



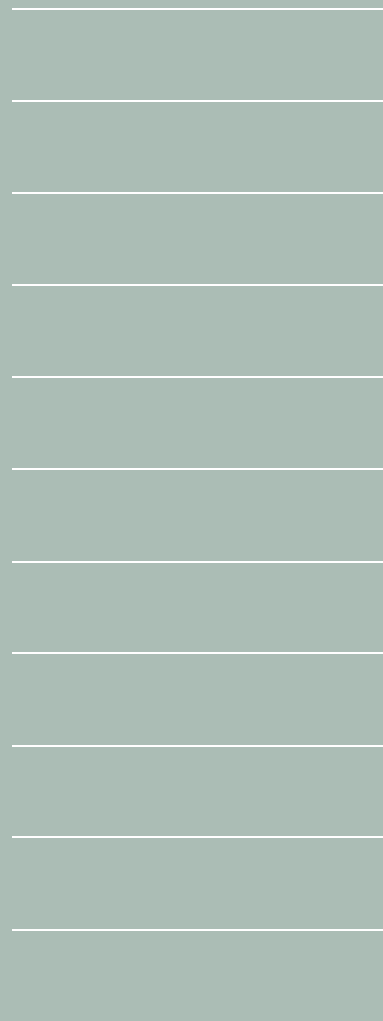
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EURO SISTEMA

REVIEW

OF THE SURVEY OF RISKS TO
LITHUANIA'S FINANCIAL SYSTEM

2017

2



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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, investment management companies and other financial institutions assess the sources of major risks to Lithuania's financial system, the probability of adverse events and their potential impact on the domestic financial system over the next 6 months.

27 respondents, o/w 8 banks operating in Lithuania, 9 insurance undertakings and 10 other financial institutions (leasing companies, financial brokerage firms, management companies, credit unions and consumer credit companies), took part in this survey. Questions were presented to the executives of the financial institutions surveyed. In summarising the opinions and calculating the proportion of financial institutions that have chosen a particular answer, the responses of all institutions were given the same weight, regardless of their market share. Participation in the survey is voluntary – respondents may choose which questions to answer.

REVIEW OF THE SURVEY RESULTS

According to the surveyed financial institutions, the risk to the domestic financial system posed by cyberattacks remains the key one (see Table 1). The importance of this risk has increased even more somewhat over H2 2017. The probability of the risk of cyberattacks, according to the surveyed, is the highest, while its potential impact on the domestic financial system is among the highest ones. Financial institutions of all types – banks, insurance undertakings and other financial institutions – assessed cyber security risk as the major one (see Chart 1). Over the half-year, these risks mainly increased for banks, all of which emphasised that the possibilities for mitigating the risk posed by cyberattacks have decreased.

Over the recent one and a half years, the risk of unsustainable development of real estate prices or imbalances in the real estate market has been one of the key risks for Lithuania's financial system. According to the surveyed participants, the importance of this risk has been increasing for the last two and a half years (see Table 2). Compared to other risks, the potential impact of imbalances in the real estate market on the financial system in H2 2017 was assessed as the highest. The assessment of the potential impact of this risk by different financial institutions was similar; however, insurance undertakings stood out with the assessment of the probability of realisation of this risk as higher. In addition, insurance undertakings and banks increased the importance of this risk over the reference period, whereas other financial system participants left it unchanged. The probability of mitigating the risk related to the unsustainable development of the real estate market was viewed by the surveyed financial market participants as medium, and this assessment remained basically unchanged over the year.

In H2 2017, the respondents named the imbalances in Scandinavian countries and their potential contagion effects on Lithuania's financial system as the third major risk to Lithuania's financial system. After diminishing slightly in H1, in H2 the importance of this risk rose substantially (see Chart 2). The assessment of this risk by all financial institutions was similar, while banks and insurance undertakings mainly assessed its importance as heightened in H2.

The risk related to a snapback in risk premia in global financial markets has also remained among major risks, although declining in importance over the half year. Other financial institutions (leasing companies, financial brokerage firms, management companies) attached most importance to a snapback in risk premia (see Chart 1). Management companies saw this risk as potentially having the strongest impact on the financial system, and the probability of its realisation as the highest, compared to other specified risks (the probability of this risk has declined somewhat over the half-year). All of the surveyed participants (mainly banks) reported that the possibilities to mitigate the risk of a snapback in risk premia in global financial markets are very good.

The importance of risks to financial system participants arising in the Lithuanian market has increased. For example, among internal risks, the risk of deterioration in the financial health of non-financial institutions has increased the most over H2 2017. The importance of the risk of unsustainable credit development (it was the highest compared to all other internal risks) and of deterioration in the financial health of households has increased as well. Insurance undertakings attached the greatest importance to deterioration in the financial health of households and non-financial undertakings or unsustainable credit development. As a major risk for themselves, the surveyed financial market participants in H2 2017 mainly named the risk of a drop in profitability during a prolonged period of low interest rates (see Chart 3).

