Report on the condition of Polish banks in 2008

Polish Financial Supervision Authority
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Contents:

MOST IMPORTANT OBSERVATIONS AND CONCLUSIONS

Despite below described trends in banks' environment and in banks the situation of the banking sector in 2008 was stable.

External environment:

(+)

Poland:

- ✓ high growth rate – Poland positively stands out against other EU countries,
- ✓ decrease of unemployment,
- ✓ increase in salaries,
- ✓ decrease in prices on real estate market (although it may have negative consequences for certain banks).

(-)

The World:

- ✓ "second wave" of financial crisis, which led to serious perturbations in the functioning of the market and to collapsing, acquisition or undermining of many financial institutions (including strategic investors of Polish banks) and caused transformation of financial crisis into world economic crisis,
- ✓ decrease of interest rates in US, Switzerland, Great Britain and EU (even to zero), some central banks engaging in "non-standard" activities and expected very high increase of budget deficits in US and certain EU countries, which inspire fears for future consequences of these actions and hinder application of monetary and budget policy in Poland.
- ✓ strong deterioration of the situation of certain countries in Central and Eastern Europe, resulting in sharp weakening of currencies in the region and negative perception of Poland,

Poland:

- ✓ sharp and serious weakening of Polish currency,
- ✓ strong deterioration of financial results of enterprises,
- ✓ sharp mood dampening in households and enterprises,
- ✓ profound bear market affecting income of banks and possibilities of financing entities on capital market,
- ✓ deterioration of the national budget's condition in last months of the year.

Banking sector:

(+)

- ✓ further development of the banking sector (good results in first three quarters),
- ✓ increase of household deposits,
- ✓ increase of liquid assets,
- ✓ increase of capitals (assigning majority of income from 2007 to capitals).

(-)

- ✓ very poor results in the fourth quarter,
- ✓ weakening of interbank market's functioning and increase of the cost of money on the market,
- ✓ strong increase of adverse balance in settlements with the finance sector resulting in the increase of sensitivity to the situation on financial markets,
- ✓ big increase of "endangered" receivables and receivables "under observation", particularly from households, as well as increase of deductions therefrom,
- ✓ a sharp increase of debts from housing loans in foreign currencies, resulting in increase or loan risk and hindering management of these loans' portfolio, without ensuring correct, from structural point of view, sources of financing,
- ✓ deepening of a gap between deposits and loans
- ✓ decline of growth rate of enterprise sector's deposits,
- ✓ decrease of the average solvency ratio,
- ✓ significant exposure of certain banks in currency derivative transactions.

MAIN AREAS OF RISK FOR BANKING SECTOR

Very strong disturbance on global financial markets and weakening of parent companies' situation

- Limitation of markets' liquidity
- Increase of the cost of money on financial market
- Difficulties in risk management, including currency loans' portfolio
- Severe weakening of the Polish currency
- Deterioration of parent companies' financial situation
- Fear for the level of support for Polish subsidiaries
- Difficulties in applying budget and monetary policy in Poland

Weakening of Poland's main commercial partners' situation

- Decrease of demand for Polish products
- Fear of increase of economic protectionism

Strong deterioration of macroeconomic condition of certain countries of Central and Eastern Europe

- Strong pressure on weakening currencies in the region, including Polish currency
- Negative climate around Poland
- Threat for Polish banks' exposure and activity of their subsidiaries
- Threat for certain Polish enterprises' activity

Expansive monetary and budget policy of US and certain EU countries

- Very strong increase of budget deficit and its servicing costs
- Difficulties in applying budget and monetary policy in Poland

Severe weakening of economic activity in Poland

- Deterioration of financial situation of certain enterprises
- Probable weakening of income situation of certain households or loss of income (*inter alia* due to increase of unemployment)
- Fear of increase of core deposits
- Probable further increase of depreciation charges and specific reserves
- Currency options problem

Limitations in access to capitals and long-term sources of financing

- Strong deleveraging
- A barrier to level growth of long-term assets (investment loans and mortgage loans)
- Increase in cost of sources and negative influence on profitability

Decline of assets' quality

- Decline of financial results and potential sources of contribution to capitals
- Negative impact on liquidity

Very strong increase of households' debts in foreign currencies

- Fear of housing loans' portfolio quality deterioration

Weaknesses in risk management process of certain banks

- Worse quality of credit portfolio
- Lower financial results

Although the situation of the banking sector remain stable in 2008, in the fourth quarter a significant increase of risk occurred, resulting from enormous disturbance on global financial markets, leading to the limitation of liquidity and increase of the cost of money on the market, severe weakening of the Polish currency and sharp deterioration of economic growth perspectives. It produced results of *inter alia*, deterioration of financial situation of certain borrowers and led to strong decline of profit in fourth quarter.

Further development of the above mentioned trends and their results pose big challenges for the banking sector in the current year. Key challenges being, maintaining necessary balance between liquidity management and profitability, risk management (including assets of lower quality) and acquiring capitals and long-term sources of financing in the situation of expected decrease of financial results, limited market liquidity and strong competition regarding acquisition of funds.

Maintaining stability of the banking sector requires continuation of banks' activities (adjusting and preventing) and stabilisation of their economic environment.

Banks:
- ✓ strengthening capital base (including leaving all profit in banks),
- ✓ adjusting risk management to current market conditions – including ensuring an appropriate level of liquid assets and capital buffer as well as conducting stress tests,
- ✓ further activities aimed at acquiring long-term sources of financing,
- ✓ restraining the increase of households' debts in foreign currencies,
- ✓ strengthening credit procedures (especially in consumer loans and housing loans) and restructuring and collecting activities,
- ✓ ensuring an appropriate level of financing of the enterprise sector (cutting them off from financing may result in sharp deterioration of functioning of the whole economy).

External environment (country):
- ✓ constant monitoring of the situation of entities dominant to Polish banks,
- ✓ responsible monetary and budget policy and common approach to EUR,
- ✓ support for enterprise sector from economic policy,
- ✓ creating a positive image of Polish economy and counteracting unjustified opinions on Polish economy.

FOREWORD

Dear Readers,

Previous year has brought high income for the banking sector, but also started sharp changes, caused by maelstrom on world financial markets and in the global economy.

At the end of the year events took place which had a negative impact on functioning of banks. Uncertainty grew in financial markets, aversion to taking risk increased, investors withdrew from currencies of Central and Eastern Europe. We observed a fast depreciation of the Polish currency, despite the fact that Polish economy positively distinguished itself against the situation in the region.

Banks themselves felt the effects of weakening of the Polish currency, as well as clients who had liabilities in foreign currencies. Thus the currency risk, so far commonly underestimated, materialised.

In this period of hard times for financial institutions, the significance of the banking sector in stabilising the whole economy is doubly important. On the one hand it is crucial in view of the current crisis of trust to guarantee safety of the accumulated deposits, and on the other – supporting real economy requires providing enterprises with funds for development. Capital strengthening of banks, also through leaving income generated in 2008 which was a good year considering financial results, in the sector, is necessary for continuing credit activity, without the fear over the safety of clients' savings.

In times of economic activity, bank management concentrates on the struggle for a market, for a client. Present situation compels changing of strategy towards more responsible activity, which will enable the institution and its clients passing through a difficult period.

I hope that the "Report on the condition of Polish banks in 2008" prepared by the Supervision, will be a valuable source of information, useful for understanding conditions in which financial institutions are currently functioning.

Enjoy reading our Report,

Dr Andrzej Stopczyński
Managing Director
of the Banking Supervision Section

I. EXTERNAL CONDITIONS OF BANKING ACTIVITY

Strong downturn in economy in second half of 2008

Macroeconomic situation

2008 can be divided in two periods according to the development of macroeconomic situation.
First, covered approximately first three quarters, which despite the symptoms of economic downturn were characterised by a fast rate of economic growth.
Second, covered the period from mid-September to the end of the year, in which a "second wave" of financial crisis started in 2007, passed through global financial markets. It led to serious disturbance in the functioning of markets, sharp increase of aversion towards risk and to reduction of access to credit and increase of financing costs. As a result of the crisis escalation, sale of assets (including currencies) of the countries from emerging markets took place together with strong decrease in prices on commodities and limitation of investment processes. Together with the previous symptoms of weakening of US and EU economy, it resulted in a sharp deterioration of economic situation and deterioration of perspectives for world economic upturn. Thus the financial crisis transformed into the economic crisis. A strong slowdown of Polish economy's growth rate and deterioration of perspectives for its development occurred as a consequence of decreasing demand for Polish products and adjusting responses of enterprises and households.

Chart 1.1
GDP growth rate (%; y/y)

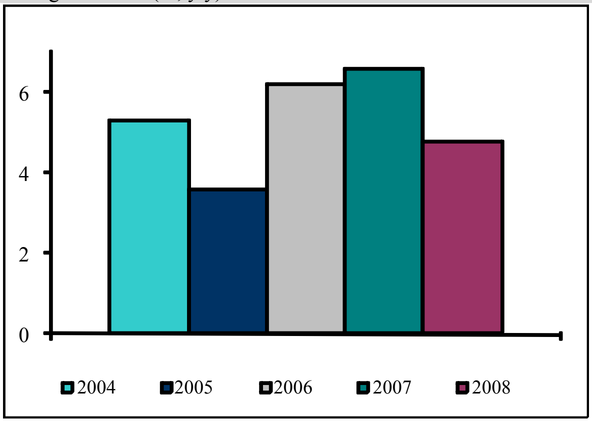
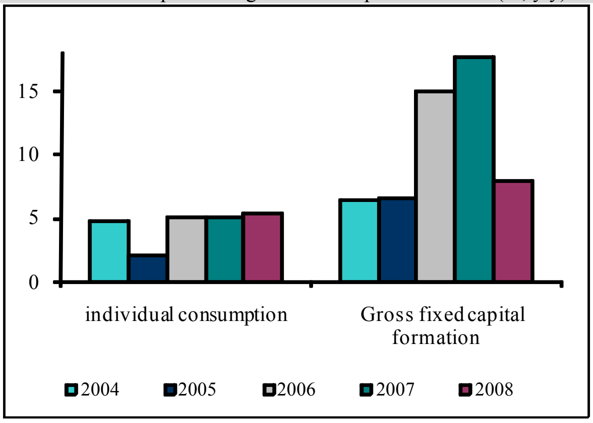


Chart 1.2
Individual consumption and gross fixed capital formation (%; y/y)



Source: GUS

According to the preliminary data of the Polish Central Statistical Office (*Główny Urząd Statystyczny*, *GUS*), gross domestic product increased in 2008 by 4.8% in real terms, which signified a considerable decrease of the growth rate compared to 2006-2007. However the most alarming thing is the strong decline of economic conditions in the fourth quarter of the previous year (in first quarter GDP growth rate equalled 6.0% as compared to the same period of previous year, in second quarter 5.8%, in third 4.8% and in fourth only 2.9%).

Decline of GDP growth rate resulted from the natural weakening of economic conditions (highest phase of the cycle was in 2007) and from fast deterioration of world economy following the escalation of financial crisis. It translated into decline of demand for Polish products abroad, decline of production and weakening of enterprises' financial situation as well as limitation of investments. Gross fixed capital formation *per annum* increased by 7.9% as compared to 17.6% in 2007. (in third and fourth quarter growth rate of investments lowered to a little above 3% y/y, while in first and second quarter it exceeded 15%).

Rate of individual consumption remained high however, which can be explained by a certain delay in transferring trends in enterprise sector to households' level.

Strong decline of production, commercial exchange and retail sales growth rates

Chart 1.3
Annual growth rate of industrial production (%)

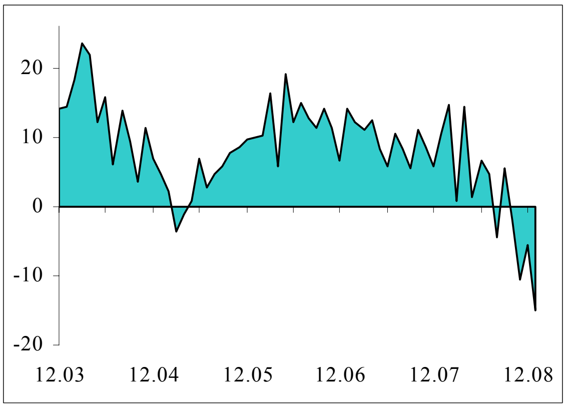


Chart 1.4
Annual growth rate of construction and assembly production (%)

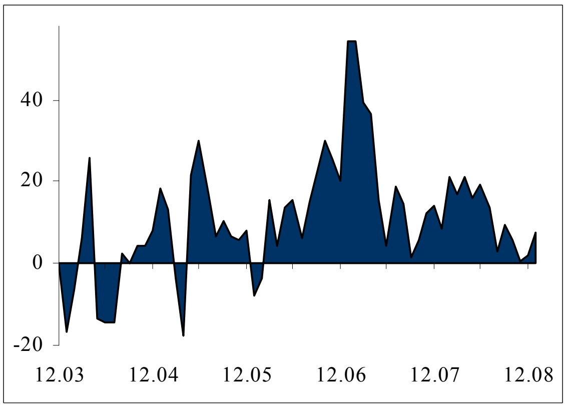


Chart 1.5
Annual growth rate of export (%, PLN, current prices)

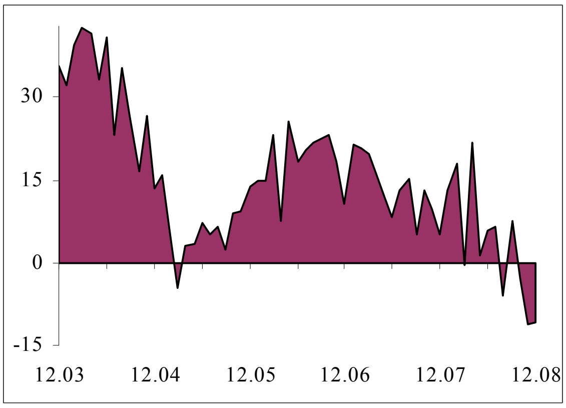
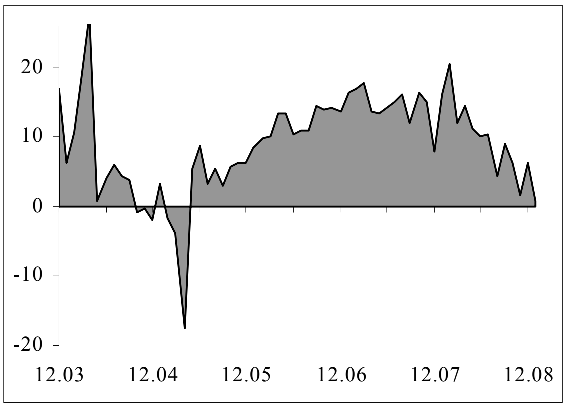


Chart 1.6
Annual growth rate of retail sales (%)



Source: GUS

Industrial production increased in 2008 only by 3.3% in total (as compared to 11.2% in 2007) which was the lowest growth rate since 2002. It resulted from reducing the portfolio of domestic and foreign orders, excessive stock, difficulties in acquiring funds and uncertainty concerning development of economic situation[1]. As a result the growth rate of production slowed down in the third quarter, and declined (by 5.2%) in the fourth quarter. In January 2009 unfavourable trends intensified and industrial production declined by 14.9%.

Increase of construction and assembly production equalled 11.0% but was lower than in 2006-2007. Simultaneously the index of general climate of economic conditions in construction deteriorated – enterprises foresee limitations on orders' portfolio and indicate high costs of employment, decrease in prices and difficulties in accessing loans as main barriers in development of activity. It is reflected in the poor growth rate of production in the last months of the previous year and in January of the current year.

Deterioration of economic conditions in the Euro zone, which is the main commercial partner of Poland, resulted in significant weakening of foreign trade growth rate. Export in PLN in current prices increased by 3.3% (as compared to 12.4% in 2007), and import increased by 6.3% (15.9%)[2]. It is necessary to note the decline of export to Germany (main commercial partner) as a result of entering this economy into recession. As a consequence the negative balance of general trade decreased further (from PLN 70.3 milliard in 2007 to PLN 88.5 milliard in 2008). According to Polish National Bank's (NBP) estimations the deficit on the current account increased to 5.4% of GDP (from 3.7% in 2007).

[1] According to estimations the degree of using production capacities in industrial processing equalled 73% in January 2009 and was the lowest since April 2003.
[2] Growth rate of export in EUR equalled 12.5% (as compared to 15.8% in 2007) and growth rate of import in EUR 15.7% (19.5%).

Economic downturn was accompanied by the decrease of growth rate of retail sales. Retail sales increased during the year by 5.3% (as compared to 7.6% in 2007), however the growth in last months was on continuously lower levels (in January of the current year the growth equalled only 0.8%).

Figure 1.7
Financial results of enterprises (PLN billion, %)

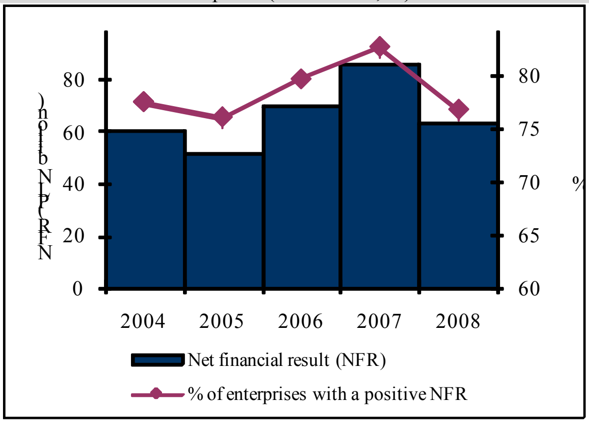


Figure 1.8
Quarterly financial results of enterprises (PLN billion)

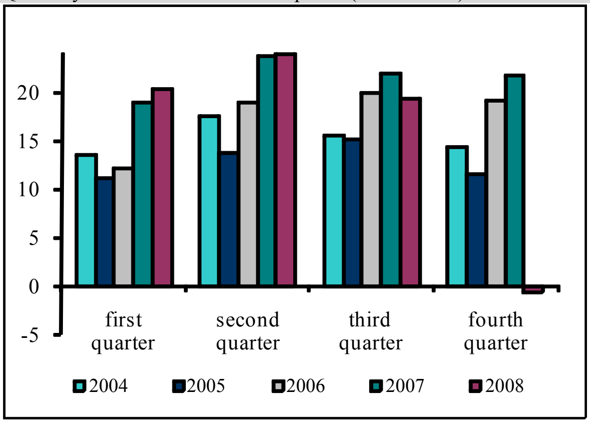


Figure 1.9
Index of the general climate of economic conditions - industry

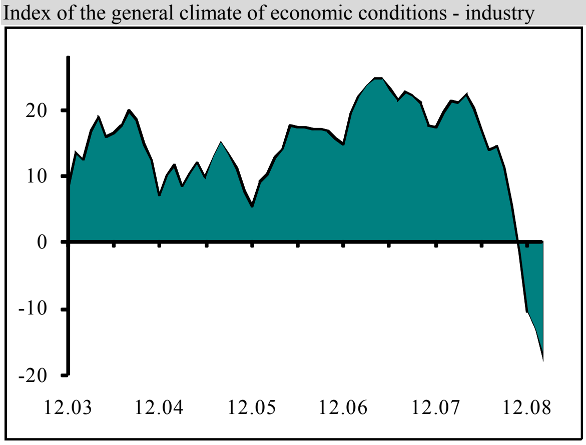
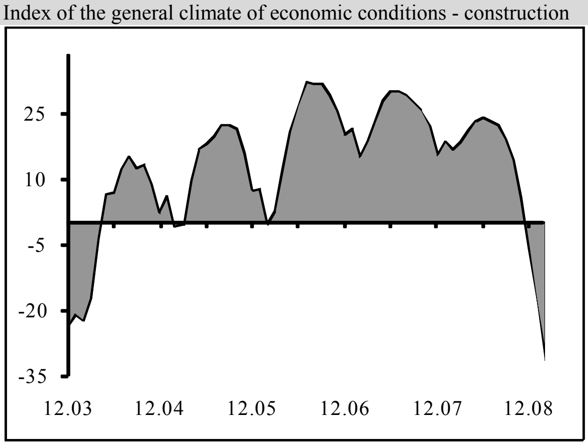


Figure 1.10
Index of the general climate of economic conditions - construction



Source: GUS

Decrease of financial results of enterprises and sharp deterioration of sentiments

Gradually deteriorating financial situation of enterprises was a consequence of accumulation of negative trends. In subsequent quarters of 2008 a decrease of the net profit growth rate was observed. In the fourth quarter a dramatic decrease of profit occurred as well as the loss of PLN 0.7 billion, while in previous quarters (and in analogous quarter of 2007) the net profit oscillated around PLN 20 billion. Moreover, it was the first quarterly loss since 2002. As a consequence, the net financial result of enterprises in 2008 equalled PLN 63 billion and was lower than in 2007 by as much as 26.9%.[3] (it was also lower than in 2006). Deterioration of basic economic relations occurred as well as decrease of percentage of enterprises showing net profit (from 82.6% in 2007 to 76.7% in 2008)[4].

A sharp decline of general indexes of the climate of economic conditions in industry and construction which occurred in last months of the previous year and at the beginning of the current year is also alarming, it will probably translate into further decline of enterprises' activity.

[3] Data concern 15.5 thousand business entities that keep accounting records and employing 50 or more people.
[4] For more see: "Financial results of non-financial enterprises in 2008", GUS.

Chart 1.11
Unemployment rate (%)

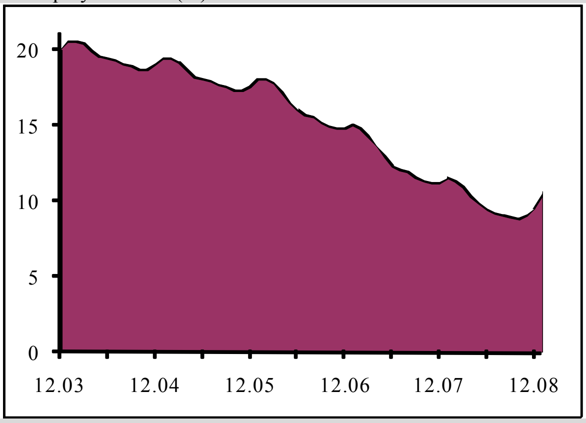


Chart 1.12
Average gross salary in enterprises (PLN)

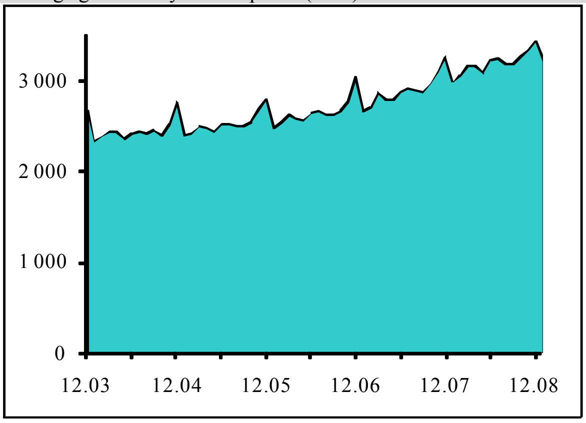
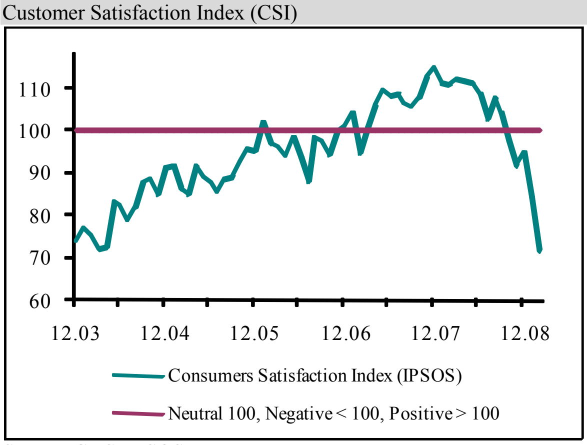


Chart 1.13
Customer Satisfaction Index (CSI)



Source: GUS, IPSOS

Improvement of situation on job market but... adverse trends are expected in 2009

Maintenance of good economic conditions for considerable part of the year led to significant improvement of the job market situation and households' income situation. At the end of 2008 there were 1 473.8 thousand registered unemployed persons (272.8 thousand less than in 2007). At the same time a noticeable lack of workforce led to a considerable increase of salaries. An average gross remuneration in enterprises equalled PLN 3179 in 2008 (10.1% more than in 2007), and its purchasing power was higher than in 2007 by 5.9%.
A relatively favourable macroeconomic situation was conducive to increase of average disability and retirement pensions[5].
Unfortunately, toward the end of the previous year this favourable image began to change, decrease of salaries' growth rate and increase in number of unemployed occurred (in January of the current year the growth rate of salaries decreased to 8.1% as compared to 11.7% in the previous year, and unemployment rate "jumped" to 10.5%). Due to fast progress of economic downturn in the forthcoming periods the weakening of the situation on the job market and deterioration of income situation in part of households is to be expected.

Sharp deterioration of consumers' sentiments

The "second wave" of financial crisis together with negative trends in economy led to the decline of customers satisfaction index (CSI). This unfavourable trend increased at the beginning of the current year, and as a result CSI decreased to the level last recorded in the end of 2001.

[5] Average disability and retirement pension in work system in 2008 equalled PLN 1419 and in real terms was higher by 4.1% than in 2007 and the average disability and retirement pension of individual farmers equalled PLN 858 which indicates increase by 0.5%.

Chart 1.14
CPI and PPI inflation (%)

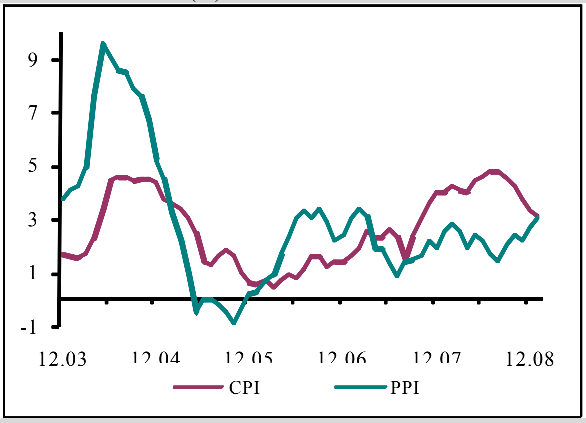


Chart 1.15
The national budget results (PLN billion)

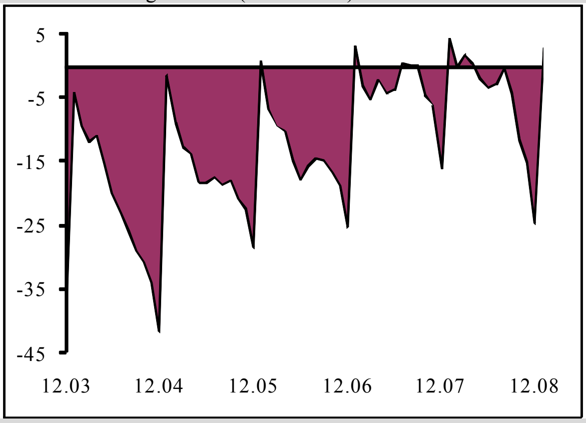


Chart 1.16
Overdraft of the State Treasury (PLN billion)

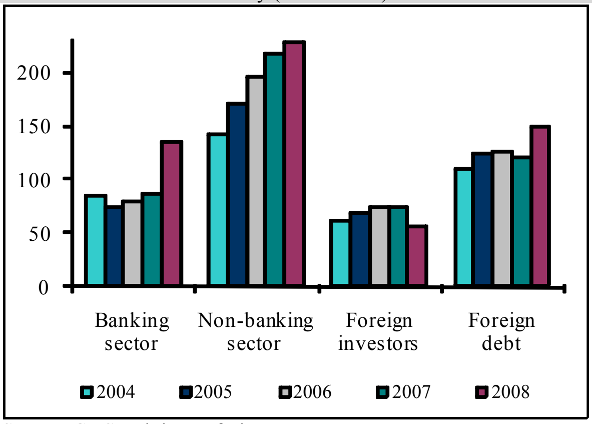
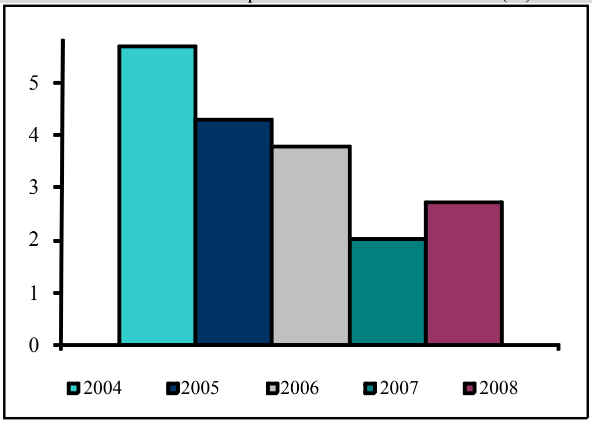


Chart 1.17
Relation of the deficit of the public finance sector to GDP (%)



Source: GUS, Ministry of Finance

Gradual decrease of inflation pressure

Very strong reduction of prices on energy resources and agricultural and food resources on global markets, together with stronger and stronger decline of economy and decrease of the growth rate of salaries led to limitations of inflation pressure in consumers area. As a result CPI inflation (year/year) decreased from 4.0% in December 2007 to 3.3% in December 2008, thus returning to the acceptable range of deviations from the objective of the monetary policy (2.5%; +/-1%). Following decrease of inflation and deterioration of perspectives for economic upturn a decrease of inflation expectations also occurred. In turn, increase of inflation measured by PPI index (from 2.3% to 2.7%) probably can be connected to a strong decline of Polish currency, and as a consequence to the increase of import costs for certain products used in production.

Increasing pressure on budget situation

The situation of the national budget was favourable till the end of the third quarter of the previous year. Deficit increased in the fourth quarter. Deficit equalled PLN 24.6 billion *per annum* (PLN 16 billion in 2007) and was slightly lower than planned, which however was achieved through cutting some expenses. Increase in value of the treasury stock falling due in the period of up to 1 year, resulting from the strong increase of emission of treasury bond in the second half of the year, is to be considered unfavourable as well.
According to NBP estimations the deficit of public finance sector equalled to 2.7% GDP in 2008 (2.0% in 2007), which is a relatively good result in comparison to other countries.

Table 1.1

Poland's ratings

Rating	Fitch	Moodys	Standard & Poors
Long-term rating in domestic currency	A	A2	A
Long-term rating in foreign currency	A-	A2	A-
Perspective	stable	stable	stable

Relatively favourable – in comparison to other countries – situation of Poland was reflected in maintaining country's rating unchanged.

Maintaining Poland's ratings and their stable perspective

Table 1.2

Medians of real estate transaction prices concluded by Open Finance clients

city	Price median 1 sq. m 02/2009	Price median 1 sq. m 02/2008	Change	Real estate price median 02/2009	Real estate price median 02/2008
Gdańsk	5 397	6 266	-13.9	315 000	350 000
Kraków	6 034	6 889	-12.4	280 000	330 000
Poznań	5 525	5 516	0.2	286 500	300 000
Warsaw	7 818	8 696	-10.1	400 000	400 000
Wrocław	5 737	6 552	-12.4	276 872	320 000

Source: Open Finance

Stabilisation of prices on real estate market transforms into gradual decrease of these prices

In the first half of 2008 the final stage of boom, characterised by restrain of real estate price growth and connected with oversupply (at given level of prices), as well as suspending part of demand due to very high prices, was observed on the housing market. Debts due to loans for financing housing needs, dominated by the exposures in Swiss franc or indexed to this currency (due to big difference in interest rates), still increased rapidly. In the second half of the year the situation drastically reversed. Demand on the housing market sharply declined as a result of tightening the credit policy by the banks and estimation of economic perspectives, and thereby the future income situation by potential buyers of apartments. As a consequence, a great imbalance started to increase on the market, which eventually transformed into a gradual decrease in prices.

The scale of decrease in prices is hard to estimate due to lack of reliable data covering the whole market, limited market liquidity and significant impact on average prices of transactions and offers from various segments (e.g. a big number of sales offers for investments in the highest segment of the market may significantly change the average price of apartments in a given city or district). For that reason it is necessary to cautiously approach presented data (including those presented in Open Finance data report). Nevertheless, we can state that the scale of decrease in prices equalled from few to several percents.[6]

[6] Broad information on the situation on real estate market and on financing of this market by banks is included in the report "Financing of real estates by Polish banks – condition on December 2008" UKNF 2009.

Monetary policy, financial market condition, reactions of banks

Change of monetary policy, start of quick cuts of NBP interest rates

According to the "Monetary policy for 2008" a key objective of the monetary policy was the pursuit of decreasing inflation to the level of a continuous target inflation of 2.5% (+/-1)[7].

Chart 1.18
Implementation of monetary policy objective (%)

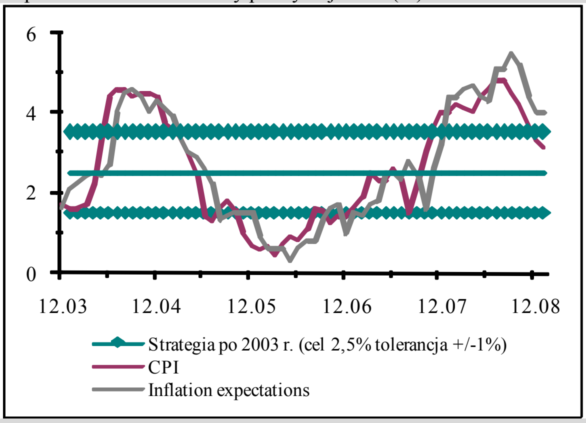


Chart 1.19
Interest rates NBP (%)

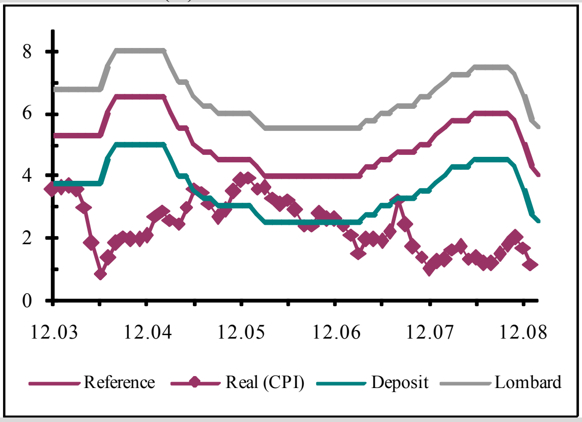


Chart 1.20
Main interest rates of central banks (%)

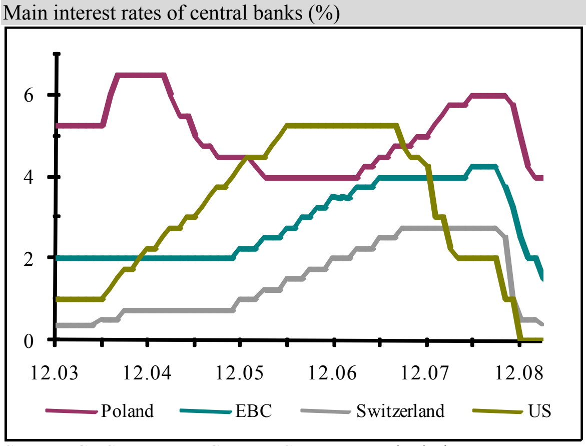
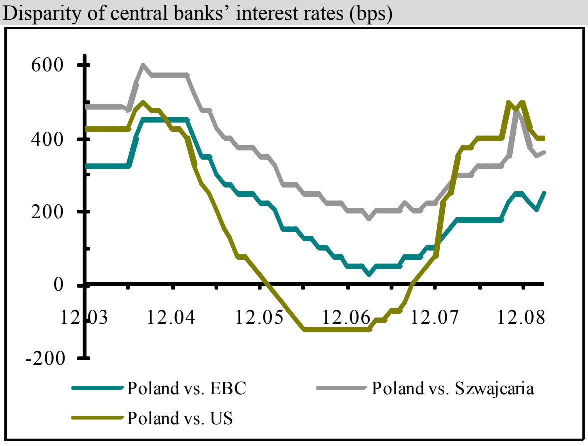


Chart 1.21
Disparity of central banks' interest rates (bps)



Source: GUS, NBP, EBC, FED, SNB, own calculations

[7] See "Guidelines of the monetary policy in 2008"

2008 was another year of implementing the strategy of monetary policy after 2003, according to which, a fundamental objective of monetary policy is stabilisation of inflation at 2.5% with permitted deviation range of +/- percentage point, but the monetary authorities' aim is to maintain inflation as close to the target as possible. Evaluation of the degree of accomplishing the objective is based on CPI index year to year (so called strategy of direct continuous inflation target). Second task of the Strategy is Poland's membership in the Eurozone, which should be coducive to the development of polish economy (*inter alia* through eliminating exchange rate risk, increasing access and decreasing costs of acquiring capital, increase of commercial exchange, strengthening competitivness, decreasing macroeconomic risk). The Strategy is implemented in conditions of liquid exchange rate, but the Council reserved a right to intervene on currency market if it was necessary for accomplishing inflation target.

Basic instrument for accomplishing target inflation is NBP interest rates which shape short-term interest rates of monetary market. It is made through operations of the open market (concluded on NBP's initiative) and deposit-loan operations (concluded on banks' initiative). On the other hand, short-term interest rates of the monetary market affect other financial instruments' prices, including interest rates on deposits and loans offered by banks to clients.

Basic NBP interest rate is reference rate determining a minimal profitability of basic NBP operations, which affects the level of interest rates on interbank deposits with a comparable date of maturity. On the other hand, lombard rate and deposit rate determine a range of deviation of daily rates of monetary market (O/N) symmetrical to the reference rate. First determines the cost of money acquired by banks in NBP, thus indicates a maximum level of rates on interbank market. Second determines the price the central bank is ready to pay for receiving a one day deposit, thus indicates a minimal level of interest rates on interbank deposits.

In the first half-year of 2008 the Monetary Policy Council (Rada Polityki Pieniężnej – RPP) increased NBP interest rates (100 bps in total), which resulted from accelerated inflation processes, exceeding the top acceptable limit of deviations from inflation target by CPI and from increase in inflation expectations. In the second half-year of the previous year, because of the "second wave" of financial crisis moving through global financial markets and the resulting difficulties in accessing credit, as well as prognosis for decrease of inflation related to the expected slowdown of Polish economy, MPC decided to change monetary policy and started a cycle of quick interest rates' cuts. Aggressive cuts of interest rates in Euro zone, US, Great Britain and Switzerland were an additional argument[8]. As a result of the cuts – 100 bps in November – December of the previous year and 100 bps in January - February of the current year – NBP rates return to the level of 2006 and equalled respectively: 4.00% for reference rate. 5.50% for lombard rate, 2.50% for deposit rate, and 4.25% for rediscount rate.

Although the situation on the financial market in the first half of 2008 can be considered relatively stable (sharp declined occurred mainly on the stock market), very strong disturbance in functioning of individual areas of the market occurred in the second half. Events from July-September of the previous year covering *inter alia,* US Government taking control over Fannie Mae and Freddie Mac, bankruptcy of Lehman Brothers, announcing takeover of the Merrill Lynch by the Bank of America and actual nationalisation of American International Group. As a consequence a crisis of trust between market participants occurred, leading to very strong disturbance on interbank market, great declines in stock markets and resources markets and "escape of the capital" from emerging markets.

Very strong disturbance in functioning of financial markets

Crisis of trust on interbank market

Chart 1.22
NBP and WIBOR 3M reference rate (%)

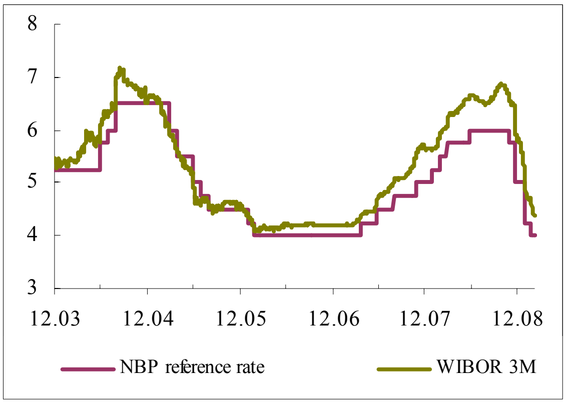


Chart 1.23
FED and LIBOR USD 3M reference rate (bps)

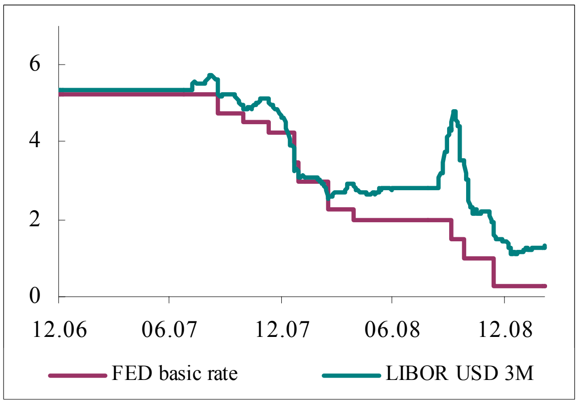
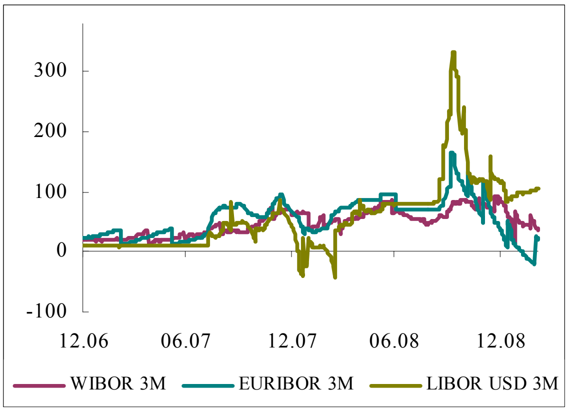


Chart 1.24
Deviation from reference rates (bps)



Source: Bloomberg, own calculations

[8] ECB decreased its basic rate from 4.50% at the end of 2007 to 2.50% at the end of 2008. (in the current year further cut by 100 bps), FED from 4.25% to range 0.00%-0.25%, SNB from 2.75 to 0.50% (middle of range). EBC reduced its rate to 1.5% and SNB to 0.38% in the current year

As a result of the crisis escalation a sharp increase in rates occurred on the interbank market, transactions' deadlines was reduced and limits for exposure for each entity were decreased; all of this led to the increase of financing costs and difficulties in managing current liquidity and securing the risk. Decline of mutual trust among market participants created a situation where banks, uncertain of contractors' financial situation, preferred to invest available funds in central banks. The measure of disturbance in functioning of the interbank market is *inter alia,* the level of deviation of rates on this market from the basic rate of central bank. Ignoring the issue of differences resulting from market expectation and considering the future level of interest rates of central bank, it is necessary to state that the consequence of the financial crisis is the increase of this deviation, suggesting decreasing trust among market participants and increase of perceivable risk level. Before the crisis the deviation of LIBOR USD 3M rate from the FED basic rate oscillated within several bps, after the "first wave" of the crisis it increase to several dozen and after the "second wave it reached about 100 bps (reaching few hundred bps in the climax of the crisis).

