Lithuanian financial system transformation in the context of globalization

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Abstract:
Purpose: The purpose of the article is to discuss the transformation of the Lithuania finance system in the context of globalization. Exploring the interdependence between the financial system and the economy, in different periods. Analyze the country's financial system transformation after the crisis period.
Methods: Contribution use general scientific methods, especially analysis, synthesis, comparison, induction and deduction. Essential sources of information were professional publications , statistic data of state Statistics Department, Bank of Lithuania, Euro stat.
Scientific aim: Main aim of this article is to analyze the transformation of the Lithuania financial system and fined out the country's economic growth and the financial system correlation, the main factors having a both positive and negative impact on economic growth.
Findings: Findings of this article are new information in this area, which can be useful for another research. The correlation between the banks , loans and GDP. However, this does not apply at the time of the economy fall.
Conclusions: Economic growth in the financial sector and economic development is best visible analyzing in the correlation between the banks , loans and GDP. However, this does not apply at the time of the economy fall. Banks , relative indicators better reflects the weight of the financial sector and the impact on the national economy. We can see that 2011 banks relative indicators dropped to 2006 level. This shows how much the financial sector's contribution decreased to economic development. Banks' loans demand fall down. Lithuania has taken strict fiscal discipline and austerity measures. This have produced results quite quickly, in 2010 GDP grew by 3.4 percent, and in 2011 even 11.5 percent. Lithuania's economy is recovering, but the financial sector and in particular banks still not recovering. The economic crisis has intervened in the banking system and has been surviving until now.

Keywords: The financial system, the banking sector, economic development, globalization.

JEL classification: G14, O16

Introduction

The last decades of the twenty first century brought major changes in the global financial dynamics. The world economic growth is getting slower, the stock markets are falling down and up, global players are crushing. This situation, often called the global financial and economic crisis, creates a new dimension of competition on the markets. In this situation, relevance re-look at the Lithuanian financial system transformation, evolution, structure and perspectives of globalization, the interdependence between the financial system and the country's economic development in the growth and crisis periods. Global change forced the European Union (EU) to review the cornerstones in its economic policy. Information Technology (IT) revolution, the knowledge society development, a political instability and integration trends are common factors which are causing the changes in global finance. Globalization International financial stability encouraged the pursuit of new global economic growth centers. Today's situation in international financial markets, the debt problems increased by countries' monetary and fiscal decisions seeking stabilize the economic recession, (Martinaityte, Kvedaraite, 2011) the effects appear to reflect the complex cross-country relationships and the extent of financial integration. The crisis 2008 has highlighted the impact of globalization on the financial sector. The financial crisis has caused credit-worthiness, liquidity, and the dramatic downturn in equity markets were affected by the essential sectors of the economy. The forecast of world economic trends is made in view of the still continuing high uncertainty in financial markets, therefore changes in any state and the reaction to them must be especially carefully, continuously analyzed and, as far as possible, predicted and controlled in order to prevent overheating or, conversely, its inefficiencies would not hinder the progress of the state. The article research object is the Lithuanian financial sector development in 1995–2012. It analyzes the evolution of the financial sector, the aggregated parts of the structure, examines the interdependency between the financial systems and economic in different periods. Lithuanian banks have become the core of the financial system. There are other financial intermediation (for example: securities market, pension funds, insurance, etc.), it penetrates behind the banks, but their value in the long term must increase. The analysis focused on three financial constituents – the assets, credits and deposits. The analysis of the bank's main indicators and GDP evolution has a goal, set the dependencies, correlations and trends.

Using relative indicators, such as the depth of the financial sector, allow better to study and see the dependencies. Banks' relative indicators better reflects the weight of the financial sector and the impact on the national economy. The financial crisis revealed important shortcomings in financial supervision, it appeared that the existing supervisory measures are insufficient to prevent and overcome the crisis. The analysis of financial system development, was made using published statistical and analytical data of the Bank of Lithuania, the Lithuanian Department of statistics, the European Central Bank, Euro stat, the International Monetary Fund, and the material in various articles.

1. Analysis of the finance system transformation from 1991 to 2000

After the restoration of Lithuania's independence (1990.03.11), we did not have own finance sector, it was necessary to solve the banking dependency issue. All credit resources generated by the Lithuanian banking system needed to be separated from the USSR central banks dependency. State banks functioned as instrument for financing central planed economy sectors. It was one functioning state insurance company. No stocks, no bonds, no leasing, no credit union, no Stock Exchange. It was a few very new (from 1988) and very small commercial banks registered in Soviet Union Central Bank. Knowledge of market economy and finance was very low. Just few specialists in all state can work with foreign payments and foreign exchange.

