



LIETUVOS BANKAS

E U R O S I S T E M A

4th International Financial
Markets Conference

**Lithuanian financial
sector:**

**Contribution to economic growth
and effectiveness**

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Vilnius



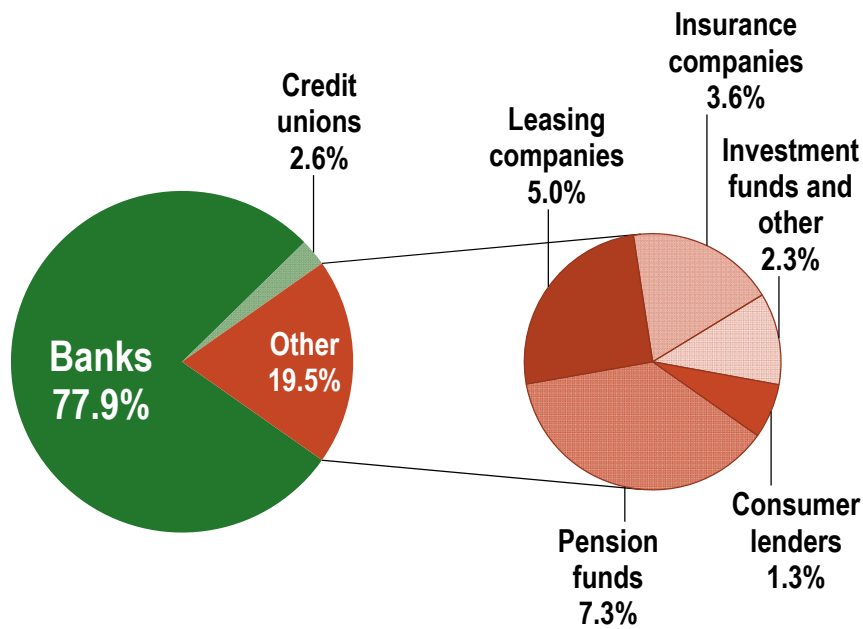
Outline

- ▶ **Some stylised facts**
- ▶ **What does determine the size of the financial sector?**
- ▶ **Is there enough financing for Lithuanian firms?**
- ▶ **Credit impulse: credit impact on GDP**



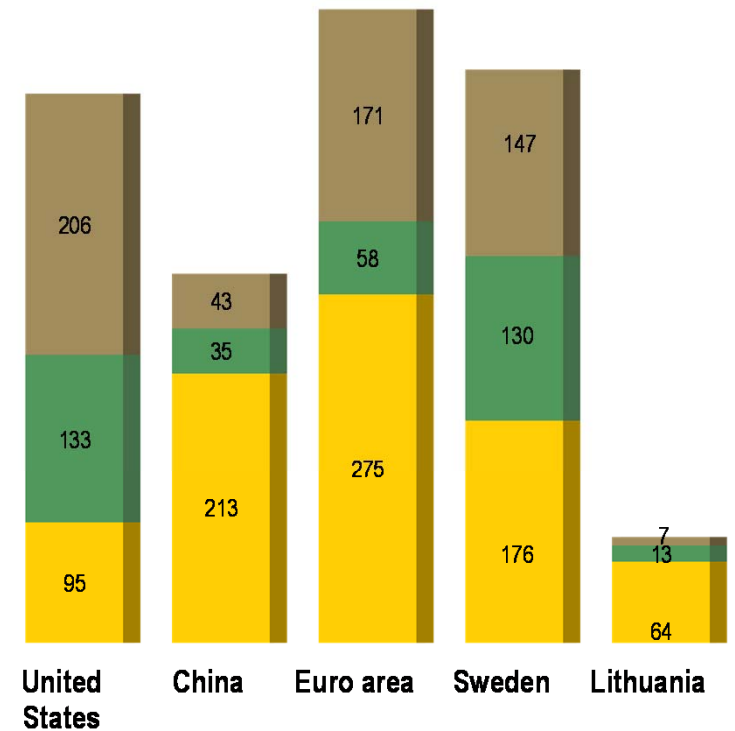
Bank-based financial system

Structure of financial institutions' assets in Lithuania



Source: Bank of Lithuania, 2015Q2.

Bonds, equities and bank assets, 2013 % GDP



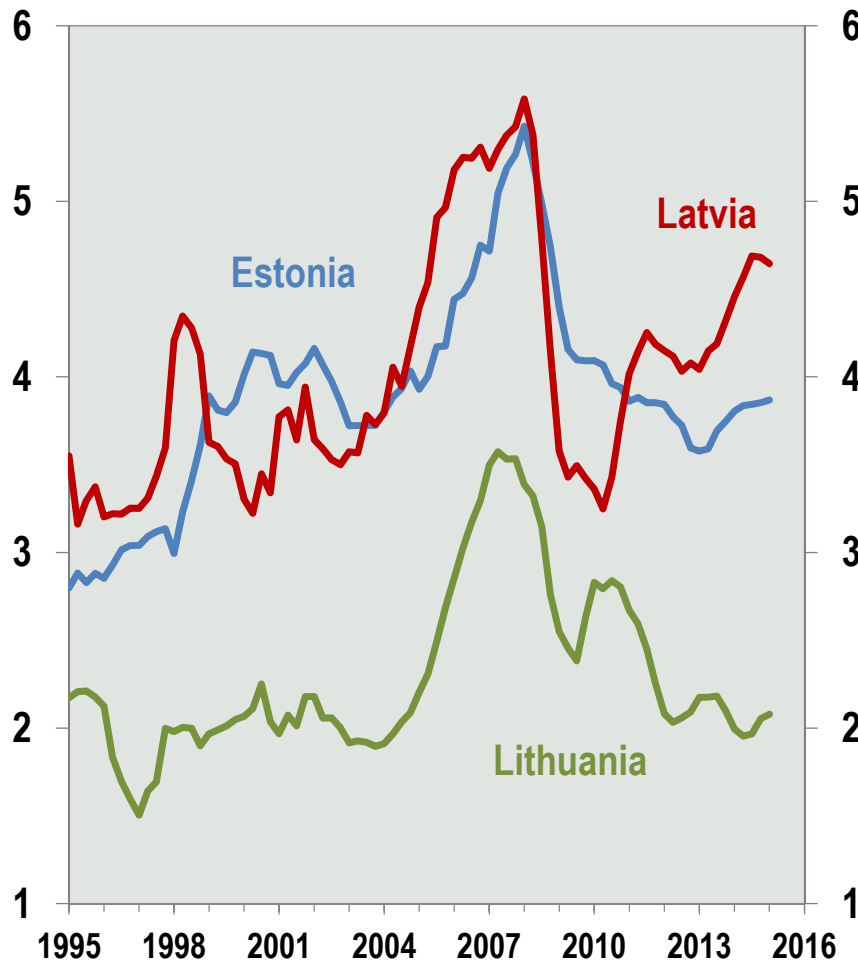
- Debt securities
- Stock market capitalisation
- Bank assets

