

THE ADJUSTEMENT OF THE BANKING MECHANISM FOR FINANCING ECONOMY UNDER CRISIS CONDITIONS

Istrate Luminita Gabriela

The Bucharest Academy of Economic Studies

Faculty of Finance, Insurance, Banks and Stock Exchanges

Coordinator: Prof. Stroe Radu Ilie, PhD

Development of complex financial products and necessity of reducing the costs encourages the creation of groups with multiple activities in the financial sector. Structures of financial group are also present in Romanian, and most of them are part of the international groups, provided that the financial capital is mainly foreign.

Both the benefits as well as the risks associated to the financial groups present in Romania are limited due to their orientation mainly mono-sectorial (very high weight kept by the credit institutions).

The National Bank of Romania has an intrinsic role for maintaining the financial stability, taking into consideration the responsibilities that result from its double aspect of monetary and prudential authority. The attributions afferent to the objectives of financial stability are exercised by prudential supervision and regulation of the institutions under its authority, as well as by formulation and efficient transmission of the measures of monetary politics and supervision of functioning under optimum conditions of the payment and reimbursement systems systemically important.

At the same time, it is necessary the identification of risks and vulnerabilities of the entire financial system, on the whole and separately, because the financial stability monitoring is preventive. The occurrence and development of some malfunctions, like the incorrect evaluation of risks and inefficiency of capital allocation can affect the stability of the financial and economic system.

Keywords: economic crisis, financial products, financial institutions, interest rate, foreign exchange rate

JEL Classification: E52; E58

1. Introduction

The main modifications registered in the structure of the Romanian banking system during 2009 were the following: the change of the status of Citibank Romania from Romanian legal entity into a foreign bank branch, Citibank Europe (starting from January 2009), closing of the branch from Bucharest of Depfa Bank in August 2009, starting of the activity of Banca Comerciala Feroviara (Railway Trade Bank) – institution with majority of autochthonous private capital – in November 2009 and the fusion between Raiffeissen Bank for Real Estates and HVB Bank for Real Estates by absorption of the latter in December 2009.

As a result, the number of credit institutions diminished to 42 units from which: 2 credit institutions with majority or integral capital of state, 4 institutions with majority autochthonous private capital, 25 banks with majority foreign private capital, 10 branches of the foreign banks and Creditcoop.

The share capital of credit institutions collected 14,4 billions Lei in December 2009, increasing by 3,2 % in real terms in comparison with year 2008. The majority private capital stays mainly at 87,8%, but slightly falling down due to the modifications occurred at the capital of the foreign banks branches, but also due to the capital increase performed at CEC Bank.

Stagnation of the aggregate net asset was attributed mainly to the divergent evolutions registered by the main components. On one side, the lending activity of the non-banking clients got reduced by 4,4% in real terms during 2009 in comparison with the end of 2008, the weight of this segment getting reduced by 3%.

Thus, the request of loans continued to be affected by: the downturn in economic activity and pessimism regarding its perspectives, as well as the persistence of the negative expectations regarding the upturn of the financial situation of the population.

On the side of the credit bidding, it has been noticed an intensification of the prudence of the credit institutions, developed by: tightening the standards and the crediting terms and increase of owning government bonds.

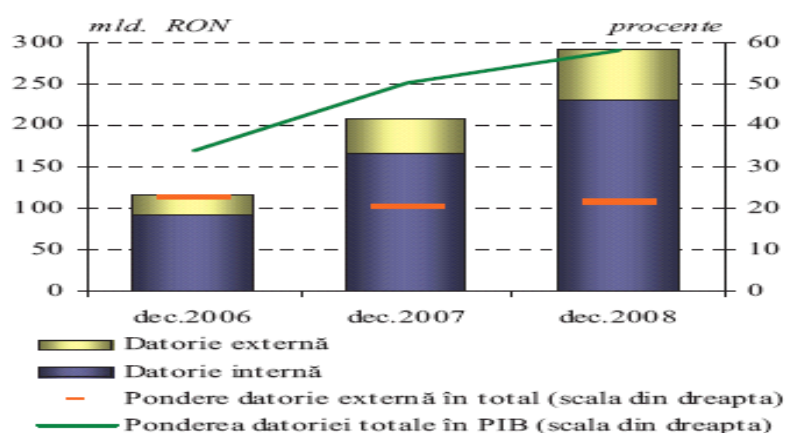
According to the destination of the private credit on institutional sectors, the dynamics of loans to population as well as the one of credits for companies became negative, the real annual rates of increase reaching -3,6% and respectively -3,7 %. There have not been recorded changes of structure, the credits to population maintaining their weight slightly superior (50,1%).

