

## **BANKS AND FINANCIAL INTERMEDIATION AS DRIVERS OF ECONOMIC GROWTH**

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**ABSTRACT:** *This paper examines the role of the financial system in supporting economic growth through the efficient mobilization and allocation of resources. It provides a detailed overview of domestic credit to the private sector, measured as a percentage of GDP, across the EU, Euro Area, Central Europe and the Baltics (CEB), and selected Central and Eastern European (CEE) economies. The analysis covers two periods, 2007-2014 and 2015-2024, capturing the effects of the 2008-2009 global financial crisis and the COVID-19 pandemic. Comparative assessment highlights heterogeneous trends across countries, reflecting differences in banking system development, the efficiency of financial intermediation, and the capacity to withstand economic shocks. The study identifies persistent disparities in credit allocation, with some economies maintaining high levels of bank-mediated financing while others, notably Romania, exhibit consistently lower domestic credit ratios.*

**KEY WORDS:** *financial intermediation, domestic credit, economic growth, banking system efficiency, financial stability, credit allocation.*

**JEL CLASSIFICATIONS:** *G21, G28, E44, O16.*

### **1. INTRODUCTION**

The development of the financial system plays a fundamental role in promoting economic growth by mobilizing savings and channelling them into productive investment and consumption (Drigă, 2006). This relationship can be better understood by examining the core functions of the financial system, including the efficient allocation of financial resources, the reduction of transaction costs, and the mitigation of information asymmetries between savers and investors. By performing these functions, financial intermediaries facilitate capital accumulation, improve the organization of production, and support sustained productivity growth.

Within this context, the banking system serves as a central intermediary, efficiently allocating funds from savers to borrowers, mitigating monitoring and

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liquidity risks, improving risk management, and enabling portfolio diversification (Konstantakopoulou, 2023). Through these mechanisms, banks channel resources toward more productive economic activities, thereby promoting investment and contributing to long-term, sustainable economic growth.

Banks, commonly characterized as intermediaries between savers and capital users, play a central role in financing production by extending their own liabilities to agents willing to accept them and using these liabilities as a medium of exchange. Beyond traditional deposit-taking and lending activities, banks facilitate payments and settlements, provide foreign exchange services, offer financial advisory, and manage risk. Through these functions, they enhance the efficiency of resource allocation, support productive investment, and contribute to overall economic welfare.

To provide these services, banks perform several core functions. The deposit function mobilizes temporarily available funds from households and firms, thereby creating a stable funding base for investment. The lending function allocates credit to economic agents to finance productive activities, directly supporting economic growth. The payments and settlement function facilitates transactions among account holders and ensures the smooth execution of financial operations essential to economic activity (Drigă, 2012). Through these mechanisms, banks channel savings into productive investments, reduce financing costs, improve the efficiency of resource allocation, stimulate innovation and firm-level competitiveness, contribute to job creation, and offer relatively low-risk returns to savers, underscoring their central role in fostering sustainable economic growth.

## **2. OBJECTIVES AND METHODOLOGY**

This study provides an overview of the key functions of the financial system, with a particular focus on the role of banks as intermediaries in mobilizing savings and channelling them into productive investments. It examines trends in financial intermediation and resource allocation using a descriptive approach based on secondary data from academic literature, official reports, and publicly available statistical sources. This approach enables an assessment of banks' capacity to allocate financial resources efficiently and support economic growth. The analysis further investigates domestic credit provided by banks to the private sector across the European Union and selected Central and Eastern European economies. By comparing periods before and after the 2008-2009 global financial crisis and during the COVID-19 pandemic, the study highlights structural differences in banking systems, variations in the efficiency of financial intermediation, and differences in recovery trajectories across countries.

