CHARACTERISTICS OF THE ROMANIAN MONETARY POLICY

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Abstract: In this paper[1] we intend to highlight some features of the monetary policy of the National Bank of Romania (NBR) between 2007 and 2014. We make some correlations in order to show how the monetary transmission mechanism has worked, as well as in order to capture the factors that have affected positively or negatively the transmission mechanism of the monetary policy in Romania. Thus, we compare the National Bank of Romania's reference interest rate with the interest rates on loans and on deposits of commercial banks in order to specify whether the monetary policy interest rate has been or not a signal pursued by commercial banks. Also, we compare inflation with monetary policy rate, the interest rates on loans and on deposits. NBR's monetary policy transmission depends on several factors, including the structure of the loans and deposits of commercial banks operating in Romania, the stock of non-performing loans, the structure of the Romanian banking system. As a result, in the article we analyze the elements that measure these factors (e.g., private sector credit in lei and foreign currency, the NPL rate, the share of net assets and of social capital of banks with majority Romanian capital in the total Romanian banking system).

Key words: monetary policy, transmission mechanism, interest rate, Romanian banking system, factors of influence

Introduction

The monetary policy, like many other macroeconomic policies, faces strong interconnections; it receives and sends signals from/to the entire economy and also from/to the international environment. The requirement for a balanced monetary policy comes from the need to integrate and solve problems in connection with the free movement of capitals, the volatility of exchange rate and of interest rates, financial contagion, judicious regulation of the commercial banks system, active and preemptive supervision, etc.

[1]The article is based on the research project "Directions and challenges of the Romanian monetary policy in the postcrisis domestic and international context" elaborated in the Center for Financial and Monetary Researches "Victor Slavescu", in 2015, under the coordination of Camelia Milea, PhD.

From the perspective of joining the Euro zone, Romania must take into account the fact that monetary policy and fiscal-budgetary policy will be the only instruments of macroeconomic policy available to the authorities in order to support the balanced development of our country's economy. The conduct of the monetary policy of the National Bank of Romania (NBR) must aim medium-term price stability, by anchoring the inflationist anticipations, and also ensuring a proper level of liquidity on the monetary and foreign exchange markets, as well as the correction of the distorted position of interest rates on loans and on deposits in relation with the monetary policy interest rate – all of them being prerequisites of a sustainable revival of the crediting process and, implicitly, of the sustainable development of the Romanian economy.

Within this context, we consider to be necessary an overall analysis of NBR monetary policy, more specifically, of the transmission of the NBR monetary policy impulse towards the real economy. Therefore, in this article we intend to highlight a few characteristics of NBR monetary policy between 2007 and 2015. We shall make several correlations in order to mark out how the monetary transmission mechanism has worked, as well as to catch the factors that had positive or negative influence on the transmission of the monetary policy in Romania.

Correlations within the sphere of the monetary policy in Romania

The analysis begins with a review of the monetary policy interest rate evolution in the period 2007-2015, which shows two points of inflexion (June 26th, 2007 and August 1st, 2008). Until June 26th, 2007, the monetary policy interest rate displayed a decreasing trend, followed by an increase until August 1st, 2008, determined by the challenges that the Romanian economy had to cope with in terms of nominal and real convergence. After August 1st, 2008, the monetary policy interest rate has had a decreasing trend drawn by the effects of the international economic and financial crisis, and implicitly by liquidity contraction.

