

# FOREIGN DIRECT INVESTMENT IN THE POLISH FINANCIAL SECTOR

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## **EXECUTIVE SUMMARY**

Foreign direct investment in the Polish banking sector has increased significantly in the last decade. At the end of September 2003, foreign banks had a stake of approximately 77% in the Polish banking sector and controlled about 67% of total bank assets. This situation is not unique in former centrally-planned economies. However, the case of Poland is of particular interest, considering the size of the country which accounts for more than 37% of the global GDP of Eastern European countries which are about to join the EU. Moreover, right from the start, the opening of the banking sector to major international banking groups played a key role in the restructuring of the banking system and was seen as a unique opportunity to create an efficient banking system providing services that could meet international standards. Lastly, a substantial and strategic share of the market is still under the control of PKO BP, a state-owned bank.

Foreign banks have acquired a dominant position in the wake of the privatisation of state-owned banks. The Polish authorities have continuously overseen this process. They first gradually opened up the capital of state-owned banks, then, in 1998-1999, sold the bulk of the remaining major state-owned banks to leading shareholders. The determining factors of financial FDI before and after privatisation were different. Before 1993, the main objective of foreign banks was to “follow their customers”, while from 2000 onwards, foreign banks started investing in specific segments of the banking sector, such as consumer credit, leasing, or mortgage loans.

The Polish authorities have also played a leading role in strengthening the Polish banking sector by imposing specific criteria for selecting foreign investors and granting licenses. During a certain period, the Polish authorities made financial FDI conditional on the foreign investors’ participation in the restructuring of the banking sector. The foreign investors were required to bail-out loss-making or low-profitability banks, as a condition for being granted a banking licence. Polish authorities also strove to convince foreign-owned banks to remain listed on the Warsaw Stock Exchange (WSE).

This paper also addresses the impact of FDI on the Polish financial sector. In spite of dwindling profitability figures in 2002 linked to narrower margins, there is some evidence that the large opening to foreign investors has contributed to improving the efficiency of the Polish banking sector. The fact that efficiency gains have not led to foreign-owned banks’ better profitability at this stage can be explained by differences in balance sheets’ structures

with Polish-owned banks, a higher ratio of non performing loans in foreign-owned banks, and the dominant position of PKO BP in the state-owned banking sector which makes it difficult to compare banks' profitability.

The paper focuses on issues relating to the stability of the financial sector. It investigates whether the different lending behaviour of foreign and Polish banks could have hindered the financing of some parts of the economy. No evidence was found that the riskiest loans have shifted in the hands of Polish-owned banks, nor that small and medium-sized enterprises have suffered from credit restriction. However, it seems that the observance of higher standards in terms of borrower selection and transparency has been instrumental in making the overall banking system more resilient.

Finally, some evidence was found that the opening of the financial sector to foreign capital has contributed to easing the access of Polish residents to foreign currency-denominated loans in the most recent period. Today, the share of foreign-currency lending in total lending to non-financial customers scores high, around 30%. This is currently the main source of concern as regards financial stability in Poland, as a sharp depreciation of the zloty could, in theory, undermine the capacity of domestic debtors to repay banks, hence deteriorating the quality of banks' assets.

## **INTRODUCTION**

As in other Central and Eastern European countries, the collapse of the centrally-planned economy has led to radical changes in the financial sector in Poland. The most striking feature has been the opening of banks' capital to private and, primarily, foreign investors, which has then reduced the role of the State in the financial sector.

Several factors account for the attractiveness of the Polish financial sector for foreign investors:

- the size of the Polish market, which is the largest among East European countries (38 million inhabitants);
- the low level of financial intermediation, with total lending amounting to 30% of GDP (as compared to 140% in the European Union) and total banking assets representing 68% of GDP (as opposed to 260% in the EU). The largest Polish banks are small by international standards, and market capitalisation on the Warsaw Stock Exchange amounted to only 14% of GDP at end-2003. Although only 54% of Polish households held a bank account in 2002, this percentage is rapidly rising<sup>2</sup>. As a result, the Polish financial sector's development prospects in the context of EU membership are promising;
- from a more general point of view, establishing a subsidiary in Poland may be viewed by many investors as a first step towards developing a network in Eastern Europe.

Given that commercial banks play a prominent part in the Polish financial sector – assets held by banks account for 82% of all financial assets<sup>3</sup> –, this case study focuses on the commercial banking sector. It first presents the main features of the foreign penetration process in the Polish financial sector, in particular the key role of Polish authorities during and after the privatisation of a large share of the banking sector. Second, assessing the impact of FDI on the Polish financial sector and financial stability, it appears that the entry of foreign banks made the banking sector more resilient and competitive, without entailing any negative effects on residual Polish-owned banks nor reducing access to credit for small and medium sized enterprises. Finally, the paper focuses on the risks associated with the high foreign currency-denominated debt of bank customers, and finds that there is a correlation between the rise in foreign currency debt and foreign penetration in the banking sector in the most recent period.

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<sup>2</sup> It should be mentioned, however, that some surveys pointed out to a higher figure, closer to 60-70%.

<sup>3</sup> Insurance companies account for 9% of total financial sector assets, pension and investment funds 5%, and co-operative banks 4%.

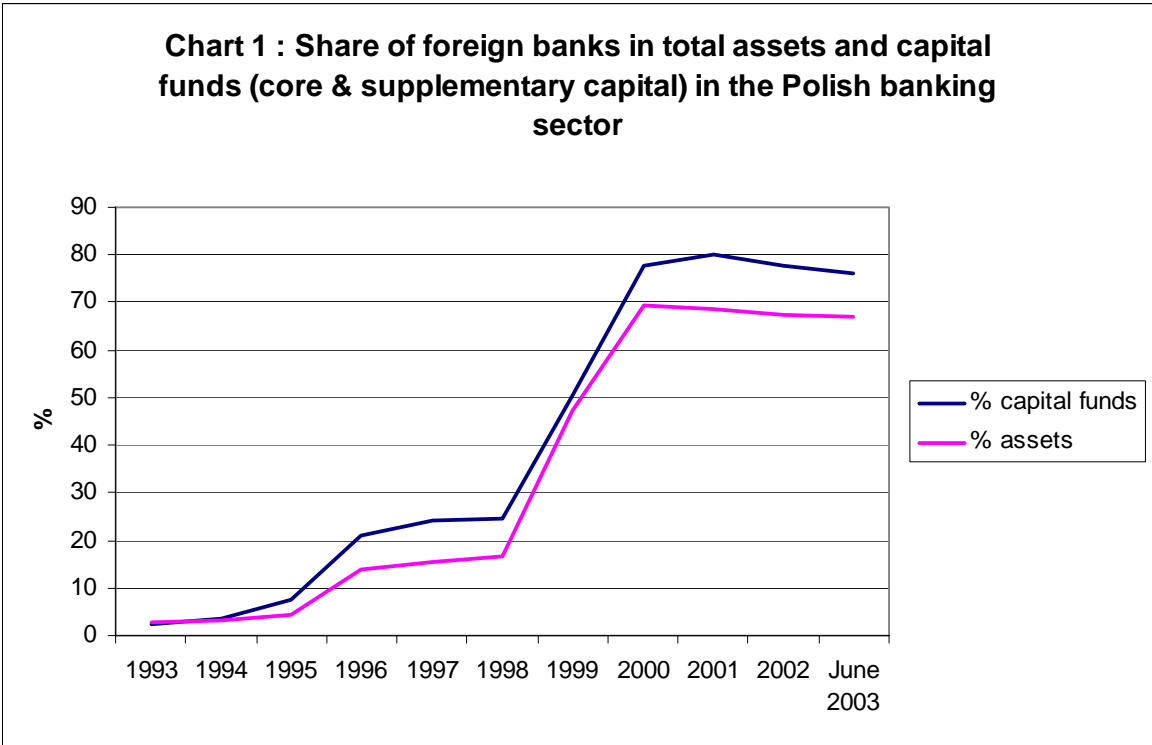
# **1. MAIN FEATURES OF THE FOREIGN PENETRATION PROCESS IN THE POLISH BANKING SECTOR**

The opening of the Polish banking sector to foreign investors has taken place under the constant control of Polish authorities. A key step in this process was the decision to privatise state-owned banks and sell them to foreign banks from 1993 onwards. During and after the privatisation process, Polish authorities have closely monitored the banking sector.