Situation on Polish interbank market can be considered quite good in comparison to disturbance occurring in other countries. WIBOR 3M rate, which is a reference rate for majority of domestic currency loans, increased from 5.7% at the end of 2007 to 5.9% at the end of 2008. However, it is necessary to note that a decrease of mutual trust among market participants occurred also in Poland, as a result of *inter alia,* information and rumours about financial problems of Polish banks' strategic investors.

Chart 1.25
Yield on Polish Treasury bills (%)

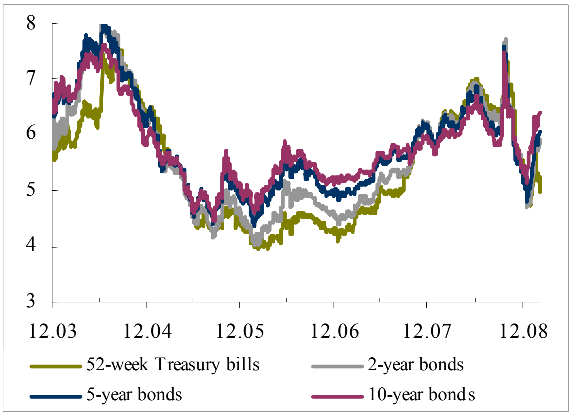


Chart 1.26
Yield on 10-year Treasury bonds (%)

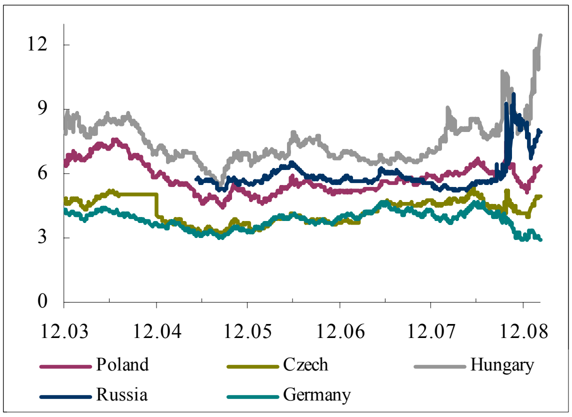


Chart 1.27
Yield on 10-year Treasury bonds cont. (%)

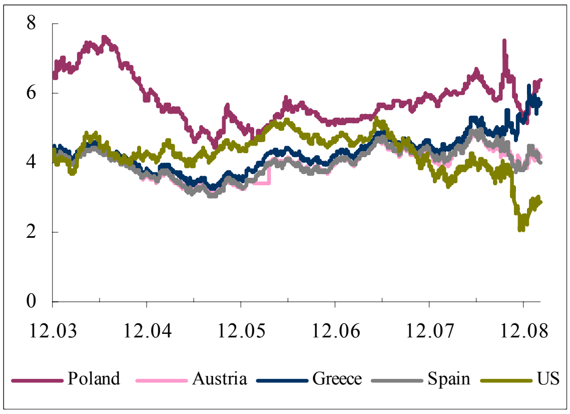
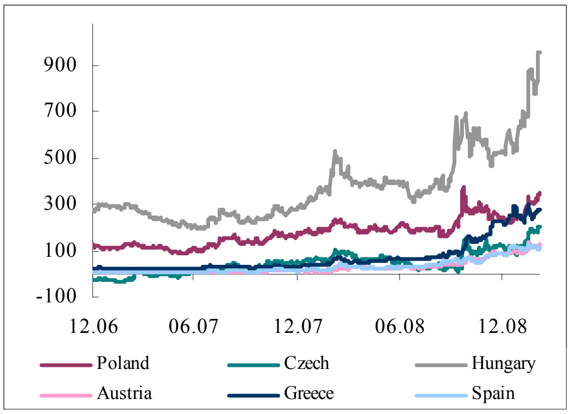


Chart 1.28
Yield differences in comparison to Germany (bps)



Source: Bloomberg, own calculations

Yield on Treasury bills *per annum* decreased slightly – Treasury bills decreased from 6.2% at the end of 2007 to 5.4% at the end of 2008; bonds decreased from 6.1% to 5.3% and 10-year bonds decreased from 6.1% to 5.3%. Three periods can be distinguished. First, covering first half of the previous year, continued yield increasing trend, resulting from tightening the monetary policy. Second, covering third quarter, was characterised by the gradual decrease of yield in connection with increasing expectations for stopping the cycle of interest rates increased by MPC. Information on the favourable condition of the budget was also an important information for

the market. Third period, covering the fourth quarter was characterised by very big variability. In October, as a result of crisis escalation on global financial markets, a sale of Polish Treasury bills occurred (in the whole 2008 foreign investors decreased their exposure to Treasury bills issued on domestic market by 25.0% from PLN 74.5 billion at the end of 2007 to PLN 55.9 billion at the end of 2008). As a consequence, the yield of bills jumped to 120-150 bps. Calming of global markets and starting aggressive cuts of interest rates by MPC translated into a sharp yield decline in November 2008 - January 2009, which was within 100-280 bps. However, In the following weeks, as a result of another wave of investors' pessimism and a very negative climate which was created around Central-East Europe countries, Polish Treasury bills were under pressure and its yield increased again.
A consequence of disturbance on global financial markets was also increase of difference between the yield on Polish Treasury bills and bills issued by the governments of the biggest and most stable countries (US, Germany, Japan) perceived as the most secure. However, increase of spread concerned most countries, including those in Euro zone (*inter alia,* Spain, Austria, Greece).

Chart 1.29
5-year CDS rates of selected countries (bps)

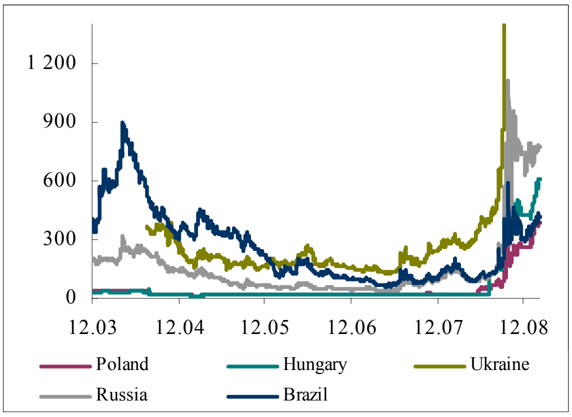
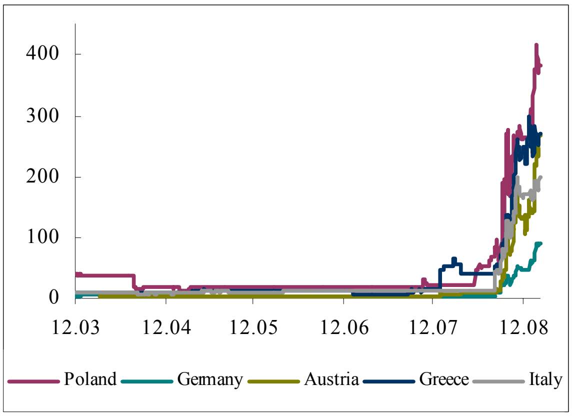


Chart 1.30
5-year CDS rates of selected countries cont. (bps)



Source: Bloomberg, own calculations

Observing the market of debt securities it is necessary to note that one of the consequences of the crisis was a sharp increase of pricings of CDS contracts[9], which are used for securing credit risk related to the issuer of debt securities (to put it simply, the bigger CDS rate the higher probability of issuer's insolvency according to the market). It must be noted that despite a strong increase of pricings of "Polish" CDS, Poland turns out very well not only against other countries in the region, but also relatively good against certain countries, members of the Euro zone (Greece, Austria, Italy).

It must be added that the situation on the Polish financial market is not only a derivative of the Poland's macroeconomic situation and the general climate on global markets, but also to a significant extent is a derivative of the situation of neighbouring countries, classified as belonging to one group by foreign investors. This makes unfavourable trends from other countries in the region transfer to Polish market. Moreover, because Polish market is the biggest and the most liquid, investors who want to open or close the exposure to Central-East European countries, often do this in Poland. As a result the scale of reactions to unfavourable trends in other countries may be bigger in Poland than in countries directly related to these trends. It seems that this trend can also be observed on foreign exchange market. In other words we are dealing with a sort of overreaction of the Polish market to external events.

[9] „Pierwsza fala" wzrostu kwotowań kontraktów CDS miała miejsce po przejęciu Bear Stearns przez JP Morgan.

Chart 1.31
Main exchange rates in relation to PLN

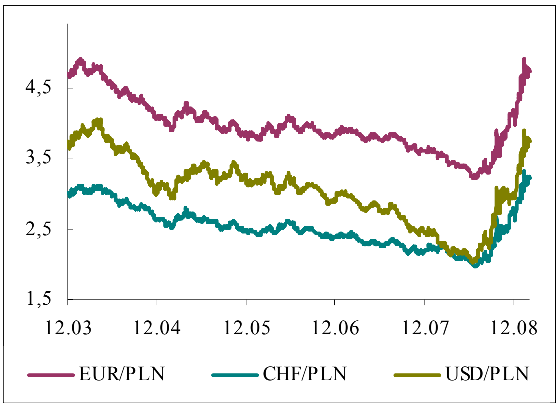


Chart 1.32
Change of selected exchange rates in relation to EUR (%; 12/2007=100)

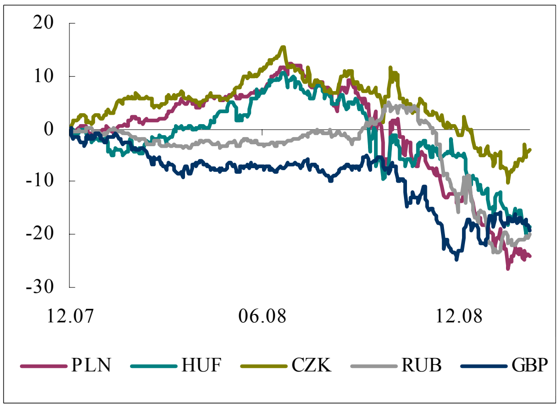
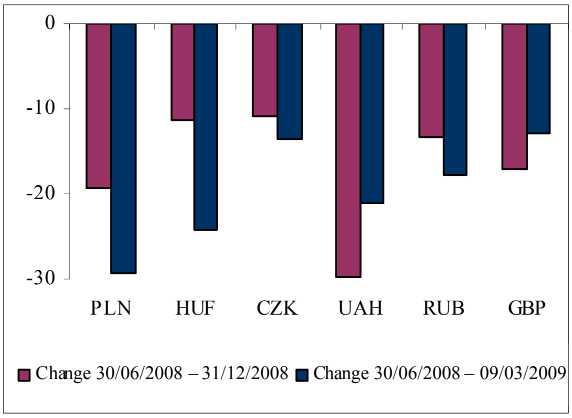


Chart 1.33
Change of selected exchange rates in relation to EUR (%)



Source: Bloomberg, own calculations

Historically high appreciation of PLN and subsequent rapid change of a long-term trend

Strong depreciation of PLN resulting from worse prospects of growth and higher risk aversion

Till the middle of the year appreciation of PLN had been taking place, resulting in PLN reaching the highest levels in last years in relation to main currencies (at the end of June of the previous year PLN strengthening was conducive to limiting inflation pressure, improving situation of importers and borrowers who have loans in foreign currencies, but at the same time it caused deterioration of the situation of exporters and their cooperating companies. At the turn of July and August of the previous year the trend on the PLN market reversed (the Polish Financial Supervision Authority – KNF warned of the possibility of realisation of such scenario in its previous reports), which under the influence of sharp deterioration of mood on global financial market and resulting aversion to risk, led to severe weakening of PLN. As a consequence at the end of 2008, 1 EUR cost PLN 4.1724 (as compared to 3.5820 at the end of 2007), 1 USD 2.9618 (2.4350) and 1 CHF 2.8014 (2.1614). In first months of the current year the depreciation of PLN deepened, which is to be connected with further deterioration of investment climate toward Central-East European countries (distinct deterioration of economic situation in Hungary, Ukraine and Baltic countries), strong symptoms of weakening of the Polish economy, big cuts of NBP interest rates, estimation of effects of derivative transactions concluded in PLN exchange rate, lack of common approach concerning introduction of euro and the attitude towards changes on foreign exchange market[10].

[10] From 2000 liquid exchange rate is applied in Poland. According to the Law on the National Bank of Poland, NBP implements the currency policy defined by the Council of Ministers in consultation with MPC. The rules of determining PLN exchange rate are determined by the Council of Ministers in consultation with MPC.

It must be added that the sale of currencies concerned not only emerging markets, but also fully mature markets like *inter alia,* GBP. It results from the fact that in the period of crisis, investors show a natural tendency to purchase key currencies (USD, EUR, JPY).
Weakening of PLN has positive aspects related to *inter alia,* improving competitiveness of Polish economy and higher value of funds received from EU, which may constitute a sort of "cushion" for the economy.

On the other hand accompanied by significant negative aspects:

- increasing foreign debts and its servicing costs (it is necessary to take into consideration so called caution requirements);
- increase in PLN value of credit assets, dependent on foreign exchange rate, increases the capital requirement due to credit risk and absorbs the capital without inflow of new loans to the economy;
- excessive expansion of banks' credit policy led to very big increase of households' debts in foreign currencies (mainly from housing loans). As a consequence, further significant weakening of PLN may increase households' debts servicing costs, which in conditions of potential increase of unemployment will increase credit risk and eventually lead to the increase of risk of the whole banking sector. The scale of impact of this factor depends on compensatory impact of the decrease of interest rates (mainly in Switzerland);
- with regard to the scale of derivative currency transactions concluded by entrepreneurs, depreciation of PLN negatively affects their results when these transactions had speculative character or their level turned out to be higher than the currency position resulting from conducted activity due to changes in entrepreneurs' environment.

Weakening of PLN may be dangerous due to high currency debts of households.

Because of the shallowness of foreign exchange market and its sensitivity to speculative transactions, exchange of EU funds directly on the market may be conducive to stability of exchange rates.

Main activities aimed at strengthening PLN should emphasise economy's foundation and include:

- responsible fiscal policy. In this context, activities aimed at maintaining budget discipline should be evaluated positively (in the situation of great disturbance on global markets and increase of aversion towards risk, increase of Polish Treasury bills' supply must lead to decrease in their prices and a negative effect on foreign exchange rate);
- responsible monetary policy – it should be taken into account that in the present situation on financial markets, decreases of NBP interest rates must not necessarily translate into decrease of interest rates on newly granted loans and into increase of credit activity (see below), and at the same time may be leading to weakening of PLN,
- and: common policy of Polish Government, President of Poland, NBP and Polish Parliament concerning introduction of euro;
- limiting the increase of currency loans to households with income that can compensate the increase of debt servicing costs related to possible depreciation of PLN.

Necessary well balanced budget and monetary policy and coherent strategy for introducing euro

Necessary limitation of increasing households' debt in foreign currencies

Necessary creation of correct image of Polish economy for foreign investors

The above mentioned activities must be supported by appropriate information policy, which will allow for the appropriate evaluation of Polish economy's foundation and thus enable appropriate evaluation of foreign exchange rate concerning its deviation from the long-term balance rate. Particularly it is necessary to show differences between Poland and other countries of the region. Opinions and analyses which are based on random data and simplified methodology, which may lead to deformed image of economic situation of Poland and the region, should be corrected as well.

Chart 1.34
Change of the indices from the end of 2003 (%)

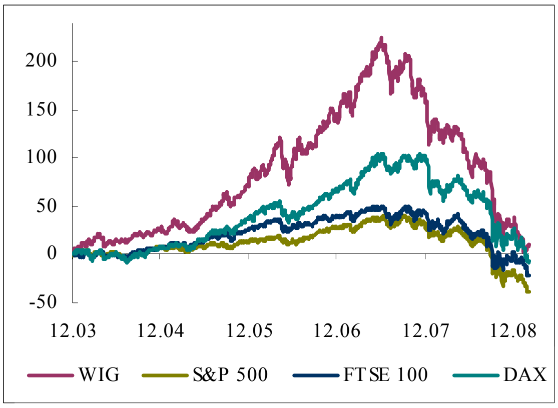


Chart 1.35
Change of the indices (%)

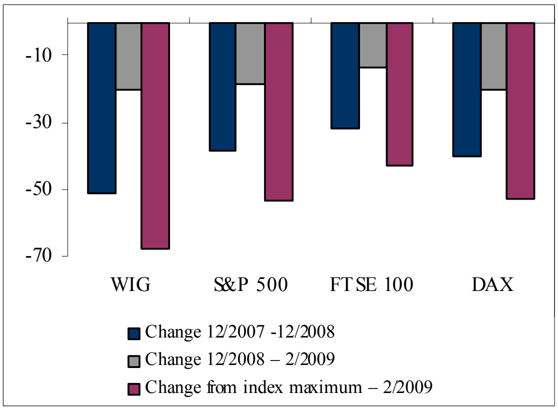


Chart 1.36
Daily change of S&P 500 index (%)

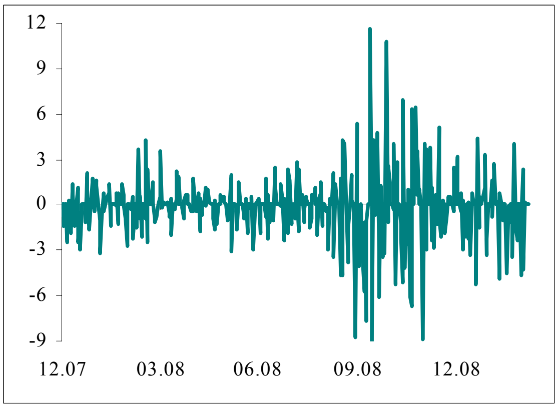


Chart 1.37
Daily change of Citigroup stock prices (%)

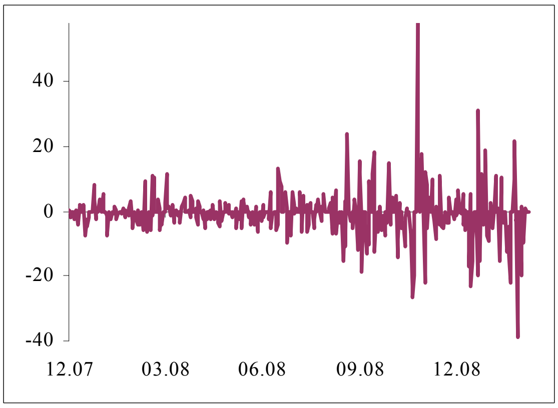


Chart 1.38
Market value of selected companies (billion EUR)

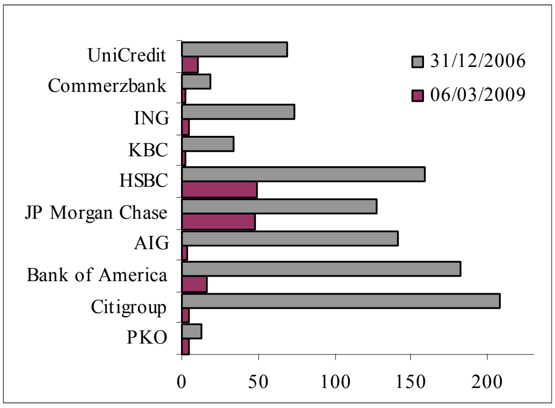
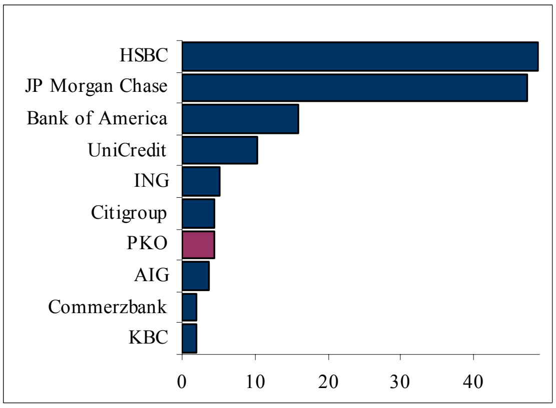


Chart 1.39
Market value of selected companies (billion EUR) – 6/03/2009



Source: Bloomberg, GPW, own calculations

Very strong declines and variabilities on stock markets. Cancellation of hossa from 2003-2007

At the turn of 2007 and 2008 a definitive breakdown of bull market on global stock markets occurred and market entered the state of very deep bear market. The strongest wave of reduction of prices occurred in autumn of the previous year, when under the influence of sharply deteriorating situation of companies in American and European finance sector, disturbance in liquidity on interbank market and significant deterioration of situation and perspectives for global economy upturn, a panic stricken stock sales took place. At the beginning of the current year declines intensified. As a result of declines quoted from autumn 2007 not only the entire wave of bull market from 2003-2007 was cancelled but also indexes of certain stock exchanges returned to levels quoted in the 90's and many companies lost several dozen percent of their value (losses often exceeded 80% or even 90%). Very big variability of quotations – daily

changes of indexes of the biggest world exchange stocks often reach few percents (even 5%-10%), which in the period before the crisis would be considered extraordinary (changes in market value of individual companies often equal from several to several dozen percent) – was also characteristic. Such big changes show that at present financial market are formed mainly by emotions and not the rational evaluation of the situation of individual companies, markets or economies. A strong dependency of investor's decisions on the situation of American market, which in many cases is not justified, is also alarming.
One of the effects of the crisis was also a big reduction of market value of companies which were "icons" of the world and regional economy, particularly from the finance sector. Before the crisis market value of many of these companies was few or several times higher than the market value of PKO BP and after recent reductions of value many of them are lower or comparable to the value of this bank.

Chart 1.40
Change of the indices from the end of 2003 (%)

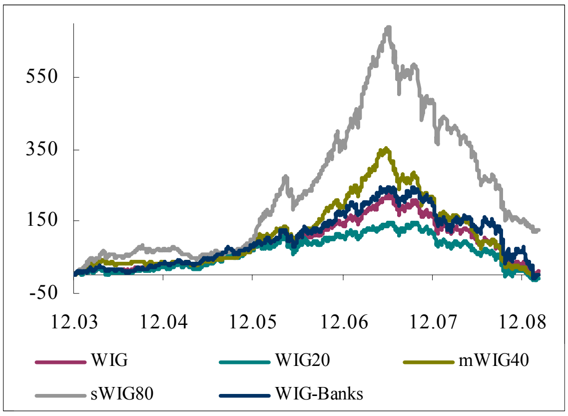


Chart 1.41
Change of stock exchange indices (%)

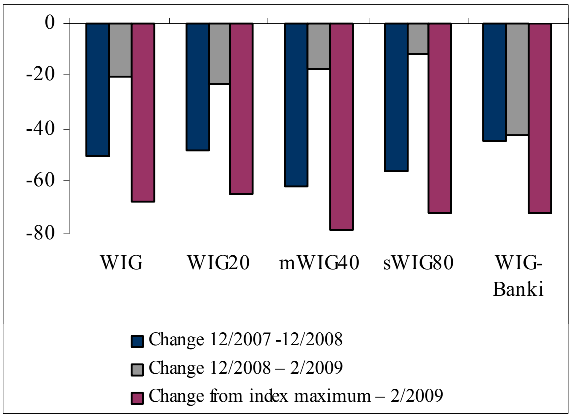


Chart 1.42
GPW capitalisation in the period 12/2007 – 02/2009 (PLN billion)

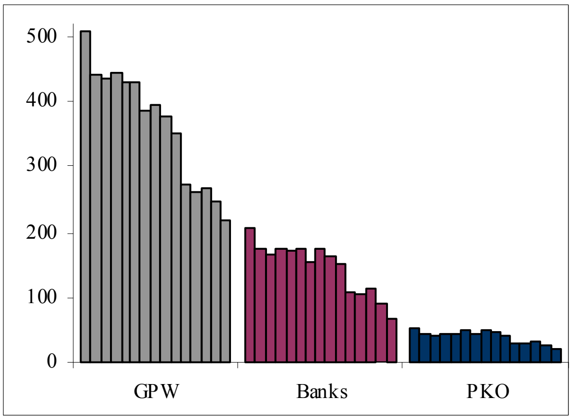
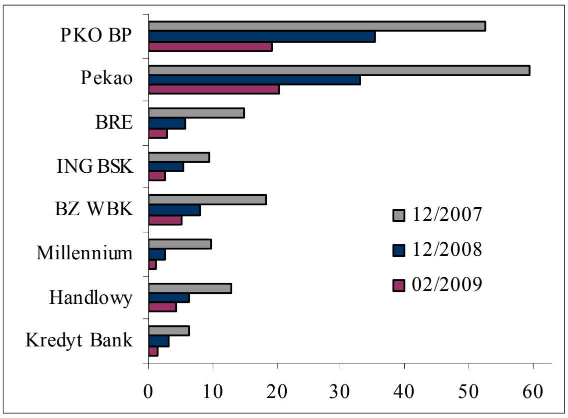


Chart 1.43
Capitalisation of the largest banks (PLN billion)



Source: Bloomberg, GPW, own calculations

Warsaw stock exchange fallowed global markets. As a consequence at the end of 2008 WIG value was lower than in the end of 2007 by 51.1%. (WIG20 by 48.2%, mWIG40 by 62.5%, sWIG80 by 56.9%, and WIG-Banks by 44.8%). Breakdown on WSE was intensified by mass amortisation of investment funds' participation units (the biggest in January of the previous year when about PLN 11 billion were withdrawn). About PLN 30 billion net were withdrawn from investment funds in the whole year, which together with the decline of stock exchange caused decrease in value of assets accumulated in funds from PLN 133.8 billion at the end of 2007 to PLN 73.7 billion at the end of 2008. (i.e. by 44.9%).
Decline of the number of individual investors in stock exchange market to 18%, i.e. the lowest level in the history of activity survey, and at the same time increase of the number of foreign investors to 43%[11] should be considered an adverse trend as well.

[11] See "Participation of various investors groups in stock exchange transactions in 2008" – GPW, 2009.

Breakdown of economic activity on stock exchange market was conducive to the increase of deposits in the banking sector, but at the same time affected bank's income from commissions and payments for acting as agent on the capital market and managing finance assets. Bear market has also adverse effect on other areas of economy *inter alia*, as a result of limiting possibilities for acquiring funds from issuing shares or possibility of limiting consumption by certain households in relation to the decrease in value of their assets. On the other hand one should ascertain that bear market has also positive aspects, *inter alia* in a form of realigning the evaluation of companies (many companies went from strong overvaluation to strong undervaluation), or increase of risk awareness related to operations on the capital market.

Reduction of prices continued at the beginning of the current year (in the period January – February WIG declined by 20.3%). Unusually weak was the banking sector which quoted declines (42.3%) comparable to the whole previous year. It should be connected to poor result of the banks in the fourth quarter of the previous year and the negative attitude of the banking sector. At the turn of February and March of the current year economic conditions improved, however it is hard to ascertain if this change of trend is permanent or is it only working of the previous reduction of prices. Fears result *inter alia,* from the fact that subsequent revisions of prognoses for global economy and individual countries further postpone the moment of economic upturn.

Chart 1.44
Change of indices and commodity prices from the end of 2003 (%)

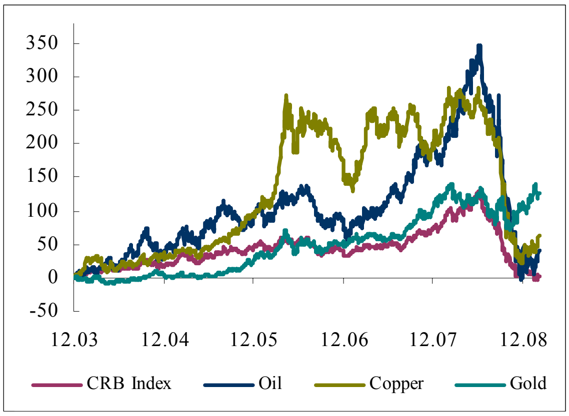
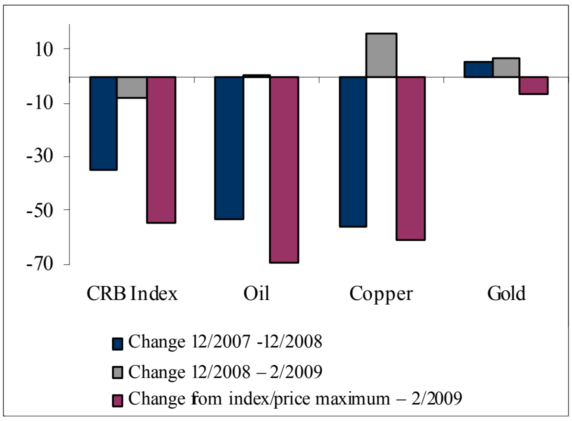


Chart 1.45
Change of indices and commodity prices (%)



Source: Bloomberg, own calculations

Strong deterioration of perspectives for global economy upturn was translated into sharp reduction of prices on commodity market, which till the middle of the previous year was increasing. The scale of the reduction of prices was so big that similar to stock exchange markets, it cancelled completely the previous bull market on commodity markets.

Very strong declines on commodity markets

As a reaction to changes of NBP interest rates and events on financial market, bank changed their deposit-credit policy. Evaluation of these changes hampered by sharp decreases of NBP interest rates at the end of the previous year and at the beginning of the current year and because of that not all changes were reflected in reporting activity. Moreover, depending on whether we survey the interest rate of all contracts' conditions at the end of reporting period (i.e. concluded before the reporting month and still in force as well as newly concluded contracts) or new contracts (i.e. data on contracts' interest rates concluded in a given reporting month) we come to partly different conclusions.

Table 1.3

Average weighted interest rates on deposits and loans in 12/2007-01/2009 (%; bps)

	Interest rates on all contracts' conditions OPS				Interest rate on new contracts OPN			
	12/2007	9/2008	1/2009	Change	12/2007	9/2008	1/2009	Change
PLN INSTRUMENTS								
Total **deposits**	3.78	4.86	6.09	231	4.22	5.67	5.19	97
Deposits for households	3.47	4.59	6.26	279	4.16	5.82	6.15	199
Deposits for enterprises	4.34	5.47	5.70	136	4.23	5.58	4.88	65
Total **loans**	8.25	9.47	9.36	111	9.52	11.32	11.61	209
Loans for households	9.54	10.71	10.82	128	11.55	13.72	14.09	254
mortgage loans	6.15	7.47	7.64	149	6.93	8.58	8.54	161
consumer loans	13.49	14.24	14.47	98	13.72	15.45	15.97	225
Corporate loans	6.51	7.56	7.32	81	7.19	8.33	7.78	59
Spread	4.47	4.61	3.27	-120	5.3	5.65	6.42	112
CURRENCY INSTRUMENTS								
Deposits								
EUR	x	x	x	x	3.60	4.10	2.00	-160
USD	x	x	x	x	4.20	2.80	1.00	-320
Loans								
EUR	x	x	x	x	5.90	6.10	4.40	-150
USD	x	x	x	x	6.10	4.10	3.20	-290
CHF mortgage loans	x	x	x	x	4.90	5.00	4.30	-60

Source: NBP, own calculations

Important: Column "Change" concerns the period 12/2007 – 1/2009 and is presented in bps

x – NBP does not publish data on OPS deposits and currency loans.

Chart 1.46

Average weighted interest rates on PLN loans (%) - OPS

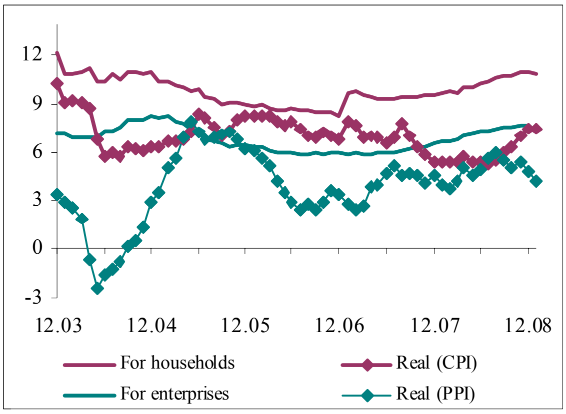
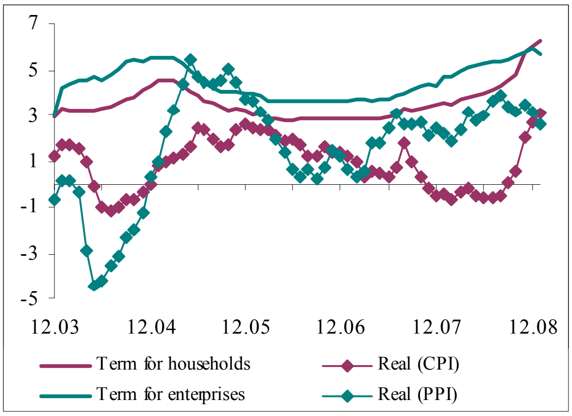


Chart 1.47

Average weighted interest rates on PLN deposits (%) - OPS



Source: NBP, GUS, own calculations

On the basis of data on the condition of all contracts and assuming that decreases of NBP interest rates in December of the previous year were reflected not until January of the current year (we obtain a zero change of reference rate - in December 2007 and in December 2008 it equalled 5.00%) it can be ascertained that the average weighted interest rates in December 2007 – January 2009:

- on term PLN deposits increased by 231 bps (from 3.78% to 6.09%), but in the case of households by 279 bps (from 3.47% to 6.26%) and in the case of enterprises by 136 bps (from 4.34% to 5.70%);
- on PLN loans increased in total by 111 bps (from 8.25% to 9.36%), but in the case of household by 128 bps (from 9.54% to 10.82%) and in the case of enterprises by 81 bps (from 6.51% to 7.32%). In the case of mortgage loans for household interest rates increase by 149 bps (from 6.15% to 7.64%) and in the case of consumer loans by 98 bps (from 13.49% to 14.47%).

By observing changes made by banks during the previous year it can be ascertain that for most of the year banks were adjusting significantly parameters of deposit-loan policy to changes of monetary policy's parameters – increase of NBP interest rates was accompanied by increase of interest rates on deposits and loans offered to clients by the banks. However, because of the "second wave" of the crisis on global markets and resulting decrease of mutual trust among market participants and deterioration of perspectives for economic upturn, banks tightened their loan policy and strengthened the pressure on acquiring deposits through increasing their interest rates. As a consequence reaction of banks to decreases of interest rates at the end of 2008 was insignificant. Although banks decreased insignificantly interest rates on new loans for enterprises, they increased interest rates on new loans for households. At the same time for fear of losing deposits they made only slight corrections of interest rates on deposits for households.

Increase of interest rates on loans and deposits resulting from strong disturbance on financial markets

Hindered impact of monetary policy instruments

A conclusion should be drawn that in the situation of strong disturbance on financial markets and big uncertainty concerning further development of the situation, influence of classic instruments of monetary policy on deposit-loan policy is indeed limited.

Table 1.4

Forecast GDP and unemployment growth in Poland and main economies.

	GDP growth rate							
	2007	2008e	European Commission		OECD		IMF	
			2009p	2010p	2009p	2010p	2009p	2010p
EU	2.9	1.0	-1.8	0.5			0.6	1.9
Euro zone	2.7	0.9	-1.9	0.4	-0.6	1.2	-2.0	invalid
US	2.0	1.2	-1.6	1.7	-0.9	1.6	-1.6	invalid
Japan	2.4	-0.1	-2.4	-0.2	-0.1	0.6	-2.5	invalid
China	11.9	9.7	6.8	8.0	8.0	9.2	6.7	invalid
Germany	2.5	1.3	-2.3	0.7	-0.8	1.2	0.0	1.0
Poland	6.7	5.0	2.0	2.4	3.0	3.5	3.8	4.8

Source: European Commission (16/01/2009), OECD (11/2008), IMF (11/2008 and 01/2009).

Main source of short and mid-term threats for Polish economy, and thus for banking sector are external factors, caused by "subprime crisis" in 2007 which in 2008 transformed into global crisis of the financial system. Very strong disturbance in functioning of financial markets slowly started to transfer to the real sphere. Thus the financial crisis transformed into economic crisis.

Main source of risk are adverse factors in external environment of Polish economy

According to IMF estimations banks' losses due to toxic American assets can reach USD 2.2 billion[12]. The range of crisis event was so wide that it forced previously unseen intervention of governments and central banks. Reaction was to support liquidity of the financial system, purchasing or guaranteeing part of "toxic assets", increasing the level bank deposits' guarantees in order to prevent "bank panic" (or temporary guarantee of all deposits), capital contributions for finance sector (including nationalisation of certain institutions) and preparing programmes for supporting individual branches or all economy[13].

Losses of financial institutions on american assets may equal USD 2.2 billion

Consequence of these measures is *inter alia,* a great increase of budget deficits of certain countries. According to European Commission forecasts the average budget deficit in Euro zone will increase from 1.7% GDP in 2008 to 4.0% in 2009. In turn, budget deficit in US will

Great increase of budget deficits of certain countries

[12] See PAP 28/01/2009.
[13] More in Financial Stability Review, EBC 2008.

reach a record level of USD 1.7 billion, which will constitute 12% GDP.

Despite the great scale of the intervention the situation of world economy remains uncertain, incoming signals give evidence of further economic downturn and deterioration of growth perspectives. It causes decline of forecasts for economic upturn of individual countries and regions. Forecasts formulated in autumn of the previous year become in most cases invalid and subsequent institutions change or announce them. According to IMF forecasts from January of the current year the growth of world economy will be the lowest since the end of WWII and will not exceed 0.5% while in November of the previous year it was estimated to 2.2%[14].

Increase of world economy in 2009 close to zero, the lowest since the end of WWII

Chart 1.48
Annual growth rate of industrial production in 2008. (%)

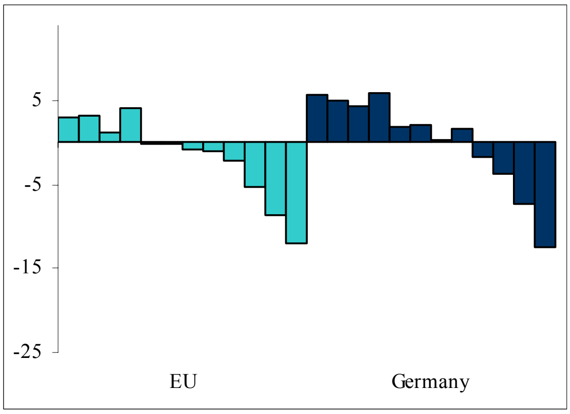


Chart 1.49
Annual growth rate of industrial production in 2008 cont. (%)

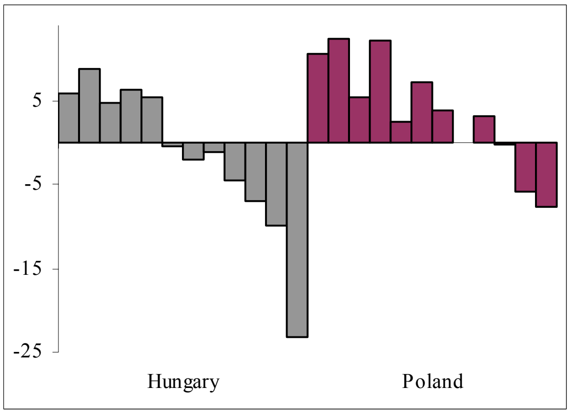


Chart 1.50
Annual GDP growth rate in 2006-2008 (%)

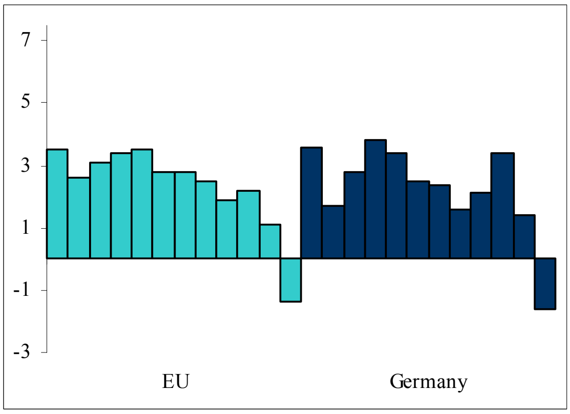
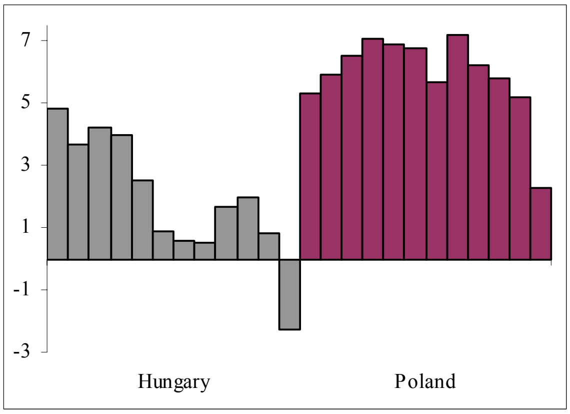


Chart 1.51
Annual GDP growth rate in 2006-2008 cont. (%)



Source: Eurostat

From the point of view of Polish economy the most important is the situation of EU countries' economies, particularly Germany, which is Poland's main commercial partner, and countries of Central-East Europe, for investors count Poland as one of the countries of this region.
As a result of intensifying financial crisis, the situation of European economy deteriorated in subsequent months of the previous year, which was reflected in the decrease of production growth rate and GDP growth rate. From May 2008 growth rate of EU industrial production

Strong weakening of european economy, especially German economy, is alarming

[14] See PAP 28/01/2009.

per annum was below zero and in December it was lower than in December 2007 by 12.1%. According to preliminary estimations, EU GDP in 2008 increase by 1.0% as compared to 2.9% in 2007, but a decrease of 1.4% per annum was quoted in the fourth quarter. A strong weakening of German economy had a significant influence on the deterioration of EU situation (decrease of industrial production from September was recorded and annual GDP growth rate in fourth quarter was below zero), which despite healthy foundation suffered damage because of decline of external demand (similar situation occurs in Japan, which due to decline of export came into deep recession). As a consequence, weakening of German economy affected Polish economy (over 25% of Polish export is to German market).
Also the condition of economies of certain countries of Central-East Europe sharply deteriorated (particularly Ukraine, Hungary and Baltic countries), which resulted from the weakening of external demand as well as from mistakes of macroeconomic policy. As a consequence it was adversely reflected on perception of Poland by part of foreign investors, who fear that Poland's situation may deteriorate.
Despite the escalation of crisis events observed during last weeks and a sharp deterioration of perspectives for world economic upturn, Governing Council of ECB assumes that in time, economy of the Euro zone, as well as world economy should start to feel positive effects of anticrisis steps in various policy fields, announced in last months. In Council's opinion, it seems that thanks to measures taken by governments, central banks and supervising institutions of individual countries as well as international institutions, there is a chance for bringing the crisis under control and returning of world economy to stable growth in the perspective of few next quarters.

