



LIETUVOS BANKAS
EUROSISTEMA

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 30 September 2019, the Board of the Bank of Lithuania took a decision¹ to leave the countercyclical capital buffer (CCyB) rate unchanged at 1%, as set in June 2018. 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 balanced, the loan-to-deposit ratio of monetary financial institutions (MFIs) is declining and fluctuates around 95%, and RE prices are close to their fair value. Nonetheless, although corporate lending has been recently shrinking, household borrowing, which represents the greater part of the household loan portfolio, remains active. In periods of moderate systemic risk, when credit and RE market activity is relatively high, the domestic output gap (compared to a sustainable level) is positive, the Bank of Lithuania seeks to ensure that banks accumulate a 1% CCyB.

CREDIT AND REAL ESTATE MARKET DEVELOPMENTS

As the corporate loan portfolio continued to shrink, the overall credit growth rate in Q2 2019 decelerated. MFI data reveal that trends in lending to non-financial corporations and households have diverged. The portfolio of MFI loans to non-financial corporations contracted – in June 2019, the annual change was -3.6% (as compared to 1.6% at the end of the previous quarter). The annual growth rate of loans to households remained virtually the same, amounting to 8.5% at the end of Q2 2019.

In Q2 2019, the MFI corporate loan portfolio was smaller than a year ago. The most recent decline in this portfolio was observed four years ago. Such trends might have been led by the stricter corporate lending conditions² and greater concentration in the banking sector. In addition, interest rates on new bank loans to enterprises continued to rise – their annual average increased by 0.58 percentage point year on year, growing by an average 0.22 percentage point over the quarter. The portfolios of loans to RE and trade companies, which comprise the main bulk of the portfolio of bank loans to non-financial corporations (28% and 21% respectively), increased by, respectively, €35 million (1.4%) and €22 million (1.2%) year on year. Over the year, corporate lending to transportation and storage enterprises saw the most significant increase (€78 million, or 11.6%), whereas lending to enterprises engaged in professional, scientific and technical activities contracted (€337 million, or 34%).³ At the end of Q2 2019, the annual flows of new loans (including renegotiations) were similar to those observed in Q1. On a year-on-year basis, the annual flow of loans up to €1 million was still one-third lower, while that of loans exceeding €1 million surged by around 4% (approximately 9 percentage points less than in Q1). Although overall bank lending to enterprises reduced, corporate funding through alternative sources regain traction. According to the data of financial accounts, corporate funding through trade credit and prepayments, loans from other enterprises, and debt securities saw a year-on-year increase (€1.3 billion, €0.5 billion and €0.6 billion respectively).⁴

Lending to households continued to grow at a rapid pace, mostly driven by growth in the household loan portfolio. Having comprised 8.9% at the start of the year, growth in the household loan portfolio decelerated to 8.5% in June, yet remained more robust and stable than in 2018 (7.6% on average). The overall growth in the household loan portfolio in Q2 was largely underpinned by the housing loan portfolio, the annual growth of which stood at 8.9% in June (a quarter-on-quarter decrease of 0.2 percentage point). At the same time, growth in the portfolio of other loans to households increased by 0.5 percentage point, standing at 6.7%. During the period under review, the decrease in the annual net flow of new consumer loans and other loans (€79 million) was outweighed by the increase in the flow of new housing loans (€106 million, or 8.8%). Overall, household borrowing remains active largely due to the favourable macroeconomic

¹ Resolution No 03–178 of the Board of the Bank of Lithuania of 30 September 2019 on the application of the countercyclical capital buffer.

² As evidenced by the 2019 survey of enterprises commissioned by the Bank of Lithuania.

³ These also include holding companies. A year ago, lending to this segment significantly increased due to a number of large lending transactions. This, however, did not form a long-term trend, as, for example, lending to such activities declined by €20 million over the quarter.

⁴ Data of Q1 2019.

environment: the unemployment rate is relatively low and wages⁵ have been rising at a surprisingly fast rate – by more than 13%. The improving financial situation of households leads to stronger household sentiment, as the consumer confidence indicator is the highest since the crisis. Nonetheless, gradually increasing interest rates on new housing loans might cut back on provision of such loans. In Q2 2019, the annual average interest rate on new housing loans stood at 2.35% (a year-on-year increase of 0.23 percentage point). However, interest rates on consumer loans continue on a downward trend – their annual average stood at around 10.74% during the same period (a year-on-year decrease of approximately 0.83 percentage point).

