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# Romanian financial system – recent developments and perspectives

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## Romania made significant progress over the past years...

- GDP growth accelerated, output gap expected to turn positive in 2016
- Inflation is very low (negative rates) mainly due to fiscal measures, domestic consumption is strong
- Strong fiscal consolidation
- MTO reached in 2014
- All nominal convergence criteria have been met since second half of 2014
- Transmission of monetary policy improved
- Lower contagion risk in the banking sector
- NPLs substantially reduced
- Romania exit the EDP in 2013 and the MIP in 2016

...This progress has been achieved with the support of EC and IMF...

...but there is an increasing risk of policy reversal by unwarranted legislative proposals and pro-cyclical fiscal measures

# I. Macro overview

## General government budget deficit

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
Budget deficit (% of GDP) cash	-0.7	-1.4	-3.1	-4.8	-7.3	-6.3	-4.2	-2.5	-2.5	-1.7	-1.2	-2.8
Budget deficit (% of GDP) ESA	-1.2	-2.2	-2.9	-5.6	-9.1	-6.9	-5.4	-3.2	-2.2	-1.4	-1.1	-3.0
Primary deficit** (% of GDP)	0.0	-1.4	-2.2	-5.0	-7.5	-5.1	-3.7	-1.2	-0.5	0.2	0.3	-1.5
Structural deficit*** (% of GDP)	-2.5	-4.4	-5.2	-8.6	-8.8	-5.8	-3.0	-2.1	-1.2	-0.7	-1.0	-3.0

\* Projections for 2016 according to Ministry of Public Finance (cash deficit, primary deficit) and European Commission - Winter 2016 Economic Forecast (ESA deficit, structural deficit)

\*\* The primary deficit is the budget deficit before including interest payable.

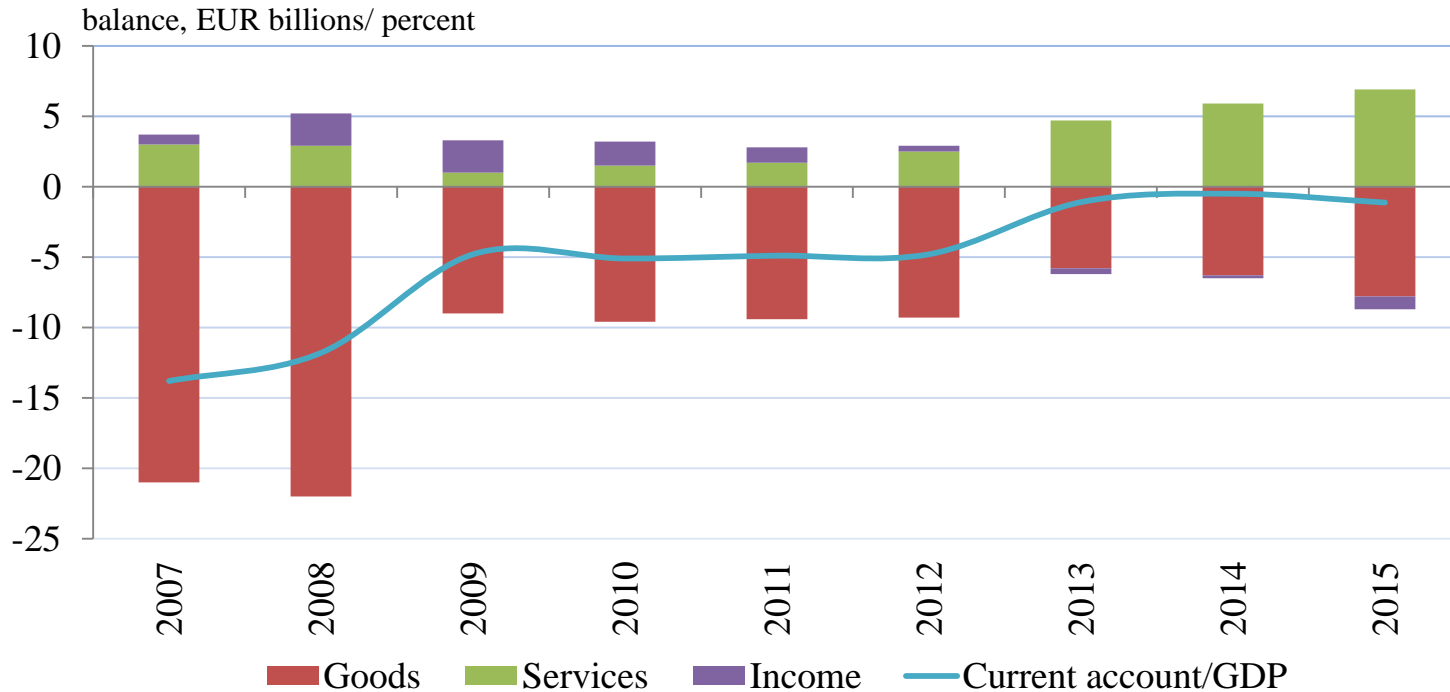
\*\*\* A structural deficit occurs if the fiscal balance is in deficit when computed at potential output level.

Source: MPF, European Commission, Eurostat

## External balance improved

- The current account deficit narrowed significantly since 2009, but resumed growth in 2015 as domestic consumption expands
- The surplus for trade in services widen over the past years, driven by transport and IT

### Current account balance

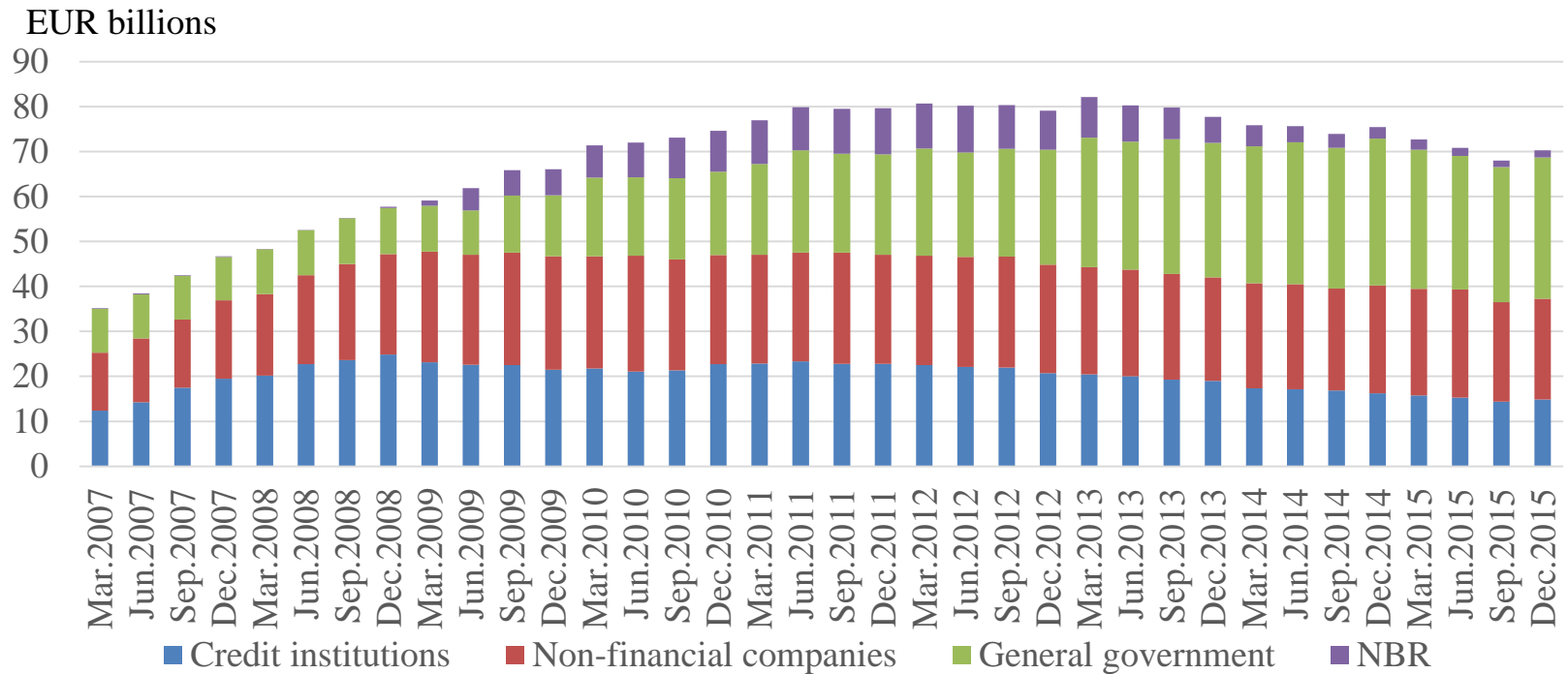


Source: NBR

## External debt declined

- External public debt increased in the aftermath of the international crisis in order to sustain a gradual deleverage in private sector
- NBR reimbursed almost entirely the IMF loans received in 2009

