ASPECTS REGARDING THE INFLUENCE OF ECONOMIC CRISE ON ROMANIAN FINANCIAL SYSTEM

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Abstract:
Financial stability in Romania has faced significant challenges in the last period, but remained robust. Capitalization of banks increased to comfortable levels, and liquidity remained at levels consistent. These developments are the consequences of efforts undertaken by credit institutions in this regard requests the National Bank of Romania and the grant agreement signed by the authorities in the European Union and International Monetary Fund, with commitments under the European Initiative Steering major Banking 9 foreign banks operating in Romania, being catalytic determinants of these efforts.

Key words: *Romanian financial system, economic performance, economic recession*

JEL classification: *F30, F40*

THE EVOLUTION OF INTERNATIONAL FINANCIAL SYSTEM

The world economy has deteriorated significantly in 2009 (-0.6 percent), suffered its first contraction in 30 years, while the EU economy has had a larger decrease (more than 4 percent), even under the stimulus government was important.

International financial system itself has received a major boost in 2009 from the monetary and fiscal authorities. Central banks in many developed economies have resorted to extraordinary measures to provide liquidities. Monetary policy rates have reached historical lows (one percent for the euro, close to 0 percent for U.S. dollar).

Since conventional measures of relaxation of monetary policy were almost depleted, a number of central banks since the approach to the quantitative yields. For example, for the euro area, measures have led to increased liquidity injected into the market (about 460 billion euros in September 2008 to 900 billion euros in July 2010). As a result, central banks' balance sheets of those developed countries have increased significantly and increased maturity of assets held.

Accessing the banks of these additional resources was skewed. As regards the ECB, credit institutions customary Greek significant existing facilities (the volume of refinancing transactions exceeding 20 percent of GDP in December 2009), so that the phasing out of these measures will be initiated taking into account the dependence external financing of certain banking groups. In the first months of 2010, the ECB initiated measures have led to further increase the support offered to banks.

In turn, tax authorities of EU Member States have adopted measures in 2009 to support the banking sector. Over 60 percent of the bank recapitalizations came from this source. These actions have enabled governments in late 2009; banks' losses can be covered in the volume brought new capital.

CEE banking sector is dominated by banking groups from the euro area. This is reflected in the homogeneity degree of vulnerability to regional shocks, common creditor problem is important (Table 1). The degree of contagion through the banking channel has experienced significant changes in 2009 in the CEE (excluding Russia, for which the index fell at regional importance). Poland, Czech Republic, Romania and

Russia remain countries that may have the greatest impact on the ECE region (common lender channel) due to the high volume of euro area banks' exposure to those countries.

Table 1: Matrix importance transmission channels of shocks caused by the indirect exposure of the main groups in the BIS reporting banks (first quarter, 2010)

	BG	***HR***	***CZ***	***HU***	***PL***	***RO***	***RU***	***TR***	***UA***	***Importance at regional level***
BG		3	2	2	2	7	1	5	3	25
HR	7		8	8	4	9	4	1	8	49
CZ	8	18		11	6	14	7	6	12	83
HU	6	14	8		5	9	5	3	8	60
PL	13	15	9	10		14	11	13	13	98
RO	18	12	9	8	6		5	10	9	78
RU	6	10	7	7	7	8		7	9	62
TR	15	2	4	2	6	11	5		6	51
UA	3	4	3	3	2	4	2	2		22
Sensitivity at regional shocks	77	78	50	50	39	76	41	48	68	

Source: BRI, BNR

THE EVOLUTION OF ROMANIAN FINANCIAL SYSTEM

Romanian economy has, like evolution, a similar pattern to other countries in Central and Eastern Europe, except Poland. Economic contraction was severe (7.1 percent) and fiscal deficit rose considerably (from 7.4 percent of GDP). No public funds were needed to support the banking sector, a significant increase in capitalization of credit institutions in Romania were fully achieved through the efforts of shareholders, including responding to requests NBR. Need to adjust the volume and structure of government spending will put pressure on short-term indirectly on the financial system. Fiscal consolidation has, however, binding under international financial markets intolerance to significant levels of budget deficits and rapid growth of the stock of public debt.

Adjusting the current account deficit (from 11.6 percent of GDP in 2008 to 4.5 percent in 2009 and remains at a low level in the first half of 2010) contributed to a substantial reduction of one of Romania's economic vulnerabilities when crisis started. Simultaneously, the external deficit financing cease-integral achieved through foreign direct investment (FDI), although their volume was down about 45 percent over the level recorded in 2008. Medium-term projections indicate increasing current account deficit coverage by FDI. In parallel, an important part of external private debt was growing maturity renewed at levels higher than originally expected, despite carrying out a process for reducing global financial intermediation, and the stock of short-term external debt and its share in total external debt fell significantly, contributing to the reduction of the two major vulnerabilities of the Romanian economy from the crisis. Most important contribution to reducing the external imbalance had systemically important companies in the real sector. At corporate level this segment after 2008 recorded a trade deficit of over 6 billion, foreign transactions ended in 2009 with a slight surplus (0.1 billion).

