Senior loan officer opinion survey

on bank lending practices and credit conditions

4th quarter 2007

Warsaw, October 2007

Summary of the survey results

- **Lending policy**: in the third quarter of 2007, the banks slightly eased the terms and standards of granting loans for enterprises, however, loan spreads for enterprises were slightly increased. The lending policy towards the sector of households was tightened. This tightening was fairly strong in the case of the segment of housing loans. Some terms and standards of granting housing and consumer loans were also tightened, in particular loan spreads.
- **Reasons for changes in lending policy**: according to the banks the most important reasons for the changes in the lending policy towards enterprises were favourable development prospects of the corporate sector. At the same time some banks assessed that credit risk increased in the sector of households, which resulted in the tightening of lending policy towards housing and consumer loans. A strong competitive pressure in the banking sector limited the scale of lending policy tightening.
- **Demand for corporate loans**: demand increased slightly more slowly than the expectations declared in the previous quarter. Demand for long-term loans grew faster than for short-term ones. Small part of banks recorded the decrease in demand for corporate loans.
- **Reasons for the change in demand for corporate loans**: the most important reason for the increase in demand was higher demand for investment financing. Basing on monetary statistics it may be expected that this category covered the financing of the purchase of real estates by enterprises. The increase in demand for bank's loans was limited by the high utilisation of alternative sources of financing, including financial markets and enterprises' own funds.
- **Demand for household loans**: demand for housing loans decreased, however, some banks regarded this drop as significant. There was a slight increase in demand for consumer loans.
- **Reasons for the change in demand for household loans**: the decrease in demand for housing loans was caused, first of all, by the tightening of the terms and standards of granting these loans. According to the banks the projections of situation on the housing market were neutral for demand for loans. The improvement in the current financial standing of households, growth in demand for financing durable goods and easing of lending policy in this market segment in the past contributed to the growth in demand for consumer loans.
- **Expected changes in lending policy**: the banks project a slight tightening of the lending policy towards large enterprises in the fourth quarter of 2007. In the segment of loans for small and medium-sized enterprises the tendency to ease the lending policy is expected. The banks project that the terms and standards of granting housing loans will be stable in the upcoming quarter. The lending policy towards consumer loans is to be eased.
- **Expected changes in demand for loans**: the acceleration of the growth rate in demand for corporate loans is expected, however, equally strong in all the market segments of corporate loans. The banks project the growth in demand for housing loans and a strong increase in demand for consumer loans.

Results of the survey - overview

The objective of the survey is to ascertain the direction of changes in the terms and standards of granting loans and demand for loans in the Polish banking system. The survey is addressed to the chairpersons of banks' credit committees. Bank's response may not take into account the opinion of the bank's other divisions than the credit division. The survey was conducted at the turn of September and October 2007 among 24 banks, whose total share of claims on enterprises and households in the total banking portfolio amounts to 78.4%.

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 structures presenting opposite trends. In line with the adopted methodology, words describing quantities (majority, half, meaningful, significant percentage of the banks, etc.) refer to the weighted percentages and not to the number of banks. Thus the phrase "the majority of the banks" should be understood as "the asset-weighted majority of the 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 third quarter of 2007, as well as the banks' expectations for the fourth quarter of 2007.