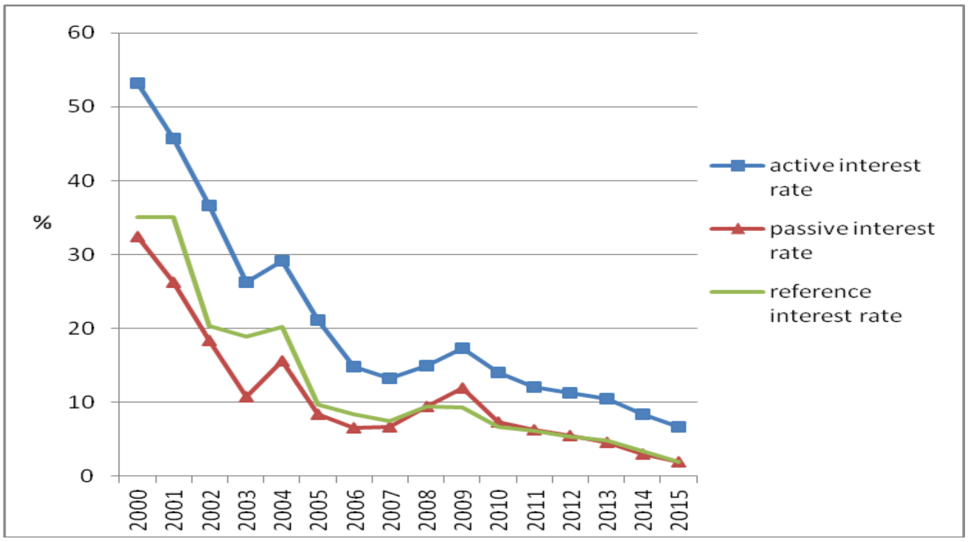
Thus, between June 1997 – the third quarter of 2008, NBR's operations on the monetary market aimed almost exclusively to withdraw the surplus of liquidity from the banking system. In the last quarter of 2008, on the background of the on-going decrease of the structural surplus of liquidity within the banking system, there have been made operations to supply liquidity. Subsequently, due to the wide movements of the autonomous factors of the liquidity there has been an alternance, not necessarily synchronized, of the direction of using the main monetary market instrument of the central bank (NBR, 2015).

NBR's data show that the monetary policy has been implemented in Romania in two different situations. Between 1996 and 2002, the real monetary policy interest rare was negative, which decreased the trust in the national currency and the demand for money, which fuelled the domestic inflationary process. As of 2003, the real monetary policy interest rate has been positive, which has increased the demand for the Romanian leu and, implicitly, its appreciation. Furthermore, inflows of foreign capitals seeking for profitable opportunities have been drawn in, which supported further the appreciation of the national currency and which supplied liquidities on the monetary market.

Hereinafter, we compare the reference interest rate with the interest rates on loans and on deposits of the commercial banks (Fig. 1), in order to see whether the monetary policy interest rate has been or not a signal followed by the commercial banks.

Several ideas emerge from Figure 1. Thus, we may notice that both the interest rate on deposits and the interest rate on loans have followed, throughout the analyzed period, the trend imposed by the monetary policy interest rate, however, keeping a certain gap from the reference interest rate.

Figure 1 – The evolution of the reference interest rate, and of the active and passive interest rates in Romania, between 2000 and 2015



Source: NBR data

The decrease of the active interest rate for the loans in Romanian leu, following the reduction of the reference interest rate in the period 2010-2015, represent the condition for the revival of lending in national currency.

The monetary policy interest rate has been almost always enframed by the interest rates on loans and on deposits, except for the period of crisis (2008-2012). This evolution shows the behaviour of the banks during the period of crisis, which have preferred to draw in deposits.

Throughout the analyzed period, the interest rate on deposits was much closer to the monetary policy interest rate than the active interest rate, which shows the prudent behaviour of the commercial banks operating in Romania, as well as their high inclination towards profit.