## **3. FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: A THEORETICAL PERSPECTIVE**

Financial development involves the quality, depth, and efficiency of a country's financial system, with commercial banks playing a central role. Banks act as financial intermediaries by mobilizing savings from households and firms and

directing them toward productive investments. They provide credit, facilitate payments and settlements, manage risk, and mitigate information asymmetries, ensuring that financial resources are allocated efficiently and used in their most productive ways. Other financial institutions and markets, such as equity and bond markets, complement this process, but the banking sector remains the backbone of financial development, forming the foundation for the broader financial system.

Economic growth refers to the expansion of a nation's output of goods and services, typically measured by real GDP over time. It reflects increases in physical and human capital, technological progress, productivity improvements, and institutional quality. Growth captures not only the accumulation of resources but also the efficiency of their use. It is central to improving living standards, generating employment, and enhancing societal welfare.

The connection between financial development and economic growth is based on the capacity of a well-functioning financial system to facilitate productive investment. Banks play a key role by reducing transaction costs, improving access to finance, and enabling firms to undertake innovative, high-return projects. Through these mechanisms, an efficient banking sector enhances capital allocation, stimulates innovation, and supports long-term economic growth.

Extensive empirical and theoretical research has highlighted the role of financial intermediation in sustaining economic growth. Schumpeter (1932) first emphasized the central function of financial institutions in facilitating capital allocation, mobilizing resources, and enabling firms to pursue innovative, growth-enhancing activities. While classical growth theory links long-term expansion primarily to capital accumulation and technological progress, it does not fully explain the diverse growth trajectories observed across countries. This underscores the importance of integrating the financial sector into growth models.

Schumpeter's framework highlights that financial intermediaries are active agents in the growth process rather than passive fund conduits. By lowering information costs, diversifying risk, and allocating capital to innovative entrepreneurs, financial intermediaries improve productivity and economic transformation. Subsequent theoretical contributions (Diamond & Dybvig, 1983; Stiglitz & Weiss, 1981) formalize how financial constraints, including asymmetric information and moral hazard, limit investment and growth when financial markets and institutions are underdeveloped.

Financial development theory identifies the roles of financial intermediaries and markets in overcoming these constraints. It is fundamentally characterized by three dimensions: depth (the size and liquidity of financial markets and intermediaries), access (the ability of individuals and firms to obtain financial services), and efficiency (the cost and quality of intermediation). Greenwood & Jovanovic (1990) emphasize that greater financial intermediation allows for more efficient allocation of capital, which in turn stimulates investment and long-term economic growth. Commercial banks play a central role within this framework by transforming short-term liabilities into long-term investment capital, managing risk through diversification and intertemporal smoothing, and facilitating real economic transactions via payment and settlement systems. Empirical evidence, including the influential synthesis by Levine

(2004), supports this framework, indicating that developed financial systems, led by efficient banks, actively promote economic growth rather than only reflecting it.

Contemporary growth literature incorporates financial development as a key determinant of long-term growth (Beck et al., 2000; Levine, 2004; Allen et al., 2011). It emphasizes its influence on capital accumulation, innovation incentives, and the efficiency of resource allocation. Efficient financial systems reduce investment barriers, channel capital toward high-productivity sectors, and lower external financing costs. From this perspective, the development of financial intermediaries, particularly banks, is not simply associated with growth but facilitates access to finance, reduces transaction costs, and stimulates firm-level innovation.

Recent theoretical work emphasizes the role of financial stability, institutional quality, and broad access in supporting the contribution of financial development to economic growth. By integrating insights from information economics and institutional economics, this modern framework provides a solid foundation for empirical analyses that assess the causal relationships between financial development and economic performance.

#### **4. DOMESTIC CREDIT TO THE PRIVATE SECTOR BY BANKS: EVIDENCE FROM THE EU AND CEE ECONOMIES**

##### **4.1. Pre- and post-crisis dynamics of domestic credit to the private sector by banks (2007-2014)**

Domestic credit provided by banks to the private sector, expressed as a percentage of GDP, is the official World Bank indicator measuring total financial resources mobilized by banks to the private sector, including both firms and households, through loans, trade credits, advances, or corporate debt securities. The evolution of this indicator provides empirical evidence on the capacity of banking systems in the European Union, the Euro Area, and selected Central and Eastern European (CEE) economies to allocate financial resources efficiently and support productive investment. As a measure of financial deepening, it reflects the effectiveness of financial intermediation in promoting macroeconomic stability and long-term growth.

