LIETUVOS BANKAS
EUROSISTEMA

Activities of financial market participants

Banking Activity Review

Q3 2023

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Banking sector at the end of Q3 2023

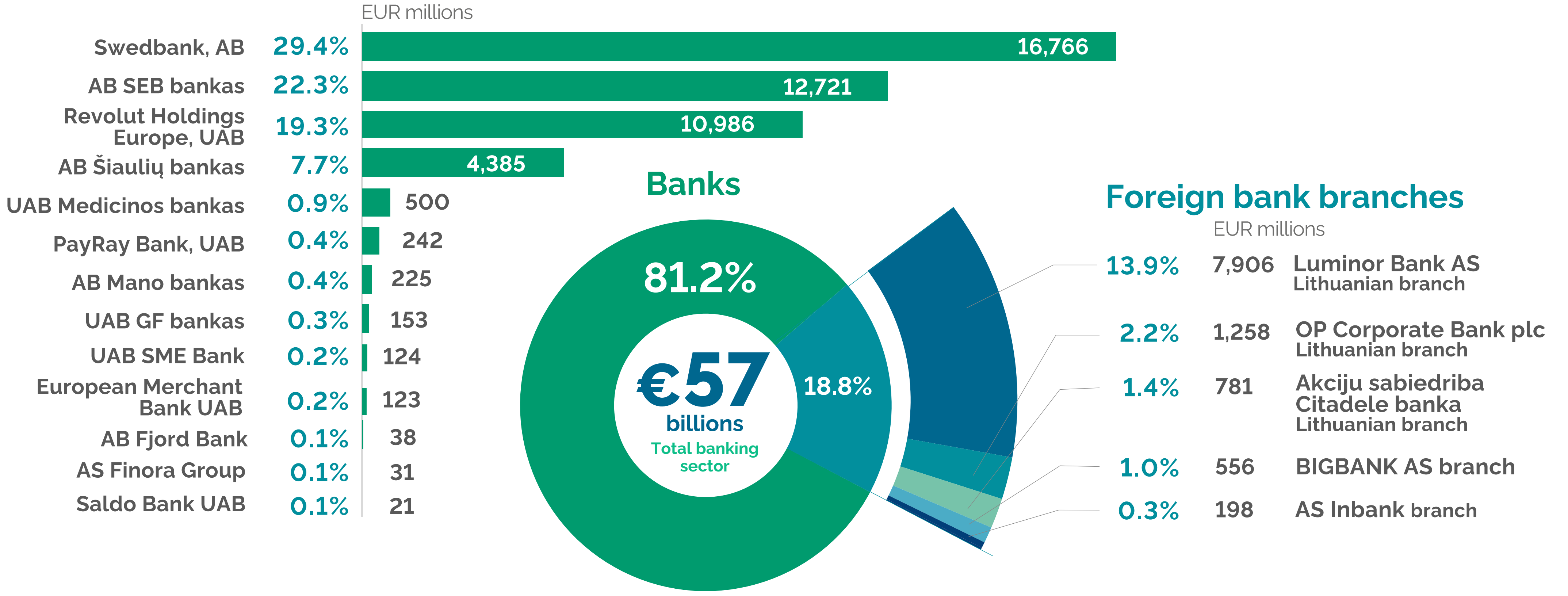
Market participants

13 banks

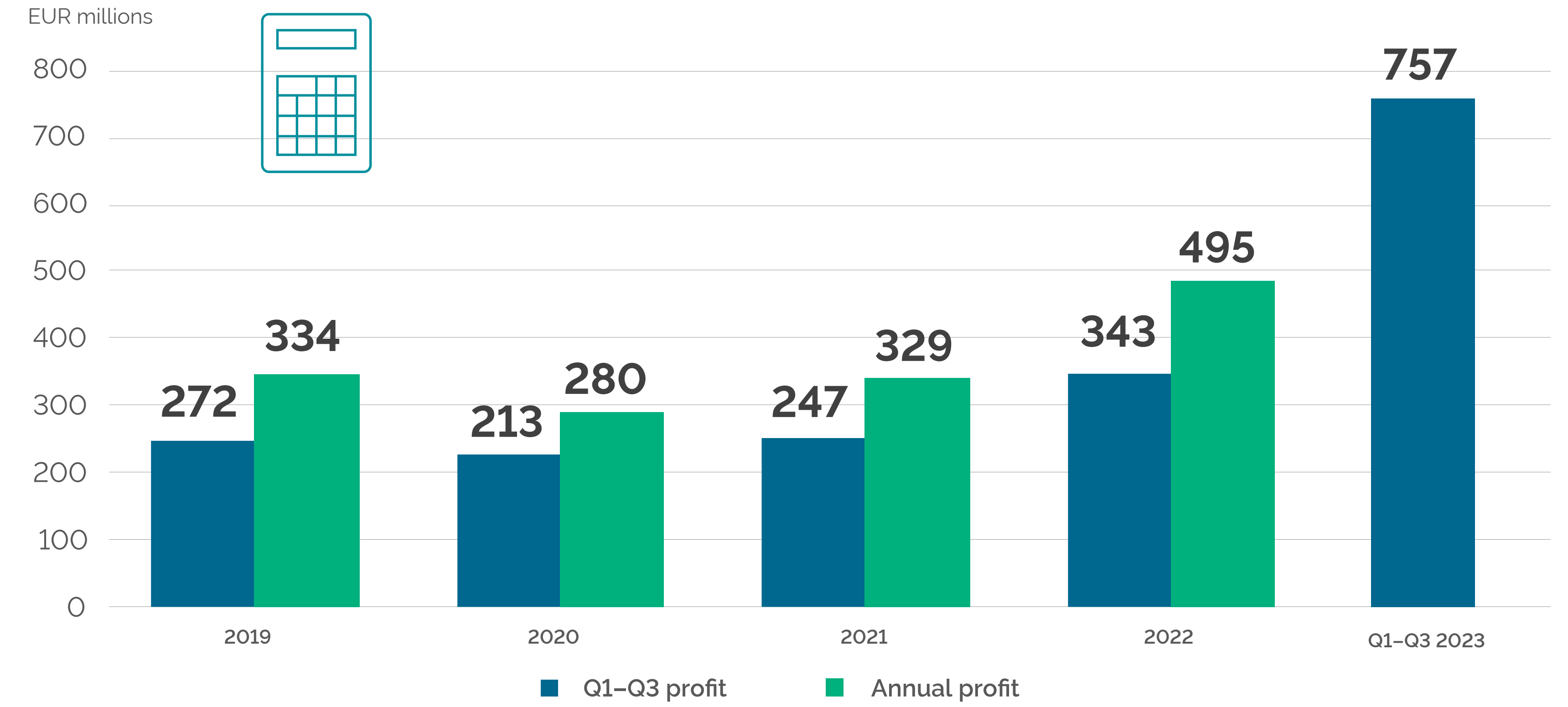
5 foreign bank branches

Assets

Market share by assets