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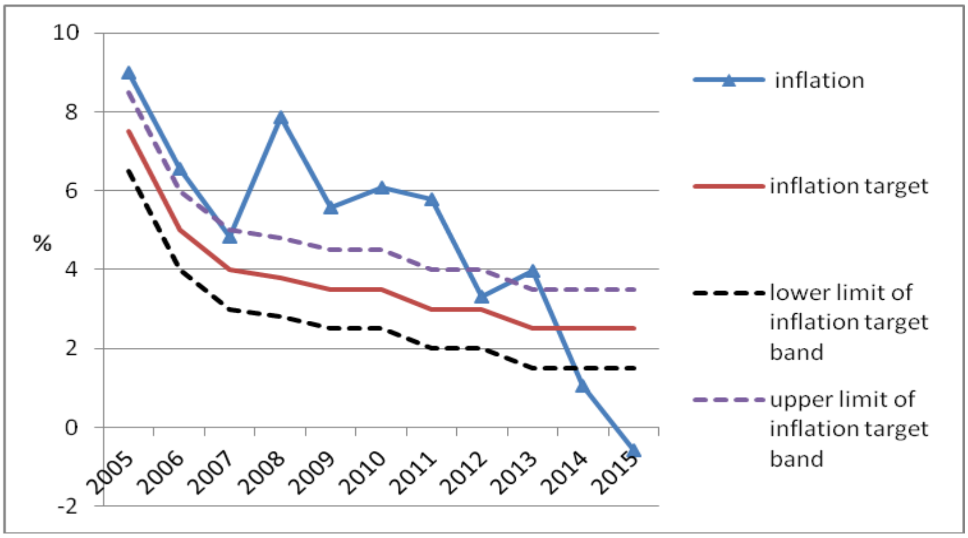
Another idea inferred from the analysis of the graphical representation refers to the perfectly synchronized evolution of the active and passive interest rates, although the band separating them has narrowed slightly. We consider, also, that this evolution shows the cautious behaviour of the commercial banks from Romania, and their determination not to reduce the profit margin.

The inflation in Romania has been consistently higher than NBR's targets in the period 2005-2013. Although most years of this period the inflation has been close to the upper limit of the inflation target interval, there have been several years when it exceeded by far the upper limit of the inflation target band (2008-2011), because during this period, the evolution of the two indicators was contrary. Thus, the inflation target displayed a decreasing trend, while inflation has increased in 2008, 2010 and 2013 compared to the previous years, because of the international economic and financial crisis. In 2014, for the first time, the inflation was lower than the lower limit of the inflation target interval (Fig. 2). This situation continued in 2015, when inflation has been negative. One may notice that there are several years in which NBR didn't accomplish its monetary policy goal, although, in terms of trend, it managed to decrease the inflation gradually.

Figure 2 – The evolution of the inflation and of the inflation targets in Romania, between 2005 and 2015



Source: NBR data

The inflation decreased continuously and strongly between 2000 and 2007, 2005 being the first year when the inflation in Romania had one-figure values.

Comparing inflation with the monetary policy interest rate, with the interest rates on loans and on deposits in the period 2000-2015 (Fig. 3), we may notice that the monetary policy interest rate, the

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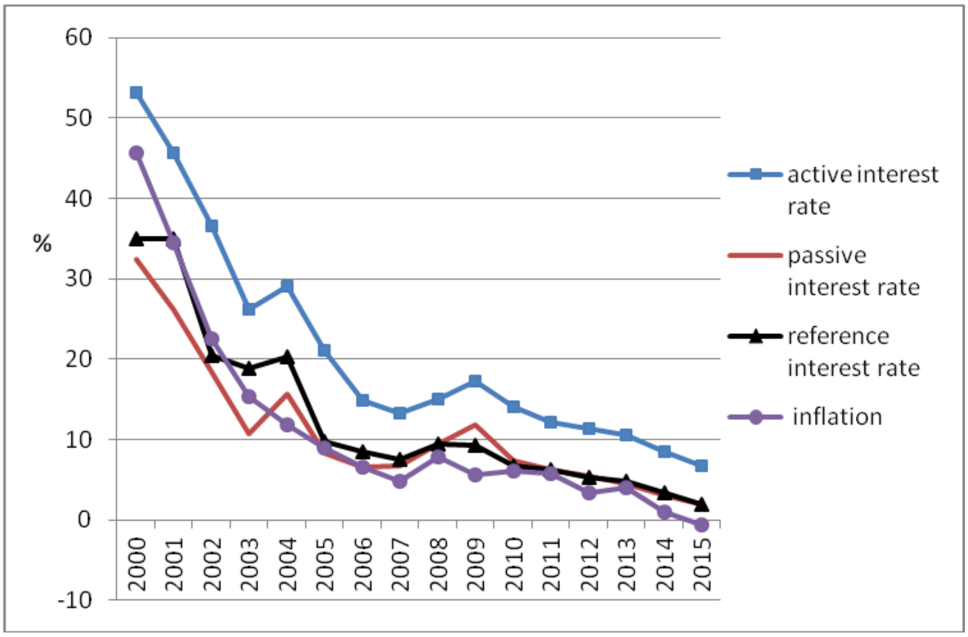
passive interest rate and inflation have had rather close values throughout this period, and even more so after 2005.

