

**UNIVERSITY “LUCIAN BLAGA”SIBIU  
FACULTY OF ECONOMIC SCIENCES**

**Summary of doctoral thesis  
SHORT-TERM BANK CREDIT MARKET IN ROMANIA  
UNDER THE CONDITIONS OF COUNTRY’S  
INTEGRATION WITHIN THE EUROPEAN UNION  
- PRESENT AND PERSPECTIVES –**

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**Sibiu,  
2014**

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## Summary

*The financial truth can be cynical, ruthless, but the other trend appears also, to talk imperative about the social needs and not to talk about the financial aspect.*

*Mugur Isărescu, Governor of National Bank of Romania*

**Key words:** short-term credit, credit activity, banking supervision, credit market, risk, Basel, European integration, disintermediation, banking union, globalization

Historically, banks have a very distant past, without being able to precisely determine their occurrence, but it is clear that before them had appeared: the currency, credit, payments, that are forming in fact, the main subject of banking activity.

Professor Ștefan I. Dumitrescu, in his "Treatise of money", states that "The first bank, in the true sense of the word, it is said to be the institution, founded in 1171, by the Doge Michele XI, under the name of *Banco de Venetia*, having the main purpose on making public funds management operations for the City. "

As time passed, they developed in such a way that they became the financial strengths and with strong influences in the economic and political life of the contemporary world.

But speaking of the pre-crisis period, the fragility of banking system was often overlooked because the high degree of stability of monetary policy and the exchange rate, associated with the rapid development of this system on international level, have as facility an extended period of increasing the investments. Many years of uninterrupted growth, have led banks to underestimate the risks of the new economic environment. Banks in many countries have invested in shares acquired from various financial institutions that were not closely supervised, thus assuming unacceptable risks by banks. In the same way, home credits have risen sharply, fueling an unprecedented boom. Debtors continued to borrow - even on high interest rates – for buying assets whose value was rapidly increasing, and banks continued to lend because the warranty was rising. All these have determined the debtors and banks to become impassive to the risks incurred. The adopted solution became the prudent diversification of bank assets, an essential condition for a robust banking system, quite well realized within the EU

space by a strong system of prudential supervision that has an importance increasingly higher. Banks operating in a diverse environment, more or less risky, require high capital or liquid assets (and here I want to emphasize the importance of short-term bank credit), much more than banks operating in a stable environment.

### ***The actuality and degree of research of the investigated topic***

Disintermediation is a word spoken more often lately within the banking field in Romania. He appeared in our vocabulary immediately after the crisis, when foreign banks started to withdraw their loans granted to local subsidiaries, loans used by them to grant credits in Romania.

Romanian banks have been able to give so many credits before the crisis precisely because of these loans taken from the parent banks in Austria, France, Italy and Greece, while the volume of local deposits, the , traditional resource of credits for banks, was insufficient and much more expensive than the one in currency, in euro or Swiss francs.

Banks took advantage of the lower interest rates on euro or Swiss francs, to provide more credits in foreign currency, underestimating the foreign exchange risk . So after the crisis of 2008, when the euro and franc were greatly appreciated in relation with the RON, many people and companies were unable to pay the rates on credits.

Along with the drastic reduction of bank credits, those loans from parent banks no longer had no reason to increase. They started to decline, once they have reached maturity, as any loan must be repaid on time. Now, foreign parent banks, also affected by the crisis, need these funds to solve matters at home.

With reference to Romania, there was a danger that parent banks to withdraw massive funds from the country, to use them for strengthening the group's position in Italy, Greece and Austria, which would have drastically reduced the resources of Romanian banks for granting new credits in the country. For this purpose was signed the Vienna Initiative, for a controlled reduction of the exposures of foreign banks in Romania and in other countries in the region. So over the past five years, from the funding of 20 billion euro granted by the parent banks to local subsidiaries before the crisis, around 8 billion have already been refunded. This reduction in funding from foreign banks affect the ability of Romanian banks to provide credit, as they were

left with fewer resources, and even it is the leading cause on maintaining the credit activity on lower volumes than before the crisis. The negative impact of this phenomenon, however, was mitigated in a wide extent by the growth of deposits attracted from the population and Romanian companies, who continuously advanced over the past five years and thus have started to take place the foreign deposits attracted in form of loans from the parent banks.

