Senior loan officer opinion survey

on bank lending practices and credit conditions

1st quarter 2007

Warsaw, January 2007

Summary of the survey results

- **Lending policy**: in the fourth quarter of 2006, banks' lending policy in the corporate sector was eased. In the consumer segment the trend to ease the lending policy came back, and in the segment of household loans the lending policy did not considerably change.
- **Reasons for changes in lending policy**: the most important reason for easing credit standards and terms of corporate loans was the competitive pressure of other banks and decrease, in the banks' assessment, in the risk related to the expected economic condition. In the segment of consumer loans to households the lending policy was eased due to the competition of other banks and non-banking financial institutions as well as lower demand for loans than expected.
- **Demand for corporate loans**: demand for loans increased strongly in the large enterprise sector and noticeably in the SME sector. Growing demand for long-term loans suggests acceleration in the growth rate of investments.
- **Reasons for the change in demand for corporate loans**: banks indicated that demand had been growing chiefly due to the increased need for investment, inventories and working capital financing. The role of own funds in financing enterprises' investments declined considerably.
- **Demand for household loans**: banks reported again a strong increase in demand for housing loans, concentrated in the segment of zloty loans. The demand for consumer loans unexpectedly eased.
- **Reasons for the change in demand for household loans**: according to the banks the main reason for the increase in demand for loans is improvement in the economic standing of households. In the segment of housing loans the increase in demand was additionally strengthened by expectations related to the further increase in housing prices and by announced withdrawal of the tax relief. In the segment of consumer loans a significant reason for changes in the demand was the change in the scale of financing the purchase of consumer goods from the savings and improvement in the economic condition of households.
- **Expected changes in lending policy**: banks project further easing of lending policy in the corporate sector, in particular in the segment of short-term loans. In the household sector, a slight tightening of lending policy is expected with regard to housing loans and a slight easing in the segment of consumer loans.
- **Expected changes in demand for loans**: banks project further increase in demand in the corporate sector, slightly stronger in the case of long-term loans than the short-term ones. Further increase in the demand for consumer loans is also expected in the sector of households. Banks project considerable decrease in the demand for housing loans, which, apart from the one-off factors, may be related to the emergence of a price barrier on the housing market.

Results of the survey - overview

The survey was conducted at the turn of December 2006 and January 2007 among 24 banks, whose total share of claims on enterprises and households amounts to 76.6% of the total banking portfolio.

The aggregation of the data behind the results consisted in the calculation of weighted percentages of responses and the net percentage, i.e. the difference between the percentages corresponding to the opposite trends. In line with the adopted methodology, words describing quantities (majority, half, meaningful, significant percentage of banks, etc.) refer to the weighted percentages and not to the number of banks. Thus, the phrase “the majority of banks” should be understood as “the asset-weighted majority of banks”. Details concerning the calculation methodology are presented in the Appendix.

The following section presents tendencies regarding the banks’ lending policy and changes in demand in the fourth quarter of 2006 as well as the banks’ forecasts concerning the first quarter of 2007.

Enterprises

In the fourth quarter of 2006, banks slightly eased their terms and conditions of granting loans in the corporate sector, in particular in the segment of short-term corporate loans. The scale of easing the lending policy was clearly smaller than the banks’ expectations at the beginning of the quarter. In the surveyed sample of banks large internal differentiation of the direction of changes in the lending policy was observed, which however resulted from the one-off factors related to a large bank (cf. Figure 1).

Banks anticipate that in the first quarter of 2007 the trend to ease the lending policy shall be relatively stronger in the corporate sector than in the fourth quarter of 2006. These changes are to refer, in the first turn, to the SME sector. In the segment of short-term loans stronger easing of lending policy is expected than in the case of long-term ones. These expectations should be, however, interpreted with great caution, as the banks’ tendency to exhibit an overly optimistic assessment of the future evolution of the terms and conditions of granting loans for enterprises has been historically observed. The only regular departure from this tendency in previous two years was recorded in the third quarter of 2006. (cf. Figure 1).

The banks that eased their lending policy most often reduced the requirements related to collaterals and cut loan spreads. In addition, the decrease in non-interest loan cost was observed and, to a smaller degree, also the increase in maximum loan size as well as the extension of permissible loan maturity. One bank indicated the easing of procedural and documentary requirements as well as the provision of a broader range of corporate customers with access to some credit products (cf. Figure 2).

