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Quarterly assessment of the financial cycle in Lithuania

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

Introduction

The quarterly assessment of the financial cycle in Lithuania (formerly – the Credit and Real Estate Market Review) is a quarterly publication issued by the Bank of Lithuania that assesses the state of the financial cycle in Lithuania and the level of cyclical systemic risk: the sustainability of trends in the credit and real estate markets, imbalances in the financial sector and the risk of their build-up or widening. The information provided in this review forms the basis for a regular assessment of the level of the rates of the financial stability instruments used, such as the counter-cyclical capital buffer and the sectoral systemic risk buffer for the housing loan portfolio.[1]

Explanation of the key terms used in this publication:

Financial cycle. *The financial cycle refers to the development cycle of the financial system, comprising four phases: expansion (growth), deceleration, recession and recovery, defined by the overall evolution of the various indicators of the financial system (in particular, those reflecting trends in the credit and real estate markets), which are related, for example, to the perception of the value of financial assets and real estate, the perceived level of risk, the tightening or relaxation of lending standards and the resulting impact on the supply of credit, and the interplay between these phenomena. The literature generally considers that the financial cycle tends to last longer than the business cycle and can significantly amplify economic booms and deepen recessions. The application of the CCyB aims at increasing the resilience of the financial system and, to some extent, reducing its pro-cyclicality and, within the meaning of financial cycle, at reducing the size of fluctuations in the financial cycle, especially in the recession phase.*

Systemic risk. *Systemic risk is the risk of a disruption to the financial system or a part of the financial system, which could have significant negative consequences for the financial system and the economy. Two types of systemic risk are generally distinguished: cyclical and structural risks. Cyclical risk is related to the evolution of the financial cycle: it rises and falls as the financial cycle unfolds and is usually associated with changes in the supply of credit and in the risk assessment of financial system participants. Structural (systemic) risk arises from the structural features of the financial system, such as the interconnectedness of financial system participants, concentration and the specific nature of business models.*

Abbreviations

CCyB – counter-cyclical capital buffer

CRE – commercial real estate

EA – euro area

GDP – gross domestic product

HCPI – harmonised consumer price index

HH – household

HP – Hodrick-Prescott filter

HPI – house price index

MFI – monetary financial institutions (banks, credit unions)

NFC – non-financial corporation

RE – real estate

SyRB – systemic risk buffer

[1] For more information, see Financial stability instruments.

Key messages

In Q1 2024, the financial cycle in Lithuania stopped slowing down, stabilising at a low level. Credit to private non-financial sector grew moderately, and banks' lending capacity was not constrained. Lending both from financial institutions and from other sources to households and businesses grew moderately over the period discussed, with nominal growth of broad credit[2] standing at 6.3% and that of MFI credit being at 7.1%. The growth of real credit levels became gradual, in line with that of nominal credit levels. This was mainly due to the continuing decline in inflation and the recovery of new loans. Bank survey results also showed a change in patterns: lending standards were not tightened further and demand for new housing and consumer loans grew. The level of corporate and household indebtedness continued to be stable, with the bank loan-to-GDP ratio remaining one of the lowest in the entire euro area (35.6%). The current account-to-GDP ratio remained positive and continued to increase, while the bank loan-to-deposit ratio has been unchanged for some time, standing at around 79%.

Growth in the corporate loan portfolio accelerated, however, the credit-to-GDP ratio remained low. Overall, upon contraction in the EA corporate credit portfolio year on year, the annual growth of the portfolio in Lithuania accelerated significantly and stood at 7.8% in 2024 March. The number of new loans granted in Q1 2024 was a third lower than a year ago, but the volume of corporate credits was higher than the long-term average due to the effect of larger-scale loans. The MFI corporate loan-to-GDP ratio has not decreased recently but remained at the lowest level in the last 20 years. The gap between the ratio and its long-term trend continued to be negative. Corporate lending from banks continued to be replaced by other sources. While this pattern does not cause significant imbalances, it increases the likelihood of contagion among businesses in the event of macroeconomic shocks. The share of corporate non-performing loans did not change significantly and remains particularly small (1.5%), with the share of non-performing loans in the manufacturing sector increasing (from 0.8% to 3%), and that of companies providing accommodation and food services decreasing substantially (from 11.4% to 5.2%) over the quarter. The financial institutions that participated in the bank survey reported that broadly, the demand for new corporate loans did not change, but was expected to increase in the future.