2. The access to financing of enterprises and population

The access to the bank financing has improved since 2008, both in the segment of companies and in the one of population.

Year 2009 marked a reversal in trend because there was an accentuated tightening of the terms and conditions of access to lending.

The number of companies which received credits from financial institutions (autochthonous or foreign) reached 16% (from the total of the active companies from Romania in March 2009, in comparison with 8% in 2005). The number, still small, of the companies which make a loan, as well as their significant role in economy prove that the decrease of financing could have important negative consequences.



Graphic 1 Evolution of debts of the non-financial companies and population.

Source : B.N.R.(The National Bank of Romania)

Trade companies and real estate companies could experience the highest impact of the decrease of access to financing, as they use much more intensely the resources of the banks comparing with the created added value. The difficulty of maintaining the external financing would affect the most the real estate companies and the manufacturing industry.

3. Modification of the lending standards in crisis conditions

At the aggregate level, the lending standards were slightly tightened in T4/2009. The net percentage of the banks which adopted such measures was 13%. The rest of the banks did not consider a new revision to be opportune, even though their expectancies were aiming this direction.

The cumulative level of restrictiveness of lending standards, corroborated with the request of lending in decrease, favored, under a certain extent, the neutral attitude of the banks.

This series of tightening of the lending standards that lasts for almost two years could end, although some banks do not exclude its continuation.

In structure, the slight tightening of lending standards was undifferentiated according to the size of the company (Small and Medium Enterprises (SME) versus corporations). Previous evolutions disfavored the access to financing of the Small and Medium Enterprises in comparison with the one of the corporations, after a lower perception at risk of the latter ones.

The perspectives of the credit bidding towards companies is differentiated by the criterion of maturity. The net percentage of the banks which notify a tightening of the lending standards for long-term is 30%, while it has been considered that there won't be any modifications for the short-term loans.

The main factors which made the banks change the lending standards are the expectations regarding the general economic situation, the risk associated to the industry in which the company activates and the risk associated to the requested guarantee/collateral.

The crediting standards of population registered an evolution differentiated on types of credits.

The net percentage of the banks which considered necessary the tightening of the crediting norms of the consumption loan, remained raised (45% in February 2012), although the anticipations showed the attenuation of the tendency.

For the credits allocated to the purchase of real-estates and lands, the restrictiveness input was lowered to the level of the banking sector (under 10%). Expectancies for T1/2010 show a slight relaxation of the standards for the real-estate credits, for the first time in almost two years.

Regarding the population sector, at the beginning of 2010, the previous relaxation tendency of some terms of mortgage loan (the spread of the medium rate of interest of the credit towards ROBOR 1M and of the maximum weight of the credit in the value of the real estate guarantee) was not confirmed in T4/2009. The only concern for some banks (33%) was manifested in the area of reducing the maximum weight of the debts service in the monthly income, on the basis of deterioration of the expectations regarding the incomes and the unemployment.

Prudence of the banks vis-à-vis the loan for consumption is equally fed by the following factors: the risk associated to the clients' creditworthiness, the risk associated to the collateral/guarantees, the expectations regarding the financial situation of population and the decisions of monetary or prudential policy of NBR (*The National Bank of Romania*).

Tightening of the maximum weight of the monthly debt service in the monthly income is the main change brought to the terms of the consumption loan, similar to the mortgage loan.

There were also tightened: the spread of the medium rate of interest of the credit towards ROBOR 1M and of the maximum limit for the loan value. The other contracting clauses were not modified.

4. The role of the Central Bank in maintaining the financial stability under crisis conditions

The National Bank of Romania has an intrinsic role in maintaining the financial stability, taking into consideration the responsibilities that result from its double aspect of monetary and prudential authority. The attributions afferent to the objectives of financial stability are exercised by regulation and prudential supervision of the institutions under its authority, as well as by formulation and efficient transmission of the monetary policy measures and supervision of functioning under optimum conditions of the payment systems and settlements systemically important.

At the same time, it is necessary identification of the risks and vulnerabilities of the entire financial system, on the whole and separately, as monitoring of the financial stability is preventive. Occurrence and development of some malfunctions, like the incorrect evaluation of the risks and inefficiency of capital allocation can affect the stability of economy and the financial system.

a) Open Market Operations (monetary market)

Open market operations represent the most important instrument of monetary policy of N.B.R. (The National Bank of Romania). These are performed on the initiative of the Central Bank, having the following functions: guidance of the interest rates, management of the liquidities conditions from the open market and notification of monetary policy orientation.

