



## 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 September 2018.

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

## Decision basis for setting the countercyclical capital buffer rate

On 20 December 2018, the Board of the Bank of Lithuania took a decision\* to leave the 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 RE market analysis 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 corporate financial health is strong, the Bank of Lithuania seeks to ensure that banks accumulate a 1% CCyB.

The portfolio of loans to the private non-financial sector has been growing. In September 2018 its annual growth rate stood at 5.5%. Weaker growth in the portfolio in Q3 2018 was led by the decline in lending to non-financial corporations, which was especially robust in the previous quarter. The annual growth rate of the portfolio of loans to households for some time has been fluctuating around 8%. 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 should slightly exceed the projected nominal economic growth.

In Q3 2018, activity in the housing market was slightly stronger and stood at historic highs. According to the Centre of Registers, on a year-on-year basis 3.5% more housing was assigned across Lithuania in Q3 2018 (a quarter-on-quarter decrease of 0.4 percentage point). Regarding price dynamics, there are still significant regional differences in Lithuania: in Q2 2018, the growth rate of house prices in the capital moderated by 0.3 percentage point and stood at 3.2%, while in the remaining part of the country it slowed down by 0.7 percentage point to 11.0%.

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 (subject to the method of assessment) remains negative (in Q2 2018 – -9.3 and -2.0 percentage points respectively). The loan-to-deposit ratio fluctuates around 100%, the current account balance is positive and house prices are not overestimated in terms of income growth rates and other fundamental factors. Thus it might be stated that the likelihood of a systemic crisis in Lithuania is low.

\*Resolution No 03-255 of the Board of the Bank of Lithuania of 20 December 2018 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 Q3 2018 lending in Lithuania remained active, yet its growth rate scaled down due to amortisation of individual large-scale loans in the non-financial sector. In September 2018, the portfolio of loans to the private non-financial sector was up by 5.5% year on year, whereas credit impulse, which shows the momentum of loan portfolio growth, once again turned negative (-0.64 percentage point), suggesting that borrowing was less active. This was mainly driven by repayment of large-scale short-term loans granted to parent companies of trade enterprises. As a result, in Q3 2018 the annual growth rate of the portfolio of loans to non-financial corporations dropped from 10.2% to 3.6%. This has been the weakest growth since the beginning of 2016.<sup>1</sup> Contrary to the corporate segment, lending to households remained stable, with its annual growth rate standing at 7.3% (unchanged from the start of 2018).

**Household lending was supported by the same factors: low interest rates, increasing wages, diminishing unemployment and improving household sentiment.** The annual growth rate of the housing loan portfolio has remained basically unchanged, fluctuating around 8.0% since the beginning of 2017. In September 2018, it stood at 8.1%, same as a year ago. The net flow of new housing loans followed an upward trajectory: over the first three quarters of 2018 it amounted to €951 million, a year-on-year increase of 8.3%. As before, such trends were mainly underpinned by fundamental factors: a prolonged period of low interest rates, rising household income and declining unemployment. In September 2018, the average interest rate on new housing loans stood at 2.33% and was 0.3 percentage point higher year on year. Despite the step-up, the cost of borrowing remains relatively low. The improving financial health of households was also a contributing factor to the lift in their expectations. At the end of the first half of 2018, the average wage (gross) in the country increased by 10.5% on a year-on-year basis (unemployment amounted to 5.9%, decreasing by 1.1 percentage points over the year). This contributed to improving household expectations: although in October 2018 the consumer confidence indicator<sup>2</sup> was still negative (-5 percentage points), it rose by 6 percentage points year on year.

**At the end of Q3 2018, lending to non-financial corporations slumped, yet such changes were driven by one-off factors.** In September 2018, the annual growth rate of the portfolio of MFI loans to non-financial corporations amounted to 3.6%, even though in June it exceeded 10.0%. The major shift occurred in September 2018, when parent companies of trade

<sup>1</sup> Such a decline might be partly related to the changing credit sources in the corporate sector rather than moderating credit growth since the aforementioned large-scale loans have been replaced by other external funding sources.

