MOLDOVAN BANKING EFFICIENCY

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Abstract. *Banking activity as a whole is the link between depositors and borrowers, aiming the provision of key services to facilitate consumption and promote economic growth. Thus, banking regulation and risk oversight are vital aspects of the efficient and sustainable functioning of the economy. Providing bank loans to the real economy and facilitating capital market activity represent the key for developing a sustainable economy and an internationally competitive banking system. Deriving from the key role the bank credit has for the functioning of the real economy, is imperative to analyze how ongoing structural changes in banks have affected their ability to fulfill the core function in intermediating loans. The banking sector as a whole in the medium severity scenario shows a strong resilience, all banks registering sufficient own funds rate. However, credit risk continues to pose the most significant threat to the stability of the banking sector, highlighting the importance of maintaining sufficient capital rate to absorb estimated losses even in the most pessimistic scenarios. Banking performance aims first of all to determine the bank's soundness, its degree of exposure to various risk categories and then its level of efficiency.*

Keywords: *economy, banking system, efficiency of banking activity, profit, regulations.*

JEL CLASSIFICATION: G20, G21

INTRODUCTION

The analysis of international experience assumes that the economic growth of a state is based on a well-developed banking system, oriented towards intensive risk-based supervision, assessment of macroeconomic factors as well as assessment of the impact it has on the risks to which financial institutions are subject to. The banking activity in the Republic of Moldova under the impact of community values and regulations is a very important topic in establishing relations between the National Bank of Moldova and the activity of commercial banks, which aims to ensure the proper functioning of the domestic financial system based on a strong and competitive banking sector, oriented towards market relations and risk prevention. The banking supervision and regulation mechanism is established according to a series of specific requirements, stipulated in normative acts and adapted to the Community values and regulations, in particular adjustment to the best practices and recommendations of the Basel Committee on Banking Supervision and European Union Directives. Providing bank loans to the real economy and facilitating capital market activity are imperative for developing a sustainable economy and ensuring an internationally competitive banking system.

The purpose of the research arises from the need to analyze the efficiency of banks in terms of lending to the real sector and the role on the capital market. The ultimate goal is to maximize profit under regulatory conditions both at the micro prudential level (individual for banks) and at macro prudential (banking system as a whole). The exposed topic is of utmost importance because the achievement of the bank's objectives, namely the basic objective of maximizing profit, has a direct impact on the sustainable development of the economy of the Republic of Moldova as well as ensuring the international competitiveness of the domestic banking system. The topicality of the research consists in analyzing the efficiency of the banking sector by focusing particularly on aspects as profitability, solvency, capital adequacy, liquidity, implementation of Basel III framework, and whether these indicators encourage the lending activity to the real economy and anticipate the future inflationary risks.

THE CONCEPTUAL FRAMEWORK

"Banking as a whole represents the link between depositors and borrowers, as well as the provision of key services to facilitate consumption and promote economic growth, thus risk surveillance and regulation of the banking sector is vital for the efficient and sustainable functioning of the economy"[1].

So, "banking activity means the organizing and conducting the banking operations, bank records and banking control in accordance with the strategies and management of banks and ensuring the role of intermediation between those who have capital and entrepreneurs".[2]

Performance can be defined as the measurable level of stability of a bank's activity, characterized by low levels of any kind of risk and a normal trend of increasing profits from one analysis period to another.[3]

A bank with a high return and a major financial result creates an image among the depositors of a safe and stable bank, thus obtaining the highest possible performance lead to the creation of a stable financial-banking system.

RESEARCH METHODS

In order to achieve the objectives, the author aimed to develop a research methodology, applying the most varied methods, so that the phenomenon of analyzing banking efficiency in the Republic of Moldova in terms of providing bank loans to the real economy and the role of banks in facilitating capital market to be explored as well as possible. Thus, the research will be oriented on two directions: theoretical and applied. The theoretical direction aims at examining the theories regarding the concept of efficiency of the banking activity. The application direction aims at analyzing the evolution of credit indicators, as well as analyzing the applied macro prudential instruments.

In this sense, the following methods will be used: analysis and synthesis. The analysis will be used during the research, for examination of the banking regulatory framework both at the community and national level, while, with the help of the synthesis, the information will be exposed in systematized and coherent way, by generalizing the sources of literature and the normative-legal basis, and expressing at the same time the author point of view on the analyzed phenomenon. Induction and deduction are two other methods that will be used for this economic research, as induction involves the transition from the particular to the general, while deduction implies the opposite. The method of content analysis involves structuring the research into three chronological poles: pre-analysis, material exploitation, processing and interpretation of results.

