ASPECTS REGARDING THE EVOLUTION OF THE ROMANIAN STOCK MARKET IN THE CONTEXT OF THE DISTURBANCES PRODUCED BY THE COVID-19 CRISIS

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Abstract: *The Covid-19 pandemic affected the entire financial sector, including the capital markets. The purpose of this paper is to highlight some of the most important effects of the pandemic on stock markets. The reaction of investors had a significant impact, which amid panic and uncertainty generated by the crisis, triggered a significant volatility in the stock markets. The response of the central banks and the authorities, which consisted in the application of monetary policy measures and the provision of liquidity in the financial system, increased the confidence of investors and determined the rapid return of the stock markets, including the Romanian one.*

Key words: Covid-19 pandemic; market volatility; market liquidity.

JEL Classification Codes: G10, H12.

1. INTRODUCTION

The Covid-19 crisis has caused an unprecedented slowdown in the economy in 2020, as many countries have adopted short-term quarantine policies to limit the spread of the virus and their economic activities have been significantly limited.

All countries in the world are severely affected by the Covid-19 epidemic. According to growth theory, the human capital promotes growth and a severe and lasting health crisis can create a macroeconomic imbalance.

Beside the major health crisis, the COVID-19 pandemic triggered an economic crisis that led to massive unemployment, numerous difficulties in repaying loans and the bankruptcy of many businesses.

To prevent this health crisis from turning into a global economic crisis, the political and monetary authorities have adopted stimulus policies of billions of euros, decided to reduce the key rates of the central bank rates and, among other things, set up funds for companies or bank loan guarantees.

2. THE STOCK EXCHANGE MARKET IN THE INTERNATIONAL CONTEXT

The rapid spread of coronavirus (COVID-19) has had profound effects on financial markets around the world. Financial markets have had two main characteristics since the beginning of the coronavirus crisis: they have fallen sharply and have been highly volatile, in a context characterized by a high level of uncertainty and an inability to make reasonable economic forecasts (the so-called fear index VIX exploded from 12.10 points on January 13 to 66.04 points on March 16, 2020).

The fluctuations were extreme and could be compared with the great episodes of crisis in history. From a certain point of view, this is the fastest stock market crash of all time. The S&P 500 index lost a third of its value in one month during the COVID-19 crisis (since its peak on February 19, 2020), while in 1929, when the great interwar crisis began, the index fell by 20 % below highs in 42 days (from 454.09 points in September 1929 to 363.6 points in October 1929).

Figure 1 compares the decline of the S&P 500 index during the dot-com crisis (which peaked on March 24, 2000), the subprime crisis (peaked on October 9, 2007) and the COVID-19 crisis (peaked on February 19, 2020).

