

THE MANAGEMENT OF NON-PERFORMING LOANS A PROBLEM OF THE ROMANIAN BANKING SECTOR

DINCU ANA-MARIANA¹, DRĂGOI VIOLETA ELENA^{*2}, PREDĂ LARISA ELENA²

¹*University of Life Sciences "King Mihai I" from Timisoara/
Faculty of Management and Rural Tourism, Timisoara, Romania*
²*Valahia University of Târgoviste/Faculty of Economics, Romania*

*Corresponding author's e-mail: violeta_dragoi@yahoo.com

Abstract: The study explores the fundamental aspects of non-performing loans of banks in the Romanian banking sector, in order to determine the extent to which Romanian banks engage in an effective reduction of them in order to make banking more efficient and ensure adequate economic growth. In addition, the factors that influence the emergence and growth of non-performing loans of Romanian banks and the impact of non-performing loans on bank profitability are examined. The results of the research show that the ways to make the effects of the lending policy more efficient have determined a permanent improvement in the quality of the loan portfolio.

Key words: non-performing loans, macroeconomic determinants, economic growth

INTRODUCTION

After the 2008 financial crisis, the number of non-performing loans increased and the high exposure to credit risk was reflected in the current level of non-performing loans in banks in the Romanian banking sector. Many financial analyses find that the non-performance of bank assets is a statistically significant predictor of bank insolvency [2,8,12,14].

Increasing bad loans in a bank can lead to bankruptcy and a loss of efficiency in the banking sector [4,5,7,10]. It is also one of the symptoms of a banking crisis.

Moreover, the current financial crisis is a banking crisis, in which the macroeconomic factor plays a significant role [3,11,15]. The management of bad loans is a problem of the banking sector and managing these loans in a less than adequate manner is dangerous to the survival of banks and threatens to endanger the overall stability of a financial system.

In general, research conducted in the field of credit quality analysis has shown that non-performing loans can hinder economic growth and reduce economic efficiency [14,15,16,17].

The specialized literature shows that the profitability of banks has a negative impact on the level of the non-performing loans rate, therefore, the level of non-performing loans must be as low as possible because it affects the profitability of banks [1,7,9,13].

A high rate of non-performing loans means for banks: decrease in profitability, due to provisions but also operational costs for monitoring and recovery of non-performing loans. Increase in capital requirements, increase in financing costs, limitation of the banks' available resources, liquidity risks, poor quality of credit, and the style of the banking industry significantly increase NPLs, while higher bank profitability reduces NPLs [1,7,9,13].

Regarding the causes of non-performing loans, after an analysis of the specialized literature, we can conclude that non-performing loans depend on macro-level factors and specific factors of each bank and its consumers [6,16,17,18].

MATERIALS AND METHODS

In this paper, the authors used as a methodology statistical research, observation, analysis and interpretation of data, information obtained from various bibliographic sources, from the National Bank of Romania and from the European Central Bank.

RESEARCH RESULTS

ANALYSIS OF THE LOAN PORTOFOLIO OF ROMANIAN BANKS

The role of credit in the economy is represented by the results obtained in the economy through the manifestation of credit relations or in the contribution it has to the achievement of economic policy objectives.

The way in which the bank, through its lending policy, allocates the funds it manages can influence economic development both locally and nationally. On the other hand, any credit institution assumes, to some extent, risks when granting loans and, certainly, all banks routinely record losses on their loan portfolio when some borrowers default on their obligations. Whatever the level of risks assumed, losses in the loan portfolio can be minimized if lending operations are organized and managed professionally. Thus, starting from this point of view, the most important function of a bank's management is *to control the quality of the loan portfolio*.

The main component of the financial system, the Romanian banking sector, through its functions of special importance for the Romanian economy.

Analysing the evolution of the changes in the Romanian banking system during the Covid-19 pandemic crisis, it can be stated that they are not major at the level of the credit institutions' shareholders and have not significantly changed the structure of the Romanian banking system.

