

FINANCIAL STABILITY AND MACROECONOMIC BALANCES: CHALLENGES AND PERSPECTIVES

Eugen Rădulescu²², PhD

Abstract

Financial stability is a global public good characterized by non-equity and non-exclusion. This public good cannot be offered exclusively by the market, the central bank and other state institutions playing an important role in ensuring financial stability. Also, given the open economy of Romania, a cross-border approach is needed, by coordinating policies in this area, in order to achieve financial stability at national level. The National Bank of Romania designs macro-prudential policy strategy within the limits of its area of competence. The macro-prudential policy objectives of the NBR, fully harmonized with the European recommendations in the field, are: (i) to reduce and prevent excessive credit and debt growth; (ii) reducing and preventing excessive maturity mismatches and lack of liquidity on the market; (iii) limiting the concentration of direct and indirect exposures; (iv) limiting moral hazard, and (v) enhancing the resilience of financial infrastructure. In order to meet the ultimate goal of safeguarding the stability of the financial system, the NBR selected, in addition to the interim macro-prudential policy objectives at EU level, two specific national targets - sustainable growth of financial intermediation and improvement of financial inclusion - for which it proposed specific instruments.

Keywords: financial stability, macroeconomic and sustainability

JEL classification: E44, E63, Q01

Introduction

The National Bank of Romania carefully monitors the stability risks and pursues, through the macro-prudential policies it has adopted or on which is preparing to adopt them, reducing the risk of over-indebtedness of the population. At the same time, the NBR considers that borrowers would be better protected in the medium term if they were required more to conclude fixed-interest credit agreements. Also, within the National Macro-prudential Supervisory Committee, the NBR highlighted the risks to financial stability stemming from constraints weak budget in the economy. To strengthen the economy's resilience to external shocks, especially on credit risk, requires a prudent and balanced mix of policies economic recovery, aiming at returning to the medium-term budgetary objective (reducing the structural deficit) and improving the discipline of payment in the economy.

Methodology of Scientific Research

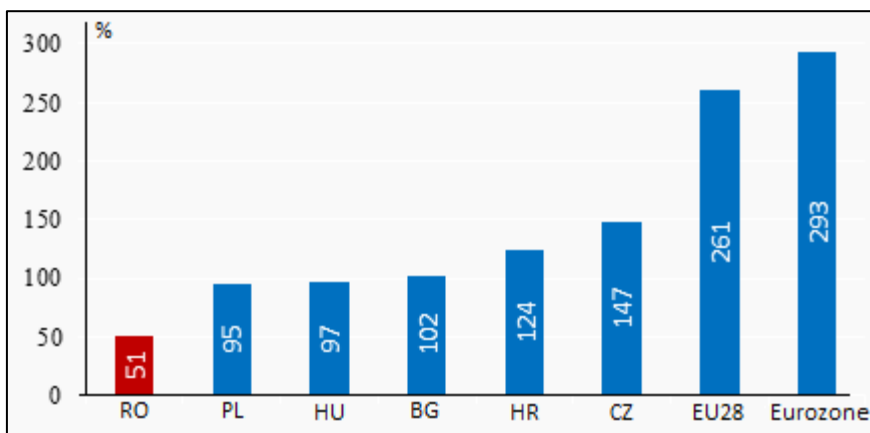
The methodology of the paper will have as direct instruments the collection of data and information from specialized literature and from existing practice in public and private institutions, but especially scientific articles published on specialized research networks, articles published in different journals, relevant books in the field of reference, legislation, analyses and studies, official documents of various tax bodies, tax documents and interactive database of the National Bank of Romania, other relevant sources identified at the libraries: CCFM, Academia Romanian, INCE, IEN, BNR, National Library, INS, etc. Moreover, in the methodology we will analyse the documents using the comparative, analytical, descriptive method, no participative and participatory observation, and the use of a set of informational sources, the collection of financial data in the established databases. Also, the paper will be based on annual reports, publications, consolidated statistical data provided by the National Bank of Romania, the European Central Bank (ECB), the International Settlement Bank (BRI), the European Commission, OECD, published annually, data to be processed in order to be able to provide a general and analytical picture of the most important changes taking place in the European Union as a whole, but also globally - considered representative for the understanding of the phenomena studied, and especially in Romania.