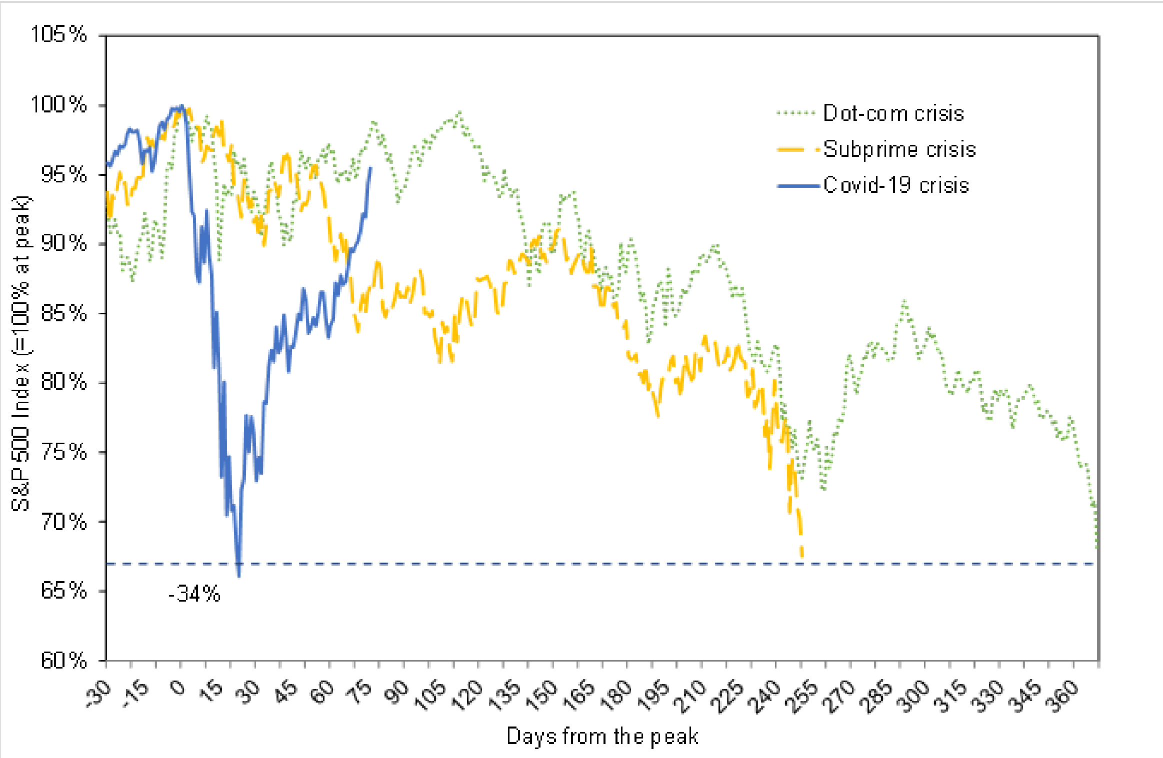

Figure 1. The US stock market in the time of COVID-19

Source: Capelle-Blancard, G., Desroziers , A, 2020

Moving in tandem with the world's major stock markets, BET, the main index of the Bucharest Stock Exchange, fell by about a third from the post-crisis highs it had barely reached in early 2020 (from 10,219.75 in January 23 to 7,039 on March 23, 2020).

The main economic effects of the pandemic were generated by the panic. The panic spread to the stock markets faster than the virus, generating a state of tension for all listed companies, regardless of their economic situation. The characteristic of this crisis on the capital market is that companies from all fields of activity have been affected. Figure 2 supports this statement. The economic sentiment indicator (ESI) for the European Union and Romania in the period 2008-2020 reached its lowest historical value, 67.1 on April 2020, shortly after the onset of the COVID-19 pandemic. The indicator had a similar evolution in the case of Romania, reaching the level of 68.5. These values are similar to those recorded during the 2008 crisis and significantly lower than those before the pandemic.

