BANCA NAȚIONALĂ A ROMÂNIEI

Romania - Financial sector

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Deputy Governor

EBRD, Nicosia, May 11th, 2017

The role of National Bank of Romania

- The role of Central Banks: secure price stability; additionally, secure financial stability and exchange rate stability
- NBR has reached all three stabilities

Price stability

- Interest rates historically low
- Low inflation, not deflation

Financial stability

- Reduced risk of legislative uncertainty
- Banking sector has been consolidated
- NPL ratio decreased
- No use of public money to save banks

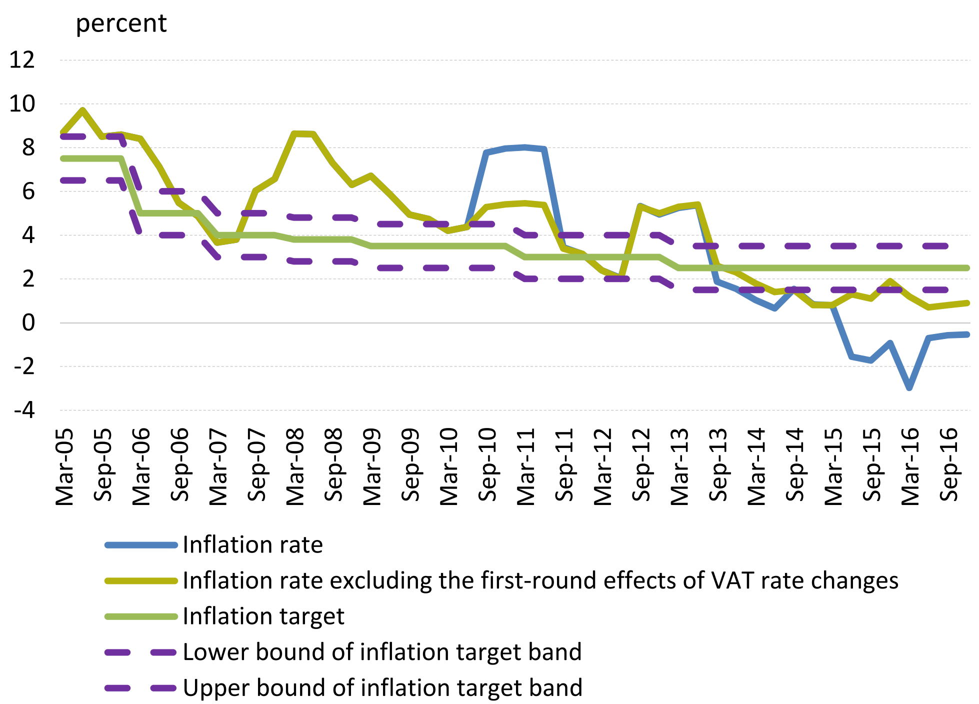
Exchange rate stability

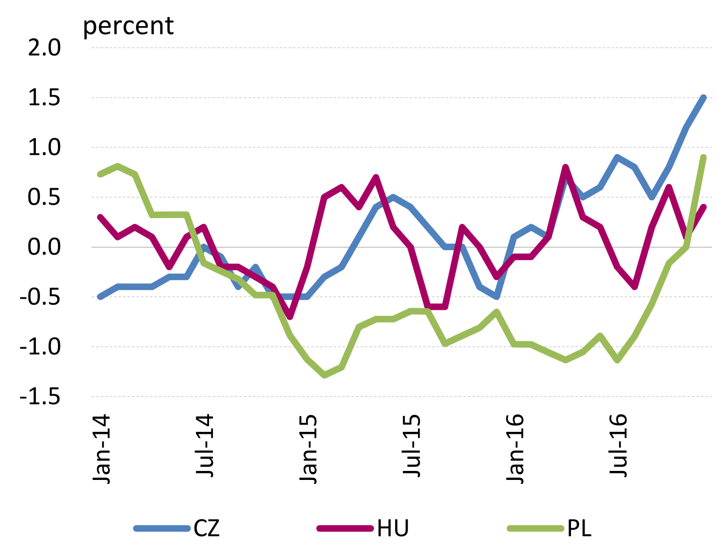
- Higher net international reserves
- Low volatility of the exchange rate

I. Price stability

I.1. Low inflation, not deflation

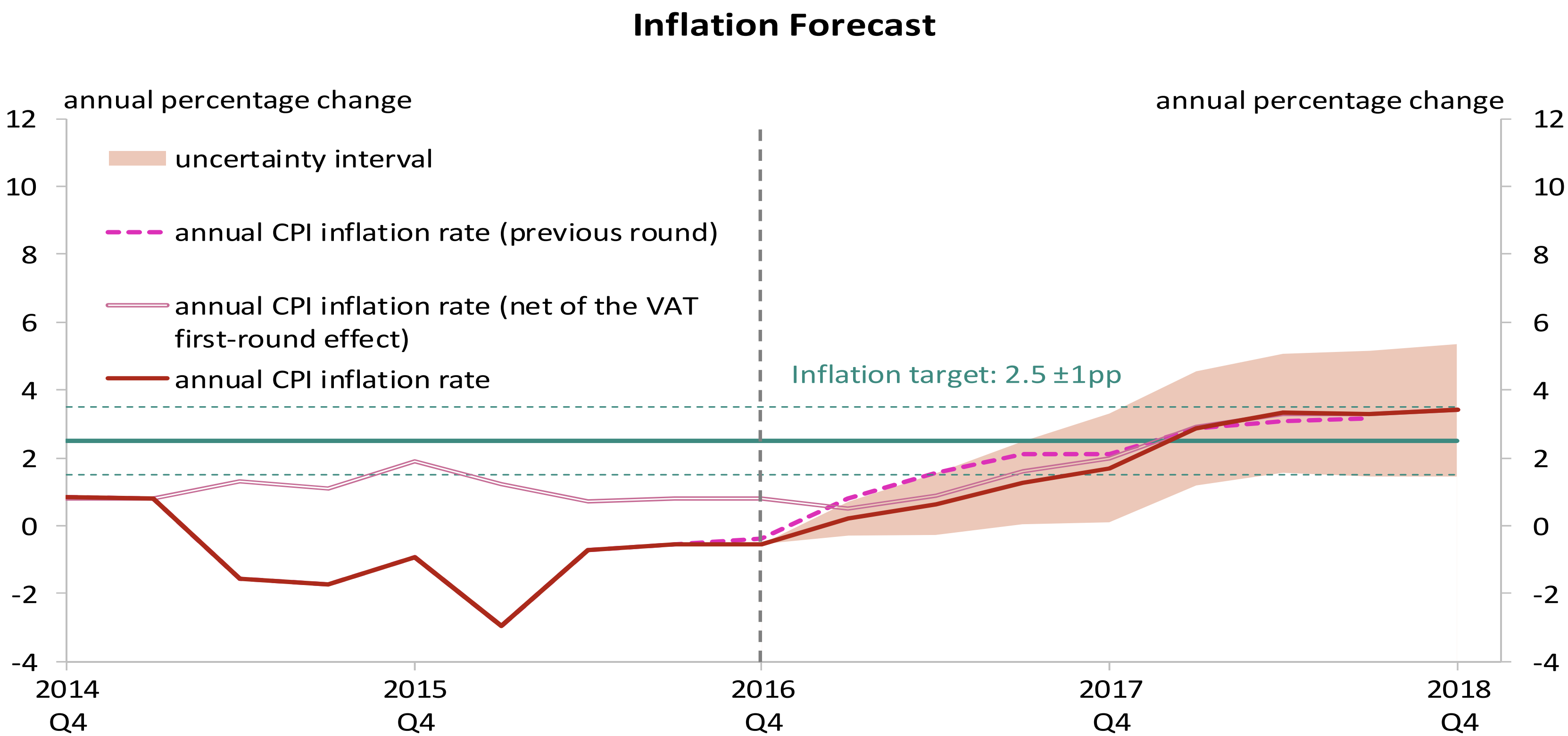
Inflation rate





Source: NBR

Inflation has re-entered into the positive territory

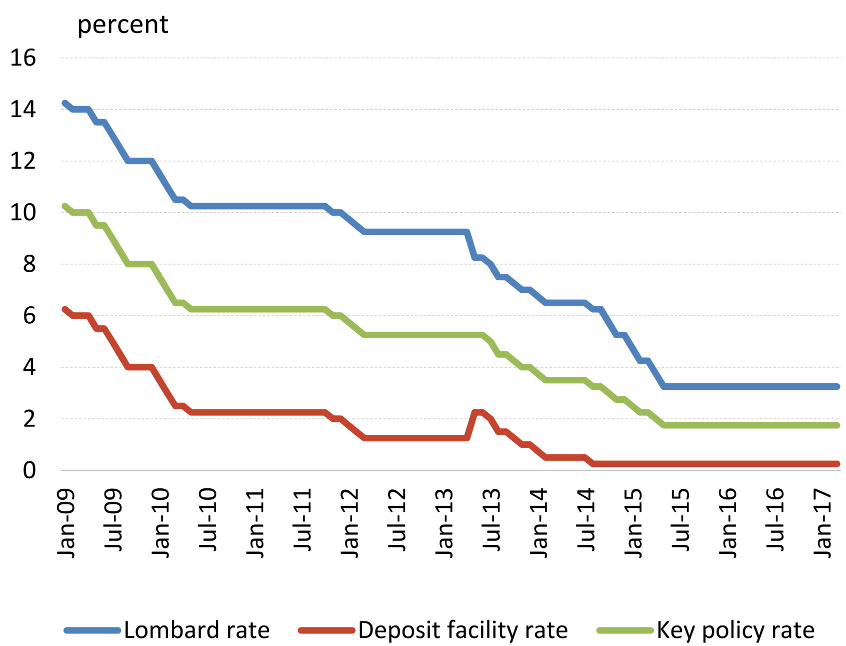


Note: According to the February 2017 Inflation Report. The uncertainty interval was calculated based on the forecast errors in the NBR projections during 2005-2016. The magnitude of forecast errors is positively correlated with the time horizon they refer to.

Source: National Institute of Statistics, National Bank of Romania projections and calculations

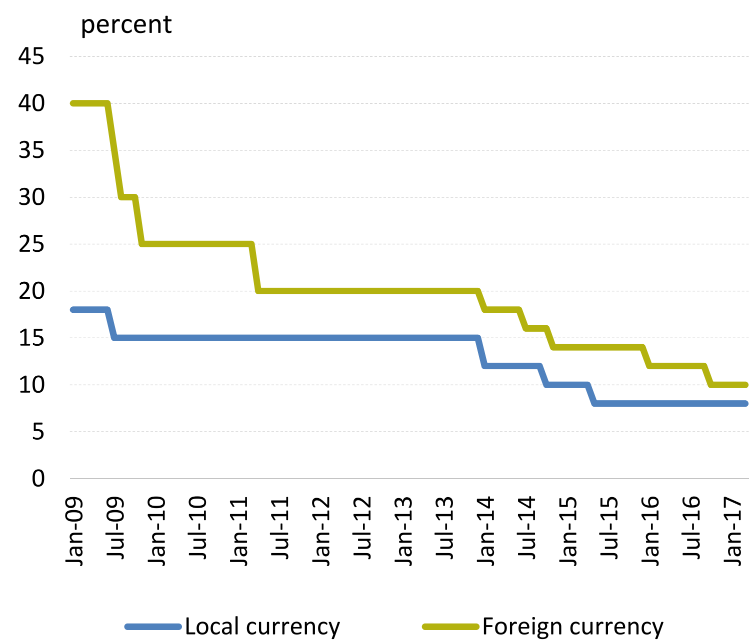
I.2. Favourable monetary conditions: Monetary policy rate at historical lows

Central bank's interest rates



Source: NBR

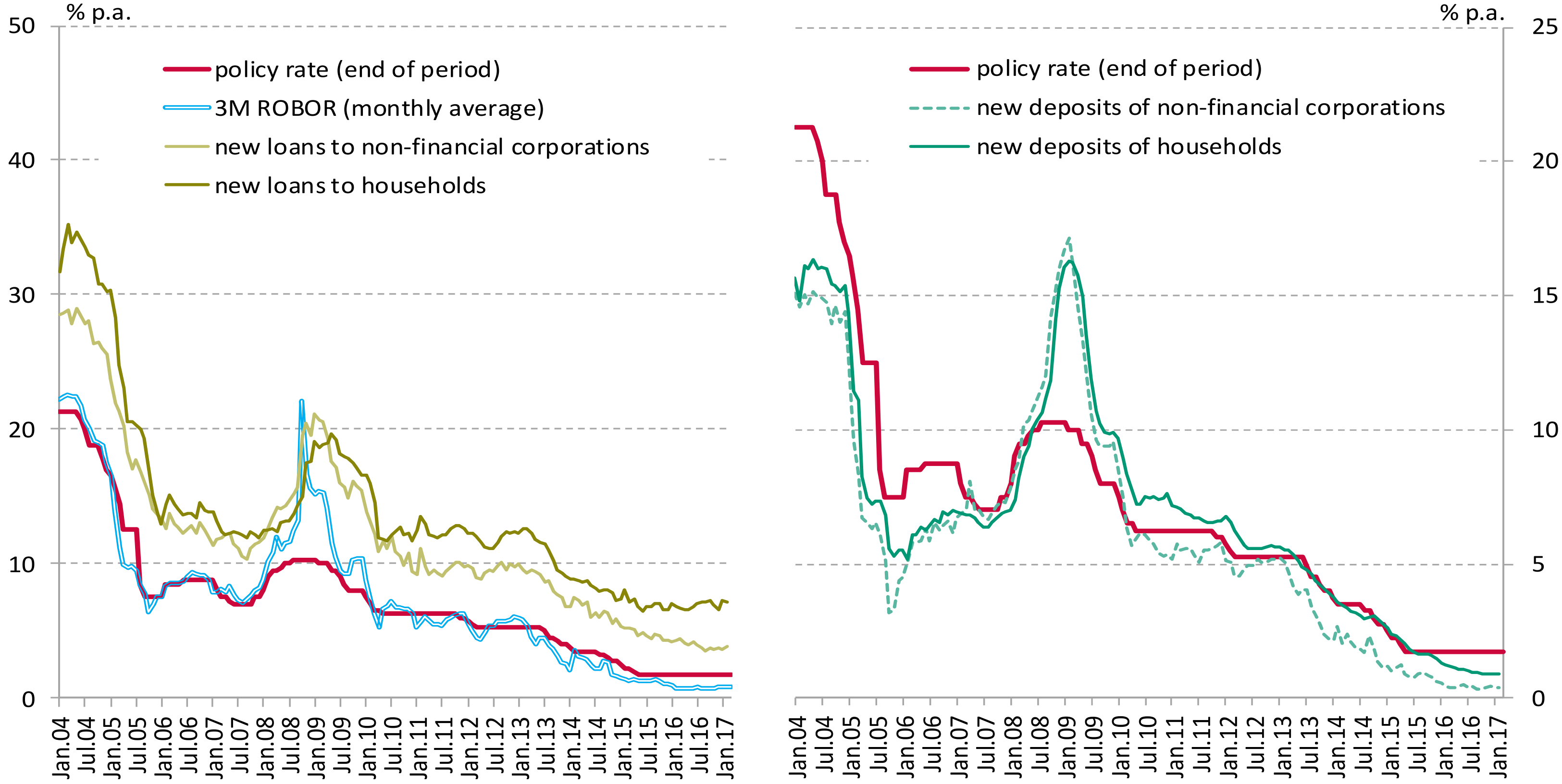
Minimum reserve requirements



Source: NBR

Interbank rates declined in line with the policy rate

Policy Rate and Bank Interest Rates to Non-Bank Clients



Source: National Bank of Romania

II. Financial stability

II.1. Reducing the risk of legislative uncertainty

- **Datio in solutum law (cont.)**

NBR warned repeatedly, through all Executive Board members, against the negative impact of this law on financial stability.

