Miscellanea

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Corporate banking In Poland. Economic role, market trends and development prospects[1]

The leading role of banks in the financing of the economy and domestic enterprises in Poland

The key elements of any financial system are, in addition to the central bank, first and foremost: the other monetary financial institutions (represented mainly by banks, and to a much lesser extent other credit institutions and money market funds), investment and pension funds and insurance companies. While a well-functioning financial sector is a lever for growth and progress, irregularities within it can place a significant burden on it.

In almost all continental European countries, monetary financial institutions (MFIs) play a key role in the financial system, with the capital market being less important. In some EU countries, however, the market part is well developed, accounting for

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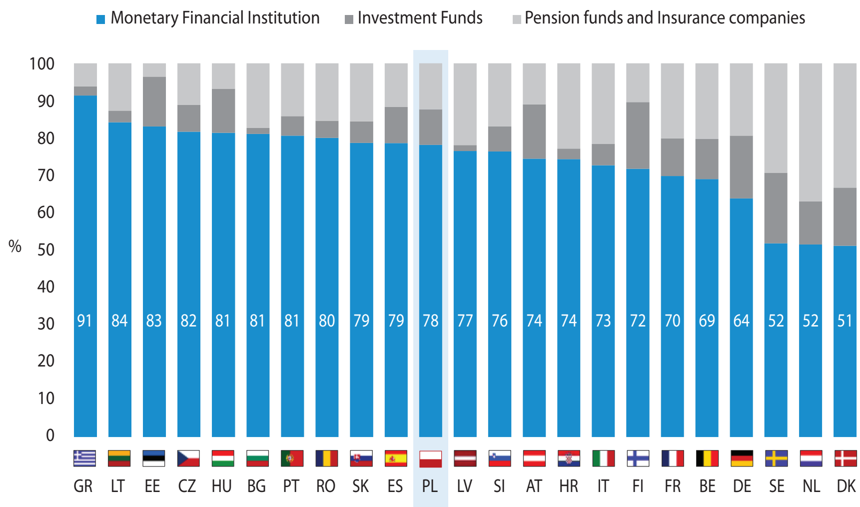
at least 30% of the total assets of the narrowly defined financial sector. Apart from the specific cases of Luxembourg, Malta, Ireland or even the Netherlands (which, for tax reasons, is a popular location for many foreign investment funds), this group includes some of the most developed economies of Western Europe (Denmark, Sweden, Germany or Belgium). In Poland, the position of monetary financial institutions (banks) is stronger than the EU average. In 2022, they held 78% of total financial sector assets, i.e. 9 p.p. more than the EU average. The particularly strong reliance of the financial system on the banking sector is a common feature of most Central European countries and some countries in the south of the continent (Greece, Portugal, Spain).

Investment funds play a relatively important role in the Polish financial system compared to other countries in the region (10% share in total assets). In contrast, the 12% share of other institutions (pension funds and insurance companies) is lower than in most Member States.

Between 2010 and 2022, the share of banks and other MFIs in the assets of the Polish financial system increased by 9 p.p. This trend contrasted with the declining role of these institutions in the European Union (down by 10 p.p.). This strong increase in the share of MFIs was driven on the one hand by the numerous development barriers faced by the capital market and on the other by their growing role in financing the state's borrowing needs. This was manifested by an increase in the share of debt instruments – mainly treasuries – in the total assets of monetary financial institutions from around 20% in 2010 to nearly 30% in 2022.

Chart 1. The share of monetary financial institutions (MIF) in the total assets of the financial sector in selected EU countries [2022]*



* Bulgaria, Estonia and Finland data for 2021.

Source: Eurostat and own calculations.

The significant financing of treasury instruments in Poland contributed to the decline in the importance of traditional lending in the period 2010–2022 by 3 p.p., mainly due to much weaker demand growth after 2019 as a result of the pandemic, as well as significant increases in interest rates. However, this decline was still significantly weaker than that observed in the EU (-7 p.p. in the corresponding period). On the other hand, the share of bank loans in the assets of the Polish financial sector amounted to 46% at the end of 2022 (according to ECB data) and was definitely higher than the EU average (31%), with only small countries in the region (Slovakia, Lithuania and Estonia) having higher ratios. The cited data document that banks in Poland are the financial foundation of the economy. It can be added that in the case of a certain group of enterprises, especially the largest ones, there is a greater diversification of financing sources (apart from banks, also the capital market and loans from foreign parent companies).

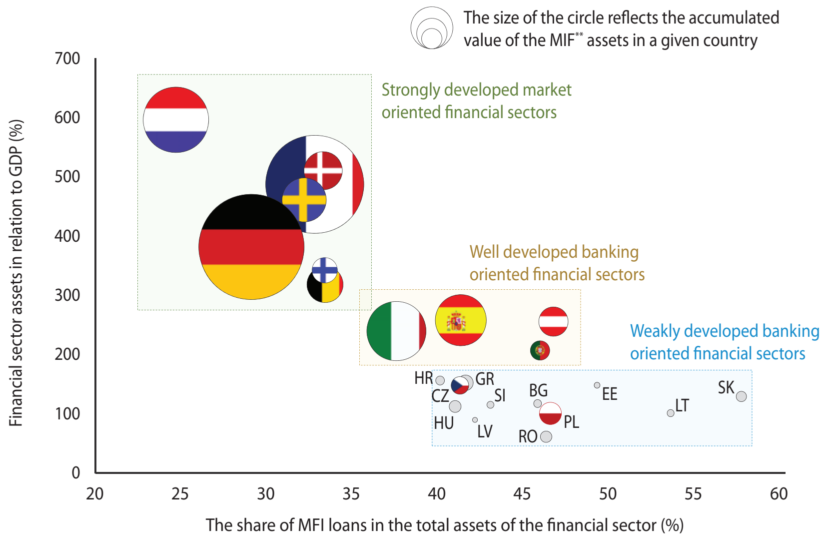
Typology of banking sector development in the EU

The typology of EU countries according to the criterion of the level of financial sector assets to GDP and the share of MFI loans in financial sector assets makes it possible to distinguish three types. The first is the so-called 'affluent north' or old EU countries with strongly developed market-oriented financial sectors, comprising the Netherlands, France, Denmark, Sweden, Germany and Finland and Belgium (financial sector assets exceeding ca 300% of GDP). The second type includes Italy, Spain, Austria and Portugal (above 200% of GDP) with a strongly developed bank-oriented financial sector. The third type includes the remaining EU countries, not exceeding 200% of GDP characterised by underdeveloped bank-oriented financial sectors (cf. Chart 2). In the so-called comparative perspective, the Polish financial sector is the largest in the third distinguished segment, with a strong position of banks in the financial market and a relatively high potential for development.