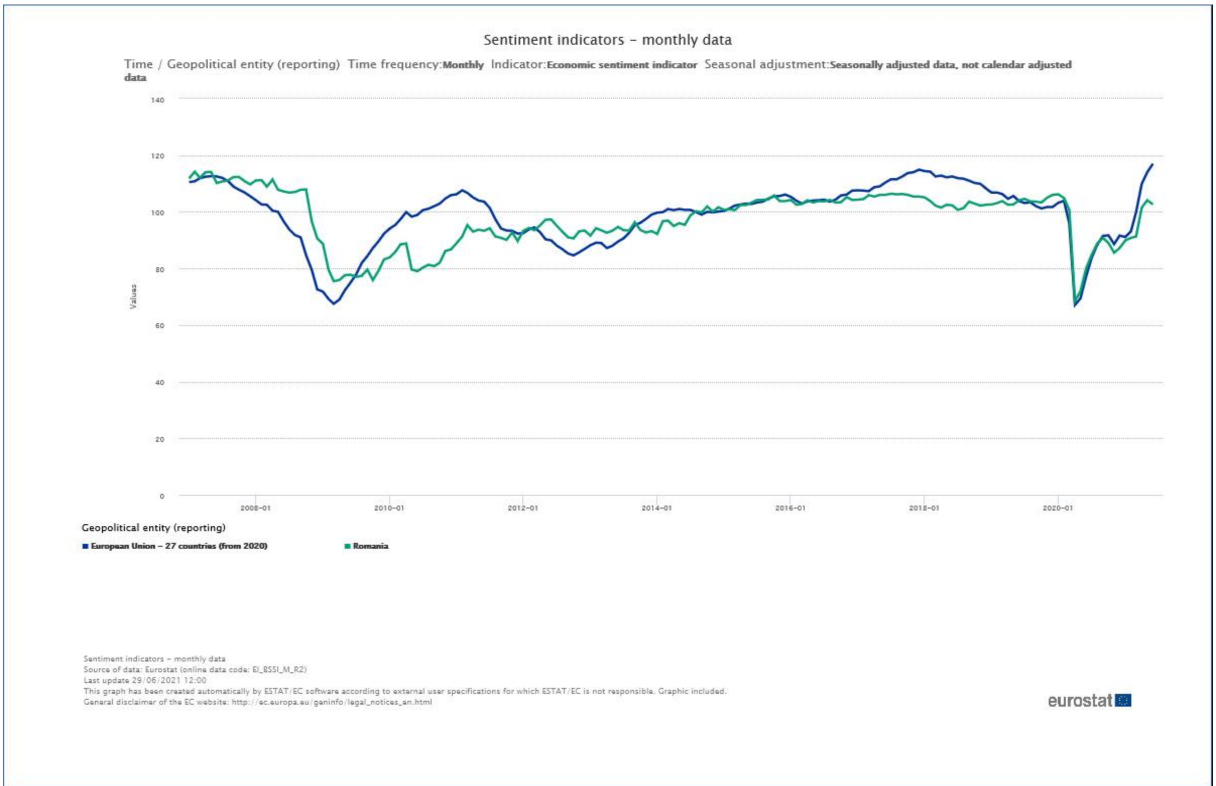

Figure 2. The evolution of the economic sentiment indicator (ESI) for the European Union and Romania during the period 2008 - 2020

Source: https://ec.europa.eu/eurostat/databrowser/view/EI_BSSI_M_R2__custom_1170733/default/table

The central banks and the authorities responded immediately, implementing intense policy measures to save the financial markets. For example, on March 15, 2020, the Federal Reserve (Fed) announced a zero percent interest rate policy and at least a $ 700 billion quantitative easing (QE) program. Following the negative responses to this market policy, the Fed announced an unlimited QE policy eight days later, stopping investors' panic and most stock markets began to recover.

In turn, the European Central Bank has continued to implement measures designed to help maintaining favorable financing conditions, support economic activities, ensure price stability and provide liquidity to the financial system.

The European Central Bank's measures have limited the increase of volatility on the European markets. In 2020, the European Central Bank (ECB) continued its quantitative easing program, which kept the refinancing rate at zero. The pandemic emergency program was supplemented by the ECB with € 500 billion in December 2020, amounting to an almost unimaginable € 1850 billion. The program is intended to ensure the maintenance of lending and to feed investments and expenditures. However, real or targeted stability has a price: the expansionary monetary policy increases the risk of bubbles in the financial and stock markets. On January 21, 2021, after the ECB decided to keep monetary policy interest rate unchanged at the lowest level in history, the European stock markets have risen.

The monetary policies of the central banks in the countries of Central and Eastern Europe consisted in reducing the monetary policy rate and active policies to support interbank liquidity and market interventions to stabilize the exchange rate. The central banks of Romania and Hungary agreed with the European Central Bank repo lines of 4.5 and respectively 4 billion euros, until June 2021.

The timely and decisive actions of the National Bank of Romania contributed to ensuring the functioning of the financial market and to supporting the flow of loans during the pandemic. These included interest rate cuts, an asset purchase program for government bonds, as well as the provision of liquidity, regulatory easing and moratoriums on bank loan repayments.

