



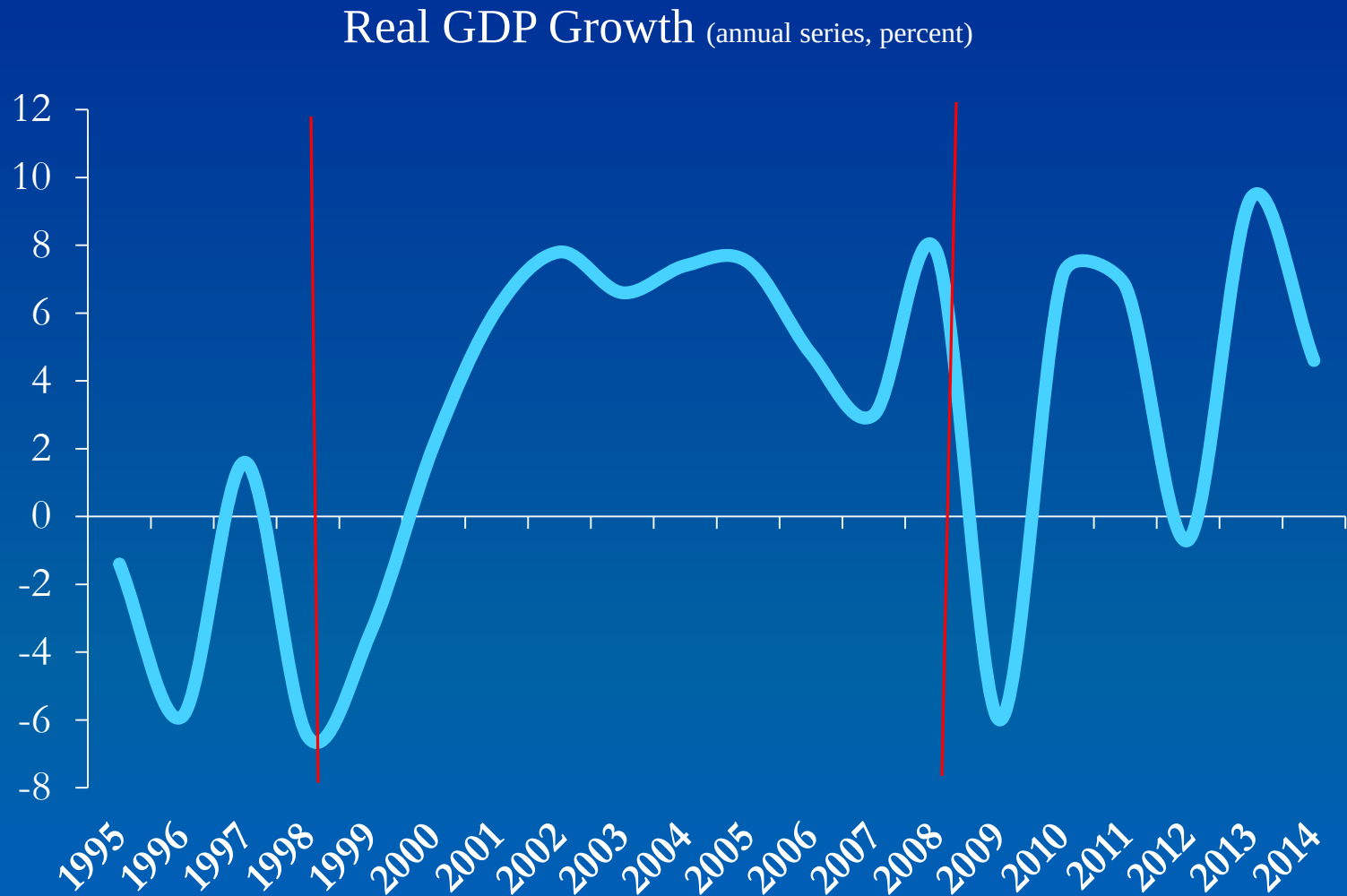
Fixing financial sector fundamentals—how to win back confidence and growth

Armine Khachatryan, IMF Resident Representative
MACRO-conference, Expert-Grup
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Presentation Outline

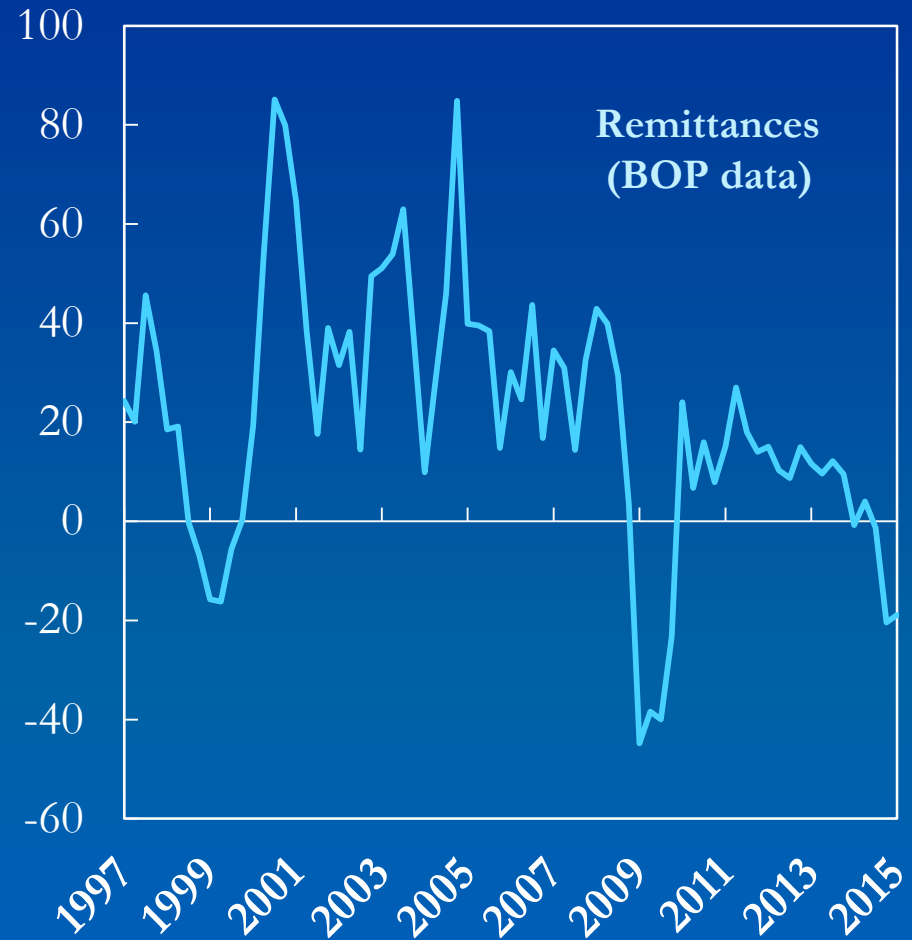
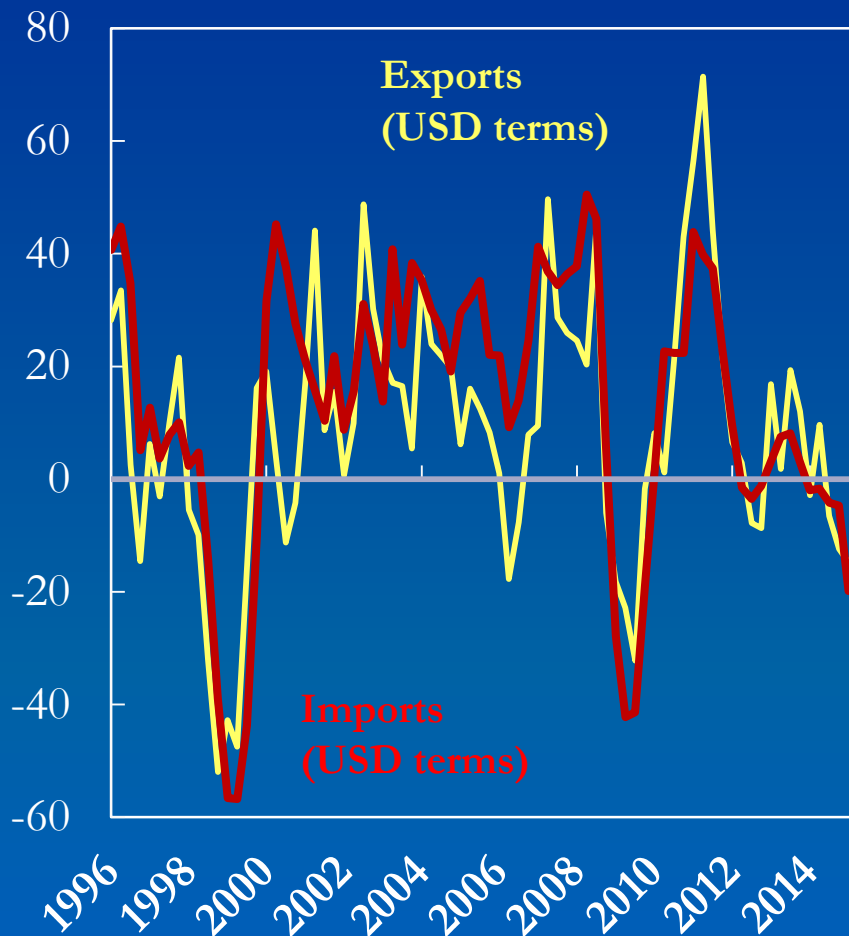
- Overview of macroeconomic developments
- Why is financial sector important?
 - Key characteristics of financial sector in Moldova
- Key challenges facing Moldova's financial sector
- Solutions

