Changes in the financing structure of the real economy in Poland - challenges for the banking sector

Jerzy Pruski and Dawid Żochowski

20. August 2005

Changes in the financing structure of the real economy in Poland - challenges for the banking sector

Jerzy Pruski[1]
Dawid Żochowski[2]

Introduction

Significant changes have occurred in the Polish banking sector over the last ten years. In the mid-1990s, due to low market entry requirements, many small private commercial banks, which were frequently established by foreign banks seeking to enter the Polish market, operated alongside state banks. A wave of privatisation occurred in the banking sector, which was followed by a period of consolidation and restructuring. These processes, coupled with a simultaneous increase in foreign investor participation, enhanced management quality and banks' efficiency, primarily with regard to risk management.

The changes, which took place in the Polish banking sector in the second half of the 1990s, improved access to loans for corporates and households alike. As a result, lending grew rapidly. The increase was, on average, more pronounced in the household sector than in the corporate one, which brought the composition of bank loans to the private sector closer to what exists in the European Union. This convergence has accelerated over the last five years. The purpose of this paper is to present the phenomena which influenced the evolution of debt structure of the real economy sector in Poland as well as to discuss related future challenges.

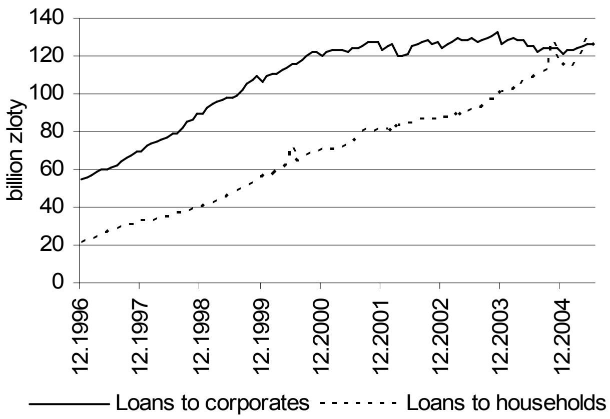
1. Changes in access to loans for the real economy sector and in the loan portfolio structure

1.1 Trends

Over the last decade, household borrowing has grown sixfold. Over the same period, corporate debt has doubled - the growth largely occurred during the first half of the period (cf. Figure 1). The ratio of loans to households to GDP rose from 5.2% in 1996 to 13% in 2004. The ratio of loans to corporates to GDP amounted to 13.2% in 1996, then reached 16.6% in 2000 and decreased to 13.7 % in 2004 (cf. Figure 2).

Figure 1

Credit growth



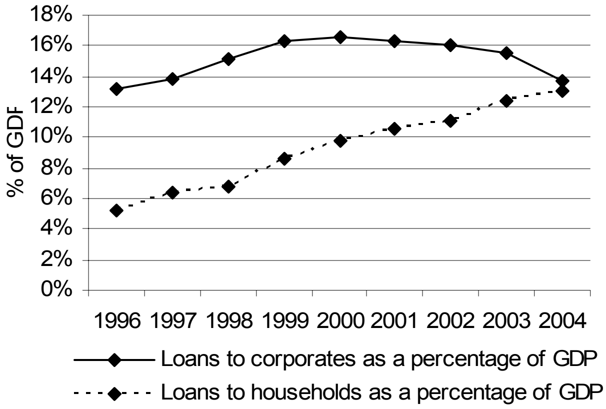
Source: NBP.

1 First Deputy President of the National Bank of Poland.

2 Economist, Financial System Department, National Bank of Poland.

Figure 2

Credit to GDP ratios



Source: GUS and NBP data, own calculations.

These figures provide an overview of the processes which occurred in the Polish banking sector during the last ten years. Initially, banks focused their lending activities on the corporate sector. Due to the economic slowdown in 2001 and 2002, and the restructuring efforts undertaken by businesses, loans to corporates did not grow in subsequent years. Faced with a lack of growth in loans to corporates, banks concentrated on the retail sector, which significantly intensified the competition in the consumer and housing loan segments.

1.2 Waves of growth in lending

Three waves of accelerated growth can be distinguished with regard to the increase in lending to households:

