Baltic Household Outlook

October 2015

- Wages in the Baltic states continue to grow
- Drop in energy and food prices has a positive impact on household purchasing power
- In terms of non-cash payment usage, Estonia exceeds the EU average, while Latvia and Lithuania are still behind Estonia and below the average level
- Euro changeover has helped to reduce the share of cash payments in household payments
- Financial position of households continues to strengthen
- Financial assets increased mostly due to the increase in deposits
- Depositors with larger savings increase their assets at a faster pace
- Despite of extremely low interest rates, term deposits make a significant share of household savings
- Among CEE countries, the share of population living in houses is the lowest in the Baltic countries.
- Among the Baltic countries, the average size of a dwelling is the largest in Estonia which is still smaller than in most of CEE countries.
- Although the satisfaction with the dwelling is relatively low compared to other countries, households have not been active to change their dwelling.
- Housing credit market shows sustainable growth in Estonia and Lithuania while in halt in Latvia.

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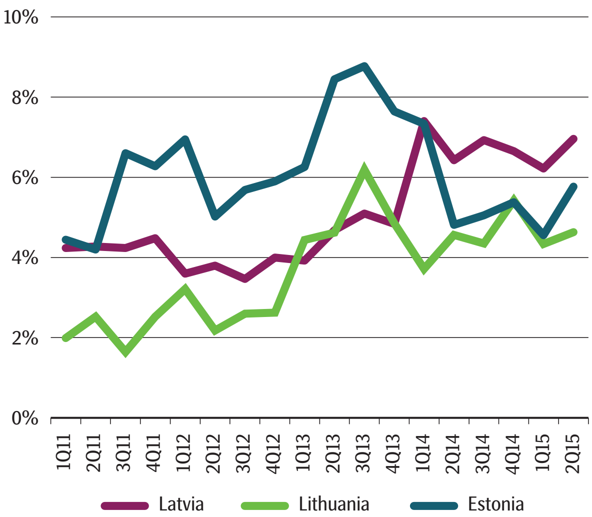
Labour market more favourable to employees

In the first half of 2015 wages and salaries in the Baltic countries continued to increase. In Latvia the average gross wages posted an even quicker growth rate than previously forecasted. During the first six months, average gross wages increased by 6.6 per cent year-on-year, reaching the highest growth rate among the Baltic countries. In the second quarter average gross wages even rose by 6.9 per cent compared to the second quarter of 2014. In Estonia wage growth rate was 5.8 per cent in the second quarter. In Lithuania wages rose at a slower rate compared to other Baltic countries. Lithuania posted a 4.6 per cent increase in average gross wages in the second quarter of 2015.

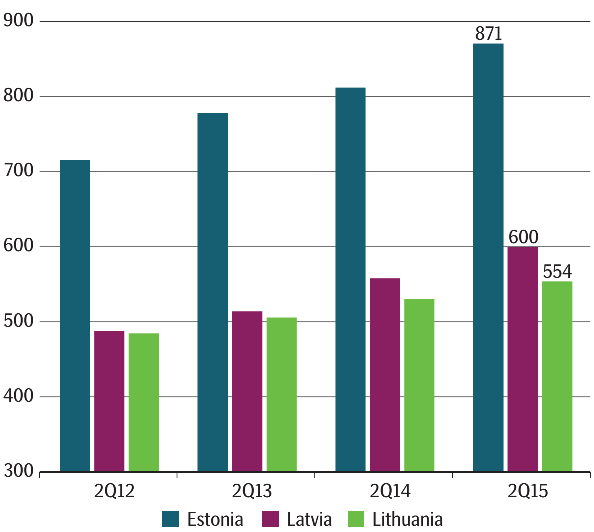
Average gross wages and salaries (%, YoY)



Source: National Statistics

Due to a reduction in labour taxes, average net (after tax) wages in Estonia and Latvia rose at a quicker pace than gross wages. In Lithuania the average net wages rose a little bit slower than gross wages. In Latvia the growth rate of net wages was the highest among Baltic countries. In the second quarter the average net salaries rose by 7.5 per cent year-on-year, reaching the 600 euro level for the first time. Average net salaries increased by 7.3 per cent to 871 euros in Estonia and by 4.4 per cent to 554 euros in Lithuania.

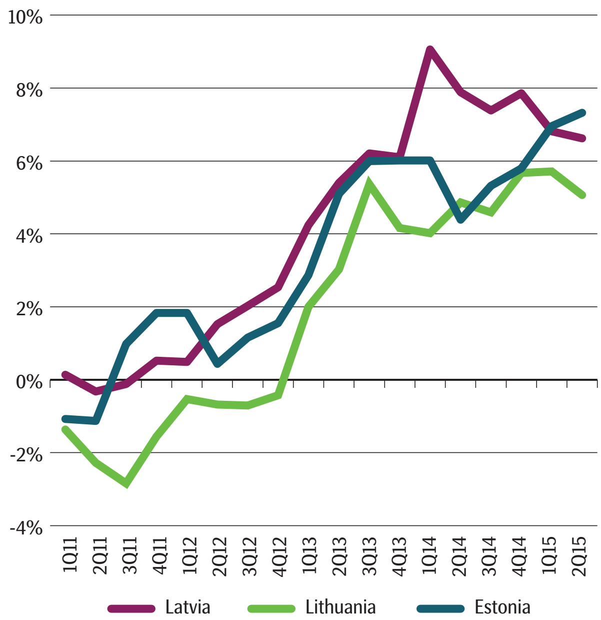
Average net wages (in euros)



Source: National Statistics

Households continue to benefit from nominal wage growth and low inflation. Due to falling energy and food prices the average inflation was close to zero. Thus real earnings and the purchasing power of employed persons has increased. In the second quarter of 2015 in Estonia real average net salaries rose by 7.3 per cent. In Latvia and Lithuania the real income of employed persons rose by 6.6 per cent and 5.1 per cent respectively. In Estonia and Latvia the average real income is above the pre-crisis level, while Lithuania is still below this level.

Real net wages (%, YoY)



Source: National Statistics

Increase in purchasing power is supporting consumption. This year household consumption is the main driver of economic growth in the Baltic countries. Lower energy and food prices have a positive impact on household expenses. Transport, food and housing costs are lower than a year ago. Decrease in fuel prices has helped to reduce the expenditure on transport by 6-9 per cent. Heating prices are lower compared to the previous heating season, thus heating costs should not be larger than in the previous heating season. The most significant drop in heating prices will be in Vilnius – 23 per cent drop compared to October 2014. In Riga central heating prices this autumn will be 19 per cent lower compared to the autumn of 2014, while in Tallinn heating prices show a 13 per cent decrease year-on-year. Although heating prices have decreased, in the case of a severe winter heating consumption will be larger, thus heating bills may not decrease by the same percentage as heating prices.

Gradual changes in payment habits; more cashless payments

Over the past 10 years in the European Union (EU), also including the Baltic states, the payment market structure has changed, with the growing popularity of non-cash payments. Despite these changes in payment habits, on average cash continues to dominate in European household payments. According to the European Central bank (ECB), cash is still the most important instrument for retail transactions in the EU, although transaction volumes vary considerably from country to country. For example, the proportion of cash usage is quite small in Nordic countries (Sweden, Finland, Denmark), while in southern Europe (Greece, Romania) nine of ten payments are made using cash.[1] Among the Baltic countries cash plays a more important role in Lithuania (81.3 per cent[2]) and Latvia (77.3 per cent) compared to Estonia (48.9 per cent). The main reasons for cash popularity are household habits, the shadow economy and lower confidence in banking and payment card service providers.

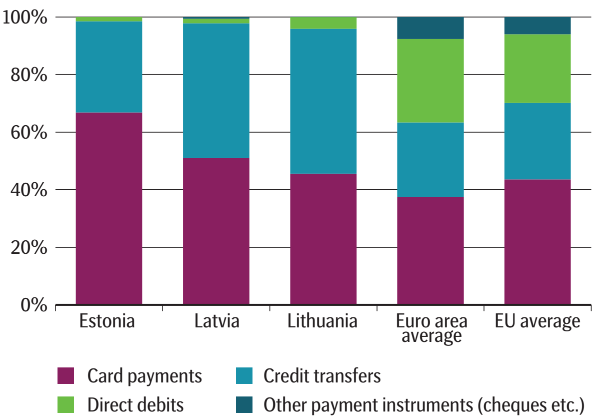
1 The social and private costs of retail payment instruments: a European perspective. European Central Bank. September'2012

2 Payments Market Review/2014. Bank of Lithuania.

Over the last decade payment cards have grown substantially, with transaction volumes more than doubling. Now payment cards are the most widely used non-cash payment instrument in the EU countries. In 2014 card payments accounted for 46 per cent of all transactions, while credit transfers accounted for 26 per cent and direct debits for 21 per cent. In 2013 the share of payment cards was 44 per cent of all non-cash transactions. At the same time credit transfers and direct debits were 27 per cent and 24 per cent respectively.

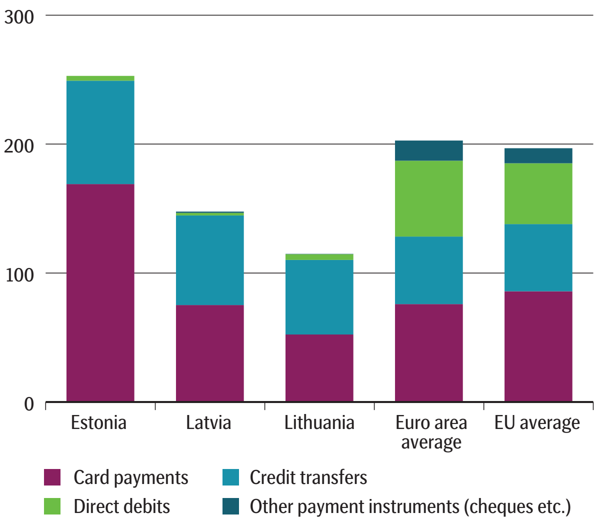
The usage of cashless payment instruments differs quite substantially across the EU countries. Card payments, at almost 70 per cent, represent the most popular non-cash payment service in Estonia. In Lithuania and Latvia payment cards and credit transfers have been the two dominant non-cash payment instruments in previous years. Direct debits, cheques and other non-cash payment instruments are rarely used in the Baltic countries.