Growth in house prices in Lithuania somewhat slowed, while housing affordability further improved alongside faster growth in wages. According to the latest data of Statistics Lithuania, the annual growth rate of house prices in Lithuania stood at 6.8% in Q1 2019 (see Chart 8). Compared to the data of the previous survey, the data of the bank lending survey carried out by the Bank of Lithuania in Q2 2019 revealed that more respondents believed that new housing prices will rise over the next 12 months, whereas a third of them noted imbalances related to the current level of house prices.

The Bank of Lithuania estimates that, in light of the dynamics of other macroeconomic and demographic indicators, house prices will remain close to their fair value (see Chart 9). Having assessed house price developments using the econometric error correction model and the Hodrick-Prescott filter and having regard to the ratio between house prices and wages as well as house prices and rent prices, in Q1 2019 house prices were somewhat (2.4%) lower than their theoretical value.

Activity in the domestic RE market remains at historic highs, yet the share of housing transactions by mortgage decreased. According to the Centre of Registers, the number of housing sold in Lithuania in Q2 2019 rose by 1.4% year on year. During this period, activity in the RE market remained markedly stronger than its long-term average, both in terms of housing transactions per capita and the housing stock. For the second consecutive quarter, activity in Vilnius new-built apartment market has been accelerating: according to the data of RE market participants⁶, the number of new housing transactions rose by 67.9% year on year. With demand in new-built apartments rising significantly, the number of unsold new-built apartments in Vilnius remained basically unchanged in Q2 2019 (decreasing by 1.1%). The major share (75.6%) of the unsold apartments comprise housing units under construction⁷, which shows that most of new housing supply available for sale were sold at the time of construction, thus not building up additional pressure on the cash flows of RE developers (see Chart 10). Overall, the recent significant boost in activity in Vilnius new-built apartment market might be related to the marked increase in the supply of new-built apartments recorded in the second half of 2018 (see Chart 11). With the dropping number of new apartments under construction, the number of new apartments available for sale is also likely to decrease. According to the data of the Centre of Registers, the share of housing acquired by loan comprised 37.8% during the period under review and was 4.3 percentage points lower year on year. The decreasing trend in the number of mortgaged housing units sold by way of purchase and sale transactions prevailed across Lithuania: the number of housing units acquired by loan stood at 51.8% (down by 5.3 percentage points) in Vilnius and 33.0% in the remainder of the country (down by 2.9 percentage points).

According to the latest data, the negative gap between the credit-to-GDP ratio and its long-term trend remained unchanged. Other credit and RE indicators did not show any imbalances as well. In Q1 2019, the ratio of credit (including non-banks) to the private non-financial sector to GDP amounted to 64.9%. The ratio has been declining for the second quarter in a row, dropping by 0.7 percentage point quarter on quarter, thus reflecting the difference in quarterly credit and GDP gains (0.7% and 1.7%, respectively).⁸

⁵ Based on the data of Q2 2019 of Statistics Lithuania, domestic growth in net wages, excluding sole proprietorships.

⁶ UAB Eika.

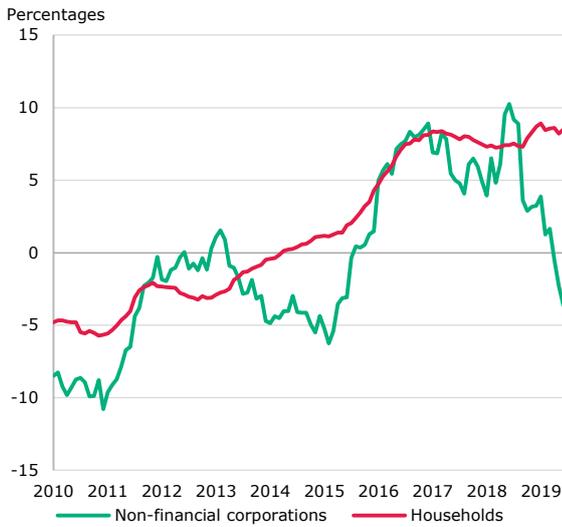
⁷ Based on the data of UAB Eika and UAB Ober-Haus.