The indicators calculated by the European Commission for the degree of confidence in the economy changed their trend in June 2020 and continued to grow, including in the first half of 2021, Romania approaching the European average.

The capital markets have had a consistent V-shaped recovery, due to generous government support programs for businesses and monetary and fiscal incentives, in the context of reducing the number of COVID -19 infections. The rapid recovery has been driven by increased investor confidence as a result of governments' prompt reaction to support the economy in various forms.

The figure below shows the evolution of stock market indices in Romania, the United States, Germany, Austria, Hungary, the Czech Republic, Poland and the Stoxx 600 (standardized, zero average, standard deviation = 1), to facilitate the comparison between the capital market developments.

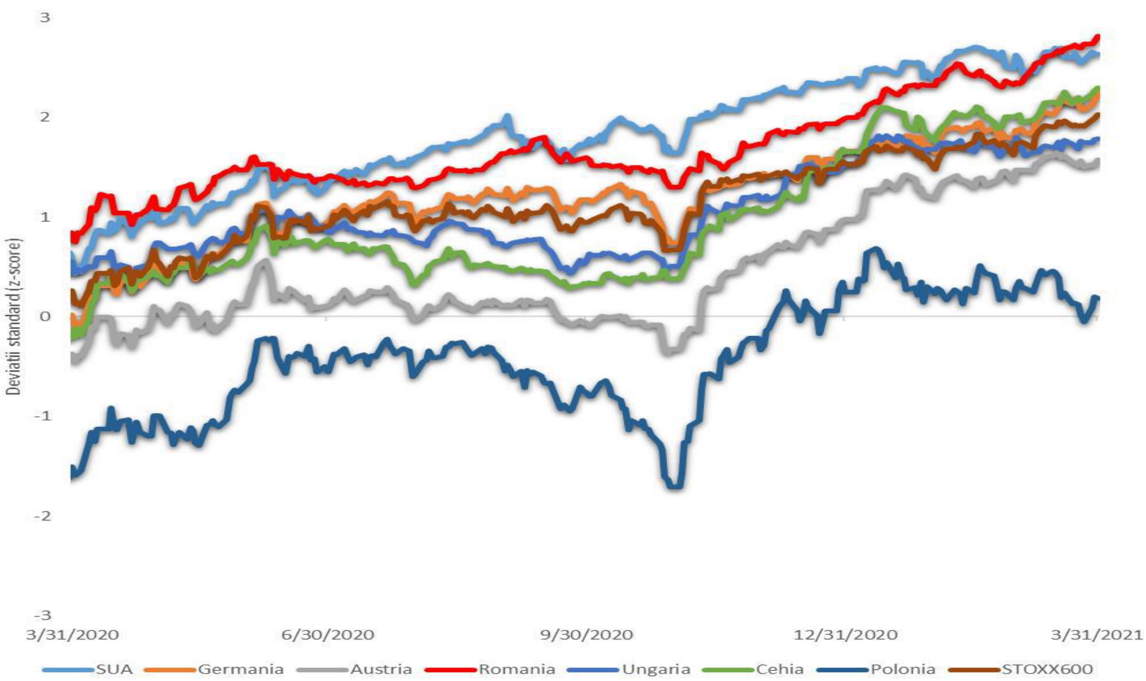

Figure 3. The evolution of stock market indices - the extension of the contagion

Source: Financial Supervisory Authority, *Report on the non-bank financial markets stability. 1/2021*, p. 62

In the first part of 2020, following the onset of the COVID-19 crisis, the BET index registered a negative adjustment due to the investors' concerns about the economic evolution, similar to the regional / international evolutions due to the contagion effect[1]. That loss was fully recovered in the first month of the year 2021, as the investor reacted positively to measures of supporting the economy adopted both in Romania and Europe. In the first quarter of 2021, the local stock market was the first in the region to exceed the pre-crisis level of 2008 with its BET index, which reached a new historical record. The growth of investment activity led the capital market to new highs in June. After the first 6 months of 2021, BET increased by 21%.