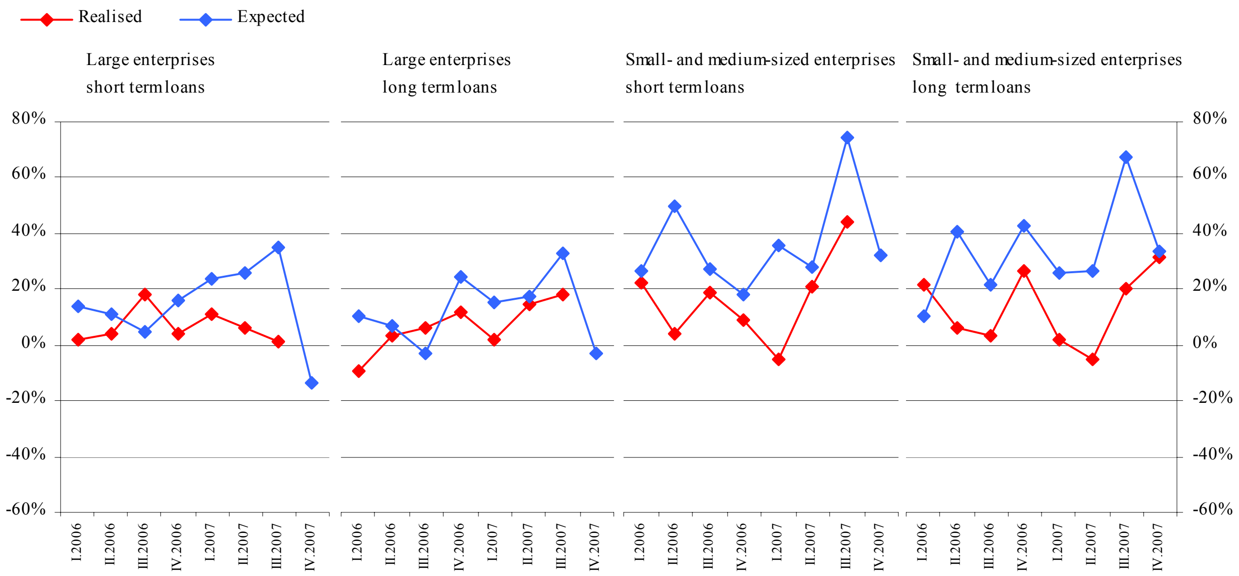
Enterprises

In the third quarter of 2007, the banks slightly eased their lending policy towards the corporate sector. It was distinctly stronger in the segment of small and medium-sized enterprises (SMEs) than in the segment of large enterprises. The changes in the lending policy towards large enterprises were small, slightly stronger in the case of long-term loans than short-term ones. The terms and standards of granting loans to SMEs were most liberalised in the last two years. They were eased, first of all, by large universal banks which had planned such a step in the second quarter. The scale of changes in the lending policy towards enterprises was, however, smaller than very optimistic expectations of the banks (cf. Figure 1).

In the third quarter of 2007, the easing of lending policy towards SMEs was related, first of all, to the lessening of the collateral requirements by the examined banks. Approximately 20% of banks increased the maximum corporate loan size. A similar percentage of banks extended the maximum loan maturity. At the same time average loan spreads were raised, following from the decision of one of the largest banks financing enterprises. The increase covered both standard loans and higher risk loans (cf. Figure 2). This bank did not declare other changes in the lending policy towards enterprises. Among other changes in the terms and standards of granting corporate loans the banks indicated the easing of documentary requirements, shortening of decision processes and raising loan size thresholds below which the granting of loan is within the competences of branch directors.

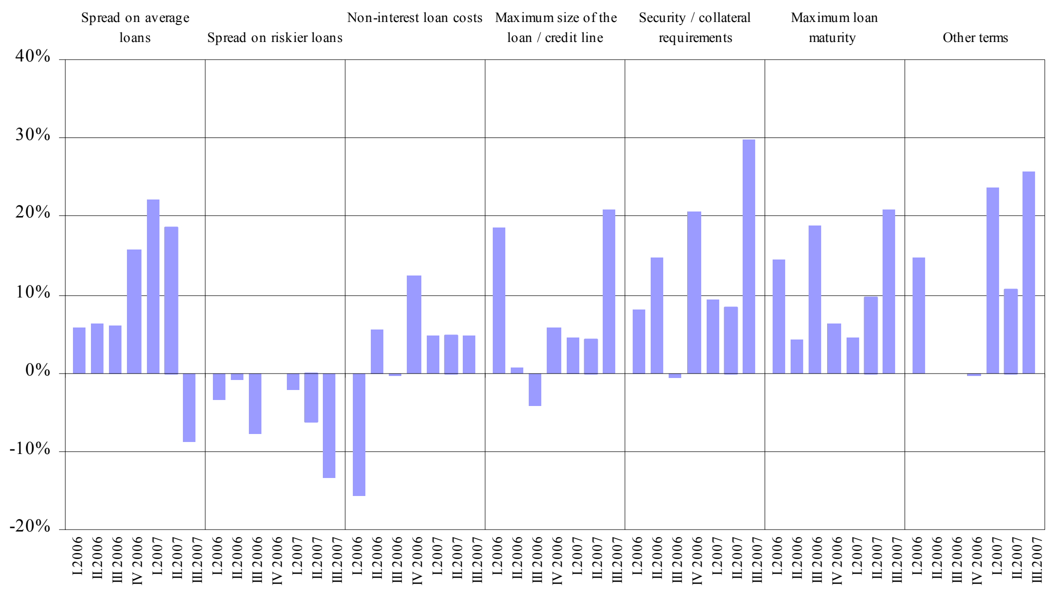
For the first time since the survey was first conducted (since the fourth quarter of 2003) the banks expect a slight tightening of the lending policy as regards short-term and long-term loans for large enterprises. None of the banks expect the easing of the terms and standards of granting such loans. Approximately one third of the banks expect further easing of the lending policy towards SMEs in the fourth quarter of 2007 (cf. Figure 1). Three small banks intend, however, to tighten their lending policy in this market segment.

