

Although credit continues to grow, most indicators that are used in the assessment of the build-up of financial system imbalances do not signal excess cyclical risk. In Q4 2017, the negative gap between the credit-to-GDP ratio and its long-term trend that has been decreasing for almost a year posted a slight increase (0.6 and 0.2 percentage point respectively), subject to the method of assessment, and amounted to -4.0^2 and -12.2^3 percentage points. On the other hand, this increase in the gap may be a short-term phenomenon, since in a longer-term context a downward trend of the negative gap was evident, driven by crediting outpacing the growth of the domestic economy. The absence of imbalances in the financial system is also suggested by other indicators. For example, the loan-to-deposit ratio remains at 100%, the current account balance has been improving for the third consecutive quarter, and although the gap between the housing prices-to-household income ratio and its long-term trend has been decreasing, it still remains negative, while the decline rate itself is moderate⁴. Given that majority of indicators show that the favourable period in the financial system is set to continue, now is the right time to accumulate additional capital reserves by increasing the CCyB rate up to 1.0%.⁵

ASSESSMENT OF MATERIAL THIRD COUNTRIES FOR THE LITHUANIAN BANKING SECTOR

The aim is that all EU financial institutions, in calculating their CCyB⁶, applied the same country-specific CCyB rates. This is necessary in order to ensure the effective application of macroprudential regulation and equal market conditions as many EU financial institutions operate outside their home country as well. Due to this, the CCyB rates set by the Member States are recognised throughout the EU, while the CCyB rate is applied to exposures in third countries (non-European Economic Area countries) in a coordinated manner⁷: the ESRB monitors and assesses the setting of the CCyB rates in third countries material for the EU banking sector and obliges the Member States to monitor the developments of cyclical risk to the financial sector and setting of CCyB rates in the other third countries material for their banking sector.

The materiality of the third countries (regarding CCyB) for the Lithuanian banking sector is assessed on annual basis by mid-year by applying the ESRB methodology⁸. This methodology is based on the monitoring of three indicators reflecting the banking sector credit exposure to private non-financial sector. The monitored indicators include the risk-weighted exposure amount, original (unweighted) exposure and defaulted exposure. A country is identified as material in terms of the CCyB, if, according to any of these metrics, exposures in a country amount to at least 1% of all exposures in a specific category (including exposures in Lithuania). In order to reduce the impact of one-off data fluctuations, not only the values of the last monitoring but also average longer-term values (of 8 quarters) are taken into account.

In 2018, same as in 2017, a single third country material for the Lithuanian banking sector was identified within the context of the CCyB application, i.e. the Russian Federation. Lending of the Lithuanian banks outside the country is low⁹. However, the share of defaulted exposures in two third countries – the Russian Federation and Panama – slightly exceeds the threshold of 1% set in the methodology as compared with such exposures in all countries, including Lithuania¹⁰, although the amount of such exposures is small (at the end of 2017 it amounted to €7.4 million). In view of the additional information, Panama is not included in the list of material third countries: it is an offshore financial centre¹¹; exposures in Panama are related only to the corporations registered rather than operating in that country, in such case, the monitoring of cyclical risk in Panama would not be necessary. Taking into account the quantitative criteria listed in the methodology, the Russian Federation continues to be a country material for the Lithuanian banking sector in terms of CCyB. According to the assessment of the ESRB, Russia is a third country material for the banking sector of the entire EU, therefore, cyclical risk development and setting of the CCyB rate in this country is monitored by the EU on a centralised basis and additional monitoring by the Bank of Lithuania is not necessary.

² Using the forecast-augmented method.

³ Using the Basel method.

⁴ By an average of 0.4 percentage point per quarter (from Q3 2014).

⁵ https://www.lb.lt/uploads/publications/docs/19260_fb5b4fc8e1f72a191126de19da1d489b.pdf

⁶ Estimation of the CCyB by the institution is stipulated in Chapter 4 of the Rules for the Formation of Capital Buffers approved by Resolution No 03-51 of the Board of the Bank of Lithuania of 9 April 2015 (<https://www.e-tar.lt/portal/lt/legalAct/e46201d0e41211e4a4809231b4b55019>).

⁷ Recommendation of the ESRB of 11 December 2015 (ESRB/2015/1) on recognising and setting countercyclical buffer rates for exposures to third countries ([http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016Y0312\(01\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016Y0312(01))).

⁸ For more information see Annex 3 of the publication of the Bank of Lithuania 'Countercyclical capital buffer. Background material for decision', Q2 2017

(https://www.lb.lt/uploads/publications/docs/17565_bb91988d25f16b150ce9c7dc96ba2402.pdf).

