THE PROFITS OF THE ROMANIAN BANKS, AFTER THE FINANCIAL CRISIS

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Abstract: *Romanian banks' profits were not constant after the Romanian economy faced the financial crisis that started in 2008. Thus, if at the beginning of the analysed period - the last decade - the years with profitable financial exercises alternated with the years in which the Romanian banks recorded losses, followed by years (from the middle of the study period) with losses, and in recent years, profitability is the main feature of the management of Romanian banks. The main cause of the losses in the banking system was the risky operations made by the Romanian banks before the crisis and during the crisis and the diminishing of bank revenues after the crisis. Periods of loss and profitability have been a feature not only of banks but of the whole economy. Thus, when banks have had high profits, all enterprises have had high profits, and banks are in line with the general trend. Also, the banks' profits represent a relatively small value from the results obtained by all enterprises in Romania. Equally true is the fact that the increase in the profitability of the banks in recent years is also explained by the restructuring carried out by their management in the last years, especially at the level of the network of the counters, the staff and partly the operations with the clients.*

Keywords: *banks, profit, income, expenses.*
JEL Classification: *G21.*

1. Introduction

The financial crisis, which has made its debut in Romania since the end of 2009, made the profitability of all enterprises deteriorate in two years after the crisis, 2009 and 2010; Romanian enterprises recorded a negative net result at the level of the entire economy. Banks have also recorded losses in some years due to the crisis. Visible to the public were just the banks’ losses, not the fact that the whole Romanian economy reported a net loss. Subsequently, the Romanian economy resumed its growth, with the cumulative value of profits exceeding, for example, 100 billion in 2017, and the profitable banks contributed to the above-mentioned amount by 5 billion. Again the public saw only the profits of the banks, not the profits of all the enterprises.

The present paper aims to analyse how large the profits, but also losses, of Romanian banks are, where the banks' profits come from, with what income and expenses they are obtained, which of these latter have an important impact on the profitability of the bank, and what other measures have been taken to increase profitability.

Analyses of bank profits, their source, the crisis/expansion-bank profit dynamic are quite common in literature and the most recent of them hone in on the variability of bank profitability, the dependence of profitability on the economic cycle moment and on private factors of influence.

In a recent study (2018) by the Committee on the Global Financial System, on structural changes in the banking system after the recession in 2008, it is noted that banks' return on equity has fallen from historically high rates previously registered before the crisis, and that many banks in advanced economies, especially in Europe, are facing slow incomes, and costs resistant to cuts.

Paul-Olivier Klein and Laurent Weill (2018), in a study on bank profits and economic growth, conclude that a high level of bank profitability contributes positively to economic growth, but it is short-lived. At the same time, the level of banking profitability in the medium and long term exerts a negative influence on economic growth. Rather, increasing profitability allows banks to increase their capital and offers more incentives to monitor loans and borrowers.

Leo de Haan and Jan Kakes (2018) note that the losses incurred by banks after the 2007-2008 recession first affected the large banks that were oriented towards the global financial market and less so the small banks oriented towards retail, but in following years, this reversed, with retail-oriented banks being the most affected, and suffering losses, as state aid and systemic risk-mitigation measures mainly targeted large banks.

The European department of International Monetary Fund, in a study (2018) on the evolution of European bank profits over the last financial cycle, notes that banks that have been successful in protecting profits were those who have seen a less pronounced deterioration in credit quality and an improvement in cost efficiency. These banks have aggressively reduced their assets, especially during the crisis, and have reduced their dependence on wholesale funding after the crisis. The study also notes that banks' high returns were associated with interest margins that remained generally stable throughout the financial cycle, including during the post-crisis period, but found no clear arguments for the existence of commissions and high fees charged to customers being associated with a better return after the crisis.

Finally, in another study on banking market trends and strategic options of European banks, the ZEB financial advisory firm (2018) notes that the improvement in bank returns recorded over the past few years cannot be replicated, because if this growth was recorded on the basis of non-litigious operations and the reduction of extraordinary costs, but the present and future is that of non-bank financial intermediaries ("shadow banks" and financial institutions), pension insurance companies. The study concludes that a decade after the financial crisis, the banking industry urgently needs product specialization, participation in financial platforms and mergers and acquisitions.