### External debt

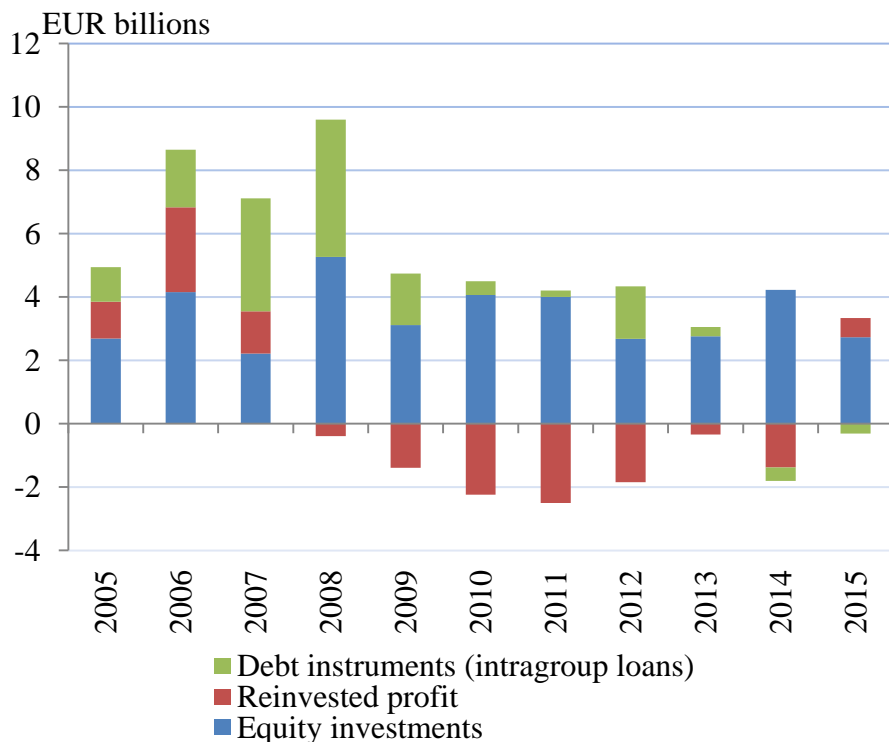


Source: NBR

## Larger transfer of EU funds and FDI resilience

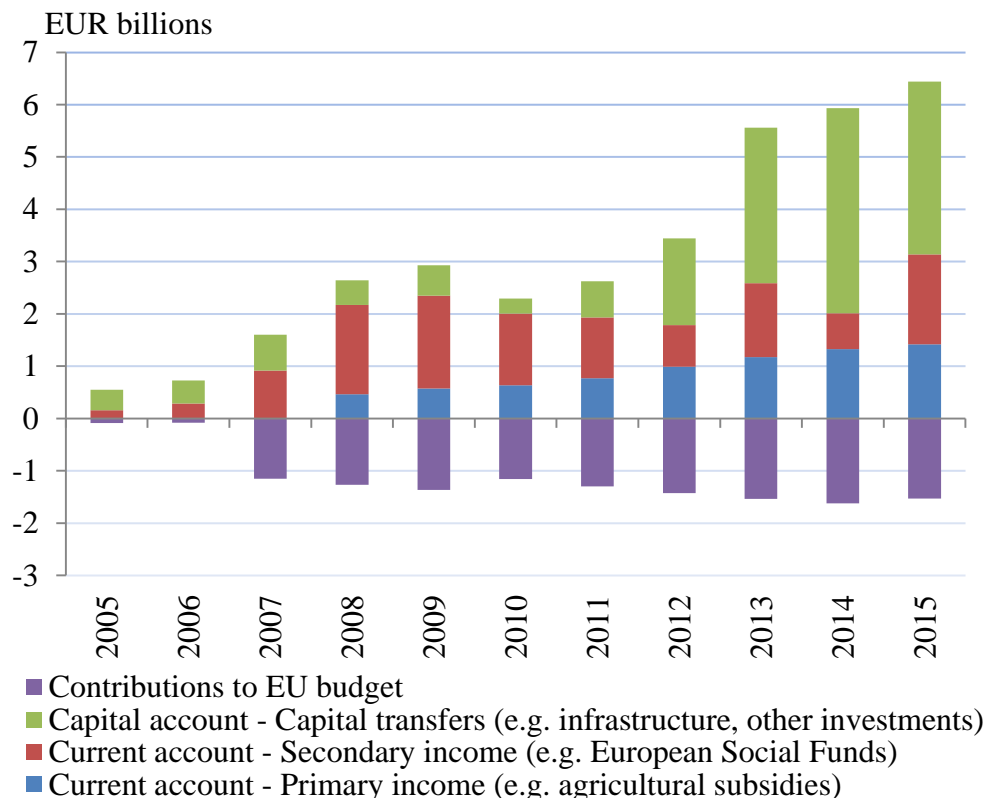
- Transfers from the EU budget improved significantly since 2013 over the increase of capital absorption
- Positive reinvested profit in 2015 signals higher confidence in local economy

### Foreign direct investments



Source: NBR

### Financial flows with the EU budget



# Romania fulfills all nominal convergence criteria

## Maastricht Criteria (Nominal Convergence Indicators)

Nominal Convergence Indicators	Maastricht Criteria	Romania	Fulfilment of the criteria
<b>Inflation rate (HICP)</b> (percent, annual average)	$\leq 1.5$ pp above $-0.7\%$ (average of the three best performing Member States*)	<b>-0.4</b> (December 2015)	Yes
<b>Long-term interest rates</b> (percent per annum, annual average)	$\leq 2$ pp above $1.9\%$ (average of the three best performing Member States in terms of price stability*)	<b>3.5</b> (December 2015)	Yes
<b>Exchange rate (vs. euro)**</b> (percentage change)	$\pm 15$ percent	<b>+1.8/ -1.8</b>	Yes
<b>General government deficit***</b> (percent of GDP)	below 3 percent	<b>1.4</b>	Yes
<b>Government debt***</b> (percent of GDP)	below 60 percent	<b>39.8</b>	Yes