<sup>2</sup> The consumer confidence indicator is calculated as the difference between households with positive and negative future outlook.

enterprises covered some of the large-scale short-term loans. Growth in the portfolio of loans to non-financial corporations is likely to rebound in the next quarter, supported by buoyant exports and robust corporate investment. In the first half of 2018, export volumes of goods and services (at current prices and adjusted for seasonal effects) were 8.6% higher year on year. Tangible corporate investments have also grown, recording a year-on-year increase of 6.1% in the first half of 2018. Moreover, almost 40.0% of firms surveyed by the Bank of Lithuania reported planning to invest in their business expansion. All this makes it more likely that corporate borrowing will continue on its upward trajectory.

**In mid-2018, no significant changes in house prices were observed – 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 Q2 2018 house prices in the country were up by 7.4% year on year (a quarter-on-quarter decrease of 0.4 percentage point). In Q2, house prices in Vilnius moderated by 0.3 percentage point to 3.2%, although in the rest of the country house prices rose by 11.0%, a quarter-on-quarter drop of 0.7 percentage point. RE market participant data for Q3 shows that such contrasting trends are likely to continue in the nearest future. According to the data of UAB Ober-Haus, in Q3 2018 apartment prices in Vilnius saw a year-on-year increase of 2.2%, whereas in other big cities<sup>3</sup> they picked up by 2.7-9.8% over the same period.

**In Q3 2018, activity in Lithuania's housing market continued to accelerate, while the number of apartment and house transactions in the country was the highest since Q3 2007.** According to the Centre of Registers, in Q3 2018, 12.0 thousand apartments and private houses were sold in Lithuania (a year-on-year increase of 3.5%). Growth in housing transactions was mostly fuelled by the rise in the number of transactions concluded in the major cities of Lithuania: in Q3 2018 the number of apartments and private houses sold in Vilnius, Kaunas and Klaipėda increased by 4.3%, 6.9% and 7.9% respectively on a year-on-year basis. In the remainder of the country, housing market activity also grew slightly stronger, with 1.9% more housing sold year on year. Activity in Vilnius primary apartment market – the largest one in Lithuania – has significantly increased compared to the previous year. According to UAB Eika, in Q3 2018 the number of new-build apartments sold in the capital grew by a third (32.7%) year on year and by a fifth (20.0%) compared to the average number per quarter in 2016-2017. Such growth in primary market activity is primarily related to an increased number of new-build apartments offered for sale by RE developers and their higher quality.

**With activity in the housing market remaining high, the supply of new-build apartments in Vilnius primary market in Q3 2018 continued expanding and stood at historic highs.** According to UAB Eika, at the end of Q3 2018, RE developers put 4.5 thousand apartments in Vilnius up for sale. The number of apartments for sale increased by 7.2% over the quarter, a year-on-year increase of almost a tenth (8.2%). However, given the significantly stronger primary market activity, the expected time frame for housing sale<sup>4</sup> has significantly reduced over the quarter (3 months) and totalled 11 months at the end of Q3 2018.

**Expectations regarding house prices remained moderate.** According to the Banking Survey conducted by the Bank of Lithuania in Q3 2018, the majority of respondents still expected the prices of new-build and old-construction apartments to remain unchanged over the next 12 months, yet the number of banks anticipating a slight increase (up to 5%) in apartment prices went up significantly. The latest Survey of Households conducted by the Bank of Lithuania shows that half of the surveyed, as previously, believed that house prices would rise, however, the share of households expecting a drop in house prices has grown.

**Although in Q2 2018 credit continued to outpace GDP, most indicators that are used to assess the build-up of financial system imbalances did not signal excess risk.** At the end of the first half of 2018, the overall annual credit (including non-banking credit) growth stood at 13.8%, while nominal GDP expanded by 7.0%.<sup>5</sup> As a result, the negative gap between the credit-to-GDP ratio and its long-term trend decreased. Subject to the method of assessment, at the end of Q2 2018 it reduced by 4.7 and 2.7 percentage points respectively compared to last year (-9.3 and -2.0 percentage points). Other indicators also suggest that there are no significant imbalances in the financial system and the level of cyclical systemic risk is low. For example, at the end of Q3 2018, the MFI loan-to-deposit ratio continued to fluctuate at 100%, the current account balance improved over the quarter and was not financed with bank loans, while the negative gap between the house price-to-household income ratio and its long-term trend slightly increased. Given that trends in RE and credit markets in Q3 2018 remained basically unchanged, the CCyB rate was left at 1.0%.