2. Analyses on the size of Romanian banks' profits

Although Romanian banks did not experience the problems their Western European or US equivalents did (bankruptcies, public bank rescue plans, takeover of banks with losses etc.), the recession and the financial crisis of 2007-2008 were not without consequences. Thus, the main consequence was that, from 2009 to 2014, i.e. for six years, the bank's financial years ended in losses (to this we added the years 2009 and 2013, as well, when profits were low and insignificant, respectively), which have accumulated over 8 billion lei. Profits were recorded in 2008 and beginning with 2015, when credit institutions began to develop their operations and totalled 26 billion lei, which meant a net positive value of 18 billion lei, i.e. an average of 1.6 billion lei for the 11 years analysed. The profit-loss cycle recorded in the banking system was of a high magnitude. For example, in 2012, banks recording losses had a market share of 60%, and in 2017 there were still banks recording losses (it is true with a minor share in the system).

The magnitude of the process, the magnitude of the losses and the long duration of the loss period prove that this was a systemic problem, and the economic growth or the resumption of this process after 2014 obviously made the banks profitable. In fact, credit is a cyclical product and so are its returns.

Correlation of profits with assets and equity shows modest values. Thus, the financial return (calculated on the basis of equity) shows, for the period when banks were profitable, values between 10 and 15%, except for the first year of the crisis when the indicator was close to 18%. Values are higher than the European average, which is about 6-7%. However, if we calculate the average of the analysed period, a value of approx. 4% results. Economic profitability (calculated on bank assets) oscillated in years with a profit of between 0.01% and 1.59%, with an average of 0.4%, as European banks record an average of 0.8% .

Table no. 1. Dynamics of bank profits

Year	Net profit/loss (billions lei)	Market share of banks with losses (%)	ROA (%)	ROE (%)	Operating Income/Operating Expenses-%
2008	4.40	9,9	1.56	17.04	186.9
2009	0.82	21,0	0.25	2.89	181.6
2010	-0.52	21,9	-0.16	-1.73	188.6
2011	-0.78	44,7	-0.23	-2.56	171.3
2012	-2.30	59,8	-0,64	-5.92	180.2
2013	0.05	28,9	0.01	0.13	176.9
2014	-4.70	39,2	-1.32	-12.45	170.3
2015	4.50	14,3	1.24	11.77	147.5
2016	4.20	7,7	1.08	10.42	154.2
2017	5.30	3,1	1.30	12.51	156.5
2018	7.17	***	1.59	14.85	179.6
Total profit	26.44	-	-	-	-
Total loss	8.30	-	-	-	-
Net values	18.14	-	-	-	-
Average	1.6	-	0.4	4.3	-

Source: BNR, Reports on Financial Stability 2008-2018, sec. Statistics / Data sets; calculations by the author

Comparing banks' operating income with their operating expenses shows us their stability in the period when banks suffered losses and a decline in the indicator at a time when banks started to make profit, with Romanian banks trying to mitigate losses by fixing the prices of products sold so as to cover their estimated expenses and losses, subsequently lowering prices, in the context of lower costs or reduced losses.

Table no. 2. Profitability of the economy-profitability of banks correlation – billions lei

Year	Profit for companies with net profit	Loss for companies with net loss	Net result	Net bank profit	% profit or loss of banks		% bank profit in net result	
					in total net profit	in total net loss	positive	negative
2008	53.32	-42.21	11.11	4.40	8.3	-	39.6	-
2009	40.28	-48.05	-7.77	0.82	2.0	-	10.6	-
2010	42.18	-43.53	-1.35	-0.52	-	1.2	-	38.5
2011	49.89	-45.30	4.59	-0.78	-	1.7	-	-17.0
2012	51.48	-45.81	5.67	-2.30	-	5.0	-	-40.6
2013	57.74	-42.02	15.72	0.05	0.1	-	0.3	-
2014	62.94	-42.08	20.86	-4.70	-	11.2	-	-22.5
2015	73.56	-36.70	36.86	4.50	6.1	-	12.2	-
2016	84.32	-33.03	51.29	4.20	5.0	-	8.2	-
2017	101.69	-31.39	70.30	5.30	5.2	-	7.5	-

Source: NBR, Financial Stability Reports 2008-2018, sec. Statistics/Data sets; calculations by the author

Periodically, the subject of bank losses or the size of banks' profits appears in day-to-day discourse. It should be said that there are profitable enterprises, but also loss-making enterprises, in any economy, generally, there are many companies that record profits in periods of economic expansion, and enterprises recording losses multiply in times of crisis or recession. It is normal for this to happen in the Romanian economy, as well, and in times of financial crisis, for banks to have more problems than the rest of the economy.

If we analyse the Romanian economy as a whole, we will see that in the first two years after the start of the 2008 crisis, at economy level, (2009 and 2010) losses were much higher than profits, and the next two (2011 and 2012), losses were slightly lower than profits, only resulting in a net result of 5 billion lei (recorded by all enterprises in our country, i.e. about 700 thousand entities). But even after the recovery of economic growth in Romania, with values well above the European average, companies with losses did not become a rarity and their losses of 30-35 billion lei, annually, represent between 30% and 50% of the positive result generated by the enterprises profitable.