BNR intervened in this debate because it answered to the requests from the President and Parliament.

Financial Stability Report 1/2016 considered legislative uncertainty as a severe systemic risk.

Three amendments proposed by NBR were adopted, limiting the amount and destination of loans, and excluding First House loans.

Other amendments proposed by NBR referring to loan to value and debt service to income limits were rejected.

NBR's position was aimed at preserving financial stability, while making sure that the law helped only those debtors who could not afford to pay anymore, not those who didn't want to pay anymore.

II.1. Reducing the risk of legislative uncertainty

❑ Datio in solutum (giving in payment) law

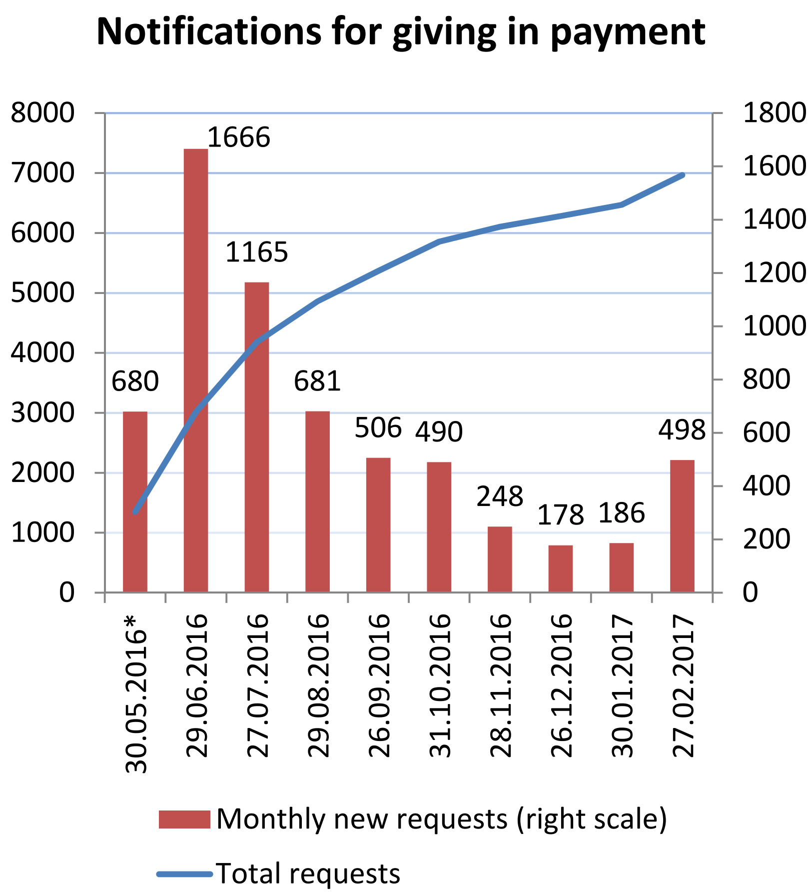
The Constitutional Court decided that the law must respect the Civil Code, so the debtor must prove that: he/she entered into default because of unpredictable circumstances (the debtor can't pay); and that he/she tried to settle with the bank; and a court of law must decide that.

Therefore, the law is no longer a loss event for banks at the moment of adoption, but only on a case by case situation, when a court decides so. Losses are phased-out over many years.

However, problems remain: debt does not go away, and the need for a solution remains. There is no standard for what unpredictable means (what is the trigger?)

Common understanding and common practice is still needed.

Number of notifications for giving in payment has consistently declined



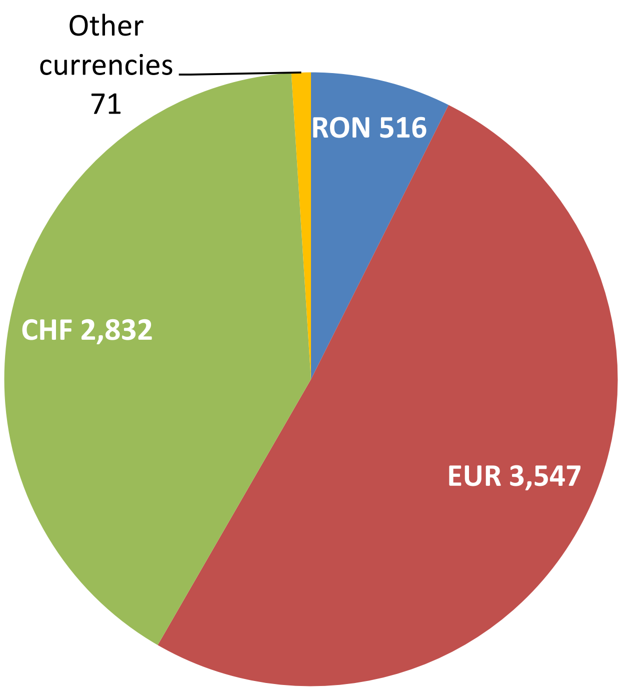
- 6966 notifications (of which 99% from physical persons)
- 6023 debtors (of which 755 notified more than one loan)
- loans amounting to 2 billion lei
- 67% are on balance sheet
- 93% are for foreign exchange loans (40% in CHF)
- 62% are NPLs
- 76% were granted in 2007-2008
- More than 90% have LTV>1

Source: NBR

Source: NBR

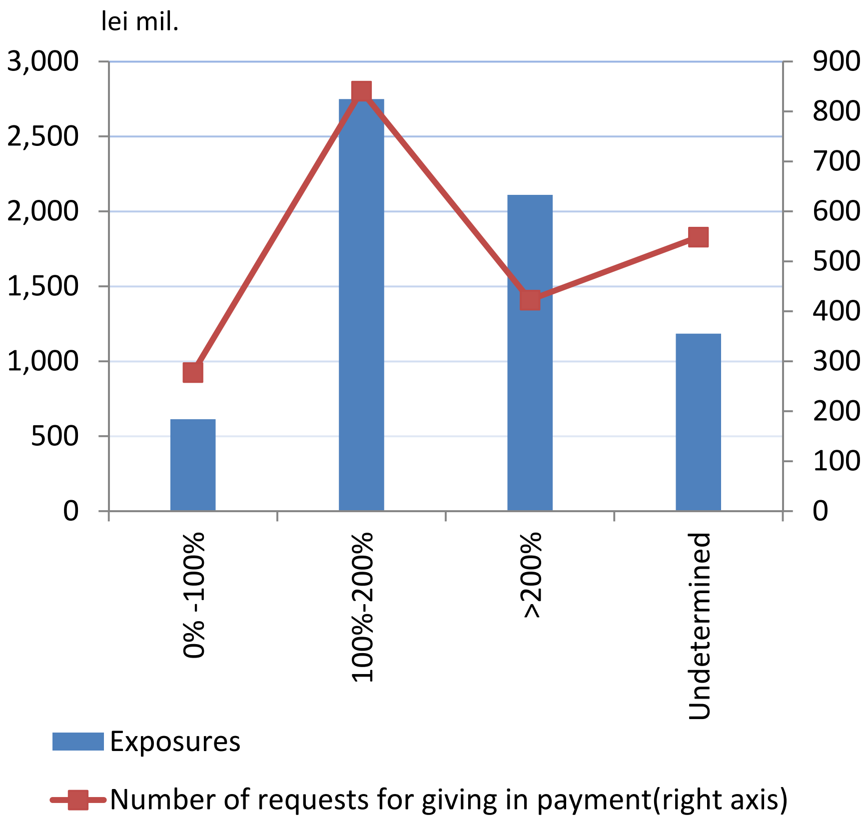
Majority of giving in payment notifications are for FX loans and for loans with LTV above 1

Structure of the giving-in-payment requests by denominating currency



Source: NBR

Distribution of giving in payment loans by LTV



Source: NBR

II.1. Reducing the risk of legislative uncertainty (cont.)

CHF conversion law

The CHF conversion law was adopted by the Parliament, but the Constitutional Court decided that the law is not constitutional.

The NBR advocated for a bilateral negotiation between banks and debtors with CHF loans. One size fits all is not the best option, each particular case requires individual solution.

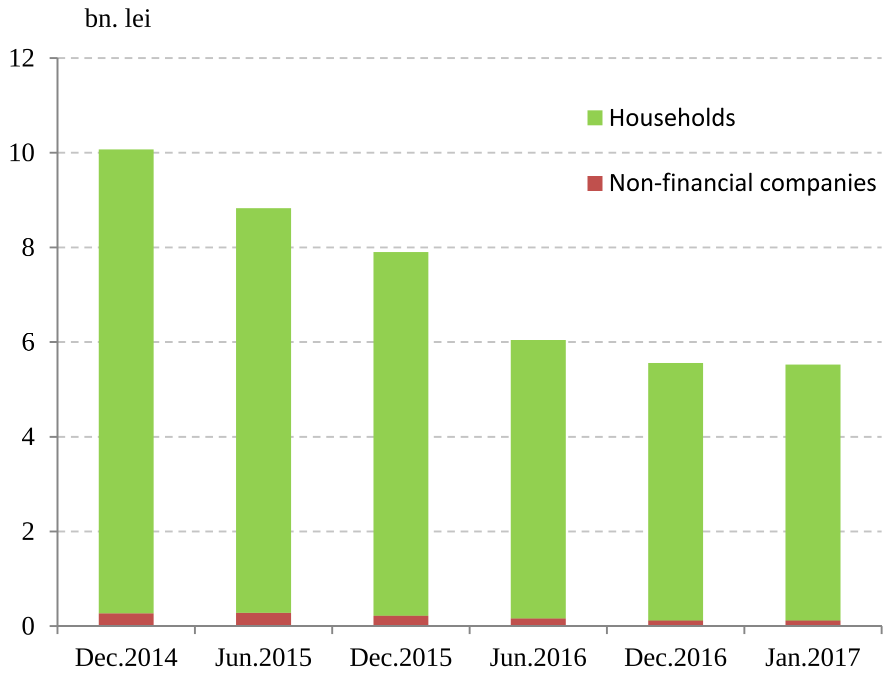
As of January 2017:

- 38 443 CHF debtors (vs. 75412 at end-2014)
- Volume: 5.4 billion lei (vs. 10 bn. At end-2014)

Since January 2015, banks received 59411 requests from debtors regarding CHF loans, of which they admitted 37366 (62.9%): 24853 conversions and 12513 restructurings.

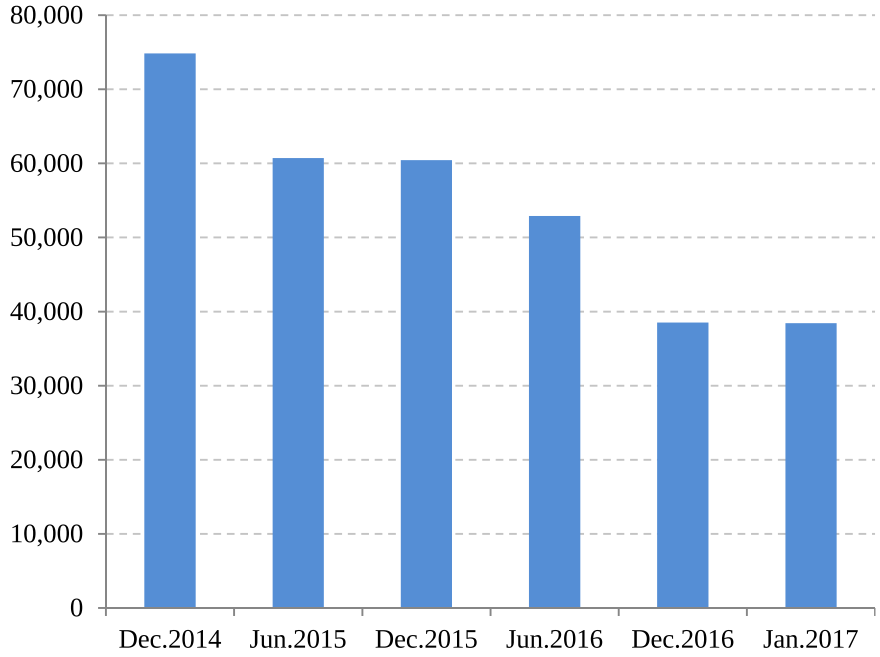
Stock of CHF loans significantly declined, as well as the number of debtors with CHF loans

