MOLDOVA

Highlights

- **The economy is growing again after the recession in 2015.** GDP increased by 4.3 per cent in 2016, supported by a bumper harvest, a recovery in household consumption and exports of goods and services, and further growth has occurred so far in 2017.
- **A new IMF programme is in place.** The three-year programme was approved in November 2016, on completion by the Moldovan authorities of prior actions mainly focused on the banking sector.
- **Banking sector vulnerabilities are being tackled.** The regulatory and supervision framework has been overhauled to provide the National Bank of Moldova (NBM) with tools for the identification of banks' ultimate beneficial owners and related party lending.

Key priorities for 2018

- **Key commitments under the IMF programme should be met.** The IMF programme is a crucial anchor for reforms and is essential to catalysing further international support and implementation of structural reforms.
- **Banking sector cleansing should be completed.** The new regulatory and supervision framework needs to be thoroughly implemented, and non-transparent shareholders still present in the ownership structure of some of the largest banks should be replaced with fit and proper investors.
- **Further business environment and governance reforms are needed.** Key priorities should include judiciary reform, simplification of the regulatory framework, an overhaul of the tax and customs administration, and improvement of governance in public institutions.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	9.4	4.8	-0.4	4.3	3.0
Inflation (average)	4.6	5.1	9.7	6.4	6.5
Government balance/GDP	-1.9	-1.9	-2.3	-2.1	-3.7
Current account balance/GDP	-6.2	-7.1	-7.2	-4.2	-4.0
Net FDI/GDP [neg. sign = inflows]	-2.7	-3.8	-3.2	-1.1	-2.2
External debt/GDP	86.4	81.4	93.7	92.1	n.a.
Gross reserves/GDP	35.5	27.0	27.0	32.6	n.a.
Credit to private sector/GDP	42.1	36.4	31.2	25.8	n.a.

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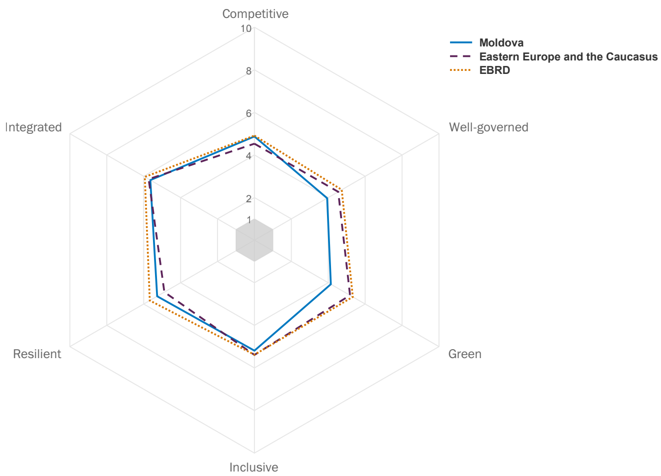
Macroeconomic performance

Economic growth has resumed. Following a 0.4 per cent economic contraction in 2015, real GDP grew by 4.3 per cent in 2016 on the back of a good agricultural season. Agricultural output increased in real terms by 18.0 per cent in 2016 after declining by 13.0 per cent in 2015. In 2016, household consumption rose by 3.6 per cent and the real volume of export of goods and services increased by 9.3 per cent, driven by higher export flows to the European Union (EU) countries. On the other hand, gross fixed capital formation contributed negatively to GDP growth, falling by 2.8 per cent in real terms in the same period. GDP continued to grow by 2.8 per cent year-on-year in the first half of 2017.

External and inflationary pressures have eased. The Moldovan leu stabilised in 2016 after depreciating by 33.6 per cent against the US dollar in 2014-15. Supported by strong export performance and recovering remittances, the leu appreciated by 13.5 per cent in relation to the US dollar in the first nine months of 2017. In the same period, inbound money transfers returned to growth of 9.5 per cent year-on-year after a decline in the previous two years. The current account deficit fell from 7.1 per cent of GDP in 2014 to 4.2 per cent of GDP in 2016. Official reserve assets increased from US$ 1.8 billion at the end of 2015 to US$ 2.6 billion in September 2017, lifting import coverage to approximately six months. Amid monetary tightening and a stable leu, inflation decelerated from 13.6 per cent year-on-year in December 2015 to 6.3 per cent year-on-year in the first nine months of 2017. General government gross debt increased from approximately 25.0 per cent of GDP in 2014 to close to 40.0 per cent of GDP in 2016, mainly due to the recognition of public debt arising from the emergency assistance provided by the NBM to the three failed banks.

