1. BANKING DEVELOPMENT

At the end of 2002, there were 10 banks operating under a license from the Bank of Lithuania, 4 foreign bank branches and 2 foreign bank representative offices. In May 2002, a new VB Mortgage Bank was established and was issued a restricted license by the Bank of Lithuania.In addition, in early 2002 the Bank of Lithuania issued permission to the Finnish bank Nordea Bank Finland Plc Lithuania branch to operate in the Republic of Lithuania (prior to that this branch operated in Lithuania under the name of Merita Bank). The privatisation of the Agricultural Bank of Lithuania was completed in March 2002, and Norddeutsche Landesbank Girozentrale of the Federal Republic of Germany acquired a 76 per cent stake in the bank from the state.

In the course of the year, the market share of the three largest banks contracted from 78 per cent to 74 per cent, and the remaining market share was divided among the smaller banks and foreign bank branches. The development of selected items of the balance sheet in the banking system is presented below.

Development of some asset and liability items in the banking system
LTL million

No.	Item	1 Jan 2002	1 Oct 2002	1 Jan 2003	Change over Q4 (%)	Change year-on-year (%)
1	Assets	15349.0	16215.4	17221.2	6.2	12.2
2	Granted loans	6502.8	7275.9	7933.2	9.0	22.0
3	Deposits and letters of credit	10415.7	11441.0	11677.4	2.1	12.1
	private companies	3077.8	3614.2	3753.9	3.9	22.0
	natural persons	6357.1	6615.6	6877.6	4.0	8.2
4	Shareholders' equity	1439.8	1642.1	1730.5	5.4	20.2
5	Profit (loss) for current year	−24.1	141.1	146.8		

According to the financial statements for 1 January 2003 presented by the banks, operating domestic commercial banks were characterised by the following:
- assets totalled LTL 17.2 billion, increasing over the year by LTL 1.9 billion (12.2 %). In comparison, banking assets in 2001 had increased by LTL 2.25 billion (17.2 %);
- total loans granted to clients amounted to LTL 7.9 billion, increasing in comparison with 1 January last year by LTL 1.4 billion (22 %);
- deposits totalled LTL 11.7 billion on 1 January 2003, increasing over the year by LTL 1.3 billion (12.1 %);
- including individual deposits of LTL 6.9 billion, increasing over the year by LTL 521 billion (8.2 %);
- including deposits in the national currency of LTL 7.5 billion, increasing over the year by 31.9 per cent;
- including deposits in foreign exchange of LTL 4.1 billion, decreasing over the year by 12 per cent.

2. COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

In 2002 most banks remained conservative in their operations, which is proved by their compliance with the prudential requirements with a sizeable reserve; according to the unaudited statements presented on 1 January 2003, the capital adequacy in the banking system was 14.75 per cent and exceeded the minimum 10 per cent capital adequacy requirement set by the Bank of Lithuania; the liquidity ratio was 42 per cent and was also higher than the minimum required 30 per cent.

In 2002 all domestic commercial banks and foreign bank branches were in compliance with all prudential requirements set by the Bank of Lithuania.

3. LOANS

In the background of economic growth in 2002, banks were more active in their crediting activities, which resulted in the fastest growth of their loan portfolio since 1994. The share of loans in net value increased from 41.3 to 45.6 per cent of total assets.

2002 saw a continued growth of the proportion of long–term loans in the loan portfolio from 67 per cent in early 2002 to 72 per cent on 1 January 2003. On the one hand, long–term loans create favourable conditions for bank customers to develop investment projects and for the economy to grow; on the other hand, they pose higher credit risk for banks as economic conditions may change over a long period.

Long–term loans granted to the population increased by 76 per cent over the year. Mortgage loans have prevailed among the long–term loans granted to natural persons, the amount of which, according to the bank survey of 1 January 2003, made up LTL 989 million, i.e. 81 per cent of the total loans granted to natural persons. Fast growth of such loans can be expected further as banks offer favourable terms and the demand for them remains high. The growth of mortgage loans should be additionally encouraged by the household income tax relief effective as from 2003 which reduces taxable income by the amount of interest paid on mortgage loans.

It should be noted with respect to loan portfolio quality that loan portfolio quality indicators improved further in 2002. In addition to the renewal of the loan portfolio and economic growth mentioned above, this was also influenced by the improved financial standing of some borrowers and the regular write–offs of bad loans and their transfer to non–systemic accounts.

The development of loan portfolio quality in the banking system is presented in the table below.