Moldova's growth is highly vulnerable - prone to several external and internal shocks

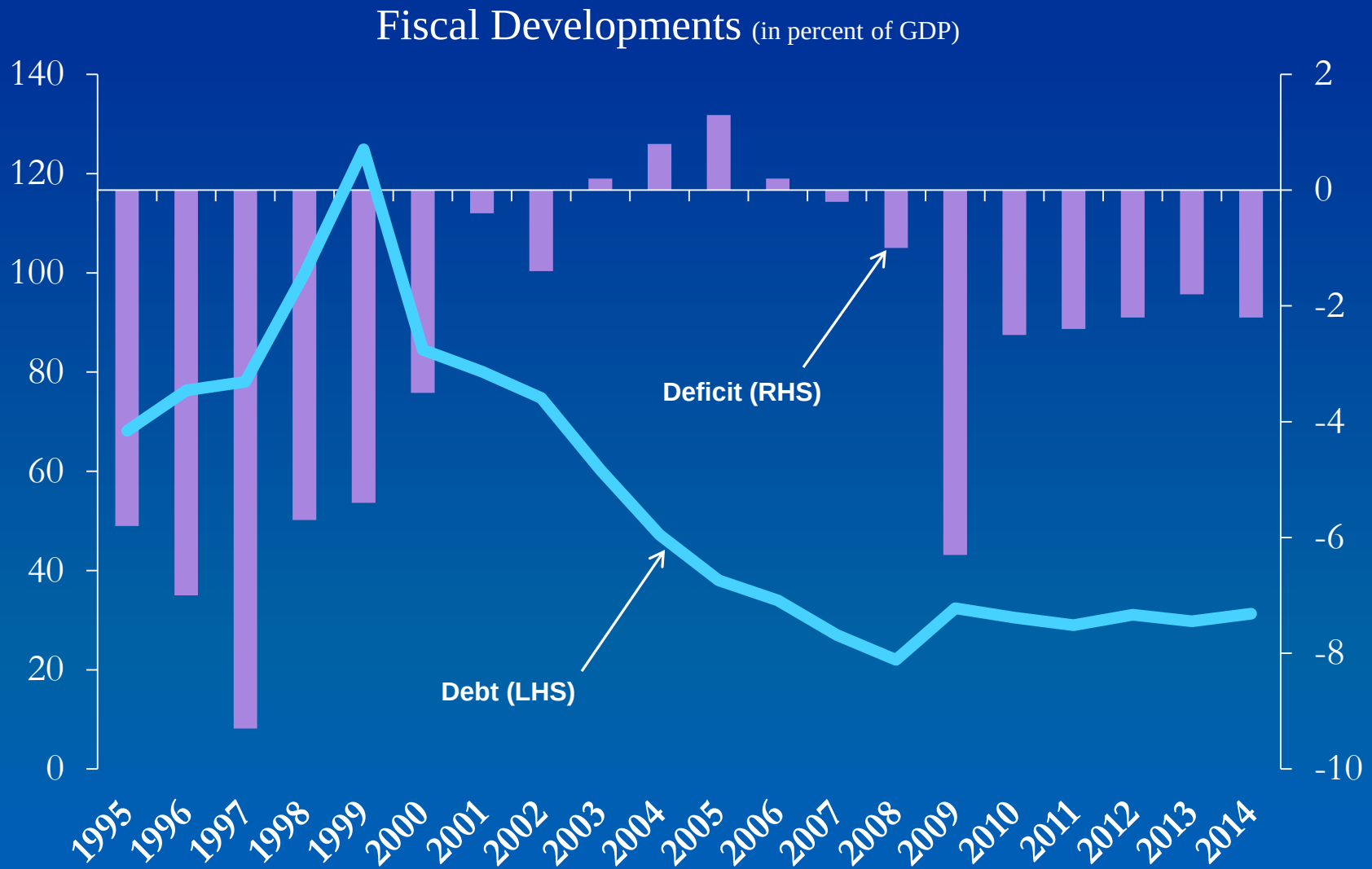


Economy is highly dependent on trading partners and remittances

(quarterly growth rates, annualized, percent)

