ROMANIAN BANKING SYSTEM: THE DEGREE OF FINANCIAL INTERMEDIATION AFTER THE FINANCIAL CRISIS

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Abstract: *In this paper we analyze the evolution of the Romanian banking system after the 2007 financial crisis and the country's accession to the European Union. The first part analyzes the main elements of the banking system: ownership structure, number of employees and banking units, loans and non-performing loans. The second part analyzes the level of financial intermediation of the banking system. The results showed that majority of the capital is private and foreign, the top five banks held over half of the bank assets, number of employees decreased due to the crisis and non-performing loans share had increased by over nine times. Romanian banking system have a low degree of financial intermediation, but the new developments of the EU banking systems proved that it can be a strong point.*

Keywords: Romania; banking system; degree; financial intermediation
JEL Classification: G01; G21

Introduction

During the crisis, the Romanian banking sector did not need support from public funds, and the main prudential indicators are placed at an appropriate level. Romanian banking system has demonstrated structural stability and managed, without major difficulties, to overcome the challenges of increasing the rate of bad loans and optimization of loan portfolios amid regulatory constraints. The main challenges to financial stability remains the credit risk and foreign contagion risk (Romania Banking Association, 2014).

The paper shows the evolution of the banking system in Romania after the 2007 financial crisis and the country EU accession. The first part describes the main elements of the banking system: ownership structure, number of employees and banking units, loans and non-performing loans. The second part analyzes the degree of financial intermediation of banking system in the Romanian economy.

1. A description of Romanian's banking system

In 2014, 40 banks were registered in Romania, from which 38 credit institutions with private majority ownership, 34 credit institutions with foreign majority ownership and 9 branches of foreign banks.

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After the transition to a market economy in 1990, the banking system was mainly state-owned, but through a series of privatizations and foreign banks entries situation has improved. In 2014, the Romanian banking system had 91.7% (Table 1) private majority ownership. Bank of Cyprus owned 10% of Banca Transilvania shares, but in 2014 sold its stake to three Romanian funds. Also it sold its branches from Romania to Marfin Bank Romania. After the Bank of Cyprus sold its stake in Banca Transilvania, the share of foreign ownership fell to 81% (Table 1) and now Banca Transilvania has domestic private ownership.

Table 1 – Share of private and foreign ownership, first five banks and Herfindahl - Hirschmann Index between 2007 and July 2014

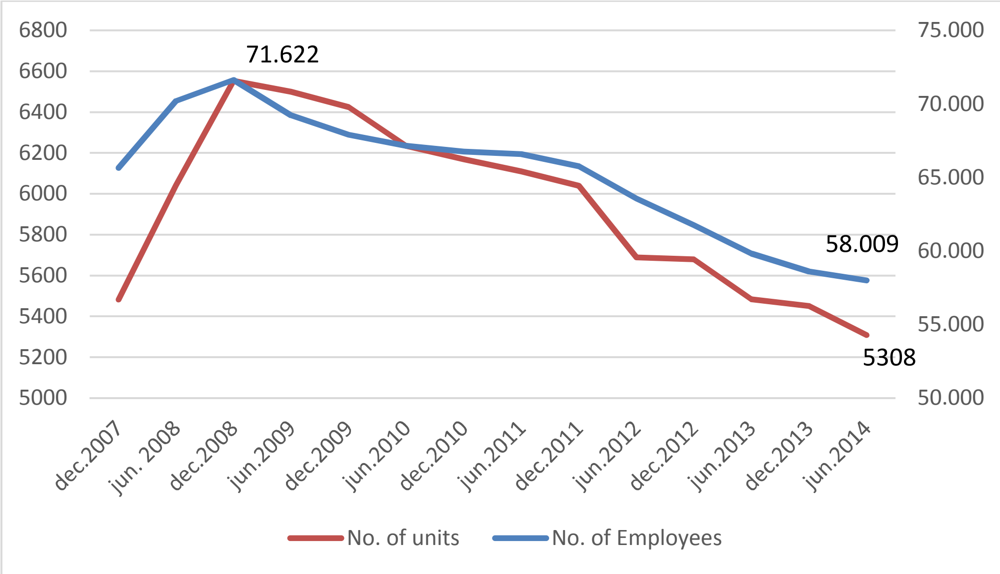
	2007	2008	2009	2010	2011	2012	2013	July 2014
Share in the total banks assets of private majority ownership (%)	94.7	94.6	92.5	92.4	91.6	91.6	91.5	91.7
Share in total banks assets of foreign ownership (%)	88	88.2	85.3	85	83	89.8	90	81
Share of first five banks in total banks assets (%)	56.3	54.3	52.4	52.7	54.6	54.7	54.4	53.9
Herfindahl -Hirschmann Index (points)	1046	926	857	971	878	852	821	806