In this way some of the largest Romanian banks have come to be self-financing, that is to exclusively grant credit from the deposits attracted from the Romanian customers, without needing loans from parent banks and without needing to resort to other solutions to attract resources, as local bonds issues, an alternative which other banks have started to use lately.

Excessive bureaucracy has always existed within the banking system in Romania, but has been less visible during the economic boom when banks were giving less importance to the department of risk. Today, contracting a loan, especially when it comes to legal entities becomes an impossible mission. The need for short-term lending, as revealed by the study made by us, represents an "urgent" need for companies given the Romania's economic recovery, as well as the need to fulfill the convergence criteria to adopt the euro.

All this happens due to the fact that the euro benefits are diverse and are felt at different levels, starting with individuals and businesses and reaching the national economy. Some of these benefits include:

- a wider supply and stable prices for consumers and citizens;
- greater security and more opportunities for businesses and markets;
- stability and economical growth;
- more integrated financial markets;
- stronger EU presence within the global economy;
- the presence of a tangible sign of European identity.

### *The research purpose*

The problem that we pursue in researching this field of short-term crediting, in a very broad sense, is that of knowing all the factors implied in this process and to address the

shortcomings so that the overall activity of short-term credit to result in meeting the needs of companies and population. To achieve this goal, we have considered the following objectives:

- the identification of economic content, necessity and characteristics of crediting in general and of short-term credit in particular;
- the general status assessment of bank credit activity in Romania;
- introducing the single currency – the impact on short-term credit activity;
- the identification of specific banking risks on credit activity and their mitigation measures;
- the access to short-term funding;
- potential measures for boosting the short-term bank crediting.

### *The research methodology*

The research was conducted under a research plan, which included the research purposes, its specific objectives and the activities set to be met for achieving the objectives described above.

To perform the activities, we have used specific methods of analysis (the observation, the reasoning, the comparison) and synthesis (the classification and grouping).

The research results are presented and analyzed using tables and graphs.

The information needed for the research were taken from specialty papers (books, studies and papers, courses, articles) in the economic field, the banking field and of the analysis one, from the country and abroad, up to date. Attached to them we turned to resources offered by the internet: digital libraries, databases with studies and specialty papers within the studied domains.

The factual information, statistics on credit, were taken from the reports of National Bank of Romania, the reports of commercial banks in Romania, as well as from the European Central Bank reports.

### *The structure of paper*

The paper where we present the research results has been divided into five chapters, each representing the result of an activity from the appropriate research plan. The content of ideas, the drawbacks and proposals for improvement were presented in detail within each chapter of the thesis, structured by subdivisions whose titles provide a complete picture of the results of our research, for the edification of the objectives suggested by the title of the respective chapter. In this regard, below we will detail the economic structure and content of the four chapters emphasizing our personal contribution resulted in conclusions, opinions and personal contributions inserted for each chapter in part.

The first chapter deals with "*Theoretical and practical foundations on short-term bank crediting*".

In this chapter we have identified the main issues concerning the short-term bank credit and we have started from the definition given by some economists who consider that „the credit represents an economic category that express relationships of distribution of a portion of the gross national product or the national income, through which the existing availabilities are mobilized and redistributed within the economy, it creates new means of payment within the economy, it ensures control on these sides, in order to meet some objective needs of capital and achieving certain objectives of economic policy”.

The economic practice shows that gross national product is not equivalent to the national income, which is why the credit may not be a distribution relationship of any of them. The national income is a component of the gross national product, along with amortization.

