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THE FOREIGN COMMERCIAL BANKS IN THE BALTIC STATES: ASPECTS OF THE FINANCIAL CRISIS INTERNATIONALIZATION

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ABSTRACT

The internationalization practice of financial institutions has been intensively studied since the 1960s. Due to increase in international capital flows, foreign direct investments and international trade at that time active development of international or cross-border banking began. At present the world is undergoing a very complex process with a high uncertainty in the global banking and financial markets. This article focuses on the banking sector development and some aspects of management of commercial banks in the Baltic States. The main subject of the article is comparative analysis of the inwards and outwards development in international banking. The main stress is placed on aggregated credit enlargements in the Baltic States during the first decade of the 21st century. During the last global economic crisis commercial banks have been looking for a possible optimization of activities and consequently changes in their networks could be an option for the assessment of their development. However the priority could be to identify the cross-border international credit expansion in the Baltic countries. On the other hand these activities rely on the countries' macroeconomic indicators, mainly to the accumulated money supply. There is a scientific self-determination described in this paper in line with an analysis of identifying the particular Baltic countries in the dynamics of accumulated deposits and credits of international banks. Subsequently it increased the money supply growth. Nowadays banks are required to make sensible strategic decisions in order to maintain sustainable banking businesses in the future. However influences of the financial institutions to the global economic recession affect international banks creating the negative feedback to their previous problems.

JEL CLASSIFICATION & KEYWORDS

■ F33 ■ G21 ■ G28 ■ K23 ■ International banking ■ Central banks ■ Baltic States ■ Sustainable credit expansion ■ Money supply

INTRODUCTION

In the post-communist transitional countries, international banks have operated only since the beginning of the 1990s, after a significant liberalization of the financial market and elimination of entry barriers. Growing foreign ownership in the banking sector raises several interesting question about the role of foreign banks in transitional economies. There is extensive literature analysing the impact of foreign banks on the stability of less developed banking markets (Dages et al 2000, Buch et al 2003). Studies about the effects of foreign banks in the Baltic transitional region have been mainly descriptive although in the modern economic literature complicated processes with high uncertainty in the global banking and financial markets are generally discussed.

The wave of the financial distress reached Lithuania and its Baltic neighbours also. Moreover, the situation in the financial markets of a small open economy should be seen as one of the country's economic security and even national security factors. The threat to security will become real when commercial banks have liquidity problems; or the central bank opens discussion about the monetary policy change and currency devaluation.

Generally a profit seeking institution, including a commercial bank, is always looking for a solution how to increase its profits, and thus assumes a certain level of risk. Sustainable macro-economic point of view of such activities often does not assess risk in any of the money supply increase and in disproportionate impact for emerging markets. Risk assessment can be compensated for by additional profitability. The more return per unit of risk, the more efficient the credit is. In general, the risk is transferred to everything threatening the country's sustainable economic growth.

The onset of the global financial crisis is often related to problems associated with international banking infrastructure and its impact on the national macro-economic processes. Realizing the real estate prices had underwent a sharp rise, high-value commercial banks created extra money supply, which in certain cases was virtually out of control of the central banks in Lithuania and Latvia.

Internationalization of banks has had several meanings in different periods. Foreign direct investment in credit institution does not mean only financial resources, new technologies, access to markets, but also a greater potential for development, a more reliable risk management and the new added value. Moreover, many economies have so far been dependent on foreign direct investment flows in the field of commercial banking. However, besides positive effects also negative aspects occur; especially because the Baltic countries do not have really independent central banks, as their monetary policy is restricted by currency board arrangements (CBA) (it was also the case in Estonia before 2011). Therefore, countries' dominant commercial banks take over the central bank's role in regulating the money supply and demand. In the absence of a serious interest in the country's macroeconomic stability, the international banks maximize their profits and increase supply of money by widely giving cross-border credit from the funds of the primary banks. Such a scenario has long been expected, but now it may be confirmed by real figures.