⁸ Moving sum of the last four quarters.

The gap between the credit-to-GDP ratio and its long-term trend turned even more negative, fluctuating between -10.9 and -4.2 percentage points at the beginning of 2019 (depending on the method of assessment) (see Chart B and C in Annex 2). Nonetheless, this year the gap between the ratio of MFI loans to the private non-financial sector to GDP and its long-term trend remained similar to that recorded at the end of 2018, comprising roughly -5%. Other indicators remained broadly unchanged: the loan-to-deposit ratio gradually decreased and stood at 95.2%, the current account balance increased to 2.6% in Q1 2019, while the gap between the house price-to-income ratio and its long-term trend remained similar as in the previous quarter (-6.3%).

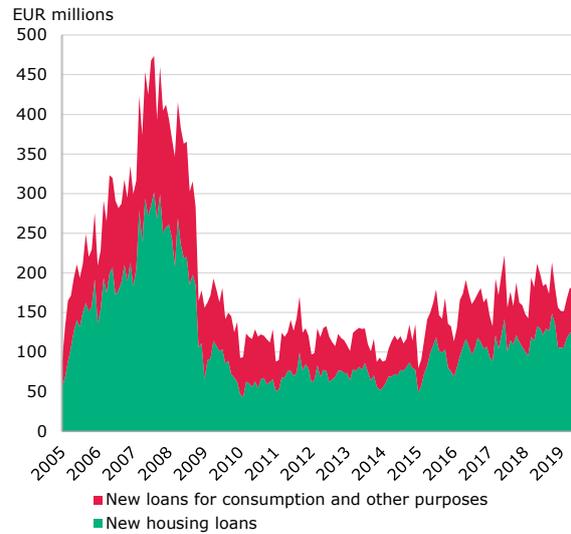
ANNEX 1. CREDIT AND HOUSING MARKET TRENDS

Chart 1. Annual growth in the portfolio of MFI loans to non-financial corporations and households (January 2010–June 2019)



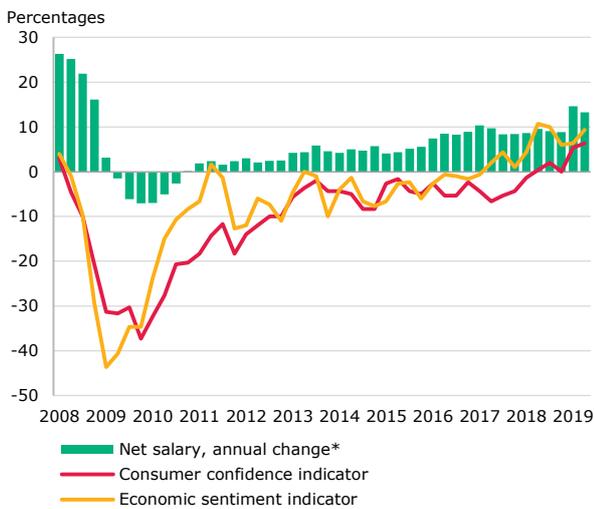
Source: Bank of Lithuania.

Chart 2. Flow of new MFI loans to households, including renegotiations (January 2005–June 2019)



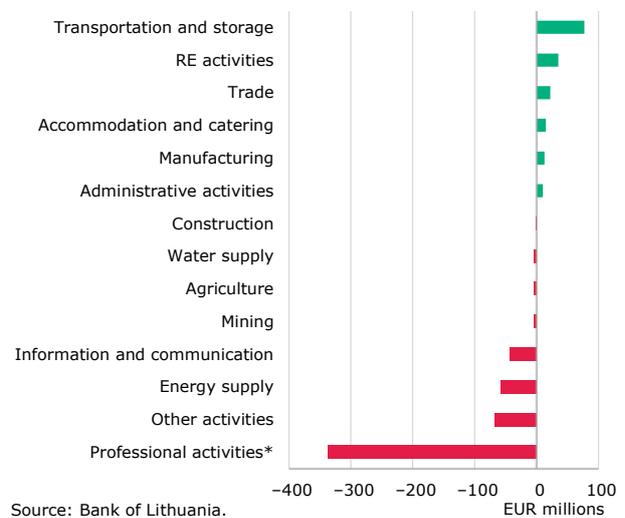
Source: Bank of Lithuania.