Relative importance of payment instruments, 2014 (% of the total number of transactions)



Source: ECB

Number of non-cash payment transactions per capita, 2013



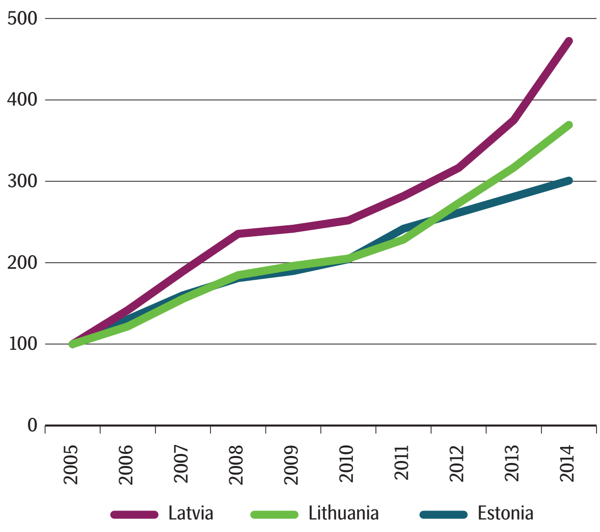
Source: ECB

According to ECB statistics, non-cash payment instruments are becoming more important for large purchases and day-to-day transactions. The main non-cash payment instruments in the euro are payment cards, direct debits, credit transfers and cheques. Card payments cover all payment transactions performed by means of a card with a debit, credit of delayed debit function. Credit transfers are orders from the payers to account-holding credit institution to transfer funds to beneficiary. A credit transfer can be made by phone, on paper, or over the internet. Direct debit can be defined as a payment instrument for debiting a payer's account where a payment transaction has been initiated by the payee on the basis of an authorisation given by the payer. Direct debit is a given permission to a creditor (for instance, bank, utility company, phone or internet provider) to collect variable or fixed amounts from your account. A cheque is viewed as a written order form from one party (the drawer) to another (the drawee) – normally a credit institution is required the drawee to pay a specified sum on demand to the drawer or to a third party specified by the drawer.

In the usage of cashless payments and payment cards, Estonia is ahead of the other two Baltic countries, exceeding the EU average, while Latvia and Lithuania are still below the average level. In Estonia more than 250 non-cash transactions were registered per capita in 2013. Per capita number of non-cash payment transactions in Estonia was 70 per cent larger than in Latvia and exceeded the number of cashless payment usage in Lithuania by more than two times.

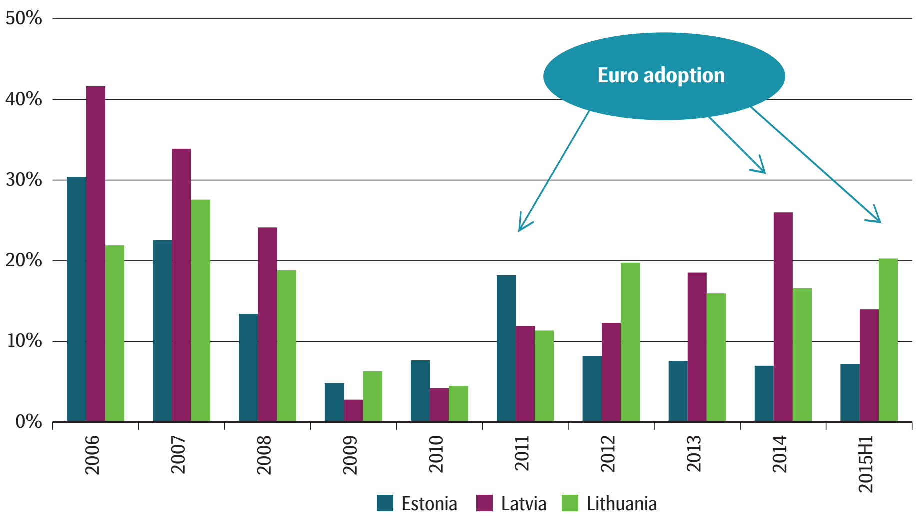
Over the last decade, card payments more than tripled in the Baltic states. The fastest increase was in Latvia. Before the crisis of 2008, card transactions rose rapidly, exceeding the 20 per cent growth rate in all the Baltic countries. In Latvia the payment card market grew at the quickest pace (approximately 30 per cent year-on-year). During the time period of 2008-2010 the payment market yearly growth rate was substantially lower compared to the previous period – only 4-6 per cent. Economic recovery helped the payment card market to gain growth rates again, albeit at a slower pace compared to the boom years. In terms of numbers of transactions the increase in card usage has been observed in all the Baltic countries. Although this general trend is similar, the starting point differs from country to country, explaining differences in growth rates. In the post-crisis period (2011-2014) Latvia and Lithuania demonstrated a 16 – 17 per cent annual growth rate in the number of card transactions, while in Estonia payment usage grew at a slower pace — on average by 9 per cent a year.

Card payments in Baltic States (2005=100)



Source: Central Banks, SEB calculations

Dynamics of card payments in Baltic States (%, y-o-y)



Source: Central Banks, SEB calculations

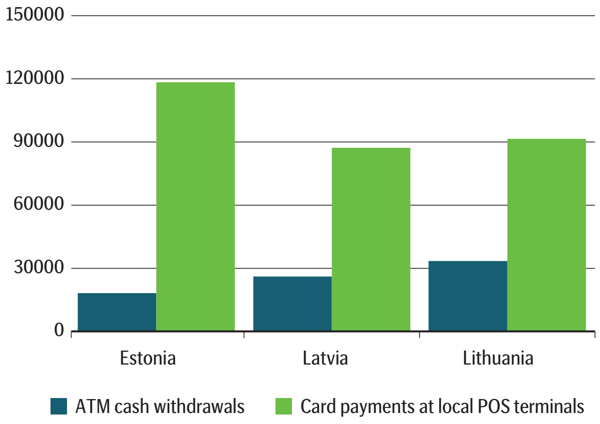
Card usage statistics show the faster growth of payment card transactions in the years when the country joined the eurozone. In 2011, when Estonia became a member state of the eurozone, payment card usage rose at the quickest pace among the Baltic countries, demonstrating an 18 per cent annual increase. The same shift can be seen in the euro adoption year in Latvia (2014) and in Lithuania (2015). It can be concluded that the introduction of the euro has helped to reduce the share of cash payments in household payments.

In the first half of 2015, the usage of payment cards continued to increase in all the Baltic countries. In Lithuania the number of card payments grew by 20 per cent year-on-year. In Latvia card transactions rose by 14 per cent and in Estonia the number of card transactions exceeded the results of the first six months of 2014 by 7 per cent.

Households' purchases with cards abroad (including online stores) continued to increase. In Latvia the share of card transactions abroad was 11 per cent of all card transactions. In Lithuania 8 per cent of all card transactions was made outside the country. In Estonia shopping abroad is less popular compared to other Baltic countries. In the first half of 2015 only 5 per cent of all card transactions was made abroad. In the first half of 2015 the total turnover of purchases made abroad with payment cards issued in Latvia reached EUR 500 million. In Lithuania and Estonia shopping abroad using payment cards was EUR 352 million and EUR 231 million respectively.

It expected that in 2015 the value and number of card payments in the Baltic states reach a record high.

Number of transactions in 1H2015



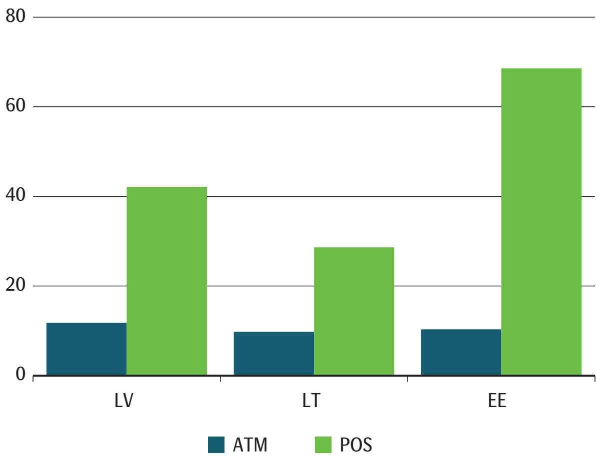
Source: Central Banks

Increasing number of purchases by payment card indicates that households use payment cards more frequently for day-to-day transactions. The average transaction value at POS terminals[3] is similar in all the Baltic states – 17 euros in Estonia and approximately 18 euros per transaction in Latvia and Lithuania.

In Estonia the difference between the number of card payments and the number of cash withdrawals at ATMs is significant. In the first half of 2015, the number of card payments at a POS was 6.5 times larger than the number of cash withdrawals. At the same time, the turnover from card payments in Estonia exceeds the total value of cash withdrawals. In Latvia and Lithuania the ratio of the number of card payments to cash withdrawals was smaller – 3.3 times and 2.7 times respectively. In Latvia the total value of cash withdrawals exceeded the value of purchases at POS terminals by two times. In Lithuania cash withdrawals are even more popular than in Latvia – the value of cash withdrawals was 2.6 times larger than the total value of purchases by card.

Regarding average cash withdrawals Lithuania ranks first among the Baltic countries. In the first six months of 2015, cash withdrawals in Lithuania have increased by approximately 5% over the year, averaging 115 euros. In Latvia and Estonia the average cash withdrawal at ATMs was 93 euros.

Number of transactions per card in 1H2015



Source: Central Banks, SEB calculations

In the first half of 2015, in Estonia the average number of card payments at a POS was 69 per card. In Latvia and Lithuania card holders at POS terminals made 42 and 29 transactions per card respectively. In Estonia households are withdrawing cash less and less frequently and use payment cards mostly for purchases in Estonia and abroad. Although card usage has risen significantly, Lithuanians still prefer to withdraw money from the ATM and pay for goods and services using cash.

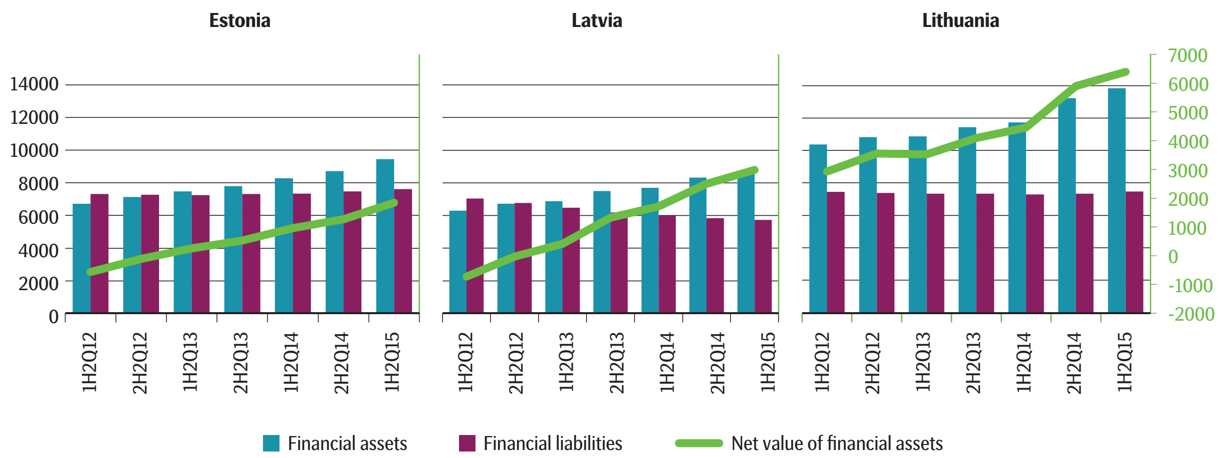
Payment market continues to change further. While the majority of transactions take place at POS terminals, fast growth is expected in e-commerce and online payments. In 2014, e-commerce card payments rose by 34 per cent in Estonia. In Latvia the number of transactions via the internet and phone rose by 69 per cent last year. A growing number of households are shopping online, including shopping abroad, as online services tend to be more convenient and often cheaper. In the future more transactions are expected to be made using smartphones and tablets.