Source: Romanian National Bank database

Herfindahl index (also known as **Herfindahl–Hirschman Index**, or **HHI)** “is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers” (The United States, Department of Justice, *n.d.*). For example, for a banking system with three banks with shares of 30, 30 and 40 percent, the HHI is $30^2+30^2+40^2=3{,}400$. A higher score indicates a greater concentration banking system and a lower score represents a system with a large number of banks of relatively equal sizes.

The HHI score of 806 points in 2014 (Table 1) is an improvement compared to 2007 and indicates a lower concentration of the banking system. The share of the first five banks (Table 1) was reduced to 53.9% (2014) from 56.3% (2007) and supports the lower degree of concentration.

Figure 1 – Number of employees and number of bank units between December 2007 and June 2014 in Romania



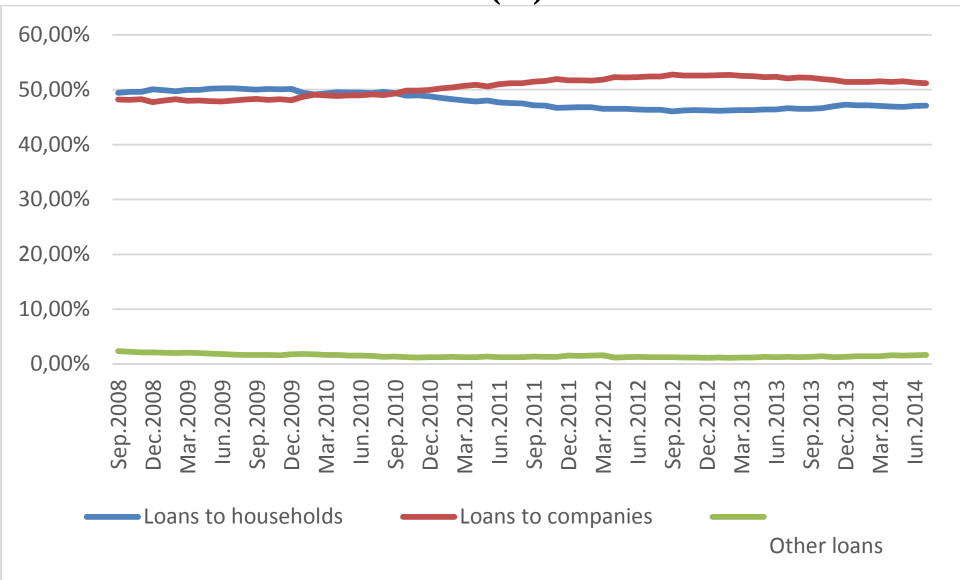
Source: Romanian National Bank database

The financial crisis has spread to Romania, affecting the banking system as well. The expansion of the banking system stopped and banks have tried to cut costs by closing agencies and reducing the number of employees in order to improve performance. 20% of employees (from 71.622 to 58.009) in the banking system were fired (Figure 1, blue line, right scale) and territorial network (Figure 1, red line, left scale) was reduced by 19% (from 6.552 to 5308).

Until 2010, household's loans (blue line) held the largest share in total loans (Figure 2), but from 2011 loans to companies (red line) held the largest share. Other types of loans (green line) have a non-significant share of under two percentage.

