

# THE DEVELOPMENT OF THE CREDIT MARKET IN SOME CENTRAL AND EASTERN EUROPEAN COUNTRIES (ESPECIALLY CASE: ROMANIA)

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## **Abstract**

*The present paper aims at presenting a comparative analysis of the non-governmental credit in the Central and Eastern European region and the necessity of passing to a proactive stage in banking regulation and surveillance, stage in which The Romanian National Bank does not only react to the market developments but also tries to anticipate them and to influence the decision-making factors in view of adopting those measures that lead to the sustainable development of the banking activity in Romania.*

Keywords: non-governmental credit, investment credit, agriculture credit, local administration credit, small and medium size enterprises credit.

## **1. Introduction**

The constant concern of the Central Bank to achieve a safe, modern and competitive banking system able to assure a good intermediation and generate the public's trust can be seen, among other things, is the systematic monitoring of the internal market of banking package and services as well as of the trends in the European banking field.

In the last years, the economic and financial framework in Romania has improved, but the differences between it and the one in the countries in Central Europe (or EU-15) are, in some respects, considerable. A carrying on of the structural changes requires financing and, if we take into account the part played by the banking field in the Romanian financial system, this financing will be mainly assured by the credit institutions. The analysis of the credit offer and demand has shown that these two factors act in the same direction: towards the increase of the credit to the private sector.

Therefore, from the point of view of the credit demand: (i) the process of restructuring the economy (in view of turning it into a functional market economy able to face the competitive forces, especially to those in EU) and (ii) the modification of the households' behaviour (as a result of both the income increase and of adjusting the consumption preferences towards the consumer durables and services) lead to an increase of the need of financial resources both for consumption and investments. From the point of view of the credit offer, the reorganization and privatization of the banking system and the increase of the competition contribute to the offer expansion.

## **2. The Development of the Credit Market in Central and Eastern Europe**

The significant development of the credit to the private sector is characteristic not only to Romania, but to most of the countries in

Central and Eastern, Baltic and Balkan Europe (Appendix 1 - Table 1 and Figure 1).

But the credit to private sector rate of rise is decreasing in the last two years (Appendix 1 - Table 1), which can indicate the beginning of the maturing period for the banking system in the case of the economies in this part of Europe.

The same table shows that in the analyzed period one can notice a special increasing development of the loan granted to households, increase that surpassed the one in the case of granting loans for companies. At the same time, the currency loan has evolved more rapidly than the one in national currency in the case of most of the analyzed countries. The more attractive currency financing conditions and the increasing trend of the national currency which is characteristic of the countries that are now in transition can both be possible explanations for the increase of the currency component of the loan. Two exceptions stand out in the analyzed sample: Poland and the Czech Republic, cases in which the component of the currency loan has decreased too (Appendix 2 - Table 2). In the case of Poland, this can be explained by the fact that the financial performances of the companies were considerable in 2004, which created a surplus of funds used for self-financing (this explanation also stands true for the Czech Republic, too). Under these circumstances some companies have decided to reduce the exposure in the case of currency and took advantage of the appreciation of the national currency in the latter half of 2004 to reimburse the loans denominated in foreign currency by means of the loans denominated in national currency in advance. The result was a diminishing of the currency loan granted to companies with 27.39% in 2004. A similar behavior can also be noticed at the households level, the currency loan decreasing with 5.15%. In the case of Slovenia, the diminishing of the national currency loan is accounted for the worsening of the loan quality, the banks being more prudent in granting them; at the same time, one can notice an increase of the currency component of credit to the private sector (in the case of Slovenia, too), increase explained by the appreciating tendency of the national currency (Appendix 2 - Table 2).

Taking into account our analyses, one can notice that, in the case of the Europe countries, those of them that have increased the credit to the private sector more have, as a rule, a smaller share of credit to the private sector in the GDP and vice versa (Appendix 2 - Table 2).

The slower rate of rise in the case of credit to the private sector is associated with a maturing of economy and an increase of the degree of financial development. In conclusion, we can assert that the development of the credit to the private sector in Romania in the last few years is similar to that in the countries in the Central and Eastern Europe. Among the main causes of this development mention can be made of the following: the improvement of the access to the banking resources, the favorable conditions of external financing, the degree of financial development, the favorable economic prospects on mid and long term as well as the necessity to continue to finance the structural reforms.

From the point of view of the debtor (Strahan și Weston, 1998) have underlined the fact that the level of financing the SME is continuously increasing as compared to the bank dimension, but the share of the credits for SME on the unit of banking asset increases a lot. A possible explanation for this is that, in the case of economic expansion, the big companies will be able to be financed up to a greater extent from their own sources or from the capital market. That is way, taking into account these arguments, the Romanian banks may turn especially towards the small and medium companies; therefore the risk margin can be easier included in the cost of the credit, if there is a decreasing trend of the interest rate.