The inflation exceeded the passive interest rate between 2000 and 2003, which means that saving was not stimulated during this period. The two indicators were almost equal the following few years, which still didn't support saving. Inflation was constantly lower than the passive interest rate as of 2007, which has stimulated saving and impeded on lending, loans being more expensive.

Figure 3. The evolution of the interest rates and of inflation in Romania, between 2000 and 2015



Source: NBR data

After 2002, the reference interest rate was higher than inflation.

One may say that as of 2007, NBR's objective for disinflation has found a more favourable environment for substantiating, since the decrease of private consumption and the stimulation of saving have brought furthermore the reduction of the pressure exerted by the aggregate demand on the growth rate of consumer prices.

The transmission of NBR's monetary policy also depends on the structure of the loans and deposits of the commercial banks operating in Romania.

Analyzing the loans granted to the private sector in national currency (lei) and in foreign currency (Fig. 4), we notice, as of 2012, an increasing trend for the loans in national currency (lei), and a decreasing trend for the loans in foreign currency, the evolution of the shares of the two types of

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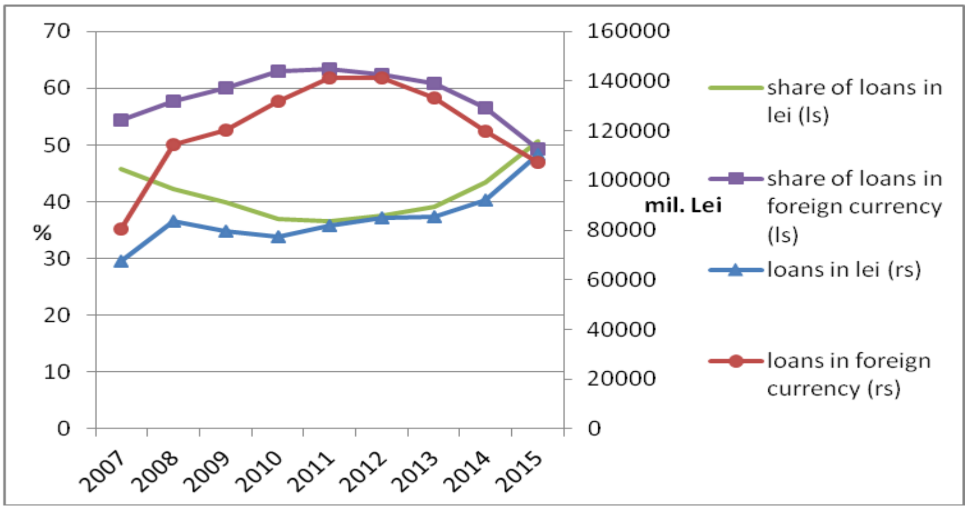
loans within the total volume of loans granted to the private sector in Romania being the same. 2015 is the first year when the proportion of loans in lei exceeds that of loans in foreign currency.

This evolution influences positively monetary policy transmission in Romania, but it has to be accompanied by a stronger reduction of the euroization phenomenon within the economy, which would allow a better transmission of the monetary policy impulses.

The decrease of the volume of loans granted in foreign currency was due both to the fast cross-border disintermediation following the shrinking of credit lines from the mother banks towards their branches in Romania, and to NBR's regulations regarding loans in foreign currency, as well as to the governmental support for buying houses programs using loans in lei.

