LIETUVOS BANKAS

Banking Activity Review

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In the first half-year of 2014 positive trends dominated in the banking sector[1]: banks operated profitably, in the second quarter the deposits of residents went up, the loan portfolio slightly increased.

Dynamics of the key indicators in the banking sector[2]

Seq. No.	Indicator	Amount as of 01/07/2013 LTL millions	Amount as of 01/01/2014 LTL millions	Amount as of 01/04/2014 LTL millions	Amount as of 01/07/2014 LTL millions	Change in Q2 2014, %	Change in Q1 2014, %	Change over a year, %
1.	Assets	76,036.5	77,578.1	77,913.4	78,530.2	0.8	1.2	3.3
2.	Debt securities	6,334.8	7,877.7	7,477.6	7,631.3	2.1	–3.1	20.5
3.	Leasing	3,505.5	3,489.9	3,422.9	3,473.3	1.5	–0.5	–0.9
4.	Loans granted to customers	51,473.1	51,015.9	50,436.1	51,037.0	1.2	0.0	–0.8
4.1.	To private enterprises	24,020.9	23,575.0	23,181.2	23,538.6	1.5	–0.2	–2.0
4.2.	To financial institutions	525.9	481.0	510.2	592.8	16.2	23.2	12.7
4.3.	To natural persons	22,773.4	22,802.0	22,787.5	22,925.4	0.6	0.5	0.7
4.3.1.	Housing loans	19,249.6	19,375.5	19,408.6	19,552.8	0.7	0.9	1.6
5.	Loan impairment	2,730.0	2,212.1	2,133.7	1,975.3	–7.4	–10.7	–27.6
5.1.	Loan impairment to granted loans ratio, %	5.0	4.2	4.1	3.7	–	–	–
6.	Deposits and letters of credit	45,429.7	47,604.5	47,902.4	48,876.4	2.0	2.7	7.6
6.1.	Of private enterprises	14,151.9	16,062.1	15,724.3	15,256.6	–3.0	-5.0	7.8
6.2.	Of financial institutions	958.4	803.6	915.5	1,189.0	29.9	48.0	24.1
6.3.	Of natural persons	26,753.6	28,038.4	27,731.9	28,507.5	2.8	1.7	6.6
7.	Shareholders' equity	7,632.4	8,029.6	7,981.9	8,261.5	3.5	2.9	8.2
8.	Profit (loss) for current year	388.4	785.7	183.2	454.6	–	–	–

With the coming into force of the Capital Requirements Directive of the European Parliament and of the Council and the Regulation from the beginning of the year, the regulatory environment for banking activities has changed substantially all over the European Union. This document is of direct applicability to all Member States and it establishes uniform supervisory requirements for banks operating in them. Despite the fact that compared to the previous banking activity regulation the new one is more strict, the prudential ratios for banks operating in Lithuania, as was expected, significantly exceeded the minimum levels: on 1 July the bank capital adequacy ratio amounted to 20.4 per cent[3] (required — 8%), the liquidity coverage ratio (LCR) and the net stable funding (NSFR) ratios were, respectively, 436 per cent and 1.5 times (required — 100% and 1 time, respectively).[4]

Despite the greater prudential indicator levels, the Bank of Lithuania encourages banks, in their activities, to have capital and liquidity buffers greater than those provided for in legislation, in order to be prepared for unfavourable scenarios, unexpected losses.

THE BANKS' LOAN PORTFOLIO

Having decreased in Q1 this year, the banks' loan portfolio (on a net basis)[5] increased in the second quarter by almost LTL 601 million (or 1.2%) and as of 1 July 2014 amounted to LTL 51 billion. The leasing portfolio (on a net basis) also grew by LTL 50.4 million (1.5%) — to LTL 3.5 billion. All of the loan portfolio (on a net basis) segments increased, but the greatest influence came from loans to private enterprises (especially the sectors providing electricity, gas and water) and housing loans to residents. The loan portfolio of business undertakings (on a net basis) increased by LTL 357 million, or 1.5 per cent, while the housing loan portfolio (on a net basis) — by LTL 144 million, or 0.7 per cent. With the country's economic development remaining stable, as well as the banks ending the loan restructuring and recovery procedures begun during the crisis, the indicators defining the quality of the portfolio in all of the loan portfolio segments and continue to show improvement trends. During the second quarter in the banking system's loan portfolio both the share of non-performing loans (0.9 p.p — to 9.6%)

[1] The domestic banking sector consists of 7 commercial banks and 8 foreign bank branches currently operating in the country.
[2] Consolidated data. The coming into effect of the Capital Requirements Regulation as of 1 January 2014 entailed the change in the consolidation volume of data collected for supervisory purposes (the controlled undertakings performing the assets management function or other ancillary functions that add to banks' key activities began to be consolidated); as a result, the data is not quite comparable with the data from previous periods.
[3] The Bank of Lithuania also publishes the capital adequacy ratios (http://www.lb.lt/2014_q2_1) of separate banks.
[4] It should be noted, that the minimum LCR and NSFR levels will be applied in the European Union in the future. In Lithuania, the LCR requirement will be applicable as of 1 January 2015, while NSFR — from 2018.
[5] 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 are used; therefore the measurement of the loan portfolio changes, loan flows differs.

and the loan impairment indicator (0.4 p.p. — to 3.7%) continued to decrease. The share of non-performing loans in the housing loan portfolio decreased over the quarter by 0.3 p.p. (o 6.5%), while in the consumer finance loans — by 1 p.p. (to 11%).

