

# ROMANIA

## Economic Update, Banking System & Investment Climate

December 2003

**NATIONAL BANK OF ROMANIA**





# Developments in 2003

- ✓ **Consolidation of robust GDP growth** (4.8% forecast), with investment and private consumption as the main drivers; in Jan.-Sep. 2003: 4.7% real GDP, with investment and private consumption growth of 7.9% and 6.4% respectively
- ✓ further **disinflation**: 14% year-end target for CPI inflation in 2003, below 17.8% in 2002; Jan.-Oct. 2003 annualised inflation 13.6%
- ✓ **current account deficit** target of 4.8% of GDP with substantial autonomous financing; in Jan.-Oct. 2003 exports and imports in EUR up 7.4% and 11.7% respectively on Jan.-Oct. 2002 (in USD, exports up 28.3%, imports up 33.8%)
- ✓ ongoing prudent **fiscal policy** (fiscal deficit target of 2.7% of GDP); 0.7% of projected GDP in Jan.-October 2003
- ✓ keeping **the total public and publicly guaranteed debt** within manageable limits (around 30% of GDP)
- ✓ comfortable level of official reserves: EUR 7.8 billion at end-November 2003
- ✓ completion of **privatisation** negotiations with IFC and EBRD: sale of 25% equity stake in **Romanian Commercial Bank** in early November 2003
- ✓ further consolidation of **access to international markets**: new 7-year EUR 700 million sovereign bond (June 2003)
- ✓ **rating upgrades**: Standard&Poor's to **BB-** (in February 2003) and **BB** (in September 2003)
- ✓ switching to the **EUR** as **reference currency** starting with 3 March 2003

# Objectives for 2004

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- **Economic growth:** 5.5 percent
- **CPI inflation:** 9 percent (December/December)
- **Fiscal deficit:** 3 percent of GDP
- **Current account deficit:** 5-5.5 percent of GDP
- **Foreign direct investment:** EUR 1.7 billion
- **International reserves** at an optimal level
- **Sustainable real appreciation of exchange rate of the ROL versus the EUR/USD basket**

# Policies to Attain Macroeconomic Objectives in 2004

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**Restructuring policies:** further restructuring of the mining, energy and railway transport sectors

**Privatisation policies:** privatisation of PETROM oil company, two electricity distribution networks, two natural gas distribution networks, the remaining portfolio under the management of the Authority for Privatization and Management of State Ownership

**Wage policies:** moderate real increase in wages in line with labour productivity gains

**Price policies:** further harmonisation of administered prices (for gas, electricity, etc.) with international prices in order to attain convergence by 2007

**Fiscal policies:** keeping budget deficit in check (3 percent of GDP); cut in quasi-fiscal deficit (particularly by reducing arrears)

**Monetary policies:** curbing inflation to 9 percent (December/December) while keeping external balance under control



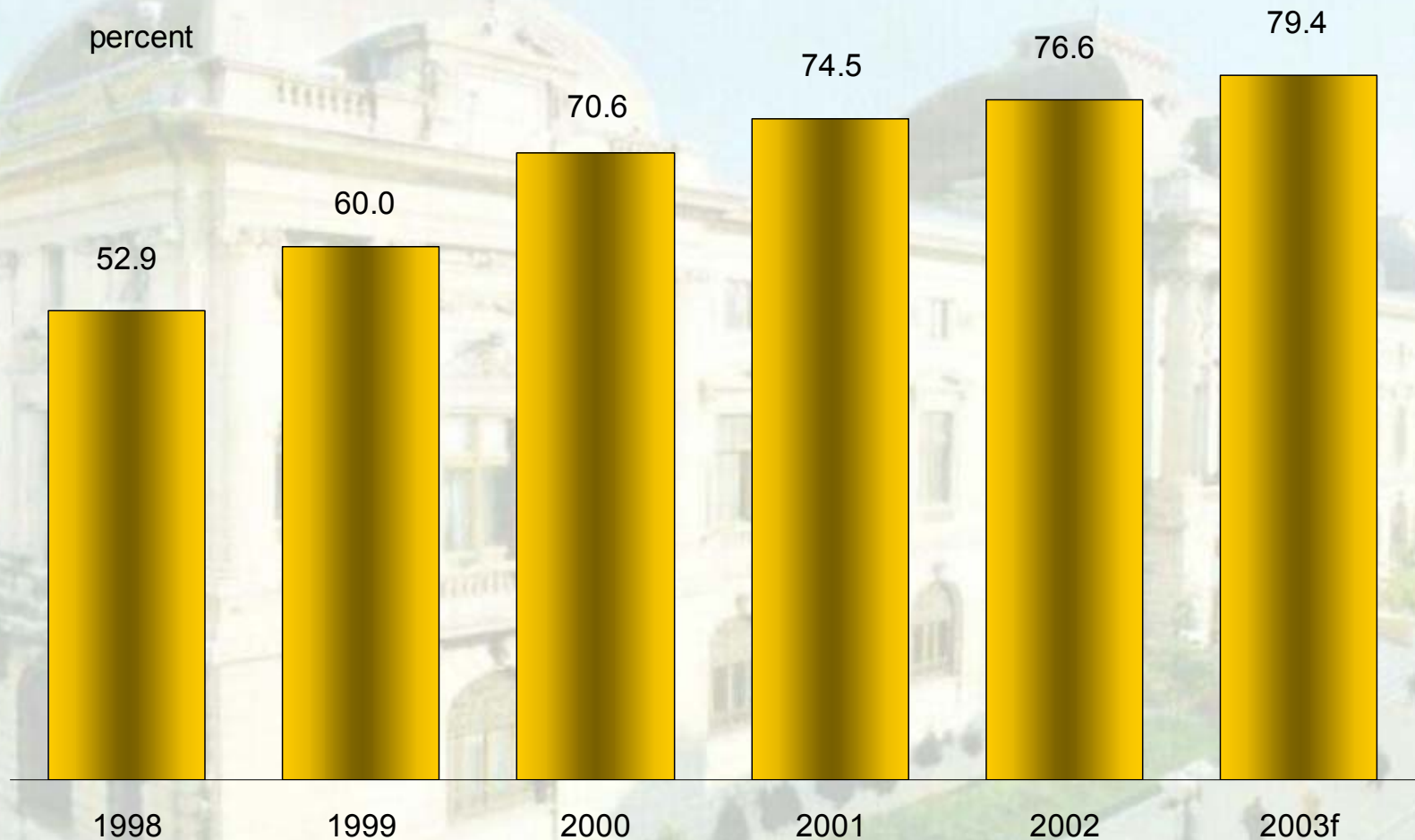
# Monetary Policies for 2004

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- ✓ Further remonetisation of the economy at a pace consistent with that of disinflation
- ✓ Further increase in non-government credit at a pace that does not entail the rise in credit risk and widening of external deficit
- ✓ Real appreciation of the ROL (against the implicit EUR/USD basket) in line with labour productivity gains and real wage growth
- ✓ Larger weight of the euro within the currency basket
- ✓ Gradual lowering of the NBR's policy rate in keeping with positive macroeconomic trends
- ✓ Further capital account liberalisation
- ✓ Increase in credibility of the NBR and in its role in anchoring inflation expectations
- ✓ Preparation of the institutional, theoretical and legal framework to ensure shifting to inflation targeting as from 2005

## Openness of the Economy\*

percent



\*) (Imports + Exports)/GDP

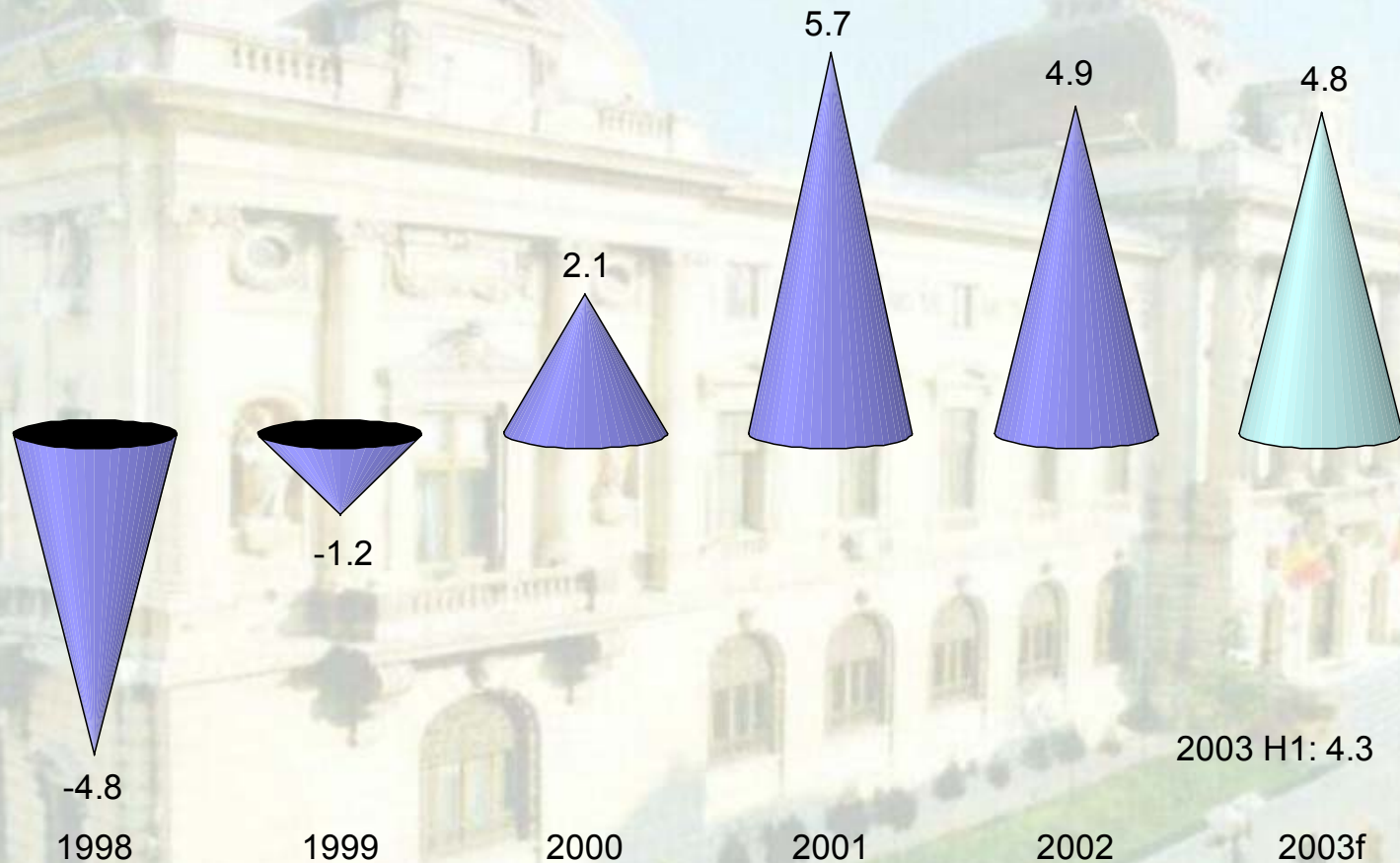
Source: National Institute of Statistics, NBR calculations

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## Real GDP

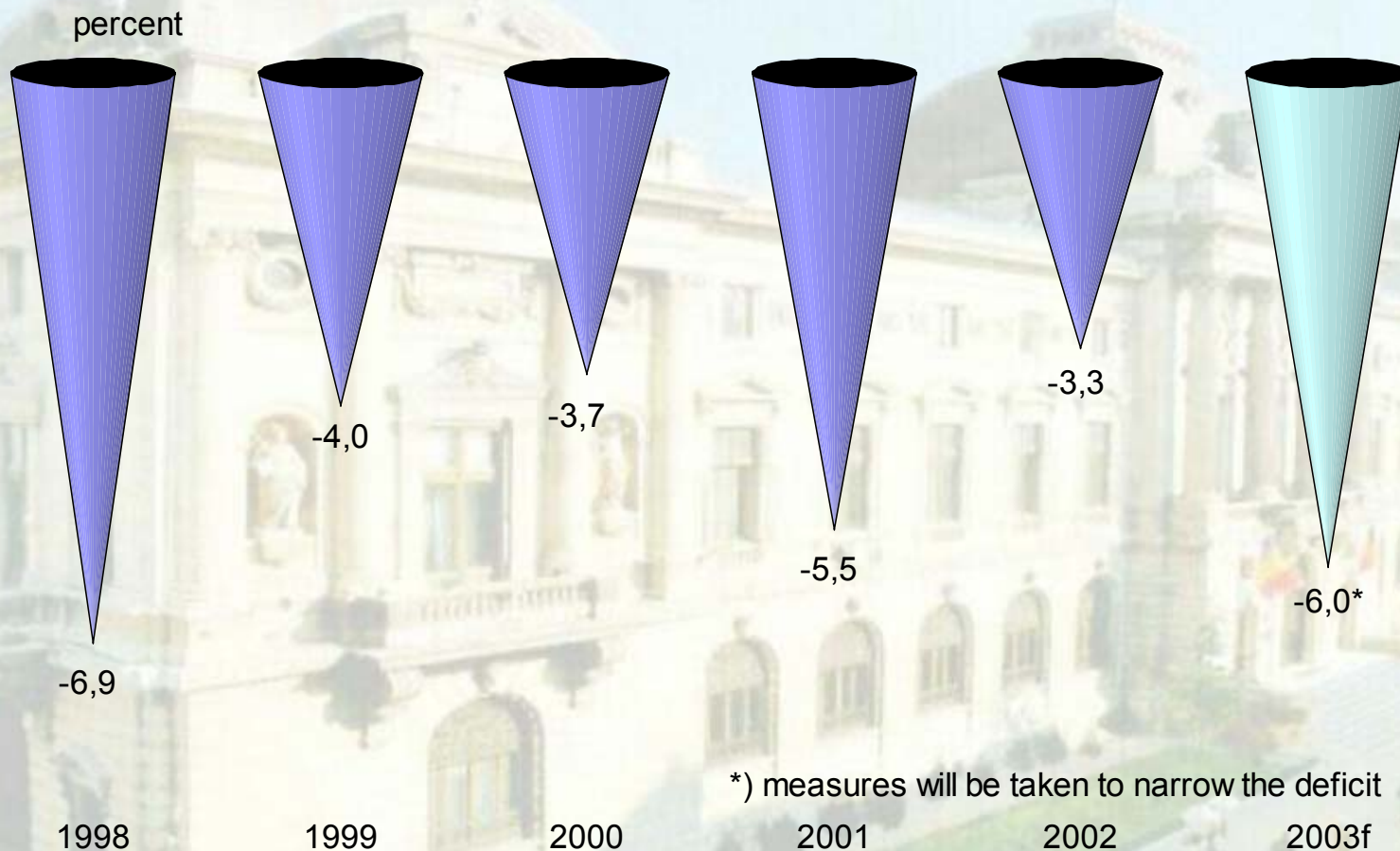
percentage change against the same period of the previous year



Source: National Institute of Statistics



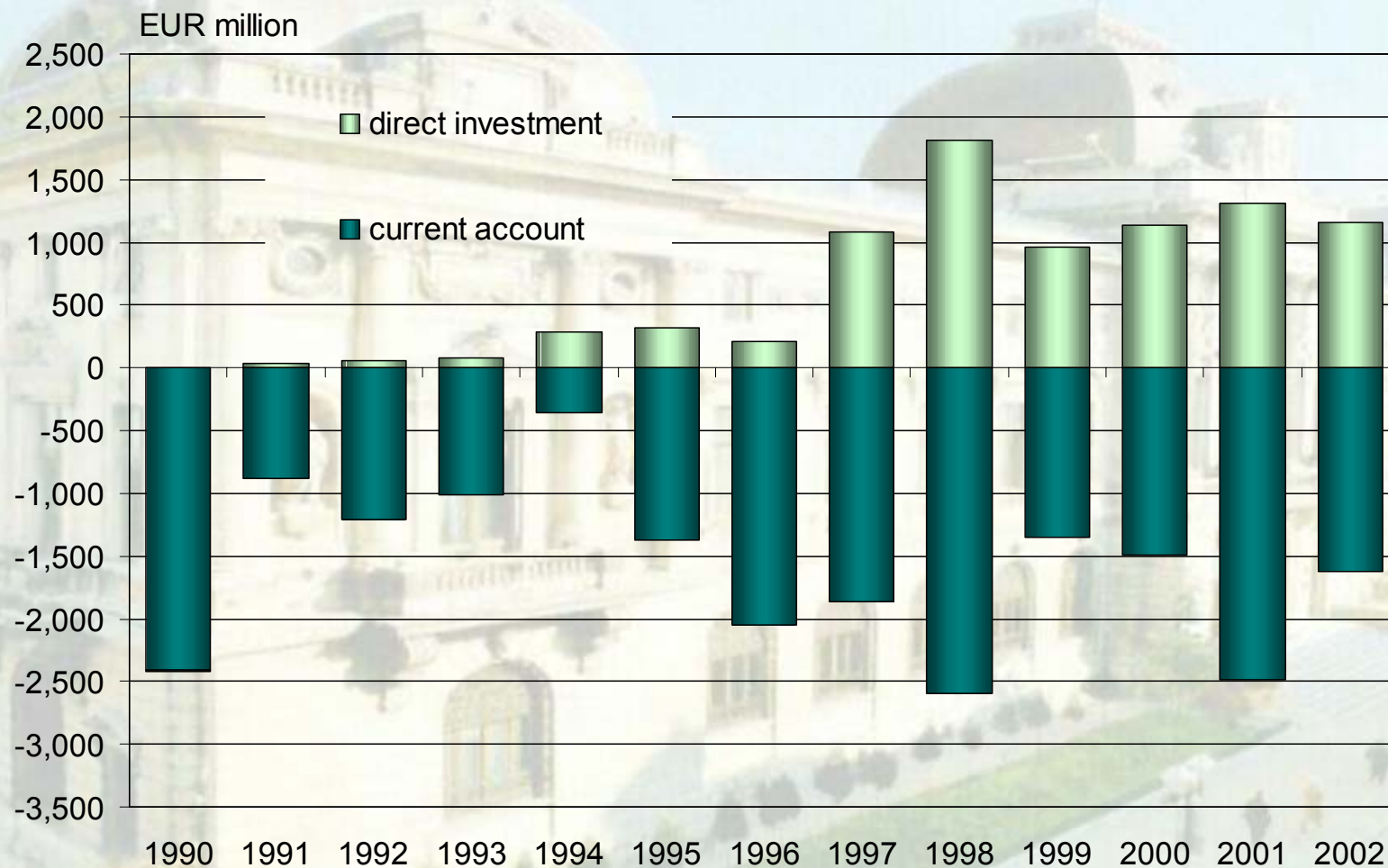
## Current Account Balance as Percentage of GDP



