



LIETUVOS BANKAS
EUROSISTEMA

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

2022/2

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TASKS, 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. 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 53 respondents (14 banks and foreign bank branches operating in Lithuania, 10 insurance undertakings, 11 credit unions and 18 other financial institutions (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. Participation in the survey is voluntary, no questions are obligatory.

The survey was conducted 16-30 November 2022.

SUMMARY

As in the previous six months, in the second half of 2022, financial institutions identified geopolitical tensions and the risk of a slowdown in Lithuania's economic growth as the most important risks to Lithuania's financial system. Geopolitical tensions were also ranked as the most pressing risk for financial institutions themselves, but the share of institutions feeling the impact of the war dropped by a tenth in the past six months. The war led to an increase in the number of cyber-attacks and the proportion of financial institutions that were exposed to attacks. The majority of financial institutions believe that the probability of a major event with a negative impact on Lithuania's financial system has increased over the six months. The share of financial institutions anticipating increased losses due to the growth in insolvencies of companies remained broadly unchanged, with the highest risk of bankruptcy seen in accommodation and food sector as well as in construction activities.

OVERVIEW OF SURVEY RESULTS

According to the surveyed financial institutions, the most important risks to Lithuania's financial system in the second half of 2022, like in the first six months, were geopolitical tensions and a potential slowdown in Lithuania's economic growth (see Table 1). The importance of these risks did not change significantly over the six months. The risks of deterioration in the financial health of non-financial undertakings and households affected by high inflation and rising interest rates go next. The importance of these risks did not change over the six months either. All financial institutions, except banks, rated the geopolitical risk as the most pressing risk for the Lithuanian financial system at the moment (see Chart 1). Banks saw the probable slowdown in Lithuania's economic growth as the most important risk. The banks also stood out in that they perceived the risks of cyber-attacks and a possible fall in Lithuanian exports as of historically high importance. Other financial institutions did not rate any of the listed risks as of historically high importance during the period under review.

Geopolitical tensions, deterioration in the financial health of households and non-financial undertakings were most frequently cited as the most relevant risks in the coming six months for the institutions represented by the respondents. This risk was identified by a quarter (26%) of the respondents, their number going down by 13 percentage points from what it was six months ago. The risk of deterioration in the financial situation of households was referred to as the most relevant risk by a fifth (21%) of the respondents, while the risk of deterioration in the financial condition of non-financial undertakings was cited as the most relevant risk by 15% of them, an increase of 9 and 8 percentage points, respectively, compared with the first six months.

The impact of the Russia's war against Ukraine felt by financial institutions declined slightly over the six months, but the number of cyber-attacks and the share of institutions that encountered them increased (see Charts 2 and 3). 30% of the respondents said they were not affected by the outbreak of the war, while the share of them claiming this was 22% in the first half of the year. As in the first half of the year, the impact of the war on financial institutions was mainly reflected by a fall in demand for the products offered, as reported by 30% of the respondents. Over the six months, the share of respondents who said that the war triggered an increase in the number of cyber-attacks almost doubled to 19%. In the reference period, 42% of the respondents experienced cyber-attacks, an increase of almost 2.5 times in half a year.

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 the best rated being the opportunities to mitigate the risk of cyber-attacks. The opportunities to mitigate the risks posed by the deterioration of sovereign debt sustainability in Lithuania and other European countries, imbalances in the Scandinavian countries, and potential problems in the European banking sector were viewed most unfavourably.

Two thirds of the respondents (65%) said that the likelihood of an event with a significant negative impact on Lithuania's financial system occurring in the near future had increased over the six-month period (see Chart 4). This is one of the highest proportions of respondents claiming so over the entire period

the survey has been conducted, but 28 percentage points lower than it was in the first half of the year. The probability of such an event occurring has remained the same over the six months, as reported by 31% or has decreased, as reported by 4% of financial institutions respectively. The respondents believe that the most likely shocks to Lithuania's financial system in the next 6 months are the deterioration in the geopolitical situation due to further developments in Russia's war against Ukraine, a bigger economic slowdown, and a rapid increase in interest rates.

