

NATIONAL
BANK OF
ROMANIA

Financial Stability Report December 2023

Year VIII (XVIII), No. 15 (25)
New series

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NOTES

The *Financial Stability Report* was prepared by the Financial Stability Department under the coordination of First Deputy Governor Florin Georgescu.

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


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OVERVIEW

Risks to financial stability have seen mixed developments since the latest *Financial Stability Report*. On the one hand, after the turmoil that battered the US and Swiss banking sectors, investor sentiment has improved in an environment characterised by expectations of easing inflationary pressures. On the other hand, the economic picture and the geopolitical setting, marked by higher uncertainty about economic growth, but also the potential aggravation of the war between Russia and Ukraine or the heightening conflict between Israel and Hamas have been challenges to the financial system.

The main systemic risks to financial stability have remained the same since the previous *Report*, yet global economic and geopolitical uncertainties have amplified (Table 1). Of the four systemic risks, two are assessed as severe, of which the risk from external developments is seen becoming more relevant in the period ahead. Domestically, the tensions surrounding macroeconomic equilibria are assessed as severe, but relatively steady, also as a result of regional and international geopolitical developments, as well as in terms of the future fiscal and income policy stance. Two other systemic risks are identified, as follows: (i) the delay in implementing structural reforms committed to by the authorities and, hence, in absorbing EU funds, especially via the National Recovery and Resilience Plan (NRRP), a risk assessed as high and unchanged for the period ahead, and (ii) the default risk for loans to the private sector, assessed as moderate, albeit on the rise.

Table 1. Map of risks to financial stability in Romania	
	Global uncertainty amid the energy crisis, the war in Ukraine and the Middle East conflict
	Tensions surrounding domestic macroeconomic equilibria, <i>inter alia</i> as a result of regional and international geopolitical developments, as well as the future fiscal and income policy stance, amid the carrying on of the budget consolidation
	Delay in implementing reforms and absorbing EU funds, especially via the National Recovery and Resilience Plan (NRRP)
	Default risk for loans to the private sector
	severe systemic risk
	high systemic risk
	moderate systemic risk
	low systemic risk

Note: The colour shows risk intensity. Arrows indicate the outlook for risk in the period ahead.

Looking at the global economy, the IMF envisages a growth rate of 3 percent for 2023 (compared to 2.8 percent previously) and of 2.9 percent for 2024. Focusing on advanced economies, worth noting is the favourable outlook for the US economy

(the IMF growth forecast being revised upwards by 0.3 and 0.5 percentage points for 2023 and 2024 respectively), unlike the expectations for the euro area performance, which have led to a downward revision by 0.2 and 0.3 percentage points respectively.

At the same time, diverging developments between countries have become more pronounced, also in terms of price dynamics. A possible decoupling of monetary policies may echo in capital markets via adjustments in investor sentiment. The low volatility and narrow risk margins in the first part of the period under review have been followed by an increase in yields on government securities, with implications for funding costs if such developments persist.

Concerns surrounding the scale, duration and impact of the Middle East conflict are also reflected in commodity markets, fuelling uncertainty, especially in the oil market, even though the impact on this market was relatively low until the completion of this *Report*. This comes at a time when oil prices are already running high amid worries about falling production of OPEC+'s largest oil exporters, i.e. Russia and Saudi Arabia. Under a hypothetical scenario envisaging an expansion of the Middle East conflict in the region, the World Bank estimates oil prices to rise between USD 140/barrel and USD 157/barrel (versus, on average, USD 81/barrel for 2024 in case the conflict does not expand). Thus far, the effects of the conflict on global commodity markets have been contained, with Europe's gas market recording the highest price increases (up 32.2 percent between 7 and 31 October 2023), which reflected a geopolitical risk premium rather than supply chain disruptions.

On the domestic front, tensions are still surrounding macroeconomic equilibria. Over the first three quarters of 2023, real GDP went up 1.9 percent (against the same year-ago period, seasonally-adjusted figures), while the European Commission's growth estimates for Romania are 2.2 percent for 2023 and 3.1 percent for 2024 (compared to growth rates between -0.7 percent and 2 percent for 2023 and between 1.4 percent and 2.7 percent for 2024 in Czechia, Hungary, Poland and Bulgaria). Uncertainties surrounding future developments in economic activity stem from the future fiscal and income policy stance, given the need for further fiscal consolidation, but also from regional and global developments caused by the heightening of geopolitical risks, amid the war in Ukraine and the Middle East conflict.

In line with the trends shown in the previous *Reports*, twin deficits have remained high. The public deficit widened to 3.55 percent of GDP January to September 2023, close to the 4.4 percent target set for this year. The Fiscal Council warned about the risk that the public deficit would reach 6.5 percent of GDP, given that the developments in the first three quarters of the year were driven by higher expenditures (especially on wages, social security and interest payments), while revenues posted slower dynamics than planned. The delay in fiscal consolidation caused the public debt to exceed in September 2023 the level seen at the end of the COVID-19 pandemic (50.5 percent of GDP). Among the countries in the region, only Romania and Czechia failed to cut back on their public debt levels in the post-pandemic period, with the other countries reporting adjustments ranging from 2 percentage points to 8 percentage points. The increase in public debt was also accompanied by a rise in the share of non-residents' holdings of government

securities issued on both domestic and foreign markets (up 4 percentage points January through September 2023 to 49.2 percent). The foreign currency component remained close to the end-2022 level, i.e. 53.4 percent. The Fiscal Council expressed its concerns about some legislative changes that further contain the transparency of budget execution and set a precedent that may pose major risks of derogations to the fiscal rules. The implementation of best practices and principles recommended by the OECD in order to comply with tax rules and commitments to the EU is important for strengthening the country's credibility as regards the management of economic policies, with positive implications for the sovereign risk premium as well.

The current account continues to post a significant deficit, albeit smaller year on year (EUR 16.1 billion in January-September 2023 versus EUR 21.1 billion in the same year-ago period), its evolution being accompanied by a rise in external deficit coverage by non-debt-creating capital flows (69 percent compared to only 35 percent in the first nine months of 2022). Nevertheless, external debt stayed on an upward trend amid the swift increase in foreign financing of general government (up 26.8 percent). This, however, came along with an improvement in the term structure, with the short-term component falling to 28 percent from 33.4 percent in September 2022. Under the circumstances, the ratio of foreign exchange reserves to short-term external debt by remaining maturity grew to 105.4 percent from 72.7 percent in the same year-ago period.

In the new economic and geopolitical context, Romania should make the most of the funds available under the Recovery and Resilience Facility, the EU instrument for implementing the reforms and investments necessary for the transition of the economy towards a sustainable growth pattern. From the start of the programme until end-September 2023, Romania drew funds worth EUR 9.1 billion, accounting for about a third of the allotted amounts. Ensuring the amounts in full is conditional on implementing all the reforms and investments provided in the NRRP by August 2026, and the European Commission's latest decision was to suspend the payment of EUR 53 million due to the inadequate fulfilment of two of the agreed milestones on energy. Moreover, one of the measures recommended to Romania during the May 2023 European Semester was to strengthen the administrative capacity to allow for a continued swift and steady implementation of the NRRP, which would entail positive long-term effects on economic activity (even after the end of the programme).

Romania also benefits from EU funds under the 2014-2020 and 2021-2027 operational programmes. At end-October 2023, the absorption rate for the cohesion policy funds under the 2014-2020 programme was 84.5 percent, whereas that for national rural development programmes stood at 80.5 percent. The NCMO Working Group on sustainable increase in financial intermediation showed the need for stronger involvement of the financial system in the co-financing of projects with non-repayable EU funds, as well as for higher predictability and transparency regarding the schedule of calls for projects, together with the related legislation, in order to raise the absorption capacity of such funds.

Romania's non-financial corporations sector still falls significantly short of adequate capitalisation. A large percentage of firms (29.5 percent in 2022) reported negative

equity and almost a third hold equity below the regulatory threshold (for further details, see Section 2.1. Non-financial corporations). Given the close connection between these vulnerabilities and the level of financial education, the “Antreprenariat de TOP” (TOP Entrepreneurship) project was launched in October this year. Project-specific objectives are aimed at developing financial knowledge, improving financial behaviour and enhancing financial attitude, encouraging a broader use of financial products and services, and improving the digitalisation of financial and business activities. The project will be coordinated by the National Bank of Romania, in partnership with representative business and financial associations, members of the academia, line ministries and the banking sector, as well as the business environment, and will follow the approach of the European Union and the Organisation for Economic Co-operation and Development.

Financial health of firms in Romania improved in 2022, despite the economic environment marked by high inflation and uncertainties, particularly about the geopolitical framework. At the same time, robust consumer demand fostered the increase in corporate profitability, with the return on equity (ROE) going up 6 percentage points from 2021 to 28.7 percent. The rise in funding costs amid high inflation was reflected in a lower interest coverage ratio (EBIT/interest expenses) reported by firms, especially by SMEs. Furthermore, companies’ level of indebtedness (debt-to-equity ratio) added 7 percentage points to 166.7 percent over the same period. Against the backdrop of heightened geopolitical and economic uncertainty, tighter financial conditions may put a drag on making payments or accessing finance, given that 16 percent of firms report a high level of indebtedness (with the debt-to-equity ratio above 200 percent) and exposure to them accounts for almost half of banks’ corporate portfolio. The 2023 financial statements will also reflect upward wage cost pressures, amid a lack of skilled labour and the announced increases in the minimum wage.

Alongside the structural vulnerabilities specific to this sector, the global uncertainties that have reflected in increases of energy and commodity costs to historical highs, as well as the need for the green transition, have again brought to the fore two strategic objectives, i.e. food and energy security. In this context, economic sectors such as agriculture, food industry and energy have become key in policy implementation, together with the sectors capable of producing a structural change in Romania’s economy, such as the high-tech industries or knowledge-intensive services (KIS).

Households’ net wealth¹ continued to grow in 2023 Q1 on the back of a significant expansion in net financial assets (up 20 percent in annual terms). Households’ wealth per capita trebled compared to 2007, amid a marked advance in net financial assets (4.5 times), yet disparities and polarisation remain important.

Bank lending to the private sector lost further momentum. On the one hand, loans to non-financial corporations continued to rise, albeit at a slower pace (up 7.8 percent year on year in September 2023 against 25 percent in September 2022). This occurred amid the slowdown in the growth rate of foreign currency lending, given the decrease

¹ Starting with this *Report*, data published by the National Institute of Statistics in national accounts, compiled in accordance with ESA 2010, have been used for the calculation of non-financial assets held by households. The differences from previous editions stem from the method of calculation of non-financial assets.

in the interest rate differential between leu- and EUR-denominated loans from a peak of 6.9 percentage points in October 2022 to 2.2 percentage points in September 2023. On the other hand, the household loan stock stayed virtually unchanged in September 2023. The breakdown by creditor is indicative of the positive dynamics of new consumer loans granted to households by the NBFIs (up 27 percent in September 2023, as the sum of 12-month flows).

Household and corporate loan repayment capacity has seen mixed developments since the latest *Report*. For firms, the NPL ratio stayed around 4 percent in September 2023, after touching 3.9 percent in July, the lowest level since the European Banking Authority's definition was introduced in 2015. The dynamics resulted from both the decline in the volume of non-performing loans and the increase in corporate exposure. The outlook for the period ahead remains under close monitoring for a number of reasons: (i) the pace of increase of new loans is significant, albeit slower than in 2022, (ii) for most of the government-backed loans (19.7 percent of total corporate loans as at August 2023) the interest subsidy period has expired or is due to expire, (iii) foreign currency loans grew to 46 percent of the stock of corporate loans and, even though the NPL ratio is still lower in relative terms (3 percent versus 4.9 percent for leu-denominated loans in September 2023), developments during the global financial crisis showed that trends could reverse briskly, and (iv) the average probability of default for September 2023 – September 2024 is estimated at 4.3 percent, well above the 2.4 percent rate of default recorded in September 2023.

Turning to households, their repayment capacity has continued to worsen. The non-performing loan ratio has gone up marginally since the latest *Report* to 3.3 percent in September 2023, with mortgage-backed consumer credit standing out with an NPL ratio of 12.5 percent, up 0.8 percentage points since the end of 2022, followed by unsecured consumer loans, on 5.6 percent.

The activity in the residential real estate market has shrunk further, and expectations are for this trend to continue. Since the beginning of the year, the volume of construction works has decreased, transactions have experienced a setback, yet residential property prices have remained relatively unchanged in June 2023 versus the same year-ago period. The elevated construction costs, with an impact on new house prices, and high lending rates continue to put pressure on access to finance, sending the volume of new housing loans down 36 percent in September 2023 versus September 2022 (12-month cumulative flow).

Banking sector

The Romanian banking sector has been experiencing good times in terms of key financial and prudential indicators, despite the challenges associated with the health crisis and the regional geopolitical context, and with the disruptions that emerged in the US and Swiss banking sectors in the first quarter of 2023. The solvency ratio (22.3 percent) is adequate and above the EU average, liquidity indicators have improved as against 2022, while the main asset quality indicators (NPL ratio and the NPL coverage ratio) place the banking sector in the EBA-defined low-risk bucket (Table 2). Profitability rose further, while the operating expenses-to-assets ratio

(2.2 percent, September 2023, annualised values) has improved by approximately one percentage point in the past ten years.

Table 2. Risk indicators for the banking sector

Risk indicators	EBA-defined prudential range	Romania					EU average	
		2018	2019	2020	2021	2022		Sep. 2023
Solvency								
Tier 1 capital ratio	>15%							
	[12%-15%]	18.64	20.05	23.22	20.86	20.48	19.22	17.3
	<12%							
CET1 capital ratio	>14%							
	[11%-14%]	18.64	19.95	23.11	20.76	19.98	18.75	16.0
	<11%							
Total capital ratio		20.71	22.00	25.14	23.32	23.40	22.30	20.0
Asset quality								
Non-performing loan ratio	<3%							
	[3%-8%]	4.96	4.09	3.83	3.35	2.65	2.61	1.8
	>8%							
Non-performing loan coverage by provisions	>55%							
	[40%-55%]	58.51	60.75	63.31	66.10	65.55	65.08	42.9
	<40%							
Ratio of restructured loans and advances	<1.5%							
	[1.5%-4%]	3.26	2.49	2.40	2.60	1.96	1.69	1.5
	>4%							
Profitability								
ROE	>10%							
	[6%-10%]	14.59	12.21	8.66	13.28	16.40	21.25	10.8
	<6%							
Cost-to-income ratio	<50%							
	[50%-60%]	53.17	54.32	53.84	53.92	52.11	47.63	56.5
	>60%							
Balance sheet								
Loan-to-deposit ratio for households and non-financial corporations	<100%							
	[100%-150%]	71.89	69.48	63.61	63.96	65.66	64.62	109.3
	>150%							
Liquidity Coverage Ratio – LCR	>140%							
	[110%-140%]	237.84	242.59	292.48	238.77	209.16	247.98	159.9
	<110%							
■ best bucket ■ intermediate bucket ■ worst bucket Source: NBR, EBA								

Banks with majority domestic capital continued to strengthen their first position in the Romanian banking sector, as they came to hold one third of bank assets, raise 34 percent of private sector deposits and make the largest contribution to financial intermediation (32 percent of total loans, September 2023). Corporate loans went primarily to companies with domestic capital (approximately 70 percent of total loans to companies). The consolidation of the Romanian banking sector is expected to continue via the mergers and acquisitions announced in 2023.

The Romanian authorities have included among the fiscal measures a permanent additional tax levied on all banks, irrespective of their financial results, by implementing time-differentiated tax rates. Applying a 2 percent tax on banks' turnover will have an annual impact equivalent to 1.5 percent of total own funds of credit institutions, Romanian legal entities, and will affect financial intermediation.

Banks' profitability indicators are further high in a European comparison, but on the domestic front, return on assets and return on equity have stood below the similar indicators recorded by the real sector in the past decade. For instance, in 2013-2022, average return on assets ran at 0.9 percent in the banking sector and at 6.4 percent in the non-financial corporations sector. Structural differences in terms of profitability have persisted across institutions, as shown by the breakdown by size (large banks are significantly more profitable) and corporate governance.

From a macroprudential perspective, operational efficiency should be improved without hindering financial inclusion and the access to finance. The national specifics (the large share of rural population, who use primarily cash as a means of payment) call for a gradual transition to digital payment solutions, while maintaining an adequate banking presence in the territory.

Government securities hold a significant share in assets (19.2 percent, September 2023) and help improve the prudential position, but can increase the concentration and interest rate risks. A large share of government securities are measured at fair value (60.9 percent), the revaluation effects being immediately recognised in own funds. However, since the beginning of 2023, government securities marked to market have contributed to rising own funds, as credit institutions did not trade securities that had previously generated losses, choosing to hold them to maturity.

Structural vulnerabilities

The Romanian economy faces a series of structural vulnerabilities (Table 3), which, unless properly addressed, can contribute to the heightening of systemic risks to financial stability, while also affecting the capacity to channel investment flows towards critical areas so as to ensure lasting and inclusive economic growth.

Table 3. Map of structural vulnerabilities to financial stability in Romania

- A.** Weak payment discipline in the economy and vulnerabilities in companies' balance sheets
- B.** Low financial intermediation
- C.** The demographic problem
- D.** Climate change

A. While economic activity stepped up during 2022, payment discipline vis-à-vis non-banks deteriorated, with the value of overdue payments increasing 9.8 percent (in 2022). On average, 11 percent of trade debt was overdue in 2022. Looking at the firms that submitted financial statements at end-2022, one third recorded losses and 15 percent reported a three-year period of losses. One of the sector's vulnerabilities,

i.e. firms with equity below the regulatory threshold, stuck to a high level in the economy. It was the case of one third of the number of companies at end-2022, while the capitalisation needs of these firms went up 1.6 percent, reaching lei 138.8 billion. The banking sector's exposure to these companies stays low (7 percent of exposure to firms as at August 2023), yet this category accounts for 21 percent of non-performing loans. Besides, these firms contribute 60 percent to the volume of aggregate losses.

B. Financial intermediation remains low and on a downtrend in Romania. The bank assets-to-GDP ratio in Romania is on a decline compared to the value recorded a decade ago (to around 50 percent in 2023 Q1 versus 57 percent in 2013 Q4), considerably below the peer economies in the region. In terms of debt to national financial institutions, there was a 3.5 percentage point drop against the pre-pandemic level, to 31.6 percent of GDP (June 2023), steepening the downward phase of the debt cycle.

Given the limited fiscal space and the rising financing costs in a challenging economic and geopolitical context, the financial system needs to become more actively involved in supporting the green transition or in funding sectors that can contribute to fulfilling the country's strategic objectives. It is also useful to channel public funds in a more targeted approach, *inter alia* by defining strategies to support competitive firms in critical economic fields. Contributions to achieving the strategic objectives at national level and to enhancing competitiveness can also come from fulfilling the outstanding energy milestones, increasing the absorption of EU funds, in general, as well as from defining strategies on recycling and the circular economy or connecting to wind energy value chains. Moreover, the modest financial education of the staff of firms in Romania, measured by an aggregate financial literacy score of 68 out of 100, shows that there is room for improving the degree of knowledge and use of financial products and services, also in the digitalisation segment.

C. Long-term demographic trends have deteriorated further in the post-pandemic period. The downtrend in population continued in 2022, amid the natural population change still running deeper into negative territory than in the pre-pandemic period (the natural population change per 1,000 people stood at -2.6 in 2022 versus -2.1 in 2019), concurrently with the resumption of emigration, after a mild halt in the trend during the pandemic. The category most inclined to emigrate is that of persons aged between 20 and 40 (up 42 percent in 2022). The medium- and long-term outlook for the population dynamics puts Romania in one of the top positions in the European Union, with a 14 percent drop in population by 2050 in a baseline scenario. Other long-term trends observed at European level, with implications for the sustainability of the economy, relate to population ageing and the decrease in active population.

The challenges generated by climate risks, green transition and the digitalisation of the economy, but also the demographic disparities at a regional level, call for adequate skills of the labour force so as to underpin a sustainable and inclusive growth of the Romanian economy. Nevertheless, Romania still ranks last among EU Member States in terms of the level of educational attainment of employees, the percentage of those with tertiary education coming in at 23.3 percent in 2023 Q2 (15.1 percentage points below the EU average).

D. The banking sector's exposure to climate risk is further high, but the degree of awareness and preparedness for addressing this risk has seen an improvement against end-2020. Climate-relevant (brown) sectors account for 52 percent (as at September 2023) of banks' corporate loan portfolio. At the same time, green loans in banks' portfolios have reached lei 3 billion (September 2023) and hold 1.6 percent in the stock of credit to firms, being channelled primarily towards green buildings (47 percent). Green finance development is key to green transition, which can be backed by directing investment to cleaner sectors and technologies, as well as by the financial system mobilising private capital for decarbonisation.

Even though green finance elicits great interest among financial institutions in Romania from the perspective of its potential opportunities for business development, according to an NBR survey conducted in mid-2023, it does come with a series of challenges. The most pressing challenge to implementing and developing green products refers to the availability of data, followed closely by the instability of the legislative framework and the lack of necessary knowledge in the field. Given the new non-financial reporting requirements on sustainability established at European level via the EU Sustainable Finance Strategy, the disclosure requirements are more detailed and relate *inter alia* to the missing information flagged by credit institutions, namely the material impact of ESG (environmental, social, governance) factors, but also information regarding their value chains. The reporting capacity and the quality of non-financial information depend, however, on improving the preparedness of firms in Romania for complying with the new disclosure requirements. According to the special issue on climate change risks of the *NBR Survey on the access to finance of non-financial corporations in Romania*, only 3 percent of companies took steps for creating expertise to meet non-financial reporting requirements.

Special feature

The pandemic crisis and the problems generated by the war in Ukraine called for the adoption of unprecedented measures to support the economies. An unwanted consequence of these measures regards the financing of economically unviable companies, known as zombie firms, with multiple ripple effects on the real economy and the financial system. The period that followed the global financial crisis of 2007-2008 saw an increase in this phenomenon, both nationally and in Europe, yet with a relatively higher magnitude in the case of Romania. At present, the share of this segment of firms ranges between 6.3 percent and 7.9 percent in total assets (depending on the definition used) and between 22 percent and 25.3 percent in terms of the number of such companies in total.

Zombie companies² have a low economic performance. The productivity of these firms, measured as a ratio of gross value added and the number of employees, represents one third of that recorded by the other firms in the economy. Moreover, these firms have a modest contribution to economic activity (merely 4.3 percent to

² Zombie firms have been defined as companies with capital shortfalls for two consecutive years or firms identified according to the methodology in Storz *et al.*, 2017 (negative return on assets, drop in fixed assets and debt/capital > 2 for two consecutive years). Firms with capital shortfalls are those with net assets, calculated as the difference between total assets and total liabilities, lower than half the value of the subscribed share capital.

the sector's value added), but entail major disruptions in terms of resource allocation in the economy, the collection of revenues to the general government budget, corporate governance and payment discipline. They account for 15 percent of overdue payments in the economy, 14.5 percent of arrears to the general government budget, while the payables payment period is double the sector average (157 days versus 77 days). Besides, these firms have a poor resilience to shocks amid their major capital shortfalls, low degree of liquidity and lack of alternative financing sources, since they are not eligible for lending by specialised institutions. The presence of a large number of zombie firms makes the entire non-financial corporations sector have a low resilience to shocks and limits its development.

The mechanisms in place to address issues related to the market exit of zombie companies lack the necessary efficiency to mitigate this vulnerability substantially. Recourse to insolvency proceedings by zombie firms is very low (1 percent within one year from the start of financial distress, 2.4 percent within two years and 3.8 percent within three years). The analysis of insolvency points to a low efficiency of the existing framework: (i) the duration of the procedure is still rather long (over one year) and more than half of insolvent firms have been under this procedure for longer than four years, (ii) this restructuring mechanism is being resorted to rather late, when the firm's financial standing has already deteriorated markedly over the course of several years, (iii) pre-insolvency procedures, albeit more frequent in recent years, have led to a very small number of cases being resolved, and (iv) recourse to the reorganisation procedure is extremely scarce, as it is both relatively lengthy and costly. In order to reduce the segment of zombie companies, one set of useful measures could consist, on one hand, in revising the legislative framework for commercial companies so as to enhance the sector's capitalisation and, on the other hand, in improving the restructuring and market exit mechanisms for unviable firms, to ensure that they are resolved faster and more efficiently.

1. INTERNATIONAL AND DOMESTIC ECONOMIC AND FINANCIAL ENVIRONMENT

Risks to financial stability have seen mixed developments since the release of the previous *Report*: (i) investor sentiment has improved after the bank turmoil in the United States and Switzerland ended and amid expectations of easing inflationary pressures, and (ii) financial system resilience has further been tested by the new and uncertain macroeconomic and geopolitical context, engendered by the risks of a higher-than-expected inflation or a steeper slowdown in the economy. At the same time, investors' optimism is already reflected in financial asset prices, and geopolitical risks are on the rise regarding a potential new heightening of tensions between Russia and Ukraine or a regional escalation of the conflict in the Middle East, with adverse implications for global commodity markets and supply chains, as international trade is already fragmented following previous shocks.

On the domestic front, tensions are still surrounding macroeconomic equilibria. Over the first three quarters of 2023, real GDP went up 1.9 percent (against the same year-ago period, seasonally-adjusted data), with a further outlook for weak dynamics during this year, followed by a potential moderate recovery in 2024. January through September 2023, the general government deficit widened by more than a third against the same year-ago period, while public debt exceeded the level recorded at the end of the COVID-19 pandemic (50.5 percent of GDP). The current account deficit remains high, even if it has started to adjust in 2023, implying also an improvement in its coverage by non-debt-creating flows (69 percent in January-September 2023 compared to only 35 percent in the same period of the previous year).

Romania continued on its path towards real convergence, the differential in terms of GDP per capita versus the countries in the region decreasing in recent years. However, economic convergence must be accompanied by the structural transition of the economy towards a growth pattern based more on high value-added, high-tech and knowledge-intensive activities, supportive of meeting environmental and digitalisation objectives. Romania enjoys the opportunity of accessing EU funds via the Recovery and Resilience Facility, but these amounts are conditional on its fulfilling the commitments on reforms and investments. Strengthening the administrative capacity to ensure a continued and swift implementation of the NRRP is an essential factor for economic growth, as well as a recommendation from the European Commission in May 2023.

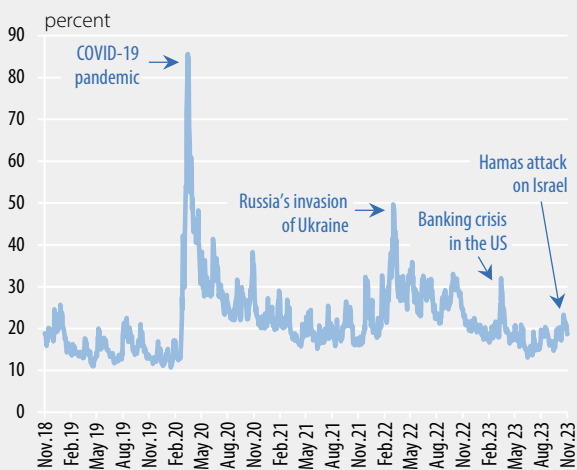
The debt cycle has further seen less favourable developments, with debt dynamics being faster for households than for non-financial corporations, amid the stronger

impact of higher interest rates on housing loans to households. The ongoing monetary policy tightening cycle in the euro area in 2023 narrowed the spread between the interest rates on new leu- and EUR-denominated loans (down to 2.3 percentage points in September 2023, compared to 5.6 percentage points in September 2022, in the real sector on aggregate). Nevertheless, foreign currency lending kept rising, yet at a slower pace than the year before.

1.1. International economic and financial developments

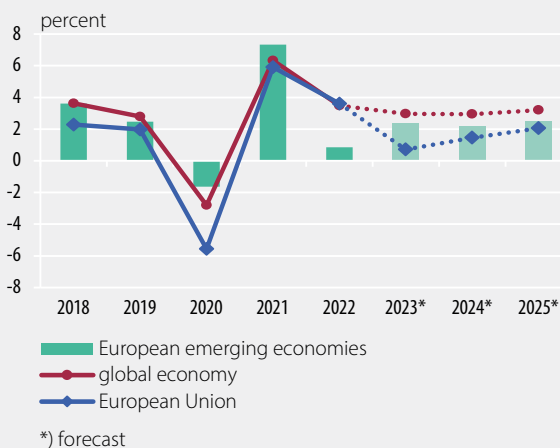
Risks to financial stability have seen mixed developments since the latest *Financial Stability Report* (Chart 1.1). On the one hand, the bank turmoil in the United States and Switzerland abated at the beginning of the period under review, and investor sentiment in international financial markets was positive, based on the perception that inflationary pressures would ease relatively quickly, without entailing a substantial drop in economic activity (there would be a soft landing). On the other hand, financial system resilience has further been tested by the new and uncertain macroeconomic and geopolitical environment, marked by the persistence of inflation (in particular core inflation), by the slow economic growth and higher financing costs, against the background of monetary policy normalisation at global level.

Chart 1.1. Risk aversion indicator (VSTOXX)



Source: Refinitiv

Chart 1.2. Economic growth worldwide, in the EU and European emerging economies



Source: IMF (*World Economic Outlook*, October 2023)

A number of factors carry the potential to fuel the already existing vulnerabilities and trigger abrupt asset price adjustments, such as a higher-than-expected inflation or a more pronounced slowdown in the economy, given that investors' optimism is already reflected in financial asset prices³. Significant geopolitical risks linger as well, i.e. a potential new heightening of tensions between Russia and Ukraine or a regional escalation of the conflict between Israel and Hamas, with adverse implications for

³ For further details, see section "Risk Assets Are Increasingly Exposed to Repricing Pressures" in *Global Financial Stability Report*, IMF, October 2023.

global commodity markets and supply chains, given that international trade is already relatively fragmented following previous shocks⁴.

Looking at the global economy, the IMF envisages a growth rate of 3 percent for 2023 and of 2.9 percent for 2024 (Chart 1.2). However, there are diverging developments between countries in terms of economic growth outlook. In what the advanced economies are concerned, mention should be made about the favourable economic developments in the US, with the IMF forecast for the US being revised upwards by 0.3 percentage points and 0.5 percentage points for 2023 and 2024, respectively, whereas the forecast for the euro area was revised downwards by 0.2 percentage points and 0.3 percentage points, for 2023 and 2024. The European Commission estimates a real GDP increase of 0.6 percent in the EU in 2023 and of 1.3 percent the following year⁵. Emerging and developing economies, except China, remain broadly resilient.

Discrepancies regarding the inflation outlook may lead to a decoupling of the monetary policies of major central banks in the near future, with implications for financial asset prices and international capital flows. Since the release of the previous *Report*, the ECB has raised its key rates on four occasions (by 25 basis points each time) up to 4.5 percent for the interest rate on main refinancing operations. Unlike the monetary authorities in developed countries, a number of central banks in emerging economies have already started their monetary policy easing cycle (e.g., some central banks in Latin America or, at regional level, the Polish and Hungarian central banks). Investors revised upwards their expectations about the monetary policy rates of major central banks (except Japan). They remain highly uncertain about future inflation developments in the euro area⁶.

In advanced economies, government bond yields increased substantially as a result of the further monetary policy strengthening by major central banks, as well as of the upward revision of investor expectations about the future paths of monetary policy rates of these banks. The rising term premia⁷ also contributed to these dynamics, especially in the US, but also in Germany, the UK and Japan.

The divergences regarding the outlook for economic growth and inflation rates have also been reflected in capital market developments. Overall, investor sentiment was positive in the first part of the period under review, and contributed to a further compression in risk margins and to low volatility, as well as to a slight easing in financial conditions in the US and the euro area (despite the tightening of the monetary policy stance of the Fed and the ECB)⁸. However, rising government bond yields in developed economies have exerted pressure on stock valuations globally, also leading to higher financing costs for companies on capital markets. Despite the

⁴ For further details, see IMF, *World Economic Outlook*, October 2023, or BIS, "Mapping the realignment of global value chains", *BIS Bulletin* No. 78, October 2023.

⁵ https://economy-finance.ec.europa.eu/system/files/2023-12/ip258_en.pdf

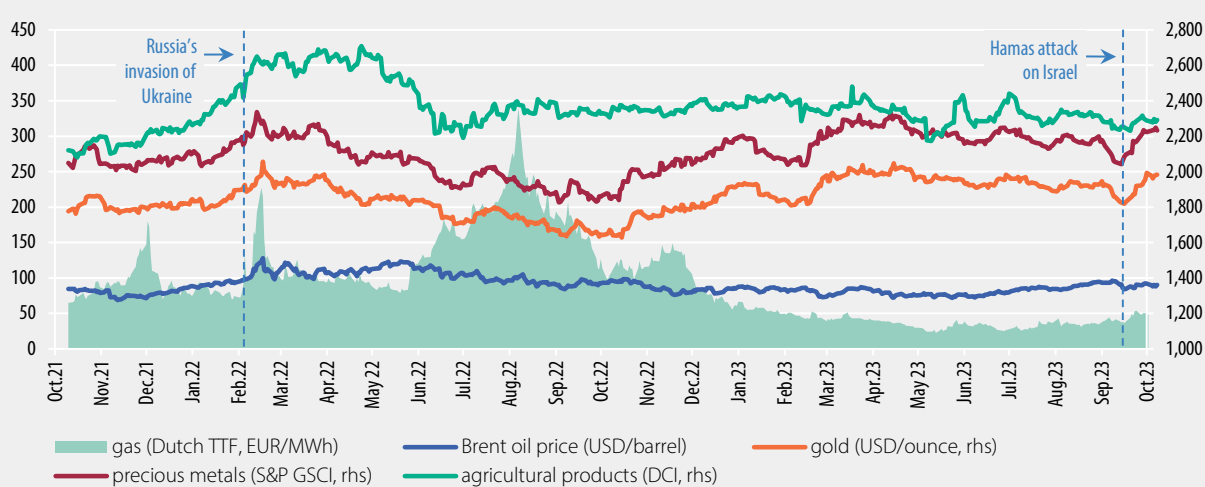
⁶ For further details, see section "Central Banks in Advanced Economies Expected to Cut Rates Soon Despite Stubborn Core Inflation" in *Global Financial Stability Report*, IMF, October 2023.

⁷ Referring to the additional compensation investors receive in exchange for taking the interest rate risk when holding long-term bonds (to the detriment of the roll-over of short-term bonds).

⁸ For details, see section "Financial Conditions Are Easing, but Lending Conditions Could Get Tighter" in the *Global Financial Stability Report*, IMF, October 2023.

slight compression of the spread between corporate bond yields and government bond yields – particularly in the US in the high-yield segment, and to a lesser extent in the investment-grade segment and also in the euro area – capital market financing costs have remained high by historical standards. The broad-based rise in interest rates puts pressure on public and private debt sustainability. Thus, the liquidity position of non-financial corporations has worsened both in developed and emerging economies (except for China). Developments also indicate an erosion of the interest coverage ratio (ICR) of non-financial corporations in the US and Europe⁹, as well as an increase in the number of bankruptcies in these regions¹⁰.

Chart 1.3. Price developments for main commodities and gold



Source: Bloomberg, Refinitiv

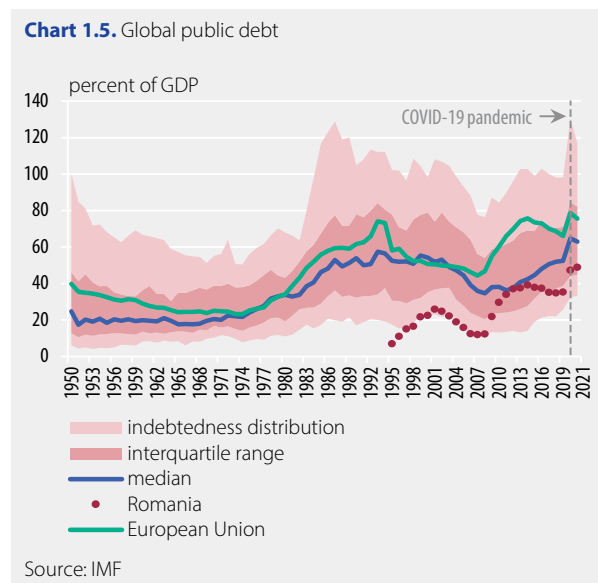
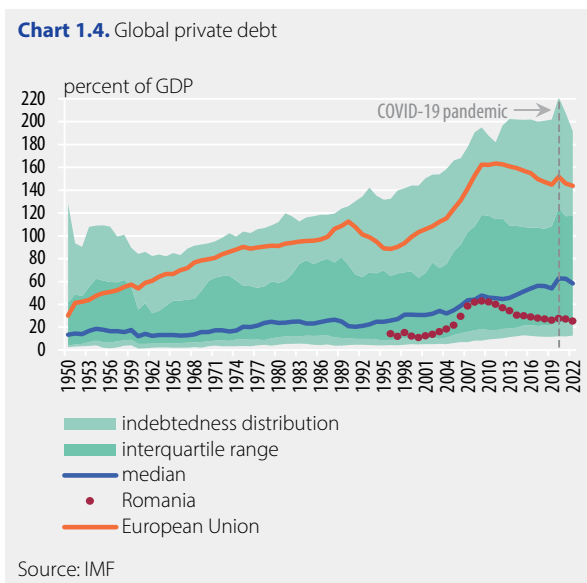
Developments in commodity markets, notably the oil market, are characterised by uncertainty, due to concerns regarding the scale, duration and impact of the conflict in the Middle East. This comes at a time when oil prices are already running high amid worries about falling production of OPEC+’s largest oil exporters, i.e. Russia and Saudi Arabia. These two countries have decided to voluntarily reduce their oil production starting July 2023¹¹ and have expressed their intention to maintain this trend until the end of the year. Thus far, the effects of the conflict on global commodity markets have been contained. Between 7 and 31 October 2023, prices rose for oil (+7 percent), precious metals (+6.5 percent) and agricultural products (+2.1 percent) (Chart 1.3). Europe’s gas market recorded significant price increases (+32.2 percent) after the recent Hamas attack, reflecting a geopolitical risk premium rather than supply chain disruptions. Nevertheless, prices remain well below the levels recorded prior to Russia’s invasion of Ukraine (-43.2 percent). The uncertain international situation fuels investors’ appetite for safer assets; therefore, the gold price increased by more than 8 percent during the same period.

⁹ For details, see section “The Credit Cycle Is Turning as Corporate Cash Buffers Deplete” in the *Global Financial Stability Report*, IMF, October 2023.

¹⁰ For further details, see the Special feature in this *Report*, “Zombie firms and the effectiveness of the insolvency procedure”.

¹¹ 1 million barrels per day (only Saudi Arabia) in July 2023; 1.5 million barrels per day in August 2023 and 1.3 million barrels per day in September-December 2023.

According to the World Bank¹², in a baseline scenario (which does not include the assumption of an expansion of the Middle East conflict) oil prices are expected to reach an average of USD 90 per barrel in the current quarter (2023 Q4), falling to USD 81 per barrel in 2024. Overall commodity prices are forecasted to drop by 4.1 percent next year, whereas base metal prices are seen declining by 5 percent in 2024 and commodity prices are anticipated to stabilise in 2025. In the event that the risk of conflict escalation at regional level materialised, which would affect the oil-producing countries in the region, the World Bank estimates a decrease in oil supply by 6-8 million barrels per day and a price hike to between USD 140 and USD 157 per barrel¹³. By comparison, in 1979, amid the impact of political changes in Iran and the ensuing US sanctions, oil prices doubled.



The ongoing tight monetary policy stances worldwide amid the persistence of inflation in the new geopolitical context, as well as the weaker growth outlook, are also reflected in the evolution of the global financial cycle, with emerging signals pointing to the end of its expansion phase. Unlike the previous financial cycles, the current one displayed extremely favourable financial conditions during its expansion stage, which helped push indebtedness above historical values (Chart 1.4). The pandemic maintained this trend, with developments being more pronounced in the government sector (Chart 1.5). Under these circumstances, the rise in indebtedness may have been accompanied by a build-up of important vulnerabilities in certain sectors, which could lead to increasing risks in the contraction stage of the financial cycle.

One sector that is already experiencing such difficulties is commercial real estate, in particular in China, considering the developments that have taken place there. The increase in financing costs amid a high level of indebtedness specific to the companies in this sector diminishes their capacity to service debt, and investors'

¹² World Bank, *Commodity Market Outlook*, October 2023.

¹³ <https://www.worldbank.org/en/news/press-release/2023/10/26/commodity-markets-outlook-october-2023-press-release>

flagging interest limits the refinancing capacity of these firms and intensifies the downward pressure on prices of commercial real estate assets.

At EU level, the difficulties encountered by the commercial real estate sector can significantly affect the banking sectors, given their high exposure in most Member States (except Luxembourg and Ireland)¹⁴. These exposures' features, i.e. their large size and concentration, their low liquidity and market transparency, are likely to pose significant risks to financial stability. At end-2022, the European Systemic Risk Board issued Recommendation ESRB/2022/09 on vulnerabilities in the commercial real estate sector in the European Economic Area, calling on the EU and national authorities to improve the monitoring of systemic risks stemming from the commercial real estate sector and, at the same time, to ensure that financial institutions with commercial real estate exposures have adequate prudent risk management practices in place, including with respect to the useful introduction or supplementation of macroprudential capital requirements. The IMF also highlights these risks and recommends close monitoring of real estate market developments¹⁵.

The European banking sector is in a better position compared to previous periods, but it faces new challenges, such as the need to include climate and environmental risks in the risk management process and the development of new technologies in the financial field. Common Equity Tier 1 capital ratio is currently at an all-time high (15.9 percent, June 2023), its dynamics being supported by the positive developments in profitability amid the strong increase in the net interest margin, while the non-performing loan ratio remained low (1.8 percent)¹⁶. The liquidity level continued the normalisation process started after the pandemic crisis, with the liquidity coverage ratio (LCR) falling to values close to those in 2020 H1 (159.9 percent). The turmoil in the US banking sector in early 2023 arose against the background of financial services digitalisation, as well as of the development of unsustainable and inadequate business models in terms of risk management. These have shown the importance of a strong and effective supervisory framework, but have also pointed towards the need for a more careful assessment of the prudential regulatory framework, particularly with regard to interest-rate and liquidity risk.

1.2. Domestic macroeconomic developments

On the domestic front, tensions are still surrounding macroeconomic equilibria. Over the first three quarters of 2023, real GDP went up 1.9 percent (against the same year-ago period, seasonally-adjusted data)¹⁷, with a further outlook for weak dynamics during this year, followed by a potential moderate recovery in 2024 (Chart 1.6). The European Commission's growth estimates for Romania are higher than those for the countries in the region (2.2 percent for 2023 and 3.1 percent for 2024 compared to growth rates between -0.7 percent and 2 percent for 2023 and between 1.4 percent

¹⁴ *Issues note on policy options to address risks in corporate debt and real estate investment funds from a financial stability perspective*, ESRB, September 2023.

¹⁵ *Global Financial Stability Report*, IMF, October 2023.

¹⁶ EBA, *Risk Dashboard*, Data as of 2023 Q2.

¹⁷ NIS press release https://insse.ro/cms/sites/default/files/com_presa/com_pdf/pib_tr3e2023.pdf

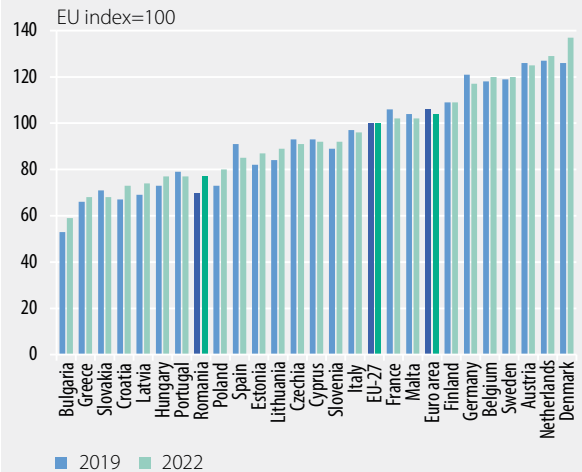
and 2.7 percent for 2024 in Czechia, Hungary, Poland and Bulgaria)¹⁸. Uncertainties surrounding future developments in economic activity stem from the future fiscal and income policy stance, given the need for further fiscal consolidation.

