

# The impact of the financial crisis on the monetary market from Romania

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*Abstract:* The financial crisis causes suffering all over the world, forcing governments to nationalise major parts of the banking sectors, and the central banks to pump large quantities of liquidities on the financial markets ["Keynes, not Marx, is back", European Voice, 21 Oct. 2008]. The causes of the current financial crisis should determine many people to remember the fact that we need the authentic markets, with a smooth transparency and operation based on a proper regulatory system and monitoring, with a correct evaluation of production factors and services.

*Key-words:* - Financial crisis, transparency, regulated market

## 1 Introduction

The current financial crisis represents a failure of the less regulated markets or not at all, proving once more that the financial market cannot regulate itself.

The financial markets have become more and more opaque, and the dimensions of the shadow banking sector, lacking regulations or having very few regulations, have grown very much [La finance folle ne doit pas nous gouverner" Le Monde, 22 mai 2008]. The banks have been involved in a distribution game of some complex financial products, under doubtful conditions and credit sales that have been based on high-risk mortgages. The improper compensation schemes, the focus on a

short term and the flagrant conflicts of interests have encouraged the speculative transactions.

The suspicious mortgage loans, based erroneously on the idea that the prices of the real estate sector in a continuous rise shall cover the debts represent a symptom of a much bigger crisis in the field of financial governing and business policies.

This financial crisis proves that the financial industry is unable to regulate itself, thus the existence of monitoring and regulating frames for banks and non-banking financial sector being necessary. The financial stability of economy represents a public asset that must be insured in an institutionalised manner.

A financial system, which is based more on the capital markets or more on banks, has the role of moving the liquidity surplus from those who save to

those who need more resources for consumption or investments. The mediation must be transparent, and the level of the interests would settle some people's wish to borrow and the other's inclination to give up a part of their own resources for a period. The banks and the capital markets ensure this mediation through transacting bonds.

The Romanian banking system has reached a certain financial stability based on a large banking sector. From the point of view of the structure and the origin of the capital, the system is mainly private, dominated by the foreign capital, by some banks and its profitability is very good, being determined by the maintenance of a large general margin, specific to the unstructured type of economy.

The loan operations performed by the commercial banks have several principles as basis:

- banking prudence;
- loan applicants' credibility;
- the viable business of the debtors;
- the precise and compulsory destination of the loan;
- charging interests and commissions for the granted loans;
- timely reimbursement of the loan, etc.

In order to offer a much more suggestive image of the loan market from Romania, we should look at the evolution of the total internal loan, on its components, such as:

- a. non-governmental loan
- b. governmental loan
- c. the comparison between this and the gross domestic product (both indicators being expressed in comparable prices), for the period 2008 - June 2010, according to the data provided by NBR.

We notice from the table below that, in Romania, for the period 2008 - June 2010, the total internal loan volume had an ascending evolution each year, although, starting with the last trimester of 2008, the effects of the international financial crisis have become obvious in the Romanian economy as well.

Table 1

*Internal loan for the period 2008-2010*  
- in mil. RON -

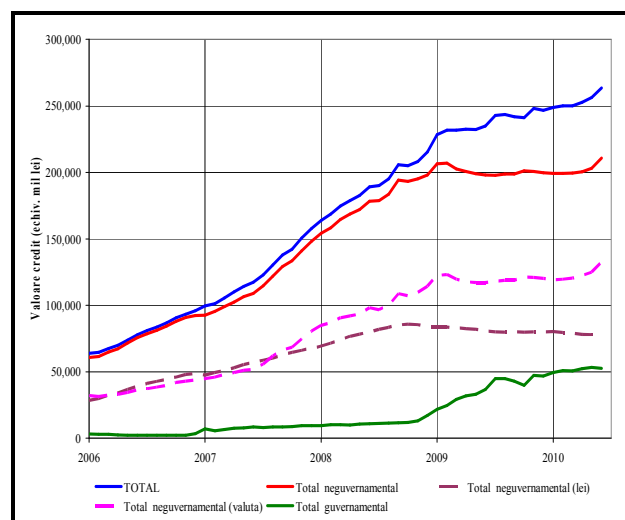
| Year  | TOTAL   | Non-governmental loan | Governmental loan | Internal loan/GDP ratio (%) |
|-------|---------|-----------------------|-------------------|-----------------------------|
| 2008  | 2276892 | 2138710.4             | 138181            | 22.13                       |
| 2009  | 2855436 | 2411090               | 444346            | 17.20                       |
| 2010* | 1521438 | 1212099.6             | 309338            | -                           |

\*until June

Source: adaptation after the Monthly Bulletins of NBR for the period 2008- July 2010

The explanation resides in the more and more emphasised growth of the governmental loan volume in 2009 compared to the non-governmental loan volume, according to the chart below.

