

ROMANIAN BANKING SYSTEM AFTER EUROPEAN INTEGRATION -TRENDS AND PERSPECTIVES OF DEVELOPMENTS

RUMUNJSKI BANKARSKI SUSTAV NAKON EUROPSKE INTEGRACIJE -TRENDOVI I PERSPEKTIVE RAZVOJA

STOICA, Ovidiu & CĂPRARU, Bogdan

Abstract: *In this paper we realise a synthetic analysis of the Romanian banking system before and after the European Union adhesion, highlighting the main implications of this phenomenon, as well as the main challenges and the perspectives. From the central bank's point of view it is analysed the degree of institutional independence, using the Grilli, Masciandaro and Tabellini index as well as its degree of transparency, applying the Eijffinger and Geraats index after the European Union accession.*

Key words: *banking system, European integration, trends, perspectives, developments*

Sažetak: *U ovom članku analiziramo rumunjski bankarski sustav prije i nakon ulaska u Europsku Uniju. Izdvajamo glavne značajke tog fenomena kao i glavne izazove i perspektive. S gledišta Središnje banke analizira se stupanj neovisnosti institucije koristeći Grillijev, Masciandarov i Tabellinijev indeks. Također se analizira i stupanj transparentnosti nakon pristupanja Europskoj uniji koristeći Eijffingerov i Geraatsov indeks.*

Ključne riječi: *bankarski sustav, europske integracije, trendovi, perspektive, razvoj*



Authors' data: Ovidiu Stoica, PhD, University Al. I. Cuza Iași, Iași, ostoica@uaic.ro;
Bogdan Căpraru, University Al. I. Cuza Iași, Iași, csb@uaic.ro

1. Introduction

The Romanian banking system suffered profound transformations in the EU integration process; however, the implications of the EU integration continue to mark its evolution, especially taking into consideration the challenges for entering the euro area. The continuous efforts in the last decade for implementing the community acquis, restructuring the banks and modernising the payment system, were correlated with changes in the monetary policy regime (the adoption of inflation targeting) and the supervision activities' strengthen.

In this paper we realise a synthetic analysis of the Romanian banking system before and after the EU adhesion, highlighting the main implications of this phenomenon, as well as the main challenges and the perspectives. From the central bank's point of view it is analysed the degree of institutional independence, using the Grilli, Masciandaro and Tabellini index as well as its degree of transparency, applying the Eijffinger and Geraats index after the EU accession. The future developments in the Romanian banking system are directly connected with the euro area integration and the increasing impact of the competition.

It is important to evaluate the possible effects of the euro area integration for the Romanian banking system, mainly effects on competition and on interest rates.

2. The Romanian banking system from the perspective of the EU adhesion

After the year 2000, the Romanian banking system developed constantly, supported by a sound and accelerated economic development. The number of Romanian credit institutions did not varied significantly (from 41 to 39 credit institutions), but the privatization of the main Romanian bank (Romanian Commercial Bank - BCR) with Erste Bank marked and changed substantially other bank system indicators, like the weight of assets with majority private capital and majority foreign capital, that increased from 53.9% respectively 50.9% in 2000 to 94.5%, respectively 88.6% in 2006 (National Bank of Romania, 2006).

| Indicator | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|-------|-------|-------|-------|-------|-------|-------|
| Number of banks per 100.000 inhabitants | 0.18 | 0.18 | 0.18 | 0.18 | 0.18 | 0.19 | 0.18 |
| Assets of top five banks/Total assets (%) | 65.5 | 66.1 | 62.8 | 63.9 | 59.2 | 58.8 | 60.3 |
| Loans of top five banks/Total loans (%) | n.a. | n.a. | 56.2 | 57.1 | 55.7 | 61.2 | 63.5 |
| Deposits of top five banks/Total deposits (%) | n.a. | n.a. | 63.0 | 64.9 | 59.5 | 57.0 | 58.3 |
| Herfindahl-Hirschmann index | 1,375 | 1,427 | 1,381 | 1,264 | 1,120 | 1,124 | 1,171 |
| ROA | 1.5 | 3.1 | 2.6 | 2.2 | 2 | 2 | 1.3 |
| ROE | 12.5 | 21.8 | 18.3 | 15.6 | 15.6 | 16.9 | 10.3 |

Table 1. Key Indicators for Romanian Banking System

One could notice also some other two significant characteristics of the Romanian banking system, beside the preponderance of the foreign capital: higher ROE comparing with the developed EU countries and a relatively high concentration, the first five banks having around 60% in all specific indicators, the Herfindahl-

Hirschmann index showing a decrease in banking concentration, due to the decreasing of the share of market of Romanian Commercial Bank after privatisation.

3. Main trends and challenges in the Romanian Banking System

The main influence factors that are challenging nowadays the Romanian banking system and will continue in the next period to have a profound impact, are: the international financial situation, due to the US mortgage market crisis (at least on short term), the process of nominal and real convergence (on a medium term horizon) correlated with the Euro area integration, the development of the national financial market.

On short term, of course, the international financial crisis caused by the subprime credit crisis, will impact on the Romanian banking market, which is dominated by foreign capital banks, owned by international financial-banking institutions. The liquidity crisis which confronted several European bank groups will reflect on the Romanian branches, from the point of view of refinancing. The shortage of liquidities that already started, determined the local banks to attract new deposits and to refinance from the National Bank of Romania (NBR). Thus, the central bank could regain, sooner than estimated, the normal position of price maker and lender of last resort after a period of increasing indebtedness of the population, which took us on the second place in the EU, with some estimations that will overpass the number one, the British. The increasing appetite for consumer credit, correlated with some very recent periods of real-negative interest rates in deposits, due to a rebounding inflation, if correlated with an expected increasing interest rate for the corporate credit, could reduce the rhythm of economic growth and to a new configuration of the credits portfolio.

