

Business & Economie

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Summary

Developments concerning **Regulatory Framework** in June were rather intensive, as a number of important legislative and normative acts were passed. The most important evolution refers to the amendments undertaken to the Law on Budget, through which the revenues and expenditures were supplemented with additional 620 million lei each. There were also adopted legislative amendments inducing the set up of a new institution – the National Commission of Financial Market – which will supervise the non-banking segment of the market. Another significant evolution which can fuel powerful debates refers to the draft law on amendments to the Law on granting licenses to specific types of activity, where the Government comes with the suggestion to increase ten-fold the fees for the license on import of tobacco items and to introduce a tax for the license on importing the mineral water.

In May the **industrial production** registered an increase of 18.9% in comparable prices as compared to May 2006. Thus the production volume came close to the level registered during the similar period in 2006 – a fact that makes us think that in June-July the industrial recession is going to be totally overcome. The lack of certitude regarding the resumption of alcoholic beverages' export to Russian Federation remains to be the main constraint that hinders the fully-fledged recovery of the Moldovan industry in short term.

The available statistical data reveal a continuous worsening of the situation in the **agricultural sector**. The drought has compromised over 40% of grain yields, and the sugar beet growers are affected in a share of 90%. The general context points out that farmers have concluded contracts with „Apele Moldovei” Concern for irrigation services only for 32 thousand ha and agricultural producers totally ignore the subsidizing possibilities for insurances against risks in agriculture.

The **services sector** has continued its trend of quick progress being supported by real revenues increase. New trends are figured out on information services market, when more and more local companies come to acknowledge the need to be well equipped and to adequately use the opportunities offered by computers and Internet. The services sector was marked by some “in force” interventions from the State Agency for Civil Aviation in realm to the activity of some operators so as to overcome management drawbacks or even eliminate the security risks by withdrawing fly licenses.

June has witnessed the most restful evolution of consumption **prices**. The price rise of 0.7% and

respectively 0.2% for non-food goods and services was compensated by the price drop by 1.3% for food products and resulted in zero monthly inflation. While having a cost decrease for fuel in April, the months of May and June have been affected by the new waves of price rise which were most painfully felt in the agricultural sector. The most serious short-term inflation factor continues to refer to the drought influence upon the agricultural sector and the prices for grain and vegetables.

The real increase of **wages** in economy continued. In May, the average wage in economy has risen over the threshold of 2000 lei, although the sectorial and geographical deviations for the given average are too high to consider it a good indicator. In June there were published the statistical data regarding the unemployment for the last quarter of 2007 and 2006. Both reports mention youth unemployment as being the most worrisome problem and this phenomenon is continuously fuelling migrants' outflows. As a result, the overall unemployment rate in the economy counts for a rather decent level in between 7% and 8%.

In June the increase of state **budget** revenues has exceeded the planned level, the average daily accumulations counting for 44.9 mil. lei, which is with 29.8% more than in 2006. Thus, after five months, the budget revenues have exceeded by 12.1% the previewed level and by 36.9% the level registered in January-May 2006. As a result of Law on State Budget revision, there were increased the allocations for wages, gas supply, construction of the railroad segment Cahul-Giurgiulesti, and roads' rehabilitation. At the same time, the main problem in the field of public funds still goes to the issues of transparency and institutional efficiency while using these resources. Although benefiting in June from budget resources and private funds from the foreign investors, roads' rehabilitation remains to be a Moldovan Eldorado for funds embezzlers.

No important changes occurred during the respective month within **monetary policy**. The National Bank maintained during these summer months a rather precautionous and optimistic stance. The inflation ranks for the time being within the interval set for by the NBM. The exchange rates fluctuations allow completion of official foreign exchange reserves. At the same time, due to the increasing trade deficit, the imports' coverage with foreign exchange reserves did not improved in real terms.

During May-June the **banking system** continued to expand – a fact confirmed also by NBM report on financial indicators for January-May period, which reveals a growth of banks' influence on the real sector of the economy. Banks' capitalization is on the rise, going hand in hand with the process for property rights redistribution through sale and purchase of bank shares. It should be noted that meanwhile the banks do not haste to reduce essentially the interest rates to be paid and levied. In May and most probably in June as well, the lending and deposits rates have actually gone up. This speaks up either for some problems with short-term liquidities (indicated also by the price rise for inter-banking credits) or for the existence of some pronounced inflationary anticipations.

