



LIETUVOS BANKAS
EUROSISTEMA

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

2022/1

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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 59 respondents (13 banks and foreign bank branches operating in Lithuania, 11 insurance undertakings, 10 credit unions and 25 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.

SUMMARY

In the first half of 2022, financial institutions identified geopolitical tensions and the risk of a slowdown in Lithuania's economic growth as the key risks to Lithuania's financial system. Geopolitical tensions were also ranked as the most pressing risk for financial institutions themselves, with almost 80% of institutions feeling the impact of Russia's war against Ukraine. The majority of the financial institutions believe that the probability of a major event with an adverse impact on Lithuania's financial system has increased over the past six months. The share of financial institutions anticipating higher losses due to increased corporate insolvencies has also grown, with the highest risk of insolvency seen in construction and transport activities.

OVERVIEW OF SURVEY RESULTS

According to the surveyed financial institutions, geopolitical tensions and a possible slowdown in Lithuania's economic growth were the key risks to Lithuania's financial system in the first half of 2022 (see Table 1). The increase in the importance of these risks is due to the outbreak of Russia's war against Ukraine, rapidly rising inflation and the potential impact of a slowdown in other economies on Lithuania's economy. These factors also lead to a significant increase in the importance of some other risks, such as cyber-attacks, the fall in Lithuania's exports, and the risk of deterioration in the financial situation of non-financial corporations and households. All financial institutions ranked geopolitical risk as the key risk to Lithuania's financial system at the present (see Chart 1). Banks and credit unions rated the risk as historically high, while insurance undertakings and other institutions assessed the risk to be currently lower than the historical peak in 2016. The assessment of unsustainable real estate (RE) price developments, which was identified as the key risk six months ago, has not changed significantly. But with the previously mentioned risks increasing, the relevance of a possible overheating of the RE market has decreased, according to the assessment of financial institutions.

Geopolitical tensions were the most frequently cited risk for the institutions represented by the respondents over the next six months. As many as 39% of respondents reported this risk. The risk of a possible slowdown in Lithuania's economic growth was identified by 19% of respondents, while the risk of deterioration in the financial situation of households was reported by 12% of respondents.

The majority of financial institutions surveyed are feeling the impact of Russia's war against Ukraine (see Chart 2). 30% of respondents indicated that the war had reduced the demand for products offered by the institutions. Almost a quarter (24%) of respondents have seen a decline in profitability, while 22% of institutions have reviewed their strategic objectives. 22% of respondents said they had not been affected by the war.

According to the respondents, the opportunities to mitigate the impact of the listed risks on Lithuania's financial system are mostly average or below average, with possibilities to mitigate the risk of cyber-attacks being rated the best. The most unfavourably rated is the ability to mitigate the risks posed by geopolitical tensions. The possibilities to mitigate the risks of deterioration in debt sustainability of Lithuania and other European countries, imbalances in the Scandinavian countries and climate change are also viewed unfavourably, but the importance of these risks is assessed as relatively lower. Like six months ago, the opportunities to reduce the risk of cyber-attacks are rated best. In the first half of 2022, 17% of respondents experienced cyber-attacks, a proportion that has not changed significantly over the past six months (see Chart 3). In addition, financial institutions have been relatively positive about the possibilities to mitigate the impact of risks from unsustainable credit developments and unsustainable real estate market developments.

Almost all respondents (93%) said that the likelihood of an event with a significant adverse impact on Lithuania's financial system occurring in the near future had increased over the six-month period (see Chart 4). This is the highest share of respondents during the entire period of the survey. That the probability of such an event occurring has remained the same over the past six months reported 5%, and that it has decreased - 2% of financial institutions. The respondents believe that the most likely shock to Lithuania's

financial system in the next 6 months is the deterioration in the geopolitical situation depending on further developments in Russia's war against Ukraine. Financial institutions have also identified prolonged high inflation, a slowdown in economic growth, and rising interest rates as possible developments.

