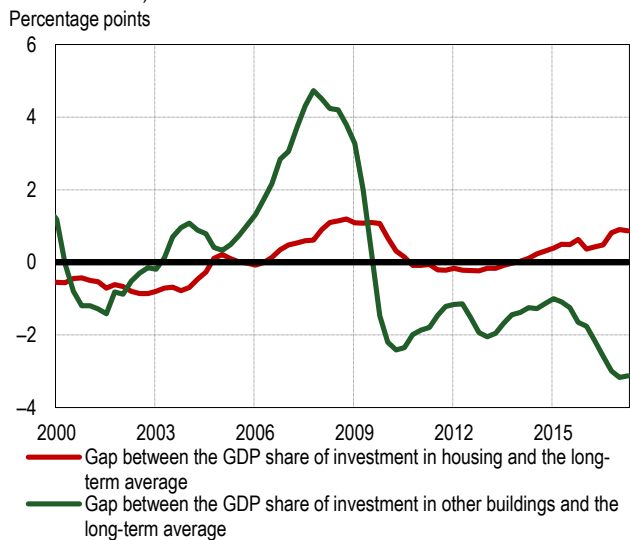
(Q1 2009-Q2 2018)



Sources: UAB Eika and Bank of Lithuania calculations.
 Note: The liquidity ratio indicates how much time would it take for developers to sell the apartments offered if demand remained the same and no more apartments were built.

Chart 9. Gap between investment in housing and other buildings (compared to GDP) and long-term average

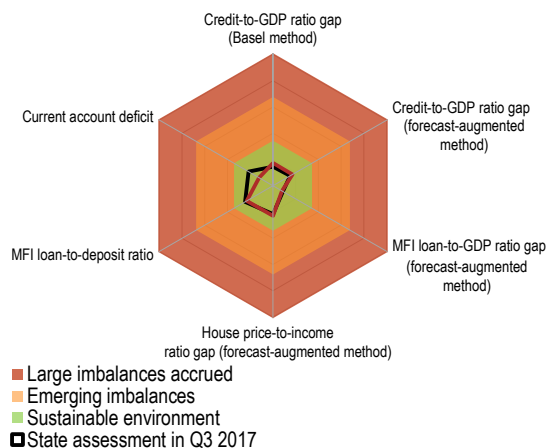
(Q1 2000-Q1 2018)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

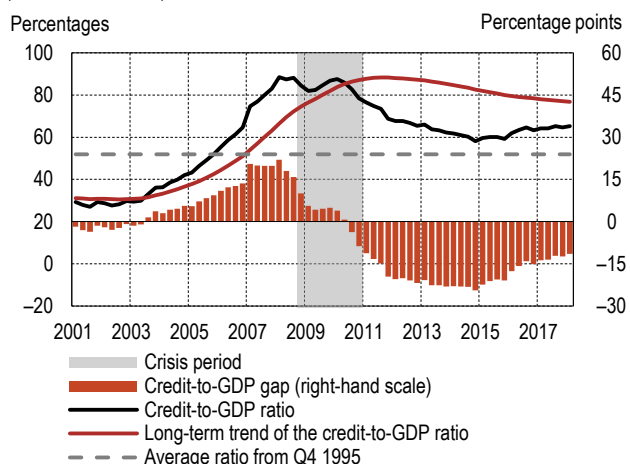
Annex 2. Credit and housing market imbalances

Chart A. Evaluation of credit market imbalances based on core and additional indicators:
(Q3 2018)



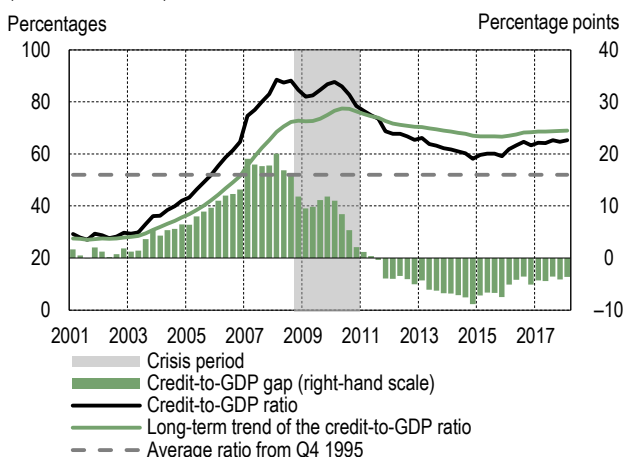
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: Axes are scaled according to the range of a particular indicator: from its minimal value up to the maximal value.