\*) Lithuania, Poland, Slovenia

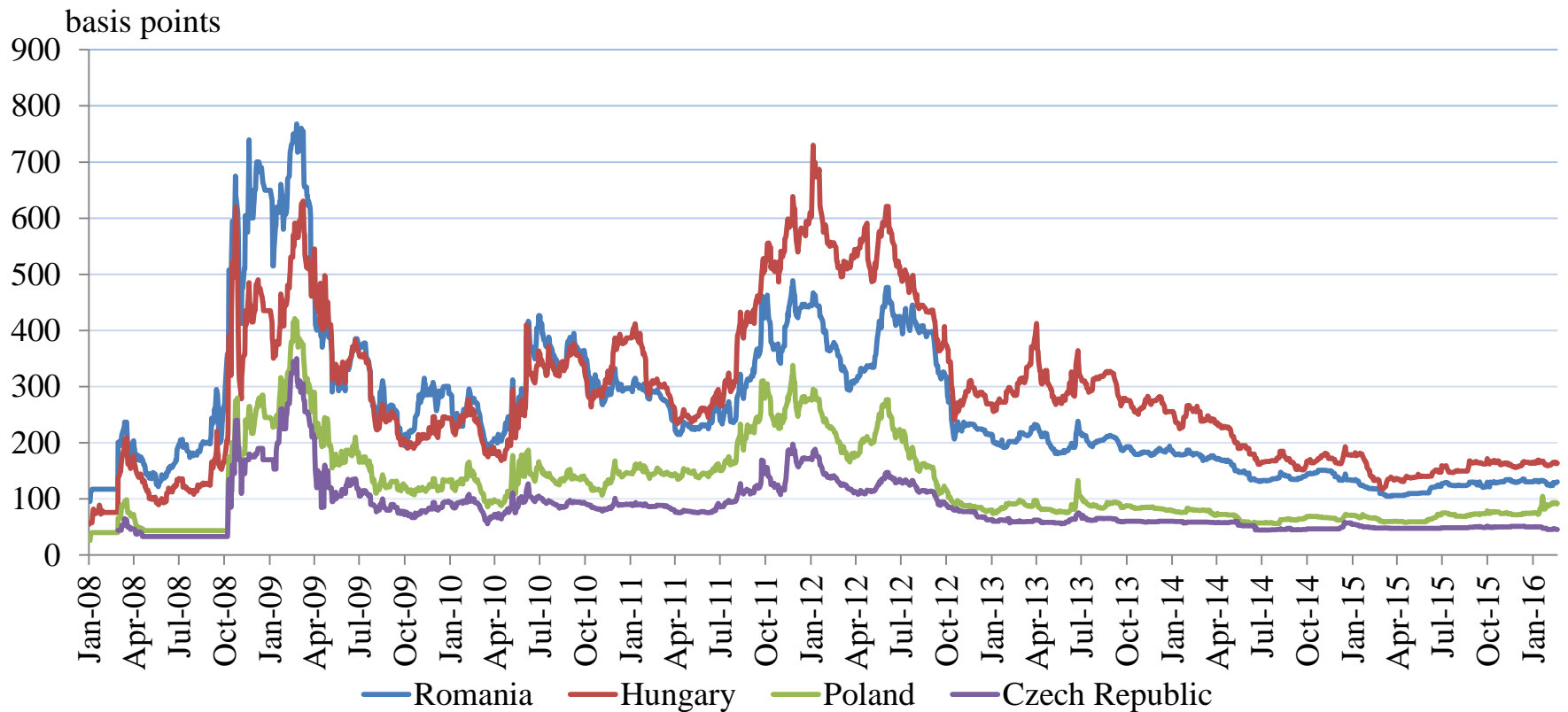
\*\*) Maximum percentage deviations of the bilateral exchange rate against the euro from its December 2013 average level in January 2014 to December 2015 based on daily data at business frequency. An upward/downward deviation implies that the currency was stronger/weaker than the average exchange rate in December 2013.

\*\*\*) 2014; ESA2010 methodology.

Source: Eurostat

# Restored macroeconomic equilibria improved investors' perception on country risk

## CDS quotes for Romania and peer countries



Source: Reuters

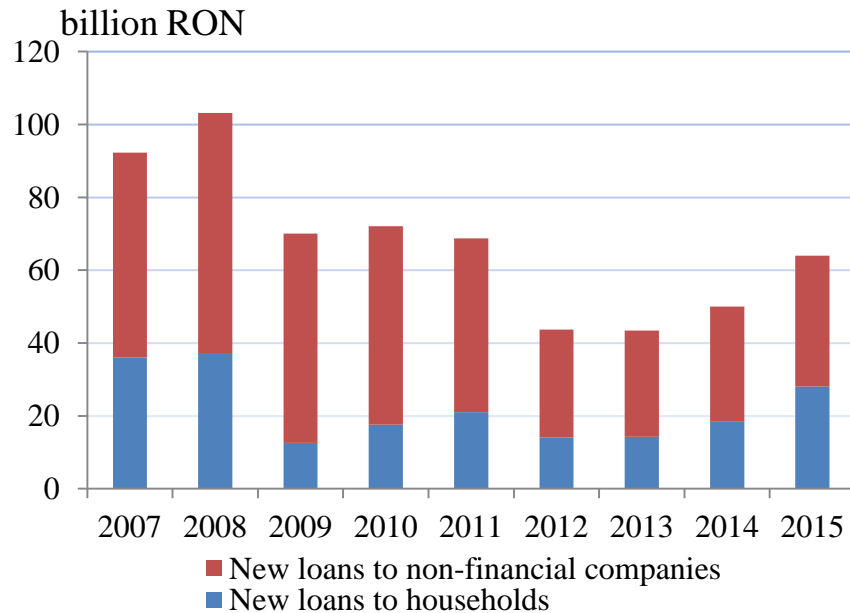


## II. Financial stability

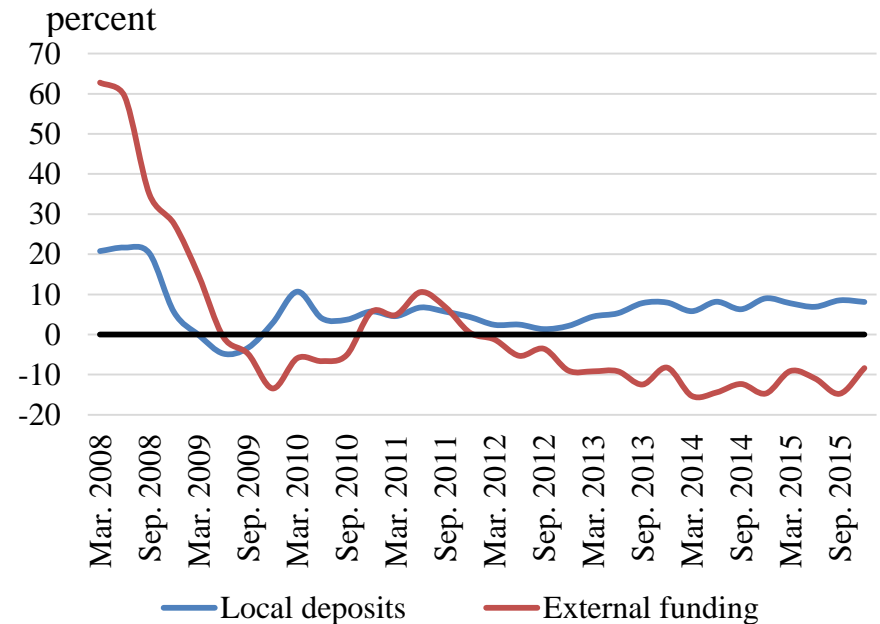
### Bank funding evolved towards less contagion risk

- Credit to private sector resumed growth, in particular credit to households
- Local deposits are replacing external funding, leading to lower contagion risk

