Senior loan officer opinion survey

on bank lending practices and credit conditions

2nd quarter 2006

Warsaw, April 2006

Summary of the survey results

- **Lending policy**: In the first quarter of 2006, after a quarter of break, a weak trend to ease the housing loans terms and conditions and credit standards in the household sector was recorded again. However, the trend to ease lending policy in the consumer loans segment is much stronger. In the corporate sector lending policy was substantially eased only in the segment of short-term loans for SMEs. The lending terms and conditions and credit standards were slightly tightened in the segment of long-term corporate loans.
- **Reasons for changes in lending policy:** The growth in competitive pressure continues to be the most important reason for the changes in lending policy.
- **Demand for corporate loans:** The banks recorded an increase in the demand for loans in the corporate sector. In the SMEs sector the trend of growth in demand was the strongest since the survey had been first conducted in the segment of short-terms loans and the strongest since the fourth quarter of 2004 in the segment of long-term loans.
- **Reasons for the change in demand for household loans:** Banks indicated that demand had been growing chiefly due to the increased need for investment (the net percentage adopted the highest value since the acceleration of economic development in the pre-accession period), inventories and working capital financing.
- **Demand for household loans:** The changes in demand were strongly differentiated between the banks and prevailed at the banks which eased their lending policy and offered products on promotional conditions. A negative net percentage both in the housing loans and consumer loans segment, which suggests a weaker demand in the entire sector, stems mainly from recording a decrease in demand by the banks with a large share in the segment of household loans. The banks anticipate, however, that in the second quarter of 2006 the demand will be growing, especially in the consumer loans segment.
- **Reasons for the change in demand for household loans:** The banks which recorded a decrease in demand considered promotional actions and raising loans with other banks to be the main reason for that fall. In turn, the banks which recorded an increase in demand deemed the eased lending policy the main reason for that growth. The distribution of demand and the reasons for changes in the household sector reflect strong competition between the banks both in the housing loans and consumer loans segment. As opposed to the previous periods, the banks dealt with a stronger pressure of non-bank financial institutions than of other banks.
- **Expected changes in lending policy:** The banks anticipate the easing of credit standards and terms and conditions of granting loans for SMEs and consumer loans for households in the second quarter of 2006. The lending policy in the housing loans segment is to be slightly tightened, which is probably related with the adjustment of lending terms and conditions and credit standards to *Recommendation S* passed by the Commission for Banking Supervision.

Synthetic results of the survey

The survey was conducted at the turn of March and April 2006 among 23 banks, whose total share of claims on enterprises and households amounts to 78.3% of the total banking portfolio.

The aggregation of 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 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 Appendix no. 1.

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

Corporates

In the first quarter of 2006, the majority of banks (78%-98% of asset weighted banks, depending on the corporate sector and loan maturity period) did not change their lending policy in the corporate sector. In other banks the tendencies to change lending policy were different in relation to the SME sector. In the SME sector the banks further eased their lending policy, although with regard to the long-term loans the percentage of banks which eased credit standards and the terms and conditions of granting loans was small (6.2%). In the sector of large enterprises a slow trend to ease lending policy that had prevailed for a few quarters changed. In the segment of short-term loans for this sector nearly none of the banks changed lending policy, however, in the segment of long-term loans most banks tightened their credit standards and terms and conditions of granting loans (cf. Fig. 1).

The banks anticipate that in the second quarter of 2006 a significant tendency to ease credit criteria and terms and conditions of granting loans will occur only in the SME sector. In the sector of large enterprises the banks expect a slight tendency to ease lending policy. In comparison with the previous quarter, the net percentage decreased slightly in the sector of large enterprises, however, in the SME sector it reached the highest values since the survey had been first conducted.

The banks that eased their lending policy most often increased the maximum amount of loan and extended the maximum lending period. On the other hand, the banks which tightened their lending policy most often increased non-interest costs of loans and widened the spread on higher risk loans (cf. Fig. 2).

