

OVERVIEW OF THE MACROECONOMIC SITUATION AND FRAMEWORK OF THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

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Abstract: The purpose of this article is to present a general analysis of the main aspects characteristic of the macroeconomic situation of the Republic of Moldova and the domestic banking system in conditions of nationally and internationally instability. Mission of each Bank is to provide banking services and products in accordance with the most modern and advanced standards to meet customer needs and shareholder expectations. The national economy follows the recovery trajectory after the decline caused by the pandemic crisis and the extreme climatic conditions in 2020 and again is affected by the regional security situation.

JEL classification: E42, F51, G21

Key words: gross domestic product, inflation rate, banking system, National Bank of Moldova, commercial banks

1. INTRODUCTION

The contemporary banking sector is undergoing profound transformations. Digitization, the context of COVID-19, the pace at which things change around us challenge commercial banks to be more competitive and adapt. Customers' expectations are growing, fueled by the extraordinary experience they have in everyday life in the era of Information Technologies. Banks must respond in the best way possible to the needs of customers to be served qualitatively, quickly and efficiently.

The regional security situation is unstable. Russia's invasion in Ukraine is anticipated to result in considerable damage to the regional economy, Moldova is one of the most affected countries by the conflict not only because of its physical proximity, but also its inherent vulnerabilities as a small, landlocked economy, with close linkages to both Ukraine and Russia. It is expected for 2022 to affect the economy through the trade and remittances channels as well as prices. All these events will sharply affect the Moldavian economy.

2. OBJECTIVES

The authors of the article aim to present the main features of the macroeconomic framework of the Republic of Moldova during the last three years and the main features of the domestic banking system in the same period.

3. METHODOLOGY

The present study is based on the statistics data presented by the National Bank of Moldova (NBM), the Ministry of Economy and the commercial banks of the Republic of Moldova. In the elaboration of the article were used various research methods. The main applied methods are statistical analysis and synthesis.

4. ANALYSES

The global economy marked by the COVID-19 pandemic crisis that plunged most countries into recession was also felt in 2021. The economic impact was manifested by increased demand for raw materials and delivery difficulties that created preconditions for rising inflation. The rapid economic recovery and declining stocks have led to a 1,8-fold increase in international gas prices since the beginning of the year. The redirection of gas to Asian countries at a higher price has led to a decrease in supply in the European region as a result, the price of gas in this region has increased considerably. In the second half of the year, it becomes clear that central banks will consider the need for anti-inflationary measures to mitigate the negative effects. The national economy follows the recovery trajectory after the decline caused by the pandemic crisis and the extreme climatic conditions in 2020. Gross domestic product (GDP) in 2021 amounted to MDL 227,6 bln. (presenting comparative prices), having increased in 2020 by 13,9 percent.

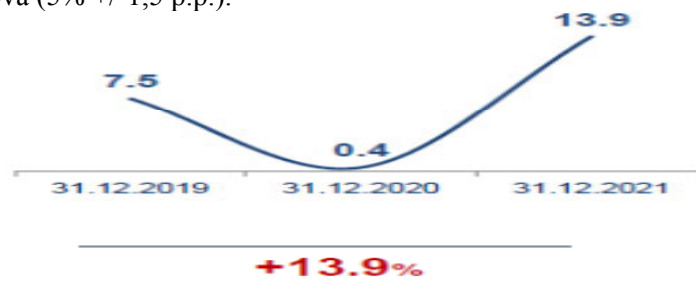


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Figure no. 1. GDP evolution in the Republic of Moldova, 2019-2021

The growth of GDP in 2021 was mostly driven by agriculture, forestry and fishing (bringing +4,2%), followed by the commerce (+2,2%), transport and depositing (+1,6%), information and communications (+1,2%), energy production and supply (+0,9%) etc. Construction had a negative impact on the change in GDP, which slowed economic growth by 1.6%.

The annual inflation rate (as of December 2021 compared to December 2020) made 13,9%, being below the variation range of the inflation target set by the National Bank of Moldova (5% +/-1,5 p.p.).



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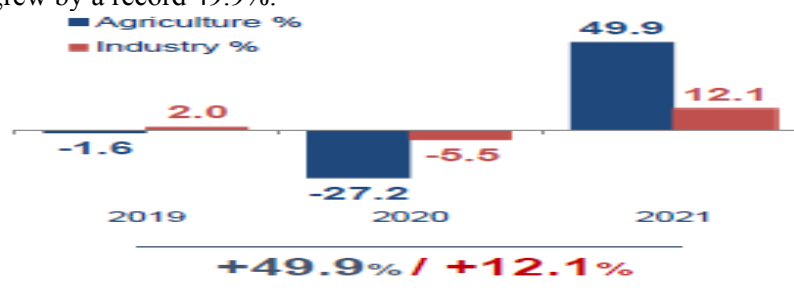
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Figure no. 2. Annual inflation in the Republic of Moldova, 2019-2021