Based on the general characteristics regarding the credit we identify that the credit policy is part of the financial policy which aims to influence the national economic development by using certain ways or means such as: handling the official discount tax, the policy of mandatory reserves, credit capping, the open-market.<sup>1</sup>

The complete definition of the credit can be achieved by taking into account the correlation of multiple points of view, which can lead to the following formulation: "The credit is an economic category that expresses the relationship of distribution of a portion of GDP or the national income, by which it mobilizes and distributes availabilities within the economy and

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<sup>1</sup> Elena Drăgoescu, „ *Public Finance*”, "Dimitrie Cantemir" University Publishing House, Târgu-Mureş, 2006, p.25

creates new means of payment, in order to meet the needs of capital and achieving some objectives of economic policy." Resulting from this, *in our opinion* the credit represents the exchange of a current monetary value against a future monetary value.

The classification of credits in terms of the period extent in which it is used, leads to the three forms of credit:

- a) *The short-term credit*, in which case the period shall not exceed, usually one year;
- b) *Medium-term credit*, when the period does not exceed 5-7 years;
- c) *The long-term credit*, when the credit period exceeds 5-7 years and up to 50 years.

Generally, short term credits identified in our study are the following:

1. *Credits for purchasing, manufacturing and sales*. They are granted on the basis of a *credit necessary* that is issued by companies to finance the operating cycle. It is given to the companies that have a high turnover through the bank and firm contracts signed with suppliers and customers. They are primarily guaranteed by the creditworthiness of economic agents and then by the stocks of raw materials, materials, products in progress and financed finished goods;
2. *Credits for seasonal needs*, that are granted to agricultural farms or units with interrupted activity, usually, by no more than 6 months. They are guaranteed with the achieved production or through the divestiture of contracts with the beneficiaries in behalf of the bank;
3. *The credit lines (revolving credits)*, are credits granted to old and very good customer of the bank. They consist in the bank coverage of all current expenses (by honoring checks and payment orders), while the debt to be covered by receipts mandatory conducted in proportion of at least 60% through bank. The guarantees are represented by contracts divested to the bank and the creditworthiness of customer. Due to the careful selection of customers, the risks taken by the bank, in the case of these credits, are very low.
4. *Credits in foreign currency* - are granted to companies with import-export activity, that are having financial performance above average, an increased turnover through the bank and firm contracts concluded with foreign suppliers. They are destined for the acquisition of raw materials, machinery and transport equipment from abroad.

As it can be seen, the short-term credits are generally working credits that are a lot used in Romania due to the following factors:

- the profitability of many economic agents is not improving;
- the power of financial market is still small;
- the price of goods is not high;
- the business volume does not increase rapidly;
- the banking competition that makes the price of credit to diminish by reducing the interest margins;
- the economic agents do not maintain their indebtedness to reasonable levels;
- the real price of capital is very high.<sup>2</sup>

By identifying these key factors in the decision of short-term crediting we arrived in the risks banking sector that requires a constant review as required by the credit market. Following the integration within the EU also the banking system in Romania has aligned to the regulations required by the ECB, the central bank becoming part of the ESCB.

From this point of the research we can address the topic of the second chapter of the thesis entitled *“The risks induced by the short-term credit activity and the impact of BASEL I, II, III and IV agreements in reducing them”*. On the economic level, in general, the risk is defined as the possibility that future revenues to be different from those expected to be obtained. In other words, the risk represents the variability of income influenced by the environment, implying the possibility of occurrence an adverse event. In our country, banks have constantly experienced an agitated economic environment. The transitional phase followed by the integration into the European Union and the impact of economic crisis, over the time has meant for banks not only the modification of statutes, legal framework of operation, freedom of choosing the partners, but also operating in a competitive market, reducing the direct refinancing by the central bank, tightening the prudential rules by central bank, financial deterioration of key major customers, so that appropriate risk management becomes a necessity.

In the conducted study, we have identified current issues facing the banking system in Romania, so that we have considered it necessary to identify the problems for each category of banking risks.