The level of risk appetite among financial institutions increased in the first half of 2022 (see Chart 5). It is currently similar to its peak in 2017. It should be noted that, although the level of risk-taking is increasing, it is perceived by financial institutions as below average. Financial institutions consider that the level of risk they themselves are willing to take is lower than that of other financial institutions (see Chart 6). Credit unions are willing to take on the highest level of risk. The majority (69%) of financial institutions say that their own risk appetite will remain unchanged over the next six months, while a quarter believe it will decrease. More than half (59%) of institutions are of the opinion that the risk appetite of other Lithuanian financial institutions will remain unchanged, while one third (34%) believe that it will decrease.

The share of financial institutions anticipating higher losses due to increased corporate insolvencies grew significantly over the half-year (see Chart 7). As the impact of the pandemic faded, expected losses due to the increased likelihood of corporate insolvencies declined, but as a result of the outbreak of Russia's war against Ukraine and the uncertainty about the future development of the economy, financial institutions are again expecting higher losses, with 40% of respondents expecting them over the next 12 months, triple the share of the same period six months ago. 19% of financial institutions expect increased losses in the next 12-24 months and 9% in the next 24 months and beyond. A third (32%) of the surveyed institutions do not think that the probability of corporate insolvencies has increased, compared to 72% six months ago.

The financial institutions surveyed see the highest risk of bankruptcy in construction and transport activities (see Chart 8). The expected risk of bankruptcy for companies engaged in the aforementioned and manufacturing activities increased the most over the half-year. The most significant decreases were perceived in the risk of bankruptcy of companies in the accommodation and catering sector, as well as in the creative, arts and entertainment sectors. Firms in the information and communication, administration and agricultural activities have the lowest perceived risk of bankruptcy.

Half of the financial institutions surveyed face challenges from the development of fintech companies in Lithuania (see Chart 9). Just over a third (36%) of respondents indicated that the growth of fintech companies increases competitive pressure. Almost a quarter (24%) of financial institutions indicate the risk of money laundering and terrorist financing is increasing. Half of the respondents (51%) do not find that the development of fintech companies poses challenges.

KEY TABLES AND CHARTS

Table 1. Assessment of risks to Lithuania's financial system (first half of 2022)

Risk	Importance	Probability	Potential impact	Mitigation possibilities
A. Geopolitical tensions and their implications for Lithuania's financial system	3.8	4.0	3.6	4.0
B. Risk of a slowdown in Lithuania's economic growth	3.6	3.8	3.5	3.7
C. Cyber-attack risk	3.4	3.6	3.2	2.5
D. Deceleration in Lithuania's exports	3.3	3.5	3.1	3.7
E. Deterioration in corporate financial health	3.3	3.4	3.2	3.4
F. Deterioration in household financial health	3.2	3.4	3.1	3.5
G. Snapback in risk premia in global financial markets	3.2	3.5	3.0	3.8
H. Unsustainable development of real estate prices or imbalances in the real estate market	3.2	3.3	3.1	3.1
I. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.9	2.8	2.9	3.9
J. Shrinking profitability of Lithuanian financial institutions due to rising interest rates	2.7	2.8	2.5	3.2
K. Unsustainable credit dynamics or imbalances in the credit market	2.6	2.4	2.9	2.7
L. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.5	2.3	2.8	3.9
M. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.4	2.3	2.4	3.9
N. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.3	2.3	2.4	3.8
O. Climate change risk	2.2	2.3	2.1	3.9

Source: Bank of Lithuania.

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

Table 2. Importance dynamics of risks to the financial system

Risk	2017		2018		2019		2020		2021		2022
	I	II	I	II	I	II	I	II	I	II	I
A. 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	2.7	3.8*
B. Risk of a slowdown in Lithuania's economic growth											3.6
C. Cyber-attack risk	3	3.1	3.1	2.8	2.9	3	2.8	2.8	3.1	2.9	3.4*
D. Deceleration in Lithuania's exports	2.3	2.5	2.5	2.5	2.6	2.7	3.7	3.2	2.6	2.6	3.3*
E. Deterioration in corporate financial health	2.2	2.6	2.4	2.3	2.5	2.6	3.4	3.6	2.9	2.7	3.3*
F. Deterioration in household financial health	2.2	2.3	2.3	2.2	2.4	2.4	3.2	3.3	2.6	2.5	3.2*
G. 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	2.8	3.2*
H. 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	3.2	3.2
I. 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	2.3	2.9*
J. Shrinking profitability of Lithuanian financial institutions due to rising interest rates											2.7
K. 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	2.5	2.6
L. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system								2.6	2.3	2.2	2.5*
M. 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	2.3	2.4
N. 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	2.2	2.3
O. Climate change risk										2.1	2.2

