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Real Economy

Monthly review of Moldovan economy and policy

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Real Economy is a monthly economic review, tracking the most important economic evolutions and policy developments in Moldova. 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: y-o-y - year on year; q-o-q - quarter on quarter; m-o-m – month on month; e-o-p – end of period; Q4:07 – fourth quarter 2007; Jan:09 – January 2009; NBS – National Bureau of Statistics; NEA – National Employment Agency; NBM – National Bank of Moldova; MDL – Moldovan leu (national currency); BEM – Banca de Economii; p.p. - percentage points.

EXPERT-GRUP is a Moldovan independent 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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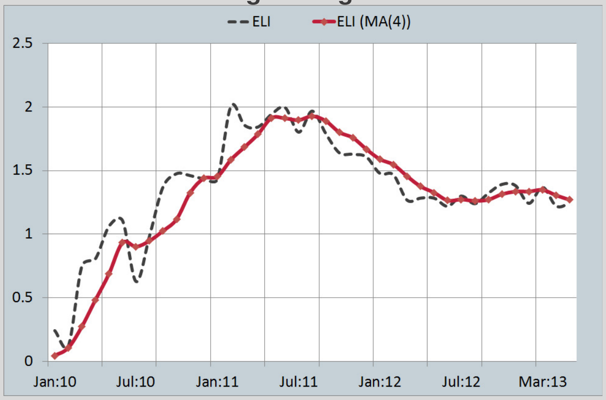
Evolution of the Economic Leading Indicator

The evolution of the Moldovan economy during Q1:13 points to a lackluster recovery in this year. As argued in previous editions, it will be led by a compensatory growth in agriculture with other sources of growth remaining anemic. The Economic Leading Indicator (ELI) computed for Mar:13 declined for the second consecutive month, owing to moderating growth in exports, remittances and money in circulation. Thus, exports grew by 11.1, which is twice slower as compared to the previous month. This slowdown has been determined by a 12.1% slump in exports to EU, particularly to Italy, Poland and Bulgaria owing to difficult economic conditions in these countries. Remittances tempered to a 4.8% growth, down from 9.6% in Feb:13 and 22.0% in Jan-13, with declining share of Euro transfers from 38.8% in Jan-13 to 38.1% in Mar:13. As remittances and exports cooled down, so did the money in circulation, decelerating from 24.2% to 20.8% during Q1:13.

Chart 1. **Economic Leading Indicator, raw data and 4-Months Moving Average**



Source: EXPERT-GRUP calculations based on NBS, NBS and Logos-Press;

On the upside, positive news are emerging from the banking sector. The quality of loan portfolios is gradually improving, as the share of non-performing loans in total credits declined to 12.6% in Apr:13 from 14.5% at the beginning of the year. Consequently, the allowances for loan losses also shrank which allowed banks to allocate more resources for lending. Total new loans in Apr:13 grew by 24.8%, primarily due to foreign currency corporate loans (+57.9%) which bodes well for a revitalization of the domestic investment activity. Nevertheless, whether this is an episodic growth or marks the beginning of an upward trend in credit expansion remains to be seen in the following months. Moreover, the recent conflict between the shareholders of the largest bank, Moldova Agroindbank (MAIB), might have negative spillovers across the entire system. It could make other banks in the following months even more risk-averse with negative consequences for their lending activity.

All in all, the national economy is sending mixed signals. On the one hand, exports to EU are declining, while remittances and money in circulation decelerate. On the other hand, most commercial banks, which are usually the most forward looking economic sector, show positive symptoms. For the following months the key challenges are related to ensuring full functionality of state authorities whose activity was strained during the last months of political deadlock. Additionally, the central bank in cooperation with other line authorities will have to undertake all the necessary measures for fixing the old problems at Banca de Economii and the newly emerged ones at Moldova Agroindbank.

Key economic figures and data

Agriculture. On May 30 the official results of the Agricultural Census have been released. While not having immediate economic and policy implications, the Census nonetheless has confirmed once again the deeply enrooted structural problems that magnify the problems associated with transition of Moldovan agriculture to a modern market-based system. The land ownership features a highly fractured sector, leading to suboptimal use of natural, technological and capital factors. To present only the most telling figure, more than 85% of the peasant households are fully subsistence-oriented. With more immediate implications, the Hydro-Meteorological Service has issued its 2013 agro-meteorological forecast for wheat, with the average yield expected to be around 29-31 quintals / ha, almost twice above the previous year level, and also about 36% above the 2002-2012 historical average.

