CHARACTERISTICS OF THE ROMANIAN BANKING SYSTEM IN THE CONTEXT OF INTEGRATION IN THE EUROPEAN UNION

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Abstract:
This paper aims at emphasizing the transformations registered by the Romanian banking system in the last couple of years and, especially, in the context of Romania's integration in the European Union. Our analysis reflects the progress registered by our banking systems, as well as its gaps in comparison with other European Union Member States, situation which implies the need of accelerating the convergence process for the purposes of becoming part of the European Monetary Union.

Key words: *European integration, banks, financial intermediation, foreign capital, crediting*

JEL classification: G21

1. Introduction

The Romanian banking system's accession to the European Union on January 1st, 2007, was a significant moment in the banking history and it emphasized the significant progress in the legal, structural and operational fields that reduced the gaps between Romania and the EU Member States.

The changes made in the Romanian banking system may be highlighted using a composite index calculated by the European Bank for Reconstruction and Development (EBRD) for the assessment of bank reforms and of interest rate relaxation.

The following are taken into consideration when determining this index: the quality of regulation and monitoring activities, the type of property and the access of private sector to funding.

The values of this index range between 1 and 4+ with the following meaning: 1 represents low progress of the transitional process and 4+ reflects full compliance with the standards and performances of developed economies.

This transition of the Romanian banking system emphasized by the EBRD index is facilitated by the data presented in table 1.

With regard to the Romanian banking system, the values of the transition index calculated by BERD show that there is still room for improvements, despite the progress of reforms. The low score of Romania (3.3% in 2008 compared to 3.67% of Bulgaria and Poland) is due to its slower reforms.

Table 1: Assessment of the banking system's reform based on the EBRD index, in some countries in Central and Eastern Europe in the period 1990 - 2008

Țări	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bulgaria	1,0	2,0	3,0	3,0	3,3	3,3	3,67	3,67	3,67	3,67	3,67
Czech Republic	1,0	3,0	3,3	3,67	3,67	3,67	3,67	4,0	4,0	4,0	NA
Hungary	1,0	3,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0
Poland	2,0	3,0	3,3	3,3	3,3	3,3	3,3	3,67	3,67	3,67	3,67
Romania	1,0	3,0	2,67	2,67	2,67	2,67	3,0	3,0	3,0	3,3	3,3
Ungaria	1,0	3,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0

Source: http://www.ebrd.com/country/sector/econo/stats/tic.xls

2. Changes in the structure and regulation of the banking system in Romania

Subsequent to the restructuring and privatization process, the alignment of the Romanian bank laws to the European requirements and the extension of banking products and services portfolio, the Romanian banking system has significantly strengthened over the last years being now the most important component of the financial system (see figures in table 2).

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Table 2: The evolution of financial system assets in Romania, in the period **2003- 2007**

-% of GDP-

Financial Agents	2003	2004	2005	2006	2007
Credit institutions including CREDITCOOP	30,8	36,6	44,6	50,6	61,5
Insurance companies	1,8	1,9	2,2	2,5	3,0
Investment funds	0,1	0,2	0,2	0,3	0,3
Financial investment companies	1,4	1,3	1,8	2,3	2,8
Lease companies	1,8	3,0	3,6	3,4	5,0
Other non-banking financial institutions	0,4	0,6	0,9	1,3	1,5
Total	36,3	43,6	53,3	60,4	74,1

Source: National Bank of Romania, Financial Stability Report, 2008, www.bnr.ro

According to the data presented in table 2 we can notice that the Romanian financial system is mainly grounded on the banking sector, where credit institutions play an essential role in financing the real economy. Such characteristic of the local financial system is also found in the financial systems of Central and East European countries. So far, the banking system is mainly oriented towards traditional banks, whose main activity consists in the attraction of bank deposits and the award of credits. This is reflected by the structure of assets and liabilities. For example, at the end of 2008, loans represented 85% of total assets of financial monetary institutions, and the deposits from customers represented 75.6% of total liabilities. Although non-banking financial intermediaries have recorded a positive trend, they represent a small percentage of the total assets of the financial system. Thus, considering the banking system as the most significant financial agent, we may say that its strength and stability are essential to support the economic growth.

