

Banking Activity in Romania: Where to?

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Abstract

Lately, the Romanian banking system has experienced legislative changes that do not correspond to those imposed at European level, changes made without previous studies, which in the long run will affect lending, leading Romania to a new financial crisis. This article presents specific banking activity in Romania, starting from the analysis of the evolution of the inflation rate at both European and national level. Subsequently, the main aspects of financial stability in Romania were mentioned, continuing with the analysis of risk indicators and the rate of non-performing loans.

Key words: loans, deposits, inflation, banking system

J.E.L. classification: E58, G01, G15, G21

1. Introduction

The Bank is a rather complex credit institution that engages in the intermediation of central bank reserves as an organization for them and other financial authorities involved in promoting financial and monetary stability. So, the Bank's attributions in the last financial exercise were influenced by their diversity in the following observations, bank activities will be classified into three elements: activities involving banking operations; activities related to providing support to the community of central banks, and activities designed to support all committees and groups hosted by the Bank. Finally, the banking activity in Romania also registered aspects favorable to the economy, because last year very good prudential indicators were found, a solid banking system that managed to overcome all the shocks encountered lately, exemplifying solvency rates over the European average, according to the ABE classification.

2. Theoretical background. Banking activity in Romania, evolution of inflation and risk analysis

To analyze the banking activity, we started from the idea that any bank is an intermediary of central bank funds, so the guiding principles used in customer service are: confidentiality of personal data of clients, their financial liquidity, information security, but also money recovery. (Badea, 2010).

To meet the objectives, bank managers apply customer-centric strategies, in order to provide them with liquid tools which provide efficient returns for comparable qualitative alternatives so as to in order to increase all the central bank's portfolio investment to properly manage the two priority, credit and market risks, and to periodically monitor all banking activities. (<https://eur-lex.europa.eu/>).

Taking this into account, most managers of credit institutions have exemplified an increase in their balance sheet lately, so that in the 90's 90 billion lei were declared, 10 years later this value doubled to 175 billion lei, and in 2018, 20 billion have been exemplified.

Analysing the market share, it is found that credit institutions intermediate about 6.5% of all international reserves, reserves used by more than 120 central bank customers. The growth of deposits was particularly strong.

Lately, instruments used over a longer period of time have been a pretty big attraction for central bank funds.

These instruments have been created to meet customer demands regarding longer marketable instruments (Căpraru, 2010, p. 57).

Commitment to excellence must remain supported by a rigorous monitoring of risk exposures, of liquidity, market and operational risks. Currently, in line with best practice, this is done by a separate unit of risk control, reporting directly to the Deputy Chief Executive Officer and through him/her, to the manager of the credit institution.

The National Bank of Romania (BNR) was established in 1880, and it is the 16th central bank in the world from a historical perspective (www.bnr.ro).

The main attributions of the NBR are shown in Figure 1.

Figure no. 1. The main attributions of the NBR

- to define and implement the monetary policy and the exchange rate policy;
- to conduct the authorisation, regulation and prudential supervision of credit institutions;
- to promote and oversee the smooth operation of payment systems with a view to ensuring financial stability;
- to issue notes and coins to be used as legal tender on the territory of Romania;
- to set the exchange rate regime and to supervise its observance;
- to manage the official reserves of Romania

Source: (<https://www.ecb.europa.eu>)

As a result, the Bank Deposit Guarantee Fund of credit institutions was established in 1996, it has legal personality, its purpose is to ensure the reimbursement of these deposits, according to the legislation in force, taking into account the limits and deadlines initially established. It has the status of interim administrator or liquidator if appointed.

In conclusion, since the establishment, the fund has had the role of guaranteeing deposits and payments to depositors in the event that a credit institution reaches the brink of bankruptcy, yet the insured amount is currently EUR 100,000, that being the maximum threshold offered to depositors. In order to illustrate the evolution of banking activity in Romania, we have chosen to reflect the evolution of the Euro-zone financial key figures to illustrate the position it occupies as member of the European Union.

3. Research methodology

In figure no. 2. the inflation rate in the Euro area over the past 10 years is identified, locating the area in which Romania is, in order to identify the inflation value in February 2019 as the latest information gathered (<https://www.ecb.europa.eu/>).

