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FINANCIAL CRISIS EFFECTS ON ROMANIAN BANKING SYSTEM

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Abstract: The financial turmoil has prompted a reality check of the banking system. This paper builds on an overview of the global financial crisis effect in Romania, emphasis the reaction of the banks in the economic crisis context and how their behavior changed and extends with measures undertaken for mitigating the effect of the crisis to enable a better understanding of the changes and trends of bank marketing strategies during crises. The purpose of the paper is to give suggestions on possible policy responses to the changing consumer buying behavior and to address the effects of the crisis on banking sector strategies.

1 Introduction

The National Bureau of Economic Research defines a crisis as a major reduction in economic activity for several months, reflected in the decrease of GDP, decline of individual's income, reduction of the level of employment, decline of industrial production and consumption.

The majority of banking crises follow a common pattern of causes and consequences [Klomp, 2010]. Banking crises are initiated by deregulatory measures, which lead to overly rapid credit expansion, and increases of asset prices. At some point, the bubble burst, with a dramatic fall in prices, disruption of the asset markets, widespread bankruptcies, increase in non-performing loans, credit losses, and acute liquidity problems within the banking system. Finally, governments have to bail out the weak banking system by large-scale recapitalization and nationalization operations.

The buildup to the latest financial crisis has similar features to earlier episodes: rapidly increasing of asset prices, credit booms episodes, dramatic expansion of marginal loans and the fail of the regulation and supervision of financial institutions to keep up with developments. The crisis was different than previous ones in new aspects: widespread use of complex financial instruments, interconnectedness among financial markets, accelerated degree of leverage of financial institutions and the central role played by the household sector.

The recent financial crisis caused a synchronized global recession episode as all advanced economies went into a recession and many emerging and developing economies followed suit, but the impact varied across regions and countries [Classens, Kose, 2010]. The cost of a recession is affected by: changes in credit and asset prices, prevailing economic conditions at the onset of a recession, countercyclical macroeconomic and financial sector policies.

The repercussions of crisis in the global economy were: the loss of confidence in the financial system, severe loss of liquidity, increased interest rates, the rising cost of internal and external funding, landslide bankruptcies, restructuring of companies and financial institutions, mergers, takeovers, financial support with funding from governments.

Although the global economy has started showing signs of growth, the recovery still appears to be fragile and the adverse effects of the crisis are likely to be felt for a long time period.

2 The effects of the crisis on the Romanian banking system

Financial crisis deteriorated worlds' economy and its recovery is expected to be uneven. Uncertainties caused banks to rewrite budgets, adjust their growth forecasts and freeze expansion plans.

The contraction of economic activity, rising unemployment, tighter lending standards changed the dynamics and structure of assets. Loans granted to the private sector posted a decelerating trend and all types of loans reported negative annual growth rates.

The central bank no longer absorbed excess cash from the system, but instead financed banks, as the inter-bank market didn't provide the necessary liquidity. To prevent banks from transferring higher costs of inter-bank funding to the customer, the national bank issued new regulations to protect customers and stimulate lending in local currency, and required branches of foreign banks in Romania to submit monthly financial reports.

Table 1: Banking system evolution (mill. Euro)

	2006	2007	2008	2009	2010	Jan. 2011
Total assets	51.885	71.952	85.278	86.893	90.412	89.730
Total loans:	26.348	41.045	49.705	47.366	48.901	48.900
- Individuals:	11.613	19.807	24.917	23.747	23.855	23.711
✓ housing loans	2.434	3.931	5.267	5.746	6.762	6.791
✓ consumer & personal loans	9.179	15.876	19.650	18.002	17.092	16.920
- Companies	14.736	21.238	24.788	23.617	25.047	25.189
Total deposits:	28.479	35.746	38.003	39.749	41.457	41.014
- Individuals	13.048	18.646	20.799	23.058	24.303	24.579
- Companies	15.431	17.100	17.204	16.691	17.156	16.434

Source: Own calculations after National Bank of Romania's Monthly Bulletins 2007-2011

In 2010, credit institutions were pressured to manage simultaneously the multiple adverse effects of the crisis: impaired quality of the loan portfolios, significant increase of loan loss provisions, the narrowing of the interest rate margin due to the global liquidity crisis and to the higher costs of attracted savings, the increased credit risk, the reduction of demand for credit and installing loan outstanding balances.