Sources: IMF GFSR and Bank of Lithuania.

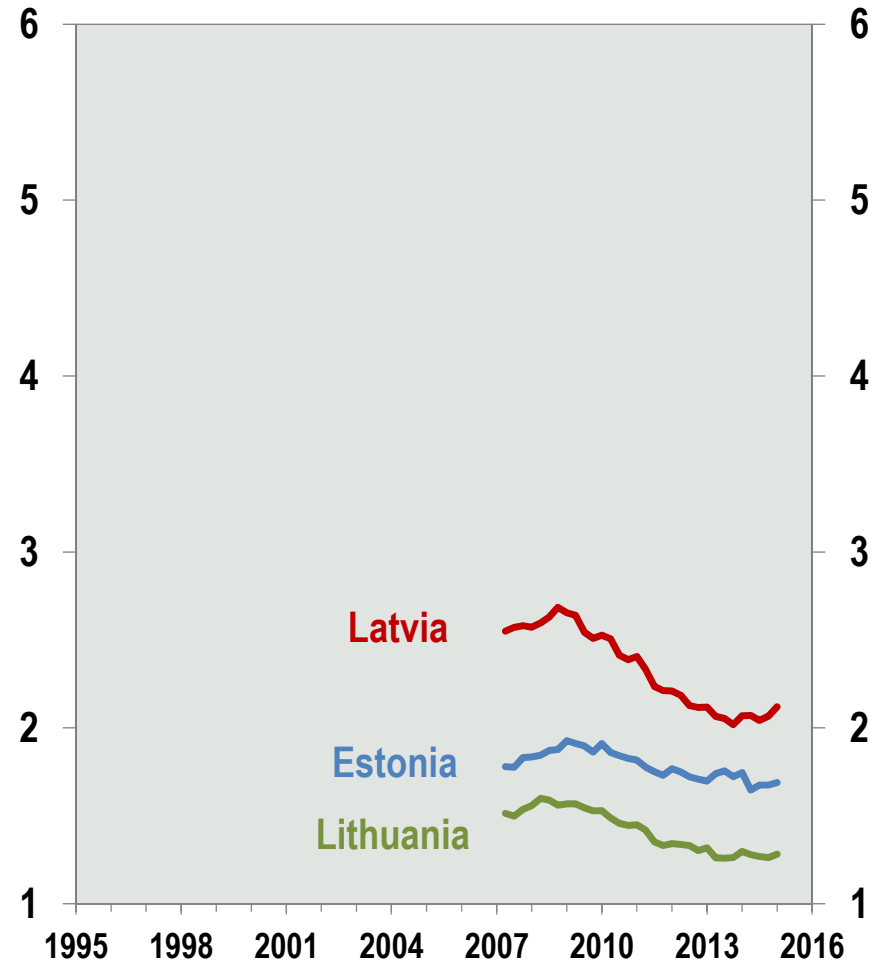


Importance of financial intermediation

Share of financial intermediation in Gross Value Added (GVA), %



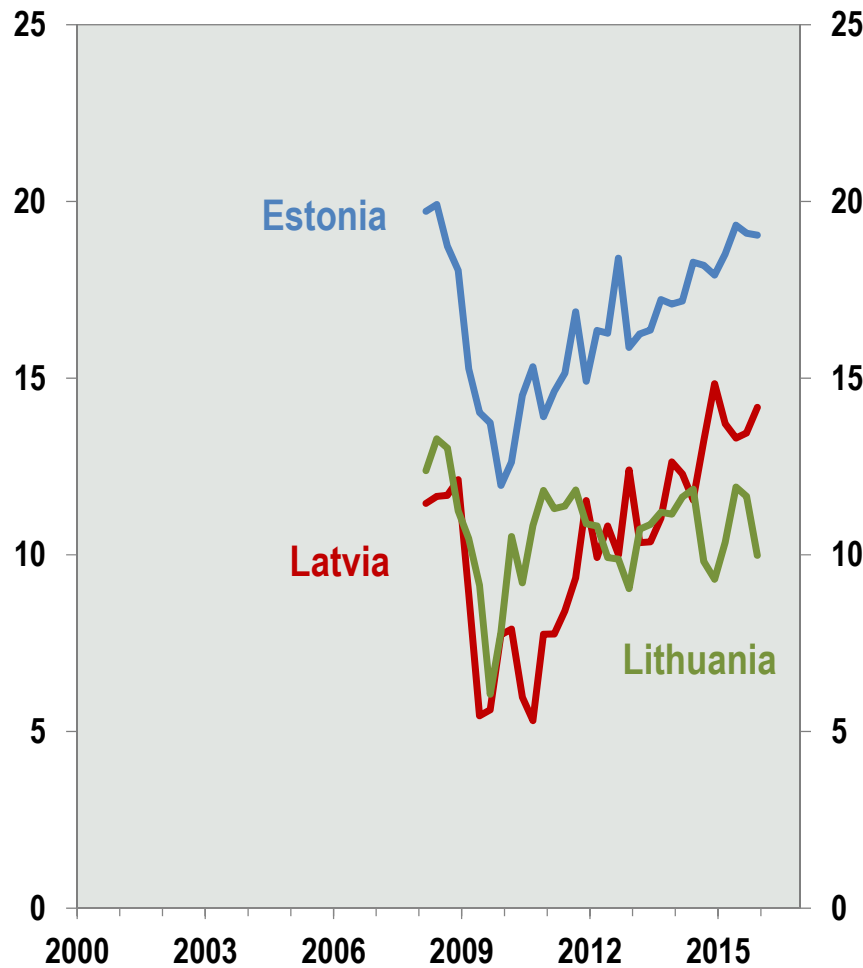
Share of financial intermediation in total employment, %