#### New bank loans



#### Banks' funding (annual change)

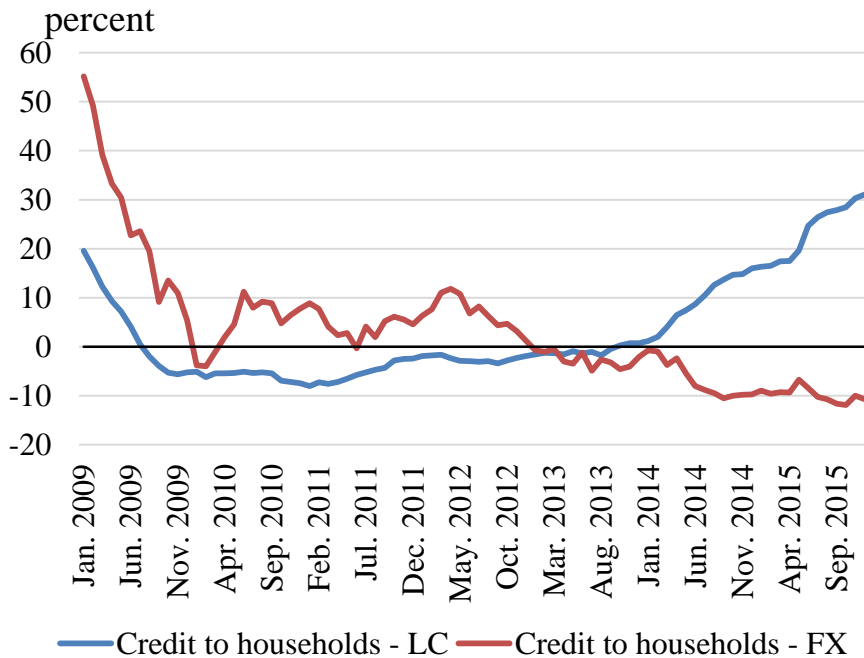


Source: NBR

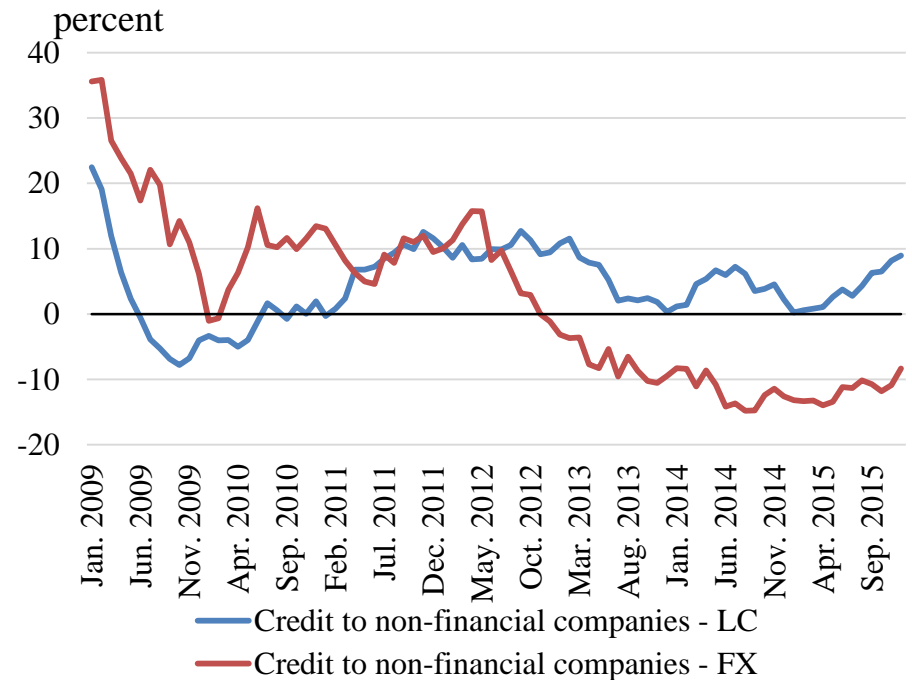
# Credit growth in local currency resumed...

- Local currency loans are the main driver of credit growth
- Prima Casa program counts for the largest share of new loans to households

## Credit to households (annual change)



## Credit to non-financial companies (annual change)

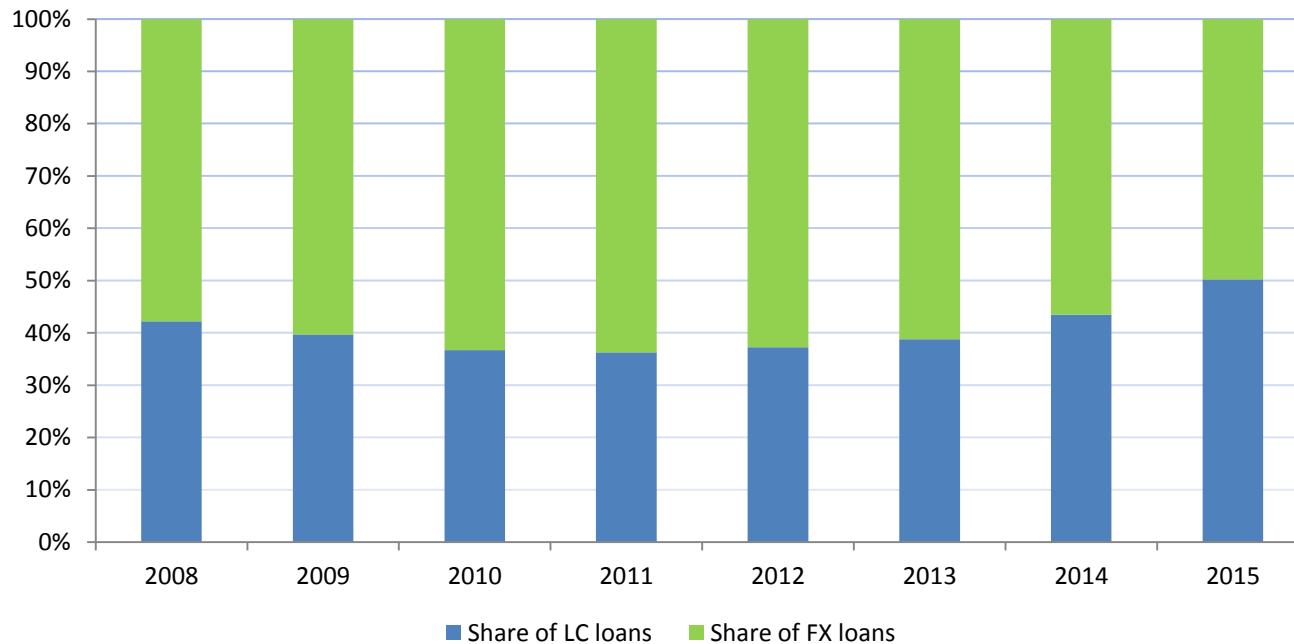


Source: NBR

## ... such that the majority of the outstanding loans are now granted in local currency

- In 2015 the share of local currency loans in banks' credit portfolios increased above 50%
- Banks' exposure to currency risk diminished significantly since the onset of financial crisis

Structure of banks' credit portfolios by currency (end of year)

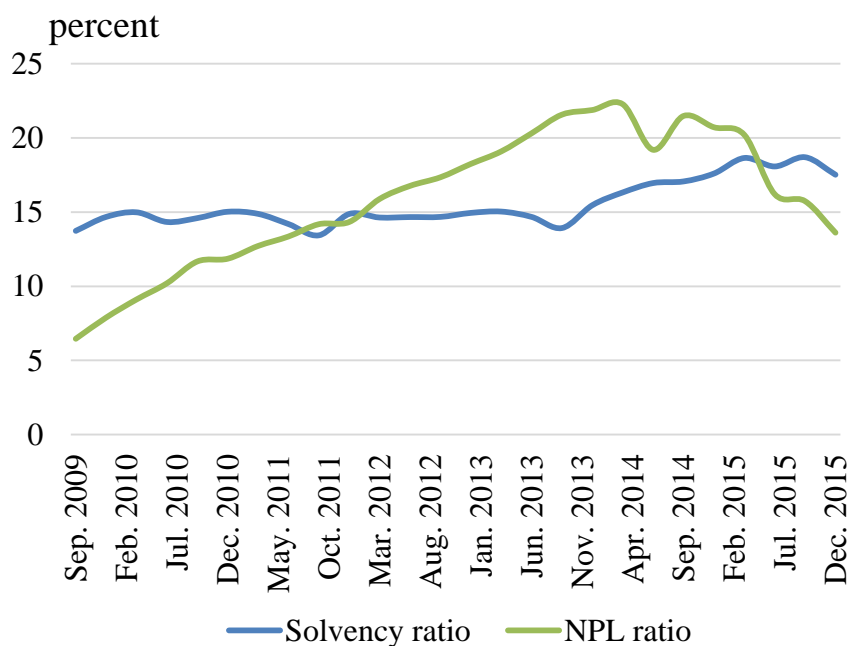


Source: NBR

# Banking sector improved its resilience to shocks

- Banks' solvency and liquidity improved
- Banks embarked in a cleaning-up process of their balance sheets from bad loans

