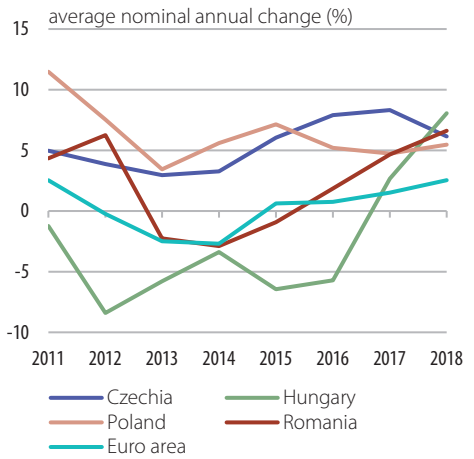
Box 6. Credit to the private sector and liquidity in the economy[1]

In 2018, the evolution of the composition and dynamics of private sector credit – relevant from the perspective of monetary transmission, as well as of structural convergence with monetary developments in the euro area and in other countries in the region – had the following characteristics:

Chart A
Credit to the private sector



Source: NCBs

1. The growth rate of credit to the private sector consolidated around the record highs for the past years reached in the latter part of 2017.

The average dynamics of credit to the private sector thus climbed further, from 4.7 percent in 2017 to a nine-year peak of 6.6 percent – the second highest level in the region (Chart A)[2]. Behind the robust advance stood new loans, which recorded faster dynamics during the year under review for both households and non-financial corporations (Chart B)[3], amid the stimulative effects exerted on credit demand and supply by: (i) wage earnings rising further at a swift, double-digit pace[4]; (ii) the relative recovery in private sector confidence in 2018 H2 and its remaining high over the year as a whole by post-2008 standards, albeit below the previous three years' levels[5]; (iii) the further alleviation of NPL[6] constraints on credit institutions' balance sheets; (iv) the ongoing diminishing trend of the loan-to-deposit ratio in the banking system, which came in at 76.2 percent in December 2018, i.e. the lowest value in over 13 years. At the same time, significant opposite influences continued to come from the persistence of structural impediments in the corporate sector[7], as well as from the risks associated with new legislative initiatives regarding the banking sector promoted in this period[8], with a potential adverse impact inter alia on NPL resolution mechanisms; moreover, credit growth was probably stymied by the upward adjustment of lending rates on new leu-denominated business to households and non-financial corporations (Chart C), under the influence of the NBR's monetary policy measures, but also by the relative tightening, during the year as a whole, of credit standards, particularly in the case of

1 For a clearer picture, changes in dynamics were analysed, as a rule, in the form of indicators calculated as an average of annual growth rates expressed in nominal terms.

2 In real terms, however, the annual dynamics of private sector credit decelerated versus 2017 (to 1.9 percent from 3.3 percent, annual averages), given the step-up in the annual inflation rate.

3 The pick-up in the annual average dynamics of credit to the private sector also reflected the decline in the volume of net loan sales compared with the previous year, but also the statistical effect of incorporating a new credit institution in the credit institutions' consolidated balance sheet, which countered that associated with two entities ceasing their activity at end-2017.

4 The average annual dynamics of the average net wage economy-wide remained in 2018 close to the post-crisis peak seen a year earlier.

5 According to DG ECFIN Surveys.

6 The NPL ratio fell from 6.41 percent in December 2017 to 4.96 percent in December 2018.

7 The large share of firms with equity below the regulatory threshold or even negative, loose financial discipline, insolvency.

8 Referring to: (i) capping interest rates on household loans, (ii) removing the enforceability of loan contracts, and (iii) the possibility to redeem the loans sold by paying at most double the price for the loan sale. They were adopted by Parliament at end-2018, but were subsequently declared unconstitutional.

consumer loans. The share of private sector credit in GDP tended to see its decline come to a halt in the reported year, although in the end it narrowed marginally (to 26.6 percent from 27.2 percent in 2017).

