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As Europe started seeing what we hope is the end of the pandemic, it is confronted with an energy crisis, an inflation crisis and most recently a geopolitical crisis to threaten its very fragile and heavily funded recovery plan targeting climate sustainable economic growth.

Romania has to battle primarily with a very large budget deficit (9.2% in 2020) and the highest inflation in more than a decade (8.35 in January 2022). With a diversified local energy market, Romania has the third lowest dependency on external sources in EU, shielding it to some extent from the external shock. A tightening fiscal strategy, combined with a European war and an EU sanctions package will have an impact on the Romanian economy that was assumed to grow by more than 4% in 2022.
Without a fully developed capital and money market and the threat of reducing foreign direct investment due to geopolitical tensions, Romanian economy will depend more on lending providers to achieve a dual target of fiscal tightening and swift economic recovery. And how does that reflect on the prospects of the banking sector?

The Romanian economy and the Romanian banks have proven to be quite resilient to the pandemic. The economy remained stable and the Romanian banks did not record a significant increase in bad loans and they are now in the process of reversing provisions. However, the long-lasting low interest rate policy has indeed hurt the profitability of the banks and has distorted the market and the banks' ability to lend successfully with a risk-based approach. The recent inflation dynamics have not yet harmed the quality of the lending book, but an increased period will indeed affect the repayment ability of the households and the small/medium enterprises. Moreover, the EU climate risk regulations have to align with the climate risk agenda of Romanian real economy in order to avoid alienating the banking system from the real economy. Finally, the war between Ukraine and Russia and an aggressive package of sanctions on Russia will exaggerate risks such as inflation, supply chain disruptions, EU GDP growth, which is funding the Romanian recovery plan, and will finally introduce new threats and responsibilities to the banks in dealing with cyber war and in implementing an unprecedented sanction plan such as excluding all Russian transactions from the banking system.

How should Romanian banks prepare to deal with a unique mix of uncertainty? (i) We do not know the future of the pandemic, but the banking system will need to intensify its digital transformation program to remain flexible and cost competitive. (ii) EU banking law is not flexible on climate risk and the banks will be forced to adapt entirely. The banks, if not with the support of the government, will need to educate the borrowers in the real economy on how to transition their own business model in order to stay eligible for banking lending. If the banks evolve their climate risk management faster than the large corporates and SMEs, then the Romanian economy will experience a severe gap in financing. (iii) Banks will need to assess the impact of fiscal policy on small/medium enterprises and establish stronger early warning indicators. A reduction of state support and an increase in interest rates indeed change the risk profile of borrowers and impair their ability to repay their loans. (iv) ECB has already signaled to the banks the need to build stronger cyber risk management frameworks. Despite effort made in the last years, an escalated cyber war in Europe combined with the digital revolution in banking may be leaving the banking system vulnerable to geopolitical games. (v) Finally, the banks will need to analyze their capacity to assess a large-scale implementation of sanctions from EU such as excluding part or all of Russian transactions from the banking system, including any access to the euro.
Banking is still the dominant platform based on which we measure the capacity of local corporations to invest and expand the Romanian economy. The European banking sector has been challenged significantly since the credit crunch of 2009 and now is in a delicate process to transform its own business model to achieve better profitability, attract more funds and deliver more loans to the real economy.
Maintaining and protecting the current momentum and the expansion of financial intermediation is of utmost importance to the macro prospects of the Romanian economy.