Activity in the commercial RE market has been muted for the second year already, however, with the prices of premises seeing no adjustments, price imbalances persist. The number and volume of CRE sale transactions were one tenth lower in Q1 2024 than a year ago. Despite low market activity, prices of premises kept rising at a relatively high average annual rate (7.8%), and the annual growth rate of the credit portfolio for RE transaction and construction companies reached its highest level since 2022 (to stand at 8.9%). Expectations of banks for further price developments improved (more and more banks are expecting stable prices rather than an adjustment) but were still slightly worse compared to the housing market. As prices continued to rise, the resulting price imbalances slightly increased (for example, Class A offices in Vilnius may be overvalued by more than 20%). The yield of Government securities decreased by around 0.5 percentage points and pushed up the CRE investment risk premium over the quarter. The CRE investment attractiveness, although gradually improving, remains markedly deteriorated, which acts as a drag on new investments. Despite the tension that still lingers in the CRE market, the weighted vacancy rate remained low at 4.3% in Q1 2024 (its long-term average is 3.6%).

The annual growth of the household loan portfolio stabilised, showing the first signs of recovery in housing lending. Although the household credit portfolio in EA compacted slightly over the year, its growth was still quite strong in Lithuania, with the annual growth rate

[2] A broader definition of credit is used, covering all credit provided to enterprises and households, regardless of the credit provider.

of 6.6% in March 2024. Even though the number and value of new housing loans were still about a tenth lower in Q1 2024 than a year ago, the number of new housing loans grew over the quarter, with the rebound in demand also reflected in the latest results of the bank survey. Provision of consumer finance loans continued to be particularly active: in March 2024, the annual growth of the portfolio of consumer finance loans to Lithuanian residents (20.4%) remained one of the strongest in EA. Over the year, the number of new loans granted to Lithuanian residents was one fifth higher. There are no household credit imbalances overall: the household credit-to-GDP ratio remains stable, and its gap with the long-term trend is negative. Non-performing loans in both the housing and consumer segments increased somewhat, but remained low (0.8% and 2.4%, respectively).

The growth rate of housing prices stopped decelerating despite the low market activity, and there are still limited-scale housing price imbalances in the market. In Q1 2024, the number of houses sold was the lowest result for the corresponding quarter since 2015. In the expectation for EURIBOR to decrease and with the number of residents intending to buy a house increasing, the annual growth of house prices stopped slowing down. Based on different indicators,[3] the annual rate of price growth ranged between 2.4% and 7% in April 2024. The housing market cycle is at a low point in Lithuania, although higher than in EA on average, where an annual price contraction of 1.1% was recorded in Q4 2023. Limited imbalances can still be seen in the housing price level: based on the median of 6 different estimates, prices are overvalued by around 5%. This means that the main economic indicators have not yet fully recovered from the post-pandemic increase in price levels. Expectations of banks towards the prices of residential RE improved marginally, with the share of banks expecting stable or rising prices increasing slightly.

Currently, the CCyB rate of 1% is applicable, which ensures that credit institutions have a capital buffer that could be released in the event of the economy experiencing a shock or cyclical risks materialising. Although the financial cycle remains on the downturn path currently, there are already signs of credit recovery and the credit quality of loans continues to be historically good, thus, there are no indications of lending capacity of credit institutions being constrained. Currently, banks and groups of central credit unions hold an accumulated capital stock which is higher than the counter-cyclical capital buffer requirement of 1%. In addition, the housing loan portfolios of credit institutions exceeding €50 million are subject to an additional sectoral SyRB rate of 2%, so as to increase the resilience of credit institutions to the risks arising from this sector.

[3] The Bank of Lithuania's repeat sales housing price index and *Ober-Haus* housing price index.

Financial cycle assessment

The financial cycle stopped decelerating, and credits to businesses and households are growing moderately. Only limited-scale imbalances in housing prices persist.