The development of the credits for the non-financial companies, depending on the destination, has been modified from the pint of view of the structure. The treasury credits are still the most important, but their share is decreasing. The loans for real estates (mortgage credits), are the most dynamic, underlining the dynamic of both the building field and especially that of the commercial spaces.

The credits for equipments have remained at a constant level in the total of the credits, which is 20% (out of which only 16, 5% are in RON and the rest in currency, a fact that can be explained by the buying of machinery and equipment from abroad).

The mortgage credits development in Czech Republic (during 1997-2002), Poland (1996-2002), Bulgaria (1999-2002), as well as the mortgage credit ratio in the total domestic credit and into GDP in those countries show that in all those analyzed countries the mortgage credit displayed an ascendant trend, with significant increases in real terms from a year to another and in Poland and Czech Republic cases the percentage of the mortgage credits in the total domestic credit rose almost fifth times comparing to the beginning of the analyzed period and their share into GDP doubled in the same period (Appendix 3 - Table 3.1.).

Those net superior levels of the indicators in those countries comparing to the ones realized in Romania show that our country ranges on one of the last places among the Central and Eastern European Countries in the mortgage credit area (Appendix 3 - Table 3.1.). In the analyzed countries there were two main factors that stimulated the mortgage credit development: (1) an active state involvement by granting some facilities to the mortgage credits beneficiaries and (2) the diversity of the financing sources (even in the medium and long-run), due to the some financing models applied concomitant in the mortgage credit area within the banking system:

1. commercial bank model (financing is based on the deposits attracted from the clients) - this one is the only effective financing model in Romania ;
2. mortgage bank model (financing is based on issuing the mortgage bonds);
3. savings house model for the dwelling area (with an active state involvement);
4. secondary market model (mortgage credits re-financing by selling the debts to some authorized institutions on the secondary market).

Implementing these models in the banking system of every country took time, legal and institutional efforts, but it paid off if we consider the positive development of the mortgage credits and their strong social impact. So, most of the Central and Eastern European Countries adopted the regulations regarding mortgage banks and the issue of the mortgage bonds (Czech Republic in 1995, Hungary and Poland in 1997, Slovakia in 1996 and 1998 and Bulgaria in 2000). We have to specify that there were two different approaches in the view of issuing the mortgage bonds: (1)

the one based on the specialized mortgage bank principle (adopted in Poland and Hungary) and (2) the other based on the principle of universal bank which can take an authorization for issuing mortgage bonds (in Czech Republic, Slovakia, Bulgaria and Romania).

Although implementing this alternative method for financing the mortgage credits had a favorable impact on their development in these countries and regulations regarding mortgage bonds protect enough the investors, in the present, mortgage bonds issue represents only 20% of the total financing sources of the mortgage credits in these countries.

For what introduction of the saving and crediting in mutual system for dwelling area is concern, the regulations in this area were implemented in 1992 in Slovakia, in 1993 in Czech Republic, in 1996 in Poland and in 1997 in Hungary. As a result of that, the activity of the saving houses rose spectacular both in the contracts number and credits number and volume area, but also in the volume of the premiums granted by state.

For example, in Czech Republic, the number of credits granted in this frame rose almost 390 times during 1995-1999 and the share of the premiums granted by state (for the savings amounts) in the state budget balance reached pretty high levels and still increasing from 0,1% in 1994 to 1% in 1999.

Going back to the structure of the Romanian non-governmental credit granted to the non-financial economic agents we can stress out that the loan denominated in foreign currency granted to companies could continue to increase if the loan for equipments is 20% of the total of the loans granted to companies, and 73% of these are loans denominated in foreign currency (that is 58% in Euro), and the credits on real estate are increasing, too (93% being in currency, 78% in Euro). On the other hand, the increase of the interest rates on the international level could influence in a negative way this type of financing.

The credit for export will continue to be at a low level especially because of the existing problems in the export field (the low level of profitability in such branches as the textile industry), in 2005 the main beneficiaries of these credits being the companies working in the wholesale trade field and broking services in the wholesale trade.

The volume of the credit granted to the households has been increasing a lot starting with the end of 2002, the most dynamic component being the consumer credit. This continues to represent about three quarters of the total of the credits granted to the households, situation that is different from that existing in the countries in the Euro zone where two thirds are destined to real estate financing. If we analyze the structure of the consumer credit, mention can be made of the fact that there is a tendency to balance the credit components granted to buying consumer goods and credits and to achieve other purposes.

The increase of the consumer credit offer can be accounted not only for the expansion policies in this field of the credit institutions, but also for the increase in these last years especially of the big shops custom to offer consumer durables in instalments. From the point of view of the demand, the explanations mention the increase of the population's purchasing power (as a result of a more permissive fiscal and income policy), the change of the low degree of endowment with consumption goods.