On the **financial market** the investors had to choose between the state securities which become more attractive and the stock market with the stable demand for bank shares and record level of dues. In June there was approved the Regulation regarding the procedure for legalizing the capital on the transferable securities market and completed the Regulation regarding the activity estimating the stocks and the afferent assets – all of these acts having the aim to implement the legislation provisions regarding capital legalization. Nevertheless, it is once again noted that the most important event in June refers to the approval of the set up for a new institution to regulate the financial market – the National Commission of Financial Market. Taking into account the importance of the new structure (equivalent practically to the one of the National Bank of Moldova), its responsibilities should be very clear and the regulatory skills should prove the highest possible level.

According to our estimations regarding the **foreign trade**, in January-June 2007 the goods exports continued to exceed the levels registered during the similar period from the last year with 23% and imports – with about 40% more. As a result, the trade deficit during January-June has gone up to almost 1,025 billion USD, being thus 1.5 times higher as against January-June 2006. At the same time the level of imports' coverage with exports is progressively decreasing, counting for about 37% during the respective period.

During June the price for **oil** (WTI) remained to be volatile, but on growth trend, with price passing the level of 69 USD/barrel for the first time since 2006. American commercial oil reserves and the end of the strike in Nigeria pushed prices downwards while the persistence of petrol deficit in USA, the geopolitical risks in Middle East and the nationalization of oil facilities in Venezuela pushed prices in the opposite direction. The International

Agency for Energy has revised its forecasts for oil global consumption upwards by 2%. The prices will remain volatile and the trend for slight price rise will persist in the near future.

The forecasts for **wheat** yields 07/08 are continued to be negatively affected by the adverse weather conditions, especially in Ukraine, the south regions of Russia and South-Eastern Europe. The forecasts for Canada harvest are on downside as well, but mainly due to crop area reduction. On the other hand, the expectations are more optimistic for the United States and Australia.

In June the dollar rate against **euro** was marked by contradictory trends. The first half of the month was characterized by rate correction trend, respectively dollar position strengthening as was already observed by the end of May. Investors' deposits were mainly modeled by the expectations to have a revival of the American economy. At the same time the markets were relatively indifferent to the economic news from the European continent, waiting for the cyclic increase factors to be on the American part in the near future. But the second half of June was marked by the strengthening of the European currency. The economic data from the United States showed that the expectations regarding the „economic revival” of the American economy proved to be premature. Thus, the dollar again started to fall against the European currency, coming close to 1.357 as compared to euro. The majority of experts anticipate that the pair would evolve around the level of 1.35 dollars / euro.

The **Russian** economy increased during January-June by 7.7% more as against the same period in 2006. The growth was chiefly driven by investment demand, constructions and industry. The consumption demand remains strong, especially for imports.

The **Ukrainian** economy is growing lively due to the private consumption and exports. The economic evolutions from Ukraine are fueled by the favorable circumstances on the market of metallurgic and chemical products, fiscal relaxation and flexible policy of the exchange rate. On the other hand, the agriculture witnessed a rather weak growth during this period when the drought conditions were affecting largely the grain harvest and probably will lead to a more difficult situation in the respective sector.

The economic perspectives for the **European Union** remain good being supported by the demand of consumption and investments. The new member sates as Lithuania, Estonia and Slovakia prove to be the most dynamic. The appreciation of the European currency

had an insignificant impact on exports due to the persistence of the high demand for European exports. But the growth rate will be most probably somehow slowed down during the second half of the year.

The **Romanian** economy continues to enjoy robust growth, which is supported by the positive dynamics in industry, retail trade and services. At the same time, the managers' expectations regarding the evolutions for June-August period are positive for all the major sectors of the economy.



Regulatory Framework

In June a series of important legislative and normative acts were adopted. Thus, due to the registry of the budget surplus during the first five months, the Law on State Budget for 2007 was amended under the chapters referring to revenues and expenditures which were increased with an amount of 620 million lei. Unfortunately, based on previous precedents, it is hard to believe that the additional public funds would be transparently targeted by expenditures categories, especially in such fields as roads' reparation, gas pipe lines construction and farmers' subsidizing.

