ANALYSIS OF THE ROMANIAN FINANCIAL STABILITY IN THE CONTEXT OF THE ECONOMIC DOWNTURN

ALINA CRISTINA NUȚĂ
LECTURER PHD, "DANUBIUS" UNIVERSITY OF GALAȚI, ROMANIA, ALINANUTA@UNIV-DANUBIUS.RO
FLORIAN MARCEL NUȚĂ
LECTURER PHD, "DANUBIUS" UNIVERSITY OF GALAȚI, ROMANIA, FLORIANN@UNIV-DANUBIUS.RO

Abstract

The main objective of our article is to analyze the financial stability of Romanian country, to highlight whether the envisaged period of our analysis (2009-2012) is or not a period of financial stability. The analysis reveals both, elements with good evolution, and vulnerabilities of the system, caused by poor macro-prudential orientation of policies on financial stability, the interdependencies and risk spreading techniques, characteristics to globalization. In addition, we have given the importance of both defining the concept of financial stability and ways to measure and characterize the financial system

Keywords: *financial stability, Romania, macro-prudential measures*

JEL Classification: *G15, G21, G28*

1. Introduction

Nowadays, the term "financial stability" becomes more a desirable situation than a reality. These issues can be seen both nationally and regionally and locally in the current context of globalization and the intensification influences of any kind of activities from one country to other nations. Targeting this objective is the responsibility of the national authorities, central banks and financial institutions, regional/international and government.

In this paper we intend to define financial stability and to identify the fundamental indicators to measure the stability or instability of the financial system. Aftewards we want to characterize the period 2009-2012 in this regard, thus pointing out the main elements underlying the situation characteristics.

2. Defining and measuring the financial stability

Some authors [1] argue that to have a definition of good financial stability, it should follow certain rules, such as: to target the collective welfare, to be directly controlled by public authority defined as organizational structures at state, regional, federal, etc.

If we discuss this concept in terms of economic contexts outlined in the economic doctrines, we might say that the financial stability never existed in the world of Adam Smith, since the system as a whole was regulated and the surgery of the financial instability had not place in a world where supply creates its own demand. The financial instability is a result of the dynamic character of the economic system, the development and remodeling of adaptability conditions of the system elements to the new socio-economic state of affairs making the periods of economic crisis in 1930 and to this day. In addition, an important aspect of targeting and achieving financial sustainability is generated by the states' capacity to manage debt levels to be sustainable [15].

The "financial stability" expression is defined differently; generated by the complexity of the concept itself. Thus, some researchers point out the definition of the capacity of a financial system to ensure an efficient allocation of savings to investment [16] or the ability to facilitate and support the efficient functioning of the economy (European Central Bank 2005), or define the financial stability by referring in fact to the opposite term, the financial instability [1].

There are two standard literature views that explain the link between bank competition and market power: the "competition-fragility (CF) view" and the "competition-stability (CS) view". CF view recognizes that greater competition in the banking system discourage profit and erodes market power [3], [13], 11]. According to CS view, greater competition between banks will result in a higher credit risk that will exaggerate the moral hazard and adverse selection problems [5], [3], [4].

To measure financial stability, it is used either a set of indicators or a composite indicator that captures interaction between sectors of the financial system and the transmission and propagation of shocks from one sector to another. Those sectors [7] are considered: real sector, corporate sector's, household sector's, external sector, financial sector, financial markets. Other authors stress that it takes even a "new economics" for financial sustainability [2].

On the other hand, are known, generally, two types of measures [1] to support financial stability, namely: preventive measures (legal framework, institutions responsible for regulatory protocols market, official information on assessments and economic forecasts , infrastructure, etc..) and remedial measures to restore financial stability (solvency and liquidity support for financial and non-financial Institutions).