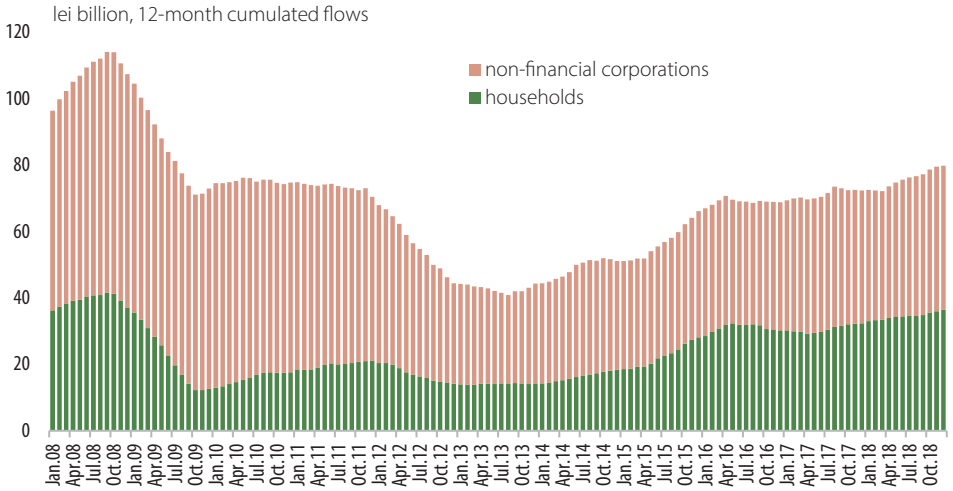


Chart B
New loans to households and non-financial corporations

2. The share of the leu-denominated component in credit to the private sector continued to rise and hit a new post-1996 high of 66.0 percent in December 2018.

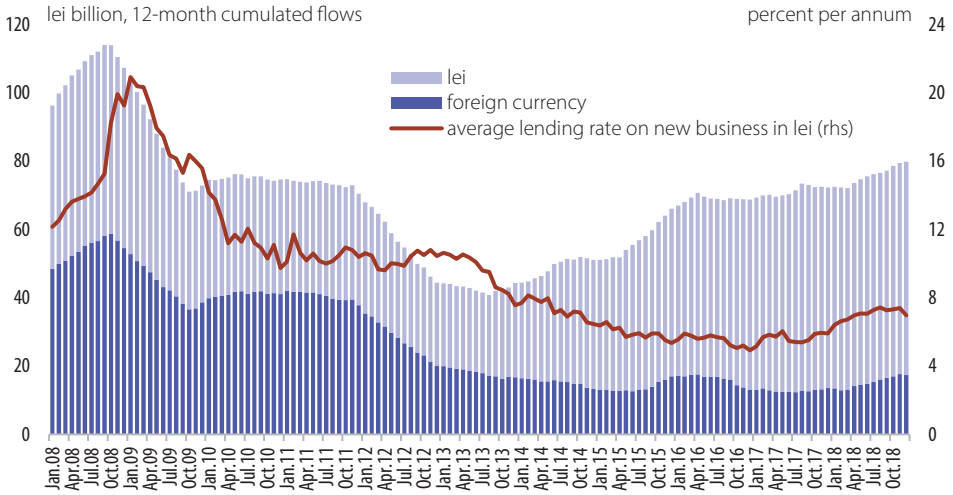


Chart C
New loans to the private sector and the average lending rate on new business in lei

However, the share widened at a slower pace than in previous years, as the annual dynamics of domestic currency credit declined slightly[9] – albeit sticking to two-digit levels, amid the sturdy advance in new loans –, while the rate of change of the foreign currency component posted considerably less negative readings (-1.4 percent at end-2018 from -10.4 percent in December 2017, based on stocks expressed in euro), due inter alia to a relative step-up in new business to non-financial corporations, but also to a statistical effect[10]. Nonetheless, the flow of foreign

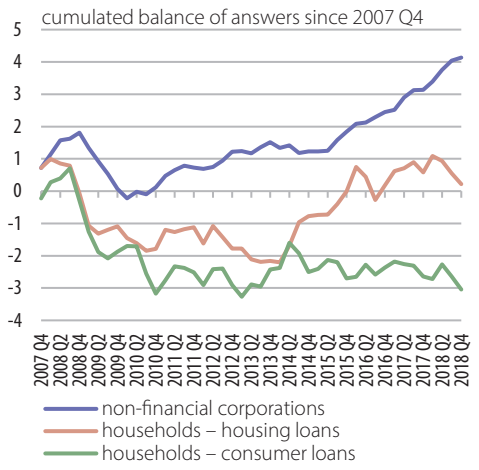
9 To 13.5 percent in December 2018 versus 15.9 percent at the end of the previous year.