Chart 3. Net salary, consumer confidence, and economic sentiment indicators (Q1 2008–Q2 2019)



Sources: Statistics Lithuania and Bank of Lithuania.
*Excluding sole proprietorships.

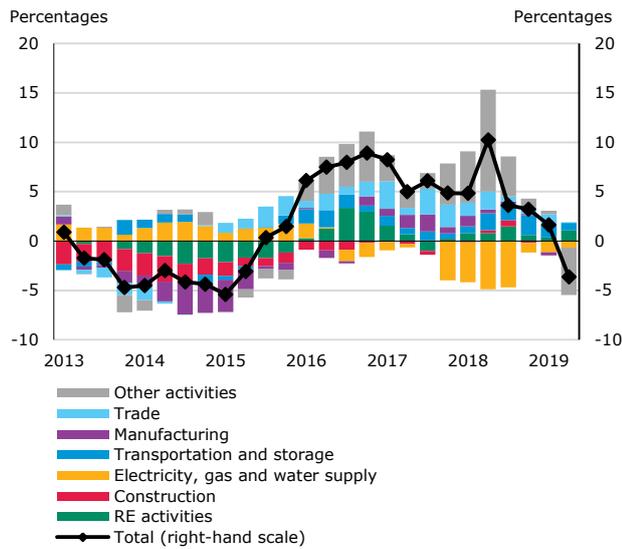
Chart 4. Annual change in the portfolio of MFI loans to non-financial corporations by economic activity (Q2 2018–Q2 2019)



Source: Bank of Lithuania.

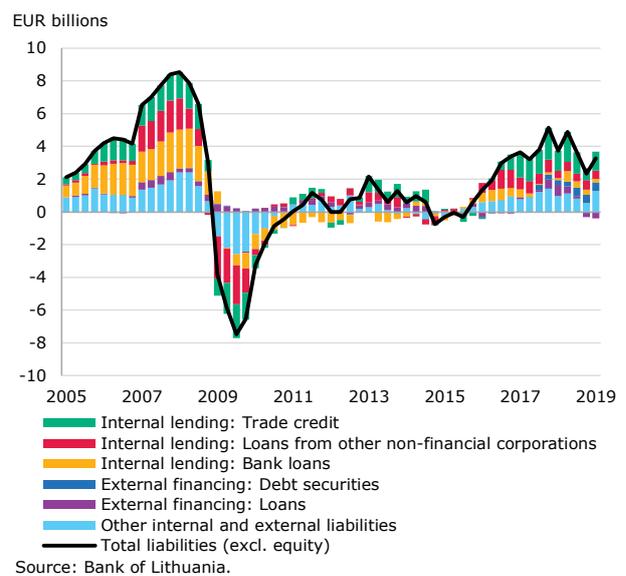
*Professional, scientific, technical activities and holding companies.
Note: Some names are abbreviated.

Chart 5. Annual change in the portfolio of MFI loans to non-financial corporations by economic activity (Q1 2013–Q2 2019)



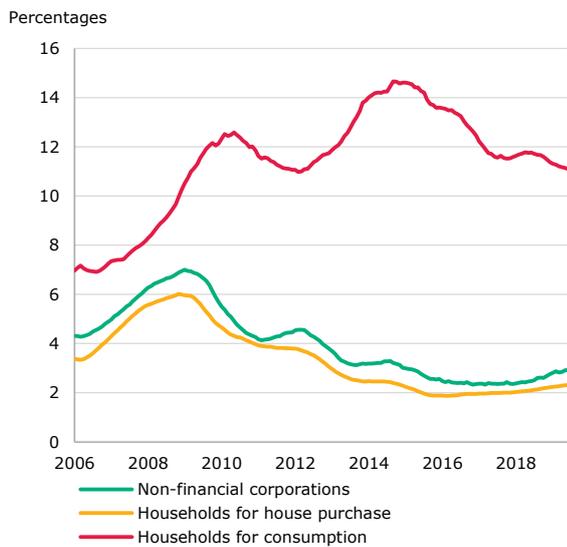
Source: Bank of Lithuania.