3 A point of sale terminal (POS terminal) is an electronic device used to process card payments at retail locations

Financial position of households continues to strengthen

In all three countries the household income increased due to improving situation in labour market. People put a share of their increased income into savings instruments. The financial assets growth in Lithuania was supported by the euro introduction. Prior to the currency change in January 2015, households brought their cash previously held at home in the national currency to financial institutions, deposited it in the accounts, and did not take it back after. The growth of net financial assets in Latvia was influenced not only by an increase in financial assets, but also by a decrease in financial liabilities. In the second quarter of the year 2015, financial liabilities of the Latvian households were lower by EUR 253 million, compared to the second quarter of the previous year. Meanwhile, in the other two countries the financial liabilities portfolio of households increased by EUR 278 million in Estonia and by EUR 165 million in Lithuania. Nevertheless, household financial assets' growth continues to exceed the growth rate of liabilities in all the countries.

Baltic households balance sheets (mEUR)*



** Due to different data collection methodology, the figures of assets, liabilities, and net financial assets are not strictly comparable*

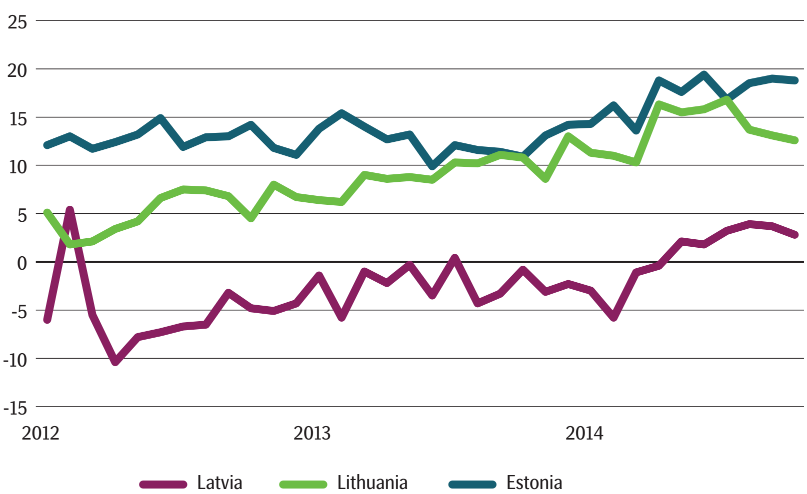
Source: SEB estimates

Households in all three countries are increasing their savings and/or reducing their liabilities (in Latvia). The increase in financial liabilities in Lithuania and Estonia can be considered an indication of improving expectations of households regarding their income.

The improvement of the financial position is confirmed by the Consumer Sentiment Surveys. According to the surveys, the share of households reporting that they can manage their finances was increasing.

The relative share of households reporting that they can manage their finances was increasing. The balance of opinions' indicator in June of the year 2015 was 18.5 in Estonia, 3.9 in Latvia, and 13.7 in Lithuania. Compared to the indicator 12 months ago, it has increased by 1.4, 5.9, and 1.5 points, respectively.

Statement on financial situation of household (balance of opinions)



Source: Eurostat

Financial assets' growth depends on deposits

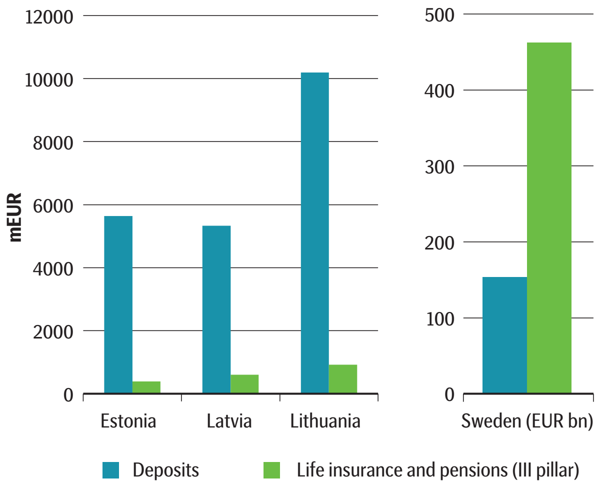
Deposits make the largest share of financial assets of the Baltic households. The long-term savings, such as life insurance and Pillar III pensions, and deposit ratio in Estonia was 1:16, in Latvia – 1:9 and in Lithuania – 1:11. Rather often deposit is the only household saving instrument besides cash.

Meanwhile, savings accumulated in the life insurance and pension funds are three times higher than deposits in much richer and advanced Sweden.

There are several reasons why deposits still make the largest part of household savings in the Baltics. The first reason – a significant share of households earn low income and till now does not have any savings. Such households should start their saving from deposits. The second – households in the Baltics still lack financial knowledge, which is a pre-requisite for those, who are willing to make deals in the financial markets and to make informed money management decisions.

So far, changes in financial assets are mostly influenced by changes in deposits. In the second quarter of the year 2015, compared to the second quarter of the previous year, deposits grew by EUR 1.5 billion or by 16 per cent in Lithuania. Deposits in Estonia and Latvia grew correspondingly by EUR 414 million and 460 million or by 8 and 7 per cent.

Household savings divided into asset classes (2Q2015)



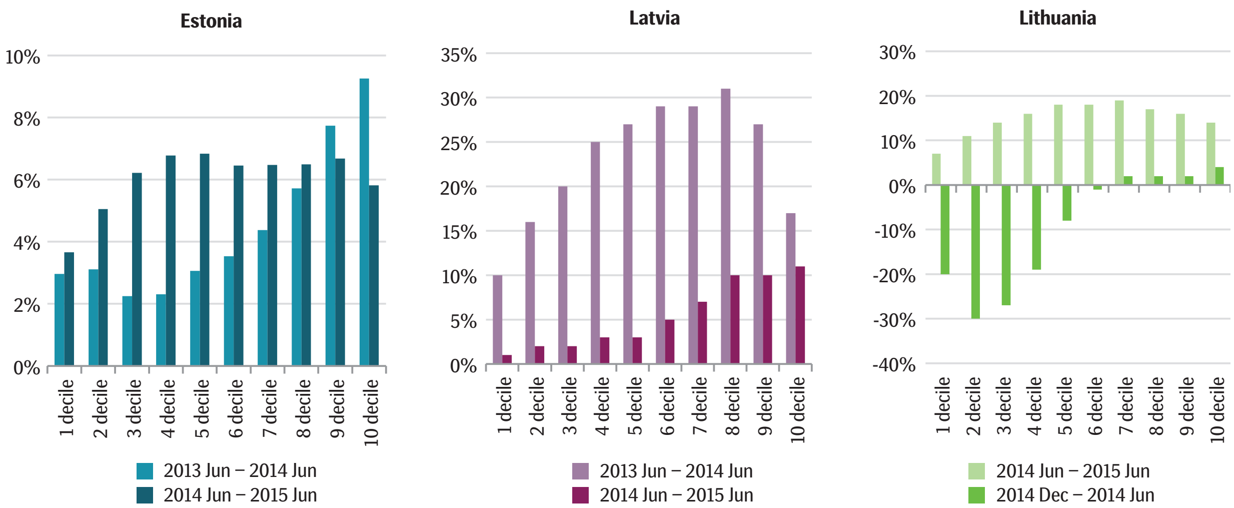
Source: SEB estimates

Larger deposits grow at a faster pace in Latvia and Lithuania

The statistics of aggregate deposit growth does not reflect whether all depositors accumulate their savings at the same pace or whether deposits mostly increase due to the fact that the rich are getting richer and for the rest situation does not change or even worsen.

To find out what depositors enjoy faster savings increase, we analysed the SEB customer data base in all three countries. We have split the depositors into deciles by the savings amount and measured yearly growth in different deciles.

Deposit volume growth by deciles



Lithuania went through the currency change period and a lot of Lithuanians brought their cash in the national currency to financial institutions at the end of the year 2014. The groups (by the deposit amount) who enjoyed the fastest growth represented the upper middle deciles the 4th to 9th. The deposit value growth in these groups exceeded the average growth rate (15 per cent). The lower cut-off point for decile 4 was EUR 270, the higher cut-off point for decile 9 – approximately EUR 4500. A similar pattern was observed in Latvia prior to the Euro introduction in 2014.

When the euro introduction effect ended, the situation changed. In Latvia the relatively larger deposits' deciles enjoined faster growth of their savings in deposit accounts in 2015. In Lithuania, the first half of the year 2015 showed a negative change in small depositors' savings. But in this case the decrease of small deposits does not necessarily mean that people with low savings spend their money. The decline in small deposits may reflect that depositors in these groups relatively more often take the money from the banks to their home to keep savings in cash.

On the other hand, relatively larger deposits (deciles 7-10 in Lithuania and deciles 8-10 in Latvia) enjoy higher than the average growth rate. The lower cut-off point of decile 7 in Lithuania and decile 8 in Latvia is near EUR 1.7 thousand.

Estonia introduced the Euro in 2011, so any effect of the currency change is no longer observed. From June 2014 until June 2015, the fastest growth of deposits exceeding the average of 6 per cent was observed in deciles 3rd to 9th. The lower cut-off point in the 3rd decile was EUR 109 in June 2014. The deposit growth pattern in the years 2013 - 2014 in Estonia was different and more similar to the deposit growth pattern in Lithuania and Latvia in the years 2014 - 2015 when the fastest growing deciles were those of the wealthy depositors, i.e. starting from the 8th decile. The lower cut-off point of the 8th decile in 2013 was Eur 2.2 thousand. Based on the changed deposit growth pattern in Estonia, one can assume that currently the middle level of Estonian depositors is growing, while in Latvia and Lithuania depositors with relatively larger savings increase their assets at a faster pace.

In theory, low income earners are more financially vulnerable to income decrease. Savings are more needed for them than for higher income earners. On the other hand, up to a certain income level the marginal utility of saving is lower than the marginal utility of consumption. Most probably, low income earners would spend every additional Euro for consumption rather than for savings. High income earners and depositors should think about their capital diversification possibilities. They are more risk averse and should seek higher rewards. However, current deflationary environment and fluctuations in the financial markets make deposits (even with no interest rate) a rational short-term choice.

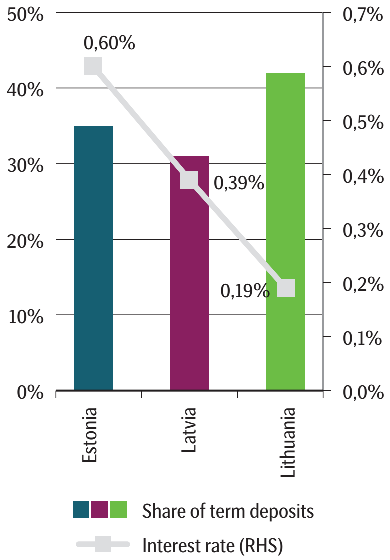
Despite of extremely low interest rates, term deposits make a significant share of household savings

Extremely low interest rates stimulate shift from term deposits to demand deposits. The average interest rate on term deposits in August made up 0.19 per cent in Lithuania, 0.39 per cent in Latvia, and 0.6 percent in Estonia. However, the relative share of term deposits is the highest in Lithuania (42 percent of the total deposits) where the interest rate is the lowest. The share of term deposits in Estonia was 35 per cent, in Latvia – 31 per cent in the total deposit portfolio.