Chart 1.6. Dynamics of GDP and of the number of persons employed



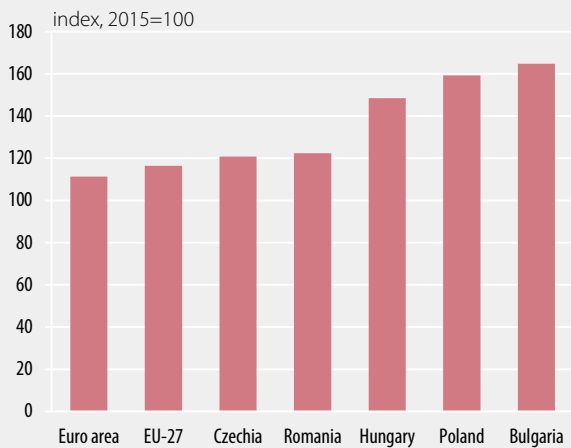
Source: Eurostat

Chart 1.7. GDP per capita (purchasing power standard)



Source: Eurostat

Chart 1.8. Industrial production index for high-tech and medium high-tech industries (average, January-August 2023)



Source: Eurostat

Romania continued on its path towards real convergence, the differential in terms of GDP per capita versus the countries in the region narrowing over the past years (by 9 percentage points against Czechia and by 3 percentage points as compared with Hungary in 2019-2022, Romania reaching the same level as the latter in 2022) (Chart 1.7). Nonetheless, economic convergence must be accompanied by a structural shift of the economy towards an inclusive growth model, with the reduction of regional disparities, and based, to a larger extent, on high value-added, high-tech and knowledge-intensive activities, supportive of meeting environmental¹⁹ and digitalisation objectives.

Certain high-tech manufacturing sub-sectors in Romania witnessed substantial increases²⁰

(Chart 1.8). Further efforts to help the transition of the economy towards a sustainable growth pattern are all the more important as, on the one hand, regional and global developments are marked by high uncertainty in the new geopolitical environment,

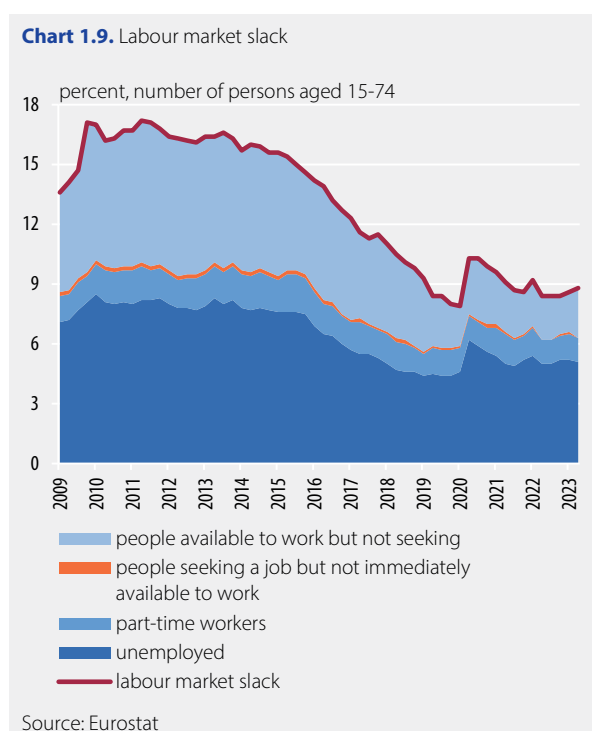
¹⁸ https://economy-finance.ec.europa.eu/system/files/2023-12/ip258_en.pdf

¹⁹ According to the European Green Deal, the objectives of EU Member States are to reduce greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels ("Fit for 55") and to achieve net zero CO2 emissions by 2050.

²⁰ An analysis of companies with domestic capital that operate in strategic sectors (identified based on the previous analyses of NCMO working groups) and that have proved to be more competitive can be found on the NCMO's website (Romanian only).

and, on the other hand, the negative effects of climate and environmental changes have deepened.

Romania enjoys the opportunity of accessing the funds available under the Recovery and Resilience Facility, the EU instrument for implementing such reforms and investments. From the start of the programme until end-September 2023, Romania drew funds worth EUR 9.1 billion²¹ following the fulfilment of 70 milestones and targets²², accounting for about a third of the allotted amounts²³. Ensuring the amounts in full is conditional on implementing all the reforms and investments provided in the NRRP by August 2026, and the European Commission's latest decision was to suspend the payment of EUR 53 million due to the inadequate fulfilment of two of the agreed milestones (specifically, milestone 129 and milestone 133)²⁴. Moreover, one of the measures recommended to Romania during the May 2023 European Semester was to strengthen the administrative capacity to allow for a continued swift and steady implementation of the NRRP²⁵, which would entail positive long-term effects on economic activity (even after the end of the programme)²⁶.



Romania also benefits from EU funds under the 2014–2020 and 2021–2027 operational programmes. At end-October 2023, the absorption rate for the cohesion policy funds under the 2014–2020 programme was 84.5 percent, whereas that for national rural development programmes stood at 80.5 percent. The NCMO Working Group on sustainable increase in financial intermediation²⁷ showed the need for stronger involvement of the financial sector in the co-financing of projects with non-repayable EU funds, as well as the importance of ensuring higher predictability and transparency regarding the schedule of calls for projects, together with the related legislation, in order to raise the absorption capacity of such funds.

Labour market tightness remained high, particularly as regards skilled workers. January through September 2023, labour market slack stood below 9 percent of the number of persons aged

²¹ Recovery and Resilience Scoreboard (europa.eu).

²² https://commission.europa.eu/system/files/2022-09/c_2022_6711_1_annexe_en.pdf; https://commission.europa.eu/system/files/2023-06/C_2023_4438_1_EN_annexe.pdf

²³ Romania's initial allocation totalled EUR 29.2 billion. On 21 November 2023, this amount was revised to EUR 28.5 billion as a result of a reduction in its maximum RRF grant allocation by EUR 2.11 billion and the inclusion of a new chapter, REPowerEU, worth EUR 1.4 billion (https://ec.europa.eu/commission/presscorner/detail/en/ip_23_5918).

²⁴ The two milestones are related to energy investments (Investment 2 and Investment 3).

²⁵ https://commission.europa.eu/system/files/2023-05/COM_2023_623_1_EN.pdf

²⁶ *Quantifying Spillovers of Next Generation EU Investment* (europa.eu); Bańkowski et al., "The economic impact of Next Generation EU: a euro area perspective", ECB, *Occasional Paper Series*, No. 291, 2022.

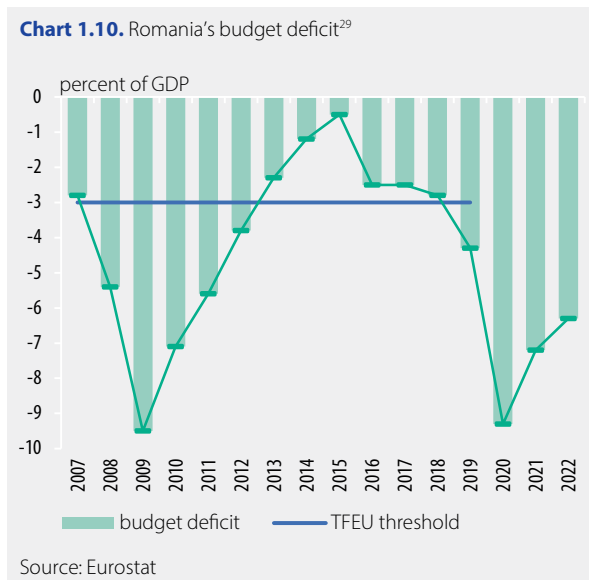
²⁷ *Analysis of NCMO Working Group on sustainable increase in financial intermediation*, 2022.

between 15 and 74, a 15-year low (except for the pandemic period, Chart 1.9), while the ILO unemployment rate continued to range between 5.4 percent and 5.6 percent. Moreover, in March 2023 43 percent of companies reported as pressing or very pressing the problem of the unavailability of skilled workforce²⁸, up 5 percentage points from June 2021. The robust wage dynamics recorded during 2023 (about 15 percent in the case of the average net nominal wage) mirrored, in turn, the relatively high labour market tightness, but also the government's income policy, marked by substantial increases in the minimum gross wage economy-wide (approximately 18 percent in January 2023 and 10 percent in October 2023), to which added the wage renegotiations that occurred on the back of high inflation.

Public sector

An analysis of the fiscal situation indicates challenges to fiscal consolidation, the general government deficit widening by more than a third January to September 2023 as compared with the same year-ago period, to lei 56 billion,

i.e. 3.55 percent of GDP (according to the national methodology, Chart 1.10). Estimates of financing needs are suggestive of their increase for capital repayments on public debt (+32.4 percent, September 2023, annual terms), 85 percent of the financing requirement being driven by the refinancing of government securities issued on the domestic market.



The negative developments occurred against the background of an increase in all types of public expenditures, which was only partly offset by the advance in government receipts in absolute terms. On the positive side, a point that deserves to be mentioned is that spending for projects financed from non-repayable external funds rose by 34.1 percent and investment spending picked up 40.2 percent respectively against the same year-ago

period. According to the 2024 European Semester launched in November 2023, the European Commission expressed significant concerns about cost competitiveness, external sustainability and deficit.

Interest expenses grew by 12.5 percent, their share in GDP being similar to that recorded in August 2022 (1.5 percent of GDP). As for revenues, worth mentioning are the receipts from wage and income taxes, which totalled approximately lei 30 billion, up by 21.4 percent, social security contributions (+12.8 percent), and reimbursements

²⁸ NBR, *Survey on the access to finance of non-financial corporations in Romania*, June 2023.

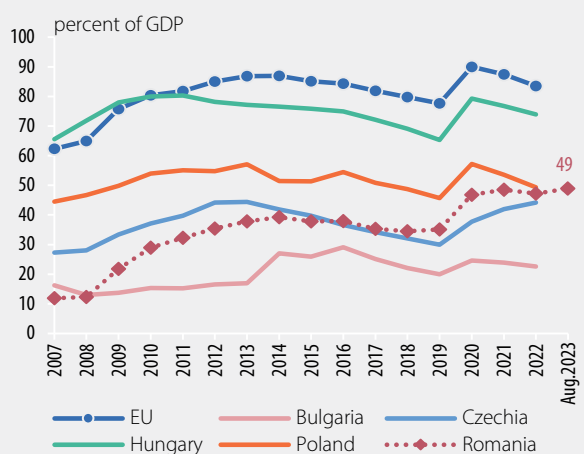
²⁹ EU fiscal rules on the public deficit limit were suspended during 2020-2022, the suspension being prolonged until the end of 2023. At the EU level, discussions are under way on new plans concerning fiscal consolidation processes, which will re-enter into force in 2024, and which might imply stricter requirements for reducing public debt.

by the EU in relation to payments made, which equalled lei 32.59 billion, up by 22.2 percent³⁰.

The Fiscal Council warned about the risk that the public deficit would reach 6.5 percent of GDP at end-2023, way above the 4.4 percent of GDP target, but also about some legislative changes that further contain the transparency of budget execution and set a precedent that may pose major risks of derogations to the

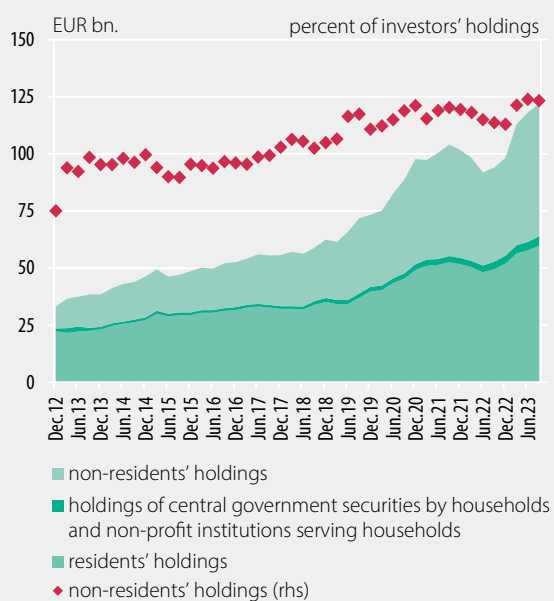
fiscal rules. In this context, changes to the fiscal framework should be thought out and implemented in a cautious, balanced and predictable manner. According to the answers provided by respondent companies to the *Survey on the access to finance of non-financial corporations in Romania*, the level of taxes and the unpredictable fiscal environment count among some of the most pressing problems firms face. The implementation of best practices and principles recommended by the OECD and compliance with tax rules and commitments to the EU are important for strengthening the country's credibility as regards the management of economic policies, with positive implications for the sovereign risk premium.

Chart 1.11. Public debt in the EU, Romania and countries in the region



Source: Eurostat

Chart 1.12. Holdings of government securities issued by the central government



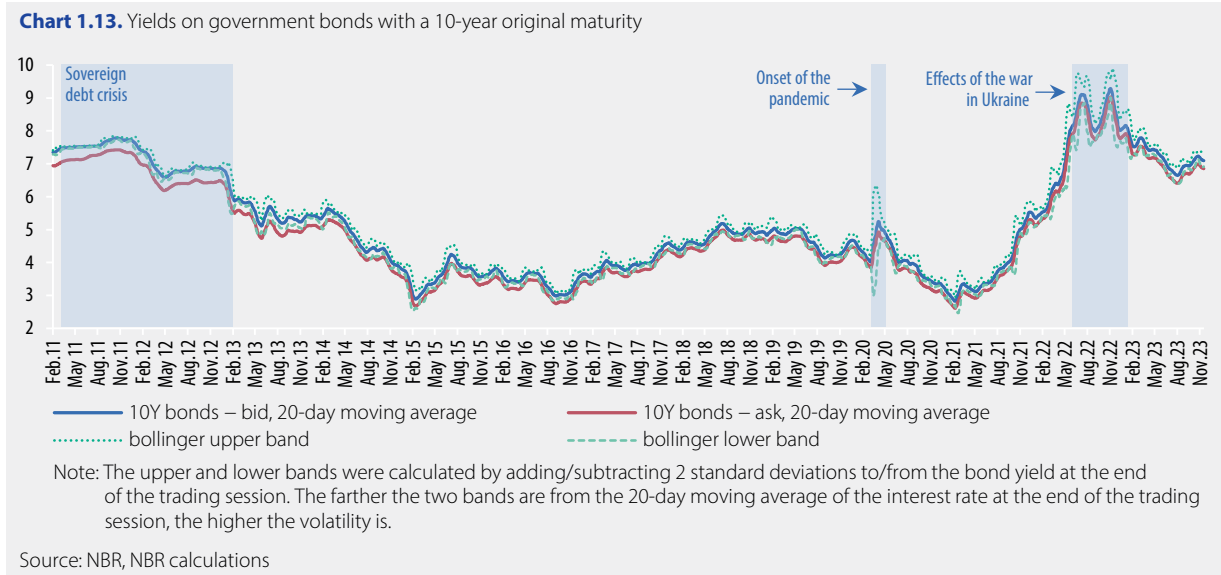
Source: NBR

The delay in fiscal consolidation caused the public debt to exceed in September 2023 the level seen at the end of the COVID-19 pandemic (50.5 percent of GDP). Unlike Romania and Czechia, the other countries in the region adjusted their public debt levels in the post-pandemic period in a range from 2 percentage points to 8 percentage points (Chart 1.11). The increase in public debt was also accompanied by a rise in the share of non-residents' holdings of government securities issued on both domestic and foreign markets (up 4 percentage points January through September 2023 to 49.2 percent, Chart 1.12). The foreign currency component remained close to the end-2022 level, i.e. 53.4 percent.

The persistence of high policy rates owing to inflation developments in the new geopolitical environment saddled with uncertainty is likely to exert additional pressure on the general government deficit by increasing debt financing costs and limiting the fiscal consolidation space to an even

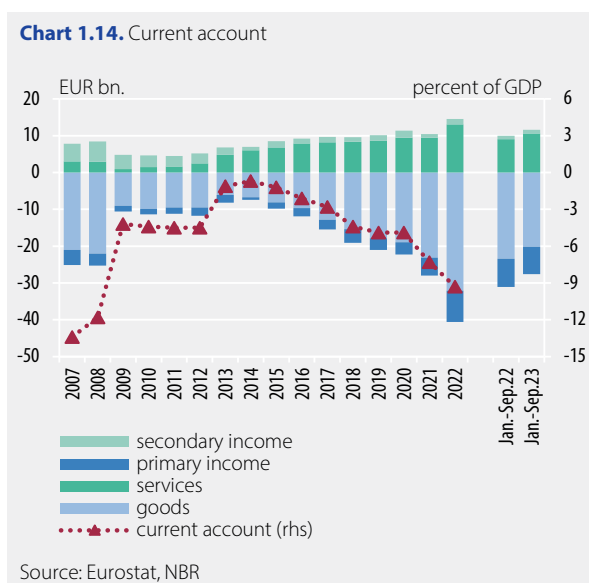
³⁰ Ministry of Finance, *Report on general government budget execution*, 30 September 2023.

greater extent. In addition, the materialisation of a geopolitical or other shock may lead to episodes of financial market volatility (Chart 1.13)³¹.



External balance

January through September 2023, the balance of payments posted a significant deficit, albeit smaller year-on-year (EUR 16.1 billion versus EUR 21.1 billion in the same year-ago period). Behind this development stood the slower growth of the deficit on trade in goods (EUR -20 billion against EUR -23.4 billion in the same year-earlier period) and the faster increase in the surplus on trade in services (EUR 10.6 billion versus EUR 9 billion, Chart 1.14). Moreover, equity flows of direct investment grew



by 6 percent as compared with the same year-ago period, while the current account deficit coverage by non-debt-creating capital flows rose to 69 percent compared to only 35 percent in the first nine months of 2022.

External debt added 12.1 percent January through September 2023, amid the swift increase in foreign financing of general government (up 26.8 percent). This, however, came along with an improvement in the term structure of external debt, with the short-term component falling to 28 percent from 33.4 percent in September 2022. Under the circumstances, the ratio of foreign exchange reserves to short-term external debt by remaining maturity grew to 105.4 percent from 72.7 percent in the same year-ago period.

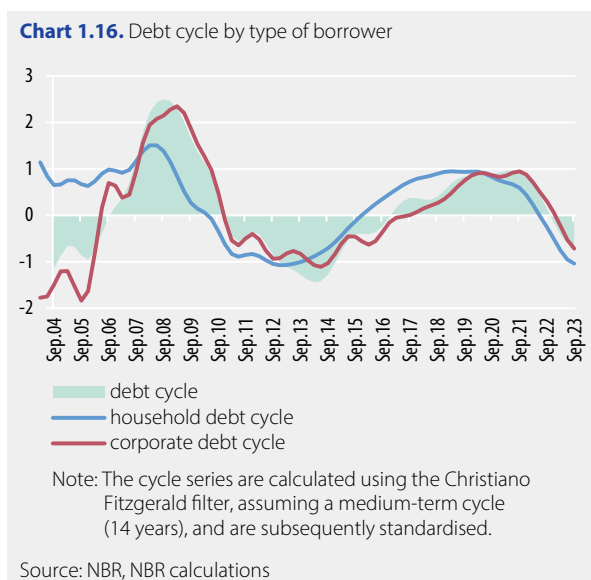
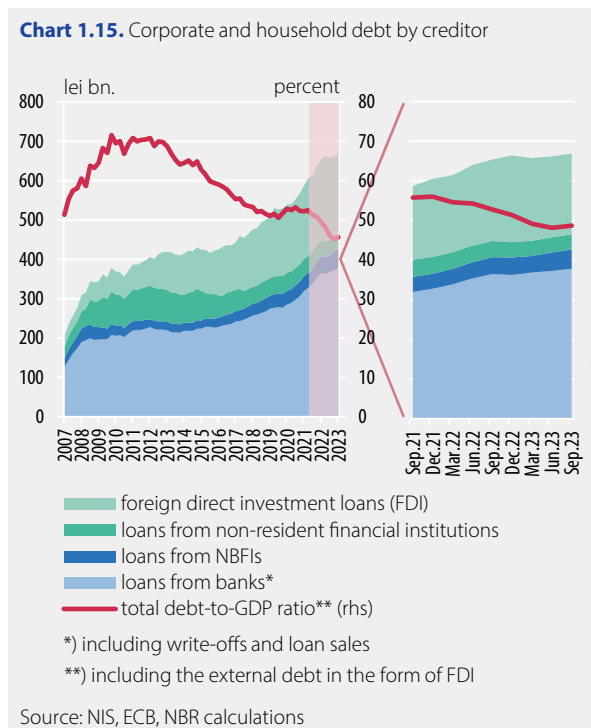
³¹ For an analysis of global and regional developments, see Section 1.1. International economic and financial developments.

1.3. Non-financial sector indebtedness

Real sector debt continued to increase at a rate slower than that of economic growth, its largest components being loans from local banks and intra-company

loans in the form of foreign direct investment.

In September 2023, total debt³² rose by 3 percent in annual terms to lei 683 billion, yet its share of GDP fell to 45.7 percent³³ (from about 50 percent in September 2022, Chart 1.15). The breakdown shows that most of the loans to non-financial corporations and households are granted by local financial institutions, their share widening slightly over the past four quarters (65 percent of total debt, up by 2 percentage points from 2022 Q3). Foreign financing remained significant for non-financial corporations, with foreign direct investment accounting for the largest share, yet posting a modest annual decrease of 1 percent to lei 203 billion in September 2023 (14 percent of GDP³⁴). After a period of decline as of 2021, loans from financial institutions re-embarked on a mildly upward trend in the past two quarters, reaching lei 38.5 billion (still below the year-earlier reading, i.e. -7 percent in 2023 Q3 versus 2022 Q3).



Non-financial corporations' demand for loans granted by local banks³⁵ contracted in 2023 Q3, whereas households' demand for housing and consumer loans picked up. For 2023 Q4, banks anticipate an increase in loan demand from the real sector. At the same time, credit standards for loans to non-financial corporations held steady. For households, banks reported an easing of credit standards for housing loans and a relative status quo in credit standards for consumer credit.

The debt cycle has further posted less favourable developments, with faster debt dynamics for households than for non-financial corporations, amid the stronger impact of higher interest rates on housing loans to households (Chart 1.16).

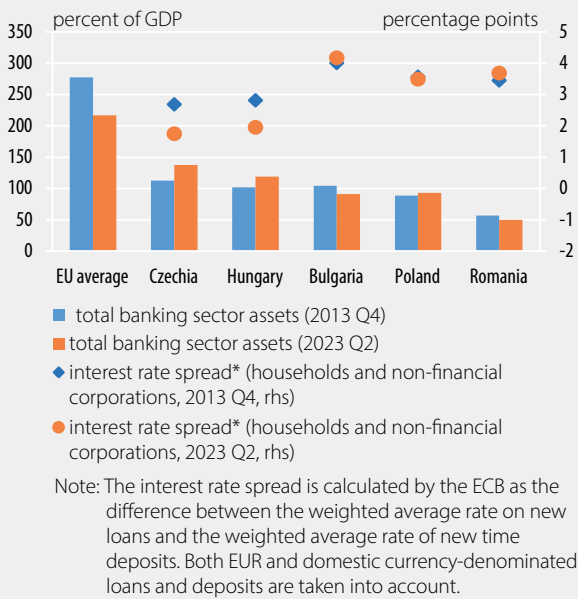
³² Total corporate and household debt comprises: (i) domestic financial debt (loans from local banks, including write-offs and loan sales, and loans from NBFIs), (ii) external financial debt (loans from foreign financial institutions), and (iii) non-financial external debt (non-financial corporations' intercompany loans).

³³ For the calculation of the shares in GDP, data as at 2023 Q2 were used, according to the NIS report of 12 October 2023.

³⁴ The same as above.

³⁵ NBR, *Bank Lending Survey*, 2023 Q3.

Chart 1.17. Banking sector size as a share of GDP and interest rate spreads

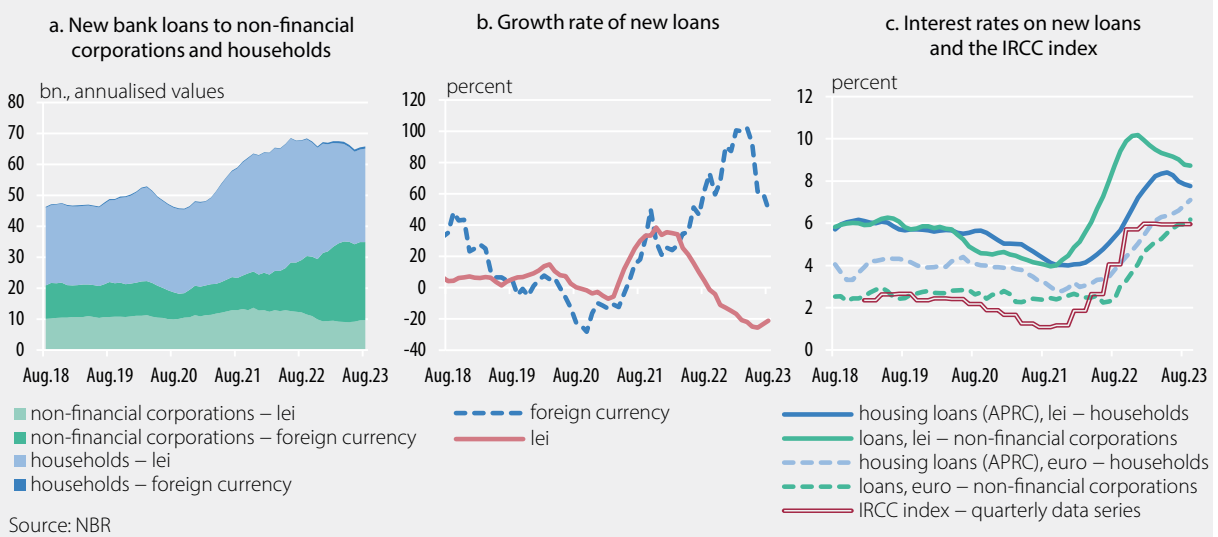


Source: ECB

Financial intermediation remains low compared to the other EU Member States. The bank assets-to-GDP ratio in Romania has declined from the level recorded a decade ago (to approximately 50 percent in 2023 Q2 versus 57 percent in 2013 Q4), a trend that is, in fact, visible across the EU economy as a whole. However, it continues to be significantly lower than that of its regional peers (Chart 1.17). In 2022, the NCMO Working Group on sustainable increase in financial intermediation³⁶ examined the opportunities for a sustainable increase in bank financing in the context of preserving financial stability. It identified measures for growth based on the drivers of financial intermediation in the countries in the region: (i) a higher capacity to absorb EU funds, (ii) a faster digitalisation of financial services, (iii) an industrial policy in place to support competitive firms' access to finance, and (iv) the financial education of entrepreneurs and managers of non-financial corporations. Following the working group's analysis, the NCMO issued

a recommendation addressed to its three member authorities³⁷. Developing the economy along the lines put forward by the NCMO recommendation is essential for catching-up with regional peers and ensuring the transition towards an inclusive, high value-added economy. Financing a green economy can be a driver of growth in financial intermediation, helping at the same time mitigate climate-related risks (details in Box 1).

Chart 1.18. New loans



³⁶ <https://www.cnsrmro.ro/res/ups/Analysis-of-NCMO-Working-Group-on-sustainable-increase-in-financial-intermediation.pdf>

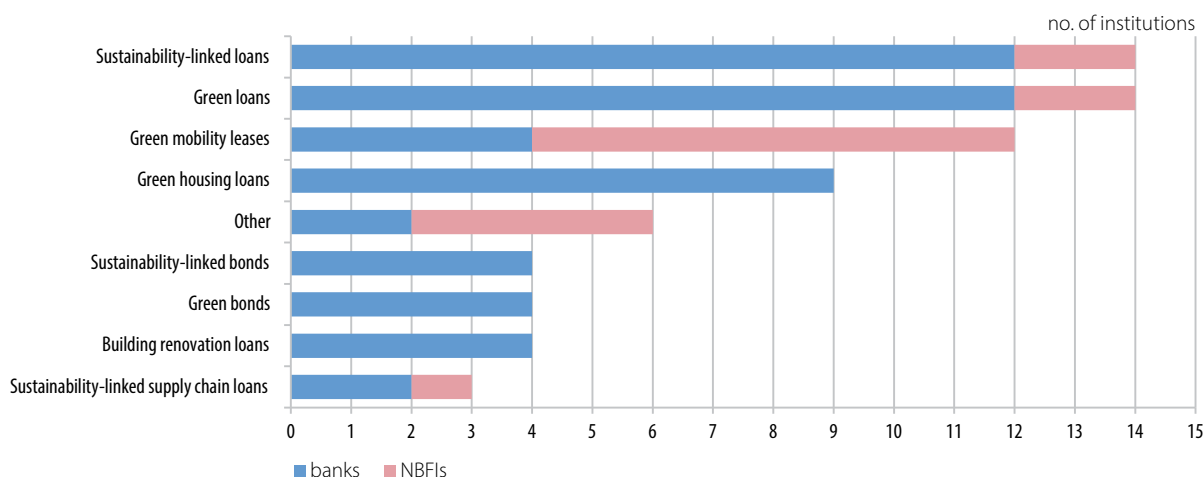
³⁷ NCMO Recommendation No. R/3/2022 on the sustainable increase in financial intermediation.

The ongoing monetary policy tightening cycle in the euro area during 2023 narrowed the spread between interest rates on new leu- and EUR-denominated loans (to 2.3 percentage points in September 2023 versus 5.6 percentage points in September 2022, in the real sector on aggregate, Chart 1.18c). Foreign currency lending kept rising, yet at a slower pace than in the previous year (Chart 1.18a, b).

Box 1. Climate change and green finance in Romania – readiness of the domestic financial system and opportunities generated by green transition

Climate change has garnered more and more attention globally over the past few years and Romanian financial institutions are no exception, increasingly embedding climate-related risks into their business strategy. The negative effects of climate risks may lead to the deepening of the already-existing vulnerabilities, with direct and indirect implications for the real sector and the financial system. In 2021, the National Committee for Macroprudential Oversight (NCMO) issued a recommendation for supporting green finance, which aimed, among others, at improving access to green finance for projects on the climate change agenda. In addition, the recommendation refers to creating a communication channel in order to ensure a prudent approach to climate risk. Therefore, the NBR conducted in July 2023 a survey among the institutions under its supervisory remit (credit institutions and NBFIs) to assess their readiness for a green transition and to increase awareness about the implications of climate and environmental risks for their activity.

Chart A. Main green products granted by credit institutions and NBFIs



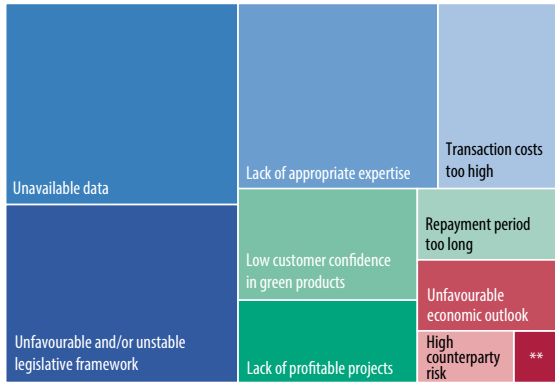
Source: NBR's 2023 Climate Change Survey

According to the participants in the survey³⁸, more than half of credit institutions integrated climate change in their strategy documents, and many of the rest of them would do this in the next three years, with non-bank financial institutions (NBFIs) answering similarly. In addition, most credit institutions and part of NBFIs

³⁸ The analysis was based on the answers of 20 credit institutions (holding 88 percent of total bank assets in June 2023) and 22 NBFIs (holding 70 percent of the total assets of non-bank financial institutions entered in the Special Register as at June 2023).

in Romania were considering integrating climate and environmental risks in stress testing exercises.

Chart B. Main challenges faced by credit institutions and NBFIs when implementing/developing green products



** = Inadequate implementation

Note: Multiple choice question, rectangle size represents answer frequency.

Source: NBR's 2023 Climate Change Survey

Green finance elicits great interest among financial institutions in Romania. These believe that financing green investments would provide opportunities for business development and sustainable economic growth. However, at the same time, it does come with a series of challenges.

In order to support activities aiming to reduce carbon emissions, some credit institutions in Romania have issued or intend to issue green bonds. Moreover, in order to diversify the portfolio and to increase the green asset ratio (GAR), most credit institutions plan to invest, in the future, in green bonds issued by government institutions or non-financial corporations. The main green products available to customers refer to green and sustainable loans, green bonds, and leases for green mobility (Chart A). The most pressing

challenge encountered by the financial system in Romania in implementing and developing green products is data availability, closely followed by the instability of the legislative framework and the lack of expertise necessary in the field (Chart B).

Awareness of climate and environmental risks by the real sector is a concern for most financial institutions (60 percent of respondents to the survey). The most frequent actions made by local institutions to this end relate to collecting information on greenhouse gas emissions, identifying and developing innovative solutions, and providing expertise to manage climate challenges.

2. REAL SECTOR

The non-financial corporations sector in Romania continues to report significant capitalisation shortfalls, affecting firms' payment discipline, as well as their access to finance. Companies with equity below the regulatory threshold further held a significant, yet gradually declining share in total firms, i.e. almost a third, while their recapitalisation needs³⁹ increased slightly in 2022 to lei 138.8 billion (+1.6 percent versus 2021). The payment discipline of non-financial corporations remains loose, which may lead to losses and liquidity challenges for trading partners. On average, 11 percent of trade credits are overdue payments, similarly to the previous year. More than 90 days overdue payments account for 8.7 percent of total trade debt, their non-performance standing well above the NPL ratio of bank loans.

The financing pattern mainly through trade credit rather than via bank loans favours the build-up of vulnerabilities such as those related to the loose payment discipline and the low capitalisation of firms. The NCMO Working Group on sustainable increase in financial intermediation analysed some of these vulnerabilities and recommended measures to improve entrepreneurs' financial education, also by raising their awareness of the cost-benefit balance of trade credits and loans from shareholders⁴⁰.

The quality of the corporate loan portfolio improved slightly in the first nine months of 2023 to 4 percent (-0.3 percentage points). Behind the evolution of the NPL ratio stood both the increase in non-financial corporations' exposures (+8.2 percent year on year in September 2023) and the decrease in the volume of their non-performing loans.

The resilience of the households sector was tested repeatedly in recent years, yet it remained robust, also supported by the debtor-related macroprudential measures implemented by the NBR. Households' capacity to service debt has slightly deteriorated since the previous *Report*, the non-performing loan ratio exceeding the 3 percent threshold, with mixed prospects for the period ahead. The default rate increased marginally (0.76 percent in September 2023 versus 0.66 percent in September 2022). For the next 12 months, the probability of default is expected to be slightly higher for both housing loans (0.27 percent in September 2024) and consumer credit (3 percent in September 2024).

The activity in the residential real estate market has further shrunk since the release of the previous *Report*, expectations being for this trend to continue in the coming period, given, *inter alia*, the further sustained growth of construction costs for residential buildings. The breakdown of the portfolio of housing loans shows that

³⁹ The recapitalisation needs were calculated as the difference necessary to meet the statutory minimum capital requirement (50 percent of share capital).

⁴⁰ NCMO Recommendation No. R/3/2022 on the sustainable increase in financial intermediation.

those granted to purchase a dwelling in addition to the debtor's primary residence post a higher NPL ratio and have been subject, as of April 2022, to stricter prudential requirements regarding their loan-to-value (LTV) ratio. Given this new regulation, the share of new loans with a lower LTV ratio widened, whereas that of new loans with a LTV ratio close to the regulatory limit, i.e. between 75 percent and 85 percent, narrowed.

Commercial real estate market activity in Romania slowed down in the first part of 2023, in line with regional developments. Investment volume plunged in the first nine months of 2023 in a year-on-year comparison (down by 63 percent, to EUR 243 million). The banking sector's direct and indirect exposure to the commercial real estate sector⁴¹ remained elevated (50 percent of total loans to non-financial corporations, as at September 2023). Against the background of higher interest rates, the assessment of companies in the construction and real estate sectors shows that they further have a higher level of indebtedness than the non-financial corporations sector as a whole, yet on the decline over the past years. The quality of the portfolio of loans granted to companies in these sectors continued to improve, the NPL ratio dropping to 4.5 percent in September 2023, from over 5 percent a year before.

2.1. Non-financial corporations

2.1.1. Non-financial corporations' economic and financial performance⁴²

The non-financial corporations sector in Romania continues to report significant capitalisation shortfalls. The low capitalisation of firms affects their payment discipline (generating 58 percent of overdue payments to non-banks), as well as their access to finance. Capitalisation can be improved by various means, such as by increasing share capital via cash or in-kind contributions, as well as by converting due, liquid and enforceable claims (e.g. loans from shareholders or partners) into capital. Companies with equity below the regulatory threshold take almost a third of total firms (30.4 percent), their share posting however a gradual decline. They account for 5 percent of gross value added, holding 9.6 percent of assets and hiring 11.6 percent of the number of employees in the real sector (Chart 2.1). By comparison, a study by the Bank of Italy⁴³ shows that in Italy only 8.5 percent of firms report equity below the legal threshold (2010-2018).

The recapitalisation needs⁴⁴ increased slightly in 2022, amounting to an estimate of lei 138.8 billion (+1.6 percent versus 2021). The breakdown shows a high concentration of recapitalisation needs, as two thirds of the undercapitalised firms

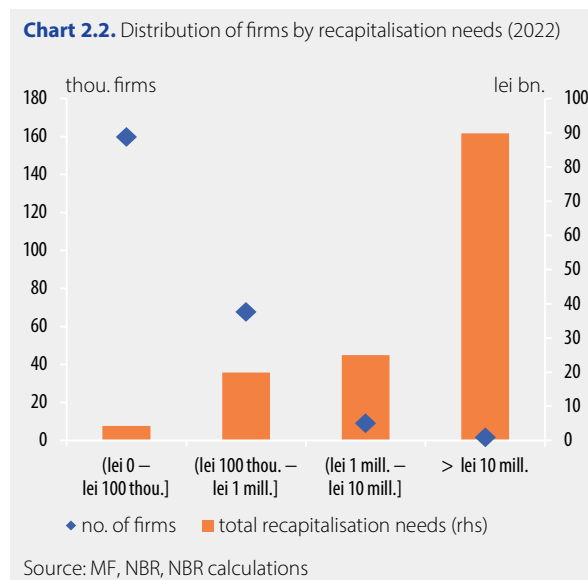
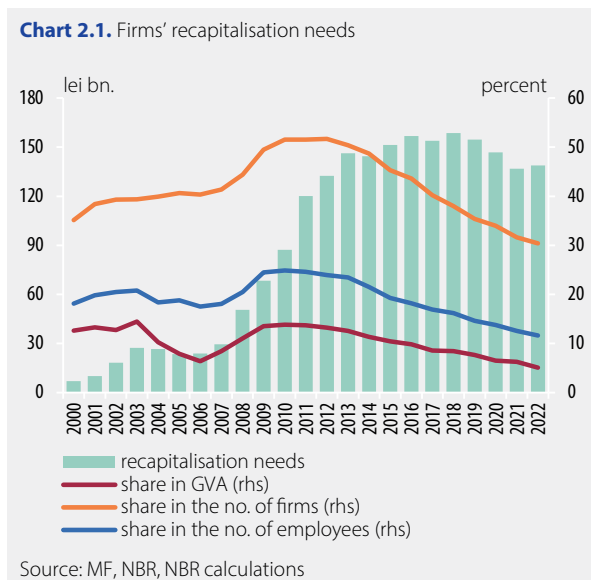
⁴¹ Loans to the construction and real estate sectors (direct exposures) and loans secured by real estate extended to non-financial corporations (indirect exposures) are taken into consideration.

⁴² The analysis in this section is based on the data for non-financial corporations that submitted their financial statements to the Ministry of Finance. The total number of companies that submitted their financial statements at end-2022 stood at 784 thousand, up by 17 percent.

⁴³ T. Orlando, G. Rodano, "Firm undercapitalization in Italy: business crisis and survival before and after COVID-19", Banca d'Italia, *Occasional Papers*, December 2020.

⁴⁴ The recapitalisation needs were calculated as the difference needed to meet the statutory minimum capital requirement (50 percent of share capital).

lack up to lei 100 thousand, while a small number of firms (0.7 percent) need an additional capital of more than lei 10 million, accounting for 65 percent of total recapitalisation needs (Chart 2.2). Moreover, companies with equity below the regulatory threshold generate 60 percent of the volume of aggregate losses.



The banking sector's exposure to these companies stays low (almost 7 percent of exposure to firms as at September 2023), but this category accounts for 21 percent of non-performing loans, posting a 12.4 percent NPL ratio. Another vulnerability faced by the non-financial corporations sector, although on a decline in the recent period, is further the high number of atypical firms. Most of these firms have zero employees (38.6 percent of non-financial corporations) and 21 percent of them have zero turnover.

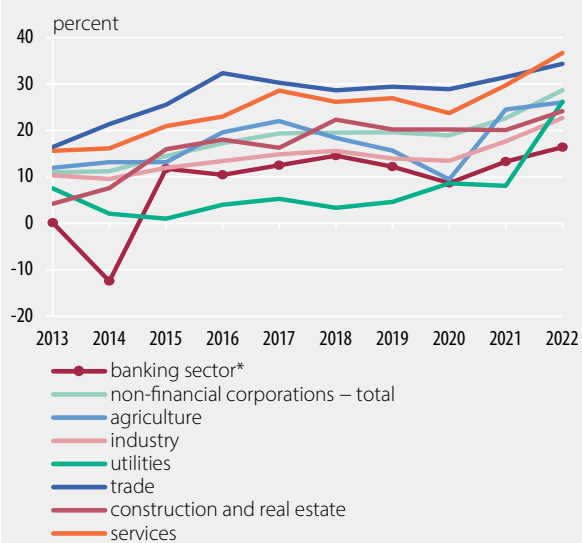
Firms' financial health posted a favourable evolution in 2022, although they came under a series of pressures, i.e. particularly higher agri-food and energy prices, as well as tighter financial conditions. Overall, companies increased their profitability, reported a robust level of liquidity and generated a significantly higher gross value added than in previous years. Thus, the return on equity (ROE) came in at 28.7 percent (+6 percentage points against 2021) (Chart 2.3), while gross value added went up by 24 percent to lei 927.3 billion. Current ratio saw a slight improvement to reach 119 percent.

The net profit of the non-financial corporations sector increased by almost 40 percent, in a high inflation environment, but also amid a relatively robust consumer demand, which allowed both the pass-through of higher costs into final prices⁴⁵, as well as the pick-up in profit margins. At the same time, several factors pushed costs up. Firms' operating and financial expenses were significantly higher overall, especially expenses on utilities (+60.8 percent), goods for resale (+26.8 percent) and raw materials and consumables (+25.8 percent). Moreover, interest expenses reached

⁴⁵ NBR, *Inflation Report*, August 2023.

levels similar to those in 2009, i.e. lei 16.5 billion, 60 percent higher than in 2021. Amid rising financing costs, the interest coverage ratio (the EBIT-to-interest expenses ratio) decreased by 9.5 percent (from 1,145.3 percent to 1,036 percent) after the significant increase in 2021. The decline was stronger on the SME segment (-15 percent), which may have implications for firms' repayment capacity. Firms with outstanding bank loans reported a better interest coverage ratio, i.e. 1,121 percent. At the same time, firms' level of indebtedness (calculated as the debt-to-equity ratio) posted a marginal increase of 7 percentage points versus 2021, to reach 166.7 percent. Looking at the distribution of the level of indebtedness, 16 percent of firms are in the risk area (with a level of indebtedness above 200 percent), similarly to the previous year (Chart 2.4). The financial conditions, which could be supported by the recent uncertainties about the geopolitical situation, as well as by the persistence of inflation, could lead to difficulties especially for companies with outstanding bank loans. Overindebted firms account for almost a half of banks' corporate loan portfolio (lei 84 billion as at September 2023), but these loans are currently satisfactorily repaid (the NPL ratio stands at 3.8 percent).