Risk appetite among financial institutions diminished somewhat in the second half of 2022 (see Chart 5). In the environment of elevated uncertainty, it returned to levels seen in the second half of 2021. All financial institutions that participated in the survey consider that the level of risk they are willing to take is lower than that of other financial institutions (see Chart 6). Credit unions and insurance companies are willing to take on the highest level of risk, while banks – the lowest one. The majority (60%) of financial institutions say that their own risk appetite will remain unchanged over the next six months, while 30% of them believe that it will decrease. More than half (55%) of the institutions are of the opinion that the risk appetite of other Lithuanian financial institutions will remain unchanged, while 40% of them believe that it will decrease.

Financial institutions anticipated losses due to increased corporate insolvencies remained broadly unchanged over the six months (see Chart 7). 42% of respondent institutions expect an increase in losses over the coming 12 months, this share being 2 percentage points higher than six months ago. 18% of financial institutions predict increased losses in the next 12-24 months and 3% in the next 24 months and beyond. Just over a third (37%) of responding institutions do not think that the probability of corporate insolvency has increased, compared to 33% six months ago.

The financial institutions surveyed see the highest risk of bankruptcy for corporates in accommodation and food sector as well as construction companies (see Chart 8). Over the half-year period, the most significant increases were in the expected risk of bankruptcy for companies engaged in accommodation and food service, creative, artistic and entertainment activities, as well as real estate (RE) activities. Only the transport activities showed a more pronounced decrease in the expected risk of bankruptcy. Firms in the information and communication, agricultural and administration activities have the lowest perceived risk of bankruptcy.

Financial institutions' expectations of growth in housing prices over the coming years fell significantly (see Chart 9). 23% of the respondents expect housing prices to increase in the coming years, compared to 3.5 times as many respondents (83%) just six months ago. 13% of the respondents are of the opinion that prices will remain the same (5% of them six months ago), while two thirds (64%) of the respondents expect a fall in prices (compared to 12% six months ago). However, financial institutions predominantly expect a relatively small fall in housing prices of up to 10%.

KEY CHARTS AND TABLES

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

Risk	Importance	Probability	Potential impact	Mitigation possibilities
A. Geopolitical tensions and their implications for Lithuania's financial system	3.6	3.8	3.4	3.8
B. Risk of a slowdown in Lithuania's economic growth	3.6	3.9	3.3	3.6
C. Deterioration in corporate financial health	3.3	3.5	3.2	3.4
D. Deterioration in household financial health	3.3	3.5	3.0	3.6
E. Cyber-attack risk	3.2	3.4	3.0	2.6
F. Deceleration in Lithuania's exports	2.9	3.1	2.8	3.7
G. Unsustainable development of real estate prices or imbalances in the real estate market	2.9	3.0	2.8	3.2
H. Snapback in risk premia in global financial markets	2.9	3.0	2.8	3.7
I. Unsustainable credit dynamics or imbalances in the credit market	2.7	2.5	2.9	2.9
J. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.6	2.6	2.6	4.0
K. Shrinking profitability of Lithuanian financial institutions due to sudden or higher than expected interest rate hikes	2.5	2.5	2.4	3.4
L. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.4	2.3	2.6	4.1
M. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.4	2.4	2.4	3.9
N. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.3	2.3	2.3	3.9
O. Climate change risk	2.0	2.1	1.9	3.5

Source: Bank of Lithuania.