Figure 1
Corporate credit standards



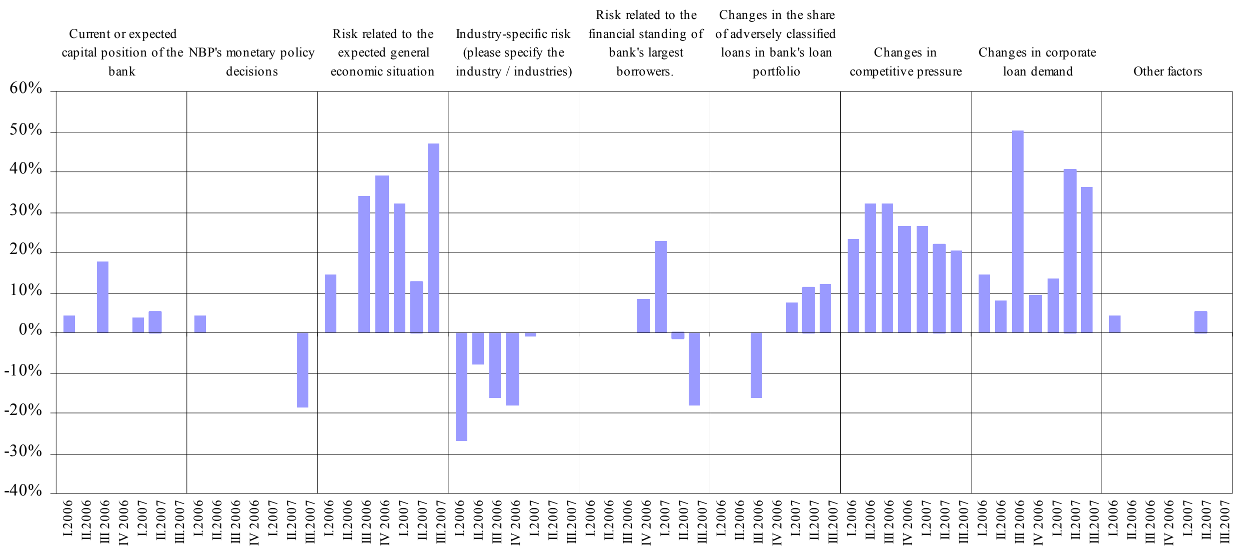
Note: the figures included in this document present the net percentage. A positive value of net percentage should be interpreted as the easing of lending policy or growth in demand for loans and a negative value of net percentage – as the tightening of lending policy or decrease in demand for loans. Details concerning the calculation methodology are presented in the Appendix.

Figure 2
Terms on corporate loans



According to the banks favourable perspectives of the development of economic situation were the most important reasons for the easing of lending policy towards enterprises in the third quarter of 2007. At the same time some banks which changed their lending policy justified it with the growth in demand for corporate loans (cf. Figure 3). It may indicate that in the period of economic upturn and strong growth in demand these banks try to increase their market share and attach new corporate customers in order to have a broader customer base in the future. The bank which increased loan spreads in the third quarter justified this decision with the worsening of financial standing of the largest borrowers. Two other banks indicated that the interest rates increase by the Monetary Policy Council made them tighten their lending policy.

Figure 3
Factors influencing changes in lending policies



The demand for corporate loans increased again in the third quarter of 2007, however, the rate of this growth fell as compared to the previous four quarters. **Demand for long-term loans grew stronger than demand for short-term ones.** Higher rate of demand growth was recorded in the segment of loans for SMEs as compared to the loans for large enterprises (cf. Figure 4). The growth in demand was markedly slower than the projections presented at the end of the second quarter of 2007. Similarly as in the previous quarter approximately 10% of banks noted the decrease in demand for corporate loans. This decrease was the strongest in the segment of short-term loans for large enterprises. The discrepancies in assessments of the direction of changes in demand for loans probably results from the strong competition on the market.

