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Summary

The Regulatory Framework witnessed in May a number of interesting evolutions. The most amazing was the promulgation of the set of laws on fiscal amnesty, capital legalization and the reform of income tax system for companies. The Government has approved the Regulation on granting guarantees and compensations to employees combining work and education. The governmental intentions are rather clear and welcome, but the Regulation providing for compulsory granting of such guarantees and compensations for all economic units notwithstanding their ownership type and legal organization form could be actually ignored by the private companies. In May, there was extended the term for financial means repatriation for a number of economic units which have carried out operations for alcoholic beverages export to Russian Federation during the period in between April 2005 and April 2006. Nevertheless it's hardly believed that such financial resources would be ever repatriated to Moldova. The Government should have promoted the integral annulment of the obligation to repatriate the money affected by the crisis occurred within the trade relations with Russia in March 2006. Also in May there was taken the decision to set up the Organization for Small and Medium Enterprises Development. Being one of the obligations stipulated under the Plan of Actions Moldova – European Union, this decision is of crucial importance. But the new organization will get efficient only when allocated larger financial amounts for granting assistance to SME support programs, endowing with human resources, ensuring transparency and enforcing certain independence while implementing policies.

The **Industry** is reversing its decline and has started a positive increase. For the first time during the last 12 months, the month of April 2007 witnessed a positive increase of production as compared to April 2006. The occurrence of positive growth is explained by depletion of recession room in winemaking sector and quick advancement of some branches that were not affected by the crisis of trade relations with Russian Federation on the other hand. The positive dynamics is getting intensified in fruit and vegetable processing branch for the third month. The extractive industry copes with an opposite situation with a clearly moderating growth. No essential changes were noted for dairy production growing slowly but steadily at 4-5%. Paper and carton production have undergone contagious effects coming from winemaking sector, but restructuring of production and conclusion of new contracts have made it possible for the growth to return to the positive slope: (-11% in January-February, +0% in January-March and +7% in

January-April 2007). The flattering of growth in concrete and cement production is rather symptomatic: +24% in January-February, +13% in January-March and practically 0% in January-April. This could serve as a premonition for a deceleration of growth in constructions sector. After the increase of 44% registered during the first quarter, a certain moderation of its expansion is natural.

According to the preliminary statistics, the **Agriculture** registered a growth of 3.0% during the first quarter of 2007 as compared to Q1-06. The given indicator is better than the one achieved in 2006 when the quarterly production slightly increased with 0.8%. Agricultural production growth in Q1-07 was determined by the growth of livestock production with 3.1%; while the crops sector registered a growth of just 1%.

Due to increase of consumption demand maintained by the constant inflow of remittances and wage increase, the **Services** sector continued to progress. Retail sales increased by 15.3%, and services rendered to the population – by 6.6%. At the same time, the market of business services provided is also growing rapidly; this would be mainly the case of telecommunication and informatics services. Unfortunately, the Moldovan business is just being initiated in culture of using ITC technologies, thus reducing significantly national competitiveness margin. In May the construction of the Cahul-Giurgiulesti railroad was launched. It is evident that the volume of goods transported by railroad when completing the given construction will depend on the use of Giurgiulesti Port strategic position. At the same time, it is important for the economic calculations not to ignore the environment risks that might be induced by the given project. The public and parliamentary debates carried out in April-May regarding the national aviation security revealed a lot of room for improving the services quality and safety. The public was informed that less than a half of aircrafts have flight certificates. The approval through a Government Decision of the National Strategy for Civil Aviation Development up till 2016 is a positive evolution in the given context, but it will be able to have an efficient impact only in long term run.

The forecasts stated in **BER-19** regarding a more accelerated **Prices** rise in April as compared to March have turned true. While in March the monthly inflation was 0.5%, in April consumer prices grew with 1%, and industrial producers' prices – with 0.3%. The cumulative inflation rate for the first 4 months counts for 3.0%, as for the last 12 months – 11.0%. Both indicators suggest

than NBM is on its “right way” for achieving the annual target of 10%. But May was the month of risks’ intensification – risks that by the end of the year could endanger inflationist targets, such as high volatility of national currency, increase of import goods consumption and adverse weather conditions.

Labor Market followed on the trend of salaries growth. According to the first four months’ statistics, the real salary has increased by 10%, counting for 1936 lei in April. The public sector registered an average wage of 1486 lei, and the real sector – 2180 lei. At the same time, the reference period proved only a 2.1% increase for teachers’ wages. This fact is mainly due to the measure undertaken by the Ministry of Education and Youth for limiting college and university enrollment plans as well as to the effects induced by the administrative delay for salary rise – facts described in **BER 18-19**. In this context, the authorities prioritized the salary rise within the public sector, notwithstanding IMF recent disapproval for the possible negative short-term effects referring to budget income shortfall as result of fiscal amnesty and income tax reduction. The minimum salary in the budgetary sector was recalculated for a monthly amount of 400 lei, nevertheless no economic effects are expected from this decision. The Government promised to revise the methodology for minimum salary calculation in the real sector of the economy based on the minimum consumption budget. This measure is a possible liberalization of payroll system in the country.

The **Budget** analysis is more and more „deja-vu” alike. Although the increase of budgetary revenues has slowed in April as compared to March, the income plan execution is really outstanding. The current revenues collected during the first four months of 2007 counted for an increase of 33.4% as compared against 2006, and a growth by 13.6% as compared to the planned level. The slight convergence of executed expenditures towards the planned level persists, with more than 80% executed in April. An important event organized in May was the presentation of the new MTEF plan for 2008-2010 during the meeting of the Steering Committee for the development of the Medium Term Expenditure Framework, which brings about a series of important novelties: redistribution of social compulsory insurance contributions to employers’ favor, increase of medical compulsory insurance contributions and introduction of two thresholds for natural persons’ taxation. The Government declared that MTEF was drafted based on consequences emerging from fiscal amnesty, zero taxation for re-invested profit and capital legalization.

All indicators of the National Bank of Moldova **Monetary Policy** tools remained unchanged in May, after in April

the monetary authority decreased by 1% the basic interest rate as result of national currency rise in value and also probably due to the hope for inflation mitigation in the next period. The reduction effect of the basic interest rate started to manifest itself during May, when several commercial banks have slightly decreased the interest rates for credits and increased them for deposits. NBM official reserve assets continued to grow in May as well, but more calmly as compared to April mainly due to MDL ascension slackening as against USD.

The most important changes observed within the monthly dynamics of the **Banking System** in April deal with the continuous increase of the foreign investments share in the bank capital going hand in hand with reduction of bank-drawn resources. The intensification of the bank competition is proved also by the growing share of interest-generating assets reaching in March and April historically high levels. Nevertheless, the slight trend for liquidities indices’ worsening continued in April as well. It is not by chance that banks have taken over aggressive marketing for attracting population resources, increasing in a spectacular manner the rates of attracted interests from 13.90% in March up to 15.45% in April representing the highest level attained since February 2005.