3. Romanian financial stability in recent days

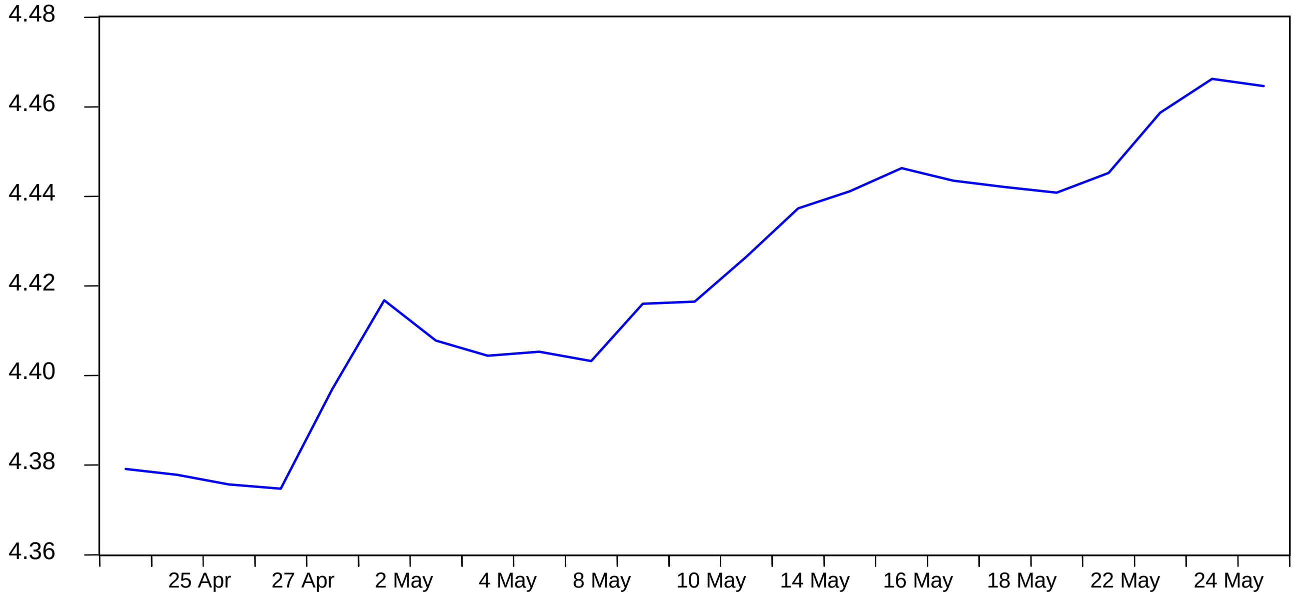
Regarding the Romanian financial stability, the last report of the Central Bank [19] highlights the continuing decline of the credit portfolio quality. In this regard, the non-performing loan ratio has evolved continuously negative from 2009 to present (from 7.9% in 2009 to 11.9% in 2010 and 13.4% in 2011). To cover the credit risk, credit institutions have raised in terms of capitalization and provisioning measures imposed following the central bank, as the ultimate supervisor of the financial context.

In addition, the implementation of International Financial Reporting Standards (IFRS) beginning with 2012, guarantees, in a certain extent, an easiest way to ensure financial stability, including the possible negative repercussions of the international financial negative events (such as public debts of states of the EU, increased vulnerability of certain sectors of the national bank).

According to the central bank of Romania, the vulnerability of the Romanian banking sector declined, and banks have now the ability to cope with external financing shock, as a result of solvency levels (14.2%) and appropriate liquidity (the existence of a significant portfolios of assets eligible for refinancing operations). In 2010-2011, including Romania's external vulnerabilities has been slower (in terms of current account deficit, short-term external debt). One of the unsolved problems of our economy is the limited absorption of structural and cohesion funds element, that, though often discussed and analyzed, cannot be considered to be solved (even now trying to improve the indicator level by the decision of removing the managers of non-performing financing programs).

As for the budget deficit, although it had a decreasing trend in recent years (before the crises and after that), it is likely that the final administrative changes (change of government and the Prime Minister) will cause a worsening of the level of this indicator. In addition, with this government, change EUR/USD exchange rate started to record new historical negative values (from 4.3747 on April 27, 2012 Ungureanu government-day fall to 4.4646 on May 27, 2012), as can be seen in the figure below, the analysis provided by the central bank, following the wave of uncertainty sent the market.

