Polish Banking Industry Country Risk Now Negative; Bank Pekao And mBank Ratings Affirmed With Negative Outlooks

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- In our view, the Polish private sector's ability to service its elevated foreign-currency denominated debt could weaken if the economic prospects fade and the Polish zloty is subject to further depreciation.
- Operating conditions for Polish banks remain difficult and a new bank levy, increased regulatory costs, and costs related to potential foreign-currency loan conversions will put further pressure on the sector's profitability in the low interest rate environment.
- This will, in our view, reduce Polish banks' capacity to absorb losses and withstand shocks and could increase risks to the stability of the banking system.
- Therefore, we consider that the Polish banking sector faces negative economic and industry risk trends over the next two years.
- We are affirming our 'BBB+/A-2' ratings on Bank Pekao and keeping our negative outlook.
- We are revising our outlook on mBank to negative from stable and affirming the 'BBB/A-2' ratings.

FRANKFURT (Standard & Poor's) Feb. 3, 2016--Standard & Poor's Ratings Services said today it had reviewed the economic and industry risk trends the Polish banking industry faces and had revised its opinion of country risk to the Polish banking sector to negative from stable.

At the same time, we affirmed our 'BBB+/A-2' counterparty credit ratings on Bank Polska Kasa Opieki S.A. (Bank Pekao). The outlook remains negative.

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We revised our outlook on mBank to negative from stable and affirmed the 'BBB/A-2' counterparty credit ratings.

Our negative view of the economic risk trend reflects our expectation that the private sector's debt capacity is not improving, as we had previously expected. We forecast the Polish economy will grow by 3.3% in 2016-2017, but we expect GDP per capita to stagnate around US$13,000 because of the depreciation of the Polish zloty (PLN) against most foreign currencies, including the Swiss franc (CHF). Previously, we expected GDP per capita would reach about US$19,000 by 2018, approaching the current level of the Czech Republic and Slovakia. We believe that the household sector's ability to repay its elevated foreign currency-denominated debt could weaken as economic prospects fade. As of Nov. 30, 2015, households' exposure to mortgage loans denominated in foreign currency amounted to PLN169 billion, or 44.5% of the total loan portfolio to households (17.5% of total loans to the nonfinancial sector).

Our negative view of the industry risk trend reflects our opinion that the banking sector's ability to absorb losses and to withstand shocks could weaken over the next two years. The new bank asset tax, effective as of February 2016 (0.44% based on banks' adjusted assets annually), and increased contributions to the Bank Guarantee Fund--including payments to the resolution fund--combined with the challenging low interest rate environment, will meaningfully reduce the banking sector's profitability from the current levels. This will, in our view, reduce the banking sector's capital buffers and capacity to generate new business, especially for smaller banks. Moreover, we believe that the banking sector's structure could change over time due to further consolidation pressure and strategic considerations by foreign parents. If we saw potential for the Polish central bank and banking regulator to be subject to political influence, it could weaken our assessment of Polish banking regulation, governance, and transparency. These factors could influence investors' perception of Poland's financial market.

The negative industry risk trend also reflects the risks related to the ongoing political debate on restructuring of mortgage loans in foreign currency. We understand that there remain significant uncertainties around the Polish president's new proposal on Jan. 15, 2016, especially in relation to the costs of the conversion and reimbursement of foreign currency spreads gained by the banks. We believe that a forced conversion shouldered principally by the banking sector could significantly weaken the sector's financial position and its capacity to support the economy. As a consequence, private sector lending and economic prospects could weaken in the medium term.

Furthermore, we understand that the Polish government will adopt the EU's bank resolution and recovery directive (BRRD) into national law in early 2016. The BRRD is set to introduce the mandatory bail-in of a minimum amount of eligible liabilities, potentially including certain senior unsecured obligations, before governments may provide solvency support. Accordingly, we believe that potential extraordinary government support available to systemically important banks' senior unsecured bondholders will likely diminish within our two-year rating horizon. If we perceive that support for senior unsecured creditors is less predictable under the new legislative framework in Poland, we would most likely revise our assessment of Polish government support to private-sector commercial banks to uncertain from supportive currently.

RATINGS AFFIRMED; OUTLOOK REMAINS NEGATIVE

Bank Polska Kasa Opieki S.A.

