# THE ROLE OF THE MONETARY POLICY IN THE CONTEXT OF THE CURRENT FINANCIAL CRISIS. THE CASE OF ROMANIA

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## Abstract

*This paper tries to present Romania's macroeconomic development since the end of 2008 up to present times, especially the monetary policy adopted by the monetary authority in the current international context. In the first part of the paper we will present in turn aspects referring to the following: the main causes that triggered the current financial but also economic crisis, its spreading pattern in EU countries, the level of economic contraction of certain European countries, including Romania. The second part refers to the time of onset of the crisis in the country, to the direct and indirect effects of the crisis on the Romanian economy, to speculative attacks on the Romanian currency and to the immediate reaction of the banks but also of the population. Part three presents the monetary policy measures taken by Romania in order to maintain price stability and continuing downward trend in inflation, the monetary policy instruments used by the Central Bank of Romania. We also discussed the monetary policy measures taken by the NBR in the current year, the situation of the economic contraction, the changes of monthly interest rate in monetary policy, the factors behind this development, the main money market operations, issues relating to financial stability and the main measures to improve the perception of foreign investors.*

***Keywords:*** *financial crisis, monetary policy, instruments, effects*

***JEL codes:*** *B22, E31, E52, E58*

## 1. Introduction

Considered as unprecedented in the last half of the 20th century, the international financial crisis has its roots in the U.S. economy. The main cause of the crisis was the collapse of U.S. housing loan market, a fall evidenced by the increase of mortgage debts to 34 billion dollars in the period between June 2006 and June 2007. In addition to this, a number of analysts (Hardouvelis[1], Gerea[2], Cernea[3]) have found that the onset of the crisis in the U.S. was also stirred by other U.S. domestic issues: the economic growth based on increasing the amount of credit - to increase more and more bank profit and obtain certain bonuses by bankers -, the rising consumer demand, the increase of unpaid loans at maturity as a result of rising interest rates, the deregulation of financial markets, the strong development of derivatives markets.

The Governor of The Central Bank of Romania (NBR) Mugur Isărescu[4] considers that the outbreak of the crisis was determined by two broad categories of causes: one of a macroeconomic type, and the other of a microeconomic type (which conditioned each other). He claims also that abundant liquidity - created by the major central banks around the world: FED and BOJ- as well as the over-saturation with savings, have led to great resources available for investment, to the use of sophisticated financial instruments, which were difficult to understand by some investors.

Lower interest rates in the U.S. have increased the appetite for assets with large gains. The risk began to be underestimated and the investors, to decrease vigilance.

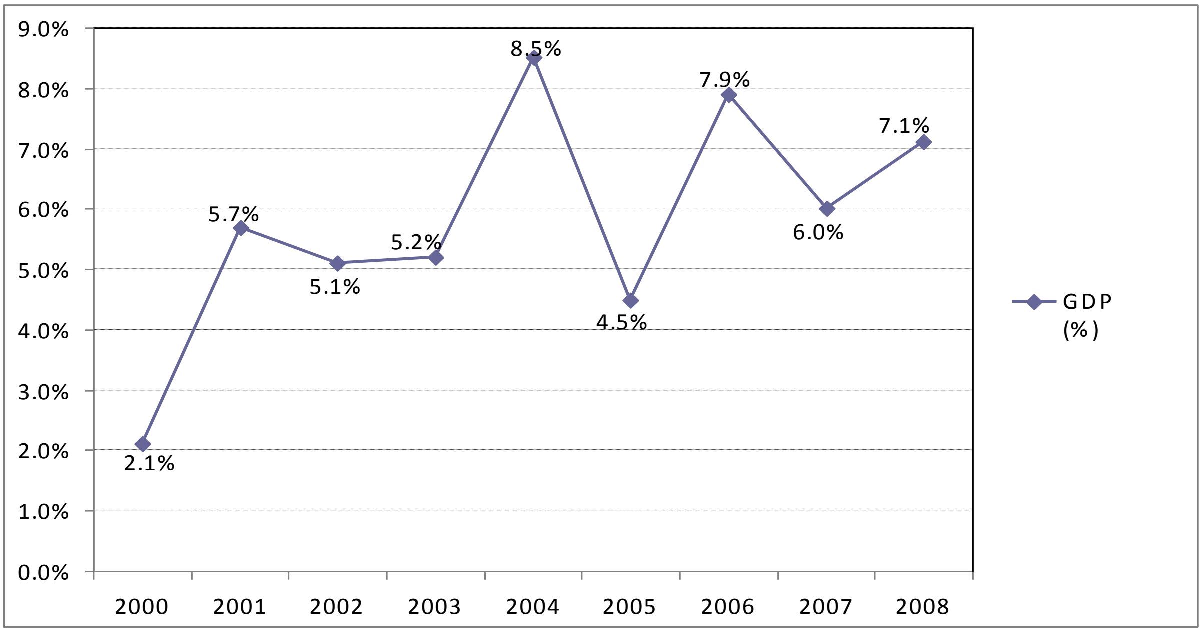
The financial crisis triggered in the U.S. was quite quickly felt by developed countries including the EU. It affected the whole EU, but it spread differently from country to country. Thus, some countries (mainly developed countries) have managed to maintain economic growth, although a rather small one, but others were deeply immersed in the economic downturn (particularly the Baltic countries, which were severely hit by the international financial crisis: Latvia whose economic contraction in the second quarter of 2009 was -22.6%, Estonia with an economic contraction for the same period of 2009 of -18.2%, and Lithuania with an economic contraction of -16.6%). Romania is situated somewhere in the middle of the European countries that went into recession (a contraction of -8.8% at the end of second economic quarter). According to Eurostat, the lowest economic contractions in the second quarter of this year were registered in Greece (-0.2%), Cyprus (-07%), France (-2.6%).