²² National Bank of Romania, email: eugen.radulescu@bnro.ro

Implementing the Results

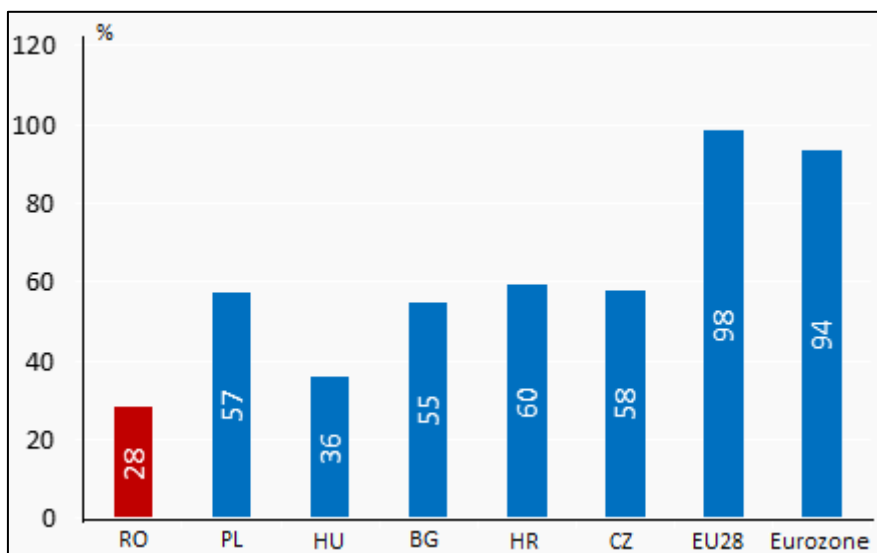
In this research paper we present financial stability and macroeconomic balances: challenges and perspectives.

Figure 1 - Banking sector assets as a share of GDP (Q1 2017)



Source: ECB

Figure 2 - Non-government loans as a share of GDP (Q2 2017)



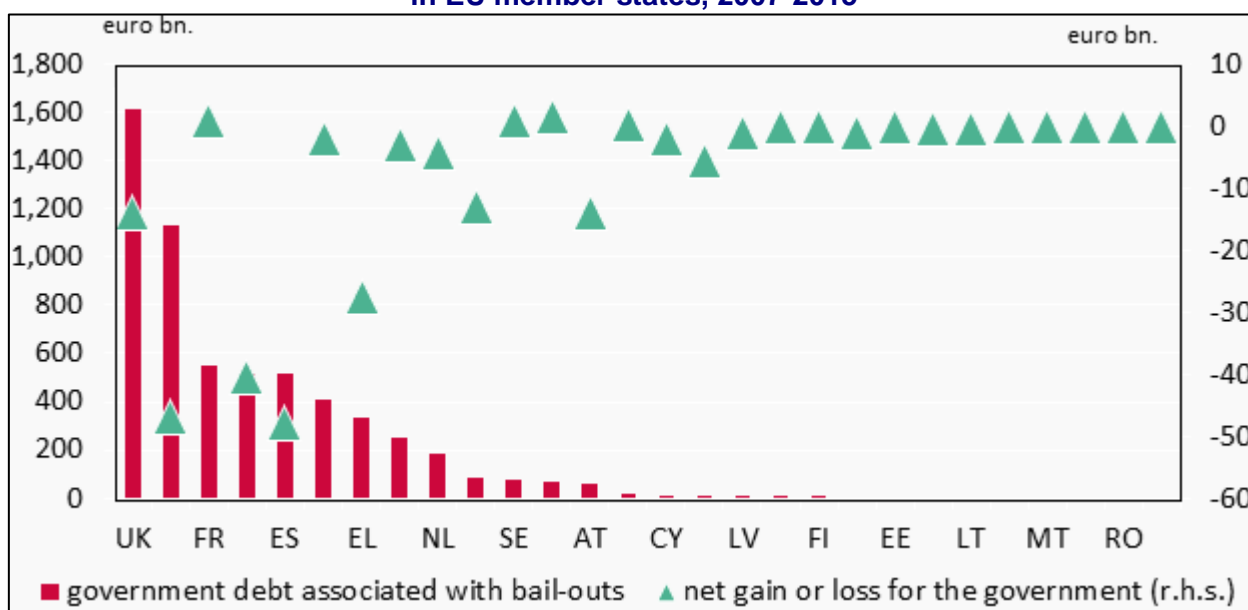
Source: ECB, Eurostat

Historically, the level of financial intermediation in Romania has remained low:

- high and persistent inflation for a long period of time;
- lending standards perceived as disadvantageous: large-scale use of other financing sources; this pattern diminishes firms' long-term capacity to benefit from development opportunities;
- an important part of the credit demand is not bankable (large number of undercapitalized companies, significant inequality in households' income);
- direct recourse to foreign funding, especially in case of large companies

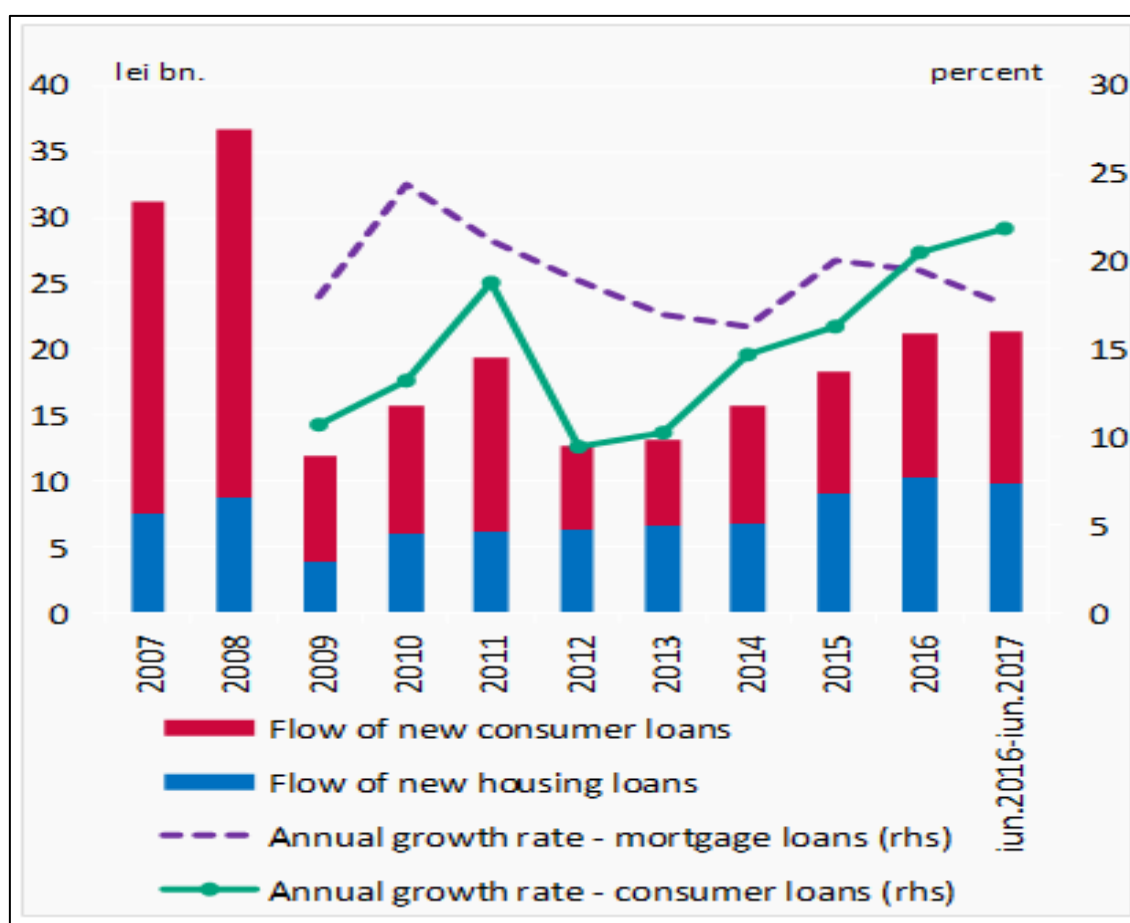
The banking sector in Romania did not need funds from the budget during the crisis.