The negative outlook reflects our view that there is a one-in-three possibility of a downgrade, driven by the introduction of the resolution framework in Poland in 2016 or a further negative rating action on the sovereign.

We expect that the implementation of the BRRD in Poland in early 2016 will decrease the potential extraordinary government support for systemically important banks. We also consider that the potential introduction of a single resolution framework for cross-border banking groups, such as UniCredit SpA, within the EU could lead to an increased bail-in risk on the subsidiary in the event of a resolution of the parent.

If we did not factor in systemic support from the Polish government, we would rate Bank Pekao above its parent UniCredit SpA only if we considered Pekao to be:

- Insulated (substantially protected from adverse parental effects or intervention); or
- Eligible for consideration of additional loss-absorbing capacity (ALAC) once Poland has adopted the BRRD, and we consider it to have an effective resolution regime where Pekao is subject to a separate resolution process from its parent.

The negative outlook also incorporates the possibility of a downgrade following a further negative rating action on Poland. If we lowered the long-term foreign-currency rating on Poland, which now carries a negative outlook, we would likely cap the rating on Bank Pekao at the level of the long-term foreign-currency sovereign rating.

Although the operating conditions for Polish banks are becoming more demanding, we consider that Bank Pekao holds sound enough capital levels to withstand potentially adverse developments in the economy and that its exposure to CHF-denominated mortgage loans is comparatively low.

We could revise the outlook on Bank Pekao to stable if we consider that potential extraordinary government support for the bank's senior unsecured creditors is unchanged in practice; or if we consider Bank Pekao to be subject to a separate resolution process from its parent and having a sufficient buffer of subordinated instruments eligible for ALAC, fully offsetting the increased bail-in risks. An outlook revision would also hinge on a similar rating action on the sovereign.

RATINGS AFFIRMED; OUTLOOK REVISED TO NEGATIVE

mBank

The outlook revision to negative from stable reflects our view that we no longer believe mBank's earnings capacity to be sufficient to counter a potentially weakening capacity of the parent bank Commerzbank AG to provide support, if we were to downgrade Commerzbank. mBank's ability to build up capital in the next two years will, in our view, be negatively affected by the increased costs related to the bank asset tax, but also the more challenging operating environment the Polish banking sector is facing. Therefore we now forecast the risk-adjusted ratio will be at 9.0%-9.5% over the next 12-18 months. The negative outlook now mirrors that on Commerzbank.

If the proposed foreign-currency loan conversion were to materialize, we think this would likely weaken mBank's financial position due to its higher-than-sector-average exposure to mortgage loans in CHF. However, if our assessment of mBank's stand-alone credit profile, specifically our combined view of its capital and risk position, were to weaken, we could factor additional notches of group support into our rating on mBank, in line with our criteria.

We could revise the outlook to stable if we take a similar action on the parent bank.

RELATED CRITERIA AND RESEARCH

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

- Commercial Paper I: Banks, March 23, 2004

Related Research

- Poland Foreign Currency Rating Lowered To 'BBB+' On Weakening Institutions; Outlook Negative, Jan. 15, 2016
- Banking Industry Country Risk Assessment Update, Jan. 14, 2016
- Banking Industry Country Risk Assessment: Poland, June 30, 2015

BICRA SCORE SNAPSHOT*

Poland	To	From
BICRA Group	5	5
Economic risk	5	5
Economic resilience	High risk	High risk
Economic imbalances	Intermediate risk	Intermediate risk
Credit risk in the economy	Intermediate risk	Intermediate risk
Industry risk	5	5
Institutional framework	Intermediate risk	Intermediate risk
Competitive dynamics	Intermediate risk	Intermediate risk
Systemwide funding	High risk	High Risk
Trends		
Economic risk trend	Negative	Stable
Industry risk Trend	Negative	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

RATINGS LIST

Ratings Affirmed

Bank Polska Kasa Opieki S.A.	
Counterparty Credit Rating	BBB+/Negative/A-2

Ratings Affirmed; Outlook Action

	To	From
mBank		
Counterparty Credit Rating	BBB/Negative/A-2	BBB/Stable/A-2

NB: This list does not include all the ratings affected.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.