The interest rates for the treasury bonds on the **Financial Markets** have changed very little. There was registered a marginal increase for the bonds with 90 days maturity and a slight drop for the bonds with 181 and 364 days maturity. The month of April witnessed a reduced banking demand for treasury bonds, but in May the bank’s interests for state securities has increased again, nevertheless the situation is going to reverse in the near future. May was characterized by a higher level of exchange rates volatility than the normal one. The appreciation of the national currency of April continued during the first days of May, reaching on the 5th of May the level of 12.3784 MDL/USD. Afterwards the trend has reversed and on the 26th of May the exchange rate counted for 12.4599 MDL/USD. The next period registered again a evolution similar to April’s, with the Leu appreciating up to 12.3244 MDL/USD on the 5th of June. The factors inducing the national currency devaluation were determined by a higher demand of foreign currency for imports and massive foreign currency market procurement for NBM foreign currency reserves. In May there was adopted during the first hearing a set of legislative amendments referring to the set up of a mega-institution to supervise the operations of the non-banking segments from the financial market (capital market, insurance market, micro-funding

services, leasing, etc.) which would emerge under the National Commission for Exchange Securities. The set up of this institution represent a commitment assumed by the Republic of Moldova when joining the Plan of Actions Republic of Moldova – European Union and the effects will integrally depend upon its capacity to impose universal observance of regulation acts and to be really independent in decision taking process (according to NBM pattern).

The **Foreign Trade** continues to pass through a rather difficult period. According to EXPERT-GRUP estimations, during January-April 2007, the imports have slightly over-passed the level of USD 1 billion and exports reached the level of USD 365.5 million - resulting in a USD 635 million trade deficit. Exports' evolution is mainly characterized by sound changes referring to geographical distribution and structure. The EU became our main commercial partner for both: export destination and import source. The textiles (22.9% out of the total) have over-passed the alcoholic beverages (16%) and became the leading export. The perspective for wine export resumption is not the brightest one. The Russian market is still closed for Moldavian wine and Belarus is trying to reorient towards raw wine from Bulgaria, Romania and Hungary. The possible granting of the Autonomous Trade Preferences would not mean a total opening of the European market either. Even after quality system adjustment, the wine exports from Moldova will undergo fees, not mentioning the financial costs and logistical efforts necessary for wine promotion on the respective market.

In April the **Oil** price has fluctuated between 62-65 USD/barrel. During May the oil price got influenced by several contradictory trends. The increase of oil reserves in the United States favored price decrease. On the other hand there were the expectancies for oil consumption expansion during the summer time, the political instability in Nigeria and the geopolitical risks in the Middle East. Although during the last week of the month, the oil price has compressed a little, a slight increase in price is already forecasted by experts for June. In May 2007 the **dollar** has corrected against **euro**, hovering at 1.34-1.35 USD/EUR. The fluctuations were mainly influenced by the information about the American economy. The less optimistic situation on emergent economies' capital markets has supported the American currency to a certain extent. The World Bank warned about the perspective for deceleration of global growth and braking of capital flows' placement on emergent markets, not excluding even „hard landing” for some of them (especially for China).

Moldova's **Trade Partners** registered positive evolutions during May. **Russian economy** increased by 7.7% as compared to April 2006. This growth is strongly supported by the strengthening of investment demands, dynamic expansion of constructions and industry. But the investment activity expansion coupled by the appreciation of the Russian ruble brings over Russian economy some serious risks as well: strong increase of imports, increase of corporative debts and undermining the inflation targets. The **Ukrainian economy** continued its strong growth: +7.6% as compared to the same month of 2006. The economic evolutions are favored by the benevolent situation on the market of metallurgical and chemical products, the fiscal relaxation and the flexible policy for the exchange rate. Although with no visible immediate impact on economic growth, the ongoing Ukrainian political crisis delayed a number of necessary strategic reforms and activities, as the ratification the necessary documents for Ukraine's joining the WTO, land, tax, administrative and pension system reforms. The **European Union** continues to enjoy a solid economic growth. Thus, in Q1/07 EU economy registered an increase of 3.1% as compared to Q1/06. The economic growth covered almost all economic sectors. Nevertheless, the highest economic growth rates are registered by the new EU members. In **Romania** the economic growth registered a solid increase of 6% during the first quarter of 2007. The growth was supported by the expansion in industry, constructions, investment demand and volume of en detail trade. Tension still persists within the political situation. After the clear winning during the plebiscite organized on the 19th of May, the President of Romania, Traian Băsescu, insists upon Government change, Parliament dismissal and calls for pre-term elections (just to remind that the autumn of 2007 is the period forecasted for the European Parliament elections as well). At the same time, it should be mentioned that the 27th of June is the day for European Commission to present the progress report for Romania and Bulgaria. It is evident that there are no sparkling successes, the main concern being for corruption prevention. The risk of safeguarding clause enforcement for Romania is high as never before.

Regulatory Framework

The month of May was the period when a number of legislative and normative acts have been adopted which will have an impact over the regulatory framework governing the entrepreneurial activities. First of all, it should be mentioned the promulgation of the set of laws on fiscal amnesty, capital legalization and the reform of income tax system for companies. The provisions of these laws were already included within the Medium Term Expenditures Framework for 2008-2010 submitted to the government for approval. The effects expected from the enforcement of these initiatives were described in previous issue of the Business and Economy Review (**BER-19**).

The Official Monitor dated 04.05.07 published the Regulation approved by the Government on guarantees and compensations granted to employees combining work and education¹. These employees will be granted the possibilities to have part-time employments, unpaid leaves for taking matriculation exams, additional paid leaves (75% from the salary) for taking yearly and quarterly exams and tests as well as one reimbursement per year for expenses related to the trips to the educational institution. Fostering the employees' professional training is evidently necessary for increasing long-term professional qualification and labor productivity, especially when such a provision is also covered by the government long-term strategy on labor force employment. At the same time, the Regulation stipulates providing guarantees and compensations as compulsory for all economic units notwithstanding their ownership type and legal organization form which has to be funded from own resources of such units. It is hardly believed that the Regulation would be enforced by the private sector, which is not willing to incur financial costs due to employees' study process, especially when companies do not plan for keeping such employees for a long-term perspective. We really think that fostering of human resources' training level improvement should not be promoted by the Government through new compulsory conscriptions upon the companies, but rather just compensate the private employers for some expenses referring to work place maintaining of the employee who is combining work and education.

The Law on public ownership lands and their delimitation came into force. One of the most

important provisions under the given law stipulates that public land cannot be transferred, does not undergo forced execution and should not be used as guarantee or obtained by third parties as usufruct (that is following a long-term usage).