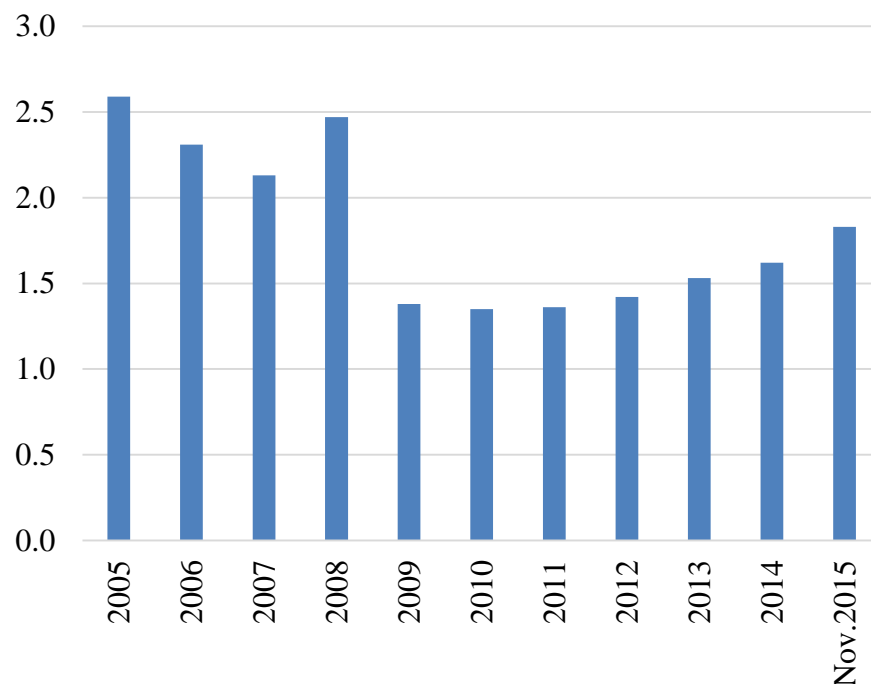
## Banks' solvency and NPL ratio



Note: NPL ratio computed based on EBA methodology starting with September 2014

Source: NBR

## Liquidity indicator

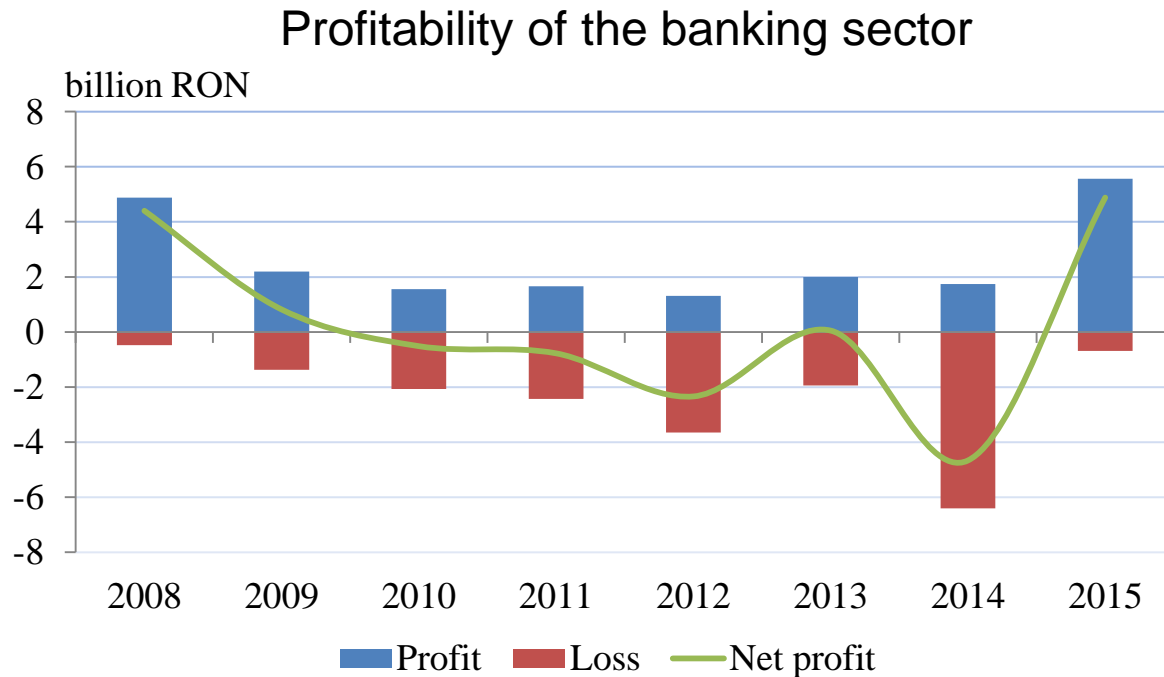


Note: Methodology changed in 2009

Source: NBR

# Banks' profitability accelerated in 2015

- ❑ Provision expenditures soared in the aftermath of financial crisis
- ❑ The large profits in 2015 are rather a recover of the high 2014 losses
- ❑ Banks' profitability resumed growth in 2015 as bad loans were partially removed from balance sheets, but profits are asymmetrically distributed



Source: NBR

# Main threat to financial stability: legislative initiatives leading to uncertainty

- BNR defends price stability, financial stability, exchange rate stability
- Some legislative initiatives are aimed at changing terms of contracts already signed, creating instability and uncertainty.
- “Datio in solutum” law was approved by Parliament – then the President sent it to reexamination.
- The European Central Bank and the European Commission warned of threats to financial stability if this law is passed in its original form.
- BNR intervenes in this debate because it answers to the requests from the Presidency and Parliament.
- We are making proposals with the aim to answer the requests of the Presidency.

# The role of NBR in this debate

Presidency's requests	NBR proposals to answer these requests
Prevent moral hazard	Optional for the future (two types of loans –with or without DS)
Allow debtors in good faith to oppose a procedure started by his guarantor	Allow debtors in good faith to oppose a procedure started by his guarantor
Introduce objective conditions to determine debtors financial situation: difficulty to pay? more real estate properties? Purpose of buying that real estate (house to live in or not)?	<ul style="list-style-type: none"> <li>- 150000 euro threshold</li> <li>- Limit to residential property only (houses/flats)</li> <li>- Only above a certain debt service to income threshold (65%)</li> </ul>
Correlate it with Prima Casa program	Exclude Prima Casa from DS law
Consult it with the European Central Bank (for transposing a directive)	Follow the opinion of the ECB regarding: legal certainty and retroactivity; target vulnerable debtors only and prevent abuse; prevent negative impact on future credit activity (all proposals above)

# The legislative initiative “datio in solutum” poses systemic risk to the financial sector

## Consequences for borrowers/depositors:

- Higher down payments
- Higher home loan interest rates
- Higher number of years necessary to save for the down payment
- Depositors may suffer losses
- Lower disposable income due to larger monthly payments
- Impact on net wealth
- Erodes financial inclusion (lower access to credit for low income persons)

## Consequences for banking system:

- Stimulates moral hazard amongst borrowers
- Impairs profitability and solvency
- Declines market value of residential guarantees
- Increases risk aversion

## Consequences for government/economy:

- Risk of questioning state guarantees
- Risk of sovereign downgrading
- Risk of higher funding costs for sovereign debt
- Lower economic growth (contraction of the construction sector, lower consumption)

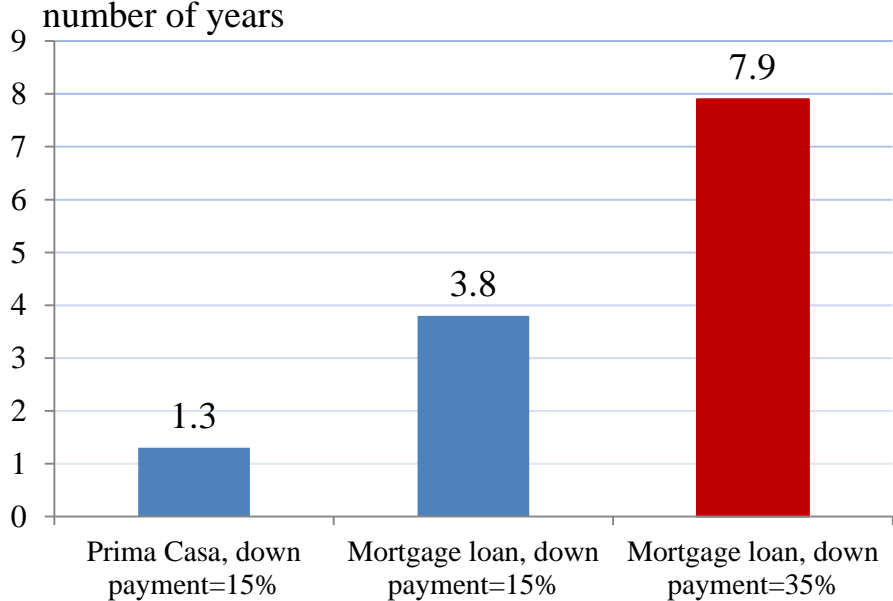


# European Commission's position

- Country Report Romania (26.2.2016)
  - risks from unwarranted legislative developments
  - DS: Not transposing Directive 17/2014 (voluntary vs. mandatory)
  - Major concern on retroactive applicability
  - Concern on wide applicability
  - Several provisions of the draft law, if applied without further amendments, are likely to undermine payment discipline and investor sentiment going forward
  - Impacts credit activity
  - Generate systemic risk
  - Challenge to financial stability
- Communication from the Commission to European Parliament, Council, ECB and Eurogroup (8.3.2016):
  - Banking sector is now well capitalized and liquid but several currently discussed legislative initiatives pose a risk to its stability.

