ANALELE ŞTIINŢIFICE ALE UNIVERSITĂŢII „ALEXANDRU IOAN CUZA" DIN IAŞI
Număr special **Ştiinţe Economice** **2010**

THE IMPLICATIONS OF THE GLOBAL CRISIS ON THE FINANCIAL PERFORMANCES OF THE ROMANIAN BANKING SYSTEM

Ioan NISTOR
Babes Bolyai University, Faculty of Economics and Business
Cluj-Napoca, Romania
inistor@econ.ubbcluj.ro

Mirela PINTEA
Babes-Bolyai University, Faculty of Economics and Business Administration
Cluj-Napoca, Romania
mirela.pintea@econ.ubbcluj.ro, miripintea@yahoo.com

Maria ULICI
Babes-Bolyai University, Faculty of Economics and Business Administration
Cluj-Napoca, Romania
maria.ulici@econ.ubbcluj.ro

Abstract

The increase of financial crisis in 2008 helped to bring the recession in developed countries and the reduction of acceleration in the economies of emerging countries. Moreover, the degree of vulnerability in emerging countries has increased through their dependence of external financing. Mutual potentiation of negative developments in financial markets and the real economy determinates a volatile environment, stressing the difficulties of forecasting the magnitude of the impact on short and medium term of the global crisis on macroeconomic developments in our country. Romanian banking sector is very affected, there are made changes of interest rate of monetary policy, of interest rates charged on loans and deposits, while the banks' bad debts are increasing.

The year 2009 brought with it the decrease in the financial performances of the credit institutions especially due to the constitution of provisions for the outstanding loans. The provisions exploded at the beginning of the year, conditions in which banks have recorded losses in January and February and, despite a slight recovery in March, first quarter results ware negative. On the other side the operational profits are still good so it depends on how each bank will be able to deal with the loans with problems in order to obtain a decrease in their provisions.

The banking system from Romania should find rapid solutions in order to improve their financial results through to improving the banking indebtedness for the entities depending on credits and in this way it contributes to accelerate the process of businesses development through credits.

Keywords: banks, provisions, loans, profitability, solvency, liquidity.
JEL classifications: G21, H81

1. INTRODUCTION

The banking sector is a vital segment of the economy, without which the modern economy may not exercise its role and functions and each country, implicit Romania, is interested in creating a solid banking system, which will allow providing an appropriate organizational framework for the enlargement of the monetary relations from economy.

Starting in the last quarter of 2008, financial and economic crisis impact on the Romanian banking sector is manifested increasingly pronounced in the indirect lane, namely that of external liquidity and the deterioration of macroeconomic conditions.

The worsening of global liquidity was reflected in particular by increasing financing costs and risks related to their short maturity. Short-term external debt of banks is a potential vulnerability that seems to be mitigated in terms of commitment from the parent banks of major new credit institutions with foreign capital to help maintain their exposure to Romania. The main concern in connection with the reduction of liquidity refers to its impact on future growth of credit and the potential negative impact on credit risk.

Central bank interventions had as an effect the improvement of the banking system liquidity in the first quarter of this year. In addition, the risk of less favorable developments due to external shocks or internal causes, appear as significantly mitigated by external funding agreements with the IMF and the EU and other foreign financial institutions, and by applying consistent set of macroeconomic and structural policies associated with them.

Profit is the ultimate objective of any economic entity and as well for any bank. This is the main source for the banks to increase capital, and its existance or its lack has a great impact on public confidence in a bank.

The concept of profitability is not related specifically with the banking area. Analysis for measuring profitability, determining economic and financial indicators and investigate ways to profit planning represent components of economic management in general, whose one important task is profit-seeking.

Bank's performances and their analysis are very useful to investors, companies seeking credit, the mere depositors or business people who have stable and extensive relationships with a particular banking institution.

Performance can be defined as the measure of stability of the business of a bank, characterized by low levels of all risk categories and a general tendency to increase profits from one period to another.

A healthy banking system is based on banks that are profitable and adequately capitalized. The profitability of banks is a relevant indicator of their competitive position on the market and of the quality of their management team.

