CURRENT TRENDS IN THE EVOLUTION OF BANK COSTS WITHIN THE FRAMEWORK OF THE ROMANIAN BANKING SYSTEM

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General considerations

Under the conditions of economic globalization it is unanimously accepted the fact that a healthy banking system is based on profitable and capitalized banks in an adequate manner. The banks' profitability is a relevant indicator of their competitive position on the banking markets and their managing team quality.

The incomes and costs of the banks represent a key source of information regarding the profitability of a bank all over the world but also in a difficult banking system such as Romania's, the attention being focused on costs and their possible reduction.

The optimization of the report between the incomes and the costs of the bank is the essential objective of the banking management with a direct influence on the bank profit, it being an important side of the evolution of the banking performances.

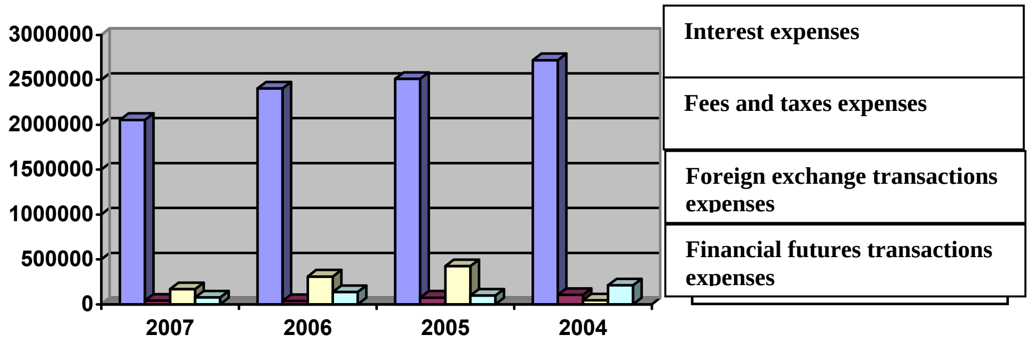
Within this context we consider as particularly important an analysis of the bank costs into the framework of the Romanian banking system, analysis which targets their structure on one side and their evolution on the other.

The first year of Romania's accession to the European Union put the Romanian banks in straight competition with the foreign ones, and made the players on the market face an authentic competition. Our country's EU membership will disseminate its effects in time, but the adjustments of this new capacity can already be seen in our banking environment, where aside from winning a market share at the expense of the other competitors and developing clients' loyalty, a major objective of the credit institutions is represented by the reduction of bank costs.

1. The evolution of the income – expense report within the framework of the banking system

Analyzing the financial statements published by the Romanian National Bank (RNB) at the end of 2007 in comparison with the previous years, we notice a rejuvenating of the growth rhythm of the profit against the one registered in the last years, based on the superior performances accomplished, especially at the level of large credit institutions. The profitability rates have continued their slightly descending trend although the evolution of the operational efficiency was positive in 2007 based on an increased interest from the credit institutions over the judicious costs management.

Diagram no.1 The evolution of the main expenses groups within the framework of the banking system

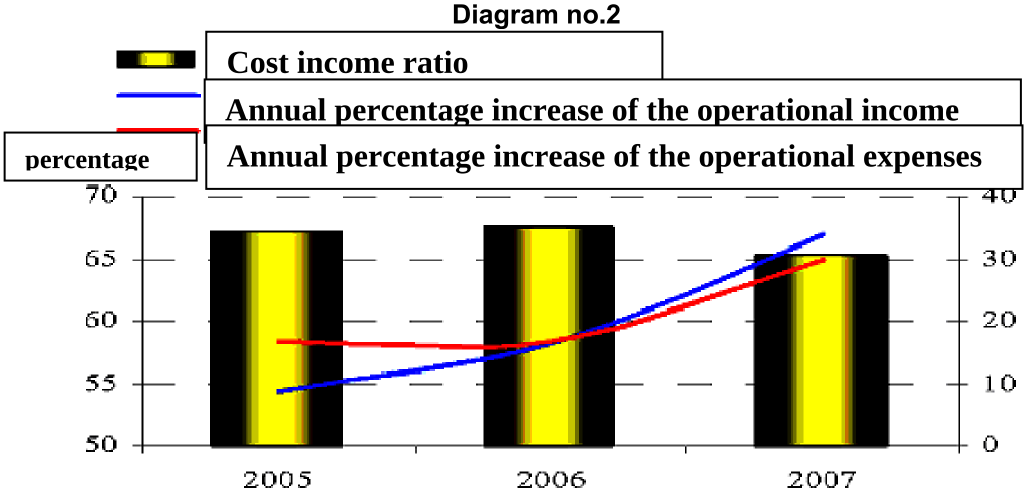


Source: Own calculation based on RNB reports

2. Cost efficiency analysis

The capacity of the credit institutions to control the operational costs in the context of rapid expansion of the crediting activity, improved over the year of 2007, the 65,3% value of the cost income ration being reduced by approximately 2,2 points in comparison with the level registered in the previous year.