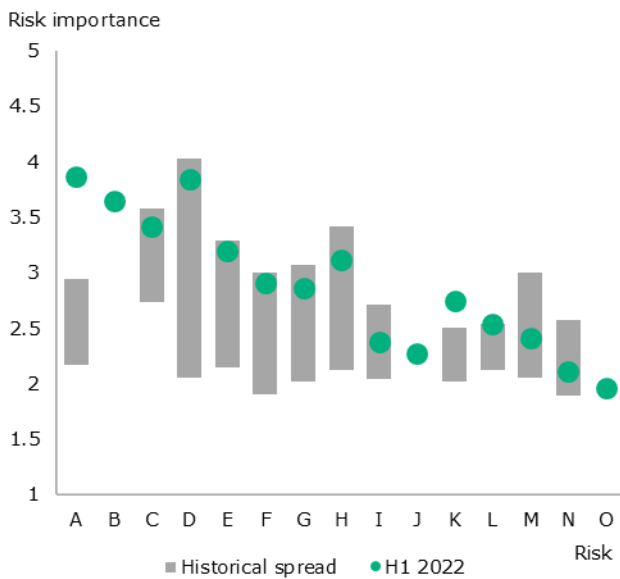
Source: Bank of Lithuania.

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.

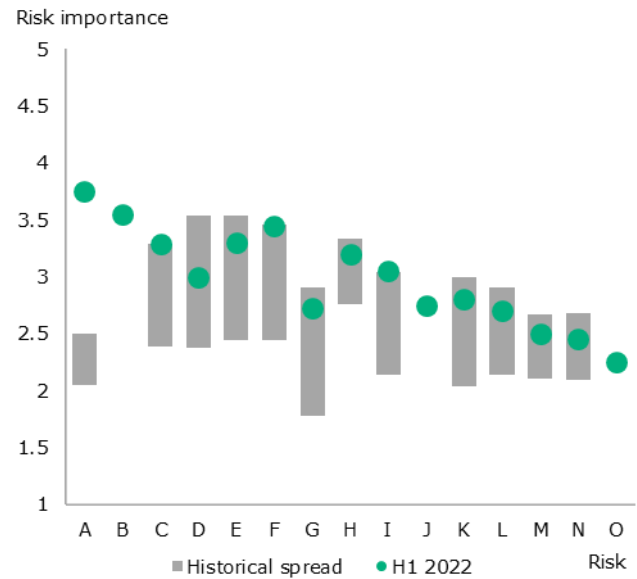
* Change in risk importance over the half-year is significant. A change is considered to be significant if risk importance decreases by 0.25 or more over six months, i.e. the risk has moved to a higher or lower importance assessment level by a quarter of a point. Significance only shown for the latest values.

Chart 1. Risk importance by financial sector

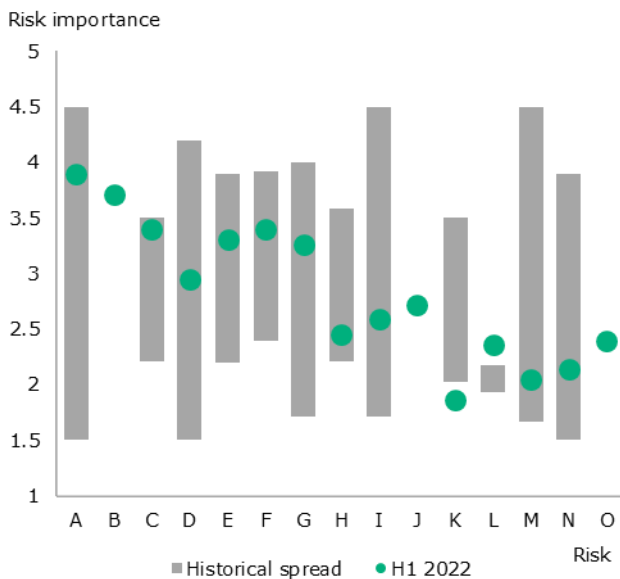
Assessment of the importance of risks to banks