**The credit risk.** *Credit risk can be defined as the risk as an interest, the credit or both may not be repaid at maturity or be partially repaid.* This risk is specific to banks whose important

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<sup>2</sup> Dumitru Tudorache , Toader Pîrjol, *Currency, banks, credit*, The Academic Publishing, Bucharest, 2005, p.380

function in the economy is the credit activity. In order for the bank activity to be profitable, it is required assuming the credit risk, but regardless of the level where is assumed, it is important the manner in which it can be limited to a maximum. The financial crisis has demonstrated some limitations in terms of effective management of risk. In this regard supervisory authorities have developed a series of methods and techniques to detect, monitor and predict the risk.

**The market risk.** Market risk is the risk that a bank to have losses due to adverse changes within the market prices. The exposure to such a risk may arise as a result of deliberately taking by the bank of some speculative positions (traded on its own name), or may result from the activities of market maker (dealer) of the bank.

**The interest rate risk.** All banking institutions face the interest rate risk. When the interest rate fluctuates bank earnings and expenditures are changing as does the economic value<sup>3</sup> of assets, liabilities and off-balance sheet positions. The net effect of these changes is reflected in the overall revenue and the capital of bank. In order to manage interest rate risk, the bank appeals to a range of policies, techniques and actions that it may use to reduce its net equity, as a result of the adverse changes in interest rates.

The interest rate risk originates in the mismatches from the revaluation of assets and liabilities and from the changes within the yield curve.

**The currency risk.** Currency risk results from the variations in exchange rates of the domestic currency of a bank against other currencies. This is caused by an inconsistency and can bring losses to a bank as a result of some unfavorable variations of the exchange rate, during the period in which an open balance-sheet position and an off-balance sheet position, either on sight or on term, for a certain currency. We can also affirm that currency risk also appears from the inconsistency which occurs between the value of assets and the capital and debts expressed in foreign currency (or vice versa), or due to a mismatch between the short-term foreign assets and liabilities, that are expressed in domestic currency. Such inconsistencies may exist between the owed capital and interest. Currency risk is "speculative" by nature and therefore, it can give rise to a gain or loss, depending on the purpose in which the exchange rate evolves.

**The liquidity risk.** Liquidity risk consists in the probability that the bank will not be able to honor its payments to customers as a result of the deviation of proportion between the long term

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<sup>3</sup> The economic value is the fair value of an asset or liability based on business analysis or other appropriate technique (eg discounted cash flow analysis).

credits and short term credits and for the lack of correlation of these assets with the bank liabilities, respectively the resources. Among the causes that lead to banking liquidity risk are as follows: the state of the real economy, the influence of the media, the financial indiscipline of customers, the dependence on financial market, the mismatch between deposits and credits maturity.

**The solvency risk.** Solvency risk is when you don't have sufficient own funds to absorb the potential losses. To defend against this type of risk, the bank has to resort to capital adequacy for the incurred risks, the equity being the last guarantor of solvency against the overall risk. The equity of a banking institute consists from *the equity capital and additional capital*. The equity capital includes: the paid-up capital, capital premium, reserves, undistributed profit and other funds, and the additional capital is composed of the subordinated debt, investment subsidies and other reserves than the equity capital. It is required a strong base for the permanent share capital and presented reserves, complemented by other forms of regulatory capital (eg undisclosed reserves, revaluation reserves, general provisions for losses on credits, hybrid instruments and subordinated debts).

**The operational risk.** According to central bank regulations in force, the operational risk is the risk of losses or not reaching the estimated profits, determined either by the use of some processes, systems and inadequate human resources, or by external events and actions. The operational risk includes the legal risk. According to the same rules, the legal risk is the risk of losses or not reaching the estimated profits because of fines, penalties and sanctions for which the credit institution is liable in case of misapplication of legal or contractual provisions and also following the fact that contractual rights and obligations of the credit institution and/or its counterparty are not properly set.