Profit

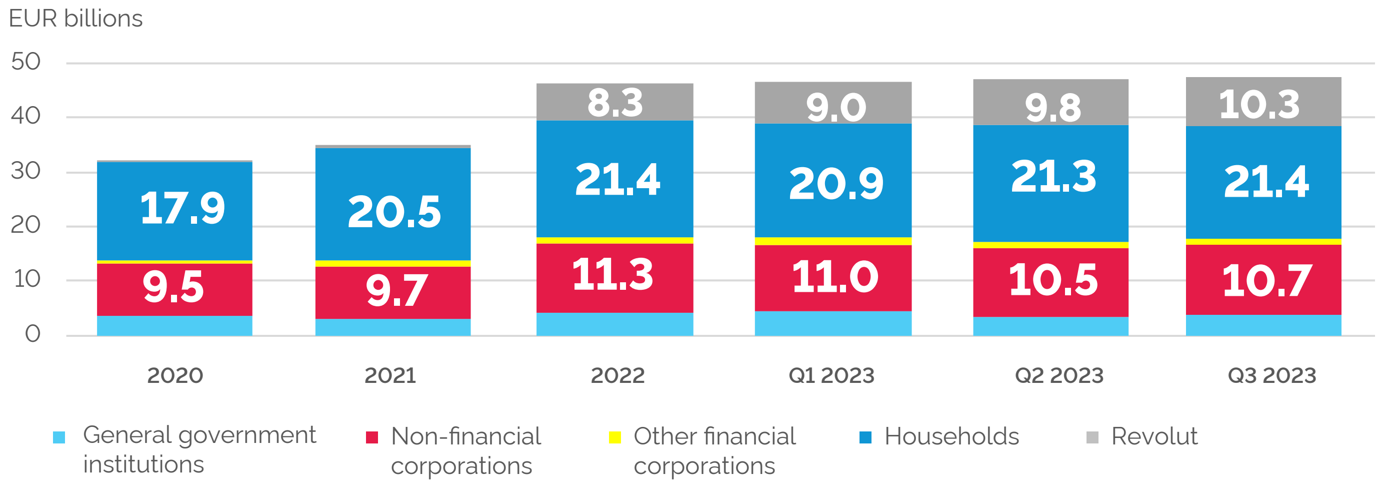


The banking sector continued to record exceptionally high profits

Source: Bank of Lithuania

Deposit and loan dynamics in Lithuania

Deposits



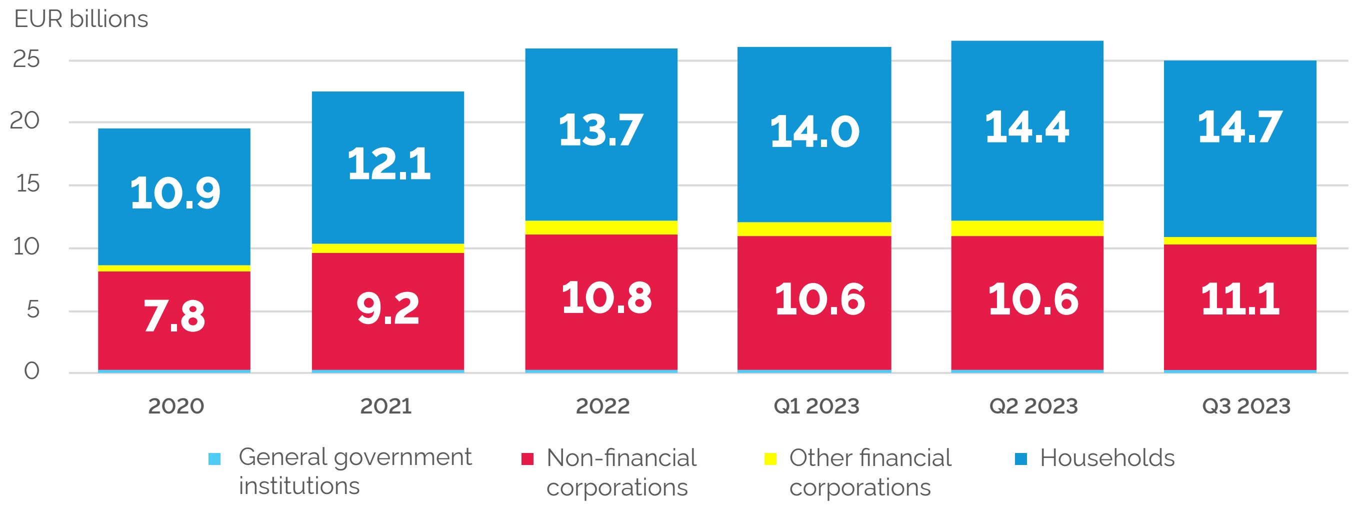
+0.5%*

Households
(Q3 2023)

In Q3 2023, resident deposits increased by €0.1 billion, or 0.5%*

*Non-resident deposits of Revolut Bank UAB are eliminated.

Loans



+1.4%

Housing loans
(Q3 2023)

Loans to non-financial corporations and households recorded the biggest growth during the quarter

Compliance with prudential requirements

Capital adequacy ratio (CAR)	Liquidity coverage ratio (LCR)
20.0%	434%
Net stable funding ratio (NSFR)	**Leverage ratio**
193%	6.4%