Dynamics and trends of bank financing of enterprises in Poland after 2010

The active role of domestic banks in financing entrepreneurship and thus stimulating economic growth in Poland is reflected in changes in the volume of loans to enterprises after 2010. After a very intensive first decade of the 21st century in this respect (total growth more than doubled), the last several years have been a period of continued expansion of banks in this area. According to ECB data, since 2010, the volume of loans granted to businesses by banks in Poland has increased (calculated in euro) by more than 60%. This is the fifth best result in the entire European Union, after Luxembourg Finland, the Czech Republic and France. In terms of nominal growth of these banking assets (+ EUR 35 billion), Poland ranks eighth in the Community, behind only the banking systems of Western European countries. This was achieved despite the unfavourable trend in the exchange rate, as there was a significant weakening of the złoty against the euro. The period of dynamic development of business banking in Poland was particularly marked in the years 2011–2019, when banks increased their corporate financing by 59%. Stronger expansion in the area of business loans was manifested at the time only by financial institutions from

Chart 2. Model and level of MIF sector development in selected EU countries [2022]*



* Bulgaria, Estonia and Finland data for 2021.
** Banks and other credit institutions.

Source: Eurostat and own calculations.

Luxembourg. Unfortunately, the outbreak of the COVID-19 pandemic brought a strong slowdown in business activity, and the uncertainty of developments resulted in a deep decline in investment. Despite massive 'injections' of funds – as part of the anti-crisis shields – there was a sharp reduction in demand for bank loans in 2010. As a consequence, Poland suffered the third strongest decline in their volume in the EU (after Lithuania and Ireland) in 2020 (-11% y/y). The next year and a half was a period of fairly rapid 'catching up', halted by Russia's aggression against Ukraine, and the accompanying economic slowdown, energy crisis and sharp rise in interest rates as a reaction to high inflation. For these reasons, in a period marked by strong uncertainty and volatility, corporate loans in Poland grew by only 2% between 2020 and 2023.

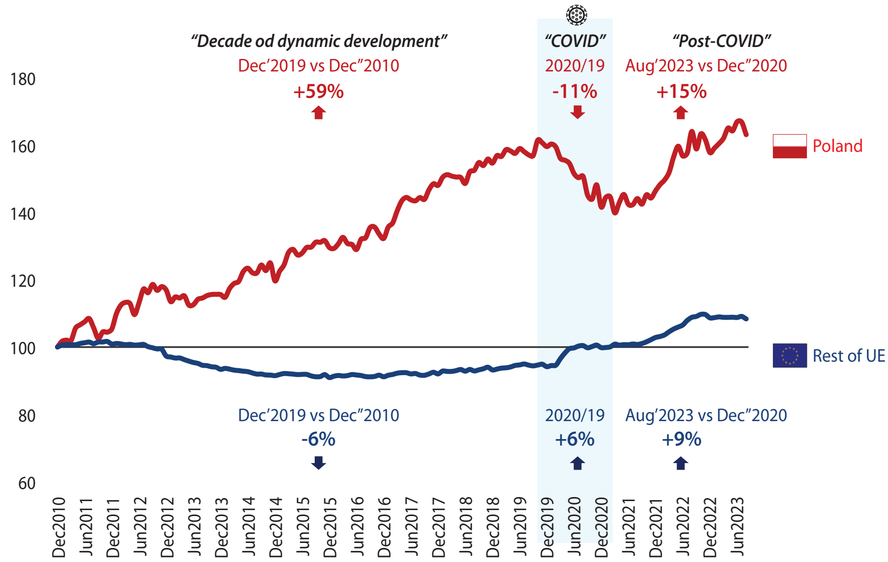
In general, after 2010, despite the occurrence of certain developmental barriers, corporate banking in Poland enjoyed favourable growth conditions due to, inter alia, the macroeconomic environment, the persistent competitive advantages and foreign expansion of Polish companies, reporting demand for financing, as well as many specialised services provided by banks (e.g. trade finance, business consultancy). For the years 2010–2022, this assessment is justified by the following circumstances, among others:

– Poland's GDP increased by more than 50%, which was the third best result in the EU (after Ireland and Malta);
– the scale of activity of Polish companies, measured by the value of their revenues, showed a 2.5-fold increase and total investment outlays were ca 2.5 times higher;
– the level of short- and long-term liabilities of Polish companies increased by 2.8 and 2.5 times respectively ;
– a factor conducive to growth was the continuing availability of cheap bank financing in a historically low interest rate environment for most of the period under review;
– the progressive internationalisation of firms is evidenced, inter alia, by the rapidly increasing ratio of exports of goods and services to GDP (up by as much as 23 p.p. to 63%; there was also a marked increase in both the percentage of firms exporting and the share of foreign sales in the total turnover of Polish firms;
– despite the disruption of the trend after the outbreak of the pandemic and the war in Ukraine, loans to businesses grew clearly faster than those to households (according to the NBP, the total value of loans to businesses increased by 83% in PLN, while the value of loans to households was nearly 20 p.p. lower).

Corporate credit demand is characterised by a strong sensitivity to changes in the economic cycle. The demand for external financing clearly weakens in periods of increased investment uncertainty and/or a real deterioration in the financial situation of companies, while it shows a vigorous growth in years of better economic conditions. This regularity has been very pronounced over the past decade or so, which has not been neutralised even by shielding measures in the form of liquidity injections for companies within the framework of anti-crisis shields.