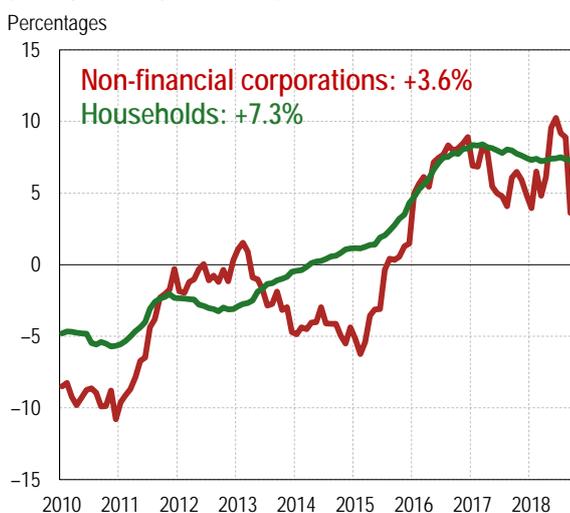
<sup>3</sup> In Kaunas, Klaipėda, Šiauliai and Panevėžys.

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

<sup>5</sup> The last four-quarter moving sum.

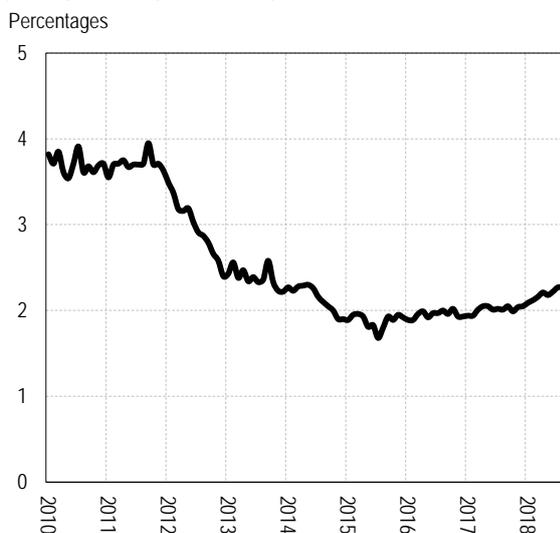
## Annex 1. Credit and housing market trends

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



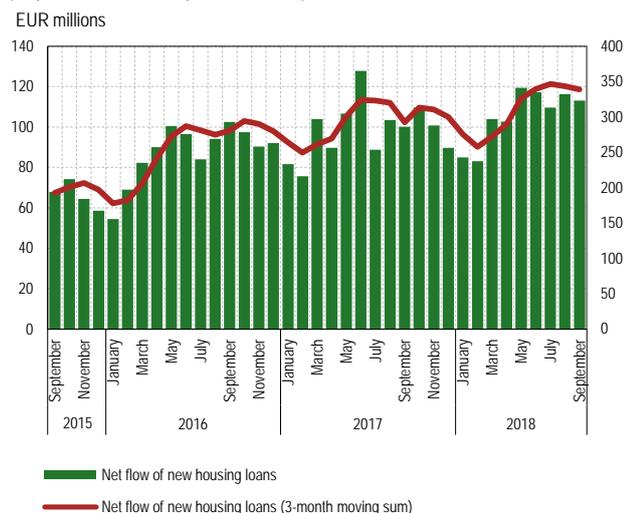
Source: Bank of Lithuania.