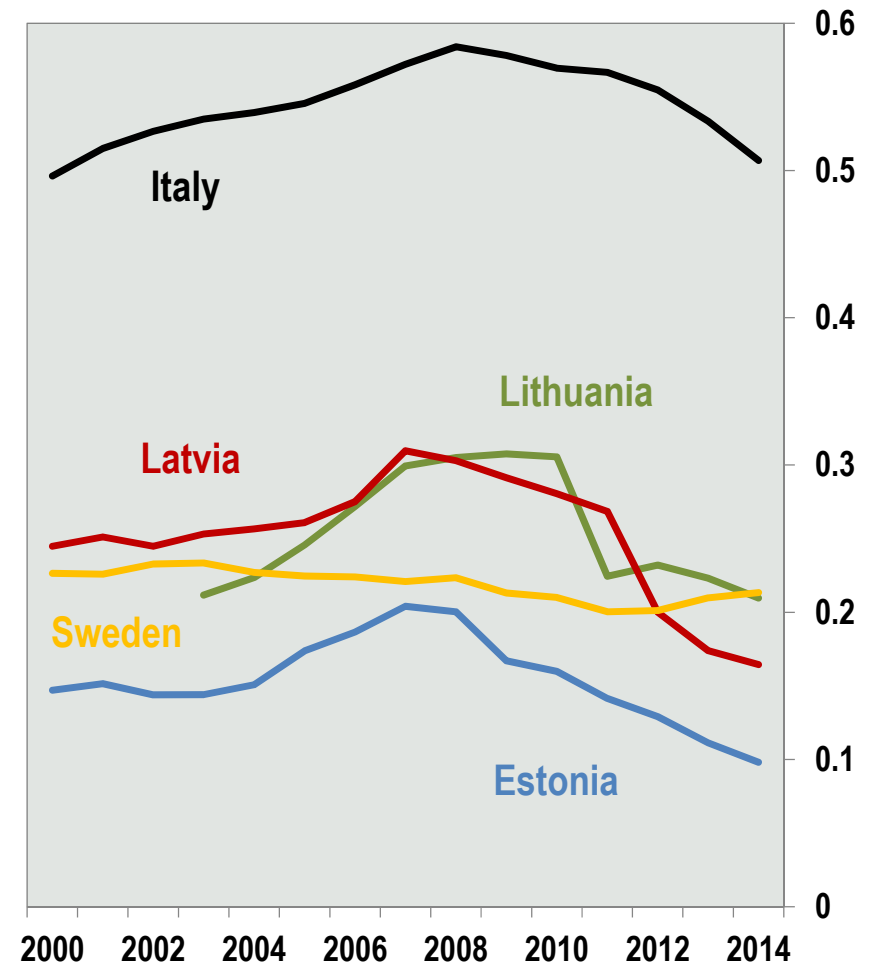


Efficiency of financial intermediation

Annual Gross Value Added (GVA) per employee, EUR thousands



Bank branches per 1000 inhabitants





Why are the sizes of financial sectors different?

► **Taxation !**

affects demand for credit through the deductibility of

- interest expenses for firms, i.e. 'debt bias'
- mortgage interest payments
- reinvested profits

subsidises the insurance sector through the deductibility of

- investments in life assurance/pension products

- yes

- abolished

- abolished

} in Lithuania

- yes

► Widespread **cash use** reduces bank deposits

► Reliance on (or abuse of) **trade credit**

► Services to **non-residents**, as in Latvia, Luxembourg, Malta



Why are the sizes of financial sectors different?

▶ Nature of **non-financial clients**

- distribution of firms by size, small vs. large firms
- aggregate size of non-financial firms – influences maximum firm borrowing capacity and bank lending opportunities
- availability and use of (cross-border) intra-group funding (e.g. FDI loans)

