

## CHALLENGES FOR BANKS IN ROMANIA IN THE INTERNATIONAL ECONOMIC CRISIS

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*In this paper we are analyzing the current state of the Romanian banking system which is facing different challenges due to the economic crisis. Identifying the main channels of crisis transmission, we can notice that the banking system has played a major role due to its structure, and the change of the banking behavior on the Romanian market. Analyzing the main indicators reflecting the health of the banking system, hence of the economy, generally speaking, the paper is trying to identify the measures which should have been taken and we still believe should be taken in order to obtain the economic recovery, the premise of a healthy economic growth.*

*Keywords: financial crisis, channel of transmission, Romanian banking system*

JEL classification: G01, G21

### 1. The general frame

Considering the latest evolutions, the Romanian banking system can be considered as being stable, with a level of capitalization, solvability and liquidity according to prudential demands, despite accelerated crediting in the latest period of time and the deep effects of the international economic crisis. In general, the level of prudential indicators does not produce major concerns, but the tendency has to be monitored carefully taking into consideration the uncertain perspectives of the world economy. According to Professor Victor Jinga, the banking system<sup>534</sup> is „an assemble of different banks, organized around a Central Bank, in order to coordinate the discount and re-discount of credits, placements and management of bank deposits”. The Romanian banking system is organized on two levels<sup>535</sup>:

- At the *top* – the National Bank of Romania, as a central bank for the Romania, exclusive emission body;
- At the *base* – commercial banks.

The central bank should ensure sustainability of the banking system, influence its behavior in order to fulfill objectives of the economy<sup>536</sup>. With the adhesion of Romania to the European Union, in 2007, The Romanian National Bank has become a member of the European Central Banks System (SEBC), and the Governor of BNR, a member of the European Central Bank General Council (BCE).

Taking into consideration the fact that the banking system was organized on the form of ownership, until December 31<sup>st</sup> 2009<sup>537</sup>, the Romanian National Bank has authorized 42 credit

<sup>534</sup> Victor Jinga, *Currency and its Contemporary Problems*, Editura Dacia, Cluj Napoca, 1981.

<sup>535</sup> Ligia Golosoiu, *Means, Methods and Instruments of Payment*, pg4, [www.biblioteca.digitala.ase.ro](http://www.biblioteca.digitala.ase.ro).

<sup>536</sup> Daniela Zapodeanu, *Currency and Credit*, Univesity of Oradea, Oradea, 2006.

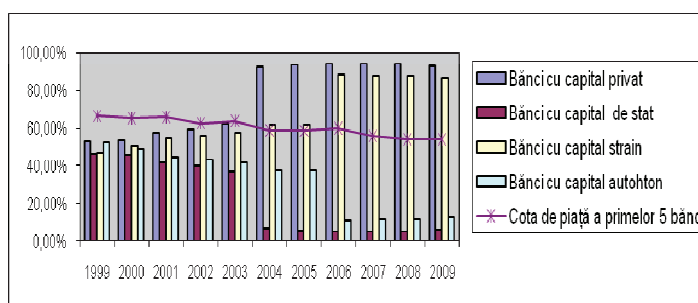
<sup>537</sup> National Bank of Romania – Monthly bulletin December 2009.

institutions, Romanian legal persons, to service financial services in national currency and in foreign currency, of which there are 2 state owned capital banks, 4 private national owned capital banks, 4 private national owned capital banks, and 25 foreign owned capital banks, 10 subsidiaries of foreign banks and Creditcoop.

Table nr.1- Credit institutions

	number	
	dec. 2008	dec. 2009
State owned capital banks	2	2
Private national owned capital banks	3	4
Foreign owned capital banks	27	25
Subsidiaries of foreign banks	10	10
<b>Total banking system</b>	<b>42</b>	<b>41</b>
Creditcoop	1	1
<b>Total credit insitution</b>	<b>43</b>	<b>42</b>

Fig.1. Share of assets according to the source and structure of capital<sup>538</sup>



About the share of assets according to the source and structure of capital, in the 2000's **almost 50%** of the assets in the banking system were owned by state owned capital banks as opposed to 2009 when under 7% of bank assets were owned by state banks. Even though they own more than half the banking system assets, the first 5 banks according to the level of assets have continued to narrow down their heft in the banking system, from 56,3% in December 2007, to 54,3% in December 2008.

This reduction of the market share in favor of smaller banks has occurred because of the higher and higher level of offer attraction and diversity of bank product and also because of the aggressive policy of client portfolio widening.

