

CREDIT RISK IN THE CONTEXT OF THE WORLD ECONOMIC CRISIS

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The risks have always been the subject matter for banking companies. To define a banking activity as one for obtaining a profit it is necessary to take into account the risk factors. For most banks lending is the main banking operation. The risk can be estimated using the credit analysis. The credit analysis – starts from the loan application and ends with the repayment day. In the context of the world economic crisis, in our country, since November 2008 we have noticed an ascending trend of the outstanding credits, both in lei and foreign currency, and because this trend still remains, banks will have to face with big troubles regarding liquidity and solvency.

KEYWORDS: credit, credit risk, the management of banking risks, the evaluation of credit risk, the world economic crisis, outstanding credits, bad credits, the methodology of the NBR, backlog, lei credits, foreign currency credits, credit repayment

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The risks have always been the subject matter for banking companies. To define a banking activity as one for obtaining a profit it is necessary to take into account the risk factors. The novelty in management of risks aims at enhancing the prevention of losses and attempts to make the risk from an abstract, intangible element a measured one. The management of banking risks is closely related to the management of bank's profitability. Usually, big risks are associated to some operations with high profitability.

The bank takes charge of some risks to obtain good results. For example, the bank takes the chance to lend more risky clients for obtaining a spare income, which is usually higher than the one obtained from good customers. The management of risks has several main objectives: ensuring the continuity of banking activity by reducing the losses resulted from the risks actions; expanding the internal control to increase the banking performances and create the possibility of comparing the risks on different centers of responsibility, types of activities, clients; providing necessary information to people responsible for taking decisions regarding the capitalization of resources. In this case it is possible to present some measurable consequences resulted from the variant chosen by the one who decides; to generate the information needed for creating a portfolio of balanced activities and so the bank will obtain results in terms of minimum risk.

For most banks lending is the main banking operation. The intermediation function between banks is based on it. The lending risk, called risk of double entry or risk of insolvency is the main banking risk. The risk of lending refers to the possibility that the debtors (borrowers or issuers of debt securities) will not pay back the loan at the maturity. It refers to the fact that the debtor may not respect the contract clauses. The loss may be total or partial and the increase of this risk depends on the number of clients, the credit volume and the level of the rate interest.

If the management of lending risk is carried out before the decision of lending we can say that we are dealing with a previous management which is necessary for taking those measures and establishing the criteria for granting the loan so as to avoid or reduce losses. After the bank takes the decision of lending, the management will be a posterior one. The posterior management of

lending risk first aims to check up the payments of the loan and in case of default of payment, to reduce the risks through an optimum revaluation of the guarantees. The lending risk can be managed globally by the rules and actions that concern the entire loan portfolio or large parts of it, or individually by those measures taken by the bank for each applicant and then the debtor. The decision of granting a loan is based on a forecast of future incomes of the debtor. As a basic principle, the bank does not grant a loan if it cannot predict that the debtor will reimburse the entire loan.

The risk can be estimated by using the loan analysis. The loan analysis – starts from the loan request and ends with the repayment day. The lending decision is sequential and it is taken on four steps: a managerial and economic-financial analysis of the debtor; an analysis of the loan request; taking the lending decision; a periodical analysis of the loan portfolio. The managerial and economic-financial analysis of the debtor – starts when the credit applicant comes with a loan request to the bank. Actually, he comes with the following documents: the loan request, signed by authorized persons; the situation of stocks and expenses for which the loan is requested; the balance sheet; the trial balance; income statement and loss account; the list of assets and values used as guarantees for requested loan; an authorization of shareholders for obtaining and using the loan. The bank can analyze the situation of a company by calculating some indicators: *liquid ratio* – evaluates the coverage rate of current liabilities with current assets; *profitability indicators* – determine the efficiency of using the company's capitals. The analysis of the loan request – if the applicant is accepted after the managerial and economic-financial analysis he becomes the bank's client. The analysis of the loan request is realized by the followings: identifying the purpose and the level of the granted loan; identifying the sources of the loan repayment; identifying the loan guarantees. Taking the lending decision – after the bank analyses the situation of the debtor and the loan it has to take a decision about granting or not the loan. In this phase it takes place: the correlation with bank's resources; taking and communicating the lending decision; the analysis of completing the lending decision.

The management of global risk of the credit aims to limit the risk assumed by the bank when lending its clients. This can be possible through a credit monitoring and by taking some measures at the entire credits portfolio. The global risk of the credit is determined by using some indicators: - Structure indicators: total credits / total assets; the losses of lending / total credits. As the result of these indicators is much higher the credit risk assumed by the bank is higher; - Dynamics indicators: *the evolution of reserve fund to cover losses, the evolution of credits*. An increase of these indicators is associated with an increase of the credit risk assumed by the bank; - Relative indicators – these indicators are the connection between the risk assumed by the bank in the lending process and its funds, as a source of covering the possible losses.