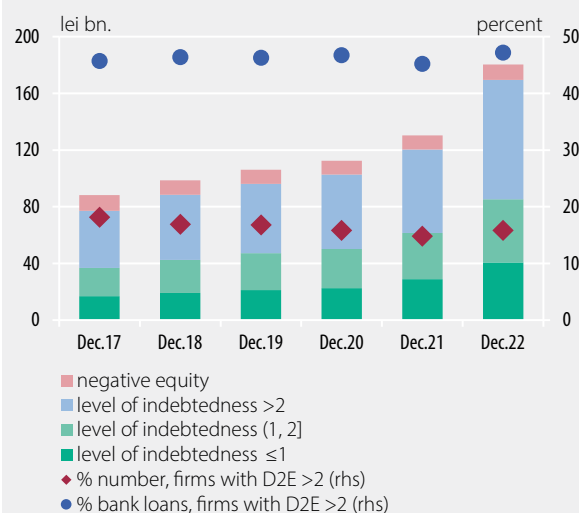
Chart 2.3. ROE by business sector and ROE for the banking sector



*) data are also available for the branches of banks established in other EU Member States, which report statistical information according to NBR Order No. 10/2018

Source: MF, NBR, NBR calculations

Chart 2.4. Distribution of bank loans by firms' level of indebtedness

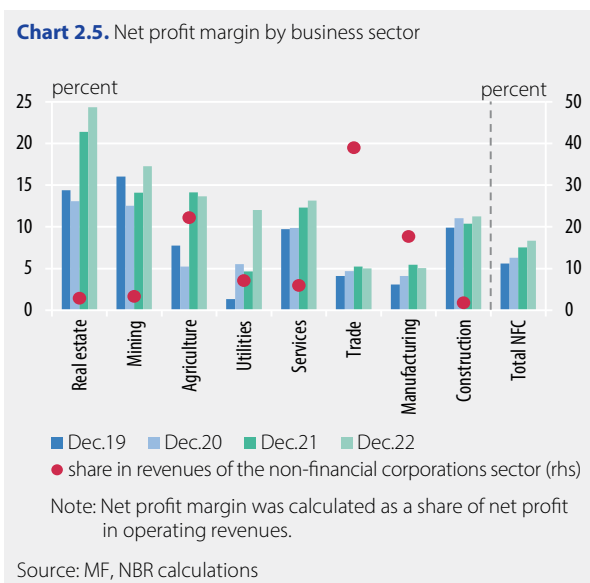


Note: D2E – level of indebtedness, calculated as the debt-to-equity ratio. Loans taken by firms that submitted their financial statements in 2022 were calculated as at September 2023.

Source: MF, NBR, NBR calculations

Net profit rose across all business sectors; however, given the hike in the average electricity sale price in 2022, utilities and mining ranked among the top economic activities in terms of net profit increase (+286 percent and +186 percent respectively). The remaining sectors saw net profit increases between 11 percent (manufacturing) and 37 percent (construction and real estate).

This improvement in the net result was also due to higher profit margins applied by some sectors. Their level went up from previous years on the aggregate (+1 percentage point to 8 percent), as well as for most industries. The largest rises versus 2021 were reported for utilities (+7 percentage points), mining

Chart 2.5. Net profit margin by business sector

(+3.2 percentage points) and the real estate sector (+2.9 percentage points). Profit margins applied in the real estate sector remain the highest (24 percent), followed by those in the mining sector (17 percent), Chart 2.5. Despite these positive developments, the same as in the previous periods, the number of firms that reported losses stays high at around 225 thousand, i.e. 28.7 percent of total active companies in 2022 (similarly to the previous year). Out of these, 15 percent recorded persistent losses over the past three years. The outlook for financial statements for the current year is mixed, given, on the one hand, wage cost pressures on the domestic front (amid factors such as the skilled labour shortage or the announced hikes in the minimum wage)⁴⁶ and, on the other hand, global uncertainty about commodity price developments and the implications of mounting geopolitical conflicts for supply chains.

Vulnerabilities stemming from the economic and geopolitical context

The war between Russia and Ukraine has led to significant increases in agri-food and energy prices⁴⁷, amplifying inflationary pressures and threatening food security in some developing economies⁴⁸. This war, as well as the conflict in the Middle East this year, revealed the global economy's shortcomings concerning the security of supply of critical raw materials for industrial production and the green transition⁴⁹ and heightened concerns about global value chain dependencies. In addition, increasingly frequent extreme climate events and the prospects for a long-term change in climate conditions point to a series of vulnerabilities to the Romanian economy, stemming from the need to ensure food and energy security for households over the long term. The OECD considers that the vulnerabilities related to possible bottlenecks in value chains and the concentration of supply in some regions can be mitigated by developing recycling and circular economy strategies¹¹. Moreover, the shift towards a circular economy is essential not only from the viewpoint of the resilience of supply chains, but also as a means to address the negative impact on the environment (such as biodiversity loss and pollution) stemming from the use of certain resources and materials⁵⁰.

Economic sectors such as agriculture and energy are becoming key sectors for policy implementation in the current context. At the same time, in order to support technological progress, especially in areas that are needed for adapting to new

⁴⁶ NBR, *Inflation Report*, November 2023.

⁴⁷ NBR, *Inflation Report*, May 2023.

⁴⁸ OECD, *Economic Outlook – Interim Report March 2022: Economic and Social Impacts and Policy Implications of the War in Ukraine, 2022*.

⁴⁹ OECD, *The supply of critical raw materials endangered by Russia's war on Ukraine*, August 2022.

⁵⁰ OECD, *Competition in the Circular Economy*, 2023, <https://www.oecd.org/daf/competition/competition-in-the-circular-economy-2023.pdf>

challenges, some high-tech industries or knowledge-intensive services (KIS) can contribute to the structural shift of the economy towards a higher value-added economy. For instance, the manufacturing of batteries and accumulators for electric vehicles (medium-high-tech industries) has the potential to support the green transition, and countries such as Poland and Hungary are already leading the region in this segment by attracting significant investment. The World Bank⁵¹ has identified a number of opportunities at the national level by connecting to value chains in the wind energy generation field; these opportunities can contribute to increasing competitiveness and reducing the intensity of sectoral emissions. According to the World Bank's analysis, the green transition will create unprecedented opportunities for growth and development that firms can seize upon, but they will need a stable economic and political environment, access to finance, as well as a skilled workforce. Thus, firms operating in the above-mentioned sectors can contribute to the achievement of the strategic objectives referred to, with positive implications for the sustainable growth of financial intermediation.

The agricultural sector plays an important role in Romania's economy, but it faces a number of structural vulnerabilities that have been a cause for concern for the authorities. The level of agri-food trade deficit and its rapid deterioration in 2015-2019 led to the establishment in 2020 of an NCMO Working Group on addressing vulnerabilities stemming from the widening of the agri-food trade deficit. This was mandated to analyse the causes and possible solutions to reduce this imbalance (Box 2). In addition, agriculture is among the most exposed sectors to physical risks (e.g. 48 percent of agricultural land is vulnerable to drought risk⁵²). At the same time, the sector's high degree of fragmentation, namely the existence of many small firms (micro-farms or subsistence farms), diminishes their ability to manage potential losses from materialising physical risks. To increase the agricultural sector's resilience and productivity, and to reduce greenhouse gas emissions, one approach could be climate-smart agriculture (CSA) alongside investments in irrigation and the adoption of agricultural conservation practices⁵¹.

Box 2. Concerns about the persisting agri-food trade deficit

The NCMO regularly monitors the implementation of recommendations on addressing vulnerabilities from the widening of the agri-food trade deficit (NCMO Recommendation No. R/6/2020). In addition, the NBR continues to assess the main risks to financial stability, *inter alia* from tensions surrounding the structure and cost of financing of the current account deficit. Moreover, the NBR periodically disseminates statistics on developments in loans to the agri-food sector, in order to encourage lending in this segment⁵³. Since the release of the *NCMO Working Group analysis on addressing vulnerabilities from the widening of the agri-food trade deficit*⁵⁴, the agri-food trade deficit has further deteriorated.

⁵¹ World Bank, *Romania Country Climate and Development Report (CCDR)*, October 2023.

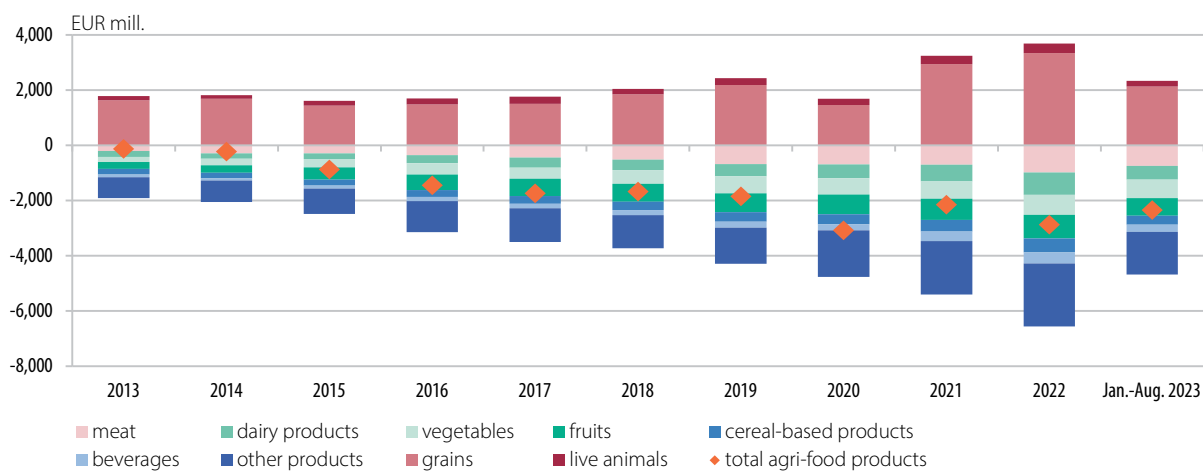
⁵² IGSU, *Country Report 5.1 Conditionality Romania 2016*, https://www.igsu.ro/Resources/COJ/RapoarteStudii/Raport_Final_de_tara%20pt%20Condit%20ex-ante%202016.pdf

⁵³ For statistics, follow this link: <http://www.cnsmro.ro/res/ups/Creditarea-firmelor-din-sectorul-agroalimentar-septembrie-2023.xlsx>

⁵⁴ *Annual Report of the National Committee for Macprudential Oversight for the year 2019* (cnsmro.ro).

High inflation, especially in the food segment, the COVID-19 pandemic, as well as the war between Russia and Ukraine triggered a series of imbalances in the prices of agri-food commodities globally.

Chart A. Agri-food trade balance

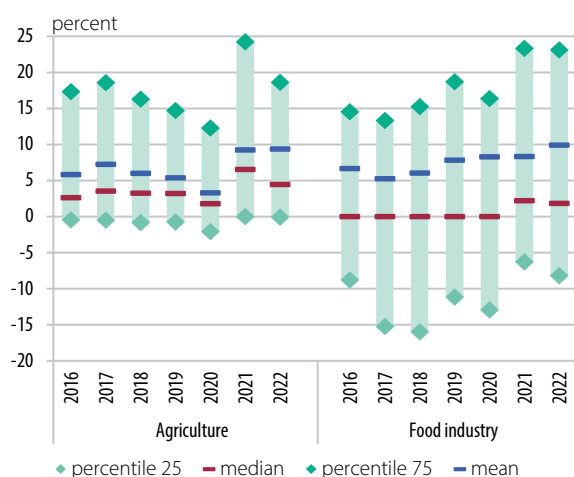


Source: Eurostat, NBR calculations

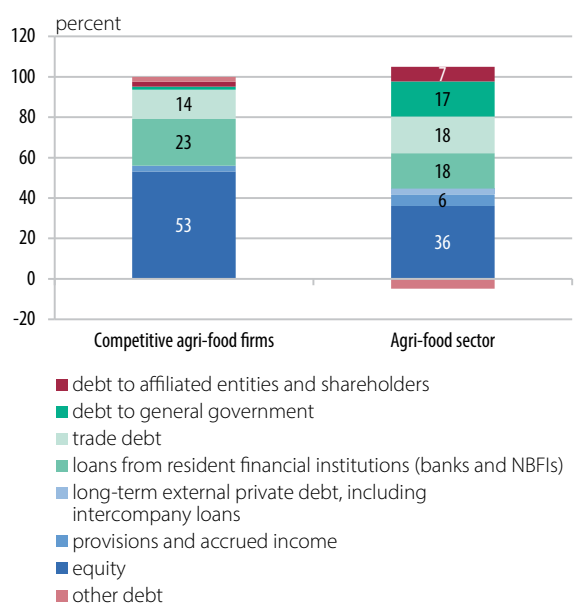
The agri-food trade deficit reached lei 2.9 billion in 2022 (+55 percent versus 2019) and accounted for approximately 10.8 percent of the balance-of-payments current account deficit in the same period. These developments may have systemic implications in terms of the correlation between the current account deficit and the outbreak of a financial or a balance-of-payments crisis. Looking at the composition, the food industry generated a deficit of EUR 6.6 billion (from EUR 4.3 billion in 2019), primarily groups such as meat, fruit, dairy; by contrast, the agricultural segment witnessed a surplus of EUR 3.7 billion (+51 percent from 2019 for grains and live animals), Chart A. The data showed a persistent imbalance between exports of raw materials and imports of processed goods. The trade in live animals recorded a surplus, whereas the trade in meat posted a deficit. In addition, on the one hand, exports of grains were significant and, on the other hand, cereal-based products were imported.

The profile of agri-food firms and their evolution compared to the 2019 reference year

In terms of their role in the economy, the non-financial corporations belonging to the agri-food sector account for 5 percent of total non-financial corporations, hold 8 percent of assets and hire 7 percent of employees in the economy. According to the financial data they submitted, performance indicators described a sounder position in 2022 than in the 2019 reference year. Specifically, the return on assets reached 9.6 percent (+3 percentage points), whereas net profit doubled (up to lei 13 billion), in line with developments in the entire corporate sector. The breakdown showed heterogeneity in terms of profitability, especially in the food industry (Chart B). In this case, half of the firms had a return on assets

Chart B. Distribution of return on assets (ROA) by business sector

Source: MF, NBR, NBR calculations

Chart C. Composition of liabilities and owners' equity of competitive agri-food firms and of the entire agri-food sector

Source: MF, NBR, NBR calculations

below 1.8 percent, and the least performing firms (25th percentile) had negative returns on assets (below -8.2 percent). However, there was an improvement compared to the previous years, when at least 50 percent of the companies in this sector recorded losses. The agricultural sector was more stable in terms of profitability, with no major discrepancies among firms (median ROA was positive in the entire period under review, 2016-2022), with fluctuations being generated rather by weather phenomena in that respective year, which influenced crop output.

The level of indebtedness, calculated as the debt-to-equity ratio, improved, reaching 167.9 percent (-33 percentage points versus 2019). By comparison, firms in the agri-food sector identified as performing according to the *Methodology for identifying competitive companies with domestic capital that operate in strategic sectors* (51 firms) had a better performance in terms of asset utilisation and a lower level of indebtedness (ROA of 12.7 percent, level of indebtedness of 87 percent). Moreover, these recorded a larger capitalisation (the share of capital in total liabilities and owners' equity was 53 percent compared to 36 percent for the entire agri-food sector), Chart C. In terms of financing, domestic companies identified as competitive had better access to financing (domestic loans from banks and NBFIs accounted for 23 percent of liabilities and owners' equity versus 18 percent for the entire agri-food sector).

Lending to this sector increased by 58 percent in September 2023 compared to the reference period of December 2019, especially in agriculture (79 percent). The hike was supported by the

agri-food component in the IMM Invest programme⁵⁵. Hence, government-guaranteed credit accounted for almost a third of the stock of loans of this sector as at September 2023 (29 percent). Agriculture made up 8.9 percent of the total corporate loan portfolio and the food sector totalled 5.1 percent (September 2023). Over time, lending to the agri-food sector was facilitated, on average, by three banks, and the breakdown showed that investment loans (with a share of more than 50 percent) and equipment loans prevailed. The non-performing loan (NPL) ratio stood below that for the entire corporate loan portfolio, i.e. 3.5 percent in

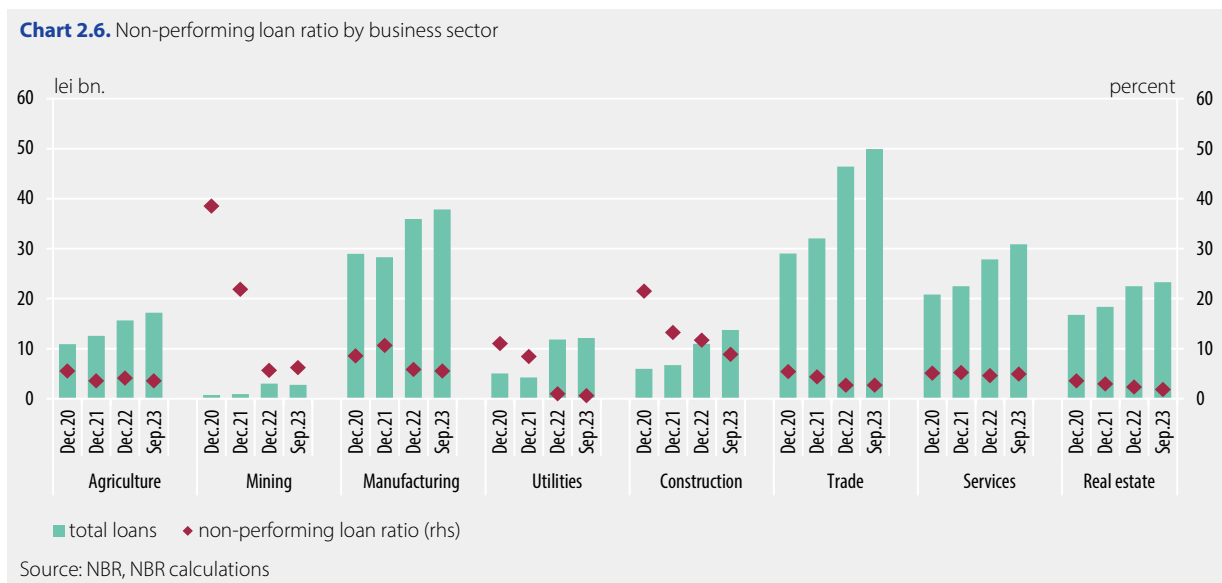
⁵⁵ The AGRO IMM INVEST programme for SMEs in agriculture, including start-ups, fishery, aquaculture and the food sector.

September 2023 for agriculture, whereas the NPL ratio for the food sector was 2.2 percent. The quality of the loan portfolio improved compared to December 2019 (reference period), in line with developments in the entire corporate portfolio, particularly in the food industry (-2.9 percentage points for agriculture and -6.2 percentage points for the food industry).

2.1.2. Financial discipline of non-financial corporations

Lending to non-financial corporations in relation to banks

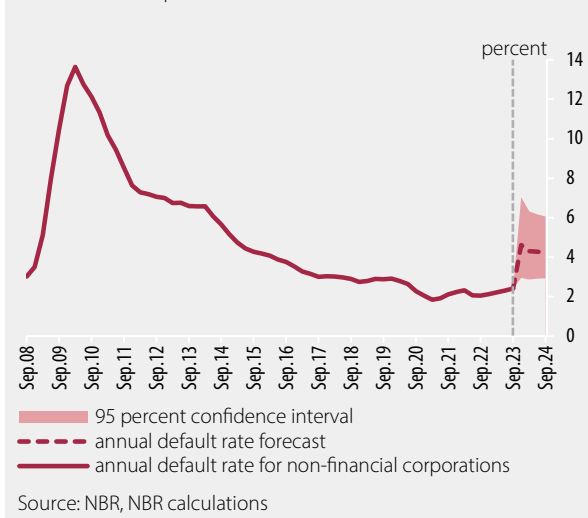
The quality of the corporate loan portfolio improved in 2023. The NPL ratio continued its downward trend until July when it reached a 3.9 percent low since the introduction of the new definition of non-performing loans by the European Banking Authority in 2015. Subsequently, the NPL ratio rose slightly to 4 percent in September 2023. Behind the positive evolution of the NPL ratio stood both the increase in non-financial corporations' exposures and the decrease in the volume of their non-performing loans. The breakdown by business sector (Chart 2.6) shows that construction posted the highest NPL ratio (8.9 percent), whereas utilities were at the opposite end (0.6 percent).



The average probability of default forecasted for September 2023 – September 2024 is 4.3 percent in the baseline macroeconomic scenario (Chart 2.7). This rate is much higher than the 2.4 percent default rate recorded in September 2023, given the current macroeconomic environment, further marked by high uncertainty arising from the war in Ukraine and the conflict in the Middle East, and by the implications of the latter for the commodity market, especially the oil segment.

After expanding swiftly in 2022, loans posted a slower increase in the period under review, with the annual growth rate standing at 8.2 percent in September 2023 (compared to 25 percent in September 2022), amid higher financing costs.

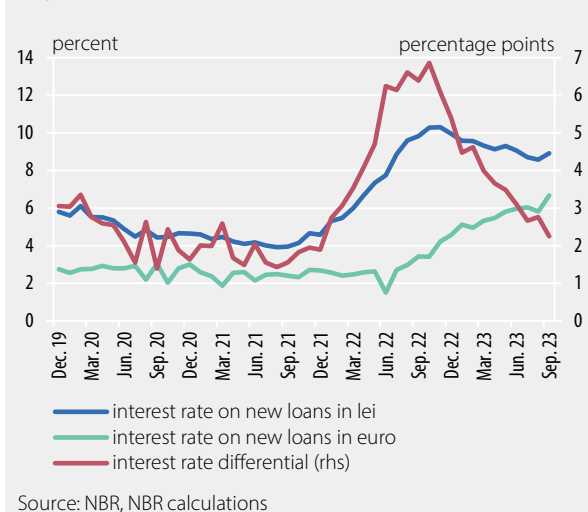
Chart 2.7. Annual default rate and one-year forecast, non-financial corporations sector



The extension of the programmes under the IMM INVEST PLUS government support scheme until the end of 2023 favoured an advance in the stock of government guaranteed loans (+28 percent in annual terms as at September 2023), to lei 37.3 billion (20 percent of corporate loans). Almost a third of them are government guaranteed loans granted in the context of the COVID-19 pandemic. This category of loans has a lower risk (a 2.21 percent NPL ratio) compared to the corporate loan portfolio (3.98 percent), but this is also because they have been recently granted and the interest payment has been government subsidised in the first year from origination. Almost all loans have been granted after 2020 (98 percent), with 41 percent of them being taken this year only (lei 15 billion as at September 2023). The average residual maturity

on these loans is almost 2 years, with most of the loans having a residual maturity between 1-3 years (68 percent of the stock of government guaranteed loans). Loans with a maturity of more than three years take 15 percent (lei 5.7 billion).

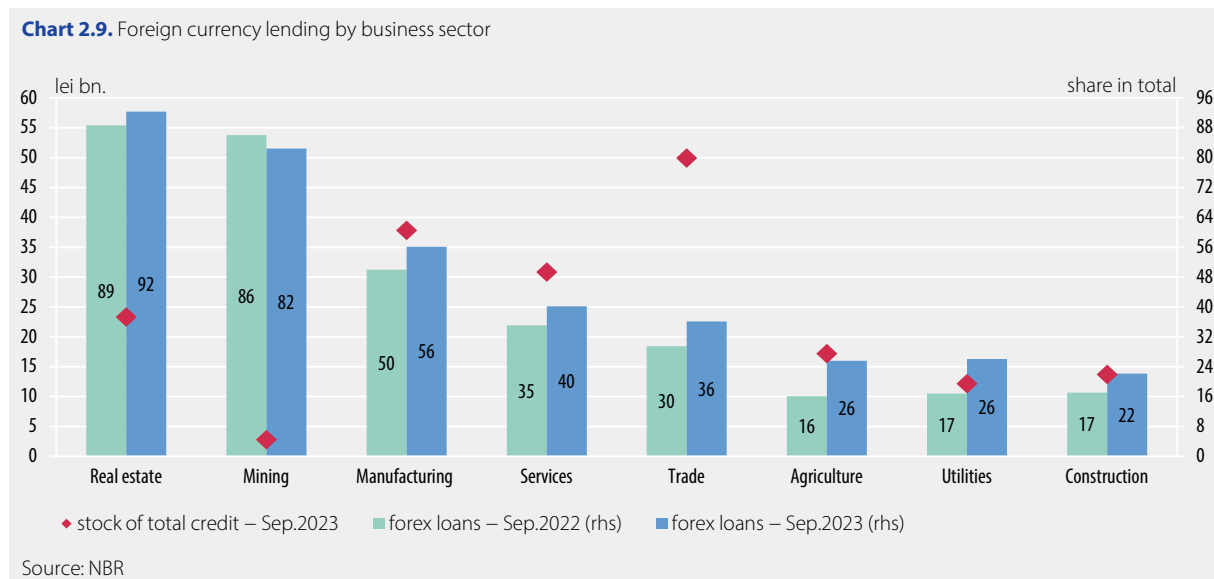
Chart 2.8. Interest rates on new loans to non-financial corporations



In 2022, the interest rate differential between leu- and euro-denominated loans rose significantly, reaching a peak of 6.9 percentage points in October 2022, which led to a stepped-up increase in foreign currency lending to non-financial corporations. Subsequently, the interest rate differential entered a downward trend (Chart 2.8), to reach 2.2 percentage points in September 2023.

The share of foreign currency-denominated loans remained relatively flat during 2023, around the end-2022 level, i.e. 46 percent of total loans to non-financial corporations (September 2023). Almost half of the new foreign currency-denominated credit (48.3 percent) went to non-foreign trade companies, therefore not being naturally hedged against the currency risk. By sector, real estate accounts for the

largest share of foreign currency loans, i.e. 92 percent in September 2023 (Chart 2.9). On the other hand, a significant share of firms with outstanding foreign currency loans comes from sectors in which contracts are closely linked with the exchange rate (utilities, real estate, construction, etc.). Over the past years, the NPL ratio of foreign currency-denominated exposures was lower than that of leu-denominated exposures (3 percent versus 4.9 percent in September 2023). However, the 2008 crisis demonstrated how fast a reversal in the NPL ratios of loans in lei and foreign currency could materialise in the event of a currency shock.



In the context of the new non-financial reporting requirements on sustainability set at European level by way of the EU Sustainable Finance Strategy, Directive (EU) 2022/2464 (Corporate Sustainability Reporting Directive, CSRD) provides for a broader scope than Directive (EU) 2014/95 (Non-Financial Reporting Directive, NFRD), applicable to a larger number of firms, and the reporting requirements are more detailed and need to be audited. According to the NBR's analyses⁵⁶, only 3 percent of companies took measures to gain expertise in meeting non-financial reporting requirements. Also, 35 percent of firms believe that the high costs for meeting the reporting requirements according to the regulations in the field (e.g. consultancy costs, costs related to gaining in-house expertise, etc.) have a negative impact on the investments needed to adapt to climate change and to mitigate its impact.

Table 2.1. Timeline for the reporting of data on the Taxonomy eligibility and alignment by firms and financial institutions

Entity/year	2022 (for the previous calendar year)	2023 (for the previous calendar year)	2024+* (for the previous calendar year)
Non-financial corporations	Taxonomy eligibility	Taxonomy eligibility and alignment	Taxonomy eligibility and alignment
Financial institutions	Taxonomy eligibility	Taxonomy eligibility	Taxonomy eligibility and alignment

*) as of 2025, financial entities can include estimates on compliance with the “do not significantly harm” (DNSH) criterion for exposures or investment in third countries

Source: European Commission, EU Taxonomy Navigator, <https://ec.europa.eu/sustainable-finance-taxonomy/>

The CSRD Directive introduces the obligation for certain categories of enterprises to disclose sustainability information, covering both the impact of the activity carried out by the enterprise or the group on the ESG factors and the manner in which they affect their development, financial position and performance. Companies should report various performance indicators linked to the Taxonomy's six environmental

⁵⁶ <https://www.bnr.ro/DocumentInformation.aspx?idDocument=41432&idInfoClass=16645>

objectives. Firms falling within the scope of the CSRD will be required to reveal the material impact of the ESG factors, but also the risks and opportunities arising from their value chains (with implications for their customers and suppliers, Table 2.1). The first companies will need to apply the new rules starting with the financial year 2024 (for reports to be published in 2025)⁵⁷.

In accordance with the recommendations of the NCMO Working Group on supporting green finance (NCMO Recommendation No. R/6/2021), as of June 2022 the NBR has started the process of collecting, in its Central Credit Register, information on the degree of EU Taxonomy alignment of loans granted, as well as on their green purpose. The aim has been to bridge data gaps and gather the information needed for conducting risk analyses on green exposures⁵⁸.

The degree of EU Taxonomy alignment of loans granted between June 2022 and September 2023 is very low, mirroring similar results at European level. For almost 90 percent of outstanding loans as at September 2023 banks lack information regarding their Taxonomy alignment or do not consider them EU Taxonomy-aligned⁵⁹. Loans considered Taxonomy-aligned or partially aligned make up 1 percent of the corporate portfolio. These are taken mainly by real estate companies (for the development of green buildings), followed by the utilities sector (for renewable energy projects). For large companies in Europe, the European Commission (EC) published a series of statistics on the level of reporting by companies included in the STOXX Europe 600 index⁶⁰. According to the EC, as at May 2023, around one third of these undertakings reported some levels of alignment with the Taxonomy for their capital expenditure (CapEx), their revenue and their operating expenses (OpEx).

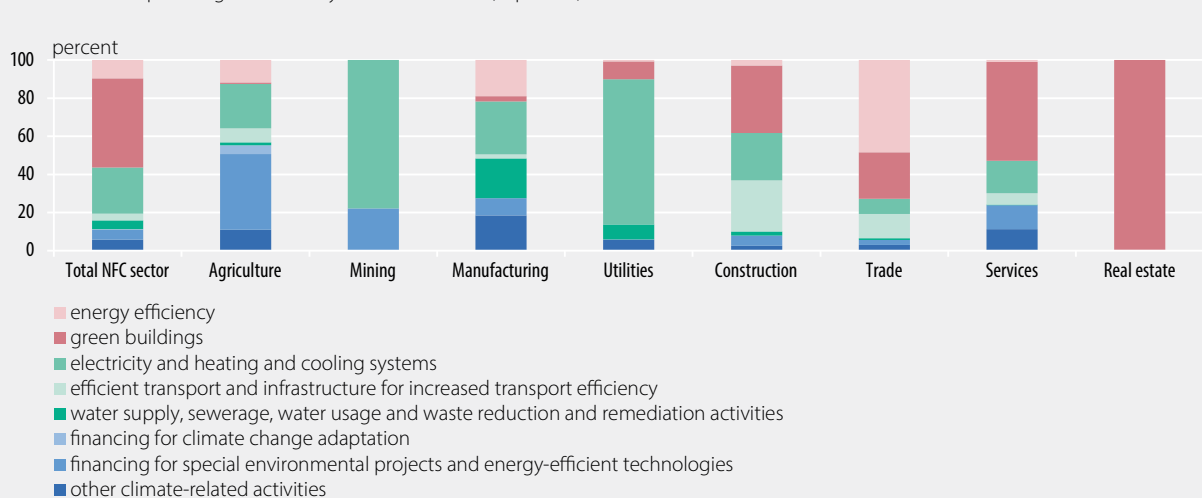
Green loans amount to almost lei 3 billion (September 2023) and account for 1.6 percent of banks' corporate loan stock. The breakdown shows that almost half of them are directed towards green buildings (47 percent), followed by electricity, heating and cooling systems, including renewable energy (24 percent), and energy efficiency (10 percent). By business sector, agriculture firms resort primarily to financing for special environmental projects or investments in energy-efficient technologies (40 percent of the green loans granted to this sector), while mining, manufacturing and the utilities sector take out mostly loans for investments in electricity and in heating and cooling systems. Firms in construction, real estate and services sectors finance their investments in green buildings through credit, whereas trading companies access green loans largely for energy efficiency purposes (Chart 2.10).

⁵⁷ https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

⁵⁸ These can include loans for electricity generation from clean sources (renewable energy: solar, wind, geothermal energy, biomass, etc.); improvement of electricity transportation and distribution mechanisms; investment in the development of electricity storage systems; investment in cogeneration systems; production of heating/cooling from clean sources.

⁵⁹ Loans do not meet the three main criteria: (i) make a substantial contribution to one or more of the six environmental objectives, complying with the technical screening criteria (TSC), (ii) do not significantly harm any of the environmental objectives (do not significantly harm – DNSH) and (iii) comply with the minimum social and corporate governance safeguards (minimum social safeguards – MSS) set out in the EU Taxonomy.

⁶⁰ https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3194

Chart 2.10. Purpose of green loans by economic sector (Sep. 2023)

Source: MF, NBR, NBR calculations

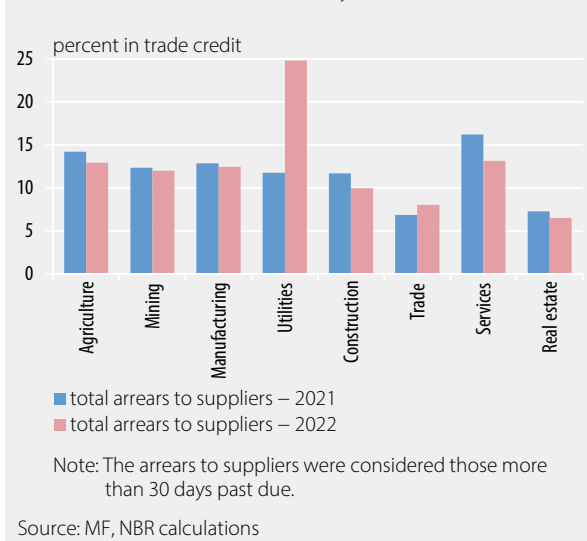
The development of green finance is essential for the green transition and it can be supported by steering investments towards cleaner sectors and technologies, as well as by mobilising private capital for decarbonisation through the financial system. In the context of shrinking fiscal space and persistently low financial intermediation, measures are needed to sustainably increase access to finance, by integrating climate-related issues into financing, and by developing the banking sector and the local capital market⁶¹.

Payment discipline in relation to non-bank partners

The non-financial corporations sector continues to face a series of structural vulnerabilities. Firms predominantly rely on loans from suppliers or shareholders to meet their financing needs, rather than turning to local banks and NBFIs, which account for 8.6 percent of the sector's liabilities and owners' equity. Trade credits remain the primary source of financing (17 percent of liabilities and owners' equity, similarly to the previous year). At the same time, the payment discipline of non-financial corporations is loose, potentially resulting in losses and liquidity challenges for trading partners. Against the backdrop of stronger economic activity, the volume of non-bank overdue payments for the non-financial corporations sector as a whole expanded by 9.8 percent year on year in 2022, given the pick-up in arrears to suppliers (+21 percent), which made up about half of total overdue payments.

On average, 11 percent of trade credits were overdue payments, similarly to the previous year (Chart 2.11). The utilities sector saw a deterioration in trade debt repayment in 2022, partly due to delays in the settlement of energy bills by the Ministry of Energy and to rising energy prices, which led to a number of market imbalances. As a result, electricity and natural gas companies faced a series of liquidity challenges and higher short-term financing needs.

⁶¹ World Bank, *Romania Country Climate and Development Report (CCDR)*, October 2023.

Chart 2.11. Trade credit default risk by business sector

However, the receivables collection period held relatively steady, at about 84 days. Firms in real estate, agriculture and construction sectors posted the longest receivables collection periods, i.e. 228 days, 128 days, and 123 days, respectively. Comparably, the payables payment period remained fairly unchanged from a year before at approximately 77 days, and the breakdown by sector is similar to that for the receivables collection period.

Major payment incidents generated by non-financial corporations witnessed unfavourable developments October 2022 through September 2023 versus the previous period. Specifically, 5,442 firms (8.5 percent more) reported a volume of lei 916.3 million (+11.4 percent). However, the volume of major incidents as a share of total payment incidents

declined over the same reference period (to 46 percent). The concentration level remains elevated, with the top 100 companies in terms of the value of incidents accounting for approximately 55 percent of major incidents involving payment instruments. By business sector, trade firms are responsible for most major incidents involving payment instruments (27.6 percent of the total volume). By company size, microenterprises cause most payment incidents, in terms of both number of firms and volume (4,385 firms, i.e. 41.4 percent of total payment incidents).

Regarding the insolvency of non-financial corporations, 6,205 firms (of those that submitted their financial statements to the Ministry of Finance) entered the insolvency procedure October 2022 through September 2023, down by 2.6 percent versus the period from October 2021 to September 2022. The stock of insolvent firms remained virtually flat in September 2023 against September 2022 (-0.5 percent), totalling 22,740 firms. The number of insolvencies increases significantly if financial corporations are also taken into account, alongside companies that have not submitted or are late to submit their financial statements⁶² (31,821 firms in total as at September 2023). The low efficiency of the insolvency procedure derives from a number of issues: the length of the procedure, the late recourse to insolvency, when companies have been facing financial difficulties for several years, or the limited use of the reorganisation procedure (see Special feature. Zombie firms and the efficiency of the insolvency procedure).

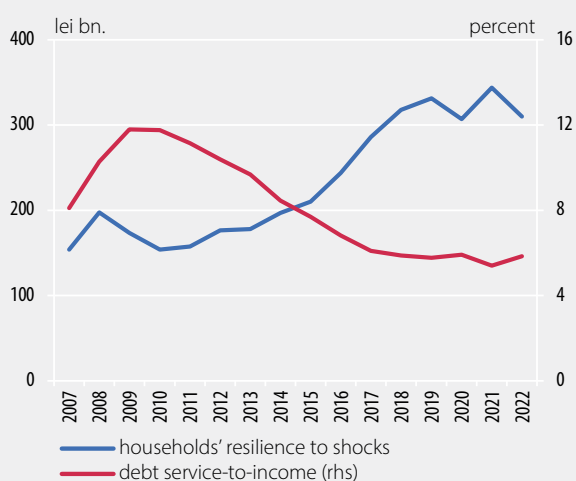
⁶² Article 237(f) and (g) of Law No. 31/1990 on commercial companies (recast) provides that companies failing to submit their annual financial statements within the legally prescribed deadline (if the delay exceeds 60 working days) can be subjected to the winding-up procedure. This particular provision was amended by Law No. 265/2022 on the Trade Register.

2.2. Households

2.2.1. Households' balance sheet and saving behaviour

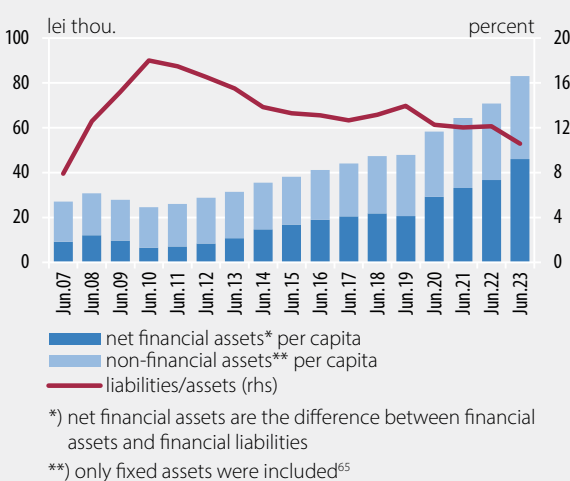
The resilience of the households sector was tested repeatedly over the recent period, amid multiple overlapping crises. In spite of these unfavourable events, households' resilience⁶³, which determines households' capacity to recover after a shock, remained robust, given that the debt service-to-income decreased considerably compared to the period after the 2008 financial crisis (Chart 2.12). These dynamics were also supported by the latest macroprudential measures implemented by the NBR to cap the level of indebtedness when accessing loans (January 2019) and the loan-to-value ratio (April 2022). However, the recent crises halted the uptrend in the level of resilience and the downtrend in the level of indebtedness, amid the increase in debt service as a result of higher interest rates.

Chart 2.12. Households' resilience to shocks



Source: NBR, Eurostat, NBR calculations

Chart 2.13. Households' net wealth⁶⁴



Source: NBR, NIS, NBR calculations

Households' capacity to withstand unfavourable conditions was also highlighted by the increase in wealth, in terms of both holdings of fixed assets (real estate) and the accumulation of financial assets. Households' non-financial assets account for approximately 16 percent of total non-financial assets economy-wide. Households' wealth per inhabitant has tripled since 2007, due to the remarkable

⁶³ Resilience is defined as the value of households' disposable income remaining after covering debt service and subsistence expenses. Subsistence expenses are defined as 50 percent of the median income, in line with the OECD's approach. By contrast, resilience is defined as the capacity to recover from a shock.

⁶⁴ Since 2020, the National Institute of Statistics has published non-financial assets, according to the national accounts methodology, prepared in line with ESA 2010. As of this edition of the *Report*, the values published by the NIS, not the NBR's in-house estimates, are used for non-financial assets. The differences from the previous editions come from how these are calculated. The annual values were linearly interpolated to obtain quarterly data, whereas for 2021, 2022, and 2023, the values were extrapolated, considering a quarterly growth rate of 2 percent (i.e. the average growth rate for 2007-2020).

⁶⁵ Fixed assets are produced non-financial assets used repeatedly or continuously in production processes for more than one year. Fixed assets consist of dwellings, other buildings and structures, machinery and equipment, weapons systems, cultivated biological resources, and intellectual property products.

advance (i.e. 4.5 times) in net financial assets (Chart 2.13), yet disparities and polarisation remain significant.

Against this backdrop, households maintained their net creditor position vis-à-vis the economy, albeit on the wane, and the loan-to-deposit ratio decreased to 54 percent (September 2023, from 60 percent in September 2022). Net financial assets⁶⁶ posted a 26 percent advance in annual terms in 2023 Q2, following the higher pace of increase of assets (+21 percent) compared to liabilities (+7 percent).

According to the *Financial Accounts*, the households sector further shows preference for low-risk assets, such as currency and bank deposits (34 percent of total), the latter reaching a historical peak in June 2023 (lei 328.2 billion) and holding the largest share of financial assets (28 percent). The trend seen after the pandemic outbreak, namely that of shifting from time deposits to demand deposits amid increased uncertainty, reversed over the recent period, with households benefiting from higher interest rates on time deposits. Thus, according to banks' monetary balance sheets, in July 2023, the value of the latter exceeded, for the first time since the pandemic outbreak, the value of demand deposits, and this continued over the following months as well. Moreover, investments in pension funds further rose (+26 percent in annual terms as at 2023 Q2), holding a relatively stable share (approximately 10 percent) of total financial assets over the past three years. The significant role that bank accounts and deposits, as well as investments in pension funds, play in households' portfolio shows the need to avoid legislative initiatives that might affect the stability of the two financial sub-systems (the banking sector and the pension fund sector).

