

ROMANIAN BANKING SYSTEM FACING THE INTERNATIONAL BANKING CRISES OF 2007

BOGDAN CĂPRARU
"AL. I. CUZA" UNIVERSITY OF IAȘI
BD. CAROL I NO. 22, IAȘI, 700522, ROMANIA
csb@uaic.ro

Abstract:

In this study we try to underline the main implications of international financial crises of 2007 on the Romanian banking system. In this context, we have done a SWOT analysis of the Romanian banking system in October 2008. Also, we have assessed the consequences of Romania's adhesion to European Union in the perspective of banking system structure.

Key words: *European integration, banking system, financial crises*

JEL classification: *E02, G01, G21*

Introduction

The crisis of mortgage loans in the United States of America has spread on international level, having an influence on the economy worldwide. The effect has reached the countries in central and Eastern Europe as well.

The Romanian economy has been affected by the international crisis, after a period of strong economic performance, when the economic growth had reached record levels. Also, the banking activity had reached increased rhythms: an extensive development of bank networks, an unprecedented increase in the levels of loans as well as in the number of employees in the banking sector, a wider range of bank products and services. This "euphoria", present in the Romanian activity, especially in the banking sector, was encouraged under the conditions of integration into the European Union.

The Romanian banking system after the adhesion to the European Union

The process of adhesion was a premise for the increase of the percentage of foreign capital in the financial and banking system in the European Union countries, but also for the appearance of certain banks from the New Europe which have started to be present in the Romanian banking system (for example in this case is OTP Hungary which overtook RoBank in 2004).

After the adhesion to the European Union, Romania entered "the single" European market. Once the Romanian banking market has been liberalized and the single banking license has been implemented, foreign banks can enter more easily the territory of our country and the expansion of competition in the local banking activity will also be determined by the possibility to offer banking services without a direct instruction.

The methods to enter the Romanian banking market can be diverse: open branches or subsidiaries; equity investment in the local banks; mergers or acquisitions of Romanian banks.

After the adhesion of our country to the EU and the liberalization of the service market, a number of 190 foreign institutions have expressed their intention to have

direct banking activities on the Romanian territory, out of which 174 are banking institutions, 3 are non-banking financial institutions and 13 e-money providers¹.

Millennium Bank, as this is the name of the local branch of the Portuguese Millenium BCP, is the first example of *greenfield investment on the banking market* after many years of acquisitions. Bank of Cyprus, La Caixa and Fortis are banks which have opened branches in Romania and around them a network will be created that could cover the main cities.

Among the other dozens of loan institutions which have notified the National Bank of Romania (NBR) there are many which are mostly specialized in managing private funds: Lombard Oldier, Credit Suisse Luxembourg, GE Artesia Bank, Danske Bank International; investment banking - UBS.

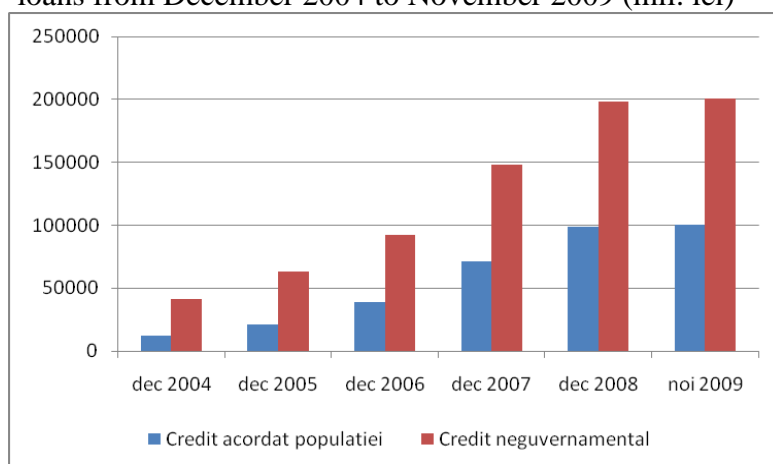
In 2008, the opening of BCR Banca Pentru Locuințe was authorized and another branch of a European bank, DEPPFA Bank Plc. Dublin opened its gates.

Also, after mergers and acquisitions at international level, some banks have ended their activity and continued to work under different names: the engulfment of Bank di Roma – Bucharest branch by UniCredit Țiriac Bank, as a consequence of the joint venture at European level between the shareholders of the two institutions (UniCredit Group and Capitalia); changing the name of Sanpaolo IMI Bank Romania into Intesa Sanpaolo Romania Commercial Bank, after the merger between Intesa SpA and SanPaolo IMI SpA; the buying out of ABN Amro by Royal Bank of Scotland.

Even though competition in the banking system is continuously increasing the Romanian banking system proves to be highly concentrated. The first 5 banks in Romania according to the value of their assets (BCR, BRD - Groupe Société Générale, Raiffeisen Bank, Volksbank, Banca Transilvania) held 55,9% from the aggregate balance sheet assets, 55,1% from the total of offered loans, 54,1% from the attracted deposits and 51,4% from the funds of Romanian commercial banks in March 2008, a letdown in comparison with March 2007.