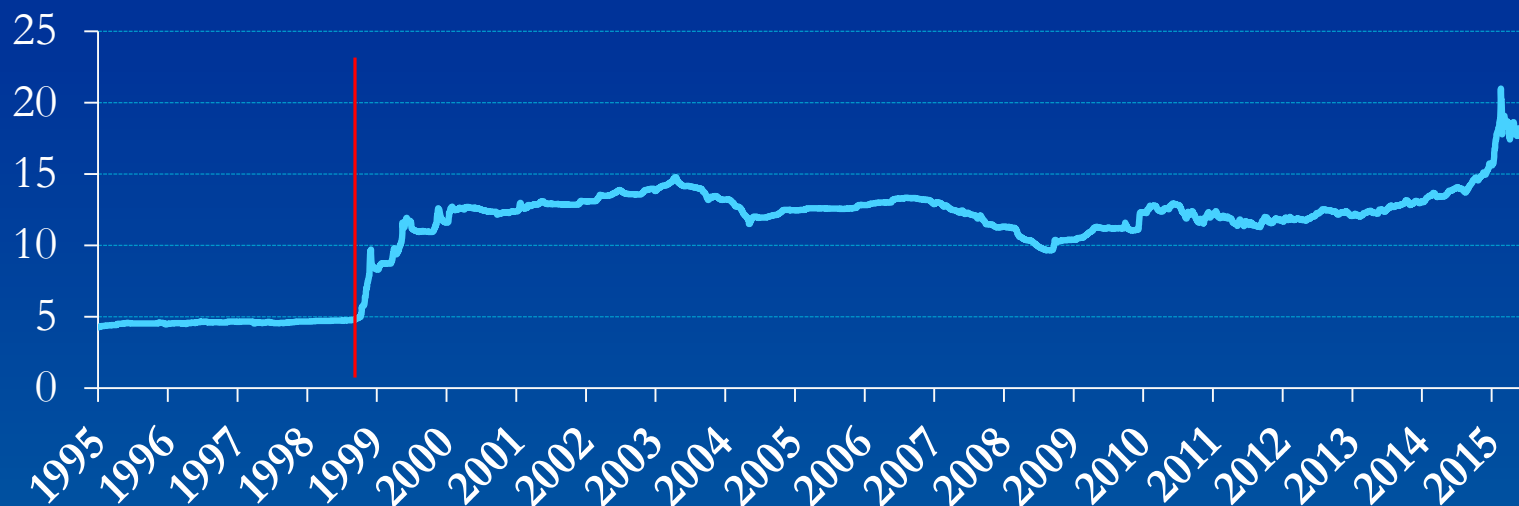


Fiscal consolidation is uneven, weakened by political cycles

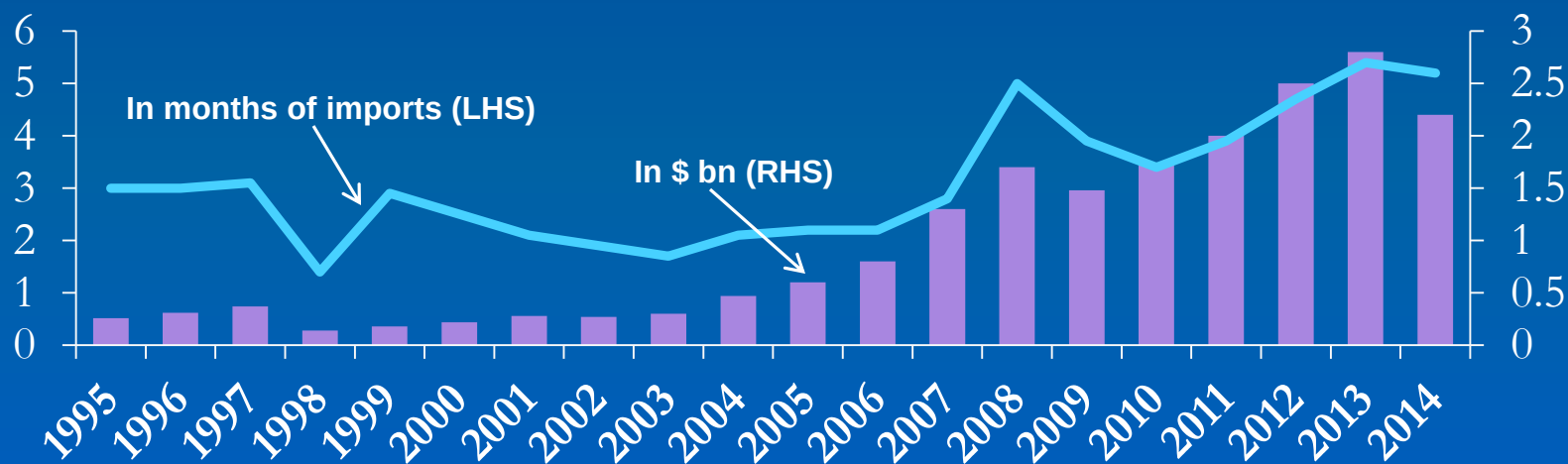


Macro-financial vulnerabilities mirrored in exchange rate and reserves dynamics – serving as buffers for shocks

Exchange Rate (nominal, daily plotted, MDL/USD1)

