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Countercyclical Capital Buffer

Background material for decision

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

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DECISION BASIS FOR SETTING THE COUNTERCYCLICAL CAPITAL BUFFER RATE

On 25 June 2019, the Board of the Bank of Lithuania took a decision[1] to leave the countercyclical capital buffer (CCyB) rate unchanged at 1%, 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 rate.

The credit and real estate (RE) market analysis points to no significant imbalances in the financial system. The credit-to-GDP ratio is stable, the current account balance is positive, the loan-to-deposit ratio fluctuates around 100%, and RE prices are close to their reference value. Nonetheless, activity in the credit market remains strong, thus the financial cycle in Lithuania is on an upswing. In periods of moderate systemic risk, when credit and RE market activity is relatively high, the domestic economy is expanding and corporate financial health is strong, the Bank of Lithuania seeks to ensure that banks accumulate a 1% CCyB.

CREDIT AND REAL ESTATE MARKET DEVELOPMENTS

Crediting in Lithuania remained active, although on a quarter-on-quarter basis its growth rate scaled down. According to the latest financial accounts, the annual growth rate of Lithuania's financial liabilities stood at 2.7% in Q4 2018, a decrease of 2.6 percentage points quarter on quarter. The annual growth rate of household liabilities increased by 1.1 percentage points over the quarter, while the annual growth rate of corporate liabilities decreased by 2.7 percentage points. Data on monetary financial institutions (MFIs) shows that lending volumes of credit institutions also reduced. The annual growth rate of the portfolio of MFI loans to the private non-financial sector amounted to 5.1% in March 2019, a quarter-on-quarter decrease of 0.9 percentage point. This was due to a significant drop in growth of the corporate loan portfolio, which accounted for a meagre 1.6% in March 2019 (3.2% in December 2018). On the other hand, recently household crediting has been extremely active, hence the annual growth rate of the household loan portfolio remained robust, to account for 8.6% in March 2019.

Growth in the MFI corporate loan portfolio decelerated. The annual growth rate of the portfolio of MFI loans to non-financial corporations decreased over the quarter and amounted to 1.6% in March 2019. These trends might have been led by the stricter lending conditions of some banks[2] and greater concentration in the banking sector. For instance, surveys of enterprises show that in 2018 and at the beginning of 2019 the share of rejected applications for external financing increased and reached 27%. In addition, as Danske bank is in the process of leaving the market and the market share of Luminor bank has reduced, the remaining banks were able to be more picky when it comes to their clientele. At the same time, interest rates on new bank loans to non-financial corporations continued to rise – their annual average increased by 0.53 percentage point year on year. As previously, the main bulk of the portfolio of loans to non-financial corporations consisted of loans for RE (27%), trade (22%) and manufacturing (14%) firms, however, over the year the portfolios of loans to RE and manufacturing firms contracted by €23 million (0.9%) and €7 million (0.6%) respectively. Over the year, lending to trade and transport firms as well as holding companies increased by €114 million (6.1%), €118 million (20.3%) and €105 million (18%) respectively. Changes in the structure of new loan flows have recently also emerged. At the end of Q1 2019, the annual flow of loans up to €1 million (including renegotiations) reduced by a third on a year-on-year basis. Conversely, the volume of loans exceeding €1 million increased by 13.3%. Although corporate lending reduced, funding through other external sources – trade credit (€0.4 billion), loans from other non-financial corporations (€0.6 billion) and debt securities (€0.5 billion) – picked up steam.

Growth in the household loan portfolio remained robust, underpinned by active mortgage lending. According to data as at March 2019, the household loan portfolio increased by an annual 8.6%. The mortgage loan portfolio expanded by 9.1%, the consumer loan portfolio – 6.2%, i.e. an increase of 0.4 percentage point

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[1] Resolution No 03-121 of the Board of the Bank of Lithuania of 25 June 2019 on the application of the countercyclical capital buffer.