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1 BASNO, Cezar, DARDAC, Nicolae. Managementul bancar. București: Editura Economică, 2002. 272 p. ISBN 973-590-702-X.

2 Căpraru, Bogdan (2010), Activitatea bancară – sisteme, operațiuni și practice, Editura C.H. Beck, Iași, 368 p. ISBN 978-606-18-0319-4

3 I.Bătrâncea, I.Trenca, A.Bejenaru, S.N.Borlea – Analiza performanţelor şi riscurilor bancare, Editura Risoprint, Cluj-Napoca, 2008, p.374

RESEARCH RESULTS AND DISCUSSIONS

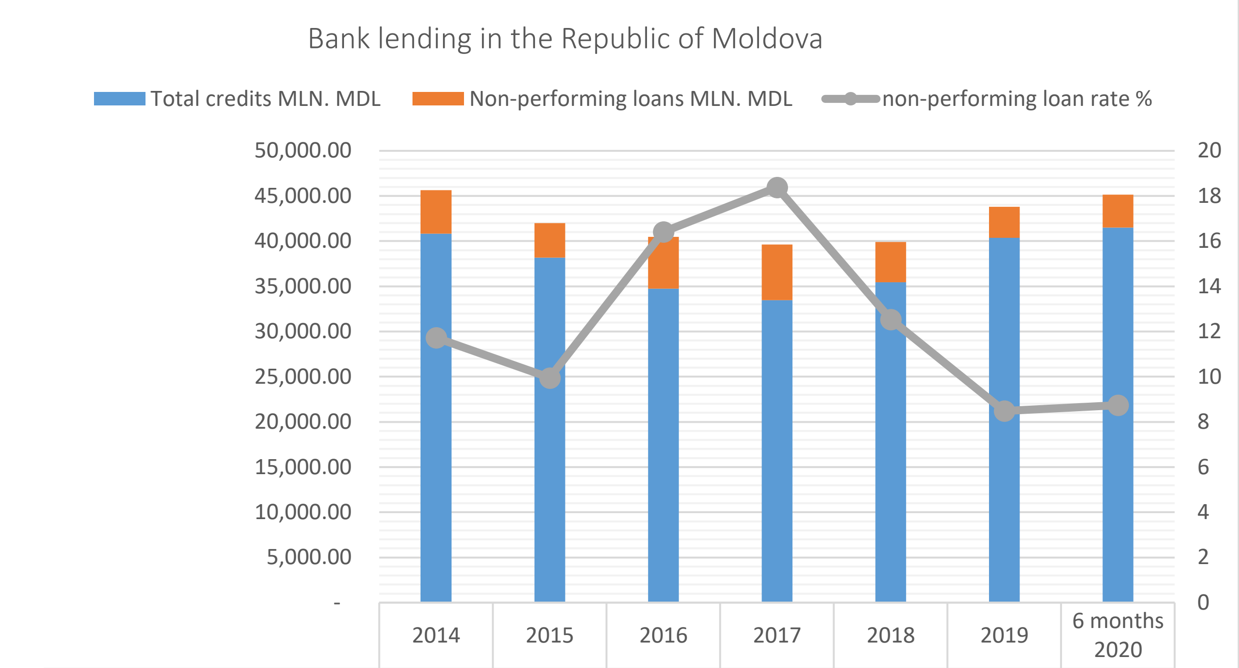
The efficiency of the banking activity in the Republic of Moldova implies the analysis of the impact of structural changes in the banking sector on the provision of financial intermediation services at a high level. The analysis focuses on bank credit and then on the provision of services related to the capital market - namely banking and trading investments. Given the key role of bank credit for the functioning of the real economy, this section examines how ongoing structural changes in banks have affected their ability to perform the core function in intermediating loans. It first covers general trends in the provision of bank loans. The role of supply factors (tightening or weakening credit standards) in shaping these trends and the determinants of these changes in credit supply will then be discussed.

The analysis of global bank credit developments shows a deterioration in lending standards, some lending structures have involved a high leverage on the assumption that asset valuations will continue to rise, while a substantial portion of lending has been directed to borrowers with a relatively weak repayment capacity (real estate developers, etc.). Bank lending trends have varied around the world during the current crisis. The growth of bank lending to the non-financial private sector has only suffered a temporary respite in advanced economies that have not been substantially affected by the crisis.

The importance of the crisis and the post-crisis adjustment in the bank balance sheets for general lending and the bank's performance show that the economies that increase credit activity during crisis and pre-crisis times and a large stock of non-performing loans as a result of the crisis recorded substantial credit declines.

