



LIETUVOS BANKAS
EUROSISTEMA

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

2021/2

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AIMS, METHODS AND PRINCIPLES OF THE SURVEY

In order to survey the views of Lithuania's financial institutions towards potential challenges to sustainable development of the national financial system, the Bank of Lithuania conducts, on a biannual basis, a Survey of Risks to Lithuania's Financial System. Banks, insurance undertakings, leasing companies, credit unions, investment management companies and other financial institutions assess the sources of major risks to the financial system of Lithuania, the probability of their materialisation and potential impact on the domestic financial system over the upcoming six months.

The survey sample included 63 respondents (15 banks and foreign bank branches operating in Lithuania, 12 insurance undertakings, 11 credit unions and 25 other financial institutions (leasing companies, financial brokerage firms, management companies). The survey questions were presented to the executives of the financial institutions included in the survey. All responses were given the same weight, regardless of the market share retained by the respondent. Participation in the survey is voluntary, and the respondents are under no obligation to answer any of the questions.

SUMMARY

As in the previous six months, in the second half of 2021, financial institutions identified unsustainable development of the real estate market and cybercrime as the key risks to Lithuania's financial system. The most pressing concern for financial institutions is the risk of deterioration in household financial health. Half of the financial institutions believe that the probability of a major event with an adverse impact on Lithuania's financial system has remained unchanged over the past six months, while the other half believe that it has increased. Financial institutions continue to see the greatest risk of bankruptcy for companies in the accommodation and food service activities sector as well as creative, arts and entertainment sectors. However, most financial institutions do not believe that the probability of corporate insolvencies has increased.

OVERVIEW OF SURVEY RESULTS

According to the surveyed financial institutions, unsustainable development of the real estate market and cybercrime continued to be the key risks to Lithuania's financial system in the second half of 2021 (see Table 1). The importance of these risks has declined marginally over the half-year. All financial institutions rated the risk of unsustainable real estate development as the most important one for Lithuania's financial system, while credit unions gave cybercrime risk slightly less importance than other institutions (see Chart 1). Insurance undertakings stood out among other institutions by attributing relatively great importance to climate change risks. According to financial institutions, none of the reported risks had reached historical highs in the second half of 2021.

A third (32%) of the surveyed financial institutions identified the imbalance between housing supply and demand as the key reason for the current rapid increase in housing prices (see Chart 2). In addition, they pointed to the housing purchases for investment purposes (27% of institutions) and rising construction costs (22% of institutions) as the main reasons for the rapid increase in housing prices. Looking ahead, 87% of institutions believe that housing prices will continue to rise in the coming year, while a fifth (22%) expect a growth rate of more than 10%.

The deterioration in household financial health was most frequently identified as the most important risk to the institutions represented by the respondents for the upcoming half-year. 21% of respondents reported this risk. Geopolitical tensions were cited as the most urgent risk by 17% of respondents, while the importance of this risk for the financial system as a whole, as judged by financial institutions, also increased significantly over the half-year, but still remained below average.

Respondents consider that the possibility of mitigating the impact of the above risks on Lithuania's financial system is mostly average or below average. The possibilities of mitigating the impact of geopolitical tensions and the risks of deterioration in the debt sustainability of Lithuania and other European countries are assessed most unfavourably. Respondents were most positive in terms of possibilities of reducing the impact of cybercrime risks. The share of respondents who had experienced a cyberattack fell by 7 percentage points to 17% in the second half of 2021. However, the share of such financial institutions was twice as high as in the second half of 2019, i.e. before the pandemic (see Chart 3). In addition, financial institutions were relatively positive about the possibility of mitigating the impact of risks from unsustainable credit developments and unsustainable real estate market development. Half of the institutions (49%) believe that the Bank of Lithuania's measures to limit systemic risk are fully adequate in the current risk environment.

