

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

2021/1

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AIMS, METHODS AND PRINCIPLES OF THE SURVEY

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

The survey sample included 55 respondents (11 banks and foreign bank branches operating in Lithuania, 10 insurance undertakings, 12 credit unions and 22 other financial institutions (leasing companies, financial brokerage firms, management companies). The survey questions were presented to the executives of the financial institutions included in the survey. All responses were given the same weight, regardless of the market share retained by the respondent. Participation in the survey is voluntary, and the respondents are under no obligation to answer any of the questions.

OVERVIEW OF THE SURVEY RESULTS

According to the financial institutions participating in the survey, the main risks to Lithuania's financial system in H1 2021 were related to the unsustainable development of the real estate market and the increase in the cyber crime rate. The importance of risks due to the unsustainable development of real estate prices and potential imbalances in the market were the highest throughout the entire period of the implementation of the survey¹. The importance of the deteriorating financial health of non-financial undertakings, which was considered to represent the largest threat in H2 2020, somewhat decreased (ranking as third most important), yet the risk remained highly relevant to financial institutions, as more than one fourth (28%) of the respondents claimed this risk to be the most important to the institutions they represent.

Banks and other financial institutions² specifically pointed out the risk of unsustainable real estate market developments to the Lithuanian financial system and all institutions, except for credit unions, stressed cyber crime risk (see Chart 1). According to banks and credit unions³, the risk of unsustainable real estate market development (risk A in Table 1) was at the highest level since 2016, while other financial institutions considered cyber crime risk (B) to be historically high⁴. Meanwhile, insurance undertakings did not refer to any of the listed risks as historically high.

According to the respondents in the survey, the possibilities of mitigating the effects of the listed risks to Lithuania's financial system are average or lower (see Table 1). The possibilities of mitigating the effects of geopolitical tensions and deterioration in Lithuanian sovereign debt sustainability were assessed most unfavourably. The respondents were most positive about a possibility to reduce the effects of risks related to cyber crime and the unsustainable credit developments. Although the possibilities of mitigating the effects of cyber crime were assessed favourably in the present, as well as in the previous surveys, nearly one fourth (24%) of the respondents indicated to have been subject to cyber attacks in H1 2021. Instances of cyber attacks are becoming increasingly frequent, and in H1 2021 the numbers were almost three times higher than before the pandemic in H2 2019 (see Chart 2).

Slightly more than half (53%) of the respondents believed that over the past six months the probability of an event with a high adverse impact on Lithuania's financial system did not change, while one third believed such event has become more probable (see Chart 3). 14% of financial institutions claimed the probability of a high-impact event had declined. The respondents feel further developments of the COVID-19 pandemic and its effects (e.g. impairment in corporate and household financial health, lockdown restrictions) are most likely to shock Lithuania's financial system in the upcoming six months. As regards other near-term probable events that pose a threat to Lithuania's financial system, financial institutions also identified the potential growth in inflation and the developments it leads to (e.g. upward interest rate movement) as well as geopolitical tensions in the relationship with Belarus and Russia.

In the course of 2021, financial institutions did not change their risk appetite (see Chart 4). After a decline in H1 2020, risk appetite increased in H2 2020, and currently is at a level similar to that in 2019. All surveyed financial institutions believed they were less risk prone than the other financial institutions (see Chart 5). In addition, nine out of ten (89%) financial institutions indicated their risk appetite would not change in the upcoming six months. A slightly smaller portion of the respondents (80%) were of an opinion that the risk appetite of other Lithuanian financial institutions would also not change.

¹ The question on the sustainability of the development of real estate market was included in the survey for the first time in H2 2014.

² Financial institutions, except for banks, insurance undertakings, and credit unions.

³ The estimate of the importance of unsustainable development of the real estate market is somewhat smaller according to credit unions as compared to the assessment by banks and other financial institutions.

⁴ No information on the type of the respondents' financial institution was collected in previous surveys.