Loans to businesses and households in Poland grew solidly until 2019, after which their trajectory diverged. Loans to businesses temporarily showed a relatively strong decline while loans to households maintained a trend of strong growth, especially in a near-zero interest rate environment and in the face of a persistently good housing market. In contrast, there was a very clear rebound in corporate demand in 2021, with a much weaker one in the retail segment. High and rising inflation in late 2021 and early 2022 contributed to a sharp tightening of monetary policy, amid the extensive consequences of the war being fought across Poland's eastern border in Ukraine (including population migration, rising energy commodity prices, the spectre of an energy crisis, economic sanctions against Russia and Belarus, changing exchange rates, new and greater risks). Initially, the increase in interest rates had a stronger impact on household credit demand (stabilisation in the first eight months of 2022 and a y/y decrease from September 2022). In contrast, the dynamics of corporate lending accelerated, which bore the hallmark of stockpiling in an environment of more expensive raw materials). At its peak, in August 2022, the dynamics was close to 20%, before quickly turning negative and reaching -6% in August 2023.

Chart 3. Changes in the volume of business loans in Euro. Poland versus rest of EU in 2010–2023 [Dec'2010=100]

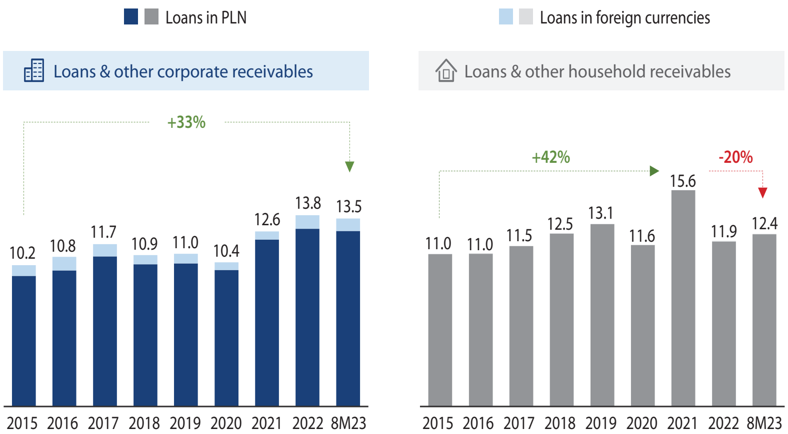


Source: EBC, own calculations

After 2010, differences in the dynamics of loan portfolios of the corporate and household segments led to a change in the entity composition of assets, from ca 31% to ca 34% for the former in August 2023. Although in the turbulent environment of the 2020–2023 period both credit segments for the non-financial sector showed very similar, weak (only a few percent) growth, corporates showed greater sensitivity in these conditions.

Loan turnover in the corporate segment is faster, due to the high share of financing of current financing needs. Thus, the ratio of new loans to total loans to corporates, at the end of a given period, is quite high. Therefore, in the trend, the volume of new corporate loans was higher than in the retail segment but only slightly. Although the situation in this respect changed visibly in 2022 and the first half of 2023, as banks extended more loans to companies than to households (cf. Chart 4). It is worth noting that in May 2023, an absolute record was set for monthly sales of loans to businesses (over PLN 18 billion). The reason for this can be seen in the strong increase in companies' demand for working capital loans in an environment of rapidly rising costs and business revenues.

Chart 4. Monthly average value of newly granted corporate versus households loans* (PLN billion)



* No renegotiated contracts.

Source: National Bank of Poland and own calculations.

The distribution of corporate lending to small and medium-sized enterprises (SME) and large companies was similar over the period under review. By mid-2023. SME held ca 55% of total bank claims on businesses. At the same time, from 2010 to the end of 2017, SME loans grew e slightly faster (73%) than larger corporations (63%). From January 2018 to August 2023, these proportions changed in favour of entities with 250 or more employees (29% vs. 12%).

The higher dynamics of lending to large entities is basically related to the greater resilience of this group of companies to economic fluctuations and the lower sensitivity of investment sentiment… In the SME sector, the collapse in loan demand as a consequence of the pandemic was not only more intense but also longer (the difference was ca 10 months). The recovery in loan demand for large companies lasted until the turn of Q3 2022. after which the SME sector was more active. In contrast, corporates entered a y/y decline towards the end of 2Q23, which deepened in 3Q2023.

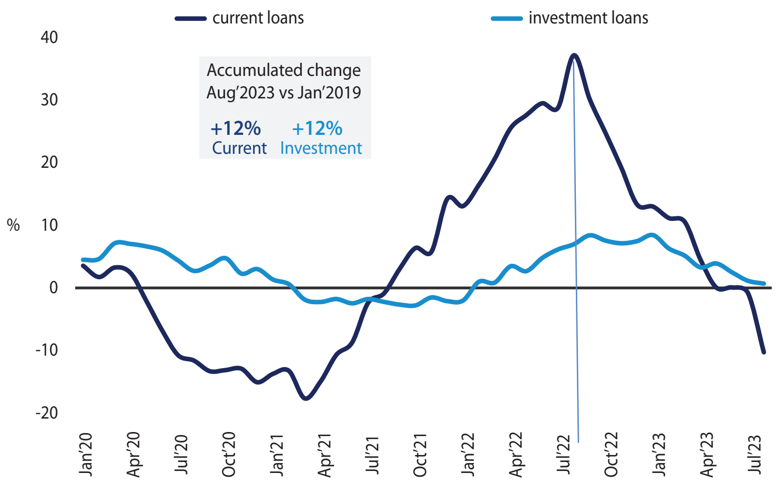
Since the end of 2010, the share of long-term receivables in the Polish banking sector has been growing and the share of investment loans almost doubled (3Q23). However, between Dec'10 and Aug'23, their share in total bank exposure to Polish companies increased by around 4 p.p., from 50% to 54%. During this period, the share of current (working capital) loans remained stable at 41% (total volume growth over the period in question of over 80%), while the importance of the small category of other loans and receivables from companies (which recorded a mere 15% growth over the period in question) declined markedly.

In the case of current loans, a break in the long-term growth trend was evident in 2H20 1H21 more strongly than in investment loans. This was, on the one hand, the result of strong economic perturbations caused by successive waves of pandemics and related and sanitary restrictions, and on the other hand, a reaction to the sizable liquidity injection that companies received under the government's anti-crisis shields. The decline in y/y growth in this area reversed sharply in mid-2021 under the influence of an increasingly pronounced post-pandemic recovery and rising inflationary pressures, reaching its peak in Aug'22 (37% y/y growth). Between 4Q22 and 1H23, the resolution of some corporate problems, including pandemic logistical bottlenecks, the calming of the situation on commodity markets (and the consequent slowdown in inventory accumulation) and, over time, the economic slowdown combined with gradual disinflation, led to another strong weakening in the growth rate of this category of corporate loans, and in 3Q23 even a y/y decline.