Industry. In Mar:13 the industrial sector sent contradictory figures and, in generally, quite disappointing. While the total output was reported to grow 4.5% y-o-y, this comes mainly as a one-off effect of the growing production of heat and electric energy in response to the colder than usual weather. The ‘real’ industrial growth (i.e. processing industry), has actually slowed down, with the +13% growth in Feb:13 going down to less than +1% in Mar:13.

Services. Evolution of retail trade and services rendered to population reflect the uneasy economic conditions in Q1:13. The retail trade volume posted a poor -3.7% decline y-o-y, while the volume of services to population rendered a 3.3% growth y-o-y, but cooled down between January and March. The wholesale trade also reported a 4.9% decline against Q1:12, while the volume of business services have been more resilient (+3.3% y-o-y). In this context, the growth in the volume of transported goods (+24.4% y-o-y in Jan-Apr:13) looks quite intriguing, and can be explained by the buoyant exports (+15% growth in Jan-Mar:13).

Households’ income and expenditures. In Mar:13 the average nominal wage grew by 11.2% and by 7% in real terms, y-o-y, with the largest contribution from the public administration where the real wages grew by 18.4%. Remittances, measured by transfers from abroad in favor of natural persons, continued to fuel the domestic demand, but at a slower pace, as they decelerated to 4.8% y-o-y in Mar:13 from 9.6% in Feb:13. Due to lower disposable incomes, in Apr:13 the population opened up by 12.8% fewer deposits as compared to the previous year, the largest drop being registered for deposits in foreign currency (-21.8%).

Public finance. During Jan-Apr:13, total state budget revenues increased by 9.5% y-o-y. VAT and excises collections grew at healthy rates (+22.1% and, respectively, +27.0%), whereas the revenues from corporate income tax posted a growth of 30.9%, y-o-y. Nevertheless, the total state budget revenues underperformed as compared to the planned level by 0.4%. It was caused by two important factors: (i) the disbursed foreign grants were only 41.4% of the planned level, and (ii) the returned VAT and excises were by 0.5% and 0.4% below the plan.

Labor market. The number of unemployed people registered at the National Employment Agency in Apr:13 declined by about 6.1% m-o-m, which is most probably related to the seasonal effect. Additionally, the number of vacant workplaces increased by 16.3% m-o-m, mostly for low skilled workers (17.8%). Official statistics have been recently released concerning the labor market in Q1:13. According to the report published, the unemployment rate hit 8.1%, which is significantly higher than in Q1:12, when the rate was 7.2%.

Prices. In Apr:13, the prices for consumer products and services increased by 0.4% m-o-m, mainly due to fruits (+4.8%), vegetables (+2.9%) and transport services for passengers (+3.5%). These inflationary pressures were mitigated by the seasonal decrease in prices for eggs (-5.7%) and dairy products (-0.6%). The annual CPI was 4.5%, up from 4.2% in Mar:13, whereas the core inflation (CPI excluding foodstuffs and beverages, fuels and products and services with regulated prices) decreased to 4.0% (from 3.9% in Mar:13).

Monetary policy. The central bank is preserving the accommodative stance of its monetary policy by keeping the policy rate at historic lows of 3.5%, which is equivalent with the forecasted annual CPI for the end of 2014. In this way, NBM prepares the ground for the economic take off for the next years and anchor the inflationary expectations in the proximity of its targeted interval (5% ±1.5 p.p.). The growth in headline CPI that paralleled with a slowdown in the core inflation supports the necessity for an easy monetary policy due to the tepid domestic demand and persistent non-monetary inflationary factors. Additionally, the central bank continued to sterilize the abundant liquidities from the banking system: the volume of NBM certificates sold in Apr:13 increased by 31.1%. At the same time, the liquidity provision facility available at the central bank was not requested by commercial banks.