Fig.1 *The variation of internal loan on components for the period 2006 - June 2010*



Source: adaptation after the Monthly Bulletins of NBR for the period 2008- July 2010

Moreover, the foreign currency transactions constitute an important part of the banking activity. These transaction present specific features, because the exchange rates based on which transactions are performed may change, without being controlled by the parties involved.

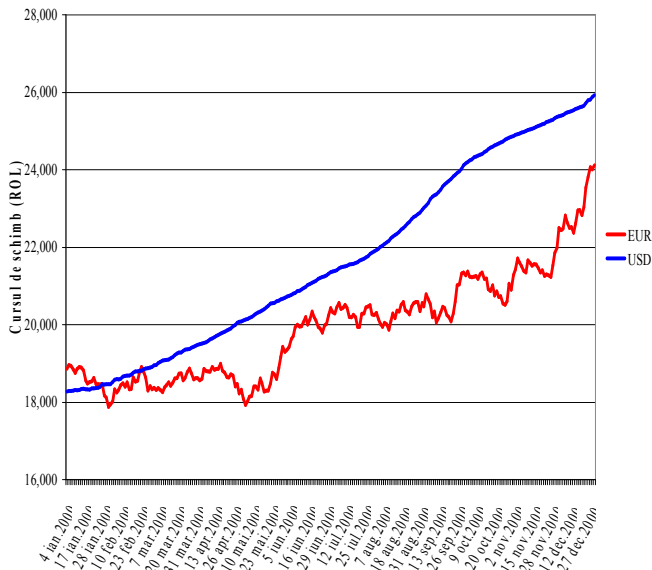
The foreign currency market represents the ensemble of relations taking place between the financial-banking institutions and their clients related to the purchase and the sale of foreign currency in order to regulate payments and cashing that occur from international economic transactions or speculative purposes.

## 2 Foreign currency market and the financial crisis

A reference moment in the operation of the foreign currency market from Romania was the year 1999 when the National Bank of Romania made a major "correction" of the exchange rate, correction determined by the fact that the International Monetary Fund introduced us on the "black list" of potential payment incapacity. At that time, the central bank resorted to the "the exchange rate

valve" in order to balance the commercial deficit - accepting to devaluate the Romanian currency (major depreciation in real terms), 1999 marking an ascending movement of the ROL/USD ratio, "year-to-year" average of 73.0% and 64.0% for ROL/EUR (the difference for the USD being given by the major strengthening of the USD on the world market).

Fig.2 The ROL/EUR and ROL/USD exchange rates in 2000

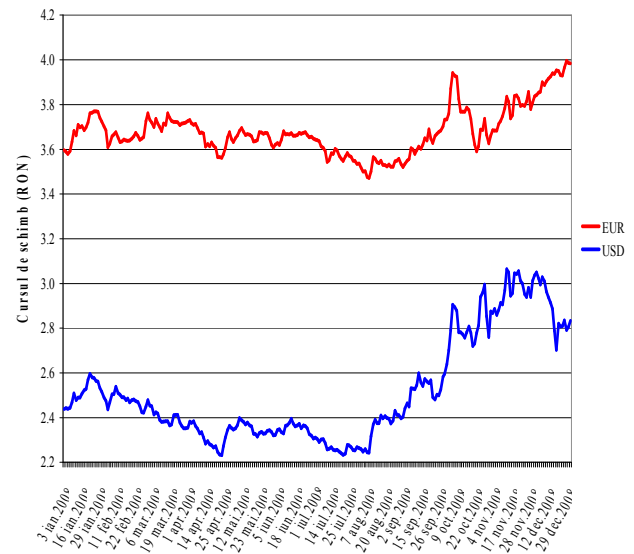


Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

Regarding the ROL/EUR exchange rate, the following trends occurred in the period 2000-2010:

- in 2000, the ROL/EUR average depreciation was smaller than the ROL/USD depreciation (with only 22.7%); the devaluation being smooth, continuous and relatively controlled;
- the ROL/EUR exchange rate in 2001 followed the trends from the international foreign currency market, where the average of the EUR exchange rate dropped until 0.89 USD;
- the strong recovery of EUR on the international markets (from April 2002) triggered the appreciation of ROL compared to EUR for about four months, and, during the next months until the end of the year and in 2003-2004, ROL depreciated, reaching the value of 40,532 for one EUR in 2004;
- between 2005-2007, ROL appreciated compared to EUR, then it depreciated again for a period;
- 2008 was characterised by a slight increase of EUR, which evolved in the interval 3.6 - 3.8 RON/EUR, while the dollar dropped under 2.4 RON/USD, according to the chart below.

