

GOVERNANCE

More and more disappointed and detached...Over two years have passed since the current governing alliance came to power. The statistical data and various monitoring reports show a mixed picture, but the public opinion seems to be much more well-defined. In this respect, the results of the last Public Opinion Barometer (POB) provides a worrying story to read (though some data of the survey have to be attentively interpreted, it is clear that the general trends are bad). At the same time, leaving alone the relative fluctuations of the rating of the parties and political leaders, other data on the general feeling of the public provide the opportunity to esteem the *Zeitgeist* of the Moldovan society at the end of 2011.

A series of the POB is revealing in this respect. Regarding the general development of the country, a record number of respondents, 83.5%, think that "things go the wrong way". Symptomatically enough, the previous anti-record was set by the CPRM in July 2009, before losing the early parliamentary elections. Thus, these data could not augur well for the AEI, if the early elections take place in December. As interesting as the previous, the reported household income is at a quite low level, similar to the one of ...July 2009. Adding the data that show that 78.4% of respondents do not think that the country is governed according to the will of the population, we obtain a disappointed and detached public. Is it the time for a change? It seems that yes, at least if we trust the Gallup index of political stability: -47.5%, a new historical anti-record!

...and Euro-skeptical. The Moldovans seem to be disappointed not only by the manner how the current alliance governs the country, but also by the idea of European integration, which the alliance insisted to identify itself with. Thus, the share of respondents that would vote for the adherence to the EU reached the lowest historical level (33.8%) and it's currently lower than the support provided to the adherence to the Customs Union of Russia-Belarus-Kazakhstan (45.6%). These developments are undoubtedly underlain by the poor performance of the AEI and the current crisis the EU struggles with. Although currently the European integration continues to be the fixed idea of the political mainstream, as well as of the public speech, the internal failures and the perpetuation of the political-economic crisis in the EU could show in another light the old geopolitical dilemma of the Republic of Moldova...

In this issue:

- Consumer rights are under focus again;
- What revenues feed the consumption this year?
- The reason underlying the slow increase in the budget revenue;
- The trade expansion keeps beating records;

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Real Economy is a monthly economic review tracking the most important policy and economic evolutions. Its readers are policymakers, CEOs of domestic and international companies and banks, representatives of the international institutions and foreign embassies, political parties and economic journalists.

Acronyms and abbreviations used:

y-o-y - year on year; q-o-q - quarter on quarter; Q4'07 – fourth quarter 2007; Jan'09 – January 2009; NBS – National Bureau of Statistics; NEA – National Employment Agency; NBM – National Bank of Moldova; EG – Expert-Grup; MDL – Moldovan leu (national currency); p.p. - percentage points;

EXPERT-GRUP is a Moldovan policy think-tank whose mission is to create a working environment in which free and non-trivial thinking thrives in order for the institution to be a leading source of unbiased economic analysis and to effectively advocate for innovative ideas and solutions to the economic problems that Moldova encounters along its path of economic transformation, societal development and European integration.

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BUSINESS CLIMATE

The results of an inspection conducted recently by the staff of the Ministry of Internal Affairs brought back the focus on the consumer rights. Thus, more and more frequently are identified attempts to sell counterfeited products or products with an extended validity period. Unfortunately, the legislation in force does not help prevent such violations. Currently, the Consumer Protection Inspectorate¹ can conduct only annual inspections with preliminary notification of the controlled business entities. The issue is complicated by the fact that the fines applied in these cases are not big enough to discourage such practices among previously amended business entities. The consumers' mistrust affects, in turn, the lawful producers. Consequently, a review of the legal acts that affect the consumer interests is crucial for the establishment of a favorable business climate.

One of the main areas of the National Development Strategy for 2012-2020, which was presented recently² by the Ministry of Economy and Trade, envisages directly the development of the business climate in Moldova. The ambitious goals focus mainly on enhancing the position of Moldova in the international business ratings and facilitating the access to crediting. The authors of the strategy aim at reaching the top of the regional listing by the end of 2020. Unfortunately, some long-term objectives specified by the Strategy conflict with the short-term needs or worse, with other objectives set by the Government. For instance, it is not feasible to plan a decrease in the number of inspections conducted by the relevant authorities when we see an increased need for such controls (i.e. NAPC inspections, inspections prior to VAT refund, sanitary inspections, inspections to identify tax evasion with the purpose of decreasing the salaries paid under the table, etc.).