There is, therefore, no justification for considering a bank recording losses or high profits one year as something abnormal, especially since in the banking world not all institutions can have profit or loss (only in this case should we think it is abnormal).

In particular, if we compare the profits or losses of banks with the same result recorded in the national economy, we will find that it was below 10%, only in 2014, the banks' losses were 11% of the total loss in the economy. Therefore, no share has an alarming value, which means that the results of the banks have been in line with the general trend.

Table no. 3. Formation of bank profit - millions lei

Indicator	dec.15		dec.16			dec.17			sept.2018		
	values	margin	value	margin	Indicator-%	values	margin	Indicator-%	values	margin	Indicator-%
Net interest income	10.620	10.620	10.903	10.903	103	11.280	11.280	103	10.155	10.155	90
Net commission income	3.808	14.428	3.834	14.737	101	3.912	11.280	102	3.077	13.232	79
Earnings or losses *)	833	15.261	2.207	16.944	265	1.470	15.191	67	174	13.406	12
Income from trading	626	15.887	642	17.586	103	353	16.661	55	268	13.674	76
Exchange rate differences	1.603	17.490	1.517	19.103	95	1.901	17.014	125	1.617	15.291	85
Other incomes	879	18.370	260	19.363	30	276	18.916	106	381	15.672	138
Staff costs	4.882	13.488	4.788	14.575	98	5.004	14.187	105	3.989	11.684	80
Administrative costs	4.856	8.632	4.660	9.915	96	4.737	9.450	102	3.662	8.022	77
Other expenses	836	7.796	819	9.096	98	825	8.625	101	671	7.350	81
Operational profit	-	7.796	-	9.096	117	-	8.625	95	-	7.282	84
Expenses with impairment of financial assets	3.943	3.853	4.067	5.029	103	1.839	6.786	45	455	6.826	25
Other	1.025	4.878	771	4.258	75	1.451	5.336	188	1.084	5.743	75
Profit/Loss	-	4.878	-	4.259	87	-	5.336	125	-	5.743	108

*) Earnings (+) or losses (-) from derecognition of financial assets and liabilities that are not measured at fair value through profit or loss

Source: BNR, Financial Stability Reports 2008-2018, sec. Statistics / Data sets; calculations by the author

If we compare, the banking profit with the net result from the national economy, we notice that:

- Banking profits accounted for between 0.3 and 12.2% of the net result of the economy, i.e. normal values. An exception is the first year of the crisis when bank profits were 40% of the total result generated by the Romanian economy. This is a great value, but it is justified by the entry of the economy into recession, the fact that many businesses began to experience losses or declining profits, and many of the banking products (see, for example, credits), although generating revenue at present, originate in the past;

- Banks' losses, as a share of the total net result, recorded higher values, but they occurred at a time when the entire economy had negative outcomes or national profits were modest;

- Let us also note that in recent years, 2015, 2016, 2017, even as bank profits were mentioned to have very high values, they represented a decreasing share in the total profits generated by the economy (6 and 5%) or 12%, 8%, 7% in the total net positive result of the economy, which means that the profits from other sectors of the economy were growing faster than the ones in the banking sector.

Analysis of bank profits in the last four years (the period when their profits were considered exaggerated) by levels of training, depending on the banks' incomes and their expenses indicate the following:

- there is remarkable stability of net interest, commission and exchange rate difference incomes (the premiums of about 11 billion lei and, probably, slightly higher in 2018, 4 billion in the second category and about 2 billion in the third category). But as in this period the volume of operations of banks was increasing, means that their relative value, per operation was decreasing;
- a series of earnings, such as from trading or earnings/losses on derecognizing financial assets and liabilities that are not measured at fair value or the other income category, had significant fluctuations, but they do not have large annual values;
- staff spending in the four years has fluctuated around 5 billion, even as bank personnel numbers are in decline;
- administrative spending in the four years has fluctuated around 4.7-4.8 billion, but as a trend a slight decrease is observed, probably explained by the reshaping of the territorial network of banks;
- operating profit fluctuated around 8-9 billion, fluctuations being generated as previously reported by some of the income (from trading or earnings/losses on derecognition of financial assets and liabilities not measured at fair value or other incomes);
- the increase in annual profit reported by banks was due to the depreciation of financial assets, which declined over the four years under review. Thus, if in 2015 and 2016 they represented 4 billion lei, in 2017 they were reduced to 2 billion lei and, in 2018, they probably did not exceed one billion lei.