Half of the respondents (49%) said that the likelihood of an event with a significant adverse impact on Lithuania's financial system did not change over the past six months, while the other half believed that such an event was more likely (see Chart 4). Only 2% of financial institutions said that the probability of a high-impact event had decreased. Respondents considered that the most likely shock to Lithuania's financial system in the next six months was sustained high inflation. Financial institutions also highlighted further development of the pandemic and possible lockdown restrictions as well as geopolitical tensions as the most likely events to threaten Lithuania's financial system in the near future.

Risk appetite among financial institutions increased in the second half of 2021 (see Chart 5). The current risk appetite is similar to the one in 2018. All financial institutions that took part in the survey consider that they are less risk-prone than other financial institutions (see Chart 6). In addition, the vast majority (84%) of financial institutions said their risk appetite would remain unchanged over the next six months. A similar share (86%) believe that the risk appetite of other Lithuanian financial institutions will remain unchanged, too.

The financial institutions that responded to the survey continue to see the accommodation and food service activities as well as creative, arts and entertainment activities as most vulnerable to bankruptcy risk (see Chart 7). The companies operating in the agricultural and information and communications technology activities face the lowest bankruptcy risk. Compared to the first half of 2021, bankruptcy risk for companies in the manufacturing and construction sector has increased slightly. In the opinion of financial institutions, bankruptcy risk for companies in other economic activities remained unchanged or declined over the half-year.

The impact of the COVID-19 pandemic on the surveyed financial institutions is decreasing (see Chart 8). A third of institutions (35%) were unaffected by the pandemic in the last six months, with the share tripling over the past six months. As in the first half of 2021, a quarter of institutions (28%) have revised their strategic objectives as a result of the pandemic.

The share of financial institutions that do not see a heightened probability of corporate insolvencies has increased drastically over the past six months (see Chart 9). In the second half of 2021, 72% of institutions shared this belief, compared to 39% in the previous half-year. Just over a tenth of financial institutions (13%) expect losses from corporate insolvencies to increase in the next 12 months. 9% of financial institutions expect losses to increase in the next 12–24 months, and 6% expect this to happen in the next 24 months and beyond.

KEY TABLES AND CHARTS

Table 1. Assessment of risks to Lithuania's financial system (second half of 2021)

Risk	Importance	Probability	Potential impact	Mitigation possibilities
A. Unsustainable development of real estate prices or imbalances in the real estate market	3.2	3.2	3.3	3.1
B. Cybercrime risk	2.9	2.9	2.9	2.9
C. Lithuanian economy overheating risk	2.8	2.8	2.7	3.7
D. Snapback in risk premia in global financial markets	2.8	2.7	2.8	3.9
E. Geopolitical tensions and their implications for Lithuania's financial system	2.7	2.9	2.5	4.3
F. Deterioration in corporate financial health	2.7	2.5	2.9	3.7
G. Deceleration in Lithuania's exports due to the slowdown in main trading partners	2.6	2.4	2.7	4.1
H. Deterioration in household financial health	2.5	2.3	2.8	3.7
I. Unsustainable credit dynamics or imbalances in the credit market	2.5	2.3	2.7	3.0
J. Imbalances in Scandinavian countries and potential contagion effects on Lithuania's financial system	2.3	2.1	2.6	4.2
K. Deterioration in European sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.3	2.1	2.5	4.3
L. Problems in the European banking sector and potential contagion effects on Lithuania's financial system	2.2	2.0	2.4	4.1
M. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system	2.2	1.7	2.7	4.3
N. Drop in profitability of Lithuania's financial institutions during a prolonged period of low interest rates	2.1	2.1	2.1	3.9
O. Climate change risk	2.1	2.0	2.2	4.0

Source: Bank of Lithuania.