**Figure 3 - Government intervention in supporting financial institutions
in EU member states, 2007-2015**



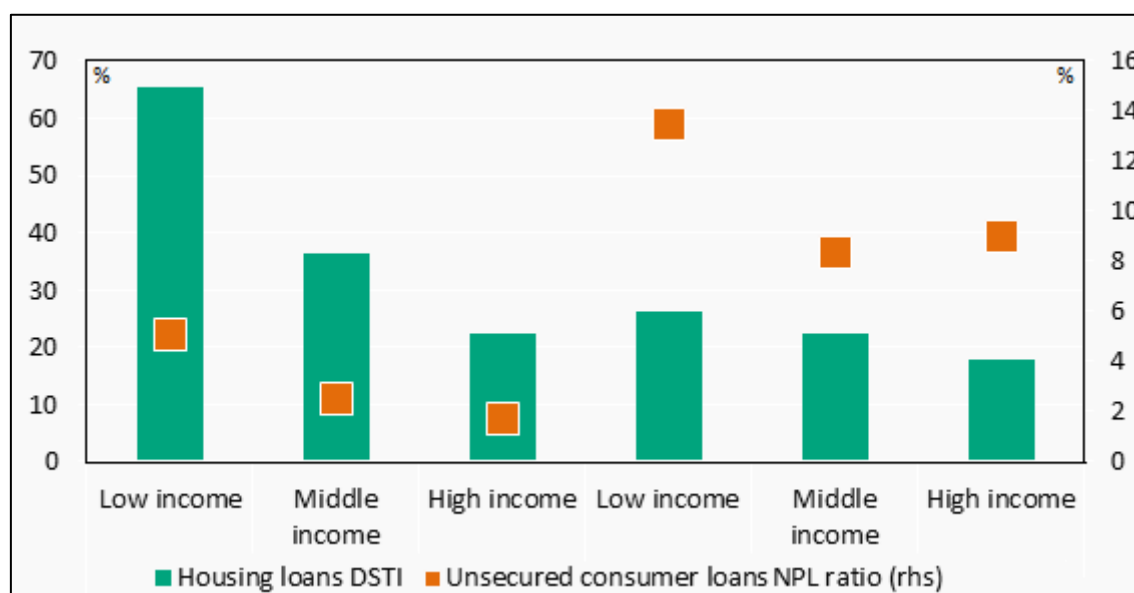
Source: Voinea, 2017, "Romania in the euro zone: when and how"

**Figure 4 - Household sector: high indebtedness, increasing vulnerabilities.
Volume of new loans.**



Source: NBR, Credit Bureau, National Agency for Fiscal Administration, NBR calculations

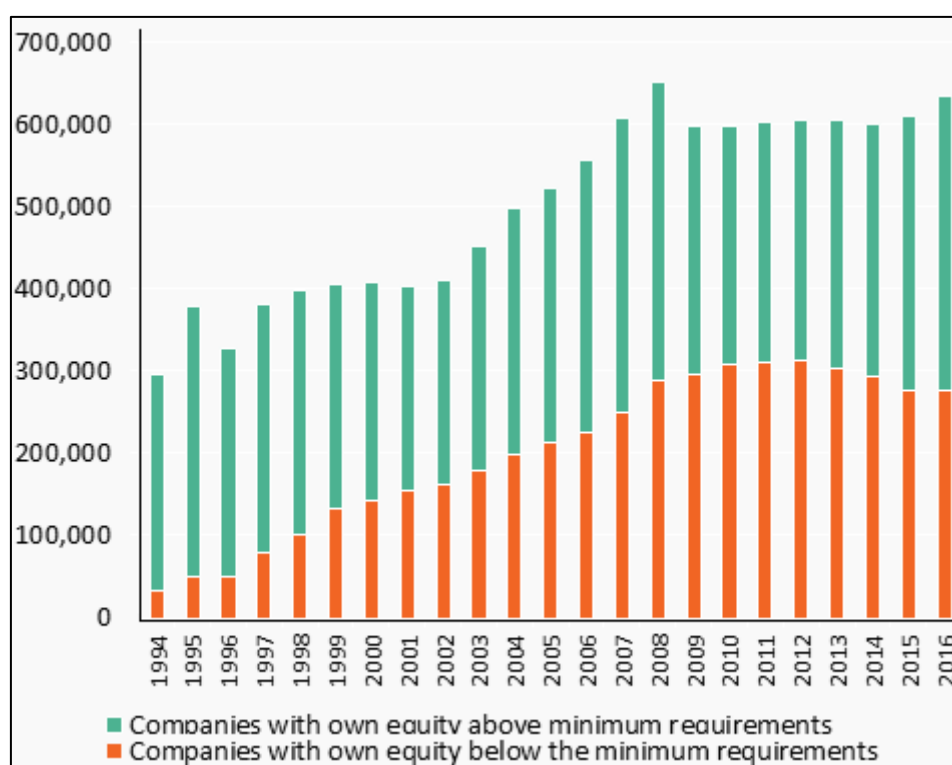
Figure 5 - Debtors' level of indebtedness (June 2017)