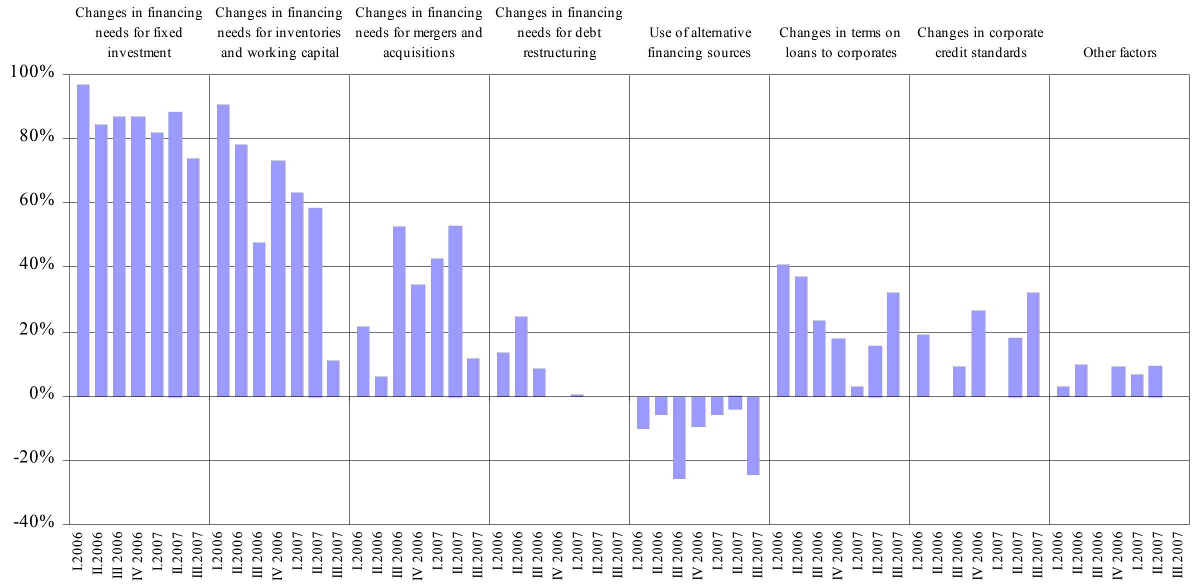
In spite of the slow-down in the rate of demand growth in the third quarter, approximately **three fourths of the banks expect the increase in demand for corporate loans in the fourth quarter of 2007** (cf. Figure 4). The differences between the expected scale of demand growth in individual segments of corporate loans market are very slight. The banks which in the third quarter of 2007 recorded the decrease in demand for corporate loans regard this decrease as the temporary phenomenon, expecting demand growth in the fourth quarter.

Figure 4
Corporate loan demand

According to the banks the major factor stimulating the growth in demand for corporate loans was still the growing demand for financing the investments of enterprises. Basing on monetary statistics, it may be expected that this category covers also the financing of real estates. The importance of this factor has remained at a similar level since the beginning of 2006. In the third quarter of 2007, the importance of changes in the demand for the financing of inventories and working capital and the demand for financing mergers and acquisitions as the factors developing demand for loans, dropped significantly. In particular, nearly 30% of the banks which recorded the changes in demand for corporate loans in the third quarter of 2007 decided that demand for inventories and working capital financing slightly decreased. It indicates that a good financial standing of enterprises to the increasingly larger degree can constitute the factor limiting demand for short-term loans. At the same time growing investments are to a large degree financed with external funds, mainly in the form of bank loans. The decrease in demand for financing mergers and acquisitions can be related both to the high valuations of Polish enterprises and to the growth in risk aversion as a result of disturbances in financial markets. **Approximately one third of the banks are of the opinion** that the easing of the terms and standards of granting corporate loans was conducive to the growth in demand for loans.

The impact of utilisation of other sources of financing enterprises, alternative to bank loans, on demand for loans has reached the highest level for a year (cf. Figure 5). It results both from the increased utilisation of own funds, which probably influences mainly demand for short-term loans, and from the intensified competition of financing directly in the financial markets. According to ca. 30% of banks the possibility of obtaining by enterprises of financing in the bond market limited demand for loans. 20% of banks expressed a similar opinion on the financing on the share market. Since the corporate bond market did not record a significant increase in the new issues value it can be expected that the competition factor from the financing of enterprises' activities in this market was connected, first of all, with declarations of some large enterprises. High utilisation of other banks' loans limited the observed demand for loans in approximately one third of the banks, which indicates that a strong competitive pressure is sustained on the market of corporate loans.

Figure 5
Factors influencing changes in corporate loan demand



Households

In the third quarter of 2007, significant changes in the lending policy took place in the segment of housing loans for households. Nearly 60% of banks tightened their lending policy. The banks, first of all, increased non-interest costs of loans and raised loan spreads (cf. Figure 7). However, the extension of loan maturity was still observed. Two banks decreased the scope of required documentation.