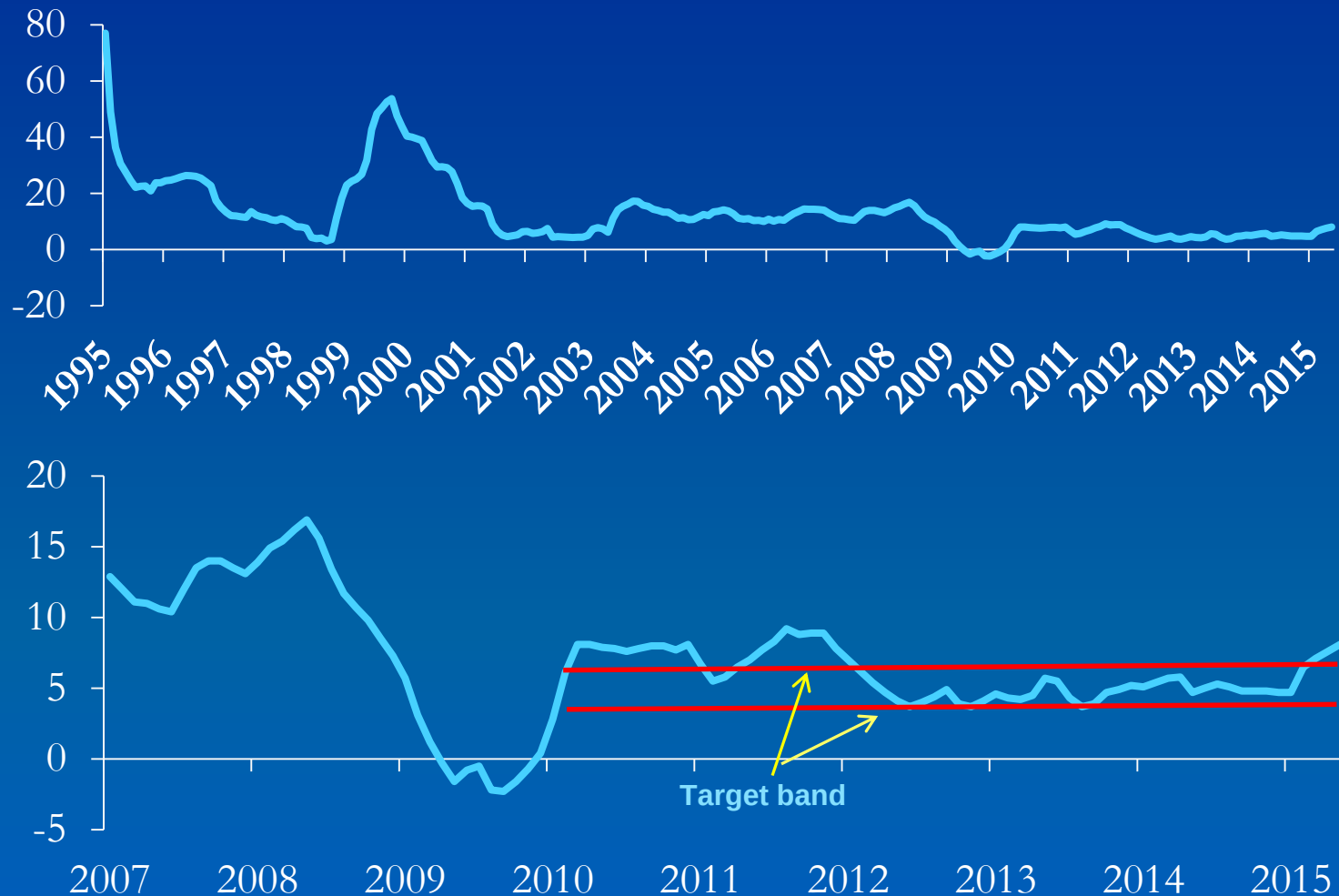


Gross International Reserves

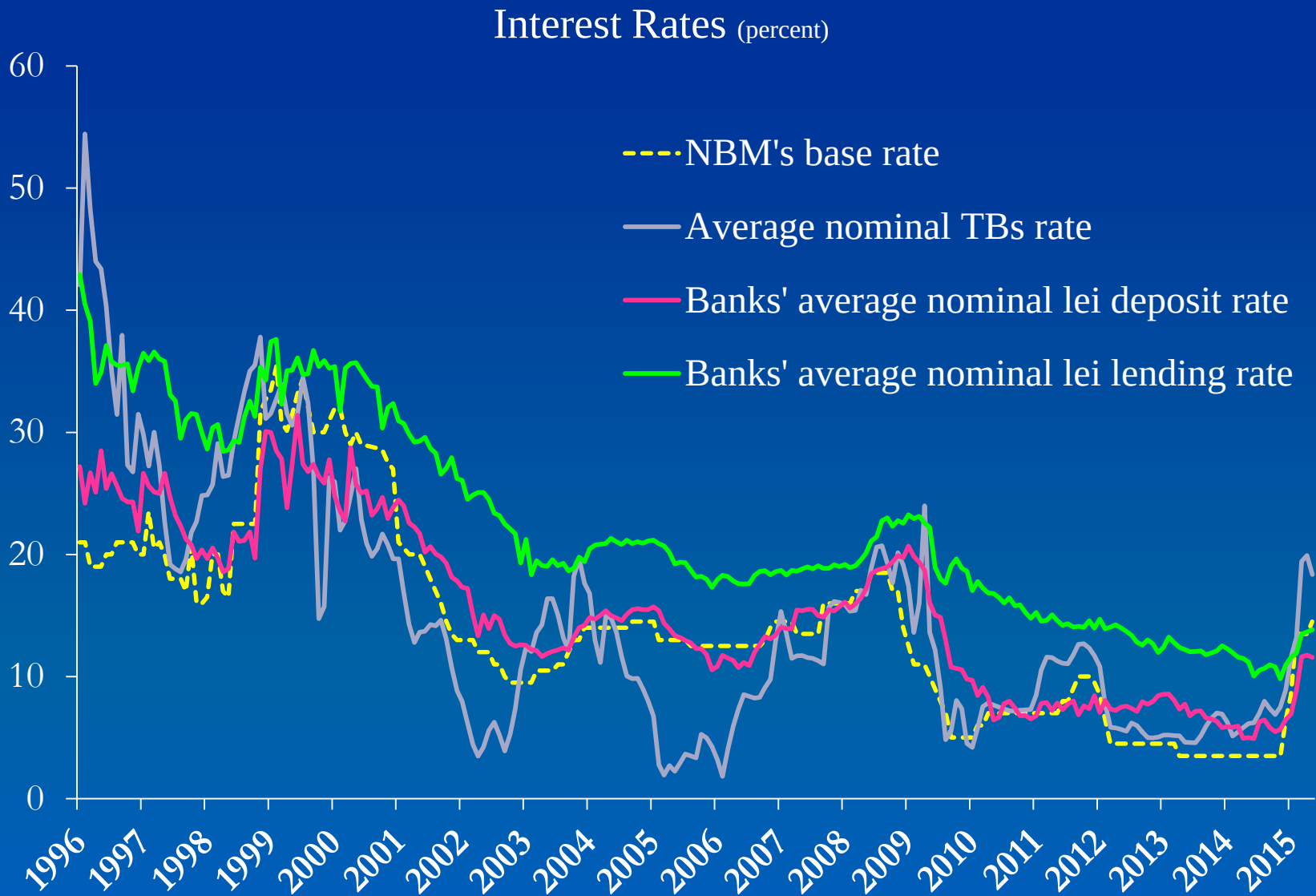


The inflation targeting framework served NBM well, but its further success is at risk

Consumer Price Index (12-month percent change)



Interest rates are on the rise reflecting increase in risks and uncertainty



A well-developed financial sector can help boost economic growth

Finance sector can help:

- Channel financial resources and improve resource allocation
 - Facilitate diversification and management of risks
 - Enhance countries' resilience to shocks
- and finally...*
- Help boost economic growth

Banks have a unique role: Why?

Banks make profit NOT by producing goods:

- Banks are dealing with savings and financial resources of the third parties
- The asset activities of banks face asymmetric information and moral hazard issues and make banks subject to overall opacity.
- Banks are tasked with risk diversification and management

Sound corporate governance in banks is fundamental

- Key to safeguard financial stability of the system
- Determine health and ability of banks to survive economic shocks
- Good governance in banks leads to:
 - attraction and allocation of financial resources in an efficient way;
 - spreading effective governance over the companies that banks are funding.

Banks' uniqueness requires type of regulatory governance that provides right incentives for good governance in banks

Key ingredients of good regulatory governance and supervision are:

- Regulator independence –combined with - accountability
- Transparency in actions and decisions
- Measures to ensure integrity of regulator's staff

As we try to make the financial system safer, we must inevitably confront the problem of moral hazard-B.Bernanke

- What is moral hazard?
- How government intervention to bailout financial institutions affects risk taking appetite and consequently moral hazard?
- What is the solution to moral hazard in the financial sector ?

Costs of bad governance and supervision are high...

- Increase in economic and financial volatility
- Increase in vulnerability/crisis risks due to promotion of greater risk-taking and leverage
- Increasing costs of capital acquisition and investments (including lower FDI), thus very high costs on society

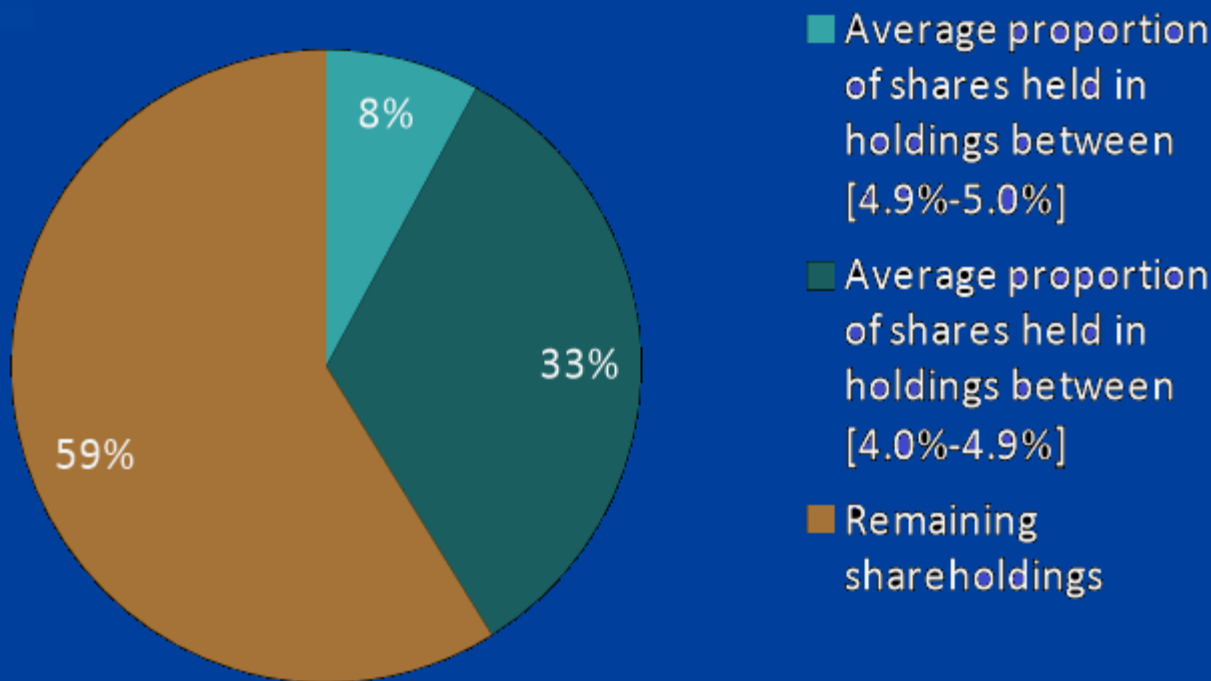
and finally...