Romania's accession to EU raised the interest of foreign financial institutions in the domestic banking market, materialized in the establishment of new entities, by bank mergers and purchases of middle sized and small banks. The presence of foreign investors raised the competition level in banking industry – by offering new banking products and direct provision of services in Romania – leading to changes in the structure of domestic banking system. Thus, in 2007 the Millennium Bank, member of the Portuguese Millennium group, was established; three branches of foreign banks were opened (Fortis Bank S.A/NV Bruxelles, Bucharest Branch of Fortis Bank, the Romanian Branch of LA CAIXA Bank and Finicredito Branch of the Portuguese group Finibanco); HVB Țiriac Commercial Bank merged Unicredit Romania, and this newly established entity presently operates under the name of Unicredit Țiriac Bank S.A; the Romanian Branch of Blom Bank Egypt transferred its operations to the Romanian Branch of Blom Bank France S.A Paris; by the end of March 2008, in the context of the service market relaxation generated by Romania's accession to EU, BNR received 134 notifications from the monitoring authorities in the countries of origin of foreign financial institutions willing to provide direct services in Romania (123 credit institutions, 3 non-banking financial institutions and 5 electronic payment providers).

Table 3 presents the structural changes in the Romanian banking system, following the licensing of new credit institutions, the merger of certain existing banks, the variety of products and services provided by credit institutions, and the raise of their assets. Presently, the banking system includes 43 credit institutions, of which 10 are branches of foreign banks, mainly privately owned, as well as a significant weight of foreign private capital, with positive effects materialized in an improved corporate management of the banking industry, an increased efficiency of risk management and an improved stability of banks. In the context of Romania's accession to EU and the implementation of the Community law in the field of financial services, there has been recorded an increased number of branches of EU credit institutions on the domestic banking market.

The professional literature addressing foreign banks shows that they may contribute to the establishment of a solid and efficient financial system. Both research studies and practice show that the entry of foreign banks by mergers and purchases has positive effects on the increased efficiency of the banking industry.

Table 3: The trend of Romanian banking system structure in the period 2003- 2008*

		2003	2004	2005	2006	2007	2008
1.	Number of credit institutions, of which:	39	40	40	39	42	43
	Branches of foreign banks	8	7	6	7	10	10
2.	Weight of assets of privately and majority privately owned banks in the total assets of banking system	62,5	93,1	94	94,5	94,6	94.7
3.	Weight of assets owned by foreign or majority foreign banks in the total assets of banking system	58,2	62,1	62,2	88,6	87.7	88.1

* Indices calculated from the prudential reports of credit institutions

Source: National Bank of Romania annual reports, 2000-2006; http://www.bnr.ro/Statistics

The structural changes in the Romanian banking system is also emphasized in the view of the significant increase in the number of bank units, reflecting the banks intention to cover as many market sectors and to provide quality products and services, in order to attract and increase consumer loyalty. For example, in 2007, the number of local bank units increased by 41.83% compared to 2006. For comparison, in Bulgaria the increase was of only 4.63% (see table 4).

Another feature of the Romanian banking system is the accelerated strengthening process, leading to an increased bank market concentration, measured by Herfindahl-Hirschmann index and the market share of the 5 leading credit institutions.

With regard to the Romanian banks, the market concentration index is moderate, but above the EU countries average (see table 5).

Table 4: The increase in number of local bank units (branches) in different countries in the period 2003 - 2007

	Number of local units (branches)				
	2003	2004	2005	2006	2007
Bulgaria	NA	5606	5629	5569	5827
Czech Republic	1670	1785	1825	1877	1862
Hungary	3003	2987	3125	3243	3387
Poland	8688	8301	10074	10943	11607
Romania	3387	3031	3533	4470	6340
EU27	206956	211442	214925	228601	233581

Sursa: Sursa: ECB, EU Banking Structures, october, 2008; http://www.ecb.europa.eu

In Romania, the leading 5 credit institutions own 56% of the total assets, similar to Bulgaria, while the Herfindahl index for Romania (1041) reveals a higher concentration than in Bulgaria (833). In 2007 we noticed a slight depreciation of the concentration index of the domestic banking system that may indicate a raised competitiveness on the banking market.