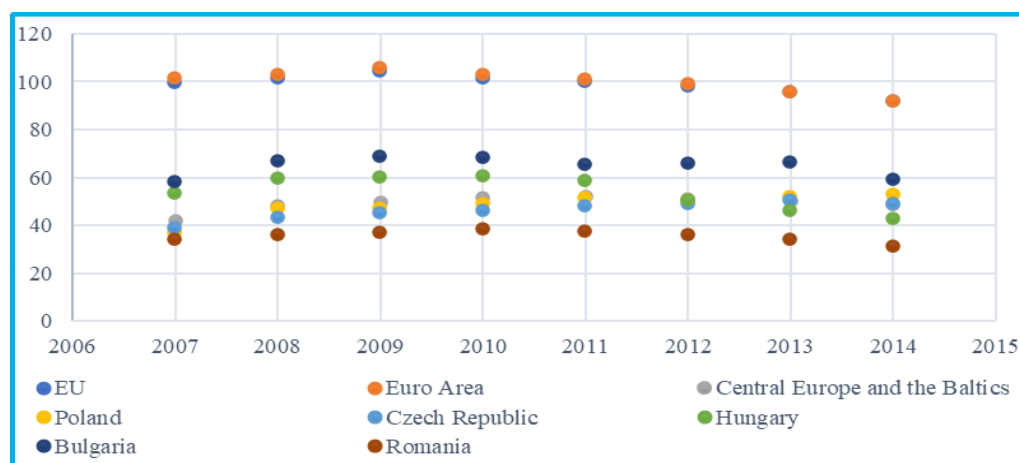
The analysis examines two distinct periods, 2007-2014 and 2015-2024, providing a comparative framework for assessing developments in domestic credit allocation. The first period captures the pre- and post-global financial crisis years, highlighting the immediate impact of the 2008-2009 crisis on private sector credit, while excluding 2005-2006, when many CEE economies were still in the early stages of financial market development. The second period reflects post-crisis recovery and more recent trends, including the impact of COVID-19-related monetary and fiscal measures. This temporal division allows for a clear evaluation of structural changes in banking systems and the heterogeneous recovery of credit provision across the European Union, the Euro Area, and selected CEE economies, with a particular focus on Romania.

Data from the World Bank for 2007-2014 reveals significant disparities in domestic credit provided by banks to the private sector across Europe, reflecting differences in the development and efficiency of national banking systems. In the EU and Euro Area, average credit levels were relatively high, at 98.96% and 99.97% of GDP, respectively. Credit allocation peaked in 2009 at 104.24% and 105.55% of GDP, reflecting pre-crisis expansion, but subsequently declined to 91.67% in both regions by 2014, reflecting post-crisis adjustments and a contraction in bank lending.

**Table 1. Domestic credit to private sector by banks (% of GDP), 2007-2014**

Year	EU	Euro Area	Central Europe and the Baltics	Poland	Czech Republic	Hungary	Bulgaria	Romania
2007	99.28	101.22	42.07	37.05	38.70	53.15	58.34	34.00
2008	101.31	103.07	48.36	47.10	43.27	59.32	66.82	35.91
2009	104.24	105.55	49.90	46.91	45.06	59.87	68.86	37.01
2010	101.61	102.77	51.85	48.87	45.86	60.29	68.11	38.29
2011	99.86	100.82	51.95	51.48	47.92	58.41	65.19	37.43
2012	98.14	98.83	50.97	50.32	49.05	50.38	65.70	35.96
2013	95.54	95.82	50.25	51.66	50.29	46.06	66.10	34.17
2014	91.67	91.67	48.78	52.62	49.09	42.49	59.14	31.09
<b>Average</b>	<b>98.96</b>	<b>99.97</b>	<b>49.27</b>	<b>48.25</b>	<b>46.16</b>	<b>53.75</b>	<b>64.78</b>	<b>35.48</b>