[1] HARDOUVELIS, A. G. *International Financial Crisis and the Uncertain Economic Future*, the conference „How is the world after Financial Turnmoil", BNR, decembrie, 2008.
[2] GEREA, N. *Subprime Credit & Financial Crisis,* the conference „How is the world after Financial Turnmoil", BNR, decembrie, 2008.
[3] CERNEA, S. *Criza financiară: impactul asupra economiei româneşti (The Financial Crisis: Its Impact Upon The Romanian Economy)*, AGER Conference, November, 2008.
[4] ISĂRESCU, M. *Criza financiară internaţională şi provocări pentru politica monetară din România (The International Financial Crisis and Challenges For The Romanian Monetary Policy)*, BNR, 2009, Access from: <http://www.bnro.ro>

## 2. The Financial Crisis in Romania. Onset in Romania. Effects

In economic terms, at the onset of the financial crisis, our country has recorded high economic growth rates for a period of several years ending in 2008 to a GDP growth of 7.1%. In this respect, the chart below is very suggestive.

**Figure 1 Evolution of the real GDP in Romania during 2000-2008**




*Source: www.insse.ro*

This growth was however accompanied by an increase in the current account deficit (CAD) to 12.5% of GDP in 2008 and in the short-term external debt (STED) as follows:

**Table 1 Evolution of CAD, STED and of the Inflation Rate in 2000-2008**

| ***Years*** | ***2000*** | ***2001*** | ***2002*** | ***2003*** | ***2004*** | ***2005*** | ***2006*** | ***2007*** | ***2008*** |
|---|---|---|---|---|---|---|---|---|---|
| *Current Account Deficit (% of the GDP)* | … | … | Average of years 2002-2006 -6,3 | | | | | -13,5 | -12,5 |
| *DETS* (billiards Euro) | 0,9 | 1,1 | 1,2 | 2,0 | 3,2 | 6,3 | 12,5 | 20,5 | 22,5 |
| *Inflation Rate (%)* | 45,7 | 34,5 | 22,5 | 15,3 | 11,9 | 9,0 | 6,6 | 4,8 | 7,9 |

*Source: www.bnro.ro/DocumentInformation.aspx?idDocument;www.insse.ro*

One could notice in the evolution of the inflation rate that since 2000, Romania has entered a downward trend - considered the main objective of the Central Bank (reducing inflation). For inflation targeting, NBR has opted for a controlled floating exchange rate in order to avoid excessive appreciation of the currency but also to discourage speculation.

In 2008, however, it is recorded an increase of the inflation rate to 7.9%, and the growth is explained by the following: increased inflationary pressure from customer demand, increasing investments and household consumption, a significant increase in budgetary expenditure, increased imports in the background of currency depreciation.

The international financial crisis was felt in Romania since the fourth quarter of 2008 through a series of direct and indirect effects[5]. The main direct and indirect effects were spread along the following channels:

**Table 2 The direct effects of the crisis on Romanian economy starting from the end of 2008**

| *No.* | *Channel* | *The direct effects of the crisis on Romanian economy* |
|---|---|---|
| *1.* | *trust* | - worsening of risk perception in the countries of Central and Eastern Europe, including Romania;<br>- reduction of foreign capital flow; |
| *2.* | *financial* | - difficulties in external financing and its cost rises |
| *3.* | *exchange rate* | - depreciation and high volatility of the currency |
| *4.* | *commercial* | - restriction of foreign markets as a result of decreased foreign demand for Romanian products, given that exporting firms have a large portfolio of banks (70% of total exports have EU destination);<br>- decrease of import |
| *5.* | *production* | - doubling of the risk of liquidity and solvency at firm level, leading to reduced economic activity (by limiting the use of the production capacity) and to closure of firms (due to dependence on international demand) |