REAL SECTOR

Changes in the structure of industrial growth. The convergence of the industrial growth to the pre-crisis rates can be noticed. Thus, in September, the annual growth was already at the level of one digit - 9.8%. However, the result for January-September is still very good, with a 10% increase y-o-y. There is a continuation of the trend that started the previous months of deconcentrating the processing industry by diminishing the share of the "food and beverages industry" group, due to the increase of only 2.7% y-o-y of this group, compared to the significant increase (between 10% and 43%) in most of other groups. Regrettably, the GVA per employee in the expanding groups is not always higher or close to the one in the food and beverages industry (MDL 60.1 thousand³) if we assume that the groups will maintain to a large extent similar levels for 2011 as well.

¹ The General State Inspectorate for Market Supervision, Metrology, and Consumer Protection.

² The public consultations took place on 7 November 2011.

³ Calculated based on the results of the "Structural survey in enterprises", 2011, NBS, <http://www.statistica.md>.

The construction in stagnation. In this sense, the construction of residential buildings is the segment that hinders the growth of the sector. Apparently, the population is not willing to invest in real estate as much as it used to, so that the amount of undertakings related to residential buildings decreased by 13.3% y-o-y in the first three quarters of the year. Altogether, the construction works carried out in January-September were at the levels of 2010, with some changes in the structure. Nevertheless, the breakdown by types of services shows some changes. Thus, the amount of construction works decreased by 15.4p.p., while the capital repairs and maintenance and current repairs increased by 20% and 27% respectively.

The hotel services recovered to the pre-crisis performance (2008). During the first three quarters of the current year, both the incoming⁴ and outgoing⁵ tourism have increased significantly by 33% and 17% respectively y-o-y. As a result of these trends, the number of tourists accommodated in the collective tourist structures with accommodation capacity recovered in Q3'11 to 97% of the level registered in the similar period of 2008. Altogether, the number of tourists registered in January-September reached 87% of the number registered in 2008 (Chart 1). It is worth mentioning that the hotel services felt the crisis effect much stronger than other sectors, not only in Moldova, but in the entire world. In this respect, a recovery to the pre-crisis results in a quite short period (compared to the transport services) is even more remarkable.

HOUSEHOLDS

Slow and uneven growth of wages. Since July the wage growth rate has slowed down; in September the increase accounted for only 0.3% y-o-y. The real wage increased in annual terms in the following sectors: agriculture, mining, wholesale and retail trade, financial activities and education. Thus, stabilization of the financial sector and increase of demand for construction materials allowed new employments and increase of wages in these sectors. The wages also converge in the budgetary sector. In September, the salaries in education reached the level of salaries in healthcare, while one year ago the difference accounted for about 20%. Nevertheless, the salaries are still low in the primary and secondary education.

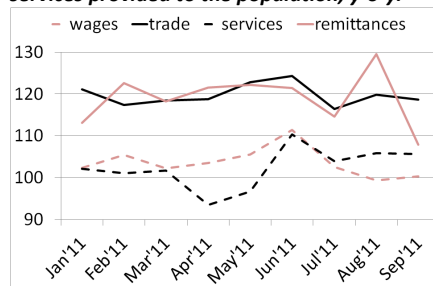
What revenues feed the consumption? The rise in wages can hardly explain the increase of the final consumption of households. The turnover in the retail trade augmented by about 18% in Q3'11, while the turnover in the services provided to population went up by about 5.1%. Thus, the trend of the retail trade is aligned more to the trend of remittances (Chart 2). Nevertheless, in September the remittance growth was at the level of a single digit. Although it's too early to reach a conclusion based on one month only, it is expected that by the end of the year the remittance growth rate will slow down. The structure of remittances shows that a significant part of them come from the CIS countries, unlike the pre-crisis situation, which is also confirmed by the data of the balance of payments of the Republic of Moldova. Thus, the share of remittances in RUR increased to about 20% (Chart 3), with a growth rate of 100% this year. At the same time, the remittances in EUR increased only by 25% on the average.