- Hinders overall economic growth

Key characteristics of the financial sector in Moldova

- Financial sector is dominated by the banking sector, non-bank financial institutions and markets are still small and underdeveloped
- Competition is limited
- Corporate governance in the financial sector (particularly banking) is a major concern, foreign participation/strategic investors in banking system remains limited
- Framework for enforcement regulatory requirements remains weak resulting in culture of regulatory forbearance
- Moldova is a textbook example of moral hazard

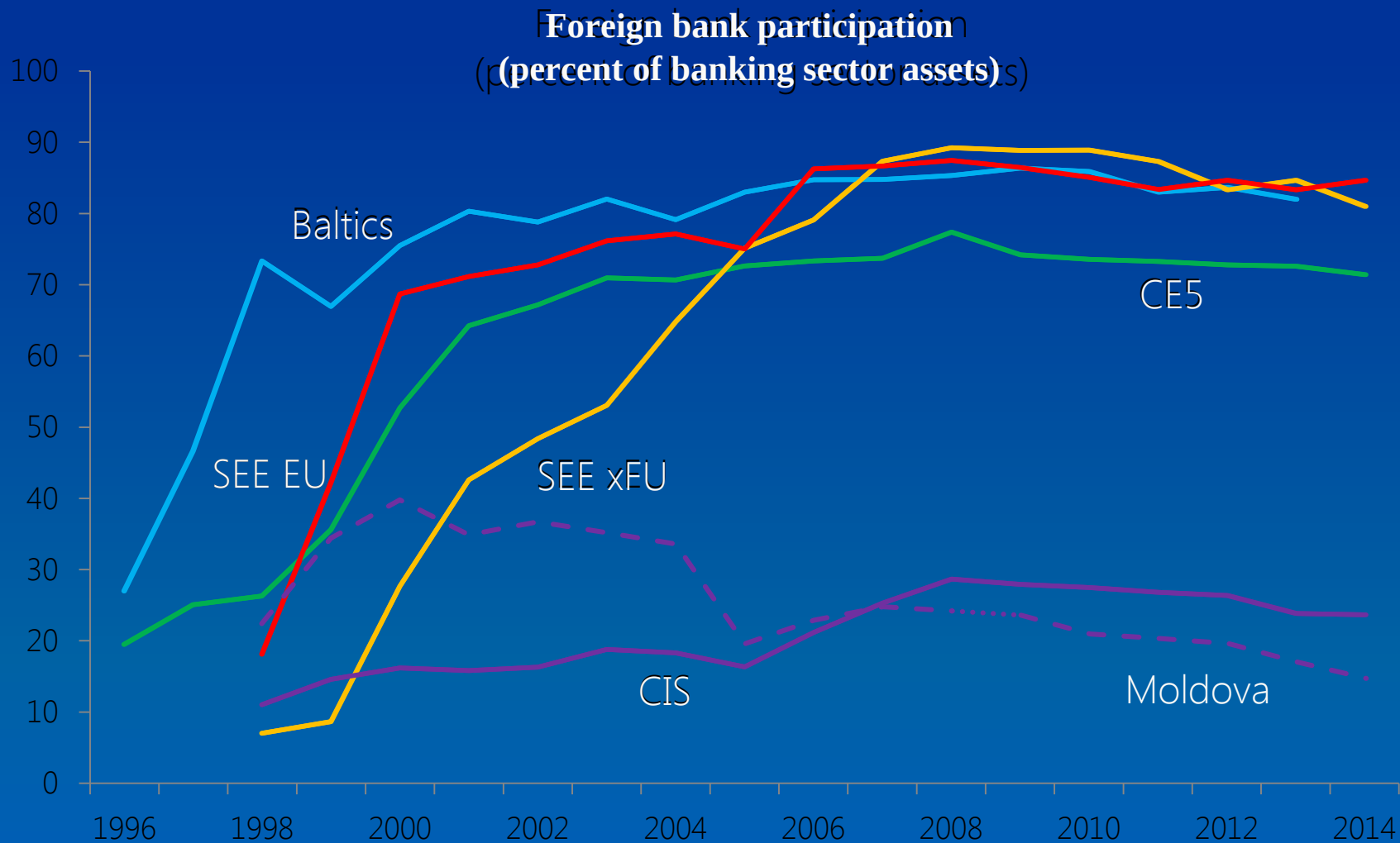
Shareholding of Moldova's 5 main deposit taking banks



Source: NBM; public information on banks' websites and staff estimates Agroindbank, Moldindconbank, Banca de Economii, VictoriaBank Banca Sociala