Figure 1
Corporate credit standards

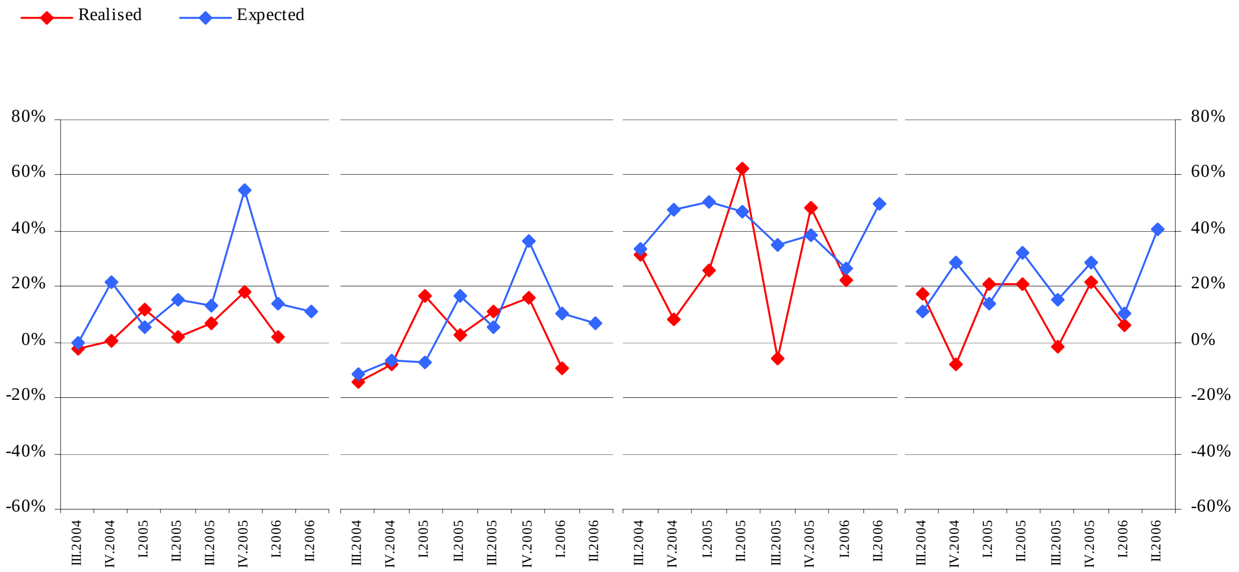
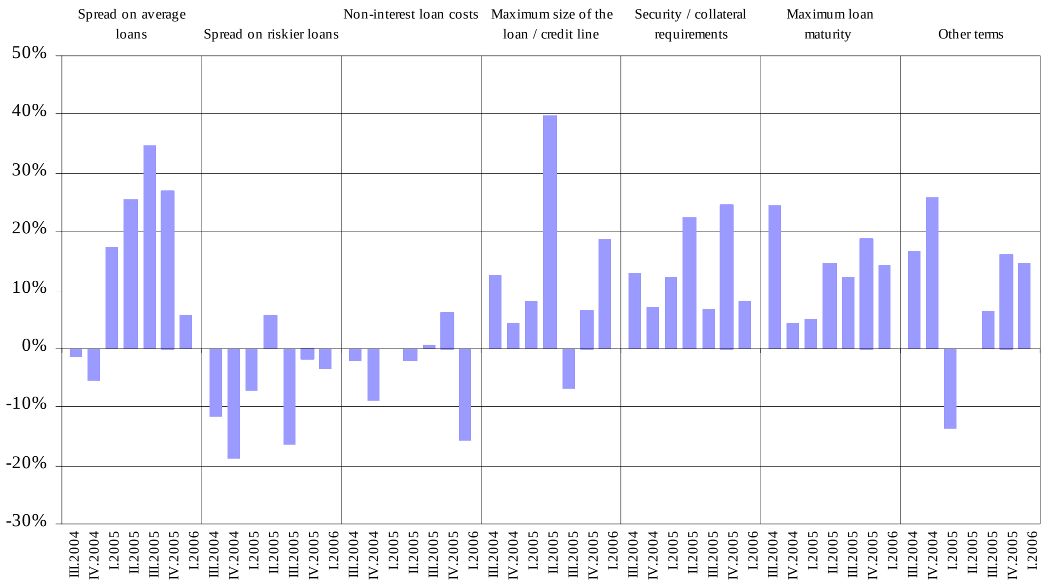
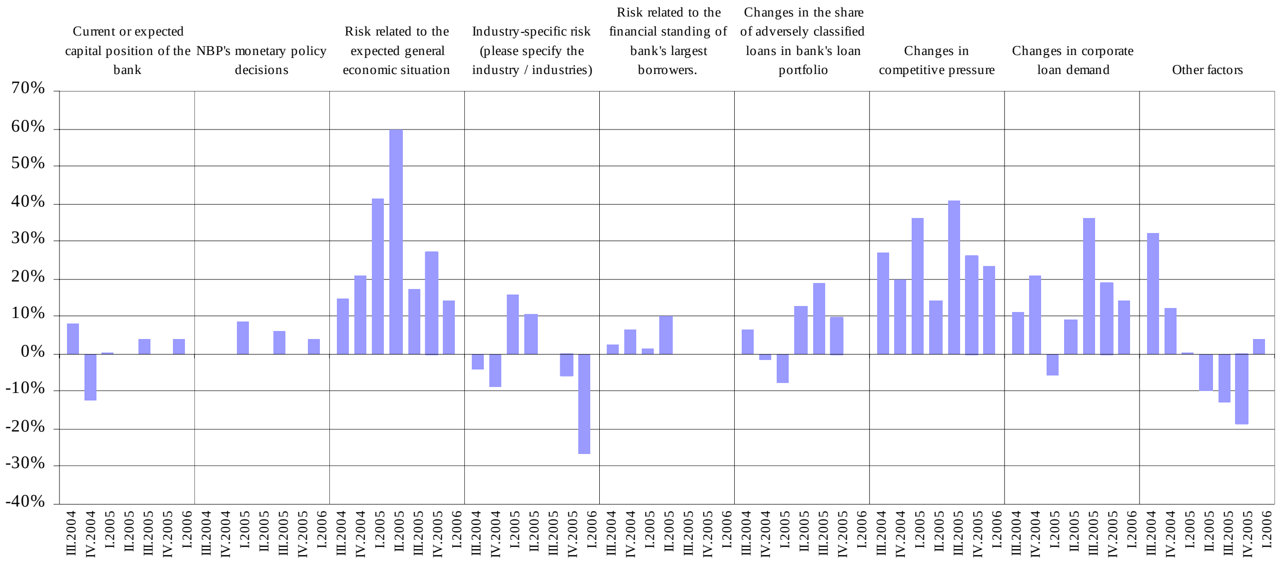


