

# FEATURES OF THE ROMANIAN FINANCIAL SYSTEM REGARDING THE INTEREST RATE TRANSMISSION<sup>1</sup>

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## Abstract

The monetary impulse transmission channel represented by the interest rate channel transmitting effects of the changes in the interest rate structure on investment as well as on components of the aggregated demand is a classic theme of the present economic literature. Through the investigation of the characteristics of interest rate transmission mechanism, our paper becomes important because the present financial crisis has a mainly weakening impact on the efficiency of the transmission between the inter-banking market exchange rate and the non-banking exchange rate. Our main goal in this research is to emphasize the characteristics and structure of the Romanian banking system (level of concentration), the lending activity of the economy private sector and the saving/investing behaviour of the economic agents that have a direct influence among the reaction of the interest rate flow from the inter-bank monetary market towards the interest rates for the client's lending and deposits of the Romanian banking sector. The exact acknowledgement and the understanding of factors that influence the credit institutions behaviour and the market reaction to the Central Banks decisions have serious implications in the monetary policy efficiency.

**Keywords:** banking system, interest rate, exchange rate, monetary policy

**JEL Classification:** E32, E42, E52

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## **1. Introduction**

The monetary transmission mechanism policy is composed of the totality of economic channel through which the monetary policy influences the macroeconomic index of the real economy. The structure of the financial system determines the way the monetary policy shocks are absorbed by liquidities and financial market prices and further transmitted to macroeconomic conduct.

The main focus both for theoretic level and practical level in what concerns monetary policy has to be circumscribed to its efficiency and analysed as a whole.

Antohi, Udrea and Braun (2003) and Cecchetti (1999), Cocris and Nucu (2013) present in their papers the importance of the features in relation to the financial system.

The changes in the Romanian financial system, beginning in 2000, had a positive impact on the interest rate channel, increasing its effectiveness, according to an earlier study conducted by Antohi, Udrea and Braun on the assessment of the monetary transmission mechanism.

## **2. The monetary policy transmission mechanism characteristics**

The impulse of a decision made by monetary authorities at time  $t$  takes on the form of a response of certain financial variables at time  $t + m$ , in a certain direction and of a certain extent, of a specific length and persistence.

In the Monetary Union countries, asymmetries in the financial structure of their economy are first caused by regulatory discrepancies, and then by the features of the financial markets (Cecchetti, 1999).

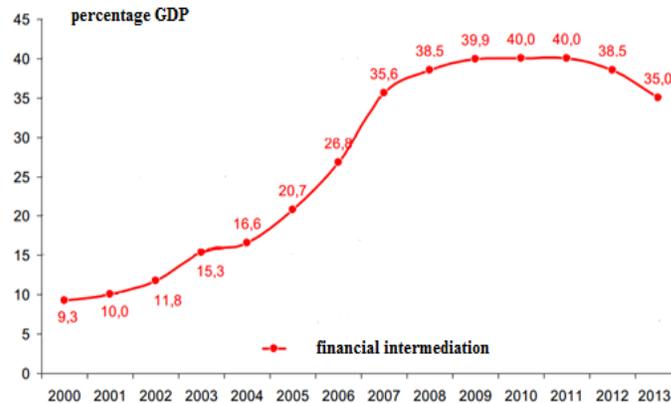
For quantifying the financial development of an economy, literature focuses on two important indicators: **monetisation level of an economy** (computed as weight of aggregate M2 in GDP) and **financial intermediation level in Romania** (weight of non-governmental credit in GDP).

The main beneficiaries of financial intermediation are non-financial companies and the population, while the credit institutions hold a dominant position in supplying financial resources.

The evolution of financial intermediation in Romania between 2000 and 2013 is shown in the next figure.