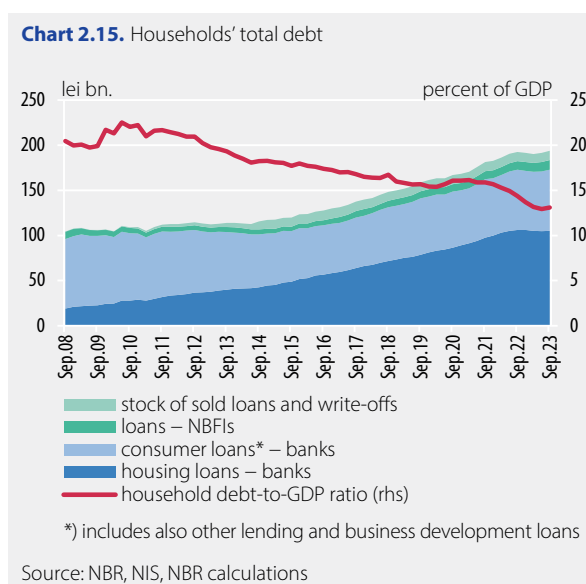
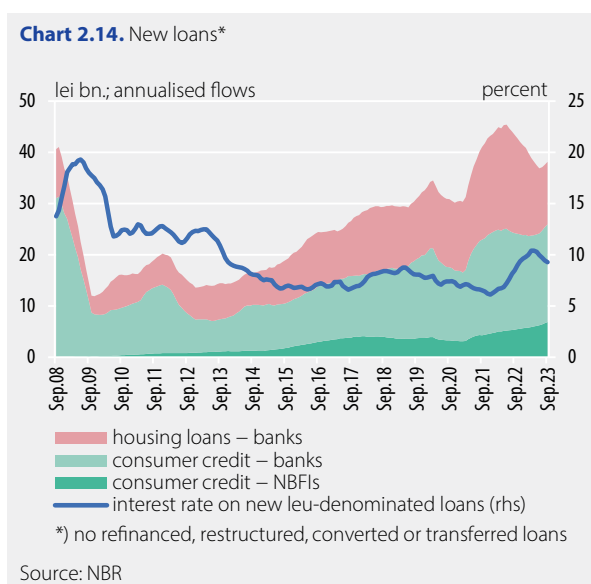
Households' holdings of government securities witnessed positive dynamics, their value increasing by 20 percent in the first two quarters of the year, amid the issues of government securities under the "Tezaur" and "Fidelis" programmes. Nevertheless, the share of this category of financial assets remains relatively modest, i.e. 1.7 percent of total (annual increase of 0.8 percentage points at 2023 Q2). The value subscribed under the "Tezaur" programme⁶⁷ in the first ten months of 2023 was lei 10 billion, which was approximately similar to the same year-earlier period, given that the yields offered peaked in November 2022 (9.15 percent annual interest rate for investments with a two-year maturity) and declined steadily over the next months (to 7.1 percent in October 2023 for a three-year maturity). Subscriptions via the "Fidelis" programme, which allow households to invest both in lei and euro and are instruments listed on the Bucharest Stock Exchange, totalled an equivalent of lei 6.9 billion by October 2023. Whereas leu-denominated subscriptions went down (-18 percent, January-October 2023 versus January-October 2022), there was greater interest in EUR-denominated securities, where yields reflected the further monetary policy tightening in the euro area (EUR 993 million in January-October 2023, around 70 percent more than in 2022 as a whole). Households' preference for EUR-denominated government securities was observed concurrently with a decline

⁶⁶ According to the national financial accounts data, <https://www.bnro.ro/National-Financial-Accounts-3726.aspx>. The data in the section of the *Report* on households' financial assets refer to information from the *Financial Accounts*, unless otherwise mentioned.

⁶⁷ According to the Ministry of Finance <https://mficante.gov.ro/web/trezor/subscrieri-realizate-prin-tezaur-%C8%99i-fidelis>

in foreign currency deposits (-5 percent in the first three quarters of 2023 compared to the same year-ago period).

Amid the steady increases in interest rates, as of the second half of the previous year, new loans to households⁶⁸ decreased on aggregate (-12 percent in September 2023 versus September 2022, 12-month cumulative flow). The breakdown shows mixed developments, with housing loans recording the sharpest decline (-36 percent), while consumer credit from non-bank financial institutions (NBFIs) witnessed a 27 percent hike (Chart 2.14).



New leu-denominated loans, accounting for 98 percent of total new loans from banks, stood on a downward trend as of 2022 H2, reaching lei 30.7 billion in September 2023. Given the spread between the interest rates on leu- and EUR-denominated loans, demand for new foreign currency loans went up, yet their flow remains insignificant compared to that in domestic currency.

Against this background, households' total debt-to-GDP ratio decreased to 13.1 percent⁶⁹ in September 2023 (-2 percentage points versus September 2022). Bank housing loans are the most important component of household debt (54.2 percent of total), on a slight decline (-1 percent in annual terms), followed by bank consumer loans (35 percent of total), which rose by 1.8 percent in annual terms (Chart 2.15).

2.2.2. Households' capacity to service debt

Households' capacity to service debt has slightly deteriorated since the previous *Report*, the non-performing loan ratio exceeding the 3 percent threshold⁷⁰

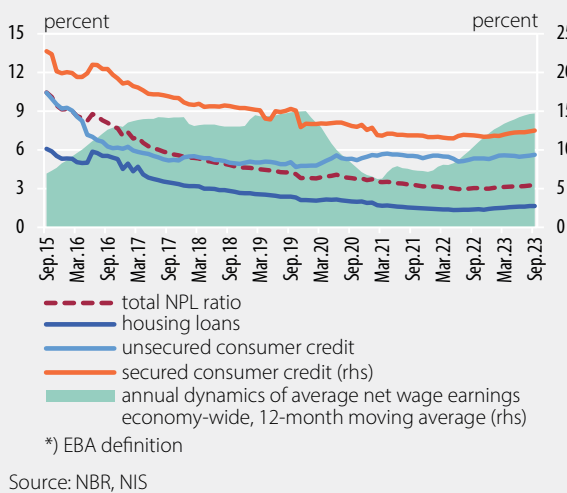
⁶⁸ Excluding refinanced, restructured, converted and transferred loans.

⁶⁹ GDP data as at 2023 Q2, released by the NIS on 12 October 2023, were used to calculate the debt-to-GDP ratios.

⁷⁰ In accordance with the EBA's prudential limits, an NPL ratio below 3 percent is considered desirable and is classified in the best bucket, whereas one exceeding 8 percent is seen as critical and falls within the worst bucket.

(3.3 percent as at September 2023, Chart 2.16). This was due to the increase in monthly instalments as a result of higher interest rates, which was only partly offset by the dynamics of net monthly wage.

Chart 2.16. NPL ratio* by type of loan and the dynamics of average net wage earnings



The breakdown shows that the NPL ratio for housing loans remained adequate (1.7 percent, September 2023), while that for consumer credit was higher (12.5 percent for consumer loans secured by real estate and 5.6 percent for unsecured consumer loans). The stock of foreign currency loans decreased significantly (13 percent in September 2023 versus 53 percent in September 2015), and the flow of new foreign currency credit remained low (2 percent, September 2023). However, worth mentioning is that foreign currency loans are characterised not only by an NPL ratio twice as high as that of domestic currency loans (6.5 percent versus 2.8 percent in September 2023, Chart 2.16), albeit on the decline (from 9.2 percent in September 2019), but also by a higher level of indebtedness at loan origination (44 percent versus 37 percent, September 2023, median values for outstanding loans).

The high NPL ratios for foreign currency-denominated loans stem especially from the stock of loans granted before January 2019, when the National Bank of Romania implemented limits to the level of indebtedness, differentiated by currency (40 percent for domestic currency-denominated loans, 20 percent for foreign currency-denominated loans). These measures proved effective in the context of multiple overlapping crises that have occurred since 2020 and have contributed to increasing the resilience of both borrowers and lending institutions.

Interest rate risk is greater for housing loans, with 74 percent of outstanding loans having a variable interest rate over the entire term of the loan, of which 66 percent are using the IRCC as benchmark. By contrast, consumer loans are mostly granted with a fixed interest rate, with only 30 percent of their stock having a floating rate. The breakdown shows that mortgage-backed consumer credit holds a higher share of loans with a variable interest rate over the entire term of the loan, i.e. 67 percent, although this type of credit accounts for only 12 percent of total consumer credit (including credit cards and overdrafts). Given that the IRCC stayed around 6 percent in 2023 H1 (5.96 percent, 2023 Q2), the monthly instalment⁷¹ for housing loans with a floating rate over the entire term of the loan stood at lei 1,670 (+14 percent, September 2023 versus September 2022).

The level of indebtedness for new loans to households remained prudent, i.e. 35 percent for consumer credit and 36 percent for housing loans (median value,

⁷¹ Calculated via the constant annuity method, using the average interest rate reported by each bank for different classes of loans, differentiated by type of credit, maturity and currency.

Chart 2.17). Vulnerable debtors, defined as borrowers with a level of indebtedness exceeding 45 percent, hold the largest share of secured consumer loans (42 percent) and “First Home”/“New Home” loans (41 percent, September 2023). However, in the latter’s case, empirical evidence⁷² has shown that borrowers that take out loans to purchase their first home are less risky and have a significantly lower probability of default.

Chart 2.17. NPL ratio* by currency and the median of the level of indebtedness for outstanding loans

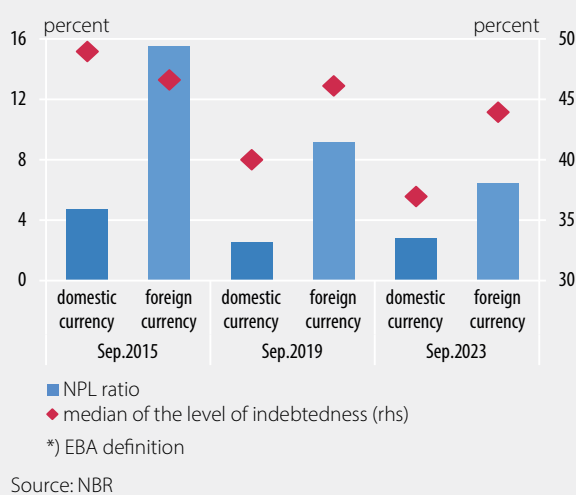
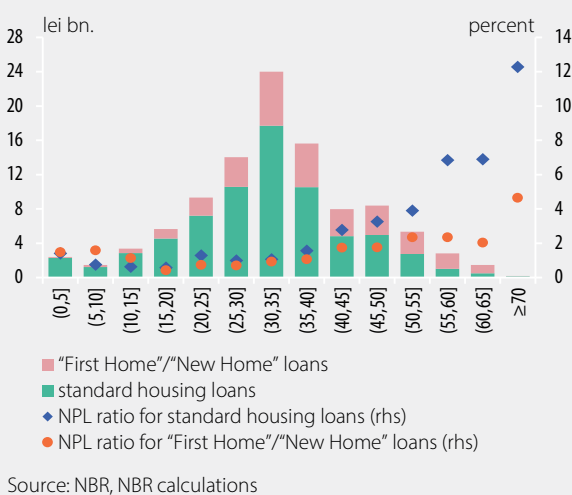


Chart 2.18. Distribution of the level of indebtedness at origination for housing loans and NPL ratio, September 2023



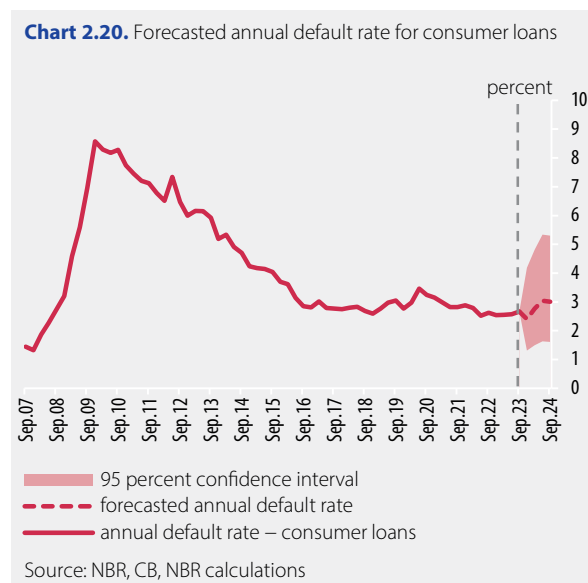
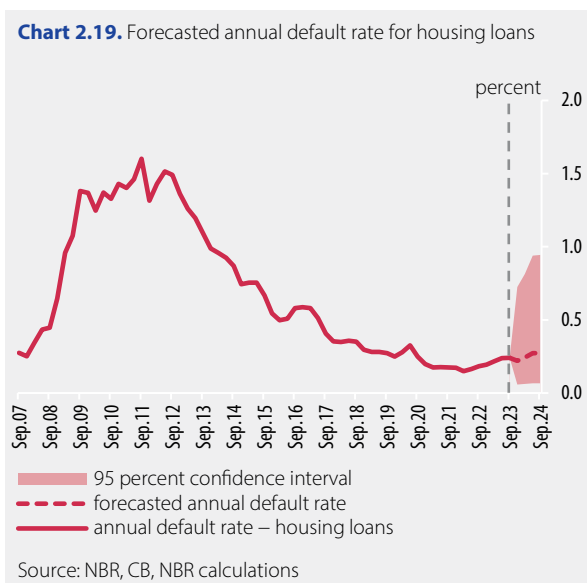
A distinct category of borrowers is more carefully monitored, namely borrowers who deferred their instalments under the moratoria implemented following the outbreak of the COVID-19 pandemic. It was proven that these debtors encountered difficulties in servicing their debt after the moratoria expired and recorded an NPL ratio almost five times as high (12.9 percent⁷³ compared to 2.9 percent, data as of September 2023), while the volume of NPLs for this category of borrowers accounted for approximately 14 percent of total NPLs, in spite of these loans holding only a 4 percent share of the total. Debtors that deferred instalments under moratoria are classified under the riskiest debtor category, with an average level of indebtedness at loan origination well above the prudential limit, i.e. around 57 percent.

In September 2023, the annual default rate⁷⁴ posted a slight increase for both types of loans compared to the same year-ago period (+0.06 percentage points for housing loans and +0.04 percentage points for consumer credit). However, it remained below that recorded after the onset of the pandemic, namely, 0.24 percent in September 2023 versus 0.33 percent in June 2020 for housing loans and 2.67 percent in September 2023 versus 3.47 percent in June 2020 for consumer credit (Chart 2.19 and Chart 2.20).

⁷² Nier, E., Popa, R., Shamloo, M., Voinea, L. – “Debt service and default: calibrating macroprudential policy using micro data”, IMF Working Paper WP/19/182, 2019; Mihai, I., Popa, R., Banu, E., – “The probability of default for private individuals using microeconomic data. What is the role played by macroprudential measures?”, ECB, 2018. These results underpinned the calibration of the exception to the cap on the level of indebtedness for loans granted to purchase a first home (45 percent versus 40 percent in the case of leu-denominated loans).

⁷³ The NPL ratio in September 2023 for loans deferred under GEO No. 37/2020 in June 2020.

⁷⁴ According to the 90 days past due criterion.

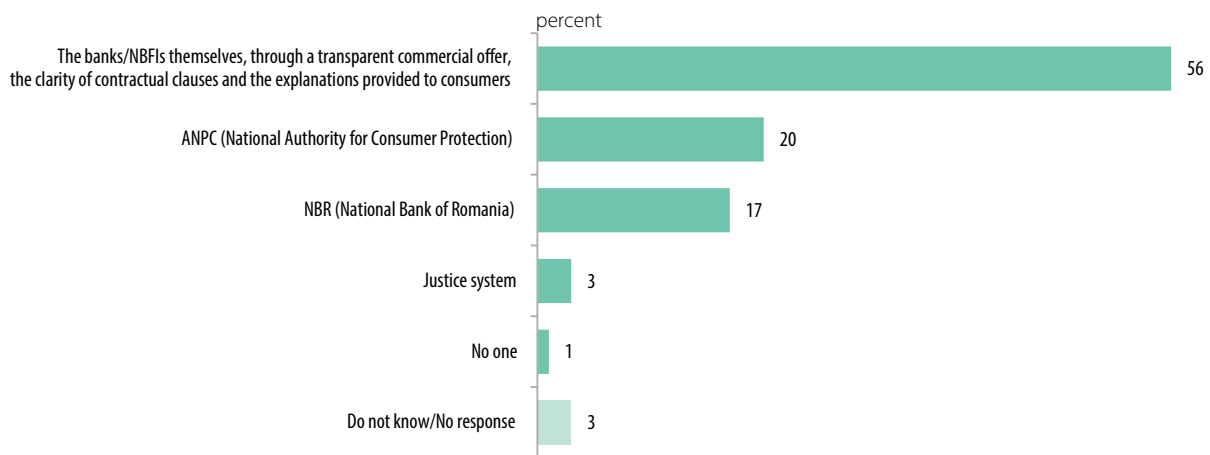


Prospects for borrowers' debt service capacity are mixed. On the one hand, looking at debtors with loans more than 90 days past due one year earlier (September 2022), their capacity to recover financially deteriorated over the recent period. Only 3.5 percent of loans more than 90 days past due in September 2022 returned to being repaid within less than 90 days, down from approximately 8 percent in 2019, whereas 83 percent remained in the NPL category (more than 90 days past due). On the other hand, the default rate increased marginally (0.76 percent in September 2023 versus 0.66 percent in September 2022) and for the next 12 months, the probability of default is expected to be only slightly higher for both housing loans (0.27 percent in September 2024, Chart 2.19) and consumer credit (3 percent in September 2024, Chart 2.20).

Under these circumstances, the Alternative Banking Dispute Resolution Centre (ABDRC) supports debtors that face difficulties, rebalancing the relationship between creditors and consumers and increasing the latter's confidence to resort to financial and banking services. The importance and utility of this mediation are highlighted by the rising number of applications and amicable settlements concluded, as shown in Box 3.

Box 3. The role of the Alternative Banking Dispute Resolution Centre (ABDRC) in supporting financial stability

The primary role of the Alternative Banking Dispute Resolution Centre (ABDRC), which is to settle amicably the disputes that may arise in contractual relations between consumers of financial services and banks or NBFIs, entails an important financial education component as well. The ABDRC's communication outreach extends to employees of commercial banks and NBFIs, who receive information about the benefits of the procedures conducted via the Centre for the overall banking and financial system.

Chart A. Who do you believe would be most capable of ensuring your protection as a consumer in your interactions with banks and NBFIs?

Source: Centre for Urban and Regional Sociology (CURS), ABDRC

The ABDRC's communication strategy for 2023 has focused on financial education. The Centre has run several financial education campaigns targeting consumers of financial services. These include a dedicated section on its website, a series of podcasts featuring top-level representatives of financial and banking institutions in Romania or members of the Steering Board discussing related topics, live streams whereby the ABDRC conciliators and bank representatives respond to consumer questions, and the "Back to school" programme. Through this programme, the Centre contributes to the financial education of students in secondary and upper secondary schools in Bucharest. The ABDRC's financial education projects are all highly visible in traditional and social media, owing to the media partnerships initiated by the ABDRC and media's organic distribution of the video and written materials provided by the Centre as part of these financial information and education campaigns.

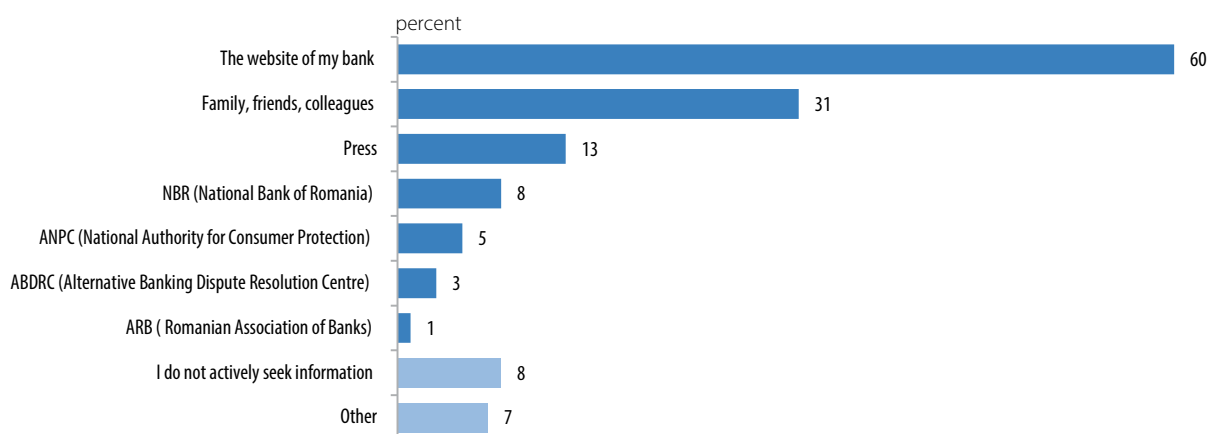
The ABDRC designed a dedicated development strategy for its social media channels and adapted the content to conform to the standards in this field. The results of the above-mentioned projects are used in creating materials for ongoing promotional campaigns on the ABDRC's social media channels (i.e. the ABDRC's website, YouTube channel, Facebook, Instagram, LinkedIn pages, as well as its new TikTok channel – where short clips are uploaded, containing relevant instructions for the general public provided by representatives of banks and the ABDRC.

Moreover, the website features an active chat function enabling consumers to contact a call-centre operator to seek clarifications on any potential queries. Several pages and sections of the website have been updated with consumer information, functions have been improved, and the templates of requests have been extended in the software application designed for consumers' referral to the Centre.

Through its call-centre, the ABDRC reaches out to consumers who wish to be contacted (following their confirmed consent obtained in the context of social media campaigns). They receive information about the procedure for alternative resolution of disputes with banks/NBFIs both by telephone and via newsletters.

In July 2023, the Centre for Urban and Regional Sociology (CURS) conducted a quantitative research study commissioned by the ABDRC, surveying 1,067 respondents who were decision-makers or co-decision-makers within their households regarding their relationship with the bank. The methodology used is based on a sampling universe consisting of households where at least one member has interacted with a bank within the past 24 months. The maximum margin of error for the overall sample is ± 3 percent at a 95 percent confidence level. The data collection was carried out through face-to-face interviews at the respondents' homes. The sample was validated using the most recent data provided by the National Institute of Statistics (NIS). The data collected were not weighted.

Chart B. Where do you source information to assist you in resolving banking and financial problems, whether you currently have them, have had them previously, or may encounter them in the future?

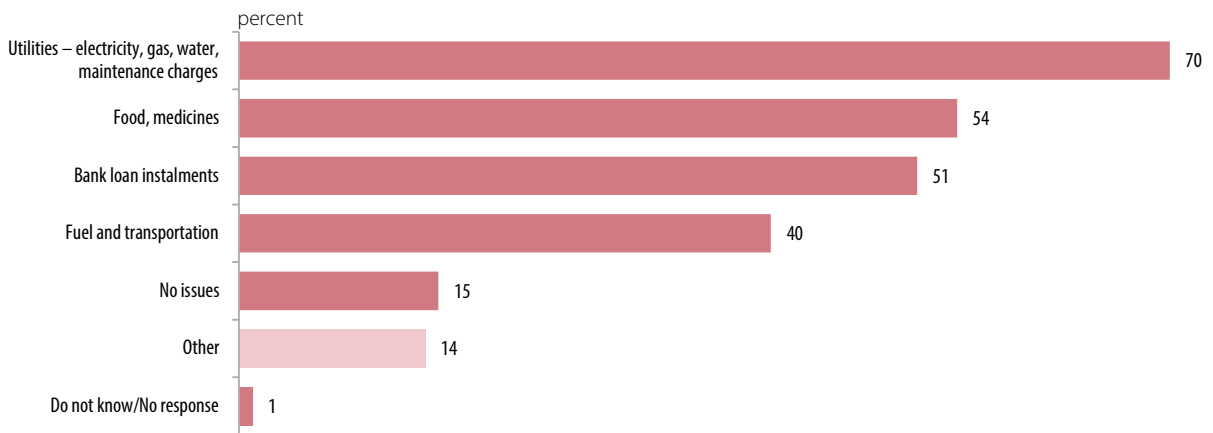


Source: Centre for Urban and Regional Sociology (CURS), ABDRC

The findings of the study cover *inter alia* the way Romanians perceive consumer protection in financial services and products, the sources of information they rely on for personal financial matters, their perception of the primary factors putting pressure on their personal budgets, as well as the key approaches to resolving the issues faced in their interactions with banks/NBFIs. Fifty-six percent of respondents believe that best qualified to protect consumers in their interactions with banks and NBFIs are the banks and NBFIs themselves, through a transparent commercial offer. In fact, consumers of financial services expect to have their rights protected by the entity that provided them with the financial product or service. The National Authority for Consumer Protection (ANPC) ranks second in terms of consumer protection expectations, with 20 percent, just three percentage points ahead of the National Bank of Romania, which takes 17 percent, although legally the NBR is not tasked with this responsibility. Only 3 percent of respondents think that the justice system would be the most qualified in this respect, while 1 percent believe

that no one would be able to ensure their protection. The ABDRC was not listed as a response option because its role is to settle amicably consumer issues with banks/NBFIs, rather than serve as a consumer protection authority.

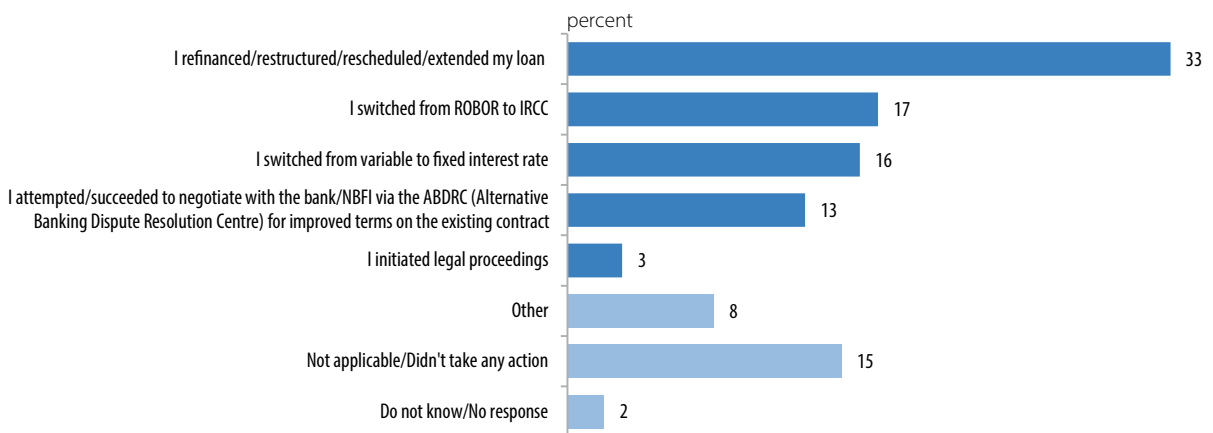
Chart C. What is the primary source of the financial issues you encounter?
Select up to 3 possible choices



Source: Centre for Urban and Regional Sociology (CURS), ABDRC

Banks are perceived as the primary source of information by 60 percent of the consumers who have faced or anticipate facing financial problems. The second source for consumer information is their close acquaintances (family, friends, and colleagues), with 37 percent, while 13 percent of the respondents in the survey conducted by CURS cited the media as their go-to option. The National Bank of Romania is the institution/authority most frequently consulted for information in the banking and financial sector.

Chart D. If you had any problems with your bank/NBFI (between 2022-2023) and found a resolution, what was it?
Multiple-choice answer

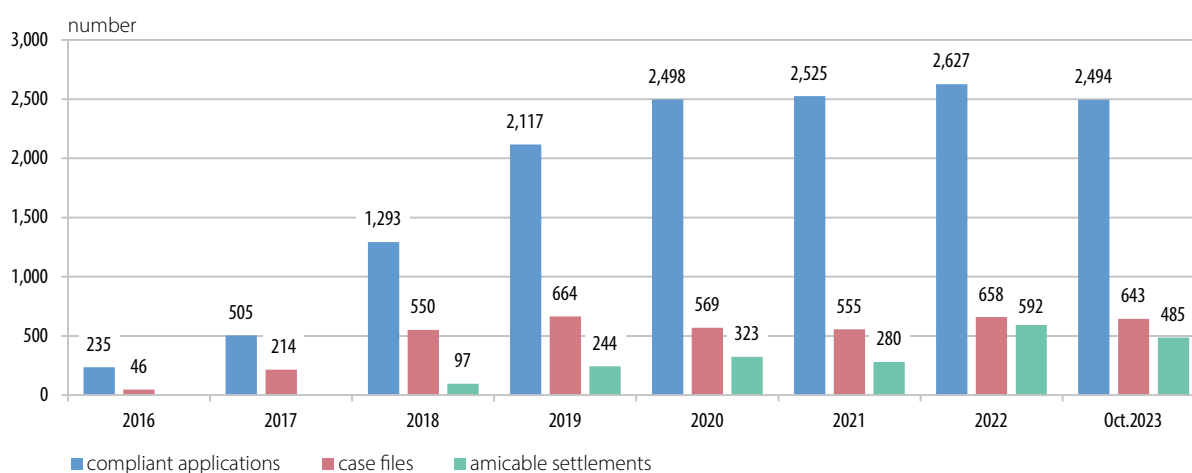


Source: Centre for Urban and Regional Sociology (CURS), ABDRC

Two-thirds of respondents (70 percent) pointed to utilities as the primary source of their financial issues, while 54 percent indicated food and medicine prices to be the main cause of the challenges facing them. Fifty-one percent of respondents cited loan instalments, while 40 percent chose fuel and transportation costs as the primary factor affecting their spending. Fifteen percent of those surveyed said they had no financial problems.

Regarding how respondents resolved the issues they had experienced in their relationship with their bank or NBF1 2022 through 2023, 33 percent successfully refinanced, restructured, or rescheduled their loans, 17 percent switched from ROBOR to IRCC, while 16 percent opted to shift from variable to fixed interest rates. A considerable share (13 percent) is taken by respondents who attempted/succeeded to negotiate with their bank/NBF1 through the ABDRC when they encountered a problem in their relationship with that particular institution.

Chart E. Annual dynamics: compliant applications, case files and amicable settlements



Source: ABDRC

The conclusions of the CURS survey show an increased consumer confidence in the banking system, which reflected as well in the conciliation work carried out by the ABDRC in the first nine months of the year.

Through its actions, the ABDRC encourages consumers to be open to building a trust-based relationship with banks. Banks understand and acknowledge the issues raised by consumers, particularly when these are justified and reasonable. Moreover, the improvement in conciliation mechanisms and the willingness of banks to be flexible in dealing with customer requests can lead to a steady and significant increase in the number of complaints settled, with an input from all parties concerned.

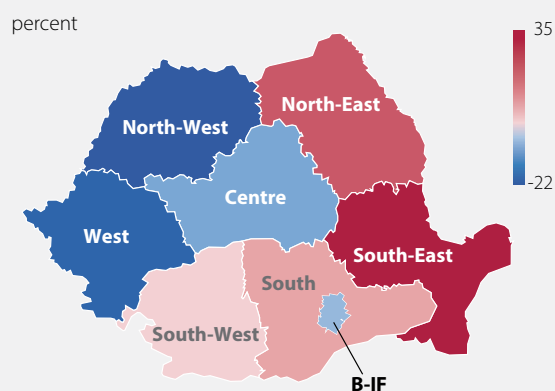
2.3. Real estate sector

2.3.1. Residential and commercial real estate markets

The residential real estate market

The activity in the residential real estate market has further shrunk since the release of the previous *Report*, on both the demand and supply side. The number of completed dwellings in 2023 H1 declined by 2 percent at national level in year-on-year comparison, and the volume of construction works in the first nine months of 2023 decreased by 7.2 percent (gross series) versus the same year-ago period, even though there were significant regional disparities (Chart 2.21).

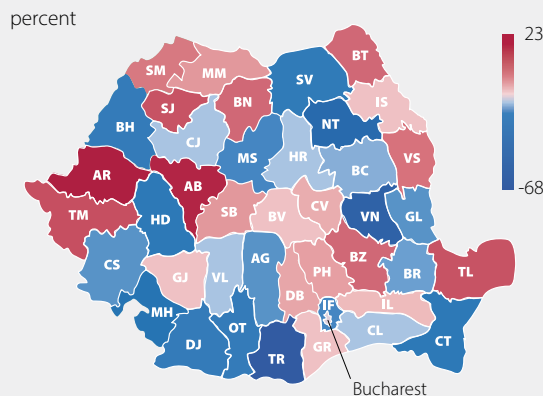
Chart 2.21. Annual dynamics of the number of completed dwellings, 2023 H1 vs. 2022 H1



Note: Colour intensity varies depending on the dynamics of the number of completed dwellings (shades of blue show a decline, while shades of red show an increase).

Source: ANCP, NIS, NBR calculations

Chart 2.22. Annual dynamics of the number of real estate transactions, 2023 Q1-Q3 vs. 2022 Q1-Q3



Note: Colour intensity varies depending on the dynamics of real estate transactions (shades of blue show a decline, while shades of red show an increase).

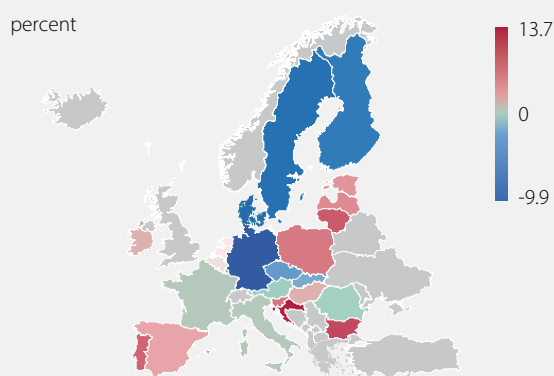
Source: ANCP, NIS, NBR calculations

Expectations are for this trend to continue in the coming period, given, on the one hand, the substantial drop in the number of building permits for residential buildings (-24 percent in January-September 2023 versus January-September 2022) and, on the other hand, the further sustained growth of construction costs for residential buildings (+15 percent January through September 2023 against the same year-earlier period).

In January-September 2023, real estate transactions experienced a setback year-on-year both at national level (-18 percent) and in the main regional centres (-21 percent in Bucharest and Iași, -16 percent in Constanța, -14 percent in Cluj-Napoca, -10 percent in Brașov) (Chart 2.22). Disparities were also visible at county level, the largest decline in trading occurring in Olt (-68 percent), ahead of Teleorman (-55 percent), whereas the counties of Călărași and Alba were at the opposite end of the spectrum (+23 percent and +21 percent respectively).

At the EU level, house prices witnessed divergent developments, as nine of the 27 Member States posted decreases in 2023 Q2 (annual developments, Chart 2.23).

Chart 2.23. Annual dynamics of residential property prices in EU countries, 2023 Q2



Note: Colour intensity varies depending on the price dynamics (shades of blue show a decline, shades of green show a status quo, while shades of red show an increase).

Source: Eurostat, NBR calculations

Germany reported the largest decline (-10 percent), while Croatia recorded the fastest increase in house prices (+14 percent).

In Romania, residential property prices remained relatively unchanged in 2023 Q2 versus the same year-ago period (+0.1 percent). Nevertheless, regional disparities were further significant also from this perspective, being in line with the asymmetrical economic development. The county of Cluj is in the top regions in terms of the highest house prices (EUR 2,329/sqm for a flat in the city of Cluj-Napoca, according to the National Association of Romanian Authorised Valuers, in 2023 Q2). The elevated construction costs continue to put pressure on new house prices, causing them to grow at a swifter pace than that of existing dwellings (4.4 percent versus

-2 percent, 2023 Q2, annual terms). As far as households' access to the residential real estate market is concerned, the price-to-income ratio⁷⁵ highlights significant regional heterogeneities, ranging between over 11 years in Cluj-Napoca or Constanța and 7 years in Bucharest.

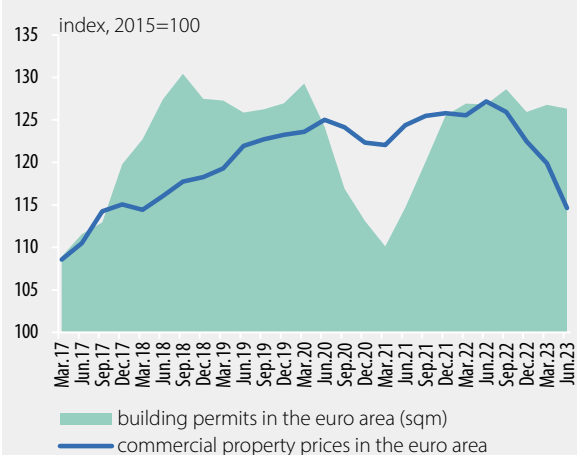
The commercial real estate market

The dynamics of commercial real estate (CRE) markets have raised concerns at European and global level (see Section 1.1). At the EU level, according to the latest assessments made by the European Central Bank⁷⁶, the CRE market has continued its downturn, in a context of tighter financial conditions and macroeconomic uncertainty, which resulted in lower demand, particularly for office buildings and retail spaces.

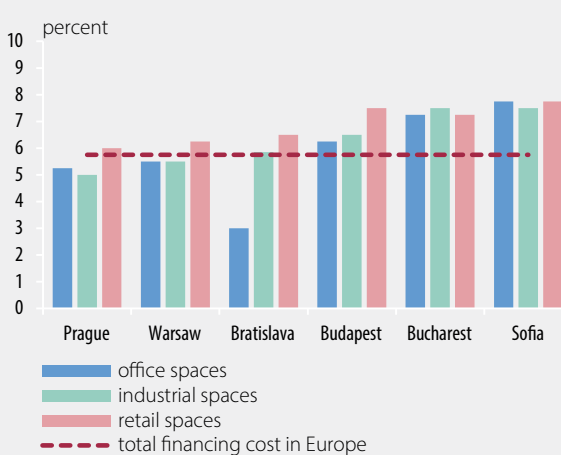
The vulnerabilities facing the CRE market are compounded by a number of structural changes that have occurred over the last years, such as the momentum gained by online shopping, the need for increased flexibility with respect to rented office spaces and the impact of climate-related policies. Against the background of low interest rates over the past decade, the CRE market had expanded, before witnessing strong corrections at the onset of the COVID-19 pandemic. Once economic activity recovered, prices resumed their upward trend, exceeding pre-pandemic levels (Chart 2.24). Starting in mid-2022, with the increase in interest rates, commercial property prices embarked on a downward path. Specifically, euro area commercial property prices fell by 10 percent in 2023 Q2 year on year. The sharp drops in commercial property prices may adversely affect the incomes generated by these properties and the liquidity and solvency of companies in the construction and real estate sectors.

⁷⁵ The ratio of the price of a standard, 2-room flat of 55 sqm to net average wage earnings adjusted by deducting subsistence expenses (calculated as a 50 percent share of the net minimum wage economy-wide).

⁷⁶ ECB, *Financial Stability Review*, November 2023.

Chart 2.24. Developments in commercial property prices and building permits in the euro area

Source: ECB

Chart 2.25. Prime yields in the capital cities of Central and Eastern European countries, 2023 Q3

Source: Colliers

At regional level, the CRE investment volume in Central and Eastern Europe over the first three quarters of 2023 decreased by 46 percent against the same year-ago period, amid investors' concerns about the rise in interest rates and the uncertainty surrounding macroeconomic developments⁷⁷, the largest decreases, of about 60 percent, being observed in Romania and Poland. In comparison with the capital cities of the countries in the region, Bucharest records higher⁷⁸ prime yields⁷⁹, which are exceeded solely by those in Budapest and Sofia for retail spaces, and only by those in the latter city for office spaces (Chart 2.25).

Commercial real estate market activity in Romania slowed down in the first part of 2023, in line with regional developments. January through September 2023, investment volume plunged by approximately 63 percent year on year (to EUR 243 million). At regional level, the largest drop in investment was recorded in Bucharest (-73 percent), concurrently with lower declines (-47 percent) in the major regional centres (the counties of Cluj, Braşov, Iaşi, and Timiş)⁸⁰. By destination, investments were mainly channelled into retail spaces, ahead of office spaces (23 percent) and industrial spaces (16 percent)⁸¹. In 2023 Q3, the most important investors in the CRE market in Romania by the origin of capital were as follows: domestic investors (38 percent), Greek (32 percent), Belgian (16 percent) and German investors (14 percent)⁸².

Construction costs further exerted pressure on CRE market activity, the average construction cost index for non-residential buildings increasing by 9 percent in January-September 2023 in annual terms, yet the pace of growth of costs decelerated

⁷⁷ CBRE, *CEE Real Estate Investment Volumes Q3 2023*.

⁷⁸ Colliers, *The CEE Investment Scene Q1-Q3 2023*.

⁷⁹ The prime yield is the best yield estimated to be achievable for a notional office property of the highest quality and specification in the best location in a market.

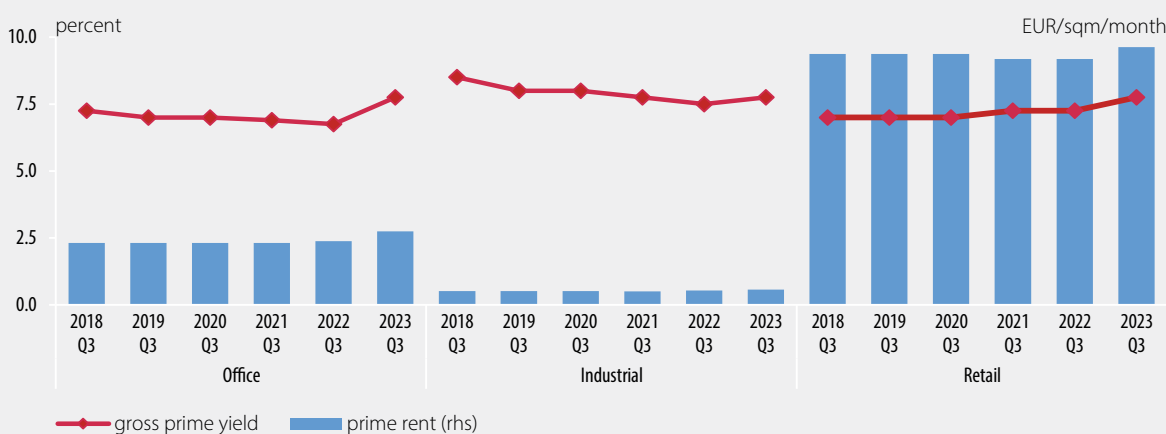
⁸⁰ According to data provided by iO Partners. Total investment volumes include only deals of at least EUR 5 million.

⁸¹ CBRE, *Romania Real Estate Investment Volumes Q3 2023*.

⁸² CBRE, *Romania Real Estate Investment Volumes Q3 2023*.

versus the same period in the prior year (+20 percent in January-September 2022 year on year). At the same time, the volume of construction works for non-residential buildings rose marginally (+1.6 percent against +18 percent in January-September 2022 as compared with the same year-earlier period). CRE market activity is expected to remain at the same level, given that, even though the number of non-residential building permits issued in the first nine months of 2023 declined by 4 percent in year-on-year comparison, the average useful floor area stipulated in building permits stayed relatively flat. From a regional perspective, decreases in the useful floor area specified in building permits occurred particularly in the Bucharest-Ilfov region (-43 percent) and the South-West region (-32 percent), while the remaining regions witnessed increases in authorised useful floor areas.

Chart 2.26. Prime rents and gross prime yields in the main segments of the commercial real estate market, 2023 Q3



Note: Rents and yields refer solely to prime locations. Rental prices are expressed in EUR/sqm per month and are VAT excluded.

Source: iO Partners

Rental prices continued to grow across all segments in 2023 Q3 versus the same year-ago period. The largest rises were visible in the office segment (+16 percent), ahead of industrial spaces (+8 percent) and retail spaces (+5 percent) (Chart 2.26). Prime yields rose substantially for office and retail spaces (+15 percent and +7 percent respectively) and moderately for industrial spaces (+3 percent). The vacancy rate added 0.6 percentage points in the case of industrial spaces, yet it was further low (4.2 percent) as compared with that for office spaces, which stood at around 13 percent.