[2] As evidenced by surveys of banks and non-financial corporations carried out by the Bank of Lithuania.

and a decrease of 2.5 percentage points respectively compared to the end of 2018. At the end of Q1 2019, the net flow of new mortgage loans amounted to €1.3 billion, a year-on-year increase of 11.2%. Growth in household loans continued to be mainly led by decreasing unemployment and rising income, the latter boasting an annual growth rate of 9.7% in Q4 2018. Improving financial health had a positive impact on household expectations: consumer confidence continued improving, as did the prospects of purchasing more expensive items. It is likely that these factors will continue to enhance new loan flows in the future. Since household borrowing rose in line with disposable income, the ratio of new mortgage loans to disposable income remained stable, decreasing by 0.19 percentage point at the end of 2018. However, growth in new mortgage loans might be limited by their increasing interest rates, which in March 2019 stood at 2.41%, reaching their peak level since 2014 (on a year-on-year basis their annual average was 0.23 percentage point higher). Interest rates on consumer loans are following a downward path – at the end of Q1 2019 their annual average decreased by 0.73 percentage point compared to the end of Q1 2018.

House prices in Lithuania increased at a somewhat faster pace, while expectations of a rise in new-build apartment prices strengthened. According to Statistics Lithuania, the annual growth rate of house prices in Lithuania stood at 7.4% in Q4 2018 (4.1% in Vilnius, 10.1% in the rest of the country), i.e. was somewhat higher than in Q3 2018 (6.6%). In comparison, the EU average for 2018 was 4.2%. More recent data provided by RE market participants (UAB Ober-Haus) shows that in Q1 2019 apartment prices in the largest cities were 0.8 percentage point higher. Although growth in house prices outside the country's largest cities remains robust, housing is several times less expensive than in Vilnius[3], albeit household income does not differ as much. Expectations regarding house price dynamics were still moderate: the majority of RE market participants and banks surveyed by the Bank of Lithuania believe that over the year to come new-build apartment prices will rise by up to 5%. Latest trends show that the share of banks and RE market participants that expect a rise in new-build apartments is increasing.

Activity in the domestic RE market remains at historical highs, while the number of housing transactions concluded over Q1 2019 increased further. According to the Centre of Registers, the number of housing sold in Lithuania in Q1 2019 rose by 6.3% year on year. Stronger housing market activity was recorded in Vilnius and Klaipėda, where over the year the number of housing sold increased by 15.3% and 12.0% respectively. According to UAB Eika, the number of transactions in Vilnius new-build apartment market increased by 75% on a year-on-year basis. With demand in new-build apartments rising significantly, the number of unsold new-build apartments in Vilnius somewhat decreased in Q1 2019 (6.0%), still remaining 9.7% higher year on year. Given increasing activity in the housing market, the role of banks became slightly more prominent: the share of housing bought with a loan amounted to 41.1% in the reference period, a year-on-year increase of 0.6 percentage point.

In Q4 2018, the gap between the credit-to-GDP ratio and its long-term trend turned even more negative. Other credit and RE indicators did not show any imbalances as well. The ratio of credit (including non-banks) to the private non-financial sector to GDP amounted to 65.6% in Q4 2018, a quarter-on-quarter decrease of 1.2 percentage points, reflecting the difference in quarterly credit and GDP gains (0.27% and 2.1% respectively). The gap between the credit-to-GDP ratio and its long-term trend turned even more negative, fluctuating between -10.5 and -3.81 percentage points at the end of 2018 (depending on the method of assessment) (see Chart B and C in Annex 2). Nonetheless, in Q1 2019 the gap between the ratio of MFI loans to the private non-financial sector to GDP and its long-term trend narrowed, yet remained negative at -4.96%. Other indicators remained largely unchanged: the loan-to-deposit ratio decreased further and stood at 96.2%, the current account balance increased to 1.6% in Q4 2018, while the gap between the house price-to-income ratio and its long-term trend narrowed yet remained negative (-6.4%). Hence even though activity in the credit and RE markets is still high, it is in line with the rising household income and higher value added generated in the country.