Stock of CHF loans



Source: NBR

Number of persons with CHF loans

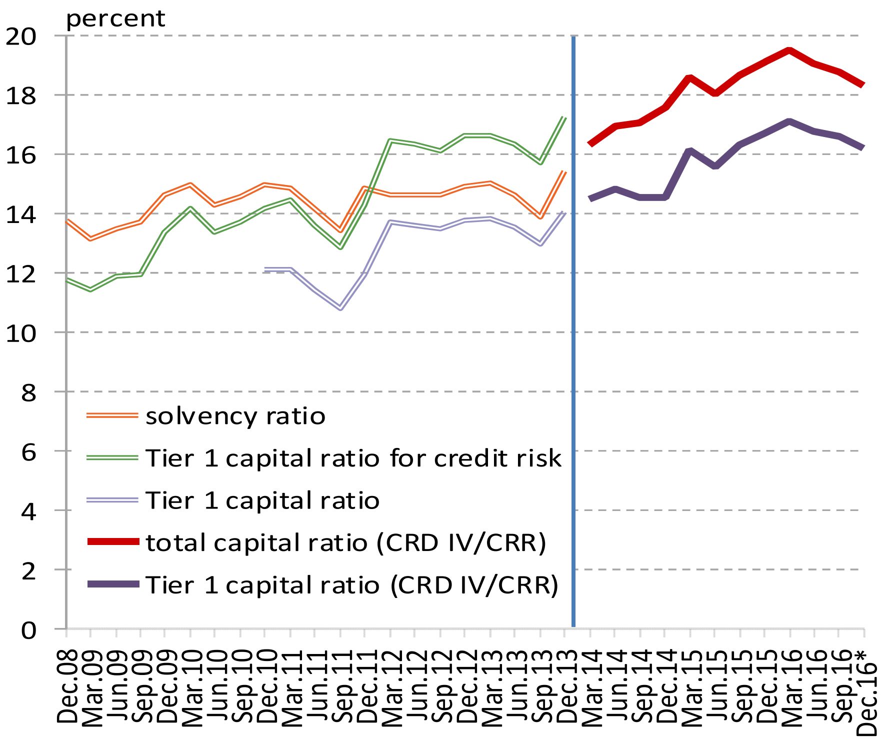


Source: NBR

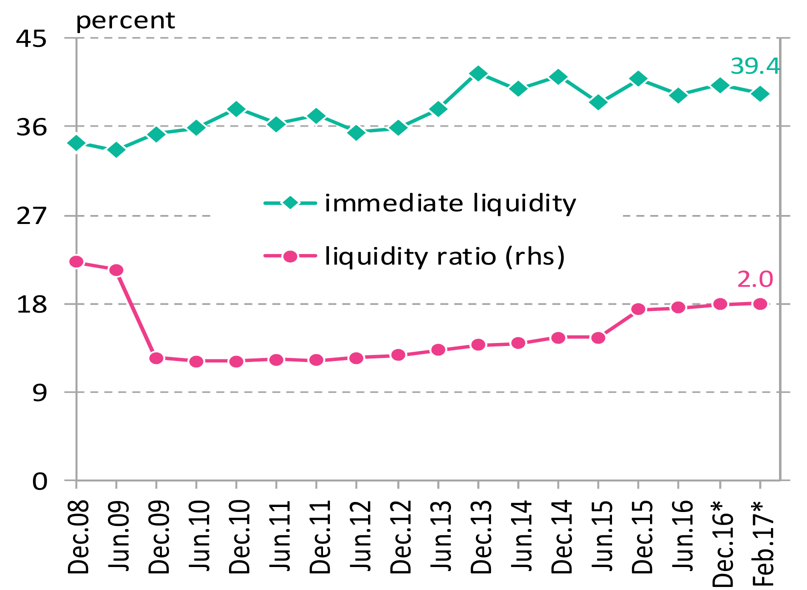
II.2. Banking sector

Analysis Ratios for the Banking System

Capital adequacy indicators



Liquidity indicators



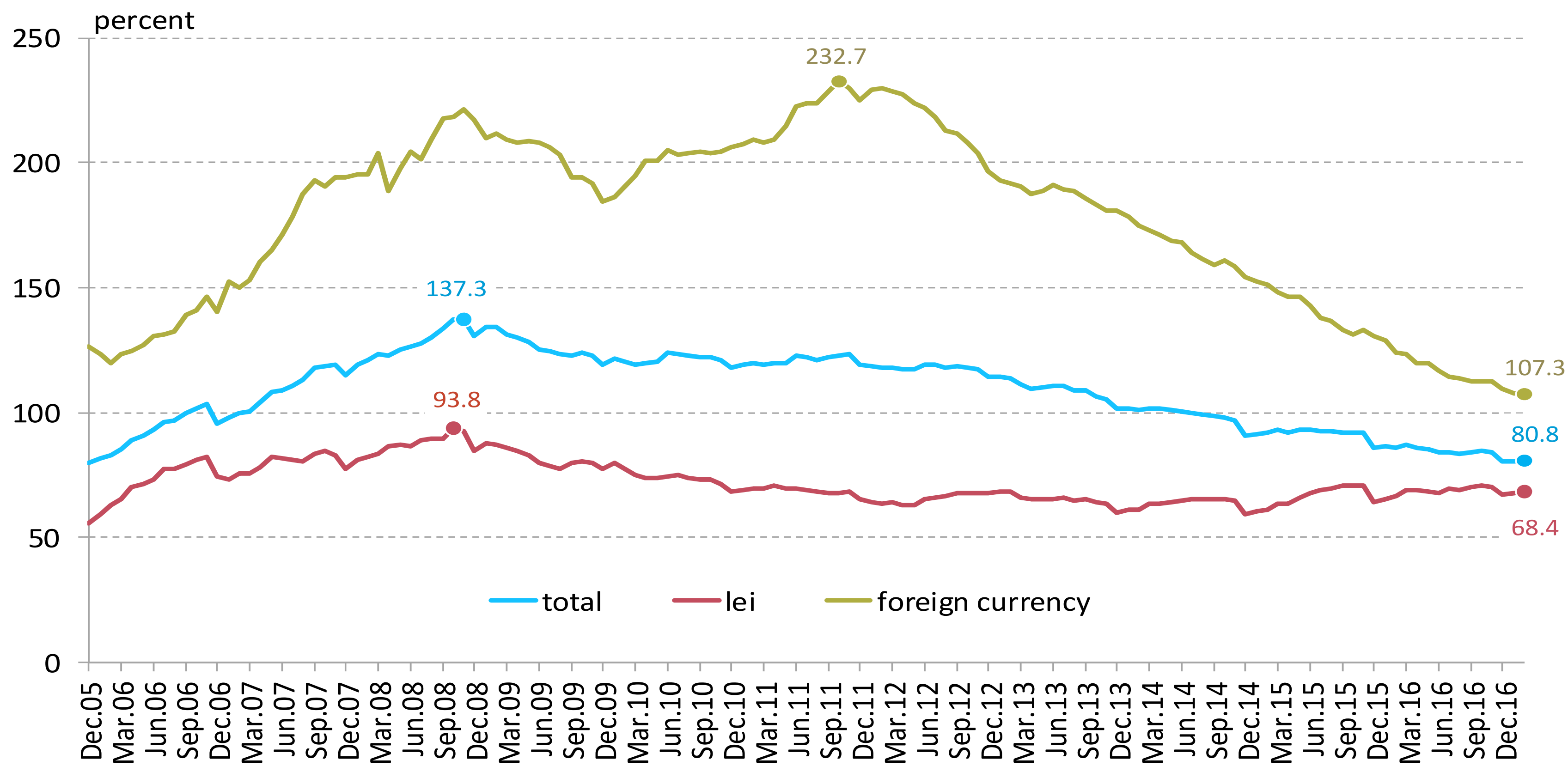
Immediate liquidity = (cash, demand deposits and time deposits with banks+ unpledged government securities)/ Total liabilities (prudent level > 30%)

Liquidity ratio = effective liquidity/required liquidity (regulated threshold = 1)

*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

Source: National Bank of Romania

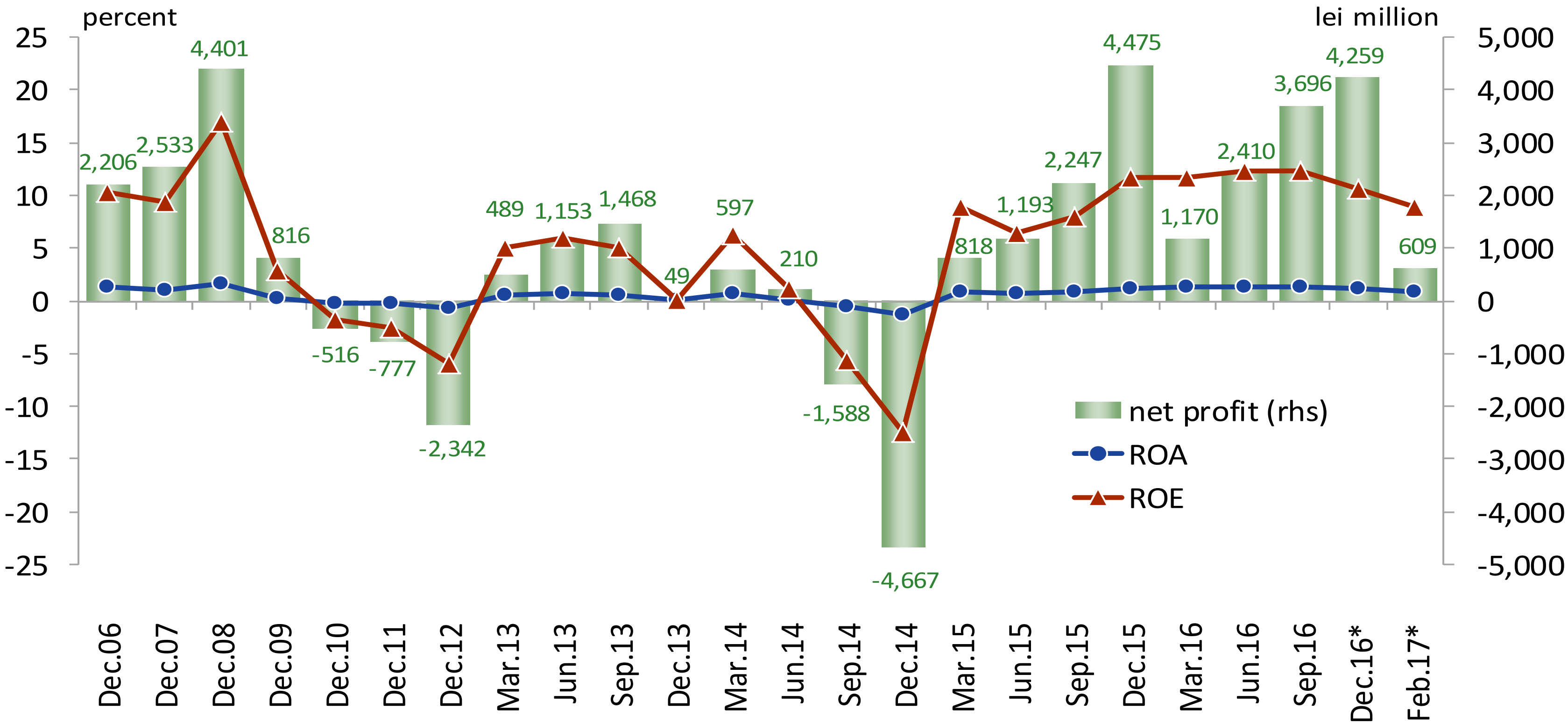
Loan-to-Deposit Ratio*



*) based on data in the monetary balance sheet

Source: National Bank of Romania

Banking System Profitability



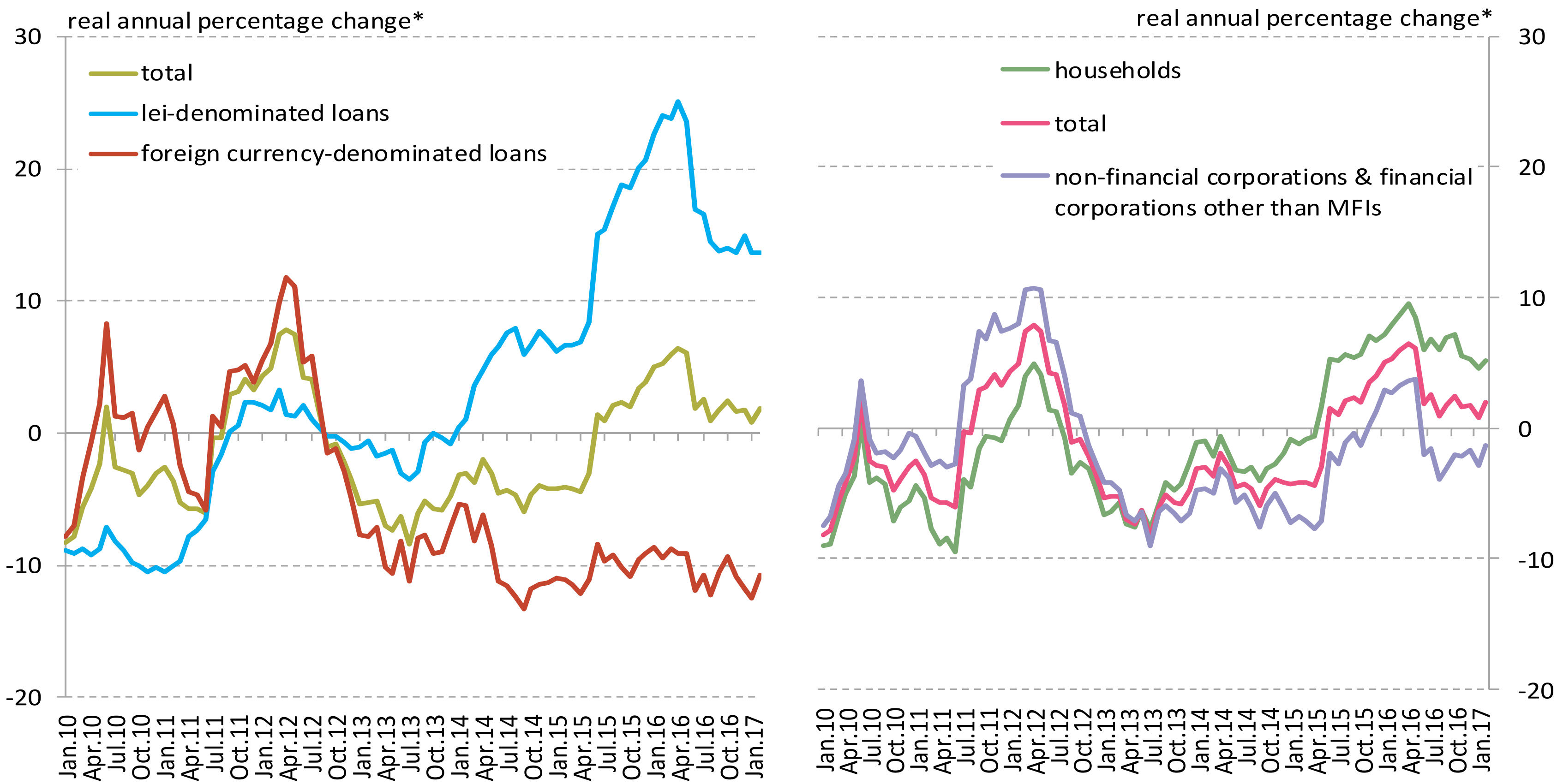
*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

Note: Starting January 1, 2012, Romanian credit institutions apply the IFRS for accounting purposes.

Source: National Bank of Romania

Loans to the Private Sector

– stock –

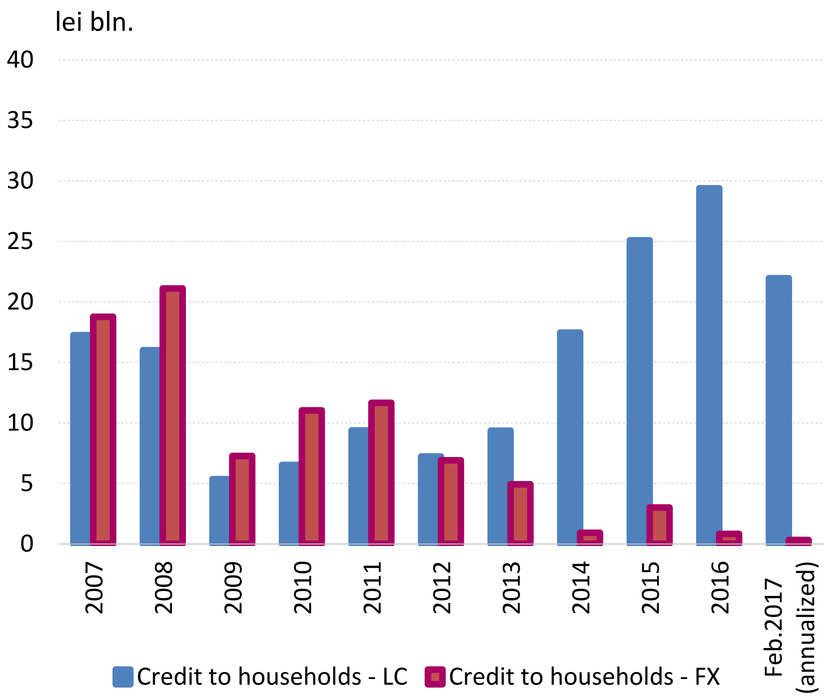


*) based on CPI

Source: National Institute of Statistics, National Bank of Romania

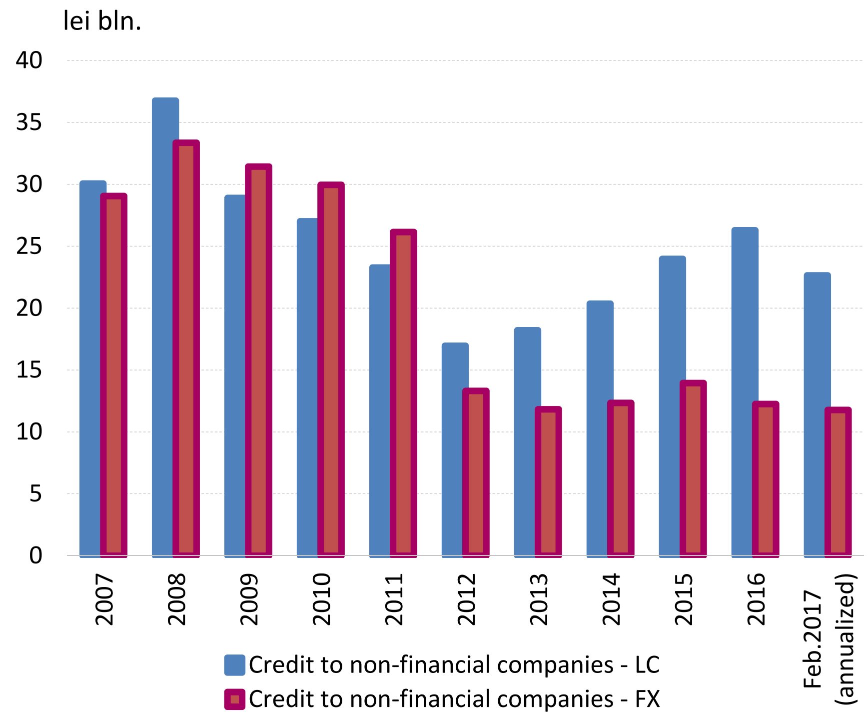
Lending in local currency accelerated, in particular to households

