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ACTIONS OF THE CENTRAL BANKS IN THE CONTEXT OF THE CRISIS AND POST CRISIS

Case studies

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Abstract

Since the international financial crisis, the external environment was an important source of risks and uncertainties, the banking and financial markets of most of the states were marked by successive waves of turbulence, central banks reverted the task of ensuring financial stability to the states and not only achieving the objective of price stability, a primary objective considered fundamental in the operating statutes of central banks. In this context, most of the monetary authorities responded to the challenges of the crisis by implementing restrictive monetary policies during the process of worsening of the financial crisis, and later to resort to relax monetary policy measures, but nevertheless adopting a cautious conduct of monetary policy. This study particularly examines the actions and measures implemented by the National Bank of Romania during the manifestation of the crisis and post crisis regarding the application of the monetary policy in order to ensure the financial stability.

Introduction

The period 2008-2010 was marked by a fast changing of the external and internal events under the impact of financial and economic crisis that swept the world economy. On an international position, for the first time in the last three decades there was recorded a contraction of global Gross Domestic Product (-0.6 percent), which was more pronounced in Europe and the USA, while in China and India was recorded a decrease of the economy's growth. At EU level, the decrease in real Gross Domestic Product was much larger (over 4 percent), despite the unprecedented stimulus measures implemented by government authorities and central banks. Following the implementation of these measures, the average budget deficit recorded in the European Union rose to almost 7 percent of Gross Domestic Product, the public debt to Gross Domestic Product increased by 12 percentage points and the interest rate monetary policy in the euro area fell to a minimum level of 1 percent per year.

2. Measures taken by the National Bank of Romania in the context of the process of worsening of the financial crisis

In Romania, the impact of financial crisis on the economy, although considerably important, mainly manifested indirectly. The business model of financial institutions in our country, based on the prevalence of traditional banking products, as well as the prudential and administrative measures taken proactively by the National Bank of Romania, was transposed in the absence of "toxic assets" in maintaining the financial stability. The transmission of the impact of the crisis was mainly achieved through five channels:

- foreign trade channel (due to a contraction of main export markets of the Romanian products);
- financial channel (due to a contraction of the external private credit lines from parent banks, with an impact on the development of non-government credit);
- confidence channel (by increasing risk aversion of foreign investors in emerging markets, which had repercussions on both productive investment and financial markets);
- exchange rate channel (due to depreciation pressures on the Romanian currency - leu);
- channel of the wealth and balance sheet effect (with a substantial reduction in the value of many property asset classes, especially the real estate, the dominant asset class used as collateral for bank and by increasing the share of non-performing loans in the assets of credit institutions).

In the context of worsening of the global financial crisis, the National Bank of Romania adopted a series of measures to maintain the stability of the banking system. They also focused on the prevention of massive capital outflows, with potential destabilizing effect, such conduct having higher probability of manifestation in crisis conditions. Thus, unlike some other countries with developed economies, in Romania was not required support from public funds for credit institutions, that responsibility reverted back to shareholders of the commercial banks.

Regarding the financial sector, the loan agreements negotiated with the IMF and the European Union in spring 2009, and those negotiated with the World Bank and other international financial institutions were concluded in order to strengthen the solvency of the Romanian banks, to ensure a safety margin in the face of possible new pressures arising from the global financial crisis.

For prudential reasons, the National Bank of Romania decided that the solvency of the banks to be at least 10 percent over the program period (2009-2010), compared to 8 percent as it was regulated. For the same reason, there were held, at the initiative of the IMF and the European Commission, two meetings of the main parent banks that have subsidiaries in Romania, and these banks have (re) confirmed their determination to maintain exposures in Romania, and ensuring a minimum credit rating of 10 percent. The solvency ratio increased with almost one percentage point in 2009, reaching 14.67 and stress tests conducted by the National Bank of Romania based on the methodology developed in collaboration with the IMF and World Bank have confirmed the robustness of the banking system in Romania.