In order to mitigate the disinflationary pressure, the NBM during 2021 made 4 times decisions to change the base rate by increasing it from 2.65% to 6.5%. The Moldovan Leu from the beginning of 2021 has marked an appreciation of 4,9% against the Euro, and a depreciation of 3,1% against the US dollar. The official reserve assets maintained by the National Bank of Moldova as of 31.12.2021 reached a value of USD 3 901,9 mln., having increased by 3,1% compared to the level recorded at the end of 2020. Turnover in trade of goods and services increased in all components in 2021: retail trade by 12.0% (presenting comparative prices), market services provided to the population by 71.3% (presenting comparative prices), trade wholesale increased by 24.5% (in current prices), market services provided mainly to enterprises increased by 28.1%. Turnover from wholesale and retail trade of motor vehicles and motorcycles, their maintenance and repair, in current prices increased by 44.0% compared to 2020.

Agriculture, after a year of severe drought, benefited in 2021 from favorable climatic conditions and due to the implementation of high-performance technologies financed from bank loans to the sector, which increased by 6% in 2021. Global agricultural production grew by a record 49.9%.



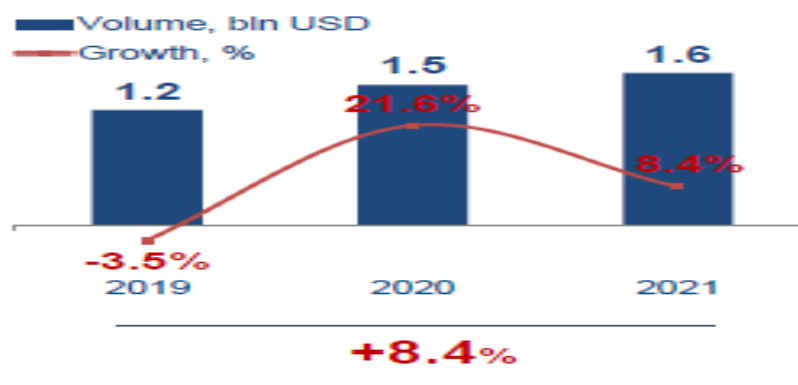
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Figure no. 3. Agriculture/Industry evolution in the Republic of Moldova (%), 2019-2021

The increase in agricultural production was determined by the essential increase in vegetable production by 75.5%, the most productive being crops corn, sunflower and wheat, which recorded the highest increases. At the same time, animal production fell more than in previous years by -7%, given the continuous decline in livestock. The industrial sector relaunched in 2021, recording an increase of 12.1%, to which all industries contributed: the extractive industry (+11.9%), the manufacturing industry (+11.4%), energy production and supply (+16.1%). The railway, road and air transport companies transported about 19,7 million tons of goods in 2021, the volume that is higher by 19.2% compared with 2020. The volume of freight by motor transport, which has the priority in the structure of the goods transported (82,3%) amounted to 16,2 million tons and constituted 20,8% more compared to the previous year.

Investments increased moderately in 2021, against the background of the decrease in 2020. The volume of investments in fixed assets increased by 4.8%, amounting to about MDL 29.6 billion. Increase in investments of the economic agents oriented in new technologies, machines and equipment, as well as the increase of the investments in the public infrastructure were the basic factors that influenced the increase of the investments. Exports and imports increased in volume. In 2021, exports increased by 27.5% and imports by 32.5%. The negative balance of trade amounted to USD 7,18 bln., compared to USD 5,4 bln. in 2020. The coverage of imports with exports in 2020 constituted 43,7%, being lower by 2,2 p.p. compared to the previous year.

The total volume of money remittances from abroad to individuals from the Republic of Moldova amounted to USD 1,6 billion in 2021, and increased by 8,4% compared to 2020. The currency structure of remittances (recalculated in USD) was as follows: EUR – 1,06 billion, USD – 0,5 million, RUB – 0,04 billion.

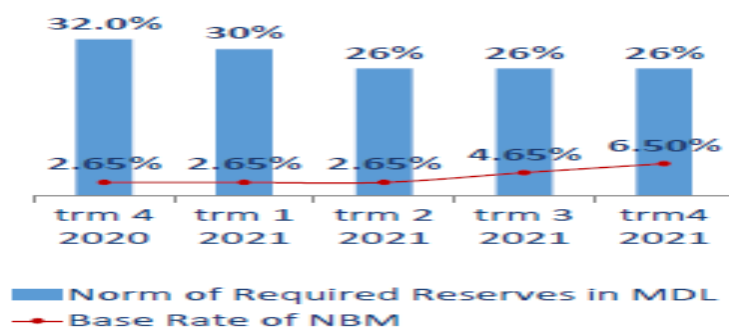


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Figure no. 4. Remittance evolution in the Republic of Moldova, 2019-2021