## **1.1 Foreign participation increased significantly in the last decade**

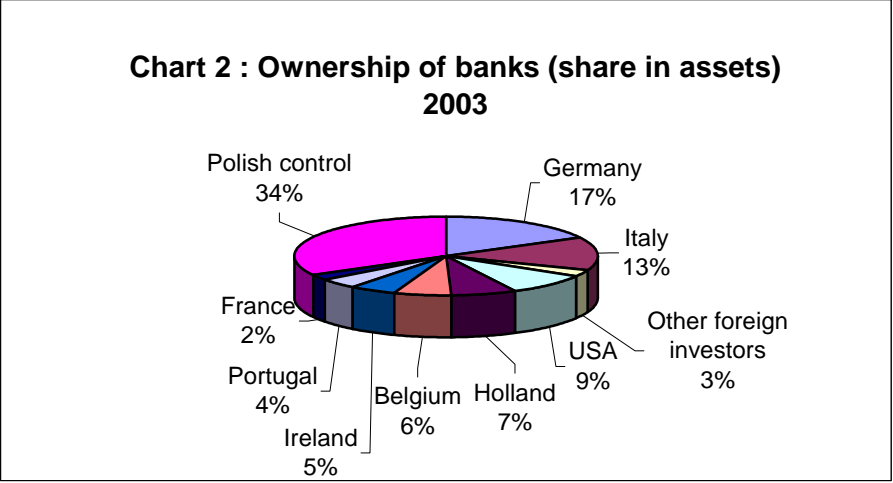
From 1989 to 1993, the number of banks increased rapidly, with the establishment of a large number of private local banks; at the same time, commercial banking activities –which were previously carried out by the National Bank of Poland – were broken down between 9 commercial banks. The acquisition of most of these banks by foreign banks, as well as the opening of subsidiaries of foreign financial institutions, gained momentum after 1995: in 1999, foreign investors controlled more than half of the market in terms of capital and outstanding loans, reflecting also the high degree of concentration of the Polish banking sector.

This process went on for several years. As a result, at the end of September 2003, foreign banks owned roughly 77% of Polish banks’ capital, representing 67% of the banking sector’s total assets (see Chart 1).



Source : NBP data

Today, eight out of the ten largest banks in Poland are controlled by foreign investors, in majority Western European banking groups (Chart 2 and annex). In particular, the Italian group Unicredito Italiano controls PEKAO SA.



Source : NBP data

However, figures do not reflect accurately foreign banks’ market share and must be interpreted in the light of “qualitative” criteria:

- a substantial and strategic share of the market remains under the control of the government and domestic investors. For instance, the largest Polish bank in terms of deposits (nearly 25% of total deposits) is the state-owned PKO BP<sup>4</sup>. This gives it a key role in the refinancing of other financial institutions. As a matter of fact, it seems that Polish subsidiaries or branches of foreign banking groups do not turn significantly to their parent companies for refinancing;
- the degree of autonomy of foreign-owned Polish banks vis-à-vis their shareholders differs markedly between shareholders’ home countries: there is anecdotal evidence that German banks have granted more independence to their subsidiaries for lending decisions. Conversely, French and American entities seem to have given much less autonomy to their affiliates.

**1.2. The privatisation process**

The entry of foreign banks in the Polish banking sector has not been linear since 1990. Foreign banks acquired a dominant position in the wake of the privatisation of state-owned banks from 1993 to 2000. The Polish authorities have been closely monitoring this process:

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<sup>4</sup>Similarly, in the insurance sector, the public insurance company PZU accounts for nearly half of the market.

banks were sold to major foreign banking groups, as Polish authorities were eager to select international banks that could provide both capital and technical expertise. There have been two main phases in the privatisation process, as illustrated in Chart 1:

- the first phase between 1993 and 1997 corresponds to a step-by-step opening of state-owned banks' capital. A minority stake was first sold to fragmented shareholders, while the State Treasury retained control of banks; foreign investors then gained control of the majority of the capital. This method was used, in particular, for five out of the nine banks spinned off from the NBP in 1989, as well as for BRE bank SA.
- The second phase was characterised by the swift privatisation of the remaining major state-owned banks in 1998-1999. The privatisation method was radically different, as Polish authorities sold a majority interest via non-public offers to selected foreign strategic investors. This method was relied upon for the sales of Bank Zachodni to Allied Irish Bank, and of Bank PEKAO SA to Unicredito Italiano and Allianz AIG together (the former bank took control of the entity in 2000).

The privatisation process came to an end in 2000; since then, no further major sales have been completed. However the consolidation process within the Polish banking industry might not be over yet.

The privatisation process led to a complete change in the way in which foreign banks entered the Polish financial sector:

- before 1993, the main objective of foreign banks was to “follow their customers”, as local banks were not properly equipped to meet the needs of foreign companies established in Poland. The core activities of these local satellites were, typically, documentary credits, cash management, or foreign exchange transactions; they would usually deal with local branches of foreign companies in the industrial or retail sector and, occasionally, with investment-grade Polish companies. In some cases, foreign banks opened a branch or a subsidiary through a consortium, which was subsequently dismantled;
- from 2000 onwards, foreign banks started to invest in specific segments of the banking industry (such as consumer credit, leasing, and mortgage loans), as illustrated by the takeover of EFL, the first leasing company in Poland with a 35% market share, and of Lukas Bank SA, a retail bank, by Crédit Agricole in 2001.



### **1.3. During and after the privatisation process, Polish authorities closely monitored FDI in the financial sector**

The Polish authorities have played a leading role in the reshaping of the Polish banking sector, by selecting foreign investors and issuing licenses under specific conditions.

Foreign investment in the banking sector has always been viewed by Polish authorities as a means of strengthening this sector. They have thus paid great attention to the origin of foreign investors, aiming at diversifying the country of origin of the parent banks and encouraging well-capitalised Western banking groups. A striking example is the policy, systematically applied from 1995 to 1998, of requiring that potential foreign investors bail-out loss-making or low-profitability banks, in exchange for a banking licence<sup>5</sup>. However, Polish authorities authorised greenfield investment in the exceptional cases when the potential investor's nationality was not yet represented in Poland (e.g. Svenska Handelsbanken) or when it intended to create new activities in Poland (e.g. car finance). In other circumstances, Polish authorities opposed mergers, while it could have boosted the banking sector's dynamism: this was the case in 1999 when public shareholders in Bank Handlowy (the PZU insurance company and the Treasury) objected to its merger with BRE bank<sup>6</sup>.

Polish authorities have also tried to keep foreign-owned banks listed on the Warsaw Stock Exchange (WSE), with the objective, *inter alia*, of ensuring a high level of accounting transparency. Currently, major banks account for a substantial share of market capitalisation, close to 48%, in spite of a relatively low float (generally less than 10%). However, this is unlikely to last, as most foreign investors are seeking to take full control of their subsidiaries, thus discontinuing their listing on the Stock Exchange.

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<sup>5</sup> NBP, "The Polish Banking System in the Nineties", 2001, p. 51.

<sup>6</sup> This example is all the more striking as the Commission for Banking Supervision publicly approved the merger which, in its opinion, would have ensured Bank Handlowy "not only dynamic growth, but also maintenance of its corporate identity and continued Polish management." ("Summary evaluation of the financial situation of Polish banks", 1999).