The short-term growth outlook is positive but significant vulnerabilities remain. The new IMF programme has eased funding pressures and helped to stabilise Moldova's economy. Current projections for growth are 3.0 per cent in 2017 and 3.5 per cent in 2018, driven by macroeconomic stabilisation and an improved external environment. However, the forecast is subject to uncertainty due to a narrow economic base concentrated in agriculture. Vulnerabilities in the financial sector remain despite recent steps to improve banking supervision and the regulatory framework.

Assessment of transition qualities (1-10)



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Major structural reform developments

Moldova's entry into an IMF programme has catalysed reforms. A three-year IMF arrangement for Moldova of US$ 179 million was approved in November 2016. The programme has a strong focus on the banking sector and on addressing debt accumulated by the energy companies, setting utility tariffs at cost recovery levels and developing a sound medium-term budget framework for 2017-19. To satisfy prior actions and secure the agreement, the authorities undertook reforms in the financial and energy sectors, amended the 2016 budget law and converted state guarantees to the NBM into marketable government securities. In April 2017, the IMF completed the first programme review and released a US$ 21.5 million tranche. Approval of the programme unlocked international budget assistance from the European Union, the World Bank and Romania.

The authorities made progress in tackling long-standing vulnerabilities in the banking sector. Legislative amendments adopted in 2016 equipped the NBM with stronger legal powers and the enforcement capacity to identify banks' ultimate beneficial owners (UBOs) and related-party lending. Under the new rules, the NBM has acquired statutory powers to deem any person to be a bank's related party on the basis of objective criteria, unless the bank is able to prove otherwise. Changes to the Banking Law approved in the course of 2016 imposed more severe sanctions on managers, administrators and shareholders of banks for misconducts. The new Bank Recovery and Resolution Law was enacted in October 2016 to provide adequate crisis management capacity to NBM by introducing new resolution and intervention tools. A Central Securities Depository was created in April 2017 to reinforce financial infrastructure and increase protection against raider attacks.

As of the end of August 2017, two of the three largest banks remained under special supervision, and the third under special administration, of the NBM. These banks together account for approximately 65 per cent of Moldova's banking sector assets. Full external diagnostic reviews were launched in these three banks focusing on exposure to related parties. Full-scope onsite inspections were conducted in the two banks under special supervision. The NBM blocked the shares of non-transparent shareholders in two banks and re-offered them for sale with a view to attracting fit and proper strategic investors. The Board of Directors of Victoriabank, one of the three largest banks, became operational again in October 2016.

Some reforms were undertaken in the energy sector. Energy tariffs have been increased closer to operating cost recovery levels, but they remain insufficient to address the accumulated debts of energy companies and to facilitate the requisite investments into energy infrastructure. To further the laws on electricity and natural gas promulgated in 2016, the parliament of Moldova adopted a new law on energy in July 2017 as an important step towards approximation with the EU's Third Energy Package. The new law supports the strengthening of the institutional set-up and independence of the energy regulator (ANRE) via, among other things, improved procedures for the appointment of its directors and establishing clear performance indicators. A new renewable energy law, approved in February 2017 and entering into force in 2018, transposes the EU directive and is expected to create an enabling framework for renewable energy projects.

A plan to restructure the government apparatus has been approved. In July 2017, Moldovan parliament supported a government restructuring plan that targets enhanced efficiency of public administration. Under the plan, the number of ministries was reduced from 16 to 9. Downsizing of public administration staff aims to generate savings on administrative expenses. According to the plan, deputy ministers are to be replaced with permanent state secretaries to foster a separation between political and administrative functions and to ensure continuity and stability in the work of ministries. The reorganisation is expected to take several months.

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Pension system sustainability was improved. The new pension law entered into force from the beginning of 2017. It is set to gradually increase the retirement age to 63 by 2019 for men and by 2028 for women. The new pension system introduces basic pension coverage and requires that all public sector employees are subject to the same contribution and benefit rules. The link between contributions and benefits was strengthened to make the system more equitable and to stimulate compliance.

Steps were taken to ease the regulatory environment for businesses but significant obstacles remain. In 2016, the total number of authorisations, permits and licences required for starting a business decreased by approximately a quarter. The authorities approved an action plan to implement one-stop-shop solutions and procedures for orderly liquidation of businesses were simplified. The reporting burden on businesses is to be lowered, effective from January 2018, by unifying five reports on payroll and payroll taxes and on mandatory social and insurance contributions into one report deliverable to a single public institution.

A moratorium on inspections was introduced and work initiated on a new mechanism for performing state controls and on reforming and reducing the number of institutions with control functions. Measures were also taken to simplify procedures for obtaining construction permits, but implementation of reforms to address the remaining regulatory hurdles, improve customs administration and overhaul the judiciary is lagging behind. Moldova ranks 44th out of 190 countries in the World Bank's *Doing Business 2018* report with lower scores in dealing with construction permits, getting electricity, enforcing contracts and resolving insolvency compared with better rankings in other doing business indicators.