During 2021, in order to support the relaunch of economic activity, the National Bank of Moldova promoted stimulus monetary policy. Towards the end of 2021, as inflationary pressures intensified, the NBM took measures to counteract the negative

effects. So: - The base rate applied to the main short-term monetary policy operations remained at 2.65% until the second half of 2021, after which it was increased in two installments to 6.5%. - The norm of required reserves held on NOSTRO account at the NBM from the volume of resources attracted in Moldovan lei and non-convertible currency was decreased in the first half of the year in three installments from 32% to 26% and maintained until the end of 2021 at 26%. The reserve requirement in the volume of resources in USD, EUR and other convertible currencies remained unchanged at 30% throughout 2021.



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Figure no. 5. The main instruments of monetary policy

In the Republic of Moldova there are 11 banks licensed by the National Bank of Moldova, including 4 branches of foreign banks and financial groups. The banking system of the Republic of Moldova is characterized by a high degree of concentration. Thus, as of 31.12.2021, the largest 4 banks (BC „MAIB” S.A., BC „Moldindconbank” S.A., OTP Bank S.A., B.C. „Victoriabank” S.A.) had 79,7 percent of assets, 82,0 percent of deposits, 80,7 percent of loans.



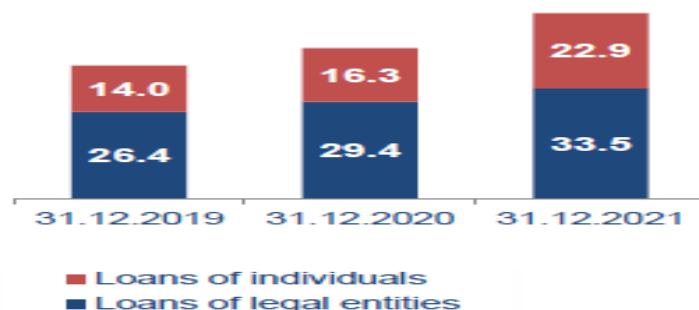
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Figure no. 5. Assets of banking sector in the Republic of Moldova (billion lei), 2019-2021

According to the profit, the top four banks have the share of 86,95 of the total profit obtained in the banking sector. The fast economic recovery, the acceleration of domestic consumption and the stimulating monetary policy of the NBM during 2021 have

boosted the impressive growth of loans to households and businesses (the volume of new loans increased by about 40%). During 2021, the trend of consolidation of own funds continued in the banking sector, while maintaining a high level of liquidity. At the same time, the year 2021 was characterized by the increase of the profitability of the banking sector. As of 31.12.2021, the profit in the banking system amounted to MDL 2,3 billion, having increased by 53,3% (MDL 800,7 million) compared to the end of the previous year

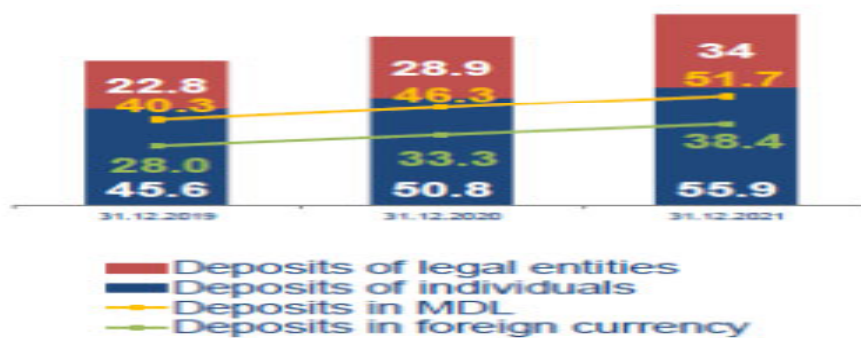
Total assets of the banking system as of 31.12.2021 constituted MDL 118,5 billion, having increased during 2021 by 14,2% (MDL 14,7 billion). As of 31.12.2021, the gross loan portfolio constituted 38,3 percent of total assets or MDL 45,5 billion. Bank investments in securities and certificates of the National Bank (CBN) registered a share of 15,9% (MDL18,8 billion), having decreased by 1,7 p.p. Other assets amounting to 18,8% (MDL 22,3 billion) are maintained by banks in other banks, in the form of cash, tangible assets, intangible assets etc. Their share increased by 1,4 p.p. During 2021, the gross loan portfolio increased by 23,5 percent (MDL10,7 billion) constituting as of 31.12.2021 the amount of MDL 56,4 billion. The increase in the loan portfolio is due to the increase in the balance of loans granted for purchase/construction of real estate – by 45,0% (MDL3,5 billion) up to MDL 11,4 billion and due to the increase of the consumer loans by 40,2% (MDL 3,0 billion) up to MDL 10,5 billion.