In 2019, bank lending returned to an upward trend after a period of four consecutive years of decline and a slight revival in 2018. In the first half of 2020 the volume of granted loans exceeds the volume recorder for the whole 2019. The total balance of loans increased by 13.9 percent. The balance of non-performing loans registered a significant decrease of 22.9%, the rate of non-performing loans constituting 8.49% at the end of 2019 and of 8.74% for the first 6 months of 2020.

The total gross loan portfolio of banks in the Republic of Moldova increased during 2019 (Figure 1) by about 4.9 billion MDL (13.9%), at the end of the period, the total balance amounted to 40.4 billion MDL (2018: 35.5 billion MDL). For 2020, the total balance of loans represents a significant increase in the first 6 months of the year, exceeding the total balance for 2019 by 1.1 billion MDL. At the same time, the stock of non-performing loans decreased by 22.9% (1.0 billion MDL), which determined the decrease of the non-performing loans rate in the total portfolio to 8.49 percent.



	2014	2015	2016	2017	2018	2019	6 months 2020
Non-performing loans MLN. MDL	4,790.34	3,798.58	5,702.64	6,151.46	4,445.36	3,428.31	3,629.30
Total credits MLN. MDL	40,841.98	38,187.61	34,761.27	33,473.29	35,452.75	40,375.46	41,509.70
non-performing loan rate %	11.73	9.95	16.41	18.38	12.54	8.49	8.74

Figure 1. The performance of the national banking system in the period 2014-2020*[4]

Source: *Created by the author based on data from the National Bank of Moldova*

Analyzing the volume of loans granted in 2019, it can be observed that the increase of 13.9% as compared to 2018 was determined to a greater extent by the loans granted to the population (+ 4018.3 million MDL) (Figure 2), while the loans granted to companies recorded a more moderate increase (+ 904.4 million MDL). Thus, the increase of loans granted to the population in 2019 was 40.2% compared to 2018. The data for the first 6 months of 2020 show a volume approximately equal to that of 2019, so if the growth rate of loans to the population will be maintained until the end of the year, then their growth will be about 2 times higher than in 2019.

During the period under review, banks continued to focus their efforts to expand their credit portfolio to the population sector. Competitive pressure and lower risk profile of borrowers – individuals have led to an increase in the supply of loans for this segment, while increasing demand from borrowers is mainly explained by the need for financial sources.

[4] *- the data are for 6 months of 2020

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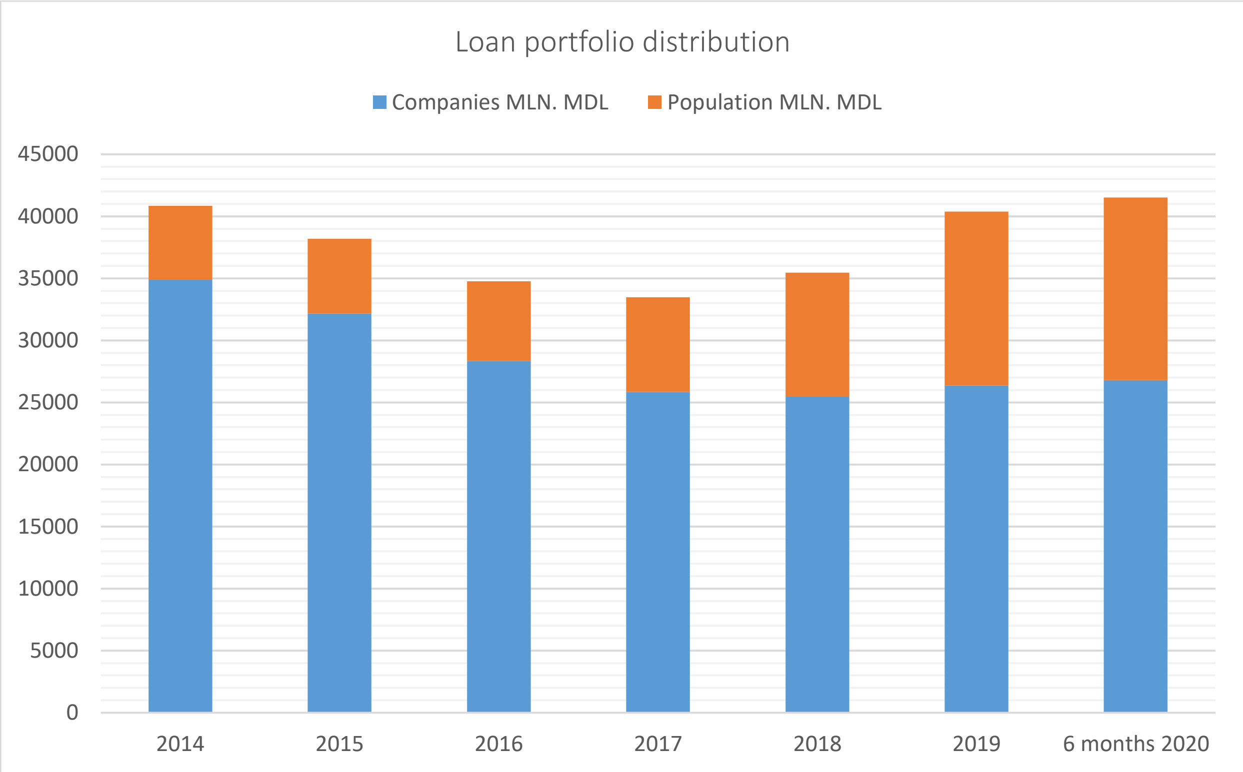