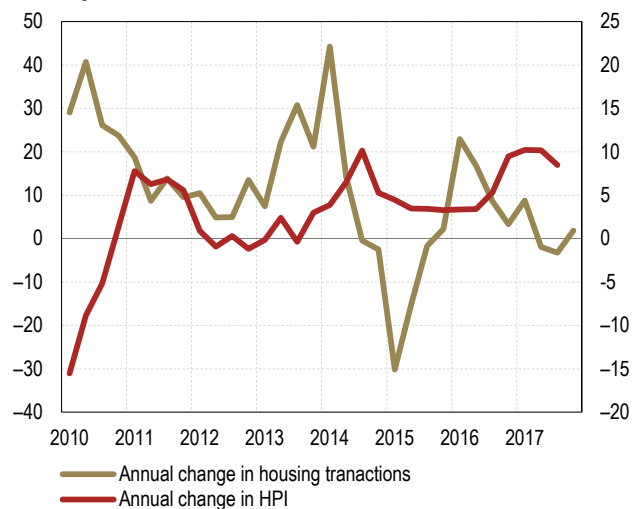
⁹ According to the data as of the end of 2017, the share of exposures (both original and risk-weighted) when lending to foreign residents was below 4.2%, of which in third countries – no more than 0.6%.

¹⁰ Russian Federation: in Q3 and Q4 2017 – 1.5%, eight quarter average – 1.4%; Panama: in Q3 2017 – 1.6%, in Q4 2017 – 1.5%, eight quarter average – 1.4%. The amount of the Lithuanian banking sector exposures to the private non-financial sector decreased in both countries in 2017: in the Russian Federation – by 9.8%, and in Panama – by 7.1%.

¹¹ According to the assessment of such international organisations as the International Monetary Fund and Organisation for Economic Cooperation and Development.

Chart 7. Number of housing transactions and annual change in the housing price index
(Q1 2010–Q3 2017)

Percentages

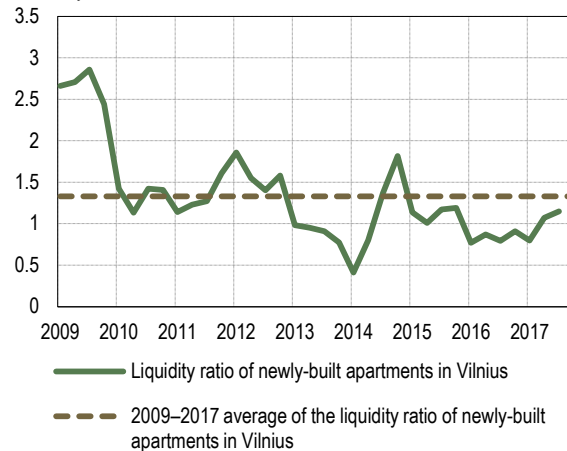


Sources: Centre of Registers, Statistics Lithuania.

Chart 8. Liquidity within new apartment market in Vilnius

(Q1 2009–Q3 2017)

Duration, years



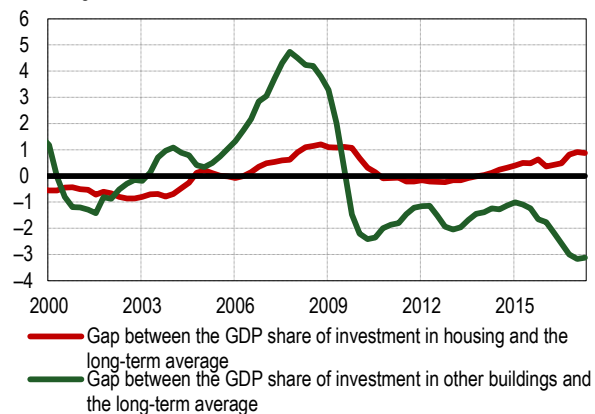
Sources: UAB Eika and Bank of Lithuania calculations.

Note: the liquidity ratio indicates how much time it would take for developers to sell apartments offered for sale if the 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–Q3 2017)

Percentages

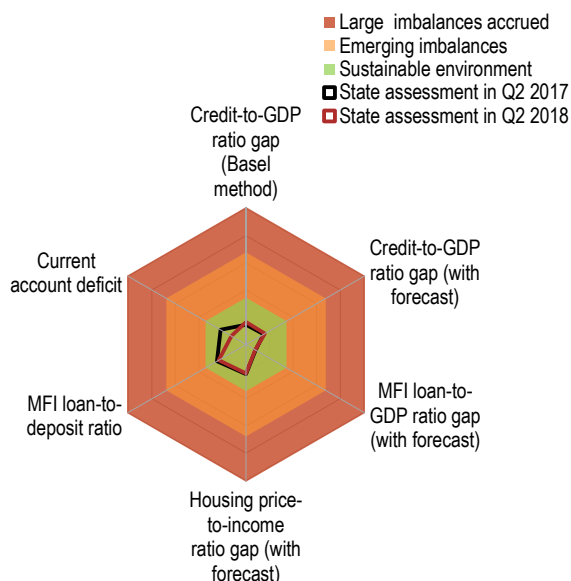


Sources: Statistics Lithuania and Bank of Lithuania calculations.