Our main research object is internationalization of credit institutions and development of money flows during the economic boom. In addition the object is to analyse the empirical data from the Baltic countries concerning credit expansion that has been based not only on local monetary resources. The last objective is to evaluate the changes in the global cross-border flows of credit in the Baltic States.

Research target: To review foreign banks structure and investment dynamics in the Baltics States after they joined the European Union. To outline a credit institution's infrastructure changes related to their expansion strategies. To overview central banks policies from global and local aspects. To assess the responsibility of the international banks concerning sustainable growth in the new markets on the basis of deposit and loan ratios.

Research methods applied were systematic analysis of statistical data and scientific literature, general and comparative analysis. The research methods analysing more general context fall into three main groups (i) quantitative methods that mainly focus on the theories and assumptions of potential claim (ii) qualitative methods that

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focus on new theories and application of knowledge and (iii) hybrid methods that use both approaches. Quantitative methods are based on the concrete case where the large amounts of banks data are analysis using statistical methods and mathematical adjustments (Spitzlinger, 2006). In this investigation mainly a mixed approach between the two extremes was applied. Comparative analysis between the three Baltic countries is also used.

Contemporary situation in the banking system

Internationalization of banks has had several meanings in different periods. Some authors (e.g., Edwards, 1975) defined multinational banks as ones operating in Euro-markets. Other economists (e.g., Aliber, 1984) suggested that there are quite a few banks that are truly international, the majority of international banks being just domestic banks with branches abroad. Distinction has to be made between the internationalization of a single bank and a whole banking sector of the country (Uiboupin, 2003). Depending on the research approach either the internationalization of a single bank or the internationalization level of the entire banking sector can be of interest. When there is a definition as an internationalization of the banking sector one can distinguish between inward and outward internationalization. The term inward internationalization is used when either foreign institution settle in a place, a country or a region, or when activities in that country or region are mainly expressed in foreign currencies. Outward internationalization can be defined as the establishment of the banking institutions of a given country in other countries (Pintjens, 1994). It is possible to calculate both sides of the internationalization of a given country, proceeding from several criteria.

- The importance of the credit sector in the economy of a country could be measured as a full amount. This can be calculated by dividing the balance sheet total of the whole banking or credit sector by the gross national product of the country. This criterion is not a true indicator of internationalization, but it indicates the size of the financial sector in relation to the economy as a whole. If this rate is high, then there are comparatively few restrictions to banking on the part of the country. This measure, certainly, has its limitations, especially in small and open economies such as Lithuania, Latvia and Estonia. Therefore it is easier to produce the financial volume than goods and services.
- The volume of banking claims in foreign countries. This symbol determines the market share in the world market. The inadequacy of this measure is that banking claims in foreign countries are not the only determinants of the size of international centres. Also non-intermediation that has been very important in recent years has developed at the cost of direct credit granting.
- The share of banking claims in foreign countries to the percentage of total banking claims. This ratio states the degree of openness of the banking sector in a given country.
- Structure of an institution's balance sheet. Here the proportion of international gross positions is taken into the account.
- The quantity of foreign banking institutions. A high number of foreign banks and their branches reflect the importance and attractiveness of a banking market. In the current publication the number of banks and their branches is used as a measure of foreign banks' entry. Moreover this measure is widely used in many empirical studies about the internationalization of banks (Hermes, 2003).
- The share of foreign banks' assets in the total banking market assets. This is a most frequently used measure of banking market internationalization, reflecting the penetration of foreign banks in a country.