Source: National Institute of Statistics, National Bank of Romania



## Balance of Current Account and Direct Investment



Source: National Bank of Romania

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## Top-Ten Countries by Investment in Joint-Stock Companies in Romania at end-September 2003

share of total subscribed capital (percent)



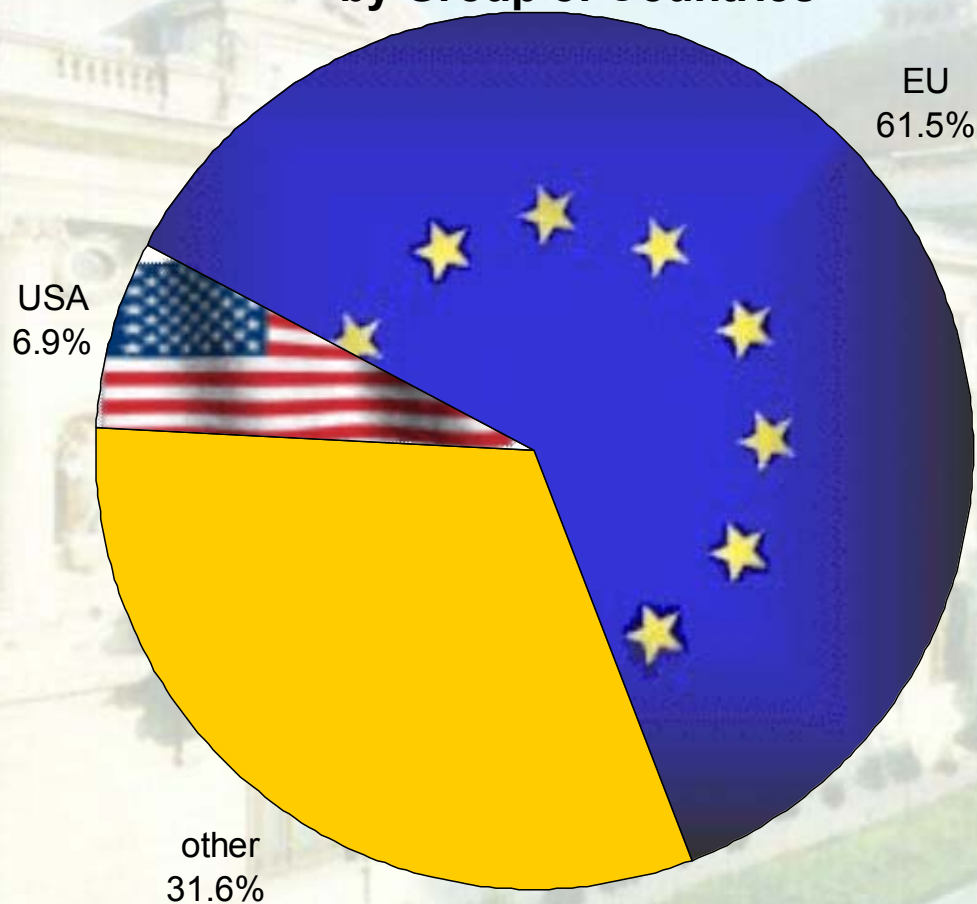
Source: The National Trade Register Office

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## Foreign Equity in Joint-Stock Companies in Romania\* by Group of Countries



\*) at end-September 2003

Source: The National Trade Register Office

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## Foreign Equity in Joint-Stock Companies in Romania\* by Sector

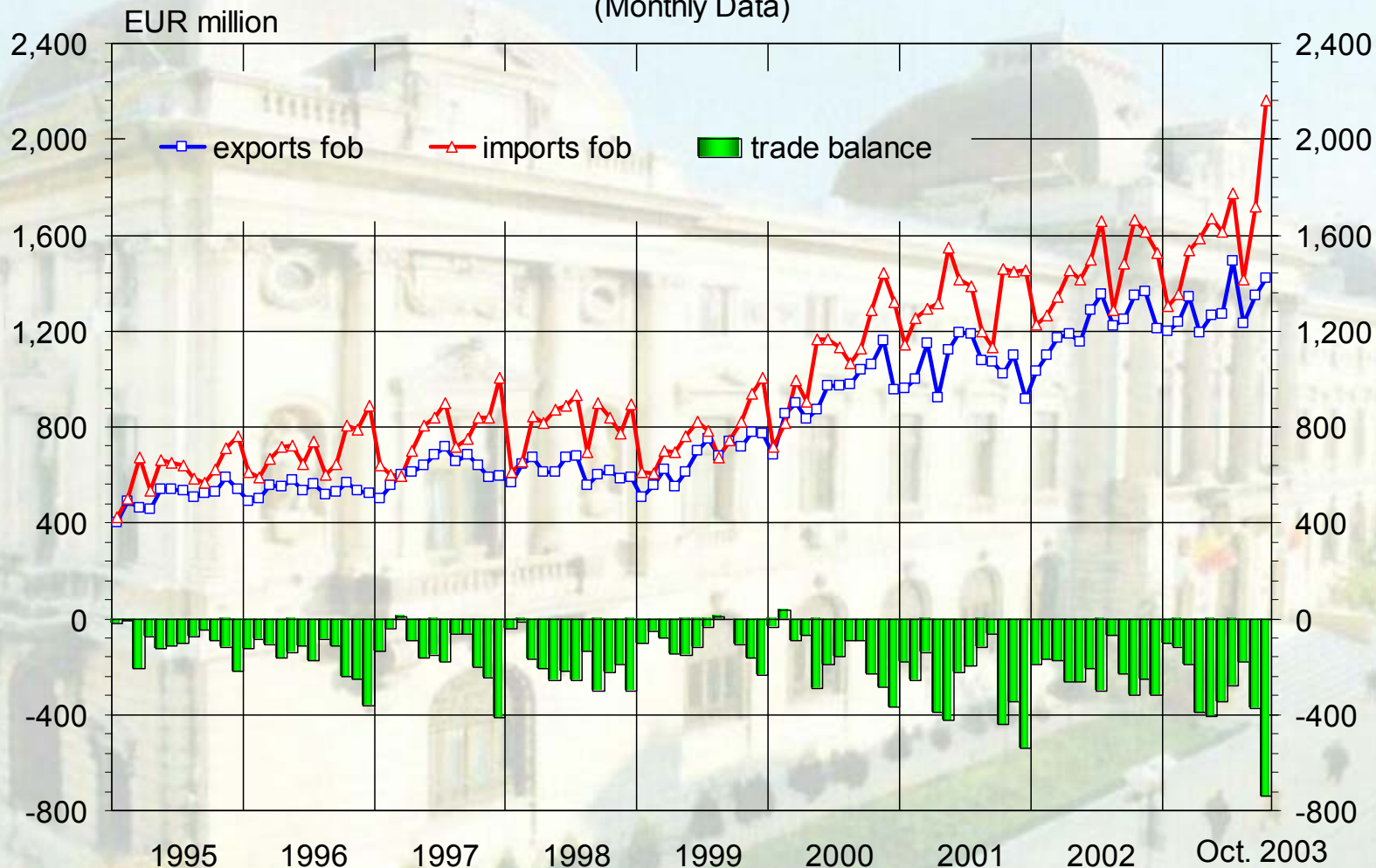


\*) at end-September 2003

Source: The National Trade Register Office



## Trade Balance (Monthly Data)

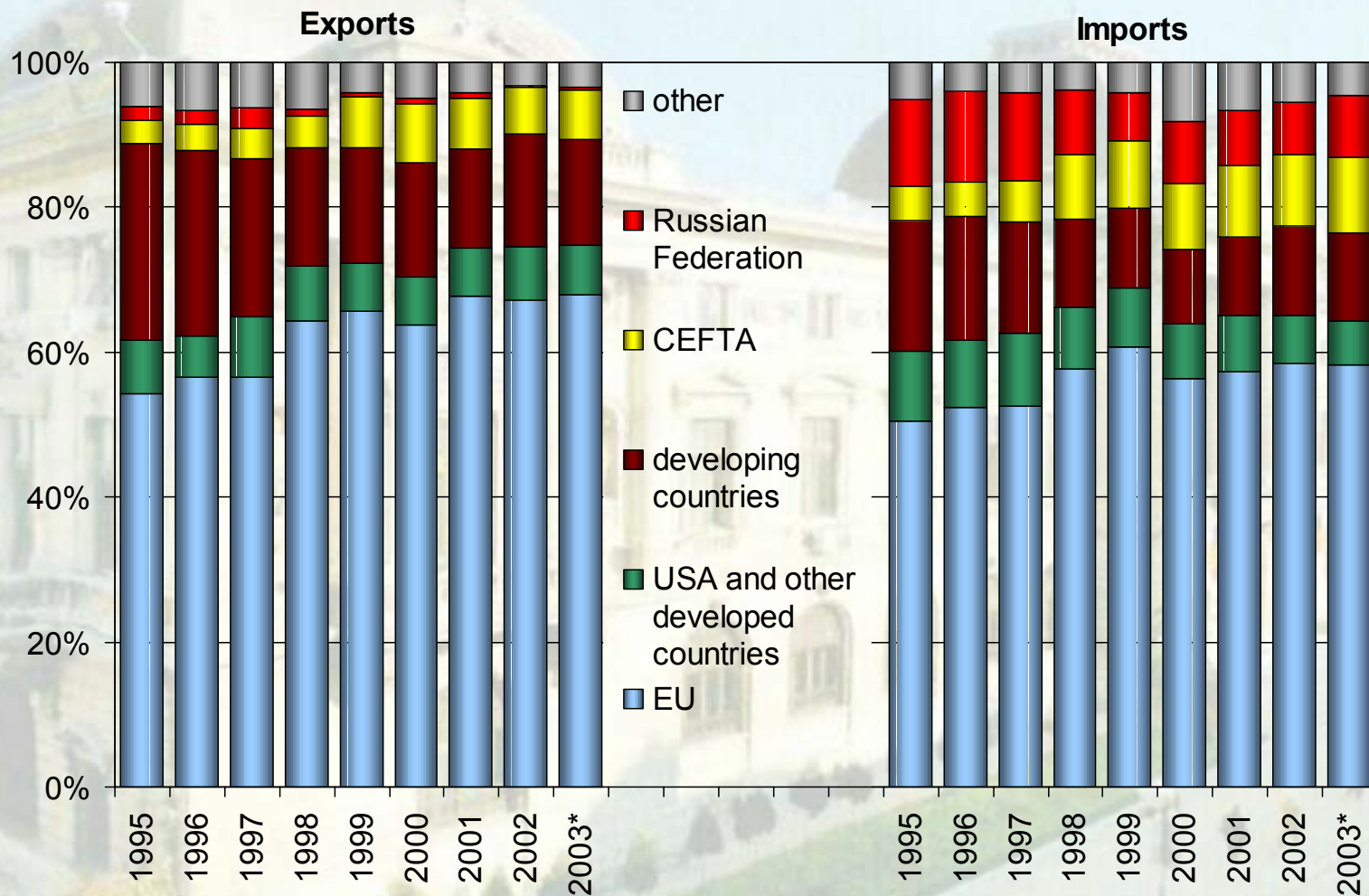


Source: National Institute of Statistics

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# Foreign Trade by Group of Countries



Source: National Institute of Statistics

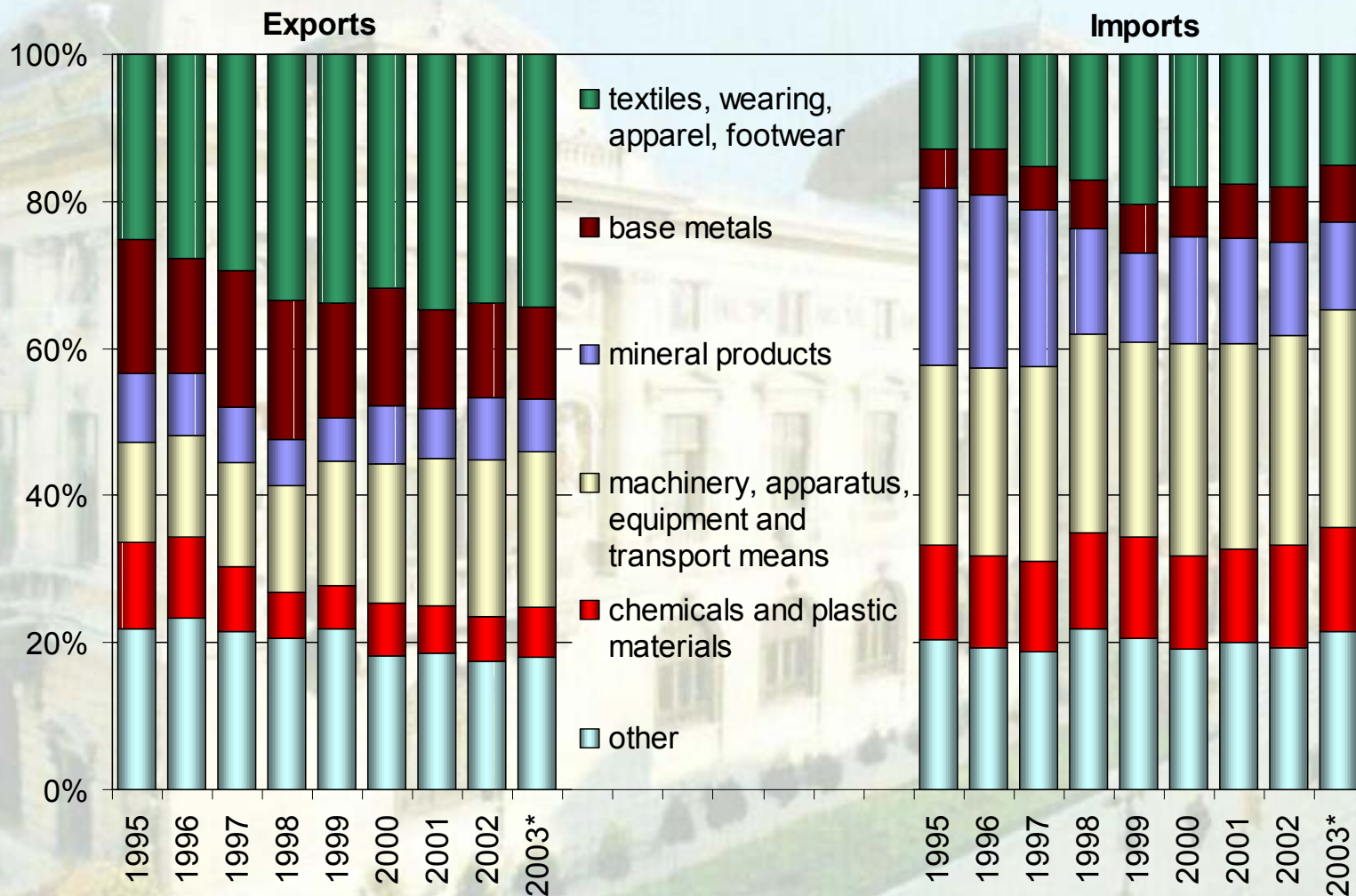
\*) Jan. - Sep.

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# Foreign Trade by Group of Commodities



Source: National Institute of Statistics

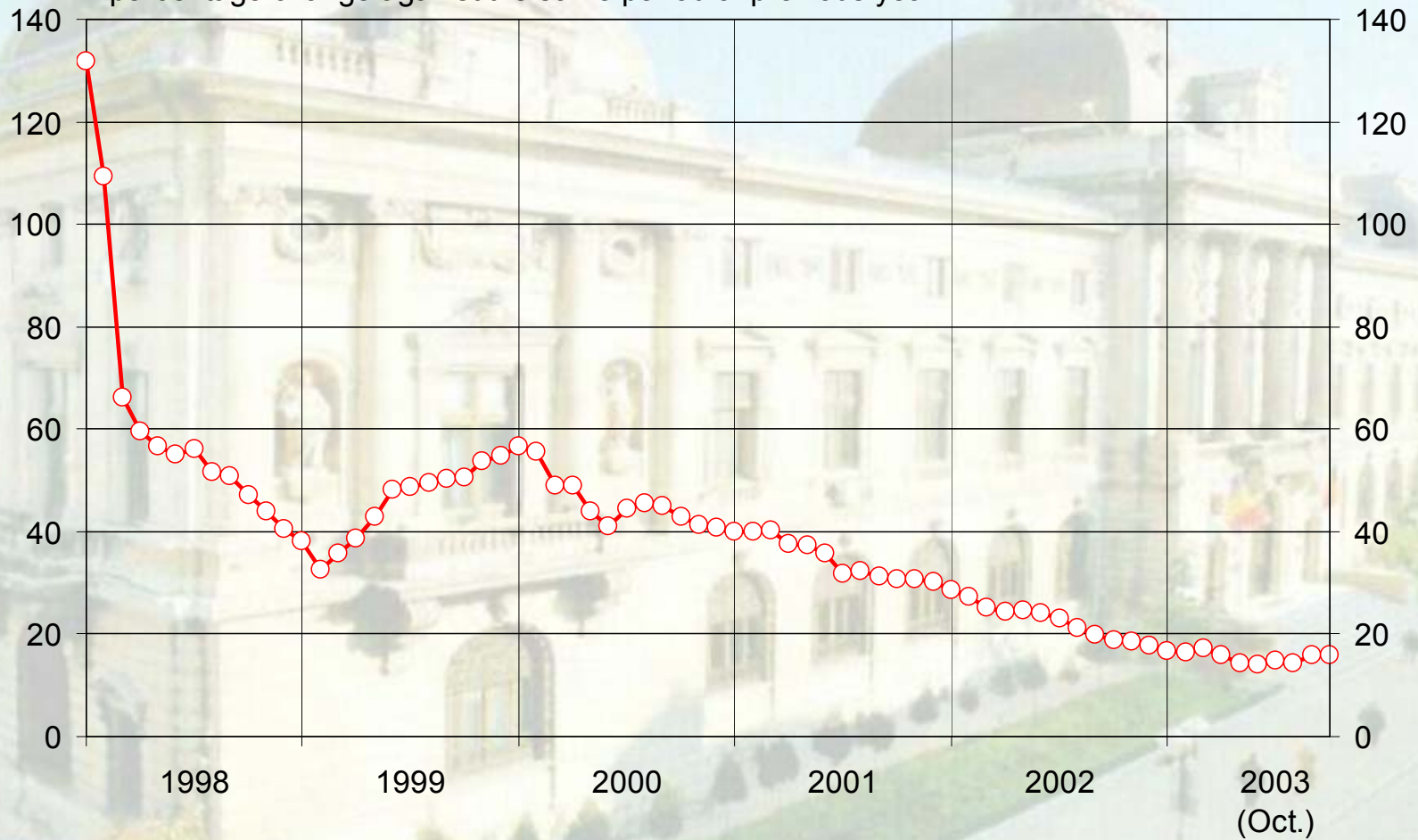
\*) Jan. - Sep.