Figure no. 1. The evolution of the EUR/RON in Romania (24.04.2012-25.05.2012)

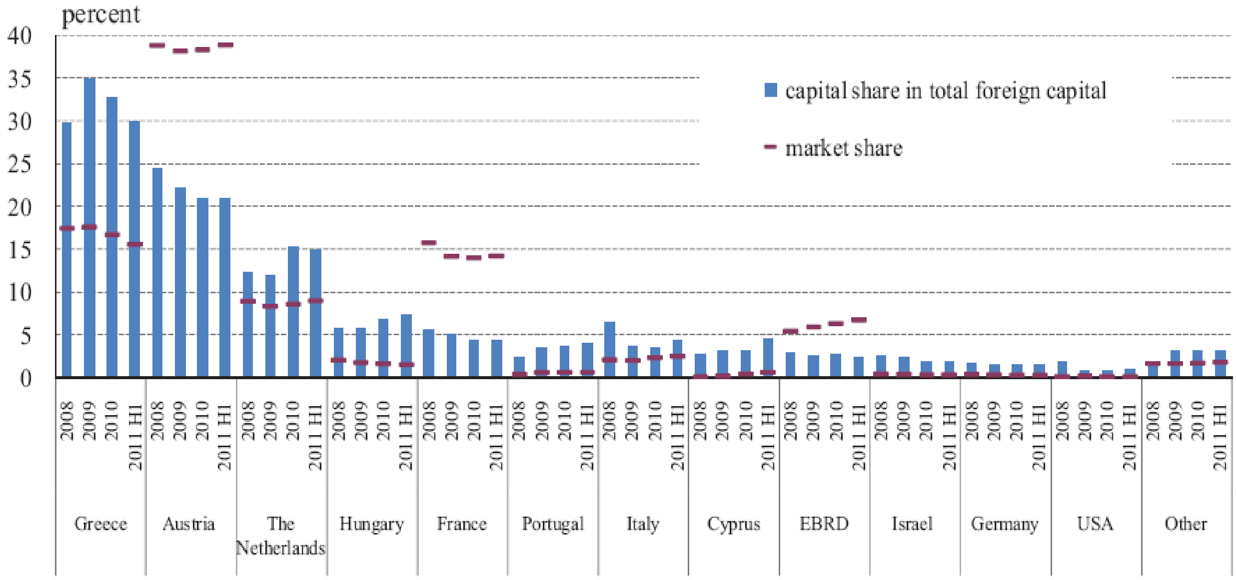


Source: NBR

These developments have significant implications for credit risk in foreign currency, which, in the absence of this new trend was quite vulnerable, the dynamics of non-performing loans in foreign currency to companies being more pronounced than in the RON segment.

Another important aspect of the international negative context influences (arising from the sensitive issues in Greece) is the place that occupy the capital of Greek origin in total foreign capital in Romania, which increases the vulnerability of the financial system in Romania and emphasizes the negative effects caused the crisis in Greece as a result of increased awareness of interconnectivity of financial institutions.

Figure no. 2: The capital share in total foreign capital of the credit institutions in Romania and the market share by country of origin



Source: NBR, Financial Stability Report, 2011

An important element for the insurance of the financial stability in the European framework is generated by the new architecture of the financial system, which debuted in 2011, when was created the new European System of Financial Supervision (ESFS), focused on two pillars, one macro-prudential (European Systemic Risk Board-ESRB), which has the major responsibility to prevent and reduce systemic risk by coordinating actions with International Monetary Fund and the Financial Stability Board, and the second level, micro-prudential (European Supervisory Authorities-ESA), which will help achieve a more effective supervision of EU financial system.

National Bank of Romania has explicit responsibilities, but not exclusive (there are other regulatory and supervisory authorities with sector oriented skills), in terms of financial stability, the responsibility of assessment and monitoring of the systemic risk (with respect to markets, institutions, infrastructure, and their interconnections with the real economy).