In terms of sustainability and environmental, social and governance (ESG) factors, office buildings remain the best-performing at national level. According to data provided by iO Partners, almost 89 percent of the stock of office buildings are certified green buildings according to international environmental standards, ahead of retail spaces (of which nearly half are certified). Colliers' report entitled *2023 Global Investor Outlook*⁸³ shows that ESG factors are among the main criteria taken into consideration by investors not just for regulatory and reputational reasons but as a result of occupier demands and the benefits in terms of long-term operational

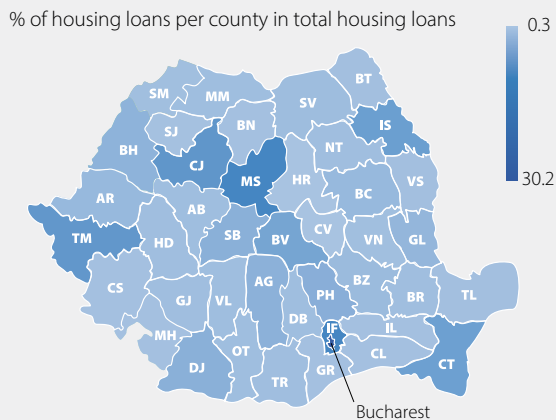
⁸³ Colliers, *2023 Global Investor Outlook*, December 2022.

costs. In addition, at the EU level, the revision of the Energy Performance of Buildings Directive sets forth stricter energy efficiency requirements for the stock of buildings. In the non-residential segment, investors have to finance improvements in the quality of assets they own, as the latter’s energy performance may have implications also for access to finance.

2.3.2. Risks generated by the residential real estate sector and real estate lending to households

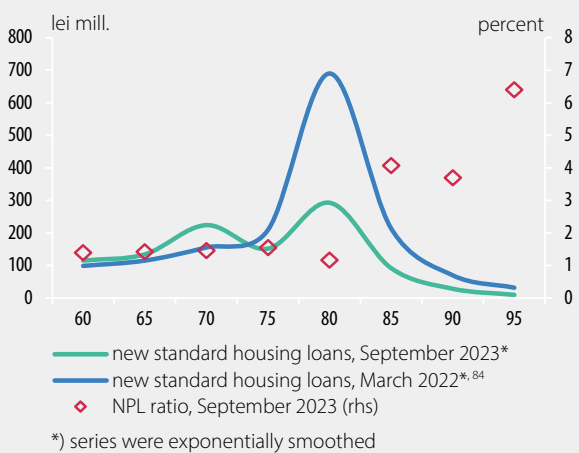
The banking sector’s exposure to the residential real estate market remained significant, accounting for 68 percent of total loans to households in September 2023.

Chart 2.27. Concentration of housing loans at regional level, September 2023



The importance of loans granted under the “First Home”/“New Home” programme continued to decline, their share in total housing loans reaching 30 percent in September 2023 from approximately 47 percent five years ago. The flow of new “First Home”/“New Home” loans has recently posted substantial decreases (-52 percent in September 2023 against September 2022, annualised values), in line with the developments in housing loans at aggregate level, taking merely 7 percent of new housing loans (September 2023). The portfolio of housing loans granted under the “First Home”/“New Home” programme further boasted higher quality than standard housing loans (their NPL ratio coming in at 1.3 percent versus 1.8 percent, September 2023).

Chart 2.28. Distribution of standard housing loans by the loan-to-value (LTV) ratio and the NPL ratio



A persistent issue for the housing loan market in Romania is the concentration of housing loans. Specifically, the six main regional centres accounted for 60 percent of the volume of such loans, 35 percent of them being concentrated in the Bucharest-Ifov region (Chart 2.27).

Amid concerns about potential corrections in the residential real estate market and the higher NPL ratio for low LTV loans, the National Bank of Romania decided (April 2022) to raise the prudential requirements for a riskier category of housing loans, namely loans granted to purchase a dwelling in addition to the debtor’s primary residence. Following this new regulation, the share of new loans with an LTV ratio between 65 percent and 75 percent widened from 28 percent in March 2022

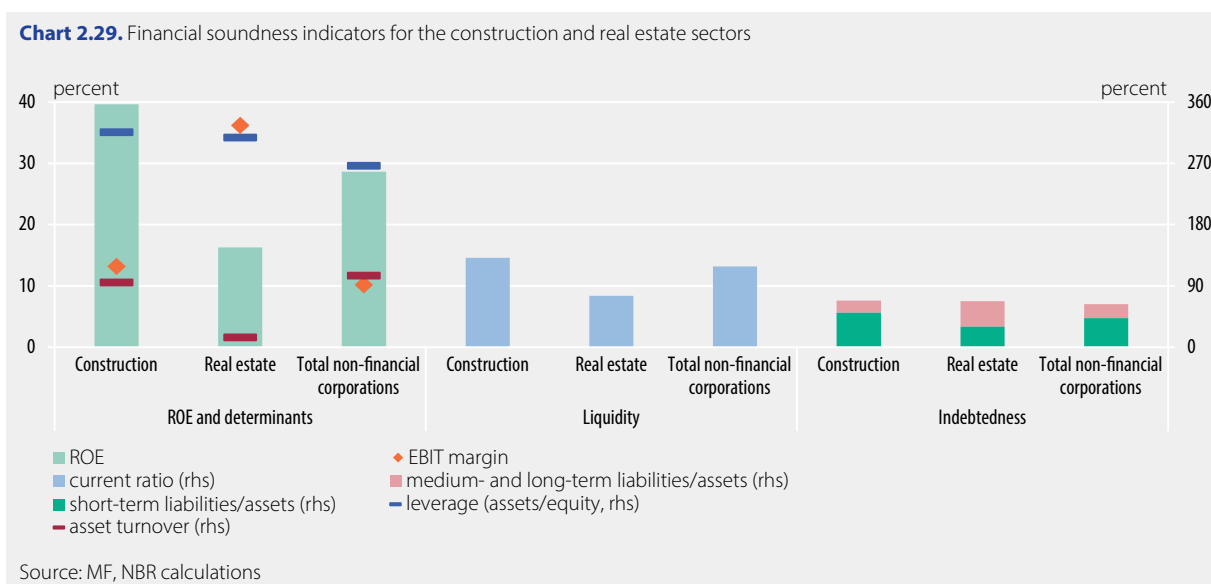
⁸⁴ As of April 2022, the cap on the loan-to-value (LTV) ratio for dwellings purchased through a housing loan by a non first-time buyer was changed by lowering it by 10 percentage points.

to 37 percent in September 2023 and that of new loans with an LTV ratio between 75 percent and 85 percent, close to the regulatory limit, shrank from 48 percent in March 2022 to 25 percent in September 2023 (Chart 2.28). Under the circumstances, the median loan-to-value ratio for new loans ("First Home"/"New Home" loans excluded) was 72 percent, whereas the LTV ratio for the entire housing loan stock stood at 69 percent (September 2023).

Rising concerns about the impact of climate change were also mirrored in the breakdown of housing loan portfolios, green loans accounting for approximately 29 percent of the total flow of new housing loans in the first nine months of 2023. Most of these loans were loans for purchasing green homes (66 percent of the flow in September 2023), ahead of loans for increasing energy efficiency. Nonetheless, looking at the housing loan stock, this category of loans still has a significant growth potential, as its weight is low, i.e. 6.3 percent in September 2023.

2.3.3. Risks generated by the commercial real estate sector and mortgage-backed lending to non-financial corporations

The banking sector's exposure to the commercial real estate sector⁸⁵ remained elevated (50 percent of total loans to non-financial corporations, September 2023), relatively unchanged from the previous year, albeit down from 55 percent in 2021. Direct exposures to the construction and real estate sectors totalled lei 37 billion (September 2023), up by 16 percent in annual terms. Indirect exposures, which are loans secured by real estate extended to non-financial corporations, were significant, approximately 1.5 times larger than direct exposures, amounting to lei 55.9 billion (September 2023), after having increased by 5 percent in annual terms.

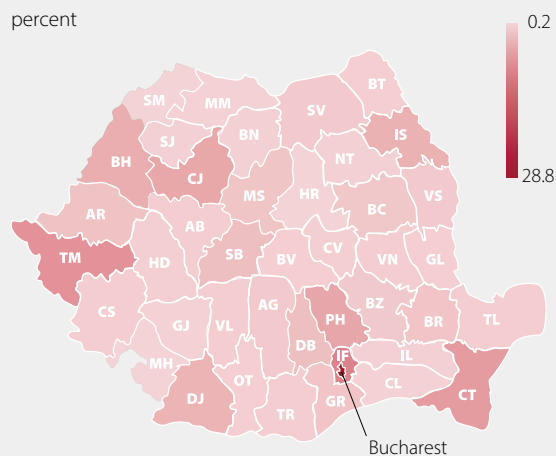


⁸⁵ Loans to the construction and real estate sectors (direct exposures) and loans secured by real estate extended to non-financial corporations (indirect exposures) are taken into consideration.

Against the background of higher interest rates, the assessment of companies in the construction and real estate sectors shows that they further have a higher level of indebtedness than the non-financial corporations sector as a whole, yet on the decline over the past years. The level of indebtedness (debt-to-equity ratio) has improved gradually (-37 percentage points versus the pre-pandemic period), reaching 210.6 percent in 2022 (as compared with 167 percent for the non-financial corporations sector as a whole). Nevertheless, construction companies have mostly short-term liabilities (51 percent of their assets), which might need to be refinanced (Chart 2.29).

Liquidity indicators slightly improved, the current ratio being above one in 2022 (101.5 percent), which is indicative of these firms' capacity to cover current liabilities without resorting to new loans. The same as the level of indebtedness, liquidity indicators for these companies performed worse than those at aggregate level (119 percent). The below-one current ratio of the real estate sector may be suggestive of its riskier profile, yet the much smaller asset turnover ratio than those of other sectors may account for the lower liquidity needs specific to its activity. In terms of profitability, companies in the construction and real estate sectors managed to cover their costs and generate satisfying returns on their investments. The margins applied by the real estate sector, calculated as the ratio of net profits to operating revenues, were further the highest as compared with those applied by other sectors (24 percent), while construction companies posted margins of approximately 11 percent.

Chart 2.30. Regional concentration of commercial real estate loans⁸⁶, September 2023



Source: NBR

The quality of the portfolio of loans granted to companies in the construction and real estate sectors continued to improve, the NPL ratio dropping to 4.5 percent in September 2023 from over 5 percent a year before. Looking at indirect exposures, the NPL ratio was higher, albeit on a declining trend, standing at 6.1 percent in September 2023 versus 7.6 percent in the same year-earlier period and over 8 percent two years ago.

Another approach to quantifying the banking sector's exposures to the CRE market is that proposed by the European Systemic Risk Board (ESRB), which defines loans aimed at acquiring a CRE property (or set of CRE properties), i.e. commercial real estate (CRE) loans. According to this approach, CRE loans accounted for 17 percent of the stock of

loans to non-financial corporations in September 2023⁸⁷, their breakdown by property type showing the following: industrial buildings held 29 percent, retail spaces took

⁸⁶ Pursuant to Recommendation ESRB/2016/14, commercial real estate (CRE) loan means a loan extended to a legal entity aimed at acquiring income-producing real estate (or set of properties defined as income-producing real estate), either existing or under development, or real estate used by the owners of the property for conducting their business, purpose or activity (or set of such properties), either existing or under construction, or secured by a commercial real estate property (or set of commercial real estate properties).

⁸⁷ The breakdown by this category of loans is available in the database of the Central Credit Register as of May 2022.

27 percent and office spaces made up 7 percent (data as at September 2023). The concentration of exposures in large regional centres (Bucharest – 29 percent, Ilfov – 10 percent, Timișoara – 7 percent, Constanța – 6 percent, Cluj – 4 percent) was also visible in the case of commercial real estate loans (Chart 2.30).

The data as at September 2023 on outstanding commercial real estate loans show that about 8 percent of total such exposures had a loan-to-value (LTV) ratio⁸⁸ of over 100 percent, while 10 percent of them had an LTV ratio between 80 percent and 100 percent. As far as these loans are concerned, a potential decrease in commercial property prices would negatively impact the values of collateral in banks' balance sheets, mirrored in higher LTV ratios. Amid the vulnerabilities in the commercial real estate sector identified at the EU level, the ESRB issued a number of recommendations⁸⁹ that are aimed at improving the monitoring of systemic risks stemming from the CRE market, ensuring sound CRE financing practices and increasing the resilience of financial institutions to commercial real estate market shocks.

⁸⁸ LTV is the ratio between the sum of all loans or tranches of loans secured by the borrower with the property purchased through the mortgage loan and the current value of the property.

⁸⁹ Recommendation ESRB/2022/9 of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area.

3. THE FINANCIAL SECTOR

The Romanian banking sector continued to follow the trend of improving financial and prudential situations, despite the challenges associated with the health crisis and the regional geopolitical context, and with the disruptions that emerged in the US and Swiss banking sectors in 2023 Q1. Macroeconomic uncertainties, as well as the fiscal measures to be introduced in 2024, could negatively impact the adequate position of banks, especially smaller ones, as well as the level of financial intermediation, which is already the lowest in the EU.

The solvency ratio stands above the EU average, i.e. 22.3 percent in September 2023 versus 20 percent EU-wide in June 2023. Liquidity is at an adequate level and has improved as compared to 2022 (the liquidity coverage ratio – LCR was 248.0 percent, whereas the net stable funding ratio – NSFR was 183.6 percent, September 2023). The funding risk is low, given the balance sheet structure and the volume of deposits taken from households and non-financial corporations, i.e. the deposit base, which has remained stable even under significant shocks. Asset quality indicators – the non-performing loan ratio (2.6 percent, September 2023) and the non-performing loan coverage by provisions (65.1 percent, September 2023 – the highest value in the EU) – place the Romanian banking sector in the EBA-defined low-risk bucket. The profitability of the sector continued to improve, with the ROE and ROA indicators determined based on the annualised profit⁹⁰ standing at 21.2 percent and 1.9 percent, respectively. This rise was underpinned by the increase in net interest income and by the efforts to optimise operating expenses (including through digitalisation). The operating expenses-to-assets ratio (2.2 percent, September 2023, annualised data) has improved by approximately one percentage point in the past ten years, exceeding the EU median (1.4 percent).

The volume of bank deposits is on the rise, supported mainly by the households sector, with the prevailing share of demand deposits in the banks' portfolio ensuring that funding costs remain low.

Amid the brisk step-up in interest rates in the EU, bank profitability has significantly improved in EU Member States, leading to new legislative initiatives concerning the additional taxation of banks in Italy, Spain, Lithuania and, more recently, Slovenia. These initiatives are exceptional in nature and limited in time. The Romanian authorities have introduced, as part of a fiscal reform package, a permanent additional tax levied on all banks, irrespective of their financial results, by implementing time-differentiated tax rates (2 percent of turnover for 2024 and 2025, and a lower tax rate as of 2026). The annual impact of applying a 2 percent tax on banks' turnover currently equals 1.5 percent of the total own funds of credit institutions, Romanian

⁹⁰ In September 2023, the banking sector's profit totalled lei 10.4 billion.

legal entities, which may affect their capital over time, as well as their competitiveness vis-à-vis other similar entities in the EU.

A series of challenges persist within the Romanian banking sector: (i) prospects for a rising credit risk in the real sector, in the context of an increased debt service due to higher interest rates and to the fiscal changes enforced by the authorities; (ii) stronger interdependencies between the banking and the government sectors, entailing a higher concentration risk and interest rate risk; (iii) a further low financial intermediation and a smaller contribution of the banking sector to supporting structural changes in the economy; (iv) fast digital transformation in the financial sector, which calls for an adjustment of the digital strategies of banks in Romania (given the heterogeneities in the degree of digital technology deployment); (v) the recent ESG developments, as well as the new non-financial reporting requirements on sustainability, compel banks to develop strategies that integrate climate change issues in terms of climate risk management (*inter alia* by quantifying exposures to transition and physical risks, as well as by developing climate scenario analyses), portfolio diversification and the rise in the share of green assets.

The non-bank financial sector' assets have increased in the recent period, coming to account for a quarter of the financial sector. The private pension sector has been the main growth driver, with a strong boost in assets (+32 percent) and an improved rate of return compared to the previous *Report*. Non-bank financial institutions also witnessed an upswing in total assets (+15 percent), with no significant changes in portfolio composition during the past year. As for the insurance sector, gross premiums written went up versus 2022 H2 and solvency ratios slightly strengthened. Investment funds were the only receding sector in the period under review (-15 percent in the 2022 Q3 – 2023 Q3 period) due to the negative developments in asset market values, together with negative net issues of fund shares and units.

3.1. Banking sector

3.1.1. Structural developments

The structural developments in the Romanian banking sector saw some changes, but the main trends specific to local banks have persisted since the last *Report*.

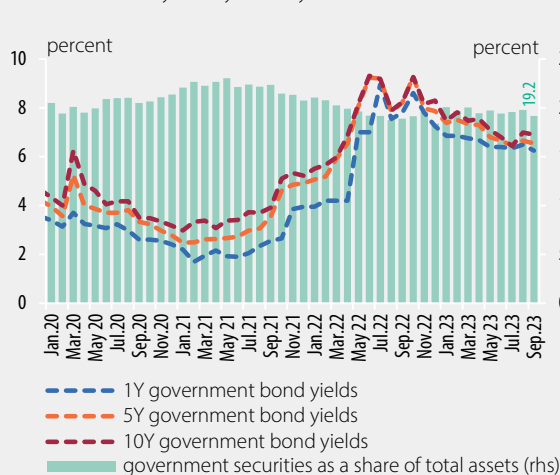
- Credit institutions managed to increase their volume of deposits (taken mainly from households), and the prevailing share of demand deposits in banks' portfolios led to further low funding costs.
- The link between the banking sector and the government (assessed in terms of direct and indirect exposures) remains strong, and the potential unfavourable developments from the perspective of the fiscal or banking framework could entail negative implications for the other institutional sector.

After the temporary shift towards EUR-denominated loans in 2022 and the first part of 2023 (especially by non-financial corporations), and against the background of a faster increase in interest rates on loans in lei versus other currencies, as of April 2023 new loans in euro have declined due to the narrowing interest rate differential.

- Banks with majority domestic capital continued to strengthen their position in the Romanian banking sector, primarily starting with 2017, as they came to hold one third of bank assets, raise 34 percent of private sector deposits and make the largest contribution to financial intermediation (32 percent of total loans, September 2023). Looking at the breakdown, corporate loans went primarily to companies with domestic capital (approximately 70 percent of total loans to companies). Therefore, the legislative measures concerning the banking sector will chiefly impact the domestic capital.

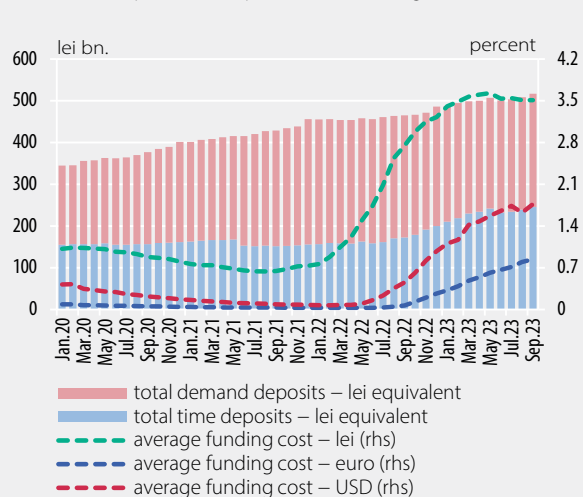
Since the latest *Report*, the banks' appetite for sovereign debt instruments has dropped marginally (Chart 3.1), the share of government securities in total bank assets falling from 20 percent (March 2023) to 19.2 percent (September 2023). The securities in banks' portfolios are mainly denominated in lei and have maturities of more than two years. The share of claims on the government sector (loans and securities) in total assets has remained constant since the prior *Report*, i.e. around 23 percent in September 2023, which is high compared to other EU countries. The direct interconnection between the banking and the public sectors is also reinforced by indirect exposures, given the loans with state guarantees granted through the "First Home"/"New Home" programme, and also via the programmes designed to support lending to SMEs (IMM Invest, Agro IMM Invest, IMM Leasing) which were implemented to bolster the economy during the pandemic. The direct and indirect exposures of banks to the general government accounted for approximately 30 percent of total bank assets as at September 2023. The government strengthened its position in terms of the market share of the banks in which it is the majority shareholder, with the share of these banks' assets increasing in recent years, from 5 percent in 2008 to 12.6 percent in September 2023.

Chart 3.1. Government securities held by banks as a share of total assets and yields by maturity



Source: NBR, Refinitiv

Chart 3.2. Deposits – composition and funding costs



Source: NBR

The migration trend towards longer-maturity savings has continued, with the share of demand deposits decreasing by 1.3 percentage points since the previous *Report* in September 2023, yet still prevailing with a 52.5 percent share (Chart 3.2). This evolution has been mainly driven by the developments in EUR-denominated funding. By currency, 68.5 percent of deposits are denominated in lei, 27.6 percent in euro and 3.9 percent in US dollars (September 2023, Chart 3.2).

Since the prior *Report*, the funding cost for deposits in local currency has stayed virtually flat, whereas the cost related to foreign currency deposits has not yet stabilised. Thus, the average interest rate on lei-denominated sources has remained relatively unchanged since the latest *Report*, coming in at 3.5 percent in September 2023 (from 3.6 percent in March 2023). The average interest rate for EUR-denominated funds (0.8 percent in September 2023, up from 0.5 percent in March 2023) reflects the credit institutions' low interest in such funding sources.

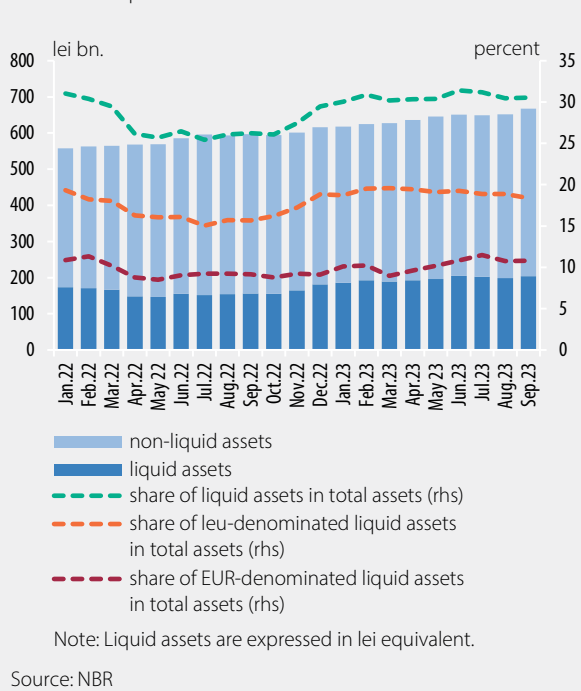
The foreign funding of the banking sector increased as of 2022, particularly in the context of the need to meet the MREL targets. This type of funding posted an average annual growth of 26 percent January 2022 through September 2023, after having seen negative average annual dynamics between 2015 and 2021. However, the share of foreign funding in total liabilities remained low (7.4 percent, September 2023), compared to the annual average of 23 percent in 2010-2014 and to the 30.7 percent peak in December 2008.

After the temporary shift towards EUR-denominated loans in 2022 and the first part of 2023 (especially for non-financial corporations), and against the background of a faster increase in interest rates on loans in lei versus other currencies, as of April 2023 new loans in euro declined due to the narrowing interest rate differential. Lending denominated in lei to the real economy dropped as of 2022 Q4 as a result of the lower appetite for loans. Recent developments indicate a rebound in new lei-denominated loans in 2023 Q3, although this has been influenced by the dynamics of refinancing.

3.1.2. Liquidity

The liquidity of the banking sector remains adequate, despite some disruptive episodes, such as bank failures in the USA, the takeover of Swiss bank Credit Suisse Group AG by UBS earlier this year, and ongoing geopolitical tensions worldwide. The central bank maintained its net debtor position vis-à-vis credit institutions amid an increase in liquidity surplus across the banking sector.

The funding risk for banks in Romania is low, given the volume of deposits from households and non-financial corporations, i.e. the deposit base, which proved stable in spite of the occurrence of significant shocks. Nevertheless, recent events have shown that current global trends in the digitalisation of banking services may affect financial stability as a result of an increased speed and size of bank runs, thereby fuelling the risk of contagion. The digital environment allows easy withdrawals and transfers of deposits via online banking platforms. At the same time, news and social media platforms help spread negative information or rumours.

Chart 3.3. Liquid assets as a share of total bank assets

Romania's banking sector ranks favourably vis-à-vis those of other European countries in terms of liquid assets in its portfolio. In the event of the funding risk materialising (*inter alia* as a result of new challenges of digitalisation), local banks hold a substantial volume of liquid assets to cope with bank runs. In September 2023, the share of liquid assets in total assets of the Romanian banking sector stood at 30.5 percent (Chart 3.3), above the EU average of 18.2 percent⁹¹ (June 2023).

The breakdown reveals that liquid assets consist mainly of leu- and EUR-denominated instruments (18.4 percent and 10.8 percent of total assets, respectively). The favourable liquidity position of banks in Romania is also ascribable to the limited potential of liquidity outflows from financial derivatives, secured lending transactions and capital market-driven transactions, which, as a rule, could witness negative developments amid high volatility in financial markets.

Liquidity indicators have improved since the previous *Financial Stability Report*. The positive performance of the liquidity coverage ratio (LCR) at aggregate level (248 percent in September 2023, up from 219.5 percent in March 2023) owes to the improvement in the stock of liquid assets (liquidity buffer), especially of central government assets (up lei 20.4 billion from March 2023). By currency, the LCR for the leu component rose by about 23 percentage points in September 2023 against the end of 2023 Q1, standing at 220.3 percent. For the euro component, the indicator held relatively steady at 229.9 percent in September 2023 (versus 230.6 percent in March 2023). The net stable funding ratio (NSFR) at aggregate level amounted to 183.6 percent in September 2023, faring better than in March 2023 (177.6 percent). The breakdown points to an improvement in the NSFR for both local currency and euro components, due to an increase in the stock of stable funding sources. Both relevant liquidity indicators posted values above the 75th percentiles of the EU-wide distributions at mid-2023 (244.8 percent⁹² for the LCR and 149.2 percent for the NSFR).

The favourable liquidity position of the local banking sector is also underpinned by the results of the latest liquidity stress test, which show an improvement, with banks capable, in general, of managing potential short-term liquidity shocks in a satisfactory manner. At the same time, the number of banks that might be affected by temporary liquidity shortfalls is small and includes mostly small-sized credit institutions, with no potential systemic implications whatsoever.

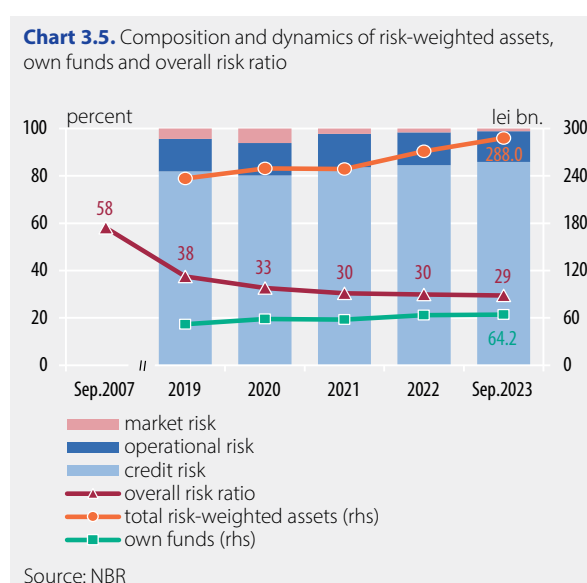
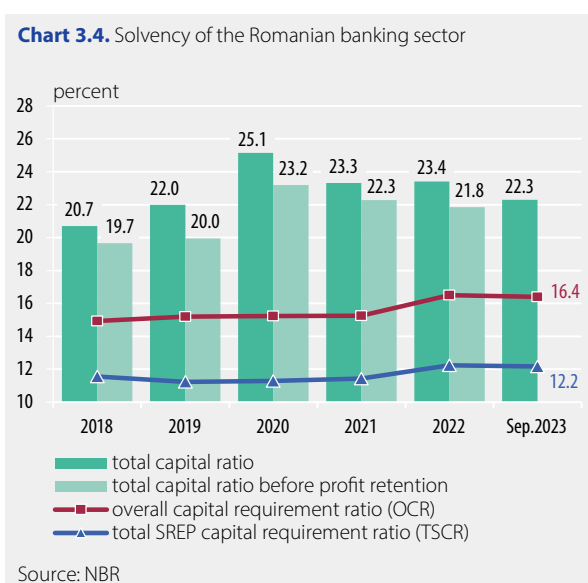
⁹¹ ECB, consolidated banking data.

⁹² EBA, 2023 Q2.

3.1.3. Capital adequacy

The total capital ratio of the Romanian banking sector remained adequate, i.e. 22.3 percent (September 2023), standing above the EU average of 20 percent.

As compared to the total SREP capital requirement ratio (TSCR) and the overall capital requirement ratio (OCR), banks in Romania have a significant capital reserve, which provides a good capacity to withstand potential adverse conditions (Chart 3.4). Banking sector profitability over the last years has supported the improvement in solvency, on the back of high profit retention rates (in 2022, they made a 1.6 percentage point contribution to the increase in total capital ratio).



Transitional measures with a favourable impact on solvency, known as the CRR “quick-fix”, the support response of the regulatory authorities to the COVID-19 pandemic, have been removed gradually. They had a marginal effect in 2023, as in their absence, the total capital ratio would have stood at 21.83 percent.

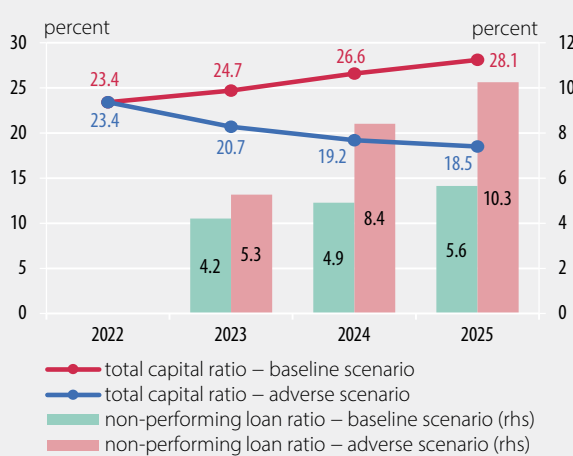
Over the past five years, own funds have permanently displayed faster dynamics than those of total risk-weighted assets, on the back of profit retention and the business model centred on retail and general government lending, which is less costly in terms of capital requirements (Chart 3.5). The gradual change in the overall risk ratio (defined as the ratio of credit risk-weighted assets to total credit risk-relevant exposures) made a significant contribution to improving solvency. While this indicator stood at 58 percent in September 2007, it currently shows credit institutions’ shift in focus to a balance sheet composition with a larger share of lower credit risk assets, reflecting the reduction in risk appetite.

The latest solvency stress test of credit institutions shows the adequate resilience of the Romanian banking sector at aggregate level, due to the good operating capacity, especially of large banks, as well as to the initially high solvency level

(December 2022). The stress test covers the three years from 2023 Q1 to 2025 Q4⁹³ and comprises two macroeconomic (baseline and adverse) scenarios developed in-house.

According to estimates, a number of (generally small) banks would not have the capacity to fully absorb the potential macroeconomic shocks in the scenarios and are foreseen to post capital shortfalls by the end of the forecast horizon. In general, the negative results of banks stem from the severe worsening of operational efficiency.

Chart 3.6. Results of the macroprudential stress test exercise (2023-2025)



Source: NBR

Under the baseline scenario, developments at the beginning of the forecast horizon are relatively severe, amid the persistent macroeconomic imbalances generated by the current geopolitical context (featuring relatively high interest rates as a result of inflationary pressures, uncertainty surrounding the international environment and the impact of implementing fiscal consolidation measures), but a recovery is expected to be seen towards the end of the forecast horizon. Under this scenario, assuming the non-distribution of dividends, the total capital ratio would rise gradually to 28.1 percent by the end of the forecast horizon (Chart 3.6). Based on estimates, the NPL ratio would go up to 5.6 percent (2025).

The adverse scenario takes into account a strongly negative evolution, its severity being associated with the protraction of macroeconomic imbalances over a longer horizon, due *inter alia* to the lingering geopolitical tensions, reflected by a high risk premium. In cumulative terms, the economic growth over the 2023-2025 horizon is negative, the unemployment rate picking up 4.7 percentage points.

This scenario assumes a strong decline in net interest income, on the back of higher interest expenses from demand deposits. The reduction in operational efficiency leads to a fast erosion of capital under the adverse scenario. According to estimates, the total capital ratio would see a severe worsening by the end of the forecast horizon, down to 18.5 percent. Moreover, the NPL ratio would stand at 10.3 percent in 2025, amid a contraction in aggregate demand, due *inter alia* to fiscal consolidation measures. The most affected portfolios would be those of exposures to non-financial corporations (small- and medium-sized enterprises, in particular), as well as the portfolios of consumer loans. Despite the strongly negative results, the banking sector could continue its lending activity, while complying with prudential capital requirements. However, worth noting are certain vulnerabilities affecting small banks.

⁹³ The stress test covered all credit institutions, Romanian legal entities, and relied on the financial and prudential statements available as at end-2022.

In the medium run, transposing the Basel III regulatory framework at EU level will lead to an increase in capital requirements, with a potential negative impact on the capital adequacy ratio, *caeteris paribus*. The EBA second mandatory monitoring exercise on Basel III full implementation included two banks in Romania, the *Report*⁹⁴ assessing the effects of implementing “pure” Basel III measures and the EU’s revised regulatory framework (CRR3). Specifically, after implementing the latest amendments to the Basel III regulatory framework, the minimum Tier 1 capital requirement will go up by 12.6 percent for the full sample of European banks at the full implementation date in 2028, and by 8.9 percent for the group of small- and medium-sized banks (in which banks in Romania have also been included). The impact associated with the changes in the Capital Requirements Regulation (CRR3) is lower, i.e. an average rise of 9 percent in the minimum Tier 1 capital requirement for all European banks and a smaller change of 3.6 percent for the group of small- and medium sized banks.

3.1.4. Asset quality and credit risk

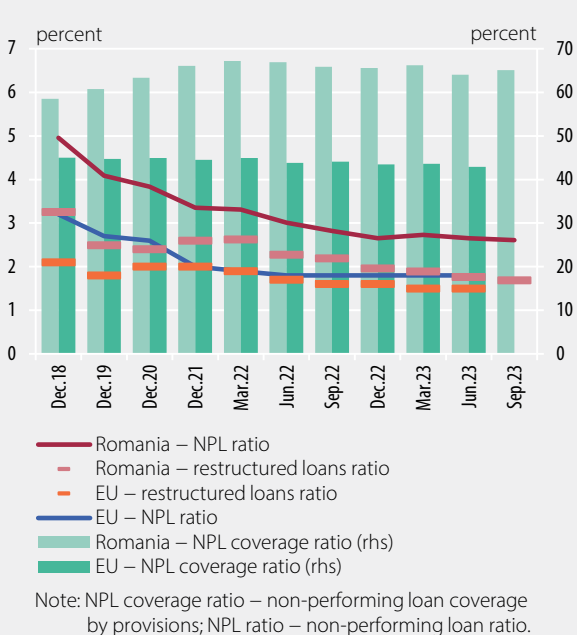
The relevant indicators measuring asset quality have generally followed an improving trend. Despite the uncertain economic environment, characterised by high interest

rates and inflation, the non-performing loan ratio held relatively steady throughout 2023, falling within the EBA-defined low-risk bucket as of June 2022 (2.6 percent, September 2023). Across the EU, the indicator also witnessed a standstill, the Romanian banking sector maintaining a gap of under 1 percentage point compared to the EU average (Chart 3.7). March 2023 through September 2023, the stock of loans increased by 5.6 percent, whereas the stock of NPLs went up by 1 percent, leading to a slight decline in the NPL ratio.

No bank in Romania classifies under the high-risk category according to the EBA in terms of the NPL ratio, with 15 banks falling within the low-risk bucket and the rest in the medium-risk bucket. Looking at portfolios, there is a small improvement in the NPL ratios for loans to large companies and to small- and medium-sized enterprises of approximately 40 basis points and 20 basis points respectively compared to end-2022, standing at 3.6 percent and 4.1 percent (September 2023).

As for consumer credit and housing loans, the indicators deteriorated slightly, going up by 20 and 16 basis points respectively compared to the same year-ago period. However, the NPL ratio and the coverage ratio reflect banks’ adequate capacity to manage credit risk, even in the current uncertain economic environment.

Chart 3.7. Asset quality indicators



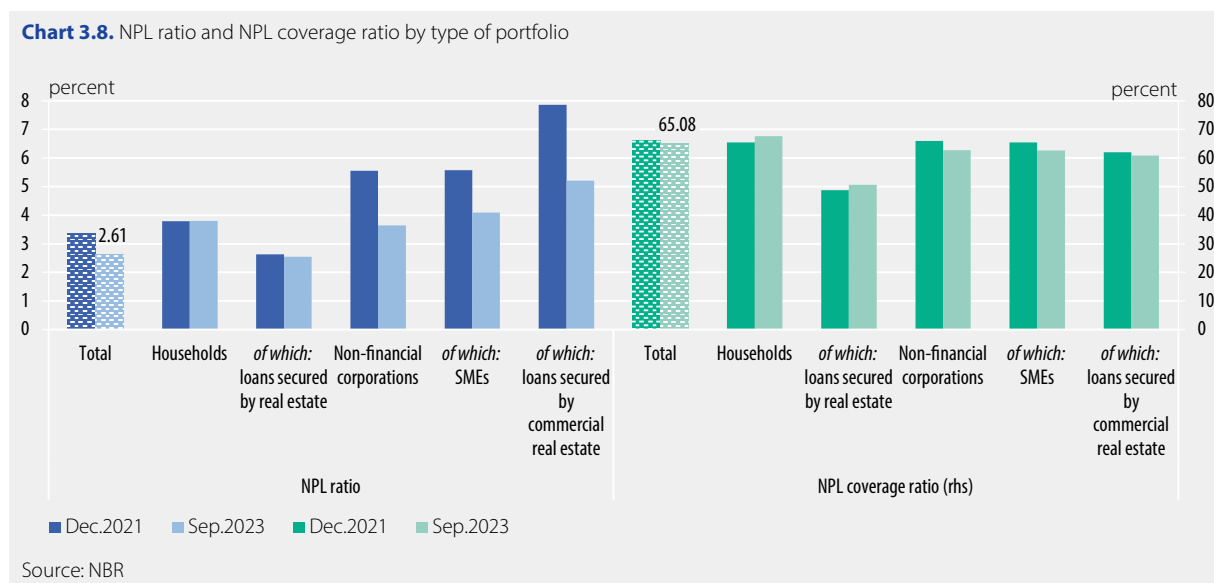
Source: NBR, EBA

⁹⁴ <https://www.eba.europa.eu/eba-second-mandatory-exercise-basel-iii-full-implementation-shows-significantly-reduced-impact-eu>

Relative to the moment in time preceding the start of the interest rate hiking cycle (December 2021), the favourable dynamics of lending, higher than those of the stock of non-performing loans, fostered the decline in the NPL ratios for all types of portfolios, which was stronger in the case of non-financial corporations (down by 1.9 percentage points, Chart 3.8), although debt service increased overall.

Non-performing loans are monitored and recovered mainly internally by banks. The stock of write-offs remained constant throughout 2023 (approximately lei 15 billion). Most exposures written off were those to non-financial corporations (76 percent of total, September 2023). Given the growth outlook for NPLs, similarly to developments in the EU, it is important to make NPL resolution more efficient, *inter alia* via legislative measures. To this end, the fiscal treatment of non-performing loan sales could be adjusted to contribute to spurring the balance sheet clean-up.

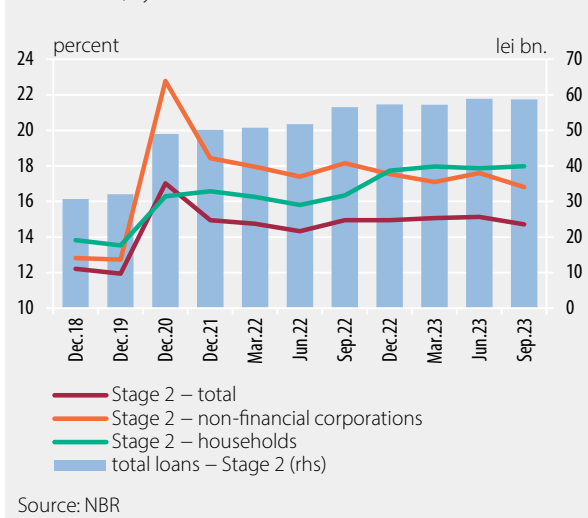
Since end-2022, the NPL coverage ratio adjusted marginally by 0.5 percentage points, to 65.1 percent in September 2023. However, the indicator is well above the EU average of 42.9 percent (June 2023, Chart 3.7). Banks' prudent attitude in credit risk management, together with weaker expectations of asset recovery amid the uncertainty surrounding the macroeconomic framework, helps this indicator stick to high levels. Over the past two years, the coverage ratio decreased for NPLs to non-financial corporations (-3.3 percentage points), relatively in line with the NPL ratio, whereas for NPLs to households, it increased by 2.2 percentage points (Chart 3.8).



The restructured loans ratio further followed a downtrend, remaining, in September 2023, 20 basis points above the EU average of 1.5 percent (June 2023), yet still in the EBA-defined medium-risk bucket. The dynamics were mainly ascribable to a decrease in the stock of restructured loans by 5.9 percent from March 2023, as well as to a rise in lending.

The share of loans classified in Stage 2 of impairment under IFRS 9 in total loans, which is a signal indicator in terms of expectations of deteriorating asset quality,

Chart 3.9. Share of loans and advances in Stage 2 of impairment under IFRS 9, by institutional sector



continued to improve, reaching 14.7 percent in September 2023 (compared to 15.1 percent, March 2023). The Stage 2 ratio for loans to non-financial corporations contracted by 0.7 percentage points since the beginning of the year, which owed primarily to the increase in the stock of loans to this segment by 9 percent (Chart 3.9).

A key element in the EU's regulatory activity following the global financial crisis was to develop a comprehensive approach to adequately manage the NPL coverage by provisions, thus avoiding the occurrence of systemic risks. This approach included the adoption of Regulation (EU) No. 2019/630 to set minimum loss coverage for non-performing exposures subsequent to 2019.

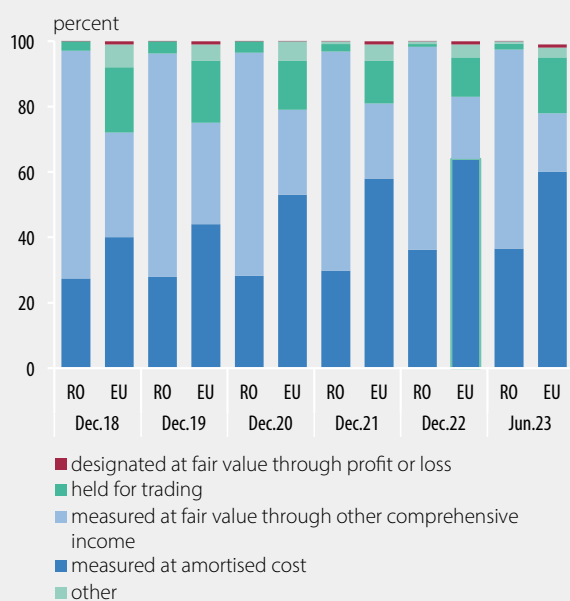
Credit institutions must comply with a predefined calendar for the coverage for non-performing exposures, depending on their type (secured or unsecured), taking into account that the longer an exposure has been non-performing, the lower probability for recovery of its value. The minimum coverage requirement applicable to non-performing exposures in accordance with this regulation stood at lei 694 million (September 2023), down by 5.5 percent from the end of the previous year, corresponding to a non-performing exposure of lei 4.37 billion. Compared to this minimum requirement, banks recorded a coverage shortfall of 5.8 percent, a relatively small amount that is deducted from Common Equity Tier 1 capital. Most exposures subject to these provisions became non-performing two to six years ago (approximately 83 percent). Minimum coverage requirements are due mostly to unsecured exposures⁹⁵ (88.2 percent, September 2023). Adequate NPL coverage is a key factor in supporting the financial health of the Romanian banking sector and for this purpose, it is critical to preserve a favourable fiscal regulatory framework.

