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Liquidity and currency risks in Polish Banking Sector

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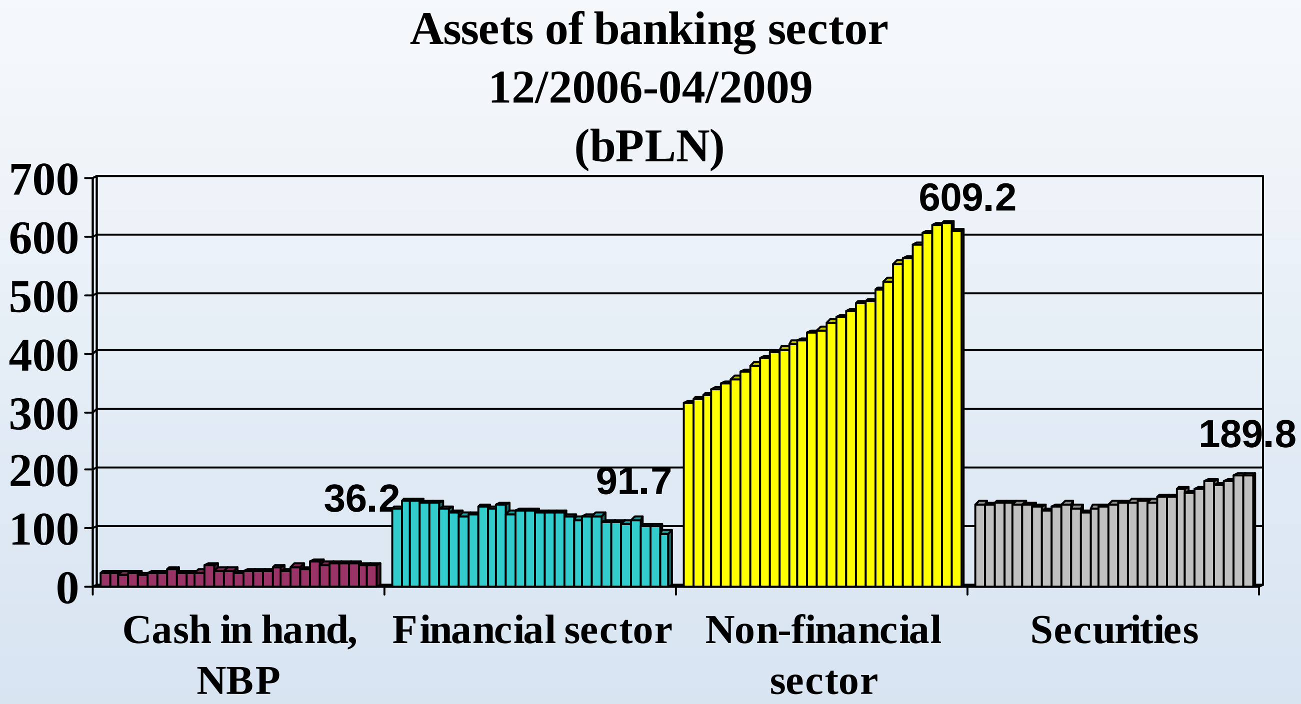
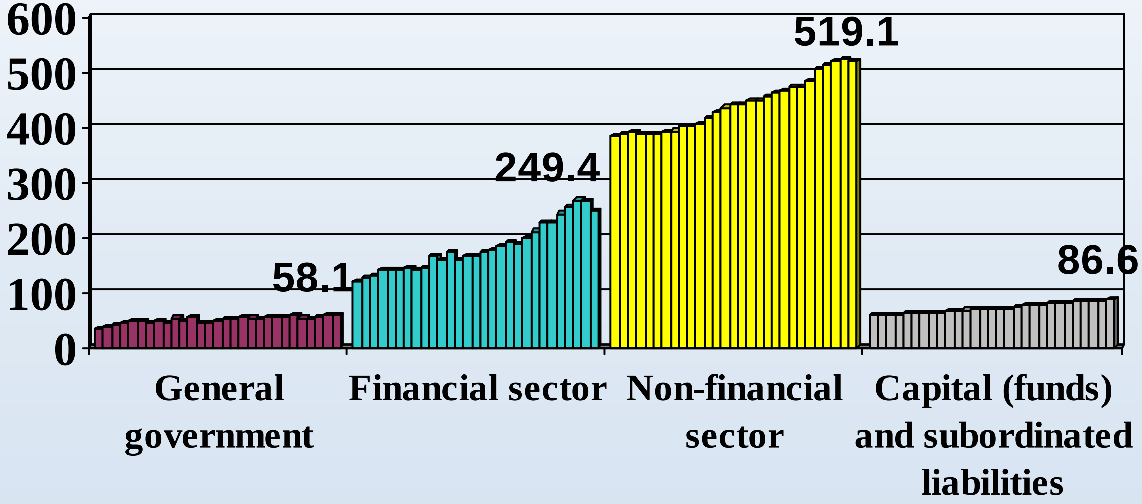
Banking sector



Banking sector

Liabilities of banking sector
12/2006-04/2009
(bPLN)