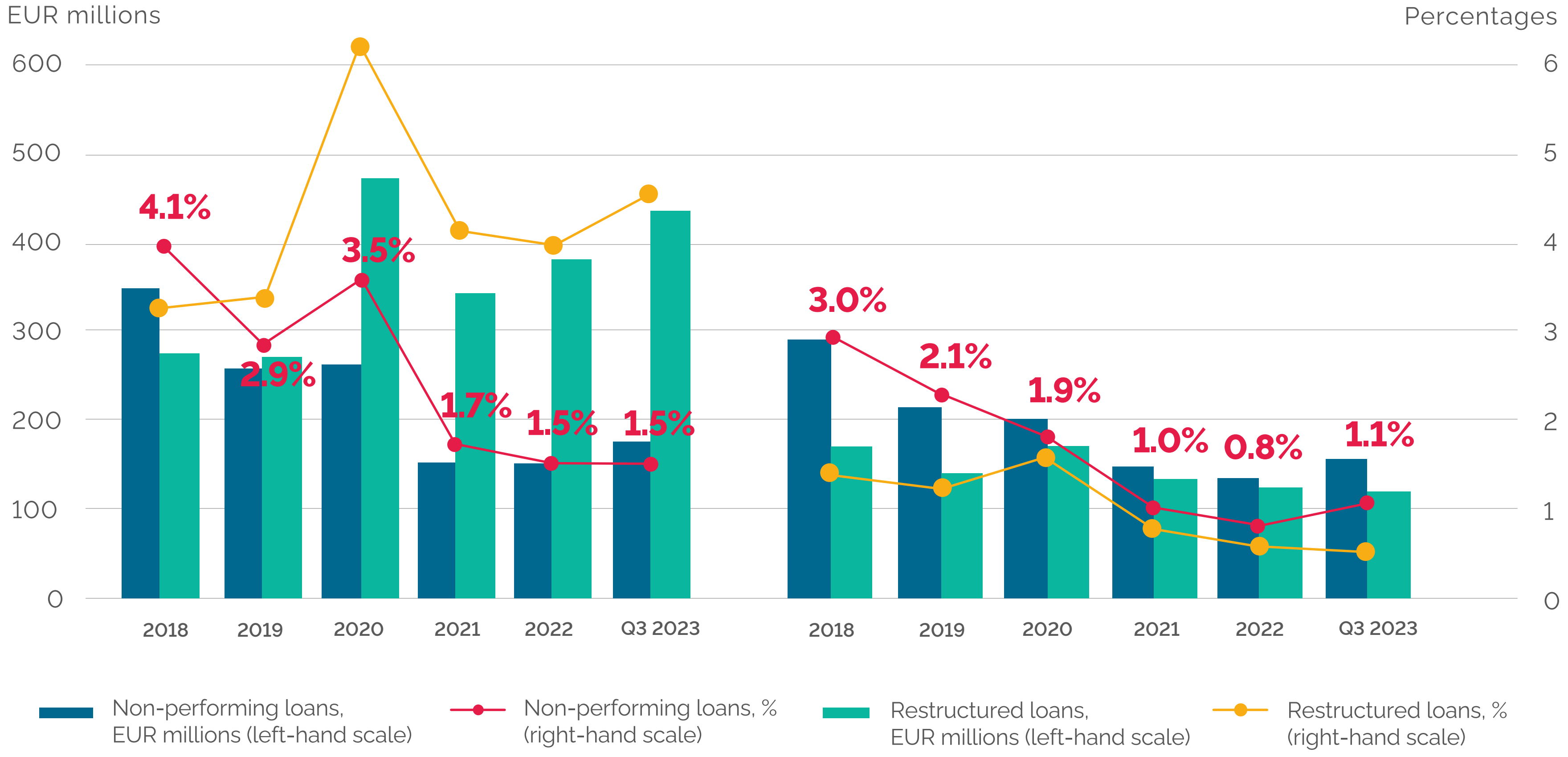
Bank capital adequacy level remained high

Bank liquidity also remained high, all banks had a high liquidity buffer

The leverage ratio was more than twice the minimum level

Loan quality 2018–Q2 2023

Non-financial corporations | Households



Source: Bank of Lithuania

So far, no significant adverse impact on the quality of the loan portfolio has been observed

The increase in the loan portfolio of banks continued in the third quarter of 2023, driven by loans to households and non-financial corporations. In the period under review, negative changes in the quality indicators of household loans were observed. The deposits of residents in Lithuanian banks continued to grow; however, a slight decreasing trend in the growth rate was observed. The transformation of demand deposits into term deposits accelerated for the third consecutive quarter.

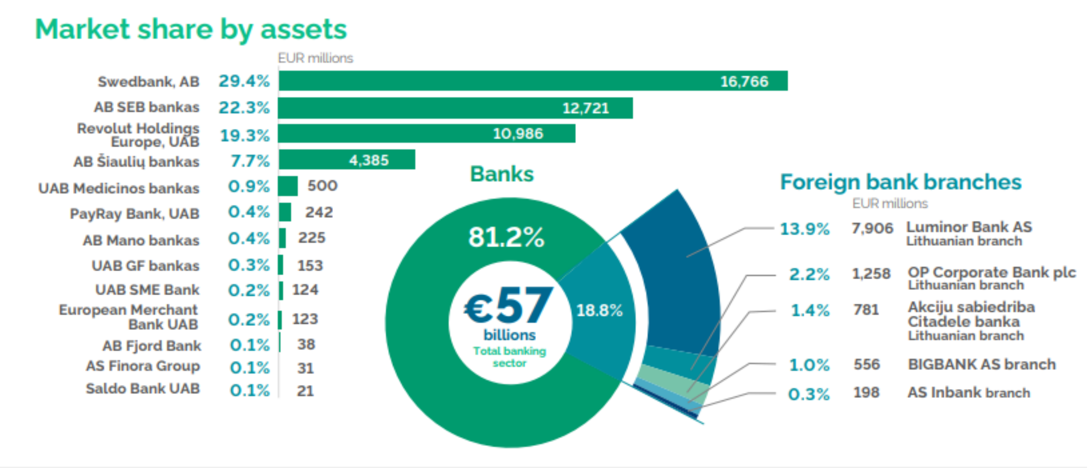
The profitability of the Lithuanian banking sector continued to be unusually high, with banks operating in Lithuania, branches of foreign banks, and other credit institutions having already paid the second quarterly instalment of the temporary solidarity levy.

