REPORT OF THE POLISH BANK ASSOCIATION

Poland and Europe

- Challenges and Limitations 2019

issue 6
September 2019

POLISH BANK ASSOCIATION

Bankowcy dla Edukacji
Program sektorowy

Table of Contents

Introduction 4
Polish economy and banking sector in numbers 6
Poland and Europe - macroeconomic data 8
Growth dynamics of European Union Member States 8
Inflation ratio 11
Trade balance - exports and imports 12
Unemployment 16
Public debt 17
Investment-to-GDP ratio 19
Banking sector in Europe 23
Loans 23
Share of non-performing loans 23
Deposits 24
Number of financial institutions 25
Banks' return on equity (ROE) 26
Trends observed in the banking sector 31
Factors limiting growth of the Polish banking sector 35
Growing disparities in the banking sector 35
Increasing share of non-performing loans 36
Approaching economic cycle turn 37
Excessive financial burdens 37
Over-regulation of the banking sector 37
New cybersecurity-related threats 38

Introduction

Ladies and Gentlemen,

The changes of social, economic, political and technological nature that we are currently observing in numerous countries are taking place at a very fast pace. Unfortunately, the contemporary world is rocked by a number of clashes and tensions of economic and territorial character. Conflicts and disputes of a purely political variety are observed as well, with all of them exerting a highly negative impact on international cooperation, security and global economic order. With all those circumstances taken into consideration, forecasting the scenarios based on which individual countries will be developing becomes a very difficult task that requires a number of processes of both intra-continental and global nature to be taken into account.

Heated discussions have been going on for a number of years, concerning the direction in which Europe will be heading. The European community faces very difficult challenges requiring it to define its own growth paths, to tackle problems related to migration, aging of the societies, and to address changes of organizational and ideological nature. Relations between certain European Union Member States, and the transatlantic relations have become more complicated. There are many indications showing that stability and orchestrated cooperation will be difficult to come by in the years to come. It is so because we will have to deal with the aftermath of Brexit, but also with a considerable slowdown in the rate of economic growth observed in numerous EU Member States. The consequences of non-standard activities undertaken in recent years by central banks, and the results of fiscal stimulation efforts that governments of many countries are pursuing still remain unknown.

The disadvantageous trends observed in the European economy, its relatively low innovativeness, the wealth of challenges faced in such areas as environmental protection, energy security and demographics - all these are phenomena that are not indifferent as far as the development prospects of the Polish economy are concerned as well.

Poland has managed to survive the world's largest financial crisis (2008-2015) with very good economic results. This was possible thanks to the good use of European funding, responsible attitudes shown by investors who placed great trust in our country, a responsible economic policy and effective undertakings of the Polish banks that provided access to a stable funding source and generated high revenues for the state budget. Will our country still be able to continue achieving such good results in the years to come, with its banking sector subjected to excessive burdens and over-regulation? Can such good results be achieved despite considerable legal uncertainties affecting the business sector, despite a continuously deteriorating position of creditors, or despite delayed implementation of certain necessary development-oriented efforts?

The pace at which the financial sector is developing depends on the economic condition and activity of customers, on the regulations in effect and on the state's economic policy. The strength and stability of banks, in turn, very often determine the economic growth opportunities of the entire country. If the profitability of banks continues to deteriorate in the time of economic growth, low unemployment rates, growing salaries and high availability of funding - which translates into a decrease in the ability to offer loans in the future - a question needs to be asked about the situation that the entire sector will find itself in once the expected change in the economic cycle arrives.

The Polish market experiences organizational change triggered by regulation and the resulting economic policy. The pace of that change is also related to the development of new technologies and bank products - with all efforts focused on ensuring an increase in the efficiency of banks, as well as in the security and comfort of its customers. On the other hand, fears are faced concerning insufficient regulation in the non-banking financial sector.

The economy has been operating under low interest rates for a couple of years now. Increasing inflation rates observed in a number of countries, slower pace of growth and "trade wars" or "currency wars" strengthen the feeling of uncertainty that impacts the sentiment of the banks' customers as well. The banking sectors tries to actively participate in and to prepare for the implementation of such growth-stimulating programs as those concerned with clean air, renewable energy sources or housing initiatives. We keep investing ourselves, although not without difficulty, in new technologies and security systems. However, excessive burdens we are required to bear mean that we are outpaced, in some areas, by the innovation leaders.

The "Poland and Europe - Challenges and Limitations" report should be treated as an introduction and invitation to a broader discussion concerned with topics that are of great significance from the point of view of Polish citizens and the national economy. These topics are related to the much needed increase in the capacity of the Polish banks and of other related institutions to participate in the implementation of national and regional development programs, with the security of deposits and the stability of financial institutions that play such an important role in market economy taken into consideration as well.

The times of threats and tensions are usually also the times of opportunities. Will we be able to make good use of them?

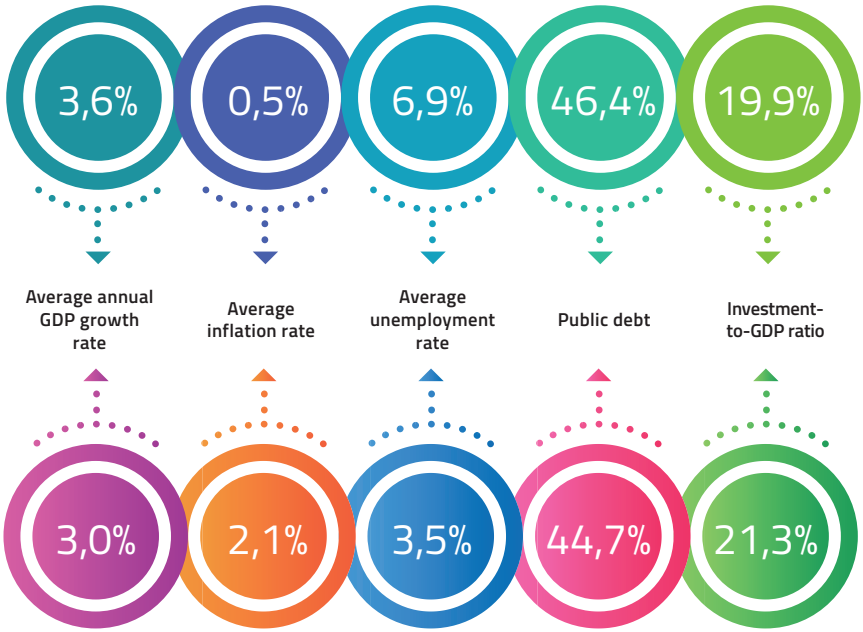
The answer is yes, but we need a correction in the policy of the state towards the national banking system.

Hoping that the report will turn out to be a source of inspiration, I remain sincerely yours,

Krzysztof Pietraszkiewicz
President of the Polish Bank Association

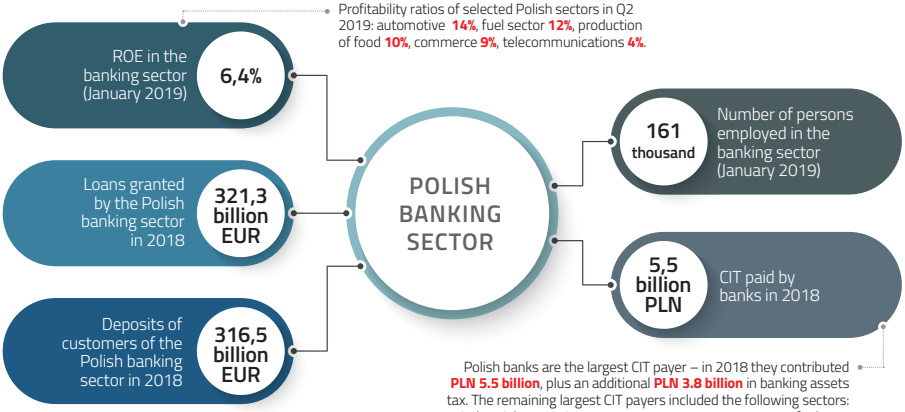
POLISH ECONOMY AND BANKING SECTOR IN NUMBERS:

POLISH ECONOMY BETWEEN 2013 AND 2018



POLISH ECONOMY IN THE YEARS 2019-2024 (FORECAST)

Source: Own compilation of PBA, based on IMF data



Source: Data sourced from the European Banking Federation, the Polish Financial Supervision Authority and the Ministry of Finance

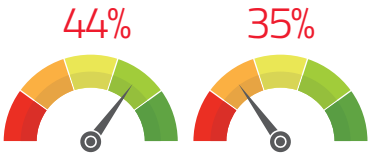
ABOUT THE REPORT

The report has been drawn up based on data sources from various financial sector institutions, such as the International Monetary Fund, the European Banking Federation or the Polish Financial Supervision Authority. Some surveys have been conducted by the Polish Bank Association itself.

Two surveys have been conducted by ZBP on its own - a wide-scale public opinion poll ordered from Instytut Badań Pollster, involving a sample group of 1028 respondents, and the Monitor Bankowy survey conducted among bankers from 120 bank facilities in Europe, conducted by Kantar TNS. Both surveys were conducted in late July and early August of 2019. Some of their results are presented below.

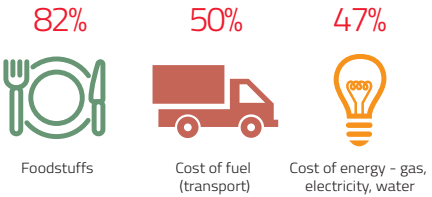
ZBP surveys - August 2019

In your opinion, the economic situation in Poland:



Source: Public opinion survey, ZBP, August 2019

The increase in the prices of which products/services has affected you the most over the past 12 months?

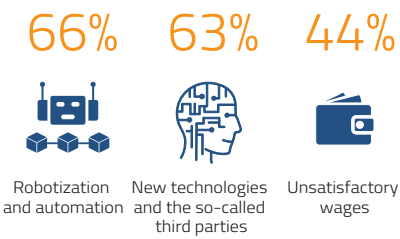


Source: Public opinion survey, ZBP, August 2019

Which of the world events will impact, in your opinion, the Polish economy in 2020 the most?

