

*Monika Zielińska-Sitkiewicz\**

## **POLISH CREDIT MARKET IN THE EU – THE MAIN CHALLENGES AND THREATS**

**Abstract.** The growth of efficiency and competition of Polish bank sector is the result of our entry to the European Union. The current level of competition and efficiency of Polish bank sector resembles that in other European countries.

However, the Polish credit market is developing worse in comparison with countries of euro zone.

This article presents situation of credit market in Poland compared to European market. The paper focuses on opportunities and threats for Polish credit market.

**Key words:** credit, European Union, the credit market, comparison.

### **1. POLISH CREDIT MARKET IN THE EU. OPPORTUNITIES AND THREATS**

Credit market plays the key role in economy. Bank lending is one of the main sources of providing capital for both institutional and individual investors. A well-known argument is that economic prosperity is determined to a large extent by the condition and development of the credit market, and examining the dynamics of indebtedness of enterprises and households facilitates the process of diagnosing and forecasting the economic situation of a given country.

Despite the fact that Polish banking sector recorded high profits last year it also experienced some serious turbulence which exerted a highly negative influence on the functioning of banks. The global financial crisis caused greater insecurity in particular financial markets and increased risk aversion. Many investors were scared away from currencies of countries of Central and Eastern Europe which resulted in a rapid depreciation of the zloty, even though the Polish economy performed much better than most other economies of the region.

The weakened position of the Polish currency led to materialization of exchange rate risk which, so far, has been greatly underestimated.

At the time of economic downturn the banking sector plays a particularly important role. On the one hand, banks are responsible for guaranteeing the

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\* Ph.D., University of Lodz.

safety of deposits placed with them, and on the other hand, they are expected to support the real economy by providing companies with assets needed for development.

## **2. SITUATION ON THE POLISH FINANCIAL MARKET IN 2008 AND 2009**

In the first half of 2008 the Monetary Policy Council increased interest rates of the NBP (the National Bank of Poland) by 100 base points what was caused by accelerated inflationary processes. In autumn of the same year the “second wave“ of the financial crisis swept the global financial markets and resulted in more difficult access to credit and forecasts on lowered inflation connected with anticipated slowdown of the Polish economy.

That was the reason why the Council decided to change its monetary policy and started a series of sharp cuts of interest rates. Drastic cuts of interest rates, which took place at the same time in the euro zone, the UK, the USA and Switzerland, provided an additional argument for taking such measures.

As a result of the cuts which were made in November and December of 2008 – by 100 base points, and by 100 base points in January and March of the present year, the NBP interest rates reached the level of the year 2006 and amounted to: reference rate – 3.75%, pawn rate – 5.25%, deposit rate – 2.25% and rediscount rate – 4.00%.

The second half of 2008 witnessed unprecedented disturbances in the functioning of the financial market. They were caused by events which occurred in the USA between July and September of 2008 when the American government took control of Fannie Mae and Freddie Mac, the Lehman Brothers collapsed, the Bank of America announced the takeover of Merrill Lynch and the actual nationalization of the American International Group took place. As a consequence, the trust between the market players was undermined and this, in turn, led to extremely strong turbulences in the interbank market, dramatic falls in equity and commodity markets, and finally to “capital outflow” from emerging markets including Poland.

As the crisis deepened several negative phenomena occurred: a sharp increase of rates in the interbank market, shortening of horizons of the concluded financial transactions, rise in costs of financing and problems with solvency management and risk management.

When compared to other countries the situation in the Polish interbank market can be seen as relatively good. Over the whole year the WIBOR 3M rate which serves as a reference rate for most credits in the Polish zloty increased from 5.7% at the end of 2007 to 5.9% at the end of 2008 and at present (June 2009) it amounts to 4.62%. One must not forget, however, that a substantial decline in the level of trust among market players was also observed in Poland.

It was caused, among other things, by information and rumours about financial difficulties of strategic investors of Polish banks.

In the first two quarters of the year the zloty appreciation took place, and as a result the zloty reached the highest values in recent years against main currencies (as of June last year 1 euro was equal to 3.3542 zloty, 1 US dollar was sold for 2.1194 zloty and 1 Swiss franc for 2.0907) In July and August last year a reverse trend in the zloty market was observed which, due to deterioration of climate in the international financial markets and resulting risk aversion, led to a strong weakening of the Polish zloty (See Fig.1). As a result, at the end of 2008 1 euro cost 4.1724 (against 3.5820 at the end of 2007), 1 US dollar – 2.918(2.4350), and 1 Swiss franc – 2.8014 (2.1614). In the first months of the present year the zloty depreciation deepened, and now 1 euro is sold at 4.4729, 1 US dollar at 3.3698 and 1 franc at 2.9491. This can be explained by further negative changes in investment climate of the countries of Central and Eastern Europe (the deteriorating performance of economies of Hungary, Ukraine and the Baltic states), serious signs of slowdown of the Polish economy, major cuts in NBP exchange rates. evaluation of effects of currency derivatives on PLN/EUR, PLN/USD, PLN/GBP and PLN/CHF, lack of the definite position on the possible date of the introduction of the euro into Poland, and finally, the attitude adopted towards changes in the foreign exchange market.