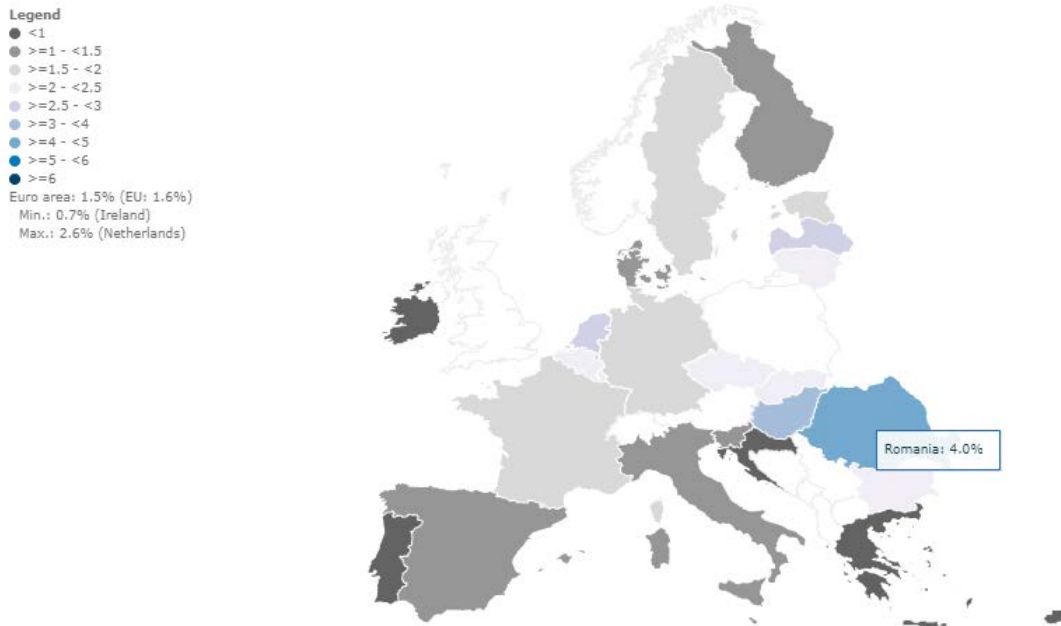
According to the data presented, it can be noted that the inflation rate in February 2019, the European average is somewhere at 1.6%, being about 2.5 times lower than the percentage recorded in Romania (4%), the lowest values being identified in Ireland (0.7%) followed by Croatia with 0.8% and Greece with 0.8%.

European countries which register an inflation rate below the European average are:

- Finland (1,3%);
- Denmark (1,1%), Spain (1,1%) and Italy (1,1%);
- Portugal (0,9%).

And those that exceed the European average are: Sweden with 1.9%, France with 1.6%, Germany with 1.7%, followed by Lithuania and Belgium with 2% each, Bulgaria 2.4% and the Netherlands with 2,6%, which shows that Romania has the highest percentage of inflation in the Euro area.

Figure no. 2. The inflation rate by country at European level



Source: (<https://www.ecb.europa.eu>)

For the calculation of European averages, only Ireland was taken into account, because the UK is currently in the Brexit negotiation process, which means that Euro-area exit measures are being negotiated.

In figure no. 3. We have reported the evolution of the inflation rate since 1996 to our country (see paragraph a) and developments in the euro area (see point b).

Figure no. 3. Evolution of the inflation rate between 1996-2019 in the Euro area and in Romania