Source: Public opinion survey and Monitor Bankowy, ZBP, August 2019

Which factors will impact, in your opinion, the Polish banking sector employment structure the most? (two answers maximum)



Source: ZBP survey, Monitor Bankowy - August 2019

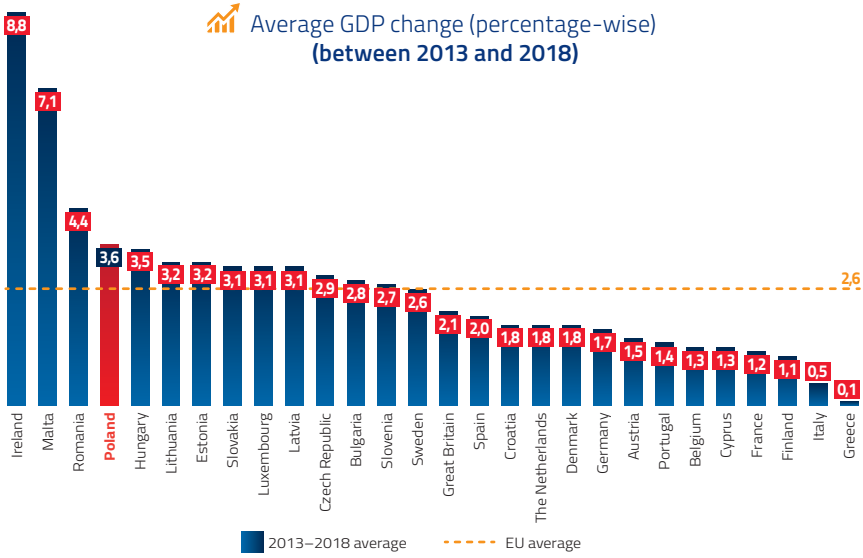
Poland and Europe - macroeconomic data

Growth dynamics of European Union Member States

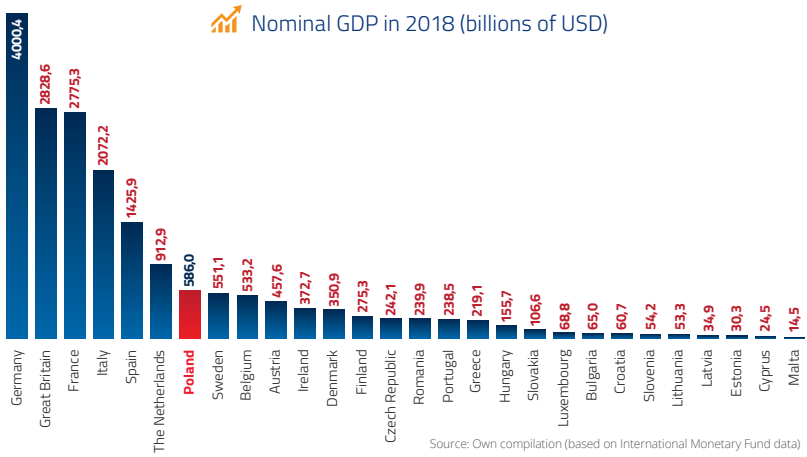
Over the past five years, Europe has been experiencing stable economic growth. According to the International Monetary Fund, no European Union Member State has experienced a long-term recession since 2013. Our economy has undoubtedly contributed to that phenomenon as well, as it has been growing at one of the fastest rates in all of Europe. It seems, however, that this period of prosperity is coming to an end. Although the forecasts are still optimistic and indicate that EU economies will continue to develop, the growth will not be as fast-paced as that observed over the past five years.

LAST FIVE YEARS

The period between 2013 and 2018 was a time of fast economic growth that was observed almost in all of the European Union Member States. This is proved, inter alia, by the average GDP growth rate of 2.6% observed after 2013. It is also worth noting that not a single country suffered from a recession, i.e. from a drop in GDP, over the past five years. Compared to the entire European Union, Polish economy is growing at a much faster pace (3.6%).



Source: Own compilation (based on International Monetary Fund data)



Source: Own compilation (based on International Monetary Fund data)

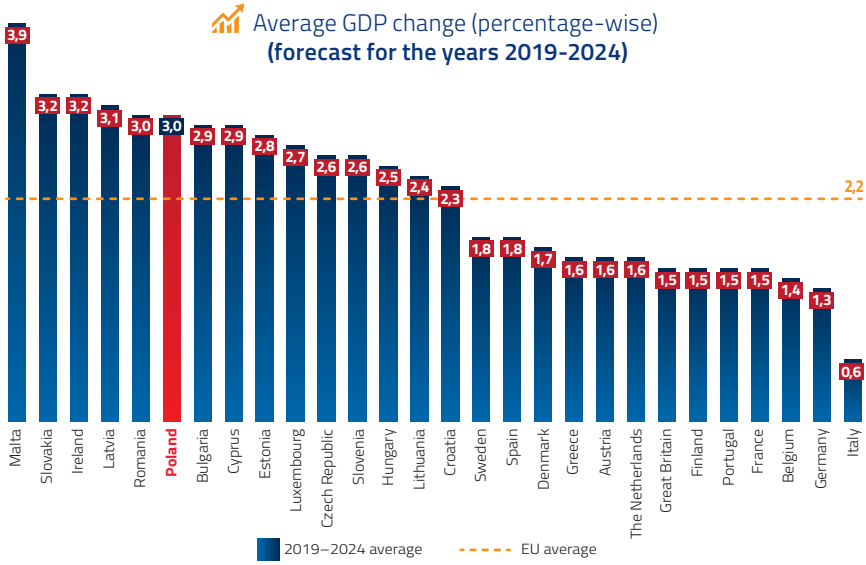
Economic growth expressed percentage-wise shows the pace at which less developed countries are catching up with Europe's economic superpowers. A comparison of nominal GDP shows that the rift between the individual economies is still considerable. The highest national GDP value is enjoyed by Germany, where the value of production exceeded USD 4 trillion in 2018. Great Britain and France completed the podium, with their GDP amounting to approx. USD 2.8 trillion each. Poland is Europe's 7th largest economy, with its GDP equaling USD 586 billion in 2018.

GDP-related indicators are not the only ones of any importance. The structure of GDP needs to be taken into consideration as well. GDP structure comprises net exports, government spending, private consumption, investments and inventories. With 2018 used as an example, according to the Polish Central Statistical Office, the growth of Polish GDP was fueled primarily by consumption (which increased by 4.5% and has contributed to 51% of the overall GDP growth) and investments (which increased by 7.3% and have contributed to 25% of the overall GDP growth). Overall, Poland's GDP increased by 5.1% YoY in 2018.

The rate of economic growth observed in Poland was the fourth largest in the EU, and the second largest in Central and Eastern Europe (with Romania developing at the fastest pace). Furthermore, the average growth rate recorded in Poland was by 0.7 pp higher than in the previous edition of the report, which has moved Poland up four places in rankings, leaving the Baltic States and Luxembourg behind. An equally significant improvement in the ranking was also experienced by the Hungarian economy which has turned out to be the fifth fastest growing. As it was the case previously, the first three places in Europe are occupied by Ireland (8.8%), Malta (7.1%) and Romania (4.4%), with Greece and Italy remaining the slowest developing economies (0.1% and 0.5%, respectively). However, compared to the previous years, the latter countries have shown a positive rate of growth for the very first time in a number of years.

FORECASTS

Economists of the International Monetary Fund are optimistic about economic growth forecasts for Europe and for Poland in the next five years. Although the analysts are showing more conservative attitudes, and although the EU average is slightly lower and equals 2.2%, the forecasts for all countries still show further, continued growth of their GDP. Poland is still expected to be one of the countries with the fastest growing GDP, although the forecast has been corrected by 0.1 pp downward compared to the previous report. A slower pace

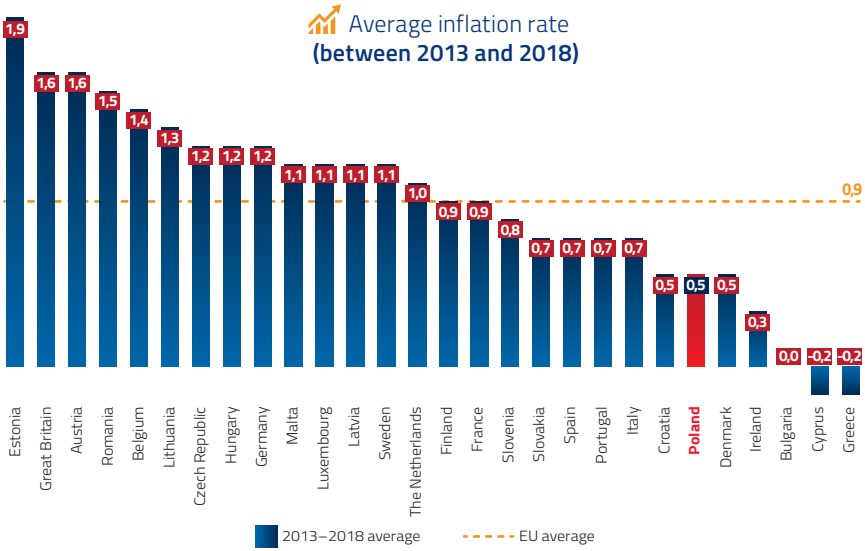


Source: Own compilation (based on International Monetary Fund data)

of growth (by approx. 0.5 pp) is also expected in the Netherlands, Romania and Lithuania. The developed economies of Western Europe, such as France (1.5%), Belgium (1.4%), Great Britain (1.5%) or Germany (1.3%) will be growing at a slower pace as well. Particular attention needs to be paid to the fact that the result of our western neighbor is the second lowest in all of EU, which undoubtedly is a very unfavorable indication for the Polish economy. The low PMI value, i.e. the indicator describing the financial activity of entrepreneurs and reflecting the market sentiment, is the first sign of the looming threat. The lowest pace of GDP growth is expected in Italy, where it will amount to 0.6% only.

Inflation ratio

LAST FIVE YEARS

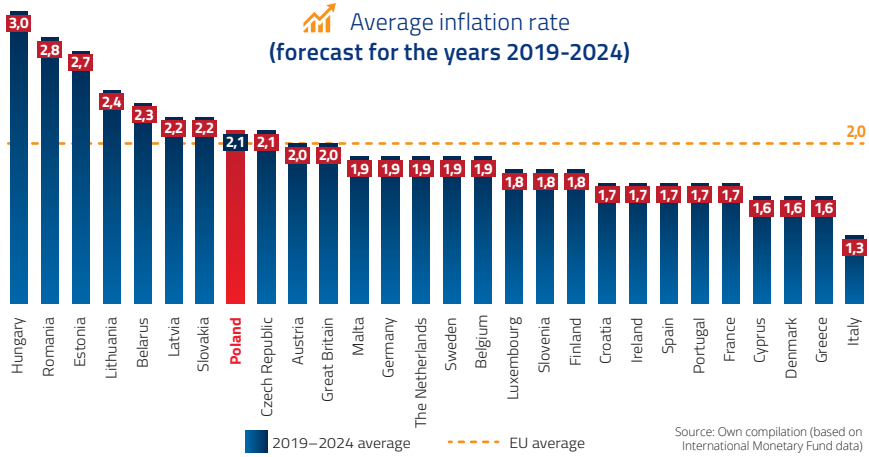


Source: Own compilation (based on International Monetary Fund data)

Despite the fact that the inflation rate has been relatively low in Poland over the past few years, the results of the last two years have increased the five-year average (0.5% after 2013). Nevertheless, Poland still is one of the EU Member States boasting the lowest inflation rate, which is rather low in Europe altogether (average of 0.9%). Furthermore, the average annual inflation rate has failed to exceed, in any of the Member States, the 2% mark.