**Table 3 The indirect effects of the crisis on Romanian economy starting from the end of 2008**

| *No.* | *Channel* | *The indirect effects of the crisis on Romanian economy* |
|---|---|---|
| *1.* | *public wealth* | - reduction of public wealth; |
| *2.* | *financial* | - reducing credit due to higher funding costs and increased uncertainty;<br>- risks in financial stability as a result of the following: the growth of underperforming loans and assets affected by reduced population income and public wealth, the lowering of income and inability to finance firms; |
| *3.* | *exchange rate* | - exposure to currency risk by firms; |
| *4.* | *commercial* | - decrease in population consumption; |
| *5.* | *social* | - increase in unemployment rate; |
| *6.* | *taxes* | - directing much lower revenues to the treasury. |

Because of prudential and administrative measures adopted over time by the NBR, the direct impact of the international financial crisis on the Romanian banking system was not felt so strongly.

[5] PÁL, R. *Potenţialul unei creşterei sustenabile a României dincolo de provocările crizei financiare (The Potential of a Sustainable Growth of Romania Beyond The Challenges of The Financial Crisis),* BNR, 2009, Acces from: <*http:/bnro.ro/Publication Document.aspx?icid=6885*>

However, in late October 2008, the first speculative attack on domestic currency (RON) took place. In the same period banks were accused of forming a cartel aiming at the interest increase. The two attempts failed, however, as banks were forced to reduce interest rates, and the attack on the national currency's share by the foreign banks resulted in significant losses for them. In this regard, the Central Bank of Romania (BNR) intervened in the market by injecting 2 billion RON, thus proving insufficient for the initiators of the speculative attack. According to the NBR Governor, Mugur Isărescu, the criteria of membership in the euro area stimulate speculative attacks on currency.

That same month, there was also a feeling of distrust among depositors, so that there were withdrawals of deposits in the banking sector of 4.7 billion RON, which meant 3.5% of deposits. The money withdrawn from banks were intended for the following: kept as cash (0.8 billion, RON), safekeeping in deposit boxes at banks, buying government securities (0.5 billion RON), the formation of deposits abroad (1, 3 billion RON), the purchase of foreign currency.

As a result of decreased confidence of depositors in the banking system, it was necessary from October 15, 2008, to increase the level of guaranteed bank deposits per person and per bank from 20,000 euros to 50,000 euros. Later, in December confidence returned in the banking system, and major banks have re-become the main beneficiaries of withdrawn deposits.

## 3. The monetary policy of the NBR in 2008

According to Law 312/2004, the main objective of the Central Bank (NBR) is to ensure and maintain price stability and its main tasks consist in setting and implementing monetary policy[6]. In 2008, NBR witnessed the creation of a downward trend of inflation, so as to achieve the annual targets within the established frame for adopting the European currency (2014). From this point of view, the NBR has faced a major challenge over the preceding year due to factors meant to keep it from achieving the annual target set for 2008: 3.85 ± 1%, thus reaching 7.9% at the end of the year. These factors include:

- accelerated rise in aggregate demand;
- rising volatile prices of food and administered prices;
- damaging of inflationary expectations and price and wage behaviors;
- faster growth of wages than labor productivity;

[6] Acces from: <*http://www.bnro.ro*>

- implementation of laxer budgetary policies in the fourth quarter due to elections;
- the possible devaluation of national currency.

All these factors were such that the NBR had to resort to the set of tools and procedures by which the Central Bank managed to implement monetary policy in order to achieve the primary objective of maintaining price stability, so that the inflation rate would not exceed the target by too far. Open-market operations were the main instrument of monetary policy to ensure the guidance of interest rates, the management ofmoney market liquidity and the signaling of monetary policy. To ensure liquidity in the banking system, the NBR has used the following open-market operations: *repurchase agreements, attracting deposits from credit institutions, issuing of certificates of deposit, reversed repo operations, sales / purchases of eligible assets, foreign exchange swaps*. Starting with the fourth quarter of 2008, however, the most predominant were open-market operations serving as liquidity injections, the NBR thus becoming creditor of the banking system.

The NBR has taken restrictive measures regarding interest rate policy. In the period February to July 2008, The NBR operated 5 changes of consecutive increase of the monetary policy interest rate from 8% to 10.25%. Also, the Central Bank maintained tight control over money market liquidity and kept rates of compulsory minimum reserves (RMO) at 20% for liabilities in lei with maturity of less than 2 years, and at 40% for liabilities in foreign currency.