Figure 1
Terms on corporate loans



The banks which eased their lending policy deemed that it had been mostly caused by the growth in competitive pressure of other banks, decrease in the risk related to the expected economic situation and change in the demand for corporate loans. In turn, the only reason for tightening lending policy was the growth in industry risk. Among the higher risk industries the banks reported, among others, construction, investments in real estates, furniture industry, shipbuilding and poultry processing. (cf. Fig. 3)

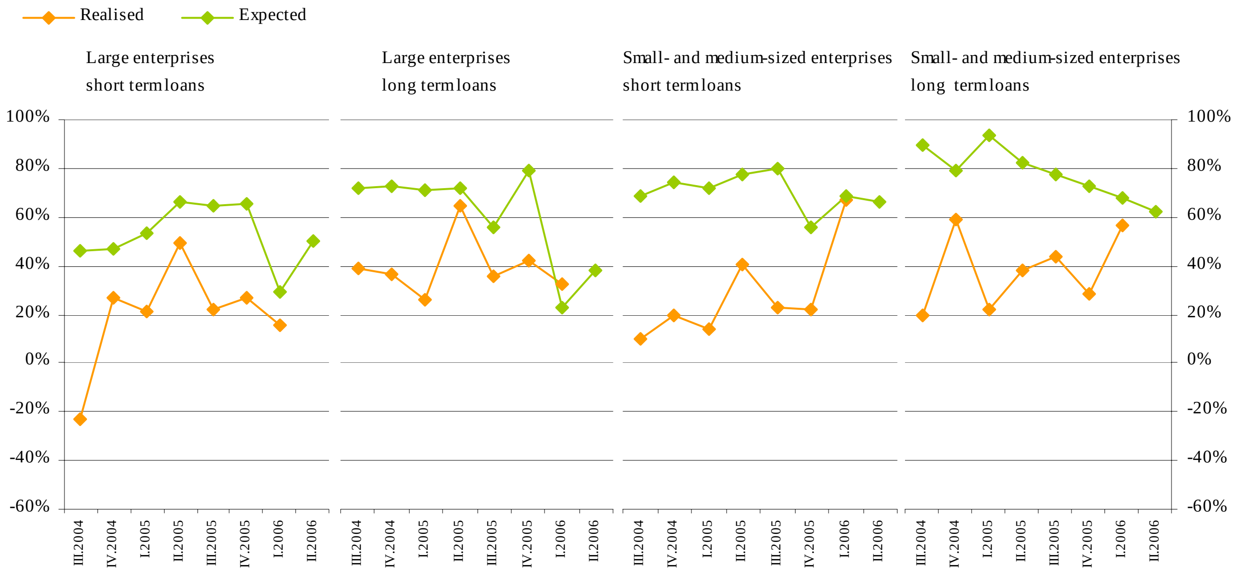
Figure 3
Factors influencing changes in lending policies