In 2009, the National Bank of Romania has developed, in collaboration with the Ministry of Finance, a Strategic Action Plan in the banking sector, which was also one of the conditions of the stand-by agreement with the IMF. According to the mentioned plan, the starting point for financial and banking crisis management is the application of private market solutions, based on the situation of banking group taken as a whole. Only while the measures of support from the private sector would prove unfeasible or exhausted, they may resort to instruments of public intervention to resolve a crisis, aiming to promote the most effective solution in terms of cost. A particular importance in the implementation of this approach was the agreement signed in March 2009 in Vienna between the National Bank of Romania and parent banks of the nine largest foreign-owned credit institutions operating in Romania, supported by the IMF agreement was extended in 2010. In this gentlemen's agreement, which paved the way for similar agreements concluded by other countries in the region, nine banks have pledged not to reduce their exposure to Romania during the operation of the SBA and to increase a proactive capitalization in accordance with the requirements of the National Bank of Romania. In these circumstances, the indicators of capitalization, solvency and liquidity of banks remained at levels consistent with prudential requirements without the need for financial support from the state. In strong correlation with the technical conditions of the stand-by agreement, there was issued a legislation which provides power the National Bank of Romania:

- to require to significant shareholders of a credit institution in its difficulty to provide the necessary financial support;
- to prohibit or limit profit distributions to remedy the financial situation;
- to suspend the voting rights of shareholders who do not comply with the request for financial support (Government Emergency Ordinance no. 25/2009, approved by Romanian Law no. 270/2009).

To improve the adequacy of bank capital, the supervisory authority has ordered a series of other measures such as monthly reporting of the solvency ratio; raising and maintaining a certain level of solvency, higher minimum requirement regulated, depending on the risk profile of the bank; maintenance of own funds at a level to ensure solvency ratio of at least 10 percent. There were also changes that have occurred in the calculation of the necessary liquidity, like the Romanian Norm no. 7/2009 introducing more stringent determination criteria. In terms of provisioning rules applied by credit institutions in Romania, there was developed a study analyzing the characteristics compared to other EU Member States and the differences from IFRS treatment, the conclusions underpinning the recommendations of the new regulations (Romanian Regulation of the National Bank of Romania no. 3/2009; Romanian Order the National Bank of Romania no. 5/2009, etc.). In line with the European practice and in order to strengthen confidence in the domestic banking system, the deposit guarantee scheme was extended for legal persons from 20 000 Euros to 100,000 Euros and the maximum payout was reduced to 20 working days, for individuals.

3. The response of the National Bank of Romania to the emergence and manifestation of the financial crisis

In the Romanian banking system, the global financial crisis felt the effects later than in the United States of America and other developed countries, respectively from the last quarter of 2008. The reason is that the spread of the crisis was achieved through indirect channels, banks in Romania did not contain in their balance "toxic" assets, and problems in the banking system is determined largely by the crisis which occurred in the real economy (Albulescu, 2013). The National Bank of Romania tried to meet the challenges of the crisis mainly through action on monetary policy instruments. In this context, the National Bank of Romania resorted to the use in an active way some Monetary Policy Tools such as reserve minimum standard ratios that were significantly lower and the monetary policy interest rate cuts. During 2007, the National Bank of Romania continued to use in an active and flexible way the components of the operational framework of the monetary policy specific to inflation targeting strategy, while maintaining its net debtor position in relation to the banking system. In order to discourage volatile capital inflows and to counter the threat of an unsustainable appreciation of the Romanian currency - leu, in the first months of 2007, the National Bank of Romania continued to resort to the practice of temporary partial absorption of excess liquidity through open market operations (deposit-taking) (RA, 2007, p.36-37, www.bnr.ro). In the context of deepening turmoil in financial markets and magnifying the inflationary pressures, the central bank resorted in 2007 and early 2008 to increase the successive monetary policy rate, which increased from 8 to 10.25 percent (2008). Since February 2009 the central bank has initiated and maintained so far a downward trend of monetary policy interest level, as can be seen from the figure no.1.

In order to make flexible the manner of controlling liquidity management and currency depreciation against the euro, the National Bank of Romania resorted to reducing the minimum standard reserves, in Romanian currency- lei but also in foreign currency. Minimum standard reserve ratio for liabilities incurred in Romanian currency -lei was reduced from 20 percent (2008) to 10 percent (2014) in four steps (18 percent, 15 percent, 12 percent - intermediate values), while the minimum standard reserve ratio for liabilities incurred in foreign currency was reduced from 40 percent (2008) to 14 percent (2014) in seven stages (35 percent, 30 percent, 25 percent, 20 percent, 18 percent 16 percent - intermediate values) (see table no. 1).

The result of measures taken by the National Bank of Romania but also of the credit demand deficit in the period July 2013 - July 2014, the interest rates charged by banks on new loans granted in Romanian currency - lei to the main categories of borrowers saw a significant decrease (by 3.3 points percentage respectively from 11.4 percent to 8.2 percent for individual customers and by 2.2 percentage points, from 8.6 percent to 6.4 percent for non-financial companies) (RSF 2014, p.40, www.bnr.ro).