Chart 1. Number of tourists accommodated in tourist facilities with accommodation capacity in Q1-Q3 2008-2011 (thousand people).



Source: NBS;

Chart 2. Evolution of salaries, remittances, turnover in the retail trade and market services provided to the population, y-o-y.

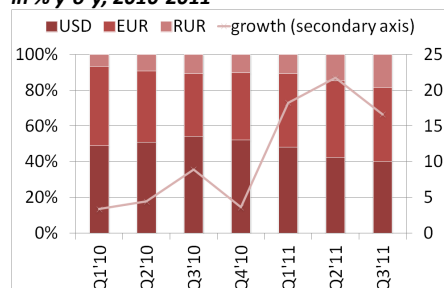


Source: NBS, NBM and EG calculations;

⁴ Tourists arrived to Moldova

⁵ Moldovan residents travelling abroad

Chart 3. Evolution of transfers from abroad by the FX structure (main axis) and increase in % y-o-y, 2010-2011



Source: NBM and EG calculations;

With one month delay, the individuals' deposits seem to slow down their increase, despite the more attractive interest rates. There is also an obvious lack of population's confidence in the situation on the foreign markets. Thus, the deposits in MDL grew to a higher extent, while the ones in foreign currency have a stable trend. In September and October, the growth rate accounted for 6.8% and 1.3% respectively, compared to 40.8% and 26.7% for deposits in MDL.

PUBLIC FINANCE

Although the main economic parameters exceeded significantly the expectations, the Government, supported by IMF, decided to be more careful in achieving the goal related to the budget deficit.

Thus, the Government approved recently the draft Law amending the Law on the 2011 State Budget. The amendments mainly envisage the decrease of the State Budget revenue and expenses by MDL 38.36 million. Even if the evolution of the budget implementation on the revenue side over the past months indicated a need for possible adjustments through decrease, this decision was unexpected and hard to accept for many people. In the last years, except for 2009, all the adjustments were made only in the positive direction.

How is it possible? This situation is caused mainly by the deficiencies of the fiscal system, including by the low capacity to collect fiscal revenues. As well, the evolution of the structure and regime of foreign trade transactions, the changes in the economic growth structure, as well as some amendments in the regulation of the VAT could contribute to the relative decrease of the budgetary revenues compared to the approved budget.

Even with money we have no roads. On the revenue side, the most important decreases were made on the following lines: "external grants" - by MDL 178 million; "taxes on foreign trade and on the foreign operations" - by MDL 52.9 million; and "administrative fees and charges" - by MDL 26.1 million. The most important lines where revenue increases are: "Total VAT" - by MDL 81.5 million and "Special Funds Revenue" - by MDL 63.6 million. As a result of the amendments made, the capital expenses decreased by MDL 386 million and the current expenses grew by MDL 358.3 million. The arguments underlying these changes are the delayed performance of some capital expenses, on one hand, and limited resources to cover the current needs, on the other hand. In functional terms, agriculture got most of the gains - MDL 141.3 million, as well as "social insurance and assistance" - MDL 231.9 million, of which MDL 204 million to cover the deficit of the State Social Insurance Budget. The expenses for "road management" witnesses the highest cuts - by MDL 334.6 million; followed by the "state services with a general purpose" - by MDL 117.9 million; and "public utilities" - by MDL 107.4 million.

FINANCIAL SECTOR

For the first time this year, the amount of bank credits remained almost at the level of the previous year. It decreased by 0.4% in October compared to the respective month of the previous year and by 18.9% compared to the previous month. After an average decrease by about 27% in the first 9 months of the current year, such a reverse of the trend (Chart 4) occurred on the background of lower average cost of credits by 1.9 p.p. in nominal terms and by 2.8 p.p. in real terms compared to October 2010. This paradox can be explained by 2 factors: (i) stabilization of the demand noticed in the last months of 2011 after a period of dynamic recovery after the previous year, when the amount of the new credits grew about 3 times faster than in the current year; (ii) higher uncertainty related to the external macroeconomic framework related to sovereign debt crisis in the Eurozone and possible consequences over the national economy. Thus, the credits in foreign currency had largest contribution (-2.2%), particularly the ones provided for 6-12 months (-32.3%) and over one year (-8.1%), which are usually contracted by companies involved in external trade.