Figure 1

**Dynamics of financial intermediation in Romania**



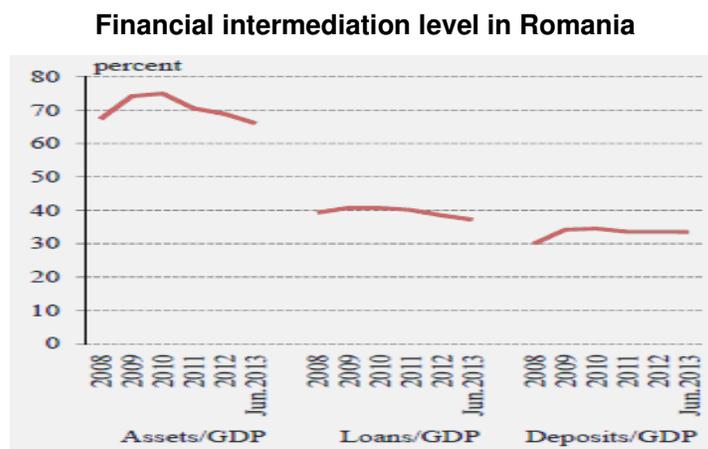
Source: NBR, own computation

As regards the financial intermediation, even if it considerably increased during 2000-2013 (from 9.3 percent in 2000 to 40 percent in 2011, encountering a decrease of 5 percent at the end of 2013), its level remaining low, acknowledging significant differences as opposed to Central and Eastern Europe.

Also, we notice the prevalent position of the financial banking institutions in Romania. After Romania's transition to the market economy, the number of credit institutions and the mostly private-owned institutions increased and they maintained the dominant position in the financial system.

Even so, if compared to the other member countries (as shown in Figure 3), the financial intermediation level in Romania (Figure 4) is still below the EU-28 average.

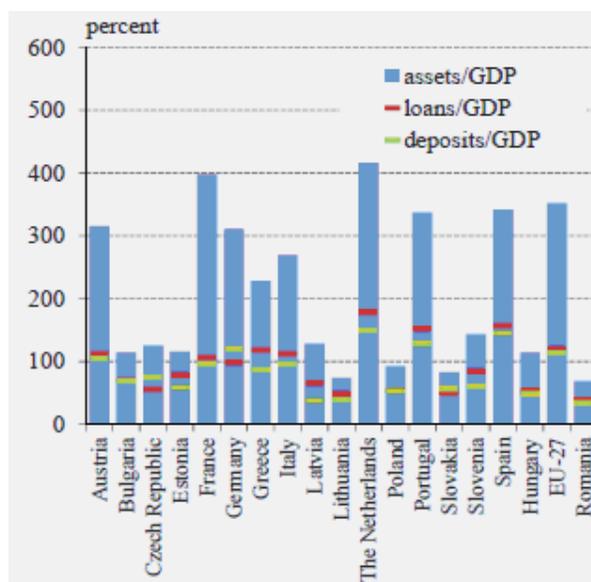
Figure 2



Source: NBR (2013 Report on Financial Stability)

Figure 3

Financial intermediation level (international comparisons)



Source: NBR (2013 Report on Financial Stability)

As regards the financial intermediation level of the credit to the private sector as weight in GDP, it diminished (from 38.4 percent in December 2012 to 37.1 percent in June 2013).

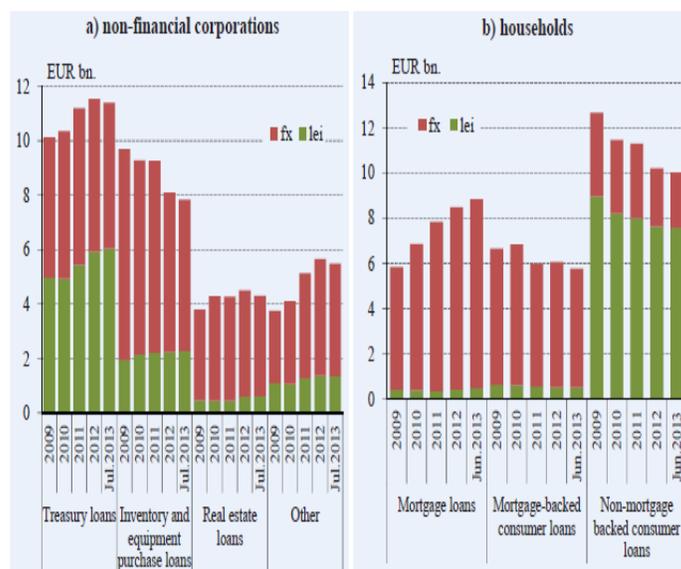
The slightly lowering trend is mostly caused by poor lending activity of the Romanian banking system. The weight of the deposits from companies and population in the GDP is similar to that over the 2011-2013 period.

The significant weight of foreign currency lending is a vulnerability of the Romanian banking sector, worsened by the present financial crisis; but it began to diminish both in relation to the credit granted to financial companies and to the population.