Financial indicators. After eight consecutive months of negative growth, in Apr:13, total new bank loans increased by 24.8% y-o-y. It was primarily fueled by foreign currency corporate lending (+57.9%), whereas consumer credits in national currency also were robust, posting a similar growth. Lower disposable incomes, shaky economy and difficulties incurred by the state-owned bank "Banca de Economii" (BEM), negatively influenced the bank deposits. Thus, in Apr:13 total new deposits fell by 17.8% y-o-y, mainly due to foreign currency deposits (-25.0%). Unlike in the previous months when the decline has been determined by short-term deposits, this time it was fueled by the long-term deposits: those opened up for more than 12 months decreased by 21.5% y-o-y. All in all, the banking sector remained sound, with the capital adequacy ratio being well-above the minimal threshold (24.9%, min. 16%) and liquidities being abundant. Additionally, the quality of loan portfolios improved: the share of non-performing loans has been on a gradual downfall since the beginning of the current year (from 14.5% to 12.6%). BEM remains plugged by high share of bad loans, which at the end of Q1:13 was 54.9%, being almost at the same level as in the previous quarter (55.28%). Although its capital adequacy improved, it remained below the minimal required level (9.59%, min. 16%). Given the systemic importance of this bank, it challenges the stability of the entire system, which calls for prompt actions from the regulatory authorities and the bank's management for fixing these problems.

Exchange rates. In Apr:13 the national currency depreciated on average by 0.2% with respect to the US dollar and by 0.5% with respect to Euro, as compared to the previous month. This depreciation could be induced by economic factors (e.g. moderating exports and remittances), as well as policy factors as the central bank's international reserves increased by 0.5% as a result of foreign currency purchases operated by NBM.

Foreign trade. Growth of Moldova's exports has slowed down a bit in March 2013, with the figure going from +18.2% y-o-y in Jan-Feb:13 to +15.4 in Jan-Mar:13. Imports reflected a similar trend, from 3.7 to 3.2 percent growth. The positive trend we spotted in the previous "Real Economy", which is the fast growth of exports to 'other countries' (i.e. other than EU and CIS), has sped up even more, reaching a growth rate of 45.5% (against 35.4% cumulatively in the previous two months). The exports to two key destinations - Romania and Russia - improved significantly in March, while those to Turkey effectively exploded, making this country a candidate for the third most important destination for Moldovan exports till the end of 2013 and which is going to replace Italy.

Key trading partners. Russian authorities from the Ministry of Economic Development have recently stated that a +5% growth is not anymore a priority for the year 2013 and not even a matter to seriously discuss for the next few years[1]. Reduction in exports, more timid consumers and the investment collapse are the main culprits for the more subdued economic perspectives. In short- to medium-term, the poorer economic conditions in Russia will trickle down into the Moldovan economy, which is linked to Russian one through investments, exports and remittances channels. Situation remains difficult in Euro area, where the unemployment rate reached new historical heights (12.2%), with Mediterranean countries – Portugal, Cyprus, Spain, Greece – hit particularly hard: in Spain and Greece one quarter of the population is out of the labor market, including more than half of the youth. With an increased number of natives leaving the two countries, their attractiveness for Moldovan migrants will gradually vanish in medium-term. In Romania, the situation remains bleak; even though the unemployment rate is below the EU-27 average, a considerable number of youth (around 22%) are not integrated into the labor market. The country tries to get itself out of a protracted and deeply-enrooted political crisis which scares investors away. High number of unemployed youth makes this endeavor even more difficult.

Global and regional markets. A rare positive news coming from Gazprom – the company seems to be ready to offer discounts on the gas exported to the most important European destinations, including Germany and Italy[2]. This may not have immediate implications for the Gazprom price policy for Moldova, however the price for gas in case of Moldova is based, inter alia, on the average price for gas in Europe. We interpret this as one of the early warning signals that Moscow may reconsider its intransigent energy policy on the background of increased competition from the part non-traditional suppliers.

[1] Статья заместителя Министра А.Н. Клепача «ДЛЯ РОСТА ЭКОНОМИКИ НУЖЕН ВЕДУЩИЙ» (по итогам круглого стола «Рост на пять с плюсом: что мешает совершить экономический прорыв в России», 29 марта 2013 г.), рубрика «В главных ролях», «Ведомости – Форум» (приложение к газете «Ведомости») от 15 мая 2013 г.