All the above criteria measure inward internationalization however outward internationalization can additionally be measured. The importance of the domestic banks in foreign and international financial markets reflects outward internationalization. One possible criterion of the outward internationalization is the number of foreign outlets of banks (Uiboupin, 2003). There could be four levels of the internationalization of the financial services sector (Pintjens, 1994). In the first position, banks act as intermediaries for international payments. This is their traditional function. The second level is attracting liabilities in foreign currencies. This is the internationalization of the liabilities side of a bank's balance sheet leading to credit granting in foreign currencies. The internationalization of the assets side of a bank's balance sheet is the third level. The fourth level is the provision of certain international financial services, such as participation in international bond issues and intermediation of international investments. Moreover globalization of banking can also be characterized as the process of expanding banking activity abroad and replacing the domestic banking business content by international content (Taeho, 1993). In current paper the globalization and internationalization of banks is described as enlargement of banks' movements into foreign markets by setting up controlled units in foreign countries. Thus the cross-border lending is not considered as a form of internalization but only foreign enlargement of a bank that is realized through foreign direct investments. Banks can be illustrated as four dimensional structures. If we refer to the international business activities of banks subsequently the national boundaries become a critical measure which defines the country of origin by which a bank is licensed; the host countries in which the credit institution's facilities are located; the countries in which the bank's clients live; and the national currencies in which the banking services are denominated. Therefore the dimensions of a bank are:

- The parent organization O_i, licensed in country I can be a bank holding company or a commercial bank. A bank holding company is a company which controls at least one bank by its share ownership or its power to elect a majority of members of the bank board;
- The banking facility B_j, located in country j produces banking services. If the banking institution has facilities that produce banking services in two or more countries – it is a multinational bank.
- The customers C_k, of banking services, residing in the country k, may be classified into government units, financial institutions, non-banking business firms and individual households.
- The banking products P_m, denominated in national currency m, can be classified into three categories: asset-based products, liability-based products, and fee-based products.

Consequently international banking contains four dimensions: $\{O_i, B_j, C_k, P_m,\}$. If as a minimum one subscript is different from the rest it is an international banking service. As a result it can be said that purely domestic banking is a special case of international banking – where all the subscripts are the same (Taeho, 1993). However international banking differs from domestic banking. Whereas a bank wants to become international, it has to estimate with international dimensions. Each dimension makes it more complicated to manage the bank efficiently and adds some risks but in a number of positions is useful also:

- Structure difference. A multinational bank has a more complicated structure. It affects personal management, product diversification and accounting problems. Nevertheless its multinational structure may enable the bank to avoid very high-level domestic competition or some regulations which may restrict domestic activity.
- Environment and marketing issues. Countries usually differ significantly from each other, including cultural, legal, well-being and other differences. Therefore it is complicated for a multinational bank to apply the best marketing strategy in different countries.
- Market entry specifics. There are several questions about how a domestic bank can become multinational, for instance, how a bank can run the internationalization process. This topic is also closely related with market entry theories, as well as merger and acquisition techniques. Even in perfect capital markets there are still exist several regulation from monetary authorities who makes it difficult to enter new banking markets.