Notes: Risks were classified according to assessment of significance. 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. 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

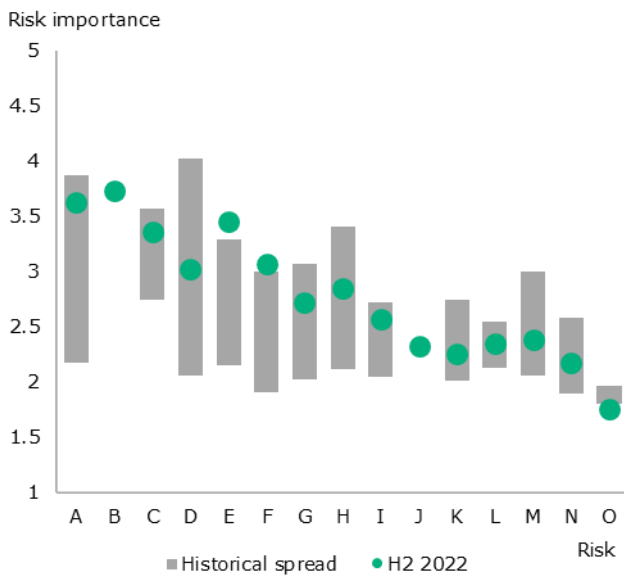
Risk	2017		2018		2019		2020		2021		2022	
	I	II	I	II	I	II	I	II	I	II	I	II
A. Geopolitical tensions and their implications for Lithuania's financial system	2.3	2.5	2.3	2.6	2.2	2.2	2.3	2.2	2.4	2.7	3.8	3.6
B. Risk of a slowdown in Lithuania's economic growth											3.6	3.6
C. Deterioration in corporate financial health	2.2	2.6	2.4	2.3	2.5	2.6	3.4	3.6	2.9	2.7	3.3	3.3
D. 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	3.3
E. Cyber-attack risk	3	3.1	3.1	2.8	2.9	3	2.8	2.8	3.1	2.9	3.4	3.2
F. 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	2.9*
G. 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	2.9*
H. 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	2.9*
I. 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	2.7
J. 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	2.6
K. Shrinking profitability of Lithuanian financial institutions due to sudden or higher than expected interest rate hikes											2.7	2.5
L. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system								2.6	2.3	2.2	2.5	2.4
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	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	2.3
O. Climate change risk										2.1	2.2	2.0

Source: Bank of Lithuania.

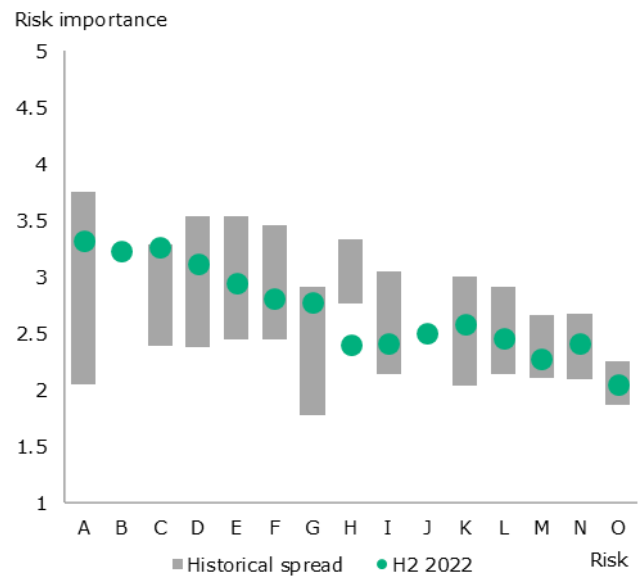
Notes: Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Specifics on risks and their level of importance are provided in Table 1. "I" means first half-year, "II" – II half-year. Change in risk importance over the half-year is significant. A change 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. Only the significance of the change in the importance of the survey values analysed is showed.

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

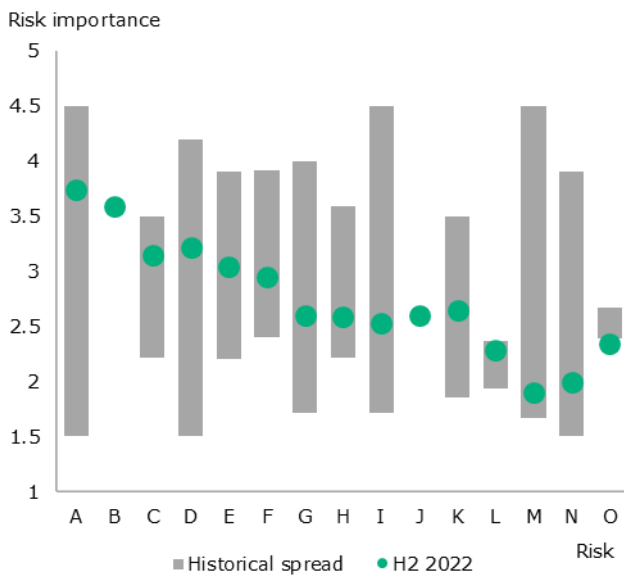
Assessment of the importance of risks to banks