Gap analysis

Structural liquidity

potential liquidity risk and capital outflow

1) Liquid assets (21 percent of total assets)
   - Cash & NBP 36.2 bPLN
   - Securities 189.8 bPLN

2) Financial sector gap (15 percent of total assets)
   - Assets 91.7 bPLN
   - Liabilities 249.4 bPLN (66 percent from non-residents)

3) Non-financial sector gap (8.6 percent of total assets)
   - Assets 609.2 bPLN
   - Liabilities 519,1bPLN

Short-term Measures

Central bank liquidity frameworks

ensuring that financial institutions have access to liquidity

- Quick and substantial injections of reserves without running the risk of rapid changes of overnight rates
- Frameworks accepting a wide range of collaterals
- Variety of instruments to address illiquidity of markets
- Standing swap lines for central banks to deal with problems of liquidity in foreign currency
- Inter-bank money market guarantee scheme

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Polish mortgage market system

<u>No two tier system</u>

1) Mortgage originators are credit risk-takers
2) Limited role of mortgage banks and MBS

<u>No prime mortgages definition (no risk standardization)</u>

LTV limits do not exist except mortgage banks
LTI limits – only general rules

<u>Short-term deposit model of refinancing of mortgage loans</u>

<u>No specific rules of real estate valuation and monitoring</u>

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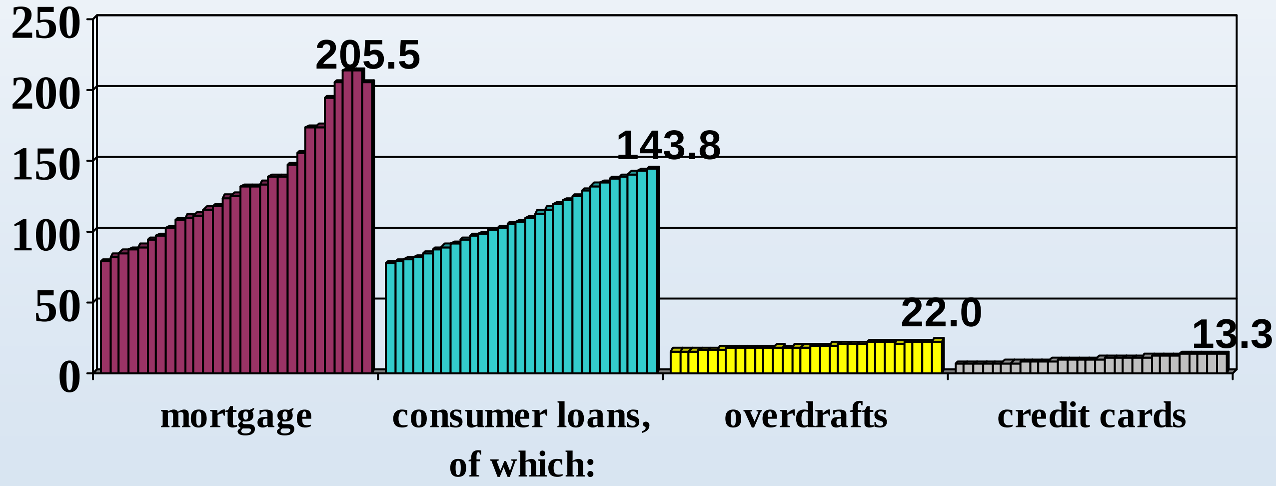
Banking sector

Loans to households
12/2006-04/2009
(bPLN)