Just like in previous surveys financial institutions believed that the catering and hospitality sector remained most vulnerable to corporate bankruptcy risk (see Chart 6). Arts and transportation sectors are assessed as high-risk, although the level of risk of these activities has decreased the most over the past six months. As six months ago, the surveyed financial institutions still regard the risk of bankruptcy to be the lowest for enterprises operating in the agricultural sector as well as in the information and communication sector. Still, compared to H2 2020, the risk of bankruptcy has slightly increased in the agricultural sector, as well as in the construction sector. In addition to the already mentioned arts and transportation activities, the risk of bankruptcy also declined in the administrative and other services sectors, according to financial institutions.

The effect of the COVID-19 pandemic on the surveyed financial institutions has declined (see Chart 7). As a result of the pandemic, the profitability of 18% of the respondents dropped over the past six months, half of the respective numbers in H2 2020 (40%). Furthermore, the share of enterprises showing higher profitability has increased by 2.5 p.p. (to 16%). About 10% of financial institutions claimed that over the past six months they were not affected at all by the pandemic.

The majority (60%) of the surveyed financial institutions predict higher losses to be incurred in the future because of increased instances of corporate insolvencies (see Chart 8). Nearly one fifth (18%) of the financial institutions project their losses will increase over the upcoming 12 months as a result of corporate insolvencies. Another 18% of financial institutions expect greater losses over the next 12-24 months, and as many as 24% expect greater losses over the next 24 months and beyond. The remaining portion of the respondents (40%) did not agree that the risk of corporate insolvencies has increased.

KEY TABLES AND CHARTS

Table 1. Assessment of risks to Lithuania's financial system (first half of 2021; total surveyed)

Risk	Importance	Probability	Potential impact	Mitigation possibilities
A. Unsustainable development of real estate prices or imbalances in the real estate market	3.3	3.3	3.3	3.1
B. Cyber crime risk	3.1	3.2	3.0	2.7
C. Deterioration in corporate financial health	2.9	2.8	3.0	3.4
D. Snapback in risk premia in global financial markets	2.7	2.6	2.7	3.9
E. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.6	2.5	2.8	3.9
F. Deterioration in household financial health	2.6	2.4	2.8	3.5
G. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.6	2.4	2.8	4.0
H. Unsustainable credit dynamics or imbalances in the credit market	2.5	2.2	2.9	2.9
I. Geopolitical tensions and their implications for Lithuania's financial system	2.4	2.4	2.4	4.3
J. Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.4	2.4	2.3	3.8
K. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.3	2.0	2.7	4.1
L. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.3	2.1	2.5	4.0
M. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.2	2.1	2.4	3.8

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 for mitigating risk: 1 – high; 2 – higher than medium; 3 – medium; 4 – lower than medium; 5 – low. The level of risk importance, probability, potential impact and possibilities for mitigation is marked in the following way:

■ low ■ medium ■ high

Source: Bank of Lithuania.

Table 2. Importance dynamics of risks to the financial system (first half of 2021; total surveyed)