Another event is related to the Parliamentary Commission's endorsement of the law draft on industrial parks, approved by the Government on the 14th of March 2007. The authorities' intention to ensure the localization of high value added production activities and to hasten the more efficient management and revitalization of public property goods from industry is very welcomed. (The parks will be established based on state and municipal enterprises as well as on free lands under state ownership for at least 50 years and on a minimum area of 10 ha). At the same time, on the basis of a sober analysis of Romanian and Bulgarian experience, we consider that the state will not be able to observe its commitments referring to contribution with its own resources for all support infrastructure of the industrial parks, taking into account the large volume of funds necessary to fulfill these goals and the foreign invertors' carefulness. Therefore, the viability of industrial parks goes for a long term perspective.

Some extremely important changes occurred regarding the financial market regulatory framework. On the 7th of June legislative amendments leading to establishment of a "mega-regulator" of the financial market were passed. The new institution – The National Commission of Financial Market – is set up based on the merging of the National Securities' Committee with the State Supervision Service for Citizens' Savings and Credit Associations and the State Inspectorate for insurances' control. But let's remind ourselves the similar fusion that took place in 2002, which involved a number of supervision and control bodies and resulted into the establishment of the Center for Fighting Corruption and Economic Frauds. For the time being, in spite of some positive trends, the corruption phenomenon remains wide-spread. In order to avoid the previous experiences, the National Commission of Financial Market should

become more efficient through optimization of the organizational structure and hiring high-qualification specialists, contributing thus to the settlement of difficulties encountered by the non-banking financial market subjects.

A rather bad news for tobacco and mineral water importers occurred on the 13th of June, when the Government approved the draft amendments to the Law on granting licenses to some types of activities, where it comes with the suggestion to increase by 10 times the fees for license granting the right to import tobacco items (from 20 thousand up to 200 thousand lei) and to establish new license fees in the amount of 100 thousand lei for the mineral water importers. Japan Tobacco, the third world top producer of tobacco items has already expressed its disapproval of the given decision considering it to be discriminating, as it is applied through administrative methods so as to limit the access of imported goods onto the market.

On the other hand, the disapproval is totally well grounded if duly paid annual fees and high excises for tobacco are taken into account. At the same time, Government's decision may be explained by the ratification, earlier this month, of Tobacco Convention which prohibits cigarettes advertising, as well as by intention to protect Tutun CTC from foreign competition along with possibility to receive more budget revenues through these measures.

Industry and Constructions

In May the industrial production registered an increased of 18.9% in constant prices as compared to May 2006. It is to be mentioned that the growth rate accounted for 5.8% in April 2007 as against April 2006. Thus, the continuous trend of stability and appearance of some perspectives for sector revival is obvious. The following industrial branches registered the most important progress: stone cutting, shaping and finishing (2,2 times increase), production of optical, precision, medical tools and equipment (1,6 times), manufacturing of medicines and pharmaceutical products (1,5 times), manufacturing of paints and glosses (30,9% increase), manufacturing of finished metal products (28,1%) and extraction industry (19,7%). It should be mentioned that the branches witnessing the most dynamic growth are not necessarily the most important ones from the perspective of contributions to the industrial production.

That is why the increase of industrial production is for the moment not sufficient to compensate the decline

registered a year and a half ago. During the first five months the production of wine registered a 2,5 times decline, distilled alcoholic beverages – 2,1 times fall, manufacturing of machinery and equipment – a 10% decrease, thermal and electrical energy production – 7,7% decrease, manufacturing of tobacco items – 7,3% decrease. It is to be noted that the decline was registered in a number of industrial branches. During January – May, the volume of industrial production was by 1.6% lower than the one registered during the similar period in 2006. In other words, now the industry is just at the same level it was before the crisis.

The decrease of wine and alcohol production was influenced by the going-on uncertainty in realm to the exports to Russia, when a number of companies found themselves in a critical situation being forced to cut over 50% of personnel. This proves once again that the focus of Moldovan wine enterprises only on one sale market turned to be their biggest strategic error which was also emphasized by the admittance of low quality production on a market where they held 60% of sale volume. A lot of local consumers had already the chance to “enjoy” of testing some unsold wines or the ones that were returned from Russia to the in-country shops.