New loans to households, by currency



Source: NBR

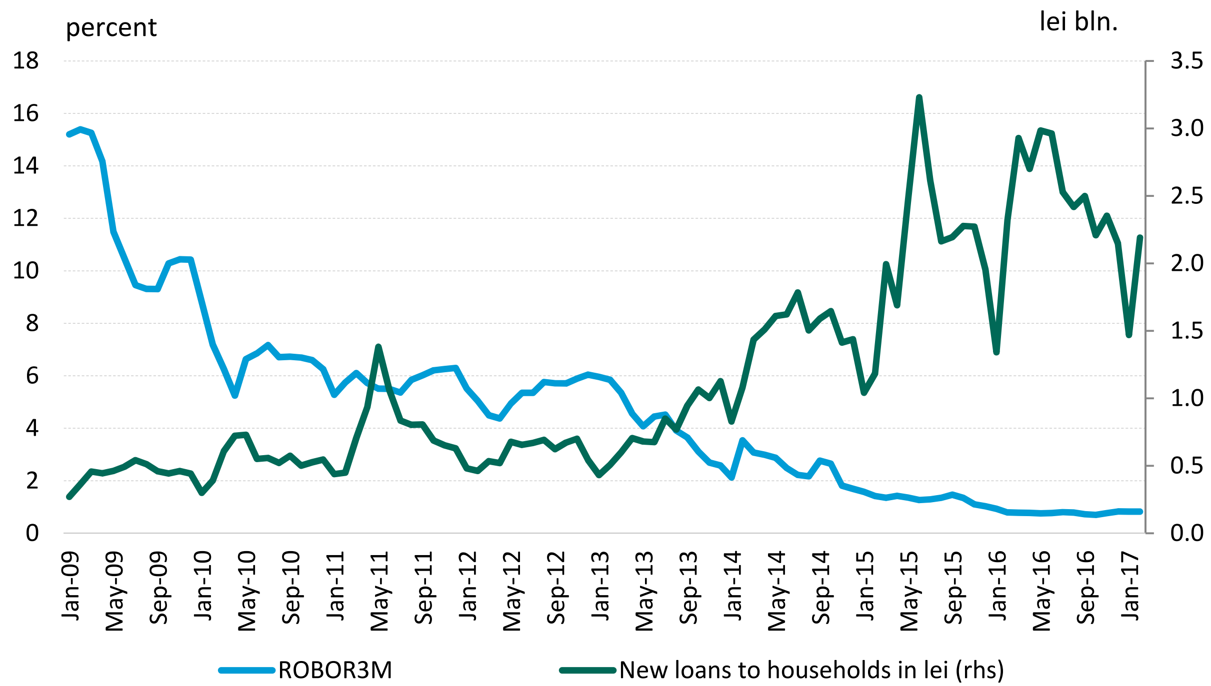
New loans to non-financial companies, by currency



Source: NBR

Lower interest rates has stimulated lending in local currency

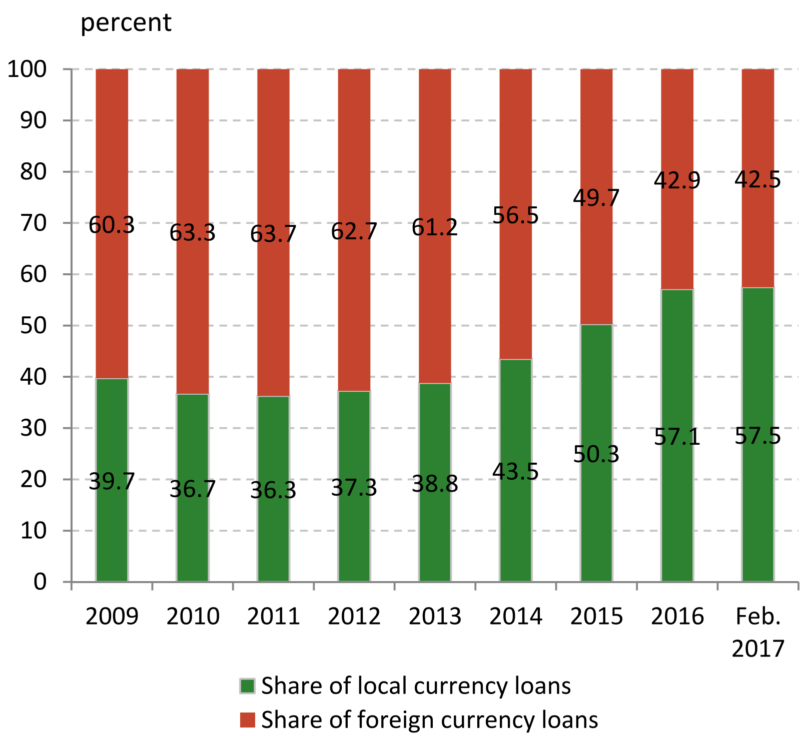
Money market interest rate and credit growth in local currency



Source: NBR

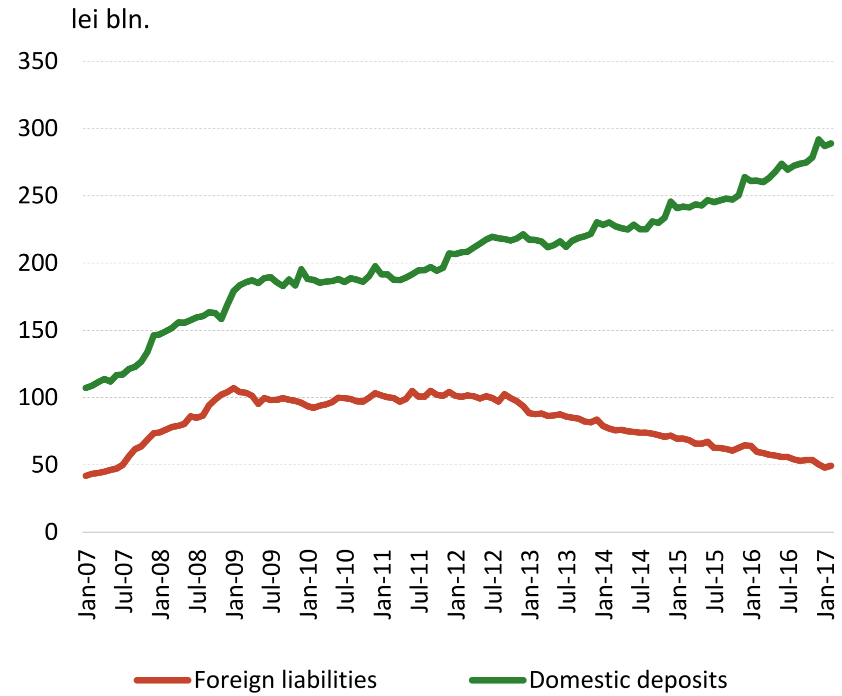
Bank funding evolved towards less contagion risk

Structure of banks' credit portfolios by currency (end of year)



Source: NBR

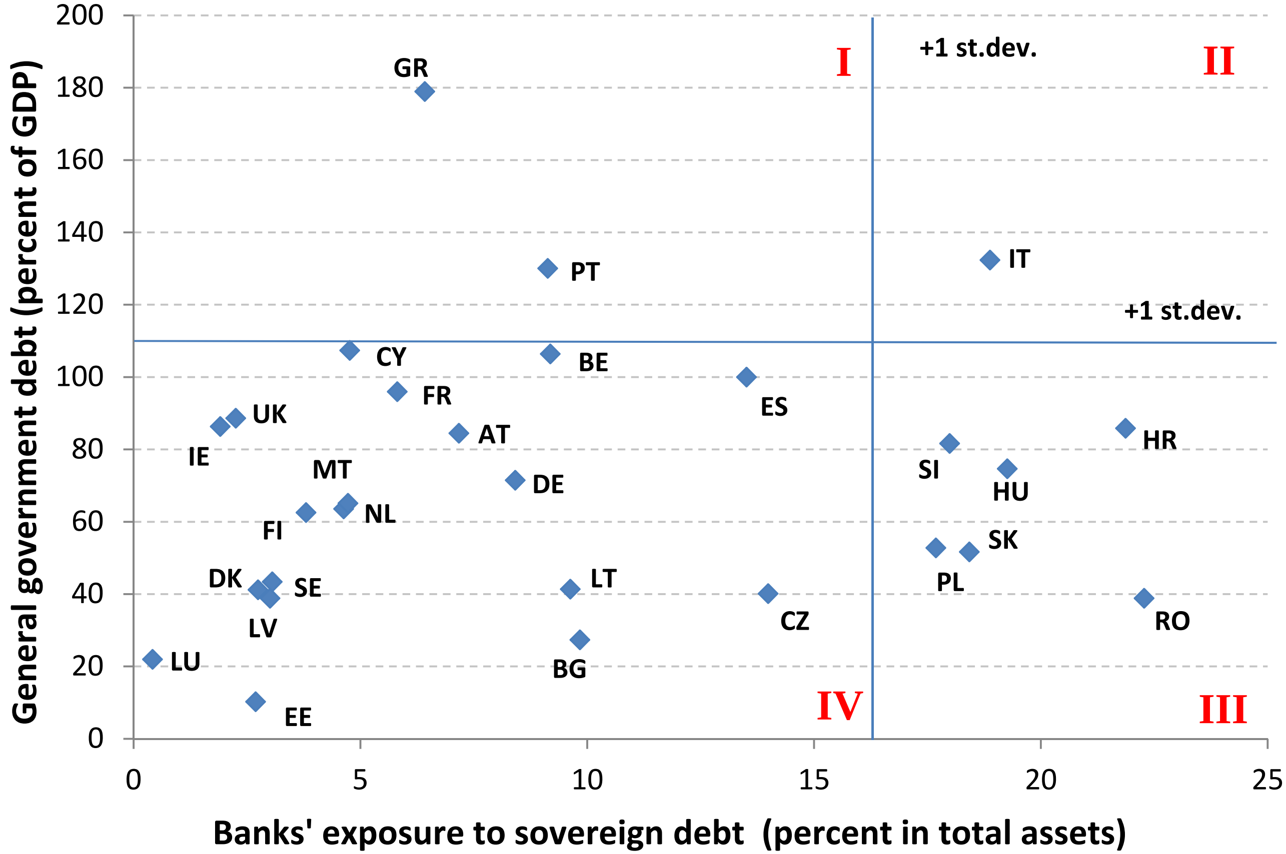
Banks' funding (annual change)



Source: NBR

Sovereign – debt nexus

Share of other MFIs credit to domestic general government in total assets (3 year average, 2014 – 2016) and government consolidated gross debt (percentage of GDP, 3 year average, 2014 – 2016) in EU

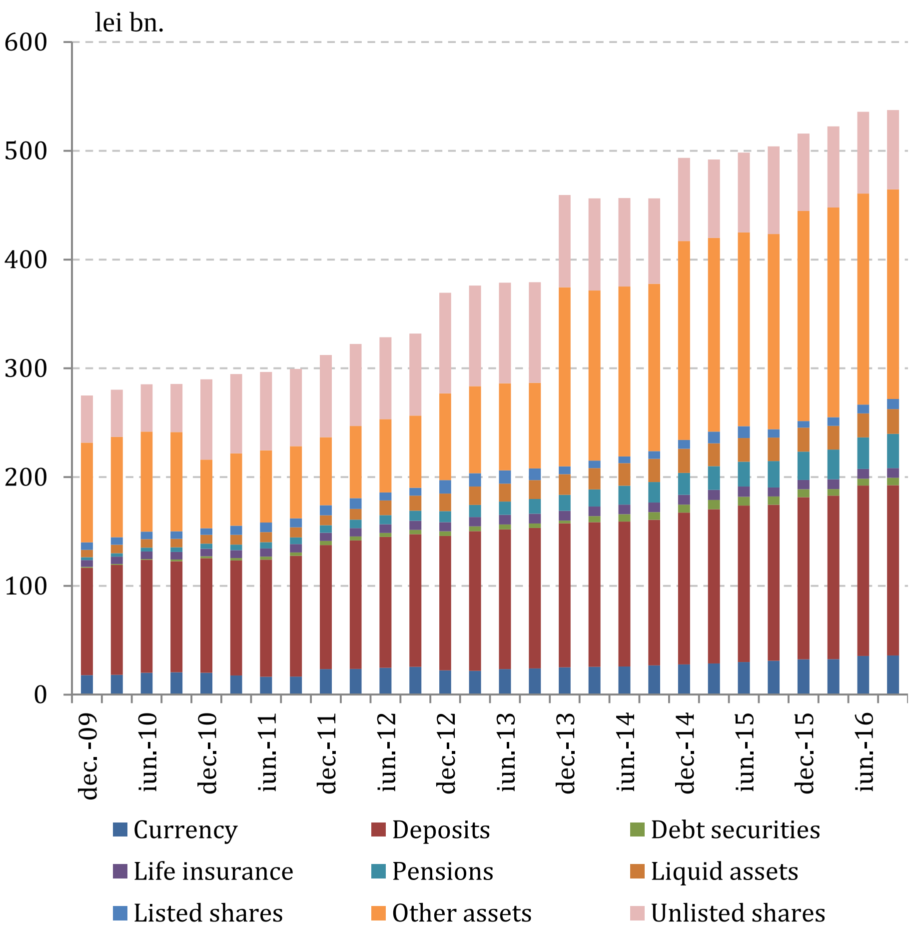


Note: the blue lines refer to the average + 1 st.dev of central government debts and the average + 1 st.dev. of banks' exposures to sovereign debt