The crisis hit Romania with a delay of one year, but the effects were very strong, changing the structure of banks' balance sheets. The decrease of external resources caused the decrease of banks' dependence on external financing. Concurrently, parent banks' supported subsidiaries in their effort to attract local market deposits. Despite the reduction in aggregate loans relative to bank deposits, credit institutions' own sources increased due to: capital increases performed by shareholders, new subordinated loans granted by parent banks and the allocation of profit to the reserve fund.

Table 2: Bank branches, employees and bank medium salary evolution

	2005	2006	2007	2008	2009	2010
Bank branches	3.514	4.401	5.814	6.552	6.425	6.170
Number of employees	52.366	58.090	65.655	71.622	67.898	66.753
Bank medium salary (Ron)	2.811	3.002	3.480	3.028	3.765	3.758

Source: Newspapers, websites of central banks, 2011

In 2010, banks' profitability entered negative territory and, as a result, were taken cost control measures, by downsizing the number of units, by reducing labor and by canceling or delaying investment plans.

The rise in interest rates margins, the sale of fixed assets and the purchase of government securities were the most frequent strategies applied by banks in order to improve their financial performance, on short term.

Table 3: The evolution of main indicators for credit institutions

	2007	2008	2009	2010
Total net assets (mill. Ron)	251.426	314.442	330.184	341.846
Total net assets of credit institutions with majority *private capital* / Total net assets (%)	94,60	94,80	92,70	92,60
Total net assets of credit institutions with majority *foreign capital* / Total net assets (%)	87,70	88,20	85,30	85,10
Capital Adequacy Ratio (> 8%)	13,78	13,76	14,67	14,66
Leverage Ratio (%)	7,32	8,13	7,55	7,87
Past due and doubtful loans / Total loans (%)	0,22	0,32	1,45	2,22
Past due and doubtful claims / Total assets (%)	0,17	0,29	1,01	1,49
ROA - Return on assets (Annualized net profit / Total average assets) (%)	…	1,56	0,25	-0,09
ROE - Return on equity (Annualized net profit / Average own capital) (%)	…	17,04	2,89	-1,02
Total operating income / Total operating expenses (%)	…	179,56	156,53	155,92
Loans granted to clients / Deposits from clients	108,72	122,03	112,80	113,46
Credit Risk Ratio (%)	4,00	6,52	15,29	20,81
Non-performing Loans Ratio	…	…	7,89	11,85

Source: National Bank of Romania, Aggregate indicators for credit institutions 2007-2010

Romanian banking sector was adequately capitalized, but credit risk intensified in the context of economic recession and increasing unemployment. The trend of non-performing loans called for a close monitoring and further provision efforts.

The tendencies in the structure of liabilities were: the prevalence of short-term maturities of deposits, the growth of own funds and the drop in foreign liabilities, mainly deposits and short-term financial loans.

Table 4: Structural indicators of the Romanian banking system

	2003	2004	2005	2006	2007	2008	2009
Number of credit institutions	39	40	40	39	42	43	42
Number of banks with majority private capital	36	38	38	37	40	41	40
Number of banks with majority foreign capital, *of which:*	29	30	30	33	36	37	35
- Foreign banks branches	8	7	6	7	10	10	10
Assets of banks with majority private capital / Total assets (%)	62.5	93.1	94	94.5	94.7	94.6	92.5
Assets of banks with foreign capital / Total assets (%)	58.2	62.1	62.2	88.6	88	88.2	85.3
Assets of top 5 banks / Total assets	63.9	59.2	58.8	60.3	56.3	54.3	52.4
Herfindahl-Hirschmann Index	1.264	1.1120	1.124	1.171	1.046	926	857

Source: National Bank of Romania, Financial stability report 2010

In 2010, banks with Austrian capital accounted for the largest market share, but in terms of the country of origin of the capital invested in Romanian credit institutions, Greece was in the lead. The increase of financial intermediation, calculated as share of bank assets to GDP is attributed to the impact of GDP drop, rather than the larger asset volume. The concentration of the Romanian banking system continued its downward trend. Bank concentration was higher for deposits compared to the level calculated for assets.

Unfavorable domestic macroeconomic developments (especially those related to gross domestic product, unemployment and wages), domestic currency depreciation, the rise in exchange rate volatility, high lending costs and higher propensity for saving of households caused the contraction for credit demand.

In order to readjust to the new economic realities, banks shifted their strategies towards: supporting clients affected by the hardships of the crisis, concluding strategic partnerships aimed at re-launching the economic activity, maintaining the stability and soundness, enhancing risk management mechanisms to adjust to the challenges posed by the difficult economic environment and actively managing the costs.