An important role in the management of global risk of the credit is played by the existence of some banking caution rules in the field of the bank commitment that is in investment operations especially in lending operations. The main issues covered by these regulations are: *the maximum exposure to a single debtor* – according to the Romanian rules, a bank may grant loans to a single client in a maximum 20% of its own funds. This rule is made to limit the bank's losses in case that the customer becomes insolvent; *the maximum aggregate exposure* – included large volume of loans granted by the bank up to 8 times its own funds. A credit is considered high when all commitments to a single borrower exceeding 10% of the bank's own funds; *creating specific risk provisions depending on the quality of granted loans* – banks are required to have the provisions to a percentage of the loan depending on the quality of the loans. To determine the quality of loans are used two appreciation criteria: debtor's financial performances and debt service. Through its lending policy the bank may set its own standards and rules carried in credits. These lending rules can refer to general banking prudential regulation outlined above, by increasing their demanding application, or may create new restrictions to be respected in the lending process.

The non-financial analysis verifies the client's credibility, as an essential psychological element that has the role to convince the bank of the professional and moral qualities of the loan's applicant, of the main partners and collaborators and also of the applicant's reputation analyzed through the products quality, services and by the way of dealing with business partners. For taking the lending decision, the credit officer will take account of the following non-financial factors: the leadership activity (the management); the client's activity; the strategy. The external non-financial factors are: field of activity; the introduction of the client activity in general economic policy and in the trends of future strategies regarding the field of activity; the influence of legislation on client's activity; the goodwill; the influence of macroeconomic factors on client's business; social characteristics of market outlets: food habits, a certain way of consuming, religion.

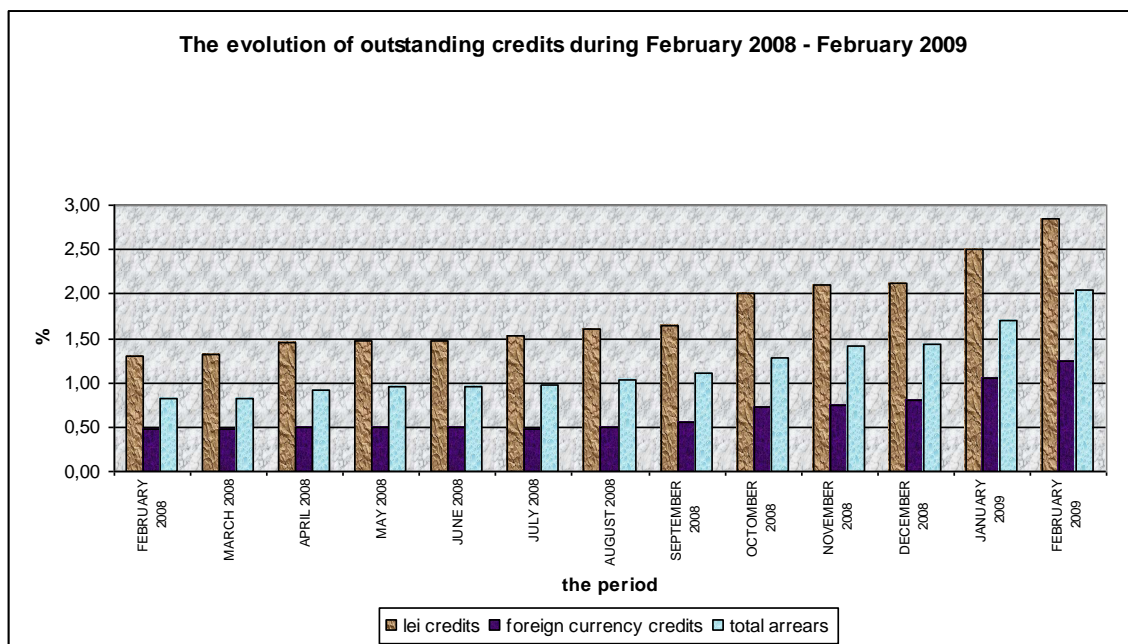
In the context of current global economic crisis, in our country the total volume of loans granted by commercial banks, classified as outstanding, has increased by 13% in September 2008, reaching nearly 4.750 billion lei (about 123 million euro). This situation occurred after in August 2008, the outstanding loans were increased, on average, by others 12-13 percentage points. Even if the bankers do not recognize that they are facing with problems in recovering the granted loans, the figures show from month to month that the volume of outstanding credits becomes bigger and bigger. The outstanding short-term credits were, at the end of September 2008, 1.860 billion lei, by 7,3% more than in August 2008, while the outstanding medium and long-term credits have increased by 4%, reaching 233 billion lei. As a result of the competition between banks for market shares, the lending conditions become more flexible and, in the future, this situation may affect the activity of banks. In September 2002, the volume of outstanding short-term credits granted in national currency has increased by nearly 40%, while the outstanding medium and long-term credits have increased by 300%.

