Impact of the recent crises on the Polish financial system and the response of the National Bank of Poland

Zbigniew Hockuba

Member of the Board

National Bank of Poland

Emerging Economies in the International Financial System

The Way Forward

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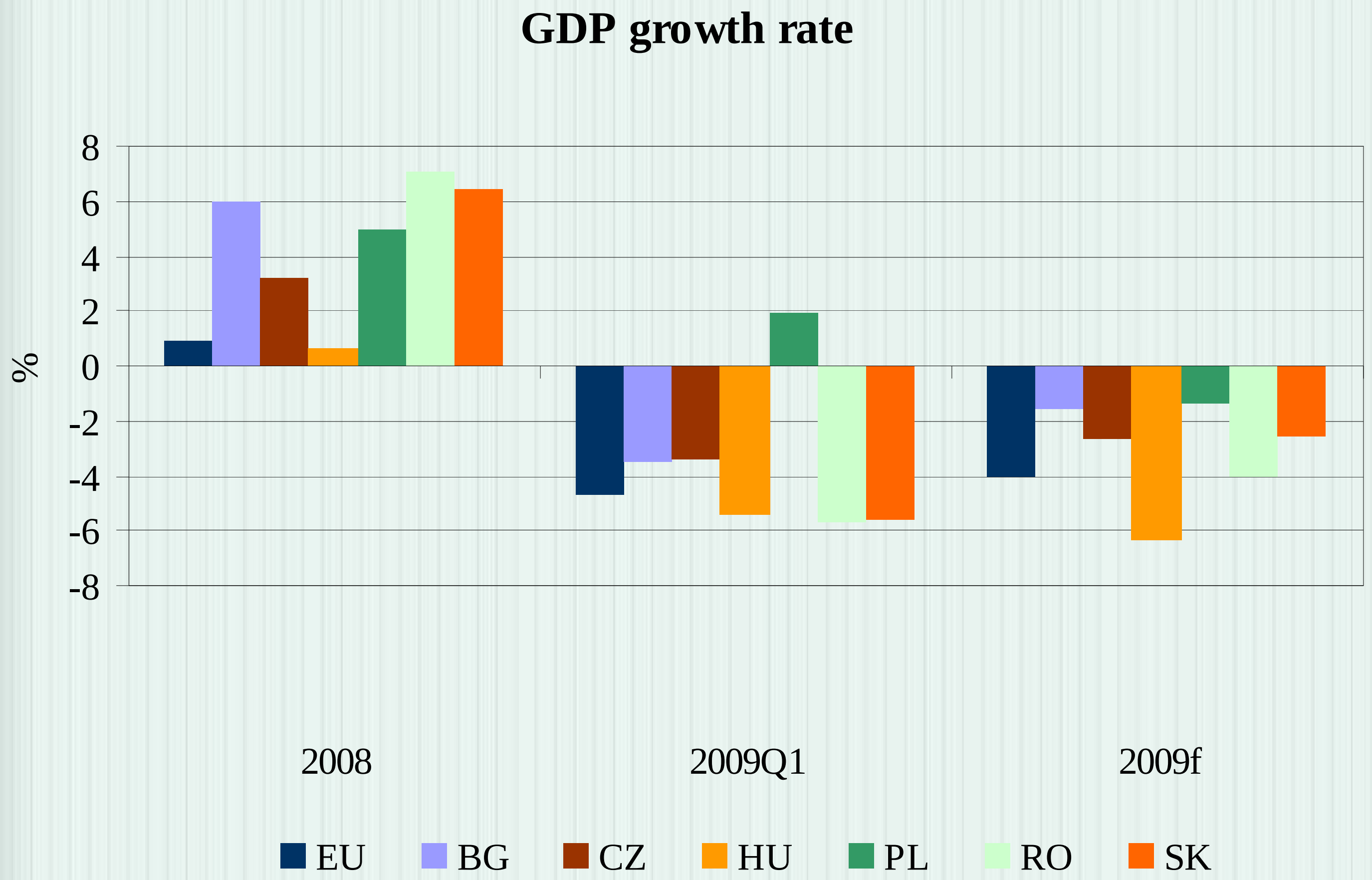
Little direct impact of the crisis on the Polish economy...