In the first quarter of 2006, the demand for corporate loans increased. The net percentage, reflecting tendencies in the entire banking sector, slightly decreased in the sector of large enterprises as compared to the previous quarter but chiefly as a result of recording decreased demand by some banks. The percentage of banks which recorded the growth in demand in the sector of large enterprises was higher than in the previous quarter. In the SME sector the banks recorded a strong growth in demand. The net percentage reached the highest value in the segment of short-term loans since the survey had been first conducted and the highest one since the fourth quarter of 2004 in the segment of long-term loans (cf. Fig. 4).

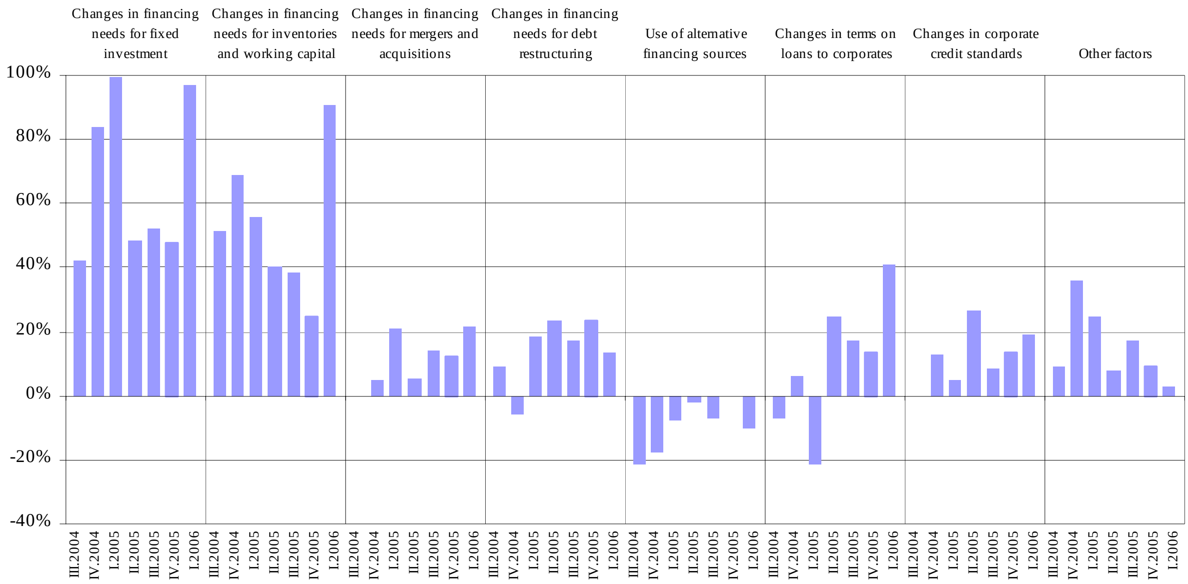
The banks anticipate that in the second quarter of 2006 the demand for corporate loans will continue to grow. A large increase in demand in the SME sector is still expected, the banks anticipate also higher increase in demand in the corporate sector, in particular in the segment of short-term loans. It is worth to highlight that the forecasts of the banks in relation to the change in demand for loans were much more accurate in the first quarter than in the previous surveys. A smaller bias of the banks' estimation was especially clear in the SME sector (cf. Fig. 4)

Figure 4
Corporate loan demand



Similarly to the previous quarter, the increase in demand was strongly affected by the increase in investment finance requirements and in inventory and working capital finance requirements. These factors were regarded as important by nearly all the banks which were affected by the change in demand – net percentages reached the highest values since the accelerated economic development in the pre-accession period (the first quarter of 2004) in the case of investment finance requirements and since the survey had been first conducted in the case of inventory and working capital finance requirements. According to the banks, the increase in demand was caused also by the easing of terms and conditions of granting corporate loans and higher demand for finance with regard to mergers and take-overs (in both cases the net percentage reached the highest values since the survey had been conducted). The only factor, listed by the banks, which affected the decrease in demand for loans was the use of alternative finance sources, chiefly own funds or borrowings from non-bank financial institutions. In comparison to the previous quarter, the impact of the increased inventory and working capital finance requirements and the easing of lending policy by the banks chiefly contributed to the increase in demand (cf. Fig. 5).