**Chart 2. Average interest rates on new housing loan agreements**  
(January 2010–September 2018)



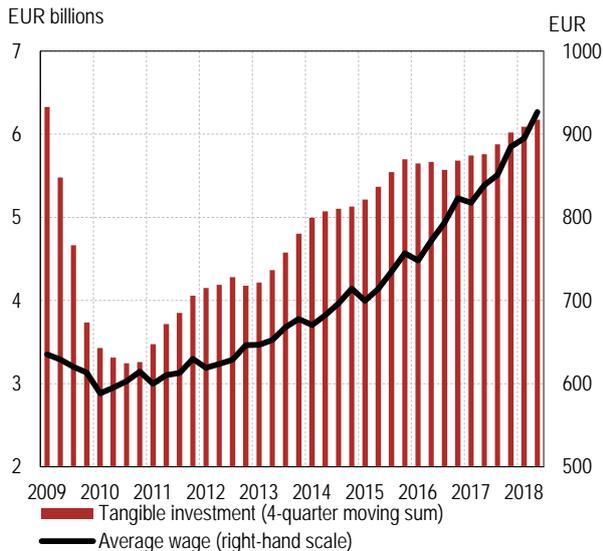
Source: Bank of Lithuania.

**Chart 3. Flow of new housing loans**  
(September 2015–September 2018)



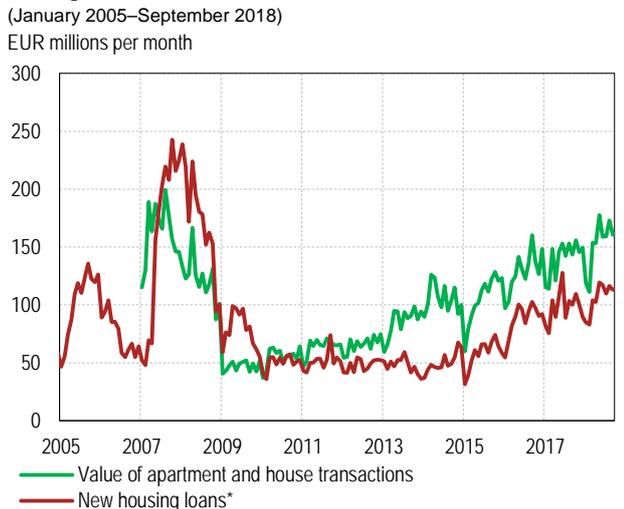
Sources: ECB and Bank of Lithuania calculations.

**Chart 4. Tangible investment and average wage**  
(Q1 2009–Q2 2018)



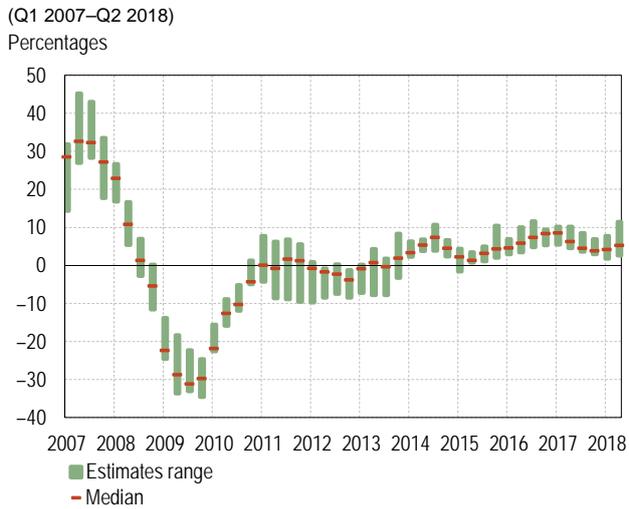
Source: Bank of Lithuania.

**Chart 5. Amount of apartment and house transactions and new housing loans**  
(January 2005–September 2018)



Sources: Centre of Registers and Bank of Lithuania.  
\*From 2015 housing loans do not include renegotiations.