It is worth noting that investment loan volumes have been much more stable over the last four years, as the business cycle was flatter and longer. It is important to note that there was no decline in their y/y dynamics throughout the crisis year 2020, which is due to the natural inertia of financing long-term projects and also less sensitivity to shock events.

Generally speaking, looking at the evolution of corporate loans after 2010, it can be concluded that the growth factor of the corporate banking sector was investment loans, while current loans were characterised by high volatility of dynamics.

Chart 5. Dynamics of current and investment loans (y/y) in Jan'2020–Aug'2023



Source: National Bank of Poland, own calculations

PLN versus foreign currency corporate loans

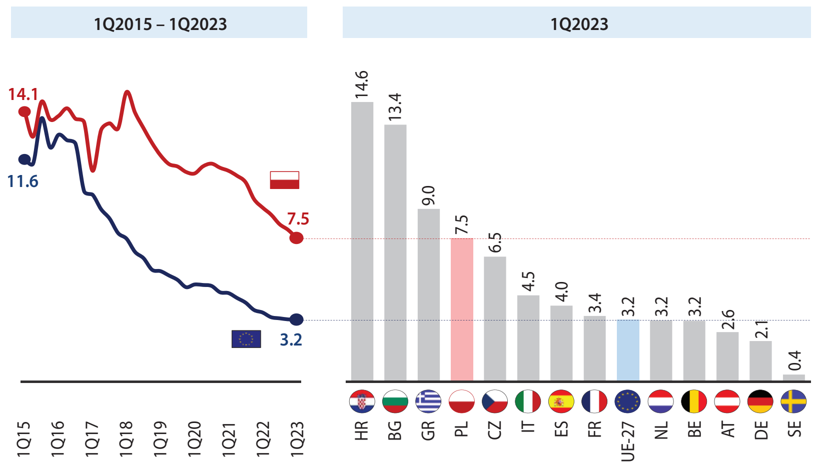
Loans granted in PLN represent the dominant part of corporate sector liabilities towards domestic banks, accounting in Aug'23 for approximately 70% of their total volume. After 2010, however, foreign currency loans (predominantly denominated in euro) showed a nearly doubled growth rate, with the total volume increasing by 126% by Aug'23 (PLN loans by 69%). Over the entire period, the share of foreign currency loans in total bank receivables from corporates increased by 7 p.p. The higher y/y dynamics of foreign currency corporate loans was inherent in recent years. Since the beginning of 2019, their value in billion PLN has increased by more than 20% in total, with only 4% growth in PLN exposures. The period of higher dynamics of foreign currency loans has continued uninterrupted since Jul'22, although it is weakening), while the PLN loan category has recorded a y/y decline since Apr'23.

The most important factor behind the higher dynamics of foreign currency lending is the persistent interest rate disparity between Poland and the euro area and other developed economies. The differences in interest rates between PLN and foreign currency loans are conducive to the search for cheaper alternatives to PLN financing – all the more so as an increasing part of companies' revenues is generated precisely in euro. This is due to both the ongoing foreign expansion and the continued strong orientation of Polish exports towards EU countries, mainly Germany and other Euroland countries. The stronger increase in the volume of foreign currency loans in the period under review is also a consequence of changes in the exchange rate (between December '10 and August '23, the złoty weakened against the euro by approximately 15% and in October '22 by as much as 23%). The depreciation of the Polish currency automatically increases the zloty value of euro-denominated loans granted to businesses. And this is regardless of changes in their demand for bank financing. The cumulative impact of these two factors occurred in 2H22n. The steeper path of interest rate rises by the MPC in Poland compared to the ECB significantly increased interest in much cheaper euro financing, which was further supported by record trade volumes with foreign countries. Moreover, this was compounded by the strong weakening of the zloty throughout 2022. Overall, there was a significant acceleration in the dynamics of foreign currency lending to businesses, which culminated in Jan'22 at 27% y/y.

Quality of loans to businesses

Since the beginning of 2018, the share of non-performing receivables (NPLs) in the banking sector's corporate loan portfolio in Poland has been improving and even the relatively strong economic turbulence caused by the Covid-19 pandemic or the outbreak of war in Ukraine did not negatively affect the quality of corporate loans. In the large corporate segment, it even decreased by 4 and 3 p.p. of PLN and foreign currency loans respectively. Positive trends (a total decrease of 3.5 p.p. in the NPL ratio) were also observed in the analysed period in terms of PLN SME receivables. The only category in which the NPL ratio in Aug'23 was still higher (by less than 1 p.p.) than in Jan'18 was foreign currency SME loans, although here too the situation was improving in 2023.

Chart 6. NPL indicator for companies in Poland versus EU and selected EU countries (%)



* According to the ECB methodology.

Source: EBC and own calculations.

The increasing quality of the corporate loan portfolio in recent years is primarily the result of increasingly effective credit risk management in Polish banks and the good financial situation of the corporate sector. In 2022, the aggregate net result of companies with 10 or more employees reached a record high of PLN 301 billion, and was almost twice as high as the average in 2017–2020.Moreover, 2021–2022 was a period for Polish companies not only of significant revenue growth, but also of a marked improvement in profitability

(in 2021 it was at a record high) and maintaining stable liquidity. In 1H2023, there was a 0.6 p.p. decline in margins and net profitability, but their level (as well as nominal net profit) was still historically high. In these conditions, with relatively weak demand, there is no risk of a sharp deterioration in the NPL ratio, and the share of non-performing receivables in the total corporate loan portfolio should remain at levels below long-term averages.

Attention is drawn to the large differences in portfolio loss between large company and SME loans. In the case of both PLN and foreign currency receivables, they amount to 5–6 p.p. to the detriment of SME sector exposures. In the case of large corporate loans, the NPL ratio has reached a relatively low level in recent years

(3.8% for PLN receivables and only 2.7% for foreign currency receivables). These values do not deviate significantly from EU averages. However, the clearly inferior quality of the SME loan portfolio means that the NPL ratio of the entire corporate portfolio of Polish banks is still much higher than the EU average, especially in comparison with the large EU countries (Germany, France and, until recently, Italy or Spain, which were struggling with serious economic problems). Worse indicators than Poland are found almost exclusively in the less developed Member States from Central and Eastern Europe. Despite the favourable trend of corporate NPL ratios in Poland, their level still represents one of the most significant challenges of the Polish corporate banking sector and requires further improvement of risk management methods, including in particular the identification of credit quality risks at an early stage.