3.1.5. Market risk

The local banking sector is one of the main creditors of central government, through the purchase of securities issued by the Romanian government, whose share in total bank assets stood at 19.2 percent in September 2023. The government securities portfolio has a positive effect on banks' liquidity and solvency positions, given the preferential treatment used to calculate liquidity indicators (LCR, NSFR) and the low risk weighting of such exposures for credit risk capital requirements (under the standardised approach, no capital requirements are set for local currency-denominated exposures). However, the large share of these assets in banks' portfolio may increase the concentration risk, with negative effects in the event of unfavourable developments in sovereign risk.

⁹⁵ Starting with the third year, unsecured exposures should be covered to a minimum of 35 percent, while the requirement increases to 100 percent starting in the fourth year. As for secured exposures, the minimum coverage is 25 percent in the fourth year and grows approximately linearly up to the tenth year, when it reaches 100 percent.

Chart 3.10. Distribution of government securities in banks' portfolio by accounting classification – Romania and EU



Source: NBR, EBA

Unlike the average of the EU banking sector, where government securities in banks' portfolios are recorded at amortised cost, in Romania they are measured at fair value (60.9 percent in September 2023, versus merely 18 percent at EU level in June 2023, Chart 3.10). In light of the resumption of the policy rate hiking cycle, the share of securities measured at amortised cost has been on an upward trend as of December 2021 (a 9.1 percentage point increase against December 2021, reaching 39.1 percent in September 2023).

The interest rate risk arising from holdings of government securities issued by central government was clearly visible throughout 2022, as the yields required by investors increased, leading to significant mark-to-market losses with important direct effects on own funds, partly mitigated by the provisions of the CRR "quick fix". However, since the beginning of the year, government securities that are marked to market have contributed to the increase in own

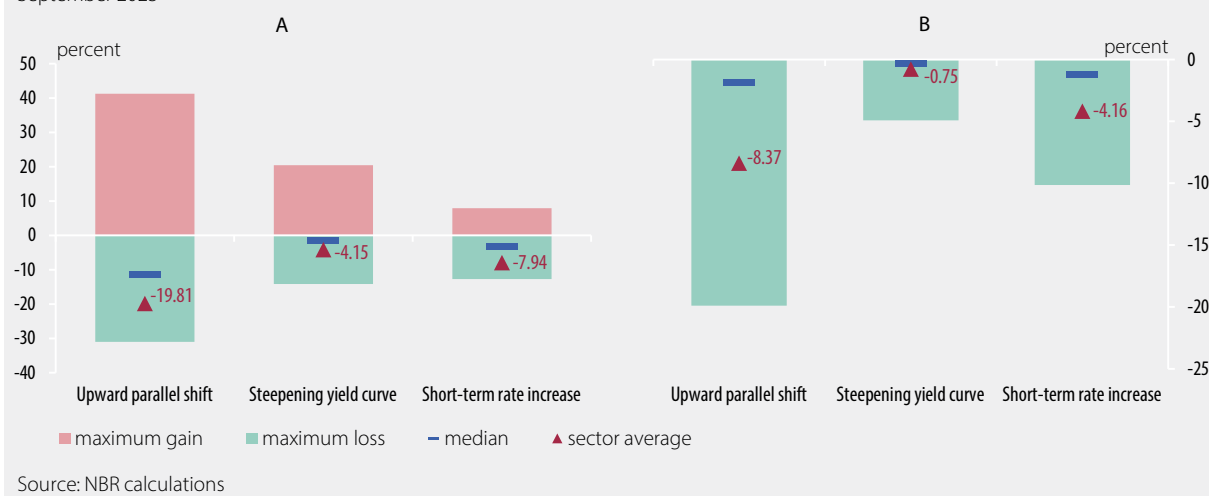
funds, as credit institutions did not trade loss-making securities, but rather held them to maturity. The positive impact on own funds stemming from the marking to market of securities measured at fair value through other comprehensive income amounted to lei 2.6 billion in the first three quarters of 2023, offsetting a part of the unrealised losses incurred in 2022, which stood at lei 5.4 billion.

In order to assess the potential impact of interest rate changes on the banking sector's government securities portfolio, an analysis was conducted by using three alternative scenarios in which a series of standardised shocks on the yield curve were simulated, according to the EBA Guidelines.

The potential impact generated only by the sensitivity of the government securities portfolio measured at fair value⁹⁶ to interest rate changes, *caeteris paribus*, would entail a reduction in the Tier 1 capital of the banking sector by up to 8.4 percent (Chart 3.11B). This is based on the most severe scenario (which envisages an upward parallel shift in the yield curves of leu- and euro-denominated instruments by 350 basis points and 200 basis points, respectively). At an individual level, the impact generated only by the portfolio of government securities measured at fair value ranges between -19.9 percent and 0 percent. Hence, all credit institutions would experience reductions in own funds as a result of the marking to market of government securities holdings.

⁹⁶ The analysis referred to the government securities issued by Romania's central government on the domestic market, held on own account in the portfolios of credit institutions, Romanian legal entities, as at 30 September 2023 and measured at fair value.

Chart 3.11. Distribution of the potential impact of changes in yield curve on Tier 1 capital, based on three scenarios, generated by the aggregate portfolio of interest rate-sensitive assets and liabilities⁹⁷ (A) or the portfolio of government securities measured at fair value (B), September 2023



The impact generated by the same scenarios on the aggregate portfolio of interest rate-sensitive assets and liabilities is equivalent to a decline of up to 19.8 percent in Tier 1 capital⁹⁸ (Chart 3.11A). The distribution of potential losses is highly heterogeneous across the scenarios and credit institutions. At an individual level, banks would witness (*caeteris paribus*) changes in Tier 1 capital ranging between -31 percent and 41.2 percent, with the impact varying depending on the balance sheet structure.

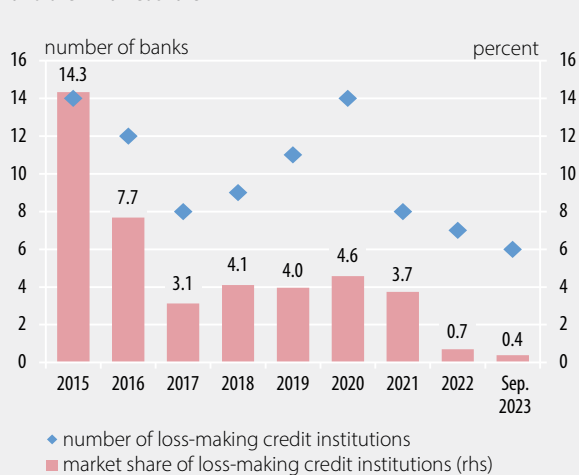
3.1.6. Profitability

At end-September 2023, the Romanian banking sector posted a net profit of lei 10.4 billion (up by 37.1 percent from the same year-ago period), on the back of higher operating profit and low net expected credit losses, given the still limited materialisation of credit risk. The annualised return on assets and return on equity improved from 2022 (ROA and ROE running at 1.9 percent and 21.2 percent respectively, versus 1.5 percent and 16.4 percent in December 2022), also exceeding European averages. Structural differences persist across institutions, depending on their size (large banks are significantly more profitable) and corporate governance.

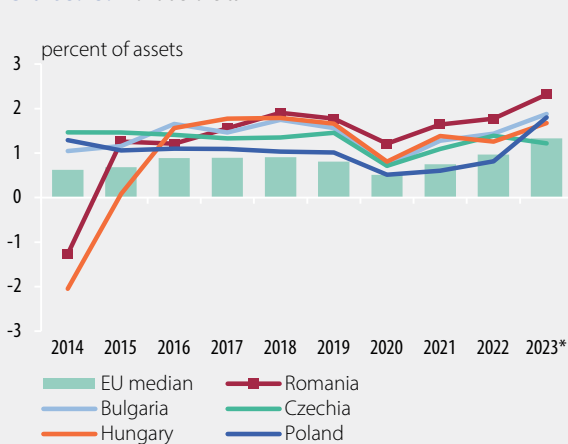
The number of loss-making credit institutions and their market share reached a low (Chart 3.12). Even though profitability indicators remain high, both banks' return on assets and return on equity are lower than the historical values recorded by companies in the real economy. Hence, the claim of excessive profitability in the banking sector does not hold up.

⁹⁷ The impact of interest rate hikes is estimated under the conservative assumption that interest rates on all financial assets and liabilities change depending on the shock applied. In fact, interest rates on a significant part of credit institutions' liabilities change only marginally (especially those on demand deposits), helping to reduce the impact or, in certain instances, to change the sign of the impact.

⁹⁸ The simulations took into account solely credit institutions, Romanian legal entities.

Chart 3.12. The number of the loss-making credit institutions and their market share


Source: NBR

Chart 3.13. Profit before tax


*) the value for the year 2023 was estimated using data as at 2023 Q1

Source: ECB (consolidated data)

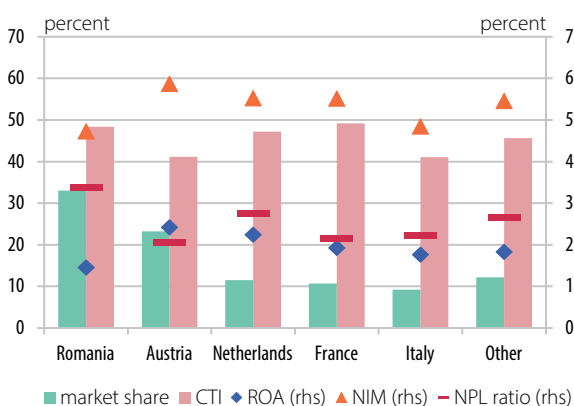
Strengthening profitability since 2015 (Chart 3.13) has contributed to enhancing credit institutions' solvency and resilience to challenges, such as those induced by the financial crisis, as well as by the current macroeconomic and financial framework. Profit distribution largely mirrors the composition of capital by country of origin of majority shareholders. Specifically, credit institutions with Austrian and Romanian majority capital account for about 55 percent of profit (Chart 3.14 and details in Box 4).

Box 4. Features of the Romanian banking sector by country of origin of majority shareholders

The Romanian banking sector currently comprises 32 banks, of which 24 credit institutions, Romanian legal entities, and eight foreign bank branches. The consolidation of the banking sector proceeded in the post-pandemic period and is expected to continue in the period ahead, amid the need to enhance operational efficiency. Three mergers and acquisitions were completed in recent years: the acquisition of Crédit Agricole Romania by Vista Bank (2021), the sale of the entire equity stake of Idea Bank to Banca Transilvania (2021) – Idea Bank remaining a stand-alone, digitally-oriented entity – and the completion of the merger between Romania's Export-Import Bank Eximbank S.A. and Banca Românească, rebranded as Exim Banca Românească (2022). At the same time, this year, the OTP Group announced its intention to exit the local market, claiming a limited growth potential via acquisitions. In October 2023, the merger of Unicredit Bank and Alpha Bank Romania and the acquisition of First Bank by Intesa Sanpaolo Bank Romania were announced.

The composition of the banking sector by country of origin of capital remained virtually stable over the past three years, with the influence of mergers and acquisitions completed during this period being rather contained (the cumulative market share of acquired banks standing below 2.5 percent). Credit institutions

Chart A. Features of banks in Romania by country of origin of majority shareholders (June 2023)

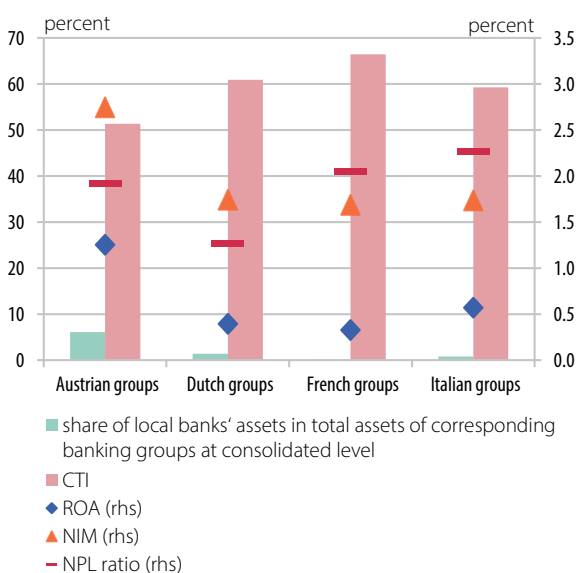


Notes: "Other" includes Greece, Hungary, Cyprus, Ireland, Luxembourg, Germany, Bulgaria, the United Kingdom and Poland (each country holds less than 3 percent of banks' net assets).

The NIM (net interest margin) and the NPL ratio (non-performing loan ratio) are calculated only for credit institutions, Romanian legal entities.

Source: NBR

Chart B. Contribution of local subsidiaries and branches to the consolidated assets of parent groups and features of major foreign banking groups active on the local market (December 2022)



Source: NBR, BankFocus, consolidated data

with Romanian capital prevail (33.0 percent of total net assets), followed by banks from Austria (23.2 percent), the Netherlands (11.5 percent), France (10.7 percent) and Italy (9.2 percent) (Chart A).

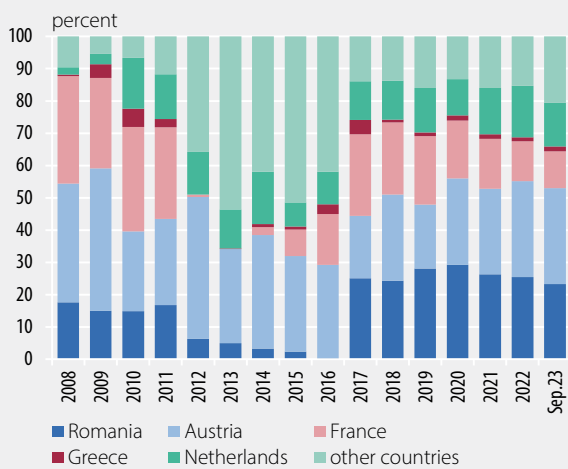
In terms of profitability and asset quality indicators, credit institutions with Austrian capital posted better financial results, on aggregate, than other groups of banks defined by the country of origin of capital. For these entities, the return on assets (ROA) reaches 2.4 percent, being associated with a higher net interest margin (NIM) of 5.9 percent. At the same time, the operational efficiency indicator, i.e. the cost-to-income (CTI) ratio of 41.1 percent, also shows a good control of operating expenses. Among the groups of banks under review, solvency, measured by the total capital ratio, is lower for the Austrian banks (22.2 percent), but close to the sector average (22.8 percent, June 2023). At the opposite end, banks with Romanian capital have a weaker financial performance than the sector average, while their solvency (23 percent) is better than that of the banking sector at aggregate level.

The importance of subsidiaries of foreign groups active in Romania and of foreign bank branches is relatively low at consolidated level for the home banking groups, as these groups perform an extensive cross-border activity. Assets of banks with Austrian capital operating in Romania account for less than 6.5 percent of total consolidated assets of their groups (Chart B). Turning to the Dutch-owned banks, this share is below 1.5 percent. Although the local subsidiaries of the French and Italian groups are relevant for the local banking market, the shares of their assets in those of the groups is small.

In terms of profitability at consolidated level, parent groups of banks with Austrian capital posted the highest returns on assets, followed by Italian and Dutch groups, while parent groups with French capital were less profitable (also due to the large

size). Despite the low importance of assets at parent group level, subsidiaries and branches of foreign banks active in Romania have significant contributions to the aggregate profits of the groups to which they belong, with NIMs and ROAs above group averages, but also higher operational efficiency. The parent groups under review have adequate capitalisation, albeit lower than their local subsidiaries.

Chart 3.14. Profit distribution by origin of share capital

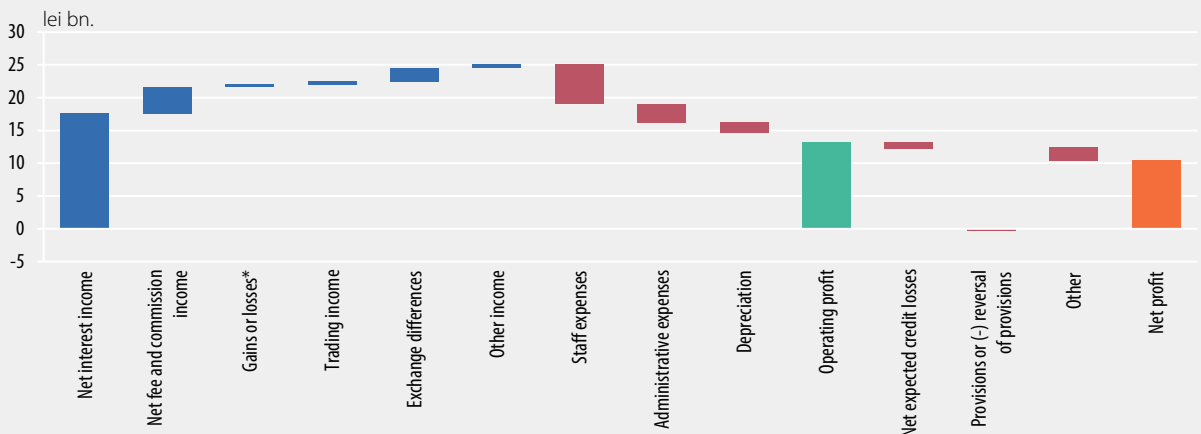


Source: NBR

Net interest income continued to be the main source of profitability, i.e. 70.2 percent of total operating income. This item strengthened its dominant position in total operating income due to its fast annual growth rate (+22.7 percent). This owed to the joint impact of several factors. On the one hand, interest income continued to rise at a swift pace (58 percent), driven primarily by the increase in income from financial assets, under the combined effect of higher interest rates and the further positive dynamics of credit to the private sector. On the other hand, the impact on net interest income was cushioned by the surge in interest expenses (149.1 percent), as the share of demand deposits in total funding declined and interest rates on time deposits increased.

Net fee and commission income held on to its second highest position in operating income, but its share went down (16.1 percent of operating income), witnessing an annual rise of 4.6 percent, while exchange rate differences further came in third (8 percent).

Chart 3.15. Profit breakdown as at September 2023



*) gains (+) or losses (-) on derecognition of financial assets and liabilities not measured at fair value through profit or loss – net

Source: NBR

The annual increase in operating expenses persisted (+9.9 percent), as a result of the pay rises associated with the inflationary environment and of the investments in digitalisation, partly offset by the ongoing decline in the number of bank units. Although the operating expenses-to-assets ratio (2.1 percent in June 2023, annualised values) exceeds the EU median (1.4 percent), as in most Central and Eastern European banking sectors⁹⁹, its level has improved by approximately 1 percentage point over

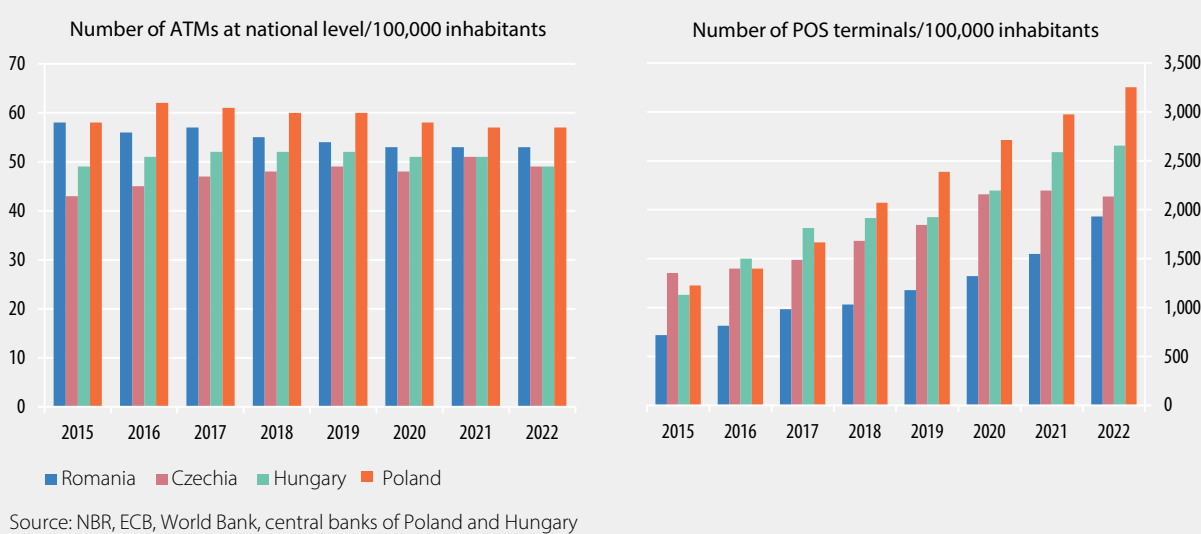
⁹⁹ Looking at the banking sectors in the region, the operating expenses-to-assets ratio, annualised on the basis of 2023 Q2 data, came in at 1.5 percent in Bulgaria, 1.1 percent in Czechia, 3.3 percent in Hungary, and 1.8 percent in Poland. Source: ECB, consolidated data, including for the national banking sector.

the past 10 years. Operational efficiency as measured by the cost-to-income ratio improved more visibly, posting a historical low of 47.6 percent, and falling within the EBA-defined low-risk bucket (<50 percent) and below the EU average (56.5 percent, June 2023).

Net annual expenses for impairment of financial assets (lei 1 billion) dropped by 29.3 percent year-on-year, with recoveries slightly lowering the level of provisions for new non-performing loans (Chart 3.15).

Enhanced operational efficiency must be achieved, from a macroprudential perspective, without affecting financial inclusion and access to finance. Although the number of ATMs per 100,000 inhabitants is comparable to that of other countries in the region, national specificities (such as the significant portion of rural population who predominantly use cash for payments) require a gradual transition to digital payment solutions, while maintaining adequate coverage across the territory. In parallel with the decline in the number of ATMs on the domestic front in recent years, there has been a fast increase in the number of POS terminals (mainly used in urban areas), a trend also visible across the countries in the region (Chart 3.16).

Chart 3.16. Evolution of the number of ATMs and POS terminals at regional level



Nevertheless, there are several challenges to the profitability of the banking sector, given the adoption of the fiscal package that includes an additional tax on credit institutions (Box 5), as well as the expectations of greater default risk for loans to the real sector, amid a higher debt service and lower capacity to improve operational efficiency for small-sized banks.

Box 5. Legislative measures concerning the additional taxation of the banking sector

The profitability of the European banking sectors has improved markedly after the start of the interest rate hiking cycle (end-2021), amid the increase in net interest income (Chart 3.15). Prompted by fiscal pressures, the government authorities of several EU countries (Italy, Spain, Lithuania and, more recently, Slovenia) have levied taxes on banks. The ECB publicly announced¹⁰⁰ that the Italian and Spanish governments' measures on the imposition of a tax on credit institutions could have negative effects on the banking sectors, as well as on the economy as a whole, given that such initiatives made it more difficult for banks to build up additional capital buffers, as their retained earnings would be reduced, making them less resilient to economic shocks.

According to the legislative acts effective in the countries that decided to impose additional taxes on banks, the applicability of such measures is limited in time, as they only serve specific purposes. In Italy, a recent amendment allows some flexibility as concerns the tax payment, the Italian banks having the alternative option of increasing their capital. However, if banks pay the tax, the funds will be used to support some debtors in paying mortgage loan instalments and reduce some taxes. This tax is one-off in nature, being applied solely for the 2023 financial year, and is capped at 0.1 percent of the value of the assets reported in the financial statements of the previous reporting year. The measure to cap the tax was taken as a result of the negative impact¹⁰¹ on the Italian banks' share prices in the capital market after the initial announcement of the measure, when no ceiling was set.

In Lithuania, the tax is intended to cover defence spending. In May 2023, a temporary windfall tax was levied on banks' profits for the financial years 2023 and 2024. The 60 percent tax is applied to the net interest income that exceeds by 50 percent the average net interest income of the previous four years.

At end-2022, the authorities in Spain decided to impose a temporary levy on banks whose gross earnings from interest, fees and commissions had exceeded EUR 800 million in 2019. The measure sets the levy for the 2022-2023 financial years; subsequently, the authorities will evaluate its maintenance on a permanent basis. Specifically, in 2023-2024, a tax of 4.8 percent of the net income from interest, fees and commissions for the preceding financial years will be collected.

Slovenia decided to impose a 0.2 percent tax on total bank assets, but the tax amount cannot be greater than 30 percent of a bank's annual net profit for the 2023-2027 period. However, banks can lower the tax amount by making contributions to a fund for mitigating the effects of floods that hit Slovenia in August 2023.

¹⁰⁰ https://www.ecb.europa.eu/pub/pdf/legal/ecb.con_2023_26.en.pdf

¹⁰¹ On 8 August 2023, the share index of Italian banks fell by 7.3 percent, while the Eurostoxx 600 Banks index dropped by 1.5 percent.

In line with these European initiatives, the authorities in Romania adopted Law No. 296 of 26 October 2023 on some fiscal and budgetary measures to ensure Romania's long-term financial sustainability, which sets forth a 2 percent additional tax on banks' turnover in 2024 and 2025. Starting in 2026, the tax will be cut to 1 percent. The additional levy would be charged irrespective of whether the bank makes a profit or not and is permanent in nature.

A simulation to measure the effects of the then draft law on the additional taxation of banks showed, according to the latest available financial statements, an annual impact of lei 1.1 billion for the Romanian banking sector as a whole (using a turnover equivalent to the annualised data for July 2023 and a 2 percent tax rate). This accounted for 1.5 percent of total own funds of credit institutions, Romanian legal entities.

The expected impact of taxes is the equivalent of 1.3 percent of banks' own funds in Italy, 1.7 percent in Slovenia and 0.6 percent in Spain. Although the measure imposed in Romania has a similar annual impact on own funds, the permanent nature of the domestic tax makes it more burdensome, given the uncertainty surrounding the capacity of some banks to make profit in the future as well. Moreover, the additional tax also applies to loss-making banks, which hold 0.4 percent of bank assets.

Although the additional tax on banks in Romania can generally be absorbed without causing financial difficulties, thanks to the profitability recorded over the past years, this tax raises several issues and has consequences in terms of financial stability. Fiscal unpredictability would rise, a situation that has frequently occurred over the last decade in relation to the banking sector, with possible negative implications for costs and the volume of financial intermediation (which is the lowest among EU countries). Mention should be made that, unlike other EU countries, the surcharge on banks in Romania is not warranted in terms of government expenditure to support the banking sector, the adequate capital level coming exclusively from private sources.

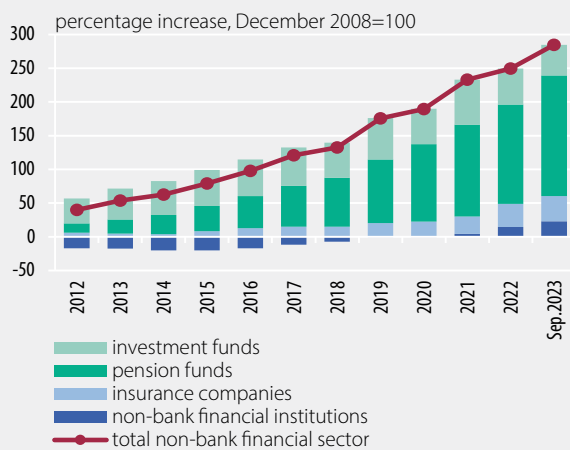
Moreover, the reforms to the regulatory framework (e.g., MREL requirements and the additional requirements that will result from the uniform implementation at EU level of the latest amendments to the Basel III framework) will require additional capital and efforts from banks in the years to come, while taxation could hamper the effectiveness of their implementation. A positive aspect is that the high profits of the Romanian banking sector were generally reinvested in the previous years, with beneficial effects on the banking sector stability, strengthening its capacity to support lending to the real sector and rolling over part of Romania's sovereign debt.

The permanent nature of the tax is at odds with the similar initiatives of other European countries that intend to implement the tax for a limited period of time and for a specific purpose. Moreover, the potential additional tax on banks in Romania in the medium run would have to be correlated with their profit making capacity.

3.2. Non-bank financial sector

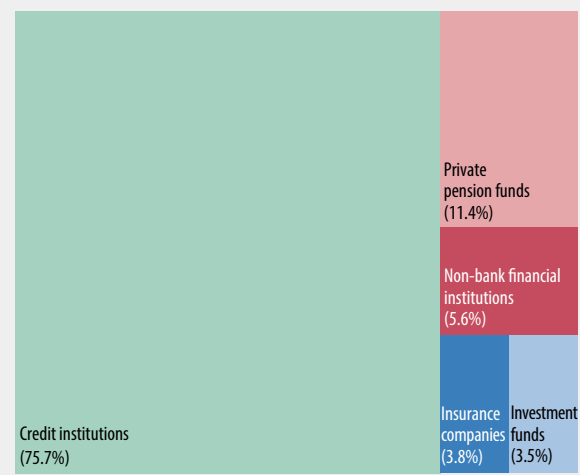
The non-bank financial sector’s assets continued to grow in the period from June 2012 to September 2023, with the largest contribution coming from private pension funds (Chart 3.17). Looking at its relevance, the non-bank financial sector accounts for almost a quarter of the financial system (Chart 3.18), showing an increase of 4.3 percentage points compared to a decade ago.

Chart 3.17. Asset dynamics of non-bank financial sector components



Source: NBR, FSA, NBR calculations

Chart 3.18. Financial sector structure by the share of assets held, 2023 Q3



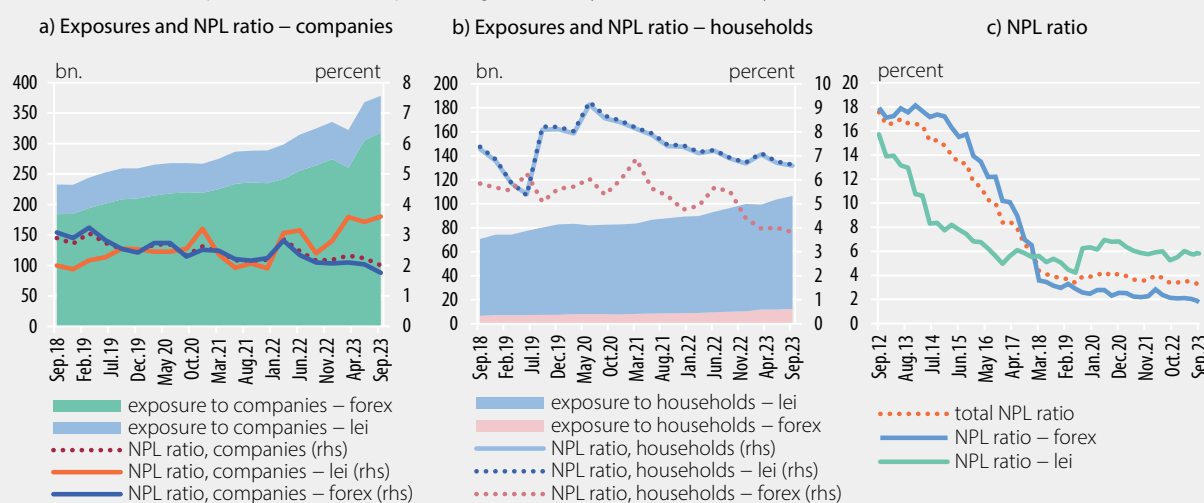
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3.2.1. Non-bank financial institutions

In September 2023, the assets of non-bank financial institutions (NBFIs) totalled approximately lei 60 billion, up 15 percent year on year. The share of NBFIs in the financial sector assets stands at 5.6 percent, on a slight rise versus September 2022, but lower than the average for the 2010-2020 period (6.4 percent).

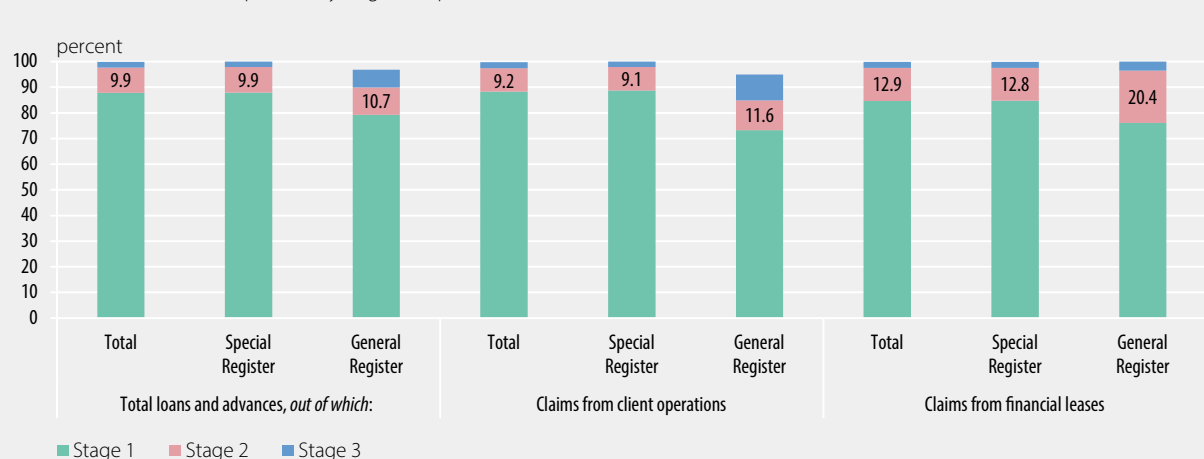
Despite their small size compared to bank credit, loans granted by NBFIs are a tool meant to increase financial inclusion via specific products, such as micro loans, targeting customers with a higher level of risk than those who access traditional financial products. The NBFIs loan portfolio expanded by 15 percent over the last period (September 2022 – September 2023) and its quality improved, the NPL ratio reaching 3.22 percent. For the non-financial corporations sector, the NPL ratio was 2 percent in 2023 Q3, and came in at 6.6 percent for loans to households (Chart 3.19).

In the non-bank financial sector, 180 NBFIs were recorded in the General Register at the time of drafting this *Report*, out of which 85 active NBFIs were listed in the Special Register. The loan portfolio quality is higher, at aggregate level, for the NBFIs listed

Chart 3.19. NBF loan portfolio and the non-performing loan ratio by sector and currency

Source: NBR, NBR calculations

in the Special Register. The breakdown by impairment stage according to IFRS 9¹⁰² in September 2023 shows that the share of loans to the real sector classified as Stage 2 of impairment in total loans, which is a signal category for the prospects of non-performance, stands at 9.9 percent for the NBFs listed in the Special Register, and at 10.7 percent for the remaining NBFs in the General Register (Chart 3.20). The coverage ratio of Stage 2 loans granted by the NBFs listed in the Special Register is 9.6 percent and 5.8 percent for the other NBFs.

Chart 3.20. NBF loan composition by stage of impairment under IFRS 9

Note: The General Register includes in this chart only those NBFs which are not listed in the Special Register.

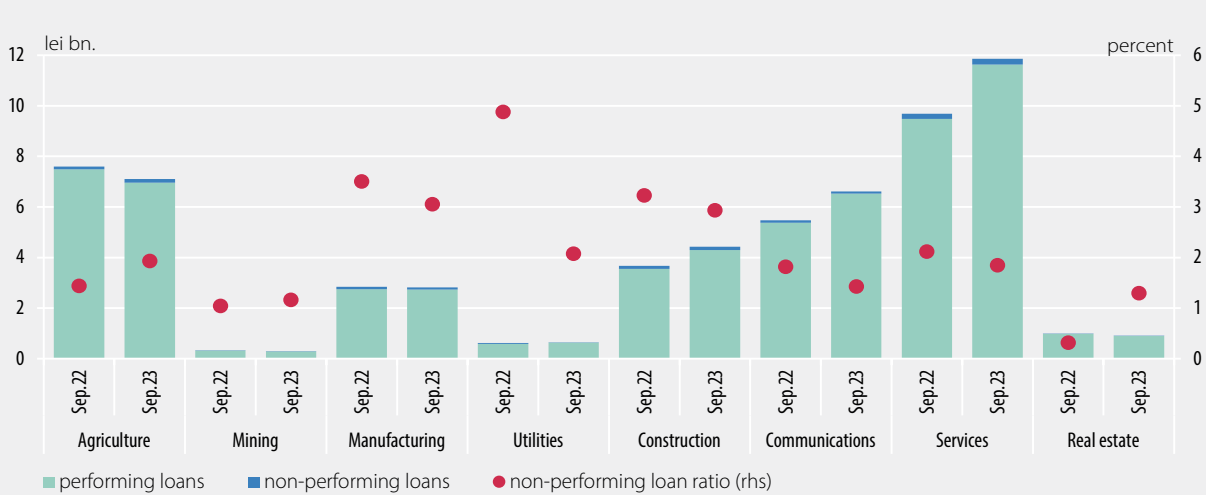
Source: NBR

Foreign currency-denominated loans further prevail among NBF exposures (68 percent of total in 2023 Q3, up by 3 percentage points against 2022 Q3),

¹⁰² As of March 2023, the NBFs report information about the breakdown of credit exposures and the related provisions by impairment stage according to IFRS 9, according to NBR Order No. 4/2022 approving the Methodological Norms on the drafting of regular financial statements at solo level, consistent with International Financial Reporting Standards, applicable to non-bank financial institutions for prudential oversight/supervision purposes.

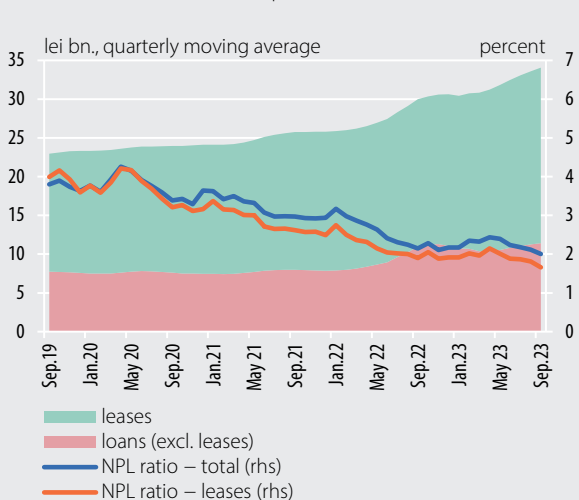
especially in the case of loans to non-financial corporations, where the former amount to 84 percent. Most companies with forex exposure are active in transport, agriculture, trade, construction of buildings, car rental and leasing, as well as real estate transactions, all these being fields where prices are typically expressed in euro. However, only 11 percent of these companies undertake export activities. The high share of foreign-currency exposure may be a source of risk to financial stability, and a potential depreciation of the domestic currency could lead to a reduction in borrowers' repayment capacity. The NPL ratio for foreign currency-denominated loans granted to both non-financial corporations and households has remained however below the total ratio since 2018, although in the past the differences in the repayment capacity of loans in lei versus foreign currency were substantial (Chart 3.19c).

Chart 3.21. NPL ratio for the corporate portfolio by business sector



Source: NBR, NBR calculations

Chart 3.22. NBFi loans to companies (leases vs. other loans)



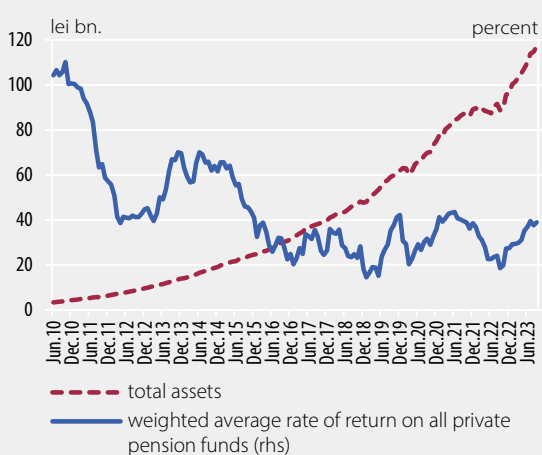
Source: NBR, NBR calculations

The breakdown of the corporate loan portfolio by borrower's business sector shows that loan quality is heterogeneous. Thus, higher NPL ratios, albeit improving over the past 12 months, are recorded for utilities, manufacturing and construction companies (Chart 3.21). As for agriculture, mining and real estate, the NPL ratio deteriorated, especially for the latter, i.e. a 1.3 percentage point worsening from 2022 Q3 to 2023 Q3. Leases continue to prevail among corporate loans granted by NBFIs (66.7 percent of total). Since 2020, the NPL ratio for this portfolio has remained below the aggregate level and on a downward trend, reaching 1.66 percent in September 2023 (against 2 percent for the rest of loans, Chart 3.22).

3.2.2. Private pension funds

As reflected in the previous *Reports*, private pension funds followed a steep upward trend between 2008 and 2023, becoming the second most important component of the Romanian financial sector. This sector's assets stood at lei 121.5 billion at end-2023 Q3, i.e. 32 percent higher versus the same year-ago period, and accounted for 11.4 percent of total assets of the financial sector in Romania (+1.8 percentage points against end-2022 Q3). Pillar II amounts are the bulk of the private pension funds, i.e. 96 percent.

Chart 3.23. Value of assets and rate of return on Pillar II private pension funds



Source: FSA

Compared to the prior *Report*, the weighted average rate of return on Pillar II privately managed pension funds increased by 1.4 percentage points March through September 2023, reaching 5.8 percent at end-September 2023 (Chart 3.23). This upswing is the result of the recalibration of the government securities portfolio consistent with the rising interest rates, and also of the positive developments in the stock market, given that shares accounted for about 25 percent of the Pillar II portfolio. The number of participants contributing to Pillar II was 4 million at end-September 2023, with 46.7 thousand persons (+1 percent) higher than in September 2022, whereas the average contribution per participant reached lei 266, from lei 234 in the same year-earlier period.

As for Pillar III, the employees in the national economy are becoming increasingly interested in voluntary private pensions. Thus, the assets of Pillar III private pension funds amounted to lei 4.3 billion in September 2023, up 31.3 percent year on year, and the number of contributors reached 320 thousand (+50 thousand persons compared to the same month last year), with an average contribution of lei 157 per participant. Furthermore, the weighted-average rate of return stood at 4.4 percent at end-September 2023, up by 1.3 percentage points from March 2023.

3.2.3. Investment funds

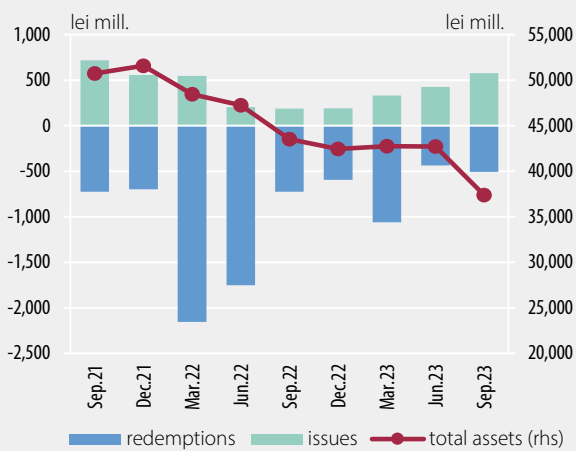
Investment funds are a part of the financial system that is still underdeveloped in Romania compared to the rest of Europe (their assets as a percentage of GDP standing at 2.8 percent versus 101 percent in the European Union in 2023 Q2). They can play an important part in the system by directing savings into productive investment and financing of the real economy, but may also pose risks during stressed market conditions. Growing concerns are expressed at European level¹⁰³ about the liquidity of euro area investment funds, their exposure to highly leveraged derivatives, and

¹⁰³ "Issues note on policy options to address risks in corporate debt and real estate investment funds from a financial stability perspective", ESRB, September 2023; *NBFI Monitor*, ESRB, June 2023.

about the risks stemming from funds exposed to corporate bonds and the real estate market (low-liquidity assets by nature and likely to become even less liquid in stressful situations). Domestically, these risks to financial stability are still low, due to the sector’s weak relevance, but also to low exposures to real estate investments or financial derivatives (real estate investment funds hold 0.3 percent of total investment fund assets, while financial derivatives account for merely 0.04 percent of investment fund assets at aggregate level in 2023 Q3).