Table 5: The trend of the concentration index of banking market in different countries in the period 2003 – 2007

	Herfindahl* Index					**Weight of the 5 leading credit institutions in the total assets**				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
Bulgaria	NA	721	698	707	833	NA	52,3	50,8	50,3	56,7
Czech Republic	11187	1103	1155	1104	1100	65,8	64,0	65,5	64,1	65,7
Poland	754	692	650	599	640	52,0	50,0	48,5	46,1	46,6
Romania	1251	1111	1115	1165	1041	55,2	59,5	59,4	60,1	56,3
Hungary	783	798	795	823	839	52,1	52,7	53,2	53,5	54,1
EU 27	545	567	600	588	628	39,7	40,9	42,1	42,1	44,4

* calculated as the sum of the square of the market shares for all credit institutions in a Member State

Source: ECB, EU Banking Structures, October, 2008; http://www.ecb.europa.eu

In the context of Romania's integration in the European Union, the banking system has registered significant progress in relation to the legislative and regulatory framework for the credit institutions. Thus, in 2007, we may notice two major regulations that aimed at creating a unitary legislative frame for banking, in compliance with European norms and practices, respectively: the approval of the Government Emergency Ordinance no.99/2006 regarding credit institutions and the adjustment of the capital via Law no.227/2007, and the approval of Government Emergency Ordinance no.28/2006 on the extra monitoring of credit institutions, insurance and/or reinsurance companies, of the companies providing financial investment services and of companies that manage investments in a financial conglomerate, via Law no.152/2007.

3. Financial intermediation, lending structure and profitability of the banking system

A significant sign of the progress recorded in the Romanian banking industry is the significant growth of the non-government credit weight in GDP (from 15.3% in

2003 to approx. 37% in 2007) and of the bank assets weight (from 31% in 2003 to 64% in 2007), indicating a positive change in the attitude of credit institutions towards the real economy and the return to their traditional function of financial intermediation (see table 6).

Table 6: Evolution of financial intermediation in different countries in the period 2003 -2007

	2003	2004	2005	2006	2007
Bulgaria:					
- bank assets / GDP (%)	50,0	64,2	76,8	85,5	104,5
- bank loans / GDP (%)	26,0	34,4	41,4	44,8	67,1
Czech Republic					
- bank assets / GDP (%)	99.9	93,8	97,7	97,4	104,7
- bank loans / GDP (%)	38,7	37,5	40,7	43,9	50,3
Hungary					
- bank assets / GDP (%)	76,4	80,9	89,8	99,1	107,7
- bank loans / GDP (%)	36,5	39,5	44,3	48,6	53,4
Poland					
- bank assets / GDP (%)	62,6	62,5	64,2	68,6	72,1
- bank loans / GDP (%)	27,6	26,1	27,2	31,2	37,3
Romania					
- bank assets / GDP (%)	31,2	37,1	45,2	50,9	64,3
- bank loans / GDP (%)	15,3	16,6	20,8	26,8	36,6

Source: Raiffeisen Research, CEE Banking Sector Report, 2008, www.rzb.at/eBusiness

The reconstruction of the financial intermediation was determined by the changes in the loan offer and demand. The increased offer was determined by the decreased returns from safe investments (in BNR and government securities), the reduced risks of crediting the real economy (in the context of its positive trends), the existence of exceeding liquidity in the banking sector, and the accelerated competitiveness of banks. The demand of credits was restored due to the accelerated economic growth, to the low macroeconomic instability and to the reduced interest rates.

Although the financial intermediation has recorded a significant growth, Romania is still ranked below the Central and East European countries (see table 6) and much below the average of Euro region (in EU-15, at the end of 2007, the weight of bank assets to GDP was of 351.4%).