Source: ECB, Eurostat

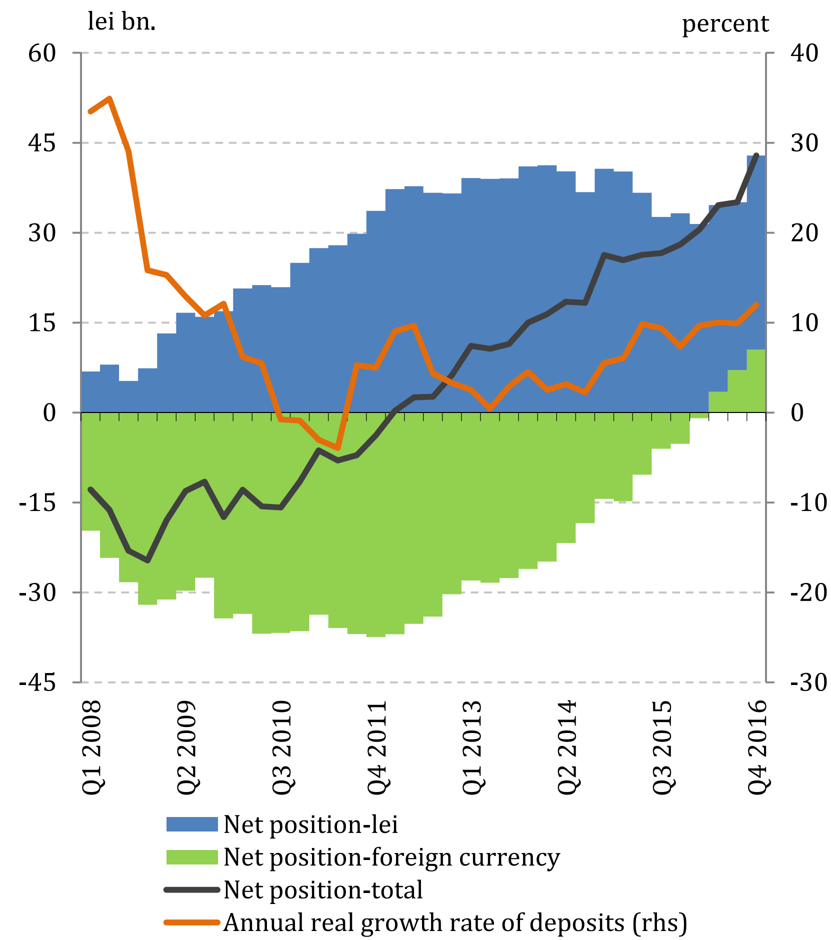
Households' financial assets

Financial assets held by households



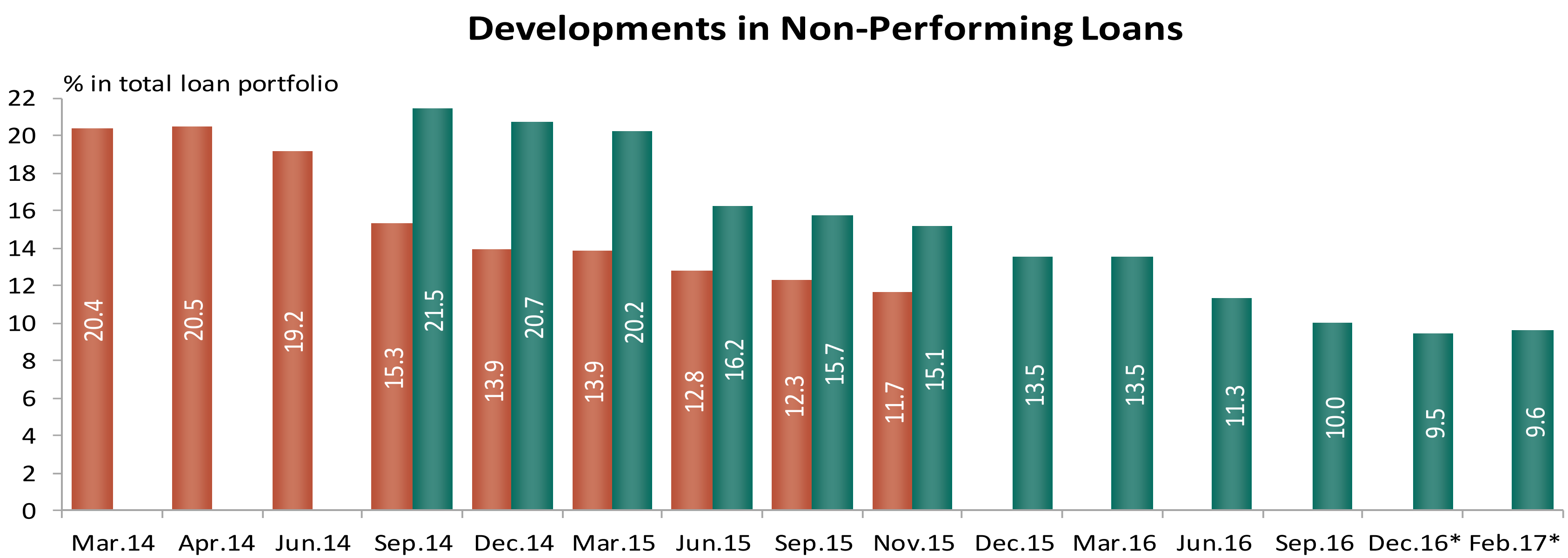
Source: NBR

Households' net position to banks and NBFIs (including loans sold)



Source: NBR

II.3. NPLs continued to decline



*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

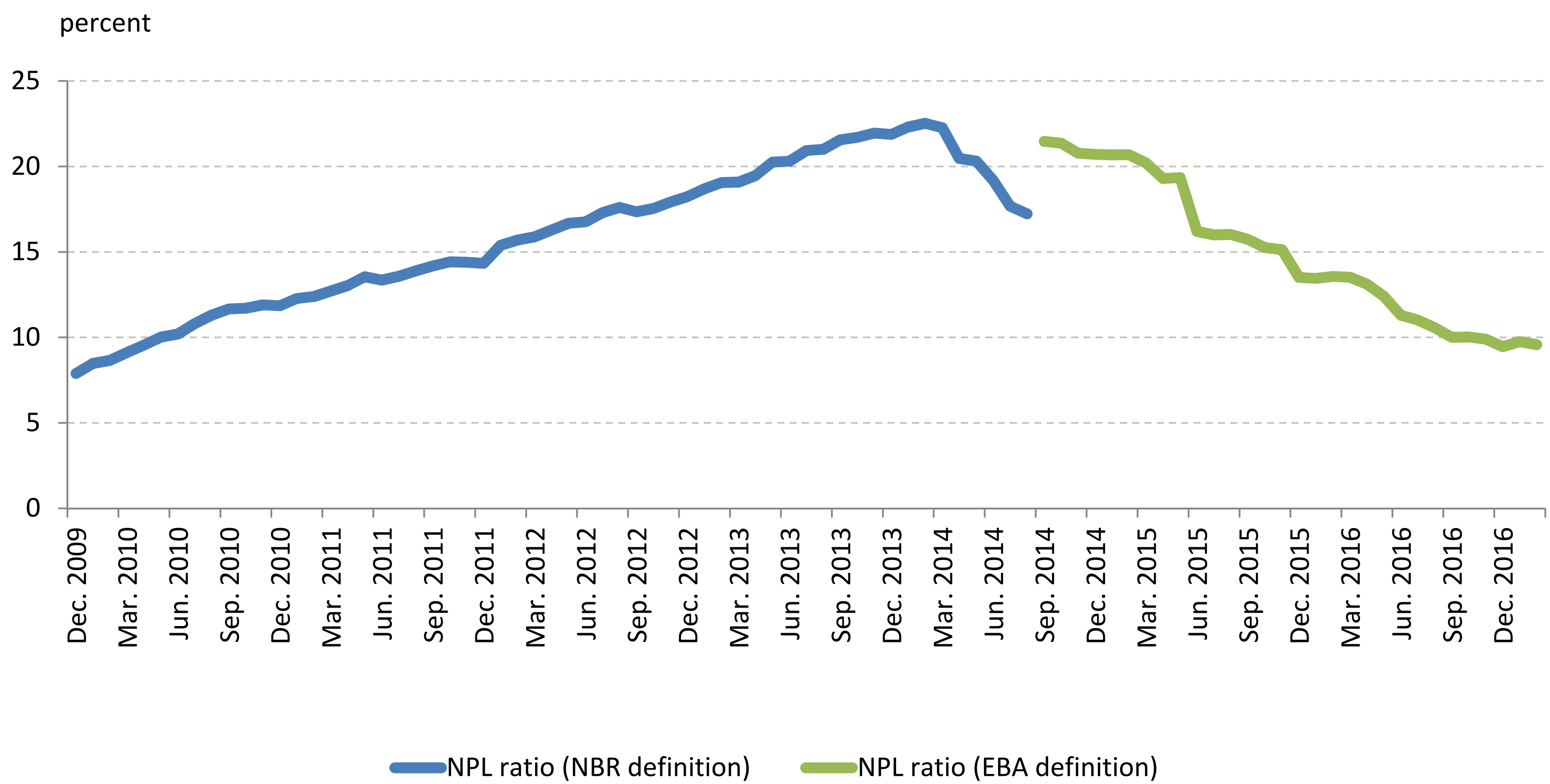
Indicator calculated based on prudential reports submitted by all banks (both banks that determine the minimum capital requirement for credit risk based on the standardised approach and banks using internal models-based approach) for loans meeting the non-performance criteria (debt service longer than 90 days and/or where judicial proceedings have been initiated).

EBA – defined indicator, determined as the ratio between **a) the total non-performing exposures represented by loans and advances** (where non-performing exposure is defined as any exposure satisfying any of the following criteria: (i) material exposures which are more than 90 days past due; (ii) 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) and **b) total exposures represented by loans and advances**.

In June 2015, the methodological notes on the FINREP framework at solo level were amended so as to include cash balances with the central bank and other demand deposits with credit institutions in the non-performing exposure report form.