Companies that have received foreign direct investments faced the crisis better than the rest of the economy. Their performance indicators have deteriorated more slowly. Companies that have benefited from FDI can contribute to the achievement of sustainable convergence towards the euro area, because:

- have demonstrated that they have a structure that allows efficient acquisition of the shocks,
- have an important role in the creation of economic value added (about 40 percent of the value generated by non-financial companies) and
- contributes over 75 percent of Romanian exports. The contribution of these firms to resume short-term domestic credit could be lower but they prefer external financing in 2009 (increasing by over 20 per cent), while their appeal to domestic bank loans fell by about 2 percent.

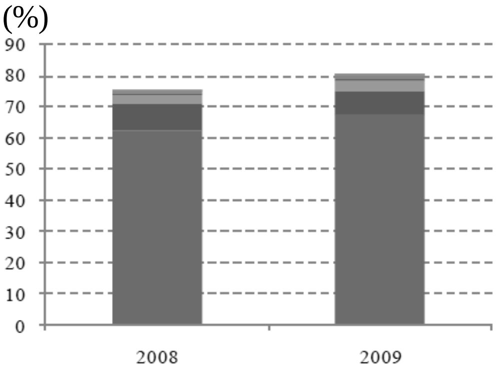
Total stock of companies and households borrowing from financial institutions (banks and IFN, domestic and abroad) has increased slightly in real terms (December 2008 - June 2010). Relative to GDP, debt stock reached 63 percent (June 2010), in particular because of base effect induced economic contraction. In June 2010, companies and public indebtedness totaled about 310 billion lei and two thirds came from the domestic banks, 9 percent of local IFN and 24 percent of foreign creditors. Since the crisis began, the supply of finance for companies and households to become more restrictive in terms of price conditions, and from that volume, in keeping with similar tightening of the region, with variations according to sources. In turn, the application has seen a significant reduction. Under these conditions, exposure of banks in Romania has dropped continuously - in real terms year on year - from September 2009 to May 2010, having first positive real annual growth (2 percent) in June 2010 and significantly reduced exposure to IFN. On the other hand, loans from foreign lenders increased by 20 percent (December 2008 - June 2010).

An important vulnerability-high share of short term foreign debt - has subsided. Between late 2008 and June 2010, the share of short-term private external debt in total external debt shrank by 11 percentage points (from about 28 percent to about 17 percent).

The financial sector continued to expand in 2009, but growth rate was significantly reduced due to financial turmoil in international financial markets, that have contaminated the domestic economy. Risks were amplified and were required infusions of capital, restructuring costs and better management of liquidity for financial system stability to not be affected. Domestic financial sector is strongly connected to the external, mainly to the European capital through relationships or finance its development and therefore depend significantly changed risks to the stability of the international financial system.

The level of financial intermediation to GDP increased in 2009, but the evolution was favored by the economic contraction, the net assets of the financial sector with only nominal advancing 4.1 percent. Financial institutions and non-bank continued to represent over 90 percent of the financial sector and private pension funds had the strongest dynamic (Chart 1). They currently hold an insignificant share in the financial system, but receive continuous streams of participants and contributions will come in a medium term, to manage a large volume of financial assets. There is a risk that the proceeds of contributions to reduce the short term due to weak economic context and fiscal imbalances. Domestic financial system is dominated by credit institutions, insurance and investment sectors, but capital markets have high growth potential as the convergence of domestic and European financial markets will continue.

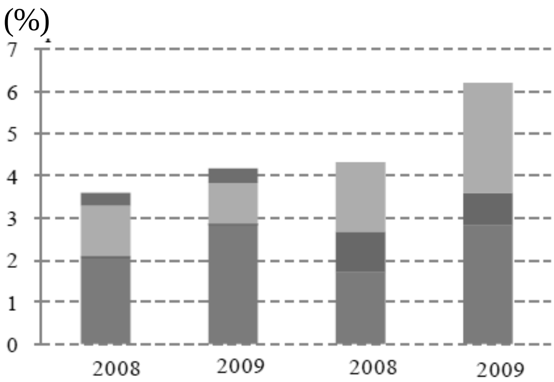
The financial sector is characterized by a heightened sensitivity to adverse events that attract resources and perform short-term and long term placements. This mode is not uniform across all financial institutions, but to a certain extent is the definition for financial intermediation activity. Shocks to the domestic financial system can be both exogenous induced by external financial markets or the real economy and endogenous. The endogenous can produce at one or more participants and can spread through contamination of pure within the financial sector, due to decreased confidence in financial institutions and off-balance sheet exposures or with the effect of depreciation of assets, withdrawal of funds payments or taking equity losses.



■ Open funds for investments
■ Financial Investments Companies
■ Private pension funds
■ Insurance companies
■ Non-bank financial institutions
■ Credit institution

Fig. 1: Financial system structure (the share of net assets in GDP)
Source: National Bank of Romania, Ministry of Public Finance, 2010

Credit institutions have a low balance sheet exposure in relation to other financial institutions (Figure 2). It has advanced in 2009, mainly due to increased money market activity, given the substantial returns on bank deposits and the preference for liquidity in the event conditions of significant risk aversion. But exposures remain at a limited level, and the capitalization of credit institutions and alternative resources, liquidity and treasury bills or funding lines may mitigate any impact.