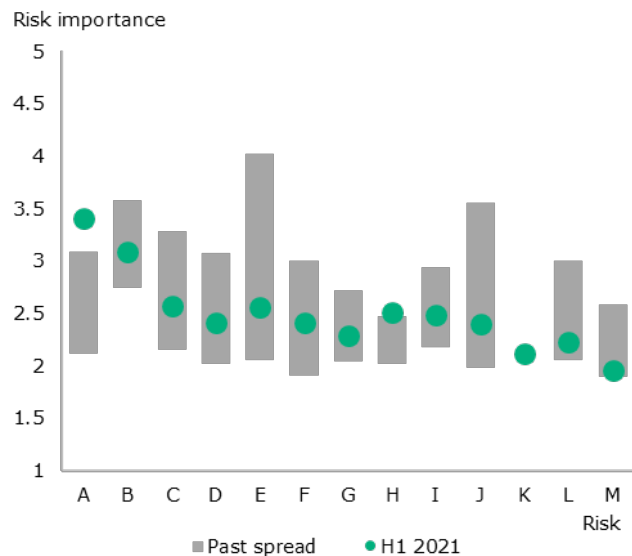
Risk	2017		2018		2019		2020		2021
	I	II	I	II	I	II	I	II	I
A. Unsustainable development of real estate prices or imbalances in the real estate market	2.8	2.9	2.7	2.7	2.9	2.9	2.7	2.5	3.3
B. Cyber crime risk	3	3.1	3.1	2.8	2.9	3	2.8	2.8	3.1
C. Deterioration in corporate financial health	2.2	2.6	2.4	2.3	2.5	2.6	3.4	3.6	2.9
D. Snapback in risk premia in global financial markets	2.8	2.7	2.7	3	2.7	2.8	3.2	2.8	2.7
E. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.3	2.5	2.5	2.5	2.6	2.7	3.7	3.2	2.6
F. Deterioration in household financial health	2.2	2.3	2.3	2.2	2.4	2.4	3.2	3.3	2.6
G. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.4	2.3	2.3	2.7	2.3	2.4	3	2.8	2.6
H. Unsustainable credit dynamics or imbalances in the credit market	2.1	2.3	2.3	2.4	2.4	2.4	2.7	2.3	2.5
I. Geopolitical tensions and their implications for Lithuania's financial system	2.3	2.5	2.3	2.6	2.2	2.2	2.3	2.2	2.4
J. Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.6	2.5	2.3	2.1	2.3	2.4	2.3	2.6	2.4
K. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system								2.6	2.3
L. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.5	2.8	2.7	2.5	2.6	2.6	2.6	2.3	2.3
M. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.4	2.3	2.2	2.4	2.5	2.6	2.5	2.3	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. "I" means first half-year, "II" – second half-year.

Source: Bank of Lithuania.

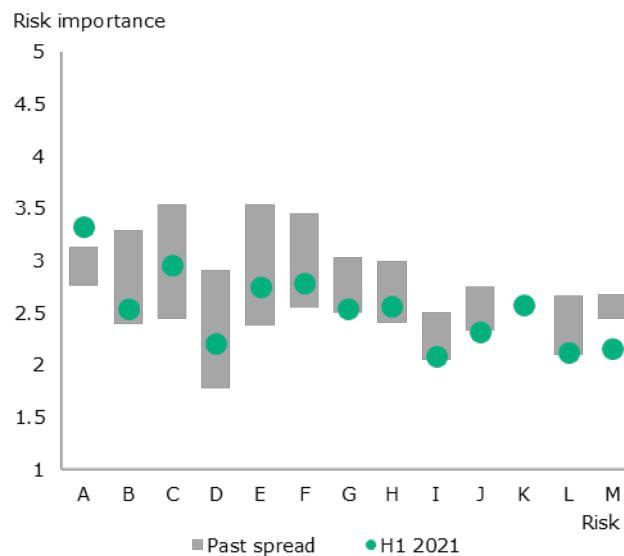
Chart 1. Risk importance by financial sector

Assessment of the importance of risks to banks



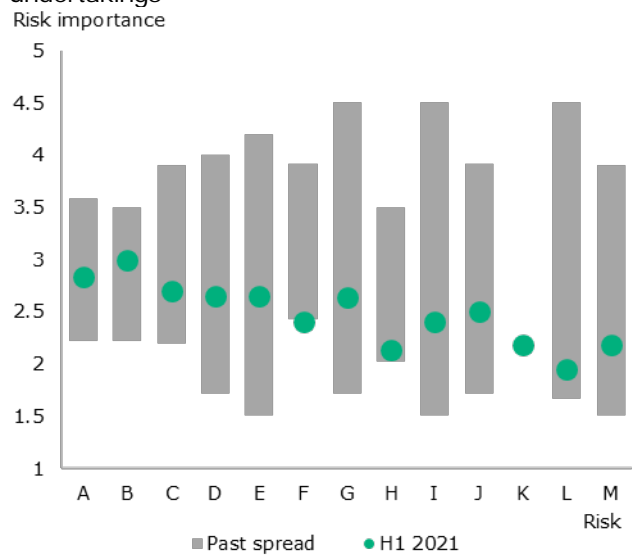
Source: Bank of Lithuania.