In this paper we have emphasized the development of standards imposed by Basel, but what is new relating to risks hedging it is brought by Basel III that raises the level of capital that a bank must hold. The application deadline of the new Basel III standards is 2019, but the recent development of the banking market suggests the necessity of even more stringent standards, that are currently under discussion by the Basel Committee and will be implemented through a new Basel IV agreement. It is proposed that the next Basel IV to include:

- Increasing the level of capital adequacy indicators;

- The introduction of simple models or standardized, rather than banks' internal models to calculate capital requirements;
- A more detailed presentation of reserves.

Therefore in the third chapter, entitled "*The efficiency analysis of short-term bank credit and the effects of Basel Agreements upon it within the context of the country's integration in European Union*", we took into account the identification of repercussions for implementing these agreements on short-term credit activity as well as the analysis of structural, quantitative and qualitative dynamics.

The period after Romania's integration in the European Union, was characterized in terms of lending activity, mainly by:

- The restriction of banking activity, due to the reduction of exposures (both in the real sector, especially on the foreign currency component, as well as the governmental one);
- The reduction in an accelerated pace of external financing, due to the reduction of intercompany financing, partly outweighed by internal market deposits;
- The growth of local base of foreign currency deposits;
- The capital reserves supplementation of through the contribution of credit institutions' private ownership.

With regard to the credit activity in RON currency, the contraction recorded since September 2012 in real terms was marginal (annual variations between -1.8 and -0.3 per cent), emphasizing since June 2013 (-2.9 percent in August 2013), mainly for maintaining on the high values the paces of decrease related to population's credits (-5.2 percent in August 2013) and the loss of rhythm observed for companies (from +6.4 percent in August 2012 to -1.2 percent in August 2013).

As it can be observed in the study, from the perspective of the evolution of short-term credit (in RON) for legal entities has registered during December 2011-August 2013 a mostly downward trend, which is surpassed by the medium term credit which had a favorable outcome (+29.8 percent in August 2013, the real annual variations), both for the credits given to companies and individuals also.

The short term credit dynamics (in RON) for individuals has registered during December 2011-August 2013 a constantly evolution, maintained at a rate of 12-14% of total credits.

On the private sector credit market, the developments were relatively homogeneous on main categories of debtors, both registering a trend change of annual growth rates, falling into negative territory due to:

- maintaining a high level of risk aversion of banks, reflected by the tightening of standards and the crediting terms;
- the high degree of indebtedness of certain categories of debtors and their efforts directed towards adjusting their own balance sheets;
- increasing the number of companies governed by the law of insolvency. The weights owned by the two institutional sectors in the relative structure of credit portfolio remained relatively unchanged, with a slight difference in favor of non-financial companies to the detriment of population.

As noted in the chart and presented in the paper, the trend of short term credits remained stable during the period December 2011-August 2013, being of 30% of total credits. Not the same thing can be said about the short term currency credit given to population, where the weight is indistinguishable, with a downward trend. The crediting decline on currency component was determined by all three maturities on both major categories of debtors, more severe on the short term category; on the maturity structure, the changes were more important for companies.

Given the study conducted and the overall crediting activity of banks in Romania, we have tried to introduce in the context the necessity of applying new regulations which we have detailed at the end of the last chapter. Thus the EU's impact was felt by applying the Liquidity Coverage Ratio-LCR and the Net Stable Funding Ratio - NSFR, both with effect from January 1, 2014 through the application of the EU Regulation No.648/2012 (Capital Requirements Regulation-CRR). According to the coverage requirement of the liquidity needs, the institutions must have a sufficient stock of liquid assets to enable them to face any imbalances between inflows and outflows of liquidity within 30 days in case of severe crisis. Currently, the main liquid assets held in the portfolio of credit institutions are Romanian government securities and availabilities at the central bank (here we mention especially the RMO). In this context, it seeks to ensure financial stability, including by strengthening the capacity of the financial system to withstand shocks and by reducing the accumulation of systemic risks, in this way ensuring a sustainable contribution of the financial sector to economic growth and implicit, the recovery of credit activity.