Figure 1
Corporate credit standards

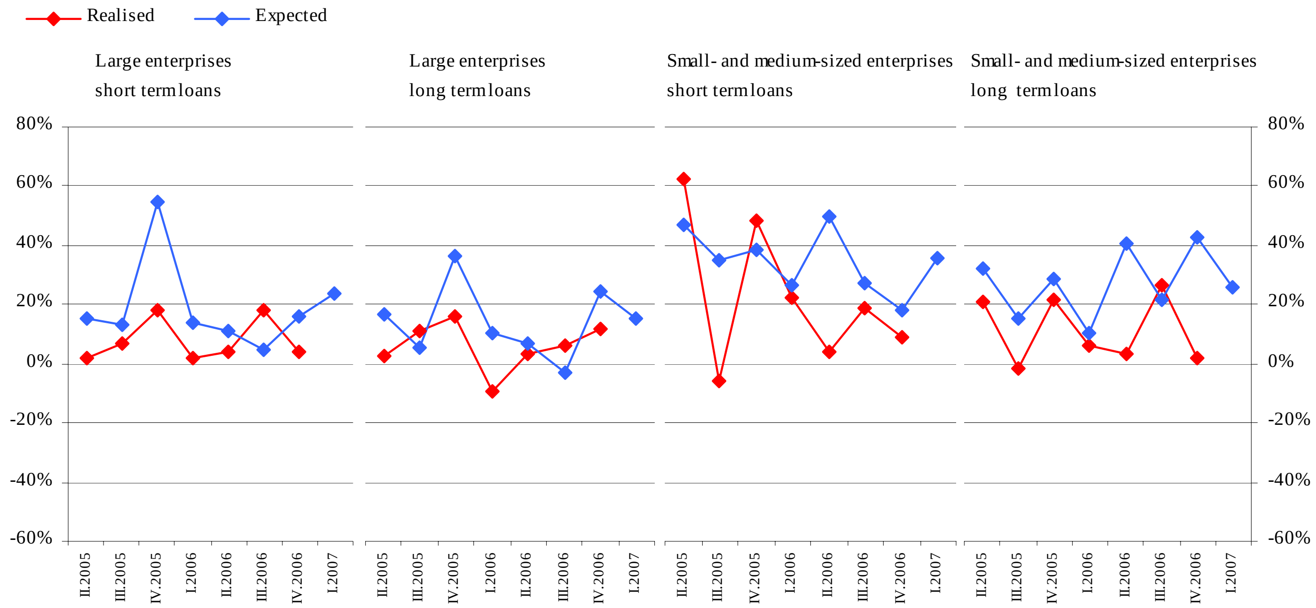
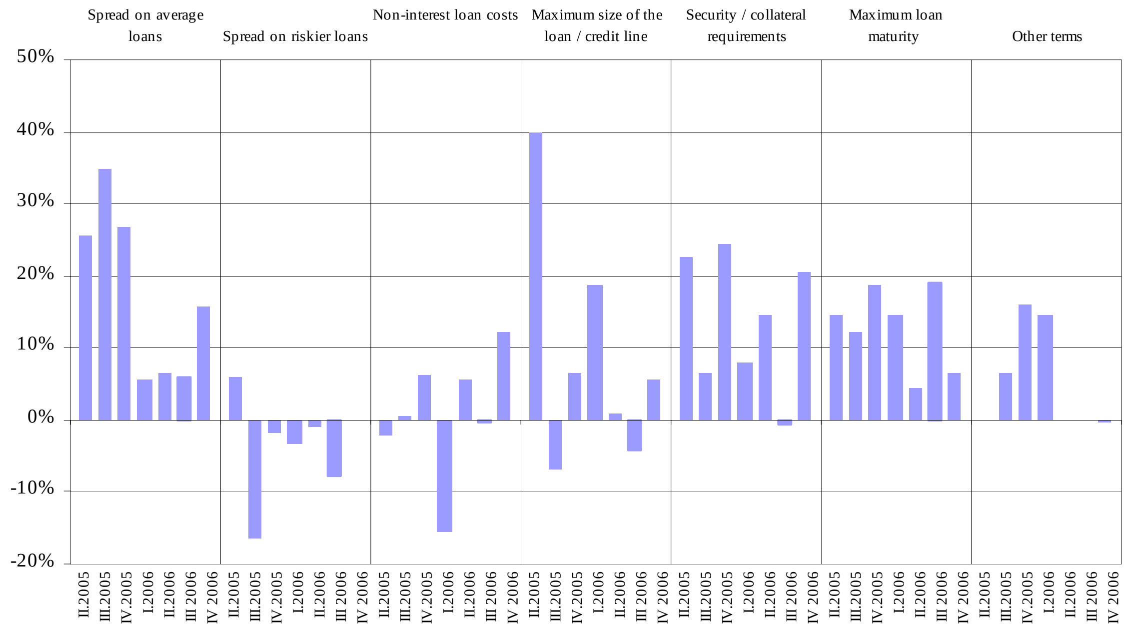
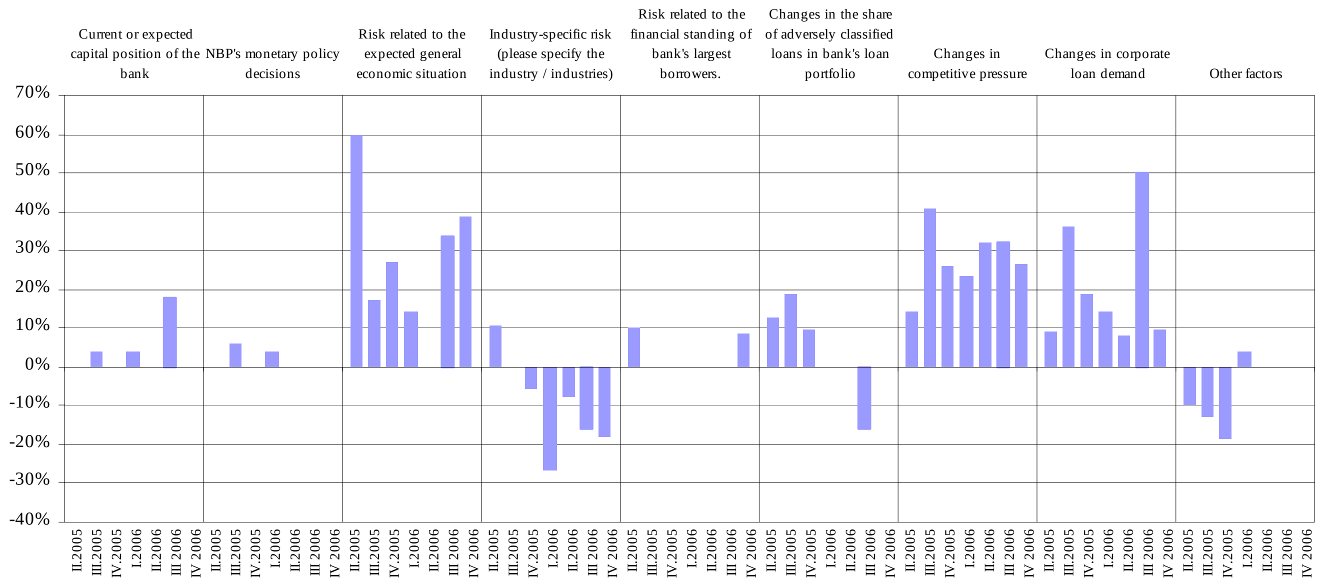