Figure 5
Factors influencing changes in corporate loan demand



Households

In the first quarter of 2006, the majority of banks (80.5% of asset-weighted banks) did not change their credit standards as regards housing loans to households. Among other banks the percentage of banks which eased their lending policy slightly prevailed. After a quarter of break the net percentage was positive again, although slightly below the values recorded in the previous periods of easing lending policy (cf. Fig. 6).

The banks anticipate slight tightening of lending policy in the segment of housing loans in the second quarter of 2006, probably in relation to the adjustment of lending policy to Recommendation S on the best practices with regard to the exposure of loans secured with mortgages passed by the Commission for Banking Supervision in March 2006. (cf. Fig. 6)

The banks which eased credit standards and the terms and conditions of granting housing loans, most often reported the demand for housing loans, the projected situation on the housing market and the growth in competitive pressure as the reasons for these changes. Among other reasons for easing lending policy, the banks reported periodical advertising campaigns and the rendering of the so-called anti-usury act effective. On the other hand, the reason for tightening the credit standards and terms and conditions of granting housing loans were the recommendations of the banking supervision (cf. Fig. 6)

The banks which eased lending policy in the segment of housing loans most often reduced the credit margin and non-interest costs of loans. Other eased terms and conditions reported by the banks included also increased maximum relation of the loan amount to the value of financed real estate (LTV) and the introduction of the possibility to earmark part of the mortgage loan for any consumer purpose (cf. Fig. 7).

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

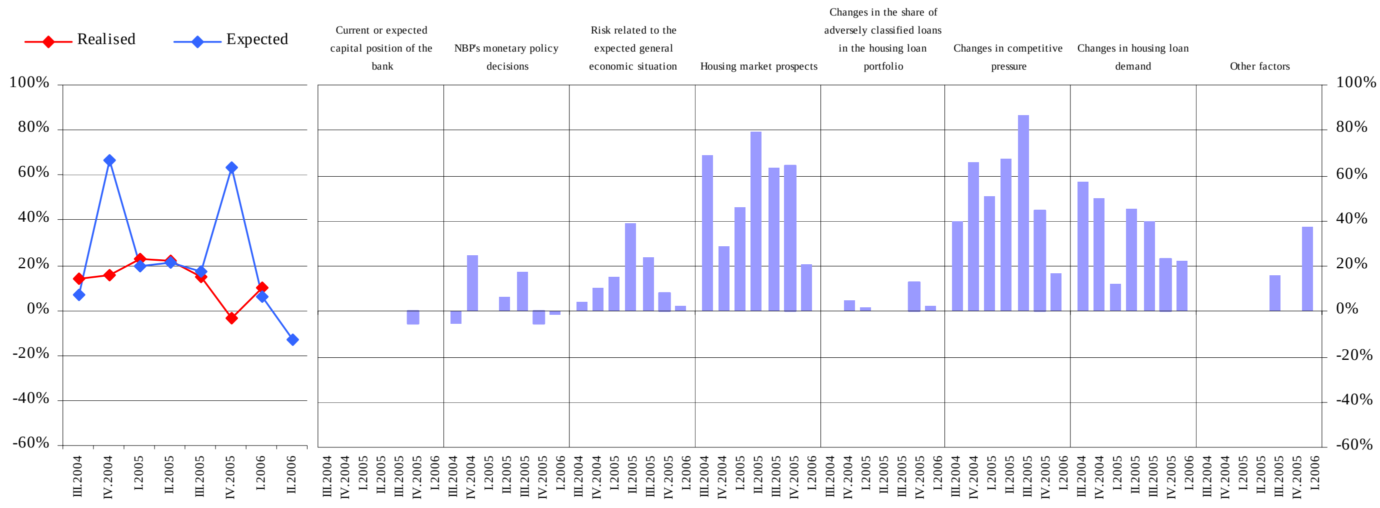
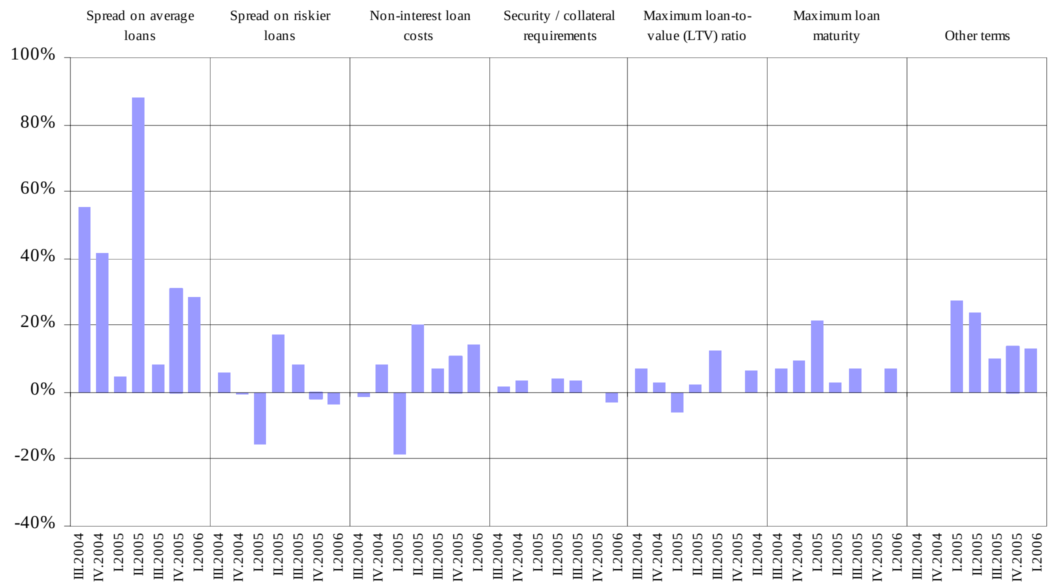