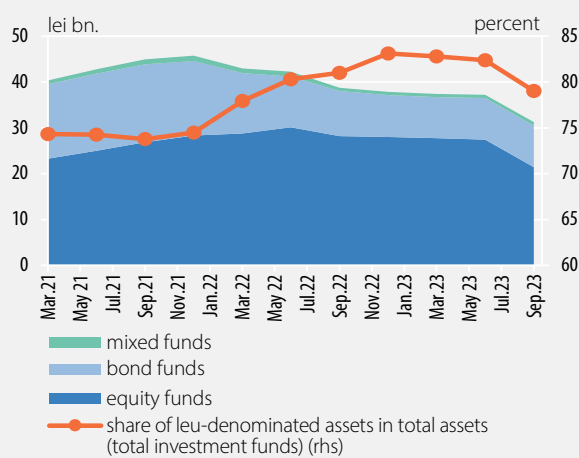
In Romania, amid the macroeconomic and geopolitical developments likely to reduce the value of assets and to step up the pace of customers’ redemptions¹⁰⁴, investment fund assets continued to decline in annual terms (down 15.2 percent in 2023 Q3, reaching approximately lei 37 billion). Moreover, compared to the other sectors, their share in total financial sector assets has seen a downward trend over the past 10 years (from 7.2 percent in 2013 Q3 to 3.5 percent in 2023 Q3). Mention should be made of the lei 8 billion decrease (i.e. by about 60 percent) in net assets of Fondul Proprietatea, an alternative investment fund, and the 74 percent drop in the net asset value (NAV) following the special dividends granted to shareholders subsequent to Hidroelectrica’s successful IPO, causing a faster rate of decline in assets as of September 2023.

Chart 3.24. Total assets, issues and redemptions of investment fund units/shares



Source: NBR

Chart 3.25. Assets by fund type and share of leu-denominated investments



Source: NBR

Net subscriptions returned to positive territory after two years of negative values, when stock redemptions were much higher than issues (Chart 3.24). Looking at the breakdown, open-end equity funds reported more issues than redemptions of fund units in the current year, in contrast to open-end bond funds (lei 36 million versus lei -46 million in 2023 Q3). The assets of open-end funds¹⁰⁵, accounting for 44 percent of total investment funds, fell by 17 percent (quarterly average between 2022 Q3 and 2023 Q3). A look at the breakdown shows that open-end bond fund assets declined by 25 percent, while open-end equity fund and multi-asset (mixed) fund

¹⁰⁴ Credit risk associated with investment funds in the euro area is specified as well, *NBFI Monitor*, June 2023.

¹⁰⁵ Open-end funds are also referred to as UCITS (Undertakings for Collective Investment in Transferable Securities).

assets increased by 20 percent and 13 percent respectively. In an uncertainty-ridden economic environment, the correlation between the liquidity of open-end funds' assets and their redemption profiles becomes more important.

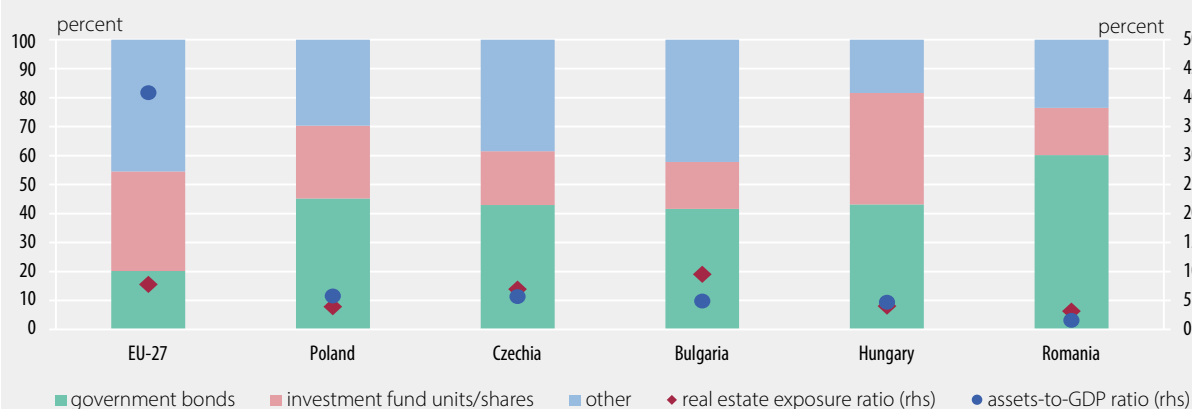
Closed-end funds, of which 92 percent were equity funds (60 percent of total investment fund assets), saw an annual contraction in assets of approximately 10 percent.

3.2.4. Insurance sector

The insurance sector further increased the value of its assets January through September, reaching lei 40.1 billion at the end of 2023 Q3 (up 11.8 percent from 2022 Q3). This segment is the second smallest in size, accounting for 3.8 percent of total assets of the financial sector.

The insurance sector ranks last in both the region and the EU in terms of the assets-to-GDP ratio (1.6 percent), which is about 3 percentage points lower than in Hungary (4.7 percent), the last but one country. Moreover, Romania lags well behind the EU-wide average of 40.1 percent of GDP (Chart 3.26).

Chart 3.26. Asset composition, assets-to-GDP ratio and real estate exposure ratio, regional comparisons (2023 Q1)



Notes: "Other" includes corporate bonds, shares, currency and deposits, and other investments. The real estate exposure ratio was calculated as (direct, indirect and overall) exposure to the real estate sector/total assets.

Source: EIOPA, Eurostat, NBR calculations

As for the asset composition, the insurers' portfolio consists mostly of government bonds and investment fund shares, on 60 percent and 16 percent respectively. The composition is relatively different from Romania's regional peers, where government bonds account for less than 50 percent of the portfolio, whereas shares and corporate bonds taken together make up more than 20 percent of the portfolio (except Hungary, where government bonds and investment fund shares constitute more than 80 percent of the portfolio). As in Romania, investment fund shares hold a significant weight in the insurers' portfolios both in the countries in the region and EU-wide (more than 15 percent and 35 percent respectively).

Insurance undertakings have little exposure to the real estate sector and are less vulnerable to developments in this sector, in a context marked by concerns about the commercial real estate sector in particular. The real estate exposure ratio for the insurance sector is below the EU average of 7.7 percent of total assets in Romania as well as in Poland, Hungary and Czechia, while Bulgaria is the only country in the region with an above-average value of 9.5 percent of total assets.

Gross premiums written collected by insurance companies in Romania amounted to lei 9.1 billion in 2023 H1, rising at an annual pace of 3.7 percent¹⁰⁶. The insurance market in Romania further relies mostly on non-life products, as 83 percent of gross premiums written originated in this segment in 2023 H1. The largest weights were held by compulsory insurance policies, namely motor third-party liability (RCA) and natural disaster insurance policies (PAD), as well as other insurance policies for land vehicles. These categories accounted for approximately 87 percent of total gross premiums written in non-life insurance.

The sector's Solvency Capital Requirement (SCR) ratio stayed above one, i.e. 1.86 at the end of 2023 Q2, up from 1.58 in the same year-ago period, yet far from the EU average¹⁰⁷ of 2.6. At the same time, the Minimum Capital Requirement (MCR) ratio came in at 4.3 in 2023 Q2, up from 3.6 in 2022 Q2, but still well below the European average of 7.2.

In the context of growing concerns surrounding climate risk across Europe, EIOPA included in its June 2023 *Financial Stability Report*¹⁰⁸ an assessment of river flood risk to the insurance sector in Europe (a significant physical risk for Romania as well). Specifically, according to estimations, the worst-case scenario envisages for the 2070-2090 period that the losses caused by flooding to EEA countries would be 249 percent higher than in the baseline scenario. For Romania, the losses expected under the same scenario would rise by 50 to 100 percent compared to the baseline scenario.

¹⁰⁶ Source: the FSA Report entitled "Evoluția pieței de asigurări în semestrul I 2023", available at <https://asfromania.ro/uploads/articole/attachments/651d5e47db04f838720059.pdf>

¹⁰⁷ The European average covers the countries in the European Economic Area (EU Member States and the countries participating in the European Free Trade Association, namely Iceland, Liechtenstein, Norway and Switzerland).

¹⁰⁸ https://www.eiopa.europa.eu/publications/financial-stability-report-june-2023_en

4. FINANCIAL SYSTEM INFRASTRUCTURE – STABILITY OF PAYMENT AND SECURITIES SETTLEMENT SYSTEMS¹⁰⁹

During the period under review, all payment and securities settlement systems in Romania continued to function smoothly, without major operational incidents.

The National Bank of Romania has been steadily monitoring financial market infrastructures in order to ensure their effective and safe operation with a view to maintaining financial stability. This implies, *inter alia*, monitoring and testing the action plans where little likely but predictable risks materialise. The oversight by the National Bank of Romania is based on the international oversight standards set out in the Principles for financial market infrastructures and implemented by way of NBR Regulation No. 3/2018.

In the first half of 2023, a comprehensive assessment of the securities settlement system RoClear, operated by the Central Depository, was finalised against compliance with the requirements of NBR Regulation No. 3/2018. The results of the assessment showed that RoClear largely met the requirements of NBR Regulation No. 3/2018, with a number of measures being currently implemented to improve the resilience of this system, especially its cyber security.

4.1. Stability of payment systems

Functioning of ReGIS¹¹⁰

In 2023 H1, ReGIS system rules remained unchanged.

Looking at the system activity, the value of processed payments increased to lei 11,401 billion compared to lei 8,350 billion recorded in the latter part of 2022. In terms of volume, the number of transfer orders came in at 4.89 million compared to 5.20 million in 2022 H2.

¹⁰⁹ This chapter was prepared by the Financial Market Infrastructures and Payments Oversight Department.

¹¹⁰ ReGIS is the most important payment system in Romania, ensuring the real-time gross final settlement of participants' transfer orders and of net positions arising from ancillary systems.

The maximum number of payment instructions recorded in one day stood at 60,450 on 25 January 2023 and the system faced no processing capacity problems¹¹¹.

In the mentioned period, the average settlement ratio¹¹² stood at 99.98 percent, reflecting a good settlement discipline. Furthermore, the average monthly availability ratio¹¹³ came in at 100 percent, indicating that the system, which functions on the technical platform operated by the central bank, was fully reliable.

The probability for the liquidity risk to materialise remains low, as reflected by the absence of gridlock situations in the waiting queues. The number of intraday loans required by the participants to facilitate payments in ReGIS decreased from 728 in 2022 H2 to 146 in the period under review.

The number of participants in ReGIS amounted to 38 entities, including ancillary systems.

In terms of the transaction volume, the participants' concentration ratio¹¹⁴ picked up very slightly from 61.64 percent to 61.70 percent, while in terms of value it rose from 61.65 percent to 61.72 percent, which shows a further low likelihood for the contagion risk to materialise in the system.

Functioning of SENT¹¹⁵

In the period under analysis the system rules remained unchanged.

The monthly availability ratio of SENT, operated by TRANSFOND S.A., stood at 100 percent¹¹⁶ for the multiple payment component in lei and at 100 percent for the multiple payment component in euro, which proves the smooth functioning of this system.

In 2023 H1, the value of netted orders in lei in SENT totalled lei 279 billion compared to lei 310 billion in 2022 H2. The number of transactions in lei amounted to 81.54 million transactions versus 87.16 million transactions in the previous six-month period.

¹¹¹ According to the oversight standards in the field, ReGIS is designed to take in, within one hour, 40 percent of the estimated maximum volume of payments per day in order to process in a short period of time a large volume of payments left unprocessed in the aftermath of a major, lengthy incident (including a cyber incident). At the same time, the processing power of ReGIS servers is scalable, so as to quickly accommodate sustained increases in the volume of payments.

¹¹² Calculated as a ratio of transfer orders settled in the system to the accepted transfer orders.

¹¹³ The availability ratio is defined as a ratio of the actual operating time to the scheduled operating time, during the system's normal operating hours.

¹¹⁴ Calculated as the sum of the five largest individual market shares in terms of the value or volume of settled transfer orders. The alert threshold stands at 80 percent, with higher values indicating a significant probability for the systemic risk to materialise.

¹¹⁵ SENT is an electronic system for the multilateral netting of retail interbank payments among participants, during several daily sessions.

¹¹⁶ The system rules set forth a minimum accepted limit of 99 percent.

The value of netted orders in euro edged down from EUR 2.088 billion to EUR 1.996 billion, while the number of payment transactions in euro went up from 282.8 thousand to 315.1 thousand in 2023 H1.

The settlement ratio¹¹⁷ of leu-denominated payment instructions remained elevated, i.e. 99.61 percent. This level indicates a good settlement discipline. The netting ratio¹¹⁸ rose slightly, from 20.73 percent to 21.65 percent, which shows a high efficiency of leu-denominated liquidity utilisation, without notable risks¹¹⁹.

The settlement ratio of EUR-denominated payment instructions remained at 100 percent, which indicates a further very strong payment discipline.

The number of participants in SENT – the lei component remained flat, i.e. 37 institutions.

In terms of the volume of netted leu-denominated transfer orders, the participants' concentration ratio went up slightly from 62.59 percent to 63.44 percent, while in terms of value it fell from 61.96 percent to 60.64 percent, which shows a low likelihood for the contagion risk to materialise in the SENT system.

4.2. Securities settlement systems

Functioning of SaFIR

In the period under analysis the system rules remained unchanged.

The government securities registration and settlement system functioned optimally, the availability ratio¹²⁰ standing at 100 percent.

In the period under review, on aggregate, the value of leu-denominated securities recorded in SaFIR followed an upward trend, rising to lei 316.3 billion from lei 275.5 billion in the previous six-month period.

The number of transactions dropped from 20.3 thousand to 19.5 thousand¹²¹. At the same time, the value of transactions fell from lei 935 billion to lei 456.7 billion.

The number of EUR-denominated transactions posted an increase from 273 in 2022 H2 to 368 in 2023 H1. Also, in terms of value, EUR-denominated transactions climbed slightly from 1.46 billion in 2022 H2 to 1.76 billion in 2023 H1.

¹¹⁷ Calculated as a ratio of the value of netted-settled transfer orders to the value of processed transfer orders.

¹¹⁸ Calculated as a ratio of net debit positions to the value of netted transfer orders. The lower the netting ratio, the stronger the effect of netting.

¹¹⁹ The alert threshold is represented by a netting ratio below 10 percent, coupled with large-value net debit positions, which can pose systemic risks if a critical participant does not participate in the settlement.

¹²⁰ The availability ratio is defined as a ratio of the actual operating time to the scheduled operating time, during the system's normal operating hours.

¹²¹ The system's processing capacity allows for much larger volumes of settled instructions.

Free-of-payment transfers expanded in terms of volume, i.e. from 2,278 in 2022 H2 to 3,166 in 2023 H1.

The settlement ratios¹²² continued to be high, standing at 99.96 percent for transactions in lei and at 98.64 percent for transactions in euro, which indicates a very good settlement discipline.

The number of participants in SaFIR amounted to 32 institutions, of which: 3 central depositories, the National Bank of Romania, the Ministry of Finance and the remaining were credit institutions or branches of credit institutions.

Functioning of RoClear

During the period under review, the Central Depository, the administrator of the securities settlement system RoClear, obtained the NBR's approval to make several amendments to the system rules. These amendments envisaged mainly finalising the operationalisation of the Bank Deposit Guarantee Fund and implementing within the Central Depository, the principle approved by the NBR in the NBR Board meeting of 2 February 2022 on the exemption of Romania-based brokers from making variable contributions to the Bank Deposit Guarantee Fund, should they be able to pre-validate securities and funds for net settlement transactions and provide proof of it at any time to the Central Depository.

4.3. Operational and security incidents affecting payment service providers

In 2023 H1, 10 major operational incidents were reported to the central bank by 5 payment services providers (PSPs). These major incidents have affected the availability and/or authenticity of some payment services relating to: (i) card payment transactions and cash withdrawals from a payment account, (ii) credit transfer payment transactions and (iii) the issuance and acceptance of payment transactions.

These incidents were caused by internal and other issues that payment services providers (PSPs) and technical service providers (TSPs) faced, such as: human errors, technical issues facing TSPs and power outages, as well as disruptions coming from technical components used in the process of payment services provision to users (equipment and application failure).

The PSPs are able to adequately manage the operational and security risks to the payment services they provide. The central bank monitors on a continuous basis the security measures applied by payment services providers in order to manage operational and security risks, including monitoring and alert mechanisms¹²³, and their adjustment based on the expertise acquired and the changes in threats and specific risks to the payments services provided.

¹²² Calculated as a ratio of the value of netted-settled transfer orders to the value of processed transfer orders.

¹²³ Early alert mechanisms to enable early detection of operational and security ICT incidents.

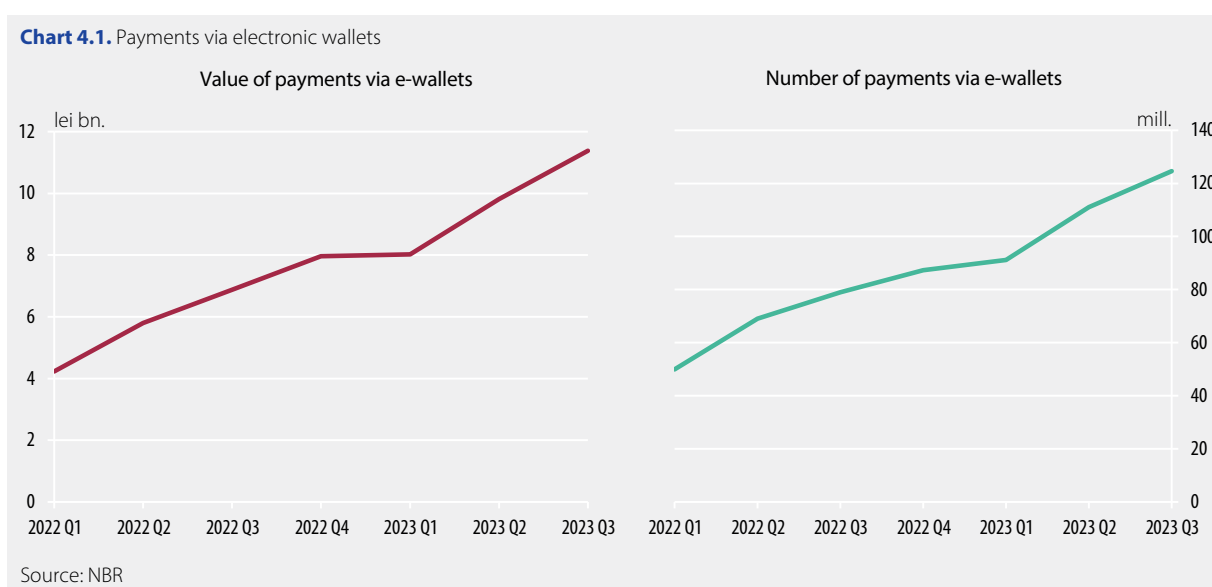
4.4. Technological innovation in payment services

Looking at 2023 H1, in the context of the ongoing monitoring of innovative solutions developed in the field of payment services and payment instruments, the NBR noted that entities were further interested in developing innovative solutions, based on both the analysis of applications received through the Fintech Innovation Hub and the assessment related to the prior consultation process in the case of entities seeking authorisation as a payment institution, an account information service provider or as an electronic money institution.

Against this background, technological developments advance at a fast speed supporting digitalisation across authorised entities, which has contributed to the development of innovative payment solutions and an increased efficiency of the internal processes of payment services providers, thus leading to easier access for customers to digital services. A number of innovative solutions have also been applied by regulatory authorities to make the ongoing monitoring of supervised entities more efficient.

Three new applications were sent through Fintech Innovation Hub, with the number of entities having submitted an application since the launch of this monitoring tool amounting to a total of 62.

Current payment trends are about diversifying banking products and services provided in an innovative, simple, fast, efficient and secure way. Thus, electronic/digital wallets¹²⁴ are increasingly used as payment solutions, especially with a greater preference for the solutions developed by BigTech (Apple Pay and Google Pay). Based on the information reported by credit institutions, in the reference period, payments via e-wallets increased by 44.5 percent in terms of volume and by 43 percent in terms of value compared to the beginning of 2022 (Chart 4.1).



¹²⁴ An electronic/digital wallet allows users to initiate card-based payment transactions (at physical terminals and online) by storing related secured identification data.

In this context, reference can also be made to the risks associated with the use of digital wallets in Romania, where some technologies embedded in mobile devices do not allow for electronic wallets developed by other companies to be installed on the same devices, thus causing dependence on a particular payment solution.

The NBR remains committed to projects that aim to develop the payments market by supporting innovation, as well as enhancing payment security. In this context, the NBR:

- a) has continued to investigate the opportunity to implement a regulatory sandbox at the NBR level by examining and analysing the interest of Romania-based Fintechs in the launch of such an instrument and the related market benefits;
- b) is an active supporter of the latest and most secure payment and settlement technologies, while ensuring an effective monitoring of technological progress and market developments in the field of payment services, with a view to developing secure and efficient services.

The NBR also assesses the complaints submitted through the dedicated channels made available to payment services users (PSUs), also with a view to identifying new fraud scenarios in order to inform payment services providers (PSPs) thereof and alert the PSUs about them; such information is available on the NBR's website at <http://www.bnr.ro/Fraude-21235.aspx> (Romanian only).

Among the most common fraud scenarios are:

a) Phishing

Third parties send payment services users an e-mail impersonating the bank, the fraudster including visual identity elements that the customer recognises as specific to the bank in question. The message sent by fraudsters may take several forms to approach the victim, but the most common form is when the victim is informed that the bank has blocked or is about to block their payment instrument soon (e.g. card or internet/mobile banking application). Therefore, in order to avoid this situation, they are asked to immediately update their personal data by clicking on a link or a button in the message; they are thus redirected to a fake website page with similar features as their bank's website, but which is actually a clone page created by attackers. On that page the victim is asked to provide sensitive data for an alleged verification, update or authentication (e.g. card number, name of card holder, expiry date, CVV/CVC code, 3D Secure Code¹, card PIN codes, etc.) which are then used by fraudsters to initiate payment transactions and/or link the payment card to electronic wallets (e.g. Apple Pay, Google Pay).

This type of fraud was also encountered on the OLX platform, in the sense that fraudsters would request the information indicated above under the pretext of using it for the payment of the products traded on the platform, which would end up invariably in the initiation of payment transactions and/or linking the payment card to electronic wallets.

Similarly, a version derived from the above mentioned ones refers to fraudsters aiming to gain access to the PSU's internet-banking or mobile-banking applications by activating the authentication/authorisation token (software) on their mobile phone.

b) Trading in crypto-assets

Third parties contact payment services users claiming to be representatives of a known crypto-asset platform and succeed in prompting them to provide sensitive payment data (card data, passwords for payment applications, OTP codes received via SMS, etc.) or in installing on the victim's phone applications that enable the third parties to remotely access their device. This takes place under the false pretences of the victim receiving large gains from small investments or withdrawing the trading profits from the crypto-asset platform.

5. FINANCIAL STABILITY, REGULATORY FRAMEWORK AND MACROPRUDENTIAL POLICIES

5.1. Capital buffers applicable to credit institutions, Romanian legal entities

In what concerns the macroprudential policy stance in the period ahead, the ECB¹²⁵ highlights that it should focus on implementing measures for preserving the resilience of banks and borrowers. Conceptually, the main factors that could guide the potential decisions to reduce/release capital buffers relate to (i) expectations of tightening of bank credit supply due to capital constraints and (ii) the anticipated likelihood of widespread materialisation of bank losses. According to ECB analyses, neither of these conditions is currently fulfilled, the deceleration in lending growth over the past months being ascribed to low credit demand, rather than to capital constraints. As regards the increased likelihood of widespread materialisation of bank losses, data further show a good quality of bank assets. Another challenge to the macro and microprudential policy approached by the ECB¹²⁶ refers to a rise in the number of liquidity management issues that can quickly become systemic risks. The relevant examples include (i) developments in the UK sovereign bond market last autumn, when the falls in bond prices resulted in forced selling by non-bank financial intermediaries and (ii) situations occurred earlier this year, namely very fast deposit withdrawals that caused bank failures in the US, or the forced merger of a global systemically important Swiss bank. Thus, the macroprudential monitoring of liquidity issues that can spread across the financial system as a whole becomes necessary as well, which will help increase the relevance of future assessments. In Romania, recent analyses show the national banking sector has an adequate level of liquidity indicators.

The tendency to strengthen macroprudential policy is visible in almost all European countries, the toolkit in use aiming primarily to calibrate the countercyclical capital buffer (CCyB) or the systemic risk buffer (SyRB), particularly through a targeted approach to risks in the residential real estate sector. Specifically, EU Member States that decided to lower or waive CCyB rates to support the economy at the onset of the pandemic have subsequently chosen to strengthen macroprudential policy by replenishing the previously released buffers, in some cases at rates higher than those set before the pandemic. To these added countries (e.g. Germany) that applied a positive CCyB rate for the first time since the buffer was introduced in the European

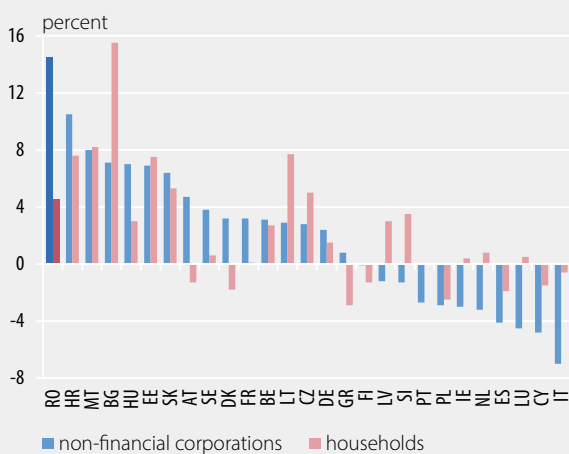
¹²⁵ Implications for macroprudential policy as the financial cycle turns.

¹²⁶ Macroprudential policy and research: learning from challenging times.

legislation. Moreover, a new trend in the countercyclical capital buffer usability has emerged at European level, as some countries (Lithuania, Estonia, Sweden and United Kingdom) opted for implementing a positive neutral CCyB rate. This buffer ensures a larger room for manoeuvre to the national authorities with macroprudential responsibilities, as it acts as a safety net that can be used in the event of an adverse shock materialising, which could destabilise the financial system. According to ESRB data, 19 Member States¹²⁷ implement or have announced they will implement a positive CCyB rate¹²⁸ in the period ahead (2023-2024), in some cases even at the highest standard rate (2.5 percent¹²⁹) stipulated in CRD V.

On the domestic front, following the assessment of lending developments, the prudential situation of credit institutions and macroeconomic conditions, the central bank was recommended to keep in place the measure to set the countercyclical buffer rate at 1 percent, as of 23 October 2023¹³⁰. The decision is in line with the adopted measures, according to which credit institutions should have adequate capital reserves that can be used in the event of systemic risks materialising. In accordance with European practices, this buffer should be built up when circumstances allow for the strengthening of the capital base – in periods when increasing capital requirements has a minimum impact, due *inter alia* to the swift rise in lending –, and will be subsequently released in order to support lending during crises, contributing to the slowdown in economic contraction.

Chart 5.1. Annual growth rates of loans to households and non-financial corporations (August 2023, stocks)



Source: European Central Bank, Statistical Data Warehouse

ECB data for August 2023 show that Romania recorded the strongest increase in the volume of loans to non-financial corporations among EU Member States (a situation that has remained unchanged since December 2022), ahead of Hungary and Croatia. Looking at the growth rate of household loans, Romania ranks ninth among the EU countries (Chart 5.1).

The latest exercise to identify systemically important institutions within the Romanian banking sector, carried out in 2023 on the basis of information having 31 December 2022 as a reference date, showed that the nine banks identified in the previous round (Chart 5.2) remained on the list of systemically important institutions. As for the other systemically important institutions (O-SII) buffer¹³¹,

the rate applicable starting with 1 January 2024 is the same as that applied in 2023, except for CEC Bank, whose systemic importance has increased (the applicable

¹²⁷ Bulgaria, Croatia, Cyprus, Czechia, Denmark, Estonia, France, Germany, Hungary, Iceland, Ireland, Lithuania, Luxembourg, the Netherlands, Norway, Romania, Slovakia, Slovenia and Sweden.

¹²⁸ In the past two years, Czechia was the only country that decided to lower the CCyB rate, after it had previously increased gradually the buffer rate to the maximum standard level.

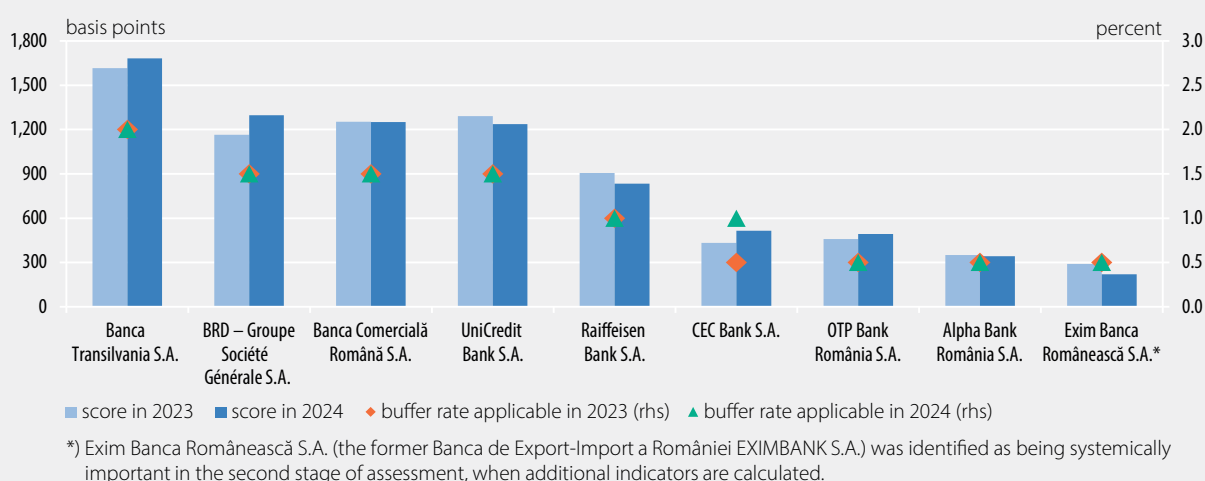
¹²⁹ Denmark, Iceland, Norway.

¹³⁰ NCMO Recommendation No. R/3/2023 on the countercyclical capital buffer in Romania.

¹³¹ NCMO Recommendation No. R/4/2023 on the capital buffer for other systemically important institutions in Romania.

O-SII buffer rate being 1 percent of total risk-weighted exposures as of 1 January 2024, as compared to 0.5 percent in 2023).

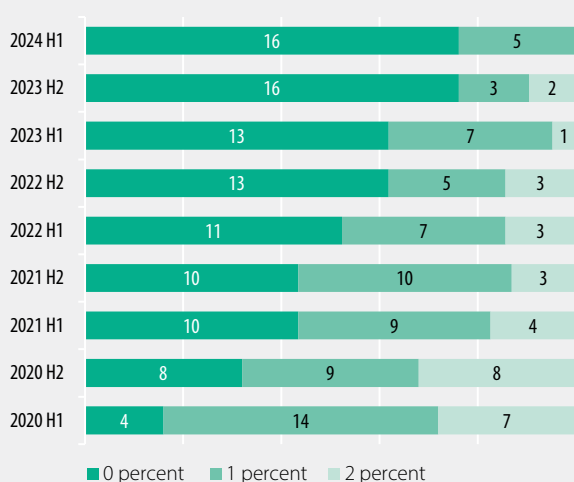
Chart 5.2. O-SII scores and buffer rates applicable in 2023 and 2024



Source: NBR

The O-SIIs play a decisive role for the Romanian banking sector, as shown by the following indicators (at 31 December 2022): (i) they hold 79.5 percent of bank assets; (ii) they provide a significant part of financial services to the real economy, i.e. 79.2 percent of loans in stock, 79.1 percent of deposits taken, and 64.1 percent of payments made; (iii) in terms of complexity, they conduct 89.9 percent of transactions in OTC derivatives, they invest 77.3 percent of foreign assets and raise 75.3 percent of foreign liabilities, while (iv) in terms of interconnectedness with the other undertakings conducting financial activities, they provide 70.1 percent of intra-financial assets, they use 73.2 percent of intra-financial liabilities and hold 98.1 percent of bonds issued.

Chart 5.3. Number of credit institutions by SyRB rate



Source: NBR

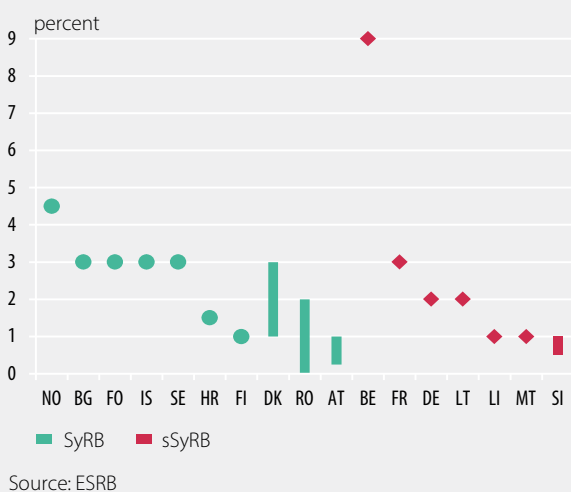
The systemic risk buffer (SyRB) is applied to credit institutions, Romanian legal entities, in order to support the adequate credit risk management. It is recalculated twice a year, based on the performance of asset quality indicators, namely the NPL ratio and the NPL coverage by provisions. For the first half of 2024, banks continued to migrate to lower SyRB rates (Chart 5.3).

The steady decline in buffer rates, since it was implemented in 2018 and up to present, underlines the effectiveness of using the macroprudential instrument. Specifically, the NPL ratio followed a downward trend (the average for the Romanian banking sector went down from 4.71 percent in December 2018 to 2.58 percent in June 2023),

entering the low-risk bucket, according to the EBA-defined thresholds (below 3 percent). Moreover, Romania has one of the highest coverage ratios in the EU (the indicator calculated for the Romanian banking sector remained in the EBA-defined best prudential range, going up from 58.58 percent in December 2018 to 63.48 percent in June 2023, well above the EU average of 42.9 percent in June 2023).

Once the CRD V legislative package was adopted, the macroprudential policy regulatory framework underwent a series of changes. Specifically, the SyRB buffer became more flexible in addressing systemic risks, as it can be applied directly to sectoral exposures. According to this framework, a systemic risk buffer may be applied to total exposures combined with sectoral exposures, third country exposures and all exposures or the sectoral exposures in other Member States.

Chart 5.4. SyRB and sSyRB rates in EEA Member States in October 2023



Up to now, seven Member States (Belgium, France, Germany, Malta, Liechtenstein, Lithuania and Slovenia) decided to implement a sectoral systemic risk buffer (sSyRB). There is homogeneity in the purpose of adopting the sectoral instrument, which is to enhance the banking sector resilience to systemic risks that may arise from real estate markets. The rates applicable to sectoral exposures range between 0.5 percent and 9 percent (Chart 5.4).

EU Member States may impose a countercyclical capital buffer on the material exposures to third countries, in order to protect national banking sectors against the risks generated by excessive credit growth in these countries. Following the latest annual assessments, the National Committee for Macroprudential Oversight designated the Republic

of Moldova as a material third country for the banking sector in Romania in terms of recognising and setting countercyclical buffer rates, and decided to monitor the economic and financial developments in this country.

As regards the coordination of EU-wide macroprudential measures to contain regulatory arbitrage, the NCMO General Board decided, since the previous *Report*, not to apply through voluntary reciprocity the macroprudential measures adopted by Norway and Sweden¹³², given that the exposures of the Romanian banking sector to these countries are immaterial.

¹³² The measures are outlined in Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures, as subsequently amended and supplemented.

5.2. The activity of the NBR in its capacity as resolution authority¹³³

The recent bank resolution activity continued to focus on resolution planning, given that no instance of credit institutions failing or likely to fail was recorded in Romania.

The main line of action in this final stage of the transition period to operationalise the bank resolution framework focused on the analysis of documents prepared by credit institutions in line with EBA Guidelines on improving resolvability¹³⁴ and monitoring banks' endeavours to further improve resolvability, in order to comply with EBA Guidelines by 1 January 2024. To this end, the NBR monitored and assessed the progress of credit institutions in implementing these measures: (i) operational continuity, (ii) access to financial market infrastructures, (iii) funding and liquidity in resolution, (iv) management information system, (v) bail-in, (vi) business reorganisation and (vii) communication.

At the same time, the MREL capacity continued to be monitored, the build-up of resources representing a major concern in the period under review, due *inter alia* to the nearing deadline for meeting the final MREL target (1 January 2024). For resolvable institutions¹³⁵, where the MREL also includes the recapitalisation amount, the weighted average MREL final target (as at 30 June 2023) was 24.5 percent of total risk exposure amount (without the combined buffer requirement, Chart 5.5)¹³⁶.

Chart 5.5. Final MREL requirement

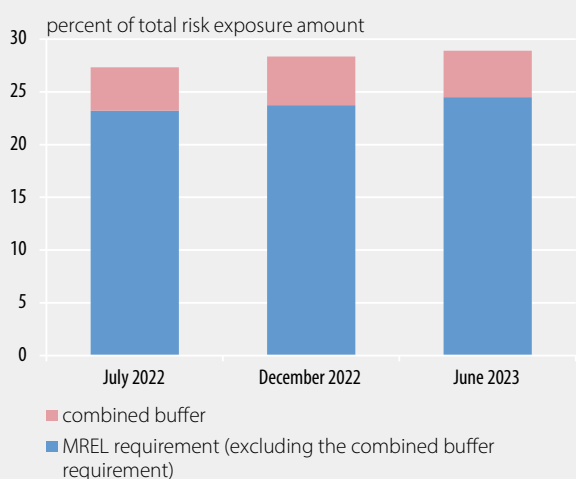
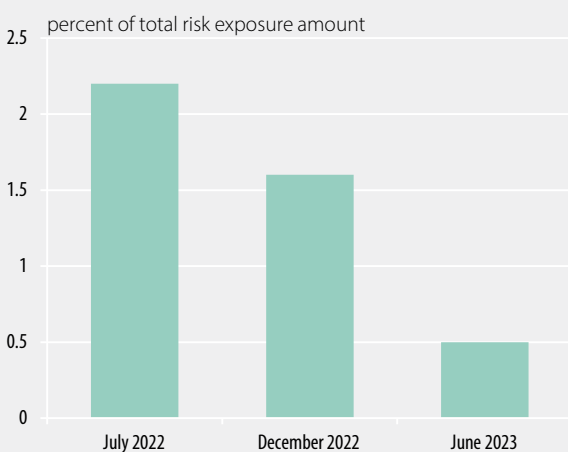


Chart 5.6. Estimated shortfall against the final target including the combined buffer requirement



¹³³ This section was prepared by the Bank Resolution Department.

¹³⁴ [https://www.eba.europa.eu/sites/default/files/document_library/Publications/Guidelines/2022/EBA-GL-2022-01%20Guidelines%20on%20resolvability/1025905/Final%20Report%20on%20Guidelines%20on%20improving%20resolvability%20for%20institutions%20and%20resolution%20authorities%20\(2\).pdf?retry=1](https://www.eba.europa.eu/sites/default/files/document_library/Publications/Guidelines/2022/EBA-GL-2022-01%20Guidelines%20on%20resolvability/1025905/Final%20Report%20on%20Guidelines%20on%20improving%20resolvability%20for%20institutions%20and%20resolution%20authorities%20(2).pdf?retry=1)

¹³⁵ Accounting for 94 percent of total risk exposure amount of banks, Romanian legal entities.

¹³⁶ MREL is revised in the course of planning, at least annually, based on the resolution strategy and other parameters, such as overall capital requirement components.

The shortfall of eligible resources, estimated against the final MREL target (without the combined buffer requirement), was covered entirely, due mainly to the rise in the stock of eligible debt instruments (up 40 percent or lei 7.5 billion) in 2023 H1. MREL eligible resources were raised primarily via issues of senior non-preferred bonds. Nevertheless, additional efforts are necessary to ensure compliance with the final MREL target including the combined buffer requirement by 1 January 2024, as the MREL capacity witnessed a shortfall at mid-2023 when compared to the final target including the combined buffer requirement (Chart 5.6).

Bank Resolution Fund

At mid-2023, the Bank Resolution Fund's resources amounted to lei 2.94 billion (lei +0.39 billion from end-2022), due *inter alia* to the collection of contributions for 2023, which were fully paid by all credit institutions.

Regulatory framework for bank resolution

In 2023, the milestone of the bank resolution framework was the publication of the European Commission's proposal to review the bank crisis management and deposit insurance (CMDI) framework¹³⁷. The package to reform the CMDI framework focuses on improvements in the following three EU legislative acts: (i) Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD), as regards early intervention measures, conditions for resolution and financing of resolution action; (ii) Directive 2014/49/EU on deposit guarantee schemes (DGSD), as regards the scope of deposit protection, use of deposit guarantee schemes funds, cross-border cooperation, and transparency; (iii) Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (SRMR), as regards early intervention measures, conditions for resolution and funding of resolution action.

The proposal to amend the EU primary legislation in the field of bank resolution aims to organise the orderly market exit for a failing bank of any size, while also having the following objectives: (i) preserve financial stability, better protect depositors, minimise the reliance on government budget funds (objectives similar to those envisaged when the current BRRD version was drafted); (ii) promote the wider use of the resolution framework and, implicitly, limit the discretion that allowed the non-harmonised implementation of the national insolvency framework to the resolution of a bank (and therefore the easier resort to government budget funds); (iii) ensure the real possibility of using industry-funded safety nets for the resolution of failing banks.

The main components of the CMDI legislative package refer to: (i) a revised public interest test for bank resolution, and (ii) the use of the resources of deposit guarantee schemes (DGS) to finance some resolution measures, facilitated by a possible

¹³⁷ https://finance.ec.europa.eu/publications/reform-bank-crisis-management-and-deposit-insurance-framework_en

revision of the position of covered deposits/DGS subrogated to the preferred claims of covered depositors in the hierarchy of insolvent creditors (removal of the DGS super-preference). Setting an explicit legal basis to prepare the resolution of banks smaller than those that can be currently included among resolvable banks is necessary to manage those specific situations in which the resolution authority will assess that a contagion risk or a financial stability risk exists or could become manifest in cases where such a bank would be resolved under normal bankruptcy proceedings. In this context, using DGS funds in resolution procedures facilitates the effective management of failing banks, by covering the potential shortage of internal resources (capital and bail-inable debt) until reaching the 8 percent threshold of total liabilities and own funds (TLOF) laid down in BRRD to access the Bank Resolution Fund's resources for resolvable banks using a transfer tool. The DGS contribution to the resolution of failing banks would be justified on principle by the common final objectives of DGS and resolution, namely shielding depositors and ensuring financial stability. Moreover, protecting public funds, as a key objective of resolution, remains a priority, while using the funds collected from the banking industry (the deposit guarantee scheme and resolution fund) is preferable to funding from taxpayers' contributions to the government budget.

As for Level 2 regulations, Commission Delegated Regulation (EU) 2023/827 laying down regulatory technical standards amending Delegated Regulation (EU) No 241/2014 as regards the prior permission to reduce own funds and the requirements related to eligible liabilities instruments¹³⁸ (the permission regime¹³⁸) was adopted. The prior permission regime is applied when an institution has expressed its intention to reduce any eligible debt instruments¹³⁹, such as senior unsecured debt instruments, debt instruments with embedded derivatives, liabilities to existing shareholders, subordinated debt or instruments eligible to meet the new iMREL requirement¹⁴⁰. These instruments can be redeemed only after the prior permission was granted by the resolution authority. The prior permission could also be a general prior permission, in which case the redemption should be made for a predetermined amount and a limited period of time. The prior permission regime applies to all credit institutions, including subsidiaries that are part of cross-border groups. The specific requirements were included in the procedural framework of the resolution authority (specific operational procedure).