A change in the nature of the challenges to monetary policy took place at the outbreak in the month of September 2008 of a deep financial and economic crisis. GDP growth in third quarter (9.1%) made the NBR to face continuous depreciation of the domestic currency, following the implementation of relaxed fiscal policy and a policy to increase revenue in terms of electoral circumstances in the last quarter of 2008. The reaction of the NBR in terms of monetary policy was difficult to determine if one considers the huge increase of the uncertainty surrounding global economic change, but also of the uncertainties and implications for the economy. In this context, The Central Bank Romania established to maintain the monetary policy rate to 10.25% in the fourth quarter as well. When banks have had problems with providing liquidity (October), the NBR's decision was to reduce the RMO rate for liabilities in lei from 20% to 18%. The measure was aimed at the proper functioning of the inter-bank money market[7].

[7] Raport Anual 2008, pag. 35, BNR, Acces from: <*http://www.bnro.ro*>

The high level of current account deficit of balance of payments (12.5% of GDP), of the budget deficit (5.4% of GDP), as well as the dependence of the banking system on external financing, have determined that Romania be placed by investors, along with other countries in the region, in the category of the economies with a higher degree of vulnerability. This new perception degradation following the worsening of Romania's risk qualification granted by two major rating agencies (S & P: BB +, and Fitch: BB +) amplified the pressure on the depreciation of the national currency. Because of these influences, annual inflation has slowed down its decline in late 2008, the level reached in December (7.9%) continuing to be placed, however, above the upper limit of 4.8%. Romania was well below the average of the most performing three EU countries, whose inflation rate was 2.3%.

NBR has acted consistently with prudential and administrative measures to achieve the following:

- reduce credit growth rate for private and public sector by introducing restrictions aimed at restricting the ease of credit for this sector and especially for the public – by no longer granting credit to the population on the basis of the ID card alone and with no supplementary guarantee;
- support lending in national currency and not in foreign one, whose rate was unstable, which could generate far more debt in the repayment of loans;
- limiting overall exposure.

For the gradual adjustment of liquidity in the banking system, the NBR was forced to keep RMO rates at high levels.

## 4. The monetary policy adopted by the NBR in 2009

In 2009 as well the NBR has set as central objective to maintain price stability and continuing the downward trend in inflation. The ambition of the National Bank for this year is $3.5 \pm 1\%$, but this was later revised by the monetary authority from 4.3% to 4.4%.

The evolution of the monthly inflation rate during 2009 is presented in Table 4.

**Table 4 The evolution of the monthly inflation rate (IR) in 2009**

| *Month* | *Inflation rate* |
|---|---|
| *January 2009* | 6.71% |
| *February 2009* | 6.89% |
| *March 2009* | 6.71% |
| *April 2009* | 6.45% |
| *May 2009* | 5.95% |
| *June 2009* | 5.86% |
| *July 2009* | 5.06% |
| *August 2009* | 4.96% |

*Source: www.insse.ro*

Given that in July, the EU registered an annual inflation rate of 0.2%, Romania has made, according to Eurostat data for the fourth consecutive time the highest inflation rate of 5.06%, followed by of Hungary and Poland with 4.9% and 4.4%. Countries with the lowest inflation rates in the EU were Ireland (-2.6%), Belgium (-1.7%), Luxembourg (-1.5%). In the euro area the inflation rate was -0.7% in July.

Except February, when the RI peaked, changes in the inflation rate ranged on a downward path, following thus the NBR's monetary policy.

In the second quarter the decline in aggregate demand had its consequences on the growth of consumer prices, yielding significant effects on factors including the different types of supply: on fuel prices and on food and by default on the RI.

The most significant influence on reducing the inflation rate was exerted by fuel prices (the volatile price group). Dynamic of food commodity prices was also favorable. The reduction of the rate of increase was moderate for the group of volatile prices, but relatively strong for food prices included in the index CORE2.

In June, the annual rate of basic CORE 2 inflation (6.08%) was slightly above the overall inflation (5.86%) due to increased prices of tobacco products (due to the adverse influence of taxes). Unlike CORE2 inflation rate, inflation-adjusted CORE2 rate - which eliminates from the calculation the prices of tobacco products and of alcoholic beverages - dropped significantly below the CPI inflation (up to 4.79%), decreasing by 1.37% as compared to March 2009 (6.16%). The dynamics of prices of imports, of food and of the relative mitigation of inflation expectations, also showed positive influences on the evolution of inflation.

Comparing Romania's inflation rate at the end of the first quarter (6.71%) with the one at the end of second quarter (5.86%), one can notice a 0.85% decrease. This reduction was caused by changes in inflation for the following goods and services[8]: for tobacco products +0.27%, for telephony services +0.3%, for non-food goods, food, other services and energy : -1.42%.

