

ROMANIAN BANK LENDING DURING THE FINANCIAL CRISIS

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Abstract: This paper examines the effects of the financial crisis on lending within the Romanian banking system. Lending in Romania contracted significantly since the fall of last year for two reasons. On one hand, the central bank's new crediting norms, that intended to limit borrowing risks, entered into force in October 2008 and forced banks to take extra-measures. On the other hand, the first signs of the economic crisis started to show in Romania at the same time and affected the lenders' liquidity. The development of Romanian bank lending at the end of 2008 reflected the impact of both credit demand and especially credit supply.

JEL classification: G01, G15, G21

Key words: financial crisis, bank lending, credit demand, credit supply, household loans, corporate loans

Financial crisis erupted in 2007 in United States from the high number of defaulting borrowers with sub prime mortgages, leading mortgage lenders to bankruptcies. Problems with loan quality in the sub prime mortgage sector forced the failure of some lenders in the primary market, but had much wider repercussions, figuring prominently in solvency problems in institutions outside the United States and contributing to increased market volatility and the virtual drying up of liquidity in the interbank and short-term money market. Major central banks have responded to the crisis with emergency injections of liquidity, and the Fed has also lowered the federal funds rate in order to deal with the crisis and prevent stronger effects of the market turmoil on the wider economy. Meanwhile, as a consequence of the crisis, leveraged buyout activity has slowed and many announced deals are either being reprised or cancelled.

The financial crisis of 2008, which started in the summer of 2007, has now assumed global manifestations. A crucial aspect worth studying is how the financial crisis affects the real economy through the supply of credit to customers. Credit crisis directly affected by the financial crisis, is expanding in Europe, leading to a blockage in bank lending due to sudden decrease in the level of economic confidence and activity slowing. It is estimated that the current crisis will last about 2 years, because companies will adapt, although the global economy will enter a period of less dynamic growth.

The initial channel of the crisis was the real estate market, which hit companies in European countries (Great Britain, Ireland, Italy and France). In addition, the real estate crisis followed by the financial crisis led to a significant worsening of the credit risks in these countries. In Italy, the credit risks for companies are deteriorating in the

context of weak growth, rising costs and blocking loans. In France, there was a significant increase of non-payment incidents for companies (up to 75% at the end of September 2008 compared to the end of September 2007). This deterioration due to slowing business was caused mainly by difficulties faced in accessing corporate credit. In Britain, the financial and real estate crisis have strong impact on consumption and companies expenditure leading to a 14% increase in company bankruptcies in the first half of 2008. In Ireland, real estate crisis has spread to the entire economy, causing a recession and non-payment incidents for companies have increased by 75% in the first half of this year.

In a market-based economy, the financial sector channels the supply of funds from savers to the demands of borrowers, which supports the wealth-creating abilities of the entrepreneurial sector. At the same time, the performance of the financial sector also depends crucially on the health of the economy. Typically, growth of loans at commercial banks declines sharply before a recession. Clearly, bank actions to limit the credit supply can exacerbate an economic downturn. For example, banks typically tighten credit standards and/or loan terms as the economy weakens and nonperforming loans increase. But an adverse shock from outside the financial sector can be just as important such as a sharp increase in oil prices or a plunge in house prices. Such shocks also slow the demand for credit because of weaker future growth of incomes and profits. In large and open economies, forces that trigger changes in the supply and demand for credit are often synchronized and difficult to distinguish.

A reduction in lending does not, by itself, show that there was a decline in the supply of credit. It is possible that the recession and general economic uncertainty reduced the demand for credit by corporate borrowers. To separate supply and demand effects, bank lending can be related to a bank's willingness or ability to lend during the crisis.

In Romania, the international financial crisis and changes in credit standards have resulted in a decrease in applications for mortgages. Lending in Romania contracted significantly since the fall of last year for two reasons. On one hand, the central bank's new crediting norms intended to limit borrowing risks, entered into force in October 2008 and forced banks to take extra-measures. On the other hand, the first buds of the economic crisis started to show in Romania at the same time and affected the lenders' liquidity, hampering lending. As an effect of the economic crisis, loans to people and companies in Romania clutched by 1.5 billion euros in January 2009 to 48.26 billion euros despite a 4.2 percent advance in December 2008.

Loans in local currency decreased in January by 1.1% in real terms, for the fourth month in a row, while loans in foreign currency, expressed in euros, dropped by 0.1%, compared with 1% last December, according to the data of the National Bank of Romania.