Table nr.2: Net assets<sup>539</sup>

	Ponderosity(%)	
	dec. 2008	dec. 2009
State owned capital banks	5,2	7,3
Private national owned capital banks (including the subsidiaries of foreign banks and Creditcoop) <i>Of which:</i>	94,8	92,7
Foreign owned capital banks , <i>Of which:</i>	88,2	85,3
Subsidiaries of foreign banks	5,6	7,4
<b>Total credit institutions</b>	<b>100,0</b>	<b>100,0</b>

The net assets of the banking system was 330,6 billion lei at the end of 2009, similar to the level of December 2008. In its structure, the private segment continues to hold the dominant position (92,7%) and the public segment holds 2,1%. The stagnation of net assets is attributed mainly to the divergent evolution of the main components. On one hand , the

non-bank clients credit activity has tightened with 4,4% in real terms compared to last year, their

<sup>538</sup>

Source for the data: Report on financial stability 2009, [www.bnro.ro](http://www.bnro.ro).

<sup>539</sup>

Banks (legal romanian persons), subsidiaries of foreign banks and Creditcoop.

heft lowering to 60,2% with 3% less. On the other hand, the credit institutions prefer placements in state notes, their heft in the structure of the assets had a significant rise (from 3,3% to 7,9%). When it comes to foreign owned capital banks, the first 3 countries regarding the capital level are: Greece (22,4%), Austria (8,4%) and Holland (9,2%). The most important change was attributed to Greece, which starting 2008, has transferred to the first position of the top foreign capital participation in Romanian banks.

## **2. Ways of transmitting the crisis in the Romanian Banking System**

The rush for widening the clients' portfolio in order to obtain higher profitability seems it hadn't the anticipated effect, on the contraire, has led to the alteration of the bank's financial situation, which did not think about the fact that more is not necessary better. From this to the financial crisis of 2008 was not a long road. This recession period is, according to Daniel Daianu, the result of the fact that not enough was learned from previous crisis episodes during the latter two decades, and we did not pay attention to the severe warnings from prestigious financial experts. History has also shown that excessive greed is the recipe for failure.

We can affirm that the banking system has played a decisive role in triggering the crisis, which as expected created the spillover effect, flooding all sectors, mutating from a banking crisis into a financial one and further into an economic one.

Most economic analysts have identified a moment and a place for the crisis emergence, the dramatic fall of the home prices in the US, manifested starting 2006, followed by the collapse of the mortgage market, but its causes are pre-sciented from the beginning of the century. The blame falls on the monetary policy adopted by banks from grate world powers – US, Japan, UK – characterized by a low interest rate that facilitated the populations' access to cheap crediting.

As a result, this led to excessive liquidity, which increased consumption of goods and services. The immediate consequence was an ungrounded rise in home prices generating a real-estate boom.

Another cause of the actual crisis is moral hazard<sup>540</sup>, a concept based on the principle too big to fail, according to which the state rescue coil for corporations, that cannot be left to bankruptcy, being too important for the economy. The banks now act more irrationally and riskier. Relaxing the crediting conditions for the population did not stop at low interest rates but also the eligible credit receivers range was widened. The debtors were not sufficiently analyzed and credits were given to people that had a bad credit history: late bill payments, low income, residual rates for other credits, inadequate guaranties. So subprime credits had a major contribution in triggering the crisis, because it determined the accumulation of underperformance credits in the banks portfolios.

Financial innovations also had a negative effect because they were followed by a lack of market transparency. Asset Backed Security bonds were created, which means a bank sells low liquidity assets to an intermediate firm that finances the transaction by emitting certificates guaranteed by the previous mentioned assets. The bank is benefits by taking these credits out of the balance<sup>541</sup> and by gathering liquidity that can be invested in profitable activities, or using it to pay dividends or to give credits.

None the less, rating agencies activities can be questioned. There is a conflict of interest because the rating agencies are paid by those whose instruments they evaluate. As a result it is highly likely that the rating does not reflect the reality and it creates the impression that the instruments or the financial institutions are safe when in fact they have a high risk incident<sup>542</sup>. So the

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<sup>540</sup> Cosmin Marinescu si restul, *Economic Crisis and Capitalism*, the Centre for Economics and Liberty.

<sup>541</sup> Silviu Cerna, *Turmoil in International Financial Markets: Causes, Consequences, Remedies*, West University, Timisoara.