Source: based on data from World Bank, <https://databank.worldbank.org>



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**Figure 1. Domestic credit to private sector by banks (% of GDP), 2007-2014**

Among the Central European and Baltic (CEB) economies, average domestic credit provided by banks to the private sector was 49.27% of GDP, with notable differences across countries. Poland exhibited a gradual increase from 37.05% in 2007 to 52.62% in 2014, indicating resilience to the global financial shock. The Czech

Republic recorded a steady upward trend, rising from 38.70% to 49.09%, while Hungary started at higher levels, peaking at 60.29% in 2010, but declining to 42.49% in 2014, reflecting post-crisis adjustment measures and banking sector constraints.

Within the broader CEE economies, Bulgaria reached a maximum of 68.86% in 2009 before decreasing to 59.14% in 2014, and Romania consistently recorded the lowest levels of domestic credit extended by banks, from 34.00% in 2007 to 31.09% in 2014. These figures indicate a shallow level of financial intermediation and slower post-crisis recovery than neighboring economies.

These patterns illustrate the significant impact of the 2008-2009 global financial crisis, which accentuated structural differences in banking system development and in banks' capacity to allocate financial resources to the private sector. While EU and Euro Area economies experienced temporary peaks followed by gradual declines, CEE and broader CEE economies exhibited heterogeneous trajectories, with some maintaining stable growth and others undergoing pronounced post-crisis adjustments. Romania's persistently low levels of domestic credit provided by banks underscore structural limitations in financial intermediation relative to other countries in the region.

#### **4.2. Post-crisis evolution of domestic credit to the private sector by banks (2015-2024)**

Data for 2015-2024 show notable differences in domestic credit provided by banks to the private sector, expressed as a percentage of GDP, reflecting variations in banking system development and efficiency across countries.

In the EU and Euro Area, domestic credit declined from 88.99% and 88.96% of GDP in 2015 to 83.91% and 84.08% in 2019, respectively. A similar downward trend was observed in several Central and Eastern European (CEE) economies: in Poland, credit decreased from 53.31% to 50.23% of GDP, while Bulgaria fell from 54.72% to 49.77%. The Czech Republic remained relatively stable, fluctuating between 49% and 51%, whereas Hungary declined from 35.06% to 33.07%. Romania followed a steeper downward trajectory, from 34.17% in 2015 to 26.67% in 2019, remaining below both European and regional averages.

In 2020, most economies experienced a rebound in domestic credit ratios. The EU and Euro Area rose to 91.24% and 92.12% of GDP, respectively, while the Czech Republic increased to 51.98%, Hungary to 37.32%, and Bulgaria to 51.25%. Poland recorded a slight decline to 49.27%, and Romania continued a modest decrease to 25.69%. These changes reflect monetary and fiscal support measures implemented during the COVID-19 pandemic, including liquidity provision and credit guarantee schemes.