Chart 1. Cyclical risk assessment matrix

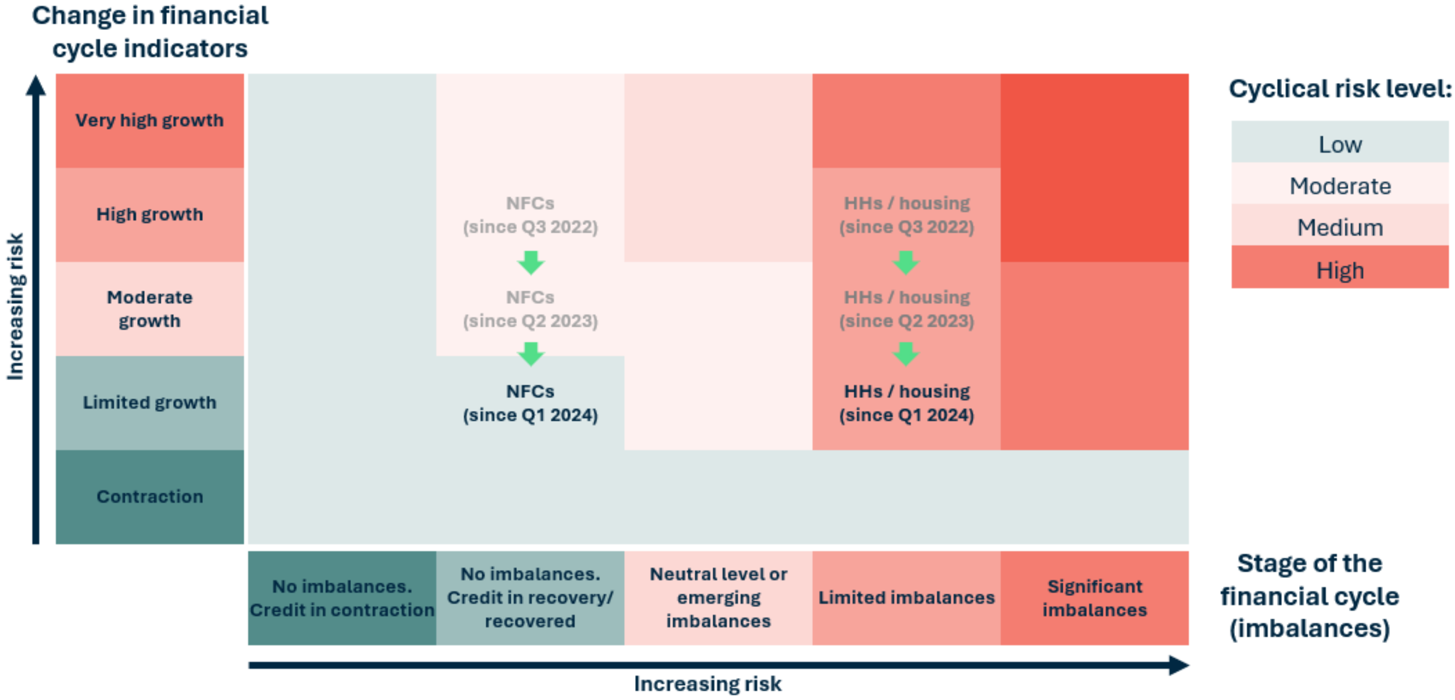
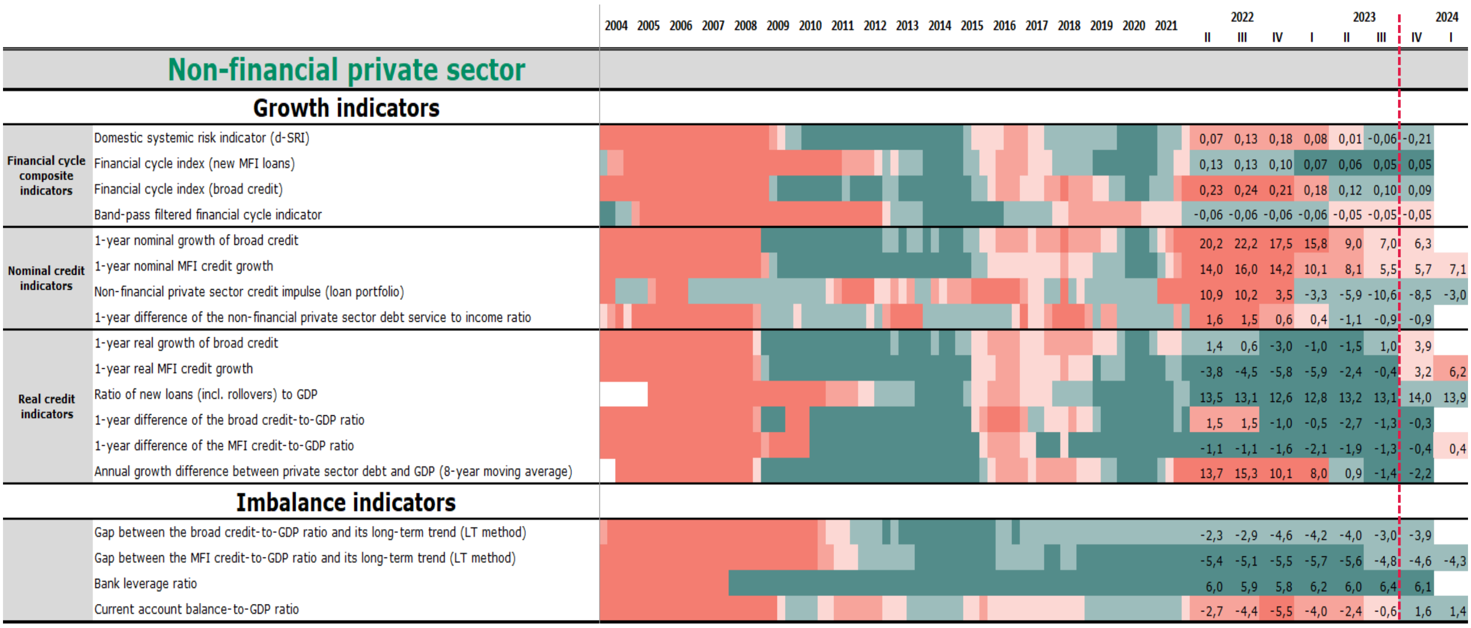