As it was the case last year, the highest increase in prices was observed in Estonia. The said increase was slightly greater than in the preceding year (by 0.2 pp). Inflation in the eurozone countries ranges, in most cases, between 1 and 1.5%. Slightly lower inflation rates are observed in Italy, Portugal and Ireland, amounting to 0.7% for the first two countries, and to 0.3% for Ireland. Deflation was observed, over the past five years, in Greece and Cyprus only.

FORECAST



Source: Own compilation (based on International Monetary Fund data)

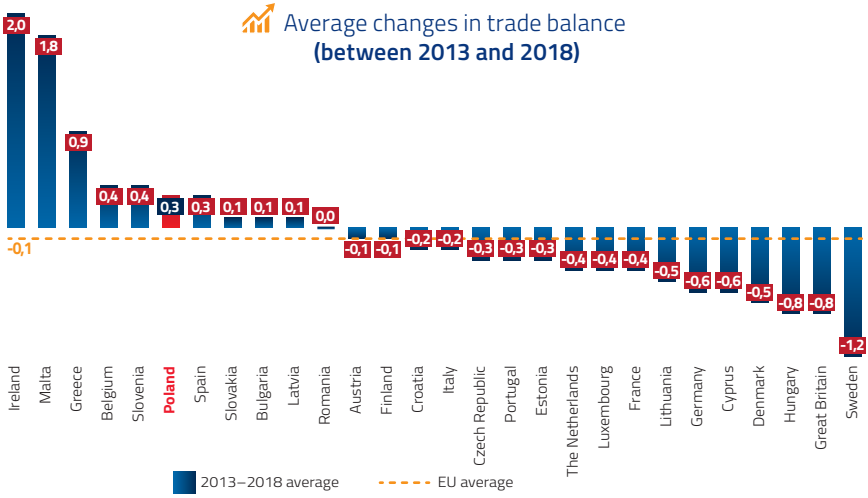
IMF forecasts clearly indicate that Poland will transform, over the next five years, from one of the countries with the lowest inflation rate, into a state in which the prices will be growing faster than in the remaining EU Member Stated (European average: 2.0%). The forecasts are, however, more optimistic that the year before, where the expected annual inflation rate was estimated at 2.5%. Currently, forecasts until 2024 indicate the average increase of 2.1%. A similar situation will be observed at Poland's southern neighbors - Czech Republic and Slovakia. The highest increase in prices (3%) is expected in Hungary, while the lowest (1.3%) in Italy.

Trade balance - exports and imports

The trade balance, i.e. the difference between the value of exports and imports, is one of the key indicators impacting the condition of the national economy. A negative balance means that a given country imports more goods than it exports.

LAST FIVE YEARS

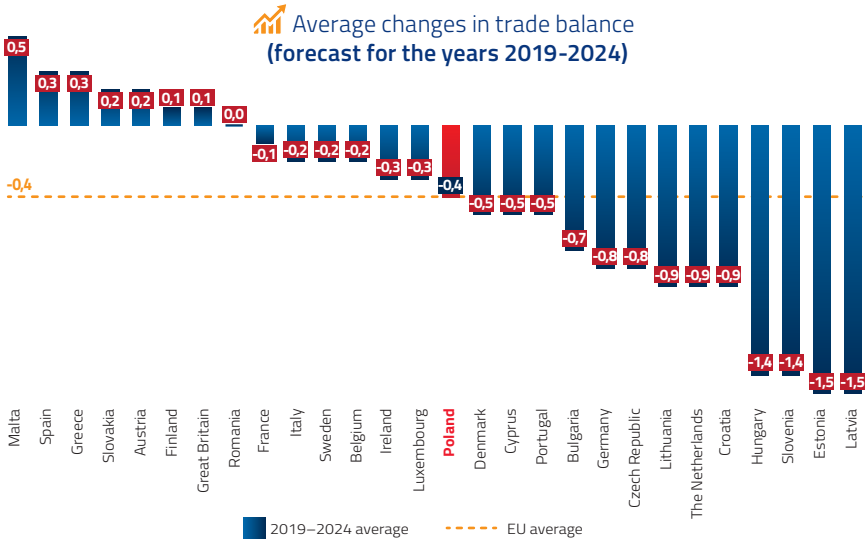
With the period of 2013-2018 taken into consideration, Poland was one of the 10 countries whose exports were growing faster than their imports. These countries include, inter alia, Ireland, Malta, Belgium and Slovakia. Unlike Poland, the majority of European countries were increasing their imports much faster than their exports. The average trade balance for the entire European Union is negative. Hungary and Great Britain (a drop of -0.8% per annum) and Sweden (-1.2%) are among the countries whose trade balance was deteriorating at the fastest pace.



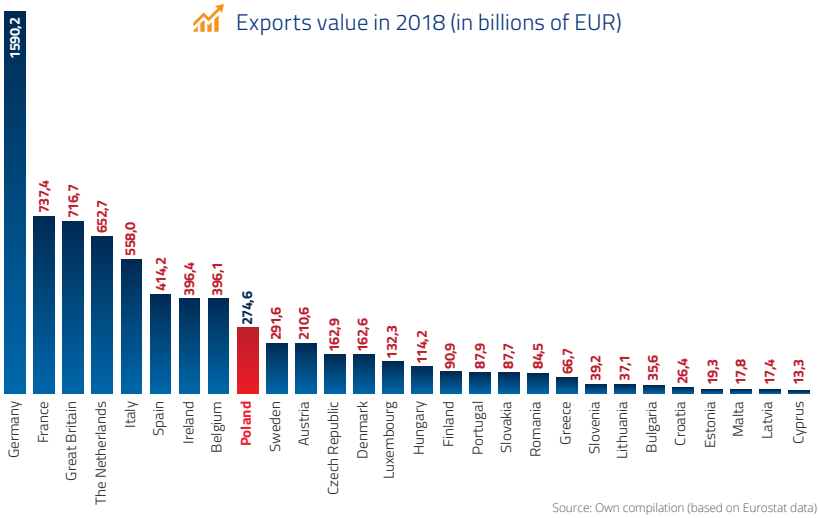
Source: Own compilation (based on International Monetary Fund data)

FORECAST

In the opinion of IMF analysts, a growth of imports outpacing the growth of exports will be a common trend in Europe. This is expected to be true of Poland as well, with its trade balance forecast to decrease systematically over the next five years, despite it already



Source: Own compilation (based on International Monetary Fund data)



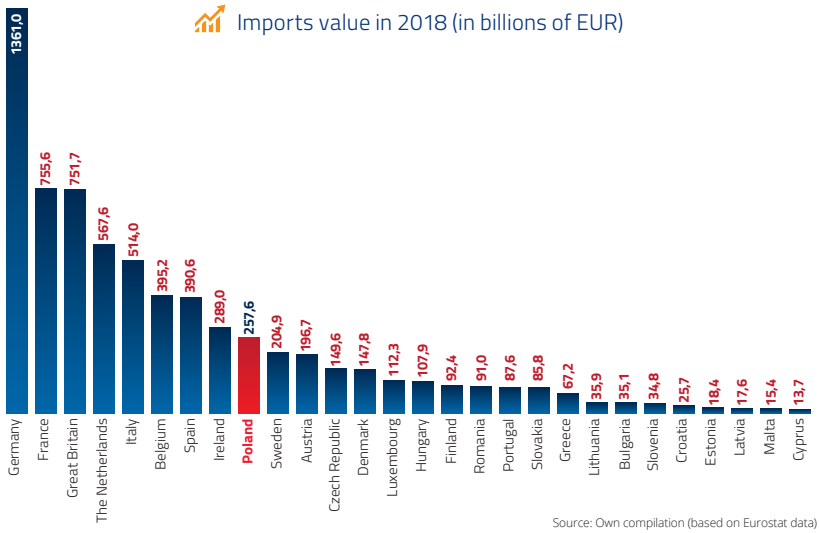
Source: Own compilation (based on Eurostat data)

As in the case of GDP growth, a change in the trade balance reflects the dynamics of the trend only. Nominal values clearly indicate that Germany remains Europe's largest exporter and importer at the same time. The value of exports of our western neighbor (EUR 1.6 trillion) is more than twice as high as the result achieved by the runner-up, i.e. by France (EUR 0.7 trillion). In Poland, the value of exports amounted to a little less than EUR 275 billion last year, with the majority of exported products sold to Germany.

being negative, according to the Central Statistical Office. Central Statistical Office estimates show that Poland exported PLN 940.4 billion and imported PLN 961.8 worth of goods in 2018. Germany is a country to which Poland exports the most, at the same time importing the most from the same source as well. Our exports to Germany are worth PLN 264 billion, while imports PLN 215 billion. Poland has the worst trade balance result in its relations with China, where the difference - for the benefit of the latter country - equals over PLN 100 billion[1].

The Baltic States, and especially Latvia and Estonia, are to increase their imports in the future. The same is expected of other countries from our region, such as Hungary or Bulgaria. Only 6 EU Member States will be able to ensure that their exports growth will exceed the increase in their imports. These countries include Malta, Spain, Greece, Slovakia, Austria and Finland. The average for all EU Member States will amount to -0.4%.

1 http://www.mapa.kuke.com.pl/chiny.html



Source: Own compilation (based on Eurostat data)

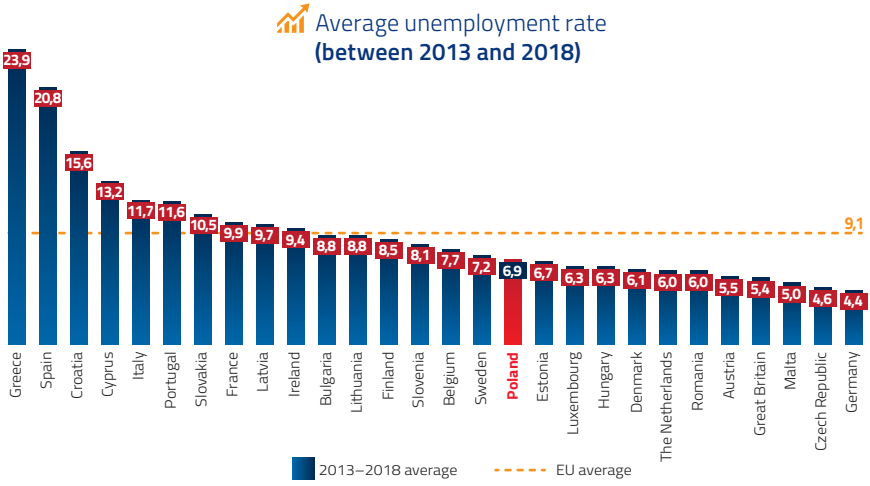
Germany is also Europe's largest importer, as the country imported, last year, approximately EUR 1.4 trillion worth of goods and services. The top three is completed by France and Great Britain, with their imports exceeding EUR 750 billion. Poland is Europe's 9th largest importer - in 2018 it imported nearly PLN 260 billion worth of goods and services.

According the European Commission's data, the largest trade partners of the European Union are the United States and China. The citizens of Europe import the most from China (over EUR 394 billion in 2018), and export the most to the United States (over EUR 400 billion in 2018). Europe's other important trade partners include Russia, Switzerland, Norway and Turkey[2].