# The legislative initiative “datio in solutum” will deteriorate the access to credit

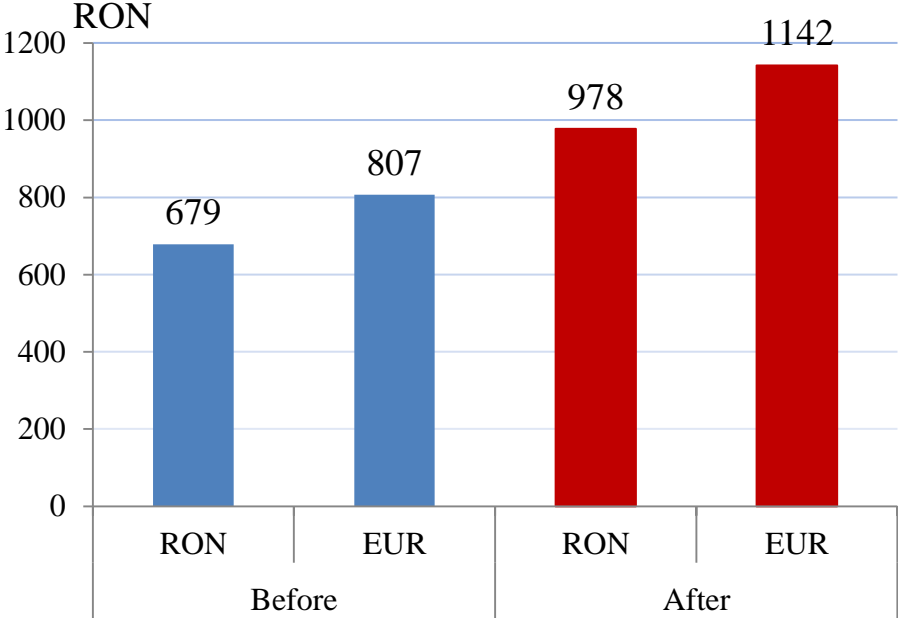
Number of years necessary to save for the down payment



Note: results obtained for 2 person household, average income, saving ratio=25%, house value=EUR 60,000, residential price decline=10%

Source: NBR

Increase of monthly payments

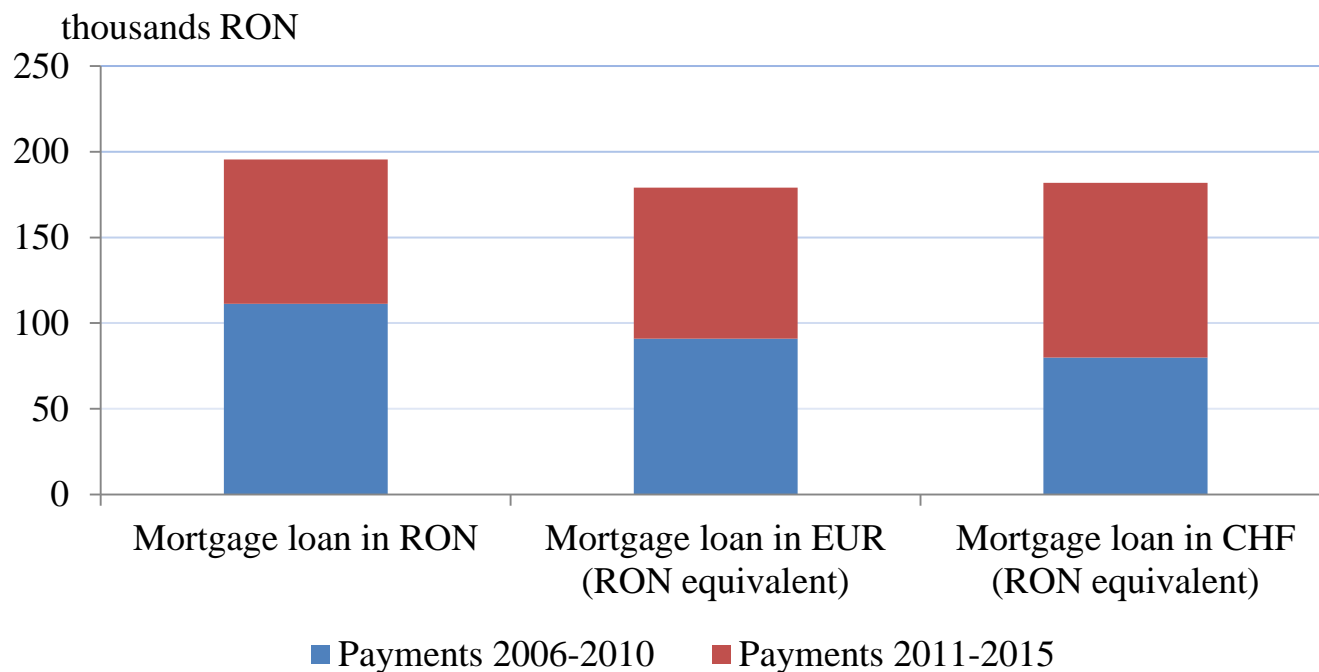


Note: results obtained for average loans, maturity=30 years, interest rate increase=150 b.p., maturity decline=10 years

Source: NBR

## Cost of mortgage loans

Total payments up to date for a mortgage loan granted in 2006, by currency



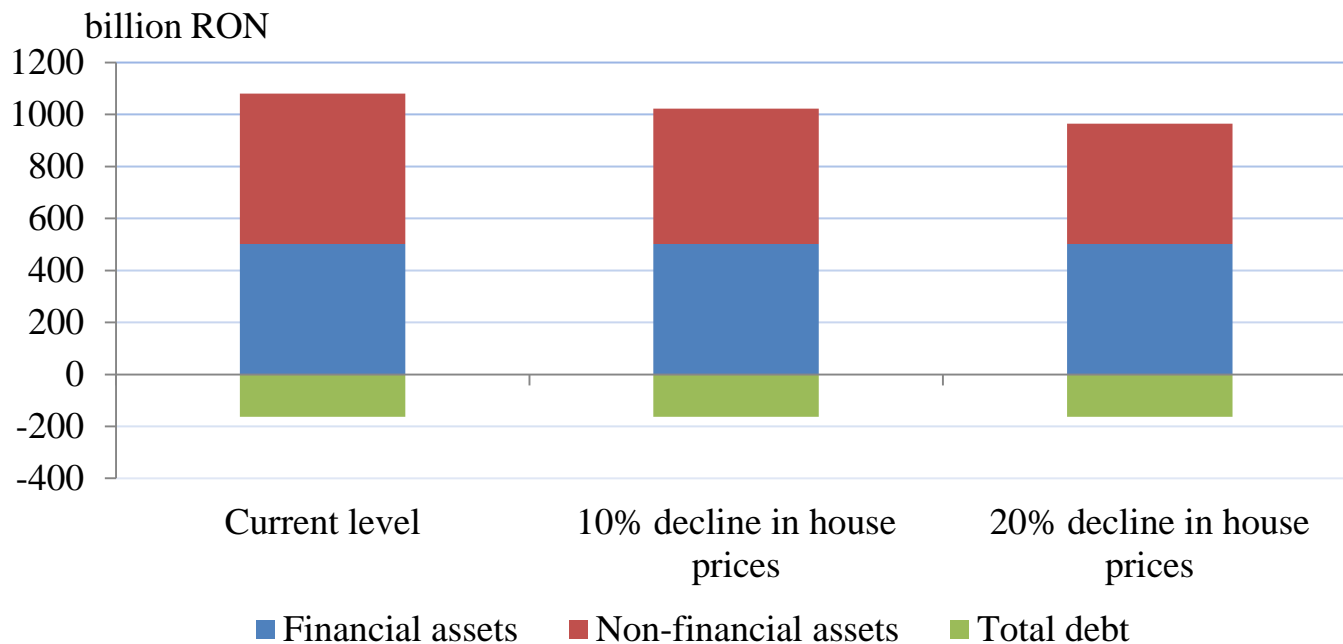
*Note: results for an average mortgage loan of EUR 60,000, granted in January 2006, loan maturity of 30 years, constant annuity*