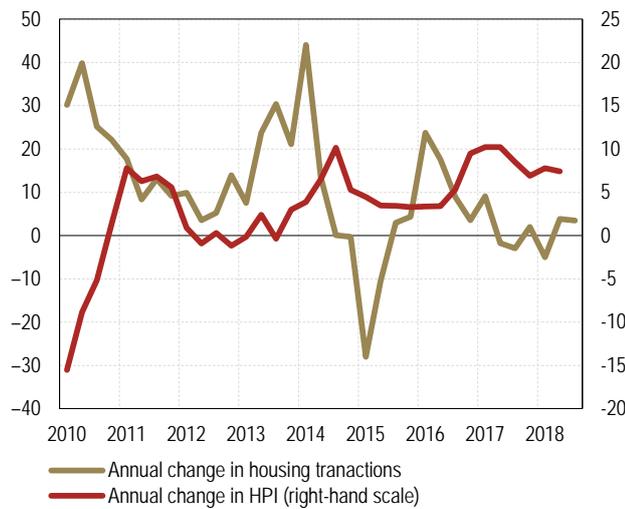
**Chart 6. Annual growth in house prices according to different sources**  
(Q1 2007–Q2 2018)



Sources: State Enterprise 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–Q3 2018)**

Percentages



Sources: Centre of Registers and Statistics Lithuania.

**Chart 8. Liquidity within the new-build apartment market in Vilnius (Q1 2009–Q3 2018)**

(Q1 2009–Q3 2018)



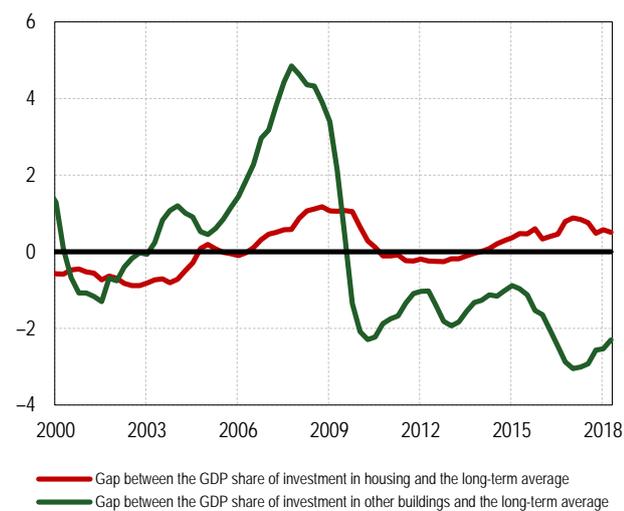
Sources: UAB Eika and Bank of Lithuania calculations.

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 the long-term average (Q1 2000–Q2 2018)**

(Q1 2000–Q2 2018)

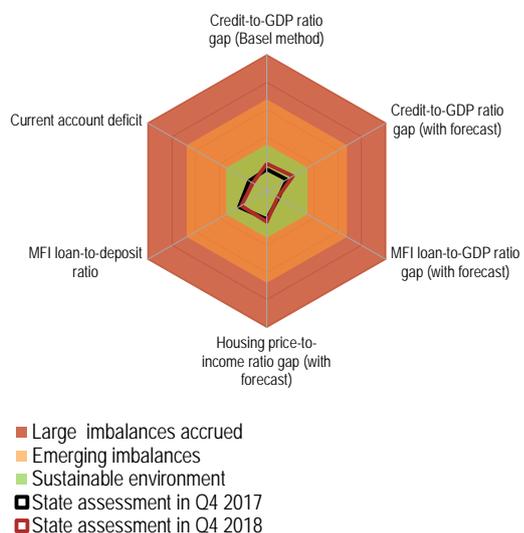
Percentages



Sources: Statistics Lithuania and Bank of Lithuania calculations.

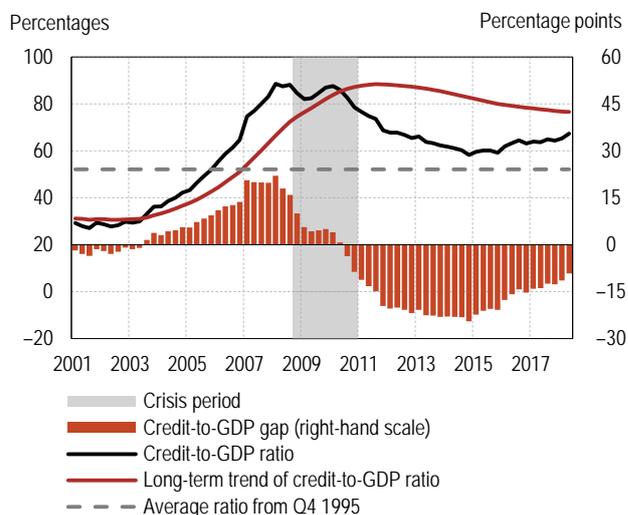
## Annex 2. Credit and housing market imbalances

