The international banking crisis and domestic financial intermediation: the experience of Poland

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The Polish banking sector has remained relatively unaffected by the direct impact of the global financial crisis due to its rather traditional banking activity model. Local banks were not engaged in investing in complex structured financial instruments and, therefore, the size of financial institutions' exposure to US subprime market risks, either in the form of holding structured financial instruments or other instruments issued by the largest investment banks, was negligible.

Additionally, the Polish banking sector entered the period of global financial turbulence and economic slowdown in a comfortable position in terms of profitability and capital adequacy (see Table 1). In fact, in 2008, Polish banks reported record high earnings, which provided them with a buffer to absorb the negative effects of the global crisis.

Despite the lack of direct exposure to Lehman Brothers, Polish banks were adversely impacted by its collapse as a result of a major increase in the risk aversion of global financial market participants. As a significant number of Polish banks are members of global or regional banking groups, the turbulence in the global market caused a major fall in mutual confidence between them, which may be denoted as an "imported" confidence crisis. As a result, liquidity in the local money and foreign exchange (FX) markets decreased significantly. Tensions in the money market were also caused by the increased risk aversion of global investors resulting in a "flight to quality" and the withdrawal of capital from emerging markets.

The above-mentioned tensions in the local interbank market were quickly addressed by the National Bank of Poland (NBP). The introduction of a repo facility, combined with the maintenance of absorbing operations, redistributed zloty (PLN) liquidity between banks, and the introduction of FX swaps enabled banks to hedge against FX risk resulting, inter alia, from significant portfolios of foreign currency denominated mortgage loans. Although the above instruments were not widely used, they restored confidence in the markets and helped to avoid a potential systemic crisis.

The macroeconomic channel proved to be a major source of contagion of the global crisis for the Polish banking sector. The economic slowdown adversely impacted the economic standing of borrowers and, consequently, the quality of banks' credit portfolios deteriorated. The irregular loan ratio had stabilised throughout 2008 at its historical minimum, at 4.4%. The amount of irregular loans, however, started to grow, triggering an increase in provisions for "bad" loans. The amount of irregular loans grew by 64% in the first three quarters of 2009 and the irregular loan ratio jumped to 7.0% at the end of September. The increase in irregular loans was concentrated in corporate and consumer loans (see Table 2). The quality of the mortgage portfolio remained high and stable – at the end of September only 1.4% of such loans were impaired.

Throughout 2009, banks continued to tighten their lending policies that started towards the end of 2007. The scale of lending policy tightening was largest at the turn of 2008 and 2009.

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In the second quarter of 2009, the changes in lending standards were less severe than in the preceding periods.

The results of the quarterly survey[2] conducted in banks suggest that the main reason for the changes to lending policies (lending conditions and criteria) was the deteriorating economic situation and uncertainty regarding future economic developments, both of which increased the credit risk associated with new lending but also hindered its proper assessment. The decreasing credit portfolio quality and capital constraints were other major reasons behind the tightening of lending policy; however, the importance of the latter factor diminished in the second half of 2009 as banks increased their capital base, mainly by retaining 2008 profits.

The tightening of banks' lending policies, accompanied by a lower demand for loans, adversely impacted credit growth (see Graph 1). Lending growth to non-financial customers in November 2009 amounted to 7.1% after adjusting for exchange rate differences. The strongest slowdown was observed in corporate lending, where credit growth became negative. Consumer lending decreased the least, as banks shifted their lending to this market segment due to the fact that margins were highest in this segment and banks sought to offset higher funding costs by enhancing high-margin products in their credit portfolios.

The current crisis has caused a change in the funding structure of banks operating in Poland. In the fourth quarter of 2008, the amount of funding obtained by banks from the Polish interbank market decreased (a fall of PLN 10.3 billion between August 2008 and December 2008; data adjusted for exchange rate movements). The fall was offset by transactions with non-residents, mostly parent companies (a rise of PLN 27.1 billion in the same period; data adjusted for exchange rate movements). The value of funding from foreign sources stabilised at December 2008 levels and has risen slightly in recent months (see Graph 2), while the funding raised from the domestic interbank market has fallen further.