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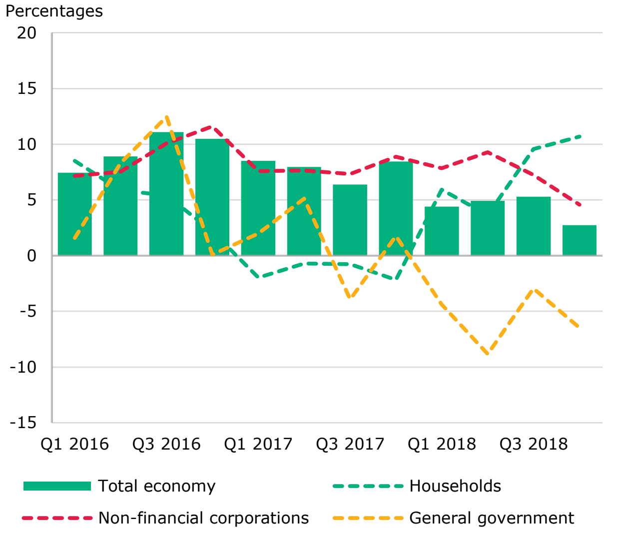
[3] http://www.registrucentras.lt/naujienos/index.php?mod=news&act=view&id=38365

ANNEX 1. CREDIT AND HOUSING MARKET TRENDS

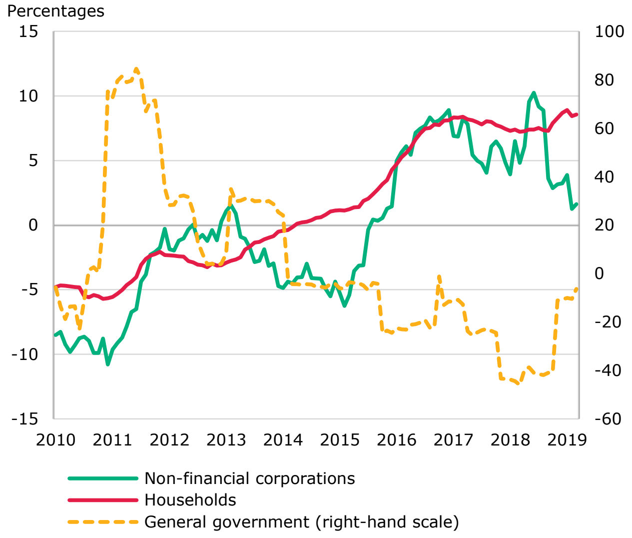
Chart 1. Annual growth rate of Lithuania's financial liabilities

(Q1 2016–Q4 2018)



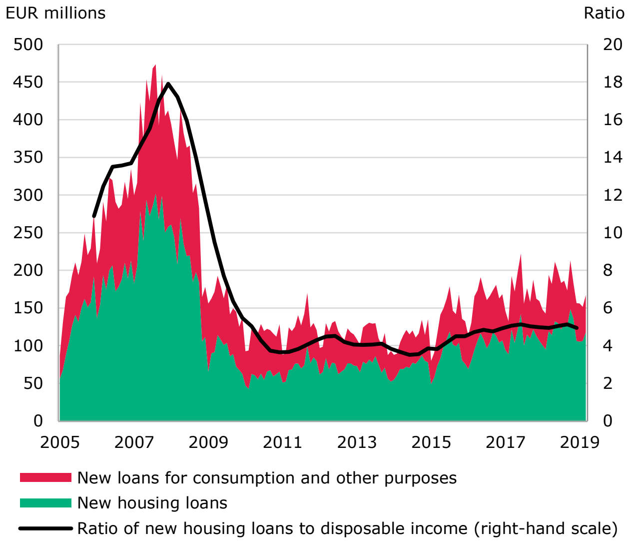
Source: Bank of Lithuania.