A more detailed depositor behaviour analysis shows that, for instance, in Lithuania approximately ¾ of the new deposit arrangements in January – August represent automatically prolonged earlier agreements. However ¼ of the new arrangements are the new money in term deposit accounts. In Estonia the share of automatically prolonged term deposit agreements was 88 per cent in January to August.

To put a term deposit when interest rate is almost zero or round zero, sounds irrational: transaction costs are incurred and further liquidity constraints (though rather symbolic) exist. However what economists call „costs" may result in reward for depositors. Separate accounts, liquidity constraints help those people who are aware of their poor ability to keep a part of their income safe from any spontaneous spending. For such people the choice of term deposit with a zero interest rate is rational.

Share of term deposits in deposit portfolio and average interest rate on term deposits (August 2015)

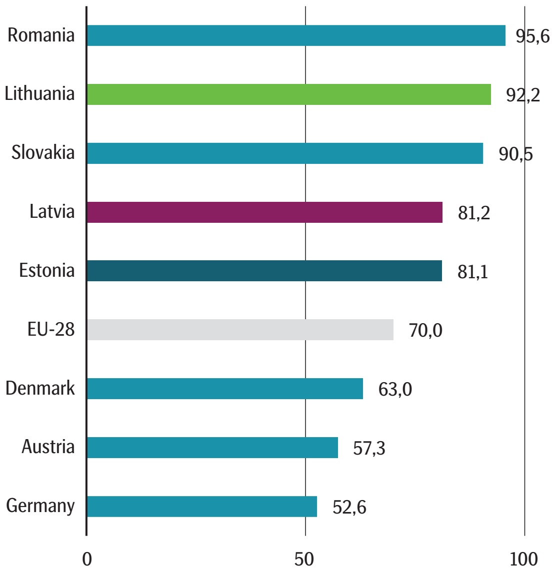


Source: European Central Bank

Home-ownership rate is high in Lithuania while the share of owners with mortgage in the population is the highest in Estonia

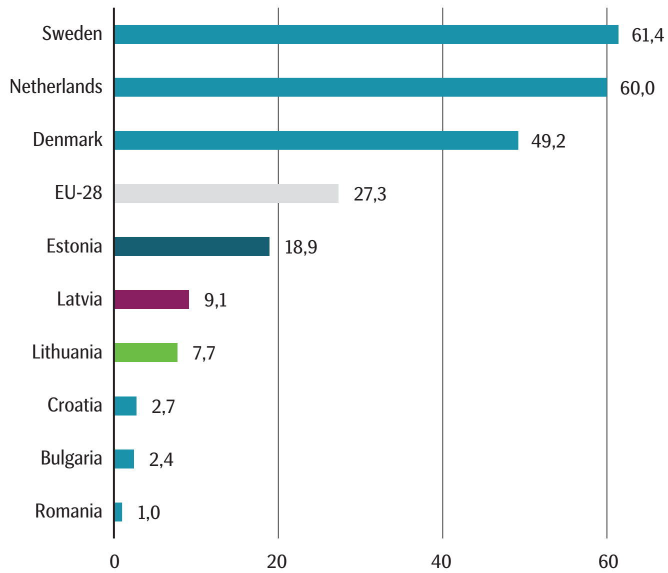
When comparing home-ownership rates across the European countries, the highest share of home owners is in the Central and Eastern European (CEE) countries, including the Baltic countries. Lithuania has the second highest home-ownership rate in the European Union as 92 per cent of the population owns the home. In Estonia and Latvia, the home-ownership rate is 11 percentage points lower as 81 per cent of the population owns the place in which they are living. The lowest share of population owning the home is in Germany, 52.6 per cent, and in the EU on average 70 per cent of population is an owner of the living. Obviously the high ownership in the CEE countries is the result of the restitution process that lead to a tenure structure with a high proportion of owners.

Share of population – owners (%)



Source: EU-SILC 2013

Share of population – owners with mortgage (%)



Source: EU-SILC 2013

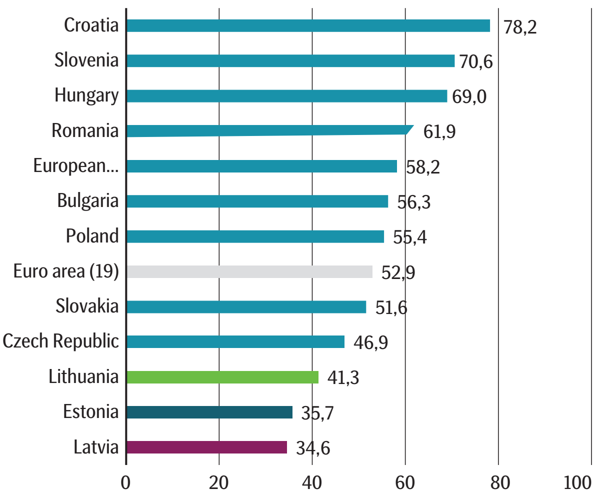
Data on the share of population which is the owner and with mortgage loan indicates the share of population which has obtained a home by borrowing.[4] The ranking of countries by the share of owners with mortgage is quite different from the ranking by the share of home-ownership. Borrowing is very common among Swedish homeowners; while 70 per cent of Swedish households own their home, 87 per cent of the owners are with mortgage loan. On the other hand, Romania, which has the highest home-ownership rate, has the lowest penetration of mortgage loan, only one per cent. In the Baltic countries, the penetration of owners with mortgage is below the EU average. Among the three countries, the highest share of population who are owners with mortgage is seen in Estonia, 19 per cent, while in Latvia the share is 9 per cent and in Lithuania it is 8 per cent. The data indicates that majority of homeowners in the Baltic countries exhibit a good financial position as they are without considerable liabilities.

4 The data does not give a full picture about how many homes have been obtained by loan in earlier years as some of the mortgages have already been paid back by the survey period. Moreover, some owners with mortgage included in the data have not used the loan for purchasing the home but have used housing as collateral for housing equity withdrawal. This type of borrowing is most common in the Netherlands.

On average, dwellings in the Baltic countries are ca 1/3 smaller than in the EU

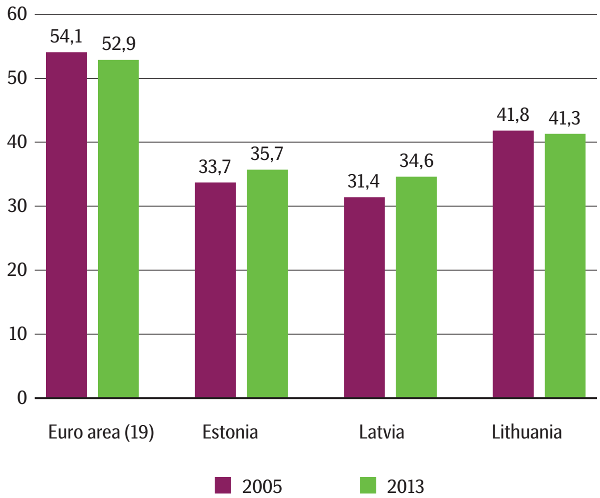
Among CEE countries, the share of households which live in a house is the lowest in the Baltic countries, according to the EU Survey on Income and Living Conditions (EU-SILC). While in Croatia 78 per cent of population lives in houses, in Lithuania the share is 41 per cent, in Estonia the share is 36 per cent and in Latvia it is 35 per cent. The rest of the population is living in flats. The share of population living in houses in the Baltic countries is far below the EU average which is 58 per cent. The differences are not induced by the different level of urbanisation, as the share of population living in low-intensity areas is lower in Croatia and Slovenia than in Latvia and Lithuania. In the countryside, the share of population living in houses is 54 per cent in Latvia, 60 per cent in Estonia and 67 per cent in Lithuania while the EU average is 81 per cent. Similarly, in towns the share of households residing in houses is 14-15 per cent in the Baltic countries while the EU average is 40 per cent. Apparently living in a flat is not a strong preference of households in the Baltic countries but is a consequence of historical reasons as the stock of flats has been high in these countries.

Share of population living in houses (%)



Source: EU-SILC 2013

Share of population living in houses (%)



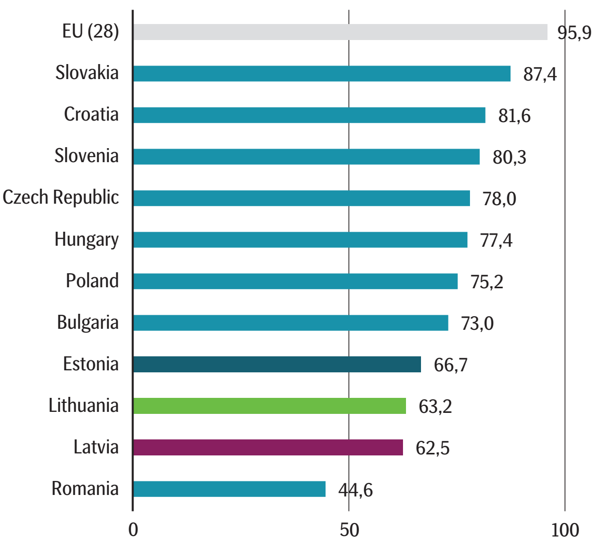
Source: EU-SILC

The shift between houses and flats occurs only gradually. When comparing the situation in 2005, the earliest data available from the EU-SILC, with 2013, the latest data available, the share of population in houses has increased in Latvia by 3.2 percentage points and in Estonia by 2 percentage points but in Lithuania the share has declined by -0.5 percentage points. In Euro area (EU28 data not available for 2005) the penetration has declined by -1.5 percentage points within this period.

The EU SILC carried out an additional survey on living conditions in 2012 which provides insights into the housing conditions of households in Europe and enables to compare the results across countries.[5] Households in the Baltic countries have on average less living space at their disposal compared to households in the other European countries. In the EU, the average size of a dwelling is 96 m² while in most CEE countries the average size is over 70 m². In Estonia, the average size of a dwelling is 67 m² whilst in Latvia and Lithuania the average size is 63 m², indicating that among the CEE countries, the average size of a dwelling is the smallest in the three countries (after Romania). To some extent the differences between countries can be explained by the fact that there are more households which live in flats in the Baltic States than in other CEE countries. But apparently small dwelling size is not indicating preferences of households but refers mainly to affordability issues. Hence, when striving for the average European living standard, there is also space for larger dwellings in the Baltic countries.

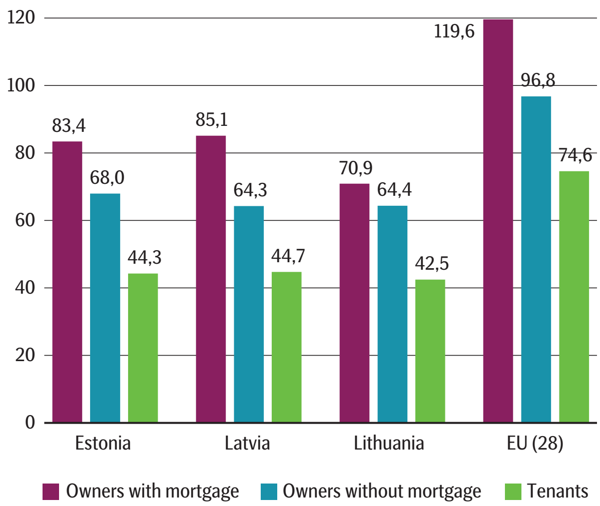
5 Although the survey was implemented in 2012, the results were published only in 2014. As the housing conditions change very gradually, the statistics is still considered to be highly relevant.