- The first wave (1996-1997) occurred during a period of rapid economic growth. The effects of the reforms undertaken at the beginning of the 1990s began to be felt by households. Conditions in the labour market and, therefore, the financial standing of households improved. The saturation of the market with consumer durables as well as the obsolescence of old equipment led households with growing optimism about prospects to purchase consumer durables on credit en masse. During this time, the rapid increase in household debt was accompanied by an even larger (in terms of volume) increase in corporate debt - enterprises were financing their rapidly growing investments.
- The second wave (1999-2000) followed the period of privatisation and consolidation in the Polish banking sector, and came directly before an economic slowdown. Among other things, automobile loans grew rapidly during this period, and the importance of housing loans also rose. Banks' cooperation with loan intermediaries gained prominence. No credit information bureau operated as yet, however, and credit scoring systems were still imperfect. This later led to a deterioration in loan portfolio quality. At the end of this growth wave, the nominal increase in household debt exceeded the increase in debt in the corporate sector. The slower growth in corporate debt was the result of the completion of the investment cycle and the economic slowdown.
- The third wave (2003-present) emerged when inflation stabilised at a low level, and interest rates decreased. Faced with stagnating lending to corporates, banks focused on the retail sector - on the housing loan segment, among other things. Intensified competition led to the extension of the range of loans on offer and terms became more attractive: access to foreign currency loans improved, and loan terms were extended to 30 years. The rise in lending was also influenced by demand-side factors such as the population boom and expectations of property price increases following Poland's accession to the EU. The increase in demand was first observed in housing loans, followed by consumer loans. Currently, demand is rising for both housing and consumer loans. At the same time, there are reasons to believe that lending to corporates has recently begun to grow after a long period of stagnation.

It can be argued that banks were insufficiently prepared for the first wave of loan growth and to some extent for the second one: no credit information bureaus operated at all, bank customers' credit histories were relatively short, and advanced credit risk assessment systems were imperfect or non-existent. Thus, the scope for proper credit risk assessment was limited. The impact of the previous two waves of accelerated growth in loans to households is worth mentioning here. In both cases, the rapid increase in lending caused a deterioration in loan quality.

The surge in lending also had an adverse macroeconomic impact. Traditional monetary policy instruments proved ineffective with regard to the first wave of growth in lending, although real interest rates were in excess of 10%, and required reserves amounted to 20%. In these circumstances, the National Bank of Poland (NBP) decided to adopt a novel solution. Six- and nine-month term deposits with higher-than-market interest rates were offered to individuals. This forced banks to offer higher interest rates on deposits. With unchanged lending margins, this meant that they had to raise interest rates on loans, which limited the growth in lending. During the second wave of growth in lending, the increase in internal demand fuelled inflation and the current account deficit (which exceeded 8% of GDP in 1999). This threatened the macroeconomic stability of the country. Since rapid fiscal adjustments were not possible, the burden of stabilising the economy had to be shouldered by monetary policy (cf. shaded areas in Figure 1, Appendix 1). Real interest rates went as high as 15% during this time.

The monetary policy decisions made by the NBP after the two first growth waves not only enabled the inflation rate to resume its downward trend, but also limited the adverse consequences of rapid growth in lending for banks. Banks' earnings deteriorated, but not to an extent which might have endangered the stability of the financial system.

At the moment, the current account deficit is not a major issue. The high central budget deficit remains a problem, although certain measures have been taken aiming to curb it. For their part, banks are already using information collected by the Credit Information Bureau and have developed their own credit risk assessment systems, which have been used and perfected for several years now. However, the current growth in loans has led to new challenges for banks as well as new threats to the stability of the financial system. It also poses new dilemmas for the National Bank of Poland. Should the central bank respond to excessively fast growth in lending despite the fact that inflation and the current account deficit are low? Does the fact that Poland adopted a floating exchange rate regime over five years ago have an impact on the effectiveness of traditional monetary policy instruments in limiting lending? In order to find answers to these monetary policy dilemmas, the reasons for the current growth in lending should be examined in more detail.

1.3 Reasons for the current wave of growth in lending

The current wave of loan growth has been caused both by supply- and demand-side factors:

Supply-side factors:

- The high rate of increase in loans to households is to some extent *the consequence of stagnation in corporate lending*. Businesses do not borrow because they have considerable amounts of available funds. The absence of growth in lending to corporates results in banks competing for retail customers because the rise in loans to households allows them to compensate for the relatively lower interest income on loans to corporates.
- With banks focusing their activities on the household sector, *competitive pressure grows*. Banks compete for new customers in the household sector by *decreasing loan prices* (both spreads and fees) and easing credit standards - they offer e.g. low lending margins which exceed market interest rates by 1 percentage point, and remain fixed through the duration of the loan agreement. The trend towards *easing loan terms and conditions as well as credit standards* by banks has also been indicated by the results of surveys on the loan market condition. The trend towards the easing of lending policies with regard to consumer loans has been noticeable among banks since the research was first conducted, i.e. from December 2003 (with the exception of the third quarter of 2004, i.e. directly after the considerable easing of credit standards). With regard to housing loans, it has been observed since the second quarter of 2004. The tendency towards easing loan terms and conditions as well as credit standards with regard to loans to households has become more pronounced since the end of 2004, especially in the consumer loan segment. At the end of

June 2005, however, banks did not expect further easing of lending policies in the consumer loan segment in the third quarter of 2005.1[3]

- *The development of bank loan distribution channels* - banks' cooperation with loan intermediaries and financial consultancy firms as well as the increased importance of active customer acquisition. According to estimates by analysts in the loan intermediation sector, loan intermediaries and financial consultants (who sometimes are part of the banks' capital groups and sometimes just cooperate with banks with which they have no capital links) are involved in about one quarter of the loans to households recorded on banks' balance sheets. Easy availability is one of the reasons for the considerable importance of loans extended by intermediaries - loans are offered at the same places where goods purchased on credit are sold.