Banks continued to strengthen their operational resilience. According to the assessment of information technology (IT) risks and control areas carried out by the Bank of Lithuania, banks rated the risk posed by third-party providers of information and communications technology (ICT) services as the highest IT risk, and cyber and IT security risk as the second largest.

The number of banking sector participants did not change in the third quarter of 2023. Currently, there are **18 participants in the banking sector** in Lithuania: **13 banks hold banking licenses (of which seven are specialised banks), and five banks operate as branches of foreign banks.** Also, the Bank of Lithuania, together with the European Central Bank (ECB), is examining one more application for a specialised bank licence.

Starting from early 2024, the four largest banks operating in Lithuania will be directly supervised by the ECB. Among them, the two largest banks, Swedbank AB and AB SEB bankas, still hold over half (51.7%) of the market share in terms of total assets. The third largest in terms of asset size, at the highest level of consolidation, is currently Revolut Holdings Europe, UAB (19.3%), with over 98% of assets located outside of Lithuania, spread across various European Union (EU) countries. At the end of the third quarter of 2023, the market share of AB Šiaulių Bankas, the fourth-largest bank by size, accounted for 7.7% of total assets

Chart 1. Banks and foreign bank branches that operated in Lithuania on 1 October 2023



Source: Bank of Lithuania.

The total assets of the other eight banks (excluding Revolut Bank UAB) that started operations in the last year grew by 8.1% in the third quarter of 2023 and amounted to €973 million, or 1.7% of the market. Foreign bank branches account for 18.8% of the market, with the Lithuanian branch of Luminor Bank AS holding the largest share.

The Centre for Financial Market Development continued to work consistently on encouraging the establishment and operation of foreign commercial banks in Lithuania. From the beginning of 2023, employees of the Centre for Financial Market Development proactively engaged with 30 different commercial banks. During this period, the Newcomer Programme received inquiries from 18 different commercial banks.

Bank assets grew by almost €0.3 billion (0.5%), **to €57 billion over the third quarter[1]**; however, after removing the Revolut Group factor,[2] bank assets fell by almost €0.3 billion (0.5%) over the period under review.

The net value of loans granted to customers, the asset item that comprises the largest share of bank assets, increased by €47 million (0.2%) to €26.6 billion.

Over the quarter, funds in the central bank decreased by more than €0.8 billion (5.2%), amounting to €15.4 billion, primarily due to a drop in the position of one bank. However, funds in other credit institutions increased by a similar amount – €0.8 billion (reaching €7.5 billion) because of several banks increasing their positions. Furthermore, banks held nearly €0.5 billion in cash. the total of the most liquid assets – cash and funds in banks – changed only slightly during the quarter, decreasing by only €36 million (0.2%) and amounting to almost €23.4 billion in total – representing 41% of the total assets of the banks.

Banks also slightly increased their debt portfolios, with investments in debt securities rising by almost €0.1 billion, or 1.6%, and amounted to €5.9 billion (10.3% of total bank assets).

Bank liabilities continued to increase due to the growth of deposits. In the third quarter of 2023, total bank liabilities increased by €1.1 billion (2.3%) – to €47.8 billion; however, after removing the impact of the Revolut Group, total deposits grew by €0.5 billion (1.4%). As a result of the continued participation of some banks in the ECB's targeted longer-term refinancing operations and the repayment of the whole deposit by one bank, central bank deposits decreased by €1 billion to €0.5 billion, and liabilities (mainly parent institutions) increased by €46 million (2.2%) to €2.2 billion during the quarter.

During the reviewed period, several banks did not meet significant position requirements. The non-compliance with requirements did not pose a threat to the operations of these banks. In response to the violations, the banks promptly took action by attracting additional capital (increasing the limits for significant positions) and/or reducing the largest positions. As a result, in October the requirements for significant positions were already being met. **Other regulatory norms limiting operational risks in banks were implemented. The bank capital adequacy level remained high in the third quarter of 2023**. The capital adequacy ratio of the banking sector increased by 0.1 percentage points to 20% in the period under review, due to the growth of risk exposures more than own funds, while top-tier capital instruments continued to dominate in the banks operating in Lithuania, with the common equity tier 1 (CET1) ratio standing at 18.7%.

Lithuania's banking sector further maintained a high leverage ratio. As of 1 October 2023, the leverage ratio had declined by 0.3 percentage points (to 6.4%) and it was more than double the established minimum threshold (3%).