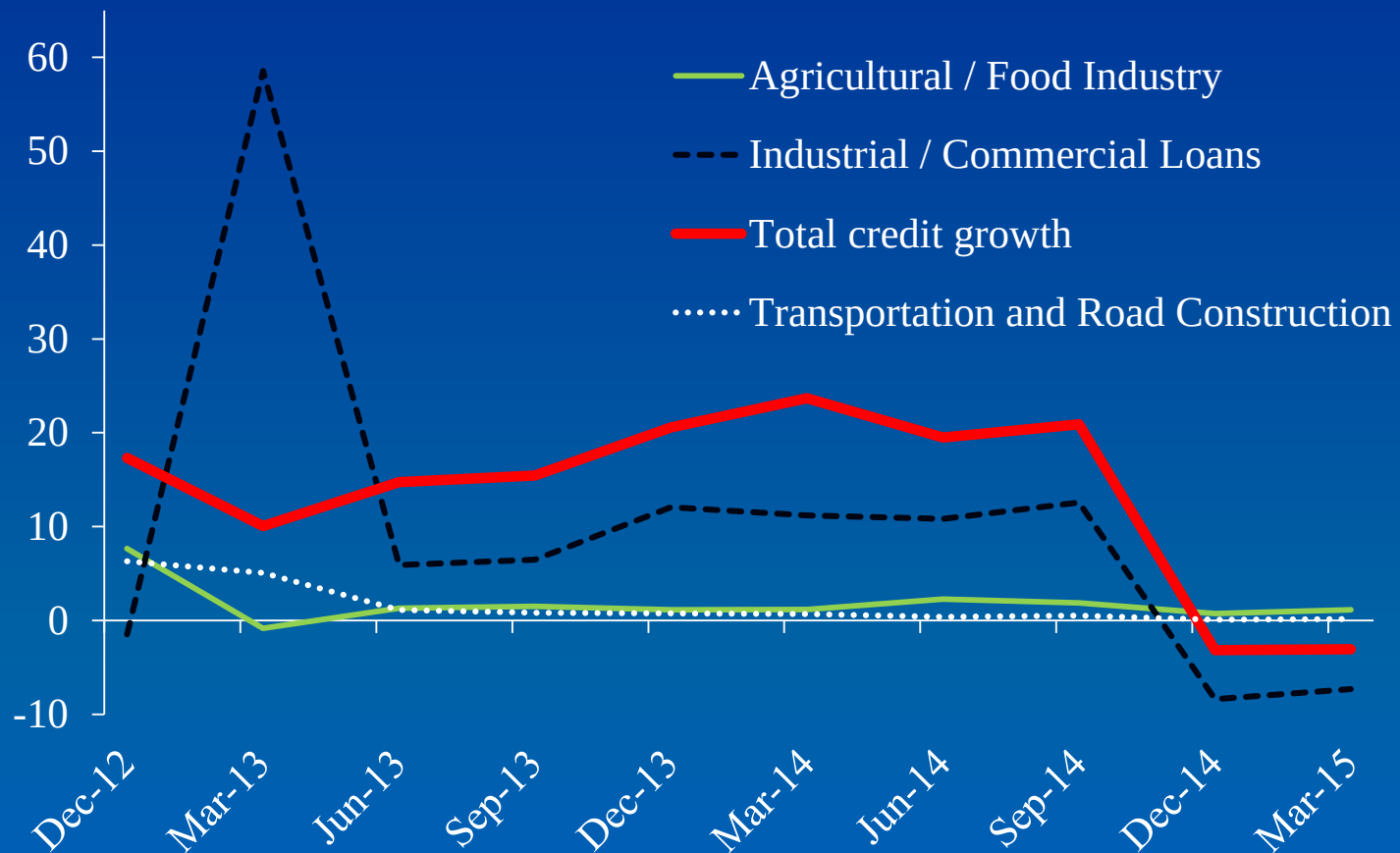
Foreign bank participation lags behind the peers

(Moldova data treat with caution)

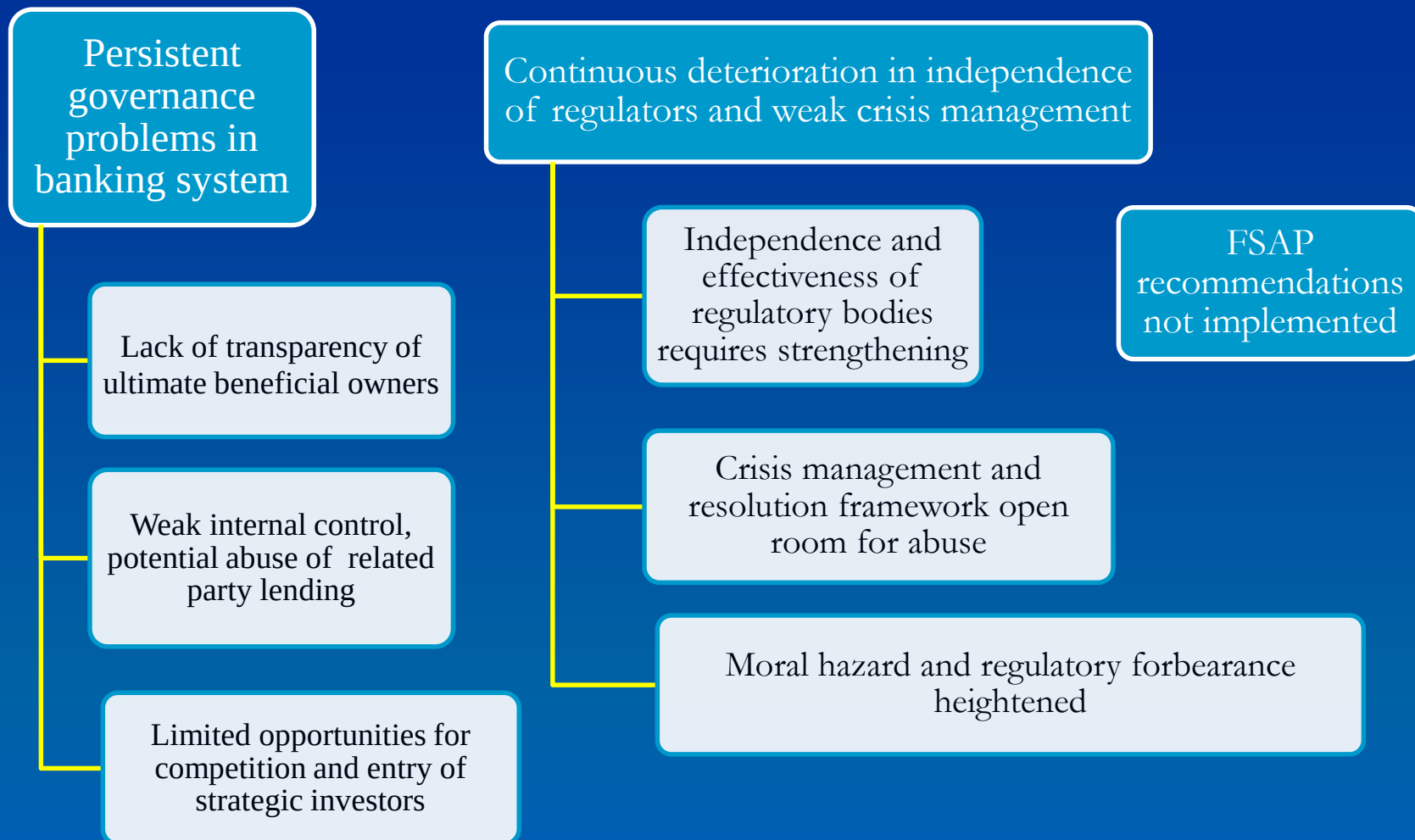


Credit growth has been driven by commercial loans

(y-o-y, quarterly)



IMF consistently flagged key challenges and risks in Moldova's financial sector



Problems persist throughout years



“Opaque ownership, NBM independence, BEM”— repeated words in IMF reports

Staff Report, Feb-2005

- A recent FSAP highlighted several weaknesses in the financial sector, including increasing government influence, opaque ownership structures, and governance issues arising from the lack of strategic investors.

Staff Report, May-2006

- The authorities and staff agreed that NBM independence needs to be strengthened
- FSAP pointed to a lack of transparency in bank ownership, a concern echoed by the EBRD.
- Opaque ownership increases the possibility that the NBM will miss instances of related-party lending.

Staff Report, Jan-2007

- Authorities agree that greater banking sector transparency will be essential to further financial sector development.
- The authorities are making progress toward privatization of Banca de Economii (BEM) to a strategic banking investor.

“Opaque ownership, NBM independence, BEM”— repeated words in IMF publications

Staff Report, Apr-2008

- Insufficient transparency of bank ownership continues to hamper development.
...
- To address the remaining weaknesses in transparency of bank ownership, the NBM will step up its efforts in identifying beneficial owners and study best international practices, especially those of EU countries, in applying ‘fit and proper’ test for significant shareholders
- Authorities committed to accelerate the privatization of the majority state-owned Banca de Economii (BEM) to a strategic banking investor, long seen as critical for enhancing competition.

Staff Report, Oct-2012

- The events at BEM and previous legally dubious takeover attempts of Moldovan banks call for improving the judicial system and achieving greater transparency of bank ownership.

