THE IMPACT OF THE FINANCIAL AND ECONOMIC GLOBAL CRISIS OVER THE ROMANIAN BANKING SYSTEM

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This paper analyzes the evolution of the Romanian banking system during 2007 - 2010 compared to the same segment of financial market dynamics in the Member States. Also seeks to detect the effects of the global financial and economic crisis on lending activity, the management of liquidity risk and thereby the effect on the profitability of the Romanian banking sector and outline the prospects of further development.
The macroeconomic and financial international background has undergone negative changes, especially in the autumn of 2008. Romania's financial system has evolved but strongly marked by the virulent manifestations of global financial and economic crisis. The banking system which is the dominant component in the financial system is well capitalized, has resisted, until now, these pressures, without recording any bankruptcy.
As a lending crunch from the increase in provision expenses, against the backdrop of bad loans it seems to be a poor performance of the banking system for the future period, taking into account the negative financial result recorded at the end of 2010.
Given the high degree of capitalization, liquidity level indicators, on this, consider that local banks are well placed to support the real economy on long-term lending conditions imposed by prudential regulations in the field.
Currently, at the level of the Romanian banking system, we consider it is necessary to continue the measures imposed by the monetary authority to ensure the reduction of uncertainty and reassure market participants in future developments, as trust is the essential factor for the crisis. In this sense, we consider very important the debate, the direct involvement of representatives of the central bank and academic themes reflecting the current state of the Romanian financial system, lessons learned from the crisis and Romania's objectives for the future - providing a sustainable process of nominal and real convergence of the Romanian economy - towards European integration in a not too distant horizon.

Keywords: financial crisis, Romanian banking system, non-performing loans, profitability

JEL classification: G01, G2, E51

Introduction

The current crisis has occasioned extensive debate on its causes and devastating effects on the banking sector, which is the largest regulated compared with other sectors of the financial market.
Comparing banking crises in the period 2008 - 2009 by the Great Depression (Richhild Moessner and William A. Allen 2010:11) shows that the size of the current crisis, commensurated with the decrease in international short-term borrowing and the amount of bank deposits was lower than the one in 1931. However, the amount of liquidity provided by central banks was higher than in 1931, when it was restricted by using the gold standard in most of the states.
The Professor (Silviu Cerna, 2010:79) notes the same thing, "the current crisis is very similar with other crises from the past".
(Marie Stephanie Stolz and Michael Wedow 2010:7) believes that consistent public support for the financial sector was the key to managing the current financial crisis.

The literature also suggests that the recent crisis reflects not only the unsustainability of global macroeconomic imbalances, but also proliferation of toxic financial instruments, a lack of authority of supervisors and unclear demarcation of the powers of the regulator.

The factors mentioned above, according to (Ross Levine, 2010: 3,7) have played a partial part. The submission of inadequate policies has created, in fact, vicious incentives which have encouraged the financial institutions to take excessive risks, diverting the public savings to unproductive targets. He also argues that there are major contradictions between a dynamic financial system and a regulatory system that failed to properly adapt to financial innovation. Thus, failures of governance in financial regulation have supported the international financial crisis.

Measures taken by governments and central banks in the U.S. and the EU in response to the crisis have been broadly similar. Thus, firstly, there have been used broadly the same instruments such as government guarantees, capital injection of liquidity, asset protection, secondly all were in used similar scope. Also, monetary policy actions and measures to rescue banks were increasingly intertwined. But as it is highlighted by (Marie Stephanie Stolz and Michael Wedow 2010: 16) there are important differences between the measures of political support taken by the U.S. and EU. While the Fed was more expansive and focused more on the individual financial intermediaries, the Euro system's operations were limited to providing liquidity.

In Romania, the state did not have to intervene to save the banks from the global financial maelstrom, as happened in the above areas, particularly in the U.S..

In the period 2009 - 2010, additional capitalization was provided entirely by the shareholders in case of entities within the Romanian banking system.

This paper is structured so as to allow exposure of the latest developments in the Romanian banking system in the period 2007 - 2010, being strongly marked by virulent manifestations of the global crisis and to outline future trends for the future period.

1. The Characteristics of the Romanian banking sector

The effects of financial and economic global crisis have intensely impacted the first months of 2009 and the financial system in Romania, namely the banking sector which is the dominant component in it. By the time Romania joined the European Union (1st of January, 2007), the industry has come a long process of privatization which was long overdue and which resulted in a strong infusion of foreign capital. In large part, the banks in the system are majority foreign-owned (76.9%), and their share in total bank assets is (86.1%), according to the latest developments (Table no. 1).