Figure 2
Terms on corporate loans



In the fourth quarter of 2006, the most important reasons for the easing of banks' lending policy was the decrease in risk related to the improving economic condition and competitive pressure of other banks (cf. Figure 3). Competition of funding directly in the financial markets, in the form of the issue of shares or debt securities, was not regarded by any bank as a rationale for easing the lending policy. The sectors towards which the banks tightened their lending policy are, *inter alia*, the armaments industry and the gambling sector.

Figure 3
Factors influencing changes in lending policies

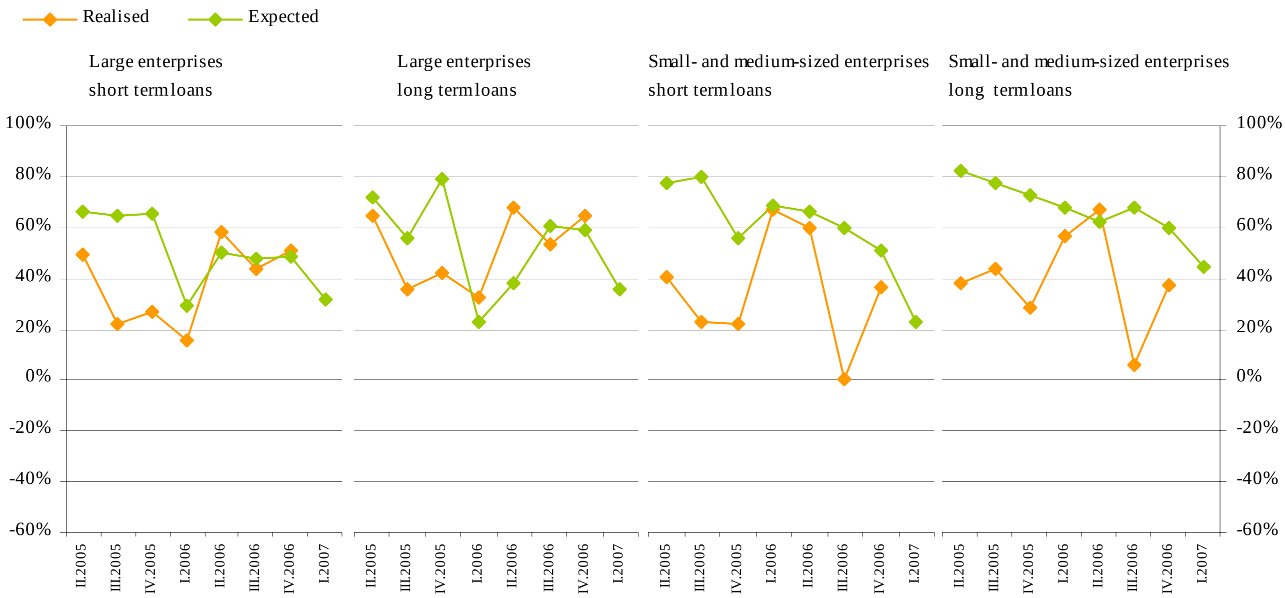


In the large enterprises sector a sustained trend of rapid growth in the demand for loans was observed, which had lasted since the second quarter of 2006. In the SME sector, after a notable and unexpected slowdown in the third quarter, a return to the trend of growing demand for loans, which emerged in the first half of 2006, was reported (cf. Figure 4). These results confirm that investments in the economy grow at a large, steady rate and show that the slowdown in the growth rate of the demand for SME loans in the previous quarter most probably resulted from the one-off factors. The use of own funds could be such a factor, as it was indicated by more than half of the banks as a determinant of decrease in the demand for loans in the SME sector in the third quarter. Moreover, the length of investment process could have contributed to such developments, resulting in the debt raised in the first half of the year being also utilised in the third quarter.

Banks anticipate that in the first quarter of 2007, the demand for loans for enterprises will grow further. The growth rate is, however, to be considerably lower as compared to the growth in demand recorded in the fourth quarter of 2006, in particular in the case of large enterprises (cf. Figure 4). Banks' expectations towards the demand for loans in the SME sector are relatively diverse, as apart from the large group of banks declaring that they expect slight increase in demand, some banks project decrease in demand or its considerable increase[1]. It means that the future demand for loans in the SME sector is highly uncertain.

[1] Banks have a possibility to grade the changes in demand. In the survey they can select from among the following options: demand will increase considerably, demand will increase somewhat, demand will remain unchanged, demand will ease somewhat, demand will ease considerably, difficult to say.

