THE IMPACT OF EUROPEAN INTEGRATION ON THE ROMANIAN BANKING SYSTEM

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This paper describes the evolution registered by the Romanian banking system over the last years in the context of accession to the European Union. The analysis presents the progress registered by our banking system, the main characteristics of Romanian banking activity after 2007 as well as a brief analysis of profitability indicators.

Keywords: European accession, banking system, profitability indicators

JEL Classification: G21

Introduction

The banking reform in Romania began in December of 1990 when the authorities have proposed the development of new banking legislation designed to obtain a modern banking system. In this way the old system was replaced with a system organized on two levels: the Romanian National Bank and commercial banks. Over the past years Romania's banking system experienced a dynamic economic development and economic growth.
One of the key elements in the process of nominal and real convergence imposed by the new economic environment was the National Bank of Romania. The accession to the European Union strengthened the performance of the reform, and NBR's activity became more and more efficient. Romania's adhesion to the European Union in January 2007 was a long awaited and prepared moment. It was neither the start nor the end of the long journey of European integration that the country had taken. Once Romania became a member of the European Union the National Bank of Romania became a member of The European System of Central Banks (ESCB).
Since 2007 the main preoccupations of NRB were: participation of our central bank in the ECB Euro system, improving banking supervision, implementation of Basel II principles, development and application of the convergence program, a monetary policy which aims at price stability.
National Bank of Romania, as a supervisor, acted in response to new threats caused by the financial crisis in the following way: by providing liquidity, by close monitoring of banks, implementing new measures to improve prudential regulatory framework and in collaboration with the Government signed some funding agreements with the International Monetary Fund and the European Union.

Consequences upon the banking segment due to the European accession.

Studies of the banking system performed within the field disclose positive results due to the accession. The financial and banking integration results are estimated from the following aspects:
The union with a distinctive market of financial services and banking products, which offers business potential under the most encouraging terms, putting forward optimizing promises of the economic performances from the macro stabilization standpoint, of the higher efficiency levels and increasing people's wellbeing.
Macro economic stabilization under the circumstances in which banks operating in two countries may import assets in countries where there are financing opportunities, thus protecting thus national economy against possible bank distress.
Banking consolidation reflects structural modifications which might produce additional competitiveness within the monetary setting, increasing client's wellbeing, operational

effectiveness and profit in terms of reducing the expenses per product unit or bank service. Bank unions may improve the effectiveness of the entire activity of the banking segment.

The main characteristics of Romanian banking activity after 2007

The first year after the accession to the European Union was an excellent year for the banking market. The main result of the European accession was the increasing competition in the domestic market. Other favorable outcomes were the dynamic banking activity and the increasing attractiveness and diversification of banking products. There could be easily observed a competition between different banks in offering more sophisticated and complex services. There is a constant effort directed towards customer attraction and portfolio enlargement. Following this path banks began to offer "express" credits, by trying to tell in less than half an hour if the client is eligible for a credit.

There was an unmatched expansion of the banking network and specialized units dedicated to corporate and retail were opened. New agencies became operational for being nearer to the potential clients. The revitalization of banking products was successful due to the bank's capability to offer promotional products which were easily accessible, and rapidly available. These are just a few signs that banks increase the market consistence.

The entry of the foreign banks on the Romanian national banking market improved the competition between banks, leading to high quality of services offered to clients by reducing costs, as well as requiring domestic banks to compete in their products range by creating new products and services. Levine Ross believes that foreign banks may improve the quality and availability of financial services in the domestic financial banking competition and may encourage the implementation of modern technologies. Foreign banks can serve to stimulate the development of the underlying banking supervisory and legal framework. They also can enhance a country's access to foreign capital.

In 2007 the Romanian market became a target for the European credit institutions. Romania's addition to an integrative group as EU had a favorable impact on the banking system. Many foreign financial groups consider that the national market is favorable for the opening of new units. Several foreign banks opened bank branches in Romania. This operation was encouraged by restrictive monetary policy imposed by NBR. As the foreign banks must comply with the requirements of the country of origin they have significant cost advantages.

The presence of foreign banks raised the competition level and offered many new banking products and direct provision of services in Romania leading to changes in the structure of domestic banking system. The most spectacular market entry belonged to Millennium Bank, member of the Portuguese Millennium group. Also 2007 brought major changes for banks in the first echelon, at the middle of the year the largest merger on local banking market was completed. HVB Ţiriac Commercial Bank merged with Unicredit Romania, whose newly established entity presently operates under the name of Unicredit Ţiriac Bank S.A. It should be noted that in the same year BCR came under the control of Erste Bank. In the same period Belgium's Fortis received the operating authorization from NBR, The Iberian group La Caixa has opened a unit in the Romanian Capital. In addition, Finicredito Branch of the Portuguese group appears on the list of new branches. Beginning March 2008 the Romanian Branch of Blom Bank Egypt transferred its operations to the Romanian Branch of Blom Bank France S.A Paris.

