



LIETUVOS BANKAS
EUROSISTEMA

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

2020/1

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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. 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 44 respondents (10 banks and foreign bank branches operating in Lithuania, 7 insurance undertakings, 9 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.

OVERVIEW OF THE SURVEY RESULTS

According to the surveyed financial institutions, the main risk to Lithuania's financial system in mid-2020 was the impact of the COVID-19 pandemic on Lithuania's economy:¹ deteriorating financial situation of firms and households and deteriorating economic situation in trading partner countries, leading to a decline in Lithuania's exports (see Table 1). Compared to 2019, the risk of cybercrime and the unsustainable development of the real estate market was pushed to the background of the pandemic, although the importance of these risks decreased only slightly compared to the second half of 2019 (see Table 2). In the opinion of the surveyed, the assessment of five risks increased significantly, while estimates of the importance of the other seven risks either remained unchanged or decreased only marginally. As a result, the overall level of risks increased significantly.

The importance of the deterioration in corporate and household financial health and the decline in Lithuanian exports due to the slowdown in the growth rate of the economies of the countries' trading partners to the Lithuanian financial system was stressed by banks in particular (see Chart 1). All groups of financial institutions, excluding credit unions, considered the risk of deceleration in Lithuania's export as the most important (risk A in Table 2). Credit unions identified the risk of deterioration in corporate financial health as the most important (B risk in Table 2). With the exception of insurance undertakings, the four most important risks in all financial enterprise groups have been at the highest level since 2016. Insurance companies also singled out the risk of a drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates (K risk in Table 2), although other groups of financial institutions considered this risk to be one of the less important to Lithuania's financial system.

According to the majority of the surveyed (64%), the probability of a high impact event in Lithuania's financial system has remained unchanged (see Chart 2). It should be noted that the number of those claiming that this probability has increased over the previous three survey periods— decreased. In mid-2020, the number of those who believed that the probability of an event with a significant negative effect increased by 9 p.p. (31.8%) compared to the previous half-year (22.9% in the second half of 2019). However, two financial institutions claimed that the probability of an event with a significant impact was reduced. According to these institutions, the biggest shock to Lithuania's financial system was the COVID-19 pandemic, the consequences of which are not yet fully clear, as well as the risk of the second wave. However, they do not expect a new, non-pandemic event with a significant impact in the next 6 months. Other institutions, when asked about the event likely to have the most negative impact on Lithuania's financial system in the next 6 months, mostly identified the risk of the second wave of COVID-19 (56.8% of respondents), tightening of conditions for bank loans to enterprises (e.g. due to problems with Scandinavian parent banks or deteriorating corporate financial health) and state budget deficit/growing debt.

Corporate risk appetite diminished in the first half of 2020 (see Chart 4). Only two institutions indicated that their level of risk appetite was high rather than low, while none claimed that the level of risk appetite was high. Besides banks, which consider both their own risk level and that of others to be the same, the vast majority of financial institutions participating in the survey consider that their risk appetite is lower compared to other financial institutions (see Chart 5). As many as 4/5 of financial institutions (77%) indicated that their risk appetite should remain unchanged over the upcoming six months, while slightly more than half of respondents (59%) believe that the risk appetite of other Lithuanian financial institutions will also remain at current levels. The latter indicators remained quite similar, compared to the previous half-year.

According to respondents, possibilities of mitigating the effects of most of the risks to Lithuania's financial system are average or lower than average (see Table 1). The possibilities to reduce the impact of geopolitical tensions and their consequences on Lithuania's financial system and the fall in Lithuanian exports

¹ The risk of the second wave of COVID-19, as a factor that could have the greatest impact on Lithuania's economy in the next six months, was reported by more than half of those who responded to the survey.

due to the slowdown of the growth rate of the main trading partners are assessed most unfavourably. Respondents were most positive in terms of possibilities of reducing the effects of cyberattack risks.

Financial institutions that responded to the survey see the highest risk of corporate bankruptcy in the catering and hospitality sector (see Chart 3).² Transportation and arts sectors have also been assessed as high risk. In contrast, enterprises active in the administrative, information and communication sectors, according to the financial institutions that responded to the survey, were believed to not be at a high risk of bankruptcy. In the opinion of representatives of financial institutions, the lack of time limits for litigation of participants in insolvency proceedings and lengthy procedures for the sale of assets are the most important factors leading to lengthy and complex bankruptcy procedures (these reasons were identified as the main ones by around half of respondents, see Chart 6). More than half of the financial institutions that responded to the survey identified high costs of bankruptcy administration as the main reason for poor satisfaction of creditors' claims in the insolvency process (see Chart 7).

² For the first time, the survey of the first half of 2020 included questions about corporate bankruptcy risk in individual sectors of the economy and various obstacles to the efficiency of insolvency proceedings.