At the same time, after the integration of our country into the European Union, bank loans have boomed in volume, especially in the case of personal loans. Thus, at the end of 2007 we could notice a double value for the loans offered to the population.

Figure no.1. The situation of loans offered to the population and non-governmental loans from December 2004 to November 2009 (mil. lei)



Source: Monthly bulletin from BNR

Issues regarding consequences of the actual international financial crises on the Romanian banking system

¹ Annual Report of BNR, 2008, p. 24

The international financial crisis has been felt inside the Romanian banking system since the autumn of 2008. A SWOT analysis of the Romanian banking system in October 2008, presents the situation as follows:

Strengths:

- The Romanian banks held significant minimum reserves in the central bank, recently reaching 20% from the deposits in lei (at present 18%) and for the deposit in foreign currency the level of minimum reserves rate was 40%. This proves the fact that NBR might have enough cash funds to pump into the system, should cash shortages appear.
- The prudential and profitability indicators for 2008, although slightly deteriorated since last year, show that the Romanian banking system is a solid one.
- Starting with the 15th of October 2008, the guarantee fund for insured depositor and credit institution has been raised to the equivalent of 50.000 Euros in lei, while the guarantee fund for juridical body and credit institution has remained at the same level, more precisely the equivalent of 20.000 Euros in lei. Even under the conditions of a limit of 20.000 Euros, 99,2% from the deposits were covered, their total value representing 60% of the total value of deposits in the system.
- The new rules for loans have decreased Romanians' interest and desire to take loans, due to the fact that banks have been forced to become more restrictive, starting first with the quality of clients. Thus, sub prime credit is avoided.
- NBR's foreign currency reserve was consistent (on the 1st of October 2008 its value was 26 billion euros) and ready to be thrown on the market when it was needed, to calm spirits down.
- NBR's communication policy is more and more active, the governor collaborates with the government and the President to send messages to the public.
- Lately, there has been a relationship of collaboration between NBR and the Romanian Bank Association.
- The activity of the Credit Bureau has become more intense, and data regarding borrowers are more detailed.
- Romanian banks have not invested in "toxic products", especially on the European market.
- The possibilities of economic increase and development of our country continued to raise the interest of foreign investors, who are willing to invest in better places.

Weaknesses:

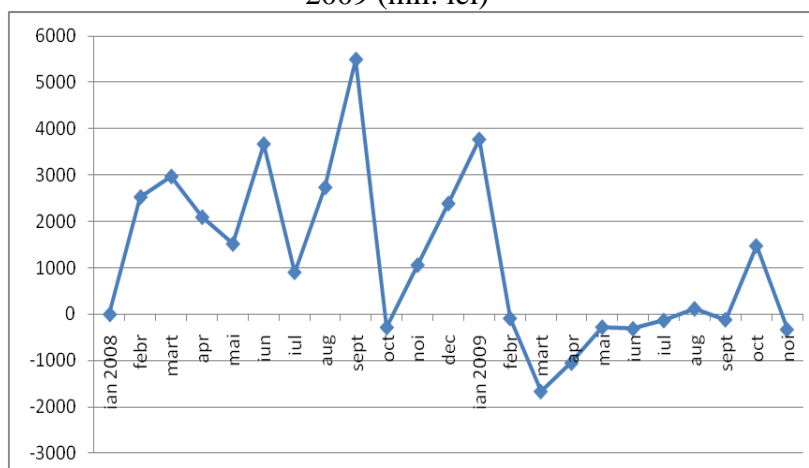
- Approximately 57% of the loans were given out in foreign currencies, which makes banks' portfolio to depend on the exchange rate.
- Some macro-economical indicators have already shown the tendency to deteriorate, which could determine certain instability at the level of external funds flow.
- The most powerful bank in the system, BCR was ranked by Standard&Poor's from BBB- to BB+;
- The degree of concentration of banking activities in Romania, although in decline, is quite high; in June 2008 the first 5 banks in the system contributed more than 50% from the total banking activity, out of which the first 2, BCR and BRD-GSG, held 37,2% out of the total assets.
- The international conditions, especially the evolution on the exchange markets in the region, made Romania a vulnerable country, especially with respect to speculative attacks.
- The public has lost faith in the banking system, due to the unethical behavior of certain banks (increase of the interest rate, unjustified commissions, and so on);

- The existence of certain banking products at promotional interest rates that would be variable later, which could have affected the clients' future capacity to repay.
- Possible settlement of the prices in the real estate market, which could affect the real estate guarantees. Nevertheless, the percentage of mortgages was only 3,8% from the gross domestic product, which is very low in comparison with levels in western countries.
- The possibility of bankruptcy for some banks from abroad, which have branches and investment in Romania.
- Due to the liquidity crunch from abroad, some major banks have sent less resources to their subsidiaries in Romania.

In Romania, the international financial crisis started in October 2008 with a speculative attack on the national currency. At the same time, NBR took some measures to decrease bank loans. Before these new regulations were put into force, the banks started to fight with all their power on the offer of loans to physical entities.