▶ Financial **regulation**

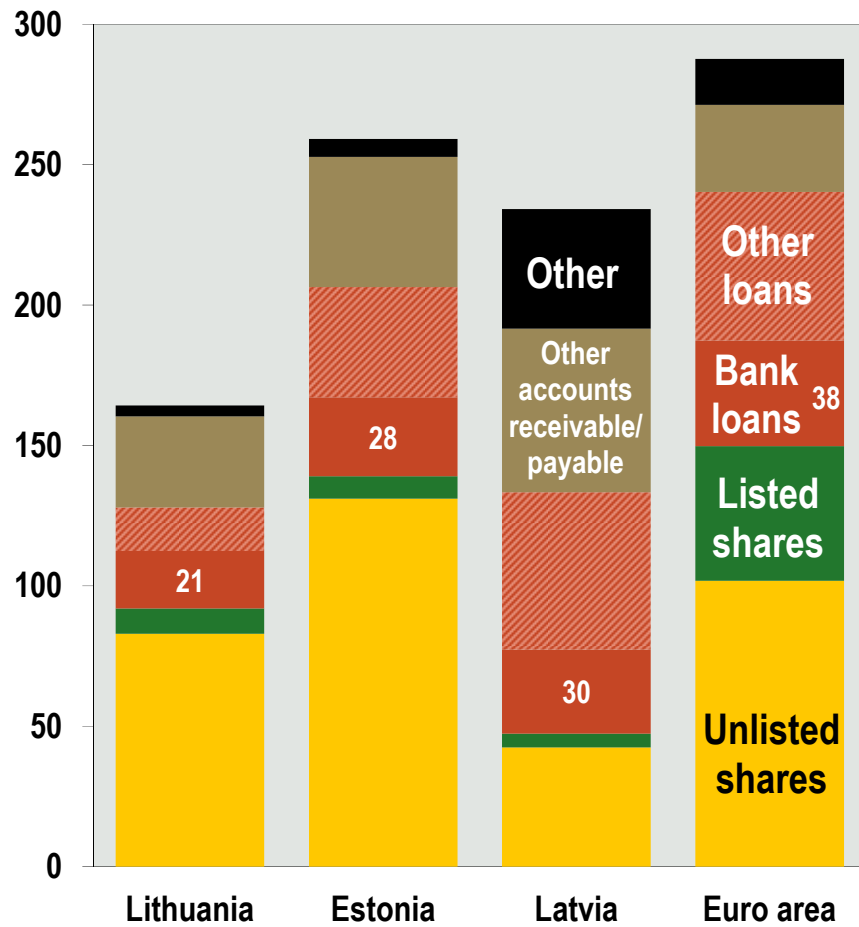
▶ Availability of **state guarantee/financing schemes** for SMEs

▶ Other factors ...



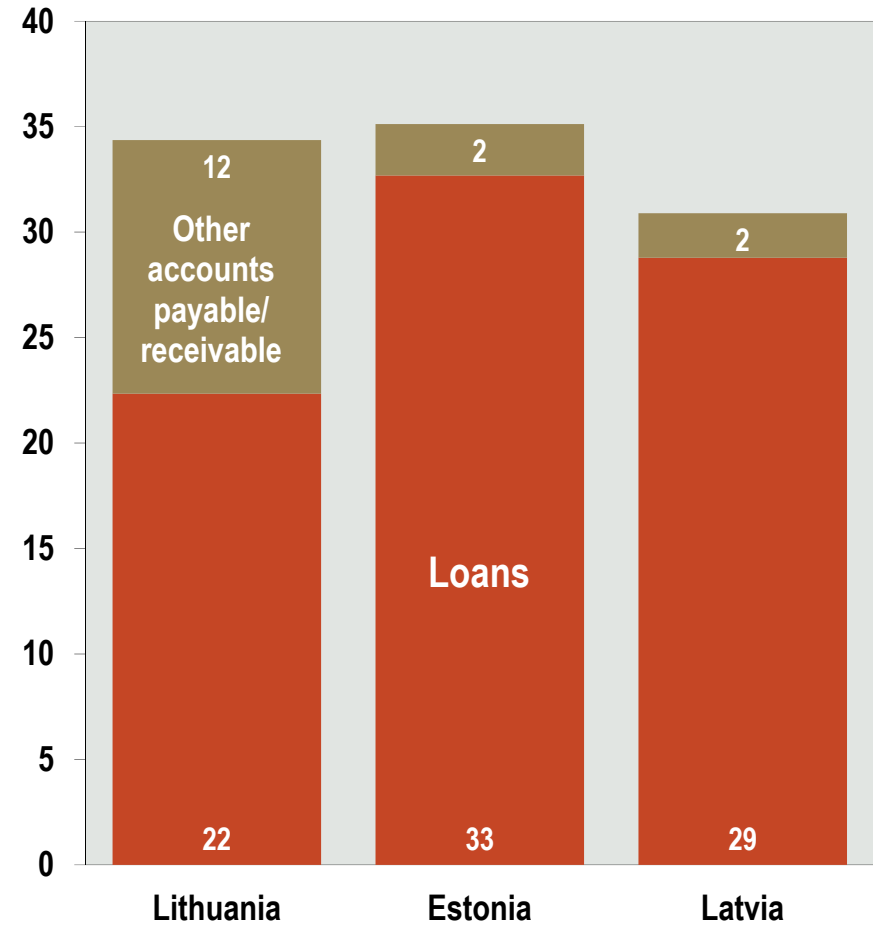
Liabilities of non-financials and households

*Liabilities of non-financial corporations,
% of GDP*



Sources: ECB, Eurostat and Financial accounts of Estonia, Latvia and Lithuania.