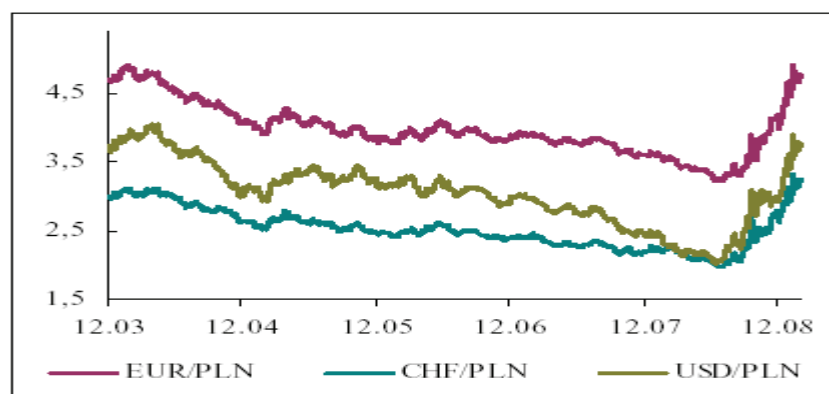


Figure 1. Rates of main currencies against the Polish zloty

Source: Report on the condition of banks in 2008. KNF (Financial Supervision Commission).

In 2008 the structure of the banking sector did not undergo any significant changes. As of the end of the year 649 banks and subsidiaries of lending institutions were in operation (see: Fig 2).

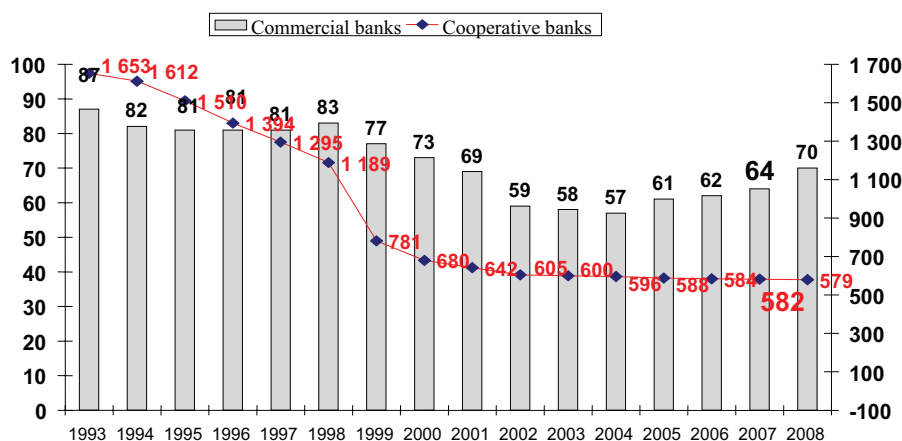


Figure 2. Number of banks and subsidiaries in Poland

Source: NBP (The National Bank of Poland)

The number of domestic commercial banks increased from 50 to 52, as Alior Bank and Alianz Bank decided to establish their operations in Poland. The number of subsidiaries of lending institutions rose from 14 to 18 as a result of starting operations by: BNP Paribas Securities Services Limited, Skandinaviska Enskilda Banken, DEPF Bank and Banco Espirito Santo de Investimento.

Foreign operations in the form of banking companies or subsidiaries were conducted by 4 banks: Pekao (in Ukraine and France), PKO Bank Polski (in Ukraine), BRE Bank (in Austria, The Czech Republic and Slovakia) and Mercedes-Benz Bank Polska (in Greece).

Domestic investors controlled 10 commercial banks and all of the cooperative banks, while the State Treasury was still in control of 4 commercial banks (directly- PKO Bank Polski and Bank Gospodarstwa Krajowego; indirectly- Bank Poczty and Bank Ochrony Środowiska). Their market share measured in assets, loans and deposits amounted to 27.7%, 28.3% and 32.4%, respectively. The share of foreign investors in assets of the Polish banking sector by country of origin is presented in Fig. 3.

Foreign investors controlled 42 commercial banks and all subsidiaries of lending institutions. Their market share measured in assets, loans and deposits was equal to 72.3%, 71.7% and 67.6%, respectively.

Investors from 17 countries are present in the Polish banking sector, yet it is the Italians who play a leading role as they control 13.4% of the sector's assets; they are followed by the Dutch, German and American investors.

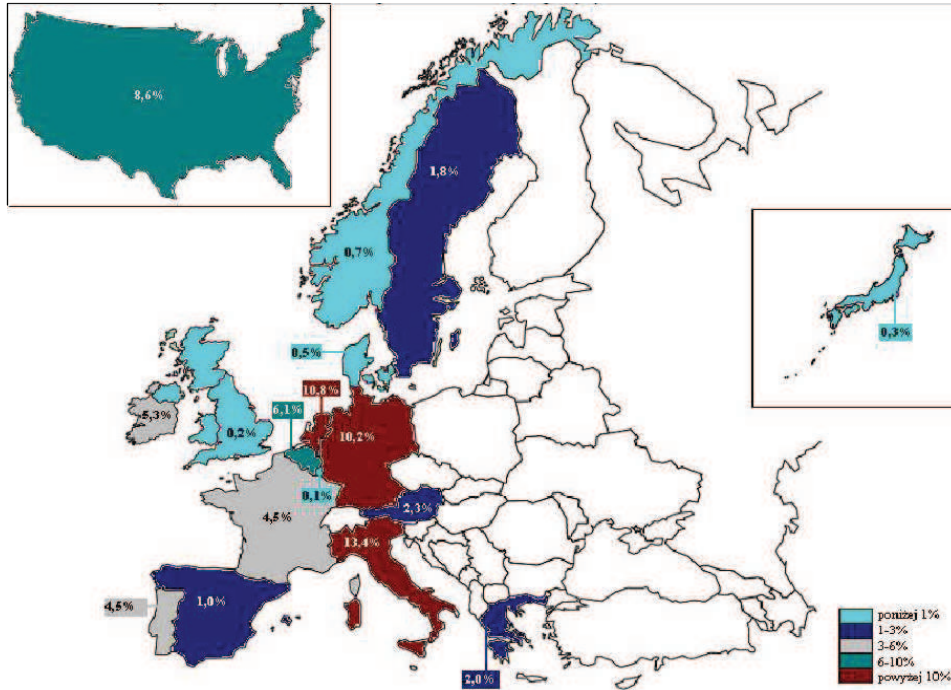


Figure 3. Share of foreign investors in assets of the Polish banking sector  
 Source: Report on condition of banks in 2008, KNF (Financial Supervision Commission).

