

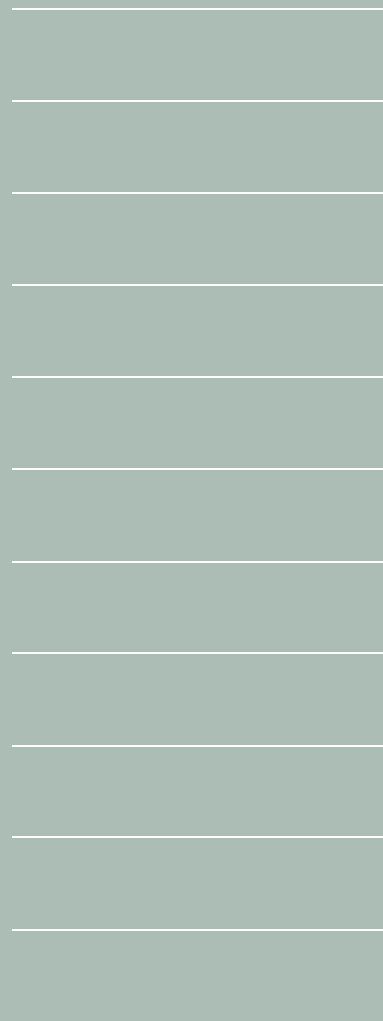


LIETUVOS BANKAS
EURO SISTEMA

REVIEW

OF THE SURVEY OF RISKS TO LITHUANIAN'S FINANCIAL SYSTEM

2018



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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.

29 respondents, o/w 9 banks operating in Lithuania, 8 insurance undertakings and 12 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 is the key one for a year and half now (see Tables 1 and 2). In H1 of 2018, the importance of this risk stayed basically unchanged and, according to the banks and insurance undertakings, remained the highest for Lithuania's financial system, while other financial institutions viewed the risk related to imbalances in Scandinavian countries as the most important one (see Chart 1). The probability of the risk of cyber attacks, as well as its potential impact on the financial system, according to the surveyed, is the highest, while the possibilities for mitigating this risk are among the lowest. According to the surveyed, over the recent half-year, four financial institutions out of 29 were subjected to cyberattacks, while for one of them these attacks resulted in losses (see Chart 2). Over the half-year the importance of this risk has increased for banks, all of which indicated that the possibilities for mitigating the risk posed by cyberattacks have decreased.

Over the recent two 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 as well. However, according to the surveyed, the importance of this risk diminished somewhat over the last half year (see Chart 2), while the possibilities to reduce it were assessed as being relatively poor. In comparison to other financial institutions, banks stood out with the assessment of likely negative effects of this risk as being higher. 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.

In H1 2018, the respondents named the snapback in risk premia in global financial markets as the third major risk to Lithuania's financial system. Compared to the H2 of 2017, in the period under review the importance of this risk remained almost unchanged (see Chart 2). The assessment of this risk by all financial institutions was similar, while banks mainly assessed its importance as heightened over the half-year.

The risk of imbalances in Scandinavian countries and their potential contagion effects on Lithuania's financial system has retained its relevance, although it declined in importance over the half year. Other financial institutions (leasing companies, financial brokerage firms, management companies) attached the most importance to the risk of imbalances in Scandinavian countries and their potential contagion effects on Lithuania's financial system (see Chart 1). They saw this risk as potentially having the strongest impact on the financial system, and the probability of its realisation as one of the highest, compared to other specified risks.

The importance of other risks, the sources of which reside in Lithuania's market has increased. For example, the risk of deterioration in the financial health of households has risen the most among domestic risks in H1 of 2018. Insurance undertakings attached the greatest importance to a deterioration in the financial health of households or unsustainable credit development. As a major risk for themselves, the surveyed financial market participants in H1 2018 mainly named the risk of deterioration in financial health of non-financial institutions (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 H1 2018, financial market participants attached greater importance to the risks of a contraction in Lithuanian exports. The risks of a potential increase in geopolitical tensions and deterioration in European sovereign debt sustainability were seen as somewhat less important. Among the risks mentioned, the assessment of a potential fall in the European banking sector's profitability was the most moderate.