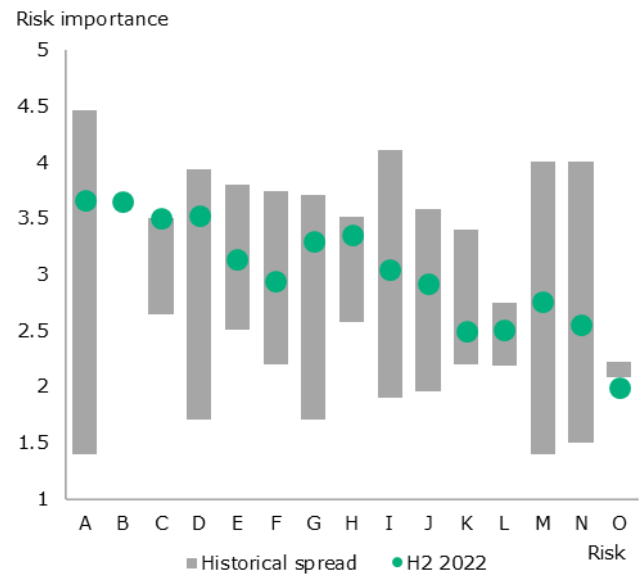
Assessment of the importance of credit union risks



Assessment of the importance of insurance undertaking risks



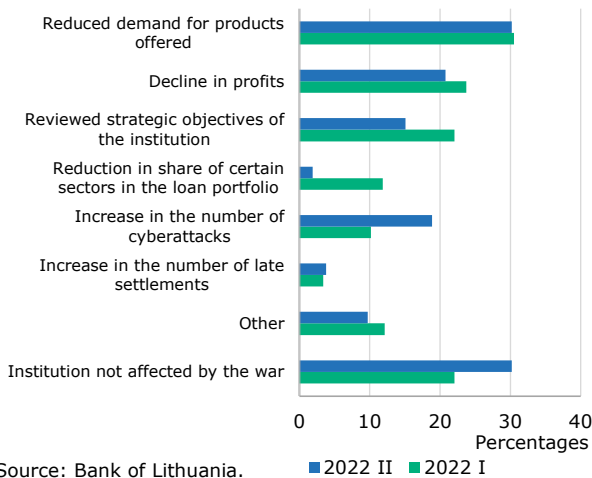
Assessment of the importance of other financial institution risk



Source: Bank of Lithuania.

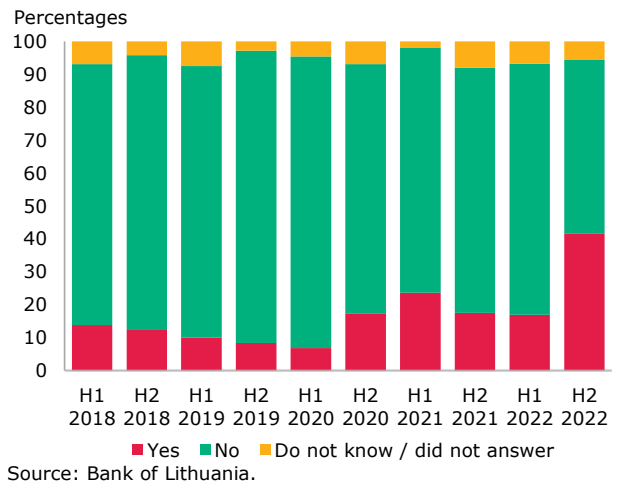
Notes: Risks are named in line with the risk sources in Tables 1 and 2. Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Assessment of the level of significance of risks: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. 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 H1 2022.

