

Poland: Bank supervision scandal and its impact on markets

A recent alleged supervision scandal in Poland will probably mean that the zloty underperforms regional currencies in the short term. The majority of first-round effects negatively affecting Polish government bonds are probably behind us. Some second-round effects are unpredictable, especially in the political sphere



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The head of the Financial Supervision Authority (KNF), Marek Chrzanowski, [resigned last week](#) following allegations of corruption. [Media reports](#) claim Chrzanowski demanded money from Leszek Czarnecki, the main shareholder in two small banks facing liquidity, credit quality and mis-selling issues, to prevent them from defaulting or being forced into a takeover by other financial institutions. The Polish zloty (PLN) and local government bonds (POLGBs) underperformed Central and Eastern Europe (CEE) FX by about 1%, which we believe was a response to this unfolding story. Chrzanowski has denied the claims.

Not systemically important

The two banks in question- Getin Noble and Idea Bank- are not systemically important (4.1% of total assets of the banking sector), but they have a non-proportionally high share in total household deposits of the sector (7%). In the past, the banks struggled with credit-related losses (due to excessively expansionary credit policy) and recently faced a risk of legal sanctions, due to the mis-selling of corporate bonds to household customers.

We see a few channels through which the fallout from this story may affect the currency and Polish local debt:

1 Liquidity constraints

According to the press, [both institutions now face the threat of deposit withdrawals](#) although the scale is unknown. The underperformance of Polish government bonds and the zloty, as well as asset swaps widening in the last week, signal that both institutions reduced liquid assets (effectively POLGBs holdings) to fight liquidity constraints.

According to publicly available balance sheets of both institutions, at the end of 2Q18, the banks had in their books about PLN9 billion of securities 'ready to sell' (presumably the majority was POLGBs). The institutions have probably already reduced their debt holdings, so further stress in POLGBs is likely to be limited. In the case of continued deposit withdrawals, they may rely on (costly) central bank aid (i.e. refinancing credit) - the National Bank of Poland and the macro-prudential committee have already pledged support if needed.

2 No second-round effects

We don't expect second-round effects. It is quite unlikely that other Polish banks would struggle with a confidence crisis - both institutions strongly differ from the banking sector in terms of reputation. Also, retail deposits up to €100,000 are secured by a deposit guarantee scheme, which means that 90% of all retail deposits in the Polish banking sector are guaranteed. Moreover, retail clients continue to flee the corporate debt market, moving towards 'safe' banks. In September, retail deposits in the banking sector increased by PLN4 billion.

3 Loose links

The links between the two banks and the rest of the sector are also limited. The lenders have had problems for a long time (as they had a large FX mortgages portfolio and got into problems when PLN started losing vs the Swiss Franc, and more seriously when the concept of FX mortgages conversion appeared). Thus, the banks lost much of their access to the interbank and the risk of a spillover via the interbank money market is limited.

4 Impact on local banks

The other channel via which this story may impact POLGBs and PLN is its impact on local banks and mutual funds capacity to cover the 2019 borrowing needs of the government. It is possible that if the two banks continue to suffer and ultimately fail under the resolution scheme, other financial institutions will be forced to take them over. At that point, the deposit guarantee scheme may need to inject capital. That would be costly for the banking sector but the number mentioned by some policymakers is about PLN2 billion, which doesn't differ from the average PLN1.7 billion

deposit guarantee scheme spent in years 2014-2017 to rescue clients of savings unions (SKOK's) and cooperating banks.

The new contribution may constrain local banks' capacity to buy POLGBs, but on the other hand, we could expect retail clients to move to safe banks and out of the two banks that are in trouble and mutual funds that suffered from Getback (securitisation company) in the last months. Also, the Ministry of Finance (MinFin) has already covered about 93% of 2018 borrowing needs (which gives it an extra buffer as we know the 2018 deficit will be lower than the adjusted plan) and pre-financed about 11% of 2019 borrowing needs. The MinFin announced last weekend that the 2018 general deficit would be close to 0.5-0.6% of GDP (below the adjusted MinFin forecast of 1.8% of GDP and the ING forecast of 1%). This is low enough to mitigate worries about a 2020 expansionary fiscal policy that the ruling PiS may run should the bank supervision scandal affect their support before the 2019 general elections.

5 Exposure to corporate debt

Another angle is the Polish financial sector's (mainly mutual funds) exposure to the troubled banks' corporate debt, which we estimate at PLN2.5 billion. Results from mutual funds (the main buyers of these corporate bonds) are already stressed due to problems at GetBack, which relied heavily on this form of funding. In the last three months, overall assets of mutual funds have shrunk by over PLN10 billion. We don't expect the two banks to default on these bonds, it is rather more likely that they will be taken over by other stronger institutions. Still, the mutual funds capacity to buy POLGBs should be limited, as it has in the last few months.

What now?

We think the noise associated with the bank supervision scandal may mean the Polish zloty continues to underperform CEE FX in the short term. The majority of first-round effects negatively affecting POLGBs are probably behind us. We think the impact on POLGBs will continue to be negative given the reliance of MinFin on local demand, but the sell-off should be limited given the superior budget position.

Author

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

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