In May, there was approved the law for extending till the 1st of October 2007 the period for financial means repatriation for a number of economic units which have carried out operations for alcoholic beverages export to Russian Federation during the period in between April 2005 - April 2006². It should be mentioned that although this is a positive evolution, it is below the winemakers' expectations and the mechanism actually refers to a limited number of beneficiaries – only a short list approved by the Government. Generally speaking, the possibility to recover the financial means is very doubtful, that is why the winemakers have requested namely for annulment of the obligation to repatriate the money affected by the crisis in the trade relations with Russia since March 2006. At the same time, this allowance should be extended for all producers and not only for those who have undertaken significant supplies.

A very important decision goes for the approval of the Government Decision regarding the creation of the Organization for the Development of Small and Medium Enterprises³. The organization will inherit the duties and empowerments of the Fund for entrepreneurship support and small business development and will actually operate as a distinct legal entity with separate budget and a certain administrative autonomy. The former Fund was totally inefficient in promoting small and medium enterprises using just small amounts of resources allocated under minimal transparency and public accountability. The new organization is expected to be efficient provided that it is allocated larger financial resources for granting assistance to the SME support programs (the traditionally allocated annual amounts of 1-2 millions are ridiculous), endowing with well trained human resources, ensuring transparency and enjoying a certain independence while implementing policies.

On the 7th of May, the Government Decision on measures for improving the situation in the sector of road transportation was approved (the issues **BER-19** makes some references to the decision). The

² Law no. 112-XVI dated April 27, 2007 on some aspects for repatriation of financial means coming from export of alcoholic beverages to Russian Federation.

³ Government Decision no. 538 dated May 17, 2007.

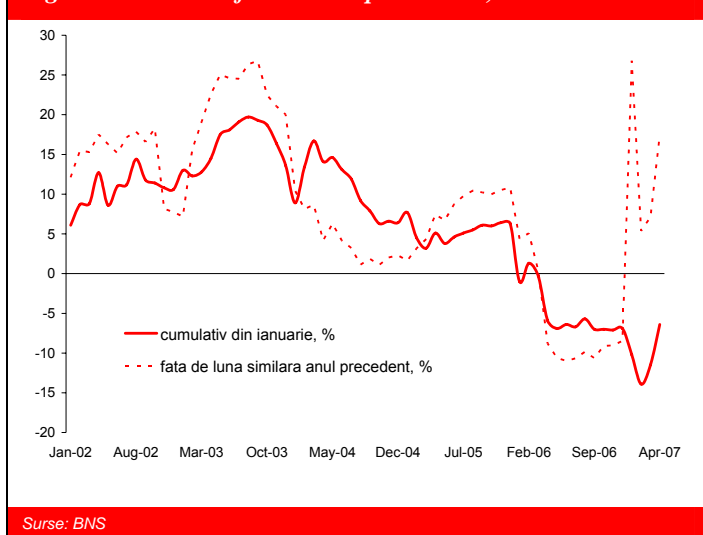
¹ Government Decision no. 435, dated April 23, 2007 from the Official Monitor nr. 60-63 (2047-2050).

most important part of the respective decision deals with a Plan of Measures providing for a number of actions to be carried out during 2007-2009. It is worth mentioning a set of actions which seem rather interesting and intend to have a certain economic impact: building bus stations in a number of cities, continuing the computerization of trip tickets selling and evidence process, equipping the taxi cabs with electronic taximeters with fiscal memory, enlarging the network of technical testing stations, etc. A very ambitious measure deals with the development during the second half of the current year of the Strategy for Auto Transportation Development in the Republic of Moldova, but the financial sources for the associate expenses and the actual framing of the given document within the general context of development policies (EGPRSP, Plan of Actions, National Development Plan) are rather unclear.

Industry and Constructions

Based on quarterly results, the previous issue (**BER-19**) pointed out that the reversal of the industrial decline started already in March 2007. This can be explained by the recession in winemaking sector reaching its bottom on one hand and fast growth of some branches that were not affected by the crisis of trade relations with Russian Federation on the other hand.

Figure 1 Increase of industrial production, %



These positive trends corroborated in April. According to the preliminary indicators, the process of industrial recovery through structural rebalancing of the sector was even more obvious in May. Although the cumulative production during the first four months of the current year counted for 6,4% less

than the level registered in 2006, it should be ascertained that the industry was already following a strong positive slope (+13.1%) when comparing the percentage attained in April 2007 against April 2006, for the first time during the last 13 months.

When analyzing the industrial dynamics as compared to the previous 12 months, it should be noted that the relative recovering of the industry is not only more evident but also earlier. This actually allows us to clarify more precisely the monthly dynamics overshadowed by the statistical data provided by NBS in cumulative expression (Fig. 1).

No significant structural changes were observed as compared to March. Nevertheless, some general moments should be mentioned. First of all, the fruit and vegetable processing branch is speeding up for the third month in a row (+16% in February, +22% in March and +36 in April). The situation is practically opposite in extractive industry which registers a clearly decelerating growth path: +100% in February, +61% in March and +34.4% in April. No essential changes were noted for dairy production which maintains a small but constant increase of 4-5%.

No changes emerged in tobacco products manufacturing either; the branch continued to cope with an almost free fall (-25%). After a significant reduction in March, the clothes production has reverted to a normal evolution and during January-April almost reached the similar level registered in 2006. Paper and cardboard production have undergone some contagious consequences coming from the winemaking sector, but the production restructuring and the new contracts have made it possible for the branch to return to the positive side: (-11% in January-February, +0% in January-March and +7% in January-April 2007).

The quick flattering of growth rate in branch of concrete and cement items production is rather symptomatic: +24% in January-February, +13% in January-March and practically 0% in January-April. This could serve as a forward looking indicator suggesting a reduction of the growth rate in constructions sector. After the increase of 44% registered during the first quarter, a certain moderation of expansion pace of the constructions sector is not only natural but also indispensable.

However, the uncertainty in regards to export of Moldovan wine to Russian Federation continues to negatively influence the economy facing the risks for unemployment increase and emigration

intensification due to the bankruptcy of some winemaking companies.

Agriculture

The preliminary statistical data register an increase of 3.0% for agricultural sector production during the first quarter of the current year as compared against Q1-06. The given indicator is better than the one achieved in 2006 when the quarterly production slightly increased with 0.8%. Agricultural production growth in Q1-07 was determined by the growth of livestock production with 3.1%, while the crops production registered a growth of just 1%.

Coming back to our relatively optimistic forecasts regarding growth prospective of the agricultural sector in 2007 (see **BER-19**), it should be pointed out that weather conditions registered in May induced a forecast revision of annual production from 6-7% to 5-6%.

Meanwhile, some semiofficial forecasts were launched regarding the average yield per hectare for the autumn wheat: 27-29 quintals and even 22-23 quintals/ha in the regions dramatically affected by the drought.

Services

Due to increase of population consumption demand maintained by the constant inflow of remittances and wage increase, the services sector continued to progress in April as well. Retail sales increased by 15.3%, and services rendered to the population – by 6.6%. However, it should be mentioned that services keep the growth level registered during the last two years, while retailing faces a slight slowdown (Fig. 2).

