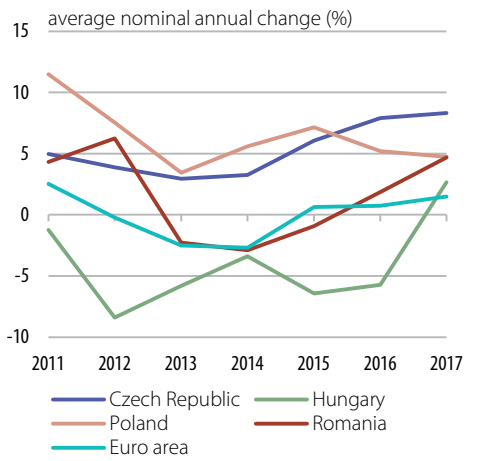
Box 4. Credit to the private sector and liquidity in the economy – developments and determinants[1]

The composition and dynamics of private sector credit and of liquidity in the economy witnessed further adjustments in 2017 – relevant from the perspective of monetary transmission, as well as of structural convergence with monetary developments in the euro area and in other countries in the region. Specifically:

1. Credit to the private sector saw its growth rate pick up to record highs for the past years (Chart A).

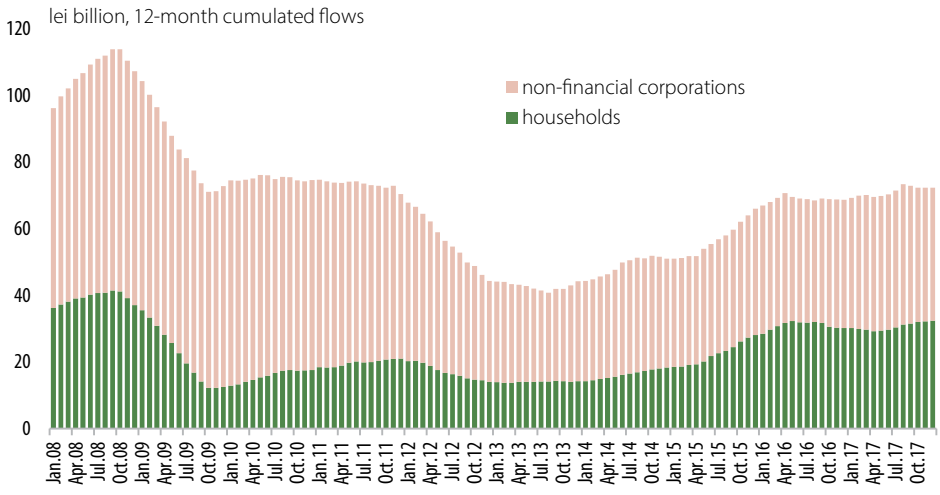
Chart A
Credit to the private sector



Source: NCBs

The average dynamics of credit to the private sector climbed to a five-year high of 4.7 percent (from 1.9 percent in 2016), which places Romania in the upper half of the ranking of countries in the region[2]. Behind the advance stood, this year as well, the increase in new loans to households, but to a lower extent than in 2016, a more important role being played in 2017 by the faster dynamics of new loans to non-financial corporations (Chart B). An opposite impact had – throughout the year, but especially in its latter part – further removals of non-performing loans from credit institutions' balance sheets, whose volume remained particularly high, although on the wane against 2016, as well as other statistical effects[3]. Against this background, the annual growth rate of private sector credit gained traction almost constantly during the first three quarters of 2017, to stand at 7.4 percent in September, before posting a relative slowdown, yet remaining at markedly higher readings than in the same year-earlier period (5.7 percent in December 2017 versus 1.2 percent).

Chart B
New loans to households and non-financial corporations



1 For a clearer picture, changes in dynamics were analysed, as a rule, in the form of indicators calculated as an average of annual growth rates, the approach being warranted by the strong asymmetry of influences exerted by some of the major determinants, as well as by the presence of statistical effects stemming from the change in the annual inflation rate or in the leu exchange rate.