As a consequence the net percentage reached the lowest value since the implementation of the requirements of *Recommendation S* in the third quarter of 2006. The changes in the lending policy in this segment were strongly divergent from the banks' expectations (cf. Figure 6). It may indicate that the banks responded with the tightening of lending policy to the unexpected, negative news from the housing loans market in the United States. Approximately one fifth of the banks decided to ease the terms and standards of granting housing loans. **The banks expect a slight easing of the lending policy** in the segment of housing loans in the fourth quarter of 2007. Three banks expect the easing of lending policy and two banks expect its tightening.

The banks indicated the risk related to the general economic situation as the most important reason for the tightening of lending policy in the segment of housing loans. It may be the symptom, given stable projections with regard to the condition of the Polish economy and the situation of the sector of enterprises, of increased uncertainty about developments in international financial markets. The examined banks were induced to tighten the lending policy also by the increase in interest rates in Poland resulting from the decisions of the Monetary Policy Council (cf. Figure 6). In the case of one of the large banks the deterioration of capital adequacy as a result of the fast growth in lending in the previous quarters was the motivation to tighten the terms and standards of granting housing loans. The competitive pressure in the banking sector continued to intensify, which was the rationale for the easing of the terms and standards of granting housing loans. **The polarisation of views of the examined banks has been maintained with regard to prospects of housing market situation development on the lending policy.** Several per cent of banks are of the opinion that these perspectives justify the tightening of lending policy, a similar percentage of banks are of the opposite view.

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

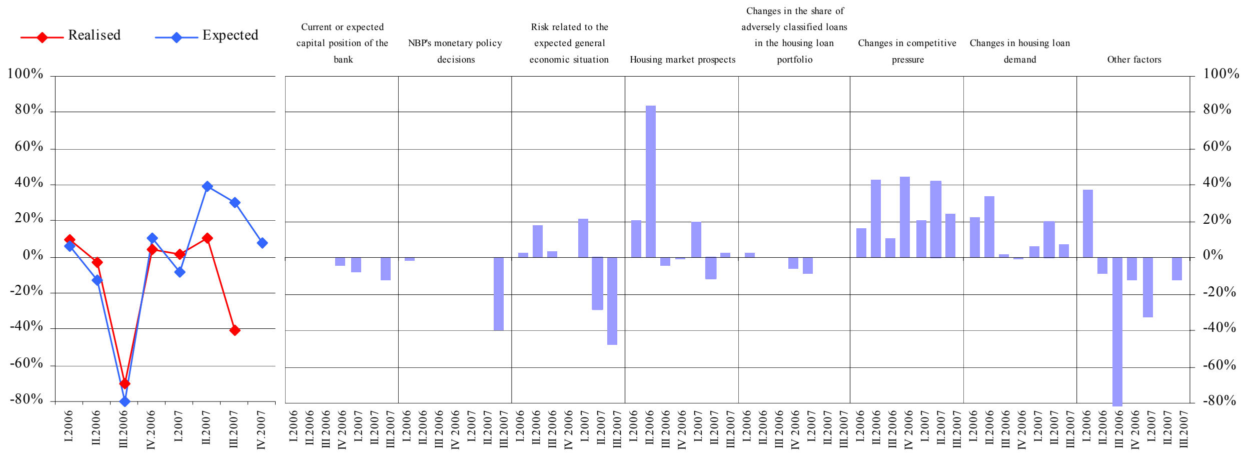
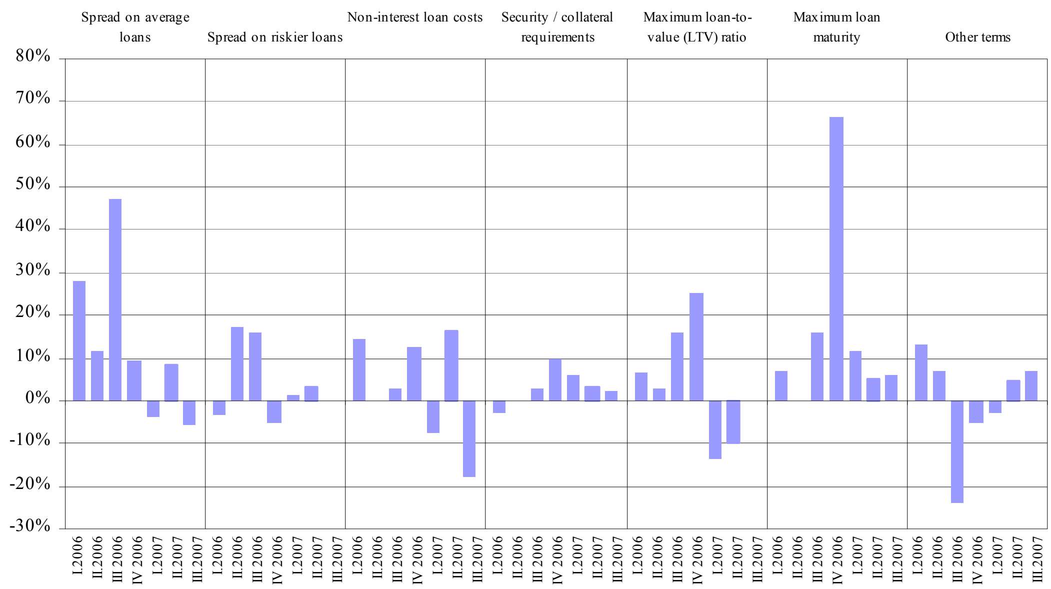