Fears increase for future consequences of great budget deficits and effects of monetary policy

However it should be taken under consideration that part of measures taken by certain countries demand to look into the future with anxiety. It concerns *inter alia,* a great increase of budget deficits, reducing central banks' interest rates almost to zero, as well as engaging in so called "unusual steps" by these banks. It is an open question whether these measures will bring about expected effects. In an extreme situation it may lead to further deepening of disturbance on financial markets as well as lead to uncontrolled growth of inflation. These fears are more clearly articulated by governments of certain countries and part of investors.[15]

Overcoming pessimism one of the keys to overcoming the crisis

One of the crisis' effects and at the same time the cause for its deepening is the increase of aversion towards risk and increasing pessimism, which lead to limitation of consumption and investments, capital flow and commercial exchange. In connection to that, one of the keys to overcome crisis trends in global scale is the return of optimism to households and enterprises.

To sum up the foregoing, the most important risk sources for Polish economy and thus for the banking sector, can be divided to:

– very strong disturbance on global financial markets, which (besides the above mentioned translation to Polish financial market) cause limitations and difficulties for Polish enterprises and banks in accessing foreign sources of financing. Disturbance led also to strong deterioration of financial situation of certain parent companies of Polish banks. Thus it causes increase of system risk due to potential limitations in supporting Polish subsidiaries. Finally, "disturbance on markets" also causes great limitations and difficulties for applying budget and monetary policy.
– weakening of economies of Poland's main commercial partners, which directly reflects in the decline of demand for Polish products and force the decline of Polish enterprises' activity. It should be taken into consideration that from the global point of view Poland does not have an open economy and therefore deterioration or improvement of main commercial partners' situation translates to a great extent on the functioning of Polish economy;
– strong deterioration of macroeconomic situation of certain countries from Central-East Europe, which on the one hand translates into adverse perception by investors of all the countries in the region, on the other is reflected in disturbance of functioning of Polish market.

[15] See a comment of the Prime Minister of China PAP 13/03/2009 ("We granted US with loans for huge amounts and it's only natural we are anxious over the safety of our capitals. If I may be honest, I'm a little worried" –said Wen. I'd like to appeal to US to keep a promise, remain a reliable country and ensure the safety of chinese capitals")"
See interview with M. Faber, who in sharp words describes FED and amarican autorities' past and present activities and expresses fears for their effectiveness and purposefulness ("Marc Faber: Limiting FED's power" – Parkiet 14/03/2009).

In connection with the above, a strong weakening of Polish economy is expected in the next periods (which is reflected in decreasing forecasts for GDP growth rate) as well as deterioration of situation of part of banks' clients. As a consequence it may affect financial results of the banking sector and cause decrease of the growth rate of new loans, which will result both from the increase of risk and from limited possibilities of acquiring sources of financing for the development of new loans.

The macroeconomic situation of Poland, compared to other EU countries, looks relatively good so far

MACROECONOMIC CONDITION WITHIN EU
together with the prognosis of the European Commission for 2009-2010

	GDP growth rate (%)				BAEL (Economic activity of the population) unemployment rate (%)			
	2007	2008	2009	2010	2007	2008	2009p	2010p
EU	2.9	1.0	-1.8	0.5	7.1	7.0	8.7	9.5
EUR zone	2.7	0.9	-1.9	0.4	7.5	7.5	9.3	10.2
Germany	2.5	1.3	-2.3	0.7	8.4	7.1	7.7	8.1
United Kingdom	3.0	0.7	-2.8	0.2	5.3	5.7	8.2	8.1
France	2.2	0.7	-1.8	0.4	8.3	7.8	9.8	10.6
Italy	1.5	-0.6	-2.0	0.3	6.1	6.7	8.2	8.7
Spain	3.7	1.2	-2.0	-0.2	8.3	11.3	16.1	18.7
Poland	**6.7**	**5.0**	**2.0**	**2.4**	**9.6**	**7.4**	**8.4**	**9.6**
Czech Republic	6.0	4.2	1.7	2.3	5.3	5.0	5.7	6.6
Romania	6.2	7.8	1.8	2.5	6.4	6.2	7.0	6.9
Hungary	1.1	0.9	-1.6	1.0	7.4	7.7	8.8	9.1
Bulgaria	6.2	6.4	1.8	2.5	6.9	6.0	6.3	6.4
Lithuania	8.9	3.4	-4.0	-2.6	4.3	5.4	8.8	10.2
Latvia	10.3	-2.3	-6.9	-2.4	6.0	6.5	10.4	11.4
Estonia	6.3	-2.4	-4.7	1.2	4.7	5.1	8.8	9.7
	Public debt/GDP (%)				**Public finance sector balance/GDP (%)**			
	2007	**2008**	**2009**	**2010p**	**2007**	**2008**	**2009p**	**2010p**
EU	58.7	60.6	67.4	70.9	-0.9	-2.0	-4.4	-4.8
EUR zone	66.1	68.7	72.7	75.8	-0.6	-1.7	-4.0	-4.4
Germany	65.1	65.6	69.6	72.3	-0.2	-0.1	-2.9	-4.2
United Kingdom	44.1	50.1	62.6	71.0	-2.7	-4.6	-8.8	-9.6
France	63.9	67.1	72.4	76.0	-2.7	-3.2	-5.4	-5.0
Italy	104.1	105.7	109.3	110.3	-1.6	-2.8	-3.8	-3.7
Spain	36.2	39.8	46.9	53.0	2.2	-3.4	-6.2	-5.7
Poland	**44.9**	**45.5**	**47.7**	**49.7**	**-2.0**	**-2.5**	**-3.6**	**-3.5**
Czech Republic	28.9	27.9	29.4	30.6	-1.0	-1.2	-2.5	-2.3
Romania	12.7	15.2	21.1	26.8	-2.5	-5.2	-7.5	-7.9
Hungary	65.8	71.9	73.8	74.0	-5.0	-3.3	-2.8	-3.0
Bulgaria	18.2	13.8	12.2	10.7	0.1	3.2	2.0	2.0
Lithuania	17.0	17.1	20.0	23.3	-1.2	-2.9	-3.0	-3.4
Latvia	9.5	16.0	30.4	42.9	0.1	-3.5	-6.3	-7.4
Estonia	3.5	4.3	6.1	7.6	2.7	-2.0	-3.2	-3.2
	Current turnover balance/GDP (%)				**CPI (%)**			
	2007	**2008**	**2009**	**2010**	**2007**	**2008**	**2009p**	**2010p**
EU	-0.5	-1.0	-1.4	-1.4	2.4	3.7	1.2	1.9
EUR zone	0.2	-0.4	-0.6	-0.6	2.1	3.3	1.0	1.8
Germany	7.6	7.1	5.2	5.4	2.3	2.8	0.8	1.4
United Kingdom	-2.8	-2.3	-5.7	-5.9	2.3	3.4	0.1	1.1
France	-2.8	-3.8	-4.0	-3.9	1.6	3.2	0.8	1.5
Italy	-1.7	-2.2	-1.2	-1.4	2.0	3.5	1.2	2.2
Spain	-10.1	-9.4	-7.1	-6.6	2.8	4.1	0.6	2.4
Poland	**-4.7**	**-5.6**	**-5.6**	**-5.0**	**2.2**	**3.3**	**1.2**	**1.6**
Czech Republic	-1.5	-0.9	-2.1	-2.6	2.6	4.2	2.9	2.5
Romania	-13.6	-12.9	-11.9	-11.1	3.0	6.3	2.6	2.3
Hungary	-6.4	-7.2	-5.5	-5.2	4.9	7.9	5.7	4.0
Bulgaria	-22.5	-24.7	-20.8	-19.6	7.9	6.1	2.8	2.2
Lithuania	-15.1	-12.6	-7.0	-7.6	7.6	12.0	5.4	4.8
Latvia	-22.9	-14.9	-6.5	-5.5	5.8	11.1	5.6	4.8
Estonia	-18.3	-10.1	-5.7	-4.3	10.1	15.3	6.8	2.4

Source: European Commission (16/01/2009)

The situation of many strategic investors has become worse but some of them received the support of governments

FINANCIAL SITUATION OF STRATEGIC INVESTORS
banks and branches with assets over PLN 10 billion
data for the end of 2008 in EUR million

	Net profit (loss)	Assets	Equity capital	CAR	Loss connected with the crisis	Capital supply by the government	Rating of Moodys financial power	Market value 27/02/2009
PKO	942	32,541	3,424	11.3			C	4,120
State Treasury								
Pekao	999	31,622	3,822	12.2			C	4,357
UNICREDIT SPA	4,012	1,045,612	54,999	11.4	3,100		C+	14,496
BRE	243	19,798	933	10			D	606
COMMERZBANK	3	625,196	19,904	13.9	2.900	18,200	C-	2,445
ING BSK	126	16,684	1,012	10.4			D+	559
ING GROEP	-729	1,331,663	28,928	12.8	10.400	10,000	C+	7,564
BZ WBK	244	13,967	1,254	10.7			C-	1,104
ALLIED IRISH	767	182,143	10,282	10.5	1.900		C	340
Millennium	118	11,378	680	10.2			D	252
B. C. PORTUGUES	201	94,424	6,248	10.5			C+	3,005
Bank Handlowy	163	10,198	1,348	12.1			C-	954
CITIGROUP	-18,919	1,389,335	101,509	15.7	68.600	46,570		6,429
Kredyt Bank	92	9,283	634	8.8			D	292
KBC GROEP	-2,484	355,317	14,210	10	4.600	5,500	C+	2,983
BGK	x	x	x	x				
State Treasury								
Raiffeisen Polska	x	x	x	x				
RAIFFEISEN INTL.	,							2,318
BGŻ	x	x	x	x				
RABOBANK	2,754	612,120	33,459	13	2.400		B+	
Getin	x	x	x	x				
Polish private								
GE Money	x	x	x	x				
GENERAL ELECTRIC	11,898	571,775	81,428					70,732
EFG Eurobank Oddz.	x	x	x	x				
EFG EUROBANK ERG	652	82,202	4,292	10.4			C	2,142
Fortis Polska	22	4,798	294	10.6				764
FORTIS BANK SA/NV					6.500	4,700		3,511
BPH	32	3,793	398	12.3	.	,	D-	133
GENERAL ELECTRIC	11,898	571,775	81,428	,	.	,		,
Nordea	39	3,807	256	8.6	.	,		230
NORDEA BANK AB	2,671	474,074	17,803	9.5	.	,	B	10,310
Deutsche Bank PBC	x	x	x	x	.	,		,
DEUTSCHE BANK	-3,835	2,202,000	30,700	12.2	12.100		B	11,845
Bank Polskiej Spół.	x	x	x	x				
Polish private								
BOŚ	2	2,658	207	11.9				236
State Treasury								
LUKAS BANK	x	x	x	x				
CREDIT AGRICOLE	1,024	1,653,200	47,300	8.6	5.700	3,000	B-	17,343
Societe Generale Oddz.	x	x	x	x				
SOCIETE GENERALE	2,010	1,130,003	40,887	10.8	6.600	1,700	B-	14,492
Santander Consumer	x	x	x	x				
GRUPO SANTANDER	8,876	1,049,632	60,002	12.2	3.600		B	39,962

Source: Bloomberg, reports of companies quoted at the Stock Exchange "x" – Polish Financial Supervision Authority does not extend individual data of supervised banks and branches of loan institutions apart from those quoted at the Stock Exchange.

The revealed loss has almost reached EUR 1 trillion

Governmental support for increasing capitals has almost reached EUR 400 billion

THE SCALE OF LOSS AND GOVERNMENT SUPPORT

Loss of financial institutions (EUR billion)

	Total financial institutions		Banks		Insurers		Fannie MaeFreddie Mac	
	Loss	Capital accessed	Loss	Capital accessed	Loss	Capital accessed	Loss	Capital accessed
World	961.0	792.2	688.0	686.8	171.5	77.1	101.5	28.3
America	657.6	444.9	407.3	348.9	148.7	67.7	101.5	28.3
Europe	278.8	293.0	257.1	283.7	21.7	9.3	0.0	0.0
Asia	24.7	54.3	23.6	54.3	1.1	0.0	0.0	0.0

Source: Bloomberg 12/03/2008

Capital support by the governments (EUR billion)

Name of the institution	Amount	Name of the institution	Amount
United States	260.4	**United Kingdom**	**43.8**
CITIGROUP	46.6	Royal Bank of Scotland	21.7
Bank of America	34.9	HBOS	12.5
AIG	31.0	Lloyds	6.0
Wells Fargo	19.4	Northern Rock	3.6
JP Morgan Chase	19.4	**Germany**	**40.3**
Fannie Mae	11.8	Commerzbank	18.2
Freddie Mac	10.7	Bayerische Landesbank	14.8
Morgan Stanley	7.8	WestLB	5.0
Goldman Sachs	7.8	IKB	2.3
PNC Financial Service	5.9	**The Netherlands**	**16.3**
U.S. Bancorp	5.1	ING Groep	10.0
other	60.0	Fortis	4.0
		Aegon	2.3
		Belgium	**12.2**
		KBC Groep	5.5
		Fortis	4.7
		Dexia	2.0
		France	**8.3**
		Credit Agricole	3.0
		BNP Paribas	2.6
		Societe Generale	1.7
		Dexia	1.0
		Switzerland	**3.9**
		UBS AG	3.9
		Luxembourg	**2.9**
		Fortis	2.5
		Dexia	0.4
		Denmark	**0.5**
		Roskilde Bank	0.5

Institutions with the highest loss (EUR billion)

Name of the institution	Loss	Capital accessed
Wachovia	79.1	8.6
Citigroup	68.6	84.8
AIG	67.8	50.9
Fannie Mae	55.4	12.1
Freddie Mac	46.1	16.1
Merrill Lynch	43.4	23.2
UBS AG	39.3	24.3
Washington Mutual	35.2	9.4
Bank of America	33.2	61.0
HSBC	32.8	17.7
JPMorgan Chase	25.9	34.7
National City	19.6	6.9
HBOS	19.3	16.8
Wells Fargo	18.2	32.5
Morgan Stanley	16.7	19.1
Royal Bank of Scotland	15.5	36.4
Lehman Brothers	12.6	10.8
Deutsche Bank	12.1	4.5
Credit Suisse	11.6	8.9
Barclays	10.7	20.2
ING Group	10.4	14.5
IKB Deutsche Industrial	10.3	8.5
Metlife	9.9	1.8
Ambac Financial	9.4	1.1
Hartford Financial	9.3	2.3
Prudential Financial	7.0	3.6
Societe Generale	6.6	8.2
Fortis	6.5	16.0
Aegon NV	6.1	3.1
Mizuho Financial Group	5.9	6.4
Credit Agricole	5.7	8.9
PNC Financial Service	5.6	6.3
BNP Paribas	5.6	2.6
Goldman Sachs	5.6	15.9
Allstate	5.6	0.0

Source: Bloomberg 12/03/2008

LIST OF TAKEOVERS resulting from the crisis

Date of takeover and the takenover entity		The acquirer	
February 2008			
Northern Rock	United Kingdom	Government of the United Kingdom	
April 2008			
Bear Stearns, New York City	United States	JPMorgan Chase	United States
June 2008			
Catholic Building Society	United Kingdom	Chelsea Building Society	United Kingdom
July 2008			
Countrywide Financial	United States	Bank of America	United States
Alliance & Leicester	United Kingdom	Banco Santander	Spain
August 2008			
Roskilde Bank	Denmark	Danmarks Nationalbank	Denmark
September 2008			
Derbyshire Building Society	United Kingdom	Nationwide Building Society	United Kingdom
Cheshire Building Society	United Kingdom	Nationwide Building Society	United Kingdom
Merrill Lynch, New York City	United States	Bank of America	United States
American International Group	United States	Government of the United States	
Lehman Brothers, New York	United States	Barclays plc	United Kingdom
HBOS	United Kingdom	Lloyds TSB	United Kingdom
Washington Mutual	United States	JPMorgan Chase	United States
Lehman BrothersC	United States	Nomura Holdings	Japan
Bradford & BingleyD	United Kingdom	Government of the United Kingdom (mortgage assets)	
		Banco Santander SA (savings)	Spain
Fortis		Government of the Netherlands (the Netherlands' assets and ABN AMRO)	
		BNP Paribas (Belgium and Luxembourg assets)	
Dexia		Goverrnment of Belgium, France and Luxembourg	
October 2008			
Wachovia	United States	Wells Fargo	United States
Landsbanks	The Republic of Iceland	FSA of the Republic of Iceland	The Republic of Iceland
Glitnir	The Republic of Iceland	FSA of the Republic of Iceland	The Republic of Iceland
Kaupthing Bank	The Republic of Iceland	FSA of the Republic of Iceland	The Republic of Iceland
BankWest	Australia	Commonwealth Bank of Australia	Australia
Sovereign Bank	United States	Banco Santander	Spain
Barnsley Building Society	United Kingdom	Yorkshire Building Society	United Kingdom
National City Bank	United States	PNC Financial Services	United States
Commerce Bancorp	United States	Toronto-Dominion Bank	Canada
November 2008			
Scarborough Building Society	United Kingdom	Skipton Building Society	United Kingdom
Parex Bank	Latvia	Hipotēku banka (ownership of the government of Latvia)	Latvia
January 2009			
IndyMac Federal Bank	United States	IMB Management Holdings	United States
Anglo Irish Bank	Ireland	The government of Ireland	

Anti-crisis measures in Poland[16]

NBP "confidence package"

In order to stabilise and improve situation on financial market the NBP developed a so-called "confidence package" which will enable banks to acquire assets in PLN for periods longer than one day, to acquire assets in foreign currencies and to expand the possibilities for banks to obtain liquidity in zloty by broadening the range of collateral in operations with the NBP.
In order The NBP plans to take the following steps to accomplish these goals: providing open market operations in the form of repo transactions, with maturities of up to three months, introducing FX swaps, introducing FX deposits as collateral in refinancing credits, introducing modifications in the operational system of lombard credits, increasing, if necessary, the frequency of open market operations to enable flexible response to changes in liquidity, and to stabilise the POLONIA rate around the reference rate. At the same time, the National Bank of Poland reminded the banks of the possibility of redemption of NBP bills before their maturity.

Legislative activity of the Government of the Republic of Poland

In order to counteract the crisis:

– the Act on the Bank Guarantee Fund was amended, which increased guarantees for deposits to EUR 50 thousand;
– "Plan for stability and development" was developed, according to which the total amount of resources allocated for the support of economy in 2009-2010 can be PLN 91.3 billion. This amount shall constitute of the following: increase of guarantees and securities for loans from 3 months to 5 years of PLN 40 billion, creation of credit expansion for small and medium-sized enterprises through BGK of PLN 20 billion, advancement of investments co-financed from EU resources of PLN 16.8 billion, investments in renewable energy sources of PLN 1.5 billion, support of consumers' demand through maintaining two PIT rates (PLN 8 billion) and VAT reform (PLN 2 billion);
– the Act on granting support for financial institutions by the State Treasury, which determines the forms, conditions and procedures for granting support for financial institutions by the State Treasury, which is dedicated for undertakings aiming at the maintenance of payment liquidity, also in connection with the development of the National Bank credit expansion. The support can only be granted for national banks in the form of: guarantees of the State Treasury, treasury securities loans, treasury securities sale with deferred due rate, treasury securities sale with arranged instalments for payment, treasury securities sale through an offer for a certain financial institution.
– the bill on the change of Act on Bank Gospodarstwa Krajowego has been passed, submitted by the Minister of Finance. BGK will be allowed to give securities or guarantees within national socio-economic programmes, especially within those concerning the support for small and medium-sized enterprises. Some of the areas of BGK activity will be excluded from the public contracts procedure. This concerns, *inter alia*, the procedures connected with the service of State Treasury foreign debt. The exclusion from the disciplines of the Act on the public contracts law included also BGK services provided for the entities of public finance sector.
– the bill on recapitalisation of some financial institutions has been passed, submitted by the Minister of Finance. According to the project, the State Treasury will be allowed to give securities to the financial institutions, which are threatened with loss of liquidity. This concerns the injection of new capital into institutions, which were recommended the increase of equity funds in the rescue plan by PFSA. The bill includes national banks and national insurance offices. In accordance with the bill, the performance of the guarantee contract will occur when shares, bonds or securities emitted by the financial institution are not taken up by current shareholders or third entities. The guarantee will be given by the Minister of Finance after receiving an opinion of the PFSA President and NBP Chief Executive Officer.

The government is determined, at the same time, to maintain the budget deficit in 2009 at the planned level.

[16] PFSA and audit measures have been widely described in Chapter VI of the material.

II. BANKING SECTOR STRUCTURE

Banking sector structure did not substantially change

Business and ownership structure

Banking sector structure did not change significantly in 2008. At the end of the year, 649 banks and branches of credit institutions conducted operations.

Table 2.1

Number of banks and branches of credit institutions[17] conducting operations

	2004	2005	2006	2007	2008
Total, of which:	653	649	647	645	649
Commercial banks	54	54	51	50	52
Branches of credit institutions	3	7	12	14	18
Cooperative banks	596	588	584	581	579

The number of domestic commercial banks increased from 50 to 52 as a result of commencement of operations by Alior Bank and Allianz Bank Polska.

The number of branches of credit institutions increased from 14 to 18 as a result of the launching of operating activity by 4 branches (BNP Paribas Securities Services Limited, Skandinaviska Enskilda Banken, DEPFA Bank and Banco Espirito Santo de Investimento).

The number of cooperative banks decreased from 581 to 579. All cooperative banks are associated under 3 structures: Bank Polskiej Spółdzielczości (350), Gospodarczy Bank Wielkopolski (151) and Mazowiecki Bank Regionalny (77).The only exception is Krakowski Bank Spółdzielczy, which operates autonomically.

The most important changes that would have the greatest impact on the banking sector structure may include the planned mergers of banks:
- GE Money Bank with Bank BPH;
- Fortis Bank Polska with Dominet Bank, whereas it is not known what plans the new owner of Fortis Bank, which BNP Paribas is to become[18], will have;
- Getin Bank with Noble Bank;
- Sygma Bank with Cetelem Bank.

Moreover, establishment of new branches of credit institutions is also planned, although the deepening global crisis may make certain investors change their plans.

Another consequence of the crisis may also be changes of strategic investors of certain Polish banks - in case of rapid weakening of financial condition of the parent company, it may decide to sell business in Poland - into other foreign investors or Polish entities (in this context, PZU and PKO Bank Polski are mentioned). At present, the only highly probable change of strategic investor, apart from acquisition of Fortis by BNP Paribas, is the planned sales of AIG Bank Polska. However, to date the transaction has not been concluded.

Outside the territory of Poland, 4 banks conducted operations in the form of banking companies or branches: Pekao (in Ukraine and France), PKO Bank Polski (Ukraine), BRE Bank (Austria, Czech Republic and Slovakia) and Mercedes-Benz Bank Polska (Greece). [19]

[17] Pursuant to the Banking Law (Article 4 (1) (17)).
[18] Consequently to the acquisition of Fortis Bank SA/NV by the Government of the Kingdom of Belgium, which subsequently concluded an agreement with BNP Paribas that once the necessary licenses are obtained, BNP Paribas will take over 75% of shares of Fortis Bank SA/NV from Belgium.
[19] Outside the banking sector, majority shares in the bank abroad are held by Getin Holding (Belarus and Ukraine).

In general, ownership structure of the banking sector also remained unchanged.

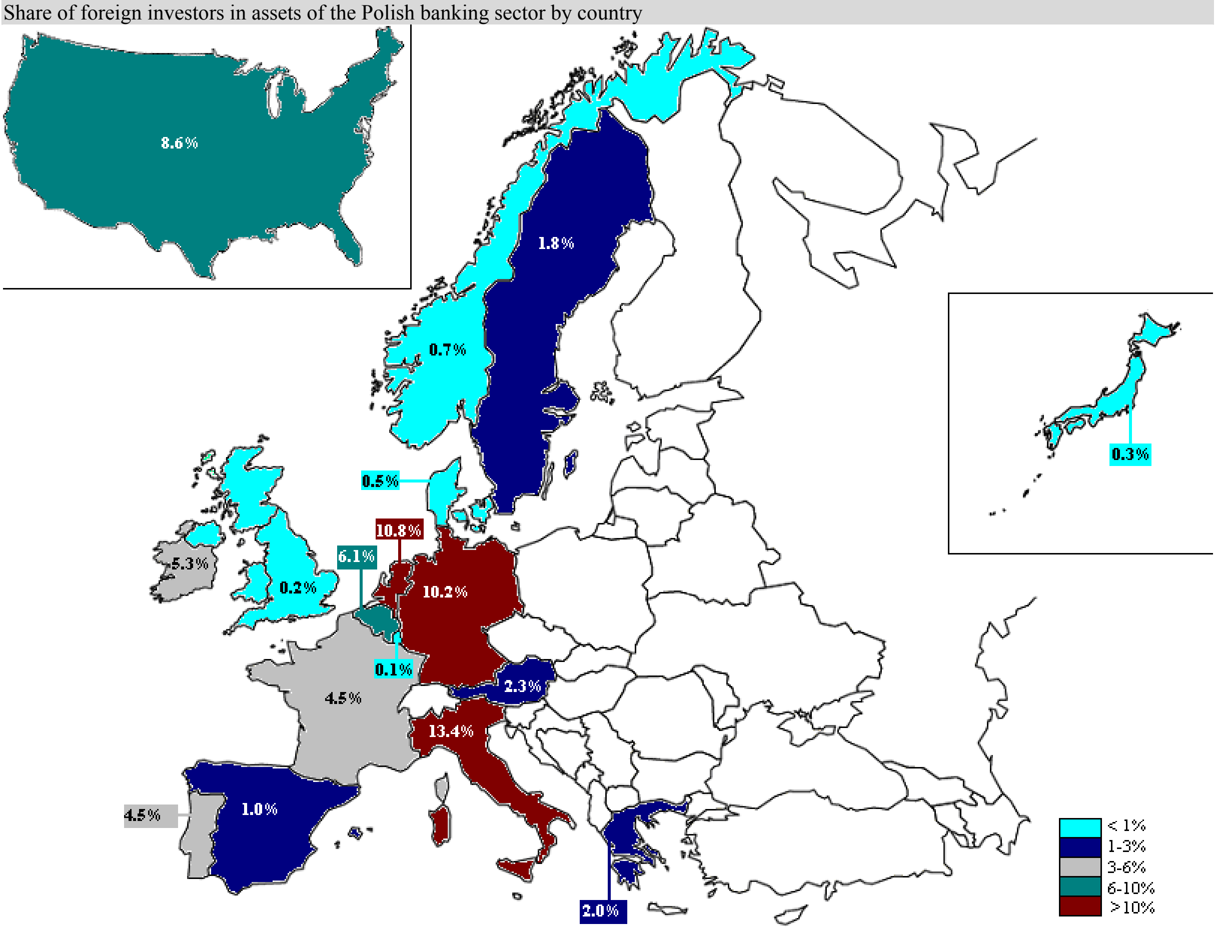
Table 2.2

Ownership structure of the banking sector measured by the share of a given group in sector assets (%)

	2004	2005	2006	2007	2008
Domestic investors, of which:	32.5	30.0	30.3	29.1	27.7
- State Treasury	20.6	20.3	19.8	18.3	17.3
- cooperative banks	5.3	5.7	6.2	6.2	5.4
- other	6.6	4.0	4.3	4.6	5.0
Foreign investors, of which:	67.5	70.0	69.7	70.9	72.3
- commercial banks	66.9	69.1	66.6	66.6	66.9
- branches of credit institutions	0.6	0.9	3.1	4.3	5.4

Domestic investors controlled 10 commercial banks and all cooperative banks, while the State Treasury continued to control 4 commercial banks (directly - PKO Bank Polski and Bank Gospodarstwa Krajowego; indirectly - Bank Pocztowy and Bank Ochrony Środowiska). Their market share measured by assets, loans and deposits accounted for 27.7%, 28.3% and 32.4% respectively.

Chart 2.1
Share of foreign investors in assets of the Polish banking sector by country



Foreign investors controlled 42 commercial banks and all branches of credit institutions. Their market share measured by assets, loans and deposits accounted for 72.3%, 71.7% and 67.6% respectively.
Polish banking sector at present includes investors from 17 countries, the dominant share held by Italian investors (13.4% of sector assets), followed by Dutch, German and US investors.

An important feature of the Polish banking sector is its high transparency, largely owed to the fact that the majority of largest banks are listed on the Warsaw Stock Exchange. At the end of 2008, 14 banks were listed on the WSE, with total assets accounting for 63.7% of total sector assets.

Employment and distribution channels of banking services

The positive prospects of their development maintained by the end of Q3 (high demand for banking services, good financial results of banks) implied increased employment and network development.

Chart 2.2
Number of persons employed in banks

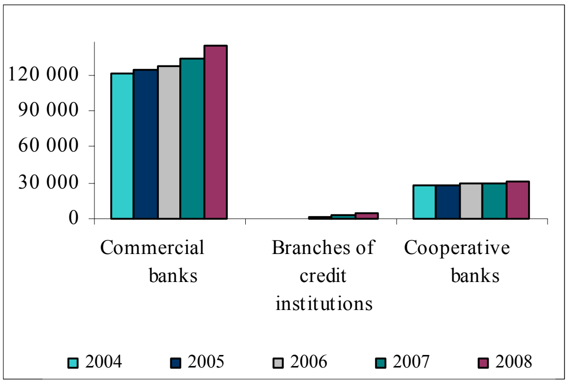
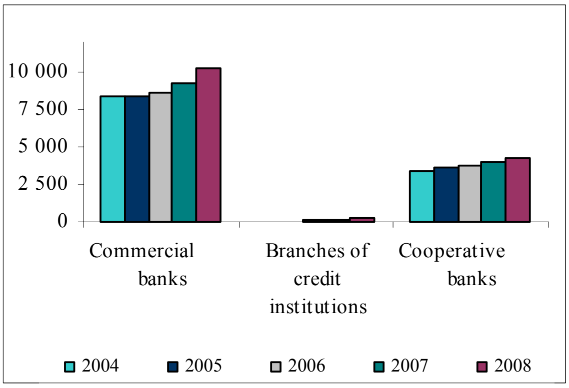
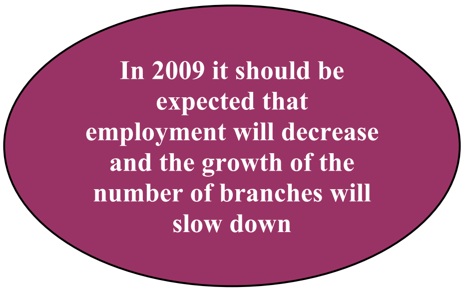


Chart 2.3
Number of bank branches



At the end of 2008, 181.3 thousand persons were employed in the banking sector, which was a rise by 8.5% (by 14.2 thousand) as compared to the end of 2007.[20] Increased employment was noted mainly in the dynamically developing medium banks and branches of credit institutions. Increased employment was also triggered by commencement of operations by two new banks: Alior Bank and Allianz Bank Polska, which employed over 2,000 persons in total.Employment reductions involved in particular PKO BP and Pekao. Due to the acquisition of the part of Bank BPH by Pekao, the majority of employees were employed in Pekao (while the remaining employees were employed in BPH).
The above data do not fully reflect the actual employment in the sector, since they do not include franchisees (at the end of 2008, 9 banks had their network of franchisees).
It is forecasted that due to the aggravating global economic crisis, and in consequence, deterioration of prospects for development of Polish economy and banking sector, in 2009 employment in the Polish banking sector will decrease by approximately 10,000 persons.



Bank branch network increased by 9.1% (by 1,220 branches) to 14,698. [21]
As it has been the case with respect to employment, the above figures do not fully reflect the actual development of distribution channels, since they do not include the growing franchising network. It should be added that the majority of branches of credit institutions do not have branch networks (or they have few networks), providing banking services mainly to enterprises and customers from their countries. Exceptions in this respect include EFG Eurobank and Sygma Banque, which intensively extend their activity on the territory of Poland, at the same time increasing employment and branch network.
As it has been the case with respect to employment, it is expected that in 2009 the growth of the number of branches will slow down and the part of banks will most probably close certain branches in order to reduce costs and improve performance. The planned mergers will have a similar effect. Two newly established banks, i.e. Alior Bank and Allianz Bank, are planning to develop branches and franchising networks.

Increased employment and branch network extension was accompanied by increased number of ATMs, development of e-banking, payment cards and non-cash transactions.

[20] By 8.7% (from 133.7 thousand to 145.4 thousand persons) in commercial banks, by 39.7% (from 3.3 thousand to 4.6 thousand persons) in branches of credit institutions and by 3.9% (from 30.1 thousand to 31.3 thousand persons) in cooperative banks.
[21] By 10.6% (from 9,280 to 10,263) in commercial banks, by 28.3% (from 184 to 236) in branches of credit institutions and by 4.6% (from 4,014 to 4,199) in cooperative banks.

Concentration

Concentration of the Polish banking sector remains moderate (in comparison with other EU Member States).

Table 2.3

Breakdown by assets (PLN billion) as of the end of 2008

	to 0.1	0,1 - 0,5	0,5 - 1,0	1,0 - 5,0	5,0-10,0	10,0-50,0	over 50.0
Number of banks and branches	404	182	8	23	9	18	5
- commercial banks	-	5	3	15	8	16	5
- branches of credit institutions	5	3	1	6	1	2	-
- cooperative banks	399	174	4	2	-	-	-
Share in sector assets (%)	2.0	3.3	0.6	5.0	6.2	38.3	44.6
- commercial banks	0.0	0.2	0.2	3.4	5.4	35.3	44.6
- branches of credit institutions	0.0	0.1	0.1	1.4	0.8	3.0	-
- cooperative banks	2.0	3.0	0.3	0.2	-	-	-

Chart 2.8
Share of 5 largest banks in sector assets (%)

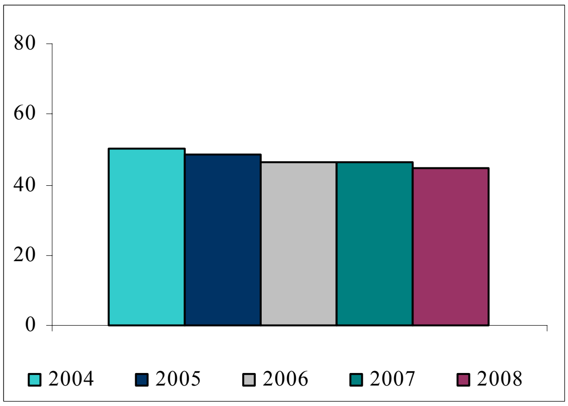
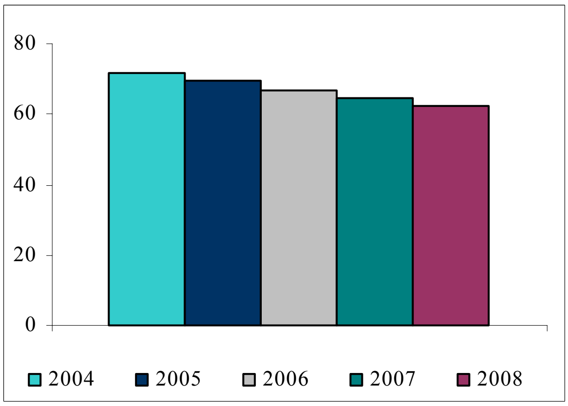


Chart 2.9
Share of 10 largest banks in sector assets (%)



As of the end of 2008:

- the share of 5 largest banks (CR5) in sector assets, loans and deposits accounted for 44.6% , 43.1% and 55.3% respectively;
- the share of 10 largest banks (CR10) in sector assets, loans and deposits accounted for 62.5%, 58.9% and 69.8% respectively.

This means a slight drop of those values with respect to 2007 (by approximately 2 percentage points), which resulted from division of Bank BPH and from dynamic development of smaller institutions.

Dominant position of PKO BP and Pekao

The undisputable leaders on the Polish market are PKO BP and Pekao, whose assets exceed PLN 100 billion and who account for over one fourth of the market. In 2007 Pekao overtook PKO BP, which resulted from the acquisition of the majority of Bank BPH, which in turn was the effect of the acquisition of HVB by UniCredit.However, as it was expected, PKO BP quickly recovered their leader position (this partly resulted from the increase in face value of the portfolio of foreign currency loans due to the depreciation of PLN) and again overtook Pekao, and in the coming periods this distance will most probably grow. [22]

[22]Similar situation occurred in 1999 when Pekao covered 3 banks controlled by the State Treasury, which led to a dynamic increase in Pekao assets. However, in the later years PKO BP left Pekao far behind.

Table 2.4

Banks and branches of credit institutions with assets exceeding PLN 10 billion as of the end of 2008 (PLN thousand) [23]

	Assets		Equity		Net financial result		Market value
	2007	2008	2007	2008	2007	2008	27/02/2008
PKO BP	108,537,600	134,755,177	11,920,949	14,131,744	2,903,632	3,300,618	19,190,000
PEKAO	124,096,151	131,940,762	14,666,788	15,947,313	2,155,478	3,527,964	20,321,480
BRE	55,941,900	82,605,579	3,324,511	3,894,453	710,094	857,459	2,823,600
ING BSK	52,010,860	69,610,475	3,838,783	4,222,130	630,724	445,413	2,602,000
BZ WBK	41,318,736	57,838,074	4,341,527	4,952,320	954,695	855,446	5,143,700
MILLENNIUM	30,530,106	47,114,922	2,519,932	2,814,883	461,595	413,409	1,171,870
BANK HANDLOWY	38,907,984	42,550,345	5,603,084	5,625,809	824,215	600,434	4,442,430
KREDYT BANK	27,128,180	38,730,676	2,276,304	2,645,513	390,539	324,917	1,358,290
BGK	x	x	x	x	x	x	x
RAIFFEISEN BANK POLSKA	x	x	x	x	x	x	x
BGŻ	x	x	x	x	x	x	x
GETIN BANK	x	x	x	x	x	x	x
GE MONEY BANK	x	x	x	x	x	x	x
EFG EUROBANK ODDZIAŁ	x	x	x	x	x	x	x
FORTIS POLSKA	14,211,014	19,869,004	1,153,956	1,217,922	177,594	78,496	3,557,170
BANK BPH	13,015,614	15,827,149	1,500,504	1,659,048	178,858	113,858	618,830
NORDEA POLSKA	10,239,448	15,764,109	920,845	1,059,983	70,532	136,420	1,070,140
DEUTSCHE BANK PBC	x	x	x	x	x	x	x
BANK POLSKIEJ SPÓŁDZIEL.	x	x	x	x	x	x	x
BOŚ	9,042,004	11,092,046	858,788	864,149	31,692	6,583	1,098,870
LUKAS BANK	x	x	x	x	x	x	x
SOCIETE GENERALE ODDZ.	x	x	x	x	x	x	x
SANTANDER CONSUMER	x	x	x	x	x	x	x

x – Polish Financial Supervision Authority does not make available unit data relating to the supervised banks and branches of credit institutions, apart from those listed at WSE

The next group includes 21 large and medium commercial banks with assets exceeding PLN 10 billion. Their total market share accounts for 82.9%.

Assets of most cooperative banks did not exceed PLN 100 million and only 6 held assets exceeding PLN 500 million. Krakowski Bank Spółdzielczości and Podkarpacki Bank Spółdzielczy remained in the lead in this segment with assets exceeding PLN 1 billion.

[23] See periodic reports of companies listed at WSE.
Note: Consolidated data, whereas equity and financial results are recognised in the part allocated to shareholders.

III. MAIN AREAS OF DEVELOPMENT – BASIC TRENDS

Historically high increase in balance sheet total caused by increased scale of operations and strong depreciation of PLN

Banking operations in 2008 can be divided into two periods.
The first period, covering approximately three first quarters, was characterised by fast development thanks to relatively favourable macroeconomic conditions, as well as high optimism of enterprises and households.
The second period covered Q4 and featured significant slowdown of lending activity and deterioration of banking performance due to the "second wave" of the financial crisis, deteriorated financial situation of certain borrowers and write-offs related to currency derivative transactions. Although in nominal terms this period was characterised by a historically high growth in balance sheet total (including loans), but it resulted mainly from strong depreciation of PLN and thus from increase in balance sheet items denominated in foreign currencies.