Development of loan portfolio quality in the banking system

Date	Loan provisions/granted loans, %	Category III, IV, V loans/total loans, %
1 Jan 1997	20.68	32.1
1 Jan 1998	18.52	28.25
1 Jan 1999	5.92	12.46
1 Jan 2000	4.47	11.92
1 Jan 2001	3.73	10.79
1 Jan 2002	2.55	7.45
1 Jan 2003	1.08	5.82

4. DEPOSITS

Deposits and letters of credit serve as the most stable and fastest growing source of funds in the bank liability structure. The increased share of private company deposits resulted in a relative decrease of individual deposits from 61 per cent to 58.9 per cent of total deposits.

In absolute figures, individual deposits grew by half a billion litas in a year. This growth was determined by the increase of demand deposits, while the individual time deposit market, that had seen annual growth of over LTL 800 million for three consecutive years, in 2002 declined by LTL 66 million, i.e. 1.5 per cent. The volume of individual deposits was also pushed down by the decline of the US dollar exchange rate.

By the end of the year, compared to the beginning, balances on the accounts of private resident companies had increased by LTL 595 million (21.7 %).

5. CAPITAL

On 1 January 2003 the registered share capital of the banking system made up LTL 1,110 million. In 2002 four domestic banks registered increases of share capital, and a new VB Mortgage Bank was established in May with an LTL 20 million share capital.

Following the completion of the bank privatisation process in 2002, the share of banking capital held by foreign investors increased, with a corresponding reduction of the state–controlled share that on 1 January 2003 made up as little as 0.15 per cent. The above development was primarily related to the privatisation of AB Lithuanian Agricultural Bank. The development of the share of foreign investors in banking capital is presented below:

1 Jan 1996	16 per cent
1 Jan 1997	25 per cent
1 Jan 1998	32 per cent
1 Jan 1999	39 per cent
1 Jan 2000	35 per cent
1 Jan 2001	58 per cent
1 Jan 2002	81 per cent
1 Jan 2003	88 per cent

There has been a significant domination of Scandinavian capital in the Lithuanian banking system, yet its share saw a relative decrease owing to a marked investment by a German bank.

6. PROFITABILITY

The total result of the domestic banking system in 2002 was a profit of LTL 146.8 million, which was the best achievement after the restoration of the country's independence. Eight banks and three foreign bank branches earned a profit of LTL 205.1 million, while two banks (Agricultural Bank of Lithuania and Sampo Bank) and one foreign bank branch (Nordea Bank Finland Plc Lithuania Branch) incurred a total loss of LTL 58.3 million. In comparison, in 2001 the banking system incurred a loss of LTL 24.1 million. The performance of the banking system and profitability indicators are summed up in the table below.

Results of operating banks

No.	Bank	Profit for current year (LTL million)	
		1 Jan 2002	1 Jan 2003
1.	Agricultural Bank of Lithuania	8.2	–50.6
2.	Ūkio Bank*	2.9	6.2
3.	Vilniaus Bank	95.2	126.5
4.	Šiaulių Bank	2.4	3.4
5.	Bank "Snoras"	4.5	10.5
6.	Medicinos Bank	1.6	1.2
7.	PAREX BANKAS	–7.1	2.8
8.	Bank Hansa–LTB	–114.0	50.1
9.	VB Mortgage Bank	–	0.1
10.	Sampo Bank	–10.1	–4.9
	TOTAL banks:	**–16.3**	**145.4**
11.	Kredyt Bank S.A. Vilnius Branch	0.7	1.8
12.	Norddeutsche Landesbank Girozentrale Vilnius Branch	–2.2	2.3
13.	VEREINS–UND WESTBANK AG Vilnius Branch	–2.2	0.1
14.	Nordea Bank Finland Plc Lithuania Branch	–4.0	–2.8
	Total foreign bank branches	**–7.7**	**1.4**
	Total:	**–24.1**	**146.8**

* Following the audit of the financial statements of Ūkio Bank, the profit for 2001 was reduced by LTL 1.55 million, while the profit for 2002 was increased by the same amount as a result of changes in the accounting policy of one company within Ūkio Bank group and owing to the efforts to maintain the comparability of bank financial statements for different periods.

Interest rates that were declining fast during the first half of 2002 stabilised by the end of the year, and the real interest margin declined but slightly over the year (by 0.25 percentage points) and stood at 4.08 per cent on 1 January 2003. It should be noted that the real interest margin of foreign bank branches is significantly lower than that of commercial banks. In the conditions of a declining real interest margin, a positive factor was that with the growth of banking assets, the share of interest–earning assets increased in proportion. From the start of the year, the ratio of interest–earning assets to total assets went up by nearly 2 percentage points to 79.95 per cent on 1 January 2003, i.e. a continually increasing proportion of assets earned interest.