## **2. THE IMPACT OF FDI ON THE POLISH BANKING SECTOR'S PROFITABILITY AND FINANCIAL STABILITY**

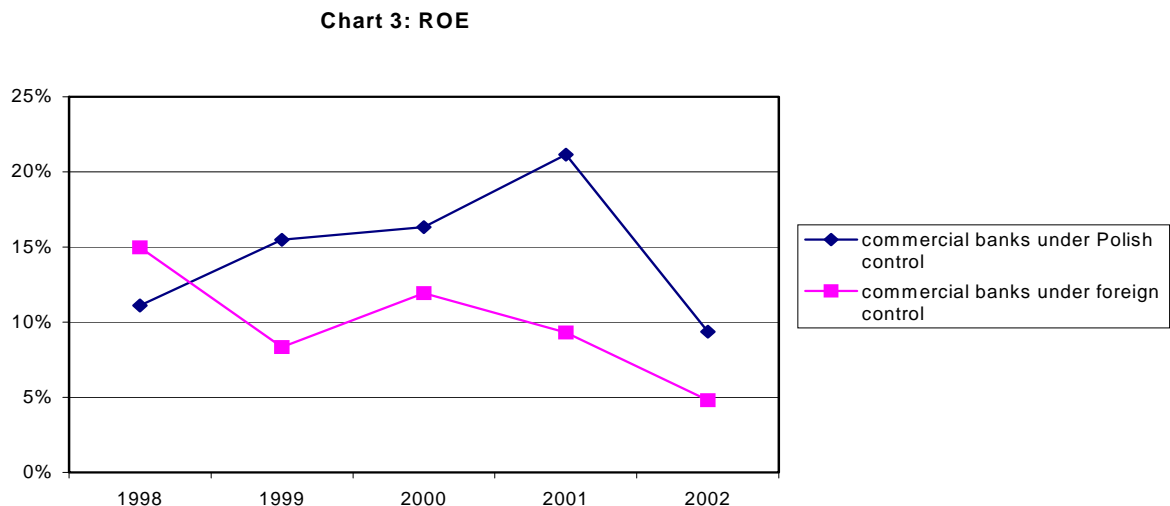
Assessing the consequences on financial stability of the opening of the Polish banking sector to foreign investors is not easy. However, there is some evidence that this large foreign presence has made the banking sector more efficient, in spite of dwindling profitability figures in 2002 linked to narrowing margins. In this section, we also focus on issues related to the stability of the financial sector.

### **2.1. A more competitive banking sector: some statistical evidence**

In the view of Polish authorities, the takeover of a large number of Polish financial institutions by major international banking groups was aimed at fostering the emergence of a stronger banking sector. Foreign participation has always been viewed as a means of enhancing substantially the quality and diversity of financial services. Some statistical evidence is found that foreign participation has helped to improve the banking sector's efficiency.

#### **2.1.1. Profitability**

As Chart 3 shows, since 1999 Returns on Equity (ROE)<sup>7</sup> have scored higher for banks with majority Polish shareholders than for those owned by foreign investors.

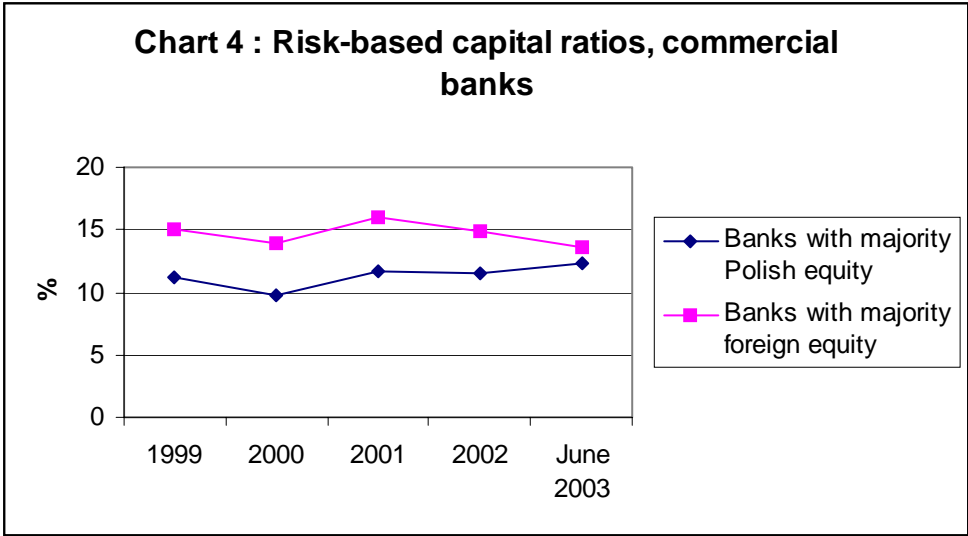


Source: Banque de France calculations based on NBP data

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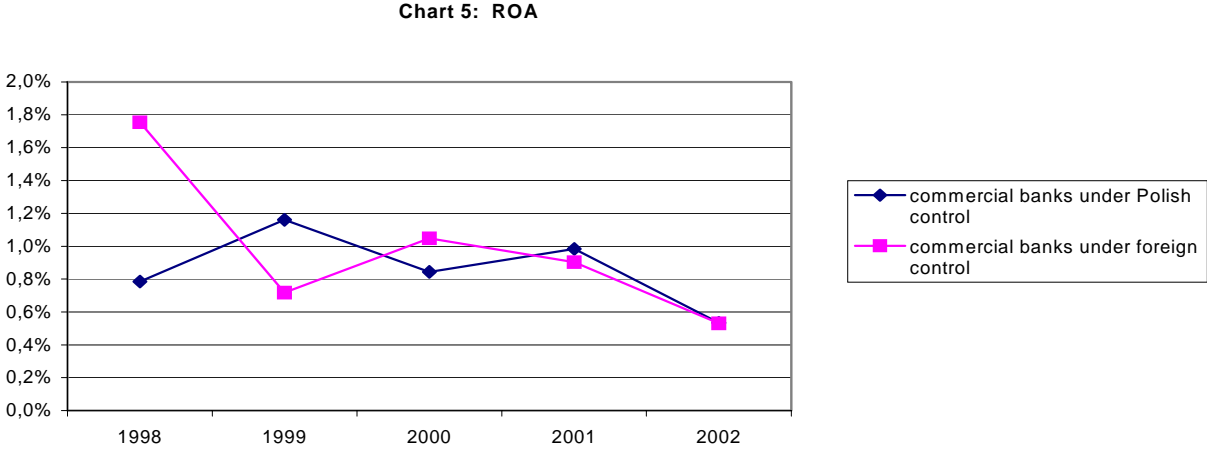
<sup>7</sup> net earnings/core capital.

However, an ROE-based approach should be treated with caution in the Polish case, since the capital adequacy ratios of Polish-owned banks are lower than those of foreign-owned banks, even if the gap has recently narrowed (Chart 4) ;



Source: NBP

For this reason, Return on Assets (ROA)<sup>8</sup> is a better indicator than ROE (Chart 5). While foreign-owned banks performed better than Polish banks in 2000, the same conclusion cannot be drawn for the subsequent years, characterised by a similar dwindling profitability.