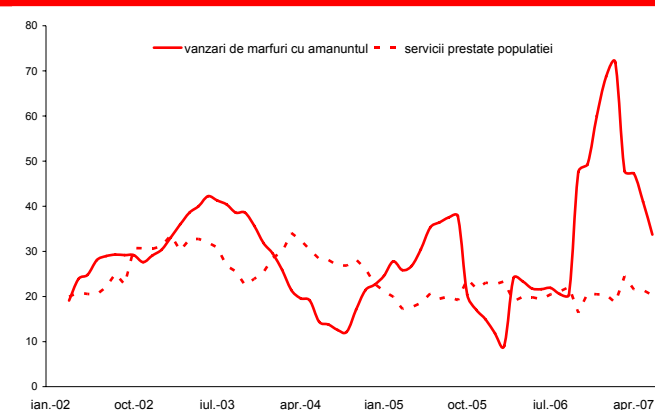
At the same time, the market of services provided to companies is growing rapidly as well; this would be mainly the case of telecommunication and informatics services. According to our estimations, the market value increased with almost 20-22% since May 2006.

This growth is due to increase of investments volume, number of suppliers and service users, diversification of offers and improvement of service quality, implementation of new service supply technologies, namely dealing with broad band Internet access. Thus, at the International Forum of Small and Medium Enterprises during the 3-5th of May, the Orange company has come up with an exclusive offer developed only for small business enterprises. The offer intends to provide individual solutions for each corporative client meeting client's

communication needs. Price optimization for mobile telephony services rendered to small enterprises constitutes an essential support granted to their activity. During the international exhibition Com-Info Moldova 2007, Moldtelecom and Sun Communications have advertised advantageous offers for free-of-charge Internet connections. Unfortunately, the Moldovan business awareness in culture of IT and telecommunication usage is only embryonic, thus reducing significantly competitiveness margin.

In May the construction of the Cahul-Giurgiulesti railroad was given „green light”. Project preliminary costs are estimated at 837 million lei and the project is going to be completed by the end of 2008. The European Bank for Reconstructions and Development (EBRD) manifested a vivid interest for the project. It is evident that the volume of goods transported by railroad when completing the project will depend on the use of Giurgiulesti Port strategic position – an unsuccessful experience for the EBRD in mid 90s.

Figure 2 Increase of population consumption, % as compared against the same month of the previous year, seasonally-adjusted (mobile average 5)



Source: NBM

Although project fulfillment will mobilize social-economic development of the southern rayons, it also bring about serious ecological risks for the region referring mainly to dangers for the natural reservation in the Prut River meadow. Just as it was the case for the Giurgiulesti Port, no serious study for project ecologic impact was actually carried out and no public hearings were conducted - and to crown it all, the Ecological Movement from Moldova was prohibited to take part to project launch.

The public and parliamentary debates carried out in April-May regarding the national aviation security revealed a lot of room for improvement in the field of air transportation services quality and safety. It was astonishing to find out that only 91 out of the 192 aircrafts owned by the country have flight certificates. A positive evolution in the given context refers to the approval through a Government Decision of the National Strategy for Civil Aviation Development up till 2016. Nevertheless, it is not clear at all what should clients do with the immediate risks that they have to cope with. The approved document states that Chisinau International Airport should be completely modernized by 2010, thus offering the clients qualitative services by reducing formalities, waiting period and the time for luggage control.

Unfortunately, the document proves more technical features than strategic ones. At the present time the only and the main functional airport is Chisinau International Airport. The airports from Cahul and Marculesti are still under certification process and the airport from Balti, although certificated and formally opened for passengers and cargo transportation is actually used for some irregular flights.

Prices

Our forecasts stated in **BER-19** regarding a more accelerated price rise in April as compared to March have turned true. While in March the monthly inflation counted for 0.5%, in April consumer prices grew with 1%, and industrial producers' prices – with 0.3%. Consumer prices registered the same increase as in April 2006, but industrial prices reached a 10 folds lower growth as compared with the previous period.

The cumulative inflation rate for the first 4 months rises to 3.0%, as for the last 12 months – to 11.0%. With moderate optimism, both indicators make us believe that inflation control is on its "right way". At the same time, it should be mentioned that in May a number of inflationary risks intensified such as high volatility of national currency, increase of import goods consumption and adverse weather conditions. These risks may undermine the achievement of inflation target of 10%.

When analyzed by categories of products and services, the tariffs for services proved to be the most stable ones (+0.5%). The local public authorities did not think it wise to modify the tariffs during the elections period. The traditional essential rise in price was registered for such non-food products as medicines (+1%) and ready-made clothes (+1.2%). The month of April faced a rather rare phenomenon

for Moldova – a slight decrease of prices for fuel (-0.7% as compared to March). The 2% price rise for food products was the major cause for consumer prices index growth. Besides the specific causes for the months of April-May referring to previous harvest fruit and vegetable stocks depletion, in 2007 the meat export to Russian Federation resumed – an event that has determined the increase of acquisition prices for meat on the internal market. At the same time, it should be noted that the solid rise in value of the national currency registered in April has restrained to the some extent the prices avalanche. The month of May has witnessed a similar pattern.

Table 1 Monthly inflation rates, %

	Jan 2007	Feb 2007	Mar 2007	Apr 2007
Consumer price index	0.9	0.7	0.5	1.0
Food products	1.4	0.4	-0.1	2.0
Non-food products	0.8	0.2	1.0	0.5
Services	0.2	1.3	0.9	0.2
Industrial price index	1.3	19.4	0.5	0.2

Sources: NBS and NBM

Labor Market

During January-April 2007, the real wage has increased by 10%, reaching in April the level of 1936 lei (156 USD). The average wage in April counted for 1936 lei which is 24% higher as compared to March. The public budget sector registered an average wage of 1486 lei, and the real sector – 2180 lei.

The labor market continues to maintain the obvious trend of improving employees' work remuneration. Thus, when compared to the previous month, the highest salary (nominal) increases were registered in medicine – 24,7%, financial activities – 15,4%, extractive industry – 10,7% and energy sector – 8,3%.

When compared to April 2006, the average monthly wage has mostly increased in public administration– 39%, trade – 32,7%, medicine – 31,4%, hotels and restaurants – 31,7%, exchange securities transactions – 28,8%, energy sector – 28,5%. These increases were based on optimization of civil servants and doctors' number within public administration structures and health care institutions hand in hand with their work remuneration rise, as well as continuous ascension of other sectors and respectively appearance of favorable development perspective.

At the same time, the reference period proved only a 2.1% increase for teachers' wages. This fact is

mainly due to the measure undertaken by the Ministry of Education and Youth for limiting college and university enrollment plans as well as to the effects induced by the administrative delay for salary rise – facts described in **BER 18-19**.