All the analysis show that the Romanian banking system is developing on sound basis and a wider liquidity crisis is not likely to succeed, taking also into consideration the significant level of minimum compulsory reserves (20% in RON and 40% in EUR).

The EU integration will have direct effects on the Romanian banking system due also to the increasing competition. Using the European Union passport, already more than 80 EU based credit institution notified NBR about the intention to offer bank services on our market. All the main players and some others new comers and medium sized banks announced their objectives to increase the market shares. Except the first two places, situated at comfortable distance, in the last couple of years were important fights for the top 10. However, until now the fight in the retail market is still somehow formal; the main effect is on the interest rate, lower and lower at least for a promotional period. But, the Effective Interest Rate continues to remain at unacceptable levels, due to increasing or new invented charges. It seems hard to understand how it is possible to reduce the interest rate and increase the charges and the total cost of credit to be even higher. The explanation is related to the increasing demand of credit, especially consumer credit, correlated with the increasing purchasing power of the population and the standard of life.

4. Future developments in the Romanian banking system

The main economic challenge for Romania in the following years is the euro area integration. From the point of view of the nominal convergence criteria (the Maastricht ones), the main concern is for the monetary ones (Isărescu, 2001). Thus, the NBR has an important role in the fight against the inflation. In the last few years, one can notice a closer correlation between the monthly interest rate and the most important interest rates, fact that suggests a more mature mechanism of interest rates formation and the fact that the central bank could count more and more on the interest rate as a monetary policy instrument, in the context of gaining gradually its position of price maker on the monetary market. As result, in the period between January 2000 and December 2006, the correlation index between the average active interest rates for non-bank clients and the monthly inflation rates registered values $0 < 0,7790 < 1$, comparing with the period January 1994 – December 1999, when registered a lower value, $0 < 0,3280 < 1$. The same situation is in the case of the correlation index between the average passive interest rates for non-bank clients and monthly inflation rates, in the period January 2000 – Dec 2006 being $0 < 0,7782 < 1$, comparing with the period January 1994 – December 1999, when was $0 < 0,4804 < 1$. These subunitary positive values of the correlation index show a correlation in the same sense, tighter and tighter.

The implementation of the community acquis in the Romanian legislation led to an increasing independence of the central bank. Analysing the degree of independence of the National Bank of Romania, using the Grilli, Masciandaro and Tabellini index (Grilli, et al., 1991), it resulted in December 2007 12 points from 15, suggesting that the central bank has an increased independence degree.

Also, the activity of the central bank became more transparent, in 2007 the index Eijffinger and Geraats (Eijffinger & Geraats, 2006) registering a 13 of 15 level, compared with the 2004 level of 6.5 points, reflecting a higher preoccupation for central banks' transparency. This substantial increase could be explain through the institutional changes in the NBR in the last few years, but also with the adoption of the inflation targeting regime, in July 2005. However, the NBR must be more and more preoccupied by the education of the citizens concerning the financial-monetary phenomenon, in order to better be understood its signals. Meanwhile, it is necessary a lower level for its discourse, targeting the common citizen, in explaining the risks to which are exposing. If the banks' clients would be more informed and responsible in taking the decisions, the result being a more efficient effect of the central bank's communication policy.

The euro adoption will determine on medium term a convergence of the interest rates for the credits with the average in the market, as result of the competition, the changes in the monetary policy (change from the national to the European Central Bank's monetary policy). The readjustment of the credit portfolio of the Romanian banks depending on the type of clients and credits means that the mortgage credit will gain its normal place in the market economy, surpassing the consumer credit and also the corporate market will become more interesting and its products more sophisticated, especially for the small and medium enterprises. The EU integration

will prioritise the investments in infrastructure by the help of the banks, as well as the public-private partnership, but the increasing competition will also determine more aggressive marketing strategies, in order to keep or to gain market share.

The reduced gap between active and passive interest rates and the increasing transparency will determine lower effective interest rates in credits and thus the profitability will decline. This must be correlated on the one hand with the increasing difficulties in insuring sufficient qualified human resources (employees), in the context of rapid expansion of agencies and on the other hand with the continuous preoccupations to maintain the profitability.

The evolutions in the mortgage market will have profound impact on the entire banking activity. Nowadays, the weight of mortgage financing in the total bank's assets is reduced, but the trend in the market is very clear. Hofmann (Hofmann, 2001), Davis and Zhu (Davis & Zhu, 2004) consider that between the credit evolution and the prices in the real estate market there is a positive correlation on the long run. The price movement on the real estate market will have direct impact on the bank's financial performances, both directly, through the eventually increasing volume of doubtful and past-due mortgage credits that will decrease the bank's performance and indirectly, through the reduced activity in the financial and economic sector as a whole.

5. Conclusions

The Romanian banking system develops continuously, taking advantage of the favourable climate created by the EU integration and the stable and rapidly developing economy. On medium term, the Euro area integration is expected to have a profound impact on the banks' profitability, due to the increasing competition and the convergence of the interest rates to European average.

6. References

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