Therefore, in terms of market share, the group of banks with Romanian capital outranked that of banks with Austrian capital, unlike at the time of the financial crisis in 2008, when the dominant position of foreign capital in the banking sector was shown Romanian, these developments being also associated with the consolidation process, which has intensified in the recent period in order to improve operational efficiency and profitability (Table 1).

Table 1.

Aggregate indicators regarding credit institutions in the Romanian banking system in the December 2019-March 2022 period

Indicators	December 2019	December 2020	December 2021	March 2022
Total credit institutions	34	34	34	34
from which foreign bank branches	7	8	8	8
Assets of institutions with foreign capital (% of total assets)	73.7	70.5	68.2	68.9
Assets of institutions with private capital (% of total assets)	91.8	89.4	88.6	88.5

Source: NBR [18, 19]

According to data published by the National Bank of Romania (BNR), at the end of 2021, the Romanian banking sector included 34 credit institutions, of which: three banks with full or majority Romanian state capital, three credit institutions with domestic majority capital, private, 20 banks with majority foreign capital and eight branches of foreign banks. Approximately 68.9% of the assets of the Romanian banking sector were owned by institutions with foreign capital at the end of March 2022.

In the structure of participations in the bank capital, Romania held a market share of about 31.8 percent of the total net assets in the case of seven banks, then, it is noted the continuity of holding a majority share of banks with Austrian capital, similar to previous years, Austria reaching a level of 23.6% in 2021, followed by the Netherlands (12.3 percent), France (11.3 percent) and Italy (8.9 percent).

In 2021, there is an increase in lending to the real sector, against the background of the narrowing of the aggregate demand deficit and the consolidation of the positive parameters that characterize the domestic macroeconomic framework.

The influencing factors on the supply side, with an effect on the restriction of credit flows to the economy, continue to consist in the adjustment of balance sheets to the prudential requirements in terms of capital adequacy and liquidity, as well as in maintaining a prudent conduct in the lending activity, against the background of an insufficiently identified eligible applications.

The progress of the Romanian banking sector, despite the health crisis, was worth noting, in the last period, through the structural indicators of the banking system regarding liquidity and solvency.

Romanian banks have the necessary resources for lending, the loans/deposits indicator being placed at 70.42% at the end of March 2022, while the solvency indicator is almost three times above the minimum allowed [18,19].

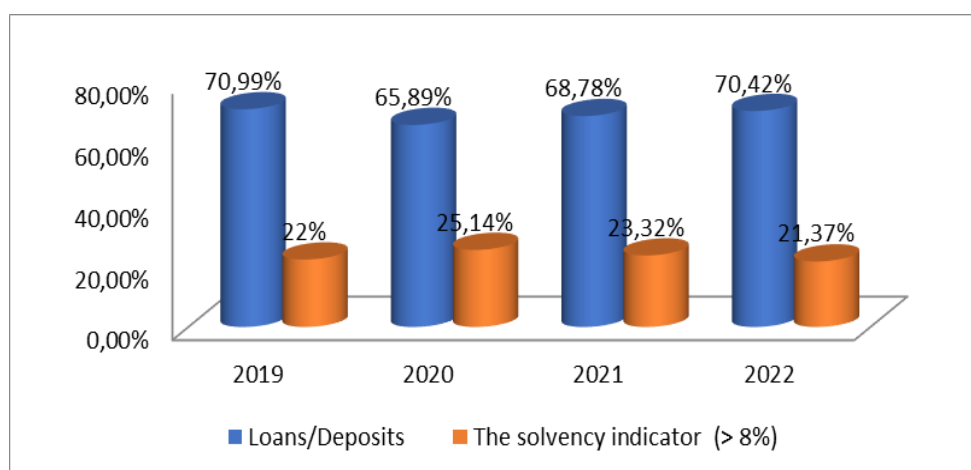


Figure 1. Structural Indicators of the Romanian Banking System

Thus, in the period since the beginning of the pandemic, the Romanian banking sector has proven, in relation to the central Cuban, a good capacity to adequately manage liquidity, through a high proportion of liquid assets (mainly government securities and exposures to the bank central) and attracting deposits from the population, the latter being characterized by a sharp migration, induced by the dynamics of interest rates for savings and the Russian-Ukrainian armed conflict.