Figure 7
Terms of housing loans



The lending policy in the segment of consumer loans for households was slightly tightened in the third quarter of 2007. The lending policy was eased, first of all, by the banks with low market share, in which the changes of lending policy were due to promotional offers. **Relatively strong expectations as to the easing of lending policy are maintained in the horizon of one quarter** (cf. Figure 8). Over half of the banks expect the easing of the terms and standards of granting loans, including over one third of the banks which expect a substantial easing of the lending policy[1]. Two medium-sized banks expressed opposite expectations.

Similarly as in the segment of housing loans, **the banks decided to increase loan spreads** also **in the segment of consumer loans** (cf. Figure 9). The increase in spreads was stronger in the category of higher risk loans than

[1] Banks have a possibility to grade the changes in lending policy. In the survey they can select from among the following options: the lending policy was significantly tightened, the lending policy was slightly tightened, the lending policy was not amended, the lending policy was slightly eased, the lending policy was significantly eased.

in the category of standard consumer loans. Some banks limited also the maximum loan size. **In combination with the limitation of documentary requirements it indicates that the increase in margins probably results from the strategic decision to undertake higher credit risk.** The banks which eased their lending policy in this market segment (ca. 20% of asset weighted banks) decided, first of all, on the extension of the loan maturity and increasing maximum consumer loan sizes. Other changes in the terms and conditions of granting consumer loans were related mainly to accepting more liberal parameters of credit scoring models.

The banks indicated that the increase in the risk related to the projected economic situation and the rise in interest rates as a result of the Monetary Policy Council's decisions (cf. Figure 8) were **the reasons for tightening the lending policy in the third quarter of 2007 in the segment of consumer loans**. The competitive pressure, both from other banks and non-bank institutions, had the largest impact on easing the lending policy for a year.

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

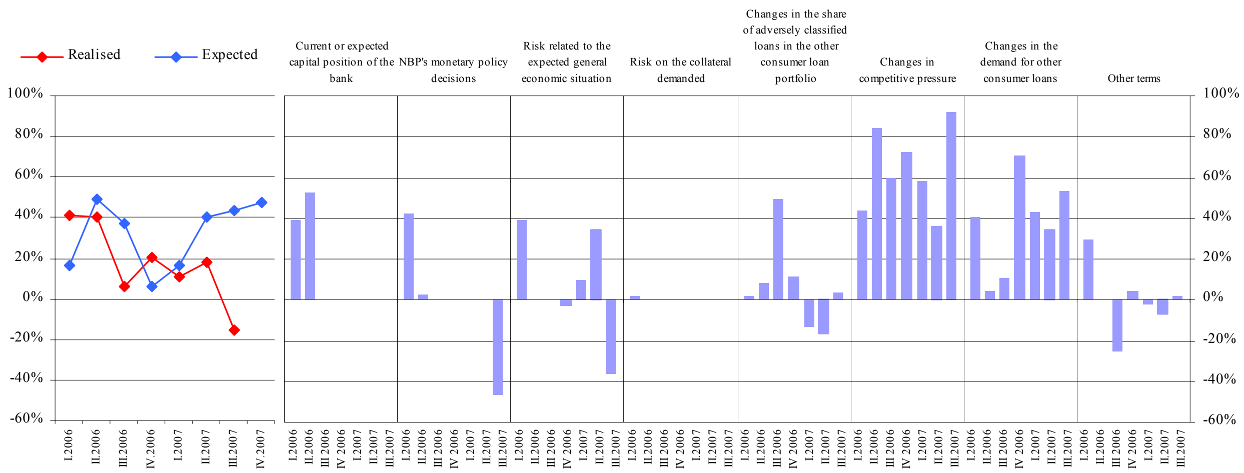
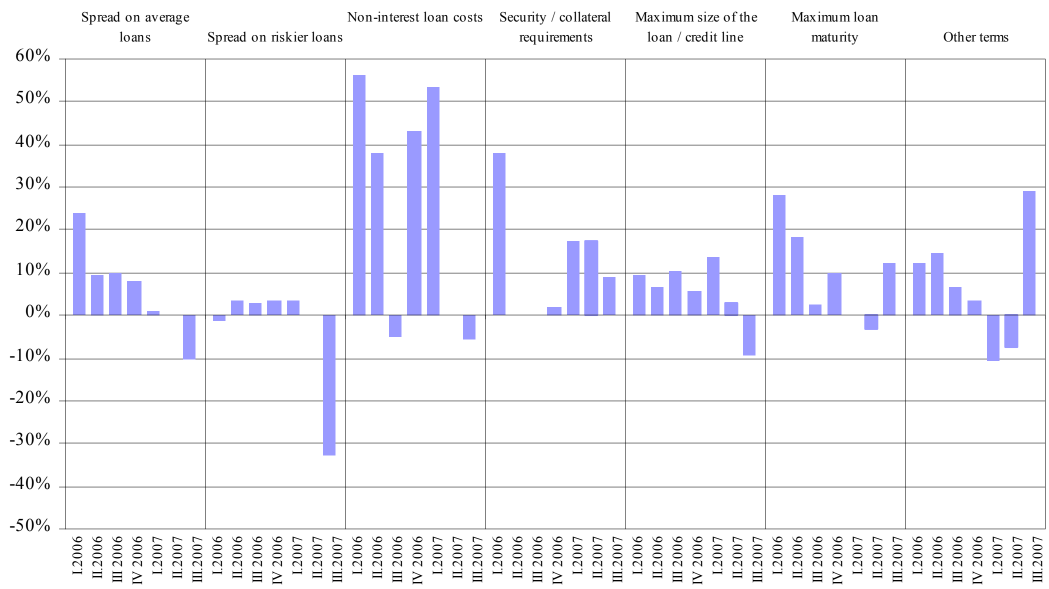