The main operations of open market being at the disposal of N.B.R. (The National Bank of Romania) are the following:

- **repo operations – of eligible assets** – liquidity-providing reverse transactions whereby the National Bank of Romania buys transactional eligible assets from credit institutions upon their commitment to repurchase the assets at the date and the price agreed on the date the transaction was concluded;
- **deposit-taking operations** – liquidity-absorbing transactions with pre-specified maturity whereby the National Bank of Romania takes deposits from credit institutions;
- **issuance of certificates of deposit** – liquidity-absorbing transaction whereby the National Bank of Romania sells certificates of deposits to credit institutions;
- **reverse repo operations** - liquidity-providing reverse transactions whereby the National Bank of Romania sells transactional eligible assets from credit institutions upon their commitment to repurchase the assets at the date and the price agreed on the date the transaction was concluded;
- **credit operations against eligible assets as collateral** – liquidity-providing reverse transactions whereby the National Bank of Romania grants loans to credit institutions that remain the owners of the underlying eligible assets;
- **outright sales/purchases of eligible assets** – liquidity-absorbing/providing transactions whereby the National Bank of Romania sells/buys eligible assets whose ownership is transferred from Seller to Buyer on a “delivery versus payment” basis;
- **foreign exchange swaps** – consist of two simultaneous transactions concluded with the same counterparty, whereby the National Bank of Romania:
 - - buys foreign currency spot against lei, for liquidity-providing purposes, and sells the same amount of foreign currency forward against lei; or
 - - sells foreign currency spot against lei, for liquidity-absorbing purposes, and buys the same amount of foreign currency forward against lei;

During 1997 – 2008, the open market operations performed by NBR were almost exclusively used with the purpose of **making use of the liquidity surplus from the banking system.**

Starting with the last part of the year 2008, at the same time with the change of the liquidity net position of the banks from surplus to deficit, the liquidity-providing open market operations became predominant, thus, the NBR becoming in the position of Creditor of the banking system.

b) Standing facilities granted to credit institutions.

Standing facilities granted to credit institutions by NBR have the purpose of: absorption, respectively liquidity supplying on a very short term (one day); notification of general monetary policy orientation and stability of the interest rates on short term on the inter-bank monetary market, by means of the interest rates afferent to the two instruments.

Credit institutions may access on their own initiative the two permanent facilities offered by NBR:

- **lending facility** which allows obtaining of a credit with overnight maturity at the central bank, counter collateral, to a pre-determined interest rate; this interest rate normally being a limit of an overnight interest rate on the monetary market;

- **deposit facility**, which allows placing of a deposit with overnight maturity at the central bank, to a pre-determined interest rate; the interest rate of the deposit facility representing, normally, the limit of an overnight interest rate on the monetary market;

c) Mandatory Minimum Reserves (MMR)

Mandatory minimum reserves (MMR) are represented by the cash assets of the credit institutions, in lei and foreign currency, kept in accounts open at the National Bank of Romania.

The main functions of the MMR mechanism in lei are: the monetary control function (being in tight correlation with the one of liquidity management by NBR) and the one of interest rate stabilization on the inter-bank monetary market. The main role of MMR in foreign currency is that to temper expansion of the foreign currency credit.

In case of postponing of the programmed entries of external funds, the covering of the financing necessary of the governmental sector from resources of the internal market in the last part of 2009, concomitantly with the maintenance of the macro-economical stability, necessitates adequacy of the financing conditions of the autochthonous banking system.

Thus, NBR decided a tough management of the liquidity from the banking system to consolidate the transmission of the signals of monetary policy, as well as maintenance of the levels of the mandatory minimum reserves rates applicable to the liabilities in lei and foreign currency of the credit institutions.

The NBR rate for foreign currency liabilities with the residual maturity date under two years of the banks was reduced by 5% (from 30% to 25%) within a special meeting of the Managing Board of the National Bank of Romania organized on 16 November 2009, the decision being adopted in the context of confirmation of postponing of the external loans calendar provided for trimester IV 2009 within the multilateral arrangement concluded by Romania with EU, IMF and other international financial institutions.

5. Conclusions

Amid the political-economical instability from the last period, but also as a result of the banks' decision to "cover" from own sources the tax on the interests received by natural persons for the deposits made in the banks, it is possible for the rate of interest for credits to register an ascendant trend in the following period.