Banks acted in a prudent and responsible manner, by undertaking prompt and efficient measures in order to diminish the impact of the financial crisis upon customers and business, supporting the Romanian economy's effort to surmount the crisis.

Table 5: The structure of loans of non-bank, non-government customers (mill. Ron)

	Loans in Lei		Loans in foreign exchange	
	Current loans	Overdue loans	Current loans	Overdue loans
January 2006	28.863	192	32.135	100
January 2007	46.505	323	44.054	90
January 2008	68.532	881	85.435	387
January 2009	81.779	2.069	122.113	1.457
January 2010	75.577	4.753	115.703	4.455
January 2011	69.225	7.805	123.395	8.945

Source: National Bank of Romania, Loans and deposits by county 2006-2011

The analysis of developments in interest rates reveals that banks charged interest rates on loans to households higher than interest rates on loans to non-financial companies; by contrast, households benefit from higher interest rates on time deposits. The average interest rate on retail and corporate deposits increased, due to the growth of the rate of monetary policy and the increase of stock interchange.

The non-performing loan ratio (the loans overdue for more than 90 days), followed an uptrend, slightly above the average for the region. Loans falling under doubtful and loss also followed a rising trend, but their pace slowed in 2010.

Table 6: Banks' loan classification (mill. Ron, end of period)

	Standard	Watch	Substandard	Doubtful	Loss
December 2006	46.374	35.860	4.585	938	1.580
December 2007	67.360	63.607	8.315	2.075	3.735
December 2008	118.629	47.370	13.906	3.993	8.581
December 2009	103.268	43.156	16.890	6.637	22.839
December 2010	101.798	42.556	17.279	6.692	24.564

Source: National Bank of Romania, Monthly Bulletins (Statistical selection) 2007-2010

An increasing vulnerability of the Romanian banking system is the worsening quality of the loan portfolio. The significant depreciation of the currency, the excessive growth of interest rates for credits, inflation, and unemployment had an impact on population income and on its possibilities regarding repayment of loans and interests. The number of individuals experiencing significant delays in reimbursement rates increased, so the bad debts of population rose.

Table 7: The structure of loans of non-bank, non-government customers (mill. Ron)

	Loans in Lei			Loans in foreign exchange		
	Corporate sector	Households	Other	Corporate sector	Households	Other
January 2007	22.531	23.612	685	24.795	17.159	2.189
January 2008	33.891	33.956	1.565	42.891	40.409	2.522
January 2009	41.557	40.584	1.727	58.071	62.723	2.777
January 2010	40.129	38.530	1.672	57.765	60.324	2.068
January 2011	40.061	35.434	1.540	65.606	65.593	1.141

Source: National Bank of Romania, Loans and deposits by county 2007-2011

Total indebtedness of companies and households with banks, both domestic and foreign, rose between 2007 and 2011. Since the outbreak of the crisis, the loan supply for companies and households tightened in terms of cost and volume. The National Bank of Romania introduced new requirements in order to moderate the surge in credits, fearing a decline in the quality of banks' exposure and higher inflationary pressures.

The financial crisis, which hit the system at the end of 2008, supported the restricted monetary policy. The new regulations issued by the central bank tightened the conditions of mortgage lending terms; commercial banks reduced the financing of real estate needs and began to redirect towards short term loans, less risky in times of financial uncertainty.

At end December 2010, the banking system continued to weather the economic crisis well and banks remain well capitalized and liquid. The capital adequacy ratio was 14.7% and all banks exceeded 11% (mandatory ratio is 8%). Non performing loans increased, causing some losses, but the authorities' monetary and financial sector policies have been appropriately prudent and proactive, helping preserve financial stability in the face of the global financial crisis.

Table 8: The structure of deposits, time deposits, deposits redeemable at notice and repurchase of non-bank, non-government customers (mill. Ron)

	Deposits in Lei			Deposits in foreign exchange		
	Corporate sector	Households	Other	Corporate sector	Households	Other
January 2007	29.419	29.616	5.505	13.289	17.527	1.601
January 2008	37.822	42.652	6.519	17.260	28.206	3.304
January 2009	35.132	53.843	9.227	23.544	35.810	6.457
January 2010	33.909	59.252	10.095	24.362	40.417	9.346
January 2011	39.047	63.850	11.887	23.210	42.312	9.145

Source: National Bank of Romania, Loans and deposits by county 2007-2011

The analysis of liabilities illustrates the consolidation of the largest share of deposits taken from non-bank clients. Retail deposits registered an increase between January 2010 and January 2011, higher than that of corporate deposits. One explanation is banks' competition for population deposits which has progressively intensified during this period.