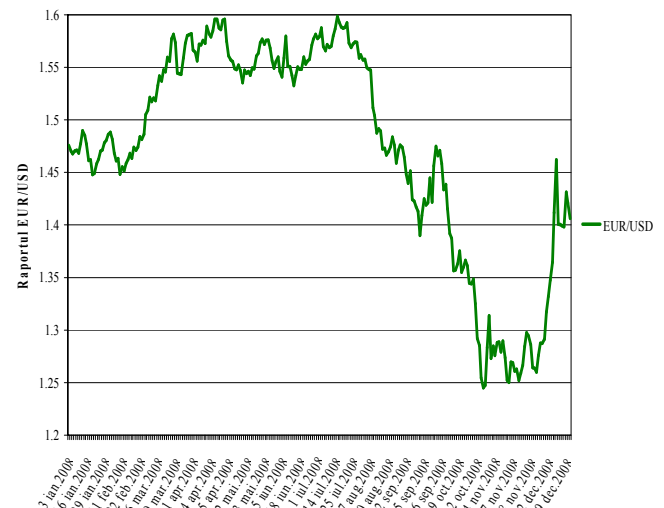
Fig.3 The ROL/EUR and ROL/USD exchange rates in 2008



Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

In Romania, the effects of the international financial crisis were felt at the end of 2008, firstly affecting the real estate sector and the housing construction sector.

Fig.4 The EUR/USD exchange rates in 2008



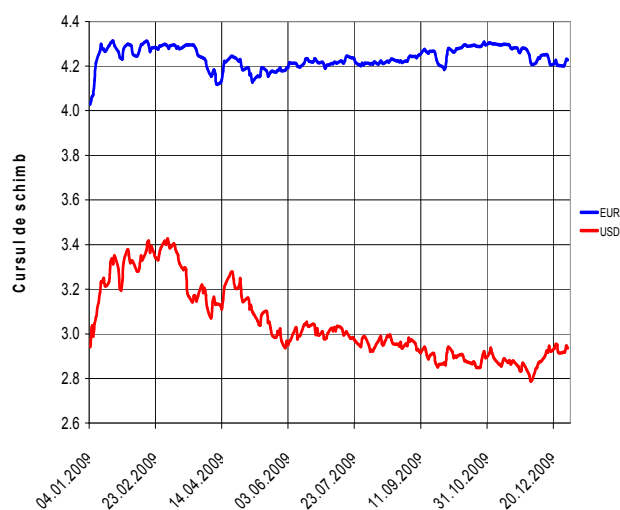
Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

The fall of the financial system seriously affected the car manufactures when the banks stopped financing the car loans. In 2008, the western banks used their resources mainly to save their own savings, and, if they had more important resources, for the purchase of other financial companies. This was the first step to save the financial system,

respectively the purchase of the "ill" banks by the "healthy" ones.

In the first half of 2009, the RON/EUR ration was relatively stable at values of 4.1 until 4.3 RON/EUR (according to the chart below) mainly to avoid the increase of inflation, because of the exchange rate collapse.

Fig.5 The RON/EUR and RON/USD exchange rates in 2009



Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

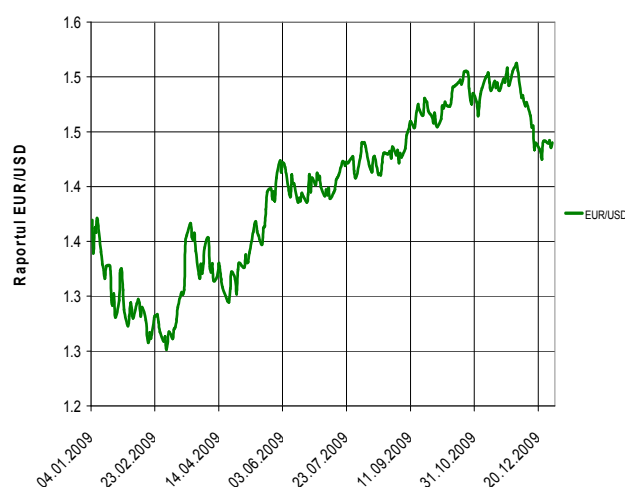
In the second trimester of 2009, RON went through a slight appreciation compared to EUR, while the trajectory reversal recorded by the exchange rate in April was succeeded by a relative stabilisation, reflecting, mainly, the blurred oscillations of the global appetite for risk. At the same time, the degree of correlation of the exchange rate evolution of RON with the main foreign currencies exchange rates in the region increased, and the daily variations reduced.