During December 2009-February 2010, as a result of reducing the monetary policy interest rate and of inter-bank efficiency, as well as amid a significant improvement of liquidity from the banking system, the interest average rates to the new term deposits and to the new credits intensified their decrease (-1,46%, to 8,13% and respectively -2,22%, to 13,75 %). Evolutions were homogenous for both client categories, but different in magnitude.

I consider that the evolutions shall not be homogenous anymore between both client categories as a result of the banks' decision to "cover" from own sources the "tax" owned by natural persons for the received interests at the deposits made in the commercial banks.

Thus, a few questions are raised. From where shall the banks take the necessary amounts for covering the "fresh" tax on the deposit interests? Shall they have a loss? In no case! And then, the explanation is simple: they shall try to recover these amounts on the basis of increasing the level of the interest rate to the granted credits (both to the new ones and to the ones in tendering).

For the economical development, this is not quite a favorable situation, thus I consider to be opportune an intervention of the central bank to adopt some decisions by which the commercial banks to be "determined" not to increase the credit interests.

References

- [1] Constantin Daniela Luminița, *Regional Economy, Theories, Models, Policies*, ASE Publishing House, Bucharest 2010
- [2] Dardac Nicolae, Barbu Teodora – *Currency*, ASE Publishing House, Bucharest 2009
- [3] Dedu Vasile, Enciu Adrian, Ghencea Stănel, *Products and bank services*, ASE Publishing House, Bucharest 2008
- [4] Dragotă Victor (coordinator), *Evaluation and financing of the direct investments, Collection of feasibility studies*, ASE Publishing House, Bucharest 2009
- [5] Dragotă Victor and company, *Markets and financial systems*, ASE Publishing House, Bucharest 2008
- [6] Dragotă Victor, Mitrică Eugen, Cataramă Delia, Novac Laura Elly, *Basic Finance*, ASE Publishing House, Bucharest 2009
- [7] Dragotă Victor, Ciobanu Anamaria, Obreja Laura, Dragotă Mihaela, *Financial Management*, ASE Publishing House, Bucharest 2003
- [8] Dumitrescu Dalina, Lazăr Paula, *Finances d'entreprise*, ASE Publishing House, Bucharest, '09
- [9] Fourastie Jean, *Le progrès technique et l'évolution économique*, Institut d'Études Politiques de Paris, 1991
- [10] Howard Stein, *Cambridge Journal of Economics, Financial liberalisation, institutional transformation and credit allocation in developing countries: the World Bank and the internationalization of banking*, Cambridge Journal of Economics, pg.257-273, Volume 34, Issue 2, March 2010
- [11] Kuznets Simon, *Quantitative Aspects of the Economic Growth of Nations*, Econ Dev & Cultural Change, 1963
- [12] Lepadatu Gheorghe, - *Fiscal Pressure and quantification indexes. Economical Tribune*, vol. 18, nr. 42, pg. 33-37, Bucharest 2007
- [13] Mitrică Eugen, *Public budget stability and its correlations with the other components of the general economic stability*, ASE Publishing House, Bucharest 2009
- [14] Mînjină Dragoș Ioan, *Relative performance of Valuation Using Multiples. Empirical Evidence on Bucharest Stock Exchange*, The Review of Finance and Banking, Volume 1, Issue 1, Bucharest 2009
- [15] Mohun Simon, *Aggregate capital productivity in the US economy*, Cambridge Journal of Economics, pg. 1023-1046, Volume 33, Issue 5, September 2009
- [16] Moinescu Bogdan, Codîrlaşu Adrian, *Strategies and instruments of administration of bank risk*, ASE Publishing House, Bucharest 2009
- [17] Moșteanu Tatiana coordinator, *Budget and public treasury*, University Publishing House, Bucharest 2008
- [18] Perroux Francois, „*Le profit et les progrès économiques*”, Revue de l'Action Populaire (112), 1957
- [19] Sharpe William, “*Capital Asset Prices: a Theory of Market Equilibrium under Conditions of Risk*”, The Journal of Finance, vol.XIX, 1964
- [20] Spencer W. Roger, Yohe P. William, , *The 'Crowding Out' of Private Expenditures by Fiscal Policy Actions*, Federal Reserve Bank of St. Louis Review, 1970
- [21] Stoian Andreea, *Public budget instability in present economic context*, ASE Publishing House, Bucharest 2009
- [22] Stroe Radu, Armeanu Dan, *Finances*, 2nd Edition revised and amended, ASE Publishing House, Bucharest 2004