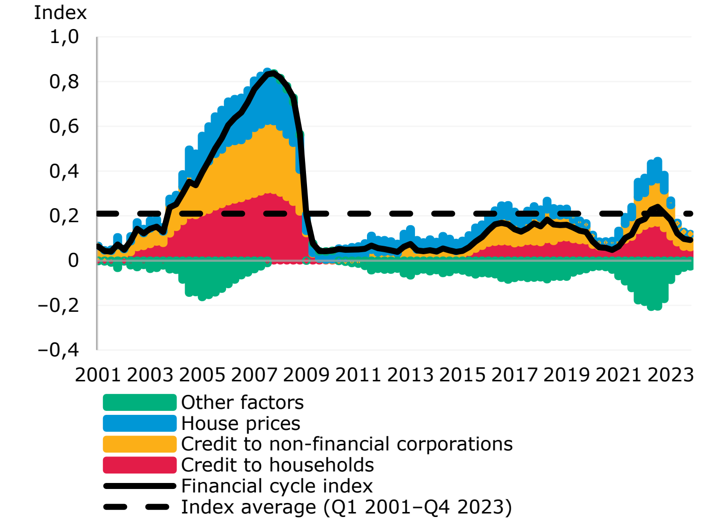
Chart 2. Map of corporate and resident credit growth, credit imbalances, and composite financial cycle indicators (Q1 2004–Q1 2024, with the most recent data represented by the red dashed lines on the right)



Note: Indicator values are rounded; some indicators are evaluated based on their percentile values, so in some cases cells of these indicators with the same value may be coloured differently.

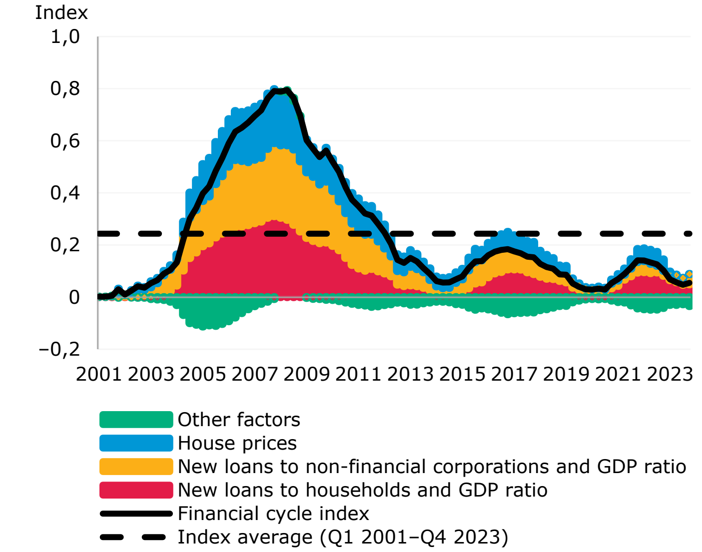
The financial cycle stabilised as both MFI and broad credit-based indices changed marginally.

Chart 3. Lithuania's financial cycle index and its drivers (broad credit, Q1 2001–Q4 2023)



Sources: State data agency and Bank of Lithuania.
Note: the assessment uses a broader definition of credit to NFCs and HHs, regardless of the credit provider.

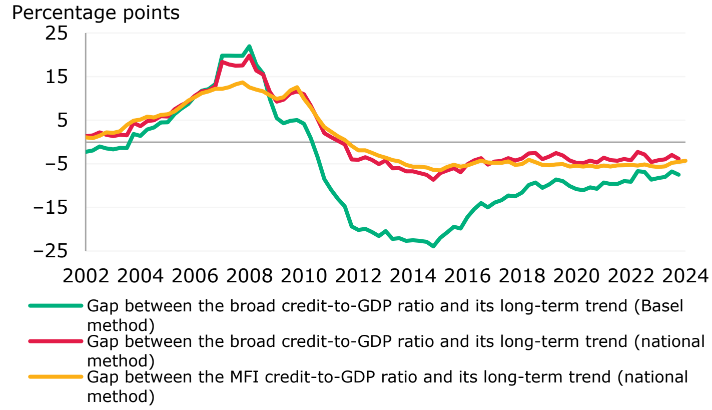
Chart 4. Lithuania's financial cycle index and its drivers (MFI loans, Q1 2001–Q4 2023)



Sources: State Data Agency and Bank of Lithuania.