**Chart A. Evaluation of credit market imbalances based on core and additional indicators (Q4 2018)**



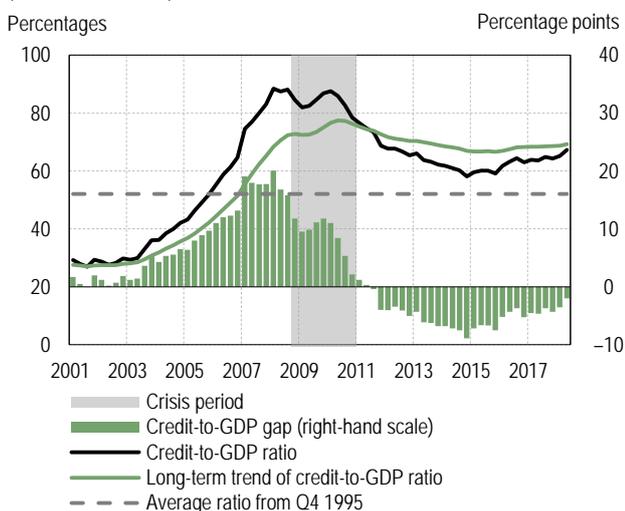
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: axes are scaled according to the range of a particular indicator: from its minimal value up to the maximal value.

**Chart B. Core indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method) (Q1 2001–Q2 2018)**



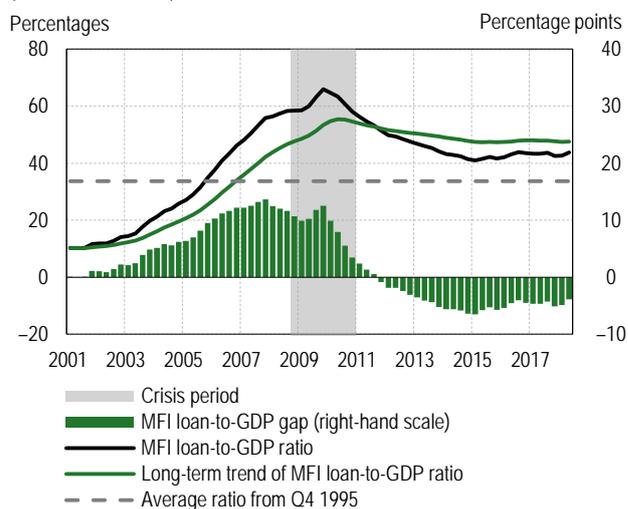
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

**Chart C. Core indicator II: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q2 2018)**



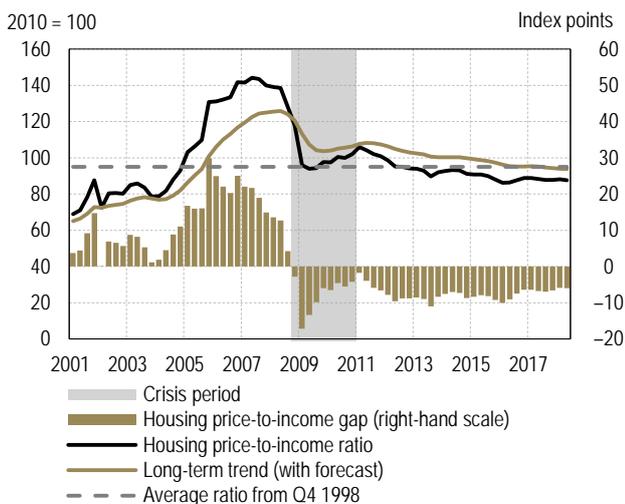
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: the long-term trend is computed by applying a one-sided HP filter with the smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