According to the surveyed, the probability of a high-negative-impact event in the financial system remained basically unchanged. In H2 of 2017 the main share of respondents saw the risk of a high-negative-impact event in the financial system as diminished; in H1 2018 there were more respondents who saw this risk as unchanged (see Chart 4). The surveyed financial institutions saw adjustments of imbalances in Scandinavian countries, macroeconomic instability in Lithuania and related markets and low interest rates as the most likely high-impact events.

Over the half-year, the risk appetite of financial institutions followed a moderate downward trend. The majority of financial institutions surveyed (55.2%) stated that they assume low rather than high or low risk, while a tenth – high rather than low risk (see Chart 5). During the survey conducted half a year earlier, no financial institutions reported assuming high rather than low risk. Banks assessed their own risk appetite more moderately than that of the market, while the assessment of insurance and other financial market participants was the opposite (see Chart 6).

KEY CHARTS AND TABLES

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

Assessment of risks to Lithuania's financial system

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

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.

Table 2. Risk of unsustainable real estate market developments that was on an upward path for two and a half years has diminished

Risks to the financial system importance dynamics

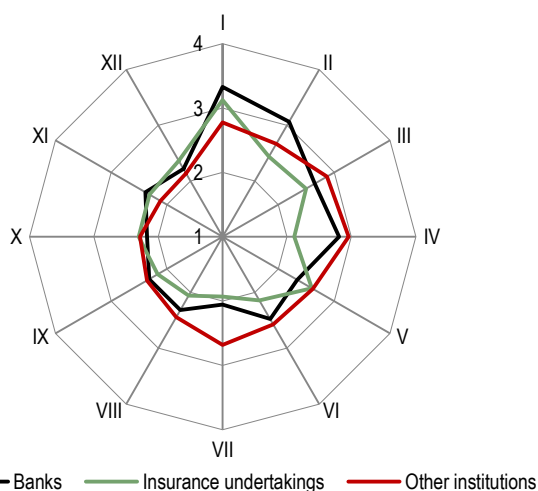
Risks	H2 2015	H1 2016	H2 2016	H1 2017	H2 2017	H1 2018
I.	2.7	2.8	2.6	3.0	3.1	3.1
II.	2.3	2.5	2.7	2.8	2.9	2.7
III.	2.9	2.6	2.8	2.8	2.7	2.7
IV.		2.4	2.7	2.5	2.8	2.7
V.	2.8	2.7	2.6	2.3	2.5	2.5
VI.	2.5	2.3	2.6	2.2	2.6	2.4
VII.	2.7	2.5	2.6	2.4	2.3	2.3
VIII.	2.4	2.2	2.2	2.1	2.3	2.3
IX.	2.3	2.2	2.4	2.2	2.3	2.3
X.	3.1	3.1	2.7	2.3	2.5	2.3
XI.	3.0	3.4	2.8	2.6	2.5	2.3
XII.			2.5	2.4	2.3	2.2

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:

low importance medium importance high importance

Chart 1. Banks and insurance undertakings 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.

Chart 2. In H1 of 2018, four financial institutions were subjected to cyber attacks, while for one of them these attacks resulted in losses

Financial institutions that were subjected to cyber attacks

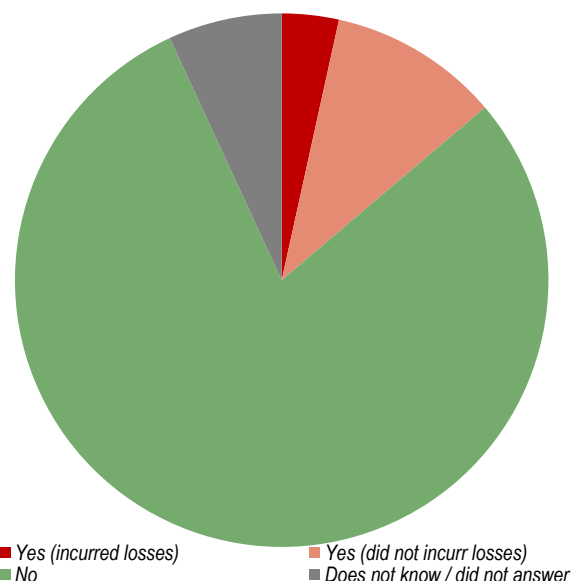


Chart 3. The majority of institutions indicated deterioration in corporate financial health as the key risk to their activities