Annex 2. Evaluation of credit and housing market imbalances

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

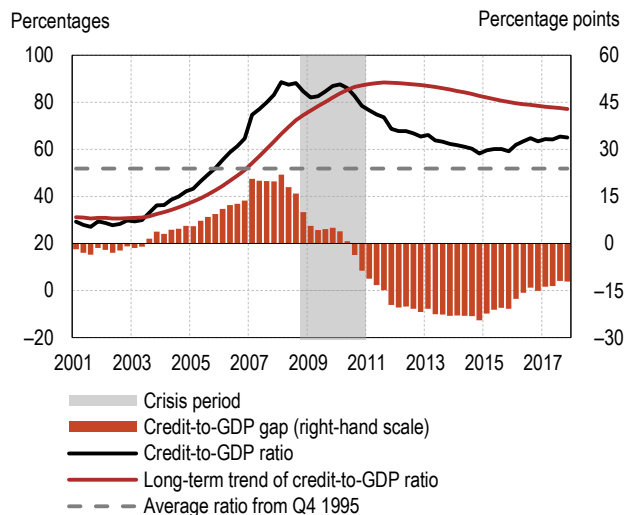
(evaluation carried out in Q2 2018)



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 private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method)

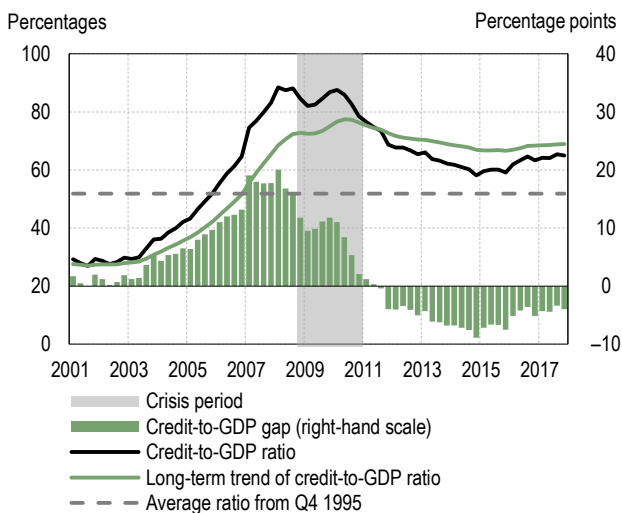
(Q1 2001–Q4 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: 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)

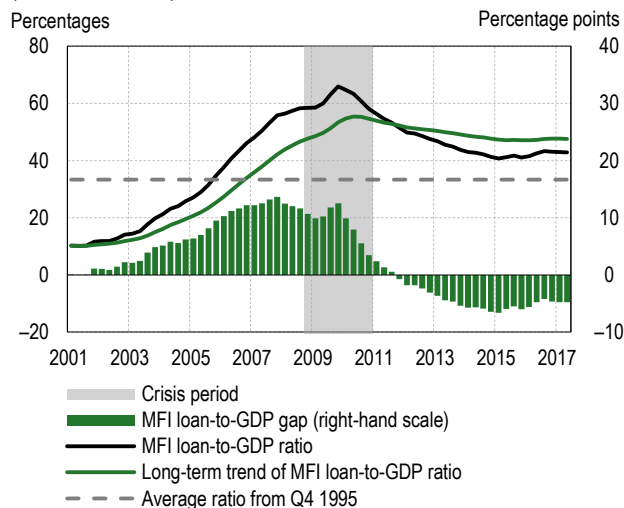
(Q1 2001–Q4 2017)



Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: the long-term trend is computed by applying a one-sided HP filter with the 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.