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



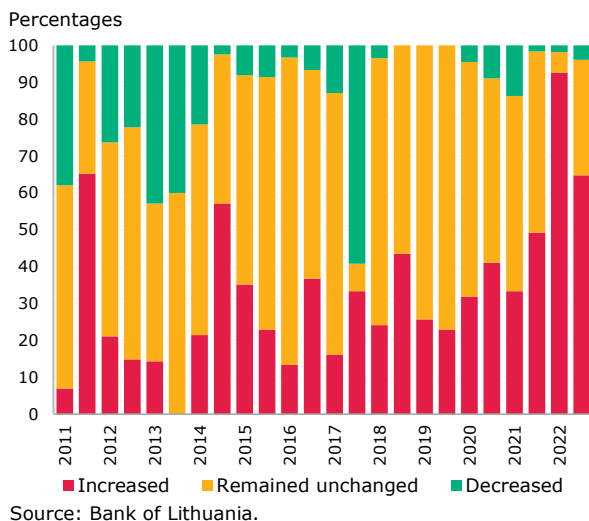
Source: Bank of Lithuania.

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



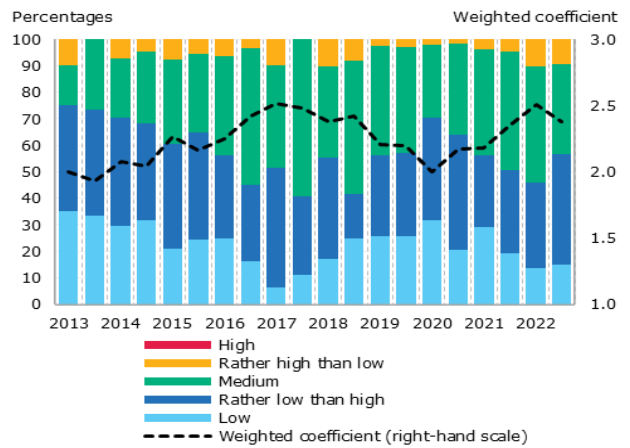
Source: Bank of Lithuania.

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.

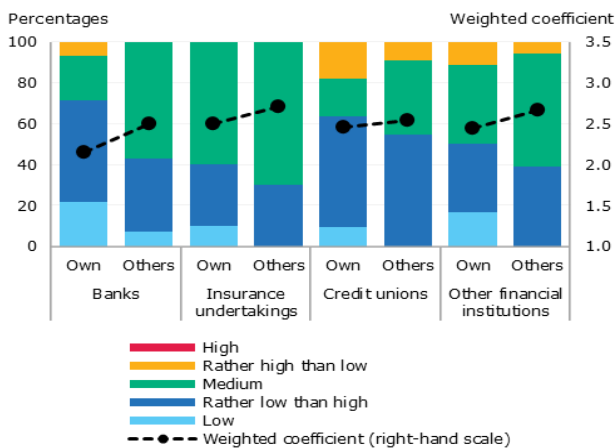
Chart 5. Level of own risk appetite (during the survey)



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.

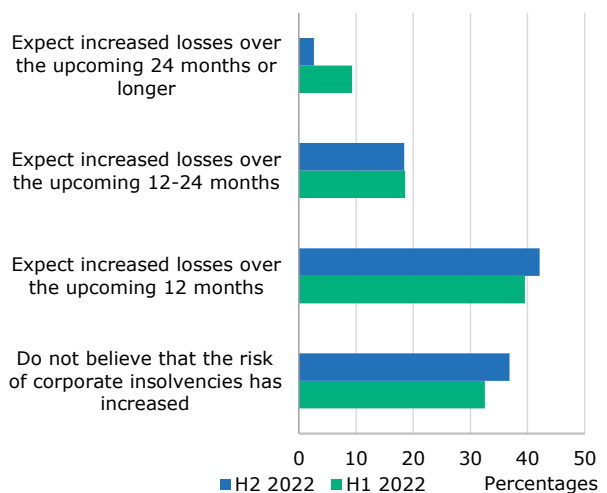
Chart 6. Level of own and other financial institutions' risk appetite (during the survey)



Source: Bank of Lithuania.

