Financial Intermediation in Romania

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Abstract

The study of financial intermediation is a current issue constantly analyzed at the level of national economies or geographical areas. The specialized literature is rich in materials and support models. Therefore, we set out to analyze the degree of financial intermediation in Romania in the current period. By studying the causal relationship between the loans to the private sector and banking sector assets as a share of GDP, we will highlight current trends, capturing the subsequent causes and effects.

In the future, this paper may be part of a larger study that aims to investigate the causes for the low level of financial intermediation in Romania, to identify the main obstacles in sustainably increasing the value of the indicator, and to sketch out possible solutions for overcoming them.

Key words: financial intermediation, financial system, non-government credit
J.E.L. classification: G01, G20, G21, G24, G30, E50

1. Introduction

The financial intermediation process refers to the set of activities through which the funds attracted from the savers are made available to those who need funds. In this sector, the main actors are the credit institutions that perform the financial intermediation in the savings-investment process. The degree of financial intermediation is defined at the level of an economy as non-government credit expressed as a share of GDP.

The analysis of this indicator occupies an important place on the agenda of central banks, national and international financial institutions, financial analysts and professional associations (e.g., Romanian Association of Banks). To a large extent, financial intermediation development correlates with the degree of development of a country, as well as with its potential to attract financial funds and investments.

The importance of the indicator at a macroeconomic level justifies its analysis carried out for the current period. Moreover, it would be interesting to identify the causes and challenges of the present period with regard to financial intermediation.

In Romania, financial intermediation, calculated as non-government credit to GDP ratio, decreased in 2013 compared to 2012. The intermediation rate of only 26.4% was in the year 2013 at the same level as in the year 2006. At that moment, our country ranked last in the European Union in terms of its financial intermediation level and also in terms of economic wellbeing and wages. As our country has not had a notable experience over the last 15 years regarding the evolution of the degree of financial intermediation, we are interested in the annual changes from the 2018 - September 2021 period and its position compared to other EU countries.

2. Theoretical background

Financial intermediation plays a key role in the savings-investment process. It essentially facilitates the transfer of capital and risk between borrowers and savers.

The reasoning behind financial intermediation has 2 directions:

- ✓ Economic agents that need capital have more information about their financial situation and development prospects than the potential capital providers
- ✓ The costs of searching and filtering the offers from possible counterparties without resorting to a qualified intermediary are prohibitive (Isarescu, 2007).

Financial intermediary is a special financial entity which performs the role of efficient allocation of funds, when there are conditions that make it difficult for lenders or investors of funds to deal directly with borrowers of funds in financial markets. Financial intermediaries include depository institutions, insurance companies, regulated investment companies, investment banks, pension funds. They are financial institutions specialized in the activity of buying and selling (at the same time) assets and financial contracts (Mayowa, 2020).

The connection between financial development and economic growth has been studied and demonstrated by many economists. In general, a well-developed and sound financial system has a positive effect on economic growth. However, the inclination towards lending and consumption can negatively influence the share of savings and, consequently, economic growth (Pagano, 1993).

There are differing views on how financial structure and implicitly financial intermediation directly affect economic growth (Levine, 1997).

Furthermore, the quality of financial products is determined by the legal framework but also by the financial education of the financial market participants. Thus, within a clear and stable legislative framework, financial institutions can develop a wide range of products and services tailored to the needs of the different categories of customers. La Porta even states that the justice system shapes the quality of financial services (La Porta *et al.*, 1998). The stability and coherence of the legislative framework is a key component of financial development, significantly influencing long-term economic growth.

In the process of explaining the relationship between financial development, degree of financial intermediation and economic growth, political aspects have been introduced as an influencing factor (Fohlin, 2000; Rajan and Zingales, 1999).

This is a particularly interesting result in light of the more recent literature on the causal relationship between financial and real growth. The inverted U-shaped relationship between financial institution assets and GDP per capita lends support to the idea that the moderately industrial countries of the time depended more on financial institutions to mobilize capital than did the most and least advanced economies (Fohlin, 2000).

Starting from these aspects highlighted by the specialized literature, we will study financial intermediation in Romania in the current period.

3. Research methodology

In the specialized literature, including on the basis of specific datasets, the range of approaches regarding the causal relationship between financial development and economic growth of a country is diverse.

Bangake and Eggoh (2011) highlighted a biunivocal causal model between economic growth and the degree of financial intermediation.

The financial development - economic growth influence model, according to which a high degree of financial intermediation will determine in the short and medium term an increase in GDP as a result of increasing the allocation of resources for the most productive activity sectors, is the one used by Banerjee (2012), Mishra *et al.* (2009), Habibullah and Eng (2006).

Herwadkar and Ghosh (2013) approached this relationship in the opposite direction: economic growth determines the degree of financial intermediation.