KEY CHARTS AND TABLES

Table 1. Assessment of risks to Lithuania's financial system (first half of 2020; total surveyed)

Risk	Importance	Probability	Potential impact	Mitigation possibilities
Deceleration in Lithuania's exports due to the slowdown in main trading partners	3.7	4.0	3.4	4.0
Deterioration in corporate financial health	3.4	3.6	3.3	3.5
Snapback in risk premia in global financial markets	3.2	3.2	3.1	3.8
Deterioration in household financial health	3.2	3.2	3.1	3.6
Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	3.0	3.0	3.0	3.8
Cybercrime risk	2.8	2.8	2.8	2.8
Unsustainable development of real estate prices or imbalances in the real estate market	2.7	2.5	2.9	3.1
Unsustainable credit dynamics or imbalances in the credit market	2.7	2.4	3.0	3.1
Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.6	2.3	2.9	4.0
Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.5	2.3	2.7	3.7
Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.3	2.3	2.4	3.6
Geopolitical tensions and their implications for Lithuania's financial system	2.3	2.1	2.4	4.2

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 of mitigating risk: 1 – high; 2 – higher than medium; 3 – medium; 4 – lower than medium; 5 – low. Risks were classified according to importance. The level of risk importance, probability, potential impact and possibilities of 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 2020; total surveyed)

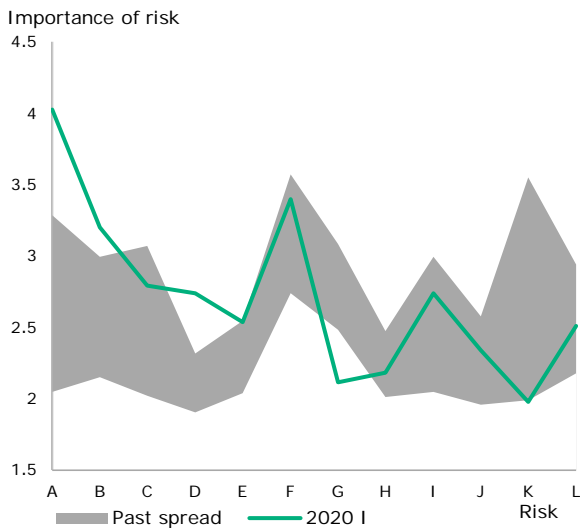
Risk	2017		2018		2019		2020
	I	II	I	II	I	II	I
A. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.3	2.5	2.5	2.5	2.6	2.7	3.7
B. Deterioration in corporate financial health	2.2	2.6	2.4	2.3	2.5	2.6	3.4
C. Snapback in risk premia in global financial markets	2.8	2.7	2.7	3	2.7	2.8	3.2
D. Deterioration in household financial health	2.2	2.3	2.3	2.2	2.4	2.4	3.2
E. 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
F. Cybercrime risk	3	3.1	3.1	2.8	2.9	3	2.8
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
H. Unsustainable credit dynamics or imbalances in the credit market	2.1	2.3	2.3	2.4	2.4	2.4	2.7
I. 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
J. 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
K. 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
L. Geopolitical tensions and their implications for Lithuania's financial system	2.3	2.5	2.3	2.6	2.2	2.2	2.3

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.

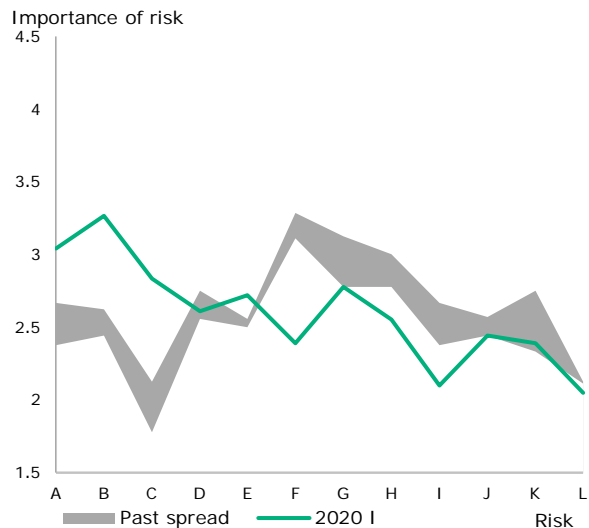
Chart 1. Risk importance by financial sector

