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EMERGING FINANCIAL SECTOR OF ROMANIA: A REVIEW

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Abstract:
The paper presents aspects of financial stability of Romania and effective functioning of financial sector in Romania. Romania is one of the post- Communist countries achieving tremendous growth and development despite problems of European economies. Financial sector is one of the several factors that has played important role for the growth and development of Romania. The regulatory authorities of financial sector will reveal features of the emerging financial sector of Romania.

Key words: Financial Institutions; Financial Intimidation; Financial Market; Financial Sectors; and Financial Service.

JEL classification: G21, G22, G23, G28

1. INTRODUCTION

The impact of BREXIT (Britain Exit from Europe Union) on Romania is yet to be assessed but the impact of high risk is not ruled out. Romania has initiated several measures to financial stability. The growth of financial sector has to be assured. In the absence of sound and robust financial sector the economic challenges and other international crisis would destabilize economy. The global economic challenges associated with cross broader tensions would always attempt to weaken financial stability in additions to internal issues. The policies of European Union and the practices international financial institutions would influence directly and indirectly the internal economic wisdom of Romania. Romania is one of emerging economies of European Union.

2. SCOPE OF FINANCIAL SECTOR IN ROMANIA

There are several roles and responsibilities of finance sector in Romania. The most important features are mentioned below:

1. Achieving financial stability for economic development of Romania.
2. Developing the Financial Sector to rescue Romanian economy.
3. Rationalizing the foreign currency lending to address the vulnerabilities.
4. Improving the bank's sources of funding.
5. Developing and fostering the non-banking financial institutions with banking financial institutions like Capital Markets, Insurance, and Pension Schemes.
6. Promoting financial vigilance of anti-corruption and anti- money laundering.
7. Empowering regulatory authorities of financial sector.
8. Establishing sound legal framework of financial sectors with appropriate laws, regulations and guidelines.
9. Making financial sectors sensitive to national and international financial policies, monetary and fiscal policies of Romania and international institutions (European Commission (2015); International Monetary Fund (2003): International Monetary Fund (2010); Mugur Isărescu (2016).

3. FINANCIAL SECTOR IN ROMANIA

The financial sector is playing an important in the development of Romania. Romania has taken several measures to improve the financial sector. It has mandate to join Europe Union in January 1, 2007. The most important aspect is to achieve financial stability and the NBR has decided for it in preference to price stability.

There are regulatory authorities. Now the NBR is assisting other nations to improve their financial sectors. Romania improves its finance sector with all the problems.

Romania requested for Financial System Stability Assessment and accordingly a joint team of IMF and World Bank conducted carried out an assessment of the Romanian financial sector in 2003. It submitted its report on September 22, 2003 with the following observations:

1. Romania has made efforts to strengthen regulatory framework of financial law and regulations for EU accession in January 1, 2007. The Statute of the National Bank of Romania (NBR) and the Banking Act provide the institutional framework for effective regulation and supervision of credit institutions in Romania. There are other laws for inspection and other key functions. However there are certain issues, in addition to other major framework, which need to be addressed such as consolidated supervision, interest rate risk, country and transfer risks, investments and market risk.
2. Even though the banking supervision is meeting most of the requirements of Basel Core Principles there is a need for improving consolidated reporting and supervision.
3. It is equally important for Romania to strengthen market and country risk management.
4. There is the risk of higher Non-Performance Loans.
5. There are difficulties to achieve economic recovery and financial intimidation.
6. There is a need to build the credibility and confidence of individual banks, the banking system, insurance, pension schemes and capital market as these are the major institutions of Romanian financial sector.
7. It is pointed for the improvements in judicial system, corporate governance, accounting and auditing and banks.
8. The privatization is still a major task.
9. The National Bank of Romania does not have adequate powers to review major acquisitions or investments by banks. Similarly NBR does not consult home supervisors before granting approvals on the acquisition of Romanian bank by foreign credit institutions.
10. Romania has drawn success in curbing money laundering and it has joined the Council of Europe’s anti-money laundering (MONEYVAL/PC-R-EV) Committee.
11. Romania has adapted several conventions on combating the financial terrorism.
12. Romania has to formulate guidelines and other relevant compliance procedures in non-bank financial sectors particularly insurance and securities sectors.
13. It is recommended to Improve monitoring and detection of physical transportation of cash at cross border crossings.
14. The NBR is implementing transparency practices in respect of roles, responsibilities and objectives on supervision and it must continue to improve.
15. In respect of the Deposit Guarantee Fund (GDF) there are recommendations of transparency and improvements in the areas of officials to disclose their private holdings, annual financial statements in the Annual Reports,
16. The National Securities Commission (CNVM), Bucharest Stock Exchange (BSE) and RASDAQ Stock Exchange are the main players of Capital Markets in Romania and there is a need for strengthening the Capital Market (International Monetary Fund (2003).