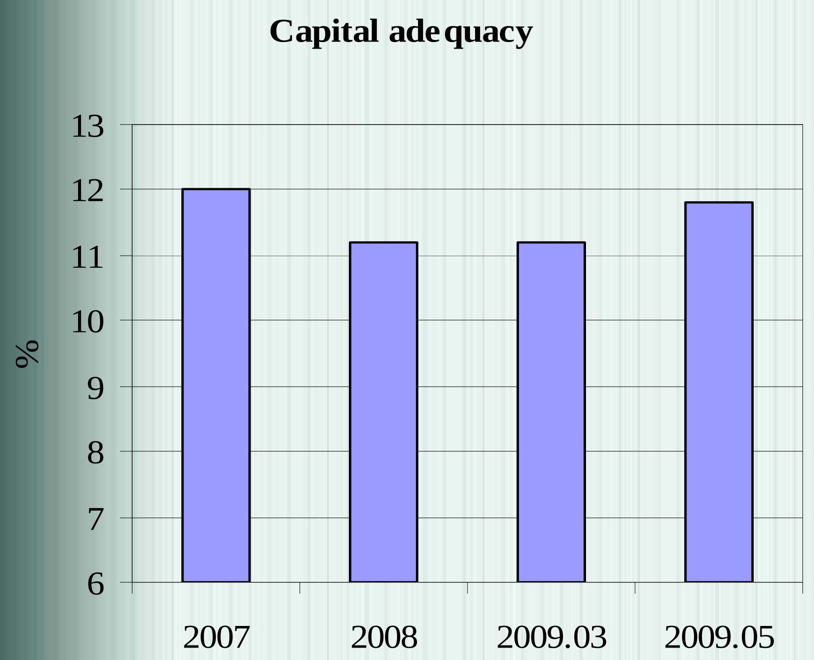
- **Relatively strong GDP growth so far** (6.7% in 2007 and 4.9% in 2008) and an above-zero forecast for 2009.
- **Relatively balanced economy**
  - CA deficit of 4.3% (4-quarter average) financed safely by FDI's, loans from mother companies and trade credit
- **Relatively good shape of the banking system**
  - Capital adequacy ratio about 11%
  - low ratio of financial assets to GDP (roughly 1,04 in Poland compared to CEE average of 1,23 and 4,36 in the euro area);
  - no securitization;
  - no exposure to high-risk assets connected to the sub-prime sector

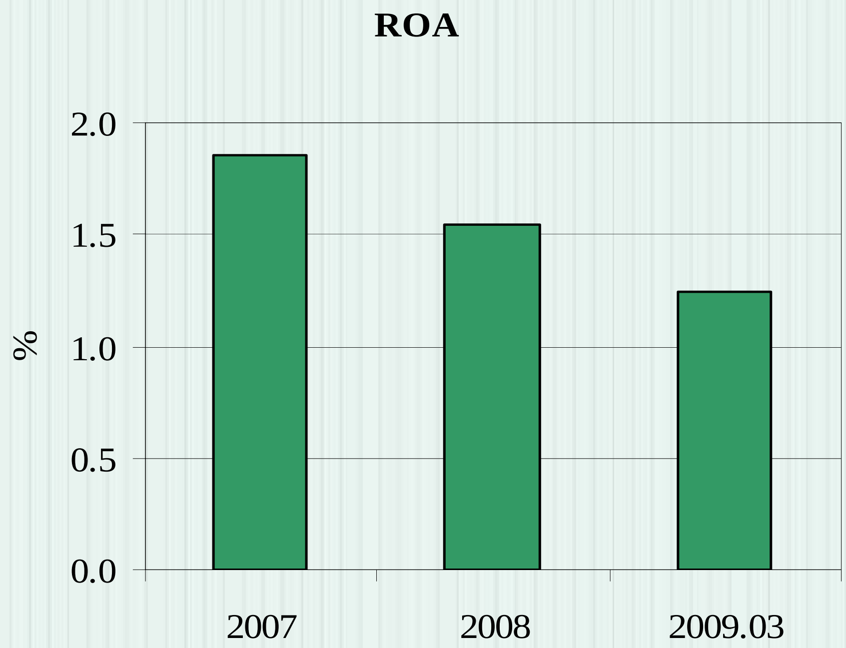
Economic situation in Poland better than in other countries of the region