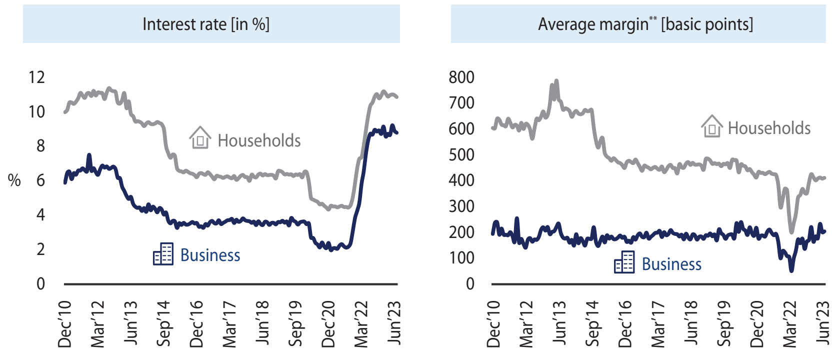
Changes in margins on new PLN and foreign currency loans and deposits for businesses

Interest rate rises have significantly improved the margins on corporate financing by Polish banks. The average interest rate on new loans to companies in just a few months of the end of 2021 and 1Q22 increased and was higher than in the whole of the past decade (around 9%) and remained at this level until 3Q22. In addition, the tightening of monetary policy became, in a fairly short period of time, the impetus for an improvement in average bank margins on corporate loans, which still reached very low levels in the first phase of the NBP rate hike cycle ('at the bottom' of Apr'22 they were only around 50 BPS and were probably the lowest after 1990. From that point onwards, the margins began to increase for several months to the average levels observed in previous years (around 200 bp.). In addition, the gap between interest rates and thus average margins obtained on new corporate and household loans has recently narrowed further. In the 20 months of 2022 and 2023, it averaged less than 200 bp. (in favour of retail loans), while it was around 230 bp in 2021, 240 bp in 2020 and 280 bp in 2019. This implies an increase in the attractiveness of corporate financing from the point of view of the banks lending to them, which was influenced, among other things, by weaker demand for high-margin consumer loans (and thus a decrease in their share in the structure of new retail lending).

Less favourably for the banks, the margins on new loans to businesses granted in euro have developed recently. In 2022, the initial interest rate increases on these loans were out of line with changes in the 3M EURIBOR rates, resulting in a reduction of more than 100 BPS in the average margins on newly granted financing of this type. In October'22, there was a change and margins on new euro corporate loans but did not reach the average level of 2019–2021, i.e. around 230 bp.

The impact of interest rate rises was more favourable for banks on PLN deposits for businesses (representing just over ¾ of banks' total liabilities to business customers) than on loans. The typical delay in adjusting interest rates on term deposits resulted in a surge in margins earned on these products mainly in 4Q22–1Q23. Consequently, the average level of margins exceeded 5% (i.e. was higher than for the entire previous decade). This allowed margins on term deposits to stabilise in the 100–150 BPS range, which was still much better than the average of the previous decade +/- 50 BPS). However, the source of the greatest improvement in banks' margins on corporate servicing was gold current deposits. In 2H22, the volume of these h deposits grew rapidly in the wake of rising corporate turnover, and their interest rates remained almost zero despite strong increases in NBP rates. Hence, the margins earned on them by banks reached long unseen levels of over 600 bp. The interest rate adjustments on PLN deposits in 2023 were small enough to reduce their margins by up to 100 bp, making them one of the most profitable classic banking products.

Chart 7. Average interest rates and margins for new business and houshold loans in PLN* in Dec'10–Jun'23



* Along with renegotiated contracts.
** The difference between the loan interest rate and 3-month WIBOR.

Source: National Bank of Poland and own calculations.

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After 2010, Poland was among the fastest growing corporate banking markets in the EU. Our country stood out at the time not only because of its above-average economic growth rate, but also because of the dynamic development of Polish companies, increasingly operating internationally. However, recent years have brought for banks, on the one hand, an accumulation of demand barriers affecting both the retail and business banking areas, and on the other hand, an accumulation of challenges of an institutional nature (credit holidays, franking credits). The resulting inconveniences for banks were already partially compensated in 2022 by the positive effects for them of interest rate rises, which in 2023 translated into a record high result for the entire banking sector. At the same time, in the period under review, we could observe considerable structural changes in the market for corporate loans and deposits (including, inter alia, strong fluctuations in demand for working capital loans, the growing popularity of foreign currency loans, or successive waves of growth in the area of current and term deposits).

It seems, however, that it was business banking that encountered somewhat more fertile ground during this economically turbulent period. This was reflected, inter alia, in higher loan growth than in the retail segment, especially in deposits, a more pronounced improvement in the quality of the corporate loan portfolio (with the exception of foreign currency receivables from SMEs), as well as a generally better response of margins to interest rate rises in the case of corporate products. This was not hampered by the generally greater sensitivity of the corporate segment to changes in the macroeconomic environment, as the 'losses' incurred in more difficult times were more than compensated for by solid increases in good economic times.

Business models and strategies of the largest banks in Poland in the corporate banking segment