Source: NBR, Credit Bureau, National Agency for Fiscal Administration, NBR calculations

The need for strong budgetary constraints to clean up the economy.

Figure 6 - The number of active non-financial corporations in the economy by level of capitalization



Source: update of Neagu, Dragu and Costeiu - "Pregătiți pentru viitor? O nouă perspectivă asupra economiei României" (2016)

Table 1

Atypical companies

	No. firms - thou. -	Debt - lei bn. -
Companies with own equity below minimum requirements	276.5 (44%)	355.7 (43%)
Companies with negative own equity	268.5 (42%)	324.5 (39%)
Companies with zero sales	164.4 (26%)	105.6 (13%)
Companies with zero employees	263.7 (42%)	159.9 (19%)
Companies with negative equity, no sales and zero employees	100.1 (16%)	65.4 (8%)

Note: The values in the parentheses represent the share in the non-financial companies' sector

Source: MPF, NBR

The need for Strong Budgetary Constraints to Clean up the Economy.

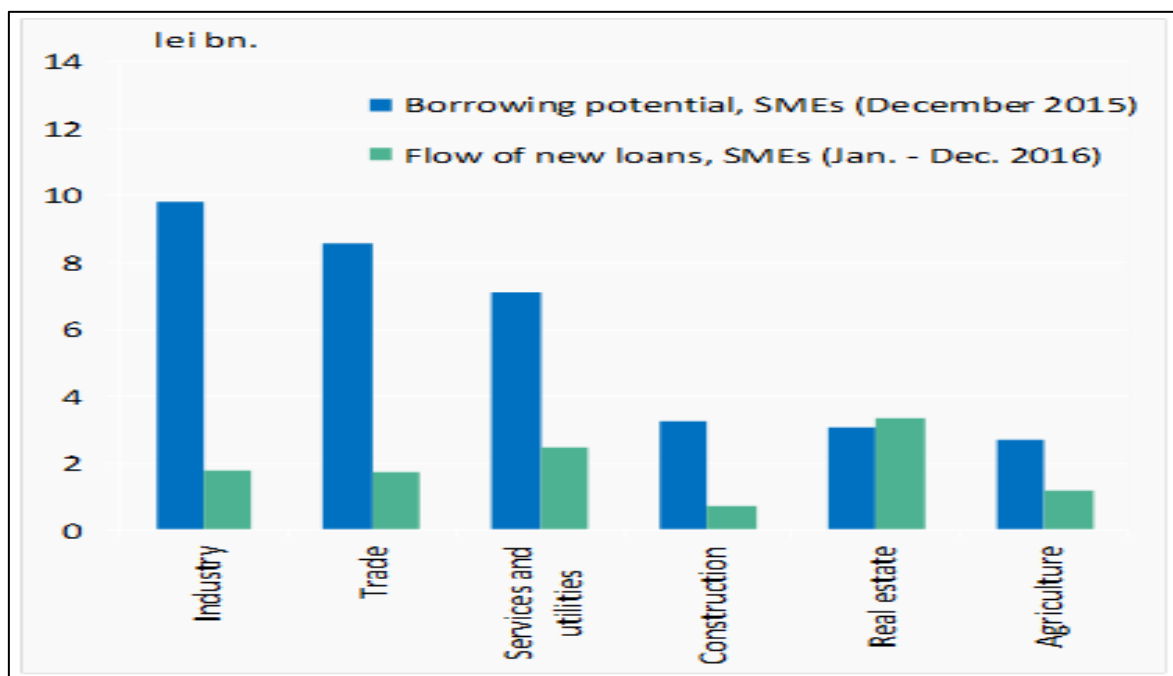
The necessary amount of capital for firms with own equity below minimum requirements:

- to reach the regulatory threshold (50% of the share capital): lei 156.8 billion;
- to reach 100% of the share capital: lei 187.7 billion.

Despite positive macroeconomic developments in recent years, the recapitalization need continued to grow (+3.7% in 2016 compared to the previous year)

SMEs' borrowing potential is significant.

Figure 7 - Borrowing potential and flow of new loans by SMEs' business sector



Source: MPF, NBR, NBR calculations

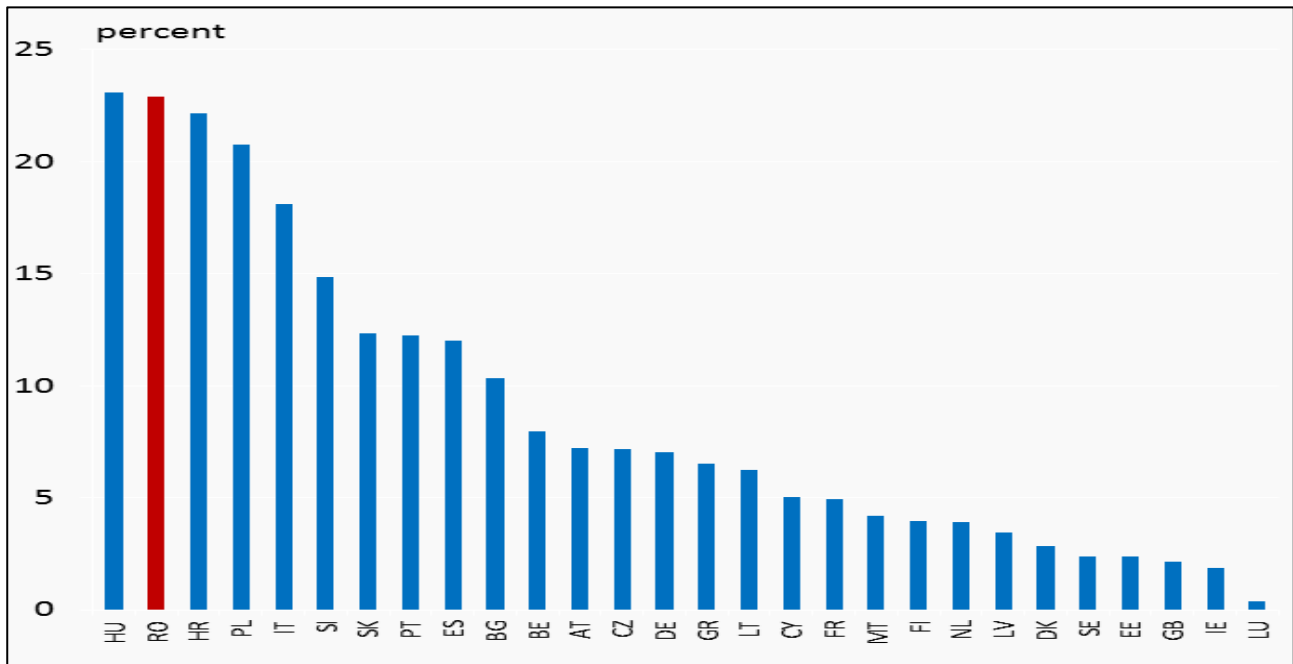
- around 12,200 SMEs can be considered well-performing companies in the economy, as they have remained among the top firms in at least 7 of the last 9 years
- among these, over 6,600 SMEs have a leverage ratio below 1 and can sustain an important volume of borrowings: lei 36.3 billion

The Necessity for Supply to Adjust to the Needs of Demand.