*Liabilities of households,
% of GDP*

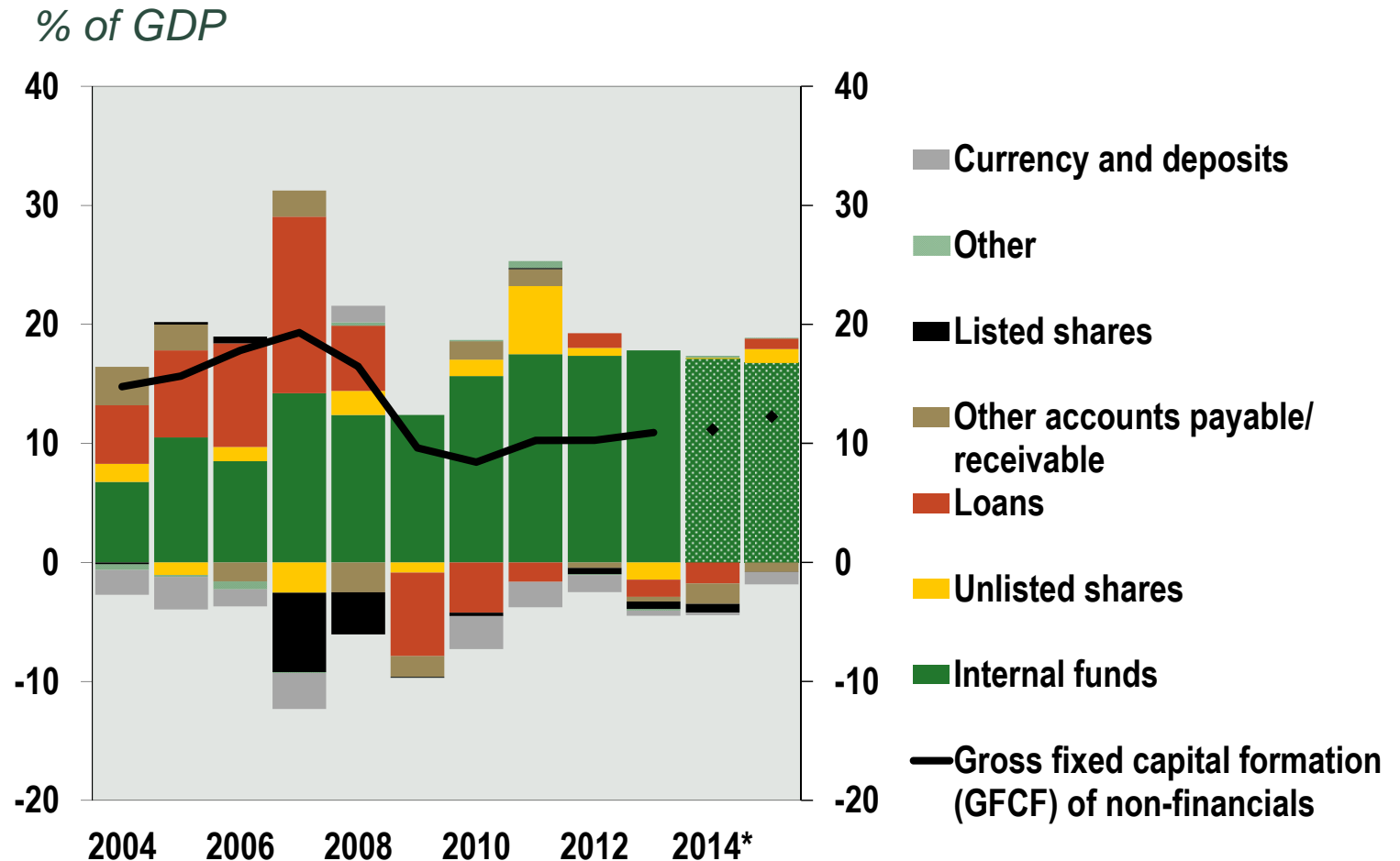


Sources: Eurostat, Financial accounts of Estonia, Latvia and Lithuania.



Financing sources: internal funds and net acquisition of financial liabilities

- ▶ Internal funds is the main and least volatile source of financing
- ▶ External financing seems to be more volatile and procyclical



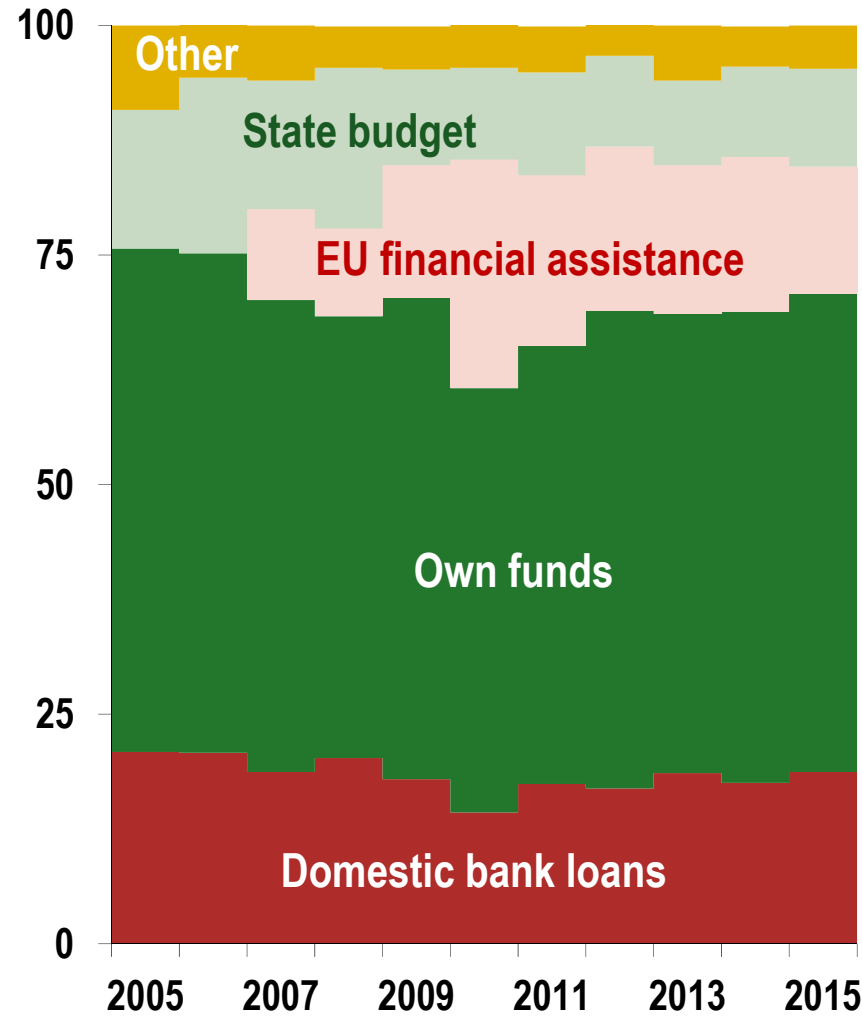
* Since internal funds and GFCF data for years 2014 and 2015 is not yet available, it is replaced with 2013 observations.