Assessment of the importance of **bank** risks



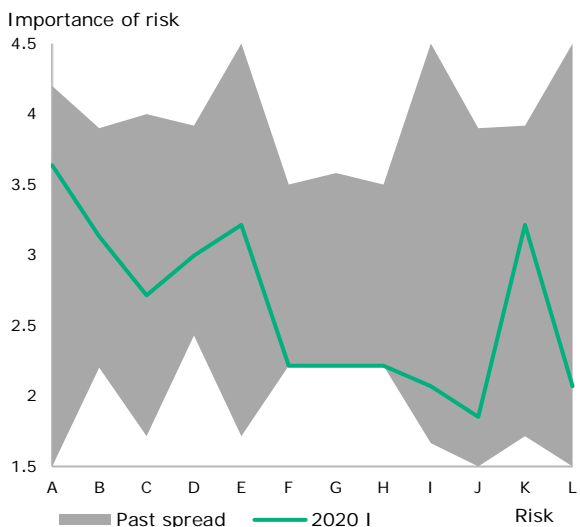
Source: Bank of Lithuania

Assessment of the importance of **credit union** risks



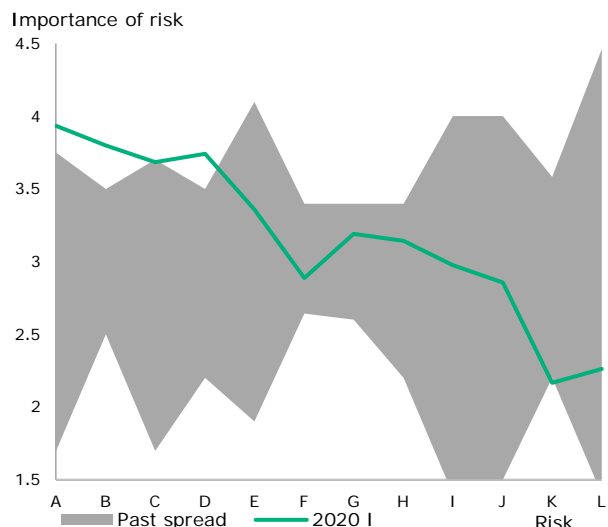
Source: Bank of Lithuania

Assessment of the importance of **insurance undertaking** risks



Source: Bank of Lithuania

Assessment of the importance of **other financial institution** risks



Source: Bank of Lithuania

Notes: Risks are numbered in line with the risk sources in Table 2; risk importance is calculated as a geometric mean of estimates for its probability and potential impact. The blue line combines the 2020 first half-year survey risk estimates according to the type of financial institution that responded. Assessment of the level of significance of risks: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. The gray colour marks dissemination of the lowest and highest risk value among the responding financial institutions of that type in the Surveys of Risks from the first half of 2016 to the second half of 2019.

Source: Bank of Lithuania.

Chart 2. Change in the probability of a high impact event in Lithuania's financial system over the past 6 months