The liquidity of the banking sector increased in the third quarter of 2023, and liquidity reserves in banks remained substantial. The liquidity coverage ratio (LCR) increased from 379% to 434% and was almost four times above the minimum threshold, i.e. the liquidity buffer in banks was four times higher than the one-month loss of cash flow. The LCR indicator increased in many of the country's banks, and the growth

[1] Should system participants adjust their statements for this or other important reasons, the data of the Review after this date may be revised.
[2] The bank's activities are mainly focused abroad, with deposits from non-resident customers in various European Union (EU) countries accounting for 98% of the bank's deposits, and the assets being removed were attracted from outside Lithuania during the quarter.

of the banking sector's LCR was mainly driven by the approaching cash flows from the parent group. In addition, the liquidity ratios of the Lithuanian banking sector continue to be positively influenced by the highly liquid Revolut Group. However, even after excluding the impact of the Revolut Group, at the end of the third quarter, the LCR remained high, reaching 270%, which is slightly higher than before the pandemic. **The LCR of the banks operating in Lithuania is significantly higher than that of banks in other European countries** – at the end of the second quarter of 2023, the average LCR of European banks was 165%.

Lithuanian banks also complied with the mandatory net stable funding ratio (NSFR) requirement for assessing long-term liquidity with a sufficient buffer. In the third quarter of 2023, the NSFR of the banking sector decreased from 197% to 193% (it would stand at 158% without the impact of the Revolut Group) and was much higher than the required minimum level of 100%.

In Lithuanian banks, funding sources are particularly stable – deposits from residents make up as much as 62% of all liabilities, which is twice the average in Europe. Recently, a downward trend in excess liquidity has been observed in most European countries, linked to the rising cost of funding in the market and with the conclusion of the ECB TLTRO financing programme; in addition, deposits from residents in European banks have started to decrease. Unlike in European banks, the deposits of residents in Lithuanian banks continued to increase; however, a slight decreasing trend in the growth rate was observed. It is likely that in the future, residents will actively seek even better-paying products. Therefore, especially with the emergence of attractive investment alternatives, the dynamics of residents' deposits in banks operating in Lithuania may change.

With a significant increase in interest rates, customers are paying more attention to pricing. For the third consecutive quarter, there has been a rapid transformation of demand deposits into term deposits – the share of term deposits increased from 21% to 25% during the quarter, and over the nine months, term deposits in banks nearly doubled (at the beginning of 2023, they were 13% – excluding the Revolut Group, where all deposits are demand ones).

The portfolio of loans and other prepayments increased by €527 million (1.6%) in the third quarter, reaching €33.3 billion, excluding positions in credit institutions and central banks (hereinafter – the loan portfolio) – by €47 million (0.2%), i.e. increased to €26.6 billion. **While loans to households and non-financial corporations**, which make up the majority of the banks' loan portfolio, **increased by 2.5% and 3.9% respectively over the quarter** (total of €772 million), decisions made by one banking group to transfer the financing of the group's entity in Lithuania to another country resulted in a decrease of €738 million in the portfolio of loans to other financial corporations (excluding credit institutions), reducing it to €492 million and significantly decreasing the overall loan portfolio growth rate. The loans to households increased equally due to both housing and consumer loans: during the quarter, housing loans grew by €164 million (1.4%) – reaching €11.5 billion, and the consumer loan portfolio increased by €166 million (9.5%) (a significant portion of the growth was attributed to the expansion of lending abroad by one market participant) – reaching €1.9 billion. In total, loans to households increased by €356 million (2.5%) during the quarter, reaching €14.7 billion. Loans to non-financial corporations saw an increase of €417 million (3.9%) during the quarter, reaching €11.1 billion. The most significant increase was in loans to companies operating in the wholesale and retail trade sector (€0.2 billion), significantly surpassing the growth of loans to companies in other economic sectors (e.g. transportation and storage, professional, scientific and technical activities, construction, real estate operations). During the period under review, loans to large enterprises grew faster than those to small and medium-sized enterprises. The total value of banks' lending commitments to non-financial corporations dropped by 3.5% to €3.25 billion. The government sector portfolio increased by €12 million during the quarter, reaching €337 million.

In the third quarter, negative changes in the quality indicators of household loans were observed. The share of non-performing loans (including loans to credit institutions) decreased by 0.02 percentage points, reaching 0.98%. The volume of non-performing loans of non-financial corporations decreased by

13.5% to 1.48% (€149 million) of the corporate loan portfolio, while those of households increased by 14.2% and accounted for 1.12% (€166 million) of loans to residents. The share of forborne loans decreased over the quarter significantly (by 0.03 percentage points) and comprised 1.65% (€522 million) of the total loan portfolio. After increasing since the beginning of the year, restructured loans to non-financial corporations began to decrease in the third quarter (decreasing by €5.1 million, or 1.1%), while the volume of restructuring of loans to households increased by €4.5 million (5.1%) during the quarter. The share of loans overdue by more than 30 days increased slightly: in the households segment, the share of overdue loans grew by 0.09 percentage points to 0.86%, while in the non-financial corporations segment it remained unchanged, amounting to 0.54%. Loans, whose credit risk significantly increased from the initial recognition, increased in both business portfolios (by 0.62 percentage points, reaching 14.02%) and household portfolios (by 0.13 percentage points, reaching 7.52%).