Sources: Statistics Lithuania and Financial accounts of Lithuania.

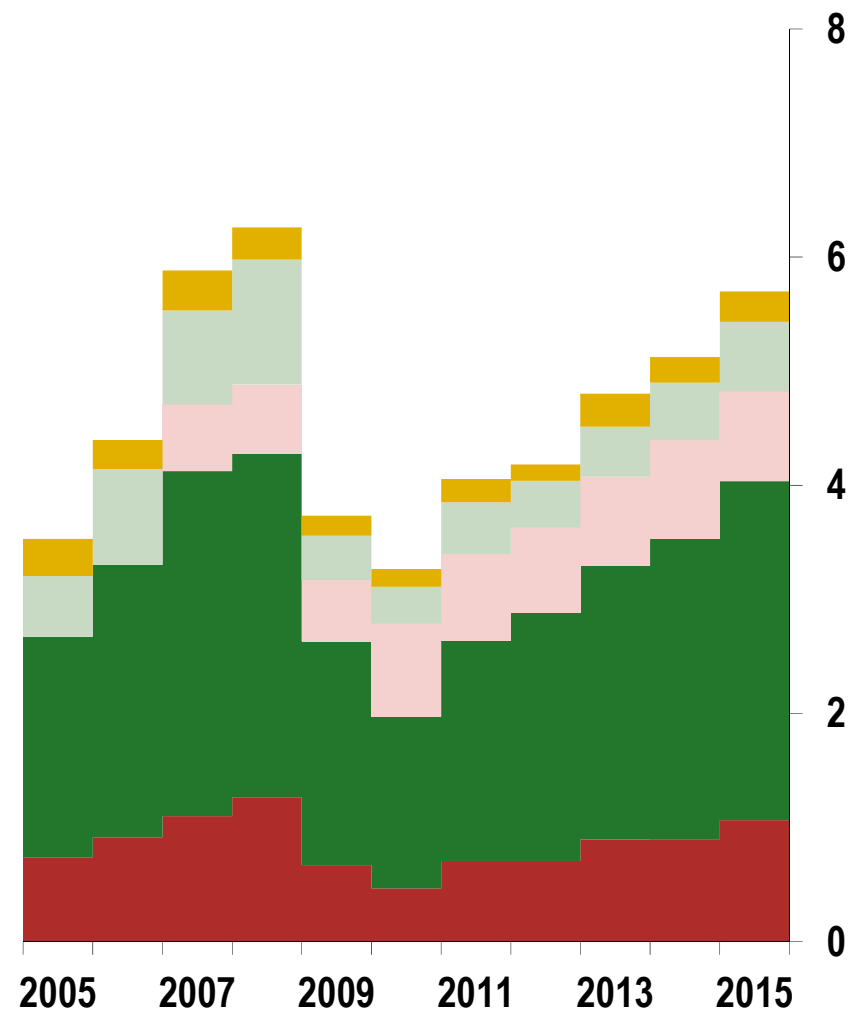


Financing of investments into tangible assets

Percentages



EUR billions

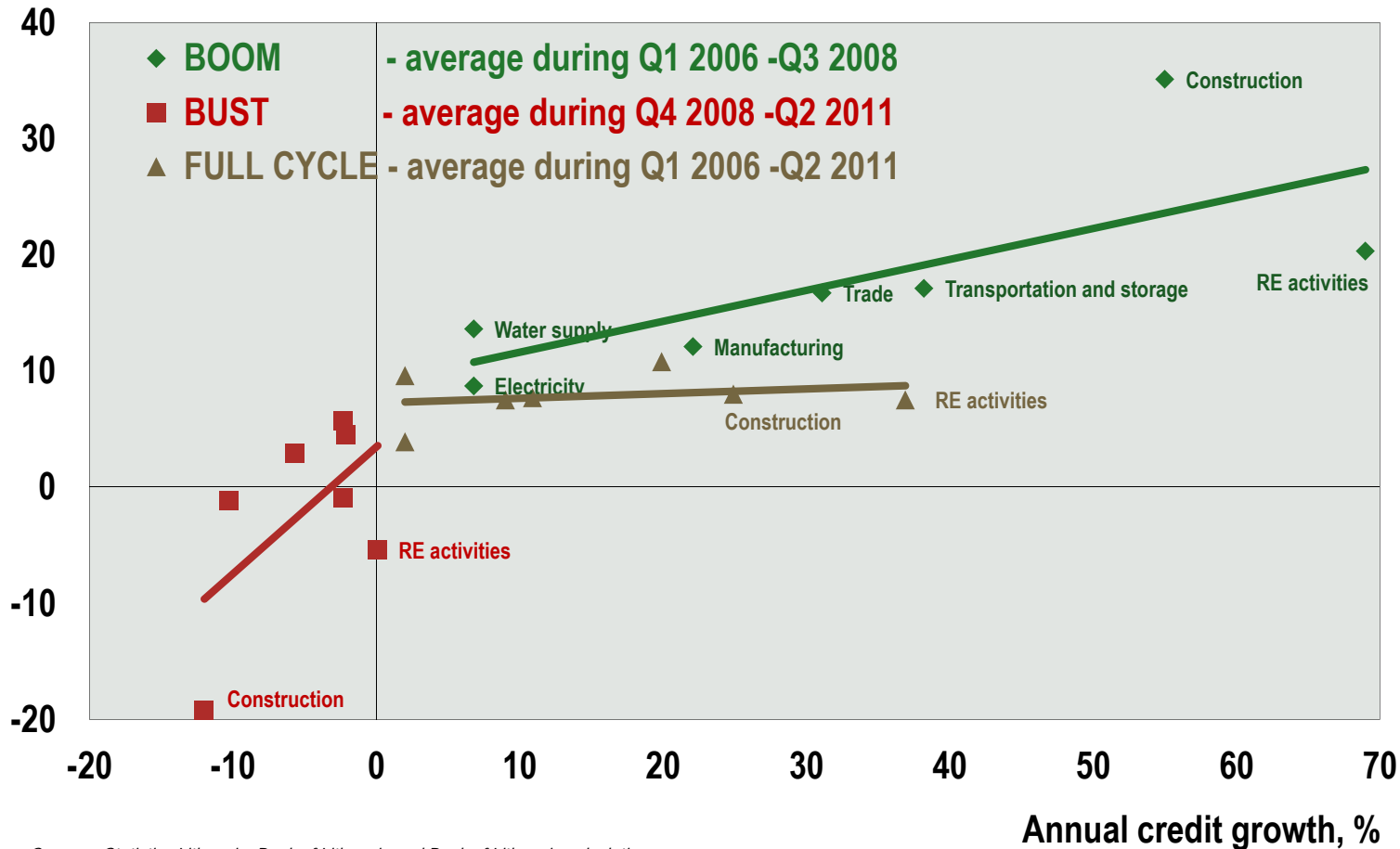


Sources: Statistics Lithuania and Bank of Lithuania calculations.



Credit allocation: procyclicality and bias towards real estate-related lending

Value added annual growth, %



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

► Mortgages and RE-related lending account for 56% of bank loans to private sector at end-2015

► Lending exhibits RE collateral bias, also due to preferential treatment in Basel regulations



Financial sector effectiveness

- ▶ **Credit impact** on GDP

