Q2 2018 overview of banking sector

The number of credit institutions operating on the Estonian market as at Q2 2018 was 16, eight of which are branches of foreign credit institutions.

The annual increase in the loan portfolio of banks slowed down to 2% by the end of Q2 2018. The relatively low increase in loans is still influenced by the departure of the loan portfolio of a market participant in 2017 – without this change, the increase in loans would have been 6.6%. This also indicates a slowdown in comparison with 7.3% in the previous quarter.

Key indicators	Q1 2018	Change	Q2 2018	
Annual increase in loan balance	2,6%	?	2%	
Annual increase in deposit balance	2,7%	?	7,2%	
Loan-to-deposit ratio	110%	?	105%	
Long-term overdues as % of credit portfolio	0,8%	?	0,69%	
Liquidity coverage ratio	152%	?	166%	
Profit	81 mln €	?	87 mln €	
Cost and income ratio	45%	?	46%	
Return on equity	10,1%	?	10%	
Return on assets	1,5%	?	1,4%	
Tier 1 Common Equity ratio	31,3%	?	30,7%	

The annual increase in the loan portfolio of private persons accelerated to 6.5% and was primarily influenced by residential loans, which increased by 6.4% y.o.y.

The annual loan increase of companies was -2.8%. The corporate loans removed as a result of the merger of two market participants are behind this indicator – without this change the annual increase in corporate loans in Q2 2018 would have reached 6.1%.

The annual increase in deposits increased to 7.2% in the end of Q2, which is one of the fastest growths in the last three years. The increase in the sector was higher than usual due to the increase in the deposits of the companies and pension funds of a market participant. Since the increase in deposits was bigger than in loans, the loan-to-deposit ration of banks improved from 110% to 105%. Non-resident deposits decreased by 8% over the quarter and the share of non-resident deposits decreased to 9.5%.

The loan quality of banks continues to improve. The share of loans overdue for more than 90 days decreased to 0.69% at the end of the quarter and the share of non-performing loans decreased to 1.7% in the consolidated portfolio.

The liquidity of banks remains strong. The liquidity coverage ratio of all banks is better than required and the average indicator in the sector was 166% (the minimum is 100%). Banks also have other liquid assets (deposits in credit institutions), and in addition to the resources meant for compliance with the liquidity coverage ratio and these included, the share of liquid assets comprises 20% of all assets.

The banks and branches of foreign banks operating in Estonia earned 87 million euros of profit in Q2 2018, which is 7% more than in Q1. The profit increase in Q2 was mainly influenced by the payment of dividends and income tax that remained in the previous quarter. The annual return on equity of the banks was 10% and return on assets was 1.4% at the end of Q2. The average return on equity and return on assets in the European Union are 6.8% and 0.5%, respectively. Irrespective of a slight decrease, the profitability of the Estonian banking sector is good.

The total income of banks decreased by 11% in Q2. The reason for the decrease in income was the dividend income that remained in Q1 which was not earned in Q2. The main types of income, interest income and fee income, increased. The costs to income ratio of the banking sector increased to 46.4%, and the respective indicator in the European Union was 64.8%.

The indicators of prudential requirements decreased to 30.7% at the consolidated level in Q2. Own funds and risk assets both increased at the consolidated level.

Main developments and risks

- The banks operating in Estonia are liquid. The average liquidity indicator exceeded the standard considerably.
- The profitability of banks remains good. Return on equity in Q2 was 10% and banks manage to remain profitable even in an environment of low interest rates.
- The share of bank loans that have been overdue for a long time, i.e. over 90 days, remains below 1% and continues to decrease. Long-term default interest is covered with write-downs.
- The share of non-resident deposits dropped to 9.5% by the end of Q2. As non-resident deposits are more volatile in their nature, banks maintain higher buffers to cover the liquidity risk related to said deposits.
- Property prices in Sweden have stabilised or increased a little in Q2 2018. However, the risk related to the Swedish property sector remains high and its realisation may also affect the Estonian banking market. It’s therefore important that Estonian banks maintain adequate capital buffers as cover for risks, the existence of which reduces the impact of the transfer of cross-border risks.

[Quarterly reviews of the banking sector]

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