In year 2008 has triggered the greatest financial crisis of the past 80 years. Originally called "credit crisis" by the specialists, this financial crisis is almost unprecedented. Although initially it was said that the Romanian banking system and economy will not be affected by this crisis, the negative impact has been felt since fall of 2008. Now, most opinions are leaning towards the conclusion that Romania is affected, but not directly and not as much as other countries that have a higher exposure to sub prime mortgage loans. At the start of the crisis, the Romanian economy had been driven through a period of several years of growth in high rates. The banking sector which has a dominant position in ours financial system had a good resistance to pressure manifested by the financial crisis. However, the global economic crisis had many negative effects

like: negative consequences on quality credit portfolio, worsening perceptions of risk, changes of interest rate of monetary policy, and interest rates charged on loans and deposits. Also a sharp contraction of non-government credit took place. Interest rates were changed and non performing loans increased. Tendency to extend the activity in new territory became lower and the number of employees became smaller.
In terms of banking structure the Romanian banking sector hasn't recorded significant changes in 2008 and the first quarter of 2009 (Table 1). DEPFA Bank Plc. Dublin opened a new branch in Bucharest and there were changes in the shareholding structure of ABN AMRO Bank, now called RBS Bank Romania S.A., after its takeover by the Royal Bank of Scotland. CitiBank România S.A. has changed its status becoming a branch of CitiBank Europe in Romania.
In 2009 in Romania there were 43 credit institutions, 32 Romanian legal entities and 11 branches of EU banking groups. In the context of the service market relaxation generated by Romania's accession to EU, BNR received notifications from 174 institutions from abroad willing to provide financial services directly in Romania.

Table 1: Romanian banking sector structure

	2005	2006	2007	2008	T12009
No. Credit institutions	40	39	42	43	43
No. banks with majority foreign capital **Branches of foreign banks**	30 6	33 7	36 10	37 10	37 11
No. banks with majority private capital	38	37	40	41	41
Market share of top five banks	58,8	60,3	56,3	54,4	54,3
Herfindahl-Hirschmann index	1124	1171	1046	926	906

Source: Source: BNR-RSF 2008

The efficiency of the banking system is reflected in the degree of system's concentration. The degree of concentration is measured using the Herfindahl-Hirschmann index or market shares in terms of assets held for the five largest banks in the system. The banking systems with a higher degree of concentration are usually less exposed to a banking crisis. The Romanian banking sector was characterized by a high concentration degree even from the first years of the banking reform. Since 2006, the Herfindahl-Hirschmann entered on a slightly downward curve, giving the image of a moderate degree of concentration. In 2008 and first quarter of 2009 the concentration degree in Romania continued its decreasing trend and in March 2009 market share of top five banks in total assets recorded a decrease to 54.3 %. Market share of loans fell to 53.7 %. On the liability side, the degree of concentration for the top five banks in the system held a total of 53.91 % in deposits. In terms of share held by the five largest banks in aggregate assets Romania is close to the average of other EU Member States.

Impact of EU accession on bank intermediation in Romania

Banks are designed to mediate the relationship between those who registered a surplus and those who recorded a shortage of resources, transforming economies and monitoring credit lending processes. Along with Romania's EU entry an increase of financial intermediation was recorded, although growth of financial intermediation accelerated in 2007 it is still one of the smallest in the European Union. Financial intermediation quantified using credit indicator Non-government credit / GDP in 2008 reached a value of almost 40% of GDP. Romania recorded the lowest level of financial intermediation among the new EU state members states at greater distance from the EU-15 (123,1%) or UE-25(118,9%). Financial intermediation quantified using the bank assets/GDP reached a value of 62% in 2008. Romania still exhibits a lower degree of financial intermediation compared to other countries in EU, indicating significant potential for future growth.

In terms of lending activity of the Romanian banking system over the past several years we can see some features**.** Even if in 2007 loan products abounded on Romanian banking market, the end of 2008 was marked by relative suppression of activity of private sector lending, retail and corporate alike. Retail credit has been affected by restrictive conditions imposed by the central bank new lending rules and by the economic-financial international context. Restricting lending to businesses was due primarily to the increase of difficulty to access bank funding. End of 2008 banking market had stiff competition in attracting deposits. Reached very high interest rates and led to increased credit costs. The first half of 2009 brought low-performing banking loans along with high financing costs, which generated economic pressure that recorded a sharp decline in the lending appetite.