- ▶ **Credit allocation** decisions

Do banks lend to sectors that

- will grow faster and/or will be able to repay in the future? or
- lend procyclically to sectors that currently grow faster?

- ▶ **Volatility/procyclicality** of credit and other forms of external financing

- to what extent external financing provided by financial intermediaries can be a diversifier for internal cash flow generation?



Credit impulse

- ▶ **Credit creates new spending power for**
 - consumption
 - investment: financial or new/existing non-financial assets
- ▶ **Credit impulse impact on GDP:**

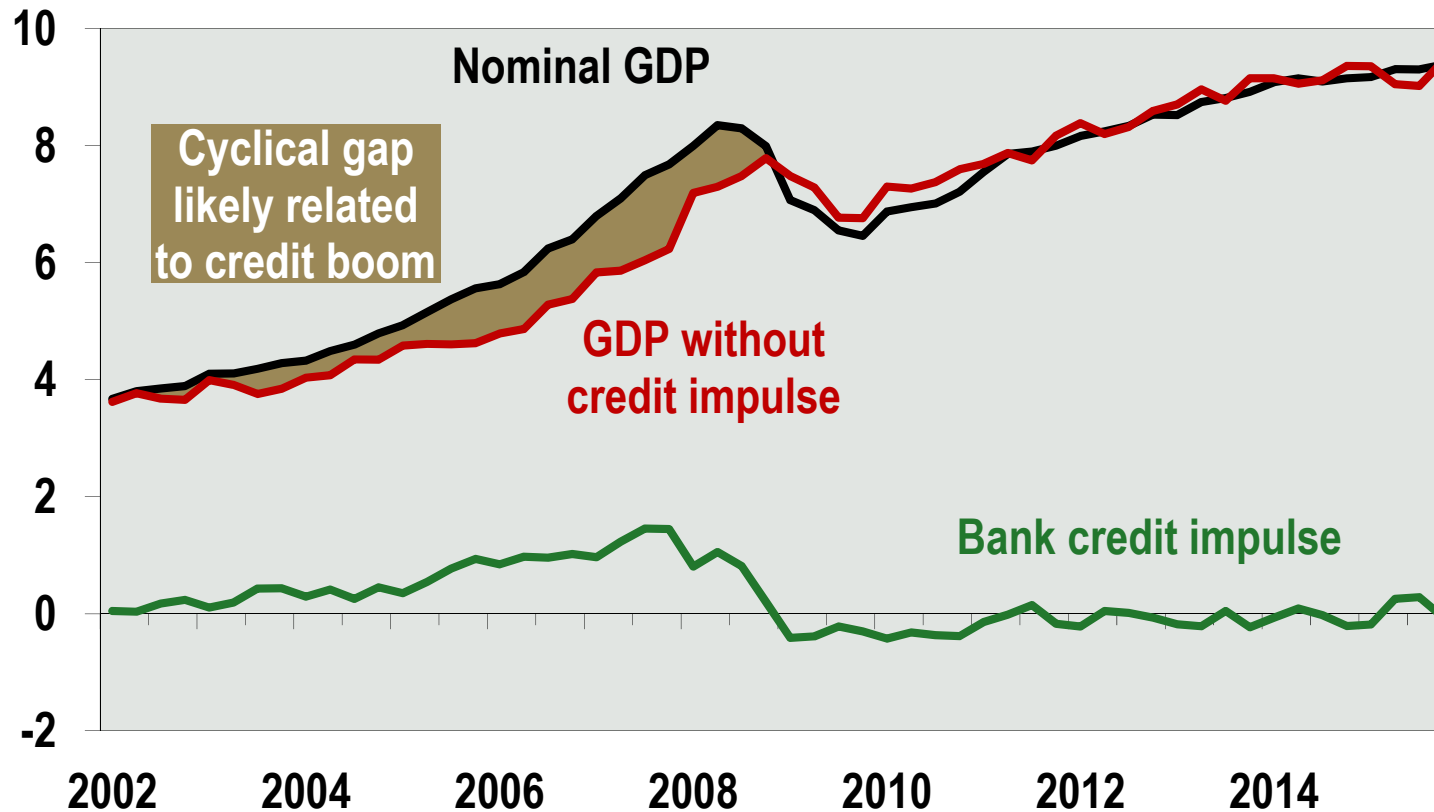
Year	Credit flow	Contribution to nominal GDP
1	0	0
2	100	100
3	120	20
4	50	-70