On the background of the financial crisis and the competition among banks the essential task of banks' management is to choose the most efficient models of profitability, which aims to cover investment opportunities with their own resources.

2. DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2008, in Romania were 42 banks with assets totalling 79 billion Euro. The Romanian banking system is dominated by foreign banks owned, their assets representing 88.1% of total banking assets in December 2008.

Market share of the banks with capital of state was only 5.3% at the end of 2008. Competition in the banking sector remained strong, banks continuing to expand rapidly their network units. The number of their units stood at 6,549 in December 2008, increasing by 19.5% compared to the end of 2007.

The rhythm of growth in non-governmental credit remained high in 2008 (25.8% in real terms in December 2008), even if it was half the level registered in 2007 (50.5%). The share of non-governmental credit in GDP increased from 35.9 % in 2007 to 39.3 % in 2008. Also, the assets of credit institutions have increased from 63.1 % of GDP in 2007 to 67.4 % of GDP in 2008. However, the degree of financial intermediation in Romania (measured by share of banking assets in GDP) remains the lowest among member countries of the European Union.

The dynamic of credit activity remained high up in September 2008, but it stopped rapidly in the last quarter of 2008, when the credit international market has been blocked (the capacity of local banks to attract funds from outside dropped). Since October, banks' aversion to risk increased, and they started to restrict credit terms.

Also, the increase of premium risk for Romania led to an increase in the cost of external financing of banks and in the interest rates on loans in foreign currency, while the disappearance of liquidity excess from the domestic market has caused an increase in interest rates for loans in lei. As a result, the balance for credits granted by banks decreased in the last months of this year.

In the second half of 2008, the banks have focused their attention mainly to attract deposits. They have aggressively increased interest rate paid on deposits attracted from individuals and companies, both the national currency, as well as in foreign currency. Increases in interest rates paid on deposits were higher than increases in interest rates on loans and it started to put pressure on the decline in net margin of interest in the last quarter of 2008.

Also, the interest of banks for investments in treasury bonds rose, because they represent a stock of liquidity and enable banks to obtain rapidly liquidity from the Central Bank by appealing to permanent credit facility.

The central bank remained concerned about the rapid expansion of credit, particularly in the first half of 2008. In February, the central bank decided to introduce additional prudential measures by increasing the provisioning in the case of granted credits in foreign currency granted to debtors uncovered for exchange risk.

The central bank also decided to introduce the "stress test" procedure for the new loans granted. Banks were forced to adopt new rules for credit and to implement this procedure since October 2008. In principle, the new rules for credit have assumed a reduction of debt capacity of the population at uncovered exchange risk, because of the reducing of maximum level agreed for the share of available income of debtor's debt service (around 10 to 15 percentage points from 65 % to 70 % initially).The central bank also allowed banks to abandon the "stress test" procedure in case of mortgage loans and those secured by mortgages at the beginning of 2009, after the quickly reduction of credit dynamic.

The following table (table no.1) shows the main developments recorded at the level monetary aggregate balance of credit (commercial banks, savings and credit banks in the field housing, credit cooperatives) and the funds from the monetary market in Romania in the period 2006-2008.

Table no.1

Monetary aggregate balance of credit institutions during 2006-2008			
(Mld. RON)	2006	2007	2008
Assets			
Loans and investments in other banks and NBR	61.9	78.3	81
-minimum required reserves	59.1	74.7	73.2
Loans to residents	92.3	148.2	204.3
-population	39.3	71.5	99.2
-companies	49.7	73	98.9
-public sector	3.3	3.7	6.3
Holdings of securities, of which:	4.0	7.3	12.3
-issued by public administration	1.8	5.9	11
External assets	4.7	6.1	6.9
Intangibles	6.8	7.9	10.3
Other assets	5.6	12	25
Total assets	175.46	259.8	339.8
Liabilities & Shareholders' Equity			
Deposits of banks and other financial -monetary resident institutions	11.9	17.1	7.2
Deposits to residents	96.3	129.1	161.9
-population	44.0	67.3	82.9
-companies	46.5	54.9	68.6
-public sector	5.8	6.9	10.4
Debit Securities	1.9	3.1	1.2
External liabilities	40.5	70.8	103.2
Equity	19.7	25.6	36.3
Other liabilities	5.1	14	30.1
Total Liabilities & Shareholders' Equity	175.46	259.8	339.8