The concentration of the Polish banking sector remains at a modest level when compared with other EU countries. The share of five biggest banks (Fig. 4) and ten biggest banks (Fig. 5) in the sector’s assets (in %) is presented below.

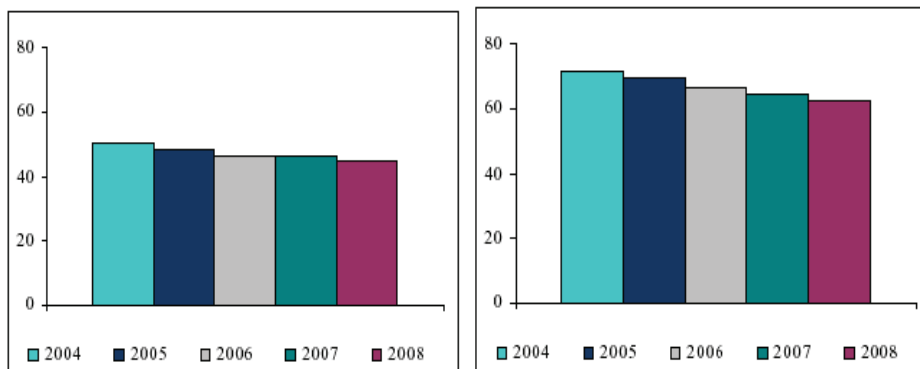


Figure 4. Five biggest banks in the sector’s assets. Figure 5. Ten biggest banks in the sector’s assets  
 Source: Report on condition of banks in 2008, KNF

The unquestionable market leaders are: PKO BP and Pekao whose assets exceed 100 billion zlotys and which have accumulated over a quarter of the market.

### 3. SITUATION ON THE CREDIT MARKET IN POLAND IN THE YEARS 2008 AND 2009

The nominal value of credits granted by banks to the non-financial sector increased from **427.5** billion zlotys at the end of 2007 to **593.6** at the end of 2008 i.e. by 38.4% in commercial banks and by 92.3 % in subsidiaries of lending institutions and by 15.1% in cooperative banks. That pace of growth was not only record high in the present decade but it was also record high in the whole period of transformation. The credit structure for the non-financial sector is shown in Table 1.

Table 1. Credit structure by entities (in bn PLN)

Credits	2005	2006	2007	2008	Change 2008/2007	
					in billion	in %
Total, incl.	258.5	322.8	427.5	593.6	166.0	38.8
Enterprises	121.2	138.3	171.7	222.7	51.0	29.7
Households	136.4	183.4	254.2	368.6	114.4	45.0
Non- commercial institutions	0.9	1.0	1.6	2.2	0.6	37.6

Source: KNF (Financial Supervision Commission).

Credits for households, which were characterized by the highest pace of growth, grew by 45.0%, while credits for the business sector grew by 29.7 %.

The dynamics of change is presented in Fig. 6 and Fig. 7. As a result of the above mentioned tendency the share of household credits went up to 62.1%, whereas business credits went down to 37.5%. The change in structure, i.e. household credits moving to the leading position, took place in the middle of 2005.

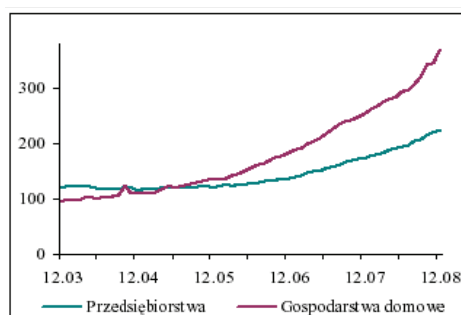


Figure 6. Credits in bn zlotys

Source: KNF.

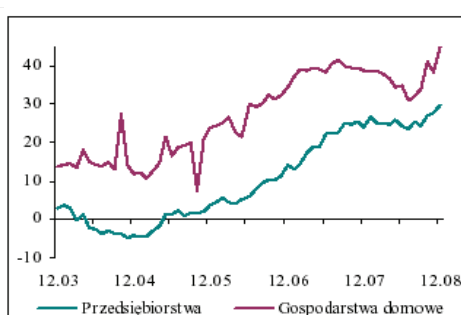


Figure 7. Annual pace of growth of credits in %

This exceptionally high dynamics of credit action in Poland was not only the result of high demand for credit but it also followed from a considerable weakening of the zloty in the second half of the last year which, taking into account a high share of mortgage loans in foreign currency, caused a significant increase in nominal value of credit portfolio – the value of loans in zloty rose by 21.0% while loans in foreign currency by as much as 91.4%. When we take into account the whole year the value of mortgage loans rose by impressive 107.2% and at the same time loans in zlotys rose by merely 12.4%.