In the first quarter of 2009, the impact of the global financial crisis on the national economy, spread initially through financial channels and foreign trade, grew substantially. For the first quarter, the economic contraction was of 7.6%, as compared to the same period of 2008[9]. The most important contribution to the contraction of economic activity was the substantial reduction in domestic demand. Gross fixed capital formation fell back slightly, and stock changes added a strong negative influence on growth. Significant reduction in domestic demand is explained not only by unfavorable dynamics of the financial resources available to the public and corporations, but also by the reduction of the propensity to consumption and investment. Alongside these, there was, however, increased propensity to save (in June 2009 total deposits of the population, both in national currency and foreign currencies, were 93,153.9 million RON compared to the same period in 2008 when they were of 77,929.6 million RON[10]). This increase was due to the uncertainty about the duration of the negative effects of economic crisis on future revenue flows.

Romania's economic contraction was 8.8% of GDP in the second quarter 2009, compared to same period in 2008, when an economic growth was taking place, thereby placing the country in the 5th position in the EU from this point of view. Taken together, in the first 6 months, the GDP fell by 7.6% as compared to the same period in 2008.

With regard to interest rate changes for financial policy operated by the central bank in 2008 and 2009, these were as follows:

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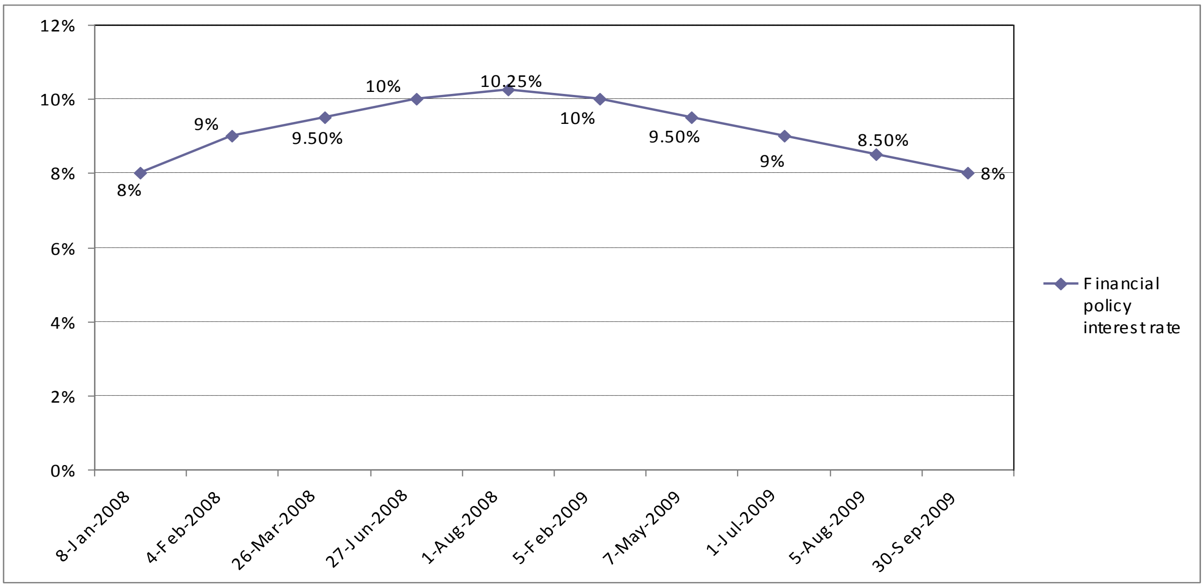
[8] Acces from: <*http://www.bursaasigurarilor.ro/MUGUR-ISARESCU-TINTIREA-INFLATIEI-RAPORT-TRIMESTRIAL-ASUPRA-INFLATIEI-AUGUST_2009-news10-i30108-l1.html*>

[9] Acces from: < *http://www.bnro.ro*>

[10] Acces from: < *http://www.bnro.ro*>

**Figure 2 Evolution of the financial policy interest rate in 2008-2009**




*Source: http://bnro.ro/Rate-dobanzi-de-politica-monetara-1744.aspx*

As the chart shows, in order to increase the liquidity of banks and relaunch credits, starting early February 2009, the NBR initiated a continuous process of cautious relaxation of the monetary policy by reducing the monetary policy rate from 10% (February 2009) to 8% in September 2009. Also, the Central Bank decided in June 2009 the RMO rate reduction from 18% to 15% for liabilities in lei with maturity less than 2 years, and from 40% to 35% for liabilities in foreign currency. The period of validity of these rates was July 24 to August 23. Subsequently, in September, NBR reduced, in addition to monetary policy interest rate, the RMO rate for foreign currency liabilities from 35% to 30% (along the validity period from August 24 to September 23). These measures were designed to reduce the interest rate charged by banks on loans granted with a gradual return (for loans and for deposits) to its normal working rate according to the monetary policy interest rates. According to analysts, the changes in monetary policy interest rates and RMO rates generated an additional liquidity for banks of 1.2 billion euros.