2 http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122530.pdf

Unemployment

LAST FIVE YEARS

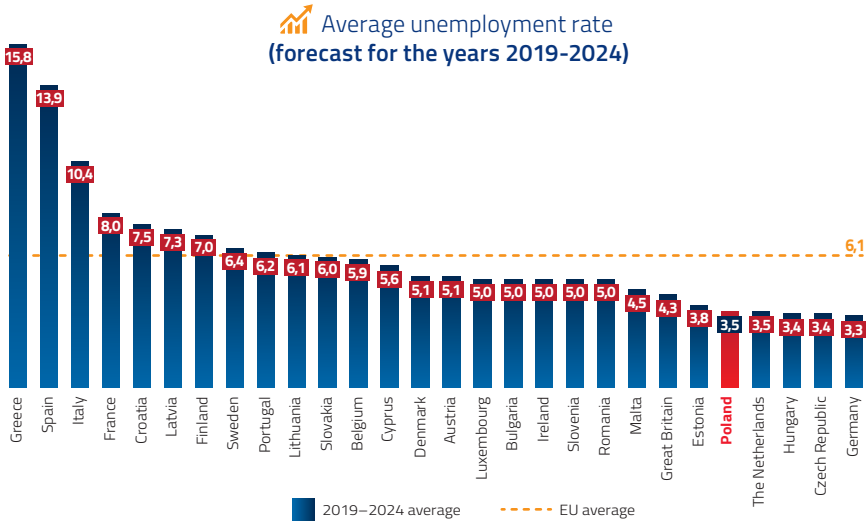


Source: Own compilation (based on International Monetary Fund data)

Results from the European labor maker, pertaining to the period of last five years, once again indicate that the unemployment rate is on a decrease in the EU. The average rate for all Member States has dropped to well below 10%, and amounted to 9.1% during the period of 2013-2018. In Poland, the unemployment rate has once again turned out to be considerably lower than the EU average. It equaled, between 2013 and 2018, 6.9%, compared to 8% in the preceding reporting period. The relatively low share of unemployed persons ranks our country in the middle of the ranking. The highest unemployment level has been recorded, for another year in a row, in Greece (23.9%), Spain (20.8%), while the lowest in our neighboring countries - Germany (4.4%) and the Czech Republic (4.6%).

FORECAST

Forecasts concerning the EU unemployment rate show a continued decrease - it is expected that the unemployment rate will decrease considerably in the majority of EU Member States. Labor market-related forecasts, pertaining to the period of the next five years, are very favorable for Poland as well. The analysts expect that in 2024 Poland will join the countries with the lowest unemployment rate that will equal, over the next five years, approximately 3.5%, on average.



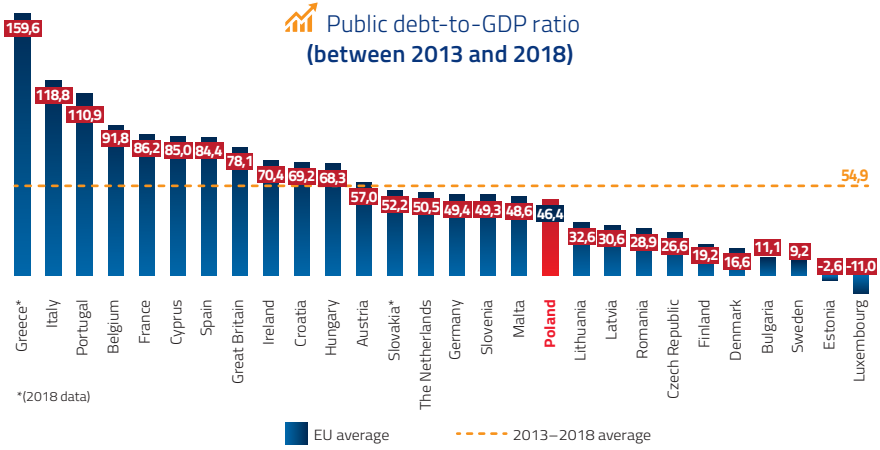
Source: Own compilation (based on International Monetary Fund data)

That result is just 0.2 pp higher than in Germany, and equal to that observed in the highly developed economy of the Netherlands. It is also worth noting that the low unemployment rate may be equivalent to an actual shortage of qualified workforce which, in the long run, may turn out to be a considerable restriction limiting the growth of the Polish economy. The trend described above may bring about, in the long run, negative consequences resulting from the lack of workforce. Data concerning the overall number of those active professionally are equally worrying. According to the Central Statistical Office, in Q4 2018, there were 16,400,000 people working in Poland. The figure was by 1.3 pp lower than in the preceding year. This shows that Poles give up work, and that the age structure of professionally active Polish citizens changes as well.

Public debt

LAST FIVE YEARS

The debt-to-GDP ratio is a very important metric showing, inter alia, the condition of the country's public finances. Against the background of the entire European Union, Poland is a country with a low debt level. Its public debt is being currently reduced, primarily



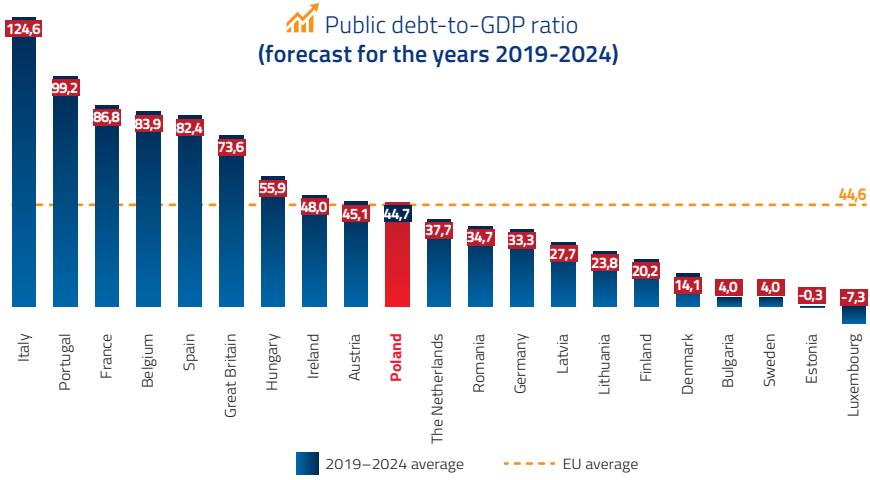
Source: Own compilation (based on International Monetary Fund data)

thanks to dynamic economic growth. Compared to the previous perspective, Poland's debt dropped by 2 pp and equaled, on average, 46.4%. Our position in the European ranking, however, has remained unchanged (18th). The EU average during the same period of time equaled 54.9%.

But the value of public debt needs to be considered along with the cost of its service. Although compared to the previous year, that cost decreased in Poland (and equals currently 1.43%), it still remains considerably higher than in Western Europe countries. Compared to the previous report, it is worth noting that Germany has considerably reduced their debt (a drop by nearly 7 pp), just as has Austria (nearly 5 pp) or the Czech Republic (over 3 pp). Greece still remains the most indebted European country, with the debt of Italy or Portugal exceeding their GDP. Luxembourg and Estonia may once again be used as examples of countries with a budget surplus.

FORECAST

According to IMF forecasts for the next five years, Poland debt-to-GDP ratio will continue to decrease. It is expected to equal 44.7% of GDP in 2019-2024. It is worth noting, however, that the drop is not as significant as in other European countries. For instance, over the next five years, the average debt in Germany will amount to slightly over 33.3% (a drop by 16 pp compared to the 2013-2018 perspective), and in the Netherlands - to below 38% (50.5% previously). Despite the fact that estimates concerning some EU Member States



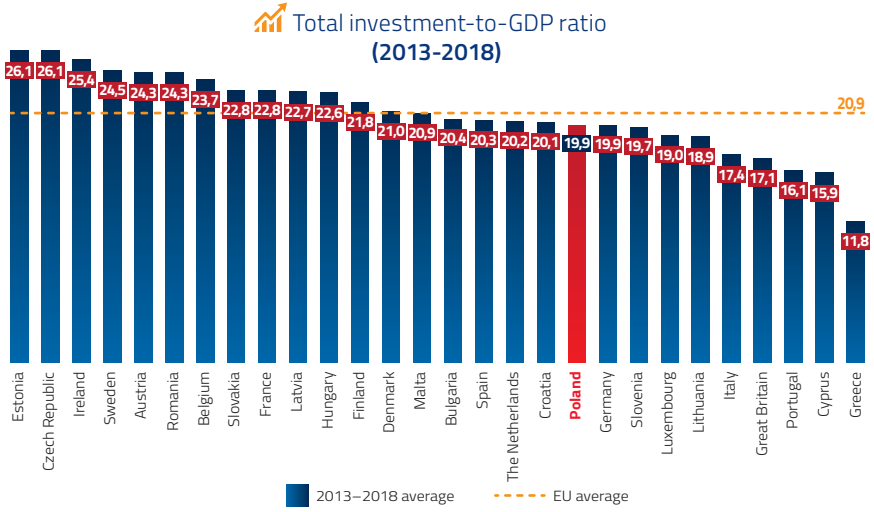
Source: Own compilation (based on International Monetary Fund data)

are not available, it may be assumed that the average public debt level is expected to be reduced by over 10 pp and will equal 44.6%. This means that Poland's result would be, for the very first time since its EU accession, above the EU's average value. With the plans assuming the provision of generous social benefits taken into consideration, one needs to bear in mind that those benefits have to be distributed in a manner ensuring that they do not impact, in the long run, the growth of the economy. Observance of the budgetary discipline, especially in the period of intense budget growth, prepares the country's finances for the reversal in economic situation. Activities of such a nature may be currently observed in numerous Western European countries, where financial discipline is one of the priorities on which budgetary plans are based.