The savings market has been diversifying into new products; several banks have introduced progressive interest rate deposits, while others combined mutual funds and classic deposits. Banks' developed savings accounts products combining interest rates not much lower than those for deposits, with the option to use the funds with limited or no restriction. Another trend was towards deposits for specific client segments – new products have been developed to fit the needs of students or parents who want to put money aside for their children.

The Romanian banking sector is one of the most competitive segments of the local economical landscape, even in the context of the global financial crisis. In 2010 banks ended with a net loss of 304 million lei, compared with a cumulative net gain of 815 million in 2009, given that 20 banks have registered profit, and 22 credit institutions have tested negative. Net assets of the banking system advanced 3.53% last year due to the transactions and investments in securities.

Table 9: Assets and net profit evolution of Romanian banks during 2007 and 2010

	Assets				Net Profit			
	2007	2008	2009	2010	2007	2008	2009	2010
BCR	59,69	64,42	62,7	67,7	532	2.153	871	465
BRD	38,97	49,18	46,2	47,5	991	1.463	785	501
Raiffeisen	15,67	18,51	20,0	21,7	339	657	...	311
CEC Bank	10,87	13,58	20,8	21,7	76	396	42	...
Banca Transilvania	13,88	16,99	19,5	21,6	368	431	62	98
Alpha Bank	12,84	...	21,1	21,3	117	153	43	...
UniCredit	12,87	17,48	20,3	20,4	285	387	329	...
Volksbank	12,68	21,09	21,7	19,7	89	126	43	...
Bancpost	13,25	14,97	14,5	13,5	105	109	-35	66
ING Bank	8,14	11,08	10,9	13,5	60	96	17	...
Total banking sector	259,8	339,41	330,0	342,0	...	5.055	840	-304

Source: Newspapers, websites of central banks, 2011

The banks compete for a highly fragmented market with modest financial penetration. BCR remains the leader by total assets, registering a market share of 19.8% in December 2010.

As consumers become more sophisticated and competition in the banking system intensifies, new retail bank products emerge, increasingly targeting specific client segments or adapted to certain distribution channels. At retail banking level, products (such as loans, deposits or debit/credit cards) were developed to specific categories. The drop in interest rates in the course of a few years has opened up the opportunity of refinancing loans, now offered by almost all banks and used especially for previously contracted long-term loans, such as mortgage. The banks' corporate portfolio was extended, as the banks introduced risk coverage products.

The importance of constant product innovation for banks' survival and success is even more apparent in the crisis context. Several banks saw an opportunity in introducing banking products adapted to the current financial situation. Cross selling become one of banks' key preoccupations: private pensions, distribution of mutual funds and insurance policies.

The accumulation of wealth has prompted the development of private banking services for high net worth individuals, offering special relationships and investment services.

The evolution of Romanian banking system depends upon the restoration of confidence in the economy, the recovery of economic growth and the international developments. Over this period, banks tightened the lending standards, increased their provisions, decreased banking intermediation and tried to revival the lending as regards larger non-financial companies and real estate loans granted to households.

3 Conclusions

Amidst the global turmoil, the banking landscape will be transformed completely. The measures for promoting the recovery of lending through the recapitalization of banks could help the rebound of the consumption credit support and the prevention of a too long recession.

The crisis can stimulate the financial restructuring and reorganization, to develop new activities and gain new markets, taking into account the conditions of competitiveness and globalization, marked by challenges of the environmental crisis and the transition to a sustainable development.

The goals to reaching the end of the crisis and restart banking activities depend on: a cautious credit policy, a policy to stimulate the savings process, diversification of bank products and services, severe bank monitoring by National Bank of Romania, governmental measures to stimulate the business environment, the restructuring of the state budget sector and actively involving banks in EU funded projects.

To exit the crisis, banks should: innovate and develop all the aspects of banking activity, improve efficiency and productivity, redefine the acceptable risks policy, define their success also through the quality of revenue, rebuilt the trust in the banking system, develop sustainable legal framework for long term, consolidate the measures imposed under their global strategy and develop new systems of risk management.

The crisis requires a close cooperation between the business environment, banks, National Bank of Romania and the government authority. Banking reforms taken as a consequence of the crisis should consider loan policies and attract loan resources, human resources, marketing strategies and the bank client relationship.

The financial crisis can be seen as an opportunity for banks to balance their portfolio by redirecting towards innovative products and services, ultimately benefiting the end consumer. This turning point will also determine competitors to look at cost positions with the interest invested previously in market share expansion.

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