As for constructions, it should be mentioned that after the first five months the real estate market is witnessing now a relative respite, when the number of transaction with luxurious apartments and flats with a lot of rooms is rather small. Although during January-May the number of purchasers decreased, the construction pace is still increasing. At the same time, the construction regulatory framework continues to induce serious problems, such as the period for obtaining the authorizations and giving constructions into exploitation. The fall of buyers' number could be explained by the fact that a lot of them have actually legalized their stay in the countries they are working in, so they have no intentions to come back to Moldova in the near future. At the same time, it should be pointed out that the trend to get families reunited abroad becomes really strong. As a result, the need to procure real estate has gone down. That's why in the near future the construction companies will have to offer new bonuses and discounts so as to maintain the sales.

Agriculture

As a primary sector of economy, agriculture was heavily affected by drought in June. As a result, there are big losses: 22% of sown areas were processed or mown and the estimates for grain yields

decreased with over 40%. The situation of sugar beet growers is alarming as well, as a share of almost 90% of them could go bankrupted. And all this going on when farmers have concluded contracts with „Apele Moldovei” Concern for irrigation for an area of only 32 thousand ha, that is just 50% of the area accessible to irrigation, taking into account the existent equipment.

In this context, the World Bank has come with the proposal to fill in wheat state reserves with at least 50 thousand tones. But the Government seems to be more cautious, promising to complete effectively the reserves with 54 thousand tones.

Thus, under the existing situation, the requests of the Association of Sugar Beet Producers seem to be fully reasonable and well grounded. They have addressed the Government with the request to declare the affected rayons as natural calamities zones, just like the neighboring countries did. The given situation proves us once again that agriculture cannot exist without grant-in-aid. EU and USA are applying large-scale subsidies even during years with favorable weather conditions. As farmers cannot pay back the credits taken previously and due to the stop since April of agricultural crops insurance (because of high risks), the Government should undertake solid efforts so as to obtain foreign support and assistance. The large losses of the sugar beet growers and the lack of financial resources could actually compromise the preparedness for field planting in 2008.

In this context, we really welcome the negotiations carried out with United Nations Fund for Agriculture and Food – the agency that organized on the 22nd of June a seminar on risk prevention in agriculture presenting the new crop species resistant to drought. As for the filling in of the Farmers' Subsidy Fund, it should be noted that the amendments undertaken during this month for the Law on State Budget for 2007 stipulate an increase with 43 thousand lei of subsidies meant for the areas affected by drought. As a result, only the farmers who have insured their harvest would receive subsidies for an amount of 22,4 thousand lei per each 100 ha. Just to note that this level is 28 times lower than the one established in France.

When taking into account that only 0.46% (8,6 th ha) out of total of agricultural plots are insured, and only one single insurance company from the country („Moldasig”) is providing insurance services against risks in agriculture, it could be concluded that our farmers are still rather conservative regarding the production process. It seems that the lesson learnt by

farmers in the droughty 2003 when a private insurance company did not fulfill its contractual obligations resulted in long-lasting effects. On the other hand, the frequent modification of the legislation dealing with grant-in-aid - when initially the state was granting subsidy for 80% of the insurance cost, afterwards for 60% so as to come back again to 80% in the second half of 2007 - represents a salient sign for lack of knowledge regarding the exact potential of the budget system. The provision of insurance services against risks in agriculture by only one single company points out the imperfections of the insurance system in the given area and the weak capitalization of the rest of companies; that is lack of healthy competition on this market segment.

Services

May witnessed the continuing natural growth within services sector, as a result of enhancing the trend to increase the remittances and wages. The retail sales registered in January-May a growth of 16.3% for private units and 12.1% - for joint ventures, and the services provided to the population – 6.5%. The highest growth rate of services (16.2%) was registered by private property units, while the joint ventures with foreign capital participation have actually registered since the beginning of the year a fall of paid-for services with 1.8% (in real terms) as against January-May 2006. Thus, services maintain the high pace, which has been specific for the last two years, while the retail sale is registering a rather slow progress.

At the same time, informational services market continues to expand. This could be explained by companies' large-scale harness of IT possibilities, especially computers and Internet. This fact is also confirmed by the outcomes of the UNDP-Moldova Project "Support in building e-Governance in the Republic of Moldova" published at the beginning of June. According to these results, almost 53.5% of companies are willing to procure PC in the following two years, that is with 10% more than the share registered last year. On the other hand, there is still a gap between the dynamics of the number of companies that have procured PC and the ones that are connected to Internet. Thus, the companies from rural area and the smallest enterprises have and will have difficulties in this context due to the high acquisition costs that will go up once the need to procure only licensed soft and to deal with the more expensive services offered by IT specialists is going to emerge.