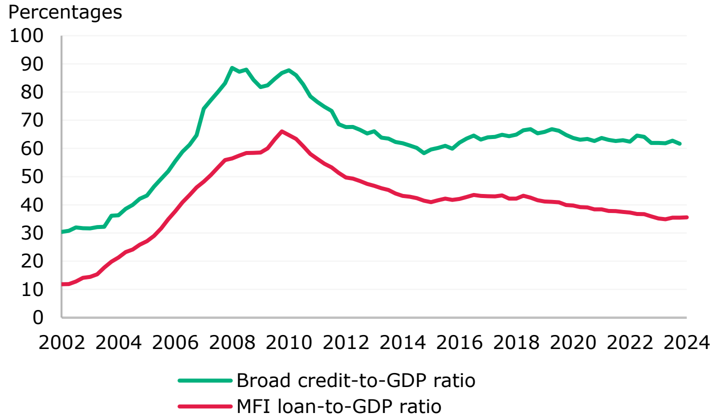
The credit-to-GDP ratio stabilised in all loan segments, and the gap from its long-term trend remains negative.

Chart 5. Gaps of credit, loans from MFIs (NFC and HH)-to-GDP ratios (Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.
Note: long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000; for the national method, before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

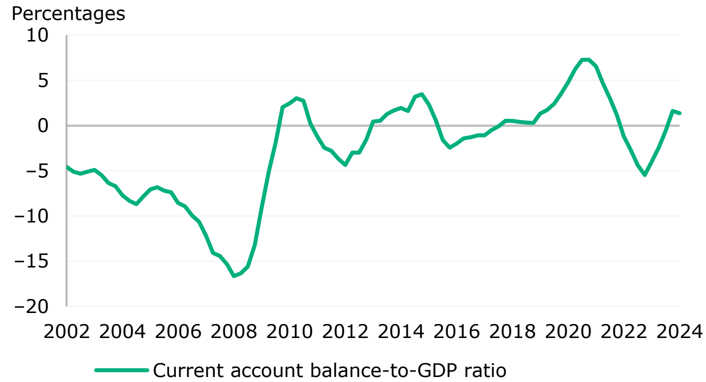
Chart 6. Ratios of credit, MFI loans (NFC and HH)-to-GDP (Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.

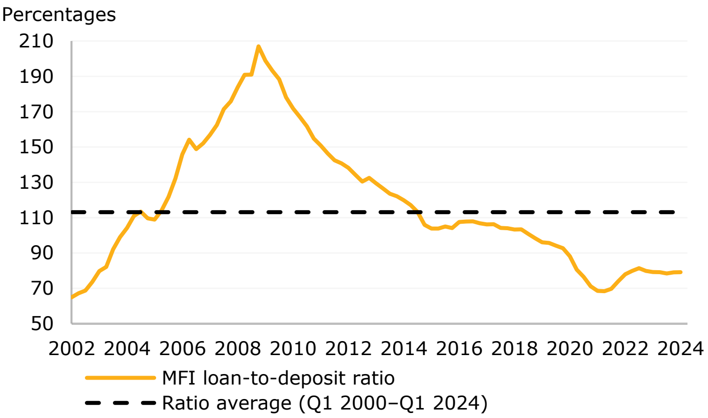
The loan-to-deposit ratio remains low, while the current account-to-GDP ratio has turned positive.

Chart 7. Current account-to-GDP ratio (Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.
Note: preliminary data for the latest quarter.

Chart 8. MFI loans (NFC and HH)-to-deposits ratio (Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.

Non-financial corporations' sector

Affected by individual larger-scale loans, real credit to companies reached a level of moderate growth, the provision of new loans remains stable in relation to GDP, more pronounced imbalances can be observed in the CRE segment only.