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## Inflation Rate (CPI)

percentage change against the same period of previous year



Source: National Institute of Statistics

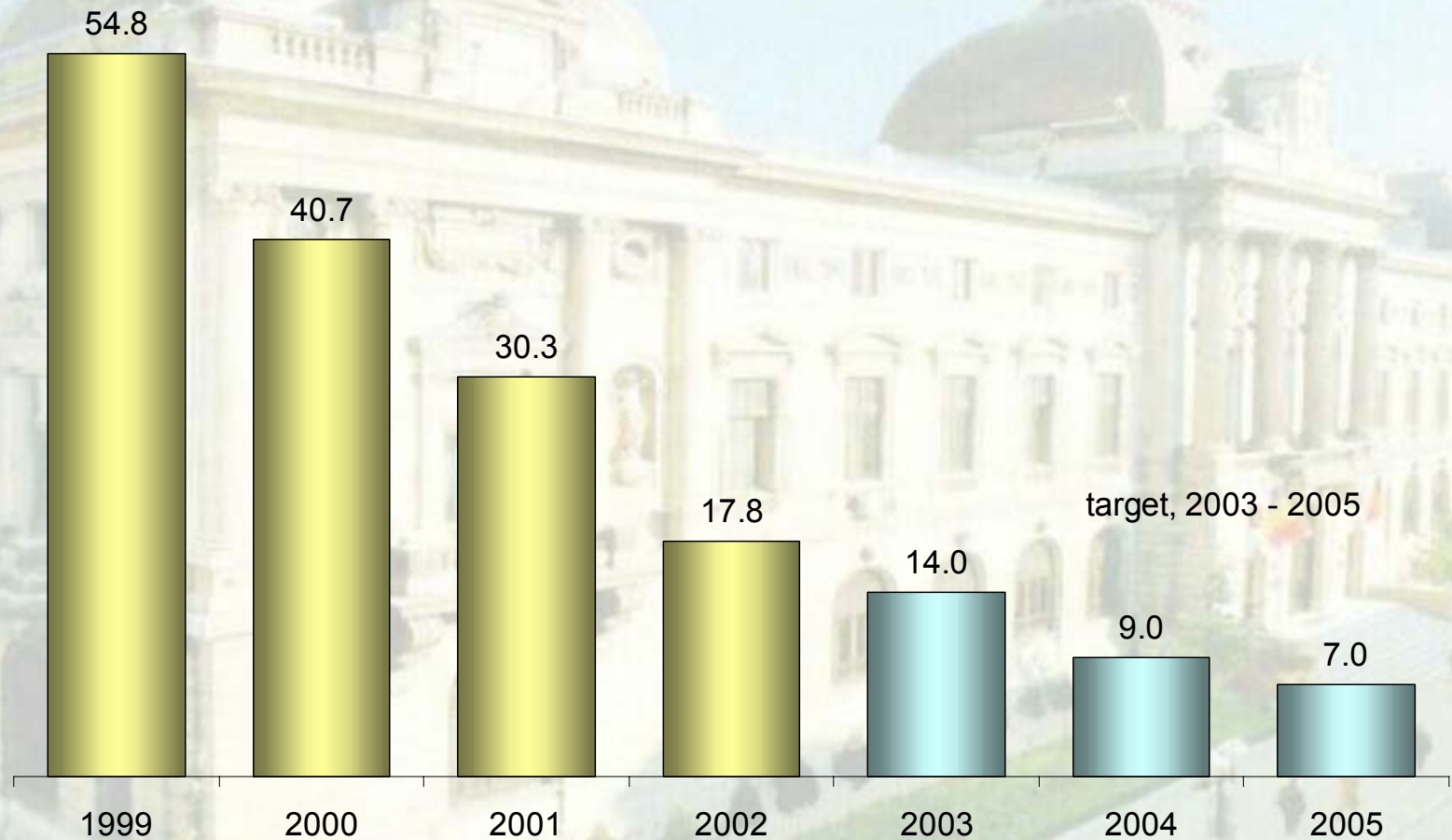
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## Inflation Rate

CPI; Dec./Dec.

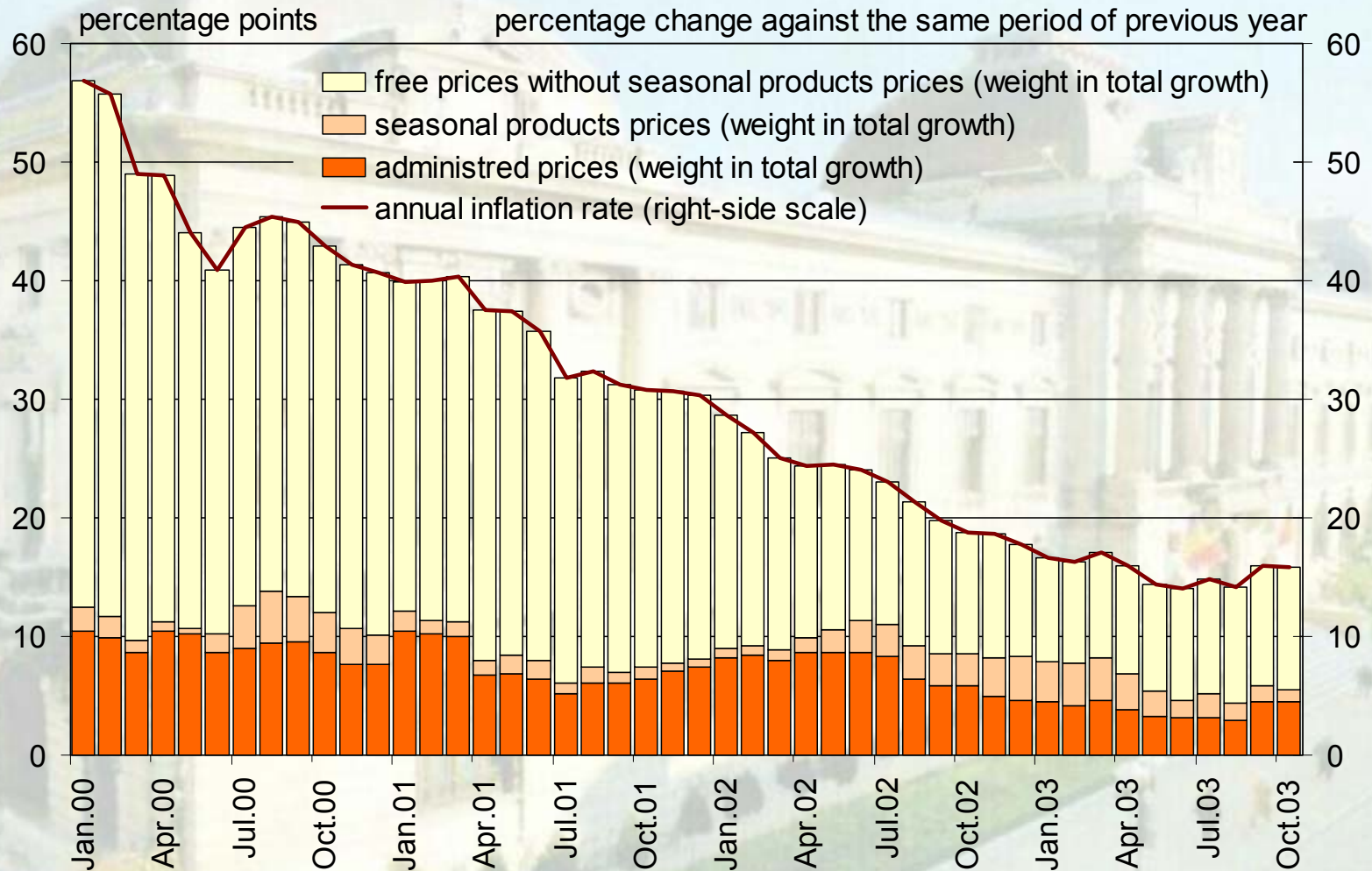


Source: National Institute of Statistics, National Commission for Forecasting

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# Inflation Rate



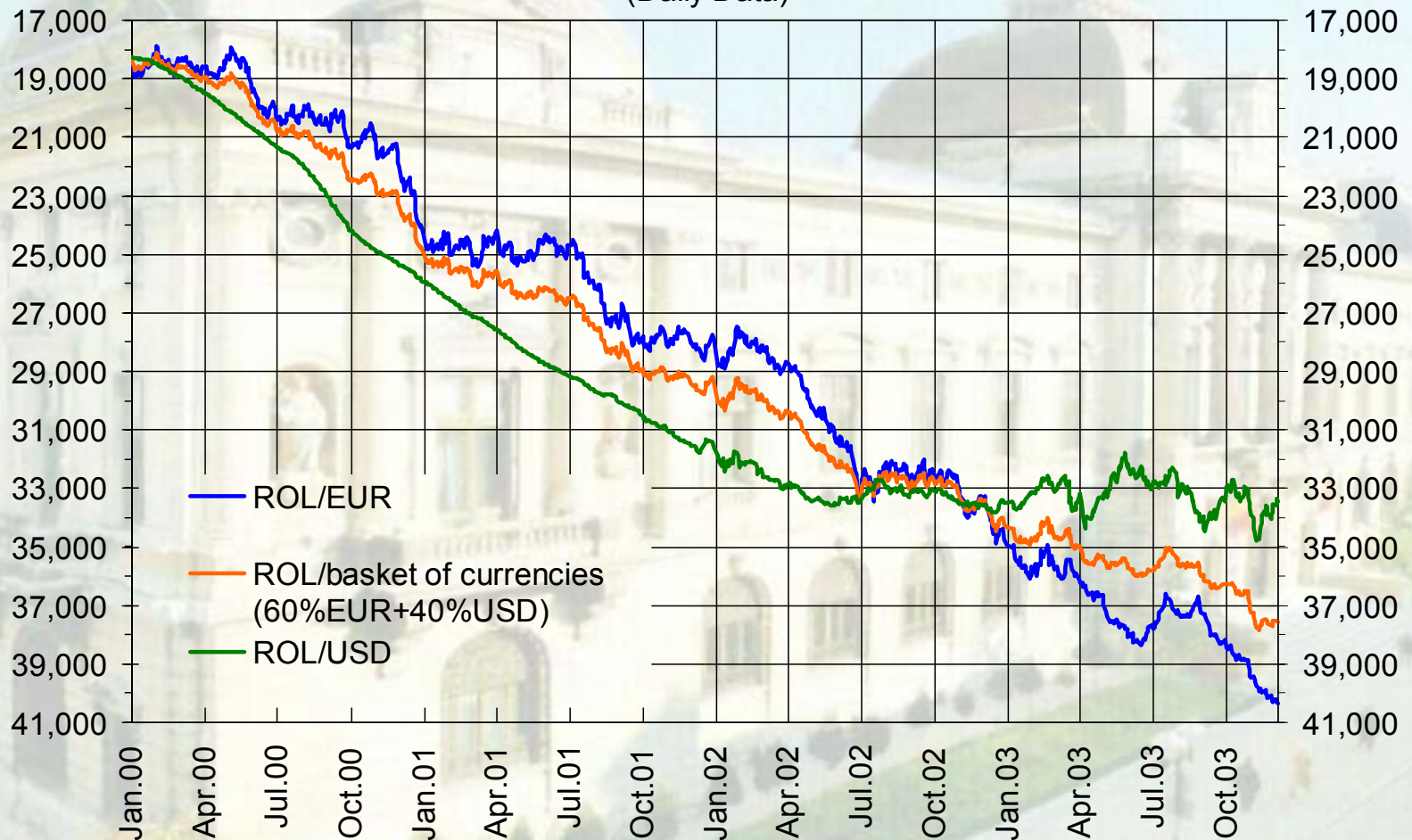
Source: National Institute of Statistics, NBR calculations

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# Nominal Exchange Rate

(Daily Data)



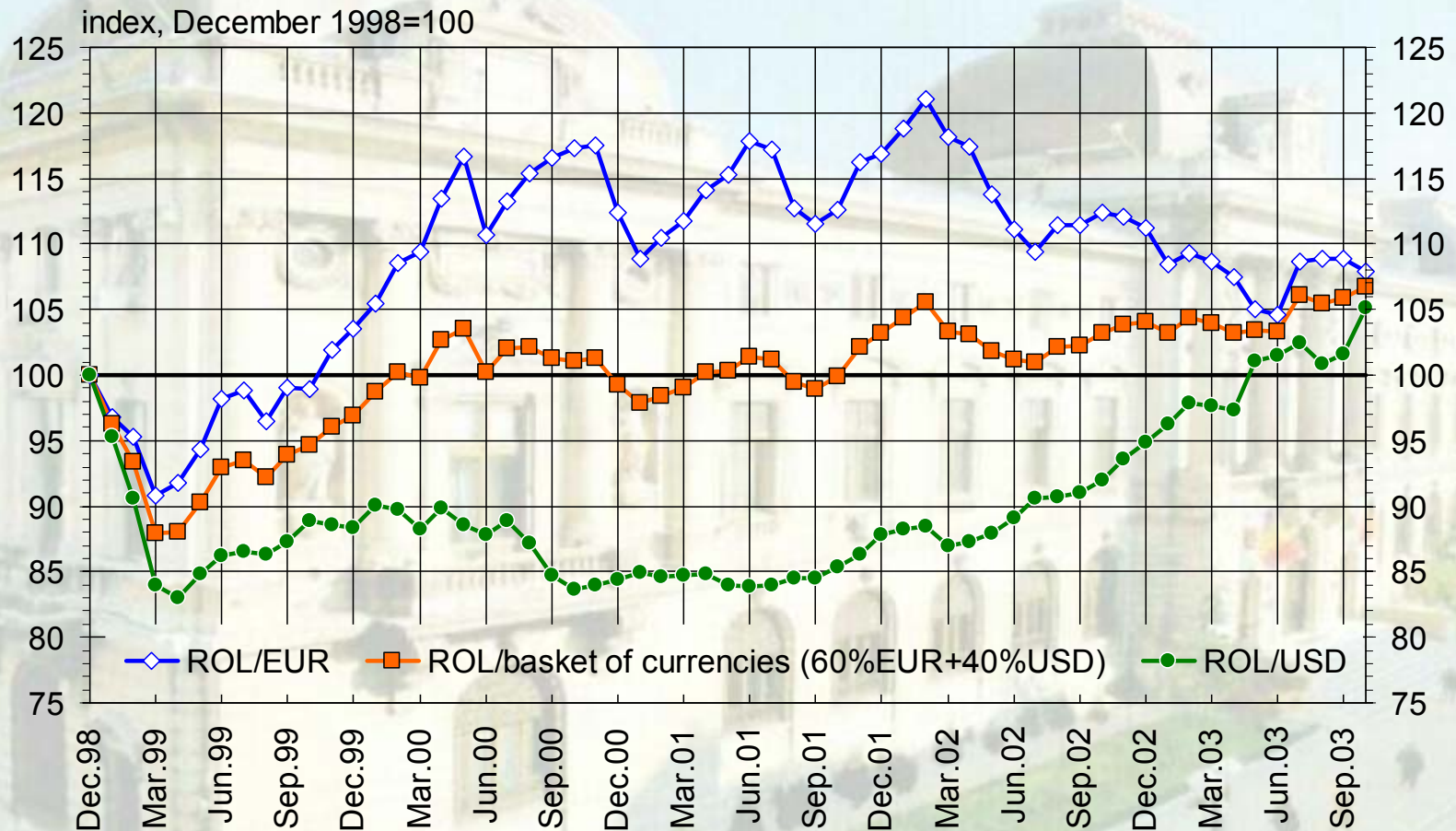
Source: National Bank of Romania

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## Real Exchange Rate\*



\*) based on CPI differential between Romania and USA/Euro area

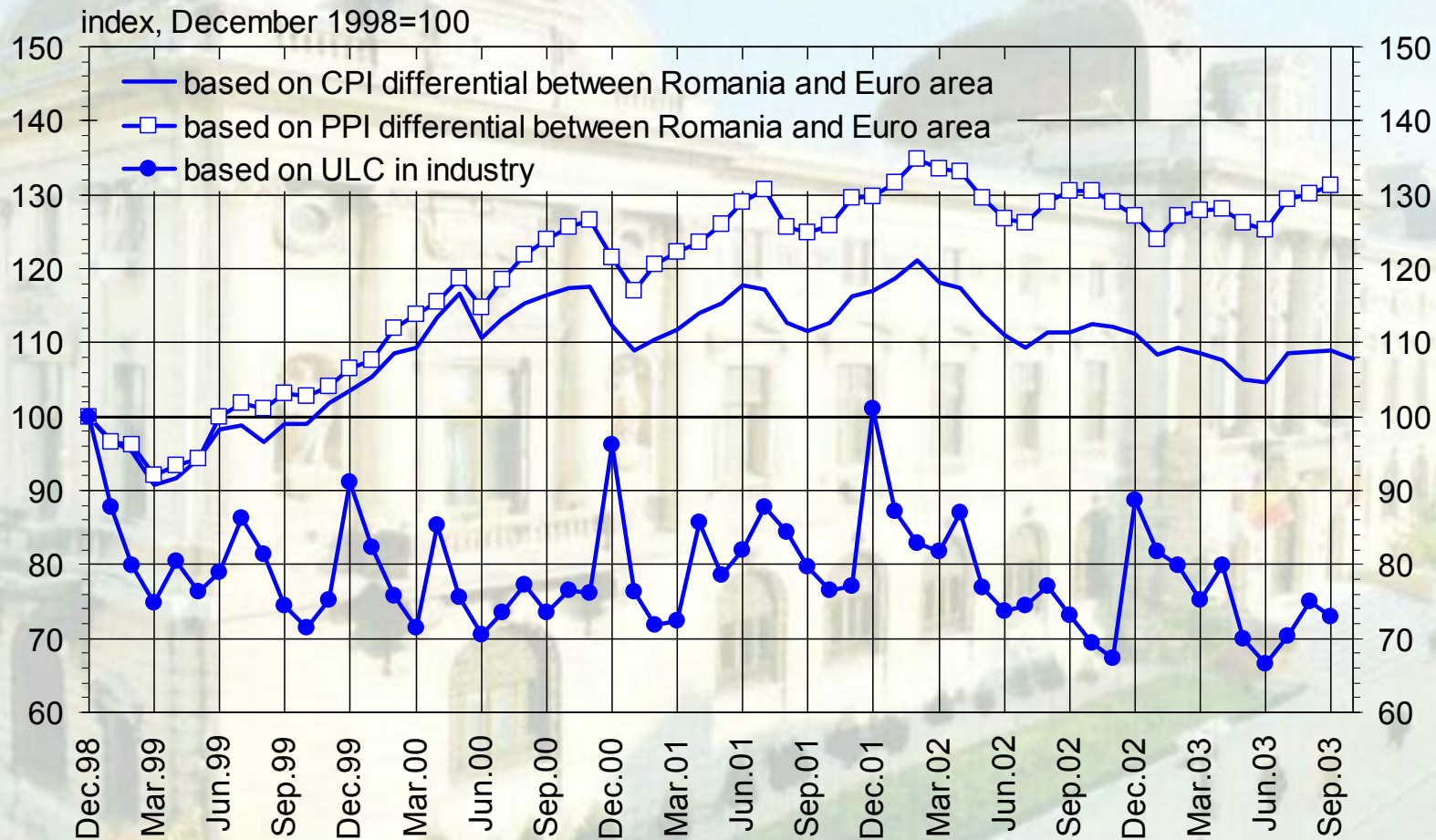
Source: National Institute of Statistics, National Bank of Romania

