

# DANSKE BANKAS

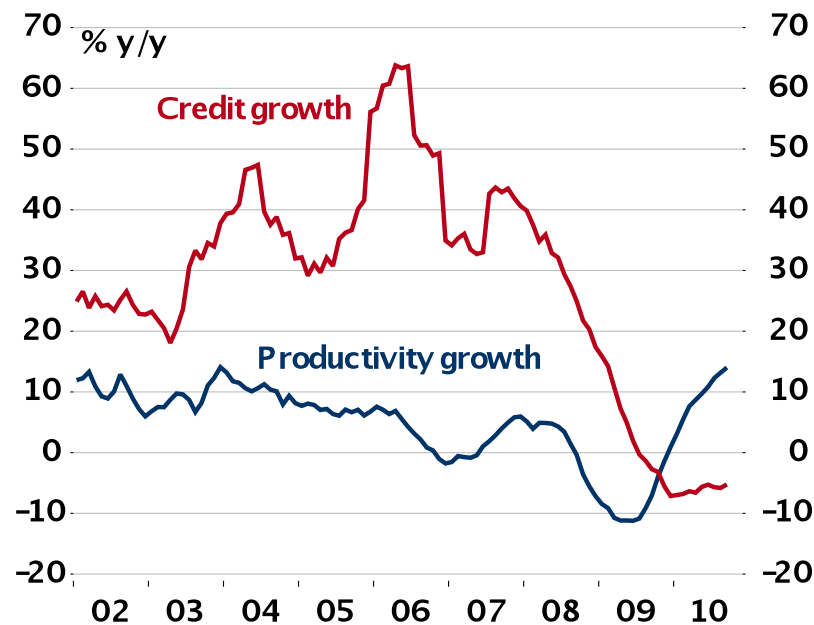
## Economy trends and business challenges in 2011

- The outlook for the Lithuanian economy

Gintautas Galvanauskas

November 24 , 2010

## Productivity of investment was matter of concern



Sources: Reuters EcoWin

- The global credit crunch has hit Lithuania hard given that private sector was highly leveraged
- Large part of borrowed funds went into low-productive areas of the economy – construction business

## Competitiveness – need to be restore

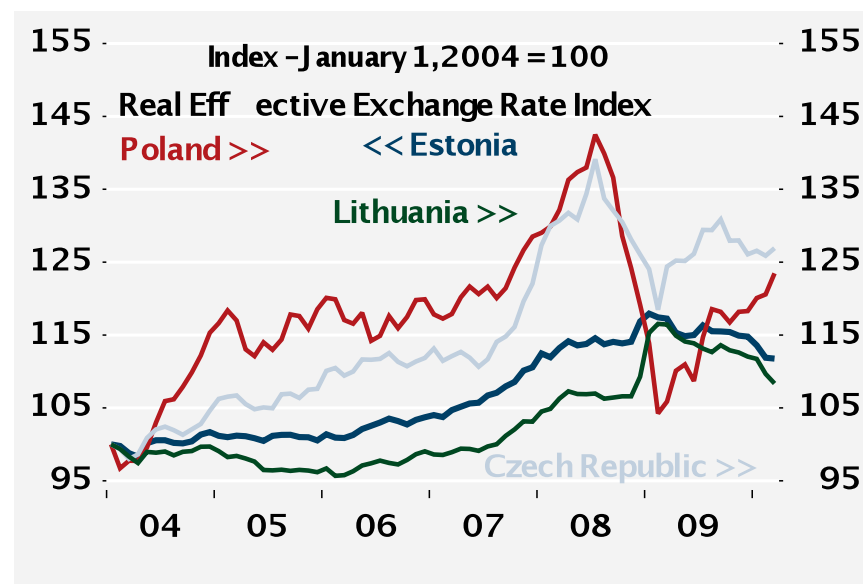
- Over the previous years, wages grew much faster than labour productivity.
- It should be pointed, that the widening of the gap between wages and productivity was mostly associated with the non tradable sector (construction, retail trade, transportation, electricity, etc).
- But manufacturing also experienced this pressure.
- Thus, distortions created in earlier periods and the misallocation of resources towards the construction sector have been corrected.
- Sharp correction in labour market helped to restore external competitiveness.