As shown in Figure 2, the credit granted mostly in foreign currency consist mainly of credit for real estate investment (to non-financial companies) and mortgage credit, *i.e.*, mortgage-guaranteed consumption credit (to the population).

Figure 4

**Loans granted by credit institution, by destination and denomination, between 2009 and 2013**



Source: CRC, NBR

Source: Monetary Balance Sheet, IFN Balance Sheet, CRC, Credit Office, NBR computations

Another important factor influencing the transmission of interbank interest rates to those used by credit institutions for the non-banking customers' sector is the level of competition between banks. In this regard, the evolution of the Romanian banking system is presented in Table 1.

**Table 1**

**Structural indicators of the Romanian banking system**

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Number of credit institutions	40	39	42	43	42	42	41	40	41
Number of majority private-owned credit institutions	38	37	40	41	40	40	39	38	39
Number of majority foreign-owned banks, of which:	30	33	36	37	35	35	34	34	36
- branches of foreign banks	6	7	10	10	10	9	8	8	9
Weight of majority private-owned banks in all assets (%)	94	94.5	94.7	94.6	92.5	92.4	91.6	91.6	92
Weight of foreign-owned banks in all assets (%)	62.2	88.6	88.0	88.2	85.3	85.0	83.0	89.8	90.8
Weight of the first five banks in all assets (%)	58.8	60.3	56.3	54.3	52.4	52.7	54.6	54.7	54
Herfindahl-Hirschman index	1124	1171	1046	926	857	871	878	852	834

*Source: NBR*

Because of the present economic context characterized by disturbances in the international financial markets and lowering trends of the real GDP at the national level, the financial intermediation level – measured as assets weight in the GDP of the Romanian financial system assets – diminished slightly (as shown in Table 2).

Following the investigation at the financial system level, we notice the prevalent position of the financial banking institutions. Although the private pension funds began to rise in 2008, the level attained shows their low capacity to ensure and maintain the stability of the domestic financial markets (especially through purchases of long-term assets).

Table 2

**Structure of the Romanian financial system  
(assets weight in GDP)**

Financial intermediation institutions	Assets weight in GDP (%)							
	2005	2006	2007	2008	2009	2010	2011	2012
Financial banking institutions	45.00	51.00	60.00	61.00	66.00	72.00	70.00	68.00
Insurance companies	2.00	2.50	3.00	3.00	3.50	3.00	2.50	2.50
Private pension funds	0.00	0.00	0.00	0.17	0.47	0.84	1.19	1.00
Financial investment companies	1.77	2.35	2.80	1.20	1.49	1.65	1.30	1.00
Open investment funds	0.17	0.30	0.30	0.20	0.67	1.07	1.23	0.88
Non-banking financial institutions	4.50	4.70	7.20	8.40	7.52	7.00	6.82	6.40
All financial system	53.44	60.85	73.30	73.97	79.64	85.56	83.04	79.78

Source: NBR Annual and Monthly Reports on financial stability (<http://www.bnr.ro/Publicatii-periodice-204.aspx>), Reports on the insurance market (<http://www.csa-isc.ro/>).

Note: The open investment funds consist of “Fondul Proprietatea”. There are no data available for 2005-2007, because the private pension fund was created in 2007.

A relevant indicator of competition in the banking system is the concentration level. Its evolution for the Romanian banking system between 2008 and 2013 is shown in Figure 5.

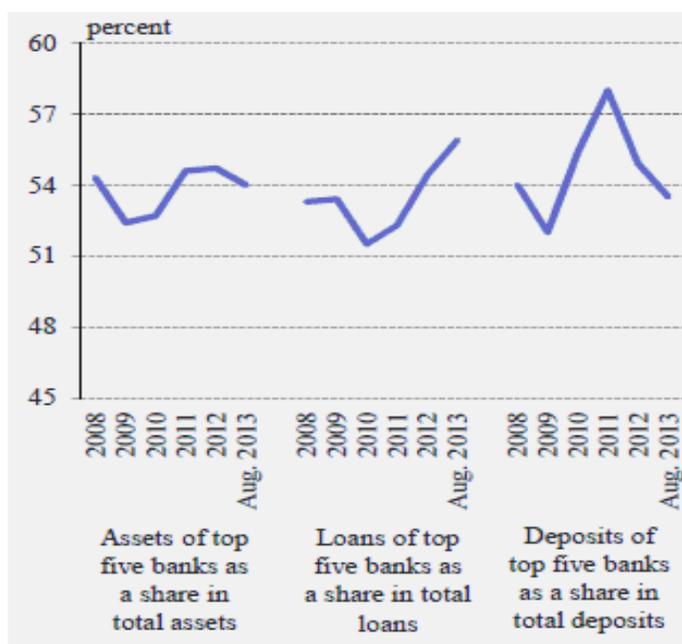
According to the 2013 Report on banking system (Source: NBR), as revealed by the weight of the assets held by the first five banks in all assets, it slightly diminished to 54 percent in August 2013.