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# Real Exchange Rate of the ROL Against the EUR

Appreciation (+)/Depreciation (–)



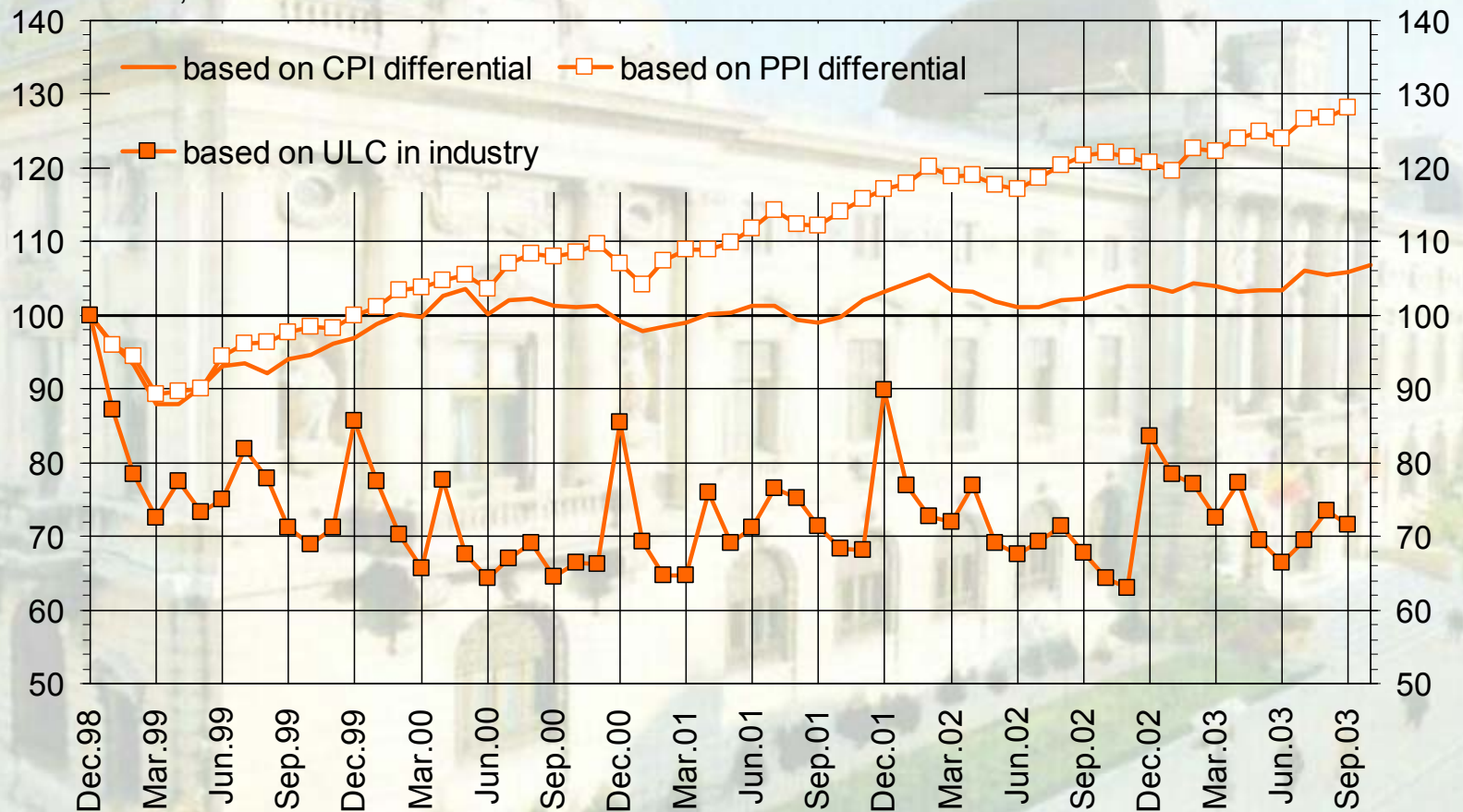
Source: National Bank of Romania

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## Real Exchange Rate of the ROL Against the Basket of Currencies (60%EUR+40%USD)

index, December 1998=100



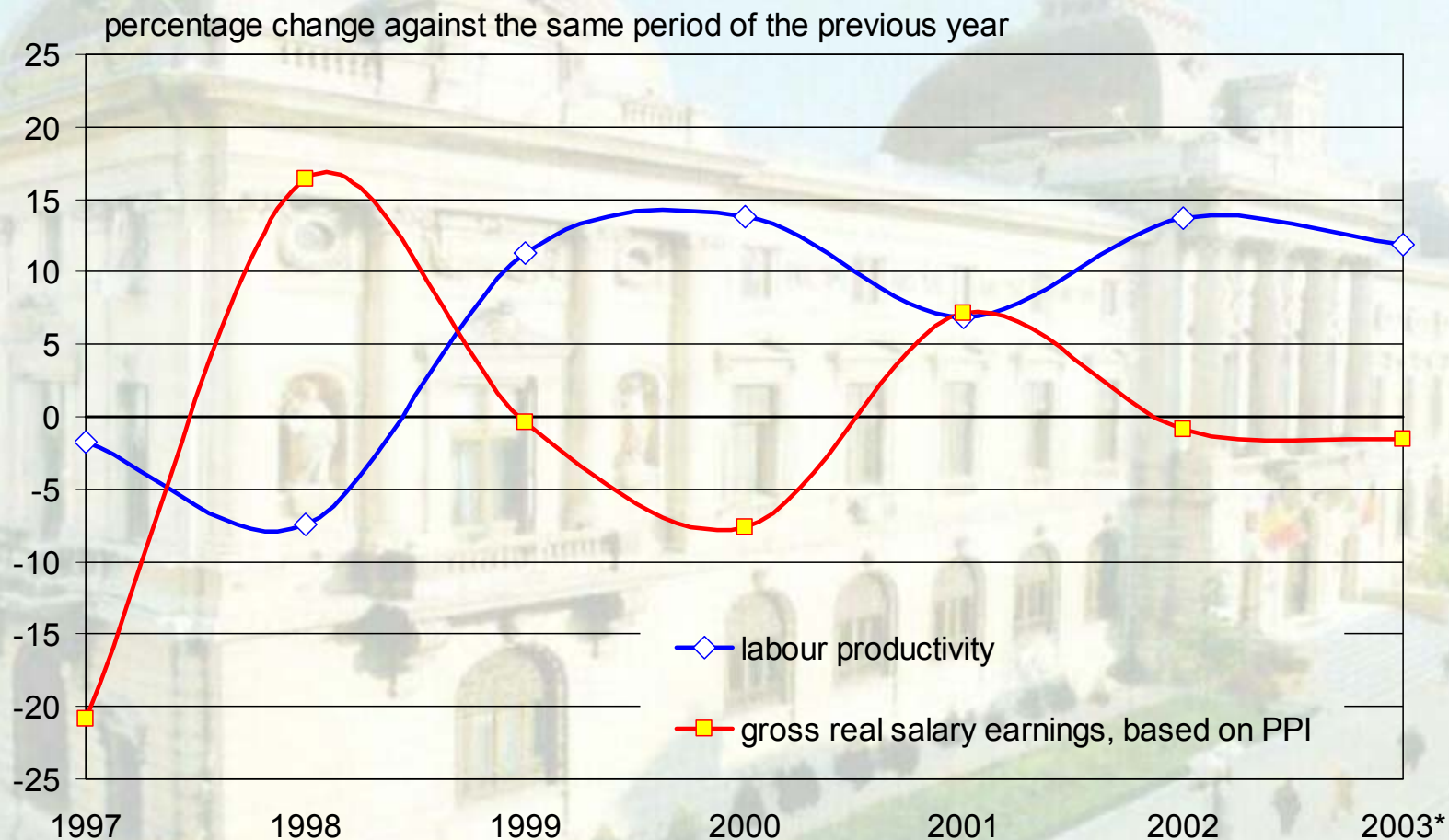
Source: National Bank of Romania

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# Real Salary Earnings and Labour Productivity in Industry



Source: National Institute of Statistics, NBR calculations

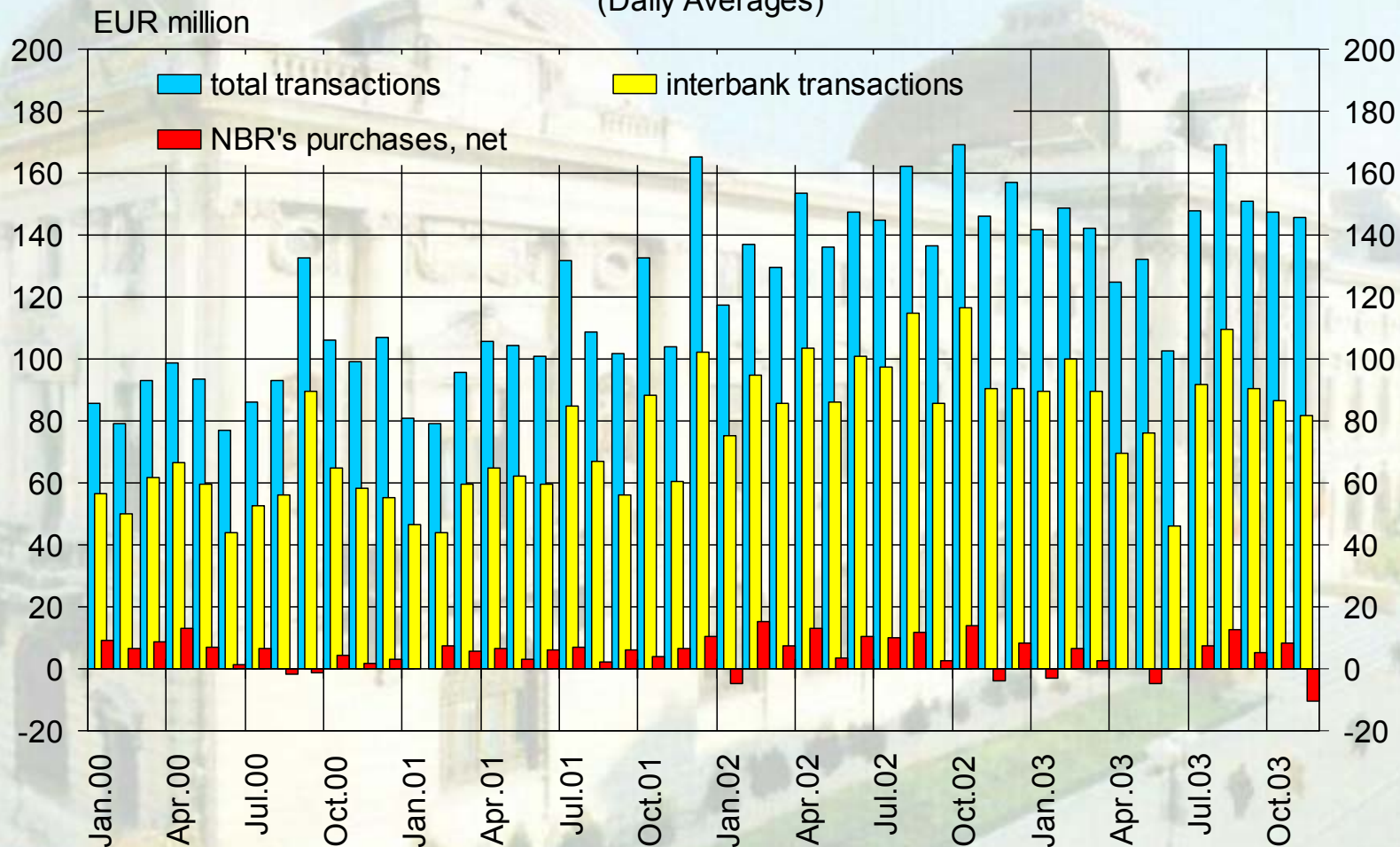
\*) Jan. - Sep.

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# Transactions on Forex Market

(Daily Averages)

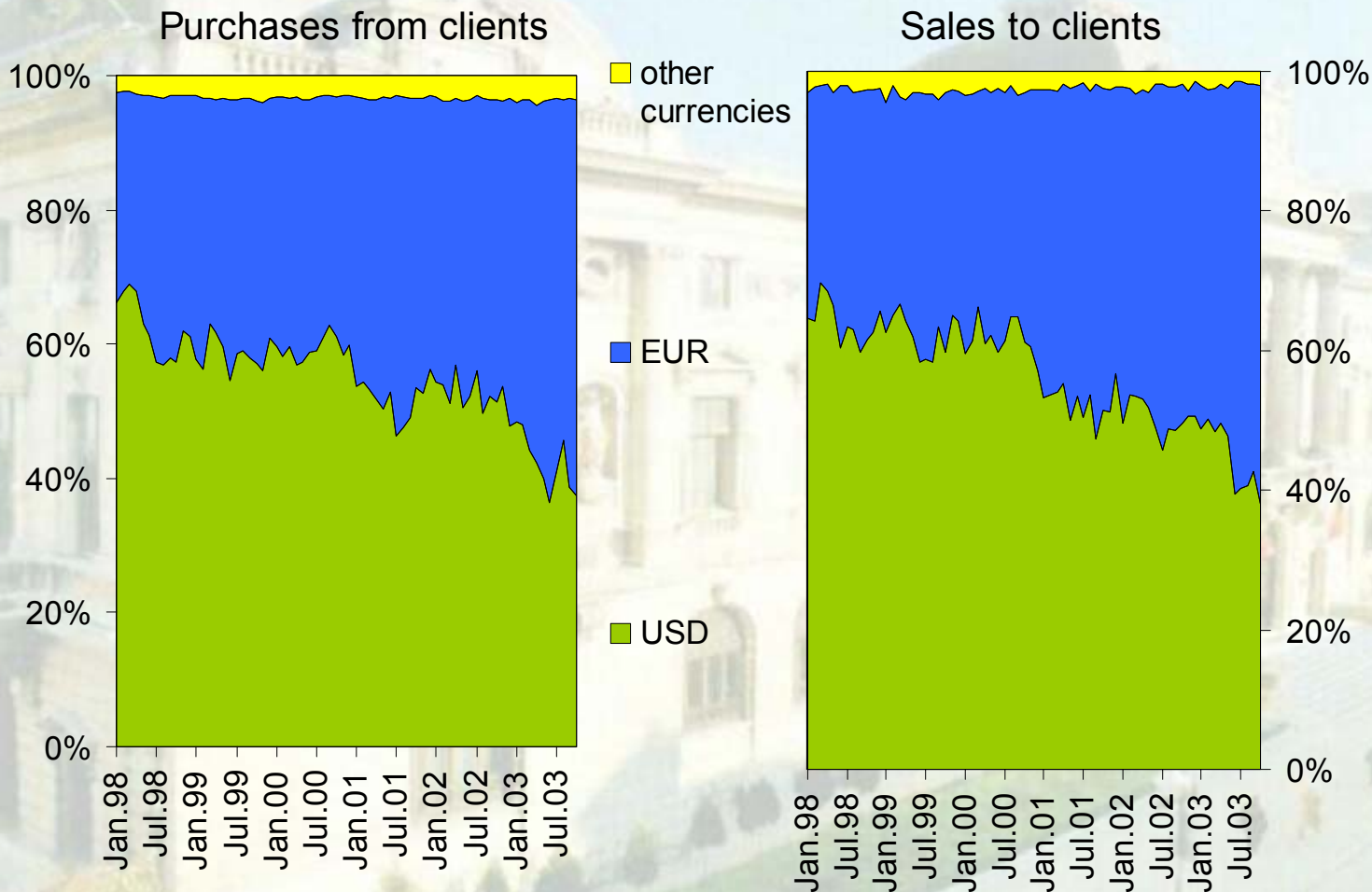


Source: National Bank of Romania

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## Transactions on Interbank Forex Market by Currency