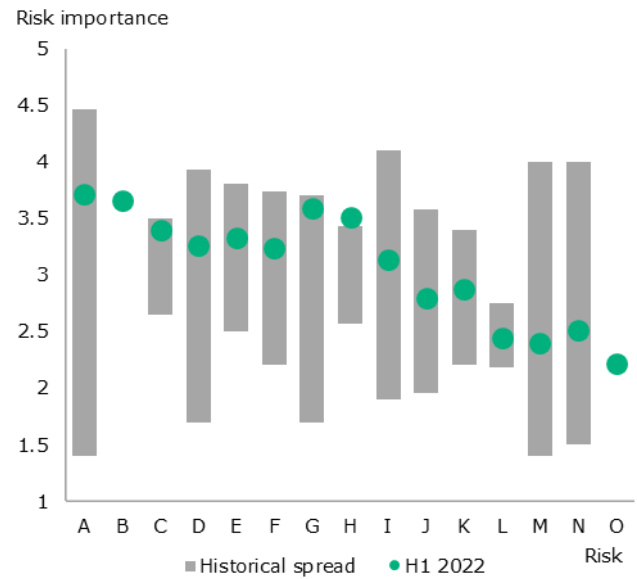
Assessment of the importance of risks to credit unions



Assessment of the importance of risks to insurance undertakings



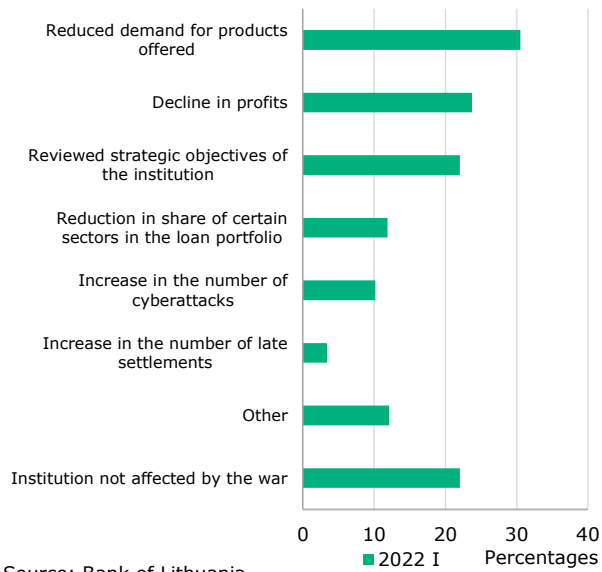
Assessment of the importance of risks to other financial institutions



Source: Bank of Lithuania.

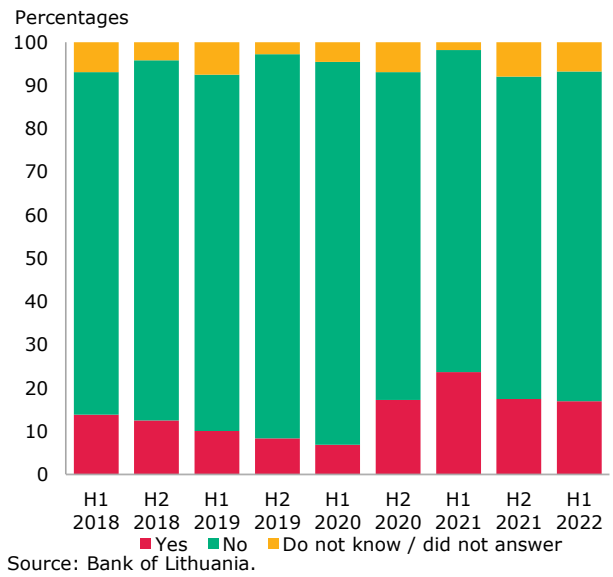
Notes: Risks are named in line with the risk sources in Tables 1 and 2. Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Assessment of the level of risk importance: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. The 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 2021.