Source: Eurostat

Polish banks entered the global financial crisis in a good shape

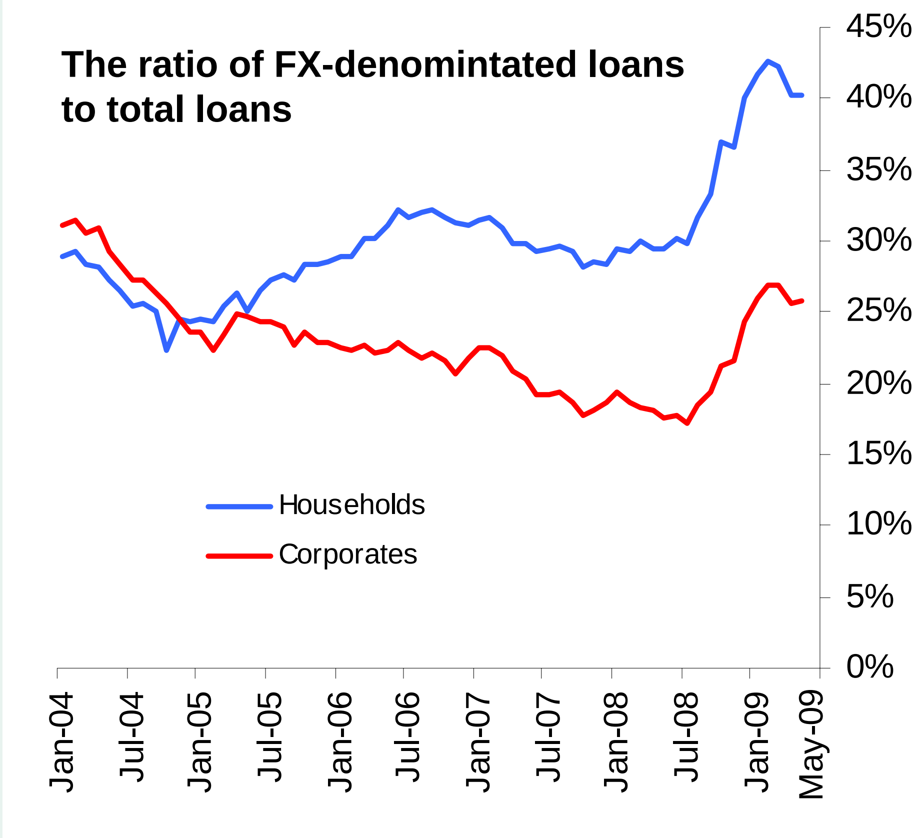




Source: NBP

2008 profits retained by most banks

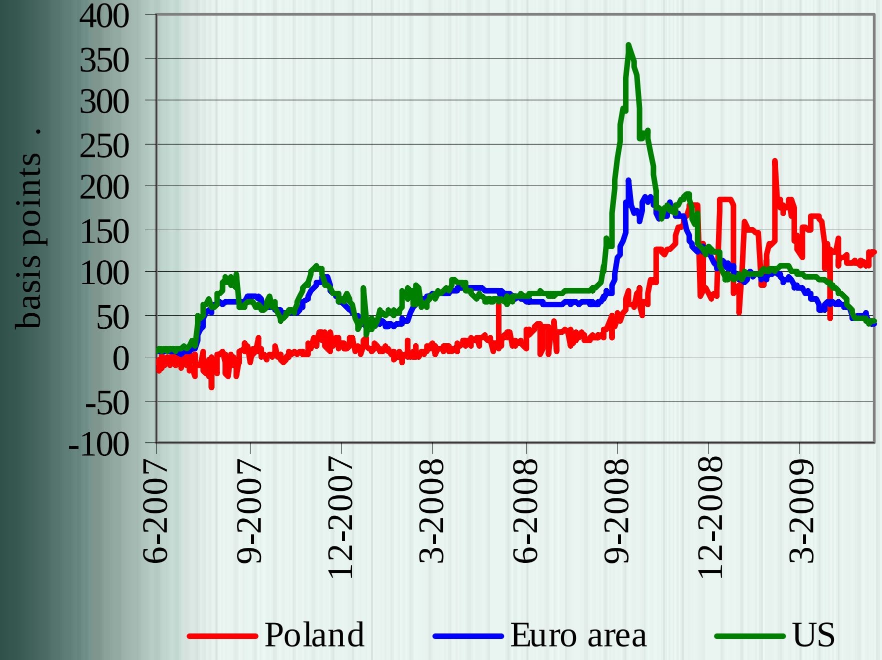
...but the global crises brought challenges