Although Romanian banks have a consistent liquidity reserve, in the context of the growing gap between the maturity of assets and that of banks' liabilities, maintaining the stability of funding sources may be affected [18,19,20].

The solvency of the Romanian banking sector remains adequate, at a level of 23.3 percent (December 2021), above the European average of 19.6 (EU average).

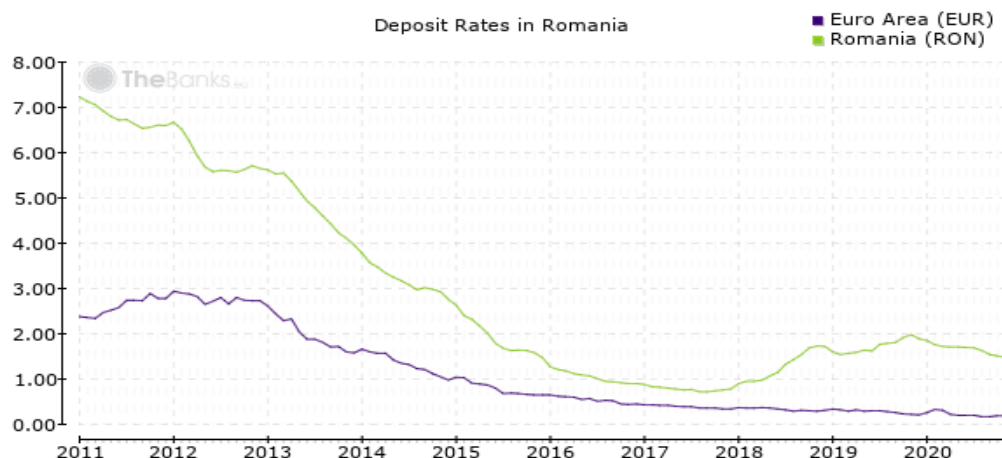


Figure 2. Deposit Rate in Romania

In the first quarter of 2022, the solvency indicator decreased by about 2 percentage points, mainly due to losses related to financial instruments as a result of the upward shift of the yield curve in lei and euros and the reduction of the share of claims on the government sector in aggregate assets (20.1 percent of assets in March 2022, down from year-end 2021). In terms of banking intermediation, calculated as the ratio between banking assets and gross domestic product (GDP), there was an increase from 2018 due to the fact that net banking assets had a nominal growth rate higher than that of GDP, in 2020 consolidated banking assets in Romania were EUR 117.81 billion (Figure 3).

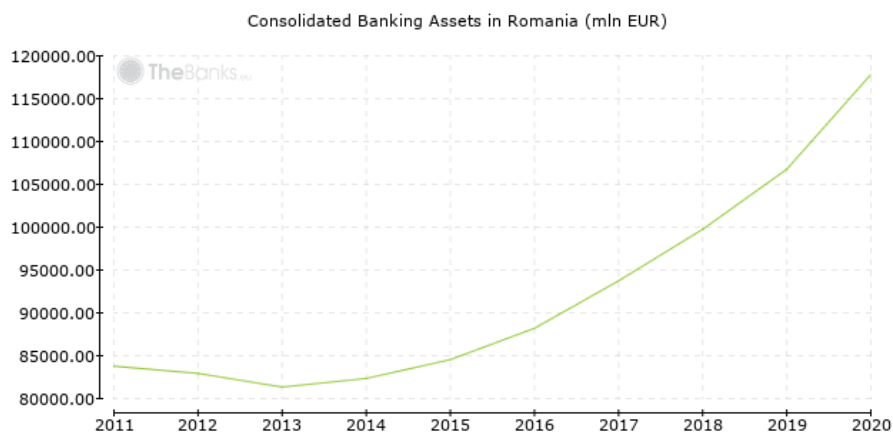


Figure 3. The Evolution of Consolidated Banking Assets in Romania

Unfortunately, our country is far below the European Union average (twice the value of GDP) with a degree of financial intermediation of approximately half of GDP, a fact that reveals the existence of a low degree of financial market depth.