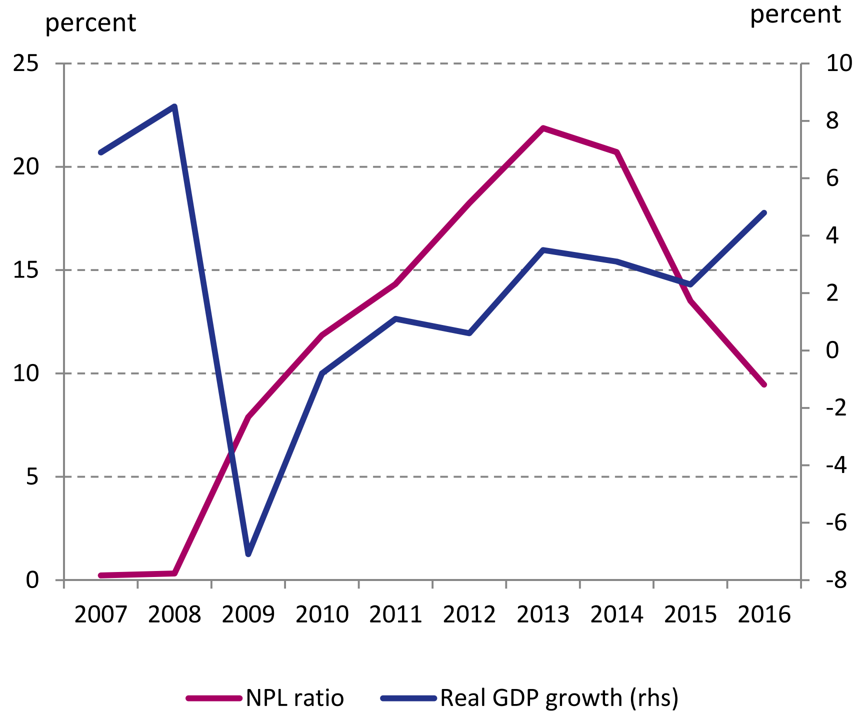
Source: National Bank of Romania

The rise and fall of NPLs



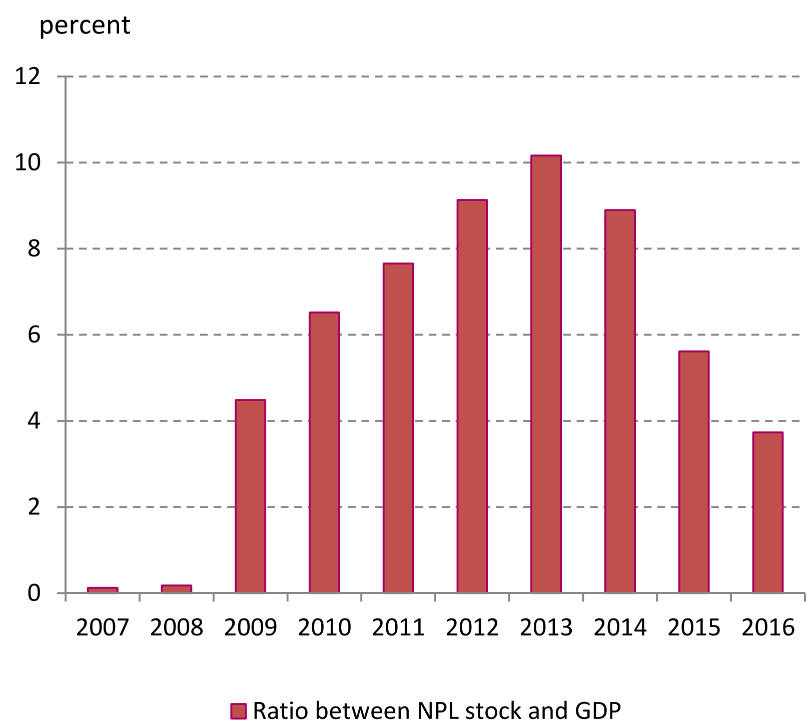
NPLs and GDP: negative correlation

NPL ratio and GDP growth



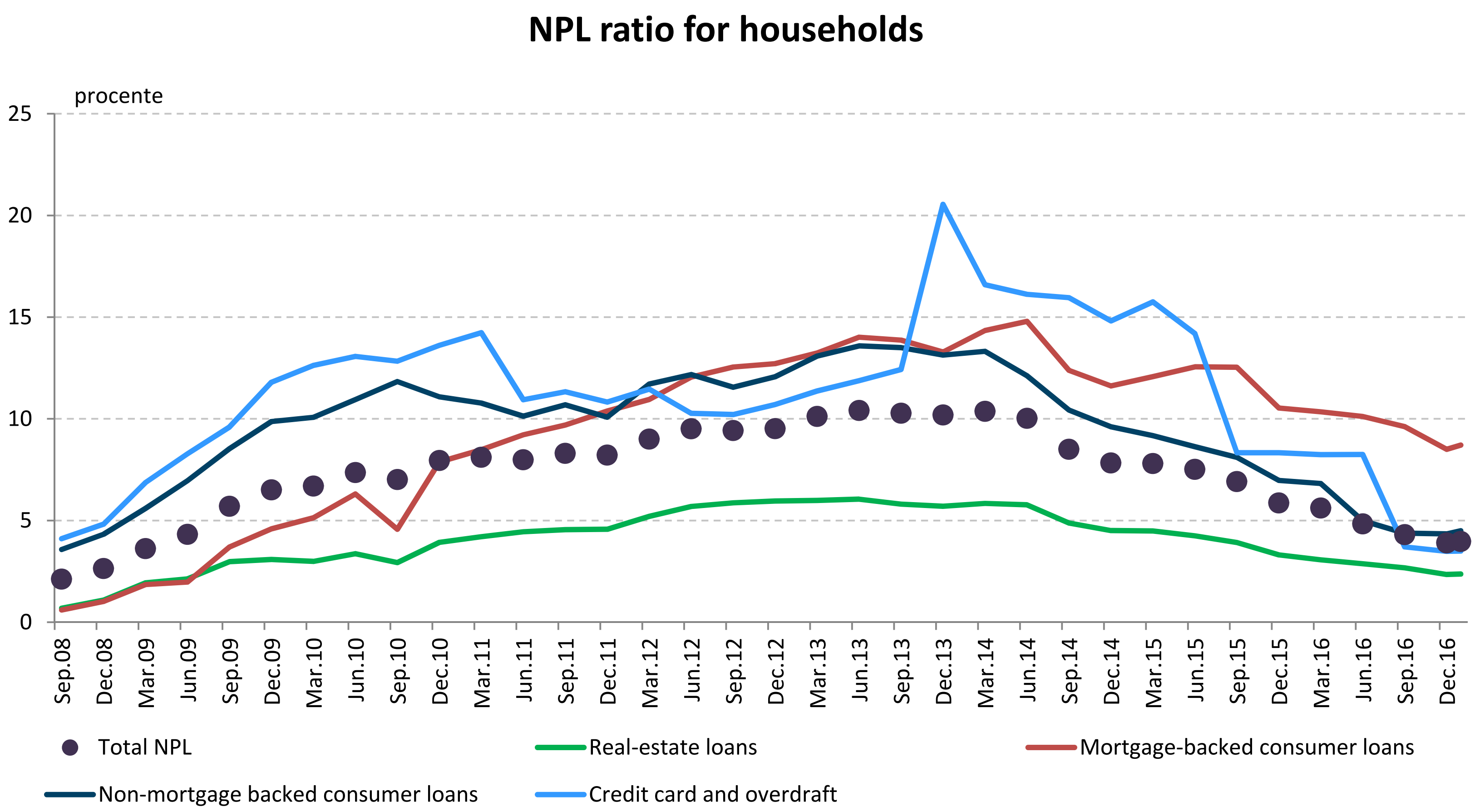
Source: NBR, NIS

NPL stock-to-GDP ratio



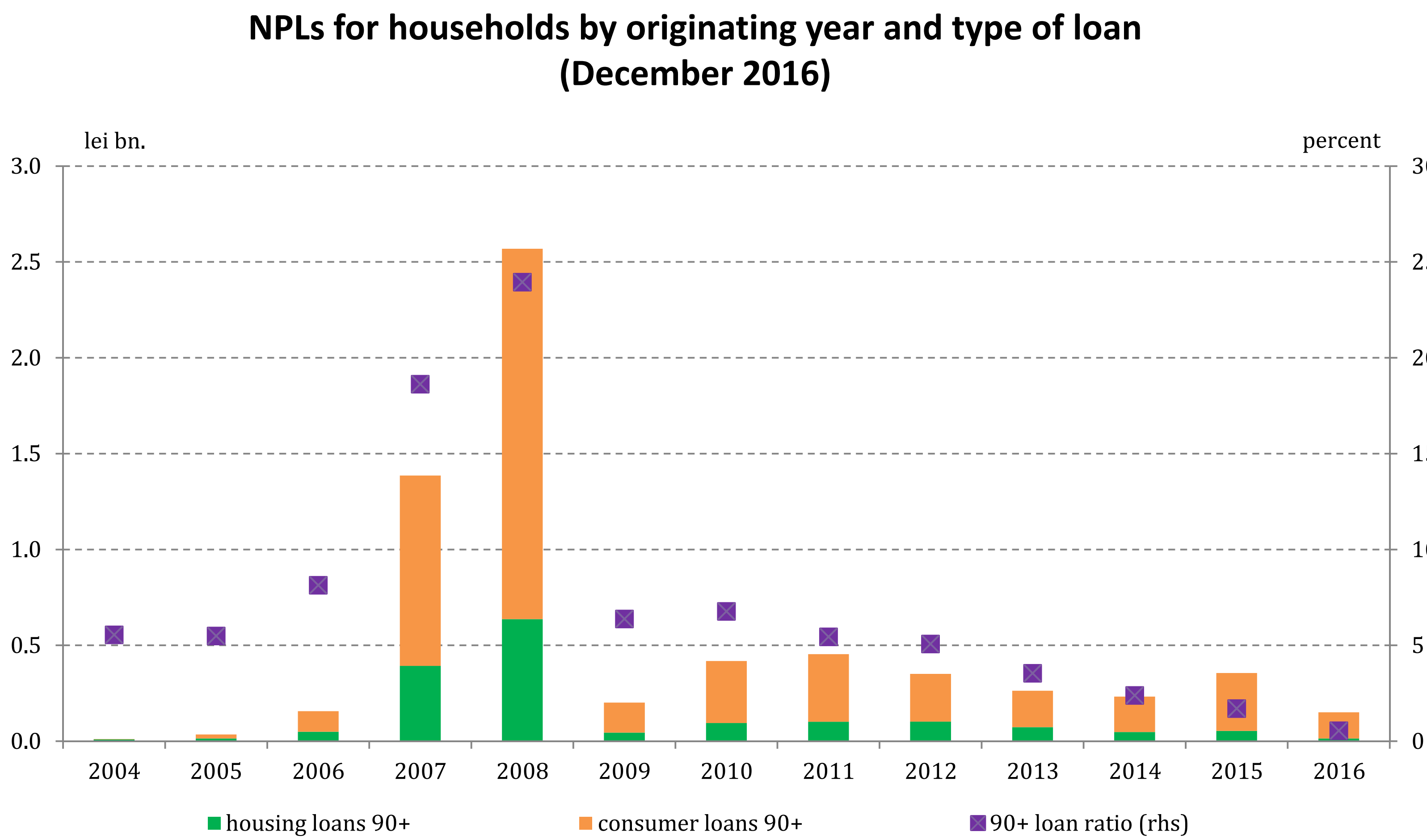
Source: NBR, NIS

Households are more resilient



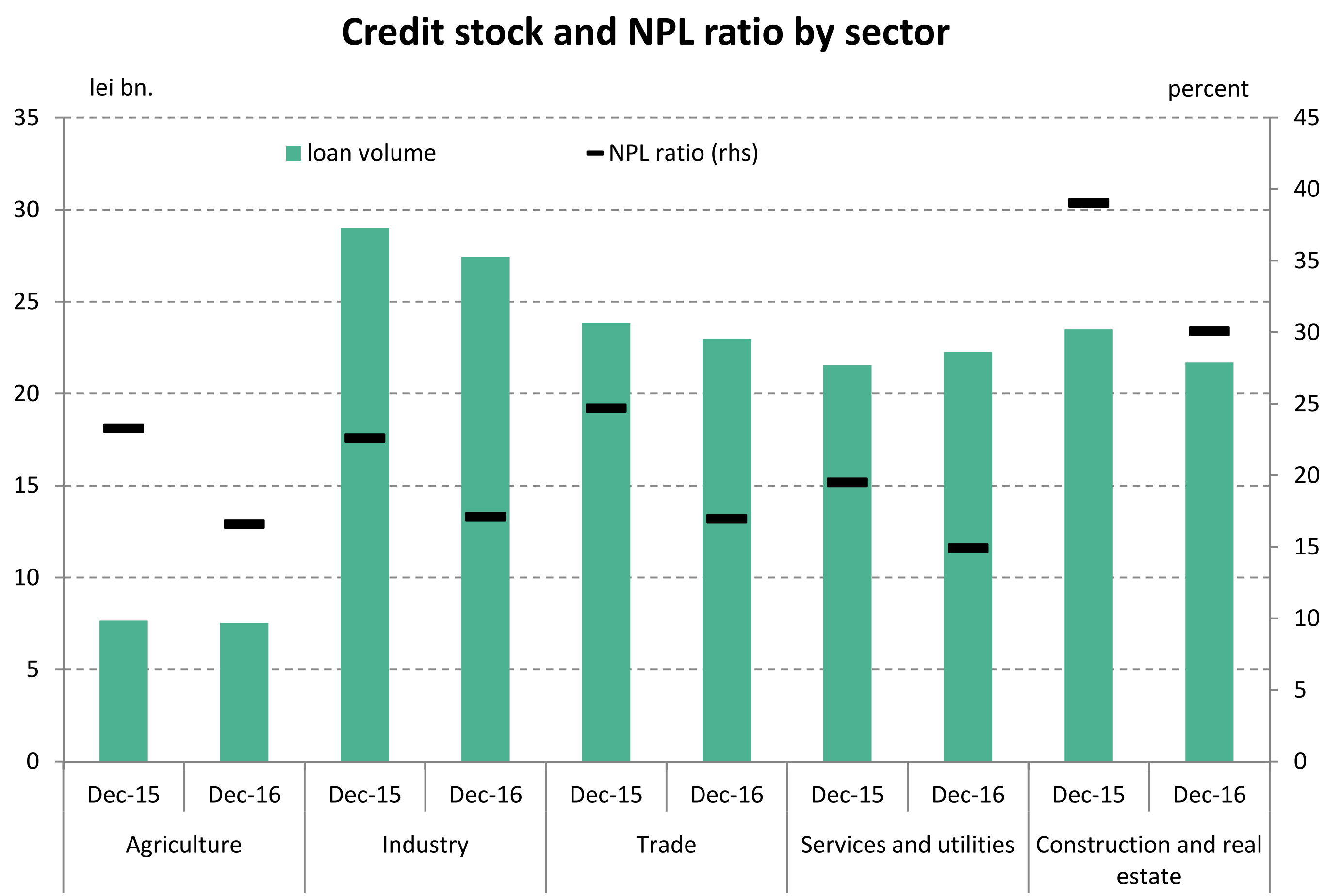
Source: NBR, Credit Bureau

Majority of NPLs were granted in 2007 - 2008



Source: NBR, Credit Bureau

NPLs distribution by sector is dominated by construction and real estate



Source: MPF, NBR

How we did it – Our way

- The first steps:

I. Vienna Initiative (2009)
  - Prevented large capital outflows
  - Stabilized the exchange rate volatility
  - Prevented further deepening of economic recession

II. Collateral valuation (2013)
  - Performed by independent auditors
  - Accompanied by NBR stress tests (EBA methodology)
  - The resulted gap was closed by year-end

How we did it: Main steps to reduce NPLs

III. Regulatory and supervisory measures (2014) (cont.)

- NBR recommendations to banks:

1. to **remove the exposures** representing non-performing loans fully covered by provisions.
2. to **fully cover with provisions** the exposures **having debt service over 360 days** without initiation of legal proceedings to recover debts, followed by their removal.
3. to **establish provisions in order to cover at least 90% of the exposures against borrowers in insolvency.**
4. to **carry out an external audit** on the IFRS provisions established by banks to cover losses for the existing loans, and also on the banks' collateral
5. to **fully cover by provisions the unsecured NPLs overdue for more than 180 days**, followed by their removal.

How we did it: main steps to reduce NPLs

IV. Collateral valuation – third revision 2015

V. Supervisory measures (2016)

- NBR recommendations to fully cover with IFRS provisions of unsecured NPLs overdue by more than 180 days, followed by the removal of exposures from on-balance sheet

VI. **NBR's ownership of fighting NPLs:** the process continued after the completion of IMF and EC agreements

How we did it: the supporting factors

The successful resolution of NPLs was favored by:

(i) an already high NPL coverage by provisions;

(ii) the proper capitalization of banks;

(iii) the active secondary NPL market on the backdrop of a strong economic outlook (with successful transactions reaching billions of euro in 2015 and 2016);

(iv) the joint approval of the resolution exercise by all credit institutions, which alleviated their concerns raised in light of the reputational risk.

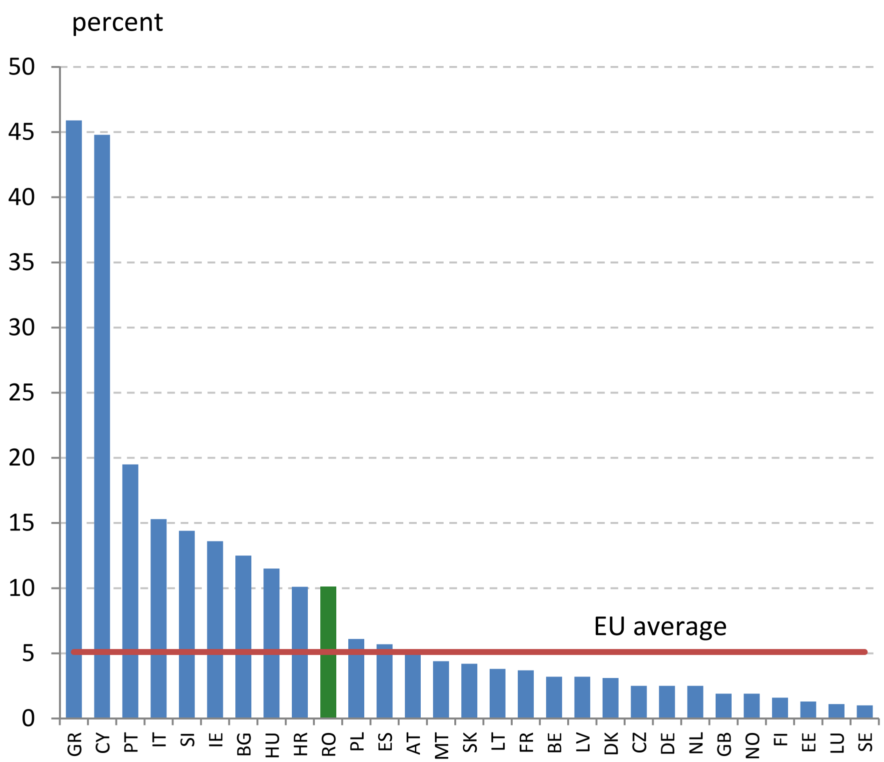
Results of the NBR’s action plan

- Total loans sold and loans removed to off-balance sheet (2014 – 2016): 17.64 billion lei (3.96 billion euro)
  - NPL ratio declined from 21.5% in September 2014 to 9.5% in December 2016 (EBA definition)

- Total costs with provisions (2015 – 2016): 20.8 billion lei (4.7 billion euro)
  - NPL coverage ratio increased from 54.1% in September 2014 to 57.7% in December 2016

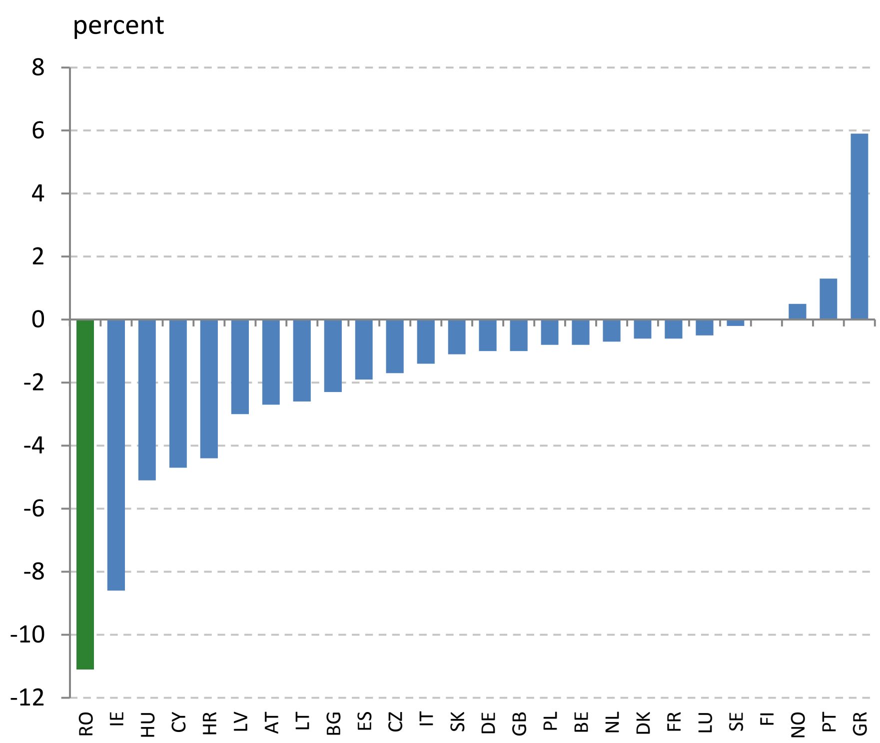
Largest decline of NPL ratio in EU

NPL ratio in EU (2016 Q4)