Demand-side factors:

- *Housing market conditions and the expected rise in property prices*. The expected increase in the VAT rate on land for property development after May 1, 2004 fuelled demand for housing units and housing loans at the beginning of 2004. This increase in demand was also related to the expected rise in housing prices after Poland's accession to the EU. Currently, demand for housing is being stimulated by the expected rise in home prices - due to the increase in the VAT rate on newly constructed homes to 22% from January 1, 2008, among other factors.
- *Demographic factors*. The entry of the 1970s/1980s population boom generation into the housing market as well as migration from rural areas and small towns to large cities are fuelling demand for homes and home purchase financing.
- The gradual *improvement in households' financial standing* caused primarily by better labour market conditions, and the increased importance of income from work abroad as well as an improvement in farmers' financial standing due to the introduction of Common Agricultural Policy subsidies have led to an increase in disposable income and an upward adjustment in households' expectations concerning disposable income. This adjustment was also caused by an improvement in expectations after Poland's accession to the EU.[4] Due to households' higher disposable income, more of them attain the creditworthiness required by banks, and therefore the numbers of potential bank customers increase. However, rising disposable income leads to an increase in current consumption. Both factors fuel the growth in lending.
- The *wealth effect* linked to the appreciation of the zloty against foreign currencies may also have an impact here. On the one hand, households that took out foreign currency loans at a lower zloty exchange rate pay lower loan instalments now, which makes their disposable income higher than expected. On the other hand, the net value of their assets (the value of the purchased home less the amount of loan to be repaid) also increases. Both factors may fuel current consumption. If exchange rate trends reverse, i.e. the zloty depreciates against foreign currencies, the mechanisms mentioned above will become detrimental to borrowers and potentially banks as well.
- *Low interest rates*, which encourage households to increase their debt and purchase goods on credit (this issue will be discussed in more detail in section 2.4).
- *Rapid growth in credit card issuance*. This form of payment and financing for consumer purchases is becoming more popular, which accelerates the increase in debt. The easing of credit card criteria and competition between banks eager to win customers are also fundamental causes for this growth.

Surveys on loan market conditions conducted by the NBP indicate that, according to banks, during the recent period (the second and third quarters of 2005), the easing of lending policies was one of the most important factors behind the growing demand for both housing and consumer loans.[5] Therefore,

---

3 *Senior Loan Officer Opinion Survey on Bank Lending Practices and Credit Conditions*, NBP, www.nbp.pl, July 2005.

4 The Household Barometer (IRG) and the Consumer Optimism Index (Ipsos) show that the improvement in attitudes in 2004 was mainly caused by a more favourable assessment of Poland's current and future economic situation.

5 *Senior Loan Officer Opinion Survey*, NBP, www.nbp.pl, April and July 2005.

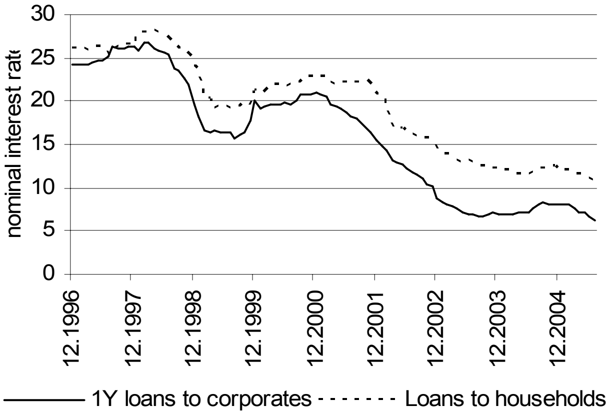
the current growth in lending is largely fuelled not only by demand-side but also by supply-side factors. This may have adverse consequences for the future quality of loans to households, since banks may grant loans to persons with increasingly low creditworthiness.

1.4 The importance of interest rate convergence for financial stability

Intensified competition in the banking sector has significantly facilitated access to loans for the real economy sector, particularly for households. This would not have been possible had inflation not stabilised at a low level, however. Low inflation has not only led to a decrease in both nominal and real interest rates, but has also allowed the stabilisation of spreads, which in turn has significantly reduced interest rate risk (cf. Figures 3-6). However, better credit risk assessment capabilities and an improvement in the financial standing of households have brought down the ratio of lending margins (as compared to the market interest rate) to the loan interest rate. Having reduced their lending margins, banks compete by reducing fees and commissions on loan agreements. All these factors have significantly reduced the cost of loans. Extended loan terms as well as easier access to foreign currency loans with lower interest rates have made borrowing more affordable for a larger number of people. It should be stressed, however, that there is still considerable room for reducing the cost of loans and improving access to them, in particular with regard to consumer loans and loans to small and medium-sized enterprises.