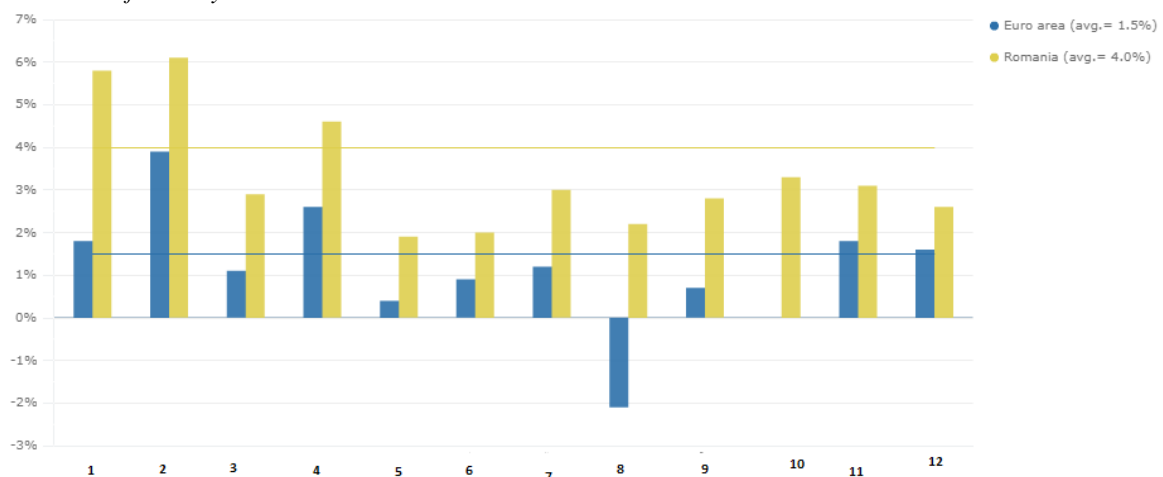


Source: (www.ecb.europa.eu)

The data presented in figure no. 3. illustrate an oscillating evolution of the inflation rate at European level, if in 1996 it represented an average of 2.5 percentage points, in February 2019 it reached a total of about 1.5 percentage points. Data show that the minimum recorded was 0.6% in mid-2009 and 2015, and the peak was at the end of 2008, about 4.1%, then 35 in 2001 and in 2012. The highest decrease was recorded during the global economic crisis - mid 2009.

Analysing the inflation rate in Romania, compared to the European average, it is noticed that during the period 1996-2019, it only recorded values below the European average in the period 2015-2019, values that are below those specific to the European average, the inflation rate in the rest of the period exemplifies values below the European average. But, in 2007 Romania's specific percentages do not exemplify high values compared to those declared in Europe, as in the beginning period when in 1997-1998 the values were over 170%, decreasing extremely in 1999, bringing a total of 28 percentage points, and since Romania became a European member state, the government tried to unify the average inflation rate at the level of the European one, not to record extremely high fluctuations.

Figure no. 4. Evolution of the inflation rate in February 2019 - in the Euro area and in Romania by main areas of activity



1 - food and beverages; 2 - alcohol and cigarettes; 3 - clothing and footwear; 4 - household; 5 - furniture; 6 - Health; 7 - Transport; 8 - Communications; 9 - recreation and culture; 10 - education; 11 - restaurants and hotels; 12 - various

Source: (www.ecb.europa.eu)

From the data presented, it is observed that in most areas of activity, the inflation rate recorded in Romania in February 2019 is above the average recorded in the European area. Thus, for the food and drink sector, the inflation rate was about 5.8 percentage points in Romania, but in the Euro area the average was 1.8%. Thus, analysing the average general inflation rate, this sector is higher by 1.8% compared to the average recorded in Romania (4%) and by 0.3% compared to the European average (1.5%). In the sector of alcohol and cigarettes, the value registered in Romania is 6.1%, and in the Euro area it is about 4 percentage points. In the category of activity - household, the registered values are 2.8% for the Euro area and 4.5% for Romania.

The main areas of activity with inflation values below the general average in Romania and the euro area are exemplified in figure no. 5.

Figure no. 5. The main areas of activity with inflation values below the general

- clothing and footwear in the Euro area (1.1%) and in Romania (2.8%);
- furniture in the Euro area (0.3%) and Romania (1.9%);
- health in the Euro area (0.9%) and in Romania (2%);
- transport sector in the Euro area (1.3%) and Romania (3%);
- communications in the Euro area (-2.1%) and in Romania (2%);
- recreation and culture in the Euro area (0.7%) and in Romania (1.8%);
- for the education sector in the Euro area no information were found, and in Romania (3.2%);
- restaurants and hotels in the Euro area (1.8%) and in Romania (3.1%);
- various in the Euro area (1.6%) and in Romania (2.6%).