Investment-to-GDP ratio

LAST FIVE YEARS

The investment-to-GDP ratio clearly shows the potential of the economy that is taken advantage of, and the pace at which the economy will be developing in the future. The higher the investment level, the less imminent the threat of a bear market and of recession. The average investment-to-GDP ratio equals, in the EU, almost 21%. The highest level of investment was observed, over the past five years, in Estonia and in the Czech



Source: Own compilation (based on International Monetary Fund data)

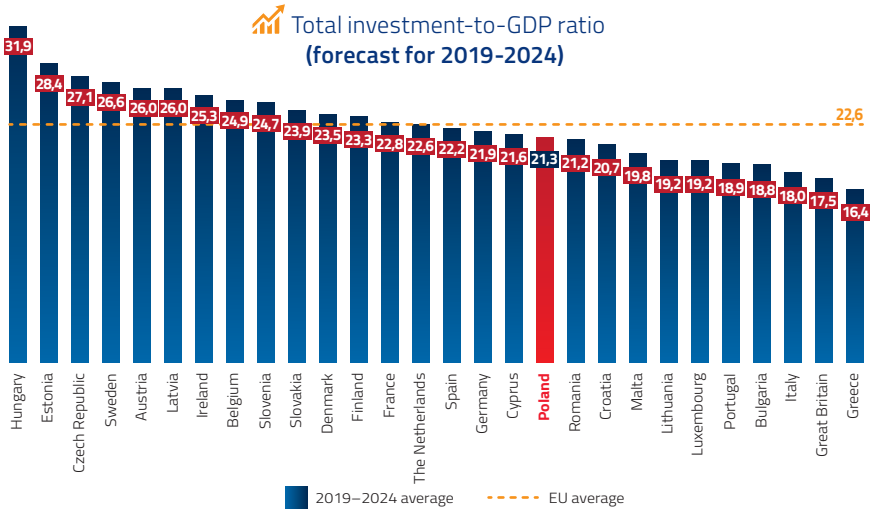
Republic, where it exceeded 26%. In Poland, the ratio is by 1 pp lower than the EU average and amounts to almost 20%. But interestingly, the same investment-to-GDP ratio was recorded in Germany as well. The lowest ratio was observed in countries facing economic problems, i.e. in Greece (11/8%) and Cyprus (15.9%).

FORECAST

Despite the fact that the average investment value is expected to rise in the European Union in the coming five years, the IMF forecast assumes that it will be lower in Poland that the EU average, and will amount to 21.3%. Compared to the previous five-year perspective, the result will be nearly 1.5 pp higher. It is worth noting, however, that a considerably higher level of investment is expected in other countries of our region, equaling as much as 32% in Hungary and over 27% in the Czech Republic.

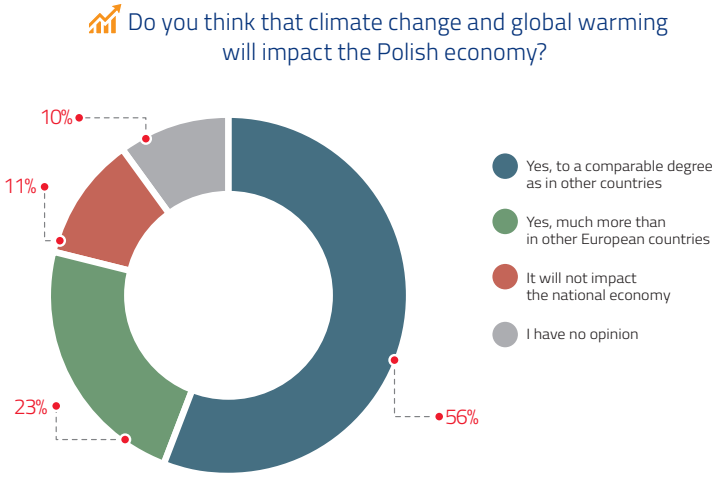
SUSTAINABLE GROWTH

Ensuring sustainable growth is one of the major objectives set by the European Union for the period of the next five years. This means that much more attention needs to be paid to environmental protection, introduction of new, environmentally-friendly technologies, and greater involvement of companies in environmental education. Poles ever more frequently notice the importance of those issues and the impact they exert on the economy.



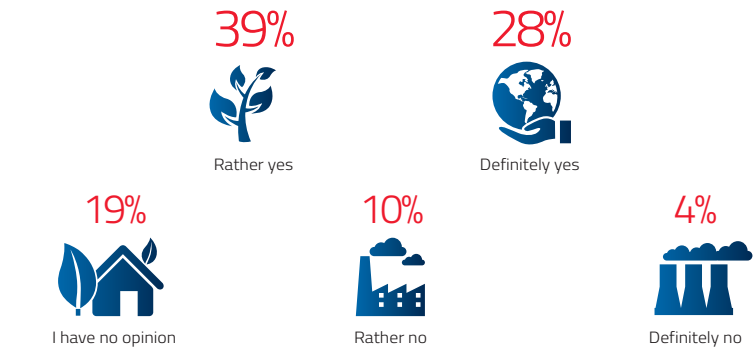
Source: Own compilation (based on International Monetary Fund data)

As stated by 79% of respondents taking part in the August survey, climate change and global warming will impact the Polish economy. Furthermore, one in four respondents say that the changes will be more significant for the Polish economy than for other countries.



Source: Public opinion survey, ZBP, August 2019

Do you think than banks should increase their involvement in projects related to environmental protection and ecology?



Source: Public opinion survey, ZBP, August 2019

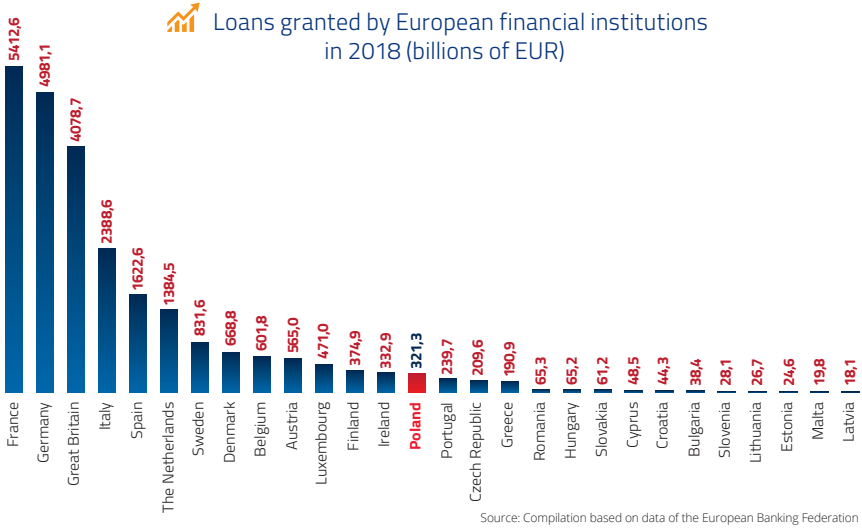
Only 11% of the respondents claim that climate warming-related factors are of no significance for economic growth.

Consumer expect, ever more frequently, a proactive approach to environmental protection to be shown by companies they are the customers of. This applies to the banking sector as well. Over 67% of respondents indicate that banks should increase their involvement in projects related to environmental protection and ecology. Such an approach confirms the growing level of consumers' awareness, and the importance of this aspect when deciding to take advantage of the services offered by a given company.

Banking sector in Europe

Loans

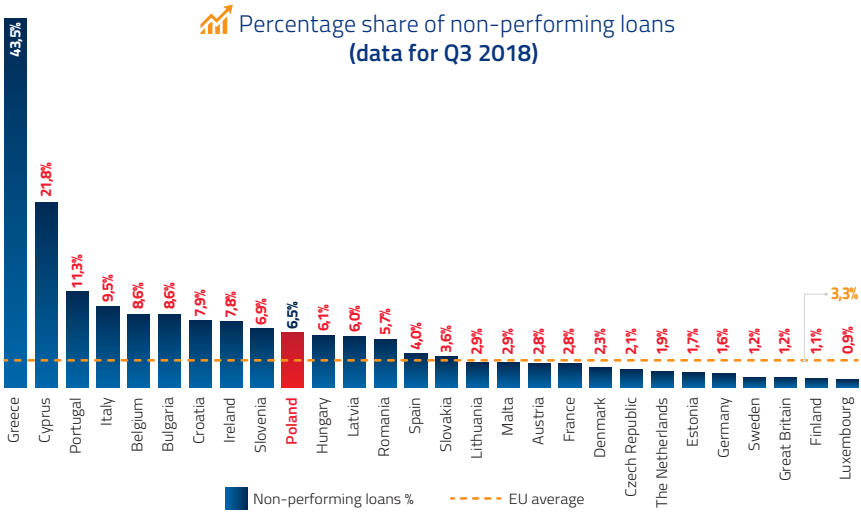
In terms of the value of the loans granted, Poland continues to be ranked in the middle of the ranking which has seen only minor modifications compared to last year. During all of 2018, Polish financial institutions extended the total of over PLN 321 billion worth of loans, i.e. EUR 20 billion more than in the preceding year. The largest increase was recorded in France, where local financial institutions granted nearly EUR 500 billion more worth of loans than in the preceding year. The value of loans granted was the lowest in Malta and Latvia, with the financial institutions of those countries extending less than EUR 20 billion worth of loans.



Source: Compilation based on data of the European Banking Federation

Share of non-performing loans

The European banking sector is highly diversified in terms of the quality of the credit portfolio, with this specific metric measured by the share that non-performing loans have in the total number of loans. The Greek banking system continues to suffer from the highest share of bad loans. Despite the fact that it dropped by 3 pp compared to the preceding

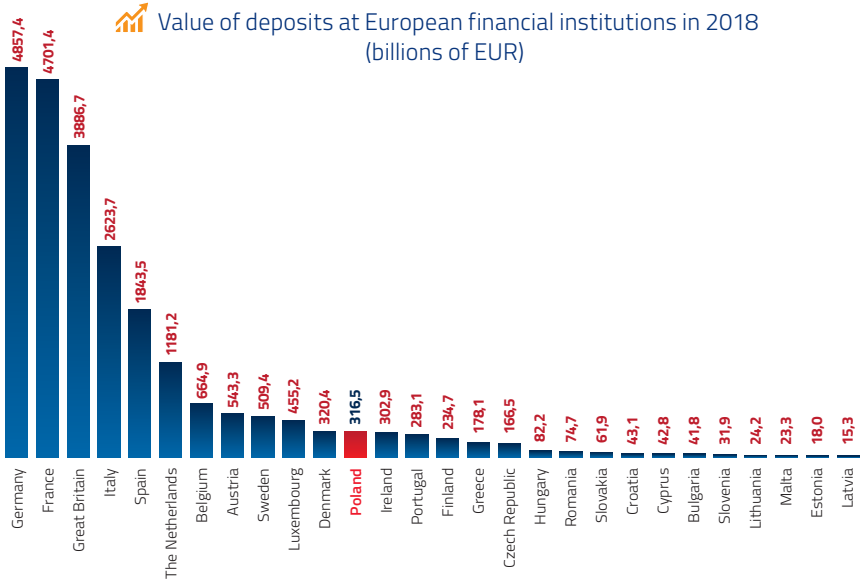


Source: Compilation based on data of the European Banking Federation

years, the share of non-performing loans still exceeds 40% there. Other countries with 2-digit results include Cyprus (21.8%) and Portugal (11.3%). The overall result is much lower than the year before, when the number of such countries equaled 8. The majority of European countries improved the quality of their credit portfolios over the past year, as evidenced by the considerable drop in EU's average from 4.4% to 3.3%. With that taken into consideration, the 0.5 pp increase in the rate to 6.5% observed in Poland last year, is even more worrying. The rate is almost twice as high as the EU average. Countries with the best quality of the credit portfolio include the following: Sweden and Great Britain (1.2% each), Finland (1.1%) and Luxembourg (0.9%).