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 for 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	
	I	II	I	II	I	II	I	II	I	II
A. 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
B. Cybercrime risk	3	3.1	3.1	2.8	2.9	3	2.8	2.8	3.1	2.9
C. Lithuanian economy overheating risk										2.8
D. 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
E. 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*
F. 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
G. 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	2.6	2.6
H. 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
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
J. 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
K. 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*
L. 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
M. Deterioration in Lithuanian sovereign debt sustainability and potential contagion effects on Lithuania's financial system								2.6	2.3	2.2
N. 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	2.4	2.1
O. Climate change risk										2.1

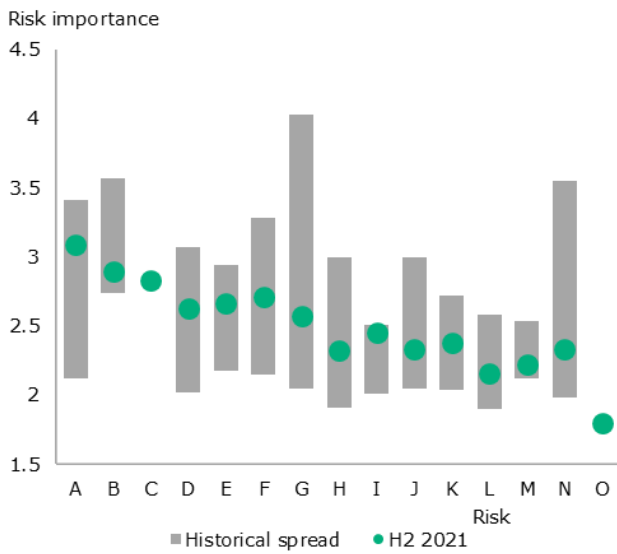
Source: Bank of Lithuania.

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" – second 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.

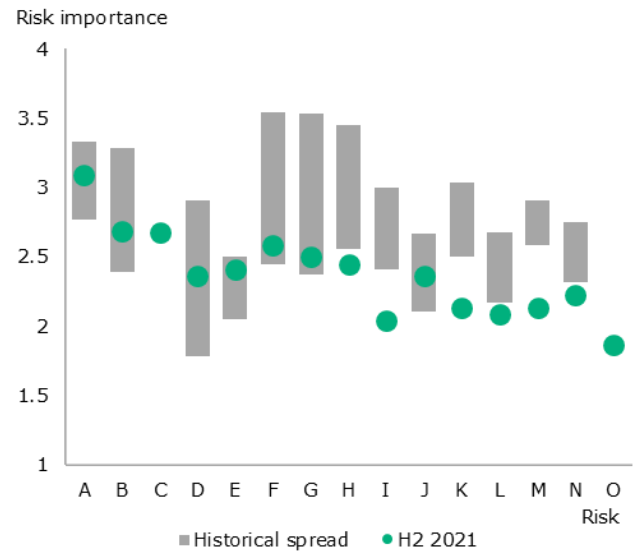
Chart 1. Risk importance by financial sector

Assessment of the importance of risks to banks



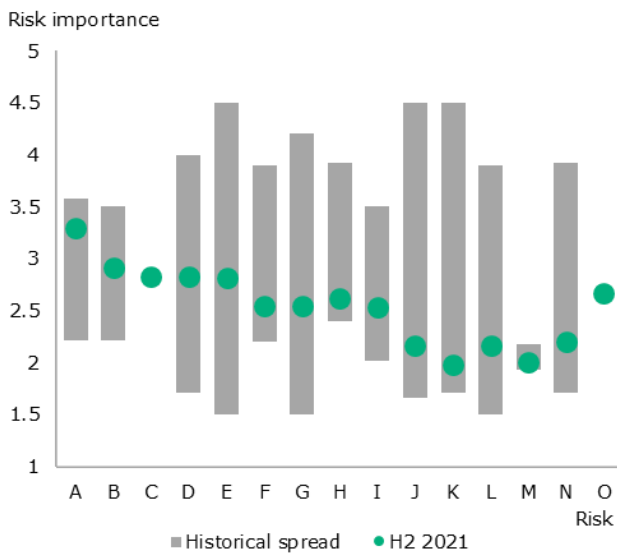
Source: Bank of Lithuania.