Source: (www.ecb.europa.eu)

In 2018 Romania was in the centenary year, celebrating 100 years since the Great Union, during which time the Romanian banking system has recorded many successes but also various failures. All of these have transcended various periods, either better or harder times since the inter-war period, followed by the Great Depression, the Second World War, continuing with the period of centralized economy and ending with the global financial crisis (<https://economie.hotnews.ro>).

Finally, the banking activity in Romania also registered aspects favorable to the economy, because at the end of last year, very good prudential indicators were found, a solid banking system that managed to overcome all the shocks encountered lately, exemplifying solvency rates over the European average, according to the ABE classification. In August 2018, there was a reduction of non-performing loans (5.5%) compared to the values registered in 2014 (20.71%), but the degree of provisioning coverage of these loans was 56.93%, well above the European average, which determined a total of 44.5 percentage points.

Analyzing the ratio between loans and deposits, it is ascertained that their level exceeds the one recorded in the European average of 116.7 percentage points, which indicates a favorable situation for them.

At the same time, profitability indicators in the Romanian banking system are performing much better than in the Euro area as the cost/income ratio has increased, recording positive values, after the negative ones exemplified in 2014, thus in March 2018 the values of the profitability indicators were 14.56 in Romania and 6.1 percentage points in Europe, and the values of the ratio were 56.86% respectively 63.4%.

After the financial crisis, the number of bank offices in Romania decreased by about 4 percent compared to 2008, a fact which was also due to the development of technology, and as such, the Romanian banking systems have adapted over the past decade to the digitization process, simplifying the services offered to clients by introducing increasingly sophisticated technologies.

Over time, banking products and services have diversified, thus Romanian bank lending has shifted from loans in Lei to foreign currency loans and vice versa, and in March 2018, the most loans in Lei were recorded since 1996, exemplifying a total of 16%. Last year, a total of 35 credit institutions were found, 8 less than 2008, the period before the global financial crisis.

One of the aspects which should be improved in the Romanian banking system is the increase in the financial intermediation rate, which at the end of last year was 27%, being below the European average and by 13 percentage points lower compared to 2011, the year when the highest level was recorded.

Another element to be improved is the educational level both among the population, but also among the Romanian entrepreneurs. As such, if citizens knew how to efficiently manage their personal budgets, they would no longer resort to loans in order to raise their standard of living, loans which have negative effects on them and lead to a decline in long-term living standards. And the entrepreneurial financial education in Romania should be implemented from a young age, and credit institutions could increase the supply of banking products and services.

Therefore, the insufficient knowledge accumulated in the financial-banking field determines a sensitivity of the clients, leading to deficiencies in the Romanian banking activities.

In Romania, there is still a category of citizens who are poorly informed about the banking system, and as such, many businesses are not financed by banking products, in 2017 most companies were financed from commercial debts 19.3% of total liabilities and debts to shareholders 10.6%.

At present, the Romanian government program has led to higher wages, leading to the growth of the banking sector, thus the short-term debt ratio has diminished for current borrowers and increased for future borrowers.

The absorption of European funds and Start-Up Nation Government Programs are offered to Romanian citizens in order to stimulate saving or financing of personal development and education, but they are also followed by certain risks.

In conclusion, all the legislative projects elaborated by the Romanian government aim at capping the interest rates, but also limiting the amounts to be recovered from the divested claims, without omitting the diminution of the character of the enforcement title encountered in the credit agreements, and in some cases the permanent elimination of the latter. In many European countries, as well as Romania, the central bank has the function of implementing monetary policy, with a role of banking and regulatory supervision, otherwise its effectiveness is diminished.

Pressure on the banking system can lead to a decrease in citizens' confidence, so salary increases can have negative consequences, leading to a budget cut, which will lead to a repeat of the 2008 crisis. Eliminating the *First Home* program would lead to many synopses in real estate financing, many construction companies will go bankrupt because the offer will be too high for the existing demand, all of which would lead to a blockade in the real estate market.