Sources: Reuters EcoWin

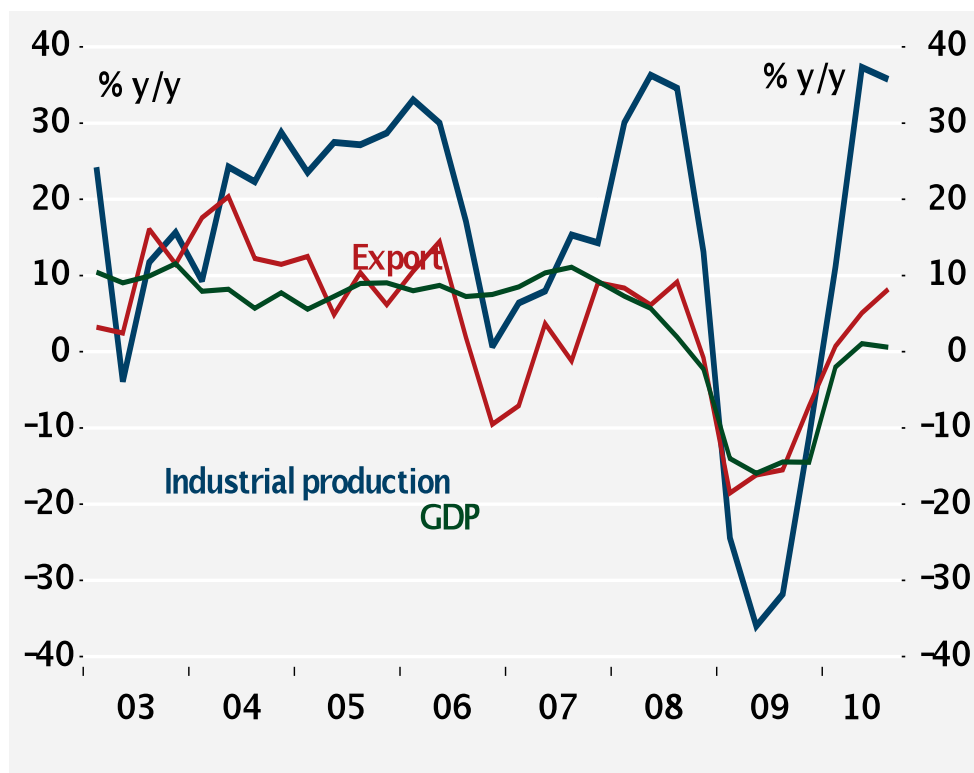
## Rapid adjustment of external imbalances, regained competitiveness

- The almost 20% increase in REER over 2004-2008 in Lithuania was mostly driven by rising wages and prices and has been partially reversed since then.
- Currently development of REER in Lithuania looks more stable than in its neighbouring countries.



Sources: Reuters EcoWin

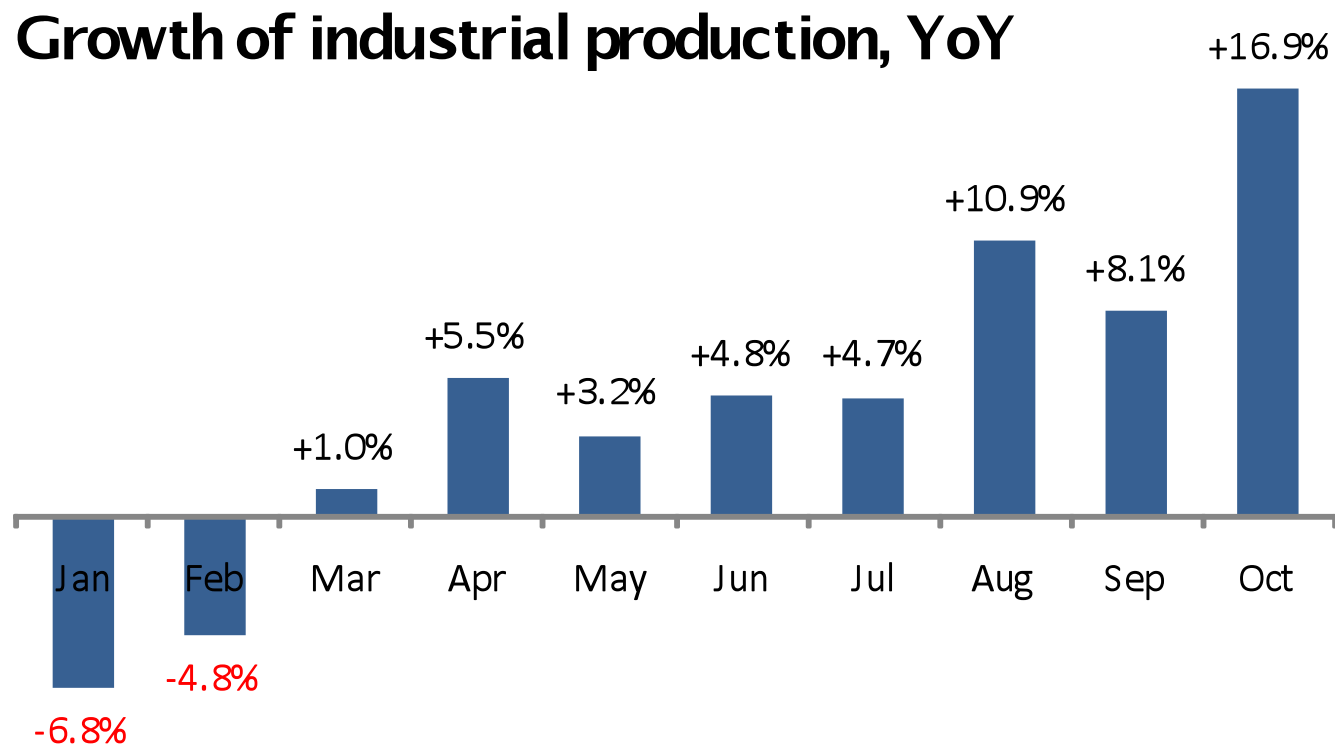
## Current stance of the Lithuanian economy