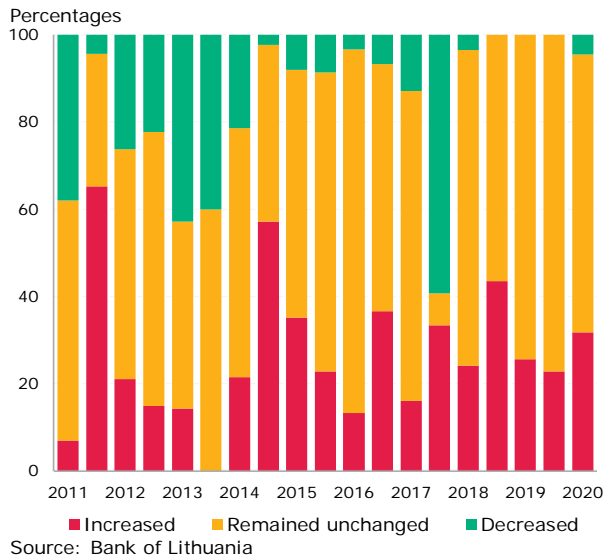


Chart 3. Corporate bankruptcy risk by sector

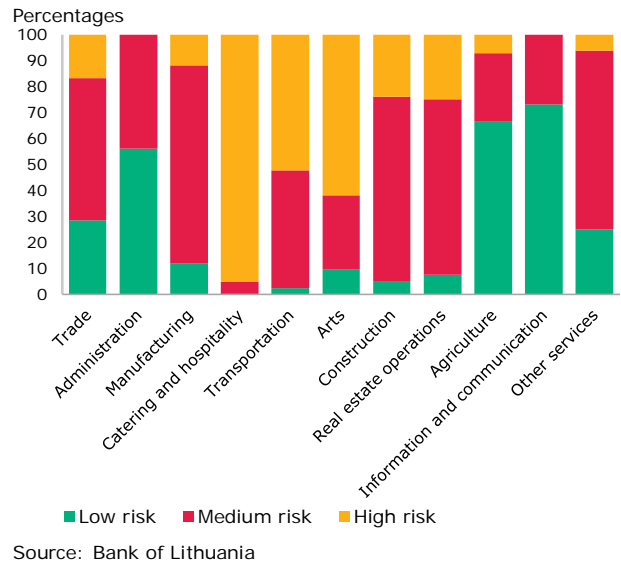
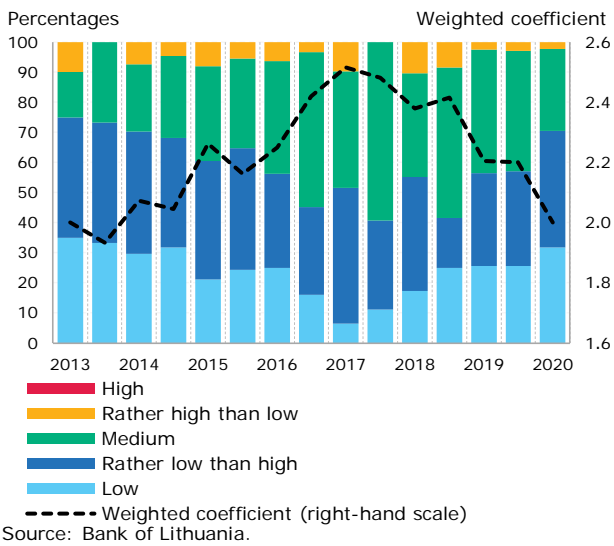
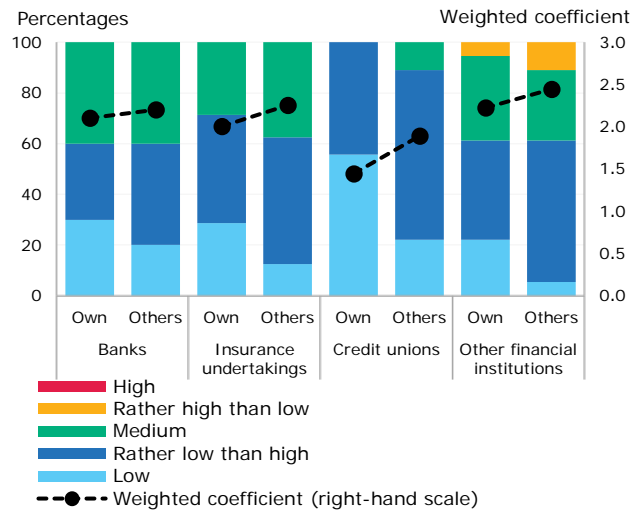


Chart 4. Level of own risk appetite (during the survey)



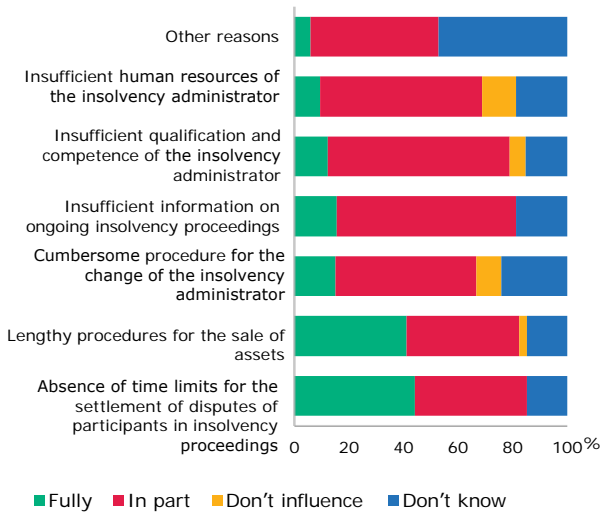
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 – high risk appetite) and adding weights to them against the share of each selected answer.

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



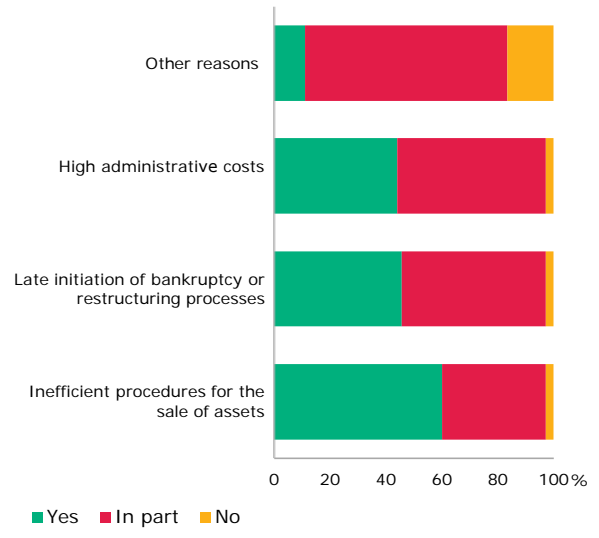
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 – high risk appetite) and adding weights to them against the share of each selected answer.

Chart 6. Reasons for lengthy and complex insolvency proceedings



Source: Bank of Lithuania

Chart 7. Reasons for low satisfaction of creditor claims in insolvency proceedings



Source: Bank of Lithuania