In March 2019, the National Bank of Romania maintained its benchmark interest rate at 2.5% and in December 2018 the annual inflation rate fell to a lower level of 3.3 percent from 3.4 percent in November, in the target range of 1.5-3.5 percent. The bank expects inflation to decrease slightly more than expected in the next three quarters, and then to remain slightly below the upper target levels, ending the year at 2.9%. Also, the rates of deposits and credit facilities remained unchanged at 1.5% and 3.5%, respectively.

Political leaders have said that the risks stem from the new set of fiscal and budgetary measures that have been in place since 1 January 2019, as well as from the future fiscal policy and the pace of growth in the Euro area and the global economy.

The interest rate in Romania averaged 5.52% from 2005 to 2019, reaching a maximum of 12.50% in May 2005 and a record level of 1.75% in May 2015 (<https://tradingeconomics.com>).

In order to recreate banking activity in Romania, I chose to briefly structure the evolution of financial stability in recent years, which has been consistently robust. The main favourable aspects were:

- decrease of the risk of overheating of the Romanian economy. In 2017, economic growth was 6.9 percentage points, which declined in 2018 to a total of 4.1%.

- public debt declined by one percentage point in 2018 compared to 2017, reaching a total of 34.1% at the end of 2018, although the foreign currency reserve fell sharply reaching 2.8 percentage points of GDP in 2017. All these aspects align the net public debt to gross public value.

- the solvency and liquidity of the banking sector determined normal values, thus the bad credit rate fell sharply from 6.41% in 2017 to a total of 5.56% in the last months of 2018.

The banking sector in Romania manages to outperform the risk indicators, which refer to solvency, asset quality, profitability and the structure of the balance sheet.

Thus, we will continue to analyze these risks in the period 2015-2018, exemplifying also the European average of 2018, such as:

- The risk-solvency indicators comprise personal level 1 and basic funds, for the first category, the European average was 16%, framed in the good level of prudence, like the values recorded in Romania during the period 2015-2018 when the values determined were 16.72%, 17.55%, 17.95% and 17.83% respectively. The same situation is also exemplified for basic level 1 personal funds, which exemplify good prudence levels at both European level (14.5%) and in Romania, when a value of 17.83 percentage points was identified in 2018;

- Risk indicators - asset quality includes several criteria such as:

- a. The rate of non-performing loans is unfavorable, so the prudence interval is the intermediate example of 3.6 percentage points in the euro area and in Romania at the end of 2018 the interval is on an intermediate level of 5.56%, but in 2015 it is identified at a bad rate of 13.51 percentage points;

b. The coverage ratio of non-performing loans determines favorable levels of prudence in Romania, a value of about 57 percentage points is identified in the analyzed period, but in the euro area a total of 46% is identified, which classifies it at an intermediate level;

c. The rate of loans and advances with restructuring measures exemplifies prudence intervals at an intermediate level in the Euro area and in 2018 in Romania, in the other period a value of over 5 percentage points is determined, concluding an unfavorable aspect.

- Risk - Profitability Indicators analyze ROE and cost/income ratio. Thus, the ROE indicator in Romania is on an accrual level of over 10 percentage points between 2015-2018, but in the euro area the values of 7.2% are ranked on an intermediate level. The cost/income ratio, which requires a good level of 50%, shows that the European average is on an unfavorable interval because it determines a percentage of 63.8%, but in Romania the level of prudence is intermediate throughout the analyzed period, because in 2015 it exemplifies a percentage of 58.46% and 53.71% in 2018.

- Risk Indicators - the balance sheet structure comprises two categories, the first refers to the ratio between loans and deposits offered to natural persons and non-financial corporations, which are identified at a good level in Romania between 2015-2018, more than 73%, resulting in a total of 74.86% in 2018, but the European average is identified at an intermediate level because it was of 116.2%, an unfavorable level would be if it were more than 150%. A similar situation for the second category, more precisely for the ratio of total debts to equity.

Lately, managers of credit institutions in Romania have encountered many risks, the most important among which are:

- diminishing investor confidence in the current Romanian economy is on a high systemic risk;
- non-repayment of credits, especially those in the non-governmental sector;
- the strain on macroeconomic equilibrium is classified as a moderate systemic risk.
- the evolution of the real estate market leads to a low risk.

