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Review of the Survey of Risks to Lithuania's Financial System

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Gedimino pr. 6, LT-01103 Vilnius
www.lb.lt

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AIMS, METHODS AND PRINCIPLES OF THE SURVEY

In order to assess the views of Lithuania's financial institutions towards potential challenges to sustainable development of the financial system, the Bank of Lithuania conducts a Survey of Risks to Lithuania's Financial System. The survey is conducted on a biannual basis (in May and November). Banks, insurance undertakings, leasing companies, credit unions, investment management companies and other financial institutions assess the sources of major risks to Lithuania's financial system, the probability of their materialisation and potential impact on the domestic financial system over the upcoming 6 months.

The survey sample included 35 respondents (5 banks and foreign bank branches operating in Lithuania, 7 insurance undertakings, 9 credit unions and 14 other financial institutions, i.e. leasing companies, financial brokerage firms, management companies). The survey questions were presented to the executives of the financial institutions surveyed. All responses were given the same weight, regardless of the market share retained by the respondent. Respondents were able to choose which questions to answer.

OVERVIEW OF THE SURVEY RESULTS

Cyberattacks and imbalances in the real estate (RE) market continued to be the major risks to Lithuania's financial system in the second half of 2019 (see Table 1). Ranked by importance, these risks in Lithuania have dominated for the whole year (see Table 2). In the opinion of the survey participants, the probability of the materialisation of these risks were deemed not only as the highest, but also these risks might potentially have the strongest adverse effect on the market. As assessed by those surveyed, none of the risks' importance decreased over the past half-year. For example, assessment of the importance of five risks remained unchanged, whereas that of seven slightly increased (Table 2).

In the second half-year of 2019, as in the first, the significance of cyber risks to Lithuania's financial system continued to be most noted by banks (see Chart 1). Nevertheless, only four financial institutions claimed having been hit by cyberattacks over the past 6 months, and none of them incurred any losses (see Chart 2). All groups of financial institutions[1], excluding insurance undertakings, considered cyberattacks as the most important risk (risk I in Tale 1). Besides the latter risk, banks, credit unions, and other institutions also highlighted the risk of contraction in exports (risk IV in Table 1). Insurance corporations, as the the most relevant risks to them, mentioned the risks of drop in profitability of Lithuania's financial institutions and a sharp increase in risk premiums (risks XI and III in Table 1). The main internal risks for the country's financial institutions[2], compared to the previous half-year, changed slightly – although this year, as in the one before, the risk of deterioration in financial health of non-financial corporations remained most important, the second main risk became deterioration in household financial health, which was particularly relevant to credit unions (see Chart 3).

According to the majority of respondents, the probability of an event that would have a strong adverse impact on Lithuania's financial system has remained unchanged (see Chart 4). For the third half-year in a row it has been noticed that there is a decrease in those who claim that this likelihood has grown. For example, in the first half of 2019, the number of those claiming that the probability of a high-impact event has grown was around 26%, while in the second half – 23%. Also, for the third consecutive half-year none of the surveyed financial institutions believed that the likelihood decreased. When asked what could have the strongest negative effect on Lithuania's financial system in the upcoming 6 months, financial institutions listed possible external shocks and the related economic slowdown (e.g. Brexit, trade wars, military conflicts). Less frequently, political instability in Lithuania was mentioned, as well as risks due to possible banking shocks in Scandinavian countries. Also mentioned are risks related to cyberattacks, money laundering scandals, external financial market shocks.

In the second half-year of 2019, corporate risk appetite remained stable, yet was smaller than a year ago (see Chart 5). This level is very similar to the one in the previous half-year in all aspects: just one institution indicated that their risk appetite is larger rather than smaller, while there were none claiming that their risk appetite is large. Besides banks, which consider both their own risk level and that of others to be the same, the vast majority of financial institutions participating in the survey consider that their risk appetite is lower compared to other financial institutions (see Chart 6). As much as 4/5 of financial institutions (80%) indicated that their risk appetite should remain unchained over the upcoming 6 months, while slightly more than half of respondents (57%) believe that the risk appetite of other Lithuanian financial institutions will also remain at current levels. The latter indicators remained quite similar, compared to the previous half-year. The situation remains the same when talking also about the opinion of financial market participants regrading their own (15%) and other (31%) institutions' lower propensity to take risks.

According to respondents, possibilities of mitigating the effects of most of the risks to Lithuania's financial system are average or higher than average (see Table 1). The posibility to reduce the impact

[1] Banks, credit unions and other financial institutions.
[2] Financial institutions were asked to identify the key risk that impacts their activities, not Lithuania's financial system.

of the weakening in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system was judged to be the lowest. At the same time, the posibilities to reduce the impact of the risks of unsustainable credit development, the financial health of households, and the contraction in Lithuanian exports are assessed most positively.