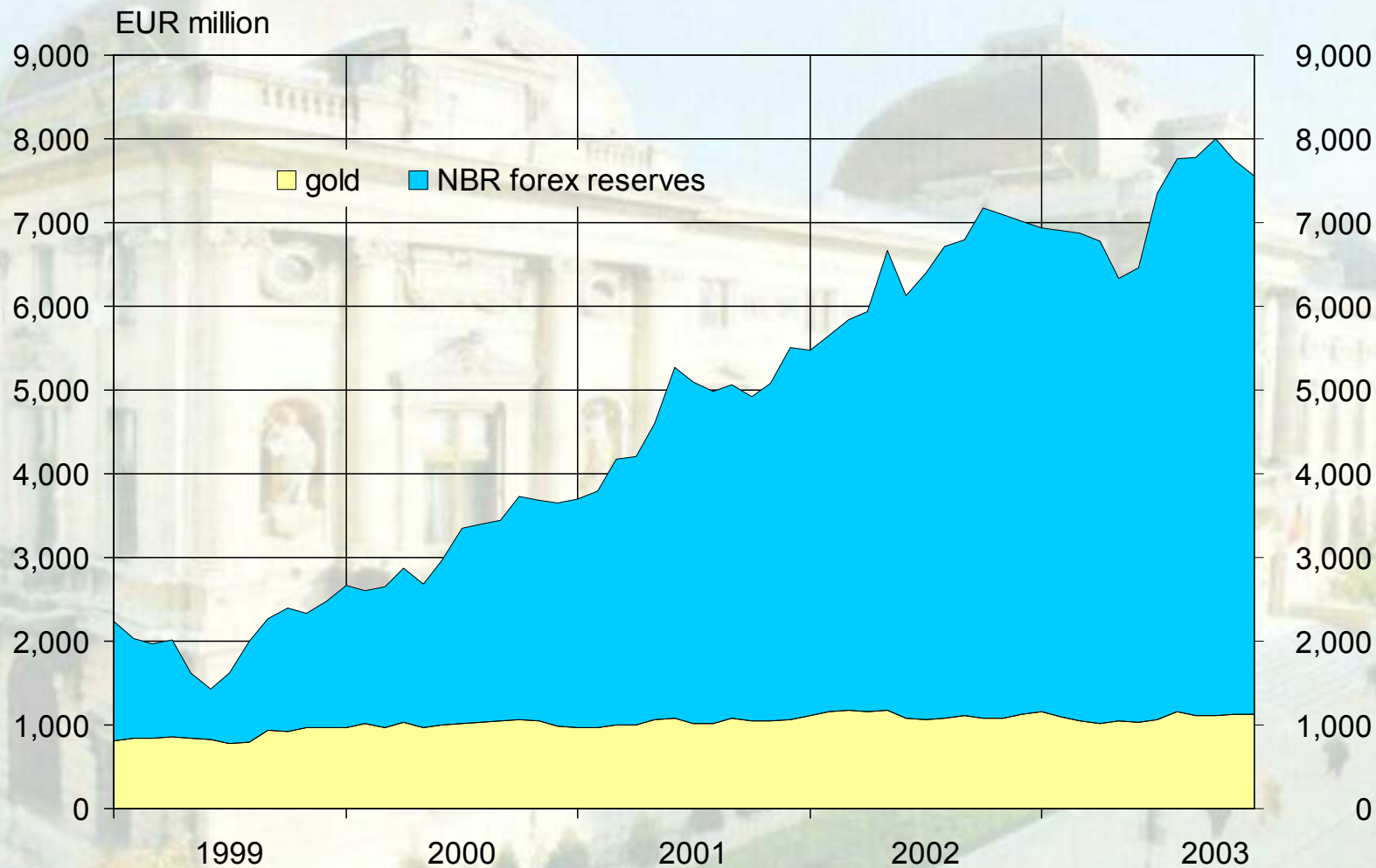
Source: National Bank of Romania

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## Gross Official Reserves



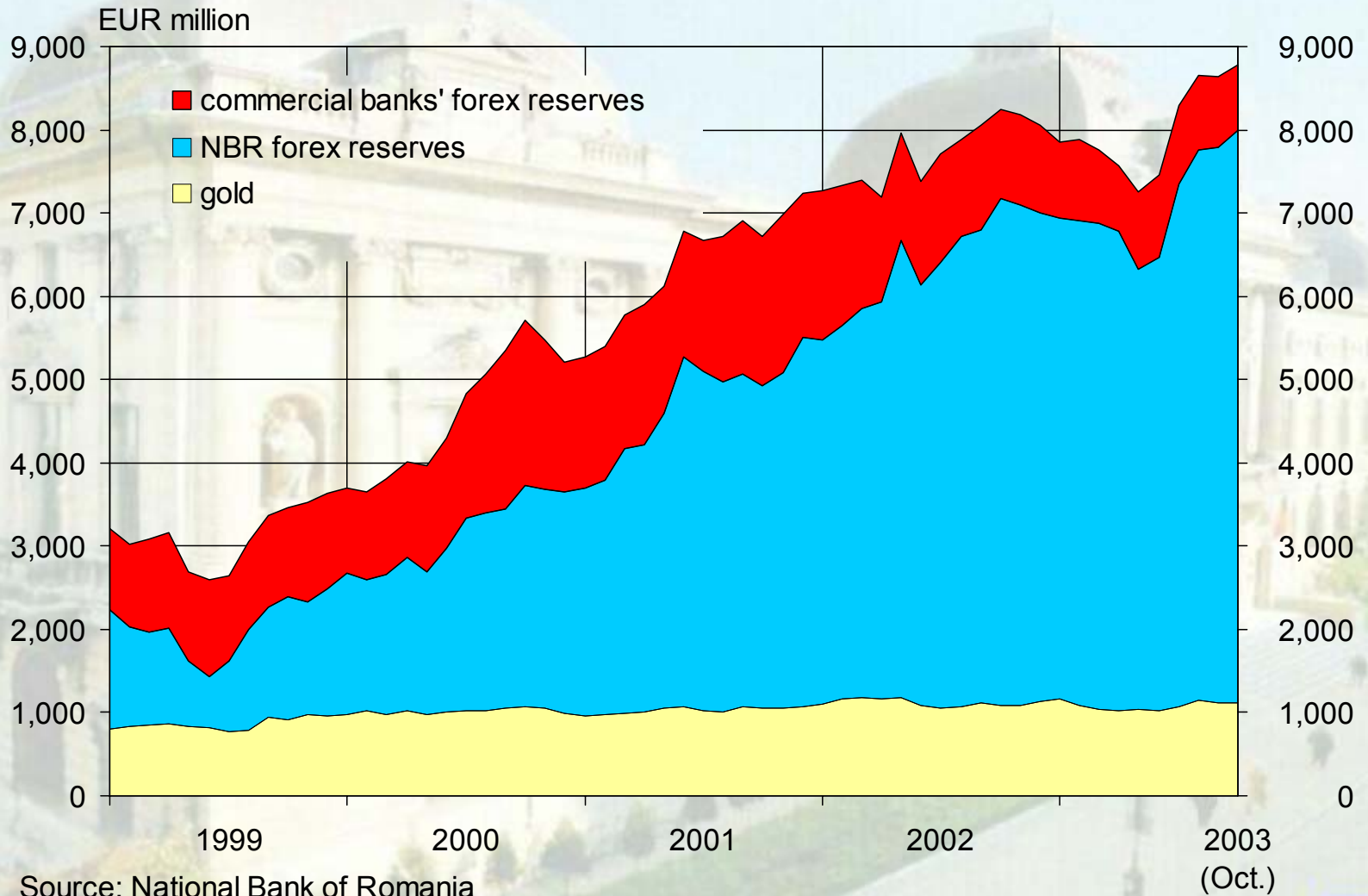
Source: National Bank of Romania

(Dec. 11)

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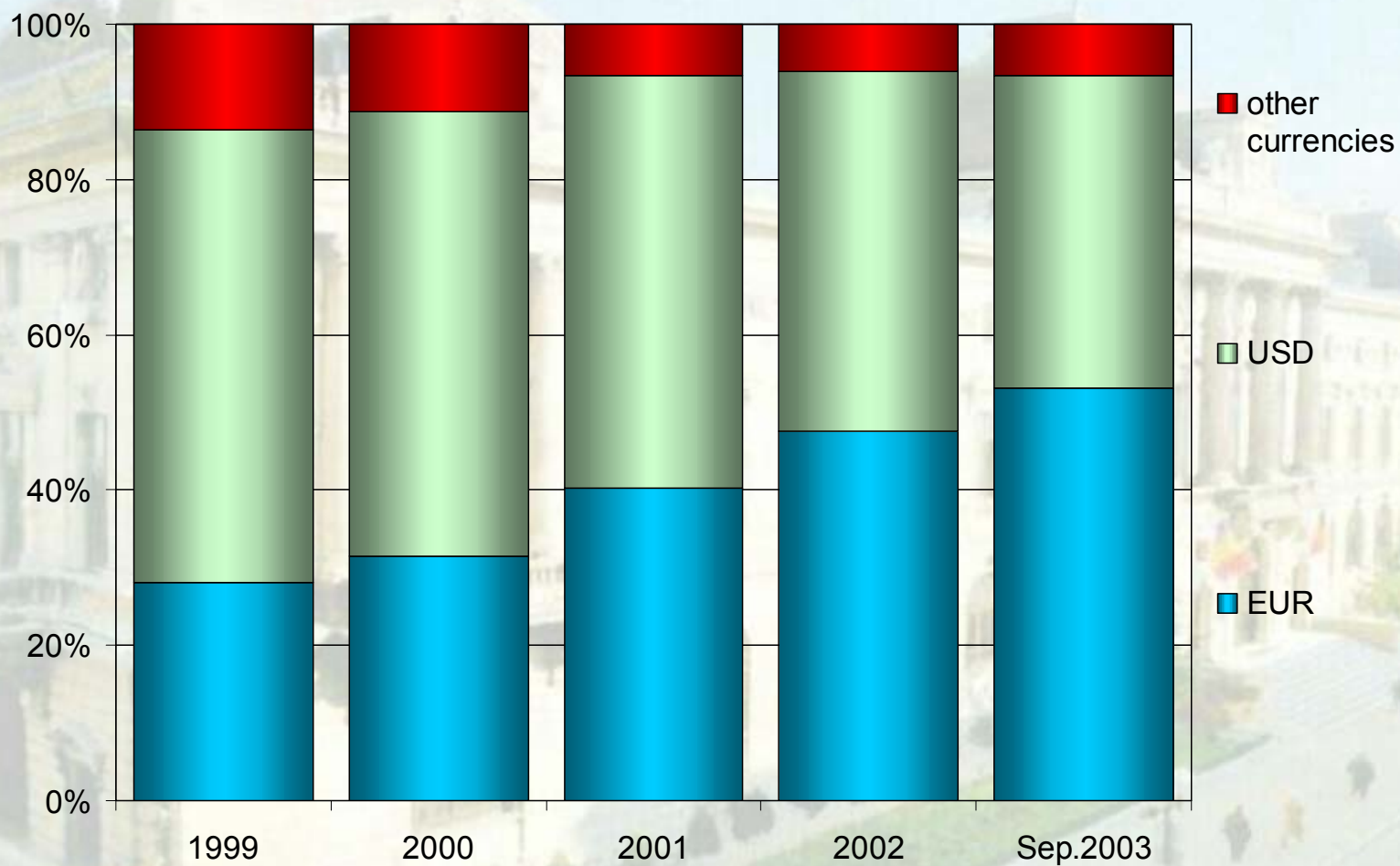
## Gross International Reserves



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## MLT External Debt by Currency



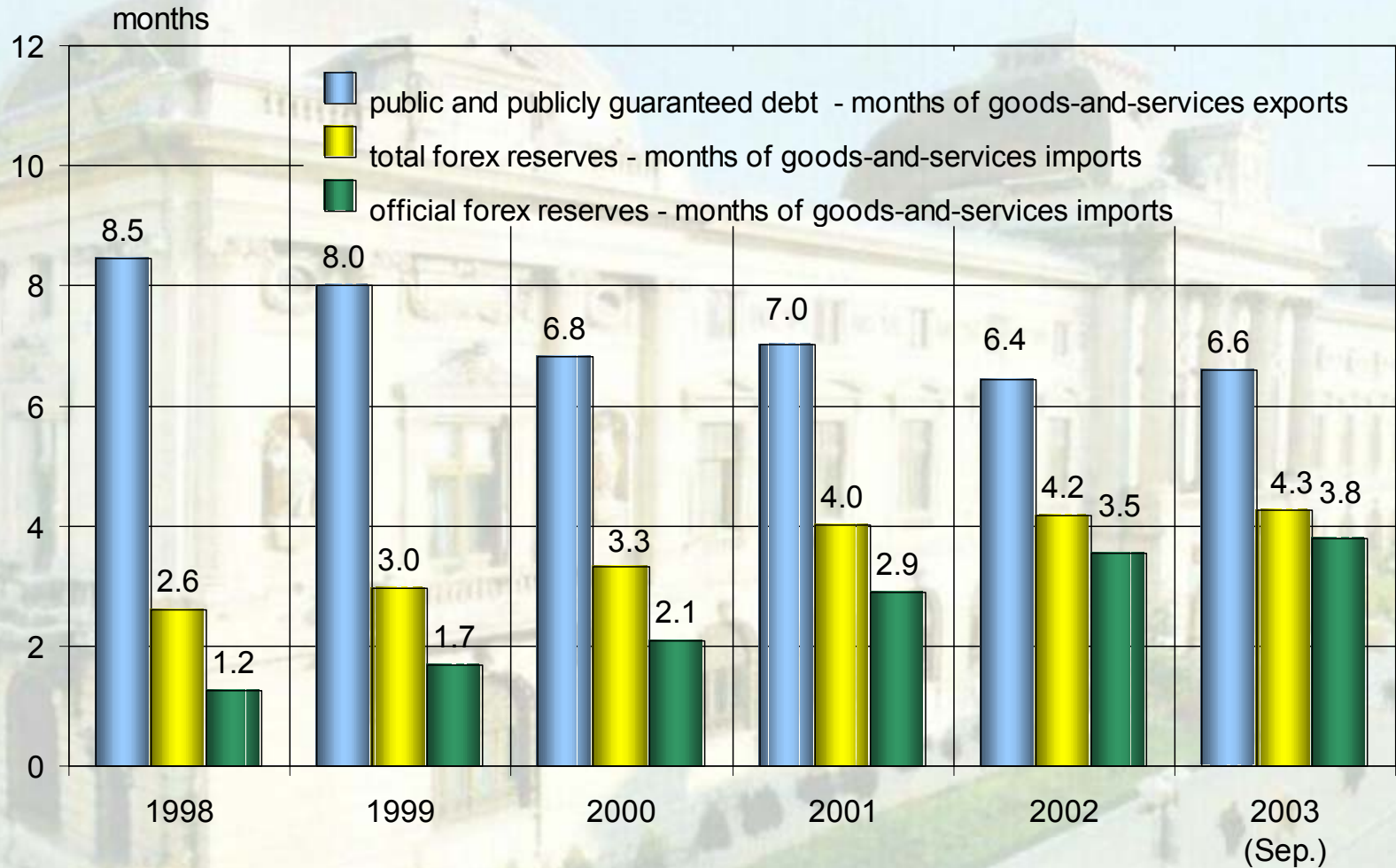
Source: National Bank of Romania

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## External Debt Indicators



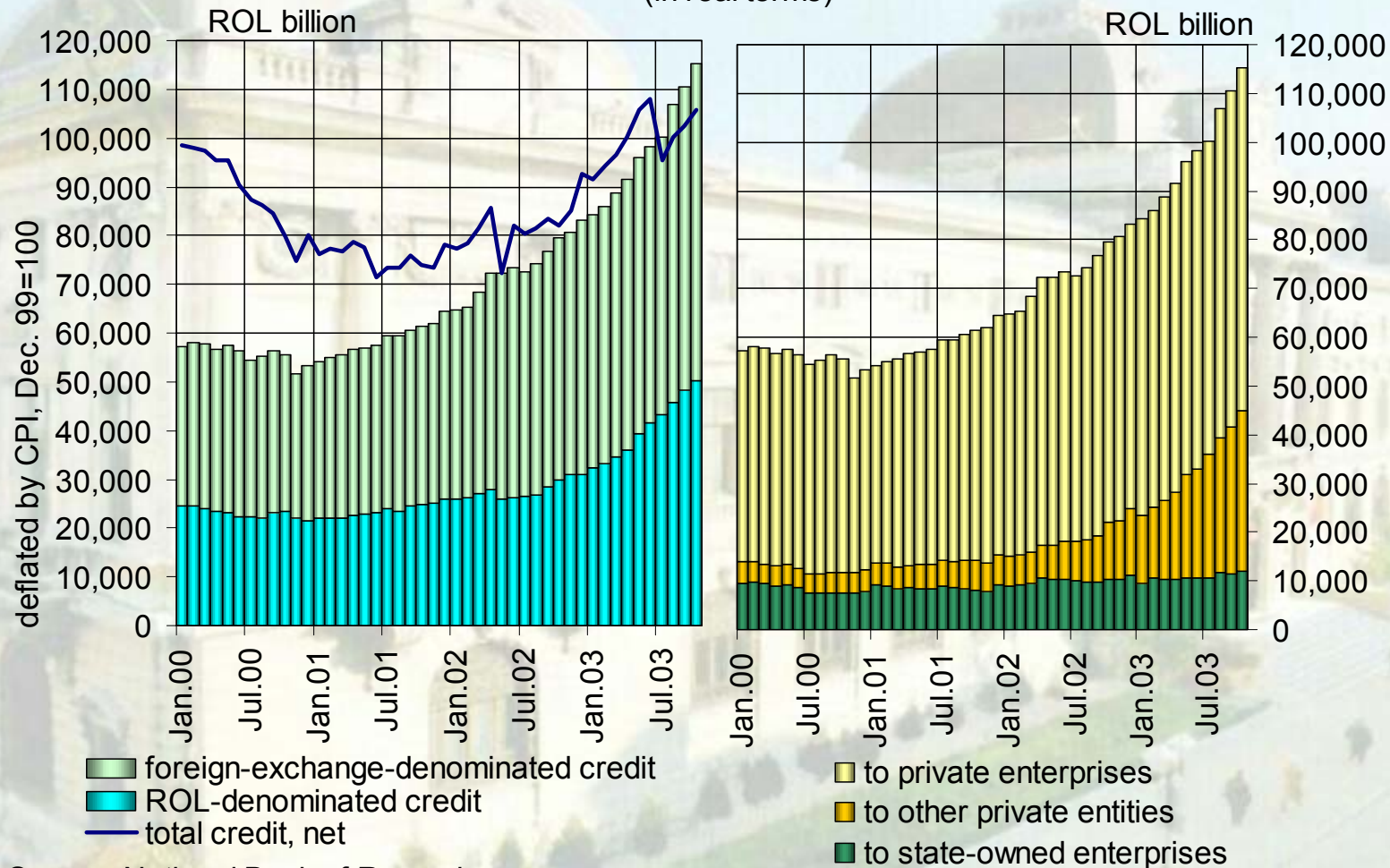
Source: National Bank of Romania

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# Total Credit and Non-Government Credit

(in real terms)