According to a study published by Lazea *et al.* (2017) there are several causal relationships (Table no.1).

The causal relationships were obtained by modeling the interconnections between the degree of financial development and economic growth.

Table no. 1. The causal relationship (Granger type) between financial development and economic growth

Financial development	**Causal relationship**	**Economic growth**
Loans to the private sector (% of GDP)	→	
Loans to households (% of GDP)	→	
Loans to the private sector (% in total credit)	←	Economic growth
Intermediate money (% of GDP)	←	
Private sector deposits (% of GDP)	←	

Source: Lazea V. (coord.)., *Financial intermediation - problems and solutions*, BNR/ National Bank of Romania Notebook no. 48 p. 16

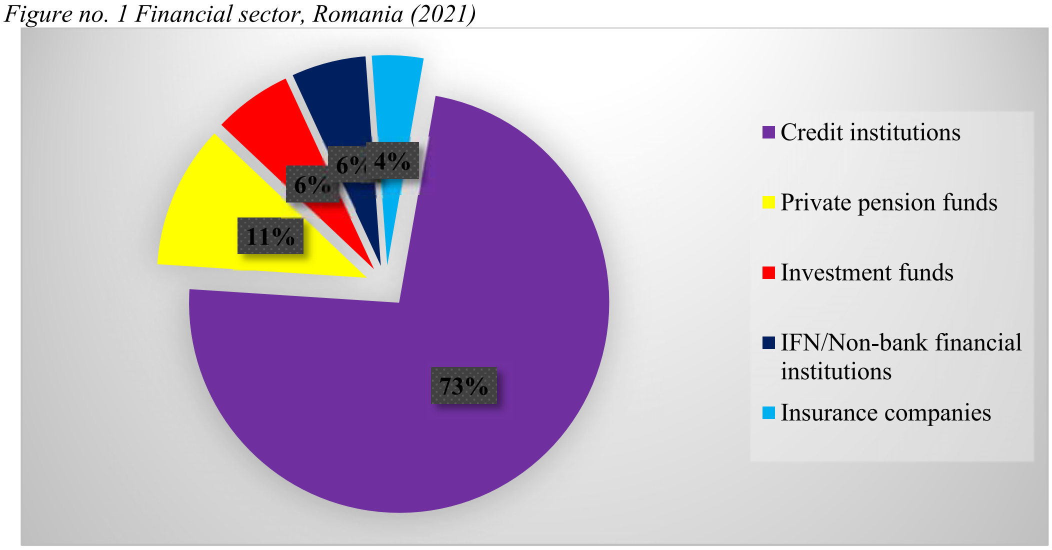
In our study, starting from the specific elements of the Romanian financial system, we will tackle the issue of the degree of financial intermediation highlighting the structure of the credit, its characteristics and dynamics, the loan-to-deposit ratio, but also the evolution of non-performing loans.

4. Findings. The structure of the Romanian financial system. Financial intermediation

A characteristic of the Romanian financial system from 1990 to the present is the dominant share of banking system assets in the total financial system assets. In percentages, these ratios were within the 70.4% - 95% range.

In the middle of 2021, the banking sector represented 70.4% of the total, being followed, at great distance, by the private pensions category (10.8%) and investment funds 5.8%.

Figure no. 1 Financial sector, Romania (2021)



Source: BNR, *Financial Stability Report*, 2021, p. 50

Regarding the dynamics and structure of the assets in the banking system in the 2018-2021 period, the following comments can be made:

- The number of credit institutions did not vary significantly: by June 2020 it was 33, and after that moment, by opening a new branch of a foreign bank, the total number reached 34.
- Regarding the volume of total assets, it was established that in the period 2018-September 2021, their volume increased significantly from 451.1 billion lei to 602.7 billion lei, i.e., by 33.6% (Table No. 2).

This increase also determines a favorable evolution of the degree of financial intermediation.