■ Shareholdings in companies in financial sector
■ Other companies in the financial sector
■ Insurance corporations and pension funds
■ Credit institution

Fig.2: Exposures to credit institutions on the domestic financial sector
Source: National Bank of Romania, Ministry of Public Finance, 2010

Exposures of financial institutions on capital market are insignificant, except life insurance companies, but in this case the investment risk is transferred in a great part to the customers. Risk indirectly, of buying insurance policies, there was in 2009, but did not affect the financial stability of life insurance companies and stock market recovery since the second quarter of 2009 could lead to increased inflows of funds during next period.

Table 2: The number of financial institutions active in Romania in late 2009

	2008	*2009*	*Evolution*
Credit institution	43	43	→
Insurance companies	44	45	↑
Insurance Brokers	459	510	↑
Pension funds	23	25	↑
Open funds for investments	54	52	↓
Financial Investments Companies	5	5	→
Financial Investments services companies	66	64	↓
Non-bank financial institutions (general register)	238	228	↓
Non-bank financial institutions (evidence register)	4513	4802	↑

Source: National Bank of Romania, 2010

The number of financial institutions has not been significant developments during 2009. Financial sector and economic tensions were felt by the participants, but mergers, acquisitions or cessation of activity led to a building at the sectoral level only, not the whole financial system. An example is the merger recorded between the two privately managed pension funds (Pillar II). The insurance and small-scale non-bank financial institutions have expanded in number; it is about constantly keeping the other categories of financial institutions (Table 2).

Turmoil in the financial markets worldwide were first felt in the capital market, increasing volatility, reduced liquidity and lower quotations of financial instruments. Due to the structure of the domestic financial system and cross-exposure reduced the adverse capital market developments have had direct impact on other financial institutions. In the next stage of development of global tensions, restrict liquidity in the international financial system and deteriorating economic activity in developed countries, particularly Romania's trading partners, led to reduced lending activity and the domestic economy into recession, and pessimistic expectations of participants financial and real sector imbalances have widened. Therefore, the quality of loan portfolios held by credit institutions and non-bank financial institutions has deteriorated, and rising unemployment and reduced income has affected the contributions received by pension funds in late 2009.

Insurance companies have experienced economic recession, but in terms of financial stability, the impact was not as strong. Due to the policy of expanding market share in the segment of high costs and significant increase in auto policies technical reserves for insurance RCA (according to legislation issued by the ISC), insurance companies have been adverse developments in international financial turmoil ahead of profitability. The economic downturn has decreased the rate of expansion of the insurance market, taking place just a contraction in the life insurance, but restructuring costs, significant income from investments and capital inflows have led to increased profitability indicators from the first half of 2009. Credit and non-bank financial institutions have increased the level of capital for the deterioration of loan portfolios affect their financial stability.

Evolution of risk does not indicate the amplitude of movements, and increased risk does not automatically imply an entry into a range of financial instability. The impact on the capital market was strong on global financial crisis and subsequent recovery was felt first in the investment funds and then in stock. At the same time, increased credit risks in the economy have not been emphasized, and keep the power low credit quality portfolios outside the area of significant risk. Non-bank financial institutions holding riskier portfolios, compared with credit institutions, through a much higher total consumer credit exposure.

CONCLUSIONS AND PROPOSES

The global economy has deteriorated significantly in 2009 and the return seems to be uneven. The EU is expected to be among the worst performance. Monetary and fiscal stimuli were consistent, but lack of sustainability of public debt and risk developments bring into question the price increases initiating measures for the gradual withdrawal of the stimulus.

World economic growth for the first time since 1980 came in negative territory (-0.6 percent) and euro zone economy dropped by 4.1 Trade sută.1 were affected, falling by over 20 percent at Overall, 16 percent respectively in Europe.

Government stimulus was significant in 2009: EU average fiscal deficit reached almost 7 percent of GDP, while public debt expressed as a percentage of GDP increased by 12 percentage points (an additional increase are expected in 2010 about 6 percentage points). These trends are unsustainable, requiring fiscal consolidation measures in most European economies. Withdrawal of fiscal stimulus may affect the economic recovery in main partner countries of Romania, which might reflect future demand for local exports.

The main challenge to financial stability in Romania remains credit risk. Lines of action identified are:

- further improve the prudential regulatory framework for proper management of risks associated with public borrowing;
- Further discouraging currency, but taking into account the current limited capacity of banks to obtain resources in local currency long term and the distinction between debtors to cover the foreign exchange rate and uncovered;
- Reviewing policies on guaranteeing bank exposures to real estate values collateral type updated to obtain a better mix between the various criteria considered in granting loans;
- Improvement of the database managed by the Central Banking Risks of National Bank of Romania to collect risk information.

Growth is expected to return in 2010, but unevenly internationally. EU countries are expected to be among the worst performing (1 percent growth versus 4.6 percent global average). Recovery is expected to be the result of both packages of fiscal measures adopted by the authorities and as a result of the revival work commencement of the private sector, but sustainability of this recovery remains affected by uncertainties in the short term.

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