Currently the financial and banking markets are turning global. It is not easy on the other hand to tell the difference between the globalization and internationalization of banks. When the internationalization could be defined as the process of increasing banking activity abroad and replacing the domestic banking business content by international one, then globalization can be seen as the next stage. The globalization of banking can then be defined as the process in which banking become worldwide in terms of geographical coverage and universal in terms of provision banking services. Geographical coverage implies that there is no longer a single directional meaning from home abroad. The universal provision of banking services presumes the harmonization of banking rules and the removal of barriers so that all banks can participate in all markets. Thus internationalization can be seen as an early stage of globalization. Yet the source suggests that banking cannot become entirely global before the globalization of customers' needs and cultures. Moreover some authors (Berger et al, 2003) concluded that banking industry may never become fully intercontinental. Even if all regulations are coordinated there will remain special products like loans to small medium sized enterprises and relationship lending that will never be global. Probably for retail customers the globalization process will take a long time as their demand for fully standardized service is quite low. So far banks must treat customers in various countries in a different way. This suggests that the expansion of specific banking activity abroad has thus far been more internationalization than globalization. Nevertheless the globalization of wholesale banking tends to grow rapidly. Therefore could be useful to overview ideas explaining reasons for banks' internationalization. At first the internationalization of services sector in general could be discussed. Significant insights into analyses of the specific aspects of the service sector internationalization were given in 1990s (Erramilli, 1990, 1993) who classified internationally traded services into two groups; soft services and hard services, which serve as useful tools in analysing the pattern of internationalization of services. Hard service could be exported in the same way as manufactured goods. Soft services require close contact and physical proximity of producers and consumers (trade, financial services). Businesses producing soft services are typically not able to enter foreign markets by exporting first. The theory of multinational banking was first developed in the 1970s (Grubel, 1977). This theory of international banking is based on the theory of foreign direct investments in manufacturing. Along with this theory multinational banks have some comparative advantages. Banks follow their customers abroad to better serve their domestic clients who have gone out of the country which is called the gravitational pull effect. The internationalization of banking grows in equivalent with foreign direct investments as banks try to meet multinational companies' demand for banking services abroad. Such banks' behaviour of moving abroad is seen as a defensive strategy that is necessary in order to assure continued business with the local primary branches of foreign subsidiaries so that the existing flow of information resulting from the institution-customer relationship will not be obstructed by a competing bank. Moreover a multinational bank can exploit market imperfections in the same methods as non-financial corporation. There are two main positive theories of multinational banking; the eclectic paradigm versus internationalization theory. The theory of internationalization emphasizes the importance of transaction costs in imperfect markets. Therefore a market imperfection is a necessary condition for internationalization. Within the internationalization framework the knowledge advantage of a firm becomes a public good within the firm (Williams, 1997). The application of internationalization theory to banking presupposes the defensive approach of banks. The bank-client relationships are unique and market knowledge about clients can be used at low marginal costs in internal markets. Therefore the motivations for multinational banks to expand abroad are market failures, location particular factors and regulatory differences. As it has been noted there are some other theories that could be subsets in internationalization theory (Williams, 1997). Comparative advantage theory is the application of Heckscher-Ohlin theory to international banking. According to that theory banks with comparative advantage dominate the world market. Banks internalize their advantage through activities of foreign branches and subsidiaries. Moreover multinational wholesale banking theory focuses on the activities of multinational banks in Euro-markets. Multinational banks can offer narrower interest margins spread in Euro-markets due to lower transaction costs in wholesale markets. Horizontal and vertical integration are also used to explain the multinational banking. Horizontal integration provides a possibility for allocation of business-specific knowledge at different markets at lower costs. Vertical integration is considered to be both internationalization and ownership advantage. However the eclectic theory fails to explain vertical and horizontal integration (Williams, 1997). Lately more attention has been paid to the network approach to internationalization since it was established that many companies' international activities are firmly interconnected (Mattsson, 1985). Not least important is a more sociological approach which concentrates on the types of relationships within the network. Banking between banks around the world is shifting from a reciprocal exchange of services to becoming more of a system in which large money-centre banks wholesale products and services to regional banks; which in turn retails them to clients in their markets.

However the internationalization cannot be carried out in service sector in the same ways as in industrial sector. On the other hand in terms of internationalization options services do not deviate radically from goods. The potential modes tend to cluster in three types: (i) exporting, (ii) various contractual models of internationalization, and (iii) various investment type modes of internationalization (Hellman, 1996). Furthermore it has been argued that internationalization may be more risky for a service company than for a manufacturing company. Thus the investment method of internationalization is very important for the banking sector. Outward internationalization follows the investment mode closely as they both are foreign branch offices, establishing new subsidiaries, joint ventures and companies' mergers.

Nowadays the internationalization of banks has been significantly influenced by structural changes in the world trade, the growth of direct investments into foreign countries; the development of European Union and other international institutions aid programs, etc. Historically the oil crisis of 1973 was one of such macroeconomic factors. Because of the crisis, monetary resources began to accumulate (without the intention of exploitation) in the oil exporting countries; while the oil importing countries suffered money shortage due to the deficit in their current account of the balance of payments. The disproportion between the location and demand of money resources gave a powerful boost to the internationalization of banks, which began to set up subsidiaries in the oil countries. Consequently an opportunity was given to drain money from oil producing countries back to the oil importing nations. The recent financial crisis essentially has similarities in money flows as it was in 1970's, i.e., from global importers to global exporters.