Figure 7
Terms on housing loans



Approximately half of the banks (47.4% of asset-weighted banks) did not change their lending policy in the segment of consumer loans, either. Among the banks which changed their lending policy, those which eased their credit standards and terms and conditions of granting consumer loans definitely prevailed. Although only some banks tightened their lending policy in this segment of loans, the general tendency to ease the credit standards and terms and conditions of granting consumer loans was stronger than in the previous quarter. The banks anticipate also that lending policy will be further eased in the second quarter of 2006 - approximately half of the banks intend to ease the credit standards and terms and conditions of granting consumer loans (cf. Fig. 8).

Increased competitive pressure is still the most important reason for the changes in lending policy. As opposed to the previous periods, the banks dealt, however, with a stronger pressure of non-bank financial institutions than of other banks. In the first quarter of 2006, the NBP's decisions on the monetary policy and the changes in demand for consumer loans constituted also an important factor for the changes in the banks' lending policy. Among other reasons, the banks reported lower risk related to the projected economic situation as well as current and projected capital situation of the banks (cf. Fig. 8).

The banks which eased the credit standards of granting consumer loans most often reduced non-interest costs of loans, decreased the requirements related to securities, extended the maximum lending period and decreased the spread on loans (cf. Fig. 9). In comparison to the previous quarter, the impact of these factors on the easing of lending policy increased.