Assessment of risk which is key for the respondent financial institution

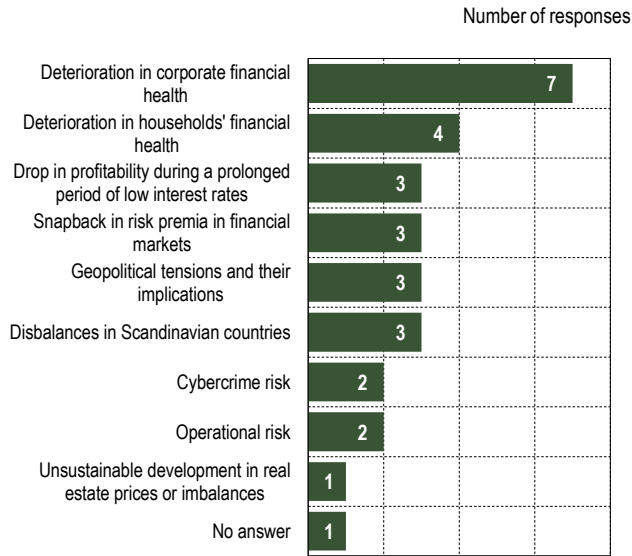


Chart 4. Nearly three fourths of institutions assessed the probability of a high-impact event as unchanged

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

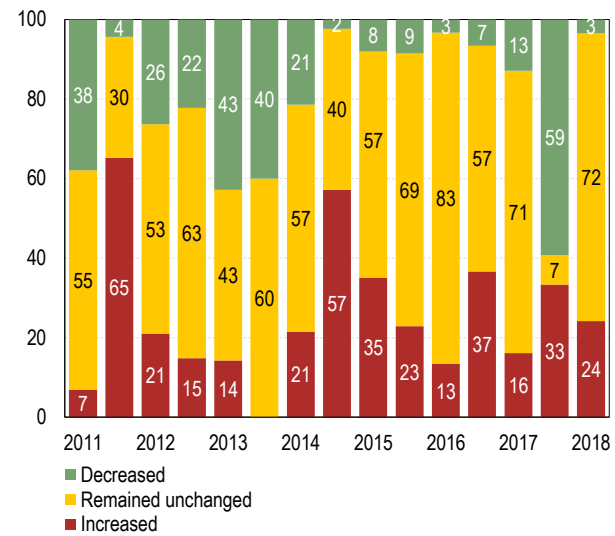
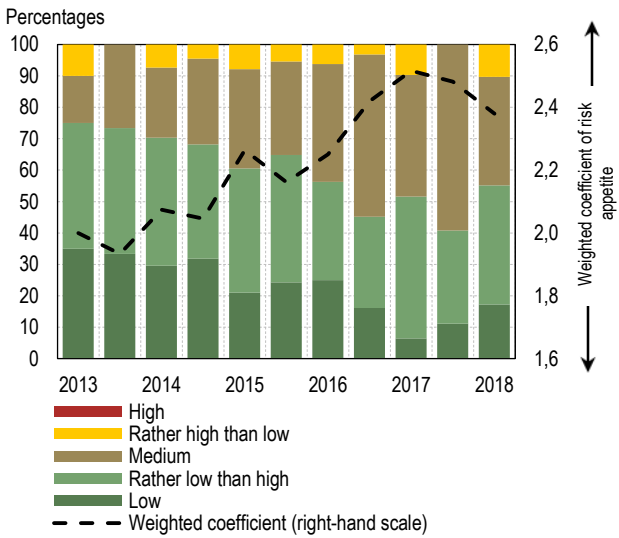


Chart 5. The risk appetite of more than a half of financial institutions is rather low or low

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. Most of the respondents assessed their risk appetite as lower against the market they operate in

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