In this context the authorities prioritized the salary rise within the public sector, notwithstanding IMF recent disapproval for the possible negative short-term effects referring to income accumulation to the state budget as a result of fiscal amnesty and income tax reform.

According to the Government Decision dated 18/05/07, the minimum salary in the budgetary sector shall be recalculated for a monthly amount of 400 lei for a full work program of 169 hours or 2.37 lei per hour starting with the 1st January 2007.

The economy real sector registered a monthly minimum salary ratio of about 700 lei, which starting with the 1st of June 2007 will be turning into 900 lei per month (5.33 lei per hour) as a result of the collective negotiations undertaken between the social partners.

Taking into account the worldwide experience, the Government promised to revise the methodology for minimum salary calculation in the real sector of the economy based on the minimum consumption budget. We assess this measure as the beginning of a possible liberalization of payroll system in the country, that would get rid of the annual indexation to the tariff coefficient for qualification category I and apply the notion of the minimum salary for the whole economy, thus providing for the quantum necessary to reproduce the labor force. These amendments will get materialized while adjusting the Law on payroll system to the new reality.

Budget

The analysis of public budget is more and more „deja vu” alike. Although the increase of budgetary revenues has slightly slowed in April as compared to March, the pace of budget execution is really outstanding, coping with the general specific trend registered during the last two years. The current revenues collected during the first four months of 2007 increased by 33.4% as compared with 2006, and by 13.6% as compared to the plan. Nothing changed essentially for the sources ensuring such a quick increase of revenues either: VAT and income taxes are the main budget pillars.

According to the last-hour information, the level of budgetary receipts was high in May as well. Thus, on

the 5th of June, the Ministry of Finance has declared that the level of revenues cashed in by the state budget during the first five months of the year increased by 14.8% as compared to the planned level and by 40% as compared to the January-May 2006⁴.

Table 2 Dynamics of national public budget

	Planned M1- M4/07	Executed M1- M4/07	Executed M1-M4/06
Global revenues, million MDL	5720	6498.1	4869.7
Including, revenues from VAT, million MDL	1932.2	2114.7	1536
Including, income taxes from business activity	472.8	648	399.5
Global expenditures, million MDL	7869.1	6191	4712.1

Source: Ministry of Finance

The trend of convergence of executed expenditures towards the planned level persists. In month of February the level of expenditures' execution was under 70%, in March - 77%, while the end of April almost 80% of planned expenditures were executed. A rather solid correction was accomplished in the fuel and energy complex where during the first quarter the quarterly expenditures were executed at a ratio of only 37% of the planned level. According to the results of the first four months, the expenditures planned in this sector were executed at 72.2%. Due to expenditures management improvement, the budgetary surplus of almost 385 millions lei registered in March decreased down to 307 millions in April.

An important event in May was the presentation of the new MTEF for 2008-2010 during the meeting of the Steering Committee for the development of the Medium Term Expenditure Framework. The project was submitted to the Government for examination and approval. MTEF 2008-2010 brings about a series of important novelties. According to the new MTEF by 2010 the contributions for state compulsory social insurance shall decrease by 1 percentage point: from 29% down to 28%, and the ratio between the employer (decreasing from 25% in 2007 down 20% in 2010) and employee (increasing from 4% up to 8%) shall change. This measure is hoped by authorities to generate paid-in salaries emergence from the shadow economy, but most probably this is not going to be enough as the total fiscal burden of contributions was not substantially reduced.

⁴ <http://www.economie.moldova.org/stiri/rom/51141/>.

It should be taken into account the fact that the contributions for compulsory medical insurance are to be increased as well from 5% in 2007 up to 7% in 2010, paid in equal shares. Thus, if employers would be more tempted to pay “formal” salaries, employees, at their turn, would get more and more tempted to receive them „informally”. The unofficially promised VAT share reduction is not going to take place in medium term period and the forecasts for after-2010 period are rather difficult to be made.

The reform of taxation of natural persons' income in 2008 is quite important as well. First of all, the three tax thresholds used at the present moment will be given up and there will be only two taxable levels: the annual income up to 25200 lei (appreciatively 170 USD monthly) will be subject to a tax of 7%, and the higher incomes – to a tax of 18%. Taking into account the structure of salaries in the economy, we think that the given threshold will emerge in a big disadvantage for the low-middle class paid on average between 200 and 400 USD per month.

Money

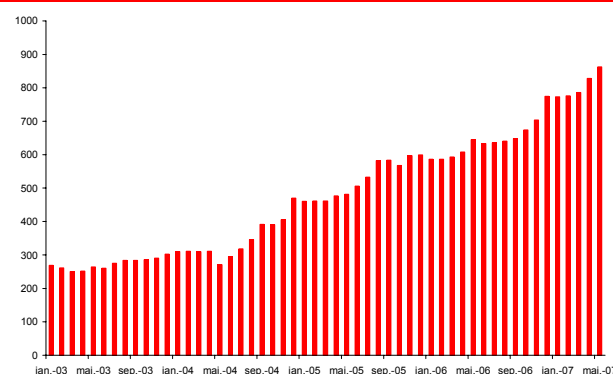
All indicators of the National Bank of Moldova monetary policy tools remained unchanged during May, after in April the monetary authority decreased by 1% the basic interest rate as a result of national currency appreciation and also probably due to the hope for inflation mitigation in the next period. When analyzing the Consumer Price Index (CPI), it can be noted that it actually could fit into the limits of the inflation target established by the NBM for 2007 at the level of 10%. In any case, the monthly inflation in annual expression (that is compared to the respective month from the previous year) has constantly decreased from 14.5% in August 2006 down to 11.0% in April 2007. The reduction effect of the basic interest rate started to manifest during May, when several commercial banks have slightly decreased the interest rates for credits and increased them for deposits.

We think that NBM will not decrease the key-interest in the near future anymore, especially taking into account the fact that the internal economic situation is not propitious for undertaking such movements. The inflationist risks will reappear in the second half of the year and will outweigh the rise in value of the national currency. The effects of pensions and salaries increase within public and private sector could get visible within inflation structure in the immediately following period. The decrease of interests for consumption credits undertaken by

some commercial banks in May represents one more factor contributing to inflation process.

Moreover, the winter weather conditions and the May drought could affect the agricultural harvest thus maintaining the high prices for food and agricultural products even during summer period. Although inflation registers a rather reasonable level at the present moment, we are expecting an increase of inflation rate in the second part of the year. As for the rise in value of the national currency registered during the recent period – it looks more like an increased volatility of the USD/MDL rate, rather than a constant rise in value of the national currency.