### **2.1. The Investment Credit**

The dimension of the investments credit market can't be analyzed without taking into consideration the volume of the investments made in our economy. If we look at the statistical data, we can emphasize that the

total amount of the investments made in Romania was in 1997-2000, almost twice smaller than the one in Hungary and almost four times smaller than the one in Poland (Appendix 3 - Table 3.2.).

In such circumstances, there are necessary some measures for stimulating the investments credits by cutting down the factors that brake the business development in Romania (diminishing the excessive fiscal burden, rising the stability of the legal and institutional frame, avoiding the inconsistency of the regulations regarding the foreign investments frame, simplifying the administrative procedures needed to settle up a new business) as well as the improvement of the conditions of the investments credit market where the banks have an important contribution (providing the consulting services to the potential clients regarding the optimum way to finance and to assist the business plans, promoting this new banking product among the investors). Given the direct connection between the investments credit development and the general economic development, it is difficult to make a relevant prediction on the investments credit development and to establish some quantitative objectives in this area, especially given the unavailable data regarding the investments credit development in the Central and Eastern European countries, fact that limits a comparative analysis between Romania and these ones.

Still, we can appreciate that the macroeconomic stability and the alignment to the European regulations will have a great positive impact on the foreign flows, in general, and especially on the investments.

In general, we can not talk about specific factors that brake the development of the Romanian investment credit market; in the present, it is influenced by:

1. the behavior of the market participants;
2. the macroeconomic circumstances.

1. a) On the one hand, the banks are against the risks that may appear when they grant credits on long and mid-terms, preferring to grant credits on short terms, which, apart from the very few risks they involve also offer the advantage of keeping a higher level of liquidity.

Apart from this, the investment plans and the feasibility studies presented to the banks by the people that want to be granted credits are not properly made out and do not take into account all the investment costs, which has negative effects on deciding upon the number of the financial resources necessary to implement the respective investments plans. Under these circumstances, banks prefer to train and use their own analysts to analyze the viability of the business run by the people that want to be granted credits and to counsel their clients, which involve extra costs.

b) On the other hand, the investors do not trust the loans, because:

- the big active interests are to be found in the cost of the equipments bought; thus diminishing the total profit of the business;
- the level of the banking culture in Romania is low, and most of the business men consider banks only as potential partners and analysts.

2. The unfavorable macroeconomic conditions have a strong influence on the volume of the financing sources of the investment loans granted in national currency. It is difficult for the banks to make people open deposits in RON on mid and long terms. At the same time, the macroeconomic instability prevented the long-term evaluation of the results generated by the investments for which loans are asked, which limited the possibility of granting credits for investments in conditions of increased security.

The access to investment loans in RON is also limited because of the restrictive level of the active interests of the banks. The dimension of the investments credit market is linked to the volume of the investments made in the national economy.

Taking into account the fact that the capital transfer in the economy are not significant and that the investors prefer to resort to less expensive means of financing (the reinvestment of the profit and of other proper sources, the shares issue, etc) we cannot expect, in the near future, a spectacular development of the investment credits in Romania. In these circumstances, in order to stimulate the investments credits it is necessary to adopt some measures of diminishing those factors that prevent the business developments in Romania (the diminishing of an exaggerated fiscal burden); the increase of the stability of the legal and institutional framework and the avoidance of legislative instability as regards the foreign investments, the simplification of the administrative measures imposed when setting up a new business), as well as the improvements of the conditions existing on the market of the investment credit, the banks having an important contribution in this direction (offering consulting services for the potential clients regarding the best means financing and assisting in making out the business plans), promoting this banking product to the investors, etc.).

However, the macroeconomic stability and the leveling up to the communitarian legislation will have a positive effect on exports in general, and on investments, in particular.

## **2.2. The Credit for Agriculture**

The lack of some adequate collateral, the low profitability level realized in the agricultural sector, the economic instability as well as other specific factors in a transition economy had a negative impact on the agricultural sector development and it was seen as a high risk sector.

This sector didn't attract investments either in other Central and Eastern European transition Countries such as Slovakia, Czech Republic, Hungary and Poland (Appendix 3 - Table 3.3.).

The banking sector in these countries acts very prudent when it comes to credit the economic agents from agricultural sector and there is a lack of competition in the banking system when it comes to provide this banking product. The commercial banks use a small part of their funds to credit agricultural sector even when those credits were guaranteed by different funds or agencies. Guarantying the credits granted to agricultural economic agents is realized in other countries by the institutions similar to the Romanian Fund for Guarantying the Rural Credit, such as:

- the Fund for Supporting and Guarantying the Agriculture and Forests in Czech Republic which was settled up in 1994 and offers collaterals for the short and long-term credits granted by the commercial banks as well as some subsidies for the interest;
- Foundation of Guarantying the Rural Credit in Hungary, settled up in 1991, offers collaterals for short and long-term credits;
- the Agency for Restructuring and Modernizing the Agriculture in Poland, settled up in 1994, offers subsidies for credits granted by the commercial banks, as well as collaterals for farmers and producers in the food industry;

- the Fund of State Support for Agriculture and Food Industry in Slovakia, settled up in 1994, offers collaterals and special credit programs for farmers and producers in the food industry.

