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Focus Notes: Romania

Credit activity remains stagnant as rainy days for the Romanian economy are not over yet

Conditions in the Romanian credit market continue to remain tight. Although total credit to the domestic economy grew in April by 9.8% yoy in real terms, the largest part of this increase (9.3pps) can be attributed to government borrowing. Credit to general government has almost doubled within a year, and now constitutes around 21% of total outstanding credit. Private sector credit grew only by 0.6% yoy, and we should note that this is the highest figure in ten months. Yet, we believe that this is rather incidental, as it will be discussed below, and should not be interpreted as a sign of recovery.

Demand for new loans remains very low

It seems that stagnation in the credit market in first four months of 2010 can be attributed to the demand, rather than the supply side. As foreign banks started to get back on their feet, they sought to begin giving out loans again, in order to return to (at least an average, compared to the past) level of profitability. Gradually, they lowered significantly the rates on new loans, induced by central bank's successive policy rate cuts, but also maybe as a part of their expansionary strategy. At the same time, they hardly cut rates on the existing loans, not only in order to make up for the lower rates on new loans, but mainly to cover the losses due to the increasing levels of non-performing loans (NPLs). Three-month ROBOR, for example, fell to 4.74% in late April, posting a historical low.

No significant recovery in lending activity seen in the ear future

Nevertheless, we do not expect to see a vigorous rebound in credit activity in the near future. Firstly, the worst financial crisis of the post-communist era has hit hard firms and households, and it seems that Romania has not got completely out of it yet. We do not expect Romanian economy to return to positive growth rates before 2011, with zero growth being our upside forecast for this year. The difficult economic situation is reflected in the high levels of NPLs, which hit a new record high in April (17.5%). Our view is that although it is possible for the increasing trend to continue for some months, they will peak up before the end of the year. In any case increases will be smaller and at significantly lower paces. Note that a recovery in lending is expected to follow the recovery in the real economy, rather than lead it.

Secondly, things have started to change since May. It turns out that fiscal turbulence in the euro area is not over yet after all. This has increased uncertainty in financial markets throughout Europe, and intensified risk

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aversion sentiment. As a result, interest rates have started picking up again in May, with three-month ROBOR bouncing to as high as 7.21% in late May, before retreating around 6.85% in mid-June.

Thirdly, an ordinance facilitating early loan repayment, recently introduced by the government in order to provide relief to indebted households, could also impede credit expansion. In practice, this ordinance will enable debtors to swap the interest rate of their existing loans with the rates currently applying on new loans, at a very low cost. Banks are expected to react by increasing rates on new loans to levels comparable to those currently applied on outstanding loans, in order to make up for the foregone revenues due to loan restructuring, but also in order to cover the administrative and the reallocation costs the latter entails.

Household deposits grow steadily

The increased aversion towards risk among firms and households is also reflected in the high deposit growth rates. In April, private domestic deposits grew by 8.8% yoy on an FX-adjusted basis, led by an 11.2% increase household deposits. This could be yet another sign that Romanians do not believe that hard times are over.

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