10 Associated with the removal from the aggregate monetary balance sheet of two credit institutions that had ceased their activity in December 2017.

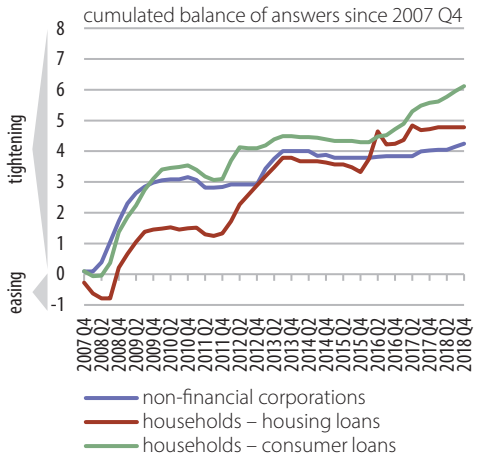
currency loans remained modest, with the domestic currency component further prevailing by a large margin in total new credit to the private sector, i.e. 78.3 percent during the year as a whole against 81.3 percent in 2017 (Chart C). At a sectoral level, the widening of the share of leu-denominated credit continued for households, to a 15-year peak of 71.9 percent in December 2018, but came to a halt during the reported period overall in the case of non-financial corporations, as the advance to a 22-year high in June 2018 was followed by a slight decline.

3. The share of household credit in total credit further slowed down its increase in 2018, yet hit a new historical high, thus exceeding more visibly the euro area level, but still trailing behind Czechia and especially Poland.

Chart D
Demand for loans



Note: (+) increase; (-) decrease.



Note: (+) tightening; (-) easing.

Chart E
Credit standards

The rise and subsequent status-quo of this share to approximately 53 percent in December 2018 (52.4 percent in December 2017) reflected the relatively more pronounced step-up in the dynamics of household credit in the first part of the year[11], mainly on the back of new consumer loans. The annual growth rate of credit to non-financial corporations gained more modest traction on average during 2018[12] – after having re-entered positive territory in 2017 –, but followed a generally upward path in the second half of the year. The stronger momentum was ascribable to the faster dynamics of new loans in foreign currency, as well as – particularly this year – of revolving and overdraft loans, whose share in total corporate credit climbed to 40.9 percent, from 39.6 percent in 2017, primarily on account of the leu-denominated component. The stronger recourse to the latter type of loans probably reflected the rise in firms' working capital requirements, due to the ongoing economic expansion, as well as to the increase in wage payments.

The swifter dynamics of the stock of loans were more pronounced for short- and medium-term credit – attributable to the domestic currency component and to forex loans respectively –, whereas the annual rate of change of long-term loans remained relatively higher. Looking at the breakdown by destination, the flow of credit increased further in services and construction, but diminished in industry, where the halt in the downward path seen a year earlier proved temporary, as well as in agriculture, for the first time in three years.

Overall, these developments were only partly correlated with the results of the successive issues of the NBR's *Bank Lending Survey*, which pointed to non-financial corporations' keener demand for loans throughout 2018, accompanied by a quasi-

[11] During the reported period overall, the annual dynamics accelerated to 9.4 percent, from 6.4 percent a year earlier.

[12] Picking up to 3.3 percent against 2.2 percent in 2017.

steady decline in the demand for housing loans and consumer credit (Chart D). The contraction in the latter case reflected the relative tightening, as of 2018 Q2, of banks' credit standards on consumer loans (Chart E). By contrast, after a slight tightening in Q1, the standards on housing loans were kept unchanged. Standards on loans to non-financial corporations remained broadly unchanged in the first two quarters of the year, before witnessing a slight tightening, amid the introduction of the systemic risk buffer by the NBR, although developments were not broad-based across the banking sector.

4. The majority share of housing loans in credit to households widened only marginally (55.2 percent in December 2018).

The annual growth rate of housing loans slightly regained momentum (12.8 percent versus 12.2 percent in the previous year), while the dynamics of the leu-denominated component declined at a slower pace, thus remaining very alert (30.9 percent from 40.1 percent in 2017), as the reduction in the volume of loans extended under the "First Home" programme, amid the lower guarantee ceiling[13], was counterbalanced by the larger flow of credit for the same purpose granted by banks without state guarantees. Looking at the breakdown by purpose/currency, leu-denominated housing loans thus held in 2018 – for the first time – the largest share in total household credit.