In the Central and Eastern European Countries such as Poland, Hungary, Slovakia, Czech Republic, agriculture and the economic sectors connected to it are more developed than in Romania and the producers organizations play an important role in agriculture, farmers being financially supported by these organizations. Financing the investments in the current assets, agricultural machines and equipments is largely provided by the commercial credits and not by the banking credits. Inputs providers and the companies in this sector provide credits to the agricultural producers as a part of their contractual relations with the latter ones. In many Central and Eastern European countries, began to develop leasing and other financing methods between the agricultural economic agents and other sectors related to them. These contractual relations are adequate for satisfying the financing needs in the short and medium run and they display very different forms: equipment leasing, forward contracts for delivering the outputs in exchange for inputs, credits in goods granted to the farms by the producers and the inputs suppliers (in the deposit certificates system - Slovakia has the most developed system of such kind). Moreover, some banks of these countries settled up their own leasing companies, as their branches. Buying the agricultural machines and equipments by those leasing companies and renting them in leasing system to the agricultural producers solved the collaterals problem.

The volume of the agricultural credits granted by the commercial banks of the analyzed Central and Eastern European Countries faced a descendent trend (in Czech Republic during 1996-2002, in Slovakia during 1995-1998 and during 2000-2002, in Hungary during 1999-2002). Regarding the share of agricultural credits in the total domestic credit, it reached low levels during 1995-2002 in Slovakia, Hungary, Czech republic, those levels being similar to the ones reached in Romania (Appendix 3 - Table 3.3.).

On the whole, the share of the Romanian credits for agriculture in the total of the credits granted by the banks has been kept at a low level because, as we have pointed out above, of the high risk of investing money in this field, as a result of the influence of some factors.

Starting with 2003, the market of the credits for agriculture expanded, as a result of starting the Rural Financing Project which is based on the Credit Agreement between Romania and the International Bank for Reconstruction and Development on the 30<sup>th</sup> of April 2001. Another important factor is the improvement of the legal framework regarding the agricultural insurances by adopting the Law regarding the compensation granting in case of natural catastrophes in agriculture and the Renting Law. Both these normative acts stimulate the insurance of agricultural crop and animal breeding. At the same time, the adopting of the Agricultural Credit Law for production is also to be mentioned.

### **2.3. The Local Public Administration Credit (LPA)**

The factors that hinder the development of the LPA market:

**1.** An important source for financing LPA is formed by the income from the state budget (in 1999, their share in the total of the LPA income amounted from 30% to 68%), and an important part is played by the amounts and deducted shares from the income taxes.

If we take into account the fact that the Parliament can modify these shares of the transfer from the State budget every year; we can say that

this mechanism of allotting the funds lacks stability and predictability.

In these circumstances, there is an insecurity regarding the share that will be given to the LPA every year. Thus, it is difficult to make long and medium-term investment plans.

Hungary was confronted with a similar situation regarding the instability of the transfers from the State budget to the local administrations. As a result of the decisions taken by the Parliament, their development decreased in the period 1991-1995, from 100% to 35%.

Unlike the situation in Hungary, the conditions imposed by the EU fiscal legislation, the stability of the formula of allotting the budgetary income to the local administrations in the countries that are members of the EU contributed to their inclusion in the category of their own income.

2. The resorting to loans depends greatly on the LPA's capacity to generate their own income, as part of the income on which they have direct control. LPA can set, follow and encash the respective income, being able to make out its own fiscal policy depending on the state of the local economy. The increase of the degree of LPA's financial autonomy, which have direct effects on the decrease of the loan risk, can be achieved by a series of measures such as: the identification of the not-declared taxation base, the decentralization of the income tax from the State budget to the local budgets, the identification of other taxes that can be decentralized from the State budget to the local budgets, setting some developing strategies for those towns with low economic potential.

3. In the present, mention can be made of a low degree of LPA's financial credibility, caused by an improper financial management, by a lack of predictability and stability of the incomes and by a system of financial reporting which do not encourage a credit analysis. In this context, banks face the difficulty of evaluating the risks which are generated by LPA's granting of loans.

4. One can notice a lack of training in the case of the participants to the credit market for LPA. On the one hand, the credit officers working for the banks are not aware of the structure of the local finances and the legal framework that governs LPA, because there are no specific norms for granting them credits. On the other hand, the LPA officers do not have the necessary training for drawing up the necessary documents for being granted credits (feasibility studies, audit reports) and are not aware of the procedure and the stages that must be followed in this direction.