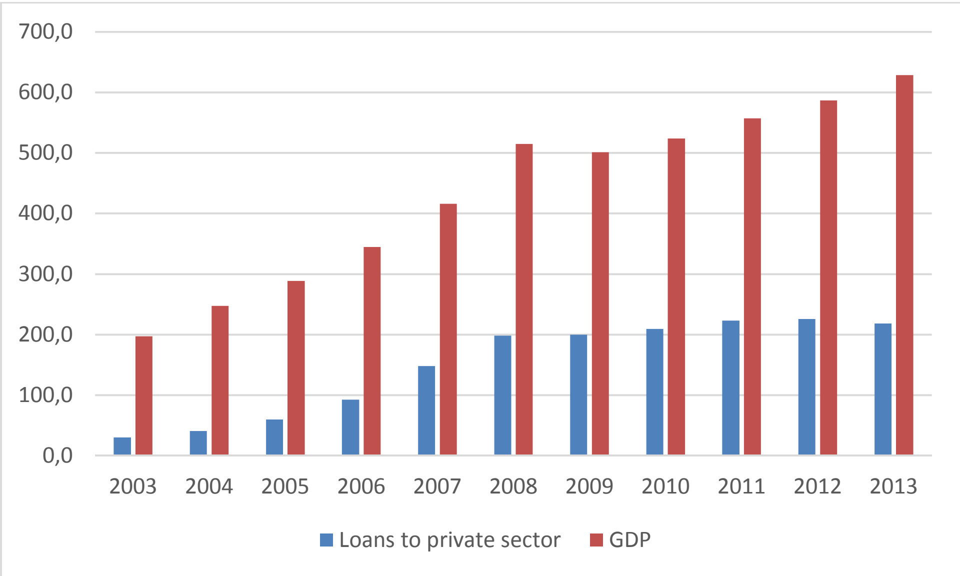
In Figure 3 we see the correlation between Gross Domestic Product (GDP) and loans to private sector. Due to the contagion effect of financial crisis, Romanian GDP fell by 6.6% in 2009 (Eurostat database) compared to 2008. The fall in GDP has reduced household credits as unemployment increased and people have fewer resources to pay monthly instalments.

Figure 2 – Loans to households, companies and other between September 2008 and June 2014 (%)



Source: Romanian National Bank database

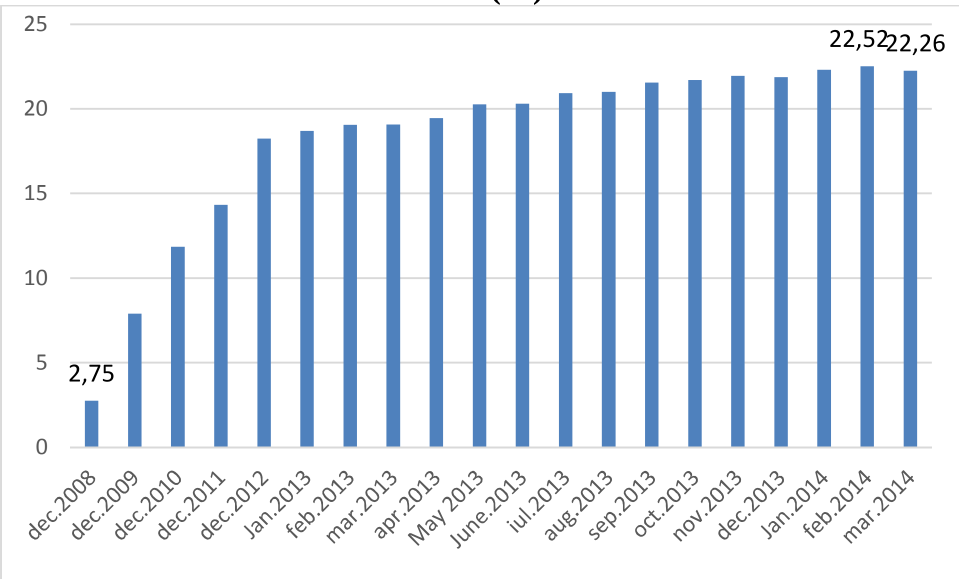
Figure 3 – Loans to private sector and GDP between 2003 and 2013 (billions RON)



Source: Romanian National Bank database

Banks granted easily loans to households, without a thorough examination of the possibilities of returning credits. Share of non-performing loans between December 2008 and February 2014 increased nine times, from 2.75% to 22.52% (Figure 4).