Chart 3.1
Balance sheet total of the banking sector (PLN billion)

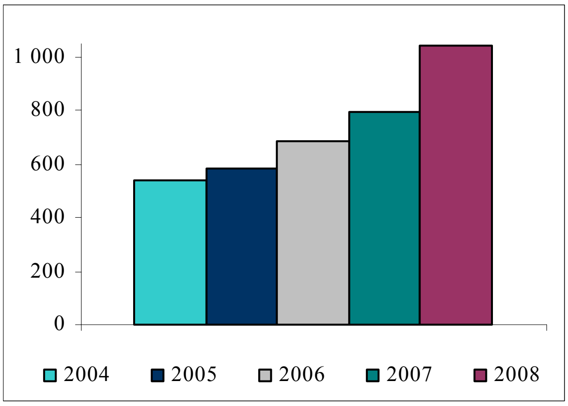


Chart 3.2
Growth rate (%)

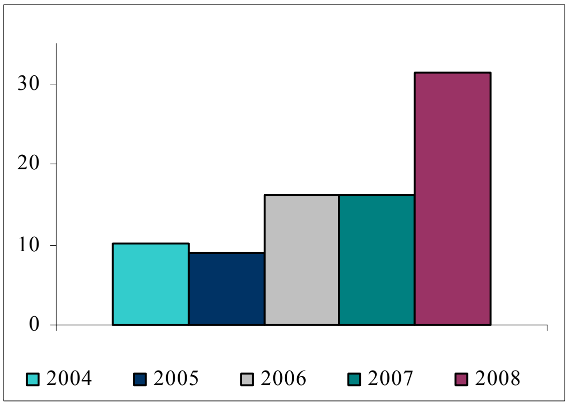


Chart 3.3
Balance sheet total of the individual groups of banks (PLN billion)

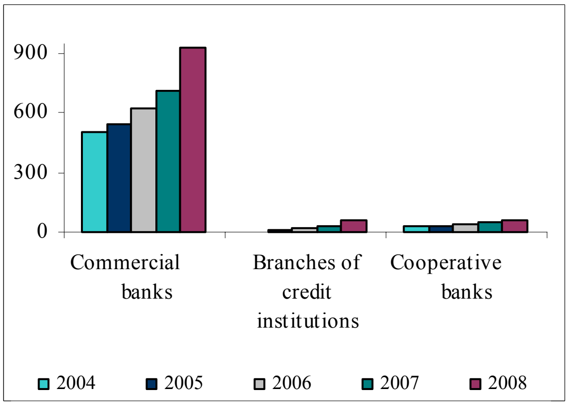
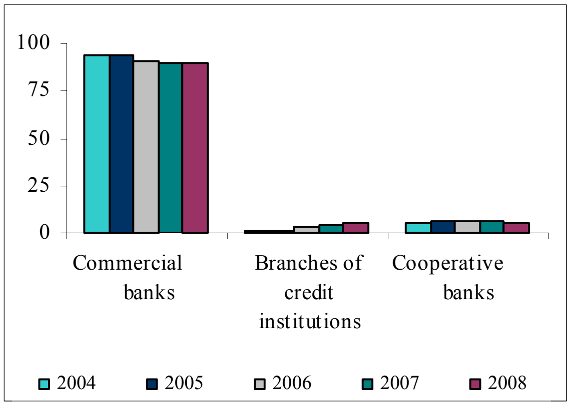


Chart 3.4
Share of individual groups of banks in sector assets (%)



In terms of 2008 as a whole, balance sheet total of the banking sector increased by 31.4% (by PLN 249.0 billion) and exceeded PLN 1 billion for the first time in history, amounting to PLN 1,041.8 billion as of end December. However, as it was already mentioned, such a growth of operating scale mainly resulted from strong depreciation of Polish currency in Q2 2008. It is worth noting, however, that after elimination of increases resulting from changes in exchange rates, growth rate was also very high and reached almost 25%.
The highest growth was faced by branches of credit institutions, which resulted from the low base effect on the one hand, and from the aggressive development strategy of the Greek Eurobank EFG and higher activity of two branches focused on corporate clients and financial market operations on the other hand. As a result, assets in this group increased by 77.1% and their share in total sector assets increased to 5.4% (from 4.3%) and became equal to the balance sheet total of cooperative banking sector.
Assets of commercial banks increased by 30.5%, whereas small and medium banks developed fastest, which was the consequence of the low base effect (as it was the case for branches of credit institutions), as well as of the aggressive strategy of certain banks striving to make the most of the good economic condition so as to

dynamically increase their market share. Very high growth rate of the balance sheet total (over 40%) was also noted in certain large banks, which were intensively developing lending activity (Millenium, BRE, Kredyt Bank, BZ WBK) and had a considerable portfolio of mortgage loans in foreign currencies. [24]
Growth rate of cooperative banks accounted for only 15.5% and their share in sector assets decreased from 6.2% to 5.4%. A relatively low growth rate can be explained by more conservative approach to business and marginal importance of balance sheet items denominated in foreign currencies.

Consequently to the very high growth rate of the balance sheet total was rapid increase in the share of banks' assets in GDP, from 67.5% in 2007 to 82.2% in 2008.

Banking sector in the context of other segments of financial market

Very high growth of the balance sheet total of the banking sector, together with lower level of assets accumulated with open-ended pension funds and investment funds (due to the slump on the capital market) caused an increase in the share of the banking sector in assets of the entire financial system.

Banking sector stability is vital for the stability of the entire financial system

Chart 3.5
Balance sheet total of the financial sector (PLN billion)

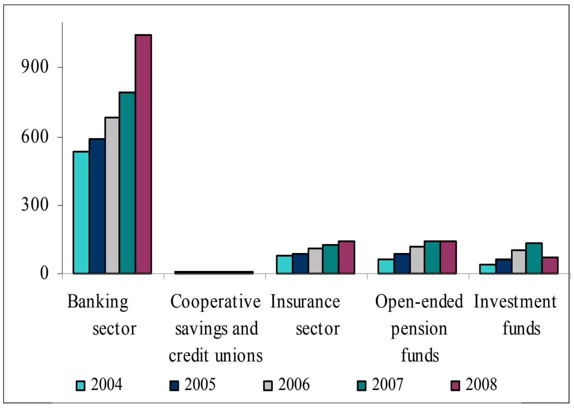


Chart 3.6
Share in financial sector (%)

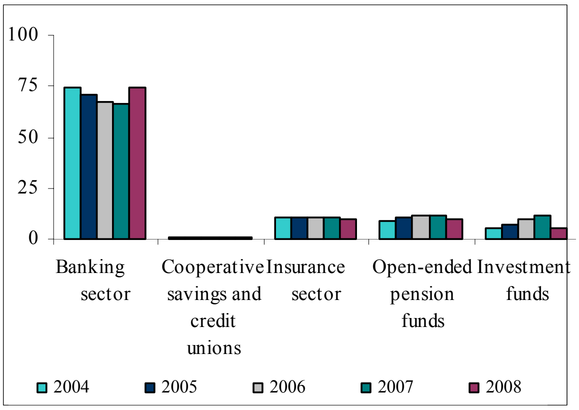
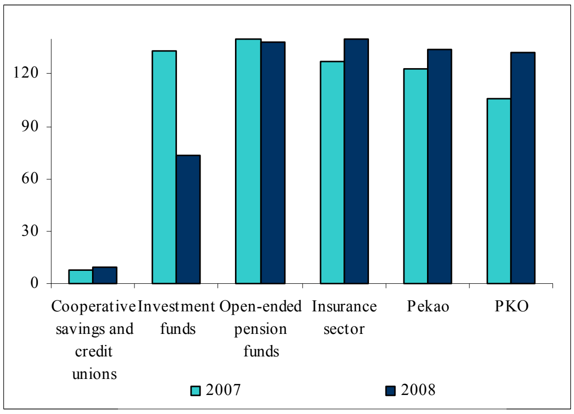


Chart 3.7
Balance sheet total (PLN billion) as of the end of 2008



At the end of 2008, assets of the total financial sector (excluding NBP) amounted to PLN 1,403.1 billion[25] (as compared to PLN 1,202.8 billion at the end of 2007), of which banking sector accounted for almost two-thirds. It should be pointed out that assets of the largest banks are comparable to total assets of the remaining components of the financial system and that the largest investment funds associations, as well as certain pension funds associations, are under the banks' control. Considering the above observations, we may state that banking sector stability is vital for the stability of the entire financial system.

[24] With the exception of BZ WBK.
[25] Note: insurance sector data as of 30/09/2009.

Main areas of development of banking activity

„Second wave" of the financial crisis caused changes in banks' operating strategy

The key factor for fast development of banks in 2008 was the dynamic increase in lending activity, financed on the basis of increased deposit base, as well as funds from the financial market. At the end of the year lending activity slowed down and banks intensified their activity aimed at acquisition of deposits (the so-called "deposit war") and increased their investments in Treasury and NBP securities in order to increase liquidity reserves in a situation of high uncertainty on the market.

Chart 3.8[26]
Loans and deposits of the non-financial sector (PLN billion)

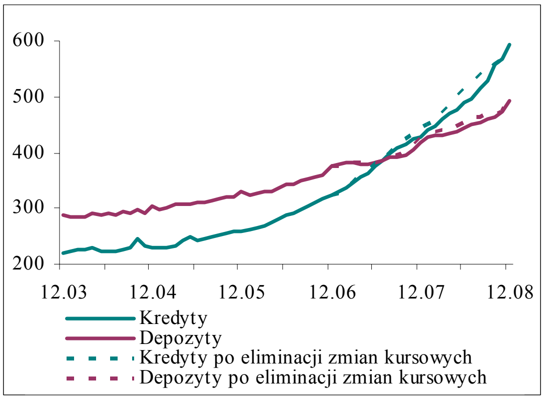


Chart 3.9
Annual growth rate of non-financial sector loans and deposits (%)

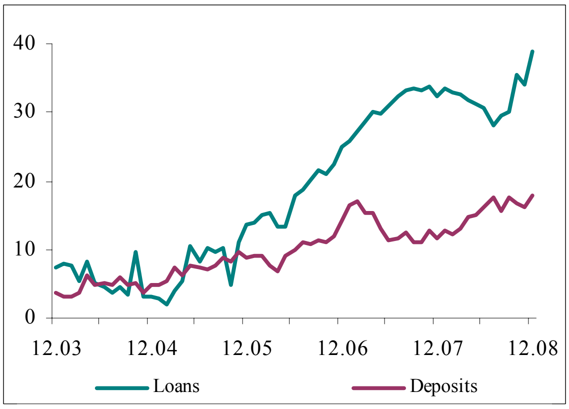


Chart 3.10
Main assets of the banking sector (PLN billion)

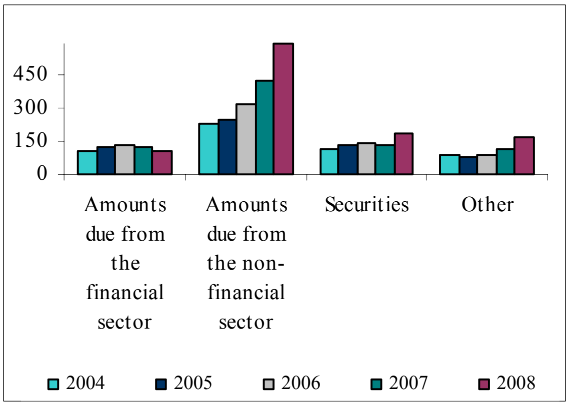


Chart 3.11
Main liabilities of the banking sector (PLN billion)

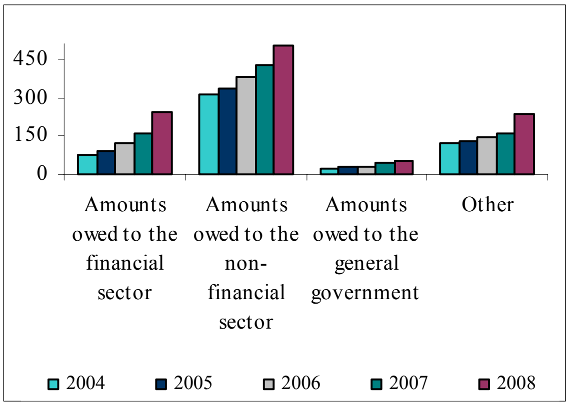


Chart 3.12
Structure of assets of the banking sector (%)

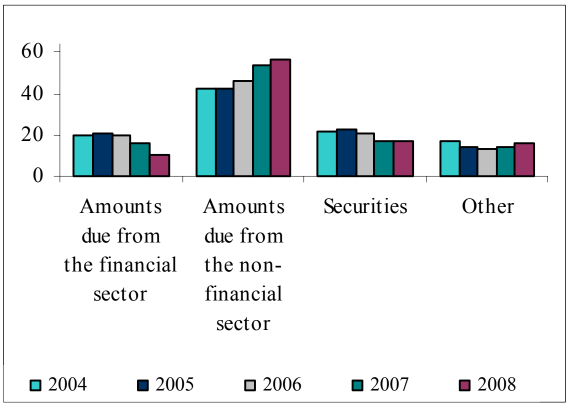
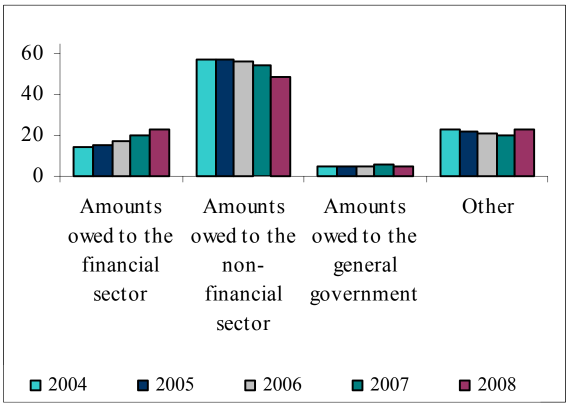


Chart 3.13
Structure of liabilities of the banking sector (%)



[26] Chart 3.8 also depicts (since December 2006) structure of loans and deposits after elimination of the impact of exchange rate changes. Calculations were based on a simplified assumption that in the case of households 100% of foreign currency loans are granted in CHF and in the case of enterprises 60% of loans are granted in EUR and 40% in USD. In the case of deposits it was assumed that 60% of them are in EUR, 30% in USD, 5% in CHF and 5% in GBP. Surplus of loans over deposits as of end 2008 amounted to PLN 76.4 billion (without elimination of exchange rate changes, to PLN 99.4 billion).

Consequently, balance sheet structure of the banking sector changed. The main changes consisted in:

– increased share of amounts due from the non-financial sector (from 53.2% as of the end of 2007 to 56.4% as of the end of 2008), accompanied by reduction of amounts owed to this sector (from 54.0% to 48.6%). It should be added that decrease in amounts owed from the non-financial sector was the effect of crisis-related events which affected mutual confidence between interbank market participants, resulting in restriction of granted limits and unwillingness to lend funds to other banks;
– decreased share of amounts due from the financial sector (from 15.8% to 10.4%), accompanied by increase in amounts owed to this sector (from 20.0% to 23.3%).

Structural change occurred – banks became net creditors of the non-financial sector

Future development of lending activity depends on banks' ability to acquire funds on the financial market

As a result, there was a gap in the financing of the non-financial sector; although by the end of 2007 the non-financial sector had a surplus in settlements with the banking sector (PLN 6.5 billion), at the end of 2008 this sector was its net debtor (PLN 81.4 billion). [27] The gap was covered with funds acquired from the financial market (see below). Banks' passing from being debtor to creditor in settlements with the non-financial sector is a material change. To put it simply, this means that the potential of financing of lending activity on the basis of funds deposited by non-financial sector entities has been exhausted (at present it is only possible to finance from increases in those funds). Consequently, lending activity development will depend on banks' ability to acquire funds on the financial market, which will be a challenge in the context of the crisis.

Lending

Growth rate of lending activity highest since the beginning of transformation process

Face value of loans for the non-financial sector increased from PLN 427.5 billion as of the end of 2007 to PLN 593.6 billion as of the end of 2008, i.e. by no less than 38.8%[28], which not only was the highest growth rate in the present decade, but also since the beginning of transformation process. In Q4, due to the "second wave" of financial crisis, lending activity slowed down (see below).

Table 3.1

Structure of loans for non-financial sector (PLN billion; face value)

	2004	2005	2006	2007	2008	Change 2008/2007 billion	Change 2008/2007 %
Total, of which:	227.7	258.5	322.8	427.5	593.6	166.0	38.8
- enterprises	117.1	121.2	138.3	171.7	222.7	51.0	29.7
- households	109.9	136.4	183.4	254.2	368.6	114.4	45.0
- non-commercial institutions	0.7	0.9	1.0	1.6	2.2	0.6	37.6

Chart 3.14
Loans for non-financial sector (PLN billion)

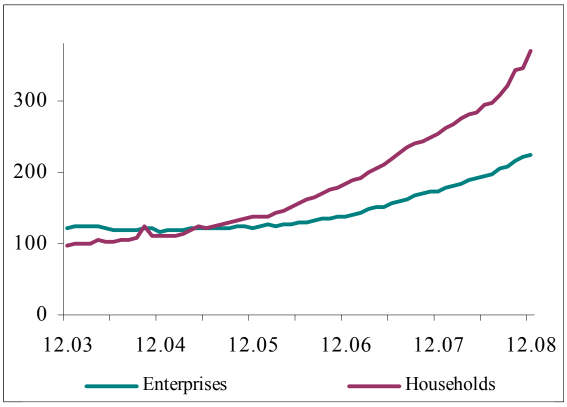
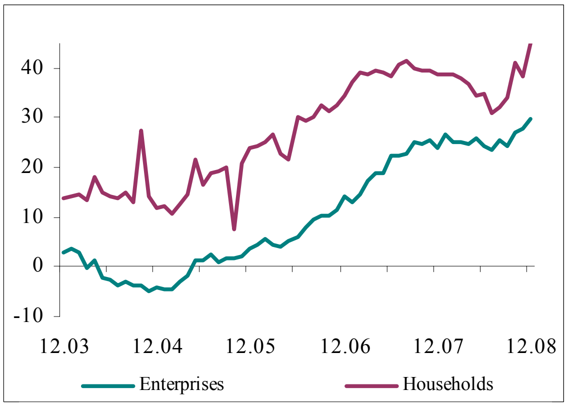


Chart 3.15
Annual growth rate of loans for non-financial sector (%)



[27] Face value of loans for the non-financial sector exceeded the value of deposits of this sector already in mid-2007.
[28] By 38.4% in commercial banks, by 92.3% in branches of credit institutions and by 15.1% in cooperative banks.

As it was the case in the previous years, the highest growth rate was noted in respect of households, which increased by 45.0%[29], while corporate loans increased by 29.7%.[30]. Consequently, the share of loans for households in loan portfolio increased to 62.1% and the share of corporate loans decreased to 37.5% (change in the structure, i.e. loans for households overtaking corporate loans, occurred in mid-2005).

Chart 3.16
Currency structure of loans for non-financial sector (PLN billion)

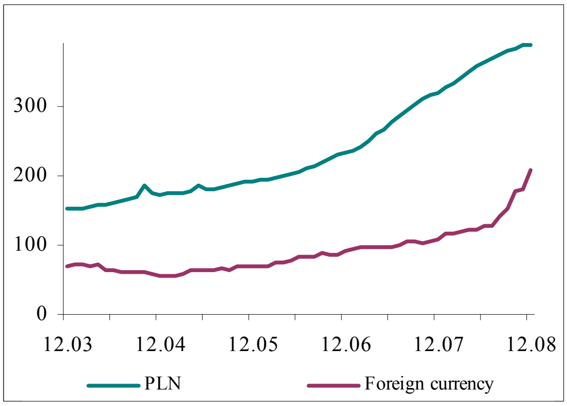


Chart 3.17
Annual growth rate of loans for non-financial sector (%)

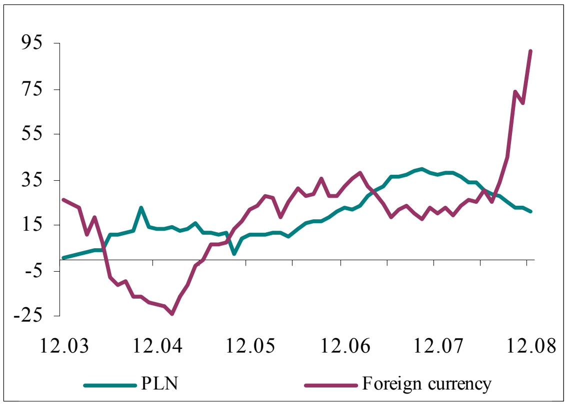


Chart 3.18
Currency structure of loans for households (PLN billion)

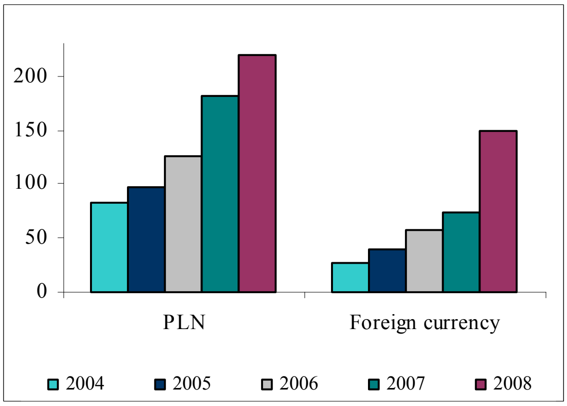
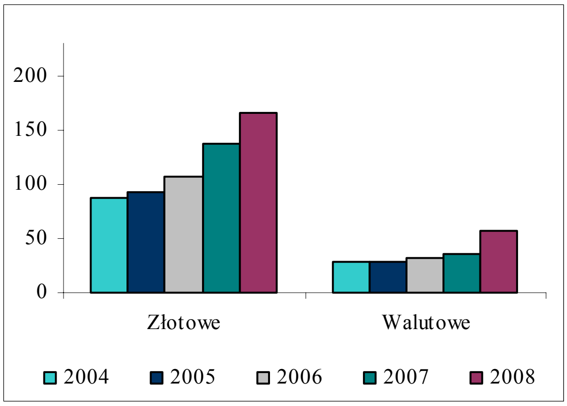


Chart 3.19
Currency structure of corporate loans (PLN billion)



Very high growth rate of loans caused by e.g. strong depreciation of PLN

Such a high growth rate of lending was not only the consequence of high demand for loans, but also of the already mentioned significant depreciation of Polish currency in the second half of 2008, which together with high share of mortgage loans in foreign currencies caused very high increase in face value of loan portfolio: the value of PLN loans rose by 21.0%, while of currency loans by 91.4%. After elimination of exchange rate changes, the increase in loans for the non-financial sector in 2008 would amount to[31] approx. 28.7% (31.6% for households, 24.5% for enterprises).

Dangerous rise in foreign currency debt of households

A particularly alarming fact is rapid growth in foreign currency debt of households, of which almost all generate income solely in Polish currency, relating to mortgage loans granted for very long periods (see below). The scale of this phenomenon is presented by the fact that while as of the end of 2004 the value of foreign currency loans for households amounted to PLN 26.7 billion and accounted for 24.3% of the value of household loan portfolio (11.7% of total loan portfolio), at the end of 2008 this value already amounted to PLN 149.6 billion and accounted for 40.6% of the value of household loan portfolio (25.2% of total loan portfolio). Consequently, there is a higher systemic risk related to PLN depreciation and turbulence on global financial

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[29] By 44.7% in commercial banks, by 136.9% in branches of credit institutions and by 13.1% in cooperative banks.

[30] By 29.5% in commercial banks, by 40.3% in branches of credit institutions and by 22.8% in cooperative banks.

[31] Due to the limitations of the reporting system, calculations were based on a simplified assumption that in the case of households and non-commercial institutions 100% of foreign currency loans are granted in CHF and in the case of enterprises 60% of loans are granted in EUR and 40% in USD.

markets, which also hampers banks' management of those portfolios. Should depreciation of Polish currency maintain in the long-term perspective and should there be a noticeable deterioration of situation on the labour market, the great part of borrowers would have problems with debt servicing, or even would be unable to repay it. Should these risks materialise, this would affect financial condition of certain banks and may lead to undermined stability of the banking sector. Therefore it is necessary to take measures aimed at limitation of further household lending in foreign currencies. Moreover, high and fast growing share of currency loans for households is one of the arguments used by analysts, who point out the increase in systemic risk in countries of Central and Eastern Europe, and consequently e.g. depreciation of their currencies. The only measure of limiting the risk related to the scale of foreign currency exposures is fast entry to the euro zone (which would eliminate exchange rate risk due to relatively stable EUR/CHF ratio).

Table 3.2

Structure of loans for households (PLN billion; face value)

	2004	2005	2006	2007	2008	Change 2008/2007	
						billion	%
Total, of which:	109.9	136.4	183.4	254.2	368.6	114.4	45.0
- mortgage loans	35.9	50.7	78.2	117.7	194.1	76.3	64.8
of which in foreign currency	20.3	32.2	50.0	65.1	135.0	69.8	107.2
- consumer loans, of which	53.6	63.8	77.5	102.5	136.4	33.9	33.1
overdrafts	14.0	14.6	15.2	17.7	20.8	3.0	17.1
credit cards	2.9	4.2	5.8	8.9	12.7	3.7	42.0
other	36.7	45.0	56.5	75.8	103.0	27.1	35.8
- investment loans	20.4	21.9	27.7	34.0	38.2	4.2	12.3

Chart 3.16
Loans for households (PLN billion)

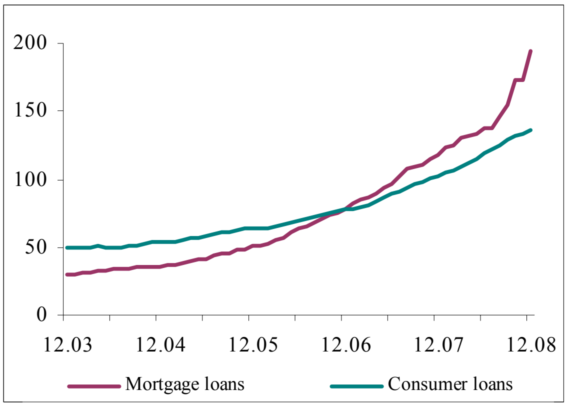


Chart 3.17
Annual growth rate of loans for households (%)

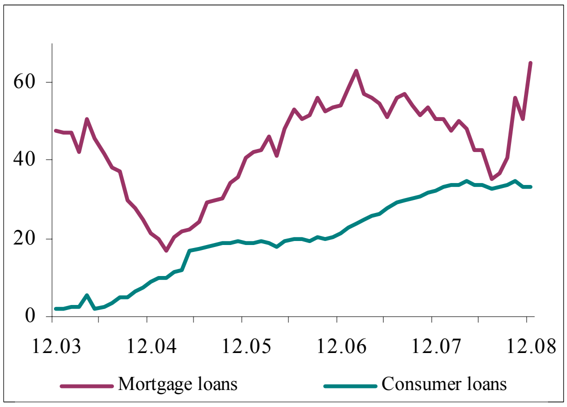


Chart 3.18
Currency structure of mortgage loans (PLN billion)

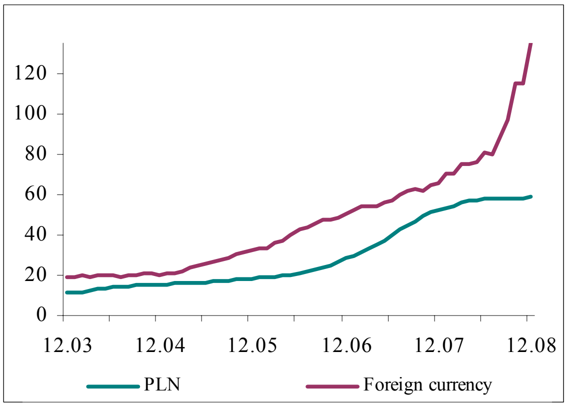
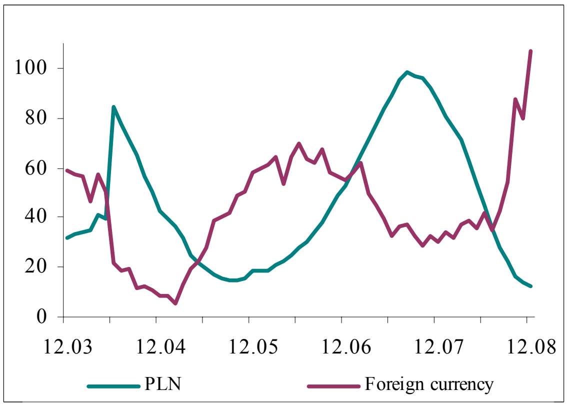


Chart 3.19
Annual growth rate of mortgage loans (%)



The factor which had greatest impact on growth rate of loans for households was high growth rate of mortgage loans, the face value of which increased by no less than 64.8% (from PLN 117.7 billion at the end of 2007 to PLN 194.1 billion at the end of 2008). Such a high growth of mortgage loans resulted from the maintained relatively high lending activity for most of the year and from strong depreciation of Polish currency in Q2, which together with the dominant share of CHF loan portfolio led to surge of debt. During the year, the value of mortgage loans in foreign currencies rose by no less than 107.2%, compared with mere 12.4% for PLN loans, which led to an increase in the share of currency loans in total mortgage loans from 55.3% to 69.5%. Such a high increase in value of mortgage loans caused increased their share in household loan portfolio from 46.3% to 52.6% and in total loan portfolio from 27.5% to 32.7%.

Unfavourable and irrational change of borrowers' preferences as to loan currency

The growing debt was triggered by unfavourable change in borrowers' preferences, i.e. increased interest in loans in CHF and reduced demand for loans in PLN at the end of 2007. This resulted from the growth of interest rates in PLN noted at the time, with a drop in interest rates in CHF and appreciation of Polish currency, which was an additional argument for borrowing in foreign currencies. The change of preferences could be measured best by results of surveys[32], on the basis of which we may state that out of ca. 300,000 loan agreements concluded in 2008 only one third was concluded in PLN, while the rest was concluded in foreign currencies.

Wrong strategy of banks

Tightened lending policy only in Q4

In 2008 banks conducted too liberal policy in respect of mortgage loans. In particular, considering the growing credit risk, they should have adopted much more conservative approach to mortgage loans, consisting in reduction of LtV, limitation of lending in foreign currencies and shortening the maximum crediting period. Moreover, in the course of conducted inspections it was revealed that banks did not comply with all provisions of Recommendation S. It was only in Q4 of 2008 that lending policy was tightened. Changes mainly consisted in increased margins and introduction or increasing of the required own contribution. In particular, banks tightened currency loans policy so that such loans became hardly accessible for many borrowers: in December the unfavourable trend with respect to loan currency was reversed and the number of loan agreements concluded in PLN doubled the number of loan agreements for loans in foreign currencies. From the point of view of banking sector safety, such measures should be considered positive. However, it should be pointed out that certain banks were forced by banking supervision to suspend lending in foreign currencies due to the lack of adequate sources of long-term financing, adjusted to asset structure.

It should be added that despite the historical growth of value of loan portfolio, interest in mortgage loans decreased, which is indirectly confirmed by reduced growth of the number of loans: while in years 2006-2007 banks granted approximately 190,000 loans each (net), in 2008 the number of loans increased only by ca. 130,000 (the number of loan agreements increased from 1.1 million at the end of 2007 to 1.2 million at the end of 2008).It should be pointed out, however, that this drop in the number of concluded loan agreements also resulted from the abovementioned tightening of lending policy of banks at the end of 2008 (increase in the number of denied loan applications).

In the mortgage loan portfolio, an increase in average value of loan agreement was noted (from PLN 106.7 thousand at the end of 2007 to PLN 155.8 thousand at the end of 2008), as was an increase in the share of large mortgage loans with value exceeding PLN 300,000 (at the end of 2008 there were already over 170,000 such loans, which accounted for over 45% of the total value of loans), as well as an increase in average LtV of loan portfolio (from 56% at the end of 2007 to 65% at the end of 2008).

Improvement of wealth and the maintained consumer optimism also favoured the increase in demand for consumer loans, which rose by 33.1% (from PLN 102.5 billion at the end of 2007 to PLN 136.4 billion at the end of 2008). One should note the relatively low increase in overdrafts (17.1%) and very high increase in debt due to credit card transactions (42.0%). This may result from the very fast development of those products and their strong promotion, which explains the fact that many customers prefer this method. However, it should be noted that high growth rate of those loans entails even faster growth of non-performing loans (54.7%), which may raise concerns as to the too loose lending policy of certain banks in respect of this product, as well as that certain borrowers may use such loans to repay other liabilities.

[32] For detailed information about the structure of loans, see PFSA report entitled *Finansowanie nieruchomości przez banki w Polsce – stan na grudzień 2008 r.*, 2009.

Chart 3.20
Structure of corporate loans (PLN billion)

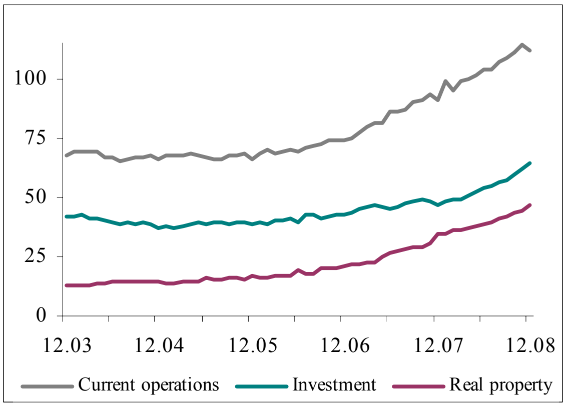
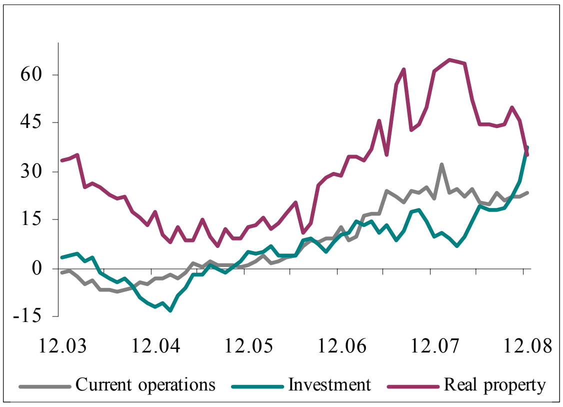


Chart 3.21
Annual growth rate of corporate loans (%)



Strong corporate lending growth

The value of corporate loans rose by 29.7% from PLN 171.7 billion at the end of 2007 to PLN 222.7 billion at the end of 2008. However, as it was the case with households, it was distorted by strong depreciation of Polish currency (albeit to a lesser extent). Unlike in previous years, the highest growth rate (37.2%) was noted with respect to investment loans, which may be explained by continuation of investment processes initiated in the previous periods, as well as by relatively favourable situation in the first half of 2008 (when very high growth of investments was noted). However, this favourable trend is dampened by the fact that the great part of growth resulted from very high (almost 75%) increase in currency loans, which accounted for over 30% of the total portfolio of those loans. Consequently, high growth rate was much affected by depreciation of PLN in the second half of 2008. Loans for real property also noted high growth rate (35.4%). However, the growth rate of those loans was definitely lower than in 2007, which resulted from the fact that the peak demand on the housing market had ended and that development prospects for this sector for the coming periods have weakened. The lowest, although also high, growth rate (23.6%) was noted with respect to loans for the financing of current operations.

It is necessary that banks ensure adequate corporate lending

In Q4 of 2008 corporate lending visibly slowed down. On the one hand, this may be explained by economy's natural transfer to a lower level of business cycle (the peak of the current business cycle was in years 2006-2007) and by the closing of accounting books at the end of the year. On the other hand, however, this may be related to deterioration of economic growth prospects due to the rapid escalation of the financial crisis. Consequently, banks tightened their lending policies towards enterprises, and the part of enterprises limited their demand for loans. This issue has been discussed in more detail below, but here it should be stated that from the point of view of economy development prospects (and thus the prospects of development of the banking sector), it is necessary that enterprises are provided with adequate funding for current operations and development. In a situation when funding is limited, banks should first focus on the financing of „sound" enterprises, and then on household consumption (applying adequate lending standards). Only lastly should they consider further extension of mortgage loan portfolio (although this would result in further drops in prices on the real property market, but in longer term this would contribute to the development of this market on the basis of „sound" price ratios), in particular in the face of difficulties with obtaining financing for longer periods.

When discussing the issue of high growth rate of loans, one should keep in mind that it is partly the consequence of low „level of banking" of Polish economy in comparison with other EU Member States (in Poland the share of loans in GDP accounts for mere 50%, while in the EU it exceeds 100%). However, the maintained high growth rate would lead to macroeconomic imbalance, as well as it would be a threat for banks in the period of less advantageous economic conditions.

Sources of financing

In 2008, banks financed the development of lending activity mainly through increase in liabilities towards financial sector (in particular to banks) and through increase in deposits from non-financial sector, and to a lesser extent through the increase in deposits from general government, capital, as well as through reduction of the part of liquid assets (mainly amounts due from the financial sector).

Chart 3.22
Amounts due from and owed to the financial sector (PLN billion)

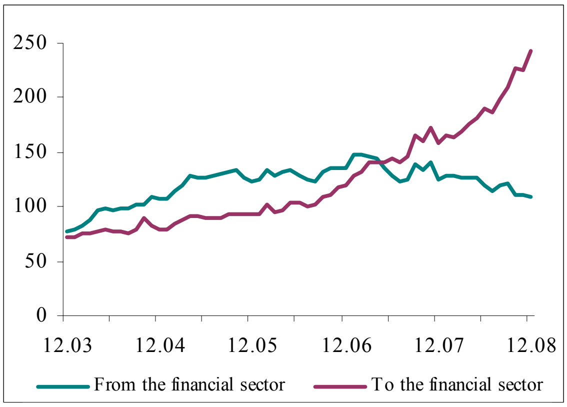


Chart 3.23
Annual growth rate of amounts due from and owed to the financial sector (%)

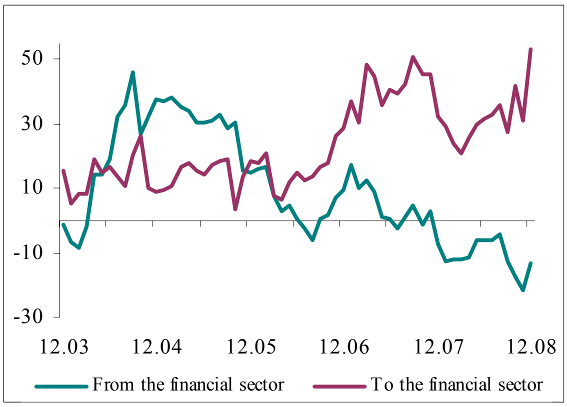


Chart 3.24
Structure of amounts due from the financial sector (PLN billion)

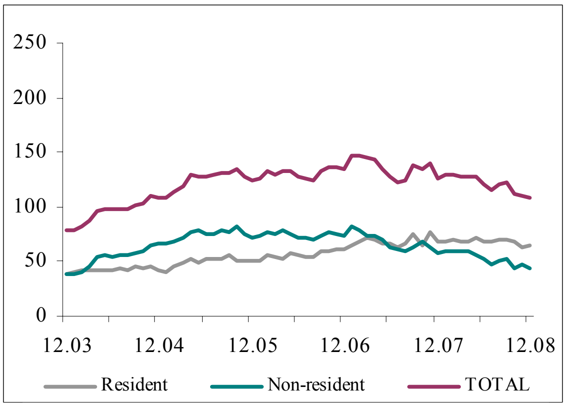


Chart 3.25
Structure of amounts owed to the financial sector (PLN billion)

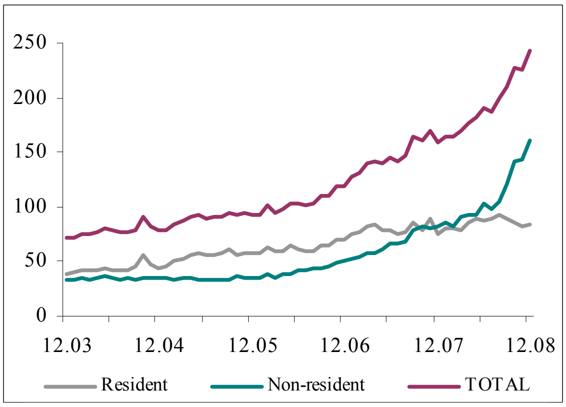
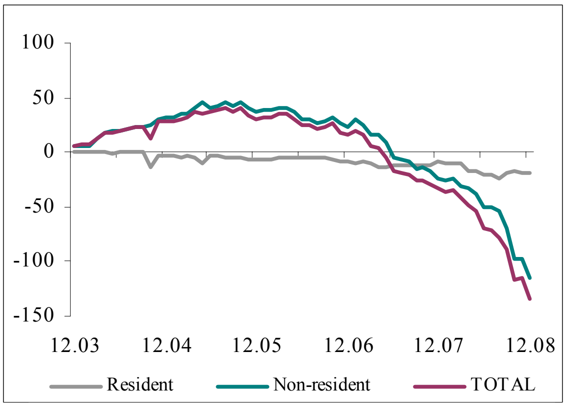


Chart 3.26
Balance of settlements with the financial sector (PLN billion)



Fast growing „deficit" of banks in settlements with the financial sector

Amounts owed to the financial sector increased by 53.3% (from PLN 158.4 billion at the end of 2007 to PLN 242.9 billion at the end of 2008). At the same time, amounts due from the financial sector decreased by 13.4% (from PLN 125.2 billion to PLN 108.4 billion). Consequently, negative balance of the banking sector in settlements with the financial sector increased from PLN 33.2 billion at the end of 2007 to PLN 134.5 billion at the end of 2008 (until the mid-2007, banking sector had a surplus in settlements with the financial sector).

Higher sensitivity of banks to the situation on the financial market

High increase in amounts owed to the financial sector mainly resulted from increased liabilities towards non-residents (negative balance in settlements with this group of customers rose from PLN 24.6 billion at the end of 2007 to PLN 115.7 billion at the end of 2008, while negative balance in settlements with domestic entities of the financial sector increased from PLN 8.4 billion to PLN 24.6 billion). Consequently, the share of non-residents in total liabilities towards the financial sector increased (from 52.1% to 65.8%). Rapidly growing "deficit" in banks' settlements with the financial sector (mainly with non-residents) resulted from:

The majority of funds came from parent companies

–

– fast development of small and medium-sized banks and branches of credit institutions, which, having poorly developed deposit base, use funds from the interbank market; expansive policy of certain large banks, which despite well developed deposit base used funds from the financial market in order to increase their lending and thus their market share;
– strong depreciation of Polish currency in the second half of 2008 which caused an increase in nominal liabilities in foreign currencies, originating from earlier periods.

Consequently, the structure of sources of financing deteriorated and sensitivity of the Polish banking sector to situation on national and global financial markets increased. However, it should be pointed out that great part of funds of non-residents originates from parent companies (often 50%-100%) and is of long-term nature. Therefore the risk is limited (the majority of parent entities declares support for liquidity and provision of funds for the development of Polish subsidiaries). Nevertheless, banks should revise their development strategies towards greater focus on the acquisition of stable sources of financing originating from domestic market, although this may be very difficult in the period of less advantageous economic conditions. The reason for this is the fact that escalation of problems of parent companies or greater tendency to apply protectionist practices may affect the operations of Polish companies and branches. In the extreme situation access to funds for Polish subsidiaries would be restricted, which would lead to problems with liquidity in the Polish banking sector.