“Opaque ownership, NBM independence, BEM”— repeated words in IMF publications

Staff Report, Jul-2014

- There are indications of active concealment of banks ultimate beneficial owners and controllers.
- ...the NBM must re-evaluate bank shareholders to ensure disclosure of ultimate beneficial owners and controllers....enforcement of the AML/CFT framework needs to be strengthened.
- The ability of regulators to take action is constrained. ... underscored the importance of respecting the independence of regulators from political interference and advised to urgently pass legislation to fully restore the NBM and NCFM's regulatory powers....Legal protection of board members and employees of these agencies should also be strengthened. In turn, these agencies need to resolutely enforce regulatory requirements.
- Staff recommended that the NBM maintain a high level of scrutiny of BEM's operations...Welcoming the launch of a diagnostic study of BEM's financial situation by an external auditor...Staff advised to initiate inspections in the other two banks without delay and, in due course, carry out an assessment of the financial situation in all other banks.

“Opaque ownership, NBM independence, BEM”— repeat words in IMF publications

Staff Report, November-2014

- Overall, little progress has been made in implementing the recent FSAP recommendations. The recommendations aim at strengthening the financial stability framework, bank governance and supervision, the crisis resolution framework, deposit insurance system, and financial market infrastructure.
- Efforts should be pursued to ensure effective verification of beneficial ownership. The NBM currently lacks effective tools to verify the information disclosed by banks and to determine whether shareholders are acting in concert below the specified shareholding thresholds.
- Staff strongly recommended to ensure disclosure of banks’ ultimate beneficial owners and controllers to the NBM and reassess whether they meet fit and proper criteria, and to strengthen the effective implementation of the AML/CFT framework.

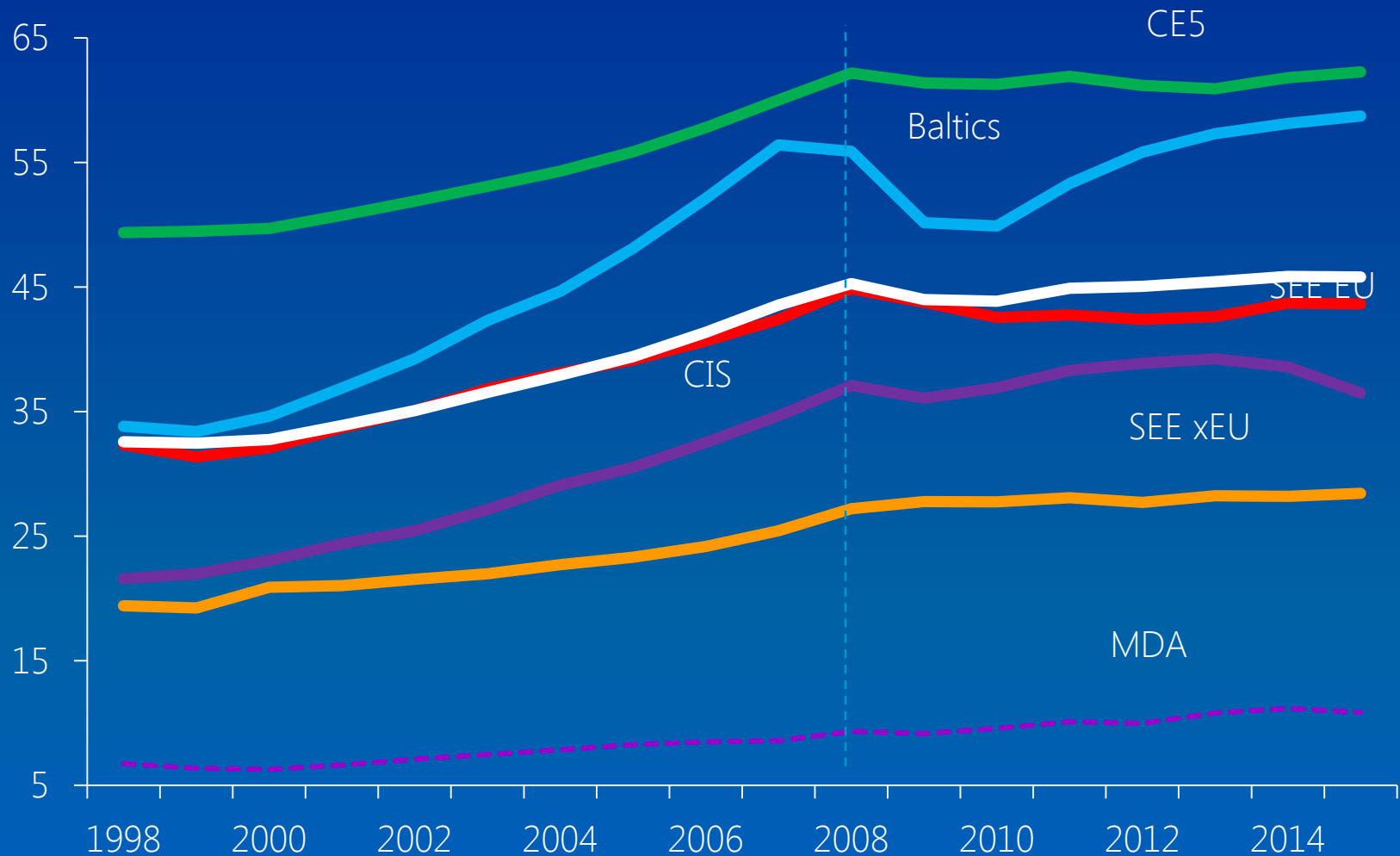
After all...

HOW MOLDOVA COMPARES WITH ITS PEERS?