Reducing RMO rates aims the following: the issue of liquidity, inter-bank interest reduction, reduction of rates of bank loans or in other words unblocking credits. Such measures regarding the RMO rate were aimed at streamlining cash flow, continuing the gradual alignment to the standards of the European Central Bank (ECB).

The main money market operations conducted by the NBR in 2009 are the following:

- repurchase operations;
- reversed repurchase operations;
- attracting deposits.

**Table 5 Repurchase, reversed repurchase and deposit attracting operations in the year 2009- billions of RON**

| *Repurchase operations* | | | | | |
|---|---|---|---|---|---|
| ***Auction date*** | ***Due date*** | ***Maturity (days)*** | ***Offerred sum*** | ***Awarded sum*** | ***Interest rate*** |
| *09.07.2009* | *09.07.2009* | *32* | 3,727.6 | 3,727.6 | 9.0% |
| *13.07.2009* | *13.07.2009* | *31* | 2,539.0 | 2,539.0 | 9.0% |
| *29.07.2009* | *29.07.2009* | *30* | 5,529.4 | 5,529.4 | 9.0% |
| *27.08.2009* | *27.08.2009* | *7* | 8,476.5 | 8,476.5 | 8.5% |
| *07.09.2009* | *07.09.2009* | *7* | 8,381.4 | 8,381.4 | 8.5% |
| ***Reversed repurchase operations*** | | | | | |
| ***Auction date*** | ***Due date*** | ***Maturity (days)*** | ***Offerred sum*** | ***Awarded sum*** | ***Interest rate*** |
| *18.05.2009* | *18.05.2009* | *7* | 153,9 | 153,9 | 9,5% |
| *17.07.2009* | *17.07.2009* | *7* | 2.060,3 | 1.963,6 | 9,0% |
| *20.07.2009* | *20.07.2009* | *7* | 219,2 | 219,2 | 9,0% |
| *03.08.2009* | *03.08.2009* | *7* | 485,6 | 485,6 | 9,0% |
| *10.09.2009* | *10.09.2009* | *4* | 1.752,8 | 1.752,8 | 8,5% |
| ***Operations to attract deposits*** | | | | | |
| ***Auction date*** | ***Due date*** | ***Maturity (days)*** | ***Offerred sum*** | ***Awarded sum*** | ***Interest rate*** |
| *21.04.2009* | *21.04.2009* | *2* | 2,170.0 | 2,170.0 | 10.0% |
| *17.09.2009* | *17.09.2009* | *4* | 2,355.0 | 2,355.0 | 8.5% |

*Source: http:// www.bnro.ro/Operatiuni-de-piata-monetara-3908.aspx*

As shown in the table above, the NBR tried to inject into the economy a greater amount of cash and absorb less. Basically, since late 2008, following a change in net liquidity position of banks from a surplus to a deficit, monetary market operations for liquidity injections became dominant, the NBR thus passing to the position of creditor of the banking system.

To avoid deepening the economic recession, to prevent the economic situation from worsening, the NBR together with state government concluded funding agreements with the IMF, the EU, the World Bank, EBRD and other foreign financial institutions. The loan amounted to around 20 billion euros, of which: 12.95 billion euros will come from the IMF, 5 billion euros from the EU, 1 billion euros from World Bank and 1 billion euros from the EBRD and other financial institutions. The first loan installment of 5 billion euros was directed to NBR reserves, thus freeing money from the bank reserves of 1 billion euros.

Repayment of these loans must take place before 2015. The loan can be considered a stabilizing factor in Romania, acting as: support for exchange rate stability so as not to jeopardize the stability of the banking sector, source of ensuring the Romanian financial system liquidity, strong commitment to public restructuring and budget transparency, an insurance of social protection.

Another stabilizing factor in Romania - following the NBR's and government's intervention- is the commitment of 9 international banks operating in our country to maintain credit lines and to continue their work in Romania and to provide additional funding if necessary. These commitments ensure: the elimination of capital outflow possibilities, ensuring the financing of the national economy, ensuring the solvency of the banking system in Romania.

## 5. Romania's financial stability in 2009

It is widely known that financial stability is the situation characterized by lack of banking crises, the existence of a certain level of stability of prices and interest rates. To ensure this, the Central Bank of any country plays a critical role.