Moreover the end of the cold war and the breakdown of the communist system became especially important factors for the internationalization of banks. The Western banks hurry to dominate these emerging markets. Evidently the Baltic States are influenced by this wave also. The latest wave of internationalization of financial institutions is characterized not only by following their existing consumers. The "follow-the-client" rule for banking internationalization is only relevant for small banks. Meanwhile the behaviour of larger banks is influenced by more complex diversification policies. One of the most common explanations for a new pattern of expansion is related to the effects of the increase in banking competition cause by financial deregulation (Berger et al, 2000). As margins and fees are tightened in domestic financial markets banks seek to expand across border to generate higher returns. Thus with banks' net interest margins under downward pressure due to the intensification of banking competition some financial institutions seek to diversify geographically onto markets with a potential to expand in addition to greater net interest margins.

Central bank policy changes

From the macroeconomic opinion, the decade preceding the first signs of the financial crisis in 2007 and its massive spread in 2008 seemed an extremely favourable period in modern history of the world economy (Hrnčir, 2009). Constant and comparatively dynamic economic growth coexisted with low and non-volatile inflation. The outbreak of the financial crisis brought that "golden decade" to an end. With the benefit of hindsight it is clear, however, that the primary causes of the crisis were already built into the "golden" period. More specifically, the long-running successful macroeconomic situation promoted undue satisfaction with the existing trends and led to underestimation of the arising imbalances and implied risks. A situation to bubbles was thus created. This period was simultaneously one of consolidation of changes in monetary policy orientation and in the concept of central banking in general. In that respect, deep changes had been taking place since the late 1970s and early 1980s. The key feature of those changes was an orientation towards price stability as the principal goal of monetary policy. The assurance gained position that price level stability is the most important way in which central banks and monetary policy can contribute to economic development and sustainable growth.

In this period, both central bankers and academic economists seemed to reach a consensus regarding the concept of modern monetary policy – the goal: price stability; the instrument: short-term interest rates. Although short-term interest rates alone have only a modest impact on economic activity, there is a standard assumption that their transmission affects medium- and long-term interest rates, which do have a substantial impact on the economy. When trying to achieve price level stability, central banks follow a specific monetary policy strategy.

Up to the 1990s, the monetary policy strategies applied led to price stability only indirectly, through the use of intermediate targets such as the targeted value of a monetary aggregate or exchange rate. In the last decade, however, an increasing number of central banks have switched to achieving price stability directly, i.e. without intermediate targets, under a monetary policy strategy of inflation targeting. This direct orientation of monetary policy on its final goal, price stability, can be considered a culmination of the growing role that price stability has been playing in the monetary policy of contemporary central banks.

A comparison of central banking and monetary policy during the recent "golden" decade with the 1960s and 1970s reveals that the changes that have taken place are profound indeed. The shift towards price stability as the dominant goal of monetary policy has been accompanied by substantial changes in the role, activities and monetary policy of central banks.

Therefore, in order to ensure financial market stability, an important role is allocated to the supervisory authorities. This key role is given to the national central bank of the country. The central bank is in charge of capital markets, monetary policy consistency, public financial control in commercial banks' activities, while at the currency board model; commercial banks are often partly taken over by the central bank's task (Bennett, 1993, Hanke, 1992). An uncontrolled and unsustainable practice of commercial banks' credit expansion took place in the all Baltic States in years 2003-2008. Loans to businesses and residential portfolio grew from 11 billion litas in 2003 to 66 billion litas in 2008. Therefore deposits grew faster than real gross domestic product (GDP). Above and beyond it is a very significant disproportion. It was a case of the central bank's inactivity. On the other hand central bank should not affect the credit institutions, especially those carrying out the current requirements. Only if a credit institution violates the regulations of the central bank it may be a subject to sanctions (Wihlborg, 2009; Fleming, 1996).

