



LIETUVOS BANKAS
EUROSISTEMA

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

2020/2

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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 the Survey of Risks to Lithuania's Financial System. It 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 60 respondents (14 banks and foreign bank branches operating in Lithuania, 12 insurance undertakings, 11 credit unions and 23 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 risks to Lithuania's financial system at the end of 2020 were related to the economic effects of the ongoing coronavirus (COVID-19) pandemic¹, namely the deteriorating financial situation of firms² and households as well as the weakening economic situation in trading partner countries and the subsequent decline in Lithuania's exports (see Table 1). The risk of deceleration in exports, which in the first half of 2020 was considered the main risk to Lithuania's financial system, has slightly faded against the risk of a weaker financial situation of non-financial corporations and the potential wave of mass bankruptcies after the completion of state support for businesses affected by COVID-19 (see Table 2). The risk of unsustainable developments in the real estate or credit markets due to the ongoing pandemic has remained in the background.

The importance of the risk of a deterioration in corporate and household financial health and of mass corporate bankruptcies was stressed in particular by credit unions (see Chart 1). According to credit unions and banks, these risks are at the highest level since 2016.³ It is also conspicuous that the assessment of the risk of unsustainable credit dynamics and imbalances in the credit market (risk K in Table 2) by credit unions and insurance undertakings is particularly low, while the assessment of the risk of unsustainable developments in real estate prices (risk J) by all financial institutions is at historical lows.

According to the respondents, possibilities of mitigating the effects of the above risks to Lithuania's financial system are mostly average or lower than average (see Table 1). The possibilities of mitigating the effects of a potential deterioration in European sovereign debt sustainability (and the contagion effects on Lithuania's financial system) as well as a snapback in risk premia in global financial markets were assessed most unfavourably. Respondents were most positive in terms of the possibilities of reducing the effects of risks related to cybercrime and credit market imbalances. Although the possibilities of mitigating the effects of cybercrime were assessed favourably, the number of financial institutions affected by cyberattacks has increased over the second half of 2020 (see Chart 3). Although none of the financial institutions participating in the survey incurred financial losses as a result of cyberattacks, eight institutions confirmed a significant increase in the number of cyberattacks during the lockdown period.⁴

Half of the respondents claimed that the likelihood of an event with a significant negative impact on Lithuania's financial system in the near future remained unchanged, while 41% believed that it increased (see Chart 2). Five financial institutions claimed that the probability of an event with a significant impact reduced. According to these institutions, the main shock to Lithuania's financial system was the ongoing COVID-19 pandemic, the consequences of which are not yet fully clear, however they do not expect a new non-pandemic event with a significant impact over the upcoming six months. Most other institutions surveyed about the event likely to have the most negative impact on Lithuania's financial system over the upcoming six months highlighted the risk of mass corporate bankruptcies (35% of the respondents) and a deterioration in the financial health of households, resulting in a decreasing profitability of Lithuanian financial institutions and an increasing state budget deficit as well as increasing debt.

In the second half of 2020, the risk appetite of financial institutions increased slightly (see Chart 4), although none claimed that their risk appetite was high. All financial institutions participating in the survey consider that their risk appetite is lower compared to other financial institutions (see Chart 5). As many as 77% of financial institutions claimed that their risk appetite will remain unchanged over the upcoming six

¹ The continuation and/or tightening of the lockdown in order to control the spread of COVID-19 as the factor that will have the most significant impact on Lithuania's economy over the upcoming six months was indicated by half of the respondents to the survey.

² The importance of the risk of a deterioration in the financial situation of non-financial corporations is currently assessed at the highest level throughout the entire period that the survey had been carried out.

³ Based on the results of surveys of risks to Lithuania's financial system prepared by the Bank of Lithuania. Previous surveys did not collect information about the type of the respondent's financial institution.

⁴ Several financial institutions mentioned in the survey that cyberattacks became a daily phenomenon during the lockdown, which increased their investment in ensuring the security of the electronic systems used.

months. About the same number (74%) believe that there will be no change in the risk appetite of other Lithuanian financial institutions. The latter indicators remained quite similar compared to the first half of 2020.