Figure 3

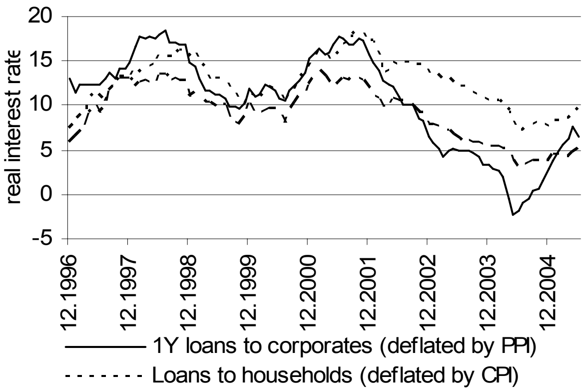
Average nominal interest rate (zloty loans)



Source: NBP.

Figure 4

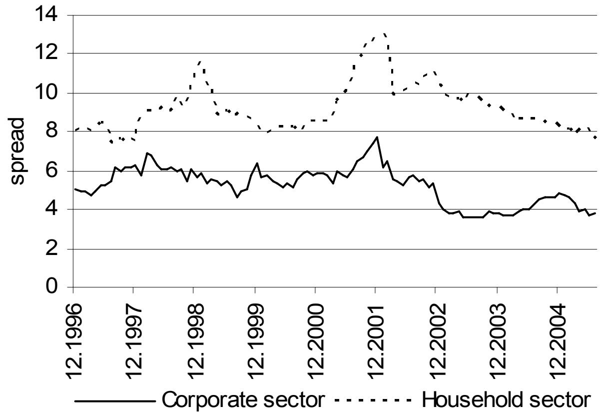
Average real interest rate (zloty loans)



Sources: GUS and NBP data, own calculations.

Figure 5

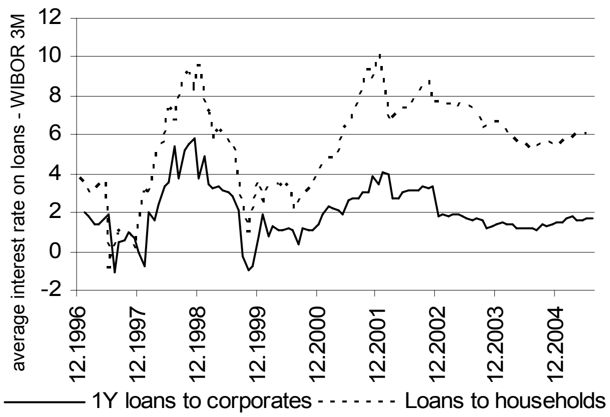
Loan-deposit spread



Sources: NBP data, own calculations.

Figure 6

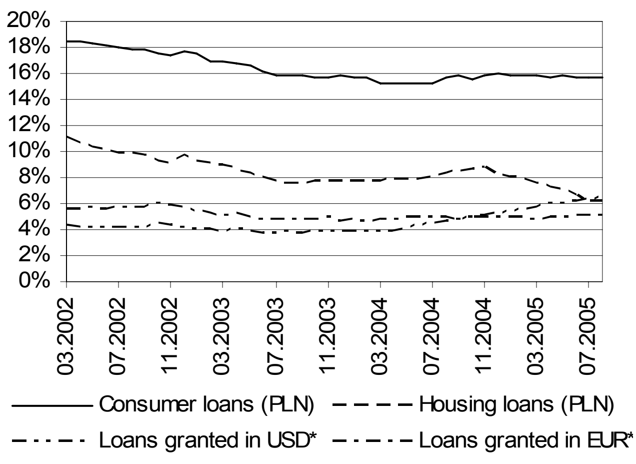
Spread on average loan



Sources: NBP data, own calculations.

Figure 7

Average interest rate on consumer loans



* The NBP has no data concerning interest rates on loans granted in CHF.

Source: NBP data.

The fact that nominal and real interest rates on loans to households are higher than those in the corporate sector (cf. Figures 3 and 4) results from the higher average interest rates on consumer loans other than housing loans (e.g. authorised overdrafts or credit card loans). The cost of loans to households is significantly lower for housing loans and foreign currency loans (cf. Figure 7).

In Poland, as in other European countries undergoing systemic transformation, foreign currency loans have come to play an important role (ca. 32% of the loan portfolio at the end of June 2005). The share of foreign currency loans in the portfolio is increasing, particularly with regard to housing loans. Due to the stabilisation in inflation and the concurrent gradual convergence in nominal interest rates,[6] the difference between interest rates on zloty and foreign currency denominated loans has significantly decreased in Poland recently (particularly for housing loans), which has also lead to a rapid growth in zloty loans (cf. Figure 7).