Source: [www.bnr.ro]

The value of total assets of banks in the first half of 2009 increased by 4.6% from 314.4 billion lei at the end of last year to 328.89 billion lei, as was reported by credit institutions to the central bank. Banks have closed in the first half at least 106 branches, of which only 70 units in June, decreasing territorial network to 6446 units, and reduced staff by 2403 employees, to 69,219 employees.

Net credits to customers fell 1.76% to 193.365 billion lei, from 106.8 billion lei in late 2008. Also, all non-bank customers loans, which means credits granted to population, firms, but also foreign companies and individuals, was maintained after the first semester to a level close to that of the end of last year.

2.1. Nonperforming loans

Commercial banks have entered on cumulative loss at the first quarter of 2009, a first in recent years, on the background of large increases in reserves established in January and February. Although provisions have increased significantly, coverage dropped from 143%

in November last year to 131% after the first quarter of this year, the coefficients being calculated by the IMF methodology.

Share of loans classified as doubtful or loss in total household borrowing increased almost three times at the end of March, to 6.03% from 2.17% at the end of first quarter of 2008. While the loans affected by arrears on at least one days, reported to total loans of the population increased from 6.08% in March 2008 to 13.3% in February 2009, there were banks which registered a level of 17-18% of the indicator itself. In table number 2 is presented the percentage of nonperforming loans to total loans.

Table no. 2

Bank Nonperforming Loans to Total Loans			
%	2006	2007	2008
Austria	2,1	1,7	...
Bulgaria	2,2	2,1	2,4
Czech Republic	3,6	2,7	3,1
Greece	5,4	4,5	4,7
Italy	4,9	4,6	...
Poland	7,4	5,2	4,4
Romania	7,9	9,7	9,8
Serbia	4,1	3,8	5,3
Hungary	2,5	2,5	2,9

Source: [www.imf.org]

2.2. Provisions

Slight decrease of provisions for problem loans has allowed banks to conclude the first half of 2009 with a slender profit of 90 million lei, but the perspective of rising unemployment - which means that more people will not be able to pay rates - still shape a half year at least as difficult.

At the moment, for a bank more important than getting the profit at the end of the year is its viability on short and medium term. The increase of the number of people with outstanding is expected to rise since unemployment is on an upward slope.

Also, the marked decline of the economy and maintaining financial blockage push more and more companies in insolvency, thus creating vicious problems for the credit institutions. The circle closes when these firms are redundant, and banks, affected by the bad loans squeeze more and more the credit activity. The pressure on profit margin in the banking system will continue to exercise, both because of the maintenance of uncertainty on financial markets, and the tendency to reduce the spread between interest rates on lending and deposit facility.

The profits earned by banks in the mid-year 2009 is over 21 times lower than the result of the first six months of 2008. In the mid of last year, the banking system reported a net profit of 1.9 billion lei. A strong shock occurred in the first quarter of 2009, when the explosion provisions pushed banks to a net result of minus 50 million euros.

Amount of provisions established by banks in the first semester increased by 49%, from 7.59 billion lei in December 2008 to 11.3 billion lei in the context of the advance speeds of debts and doubtful debts. In June was registered the first monthly drop on the last two years and a half, provisions going down by 2.63% against the provisions of May. Last year the banking provisions increased by over two times, from 3.6 billion lei in late 2007 to 7.59 billion lei. In table number 3 we presented the situation of the banks' provisions to nonperforming loans for a number of countries including Romania.