Running at much lower levels, the annual rate of change of consumer credit and other loans witnessed, however, a markedly sharper upward adjustment (to 5.5 percent, after having returned to positive territory in 2017), with the prevailing contribution of the domestic currency component. This reflected the influences of the stronger dynamics of the credit flow – amid the further quick-paced increase in wage earnings, as well as a lower magnitude of the rise in related interest rates, ascribable inter alia to the keen competition on this segment of the banking market –, but also the statistical effect of including a new credit institution in the aggregate monetary balance sheet.

Looking at other countries in the region and at the euro area, the share of housing loans in total credit to households in Romania continues to exceed slightly that in Hungary, but remains well below those in Czechia and the euro area.

As for liquidity in the economy, the most important developments were:

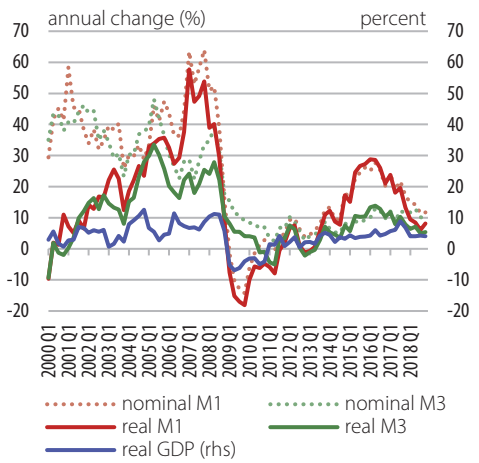
1. The relatively constant degree of monetisation of the economy for the second consecutive year (40.4 percent at end-2018 versus 40.9 percent at end-2017).

Behind these developments – implying that the Romanian economy's degree of monetisation stuck to a markedly lower level than those prevailing in Europe – stood the quasi-standstill at a relatively high value of the annual dynamics of broad money

[13] In 2018, the guarantee ceiling earmarked for this programme was lowered to lei 2 billion (Government Decision No. 10/2018) from lei 2.5 billion in 2017 (topped up afterwards by lei 175 million).

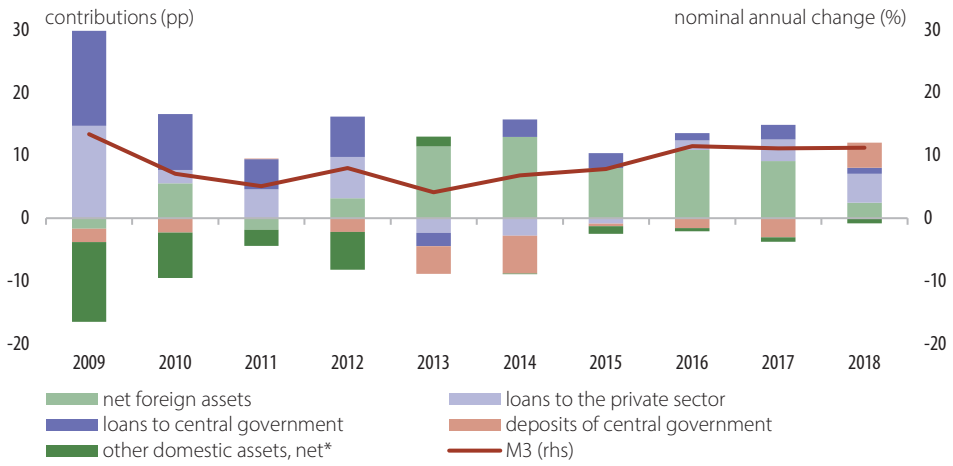
(M3)[14], i.e. 11.2 percent from 11.1 percent in 2017 (Chart F). The latter reflected the influences exerted by the relative easing of the budget execution, but also those stemming from the contraction in disbursements from EU funds, the higher external payments, as well as from the larger stock of alternative financial instruments (leu-denominated government securities[15], foreign currency deposits with a maturity of over two years) held by non-bank clients.