Chart 3.27
Amounts due from and owed to non-residents (PLN billion)

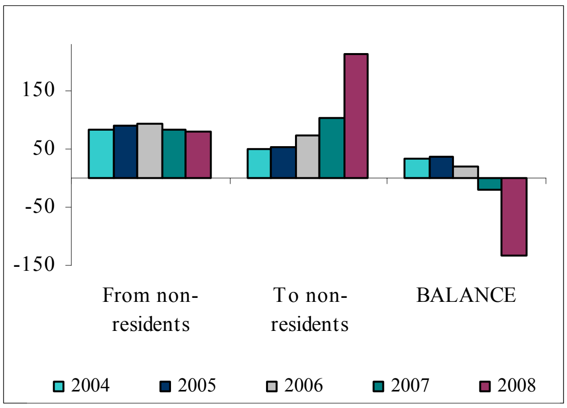
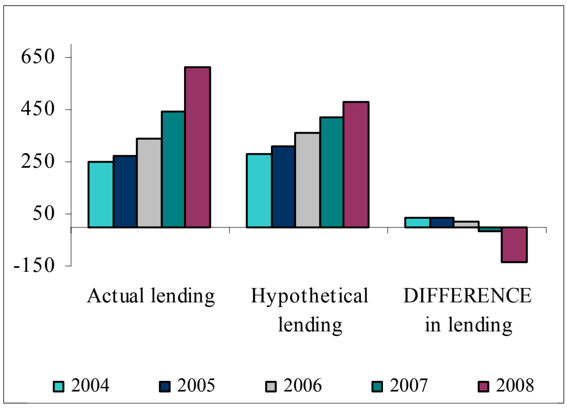


Chart 3.28
Actual and hypothetical lending activity (PLN billion)



Without foreign capital there would be no lending boom in years 2007-2008

Although by the end of 2006 banking sector had a surplus in settlements with non-residents, in years 2007-2008 it was non-residents who mainly financed the development of lending activity in Poland. In other words, if it was not for the foreign funds, the scale of lending activity in years 2007-2008 would have be significantly lower (in particular in 2008).

Therefore it is necessary that good climate for investments is created in Poland, otherwise the level of financing of Polish economy will drop.

Banks controlled by domestic entities have practically a balanced position in settlements with foreign financial sector (with specific exception of BGK and BOŚ, who e.g. intermediate in allocation of funds from EU). Thus it may be stated that banks controlled by domestic entities are to a small extent exposed to the risk resulting from limited financing on the foreign financial markets (one may only speak about limitation of development potential due to increased costs of acquisition of additional sources of financing on foreign markets).

Banks controlled by domestic entities have closed position in settlements with non-residents

Table 3.3

Structure of deposits of the non-financial sector (PLN billion; face value)

	2004	2005	2006	2007	2008	Change 2008/2007	
						billion	%
Total, of which:	302.8	329.1	375.6	419.3	494.1	74.8	17.8
- enterprises	84.9	99.2	125.9	144.8	149.1	4.3	3.0
- households	208.7	219.9	238.8	262.4	330.8	68.4	26.1
- non-commercial institutions	9.2	10.0	10.9	12.1	14.2	2.1	17.3

Chart 3.29
Deposits of the non-financial sector (PLN billion)

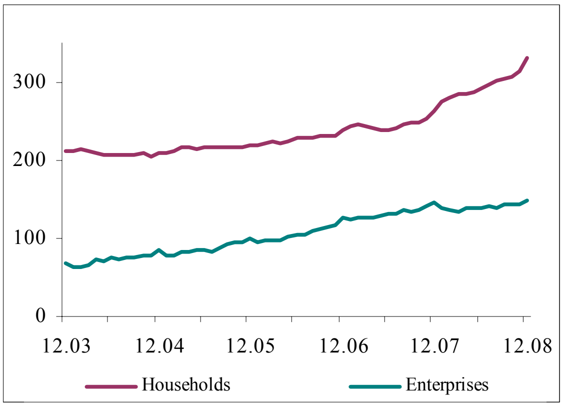


Chart 3.30
Annual growth rate of deposits of the non-financial sector (%)

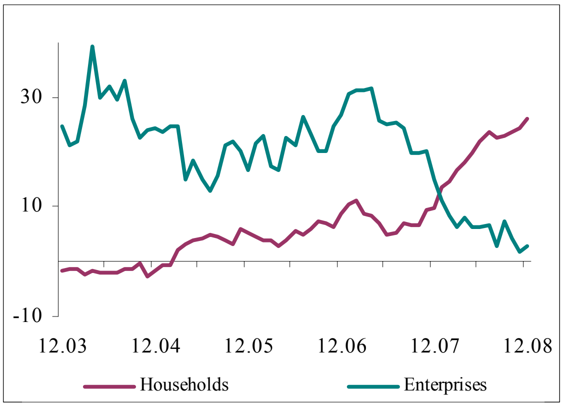


Chart 3.31
Structure of household assets (PLN billion)

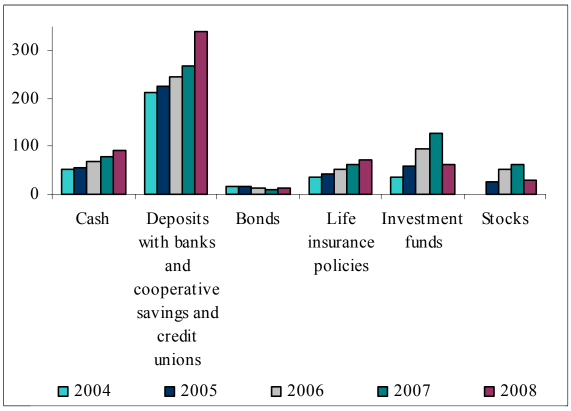
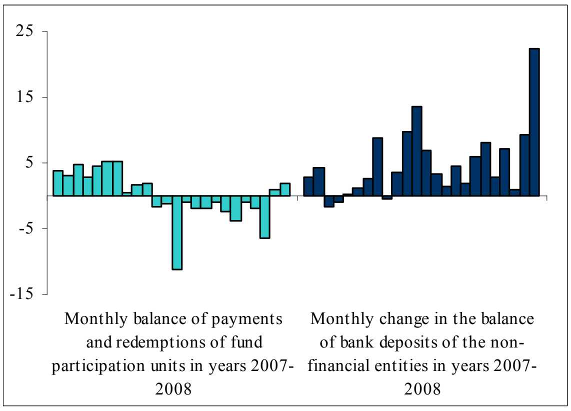


Chart 3.32
Inflow of funds to investment funds and banks (PLN billion)



Source: NBP, Analizy Online

Deposits from non-financial sector increased by 17.8% (from PLN 419.3 billion at the end of 2007 to PLN 494.1 billion at the end of 2008) [33], and, unlike in the previous years, the growth rate of deposits from enterprises was visibly lower than the growth rate of deposits from households.

[33] By 17.3% in commercial banks, by 66.4% in branches of credit institutions and by 13.1% in cooperative banks.

Historically high growth of household deposits

Deposits of households increased by no less than 26.1%[34] (compared to 9.9% in 2007), which was the highest growth rate in the decade. Such a high increase in household deposits resulted from more attractive deposits offered by banks ("deposit war"), higher wages and salaries and final breakdown of bull run on the stock market, which resulted in withdrawal of the part of funds from investment funds and their investment in the banking system (in January 2008 a historically high outflow of funds from investment funds was noted, exceeding net PLN 10 billion).
A fact that may be considered particularly favourable is that the growth rate of time deposits (49.7%)[35] was definitely higher than the growth rate of current deposits (4.9%), which led to a significant increase in the share of time deposits in total household deposits (from 47.3% to 56.1%). This undoubtedly improves the stability of deposit base and thus security of banking operations.

Alarming slump in growth rate of corporate deposits

Corporate deposits increased only by 3.0%[36] (against 15.0% in 2007), which in turn was one of the lowest growth rates in the decade and together with other data (such as deterioration of financial results, lower industrial production) confirms that the economic conditions in the corporate sector are visibly worse.

It should be noted that despite strong depreciation of PLN, the value of foreign currency deposits dropped by 3.8%[37], which confirms high confidence of domestic entities in Polish currency. However, one should keep in mind that the drop mainly related to enterprises, which most probably may be treated as a symptom of deteriorating trade.

Chart 3.33
Amounts due to general government (PLN billion)

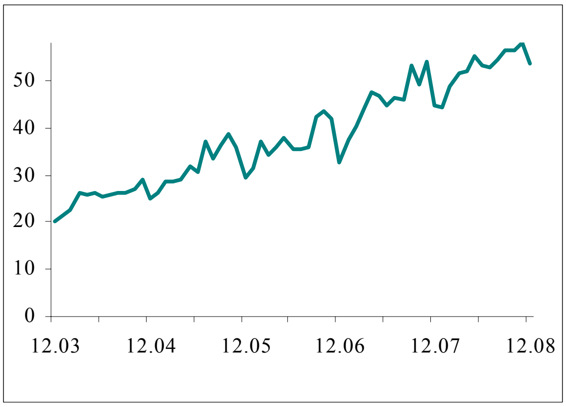
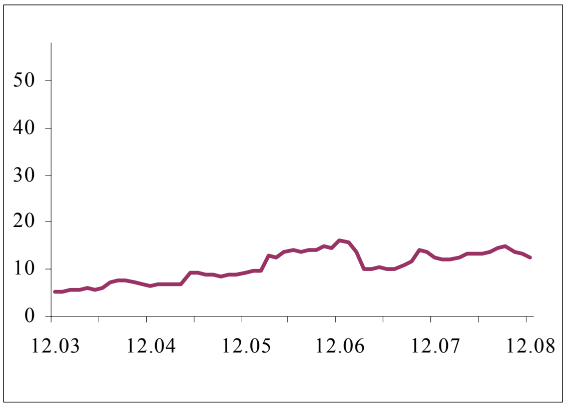


Chart 3.34
Own debt securities issued (PLN billion)



Liabilities towards general government increased by 19.7% (from PLN 44.7 billion at the end of 2007 to PLN 53.5 billion at the end of 2008) [38], although the use of those funds for development of banking activity was of relatively minor importance (such liabilities accounting for mere 5.1% of the balance sheet total).Increase in funds on current accounts and deposits of this sector resulted from higher tax take, proceeds from the Social Insurance Fund (FUS) and National Health Fund (NFZ) premiums, as well as from the inflow of EU funds.

Liabilities from the issue of own securities are of little importance in the financing of banking operations. At the end of 2008 total value of these liabilities amounted to PLN 12.5 billion (compared to PLN 12.4 billion at the end of 2007) and accounted for mere 1.2% of the balance sheet total in the sector.

[34] By 26.2% in commercial banks, by 191.5% in branches of credit institutions and by 13.7% in cooperative banks.
[35] In particular, it was noted that household deposits with original maturities exceeding 1 year more than doubled (from PLN 8.5 billion at the end of 2007 to PLN 19.5 billion at the end of 2008), although their share in total deposits of this group of customers was still marginal and accounted for only 6.0%.
[36] By 2.3% in commercial banks, by 17.0% in branches of credit institutions and by 7.4% in cooperative banks.
[37] Throughout 2008, corporate deposits in foreign currencies decreased by 14.2%, while household deposits increased by mere 4.6%.
[38] Approximately 25% of deposits of this sector was accumulated with BGK.

The structure of securities issued by banks proves high stability of this source of financing (63.9% of securities have maturities exceeding 1 year; only 6.7% of such securities was held by foreign investors). Despite the lack of risks resulting from this source of financing for the entire sector, certain banks are highly dependent on this source of financing and in the context of further deterioration of market sentiments they may have difficulties with acquiring sufficient funds or they would need to incur higher costs.

Table 3.4

Capital (funds) and subordinated liabilities of the banking sector (PLN billion)

	2004	2005	2006	2007	2008	Change 2008/2007	
						billion	%
Total, of which:	52.5	54.9	59.2	68.5	82.6	14.1	20.5
- core capital (fund)[39]	12.0	12.5	13.4	14.4	16.1	1.7	11.8
- supplementary capital (fund)[40]	18.1	19.1	21.1	31.2	38.2	7.0	22.5
- reserve capital (funds)	12.0	11.8	12.3	9.5	10.7	1.3	13.6
- general banking risk fund	6.5	7.1	7.8	7.5	8.5	1.0	13.1
- revaluation reserve	1.3	1.1	1.2	0.1	0.4	0.4	603.6
- subordinated liabilities	3.1	3.2	2.9	5.6	7.6	2.0	35.3
- other (balance)	-0.5	0.2	0.5	0.4	1.1	0.7	211.8

Chart 3.35
Main fund items - commercial banks (PLN billion)

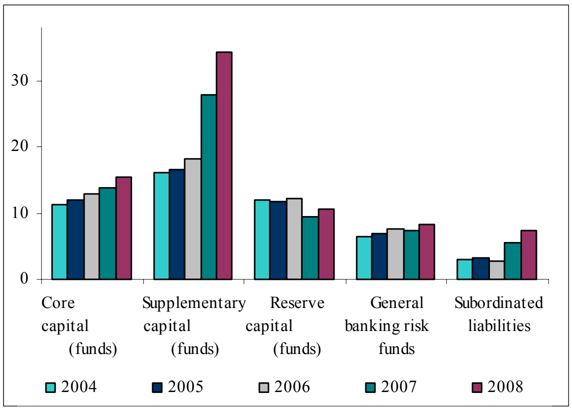
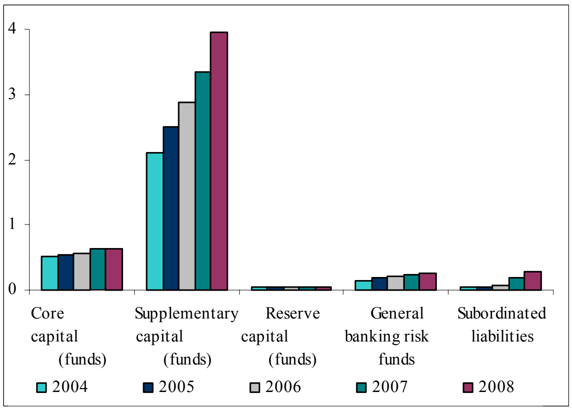


Chart 3.36
Main fund items – cooperative banks (PLN billion)



Capital (funds) and subordinated liabilities of the banking sector increased by 20.5%, from PLN 68.5 billion at the end of 2007 to PLN 82.6 billion at the end of 2008[41] and accounted for 7.9% of the balance sheet total (8.6% at the end of 2008).Increase in capital mainly resulted from increase in supplementary capital (by PLN 7.0 billion) consequently to sharing profits for 2007, and to a lesser extent from increase in other reserve capital, general banking risk reserves and subordinated liabilities. Another important factor was the emergence of two new banks on the Polish market, i.e. Alior Bank and Allianz Bank (Alior Bank has equity amounting to PLN 1.5 billion).

The main items of capital included core capital and supplementary capital, accounting in total for almost two thirds of capital (19.4% and 46.2% respectively).[42]

[39] Share capital (fund) in cooperative banks.
[40] Reserve fund in cooperative banks.
[41] By 20.8% (from PLN 64.1 billion to PLN 77.4 billion) in commercial banks and by 16.6% (from PLN 4.5 billion to PLN 5.2 billion) in cooperative banks.
[42] In the case of cooperative banks, reserve fund accounted for approximately ¾ of total capital.

Noticeable slowdown of lending activity

**Slowdown of lending activity
a threat and potential countermeasures**

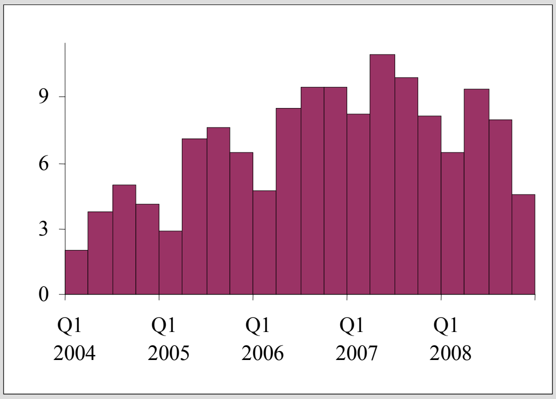
Scale

At present it cannot be precisely stated to what extent deterioration of lending activity would affect Polish economy, which results e.g. from high uncertainty as to the future development of macroeconomic conditions both in Poland and in global economy (this is depicted e.g. by high variability and divergence of economic growth forecasts).

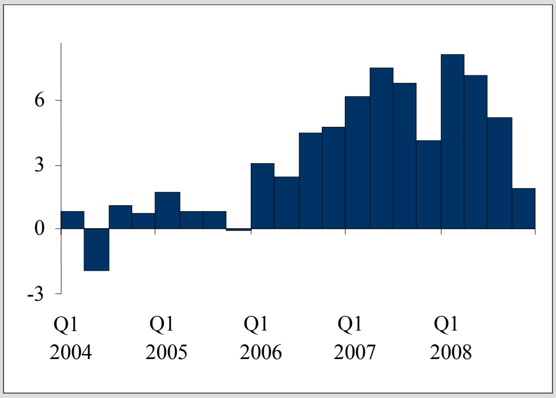
Loans for the non-financial sector between September 2008 and January 2009 (PLN billion; face value)

	IX	X	XI	XII	I
Face value					
Total non-financial sector	529.6	559.3	567.2	593.6	612.6
- households	319.8	342.6	345	368.6	382
- enterprises	207.8	214.6	220	222.7	228.4
Change (month/month)					
Total non-financial sector		29.7	7.9	26.4	19
- households		22.8	2.4	23.7	13.3
- enterprises		6.8	5.4	2.7	5.7
Data adjusted by exchange rate change (exchange rates as of 30 September 2008)					
Total non-financial sector	529.6	537.6	546.3	548.3	551
- households	319.8	325.9	330.8	334.3	337.2
- enterprises	207.8	209.5	213.4	211.8	211.6
Change (month/month)					
Total non-financial sector		8	8.8	2	2.7
- households		6.2	4.9	3.5	2.9
- enterprises		1.8	3.8	-1.6	-0.2

Quarterly growth rate of household loans adjusted by exchange rate change (%)

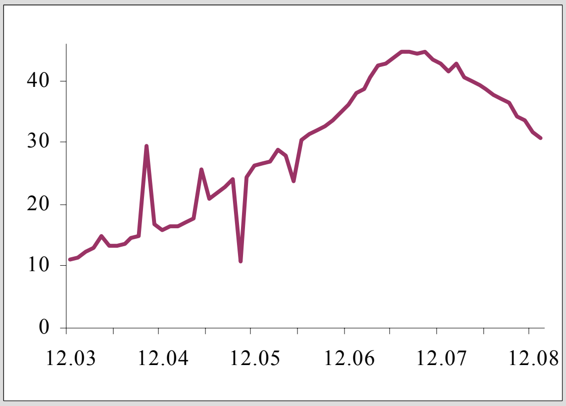


Quarterly growth rate of corporate loans adjusted by exchange rate change (%)

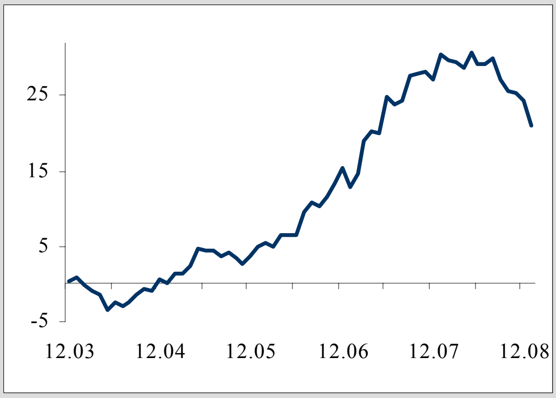


On the basis of available data one may only state that in Q4 of 2008 there was a significant slowdown in lending activity for enterprises and in the growth rate of household loans.
Although in the same quarter a historical growth of the value of loan portfolio was noted, amounting to PLN 4.0 billion, i.e. 12.0% (for households, PLN 48.9 billion, i.e. 15.3%, and for enterprises, PLN 14.9 billion, i.e. 7.2%), it was almost entirely the effect of very strong depreciation of PLN against the main currencies (which increased by 20%-30% against PLN).Consequently to PLN depreciation, currency loans increased by no less than PLN 56.2 billion, i.e. by 37.2%, while the increase in PLN loans was only by PLN 7.8 billion, i.e. by 2.1%. After elimination of exchange rate changes, the increase in loans amounted to approx. 3.5% (4.5% for households, 1.9% for enterprises). In comparison, similar growth in Q4 of 2007 amounted to ca. 6.6% (8.1% for households, 4.2% for enterprises).

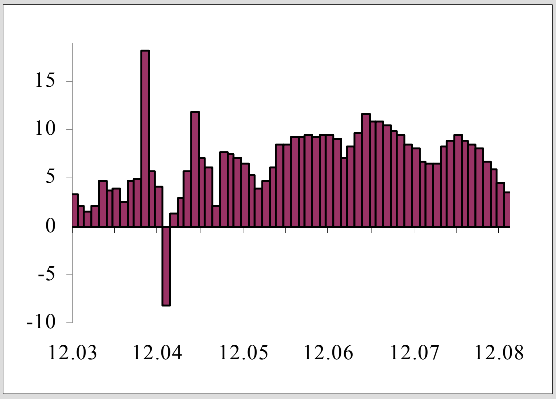
Annual growth rate of household loans adjusted by exchange rate change (%)



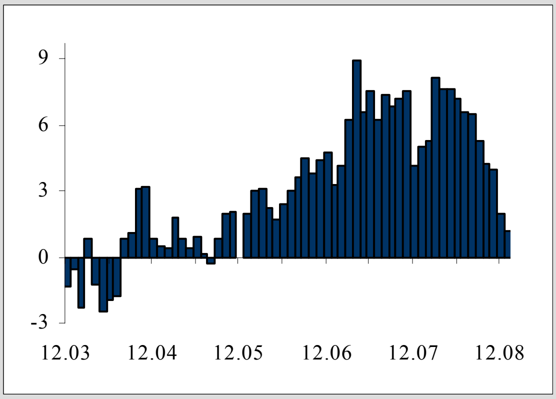
Annual growth rate of corporate loans adjusted by exchange rate change (%)



Rolling quarterly growth rate of household loans adjusted by exchange rate change (%)



Rolling quarterly growth rate of corporate loans adjusted by exchange rate change (%)



Decrease in growth rate is even better visible when we take into account the annual growth rate of loans[43] or the rolling quarterly growth rate[44], adjusted by exchange rate change.

Despite visible drop in lending activity in Q4 of 2008 and in January 2009, on the basis of the obtained results one cannot definitely state that this decrease results from limitation of lending activity caused by the “second wave” of the financial crisis that appeared on global markets in autumn 2008. It should be noted that:

– after “clearance” of data of exchange rate changes, it turns out that in the case of households, lower growth rate of lending has been noted already since mid-2007, which can be explained by the peak of real property boom at the time;
– the peak of growth rate of lending activity for enterprises was in the first half of 2008, after which it visibly weakened, which can be explained by economy’s entry into the lower stage of business cycle, characterised e.g. by slump in the growth rate of investments in Q3 of 2008 (and thus in general before the next escalation of the financial crisis), lower growth rate of industrial production and deterioration of financial results of enterprises. This process was intensified by rapidly deteriorating development prospects of world economy and the related drop in demand for Polish products, which led to rapid cooldown of Polish economy;
– in years 2006-2008, very high growth rate of lending activity was noted, thus it would be extremely difficult to maintain such growth rate in the coming years (considering e.g. the issue of financing – see below).

[43] Calculated as t/(t-12)*100-100 taking into account the exchange rate as of t-12.
[44] Rolling quarterly growth rate, calculated as t/(t-3)*100-100 taking into account the exchange rate as of t-3, permits the analysis of the growth rate in the last three months (quarter) and well defines the trends in the previous periods (monthly changes are often too short to note any trend and annual changes cover too long a period to illustrate the analysed event in a proper way).

One should keep in mind that the decrease in lending activity for enterprises noted in December 2008 (month on month, taking exchange rate changes into account) is characteristic for the month, which results e.g. from the closing of accounting books. In January lower financing was also noted, but the drop was slight (by approx. PLN 0.2 billion). However, decrease in operating loans (by PLN 1.2 billion) and investment loans (by PLN 0.3 billion) may be considered alarming; this may prove both limited financing and limitation of the scale of operations by certain enterprises. On the other hand, overdrafts increased (by PLN 0.6 billion), and so did loans for real property financing (by PLN 0.6 billion). As for the increase in household loans noted in December and January, it may be explained by an increase in debt in respect of consumer loans, which may be connected with holidays season and launching of subsequent tranches of mortgage loans.

However, talks conducted by representatives of banking supervision with representatives of banks confirm that lending policy has become stricter. This is also confirmed by the results of NBP survey (the survey was conducted on the turn of December 2008 and January 2009 among 30 banks whose total share of liabilities from enterprises and households in banking sector portfolio accounts for almost 90%). On the basis of survey results it was stated that in Q4 of 2008 there was a strong limitation of supply of lending in all credit market segments:

- 80% of analysed banks tightened lending criteria for enterprises, where all requirements were defined in a stricter manner. 80% of banks declared increasing margins, 60% declared requesting higher collateral, over 50% declared increasing non-interest borrowing costs, while over 30% declared reduction of the maximum loan amount;
- 85% of banks tightened mortgage loan granting criteria. Almost all banks increased their margins, 90% increased the required own contribution level, 40% increased non-interest borrowing costs, 20% shortened the maximum crediting period, while 5% tightened the criteria relating to the required collateral. Moreover, nearly 70% of banks tightened other requirements (creditworthiness calculation, documents certifying borrower’s income and the rules of real property valuation);
- over 75% of banks also tightened the criteria of granting consumer loans for households. 40% of banks declared increased margins, 22% declared establishment of additional collateral, 15% declared reduction of the maximum available loan amount, while over 10% declared increasing non-interest borrowing costs.

From among the main reasons for the tightening of lending criteria, banks pointed out to the risk related to the deterioration of macroeconomic conditions. Deterioration of the current and future capital situation was also important. In Q1 2009 banks expect further tightening of lending policy for enterprises, slight tightening of mortgage lending (10% of banks expects to loosen them up) and definite tightening of consumer lending policy.

Visible slowdown of the growth rate of lending activity in the coming periods is also confirmed by the results of survey on banks’ financial plans for 2009, which show that banks forecast an increase in loan portfolio of approximately 10%, with household loans increasing by 11% (mortgage loans by 8%) and corporate loans by 10%. However, one should keep in mind that the deteriorating conditions of macroeconomic environment may affect the possibility to implement those plans.

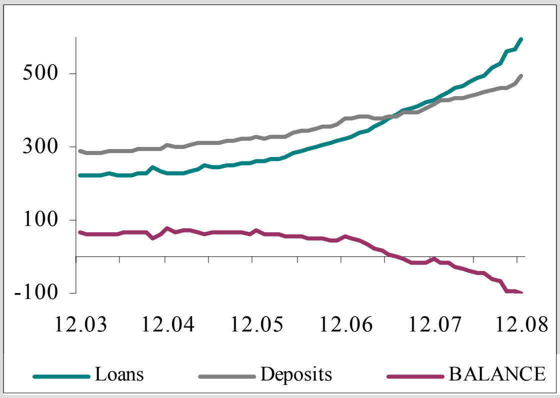
To sum up, at present it is difficult to unanimously state whether the noted phenomenon of limited lending activity results from the "second wave" of the crisis, or is it the consequence of the fact that the peak of economic boom and rapid cooldown of economy (due to the transformation of the global financial crisis into economic crisis) and the resulting adjustment of enterprises and households to new operating conditions. In particular, enterprises adjust their level of financing to the decreasing contract portfolio and the adjusted investment plans, as well as to the shortening of periods of implementation of their business decisions, while households postpone the part of consumption and investment decisions. Therefore it seems that we are facing both those phenomena, i.e. on the one hand, significant tightening of banks’ lending policy (due to aversion to risk and obstacles in access to the sources of financing of operations), while on the other hand, limitation of demand for loans from enterprises and households (due to the more pessimistic perception of their prospects).

Limited possibility of administrative impact on banks' policy

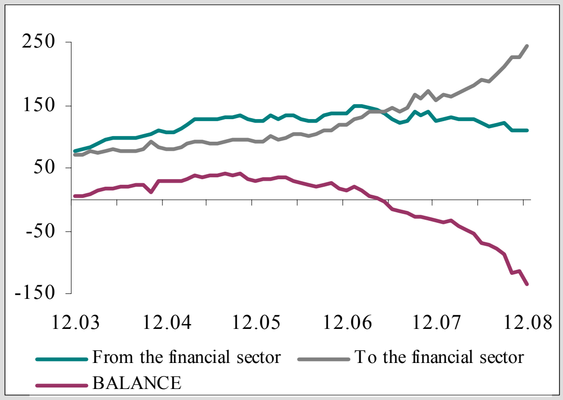
Potential increasing of lending activity

It seems that in the context of strong turbulence on global financial markets (in particular drop in confidence between financial institutions) and significant weakening of macroeconomic situation, banks have limited potential to increase their lending activity.

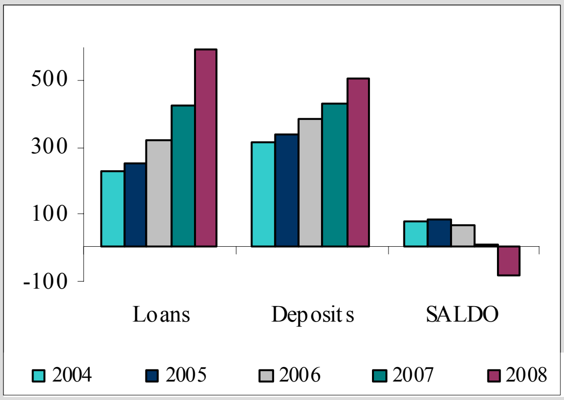
Loans and deposits (PLN billion)



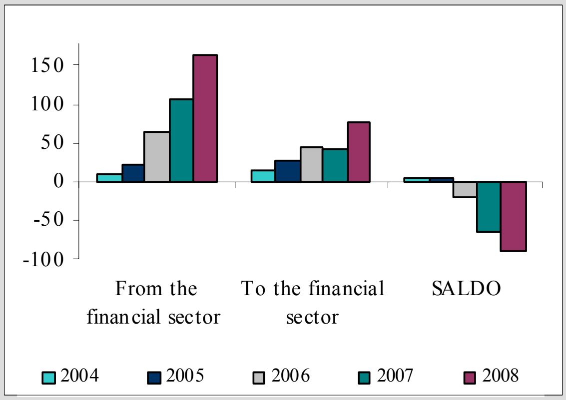
Amounts due from and owed to the financial sector (PLN billion)



Increase in amounts due from and owed to the financial sector (PLN billion)



Amounts due from and owed to non-residents (PLN billion)



Apart from external factors, another important element that limits the possibilities to develop lending activity are structural changes that have occurred in the last few years.

In years 2005-2008 banks invested significant funds in the financing of real property market (almost PLN 200 billion), in particular in mortgage loans (over PLN 170 billion). [45] On the one hand, this triggered strong development of construction sector, yet on the other hand it led to a rapid and fundamentally irrational increase in prices of real property and it was the main reason for the „exhausting" of deposit base. Fast growth of consumer loans (over PLN 80 billion) and dynamic development of lending activity for enterprises (over PLN 100 billion) had a similar effect.

Consequently to the lending boom noted in years 2005-2008 (in particular mortgage loans), there was an „exhausting" of deposit base, on the basis of which lending activity was developed, and it led to a situation where the banking sector has become a net creditor of the non-financial sector. Although by the end of 2007 the non-financial sector had a surplus in settlements with the banking sector (PLN 6.5 billion), at the end of 2008 this sector was its net debtor (PLN 81.4 billion).[46]

[45] Such loans often reached or even exceeded 100% of real property value (many banks offered loans for even 130% of real property value).
[46] Face value of loans for the non-financial sector exceeded the value of deposits of this sector already in mid-2007.

Banks' passing from being debtor to creditor in settlements with the non-financial sector is a structural change. This means that the potential for the financing of development of lending activity on the basis of non-financial sector deposits has become much limited. At present it is only possible to finance from increases in deposits and their potential decrease may imply the need to reduce lending activity. Consequently, lending activity development will depend on banks' ability to acquire new deposits of the non-financial sector and funds on the financial market, which will be a great challenge in the context of the crisis.

Moreover, the lending boom noted in the last few years was partly the consequence of expansion of foreign banks and branches of credit institutions, which used funds provided by their foreign owners. This was particularly visible in 2008. Although at the end of 2006 Polish banking sector had a surplus in settlements with non-residents, at the end of 2007 it was already their debtor. This tendency became even worse in 2008. This means that without foreign funds, such a strong expansion of lending in years 2007-2008 would have been impossible. What is even more important, one may draw a conclusion that banks' ability to acquire foreign funds will be one of the most important factors for the development of lending activity in 2009. However, acquisition of those funds may be difficult due to the drop in confidence between financial institutions, signals of protectionism and negative sentiments towards the countries of Central and Eastern Europe.

Therefore the question about real possibility to increase lending activity of banks in the coming periods is quite natural.

Financial plans indicate a strong increase in deposits of approx. 20%, but one should treat such figures with caution. Firstly, no such high growth had occurred in this decade. Secondly, macroeconomic assumptions adopted in many financial plans (GDP growth rate, unemployment rate, level of exchange rates) seem unreal in the context of the inflowing macroeconomic data. Thirdly, it seems that banks assume in their plans that not only will they acquire „new" deposits, but also they will manage to take over the part of competitors' deposits. Thus deposit base growth most probably will be definitely lower than it may seem from financial plans. Moreover, reduced NBP interest rates may translate into a drop in interest rates on deposits (although this is not obvious in the context of turbulence on financial markets), which with the probable decrease in inflation and the maintained uncertainty on the market may cause an outflow of the part of deposits. At the same time, a significant slowdown of economic growth (in an extreme situation of stagnation or recession) will be a factor that would much limit the inflow of new deposits.

Although banks have significant funds invested in Treasury and NBP securities (approximately PLN 160 billion), question remains which part of this portfolio may be floated on the market without losses and with adequate level of liquid assets, which is of particular importance in the context of turbulence on financial markets. In particular it should be noted that despite great value of securities portfolio, their share in assets (ca. 17%) is near the historical minimum levels.
In this context there is also the issue of financing of the budget deficit: banks are one of the main creditors of the State Treasury (they hold approx. 30% of portfolio of Treasury securities issued on the domestic market). Therefore one may ask who and at what price will purchase Treasury securities if banks abstain from their purchase. It is relevant, because with respect to the negative climate towards countries of Central and Eastern Europe and large borrowing needs of highly developed countries related to their anti-crisis plans, one may expect decreased demand for Polish Treasury securities from foreign investors.

To sum up, due to structural changes that had occurred in the last few years and deterioration of the macroeconomic situation and negative climate on the financial markets, one should expect limited possibilities of extension of banks' lending activity. The growth rate of lending activity will depend to a great extent on the financial condition of strategic investors of Polish banks and their potential for providing additional funding for the development of operations in Poland.
Particularly strong limitations will be most probably imposed with respect to long-term lending, i.e. investment loans and mortgage loans.

Limited possibility of administrative impact on banks' policy

Potential administrative impact on banks

When considering the calls for administrative stimulation of lending activity, one should keep in mind a number of aspects that must be taken into account when making their decisions:

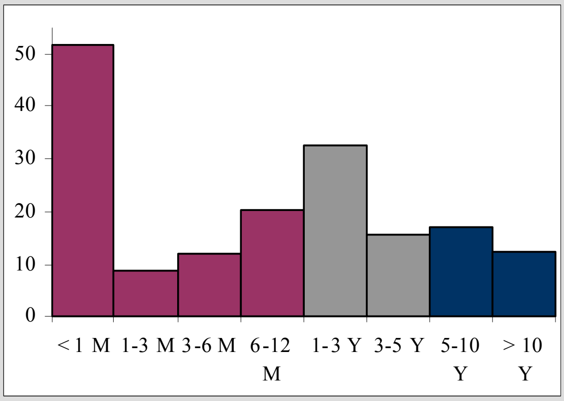
– Firstly, 80% of assets of Polish banking sector is held by private owners (mostly foreign). Therefore the impact of administrative bodies will most probably be limited. On the other hand, there is a potential impact on the activity of banks controlled by the State Treasury (accounting for approx. 20% of sector assets). Such banks could exerce pressure on their competitors, as well as seek to take over sound corporate clients for whom other banks have limited the financing potential. One should keep in mind, however, that those banks cannot be forced to finance weak enterprises or investment projects without any chances of success. In other words, they cannot bear excessive risk so as to avoid a situation where losses would need to be covered from public funds;
– secondly, one should remember that even though banks can be „forced" to increase their lending activity, in some time a great part of loans granted „under pressure" may turn out to be „irrelevant", which would trigger critical events;
– thirdly, influencing economic growth through the low interest rate policy does not guarantee an automatic return of the economy to the path of fast, strong growth (which was the case with Japan), while on the other hand this may lead to reduction of deposit base and investors seeking more risky and thus more profitable investments, which was one of the reasons for the present crisis in world economy. Moreover, NBP interest rate cuts need not necessarily translate into decreased interest rates on new loans (due to increased margins), and at the same time they may be the reason for significant depreciation of Polish currency, which may lead to significant deterioration of the quality of banks' loan portfolio, with all adverse effects for the stability and safety of the banking system

It should also be stated that the possibility of the PFSA impact on banks in order to enhance lending activity are much limited. In accordance with the Act on financial market supervision and the Banking Law, the main objective of banking supervision is to ensure security of funds accumulated on bank accounts and compliance of banking operations with legal provisions and decision on the issue of license for the establishment of a bank. Given its position, PFSA must then guard sector security, which would be at risk if banks loosened their lending standards too much. Considering this, PFSA must focus on measures aimed at ensuring safety and stability of the banking system, as well as at creation of a climate of mutual confidence between the participants of financial market. In particular, this should consist in the creation of tools limiting risk and measures aimed at strengthening capital situation of market participants.

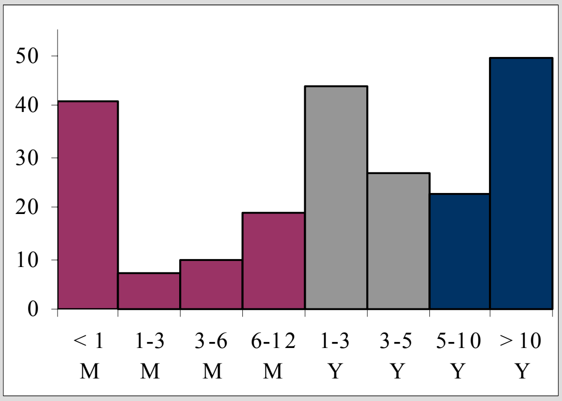
Therefore it seems that potential administrative impact in order to increase lending activity is limited and may have many adverse side effects. Thus potential administrative measures should mainly focus on building confidence between market participants, problem solving, as well as creation of adequate regulatory solution that would prevent critical events in the future.

In the context of measures aimed at stimulating lending activity, important role may be played by adequate system of guarantees and sureties (granted e.g. by BGK).
Measures that trigger lending activity, as well as enhance stability and safety of the banking sector, may also include proposal to liquidate or reduce tax burdens related to interest on bank deposits and taxation of capital gains. Although this would lead to a decrease in budget proceeds, on the other hand it could contribute to the growth of deposit base and tendency to invest on the capital market. Consequently, this might have a positive impact on lending activity and trigger the growth of corporate financing through capital market. In particular, liquidation of tax on deposits with maturities exceeding 1 year would be desirable, since it would be an incentive to make long-term savings and it would contribute to the stability of the banking sector. On the other hand, one should approach the subject of proposed reduction of reserve requirements with care, since such an action would not necessarily translate into adequate stimulation of lending activity and at the same time it would reduce the liquidity buffer, which may be undesirable given the fact that situation on the financial market is difficult to forecast. Therefore, if MPC decided on taking such measures, this should be a process divided in time.

Structure of amounts due from enterprises by maturities(PLN billion) as of the end of 2008



Structure of amounts due from households by maturities(PLN billion) as of the end of 2008



In the context of weakening lending activity and macroeconomic conditions one should also note adequate construction of lending policy.

Therefore it should be suggested that banks focused mainly on ensuring adequate level of corporate financing, since it is vital for the functioning of the entire economy. Cutting enterprises off the loans may lead to fast deterioration of the condition of the economy as a whole, which would ultimately lead to deterioration of the condition of banks themselves. In particular, it is necessary to ensure funds for current operations and continuation of the commenced investment processes (in 2009 loans for enterprises, amounting to PLN 92.8 billion, are maturing).

In the first place, banks should ensure adequate level of financing of sound enterprises

Secondly, we should aim at ensuring balanced growth in consumer loans, which should mitigate the threats resulting from probable weakening of consumer demand. However, this should be done in the context of higher lending criteria, since the available data on the quality of those loans clearly indicate that negative events occur in respect of this portfolio that result from wrong lending policy and poor risk management in certain banks.

At the same time it seems that in the context of limited funds for the development of lending activity, one of the last objectives would be further extension of the mortgage loan portfolio. Lending policy in this respect was the main reason for the „exhausting" of deposit base, as well as contributed to the creation of one of the main areas of systemic risk, resulting from e.g. very high share of loans in foreign currencies. There was also a surge in prices on the real property market: the price became not the actual resultant of costs and margin, but rather of the demand power stemming from creditworthiness of customers and their tendency to borrow. This in turn led to significant debt of the part of households, which in the case of deterioration of financial situation may have adverse effects both for the banks and for the entire economy. Therefore tightening of lending policy in this respect (reduction of LtV, limitation of lending in foreign currencies and shortening of the crediting period), apart from the increase in the future portfolio quality, should lead to stabilisation of the situation on the real property market, illustrated e.g. by drop in prices to their fundamental value. Such a decrease would be favourable both for the consumers and for the long-term, stable economic growth and banking sector safety.

To sum up, at present it cannot be precisely determined to what extent the slowdown of lending activity would affect Polish economy. On the basis of available data and information, however, one may expect a significant slowdown of lending activity, which results from the tightening of banks' lending policy, reduced demand for loans from the part of enterprises and households, and limited potential to finance the development of lending activity.

IV. FINANCIAL RESULT AND PERFORMANCE

Higher financial results for the entire year, however, much worse results in Q4

Financial result

The relatively positive macroeconomic condition in the first half of 2008 and extension of the scale of banking sector operations were reflected in higher financial results of Polish banks in the first three quarters of 2008. However, in Q4 there was a strong deterioration of banking sector results.