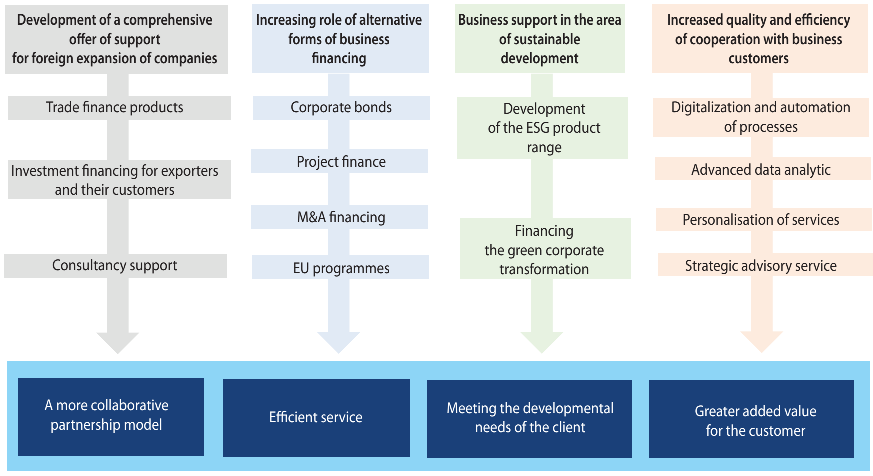
Since the beginning of the system transformation in the 1990s, after a short period of explosion in the issuing of operating licences to new commercial banks, the number of which exceeded 100, a process of concentration triggered by both the processes of sanitation of problem banks and rationalisation aimed at improving profitability (e.g. through economies of scale) began. The direction of changes in the business model of banks in Poland in the area of corporate banking was aimed at better adapting their activities to the needs of enterprises and helping to create added value. Banks responded to the increased volatility of the economy, cost rationalisation, digitalisation and computerisation, as well as the internationalisation of corporate activities. Legal norms and general regulations and, in particular, the implementation of ESG concepts were very important. In response to the environment, banks' strategies were stimulated internally and focused on the search for efficient ways to allocate capital, provide new services and service business areas, as well as on the modernisation of technology and banking operations and process optimisation. As a trend, corporate banking in Poland organically combined external conditions, whether global, regional or national, with internal changes in the organisation and operation of banks.

Significant activities of a strategic nature undertaken by banks in the area of corporate banking include, above all:

- development of the offer of comprehensive support for foreign expansion of corporate clients;
- development of alternative (including specialised) forms of financing corporate activities;
- support for companies in the area of sustainable development and ESG;

- improving the quality and efficiency of business customer service, e.g. through the use of the latest technological developments (digitalisation and automation), development of advisory services, personalisation of services or creation of additional value for customers based on advanced data analytics.

Chart 8. Key elements of the customer-centric evolution of corporate banking



Source: Bank Pekao.

At the end of 2Q23, the share of the eight largest banks in the sector's assets was over 60% and amounted to PLN 1.8 trillion. The leader in this respect was PKO BP with a share of ca 16%, followed by Bank Pekao (ca 10%) and Santander Bank Polska (ca 9%). It is characteristic that the eight largest banks in Poland are universal in nature, with a diversified asset structure reflecting priorities in servicing specific market segments (e.g. BNP Paribas Polska has a specialisation in developing relationships with agri-food market participants, supporting the sustainable transformation of this sector). In the loan portfolios of ING Bank Slaski, Bank Pekao, Santander Bank Polska and BNP Paribas Polska, the share of the business segment fluctuates around or exceeds 50%, while the portfolios of Millennium Bank or Alior Bank indicate a focus on retail banking.

In shaping their market positions, banks in Poland try to use their competitive advantages in individual sub-segments, although the strategies of the largest banks in the area of corporate banking used for this purpose have many common features, such as:

- concentration and striving to improve the efficiency of capital management through, among other things, cross-selling and sector specialisation;
- the use of advanced data analytics to strengthen relationships with corporate customers and improve their satisfaction with the bank;

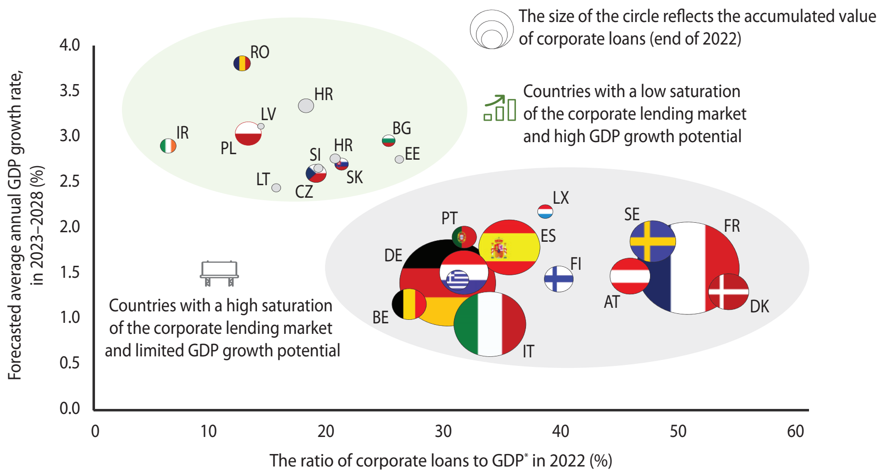
- development of electronic and mobile banking by expanding the scope and possibilities of self-service in remote channels (primarily for SME);
- automation and optimisation of credit processes with a view to increasing customer satisfaction (convenience, speed and, predictability of decisions);
- actively participating in the energy transformation of the Polish economy, as well as supporting corporate customers in implementing ESG concepts.

With the development of banking technology and computerisation, banks have gained access to rich databases that have enabled the development of relationships in corporate banking and the support of the competence of banking staff in dealing with customers as a factor of bank success. The use of staff competencies and information from databases make it possible to create competitive advantages based on specific activities in selected market segments. The choice of these segments is often rooted in the history of mergers and acquisitions in the banking sector or specific missions to operate in the Polish market, which to a certain extent determined the current asset structure. For example, the current customer base and portfolio of corporate assets at BNP Paribas Polska were shaped by the M&A processes the bank went through over the last decade. By contrast, in the case of Alior Bank, which was founded in 2008 as a bank primarily based on the online channel and targeting retail banking customers, today has a corporate portfolio that is relatively overweighted towards smaller companies, and the bank's strategy itself naturally addresses mainly solutions for micro, small and medium-sized companies. The origin of capital is often also significant. Being part of an international, financial capital group naturally supports opportunities to strengthen its position in international banking and servicing foreign capital groups (i.e. global corporations with their origin in the country of the main shareholder). In turn, the direct or indirect presence of State Treasury capital in the bank's shareholding structure and the bank's long history of presence on the Polish market often correlates with the possession of a significant portfolio of clients from a group of Polish enterprises and so-called national champions.