Average size of a dwelling (m²)



Source: EU-SILC ad hoc module 2012

Average size of a dwelling (m²)



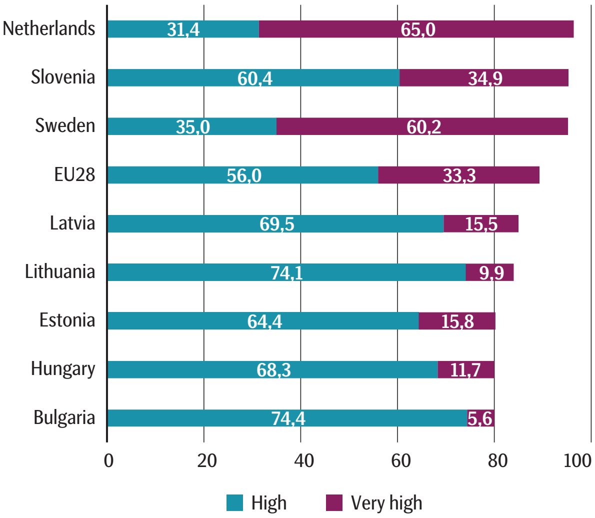
Source: EU-SILC ad hoc module 2012

The largest gap in the average size of a dwelling is for tenants as they live in a dwelling which is approximately 60 per cent of the average size of the tenant's dwelling in the EU. As the share of tenants is low in the Baltic countries, those who rent evidently tends to prefer small residents. Owners with mortgage live in the largest homes, in Latvia the average size is 85 m², in Estonia 83m² and in Lithuania 71m². The statistics indicates that households are able to buy larger dwellings when borrowing. The biggest difference between the size of a dwelling between an owner with mortgage and an owner without mortgage is in Latvia where an owner with mortgage lives in a dwelling which is 32 per cent larger than the residence of an owner who does not have any mortgage. In Estonia, the difference in the size of a dwelling between the two owners is 23 per cent and in Lithuania 10 per cent. However, even when households are able to obtain larger homes when borrowing, the average size of a dwelling remains still far below the EU average.

Satisfaction with the dwelling is low in the Baltic countries

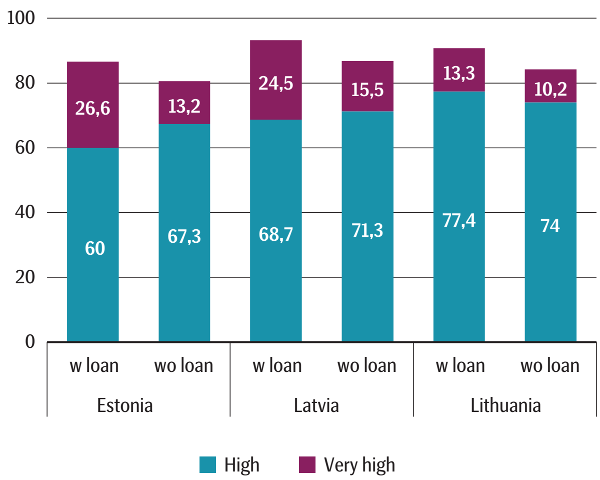
An assessment indicating how satisfied households are with their dwelling varies substantially across European countries. According to the EU SILC, households are satisfied or very satisfied with their dwelling the most in the Netherlands, where 96 per cent of the population gives a positive assessment to their home. In the Baltic countries, the satisfaction with the dwelling is below the EU average. In Latvia, 85 per cent of population is satisfied with the dwelling while the share is 84 in Lithuania and 80 in Estonia. Only households in Hungary and in Bulgaria are less satisfied with their homes than households in Estonia.

Overall satisfaction with the dwelling



Source: EU-SILC ad hoc module 2012

Overall satisfaction – owners



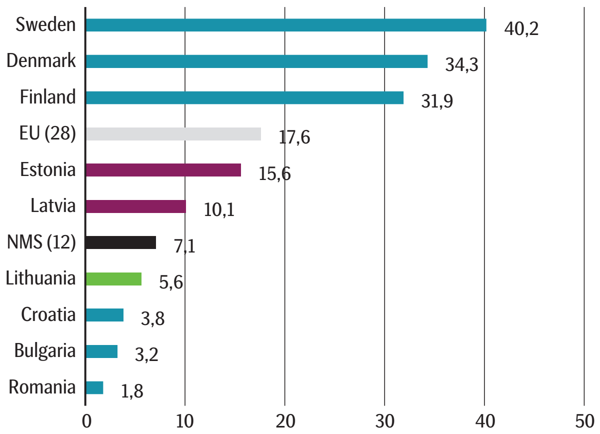
Source: EU-SILC ad hoc module 2012

There are several reasons for not being satisfied with their homes: 24 per cent of population in Latvia report that there is not enough space in their homes, in Lithuania the space problem is reported by 22 per cent of the population and in Estonia by 18 per cent. There are also other issues related to the facilities in the dwelling, heating system or overall quality of the dwelling which create dissatisfaction with the dwelling. Evidently, the average living conditions in the Baltic countries are far below the EU average level, indicating a need for improvement in housing conditions.

Homeowners with mortgage are more satisfied with their dwelling than homeowners without mortgage, the share of very satisfied households among homeowners with loan compared to homeowners without loan is 13 percentage points higher in Estonia, 9 percentage points in Latvia and 3 percentage points in Lithuania. Apparently, households have been able to increase their satisfaction with their homes with the help of a loan.

Although substantial share of households is not satisfied with their dwelling, relatively small share of population has taken an action by changing the dwelling. The biggest movers in Europe are households in the Nordic countries. In 2012, the largest share of households who reported that they had changed the dwelling within the last five years was in Sweden, being 40 per cent. In the Baltic countries the share of population who has moved during this period is several times lower and below the EU average, which is 18 per cent. Among the Baltic countries, the share of population who has moved is the highest in Estonia, at 16 per cent. In Latvia, the share of population who has changed the dwelling within the five years is 10 per cent and in Lithuania 6 per cent. In Lithuania, the share is below the average of the New Member States (7 per cent).

Share of population moved within the last five years



Source: EU-SILC ad hoc module 2012

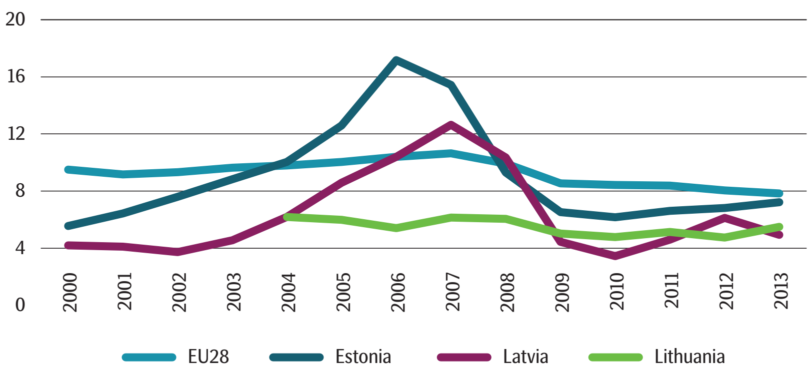
Although the data about moving has been collected during the turbulent period when some of the moves have probably not been voluntary, the main reasons for movement have been family-related (approximately half of the cases), such as change in the family size, or dwelling-related (approximately 1/5 of the cases), such as the need to improve the living conditions. In Estonia, 5 per cent of household reported in 2012 that they were planning to change the dwelling, while in Latvia, 4.2 per cent of households and in Lithuania, only 2.4 per cent of households were planning to move.

The analysis suggests that there is relatively low mobility in the Baltic countries which is not in line with the need to improve the living conditions. To some extent it may be explained by the financial possibilities of households. SEB's affordability analysis shows that new flats are more affordable in Tallinn than in Riga or Vilnius. It takes 30 months for a household with an average wage to accumulate the needed initial payment of 15 per cent to buy a flat in Tallinn; to buy a flat in Riga 39 months is needed and to buy a flat in Vilnius 43 months is needed. The calculations confirm that households need to exhibit substantial financial effort to improve their living conditions. Even when the financial conditions of the Baltic households have improved substantially since the recession, it is apparently not sufficient to induce a remarkable qualitative shift in the living conditions.

The investment rate of households is the highest in Estonia

According to the aggregate statistics in the National Accounts, households invest a relatively small share of their income into dwellings. The investment rate, i.e. gross investment (which mainly consists of the purchase and renovation of dwellings) to disposable income, was extraordinary high In Estonia and in Latvia in 2005 – 2007 when the investment rate exceeded markedly the average rate in the EU. The investment rate peaked at 17.2 per cent in Estonia in 2006 and 12.6 per cent in Latvia in 2007 while the EU average investment rate has been around 10 per cent. Residential investment of households in Estonia and Latvia dropped sharply concurrently with the downturn of the economy and has remained below the EU average rate since 2009. In Lithuania, the residential investment rate has not experienced extraordinary fluctuations but it is quite stable around 5-6 per cent.

Investment rate of household sector (%)



Source: Eurostat

In recent years the investment rate of households in Estonia has started to increase while the EU average rate has been declining. In 2013 (the latest available data) the investment rate was 7.2 per cent in Estonia which is only 0.6 percentage points lower than the EU average. In Lithuania, the investment rate was 5.5 per cent and in Latvia it was 4.9 percent. Although the living conditions are lower in the Baltic countries compared to the EU average, the relatively low investment rate implies that households in the three countries are not going to catch up the average European level in the recent future. In order to improve the living conditions, households should increase the residential investment rate in all Baltic countries above the EU average.

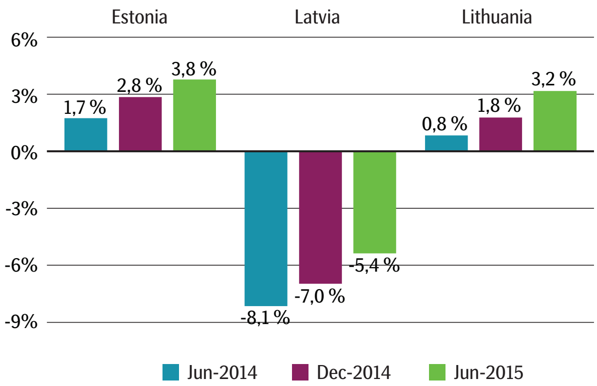
Housing credit market shows sustainable growth in Estonia and Lithuania

The development on housing credit market is continuing the same pattern since 2013, namely gradual portfolio growth in Estonia and Lithuania while a continuous decline in Latvia. At the end of 2015:Q2, the housing loan volume grew at a yearly rate of +3.8 per cent in Estonia and +3.2 per cent in Lithuania, exhibiting a higher growth rate than a year ago in both countries.[6] In Latvia, the yearly fall in housing loan portfolio is still at a remarkable level, namely – at 5.4 per cent. To recall, the deleveraging rate in Estonia was never below -2.3 per cent y-o-y (which occurred in 2010:Q4) and in Lithuania it was never below -1.7 per cent (2012:Q3). Apparently the recovery of housing credit market is going to take substantially longer time in Latvia than in other Baltic countries.