Chart 6. Annual change in credit granted to non-financial corporations (Q1 2005–Q1 2019)



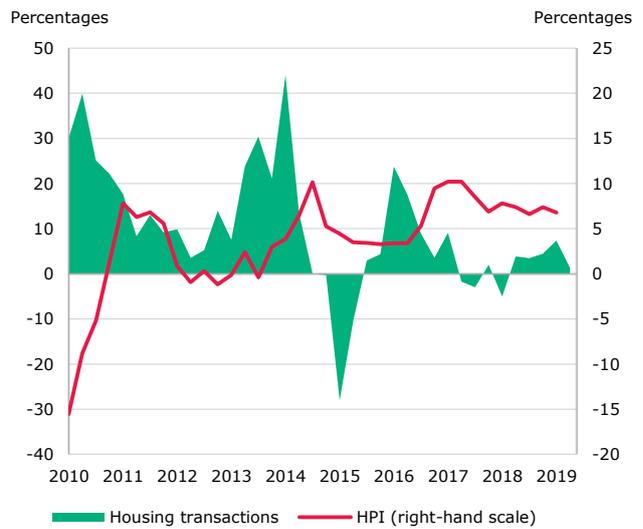
Source: Bank of Lithuania.

Chart 7. Average annual interest rate on new loans to non-financial corporations and households (12-month moving average) (January 2006–June 2019)



Source: Bank of Lithuania.

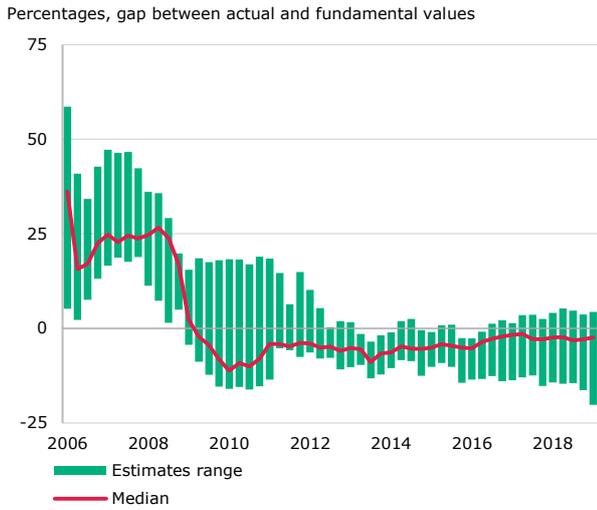
Chart 8. Annual change in the number of housing transactions and the house price index (HPI) (Q1 2010–Q2 2019)



Sources: Centre of Registers and Statistics Lithuania.

Chart 9. Gap between actual house prices and their fundamental values

(Q1 2006–Q1 2019)



Source: Bank of Lithuania.
 Note: Calculated based on the house price-to-rent ratio, house price-to-income ratio, an econometric model and the HP filter.

Chart 10. Number of unsold apartments in under-construction and completed multi-apartment buildings in Vilnius

(Q1 2012–Q2 2019)

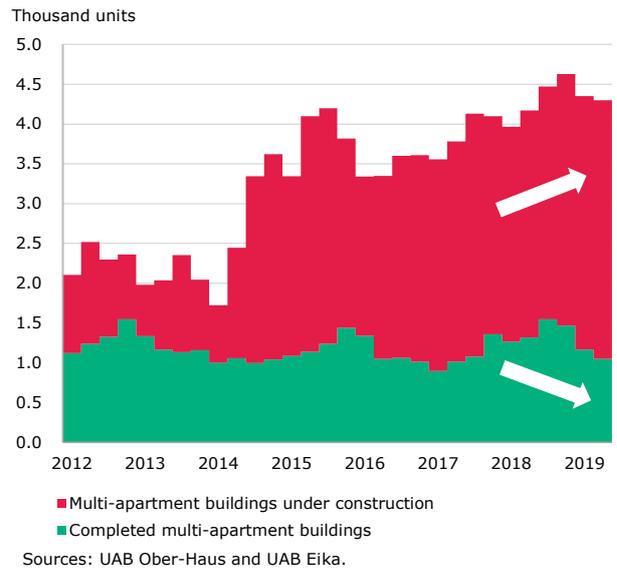
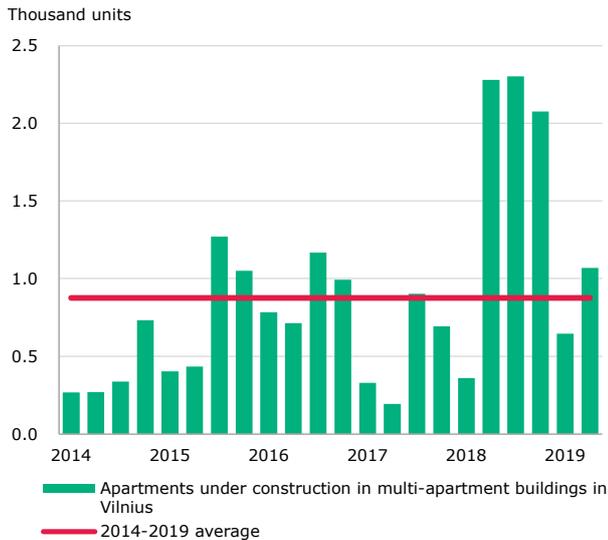