Sources: Reuters EcoWin

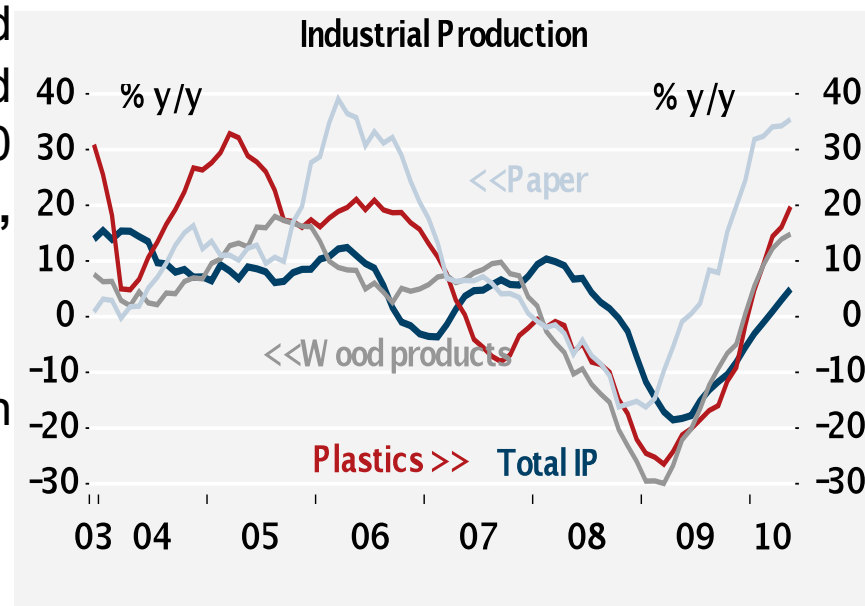
- Lithuania's economy appears to be recovering relatively rapidly after the crisis.
- According to preliminary estimates, industrial and service enterprises increased their outcome while construction, agricultural and retail sectors declined further in Q3 10.
- We expected relatively strong agricultural results, but it looks like bad weather conditions, which impacted globally, have significantly affected Lithuanian agricultural performance

# Lithuanian industrial production is recovering



## Export oriented industries indicated a significant upside

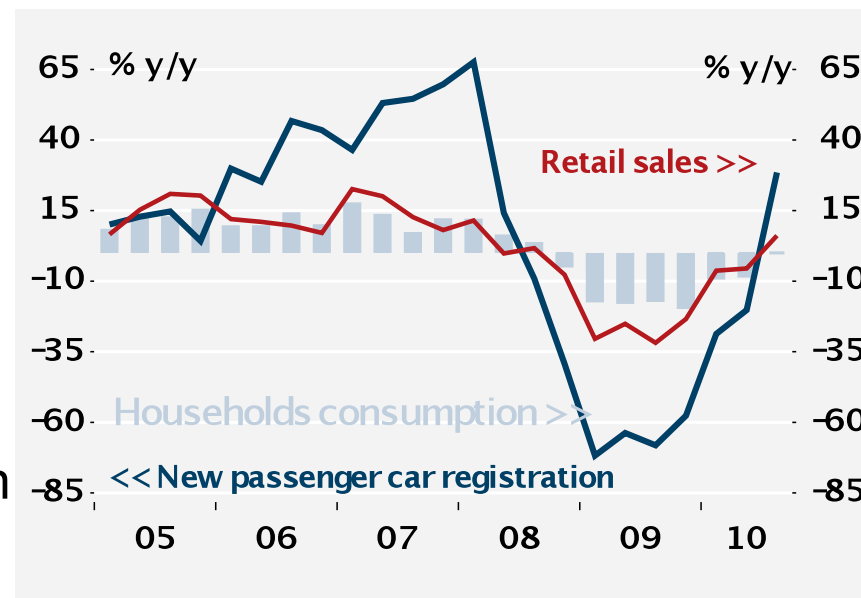
- Manufacture industries underwent rapid recovery and this trend have continued further. The most rapid recovery in Q3 10 have been observed in **wood, paper, chemical and plastics industries**.
- External conditions improved significantly:
- Russia (more than 10% of Lithuanian export);
- Germany (up to 9% export)
- Nordic economies (up to 11% export);
- Poland (up to 6% export).
- **Germany, Poland, Nordic economies and Russia** are very important for the Lithuanian export market, which is growing faster than the euro zone on average. It gives hope for the relatively high export growth rates.