The ratio of loans to special provisions remained unchanged during the quarter and at the end of the quarter stood at 1.02%. The coverage ratio of non-performing loans with special provisions decreased by 0.81 percentage points to 34.68% (business – 25.98%, households – 42.51%). The level of provisions continues to be lower than the average for euro area banks.

In the third quarter of 2023, deposits in Lithuania were increasing. After eliminating the impact of the Revolut Group (i.e. deposits attracted outside Lithuania), total deposits increased by €0.6 billion (1.6%). Over the quarter, deposits of the government sector increased the most (€0.3 billion or 8%), followed by non-financial corporations (€0.2 billion or 2.1%), and household deposits – by €0.1 billion (0.5%).

The Revolut Group's deposits increased by almost €0.5 billion (5%), almost to €10.3 billion, in the third quarter of 2023 as a result of its foreign operations, deposits from non-resident customers in various EU countries account for 98.2% of the total deposits it attracts.

The Lithuanian banking sector continued to show unusually high profitability indicators – in the third quarter of 2023, a profit of €242.4 million was earned, slightly less than in the second and first quarters (€256.7 million and €258.4 million respectively). However, considering the solidarity levy paid each quarter, the profit in the third quarter would be the highest in history when evaluating quarterly profitability.

In the three quarters of 2023, banks and branches of foreign banks made a combined profit of €757.5 million, 2.2 times more than in the same period in 2022 (€342.9 million). 14 banks and foreign bank branches were profitable, and four market participants operated at a loss. All of the loss-making market participants suffered an aggregate loss of almost €7.4 million, including the recently launched specialised banks, whose operating costs are higher than their revenues.

At the end of November, banks operating in Lithuania, foreign bank branches, and other credit institutions transferred almost €104 million as the second advance payment of the temporary solidarity levy for the third quarter, while the first instalment for the second quarter amounted to €56 million. Based on the Bank of Lithuania's calculations, the total solidarity levy for 2023 could reach around €250 million.

The twice-rising interest rates in the third quarter due to ECB decisions continued to have a significant impact on banks' interest income growth. Although interest expenses due to increased deposit interest rates continued to rise in the third quarter, and their growth was even higher than the increase in interest income, the absolute growth in interest expenses from the beginning of the year was still significantly lower than the growth in interest income. For these reasons, the profits of banks increased.

In the three quarters of this year, banks' interest income increased by €1.15 billion (almost threefold) to €1.7 billion compared to the same period last year, while interest expenses rose by €196 million (2.6 times) to almost €258 million. Interest income has increased significantly for the fourth consecutive quarter: in the third quarter, interest income rose by a further €80 million or almost 13.7% compared to the second quarter. Interest expenses also increased by almost €124 million (46.7%). The rise in interest income rates was also influenced by the income received by some market participants from overnight deposits held with the central bank, which amounted to more than €183 million, compared with only €2.8 million a year earlier.

Over the three quarters of 2023, total net interest income increased by €955 million (almost 2.9 times) to almost €1.46 billion compared to the same period last year.

Net income from fees and commissions increased by €271 million (84%) and amounted to €592 million. Excluding the significant impact of the Revolut Group, net fee and commission income increased by €12.9 million, or 6.3% – to €218 million. The banks' staff costs increased by €25.5 million (15.9%) in the three quarters of 2023 (excluding the impact of the Revolut Group) compared to the same period in 2022.

The value of loans decreased more than 2.5 times compared to a year ago: over the first three quarters of 2023, the value decreased by €47.1 million, while during the same period in 2022, it decreased by €25.2 million.

In the third quarter, the indicators of banks' assets and equity returns slightly decreased, but due to the rapidly growing profit, the changes in these indicators compared to their values a year ago (as of 1 October 2022) were significant: the return on assets increased by 0.84 percentage points, reaching 1.79%, and the return on equity increased by a staggering 14.39 percentage points, reaching 24.59%.

Based on the analysis results, banks should continue to strengthen their operational resilience. According to the information provided by banks, the Bank of Lithuania conducted an assessment of IT risk and control areas. Banks assessed the risk of third-party providers offering ICT services as the highest IT risk, while cybersecurity and IT security risk were rated as the second largest in terms of magnitude. Taking into account the analysis results, banks should actively manage IT and related risks at the board level, initiate more frequent third-party IT service audits, strengthen IT change management processes, and actively engage in the activities of platforms for sharing cyber information.