In this context, a question arises: can achieving interest rate convergence before joining the euro area be dangerous for financial system stability? There are mechanisms at work here that have both favourable and adverse impacts on financial system stability. On the one hand, low interest rates improve access to loans and contribute to an increase in lending, which, given intense competition for market share, may lead to a deterioration in portfolio quality in the future. Excessively rapid growth in lending also poses a risk of higher inflation and current account imbalance. On the other hand, under fully liberalised capital flows and a floating exchange rate, domestic interest rates on par with foreign ones encourage an increase in domestic currency debt. Until recently, Poles used to borrow extensively in euros and dollars, while currently only loans denominated in Swiss francs really compete with zloty loans. It appears, however, that the risk to financial stability linked to decreasing domestic interest rates is lower than that caused by higher domestic interest rates. The Czech Republic is an example of a country in our region which achieved interest rate convergence much earlier than Poland. The increase in lending there has not been rapid enough to threaten the stability of the banking system.

2. Alternative sources of funding for the real economy (other than loans) - the disintermediation phenomenon

The importance of the capital market and other forms of external financing is increasing, but remains limited. The increased capitalisation of the stock exchange has largely been the result of privatisation (funds obtained in this manner go to the central budget and not to businesses), a rise in the value of listed companies and the fact that shares of major foreign companies have been listed on the stock exchange since 2002. Growing capitalisation has not resulted from an increased importance of the capital market in raising funds by domestic businesses. The size of the market for non-government debt securities, issued by corporates, remains small compared to bank lending to corporates (cf. Table 1). Surveys conducted by the NBP also indicate that bank loans remain the most important source of external corporate financing. To a large extent, enterprises resort to internal financing or accumulate liabilities arising from services and supplies (trade loans).[7] A slightly different picture emerges when the ratio of funds obtained by businesses from new stock and debt security issues is compared to the increase in lending to the corporate sector in subsequent years (cf. Table 2). It should be noted that the higher level of this ratio between 2001 and 2003 was the result of deliberate lending policies implemented by banks (the tightening of lending policies in response to a significant increase in delinquent loans). The dominance of non-bank financing in 2004 (bank lending to this sector decreased at this time) resulted from low demand for loans by corporates and not from a significant rise in funds obtained on the capital market. After a considerable improvement in earnings, enterprises accumulated a large amount of liquid funds (mainly deposits) from 2003 onwards and repaid existing loans rather than drawing new ones. The deleveraging, which happened on a micro scale, caused a nominal decrease in corporate sector debt in 2004.

---

6 The phenomenon of interest rate convergence discussed here refers to short-term market rates, since a significant majority of zloty loans are floating-rate loans.

7 *Wybrane determinanty rozwoju rynku akcji i korporacyjnych instrumentów dłużnych w Polsce. Wyniki badania ankietowego*, NBP, www.nbp.pl, 2004, p. 12-13.

Table 1

Stock exchange capitalisation, the non-government debt securities market and lending to corporates

In millions of zloty

	Millions of zloty			% of GDP		
Year	**Stock exchange capitalisation**	**Non-government debt securities issued by enterprises**	**Loans to corporates**	**Stock exchange capitalisation**	**Non-government debt securities issued by enterprises**	**Loans to corporates**
1994	7,450	–	30,936	–	–	–
1995	11,271	–	38,218	3.4%	–	11.6%
1996	24,000	–	50,592	5.8%	–	12.2%
1997	43,766	3,107	54,511	8.7%	0.6%	10.8%
1998	72,442	6,989	69,856	12.3%	1.2%	11.9%
1999	123,411	8,488	89,552	18.9%	1.3%	13.7%
2000	130,085	13,311	106,711	18.0%	1.8%	14.7%
2001	103,370	15,039	119,852	13.6%	2.0%	15.8%
2002	110,565	16,072	123,561	14.2%	2.1%	15.8%
2003	167,717	16,343	124,725	20.6%	2.0%	15.3%
2004	291,698	17,235	126,535	32.9%	1.9%	14.3%
2005 *	337,601	18,218	121,540	36.1%	1.9%	13.0%

Sources: WSE, NBP.

Table 2

Funds obtained on the capital market and the increase in the size of the non-government debt securities market versus changes in bank lending to the corporate sector

In millions of zloty

Year	**Funds obtained on the stock exchange[1] (A)**	**Increase in the size of the non-government debt securities market[2] (B)**	**Increase in loans to corporates (C)**	**(A+B)/C, %**
1994	1,657	–	7,281.5	23%
1995	700	–	12,374.3	6%
1996	1,391	–	3,918.9	35%
1997	4,110	–	15,345.3	27%
1998	3,827	3,882	19,695.4	39%
1999	4,856	1,499	17,159.1	37%
2000	3,577	4,823	13,141.6	64%
2001	2,918	1,728	3,708.9	125%
2002	567	1,033	1,163.4	138%
2003	1,472	270	1,810.5	96%
2004	4,919	892	–4,994.8	n/d

[1] Excluding issues related to privatisation. The data do not include funds which have been withdrawn from the capital market (where stock has been redeemed and the company delisted). [2] Issued by businesses. Figures for 1998-1999 include bank bonds.

Sources: Fitch Polska, Polish Securities and Exchange Commission, NBP.