Regarding the evolution of credit intermediation, the ratio of bank credit to GDP is 26.8% in December 2021 (Figure 4). And these values are far below those recorded on average in the EU, but also in countries in the region such as Poland, the Czech Republic or Hungary. The analysis of the evolution of the level of financial intermediation indicators shows that the main structural factors that contributed to this evolution are factors specific to the Romanian economy.

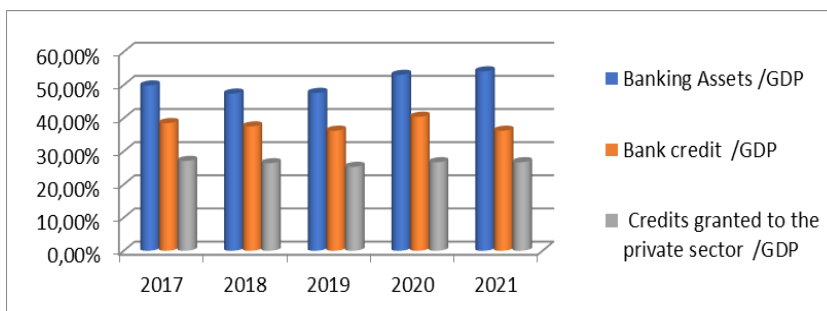


Figure 4. Indicators of Financial Intermediation

Regard of assets quality non-performing loans rate (according to EBA classification) improved at 3.3% in March 2022, compared to 3.83% at the end of 2020, but remains in the medium risk zone, with an EU average of 2% (Figure 5).

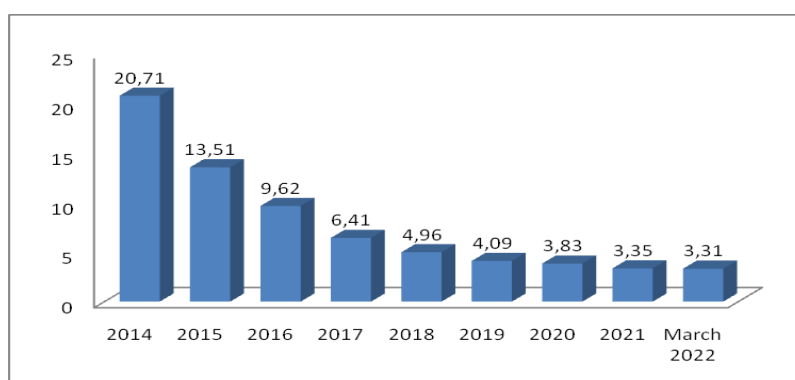


Figure 5. The Rate of Non-Performing Loans in Romania

The degree of provision coverage of non-performing loans continued to increase, evolving up to 67.2% in March 2022, its dynamics placing Romania at the top of the European ranking (Figure 5 and Figure 6).

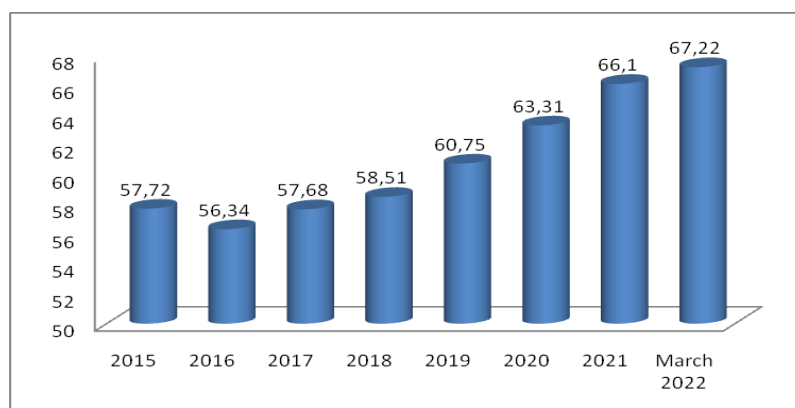


Figure 6. The Degree of Cooperation with the Provision of Non-Performing Loans in Romania

Regarding the performances recorded by the Romanian banking system, starting from 2018, the ROA and ROE indicators began to decline, which stood at 1.55% and 14.58%, respectively, until 2020, decreasing by 0.6 p.p. and respectively by 5.92 p.p. compared to 2018. From 2021, the positive trend resumes in the level of ROA and ROE indicators that had positive values higher than 2020 from 0.95% to 1.36% and respectively 8.66% to 13.28% (Figure 7).