The importance of other risks, the source of which could rather be related to the non-Lithuanian market, remained basically unchanged. In H2 2017, financial market participants attached greater importance to the risks of a contraction in Lithuanian exports and a potential increase in geopolitical tensions. The assessment of a potential fall in the European banking sector's profitability or likely imbalances in the European countries' loan market was more reserved during the reference period.

According to the surveyed participants, the probability of a high-negative-impact event in the financial system has decreased. Unlike during the few recent years, when the main share of respondents saw the risk of a high-impact event in the financial system as heightened, in H2 2017 there were many more respondents who saw this risk as lower (see Chart 4). As the most likely high-impact events, the surveyed financial institutions saw adjustments of imbalances in Scandinavian countries, low global financial market interest rates and their likely increase or macroeconomic instability in Lithuania.

Over the half-year, the risk appetite of financial institutions followed a moderate downward trend. Most financial institutions surveyed (59.3%) claimed assuming medium risk, while the rest of them (40.7%) reported assuming low or low rather than high risk (see Chart 5). During the survey conducted half a year earlier, nearly a tenth of the respondents reported assuming high rather than low risk, whereas in this survey there were no such respondents. Financial institutions of all types assessed their own risk appetite more moderately than that of other financial market participants (see Chart 6).

Table 1. Cyberattacks is the most likely and major risk to the financial system

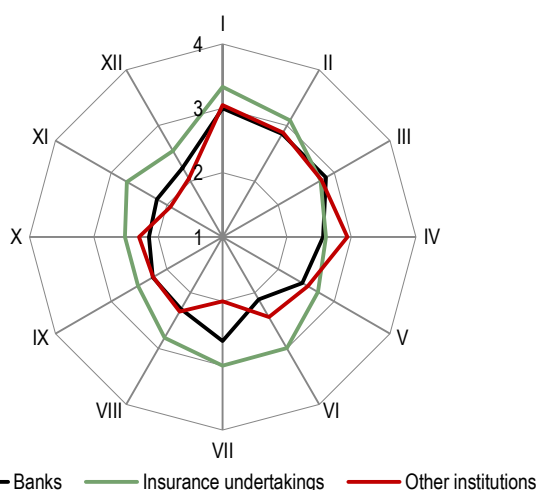
Assessment of risks to Lithuania's financial system

Risks	Im-portance	Proba-bility	Poten-tial impact	Poss-ibilities of miti-gating
I. Cybercrime risk	3.1	3.1	3.2	2.9
II. Unsustainable development of real estate prices or imbalances in the real estate market	2.9	2.6	3.3	3.1
III. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.8	2.4	3.2	1.9
IV. Snapback in risk premia in global financial markets	2.7	2.6	2.9	1.7
V. Deterioration in corporate financial health	2.6	2.1	3.1	2.5
VI. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.5	2.2	3.0	2.0
VII. Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.5	2.5	2.6	2.2
VIII. Geopolitical tensions and their implications for Lithuania's financial system	2.5	2.1	2.9	1.7
IX. Unsustainable credit dynamics or imbalances in the credit market	2.3	1.9	3.0	3.4
X. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.3	2.0	2.7	1.9
XI. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.3	2.0	2.6	1.8
XII. Deterioration in household financial health	2.3	2.0	2.5	2.5

Notes: Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. **Probability:** 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. **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.

Chart 1. All of the surveyed financial market participants assessed cybercrime risk as the major one

Importance of risks by financial institution sector



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.

Table 2. The importance of three major risks to financial system participants has increased over the past three years

Risks to the financial system importance dynamics

Risks specified	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	H2 2017
I.	Medium	Medium	Medium	Medium	High	High
II.	Low	Low	Low	Low	Low	Low
III.	Medium	Medium	Medium	Medium	Medium	Medium
IV.	Medium	Medium	Medium	Medium	Medium	Medium
V.	Medium	Medium	Medium	Medium	Low	Low
VI.	Medium	Medium	Medium	Medium	Low	Low
VII.	High	High	High	High	Medium	Medium
VIII.	High	High	High	High	Medium	Medium
IX.	Low	Low	Low	Low	Low	Low
X.	Medium	Medium	Medium	Medium	Medium	Medium
XI.	Medium	Medium	Medium	Medium	Medium	Medium
XII.	Low	Low	Low	Low	Low	Low

Notes: Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Risks are enumerated in line with the risk sources in Table 1. The level of risk importance is marked in the following way:

