

The structure of Romanian banking system in the context of European integration and the financial crises of 2007

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Abstract

In this study we try to assess the main implications of international financial crises of 2007 on the Romanian banking system. Also, we intend to underline the implications of the European integration in this context.

This process has both positive and negative effects on the Romanian banking system, taking in account the context of actual crises. The great exposures to the foreign capital increase the effect of contagion and the dependence to the foreign financial resources. On the other hand, the European acquis has disciplined the banks in the spirit of prudence and has amplified the competition.

In the first part of the paper we have assessed the main consequences of Romania's accession to European Union in the perspective of banking system structure. After that we have done a SWOT analysis of the Romanian banking system in October 2008 and we have assessed the main implication of the financial crises on it, during the period of 2008 - 2009.

The Romanian banking system suffers itself from the effects of the international financial crises in its diminished volume of activity. Nevertheless, Romanian banks did not experience payment incapacity, and profitability indicators have reached positive levels. Also, prudential indicators have been maintained at a reasonable level, although part of them experienced a decrease.

Keywords: European integration, banking system, financial crises

JEL Classifications: E02, G01, G21

Introduction

After the accession to the European Union, Romania entered "the single" European market. Once the Romanian banking market has been liberalized and the single banking license has been implemented, foreign banks can enter more easily the territory of our country and the expansion of competition in the local banking activity will also be determined by the possibility to offer banking services without a direct instruction. In this paper we try to underline the impact of international financial crises of 2007 on the Romanian banking systems in the context of recent Romania's accession to European Union.

In the first part of the study we assess the influences of European integration on the structure of the Romanian banking system, underlying the increasing of the share of foreign capital in the Romanian banking system, the volume of banking activities and the competition.

In the second part of the study we make a SWOT analysis of the Romanian banking system in October 2008, when the crises stroke the Romanian economy. After that, we assess the main effects of the financial international crises on the Romanian banking system.

The influences of European integration on the structure of the Romanian banking system

The process of accession was a premise for the increase of the percentage of foreign capital in the financial and banking system in the European Union countries. In the table below we can see a continuous growth of the foreign capital in the Romanian banking system, especially in the years before and after.

Table 1. Foreign capital in the Romanian banking system

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Number of banks with majority foreign capital, of which:	29	32	32	29	30	30	33	36	37
- Branches of foreign banks	8	8	8	8	7	6	7	10	10
Assets of banks with majority foreign capital/Total assets (%)	50,9	55,2	56,4	58,2	62,1	62,2	88,6	88,0	88,3

Source: NBR, Financial Stability Report 2009, p. 18

From the viewpoint of the homeland of capital of credit institutions operating in Romania, the top have been modifying in the period of 2000 - 2008. In terms of capital contribution, in 2008 Greece came in the lead, holding 22.4% of aggregate foreign capital, Austria came in second with 18.4% and third came the Netherlands with 9.2%.

Table 2. Structure of shareholding by country (percent of total foreign capital for the first 5 countries)

	Dec. 2000	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008
Austria	3,2	21	24	21,5	24,6	21,8	23,9	22,0	18,4
Greece	8,5	6	8,2	11,1	10,1	12,4	16,4	21,7	22,4
Italy	0,4	1,1	2,7	4,6	8,4	5,8	6,7	3,9	4,8
France	6,8	3,4	5,7	5,9	5	5,6	4,4	5,0	4,2
Netherlands	3,1	8	3,5	4,5	5,9	8,2	7,4	7,7	9,2
Total	40,4	53,2	55,8	58,2	70,6	68,9	73,2	75,7	75,5

Source: NBR, Financial Stability Report 2006 -2009

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

After the accession of our country to the EU and the liberalization of the service market, a number of 190 foreign institutions have expressed their intention to have direct banking activities on the Romanian territory, out of which 174 are banking institutions, 3 are non-banking financial institutions and 13 e-money providers (NBR, 2008).

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

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

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

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

Even though competition in the banking system is continuously increasing the Romanian banking system proves to be concentrated. The first 5 banks in Romania according to the value of their assets (BCR, BRD - Groupe Société Générale, Raiffeisen Bank, Volksbank, Banca Transilvania) held 54,4% from the aggregate balance sheet assets, 53,5% from the total of offered loans, 54,1% from the attracted deposits and 51,4% from the equity of Romanian commercial banks in December 2008, a letdown in comparison with December 2007. Starting with 2006, the value of Herfindahl-Hirschmann index entered a slightly downward path, still posting a moderate concentration. This indicators proof an improving in bank competition in the Romanian banking system as a consequences of entering in the European single market.