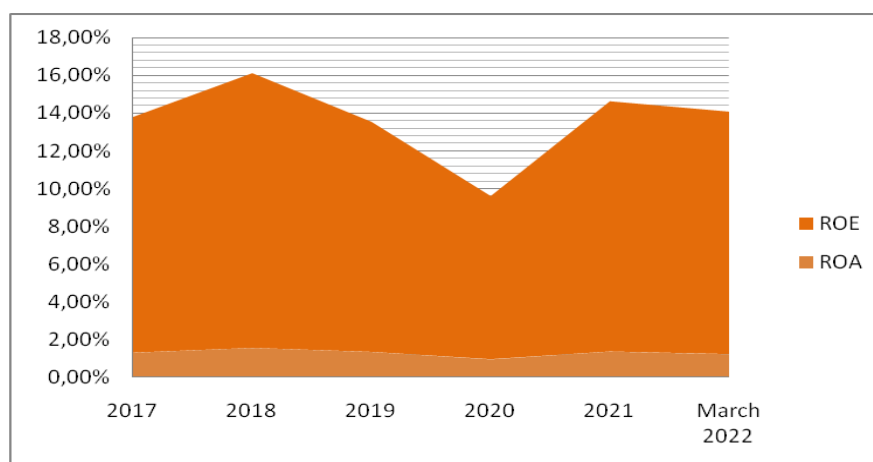


Figure 7. The Evolution of Performance Indicators in Romania

After the contraction in 2020, associated with the outbreak of the COVID-19 pandemic, the Romanian banking sector improved its performance in 2021, in the context of the vaccination campaigns and the fiscal and monetary stimulus measures adopted. The accentuation of inflationary pressures in the first part of 2022, including in the conditions of the war between Russia and Ukraine, which determined the increase of the interest rate at the level of central banks (in May 2022, the monetary policy interest rate was adjusted upward to 3.75 % per year), changed the upward trajectory of the performances of the Romanian banking sector [5].

CONCLUSIONS

The National Bank of Romania and the credit institutions in the Romanian banking system have made and are making efforts to adequately manage the quality of loans to ensure a safe and healthy development of the entire lending mechanism in Romania, referring to the present and future but with strong anchors in the past, showing such maturity in terms of understanding the mechanisms of crediting and risk management related to this activity.

Against the background of the vulnerabilities of the Covid-19 pandemic, in the context of the energy crisis and the war in Ukraine, the relevant indicators for measuring the quality of assets continued their improving trend, the evolution being a modest one, but the prospects for the next period indicate a deterioration, similar to the evolutions expected on international plan.

The risks related to the non-repayment of loans contracted by the non-governmental sector have, in the last period, been kept at a manageable level, their effects being counteracted by the credit institutions maintaining adequate levels of solvency and liquidity; this is mainly due to the policies and prudential rules implemented by the central bank of Romania.

In conclusion, the quality of the bank's loan portfolio is one of the significant predictors of the financial and economic stability of any country, and it is negatively affected by a wide range of macroeconomic determinants. Therefore, Romanian banks will remain alert in the event of an unfavourable economy and must be able to adequately manage credit risk, as a result of maintaining the tendency to accelerate lending activity and the continuation of the phenomenon of tension in macroeconomic balances.

In the case of companies, the situation of the Romanian economy is clearly linked to the quality of the loan portfolios granted by credit institutions in the Romanian banking system.