Among the forms of external financing available to corporates, the non-government debt securities market has developed at the fastest rate in recent years (cf. Table 2). It should be stressed, however, that this source of funding is only cost-efficient for large enterprises. In Poland, an issue of bonds by even a medium-sized enterprise could be unsuccessful or prove too expensive.

The increased importance of lease agreements in recent years has been largely caused by changes in tax regulations and regulations allowing the leasing of lorries by companies. Due to the impending elimination of VAT deductions, including VAT deductions on passenger vehicle purchases, vehicle leasing became more widespread in 2003 and 2004 (cf. Table 3). Leasing should see further growth, however, since it is still more attractive from a financial standpoint than taking out bank loans. The fact that the European Commission considers expenditures arising from lease agreements to be eligible for subsidies from the European Regional Development Fund may contribute to a rapid increase in the significance of such agreements for corporate financing in Poland.[8]

Table 3

Value of leased assets versus lending to the corporate sector

In millions of zloty

	Movables (A)	Property (B)	Total A+B (C)	Loans to corporates (D)	C/D, %
1999	5,863	7,544	13,406	106,711	12.6%
2000	8,937	3,060	11,997	119,852	10.0%
2001	5,128	6,445	11,573	123,561	9.4%
2002	7,281	7,841	15,122	124,725	12.1%
2003	10,456	625	11,081	126,535	8.8%
2004	11,822	1,930	13,751	121,540	11.3%

Sources: Polish Association of Leasing Companies, NBP.

The relative increase in the importance of non-bank forms of corporate financing in recent years has been primarily the result of an absence of growth in lending. In view of the expected increase in loans to corporates, the role of banks in corporate financing should grow again. Despite the fact that no real growth was observed in lending to corporates over the last five years, banks see opportunities for loan growth in this sector, particularly with regard to small and medium-sized enterprises (SMEs). Their offer for SMEs is developing and the survey on the loan market condition indicates that banks are easing loan terms and conditions as well as credit standards in this sector,[9] which may result in a growth in lending to SMEs in the immediate future.

Therefore, the disintermediation phenomenon has not emerged in Poland to a degree that might threaten the dominant position of banks with regard to funding the corporate sector in the near future. It should also be noted that banks are shareholders in large leasing companies. In situations where a given leasing company is not owned by a bank, this company will refinance (at least in part) the purchase of leased movables or property using a bank loan. Both types of relationships between banks and leasing companies either encourage lending to leasing companies or at least have a favourable impact on the banks' consolidated earnings (higher potential profits from holding equity interest in subsidiaries - leasing companies). In the case of the non-government debt securities market, although banks lose potential borrowers, as underwriters they gain income from commissions and fees for preparing and conducting debt issues through which enterprises obtain funding. Although the non-government debt securities market has considerable potential for development, which may

8 *Financial System Development Report*, National Bank of Poland, www.nbp.pl, 2005.

9 *Senior Loan Officer Opinion Survey on Bank Lending Practices and Credit Conditions*, NBP, www.nbp.pl, July 2005.

lead to a slowdown in lending to the corporate sector in the future, surveys conducted by the NBP do not indicate that this market could become the main source of corporate financing in future years.[10]

3. Challenges related to changes in bank loan structure

The increase in household sector debt, which has mainly been linked to financing home purchases, poses new challenges for banks as well as new threats to banking sector stability.

The post-accession experience of Portugal and Greece indicates that a potentially prolonged period of heightened demand for housing loans should be expected in Poland. Therefore a liquidity shortfall problem may emerge in the coming years, forcing banks to look for other long-term sources of financing housing loans. Currently, banks finance loans mainly through deposits whose maturity is much shorter than that of loans. At the same time, the loan growth rate is faster than that for deposits. Additionally, corporate deposits, which are a less stable source of bank financing than deposits from individuals, have played an important role in financing banking activity in recent years. If the expected economic recovery materialises, funds obtained from corporate savings will become the primary financing source. Only some of those funds will return to the banking sector as deposits. It should also be remembered that intense competition from non-bank financial institutions will be a factor. Households use an increasing proportion of their savings to purchase investment fund participation units or deposit their savings in credit unions. Banking supervision authorities are currently discussing possible solutions to this problem with banks. Banks are considering whether to resort to a greater extent on such methods of financing as bank bond issues or asset securitisation. Limiting the amount of claims on the financial sector (primarily from abroad) may also be a source of asset financing for banks. At the end of 2004, such claims constituted 12.2% of assets. Such measures could have a significant impact on exchange rate movements. The importance of obtaining financing from parent banks may also grow. The example of NyKredit Polska bank, which recently ceased to operate in Poland as an independent bank, and opened a branch office of the Danish parent bank, indicates that this is a possible trend. As a result, the management board of the company intends to offer mortgage loans in Poland that will be refinanced on the Danish mortgage bond market. However, research conducted by the NBP indicates that the liquidity shortfall problem in Poland will not be as acute as in Portugal and Greece.[11]