Table 3. Bank concentration in the Romanian banking system (2005 - 2008)

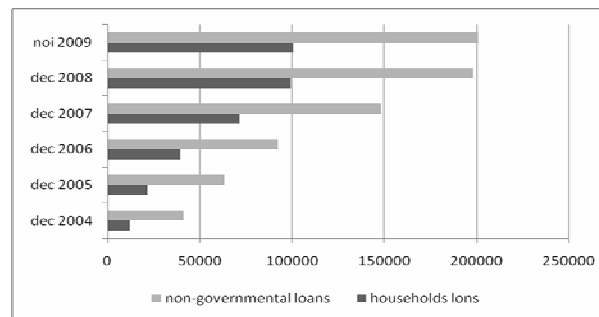
	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008
Market share of the top five banks in total assets (%)	58,7	56,4	60,3	54,4
Market share of the top five banks in total loans (%)	61,1	57,1	63,5	53,5
Market share of the top five banks in total deposits (%)	57,0	60,0	58,3	54,1
Market share of the top five banks in total equity (%)	55,2	50,1	53,3	48,5
Herfindahl-Hirschmann index	1.124	1.171	1.046	926

Source: NBR

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

After the accession of our country into the European Union, bank loans have boomed in volume, especially in the case of households loans. Thus, at the end of 2006 and 2007 we could notice a double value for the loans offered to the households.

Figure 1. The situation of loans offered to the households and non-governmental loans from December 2004 to November 2009 (mil. lei)



Source: Monthly bulletin from BNR

The credit institutions in Romania, in their pursuit to gain a larger market share, have continuously grown their outlets. In the period 2004 - 2008 the established units have been doubled, and the number of employees grew with 45%.

Table 4. The evolution of number of employees and outlets (2004 - 2008)

	2004	2005	2006	2007	2008
Number of employees	49.522	52.366	58.090	65.657	71.622
Number of outlets	3.038	3.514	4.401	5.482	6.552

Source: NBR

The financial crises and its effects on the Romanian banking system

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

Strengths:

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

Weaknesses:

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

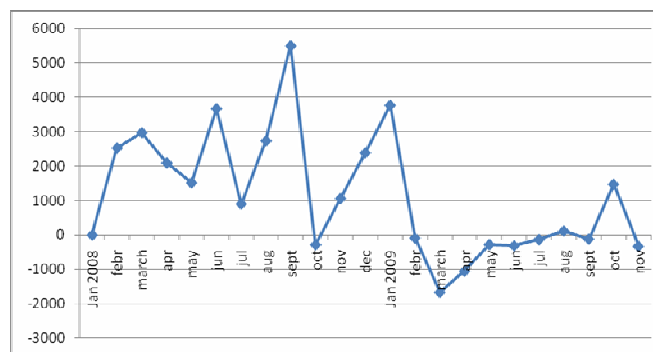
- The public has lost faith in the banking system, due to the unethical behavior of certain banks (increase of the interest rate, unjustified commissions, and so on);
- The existence of certain banking products at promotional interest rates that would be variable later, which could have affected the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

The increasing of the share of market of the foreign banks also increases the vulnerability of the Romanian banking system from the perspective of the contagion effect. From this point of view, Romanian banks with foreign capital are dependent on the financial resources of parent undertakings. In the boom period, the parent undertakings sustained the credit activities of the Romanian subsidiaries with large volumes of financial resources. The international financial crises affected first the liquidities of parental undertakings therefore their financial support was cut off and so affected the liquidities of Romanian subsidiaries.

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

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

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



Source: NBR monthly bulletins

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

coverage of late payments by provisions continuously decreased, from 123% in August 2008 to 107%, in August 2009.

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

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

With the purpose of encouraging mortgage loans and the related economic sectors, in 2009, the government launched a program called "First Home". In this program, the state, with the help of the National Credit Guarantee Fund for Small and Medium-Sized Enterprises, made a pledge to issue guarantees in the name and in the state accounts in the favor of banks which offer loans to physical entities to buy houses.

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

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

Table 3. Profitability and prudential indicators

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

Source: NBR

The market share of the top 10 banks in total assets was modified in about one year and half. Some of banks lost market share and had negative profits, as we can see in the next table:

Table. 4. Evolution of top 10 banks in assets and net profits

Rank	Bank	Market share in total assets (%)		Profit/loss (mil. Euros)
		Dec. 2008	Jun. 2009	
1	BCR Erste	20,3	20,4	75,8
2	BRD - GSG	15,7	15,0	101,0
3	Volksbank	6,8	6,8	-36,0
4	Raiffeisen	6,0	5,9	20,0
5	Banca Transilvania	5,4	5,8	2,6
6	UniCredit Țiriac	5,5	5,8	30,0
7	CEC	4,3	5,5	4,5
8	Bancpost	4,8	4,8	-117,0
9	Alpha Bank	5,5	4,8	N/A
10	ING Bank	3,5	3,15	N/A

Source: Ziarul Financiar

Conclusions

The Romanian banking system suffers itself from the consequences of the international financial crises in its diminished volume of activity. Nevertheless, Romanian banks did not experience payment incapacity, and profitability indicators have reached positive levels. Also, prudential indicators have been maintained at a reasonable level, although part of them experienced a decrease (for example the level of unprofitable loans). The process of European integration has also positive and negative effects on the Romanian banking system, taking in account the context of actual crises. The great exposures to the foreign capital increase the effect of contagion and the dependence to the foreign financial resources. On the other hand, the European *acquis* has disciplined the banks in the spirit of prudence and has amplified the competition.

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