Assessment of the importance of risks to credit unions



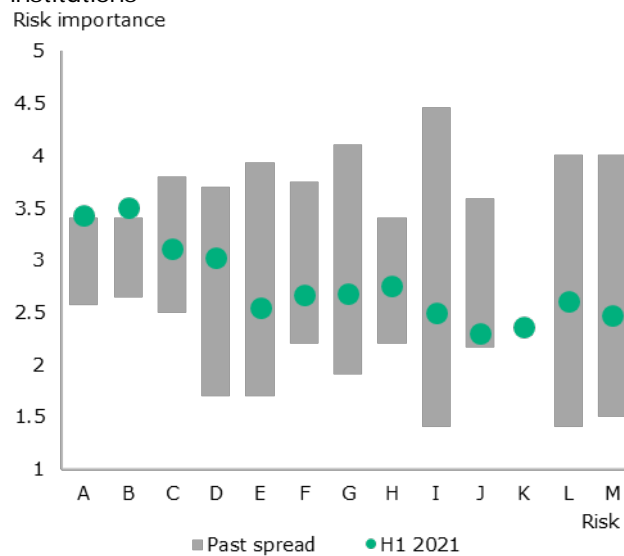
Source: Bank of Lithuania.

Assessment of the importance of risks to insurance undertakings



Source: Bank of Lithuania.

Assessment of the importance of risks to other financial institutions

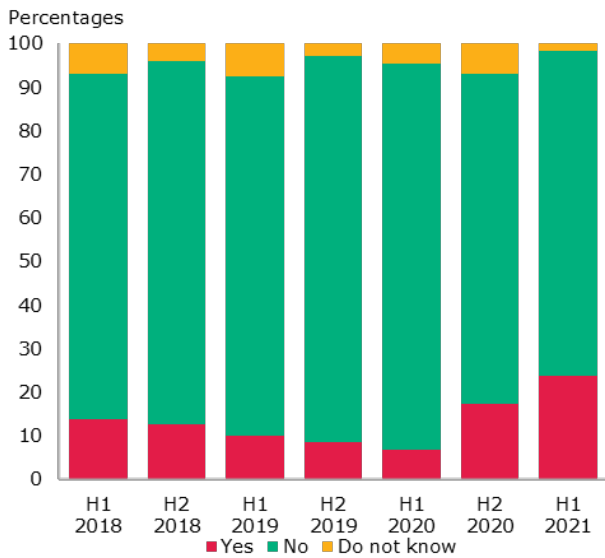


Source: Bank of Lithuania.

Notes: Risks are named in line with the risk sources in Tables 1 and 2. Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Assessment of the level of risk importance: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. The grey colour marks dissemination between the lowest and highest risk values among the responding financial institutions of that type in the surveys of risks from H1 2016 to H2 2020.

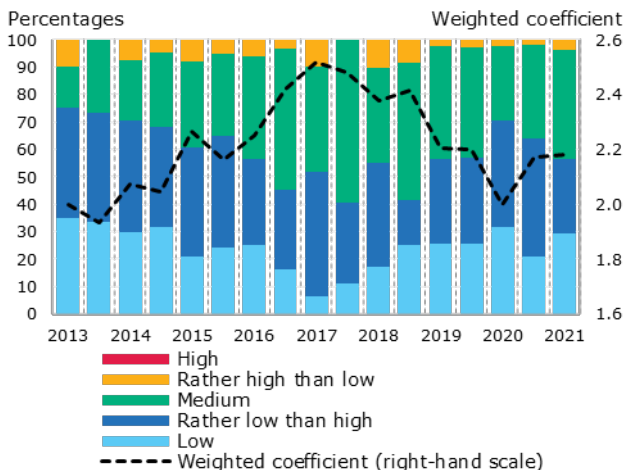
Source: Bank of Lithuania.