REFERENCES

- [1]. **ASLI DEMIRGUC K., ALVARO P., RUIZ ORTEGA C.**, 2021, Banking performance during the Covid-19 crisis, *Journal of Banking & Finance*, Vol 133, <https://www.sciencedirect.com/science/article/pii/S0378426621002570?via%3Dihub>
- [2]. **BADEA L. (coord.), SOCOL A., DRAGOI V., DRIGA I.A.**, 2010, *Managementul riscului bancar*, Editura Economică, București
- [3]. **BERHANI R.**, 2014, *Macroeconomic Determinants of Nonperforming Loans of in albanian banking system*”, Conference: International Conference on Economic and Social Studies, At: Sarajevo, Volume: Part 1, ISBN 978-9958-834-39-4
- [4]. **DARDAC N., BARBU T.**, 2012, *Instituții de credit*, Editura ASE, București
- [5]. **DRĂGOI E.V.**, 2013, *Gestiune bancară*, Editura Valahia University Press, Târgoviște
- [6]. **ELSIGER H., LEHAR A., SUMMER M.**, 2006, Risk assessment for banking systems, *Management Science* 52(9), 1301-1314, DOI: 10.1287/mnsc.1060.0531
- [7]. **GHOSH A.**, 2015, *Banking-Industry Specific and Regional Economic Determinants of Non-Performing Loans: Evidence from US States*”, *Journal of Financial Stability* 20, p. 93–104. Follow journa, DOI:10.1016/j.jfs.2015.08.004
- [8]. **HADA T., BARBUTA-MISU N., IUGA I.C., WAINBERG D.**, 2020, *Macroeconomic Determinants of Nonperforming Loans of Romanian Banks*, *Sustainability*, 12, 7533; doi:10.3390/su12187533
- [9]. **HANEEF S., RIAZ T., MUHAMMAD R., MANSOOR R.A., ISHAQ H.M., KARIM Y.**, 2012 *Impact of Risk Management on Non-Performing Loans and Profitability of Banking Sector of Pakistan*, *International Journal of Business and Social Science*, 3(7), pp. 307-315
- [10]. **ISARESCU M.**, 2016, the governor of the BNR, *Speech at the Opening of the High Level Regional Seminar on the Resolution of Non-Performing Loans*, Bucharest. <http://www.bnr.ro/Discurs-in-deschiderea-seminarului-regional-la-nivelinaltprivind-rezolucia-creditelor-neperformante-14313.aspx>
- [11]. **JOHANNES P., SHEEFENI S.**, 2015, *The Impact of Macroeconomic Determinants on Nonperforming Loans in Namibia*, *International Review of Research in Emerging Markets and the Global Economy (IRRE)*, 1(4)
- [12]. **LARYEA E., NTOW-GYAMFI M., AZUMAH A.A.**, 2016, *Nonperforming loans and bank profitability: evidence from an emerging market*, *African Journal of Economic and Management Studies*, 7(4), pp. 462-481, DOI 10.1108/AJEMS-07-2015-0088
- [13]. **PAUNA V., DIACONU A., PLATAGEA S.G., GEORGESCU R.I.**, 2022, *Banking management in the prism liquidity – profitability interrelation*, *Theoretical and Applied Economics*, Volume XXIX (2022), No. 1(630), Spring, pp. 93-100
- [14]. **RADOI M.A.**, 2009, *Gestiune bancară*, Editura Economică, București
- [15]. **SAOM SHAWLEEN A., TASANOVA N., NAWAR N.**, 2022, *Are non-performing loans sensitive to macroeconomic determinants? An empirical evidence from banking sector of SAARC countries*, *Future Business Journal*, <https://doi.org/10.1186/s43093-022-00117-9>
- [16]. **SEGUN T.B., AKINLO E.A.N.**, 2020, *Determinants of Nonperforming Loans After Recapitalization in the Nigerian Banking Industry: Does Competition Matter?*, *African Development Review*, DOI: 10.1111/1467-8268.12661
- [17]. **SYED, A.A.**, 2021, *Determinants of Nonperforming Loans: A Review of Empirical Evidence*, *New Challenges for Future Sustainability and Wellbeing*, ISBN: 978-1-80043969-6, eISBN: 978-1-80043-968-9
- [18]. *** BNR, *Raport asupra stabilității financiare*, 2022, Anul VII (XVII), nr. 12 (22)
- [19]. *** BNR, *Annual report*, 2021
- [20]. *** Banca Centrală europeană, www.bce.eu.int