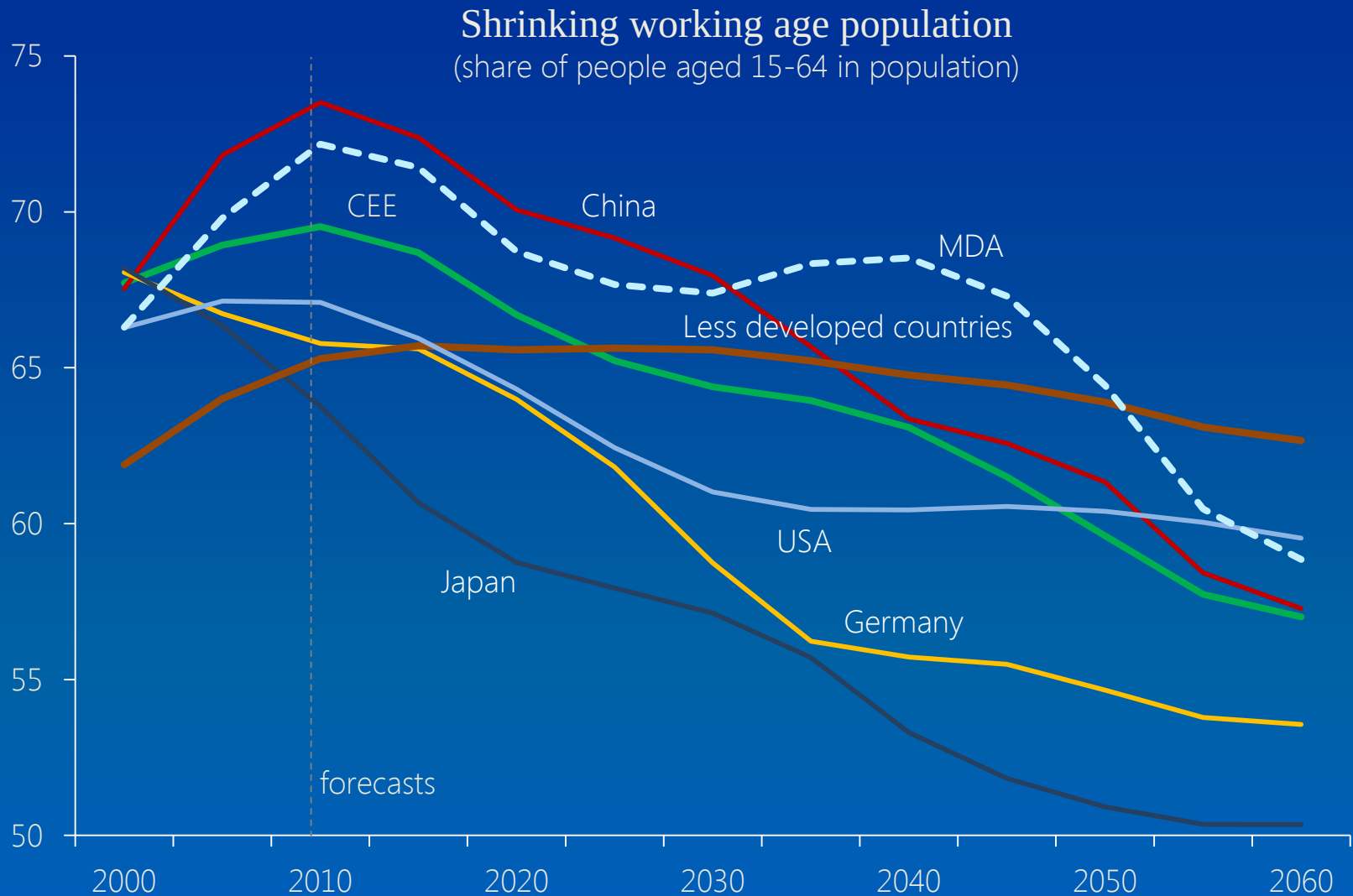
(based on IMF project on 25 years of transition)

How Moldova compares - growth and convergence

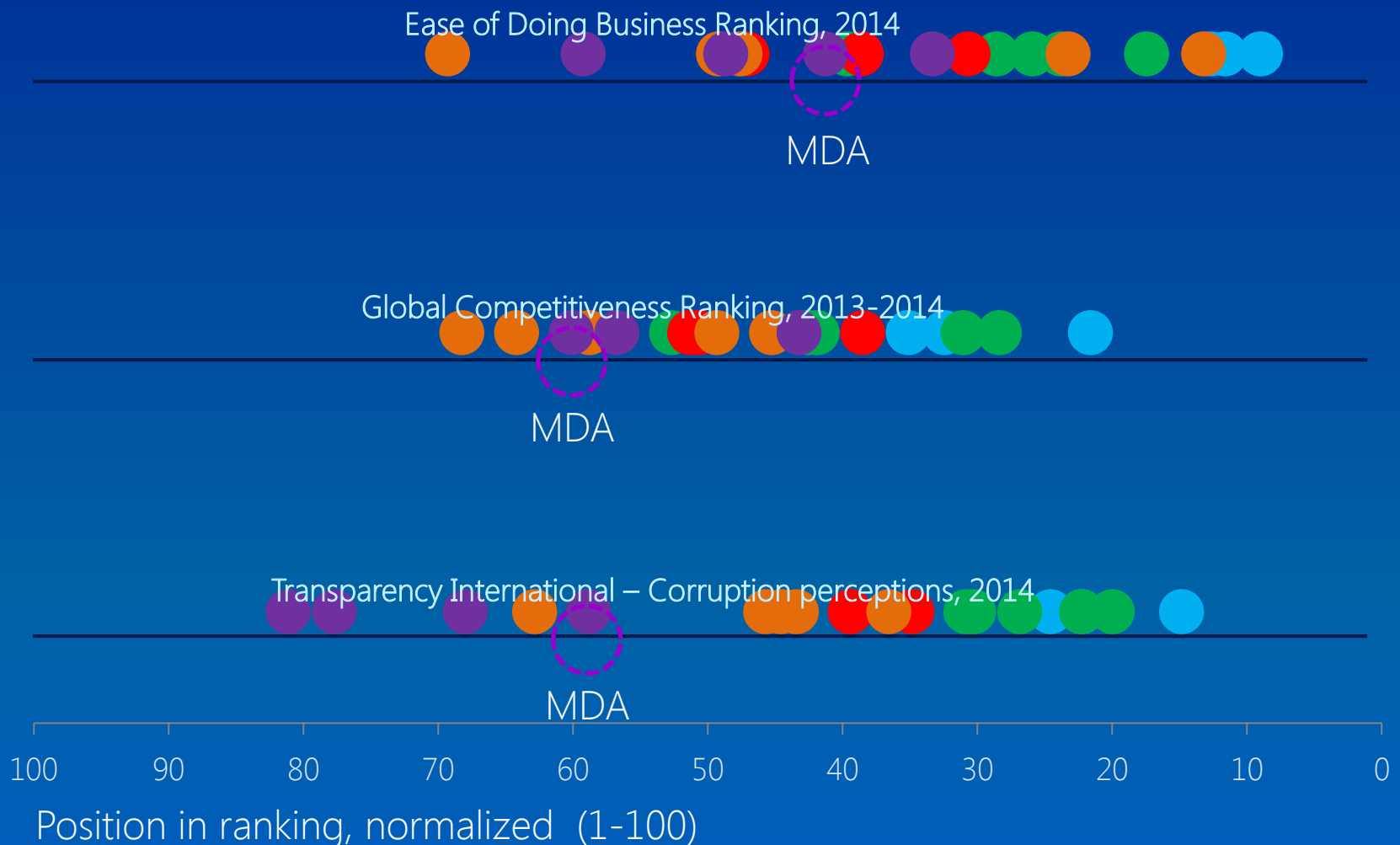
Percent of advanced economy average GDP per head at PPPs



How Moldova compares - demographics



How Moldova compares - structural reforms/business environment



WHERE TO GO FROM HERE?
HOW TO RESTORE CONFIDENCE?

FIXING FUNDAMENTALS OF ECONOMIC GOVERNANCE - MACROCRITICAL

Build strong institutions

Strengthen the rule of law, impose zero tolerance to corruption

Economic governance Williamson (2005) the 'study of good order and workable arrangements'. This includes the institutions and organizations that support economic transactions by protecting property rights, enforcing contracts, and organizing collective action to provide the system of rules, regulations, and information that are needed to lend feasibility or workability to the interactions among different economic actors, individual and corporate.

Improve business/regulatory/ investment environment

Strengthen independent media

Fund advice covers key aspects of economic governance

Short-term

- Enable NBM and NCFM to effectively regulate banking /financial system
- Enhance governance and risk management in financial sector
- Seek for crisis resolution options that would NOT undermine NBM ability to control inflation
- Improve financial safety nets and crisis management framework
- Foster the development of the debt and interbank money market
- Refrain from measures eroding tax base, and distorting resource allocation
- Ensure cost recovery level of utility tariffs and enhance targeted social assistance

Medium and long-term

- Strengthen further banking / financial sector regulation and supervision
- Strengthen inflation targeting framework
- Continue medium-term fiscal consolidation to ensure debt sustainability
- Provide efficient framework for resource allocation, and burden sharing (including taxation, wage policies, pensions reform, etc.):
- Foster sector restructuring/reforms, privatization and competitiveness

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THANK YOU!