Source: Banque de France calculations based on NBP data

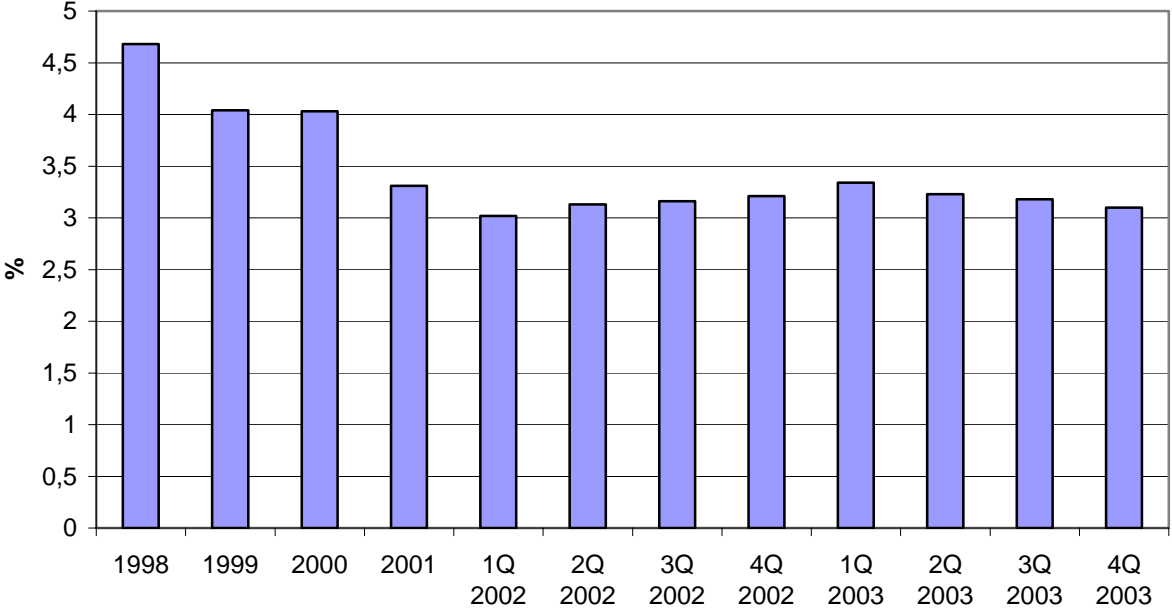
Thus, at this stage, neither ROA nor ROE figures point to an improvement in the Polish banking sector’s profitability as a result of foreign presence in Poland. However two main factors should be taken into account:

- first, takeovers of Polish banks by foreign investors are still recent and high provisioning or general expenses may be viewed as the legacy of the dire situation of the Polish banking sector at the end of the communist period;

<sup>8</sup> Net earnings/total assets.

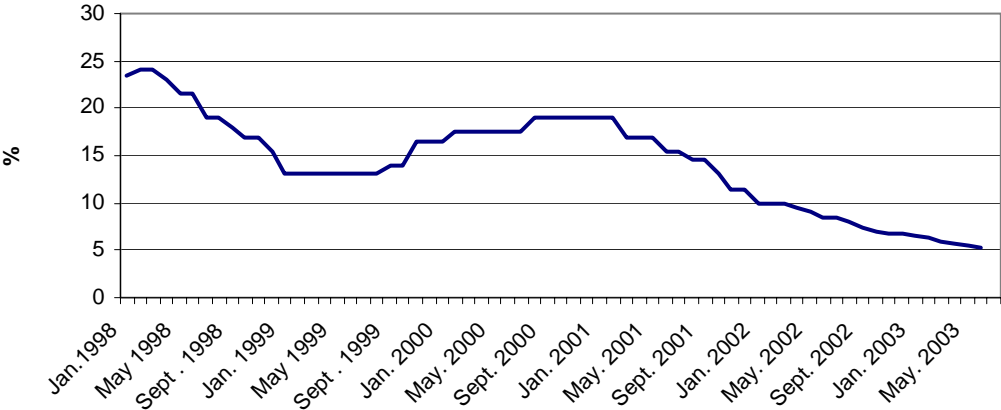
- second, the drop in profitability figures for the entire banking sector in 2002 is due to the reduced net interest margins<sup>9</sup> resulting from to the fall in interest rates (Charts 6 and 7).

**Chart 6 : net interest margins, commercial banks**



Source: NBP data

**Graph 7 : Reference rate 1998-2003**



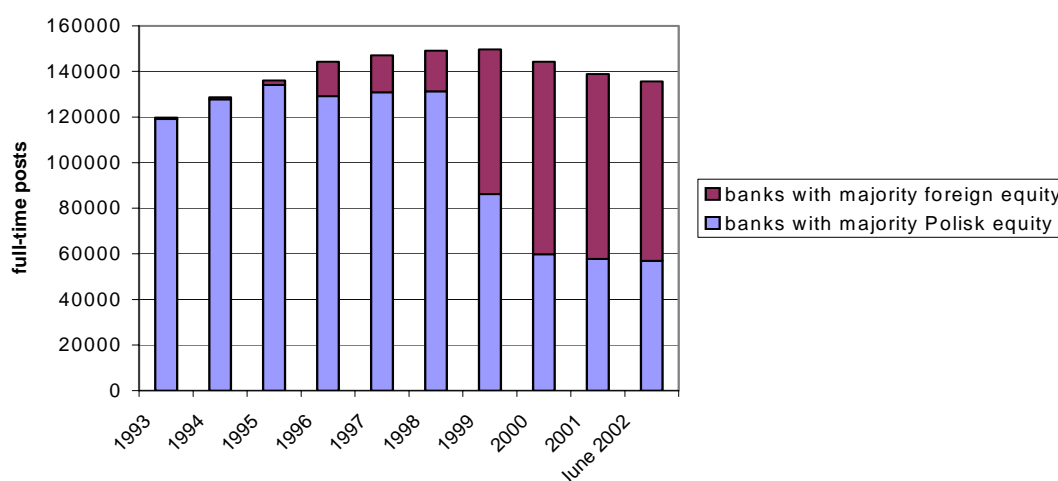
Source: NBP

<sup>9</sup> Net interest income/average total assets.

## 2.1.2. Productivity

While financial indicators do not always give a clear illustration of the beneficial effects of foreign penetration, productivity figures clearly show that foreign-owned banks perform better than Polish banks. The entry of foreign banks has been instrumental in tackling the problems of overstaffing in some previously state-owned Polish banks. Since 2000, staff numbers in commercial banks have decreased (Chart 8) as a result of the restructuring process and the large number of mergers initiated by foreign investors. This process has also fostered the modernisation of the banking industry and the implementation of modern centralised IT systems.

**Chart 8: Staffing at commercial banks**



Source: NBP data

From 2002 onwards, the National bank of Poland has stopped publishing separate data for Polish-owned and foreign-owned banks. However, recent data published by banks themselves show that this trend has goes on in 2003 : while some major foreign-owned banks pursued large-scale restructuring plans leading to significant job cuts, the decrease in the Polish-owned PKO BP staff is more limited (table 1).

**Table 1: staff reductions in the 3 major banks operating in Poland, 2000-2003**

Staff	end 2000	Sept 2003	
Pekao SA (Unicredito - Italy)	20174	15875	-21%
Pekao BP (Treasury – Poland)	39000	36847	-6%
BPH-PBK (Bayerische Hypovereinsbank – Germany)	14286	10791	-24%

Source : banks' published data

Productivity figures indicate that foreign-owned banks have fared better than Polish-owned banks since 1998, in particular as regards the assets/employee ratio as well as the loans or

deposits/employee ratios. It is also the case for the net earnings/employee ratio, in spite of a smaller gap in 2002 due to the drop in net earnings of foreign-owned banks. (Charts 9 to 12).