The pressure of the world financial crisis has brought about considerable changes in the competences of central banks and in the nature and instruments of monetary policy. The quantitative reduction policy, the dramatic growth in central banks' balance sheets and the growth in their credit exposures, including to the non-banking sector, to previously unimaginable proportions represents a departure from standard central banking and monetary policy (Hrnčir, 2009). However the Baltic States central banks have less monetary policy instruments because of the currency boards arrangements, but despite it they showed very few efforts to curb sky-rocketing money supply by international banks using cross-border loans.

Empirical Evidence from the International Banks in Baltics

The internationalization of banking in Baltic States is the priority subject of this paper. Comparative analysis is used and efforts are made to classify the over lending problems that arise in commercial credit institutions in the global financial crisis. The scientific problem is to determine how international banking institutions are managing local deposits then cumulating loans with additional foreign credit, which has a real effect on the domestic money supply. The qualified aggregate deposits to loans ratio could be a suitable indicator for the evaluation of the responsibility of credit institutions. In addition, such an overflow of credits could be an indicator of central bank's supervision activities as well as its main function to control the stability of domestic prices. Therefore international banks are operating like central banks as concerns money supply activities. On the other hand real central banks have practically only one monetary policy instrument: setting the required reserves rate for the commercial banks. However, the key factor could be and should be a restriction on the activities of commercial banks to issue loans only in the domestic currency. Reviewing the largest operating international banks in the Baltic States revealed that the major banks in the region are controlled by foreign banks; mainly from Sweden and Denmark.

As it was mentioned, the main feature of the internationalization of banks was a sustainable development in the 1990s. Furthermore, global international banks could be intended for those banks that operate in more than a few countries where the primary bank has branches or departments (Angkinand, 2010). This requires not only having a harmonized legal regulation but a unified terminology and standards in the settled services that could be closely coordinated in the terms of the monetary policy to keep sustainable banking sector. Certainly these strategic objectives and implementation of the guidelines require a methodical and prolonged effort (McCauley, 2002).

The large decline in real activity in many countries could be explained by a decline in the supply of credit while, and the decline in real activity in turn could explain a declining demand for credit. Disagreements among economists about the appropriate response to the crisis reflect differences in opinion about the main source of current problems and the need for adjustment (Østrup, et al, 2009).

The transition from administrative to market economy methods of regulation was a challenge for the central bank and for other credit institutions in the Baltic States. The central bank has no right to interfere in the activities of credit institutions; therefore a directive must be carried out in accordance with laws and maintain credibility. Central bank's procedures should not affect the decisions of credit institutions provided; especially those that concern the prudential requirements. Consequently, adopted amendments to banking law strengthened the supervision of banks. The primary supervisory objective was to train banking controllers, license an inspection system and to ensure the security of funds. Harmonization of banking regulations for the risk control and regulatory domains to common international standards is a critical matter for competitiveness (Cerasi, Chizzolini, 2001).

However an each party should take extra measures to ensure the success of banking and financial stability. For instance it is known that since 1997 the Baltic States have been strengthening existing banks by admitting foreign bank to Lithuanian, Latvian and Estonian markets mainly fulfilled by privatization of banks (Dubauskas, 2004, 2005). Significant growth of foreign capital in the banking sector (Lithuania, Latvia and Estonia) accelerated the integration of the Baltic banks into the global financial system.

Another radical change in behaviour of commercial banks underway since the crisis began in 2008, concerns "bad" loans. These are loans whose payments are delayed for more than 60 days or whose collateral is significantly impaired. In 2009 increased from 4.6 to 19.3 percent of percent of year-end. Banks were forced to make huge provisions for such loans. Throughout the Lithuanian banking system reserves are nearly 4 billion litas. According to Danske bank analysis, this was very risky (Valgreen, 2006). These warnings proved true in those countries.