Table 4.1

Main profit and loss account items (PLN million)

	2004	2005	2006	2007	2008	Change 2008/2007	
						PLN million	%
Net interest	16,562	18,542	20,702	24,339	29,946	5,607	23.0
Net commissions	8,270	7,537	9,142	10,998	11,324	326	3.0
Income from stocks, shares and other securities	352	802	1,107	967	1,511	545	56.3
Result of financial transactions	1,237	880	1,171	1,448	-785	-2,233	-154.2
Foreign exchange result	2,923	3,858	3,010	3,665	6,543	2,878	78.5
Profit on banking operations	29,343	31,619	35,131	41,416	48,629	7,213	17.4
Other operating income and costs	162	627	618	1,063	1,027	-36	-3.4
Administrative costs	16,527	17,549	18,997	21,772	24,805	3,033	13.9
Amortisation and depreciation	2,686	2,329	2,184	2,290	2,335	45	2.0
Net provisions and revaluation	2,378	1,581	1,667	1,713	5,231	3,518	205.3
Extraordinary profit (loss)	0	1	1	0	0	0	48.0
Gross profit (loss)	7,916	10,934	13,030	16,700	17,187	487	2.9
Net profit (loss)	7,141	9,110	10,697	13,642	13,935	293	2.1

Chart 4.1

Components of the financial result of the banking sector (PLN billion)

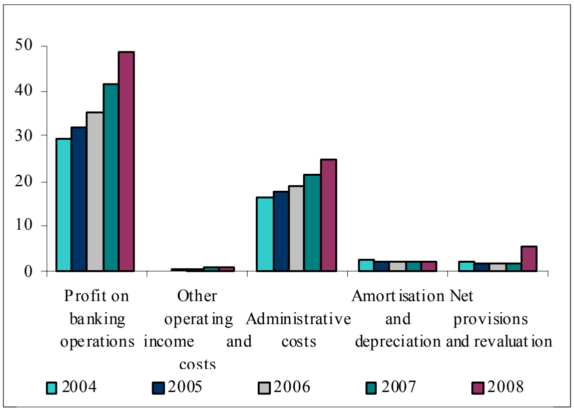
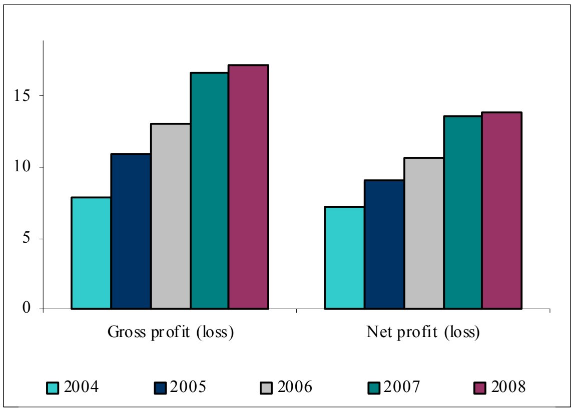


Chart 4.2

Gross and net profit (loss) of the banking sector (PLN billion)



According to preliminary data, in 2008, net financial result (net profit or loss) of the banking sector amounted to PLN 13.9 billion, which was the historical peak, but it was higher by only 2.1% (i.e. by PLN 0.3 billion) than in 2007. Better results of banks were mainly the consequence of the increase in net interest income and foreign exchange result.

Out of 649 banks and branches of credit institutions conducting operations, the majority reported better financial results than in 2007. 85 banks reported deterioration of financial results (22 commercial banks, 5 branches of credit institutions and 58 cooperative banks).

Only 16 entities reported a net loss amounting to the total of PLN 0.4 billion (6 commercial banks, 8 branches of credit institutions and 2 cooperative banks). However, it should be stated that over two thirds of losses were incurred by newly established banks and branches of credit institutions, and thus those institutions on the one hand incurred relatively high administrative costs, and on the other hand they reported low income, which is characteristic for the early stage of development.

Nearly 40% of the profit of the banking sector was generated by two largest banks: PKO BP and Pekao, which emphasises their dominant role in the system.

Chart 4.3
Components of the banking sector profit on banking operations in 2008 (PLN billion)

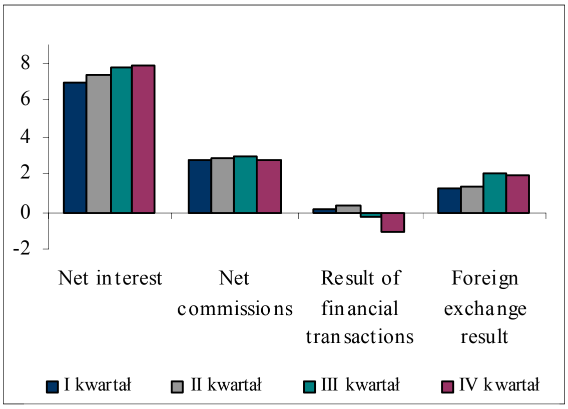
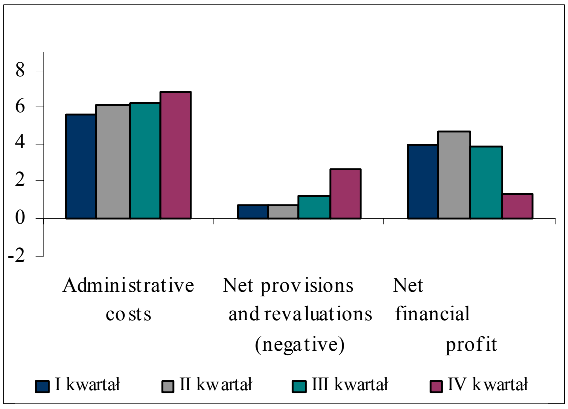


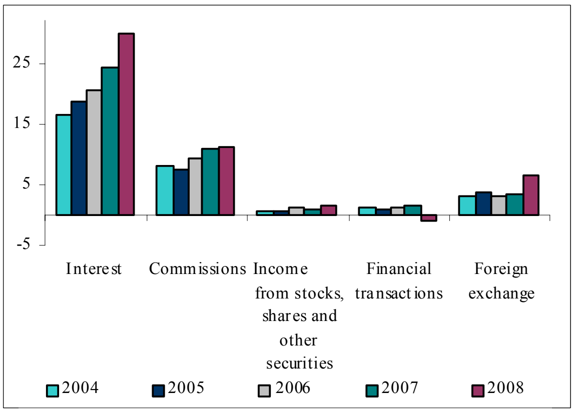
Chart 4.4
Costs, provisions and net profit of the banking sector in 2008 (PLN billion)



In Q4 of 2008 there was a strong deterioration of banking sector results. Net profit in that quarter (PLN 1.3 billion) accounted for only ca. 30% of the profit generated in each of the previous quarters of this year and was nearly 60% lower than in the corresponding period of 2007. It should be added that worse results concerned both commercial banks and cooperative banks. The scale of this phenomenon may be reflected to certain extent by the fact that no less than 73 banks reported a loss in that quarter (19 commercial banks, 10 branches of credit institutions and 44 cooperative banks).[47] Such a significant deterioration of results was the effect of the increased write-offs resulting from the deterioration of the financial standing of the part of borrowers, write-offs for derivative transactions in foreign currencies (PLN 1.4 billion), write-offs made by PKO BP for their operations in Ukraine, book loss of ING BSK on eurobond portfolio and increased administrative costs.

Very poor Q4 due to the increase in write-offs for non-performing loans and derivative transactions

Chart 4.5
Banking sector profit on banking operations (PLN billion)



Profit on banking operations increased by 17.4% (from PLN 41.4 billion in 2007 to PLN 48.6 billion in 2008). The rise mainly resulted from:

– higher income from interest by 23.0% (from PLN 24.3 billion to PLN 29.9 billion), and
– foreign exchange result by no less than 78.5% (from PLN 3.7 billion to PLN 6.5 billion). The higher foreign exchange result was supported by the increase in the portfolio of denominated and currency loans, as well as by extension of spread related to depreciation of Polish currency, thanks to which the result

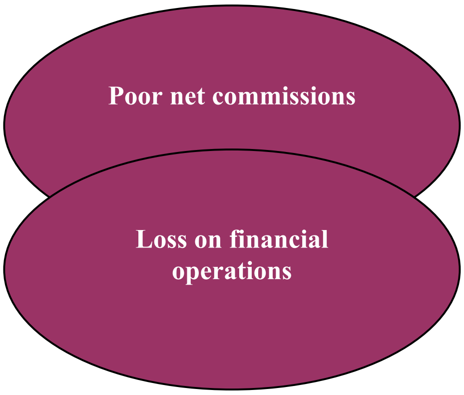
High net interest

Very good foreign exchange result

[47] Only in a few cases could this be considered a loss resulting from early stage of development.

generated in the second half of 2008 was higher by over 50% than the result generated in the first half of the year.

The impact of the remaining items in generating profit on banking operations was slight or negative, whereas it should be pointed out that:



- minimum increase in net commissions compared to previous years (by 3.0% from PLN 11.0 billion in 2007 to PLN 11.3 billion in 2008). Low growth rate can also be explained by higher competition, slowdown of lending activity at year-end and unfavourable situation on the capital market, resulting in decrease in banks' income from the sales of participation units in investment funds, fees for assets management and intermediation in trading in financial instruments;
- loss on financial transactions amounting to PLN 0.8 billion (against PLN 1.4 billion profit in 2007), incurred in the second half of 2008, that much resulted from negative valuation at fair value of derivative transactions in foreign currencies and bonds (in Q4 alone the loss amounted to PLN 1.1 billion).

Chart 4.6
Structure of interest income of the banking sector (PLN billion)

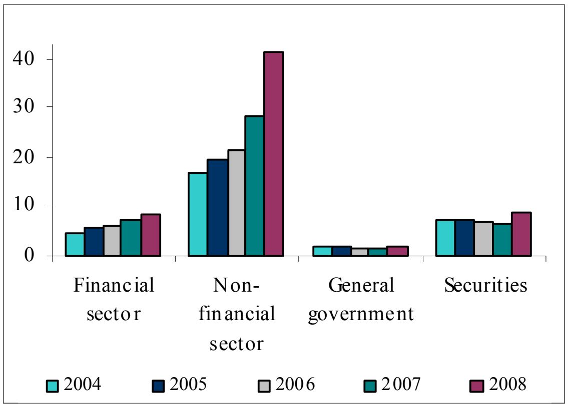


Chart 4.7
Structure of interest costs of the banking sector (PLN billion)

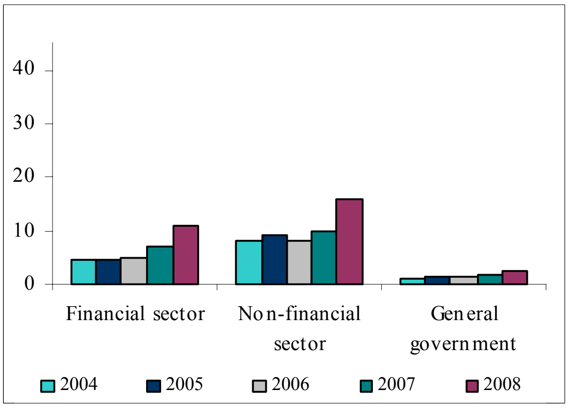
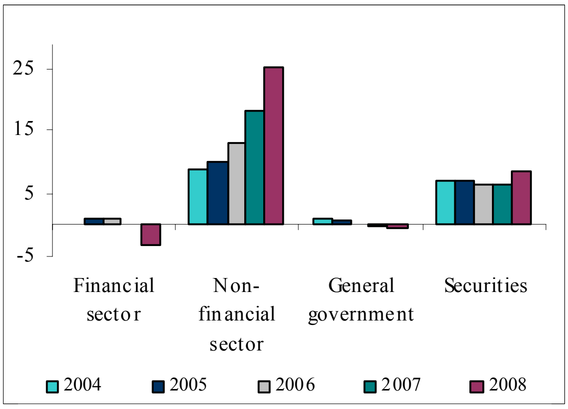


Chart 4.8
Net interest in particular sectors (PLN billion)



Net interest increase resulted from significantly better result on operations with the non-financial sector (which increased by 38.1% from PLN 18.3 billion to PLN 25.2 billion), thanks to increased volume of loans and their interest. Although these factors also caused an increase in interest rates on bank deposits, due to the fact that interest rates on deposits are lower (in particular in the case of current deposits which account for nearly one half of the portfolio), total increase in interest costs (by PLN 6.1. billion) was definitely lower than the increase in interest income (by PLN 13.0 billion). Also the extension of the portfolio and improvement of profitability of securities contributed to such a result (interest in this respect rose by 34.5% from PLN 6.4 billion to PLN 8.6 billion). On the other hand, very high increase in liabilities towards the financial sector (effect of the higher lending activity) resulted in deterioration of the negative interest result on operations with this sector (from PLN 0.1 billion to PLN 3.1 billion).

Chart 4.9
Administrative costs and amortisation/depreciation (PLN billion)

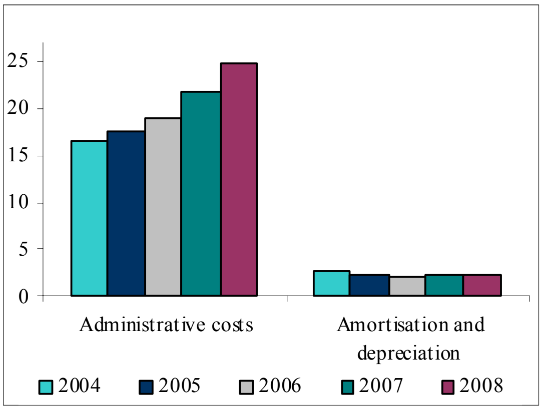
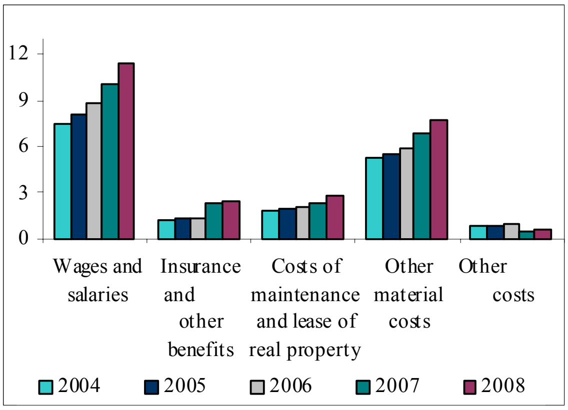


Chart 4.10
Structure of administrative costs (PLN billion)



Fast development of operations caused a 13.9% increase in administrative costs of the banking sector (i.e. from PLN 21.8 billion to PLN 24.8 billion). The main reason for the rise in costs was increasing personnel costs, which, including social insurance costs and other employee benefits, rose by 12.4% (from PLN 12.3 billion to PLN 13.8 billion). Higher personnel costs resulted from higher employment and general rise in wages and salaries in the national economy, which forced banks to increase salaries (competitive pressure). The extension of the scale of operations (including sales networks) and launching operations in new banks and branches of credit institutions resulted in the 20.7% increase in costs of maintenance and lease of real property and in the 14.9% increase in other material costs. The share of other costs was insignificant.
Amortisation and depreciation (PLN 2.3 billion) was at the level similar to that in the previous years.

Chart 4.11
Net provisions and revaluation (PLN billion)

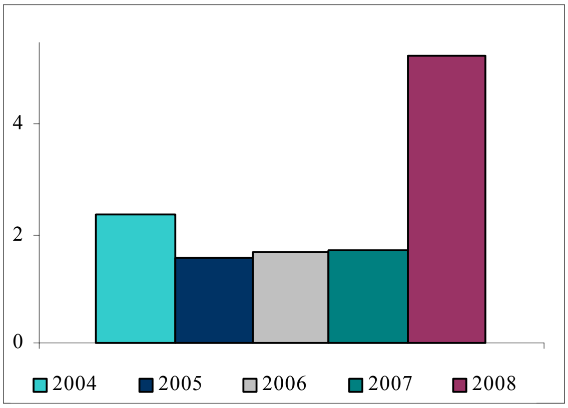
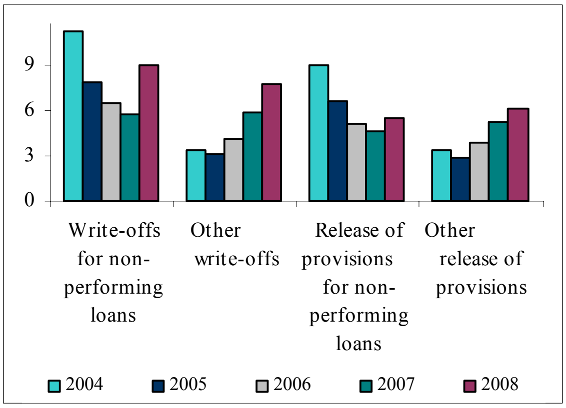


Chart 4.12
Write-offs and release of revaluation reserves (PLN billion)



Loosened lending standards implied the increase in net provisions and revaluations

A nearly tripled negative balance of provisions/impairment write-offs is alarming, from PLN 1.7 billion in 2007 to PLN 5.3 billion in 2008 (of which PLN 2.6 billion in Q4 of 2008), which is the highest figure since 2002.Such a high increase in negative balance of write-offs was the effect of considerable growth of loan portfolio and the noted loosening of lending policy by certain small and medium-sized banks and branches of credit institutions, which in the last few periods conducted very aggressive lending policy aimed at gaining the highest possible market share. This is confirmed e.g. by the fact that many small and medium-sized entities reported higher negative balance of write-offs/provisions than much larger banks. High level of write-offs should be explained by the increase in non-performing consumer loans, as well as deterioration of the part of mortgage loan portfolio. Certain banks also noted a considerable increase in write-offs resulting from the deterioration of the financial condition of the part of corporate clients, which confirms that economic conditions dampened in certain economic areas. Moreover, banks had to create write-offs for derivative transactions in foreign currencies

and for capital investments in countries of our region. Consequently, in 2008 provisions/write-offs absorbed 10.8% of profit on banking operations against 4.1% in 2007.
However, it should be added that it is uncertain whether all banks have applied an adequately conservative approach and created sufficient provisions for the coverage of all risks.

Chart 4.13
Components of the financial result of commercial banks (PLN billion)

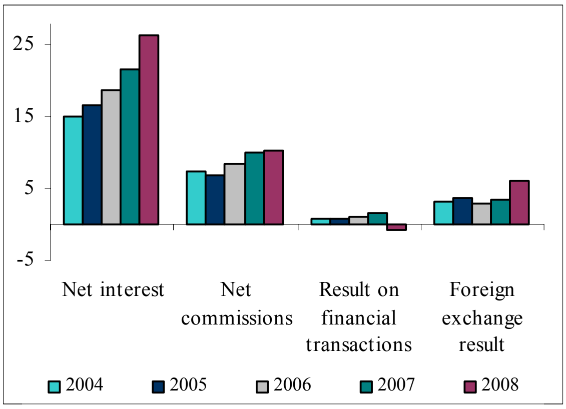


Chart 4.14
Components of the financial result of commercial banks (continued) (PLN billion)

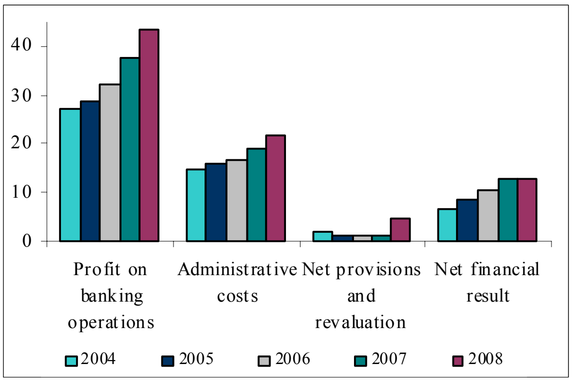


Chart 4.15
Components of the financial result of branches of credit institutions (PLN million)

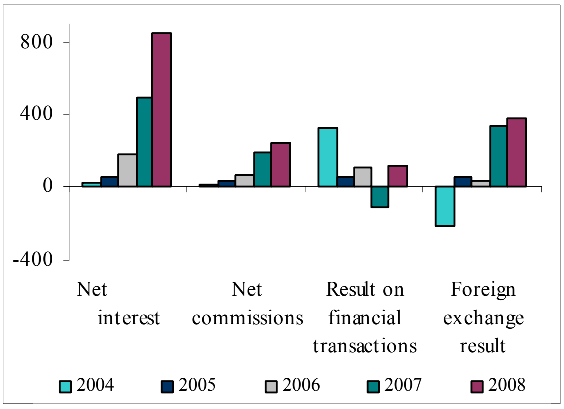


Chart 4.16
Components of the financial result of branches of credit institutions (continued) (PLN million)

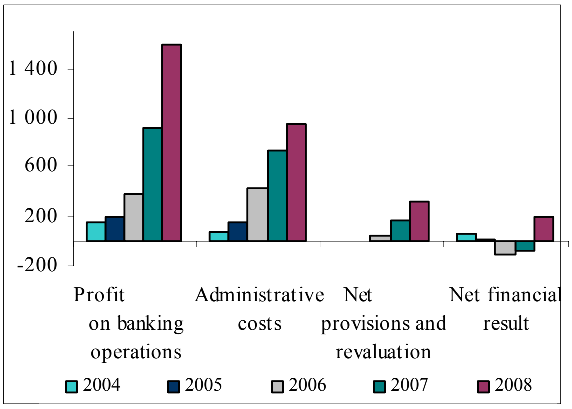


Chart 4.17
Components of the financial result of cooperative banks (PLN million)

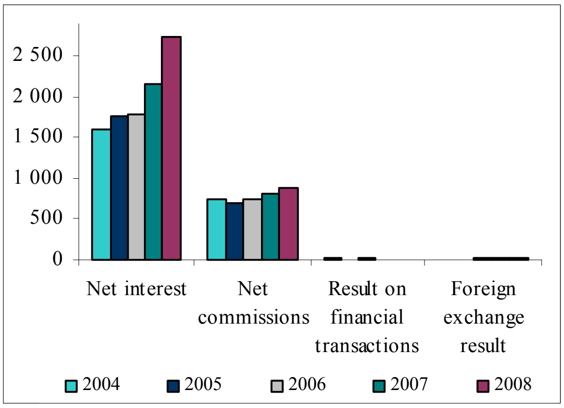
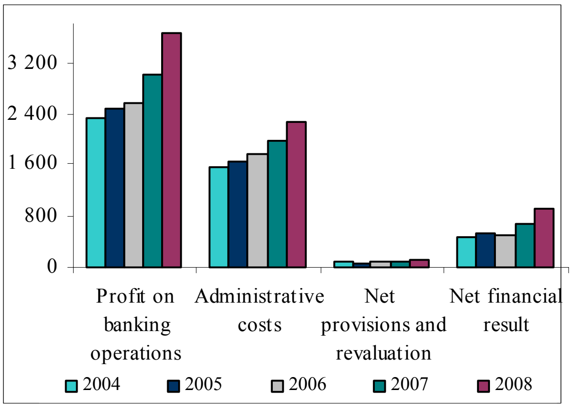


Chart 4.18
Components of the financial result of cooperative banks (continued) (PLN million)



As far as particular groups are concerned:

– net financial result of commercial banks increased by 1.7% (from PLN 13.0 billion to PLN 12.8 billion), due to the lower result on financial transactions (by by PLN 2.4 billion), low increase in net commissions and the fact that the negative balance of provisions/write-offs tripled (from PLN 1.5 billion to PLN 4.8 billion);

- unlike in years 2006-2007, branches of credit institutions reported net financial profit (PLN 0.2 billion compared to PLN 0.1 billion of loss in 2007). However, taking into account the aggressive policy of certain institutions and the related fact that the negative balance of provisions/write-offs almost doubled, question remains whether this group would hold this position in the coming periods;
- cooperative banks remained in the relatively best condition. Their net financial result increased by 33.8% (from PLN 0.7 billion to PLN 0.9 billion) due to e.g. the increase in interest rates noted throughout most of the year (great part of loan portfolio is connected with NBP interest rates). Banks from this group also reported the lowest growth rate of negative balance of provisions/write-offs, which can be explained by conservative business model of those institutions (which is indirectly confirmed by the structure of the result on banking operations, almost the total of which consists in net interest and net commissions).

Performance

Despite lower profits in Q4 the banking sector maintained high performance

Despite very poor results in Q4, throughout 2008 banks managed to maintain high performance or even improved it in certain areas.

Chart 4.19[48]
Net Interest Margin (%)

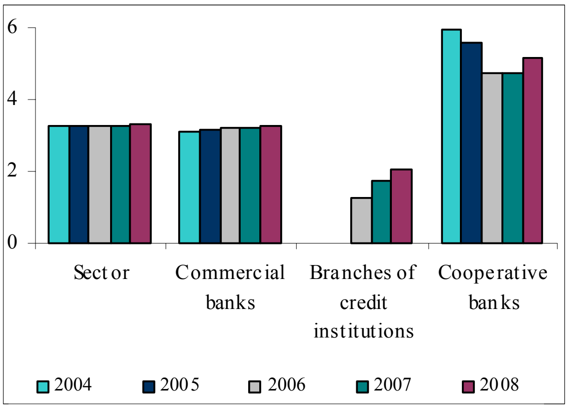


Chart 4.20[49]
Cost-Income Ratio (%)

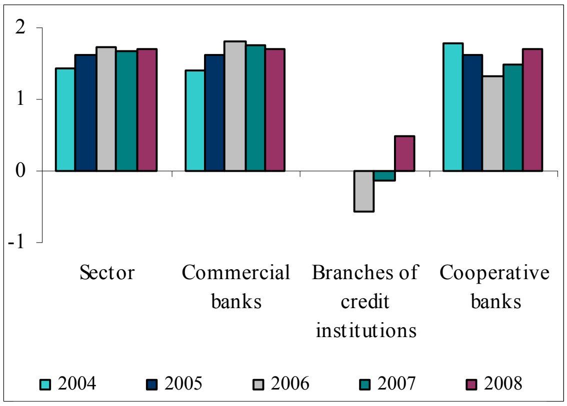


Chart 4.21[50]
ROE (%)

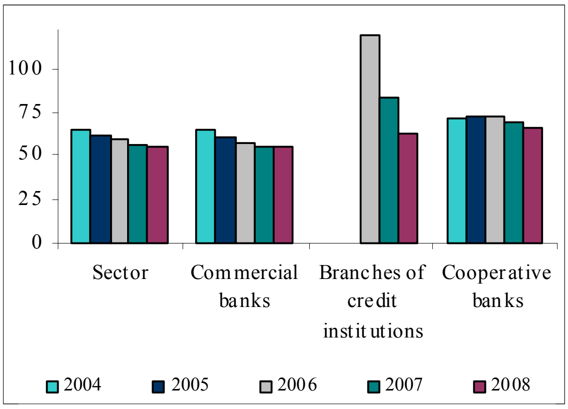
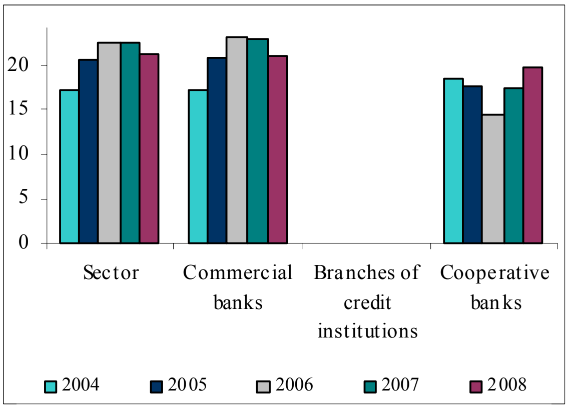


Chart 4.22
Gross profit (loss) / 1 employee (PLN thousand)



In particular, Cost to Income ratio improved, decreasing from 56.3% to 54.7%. Similarly to the previous years, the highest performance in this respect was reported by commercial banks (53.4%), whereas improvement for cooperative banks should also be noted (decrease from 69.2% to 65.7%).
Thanks to interest rate increase, Net Interest Margin (NIM) rose from 3.3% in 2007 to 3.4% in 2008. Similarly to the previous years, the highest margin was generated by cooperative banks (5.2%), which was the effect of NBP

48 Relationship between net interest to average assets.
49 Relationship between operating costs (administrative costs and amortisation/depreciation) and the profit on banking operations adjusted for the result on other operating income and costs.
50 Relationship between net profit (loss) to average core capital (funds).

interest rate increase (in the first half of the year) and lower competitive pressure. The lowest margin was reported by branches of credit institutions (2.1%), which may be explained by aggressive policy aimed at acquiring considerable market share, as well as high share of branches focused on corporate clients. However, these trends changed significantly at the end of the year, when banks, consequently to the change in assessments of macroeconomic prospects, much increased their risk premium being a component of interest margin for credit products.
Return On Equity (ROE) dropped to 21.2% (from 22.5% in 2007), which means, however, that it remained at a high level noted in the previous years. It should be noted that this ratio slightly decreased in the commercial banking sector (from 22.9% to 21.0%), while it increased in cooperative banks (from 17.2% to 19.6%). It was partly the effect of the launching of operations by new banking sector entities, Alior Bank and Alianz Bank.

Profit sharing

According to information on profit sharing for 2008, the majority of commercial banks decided to leave total profits at bank and to allocate them to capital; in accordance with the plans of management boards of 24 commercial banks which generated 80% of net profit of the banking sector (those banks accumulated nearly 70% of sector assets), 99% of profits is to be allocated to capital, while only less than 1% to dividend payment.
Considering visible deterioration of prospects of development for Polish economy, as well as the noted decrease in the average capital adequacy ratio, such measures should be considered positive.

To sum up, according to preliminary data (before audit), the banking sector achieved in 2008 slightly better results than in 2007. However, due to the deterioration of financial condition of the part of borrowers and the related high write-offs (also related to derivative transactions in foreign currencies) as well as considerable increase in the cost of financing of operations in Q4 of 2008 there was a slump in results of the banking sector.

Banks' forecasts show that in 2009 they are expecting financial result that is lower by ca. 5%. However, considering the current prospects of development for Polish economy and the results achieved in the first two months of 2008, those plans would need to be verified, both in terms of possible scale of operations and the resulting performance, which will probably translate into greater decrease in financial results of the banking sector. The financial result of this sector in 2009 may be also affected by valuation and write-offs for derivative transactions in foreign currencies, approximately 70% of which will mature this year.

V. MAIN AREAS OF RISK

Liquidity risk

Banking sector liquidity remains satisfactory. The major source of the risk of liquidity loss is the mismatch between contractual maturities of assets and liabilities[51] and turbulence on global financial markets. Consequently to the escalation of the financial crisis and further decrease in confidence between market participants there was a limitation of market liquidity and practical elimination of transactions with longer maturities. This was also visible in Poland.

Chart 5.1
Maturities of banking sector assets (PLN billion)

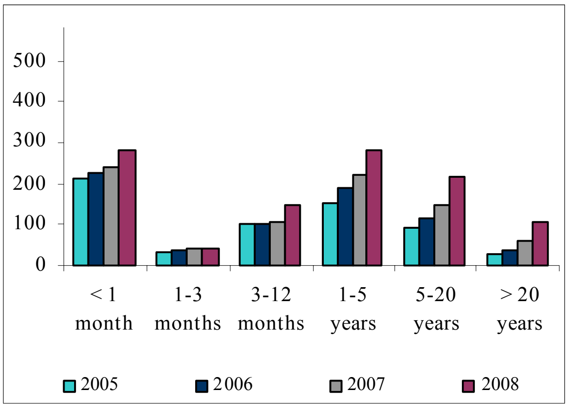


Chart 5.2
Maturities of banking sector liabilities (PLN billion)

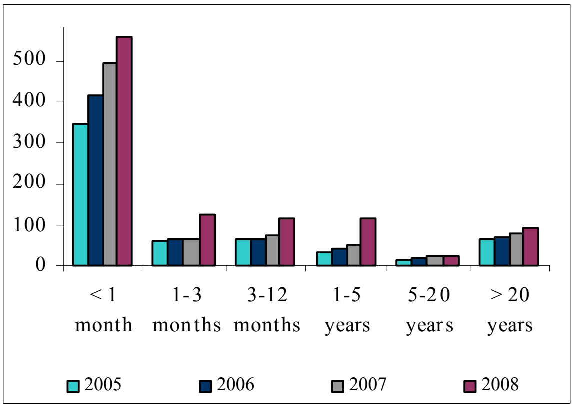


Chart 5.3
Gaps in individual payment ranges (PLN billion)

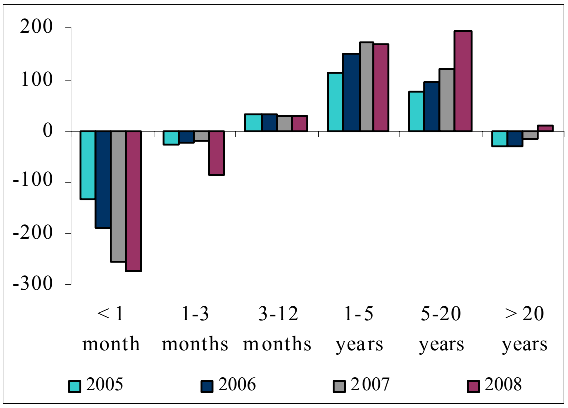


Chart 5.4
Selected liquidity measures for the banking sector (PLN billion)

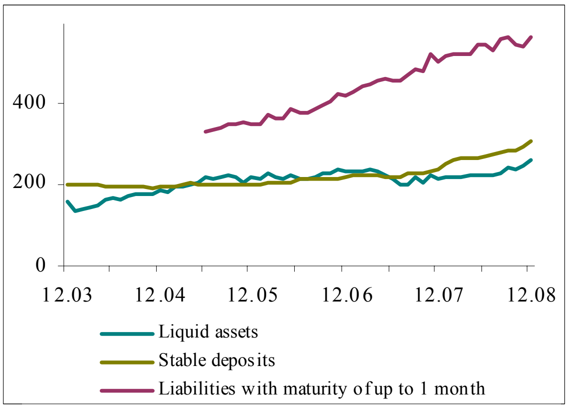
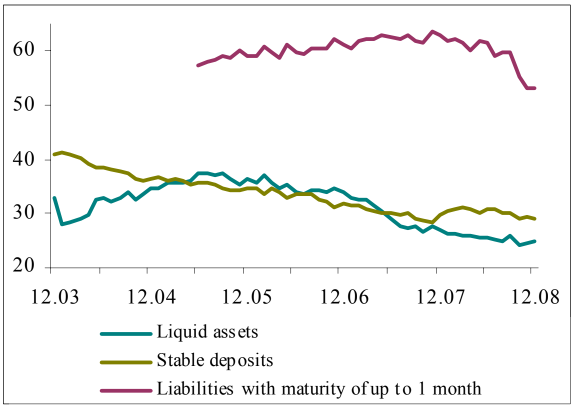


Chart 5.5
Share in the balance sheet total of the banking sector (%)



[51] It must be borne in mind that one of the fundamental functions of banks is to adjust the structure of money demand and supply.

Despite the relatively stable situation in respect of liquidity, the following negative aspects should be mentioned:

- increased mismatch between assets and liabilities with the maturities of up to 1 month and over 1 year. The negative gap[52] for up to 1 month increased from PLN 257.0 billion at the end of 2007 to PLN 274.1 billion at the end of 2008, and the positive gap for over 1 year – from PLN 277.8 billion to PLN 368.8 billion.[53] The increase in the mismatch was a consequence of the very fast growth of lending, which was developed mainly on the basis of short-term liabilities and the liquidation of part of liquid assets (mainly amounts due from the financial sector[54]). As a consequence, the structure of the sources of financing for the development of activities deteriorated in terms of stability;
- the already discussed fast growing negative balance in settlements with the financial sector, resulting from expansive lending policy. Consequently, liquidity decreases and sensitivity to situation on financial markets increases. However, as it has already been mentioned, the majority of funds obtained on the financial market comes from parent companies and is often of long-term nature. This results in limitation of liquidity risk, although it makes the subsidiary dependent on the financial standing of the parent company. In this context it must be added that the majority of entities controlled by foreign financial institutions have declared liquidity support from their parent companies and to date those institutions have been supporting Polish entities (even despite their own financial problems). It must be also borne in mind that in the case of a majority of Polish subsidiaries, their position in the entire group is marginal. Therefore, unless the situation of the parent company deteriorates significantly, Polish subsidiaries should not encounter any problems in obtaining support, because the possible failure to grant such support exposes parent companies to the risk of the loss of reputation.

Alarming growing dependence on funds from financial market and lack of confidence among market participants

Positive aspects include the increase in stable deposits by 28.6% (from PLN 235.1 billion at the end of 2007 to PLN 302.4 billion at the end of 2008) and in liquid assets by 21.2% (from PLN 212.7 billion to PLN 257.8 billion), as well as increase in the ratio of coverage of liabilities with maturities of up to 1 month with liquid assets (from 42.6% to 46.4%). The growth of stable deposits[55] occurred thanks to a more attractive deposit offer and recession on the capital market, while increase in liquidities can be explained by higher aversion to risk resulting in a shift towards liquid and secure investments. Despite the increase in value, the share of both items in the balance sheet total slightly lowered (to 24.7% and 29.0% respectively).

Further increasing of long-term stable sources of financing is desirable

At present, the main source of liquidity risk for the banking sector are turbulences on the global financial market, which are reflected at the national level as lower confidence between financial institutions, which leads to reduced trading on the interbank market, as well as restriction of exposure limits for certain entities or financial instruments and shortening of deadlines of the concluded transactions. All this leads to obstacles in current liquidity management and risk hedging, as well as emphasises the need to focus on obtaining long-term and stable sources of financing. It should be added that, as it has already been mentioned, measures taken by MoF, NBP („Confidence Package") and PFSA may improve the situation only to a limited extent and the crucial role in restoring confidence on the market must be played by banks themselves and their professional organisations.

At present main source of risk is the turbulence on the interbank market

[52] The gap consists in the difference between assets and liabilities with a given maturity period.

[53] An analysis based on measures established on the basis of contractual maturity dates does not take into account a range of factors, among others, deposit base, the liquidity of instruments available for sale, access to external sources of financing (e.g. line of credit, support from the parent institution, or the possibility of refinancing at the central bank). Yet despite the many drawbacks, it shows phenomena to which attention should be paid.

[54] As it has already been mentioned, turbulence on financial markets had major impact on reduction of amounts due from the financial sector, since they caused banks' aversion to grant loans to each other and reduction of the granted limits.

[55] Despite the taken measures, deposits with maturities exceeding 1 year remain marginal among the sources of financing of banks' operations (at the end of 2008 they accounted for mere 1.6% of the balance sheet total).

In January 2008, Resolution of the Commission for Banking Supervision No. 9/2007 on establishing mandatory standards of bank liquidity entered into force, whereas by 29 June 2008 banks and branches of credit institutions were not obliged to comply with the limits referred to in the Resolution.

Chart 5.6
Breakdown of banks with assets exceeding PLN 200 million by liquidity measures

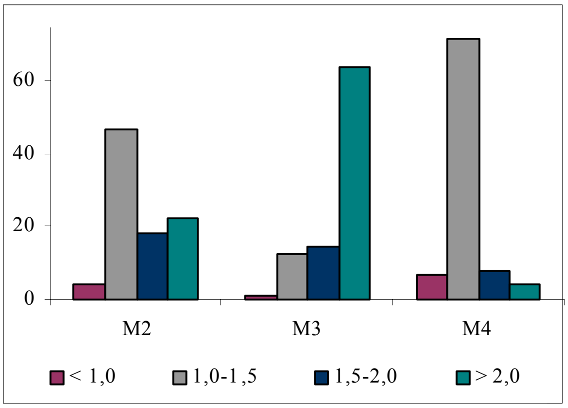


Chart 5.7
Breakdown of banks with assets below PLN 200 million by liquidity measures

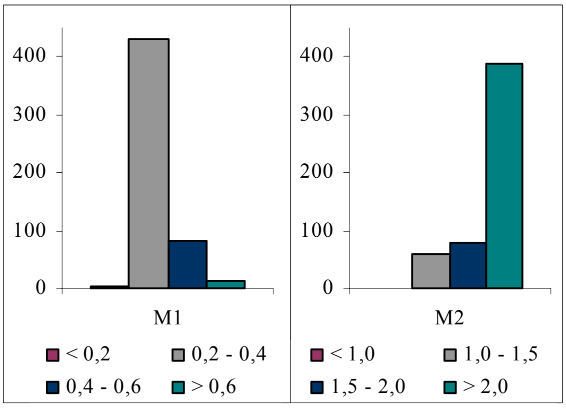
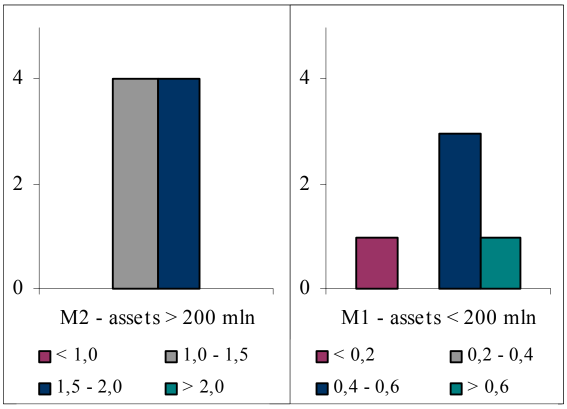


Chart 5.8
Breakdown of branches of credit institutions by liquidity measures



On the basis of analyses to date it can be stated that most banks (including all systemically important banks) and branches of credit institutions comply with the imposed standards. [56] Only 13 banks (2 commercial banks, 10 cooperative banks and 1 branch) did not comply with the requirements stipulated by Resolution, but their total share in sector assets accounted for mere 0.5%.

To sum up, current liquidity situation of the banking sector is satisfactory and the main source of risk are turbulences in the functioning of the interbank market, reflected e.g. by reduced mutual confidence between market participants, lower mutual limits and shortened transaction periods, which is a considerable obstacle in liquidity management.