The Bank of Lithuania, established in March 1990. From 1990 to 1992 when Lithuania was still in the ruble zone, the Bank of Lithuania was not able to pursue an active monetary policy, and its main efforts were aimed at preparing for the introduction of the national currency. In 1992 the temporary currency, was introduced, which allowed the Bank of Lithuania to perform the functions of an independent central bank. The national currency "litas" (LTL) was introduced in 1993, triple-digit inflation was curbed and the exchange rate of the "litas" was stabilized. In July 7, 1992 Republic of Lithuania adopted the Law on Commercial Banks, which provides for a theoretical framework for the banking establishment, operation, reorganization as well as liquidation. However, open the Eastern market, the gap of high inflation led to get huge profits from trading in rubles, vouchers, and other currencies. Banking laws and normative documents were not complete and no one forced to follow them strictly, since the government allowed banks to operate even in the absence of compliance with the baseline requirements. After the banking crisis in 1995–1996, the Bank of Lithuania has taken an important step to strengthen the banking sector control. Until the end 1995 the 15 of the registered 27 Lithuanian banks have collapsed or their activities were suspended due to liquidity problems, or other irregularities. One of the main reasons was the lack of qualifications of bank employees. The banking analysts, risk management professionals shortage of Lithuanian labor market.

From 1995 foreign investors started invest in Lithuania finance system, insurance companies and banks. Foreign capital permanently increased in the banking sector. Scandinavian strategic investors acquired the two largest state banks. Last state bank controls 12 percent of the banking assets in 2002 sold to the German bank Nord LB, now owned by Norwegian investors. Foreign banks first branch opened in 1997, and in 2011 there were 12 branches. Foreign banks increased competition and quality of service. Foreign banks have been providing credit resources to the Lithuanian economy. This accelerated GDP growth. Since 1996 all commercial banks were required to comply with International Accounting Standards and the audit report was carried out by international audit company.

2. Analysis of the finance system transformation from 2000 to 2012

Information technology advances have changed not only the bank's strategy, but also promoted the evolution of the banking system. XXI a. banking system is no longer able to bring such a success for banks, which would bring up to 2000, because the banks to their customers, competitors enables anytime, anywhere in the world just a computer mouse click to perform most of the banking operations. Therefore, it can be said that increasing competition between banks for the creation of such banking operations, which are most convenient to the customer. Popularity of electronic commerce, the rapid development of information and communication technology developments have role in enabling of an increasing number of banks in Lithuania started to provide online banking services in the beginning twenty-first century. Customer capital is considered to be as the key source of competitive advantage in the economy of knowledge (Cabrita and Bontis, 2008) and it is an essential element of structural fund for any kind of company, especially for the know-how companies, which include financial services industry, such as banks, insurance companies.

At present the Bank of Lithuania has licensed eight commercial banks, 12 foreign bank branches and representative offices. In Lithuania, the banks are major part of the financial system. The banking assets consists of 78.97 billion LTL (1 EUR = 3.45 LTL), and was 74.5 per cent of GDP, and more than 80 per cent of the total financial system assets in 2011 (Figure 1).

The Lithuania banks assets, except foreign bank branches, consist of 67 per cent of the total financial system assets. Foreign bank branches have 16 per cent of total financial system assets. Pension funds makes 4 per cent and leasing company makes 6 per cent. Further analysis will concentrate on the development of the banking sector.

In comparison with the EU's old Member States, Lithuania's financial system is very small. The German financial system assets consists of about 322 per cent of GDP, the Belgian – 324% of GDP, in the United Kingdom financial system amount about 550% of GDP, while Lithuania – 90.1% of GDP. Another important indicator of banks' loan-to-GDP ratio, which amounts of about 160% of the EU average, Luxembourg – 255%, Belgium – 242%, Finland – 170%, while in Lithuania, only 51% of GDP, where we need to grow.