Chart 2. Change in the share of financial institutions affected by cyber attacks



Source: Bank of Lithuania.

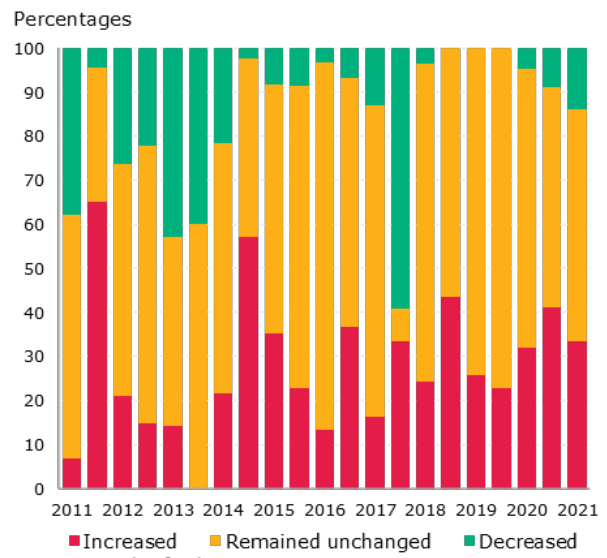
Chart 4. Level of own risk appetite (during the survey)



Source: Bank of Lithuania.

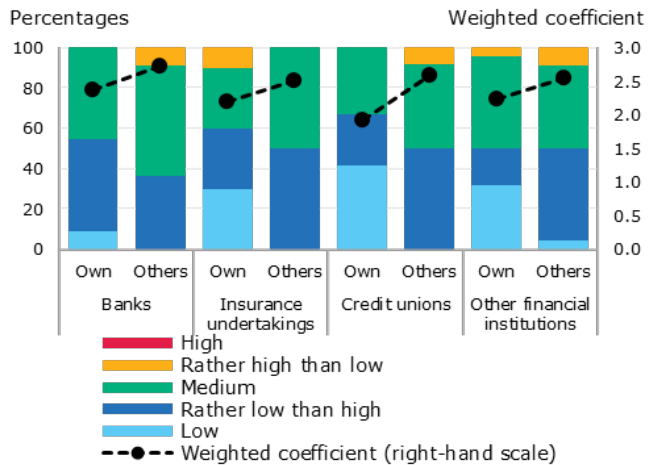
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 is high risk appetite) and adding weights to them against the share of each selected answer.

Chart 3. Change in the probability of a high-impact event in Lithuania's financial system over the past 6 months



Source: Bank of Lithuania.

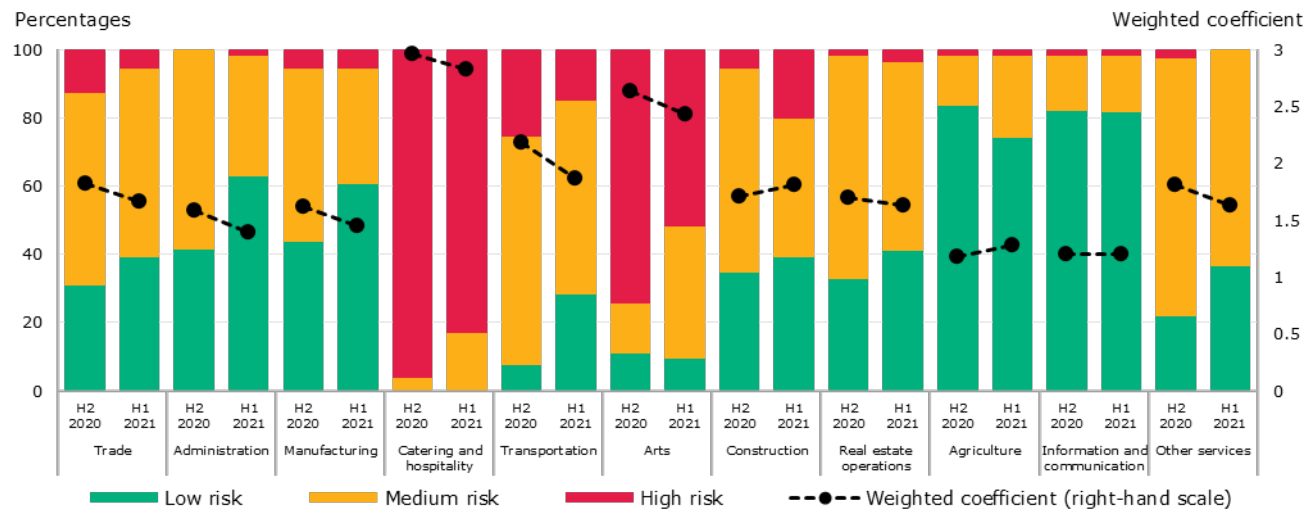
Chart 5. Level of own and other financial institutions' risk appetite (during the survey)