In April-June 2009, RON appreciated compared to EUR with 1.5 percent in nominal terms and with 2.1 percent in real terms (compared to a depreciation of 8.6 percent and, respectively, 6.2 percent in the 1<sup>st</sup> trimester); the appreciation of RON was larger in comparison with USD - 8.2 percent in nominal terms and 8.9 percent in real terms – when the value of the American currency dropped significantly compared to EUR. From the point of view of the annual average variation of the exchange rate recorded in the second trimester of 2009, RON slightly reduced its nominal depreciation compared to EUR (12.9%), as well as to USD (24.1%).

In July-September, RON depreciated compared to EUR with 0.5% in nominal terms, as well as real

terms; but compared to USD - when the value of the American currency dropped compared to EUR - RON appreciated with 3.1% in nominal terms and with 3.3% in real terms. From the point of view of the annual average variation of the exchange rate recorded in the third trimester, RON increased its nominal depreciation compared to EUR (15.3%), but reduced it compared to USD (19.3%). The RON/EUR exchange rate maintained relatively stable in July and August, its evolution reflecting the divergent impact of some of its main determiners.

Fig.6 The EUR/USD exchange rates in 2009

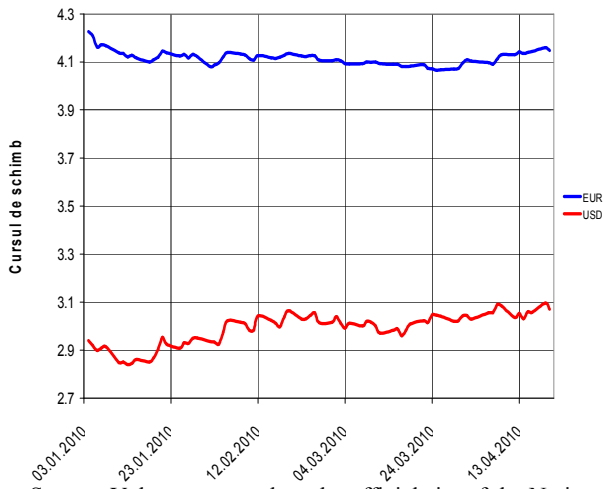


Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

The ascending trend of the RON/EUR ratio emphasised in the first part of the 4<sup>th</sup> trimester based on the deterioration of the investors' perception on the economic and financial evolutions from the region and of the tensions of the internal political environment. The RON/EUR ratio regained a descending trend, the movement reflecting a relative improvement of the global appetite for risk and, towards the end of the interval, the shaping of the perspective of internal political climate stability. This evolution was accompanied by the increase of the daily variations of the RON/EUR exchange rate.

The first part of 2010, from the point of view of the exchange rate, was relatively calm, reflecting the decrease of EUR compared to USD, the cause being the financial crisis of some countries from the European Union - the PIGS countries: Portugal, Ireland, Greece (mainly) and Spain - which have difficulties in financing their budget deficits, as well as in paying their accumulated debts, according to the chart below.

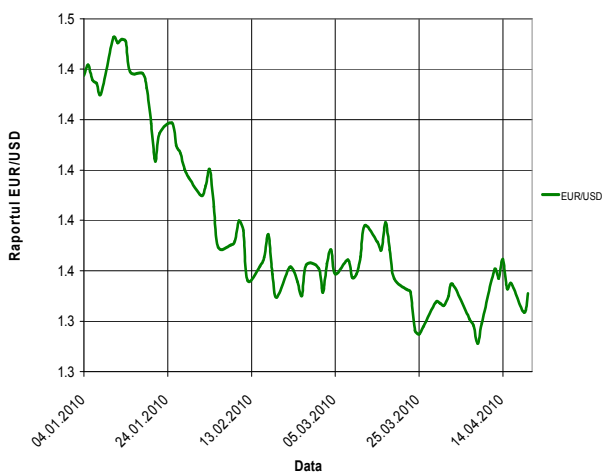
Fig.7 The RON/EUR and RON/USD exchange rates in the first part of 2010



Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

The RON/EUR exchange rate reversed in April 2010, its ascending movement during the 2<sup>nd</sup> trimester reflecting mainly the amplification of the fears generated by the crisis of the sovereign debt of Greece and by the potential extension to other states in the euro zone. The increase of the RON exchange rate accelerated in the last part of the interval, at the same time with the increase of the daily variations, as a consequence of the tensions in the political environment and on the internal financial market in the context of the deterioration of the perspectives for the budget execution and of supplementing the fiscal consolidation measures by the authorities (see the chart below).