With the decline of interest rates, the banking system earned a lower interest income in 2002 and incurred lower interest expenses than in 2001. Net interest income was LTL 25 million higher in 2002 than over the previous year.

Operational expenses, as before, accounted for the largest share of banking expenses. However, the rate of growth of operational expenses was significantly slower that during the previous year with annual increase of 5.3 per cent, while in 2001 they went up by 14.7 per cent.

7. AUDIT OF BANK ANNUAL FINANCIAL STATEMENTS

The audit of 2002 financial statements in all banks was performed by international auditing companies. The auditors expressed unqualified opinions in respect to the financial statements of all banks with the exception of the Agricultural Bank of Lithuania.

In presenting their opinion with respect to the financial statements of the Agricultural Bank of Lithuania, the auditors gave a qualified opinion on the different treatment of specific provisions on loans. In the auditors' opinion, if the loan provisions in the bank were calculated on the basis of future cash flows (as well as the sale of collateralised assets) at current value, the loss of the Agricultural Bank of Lithuania for 2002 would be lower and the shareholders' equity and assets would increase by approximately LTL 19 million.

8. LITHUANIAN CENTRAL CREDIT UNION

In November 2002, the Board of the Bank of Lithuania passed a resolution to issue a license for the operations of the Lithuanian Central Credit Union (LCKU). The Central Credit Union was accorded a statutory function to support the liquidity and restore the solvency of credit unions.

According to the data of 1 January 2003, the assets of the LCKU made up LTL 6.2 million; it held LTL 0.8 million of credit union deposits and LTL 0.5 million loans to credit unions. The share capital of the LCKU consisted of the share of the Government of the Republic of Lithuania (LTL 5.3 million) and the shares of 36 LCKU credit union members of LTL 1 thousand each.

From the start of its operations, the LCKU complied will all prudential requirements and earned an audited profit of LTL 117 thousand.

9. CREDIT UNIONS

On 1 January 2003, there were 53 credit unions in Lithuania; financial accounts were presented by 52 credit unions with the total of nearly 21 thousand members. Thirteen new credit unions were established in 2002, which was the highest number from the start of credit unions, and the license of one credit union was revoked.

Development of the main items of the consolidated balance sheet of credit unions

No.	Balance sheet item	Amount (LTL thousand)			Change over Q4 (%)	Change year-on-year (%)
		1 Jan 2002	1 Oct 2002	1 Jan 2003		
1.	Assets	33837.6	56487.2	70119.6	24.1	2.1 times
2.	GS	1972.1	2293.5	2636.3	14.9	33.7
3.	Granted loans	21063.7	38884.1	45885.9	18.0	2.2 times
4.	Deposits	26514.1	44902.5	56514.6	25.9	2.1 times
	Of which members and associated members	20676.0	38449.2	50090.4	30.3	2.4 times
5.	Share capital	4013.0	6377.6	7550.5	18.4	88.2
6.	Profit (loss) for current year	359.5	290	414.2	–	–

The activities of credit unions expanded fast last year. According to the data of the financial statements checked by credit union inspectors (independent auditors) and approved by general meetings of the shareholders, in 2002:
- assets increased by 2.1 times and on 1 January 2003 made up 0.41 per cent of total assets in the banking system. The assets of two largest credit unions ("Ūkininkų viltis" and Pakruojis farmers) accounted for 20.7 per cent of total assets of credit unions on 1 January 2003;
- granted loans increased by 2.2 times and made up 65 per cent of total assets. On 1 January 2003, 31 credit unions held specific provisions (LTL 255.7 thousand);
- investment in Government securities increased by 33.7 per cent;
- deposits increased 2.1 times, of which the largest share (89 %) were deposits of members;
- the share capital of credit unions grew by 87.8 per cent.

Last year, 37 credit unions earned a profit, while 15 credit unions incurred losses. According to the audited financial statements, approved by the general shareholders meetings, in 2002 credit union profit was LTL 414.2 thousand, which was the highest since the restoration of the country's independence (in comparison, in 2001 it was LTL 359.5 thousand). Higher profits were determined by the increased volume of operations, but the relative profitability and efficiency indicators somewhat declined.

Similar to previous years, the main source of income was interest income (87.1 per cent of total income). Interest expenses and operational expenses accounted for the largest share of expenses, 46.6 and 42.7 per cent, respectively.

In 2002 all credit unions complied with the prudential requirements of the Bank of Lithuania.