Chart 9. Map of indicators of growth and imbalances in the corporate sector
(Q1 2004–Q1 2024, with the most recent data represented by the red dashed lines on the right)

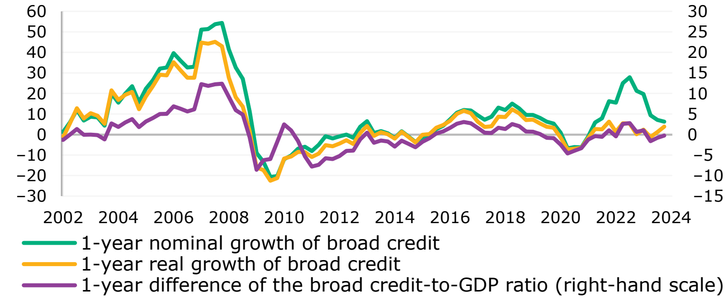
Non-financial corporations sector

		2022 II	2022 III	2022 IV	2023 I	2023 II	2023 III	2023 IV	2024 I
Growth indicators									
Nominal corporate credit indicators	1-year nominal growth of broad credit	25,0	27,9	21,3	19,7	9,4	7,1	6,2	
	1-year nominal MFI credit growth	17,5	21,3	18,3	10,0	7,0	3,1	4,3	7,8
	1-year difference of NFC debt to equity ratio	3,7	4,9	4,4	3,2	-0,3	-1,1	1,1	
	1-year difference of the NFC debt service to income (profit) ratio	3,3	5,3	2,2	1,1	-0,8	-2,0	1,0	
Real corporate credit indicators	1-year real growth of broad credit	5,5	5,3	0,1	2,4	-1,2	1,2	3,8	
	1-year real MFI credit growth	-0,9	-0,2	-2,3	-5,9	-3,3	-2,6	1,9	6,9
	1-year difference of the broad credit-to-GDP ratio	2,6	2,8	0,6	1,0	-1,6	-0,8	-0,2	
	1-year difference of the NFC debt service to income (profit) ratio	0,0	0,2	-0,1	-0,9	-0,9	-0,9	-0,4	0,3
	Ratio of new loans (incl. rollovers) to GDP	8,4	7,9	7,5	7,9	8,3	8,5	9,3	9,3
	Credit impulse (loan portfolio)	0,6	1,8	-1,4	-4,1	-1,5	-2,1	0,6	1,9
CRE indicators	1-year nominal growth of CRE credit	9,8	9,2	12,2	5,3	6,3	6,0	4,8	8,9
	1-year growth of the number of CRE transactions (2-year moving average)	20,7	16,3	5,7	4,8	-3,3	-9,6	-8,6	-13,7
Imbalance indicators									
Indicators of corporate credit imbalances	Gap between the broad credit to NFC-to-GDP ratio and its long-term trend (LT method)	-0,4	-0,7	-2,1	-1,8	-1,8	-1,0	-1,8	
	Gap between the MFI credit to NFC-to-GDP ratio and its long-term trend (LT method)	-3,5	-3,0	-3,2	-3,5	-3,5	-2,9	-2,6	-2,5
	MFI credit-to-GDP ratio	15,3	15,6	15,2	14,7	14,3	14,8	14,9	15,0
	NFC short-term liabilities to short-term assets ratio	40,1	43,7	38,2	41,2	42,6	43,9	39,7	
Indicators of CRE imbalances	Deviation between current and historical CRE yield and government bond spread	-0,3	-1,1	-2,4	-2,3	-1,9	-1,9	-1,6	-1,2
	CRE price misalignment indicator (Vilnius office prime)	15,3	11,1	8,8	8,3	10,7	19,3	27,7	

Note: Indicator values are rounded; some indicators are evaluated based on their percentile values, so in some cases cells of these indicators with the same value may be coloured differently.

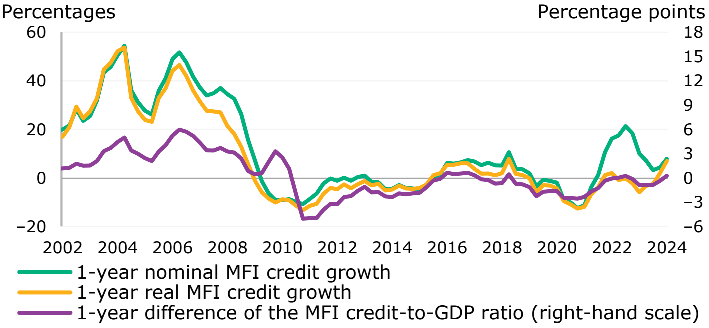
Driven by individual loans, the growth of the portfolio of bank loans to companies was stronger, while the growth of broad credit levels did not change significantly.

Chart 10. Corporate credit developments
(Q1 2001–Q4 2023)



Sources: State data agency, Bank of Lithuania and Bank of Lithuania calculations.