During the last quarter of 2008 and the first quarter of 2009, banks competed fiercely for stable sources of funding, especially household deposits. This was visible in interest rates on new household deposits which, in the first half of 2009, were slightly above the interbank rate.

The increase in credit risk and funding costs adversely impacted banks' profitability (see Table 1). Return on assets (ROA) and return on equity (ROE) in the first 11 months of 2009 were lower than in the corresponding period of the previous year (annualised ROA amounted to 0.72% in November 2009 and 1.78% in November 2008, and annualised ROE amounted to 9.5% and 24.0%, respectively). It should be emphasised, however, that the majority of foreign-owned banks in Poland reported higher profitability than their foreign parent entities and their business model – based on credit-deposit activities and limited engagement in financial instruments – makes their earnings more stable and less prone to adverse market developments.

The majority of Polish banks followed the NBP's and the Financial Supervision Authority's recommendations and retained 2008 profits in order to increase their capital base. As a result, the average capital adequacy ratio in the banking sector increased to 12.5% at the end of November 2009 (compared to 11.2% at the end of 2008) (see Table 1). Stress tests conducted by the NBP[3] indicate that banks have sufficient capital buffers to absorb potential losses resulting from even very strong adverse economic developments.

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2 Senior loan officer opinion survey on bank lending practices and lending conditions, 2008 and 2009 editions.

3 *Financial Stability Report*, December 2009.

Appendix

Table 1

Profitability and capital adequacy of the Polish banking sector

	12–2006	12–2007	12–2008	6–2009	11–2009
Net earnings (PLN billions)	10,697	13,651	13,737	4,549	8,330
ROA*	1.70%	1.85%	1.53%	0.97%	0.72%
ROE*	22.2%	24.9%	20.5%	12.8%	9.5%
Capital adequacy ratio	13.2%	12.0%	11.2%	12.5%	12.5%

*Annualised.

Source: NBP.

Table 2

Profitability and capital adequacy of the Polish banking sector

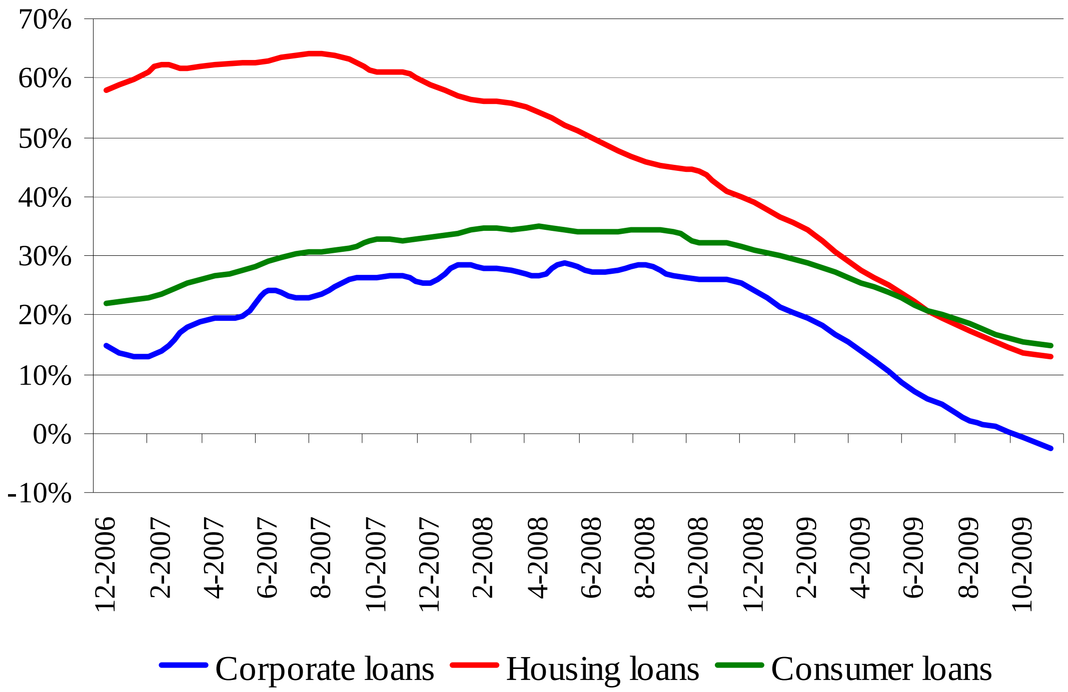
(in per cent)