Table no. 1. Structural indicators of the Romanian banking system

	2007	2008	2009	2010
Number of credit institutions	42	43	42	42
Number of banks with private capital majority	40	41	40	40
Number of foreign-owned majority capital banks, from which: - Branches of foreign banks	36 10	37 10	35 10	35 9
Share in total assets of banks with majority private capital (%)	94,7	94,6	92,5	93,2
Share in total assets of banks	88	88,2	85,3	86,1

	2007	2008	2009	2010
with majority foreign capital (%)				
Share of top five banks in total assets(%)	56,3	54,3	52,4	53,1
Herfindahl – Hirschman parameter	1.046	926	857	874

Source: National Bank of Romania

As shares in the share capital of domestic banks and foreign branches in late 2009, the first three positions were occupied by Greece (26.6%) held position at the end of 2008, Austria (16.9%) and Netherlands (9.0%).
As one can see in the table above, during 2007 - 2010, the Romanian banking sector structure in terms of number of credit institutions and foreign capital share in total sector assets examined, has not encountered significant changes.
Instead, it should be noted that the degree of concentration in the Romanian banking system remains a downward trend throughout the analysis period since 2007, as we show the Herfindahl - Hirschman Index (HHI), which is calculated by:

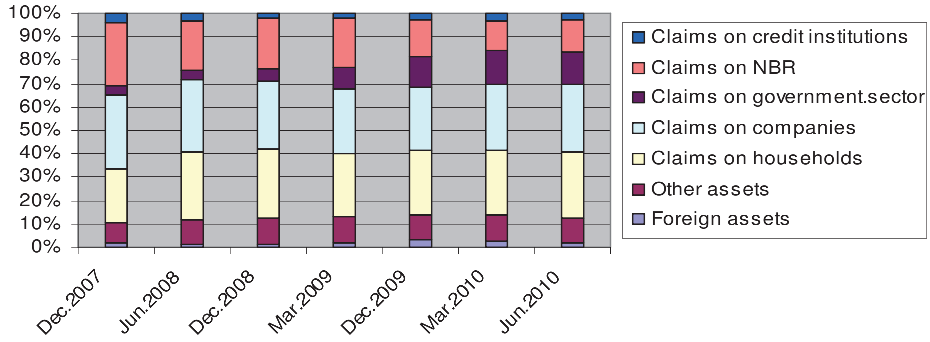
$$IHH = \sum_{i=1}^{n}\left(\frac{A_i}{A}\times 100\right)^2, \text{ i=1, …, n} \quad (1)$$

where: Ai = corresponding to period-end balance sheet net assets of the credit institution "i";
A = the aggregate net level of the balance sheet asset (from the total banking system).
It should be noted that for values between 1000 and 1800, the Herfindahl - Hirschman parameter means an average concentration of the banking system. For Romania, the concentration of the banking system remains at a moderate level, which is below the EU average of 1120 points for 2008 (Mugur Isărescu, 2009: 319).
With regards to the level of financial intermediation calculated as a percentage of non-government Domestic Product (GDP), Romania remains below the EU Member States, namely below 50%, although in recent years, it has recorded a very high government credit rate, until the autumn of 2008, due to uncertainties caused by the global financial crisis.

2. The impact of the financial crisis over the lending banking sector

Since the first quarter of 2009 and so far, the international financial crisis had an impact on the Romanian banking sector, in particular over the external liquidity channel, also the macroeconomic conditions were significantly affected. Thus, the Romanian economy went into negative territory where real GDP registered a severe contraction (by 7.1% in the year 2009) and (1.3% in the year 2010) and the fiscal deficit rose to 8.3% of GDP for 2009.
Amid the problems outlined above, during 2009-2010, there were significant changes in the dynamics and structure of the Romanian banking system assets (Chart no. 1).

Chart No. 1 Structure of the Romanian banking sector assets



Source: the author

During 2009, credit released to the private sector registered a contraction for government securities, which rose 3.7 times at end 2010 compared to 2007, under the bank's risk aversion and uncertainty about future developments to maintain the domestic and financial international market.

Being noted that in June 2010 there has been noticed a return of non-governmental credit, an increase of 6.4% compared to June 2009.

It also notes that investments of domestic credit institutions had a decreasing trend over the period, the fund reserve ratio reductions level operated by the central bank. However, foreign assets have a slightly upward trend, increasing balance of loans due to non-euro residents.

3. Quality assets and significant risks

First, we deem it necessary to present, in the context of deteriorating domestic economic climate more pronounced in January 2009-September 2010 and existing liquidity problems on international markets, changing the behavior of the Romanian banking system, which is much more cautious in lending.

According to the evolution of the data in (Table no. 2), it concludes that we have overcome a well-capitalized banking system, the levels recorded at the two indicators: solvency and leverage, in the period, are maintained at an appropriate level above the regulatory minimum (8%) and harmonized with those in force in EU. The Solvency parameter is maintained at the same level in the last two years, the fund raising of capital by shareholders reduce credit and non-government credit growth.