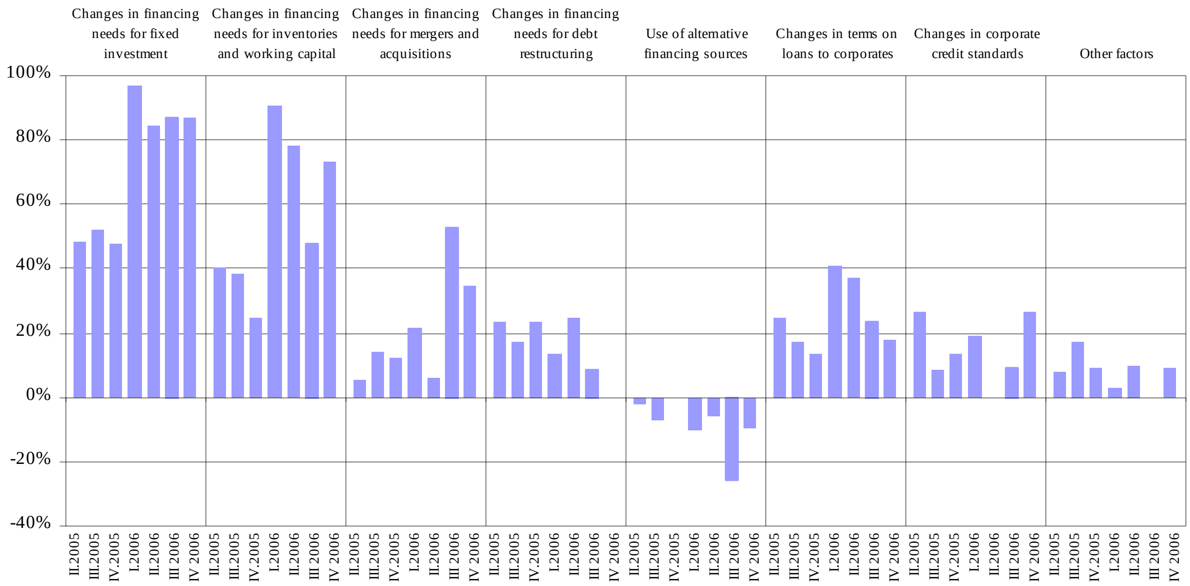
Figure 4
Corporate loan demand



In line with the previous two quarters, the increase in corporate loan demand was most heavily impacted by the increase in demand for financing of investments, inventories and working capital. Besides, significant impact on the increase in demand was made by the increase in demand for financing of mergers and acquisitions. The net percentage measuring the power of impact of these factors on the increase in demand did not change considerably in the case of demand for financing of investments, increased considerably in the case of financing of inventories and working capital and it eased in the case of financing of mergers and acquisitions. Enterprises take advantage of good economic conditions and their favourable financial standing to expand the scope of operations and expand their customer base not only through investments but also through mergers and acquisitions. The impact of easing terms and conditions of granting loans for enterprises on loan demand was compliant with the scale of changes of both elements of the lending policy, i.e. slight in the case of loan terms, which were not eased considerably by the banks, and stronger in the case of more eased loan conditions. The importance of alternative (to bank loans) sources of funding as a factor hampering the rise in demand for loans decreased. In particular the impact of the use of enterprises' own funds and other banks' loans on the demand for loans was strongly subdued. 9% of banks (asset-weighted) mentioned the decrease in the use of other banks' loans by enterprises as a factor of increase in demand for their loan (cf. Figure 5). This may have arisen from tightening the lending policy in the corporate sector by a large bank.

The increase in demand in the corporate sector as well as its reasons suggest that enterprises continued investments in the fourth quarter of 2006, financing them, to a significant degree, with the debt raised with the banks. According to the banks the use of own funds for investment purposes gradually decreases after attaining its maximum in the third quarter.

Figure 5
Factors influencing changes in corporate loan demand



Households

In the fourth quarter of 2006, a previously anticipated slight easing of lending policy was recorded in the segment of housing loans for households. A substantial majority of banks (77.7%, asset-weighted) did not change, however, their lending policy in this area (cf. Figure 6). These data indicate that the adjustment of banks' lending policy to the requirements of *Recommendation S* was finished in the third quarter. In the upcoming quarter the banks project slight tightening of their lending policy.

Banks which eased their lending policy in the fourth quarter in the segment of housing loans provided as the reason for such an action the competitive pressure of other banks, as well as – to a smaller degree – of other financial institutions. The only bank which tightened the lending policy in this segment indicated the growth in the share of classified loans in the housing loans portfolio and the decrease in the capital adequacy ratio as the reason for tightening the lending policy (cf. Figure 6). In the group of banks active in the segment of housing loans (and not covered in this survey), a few small banks did exhibit a similar direction and scale of changes in the capital adequacy ratio, which were compensated with capital increases through new share issues.

In the group of banks which eased standards and terms of granting housing loans, two thirds of them extended the maximum loan maturity and one fourth of the banks eased the requirements with regard to loan-to-value ratio. Other conditions of the lending policy remained basically unchanged (cf. Figure 7). It confirms the supposition that banks are unable to compete further through cutting the cost of housing loans and decide to build the competitive edge through other terms and conditions of a loan agreement. Simultaneously, these terms allow to partially reduce, from the borrower's point of view, the impact of *Recommendation S* on the methodology of examining customer creditworthiness and, consequently, on the maximum loan size that can be extended to individual customer.