In Estonia, the current loan volumes are at EUR 6.17 billion which are almost on the same level (in nominal terms) as at the peak in November 2008 (EUR 6.21 billion). In Lithuania, the volume of EUR 6 billion is also very close to the highest stock of housing loan in February 2009. However, as the wages and deposits have increased noticeably since 2009 in both countries, the housing volumes are considered to be at a much more solid level than they were in 2008-2009.

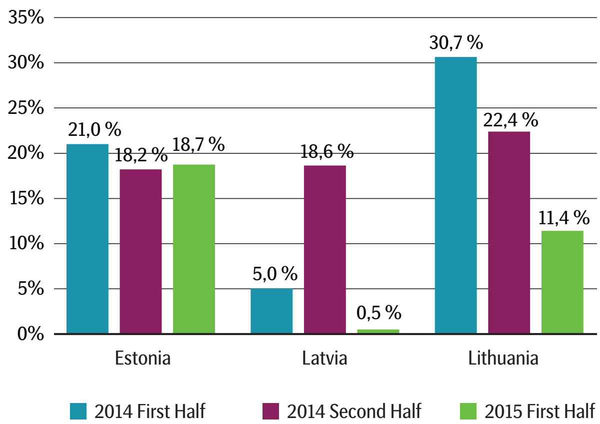
6 The growth rates for Lithuania are calculated after adjusting the portfolio changes to the shifts of volumes between loan types due to new gross-up procedure.

Housing loan portfolio, y-o-y change



Source: National Central Banks, SEB estimations

Volume of new housing loans, y-o-y change



Source: National Central banks, UAB „Busto paskolu draudimas"

In Estonia, the interest for housing loans has increased at a firm rate over the last years as the bi-annual volumes of granted loans are ca 18-20 per cent higher compared to the same period a year ago. In the first half of 2015 19 per cent more new housing loans were issued than in the first half of 2014. In Lithuania, the growth of new housing loans is decelerating as in the first half of 2015 11 per cent more housing loans were issued compared to the same period a year ago while the growth rate was 31 per cent in the first half of 2014.

In Latvia, new housing loan volumes showed an upturn of 19 percent in the second half of 2014 while the new volumes remained more or less at the same level in the first half of 2015 compared to the same period a year ago. Developments on housing credit market in Latvia have been affected by the discussion of a new insolvency law in the second half of 2014 when compulsory consumer protection (non-recourse or "leave the keys" option) was planned to be introduced from the beginning of 2015. As the new law would have entailed stricter credit conditions from credit suppliers, there was a rise in the new housing loans in the anticipation of the changes. Although the plan did not materialise as a compulsory requirement in loan contracts, apparently the increase in granted loans in the second half of 2014 was induced by the plan.

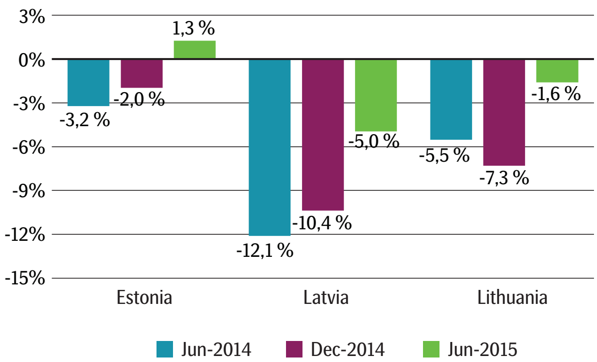
Taking the need to improve the living conditions in all Baltic countries, households in Estonia and Lithuania are expected to further activate their borrowing for housing. In Latvia, although the need from households is present, the financial possibilities of households are less prosperous than in the other two countries. Therefore the housing credit market remains in halt in Latvia also in the following year.

Consumer credit and other borrowing started to rise in Estonia but is still declining in Latvia and Lithuania

In Estonia, the stock of consumer credit and other borrowing has increased by 1.3 per cent by the end of 2015:Q2 compared to the same period a year ago. The volume has increased slightly month by month since April 2015, indicating that the downward trend is turning into positive trend. The stock of consumer credit and other borrowing is ca 1/3 lower than it was at the peak period in December 2008.

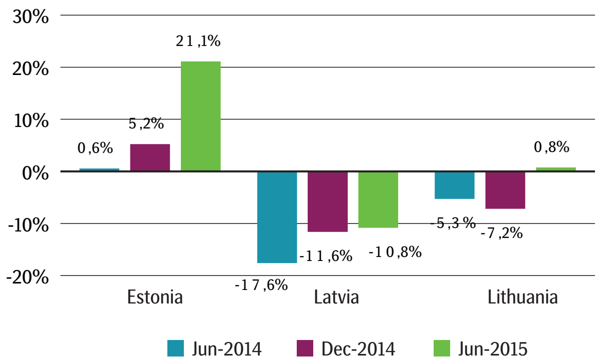
In Latvia and Lithuania, the consumer loan and other borrowing portfolio is continuously declining, although the speed of deleveraging is slowing down. The portfolio fell by -5 per cent in Latvia and -1.6 per cent in Lithuania at the end of 2015:Q2 compared to a year ago. For comparison, at the end of 2014 the decline in the volumes of the consumer credit and other borrowing was -10 per cent in Latvia and -7 per cent in Lithuania. In Latvia, the current loan volumes are on the same level as they were in October 2005, while in Lithuania on the same level as in October 2006.

Consumer credit and other lending portfolio, y-o-y change



Source: National Central Banks, SEB estimations

Volume of short-term loans, y-o-y growth



Source: National Accounts

In Estonia, about 60 per cent of short-term loans (up to one year) are granted by non-financial institutions and the portfolio consists mainly of hire purchases or other type of borrowing for consumption purposes. The volumes of all short-term loans (from non-financial and financial institutions) have been increasing steadily; the volumes were 5.2 per cent higher at the end of 2014 compared to the end of 2013. In 2015:Q1, which is the latest data available from the National Accounts, the volumes in short-term borrowing showed a significant yearly rise by 21 per cent. At the same time the volumes of short-term loans from financial institutions exhibit a declining trend. The data indicates that the other financing options besides financial institutions are exploited markedly by households and that there is a shift from financial institutions to other sources in financing short-term needs.

In Latvia, the volume of all short-term loans is declining faster compared to the volumes of consumer loans in financial institutions, hinting that the whole consumer credit market is lingering. In Lithuania, the drop in the volumes of all short-term loans and in the portfolio of consumer loans from financial institutions has been comparable. Only in the beginning of 2015 the volume of short-term loans increased by 0.8 per cent in Lithuania while the portfolio of consumer loans and other credit from the financial institutions dropped by 1.6 per cent.

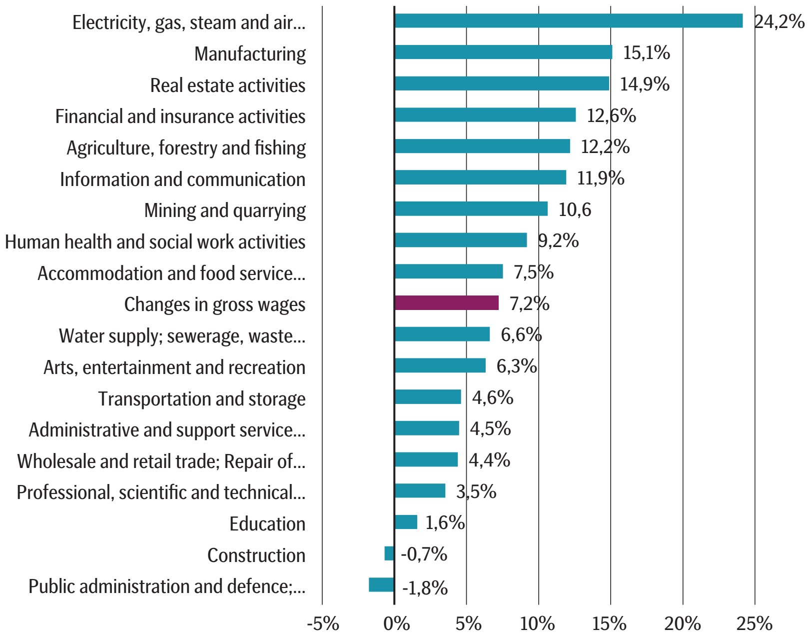
Taking into account that the real wages and consumption of households is increasing at a steady rate in all Baltic countries, there is no need to boost consumption to higher growth rates with the help of borrowing. Therefore the role of consumer loans in financing consumption is not expected to expand. In Estonia consumer loans are continuing to increase at a slow.

Estonia

- The average nominal wage reached 1082 EUR in 2015:Q2. The nominal wage increased by 5.8 per cent on yearly basis and the growth rate is higher than in previous periods. For comparison, in 2014:Q2 the annual nominal wage growth was 4.8 per cent. The real wage growth in 2015:Q2 was even higher than the nominal growth rate, at 5.9 per cent, as prices have slightly declined. When looking at a longer period and comparing with the real wage at the peak in 2008:Q2, on average the real wage has grown by 7.2 per cent in seven years. The rise in the real wage has been very heterogeneous between sectors, since 2008:Q2 the wage has increased the most in electricity and gas production sector, by 24 per cent, while showing solid increase also in the manufacturing and real estate activities, 15 per cent. The real wage has not increased in public administration and defence where the wages are still lower than in 2008:Q2.

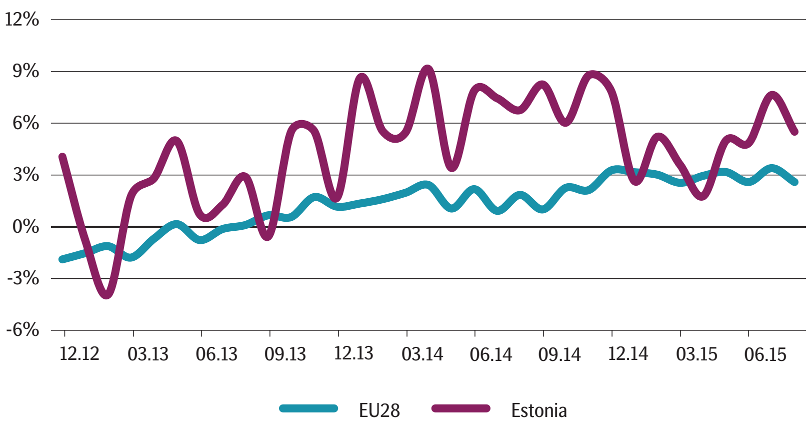
- The rise in real wage is accompanied by strong consumption growth. The average growth rate of retail trade excluding motor vehicles was 3.8 per cent in the first half of 2015 which is somewhat lower than the rate in 2014 in the same period, 6.7 per cent. Retail trade (excluding motor vehicles) in July 2015 slightly exceeded the growth rate in July 2014 (7.7 per cent and 7.5 per cent, respectively) but in August 2015 the growth rate was lower than a year ago (5.5 per cent and 6.8 per cent, respectively). Consumption in Estonia is increasing at higher rate than in most other European countries; the average growth rate of retail trade excluding motor vehicles was 2.6 per cent in the EU in August 2015.