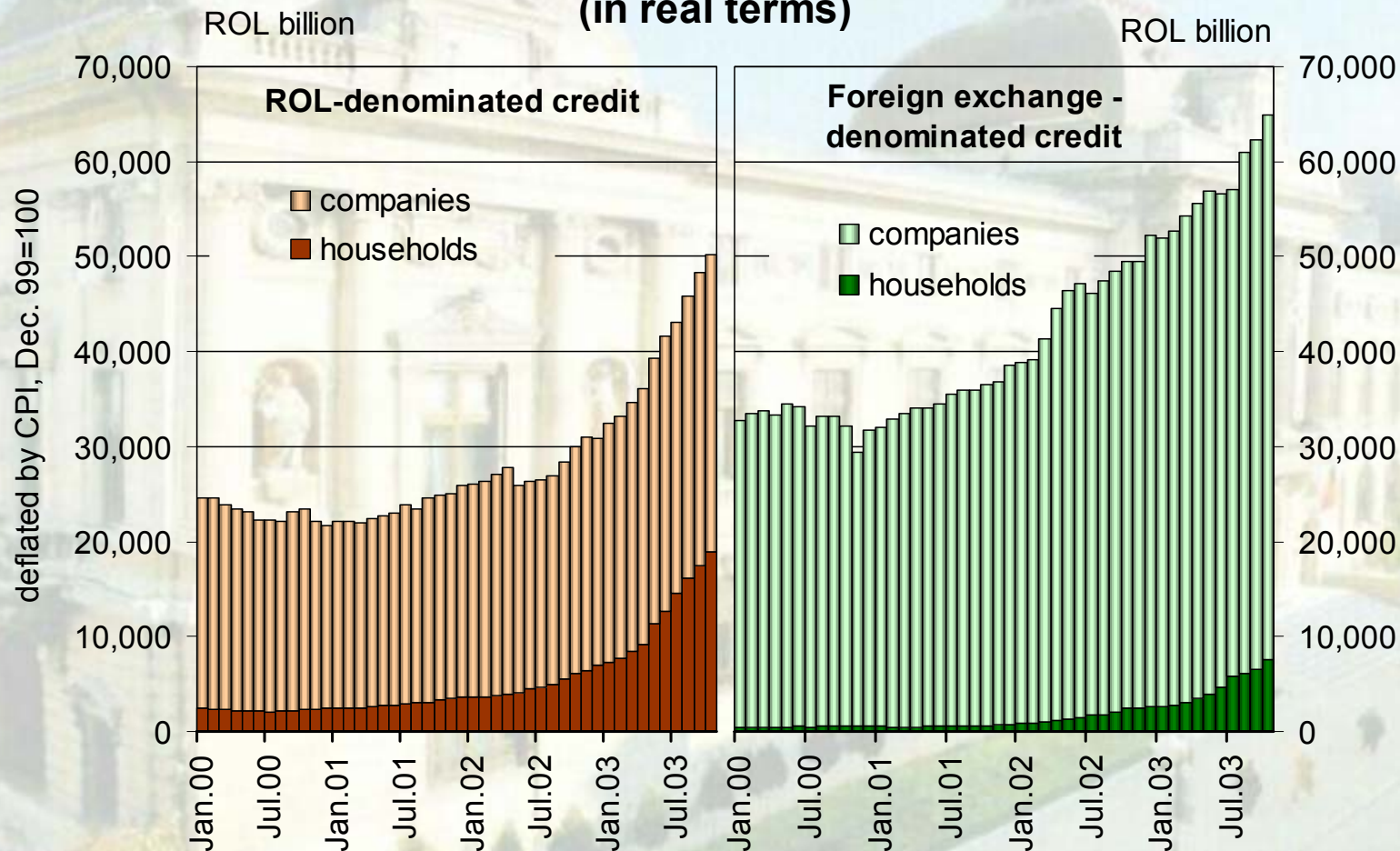


Source: National Bank of Romania

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## Credit to Non-Government (in real terms)



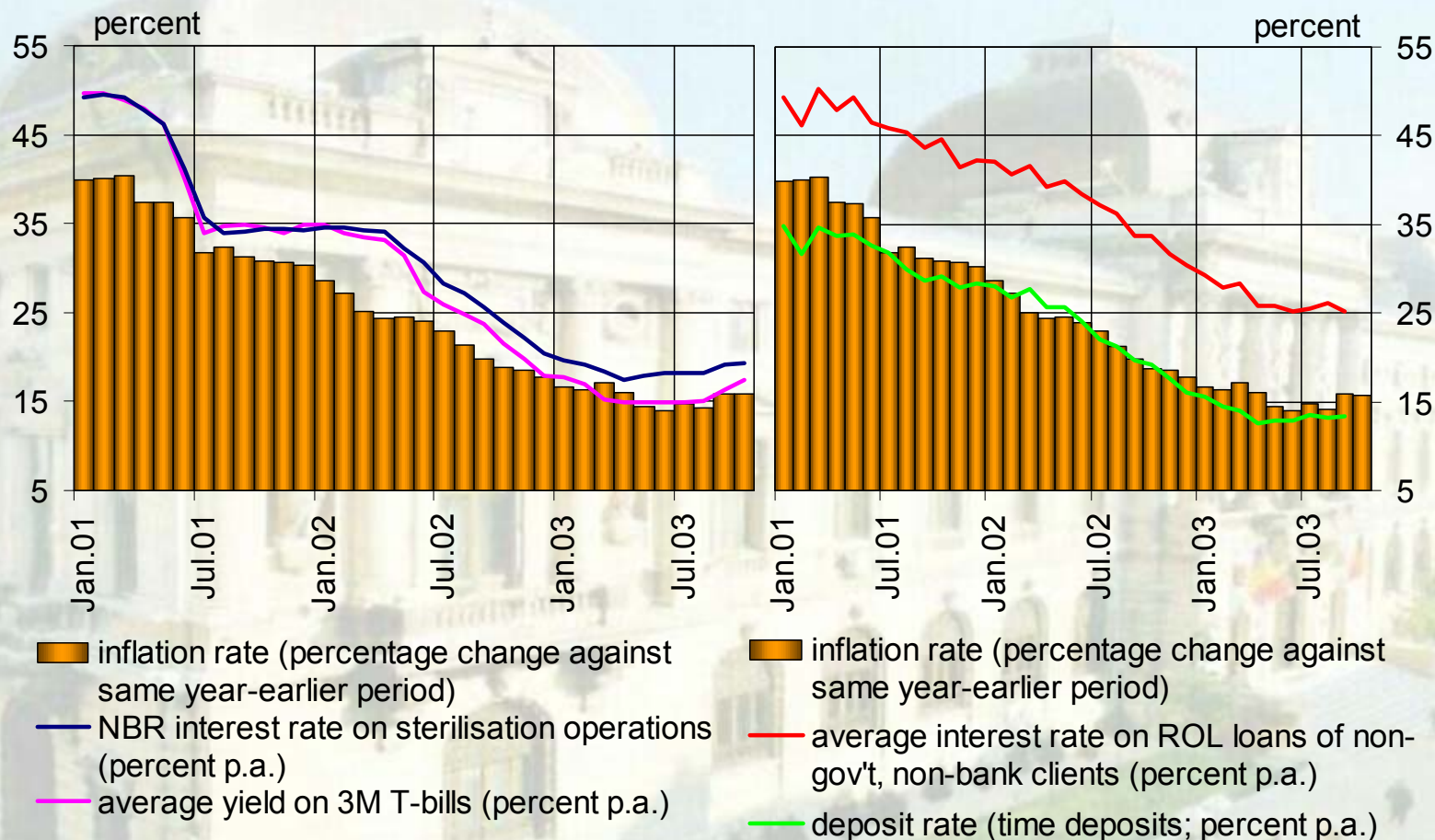
Source: National Bank of Romania

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## Inflation Rate and Interest Rates



*NBR's policy rate increased to 21.25% on November 20, 2003.*

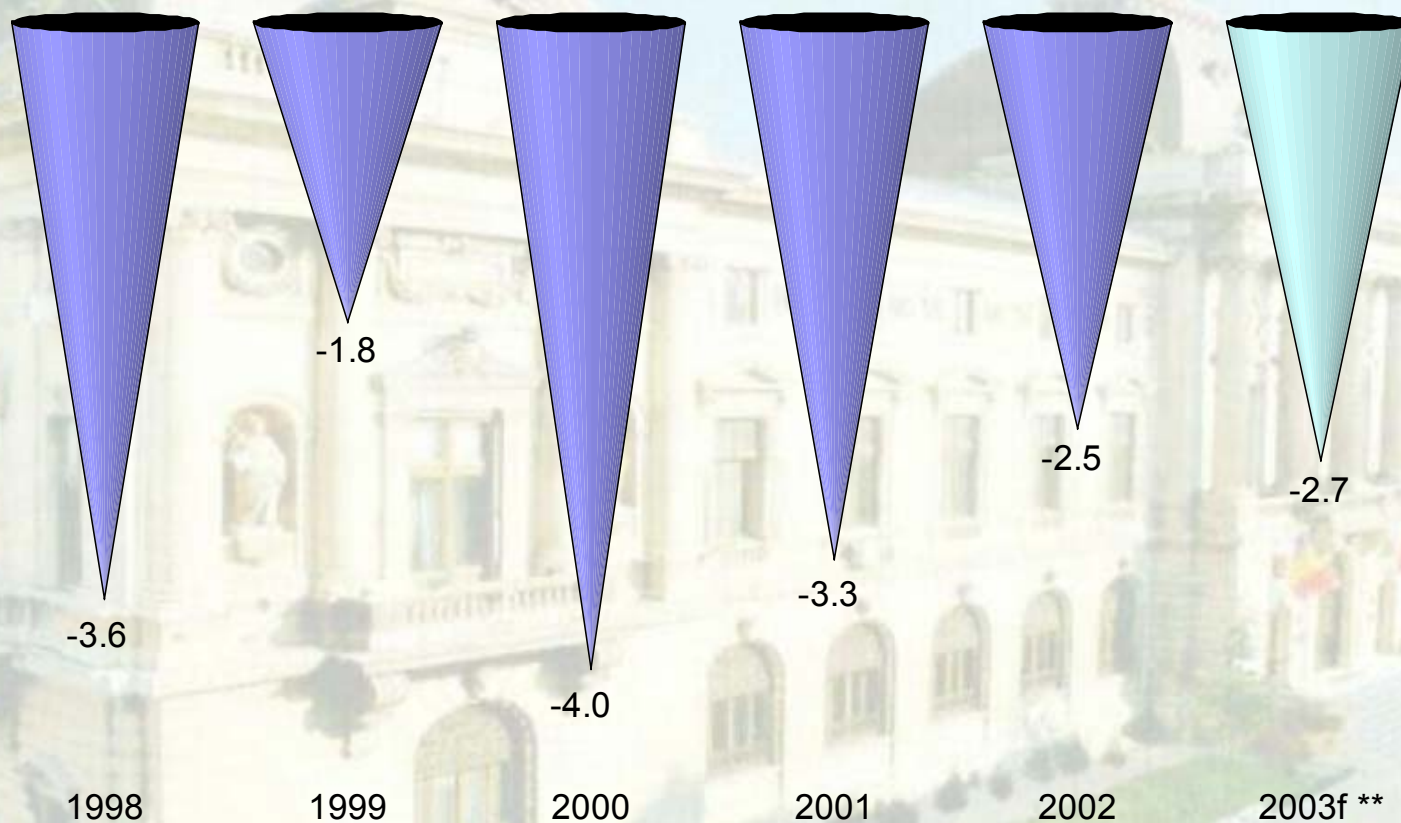
Source: National Institute of Statistics, National Bank of Romania

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## Fiscal Deficit as Share of GDP\*

percent



\*) adjusted to IMF methodology

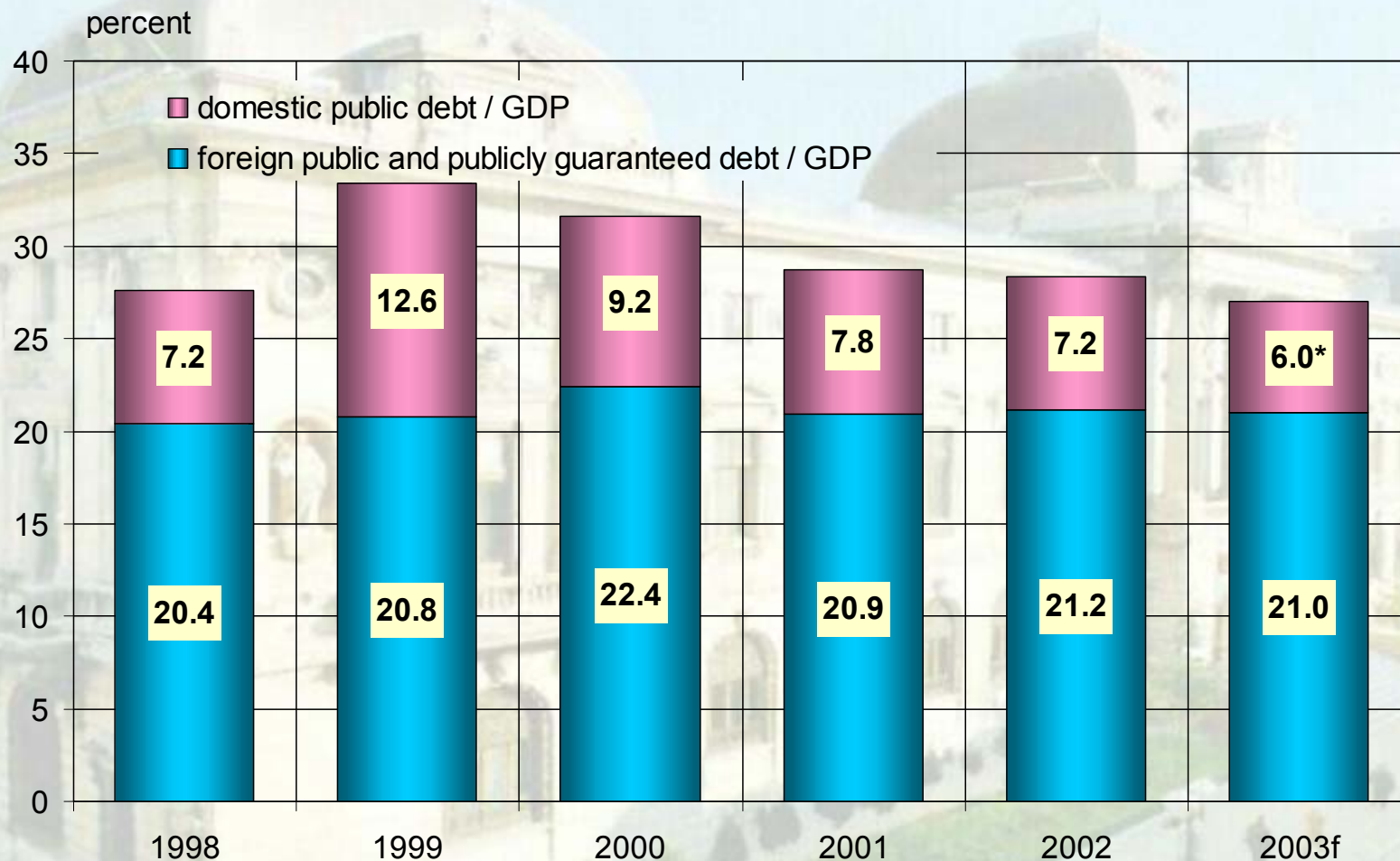
\*\*) as per current IMF Stand-By Arrangement

Source: Ministry of Public Finance, National Institute of Statistics

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## Public Debt as Share of GDP



\*) Jan. -Sep. 2003: 5.2 percent

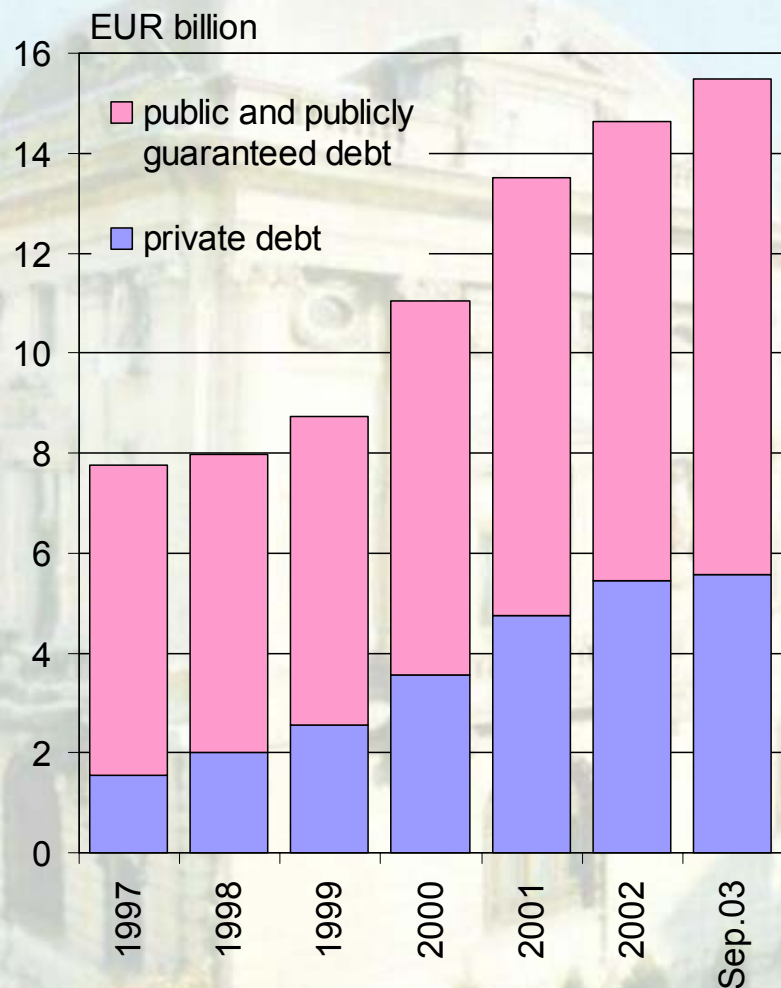
Source: Ministry of Public Finance, National Institute of Statistics, National Bank of Romania