<sup>542</sup> Luminita Todoran, *Financial crisis' effects on the Romanian economy*, West University, Timisoara.

objectivity of these agencies can be altered and this would lead investors to erroneous decisions. Analyzing the succession of events that paint the crisis picture we notice that the first moments of decay for the American economy appear in 2006, when the volume of sales decreases and the non-imbursed mortgages increase. The follow-up is the great number of bankruptcies in 2007 beginning with New Century Financial, specialized in subprime credits. 2008 is the year of bankruptcies and surprising nationalizations: Bear Stearns, Fannie Mae, Freddie Mac, Merrill Lynch, Lehman Brothers. Financial turbulences are felt all around Europe, starting with UK, Holland and short after by the official recession of the US (December 1<sup>st</sup> 2008), and of the Euro area.

How was the crisis exported into Romania? The answer that puts together all the channels of crisis transmission is: Globalization! The development of commercial relations between countries determines a propagation of unbalances much more rapid towards partners of the affected countries. If in July 2008, Lucian Croitoru was transmitting an optimistically message, as an advisor for the BNR governor, saying that “the Romanian banking system is feeling good”, because “international turbulences have not affected it<sup>543</sup>”, presently we are searching for measures to limit the crisis effects on our economy.

The crisis was transmitted into Romania through different channels, indirectly (commercial channel, financial channel, trust channel, balance) and directly (bank sector, capital market and foreign currency channel). Through the commercial channel Romania is affected by its commercial relations with the US and other EU states noticing fewer export or even no exports at all in certain sectors. Through the financial channel, the crisis limits access to external financing and diminishes the crediting volume generating difficulties that “helps” external private debt. Regarding the trust channel, a lot of foreign investors have left Romania, which had as an effect the remission of the foreign investments flux. On the effects channel a deterioration of the population and companies net asset took place, following the fact that foreign currency credits had a high heft and because the fall of mobile and immobile assets prices.

Directly, the most exposure to the crisis’ effects had the Romanian Banking System, because of the fact that it is mostly made out of foreign owned capital banks. As so, problems could rise regarding refinancing resident banks, and its consequences would be the limitation of credit lines for Romanian banks, meaning a more difficult access to external financing for the Romanian private.<sup>544</sup> A positive aspect of the fact that Romania’s Banking System has not been exposed to toxic assets, not emitting mortgage guaranteed bonds, and also the fact that the heft of the mortgage client in the amount of non-governmental credit is relatively small. When talking about the capital market, we can observe that the evolution of Bucharest Stock Exchange’s indicators has been affected, especially on the financial institutions bonds segment, and the liquidity of the market has reduced. The effects of the crisis were felt on the foreign currency channel also, the volatility of the exchange rate has affected economic agents and also people. The RON depreciation created difficulties for importers and debtors that have taken loans in foreign currencies, while the appreciation over a certain limit has under-privileged exporters.

### **3. The condition of the Romanian Banking System in the economical crisis context**

At macroeconomic level, in Romania, the economic growth took place on unsustainable basis, based on credit consumption of imported goods. As a consequence a current account deficit took place, which indicates the dependence of external financing<sup>545</sup> so that governmental credits

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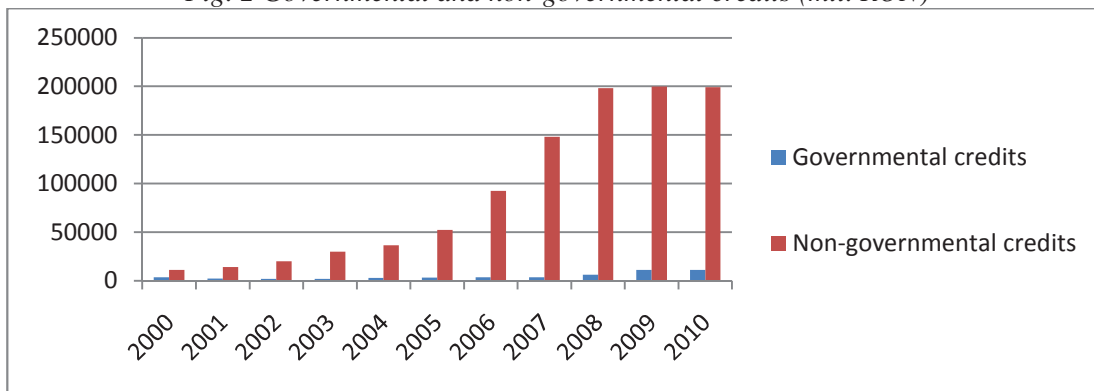
<sup>543</sup> Lucian Croitoru, interview given to the ‘Bursa’ magazine.