In the last chapter entitled "*Perspectives of short-term credit activity within the context of European integration with implications for economical and financial development of the country*" we have considered aspects regarding the companies and population finance implications in the overall state of Romania. The existence of an inconsistent and incomplete legal framework, as well as judicial and extrajudicial procedures for recovery of the claims, by forced execution which is costly and long-term negative, has a negative impact for funding. The significant share of inefficient firms reduces the level of safety within the crediting activity. Thus, the delays in restructuring the real sector make a large number of economic agents not to be eligible for credits.

For stimulating the credit activity of economic agents on the short term, we suggest the following general measures:

- accelerating the reorganization of the real sector of economy (the efficiency of companies with losses, implementing/enhancing corporate governance standards etc.), so as to increase the share of the healthy part of the economy, the only one that banks can safely lend.
- improving the flow of information between market participants (creating of information centers, increasing the promotion of the products offered by banks, creating a virtual database containing all available funding programs, etc.).
- developing an educational program on funding opportunities for economic agents in different sectors of the national economy, expert assistance in preparing loan documentation, especially on business plans and cash flow; including in the curriculum (secondary) of modules on basic banking products and services.
- in the case of producing companies, analyzing the possibility of giving credits that are based with the next production;
- high quality credit standards to ensure an appropriate relationships with clients on the entire period of the loan;
- the banks to use certain methodologies such so that the granting activity of short-term loans to be profitable: offering a variety of short-term credit products for different sectors of the economy, using local information for understanding and monitoring the clients, appropriate mechanisms of internal control;

- carrying out an extensive promotion of new lending products for economic agents and making available to the interested parties of certain instructions that are easy to understand and follow;
- creating certain tools to allow creditors the knowledge of the situation of credits that were given to applicants (credit rating agencies, databases centrally administered for the use of banks);
- standardization of analytical methods and content of credit contracts at the level of the banking system, so that the contracts to be easily transferred to other banks;
- the further improvement of macroeconomic framework in foreseeable conditions so that the credibility of business plans to grow both in terms of the donor and the recipient and the funding activity to run in safety conditions.

Toughening the credit conditions imposed by the central bank, once with the economic crisis in Romania, in early 2009 definitely affected the credit demand among the population. In the past year, however, Romania has followed European trends of relaxation of credit conditions, the local banks anticipating a softening of lending standards, regardless of the destination of the credit given to population.

For stimulating the short term credit activity for population, we propose the following general measures:

- continuing the trend of easing the credit standards;
- informing customers (potential) on the risks from accessing a short-term loan (An informed customer can better evaluate the impact of possible shocks and to maintain the possibility of reimbursement);
- improving the flow of information to the public on accessing short-term credits (creating some information centers, increasing the promotion of products offered by banks);
- offering a variety of short term banking products for individuals, divided into different categories according to the age, profession, etc.
- reducing, as far as possible, the interest rates for credits in RON and foreign currency;
- improving the quality of refinance credits by providing certain facilities;
- avoiding the application of commissions that are not covered, etc.

Regarding the persons that are in difficulty of payment, there should be also taken some measures to facilitate their approach to payment and for the banks, the recovery of debts.

According to the latest specifications of the government, people with incomes below the national average of 1,600 lei, who have difficulty in paying the rates to the bank, but did not exceed the maturity more than 90 days, will be able to receive a halving of the rate for a period of two years, reduction that can't exceed 500 RON, clarifications that arrived after the negotiations with the International Monetary Fund, European Commission and World Bank. In the last part of this chapter we made a synthesis of the recent and future bank regulations and activities concerning the short-term credit activity.

We conclude that we have achieved our proposed objectives in the research on short-term bank credit during the four chapters, but we are convinced that any scientific endeavor, as our doctoral thesis is perfectible. We appreciate, however, that it constitutes as a real and valuable basis for new beginnings, for further scientific researches.

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