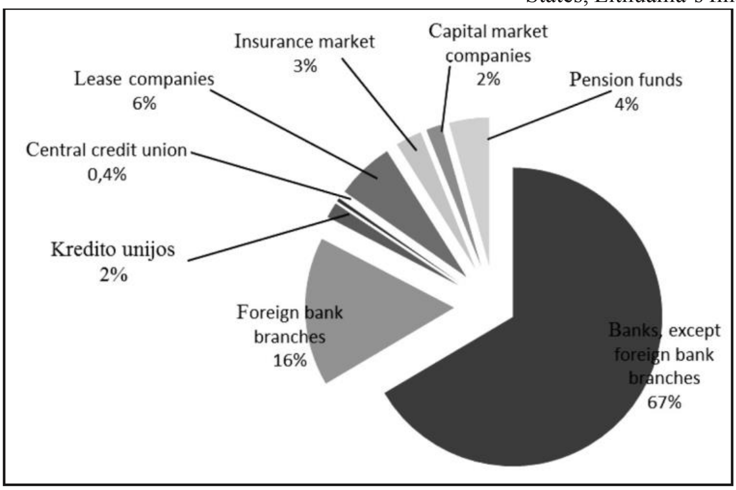

Figure 1. Lithuania financial system structure (at the end of the year 2011). Sources: AB NASDAQ OMX Vilnius, Association of Lithuania's Banks, the Lithuanian Statistics Department, and Bank of Lithuania.

The banking sector is characterized by a high concentration of the three largest banks, which controls about 60 percent of the market. This increases systemic risk, because of the large bank bankruptcy dramatic repercussions for the entire sector and reduce competition.

Financial system for the state, the welfare of the people are constantly studied and analyzed. The existence of developed financial system, which is based on the banking sector as well as its activities are the backbone of state, seeking not only to ensure quality and full life for its citizens, but who wish to successfully compete in global markets(Martinaityte, Kvedaraite, 2011).

Although the earliest scientific studies have not been recognized in the financial system and economic dependence over time as market conditions, economic experts are increasingly began to examine the dependence of these two phenomena, the direction of causality. Today is frequent agreement on the financial system in correlation with the country's economy, but its direction, strength, are still standing is the subject of debate and controversy (Akinlo, Egbetunde, 2010). It is very important to identify the most important financial system functions, analyze their impact on the economy, thus demonstrating that these be made on the basis of the financial system and economic compatibility analysis. Scientists still disagree as to whether financial sector development is a consequence of economic development, or,

Conversely, the financial sector is directly influenced by the country's main macroeconomic indicators (Rioja, Valev, 2004). The question, if the signs of economic growth are reflected on the financial sector due to its rapid development, or, conversely, the potential for economic growth naturally leads the development of new financial services, new financial products, new financial channels (Zsolt, 2000) argued that without an efficient banking sector couldn't be created favorable conditions for economic development. Another studies examined the economic dependence on the financial sector in the long term (Levine, Loayza, Beck, 2000).

The analysis of the bank's main indicators and Gross domestic product (GDP) evolution in 1995–2012 (Figure 2) shows what big changes had Lithuania finance system. GDP has increased four time, banking assets grew ten-fold. Loans increased by fifteen times. The particularly strong growth of GDP and the bank's main indicators since 2004, when

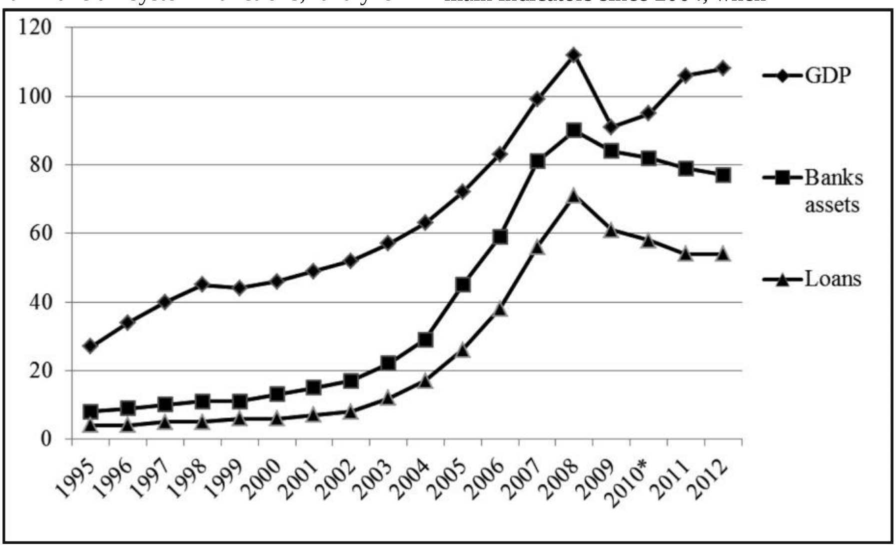

Figure 2. The bank's main indicators and GDP in 1995–2012(billion LTL). (1 EUR = 3.45 LTL).