All of these are classified into 4 systemic risk categories: severe, high, moderate and low. Thus, in 2018 there were no severe systemic risks.

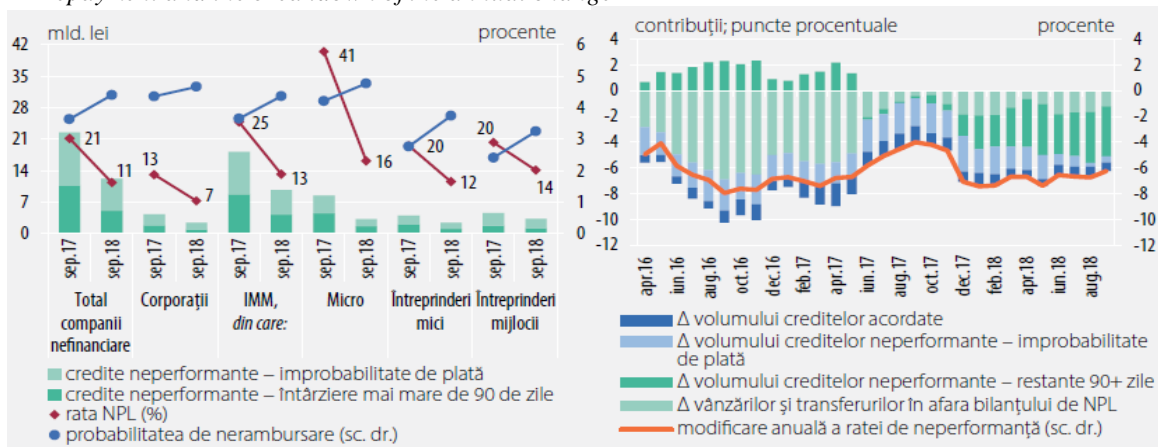
4. The rate of non-performing loans in Romania

In Romania, the rate of non-performing loans has gradually diminished as citizens have become more and more oriented on new loans, although the rate has increased by around 8 percentage points at the end of 2018 compared to the similar period of 2017. New loans contracted by natural persons increased by 12 percentage points in 2018 compared to the previous year, their value amounting to about 25 billion ROL, their destination being in real estate and sometimes in consumption.

Most of the loans were granted in Lei, especially in the first months of 2018, with an emphasis on fixed interest (for consumer loans) and a fixed interest rate of at least 5 years for mortgages. However, increasing the indebtedness of Romanian citizens could lead to negative effects on the financial system and on economic growth. In 2018, the economic and financial situation of the Romanian companies improved significantly, because the positive evolution was exemplified by the economic growth in Romania.

In 2018, the total number of credits granted in Romania increased, due to the implementation of the non-performing loans resolution measures, although in the last months the default rate determined only decreasing values, reaching a percentage of 9.5% compared to 12.2% exemplified at the end of 2017.

Figure no. 6: The rate of non-performing loans granted to companies in Romania, the probability of repayment and the breakdown of the annual change