Table no. 4. Bank personnel, the territorial network, labour productivity in banks

	Bank personnel thousands ppl.	Banking units	Central employees / Total employees	Banking assets billion lei	Private sector credit billions lei	W1 (bank assets/bank personnel - million lei)	W2 credits/bank personnel million lei	Resident population	No. residents/agency thousands ppl.
2008	71,62	7305	28,83	339,5	198,1	4,7	2,8	20,64	2,82
2009	67,90	7144	30,04	364,5	199,9	5,4	2,9	20,44	2,86
2010	66,75	6894	31,01	385,2	209,3	5,8	3,1	20,29	2,94
2011	65,77	6777	31,68	392,8	223,0	6,0	3,4	20,20	2,98
2012	61,77	6458	32,66	404,9	225,8	6,6	3,7	20,10	3,11
2013	58,61	6213	33,67	408,7	218,5	7,0	3,7	20,02	3,22
2014	57,73	6022	35,26	405,3	211,1	7,0	3,7	19,95	3,31
2015	55,93	5669	35,67	417,1	217,4	7,5	3,9	19,88	3,51
2016	54,93	5501	36,64	429,0	220,1	7,8	4,0	19,76	3,59

Source: BNR, Financial Stability Reports 2008-2018, sec. Statistics / Data sets; calculations by the author

In other words, big profits now and big losses from previous years are explained by the exuberance of the credit process, they originate in the provision accounting methods, but are legal and binding in the European Union and, therefore, in Romania. Only those who do not know the law and the customs of the matter can raise such issues.

Some of the larger bank profits recorded in recent years are also explained by restructuring processes within credit institutions. Thus, statistical information available until 2016 indicates that the territorial network of banks has narrowed by about a third between 2008 and 2016 and the process has certainly continued beyond 2016, with the number of banking units probably currently ranging between 4-4.5 thousands. Obviously, this led to the growth of population served by a physical unit (agency/branch), from 2.8 thousand to 3.6 thousand people per physical banking unit. But these figures can be misleading because, on the one hand, demographic information is not sufficiently accurate in Romania, since emigration is not fully encompassed in these statistics, and on the other hand a large part of the population, in particular the declining rural, lacks access to banks.

Banking staff decreased by a quarter, from 72,000 employees to less than 55,000 and, at present, is likely currently around 45-50 thousand people.

The reduction of the physical network and employees was determined by the intense promotion by banks of alternative channels, long-distance banking (mobile banking, internet banking), automatic bank counters and the commissioning of some of the traditional services (collection of invoices, commissioning of withdrawals cash at the counter, etc.).

The reduction in bank staff also led to an increase in labour productivity, with bank-per-employee assets doubling between 2008 and 2016, and credit per employee increasing by 50% over the same period, arguments in favour of wage stability, even as the volume of operations (assets, loans, etc.) has increased.

3. Conclusions

Starting with 2009 and until 2014, for six years, banks' financial years ended with losses that have accumulated more than 8 billion lei. Profits were recorded in 2008 and starting in 2005, when credit institutions started to develop their operations and totalled 26 billion lei, which meant a net positive value of 18 billion lei, i.e. an average of 1.6 billion lei for the 11 years analysed. The profit-loss cycle recorded in the banking system was of a high magnitude. For example, in 2012, banks recording losses had a market share of 60%, and in 2017 there were still banks recording losses (it is true, with a minor share in the system).

The magnitude of the process, the magnitude of the losses and the long duration of the loss period prove that this was a systemic problem, and the economic growth or the resumption of this process after 2014 obviously made the banks profitable.

Banking profits accounted for between 0.3% and 12.2% of the net result of the economy, i.e. normal values. Banks' losses, as a share of the total net result, recorded higher values but they occurred when the entire economy had negative outcomes or national profits were modest. In the last years, 2015, 2016, 2017, even as bank profits were mentioned to have very high values, they represented a decreasing share in the total profits generated by the economy. The increase in annual profit reported by banks was due to the depreciation of financial assets, which decreased over the four years under review. Thus, if in 2015 and 2016 they represented 4 billion lei, they were reduced to 2 billion lei in 2017 and, in 2018, probably did not exceed one billion lei.

Some of the banks' higher profits recorded in recent years are also explained by the restructuring processes within credit institutions: bank personnel has fallen by a quarter, the territorial network of banks has narrowed by about a third, all of which has generated a labour productivity growth, bank-per-employee assets doubled in value, and credit per employee increased by 50%.

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