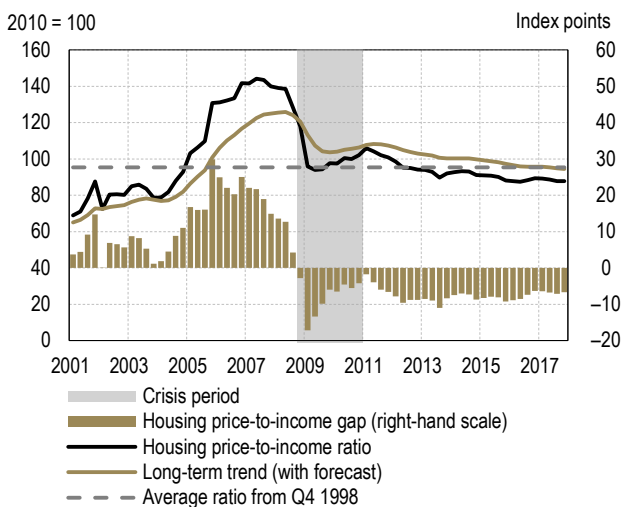
Chart D. Additional indicator I: MFI lending to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method)

(Q1 2001–Q1 2018)



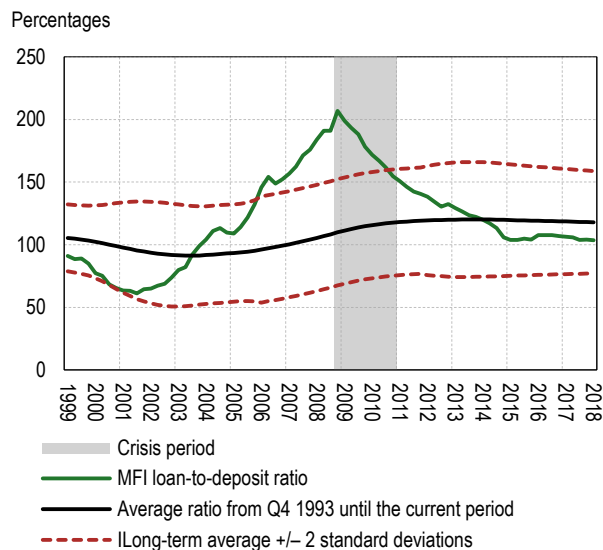
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart E. Additional indicator II: Housing prices-to-household income gap (calculated using the forecast-augmented method) (Q1 2001–Q4 2017)



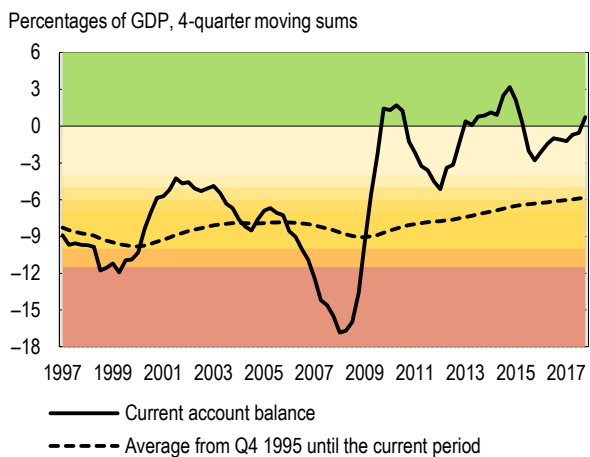
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Notes: 1) income – household wages and salaries; 2) the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

Chart F. Additional indicator III. Ratio of MFI lending to the private sector and private sector deposits (after eliminating seasonal effects) (Q1 1999–Q1 2018)



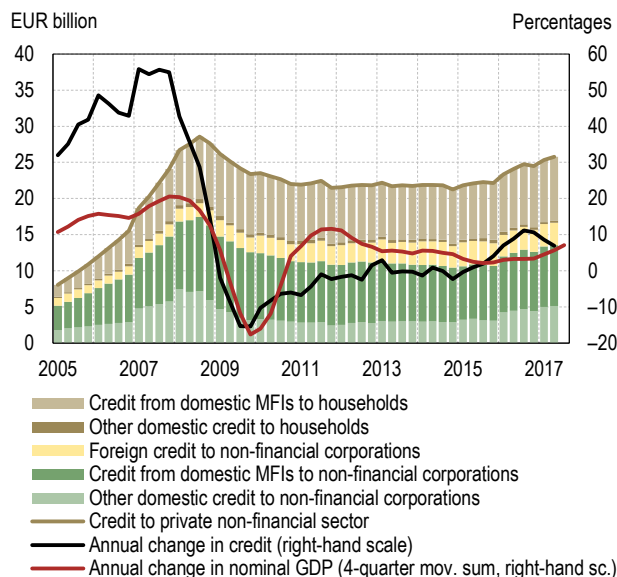
Source: Bank of Lithuania calculations.
Note: the ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding Q2 2016–Q4 2011 data.

Chart G. Additional indicator IV: Current account balance (4-quarter moving sums)-to-GDP ratio (Q1 1997–Q4 2017)



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 (Q1 2005–Q4 2017, nominal GDP dynamics – until Q1 2018)



Sources: Statistics Lithuania and Bank of Lithuania calculations.