Chart 11. Under-construction apartments in multi-apartment buildings in Vilnius

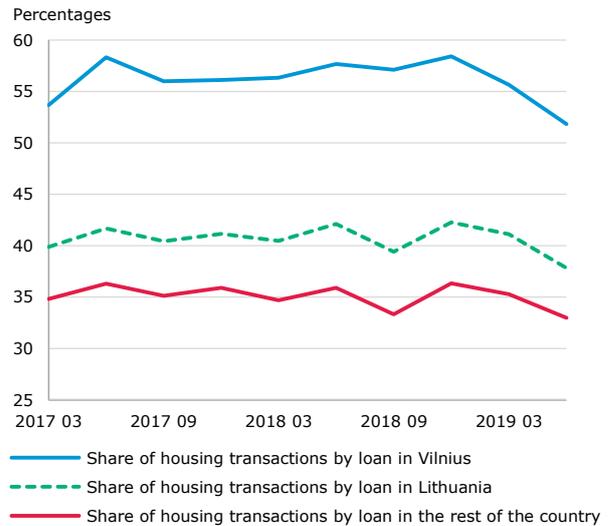
(Q1 2014–Q2 2019)



Source: Statistics Lithuania.

Chart 12. Share of housing transactions by mortgage

(Q1 2017–Q2 2019)

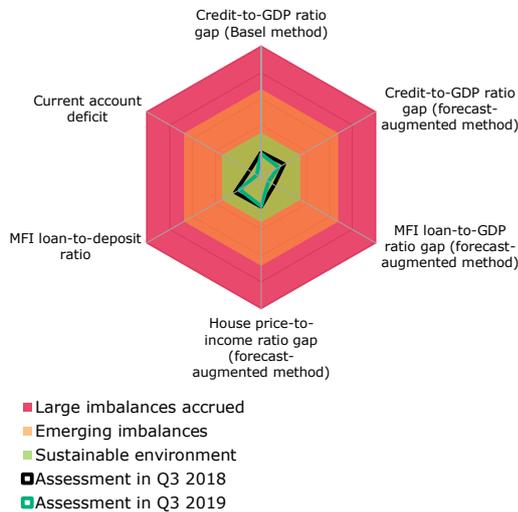


Source: Centre of Registers.

ANNEX 2. CREDIT AND HOUSING MARKET IMBALANCES

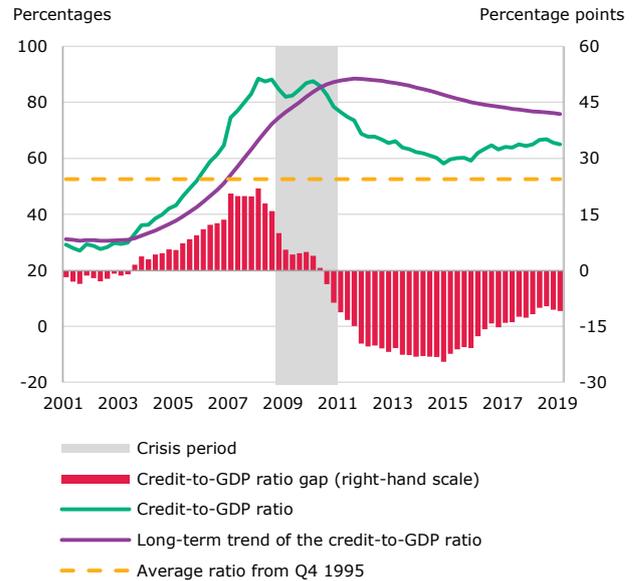
Chart A. Evaluation of credit market imbalances based on core and additional indicators