Corporate financing structure, investment needs and development potential of corporate banking in Poland

The marked slowdown in the development of the corporate loan market in recent years may raise doubts about the long-term prospects of this part of the Polish banking sector. However, comparative analyses to other European countries indicate that the Polish market is much less saturated with loans, which may be an indication of a relatively high development potential. According to the ECB, the weak growth in the volume of domestic corporate loans, over the last four years, with a solid average annual rate of nominal economic growth, has resulted in a decline in the loan-to-GDP ratio by around 3 p.p., to a level not seen in the whole of the previous decade of around 13%. In turn, for the EU (excluding Poland) at the end of 2022, with a successive decline, the ratio was 11 pp lower than in 2010. In terms of the ratio of business loans to GDP, Poland ranks third from the bottom in the EU (ahead of Romania and Ireland). The gap in the saturation of the business loan market between Poland and the EU average at the end of 2022 was as high as 21 p.p., comparable to the gap in the housing loan market. This may be an indicative measure of the development potential of the domestic banking sector. This assessment is further legitimised by the results of the analysis conducted in terms of GDP growth rate forecasts and the ratio of business loans to GDP (cf. Chart 9).

Chart 9. Share of loans to enterprises in GDP and projected growth rate in 2023–2028



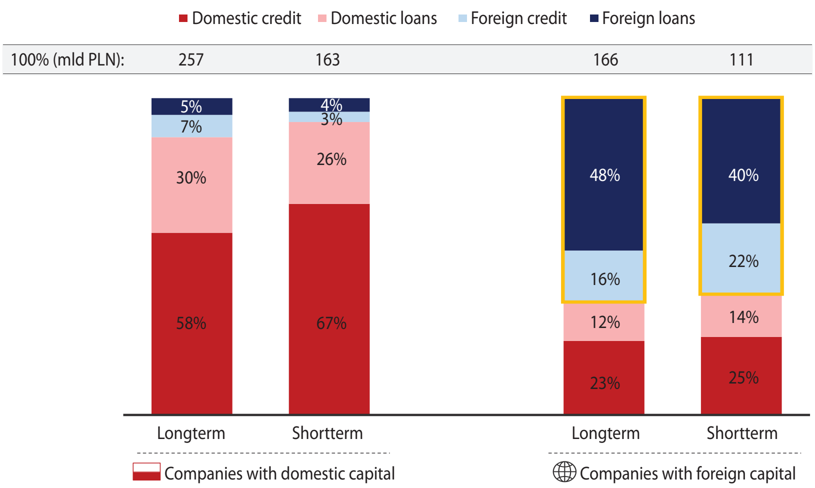
* Loans to domestic non-financial enterprises.

Source: EBC, Eurostat, own calculations.

This two-criteria analysis leads to the grouping of EU countries into two clusters. The first is formed by the so-called new EU member states plus Ireland , as countries with high development potential for corporate banking (fast GDP growth rate and low saturation of corporate loans). The second cluster is made up of the so-called old EU member states with the highest saturation of the corporate loan market and relatively worse GDP growth prospects. to which they belong (low saturation of the corporate loan market), yet with above-average good (compared to the entire EU) medium-term economic prospects.

In the first cluster, by far the largest volume of corporate loans is held by banks in Poland and the relatively low saturation of the market with loans creates high growth potential. This is all the more so because enterprises in Poland are faced with gigantic investment challenges, with an estimated value of ca PLN 250 billion a year on average. These include, on the one hand, large-scale infrastructure investments (e.g. in energy, roads and rail transport, modernisation of the army), as well as investments resulting from the Fit for 55 commitments and the possibility of using funds from the National Reconstruction Plan and, in particular, funds from the new perspective of the EU Structural Funds. In addition, it will be important to invest in research and development in view of the planned increase in their share of GDP to catch up with other EU countries. A challenge in this area will be financial engineering resulting from, among other things, the role of investors of public entities and the need to develop public-private partnerships in lending for investment projects.

Chart 10. Structure of corporate* credits and loans by term and grantor in Poland or abroad



* Data for companies with 10 or more employees.

Source: Pont Info, own calculations.

When considering the saturation of credits for enterprises and the development potential of this market segment in Poland, one cannot overlook the role of foreign parent companies in financing their subsidiaries (in terms of capital or organisation). In particular, it is about alternative sources of financing to domestic banks, as the offer of banks in Poland is not attractive enough to finance their needs more favourably, especially investment ones. This is another limiting factor in catching up with the EU-leading corporate credit saturation ratios.

In 2015–2022, enterprises with 10 or more employees with foreign capital brought on average ca 40% of the revenue of the enterprise sector in Poland , while their share in total investment outlays was 38%. In turn, an analysis of data on the structure of SME loans and credits (GUS reports with the symbol F-02) reveals significant differences in the financing structure of Polish entities and those with foreign capital. At the end of 2021, the former took 60% of all short-term and around two-thirds of long-term loans and credits from Polish banks, while a further 30%

and 26%, respectively, came from non-financial domestic entities with capital ties to them. The debt structure of companies with foreign capital was asymmetric, as domestic banks accounted for only 23% of all long-term loans and credits and 25% of short-term loans and credits. On the other hand, 64% of long-term and 62% of short-term financing came from abroad, in particular loans from parent companies (nearly half of all long-term loans and advances and 40% of short-term loans. In 2021, the use of foreign financing by companies resulted in a severe reduction in the assets of Polish banks. In the case of enterprises with Polish capital, this amounted to approximately PLN 44 billion, while in the case of enterprises with foreign capital it was more than PLN 170 billion. What is more, SME liabilities on foreign loans and credits show an increasing trend. Between 2015 and 2021, the amount of liabilities increased by PLN 42 billion, i.e. by nearly ¼, i.e. by more than a quarter. However, this increase was smaller than that of domestic financing. As a result, the share of foreign sources in total SME loans and advances decreased by around 5 p.p. over the period.

The development potential of the corporate banking sector may be further enhanced by the foreign expansion of Polish companies within the EU as well as with third countries, which will naturally create demand for specialised financing and advanced advisory services.

Between 2015 and 2022, Poland's share of intra-EU trade increased from 5.1 to 6.1%, and with third countries it is lower (3.3%) but with an increasing trend. However, it must be taken into account that this expansion will face demand barriers in EU countries and the UK in conjunction with the phases of the business cycle and the technology race requiring high capital expenditure. All the more so as one has to reckon with a reduction in the competitive advantages of Polish enterprises resulting from lower costs, labour standards and, finally, entrepreneurial flexibility, especially of SMEs. Assuming no fundamental changes in business conditions, Poland will remain an important production base for the wealthier Western Europe, and Polish companies, operating on an increasingly international scale, will be quicker than their EU competitors to increase their presence also on third markets.