	12–2006	12–2007	12–2008	3–2009	6–2009	9–2009
Non-financial sector	7.4	5.2	4.5	5.3	6.3	7.0
Households' housing loans	1.8	1.2	1.0	1.1	1.2	1.4
Households' consumer loans	7.9	6.6	6.6	7.3	8.0	9.4
Corporate loans	9.7	6.9	6.2	7.9	10.0	10.8

Source: NBP.

Graph 1

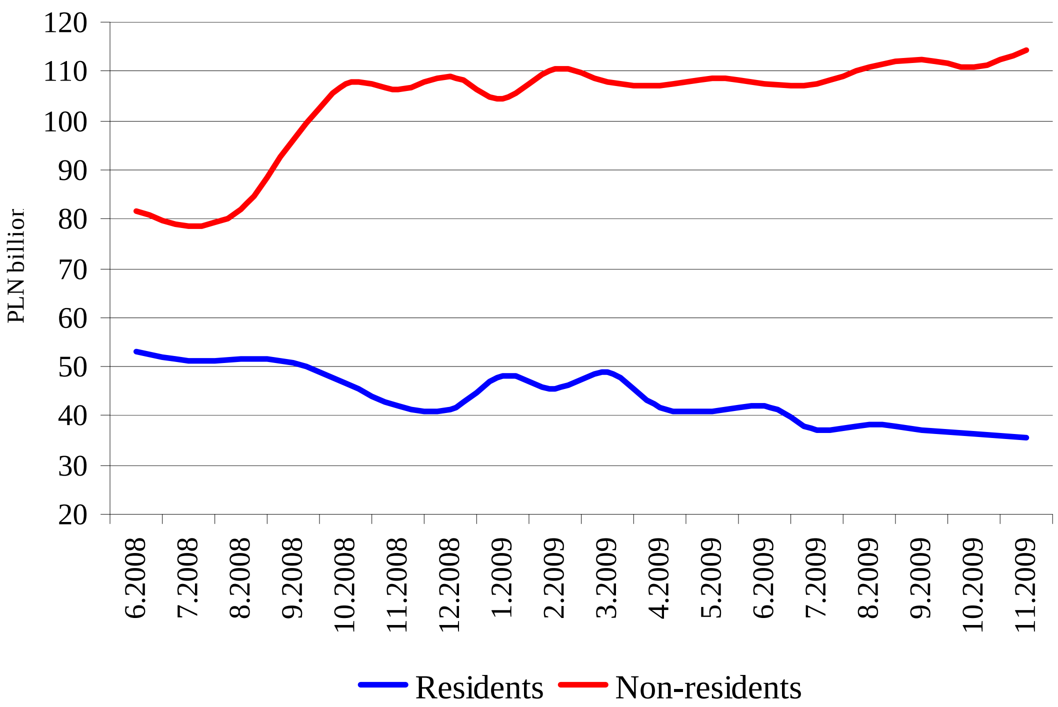
Annualised credit growth in the banking sector (data exchange rate adjusted)



Source: NBP.

Graph 2

Banking sector liabilities towards resident and non-resident monetary financial institutions (exchange rate adjusted)



Source: NBP.