The loans granted to the population registered a fast decrease in 2008 (only 30.5%, compared with 71 % in the previous year) and in the first quarter of 2009 (19% compared to end-March 2008). The same trend was noted in the case of credit non-financial corporations.

The non-governmental credit's structure registered after Romania accession to the European Union created some changes in terms of the currency in which the credit was granted. Analysis of credits given to population depending on the currency by 2006 showed a predominance of loans in lei. Since 2007 foreign currency loans dominated in a total of 53.05% share of total lending to the population. This tendency of loan currency is also seen in 2008. Foreign currency loans had a faster evolution than in local currency in most countries of Central and Eastern Europe. More attractive terms of financing and currency appreciation which tend to feature in transition countries may be possible explanations of growth in the foreign exchange component of non-governmental credit. Therefore, the predominant inclination in the structure of credits granted to population was the ones in foreign currency. In the area of the retail segment, the consumption credits represented 77, 1%, while the credits for dwellings held an inferior percentage of 19, 9% at the level of 2007, the last ones being mainly contracted in foreign currencies.

Within the retail component in 2008, the credit's structure according to their destination underwent major changes against the year of 2007. The consumption credits remained dominant, holding 74,3% from the total, with a slight preference for the national currency superior to the foreign currency one, while this component is much more represented in the dwelling credits holding up to the end of 2008 a percentage of 92,1% from the total of dwelling credits.

Specialists pay attention to analysis of bank performance, especially to concentration and profitability, because banking performance is best represented by profitability indicators.

Tabel 2: Evolution of indicators of profitability in the Romanian banking system in 2004 - 2009

Indicators	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Solvency Ratio	20,6	21,6	18,1	13,78	12,34	14
ROA	2,4	1,9	1,5	1,3	1,4	0.2
ROE	18,5	15,2	11,7	11,4	15,9	2.7

Source: BNR-RSF 2008 and FMI, Global Financial Stability Report

A healthy bank system is built on profitable banks, this is the reason why understanding the profit sources and analysis of profitability indicators is really important. Since 2004 profitability indicators of our banking system had a descending trend. In 2007, the profitability of Romanian

banks followed the downward trend due to: the increase in the cost of investments and due to the narrowing of interest margins.
Solvency Ratio in the banking system in Romania registered a decrease in recent years. Solvency ratio or capital adequacy has been a constant preoccupation of bank management and prudential regulations because of its significance on the soundness and security of bank deposits. Solvency ratio remains at a higher level than the minimum threshold required by the prudential regulations applicable in Romania since 2007 and also on European and international level.
Return on assets – ROA is an indicator that best reflects the bank's management capability to use resources available in order to optimize bank's profit. This indicator finds a downward trend during the analyzed period for the Romanian banking system. In 2009 the ratio between net profit and total assets on annualized average dropped to 0.2% from 1.4% in December 2008.
Similarly, *Return on equity ROE* the indicator which constitutes the most significant expression of profit and highlights the results of bank management in its entirety, reached 2.7% at the end of December 2009 from 15.9% in December 2008.
Despite the decline recorded in the recent years for both indicators of profitability return rate on assets (ROA) and return rate on equity (ROE) evolution does not indicate deterioration of the banking sector profitability. The result of intensifying competition and the decrease of inflation lead to the decrease of the interest rates and implicitly of the income of the banks. In recent years banks accepted lower profit margins to consolidate market position.
Compared with EU countries Romanian banking system has a lower financial return than the European average, situation resulting from the reduction in recent years of spread between the assets and liabilities.

Conclusions

European Union can be seen as a well developed and solid economic structure. Romania's accession to the UE had a positive effect on the banking climate and also put pressure to achieve compatibility. The Romanian banking system suffered a major move on with the integration into EU, in terms of structure. The new banking entities appeared due to purchases and mergers, share of foreign capital participation has increased substantially and the presence of foreign banks raised the competition level. Despite this the international crisis had negative effects on the Romanian banking system and Romania's desire to adopt the euro revealed weaknesses in the system. To exit the crisis and to recreate a competitive, robust and efficient system a few changes must be made where weaknesses should be removed. Banks must prove that they are a trusted brand, their product portfolio must be constantly renewed and operate effectively in terms of costs. These are some requirements that banks must meet in order to remain competitive in the EU market. Due to the lack of external financing strongly felt because of the financial crisis, the banks should pay more attention to the selling activity.

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