KEY CHARTS AND TABLES

Table 1. Assessment of risks to Lithuania's financial system (second half of 2019; total surveyed)

Risk	Im-portance	Probability	Potential impact	Possibilities of mitigat-ing
I. Cyberattacks	3.0	2.9	3.1	2.1
II. Unsustainable RE price developments or imbalances in the RE market	2.9	2.7	3.1	3.0
III. Snapback in risk premia in global financial markets	2.8	2.6	3.0	2.9
IV. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.7	2.5	2.9	2.0
V. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.6	2.4	3.0	2.3
VI. Deterioration in corporate financial health	2.6	2.5	2.8	2.1
VII. Problems in the European banking sector and potential contagion effects on Lithuania	2.6	2.3	2.9	2.7
VIII. Unsustainable credit dynamics or imbalances in the credit market	2.4	2.5	2.4	2.0
IX. Deterioration in household financial health	2.4	2.2	2.7	2.0
X. Weakening European sovereign debt sustainability and potential contagion effects on Lithuania	2.4	2.2	2.7	3.1
XI. Drop in profitability of Lithuania's financial institutions amid a prolonged period of low interest rates	2.4	2.4	2.4	2.5
XII. Geopolitical tensions and implications for Lithuania's financial system	2.2	1.9	2.6	2.6

Notes: Risks were classified according to importance. Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Importance, probability and potential impact: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. Possibilities of mitigating risk: 1 – high; 2 – higher than medium; 3 – medium; 4 – lower than medium; 5 – low. Risks were classified according to importance. The level of risk importance, probability, potential impact and possibilities of mitigation is marked in the following way:

Low Medium High

Source: Bank of Lithuania.

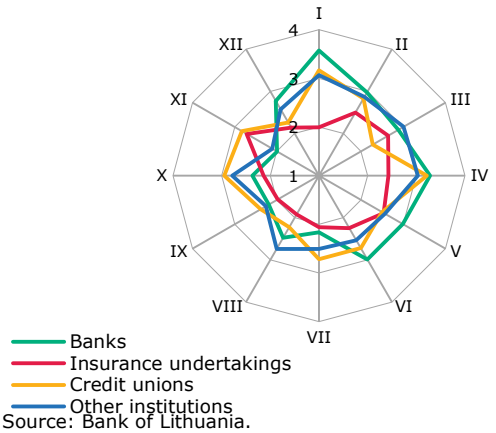
Table 2. Importance dynamics of risks to the financial system (second half of 2019; total surveyed)

Risk	2016	2017		2018		2019	
	II	I	II	I	II	I	II
I. Cyberattacks	2.6	3.0	3.1	3.1	2.8	2.9	3.0
II. Unsustainable RE price developments or imbalances in the RE market	2.7	2.8	2.9	2.7	2.7	2.9	2.9
III. Snapback in risk premia in global financial markets	2.8	2.8	2.7	2.7	3.0	2.7	2.8
IV. Deceleration in Lithuania's exports due to an economic slowdown in main trading partners	2.6	2.3	2.5	2.5	2.5	2.6	2.7
V. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.7	2.5	2.8	2.7	2.5	2.6	2.6
VI. Deterioration in corporate financial health	2.6	2.2	2.6	2.4	2.3	2.5	2.6
VII. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.5	2.4	2.3	2.2	2.4	2.5	2.6
VIII. Unsustainable credit dynamics or imbalances in the credit market	2.2	2.1	2.3	2.3	2.4	2.4	2.4
IX. Deterioration in household financial health	2.4	2.2	2.3	2.3	2.2	2.4	2.4
X. Weakening in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.6	2.4	2.3	2.3	2.7	2.3	2.4
XI. Drop in profitability of Lithuania's financial institutions amid a prolonged period of low interest rates	2.8	2.6	2.5	2.3	2.1	2.3	2.4
XII. Geopolitical tensions and implications for Lithuania's financial system	2.7	2.3	2.5	2.3	2.6	2.2	2.2

Notes: Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Specifics on risks and their level of importance are provided in Table 1. Laikotarpio žymėjimas: "I" means first half-year, "II" – second half-year.

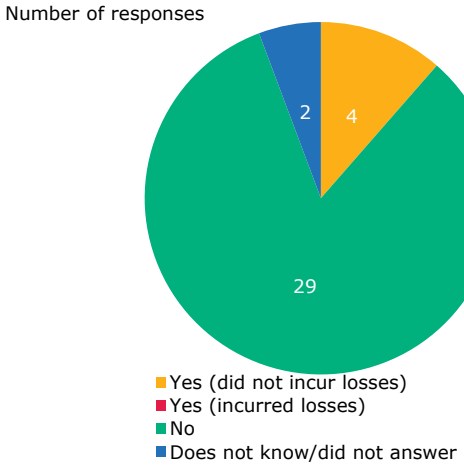
Source: Bank of Lithuania.