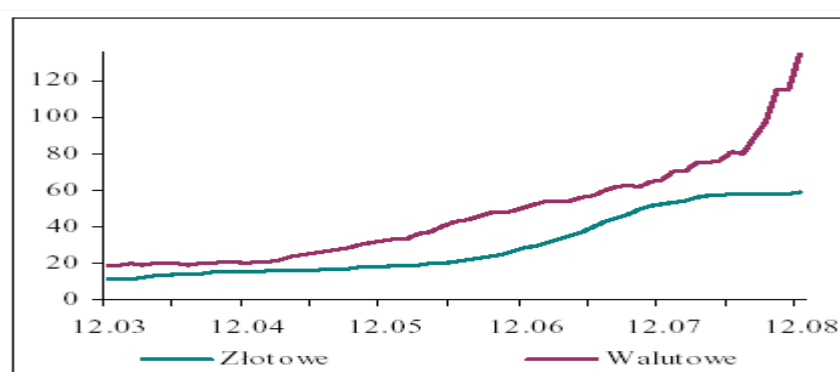


Figure 8. Currency structure of mortgage loans

Source: KNF.

What is particularly disturbing here is the rapid growth of the number of Polish households which have taken out long-term loans in foreign currencies but almost all of them receive wages in the Polish zloty.

Let us quote some numbers in order to depict the range of this phenomenon. The end of 2004 witnessed 26.7 billion zlotys worth of foreign currency loans of Polish households which accounted for 24.3% of the credit portfolio for households (11.7% of the total value of credit portfolio). However, at the end of 2008 this value was equal to impressive 149.6 billion (Cf Fig 9) and accounted for 40.6% of the value of credit portfolio for households (25.2% of the total number of credits).

The share of loans denominated in foreign currency rose from 55.3% to 69.5%. Such a high rise in value of housing loans caused an increase in their share in credit portfolio for households from 46.3% to 52.6%, and in the total credit portfolio from 27.5% to 32.7%.

As a result, a rise of systemic risk connected with the zloty depreciation and disturbances in the global financial markets occurs. Therefore, banks find it difficult to manage the portfolio of such credits. If the zloty continues to be weak over a longer period of time and the labour market seriously deteriorates, then it may turn out that a large percentage of borrowers will find it difficult to service their debt or will be unable to repay it. Should these risks occur they may have a negative influence on the financial condition of some banks and may threaten the stability of the banking sector.

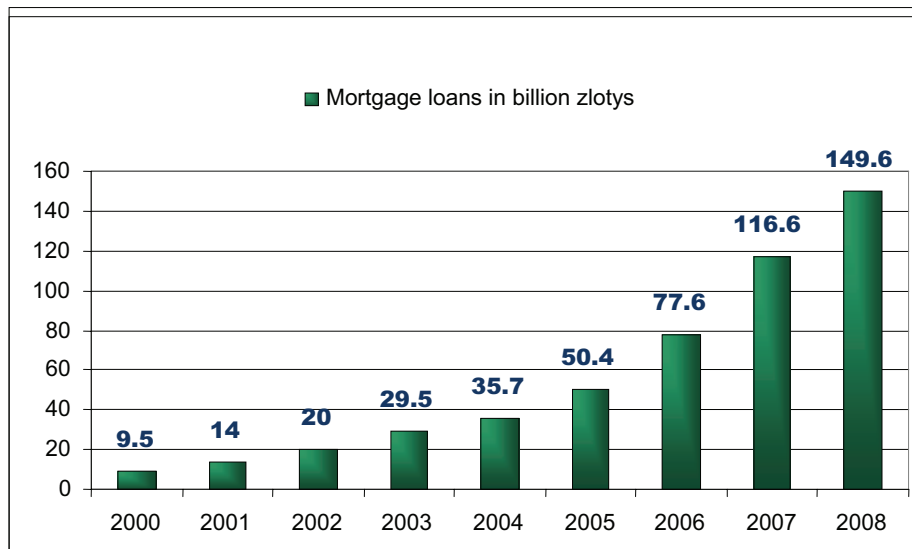


Figure 9. Mortgage loans in Poland – value of assets

Source: NBP (National Bank of Poland)

The National Bank of Poland (NBP) monitors the Polish credit market using its reports. At present the total value of credits and loans as well as liabilities such as guarantees and outstanding liabilities of households and enterprises to financial institutions, amount to 625.5 billion zloty (liabilities of households are equal to 392.5 bn and enterprises – 230.8 bn). The NBP presents also threatened debts giving them ranks according to 3 types: substandard (when payment is delayed), doubtful (30 days of delay or more), and lost (60 days of delay or more).

According to the NBP the present amount of liabilities of individual customers and businesses to banks is equal to 35.8 billion. The estimations of the National Bank of Poland show that lost liabilities of businesses and households amount to 19.4 billion, so-called doubtful to 6.7 billion and so-called substandard to 9.7 billion. The total amount of threatened liabilities of households to banks equals 15.66 billion of Polish zlotys, and the dynamics of these liabilities is presented in Fig. 10.

The information on slower growth of the amount of threatened mortgage loans of individual customers in the first quarter of 2009 sounds slightly more optimistic. It changed from 1.91 bn to 2.32 bn zlotys (loans in foreign currency constitute 41.7% of this amount). In real numbers, however, this growth is greater than in the previous quarter of the year (0.41 bn against 0.38 bn). The pace of growth of value of housing credits with payment delayed 1 to 3 months, known in the banking jargon as “under observation” liabilities, is slower.