Chart 2. Share of financial institutions that feel the impact of Russia's war against Ukraine (multiple answers possible)



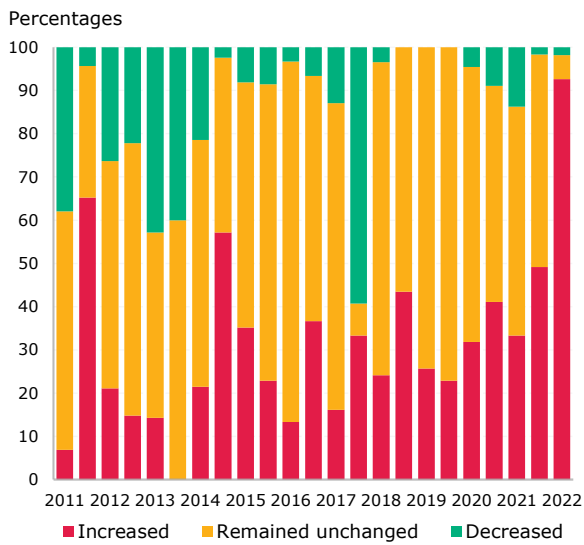
Source: Bank of Lithuania.

Chart 3. Change in the share of financial institutions affected by cyber-attacks



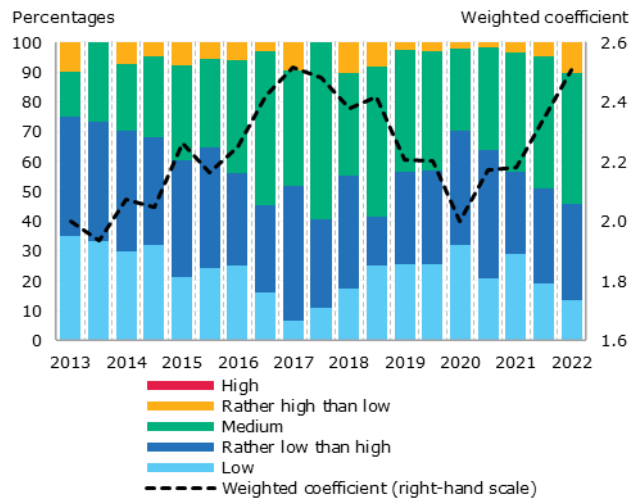
Source: Bank of Lithuania.

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.

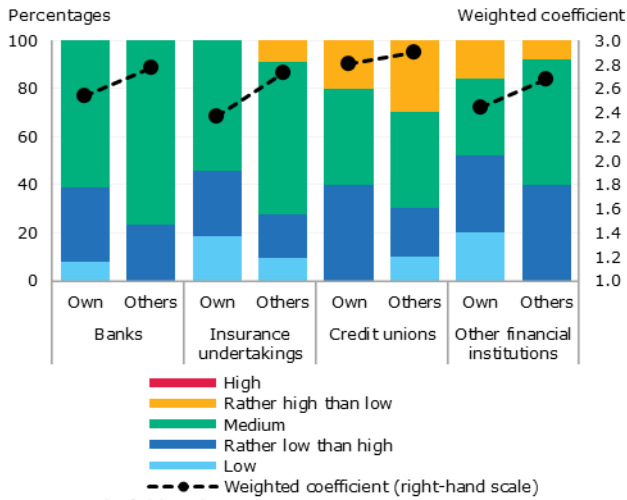
Chart 5. Level of own risk appetite (during the survey)



Source: Bank of Lithuania.

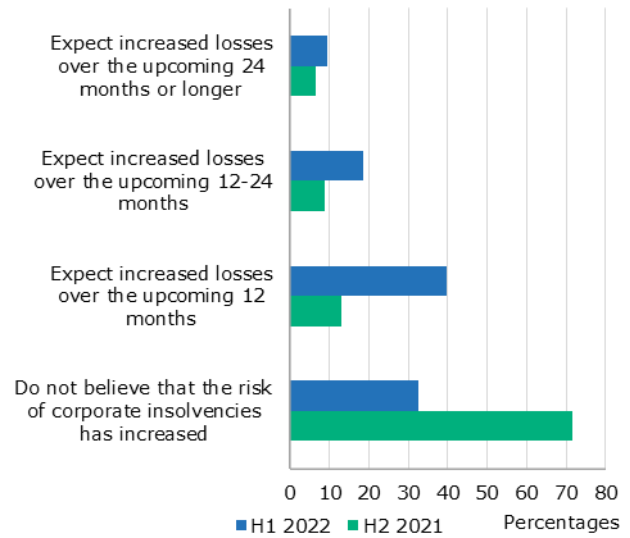
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 is high risk appetite) and adding weights to them against the share of each selected answer.