The dynamism of the bank loan market in Romania (see the data in table 7) is predominantly supported by the loan granted to the population, which registered a fast increase determined by the diversification and attractiveness of the offers of the credit institutions, as well as by the increase of the demand of the population for consumer and real estate loans. By way of comparison, in Bulgaria, the increase of credits granted to non-financial corporate exceeded the increase of credits granted to households.

As concerns the credits granted to households by the Romanian credit institutions, the most significant increase was registered for credits for the purchase of houses, which, in 2007 augmented by 81%, whereas consumer loans increased by 65% (see table 8). Such an evolution was determined by the intensification of the orientation of the banks towards retail, by the reduction of the interest rates for credits in lei and foreign currency and by the growth of the population's incomes. As a matter of fact, the significant growth of credits for houses and of consumer credits can also be seen in other analyzed countries in Central and Eastern Europe: in Bulgaria, the increases were of 64%, respectively 49%; in Poland of 59%, respectively 35.98%; in the Czech Republic of 51.91% and 30.22%; in Hungary of 15.68% and 39.82% (see table 8).

Table 7: Evolution of loans granted to the economy of credit institutions in the period 2005 – 2007 (in % year on year in Euro terms)

	increase in loans granted to the economy by credit institutions			increase in loans granted to non-financial corporations			increase in loans granted to households		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Bulgaria	34,40	23,35	64,67	22,91	18,81	72,93	58,36	30,70	52,49
Czech Republic	28,87	40,11	29,75	21,94	26,87	22,31	39,23	36,60	38,77
Hungary	15,33	18,46	16,17	10,84	13,44	10,91	22,94	26,14	23,40
Poland	16,45	25,05	33,13	4,51	14,45	33,13	29,38	34,32	47,27
Romania	57,77	72,57	52,43	41,86	55,66	38	92,60	100,09	70,67
MU 13	9,21	10,31	9,49	8,18	12,80	13,77	10,06	8,27	5,85
EU 27	10,33	10,97	8,52	10,76	13,69	13,87	10,03	9,03	4,52

Source: processed data based on ECB, EU Banking Structures, October, 2008; http://www.ecb.europa.eu

The considerable dynamics of the households and of the consumer loans in the analyzed countries from Central and Eastern Europe illustrate the population's tendency of coming close to the consumer standards in the developed countries.

The structured analysis of the credits granted to households emphasizes the fact that mortgage loans, although they have registered a significant increase, have a low percentage, of 19.87%, whereas consumer loans (including other types of loans) have the biggest percentage in Romania, at the level of 2007. Comparatively, in the European Union mortgage loans account for 73% of the loans (see the data in table 8). At the same time, from this perspective, Romania is the last country, if we consider that in Bulgaria loans for houses account for 40.75%, in the Czech Republic for 70.89%, in Hungary for 53%, in Poland for 44.96% of the total number of loans. Such a situation stresses, in particular, the low purchasing power of the Romanian population and its predominant orientation towards consumption. Consequently, bank loans for the Romanian population must be in line with the European banking standards concerning the ration between mortgage and consumer loans.

Table 8: Evolution of the loans granted to households by the credit institutions in the period 2005 – 2007 (EUR millions)

	Loans for housing purchase			Loans for consumer credit			other loans to households		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
BG	1006	1751	2876	2147	2400	3576	388	477	605
CZ	9737	13639	19375	3089	4007	5218	1591	2048	2737
HU	9029	10728	12410	4766	6891	9635	1261	1373	1392
PL	13181	20505	32783	13875	16239	22082	9805	12768	18047
RO	766	2176	3940	4910	9239	15278	131	204	612
MU 13	2916666	3214028	3436867	556045	588802	617856	722557	739568	753384
UE 27	4331901	4781066	5011505	824872	877380	913542	864635	906475	936479

Source: ECB, EU Banking Structures, october, 2008; http://www.ecb.europa.eu

The significant expansion of the credits granted to households accelerated the increase of internal demand and determined the considerable increase of the current account deficit which has reached a worrying level, especially in Bulgaria and Romania (see the data in table 9).