5. In the present, one can notice the absence of a legal framework to regulate the way of solving the LPA's cases of insolvency; there are only legal provisions which have in view the means of remedying the cases when the short-term loans were not paid back (making out and handing in a recovering plan according to the provisions of Art. 54, Law no. 189/1998, taken from Art. 62, OUG no. 45/2003). We consider that it is best to draw up some procedures that aim at foreseeing the means of supporting LPA in view of recovering and obtaining their financial stability.

6. There are many territorial-administrative units with a low number of inhabitants (1,674 of local councils, having a share of 57% out of their total number, represent towns with less than 5,000 inhabitants), which can not start programs of important investments.

7. It is necessary to develop a credit culture for LPA in the case of the market participants, especially in the case of LPA and that of the public creditors. It is compulsory that the public creditors practice



the crediting standards in accordance with the one imposed by the Government to the private credit institutions. Thus, it is imperative to carefully monitor the payments for the reimbursement of the loans granted to LPA, even if they are financed from the State budget and, maybe, granted in preferential conditions. Apart from this, the demand of the local authorities for bank loans could be encouraged by not granting subsidies with interest in the case of the loans granted from the public institutions, it is better that the respective subsidies take another form (for e.g. transfers from the State budget which cover a part of the investment costs).

#### **2.3.1. The Prospects of the Development of the Credit Market for LPA**

It is difficult to set some quantitative objectives for the future development of the credit market for LPA because:

- the existing data base referring to the credit market for LPA in Romania is insufficient in order to make its general characterization and does not offer the possibility of making predictions;
- the available information about the situation of the municipal credit tries that are now acceding to the EU does not allow the setting of several goals for our country, because of the significant differences existing between these countries and Romania, from the point of view of the conditions and the structure of the municipal credit;
- the prospects of the credit development for LPA in Romania must also take into account the effect of partial or total eliminating the hindrances mentioned above as well as the implications of the process of accession to the EU, which imply an increase of the investments for the local infrastructure, according to the European demands.
- It is difficult to foresee the future development of the volume of the municipal bonds credit, because of the fact that this market has been recently opened (October, 2001) and because of the existing insecurity referring to the possibility of putting into practice the intentions expressed by LPA of resorting to this means of obtaining financing sources.

#### **2.4. The Credit for Small and Medium Enterprises (SME)**

Taking into account the fact that the SME field is continuously changing and is very important for the entire national economy, an analysis of the market of the credits granted to this category of enterprises must take into account both its development and the participation of the respective field in forming the macroeconomic indicators.

The factors that hinder the development of the credit market for SME:

**1.** The economic potential of the SME field, in spite of its important contribution to the GDP, is not still perceived by the banking field as a real economic potential in which investments must be made and out of which profit can be obtained. The alternatives that are at the disposal of the banks for investing the available funds and from which they can benefit because of some low costs, because of the low competitiveness existing in the system, is more attractive as compared to granting credits to the SME field to which, besides this, other risks are associated, risks that the banks are not yet prepared to identify and manage (Appendix 3 - see Table 3.4. for the structure of non-governmental credit and its share of GDP).

**2.** The fact that SME do not know very well the financing offers of the banks because of the latter low level of transparency. Therefore, it is

compulsory to improve the information flow among the market participants (setting up some informative centers for SME, a better promotion from the part of the banks of their products, creating a visual data base comprising the total of the available financing programs.

**3.** The banks face a lack of information regarding their clients' business behavior mainly because of the lack of a presentation of the respective clients' relations with various creditors. In order to surpass this obstacle, we must take into account, on the one hand, the updating of the Center of Banking Risks - part of the NBR- (the reporting requirements have been extended in the case of the financial institutions, too, taking into account of the information referring to the debtor groups among which there are economic links, providing pertinent information about both history of the credits and the debtors' payment incidents, providing information referring to the frauds in the case of the credit cards) and, on the other hand, setting up a private credit office.

**4.** The banks do not have at their disposal a very developed territorial network; this hinders the access of the SME to this financing means. Apart from this, the programs for granting credits to SME are not to be found in all the branches of a bank. For example, one of the trade banks that benefited from BERD financing line between 2002 and 2003 for crediting the SME which amounted to 10 millions Euros, had at its disposal a branch network with a low degree of territorial covering (15 counties and Bucharest) and the respective product was destined for financing the SME only in 9 counties and Romania.

**5.** The SME find it difficult to give guarantees at the levels required by the banks (usually, they are situated in the range 150%-200% as compared to the level of the required credit), which makes them resort to other financing sources (for example, commercial credit). This is also explained by the fact that, if most of the SME function in such fields as commerce and other services (over 80%), they have only a few fixed assets, thus being unable to offer the required guarantees.