The Financial System Stability Assessment of IMF has found that Romania has implemented many of the recommendations of 2003 of FSAP of IMF but the banking system leads the financial sector. It puts more stress on the financial sector when there is crisis in banking system on account of rapid deterioration of economic conditions and the depreciations of leu. It may lead to undercapitalization of banks. There should be a well-established cross-sectoral cooperation and coordination in supervision of financial groups (International Monetary Fund (2010).

The National Bank of Romania has splendid achievement in maintaining capital buffers 4 with 27.1% in September, 2014 and it has increased from 10% in 2007 despite of deterioration in asset quality. The Non-Performance Loan increased to 22.65 in March 2014 from 2.8% in December, 2008 and it has affected the credit supply. However the corporate insolvencies declined to 35,700 in 2014 from 38,300 in 2013. The NBR has however successfully tackled it by the loan-loss provisioning policy. There is continuous declining in credit to households and corporate sectors. The loans to SMEs and corporate sector declined to by 5.2 5 in 2013 and 4 in August, 2014 due to both demand and supply factors such as financing capacity, collateral requirements and lending practices. The households' ratio of credit declined to 68.4% in 2014 from 76.4% in December 2011. The NBR has remarkably achieved in capitalization of banking system with foreign parent banks which have provided additional capital support of Euro 1.87 billion from 2009 to 2014 December, to their Romanian affiliates (European Commission (2015).

4. IMF ON FINANCIAL SECTOR OF ROMANIA

It is accepted universally that the IMF with its leadership has played an important role in euro-areas crisis (Nicolas Véron (2016). During the euro-area crisis, the financial sector issues dominantly played crucial role. The systemic risks affected the Banking Sector of EU in 2007-2008 financial crisis. However it took long time for IMF to recognize it (Minutes of the IMF Executive Board Meeting (2008). It was discovered that the 'undercapitalization, funding asset quality and sovereign risk 'were the causes (Nicolas Véron (2016). The IMF has accepted it (International Monetary Fund (2009). Realizing the importance of financial sector Romania made several efforts to achieve the financial stability. One of the efforts is to request IMF and accordingly, the IMF has made several recommendations on many areas of financial sector of Romania through Financial System Stability Assessment on Romania. I have considered here only main areas of recommendations on the Financial Sector of Romania. The main areas are Capital Markets, Insurance, and Pension Schemes which are emerging non-banking and Banking institutions of financial sector of Romania.

4.1. Capital Markets

There are three recommendations on Capital markets. The first recommendation is to strengthen capital markets of Romania through disclosure, transparency, and integrity and to enhance powers of the Securities Commission for effective enforcement. The second recommendation is on stock exchange to rationalize listing and delisting of companies. The third recommendation is on the functioning of Financial Investment Funds (International Monetary Fund (2010). Security markets in Romania are very small and less active. As per the report to IMF in 2008 the equity market capitalization has increased to Euro 24.6 billion in 2008 from Euro 3.0 billion. The top ten stocks account for 90% of market capitalization and it indicates slow growth of capital markets. Equally the Corporate Bond market is small. Even though the derivatives markets achieved relatively good growth of Euro 3.5 billion in 2007 from Euro 51 million in 2003 it declined to Euro 1.8 billion in 2008.