[2] Gazprom estimează că prețul gazelor pentru Europa ar putea scădea cu 7-10%, http://www.agerpres.ro/media/index.php/international/item/200661-Gazprom-estimeaza-ca-pretul-gazelor-pentru-Europa-ar-putea-scadea-cu-710.html

Key policy developments in May 2013

Policy development	EXPERT-GRUP commentary
May 2. Tokhir Mirzoev, the IMF representative in Moldova stated in an interview that the recently adopted measures related to the reintroduction of the 8% VAT for agricultural producers, adoption of a single agricultural tax and pension raises are contradicting the previous agreements between the Government and IMF.	Maintaining good relations with IMF for a country running high current account and budgetary deficits is extremely important, not only for monetary purposes, but also for its international image. Breaking the Government's commitments within the IMF memorandum induces uncertainty in relations with the international community and does not bode well for potential cooperation with IMF. It also reveals the strong lobby the biggest agricultural producers have in the Government offices, as the laws on consolidating the 8% VAT and adoption of a single agricultural tax are clearly in their interests.
May 10. EBRD reviewed its forecast for the GDP growth of Moldova for 2013 from 3% to 2.5%, due to persistent economic difficulties in EU and Russia, with repercussions on exports and remittances.	This downwards revision is in line with the evolution of the Economic Leading Indicator estimated by EXPERT-GRUP, which points on a very tepid recovery for 2013, mainly driven by the compensatory growth in agriculture. In case it will materialize, the Government will have to rectify the state budget for 2013, which was initially build on a 5% economic growth.
May 16. Following the negotiations between Moldova and EU on DCFTA, held on 15 and 16 May, the European officials agreed to offer unlimited duty-free access on the EU market for Moldovan wines. Additionally, 10 agrifood products (e.g. meat, sugar, eggs etc.) will be exported duty-free, but under maximum annual quotas.	Over the last years, EU was gradually increasing the export quotas for Moldova, including for wine products. As a result, it was hardly an obstacle for the Moldovan producers to tap the European market. Hence, the elimination of these quotas will have a minor impact on wine exports to EU. The same holds true for other agrifood products, which will be subject to export quotas after the DCFTA will be signed. In fact, the main challenge faced by the Moldova exporters, especially the agrifood producers, are the non-tariff barriers. These are particularly related to quality standards, the implementation of which require significant investments and expertise. Main benefits of the DCFTA are mostly related to its "Deep and Comprehensive" component, which will imply modernization of the quality infrastructure and institutional harmonization in order to eliminate the non-tariff obstacles to trade.
May 17. According to the draft Strategy for Agriculture and Rural Development for 2014-2020, which has recently presented for public debates, the volume of subsidies for farmers will grow from the current level of MDL 400 million to about MDL 750 million in 2020.	Before enlarging the financial envelope for supporting the agricultural farmers, it is necessary to improve significantly the mechanisms for allocation of these resources. Currently, about 80% of subsidies are allocated to only 10% of agricultural producers and the selection of beneficiaries and disbursement procedures are not transparent. Moreover, the allocation of these subsidies depend on the yearly state budgets, which induces uncertainty and undermines the medium- and long-term planning. Hence, it is necessary to adopt a distinct law, which would regulate more clearly this process and adopt a long-term subsidy program. Additionally, the subsidies should be allocated per output, rather than total investments, which will create the right incentives for beneficiaries to be more efficient.
May 28. The commercial bank "Moldova Agroindbank" (hereafter MAIB) issued a press statement in which warned the public opinion and relevant institutions about a new wave of illegal attempts of a group of persons to take control over an important amount of bank's shares. MAIB argues that it is a follow up of the "raider attacks" commenced in 2011 and 2012 and urges about the high risks for the bank, its creditors, debtors and the country's overall macroeconomic stability.	The gravity of this statement is underlined at least by three important aspects: (i) commercial banks on very rare occasions publicly recognize the risks faced by their clients; (ii) MAIB is the largest bank in Moldova, accounting for about one fifth of total assets of the banking system, meaning that the troubles incurred by this bank will imply systemic repercussions; (iii) the warning comes 1.5 months after a series of law provisions entered into force, which granted the central bank the possibility to approve any significant transactions with shares issued by commercial banks and to analyze the "shareholders' quality". Currently, there are more questions than answers (e.g. who are the new shareholders? why MAIB disclosed this sensitive issue, knowing that it might undermine the confidence of depositors?