Table no.3

Bank Provisions to Nonperforming Loans			
%	2006	2007	2008
Austria	75,3	76,4	...
Bulgaria	47,6	...	...
Czech Republic	57,7	56,4	56,3
Greece	60,9	...	...
Italy	46	49,5	...
Poland	57,8	...	...
Romania	18,2	25,7	27,8
Serbia	...	...	...
Hungary	53,9	58,1	80,3

Source: [www.imf.org]

The expectations are that they will continue to grow in the next six months. This fact is explained by an important principle in accounting, namely the precautionary principle. Impact is primarily on profitability, but if reserves grow over a certain level - for example 10-15% of loan portfolio - the impact could be also on the solvency of banks. This level currently reaches approximately 6% of the loan portfolio.

Banks have led the credit activity at a level that make sense in the current economic context, by lax lending strategies of the past, and provisioning policies in a fair standard, the fight between credit institutions is now for good customers. At the individual level, the approach of banks is generally rational in terms of lending activity. There is a suspicion that combined at the industry level such justified individual conduct would have an unfavorable influence on the Romanian economy.

In the current economic situation in which there are many uncertainties, you can not force banks to give loans, as you can not force any customers to take loans. There was never a 100% freeze of lending. Banks still have honored the lines of credits to their best customers or still have given new loans to good customers with a good credit rating. Even now banks try to bring new clients. Competition moved for the segment of good customers.

2.3. Credit risk

Overdue and doubtful debts have increased over 2.7 times in the first semester, to 2.47 billion lei, in the context in which in June the monthly growth rate was slightly tempered to about 5%, compared to over 8% in May.

The credit risk rate, respective the overdue and doubtful loans and interest on all loans and interest, increased by 5.23 percentage points from 6.53% at the end of the last year to 11.76% in June. At the end of the first semester of 2008, credit risk rate stood at 4.72 percent.

Loans granted by the banking system reduced their share in total assets from 62.6% in December 2008 to 58.79%, in the context in which net loans to customers fell with 1.76% to 193.365 billion lei.

2.4. Cost / income ratio

In the first half of this year, the Romanian banking system has experienced a rapid increase in costs. Thus, at the end of June 2009, cost / income ratio was higher in Romania than in Hungary or Poland, knowing that at the end of the last year the indicator of performance was in line with the region.

Romanian banking system was characterized by a low efficiency in the first half of this year. Data published by the National Bank of Romania shows that, in June 2009, the ratio between costs and revenues of the credit institutions was 67.23%. In contrast, in Hungary or Poland, their banking systems recorded a level of banking performance indicator caught between 52% and 55%.

2.5. Profitability and Rentability

Domestic banks earned 4.5 billion euros last year from interest and commissions, which means a share of 5.8% of total assets. For example, in Hungary and Poland such incomes reported to assets were about 3.8%.

It is expected that the profitability of local banks to drop significantly this year amid the increase of the expenses with risk provisions, of the bad loans and after a low activity on market lending.

Romanian banks have recorded the highest profits last year reported to total assets of the EU, in the context in which the global financial crisis was felt with delay on the local market and profit margins from interest and commissions were at a high level.

The decrease of the efficiency of the Romanian banking system was determined, first, by the drastic slowing of the process of lending. At the end of June, the credit balance for non- governmental loans was with approximation of 198.06 billion lei (47.1 billion euros), nearly similar to that of December 2008 - when the balance was 198.09 billion lei.

Also, the reduction of external financing led credit institutions to attract deposits with interest rates higher than those in 2008. Thus, on the sector of investments in local currency, interest rates on term deposits went up in 2009, even up to 16% per year, compared with 9% - 10% in 2008. Also, in case of deposits in euro rates rose from around 4% last year to a maximum of about 7% in 2009. In this context, the profitability of assets held by Romanian banks was at the end of June 2009, only 0.05% knowing that in December 2008 its level was 1.56%.

Financial institutions prefer to provide to debtors the possibility for restructuring and rescheduling loans rather than mortgages run as they lost out on the one hand, and would be forced to hunt further on the debtors, on the other hand. Banks will try to offer their customers a way to pay rates at least as long as mortgaged property can not be recovered to settle debts. Overall balance of the arrears to six months of the population reached around 1.5 billion euros.