The measures taken and the monetary policy applied by the National Bank of Romania sought to create proper conditions for recovery of financial intermediation activity and thus sustainable recovery of the economic activity. Although, the evolution of the credits and bank assets has been improved, and by contrast showed a downward trend.

As can be seen in Figure no. 2 both growth and the degree of intermediation degree within the analyzed period were supported by foreign currency lending. Currently, the process of deleveraging is the main challenge for the banking system as sources attracted from parent banks have shown a downward trend (9.1 billion Euros in the period 2008 - June 2014), due to increase savings in the local market which led to the replacement of external and domestic sources, especially short-term mobilized from the population, which does not allow their placement by banks on longer.

After a 16.6 percent share of credit of Gross Domestic Product in 2004 to the end of 2010 it experienced a considerable upswing recording a share of 40.75 percent, in the context of relaxing the credit conditions, stabilizing the inflation, raising the supply and demand for credit. But the growth of Non-governmental credit (NGC) paved the credit boom of 2005-2007, culminating in the emergence of the global crisis that has dominated the local economy leading to a stagnation of NGC growth around 40% of GDP between 2009 AND 2011. Later this year can be seen even a worsening trend is the evolution of private sector credit, reaching 34.8 percent in 2013. The effects of deleveraging occurred at the level of parent banks, which achieved a consolidated balance balancing structure for compliance with the new capital requirements by reducing risk exposure and the local subsidiaries were faced with the process of credit restraining.

In the post crisis period the National Bank of Romania undertook substantial efforts to improve the quality of the loan portfolio and reducing nonperforming loans, establishing measures, such as removal of all exposures outside the balance sheet representing fully provisioned bad loans, the creation of adjustments from depreciation (provisions IFRS), the achievement of an external audit of adjustments from depreciation (IFRS provisioning) due to outstanding loans portfolio at 06/30/2014 and collateral evaluation (Georgescu, sept.2014).

Since 2008 the monetary policy pursued by the National Bank of Romania has become more restrictive due to the financial turmoil triggered by the global crisis, and the central bank resorted to the diversification of intervention methods. The National Bank of Romania retook into consideration the disinflation process resumed in 2008, aiming to replacing the inflation to a better path consistent with projected inflation targets and acting quickly to inflationary pressures by using monetary instruments so as to support disinflation.

The operational framework suffered a significant change in the last quarter of 2008, given that, in the context of a continuing decrease of the structural liquidity excess in the banking system the net liquidity of credit institutions became a negative trend. Accordingly, a first for the past ten years, the main role in managing liquidity and influencing interest rates was taken by monetary injection operations, and the National Bank of Romania returned from October to a creditor position of the banking system. The objective of reinitiating disinflation and repositioning the annual rate of inflation on a trajectory consistent with achieving the established targets in a short and medium term proved to be a challenge for monetary policy during the post-crisis period. Despite all its efforts, the National Bank of Romania failed to consolidate disinflation, the inflation rate continued to be volatile, especially in 2011-2013. An evolution, and future inflation projection is shown in the Figure no.3.

4. Conclusions

In conclusion, we can say that the measures taken by the National Bank of Romania in terms of prudential regulation and supervision aimed not only to overcome the difficulties caused by the international context, but also to fit into a broader vision, which aims to ensure long-term stability of the financial system. The actions taken by the National Bank of Romania in terms of financial stability were not likely to affect fundamental pursuit of price stability, but rather an important prerequisite to achieve it on a medium and long term period. As a result of measures taken by the central bank, we can say that Romania's banking system still has sufficient resources to manage shocks generated by a possible increase in credit risk, by a comfortable level of capital adequacy and high quality, the proof in this respect is the high value of the solvency ratio (15.5 percent) and the Tier 1 ratio (14.1 percent). With regard to the assessment of the solvency and liquidity of the banking sector, the National Bank of Romania continued to conduct periodic exercises of testing the resistance to potential shocks to the banking financial system.