Chart 9: assets / employee

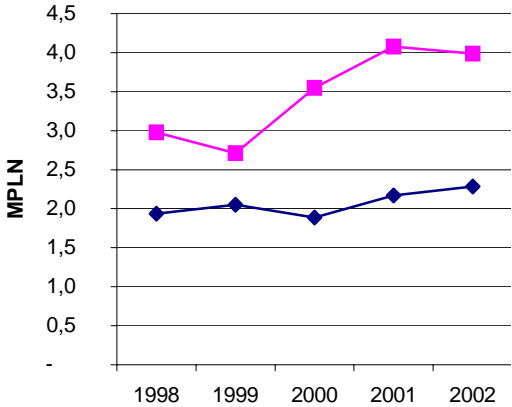


Chart 10: net earnings / employee

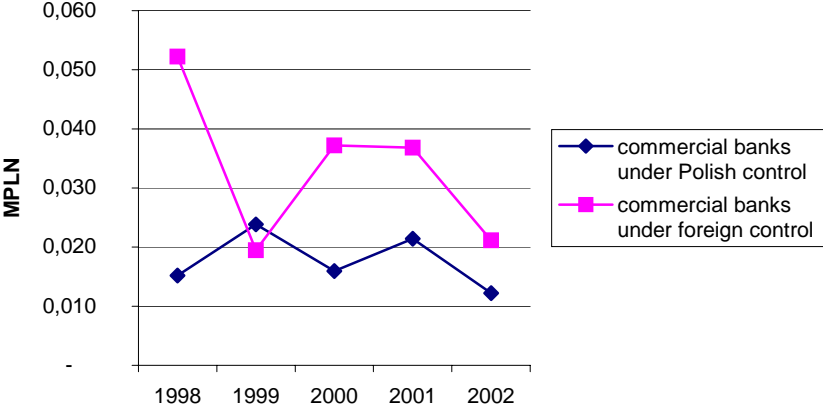


Chart 11: loans / employee

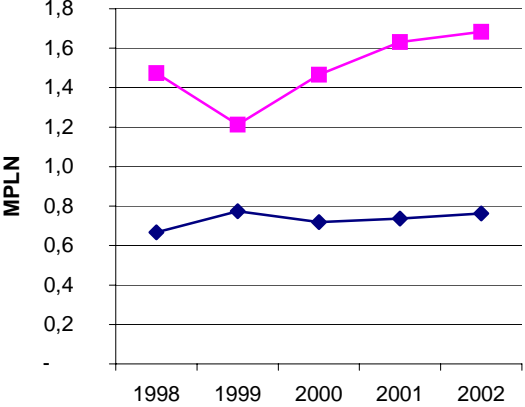
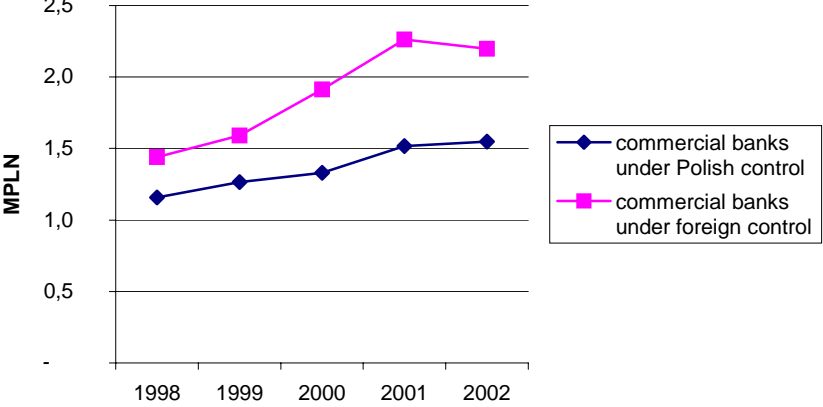


Chart 12: deposits / employee

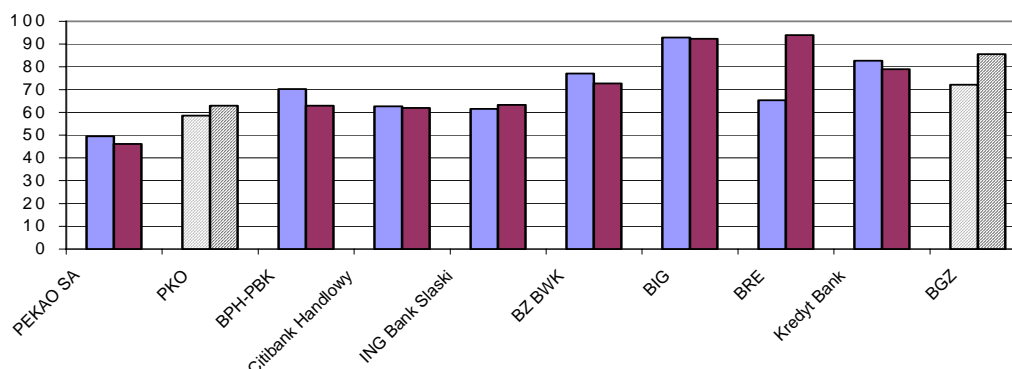


Source: Banque de France calculations based on NBP data

The same conclusion can be drawn from the comparison of productivity indicators for banks of similar size(Chart 13):

- there is a sharp contrast between the cost/income ratios of the two largest banks, PEKAO SA and PKO BP: PEKAO SA’s cost/income ratio is one of the lowest in the sector as a result of large staff lay-offs, while the Polish-owned PKO BP has very high operating costs, due to the fragmentation of its deposit base (ie a large number of deposit accounts) and the lack of an integrated IT system ;
- to a lesser extent, the same observation can be made as regards BGZ and other equal-sized banks.

**Chart 13: cost/income ratio**  
**Main banks, 2001 and 2002**  
**(Banks under Polish control: PKO and BGZ)**



Source: FITCH RATINGS

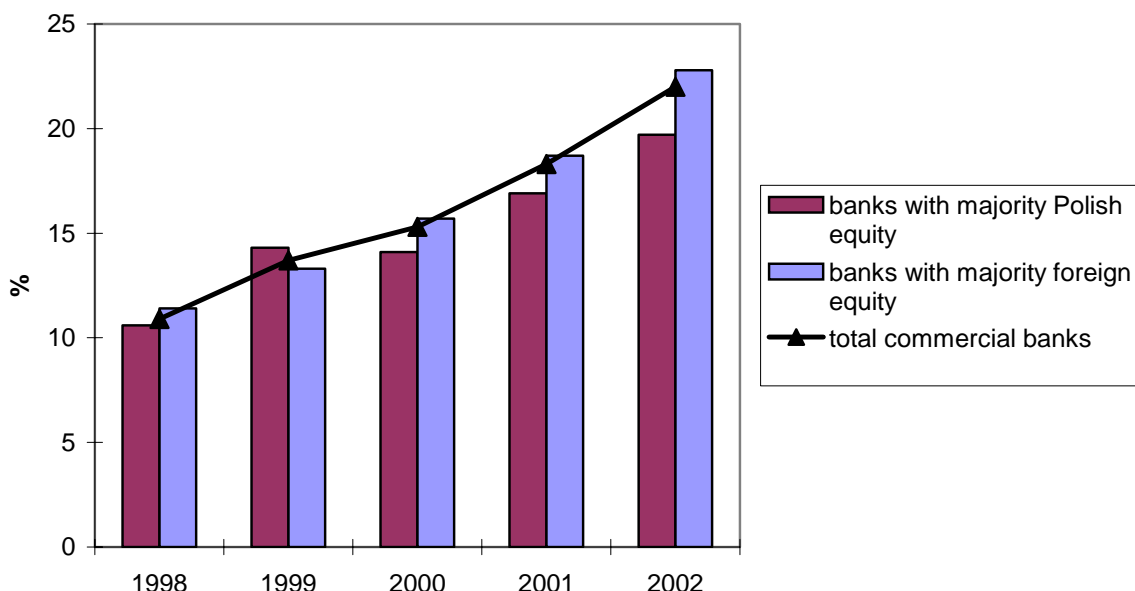
How can we account for the fact that higher productivity rates do not lead to better foreign-owned banks' profitability?