As Figure no. 3 shows, with the exception of Poland, the capital markets had a rapid growth trend in the first quarter of 2021 which is not supported by economic fundamentals. Their strong correction may lead to a steep increase of the market risk.

Yang and Zhou (2017) consider that US QE after the global financial crisis of 2008 significantly contributed to the increase of the systemic risk at that time.

Zhang, Hu and Ji (2020) consider that some political responses are needed to stop the virus and balance the stock markets; however, the unconventional policy interventions, such as "unlimited US QE, create additional uncertainty and can cause long-term problems."

According to Gormsen and Koijen (2020), the monetary policy actions and the fiscal stimuli can create inconsistencies between investors' short-term and long-term expectations.

Risky asset / investment management works on the assumption that what is favorable to the stock market – the unconventional monetary policy and the fiscal waste - is necessarily good for the real economy as well, with the latter ultimately validating its optimism. For now, there is a divergence between asset prices and their core value. Thus, there will be no end to the policies of monetary expansion and encouragement of consumption. This divergence is a vulnerability. The escalation of the geopolitical tensions between the US and China, the rising inflation or the nationalist impulses prevailing over the common good in Europe are exogenous triggers that would lead to a reversal of the intrinsic price-value pair.

The ECB's massive support for the banking sector also raises the question of whether the unconventional monetary policies are the best way to channel public aid to the real economy, rather than the coordinated fiscal stimulus.

3. THE ROMANIAN STOCK EXCHANGE MARKET

The Romanian capital market went through a sensitive period during 2020, due to the fact that in times of crisis the stock markets react emotionally and therefore it registered relatively wide fluctuations. The decrease of share prices even by 20-30% compared to the beginning of the year, as a result of investors' fears regarding the COVID-19 pandemic led to the decrease of the stock market capitalization of the regulated market of the Bucharest Stock Exchange (BVB) from the value of RON 162.18 billion registered on February 28, 2020 at the value of RON 120.29 billion on March 31, the minimum of 2020 of RON 113.85 billion being reached on March 18.

The high volatility on the capital market from March 2020 determined an intense trading activity on the Bucharest Stock Exchange. As can be seen from Figure no 4, the value of transactions with shares on the regulated market in March was RON 1.58 billion, representing

[1] According to the International Monetary Fund, contagion is defined as the impact of changes in the price of assets in one region (stock market) on prices in another region. The contagion index for the Romanian capital market is calculated based on the yields of the most important European stock exchanges. The contagion analysis made in the Financial Supervisory Authority report indicates that the Romanian capital market is sensitive to risk factors that influence neighboring capital markets (Poland, Austria and Hungary).

almost double sometimes even triple compared to the values of 2019, 2020, 2021 1st semester and in September 2020 there was a record value of RON 2.70 billion, due to the fact that the BVB was promoted to emerging market status by the rating agency FTSE Russell in that month, the investors being driven by this new status of the capital market.