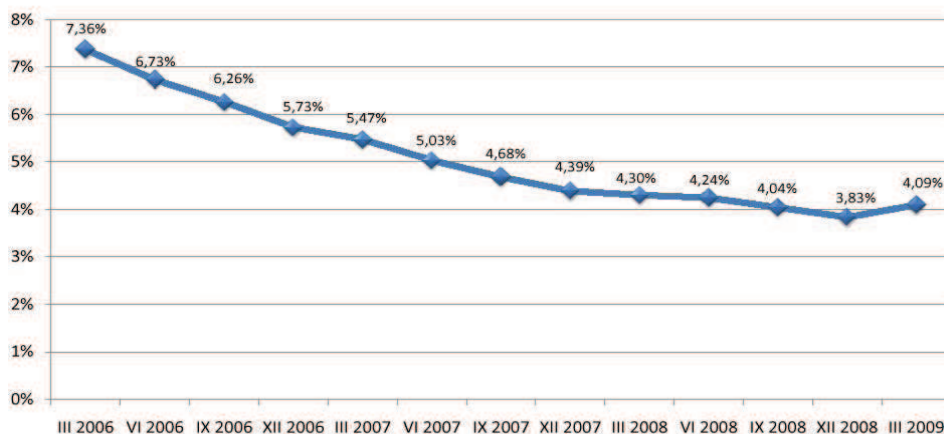


Figure 10. Threatened liabilities from individual customers

Source: National Register of Debts

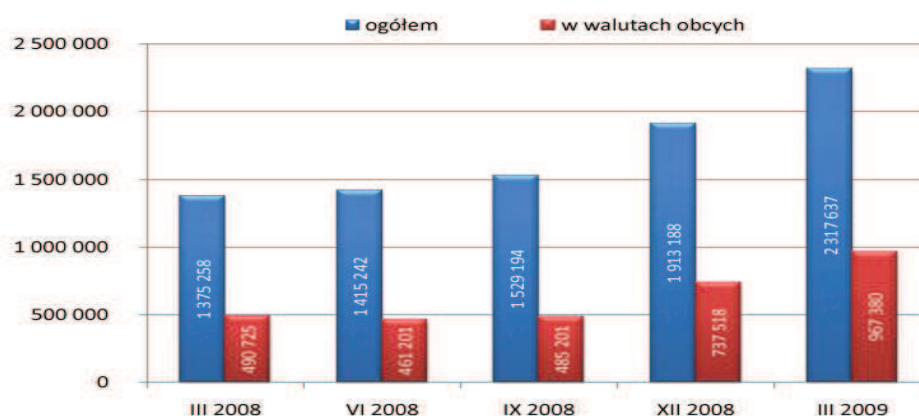


Figure 11. Threatened housing loans of individual customers

Source: National Register of Debts

The value of credits for the business sector increased by 29.7% i.e. from 171.7 bn zlotys at the end of 2007 to 222.7 bn zlotys at the end of 2008. It was seriously affected by the strong depreciation of the zloty yet to a smaller extent than in case of households. Investment credits were characterized by the highest rate of growth but this positive tendency was diminished by the fact that a substantial part of this growth resulted from the very high (nearly 75%) rise in foreign currency credits accounting for over 30 % of the whole credit portfolio. As a consequence, the high dynamics was strongly affected by the weak zloty in the second half of the year. The equally high dynamics characterized mortgage loans but the dynamics of these credits was much lower in 2008 than in 2007 what resulted from the final stage of the boom in the housing market and poor pros-

pects for development of this sector in the near future. The lowest, yet still high (23.6%), rate of growth was shown by credits for current activities of enterprises. The structure and dynamics of credits are presented in Fig. 12 and Fig. 13.

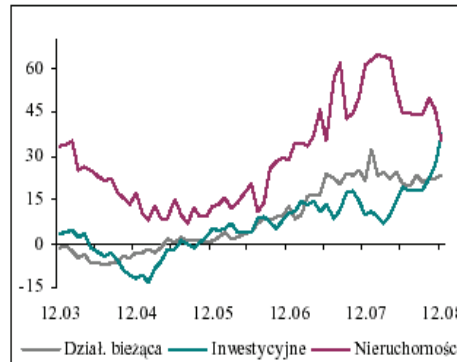
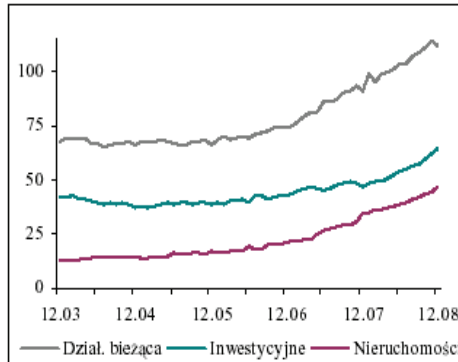


Figure 12. Structure of credits for enterprises      Figure 13. Annual rate of growth of credits (%)  
Source: KNF (Financial Supervision Commission).

The end of the previous year witnessed a marked slowdown in credit action for enterprises. On the one hand, this situation can be explained by a natural transition of the economy to a lower stage of the business cycle (the present business cycle reached a peak in the years 2006–2007), and closing of accounting books for the end of year. On the other hand, this situation can be associated with much worse prospects for economic growth due to a serious deepening of the global financial crisis. Banks tightened their credit policy towards the business sector and many businesses decided to curb their demand for credit.