Banks operating in Poland have little experience with long-term products - they have not researched the life cycle of housing loans, among other things. Despite the fact that expertise may be transferred from parent banks, the insufficient understanding of the specific features of housing loans in Polish conditions poses new challenges related to credit risk management. The growing share of property loans in banks' loan portfolios makes them more exposed to collateral risk. In particular, the exposure of the banking sector to the risk stemming from price movements in the real estate market is increasing. At the moment, however, the increase in prices is not considered excessive.[12] On the other hand, banks are increasingly exposed to the risk of deterioration in the quality of mortgages used as collateral. For example, the amendments introduced to the Civil Code in the last year require that substitute housing be provided to occupants upon eviction, which significantly limits the possibility of enforcing claims against mortgages.[13]

The growing share of foreign currency debt increases banks' exposure to indirect foreign exchange risk through their customers' open foreign exchange positions. Research conducted by the NBP in 2003 concerning the impact of the exchange rate on the quality of foreign currency loans indicated that this relationship was statistically significant.[14] In 2003, the zloty depreciated by more than 20%

---

[10] *Wybrane determinanty rozwoju rynku akcji i korporacyjnych instrumentów dłużnych w Polsce. Wyniki badania ankietowego*, NBP, www.nbp.pl, 2004, p. 33-36.

[11] Michał Broza-Brzezina, *Lending Booms in Europe's Periphery: South-Western Lessons for Central-Eastern Members*, paper presented at the DAMS science seminar on February 1, 2005 r (mimeo).

[12] *Financial Stability Report - 2004*, National Bank of Poland, www.nbp.pl, 2005, p. 45-48.

[13] Pursuant to the Civil Code, this obligation rests on the municipality and on the debtor, and finally on the creditor.

[14] *Financial Stability Report - 2003*, National Bank of Poland, www.nbp.pl, 2004, p. 120-130.

against foreign currencies and there was a danger that this might jeopardise the repayment of foreign currency loans taken out when the domestic currency was stronger. Banking supervision authorities stressed the importance of foreign exchange risk at that time and now it is taken into account when granting foreign currency loans, e.g. by stipulating stricter requirements concerning the borrower's acceptable income compared to zloty loans.

The National Bank of Poland has recently developed a new tool for assessing loan market conditions. Quarterly surveys, which have been conducted by the NBP since the end of 2003, make it possible to obtain a full picture of changes in loan market conditions with regard to both the supply and demand sides, and provide sufficiently early warning of adverse trends. Market participants as well as banking supervision authorities are increasingly interested in the results of the survey. The survey signalled the recovery in lending to corporates at an early stage, so its future findings may prove useful in forecasting movements in lending.[15] It also predicted the EU accession effect - an above-average increase in demand for loans and an extraordinary easing of lending policies in the second quarter of 2004. The latest edition of the survey has enabled the identification of a new trend in the Polish loan market: the easing of credit standards and loan terms and conditions, which has continued for a long time despite the steadily rising demand for loans, has caused a situation where the demand for loans is amplified by the banks' decisions with regard to lending policies. In the latest edition of the survey, banks indicated that in terms of the household sector, easing loan terms and conditions as well as credit standards was the main reason for the growing demand for housing and consumer loans.[16] Thus according to the banks, their lending policies are currently the most important factor generating demand for consumer loans. Since the NBP is aware of this, it may respond to any adverse trends early enough to mitigate the threat to banking sector stability should the financial standing of banks' customers deteriorate.

The growth in lending may pose a problem given interest rate convergence. The ability of the central bank to influence long-term interest rates is limited due to the expected convergence in long-term interest rates.

Should the proportion of foreign currency loans in bank assets rise, which would lower the efficacy of interest rates as monetary policy instruments, the central bank might respond by using supervision tools.

Bibliography

1. Michał Broza-Brzezina, *Lending Booms in Europe's Periphery: South-Western Lessons for Central-Eastern Members*, paper presented at the DAMS science seminar on February 1, 2005 r (mimeo).
2. *Financial Stability Report - 2003*, National Bank of Poland, www.nbp.pl, 2004, p. 120-130.
3. *Financial Stability Report - 2004*, National Bank of Poland, www.nbp.pl, 2005, p. 45-48.
4. *Senior Loan Officer Opinion Survey on Bank Lending Practices and Credit Conditions*, NBP, www.nbp.pl, April 2005.
5. *Senior Loan Officer Opinion Survey on Bank Lending Practices and Credit Conditions*, NBP, www.nbp.pl, July 2005.
6. *Wybrane determinanty rozwoju rynku akcji i korporacyjnych instrumentów dłużnych w Polsce. Wyniki badania ankietowego*, NBP, www.nbp.pl, 2004.