[56] See Resolution of the Commission for Banking Supervision No. 9/2007 on establishing mandatory standards of bank liquidity.
For banks with balance sheet total exceeding PLN 200 million: short-term liquidity gap (minimum value 0); M2 – short-term liquidity ratio (minimum value 1); M3 – ratio of coverage of non-liquid assets with equity (minimum value 1); M4 - ratio of coverage of non-liquid assets and assets with limited liquidity with equity and stable external funds (minimum value 1). For banks with balance sheet total below PLN 200 million: M1 – ratio of share of primary and supplementary liquidity reserve in total assets (minimum value 0.2); M2 – ratio of coverage of non-liquid assets with equity (minimum value 1).
For branches of credit institutions with balance sheet total exceeding PLN 200 million: short-term liquidity gap (minimum value 0); M2 – short-term liquidity ratio (minimum value 1).For branches of credit institutions with balance sheet total below PLN 200 million: M1 - ratio of share of primary and supplementary liquidity reserve in total assets (minimum value 0.2).<.

Credit risk

Reversed donward trend of the value of non-performing loans

Amounts due from the non-financial sector remain the main source of credit risk. They constitute 97.8% of total non-performing loans, while non-performing loans of the financial sector – only 1.9%, and those of the general government – 0.3%. However, at the end of the year another credit risk factor appeared to a much greater extent than before that was related to banks' involvement with derivative transactions in foreign currencies with clients. This risk results from potential risk that the client fails to repay his contractual liabilities towards the bank due to deteriorating economic environment - loss or postponement of export currency inflows and in extreme cases, due to speculative nature of transaction.

Table 5.1

Non-performing loans to the non-financial sector (PLN million; face value)

	2004	2005	2006	2007	2008	Change 2008/2007	
						PLN billion	%
Total, of which:	35,002	29,047	24,231	22,713	26,804	4,092	18.0
Commercial banks	33,665	27,789	22,958	21,622	25,208	3,586	16.6
Branches of credit institutions	409	337	373	241	695	454	188.6
Cooperative banks	929	921	901	850	901	51	6.0

Chart 5.9
Total non-performing loans to the non-financial sector (PLN billion)

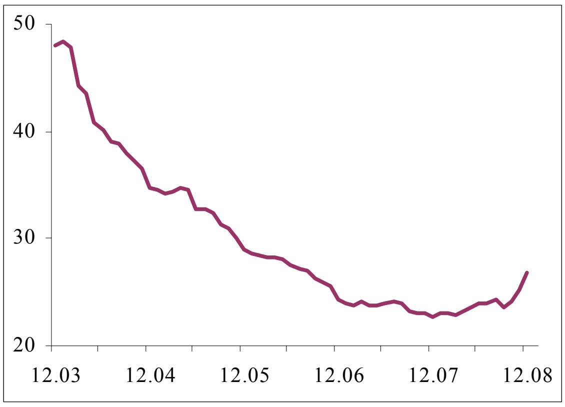


Chart 5.10
Share of non-performing loans in total receivables (%)

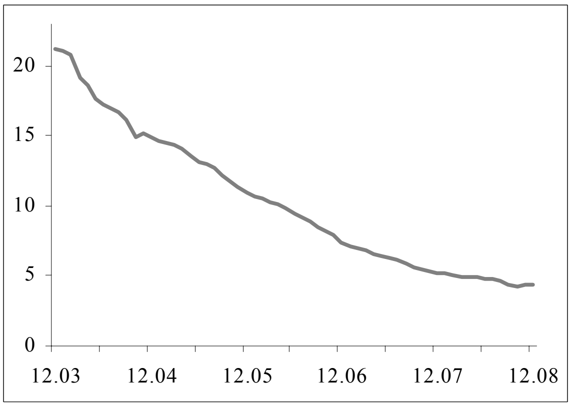


Chart 5.11
Non-performing loans to the non-financial sector (PLN billion)

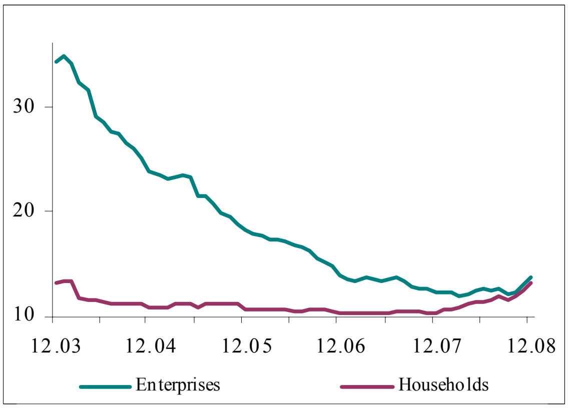
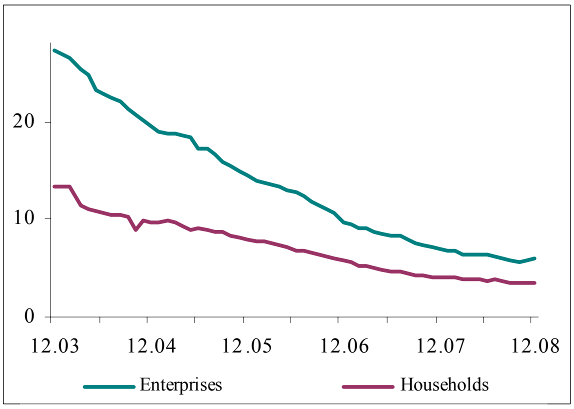


Chart 5.12
Share of non-performing loans in total receivables (%)



Very fast growth of lending activity noted in the last few years, combined with excessive loosening of lending policy standards and deterioration of macroeconomic situation in the second half of 2008 caused an increase in non-performing loans from the non-financial sector[57] in 2008 by 18.0% (from PLN 22.7 billion at the end of 2007 to PLN 26.8 billion at the end of 2008).

The increase in non-performing loans was caused by a 25.3% increase in non-performing loans of households (from PLN 10.4 billion to PLN 13.1 billion), whereas non-performing loans of enterprises rose by only 12.4% (from PLN 12.2 billion to PLN 13.7 billion). This also seems to confirm the hypothesis that lending standards in retail banking were too loose. It should be noted that at the end of 2008 non-performing loans of households considerably exceeded the level of PLN 10-11 billion, which was maintained in years 2004-2007.Moreover, given the general deterioration of economic conditions, one may fear that such receivables will increase even more in the coming periods.

High increase in non-performing loans and „watch list" loans for households

Considering individual groups of banks, one may state that the highest (nearly triple) increase in non-performing loans related to branches of credit institutions operating on retail market, which may be explained by very expansive lending policy of certain entities in this group. This confirms the general rule that if banks report rapid development, it usually occurs with loosened creditworthiness assessment standards for borrowers.

Due to very fast development of loan portfolio, despite the increase in non-performing loans, their share in total receivables decreased from 5.2% at the end of 2007 to 4.4% at the end of 2008 [58] (enterprises, from 6.9% to 5.9%, households, from 4.1% to 3.5%).However, due to visible symptoms of weaker economic conditions and probable slowdown in the growth rate of lending activity, in the coming periods we may expect deterioration of loan portfolio quality measured by share of non-performing loans in total receivables. This is confirmed by Q4 of 2008, when despite very high nominal growth of the value of loans, the increase, albeit minimum, in the share of non-performing loans in total receivables was noted.

Chart 5.13
Non-performing loans to households (PLN billion)

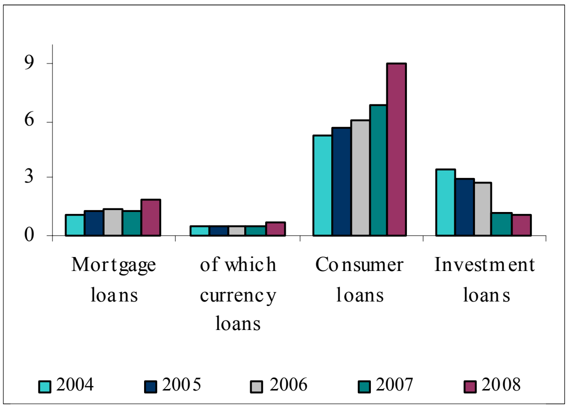
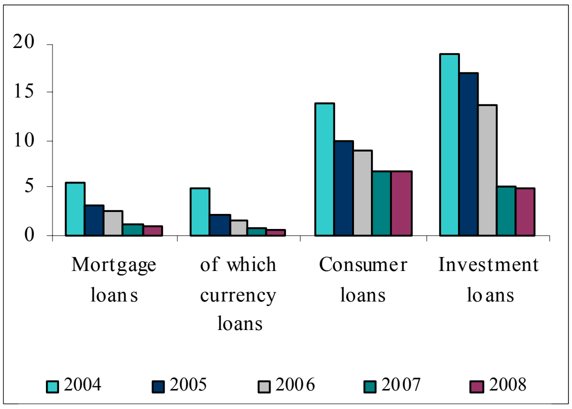


Chart 5.14
Share of non-performing loans in total loans (%)



On account of the dominant position of retail banking, the analysis of the quality of the loan portfolio for this group of customers becomes particularly important. Therefore, the following should be established:

– relatively high quality of the mortgage loans portfolio measured by the share of non-performing loans in total loans – at the end of 2008 the share of non-performing loans accounted for 1.0% against 1.2% at the end of 2007. This may be explained by several factors. The nature of those loans appears to be of key importance. In the case of most customers, they are taken out for their own residential needs. As a consequence, such loans are among those best repaid, since if needs be, households strive to limit other expenditure in order to prevent the loss of their own apartment. Equally important are higher requirements

[57] The definition of non-performing loans is included in the Ordinance of the Minister of Finance of 10 December 2003 concerning the principles for establishing provisions against operational risk. Setting aside the exceptions (see the detailed provisions of the Ordinance), non-performing loans cover credit exposures in the case of which the delay in repayment exceeds 3 months (6 months for retail loans) and/or the circumstances of the borrower indicate that the timely repayment may be at risk. Banks which apply the IFRS establish receivables at risk of impairment in accordance with the provisions of IAS 39, taking into account the good practices included in Recommendation R regarding the identification of impaired receivables and establishing write-downs on them. Then, for reporting purposes, they translate the results obtained into categories which are closer to those defined in the Ordinance of the Minister of Finance.

[58] In commercial banks they decreased from 5.5% to 4.7%, in branches of credit institutions increased from 1.5% to 2.3%, and in cooperative banks decreased from 3.0% to 2.8%.

Increase in non-performing mortgage loans, in particular in foreign currencies

regarding creditworthiness verification and noticeable improvement in the financial standing of households that has occurred in recent years, as well as PLN appreciation until mid-2008, resulting in reduction of currency loan servicing costs. Finally, one should keep in mind that the majority of those loans are loans with very short „history'.

Despite the low share of non-performing loans, a number of alarming aspects must be pointed out. Firstly, the value of non-performing mortgage loans increased by 43.5% (from PLN 1.4 billion at the end of 2007 to PLN 2.0 billion at the end of 2008). Secondly, the portfolio of non-performing mortgage loans in foreign currencies increased by 59.3% (from PLN 0.5 billion to PLN 0.8 billion), whereas in PLN by 35.1% (from PLN 0.9 billion to PLN 1.2 billion). Thirdly, a particularly alarming signal is the increase in „watch list loans"[59] by 86.3% (from PLN 2.0 billion to PLN 3.7 billion), whereas, again, the highest growth rate was reported in respect of loans in foreign currencies. It should be added that the growth rate of non-performing loans and „watch list" loans intensified in Q4 of 2008. In particular „watch list' loans increased by no less than 78.4% in this quarter (by PLN 1.0 billion), i.e. much more than CHF increase against PLN (29.1%). All these symptoms confirm the growing number of clients who face temporary problems or are unable to settle their liabilities. Given the further depreciation of PLN noted at the beginning of 2009 and deterioration of situation on the labour market, one may fear that the part of „watch list" loans will become non-performing loans;

Negative trends in consumer loan portfolio of certain medium-sized banks and branches

- increase in non-performing consumer loans by 33.5% (from PLN 6.7 billion at the end of 2007 to PLN 9.0 billion at the end of 2008), which constitute the main item among the non-performing loans to households. Although the quality of those receivables as measured by the share of non-performing loans in total receivables remained at the 2007 level, that is a consequence of the fast increase in the value of those loans. The fact that the value of „watch list' loans doubled (from PLN 0.8 billion to PLN 1.6 billion) is also negative. This indicates that the lending policy of some banks has become too loose in that segment of the market. It should be pointed out that over 70% of the increase in non-performing consumer loans was generated by 9 small and medium-sized bans and branches of credit institutions, which conducted aggressive lending policy in the last few years;
- improved quality of investment loans, which reflects the overall improvement in the macroeconomic situation in recent years, as a result of which the condition of small enterprises (which are often family-based), which are the main entities taking such loans, has improved as well.

Concerns regarding materialisation of risk related to exchange rate and deterioration of labour market conditions

Despite the relatively high, at present, quality of the portfolio of mortgage loans, it must be borne in mind that the majority of those loans have a very short "history" – most of them are loans launched in years 2006-2008. Moreover, those loans were granted in exceptionally favourable macroeconomic conditions, i.e., among others, with wages increasing at a fast pace, low interest rates, appreciation of Polish currency and the abruptly increasing prices on the real property market. Therefore, the current quality of those loans is high. However, there is also a substantiated fear that due to the rapidly deteriorating economic conditions and strong depreciation of PLN, in the coming periods certain risks related to mortgage loans may materialise.[60] This may be confirmed by the abovementioned negative events noted in loan portfolio at the end of 2008. Banks that are most exposed to risk of deterioration of mortgage loan portfolio and the resulting negative effects for financial results and capital position are banks that granted loans with very high LtV, at the same time applying very liberal creditworthiness assessment standards and low margins which covered neither the expected costs of risk, nor, in certain cases, higher costs of financing of loan exposure.

Although by mid-2008 it seemed that the main area of risk that may appear would be the risk of considerable interest rate rise, at present the main source of anxiety is the rapid and very strong depreciation of PLN combined with symptoms of deterioration of situation on the labour market. Therefore one may fear that in the coming periods the part of borrowers would be unable to settle their liabilities. This mainly relates to borrowers who at the moment of obtaining the loan were on the verge of creditworthiness and do not have adequate financial buffer. It seems that loans exposed to the greatest risk are those granted in the second half of 2006 and

[59] In accordance with the Ordinance of the Minister of Finance of 10 December 2003 concerning the principles for establishing provisions against operational risk, "watch list" loans include credit exposures for which the delay in the repayment of capital or interest exceeds 1 month and does not exceed 3 months.

[60] For more details, see *Report on the condition of Polish banks in 2007*.

in the first half of 2007 in a situation of historically low interest rates, strong PLN, „surging apartment prices' and very strong competition between banks and aggressive sales policy causing excessive loosening of lending procedures. One of the effects of the subprime crisis was revision of lending policies of banks and customer attitudes (e.g. this may explain slowdown in apartment prices and their gradual decrease).

Need to adjust the level of risk to the situation in countries of Central and Eastern Europe

It should be added that with respect to significant deterioration of conditions in certain countries of Central and Eastern Europe, banks conducting operations in those countries, cooperating with entities from those countries or indirectly exposed to the risk of those countries through lending to enterprises operating on those markets, should take the present level of risk into account when planning their operations.

At the end of 2008 the value of earmarked provisions/impairment write-offs for non-performing loans amounted to PLN 16.4 billion[61] (the value of legal security reducing the basis of creation of provisions amounted to PLN 6.1 billion). This means that banks had required level of provisions – the rate of coverage of substandard loans with provisions was 137.0%, doubtful loans – 119.7%, and bad debts – 96.2%. Moreover, banks had provisions/write-offs for „standard" and „watch list" loans to the non-financial sector, amounting to PLN 3.8 billion.

To sum up, one may state that at the end of 2008 loan portfolio quality was satisfactory. However, an alarming symptom is the fast increase in non-performing and „watch list' loans in respect of consumer loans and mortgage loans in foreign currencies that occurred in Q4 of 2008. One may fear that in a situation of maintained weak PLN and deteriorating situation on the labour market, in the coming periods we may face considerable deterioration of loan portfolio quality.

Credit risk related to banks' involvement in derivative transactions in foreign currencies with customers is another element that poses potential threat to the banking sector result. According to valuation as of 13 February 2009, total negative NPV of transactions in all currencies amounts to PLN 18.1 billion. Approximately 50% of this amount is valuation of option transactions, while the remaining 50% are forwards and swaps. Banks conducted detailed analysis of all derivative contracts with customers. The analysis was presented to PFSA. The analysis revealed that approximately 80% of customers had security in the form of opposing currency exposures for business transactions at the level exceeding the concluded (issued) derivative contracts. Another group of clients, accounting for ca. 10%-15%, are customers who at the moment of conclusion of derivative transactions had currency exposures for business transactions at the level exceeding the concluded (issued) derivative contracts. However, due to negative changes in economic conditions, they lost the part of contracts or the contracts were postponed. Those customers partly incur real losses at the moment of settlement of derivative transactions, and at present they have a liability towards the bank due to the negative valuation of such transactions. The last group of clients, ca. 5%-10%, are clients who concluded derivative contracts for amounts exceeding potential business exposure in foreign currencies, or concluded derivative transactions in more than one bank. These clients concluded speculative transactions and incur actual losses in this respect.

[61] Pursuant to the Ordinance of the Minister of Finance of 10 December 2003 concerning the principles for establishing provisions against operational risk, specific provisions against the risk related to credit exposures classified as "substandard", "doubtful" and "bad debts" are established on the basis of an individual assessment of the risk related to a given exposure, yet at least in the amount of the required level of reserves, which in relation to the basis for establishing specific provisions constitutes 20%, 50%, and 100%, respectively.The basis for establishing specific provisions is the balance sheet value of the credit exposure (without capitalised interest), taking into account the forecast amount of remittance of part of the credit exposure due to the restructuring of debt. The value of collateral may be deducted from the basis for establishing provisions. Banks which apply the IFRS establish write-offs for impairment on the basis of estimates of the future cash flows related to extending the loan, discounted with the effective interest rate, and present them in reports for the NBP in a manner close to the principles applicable for banks which apply PAS.

Capital adequacy

Full implementation of CRD

At the beginning of 2008 full implementation of all provisions of CRD into the Polish banking system was carried out.[62]

Table 5.2

Own funds of the banking sector (PLN billion)

	2004	2005	2006	2007	2008	Change 2008/2007 billion	Change 2008/2007 %
Total own funds of banks	43.1	46.1	51.6	61.8	75.0	13.2	21.4
- core funds	42.9	45.6	50.3	60.0	72.0	12.0	20.0
- supplementary funds	3.4	3.8	4.3	5.8	8.6	2.8	49.5
- deductions from the sum of core and supplementary funds	3.5	3.7	3.4	4.3	6.1	1.9	43.8
- trading book ancillary capital	0.3	0.4	0.3	0.3	0.5	0.3	101.5

Chart 5.15
Own funds of commercial banks (PLN billion)

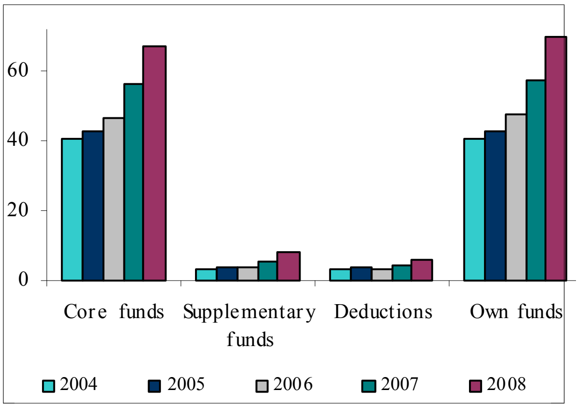


Chart 5.16
Breakdown of commercial banks by volume of own funds

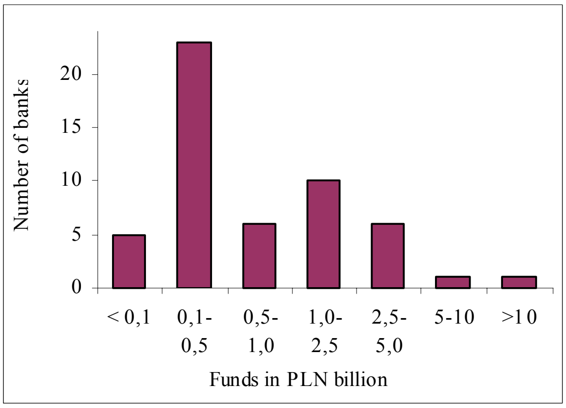


Chart 5.17
Own funds of cooperative banks (PLN billion)

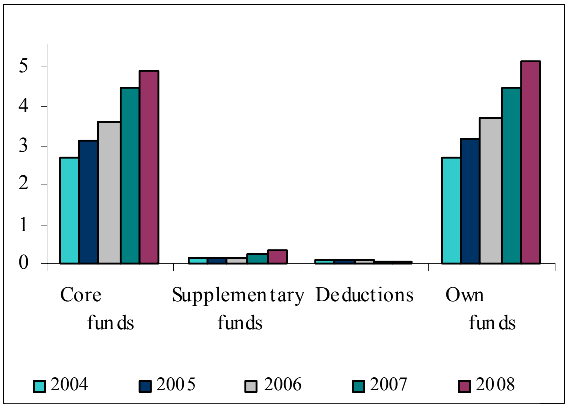
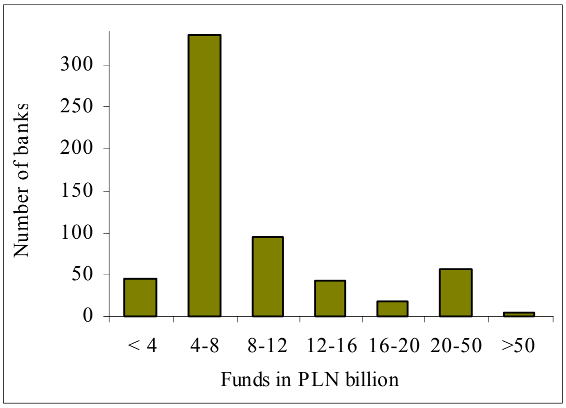


Chart 5.18
Breakdown of cooperative banks by volume of own funds



In 2008 own funds of the banking sector increased by 21.4% (from PLN 61.8 billion to PLN 75.0 billion). The increase in own funds was mainly due to the increase in core funds (mainly due to the fact that 60% of profits for 2007 was left at banks), which reached the level of PLN 72.0 billion and were by 20.0% higher than at the end of 2007.

[62] In March 2007, the Commission for Banking Supervision adopted a set of resolutions which, together with the earlier amendment to the Banking Law, lead to the full transposition into Polish legislation of the provisions of directives 2006/48/EC and 2006/49/EC (jointly referred to as the CRD), which implement on the EU ground the so-called New Capital Accord (or Basel II).The resolutions entered into force as of 1 April 2007, but until 2007, for the purposes of calculating the capital adequacy banks could adopt an approach based on the previous regulations in respect of part or all of the assets portfolio. Only 5 commercial banks used the possibility to apply the new regulations (their share in sector assets only amounted to 1.2%).

Own funds of commercial banks increased by 21.8% (from PLN 57.3 billion to PLN 69.8 billion). All commercial banks met the requirement of holding minimum own funds at the level of EUR 5 million.

Own funds of cooperative banks increased by 16.2% (from PLN 4.5 billion to PLN 5.2 billion), while average own funds amounted to PLN 9.0 million. Due to the rapid depreciation of PLN, in the second half of 2008 79 banks did not meet the requirement of holding minimum own funds at the level of EUR 1 million at the year-end.Supervisory measures aimed at supplying their funds with profit generated in 2008 were taken towards those banks.

Due to strong PLN depreciation 79 cooperative banks did not meet the required minimum level of own funds

Chart 5.19
Capital requirements of the banking sector (PLN billion)

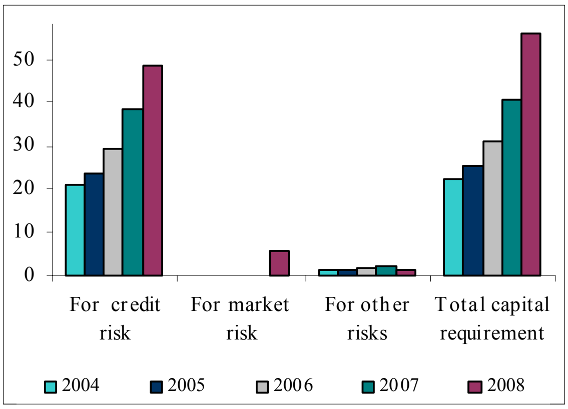


Chart 5.20
CAR – Capital adequacy ratio (%)

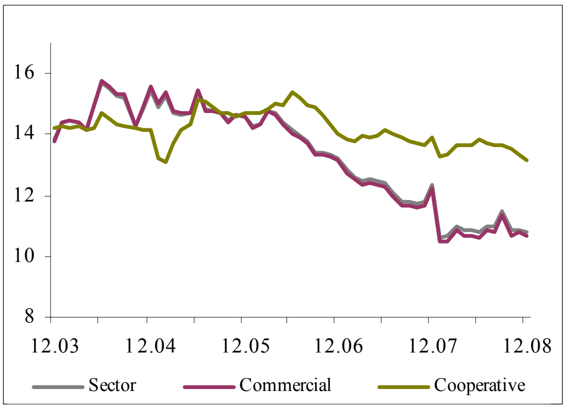


Chart 5.21
Breakdown of commercial banks by CAR

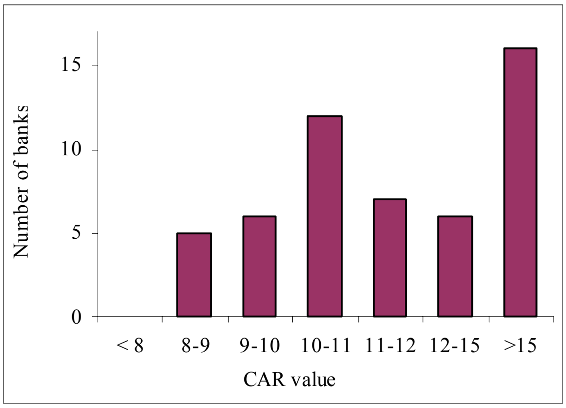
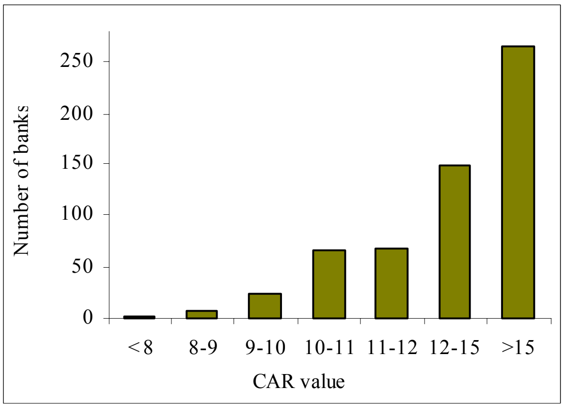


Chart 5.22
Breakdown of cooperative banks by CAR



In 2008 total capital requirement increased by 36.4% (from PLN 40.7 billion at the end of 2007 to PLN 55.6 billion at the end of 2008).
The increase in total requirement was caused by two factors. Firstly, due to very high growth of lending activity (partly resulting from increase caused by string depreciation of PLN in the second half of 2008) credit risk rose by 26.3% (from PLN 38.6 billion to PLN 48.7 billion)[63]. At the end of the year the requirement accounted for 87.6% of the total requirement. Secondly, it was necessary to take into account the operational risk requirement in capital adequacy account (since the beginning of 2008). [64] At the end of the year capital requirement in this respect amounted to PLN 5.7 billion (commercial banks - PLN 5.2 billion, cooperative banks - PLN 0.4 billion) and accounted for 10.2% of the total capital requirement.

The importance of other requirements was marginal (total requirements against other risks amounted to PLN 1.2 billion and accounted for mere 2.2% of the total requirement).

[63] In Q4 of 2008 alone, the increase in credit risk requirement amounted to PLN 5.0 billion, which may be explained by strong depreciation of PLN.
[64] Operational risk is the possibility of loss resulting from non-adjusted or defective internal processes, persons and systems or external events, including legal risk.

The increase in the total capital requirement was not offset by a sufficiently large increase in own funds. As a consequence, the average capital adequacy ratio[65] of the banking sector decreased from 12.1% at the end of 2007 to 10.8% at the end of 2008 (the increase in CAR noted in September 2008 resulted from launching of operations by two new banks, which increased the level of own funds with no increase in capital requirements).

Considerable decrease in average capital adequacy ratio

The lower capital adequacy ratio was observed mainly in commercial banks, where it dropped from 12.0% do 10.7%. In the sector of cooperative banks, the average capital adequacy ratio of cooperative banks decreased only from 13.8% to 13.2%, which may be explained by high increase in own funds, moderate increase in lending activity, allocation of lower risk weight to the greater part of loan portfolio of cooperative banks due to the introduction of NCA, as well as operational risk requirement that was relatively lower than in commercial banks.
At the end of 2008 only one small commercial bank did not comply with the minimum CAR requirement (8%). However, thanks to the support of the parent company, situation will become normal in the near future. Also one cooperative bank failed to meet the statutory requirements concerning CAR. In this case this bank will merge with a stronger bank, which would end any potential threats.

Considering the threats resulting from turbulence on global financial markets and visible weakening of economic conditions, banking supervision addressed banks' management boards to increase capital for the coverage of all risks related to banking operations. It was also pointed out that in a situation of the expected considerable slowdown of the growth rate of Polish economy, as well as visible deterioration of economic conditions in global economy, maintenance of CAR at the level of 8% may turn out to be insufficient. Therefore it was recommended to banks that they take measures aimed at increasing own funds, including core capital, to the amount guaranteeing the maintenance of CAR at the secure level no lower than 10% and Tier 1 ratio no lower than 8%. Moreover, in the case of banks that do not meet those requirements, the supervision authority expects them to allocate the entire 2007 profit to capital increase. In the case of other banks it was recommended that they adopt a cautious approach to dividends and that the largest possible share of profits is allocated to the funds.

Banks have adequate funds, but they must be increased

In the opinion of banking supervision, such measures will increase safety of the banking system and enhance confidence between banks. This is particularly important in the context of banks' problems with acquiring capital from other sources and probably decrease in banks' profits in the coming periods, which will be the consequence e.g. of higher write-offs.
It should be added that consultations conducted with banking supervision in other countries by the Polish banking supervision shows that many supervision authorities are considering increasing minimum capital requirement.

To sum up, capital adequacy of the banking sector was satisfactory. The funds held by banks sufficiently covered the risk related to their operations and permitted their further development (the surplus of own funds over the total capital requirement amounted to PLN 19.4 billion). However, further increasing of banks' capital base is necessary, in particular in the context of strong symptoms of weakening economic condition and increased level of risk.

[65] The capital adequacy ratio of a bank is calculated in percentages as a fraction, multiplied by 100, whose numerator is the value of own funds plus the trading book ancillary capital and the denominator is total capital requirement multiplied by 12.5 – see Resolution 1/2007 of the Commission for Banking Supervision of 13 March 2007.

VI. MAIN REGULATORY CHANGES AND SUPERVISORY ACTIVITIES

The main objective of banking supervision is to ensure security of funds accumulated on bank accounts and compliance of banking operations with provisions of the Banking Law, by-laws and decision on the issue of license for the establishment of a bank.
Moreover, pursuant to the Act on financial market supervision, the objective of financial market supervision is to ensure proper functioning of this market, its stability, security and transparency, confidence to the financial market, as well as ensuring protection of interests of market participants.

Actions taken under banking supervision consist in particular in:
- evaluation of financial standing of banks;
- assessment of the quality of operational risk management;
- assessment of compliance of the granted loans, credits, letters of credit, bank guarantees and sureties, as well as issued bank securities, with relevant legislation in force;
- analysis of hedging and timely repayment of loans and credits;
- assessment of compliance with risk standards for banking operations, specified by regulations.

The framework of supervisory policy is established by way of the provisions of the Banking Law, Act on financial market supervision and prudential regulations issued on the basis of those acts, and decisions of CBS/PFSA.

Main regulatory changes

The main objective of regulatory policy implemented in 2008 was continuation of measures aimed at improvement of risk management of banks.

Due to the need resulting from Article 80 of the Act on financial market supervision regarding the issue by PFSA by 1 January 2009 of executive acts to the Banking Law, issued by CBS and expiring with the end of 2008, banking supervision prepared drafts amending CBS resolutions.They were adopted by PFSA on the meeting on 17 December 2008.
In general, PFSA resolutions transposed the provisions of CBS resolutions, whereas in certain CBS resolutions technical amendments were introduced resulting from the submitted doubts as to interpretation and necessary completions. In particular:
- PFSA Resolution No. 382/2008 on detailed principles and conditions of accounting for exposures in determining compliance with exposure concentration limit and large exposure limit (…) was much modified as to the planned amendments to CRD with respect to exposure concentration limits. This mainly refers to interbank exposures which in accordance with the amended Directive are to be covered by concentration limits. This results from the fact that interbank exposures become increasingly more important and in the case of crisis they may lead to spreading of critical events. Therefore the originators of amendments to CRD noticed the need to manage those transactions in a more cautious manner. Consequently to the conducted works, the European Commission has decided that it is relevant to treat interbank exposures similarly to other exposures, i.e. without taking into account their maturities as a factor justifying exclusions from concentration limits. It was also proposed to introduce a quota-based concentration limit for such transactions and certain exclusions were abandoned.
  Amendments to the Resolution are introduced with adequate transitional period which would permit banks to adjust their exposures to new levels.
- in PFSA Resolution No. 386/2008 on establishing mandatory standards of bank liquidityamendments were introduced that were advantageous for banks and branches of credit institutions. Changes consisted in the introduction of "subsidiary" to definitions (in accordance with the provisions of Article 4 (1) (9) of the Banking Law) and recognition that an agreement concluded with subsidiary of a regulated entity may be considered a source of liquidity hedging, if the subsidiary of the regulated entity is subject to consolidated supervision conducted by the competent supervision authority (conducting consolidated supervision of the regulated entity). The relevance of amendments was due to the fact that in the transitional period of the Resolution it was noted that certain banks include agreements concluded by the banks with group entities in the core liquidity reserve. Such group entities are subsidiaries established for the performance of specific functions, such as supplying griouyp entities with „liquidity" on behalf of the parent entity, but they could not be treated in the same manner as regulated entities, since their articles of association do not specify clearly that their operations are of banking, brokerage or investment nature. Their parent entity is the

regulated entity. In efficiency assessments of concluded agreements as liquidity hedging source, submitted to PFSA, banks recognised that the subsidiary with which the agreement has been concluded and which is owned in 100% by the parent entity, is a regulated entity with stable financial condition.

Due to the need to extend protection of market participants, on 17 December 2008 PFSA adopted a resolution introducing Recommendation S II. The Recommendation introduces suggestions that are additional to those included in Recommendation S, related to the obligation to inform customers about currency spread, burdens and risk related to differences between the sell rate and buy rate of foreign currencies before and during the period of validity of the credit agreement in the case of loans granted in foreign currency or indexed to foreign currency. In accordance with the new recommendations, the banks should permit the customer upon request to repay installments in the indexation currency in the case of a loan indexed to foreign currency (change in the manner of repayment should cover all installments from the date of amendment of the agreement, which means that it may occur only once throughout the agreement validity period). In the opinion of PFSA, these amendments will improve the relations between banks and customers who will be better informed about the consequences of their decisions. Due to the fact that banks should introduce necessary adjustment measures, PFSA expects that recommendations will be introduced in banks no later than by 1 April 2009.

In June 2008 banking supervision sent to banks a questionnaire concerning the rules and procedures of creditworthiness assessment applied by banks. The questionnaire was the effect of earlier signals and analyses which showed that certain banks did not comply with adequate standards in this respect. The analysis also covered a simulation aimed at establishing maximum amount of loan that could be lent by individual banks on specific conditions, as well as household debt service ratio (DSR). On the basis of the results it was revealed e.g. that differences in amounts of loans granted by specific banks can reach even 600%. What is more important, it was confirmed that certain banks are willing to grant loans, of which debt servicing cost would exceed 70% of household income. Such a high DSR leaves practically no margin for potential increase in subsistence costs or interest rates.
Survey results were used when draft Recommendation T was being prepared, the document defining best practices in credit risk management for household loans and implementation of customer creditwrthiness assessment standards. The draft document was subject to broad consultations with banking environment (at present the consultations are analysed as to their potential inclusion in Recommendation provisions) and the process itself resulted in adequate self-regulatory reactions of banks.
In the opinion of banking supervision authority, introduction of the rules described in Recommendation T will improve risk management and thus banking sector safety.

Main supervisory activities

Supervision focused on two main directions:
- assessment of stability of the banking sector identification of systemic risks, preventive measures and providing adequate recommendations to banks,
- assessment of situation of individual banks, in particular quality of risk management process.

In response to escalation of critical events PFSA took necessary preventive and adjusting measures towards the supervised entities. Banking supervision immediately responded to signals regarding problems of capital groups which could translate to the situation of subsidiaries operating in Poland.

Supervisory measures focused on a number of areas: additional recommendations and suggestions, monitoring activities, meetings with banks' management boards, contacts with parent entities, participation in the works of Financial Stability Committee.

Within those measures e.g.:
- banks were obliged to verify their investment policy and structure of the sources of financing,
- banks were obliged to review their contingency plans with the view of taking into account potential lack of liquidity on the local market or limited support from parent entity,
- banks were asked to assess current situation on the interbank market and to provide information on measures aimed at limitation of liquidity risk, in particular financing of currency and currency-indexed mortgage loans,
- monitoring of exposures towards specific entities or regions was conducted (such as the US, Iceland, Russia, Ukraine);

- monitoring of exposures of banks much exposed to foreign financial entities was conducted (information on type of instruments and maturities and the method of hedging of risk related to those exposures);
- introduction of the obligation to report new exposures to foreign entities every day and warning against transactions that may involve unjustified transfer of funds to parent entities;
- introduction of obligation of weekly reporting of currency liquidity,
- monitoring and analyses of derivative transactions in foreign currencies concluded with non-financial sector entities;
- necessary individual measures were taken towards the selected banks with respect to the abovementioned areas.

Meetings with bank management boards are essential element of supervisory activities. Conclusions from those meetings show that to date events on financial markets are not a direct threat to banking system stability. However, decreased mutual confidence between financial market participants is alarming, reflected in limitation of the scale of transactions on the interbank market (expressed in transaction value and deadlines).

At the same time, PFSA regularly meets representatives of parent entities in order to learn their economic condition and strategic plans towards subsidiaries.

Considering global nature of the crisis, banking supervision remains in regular contact with supervision authorities from other countries, thanks to which e.g. it is possible to verify assessment of situation of parent entities towards institutions operating in Poland.

Direct supervision of banks is of analytical and inspection nature.

The aim of inspection policy conducted in 2008 was continuation of measures aimed at identification of threats and high risk areas. Control activities were conducted on the basis of the annual plan of control activities. Inspection plan for commercial banks was developed in accordance with the analytical model based on supervisory cycle and taking into account the results of current analysis of the economic and financial situation. On the other hand, when planning inspections at cooperative banks, the main criteria were: date of the last comprehensive inspection, degree of implementation of repair procedure, analytical assessments and forecasts of economic and financial situation, manner of implementation of post-inspection recommendations and the earlier supervisory measures applied to the bank.

Table 6.1

List of control activities carried out in 2008

	Comprehensive inspections	Problem-solving inspections	Other	total
Commercial banks				
- number of control activities	14	4	7	25
- number of man-days	7,614	708	277	8,599
Cooperative banks				
- number of control activities	60	20	3	83
- number of man-days	4,051	295	59	4,405
Branches of credit institutions				
- number of control activities	0	1	0	1
- - number of man-days	0	73	0	73

Comprehensive inspections covered the analysis of asset quality, liquidity, interest rate risk, currency risk, operational risk, financial profit or loss, capital and management, as well as compliance with provisions regulating banking operations, by-laws and terms and conditions specified in license for the establishment of a bank.Each area was assessed according to the methodology of a point-based bank rating, adopted by banking supervision authority. Information about the global score awarded as a result of inspection and about partial assessments was communicated to banks and to foreign supervision authorities. Comprehensive inspections also included additional tasks ordered by the NBP Management Board, such as controls of payment of the reserve requirement amount.

Problem-solving inspections analysed the selected areas of banking activity which in the opinion of banking supervision authority could increase the risk of banks. Particular emphasis was put on the continuation of the process of verification of banks' implementation of CRD and recommendations resulting from Recommendation S. Also the issues related to counteracting money laundering and the financing of terrorism, as well as implementation of recommendations issued after the previous inspections, were assessed.

Results of 2008 inspections revealed that not all banks adjusted to regulations in force to satisfactory extent. The most important irregularities concerned:
- Bank customers' creditwrtiness assessment process;
- Method of monitoring of mortgage-backed credit exposures portfolio;
- Lack of assessment of impact of exchange rate and interest rate changes on credit risk;
- Internal capital estimation and maintenance process;
- Business continuity management process;
- Compliance risk management;
- Scope, quality and frequency of management reporting of banks;
- Scope of activity of internal audit and efficiency of control.

The findings resulting from the conducted control activities in commercial banks were presented in inspection reports. After the conducted inspections banks received PFSA recommendations relating to elimination of the revelaed irregularities in order to limit operational risk of banks. The most frequent recommendations were as follows:

In respect of asset quality:
- To ensure full implementation of provisions of Recommendation S;
- The need for improvement of quality of creditwrthiness assessment;
- To ensure compliance of internal system of exposure review with the requirements of Ordinance of the Minister of Finance concerning the principles for establishing provisions against operational risk;
- To adjust the rules of valuation of off-balance sheet assets and liabilities to the provisions of International Accounting Standards and requirements of Recommendation R relating to the rules of identification of impaired balance sheet credit exposures, creating impairment write-offs for balance-sheet credit exposures and provisions for off-balance sheet credit exposures.

In respect of liquidity risk:
- To ensure contingency plan in case of liquidity crisis;
- To ensure stable and diversified sources of financing of mortgage loan portfolio;
- To conduct comprehensive analyses of long-term liquidity and to take effective measures aimed at adjusting time structure of sources of financing to the structure of long-term assets;
- To take limits related to liquidity items directly related to the financing of long-term mortgage-backed loans into account in the system of liquidity risk limits;
- The need to improve liquidity risk management, e.g. through realignment of liquidity gap and analysis of liquidity risk in subsidiaries.

In respect of interest rate risk and currency risk:
- Stress testing;
- To establish caps for market risk that would be acceptable for banks.

In respect of operational risk:
- To ensure data security in IT systems;
- To increase security of e-banking transactions;
- To develop/update business continuity plans adjusted to the scale and scope of bank's operations.

