Q2 2019 overview of banking sector

The yearly growth in loans of the banking sector climbed to 7% by the end of the second quarter (All the yearly growth figures reported here and subsequently exclude the impact of Luminor Bank AS merging with its Latvian and Lithuanian units.)Growth in lending to financial institutions and state-owned companies accelerated in the second quarter. Loans to private individuals grew by 6% over the year, with housing loans growing at 6.5%. The growth in lending was restrained by the continuing reduction in the portfolio of corporate loans. The growth in lending to non-financial companies declined by 0.7% over the year.

Key indicators	Q1 2019	Change	Q2 2019
Yearly growth in the loan stock	6,5%	?	7,0%
Yearly growth in the stock of deposits	5,8%	?	5,8%
Loan-to-deposit ratio	110%	?	106%
Non-performing loans as a share of the loan portfolio	2,00%	?	1,85%
Liquidity coverage ratio	135%	?	143%
Profit	45 million euros	?	120 million euros
Ratio of expenses to income	46%	?	48%
Return on equity	9,9%	?	9,9%
Return on assets	1,29%	?	1,21%
Core Equity Tier 1 ratio	26,3%	?	26,5%

The yearly growth in deposits was 5.8% at the end of the second quarter. As loans grew faster than deposits did, the loan-to-deposit ratio rose by one percentage point over the year to 106%.

The share of non-performing loans at the consolidated level was 1.85%, and had also fallen over the quarter. In total the sector had 630 million euros of non-performing loans at the end of the second quarter, which was 50 million euros less than at the end of the first quarter. There were 284 million euros in provisions at the end of the second quarter, an amount which was more or less the same as in the first quarter.

The liquidity position of the banks remains strong. All the banks met the Liquidity Coverage Ratio (LCR) with sufficient margin, and the average LCR indicator for the sector was 143%, which exceeded the minimum of 100%. Alongside the funds dedicated for meeting the Liquidity Coverage Ratio, the banks also have other liquid assets, notably deposits in credit institutions, and including these, liquid assets were a fifth of assets.

Client deposits increased by 3% over the quarter and were 5.8% up on a year previously. The biggest increases were of 612 million euros in the deposits of the central government and of 446 million euros in household deposits, while the deposits of credit institutions fell by 144 million euros. At the end of the second quarter, 8.9% of deposits were non-resident. As non-resident deposits have decreased, so have non-resident revenues. Four years ago, service fee and interest income provided around a fifth of total income, but by now this has fallen below 10%.

The banking sector earned an unconsolidated, or individual-level, 120 million euros in profit in the second quarter. The quarterly growth in this was 75 million euros.

The return on equity over the year for the banks was 9.9% in the second quarter, which was the same as in the first quarter. The return on assets of the banks was 1.21% in the second quarter. For comparison, the average return on equity of the banking sector in the European Union was 6.8% in the first quarter of 2019, and the return on assets was 0.45%.

The total revenues of the banks increased by 25% over the quarter to 376 million euros. This growth in revenues was mainly down to dividend income, though interest income also increased. The current expenses-to-income ratio of the banking sector over the year was 47.7%, while the average expenses-to-income ratio in the European Union was 66.3%.

The prudential standards for equity fell in the first quarter at the individual level, as the CET1 ratio was 24.4% at the end of the first quarter, which was down by 0.9 percentage point. At the consolidated level the CET1 ratio was 26.5%, which showed no significant change.

Main development trends and risks

- The financial position of the banking sector remains strong. Growth in the economy continues to slow as forecast and assessments of the ability of the banks to cope with slower growth have taken on greater relevance.
- The loan quality of the banks remains good and continues to improve. Non-performing loans make up 1.85% of the loan portfolio.
- The quality of the loan portfolio has improved partly because of sales of non-performing loans. Although the terms of sale for non-performing loans are currently favourable, the banks must consider the risk from that business model, and they should have sufficient plans for business continuity.
- Lending continues to grow fast at several small banks. It is important that small banks experiencing rapid growth pay attention to their long-term capital planning and invest sufficiently in internal controls.
- The profitability of the banks remains good, and the return on equity in the second quarter was 9.9%. The banks have been able to maintain their profitability as interest rates are low and volatility has increased in the financial markets.
- At the end of the second quarter, 8.9% of deposits were non-resident. The banks are exposed to significant reputational risk from serving non-resident clients in earlier periods, and this could have an important impact on the behaviour of depositors.
- Real estate prices fell a little in Sweden in the second quarter, remaining below the peak that they reached in 2017. Prices have held relatively stable in the past year and a half. The risks

related to the Swedish real estate sector remain high though and any realisation of these risks could impact the Estonian banking market. This makes it important for the banks to maintain sufficient capital buffers to guard against the realisation of these risks, and these buffers reduce the impact of cross-border risks.

Quarterly reviews of the banking sector

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