Figure 6
Lending policy and factors influencing its changes – housing loans

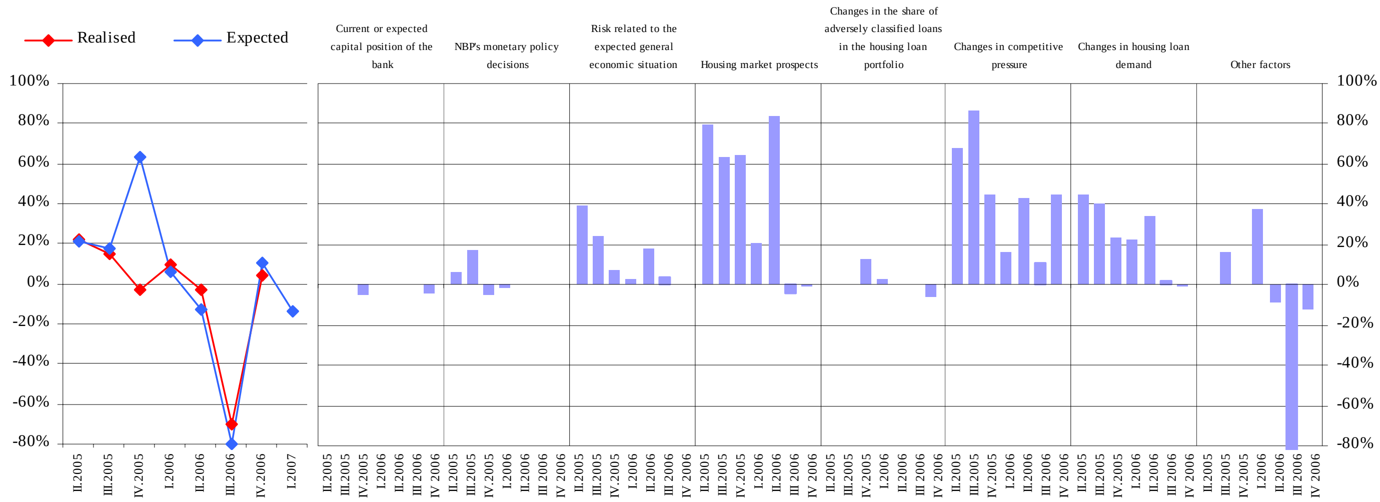
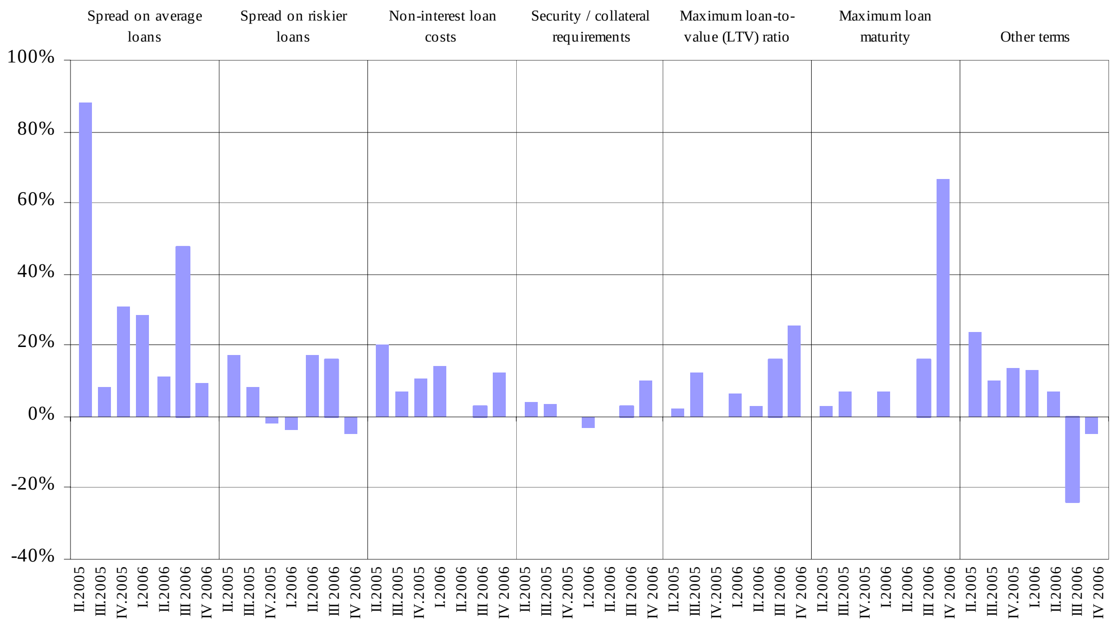


Figure 7
Terms of housing loans



Three fourths of the banks did not change their lending policy in the segment of consumer loans. Other banks eased credit standards and terms. The banks' projections for the first quarter of 2007 assume further easing of the lending policy in this segment, which is to be of a similar scale as in the fourth quarter (cf. Figure 8). Banks anticipating the easing of lending policy with regard to consumer loans in the current quarter mostly did not change the standards and terms of these credits in the previous quarter.

The main reasons for the changes in terms and conditions of granting consumer loans were competitive pressure which was exerted on the surveyed banks by, to the same extent, other banks and non-bank financial institutions, as well as falling demand. A relatively significant factor favouring the ease of lending policy was the change in the share of classified loans in the portfolio of consumer loans (cf. Figure 8).

Banks, which eased their terms and conditions of granting consumer loans, most frequently decreased the non-interest costs of loans and extended the maximum loan maturity. It should be noted that the non-interest costs of loans were lowered by 43% of the banks which eased the terms and conditions of consumer loans. This means the return to the trend present in the first half of 2006. The scale of changes in other terms and conditions of granting consumer loans was small (cf. Figure 9). Three banks (10% of banks) decided to extend the maximum loan maturity and two banks (8% of banks) reduced loan spread.