Table 9: Evolution of current account balance in different countries in the period 2004- 2008 (in percent of GDP)

	2004	2005	2006	2007	2008
Bulgaria	- 6,8	- 12,5	- 17,9	- 21,7	- 18
Czech Republic	-5,2	-1,6	-3,2	-2,6	-2,9
Hungary	- 8,6	-7,6	-7,5	-6,4	- 5,9
Poland	- 4,0	-1,2	- 2,7	- 4,1	- 5,2
Romania	- 8,4	- 10,2	- 11,8	- 14,4	- 14,0

Sursa: http://www.ebrd.com/country/sector/econo/stats

At the same time, the fast increase of the credits granted to households and especially, of the foreign currency loans, has determined the monetary institutions in the above mentioned countries to pay special attention to the preservation of financial stability. Thus, the National Bank of Romania has adopted several restrictive measures, among which: the preservation of the minimum bank reserves at a high level (40% for liabilities in foreign currencies and 18% for the liabilities in the national currency).

As concerns the evolution of the profitability of the Romanian banking system (see the data in table 10), we may notice a descending trend of the solvency rate, which is, nevertheless, above the set limit (8% starting with January 2007). This evolution appeared as the result of the increase of the degree of financial intermediation.

The return rates (ROA and ROE) registered an increase at the level of 2008, due to the concerns of the credit institutions in relation to the increase of cost efficiency and to the desire of large credit institutions of obtaining superior results.

Table 10: Evolution of indicators of profitability in the Romanian banking system, in the period 2005 - 2008 (%)

INDICES	2005	2006	2007	2008
Solvency index (≥ 8%)	21,07	18,12	13,78	12,34
ROA (annual net profit /total assets – average value)	1,9	1,5	1,3	1,66
ROE (annual net profit /equity – average value)	15,2	11,7	11,4	18,11

Source: Monthly report of the National Bank of Romania, no: 12/2008; http://www.bnr.ro/Statistics

By way of comparison with other European countries (see the data in table 11), the Romanian banking system has a close return on assets (ROA), but the return rate on equity is below the European average. Consequently, the efforts of the credit institutions, in the context of the increase of competition, must be oriented towards the increase of the efficiency of the performed activities.

Table 11: Comparative situation of ROE and ROA at European level, in the period 2005- 2007 (%)

	2005		2006		2007	
	ROE	ROA	ROE	ROA	ROE	ROA
Austria	14,8	0,6	16,9	0,7	18,3	0,8
Bulgaria	22,1	2,1	24,4	2,2	25,4	2,5
Czech Republic	25,2	1,4	22,5	1,2	23,1	1,3
Greece	15,9	0,9	12,8	0,8	20,1	1,3
Hungary	24,7	2,0	24,0	1,8	22,9	1,8
Poland	21,9	1,6	21,0	1,7	25,6	1,8
Romania	15,2	1,9	11,7	1,5	11,4	1,3
European average	**15,0**	**0,5**	**16,7**	**0,6**	**...**	**...**

Source: National Bank of Romania, Financial Stability Report, 2008, http://www.bnr.ro

4. **Conclusions**

Romania's integration in the European Unions has led to major changes in the banking sector as well. Thus, at a structural level there appeared new banking entities, through purchases and mergers, a significant development of the banking units network was registered, and the participation quota of foreign equity from member states of the European Union considerably increased. At the same time, competition in the banking market became fiercer and was accompanied by the development and diversification of banking products and services.

As of January 2007, the credits institutions belonging to other EU member states have accessed the domestic banking market via the simultaneous expansion of the liberties related to setting up businesses and providing services.

The current international financial crisis, as well as Romania's perspective of adopting the Euro, create new challenges for the Romanian banking system and stress the existence of some weak aspects, which must be eliminated for the purposes of building a solid, competitive and efficient banking sector.

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