Serious problems occurred in cargo and passenger transportation sector. It should be noted that for the first time, a number of managers from Air Moldova Company were sanctioned in public by the State Administration for Civil Aviation (SACA) for repeated perturbation of flights timetable, when admitting flight delays from 1 to 9 hours. At the same time, on the 21st of June, SACA withdrew the air operator certificates from seven air companies which are activating outside the country: Jet Stream, Grixona, Tiramavia, Jet Line International, Pecotox-Air, Valan, International Airport Marculesti and International Cargo Charter. It should be noted that this measure was taken due to a number of accidents which resulted with the aircraft destruction, human life losses and inclusion of the given companies into the "black list" of the European Commission. Thus, efforts are made in order to avoid the flight towards EU carried out by less secure companies, to have a more efficient management and to improve flights security.

Meanwhile, favorable pre-conditions to improve the quality of cargo and passenger transportation services emerged last month. Thus, on the 28th of June there was signed the Agreement for crediting the first project to rehabilitate the national roads "Moldova – European Roads" co-funded by the European Bank for Investments, which stipulates the rehabilitation of 500 km of national importance roads that are linking the East with the West and the North with the South of the country. The total value of the project is to be of about 100 million euros. The project will be carried out within 2007- 2011.

Taking into account that the cost of one kilometer of European road in EU counts for about 1.5 mil. euros, and the mentioned project is going to allocate only 200 thousand Euros, it is rather difficult to believe that the roads will be really of European standard. Moreover, it is well known that namely the projects carried out for roads rehabilitation are famous for funds misappropriation, thus affecting essentially the quality of works.

Prices

After an increase of 0.9% in May 2007, the prices remained stuck in June. This was determined by the price rises by 0.7% and respectively 0.2% for non-food goods and services which was actually balanced by the price drop with 1.3% for food products.

Cumulative inflation rate for the first half of the year counts for 3.9%, and for the last 12 months – 10.4%.

In other words, at the beginning of July the achievement of the inflationary target established for 2007 at the level of 8-10% seemed to be even more probable than it was in April-May. On the other hand, the effect of some inflation risks surfaced as well. Especially the adverse weather conditions have determined the price rise, although rather modest for the time being, for wheat and farinaceous products with about 1% and 0.7%. However, the possibility to have a more significant price rise for bread stays on up till the end of this year.

Just like during the previous months the prices went up significantly for medicines (+1.4%). Although in April there was a slight drop for fuel price (-0.7% as compared to March), the May-June witnessed again rises for fuel costs. At the same time, the pressures for the national money appreciation were felt in May-June as well and served as a basis for reducing the inflationary pressures in the economy.

Table 1. Monthly inflation rates, %

	Mar 2007	Apr 2007	May 2007	Jun 2007
The index of the consumer prices	0,5	1,0	0,9	0,0
Food products	-0,1	2,0	1,6	-1,3
Non-food products	1,0	0,5	0,6	0,7
Services	0,9	0,2	0,4	0,2
The index of industrial prices	0,5	0,2	0,8	0,7

Sources: NBS and NBM

Labor Market

During the first five months the real wage grew by 10%, counting for 2048 lei (165 USD) in May. At the same time, the wage in the budget sector counted for 1702 lei, and in the real sector – 2226 lei, which represents an increase by 14.5% and respectively– 2.1% not including April.

The quantum of the minimum wage counts in May for 900 lei per month (5.33 lei per hour) as a result of the collective negotiations between the social partners. We think that due to the merger of the two trade-union confederations, which took place at the beginning of this month and because of the final settlement of the divergences existent between them, the National Confederation of Trade-Unions will be able to claim during the collective negotiations for a higher level of the minimum wage. At the same time, it cannot be ignored that the given merging was guided not only by the aim to protect the employees' interests but also by the need to settle the divergences regarding the real estate property.

The employees' payroll rise continues to be felt on the labor market. The highest rises in (nominal) wages are to be found in education – 24% as compared to April, in medicine – 18,3%, constructions – 11,2%, energy sector – 10,57% and financial activities – 7,4%. The increase in wages in some of the above mentioned sectors was induced by the authorities' promises in regards to the rise in salaries for teachers and doctors and the boom in constructions, which respectively influenced the slight increase in the other sectors. At the same time, when analyzing the overall economy situation, it can be ascertained that the highest levels of salaries are to be found in financial institutions – 4182 lei, and the lowest in agriculture– only 959 lei (that is with 8.6% more than in April). The explanation for the given situation derives from the difficulties encountered by the agrarian sector, especially the adverse weather conditions, low labor productivity and extremely low investments. But, let's not forget that about 40% of employees are activating namely in agriculture.