<sup>544</sup> Silviu Cerna, *Turmoil in International Financial Markets: Causes, Consequences, Remedies*, West University, Timisoara.

<sup>545</sup> Mugur Isarescu, *The International Financial Crisis and Challenges for Monetary Policy in Romania*.

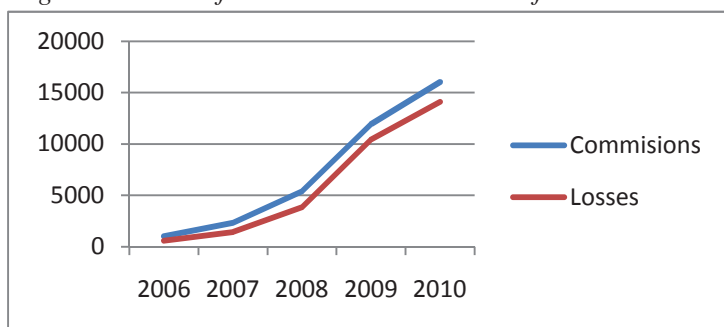
become double in 2009 compared to 2007. As non-governmental credits are concerned there is a roof level beginning 2008, when in previous years there was an alert growth due to the unsustainable economic growth.

Fig. 2 Governmental and non-governmental credits (mil. RON)



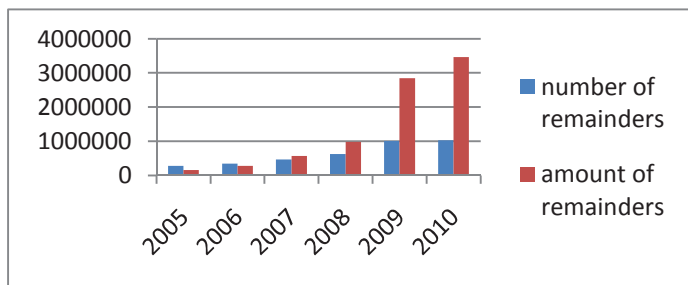
The roofing took place after the crisis begun because fo the reticence towards credit of nonbanking economic agents but also because of the alterations in the banks consumers behaviour. Banks have become more prudent regarding credits for crisis affected sectors (constructions, petrol industry, automobiles, textile industry).

Fig.3 Evolution of commissions and losses of banks



The reticence of banks to give credits is put upon the growth of losses, which led to more commissions, limiting the crediting possibility.

Fig.4 The evolution of number and amount of bank remainders



Economic growth based on credit consumption of imported goods facilitated the conditions of crediting during 2006 and 2007. We could notice that after that period, beginning 2008, and an increase in the number of arrears. The remainder sums grow at a higher rate because of remainder credits.

### Conclusions

Taking into consideration these characteristics of Romania's economy, the answer to the adverse effects of the crisis cannot be similar to the one formulated by some European countries or the US. The measures used in other countries cannot be simply duplicated. At a macroeconomic level, the main stimulation measures for the economy are as followed:

-adopting a complete and coherent mix of policies, by strengthening the fiscal policy and the income policy<sup>546</sup>;

-improving the absorption capacity for structural funds and replacing the private external financing with public external financing;

-creating new jobs in less occupied domains (infrastructure, tourism, food industry)that can slowly take on the role of an economic growth motor.

As the banking system is regarded, we believe that a series of actions are necessary in order to relaunch the activity of financial institutions like:

-holding the credit lines from mother banks towards their subsidiaries;

-relaunching the crediting process;-sustaining the national currency credits;

-a careful analysis of credit applicant, that take into consideration their capacity to reimburse the credit;

-soliciting guaranties accordingly to the given credit by orienting towards complementary services: Internet Banking, Mobile Banking, Home Banking;

-stimulating economy on one hand, and the justified consumption on the other hand.

After the year 2008 has been characterized by significant growth in all areas, 2009 has brought the most severe crises ever experienced in the latest decades. It seems that 2010 won't be problems free, because Romania's banking system profitability will remain at a low level, the level of un-efficient credits is expected to rise, the volume of the populations' and companies' deposits will also rise, 2010 being considered a year of economy. Probably, the banking system will know a visible come-back only in 2011.

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