WAYS OF FINANCIAL CRISIS TRANSMISSION IN ROMANIA

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Abstract: The financial system in Romania evolved in an environment strongly marked by the global financial and economic turmoil. The Romanian economy had reported high economic growth for several years, accompanied by the build-up of a relatively significant external deficit, as well as by the rise in short-term external debt. The banking sector, which holds a key position in the financial system, withstood these pressures well. The repercussions of the deteriorating external economic environment affected the Romanian economy with a certain time lag, adversely affecting above non-financial private sector. The National Bank of Romania, in its capacity as supervisory authority, responded to the new threats by meeting the specific liquidity needs. Measure adopted like strictly monitoring of banks, improve the prudential regulation framework and, signing, together with the Government, financing agreements with the International Monetary Fund and the European Union. These agreements ensure the adequate financing of the current account deficit and render economic and financial policies more credible.

Keywords: private sector, method, methodology, economics

1. International economic context

International financial turbulences that started in 2007 translated into a deep crisis one year later. Starting September 2008, this crisis has intensified, affecting seriously world economic growth. The international economic advance forecasted for 2008 is expected to be followed by a 1.3 percent decline in 2009 [2].

The state of global financial markets worsened abruptly starting September 2008 after the bankruptcy of US incorporated Lehman Brothers investment bank. The confidence among participants dropped sharply, with the risk premiums rising to overly high levels. Consequently, interbank market functioning was severely hurt and banks with excess liquidity were reluctant to lend their surplus to other credit institutions.

The response of governments and central banks to avoid the crisis effects was unprecedented. Fiscal and monetary policies were put on a strongly expansionary path. Key measures adopted by central banks were aimed at:
a) substantial and fast easing of monetary policy;
b) increasing the volume and frequency of open-market operations in order to provide the necessary liquidity;
c) enlarging the range of eligible collateral and maturities pertaining to the provision of liquidity.
Major central banks joined efforts and correlated to a larger extent their monetary policy actions.

In fact, central banks appear to be granted a stronger formal mandate with a view to ensuring financial stability by resorting to measures for the reorganisation of regulatory and supervisory structures (e.g. *Blueprint for a modernized financial regulatory structure* in the USA or the *De Larosière Report”* in the EU) [5]. The narrowing of monetary policy caused the fiscal stimulus play a greater role. Such measures envisaged either the support for the banking system via:
- recapitalisations;
- government guarantees;
- programmes for toxic assets purchase;
- the boost of aggregate demand by raising government investment;
- cutting taxes;
- implementing programmes for fostering new motorcar purchases;
- granting subsidies to employers etc.

In OECD countries, fiscal packages approved until March 2009 for 2008-2010 period accounted 3.4 percent of these countries’ GDP [6]. Despite such efforts, lending conditions remained tight, whereas aggregate demand and employment continued deteriorating in many countries. The difficulties encountered by nonfinancial corporations in securing financing and the weaker demand due to wealth and balance

sheet effects entailed severe repercussions on the output volume. The world economy posted a significantly slower growth rate and a severe decline is expected for 2009.

2. Romanian economic context

Economic and financial integration has allowed not only positive effects, but also negative ones to be rapidly transmitted abroad, and even countries without direct exposure to world financial market. A global crisis requires a global solution, is the central ideea that all international financial organization adopted. The IMF is increasingly involved in such solutions and in providing financial assistance to a growing number of emerging countries, of which many in Central and Eastern Europe (Hungary, Ukraine, Latvia, Poland and Romania).

Fiscal and monetary policy measures were backed by the expansion of the coverage limit per depositor. Across the EU, the regulations on deposit guarantee schemes were amended: the guarantee crossover was raised to EUR 50,000 (and is due to reach EUR 100,000 by the end of 2010), coinsurance was abandoned and the time span for making compensatory payments was reduced. A proposal of revising capital requirements for EU-wide credit institutions is also in progress. It deals with improved management of large exposures, liquidity risks, securitized products risks, better supervision of cross-border banking groups and higher-quality bank equity.

In the beginning, the crisis influenced predominantly developed economies. However, the risk aversion in these countries showed rapidly through into emerging economies. The Central and Eastern Europe (CEE) region was also affected (Figure 1). Market sentiment began to weigh increasingly on the dynamics of spreads and of exchange rates in the CEE countries. The downgrades reflect the mounting risks to the economy stemming from high and rising private-sector leverage and the related dependency on an increasingly uncertain external financing channel.

The Romanian financial structure in 2008 is shown in the table 1. Characteristic for Romania is the percent detained by the credit institutions by 82.76 percent of total net assets. Constitutes one of the ways of transmission crises in Romania developed in continuation.