Chart 1. Importance of risks to Lithuania's financial system by financial institution sector



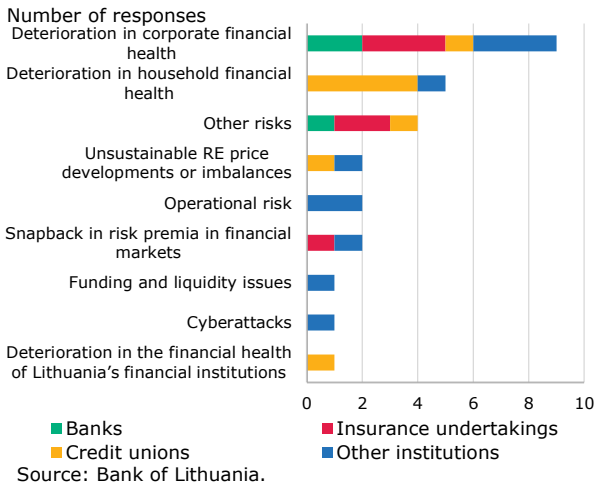
Source: Bank of Lithuania.
Note: Risks are enumerated in line with the risk sources in Table 1; risk importance is calculated as a geometric mean of estimates for its probability and potential impact.

Chart 2. Financial institutions that encountered cyberattacks



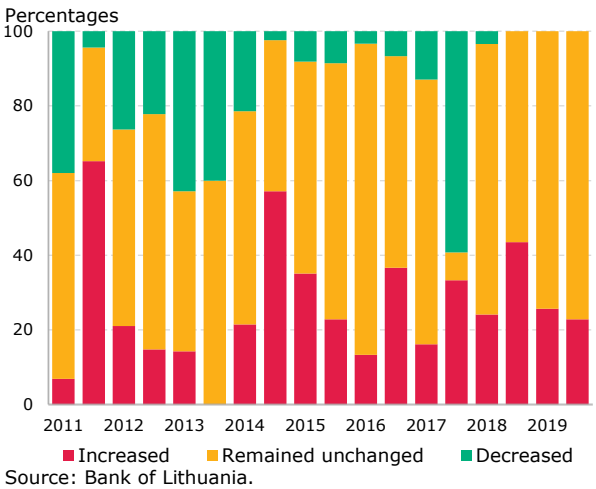
Source: Bank of Lithuania.

Chart 3. Risk importance by financial sector



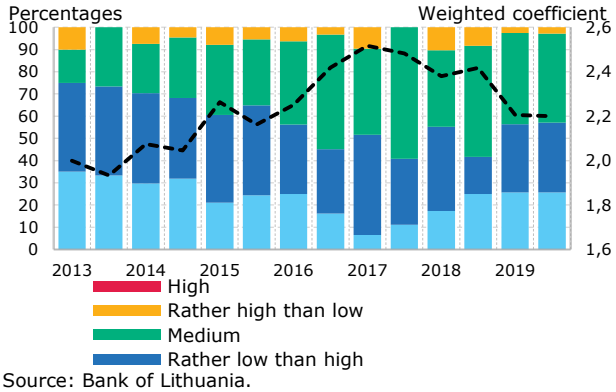
Source: Bank of Lithuania.

Chart 4. Change in the probability of a high-impact event in Lithuania's financial system over the past 6 months



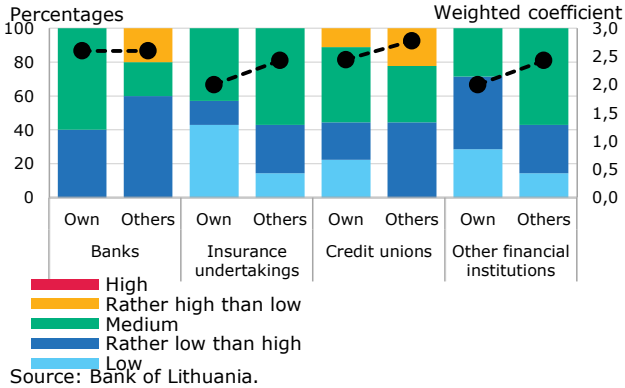
Source: Bank of Lithuania.

Chart 5. Level of own risk appetite (during the survey)



Source: Bank of Lithuania.
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 – high risk appetite) and adding weights to them against the

Chart 6. Level of own and other financial institutions' risk appetite (during the survey)



Source: Bank of Lithuania.
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 – high risk appetite) and adding weights to them against the share of each selected answer.