Sources: Reuters EcoWin

## Domestic demand remain weak

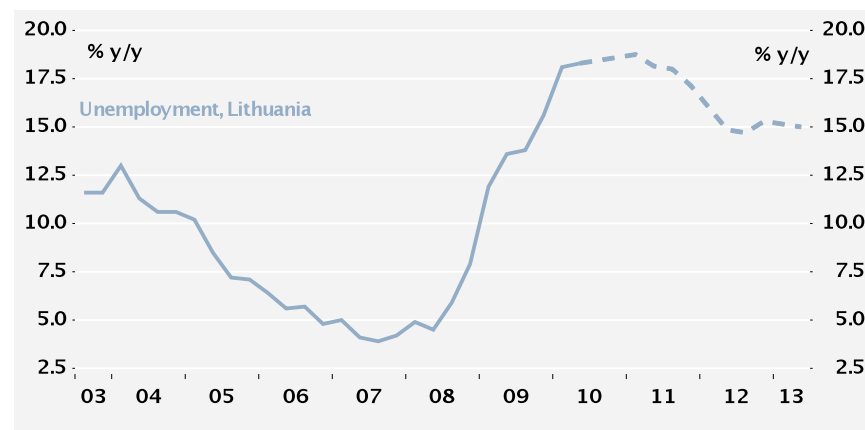
- Domestic demand is still showing a weak signs of recovery.
- However, this area is more problematic, the unemployment rate remains high and fiscal consolidation need will has a negative impact on disposable income dynamics.



Sources: Reuters EcoWin

# Unemployment

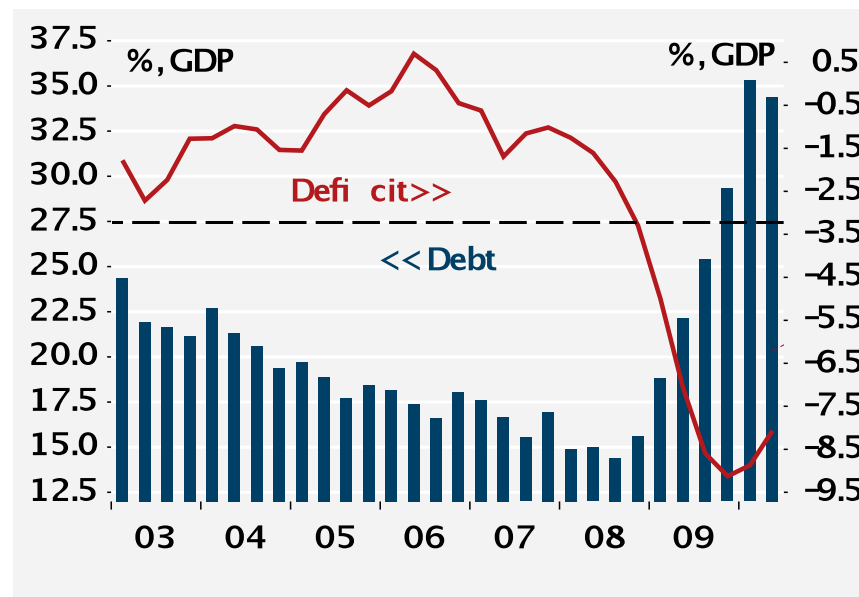
- Over the Q3 10 unemployment decline only marginally to 17.8% down from 18.3% in Q2 10.
- Unemployment is expected to decline mainly in export-oriented sectors.
- However, the normal feature of economic cycles is that unemployment continues to rise even after the economy has begun to recover.



Sources: Reuters EcoWin

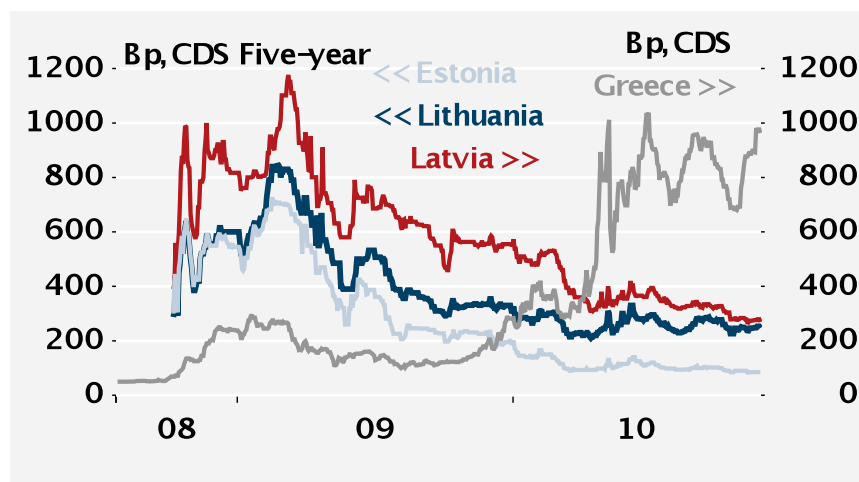
## Fiscal policy

- The rapid deterioration of public finances in 2009 has been got under control by implementing restrictive measures totalling of around 8% of GDP.
- Fiscal policy measures taken by the Lithuanian government seem to have been well received by financial markets.
- The general government deficit is expected to narrow to 8.4% of GDP in 2010.
- Official euro data have been postpone to 2014.