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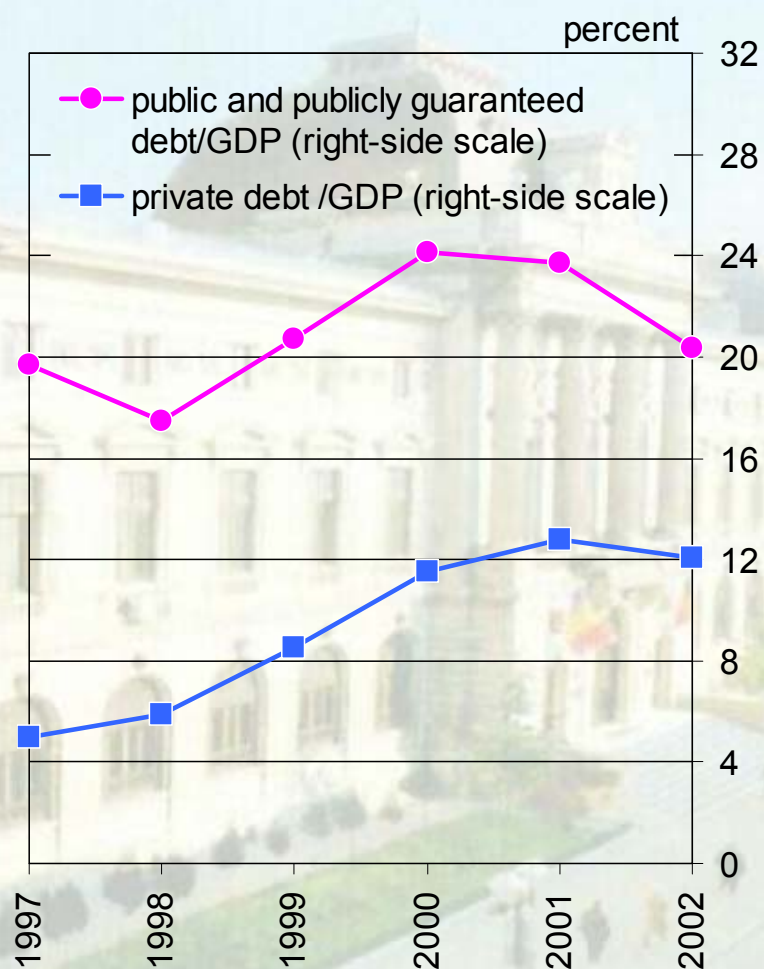




## MLT External Debt

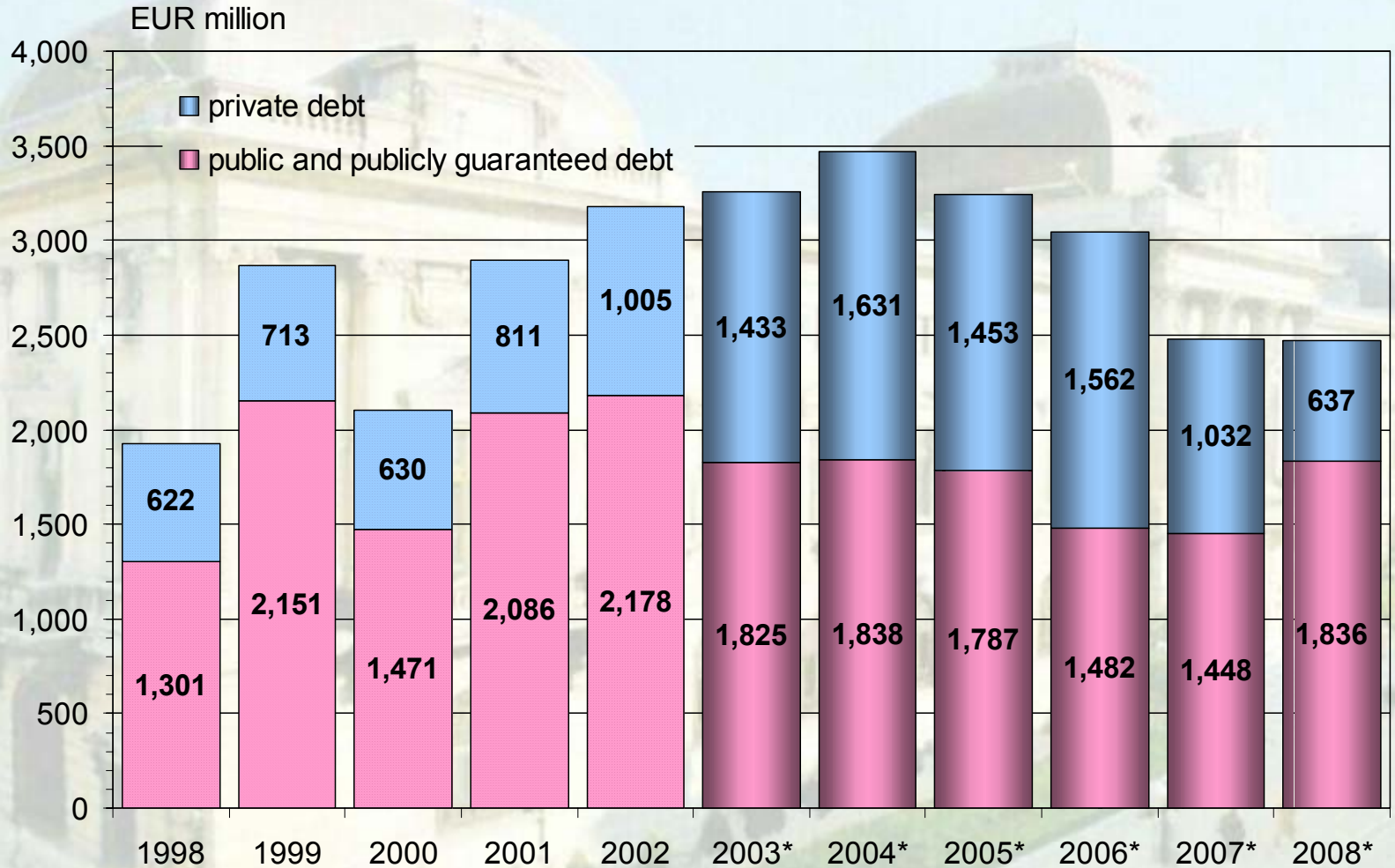


## MLT External Debt / GDP



Source: National Bank of Romania, National Institute of Statistics, Ministry of Public Finance

## MLT External Debt Service



Source: National Bank of Romania

\*) projection

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## Spread of Romania's Eurobonds 2008, 2010 & 2012



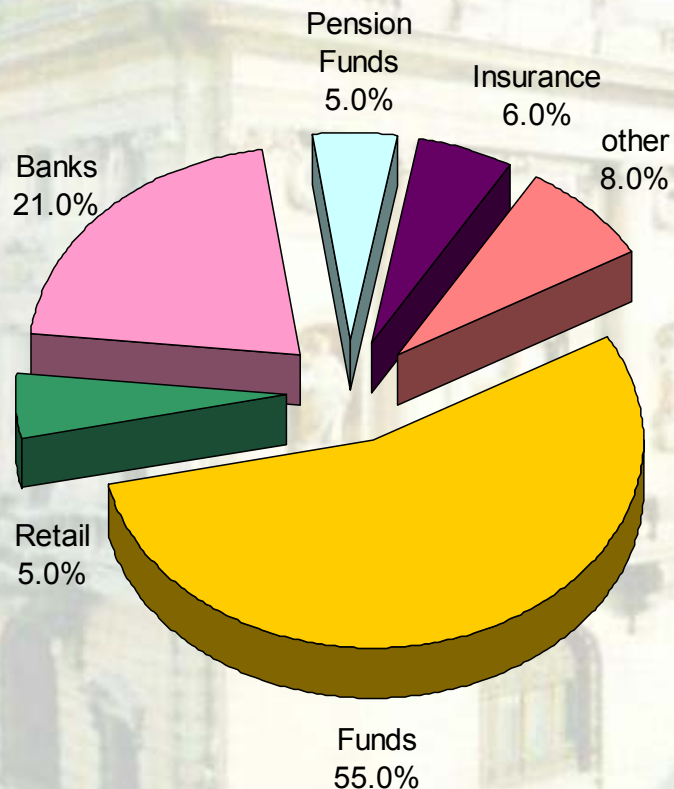
Note: Romania '08 was 592 bps over Bunds at launch and 152 bps on 3 December '03  
 Romania '10 was 271 bps over Bunds at launch and 168 bps on 3 December '03  
 Romania '12 was 365 bps over Bunds at launch and 175 bps on 3 December '03

Source: Bloomberg

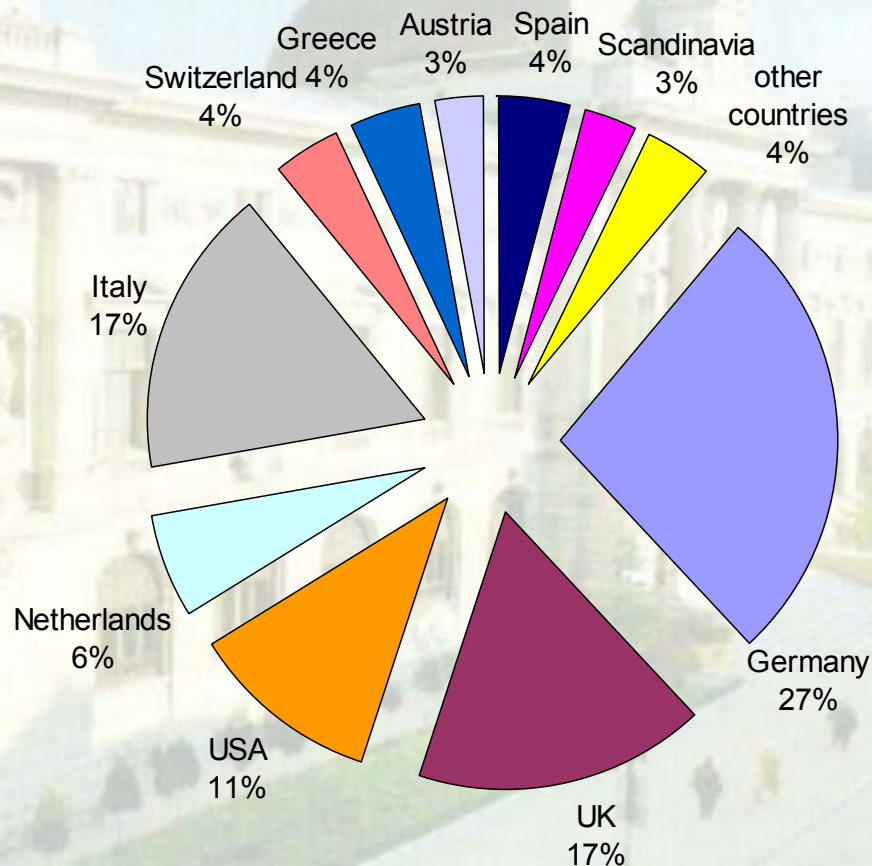


# Romania's Eurobonds 2012

## Distribution by Investor



## Distribution by Geography

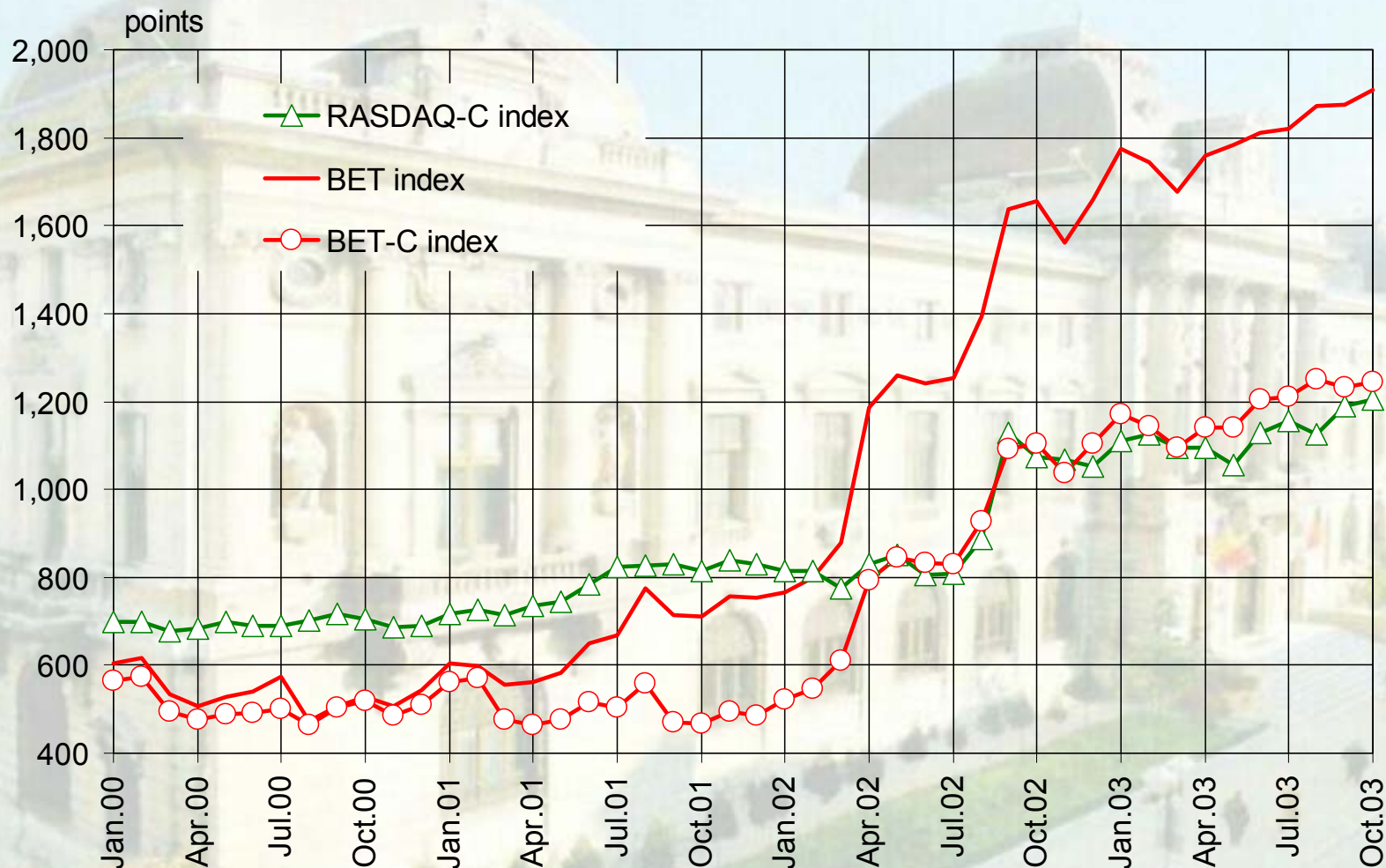


Source: Ministry of Public Finance

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## Bucharest Stock Exchange and RASDAQ Indexes



Source: Bucharest Stock Exchange and RASDAQ

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# Main Stages of Banking System Reform (1)

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## **1991-1996:** first stage of banking system reform

- ✓ enactment of Law No. 33/1991 on banking and Law No. 34/1991 on the Statute of the National Bank of Romania ensured the two-tier banking system by assigning the central bank new functions (monetary and foreign exchange policies, supervision, regulation, payment system) and establishing new commercial banks;

## **1997-2000:** second stage of banking system reform

- ✓ improvement and extension of the legislative framework for banks by approving new laws: Law on bank privatisation (Law No. 83/1997); Banking Act (Law No. 58/1998); Bank Insolvency Act (Law No. 83/1998); the NBR Act (Law No. 101/1998);
- ✓ new legislative framework for credit co-operatives – Government Emergency Ordinance No. 97/2000, as amended by Government Emergency Ordinance No. 272/2000, as amended and approved by Law No. 200/2002;
- ✓ primary goal of the National Bank of Romania: stability of the domestic currency in order to ensure price stability;
- ✓ intervention tools were upgraded by removing former directed credit lines and introducing open-market operations.



# Main Stages of Banking System Reform (2)

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**2001-2004:** third stage of banking system reform

- Completion of harmonisation of the legislative framework for banks with EU Directives:

**2001:** Amendment and supplementation of Laws Nos. 101/1998, 58/1998, and 83/1998:

- ✓ ensuring free exchange of information with other domestic and foreign supervisory authorities
- ✓ strengthening the supervisory powers of the NBR in respect of bank managers, Board members and significant shareholders
- ✓ adopting the Basle Core Principles concerning legal protection of supervisors
- ✓ strengthening the legal framework concerning the criteria for bank insolvency

# Main Stages of Banking System Reform (3)

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**2003:** Adoption by Parliament of Law on Banking Activity; decisive role in full transposition of EU banking legislation:

- ✓ ensuring a unitary regime applicable to credit institutions
- ✓ setting-up a legal framework for ensuring the right of free establishment and free provision of services
- ✓ inclusion of electronic money institutions in credit institutions' category
- ✓ provision of bank activities covered by mutual recognition

# Main Stages of Banking System Reform (4)

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## 2003-2004:

- Adoption of special legislation on payment systems and cross-border credit transfers; implementation of oversight and payment system upgrading
- Extension of the legislative framework for transposition of EU Directives concerning financial collateral and reorganisation and winding-up of credit institutions

**2004:** Amendment of the NBR Act in accordance with the commitments made upon the provisional closure in June 2002 of Chapter 11: “Economic and Monetary Union”:

- ✓ clear-cut definition of the NBR primary goal, i.e. price stability
- ✓ enhancement of central bank independence
- ✓ removal of direct financing of the Treasury by resorting to the overdraft facility
- ✓ prohibition of public institutions’ privileged access to the resources of financial institutions