(Q3 2019)



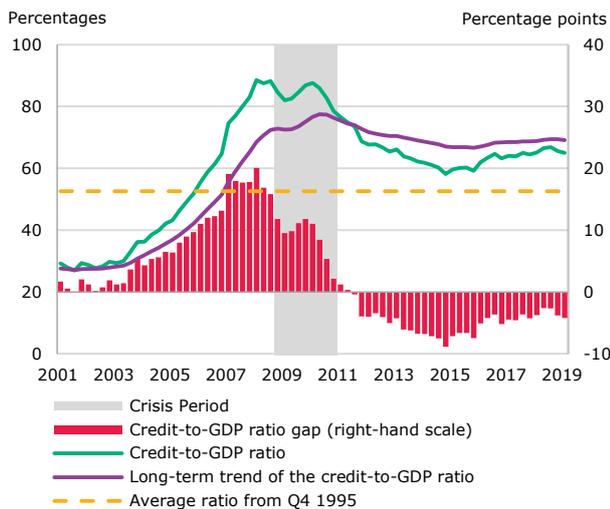
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: Axes are scaled according to the range of a particular indicator: from its minimal value up to the maximal value.

Chart B. Core indicator I: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the standardised Basel method) (Q1 2001–Q1 2019)



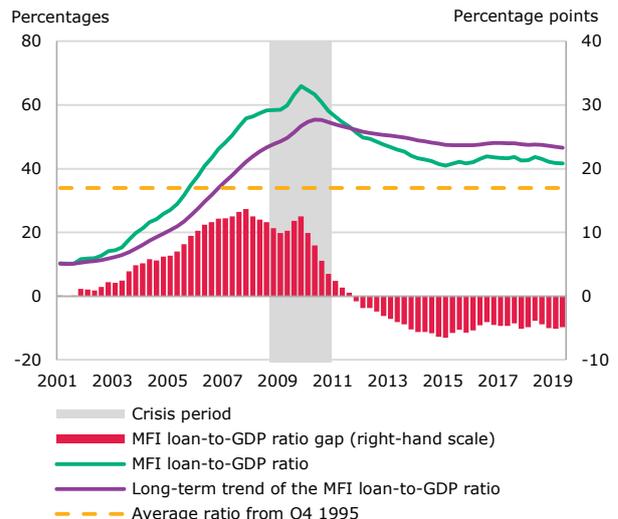
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed using a one-sided HP filter with a smoothing parameter of 400,000.

Chart C. Core indicator II: Credit to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q1 2019)



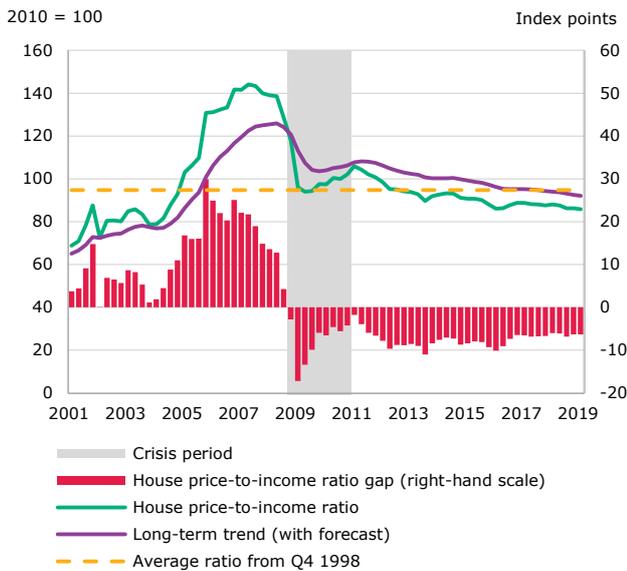
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

Chart D. Additional indicator I: MFI loan to the private non-financial sector-to-GDP ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q2 2019)