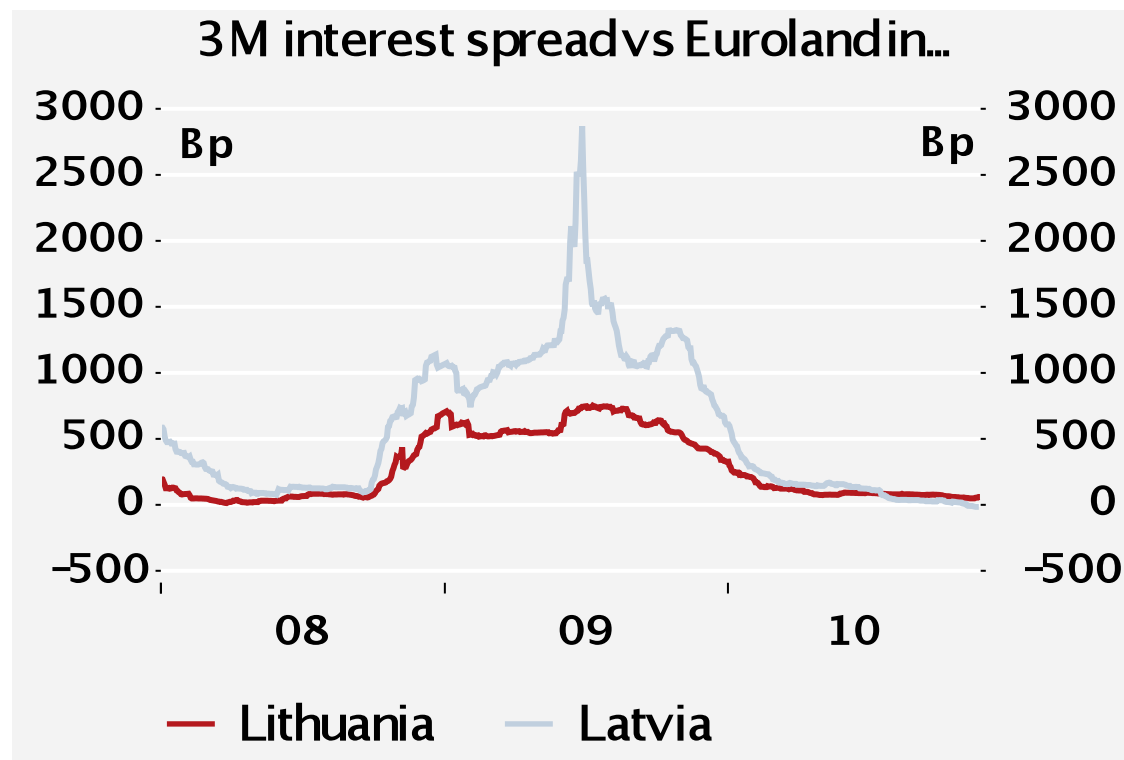
Sources: Reuters EcoWin

## Tension in the financial market eased due to fiscal consolidation



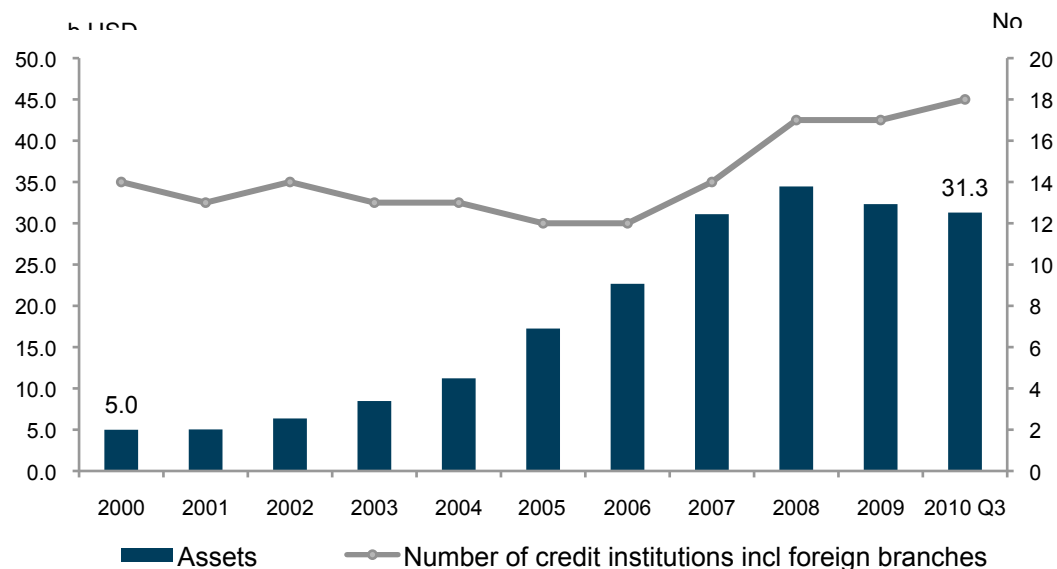
- In 2009-2010 Lithuania issued one 5-year euro and three dollar denominated bonds 5; 7 and 10-year maturities with great success.
- Interest rate declined significantly from 9.375% (interest rate for which Lithuania distributed first Eurobonds in the international markets) to 6.75% for USD bonds in 2009, 7.375% for USD bonds in 2010 and finally to 5.125% for USD bonds in September 2010.