2 In real terms, however, the average dynamics of private sector credit decelerated slightly, to 3.3 percent from 3.5 percent, given the step-up in the annual inflation rate.

3 Associated with the removal from credit institutions' consolidated balance sheet of two entities that had ceased their activity.

As a share in GDP, the stock of private sector credit continued to decline however in 2017, posting similar developments to those recorded in the period under review, as well as over the past years, by other countries in the region and by the euro area.

2. The share of the leu-denominated component in credit to the private sector continued to rise at a swift pace and hit a new post-1996 high.

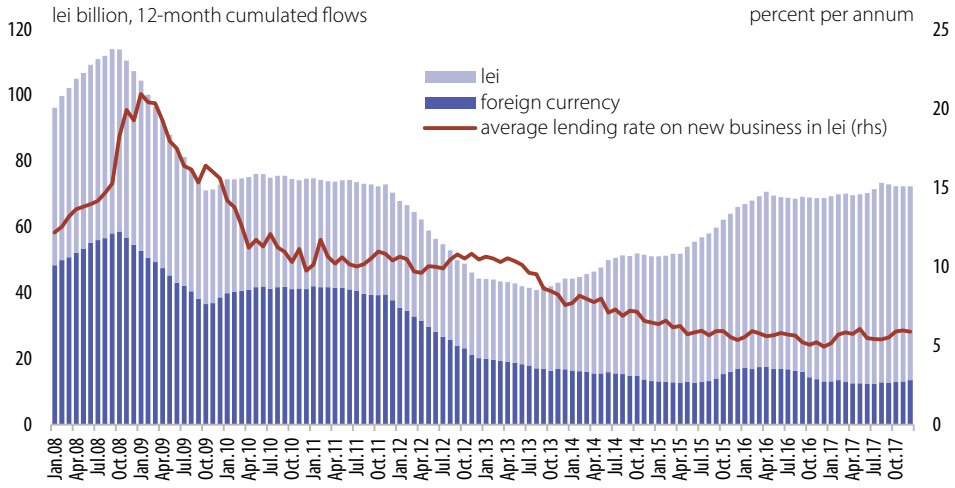


Chart C
New loans to the private sector and the average lending rate on new business in lei

The advance – resulting in a level of 62.8 percent in December 2017 versus 57.2 percent at end-2016 – occurred in a context in which the annual dynamics of domestic currency credit regained momentum towards mid-year and subsequently remained relatively stable (ending the year at 15.9 percent against 14.3 percent in December 2016), whereas the rate of change of the foreign currency component stuck to negative values (-10.4 percent, based on stocks expressed in euro, versus -12.5 percent at end-2016). Behind these developments stood primarily: (i) the robust growth in new leu-denominated credit (Chart C), alongside the slight widening of its share in the total flow[4], as well as (ii) the larger share of foreign currency credit in total loans removed from balance sheets. The trend was common to both major categories of recipients, but continued to be much more pronounced for households, in the case of which the share of the domestic currency component, which had become prevalent again in 2016, slowed its advance only slightly, reaching a 13½-year peak of 65.8 percent in December 2017[5].

3. The share of household credit in total credit, which had come to prevail in 2016, slowed down its increase, yet hit a new historical high (52.4 percent).

This was due to the more pronounced steepening of the uptrend in the dynamics of credit to non-financial corporations, which returned to positive territory for the first time in four years (2.2 percent in nominal terms as annual average, against -2.9 percent previously), under the impact of: (i) the stepped-up increase in new

4 Calculations based on the credit flow adjusted for the effect of loan renegotiation.

5 From 58.5 percent in December 2016.

credit and revolving loans – in line with the pick-up in economic growth and the strong confidence that characterised the business environment in the first quarters of the year, but also with the historically low interest rates –, as well as of (ii) the reduction in annual terms in the volume of loans removed from banks' balance sheet. The advance was stronger for short- and medium-term credit, whereas the dynamics of longer-term loans posted a slight decline. Looking at the breakdown by destination, the highest increases in the flow of new credit were seen in agriculture and construction respectively; however, positive growth rates were also recorded across services and industry, i.e. sectors that further accounted for around three fourths of the volume of new credit to non-financial corporations. By type of recipient, the share of low[6] and very low[7] value loans in total new leu-denominated credit to non-financial corporations was on the rise, hinting at an improvement in SMEs' access to finance, fostered also by the decline/quasi-standstill in interest rates on these loans at historically low levels and, at the same time, somewhat closer to those on high-value loans[8].