Source: developed by the authors on the basis of <https://www.bnm.md/bdi/pages/reports/drsb/DRSB10.xhtml>

Figure no. 6. Loans of banking sector in the Republic of Moldova (billion lei), 2019-2021

During 2021, in the banking sector continued the trend of increasing the balance of deposits, which increased by 10,4% during the reference period, constituting MLD 90,1 billion (deposits made by individuals constituted 62,1% of total deposits, deposits made by legal entities – 37,8% and deposits made by banks – 0,1%). The increase in deposits was due to increase in the deposits made by legal entities by MDL 5,3 billion (18,4%) and increase in deposits made by individuals by MDL 5,1 billion (10,1%).



Source: developed by the authors on the basis of:
<https://www.bnm.md/bdi/pages/reports/drsb/DRSB1.xhtml>;
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Figure no. 7. Deposits of banking sector in the Republic of Moldova (billion lei), 2019-2021

The capital of banks during 2021 increased by 8,7 percent (MDL1,6 billion), constituting MDL 19,4 billion. The increase in banks ' capital was mainly driven by the profit of MDL 2,3 billion.

In the context of current events, in particular the conflict between the Russian Federation and Ukraine we can predict that impacts on the economy will flow through three main channels:

- higher prices for commodities (e.g. food, energy) will push up inflation further, in turn eroding the value of incomes and weighing on demand;
- national economy will grapple with disrupted trade, supply chains, and remittances as well as an historic surge in refugee flows;
- reduced business confidence and higher investor uncertainty will weigh on asset prices, tightening financial conditions and potentially spurring capital outflows.

Longer term, the war may fundamentally alter the global economic and geopolitical order should energy trade shift, supply chains reconfigure, payment networks fragment, and countries rethink reserve currency holdings. Increased geopolitical tension further raises risks of economic fragmentation, especially for trade and technology.

We can notice that lending is a priority of the commercial banks in the Republic of Moldova, with important impact for customers, consumers and the national economy. In 2021, the banks permanently offered lending solutions through dedicated campaigns, by adapting existing lending products to market requirements and customer needs or by periodically adjusting the price conditions offered to customers. In the lending activity of individuals, the banks focused on increasing the number and volumes of loans granted to clients with good payment capacity, improving the quality of the portfolio and reducing the response time and approval of clients' requests.

In 2021 the banks of the Republic of Moldova continued the development and implementation of card products, as well as attracting new customers. The development of remote services is a priority direction in the banking activity, even more aware in the pandemic conditions.

Some examples of remote service solutions offered by the banks to individuals are:

- Web Banking remote service through which customers can manage all card accounts at any time of the day and from any corner of the world;

- Mobile Banking mobile application that provides quick and secure access to your card accounts, directly from the mobile phone, anywhere and anytime;
- SMS notifications information service via SMS messages sent to the mobile phone about transactions made with the card and on the card account Notifications are sent to subscribers of all mobile operators in Moldova, etc.

Some examples of remote service solutions offered to legal entities are:

- Web business remote banking system that provides the right solution for account management;
- Mobile business information and payment management service on the mobile phone;
- SMS business information service through informative SMS and detailed emails, sent in real time, whenever certain amounts of money enter or are withdrawn from the customer's current accounts, etc.

The activity of the banks is based also to deposits of individuals and legal entities, money remittances, foreign exchange operations, servicing customer accounts and cash transactions, bancassurance, cash collection, payments receipt from the population, rental of safety boxes, escrow service, etc.

5. CONCLUSIONS

Regarding macro environment, we can say that political stability for 2022 maintained, though under degree of uncertainty in case the War directly impact Moldova. The expected economic recovery is expected to turn into recession due to negative impact of the war in Ukraine. The rise in wages, remittances and social benefits is contributing to significant growth in private consumption. Inflation will rise significantly, While the effects will be mitigated by controlling prices for regulated services, as well as by providing support to the population. The national currency may slightly depreciate (or be quite stable) in relation to main base currencies, the euro and the US dollar. Remittances will decline (mainly from Russia) as well as result of closer some remittances agents.

Regarding banking system, we can suppose that the NBM will promote a conservative or even restrictive monetary policy, having a negative impact on aggregate demand. This can mainly result in the increase of the base rate and less probable increase in mandatory reservation rate. The rise in inflation will lead to an increase in the base rate, as a result, an increase in interest rates on financial instruments is expected (including loans). The base rate was expected to increase to about 12.5% in 2022, however it can reach the level of 19.5% according to the current NBM methodology, and will decline in subsequent periods. Low credit penetration into GDP indicates upside potential. The digitalization of banks has accelerated globally and has spurred the use of mobile banking services. New self-service options are available to customers and major competitors have succeeded in this (impact on penetration and lending strategies of all banks). The banks will continue major infrastructural investments preparing for the future and post war context.

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