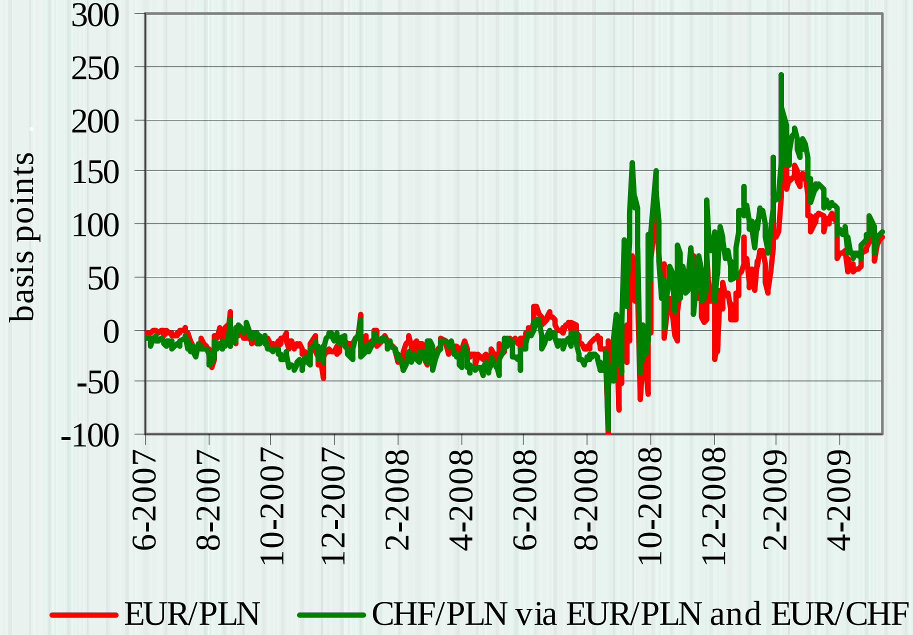
Strong appreciation of the zloty spurred FX-denominated lending