Chart 2. Annual growth in the portfolio of MFI loans to non-financial corporations, households and general government
(January 2010–March 2019)



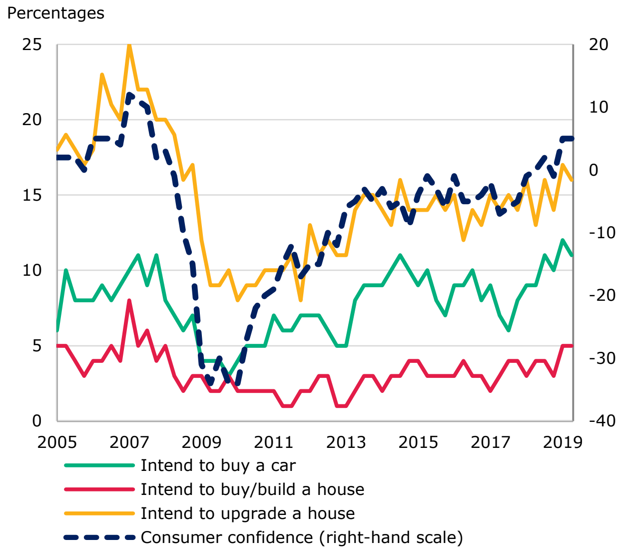
Source: Bank of Lithuania.

Chart 3. Flow of new MFI loans to households
(January 2005–March 2019)



Source: Bank of Lithuania.

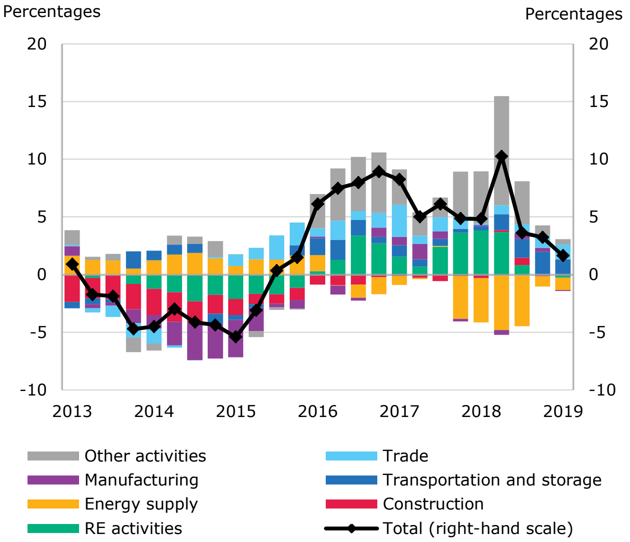
Chart 4. Consumer survey results
(January 2005–April 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Chart 5. Annual change in the portfolio of MFI loans to non-financial corporations by economic activity

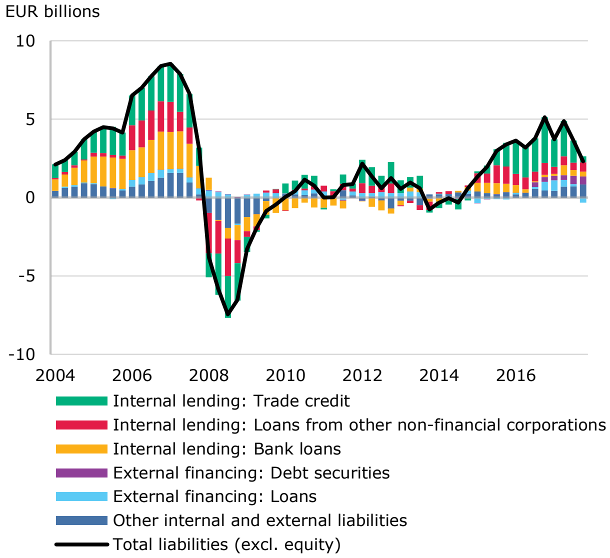
(Q1 2013–Q1 2019)



Source: Bank of Lithuania.

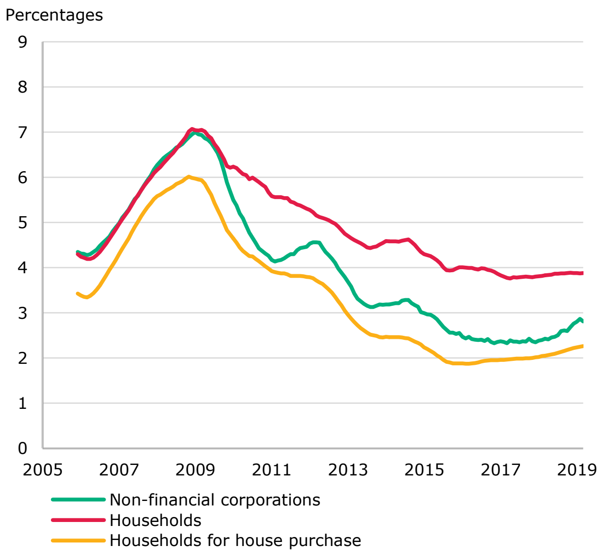
Chart 6. Annual change in credit granted to non-financial corporations

(Q1 2004–Q4 2018)



Source: Bank of Lithuania.