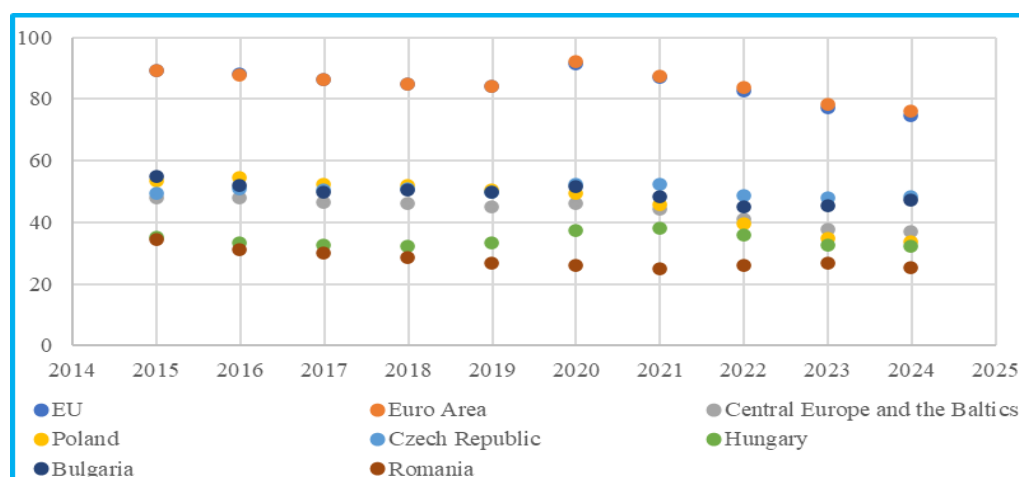
From 2021 to 2024, domestic credit ratios declined in most economies, reflecting post-pandemic adjustment. By 2024, ratios had fallen to 74.30% in the EU and 75.86% in the Euro Area. In the CEE region, Poland decreased to 33.51%, Hungary to 32.12%, and Bulgaria to 47.03%, while the Czech Republic remained around 48%. Romania's ratio remained largely stable, fluctuating between 24% and 26%, reaching 25.22% in 2024.

From 2021 to 2024, domestic credit ratios declined across most economies, reflecting post-pandemic adjustments. By 2024, ratios had fallen to 74.30% in the EU and 75.86% in the Euro Area. In the CEE region, Poland decreased to 33.51%, Hungary to 32.12%, and Bulgaria to 47.03%, while the Czech Republic remained around 48%. Romania's ratio remained largely stable, fluctuating between 24% and 26%, reaching 25.22% in 2024.

**Table 2. Domestic credit to private sector by banks (% of GDP), 2015-2024**

Year	EU	Euro Area	Central Europe and the Baltics	Poland	Czech Republic	Hungary	Bulgaria	Romania
2015	88.99	88.96	47.83	53.31	49.26	35.06	54.72	34.17
2016	87.94	87.73	47.87	54.34	50.57	33.28	51.95	31.09
2017	86.32	86.20	46.32	52.27	50.23	32.35	49.74	29.90
2018	84.86	84.80	45.85	51.90	50.72	32.22	50.48	28.56
2019	83.91	84.08	44.74	50.23	49.44	33.07	49.77	26.67
2020	91.24	92.12	45.88	49.27	51.98	37.32	51.25	25.69
2021	86.81	87.38	44.23	45.73	52.03	38.08	48.10	24.72
2022	82.50	83.44	40.70	39.32	48.63	35.73	44.69	25.85
2023	77.18	78.29	37.55	34.71	47.71	32.53	45.28	26.49
2024	74.30	75.86	36.90	33.51	48.00	32.12	47.03	25.22
<b>Average</b>	<b>84.41</b>	<b>84.89</b>	<b>43.79</b>	<b>46.46</b>	<b>49.86</b>	<b>34.18</b>	<b>49.30</b>	<b>27.84</b>

Source: based on data from World Bank, <https://databank.worldbank.org>



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**Figure 2. Domestic credit to private sector by banks (% of GDP), 2015-2024**

On average for 2015-2024, domestic credit in the EU and Euro Area was 84.40% and 84.89% of GDP, respectively. Among selected CEE economies, the Czech

Republic and Bulgaria reported the highest averages (49.86% and 49.30%), followed by Poland (46.46%) and Hungary (34.18%), while Romania had the lowest average at 27.84%. These figures highlight differences in financial intermediation across the region, with Romania consistently recording lower levels of domestic credit provided by banks to the private sector compared with EU and neighbouring economies.

