REDEFINING THE ROLE OF CENTRAL BANKS IN A WORLD WITH CHANGING PARADIGMS THE CASE OF THE NATIONAL BANK OF ROMANIA

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*) The opinions expressed in presentation are those of the author and do not necessarily represent the views of the National Bank of Romania, nor do they engage it in any way

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Four major shifts in paradigms:

1) Large presence of foreign banks seen as a liability, rather then an asset

2) Forex reserves of CB's assessed as coverage of ST debt rather than as a coverage of months of imports (shift from a "current account" to a "capital account" approach)

3) Inflation worries become subdued by financial stability worries

4) New compromise between inflation and GDP growth (a ST approach)

1) Large presence of foreign banks seen as a liability, rather than an asset

Out of 11 CEE countries, Romania ranks 4th in terms of foreign ownership of banks. This large exposure only becomes problematic if:

a) net bank external debt (as % of GDP) is very high and can be withdrawn quickly

b) forex lending dominates and has a large probability of default

Country	Foreign ownership of banks (% of total)	Net bank external debt (% of GDP)	Forex lending (% of total)
Estonia	97	40	86
Czech Rep.	97	-5	14
Croatia	91	7	62
Romania	**88(4th)**	**20(7th)**	**58(5th)**
Lithuania	85	25	68
Bulgaria	84	13	56
Hungary	80	24	67
Serbia	76	9	68
Macedonia	71	3	55
Poland	70	8	33
Latvia	68	46	90

Source: Fitch Ratings

- In order to maintain/roll-over a higher percentage of the net bank external debt, the NBR has taken the following steps:
    - ✓ meeting in Vienna with the nine most important foreign banks, under the IMF SBA: a model to be replicated by other countries
    - ✓ meeting in Athens with the seven Greek Banks present in Romania
- In order to prevent/minimize defaults on forex credit that could trigger wider consequences, the NBR is:
    - ✓ stress-testing all the banks that have at least 1% of the market, plus selected smaller banks
    - ✓ requiring the banks to eventually bring in new capital in order to have a CAR of at least 10%
- It is considered to empower the NBR to mandate changes in the management/ownership of banks, if not satisfied with their compliance

2) Forex reserves of CB's as a coverage of ST debt (rather than in months of import)

- Investors are looking at ST debt coverage or at maturing debt (ST debt + MLT debt amortization) coverage = the Guidotti - Greenspan ratio.
  On both accounts, Romania fares better than the average CEEC and is rapidly improving during H1 2009, thanks to the IMF package, of which EUR 5 billion have already been disbursed

Country	Guidotti-Greenspan[1)] ratio (2009)	Swaps	IMF-led support packages (USD bn)
Serbia	73	-	3.9
Czech Rep.	89	-	-
Romania	**99 (3rd)**	-	**27**
Macedonia	101	-	-
Bulgaria	126	-	-
Poland	140	EUR 10 bn	20.5
Croatia	151	-	-
Hungary	157	EUR 5 bn	25.8
Lithuania	211	-	-
Latvia	320	EUR 0.5 bn	10.5
Estonia	370	SEK 10 bn	-

1) Without taking into account swaps or IMF packages

Source: Fitch Ratings

Romania: Outstanding external debt and reserves

Indicator (EUR million)	Dec. 2008	Mar. 2009	% Change
Total external debt	73,004	71,632	-1.9
0/w:			
- MLT external debt	50,804	51,115	+0.6
- ST external debt (original maturity)	22,200	20,517	-7.6
- ST external debt (remaining maturity)	31,423	31,361	-0.2
Forex reserves	26,220	25,121	-4.2

Source: NBR

- The NBR will use its massively improved reserve coverage of debt in order to **gradually** reduce MRR. The first steps: starting May 23rd, banks' liabilities exceeding 2 years maturities are not subject to MRR anymore

- Caveat: ST debt should not continue to fall as quickly as in Q1 2009; the coverage ratios are likely to improve, but less abruptly

3) Inflation worries become subdued by financial stability worries

- There is no systemic risk on the horizon. If needed, banks will be dealt with on a case-by-case basis, through mandatory re-capitalization and/or change of ownership

- In any case, re-capitalization will **not** be done with public money

- Progress is expected in coordinated approach to the recommendations from the Larosiere Report

4) New compromise between inflation and GDP growth

- Inflation in April was 6.45% having become the highest in the EU (in December, at 6.3%, it was the fifth highest, after the Baltic States' and Bulgaria's)
- The Baltic States have achieved rapid disinflation due to a dramatic recession. In Q1, Romanian GDP fell by 6.4%, whereas in Estonia: -15.6%, Latvia: -18.0%, Lithuania: -12.6%
- Romania has avoided a Baltic-style recession due to its flexible exchange rate. The depreciation from 3.8 to 4.3 RON/EUR has taken some pressure off the real economy. However, further depreciation should be avoided
- A dramatic relaxation of the policy interest rate (by 2-3 pps) would do more harm (inflation) than good (GDP growth). The result could be **stagflation**, the worst possible combination of all

Addendum: An enhanced consistency expected from the Rating Agencies

- Since 2006, only Moody's has kept unchanged its assessment of Romania, while both S&P and Fitch have downgraded Romania by two notches, **from an already very low level**

- It is true that in the meantime Fitch has downgraded Hungary and Latvia by four notches, Lithuania by three notches, Bulgaria and Estonia also by two notches, but given the very low starting point, Romania is the only EU-member country with sub-investment grade

- This looks excessively harsh, given that in most tables from Fitch's latest International Special Report, Romania ranks average (3rd to 9th position out of eleven countries)

- Question: what do the country rankings reflect? Past performance or future prospects? On both accounts, Romania looks overly penalized