Figure 3 NBM official foreign currency reserves, millions USD



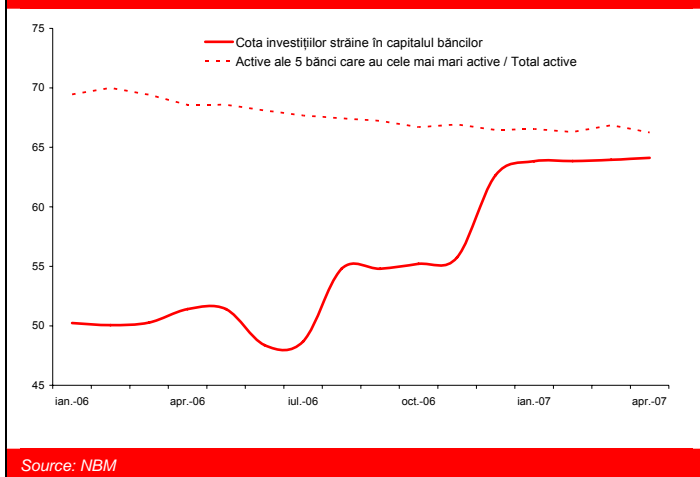
Source: NBM

NBM official reserve assets continued to grow in May as well, but more calmly as compared to April mainly due to a slight abatement of the MDL ascension against USD (Fig. 3). Nevertheless, a moderate rise in value of the MDL should be registered in June and further on as result of large amounts of money coming from the people working abroad or from real estate transactions. Of course the further on strengthening of the national currency will deepen even more the commercial deficit and will discourage the export as well. It is evident that the rise in value of the national currency which is not covered by real growth of labor productivity in economy helps to set up an artificial deflation, to support undeservedly the importers, to foster groundlessly the consumption and to induce disequilibrium between the exports and the production. The deep economic misbalance is extended even more, thus emerging into an external deficit which undergoes the risk to explode.

Banking System

In May the data on banking system evolution during April were published. The most important changes observed within the monthly dynamics deal with the continuous increase of the foreign investments share in the bank capital going hand in hand with reduction of concentration of bank assets (Fig. 4).

Figure 4 Evolution of foreign investment and concentration of bank assets, %

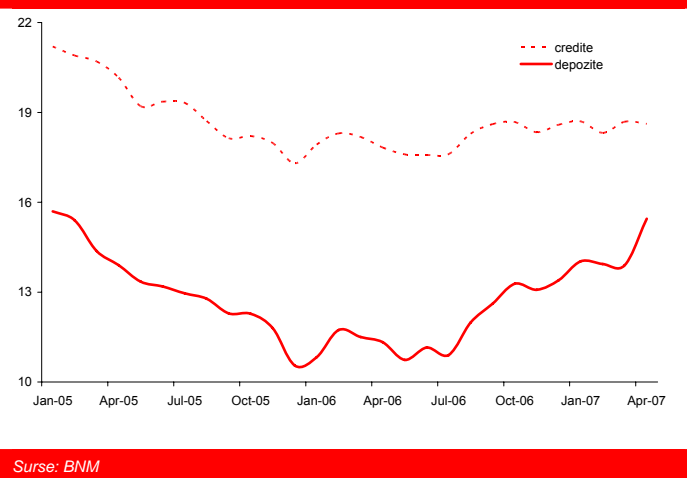


The bank competition intensification is proved also by the trend for growth of interest-generating assets registering a share of 83.33% out of the total of bank assets in March and 83.53% in April – these being the two historically maximum ratios. They have grown due to banking entities' increased efforts to place the resources under consumption credits, credits for small and medium enterprises, farms, etc., that represent market zones open for exploration. At the same time, the need for territorial extension imposes upon the banks a number of non-interests expenses, thus worsening somehow the indicators for crediting activity performance.

The slight trend for liquidities indexes worsening continued in April as well. It is not by chance that banks have taken over aggressive marketing for attracting population resources, increasing in a spectacular manner the rates of attracted interests (Fig. 5).

Thus, the average rate of interest for the attracted deposits has increased from 13.90% registered in March, up to 15.45% registered in April, representing the highest attained level since February 2005. The rates of interest for deposits attracted in foreign currency have significantly increased by 0.4 percentage points.

Figure 5 Evolution of bank interests rates, %



At the same time the willingness to keep the clients hinders the banks from increasing substantially the interest rates for credits. On the contrary, the average rates for banking system were actually reduced in April from 18.69% down to 18.62%. Although the rate for the credits in foreign currency registered only a slightly visible decrease of only 0.15 percentage points - it actually reached the minimal level for the last 12 months.

Financial Markets

The interest rates for the treasury bonds have changed very little during the month of May 2007 (Fig. 6, page 13). The interests for the bonds with 90 days maturity have increased from 11.31% in April up to 11.36% in May. The interests for the bonds with 182 and 364 days maturity have, on the contrary, decreased a little by respectively 0.04 and 0.03 percentage points. The rate for state securities of 2 years circulation period undergoing more significant risks has considerably increased by 0.4 percentage points, reaching the annual level of 13.1%.

The month of April witnessed a reduced banks demand for treasury bonds, but in May the bank's interests for state securities has increased again. While the auction from the 2nd of May has called for procurement demands in the amount of 54 millions (the bid of the Ministry of Finance being of 50 millions), the last auction from the 22nd of May has called for a demand of 63 millions (the maximum of the month), although the bid remained the same. Nevertheless, this monthly dynamics cannot be seen as a long term trend. According to our opinion, the banks' demand for state securities will decrease again during the following months.

The foreign currency exchange rates registered a rather “wired” evolution during May – beginning of June. The main characteristic of the given time reveals a higher volatility than the normal level for the respective period. The rise in value of the national currency launched in April continued during the first days of May, reaching on the 5th of May the level of 12.3784 MDL/USD. Afterwards the trend has reversed and on the 26th of May the exchange rate counted for 12.4599 MDL/USD. The next period registers again the evolution from April, with dollar devaluation down to 12.3244 MDL/USD on the 5th of June. The main causes for Leu appreciation refer to inflows of foreign currency from natural persons and entrance of large foreign investments. The factors inducing the national currency devaluation were determined by a higher demand of foreign currency for imports and massive foreign currency market procurement for filling in NBM foreign currency reserves.

On the 4th of May, the Parliament has adopted during the first hearing a set of legislative amendments referring to the set up of a mega-institution to supervise the operations of the non-banking segments from the financial market (capital market, insurance market, micro-funding services, leasing, etc.). This institution would emerge under the National Commission for Exchange Securities. The expectations regarding the perspective of the mega-regulator functioning are broadly spread from one extreme to another.

Figure 6 Evolution of the average interest rate for 90 days-TB, %



Source: NBM

The majority of professional participants on the exchange securities market welcome the given decision, considering that placing the non-banking segments of the capital market under the custody of

one single regulatory institution would ease segments' integration and accelerate funds' circulation among them. On the other hand, the opponents of the given idea consider that the appearance of a big bureaucratic institution with large competence would lead to reversal of positive development trends. This point of view is mainly shared by the operators from the insurance services market. EXPERT-GRUP considers that the effects of the new institution set up would totally depend upon its capacity to impose universal observance of regulation acts and to be really independent in decision taking process (similarly to the NBM case). In any case, the set up of this institution represent a commitment assumed by the Republic of Moldova when joining the Plan of Actions Republic of Moldova – European Union.