Table no. 2 Romanian banking system indicators

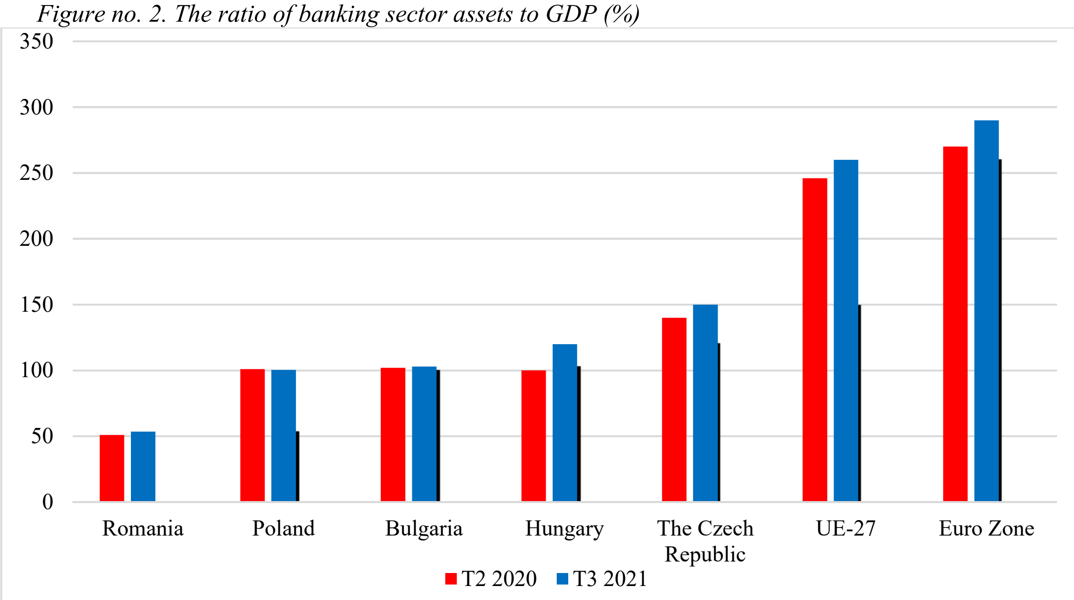
	Dec. 2018	**Dec. 2019**	**Dec. 2020**	**Jun. 2021**	**Sep. 2021**
Number of credit institutions	33	33	34	34	34
of which foreign banks' branches	**7**	**7**	8	8	8
Total net assets (*billion lei*)	451,1	495,2	560,9	585,9	602,7
Assets of private-owned institutions *(% in total assets)*	91,9	91,8	89,4	88,7	88,9
Assets of foreign-owned institutions *(% in total assets)*	75,0	73,7	70,5	69,4	69,7

Source: BNR https://www.bnr.ro/Indicatori-agregati-privind-institutiile-de-credit-3368.aspx (accessed, November 11, 2021**)**

- Since the beginning of the COVID-19 pandemic (April 2020) until the second quarter (T/Trimester) of 2021, the net assets of the banking system increased in each quarter, totaling a variation of + 16% (Jun. 2020-Sept. 2021). Thus, it can be seen that the pandemic did not negatively influence the activity of the sector and financial intermediation.
- A characteristic of the field is the large ratio of assets covered by private-owned credit institutions (approximately 90%, on average). In fact, the non-private capital comes from 2 credit institutions: CEC Bank and Exim Bank).

In order to compare the degree of financial intermediation in Romania with that of other EU member states, a starting point is the ratio of banking sector assets to GDP (Graph no.2).

Figure no. 2. The ratio of banking sector assets to GDP (%)



Source: Author's own concept (carried out on data taken from BNR, Eurostat)

Against the background of credit growth, in the first half of 2021, the degree of financial intermediation registered a positive evolution compared to the same period of the previous year, amid continuing the sustained progress of the assets of financial institutions. Thus, in the second quarter of 2021, the ratio of financial system assets to GDP was 76.2 percent (an increase of 5.5 percentage points, year on year). However, Romania registered a degree of financial intermediation of only 26.6%, about 3 times lower than the EU average of 85%.

5. Conclusions

The financial system of a country should be a network that facilitates the relations between the financial institutions and the other financial market actors by providing the specific legislative framework and tools. Financial intermediaries are those which provide the liquid assets needed by economic agents, households, and the government.

It was found that in the developed economies the ratio of banking sector assets to GDP is high, as well as the degree of financial intermediation. Moreover, the level of financial culture is a determining factor in the adoption under financial security conditions of the loaning decision. In Romania there is an inequality of income, but even in households with above average income there is a reduced inclination towards savings. Regarding lending, there are usually 2 opposing attitudes in the case of Romanians. One category avoids resorting to lending in any form, regardless of the cost/situation, and almost excludes banking from everyday life and another category, inclined to consumption, uses loans in order to meet continuing general needs. The middle class is rather poorly represented. They are saving money, they resort to lending, but they may be reluctant to provide collateral.

As a result, the banks' offer is also quite low in terms of retail credit.

Regarding the lending for the economy, the predominant use of lines of credit and less of investment loans can be observed. These directions can also be explained by the inconsistency of the legislative framework and the multiple changes in the fiscal field.

Consequently, although the degree of financial intermediation in our country is low compared to other EU countries and the EU average, this situation is somewhat explainable. The positive thing is that every year the degree of financial intermediation increases.

As a recommendation for future research, one can analyze the influence of financial education on the lending / savings decision, as well as the effects of atypical laws on the degree of financial intermediation (e.g., the Law on giving in payment).

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