Figure 8

Lending policy and factors influencing its changes – consumer loans

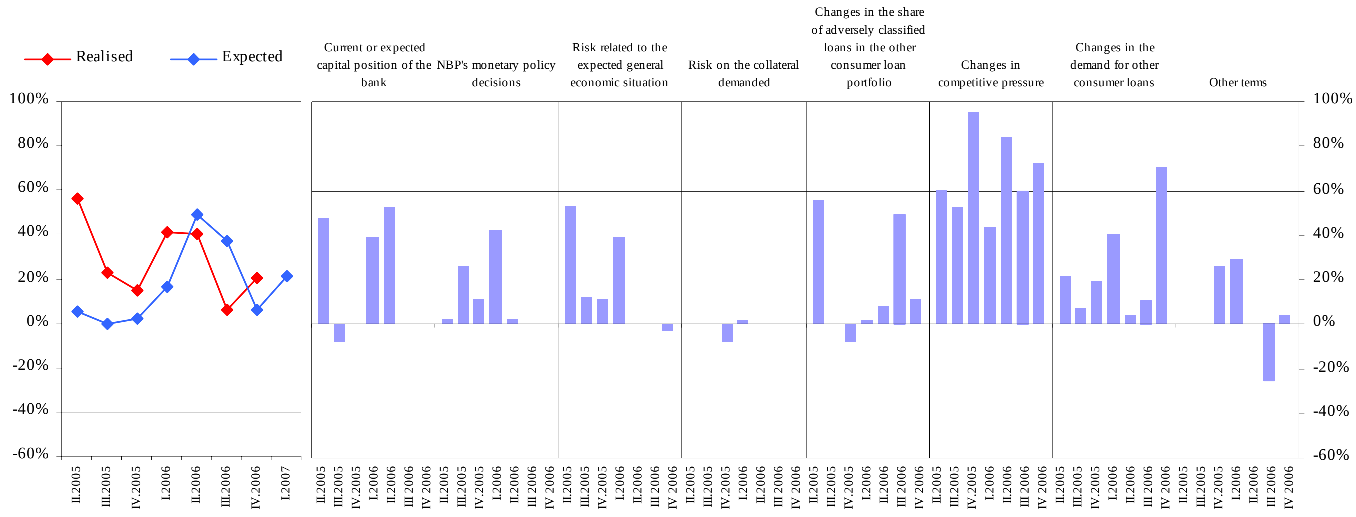
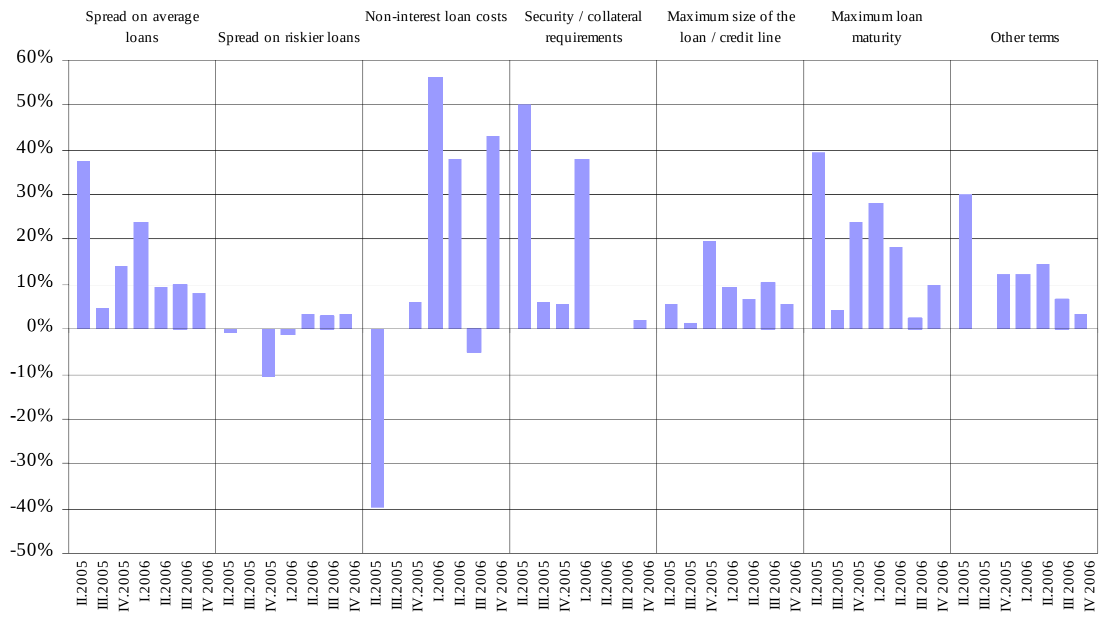