*Source: NBR calculations*

# Lower house prices would affect households net wealth

- A potential decline of house prices due to “datio in solutum” may trigger wealth losses for households
- 10% lower house prices could reduce households net wealth with 6.3% (57.8 billion RON)

Impact of house prices decline on households net wealth



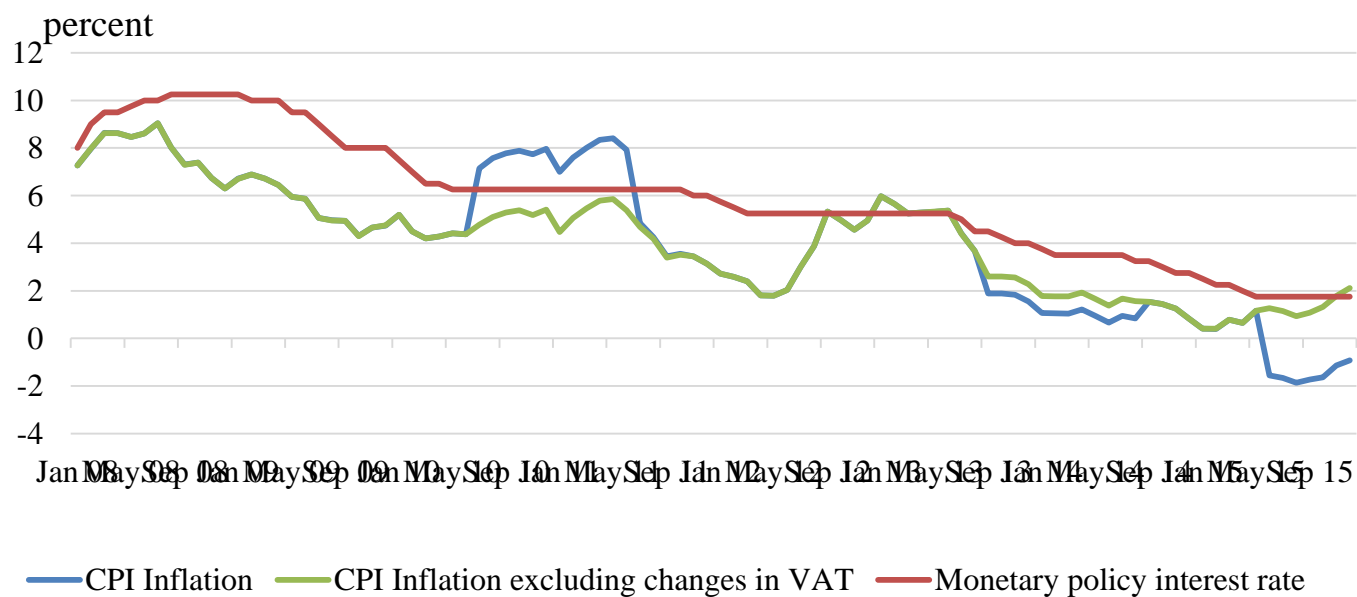
Source: NBR calculations

### III. Monetary policy

## Monetary policy interest rate declined significantly along with the inflation rate

- NBR successfully lowered inflation rate over the past years
- Inflation rate became negative in the context of VAT cuts; inflation is expected to return positive this year as the influence of fiscal measures diminishes

Inflation rate and monetary policy interest rate

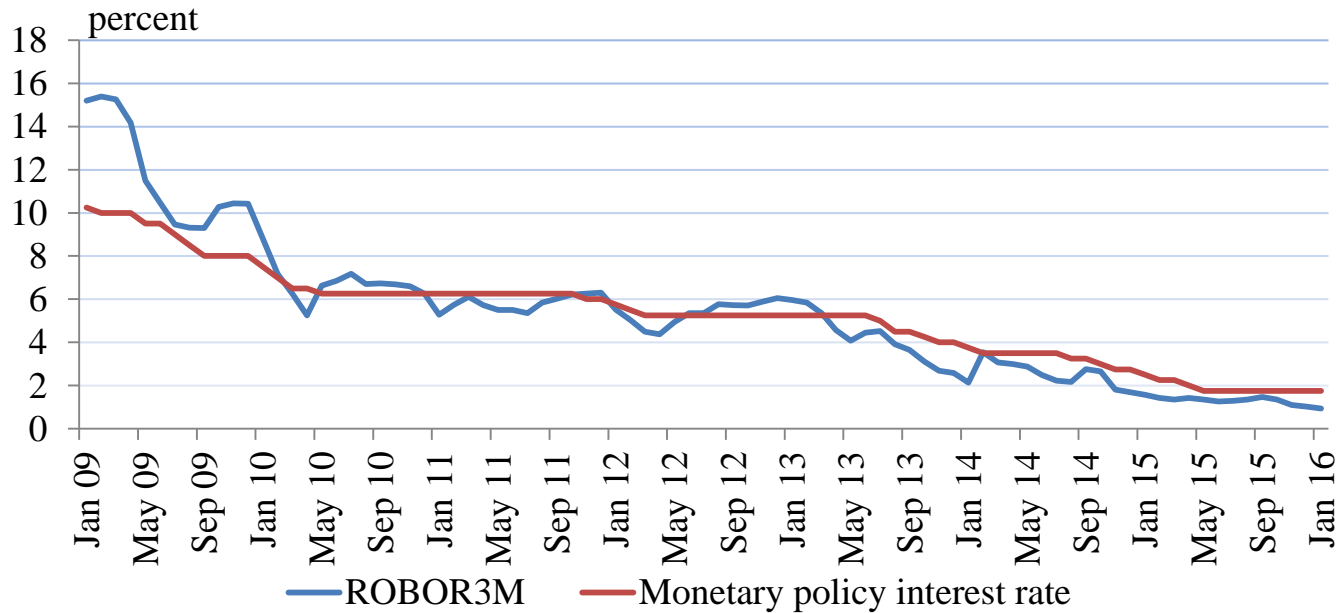


Source: NBR

# Credit costs at historical lows

- ❑ Money market interest rates declined below 2 percent as NBR lowered significantly the monetary policy interest rate, whilst liquidity in banking system is adequate
- ❑ Low money market interest rates reduced costs for borrowers