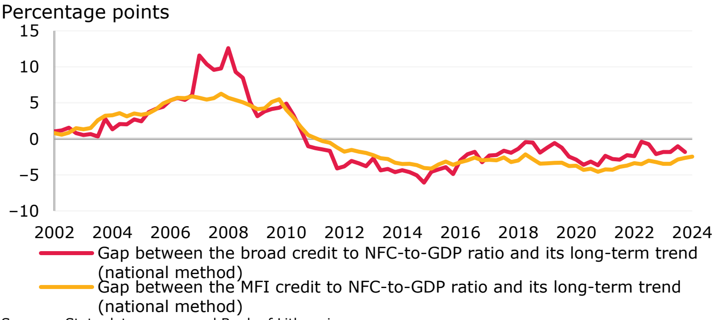
Chart 11. Developments in corporate borrowing from MFIs
(Q1 2002–Q1 2024)



Sources: State data agency, Bank of Lithuania and Bank of Lithuania calculations.

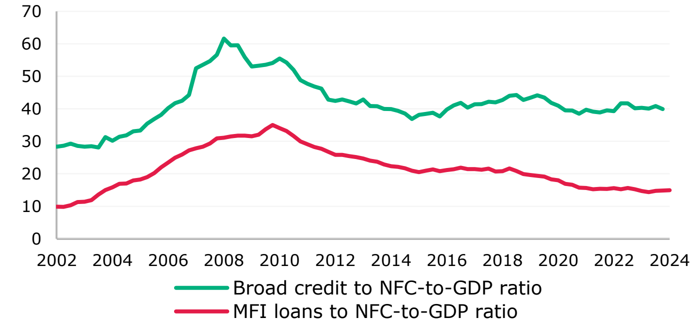
The gap between the MFI credit to companies-to-GDP-ratio broadened slightly but remained negative. Credit-to-GDP ratios did not change in principle as the rate of lending to companies was in line with the economic growth.

Chart 12. Corporate credit imbalances
(Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.
Notes: 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 13. Corporate credit, MFI loans-to-GDP ratios
(Q1 2002–Q1 2024)

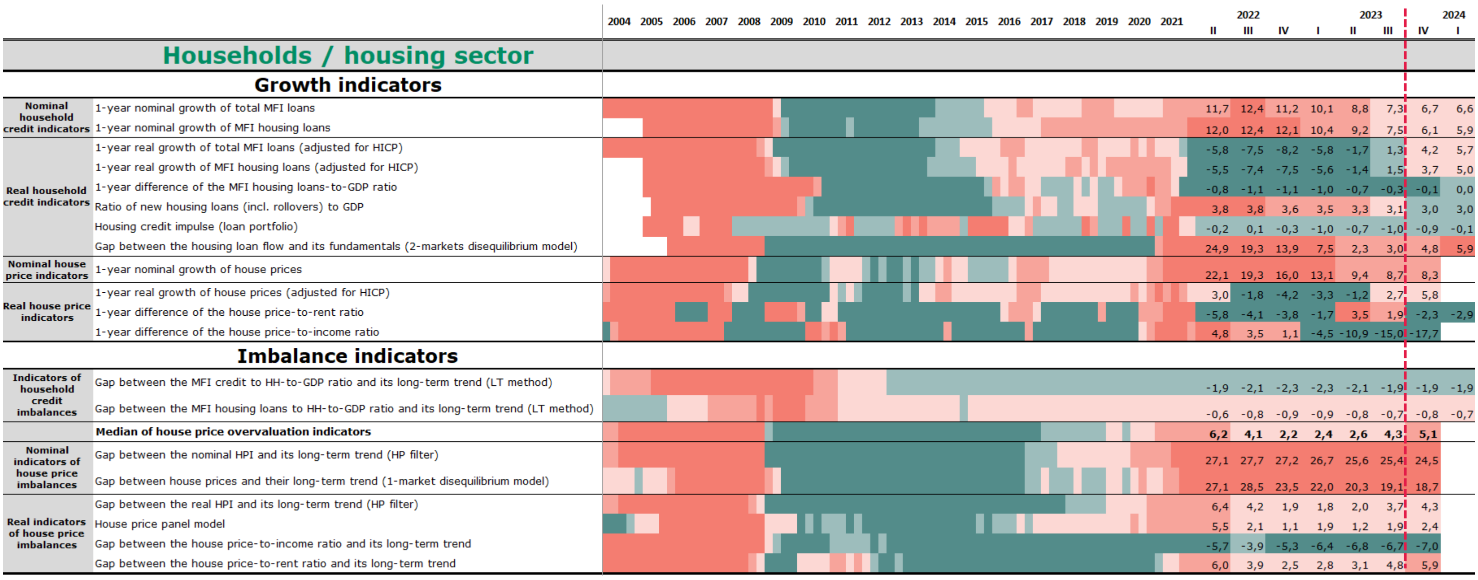


Sources: State data agency and Bank of Lithuania.

Households/housing sector

Household borrowing is growing moderately, there are first signs of a recovery in housing credit; however, the limited-scale imbalances in house prices persist.