**6.** In the present one can notice the absence of the portfolio of the Romanian banks of the credits granted to newly-created SME or to those that have not started their activities, but have in view to make an investment, although the eligibility criteria of some of the financing programmes from external funds do not reject this category of beneficiaries (for example, the financing programmes from BERD sources). There are many causes that have generated this situation. Among these, we mention the low level of the owned properties which can be given as guarantee in the case of obtaining credits.

**7.** Another problem arose at the level of the demand. The most part of the SME is formed by the micro-enterprises (92.5% in 2000) and, because of their low volume of activity, the financing demand, both for supporting the current activity (treasury credits) and investments, has in view mainly the low-value credits, under the breakeven point of the banks.

**8.** Although most of the credits granted to SME were destined for micro-enterprises, however, the percent of the respective credits is rather low as compared to the share of this category of companies in the total of the SME (about 90%). Apart from that, the general causes that restrict the credit market for SME (the high level of the interest rates as well as that of the required guarantees, the applicants' lack of training, etc.), there are also specific hindering factors in the case of micro-financing, such as the lack of symmetry of information.

**9.** It is also to be noted the fact that there are only a few long-term credits granted to SME by the banks because of the microeconomic

instability (the inflation rate), the high degree of uncertainty regarding the life span of SME and the lack of some long-term financing sources.

10. Taking into account the fact that an important part of the external funds for financing the SME is obtained by means of the Regional Development Agencies (especially *grants*), our opinion is that giving up on this system, at the same time with the increase of the involving degree of the commercial banks, especially of the micro-financing ones, in obtaining such funds, could have good results for the development of the credit market.

#### **2.4.1. The Prospects of Developing the Credit Market for Small and Medium Enterprises**

It is difficult to make realistic predictions about the development of the credit market in the case of SME because:

- from the point of view of the offer, it is difficult to say up to what extent the crediting programs from other sources, placed at their disposal by the external financing sources (BERD, PHARE, American and German Governments, etc.) will achieve the goals for which they have been created;
- It is difficult to make a forecast of the credit demand for SME if we take into account the fact that it is difficult to predict the overall development of the SME field because of the great number of variables that influence it.
- the credit market will also be influenced future degree of development of other products too, which have in view the SME's financing need (commercial credit, *factoring*, *leasing*, etc.) as well as the involvement of the credit unions in granting loans for the SME field. As far as this last aspect is concerned, mention can be made of the fact that, if there are enough data, one must analyze the way in which the credit granted by the credit unions can be an alternative of the bank loan in the case of SME;
- the existence on the market of some other providers of such services (The German Fund, The American Fund, The Regional Development Agencies by means of which external funds are obtained) which can distort the competition, as they can grant credits for SME in better conditions than the banks;
- the prospects of developing the investment funds with venture capital is an important financing source especially for micro enterprises and newly created companies in the countries in which the accession process in the European Union is in progress.

### **3. Conclusions and Suggestions**

This development of non-governmental credit could lead to a share of 30% of the non-governmental credit in the GDP in 2010, a value which is still under the values recorded in the present in most of the central and Eastern Europe countries. The difference between Romania and these countries shows, on the one hand, the potential of development of the Romanian banking field but, on the other hand, it shows either: (i) the existence of a certain limitation of the investment possibilities in the real economy, or (ii) the existence of an oligopoly state in the Romanian banking system which is also characterized by the use of some high prices (interest rates) which lead to a less attractive financial intermediation and/or (iii) the existence in the possession of the companies of some personal or borrowed resources (from other non-

financial companies) which are significant or are still increasing, a fact which makes them resort to credits granted by the banks only occasionally.

The significant rise rate of the credit, as well as the fact that it is mainly addressed to households and to currency financing, are all characteristics met not only in the last years in Romania, but in most of the countries in the Central and Eastern Europe. Faced with these developments, the Romanian banks have found the instruments necessary to a proper management of the crediting process, fact that can also be noticed in the low and the decreasing level of the credits in the total of the unpaid granted credits. However, this indicator can undervalue the credit risk existing in the system, because the maturities of financing are ever greater, the provisions are pro-cyclic and the rise rate of the loans is considerably superior to the rhythm in which the credits, other than the standard credits, are entered in the balance. In this respect, a possible solution could be the change of the present regulation regarding the provisions in view of adopting a dynamic provisions framework.

Among the products we estimate the Romanian banking sector will especially make use of, mention can be made of: the credits granted for buying consumer durables granted to households; credit cards, taking into account the fact that the interest rate for these products has the lowest elasticity, generating substantial outputs for RON, if the interest rate decreases; mortgage credits, including those granted for companies, and the credits granted to the companies working in the field of office building; derivatives offered to clients to cover the exchange rate risks and interest rate, if the degree of financial culture will increase and the clients of the bank will ask for products to cover the respective risks; the currency credit granted to companies could still increase; the credit for export could remain at a low level on a short term especially because of the problems existing in the export field (the low level of profitability in such branches as textile industry, furniture, etc), in 2005 the main beneficiaries of these credits being the companies working in the field of wholesale trade and intermediation services in the wholesale trade.