Figure 4 – The evolution of the loans in lei and in foreign currency, granted to the private sector in Romania, between 2007 and 2015



Source: NBR data

The financial intermediation (calculated as a proportion of the private sector loans within the GDP) has decreased from 35.6% in 2007, to 30.5% in 2015 (after peaking to 39.9% in 2009), on the background of less loans granted in foreign currency.

Figure 5 shows that both foreign currency deposits and national currency (lei) deposits of the private sector have increased during the surveyed period, the growth of the deposits in lei being more important, on the background of a decreasing passive interest rate. This evolution can be explained by the positive real passive interest rate after 2007. Although the lending in foreign currency decreased as proportion within the total volume of loans, being better correlated with the volume of foreign currency deposits, and the deposits in lei cover properly the loans granted in lei, an imbalance can be, however, noticed between the volume of loans and that of deposits in foreign

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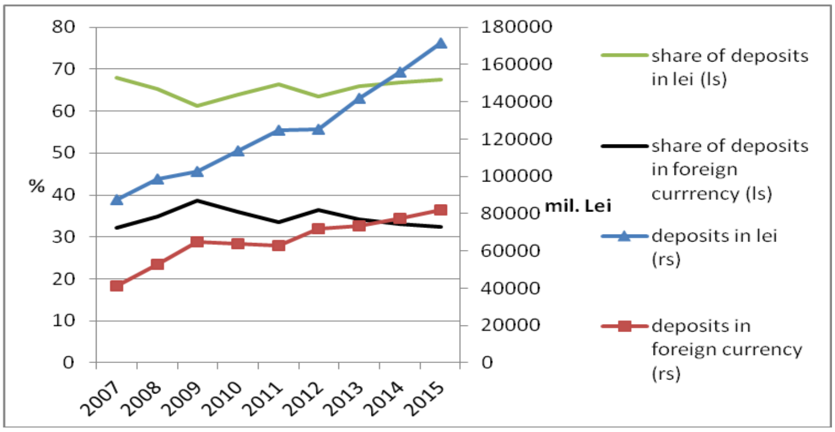
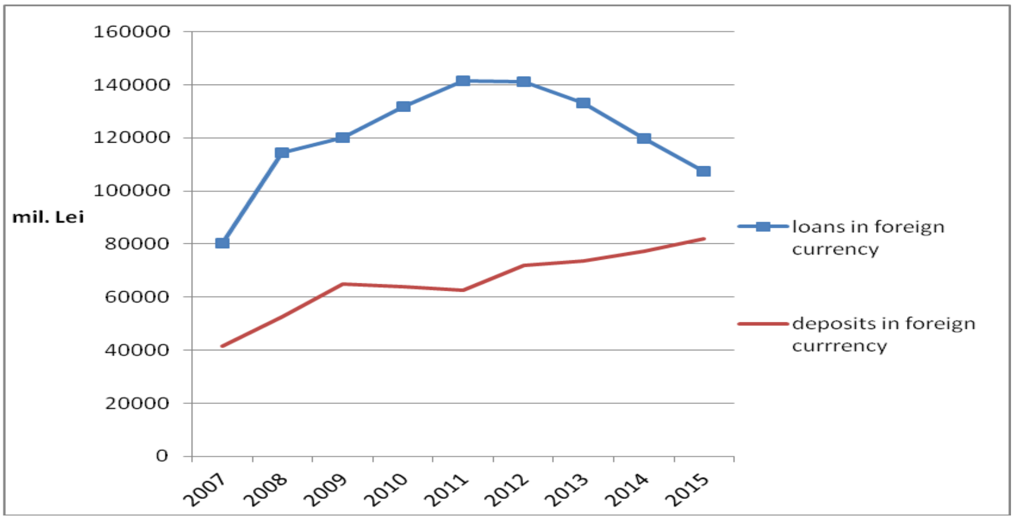
currency (Fig. 6). This calls for further internal reorganization of the commercial banks' portfolios of products and services, so that the banking system and the economy, in general, should feel less and less the burden of loans in foreign currency.