The banking system's loan portfolio is impacted also by the international political environment. In the assessment by the market participants themselves, the impact of the sanctions announced by Russia on the ability of customers to fulfil their assumed obligations to banks is insignificant. According to bank analysts, the food product import sanctions by Russia will affect a limited number of fields of business — food product transporters, dairies and part of the beef cattle growers and processors, as well as vegetable growers and some customers that have close ties with Russian residents. The total balance of liabilities in the enterprises operating in these economic sectors amounts about 6 per cent of the business loan portfolio. However, it should be noted that large credit losses are not expected, as some enterprises have opportunities to refocus their fields of activities, others have a smaller financial leverage (than before the earlier crisis) and decreased scope of activity, while even other enterprises have sufficient collateral positions.

Recently, a lot of attention has been paid by the European Central Bank (ECB) to the loan portfolio quality. The single supervisory mechanism will begin to operate from 1 November 2014 and it will begin to carry out banking supervision. Currently, together with the supervisory authorities of the euro area banks, in all 18 countries of the euro area asset quality review is being performed, and its results will be published in October. As Lithuania integrates into the euro area, the Bank of Lithuania also performs this ECB task, as in the euro area countries, the results of this task will be published in October.

PROFITABILITY AND EFFICIENCY OF OPERATIONS

In the first half-year of 2014, banks and foreign bank branches earned LTL 454.6 million — 17.1 per cent more than in the first half-year of 2013. This change was most affected by increasing net interest income and net services and commission income, as well as the decision of the Administrative Court of Lithuania to terminate the December 2012 Decision of the Competition Council of the Republic of Lithuania, according to which three banks were fined LTL 47.7 million for violating the Republic of Lithuania Law on Competition. According to the International Financial Reporting Standards, banks included these fines in their 2012 expenditure; therefore, after the court's decision these expenses were eliminated.

In Q1 2014, the activities of seven banks and six foreign bank branches were profitable, while two foreign bank branches operated at a loss.

In the first half-year, compared to the same period last year, the net interest income of banks grew by 38.9 million (6.7%) — to LTL 618.6 million. As in previous periods, this growth was driven by smaller interest expenses experienced by banks. These expenses in the previous three quarters are practically at the same level. Therefore, the possibilities to decrease them even more have already been used. In September, when the ECB made the decision to decrease the interest rate by a further 0.1 p.p. (to 0.05%), the possibility for banks to increase income on debt are also limited.

As the volume of banking services and operations increase, so too does the income of banks from transfers, settlements and payment transactions, thus the banks' service and commission incomes continued to grow. In the first half-year of 2014, compared to last year, they increased by LTL 16.3 million (4.9%) — to LTL 346.9 million. The aforementioned growth was impacted by the increased income of bank-founded financial services centres that provide services to banks located abroad, received from account management, credit operation administration and other services. For several years in a row the prevailing trend has been that the share of net interest income earned by banks in the total income is slowly decreasing and the share of net service and commission income continues to grow even more.

Banks, in seeking to optimise their activities, as has become common, paid a lot of attention to the improvement of the efficiency of their operations: encouraged the development of e-banking, decreased the number of customer service divisions, established self-service centres. These actions had a positive effect: in the first half year of 2014, compared to the same period in 2013, staff costs decreased by 1.9 per cent. It is possible that the greater impact of the increase of operating efficiency on the banks' profitability will manifest in the future, since banks had to assume the one-off restructuring expenses.

Despite the desire of banks to seek efficiency, the Bank of Lithuania hopes that banks will cautiously implement the cost-cutting policy and devote adequate resources and attention to risk management, control, IT security.

Already this year the banking activity results will be impacted by the euro adoption and it is expected that in 2014 banks should experience about LTL 100 million in expenses directly related to the euro adoption, while it is later projected that bank income will decrease by about LTL 110 million (banks will lose part of their income related to currency exchange operations).

Due to the increased banking activity income, the banking activity efficiency indicators were slightly larger than in the respective period in 2013: the banking sector's return on equity indicator totalled 10 per cent (a year ago — 8.7 per cent), return on assets indicator — 1.17 per cent (a year ago — 1.01%). These indicators are better than the averages of the 45 biggest banks in the countries of the European Union (7.5% and 0.4%, respectively). Net interest margin of banks, showing the difference between interest rates received by banks for their invested assets and interest rates paid to creditors, increased by 0.1 per cent (to 1.53%).