Further a progress of the banking networks and a deposit/loan ratios are evaluated in the three Baltic States. This first country discussed is Estonia followed by Latvia and Lithuania (Tables 1, 2).

Table 1: Danske“, „Nordea“, „SEB“ and „Swedbank“ Loans in Euro millions

Year	2004	2005	2006	2007	2008	2009	2010
ESTONIA							
Total Sum	5641	7724	11639	15033	16366	9893	9737
Index (year 2004=1)	1	1,37	2,06	2,66	2,9	1,75	1,73
LATVIA							
Total Sum	3679	6450	10653	13696	15262	10378	9387
Index (year 2004=1)	1	1,75	2,9	3,72	4,15	2,82	2,55
LITHUANIA							
Total Sum	4055	6587	9928	14787	17440	13140	11856
Index (year 2004=1)	1	1,62	2,45	3,65	4,3	3,24	2,92

Source: Calculated by the authors from commercial banks' annual reports

According to the size of the loan portfolio Swedbank leads in Estonia with the total amount of 8 billion of euros. Its volume of loans almost tripled from 2004 to the end of 2008. Next comes SEB whose loan portfolio increased significantly every year except in 2008 when the rise was only 1 percent. The loan portfolios of Nordea and Danske banks had similar sizes from year to year with the only contraction in 2008, when Nordea Bank was able to overtake its rival. These loan volumes of two banks have increased more than fourfold from 2004 to the end of 2008. It should be mentioned due to the start-up situation no data were available for the DnB Nord in Estonia during the analysed period. Besides, this bank has quite a small share in the total international banking in Estonia.

In general, the index of the loan portfolio increased from 1 to 2.9 from the year 2004 to 2008 and decreased to 1.73 in

Table 2: Danske“, „Nordea“, „SEB“ and „Swedbank“ Deposits in Euro millions

Year	2004	2005	2006	2007	2008	2009	2010
ESTONIA							
Total Sum	3950	5735	7487	8748	8900	5170	5565
Index (year 2004=1)	1	1,45	1,9	2,21	2,25	1,31	1,41
LATVIA							
Total Sum	2460	3450	4308	5547	5393	9085	8159
Index (year 2004=1)	1	1,4	1,75	2,25	2,19	3,69	3,32
LITHUANIA							
Total Sum	4188	5630	6741	8777	8253	8371	8988
Index (year 2004=1)	1	1,34	1,61	2,1	1,97	2	2,15

Source: Calculated by the authors from commercial banks' annual reports

2010. On the other hand, the index of the deposit rose from 1 to 2.25 from 2004 to 2008; with an obvious decreasing trend in 2009 and 2010 (see table 2). This means that part of the total loan portfolio increase during the economic growth was financed from the outsourced capital inflows.

Analysis of banks in Latvia showed that all evaluated banking networks were also operating in the other Baltic and Nordic countries. The overview of the international banks' subdivisions variation on the yearly basis revealed a negative change in the Swedbank network; where the number of branches decreased by 5 units. However this change occurred in 2008. The same years the number of branches shrunk in the DnB NORD bank network. Other banks showed a growing number of branches in the reviewed years. DnB NORD, Danske Bank and the Nordea Bank increased their banking network annually since 2004.

Nevertheless, Swedbank had a prime position in the size of the loan portfolio in Latvia since 2004. Its loan volume has more than quadrupled and at the end of 2008 amounted to 6 billion of euros. However the loan portfolio decreased in 2009 and 2010. The SEB's loan portfolio was narrowly ahead of the Nordea bank's portfolio in 2008. Besides none of the analysed banks' loan portfolio had decreased in 2008; there was an obvious drop was only in 2009 and 2010.

Analysis of banks' deposit and lending ratios showed that Nordea, DnB NORD and Danske Bank had the lowest ratios. This situation can be easily explained by the fact that these banks receive additional funding for its activities from the primary (mother) banks operating in other countries. However the respective ratios of SEB and Swedbank ranged between 45 to 65 percent because these banks were able to operate without an additional funding.