Haugland and Vilkøren state that "both communication and monetary policy decisions indicate that financial stability is about to have a well-defined role in monetary policy, which may be due to the acknowledgement that financial stability, has consequences on the future developments of inflation and production[11].

In general, inflation is regarded as the main source affecting the financial stability of a country. The opinions of two experts, Borio and Lowe[12], achieving low inflation rates leads to the creation of a new economic climate which means a reassessment of the relationship between price stability and financial stability. Typically, periods characterized by high rates of inflation faced with severe financial instability and crises of the banking sector, finally reaching an economic downturn. However Crockett[13] believes that a low inflation rate is not a sufficient condition for short-term financial stability.

Any country that is engaged in a process of disinflation has to choose an appropriate inflation reduction rate so as to reduce or avoid conflict with financial stability. Our country has made in the period 2000-2007 an average disinflation rate of 5.8% per year, without affecting financial stability. Romania has been criticized for delays in reducing inflation. Their cause was the failure of structural reforms. Replacing these reforms with greater

[11] HAUGLAND, K., VILKØREN, B. *Financial stability and monetary policy- theory and practice,* Norges Bank, Ecconomic Bulletin, no.1, 2006

[12] BORIO, C. & LOWE, P. *Asset prices, financial and monetary stability: exploring the nexus, BIS*, Caiet de Studii no.127, 2002

[13] CROCKET, A. *Central banking under test?,* Conference "Monetary Stability, Financial Stability and the Business Cycle", Basel, 28-29 March 2003

increase of interest rates would have led to the deterioration of the financial situation of firms and households, and such a situation would have also deteriorated the financial stability of the banking system. In the long term, failure to maintain financial stability actually leads to re-boosting inflation[14].

Economic contraction in Romania exerted negative influence on the financial position of companies, on the increase of the unemployment rate, with particular negative repercussions on the financial system, especially on banks.

According to the Financial Stability Report in 2009[15], reducing access to domestic and foreign financing can have negative effects on corporate debt repayment. One of the most serious current vulnerabilities to financial stability is the DETS (due to the reduction since the last months of 2008 of external funding and the perceived country risk due to the foreign exchange reserves of the country). Its weight is important (43%) in external debt and more than 80% belongs to the private sector. A third of the balance sheet liability of Romanian banks is externally funded with foreign currency. Of this third, half is on a short term. In the recent months, however, this vulnerability decreased significantly, following the decision of major banks to maintain exposure to Romania and the signing of loan agreements with the IMF and the EU – who cover the deficit of external financing and credibility. According to the 2009 Financial Stability Report, the Romanian banking sector capital share of the countries operating in Romania is: Greece (30.7%), Austria (23.5%), the Netherlands (11.9%), Italy, Hungary and France (6%).

Financial stability has been threatened in recent months also by the population as a result of the following: increase of population debt especially in foreign currency, on a long term and for consumer goods, increase by more than two times in the last year of the debt, from 2,343 million RON in the month of June 2008 to 5,795 million RON in the month of June 2009 (a growth which is explained by the following: increased installment rates, reduced wages, job losses), net property damage. For these reasons and due to more expensive external financing, banks turned to attracting savings from the public.

[14] MUGUR, I. *Criza financiară internaţională şi provocări pentru politica monetară din România (The International Financial Crisis and Challenges for the Romanian Monetary Policy)*, BNR, 2009, Acces from: *< http://www.bnro.ro>*

[15] *Raportul de stabilitate financiară în anul 2009 (The 2009 Financial Stability Report),* Acces from: *<http://www.bnro.ro/files/d/Pubs_ro/RFS/RFS2009.pdf>*

So that banks can cope with strong potential shocks, the NBR decided, as a cautious measure, that they should provide and maintain during the period 2009-2010, a minimum level of solvency of 10%, as recommended by the IMF as well.

## 6. Measures for a better perception of investors in Romania

If before the onset of the international financial crisis, Romania was a country with the most profitable investment opportunities, at present, according to Deloitte[16] study, the option for investments in Romania and Bulgaria represent only 5% of the total investments. New investments are aimed at Poland, the Czech Republic, Slovakia and Hungary. According to the same study, 79% of investors focus on Central Europe, 8% on the countries of former Yugoslavia, 5% on our country and Bulgaria, and 3% on the Baltic countries. The lack of interest from foreign investors in Romania and the perception of Romania as a country with high risk are due to the sharp deterioration of the economic climate in our country and large external imbalances that increase the vulnerability of the economy.