3. The impact above financial private sector

a) The aggravation of risk perception

The region was classified as a high-risk area, within which Romania is not immune and the contagion has spread from one country to another. Forecasts for the region are pessimistic:

- economic declines are broad based;
- companies disinvest;
- unemployment is on the rise;
- current account deficits undergo (disorderly in some cases);
- adjustments and fiscal deficits widen significantly (Table 2).

Table 1. Romanian financial structure 2008

Institution	Percent of total net assets
Credit institutions	82.76
Pension funds	0.24
Non-bank financial institutions	11.18
Financial investments companies	1.53
Insurance companies	4
Investments funds	0.29

Source: National Bank of Romania

Table 2. Adjustments and fiscal deficits

Indicators (%)	State						
	BG	LV	HU	PL	RO	HR	TR
GDP	-1.6	-13.1	-6.3	-1.4	-4	-3	-3.7
Gross fixed capital formation	-12.7	-24	-10.6	-6.2	-6.5	-7.5	-7.9
Unemployment	7.3	15.7	9.5	9.9	8	9.6	13.1
Inflation	3.9	4.6	4.4	2.6	5.8	3.1	7.3
Current account deficit/GDP	-18.8	-1.5	-5	-4.7	-7.4	-5.9	-1.8
Public debt/GDP	16	34.1	80.8	53.6	18.2	34.6	42.7
Fiscal deficit/GDP	-0.5	-11.1	-3.4	-6.6	-5.1	-3.3	-4.6

Source: European Commission, spring forecasts, May 2009

b) International market contraction

Rating investors by country of residence of the issued share capital of companies Commercial subscribed by companies with foreign participation illustrates the first economic integration of Romania into the European Union and secondly interdependence between exports and direct foreign capital attracted by Romania.

The table 3 comprises rank by country of residence of investors in Romania 1991-2008 [7]. Economic activity in Romania's main trading partners (Germany, Italy and France) is expected to witness some of the largest contractions in the euro area (between -5.4% and 3.0% [2]. Consumer confidence in these countries has seen

a sharp decline (figure 2), with a bearing on the demand for imports as well. Consequently, given that Romania's export markets are adversely affected, domestic firms engaged in foreign trade activities might encounter problems. The significant depreciation of the leu starting with the autumn of 2008 has helped alleviate difficulties somehow.

Table 3. In Romania 1991-2008

Country of origin	Number of companies	Capital (mil. euro)
Netherlands	3456	4015
Austria	5375	2650
Germany	16664	2278
France	5873	1776
Cyprus	4255	1099
Italy	26984	935
USA	5755	724

Source: Romanian Agency for Foreign Investment

Exporting companies contributed by almost 16 percent to value added creation (June 2008), holding about 10 percent of loans granted (December 2008), which explains their importance to the Romanian economy and the banking sector [1]. Until first quarter of 2009, Romania counted among the least affected CEE countries in terms of export activity (Figure 3).

c) Difficulties in the external financing

Access to financing has become more difficult and more expensive given that:

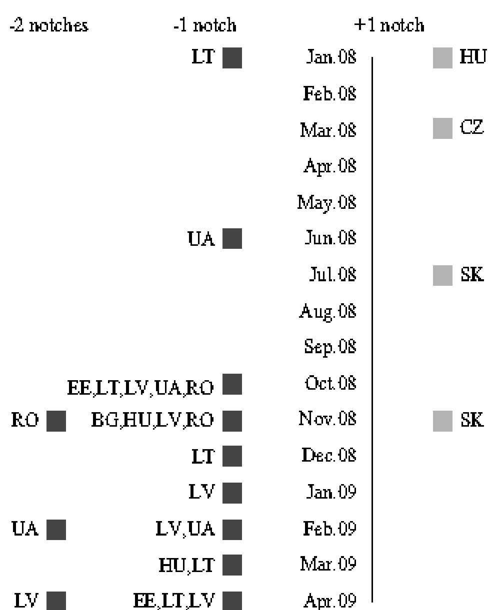

Figure 1 Rating changes in CEE (S&P, Fitch and Mood's rating agencies)

Source: Bloomberg

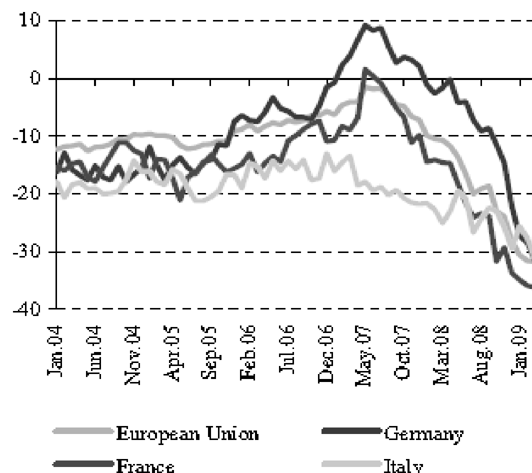

Figure 2. Consumer confidence indicators in main trading partners (balance, seasonally adjusted)