In respect of capital adequacy:
- To ensure full implementation of provisions of CBS Resolution No. 1/2007 on the scope of the capital requirements against particular risks (…) – currently PFSA Resolution No. 380/2008;
- To develop and approve an internal procedure for estimation and maintenance of internal capital.

In respect of management:
- To review and update business strategy and organisational structure of the bank;
- To take measures ensuring adequate compliance risk management;
- To improve efficiency of supervision conducted by Bank's Supervisory Board and Management Board of the credit risk management process (in particular with respect to the financing of real property market);

- To improve management information quality;
- To eliminate the revealed cases of breached law and internal regulations of banks and to ensure that legal provisions are complied with in the future;
- To eliminate reporting mistakes and to ensure ccorrectness of reports in the future;
- To enhance internal control system mechanisms in order to ensure that legal provisions binding for the banks and internal procedures are complied with, as well as to ensure correctness of accounting records and reports.

Analytical supervision, which is integrally related with inspection supervisions, consists in constant monitoring and assessment of the condition of the banking sector and individual banks, identification of actual or potential risks and, if necessary, interventions. Supervision is carried out on the basis of the reports submitted by banks, surveys, meetings with bank representatives and other available information.
Once a quarter, a comprehensive analysis of the situation of individual banks and of the entire banking sector is prepared. On the basis of quarterly analysis of the economic and financial situation of individual banks, banks are awarded points according to CAEL rating and areas which are potential source of risk and which require particular attention during inspection are listed. At the same time, comprehensive supervision includes the analyses of consolidated financial statements of banks, economic and financial situation of holding companies and parent entities of banks.
Analytical supervision also covers current activities consisting in analysis of compliance of banks' operations with legislation in force, issuing opinions on banks' applications for supervisory authorities' consent for taking specific measures or obtaining specific powers.

Under analytical supervision many ad hoc information were prepared concerning e.g. the manner of analysing creditworthiness by banks, real property financing or derivative transactions in foreign currencies.

Under the present supervision, authorities cooperate with e.g. Ministry of Finance, National Bank of Poland, foreign supervision authorities and other external institutions, as well as the abovementioned anti-crisis measures are taken.

VII. POLISH BANKING SECTOR IN THE CONTEXT OF OTHER EUROPEAN UNION MEMBER STATES

Polish banking sector is an integral element of the European banking system. Therefore it is worth to compare it with other European Union Member States.[66] However, considering the strong impact of financial crisis from years 2007-2008 on banks' results, we decided not to present data on performance of banking operations[67], but only to present structural data.

Table 7.1

Polish banking sector in the context of other European Union Member States at the end of 2007 (EUR billion,%)

	Assets	Number of credit institutions	Employment	No. of branches per 1 million of residents	Assets to GDP	Loans to GDP	Mortgage loans to GDP	Deposits to GDP	CR 5	Share of foreign investors
Austria	891	803	78	514	329	139	24	111	43	27
Belgium	1 298	110	67	417	392	126	34	155	83	25
Bulgaria	31	29	31	767	107	66	10	68	57	82
Cyprus	91	215	11	1,151	607	273	47	350	65	32
Czech Republic	140	56	40	181	110	53	15	73	66	92
Denmark	978	189	50	399	429	221	104	79	64	19
Estonia	21	15	6	205	131	96	35	57	96	97
Finland	288	360	25	309	160	82	35	56	81	65
France	6,682	808	479	622	353	114	34	83	52	13
Greece	383	63	65	344	167	87	28	109	68	23
Spain	2,945	357	276	1,013	281	177	59	144	41	12
The Netherlands	2,195	341	114	220	392	193	70	157	86	18
Ireland	1,337	81	42	269	715	257	66	175	46	47
Lithuania	24	80	10	285	86	63	17	42	81	83
Luxembourg	915	156	26	470	2,542	533	41	822	28	95
Latvia	31	31	13	297	155	104	34	72	67	58
Malta	38	22	4	260	760	405	40	280	70	42
Germany	7,562	2 026	691	483	312	130	40	119	22	11
Poland 2007	**221**	**712**	**174**	**354**	**67**	**36**	**10**	**36**	**47**	**71**
Poland 2008	**250**	**711**	**181**	**386**	**82**	**47**	**15**	**39**	**45**	**72**
Portugal	440	175	61	569	270	158	62	118	68	23
Romania	72	42	66	295	60	35	3	32	56	82
Slovakia	50	26	20	216	91	45	11	57	68	96
Slovenia	43	27	12	356	126	86	8	58	60	29
Sweden	846	201	44	203	255	134	40	57	61	9
UK	10,093	390		204	500	288	54	290	41	53
Hungary	109	206	42	335	108	65	12	51	54	57
Italy	3,332	821	342	560	217	112	17	73	33	17
EU	**41,072**	**8,348**	**2,787**	**471**	**334**	**157**	**41**	**136**	**44**	**29**

Source: ECB, own calculations

In terms of assets, Polish banking sector is still small in comparison with EU-15 (its assets hardly account for 1% of total assets of all EU Member States), but on the other hand it is the largest among the new Member States (accounting for over 30% of total assets in this group).

It is characteristic of Poland, as it is in the case of other new EU Member States, that not only the banking sector assets are very low, but also the relationship between those assets and GDP is very low. On the one hand, this

[66] See *EU Banking Structures*, ECB 2008.

[67] See *Financial Stability Review*, ECB 2008.

proves that the economy has low "banking culture", on the other hand, that this sector has great growth potential. It is worth noting that in 2008 assets to GDP ratio rapidly increased in Poland.
Due to high increase in mortgage loans for households in the last years, their share in GDP grew considerably, although it is still much lower than in most EU Member States. However, the relatively low share in GDP does not equal low risk for the sector.

Despite relatively small scale of banking operations, PKO BP and Pekao are one of the largest banks in Europe in terms of the number of customers, branch network, generated financial results and market value.

Considering the number of operating credit institutions, Polish banking sector is one of the largest in Europe. However, the number of branches per 1 million residents is below average.

The level of concentration of the Polish banking sector (measured by the share of the five largest banks in total banking sector assets) is slightly over the average EU level.

Ownership structure of the Polish banking sector is characteristic for the new EU Member States, where the share of foreign investors is very high.

To sum up, the scope of operations of the Polish banking sector in the context of highly developed EU Member States is low, which on the one hand proves low level of “banking culture” of Polish economy, and on the other hand, the development potential of the sector.

STATISTICAL ANNEX

List of tables

Table 1.1 - Number of banks, employment, network size, market share

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Number of banks	**647**	**645**	**649**	**51**	**50**	**52**	**12**	**14**	**18**	**584**	**581**	**579**
Employment	**157,931**	**167,127**	**181,295**	**127,201**	**133,724**	**145,420**	**1,826**	**3,300**	**4,610**	**28,904**	**30,103**	**31,265**
Network	**12,562**	**13,478**	**14,698**	**8,592**	**9,280**	**10,263**	**171**	**184**	**236**	**3,799**	**4,014**	**4,199**
- branches	5,184	5,607	6,118	3,770	4,134	4,597	12	14	18	1,402	1,459	1,503
- other	7,378	7,871	8,580	4,822	5,146	5,666	159	170	218	2,397	2,555	2,696
Market share:												
- assets	100.0	100.0	100.0	90.7	89.6	89.2	3.1	4.3	5.4	6.2	6.2	5.4
- loans to non-financial sector	100.0	100.0	100.0	90.5	89.9	89.9	2.5	3.6	3.6	7.0	6.5	6.5
- deposits of the non-financial sector	100.0	100.0	100.0	89.7	89.4	89.4	1.8	1.9	1.9	8.6	8.8	8.8
- equity	100.0	100.0	100.0	92.7	92.8	92.8	x	x	x	7.3	7.2	7.2
- net profit (loss)	100.0	100.0	100.0	96.3	95.5	95.5	-1.0	-0.6	-0.6	4.7	5.0	5.0

Table 1.2 - Concentration

	5 largest banks			10 largest banks			15 largest banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Employment	**42.7**	**43.0**	**39.8**	**58.3**	**57.0**	**52.0**	**67.5**	**65.3**	**61.5**
Network	**41.8**	**41.4**	**39.2**	**52.7**	**51.2**	**47.9**	**57.6**	**55.9**	**54.4**
- branches	38.6	47.3	45.4	56.3	62.0	57.7	64.0	64.2	62.6
- other	44.0	37.1	37.5	50.0	43.4	44.0	52.9	49.8	52.2
Market share:									
- assets	46.5	46.6	44.6	66.7	64.5	62.5	76.6	73.9	73.2
- loans to non-financial sector	44.0	44.6	43.1	61.7	60.9	58.9	75.2	73.3	73.7
- deposits of the non-financial sector	54.7	56.9	55.3	72.5	72.7	69.8	80.8	79.6	78.4
- equity	45.0	47.1	45.8	65.7	64.1	62.4	76.3	75.4	72.6
- net profit (loss)	54.5	49.6	62.0	77.6	65.6	76.5	86.1	85.2	82.3

Table 1.3 - Ownership structure

	Domestic investors			of which: State Treasury			Foreign investors		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Number of banks	**595**	**591**	**589**	**4**	**4**	**4**	**52**	**54**	**60**
Market share:									
- assets	30.3	29.1	27.7	19.8	18.3	17.3	69.7	70.9	72.3
- loans to non-financial sector	30.1	29.9	28.6	19.8	19.5	18.5	69.9	70.1	71.4
- deposits of the non-financial sector	33.5	32.5	32.4	22.7	20.8	20.0	66.5	67.5	67.6
- equity	27.1	29.9	30.8	16.5	18.9	19.6	72.9	70.1	69.2
- net profit (loss)	28.0	31.6	36.8	21.2	23.2	26.3	72.0	68.4	63.2

Table 1.4 - Foreign investors by country

	Number of controlled banks and branches of credit institutions			Share in assets (%)		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Italy	4	4	4	19.9	17.4	13.4
The Netherlands	4	4	5	8.2	10.9	10.8
Germany	9	9	10	8.4	9.3	10.2
United States	6	5	6	7.8	7.3	8.6
Belgium	3	4	4	4.9	5.6	6.1
Ireland	1	2	3	4.6	5.0	5.3
France	10	9	10	3.9	3.9	4.5
Portugal	1	2	3	3.6	3.9	4.5
Austria	1	1	1	2.3	2.2	2.3
Sweden	1	1	1	0.2	1.3	2.0
Greece	3	3	4	1.2	1.5	1.8
Spain	1	2	2	0.9	1.0	1.0
Norway	1	2	1	0.3	0.7	0.7
Denmark	3	2	2	0.5	0.5	0.5
United Kingdom	2	2	2	0.2	0.2	0.3
Japan	1	1	1	0.1	0.2	0.2
Luxembourg	x	1	1	x	0	0.1
- other	1	x		2.7	x	
Total	**52**	**54**	**60**	**69.7**	**70.9**	**72.3**
- of which: from EU Member States	43	45	52	61.4	62.6	62.7

Table 2.1 - Balance sheet (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Balance sheet total	**681,791.6**	**792,777.4**	**1,041,768.9**	**618,713.6**	**712,149.8**	**929,096.4**	**20,952.6**	**31,703.0**	**56,145.4**	**42,125.4**	**48,924.6**	**56,527.2**
Assets												
Cash in hand, transactions with central bank	22,954.5	28,214.5	39,487.1	21,837.5	26,630.2	36,517.2	217.4	361.0	1,579.0	899.6	1,223.3	1,390.9
Amounts due from the financial sector	134,468.2	125,204.3	108,396.2	114,154.9	102,207.4	80,851.1	7,653.1	9,227.0	11,251.3	12,660.2	13,769.9	16,293.9
Amounts due from the non-financial sector, of which:	314,685.3	421,746.5	587,565.7	284,230.6	378,763.8	526,241.3	8,083.4	15,520.8	29,682.0	22,371.2	27,461.8	31,642.3
Amounts due from the general government	22,775.8	21,422.1	24,603.6	21,223.5	19,701.4	22,580.8	23.8	5.3	4.8	1,528.5	1,715.3	2,018.0
Receivables under securities repurchase agreements	1,778.7	5,987.1	9,020.4	1,778.7	5,987.1	8,359.6	0.0	0.0	660.9	0.0	0.0	0.0
Securities, of which:	142,516.7	135,643.6	180,998.0	136,222.3	128,722.3	172,022.7	3,527.5	4,319.4	6,152.4	2,766.8	2,601.9	2,822.9
Tangible fixed assets	20,283.0	21,964.1	25,587.4	18,404.6	19,764.5	23,117.0	199.7	329.9	397.3	1,678.7	1,869.7	2,073.1
Other assets	22,329.4	32,595.2	66,110.4	20,861.4	30,372.9	59,406.7	1,247.7	1,939.6	6,417.7	220.3	282.6	286.1
Liabilities												
Transactions with central bank	4,950.3	3,041.1	17,850.0	4,023.2	2,929.1	16,236.7	927.0	112.0	1,613.2	0.1	0.1	0.1
Amounts owed to the financial sector	118,994.2	158,408.3	242,898.2	107,260.5	139,164.8	211,482.4	11,218.4	18,335.0	30,515.2	515.3	908.4	900.5
Amounts owed to the non-financial sector	383,884.8	428,247.6	506,171.2	344,850.1	383,273.7	450,758.7	6,667.0	8,020.0	13,483.6	32,367.8	36,954.0	41,929.0
Amounts owed to general government	32,459.1	44,705.8	53,516.3	28,820.0	39,857.0	46,995.7	23.3	27.2	114.2	3,615.9	4,821.6	6,406.4
Payables under securities repurchase agreements	13,804.6	13,270.9	14,715.6	13,351.2	11,886.9	12,467.4	453.4	1,384.1	2,248.2	0.0	0.0	0.0
Payables under issue of securities	15,910.5	12,393.0	12,480.1	15,910.5	12,393.0	12,171.9	0.0	0.0	308.1	0.0	0.0	0.0
Other liabilities	41,535.6	51,140.3	97,247.4	38,553.4	46,066.4	88,232.5	1,796.4	4,108.4	7,991.8	1,185.8	965.5	1,023.2
Reserves for off-balance sheet liabilities	398.4	418.4	401.9	396.1	410.0	399.6	0.3	5.5	0.5	2.0	2.8	1.8
General banking risk reserve	653.4	521.3	295.9	550.0	410.1	166.7	0.0	0.0	0.0	103.4	111.1	129.3
Capital (funds) and subordinated liabilities	59,208.2	68,343.3	82,277.8	55,393.9	64,058.9	77,364.5	-17.5	-193.8	-309.8	3,831.7	4,478.2	5,223.0
Profit (loss) pending approval	-704.8	12.0	-20.2	-701.2	27.5	0.0	-3.6	-15.6	-20.2	0.1	0.0	0.0
Profit (loss) of the current period	10,697.3	12,275.4	13,934.7	10,305.9	11,672.3	12,820.3	-112.0	-79.8	200.6	503.4	682.9	913.9

Note: Profit of the current period recognised in 2007 does not include income from discontinued operations of Bank BPH, which, due to the acquisition of the majority of the bank by Bank Pekao, was reported in the capital of Bank Pekao.

Table 2.2 - Amounts due from and owed to the financial sector – face value (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Amounts due from the financial sector	**135,148.1**	**125,707.7**	**108,962.8**	**114,826.4**	**102,704.1**	**81,410.9**	**7,654.4**	**9,228.6**	**11,252.9**	**12,667.2**	**13,775.1**	**16,298.9**
Resident	61,755.1	67,562.5	64,689.7	45,850.8	48,879.9	39,364.1	3,237.1	4,907.5	9,026.6	12,667.2	13,775.1	16,298.9
Non-resident	73,393.0	58,145.2	44,273.1	68,975.7	53,824.2	42,046.8	4,417.3	4,321.1	2,226.3	0.0	0.0	0.0
Amounts owed to the financial sector	**119,534.2**	**158,766.2**	**243,204.9**	**107,800.4**	**139,522.5**	**211,788.9**	**11,218.4**	**18,335.1**	**30,515.3**	**515.4**	**908.5**	**900.6**
Resident	69,383.5	75,998.4	83,229.8	61,033.2	65,635.9	77,912.1	7,834.8	9,453.9	4,418.0	515.4	908.5	899.6
Non-resident	50,150.7	82,767.8	159,975.1	46,767.2	73,886.6	133,876.8	3,383.5	8,881.2	26,097.3	0.0	0.0	1.0

Table 2.3 - Loans and deposits of the non-financial sector – face value (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Total loans	**322,775.0**	**427,542.8**	**593,577.8**	**291,952.5**	**384,167.1**	**531,665.6**	**8,123.4**	**15,524.4**	**29,848.5**	**22,699.1**	**27,851.4**	**32,063.7**
- PLN	232,391.9	319,254.4	386,261.5	204,317.5	279,948.4	338,019.2	5,385.7	11,464.1	16,188.4	22,688.7	27,841.8	32,053.9
- foreign currency	90,383.1	108,288.5	207,316.3	87,635.0	104,218.6	193,646.4	2,737.7	4,060.3	13,660.1	10.4	9.5	9.8
Loans for households	**183,422.4**	**254,201.8**	**368,636.3**	**163,193.6**	**223,685.9**	**323,778.5**	**2,013.2**	**8,358.1**	**19,796.7**	**18,215.6**	**22,157.7**	**25,061.1**
- consumer loans	77,519.6	102,481.4	136,386.3	70,498.2	91,757.9	121,578.1	1,339.7	4,445.5	7,574.3	5,681.7	6,278.0	7,233.9
overdraft	15,213.1	17,721.6	20,754.8	13,508.0	15,752.1	18,418.7	0.0	0.3	70.8	1,705.1	1,969.3	2,265.4
credit cards	5,828.8	8,916.1	12,662.8	5,634.1	8,643.6	12,240.7	192.0	267.9	411.7	2.7	4.5	10.3
other	56,477.7	75,843.7	102,968.7	51,356.1	67,362.2	90,918.7	1,147.7	4,177.3	7,091.7	3,973.9	4,304.2	4,958.2
- mortgage loans	78,174.8	117,732.2	194,068.0	76,042.9	112,024.5	180,090.8	503.3	3,191.2	10,821.0	1,628.7	2,516.6	3,156.1
PLN	28,206.6	52,600.2	59,097.8	26,296.0	48,678.1	54,503.8	282.6	1,405.6	1,438.4	1,628.1	2,516.5	3,155.5
foreign currency	49,968.2	65,132.0	134,970.2	49,746.9	63,346.3	125,587.0	220.7	1,785.5	9,382.6	0.6	0.1	0.6
other real property	3,186.9	4,956.3	5,258.8	2,139.3	3,468.6	3,131.7	16.9	150.1	457.7	1,030.5	1,337.6	1,669.4
- investment	17,924.7	21,331.0	24,074.6	11,057.5	12,707.5	14,719.4	86.0	134.4	164.1	6,781.1	8,489.1	9,191.1
- other	6,616.4	7,700.8	8,848.6	3,455.7	3,727.5	4,258.5	67.3	437.0	779.6	3,093.6	3,536.4	3,810.5
Corporate loans	**138,342.7**	**171,713.8**	**222,702.3**	**127,859.9**	**159,022.3**	**205,860.9**	**6,091.0**	**7,163.8**	**10,050.6**	**4,391.8**	**5,527.8**	**6,790.7**
- current operations	74,361.7	90,581.1	111,933.8	66,752.3	82,520.4	101,308.8	5,154.0	5,263.2	7,330.9	2,455.5	2,797.4	3,294.1
- investment	42,718.4	46,808.8	64,291.8	40,523.1	43,230.6	60,014.8	730.8	1,573.1	2,005.3	1,464.4	2,005.1	2,271.7
- real property	21,262.6	34,324.0	46,476.7	20,584.5	33,271.3	44,537.3	206.2	327.5	714.4	471.9	725.2	1,225.0
Loans for non-commercial institutions	**1,009.9**	**1,627.3**	**2,239.2**	**899.0**	**1,458.9**	**2,026.2**	**19.2**	**2.5**	**1.2**	**91.7**	**165.9**	**211.8**
Farm loans	16,016.3	18,214.9	18,968.6	5,654.8	6,172.6	6,142.7	0.0	0.0	0.0	10,361.4	12,042.3	12,825.9
- preferential	12,839.4	14,915.1	15,004.7	5,213.3	5,755.4	5,552.7	0.0	0.0	0.0	7,626.1	9,159.7	9,451.9
Total deposits	**375,570.7**	**419,307.8**	**494,144.4**	**336,809.4**	**374,720.1**	**439,522.1**	**6,591.7**	**7,870.1**	**13,093.8**	**32,169.7**	**36,717.6**	**41,528.6**
- PLN	314,713.4	362,222.8	439,250.9	279,052.1	319,423.1	386,921.2	3,773.5	6,445.1	11,182.8	31,887.8	36,354.7	41,146.8
- foreign currency	60,857.3	57,085.0	54,893.5	57,757.3	55,297.0	52,600.8	2,818.2	1,425.1	1,911.0	281.9	362.9	381.7
Deposits of enterprises	**125,885.6**	**144,808.9**	**149,144.8**	**117,012.6**	**135,756.7**	**138,885.6**	**6,021.8**	**5,597.2**	**6,547.0**	**2,851.1**	**3,455.1**	**3,712.1**
Deposits of households	**238,817.9**	**262,399.5**	**330,807.8**	**209,884.7**	**228,064.7**	**287,844.8**	**559.4**	**2,213.1**	**6,450.1**	**28,373.8**	**32,121.7**	**36,512.8**
Deposits of non-commercial institutions	**10,867.3**	**12,099.4**	**14,191.8**	**9,912.1**	**10,898.7**	**12,791.6**	**10.4**	**59.8**	**96.6**	**944.7**	**1,140.8**	**1,303.6**

Table 2.4 - Securities (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Total	**142,516.7**	**135,643.6**	**180,998.0**	**136,222.3**	**128,722.3**	**172,022.7**	**3,527.5**	**4,319.4**	**6,152.4**	**2,766.8**	**2,601.9**	**2,822.9**
Resident	135,199.8	129,521.7	177,408.4	129,024.6	122,771.3	168,433.1	3,408.3	4,148.5	6,152.4	2,766.9	2,601.9	2,822.9
Non-resident	7,316.9	6,121.9	3,589.7	7,197.7	5,951.0	3,589.7	119.2	170.9	0.0	0.0	0.0	0.0
Equity	1,484.4	1,439.5	1,047.2	1,467.5	1,417.2	1,033.9	0.0	0.0	0.0	16.9	22.3	13.3
Debt	140,925.4	134,026.4	179,817.9	134,675.0	127,194.7	170,889.2	3,527.5	4,319.4	6,152.4	2,722.9	2,512.4	2,776.3
- bills	18,362.1	7,756.0	10,197.7	15,902.1	6,984.8	9,464.1	1,385.3	0.0	0.0	1,074.7	771.2	733.7
- NBP bonds	8,050.0	8,036.6	8,145.7	7,979.5	7,966.0	8,074.3	30.0	43.3	43.8	40.5	27.3	27.6
- Treasury bills	12,109.5	11,445.9	36,940.5	10,765.4	10,007.4	33,759.2	233.8	209.3	1,952.0	1,110.3	1,229.2	1,229.3
- Treasury bonds	90,393.1	92,894.6	110,300.9	88,391.9	88,676.2	105,587.5	1,600.2	3,817.0	4,123.7	401.0	401.4	589.7
other	12,010.7	13,893.4	14,233.0	11,636.1	13,560.3	14,004.1	278.2	249.8	33.0	96.3	83.3	196.0
other	106.9	177.7	132.9	79.8	110.4	99.7	0.0	0.0	0.0	27.1	67.3	33.2

Table 2.5 - Capital (funds) and subordinated liabilities (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Total	**59,225.7**	**68,537.1**	**82,587.5**	**55,393.9**	**64,058.9**	**77,364.5**	**x**	**x**	**x**	**3,831.7**	**4,478.2**	**5,223.0**
Core capital (funds)	13,429.0	14,366.3	16,062.7	12,866.7	13,742.8	15,436.4	x	x	x	562.3	623.5	626.3
Own stocks	-2.4	-2.2	-99.1	-2.4	-2.2	-99.1	x	x	x	0.0	0.0	0.0
Supplementary capital (fund)	21,085.4	31,178.1	38,178.7	18,201.5	27,831.7	34,235.6	x	x	x	2,884.0	3,346.4	3,943.1
Other reserves	12,285.4	9,460.4	10,744.6	12,245.3	9,419.3	10,696.9	x	x	x	40.1	41.1	47.7
General banking risk fund	7,759.3	7,499.6	8,484.5	7,559.0	7,269.5	8,217.9	x	x	x	200.2	230.1	266.6
Profit (loss) brought forward	-33.1	-114.7	275.6	-47.7	-120.7	275.3	x	x	x	14.7	6.0	0.3
Revaluation reserve	1,229.3	58.9	414.4	1,118.3	-46.7	318.6	x	x	x	110.9	105.6	95.9
Other supplementary funds (CBS/PFSA/Banking Law)	573.9	531.1	952.5	573.9	531.1	952.5	x	x	x	0.0	0.0	0.0
Reserve for risk and expenditures unrelated with core activity	0.0	0.0	0.0	0.0	0.0	0.0	x	x	x	0.0	0.0	0.0
Maturity-adjusted subordinated liabilities	2,498.3	5,152.4	7,180.4	2,455.9	4,991.1	6,944.2	x	x	x	42.4	161.3	236.2
Other subordinated liabilities	424.5	434.5	378.5	407.8	407.8	339.0	x	x	x	16.8	26.8	39.5
Interest on subordinated liabilities	15.7	35.1	47.1	15.7	35.0	46.8	x	x	x	0.0	0.1	0.3

Table 3 - Profit and loss account (PLN million) and performance

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Net interest	**20,702.2**	**24,339.5**	**29,946.5**	**18,723.3**	**21,669.7**	**26,354.4**	**177.9**	**497.6**	**849.4**	**1,801.1**	**2,172.2**	**2,742.7**
- income	35,005.9	43,231.4	59,810.5	31,991.5	38,729.0	52,987.9	534.8	1,510.5	2,776.7	2,479.7	2,991.9	4,045.8
- costs	14,303.7	18,891.9	29,864.0	13,268.2	17,059.3	26,633.6	356.9	1,012.9	1,927.4	678.6	819.7	1,303.1
Net commissions	**9,142.0**	**10,997.7**	**11,323.9**	**8,338.2**	**10,007.0**	**10,207.8**	**60.6**	**186.4**	**239.9**	**743.2**	**804.4**	**876.2**
- income	11,218.4	13,895.8	14,661.0	10,295.3	12,529.0	13,195.8	110.8	484.9	505.9	812.4	881.9	959.4
- costs	2,076.5	2,898.0	3,337.2	1,957.1	2,522.0	2,988.0	50.2	298.5	266.0	69.1	77.5	83.1
Income from stocks, shares and other securities	1,106.7	966.6	1,511.1	1,099.8	960.7	1,497.1	0.0	0.0	0.0	6.9	5.8	14.0
Result of financial transactions	1,170.5	1,447.9	-785.4	1,050.4	1,548.1	-894.9	105.3	-109.7	116.2	14.8	9.5	-6.6
Foreign exchange result	3,009.5	3,664.8	6,543.1	2,962.3	3,319.5	6,135.4	33.9	329.5	382.9	13.3	15.8	24.9
Profit on banking operations	**35,130.8**	**41,416.5**	**48,629.2**	**32,174.0**	**37,505.0**	**43,389.7**	**377.6**	**903.8**	**1,588.3**	**2,579.3**	**3,007.7**	**3,651.2**
Other operating income	1,814.1	1,870.1	1,962.8	1,712.8	1,707.6	1,790.0	19.8	47.4	42.5	81.5	115.1	130.3
Other operating costs	1,196.2	806.9	935.9	1,107.4	676.3	794.6	23.7	47.1	40.2	65.1	83.4	101.1
Result from fair value hedge accounting	2.2	-4.3	-6.1	4.2	-2.4	-8.0	-1.9	-2.0	1.9	0.0	0.0	0.0
Administrative costs	**18,997.4**	**21,771.9**	**24,804.9**	**16,823.8**	**19,092.9**	**21,630.6**	**427.7**	**734.3**	**933.5**	**1,745.9**	**1,944.7**	**2,240.8**
- wages and salaries	8,824.8	10,066.7	11,429.0	7,628.1	8,644.2	9,741.5	160.7	265.3	340.9	1,036.1	1,157.1	1,346.6
- insurance and other benefits	1,912.9	2,211.2	2,367.6	1,654.8	1,906.4	2,021.4	29.3	51.6	74.4	228.8	253.1	271.8
other	8,259.6	9,494.1	11,008.3	7,540.9	8,542.2	9,867.7	237.7	417.4	518.1	481.0	534.5	622.5
Amortisation and depreciation of fixed assets and intangible assets	**2,183.7**	**2,290.0**	**2,335.0**	**2,012.5**	**2,062.7**	**2,080.4**	**23.6**	**66.7**	**77.3**	**147.6**	**160.6**	**177.4**
Net provisions and revaluation	**1,667.0**	**1,713.0**	**5,230.5**	**1,551.7**	**1,469.9**	**4,794.8**	**37.6**	**165.7**	**322.2**	**77.8**	**77.4**	**113.6**
write-offs for provisions and revaluation	10,725.8	11,679.3	16,865.7	10,312.7	11,128.9	16,109.5	57.6	196.5	347.2	355.4	353.9	409.1
of which: for non-performing loans	6,542.8	5,789.6	9,100.5	6,227.8	5,437.2	8,532.5	32.4	102.0	297.9	282.5	250.4	270.2
release of provisions and revaluation	9,058.7	9,966.2	11,635.2	8,761.0	9,659.0	11,314.7	20.1	30.7	25.0	277.6	276.5	295.5
of which: non-performing loans	5,120.8	4,652.9	5,495.9	4,890.5	4,428.6	5,282.1	7.9	19.0	3.6	222.4	205.3	210.2
Operating result	**12,902.9**	**16,700.5**	**17,189.4**	**12,395.6**	**15,908.4**	**15,781.4**	**-117.2**	**-64.7**	**259.5**	**624.5**	**856.7**	**1,148.6**
Extraordinary profit (loss)	1.4	0.1	0.2	1.5	0.1	0.3	0.0	0.0	0.0	0.0	0.0	-0.1
Negative goodwill fully recognised in the financial result	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Share in profits (losses) of subsidiaries	11.0	0.3	-2.6	11.0	0.3	-2.6	0.0	0.0	0.0	0.0	0.0	0.0
Profit (loss) on assets for sale	114.6	-1.1	0.3	114.6	-1.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Gross profit (loss)	**13,029.9**	**16,699.8**	**17,187.3**	**12,522.7**	**15,907.7**	**15,779.3**	**-117.2**	**-64.7**	**259.5**	**624.5**	**856.8**	**1,148.5**
Income tax	2,321.0	3,059.9	3,244.9	2,204.7	2,871.1	2,951.1	-5.1	15.1	59.2	121.4	173.6	234.6
Other obligatory decreases in profit (increases in loss)	11.7	-2.2	7.8	12.1	-2.5	8.0	0.0	0.0	-0.3	-0.4	0.2	0.0
Net profit (loss)	**10,697.3**	**13,642.2**	**13,934.7**	**10,305.9**	**13,039.1**	**12,820.3**	**-112.0**	**-79.8**	**200.6**	**503.4**	**682.9**	**913.9**
Performance												
Net Interest Margin (%)	3.3	3.1	3.4	3.3	3.1	3.0	1.3	1.9	2.1	4.8	4.8	5.2
Cost-Income Ratio (%)	59.2	56.3	54.7	57.4	54.6	53.4	119.1	84.4	62.7	72.9	69.2	65.7
ROA (%)	1.7	1.7	1.6	1.8	1.8	1.5	-0.6	-0.1	0.5	1.3	1.5	1.7
ROE (%)	22.5	22.5	21.2	23.1	22.9	21.0	x	x	x	14.5	17.2	19.6
Average gross monthly salary (PLN)	4,656.5	5,019.5	5,260.8	4,997.4	5,386.9	5,591.5	7,331.7	6,700.4	6,166.4	2,987.1	3,203.2	3,589.2
Assets / 1 employee (PLN thousand)	4,317.0	4,758.0	5,746.3	4,864.1	5,328.9	6,389.1	11,474.6	10,147.3	12,179.0	1,457.4	1,625.1	1,808.0
Gross profit (loss) / 1 employee (PLN thousand)	82.5	100.1	94.8	98.4	119.1	108.5	-64.2	-17.5	56.3	21.6	28.6	36.7

Table 4 - Non-performing loans (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Non-performing loans	**25,000.7**	**23,205.5**	**27,419.7**	**23,716.7**	**22,106.0**	**25,815.6**	**372.9**	**240.8**	**695.1**	**911.2**	**858.7**	**909.0**
Financial sector	663.0	395.6	520.0	655.9	390.4	514.2	0.0	0.0	0.0	7.1	5.2	5.7
Non-financial sector	24,231.4	22,712.8	26,804.4	22,957.8	21,621.7	25,207.9	372.9	240.8	695.1	900.8	850.2	901.3
enterprises	13,771.0	12,158.8	13,657.4	13,153.5	11,740.0	13,224.0	310.7	113.0	73.2	306.8	305.8	360.1
households	10,384.4	10,497.9	13,064.1	9,734.9	9,830.6	11,905.4	61.7	127.4	621.4	587.8	539.8	537.2
non-commercial institutions	76.0	56.1	82.9	69.4	51.1	78.4	0.4	0.4	0.5	6.1	4.6	4.0
General government	106.4	97.1	95.4	103.0	93.9	93.4	0.0	0.0	0.0	3.4	3.2	2.0
Share of non-performing loans in total receivables	**5.2**	**4.0**	**3.7**	**5.5**	**4.3**	**4.0**	**2.4**	**1.0**	**1.7**	**2.5**	**2.0**	**1.8**
Financial sector	0.5	0.3	0.5	0.6	0.4	0.7	0.0	0.0	0.0	0.1	0.0	0.0
Non-financial sector	7.4	5.2	4.4	7.7	5.5	4.7	4.6	1.5	2.3	4.0	3.0	2.8
enterprises	9.7	6.9	5.9	10.0	7.1	6.2	5.1	1.6	0.7	6.9	5.5	5.3
households	5.6	4.1	3.5	5.9	4.4	3.7	3.0	1.5	3.1	3.2	2.4	2.1
non-commercial institutions	7.5	3.4	3.7	7.7	3.5	3.9	2.3	16.8	39.0	6.7	2.8	1.9
General government	0.5	0.5	0.4	0.6	0.5	0.4	0.0	0.0	0.0	0.2	0.2	0.1
Non-performing loans for households	**10,206.4**	**10,377.9**	**12,942.1**	**9,573.3**	**9,718.5**	**11,789.0**	**48.8**	**122.5**	**618.4**	**584.3**	**536.9**	**534.7**
consumer loans	6,103.2	6,728.7	8,981.7	5,819.5	6,395.5	8,154.9	44.0	116.8	597.0	239.7	216.4	229.8
overdraft	1,376.6	1,319.7	1,339.2	1,334.9	1,278.8	1,295.9	0.0	0.0	0.0	41.7	41.0	43.2
credit cards	412.5	555.1	858.6	383.2	529.3	828.2	29.3	25.8	30.2	0.1	0.1	0.2
other	4,314.0	4,853.8	6,784.0	4,101.4	4,587.4	6,030.8	14.6	91.1	566.7	198.0	175.3	186.4
mortgage loans	1,370.7	1,361.6	1,954.2	1,339.9	1,327.5	1,901.9	0.8	3.8	18.3	30.0	30.4	34.0
PLN	852.3	889.1	1,201.2	821.8	856.0	1,162.4	0.8	2.7	4.9	29.7	30.4	34.0
foreign currency	518.4	472.6	753.0	518.1	471.5	739.5	0.0	1.1	13.5	0.3	0.0	0.0
other real property	179.6	137.2	151.5	163.6	120.3	125.9	0.0	0.0	0.0	16.0	16.9	25.6
investment loans	1,389.1	1,184.5	1,128.9	1,224.5	1,034.8	991.1	1.3	1.9	3.1	163.3	147.8	134.6
other	1,163.8	965.9	725.8	1,025.8	840.5	615.1	2.7	0.0	0.0	135.3	125.4	110.6
Share of non-performing loans in total loans												
Total	5.6	4.1	3.5	5.9	4.3	3.6	2.4	1.5	3.1	3.2	2.4	2.1
consumer loans	7.9	6.6	6.6	8.3	7.0	6.7	3.3	2.6	7.9	4.2	3.4	3.2
overdraft	9.0	7.4	6.5	9.9	8.1	7.0	43.8	0.0	0.0	2.4	2.1	1.9
credit cards	7.1	6.2	6.8	6.8	6.1	6.8	15.3	9.6	7.3	2.5	1.7	1.7
other	7.6	6.4	6.6	8.0	6.8	6.6	1.3	2.2	8.0	5.0	4.1	3.8
mortgage loans	1.8	1.2	1.0	1.8	1.2	1.1	0.2	0.1	0.2	1.8	1.2	1.1
PLN	3.0	1.7	2.0	3.1	1.8	2.1	0.3	0.2	0.3	1.8	1.2	1.1
foreign currency	1.0	0.7	0.6	1.0	0.7	0.6	0.0	0.1	0.1	43.2	0.0	0.0
other real property	5.6	2.8	2.9	7.6	3.5	4.0	0.0	0.0	0.0	1.5	1.3	1.5
investment loans	7.7	5.1	4.9	11.1	4.5	4.3	1.6	0.0	0.0	2.4	0.6	0.6
other	1.8	11.1	8.4	29.7	9.7	7.1	4.0	0.0	0.0	4.4	1.4	1.3
Hedges and reserves / write-offs for non-performing loans of the non-financial sector												
- hedge value	5,603.6	4,823.7	6,094.4	4,983.1	4,469.9	5,760.3	255.0	41.3	10.2	365.5	312.6	323.9
basis for the creation of reserves / write-offs	18,103.9	17,451.2	20,265.6	17,466.1	16,723.4	19,013.6	110.3	199.6	684.9	527.6	528.2	567.1
statutory reserves / write-offs	16,247.3	15,268.8	16,500.5	15,711.3	14,663.7	15,571.9	100.9	162.9	475.6	435.1	442.3	453.0
created reserves / write-offs	16,594.8	15,621.1	16,427.4	16,032.6	14,982.8	15,464.0	118.7	184.3	500.3	443.5	453.9	463.1

Table 5 - Capital adequacy (PLN million)

	Total banking sector			Commercial banks			Branches of credit institutions			Cooperative banks		
	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008	12/2006	12/2007	12/2008
Total own funds of banks for capital adequacy ratio	**51,570.1**	**61,764.6**	**74,999.2**	**47,841.6**	**57,304.6**	**69,817.0**	**x**	**x**	**x**	**3,728.5**	**4,460.0**	**5,182.2**
short-term capital	335.8	272.9	549.9	335.0	272.9	549.9				0.8	0.0	0.0
Tier I capital	50,324.7	60,002.8	71,966.4	46,676.5	55,761.5	67,067.6	x	x	x	3,648.2	4,241.3	4,898.8
Tier II capital	4,299.8	5,742.4	8,600.1	4,146.4	5,475.5	8,262.0	x	x	x	153.4	266.9	338.1
deductions from the sum of Tier I and II capital	3,390.2	4,253.6	6,117.2	3,316.3	4,205.4	6,062.4	x	x	x	73.9	48.2	54.7
Breakdown of banks by own funds												
< 3	97	2	0	0	0	0	x	x	x	97	2	0
3 < 10	402	472	436	0	0	0	x	x	x	402	472	436
10 < 20	69	83	101	0	0	0	x	x	x	69	83	101
20 < 50	17	21	39	2	0	1	x	x	x	15	21	38
50 < 100	7	8	7	6	5	4	x	x	x	1	3	3
100 < 200	11	11	9	11	11	8	x	x	x	0	0	1
200 < 500	13	12	15	13	12	15	x	x	x	0	0	0
500 < 1000	6	7	6	6	7	6	x	x	x	0	0	0
1000 < 2000	6	7	7	6	7	7	x	x	x	0	0	0
2000 < 5000	5	6	9	5	6	9	x	x	x	0	0	0
5000 < 10000	2	1	1	2	1	1	x	x	x	0	0	0
> 10000	0	1	1	0	1	1	x	x	x	0	0	0
Total capital requirement	**31,150.9**	**40,724.8**	**55,553.3**	**29,020.7**	**38,141.2**	**52,409.5**	**x**	**x**	**x**	**2,130.3**	**2,583.6**	**3,143.9**
Credit risk	29,514.8	38,552.1	48,680.5	27,397.9	35,986.3	45,973.5	x	x	x	2,116.9	2,565.8	2,707.0
Operational risk	x	x	5,650.3	x	x	5,225.7	x	x	x	x	x	424.6
Equity and debt securities price risk and currency risk	287.1	468.6	354.5	285.1	466.1	352.8	x	x	x	2.1	2.6	1.7
Interest rate risk	702.9	894.3	734.5	702.9	894.3	734.3	x	x	x	0.0	0.0	0.2
Excess of large exposure limit	357.0	380.6	110.5	346.5	369.4	107.8	x	x	x	10.5	11.2	2.7
Excess of capital concentration limit	2.1	0.0	2.2	2.1	0.0	2.2	x	x	x	0.0	0.0	0.0
Other	287.0	429.2	20.8	286.2	425.1	13.2	x	x	x	0.8	4.0	7.6
Capital adequacy ratio	**13.2**	**12.1**	**10.8**	**13.2**	**12.0**	**10.7**	x	x	x	**14.0**	**13.8**	**13.2**
Median (Me)	15.1	15.2	14.1	13.8	12.1	11.5	x	x	x	15.3	15.5	14.4
Arithmetic mean (x)	17.3	18.4	16.7	16.4	16.2	19.1	x	x	x	17.4	18.6	16.5
Breakdown of banks by capital adequacy ratio												
< 8	1	1	2	0	0	1	x	x	x	1	1	1
8 < 10	62	67	47	2	4	12	x	x	x	60	63	35
10 < 12	96	112	150	10	19	17	x	x	x	86	93	133
12 < 15	144	129	154	18	10	6	x	x	x	126	119	148
> 15	332	322	278	21	17	16	x	x	x	311	305	262