Policy development	EXPERT-GRUP commentary
	why the central bank reacted only after the issue become public?). In any case, it does not bode well for the country's macroeconomic stability and investment attractiveness.
May 29. The Government decided to modernize the Chisinau International Airport through a concession with a private company. The period of concession would be 49 years, during which the company would undertake all assets and liabilities of the airport, operate a series of capital investments (e.g. construction of a new terminal for passengers and a parking area), and adjust the entire airport infrastructure to EU standards. Additionally, the company will have to disburse to the state budget yearly at least 1% of its annual turnover.	Although the concession is a form of public-private partnership (PPP), it is regulated by an old-fashioned Law on concessions (Law no. 534 of 13.07.95). Unlike the Law on PPP adopted in 2008 and modified in 2010, it does not clearly stipulate the mechanisms for mitigating the risks related to the selection of private partners and implementation of the PPP project. Thus, the Government should firstly correct these flaws and adjust the Law of concessions to the best international standards, which could better protect the public interest and bring net benefits for the state. Moreover, it is essential that the selection procedures of the private company are fully transparent and the competition for undertaking this project – strong enough to choose an appropriate private partner.
May 30. On the next day after MAIB issued a statement about the supposed illegal attempts of a group of people to take control over an important amount of bank's shares, the central bank came with a public response. Thus, it reminded about the provision from the Law on financial institutions that NBM can suspend the rights of shareholders on their stocks in case it is proven that the acquisition has been a result of concerted actions. NBM also stated that all recent transactions operated with MAIB stocks were small, being below 5% of the bank's equity, and hence did not require the central bank's approval. Finally, NBM argues that these issues did not affect the bank's soundness and it committed to undertake all the necessary actions for protecting the stability of the banking system.	The purpose of NBM's statement was to calm the public opinion and to counterbalance the statement issued by MAIB and, in this way, to mitigate the risk of harming the confidence in the largest commercial bank. The central bank emphasize that although the stocks were transferred in small amounts which did not required its approval, it still has an important tool in preventing eventual illegalities. Thus, if it finds that the acquisitions were a result of concerted actions of bank's shareholders, NBM could consider them illegal. Therefore, in solving this issue the cooperation between the central bank and other line institutions (e.g. National Anticorruption Center, Information and Security Service, Ministry of Interior, National Commission of Financial Markets) is crucial. Additionally, NBM should undertake the leadership in this process and be fully accountable for its outcomes as the main regulator of the banking sector. It is also important for restoring the public and, especially, investors' confidence in the abilities of NBM to protect the stability of the banking system, which was shattered during the last years after the bankruptcy of two commercial banks and the difficulties emerged at Banca de Economii. Thus, solving this issue in due terms is not only a matter of financial stability, but also of restoring the confidence in the domestic business climate.
May 30. The Moldovan Parliament voted a new Government led by Iurie Leanca, which ended the three months long political deadlock. The western community warmly welcomed this approval. Thus, EU's Foreign Affairs Chief Catherine Ashton and Commissioner for Enlargement and Neighborhood Policy Stefan Fule, said in a joint statement that it "puts an end to a protracted political crisis that has endangered the stability of Moldova's state institutions."	The approval of Iurie Leanca's pro-western Government is the result of very complex and difficult negotiations among three parties forming the current ruling alliance (PLDM, PD and part of PL). Although this solves the political crisis, the new-old Government will face a series of constraints and challenges. Firstly, there is not so much time left before the EaP Summit in Vilnius of November 2013. Hence, it will have to act rapidly in order to restore the functionality of the key state institutions, especially the law-enforcement bodies, and speed up the reform process. Secondly, the relations between the coalition parties are far from smooth, while the upcoming general elections of 2014 might again steer tensions among them. Therefore, the key challenge faced by Leanca as a Prime Minister will be to keep up with the Government's reform agenda, insulate it from political interferences and consolidate the country's European integration process, especially the negotiations on DCFTA and visa-free regime.