The financial institutions that responded to the survey see the greatest risk of corporate bankruptcy in the catering and hospitality sector (see Chart 6). Transportation and arts sectors have also been assessed as high-risk, although according to respondents' assessment, the risk of bankruptcy in the transportation sector has decreased as compared to the first half of 2020. In the opinion of the surveyed financial institutions, for enterprises operating in the agricultural sector as well as in the information and communication sector the risk of bankruptcy remains low. Compared to the first half of 2020, the risk of bankruptcy has slightly increased in the administrative sector, while it has slightly decreased in the construction, real estate operations and manufacturing sectors.

All of the surveyed financial institutions felt the impact of the COVID-19 pandemic (see Chart 7). During the pandemic, the profitability of 23 respondents dropped. A large number of the respondents (33%) claimed that they had to revise the institution's strategic objectives due to the COVID-19 pandemic, while 22% stated that they had experienced increased delays in meeting obligations on time. In the meantime, eight financial institutions claimed that their profitability has increased during the pandemic period.

Most financial institutions expect greater losses in the future due to increased corporate insolvency (see Chart 8). 40% of the surveyed institutions forecasted increased losses due to corporate insolvency over the upcoming 12 months. About the same number of institutions (38%) expect higher losses, however they remain reserved in terms of forecasting a period in which such losses will occur.

KEY CHARTS AND TABLES

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

Risk	Importance	Probability	Potential impact	Mitigation possibilities
Deterioration in corporate financial health	3.6	3.7	3.4	3.5
Risk of corporate mass bankruptcies	3.5	3.7	3.3	3.6
Deterioration in household financial health	3.3	3.3	3.3	3.7
Deceleration in Lithuania's exports due to the slowdown in main trading partners	3.2	3.3	3.1	3.7
Cybercrime risk	2.8	2.8	2.9	2.9
Snapback in risk premia in global financial markets	2.8	2.8	2.8	4.1
Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.8	2.7	2.9	4.1
Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.6	2.7	2.5	3.8
Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.6	2.3	2.9	4.0
Unsustainable development of real estate prices or imbalances in the real estate market	2.5	2.1	2.8	3.3
Unsustainable credit dynamics or imbalances in the credit market	2.3	2.0	2.8	2.9
Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.3	2.0	2.7	3.9
Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.3	2.0	2.5	4.0
Geopolitical tensions and their implications for Lithuania's financial system	2.2	2.2	2.4	4.0

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. 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 (second half of 2020; total surveyed)

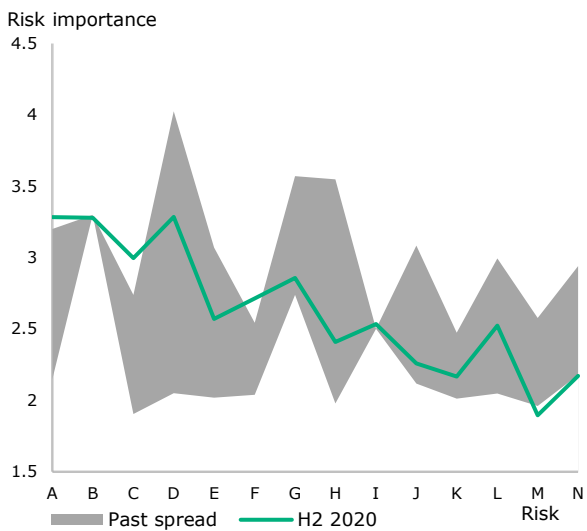
Risk	2017		2018		2019		2020	
	I	II	I	II	I	II	I	II
A. Deterioration in corporate financial health	2.2	2.6	2.4	2.3	2.5	2.6	3.4	3.6
B. Risk of corporate mass bankruptcies								3.5
C. Deterioration in household financial health	2.2	2.3	2.3	2.2	2.4	2.4	3.2	3.3
D. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.3	2.5	2.5	2.5	2.6	2.7	3.7	3.2
E. Cybercrime risk	2.8	2.7	2.7	3	2.7	2.8	3.2	2.8
F. Snapback in risk premia in global financial markets	2.4	2.3	2.3	2.7	2.3	2.4	3	2.8
G. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	3	3.1	3.1	2.8	2.9	3	2.8	2.8
H. 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	2.6
I. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system								2.6
J. 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
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
L. 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
M. 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
N. 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

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.