Overall an index of the loan portfolio has increased from 1 to 4.44 in Latvia from the year 2004 to 2008. On the other hand, the index of the deposit portfolio grew from 1 to 1.95 over the period 2004 - 2008. This means that a larger part of the total loan portfolio growth was financed from the outsourced capital inflows.

Analysis of the banks involved in international banking activities in Lithuania showed that the situation was quite analogous to that in Latvia. The largest bank in Lithuania in terms of the banking network is Swedbank, which increased its number of branches from 2004 to 2007. Even so Swedbank closed eight of its branches in 2008 while other banks were still expanding their branch networks. The Lithuanian division of the DnB NORD bank nearly doubled its branch network and was ahead of the SEB bank in the year 2005. SEB's network increased by 20 units, Nordea Bank's by 14 local subdivisions and Danske bank by 11 subdivisions from 2004 until the end of 2008.

Analysis showed that under the economic growth the credit volume raised SEB to the first place during the years from 2004 till 2008. Moreover, its loan portfolio volume increased fourfold within five years. Swedbank took the second position, with an average annual loan portfolio growth by 44 percent. In general all analysed Lithuanian banks loan portfolios grew very rapidly.

Danske and Nordea banks had the lowest deposits to loan ratios in Lithuania in 2004-2010. This means that these banks required additional funding from their primary (mother) banks. In general that could have been one of the main reasons of the overheating of financial markets in Lithuania as well as in the other Baltic countries. For instance an accumulated loan portfolio for these five biggest banks was 17.4 billion euros when the aggregated deposit of the same banks amounted to only 8.2 billion euros only in 2008. Thus, additional funding from foreign primary banks was 9.2 billion euros. The highest deposit to loan ratio were shown by Swedbank and SEB. On the whole of the loan portfolio increased from 1 to 4.06 in Lithuania from 2004 to 2008 but decreased again to 2.9 by the end of 2010. Alternatively, the index of the deposit portfolio grew from 1 to 2.07 over the period 2004-2008. With some decline in 2009 it continued to increase to 2.1 in 2010. Nevertheless, this means that about a half of the total loan portfolio growth was financed from the outsourced capital inflows.

Conclusion

The changes in central banking in response to the global financial crisis and the related departure from technical monetary policy towards a more radical policy represent a major defining moment and abandonment of the conditions and tendencies of the past decade, although with varying intensities across central banks. These changes occurred under the pressure of the crisis, in an environment where standard monetary policy approaches and instruments had failed or were far less effective. Nevertheless, not many changes occurred in the central banks of the Baltic States, with exception of the Estonian central bank.

A review of the international banking business performance exposed that banks are largest foreign-owned financial intermediaries that support the availability of liquidity for the global sustainable development in the Baltics. The international banking business is quite novel in the Baltics and it acts as a replacement for a local bank which could be characterized by universality.

Analysis of developments in international banking expansion problems revealed that a skyrocketing credit growth was financed not only from the local savings but even in the larger amounts from the cross-border international banks' resources. Summarizing the analysed banking indicators of the Baltic States can say that the lowest credit deposit ratio was in Estonia followed by Lithuania and Latvia during the study period 2004-2010. Nevertheless, the decline of banking network reflecting a possible financial crisis started in Estonia also in 2008. Analysis of network and credit expansion activities in the Baltic States revealed that in all three countries Swedbank played the leading role according to key financial data for the period from 2004 to 2010.

It seems that the main reason of the "overheating" in the Baltic economies could be explained as the uncontrolled additional cross-border money supply for dominating international banks branches in this region. Moreover, in this case the controlling institutions (mainly the central banks) did not act as it is suggested by many monetary expansion theories.

However, the influence of the banks credit expansion on the global financial recession affect banks themselves. The recent decline in activities will generate new consequences in the future. As a result, the growth of credit could be related to available local deposit resources.

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