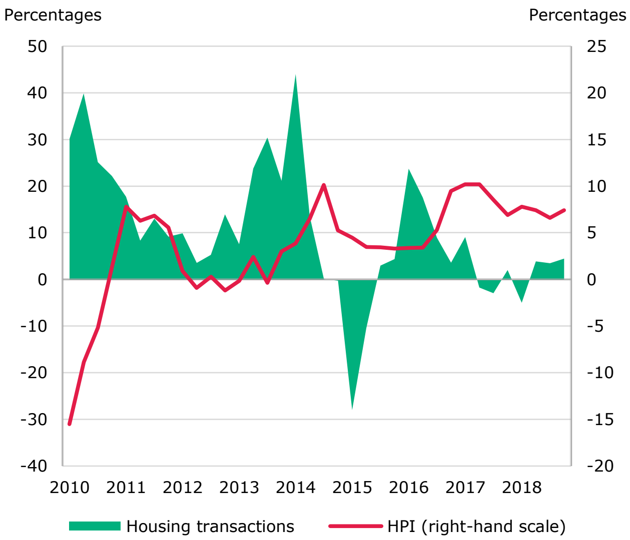
Chart 7. Interest rates on new loans to non-financial corporations and households (12-month moving average)
(January 2005–March 2019)



Source: Bank of Lithuania.

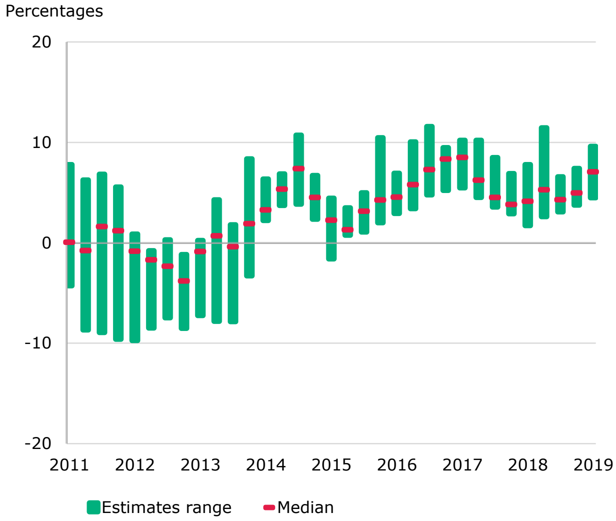
Chart 8. Annual change in the number of housing transactions and the house price index (HPI)

(Q1 2010–Q1 2019)



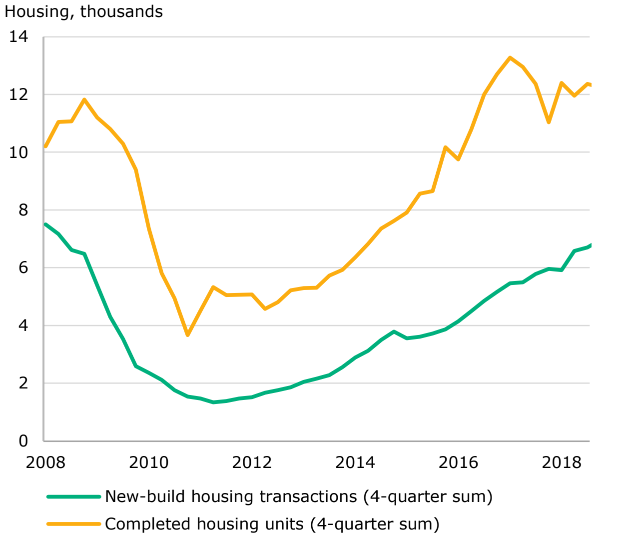
Sources: Centre of Registers and Statistics Lithuania.