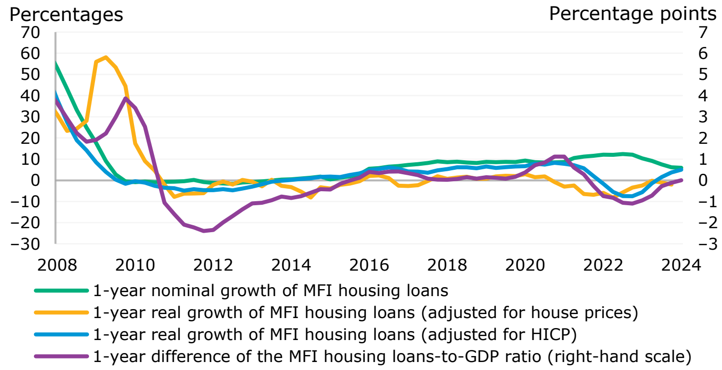
Chart 14. Map of indicators of growth and imbalances in the household and housing sector
(Q1 2004–Q1 2024, with the most recent data represented by the red dashed lines on the right)



Note: Indicator values are rounded; some indicators are evaluated based on their percentile values, so in some cases cells of these indicators with the same value may be coloured differently.

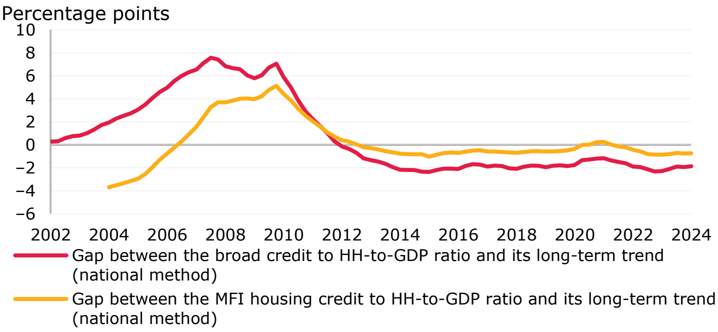
The real growth rate of credit for house purchase increased; however, the annual growth of housing prices was still stronger than the growth of mortgage loans, thus, no excess borrowing was observed.

Chart 15. Housing credit developments
(Q1 2008–Q1 2024)



Sources: State data agency, Bank of Lithuania and Bank of Lithuania calculations.

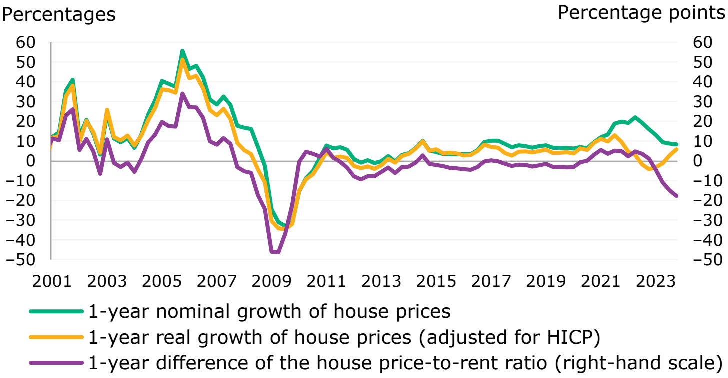
Chart 16. Household credit imbalances
(Q1 2002–Q1 2024)



Sources: State data agency and Bank of Lithuania.
Notes: 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.

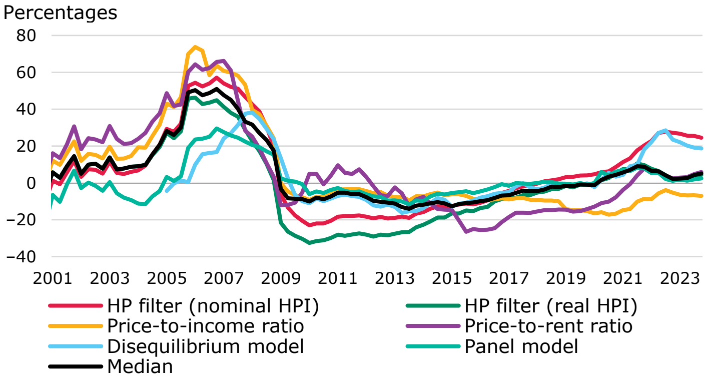
Even though wages and salaries continue to rise faster than house prices, nominal annual price growth is no longer decelerating, while the overvaluation moved up slightly due to an increase in the real house price growth.

Chart 17. Housing price developments
(Q1 2001–Q4 2023)



Sources: State data agency and Bank of Lithuania calculations.

Chart 18. Gap between housing prices and their fundamental values (Q1 2001–Q4 2023)



Source: Bank of Lithuania calculations.