ANNEX. KEY INDICATORS OF THE BANKING SECTOR[3]

Table 1. Main items of the balance sheet statement

No.	Indicator	01/10/2022 EUR millions	01/07/2023 EUR millions	01/10/2023 EUR millions	Quarterly change, %	Anuual change, %
1.	Assets	53,014.5	56,749.5	57,031.3	0.5	7.6
1.1.	Debt securities	4,773.9	5,798.8	5,892.8	1.6	23.4
1.2.	Equity securities	83.1	65.6	65.0	-0.9	-21.7
1.3.	Financial derivatives	207.6	109.9	115.8	5.3	-44.2
1.4.	Cash	512.3	470.2	458.3	-2.5	-10.5
1.5.	Funds with central banks	15,404.6	16,229.8	15,383.5	-5.2	-0.1
1.6.	Funds with credit institutions	3,927.7	6,694.8	7,517.2	12.3	91.4
1.7.	Loans to customers (incl. leasing)	25,564.3	26,572.9	26,619.7	0.2	4.1
1.7.1.	to general government institutions	314.0	325.0	336.6	3.6	7.2
1.7.2.	other financial corporations	1,143.6	1,229.6	492.1	-60.0	-57.0
1.7.3.	non-financial corporations	10,740.6	10,633.9	11,050.3	3.9	2.9
1.7.4.	households	13,366.1	14,384.4	14,740.8	2.5	10.3
1.7.4.1	o/w loans for house purchase	10,726.8	11,362.1	11,526.5	1.4	7.5
1.8.	Other asset positions	2,541.0	807.7	979.1	21.2	-61.5
2.	Liabilities and equity	53,014.5	56,749.5	57,031.3	0.5	7.6
2.1.	Deposits of central banks	1,613.5	1,489.7	488.9	-67.2	-69.7
2.2.	Liabilities to credit institutions	1,822.5	2,135.5	2,181.7	2.2	19.7
2.3.	Financial derivatives	118.9	76.5	70.0	-8.4	-41.1
2.4.	Deposits	42,239.9	46,698.0	47,790.1	2.3	13.1
2.4.1.	of general government institutions	3,893.7	4,032.8	4,354.7	8.0	11.8
2.4.2.	of other financial corporations	1,315.7	1,326.6	1,465.5	10.5	11.4
2.4.3.	of non-financial corporations	10,841.3	11,951.5	12,288.8	2.8	13.4
2.4.4.	of households	26,189.1	29,387.1	29,681.1	1.0	13.3
2.5.	Debt securities outstanding	105.8	235.4	238.1	1.2	125.0
2.6.	Other liability positions	2,547.1	2,437.0	2,336.2	-4.1	-8.3
2.7.	Equity	4,566.7	3,677.6	3,926.4	6.8	-14.0

Source: Bank of Lithuania.

[3]Should banks adjust their statements for important reasons, the data of the Review after this date may be updated.

Table 2. Main items of the profit (loss) account

No.	Indicator	01/10/2022 EUR millions	01/07/2023 EUR millions	01/10/2023 EUR millions	Quarterly change, %	Annual change, %
3.	Current year profit	342.9	515.1	757.5	–	120.9
3.1.	Net interest income	506.7	922.7	1,461.2	–	188.4
3.2.	Net income from fees and commissions	321.2	367.5	592.1	–	84.3
3.3.	Administrative expenses	515.3	349.3	566.6	–	10.0
3.4	Impairment of loans and non-financial assets	25.2	37.5	47.1	–	87.1

Source: Bank of Lithuania.

Table 3. Other performance indicators of banks

No.	Indicator	01/10/2022 EUR millions	01/07/2023 EUR millions	01/10/2023 EUR millions	Quarterly change, p.p.	Annual change, p.p.
4.	Capital adequacy ratio	19.86	19.90	20.02	0.12	0.16
5.	CET1 capital adequacy ratio	19.63	18.47	18.66	0.19	-0.97
6.	Liquidity coverage ratio	421.54	379.03	434.45	55.42	12.91
7.	Net Stable Funding Requirements	179.15	196.78	192.72	-4.06	13.57
8.	Leverage ratio	5.85	6.07	6.40	0.33	0.55
9.	Net interest margin	1.46	3.29	3.45	0.16	1.99
10.	Return on assets	0.95	1.83	1.79	-0.04	0.84
11.	Return on equity	10.20	26.01	24.59	-1.42	14.39
12.	Cost-to-income ratio (EBA methodology)	55.55	35.86	38.06	2.20	-17.49
13.	Non-performing debt instruments	0.58	0.59	0.58	-0.01	0.00

Source: Bank of Lithuania.

Notes: EBA – European Banking Authority.