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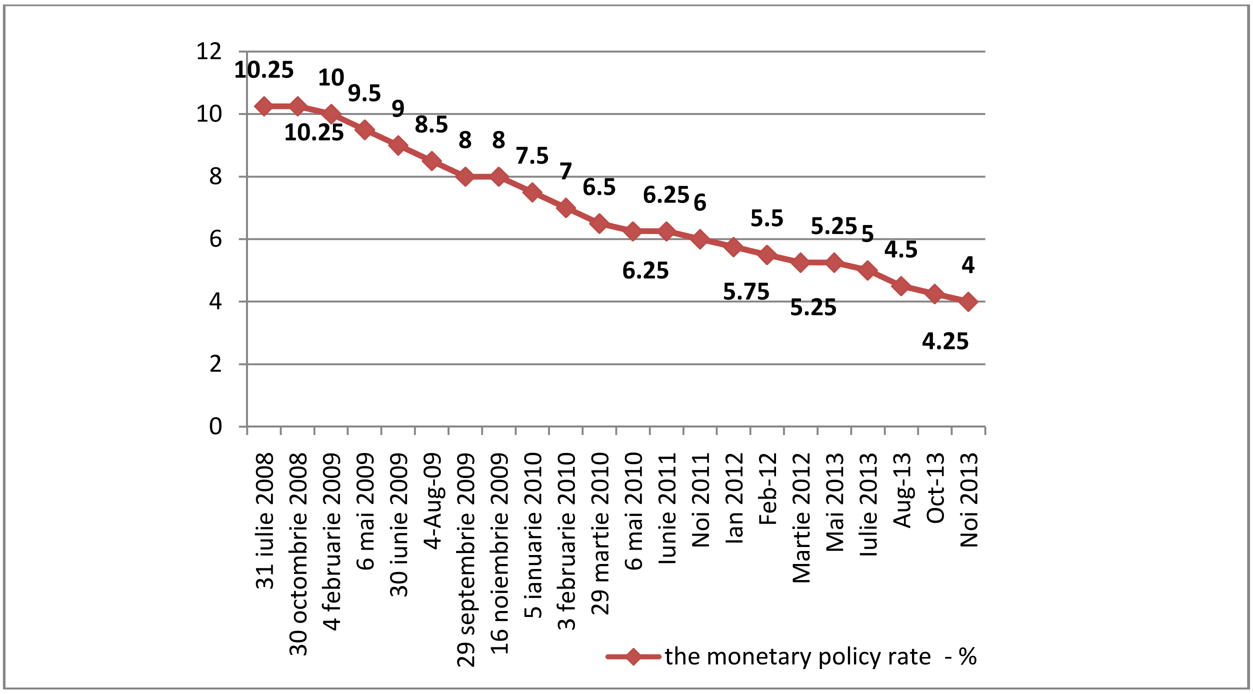

Figure No. 1. The evolution of the monetary policy rate in the post crisis
Source: prepared by the author based on data available information on www.bnr.ro,

Table no. 1. Monetary policy decisions on minimum stadard reserves adopted by the central bank during 2008-2014

Minimum stadard reserves		
	Minimum standard reserve ratio for liabilities incurred in Romanian currency -lei	**Minimum standard reserve ratio for liabilities incurred in foreign currency**
31 iul 2008	20.00	**40.00**
30 oct 2008	18.00	**40.00**
4 feb 2009	18.00	**40.00**
6 mai 2009	18.00	**35.00**
30 iun 2009	15.00	**30.00**
4 aug 2009	15.00	**30.00**
29 sept 2009	15.00	**25.00**
16 noi 2009	15.00	**25.00**
5 ian 2010	15.00	**25.00**
3 feb 2010	15.00	**25.00**
29 mar 2010	15.00	**25.00**
6 mai 2010	15.00	**25.00**
Iunie 2011	15.00	**20.00**
Ian 2014	12.00	**18.00**
Iul 2014	12.00	**16.00**
Noi 2014	**10.00**	**14.00**

Source: prepared by the author based on data from www.bnr.ro, http://www.bnr.ro/Statistica-87.aspx