The economic and financial crisis, which had the fallowing ingredients [17], among others: the rapid expansion of credit to U.S. households, increasing exposure of the U.S. banking system, expansion of the financial innovation, revived the concerns of national and international institutions about financial stability, through the implementation of the macro-prudential standards to the international level, thus giving a greater importance of this aspect, due to the negative effects it had relaxed supervisory framework during the previous period of the global financial crisis. Thus, G-20, FSB (Financial Stability Board), BCBS (Basel Committee on Banking Supervision), and other international organizations institutions have provided measures [19] regarding the improvement of the volume and quality of capital, introducing a level of maim indebtedness (leverage ratio) and measures aimed at increasing liquidity reserves and reduce unstable funding structures. All these measures are considered in the context of the regulatory reform of financial system proposed by the BCBS.

IMF's latest report on financial stability shows that the authorities of the Emerging Markets respond to the effects of turbulence to the extent that they have enough power to reduce the possible harmful effects on the economies.

Table no. 1: Capital Flow, Banking, and Policy Indicators in some countries

	Vulnerability of External Sector (% of WEO projection of 2012 reserves)					Banking System Cross-Border Financing Vulnerability		Vulnerability of Real Economy to Euro Area	Fiscal Policy Room		Monetary Policy Room		Position in the Credit Cycle
						Liabilities to BIS reporting banks							
Country	Current account	External Refinan	Short-term Liabilities	Debt Portfolio	Equity Portfo	% of total credi	%t of 2012	Exports to euro area (% of 2010 GDP)	Gross public	Adjustment of primary balance	2012 inflation target	WEO projection of 2012	Growth of private credit

	deficit in 2012	cing needs in 2012	to BIS repor t ing bank s	liabili ties	lio liabili ties	t	GD P		debt (% of GDP)	(% of GDP) in 2011–20 to achieve debt target in 2030	(%)	CPI inflation (%)	since Dec. 2008 (% of 2012 GDP)
Europe													
Croatia	–2.7	144	119	57	6	78	96	10.2	52	. . .	. . .	2.5	6.9
Hungary	–6.1	154	60	108	36	52	67	41.9	76	5.3	3.0/4.0	5.0	–0.8
Kazakhsta n	–24.1	37	13	43	7	16	8	10.2	15	–6.1	6.0–8.011	6.4	6.6
Poland	27.5	135	40	110	29	28	28	19.0	56	4.4	2.5/3.5	3.2	12.5
Romania	**16.4**	**100**	**64**	**12**	**4**	**61**	**44**	**16.5**	**35**	**1.8**	**3.0/4.0**	**3.6**	**4.4**
Russia	–17.3	31	13	9	47	16	8	9.0	11	–2.4	5.0–6.012	6.2	13.2
Turkey	82.0	164	96	70	75	23	18	5.0	37	–1.8	5.0/7.0	8.6	23.4
Ukraine	37.8	181	28	61	10	14	13	5.4	38	–0.1	. . .	9.6	2.4

Source: IMF, GFSR, 2012

In this respect, the possibilities of reaction to the impacts of production of the negative financial events becomes real through measures such as changes in foreign reserves, reductions in interest rates, as it did in Romania. The main problem of the countries of Eastern Europe is that most have high current account deficits, which cause them to be unsustainable.

4. Concluzii

Our work has tried to achieve a radiography and analysis of Romanian lately financial stability. After highlighting the main definitions and approaches to this concept in the literature we reviewed how this concept can be measured and found that some authors use to measure the financial stability by a set of indicators and other authors propose a composite indicator, which captures all aspects that are involved in activities to ensure financial stability. Another level of our analysis was devoted to analyzing the financial stability of Romania, based on official reports provided by the Romanian National Bank and International Monetary Fund. This last aspect of analysis revealed problem-elements, that put economy at risk, at a possible spread of external financial shocks, vulnerable elements to be addressed through macro-prudential approach, leaving the micro-prudential approach, which "forget" some general aspects and normality-elements, which does not cause concern at any level and that promote financial stability of the analyzed country.

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