Fig.8 The EUR/USD exchange rates in 2010



Source: Values presented on the official site of the National Bank of Romania: [www.bnro.ro](http://www.bnro.ro)

In the interval April - June 2010, RON depreciated compared to EUR with 3.6 percent in nominal terms and with 3.1 percent in real terms (compared to an appreciation of 3.3 percent in nominal terms and, respectively, 5.5 percent in real terms in the 1<sup>st</sup> trimester); compared to USD - when the value of the American currency increased significantly compared to EUR [On June 8, the EUR/USD ratio reached its lowest value from March 10, 2006] - RON depreciated with 12.7 percent in nominal terms and 12.4 percent in real terms (compared to a depreciation of 3.9 percent and, respectively, 1.8 percent in the 1<sup>st</sup> trimester).

The change occurred in April in the RON/EUR exchange rate was mainly the consequence of many worries of the financial investors related to the public finances from Greece [Reflected by the increase at a world record, from the perspective of the EMU history, of the cost of financing the state on the external financial markets]. The ascending movement of the RON/EUR ratio was increased by the worsening of the investors' perception on the short term perspective of the Romanian economy, given: the negative review of the predictions regarding the GDP evolution and of the budget deficit in 2010 [According to the statement from May 10 of the chief of IMF mission for Romania, in 2010, the share of the consolidated general budget deficit in the GDP could reach 9.1 percent in the absence of adjusting measures], but especially the emphasis of the uncertainties related to the ability of the government to implement the measures of budget expenses reduction announced on May 7, implicitly of ensuring the carrying out within the agreed parameters of the agreement concluded with EU and IMF and the international financial institutions.

## 4 Conclusions

RON should appreciate compared to EUR according to the logic of real conversion on a long term until the adoption of the common currency. However this argument is not infallible, because the loans granted in foreign currency have varied due dates, thus one cannot base one's judgement on a horizon of only 5 years. There is also something that alters the analysis of the banks as individual entities, meaning the fact that they ignore that the western Europe needed decades to bring the stock of loans in economy to the level of today (as a share from the GDP), and the growth speed from Central and Eastern Europe may destabilise the local systems.

Romania has a solid banking sector, if we see it according to the volume of non-performing loans in the banks' balance sheets, the level of the leverage (the ratio between the own capital and the finances attracted by banks), the level of the reserves (estimates and gold) of NBR. However, we have weak points as well that are obvious in other emergent economies from EU, such as the dual nature of the monetary system, the fact that a significant part of the loan granting is dominated by the foreign currency, any massive depreciation causing damages to the borrowers, as well as the banks. It is mainly about the external deficits, especially the one of the current account whose finance has been under 60% in the last two years through foreign direct investments. Secondly, although RON has a full convertibility, Romania does not benefit from the advantages of a reserve currency, meaning the central bank may not issue a local currency as ECB does as last instance borrower.

A loss of trust in RON would force NBR to take into account the coverage of all the monetary receivables of the population and the companies, which would mean the entire monetary fund from economy. Without issuing new currency, this would mean a reduction of liquidities in economy, an excessive rising of the loans, an inevitable entry of the local economy into profound recession, but issuing new currency without coverage would have disastrous effects. [2]

The first emergency is to cope with the effects of the economic crisis. The Romanian companies suffer because of the recession from the developed countries of EU and the public budget cannot do a lot through its own resources to fight the effects of the crisis, because we have large external deficits and the access to the international loans is limited. It would be ideal if the European Investment Bank granted Romania a warranty, a kind of enhancement loan, with which it could ease the attraction of external sources, and NBR would enter a swap-type of commitment with the European Central Bank, as Poland has done. These facilities would support the payment balance of the country and would discourage the speculative attacks against RON.

An anticrisis program with a budget adapted to the situation is necessary, to have sufficient flexibility. Thus, a partnership should function between the government, NBR and the commercial banks to avoid the brutal decrease of loans in economy.

The decision factors from EU at European and national levels must come up with a strong answer to this crisis, but they need pragmatism, cooperation

and lack of prejudices in order to reach these common objectives.

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