Figure 4 - Share of non-performing loans (over 90 days) between December 2008 and March 2014 (%)



Source: Romanian National Bank database

Romanian National Bank issued a recommendation for banks to provisioned 90% of exposures of insolvent companies, but only four banks have complied with the recommendation. After November 30, 2014 other banks risks suspension of the right to collection of term deposits (Capital, 2014a).

The losses of the banking sector in Romania since the beginning of the crisis and exceeded one billion Euros (2013). Provisions made by banks in the cleaning process of NPL portfolio resulted in a system net loss at nine months of 1.58 billion RON (2014) (Hotnews, 2014). Part of the loss was covered by charging high fees to banking services (Capital, 2014b).

2.The degree of financial intermediation

In 2004, on the biggest wave of accession of ten countries (Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia) to the European Union, Romania wanted to be part of the select group because it was seen as a safety net that will protect it in any way and will not repeat the seizures experienced by the economy and society in the 90s. Moreover, euro area countries were seen as final target, a dream place.

Table 2 – Assets/GDP

Year	2008	2009	2010	2011	2012	2013	2014 T2
%	67,4	74,2	75,0	70,5	69,0	65,0	61,6

Source: Romanian National Bank database

"The banking system is still, for many years, one of the weaknesses of the Romanian economy. There is not a sector that can really mediate between people who save money and those who need money. The good news is that lately many foreign banks have come through the standards they bring, can increase competition," said Nout Wellink, a large Dutch banker (Ziarul Financiarul, 2013).

Today, more than ten years later, this delay "development" of bank intermediation is presented as a strong point for Romania. Romania has only 61.6% (Table 3) share of bank assets to GDP, compared to 200-300% every Western country and even 700-800% in Cyprus.

Table 3 – Loans/GDP

Year	2008	2009	2010	2011	2012	2013	2014 T2
%	39,3	40,7	40,7	40,0	38,5	34,8	33,3

Source: Romanian National Bank database

Until 2013, the indicator Loans/GDP (Table 3) was higher than deposits/GDP (Table 4) because banks received funding from parent banks. The financial crisis has affected parent banks and they reduced funding to entities in Romania (Bancherul, 2014) and the only chance for further lending represent deposit collection from domestic market.

Table 4 – Deposits/GDP

Year	2008	2009	2010	2011	2012	2013	2014 T2
%	30,0	34,1	34,5	33,6	33,6	34,3	33,2

Source: Romanian National Bank database

Maintaining deleveraging, after 5 years of crisis, even at a sustained pace, it is not a positive sign for the banking market or Romanian economy, which has fewer and fewer resources available for financing from foreign banks. The main source of funding for credits remains attracting deposits from the population, but the interest rate on deposits is on a downward trend which discourages saving.

Conclusions

In the last 25 years, the banking system in Romania has come a long way from centralized economy to a market economy, with 40 banks, and private and foreign majority ownership. In 2014, 91.7% of total banks assets were held private, 81% were foreign ownership and the first five banks held 53.9%. Banks were affected by the financial crisis, 20% of employees were laid off and 19% of the territorial network was closed.

Share of non-performing loans increased nine times between 2008 and 2014 and the Romania National Bank issued a recommendation for banks to provisioned 90% of exposures of insolvent companies, but only four banks have complied with the recommendation. After November 30, 2014 other banks risks suspension of the right to collection of term deposits.

The banking system in Romania shows, even in 2014, a low degree of financial intermediation, but developments in the world economy shows that this can be an advantage, even if a decade ago was considered a weakness.

Acknowledgement

This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/142115 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain”

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