Table No. 2. The main prudential indicators

	Indicators	Dec.07	Dec.08	Dec.09	Dec.10
Capital adequacy					
1	Solvency ratio (>8%)	13,78	13,76	14,67	14,66
2	Leverage ratio (Tier 1 capital/ Total assets, average)	7,32	8,13	7,55	7,87
Asset quality					
3	Loans (gross value)/ Total assets (gross value)	59,09	62,50	59,13	58,66
4	Interbank placements and loans	29,98	26,01	23,03	19,59

	Indicators	Dec.07	Dec.08	Dec.09	Dec.10
	(gross value) / Total assets (gross value)				
5	Past-due and doubtful loans / Total loan portfolio (net value)	0,22	0,32	1,45	2,22
6	Past-due and doubtful claims / Total assets (net value)	0,17	0,29	1,01	1,49
7	Credit risk ratio	4,00	6,52	15,29	20,81
8	General risk ratio	56,94	50,73	47,29	44,56
Liquidity					
9	Cash ratio	38,70	34,43	35,28	35,9
10	Liquidity ratio (effective liquidity/ required liquidity)	2,13	2,47	1,38	1,36
11	Loans to clients / Deposits from clients	108,7	122,0	112,80	117,95
Profitability					
12	ROA (Net profit/ Total assets, average)	1,01	1,56	0,25	-0,09
13	ROE (Net profit/ Own capital, average)	9,43	17,04	2,89	-1,02

Source: National Bank of Romania

In the period 2009 - 2010, lending activity registered a downward trend, just as the indicator shows the evolution of credit extended to customers in total assets, the gross amount, from 59.13% to 58.66% in December 2009 and at the end of 2010, compared to 62.50 lei as it was before the crisis.

In this case, both supply and demand for credit continued to be influenced by several factors, such as the supply side - (i) maintaining tighter lending standards and terms, (ii) reducing the excess liquidity inside the banking system, (iii) increase of government securities held by credit institutions. At the level of loan demand inhibitors were the most important factors were: (a) maintaining the high cost of credit, (b) the volatility of currency exchange rate, (c) negative view of economic growth and unemployment and (d) the increasing inclination for people to save.

According to the unfavorable evolution of the indicators that reflect the quality of loan portfolio which has increased the vulnerability of the banking system over the period analyzed. Thus, credit risk, which is considered one of the most important risks in recent years has gained a high level in the late 2010 and 20.81% compared to the level before the crisis, 4.00%.

The results of the stress testing exercise over the credit institutions run by the NBR in July 2010 for a two-year horizon, show us that the impact on loan portfolio quality is significant. Increased costs (provisions) that the impairment of financial assets was approximated to 38% in 2010 and 21% for 2011, this trend is confirmed in practice.

In December 2009, loan portfolio quality in the banking sectors in the EU Member States had the same negative trend as in Romania, their level doubled from the previous period. In late 2008, the rate loans/ deposits reached 122%, and in February 2009 began to decline due to the concentration of the banking entities to attract deposits from customers and lending moderation. The ratio level at 31st of December 2010, of 117.8% indicates limited level of liquidity in the system.

4. Profitability of the banking system – trends

At the end of 2009, the Romanian banking system registered a net profit of 193 million euros. Compared with 2008, the aggregate profit fell more than 5 times because of bad loans and thus increased the spending provisions to cover credit risk assumed combined with low incomes.
An entirely different situation is found in the year 2010 when the Romanian banking system registered a negative financial result - an aggregate cash net loss of 71 million. The main factors affecting the profitability of the system in 2010 were: the relative lack of liquidity of foreign markets, indirectly affecting bank operations in Romania, increased risk aversion of banks and increased provision expenses.
Thus, both ROA and ROE indicators (Table No. 2) have negative values at the end of 2010 (-0.09% and - 1.02%).
Here, given the current circumstances, we conclude that the profitability of the banking system will remain under pressure, given the unfavorable trend of deterioration in asset quality, which involves increasingly reserves, according to delay economic recovery, amid a recession and persistency in a limited risk appetite for banks.

Conclusions

Currently, at the level of the Romanian banking system, we consider it is necessary to continue the measures imposed by the monetary authority to ensure the reduction of uncertainty and reassure market participants in future developments, as trust is the essential factor for the crisis. In this sense, we consider very important the debate, the direct involvement of representatives of the central bank and academic themes reflecting the current state of the Romanian financial system, lessons learned from the crisis and Romania's objectives for the future - providing a sustainable process of nominal and real convergence of the Romanian economy-towards European integration in a not too distant horizon.

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