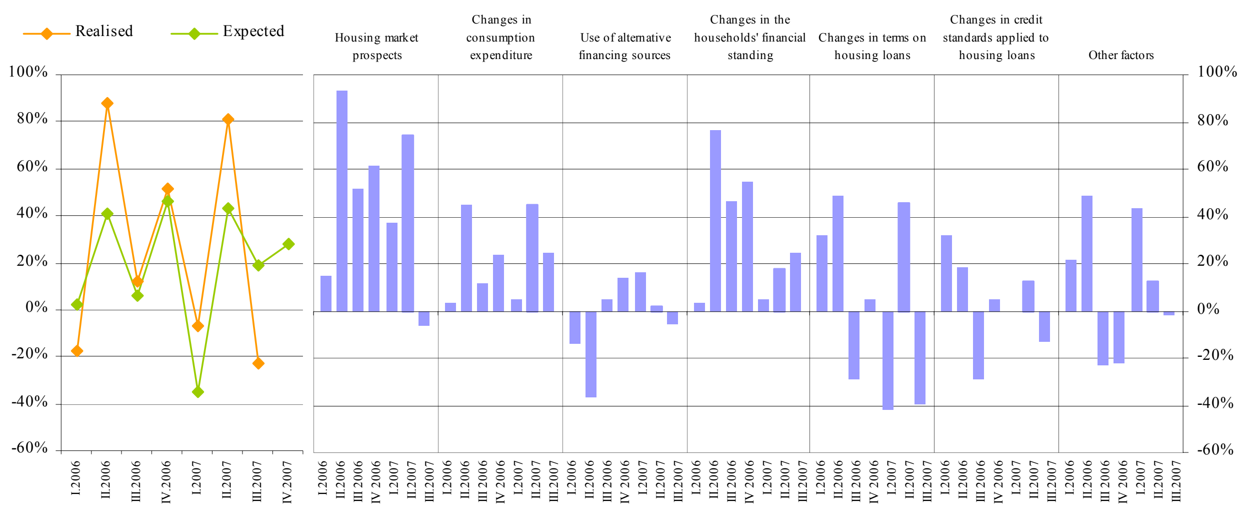
Figure 9
Terms on consumer loans



The banks assessed that **in the third quarter of 2007 a slight decrease in demand for housing loans** took place. It should be noted, however, that 13% of banks regarded this drop in demand in the third quarter as substantial. At the same time 10% of banks recorded the growth in demand for housing loans. At the end of the second quarter of 2007, the banks expected a slight increase in demand (cf. Figure 10).