Deposits

In terms of the value of deposits made, Germany continues to dominate with over EUR 4 trillion 857 billion - almost EUR 100 billion more than in the previous year's report. The French are closely behind with their bank account deposits, as they have managed to halve the distance to Germany by increasing the value of their deposits by approximately EUR 350 billion. Hence, both those countries are not far in front of Great Britain, ranking third and having increased the value of its deposits by EUR 30 billion. This results is definitely impacted by Brexit-related uncertainties, and by the fact that financial institutions

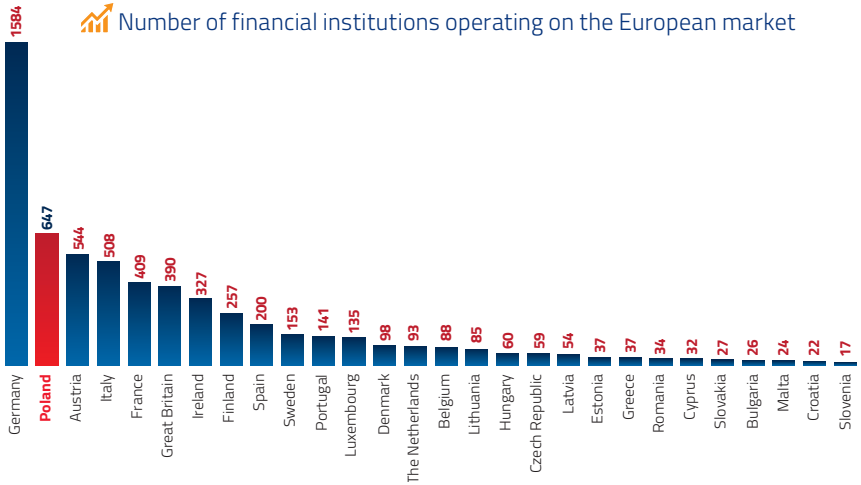


Source: Compilation based on data of the European Banking Federation

transfer some of their operations from London to Paris and Frankfurt. Poland is ranked in the middle of the table, with its deposits equaling EUR 316.5 billion - by almost EUR 20 billion more than the year before. This means that Poland has overtaken Ireland whose deposits increased, last year, by EUR 1.3 billion only. Small Baltic States - Estonia and Latvia - are at the end of the ranking list, with the value of their deposits equaling to less than EUR 20 billion.

Number of financial institutions

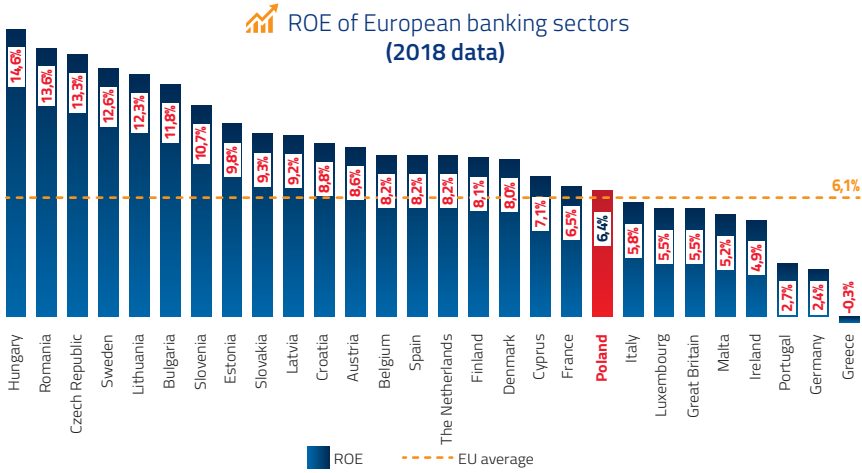
Data of the European Banking Federation indicate, for another year in a row, a downward trend related to the number of financial institutions operating on the common European market. Compared to 2017, their number decreased by 200 in 2018, and currently amounts to 6,088. Germany has the largest number of such institutions - over 1,500. Poland also has a large number of entities active on the financial market - nearly 647 (an increase by 2 YoY), which ranks our country second in Europe. It worth noting, however, that the great majority of those entities are co-operative banks operating in Poland (over 500).



Source: Compilation based on data of the European Banking Federation

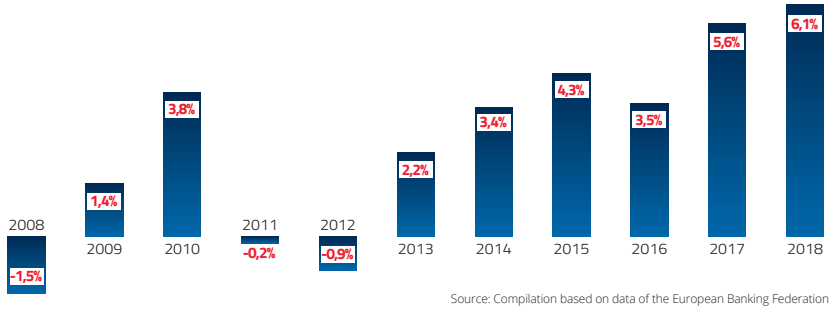
Banks' return on equity (ROE)

There were as many as seven European banking sectors in the last year's report whose ROE exceeded 10%. The Hungarian institutions are in the lead for another year in a row, with their average ROE equaling 14.6%. Romania ranks second, with its ROE increasing by approximately 2 pp compared to last year's result. Currently, it equals 13.6%. The average



Source: Compilation based on data of the European Banking Federation

ROE in the European banking sector



Source: Compilation based on data of the European Banking Federation

ROE in the European Union amounts to 6.1%, meaning that it has increased by 0.5 pp compared to the previous year's report. Despite the fact that ROE of the Polish banking sector is higher than the European average (according to January 2019 data of the Polish Financial Supervision Authority it equals 6.4%), it is one of the lowest in Europe. This year, Greece was the only country in which ROE was negative (-0.3%), meaning that the difference between the highest and the lowest is, at present, by almost 50% smaller than last year and equals as little as 15%. This proves that the European banking sector is relying, to an ever increasing degree, on the synergies created.

PROFITS OF THE BANKING SECTOR, AS PERCEIVED BY POLISH CITIZENS

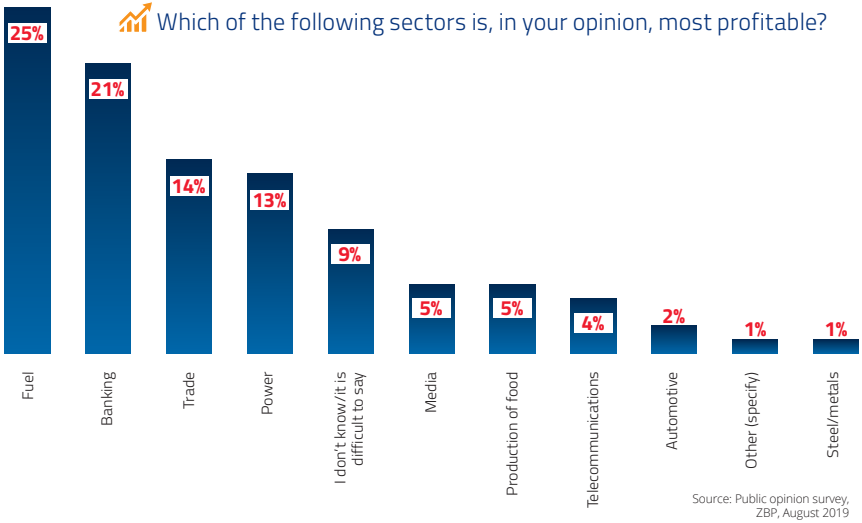
When comparing ROE of individual industrial sectors in Poland, it turns out that automotive, fuel and food industries enjoy the best results, amounting to 14%, 12% and 10%, respectively. Retail and metal industries follow suit, with their ROE equaling approximately 9%. Telecommunications (ROE - 4%), power (ROE - 3%) and media (ROE - 1%) sectors are one of the least profitable in Poland[3]. However, the general public perceives the profitability of individual industry sectors in a different manner. One in four Poles were right in say-

3 Based on a study by www.biznesradar.pl

Public opinion polls show how different the real financial results of individual sectors and their perceptions among the general public are.

PUBLIC OPINION

Which of the following sectors is, in your opinion, most profitable?

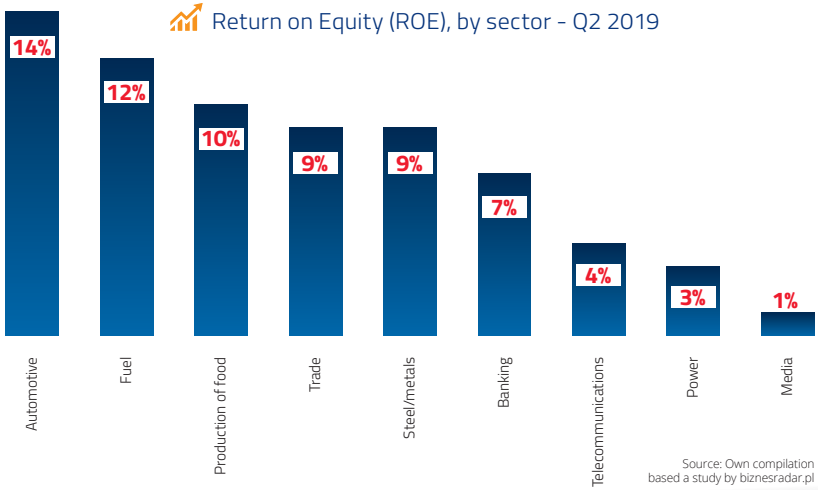


Source: Public opinion survey, ZBP, August 2019

Automotive, fuel or food sectors are the ones whose profits are almost twice as high as those of the banking industry. Nevertheless, in the opinion of the general public in Poland, Polish banks generate high profits.

ECONOMIC ANALYSES

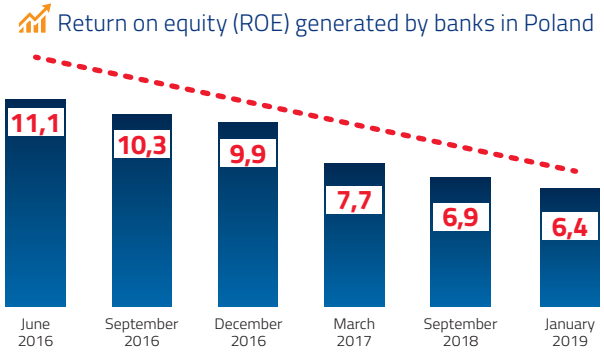
Return on Equity (ROE), by sector - Q2 2019



Source: Own compilation based a study by biznesradar.pl

ing that the fuel sector is one of the most profitable industries. But the surveyed ranked the banking sector second (21% of the respondents stated this was the most profitable industry). The banking sector was ranked, by the respondents, higher than retail, food or metal industries, which generate, in reality, much higher ROE. Interestingly, despite the fact that the profitability of the automotive sector is considerably higher than that of other industries, only 2% of Poles stated that this sector generates significant profits.