By the same token, the number of official unemployed in rural area is lower than in urban area and counts for about 43%. Nevertheless, population migration still continues in both directions, from rural area to urban, especially to Chisinau and abroad, looking for a better job that would ensure a decent life – all of this determines an acute insufficiency of labor force in agricultural sector.

Rather worrisome is the unemployment rate among the youth in between 15 and 24 years old –13.9%. Only 0.7% out of the total number of unemployed people are taking training courses. This could be explained when analyzing unemployment structure by education and age, the preferences for the training courses, further on possibilities for being employed, etc.

When looking at the youth possibilities to get seasonally employed during the summer time, it can be noted that companies are actually not so interested to employ seasonally pupils and students, even though coping with acute lack of permanent workers. One of the reasons would go for the fact that minors cannot be sanctioned for breach of labor discipline and don't have corresponding labor productivity. However, the viewpoint of the National Confederation of Employers from the Republic of Moldova in regards to the given situation is rather vague, as the issue referring to minors' employment is simply ignored by them, even the issues in realm to the employment in agriculture, where the volume

of seasonal works coincides with pupils' summer holidays.

Meanwhile, the National Federation of Employers from Agriculture and Food Industry is mentioning in its activity report published in early June that every tenth child working in vegetable and fruit cultivation is exposed to substances harmful for health. This statement makes us think that the acute lack of labor force in rural areas and the limited access to modern agricultural equipment and technologies serve as direct reasons determining the children to get involved in such activities.

Budget

Increase of state budget revenues continued in June, reaching a much higher level than the planned one when the daily average accumulations counted for 44,9 mil. lei, that is by 29.8% more as compared to 2006. Thus, in the first five months, the budget revenues exceeded with 12.1% the planned level and with 36.9% the level registered in January-May 2006. It can be noted that practically all revenue categories counted for higher levels than the planned ones; in some cases the surplus gets to be twice higher (for instance, the incomes from public property goods sale and privatization). Only the revenues coming from the special means of public institutions have registered a 11% lower level than the planned one, as well as the revenues from foreign grants – 51.76% of the planned amount.

Taking into account the budget surplus, the problem regarding non-execution of budget expenditures chapter becomes more salient, as only 81.3% were used. There are low allocations for science and innovations (48.4% less), for education (30.8% less), culture and art (34.3% less) etc. In this context, it is rather unfortunate that these sectors which are of strategic importance within industrialized countries and usually are highly supported by state are not actually funded in the Republic of Moldova at least according to the previously planned figures.

The campaign aimed at fighting corruption in education is rather inefficient based on under-funding situation in the sector. The same situation goes for science and innovation as well as culture. Although the Code of Science and Innovation entered into force 2 years ago, it did not proved much result as a lot of scientists and scientific researched left the Academy of Science, and the remaining ones are not provided with financial and logistic support so as to be able to activate. Thus, it is rather difficult to believe that the increase of allocations for science up

to 3% from GDP in 2012 – 2015 is a goal that can be really achieved, when science is actually funded with 50% less than the initially planned level.

Table 2 Dynamics of national public budget

	Planned M1- M5/07	Executed M1- M5/07	Executed M1- M5/06
Global revenues, million MDL	7272,9	8154,3	6205,5
Including, revenues from VAT, million MDL	2500,9	2711,8	2007,5
Including, income taxes from business activity	545,8	693,9	475,0
Global expenditures, million MDL	9816,9	7976,2	6039,8

Source: Ministry of Finance

Taking into account the given situation, in the middle of June, the Parliament amended the Law on State Budget for the current year, thus increasing the budget incomes and expenditures with 620 mil. lei each; and namely, 150 mil. lei will be received additionally by the budget sector employees for the partial increase in salaries, 115 mil. lei – for the gas supply program of the republic, 100 mil. lei – for the railway segment Cahul-Giurgiulesti, 90,4 mil. lei – roads' rehabilitation program, 43 mil. lei – fueling the subsidies in agriculture, as well as for re-targeting some financial resources.