According to the banks, the tightening of the terms and standards of granting housing loans had the largest impact on the decrease in demand for these loans (cf. Figure 10). It should be noted that the sustained improvement in the economic standing of households did not result in the increase in demand for loans, which may be due to the growing cost of loans and low availability of flats owing to high prices. For the first time since the survey was conducted (in four years) the banks regarded that the projections of developments in the housing market – stabilisation of the prices of flats in the metropolitan areas – were the rationale for a slight decrease in demand for housing loans. If this observation were confirmed in the following quarters, it would indicate the hampering of demand for housing loans, which could lead to the change in the tendencies on the real estate market.

Figure 10
Demand for housing loans and factors influencing its change

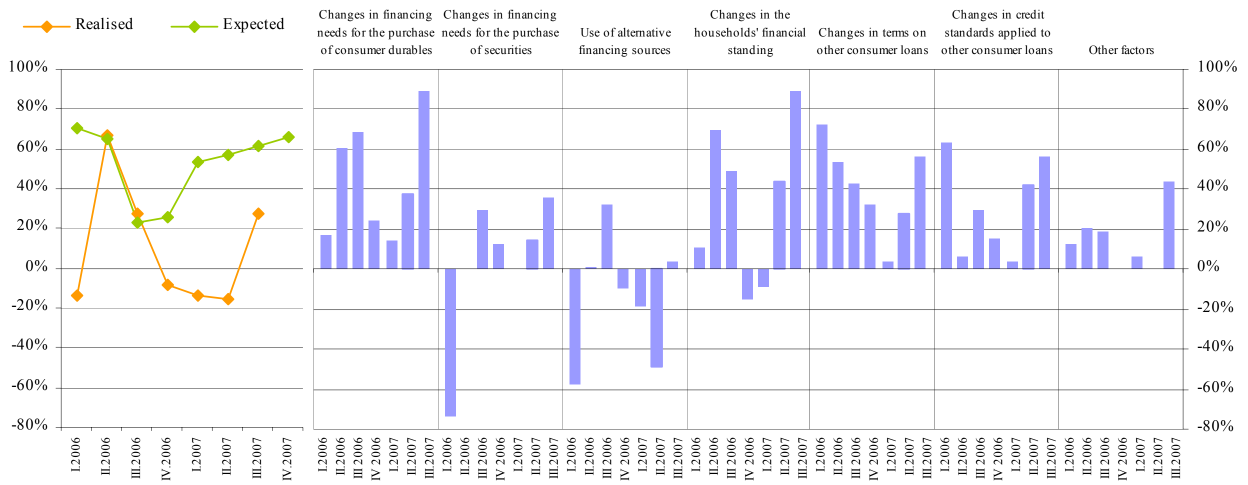


In the fourth quarter of 2007 the banks expect a slight increase in demand for housing loans (cf. Figure 10). It seems that these expectations can be justified with the projections of further income growth of households in combination with with the stable lending policy and expected slight changes in the prices of flats.

In the third quarter of 2007 the demand for consumer loans increased in approximately one fourth of the examined banks. The banks still declare the expectations of strong growth in demand in the upcoming quarter. Approximately two thirds of the banks expect it (cf. Figure 11).

According to the banks which recorded the growth in demand for consumer loans in the third quarter of 2007, the improvement in the economic standing of households and growing demand for financing the purchase of durable goods were its key reasons. The easing of the terms and standards of granting consumer loans also played an important role. The importance of the utilisation of households' own funds and the loans from other banks decreased as a factor hampering the growth in demand for loans offered by the examined banks (cf. Figure 11). A few banks stated that promotional offers and the extension of the range of credit products contributed to the recorded growth in demand.

Figure 11
Demand for consumer loans and factors influencing its change



Appendix

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

<table>
<tr><th>Questions no.</th><th>Market segment</th><th>Type of loans</th></tr>
<tr><td rowspan="2">1, 4, 6, 7</td><td>Short-term corporate loans</td><td>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</td></tr>
<tr><td>Long-term corporate loans</td><td>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</td></tr>
<tr><td>2, 3, 5</td><td>Total corporate loans</td><td>Total amount of loans outstanding from state-owned enterprises and companies, private enterprises and companies as well as cooperatives and sole traders</td></tr>
<tr><td>8, 9, 10, 13, 14, 16, 17</td><td>Housing loans to households</td><td>Housing loans to persons</td></tr>
<tr><td>8, 11, 12, 13, 15, 16, 17</td><td>Consumer and other loans to households</td><td>Total loans outstanding from persons less housing loans to persons</td></tr>
</table>

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 the two first months of 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 the third month of the period are 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.