Sources: Lithuania Statistics Department, Bank of Lithuania, and the author's calculations.

Table 1. The bank's main indicators and GDP in 2005–2011(billion LTL). (1 EUR = 3.45 LTL).

	2005	2006	2007	2008	2009	2010	2011
GDP	72	83	99	112	92	95	106

Banks Assets	45	59	81	90	84	82	79
Assets./GDP	63%	71%	82%	80%	91%	86%	75%
Banks Loans	26	38	56	71	61	58	54
Credit/GDP	36%	46%	57%	63%	66%	61%	51%
Loans R.E.	6.4	10.3	16.7	19	20.3	19.8	19.5
Credit R.E./GDP	9%	12%	17%	17%	22%	21%	18%
Deposits	25	30	37	38	41	45	43
Deposits/GDP	35%	36%	37%	34%	45%	47%	41%
Banks Profit	0.35	0.67	1.16	0.87	–2.98	–0.27	1.11

Sources: Lithuanian Statistics Department, Bank of Lithuania, and the author's calculations.

Lithuania joined the European Union (EU) membership (Figure 2).

The economy decreased during the period 2008–2009, GDP fell sharper than loans. However, the loans declined at the beginning of the economic dynamics in 2010–2011, and the GDP contrary increased.

Deposits with banks grew slower in GDP rise period time and in fall time did not decrease but even increased in 2009 and 2010 (Table 1). It was unexpected for crises time.

Economic growth in the financial sector and economic development causality and causes (Levine, 2000) is very important. It is the best visible, analyzing the correlation between the banks loans and GDP, as claimed (Kendall, 2009), but this does not apply at the time of the fall (Balkevicius, 2012) (Figure 2).

In the autumn of 2008, the Central and Eastern Europe faced a global financial crisis like a fireplace (Aslund, 2011). The new ten European Union (EU) Member States from Eastern Europe faced a huge economic overheating. All new members perceived significantly increased inflation: in Bulgaria, Estonia, Latvia and Lithuania it became double. The financial crisis is already well estimated, it was a great blow on 15 September 2008, and the United States (US) investment bank Lehman Brothers went bankrupt. Suddenly the world decreased financial liquidity, and Eastern Europe faced "sudden stop" – it was left without credit, and liquidity. Although, free monetary policy has been a global phenomenon, so these small and very open economy countries were difficult to prevent.

In 2009, GDP fell by more than 18 per cent, banks granted loans more than 15 per cent (Figure 2).

Lithuania has taken strict fiscal discipline and austerity measures. This have produced results quite quickly, in 2010 GDP grew by 3.4 percent, and in 2011 even 11.5 percent.

Lithuania's economy is recovering, but the financial sector and in particular banks still not recovering. The banking assets continue to decline with the economic growth (Figure2), loans have stabilized. Banks' profitability has returned to pre-crisis level (1.11 billion LTL) (Table 1). But their weight and influence in the economy decreases. This is a cause for concern.

Foreign banks have brought out the credit resources of the Lithuanian economy, which has been led from their parent banks. This has exacerbated the Lithuanian economic recovery. Banking profits quick recovery from the crisis has shown that credit assessment was overly conservative. Banks losses during the crisis due to bad loans were quickly covered. Scientists studying the dependencies use relative indicators, such as the depth of the financial sector (measured by the ratio of credit to GDP). Banks' relative indicators better reflects the weight of the financial sector and the impact on the national economy. We can see that 2011 banks relative indicators dropped to 2006 level (Figure 3). This shows how much the financial sector's contribution decreased to economic development.

Banks do not take it easy this day bank stabilization indicators (assets, deposits, loans), but rather the relative indicators and banks weight loss in Lithuanian economy.

A fall in Bank loans supply and demand, as confirmed by the Bank of Lithuania carried out information for enterprises and banks in the survey in 2012. Banks relative asset curve is similar to deposits