- First, balance sheet structures differ significantly between Polish- and foreign-owned banks : deposits from non-financial customers – the cheapest source of funding for banks –account for a larger stake in Polish-owned banks' liabilities in comparison with foreign-owned banks (respectively 65% and 53% of total liabilities in June 2003). As regards assets, Polish-owned banks' exposure to credit risk is lower than for foreign-owned banks (credit lending accounts respectively for 33% and 43% of assets).
- Second, foreign-owned banks have suffered from a higher concentration of “irregular claims”<sup>10</sup> than Polish-owned banks from 2000 onwards (Chart 14). This is also confirmed by the Polish central bank<sup>11</sup>. The accuracy of these figures is contingent upon whether this clarification reflect the true value of loans and is enforced correctly by banks. However, figures underscore that foreign penetration has not resulted in a concentration of non-performing loans in Polish-owned banks. More precisely, one may distinguish between two types of foreign presence :
  - on the one hand, some foreign-owned banks whose core business is focused on corporate clients based in their home country or investment-grade local companies. These banks may be viewed as mostly insulated from the rest of the economy. However, they represent only a small share of the Polish banking sector;

<sup>10</sup> This concept must be considered as a proxy of non performing assets.

<sup>11</sup> “The financial performance of the large banks previously privatised with the involvement of foreign investors has suffered from their exposure to state enterprises”, NBP, « Summary evaluation ... », first half 2002.

**Chart 14 : ratio of irregular claims to total claims**

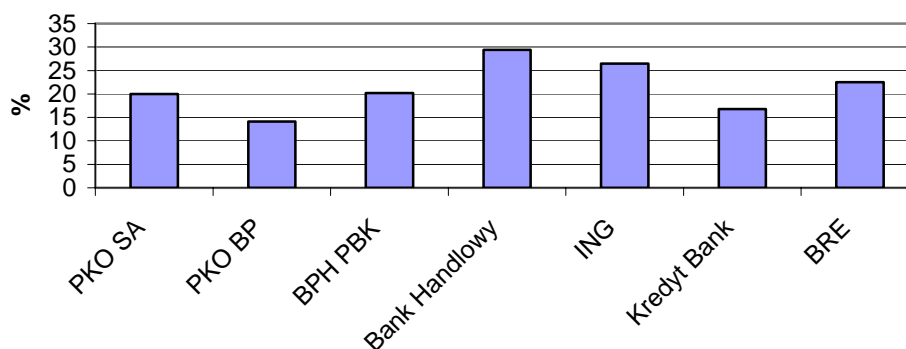


Source: NBP data

- on the other hand, foreign banks that have purchased a retail network and compete with Polish-owned banks on the same markets. Like their Polish-owned counterparts, they are vulnerable to a deterioration in credit risk.

2002 public figures available for some major banks bring about the same conclusion (Chart 15).

**Chart 15 : Ratio of irregular claims to total claims - major banks - 2002**



Source : banks accounts

Against this background, one may suggest that the higher performance of foreign-owned banks in terms of productivity should lead to higher profitability once they have ridden themselves of non-performing loans inherited from the past.

- Third, one must bear in mind that any comparison between Polish- and foreign-owned banks is difficult, given that PKO BP has a dominant position in the state-owned banking sector. Therefore the higher profitability of the Polish-owned banking sector rests with



PKO BP, which benefits from its specialisation on households and property loans in a context of increasing credit risk.

## **2.2. The impact of financial FDI on the financing of the economy and financial stability**

According to conventional wisdom, the presence of foreign banks is likely to enhance financial stability in the host country: foreign banks improve risk management in the whole banking sector by disseminating a pervasive “risk culture”; foreign-owned banks might even act as a shield against major economic downturns, given that the foreign shareholders are well-capitalised world-wide banks and are assigned the highest rating grades. Recently, the Polish authorities themselves considered that foreign shareholders would be likely to support their Polish affiliates in the event of an economic downturn : “In the event of any crisis situation, it can be expected that these foreign investors would be both capable of serving as a source of capital infusions to the banks they control, and also willing to do so”<sup>12</sup> . It is impossible to figure out whether these assumptions are correct. One can only point out that, should foreign investors withdraw from the Polish market in the event of a severe economic downturn, their departure would entail huge costs in relation to their investment.

In this section, we try to assess whether the entry of foreign banks in the Polish banking sector has had a positive impact on the financing of the economy and the stability of the financial sector. Two questions arise in the case of Poland:

- has the respective lending behaviour of foreign and Polish banks contributed to reducing the availability of financing to certain sectors ?
- are there any differences between foreign- and Polish-owned banks as regards the activity in foreign currency-denominated lending, which represents the greatest risk for financial instability in Poland?

### 2.2.1. There is no clear negative impact on the financing of small and medium-sized enterprises

First of all, it should be stressed that foreign banks’ reluctance to lend to non-profitable or insufficiently transparent companies (e.g. state-owned companies in sectors such as shipyards, mining or steel metallurgy, or SMEs) is to be viewed as a positive consequence of foreign presence. Complying with higher standards in terms of borrower selection and transparency practices is instrumental in making the banking system more resilient. In the case of Poland,

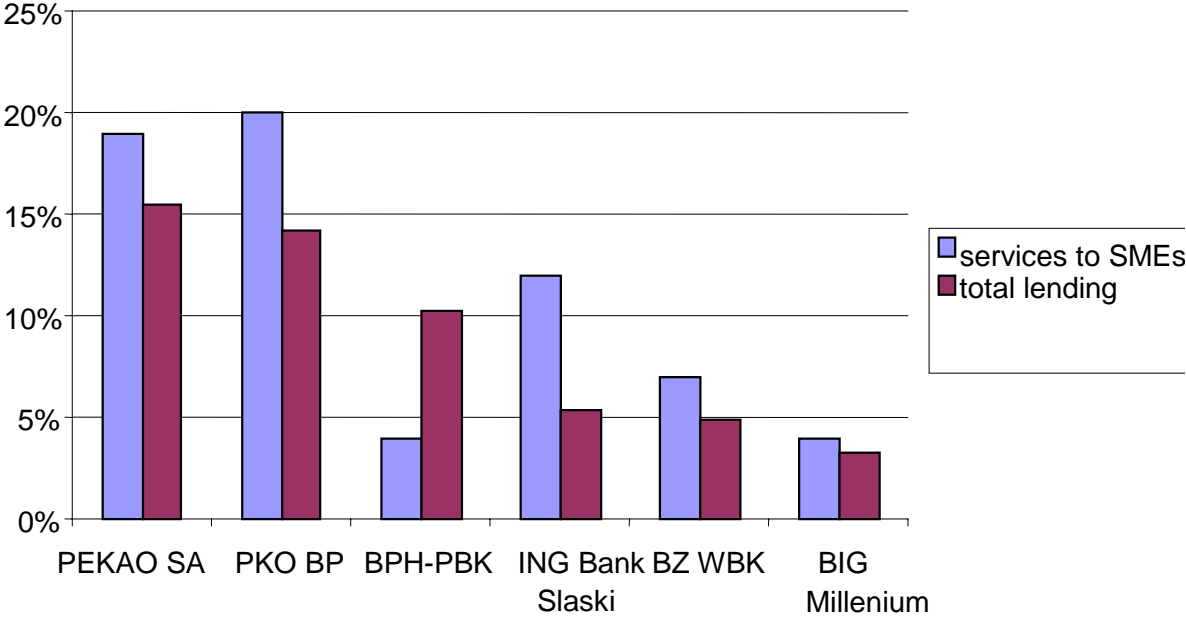
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<sup>12</sup> NBP, “*Summary evaluation...*”, 2001.

the presence of foreign banks has helped to liberalise the economy and break the “incestuous” links between state companies and banks.

Actually, there is no apparent bias in the lending behaviour of foreign-owned banks in comparison with Polish-owned banks. Differences between banks reflect different specialisation choices: foreign-owned PEKAO SA lends more to companies than the Polish-owned PKO BP (79% and 28% respectively), and only 10% of this amount is directed at SMEs in the case of PKO BP. Figures of major banks’ market shares on services to SMEs also show that the penetration of foreign-owned banks is generally greater than their share in total lending (Chart 16). Therefore one may conclude that they have not attracted the most creditworthy borrowers and left the riskiest firms to Polish-owned banks.

