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Procedia Economics and Finance 32 (2015) 558 – 565

Procedia Economics and Finance

www.elsevier.com/locate/procedia

Emerging Markets Queries in Finance and Business

Lending convergence in the Romanian banking sector

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Abstract

Lending convergence is to be expected in developed banking sectors but has the potential to enhance cyclicality. We study lending variations in Romania from 2007 to 2013 and find that the onset of the financial crisis was accompanied by lending stagnation and an increase in banking convergence. We argue that lending variations depend on sectorial developments, which in turn depend on economic growth. Results from econometrical convergence models confirm a sudden increase in banking convergence during the financial crisis, followed by a relative moderation after 2012. Lending convergence is important for macroeconomic policy makers, while also allowing for macroprudential adjustments.

Selection and peer-review under responsibility of Asociatia Grupul Roman de Cercetari in Finante Corporatiste

Keywords: financial convergence; lending; credit risk; financial crisis.

1. Introduction

While the process of globalization has made international markets more connected, this tendency has been more evident in the case of financial markets. Large international financial groups expanded worldwide and their local subsidiaries benefited from their reputation, financial support and best practices. As such, the financial market itself had its way of promoting similar practices, which depended less and less on geographic borders.

Another important determinant of financial convergence has been the ever-improving regulatory framework. The Basel Accords signaled the need perceived by the international financial community to ensure a more

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Selection and peer-review under responsibility of Asociatia Grupul Roman de Cercetari in Finante Corporatiste
doi:10.1016/S2212-5671(15)01432-X

systematic prudential regulation, in a better integrated world financial market. The multiple integration envisaged as underlying the construction of the European Union has led things even further. The successive developments of the Capital Requirements Directive followed the Basel Accords, while the European Banking Authority and, within the recently developed banking union, the European Central Bank have clear tasks with regard to ensuring the so-called European level playing field. Banking integration is looked upon by central banks and the generally large size of the banking sector gives it a central position in financial stability assessments.

In recent practice, the European financial integration is perceived as being on an improving path since mid-2012, while also allowing for the persistence of market fragmentations (European Central Bank, 2014). The European banking union is expected to enhance the level playing field, therefore supporting banking convergence. The national central banks and/or supervisory authorities assess developments in the banking sectors considering the European financial integration, as it is also the case for Romania (National Bank of Romania, 2013), and their domestic assessments often take into account banking convergence, mostly under topics such as peer comparisons, concentration and contagion risk.

Financial integration puts banking sectors on a tendency of convergence. While there is no single measure to account for banking convergence, a relevant series of studies covered topics such as interest rates and profitability. As such, corporate and mortgage rates have been shown to converge slowly within different banking sectors (Adam et al., 2002), while interest rates convergence could be higher when considering national characteristics of borrowers (Affinito and Farabulini, 2006). With regard to profitability, bank convergence is higher in the US and weaker than expected in Europe, butthere seems to be flaws in assessing convergence with the use of interest rates (Gropp and Kashyap, 2009).Other studies proposed alternative instruments such as the ratios of deposits and loans to GDP, finding that convergence is higher within the so-called clubs, such as the euro-area (Affinito, 2011). Moreover, with a view on limiting the impact of national characteristics of borrowers, corporate and mortgage interest margins have been proposed as an improvement over the useof interest rates convergence models, while also maintaining most of its benefits (Muntean, 2014).

Other stream of research studied banking convergence focusing on credit supply. Measuring bank competition seems to provide better results when restricted to lending, as such changes in competition have an impact on funding conditions at country-level with further consequences, such as those related to the transmission of the monetary policy (Brämer et al., 2013).Analyzing credit supply for a banking sector consisting of a mix of state-controlled banks, foreign-owned banks and domestic private banks, a study suggests that ownership affects credit supply, particularly during crisis, creating a problem of loyalty to the local economy (Fungáčová et al., 2013).Economic integration has been expected to increase bank competition, but even when this is not demonstrated, there are findings with regard to a convergence in bank competition itself (Weill, 2013).The financial crisis has been shown to stop country-level convergence with regard to market power, while determinants of convergence at bank-level include ownership characteristics, asset quality and capitalization (Efthyvoulou and Yildirim, 2014).

The relationship between economic growth and bank lending is not always straightforward, being affected by credit supply and credit demand factors.Local lending in Romania decreased since Q4 2012, although the economic environment improved (National Bank of Romania, 2014). Credit supply has been shown to be affected by the decrease of parent bank funding, the persistence of high NPL levels and the relative high share of short-term local funding in the banks' balance sheets. On the other hand, credit demand was also affected by the continued adjustments of non-financial entities following the financial crisis.

Compared to assessing banking convergence in an integrating international environment, analyzing the same developments at national level is likely to provide stronger results. This may come as a consequence of common determinants shared by local credit institutions, such as the phases of the economic and credit cycles, external risk perceptions and regulatory developments. However, banking convergence at national level is also likely to change in time. Understanding common developments of credit institutions is important for the