Last year, incomes from interest and commissions of the banks on the Romanian market represented 5.8% of total assets held. In terms of the assets of the banking system amounted to 78.9 billion euros in December 31 can be deduced that banks have earned from interest and commissions no less than 4.5 billion euros. For example, the similar incomes of the banks in Hungary accounted for only 3.8% of total assets.

Rates of return (ROA and ROE) continued their trend slightly upward, although the development of operational efficiency was positive in 2008, amid an increased focus from credit institutions on judicious management of operational costs. The next perspective can not be excluded if a more strongly negative impact on the profitability of credit institutions, due most likely to increase interbank funding costs amid international financial turmoil persists.

In the following table (table no.4) we presented the evolutions of some financial indicators regarding the banking systems from a number of countries including Romania.

Table no.4

	2006		2007		2008	
	ROE	ROA	ROE	ROA	ROE	ROA
Austria	16,9	0,7	18,3	0,8	...	0,70
Bulgaria	24,4	2,2	25,4	2,5	23,10	2,10
Czech Republic	22,5	1,2	23,1	1,3	23,70	1,30
Greece	12,8	0,8	20,1	1,3	...	0,70
Italy	11,5	0,8	...	0,80	...	....
Poland	21,0	1,7	25,6	1,8	22,20	1,70
Romania	11,7	1,5	11,4	1,3	18,10	1,70
Serbia	10,0	1,7	12,8	2,1	10,60	2,10
Hungary	24,0	1,8	22,9	1,8	17,70	1,50
European Average	16,7	0,6	11,40	0,40	...	...

Source:[www.imf.org]

Romanian banks have managed to be the most profitable in Europe even if the minimum reserves (RMO) required by the NBR are the highest in the EU. For example for the liabilities in foreign currency, banks must reserve up to 30% at NBR.

During the next period it is expected the crisis to be felt more acutely in the banking system.

Some banks have already reported in the first half of 2009 a level of equity returns by about one third lower than in the corresponding period last year amid increased costs with risk provisions generated by the increase of the bad loans portfolio.

2.6 Solvency and liquidity

The year 2008 marked the downward of the slowing trend of solvency ratio calculated at the aggregate level for lending institutions, this ratio reached 12.3% at the end of December 2008 while at the end of March 2009 indicator stood at 12.03%. Relevant factors to the situation referred were the actions to increase the capital of credit institutions, as well as slowing the growth rate of non-governmental credit, particularly in late 2008 and first quarter of this year.

Even while maintaining an overall downward trend, the solvency ratio is at a level corresponding to all credit institutions, being higher than the minimum threshold required by the prudential regulations applicable in Romania (8%), aligned with those in force in EU.

The comfortable financial result recorded in 2008 by the banking system in Romania was made in a framework characterized by the end of an economic favorable cycle (characterized also by financial and banking activities with highs in expanding the operations) and the start of a difficult period marked by financial international crisis, as well as uncertainties regarding future domestic macroeconomic developments.

Under this circumstances, the increase of the minimum solvency ratio - which measures the adequacy of capital held by banks to the risks taken - from 8% to 10% is a good decision. In mid-year solvency indicator stood at a comfortable level, 13.5%.

Good financial results, and the high degree of capitalization have helped strengthen the shock resistance of Romanian banking system. Extension of the period marked by turbulence and uncertainty could affect the profitability of banks by the high costs of financing and high costs with provisions. Romanian banking system achieved in 2008 an aggregate net income of 4 681.9 million lei (1 271.3 million euro), up with 73.9% the one recorded in 2007.

Since the last quarter of 2008, impact global financial and economic crisis over the Romanian banking sector manifest themselves in ever more pronounced in an indirectly way: on an external liquidity and that of the damage of macroeconomic conditions.

Worsening global liquidity was reflected especially by increasing the cost of financing and risks related to the maturity of their short. The external debt on short term of the banks represent a potential vulnerability, what appears to be mitigated under the conditions commitment from the mother-banks of the main nine credit institutions with foreign capital to maintain its exposure to Romania.

The main concern in connection with reduced liquidity concerns its impact on future growth of credit and the potential negative impact on credit risk. Central bank interventions have had the effect to improve the liquidity of the banking system in the first quarter of the current year.