Assessment of the importance of risks to credit unions



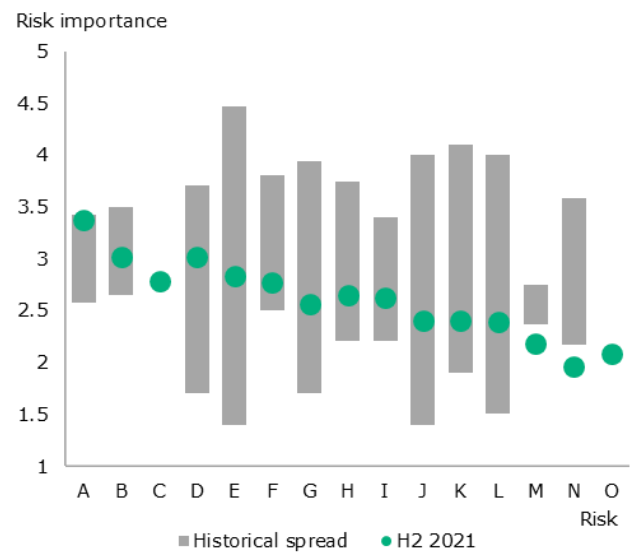
Source: Bank of Lithuania.

Assessment of the importance of risks to insurance undertakings



Source: Bank of Lithuania.

Assessment of the importance of risks to other financial institutions

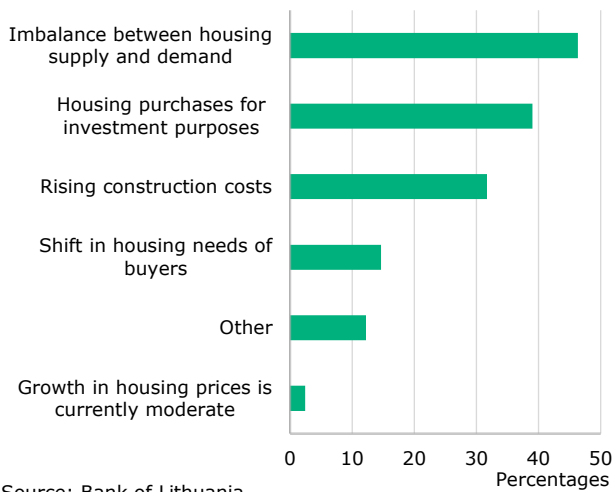


Source: Bank of Lithuania.

Source: Bank of Lithuania.

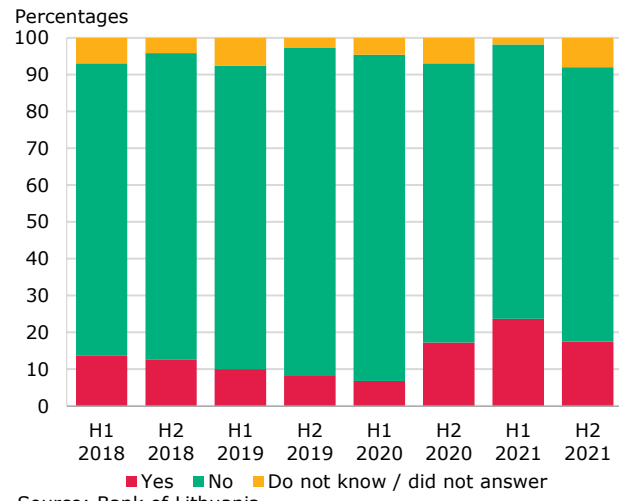
Notes: Risks are named in line with the risk sources in Tables 1 and 2. Risk importance is calculated as a geometric mean of estimates for its probability and potential impact. Assessment of the level of risk importance: 1 – low; 2 – lower than medium; 3 – medium; 4 – higher than medium; 5 – high. The grey colour marks dissemination between the lowest and highest risk values among the responding financial institutions of that type in the surveys of risks from H1 2016 to H1 2021.