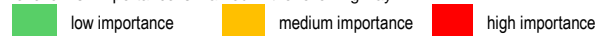
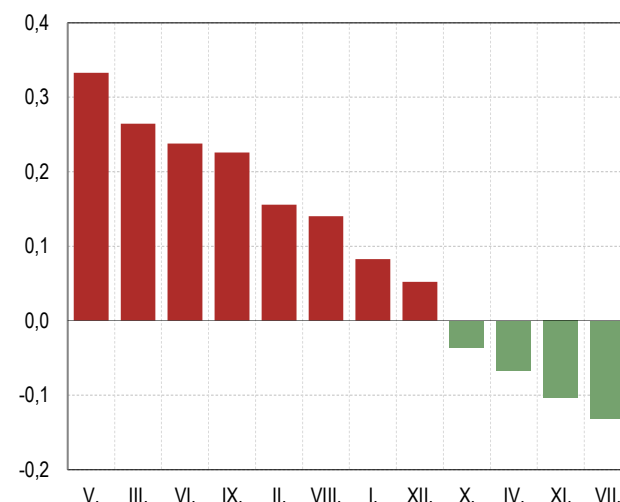


Chart 2. Over H2 2017, the importance of the risk of a potential deterioration in enterprises' financial health has increased the most

Change in the importance of risks over H2



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 3. The majority of institutions indicated the drop in profitability during a prolonged period of low interest rates as the key risk to their activities

Assessment of risk which is key for the respondent financial institution

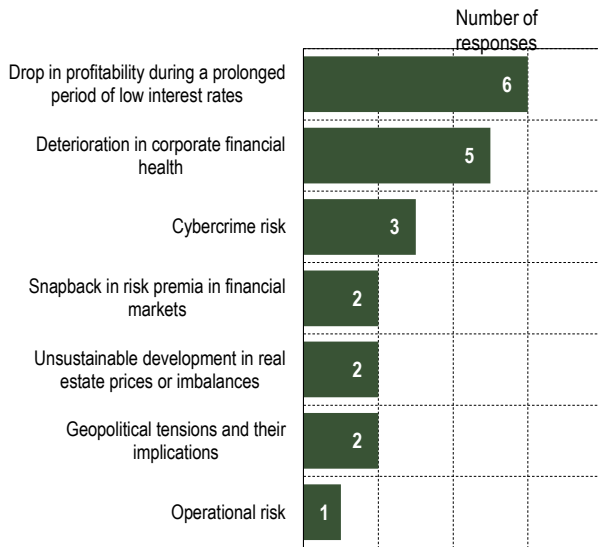


Chart 4. The number of respondents who assessed the probability of a major negative impact as a decreased one has grown significantly over the recent half-year

Change in the probability of a high-impact event in Lithuania's financial system in the near future over the past 6 months

Percentages

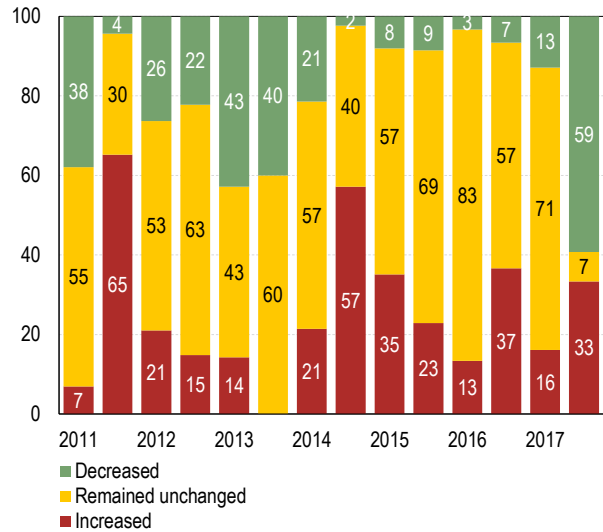
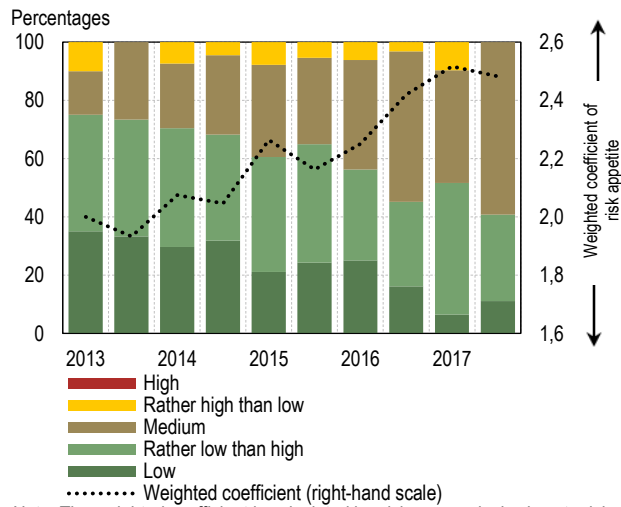


Chart 5. The risk appetite of the majority of financial institutions is medium

Level of own risk appetite (during the survey)



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.

Chart 6. Respondents of all types assessed their risk appetite as lower against the market they operate in

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

Percentages