Figure 2. Loan portfolio distribution

Source: *Created by the author based on data from the National Bank of Moldova*

The currency structure of loans granted is characterized by the sharp increase in loans in national currency (+ 23.4%) in 2019 compared to 2018. Thus in 2019 the majority share of loans was held by the national currency in the amount of 66.7 at percent, 24.2 percent by the euro and 9.1 percent by the US dollar. For the first half of 2020, the currency structure of loans granted remains similar to that of 2019 with a share of loans in MDL of 68.9 percent.

The gross balance of loans granted to individuals and legal entities in 2019 and the 6 months of 2020 recorded the largest increases in the last 5 years. This growth was stimulated both by the supply factors (easing standards and lowering interest rates) and also by the demand factors (increasing the need to finance business and population). At the same time, the persistence of competition both between banks and with non-bank credit organizations favors the relaxation of lending conditions for consumers, thus having a stimulating effect on lending.

Bank lending as a share in GDP (Figure 3) accounted for 19.2% in 2019, decreasing in the last 5 years, for example in 2014 the a share of the gross balance of bank loans in GDP represented 30.6%.

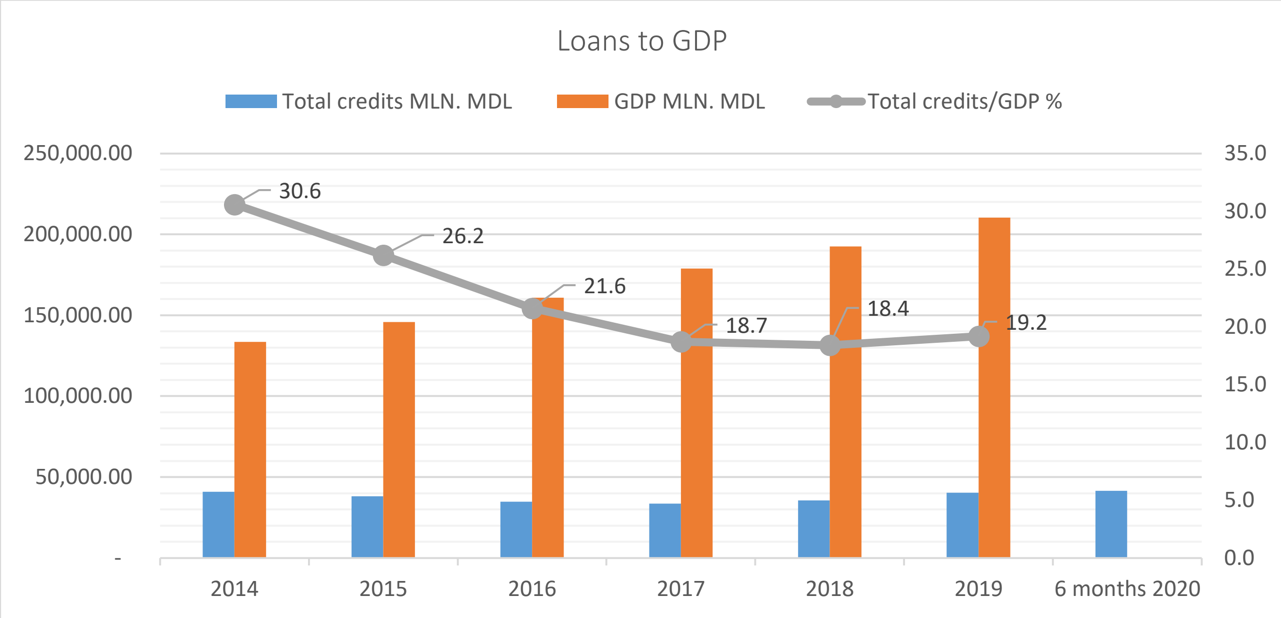

Figure 3. Loans to GDP

Source: *Created by the author based on data from the National Bank of Moldova*

The heterogeneity of lending conditions between banks and countries reflects the incidence of various cyclical and structural factors. Macroeconomic uncertainty may be to the detriment of credit growth, as banks are less willing to finance projects when their yields are volatile and less predictable. Alessandri and Bottero (2017) found that an increase in aggregate uncertainty has reduced the credit approval rate of Italian banks, but the negative impact on credit supply is lower for better-capitalized banks with higher liquidity buffers.