Source: EBA Risk Dashboard - 2016 Q4

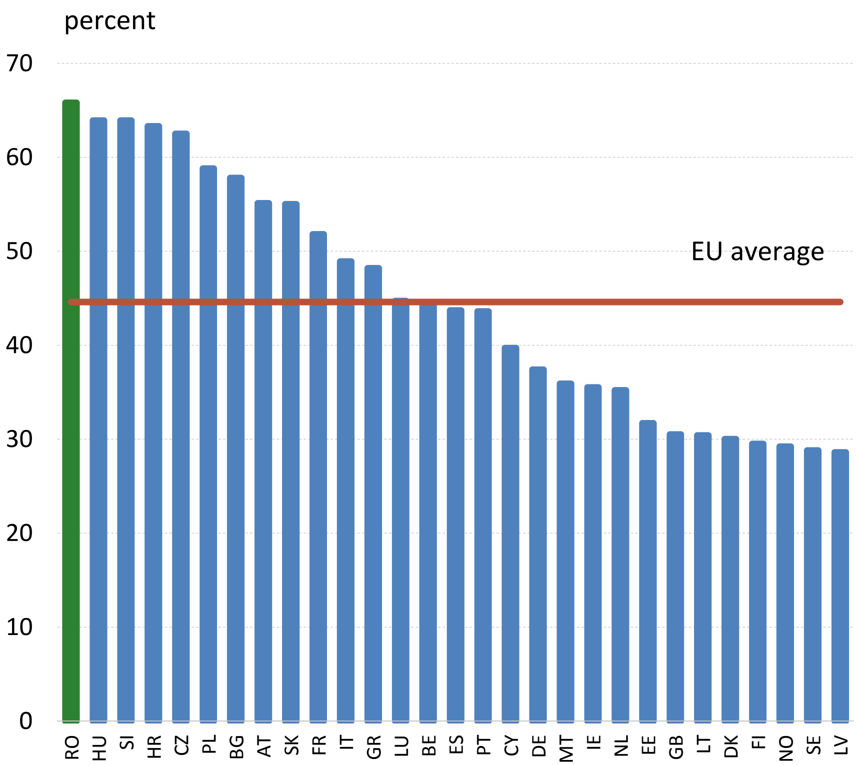
Change of NPL ratio between March 2015 and December 2016 (EBA definition)



Source: EBA Risk Dashboard – 2015 Q4 and 2016 Q4

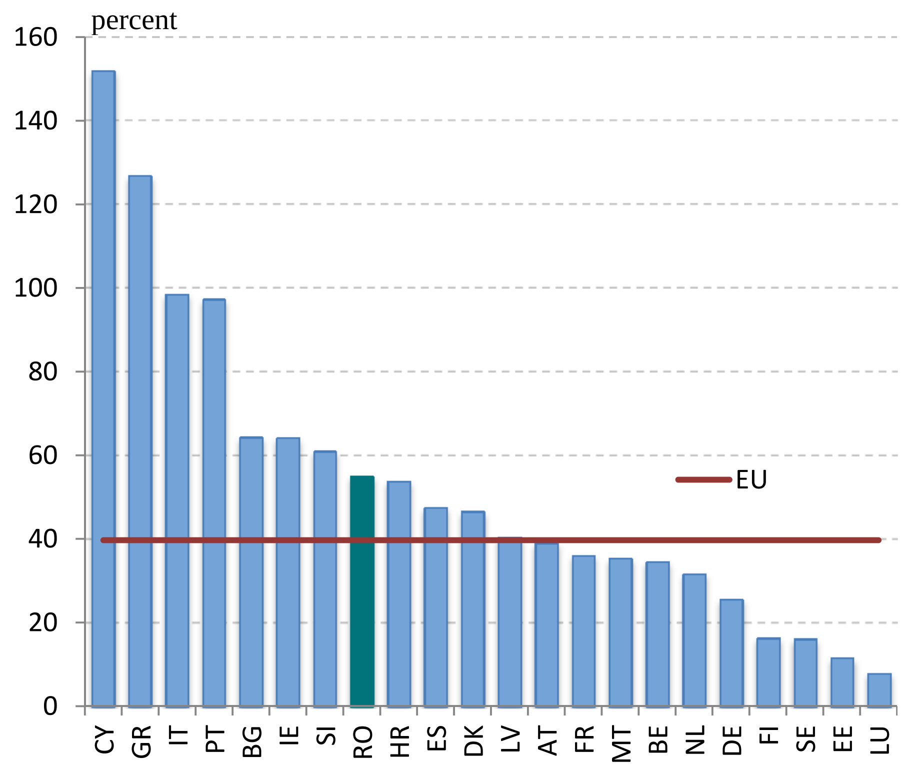
NPL coverage ratio the highest in the EU

NPL coverage ratio in the EU (2016 Q4)



Source: EBA Risk Dashboard - 2016 Q4

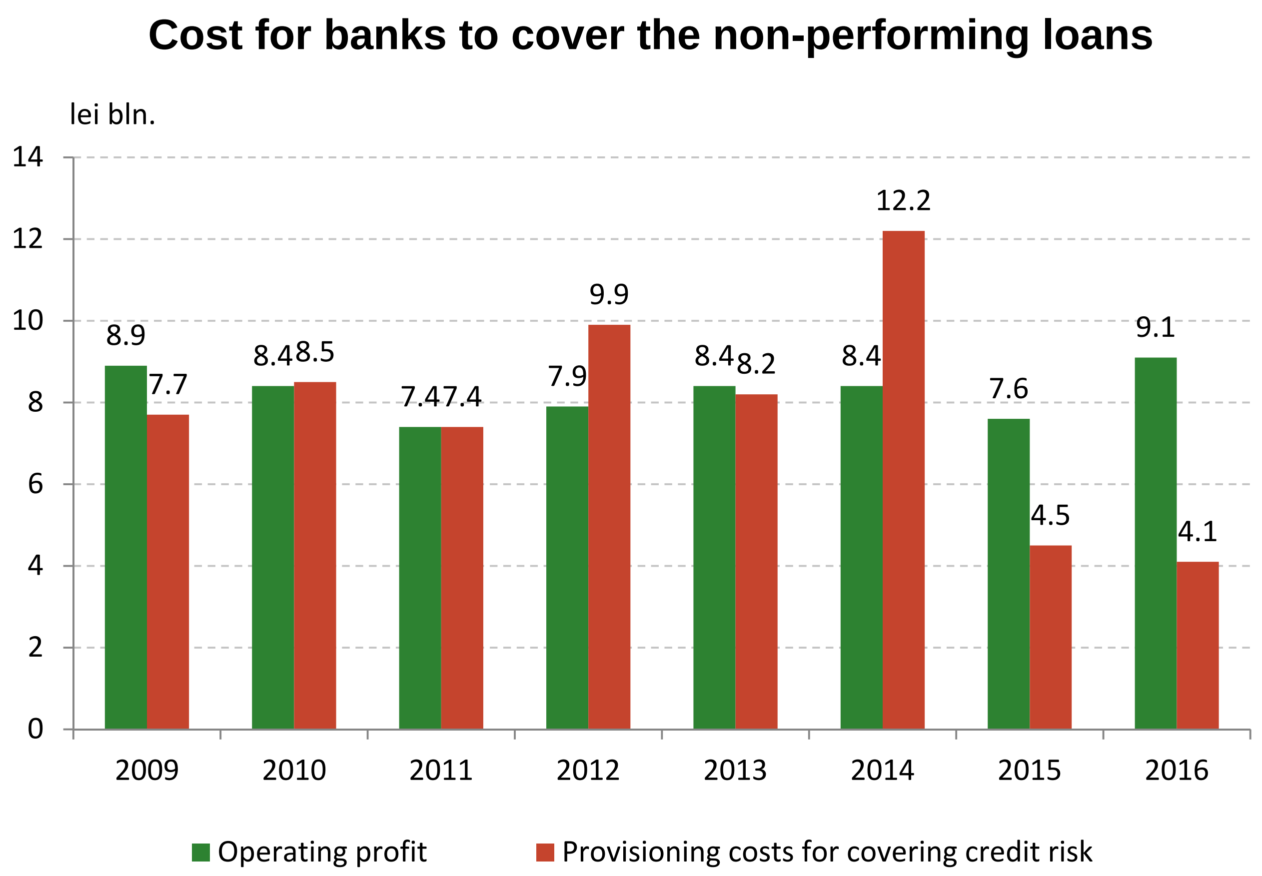
Texas ratio (September 2016)



Note: Texas ratio is the ratio of non-performing loans as defined by EBA to the sum of the Tier 1 capital and loan loss provisions

Source: ECB, consolidated data

Provisioning cost for covering credit risk



Source: Florin Georgescu, 2016, National Bank of Romania's experience in dealing with the NPLs challenge; NBR

Room for growth

- Not credit-driven economic growth: nominal credit increased slower than nominal GDP
- Financial intermediation declined, but banks have cleaned their balance sheets and should be ready for renewed credit activity
- We might be close to a turning point, where credit activity would accelerate on sounder grounds.

II.4. Romania, one of the five EU countries which haven't used public funds to support financial system during the crisis

Costs/revenues for governments to support financial institutions (mil. Euro)

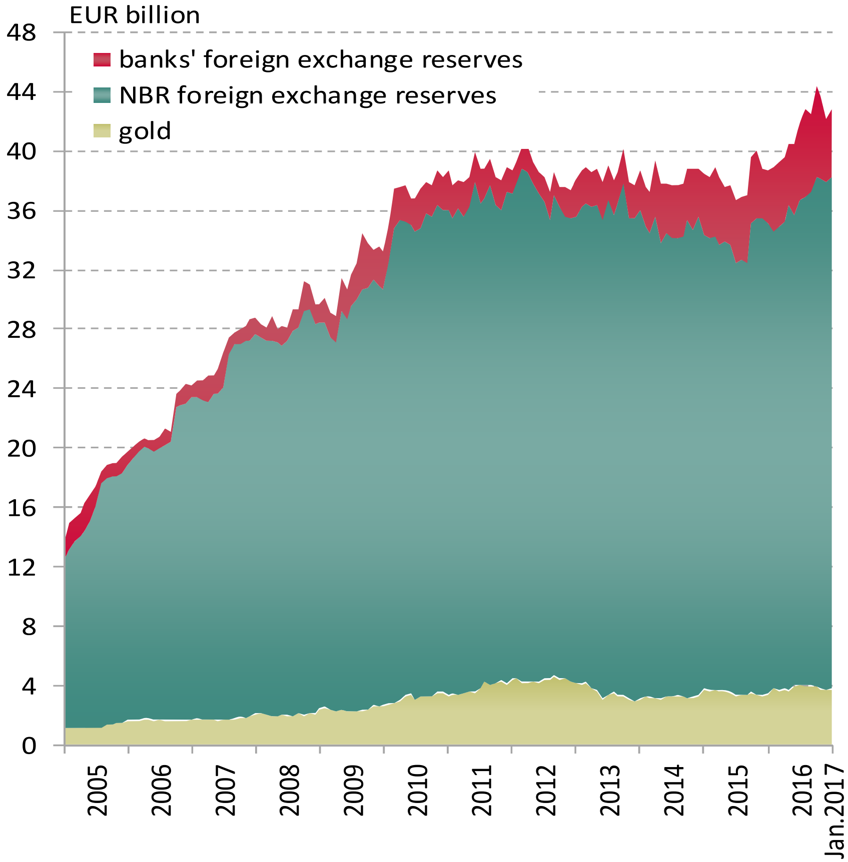
	2007	2008	2009	2010	2011	2012	2013	2014	2015
BE	-	-30.0	-0.7	280.9	-193.3	-2,116.3	600.8	-93.6	-97.9
BG	-	-	-	-	-	-	-	-739.2	-95.3
CZ	-	-	-	-	-	-	-	-	-
DK	-	0.6	162.1	562.1	-180.4	511.3	326.1	163.3	11.3
DE	-	-3,071.5	-2,980.3	-33,004.4	173.6	-1,168.2	1,435.6	577.6	-491.5
EE	-	-	-	-	-	-	-	-	-
IE	-	-	-3,767.0	-35,543.7	-6,370.5	354.9	438.7	14.6	-1,765.6
EL	-	-	373.0	960.0	633.0	-5,347.0	-19,446.0	136.0	-7,171.0
ES	-	-12.0	696.0	771.6	-3,515.0	-38,289.0	-3,277.0	-1,350.0	-535.0
FR	-	48.0	1,356.0	995.0	601.0	-2,198.0	238.0	27.5	-18.2
HR	-	-	-	-61.7	-3.0	-29.5	-3.9	-4.0	-69.8
IT	-	-	-16.5	88.0	177.4	-86.3	-150.0	361.9	-3,534.8
CY	-	-	10.0	27.0	25.0	-40.5	-31.0	-1,486.0	-161.0
LV	-	2.1	-183.9	-401.7	-70.3	-101.5	33.1	-79.5	-8.4
LT	-	-	-	-32.3	-888.7	-41.3	-174.9	475.5	212.0
LU	-	-20.4	-68.7	50.7	54.7	27.7	-3.0	46.3	71.6
HU	-	-	4.3	7.4	9.8	0.8	-	-	-
MT	-	-	-	-	-	-	-	-	-
NL	-	-161.0	-2,304.0	-1,082.0	-112.0	-221.0	-1,188.0	-50.0	412.0
AT	-	2.2	-2,656.6	-327.0	-292.4	-1,318.9	-1,489.8	-5,338.9	-2,201.5
PL	-	-	-	-	-	-	-	-	-
PT	-	2.4	12.2	-2,219.3	-866.3	-932.0	-585.2	-5,126.5	-2,822.6
RO	-	-	-	-	-	-	-	-	-
SI	-	-	3.7	13.5	-236.9	-62.1	-3,671.1	-693.4	-529.9
SK	-	-	-	-	-	-	-	-	-
FI	-	-	-	-	-	-	-	-	-
SE	-	-1.5	128.7	262.1	228.4	134.1	111.8	6.9	1.7
UK	61.4	-5,587.2	-8,076.9	1,522.4	1,077.3	2,009.0	-1,225.8	-769.1	-564.9