Also, very interesting is the evolution of the credits granted in a foreign currency: the outstanding short-term credits granted in a foreign currency were increased by 14% in September, while for those on medium and long term the increase was over 51%. The most credits were for buying consumer durable goods - these were estimated at 500 million euro, three times more comparing with the end of the third quarter of the last year.

Although the percentage of the durable goods granted in lei was over 72,84% of the total, the banks granted also the population in foreign currency. A new threat, also in this context, seems to come from the restructuring of the state-owned companies (which will be accelerated in the next period) that will be certainly a surprise to the banking system, or at least for banks that have competed in lending to individuals in the last period. The restructuring implies in most cases a staff restructuring and we have to keep in mind that the employees of these companies are the bank's favorites.

Based on data published by the National Bank has identified a trend of the arrears situation recorded in 2008, January 2009 and February 2009 and so we can notice that the share of the currency credits arrears has grown more easier than the share of the national currency credits arrears, increased by almost 1% from the beginning of the year until November.

The evolution of outstanding credits during February 2008 - February 2009



It is noticed a slightly increasing trend of the outstanding credits, both in lei and foreign currency, during February 2008 – October 2008 and a further more increasing trend during November 2008 – February 2009.

According to data published by the National Bank of Romania in the statistics, in November, the percentage of the balance arrears of the credits granted in lei represents 2,21% of total balance of credits granted in the national currency. Compared with February 2008, the value of arrears has increased over 3,2 times, both in the companies area and population. In the context of the actual economic crisis, the arrears increase was expected but the bankers appreciate that the situation is under control. Regarding the credits bigger than 20.000 lei in equivalent, 13,80% of these are arrears.

According to the methodology of the National Bank of Romania, the arrears represents the cumulate value of the capital rates, of the interests and the commissions and they are the result of a late payment, even if it is a day late. All this is regarded from an accounting point of view. In terms of cautiousness, the credits with payment delays are divided in five categories – standard, in observation, under standard, doubtful (delays between 61 and 90 days) and loss (over 90 days). For example, if a customer has delayed more than 90 days with payment rates, the entire value of the granted loan (including interests and commissions) will be considered loss, and bank will make 100% provisions.

Also, according to data received from The National Bank of Romania, the value of bad loans (doubtful and losses) reached 16,76 billion lei at the end of February (8,42% share in total credits), with 4,2 billion lei more than December 2008. Meanwhile, because of the loans arrears, banks made in the first two months of this year provisions that worth more than two billion lei, actually the total was 9,64 billion lei. According to Radu Gratiian Ghetea, president of the Romanian Association of Banks, the banks have the situation under control and so they don't have to worry too much but on the other hand, this situation may evolve for the better or for worse and in the context of increasing arrears, some banks will try to recover their claims from specialized companies.

This year in March, in the banking system, the outstanding and doubtful credits represented around 4% of total portofolio of the banks. In the third and fourth quarter of 2008, the clients had

suffered a combined effect of the successive interest increase and the depreciation of the national currency is expected to accelerate the trend of worsening the quality of investment portfolio. It is noticed a big pressure on both individual clients as well companies and it is very difficult to predict how far will raise the share of the outstanding loans.

Even if the companies have less credits than people have, actually they come to 100,3 billion lei compared with 103,2 billion lei, their credits arrears are two times higher than population's – according to data provided by The Directorate of Bank Supervision of The National Bank of Romania. Thus, if at the end of February the arrears of the population came to 1,464 billion lei, with a share of 1,43% in loans, the arrears of the companies reached 2,79 billion lei (2,78% of loans). The arrears of the population and companies from Bucharest have risen only in the first two months of 2009 with 72% and, at the end of February, they have come to 1,42 billion lei.

Conclusions:

Referring to lei and foreign currency credits, the arrears of the clients, both individuals and businesses, have increased significantly since October 2008.

Thus, in October, the rate of outstanding credits in total credits was 1,1% and in February 2009 it was 2,05%. In February 2009 there has been a level of arrears for lei credits of 2,8% and for credits granted in a foreign currency 1,25%. We can say that the rate is still in reasonable limits, but there is still a risk that the volume of outstanding loans to increase depending on the evolution of financial crisis, and certain clients, individuals or legal persons, may be unable to pay the credit interests and also to pay back the entire loan.

Since November 2008 we have noticed an ascending trend of the outstanding credits, both in lei and foreign currency, and because this trend still remains, banks will have to face with big troubles regarding liquidity and solvency.

Stabilizing the exchange rate of the national currency would have positive effects on the reimbursement of a loan, especially for loans borrowed in a foreign currency. Also, reducing the interest of monetary policy by The National Bank of Romania and the interests of granted loans by the commercial banks will have the same effect.

It is very important that The National Bank of Romania and the commercial banks to apply appropriate policies in order to reduce the outstanding credits or at most to be maintained at current levels.

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