The results of the simulations reveal that the banking sector as a whole in the medium severity scenario shows a solid resilience, all banks registering a rate of own funds over 10.0 percent. However, credit risk continues to pose the most significant threat to the stability of the banking sector, highlighting the importance of maintaining sufficient capital buffers to absorb estimated losses even in the most pessimistic scenarios of deteriorating asset quality.

A large stock of non-performing loans can also impede the provision of credit. Banks with high non-performing loan rates in the post-crisis period tended to reduce their lending, especially in some banks in the area. Bank-level data indicate that depreciation has mechanically influenced loan growth, but not to a large extent - on average, net depreciation has reduced the average annual loan growth. The mechanisms by which non-performing loans have a negative impact on the supply of bank loans are probably more indirect: non-performing loans bank capital and distract management from new opportunities, such as stimulating low-capitalized banks to postpone the recognition of problem loans through "ever greening".

Banks' capital market businesses can be divided into two broad categories: banking and trading. Investment banking refers to activities from which banks earn revenue from capital raising fees for clients in the debt and equity markets and procurement advisory services. This line of business requires low direct capital and tends to generate high, albeit volatile, returns on equity. Investment banking remained a strategic goal of large global banks in the post-crisis period, and their business units did not change significantly from pre-crisis years, apart from cost reductions. Global activity, measured by the volumes of transactions and commissions, has sometimes approached crisis highs.

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Global revenue market shares did not change substantially in the post-crisis period, although the top five European banks (all G-SIBs) ceded some to non-US banks.

The second, even larger, area of activity and income on the banking capital market includes various commercial enterprises, broadly grouped into equity and fixed income, foreign exchange and commodities (FICC). In the boom years before the crisis, many banks have substantially expanded their trading activity, with the largest banks in the US and Europe increasing in particular the scope, complexity and geographical coverage of their activities, often by acquiring independent dealers. Some major US banks have also adapted their strategies and business models to business trading during the crisis, by acquiring unsuccessful institutions. Meanwhile, moving in the other direction, some commercial companies have changed their legal structure to become banking holding companies. Following the crisis, the operational adjustments of banks 'business were expanded even more sharply than for investment banks and other banking lines of business, as flat revenues, rapidly evolving technology and stricter regulation pressed banks' business units. Banks also reversed the surpluses accumulated in the pre-crisis boom, when assets and trading risk were increasingly deposited in bank balance sheets to facilitate market creation or securitization, or to support proprietary trading.

CONCLUSIONS

The analysis of the efficiency of the Moldovan banking system demonstrates satisfactory financial performance, banks maintaining solid positions of profitability and solvency. Banks register a favorable level of liquidity, and the liquidity surplus in the banking sector did not increase significantly due to the activation of channeling liquid assets to lending, thus, 2019 representing the year of the return of banking intermediation to positive trends.

In the domestic financial sector, the level of systemic financial risk is considered to be low. This is due to the slow recovery of lending activity, which shows no signs of overheating. On the other hand, 2019 can be characterized as a transitional period in terms of accounting and prudential requirements, with an impact on the financial results of banks. In this context, some non-cyclical macro-prudential instruments have been applied. For 2020, it is characterized by a dizzying increase in the opening of the lending sector to the real economy, which requires banks to create and maintain sufficient capital buffers to absorb estimated losses even in the most pessimistic scenarios of deteriorating asset quality. To ensure greater efficiency of the banking system, the regulator uses the following instruments to ensure the stability of the banking business, namely: (1) the capital buffer, (2) the countercyclical capital buffer, (3) the systemic risk buffer, (4) the shock absorber of the systemically important company.

Banking performance aims first of all to determine the bank's soundness, its degree of exposure to various risk categories and then its level of efficiency. A positive and maximum result expected by the bank starts from the considerations of financial diagnosis on the banking activity which is divided into two directions: the diagnosis of profitability (return on equity, economic profitability); and risk diagnosis (exploitation risk, financial risk, bankruptcy risk).

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