From the point of view of the challenges at the microeconomic level generated by the dynamic of the credit to the private sector, which could affect the financial stability, the research focused especially on analyzing: (i) the credit risk, (ii) the exchange risk, (iii) the financing sources for granting credits.

The rate of significant rise of the credit, as well as its directing especially towards households and towards foreign currency financing, are all characteristics to be met in the last years not only in Romania but also in most of the countries in Central and Eastern Europe.

In view of reducing the risks that may occur in the credit granting activity and for promoting the financial development, a series of measures must be taken into account, out of which the most important refer to expanding the data base with the history of the debtors of the non-banking financial institutions.

Thus, we can obtain the whole picture of the volume and dynamics of the indebtedness in the entire financial system, based on which the measures for maintaining the financial stability will be better explained. Such kind of measures could lead to a diminishing of the volume of the unpaid money debt and the companies could be financed by the banking system which is able to better discipline the players in case of non-payment. The implementing of the present standards referring to provisions so that they are dynamic would imply a high volume of provisions in the

periods characterized by an increase of granting credits and economic expansion so that there be enough resources for covering the losses in the period of economic slowdown or even recession (anti-cyclic approach). It is necessary to replace the administrative standards which limit the exposure of the credit institutions to the debtors that are not covered in the case of the exchange risk for 300% of their own funds with standards that are market-oriented, case in which the exposure to these debtors are to be penalized by supplementary capital requirements.

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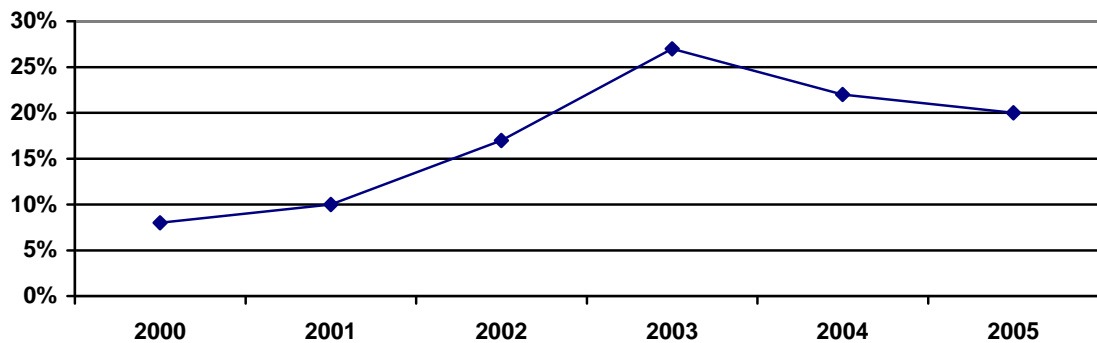
Appendix 1

Table no. 1. The dynamic of the financial development in some Central and Eastern European Countries (2000-2005)

	Real expansion of the credit to the private sector (average value)	Share of the credit to the private sector of GDP (average value)
Ukraine	36,9	18,1
Latvia	35,6	29,0
Albania	30,0	7,2
Bulgaria	29,9	22,2
Lithuania	25,4	16,6
Russia	25,2	18,6
Belarus	22,2	10,3
Estonia	21,1	3,5
Moldavia	20,2	17,3
Hungary	18,1	38,2
Croatia	14,1	48,4
Romania	12,6	8,5
Slovenia	9,5	40,3
Bosnia	7,1	3,2
Macedonia	4,8	19,3
Poland	3,2	28,1
Czech Republic	-5,8	36,0
Slovakia	-8,5	38,1

Source: Hilbers et al. (2005); National Bank of Romania, Romanian National Institute of Statistics.

Figure no. 1 Real increase of the non-governmental credit in the Central and Eastern Europe (2000-2005) (average value)



Source: Hilbers et al. (2005); National Bank of Romania, Romanian National Institute of Statistics.

Appendix 2

Table no. 2. The development of the non-governmental credit in some Central and Eastern European Countries (2004-2005)- %

	Total non-governmental credit						Non-governmental credit for companies						Non-governmental credit for households					
	Total		National currency		Foreign currency		Total		National currency		Foreign currency		Total		National currency		Foreign currency	
annual	04	05	04	05	04	05	04	05	04	05	04	05	04	05	04	05	04	05
Romania	69,5	37,9	102	21	50	51	39	29,2	56,4	18,5	31	36	259	58,3	249	21	284	148
Bulgaria	0	48,3	0	35	0	66	0	38	0	8,6	0	62	0	76,2	0	70	0	144
Hungary	33,4	19,2	9,5	9,5	38	38	23	12,9	13,8	4,2	39	26	61	27	45	15	107	62,4
Czech Republic	11,5	16,5	14	18	-3,6	1	-1,7	7,5	-0,5	9,1	-3,7	0,8	32	32	32	32	0,7	13,8
Slovakia	13,6	4	11	-0,2	25	21	3,8	-14	0	0	0	0	39	37	0	0	0	0
Poland	7,1	3,6	0,7	13	25	-18	2,7	-4	2,1	7	15	-27	13	13	4,3	20	43	-5,2