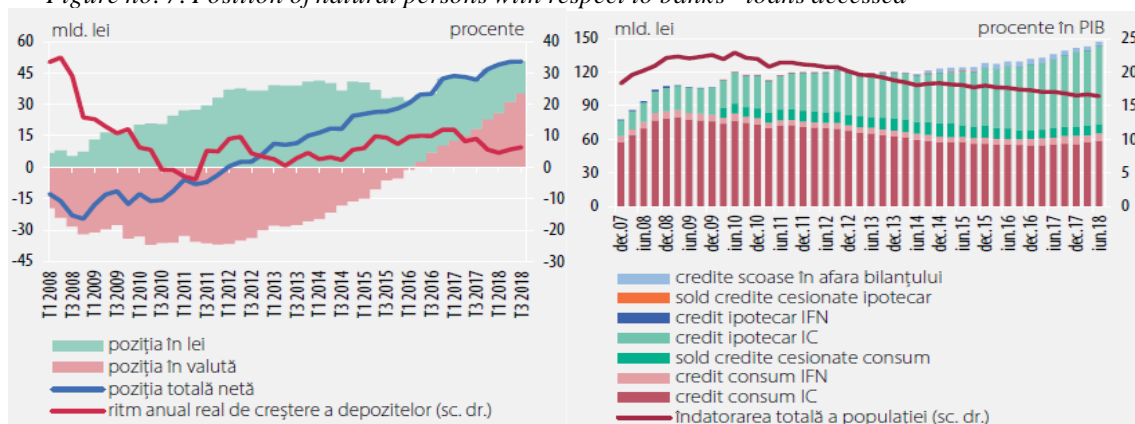


Source: (www.bnr.ro)

From the data presented, the probability of non-payment of loans to non-financial corporations increased by 8% in 2018 compared to 2017, but in each of the other categories of companies there is an increase in the non-reimbursement of credits in the last year, and the lowest growth percentage has been identified in corporations. However, non-performing loans have been very much allocated to SMEs at around 18%, other forms of non-financial companies have been allocated up to 5 percentage points of total loans. The volume of credits granted over the last 3 years is oscillating, however, the annual change in the rate of non-performance between April 2016 and August 2018 shows an insignificant difference. In June 2018, the probability rate specific to credits taken by non-financial corporations was 3.1 percentage points, much lower than in the previous year, and by 2019 it is forecast to reach 4.8 percentage points.

At the end of last year, Romanian citizens strengthened their position as net creditor to the banking sector in Romania, as they managed to record a total of 50.5 billion lei, a rise mainly due to salary increases in the last period 2017-2018, the evolution of the population lending preferences is illustrated in Figure 7. The analysis is carried out over a period of 10 years (2008-2018), and the evolution of the total debt of the population is also identified here.

Figure no. 7. Position of natural persons with respect to banks - loans accessed



Source: BNR

From the data presented, it can be concluded that citizens' preferences for loans in ROL started to increase by about 35%. When analyzing the net position for foreign currency loans, they were exemplified in September 2018 as double compared to September 2017, even though the growth rate of deposits was lower than that of lending. The total debt of Romanian natural persons gradually increased, reaching 147 billion Lei, by 8.3 percentage points more in June 2018. This increase was due to the increase in the demand for mortgage banking, by about 14 percentage points at the end of 2018, in line with the increase in consumption-oriented loans, by around 6

percentage points. Total citizen's indebtedness increased from 2007 to 2010, then declined year by year, until it reached a similar figure at the end of 2018 with the one at the start of the analysis, illustrating a decline of 0.4 percentage points in June 2018 compared to June 2017. Consumer credit IC and IFN had approximately the same evolution as the total debt of Romanian natural persons, but the highest values are recorded during the financial crisis, mortgage credit is more visible in the last 5 years, it exemplifies a total of 25 percentage points, compared to consumer credit which manages to reach just 10 percentage points at the end of 2018.

In conclusion, the dynamics of bank credit was influenced by the decisions of credit institutions and those of debtors who want to repay their debts, or part of them, in advance.

5. Conclusions

Specialists believe that the Romanian banking system is moving towards a favourable line, managers are much better prepared than they were before the financial crisis, they are able to overcome certain unforeseen situations because they are based on certain aspects that simplify their activities:

- foreign exchange reserves increased by about 5 billion Euro at the end of last year, compared to 2008, reaching a total of 32.4 billion Euro.

- Romanian banks are no longer completely dependent on external financing, as the share of external liabilities of the total of liabilities diminished to 9.1% in 2018 and the risk of debt financing decreased to 2.7% in the past 10 years.

- the banking financial system is better consolidated, became much stronger, no longer needs the Romanian state's intervention for recapitalization, managed to rapidly reduce the rate of bad loans in the Euro area, decreased the currency risk.

As a result, the profitability of the banking system is above the European average, as at the end of 2018 a capital return of 15.7% was identified, compared to 7.2% determined in Euro zones. The main reason for this is the reduction of net expenditures, but also due to a robust pace in lending. Thus, interest income in Romania is the main source of operational income for credit institutions, and financial intermediation is assimilated to the ratio between lending and deposit rates (services for citizens).

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