RETURN ON EQUITY GENERATED BY BANKS IN POLAND

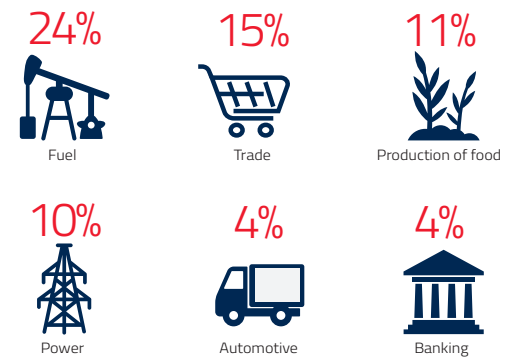


Source: Statistical data of the Polish Financial Supervision Authority (own compilation)

POLES ARE NOT AWARE THAN BANKS ARE THE LARGEST TAXPAYER IN POLAND

ACCORDING TO THE PUBLIC OPINION

Która z poniżej wymienionych branż według Pana/Pani płaci największe podatki?



Source: Public opinion survey, ZBP, August 2019

Polish banks are the largest CIT payer – they contributed **PLN 5.5 billion** in 2018, with an additional **PLN 3.8 billion** in banking assets tax. The remaining largest CIT payers included the following sectors: industrial processing **2.73**, commerce **1.57**, power **1.56**, fuel **1.35**

CIT PAID, BY SECTOR

- Industrial processing **PLN 2.73 billion**,
- Trade **PLN 1.57 billion**,
- Power **PLN 1.56 billion**,
- Fuel **PLN 1.35 billion**.

According to Poles, the fuel sector is not only the most profitable, but it also pays the highest taxes - 24% of respondents show that this industry is subjected to the highest tax burden. Commerce, food and power sectors are also named as industries paying high taxes. Interestingly, despite the fact that the banking sector is one of those with the highest tax burdens, only 4% of the surveyed stated that it accounts for considerable budget revenues.

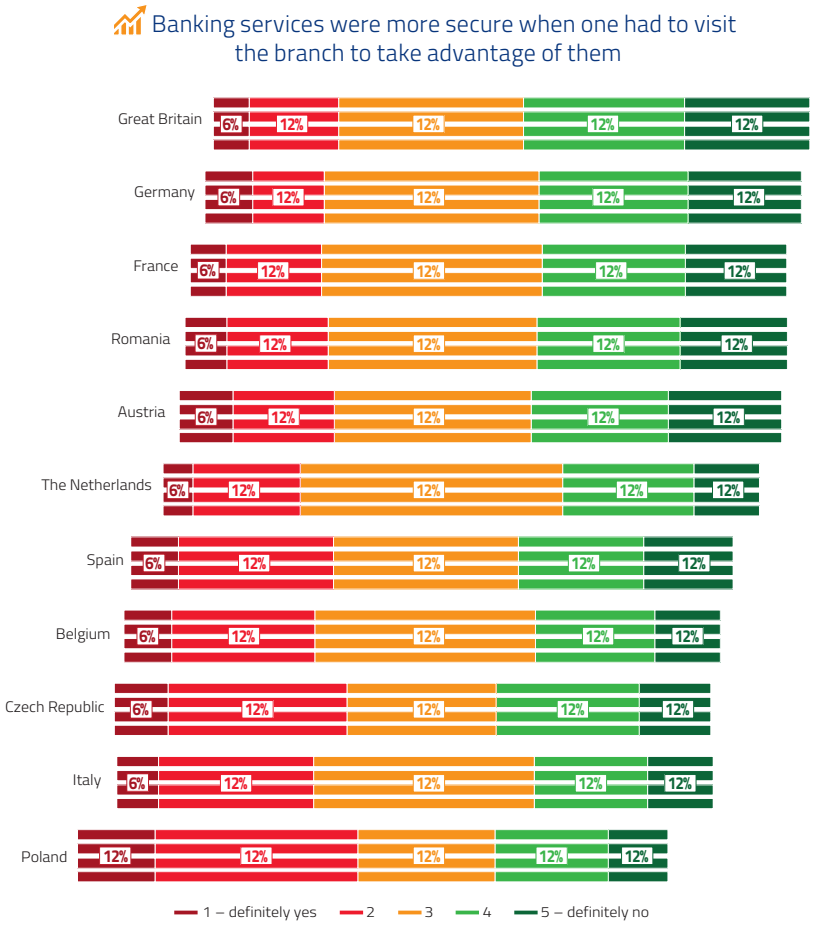
The results of both surveys show that Poles still perceive the banking sectors to be one of the most profitable ones, and one bearing one of the lowest tax burdens. In reality, the situation is completely different - low ROE of bans, and the increasing number of regulatory acts and levies have turned this sector into one of the least attractive for potential investors, which is reflected by the gradual withdrawal of foreign banks from Poland.

According to a recent analysis by "Rzeczpospolita" daily, the banking sector contributed, in 2018 alone, over PLN 5.5 billion in taxes (CIT). The result was my almost PLN 1.2 billion higher than the year before[4]. It is worth noting, however, that the income tax on their earning is not the only fiscal contribution of banks. They also pay the so-called banking tax (on some of their assets). That tax equaled, in 2018, PLN 3.8 billion, meaning that financial institutions are the sector operating under the highest burden of state-imposed levies.

4 https://www.rp.pl/Budzet-i-Podatki/308139898-Banki--podatkowa-dojna-krowa.html

Trends observed in the banking sector

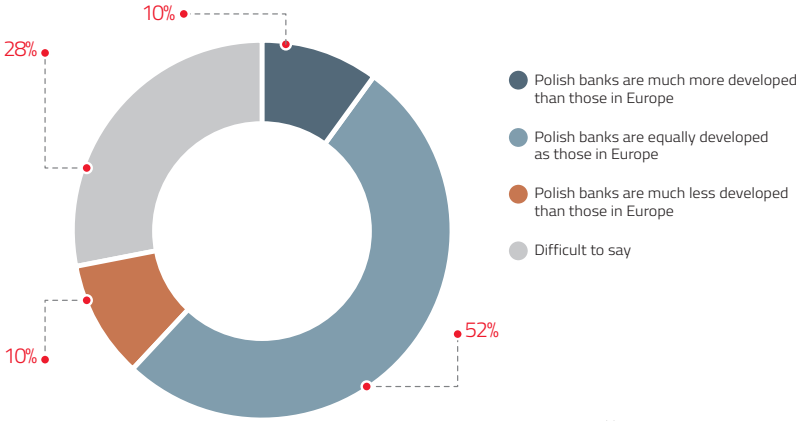
The Polish banking sector has undergone a thorough technological transformation over the past few years. The said transformation involved a number of institutions from the entire financial market. Today, the sector is perceived as one of the most technologically advanced industries of the Polish economy. Furthermore, it stands out not only against the domestic background, but also serves as a role model for numer-



Source: ING Financial Barometer

ous banking sectors of Western Europe. The high share of cashless payments (i.e. cases in which mobile technologies are used) may serve as a good example here. According to this year's edition of *ING Financial Barometer - Future of the banking sector*, Poles use mobile banking solutions more frequently that citizens of other European countries. Furthermore, Poles are one of the few nations in Europe that disagree with the statement that traditional banking is safer than online banking. This is evidenced by the high degree of trust placed in Polish banks - a phenomenon that stems from the cybersecurity-related efforts these undertake. According to a survey of the Polish Bank Association, 65% of respondents are satisfied with the technological solutions their bank has introduced. Only 6% of the surveyed are of the opinion that their bank is lagging technologically behind the market. This low share confirms also the high quality of online and mobile banking services offered to Polish customers.

How do you assess the technological advancement of Polish banks compared to their European counterparts?



Source: Public opinion survey, ZBP, August 2019

Considerable technological advancement and the wide-scale use of state-of-the-art solutions are not always notices by Polish consumers, however. According to more than half of Polis respondents, Polish banks are developed, from the technological point of view, to the same degree as banks in other parts of Europe. A large share of the respondents (28%) find it difficult to assess this aspect. It is worth noting, however, that

high burdens of the banking sector may result, in the long term, in cost-cutting measures. Development of new technologies may undoubtedly be an area that may suffer the most. Therefore, despite the high level of current technological advancement of the banks, their development in this respect may slow down, and they may be overtaken by other European institutions.

TECHNOLOGIES OF THE FUTURE

The banking sector, just as it is the case in other industries, effectively puts to use state-of-the-art technological solutions in order to enhance the security of banking operations and to foster the banks' management processes. Many such solution have already been implemented by banks, while other are still being developed or tested to ensure that they may be introduced in the nearest future. In a survey conducted among bankers, more than half of all respondents stated that artificial intelligence and cybersecurity-related solutions will be technologies that will bring about the biggest change in the banking sector. Almost one in three respondents claimed that a large change will also affect the way in which data clouds are used, while one in four respondents underline the importance of blockchain.

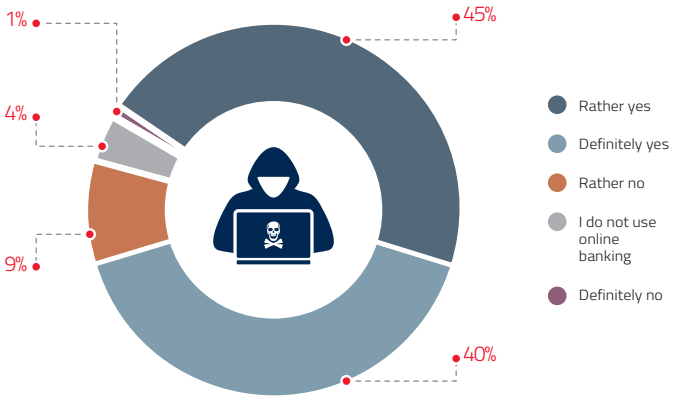
According to the "Humans vs. AI" report drawn up by Accenture in June 2019, 67% of bank employees are of the opinion that smart technologies will create new professional opportunities for them, while 63% expect that this will positively impact their work. Interestingly, contrary to common opinions stating that bankers will be replaced by artificial intelligence, as many as 67% of managers expect the employment level to be boosted by the introduction of AI. Furthermore, according to Accenture estimates, those banks that will fully implement strategies based on the cooperation between humans and algorithms, may increase their employment by 14% until 2022, simultaneously generating a 34% growth in profits.

According to the survey by the Polish Bank Association, robotization and automation of processes will be the most important factor (according to bankers) that will change the employment structure in the Polish banking sector (66% of respondents). New technologies and competition of the so-called third parties follow suit (answer selected by 63% of bankers). Such factors as financial crisis or migration were not as popular among the surveyed.

SECURE BANKING

As online and mobile banking gain in popularity, a need has arisen to create the conditions enabling the services offered to be used in a secured manner. Today, each customer is so to say handed the keys to the bank, so that they can comfortably access private banking solutions. This means, however, that a number of threats have to be dealt with, such as, inter alia, hacker attacks or phishing attempts. Numerous cybersecurity technologies are implemented by banks attempting to protect their customer as best as they can, but nothing will offer a higher level of protection than regular prudence and care, as well as compliance with some rules, such as changing passwords on a regular basis. When asked whether they pay attention to cybersecurity-related issues in their everyday use of online banking, 85% Poles say "yes". However, situations still occur today in which login credentials are easily phished from customers. One needs to remember that even the most advanced banking technologies are not capable of protecting the customers from losing their money in such scenarios.