Growth of average real wage by sector 2008:Q2 - 2015:Q2 (7 years)



Source: Statistics Estonia

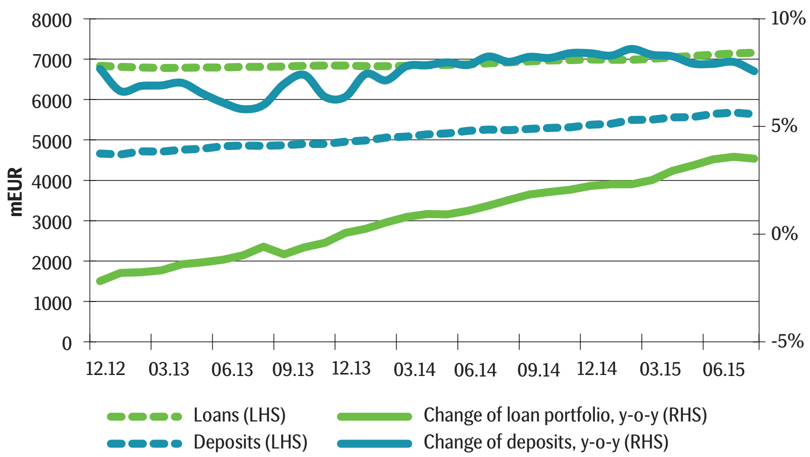
Retail trade growth y-o-y (in real values)



Source: Eurostat

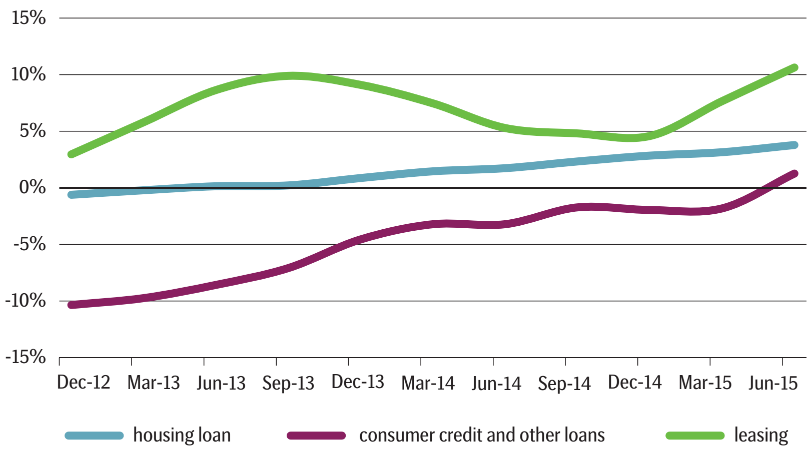
- The volume of total loan portfolio is growing at a slightly higher pace than in previous periods; the portfolio increased by 3.5 per cent on yearly basis at the end of 2015:Q2 while showing comparable growth rate in August and September 2015. For comparison, at the end of 2014 the portfolio was 2.2 per cent larger than at the end of 2013. The main contribution to the rise in loan portfolio comes from housing loan portfolio which increased 3.8 per cent by the end of 2015:Q2. At the end of 2014 the portfolio growth rate was 2.9 per cent, showing that the stock of housing loans continues to increase at a higher rate. The growth rate has gradually increased in July and August 2015 (3.9 per cent and 4.0 per cent, respectively). The volume of consumer credit and other borrowing started to increase in April 2015 and at the end of 2015:Q2 the portfolio was 1.3 per cent higher than a year ago. The growth rate of leasing balance is most volatile, at the end of 2015:Q2 the balance was 10.6 per cent higher than a year ago while the growth rate is even higher in July and August 2015 (11.5 per cent and 12.0 per cent, respectively). Almost as high growth rates in leasing volumes were observed in the middle of 2013.
- When looking at households' appetite for new loans, the volume of new housing loans increased by 19 per cent in the first half of 2015 compared to the first half of 2014 which is a comparable growth rate to the previous periods. In the first half of 2015, about 4 per cent more consumer credit and other loans were granted compared to the first half of 2014, showing the same growth rate as in the second half of 2014. While new leasing volumes were declining in 2014, in 2015 the issuing has picked up and 20 per cent more leases were granted in the first half of 2015 compared to the same period a year ago.

Household loans and deposits



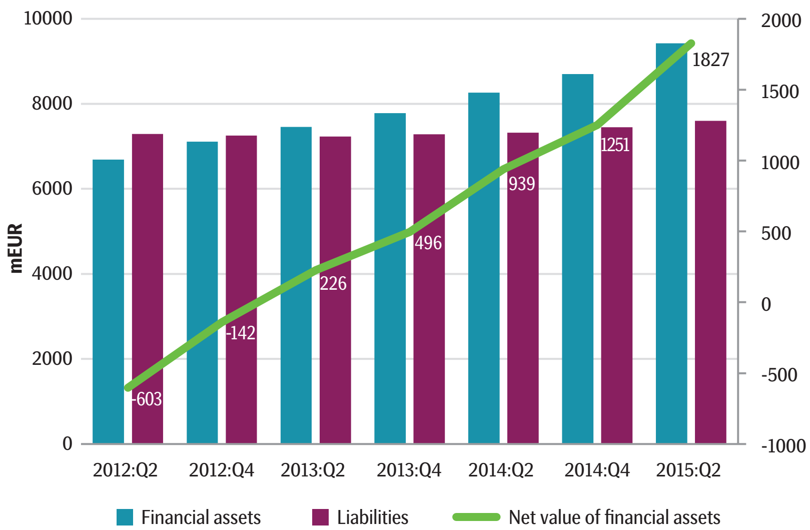
Source: Bank of Estonia

Y-o-y changes in loan and leasing portfolio



Source: Bank of Estonia

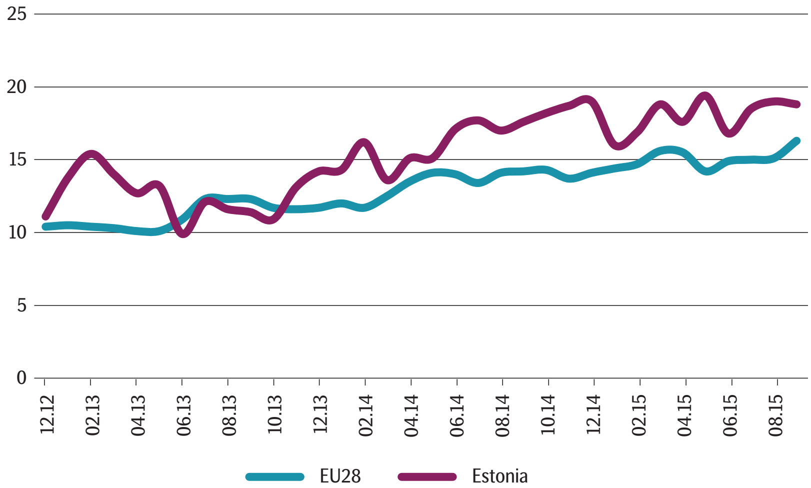
Financial position of households



Equities not registered at OMX are excluded
Source: SEB calculations

- Households' financial assets are accumulating at an increasing rate, at the end of 2015:Q2 the balance of financial assets was 14.1 per cent higher than a year ago. For comparison, in 2014 financial assets grew by 11.8 per cent. Households increased the balance of total deposits by 268M EUR within the first half of 2015. It is 5 per cent more than at the end of 2014 while the yearly growth rate has been 8 per cent and the growth rate continues to be at the same level in July and August 2015. Although the balance of liabilities is increasing likewise at a higher rate, from 2.3 per cent at the end of 2014 to 3.8 per cent at the end of 2015:Q2, the growth rate of assets exceeds by far the growth rate of liabilities. Consequently, the financial position of households continues to strengthen. The reinforcement of the financial position is confirmed by the Consumer Sentiment Survey. According to the survey, the share of households who report that they can manage their finances increases at a steady rate and the balance was 19 in September 2015, meaning that the share of households who can save exceeds the share of household who are using their savings by 19 percentage points. The assessment about the financial situation is higher in Estonia compared to the EU average where the average balance is around 16 in September 2015.

Financial situation of households



Source: Consumer Sentiment Survey

- Within three years, from 2012:Q2 to 2015:Q2, the share of deposits of total financial assets has decreased from 68 per cent to 60 per cent, although deposits have shown solid increase of 24 per cent within this time period. Pension funds have accumulated 87 per cent more assets within the three years reaching the share of 30 per cent from total financial assets of households. Hence, the long-term saving has been accumulating even faster than the buffer stock saving.

mln EUR	2012:Q2	2012:Q4	2013:Q2	2013:Q4	2014:Q2	2014:Q4	2015:Q2
Financial assets	**6690**	**7110**	**7460**	**7783**	**8261**	**8704**	**9427**
Demand and overnight deposits	2464	2649	2942	3061	3361	3554	3924
Term and other deposits with maturity	2105	2012	1906	1897	1868	1821	1718
II pillar pension funds	1235	1416	1533	1709	1921	2196	2449
III pillar pension (Funds + insurance)	265	281	287	303	314	338	360
Other investment via financial institutions*	247	332	335	365	385	395	442
Other securities**	375	420	457	449	412	400	534
Liabilities	**7293**	**7253**	**7234**	**7287**	**7322**	**7452**	**7600**
Housing loans	5833	5846	5841	5896	5942	6064	6167
Consumer loans	594	608	593	591	596	603	620
Other loans	529	451	433	419	397	388	386
Leasing	338	348	367	380	387	398	428
Net value of financial assets	**-603**	**-142**	**226**	**496**	**939**	**1251**	**1827**

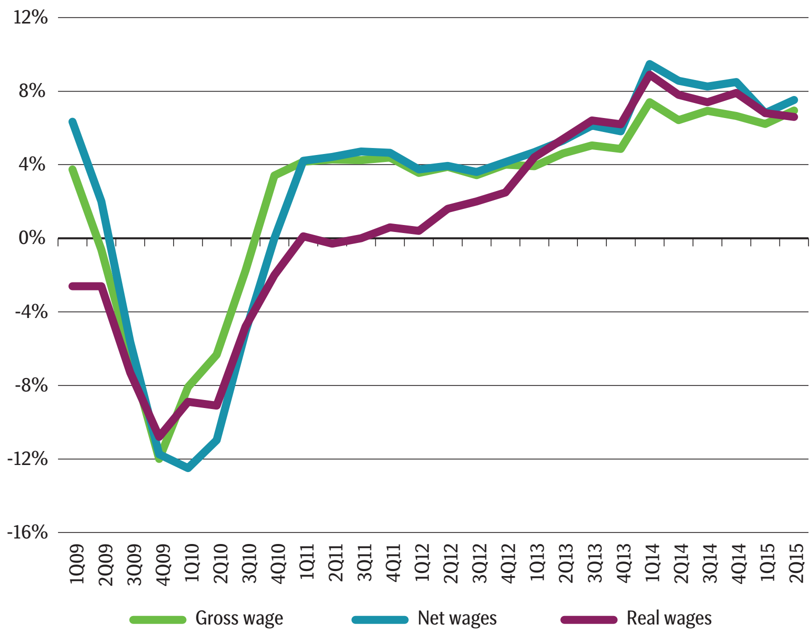
Source: Bank of Estonia, Estonian Central Register of Securities, Financial Supervision Authority, SEB calculations
** Private portfolios, foreign investment funds and unit-link insurance*
*** Registered at Estonian Central Register of Securities*

Latvia

- Despite slowdown of economic growth the situation in labour market continues to improve gradually. In the second quarter of 2015 unemployment rate was 9.8 per cent -- decrease by 0.9 percentage points compared to second quarter of the previous year and decrease by 0.4 per cent compared to the last quarter of 2014. Although the number of long-term unemployed persons who have been seeking a job for 12 or more months declined, the share of the long-term unemployed persons remained at 43 per cent level. The number of long-term unemployed persons is still high in Latvia, and it could be reduced with the state support programs.