4.2. Insurance and Pension

The insurance and pension sectors are very small. It is recommended to improve the Insurance Supervisory Commission. It is suggested to have major insurance reforms of promoting long term pension fund portfolio management and establishing sound organizational structure of pension fund management.

4.3. Banking

The National Bank of Romania aims to achieve financial stability and managing the systemic risks by allocating resources of economy. Mr. Mugur Isărescu has stated on the role of National Bank of Romania on achieving financial stability of Romania (Mugur Isărescu, 2006). The total assets of financial intermediation institutions declined below EU by 53% of GDP in 2005. The National Bank of Romania after the fall of communism it has to swiftly from a mono-bank system to two tier system. Previously it was the centralized banking and now it has commercial banking operations and central banking operations. It has created tremendous pressure on the reform of central banking governance.

The main recommendation is pertaining to credit information and credit assessment. National Bank of Romania published Financial Stability Report in December 2016 explaining the risks to financial stability. One of the high systemic risks is on the risk of abrupt investor sentiment due to uncertainties of global economic growth and geopolitical tensions. The institutional financial system may affect financial stability of Romania. If there is sudden change in capital inflows as Romania's external borrowing is less it will not affect the financial stability. The second factor that it will not affect the financial stability of Romania on improving the performance of production sectors. Thus the risk of capital outflows can be neutralized by managing international reserves and macroeconomic policy. Another high systemic risk is relating to the legislative framework on the banking sector solvency. The Constitutional Court has declared unconstitutional of the Law No 77/2016 with reference to the provisions of converting CHF-denominated loans into leu-denominated loans. In respect of debt discharge the Constitutional Court has permitted on exceptional cases. The total capital ratio is 18.8% which signifies a healthy banking sector of Romania. The Non-Performing Loan has also declined by 3.5% which is above EU average. Therefore the Romanian banking sector is stronger to meet any challenges of future (Financial Stability Report (2016).

5. FUNCTIONS OF REGULATORY AUTHORITIES OF FINANCIAL SECTOR IN ROMANIA

The National Committee for Financial Stability came into force in 2007 to prevent, appraise and manage issues of systemic impacts. It includes the Governor, National Bank of Romania, the President, Financial Supervisory Authority and the Chairman, Bank Deposit Guarantee Fund. In 2004, the National Bank of Romania created Financial Stability Department to achieve financial stability and it has started functioning earlier to the global economic and financial crisis. There were two issues such as price stability and financial stability. These two issues were debated and finally decided in favour of financial stability. One of the Deputy Governors of the National Bank of Romania is to achieve financial stability. The National Bank of Romania and Financial Supervisory Authority (FSA) are two other authorities to supervise banks and non-banking financial institutions and to supervise other financial markets respectively. The Government has promoted the National Committee for Macroprudential Oversight and there is a decision-making body. The Decision-making body has nine members of which there are five from National Bank of Romania (Governor, First –Deputy Governor, two Deputy Governors and Chief Economist); two members are from Financial Supervisory Authority consisting the President and the First-Vice president; and other two members are Government representatives appointed by the Prime Minister (Mugur Isărescu (2006).

6. GROWTH AND DEVELOPMENT OF ROMANIA

The economic growth of Romania is consistent in 2015 and 2016. There is excellent growth in domestic consumption in 2015 by Euro 7.4 billion and it has already achieved in 2016 H1 by Euro 4.5 billion. The balance of trade is Euro 1.3 billion which is 10 times lower than