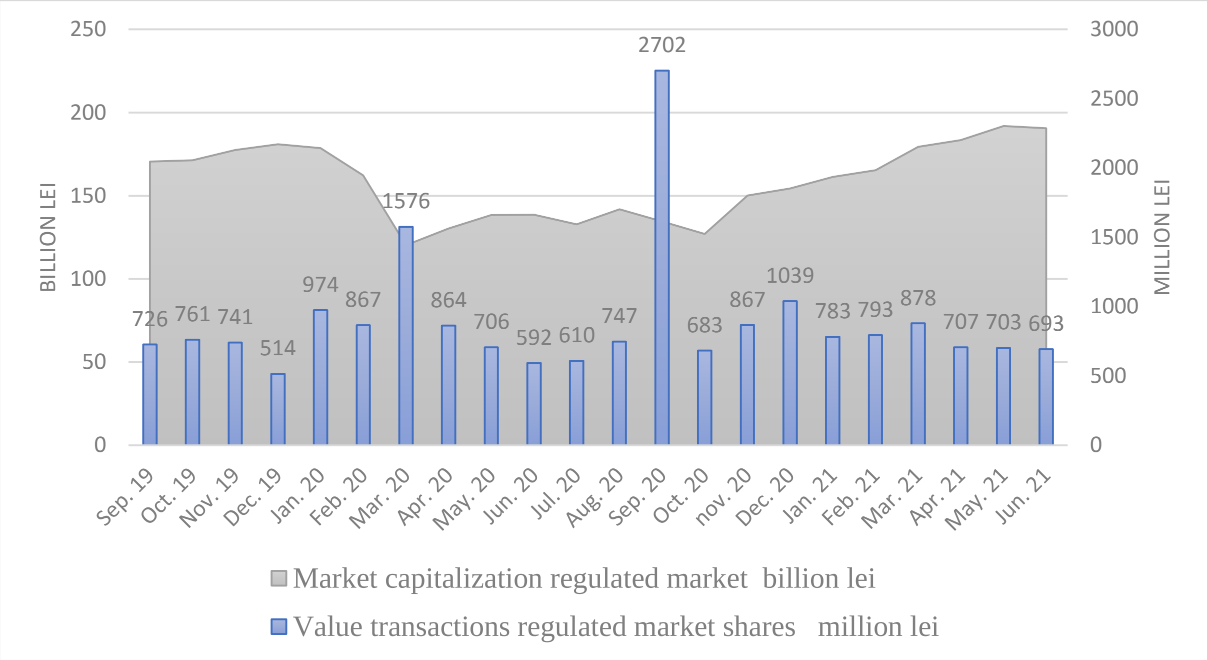

Figure 4. **Evolution of monthly transactions (shares) and market capitalization on the regulated market of BVB**

Data source: https://www.bvb.ro/TradingAndStatistics/Statistics/GeneralStatistics

The return of stock quotes led to the gradual recovery of the market capitalization during 2020, so that at the end of the year it reached the value of RON 154.37 billion, slightly below the level reached before the onset of the coronavirus pandemic. At the end of the first half of 2021, the market value of companies listed on the main market of BVB exceeded the record after the financial crisis, recorded in 2019.

Table 1. The evolution of BVB's regulated stock market

Year	No of transactions	Total annual value of share transactions (million RON)	Average daily trading value of shares (million RON)	Capitalization (million RON)
1st semester 2021	449,442	4,842.08	36.75	190,503.9
2020	744,793	12,226.99	49.10	154,365.4
2019	468,325	9,678.26	38.87	180,853.6
2018	536,221	11,457.32	46.01	142,986.1
2017	808,429	11,852.37	47.79	164,376.2
2016	653,270	9,253.80	36.43	146,549.7
2015	685,248	8,803.40	35.07	146,002.5

Data source: https://www.bvb.ro/TradingAndStatistics/Statistics/GeneralStatistics

Despite the deteriorated macroeconomic context and the increasing risks on the financial markets, Table no. 1 shows an increase in liquidity on the local capital market in 2020 compared to 2019, both in terms of the value traded and the number of transactions. It is also the highest annual value of traded shares ever recorded on the main segment of the Romanian stock exchange. In 2020, the record was also reached in terms of the average daily liquidity.

Liquidity on the stock market is important because it influences investors' demand for shares. Liquidity means that a significant amount of an asset can be traded continuously, which decreases the investors' uncertainty and therefore decreases the risk premium of the shares held.

In 2020, in Romania, the turnover ratio as the value of domestic traded shares divided by their market capitalization, value annualized by multiplying the monthly average by 12, increased, reaching the level of 10.62%. The highest value in the EU was recorded in Germany: 79.42%. Other markets in the CEE region, such as Austria, Hungary or Poland, also had liquidity levels above the EU average of 25.4%, as Figure 5 shows. However, Romania surpassed Slovenia, Croatia, Bulgaria, but also Cyprus and Luxembourg.