Statistical annex

Table 1. Key Monthly Indicators

Indicator	May:12	Jun:12	Jul:12	Aug:12	Sep:12	Oct:12	Nov:12	Dec:12	Jan:13	Feb:13	Mar:13	Apr:13
Industrial production, y-o-y, % ch.	10.6	0.2	1.0	-5.2	-10.7	-6.0	-7.9	-3.1	-2.1	-0.7	1.5	n.a.
Retail trade, y-o-y, % ch.	0.5	0.2	1.6	1.9	-1.2	4.3	-2.6	-12.4	-6.6	5.1	-3.7	n.a.
Services to the population, y-o-y, % ch.	8.6	2.0	2.6	3.7	2.5	-1.8	3.5	-1.2	9.1	8.3	3.3	n.a.
Exports of goods, y-o-y, % change	1.7	3.7	-9.9	-15.8	2.4	-0.4	-11.0	-14.1	9.9	25.9	11.1	n.a.
Import of goods, y-o-y, % change	-2.2	-3.7	0.4	-3.3	-7.1	6.2	-3.4	-5.7	2.8	4.5	2.5	n.a.
Official reserve assets, million USD	2043.0	2059.0	2094.3	2231.6	2326.8	2421.5	2422.4	2515.0	2519.7	2488.1	2469.1	2481.0
Freighted cargo, y-o-y, % ch.	24.0	23.9	23.1	-11.5	-16.2	13.9	1.4	-16.4	-13.5	41.3	34.3	28.2
Registered unemployed at NEA (e-o-p)	34803	31722	29412	27243	25552	24609	25586	26297	26643	27160	26324	24723
Real salary, y-o-y, % ch.	4.2	6.1	5.4	5.7	3.2	6.0	5.3	4.9	8.8	4.1	7.0	n.a.
Budgetary revenues, y-o-y, % ch. *	14.0	12.3	16.1	14.5	12.7	13.3	14.1	11.2	9.5	14.9	14.3	12.7
CPI, y-o-y, %	4.1	3.7	4.0	4.4	4.9	3.9	3.7	4.1	4.6	4.4	4.2	4.5
IPPI, y-o-y, %	5.7	6.0	5.0	4.8	5.3	5.0	4.1	4.5	1.6	2.8	3.4	3.7
Nominal exchange rate MDL/USD (e-o-p)	12.00	12.26	12.54	12.47	12.39	12.27	12.37	12.06	12.10	12.25	12.41	12.31
Money transfers from abroad, y-o-y, % ch.	10.6	-7.4	4.5	3.7	-5.8	23.6	3.6	-0.9	22.6	9.7	4.9	n.a.
M2 monetary aggregate, y-o-y, % ch	11.3	11.8	14.1	18.2	21.4	20.8	23.7	23.5	27.2	26.1	23.4	25.0
NBM base interest rate, %	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	3.5
Banks deposits interest rate, % (e-o-p)	7.5	7.59	7.40	7.15	7.94	7.72	7.96	8.44	8.55	8.56	8.09	7.33
Banks credits interest rate, %	13.98	13.69	13.38	12.82	12.58	13.0	12.68	11.98	12.41	13.23	12.77	12.4
Non-performing loans, % of total loans	14.7	15.3	15.2	15.3	14.5	14.4	14.7	14.5	14.6	14.5	13.0	12.6

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;

Table 2. Key Quarterly Indicators

Indicator	Q2:11	Q3:11	Q4:11	Q1:12	Q2:12	Q3:12	Q4:12	Q1:13
Real GDP growth, % y-o-y *	7.5	6.7	6.4	1.0	0.8	-0.2	-0.8	n.a.
Agricultural production, y-o-y, % ch.*	3.9	3.7	4.6	0.6	-2.1	-21.6	-22.4	0.6
Construction works f-a-p, % ch.*	12.9	3.1	1.4	4.9	3.6	0.8	-1.3	3.7
Fixed capital investment, y-o-y, % ch.*	131.8	111.3	109.3	95.4	-0.6	-0.7	-4.1	4.5
Net FDI flows, y-o-y, % change	100	-1.8	33.3	-51.3	-26.3	-68.2	-22.2	n.a.
Unemployment rate, %	6.2	5.3	6.2	7.2	4.5	4.8	5.9	8.1
Employment rate, %	41.9	42.9	38.4	34.3	40.5	41.1	37.9	34.5

*Note: * - cumulative;*

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;