#### 4. POLISH CREDIT MARKET AGAINST THE EUROPEAN UNION MARKET

When dealing with a problem of high dynamics of credits we must not forget that it can partly be attributed to a low level of “banking presence” in the Polish economy in comparison with other EU countries (share of assets and credits in GDP). When we measure the “banking presence” by giving the number of branch offices per 1 million of inhabitants then Poland occupies the 12 position in the EU (below the average). However, when we take into account the number of lending institutions then Poland is ranked 5 (see: Fig. 14 and Fig. 15).

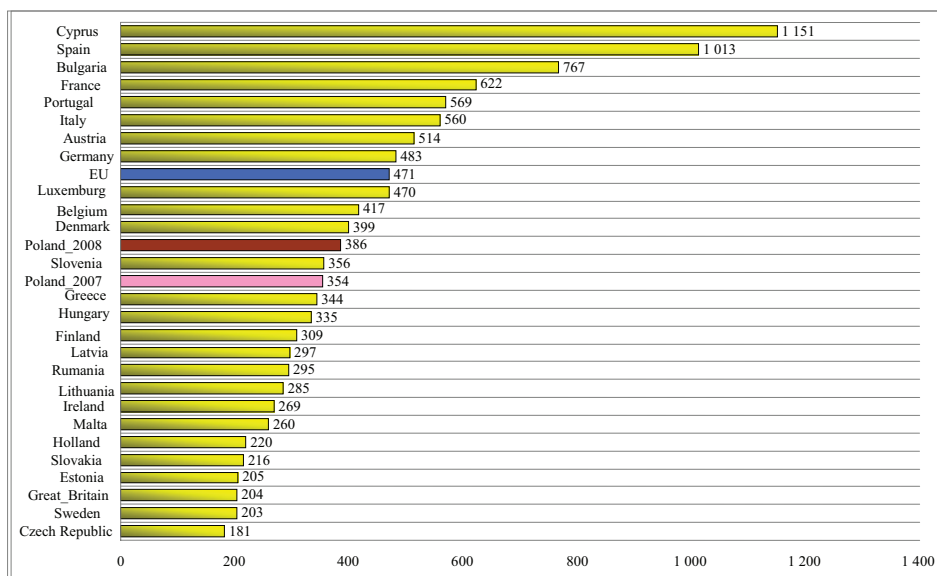


Figure 14. Number of branches of banks per 1 million of inhabitants

Source: ECB(European Central Bank) and KNF

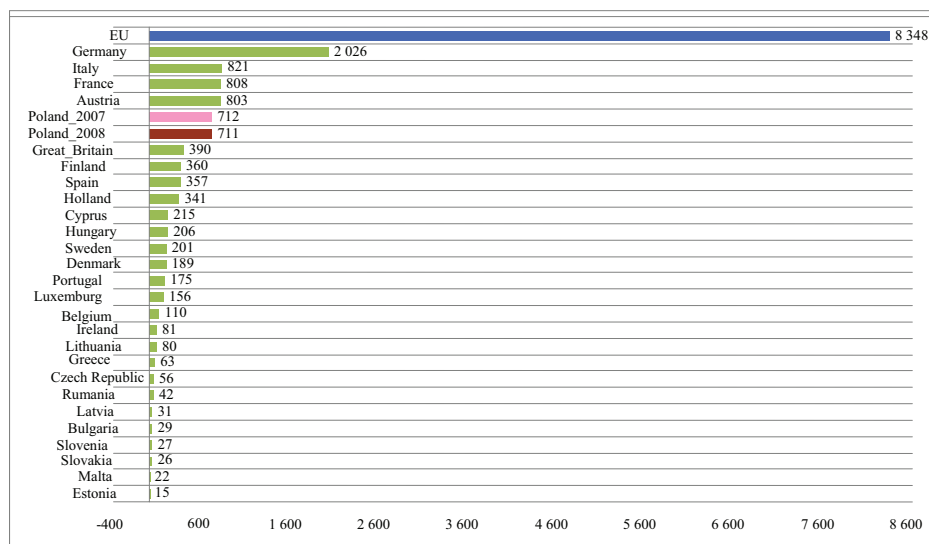


Figure 15. Number of lending institutions in the EU countries

Source: ECB and KNF.

When we consider the volume of assets of the Polish banking sector in comparison with the “old” members of the EU, it seems to be quite small (its assets constitute less than 1% of the assets of all member states) but at the same time it is the biggest among the “ new” members of the EU (it accounts for nearly 30%

of assets of this group of countries). The 16 position of Poland against other EU countries is depicted in Fig. 16.