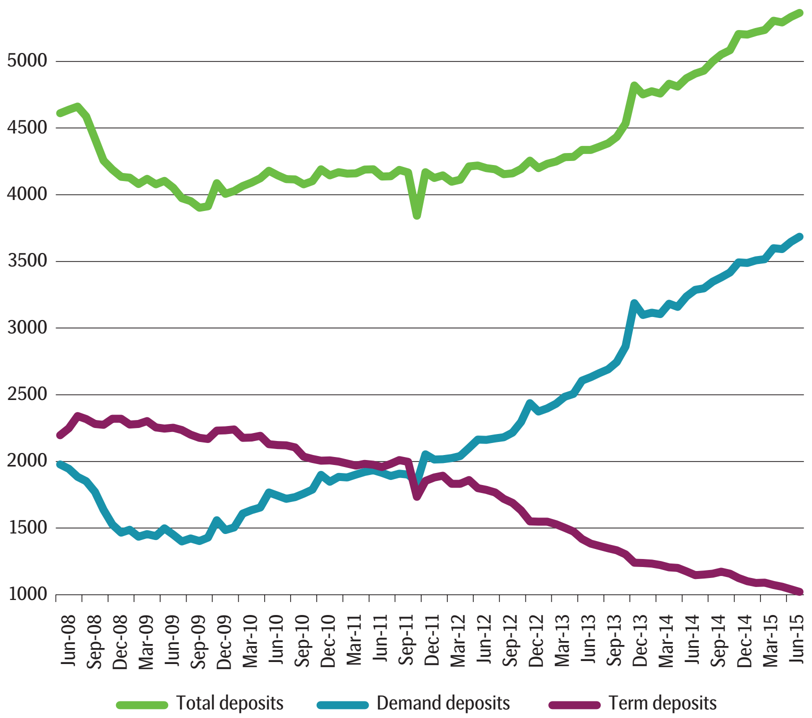
- During the first half of 2015 households' income continued to rose. Average gross wages and salaries grew by 6.6 per cent compared to the first half of 2014. In the first quarter the growth rate of average gross wages was 6.3 per cent year-on-year, while in the second quarter wages increased by 6.9 per cent compared to corresponding quarter of 2014. In the second quarter of 2015 the average monthly gross wages and salaries was 815 euros. Partly wage growth rate was affected by an increase in the minimum monthly wage. Since January of 2015 the minimum monthly wage has increased from 320 to 360 euros or by 12.5 per cent.

Changes in average wages (%, YoY)



Source: CSB

Household deposits (mEUR)



Source: Central Bank

- Due to the decrease in labour tax burden – reduction of Personal income tax from 24 per cent to 23 per cent -- net wages and salaries rose at quicker pace. In the second quarter of 2015 the average monthly net salary reached 600 euros level, demonstrating 7.5 per cent increase year-on-year. In the first half of year the inflation stayed low, thus purchasing power of households was not affected significantly. Wage increase and low inflation means more money into household pockets. In the second quarter the average real wage (net wage taking into account changes in consumer prices) grew by 6.6 per cent year-on-year.

- The increase in disposable income was reflected in dynamics of consumption and savings as well. In the first half household consumption expenditure rose by 2.5 per cent year-on-year. Despite increase in household spending, households remain quite cautious and are not in hurry to spend all income. Trends are unchanged -- households are increasing their savings and paying back their debt.

- The household deposits in commercial banks increased by approximately 9 per cent compared to the previous year. Since the beginning of the year households deposits have grown by 127 million euros or 2.4 per cent. Very low (zero per cent) interest rates stimulates shift from term deposits to saving accounts and demand deposits. In the first six months of 2015 money at savings accounts and demand deposits rose by 10 per cent and 4 per cent respectively, while the total volume of term deposits shrunk by 7 per cent.

- The long-term savings (private pensions and life insurance) continued to increase. In the first half of 2015 the total contributions to private pension plans rose by 50 per cent compared to the first half of previous year. The share of private pensions and life insurance savings has increased to 7 per cent of total financial assets of households. In the first half of 2015 household financial assets rose by 4.7 per cent or 390 million euros. At the end of June the total financial assets, also including 2nd pillar pension capital, were 8.7 billion euros.

- Growing income and savings makes households less vulnerable. Besides households continue to reduce their debt. In the first half of 2015 the financial liabilities of households decreased by 100 million euros to 5.7 billion euros. As the amounts of newly granted loans are lower compared with the amortisation of previously issued loans and loan write-offs, the total household loan portfolio continue to shrink.

	IIQ 2012	IVQ 2012	IIQ 2013	IVQ2013	IIQ 2014	IVQ 2014	IIQ 2015
Financial assets	**6 277**	**6 702**	**6 850**	**7 482**	**7 671**	**8 307**	**8 697**
Deposits	4 136	4 257	4 349	4 820	4 874	5206	5334
Securities and financial instruments	403	559	541	592	426	528	571
Life insurance and private pension funds	395	424	440	474	520	564	604
Pillar II pension funds	1 342	1 462	1 521	1 681	1 851	2009	2188
Liabilities	**7 023**	**6 748**	**6 451**	**6 162**	**5 964**	**5 811**	**5 711**
Mortgage loans	5 547	5 328	5 288	5 055	4 864	4723	4605
Consumer loans	800	770	519	488	506	437	447
Other loans	522	481	486	453	424	463	461
Leasing	154	170	158	166	170	189	198
Net value of financial assets	**-747**	**-46**	**399**	**1 320**	**1 708**	**2 496**	**2 985**

Lithuania

- Increase in average income of the employed. Net average income at the end of the first half of the year made up EUR 554 and was higher by EUR 23 (4.3 per cent) than one year ago. Average number of the employed within a year grew by 29.4 thousand, or by 2.5 per cent. Decreasing unemployment and growing demand for labour force may result in continuing wage growth. An increase in real income of the employed was slightly higher - the general price level was increasing at a slower pace, as compared to average wage. Irrespective of threats of the majority population that after the EUR introduction all prices will go up, the general price level within the period of one year dropped by 0.5 percent in June.

- Stagnation at the start of the year followed by growing consumption. The retail trade turnover indices showing the household consumption, after the growth stagnation in January, continued to rise during other months of the year. For instance, in the second quarter, as compared with the first quarter, the indices obviously improved: retail trade turnover (except of motor vehicles) in constant prices was higher by 14.7 per cent, as compared with the first quarter of the year and by 5.5 per cent higher than a year ago. Foodstuffs turnover improved by 12.8 per cent and by 2.8 per cent, and turnover of non-food products – by 15.1 per cent and 6.5 per cent, respectively. Increasing income, higher expectations for the future and lack of motivation to save should be mentioned as the factors that explain consumption growth. In the near future, the impact of these factors will be also observed.

- Growth in financial assets of households resulting from new inflows into deposit accounts. The total deposit portfolio within the first half of the year 2015 grew by EUR 213 million. Non-term deposits went up by EUR 78 million, and term deposits started to grow in January but continued to fall within other months of the year. However, the overall result remained positive (EUR 66 million).

- Stock market fluctuations made negative effect on the asset value. A successful start to the year in the stock markets was followed by greater fluctuations in the second quarter. Such fluctuations also made effect on financial assets of households. For instance, the above-mentioned fluctuations resulted in decrease in the value of assets in Pillar II Pension Funds accumulated by the Lithuanian households: the average pension funds real return in the second quarter was negative (-2.6 per cent).

- Fluctuations in the stock markets had no impact on long-term savings behaviour of households. Irrespective of current instability in the stock markets, the number of participants in Pillar II Pension Funds continues to rise: at the end of the second quarter, the number of participants reached 1,169 - more by 1.2 per cent, as compared with the previous quarter (participation in Pillar II Pension Funds in Lithuania is voluntary). Fluctuations in the stock markets did not threaten those, who accumulate assets in Pillar III Pension Funds: premiums of private individuals under the unit-linked life insurance agreements in the second quarter amounted to EUR 5 million, or higher by 15 per cent than one year ago or in the first quarter. In the opinion of the SEB Group analysts, such downward trend spreading in the global financial markets is only a temporal phenomenon and may not be deemed to be a long-term trend of decrease in value, therefore if the participants more sensitively respond to negative news and decide to immediately divest, such action would produce non-beneficial consequences for them.

- Since the end of February, the value of all type credit portfolios went up: consumer credits – by EUR 21 million, other credits – EUR 13 million. Currently increasing demand for the mortgage credits might also result from the requirements of the Responsible Lending Regulations to be introduced in November: a shorter credit maturity, the additional requirement to assess the probability of increase in variable interest. After the effective date of the above requirements, i.e. from 1 November the demand for mortgage credits may drop temporarily.

- Consumer loans are gaining a positive attitude of households. Growth of the consumer loan portfolio observed in June, continued its growth in July and it is a rare phenomenon since the year 2009. The portfolio growth lasting for two month was identified only twice: in November–December of 2013 and in April – May of 2014. In July, the value of credit portfolios continued to grow. Improving expectations stimulate the households to obtain credits.

	1H2012	2H2012	1H2013	2H2013	1H2014	2H2014	1H2015
Financial assets	**10 420**	**10 875**	**10 908**	**11 479**	**11 790**	**13 274**	**13 893**
Deposits	7 974	8 322	8 261	8 694	8 744	9 981	10 194
Securities other than shares	345	280	335	306	322	342	362
Investment funds	197	197	211	161	210	227	374
III pillar pension funds and life insurance	623	684	652	747	796	858	919
II pillar pension funds	1 281	1 392	1 449	1 571	1 718	1 866	2 044
Financial obligations	**7 492**	**7 417**	**7 380**	**7 385**	**7 336**	**7 381**	**7 501**
Housing loans	5 892	5 874	5 872	5 892	5 913	5 997	5 988
Consumer loans	677	656	654	661	651	632	656
Other loans	923	888	854	833	773	752	857
Net financial assets	**2 928**	**3 558**	**3 528**	**4 094**	**4 454**	**5 893**	**6 392**

Source: Bank of Lithuania, Lithuanian Bankers' Association.