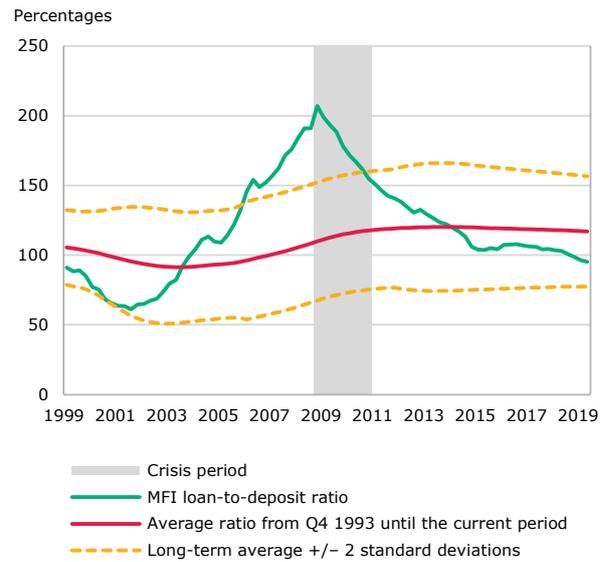
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Note: The long-term trend is computed by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window using a 4-quarter weighted average.

Chart E. Additional indicator II: House price-to-income ratio gap (calculated using the forecast-augmented method) (Q1 2001–Q1 2019)



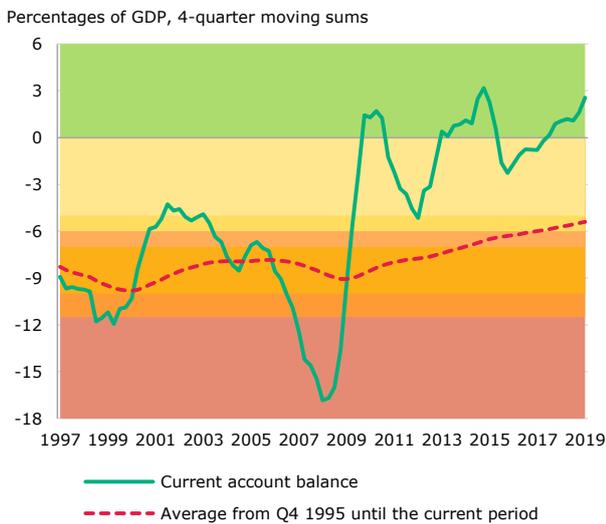
Sources: Statistics Lithuania and Bank of Lithuania calculations.
Notes: 1) income – household wages and salaries; 2) the long-term trend is estimated by applying a one-sided HP filter with a smoothing parameter of 400,000; before applying the filter, the ratio is modelled for the next 5-year window 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–Q2 2019)



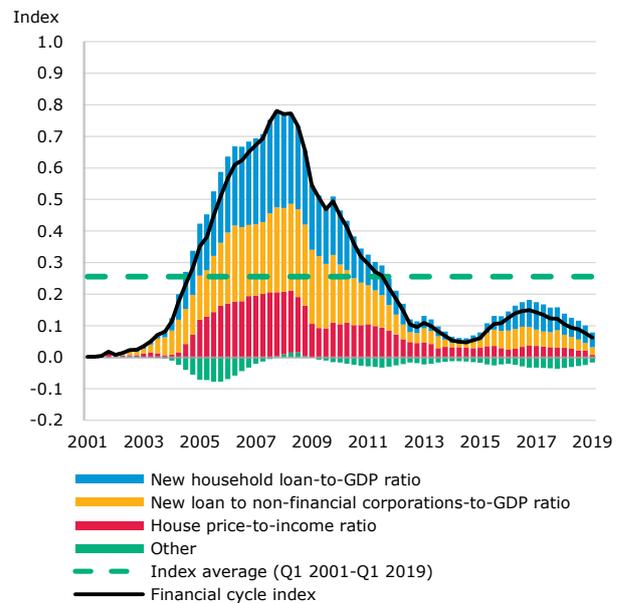
Source: Bank of Lithuania calculations.
Note: The ratio develops in a balanced way if it does not deviate from its long-term average by more than two standard deviations. Standard deviation is computed on the basis of data covering the period of moderate changes in the ratio, excluding data for Q2 2006–Q4 2011.

Chart G. Additional indicator IV: Ratio between the current account balance (4-quarter moving sums) and GDP (Q1 1997–Q1 2019)



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–Q1 2019)



Sources: Statistics Lithuania and Bank of Lithuania calculations.