**Chart 16 : some major banks' market shares on services to SMEs**



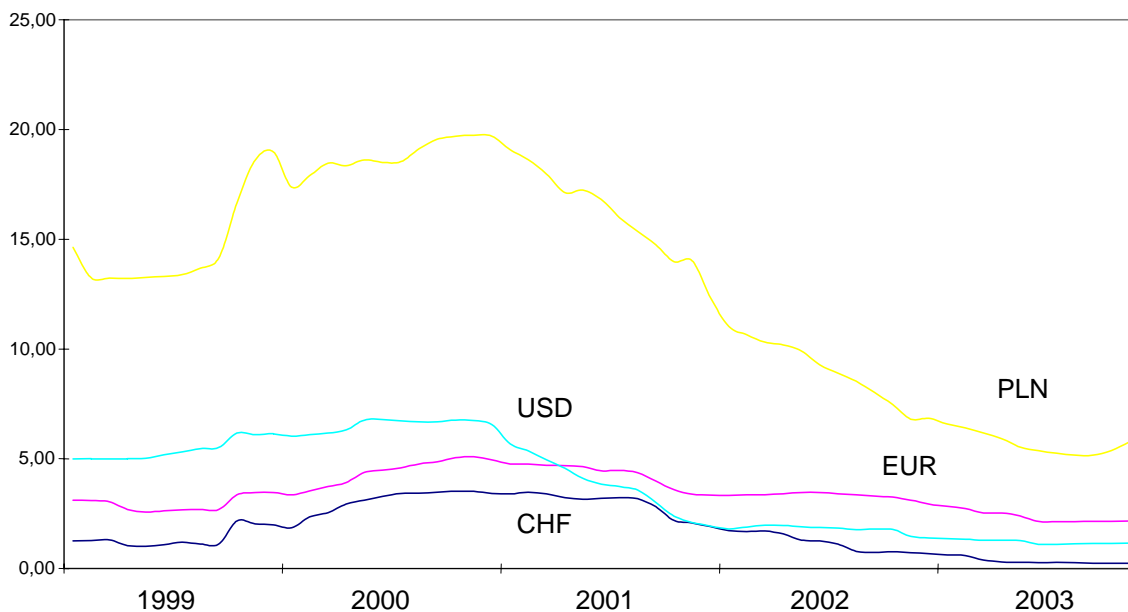
Source: PKOBP

2.2.2. Foreign penetration may have an indirect impact on financial stability through its effect on foreign currency-denominated lending

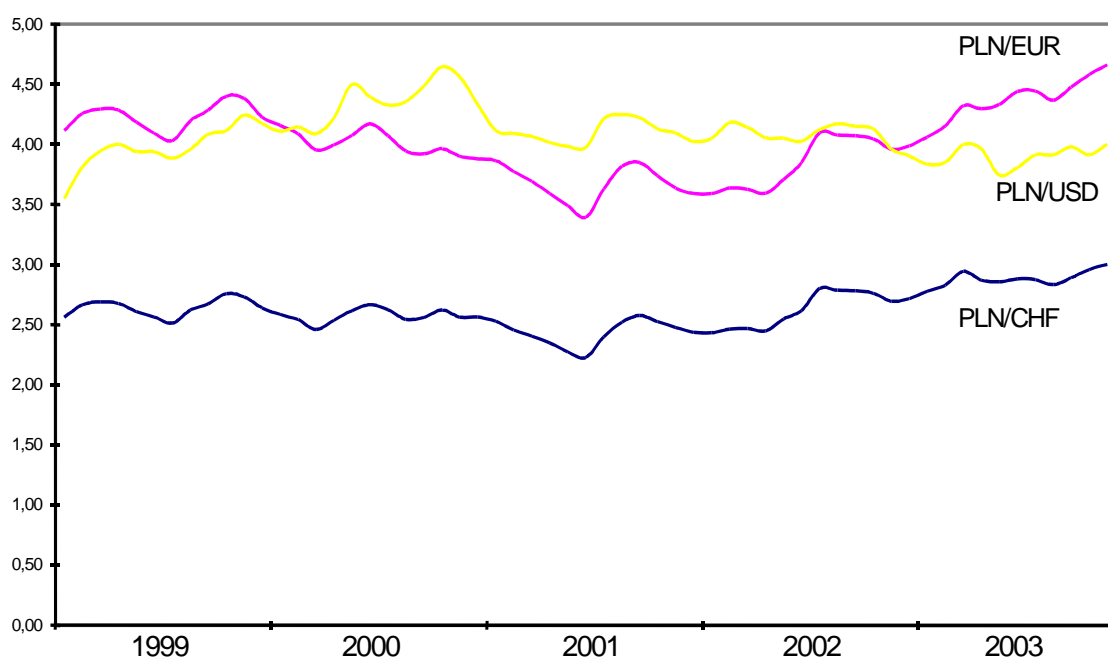
The diagnosis: foreign currency-denominated loans have increased since 2000

External debt of non-financial customers has risen sharply, reflecting their strong appetite for foreign currency-denominated loans. This move has been fuelled by a combination of factors : higher rates on zloty loans (chart 17), relative stability of the zloty against international currencies until mid-2002 (chart 18) and higher competition between banks.

**CHART 17 : 3 MONTHS INTEREST RATES FOR VARIOUS CURRENCIES**



**CHART 18 : ZLOTY'S EXCHANGE RATE AGAINST USD, EUR AND CHF**

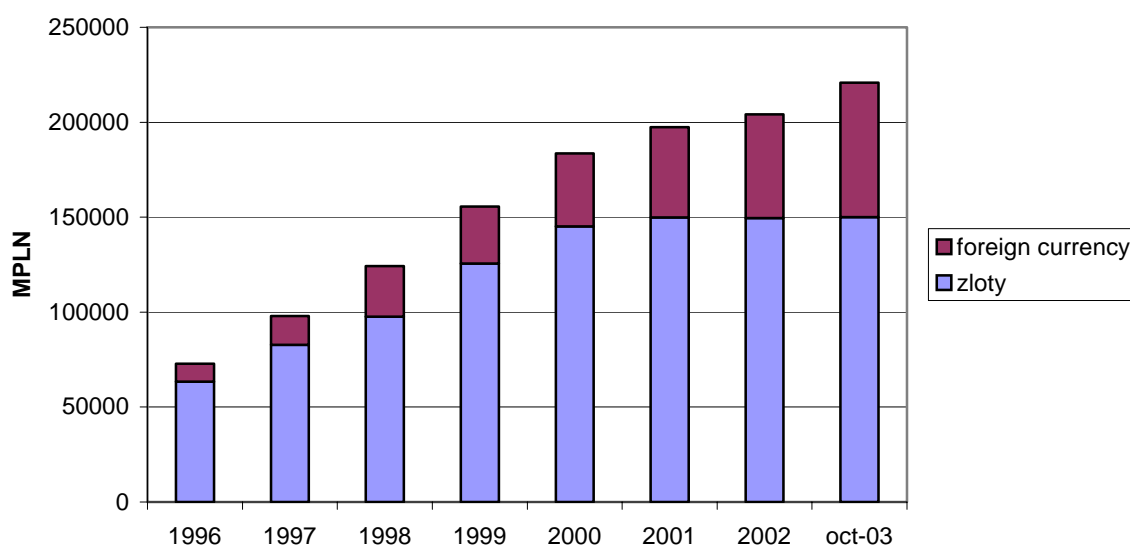


The share of foreign-currency lending in total lending to non-financial customers, which amounted to 20% at the end of the 1990s, has increased dramatically from 2000 onwards (Chart 19). In October 2003, 32% of outstanding loans to non-financial customers were denominated in foreign currencies. Households are the most exposed and account for 40% of

all foreign currency borrowings (2/3 of their housing borrowing is foreign-currency denominated). On the opposite, only 1/3 of lending to companies was denominated in foreign currencies.