The market of insurance services was overwhelmed by the rumors which were afterwards confirmed by some events and dealings over the stock exchange, referring to QBE Insurance Company intention to withdraw from Moldova market. According to some information published in May, the National Commission for Exchange Securities has approved a company's tender-bid for procurement of one fourth of shares from QBE ASITO Insurance Company⁵. Even though this would eventually be confirmed, we do not think that the withdrawal of one of the biggest operators from the market is determined by the worsening business perspective in Moldova, it is more likely dealing with some corporative strategies. At the same time, in the context of the recent legislative modifications (imposing the increase of normative capital for the insurance companies) we can expect for the business to be taken over by other foreign operators, possibly some international companies' subsidiaries from Romania.

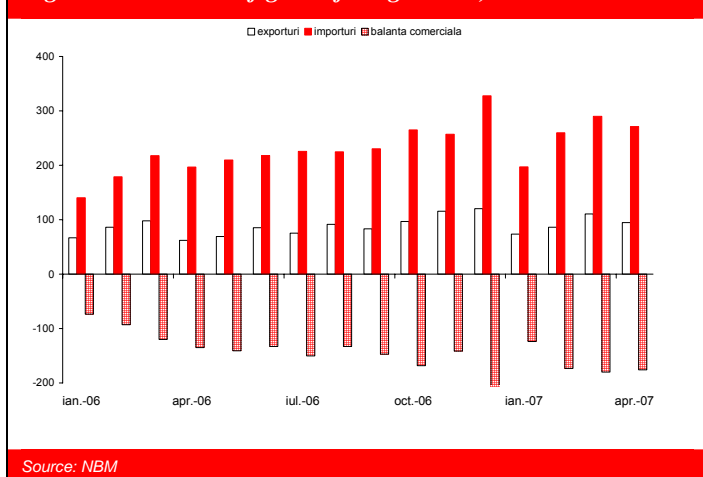
Foreign Trade

The Republic of Moldova's foreign trade continues to pass through a rather difficult period. Although the exports have enliven a little (+7.8% in Q1/07), the imports' growth was even more staggering (+39%). The conjunction of the timid exports and fast imports resulted in a continuous expansion of the commercial deficit, which reached an overwhelming amount of 476.5 mil. USD during the first quarter of 2007, that is by 1.7 folds more as compared to the same period of 2006. This trend has kept its pace further on. According to EXPERT-GRUP estimations, during January-April 2007, the imports have slightly overpassed the level of 1 billion USD (aprox. 271 mil.

⁵ The weekly newspaper „Logos-Press”, no. 19 dated May 18, 2007.

USD in April 2007), and exports reached the level of 365.5 mil. USD (aprox. 95 mil. USD, Fig. 7) – resulting in 635 mil. USD of commercial deficit for the given period of time.

Figure 7 Evolution of goods foreign trade, millions USD



Source: NBM

Exports' expansion is further on influenced by the increase in consumption demand maintained by the boost of remittances inflow (+29%, Q1/07) and local companies' inability to cope with such a demand and implicitly with the competition from external rivals' behalf. At the same time, the increase of imports' value was determined also by the rise in prices for energy resources.

Exports' evolution is mainly characterized by sound changes referring to geographical distribution and structure. Thus, the trade relations with the EU are witnessing a rather dramatic increase. The EU became our main commercial partner for both export destination and import source. On the other hand, the exports towards CIS and Russia first of all are declining. This fall is mainly determined by the impediments set up by Russian Federation for Moldova's alcoholic products. The exports to CIS suffered for a long period of time from incertitude implied by wine export in bulk to Belarus.

Some important changes occurred symptomatically within our exports' structure. Hence, the textiles (22.9% out of the total) have over-passed the alcoholic beverages (16%) and reached the level of the leading Moldavian export. Moreover, the decline of alcoholic beverages' export is so deep that even the vegetable products (17.6%) have over-passed them leaving the alcoholic beverages at the present moment on the third place within exports general structure.

The perspective for wine export resumption is not the brightest one. The Russian market is still closed for Moldavian wine and Belarus is trying to reorient itself towards wine products from Bulgaria, Romania and Hungary⁶ or directly from Moldovan producers avoiding the intermediary companies (see BER previous issues). Besides, the expected EU grant of the Autonomous Trade Preferences would not mean a total opening of the European market either. Even after quality system adjustment (something that is not so easy to do) the wine exports from Moldova will be subject to some fees, not mentioning the financial costs and logistical efforts necessary for wine promotion on the respective market. In addition to the South Asia sale markets (see **BER 19**), Moldova tries to increase the value of its wine products on Ukrainian market as well: a delegation of Moldova-Wine Industrial Agency visited Cernauti region trying to establish some bottling units for Moldovan wine in the region.

It should be also mentioned that in the month of May of the current year, the Embassy of the Republic of Moldova in Czech Republic has organized in Brno city a businessmen forum. Meanwhile, the Moldavian-Czech trade relations are extremely weak when compared to the regional context: our exports reach only for 5.6 mil. USD and it is evident that they need a more active promotion and support. Nevertheless, we should not expect a spectacular revival for these trade relations in the nearest future.

Global Markets

In April the **oil** price (WTI brand) has fluctuated in between 62-65 USD/barrel. During May the oil price got influenced by several contradictory trends. The increase of commercial oil reserves in the United States led to price decrease and the expectancies for oil consumption expansion during the summer time of the current year and the political instability in Nigeria registering forced losses of about 800 thousands barrels per day in the extraction sector induced a rise in prices. At the same time, the geopolitical risks in the Middle East still persist. Although during the last week of the month, the oil price has compressed a little, a slight increase in price is already forecasted by experts for the month to come⁷.

The forecasts for **wheat** harvest 07/08 are negatively affected by the adverse weather conditions (an

⁶ Analitique.... It is very curious the fact that the Belarus part becomes disappointed with the quality of the wine material from Moldova, just when taking over the total control over brut wine export through MoldBelVin joint stock company.

⁷ Source: The Economist, International Energy Agency, Reuters, RBC.

extremely dry spring) registered in the European Union and Morocco and by substitution of wheat plantations with barley and oily crops. Expectancies are more optimistic for the United States, Australia and CIS. Nevertheless, the global wheat production is revised downwards: - 2 mil. tones drop down to 621 mil. tones, that is with 28 mil. tones more than in 2006. At the same time, wheat global consumption is revised in upwards direction - 2 mil. tones increase as compared to the previous month. As a result, the experts are actually forecasting the lowest global stocks of wheat since 1981/82. It should be also mentioned that the most drastic fall of stocks would be for the EU, leading thus to wheat import growth on the respective market⁸.