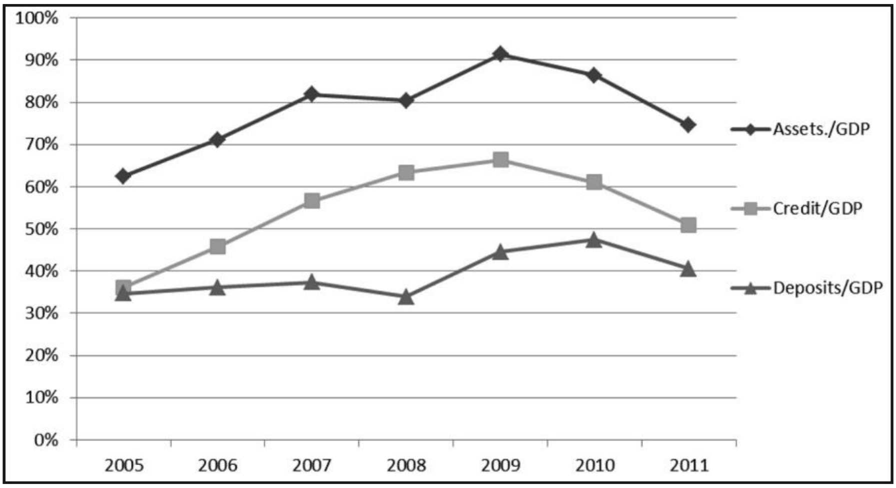

Figure 3. Banks relative indicators (in relation to GDP) change 2005–2011. Sources: Lithuanian Statistics Department, Bank of Lithuania, and the author's calculations.

curve, which shows the relationship, especially in the period 2007–2011m.

Banking analysts have long been talking about the real estate bubble risk, but banks continue to irresponsible lending to construction companies and individuals. Banks' loan portfolio growth was about 50 percent per year and individuals to real estate even more than 60 per cent in 2005, 2007. Rapid growth in the loan portfolio and the Bank of Lithuania had to cause a concern.

Non-financial corporate and commercial banking survey (Bank of Lithuania 2012) show that most of them do not see a need to have the external resources, or borrowing too expensive. Companies that have all the financial needs of the business entirely from internal sources of funding accounted for nearly threequarters of the survey respondents. Improving the performance of non-financial firms, borrowing from banks demand could be constrained because is their business tends to be financed from internal financial resources (the Bank of Lithuania 2012).

3. The financial system Future

Financial sector collapse has given a clear signal about the market economy has changed significantly and the banking industry must take responsibility not only for a profitable business, but also for the banking activities of the possible consequences economy as a whole (Martinaityte, Kvedaraite, 2011).

The financial crisis revealed important shortcomings in financial supervision, it appeared that the existing supervisory measures are insufficient to prevent and overcome the crisis. This problem is considered in both the United States (IMF 2012), and the European Union. Development of new banking regulation and control mechanisms in order to minimize the risks of crisis and limiting individual banking products profitability. It will take time; it appears all of the Euro system's special incentive measures and effects of the gain.

The European Central Bank argues that on May, in 2012 it is very important that the banks would continue to strengthen its resistance to a variety of ways, and limited distributing it for profit (ECB 2012). In order to ensure the proper functioning of credits and a normalization of all sources of financing would be very important for the reliability of banks' balance sheets. It is proposed to limit or restrict guarantee and bond yields (Kuodis 2011).

The Bank of Lithuania, in order to achieve sustainable development in the financial market and for ways to effectively deal with the banks and their users' associations posed problems, was set up Consumer and banking Council and taken to coordinate its activities.

Lithuanian financial sector supervisory authorities transformed into a single supervisory agency the Bank of Lithuania in 2012. Created preconditions for achieving stability in the financial sector and expect a systematic, balanced approach to the financial sector harmonious development. A new monitoring system to ensure the market and its participant's transparency, market integrity and consumer protection – gaining weight.

Conclusion

Lithuania financial sector is very small. At the moment banking sector is the most important. The research results are based on the statistical data from 1995 to 2011 and indicate the financial market situation. Banking assets grew ten-fold. Loans increased by fifteen times.

Economic growth in the financial sector and economic development is best visible analyzing in the correlation between the banks' loans and GDP. However, this does not apply at the time of the economy fall.

Banks' relative indicators better reflects the weight of the financial sector and the impact on the national economy. We can see that 2011 banks relative indicators dropped to 2006 level. This shows how much the financial sector's contribution decreased to economic development.

Banks' loans demand fall down. Non-financial firms, borrowing from banks demand could be constrained because their business tends to be financed from internal financial resources. The confidence level of the banks fell as business partners.

Lithuania has taken strict fiscal discipline and austerity measures. This have produced results quite quickly, in 2010 GDP grew by 3.4 percent, and in 2011 even 11.5 percent. Lithuania's economy is recovering, but the financial sector and in particular banks still not recovering.

The economic crisis has intervened in the banking system and has been surviving until now.

Information technology advances have changed not only the bank's strategy, but also promoted the evolution of the banking system and its human capital. Due to the changes in knowledge economy, the finance specialist's profession competence changes as well.

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