Interest rate differential against the EURIBOR decreased to almost zero



Sources: Reuters EcoWin

# Lithuanian banking sector



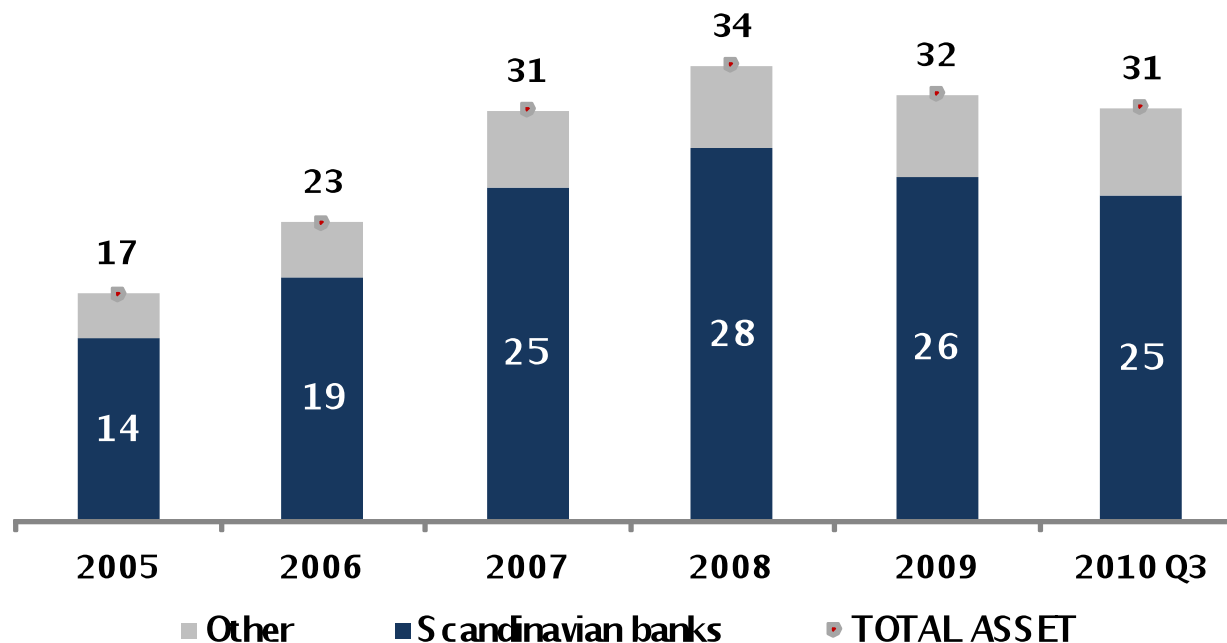
Sources: Danske bankas

- 9 branches of foreign banks (Danske, Nordea, Unicredit, Handelsbanken and other)
- 3 banks own by Nordic shareholders (SEB, Swedbank, DnB Nord)
- 6 banks own by other shareholders

TOTAL NUMBER OF BANKS: 18 (14 banks are actually operating)