By contrast, the growth rate of household credit posted a relatively slower acceleration (6.4 percent in nominal terms against 5.5 percent in 2016), but still hit an eight-year high, further outpacing the advance in loans to companies; the increase was underpinned by the robust, two-digit advance in new business to this segment[9] (although trailing behind that seen in 2016), benefiting however from the relatively lower volume of NPLs removed from banks' balance sheets.

In terms of European comparisons, the share of household credit in Romania continued to exceed those recorded in the euro area (albeit only marginally) and Hungary, while standing lower than in Poland and the Czech Republic.

4. The majority share of housing loans in credit to households also widened (54.3 percent in December).

The increase in the relative weight of housing loans was ascribable, this time as well, primarily to the "First Home" programme[10], but also to the larger flow of credit for the same purpose granted by banks without state guarantees. The average dynamics of housing loans remained robust, although slowing after two years on the rise (12.2 percent against 15.8 percent in nominal terms). The currency breakdown shows the significant contribution of the leu-denominated component (a growth rate of 40.1 percent, yet well below the 76.9 percent dynamics in 2016), whose share in total housing loans prevailed for the first time (59.1 percent at the end of the year).

At the same time, consumer credit and other loans advanced at a much slower pace, their relative rebound in the first three quarters of the year – resulting in the

6 Below EUR 1 million equivalent.

7 Below EUR 0.25 million equivalent.

8 Above EUR 1 million equivalent.

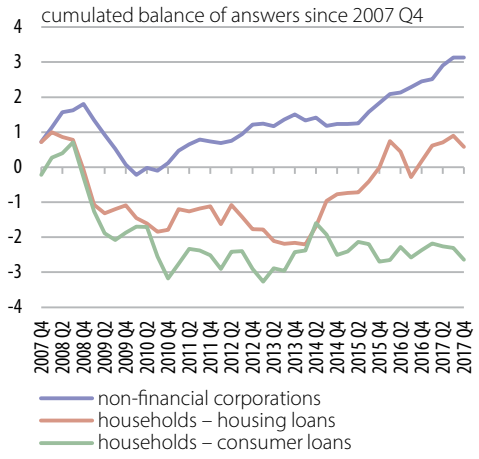
9 Calculations based on the credit flow adjusted for the effect of loan renegotiation.

10 The guarantee ceiling earmarked for this programme was, however, lowered in 2017.

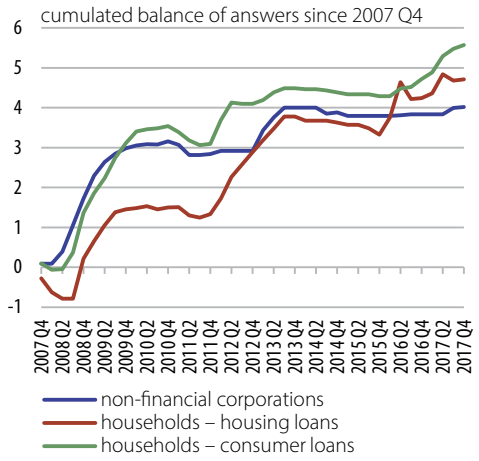
annual dynamics re-entering positive territory in May (for the first time in five years) and accelerating to 2.7 percent in September – being followed by a slowdown towards end-2017, amid the relative worsening of household expectations on their financial standing and employment[11].

Looking at other countries in the region and in the euro area, the share of housing loans in total credit to households in Romania is close to that recorded in Hungary, but remains well below those in the Czech Republic (around 60 percent) and especially in Poland and the euro area (75 percent).

Chart D
Demand for loans



Note: (+) increase; (-) decrease.