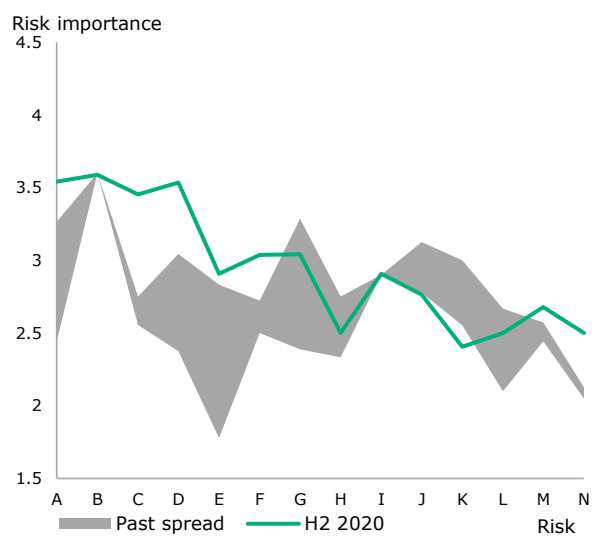
Chart 1. Risk importance by financial sector

Assessment of the importance of risks to banks



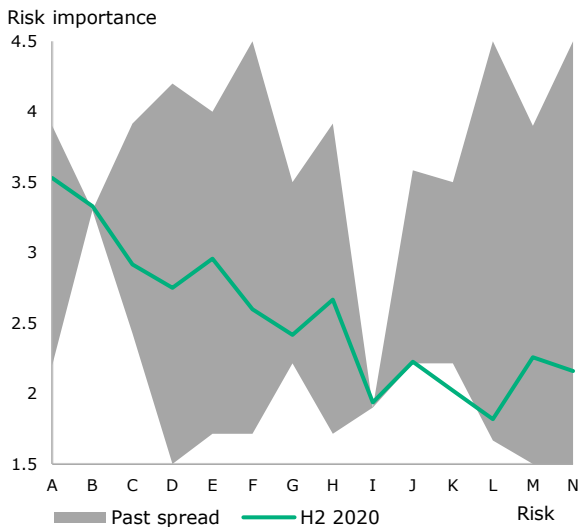
Source: Bank of Lithuania.

Assessment of the importance of risks to credit unions



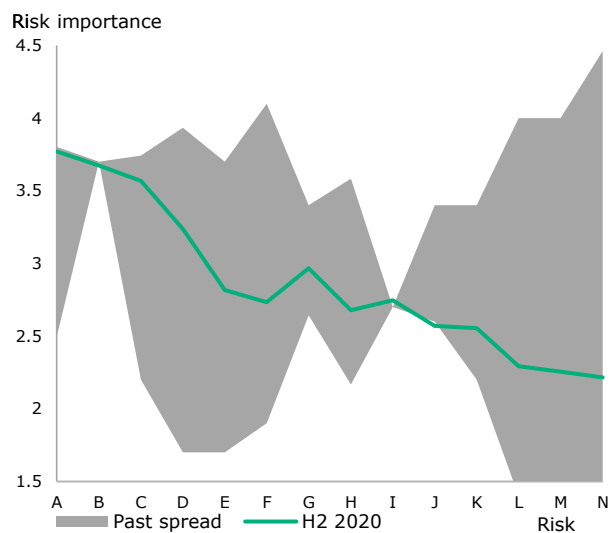
Source: Bank of Lithuania.

Assessment of the importance of risks to insurance undertakings



Source: Bank of Lithuania.

Assessment of the importance of risks to other financial institutions



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 green line combines the H2 2020 survey risk estimates according to the type of financial institution that responded. 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 value among the responding financial institutions of that type in the surveys of risks from H1 2016 to H1 2020.