Figure 9

Terms on consumer loans

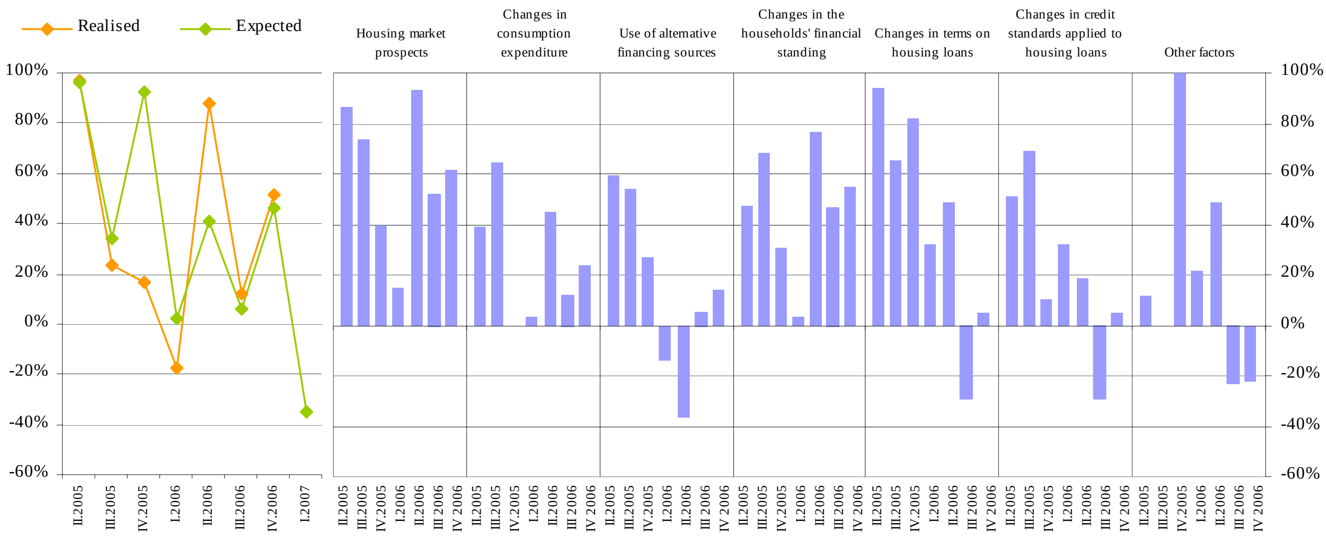


In the fourth quarter of 2006, the increase in demand for housing loans was strong, even taking into account the basis effect related to the partial reallocation of demand from the third quarter to the second quarter of 2006. The surveyed group of banks shows a considerable polarisation in terms of the observed changes in demand. Approximately two thirds of the banks noted the increase in demand and one bank indicated the decrease in demand in the fourth quarter (cf. Figure 10). This bank, specialised in foreign currency loans, considerably tightened the lending policy in the segment of foreign currency housing loans in this period.

According to the banks, the expected growth in prices on the property market and improvement in the economic condition of households were the most important factors influencing the increase in demand for housing loans in the fourth quarter of 2006. A significant factor of the growth in demand was also the change in the households' consumer spending and the elimination of a tax relief related to the purchase of a flat (the so-called interest relief) projected for the end of 2006. The tightening of the lending policy with regard to foreign currency loans, introduced in July 2006 in *Recommendation S*, hampered the demand for housing loans (cf. Figure 10).

Figure 10

Demand for housing loans and factors influencing its change



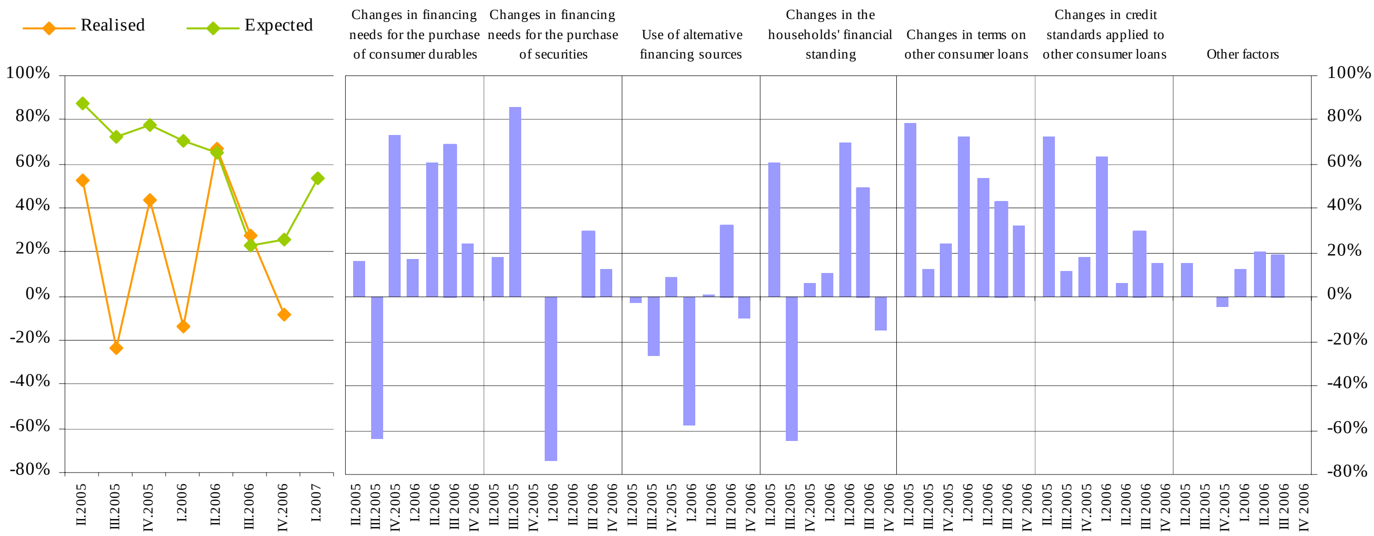
Unlike in the entire history of the survey, in the upcoming quarter the banks project the easing of demand for housing loans. The net percentage of responses to the question about the expectations regarding the demand reached the level of ca. -35%, and half of the banks (asset-weighted) project the decrease in demand in the first quarter of 2007 (cf. Figure 10). It seems that sustained households' expectations that the increase in housing prices will be much faster than the increase in the households' disposable income could be identified as the rationale for such forecasts. Therefore, a demand barrier may emerge in the housing loans market in the first quarter of 2007. In addition, the banks' projections can be influenced by the expected increases in interest rates on zloty and Swiss franc loans, and can take into account a one-off effect of eliminating the tax relief.