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 is high risk appetite) and adding weights to them against the share of each selected answer.

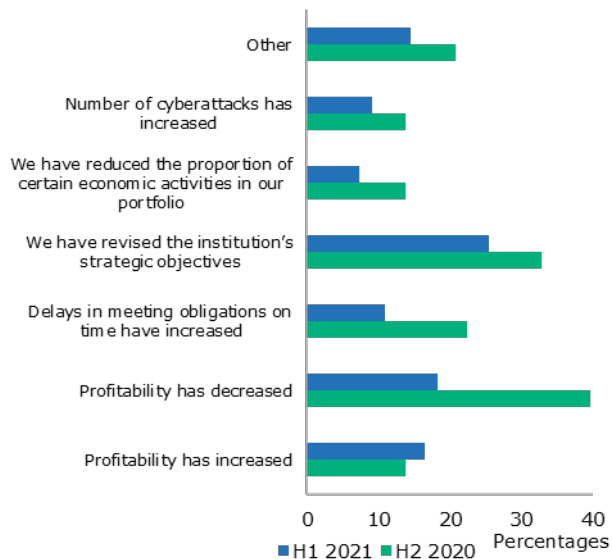
Chart 6. Change in corporate bankruptcy risk by sector



Source: Bank of Lithuania

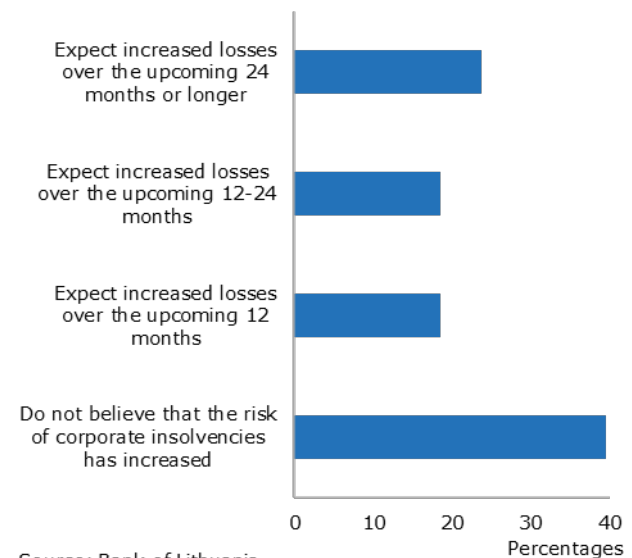
Note: The weighted coefficient is calculated by giving numerical values to perceived risk levels from 1 to 5 (where 1 is low and 5 is high perceived risk and adding weights to them against the share of each selected answer.

Chart 7. Share of financial institutions impacted by the indicated effect of the COVID-19 pandemic (several answers are possible)



Source: Bank of Lithuania.

Chart 8. Expectations of financial institutions concerning higher losses in the future due to increased corporate insolvency



Source: Bank of Lithuania.