Opportunities to finance investment needs in the transition of the economy to sustainable development

In the context of the major investment challenges facing Poland later this decade, the question arises to what extent the banks' capacity to finance such needs has not been undermined by several years of weaker financial performance of domestic institutions, which, especially in 2021

and 2022 were burdened by large regulatory costs (credit holidays, franking credits). All the more so as the problem of CHF loans has not yet been fully resolved. As at the end of 1H23, the estimated total value of created provisions of banks with portfolios of such loans in their balance sheets amounted to around PLN 46 billion, which accounted for 62% of the volume of such loans. Covering the entire portfolio requires incurring additional costs on account of created provisions of about PLN 27 billion, and it should be remembered that the target level of provisions will be even higher. Another thing is that the current environment of high interest rates is conducive to a quicker final resolution of the franking problem by the banks, which as of today seems to be closer than further.

Importantly, the high interest rates and record profits of banks this year are also conducive to improving their capital adequacy ratios. After both the total capital ratio and Tier 1 ratio fell by more than 2 p.p. between 2H21 and 3Q22, recent quarters have already seen them improve strongly, in both cases to record levels (21.6% and 19.9% respectively at the end of 1H23). Despite these achievements, the question remains as to whether these are sufficient parameters for banks to be the leading provider of capital for all transformational investments, representing a de facto additional outlay over and above that incurred by companies and other domestic entities (including the government sector and households) to date. Analyses and simulations indicate that the potential for domestic financial institutions to finance such investments is significant under certain conditions. On the one hand, this is due to the possibility of releasing part of their capital surplus and, on the other hand, feeding the capital base from annual profits. The estimated maximum potential for generating additional loan volume resulting from the release of capital surplus across the sector would be ca PLN 400bn. By 2030, this would mean a maximum of PLN 55–60 bn of additional lending per year. On the other hand, assuming annual replenishment of the capital base with part of the profits generated in the amount of PLN 10 billion, it would be possible to further increase lending by a maximum of another PLN 100 billion annually. In view of the inclination of some banks to maintain a dividend policy favourable to shareholders, this would be possible in the presence of relatively good market conditions (especially interest rates), as well as a limited number of crisis events weighing on banks' results (e.g. additional regulatory burdens, participation in financing bankruptcies). Under these assumptions, the maximum total potential for banks in Poland to increase their financing of the economy can be estimated at around PLN 150–160 billion per year.

Between 2010 and 2022, the average annual increase in loans and other receivables of banks amounted to less than PLN 60 billion. Assuming that this trend would continue in the following years as well, the remaining amount of up to PLN 100 billion per year could be used to finance new investments in the Polish economy. In combination with other available instruments (e.g. EU funds, foreign credits and loans, debt instruments) and investors' own funds, the financing of investment projects transforming the Polish economy to a new higher quality seems realistic.

The above estimates indicate that the Polish banking sector could be a key vehicle for financing new and desirable investments in Poland. This would benefit both the economy and the banking sector itself, especially the corporate banking segment, whose development could significantly accelerate under such conditions. A separate problem is the supply-side aspects of making such investments, including the ability of individual sectors to effectively undertake the relevant projects.

While the simulation of the development of the banks' capital base provides a rationale for increased lending, its feasibility and business efficiency will depend on the regulatory environment of the financial sector as a whole and processes in the real economy. Both these aspects will determine the sector's ability to generate profits that banks could use to increase their capital.

A separate problem is the implementation of large and mega investments in particular, involving multi-phase transformation projects. This involves both technological and financial barriers. Such barriers include:

- The size and complexity of projects. For example, the estimated value of the investment associated with the construction of the first nuclear power plant is PLN 86 billion and the offshore wind farm 'Baltica' is PLN 30–40 billion. The banking sector is preparing to finance such costly and technologically complex investments, but funds from individual financial institutions are not sufficient to cover the required outlays. This implies the need to arrange bank consortia with the participation of domestic and foreign banks, as well as advanced financial engineering using the funds of national or EU support programmes) and capital market instruments.
- Banks' requirements for sustainable development. The requirements on borrowers in relation to climate and environmental policy result in banks limiting their financial exposure to companies and transactions involving 'non-green' assets, while increasing financing to support the development of zero- or low-carbon energy sources. This means that other factors such as environmental, social and corporate governance (ESG) impacts must be analysed alongside return on investment. In practice, investment projects will be subject to higher requirements by banks than before. The decision to grant financing will be preceded by an examination of the expected impact of the investment on the environment – if this is negative, commercial criteria will not be a sufficient argument for granting financing.
- Law and regulation. Effective participation in financing sustainable development and especially climate transformation requires the elimination of legal risks, especially those originating from EU directives or regulations. Furthermore, the implementation of sustainability and ESG concepts requires additional investment or costs on the part of the banks themselves. This will require the involvement of the entire organisation and, in particular, the revision of lending policies and procedures, the adaptation of IT infrastructure, the revision of the competences of staff and business partners, and customer education. Open coordination of business models and alignment of the strategies of banks and financiers will be necessary. The development of databases and the application of modern technologies in the shaping of customer relations will extend the credit assessment horizon and affect funding volumes accordingly, within adjusted concentration limits and prudential standards.
- Convergence of the status of financial market players. Under conditions of high demand for mobilising capital for systemic transformation in line with the con-

cept of sustainable development and intensifying competition in the financial services market, the inequality of the status of financial market players generates additional development barriers, risks and affects customer confidence.

"Bankability" of projects. The dynamics and complexity of regulatory changes will imply the need for support in the loan process by specialised consultants. On the one hand, support to the borrower in the preparation of the loan documentation, especially from the side of formal and financial requirements, and on the other hand, support to the lender – from the substantive and technological side, allowing an objective assessment of the feasibility and economic efficiency or due diligence of the project. Overcoming or mitigating the above barriers will depend to a large extent on the content of the rules, regulations and the attitudes of the regulator towards emerging challenges. Of cardinal importance will be those solutions that will generate operating costs and allow for the generation of profits in the increasingly competitive environment in which banks operate. In light of the analyses conducted and projections formulated, it can be argued that in the foreseeable future, banks in Poland will constitute a key link in the civilisational leap to the era of sustainable development.