In 2009, as we can notice in the following chart, the rhythm of increase of loans to the population diminished, or decreased in certain periods.

Figure nr.2. Variation of loans to the population from January 2008 to November 2009 (mil. lei)



Source: NBR monthly bulletins

At the same time, 2009 led to an increase of unprofitable loans. Thus, the percentage of late payments in the total of loans rose from 4,62% in May 2008, to 11,47% in May 2009 and 13.3% in August. Also, the degree of coverage of late payments by provisions continuously decreased, from 123% in August 2008 to 107%, in August 2009.

As a consequence of the liquidity crunch in the last part of 2009, banks in the system increased the interest rates for deposits, a phenomenon which leads to an increase in their volume. Thus, during the period September 2008 – September 2009, deposits from the population increased by 16,26%, under the conditions of a relatively constant rate for the offered loans, for the same period. In this context, the loan / deposit ratio fell from the maximum of 124,7% to 117,5%.

However, savings in Romania continue to be reduced, in comparison to many countries in the region. Thus, the level of bank deposits per capita, at the end of 2009, was 1.034 euro/inhabitant, in comparison to Poland – 2.281 euro/inhabitant, Hungary 2.764 euro/inhabitant and the Czech Republic – 5.870 euro/inhabitant.

With the purpose of encouraging mortgage loans and the related economic sectors, in 2009, the government launched a program called "First Home". In this programme, the state, with the help of the National Credit Guarantee Fund for Small

and Medium-Sized Enterprises, made a pledge to issue guarantees in the name and in the state accounts in the favor of banks which offer loans to physical entities to buy houses.

In 2009, the National Credit Guarantee Fund for Small and Medium-Sized Enterprises received approximately 11.500 requests in the "First House" programme, the value of insurance policies representing 485 million Euros from the approved maximum limit of 1 billion euros.

From the perspective of bank premises and staff, the effects of the international financial crises were seen even from the first five months of 2009, 37 bank offices were closed and 2.077 employees were dismissed, in comparison to the end of 2008 when the numbers reached a maximum. These figures continued to decrease during the following months, reaching a number of 6.464 bank offices closed in September 2009, 90 offices less at the end of 2008 and 68.462 employees, 3.138 less than in December 2008. Most of the dismissed staff was from small and medium bank offices.

In September 2009, as compared to September 2008, the profitability and prudential indicators proved to be slightly affected, as shown below:

Table nr.1. Profitability and prudential indicators

	Sept. 2008	Sept. 2009
Solvency ratio	11,85	13,73
Leverage ratio (Tier 1 capital/Total assets (average))	7,10	7,04
Doubtful and past-due claims/Total assets (net)	0.22,	0.92
Doubtful and past-due claims (net)/Total equity	2,43	10,46
ROA	1,77	0,28
ROE	19,41	3,22

Source: NBR

The goals to reaching the end of the crisis and restart banking activities in Romania on a positive trend, under stable conditions, depend on a series of aspects, such as:

- A cautious credit policy, in parallel with a policy to stimulate the savings process, in the context of a balanced management of assets and liabilities;
- Diversification of the range of bank products and services, especially for the small and medium-sized enterprises and corporations;
- Severe bank monitoring by NBR;
- Governmental measures to stimulate the business environment;
- The restructuring of the state budget sector from the perspective of the measures regarding human resources should be undertaken gradually, on sound principles and with the smallest effects on the work force, when a number of employees from the budgetary field are clients or potential clients of retail banks;
- Guiding bank loans to the priority sectors in economy;
- Actively involving banks in EU funded projects.

Conclusions

The Romanian banking system suffers itself from the consequences of the international financial crisis in its diminished volume of activity. Nevertheless, Romanian banks did not experience payment incapacity, and profitability indicators have reached positive levels. Also, prudential indicators have been maintained at a reasonable level, although part of them experienced a decrease (for example the level of unprofitable loans). The end of the crisis requires a close cooperation between the business environment, banks, NBR and the government authority. Banking reforms

taken as a consequence of the present financial crisis should mainly consider loan policies and attract loan resources, a sound asset-liability management, human resources, marketing strategies and the bank – client relationship.

REFERENCES

1. Casu, B., Girardone, C. Bank Competition, Concentration and Efficiency. in the Single European Market, University of Essex Discussion Papers no 2/2005
2. Căpraru, Bogdan, Banca centrală și mediul economic, Ed. Universității “Al. I. Cuza” Iași, 2009
3. Căpraru, Bogdan, Activitatea bancară. Sisteme, operațiuni și practice, Ed. CH Beck, București, 2010
4. Claessens, S., Demirgüç-Kunt, A. and Huizinga, H. How Does Foreign Entry Affect the Domestic Banking Market?, World Bank Policy Research Working Papers. 1998, no 1918
5. Stoica, O., Căpraru, B. Challenges in the Romanian banking industry in the framework of the European integration, in The proceedings of the international conference The impact of European integration on the national economy, Risoprint Publishing House, Cluj-Napoca, 2005
6. NBR Annual Report 2008
7. NBR Financial Stability Report 2008, 2009