- ▶ **Credit impulse = Δ credit flow $\approx \Delta$ (Δ credit stock)**



Credit impulse in Lithuania

Eur billions

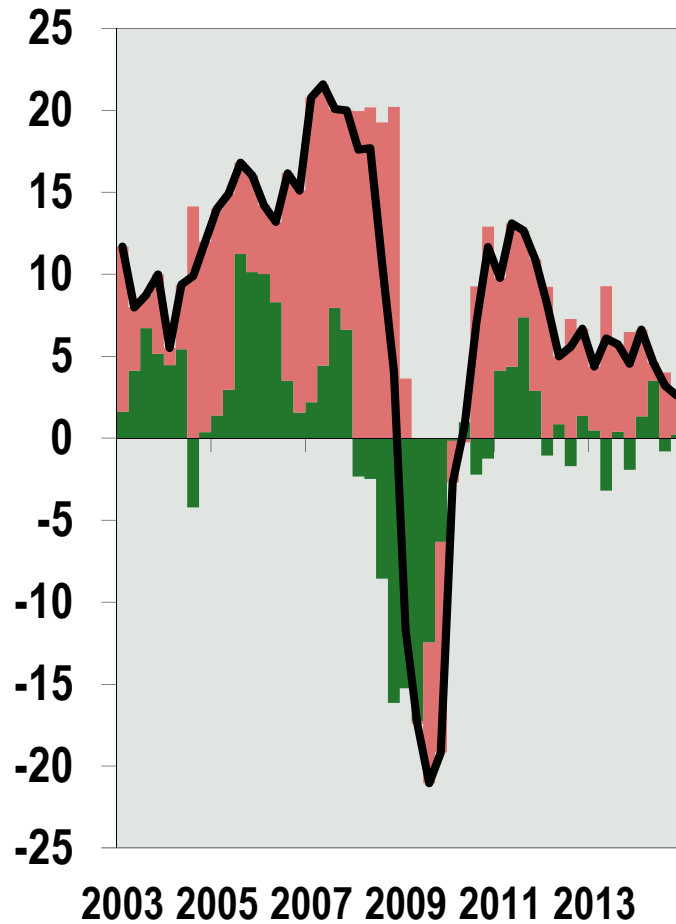


Source: adapted from T. Ramanauskas et al., "Kreditavimą lemiantys veiksniai ir jo sąryšiai su ekonominiais procesais", *Monetary Studies*, 2015.

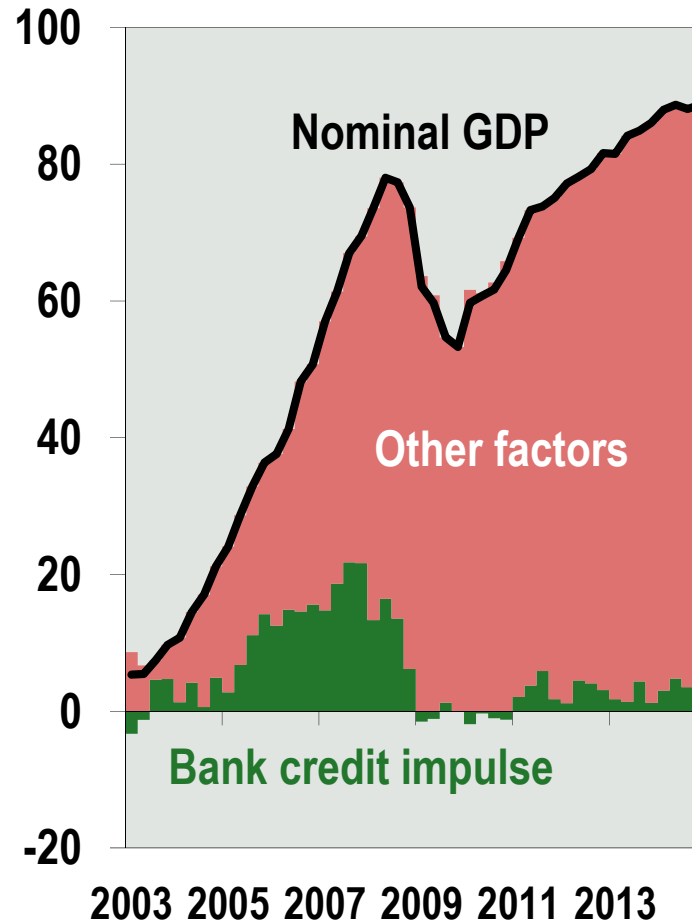


Credit impulse in Lithuania

Annual growth, percentages



Cumulative growth, percentages





Conclusions/ suggested takeaways

- ▶ **Financial sector size is not everything ...**
- ▶ **... there may be good reasons why the financial sector in Lithuania is not as large as in Latvia and Estonia**
 - Aggregate size and demand for credit by non-financial firms
- ▶ **... but the financial sector may still be quite effective and sufficient for economy needs**
- ▶ **New credit and external financing more generally contribute to GDP growth**
 - It is difficult, however, but nevertheless important to separate bad credit during boom times from good credit for productive investment and use macroprudential instruments to tame the latter