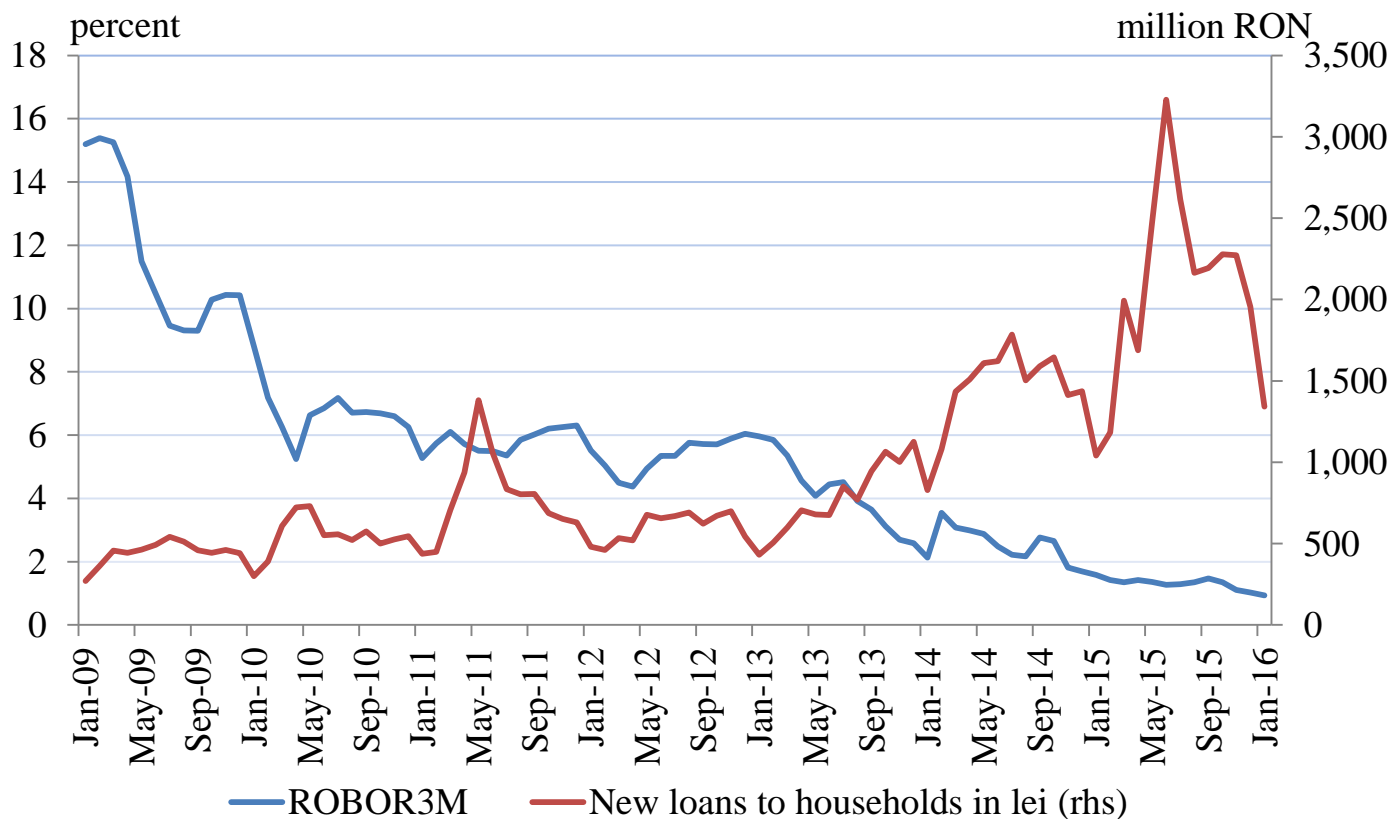
## Money market interest rates



Source: NBR

# Stronger credit growth in local currency due to lower interest rates

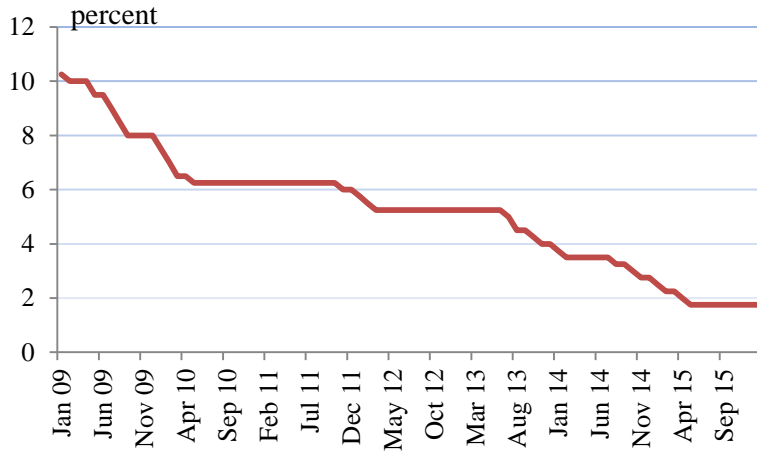
Money market interest rates and new loans granted to households in local currency



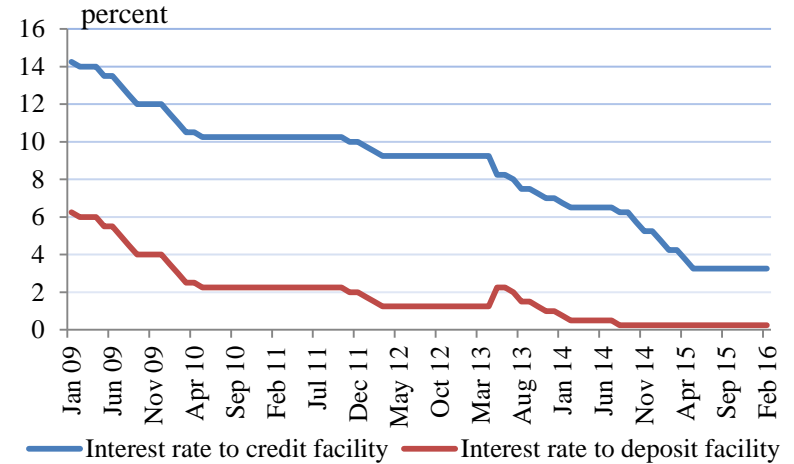
Source: NBR

# A variety of monetary policy instruments

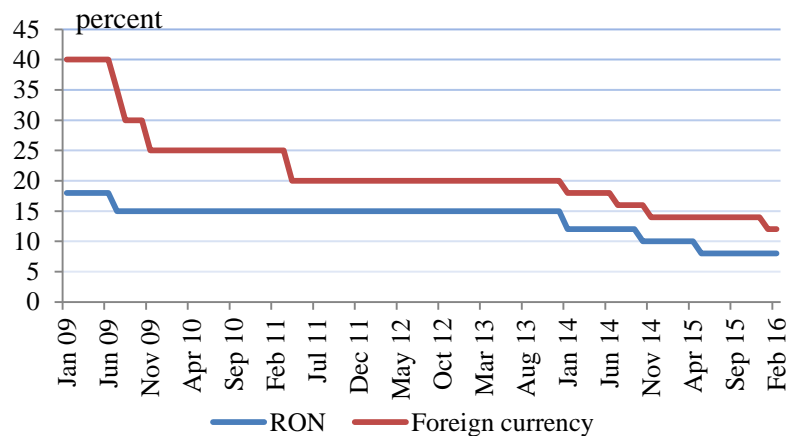
## Monetary policy interest rates



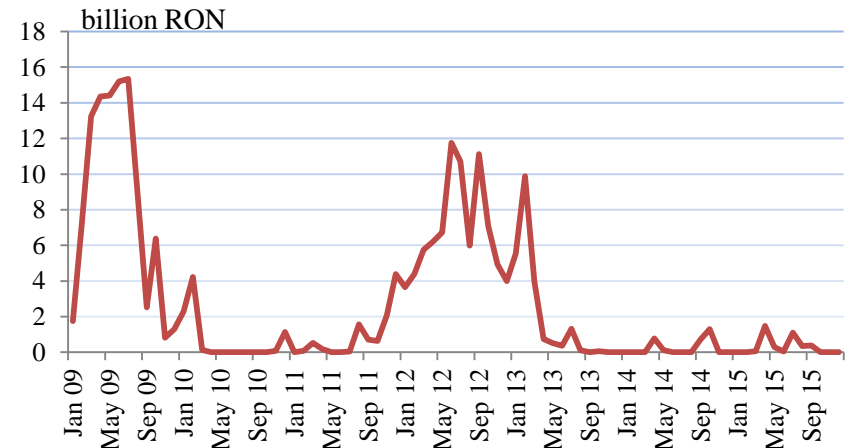
## Interest rates corridor



## Minimum reserve requirements



## Open market operations (repo)





# Challenges ahead

## External challenges

- Brexit, refugees crisis and sluggish economic growth in the euro area increase uncertainty in the EU
- Divergent monetary policy in the United States and the euro area pose risks to emerging markets
- Low commodity prices: asymmetric consequences for companies, households and commodity producers

## Domestic challenges

- Risk of policy reversal by pro-cyclical fiscal measures
- Legislative unpredictability



Thank you