Another piece of Level 2 legislation that entered into force in 2023 was Commission Delegated Regulation (EU) 2023/662 amending Delegated Regulation (EU) 2015/63 as regards the methodology for the calculation of liabilities arising from derivatives, in the context of determining the contributions to be paid by institutions to the resolution fund. These provisions were implemented when setting the amount of contributions to the Bank Resolution Fund for 2023.

Furthermore, Level 3 regulations were supplemented with Guidelines EBA/GL/2023/05 amending Guidelines EBA/GL/2022/01 on improving resolvability for institutions

¹³⁸ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0827>

¹³⁹ Including those with residual maturity of up to one year.

¹⁴⁰ Internal MREL, namely the requirement applicable to the subsidiary of a resolution entity, when using the Single Point of Entry (SPE) resolution strategy.

and resolution authorities, which set forth the following recommendations:

- (i) a self-assessment by resolution entities of their resolvability, the results of which should be submitted to the resolution authority at least every two years;
- (ii) a multi-annual testing programme developed by resolution authorities;
- (iii) a master playbook, i.e. an integrated operational manual, for the most complex institutions (G-SII resolution groups or Top Tier banks), setting out how the operational arrangements of the institution would effectively support the execution of the resolution strategy. The Guidelines enter into force as at 1 January 2024.

Special feature. Zombie firms and the efficiency of the insolvency proceedings

The pandemic crisis and the problems generated by the war in Ukraine called for the adoption by Member States of unprecedented measures to support the economies. Government loan guarantee programmes can, however, have unwanted effects as well, such as the financing of economically unviable companies, also called zombie firms in the literature. The zombification¹⁴¹ of the economy implies that unprofitable companies are artificially kept alive either through government programmes or via bank loans and/or interest rates kept at a very low level¹⁴². This can occur especially in times of economic recession or crises (such as the pandemic one) and is associated with declines in productivity over the medium and long term and the weakening of the financial sector. On one hand, zombie companies have low productivity and low resilience to shocks. On the other hand, the development of the zombie firms' segment can be accompanied by the crowding-out of healthy companies from the credit market and the disruption of competition mechanisms. These effects are more visible if the policies supporting unviable firms are kept in place for longer. A possible solution to contain these unwanted effects consists in developing an efficient insolvency framework and, in the case of public support schemes, applying mechanisms to select performing companies¹⁴³.

In Romania, the zombie firms' segment increased after the global financial crisis of 2007-2008. Even though these developments were similar to those observed at European level amid the bleak economic picture in the aftermath of the crisis, the significantly higher magnitude of the phenomenon in Romania owed to the challenges faced by companies in debt restructuring and/or market exit, but also to the loose payment discipline that fostered, *inter alia*, tax optimisation practices. The NCMO Working Group on firms' financial soundness, set up in 2017, estimated the negative impact exerted by the development of the zombie companies' segment in terms of economic growth rate at -0.3 percentage points per annum, on average, in the period from 2007 to 2016, and at EUR 10 billion in terms of nominal GDP loss for the year 2016. Despite the marked decline in the number of zombie firms in recent years, their share continues to exceed the EU levels.

An important share of zombie companies can generate, besides competitiveness and economic growth issues, significant vulnerabilities for the financial system.

¹⁴¹ The term was initially used in the context of the situation in Japan following the 1990s crisis. See Caballero, R. J., Hoshi, T. and Kashyap, A. K. – "Zombie lending and depressed restructuring in Japan", *American Economic Review*, 98(5), 2008, pp. 1943-1977.

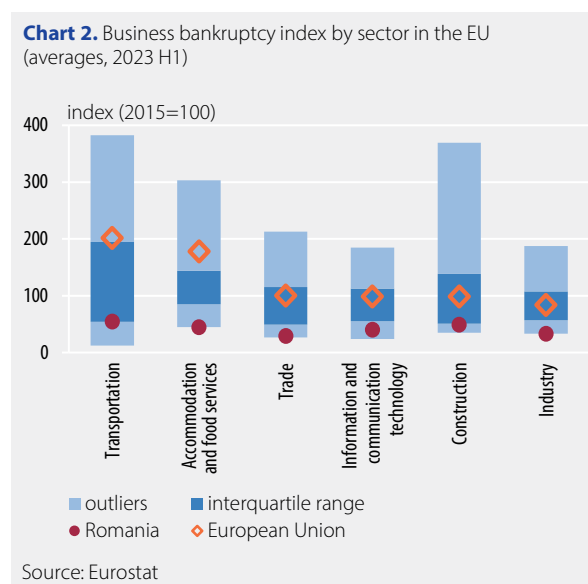
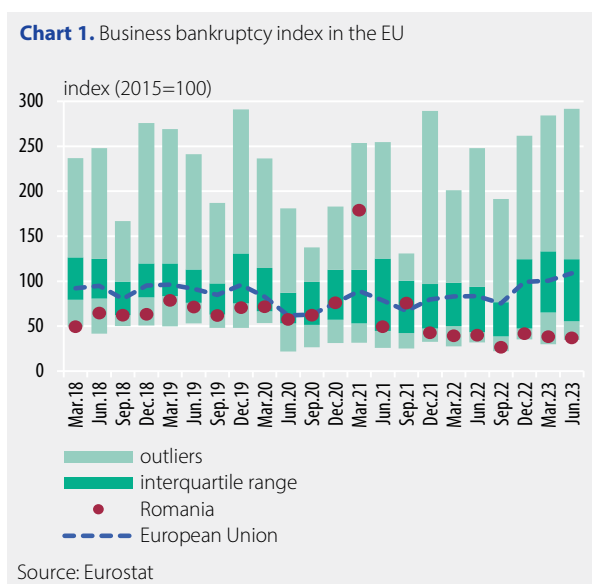
¹⁴² Peek, J. and Rosengren, E. S. – "Unnatural selection: Perverse incentives and the misallocation of credit in Japan", *American Economic Review*, 95(4), 2005, pp. 1144-1166.

¹⁴³ Laeven, L., Schepens, G. and Schnabel, I. – "Zombification in Europe in times of pandemic", *ECONtribute Policy Brief Series*, No. 011, University of Bonn and University of Cologne, 2020.

These companies have a high degree of pass-through of shocks in the economy, given the limited access to alternative sources of finance. Zombie firms are highly indebted (the debt-to-asset ratio is 2.4 times higher the economy-wide average) and have a low level of liquidity (liquidity indicators are less than half of those for the non-financial corporations sector). In view of the major negative implications that zombie companies can have for the financial sector, the NCMO decided in 2017 to establish a working group to identify and assess the key measures for addressing the structural vulnerabilities in the non-financial corporations sector. Based on the findings of the working group analysis, the NCMO recommended the government (NCMO Recommendation No. R/2/2018) to identify, together with businesspersons and social partners, the best measures to improve the regulatory framework for the non-financial corporations sector. Furthering these efforts, also by amending the legislative framework to improve capitalisation in the economy, is necessary for enhancing the resilience of the real sector, especially during periods of adverse economic developments, and for mitigating the negative effects on the financial sector.

The European context

The zombie companies' segment rose markedly in Europe after the international financial crisis of 2007-2008 and the euro area sovereign debt crisis. These dynamics saw a reversal afterwards, with values returning in 2019 to the vicinity of the 2007 readings. Specifically, the largest share was recorded in 2013, i.e. 2.2 percent in the euro area, while it was significantly higher in GIIPS countries¹⁴⁴ (4.7 percent). Recent analyses¹⁴⁵ do not point to major developments of this sector, while evolutions in the credit market do not show any evidence of crowding out of healthy firms or negative externalities on funding costs amid losses incurred by banks from loans to zombie firms.



¹⁴⁴ Greece, Ireland, Italy, Portugal and Spain.

¹⁴⁵ Havemeister, L. K. and Horn, K. – "Fear the walking dead? Zombie firms in the euro area and their effect on healthy firms' credit conditions", *ESRB Working Paper Series* No. 143, 2023.

Unlike the zombie firms' segment, insolvency witnessed a step-up at European level, with the business bankruptcy index rising in 2023 Q2 to the highest level since 2015 (Chart 1)¹⁴⁶. The below-expectations economic performance, the higher costs amid the energy crisis and the war in Ukraine, as well as the interest rate hikes due to persistent inflation (the key ECB rate went up from 0 percent in June 2022 to 4.5 percent in September 2023) put additional strains on the financial standing of firms, many of which were facing difficulties after the COVID-19 pandemic. Developments across countries were heterogeneous, given the major differences in terms of insolvency proceedings, macroeconomic conditions and measures to support the economy during the pandemic. For instance, in Hungary and the Netherlands the increases were significant (of more than 50 percent on average in the first two quarters of 2023 versus the same year-earlier period), while in Denmark and Bulgaria the number of bankruptcies diminished on average by over 15 percent during the same period. The breakdown by business sector shows further swift dynamics in the case of transportation and accommodation and food services (Chart 2), i.e. the sectors more visibly affected by the COVID-19 pandemic, but also by the extreme weather events in recent years.

The domestic context – zombie companies¹⁴⁷

In Romania, the zombie companies' segment is important (Chart 3). Based on the same definition for zombie firms as that used in the European analysis¹⁴⁸, the share of this sector ranged between 2.6 percent prior to the financial crisis of 2007-2008 and 10.2 percent in 2010, before returning to 3.1 percent in 2022.

Complementing the definition of zombie firms¹⁴⁹ with information on the capitalisation level, their share is markedly higher. Specifically, in 2011, the zombie companies' segment peaked at 18.4 percent of total assets held by non-financial corporations. Starting 2015, the number of these companies has been on a steeper downward path, which was temporarily brought to a halt by the COVID-19 pandemic. At present, the importance of this segment has lowered substantially, but continues to exceed the European level. The share of this segment ranges between 6.3 percent and 7.9 percent in total assets (depending on the definition used) and between 22 percent and 25.3 percent in terms of the number of such companies in total.

The swift expansion of the zombie companies' segment took its toll on the local financial sector as well, generating losses and limiting its capacity to extend new loans to non-financial corporations. In 2010, zombie firms accounted for one fifth of the

¹⁴⁶ <https://ec.europa.eu/eurostat/web/products-eurostat-news/w/ddn-20230817-1>

¹⁴⁷ Zombie firms were defined as companies with capital shortfalls for two consecutive years or firms identified according to the methodology in Storz *et al.*, 2017 (negative return on assets, a decrease in fixed assets and Debt/Equity > 2 for two consecutive years). Firms with capital shortfalls are those with net assets, calculated as the difference between total assets and total liabilities, lower than half the value of the subscribed share capital. See Storz, M., Koetter, M., Setzer, R. and Westphal, A., "Do we want these two to tango? On zombie firms and stressed banks in Europe", *ECB Working Paper Series* No. 2104, 2017.

¹⁴⁸ Negative return on assets, a decrease in fixed assets and EBITDA/Debt < 5 percent for two consecutive years. See Storz, M., Koetter, M., Setzer, R. and Westphal, A., "Do we want these two to tango? On zombie firms and stressed banks in Europe", *ECB Working Paper Series* No. 2104, 2017.

¹⁴⁹ Storz, M., Koetter, M., Setzer, R. and Westphal, A., "Do we want these two to tango? On zombie firms and stressed banks in Europe", *ECB Working Paper Series* No. 2104, 2017.

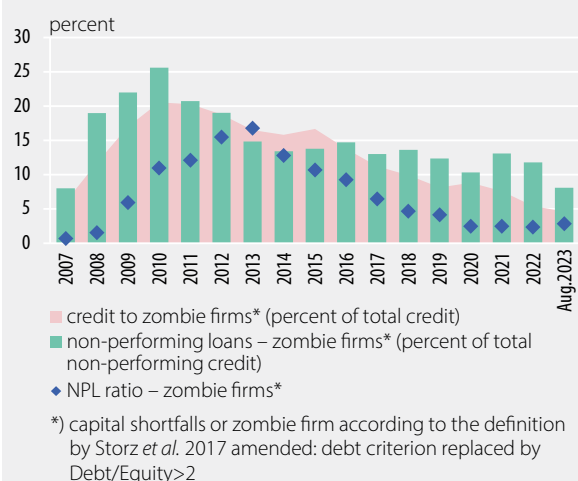
volume of credit to non-financial corporations (Chart 4), with the largest part provided by credit institutions (more than 80 percent), especially in foreign currency (around 80 percent). The quality of this portfolio deteriorated rapidly in the period that followed the 2007-2008 global financial crisis, the NPL ratio increasing from merely 1.5 percent in 2008 to 17 percent in 2013, similarly to sector-wide developments. The financing of zombie firms by financial institutions in Romania is currently less than 5 percent of total credit, while the NPL ratio for this portfolio stands at 2.8 percent (August 2023).

Chart 3. Zombie firms by various criteria



Source: MF, NBR, NBR calculations

Chart 4. Bank and NBF credit to zombie firms*



Source: MF, NBR, NBR calculations

Neither in the period following the 2007-2008 global financial crisis, nor recently did the government support programmes entail an expansion of the zombie companies' segment. The banking sector also played a major role in this respect, as numerous credit institutions did not loosen financing standards in the case of these programmes. The significant government effort to prop up the economy during the pandemic was channelled to zombie firms only to a very small extent (0.76 percent of total in August 2023), yet these state guaranteed loans exhibit a very high non-performing ratio (14.6 percent).

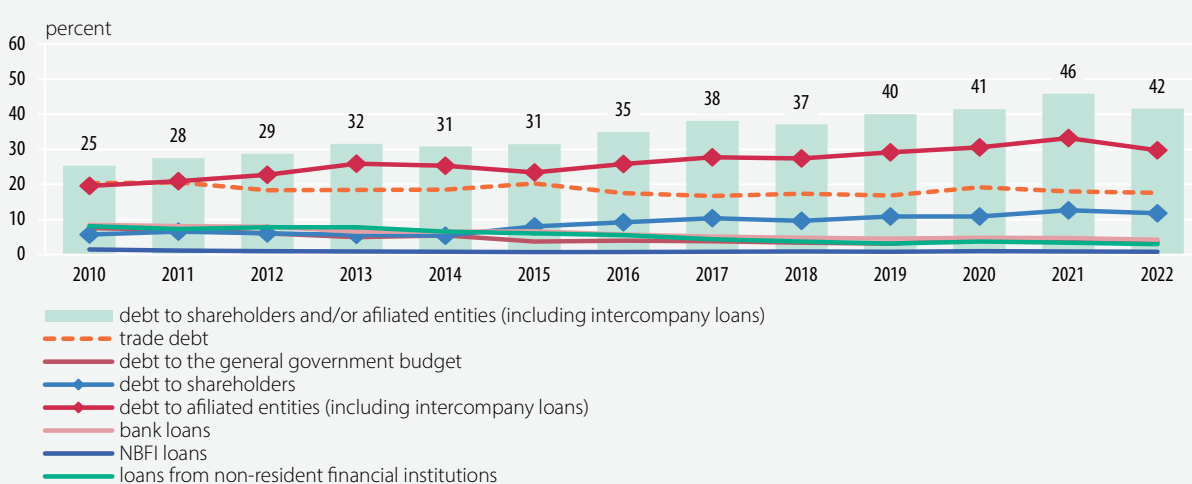
Zombie companies have an extremely low capitalisation level, being financed via loans from

¹⁵⁰ The company's net assets, calculated as the difference between total assets and total liabilities, dropped to less than half the value of the subscribed share capital, pursuant to Art. 153²⁴ of Law No. 31/1990 on commercial companies (recast).

¹⁵¹ Negative return on assets, a decrease in fixed assets and EBITDA/Debt < 5 percent for two consecutive years. See Storz, M., Koetter, M., Setzer, R. and Westphal, A., "Do we want these two to tango? On zombie firms and stressed banks in Europe", ECB Working Paper Series No. 2104, 2017.

shareholders and/or intercompany lending or credit from affiliated entities. This type of finance has gained prominence in recent years, from 25 percent of total debt in 2010 to 42 percent in 2022 (Chart 5). By comparison, trade debt fluctuated around 20 percent, while loans from resident financial institutions and NBFIs shrank from 18 percent to 8 percent in the same period. The prevailing use of financial resources in the form of debt, especially in relation to shareholders or affiliated entities, might also hint at a possible tax optimisation behaviour, because this type of finance allows for the distribution of income, which is tax deductible, also where firms do not have profit.

Chart 5. Contribution of various types of finance to zombie firms' total debt



Source: MF, NBR, NBR calculations

Foreign financing is also a major source of finance for zombie companies. The intercompany loans or the loans from other non-resident firms were largely taken at higher interest rates than those charged by local banks on foreign currency credit, which might point to a possible mechanism of income transfer to the group. External loans from firms within the group totalled, on average, 10 percent of all debt in the past 11 years (Chart 6), standing out as the main form of long-term foreign financing (74 percent in 2022). The interest rate spread on EUR-denominated loans from non-resident firms and local banks averaged out at 0.6 percentage points in the pre-pandemic period and narrowed to 0.4 percentage points during the pandemic (Chart 7).

The other firms in the economy do not share these developments in foreign currency financing costs. The start of the interest rate hiking cycle, following the change in the monetary policy stance amid the step-up in the inflation rate, brought this pattern to a halt, with the interest rate spreads turning strongly negative as of 2022 Q4 for the entire economy (Chart 7).

A large part of the firms that had faced major financial hardships in the aftermath of the 2007-2008 financial crisis never recovered, but they did not exit the market either. One third of the companies identified as zombie firms in 2022 had been in this

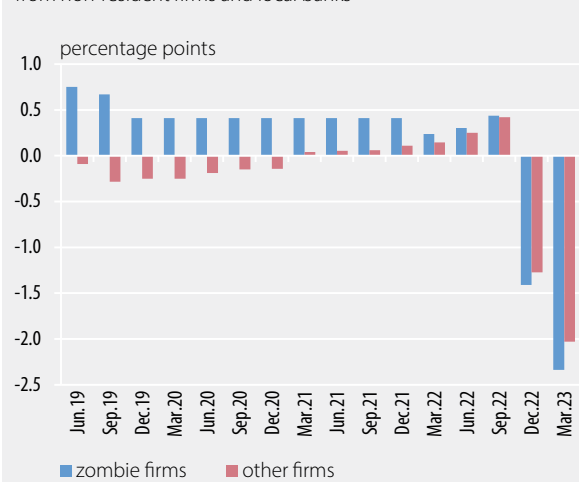
condition for over a decade. Only a small part of zombie firms are struck off the Trade Register or resort to reorganisation.

Chart 6. Foreign currency financing of zombie firms



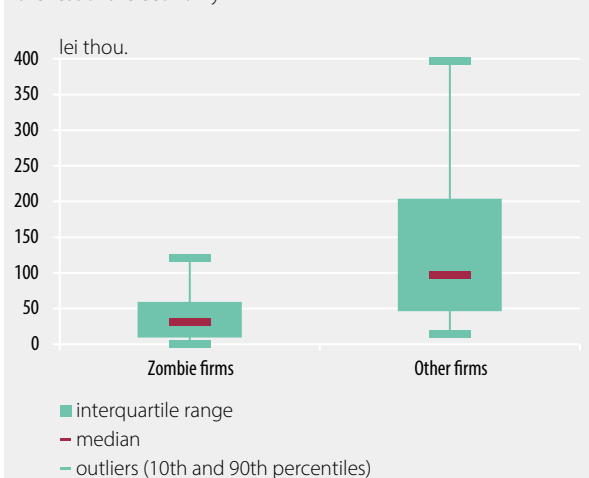
Source: MF, NBR, NBR calculations

Chart 7. Interest rate spread on EUR-denominated loans from non-resident firms and local banks



Source: MF, NBR, NBR calculations

Chart 8. Productivity (GVA/employee) of zombie firms versus the rest of the economy



Source: MF, NBR, NBR calculations

Of the firms with sizeable capital shortfalls during 2007-2014, only 11.6 percent were struck off over the following five years. Recourse to the insolvency procedure is also very low. The average percentages in the past decade have been of merely 1 percent within one year since the start of financial difficulties, 2.4 percent within two years and 3.8 percent within three years. As regards the use of the reorganisation procedure for addressing financial issues, only 25 firms of the companies identified as zombie (less than 0.1 percent of total) have resorted, on average, to this restructuring mechanism in the past five years.

Zombie companies are almost entirely domestically-owned (93 percent of firms have more than 50 percent Romanian capital¹⁵²) and, although

making up over one-fifth of the firms, contribute merely 4.3 percent to the sector's value added and hold less than 7 percent of assets. These companies record low productivity (the median representing one third of that reported by the other firms in the economy, Chart 8) and contribute to a weak discipline in the economy. Specifically, they are accountable for 15 percent of overdue payments in the economy and 14.5 percent of arrears to the government budget, to which adds a payables payment period double the sector average (157 days versus 77 days).

¹⁵² Domestically-owned companies, while accounting for 93 percent of the number of zombie firms, cumulate only 13 percent of the medium- and long-term external debt of the zombie firms' segment and merely 9 percent of intercompany lending. These companies represent only 51 percent of zombie firms' assets, but hire 77 percent of employees.

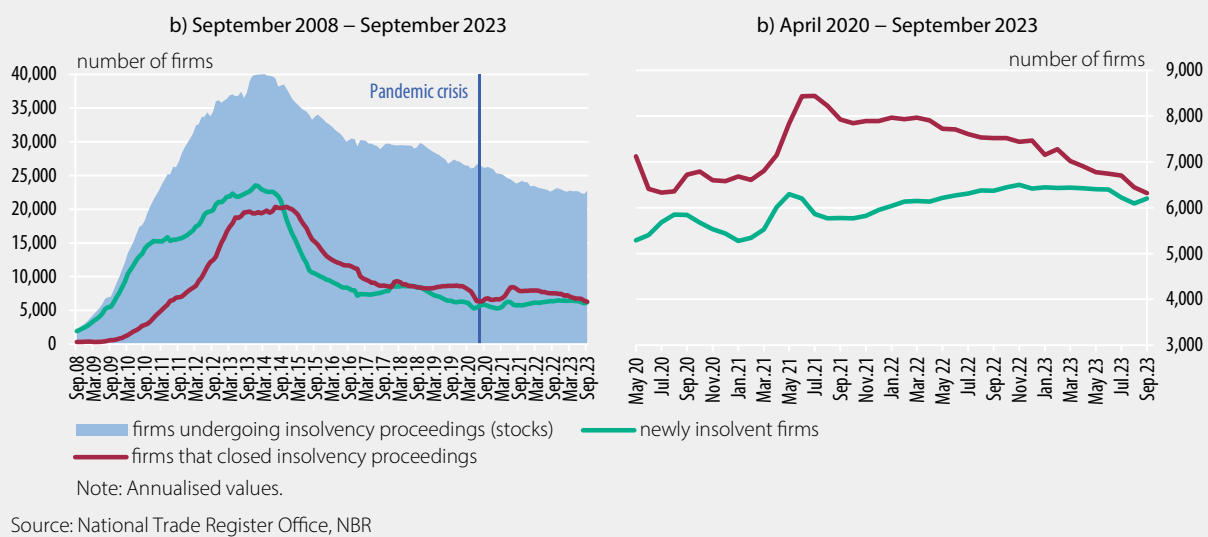
The lengthy period over which a company with major capital shortfalls can remain operational, as well as the low recourse to insolvency or other restructuring mechanisms when the company is experiencing major financial issues, is indicative of deficiencies in the market exit mechanisms for unviable firms and of loose payment discipline in the economy.

Insolvency of legal entities in Romania¹⁵³

Insolvency regained pace in Romania as of end-2021, after the number of newly insolvent firms had hit the lowest reading since 2008 during the COVID-19 pandemic, while the resolved cases of insolvency dropped significantly in the first year of the pandemic (-23 percent from a year earlier). In 2022, the number of newly insolvent firms stood at 6,418 (up 1.6 percent against 2019).

A halt in this upward trend was noticeable as of 2023 Q2, yet the number of newly insolvent firms stays above the values recorded at the end of the pandemic (the year 2021). The first nine months of 2023 saw the opening of 4,399 new insolvency proceedings (down 4.6 percent versus the same year-earlier period, yet 4.8 percent above the level seen in the same period of 2021, Chart 9). These developments were also accompanied by an increase in the number of large companies undergoing insolvency proceedings. Thus, in the first nine months of 2023, some 12 large companies entered the insolvency procedure, after 11 other similar entities had done the same in 2022, compared to only 6 in 2021.

Chart 9. Developments in corporate insolvencies

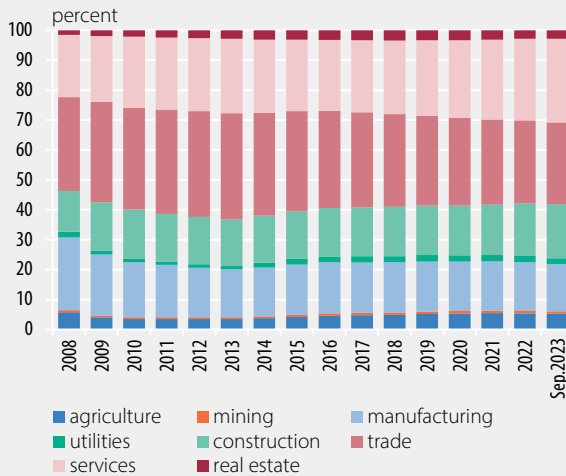


The analysis by business sector shows an increase in the shares of firms operating in services (to 27.4 percent, 9 percentage points higher than in 2008) and in construction (to 17.7 percent, up 5 percentage points) at end-2022, whereas the share of manufacturing companies in total insolvent firms narrowed (to 15.7 percent from

¹⁵³ The analysis refers only to the non-financial corporations that entered insolvency proceedings in the period from 2008 to 2023 and that submitted financial statements to the Ministry of Finance at least once in the past 15 years.

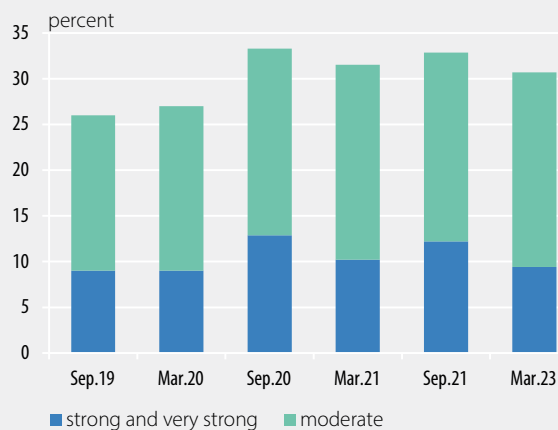
22 percent, Chart 10). Moreover, of the firms in manufacturing, most of the insolvent ones carry out low-tech or medium-low-tech activities (66 percent and 26 percent respectively).

Chart 10. Composition of insolvent firms by business sector



Source: National Trade Register Office, NBR

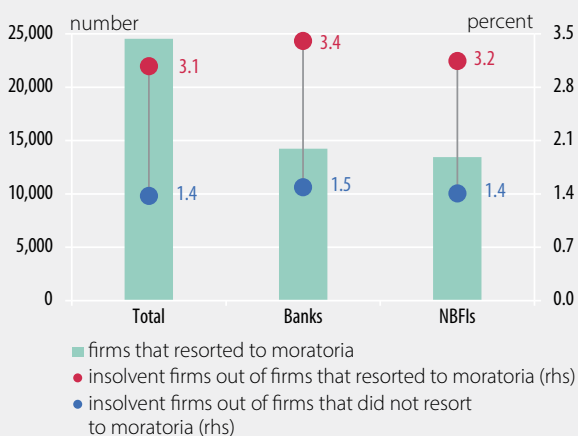
Chart 11. The most pressing problems faced by non-financial corporations in the last six months – insolvency



Source: NBR, Survey on the access to finance of non-financial corporations in Romania

Firms' concerns about the problems generated by insolvent companies have been on the rise in recent years, with an increasing number of companies flagging insolvency (their own or that of trade partners) as one of the pressing issues with a moderate or strong and very strong impact on activity (Chart 11).

Chart 12. Firms that resorted to loan moratoria up to April 2021 and the percentage of companies that entered insolvency proceedings in the following two years



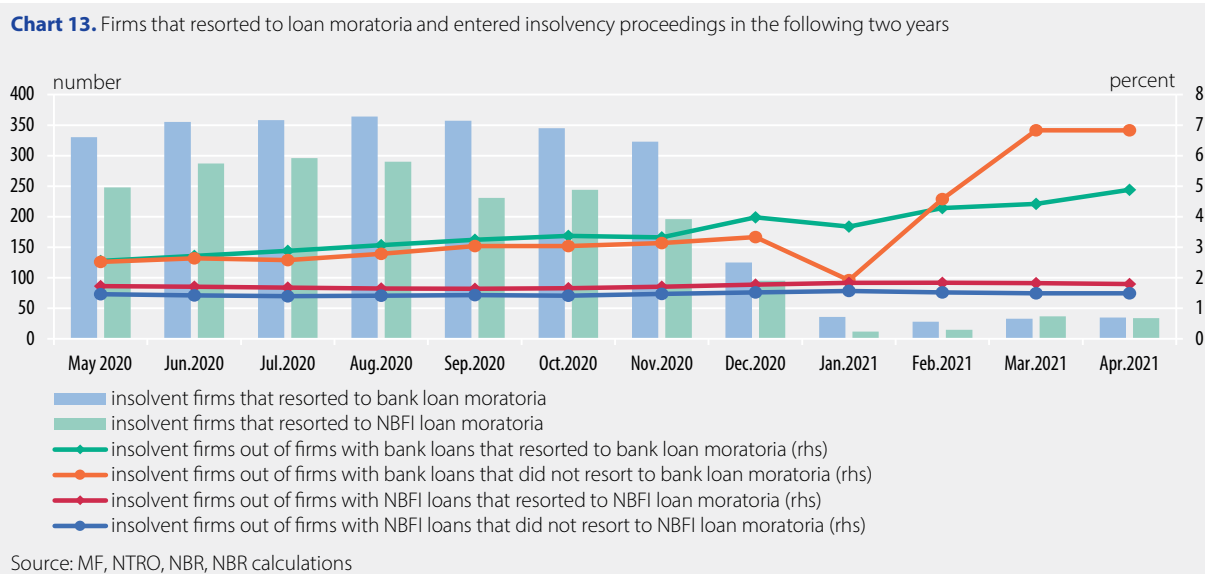
Source: MF, NTRO, NBR, NBR calculations

Insolvent firms have a low contribution to economic activity, generating below 2 percent of gross value added, but hold approximately 4 percent of corporate sector assets and hire 1.3 percent of employees, although accounting for less than 3 percent of the number of firms.

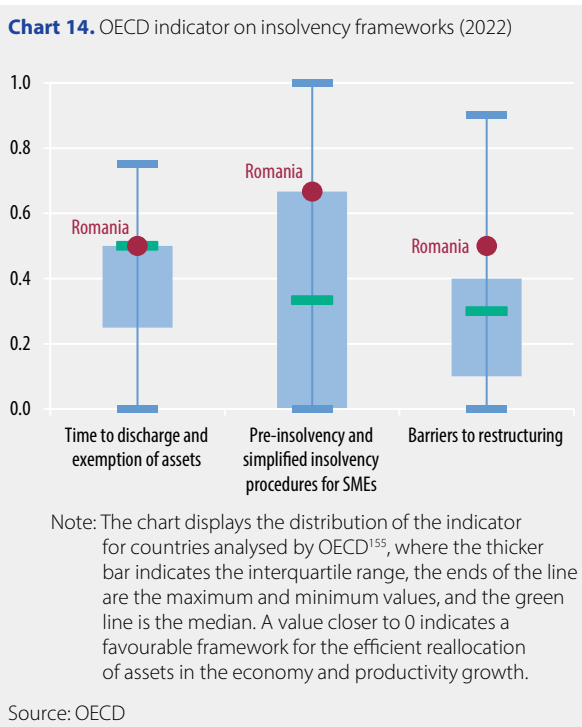
Firms' recourse to moratoria

The resort to loan deferral under moratoria was only of temporary help for some of the firms, as they faced major financial challenges afterwards. The share of companies that resorted to moratoria and then became insolvent was twice higher than that of insolvent firms that did not apply for a loan deferral (3.1 percent versus 1.4 percent, Chart 12).

Recourse to moratoria during the second year of the pandemic was made to a larger extent by firms with financial hardships, a wider share of them reporting insolvency over the following two years (Chart 13).



Specifically, 5 percent of firms with moratoria for bank loans as at April 2021 and 7 percent of those with moratoria for NBFi loans entered insolvency proceedings two years later, compared to 4 percent of firms that resorted to moratoria the first months into the pandemic. Currently, 2.7 percent of insolvent firms are companies for which loan repayments were suspended, representing 854 companies (April 2023), while their share has been on the rise over the past year (up 0.9 percentage points in the period from April 2022 to April 2023). Of the newly insolvent companies in the past year, 6 percent are firms that previously resorted to loan moratoria.



Efficiency of the insolvency proceedings

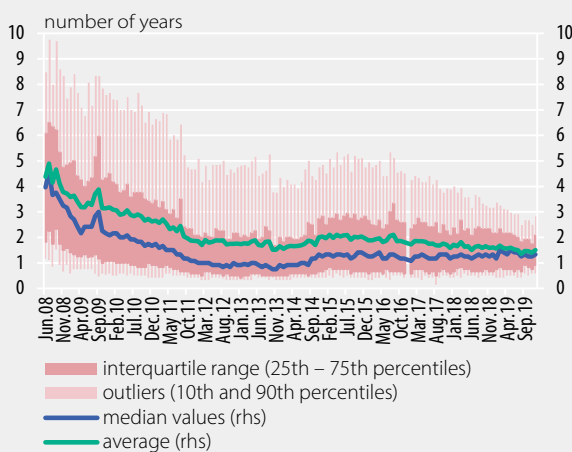
Company insolvency needs to be a mechanism that facilitates, on one hand, the market exit of unviable firms and, on the other hand, the restructuring of entities faced with temporary financial distress in a relatively brief time span, to ensure resource reallocation in the economy at low costs. According to the OECD¹⁵⁴, the insolvency procedure in Romania is among the least favourable to the economy (in terms of enabling the efficient reallocation of assets in the economy and productivity growth), with limitations regarding (Chart 14): (i) the time to discharge and exemption of assets, (ii) the development of early warning mechanisms for major financial issues and the introduction of simplified procedures for SMEs, and (iii) company restructuring.

¹⁵⁴ OECD, "Enhancing insolvency frameworks to support economic renewal", *OECD Economics Department Working Papers* No. 1738, 2022.

¹⁵⁵ The analysed states are the OECD countries and Bulgaria, Croatia, Cyprus, India, Malta, Romania and South Africa.

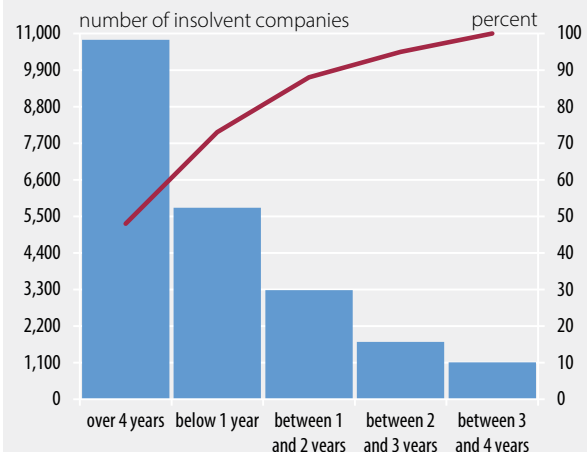
The insolvency procedure in Romania is a lengthy process. Even though the time span for an average procedure has shrunk considerably in recent years, the distribution of individual cases shows a strong skewness towards high values of the insolvency duration (Chart 15). Thus, the median value dropped from 4 years and 4 months for companies that entered insolvency in 2008 to 1 year and 4 months for those in 2019, while the 75th percentile of the distribution receded from 6 years to 2 years in the same period. Furthermore, the analysis of insolvent firms as at May 2023 shows a sizeable share of companies undergoing the insolvency procedure for more than four years (Chart 16). Major differences also arise in terms of a sectoral analysis, with mining firms posting values of over two years (median values for the entire period under review, 2008-2019) and trade companies of around 1 year.

Chart 15. Length of the insolvency procedure by the month of entering insolvency (2008-2019)



Source: NTRO, NBR calculations

Chart 16. Companies under insolvency proceedings as at May 2023 by the number of years since the start of the procedure



Source: NTRO, NBR calculations

Preference for pre-insolvency procedures has risen in recent years. The value of fixed assets of companies that resorted to arrangements with creditors¹⁵⁶ went up from EUR 15 million in 2019 to approximately EUR 1 billion in 2020. Moreover, the value of assets of companies that concluded such an arrangement in 2020 makes up around two thirds of the asset value of insolvent firms. The first quarter of 2023 saw the launch of five procedures for arrangements with creditors in the case of companies with assets of over EUR 1 million.

Nevertheless, the efficiency of these measures is far from optimal. The period from 2010 to 2019 saw the signing of 80 arrangements with creditors, but only seven of them were successfully completed. Moreover, the latest amendments to the legislative framework¹⁵⁷ dented the efficiency of these measures even further.

¹⁵⁶ The arrangement was introduced in the legislation in July 2010 via Law No. 381/2009 introducing the arrangement with creditors and the ad-hoc mandate. Pursuant to Article 3d), "the arrangement is a contract between the borrower, on one hand, and the creditors holding at least two thirds of the value of accepted and undisputed claims, on the other hand, whereby the borrower proposes a plan for the recovery of its enterprise and for covering the claims of these creditors against it, and the creditors accept to support the borrower's efforts to overcome the distress of the borrower's enterprise".

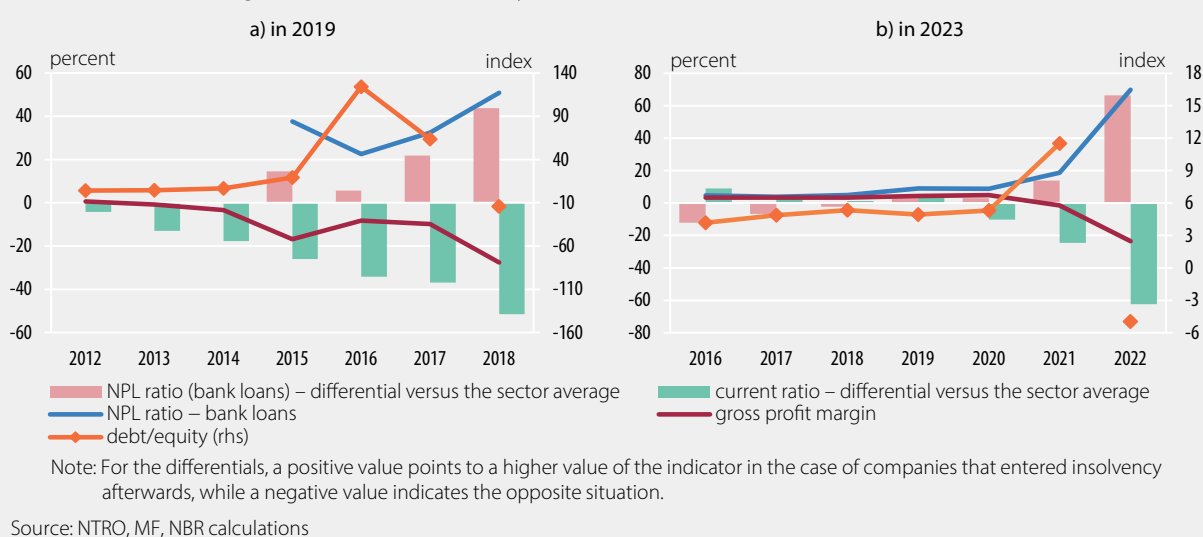
¹⁵⁷ Law No. 49/2023 approving Government Emergency Ordinance No. 62/2022 on amending Article 262 para. 32 of Law No. 85/2014 regarding insolvency prevention and insolvency proceedings and Government Emergency Ordinance No. 19/2022 on certain measures regarding performance guarantees under public procurement contracts and sectoral contracts.

Specifically, the length of the procedure for the arrangement with creditors was extended by two years, which increases its overall duration to five years. Under the circumstances, the settlement of disputes on debt repayment could span an entire business cycle if the borrowing firm enters insolvency proceedings after the whole period of the arrangement with creditors.

The low efficiency of insolvency proceedings in Romania is also due, *inter alia*, to the fact that firms or their creditors resort to this option rather late, with companies already facing major financial challenges for at least three years (Chart 17).

Prior to the pandemic, firms recorded significant negative values of profitability, increases in the indebtedness level (measured by the debt-to-equity ratio) and in the NPL ratio on loans taken from banks two to four years before entering insolvency (Chart 17a). During the pandemic crisis, developments were faster, with deteriorations being observed already from the first year of the pandemic (Chart 17b).

Chart 17. Financial standing of firms that entered insolvency



A very small share of companies entering the insolvency proceedings resort to reorganisation (3.4 percent on average in 2023), and this share has been declining in recent years (the peak was in 2016, i.e. 4.6 percent). It takes over one year on average (18 months in the period from 2010 to 2019) to complete the reorganisation procedure. The longer the firm stays in the reorganisation procedure, the higher the cost of the procedure. Thus, firms undergoing reorganisation for one year witness a reduction in assets by 1.7 percent on average, while those completing this procedure in two years see a contraction in assets of 3.6 percent on average.

Summing up, zombie companies have a low economic performance and a modest contribution to economic activity. They entail major disruptions in terms of resource allocation in the economy, the collection of revenues to the general government budget, corporate governance and payment discipline. Besides, these firms have a poor resilience to shocks amid their major capital shortfalls, low degree of liquidity and lack of alternative financing sources, since they are not eligible for lending by

specialised institutions. The presence of a large number of zombie firms makes the entire non-financial corporations sector have a low resilience to shocks and limits its development. The mechanisms in place to address issues related to the market exit of zombie companies lack the necessary efficiency to mitigate this vulnerability substantially.

The analysis of insolvency points to a low efficiency of the existing framework:

(i) the duration of the procedure is still rather long (over one year) and more than half of insolvent firms have been under this procedure for longer than four years, (ii) this restructuring mechanism is being resorted to rather late, when the firm's financial standing has already deteriorated markedly over the course of several years, (iii) pre-insolvency procedures, albeit more frequent in recent years, have led to a very small number of cases being resolved, and (iv) recourse to the reorganisation procedure is extremely scarce, as it is both relatively lengthy and costly.

In order to reduce the segment of zombie companies, one set of useful measures could consist, on one hand, in revising the legislative framework for commercial companies so as to enhance the sector's capitalisation and, on the other hand, in improving the restructuring and market exit mechanisms for unviable firms, to ensure that they are resolved faster and more efficiently.

Abbreviations

ANCPI	National Agency for Cadastre and Land Registration
BIS	Bank for International Settlements
CB	Credit Bureau
CCR	Central Credit Register
CEE	Central and Eastern Europe
CRD IV	Capital Requirements Directive IV
CRR	Capital Requirements Regulation
DSTI	debt service-to-income
EBA	European Banking Authority
EBIT	earnings before interest and taxes
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European System of Accounts
ESRB	European Systemic Risk Board
EU	European Union
Eurostat	Statistical Office of the European Union
FDI	foreign direct investment
FSA	Financial Supervisory Authority
GDP	gross domestic product
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LCR	liquidity coverage ratio
LTV	loan-to-value
MF	Ministry of Finance
NBFIs	non-bank financial institutions
NBR	National Bank of Romania
NCMO	National Committee for Macroprudential Oversight
NIS	National Institute of Statistics
NPL	non-performing loans
NSFR	net stable funding ratio
OECD	Organisation for Economic Co-operation and Development
O-SII	Other Systemically Important Institutions
ReGIS	Romanian electronic Gross Interbank Settlement
ROBOR	Romanian Bid Offered Interest Rate
ROE	return on equity
SaFIR	Government securities depository and settlement system
SENT	Electronic Net Settlement System
SMEs	small- and medium-sized enterprises
VAT	value added tax

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