To increase the interest of bankable firms in the products offered by credit institutions, it is necessary:

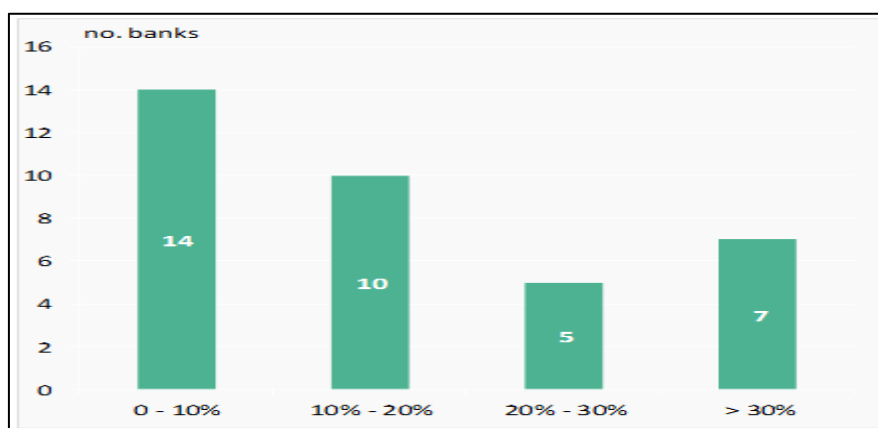
- to develop flexible products, which accommodate companies' specific requirements (*tailor-made products*);
- to set up special divisions, focusing on lending activities to more riskier segments, such as start-ups;
- to simplify the lending process;
- to improve the skills of bank staff involved in loan analysis and risk management.

Figure 8 - Banks' sovereign exposures as a percentage of total assets, EU comparisons (August 2017)



Source: ECB

Figure 9 - The distribution of local banks based on the share of sovereign exposures in their assets (June 2017)



Source: NBR

Banks' exposures to the public sector: pros & cons

Advantages

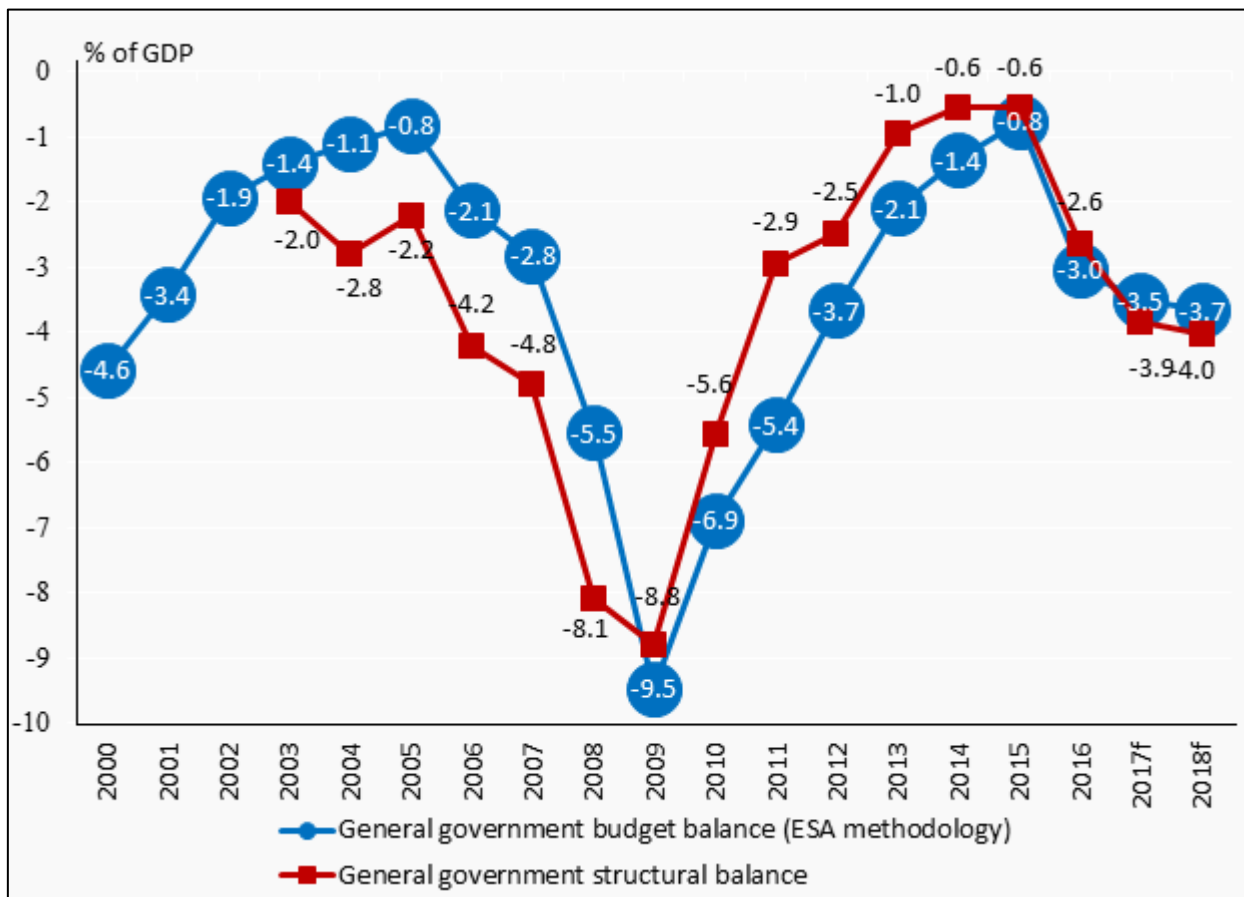
- stabilizing role in periods of financial turmoil
- investments with low risk
- help improve banks' liquidity position