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



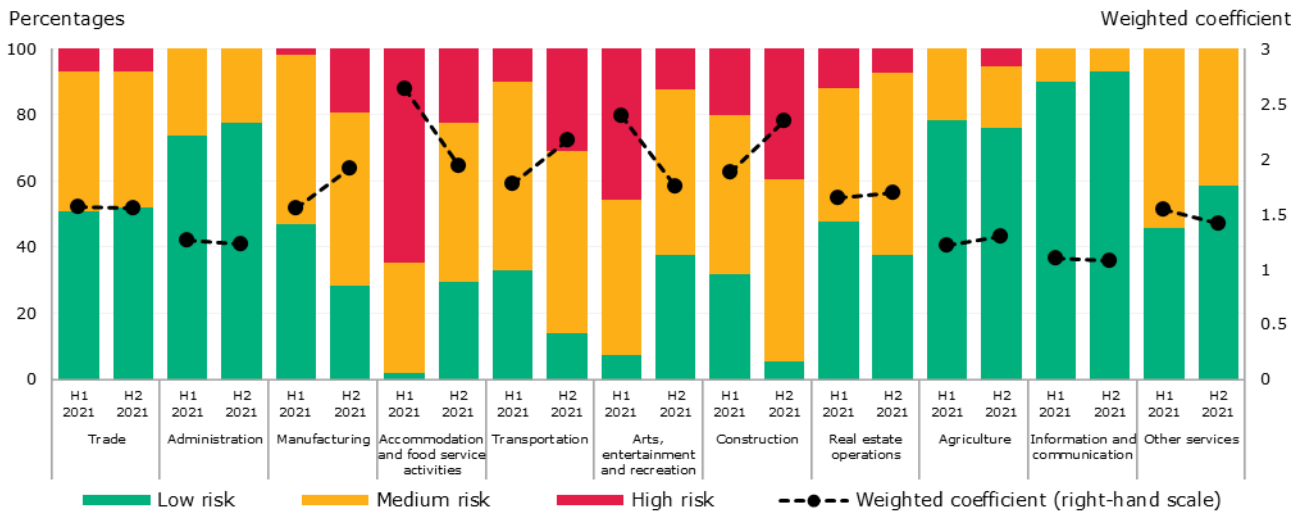
Source: Bank of Lithuania.
 Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 is high risk appetite) and adding weights to them against the share of each selected answer.

Chart 7. Expectations of financial institutions concerning higher losses in the future due to increased corporate insolvency



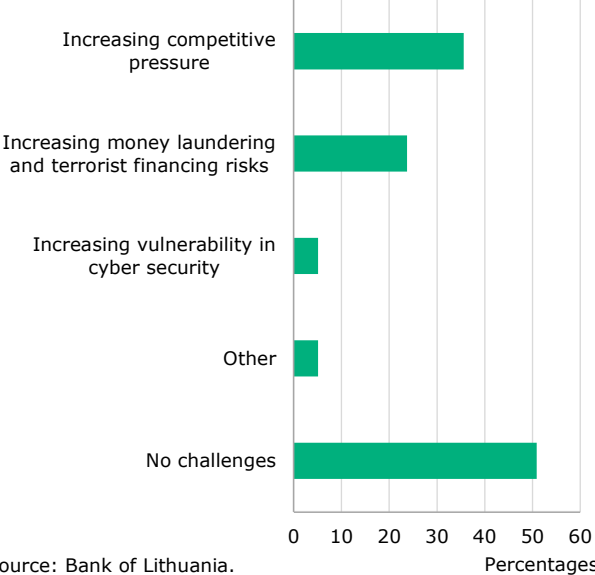
Source: Bank of Lithuania.

Chart 8. 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 9. Challenges for financial institutions posed by the development of fintech companies in Lithuania (multiple answers)



Source: Bank of Lithuania.