Source: European Commission

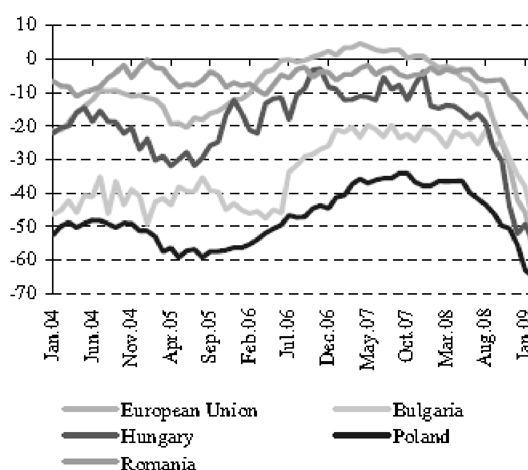

Figure 3. Indicators on the change in the volume of export orders in EU countries (balance, seasonally adjusted)

Source: European Commission

- international creditors are reluctant to providing further liquidity;
- governments all over the world have started to compete strongly with the private sector for resources;
- some rating agencies downgraded Romania's rating to below "investment grade", thereby worsening the perception of sovereign risk.

In 2008, Romanian companies and financial institutions resorted heavily to foreign loans, which summing up 13.7 billion EUR (thereby fuelling external debt), a volume roughly equal to the new domestic bank loans granted to companies and households in 2008.

Market sentiment is weighing increasingly heavily on the setting of the financing cost for the European emerging countries (figure 4). As a

matter of fact, the larger resort to CDS when assessing sovereign risk (in spite of the low level of liquidity and transparency of these instruments), heightens the role played by sentiment changes while determining loan costs. The financing provided on an increasingly larger scale by the IMF to emerging countries is aimed at alleviating the pressures on the costs of and access to financing.

d) The solvability reduction

Financial turbulences sparked concerns over the liquidity risk management. Nevertheless, the emergence of the economic crisis enhances the probability that the solvency risk across companies might take precedence over the liquidity risk. Romania's financial stability may be affected by contagion from both directions.

Table 4. (I) Via Romanian banking sector

Home country of shareholders	GDP estimate for 2009	Share in the Romanian banking sector's capital
Greece	-0.9	30
Austria	-4.0	24
Netherlands	-3.5	12
Italy	-4.4	6
Hungary	-6.3	6
France	-3.0	6

Source: European Commission

Central banks in the countries of origin of the Romanian banking capital pumped considerable amounts into their financial systems with a view to resuming lending and restoring smooth money market functioning. These inflows had a different impact on financial resources of Romanian banks' subsidiaries. Some of them posted higher own capital and external liabilities, and others saw an opposite development [4]. Under these circumstances, domestic loans seem to play an increasingly important role.

The economic and financial crisis is expected to generate significant losses worldwide. According to the IMF estimates, they might total almost USD 4000 billion, of which two thirds would be incurred by banks [3].

4. Conclusion regarding ways of crises transmission in Romania

The decline in global economic activity and the materialisation of losses will generate contagious effects also on:

a) The domestic banking sector. Thus, the economic downturn in the countries of origin of Romanian banking capital will make it harder for debtors in these countries to service their debts. Table 4 presents contagion of the global crisis via Romanian banking sector channels (Dec. 2008).

The solvency of origin banks will be damaged, adding to the already existing liquidity problems. Consequently, the need to recapitalise parent banks will diminish the resources they might channel towards their subsidiaries abroad. Against this background, the main foreign banks' commitment to maintaining their exposure to Romania might lessen this risk somehow.

Table 5. (II) Via Romanian economy

Home country of shareholder's (June 2008)	GDP estimate for 2009	Share in	
		Domestic bank loans	GVA (June 2008)
Netherlands	-3.5	2.2	6.8
Italy	-4.4	1.3	1.5
France	-3.0	1.2	3.0
Germany	-5.4	1.2	3.7
Austria	-4.0	0.9	3.6
Turkey	-3.7	0.6	0.5

Source: European Commission

b) Romania's real economy. Non-resident shareholders of companies operating in Romania may encounter difficulties in preserving their cross-border investment at the same level. As a result, foreign-owned local companies might witness a drop in the financing via this channel, which may slow their activity. These companies hold a relatively significant share of total domestic bank loans (almost 15%) in value added formation across the economy. Contagion via characteristics of Romanian economy is presented in the table 5 (December 2008).

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