Chart 9. Annual growth in house prices according to different sources
(Q1 2007–Q1 2019)



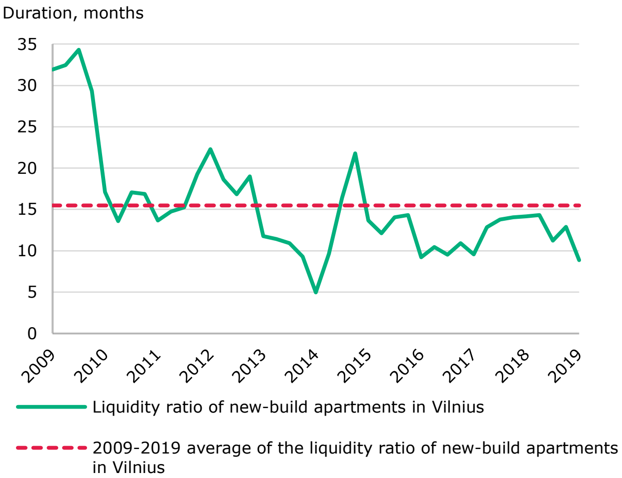
Sources: Centre of Registers, Statistics Lithuania, UAB Ober-Haus, Aruodas.lt.

Chart 10. Number of new housing transactions and completed housing units
(Q1 2008–Q1 2019)



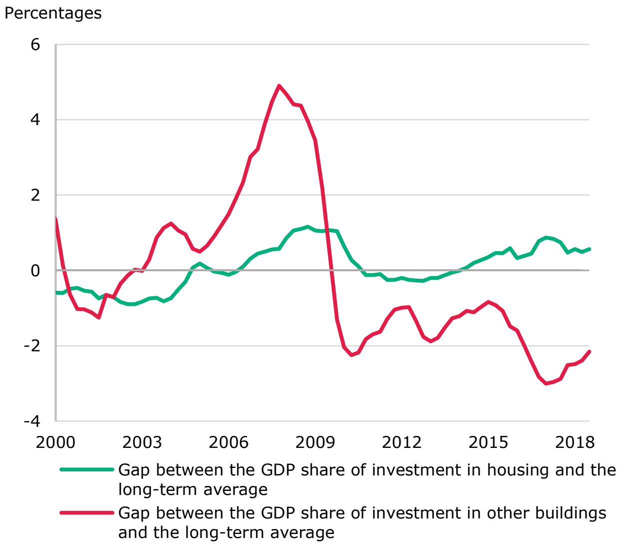
Sources: Centre of Registers and Statistics Lithuania.

Chart 11. Liquidity within Vilnius new-build apartment market
(Q1 2009–Q1 2019)



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

Chart 12. Gap between investment in housing and other buildings (compared to GDP) and the long-term average
(Q1 2000–Q3 2018)

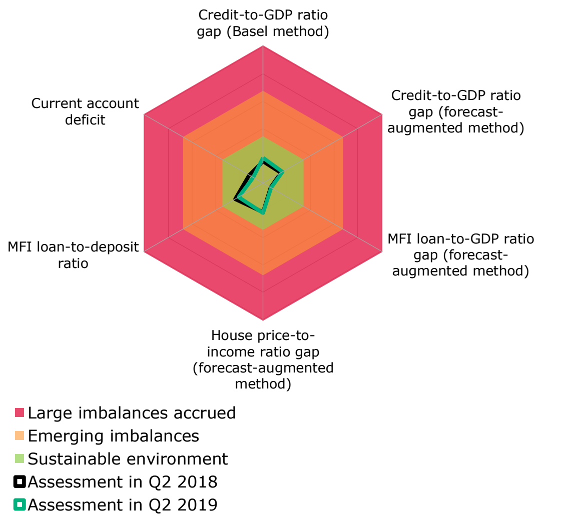


Source: Statistics Lithuania.