Note: (+) tightening; (-) easing.

Chart E
Credit standards

The developments witnessed in 2017 by the dynamics and composition of credit to the private sector broadly reflected the favourable influences exerted on credit demand and supply by: (i) the subdued levels, close to the historical lows, of lending rates on new business in domestic currency to households and non-financial corporations, under the impact of interbank money market rates dropping to record lows/ staying in the vicinity thereof during 2017 Q1-Q3, in the context of the NBR's monetary policy measures; (ii) the further swift increase in households' disposable income, driven mainly by the rise in wage earnings; (iii) the high private sector confidence[12] when compared to the post-2008 period; (iv) the protracted easing trend of credit institutions' balance sheet constraints generated by non-performing loans (the NPL ratio fell from 9.6 percent in 2016 to 6.4 percent in 2017); (v) the further reduction in the loan-to-deposit ratio, to an 11½-year low of 76.9 percent in December 2017; (vi) the consolidation at relatively high levels of the growth rate of house prices[13], supportive of the improvement in monetary transmission via the wealth effect and, as the rise in house prices cushions lending constraints, via the balance sheet effect; (vii) the mitigation of legislative risk following the Constitutional Court rulings on the Law on debt discharge and the Law on converting CHF-denominated loans into leu-denominated loans at the historical exchange rate.

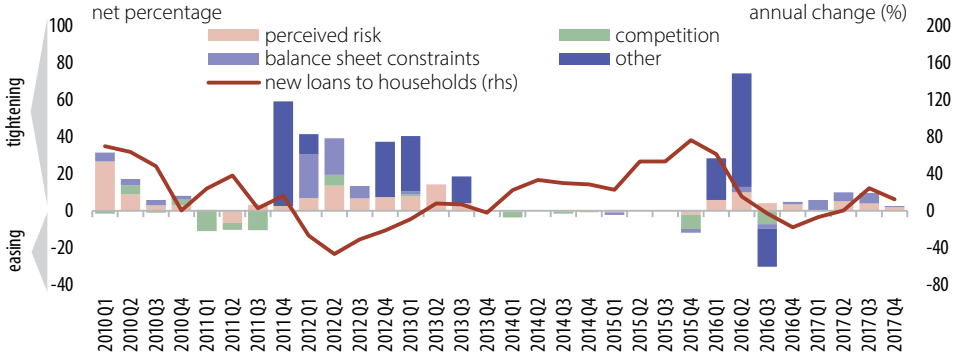
Opposite influences came from the persistence of structural obstacles, the major ones being the inadequate level of capitalisation of domestic small- and medium-sized firms (a large part of which have negative capital), their low profitability and the prevalence of both lack of payment discipline and relatively easy recourse to insolvency proceedings, but also the high indebtedness of some categories of borrowers; to these added prudential measures adopted by

[11] According to the results of the DG ECFIN survey.

[12] According to the results of the DG ECFIN survey.

[13] According to NIS data, the house price index fluctuated around its post-2008 high reached in 2016.

the NBR[14], as well as the likely protraction of the balance sheet adjustment process across some customer segments.



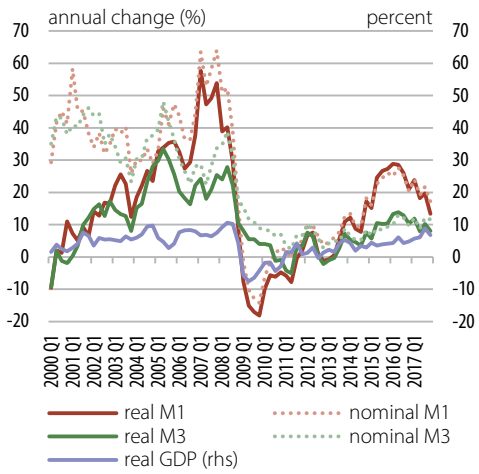
*) quarterly flow – weighted averages

Note: Perceived risk includes expectations on the economic and financial standing, collateral risk, industry risk, expectations on the real estate market. Competition refers to competition among banks, non-banks or other sources of funding. Balance sheet constraints refer to the situation of the bank's capital, developments in non-performing loans, the NBR's monetary policy or prudential decisions.

