Opening Remarks for the 11th edition of the Regional Seminar on Financial Stability

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Welcome

Governor, distinguished guests, it is an honor to give these opening remarks at the annual regional seminar on financial stability.

I would like to congratulate the NBR for their already habitual, but nevertheless always appreciated, organizational abilities. The IMF has supported the National Bank of Romania in organizing this seminar for the past 11 years now and we look forward to our continuous collaboration in years to come.

This seminar is already an established tradition in the region. It is an important forum to update participants on recent trends and developments in the field of financial stability and provides an opportunity for sharing country-level experience. For us at the IMF, it is also an invaluable opportunity to learn from practitioners in our member countries in the region, with a view to disseminating what we learn to other parts of the world which could be facing similar challenges.

Overview[1]

Let me start with a quick overview of developments in Europe. The economic recovery is strengthening and broadening appreciably. In Emerging Europe, actual growth is exceeding trend in many countries, with several economies experiencing positive output gaps for a while now. Also, in many emerging economies, unemployment has returned to levels prevailing before the global financial crisis and most emerging European economies are now seeing robust wage growth, in some cases beyond productivity increases. Regarding inflation, most emerging European economies (notably, in Central and Southeastern Europe) have witnessed similar developments: somewhat higher but still low inflation since early 2017, notwithstanding an acceleration of wages. Nonetheless, expectations point to further increases in inflation.

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[1] This section draws from the upcoming issue of the Regional Economic Outlook prepared by the IMF's European department.

Looking forward, risks to the outlook appear more balanced over the near term, but are still tilted to the downside over the medium term. There is even some upside to the IMF's projections in the short run, as we may underestimate the vigor of the recovery. A crucial question is how sustainable the rebound is. Over the medium term, adverse demographic trends and subdued productivity are likely to hold back growth. Business survey data indicate that shortages of skilled labor are seen as beginning to constrain the expansion. Moreover, the outlook is subject to a number of important domestic and external downside risks.

Perhaps the key message from the latest issue of the IMF's World Economic Outlook[2], is that policymakers should take advantage of the improved prospects in the world economy to rebuild room for fiscal policy maneuver and enhance the economy's capacity to grow and absorb shocks. That is, we need to prepare for a rainy day now that the sun is finally shining. This message is relevant for Europe and especially for financial systems, as interest rates will likely rise over the medium run.

Today and tomorrow we will be discussing some important areas in which financial systems can be better prepared to maintain financial stability when times are less bright.

Developments in Romania

I would like to turn now very briefly to developments in Romania. In the last few years, there has been very significant progress towards strengthening the Romanian banking system. And not in an insignificant part, because of the professional and perseverant work of the NBR. Just to name a few key developments:

- The NPL ratio fell to around 8 percent from a peak of 22 percent in 2014, reflecting write-offs and sales encouraged by the NBR. This is one of the sharpest declines in Europe and it should serve as a model to other countries facing high levels of NPLs.

- The banking system, on average, continues to enjoy comfortable levels of capital adequacy and liquidity, and profitability has improved.

- The risk from legislative initiatives which could have posed substantial risks to financial stability has abated.

Nevertheless, rising lending to households and substantial banks' exposure to the sovereign, highlight the need for continued monitoring and to continue strengthening the preparedness of the NBR.

[2] https://www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017.

A week from today, a joint mission from the IMF and the World Bank will arrive in Bucharest to start work on the regular assessment of Romania's financial system (or FSAP). The last FSAP was conducted in 2009. The report with the conclusions and recommendations of the current exercise will be published in the first half of next year.

The FSAP will complement the work done by the NBR in several areas, including:

- Stress tests to help quantify risks from the main domestic vulnerabilities;
- A detailed Basel Core Principles (BCP) assessment, which will pay special attention to credit risk, the ongoing shift to risk-based supervision, transition to IFRS 9, and operational risks related to fraud;
- Macroprudential analysis to look at both NBR internal and external decision-making structures;
- An analysis of crisis management and resolution arrangements, with specific attention to the practical implementation of the EU resolution framework in Romania; and
- Access to finance and provision of non-bank financial services, including impediments to the granting of loans to SMEs, the regulation of buyers of NPLs, as well as the regulation of non-bank financial institutions.

First topic: Dealing with NPLs

Despite the progress made here in Romania in reducing NPLs, dealing with the high volume of bad debt is still an important issue, also in several advanced as well as emerging European countries. In particular, NPLs have been declining across Emerging Europe but remain higher than 10 percent in 8 countries, and this impacts economic performance. While disentangling demand and supply effects is difficult, high NPLs in several economies appear to be a factor that is hindering credit growth. Equally, or even more important, is the need to prevent the excessive rise of NPLs the next time the cycle turns.

Tackling NPLs requires a comprehensive strategy and the involvement of many stakeholders. The main elements of such a strategy should include efforts in three main areas: (i) loan loss provisioning; (ii) loan write-downs of NPLs, in whole or in part, where collection is unlikely; and (iii) collateral valuation. These efforts should be supported by enhanced supervisory guidance, supervisory reporting, and risk disclosure. Moreover, this should be complemented by efforts to improve banks' early warning systems (EWS), and to develop the market for NPLs.

Today, we will have the opportunity to discuss these issues in more depth.

Second topic: "fintech"[3]

We will also have a session on fintech, to which I am particularly looking forward to. This is obviously an area where we are seeing only initial developments, but where new advances in technology will surely lead to financial innovation in unanticipated forms. This creates opportunities and challenges for consumers and service providers. And the same goes for regulators. The key challenge for the latter is to find a balance between efficiency and stability tradeoffs in the face of rapid changes. They will need to make sure that risks to stability and integrity –including from cyberattacks, money-laundering and terrorism financing—can be effectively managed without stifling innovation.

Fintech is also an international issue. With the blurring of boundaries among entities, activities, and jurisdictions, policymakers need to consider implications for common standards and legal principles. International cooperation will therefore be essential, and the IMF is well placed to play a significant role.

Research on financial stability by young professionals and other topics

This afternoon we will have also a session devoted to research by the NBR's young economists. I think this is a very welcome addition to this year's seminar to showcase the good work being done at the National Bank.

Finally, we will also have the opportunity to discuss matters related to regulatory challenges and banking resolution. These are areas where many issues remain unsettled and are being intensely debated. This bodes well for interesting discussions.

Conclusion

To conclude, let me reiterate the IMF's strong commitment to support your efforts to strengthen the environment for financial stability in the region. Strong and sound financial systems are a key ingredient towards the common goal of improved economic welfare.

I look forward to the panelists presentations and tomorrow's high level roundtable. Let me finish here and wish the seminar a great success. Thank you!

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[3] This section draws from He et. al (2017), Fintech and Financial Services: Initial Considerations, IMF, staff discussion note.