In the segment of consumer loans the banks noted an unexpected slight decrease in demand. Approximately one third of banks (asset-weighted) recorded a decrease in demand, approximately one fourth – an increase in demand.

In the first quarter of 2007, the banks project that the demand for consumer loans will strongly increase (cf. Figure 11).

According to the banks which recorded the increase in demand for consumer loans in the fourth quarter of 2006, its most important reasons were the change in economic condition of households and the utilisation of savings for purchases of consumer goods. The same reasons for the changes in demand were specified by the bank which recorded the decrease in demand. The increase in demand was also influenced, yet to a relatively small extent, by the growing demand for financing of the purchase of durable goods and easing the terms and conditions of granting consumer loans by the banks (cf. Figure 11).

Figure 11
Demand for consumer loans and factors influencing its change



Appendix 1

Methodology

The results of surveys are presented in the form of structures, i.e. the percentages of banks, which chose a given option in response to particular questions. Banks' responses are weighted with the share of the given bank in the market segment to which a given question relates. Weighing of responses is a solution frequently applied in preparation of results of qualitative surveys.[2]

The importance of particular banks in a given market segment is represented by the share of loans outstanding of a given bank in the loan portfolio of all 24 banks responded to the survey, broken down by particular types of loans. The following table presents the market segment to which particular questions refer, and the type of loans outstanding which was used to calculate the shares of particular banks in a given market segment.

Table 1

Market segment and the respective type of loans taken into consideration in calculation of the weights

Questions no.	Market segment	Type of loans
1, 4, 6, 7	Short-term corporate loans	Loans outstanding from state-owned enterprises and companies, private enterprises and companies as well as cooperatives and sole traders with the basic term to maturity of up to one year, together with the outstanding on the current account
	Long-term corporate loans	Loans outstanding from state-owned enterprises and companies, private enterprises and companies as well as cooperatives and sole traders with the basic term to maturity above 1 year
2, 3, 5	Total corporate loans	Total amount of loans outstanding from state-owned enterprises and companies, private enterprises and companies as well as cooperatives and sole traders
8, 9, 10, 13, 14, 16, 17	Housing loans to households	Housing loans to persons
8, 11, 12, 13, 15, 16, 17	Consumer and other loans to households	Total loans outstanding from persons less housing loans to persons

Note: All types of claims relate to residents only. In the case of corporates the distribution between large enterprises and small and medium-sized enterprises was not retained, due to a lack of relevant data in banking statistics.

Source: NBP.

Thus a weight, corresponding to a given bank's share in a given market segment is assigned to particular responses. At the calculations of weights the average amount of claims of a given type in July and August 2006, that is the period covered by the survey, was taken into account.[3] Where a bank marked "*Not applicable*" in the response options, a weight of 0 was assigned. Thus while calculating

[2] Cf.: M. Bieć „*Business survey: Methods, techniques, experience*", Papers and Materials of the Research Institute for Economic Development, No. 48, Warsaw School of Economics, pp. 71-114.

[3] No data on claims loans of particular banks in September 2006 were available at the time of analysing the results of the survey, due to an about three-week delay in reporting.

the structures for particular questions, only banks being active in a particular market segment were taken into account.

Apart from structures, the so-called net percentage was calculated for each response, that is the difference between the percentages of responses showing opposing directions of changes. This magnitude indicates a general tendency in the specific market segment. The method of calculating the net percentage for particular questions is presented in the following Table 2.

Table 2

Method of calculating the net percentage

Questions no.	Definition of net percentage
1, 2, 8, 9, 11	The difference between the percentage of responses „Eased considerably" and „Eased somewhat" and the percentage of responses "Tightened considerably" and "Tightened somewhat". A negative index indicates a tendency of tightening the credit standards.
3, 10, 12	The difference between the percentage of responses "Contributed considerably to the easing of lending policies" and "Contributed somewhat to the easing of lending policies" and the percentage of responses "Contributed considerably to the tightening of lending policies" and "Contributed somewhat to the tightening of lending policies". A negative index indicates a given factor's greater contribution to the tightening than to the easing of lending policies.
4, 13	The difference between the percentage of responses „Increased considerably" and „ Increased somewhat" and the percentage of responses „Decreased considerably" and „Decreased somewhat". A positive index indicates an increase in demand.
5, 14, 15	The difference between the percentage of responses „Contributed considerably to higher demand" and „Contributed somewhat to higher demand" and the percentage of responses „Contributed considerably to lower demand" and „Contributed somewhat to lower demand". A positive index means that a given factor contributed to an increase in demand, and a negative one – to a decrease in demand.
6, 16	The difference between the percentage of responses „Ease considerably" and „Ease somewhat" and the percentage of responses „Tighten considerably" and „Tighten somewhat". A positive index indicates the expected easing of the lending policies.
7, 17	The difference between the percentage of responses „Increase considerably" and „Increase somewhat" and the percentage of responses „Decrease considerably" and „Decrease somewhat". A positive index indicates the expected increase in demand.

Source: NBP.