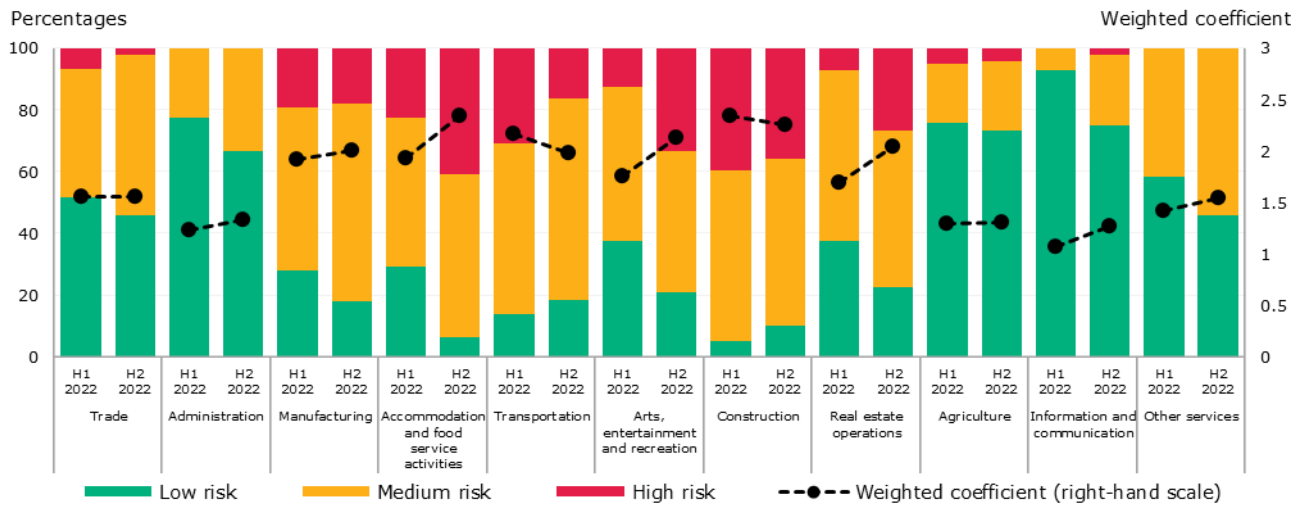
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 is high risk appetite) and adding weights to them against the share of each selected answer.

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



Source: Bank of Lithuania.

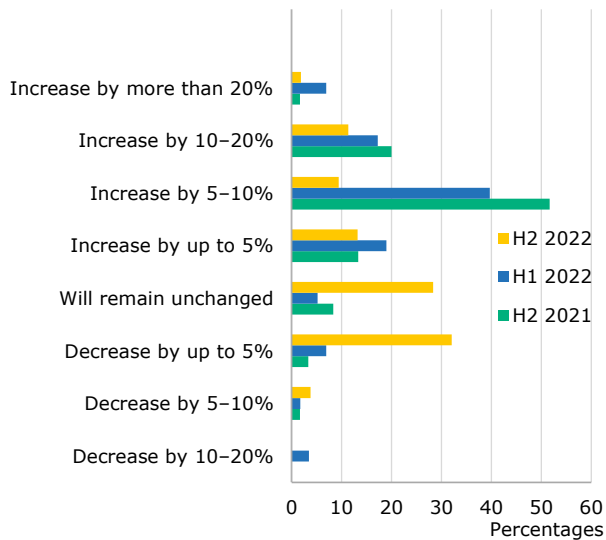
Chart 8. Change in corporate bankruptcy risk by sector



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. Financial institutions' expectations of housing price developments over the coming year



Source: Bank of Lithuania.