In May 2007 the **dollar** has corrected somehow against **euro** (Figure 7). The dollar has gained some territory in regards to euro, varying in between 1.34 and 1.35 USD/euro. The fluctuations were mainly influenced by the information about the American economy. A number of statistical data ascertaining the positive evolution of the European economy were just missed out, as they were included in the price during the previous month. The American economy evolutions represented mainly some mixed boosts, which based on perseverance of some important misbalances and risks (commercial deficit, real estate market weakening) induced a number of data indicating an attempt to revive the American economy.

Figure 8 Evolution of euro/dollar rate on international markets, USD/EUR



Source: Rossbusinessconsulting

Thus, the data on industrial production, labor market and consumers' confidence overrun our

⁸ Source: USDA, World Agricultural Supply and Demand Estimates, Wheat Outlook; International Grains Council, Grain Market Report.

expectancies. At the same time, the less optimistic situation on emerging markets can actually support the American currency. The World Bank is warning about the perspective for deceleration of global growth and braking of capital flows' placement on emergent markets, not excluding even „a hard landing” for some of them. For instance, the Fed ex President, Alan Greenspan, is forecasting such an evolution for the Chinese economy. In this context, the American dollars would be less risky for investors than the hazardous assets in emergent economies⁹.

Trade Partners

In **Russia** the economy is keeping the ascendant pace. Thus, during January-April 2007, Russian economy registered a healthy increase of 7.7% as compared to the same period of 2006. The growth is strongly supported by the strengthening of investment demands (+19.9%), dynamic expansion of constructions (+23.7%) and industry (+7.5% with a slight deceleration in April), and also a high level of consumption demand based on exports' deceleration (only +7.3%) and imports' enhancement (+41.1%). The increase of real wage and disposable income¹⁰ induced the expansion of retail trade by 13.6%¹¹. At the same time, besides the important contribution to the economic growth, the investment activity expansion coupled with the appreciation of the Russian ruble brings over some serious risks as well. First of all, this is the solid increase of imports that induced the worsening of the trade balance – for the first time since 1998. Secondly, the lion's share in the private investment inflow is funded through commercial banks the increase of consumption, bank income, capital attraction for companies through public circulation of bonds, major corporative merging and only a very little share goes to investments in productive capital. Thirdly, all of this could lead to increase of debts (denominated in US dollars) of a narrow segment from the corporative sector which covers strategic companies for the Russian economy: 34.4 billions USD. A sharp decrease in value of the Russian ruble could place these companies under great pressure. And finally, the extraordinary inflow of capital has determined also the expansion of money supply making the inflation targets more difficult to be achieved.

⁹ Reuters, RBC, Global Insight Inc., The World Bank.

¹⁰ Nevertheless, the speed of real salaries' expansion overpasses the productivity one and this can have adverse effects on competitiveness of Russian producers going hand in hand with maintenance of Russian ruble rise in value.

¹¹ Ministry of Trade and Economic Development, Институт Экономики Переходного Периода, Institute of Transition Economy

In April 2007 the **Ukrainian** economy continued its strong growth: +7.6% as compared to the same month of 2006. The expansion of private consumption and exports are the factors supporting the growth. The economic evolutions are favored by the positive situation on the market of metallurgical and chemical products, the fiscal relaxation (on income tax and VAT) and the flexible policy for the exchange rate. All these contributed to the revision undertaken by the Ukrainian Ministry of Economy for the forecasts regarding the upwards economic growth. From the economic point of view, the balance of payments statement would still be a major concern for the Ukrainian policy makers and it is really unlikely for it to get settled in 2007.

The Ukrainian political crisis is going on. Although it has no visible immediate impact on the economic growth, it will delay a number of necessary strategic reforms and activities, as the ratification the necessary documents for Ukraine's joining the WTO, land, tax, administrative and pension system reforms. At the same time, the executive power is definite to promote a large set of measures for population social support – a very important tool to be used during the pre-election fight¹².

Table 3 Economic indicators of Moldova's main trade partners

	GDP, %		Industrial production, %	Inflation, %	Unemployment, %
	Last data	2007, forecast			
Russia	7,7 01-04/07	6,3	7,5 01-04/07	4,0 04/07	7,0 04/2007
Ukraine	7,9 01-04/07	6,2	12,5 01-04/07	1,3 04/07	6,7 2006
Romania	6,0 T1/07	6,5	8,2-9,4 03/07	3,8 04/07	7,2 04/07
Germany	3,6 T1/06	2,2	6,9-7,7 03/07	2,0 04/07	6,7 03/07
Italy	2,3 T1/07	1,7	1,6 03/07	1,8 04/07	6,5 T1/06

Source: *The Economist*, IMF, World Bank, Derjkomstat, Goskomstat, Eurostat, INS România, EXPERT-GRUP.

The European Union continues to enjoy a solid economic growth. Thus, in Q1/07 EU economy registered an increase of 3.1% as compared to Q1/06. The economic growth covered almost all economic sectors. Nevertheless, the highest economic growth rates are registered by the new EU members: Latvia, Slovakia and Lithuania. Only

Germany and Spain enjoy high rates for economic growth from the „old Europe”. The industrial production is also growing dynamically (+3.7 in March 2007 as compared to March 2006) meeting the increased level of internal and external demand. Notwithstanding the rise in value of the single European currency, **the euro zone** registered a trade balance surplus of 7.4 billion euro in March 2007 – the highest level being attained by Germany with 5,8 billions euro.

Romania witnessed a solid economic growth of 6% during the first quarter of 2007. The growth was supported by the expansion in industry (+7.4% in 01-02/07), constructions (+32.7%, 03/07), investment demand (+15.9) and volume of en detail trade (+4.3%, Q1/07). At the same time, managers' expectations regarding the evolutions for May-July are rather positive for all the major sectors of the Romanian economy: industry, constructions, retail trade and services.

Tensions still persist within the political situation. After the clear winning during the plebiscite organized on the 19th of May, the President of Romania, Traian Băsescu, insists upon Government change, Parliament dismissal and calls for pre-term elections (just to remind that the autumn of 2007 is the period forecasted for the European Parliament elections as well). At the same time, it should be mentioned that the 27th of June is the day for European Commission to present the progress report for Romania and Bulgaria. It is evident that there are no sparkling successes, the main concern being for corruption prevention. This fact is well-grounded by the warning called for the both countries by the European Commissary for Justice, Mr.Franco Frattini and afterwards by the Commissary for Extension, Mr. Olli Rehn, mentioning the possibility to rouse the safeguarding clause if the both country do not submit clear evidence for solid progress achievement in corruption control sector. Although this warning is used more like a tool urging Romania and Bulgaria to implement the necessary reforms, it is nevertheless important for the internal political fight not to compromise the reform process and the economic convergence towards the other members of the European Union¹³.

¹² Інститут економічних досліджень (Institute for Economic Research and Policy Consulting), Міжнародний центр перспективних досліджень (International Centre for Policy Studies), Експерт-Україна (Expert-Ukraine).

¹³ Source: Financial Week, Capital, The Current, The Economist.