# **Cleaning-up the Banking System**

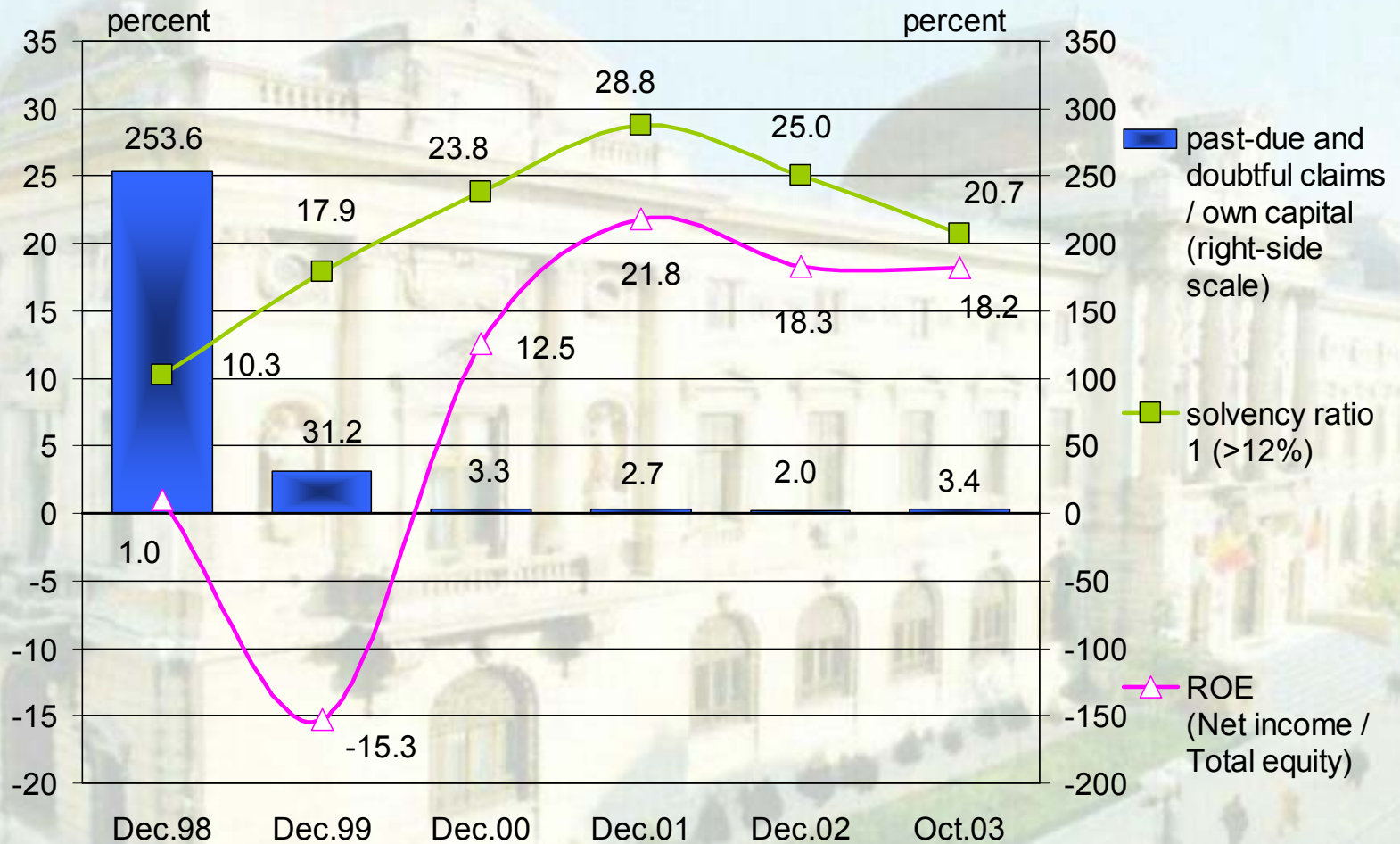
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Romania's banking sector was at a critical point at end-1998, but it has turned around remarkably since then

- ✓ The sector is now majority privately owned (29 banks out of 38), foreign capital accounting for 65 percent of bank capital
- ✓ Prudential indicators show improved health of the sector
- ✓ Prompt remedial measures have been taken against insolvent credit institutions
- ✓ High transparency of data on banking system activity has been secured
- ✓ Bank regulations have been tightened:
  - Minimum capital and own funds requirements have been gradually increased to ROL 320 bn. (EUR 8 mn.)
  - Capital adequacy ratio was raised from 8 to 12 percent of risk weighted assets
  - Loan classification and provisioning rules have been tightened (three criteria apply simultaneously: debtor's financial performance, debt service, and initiation of judicial proceedings)
  - On-site inspections are carried out every year
  - An early warning system and an internal rating system to track individual bank performances on a monthly basis have been employed since 2000
  - Since January 2003, major banks have been required to produce accounts based on International Accounting Standards



# Analysis Ratios for the Banking System

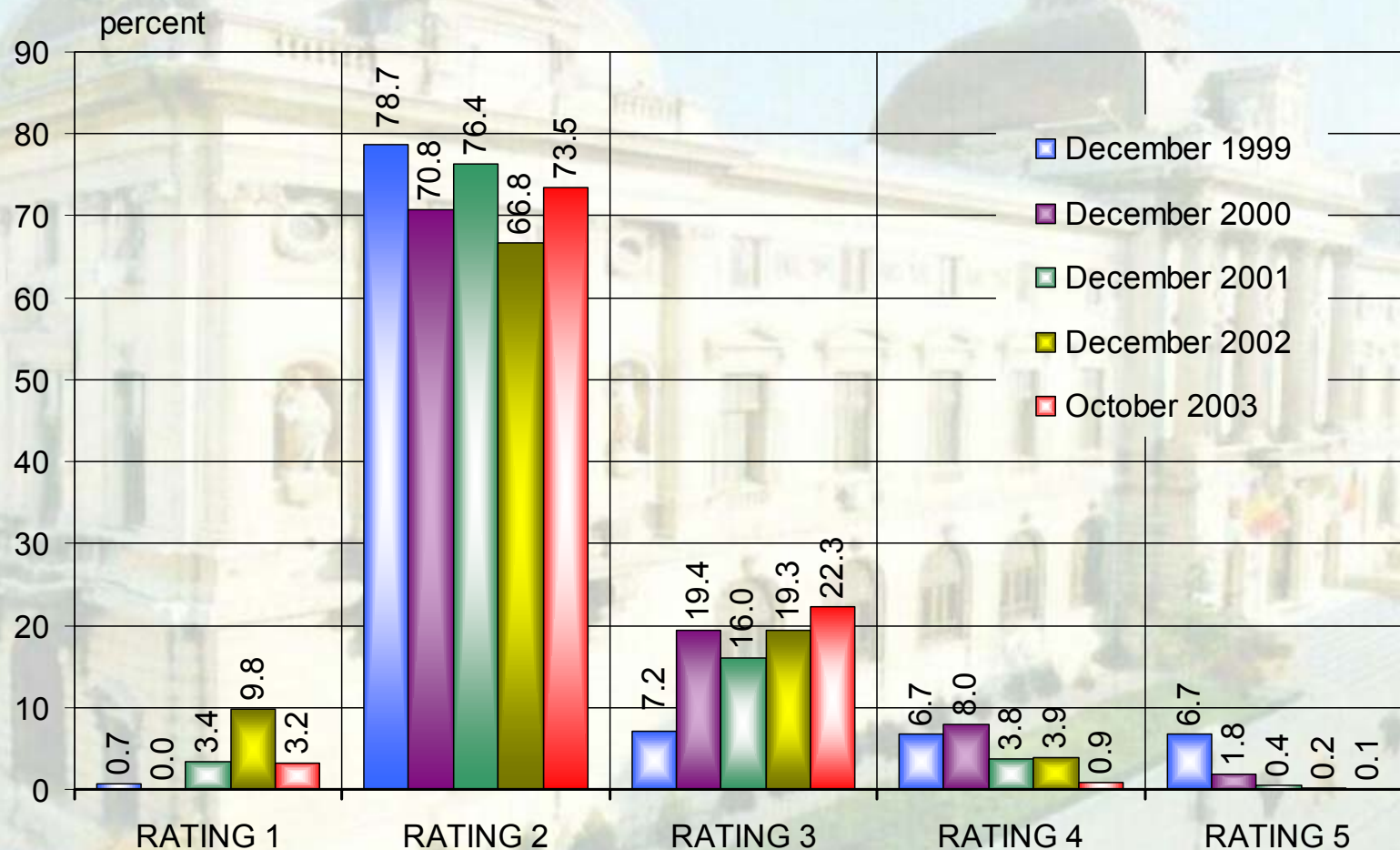


Source: National Bank of Romania

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## The Weight of Banks Classified by the Five Composite Ratings in Total Bank Assets



Source: National Bank of Romania

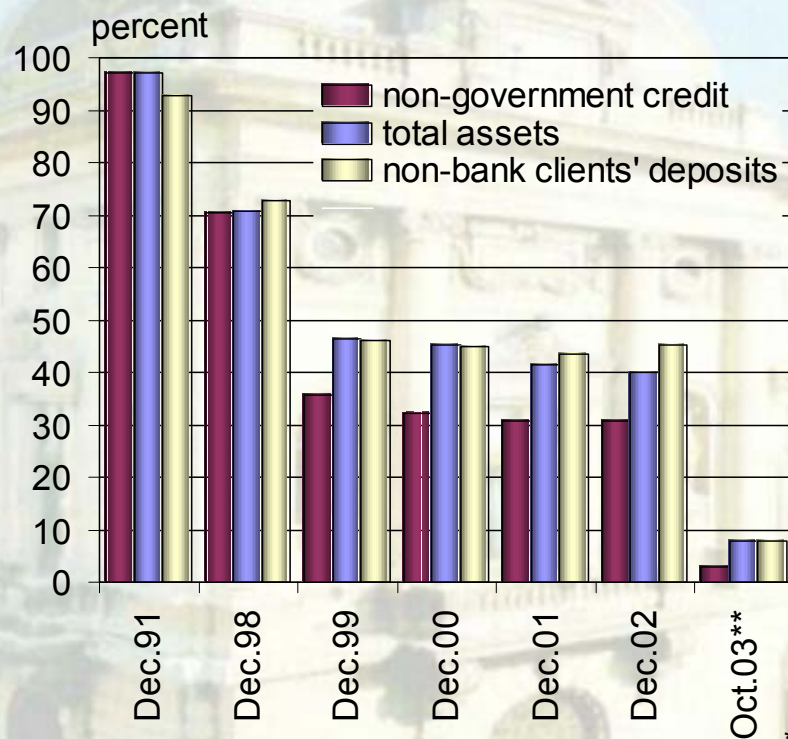
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## Share of Majority State-owned Banks\* in Total Banks

share in total banks (%); October 2003



	Total assets	Non-govt. credit	Non-bank clients deposits
<b>Banks with majority foreign capital</b>	<b>59.2</b>	<b>65.5</b>	<b>55.7</b>
<b>Banks with majority domestic private capital<sup>1</sup></b>	<b>32.7</b>	<b>31.3</b>	<b>35.3</b>
<b>Banks with majority domestic state-owned capital<sup>2</sup></b>	<b>7.9</b>	<b>2.9</b>	<b>7.9</b>

1) including BCR; 2) excluding BCR

\*\* ) excluding BCR.

\*) Banca Comercială Română (BCR), Banca de Export-Import a României (EXIMBANK), Casa de Consemnațiuni (CEC);

BANC POST and Banca Română pentru Dezvoltare (BRD) until Feb. '99 and Banca Agricolă (BA) until Sep. '01.

Source: National Bank of Romania

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# STRUCTURE OF ROMANIAN BANKING SYSTEM

## at end-October 2003

	Number	Percent in total net assets
<b>Commercial banks, of which:</b>	<b>30</b>	<b>92.1</b>
Banks with majority state-owned capital	3	38.4
Private-sector banks, of which:	27	53.7
▪ with majority domestic capital	6	3.9
▪ with majority foreign capital	21	49.8
<b>Foreign branches</b>	<b>8</b>	<b>7.9</b>
<b>Total banking system</b>	<b>38</b>	<b>100.0</b>

## Number of Banks in Romania

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Oct. 2003
<b>Banks, of which</b>	<b>7</b>	<b>11</b>	<b>12</b>	<b>14</b>	<b>20</b>	<b>24</b>	<b>31</b>	<b>33</b>	<b>36</b>	<b>34</b>	<b>33</b>	<b>33</b>	<b>31</b>	<b>30</b>
- with majority public capital	5	6	7	7	7	7	7	7	7	4	4	3	3	3
- with majority private capital, of which:	2	5	5	7	13	17	24	26	29	30	29	30	28	27
- with majority domestic capital	2	5	5	6	8	9	14	13	13	11	8	6	4	6
- with majority foreign capital	-	-	-	1	5	8	10	13	16	19	21	24	24	21
<b>Foreign banks' branches</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>7</b>	<b>9</b>	<b>10</b>	<b>9</b>	<b>7</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>Total banking system</b>	<b>12</b>	<b>16</b>	<b>17</b>	<b>20</b>	<b>27</b>	<b>31</b>	<b>40</b>	<b>43</b>	<b>45</b>	<b>41</b>	<b>41</b>	<b>41</b>	<b>39</b>	<b>38</b>

Source: National Bank of Romania



## Concentration of the Banking System (Top 5 Commercial Banks)

<b>DECEMBER 2002</b>	<b>ROL bill.</b>	<b>EUR mill.</b>	<b>percent in total system</b>
<b>Assets</b>	<b>295,320.1</b>	<b>8,457.3</b>	<b>62.8</b>
<b>Loans</b>	100,328.3	2,873.2	56.2
<b>Government securities</b>	31,232.5	894.4	74.2
<b>Deposits</b>	234,298.7	6,709.8	63.0
<b>Own capital</b>	42,996.8	1,231.3	64.5
<b>SEPTEMBER 2003</b>			
<b>Assets</b>	<b>343,875.0</b>	<b>8,939.7</b>	<b>63.0</b>
<b>Loans</b>	146,893.9	3,818.8	57.2
<b>Government securities</b>	19,194.3	499.0	74.5
<b>Deposits</b>	260,752.9	6,778.8	63.7
<b>Own capital</b>	46,435.8	1,207.2	61.5

Source: National Bank of Romania

# Foreign Equity Interest in the Capital of Banks in Romania

end-September 2003

Country	Foreign equity interest	
	Percentage of total foreign capital	Percentage of total capital
Austria	38.6	22.0
Greece	14.5	8.2
France	10.9	6.2
Netherlands	8.1	4.6
Italy	6.6	3.7
Germany	1.5	0.9
United Kingdom	1.4	0.8
<b>Total EU</b>	<b>81.6</b>	<b>46.4</b>
U.S.A.	7.1	4.0
Turkey	2.7	1.5
Monaco	1.7	1.0
Switzerland	1.2	0.7
Other countries including EBRD and IFC	5.7	3.1
<b>Total</b>	<b>100</b>	<b>56.7</b>

Source: NBR

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## Selected Banks with Foreign Ownership in Romania

SEPTEMBER 2003	Net Assets		
	ROL bill.	EUR mill.	% of total
<b>A. Banks with majority foreign ownership, of which:</b>	<b>271,805.3</b>	<b>7,066.1</b>	<b>49.8</b>
1. BRD - Groupe Société Générale	73,584.5	1,913.0	13.5
2. Raiffeisenbank	35,002.9	910.0	6.4
3. ABN Amro Bank Romania	32,537.7	845.9	6.0
4. Alpha Bank	18,441.0	479.4	3.4
5. Citibank Romania	17,086.1	444.2	3.1
6. HVB Bank Romania	16,030.5	416.7	2.9
<b>B. Foreign bank branches, of which:</b>	<b>42,916.8</b>	<b>1,115.7</b>	<b>7.9</b>
1. ING Bank N.V., Amsterdam	25,563.6	664.6	4.8
2. Banca di Roma S.p.a. Italia	899.2	23.4	0.2

Source: National Bank of Romania



# **Financial Sector Assessment Programme**

performed by a joint World Bank/IMF team

(10-14 March and 12-23 May 2003)

<b>Type of analysis</b>	<b>Conclusion</b>
Analysis of corporate finance and leverage, and of the potential vulnerabilities of the banking system	Banks are able to deal with considerable stress from the corporate sector
Stress tests (credit risk, interest rate risk, and exchange rate risk)	High resilience of the banking system to shocks
Financial soundness indicators	High capital adequacy ratios, strong liquidity, and manageable levels of non-performing loans.

## **General conclusion:**

The Romanian authorities have been remarkably successful in stabilising the economy and the financial sector over the past years.

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# Strengthening Supervisory Capacity on Credit Institutions

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- Completion of the authorisation process of credit co-operatives
- Prudential regulations applicable to all credit institution categories
- Harmonisation of the accounting standards applied by credit institutions and presentation of annual financial statements according to the EU Directives and IAS requirements (starting with the 2003 financial year)
- Clarifying the credit unions' regime

# Progress in Banking System Transition according to the EBRD

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- Banking reform & interest rate liberalisation: **3-**
  - ✓ Substantial progress in establishment of bank solvency and a framework for prudential supervision and regulation
  - ✓ Full interest rate liberalisation
  - ✓ Significant lending to private enterprises and significant presence of private banks
- Trade and foreign exchange system: **4**
  - ✓ Current account convertibility
  - ✓ Significant progress towards capital account convertibility



# Current Issues

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- Bank lending on the rise

- Starting from a very low point, non-government credit increased by a real 45 percent yoy in October 2003...

*but*

- Credit boom led to wider trade deficit
- Foreign currency lending accounts for a large part of the increase and the associated currency risk enhances credit risk

- Banking sector regulation and prudential supervision strengthened

- From January 2003, more information about the borrower was taken into account when classifying and provisioning banks' loans, including their payment history and financial performance
- Supervision has been extended to cover the former credit co-operatives and savings banks for housing...

*but*

- non-banking financial activities (leasing, for instance) remain largely unregulated

# Main Stages of Capital Account Liberalisation in Romania (1)

- 1991:** ● **capital inflows** (direct investment + investment in real estate, except land)
- 
- 1997:** ● **capital inflows** (shares + bonds)
- **inflows** of money into bank current accounts
  - **inflows** and **outflows** of short-term trade credits
- 1998:** full current account liberalisation (acceptance of Article VIII of the IMF's Articles of Agreement)
- 
- 1999:** ● **inflows** of medium- and long-term loans
- 
- 2001:** ● **capital outflows** (direct investment, shares, bonds...)
- residents' **right** to issue shares and bonds abroad
  - **outflows** of trade-related medium- and long-term loans
  - **capital outflows** through personal transfers (inheritances and legacies, emigrants)

# Main Stages of Capital Account Liberalisation in Romania (2)

- |                       |  |
|-----------------------|--|
| 2002:                 | ● <b>outflows</b> of financial medium- and long-term loans   |
| 2003:                 | ● <b>operations</b> carried out by residents in foreign shares and bonds<br>● <b>inflows</b> and <b>outflows</b> of short-term loans                                     |
| 2004:                 | ● <b>right</b> of non-residents to issue/deal in shares and bonds in Romania   |
| By EU accession date: | ● <b>inflows</b> of money into bank deposit accounts (in ROL) and on the money market (in ROL)<br>● <b>outflows</b> of residents' money into bank accounts opened abroad |

## Legend:

green colours: low volatility  
blue colours: medium volatility  
red colours: high volatility

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# Major Challenges in the Medium Term

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- Improvement of business environment mainly by in-depth reforms in the judicial field and public administration
- Strengthening of financial discipline in state-owned and public utilities companies
- Fast-paced restructuring and privatisation in the energy and financial sectors

# Conclusions

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- Romania's recent macroeconomic performance is remarkable:
  - ✓ robust economic growth
  - ✓ gradual disinflation
  - ✓ low fiscal deficit
- Improved domestic economic environment boosted foreign direct investment in 2003
- Economic reforms made considerable headway, but they still have to be accelerated
- Accession to the EU in January 2007 is an ambitious yet fully achievable goal
- Today's major economic imperatives can only be fulfilled by pursuing a consistent economic policy mix