In order to improve perceptions of investors in Romania, the main measures needed would be the following:

- improved capacity to absorb EU funds so as to achieve a change of external private funding with external public funding;
- creating new jobs in poorly exploited areas such as infrastructure, tourism - with great potential but scarcely exploited because of the lack of roads and highways in Europe;
- placing even in times of crisis investments in infrastructure, whose poor state drives away the many potential foreign investors;
- improvement of agricultural infrastructure (by use of irrigation systems in large areas), because Romanian agriculture is insufficiently exploited especially if we consider that it is an agricultural potential that could provide food for about 80 million people. It should also be considered that a significant proportion of agricultural land could be used for the production of organic farming, increasingly sought and bought by people, even if their price is slightly higher than those existing in abundance on the market and chemically treated.

It is considered that the infrastructure, tourism and agriculture should and could take over the role of growth catalysts in Romania.

[16] Acces from: <*http://www.evz.ro/articole/detalii-articol/862932/Investitorii-ocolesc-Romania-si-Bulgaria*>

## 7. Conclusions

The main conclusions stemming from the work are as follows:

1. The financial crisis that started in the U.S. was quite quickly spread to developed countries, including the EU, but the spreading pattern was different from country to country. Some countries managed to maintain a slight growth, but others were sunken deep in economic recession. Romania is somewhere in the middle of the European countries to have gone into recession.

2. At the onset of the crisis, our economy registered higher rates of growth over several years ending in 2008 with a GDP growth of 7.1%. This growth was however accompanied by an increase of the current account deficit and of the external debt in the short term. The international financial crisis was felt in Romania since the fourth quarter of 2008 through a series of indicators: the worsening of the risk perception in the countries of Central and Eastern Europe - which Romania is part of; the restriction of exportation due to falling foreign demand for Romanian products, given that exporting firms have a large share in the portfolios of banks; difficulties in external financing and its price increase; a doubling of the risk of liquidity and solvency of firms, leading to reduced economic activity and the market exit of some firms.

3. The main objective of the Central Bank (NBR) is to ensure and maintain price stability. In 2008, the NBR sought continuing the creation of a downward trend of inflation, so as to achieve annual targets established in the frame for adopting the European currency (2014). From this point of view, the NBR faced a major challenge over the previous year due to factors preventing it from achieving the annual target set for 2008: $3.85 \pm 1\%$, thus reaching at the end of the year the value of 7.9%, well above the top three performances in the EU (2.3%). The NBR had to resort to the set of tools and procedures by which the Central Bank managed to implement monetary policy enabling it to achieve the primary objective of maintaining price stability so that the inflation rate would not go too high compared to the target. Open-market operations were the main instrument of monetary policy aimed at influencing interest rates, managing financial market liquidity management and signaling monetary policy. To this end, the NBR used the following open market operations: repurchase agreements, attracting deposits from credit institutions, issuing of certificates of deposit, repo operations, sales/purchases of eligible assets, foreign exchange swaps. Starting with the fourth

quarter of 2008, however, more predominant were open-market operations for liquidity injections, the NBR becoming creditor of the banking system.

4. To avoid deepening the economic recession, the NBR and the state government concluded funding agreements with IMF and the EU to cover the current account deficit and to improve the reliability of the economic and financial policy. The loan amounts to approximately 20 billion euros. The first loan installment 5 billion euros was directed to the NBR reserves, thus freeing money from the reserve of banks of 1 billion euros.

5. To increase the liquidity of banks and relaunch credit, the NBR gradually decreased the monetary policy interest rates (in February from 10.25% to 10%, to 9.5% in May, to 9% in July) reaching 8% starting from August 5. Still in August 2009, minimum reserve ratios for foreign currency liabilities with maturity of less than 2 years decreased from 35% to 30% and for liabilities in lei, with the same maturity, from 18% to 15%. According to analysts, the monetary policy and RMO interest rate changes generated additional liquidity for banks by 1.2 billion euros.

6. Rates of inflation recorded in June and July of this year reached the highest inflation rates in the EU: 5.9% and 5.06%. The target proposed by the National Bank for this year is 3.5 ± 1%, but this was later revised by the monetary authority from 4.3% to 4.4%.

7. Romania's economic contraction was of 8.8% of GDP in the second quarter of 2009 compared to same period in 2008, in times of economic growth, thereby ranking on the 5$^{th}$ position in the EU from this point of view. For the first quarter, the contraction was of 7.6% compared to the same period of 2008. Taken together, in the first 6 months, the GDP fell by 7.6% as compared to the same period in 2008.

8. In order to improve the perception of Romania by investors, the following measures should be taken: improve the capacity to absorb EU funds; create new jobs in poorly exploited areas such as infrastructure, tourism; make investments in infrastructure; improve agricultural infrastructure ( by using irrigation systems in large areas).

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