The Herfindahl-Hirschman index<sup>2</sup> for August 2013 shows a higher concentration of credits (875 points), while the concentration of deposits is 825 points and that of assets reaches 834 points.

According to Figure 6 (asset concentration level – international comparisons); the Herfindahl-Hirschman index places the Romanian banking system below the EU average.

Figure 5

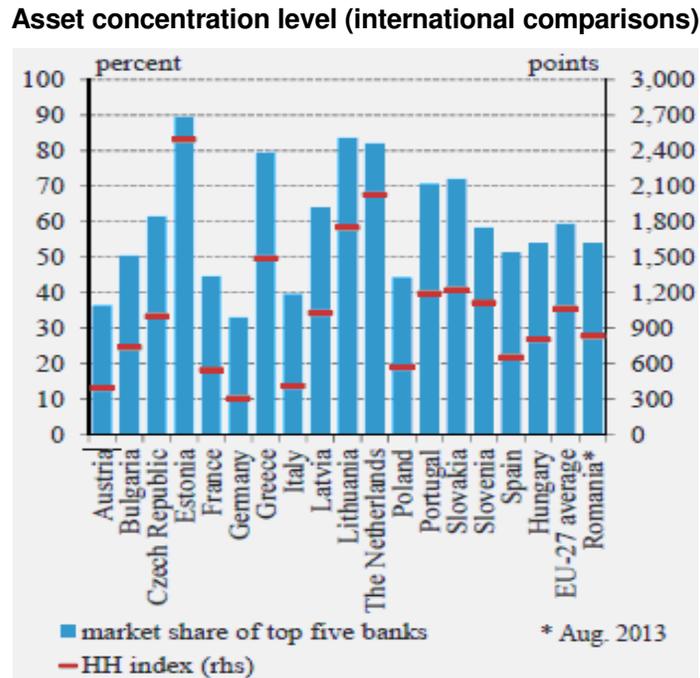
**The concentration level of the Romanian banking system**



Source: NBR (2013 Report on Financial Stability)

<sup>2</sup> The Herfindahl-Hirschman index measures the concentration of the bank portfolios. A value below 1000 points indicate a non-concentrated market; between 1000 and 1800 points, the index indicates an average concentration of the banking system and a value over 1800 points indicates a highly concentrated market.

Figure 6



Source: NBR (2013 Report on Financial Stability)

The concentration of the Romanian banking system, as reflected by the share of the top five banks in total bank assets, declined slightly to 54 percent.

Deposits also followed a similar trend, as in August 2013, the top five banks (in terms of their asset size) accounted for 53.5 percent of the deposits taken.

The relative decline in the banking system's concentration in the first half of 2013 shows the stiffer competition among credit institutions in terms of deposits taken.

### 3. Conclusions

The main role of the financial intermediation in the efficient assignment of resources in economy is emphasized by the international theory and practice also applicable to the transitory

economy, financial intermediation having an economic mobilization role.

In Romania, the lending is more important for the economic increase because the self-funding capacity of the firms is low, the small and medium sized business sectors are low, and the role played in the financial market by other intermediate is still reduced. For Romania, the financial intermediation is a banking process because banks been holding the great majority of financial assets.

The Romanian banking system, in spite of the rapid development from the passed years, encounters itself in an early stage of financial enlargement as compared to the majority emerging economies.

Specific to Romanian economy the transmission mechanism of the interest rate pass-through is based on transitory measures previously taken over National Bank of Romania in view of credit increase limitation granted to unprotected debtors towards the currency risk and financial stability.

Thus the efficiency of interest rates transmission mechanism has been gradually gained as a bigger financial stability has been achieved.

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