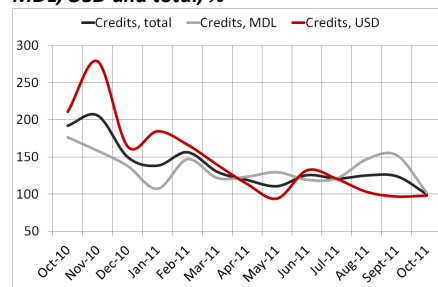
The NBM took under special supervision CB Universalbank JSC due to the insufficient capitalization, poor financial and managerial performance, as well as because of litigations among shareholders. With a share of about 0.9% of the total bank assets, the financial difficulties of the respective bank don't have major impacts on the entire sector. Respectively, they don't have a systemic character. We rather speak about an isolated case of a bank that did not manage to restructure its "toxic assets" accumulated during the recent economic crisis, as well as an inefficient risk management. Thus, according to the data as of the end of Q3, the share of non-performing credits in the total credits is 3 times higher than the average in the sector (24.33% compared to 8.13%) and the efficiency indicator calculated by the NBM is two times lower (89.51 compared to 174.17). This had a crucial impact on the profitability level and currently Universalbank is the single bank incurring losses. Consequently, this bank ranked the last in the latest issue of the Bank Performance Rating developed by Expert-Grup (Chart 5). We nevertheless think that NBM will manage to keep the situation under control, so that the bank could stay solvent and fix its internal issues as fast as possible.

CURRENCY AND PRICES

In October the prices increased by 1.5% compared to the previous month, which was the largest increase in the current year. It was determined mainly by the price increases for public utilities (+3%) due to the adjustment of the tariff for piped gas (+22.3%) and the central heating by 4%. The foodstuff also contributed significantly (+1.1%), particularly due to price hikes of eggs (+16.4%), vegetables (+8.6%) and dairy products (+2.4%). The main reasons were the increase of the demand and the external prices, climate and increase in the cost of raw materials. Though with a slower rate, the prices for non-foodstuffs, also, increased by +0.8%, particularly due to the prices for garments (+1.1%) and footwear (1.7%). This proves that besides the non-monetary factors, the rise in the level of prices was also caused by the increase in the disposable income of the population.

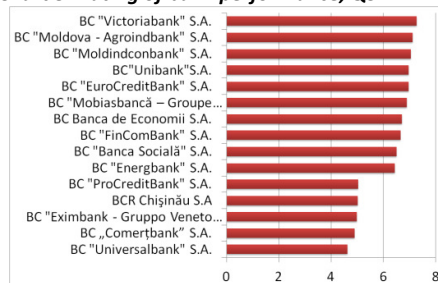
At the end of October, the annual consumer price index recorded the highest level compared to the other countries from this region (8.9%). Although the discrepancy between the current inflation and the one targeted by the NBM will most likely increase in the upcoming 2-3 months, this could be followed by a deflationary trend during the following year. The cause is the prevalence of non-monetary factors that usually have a short-

Chart 4. Annual increase of new credits in MDL, USD and total, %



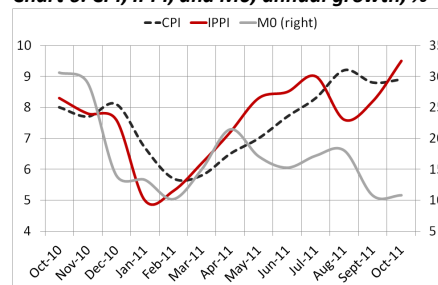
Source: NBM

Chart 5. Rating of bank performance, Q3'11



Source: EG

Chart 6. CPI, IPPI, and M0, annual growth, %



Source: NBS and NBM;

term impact and that cannot be controlled by the central bank. This is confirmed by Chart 6 where we can see a stabilization of the annual growth rate in the amount of money in circulation (M0) parallel to the increase in the industrial production price index (IPPI). Taking into account these circumstances and the lower inflationary expectations for the next year, the NBM did not tighten the monetary policy, keeping the reference interest rate at the level of 10% and the required reserves - at 14%.