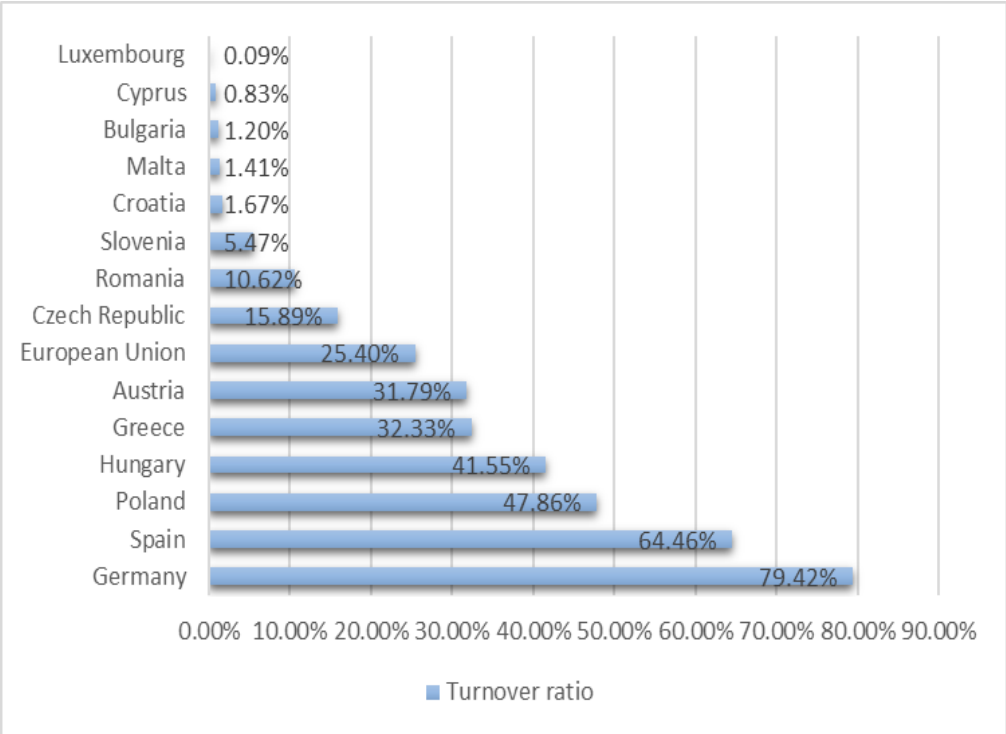

Figure 5. European stock market turnover ratios in 2020 as the value of domestic shares traded divided by their market capitalisation annualised

Data source: https://www.fese.eu/statistics/

During the year 2020, several companies and the Ministry of Public Finance used the capital market to finance themselves through issues of shares and bonds, both in RON and EURO. In 2020, the primary, secondary and other public offers on the Bucharest Stock Exchange cumulated the value of RON 6.21 billion, approximately 3 times higher than in 2019.