Challenges:
higher risk aversion and lower market liquidity

3M depo-OIS spread



FX swap margins



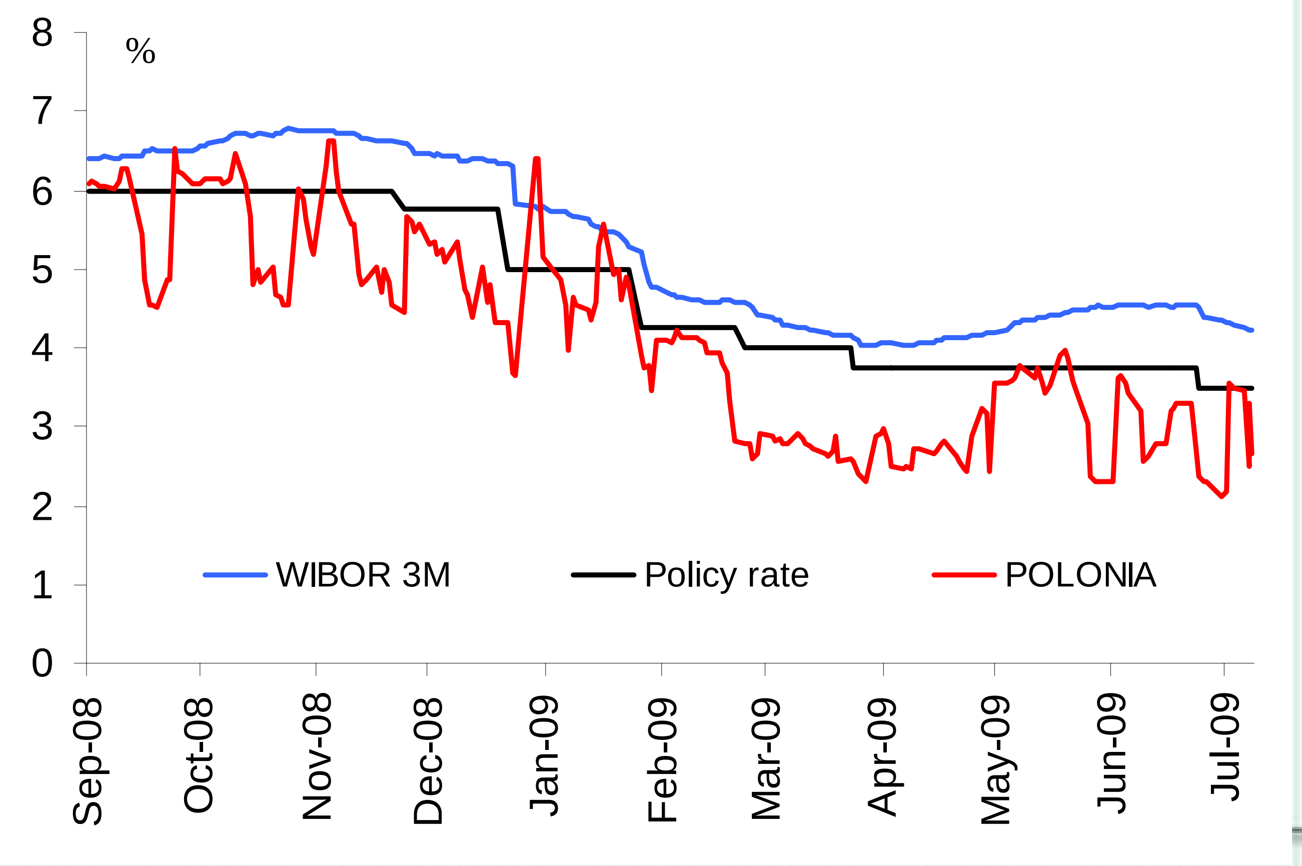
NBP provided adequate help to the banking sector

In October'08 the NBP implemented a package of measures designed to address problems in the interbank market. The mains aims included:

- Conducting full-allotment refinancing operations in zlotys for maturities up to 6 months (even though the banking sector as a whole has surplus liquidity).
- Conducting FX swaps in USD, EUR and CHF to enable banks to obtain funds in foreign currencies.
- Broadening the range of collateral accepted by the NBP to make it easier for banks to refinance.

The NBP responded also by cutting interest rates (from 6% to 3.5%)

Interest rate cuts together with longer-term refinancing operations conducted as part of the "Confidence Package" contributed to the fall of 3M interbank rates indexing the cost of credit in the economy.



Foreign parent companies provided funding to their Polish subsidiaries

- Foreign banks own 70% of the Polish banking sector.
- The ratings of Polish banks were downgraded as a result of the negative assessment of the parent entities and the market assessment of risk related to investment in Polish banks rose.
- The turmoil on the international markets led to a reduction in mutual limits for interbank operations on the Polish market which significantly decreased the liquidity of the interbank market.
- Nevertheless, parent companies provided large scale funding to their Polish subsidiaries.
- Despite the losses recorded by many foreign parent entities, most Polish banks decided to retain 2008 profits in capital.
- Some banks also received subordinated loans from parent entities.

Lessons learned and the way forward…

- The financial crisis draws attention to the risks inherent in FX lending and – more importantly – to the build up of currency mismatches on banks' balance sheets.
  - In Poland such mismatches were hedged with the resort to off-balance sheet instruments (e.g. FX swaps), but when the market dried up, the NBP had to step in.
- The crisis has tested the viability of both fixed and floating exchange rate regimes.
- Floating exchange provided considerable relief for the Polish economy as an automatic stabiliser
  - in good times, it limited the purchasing power of foreign currencies through appreciation, probably slowing down the growth in asset prices;
  - in bad times, it renders Polish exports more attractive through depreciation and thus provides the much-needed stimulus to the economy.