MOLDOVA

Highlights

- **Economic output has been growing steadily.** GDP grew by 4.5 per cent in 2017 supported by a favourable external economic environment and a recovery in household consumption. In the first half of 2018 growth continued at a similar pace.
- **Foreign investors have entered two systemically important banks**. The recent acquisitions of a 39.2 per cent stake in Victoriabank and a 41.09 per cent stake in Moldova Agroindbank by fit and proper investors are steps towards transforming the banking sector. These also mark the first entries since 2007 of foreign bank investors into Moldova.
- **Recent business environment reforms include welcome improvements but have also raised concerns.** New tax simplification and deregulation measures should contribute to a more enabling business environment, but an amnesty regarding previous offences may obstruct the administration of justice.

Key priorities for 2019

- **Shareholder fitness should be restored at one of the country's systemic banks as soon as possible.** In order to shore up financial stability, the removal of opaque shareholders needs to be finalised in the second largest bank which remains under the temporary administration of the National Bank of Moldova.
- **IMF programme implementation should continue without delays.** Implementation of structural reforms and macroeconomic policies agreed under the programme is crucial for maintaining investor confidence and for receiving financial support from international development partners.
- **Supervision of the non-bank financial sector should be enhanced.** To mitigate migration of risks from the banking sector, more needs to be done to strengthen supervision of non-bank financial institutions, as well as to enhance the capacity of the financial sector regulator.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	4.8	-0.4	4.3	4.5	4.0
Inflation (average)	5.1	9.7	6.4	6.6	3.6
Government balance/GDP	-1.9	-2.3	-2.1	-1.0	-3.5
Current account balance/GDP	-7.1	-7.1	-4.2	-5.9	-7.4
Net FDI/GDP [neg. sign = inflows]	-3.8	-3.2	-1.2	-1.6	-2.8
External debt/GDP	80.9	93.1	91.4	72.8	n.a.
Gross reserves/GDP	27.0	27.0	32.6	29.3	n.a.
Credit to private sector/GDP	36.4	31.2	25.8	18.9	n.a.

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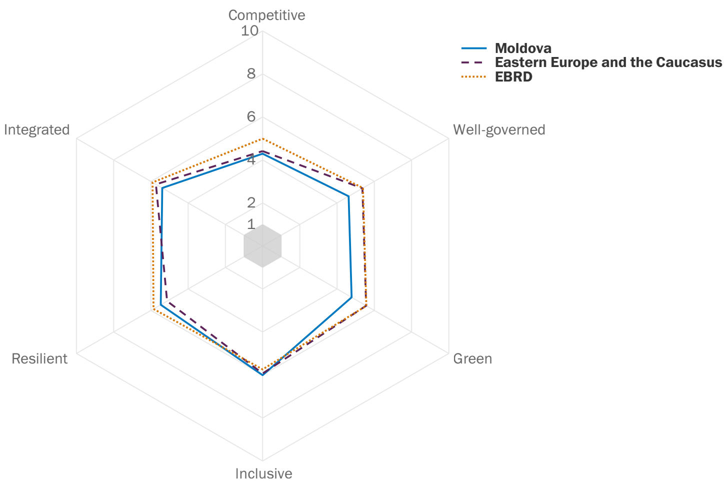
Macroeconomic performance

Robust economic growth has continued. Real GDP grew by 4.5 per cent in 2017, supported by a favourable external economic environment. Exports of goods and services continued to expand in 2017 on the back of growing exports to the European Union (EU). The volume of agricultural output increased by 7.9 per cent in 2017. Rising remittances and real wages have bolstered household consumption which, in turn, increased by 5.3 per cent in 2017. After contributing negatively to GDP growth in 2015-16, gross fixed capital formation rebounded in 2017, expanding by 5.2 per cent in real volume terms. GDP continued to grow by 4.5 per cent year-on-year in the first half of 2018.

Economic stabilisation is aided by a benign external environment. The current account deficit widened from 4.2 per cent of GDP in 2016 to 5.9 per cent of GDP in 2017, reflecting consumption-driven import growth. At the same time, remittances to Moldova increased by 12.8 per cent and exports of goods and services by 18.9 per cent in nominal US dollar terms. The expansion of Moldova's international trade was driven chiefly by increased cross-border flows with EU countries under the supportive framework of the Deep and Comprehensive Free Trade Agreement (DCFTA) signed in 2014. The Moldovan leu appreciated by 16.8 per cent during 2017 and by a further 1.4 per cent by the end of September 2018. International reserve assets of the National Bank of Moldova (NBM) increased from US$ 2.2 billion at the end of 2016 to US$ 3.0 billion in September 2018, covering approximately six months of imports. Inflation slowed from an average of 6.6 per cent in 2017 to a more manageable 3.7 per cent in the first nine months of 2018. At 1.0 per cent of GDP in 2017, the fiscal deficit was lower than projected as delays in external financing and the reorganisation of ministries led to under-execution of spending.