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

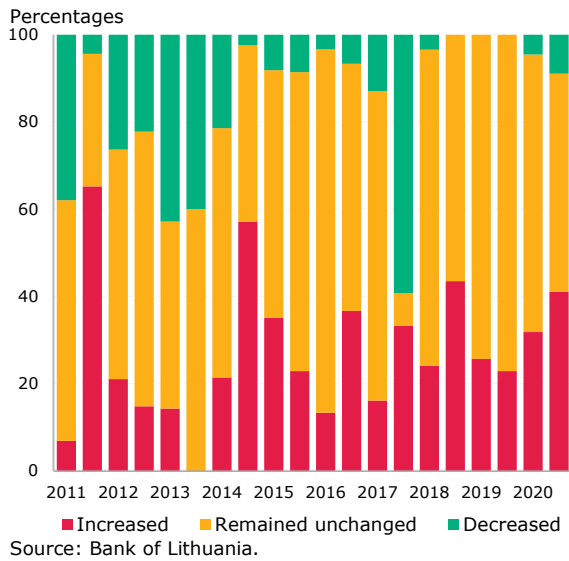


Chart 3. Change in the share of financial institutions affected by cyberattacks

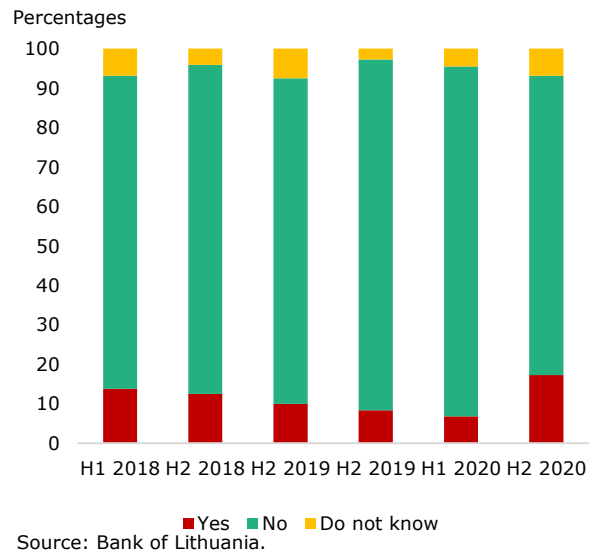


Chart 4. Level of own risk appetite (during the survey)

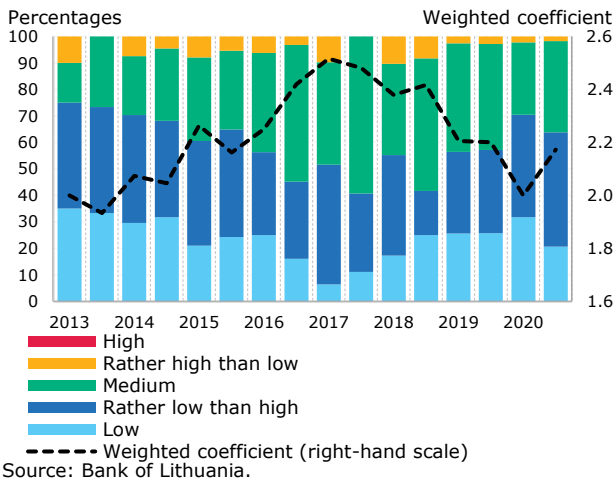
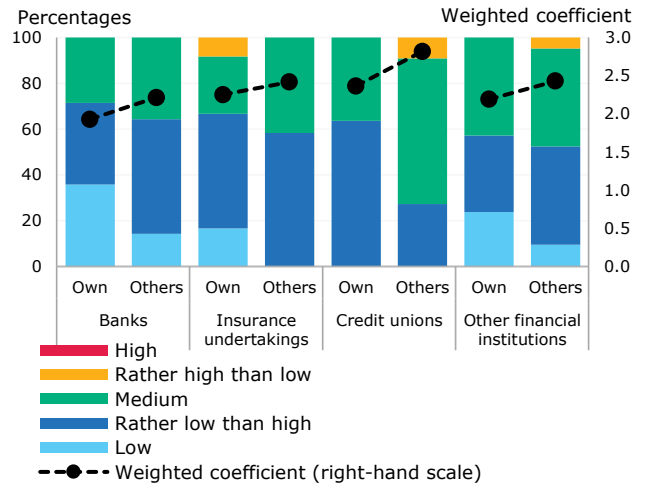