Figure 5 – Deposits in national currency (lei) and in foreign currency in Romania, between 2007 and 2015



Source: NBR data

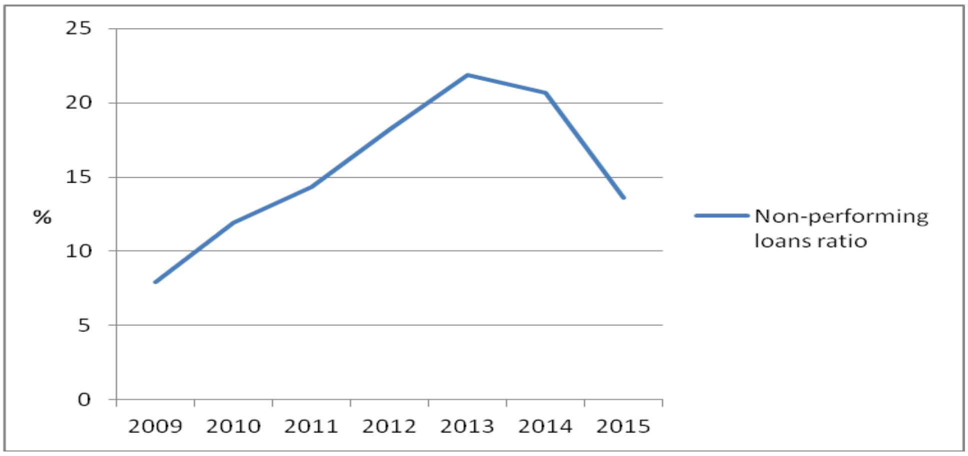
Figure 6 – The evolution of loans and deposits in foreign currency in Romania, between 2007 and 2015



Source: NBR data

We have also analysed the non-performing loans ratio[2]. This indicator (Fig. 7) increased continuously and sharply throughout 2009-2013. Its evolution can be explained by the effects of the economic and financial crisis, which generated the decrease of the incomes and, therefore, the deterioration of the payment capacity of debtors. The shrink from 2014 is caused by the change in the calculation methodology for this indicator[3]. But comparing data calculated according to the same methodology, one can see a reduction tendency of the non-performing loans throughout 2015 compared to 2014.

Figure 7 – The evolution of the non-performing loans ratio in Romania, between 2007 and 2015



Source: NBR data. The data from 2014 and 2015 of the indicator are calculated based on EBA's definition.

The significant stock of non-performing loans hindered the efficient transmission of NBR monetary policy, among others due to the “resistance” of the active and passive interest rates to the change of the monetary policy interest rate, on the background of the commercial banks’ aim to recover the loss caused by loans granted in the past which were no longer given back by the debtors.

[2] The non-performing loans ratio (gross exposure of the non-banking loans and interests classified as second category loss, whose debt service > 90 days and/or for which court actions against the action or debtor have been started/ total loans and interests classified, pertaining to non-banking loans, excluding the elements outside the balance sheet).

[3] As of May 2014, it is no longer calculated the indicator “Non-performing loans ratio”, determined on the basis of the reports done according to NBR regulation no.16/2012 regarding the classification of loans and placements (applicable only to the banks that use the standard approach in assessing credit risk); instead, the indicator is determined on the basis of the reports made by all the banks: both those using the standard approach in assessing credit risk, and those applying internal rating models. It has been replaced by Non-performing Loans Ratio (EBA definition) starting with December 2015 (Non-performing exposures from loans and advances/Exposures from loans and advances). In line with EBA’s definition, implemented in the national framework via NBR Order no. 6/2014, non-performing exposures are those that satisfy any of the following criteria: 1) they are significant exposures which are more than 90 days past due; 2) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past due amount or of the number of days past due.

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Within this context, in 2014, NBR has developed a four-stage plan to clean the portfolios (e.g. excluding from the balance sheets the fully provisioned non-performing loans; whole provisioning and exclusion from the balance sheets of the loans with a debt service over 360 days, as well as of the loans granted to bankrupt companies), which has brought about the reduction of the non-performing loans ratio from 21.9% in 2013, to 13.6% in 2015, but this deteriorated the profitability indicators due to the higher expenditure with provisions (loss of 4.7 billion lei, the highest from the outburst of the crisis) (NBR, 2015).