Source: Eurostat

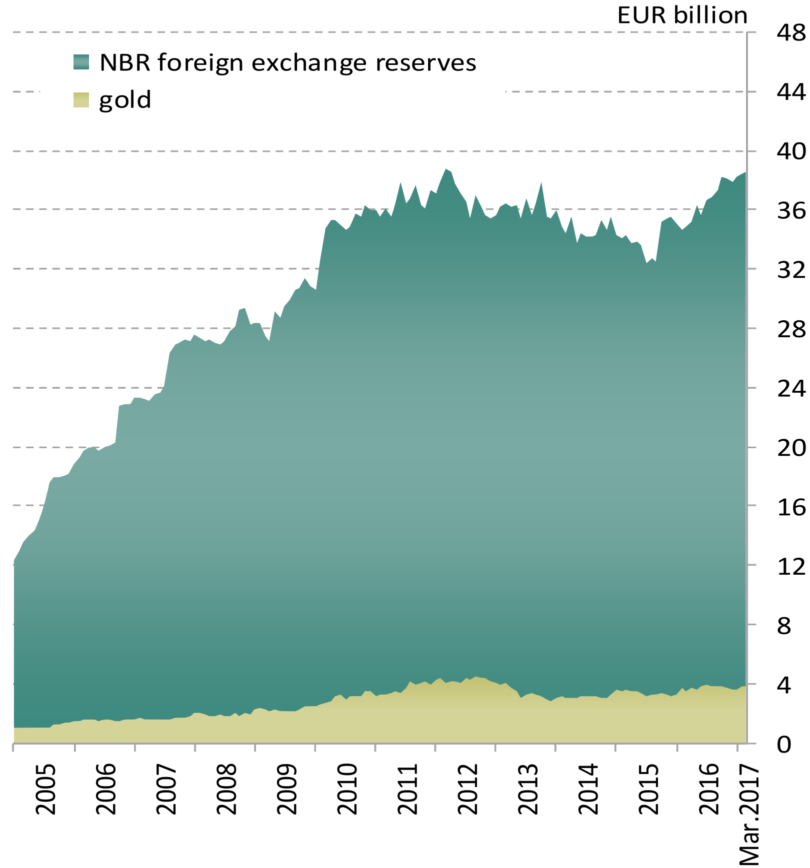
III. Exchange rate stability

III.1. Larger international reserves

Romania: Foreign Reserve Assets

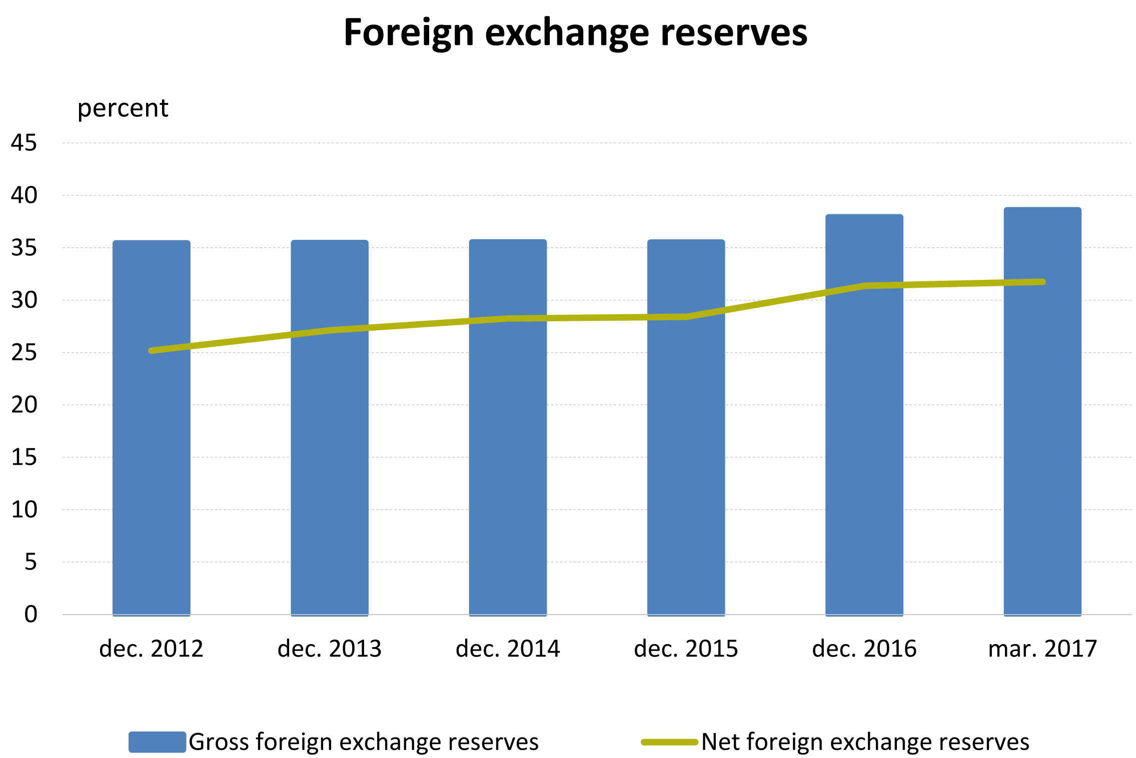


Romania: International Reserves



Source: National Bank of Romania

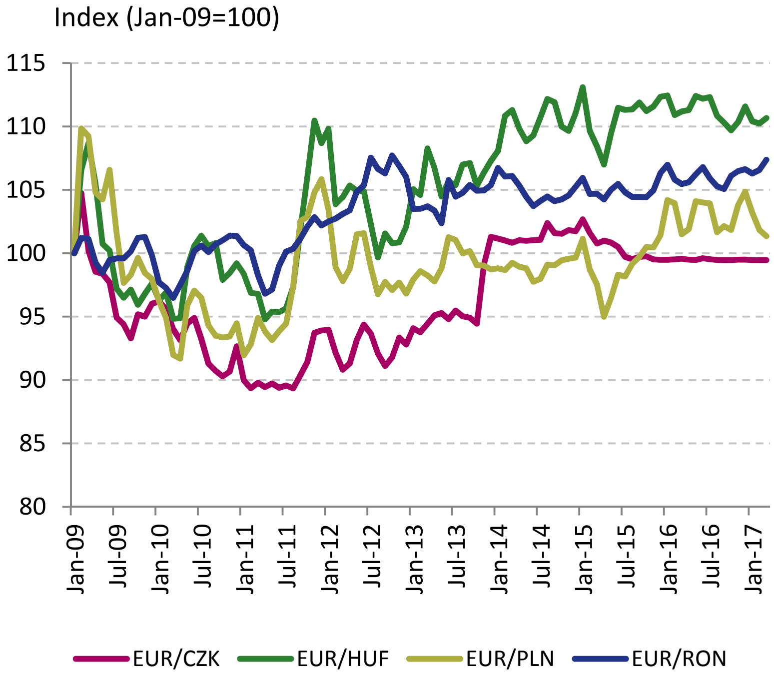
Net forex reserves increased despite IMF loan reimbursement and lower minimum reserve requirements for banks' FX liabilities



Source: NBR

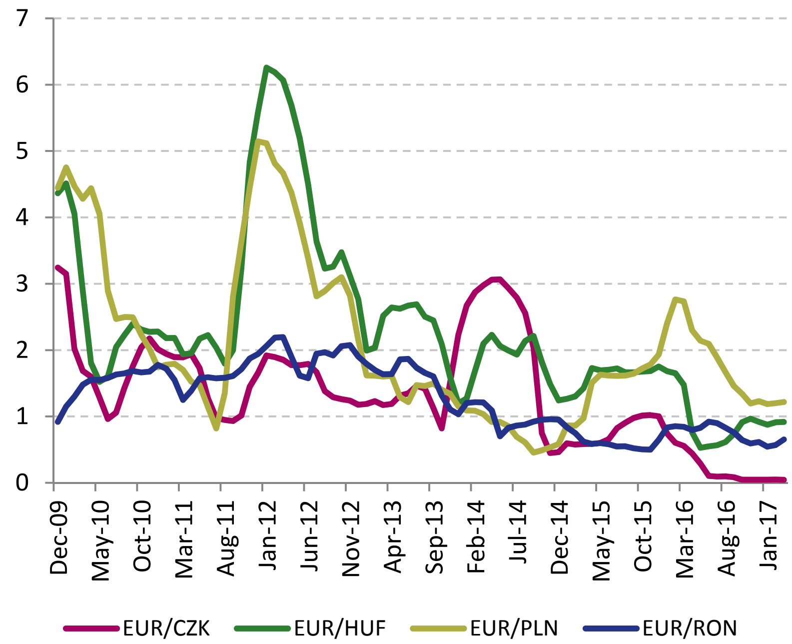
III.2. Low exchange rate volatility

Exchange rate against euro



Source: Eurostat, NBR calculations

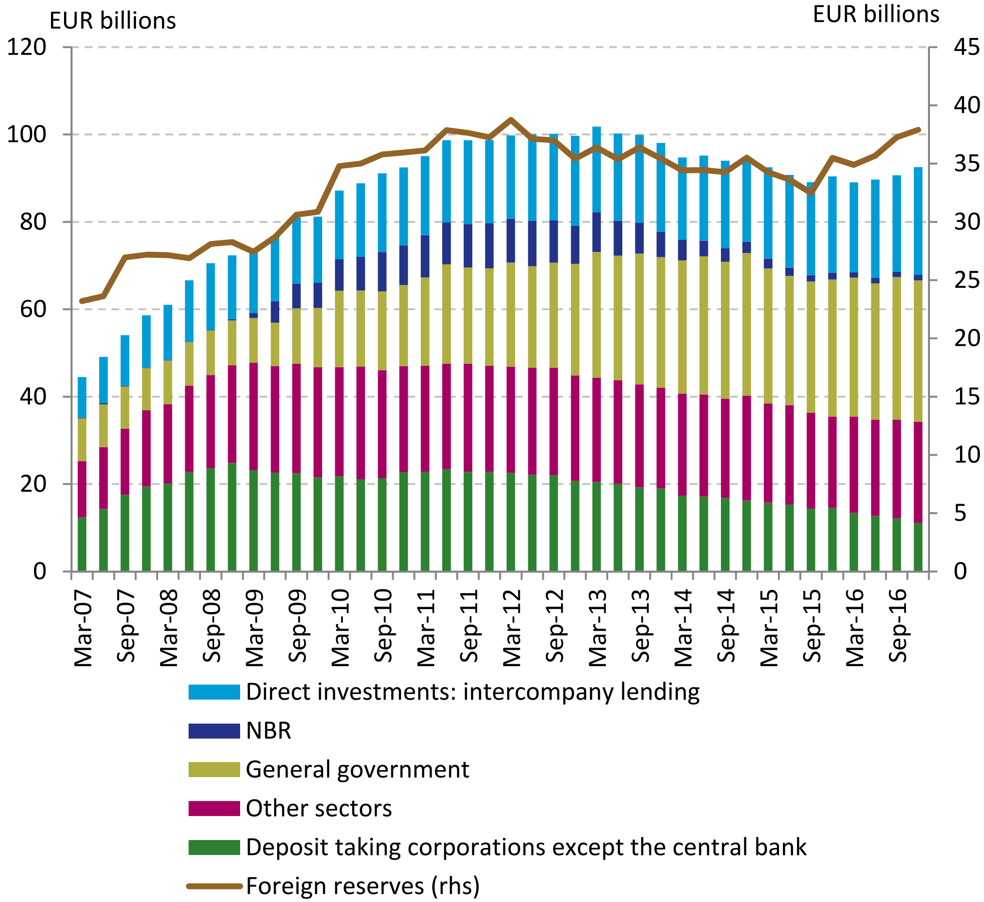
Volatility of the exchange rate against euro



Source: Eurostat, NBR calculations

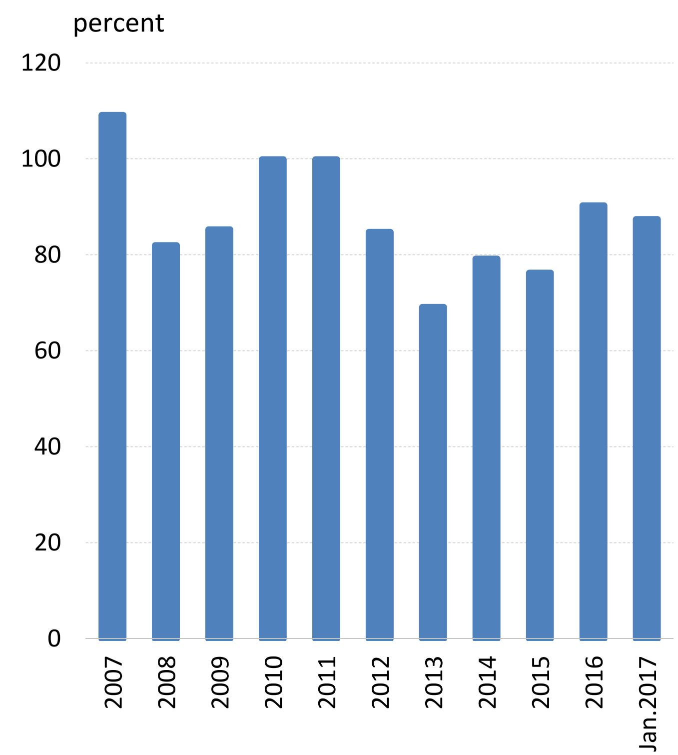
External debt has stabilized

External debt



Source: NBR

International liquidity (Guidotti ratio)

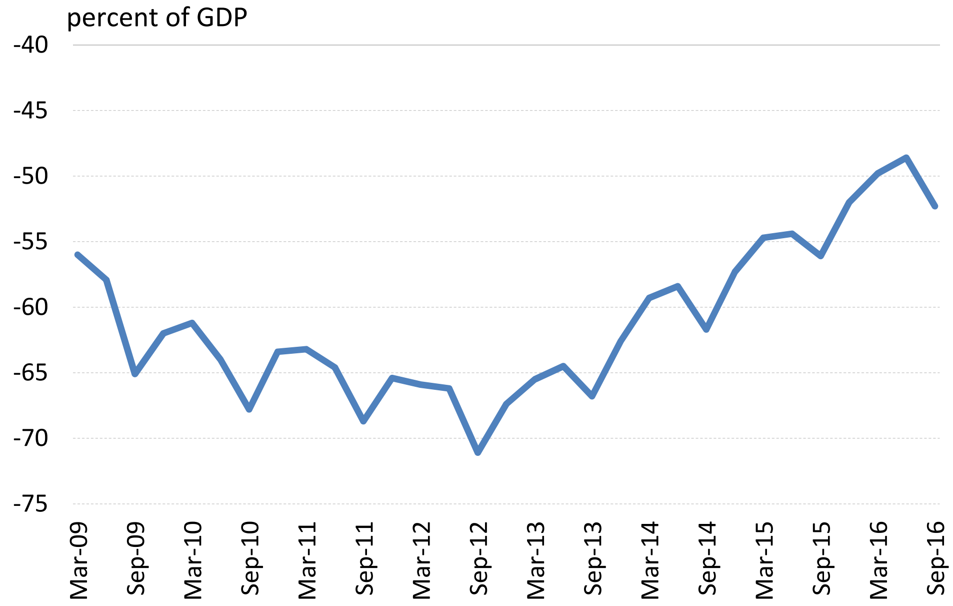


Note: *Guidotti ratio = (Short term external debt + debt service of long term external debt in the following 12 months)/ Foreign exchange reserves*

Source: NBR

International investment position has improved

Net international investment position



Source: Eurostat

IV. Key messages

- NBR has reached all three stabilities: price stability, financial stability and exchange rate stability.
- Low inflation, but no deflation.
- Interest rates at historical lows stimulate local currency lending.
- Romania is one of the 5 EU members which haven’t used public funds to support the financial sector since the crisis hit.
- Banks continued to clean-up their balance sheets from non-performing loans.
- Banks are well capitalized and liquid. Contagion risk declined.
- There is room for enhanced credit activity, on sounder grounds.
- Larger net foreign exchange reserves and improved international liquidity.