Source: [www.cnb.cz](http://www.cnb.cz); [www.mnb.hu](http://www.mnb.hu); [www.bnro.ro](http://www.bnro.ro); [www.nbs.sk](http://www.nbs.sk); [www.nbp.pl](http://www.nbp.pl); [www.bnb.bg](http://www.bnb.bg)

Appendix 3

**Table no. 3.1. Mortgage credit development in some Central and Eastern European countries**

Country	Year	Domestic credit (mil. USD)	Mortgage credit		
			(mil. USD)	Share of domestic credit	Share of GDP
Czech Republic	1998	38.304,4	549,7	1,44	1,03
	1999	36.554,4	735,3	2,01	1,29
	2000	32.869,8	869,7	2,65	1,58
	2001	28.016,3	1134,5	4,05	2,20
	2002	28.253,9	1477,6	5,23	2,60
Poland	1997	46.988,4	371,3	0,79	0,25
	1998	49.862,8	546,7	1,10	0,38
	1999	57.388,2	848,5	1,48	0,53
	2000	60.580,1	1439,9	2,38	0,92
	2001	59.105,1	2141,2	3,62	1,36
	2002	70.886,8	3364,4	4,75	1,95
Bulgaria	1999	2.464,9	41,5	1,68	0,33
	2000	2.875,7	46,5	1,62	0,36
	2001	3.736,3	59,2	1,58	0,44
	2002	6.402,2	91,3	1,43	0,54
Romania	2000	4.354,1	10,1	0,23	0,03
	2001	4.533,5	27,3	0,60	0,07
	2002	5.976,8	41,3	0,69	0,09

Source: [www.cnb.cz](http://www.cnb.cz); [www.bnro.ro](http://www.bnro.ro); [www.nbp.pl](http://www.nbp.pl); [www.bnb.bg](http://www.bnb.bg)

**Table no. 3.2. Total volume of the investments made in the entire economy (billion USD)**

	1998	1999	2000	2001	2002
<b>Poland</b>	16,29	21,2	20,13	18,8	16,05
<b>Hungary</b>	8,4	9,76	9,53	9,93	11,14
<b>Romania</b>	5,51	4,86	3,87	4,12	4,82

Source: CESTAT Statistical Bulletin 2001/3, 2002/4

**Table no. 3.3. Agriculture credit development in some Central and Eastern European countries**

Country	Year	Domestic credit (mil. USD)	Mortgage credit	
			(mil. USD)	Share of domestic credit
Czech Republic	1996	39.472,8	1165,8	3,0
	1997	41.731,9	1197,4	2,9
	1998	38.304,4	998,3	2,6
	1999	36.556,4	865,9	2,4
	2000	32.869,8	754,2	2,3
	2001	28.016,3	559,9	2,0
	2002	28.253,9	454,5	1,6
Slovakia	1996	12.682,6	615,9	4,9
	1997	14.172,9	610,1	4,3
	1998	14.164,2	520,5	3,7
	1999	15.154,6	439,9	2,9
	2000	13.762,0	454,5	3,3
	2001	13.010,8	316,0	2,4
	2002	14.364,0	293,7	2,0



Hungary	1996	36.755,2	549,1	1,5
	1997	32.575,8	634,4	1,9
	1998	29.819,5	813,3	2,7
	1999	29.583,9	896,0	3,0
	2000	25.299,6	890,3	3,5
	2001	25.514,9	840,5	3,3
	2002	25.937,7	788,9	3,0
Romania	2001	4.354,0	90,8	2,1
	2002	4.533,0	71,0	1,6

Values have been deflated with CPI (Consumer Price Index)

Source: [www.cnb.cz](http://www.cnb.cz); [www.mnb.hu](http://www.mnb.hu); [www.bnro.ro](http://www.bnro.ro); [www.nbs.sk](http://www.nbs.sk)

**Table no. 3.4. Share of different types of non-governmental credits of GDP in 2002 (%)**

	Poland	Hungary	Czech Republic	Romania
Loans to private economic agents	36,0	36,8	58,0	7,20
Loans to households	8,4	10,1	4,7	0,53

Source: [www.cnb.cz](http://www.cnb.cz); [www.mnb.hu](http://www.mnb.hu); [www.bnro.ro](http://www.bnro.ro); [www.nbp.pl](http://www.nbp.pl)

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