Chart 2. Factors contributing to the rapid rise in housing prices in Lithuania



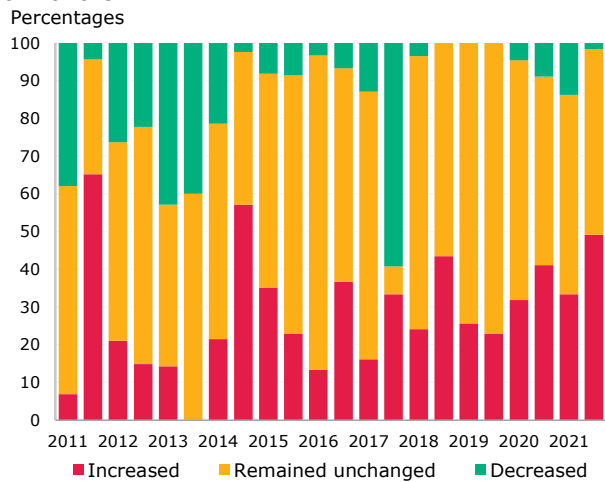
Source: Bank of Lithuania

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



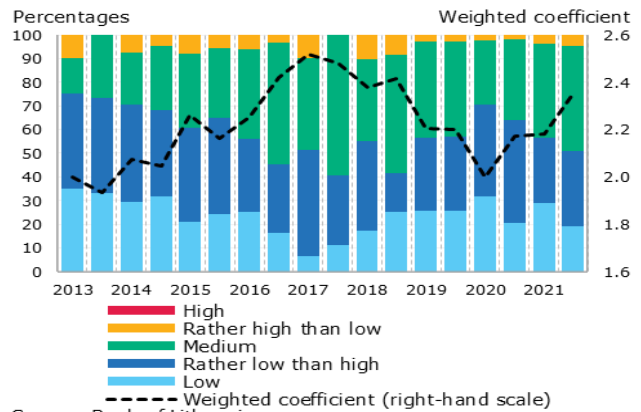
Source: Bank of Lithuania.

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.

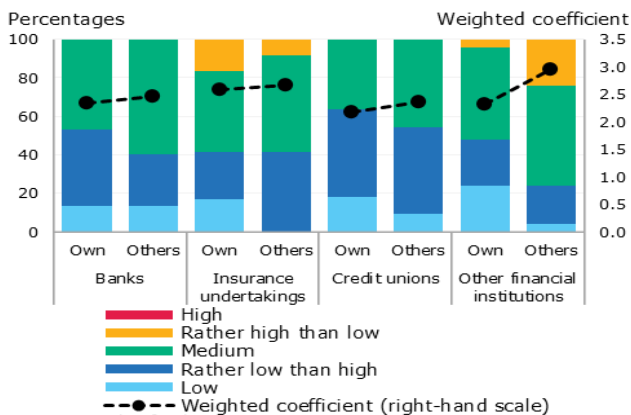
Chart 5. Level of own risk appetite (during the survey)



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.

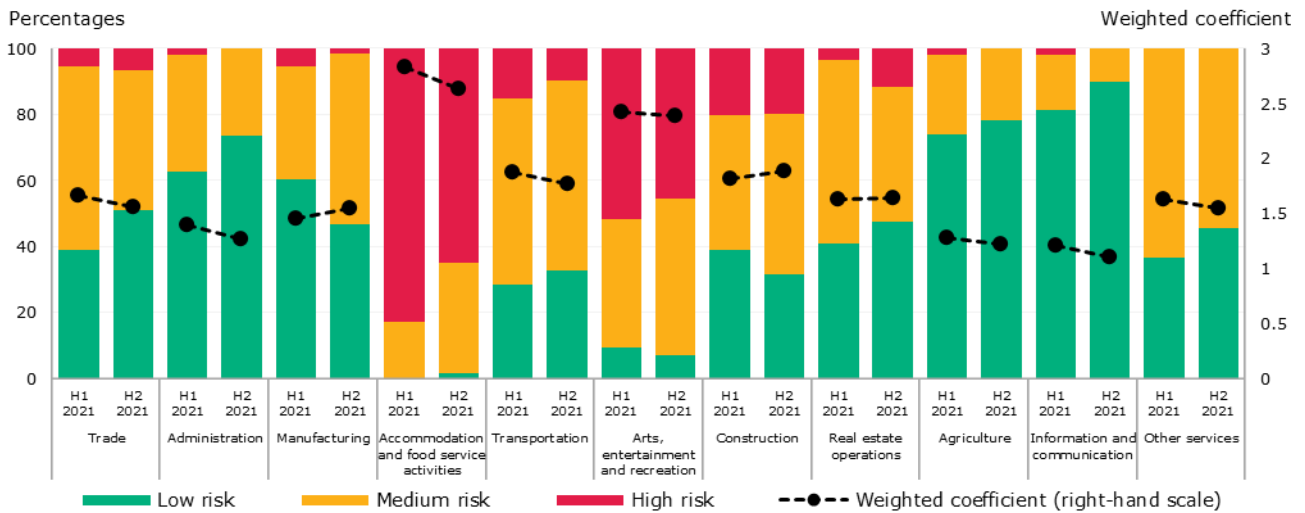
Chart 6. Level of own and other financial institutions' risk appetite (during the survey)