Another element which influences the mechanism of monetary policy transmission is the structure of the Romanian banking system in terms of the proportion of net assets and social capital of the banks with majority domestic capital within the entire banking system from Romania.

In 2007, in Romania there were 42 credit institutions, 32 of them being banks, Romanian legal entities, while 10 were branches of foreign banks. There were 26 banks with majority foreign capital, 3 credit institutions with majority Romanian private capital and 2 credit institutions with whole or majority government capital.

At the end of 2015, there were a total of 36 credit institutions, from which 7 were subsidiaries of foreign banks. In 2014, there were 40 credit institutions, of which 9 were branches of foreign banks, and 31 Romanian legal entities. In terms of social capital, the Romanian legal entities had the following structure: 25 credit institutions, with majority private foreign capital, 4 credit institutions with majority Romanian private capital and 2 credit institutions with whole or majority government capital.

Although, in the period analyzed, mergers and takeovers have taken place between some of the banks on the money market, the number of credit institutions from the Romanian market, and the structure of the banking system have remained about the same, which shows a rather high stability of the Romanian banking system.

In terms of net assets, according to the balance sheets, the banks with majority Romanian capital held 9.8% in 2014, while the banks with majority foreign capital held 80.1%. The branches of foreign banks held 9.8% (Fig. 8).

Figure 8 – The structure of the Romanian banking system according to the net assets, in the period 2007 - 2014

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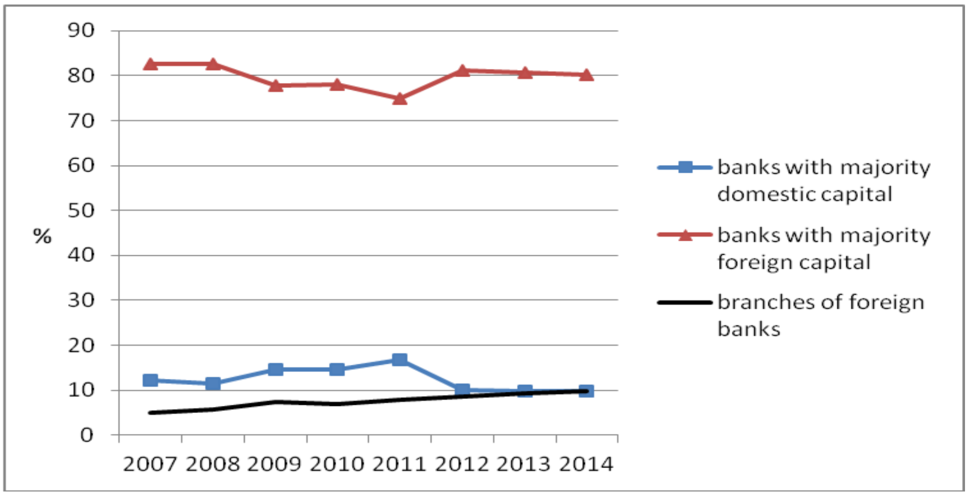

Source: NBR data

Analysing the evolution of the banks with majority domestic capital within the Romanian banking system in terms of net assets (Fig. 8), one may notice that they are clearly dominated by the banks with majority foreign capital throughout the entire surveyed period. Although the proportion of the net assets of banks with majority Romanian capital increased from 2009 to 2011, it decreased afterwards until 2014, included.

The same situation can be noticed in terms of social capital of the banks with majority Romanian capital (Fig. 9). Therefore, the Romanian banking system is strongly dominated by the banks with majority foreign capital.

Figure 9 also shows an unfavourable evolution for the Romanian economy, namely the decrease of the proportion of banks with majority domestic capital within the Romanian banking system, in terms of social capital, starting from 2012, although the trend of this indicator had been ascending from 2007 to 2011.