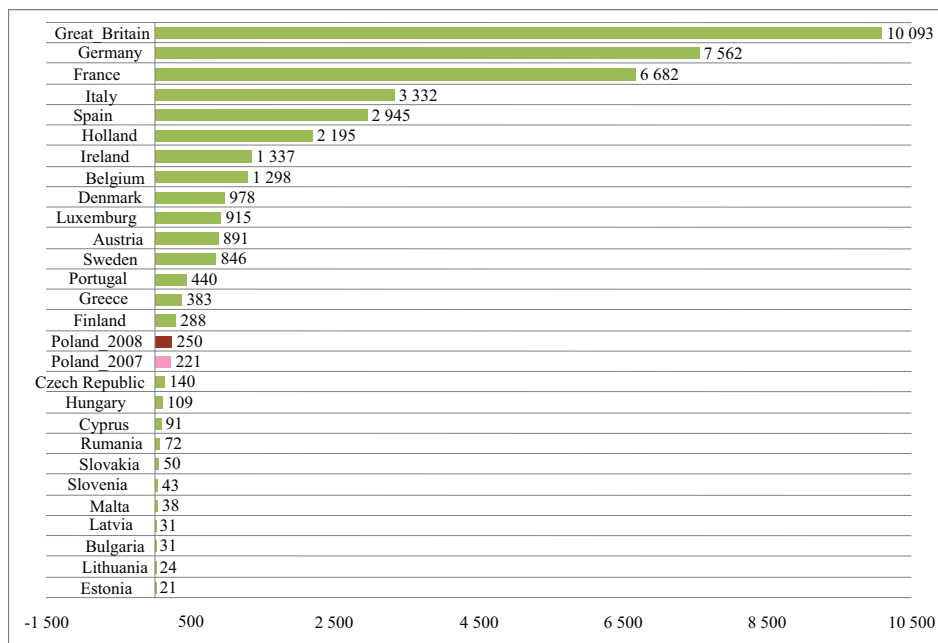


Figure 16. Assets of the banking sector in euros (bn)

Source: ECB and KNF.

The characteristic feature of Poland and the remaining “new” EU members is not only a low level of assets of banking sector but also their low share in GDP. This is a sign of a low level of “banking presence “ in the economy but at the same time it shows a great potential of the sector. It is worth mentioning that in the previous year the relation of assets to the GDP increased abruptly – from 67% in 2007 to 82% in 2008. Moreover, the share of the amount of granted credits in relation to the GDP rose from 36% in 2007 to 47% in 2008. (see: Fig.17).

According to the data collected by ZBP (the Union of Polish Banks) there was a rise in the share of volume of mortgage loans, (financing the real estate market) in relation to GDP and at the end of December 2008 it exceeded 15% (see: Fig 18). This result can be compared with the data gathered by the European Mortgage Federation in 2008 where the EU average for this index amounts to approximately 50%. In case of countries like Denmark it is equal to 104%, Estonia – 35% and finally, Romania – 3%. According to experts from the ZBP (the Union of Polish Banks) such a big disproportion between the portfolio financing the real estate market in Poland and GDP means that the potential of the Polish housing market has not been used yet and it can be used for many years to come.

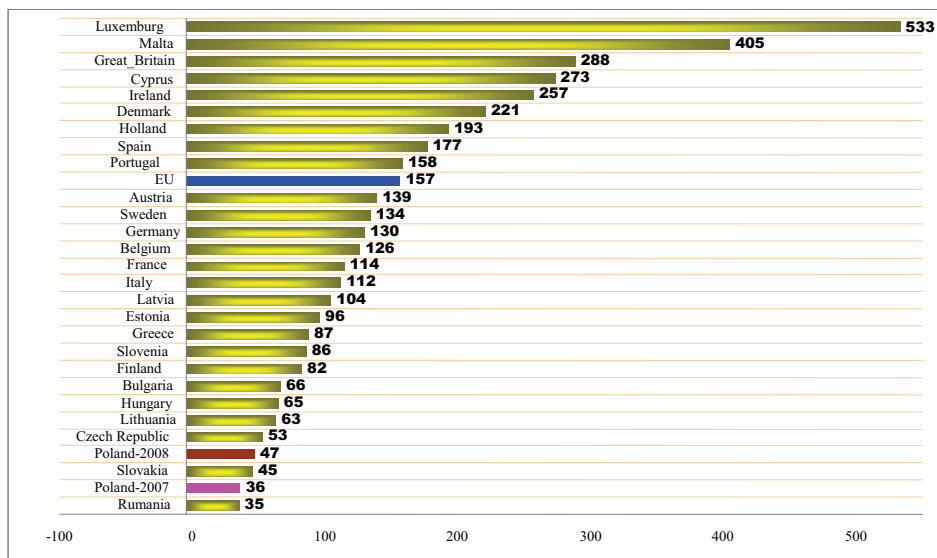


Figure 17. Credits in relation to GDP (in%)

Source: ECB and KNF.

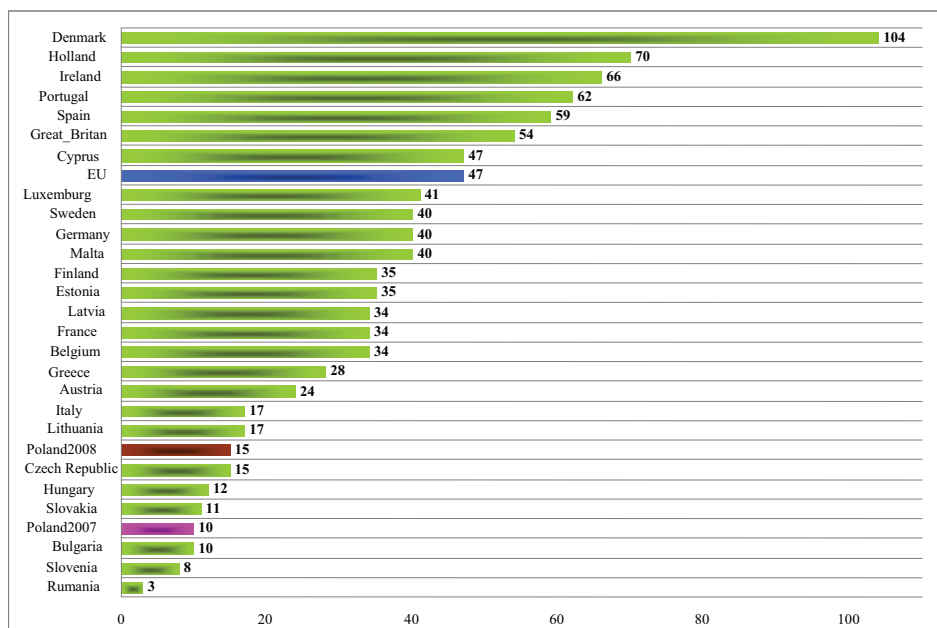


Figure 18. Housing credits in relation to GDP (in %)

Source: ECB and KNF.