ANNEX 2. CREDIT AND HOUSING MARKET IMBALANCES

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

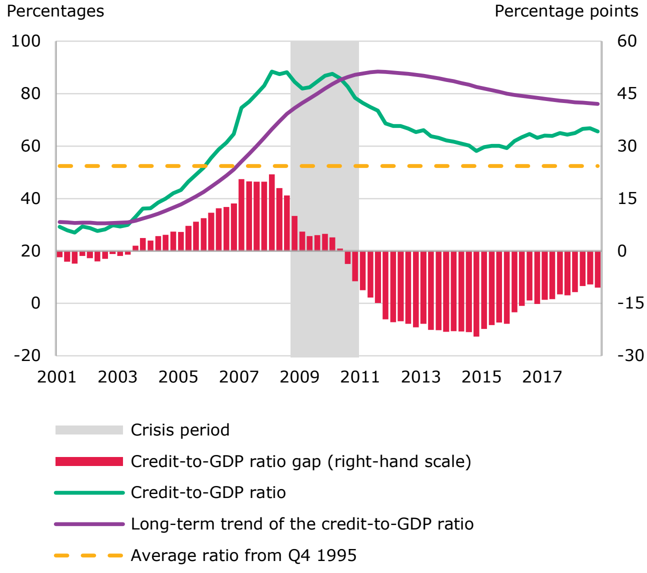
(Q2 2019)



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.

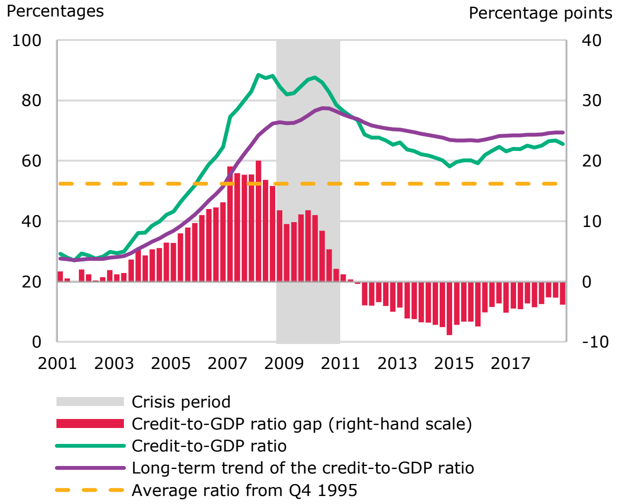
Chart B. Core indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method)

(Q1 2001–Q4 2018)



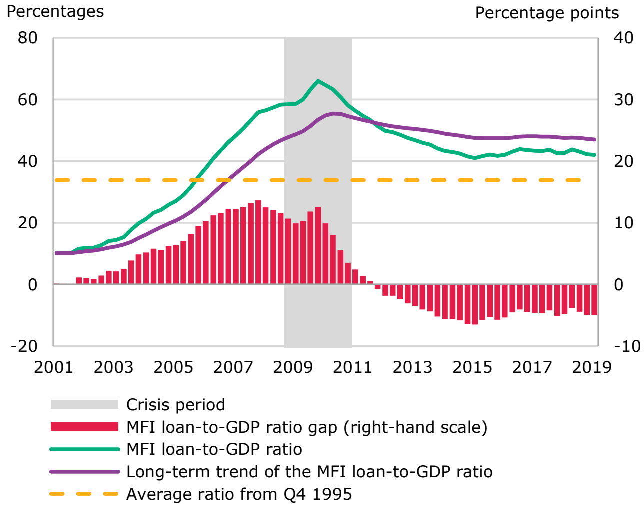
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

Chart C. Core indicator II: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q4 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 5-year window using a 4-quarter weighted average.