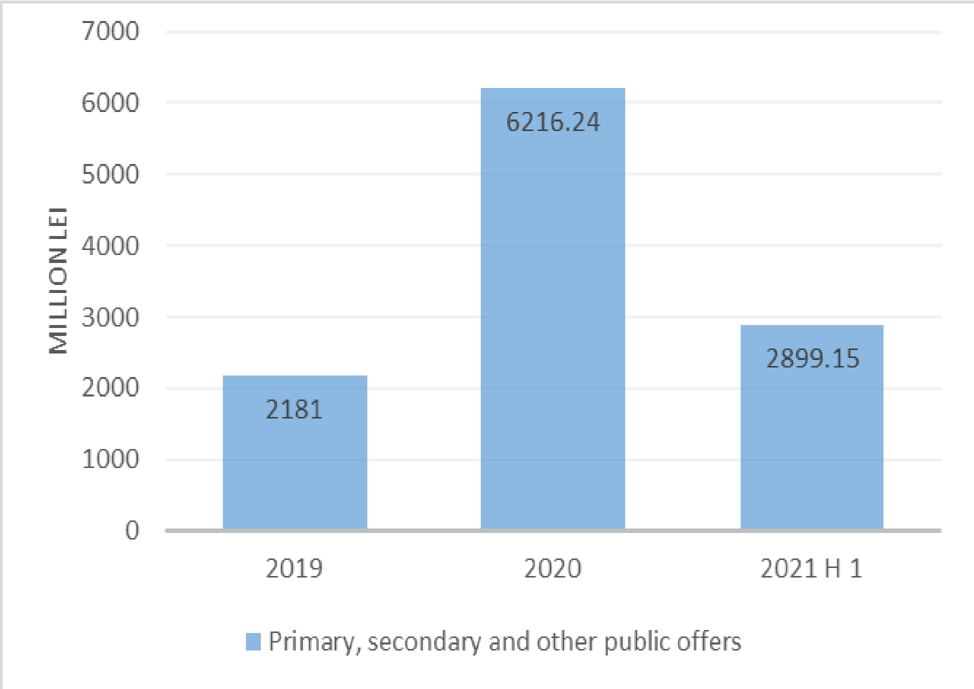

Figure 6. The evolution of primary, secondary and other public offers on the Bucharest Stock Exchange regulated market for 2021 (1st semester)

Data source: https://www.bvb.ro/TradingAndStatistics/Publications/MonthlyReports

The attractive market conditions in 2021 have led to the best-performing first half in terms of revenue in the last 20 years. The value of primary, secondary and other public offers in the 1st semester of 2021 exceeded that recorded in the entire 2019, as Figure 6 shows. This significant increase can be attributed to the ample liquidity and new opportunities driven by the COVID-19 pandemic. At the same time, the speculative and opportunistic transactions, along with the popularization of the retail investment platforms among the general public, have made investments more affordable than ever. Even with fears of a market correction, as long as liquidity is available, investors will continue to look for opportunities in the capital market. There is a growing interest from companies and investors for listings in the alternative market, AeRO.

In the first half of 2021, the primary public offerings ran in sectors such as cyber security, construction, retailers and transport. The Ministry of Public Finance continued with another round of sales of government bonds for the population, attracting RON 1,396 million. The corporate bonds segment is also very active this semester, a RON 195 million issue coming from the main player in the Romanian agricultural industry, Agricover Holding, and the Romanian Commercial Bank issued bonds worth RON 1 billion.

4. CONCLUSIONS

At the beginning of the coronavirus crisis, in a context characterized by a high level of uncertainty, the stock markets around the world fell sharply and were very volatile. The BET index registered a negative adjustment similar to the international and regional developments, decreasing by about 25% between December 30, 2019 and March 30, 2020.

The central banks and the authorities responded immediately by implementing intensive policy measures to save the financial markets, especially by reducing the monetary policy rate and providing liquidity in the financial system.

The recovery of capital markets has been rapid, driven by increased investors' confidence in the context of reduced COVID infections and vaccine discovery, along with some generous government support programs for businesses and monetary and fiscal incentives, but also due to the liquidity that flooded the market. The zero interest rate and the financial support from the European Central Bank and The Federal Reserve System have found their way into the trading market, making investments more affordable than ever.

The increase in investment activity led the Romanian stock market to new highs in June 2021. The BET index increased by 21%, reaching an all-time high of 11,967 points. At the end of the 1st semester of 2021, the market value of the companies listed on the main market of BVB reached the value of RON 190.5 billion, exceeding the level at the end of 2019, which marked the best performance of the local stock market since the financial crisis of 2008. However, this growth does not seem to be supported by economic fundamentals as there is a divergence between the asset prices and their core value, and a strong correction can lead to a sharp increase of the market risk. Decoupling financial markets from economic fundamentals can generate speculative bubbles and increase systemic risk. Even with fears of a market correction, as long as liquidity is available, investors will continue to look for opportunities on the capital market.

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