#### 4.3. Comparative analysis of domestic credit to the private sector by banks: 2007-2014 vs 2015-2024

A comparison of the two periods, 2007-2014 and 2015-2024, highlights the effects of the 2008-2009 global financial crisis and the post-pandemic dynamics of domestic credit provided by banks to the private sector, expressed as a percentage of GDP. In the EU and Euro Area, domestic credit peaked pre-crisis in 2009 at 104.24% and 105.55% of GDP, before declining to 91.67% by 2014. During 2015-2019, ratios continued to decrease, reaching 83.91% in the EU and 84.08% in the Euro Area. In 2020, they temporarily rose to 91.24% and 92.12%, reflecting monetary and fiscal measures implemented during the COVID-19 pandemic. From 2021 to 2024, ratios declined again, reaching 74.30% and 75.86% in the EU and Euro Area, respectively. Overall, the trajectory indicates a long-term decline in domestic credit relative to GDP, with temporary peaks corresponding to crisis-related interventions.

**Table 3. Average domestic credit to the private sector by banks (% of GDP) - comparative periods**

Region / Country	2007-2014 Average	2015-2024 Average
EU	98.96	84.40
Euro Area	99.97	84.89
Central Europe & Baltics (CEB)	49.27	43.79
Poland	48.25	46.46
Czech Republic	46.16	49.86
Hungary	53.75	34.18
Bulgaria	64.78	49.30
Romania	35.48	27.84

*Source: based on data from World Bank, <https://databank.worldbank.org>*

In Central Europe and the Baltics (CEB), domestic credit increased from 42.07% in 2007 to 48.78% in 2014. During 2015-2019, ratios declined gradually from 47.83% to 44.74%, followed by modest fluctuations during the pandemic and post-pandemic period, ending at 36.90% in 2024. Trends varied across CEB countries: the Czech Republic maintained relatively stable ratios, Poland experienced moderate increases followed by declines, and Hungary underwent a post-crisis decrease.

Within the broader Central and Eastern European (CEE) economies, Bulgaria recorded higher levels of domestic credit, peaking at 68.86% in 2009 and averaging 49.30% over 2015-2024. Romania consistently exhibited the lowest levels, with a

temporary rebound in 2010 following the 2008-2009 global financial crisis, returning to 34% in 2015. Despite targeted support measures for small and medium-sized enterprises, domestic credit subsequently declined, reaching 25.22% in 2024. This trajectory illustrates that, although policy interventions provided temporary relief, structural constraints in the Romanian banking system and slower post-crisis recovery limited sustained growth in credit allocation to firms and households.

The comparative perspective highlights structural differences in banking systems, variation in financial resource allocation to the private sector, and diverse trajectories across regions and countries.

## 5. CONCLUSIONS

This study examined the role of banks and financial intermediation in supporting economic activity, focusing on domestic credit provided to the private sector across the EU, Euro Area, Central Europe and the Baltics (CEB), and selected CEE economies. The analysis reveals significant variation in domestic credit across countries and periods. During 2007-2014, the 2008-2009 global financial crisis produced pre-crisis peaks followed by subsequent declines. EU and Euro Area economies maintained relatively high credit-to-GDP ratios, whereas CEB and broader CEE economies exhibited lower levels and slower post-crisis recovery. Bulgaria and the Czech Republic performed relatively well, while Romania peaked in 2010, returned to 34% in 2015, and declined further despite targeted support measures.

For 2015-2024, domestic credit generally declined, with a temporary rebound in 2020 due to COVID-19-related monetary and fiscal interventions. Post-pandemic adjustments led to renewed declines, with Romania consistently exhibiting the lowest levels among the analysed countries. The comparative analysis of the two periods highlights heterogeneous trends, reflecting differences in banking system development, financial deepening, and crisis resilience. Overall, domestic credit allocation is influenced by banking sector capacity, structural characteristics, and policy measures, with Romania consistently exhibiting limited credit growth relative to EU and regional peers.

These findings provide a comprehensive overview of domestic credit trends and structural differences across countries, laying a foundation for further research on how variations in bank credit influence economic performance. Future studies could examine the relationship between domestic credit and key economic indicators, including annual GDP growth and GDP per capita, together with financial inclusion and non-performing loan ratios. This approach would offer a more detailed understanding of how financial intermediation supports economic development.

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