The increase in foreign currency lending has not discontinued, in spite of lessening interest rates on zloty loans and the depreciation of the zloty from mi-2002 onwards, as the difference between the rate on zloty-denominated deposits and the interest rate charged on foreign-currency loans remains large (see Charts 17 and 18 and table 2). However, a shift has occurred since June 2003 with the amount of housing loans in zloty higher than those denominated in foreign currency.

**Chart 19 : structure of gross claims on non-financial sector, commercial banks, by currency**



Source: NBP data

**Table 2 : average interest rates on lending to non-financial customers**

	March 2002	December 2002	September 2003
<b>Average interest rates on loans in zloty, of which :</b>	<b>15,0%</b>	<b>12,8%</b>	<b>10,8%</b>
- corporate sector	13,4%	10,6%	8,9%
- households - short-term credit	18,5%	17,5%	15,6%
- households – housing finance	11,1%	9,0%	7,3%
- households – other loans	21,3%	20,1%	16,3%
<b>Average interest rates on foreign-currency denominated loans</b>			
- <b>in EUR</b>	<b>5,6%</b>	<b>5,6%</b>	<b>4,7%</b>
- <b>in USD</b>	<b>4,3%</b>	<b>4,2%</b>	<b>3,8%</b>

Source : NBP

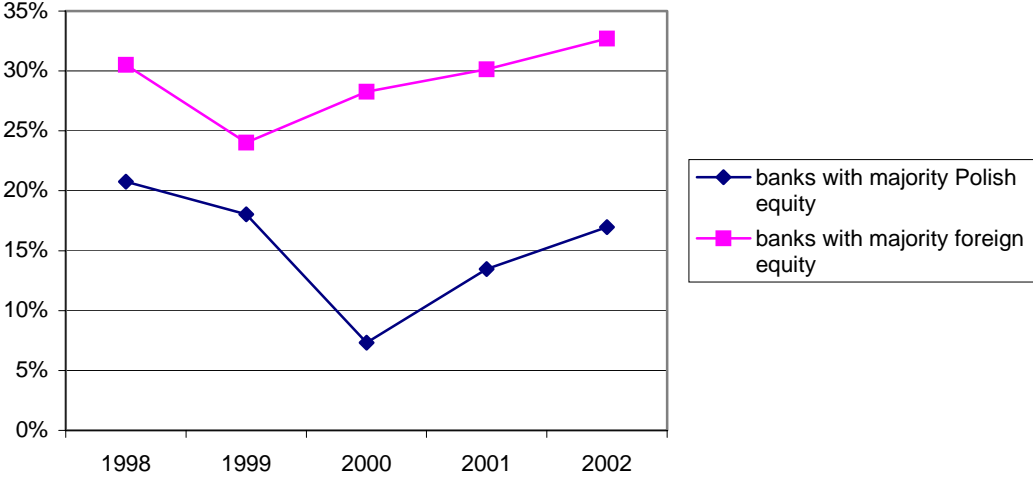
The rise in foreign currency lending during the first semester 2003 is, to some extent, overstated considering the depreciation of the zloty vis-à-vis the Euro and the US dollar

during this period (50% of outstanding credits are denominated in Euro, 26% in US dollars and 22% in CHF). However, zloty-denominated loans indexed on foreign currency were integrated in foreign-denominated loans only in May 2003, which indicates *a contrario* that this figure had been substantially underestimated before.

The entry of foreign banks may account for this evolution

There is some evidence that the opening of the financial sector to foreign capital has facilitated the access of Polish residents to foreign-denominated loans. Between 1998 and 2002, foreign-owned Polish banks posted a larger share of foreign currency-denominated claims on non-financial customers in total lending than Polish-owned banks (Chart 20). In October 2003, 37,6% of total lending by the eight largest banks with majority foreign equity were foreign-currency denominated, while Polish-owned banks allocated less than 20% of their lending in foreign currencies. This could indicate that foreign banks have adopted a more aggressive strategy than their Polish-owned counterparts in order to capture a larger share of the market.

**Chart 20: share of foreign currency-denominated claims on non-financial corporations in total claims, commercial banks, by bank nationality**



Source: Banque de France calculations based on NBP data

This situation carries potential risks for the stability of the financial system in the event of a depreciation in the zloty, which could undermine the capacity of domestic debtors to repay banks, and hence deteriorate the quality of banks assets. At this stage, the ratio of non performing claims to total claims is higher for zloty loans than for foreign-currency loans (respectively 23.7% against 17.7%) and is rapidly rising for both. However, reasons for

concern remain, and have led the General Inspectorate of Banking Supervision (GIBS) to point to the need for a “special monitoring of the foreign exchange risk assumed by borrowers”<sup>13</sup>.

From a financial stability point of view, the magnitude of foreign exchange risk for both banks and households is a serious cause for concern.

- As regards banks, the strong growth in foreign currency claims has not been matched by a corresponding rise in foreign currency liabilities: as of end-June 2002, foreign currency assets were some 10 percentage points above foreign currency liabilities. Banking authorities consider that banks are globally relatively insulated from exchange rate movements, as they hedge their exposure to foreign exchange risk using off-balance sheet instruments. Furthermore, Value At Risk (VAR) analyses indicate that banks’ exposure to FX risk remains relatively small <sup>14</sup>. In March 2000, Polish banking authorities sought to reduce FX risk by introducing a separate risk capital requirement against overall net FX positions exceeding 2% of the capital base. However, individually, commercial banks may show an exposure to foreign exchange risk: at end-June 2002, six banks maintained open FX positions exceeding 10% of their capital base, while another seven had positions between 3% and 10%.
- As regards a possible currency mismatch in private agents’ balance sheets, there is greater cause for concern, especially for households who have no foreign currency income and generally no access to protection against foreign exchange risk. However, Polish households own a substantial part of their assets in foreign currency, following in a long-established tradition of defiance vis-à-vis their national currency. While subsiding since the mid-1990, foreign currency deposits score at 18% in 2002 (against 50% in 1993-1994).

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<sup>13</sup> National Bank of Poland, “*Summary evaluation ...*”, first half 2003, p. 13.

<sup>14</sup> National Bank of Poland, “*Summary evaluation ...*”, first half 2002, p. 17.

### Annex: Top Ten Polish Banks

Rank	Bank	Major shareholders	Nationality of the main shareholder / date of purchase	Assets	Staff
				As a % of all commercial banks	
1	PEKAO SA	- Unicredito Italiano 53,2%	Italy / 2000	16.2 %	13.5 %
2	PKO BP	- Polish State 100%	Poland	16 %	23 %
3	BPH-BPK	- Bayerische Hypovereinsbank 71.7%	Germany / 1999	10 %	8.5 %
4	Bank Zachodni WBK	- Allied Irish Bank 80%	Ireland / 1997	5.3 %	6.6%
5	Bank Handlowy	- Citibank 91.4%	USA / 2000	4.9 %	2.8 %
6	ING Bank Slaski	- ING Barings 54%	Netherlands / 1996	4.5 %	4.4 %
7	Kredyt Bank	- KBC Bank 24.6% - Banco Espirito Santo 19.9%	Belgium	4.4 %	2.8 %
8	BGZ	- Polish State 100%	Poland	4.2 %	4.5 %
9	BIG Bank Gdanski	- Banco Commercial Portugues 44.1% - EUREKO 15%	Portugal / 1997	4.2%	4.2 %
10	BRE SA	- Commerzbank 50%	Germany /2000	3.8%	2 %
	Other banks			26.6%	27.4%
	Total			100%	100%

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