Chart B. Core indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method)
(Q1 2001-Q1 2018)



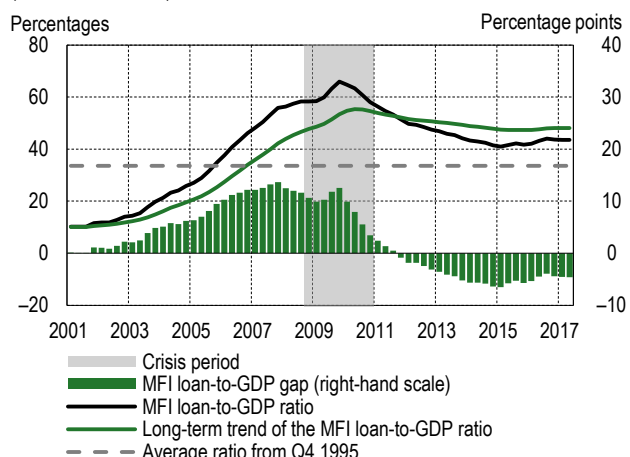
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

Chart C. Core indicator II: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method)
(Q1 2001-Q1 2018)



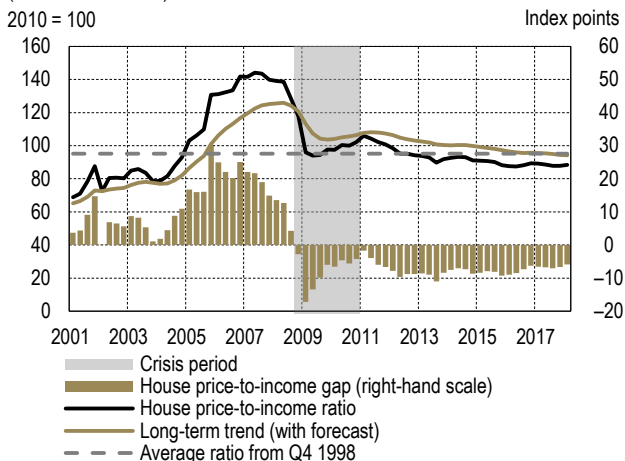
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart D. Additional indicator I: MFI lending to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method)
(Q1 2001-Q2 2018)



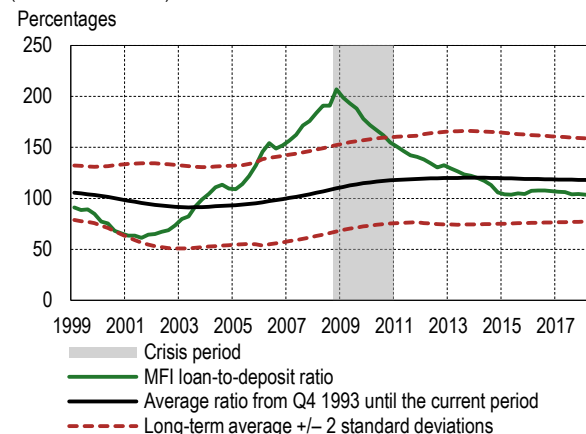
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is estimated by applying a one-sided HP filter with a smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart E. Additional indicator II: House price-to-household income ratio gap (calculated using the forecast-augmented method) (Q1 2001-Q1 2018)



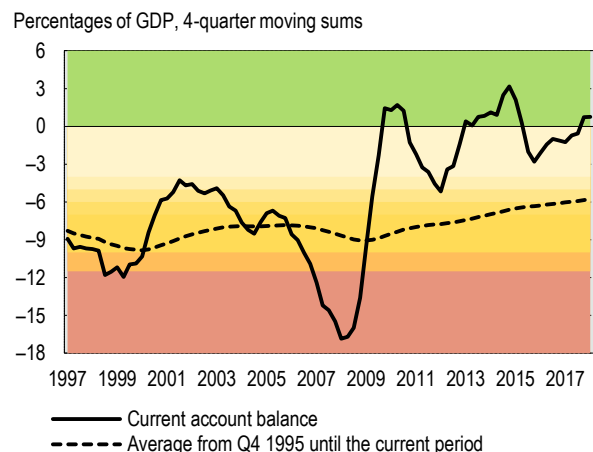
Sources: Statistics Lithuania and Bank of Lithuania calculations.
 Note: The long-term trend is estimated by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart F. Additional indicator III: Ratio between MFI loans to the private sector and private sector deposits (adjusted for seasonal effects) (Q1 1999-Q2 2018)



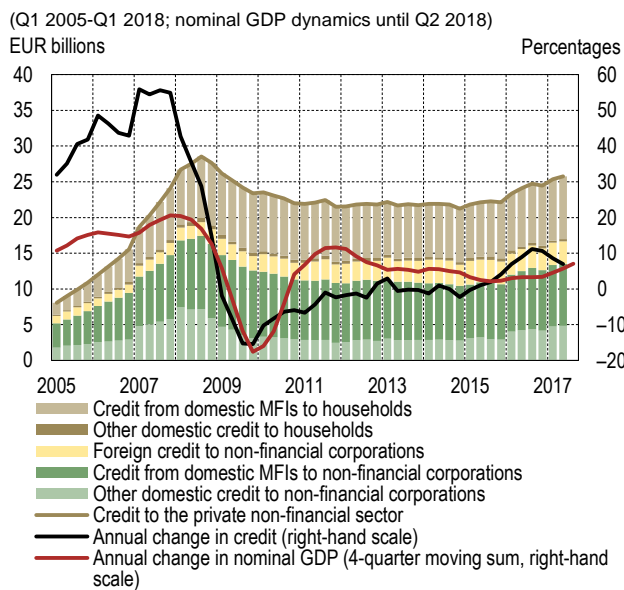
Source: Bank of Lithuania calculations.
 Note: The ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding data for Q2 2006-Q4 2011.

Chart G. Additional indicator IV: Ratio between the current account balance (4-quarter moving sums) and GDP (Q1 1997-Q1 2018)



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 H. Credit and nominal GDP moving dynamics



Sources: Statistics Lithuania and Bank of Lithuania calculations.