Figure 8
Lending policy and factors influencing its changes – consumer loans

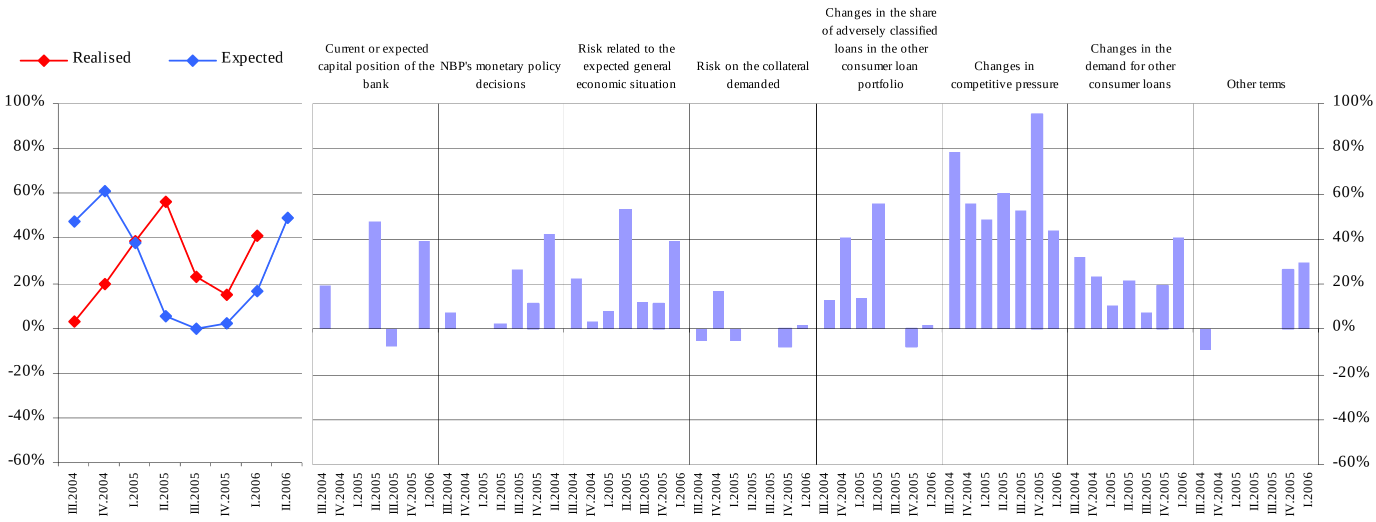
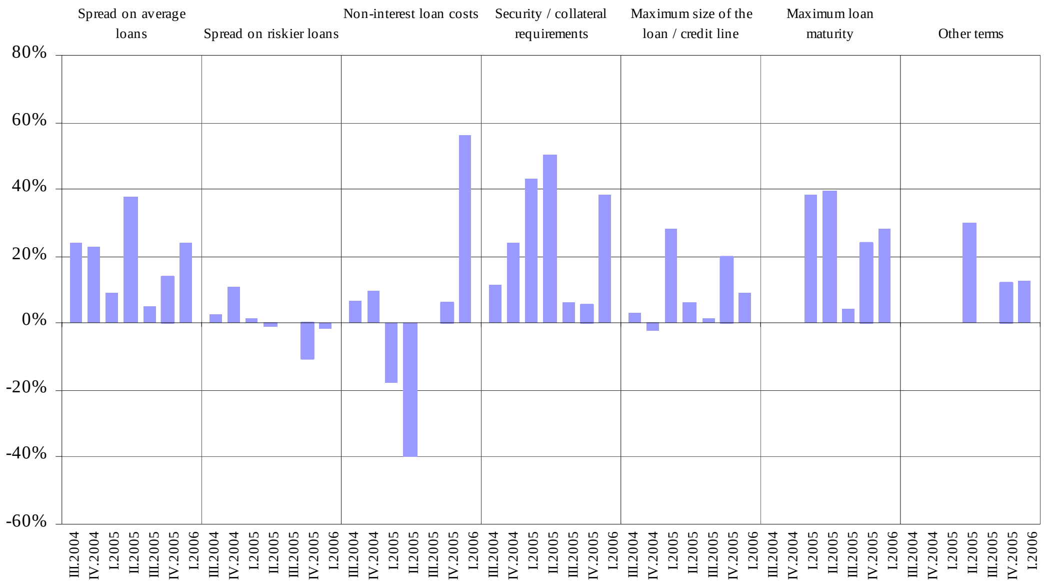