Chart F
Broad money and GDP



Source: NIS, NBR

From the perspective of M3 counterparts (Chart G), credit to the private sector became the key determinant of monetary expansion in the reported year, its contribution being followed by that of central government deposits, which contracted for the first time in seven years. Net foreign assets of the banking system, which had represented the major source of money creation in the period from 2014 to 2017, saw their expansionary effects abate considerably, the same as credit institutions' government security holdings.



*) long-term financial liabilities, capital accounts, other assets and other liabilities

Chart G
M3 and its counterparts

2. The consolidation of the majority share held by narrow money (M1) in M3 (to a 24-year high of 61.7 percent in December 2018 from 60.2 percent at end-2017) – Chart H.

The share of M1 in M3 widened also in 2018 – the same as in the euro area and in the countries in the region, except for Czechia –, the M3 composition thus continuing to narrow slightly the gap vis-à-vis some of the countries under comparison. The advance occurred in a context in which the annual dynamics of ON deposits and currency in circulation further exceeded the growth rate of time deposits, but the gap between them diminished, as the former embarked on a primarily downward path. These developments reflected the influences stemming,

[14] In real terms, the annual M3 dynamics slowed against 2017 (6.3 percent versus 9.6 percent, as annual averages), due to the pick-up in the annual inflation rate.

[15] In 2018, the MPF conducted three government security issues for households, totalling lei 2.1 billion.

on one hand, from (i) the keener demand for money for current transactions, in correlation with the further robust growth rates of economic activity and private consumption, their slowdown notwithstanding, but also with the faster price dynamics and, on the other hand, from (ii) the slight increase in the opportunity cost of holding liquid monetary assets. In turn, after having reached a peak for the past approximately six years in mid-2018, the annual rate of change of time deposits with a maturity of up to two years re-embarked on a downward path, amid the decline in non-financial corporations' deposits, associated inter alia with dividend payments by state-owned enterprises.

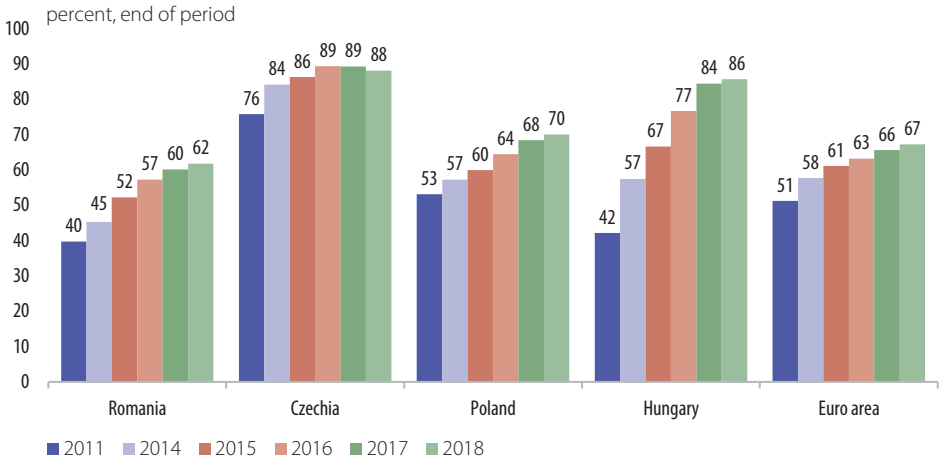


Chart H
Share of M1 in M3, international comparison

Source: NCBs

Against this background, the share of ON deposits in M3 peaked at a post-August 1994 high of 43.9 percent in December 2018, while that of currency in circulation posted only a marginal downward correction, to the vicinity of the second consecutive peak of the post-1995 period (18.4 percent in September 2018).

3. The slight decline in the share of the leu-denominated component in total non-banking sector deposits, although it further clearly prevailed (67.0 percent versus 68.0 percent in 2017, annual averages).

Behind the decline – a first for the past five years – stood the faster pace of increase of foreign currency deposits, along with the slowdown in the dynamics of leu-denominated deposits. The divergence was particularly visible for households, whose forex deposits saw their share in total bank deposits widen to a 14-year high of 39.9 percent in September 2018. By contrast, the share of non-financial corporations' foreign currency deposits in total bank deposits shrank slightly (to 23.5 percent from 24.7 percent, annual averages), given that the growth rate remained clearly below that of domestic currency deposits, despite its acceleration against the previous year.