It appears that maintaining such a high dynamics in the credit market will lead to a macroeconomic imbalance, and what is more, it will pose a threat to banks themselves at the time of economic downturn.

A relatively low share of housing loans for households in relation to GDP does not necessarily involve a low risk for the sector.

Despite a rather limited range of banking operations of the Polish banking sector, the two banks i.e. PKO BP and Pekao belong to the biggest banks in Europe when it comes to the number of customers, network of branch offices, achieved financial results and market value.

The level of concentration of the Polish banking sector (measured with the share of 5 biggest banks in the assets of the banking sector) remains slightly above the average level for the EU

The ownership structure of the Polish banking sector, which is characterized by a high share of foreign investment, is typical of the “new” members of the EU.

## **5. ECONOMIC CRISIS AND THE CREDIT MARKET IN THE EU**

Both in Poland and in the remaining EU countries banks have adopted stricter criteria of granting all kinds of credits and raised their credit margins. Changes in the credit policy result from a high level of insecurity about the future of economic situation which hinders banks from producing correct assessments of credit risk. Moreover, many banks have limited credit supply due to increasing capital restrictions which was well noticeable in case of credits for enterprises. Another factor which affects the decline in credit supply is a deterioration of quality of credit portfolio, say the banks. It is worth noticing that a decline in credit action can be attributed to diminished credit demand from both enterprises and households.

The expectations of the banking sector for the coming months do not look particularly optimistic, as banks predict

- a further tightening of lending policy towards businesses (a slight rise in demand for short-term credits and a further decline in supply for long-term credits),
- a slight tightening of credit policy in the real estate market and a decrease in supply for loans,
- further restrictions in lending policy and stabilization of demand for consumer credit.

## **6. PROSPECTS FOR DEVELOPMENT OF CREDIT MARKET – OPPORTUNITIES AND THREATS**

In the light of fast and constant development of financial products and well-established fragmentation of the EU market a new European initiative appears to be a great challenge and an opportunity for development. It is aimed at encouraging consumers to use credit facilities outside their countries of origin.

A new Directive on Credit Contracts for Consumers (2008/48/WE) has been issued and it regulates a further market integration and guarantees a high level of consumer protection.

The regulation is based on the principle of transparency and consumer law. It takes into account the responsibility of providing the consumer with exhaustive and comprehensive information with ample time needed to sign the credit contract. In order to enable consumers a full understanding of the contract and a possibility to compare different credit offers it is required that “pre-contract” information is presented in a standardized form – the so-called Standard European Consumer Credit Information. Moreover, consumers are to be informed about the amount of the real annual interest rate.

The Directive provides two basic rights for consumers:

- the right to withdraw from the credit contract within 14 days from signing it without stating the reason,
- the possibility of earlier credit repayment at any given time, and when this is the case the creditor may claim an appropriate and objectively justified compensation.

The Member States have been given time to incorporate the Directive into their legal system until 12 May, 2010.

The new law on the opening of domestic credit markets, which is proposed by the European Parliament, is to increase competitiveness among banks. It also offers an excellent opportunity for development to emerging markets with a large credit potential such as Poland. The most fundamental change in the consumer credit market which will be brought about by the implementation of the directive, will be an extension of the definition of the consumer credit. Any credit up to the 75.000 euro will be treated as consumer credit, so the new definition of consumer credit will encompass mortgage loans.

If the integrated credit market is to work fast, efficiently and safely to the benefit of both sides i.e. the creditor and the borrower, it will be necessary to grant access to bank databases in particular countries.

To sum up, despite the fact that the scope of activities of the banking sector in Poland is expanding, it still lags behind the “old” countries of the European Union. The development process of the Polish banking sector has been seriously hampered by the global financial crisis although to a much smaller extent than in the “old” members of the EU.

At present, the most serious risk factor for the expansion of the banking sector seems to be a decrease in solvability coefficient recorded by numerous banks. Currency risk causes a rise in value of assets, and pooling reserves for unpaid loans has become the main cause of a decrease in banking capital. Consequently, banks are less inclined to grant credits what, in turn, adversely affects the functioning of the whole economy.

Finally, we need to emphasize that the constantly growing integration of the credit market in the EU is both an opportunity and a challenge for the Polish banking sector whose potential is still untapped.

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*Monika Zielińska-Sitkiewicz*

#### POLSKI RYNEK KREDYTOWY W UE – SZANSE I ZAGROŻENIA

Wzrost efektywności i konkurencyjności polskiego sektora bankowego wynika głównie z wejścia Polski do Unii Europejskiej. Obecny poziom konkurencji i efektywności w polskim sektorze bankowym jest zbliżony do tego, jaki występuje w krajach strefy euro.

Jednakże rynek kredytowy w Polsce w porównaniu z innymi krajami Unii Europejskiej jest słabiej rozwinięty. Jaki jest stan tego rynku na tle innych krajów europejskich oraz jakie stoją przed nim szanse i zagrożenia zaprezentuje ten artykuł.

**Słowa kluczowe:** kredyt, Unia Europejska, rynek kredytowy, porównanie.