Do you pay attention to cybersecurity-related issues in your everyday use of online banking (i.e. change your password, make sure that you log in safely)?



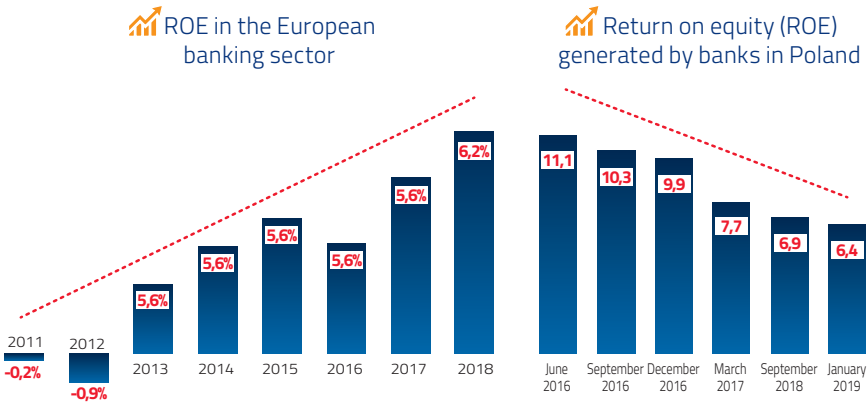
Source: Public opinion survey, ZBP, August 2019

Factors limiting growth of the Polish banking sector

The dynamic changes that have taken place in the European legal and financial system over the past few years force a redefinition of the current models based on which the banking sector operates, and require it to get ready for the approaching challenges. These changes must take into consideration both the increasing expectations of the market and of the customers (continuous optimization of product offering, introduction of state-of-the-art payment technologies, pressure exerted by GAFA giants or increasing pricing competition on the market of credit and savings products), and the external factors that are independent of the financial sector (new legal regulations, both domestic and pan-European, cybersecurity-related challenges, global monetary and fiscal policy). In the face of such a large (and continuously) growing number of limitations and challenges faced by the financial sector in Poland, it seems to be of key importance to clearly identify a group of factors that pose the greatest threat to the stability of the financial sector. These may include the following:

GROWING DISPARITIES IN THE BANKING SECTOR

Outside of the group of the largest Polish banks, the rest of the sector generates low profits that hinder their future growth. ROE of five largest banks exceeds 10%. Banks with a lower value of assets achieve ROE of approx. 4%. The smallest banks achieve ROE of below 2%. The average ROE for the Polish banking sector equaled, in 2018, as little as 6.4%. In order to improve their financial results, the Banks have considerably cut their in-house expenses. The process of limiting the headcount and the number of



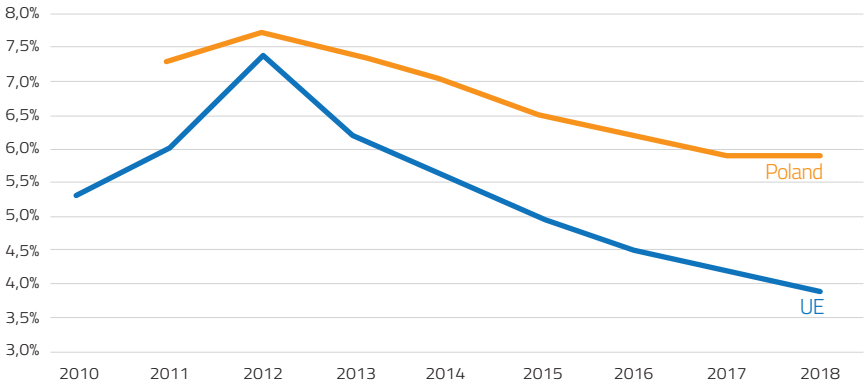
Source: KNF data

operational facilities is on-going. Despite all that, overheads have remained high, which stemmed from considerable external burdens, mainly related to the banking tax and Bank Guarantee Fund contributions.

INCREASING SHARE OF NON-PERFORMING LOANS

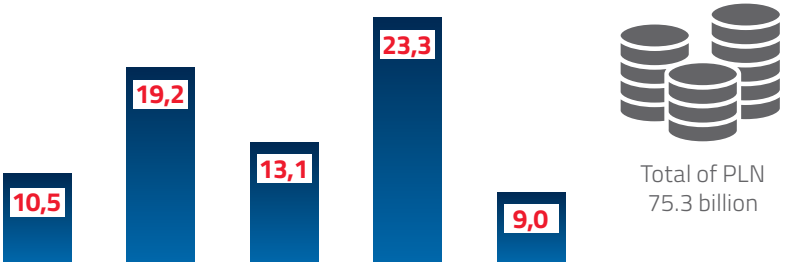
The situation concerning non-performing loans in Poland is in complete disagreement with the progress that has been made by European banking systems in the area of bad loans. Just over a decade ago, Poland enjoyed a low non-performing loan ratio, which set the Polish banking sector apart, in a positive manner, from its European counterparts. Although that ratio continues to decline, its decrease is not as dynamic as in other countries today.

NPL in Poland and in Europe



Source: KNF data

Impaired loans in Q1 2019 (billions of PLN)



Source: KNF data

APPROACHING ECONOMIC CYCLE TURN

Despite the period of growth and good economic sentiment that the Polish economy is currently enjoying, the continuously growing inflation ratio and the record-low interest rates and lending herald a high probability of a shift in the economic cycle. The potential change of interest rates may also exert a negative impact on the value of installments in the case of loans taken out in Polish zlotys. The situation in which the majority of monthly loan-related payables will increase may prove to be challenging for many customers of the Polish banking sector - both corporations and households.

The potential shift in the economic cycle is not favorable for the Polish financial sector as well, due to the dropping level of the attractiveness of the Polish banking sector for foreign investors. The most important aspect, however, will be the increasing discrepancies between financial products offered by banks within and outside the eurozone. If the downturn trend continues, Polish banks may face considerable problems in obtaining capital from foreign investors.

EXCESSIVE FINANCIAL BURDENS

Over the past few years, the banking sector in Poland had to deal with a growing number of new operating cost items, ever more significantly impacting effectiveness, profitability or financial liquidity of the entire system. Such costs include, inter alia, the banking tax (the highest in all EU Member States), the prudential fee, FOŚG contributions, costs related to the introduction of the split payment mechanism and the requirement to offer "free" accounts to customers. Bank Guarantee fund contributions are a big burden for the banks as well, as they are currently higher than amounts the Polish banking sector earmarks for the development of its IT systems. The increasing financial burdens force the banks to give up increasing their share capital (i.e. boosting their stability), and require them to seek funding that is necessary to fund their core operations - the banking tax and Bank Guarantee Fund contributions account currently for almost 2/3 of non-personnel costs borne by the banks. Combination of those burdens, along with the potential change in the economic cycles or with a sudden collapse of the global financial market (e.g. resulting from a customs war) poses a real threat for the liquidity of Polish and European banking sectors.

OVER-REGULATION OF THE BANKING SECTOR

Any direct and indirect intervention of national and European legislators in the mechanisms based on which the international financial sector operates may result in a num-

ber of advantages, but also in numerous threats affecting the efficient operation of the sector under the new conditions. Although all negative reform results cannot be eliminated at the planning stage, the adverse consequences of some categories of activities (e.g. increased regulation of the sector) may be forecast with a high degree of certainty. GDPR or PDSII directives may serve as good examples here which, despite the noble intentions of their authors, have turned out to be more disrupting rather than helpful and advantageous for a number of European economic sectors. Other examples of legislative acts whose implementation may turn out to be problematic for the financial sector include, inter alia, the MREL directive or acts related to mortgage loans (act on the reimbursement of spread or potential acts pertaining to debtors with loans in foreign currencies, etc.) These regulations seem to be unnecessary reproductions of existing provisions (inter alia CRD IV or CRR) that effectively monitor stability of the banking sector, preventing a wide-scale destabilization of the financial sector.

NEW CYBERSECURITY-RELATED THREATS

Polish online and mobile banking systems are one of the quickest growing areas in the European banking sector. Over the past years, Poland and Europe have seen a dynamic growth in the number of new financial products and services, but also in the number of threats and in the complexity of methods used by criminals to fraudulently obtain personal data and funds from banks' customers. In order to protect the users of the financial system against cyber threats, representatives of the Polish banking sector have been undertaking, for several years now, proactive and reactive efforts focusing on increasing the level of security of their customers, inter alia by conducting information campaigns increasing the level of awareness about cyber threats, conducing dialog with the customers via different communication channels suited to the age and life style of customers (also via such educational projects as "Bankers for Education"), or by establishing specialized institutions (such as, inter alia, the Bank Cybersecurity Center operating within the Polish Bank Association) that support the efforts of the sector participants, aiming to eliminate the weak points within the banking infrastructure. The scale and the intensity of cybersecurity threats may require however, that non-bank participants of the financial ecosystem (e.g. governmental administration, uniformed services, etc.) cooperate closer in order to even more effectively protect the Polish financial infrastructure against cyberattacks. But the new fiscal barriers are the most important challenge that will have to be faced by the Polish banking sector, as they systematically reduce the surplus of funds that could be invested by the financial sector in the continued expansion and in boosting the security of the Polish banking infrastructure.

SOURCES:

- International Monetary Fund statistical data - august 2019.
- OECD statistical data - August 2019
- World Bank statistical data - August 2019
- European Banking Federation statistical data - August 2019
- Eurostat statistical data - August 2019
- Ministry of Finance statistical data - August 2019
- "Situation of Banks in 2018" - Report by the Polish Financial Supervision Authority
- Public opinion survey conducted by Instytut Badań Pollster to the order of the Polish Bank Association, August 2019
- Survey conducted among employees of the banking sector by TNS Kantar to the order of the Polish Bank Association, August 2019
- Technical analyses of the capital market - based on data by Biznesradar.pl
- ING Financial Barometer - an International Survey: the Future of Banking, June 2019
- "Humans vs. AI - in the Search of the Holy Grail" - a report by Accenture Consulting, June 2019

POLISH BANK ASSOCIATION

Bankowcy dla Edukacji
Program sektorowy

FOR MORE INFORMATION, PLEASE CONTACT POLISH BANK ASSOCIATION

Przemysław Barbrich, PhD
Head of Public Relations, ZBP.
tel. 660 763 831
przemyslaw.barbrich@zbp.pl

Paweł Minkina
Adviser to the Management Board, ZBP.
tel: 603 62 62 69
pawel.minkina@zbp.pl

Michał Polak
Educational Programs Director, WIB
tel. 503 624 032
michal.polak@zbp.pl

Piotr Gałązka
Director of Representation Office
in Brussels
Polish Bank Association
tel 0048 605 255 191