FOREIGN TRADE

The expansion of the foreign trade keeps beating records. The statistical data for the first three quarters of 2011 show a continuous expansion of Moldova's commercial exchanges. Thus, during this period the exports increased by 56.9% and the imports by 40.1% y-o-y. On both sides the record historical levels of 2008 are left far behind. Nevertheless, a decreasing trend is noticed in the expansion of the exports and it is very likely that this trend would strengthen even more in late 2011 because of the less favorable statistical comparison basis in the last quarter, but also because of the clearer and clearer signs of a new wave of economic recession. The European Union is the first on the line of struggle with this crisis and, certainly, Moldova will feel the consequences of this crisis, since the community market is its main sales market.

We cannot overlook the data that show that the current expansion of the exports is explained by the expansion of re-exports. During the current they accounted for 41.7% of the total exports, explaining 31.2% of the increase. The high share of re-exports obviously impinge the numerical beauty of the Moldovan "trade miracle", showing that this expansion is generated only partially by the economic development of the country. Thus, a small number of companies benefit of re-exports, because re-exports involve neither know-how transfer nor significant job creation. That is why we should not be amazed by the situation where the exports progresses by almost 60%, while the industrial output increases by 10% only and no new jobs are created. A change of the development paradigm is further than we would like it to be...

STATISTICAL APPENDIX

TABLE 1. MOLDOVA: MAIN SHORT-TERM ECONOMIC INDICATORS

	Mar'11	Apr'11	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11
Industrial production growth rate, y-o-y, %	3.7	11.4	4.9	11.6	7.8	19.4	9.8	n.a.
Retail-trade growth rate, y-o-y, %	18.4	18.8	22.8	24.2	16.4	19.8	18.7	n.a.
Services to population growth rate, y-o-y, %	1.7	-6.5	-3.3	10.0	3.9	6.7	5.6	n.a.
Merchandise exports, million USD	182.9	175.9	173.6	172.5	181.0	186.0	182.6	n.a.
Merchandise imports, million USD	457.5	421.1	437.6	417.5	414.8	420.6	484.2	n.a.
Official reserve assets, million USD	1793.4	1918.4	1909.4	1901.5	1988.1	2018.9	1968.4	2018.9
Registered unemployed, persons, end-period	51204	48686	44719	41141	39146	37397	35482	34860
Real wage growth rate, y-o-y, %	2.2	6.8	5.5	11.4	2.5	-0.6	0.3	n.a.
Budget revenues growth rate, cumul. y-o-y, %	9.7	5.3	7.9	10.1	9.3	9.3	11.2	n.a.
Consumer prices growth rate, y-o-y, %	5.8	6.5	7.0	7.7	8.3	9.2	8.8	8.9
Nominal exchange rate, end-period, MDL/USD	11.90	11.69	11.67	11.61	11.40	11.34	11.92	11.6
Nominal exchange rate, end-period, MDL/EUR	16.82	16.87	16.60	16.75	16.30	16.37	16.23	16.42
Broad money (M2) growth rate, y-o-y, %	17.38	20.51	22.1	21.1	20.4	21.06	18.0	16.07
Central bank refinancing rate, end-period, %	8.0	8.0	8.0	8.0	9.0	10.0	10.0	10.0
Bank deposit rate, %	6.79	7.23	7.83	7.28	7.75	8.0	6.87	7.6
Bank lending rate, %	14.6	15.05	14.59	14.20	14.32	14.06	14.11	14.03
Banks liquid assets, % of total assets	33.2	32.82	33.34	31.77	32.30	32.68	31.67	32.91
Banks unfavorable credits, % of total credits	10.73	10.55	10.19	9.20	9.27	8.94	8.13	9.74
Currency deposits, % of total deposits	47.98	48.30	47.20	47.64	46.84	46.71	46.91	46.94

Source: NBS, NBM, and calculations and estimations of EG.