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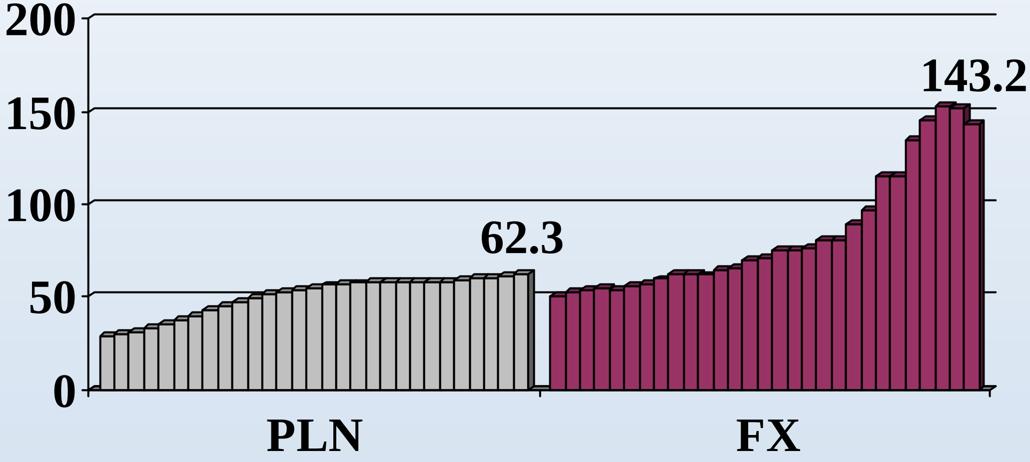
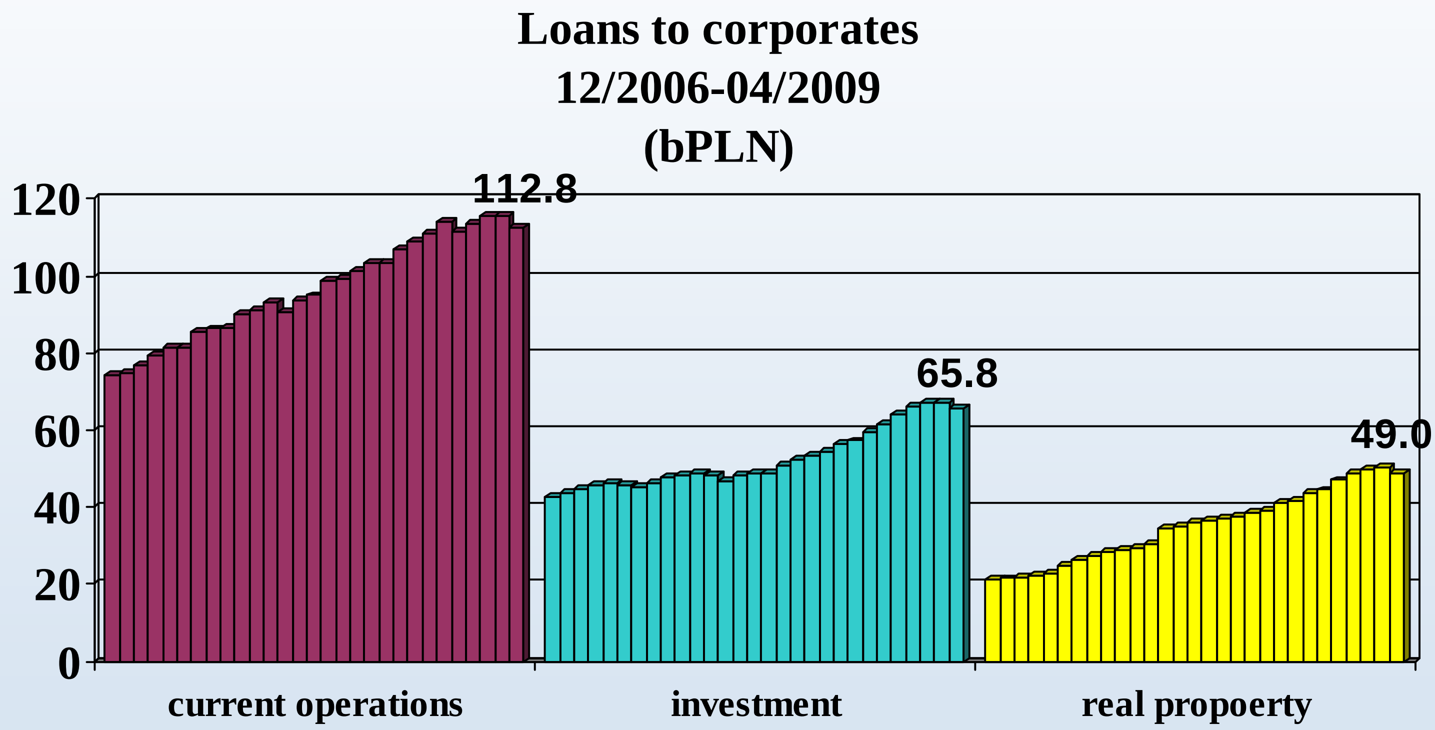
Banking sector

Currency structure
of mortgage loans for households
12/2006-04/2009
(bPLN)



Banking sector



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Mortgage loans

Low share of mortgage loans in GDP (17.5 percent)

- GDP gap between euro zone and new EU member countries
- Risk of higher inflation

High share of mortgage loans in total loan portfolio (33,7 percent)

- Potential high profitability
- Good collateral (mortgage) = low credit risk
- Long-term asset

High share of mortgage loans denominated in foreign currency in total mortgage loans (69.8 percent)

- Low domestic saving
- Carry-trade effect (interest rate difference)
- Foreign liquidity accesss

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Risk of foreign currency funding

Potential foreign capital outflow

- Migration of foreign capital (deleveraging effect)
- Capital mergers

Increasing cost of foreign fund

- Repricing of East European Countries' risk
- Credit interest rate formula (CHF libor + fixed margin)
- Higher capital requirements due to depreciation of Polish zloty
- Impact of real estate prices decrease and depreciation of Polish zloty on credit provisions

Increasing FX liquidity and credit risks

- Extra liquidity cost – high FX swaps cost
- Extra deposit demand (in Polish zloty)
- Increase of LTI due to depreciation of Polish zloty

Long-term Policy Lessons

Risk of short-term FX funds!

- Liquidity risk
- Credit risk

Domestic saving (model of commercial bank?)

- Short-term deposits
- High interest rates volatility

Securitization (MBS)

- Institutional model of securitization (American model, mortgage bank model..?)
- Mortgage products standardization
- Domestic vs. international demand for MBS
- Euro adoption