In real terms, private lending in lei started to fall after the breakout of the financial crisis in Central and Eastern Europe, namely in the last quarter of 2008, by 2.4% in December, by 0.7% in November and by 0.4% in October. Foreign currency lending fell in November by 0.9% on the month, expressed in euros, but hiked 2.3% in domestic currency. In October 2008, foreign currency loans rose 0.4% in euros and decreased by 1.5% in lei. In the last part of 2008, lending was almost blocked due to the financial turmoil, as well as due to the implementation of new, more restrictive household lending rules by the central bank. In nominal terms, January was the first month after October when loans rose, expressed in lei and in foreign currency as well.

Private lending in foreign currency, expressed in lei, rose 7.2% on the month in January, compared with a 4.4% growth in December, while loans in lei rose 0.1%, after a 2.1% drop in December.

At the end of 2008, development of lending standards and terms regarding both companies and households has confirmed the trend that was previously recorded, with a significant tightening, more pronounced in household lending.

Lending standards concerning small and medium companies were hardened faster than banks expected, while the situation regarding large companies was reverse. Factors that contributed to this situation were: expectations for the entire economy, risk associated with the industry the company operates, risks associated to required collateral and changing the weight of bad loans in bank portfolio. Risks associated to companies increased. In this regard, the main sectors regarded were construction and real estate transactions.

Households lending standards were severely tightened in the whole banking sector for both consumer and housing loans. Lending terms have become considerably more restrictive, most significant developments were that concerning the decreasing of debt service ratio in monthly income and the increase of risk premium paid by customers.

Thus, during March to May 2008 the growth rate of loans granted to the private sector slightly reduced and posted a faster decline between June and August 2008, so that in the September-November 2008 the growth rate of lending to private sector diminished rapidly, reaching the lowest level of the last three years (-9.3% to 34.9%). The trend of decline that characterized the dynamics of credits both in lei and foreign currency, posting a three and a half year low. However, loans in foreign currency continued to be more dynamic than those in domestic currency (particularly in case of households) so that the average share of foreign currency loans in total lending to the private sector recorded a peak of the last three years (55.9%).

Table no. 1. Loans granted by credit institutions to households in the Romanian banking system in 2008 (million lei)

Period	Lei	EUR	Other currencies	Total
Jan.	33944.2	33086.1	7115.7	74146.0
Feb.	34778.4	33990.9	7903.7	76673.0
Mar.	35712.0	35200.0	8730.0	79642.0
Apr.	36608.8	36035.0	9091.2	81735.0
May	37358.1	36903.0	8990.3	83251.4
Jun.	38045.0	38944.8	9928.4	86918.2
Jul.	39297.9	38733.6	9791.2	87822.7
Aug.	40249.4	40204.0	10105.2	90558.6
Sep.	41016.6	43540.8	11490.0	96047.4
Oct.	41377.9	42451.5	11935.7	95765.1
Nov.	41299.7	43881.4	11644.2	96825.3
Dec.	40944.3	45814.6	12451.3	99210.2

Source: NBR, *Monthly Bulletin No. 12/2008*

These developments reflected the impact of both credit demand and especially credit supply. The latter came under more intense pressure from several factors, such

as:

- the implementation of the new provisioning coefficients in relation to foreign currency loans (NBR Regulation No. 4/2008 amending and supplementing NBR Regulation No. 5/2002 on the classification of loans and placements as well as the setting up, regularization and use of specific provisions for credit risk and the methodological norms for the enforcement thereof);
- tightening of external financing conditions for banks;
- reduction of the liquidity surplus in the banking system;
- increasing prudence of credit institutions based on increased adverse selection risk;
- customers' lower degree and/or scope of eligibility (partly due to the enforcement of NBR Regulation No. 11/2008 amending and supplementing NBR Regulation No. 3/2007 on limiting credit risk associated with loans to households, effective as of October 2008);
- more restrictive lending terms and conditions;
- increased interest of banks for government securities and external assets (although their share in the monetary balance sheet remained subdued).

Table no. 2. Indexes for estimating the relative variance of household loans in the Romanian banking system in 2008 (%)

	Lei	EUR	Other currencies	Total
Feb./Jan.	102.46	102.73	111.07	103.41
Mar./Feb.	102.68	103.56	110.45	103.87
Apr./Mar.	102.51	102.37	104.14	102.63
May/Apr.	102.05	102.41	98.89	101.86
Jun./May	101.84	105.53	110.43	104.40
Jul./Jun.	103.29	99.46	98.62	101.04
Aug./Jul.	102.42	103.80	103.21	103.12
Sep./Aug.	101.91	108.30	113.70	106.06
Oct./Sep.	100.88	97.50	103.88	99.71
Nov./Oct.	99.81	103.37	97.56	101.11
Dec./Nov.	99.14	104.41	106.93	102.46

At the same time, credit demand has been negatively influenced by:

- the strong increase of interest rates for lending;
- deterioration of market operators' expectations regarding economic and financial conditions;
- low-income households potentially reaching the indebtedness ceiling;
- the weaker domestic currency and increased uncertainties surrounding its evolution;
- maintaining a high level of foreign financing for non-banks.