In addition, the risks of less favorable evolutions, caused by external shocks or internal causes, appear as significantly alleviated by financing agreements abroad with the IMF and the EU, and with other foreign financial institutions, and by applying to a coherent set of macroeconomic and structural policies associated to them.

The liquidity ratio calculated in accordance with regulations in force is maintained at levels exceeding the minimum limit governed by the NBR. Asymmetry on bank holdings of cash could significantly increase on short term, some of these difficulties to cope with fluctuations in liquidity. Also, the relevation of the ratio is closing strong in times of crisis when liquidity of different asset tends to deteriorate. In table number 5 are presented the solvency and liquidity ratios for Romania in the period 2006-2008.

Table no.5

	2006	2007	2008
Solvancy ratio	18,10	13,80	12,30
Liquidity ratio	2,30	2,15	2,56

Source: [www.bnr.ro]

3. CONCLUSIONS

The financial crisis has exposed the Romanian banks to global pressures of liquidity and of reduced economic activity worldwide. Global conditions from financial markets remain difficult, after Romania's rating was lowered, and in the context of the global financial crisis, authorities have requested support from IMF, World Bank and the European Union.

Although the package offered by IMF supports the country's credit quality, economic perspective is difficult and the authorities will have to adopt strict policies for international support given to have the desired effects.

There will be pressure on revenue growth rate due to increasing risk costs and reduced margins caused by increasing financing costs. Low efficiency limits the absorption capacity of the costs of nonperforming loans.

Almost half of Romanian banks have recorded losses in the first quarter of 2009, according to Romanian accounting standards, largely due to costs related to nonperforming loans. Global recession could lead to the extension of credit losses and reduction of profitability of Romanian banks in 2009 and 2010. This could force the parent banks from abroad, to inject additional capital to support the activity of subsidiaries from Romania.

Also, banks have been affected by the reduced level of growth of lending activity, which affected the revenue obtained from fees.

The quality of assets held by the Romanian credit institutions has considerably deteriorated in 2008 and first quarter of 2009. This trend is expected to continue considering the severity of the crisis and reduced availability of financing, being difficult to estimate when the losses related to non-performing loans will reach the highest level. The fact that mother banks have showed their support for subsidiaries in Romania in the context of the agreement signed with the International Monetary Fund offers a dose of comfort.

The rating of Romanian banks owned by foreign groups reflects the support they can enjoy from the major shareholders, but the rating is limited by the country ceiling of Romania established by Fitch to 'BBB'.

Fitch considers that a stronger capitalization of Romanian banks would provide a point of support in front of potential asset quality problems in an economy in full syncopation. The indicator of the banking system established by Fitch for Romania is 'D', reflecting the intrinsic banks' weakness.

If there are no major improvements in the operational environment, not expected in the medium term, also reflected by the negative short-term perspective of credit rating of Romania, the potential for an increase in individual ratings of Romanian banks is reduced.

It is imperative to use every lever available to try to solve the current problems but, however, banks must not lose sight of the need for innovation and development of all aspects of banking activity. In 2009, this goal will be reached by the need of the credit institutions to improve efficiency and productivity. Operations must be streamlined, transactions' cost reduced as possible and the products and banking services rethought.

The banking system from Romania should find rapid solutions in order to improve their financial results through to improving the banking indebtedness for the entities depending on credits and in this way it contributes to accelerate the process of businesses development through credits.

References

[1] Oprițescu Marin, *Noi abordări în analiza performanțelor bancare*, Finanțe - Provocările viitorului, no. 8, Editura Universitaria Craiova, 2008
[2] ***Financial Stability Report of National Bank of Romania, 2009
[3] ***Financial Stability Report of National Bank of Romania, 2008
[4] ***Financial Stability Report of National Bank of Romania, 2007
[5] ***Global Financial Stability Report Responding to the Financial Crisis and Measuring Systemic Risks, World Economic and Financial Surveys, April 2009
[6] www.bloomberg.com
[7] www.bnr.ro
[8] www.imf.org
[9] www.zf.ro