Chart F
Drivers of changes in credit standards on household loans*

Against this background, the successive issues of the NBR's *Bank Lending Survey* pointed to the continued rise in non-financial corporations' demand for loans and in households' demand for housing loans during the first three quarters of the year, accompanied by fluctuating demand for consumer credit (Chart D). The latter seems to have been caused, inter alia, by a relative tightening of banks' credit standards applicable to that particular category of loans, a process that was extended throughout the year under review (Charts E and F). In the first two quarters of the year, credit institutions tightened the standards on housing loans as well, the measure being afterwards reversed in Q3; looking at credit terms for these loans, the main changes consisted in the increase of the maximum loan amount to collateral value (LTV) and the temporary easing of the maximum monthly debt service to monthly income. At the same time, standards on loans to non-financial corporations remained unchanged, except for Q3, when they witnessed a relative tightening.

Chart G
Broad money and GDP



Source: NIS, NBR

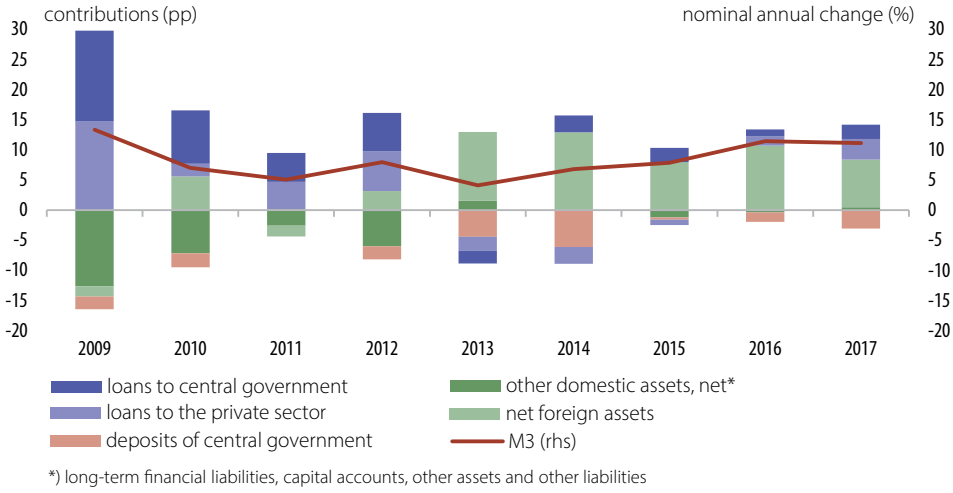
Liquidity in the economy witnessed the following developments:

1. The increase in the economy's degree of monetisation came to a halt (40.8 percent at end-2017 from 41.2 percent at end-2016).

After four years of steady rise, the degree of monetisation remained relatively constant in 2017, amid the slight slowdown in the average pace of increase of broad money (11.1 percent against 11.4 percent in 2016 in nominal terms and 9.6 percent versus 13.2 percent in real terms – Chart G), primarily under the influence of the reduction in the annual dynamics of inflows from EU funds.

[14] NBR Regulation No. 5/2016 amending and supplementing NBR Regulation No. 17/2012.