**Chart D. Additional indicator I: MFI loans to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q3 2018)**



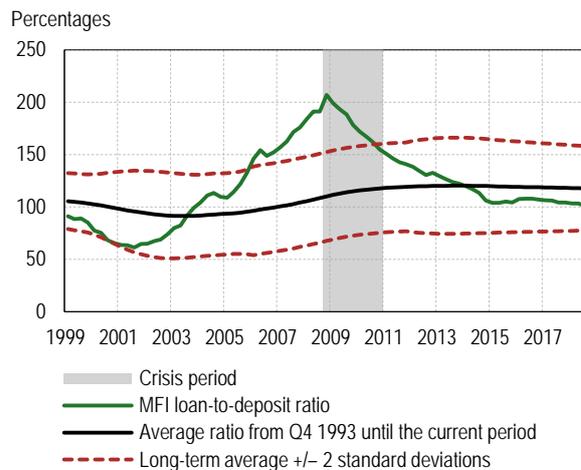
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Note: the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window using a four-quarter weighted average.

**Chart E. Additional indicator II: House price-to-household income gap (calculated using the forecast-augmented method) (Q1 2001–Q2 2018)**



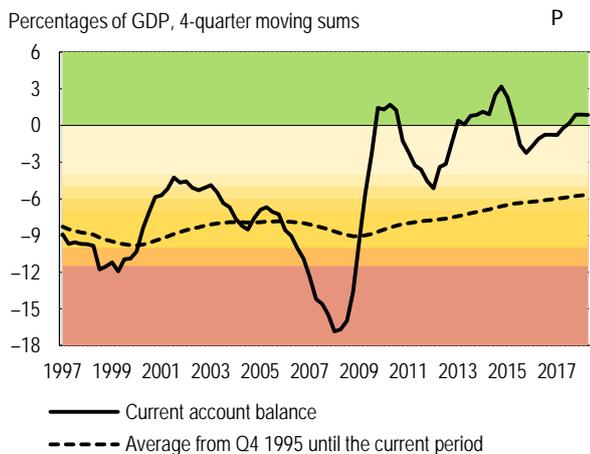
Sources: Statistics Lithuania and Bank of Lithuania calculations.  
 Notes: 1) income – household wages and salaries; 2) the long-term trend is estimated by applying a one-sided HP filter with the smoothing parameter 400,000; before applying the filter, the ratio is modelled for the next five-year window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

**Chart F. Additional indicator III: Ratio between MFI loans to the private sector and private sector deposits (adjusted for seasonal effects) (Q1 1999–Q3 2018)**



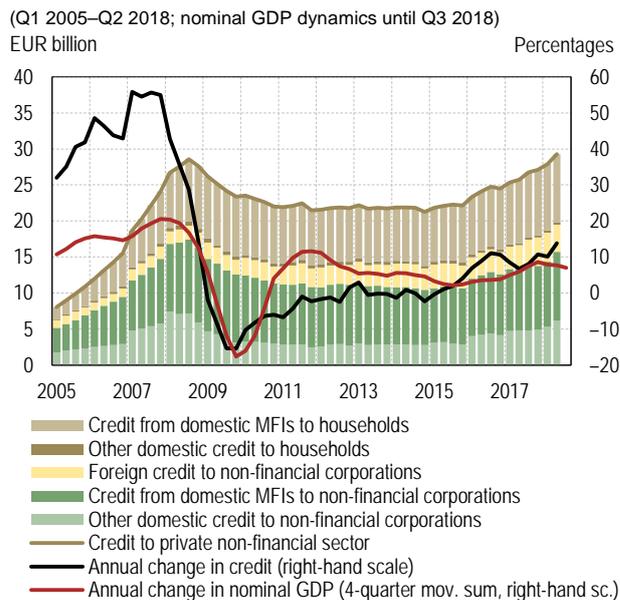
Source: Bank of Lithuania calculations.  
 Note: the ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding Q2 2016–Q4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

**Chart G. Additional indicator IV: Ratio between the current account balance (4-quarter moving sums) and GDP (Q1 1997–Q2 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.