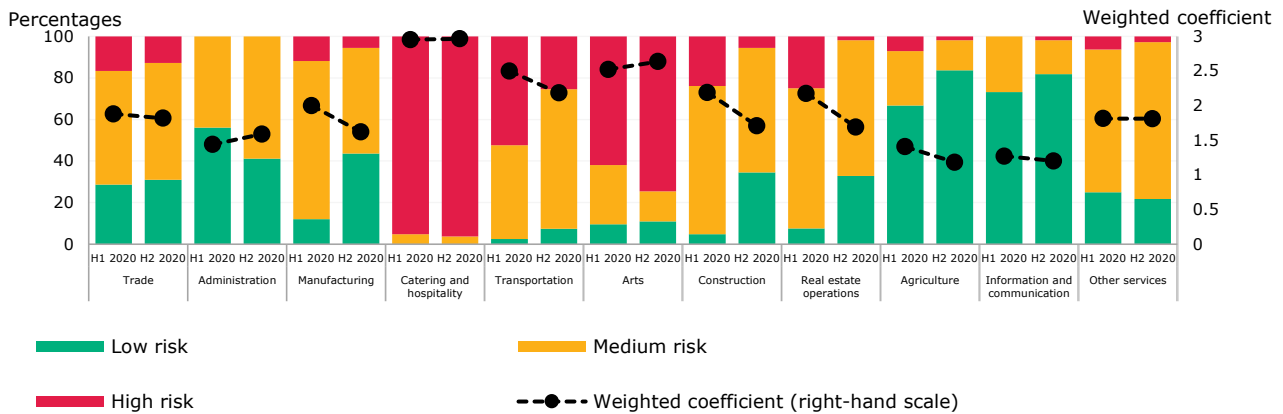
Chart 5. Level of own and other financial institutions' risk appetite (during the survey)



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

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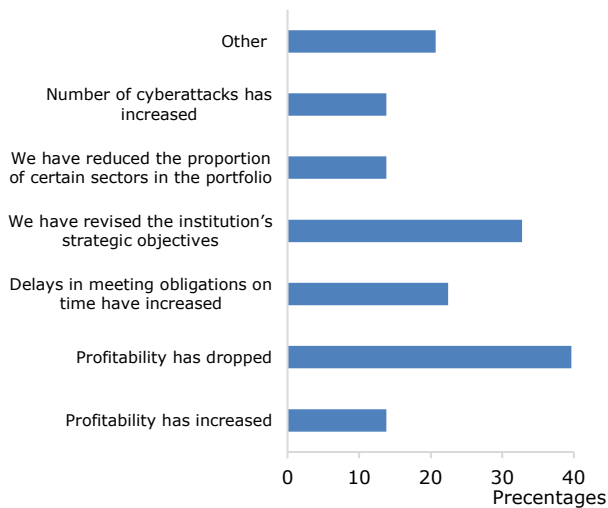
Chart 6. Change in corporate bankruptcy risk by sector



Source: Bank of Lithuania.

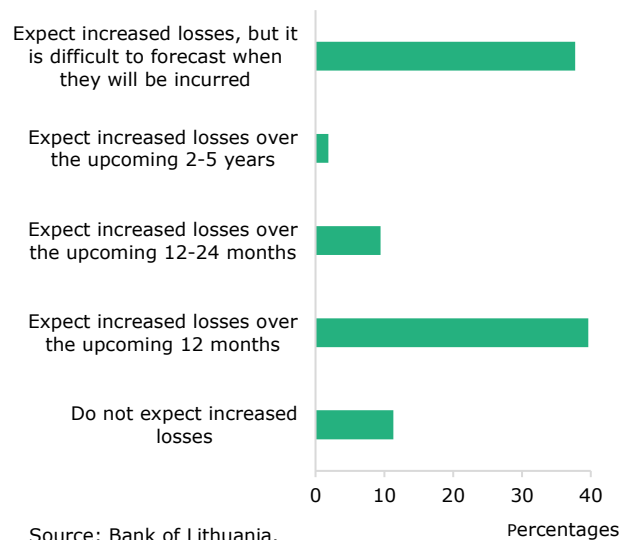
Note: The weighted coefficient is calculated by giving numerical values to risk appetite levels from 1 to 5 (where 1 is low and 5 – high risk appetite) and adding weights to them against the share of each selected answer.

Chart 7. Share of financial institutions impacted by the indicated effect of the COVID-19 pandemic (several answers are possible)



Source: Bank of Lithuania.

Chart 8. Expectations of financial institutions concerning increased losses in the future due to increased corporate insolvency



Source: Bank of Lithuania.