---

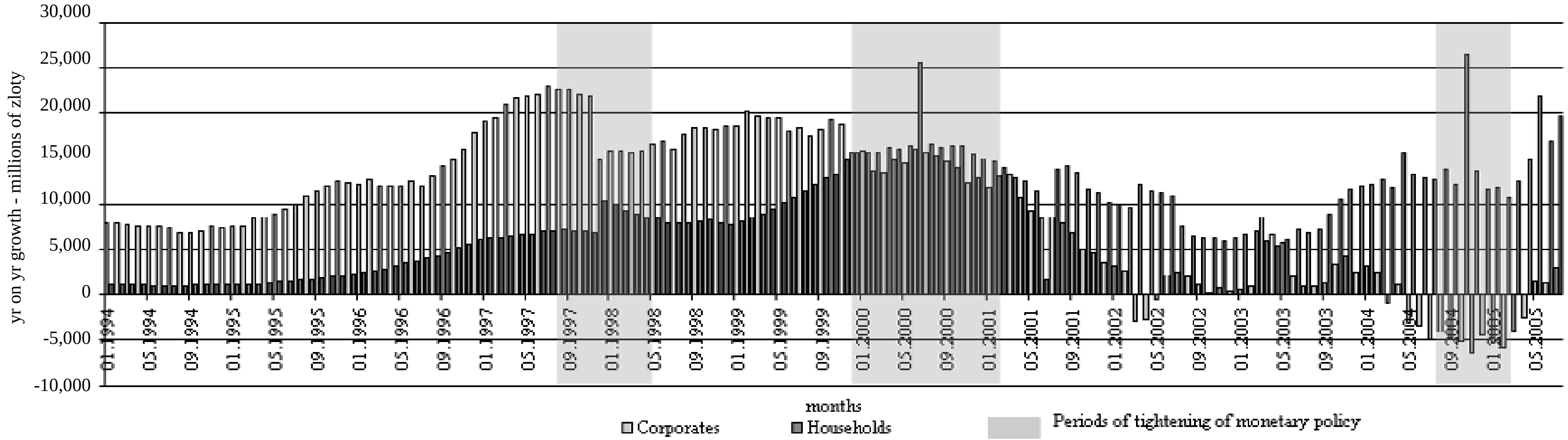
[15] The available time series, which currently consists of only eight samples, does not enable the construction of reliable forecasting models.

[16] *Senior Loan Officer Opinion Survey on Bank Lending Practices and Credit Conditions*, NBP, www.nbp.pl, July 2005.

Chart 1

Bank claims on the real economy sector

Y/y, millions of zloty

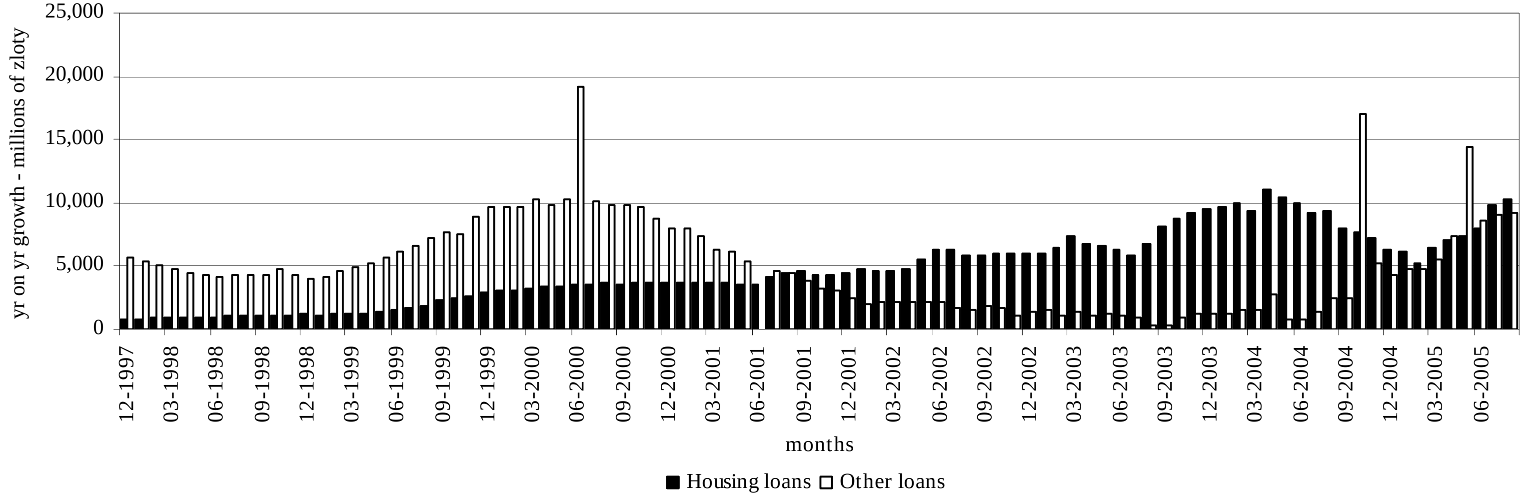


Source: NBP.

Chart 2

Bank claims on households

Y/y, millions of zloty



Source: NBP.