Figure 9 – The structure of the Romanian banking system according to social capital, in the period 2007-2014

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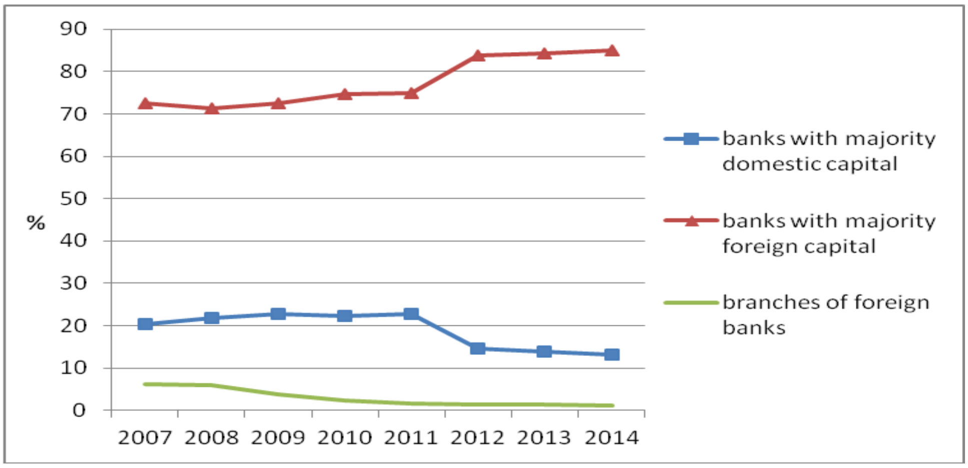

Source: NBR data

Therefore, the domination of the Romanian banking system by the banks with majority foreign capital represents a major hindrance in the transmission of NBR's monetary policy impulse towards the real economy.

Figures 8 and 9 show a rather constant evolution of the Romanian banking system's structure in terms of social capital and of net assets, which translates into a rather significant stability of the Romanian banking system.

Conclusions

Within a context defined by global financial interdependence and increased uncertainty, monetary policy should be characterized by commitment, dynamic consistency, transparency, responsibility, qualitative evaluation, avoidance of excessive fluctuations and flexibility, a set of attributes that unavoidable involve a specific level of complexity (Solans, 2000).

The decrease of loans in foreign currency and the increase of loans in national currency (lei), starting with 2012, has influenced positively the monetary policy transmission in Romania, but this evolution must be supported by a stronger reduction of the euroization phenomenon, in order to allow for a better transmission of monetary policy impulses.

The improved capitalization of the Romanian banking system also concurred to the alleviation of the challenges to the Romanian monetary policy.

On the other hand, the intensification of banks' efforts to clean up their balance sheets affected negatively the profitability of the banking system, with effects towards increased aversion to the decrease of active interest rates, despite the repeated reduction of the monetary policy interest rate.

Among the impediments in the monetary policy impulse transmission towards the real economy, one may mention: the important stock of non-performing loans; the significant dominance of the

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foreign capital within the Romanian banking system and the reduction of the proportion of banks with majority domestic capital within the Romanian banking system in terms of social capital and net assets, as of 2012; the intensification of banks' balance sheets cleaning-up activities.

Based on the analysis in the paper, we can conclude that the monetary transmission mechanism is not working properly in Romania (the commercial banks don't observe exactly the signals transmitted by NBR).

We consider to be necessary a proper mix of macroeconomic policies (monetary, fiscal-budgetary and income) in order to ensure the sustainability of the disinflation process, as well as to anchor the medium-term expectations, with a view to prevent the boost of macroeconomic imbalances and to ensure a sustainable and lasting economic growth. Within this context, fiscal policy must play a key-role in securing the external equilibrium. The fiscal policy should provide more room for manoeuvre for the imbalances between saving and investment in the private sector, and should avoid the adoption of a pro-cyclic behaviour. At the same time, the income policy should not put too much pressure on the demand and should avoid materializing the risk that the rate of wages rise exceeds labour productivity dynamics.

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