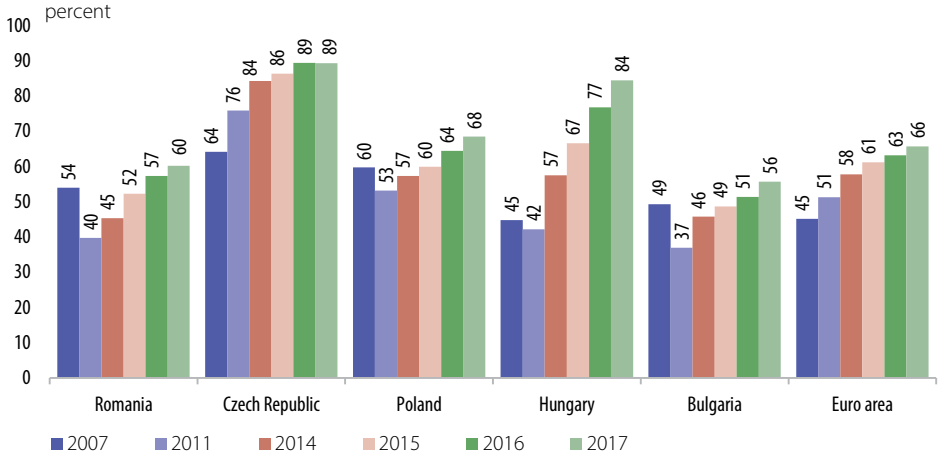
From the perspective of broad money (M3) counterparts, these developments reflected the slower increase in banks' net foreign assets and, to a lower extent, the relatively faster dynamics of central government deposits (Chart H). Expansionary influences, albeit of a relatively smaller magnitude, came especially from the faster advance in credit to the private sector and from the sharper rise in credit institutions' government security holdings.



*) long-term financial liabilities, capital accounts, other assets and other liabilities

Chart H
M3 and its counterparts

2. The majority share held by narrow money in M3 consolidated (60.2 percent in December from 57.3 percent at end-2016) – Chart I.



Source: NCBs

Chart I
Share of M1 in M3, international comparisons

The share of M1 in M3 continued to widen to record highs, albeit at a relatively slower pace, this evolution – similar to that recorded in other countries in the region – being conducive to bringing the M3 composition close to that in the euro area.

Behind the advance stood the persistently high growth rates of currency in circulation and household ON deposits (hence their shares in M3 hit new post-1996

and post-1994 highs respectively), as well as the swift, albeit decelerating, dynamics of ON deposits from non-financial corporations, especially in the first part of the year. These developments reflected the joint effects exerted by the keener demand for money for current transactions – in correlation with the evolution of the rate and of the composition/determinants of economic growth – and by the further decrease in the opportunity cost of holding liquid monetary assets, followed by this cost sticking to low readings throughout the year in the case of households and during the first quarters in the case of companies.

Towards the end of the year, however, the uptrend in the share of M1 in M3 came to a standstill and even tended to reverse, most likely as a result of the adjustment of the NBR's monetary policy stance. Thus, a relatively large share of non-financial corporations' currency holdings shifted to time deposits, more responsive to changes in specific interest rates, which in turn replicated faster the increase in interbank money market rates; against this background, the annual dynamics of non-financial corporations' time deposits with a maturity of up to two years re-entered positive territory and stepped up to a four-year high.

3. The decline in the share of household deposits in total non-banking sector deposits resumed after a temporary interlude in 2016 (59.1 percent in December 2017 from 59.6 percent at end-2016).

The annual dynamics of household deposits lost momentum successively in the latter part of the year, in parallel with the widening of the share of ON deposits in household M3 deposits to record highs for the post-crisis period. Alongside the sustained increase in household income, as well as the faster growth rate of retail trade turnover, these evolutions hint at a relatively stronger propensity for consumption during this period, given the consolidation – for most of the year – of the optimism vis-à-vis the financial standing/employment prospects and the low interest rates on time deposits.

In this context, but also amid the faster dynamics towards year-end of EU funds disbursements, as well as of government spending on goods and services, M3 deposits from non-financial corporations saw an almost continuous uptrend. During the year as a whole, their average rate of change stood, however, below the 2016 reading, given inter alia the lower volume of inflows from EU funds, the swifter pace of increase of imports, as well as the larger amounts distributed as dividends to shareholders, including to the public sector[15].

[15] In line with the provisions of Government Emergency Ordinance No. 29 of 30 March 2017 amending Article 1 paragraph (1) letter g) of Government Ordinance No. 64/2001 on profit distribution at national companies, national corporations and commercial companies that are either fully or majority state-owned, as well as at *régies autonomes* and amending Article 1 paragraphs (2) and (3) of Government Emergency Ordinance No. 109/2011 on the corporate governance of public enterprises.