2007(Financial Stability Report (December, 2016). Romanian has achieved high human development with 52nd position out of 188 countries. (Human Development Report 2015) The HDI value of Romania has increased to 0.793 from 0.703 from 1990 to 2014 with an annual increase of 0.5%. The life expectancy has increased by 5.0 years for the period from 1990 to 2014 (Human Development Report 2015). The International Monetary Fund (IMF) has announced that Romania has achieved highest growth rate of 5% in Europe and it has improved from the forecast of 4.2% in April 2016 (IMF: World Economic Outlook October 2016). However it has warned Romania that the growth may slow down to 3.8% in 2017 and further it will go down to 3.3% in 2018. The overall growth rate of European nations is 2% and emerging economies will record 3.3% growth rate .The forecast of IMF on the Consumer Price Index of Romania will be positive of 1.7% increase in 2017 and further would increase to 2% in 2018. The unemployment rate has reduced to 6.4% in 206 from 6.8% in 2015. It is expected to reduce to 6.2% in 2017. The World Bank has estimated 5.1% growth in 2016 (World Bank (2016). In early November the European Commission revised economic growth rate of Romania is 5.2 %.(AGEPRESS, 2016).

7. CONCLUSION

The first important decision is the preference of financial stability to credit stability. Consistent harping on the financial stability has yielded results. The second decision is to avail the expertise advice of the IMF on Financial Stability and it has helped them to organize financial sector immensely. The third most important decision is to access to European Union on January 1, 2007 and it has created urgency for implementation of recommendations of 2003 of FSAP of IMF. In the newly opened markets of emerging Europe the large banks and insurance companies have established their presence unlike Insurance in Romania. More efforts are required in this direction. Recently created Banking Union of Europe Union may lend a helping hand in strengthening Romania. The main functions of the Banking Union are : 'Firstly, a single rulebook for banks; secondly, a single framework for banking supervision; thirdly, a single mechanism for resolving banks, funded by levies on the sector itself; fourthly, a common backstop in case temporary fiscal support is needed and fifthly, a common system for deposit protection' (.Vítor Constâncio (2013). Romania has to formulate its legal framework to meet the needs of functions of Banking Union. In addition to it, the financial regulations need to be strengthened. The Europe Union has the expertise of framing and implementing them. Thus taking the assistance of the team from the Banking Union is essential. Normally the national government implements the financial regulations as in the case of Romania. The European Union has helped Romania to implement financial regulations through the European Central Bank (ECB), the Committee of European Banking Supervisors (CEBS) and the Committee of European Securities Regulators (CESR), (Walter W. Eubank (2010). Europe has experienced difficulty in maintaining financial stability during the euro area crisis (Ajai Chopra (2011). Never the less Romania was able to sustain its financial stability reasonably well during this period. Thus Romania has to explore all the options available. Romania has the lowest assets of financial sector to GDP by 75.6 % in 2015 comparing to EU 28 in terms of assets of financial sector to GDP which stood at 284.6 % in 2015 (Financial Stability Report, April 2016). The financial sector of Romania lacks far behind to other EU nations and therefore more concerted efforts are imminent. Above all there has to be effective judicial system in Romania. There are genuine problems to Romania due to change of political system from communist regime to democratic state. Presently it has established Constitutional Court of Romania in 1992 and it has introduced the principles of transparency, independence, and credibility with competent Courts and Judges. The World Bank has allotted Euro 110 million for establishing a strong Judicial System in Romania (World Bank (2016). The project is twelve years (2005 to March, 2017). The faith in judiciary has increased from 22% in 2005 to 44% in 2014. The people have recognized the importance of rule of law, separation of powers and independence of judiciary. Anti-Corruption machinery has punished former Prime minister, Ministers, Public Prosecutors and Judges (Judge Cristi Danilet, 2014). Reform of Judiciary has already shown results. European Union has initiated judicial reforms and accordingly Romania has adopted strategy. The Strategy of judicial reforms could not be fulfilled in the first phase of 2003-2005 but eventually it got extended to 2005-2007. It demands a total transformation of judicial power. The documentations can be prepared but it is equally important to be accepted and implemented. The principles of Rule of Law are accepted and practiced. People must recognize it. Institutional changes are important for successful judicial system. The judges are selected and appointed and they have to be regularly trained. Courts and training institutions need to be created adequately..

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