# Banking sector dominated by Scandinavian Banks

Total assets, bnUSD

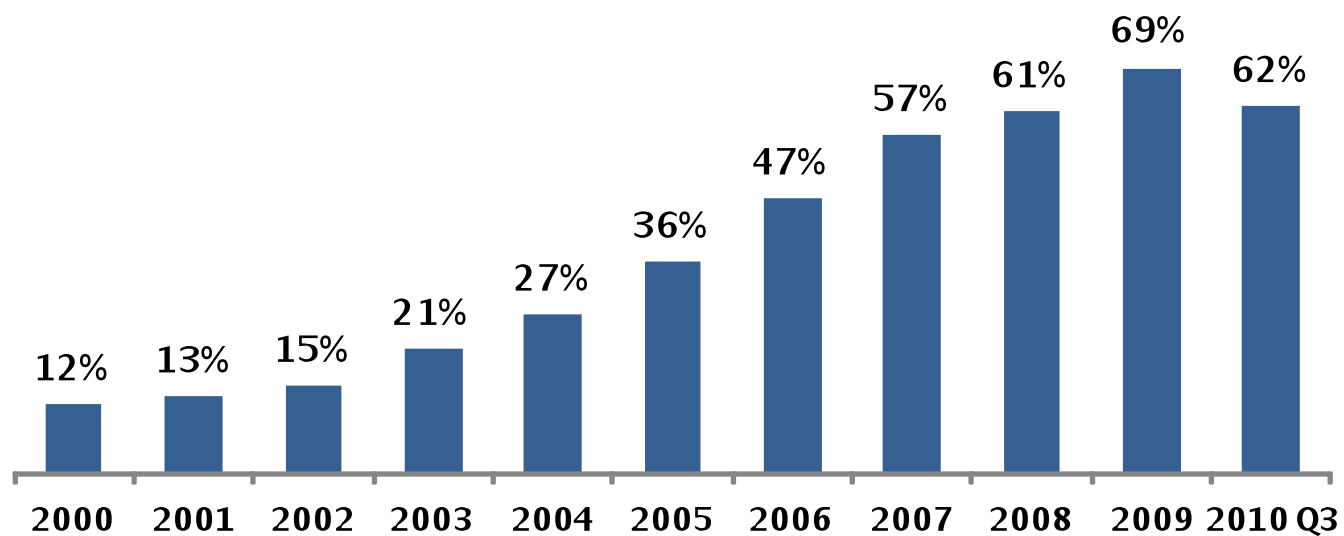


Sources: Danske bankas

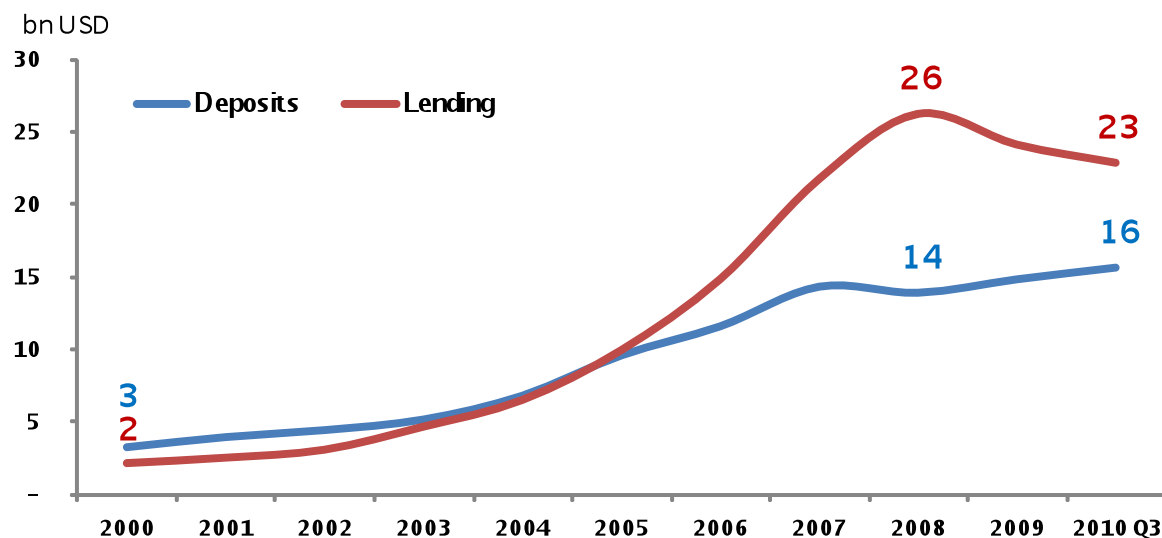
- Banks with capital from Scandinavian countries represent 80% of Banking sector total assets

# Lithuanian banking sector penetration

## Lending/GDP



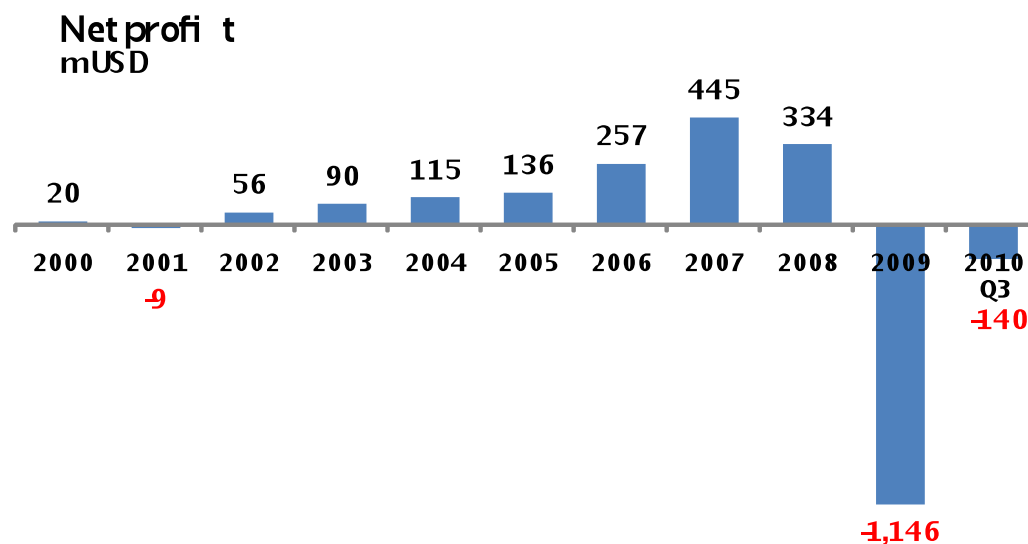
# Lending and deposits of the banking sector