Table no. 3. Loans granted by credit institutions to non-financial corporations in the Romanian banking system in 2008 (million lei)

Period	Lei	EUR	Other currencies	Total
Jan.	33892.0	38540.2	3976.2	76408.4
Feb.	35041.1	38866.3	3918.1	77825.5
Mar.	36767.7	40352.8	3972.4	81092.9
Apr.	38423.8	40647.0	4170.4	83241.2
May	39439.6	41476.4	3857.5	84773.5

Period	Lei	EUR	Other currencies	Total
Jun.	40051.3	42848.9	4000.8	86901.0
Jul.	40657.0	41864.3	3961.6	86482.9
Aug.	41198.0	42962.8	4461.6	88622.4
Sep.	42285.0	46305.7	4990.4	93581.1
Oct.	42492.5	44963.4	5573.2	93029.1
Nov.	42424.2	46295.6	5469.4	94189.2
Dec.	40945.8	48942.3	4717.4	94605.5

Source: NBR, Monthly Bulletin No. 12/2008

Table no. 4. Indexes for estimating the relative variance of corporate loans in the Romanian banking system in 2008 (%)

	Lei	EUR	Other currencies	Total
Feb./Jan.	103.39	100.85	98.54	101.85
Mar./Feb.	104.93	103.82	101.39	104.20
Apr./Mar.	104.50	100.73	104.98	102.65
May/Apr.	102.64	102.04	92.50	101.84
Jun./May	101.55	103.31	103.71	102.51
Jul./Jun.	101.51	97.70	99.02	99.52
Aug./Jul.	101.33	102.62	112.62	102.47
Sep./Aug.	102.64	107.78	111.85	105.60
Oct./Sep.	100.49	97.10	111.68	99.41
Nov./Oct.	99.84	102.96	98.14	101.25
Dec./Nov.	96.52	105.72	86.25	100.44

During this period, the supply of loans was stymied by the contraction of banks' excess liquidity and the tightening of external financing conditions for credit institutions. The growth rate of household and corporate loans continued to decelerate across all categories, along with the sizeable contraction in the volume of new business to households and non-financial corporations. The dynamics of the household loans granted in Swiss francs posted the sharpest deceleration, with credit institutions relinquishing almost entirely their lending activity in this currency in November 2008. At corporate level, the worst hit category was that of loans with a maturity of over 5 years (accounting for 28.5 percent of total corporate credit), whose foreign currency component recorded, for the first time, three successive monthly retrenchments in terms of volume.

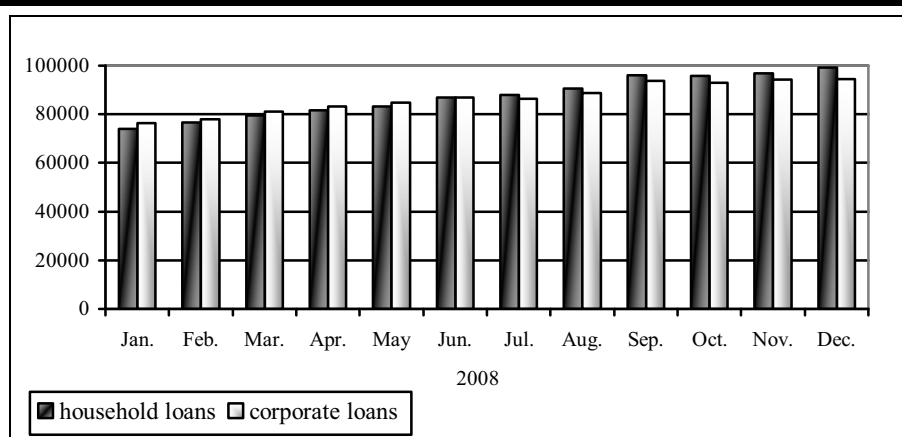


Figure no. 1. Household and corporate loans granted by Romanian credit institutions in 2008

In conclusion, we can say that the development of loans granted to households and non-financial companies by the Romanian credit institutions was a immediate consequence of a prudent policies provided by the National Bank of Romania which has materialized in:

- slowing down the expansion of credit to the private sector;
- supporting lending in domestic currency to the detriment of foreign currency credit;
- limited overall risk exposure;
- low share of overdue and doubtful loans in total loan portfolio (1.1% as of September 2008).

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