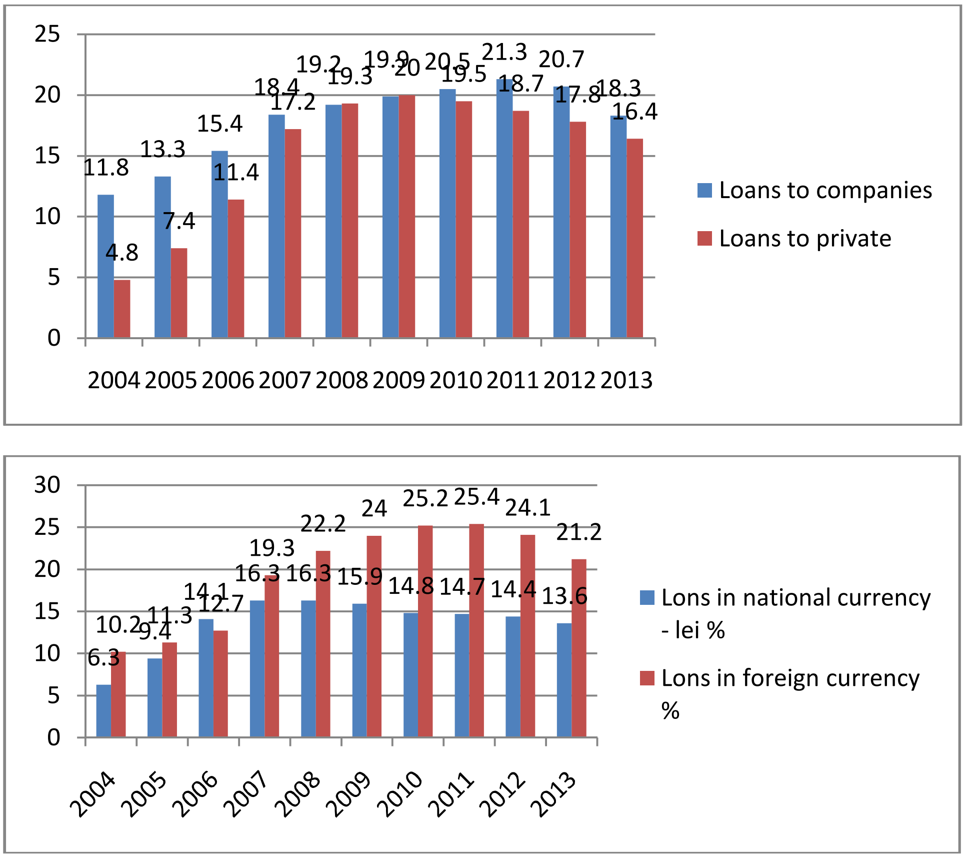

Figure No. 2. The evolution of private sector credit separated on beneficiaries and types of currency (% GDP)

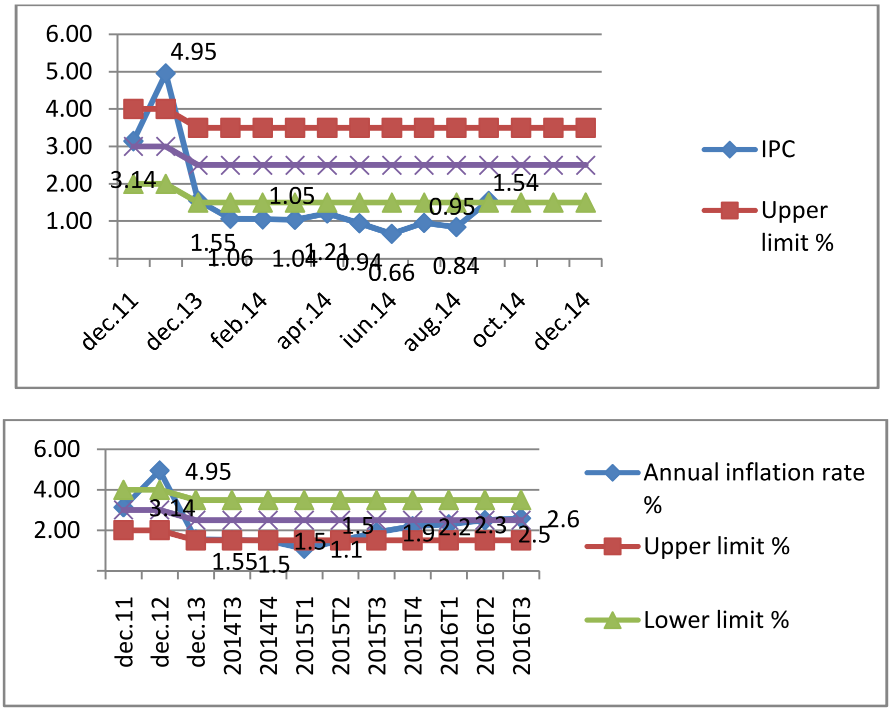

Figure No. 3. Evolution and forecast of inflation rate in 2011-2016
Source: prepared by the author based on data from www.bnr.ro, http://www.bnr.ro/Statistica-87.aspx