Structural and demographic challenges may act as a drag on potential growth. The economy is forecast to grow by 4.0 per cent in 2018 and in 2019. The lack of diversification in the economy is a key constraint holding back medium-term growth prospects. Agriculture's significant weight in economic value creation leads to volatility of growth and low overall productivity. Population ageing and the outflow of migrants are also key challenges that, if not addressed, will dampen the economy's long-term potential.

Assessment of transition qualities (1-10)



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Major structural reform developments

Reforms committed to under the IMF programme are on track. In June 2018 Moldova completed the third review of the IMF's Extended Credit Facility and Extended Fund Facility arrangements, signed in November 2016, which remain an important facilitator of reforms. To satisfy programme conditionalities, significant strides were made in a number of areas, including steps to instil shareholder transparency in the banking sector, improve the regulation of the non-banking sector and adjust the electricity tariff-setting methodology.

Major governance reforms have advanced in the banking sector. Procedures for share cancellation, issuance and sale of newly issued shares were amended in December 2017 to enable the removal of unfit shareholders. This was followed by the replacement of the non-transparent shareholder with fit and proper investors in two of the systemic banks. In January 2018, a strategic investor from Romania acquired a 39.2 per cent equity stake in Victoriabank, which was the third largest bank by assets at the time of the transaction. The new shareholder has launched a modernisation of the bank by, inter alia, introducing sound corporate governance as well as risk management standards and practices. In October 2018, a consortium of international investors acquired a 41.09 per cent stake in Moldova Agroindbank, the largest commercial bank in Moldova. At the same time, shareholder fitness in the third systemic bank remains to be restored.

The financial sector's legal, regulatory and supervisory framework has been further strengthened. A new anti-money laundering (AML) law was adopted in February 2018. All banks were instructed to conduct self-assessments of corporate governance practices. In April 2018, the NBM approved the list of related party exposures for the three largest banks and the time-bound plans for unwinding related party exposures were submitted and agreed with the NBM. The NBM completed onsite inspections and shareholder checks in non-systemic banks in May 2018. The government published a report on the findings of the independent investigator of the 2014 bank fraud and in March 2018 submitted it to the Anti-Corruption Prosecutor's Office which, in turn, developed a strategy to recover assets containing time-bound actions. The Central Securities Depository, responsible for the registration, book-keeping and settlement of financial securities issued by legal entities, became operational in July 2018. In the same month, the deposit guarantee ceiling was increased from approximately US$ 1,200 to US$ 3,000, risk-based banks' contributions were set up, and conditions under which the NBM or the Ministry of Finance could finance the guarantee fund were clarified.

The authorities are setting up a regulatory and supervisory framework for non-bank credit organisations. The aim is to prevent migration of risks from the banking sector to the non-bank financial sector. The law on non-bank credit organisations came into force in March 2018. It sets the regulatory framework and introduces capital requirements for these entities. Organisations covered by the law will be subject to a minimum capital requirement of 5 per cent of assets. If book value of assets exceeds 25 million lei (approximately US$ 1.5 million), such organisations will be required to perform an external audit of financial statements. The register of non-bank organisations is to be held at the National Commission for Financial Markets.

Pro-business tax measures have been adopted, along with reduced penalties for economic crimes. The package of business reforms was introduced in July 2018 to lower the regulatory and tax burden on businesses, but it also includes an ill-conceived capital amnesty and legislative revisions to reduce criminal liability for certain economic crimes. Progressive personal income tax rates of 7 per cent and 18 per cent were replaced by a single flat rate of 12 per cent. The employer social contribution rate was lowered from 23 per cent to 18 per cent. The value added tax rate for hotels, restaurants and cafes was cut to 12 per cent. A capital amnesty introduced by the package allows for registration of financial means and property without the need to provide documents attesting their origin until the end of 2018, conditional on paying 3 per cent of the asset value. This possibility does not apply to public officials. Furthermore, the package reduces the severity of punishment for a range of economic crimes in exchange for higher monetary fines. A reform of the state control function adopted in the second half of 2017 reduced the number of control institutions from 70 to 18 and streamlined procedures. In July 2018, the government launched a single window for issuing permits.

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A new methodology for calculating electricity tariffs is in place. The revised version was developed, adopted and published by the regulator (ANRE) and agreed with the Energy Community Secretariat, and is consistent with the new energy law. The methodology provides for annual setting of tariffs via established rules for determining costs, capital investment and profitability.