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.

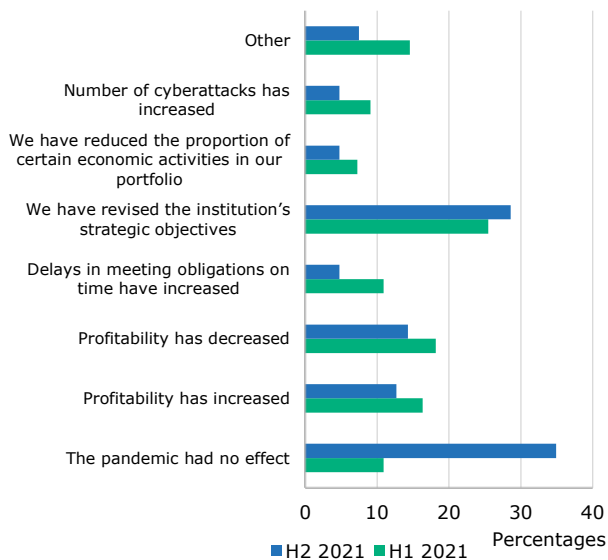
Chart 7. Change in corporate bankruptcy risk by sector



Source: Bank of Lithuania

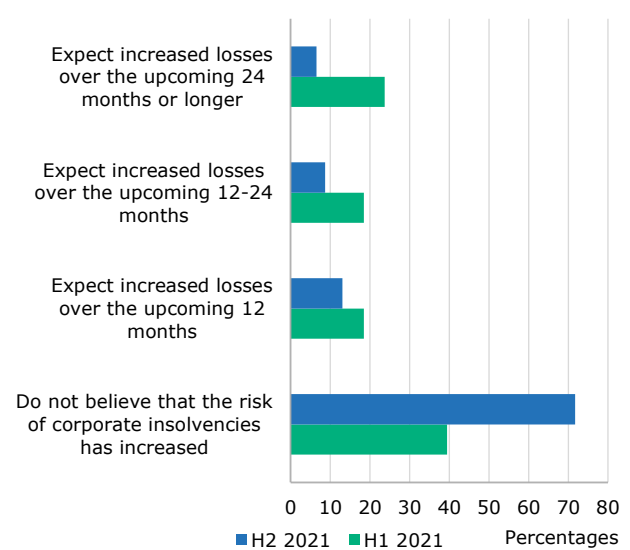
Note: The weighted coefficient is calculated by giving numerical values to perceived risk levels from 1 to 5 (where 1 is low and 5 is high perceived risk and adding weights to them against the share of each selected answer.

Chart 8. Share of financial institutions impacted by the indicated effect of the COVID-19 pandemic (several answers are possible)



Source: Bank of Lithuania.

Chart 9. Expectations of financial institutions concerning higher losses in the future due to increased corporate insolvency



Source: Bank of Lithuania.