Sources: Danske bankas

- During 2005-2008 Lithuanian banking sector became highly leveraged, that was unsustainable in the long-term
- Gap between lending and deposits was covered mainly through loans of foreign banks
- Since 2009 deleveraging is taking place – the gap decreased by almost 2 times

## Profitability of Banking sector

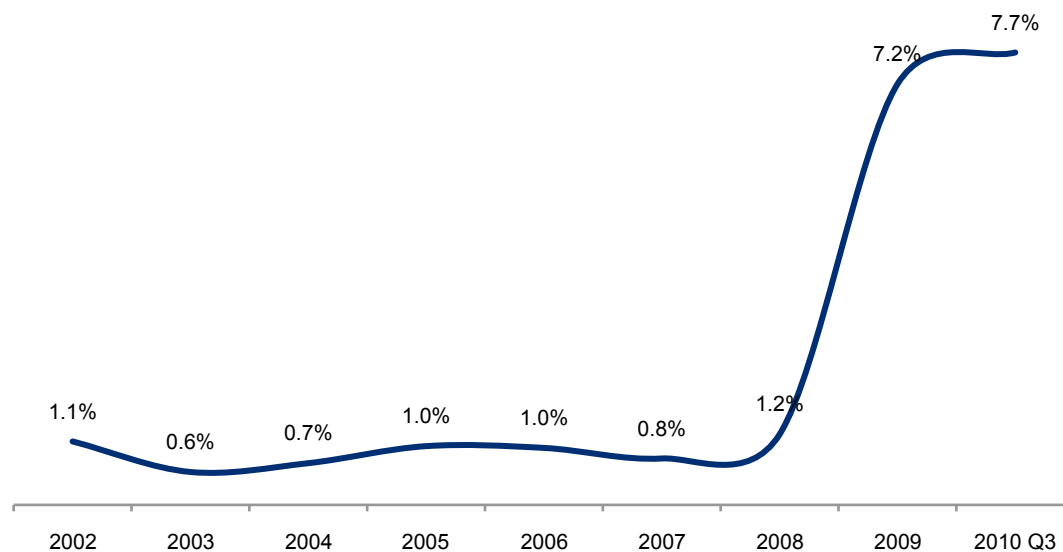


Sources: Danske bankas

- Almost all profit earned by sector in 2000-2008 was reduced by last years' losses
- Loan impairments determined the losses in 2009-2010

# Impairment shock

## Credit impairment/lending



- Huge level of impairments in 2009, however stabilization is visible in 2010

Sources: Danske bankas

## Current stance of the financial system

- Liquidity risk is very low (parental interbank funding )
- Banks capital base is solid
- Provisions for bad loans would remain at relatively stable level in 2010 and will decline in 2011
- Banking system has coped quite well with the losses brought about by bad loans and the situation has definitely stabilized.

## The main risks to the financial system

- Tensions in real estate market
- Labour market conditions continuously deteriorating (increasing unemployment level negatively affecting households' ability to service debt)
- Current demand for investment remains low

## Forecasts

Year	Gdp <sup>1</sup>	Infl ation <sup>1</sup>	Export <sup>1</sup>	Unemploy ment <sup>2</sup>	Current acc1, <sup>3</sup>
2009	-14.7	4.5	15.6	15.6	3.8
2010	0.5	1.3	18.4	18.4	3.3
2011	3.6	2.3	17.4	17.4	4.3
2012	3.2	2.2	16.7	16.7	1.6

1) Average % y/y; 2) % of total work force; 3) Export and import prices, EUR

## Conclusions

- Growth is based on the recovery in export-related activities
- The recovery in Germany, Poland and Russia will have a positive impact on exports outlook. Exports have already begun moving up strongly and industrial production should improve further as well
- We expect private consumption to move up in next year, at the earliest.
- Capacity utilisation in manufacturing has gradually increased toward the level before the crisis. Capacity utilisation in manufacturing, based on EU evaluation, already amounts to about 66% in Lithuania in Q2 10.
- The increase in capacity utilisation is a good indicator for investment demand and potential job creation in the future
- Official target to joint euro zone is 2014



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