Figure 9
Terms on consumer loans

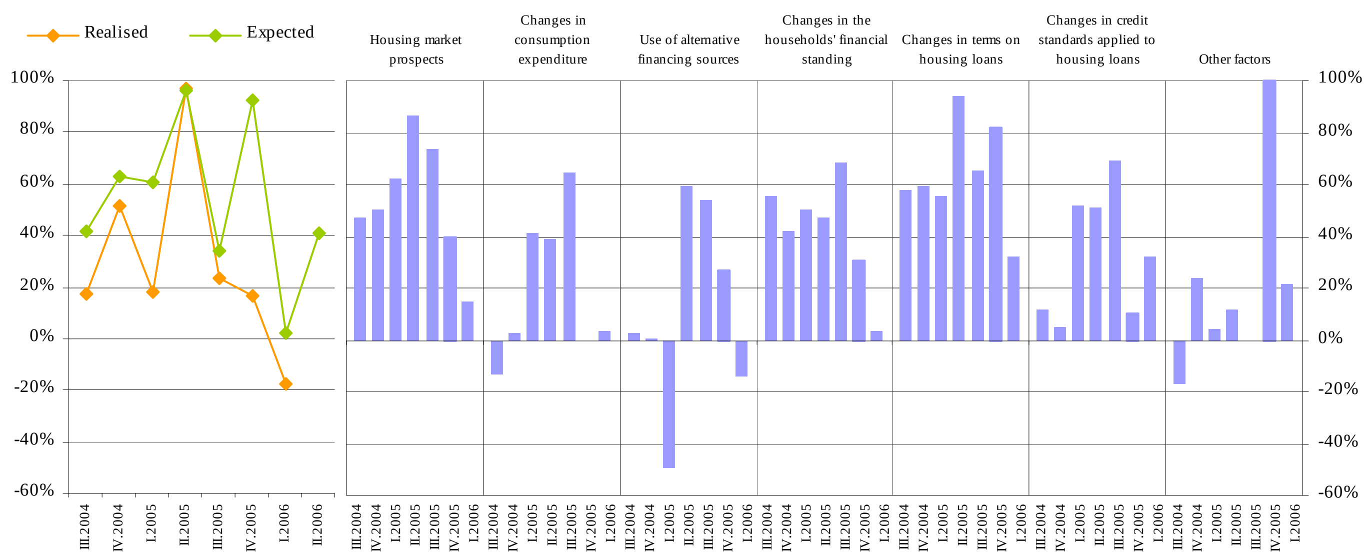


In line with the low demand for housing loans projected by the banks in the previous quarter, the tendency of further growth in demand was halted. A negative net percentage should not be, however, interpreted as a change in the tendency on the housing loans market. In the majority of banks (55.6% of asset-weighted banks) the demand did not change as compared to the previous quarter and among the remaining banks those which reported the decrease in demand prevailed. The banks' responses to the question about the change in demand were strongly differentiated – all the possible responses were reported, which hardly ever happens.[1] Among the banks which reported meaningful changes in demand, those which recorded a significant increase in demand prevailed. None of the banks projects, however, the decrease in demand in the second quarter of 2006 – 30.4% of asset-weighted banks expect that the demand will increase and 10.7% of them that it will significantly increase (cf. Fig. 10).

The reasons for changes in demand for housing loans prove also the lack of reasons for changing tendencies on the housing loans market. The banks which recorded the decrease in demand deemed that it had resulted rather from using alternative finance sources (promotions of other banks) or seasonal factors (lack of supply of new investments, waiting for starting a construction season, waiting for spring promotional offers) and once-off factors (change in the amount of court fees). The banks which recorded the increase in supply most frequently regarded the easing of lending policy as the main reason (cf. Fig 10).

The analysis of demand distribution between the banks and reasons for changes provided by the banks prove rather a strong competition between the banks than a weakening market. Some banks which do not keep pace with competition in a given period can record the decrease in demand, however, in the subsequent periods they adjust their lending policy in order to compete for the constantly growing housing loans market. The reasons for changes in demand which are increasingly often endogenous (changes in lending policy, changes in the competitive pressure of other banks) rather than exogenous (forecasts regarding the situation on the housing market, changes in the economic standing of households).

Figure 10
Demand for housing loans and factors influencing its change



With regard to the changes in demand for consumer loans[2] the situation was similar as in the housing loans segment. Although a larger number of surveyed banks (non asset-weighted banks) recorded rather an increase than decrease in demand, those banks which have a lager share in the consumer loans market prevailed. For this reason

[1] Possibile responses to the question about demand are as follows: decreased considerably, decreased somewhat, remained basically unchanged, increased considerably, increased somewhat.
[2] The question about the demand for loans to households relates to housing loans and other loans (consumer loans and others), here refered to as consumer loans.

the net percentage was negative, similarly as in the third quarter of 2005. In the second quarter of 2006, the banks forecast, however, that demand will increase and as much as 32.4% of asset-weighted banks project significant increase in demand (cf. Fig. 11).

The reasons for changes in demand for consumer loans were also similar to those recorded in the case of housing loans. The banks, where the demand changed, considered that the most important reason for the decrease in demand was the fall in the demand for financing the purchase of securities and the use of alternative finance sources (mainly the loans raised with other banks). A positive impact on the growth in demand was, first of all, the easing of lending policy by the banks; this impact was comparable to the one recorded in the second quarter of 2005 (cf. Fig 11). As in the case of housing loans, it can be said that demand is focused at the banks which ease their lending policy, which proves rather a strong competition between the banks than a weakening market of consumer loans.

Figure 11
Demand for consumer loans and factors influencing its change