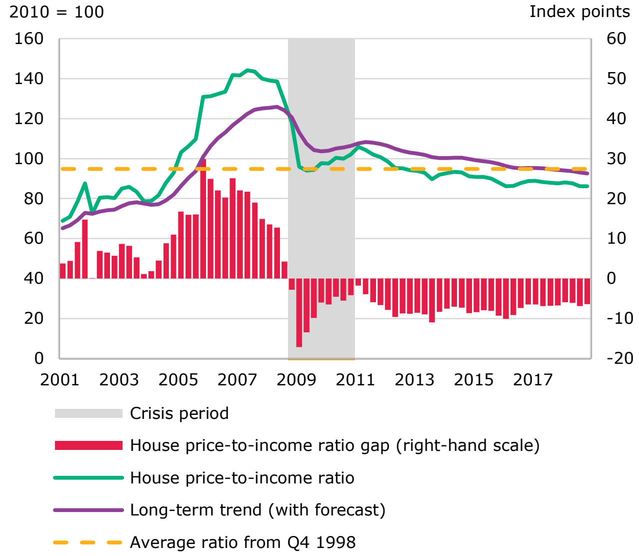
Chart D. Additional indicator I: MFI loans to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q1 2019)



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 5-year window using a 4-quarter weighted average.

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

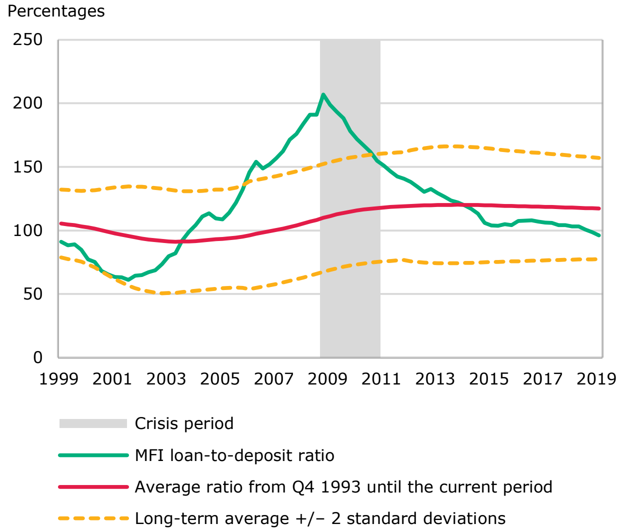
(Q1 2001–Q4 2018)



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 a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

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

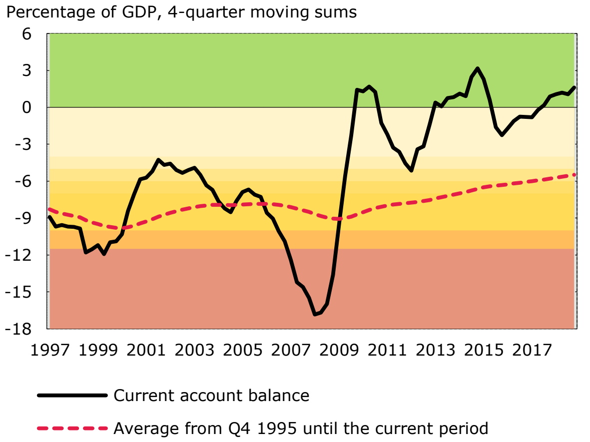
(Q1 1999–Q1 2019)



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

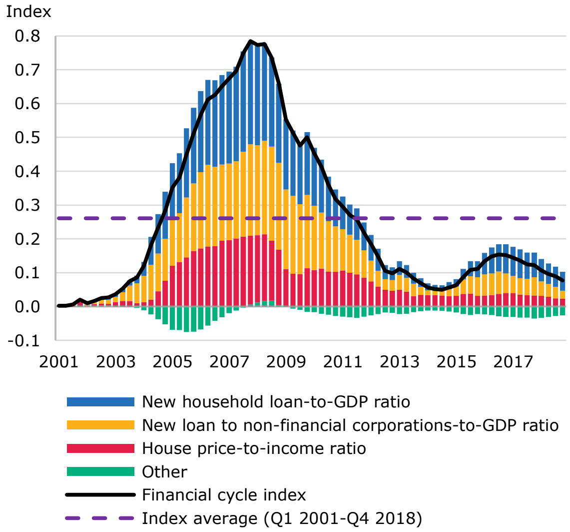
(Q1 1997–Q4 2018)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: Different 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. Contributions to Lithuania's financial cycle index

(Q1 2001–Q4 2018)



Sources: Statistics Lithuania and Bank of Lithuania calculations.