Diagram no.2



Source	NBR

This performance was obtained based on a superior dynamics of the operational income in comparison with the operational expenses.

The structural analysis of the operational income emphasizes the diversification of the sources of gains of the banks, due to the fact that full advantages was taken from the opportunities offered by the financial market.

We can see that the net income from foreign exchange transactions was the most dynamic component of the operational incomes, whereas, the fees incomes standstill at approximately 18% in the operational incomes registered in 2006, their value increasing to a similar rhythm to the one of the operational incomes.

The interests from net incomes have reduced their weight in the operational incomes based on a slower increase of the interests incomes in comparison with the one of the interests expenses, the substantial increase of the interests expenses against the same period of the previous year is mainly due to the increases registered at the level of the paid interests for the deposits drawn from other credit institutions but also from those relating to the loans drawn from them.

The recent disturbances on the international financial markets have increased even more the volume of the interests expenses by increasing the interest rates associated to the interbanking resources.

3. Operational costs analysis

As the diagram below shows, in the operational expenses structure, the personnel expenses continue to represent the main component based on the increase of the number of the banking officers with 7648 persons, against 58536 persons in the year 2006.

Diagram no.3

Source: NBR

At the same time, the expenses on materials, works and services performed by third parties but also the amortization expenses have not registered significant side slipping.

The contingencies expenses have increased in real terms in 2007, mainly as an effect of the non governmental credit expansion, but also due to legislation changes.

Keeping with the strict levels of the profitability set by the shareholders and the increasingly competition on the Romanian banking market are pressure factors over the credit institutions in finding proper solutions with regard to continuing the positive dynamics of the efficiency of the banking activity. The profits arise more and more from the volume of the activity with valuable effects over the financial mediation in Romania.

Romania is ranking 5th in a top of the member states of the European Union as regards the differences of the banks' tariffs for the services they perform, according to a report of the World Bank, Capgemini, ING and the

European Financial Marketing and Management Association.

The tariffs differences for the banking retail segment was calculated at 46%, Romania being on the fifth place in EU after Denmark, where the differences between bank tariffs can reach 154%, Ireland 51%, Spain - 50% and Slovakia - 47%. The analysts think that retail is still a national business and have analyzed the differences between the tariffs at a national level. It is stated in the report made by the World Bank, Capgemini, ING and the European Financial Marketing and Management Association that the differences are generally associated with the markets where the rhythm of the changes is rapid such as Spain and Ireland in the euro zone, Denmark, Romania and Slovakia outside the euro zone or China and India in Asia – Pacific.

The analysts note that on the mature markets, the tariffs of the banks are of close value due to competition. According to the report, this year, 40% of the incomes relating to the services performed by the Romanian banks will be obtained from account management, 32% from payments, 27% of the tariffs perceived following the use of cash, and 1% of different exceptional operations performed by the employees of the credit institutions, such as suspending some payments or documents searching.

At the level of all EU member states which have not adopted the euro, 20% of these incomes come from accounts management, 16% from the use of cash and 9% from exceptional operations. The greatest weight in the banking services incomes, of 55%, will be represented by the payments made by the clients of the banks.

Conclusions

In our opinion, the main challenge for the Romanian banking system is to join the competition for the reduction of the banking costs – because until now, there has been a fierce competition between the banks focused mainly on getting a market share.

Also, we think that the year 2008 could be a very difficult one for the banking sector in Romania. The profitability of the banks may decrease under the pressure of interest and competition margins, the costs increase with the investments for network expansion, but also the world crisis on liquidity.

In our opinion, another important factor which can reduce the profit rate at the level of the Romanian banking sector is represented by the increase of the contingencies need as an effect of the assisted credit dynamics, continuing the investments in the territorial networks, but also the costs related to the implementation of the Basel II Agreement.

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