TABLE 2. MOLDOVA: MAIN LONG-TERM ECONOMIC INDICATORS

	2003	2004	2005	2006	2007	2008	2009	2010
Population, million (excluding Transnistria), end year	3.618	3.607	3.600	3.590	3.581	3.573	3.568	3.563
GDP, billion USD, current prices	1.981	2.598	2.988	3.408	4.401	6.055	5.403	5810
GDP per capita, USD at PPP	1923	2126	2359	2559	2720	3004	2839	3088
GDP growth rate, y-o-y, %	6.6	7.4	7.5	4.8	3.0	7.2	-6.5	6.9
Private consumption growth rate, y-o-y, %	18.5	6.2	10.1	7.0	3.6	4.5	-7.9	9.0
Gross fixed capital formation growth rate, y-o-y, %	19.2	11.0	17.7	2.8	10.5	-7.8	-37.2	17.2
Industrial production growth rate, y-o-y, %	15.6	8.2	7.0	-4.8	-1.3	0.7	-22.2	7.0
Agricultural production growth rate, y-o-y, %	-13.6	20.8	0.8	-1.1	-23.1	32.1	-9.9	7.9
Share of industry in GDP, %	20.5	20.5	19.1	18.0	19.1	13.9	13.0	13.3
Share of agriculture in GDP, %	18.3	17.5	16.4	14.8	10.0	8.8	8.5	12.0
Merchandise exports, million USD	805.1	994.1	1104.6	1060.8	1373.3	1646.0	1321.5	1582.1
Merchandise imports, million USD	1428.1	1748.2	2296.1	2644.4	3676.4	4866.3	3333.0	3855.3
Service exports, million USD	249.93	332.08	398.94	465.66	625.08	837.2	677.7	689.79
Service imports, million USD	294.26	353.05	419.68	487.64	631.16	824.72	701.8	770.10
Net foreign direct investment, million USD	73.64	147.8	190.86	234.16	522.04	691.49	112.0	198.9
Net work remittances, million USD	440.2	659.5	868.8	1119.0	1419.4	1795.8	1106.8	1253.3
Current account/GDP, %	-6.6	-2.2	-8.1	-11.7	-15.2	-16.7	-8.6	-8.3
Official reserve assets, end-year, million USD	302.27	470.27	597.44	775.3	1333.7	1672.4	1480.3	1717.7
Total external debt stock, million USD	1929.4	1881.8	2078.1	2528.9	3355.9	4106.1	4368.8	4618.1e
External debt/GDP, %	97.5	72.5	69.6	74.3	76.3	67.9	80.8	82.2
External debt/exports of goods and services, %	182.2	141.5	138.0	164.8	167.4	164.6	215.1	205.9
Employment rate, % of population aged above 15	47.5	45.7	45.4	42.9	42.5	42.5	42.8	38.5
Unemployment rate, % of the economically active population	7.9	8.1	7.3	7.4	5.1	4.0	6.4	7.5
Real wage growth rate, y-o-y, %	15.4	10.1	6.8	14.2	8.0	10.2	9.0	0.7
Consumer prices, year average, %	11.6	12.5	12.0	12.8	12.4	12.8	0.0	7.4
General government balance, % of GDP	1.0	0.4	1.5	-0.3	-0.3	-1.0	-7.0	-2.5
General government expenditure, % of GDP	33.1	35.1	37.0	40.1	41.8	41.6	43.5	40.8
Exchange rate, year average, MDL per USD	13.9	12.3	12.6	13.1	12.1	10.4	11.1	12.4
Broad money (M2) growth rate, y-o-y, %	24.4	44.8	36.7	12.2	47.3	18.3	-3.8	18.4
Central bank refinancing rate, end-year, %	14.0	14.5	12.5	14.5	16.0	14.0	5.0	7.0
Total commercial bank loans, % of GDP	28.5	30.3	30.2	33.6	40.2	39.8	41.4	37.2
Bank deposit rate, average per period, %	12.7	15.2	13.0	11.9	15.1	18.1	14.7	7.56
Bank lending rate, average per period, %	19.2	21.0	18.9	18.2	18.9	21.0	20.3	16.25

Source: NBS, IMF, NBM, and calculations and estimations of EG.