- eligible collateral to access the central bank's lender-of-last-resort facilities

Disadvantages

- increased interdependencies between banks and sovereigns
- limitations on private sector lending activities (crowding-out)
- concentration risk
- the risk of new EU regulations strengthening the capital requirements for sovereign debt holdings

Figure no.10. Essential challenges to macroeconomic balances/The need for counter-cyclical policies



Note: The structural balance is the general government balance adjusted for the cyclical component (estimated based on potential output). Data for 2017 and 2018 are forecasts of the European Commission.

Source: European Commission (AMECO), Fiscal Council

Conclusions

Essential challenges to macroeconomic balances

The need for counter-cyclical policies

Highly pro-cyclical policies in 2006-2008 resulted in:

- a well above-potential acceleration in economic growth
- significant deterioration of the current account deficit to exceptional levels (13.8% of GDP in 2007 and 11.8% of GDP in 2008)
- permanent budgetary expenses based on extraordinary revenues (e.g., excessive and undifferentiated pensions growth)
- rapid public debt growth (from 12.7% of GDP in 2007 to 23.2% of GDP in 2009)
- exhausting all resources for counter-cyclical policies in the recession period that followed

Essential challenges to macroeconomic balances

The need for counter-cyclical policies

Where we stand now:

- economic growth is above potential (+5.9% in H1 2017 compared to H1 2016)
- current account deficit remains within manageable limits (2.5% of GDP in Q2 2017), but Romania is one of the few EU countries with significant and increasing deficits
- the authorities committed to maintaining the public deficit below 3% of GDP
- alarmingly approaching the sustainable public debt threshold in terms of our economy's conditions: 37.6% of GDP in 2016, compared to a maximum estimated value of 40-45% of GDP at current costs
- the massive increase in the public wage bill is an overwhelming burden for the coming years, even without granting the remaining promised salary increases
- drastically limiting the public capital expenditure results, among others, in a reduced capacity to access European funds
- European Commission's forecasts indicate a continuous increase in the public deficit in the next years (to 3.7% of GDP in 2018)

Rapid decrease in the fiscal space/ A potential recession at European level could produce much more severe effects in Romania.

Essential challenges to macroeconomic balances:

The demographic issue:

- the natural decline of population is one of the highest in Europe;
- migration to other countries has reached endemic levels, considering that over 15% of total population, or 25% of the workforce, has left Romania, and this process is ongoing;
- for some top professions, such as the ones in healthcare, the situation tends to become critical;
- the lack of qualified personnel is the main deterrent to economic development;
- nevertheless, the underemployment remains a widespread phenomenon, especially in underdeveloped areas (there are counties where the number of socially-assisted individuals is significantly higher than that of the persons employed).

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