The analysis of additional funding fields makes us conclude that in reality we will face actually the same situation of under-funding due to the misallocation of money according to the pre-determined expenditure categories. Thus, education already coped with several such experiences, which are known in the case of investment expenditures in infrastructure as well. We are rather skeptical about the transparency of resources use, as the most violations for the correct allocation of money were mainly emerging in the case of roads' reparation. Or, maybe these resources will be oriented so as to pay back a part of the credit granted by the European Bank for Investments in a total value of 100 mil. euros for the rehabilitation of national roads?

In regards to the 80% subsidies for the insurances granted to farmers, the authorities declared that only the ones who have insured their harvest will actually benefit from them. But taking into account that only 8600 ha of land were insured and that farmers will receive 22,5 thousand lei per each insured 100 ha, then in reality there will be only 2,1 mil. lei allocated for grant-in-aid. And who is going to benefit from the remaining 40,9 mil. lei?

Money

No essential changes were adopted in June for the National Bank of Moldova's monetary policy tools. The evolution of the consumption price index is favorable to maintain optimistic policy stance however. At the same time, the expected effects from decrease of REPO rate with one percentage point in April 2007 are not yet visible. By the contrary, the commercial banks seem to increase instead of decreasing the lending and deposits rates. It is also noted an essential rise in the price of the credits on the inter-banking market. This dynamics could be explained by the lack of trust of commercial banks towards the inflationary perspectives in economy.

The official reserves continued to increase with stability, counting for the level of 878.5 million USD by the end of June. On the other hand, it should be mentioned that due to the quick increase of imports, the foreign exchange reserves did not improved essentially in relative terms; they continue to cover only 3 months of imports.

Banking System

June is witnessing the upward trend for banking system development – a fact confirmed also by the NBM report on financial indicators for the period in between January and May, which is revealing an increase of banks' influence upon the real sector of the economy. Banks' capitalization is going up and their stakeholders are changing. Thus, in the middle of June, the National Commission for Securities has registered the tender offer for selling out the „Unibank”, where the „Petrocomert” commercial bank from Russia is holding 100% of shares with a total value of 241.96 mil. lei; bank's nominal share capital being of 9.38 mil. USD (according to EU directive nr. 2006/48/CE – minimum 5 mil. euro for nominal share capital). It is rather probable that the new owner will be an investor from the West. This event represents a symptom of local banking system development and maturation process.

The substantial majority of lending resources in May was carried out by „Eximbank”- with 145,1 mil. lei, „Moldova Agroindbank” – with 144,7 mil. lei and „Victoriabank” – with 133,6 mil. lei, ensuring 65% of banking system increases. As a result, the volume of credits granted in Moldovan Lei have passed over the level registered in April with 2,41%, being, however, lower than the level registered in March - 12,96%. At the same time, the volume of credits in foreign currency (expressed in MDL) has went up as compared to April - with 41,5%, and as compared to

March – with 19,6%. The natural persons have concluded contracts for 28,5% out of the total volume of granted credits.

The evolution of lending interests looks more like a cycle. It is observed that during January-March, the interests have constantly gone up, so as to go afterwards down in April and register again a rise in May. This dynamics proves banks' prudence – a fact confirmed by the warnings stated in IMF reports regarding the crediting risks of the Moldovan banking system. In this context the credits' share in GDP remains to be around 30% (in EU this share counts for 25-26%). It is forecasted that this share can go up by the end of the year by about 1-2%, but no more, taking into account the existing risks. As for the contracts duration – the highest weights goes for the short term credits. Thus, 71% out of total of credits in foreign currency granted to legal entities were contracted for a period up to 12 months; that is with 1,8% less than in April. This fact reveals the prudent policy undertaken by the banks. At the same time, May has witnessed a rise with 0,19% for the average interest weighted by credits granted in lei to legal and natural persons up to 18,81%, and the credits in foreign currency have increased with 0,01%, counting for 11,01%.

The deposits volume has also increased in May with 4,3% as compared to April. The average interest rate for deposits in lei counted for 15,4%, and in foreign currency – 5,91%. As a result, the banks' profits register constant increases. In this context, the competitiveness among banks gets intensified based on the activity emergence from some other financial institutions, like life insurance companies.

Thus, already for 2,5 years, the 100% Austrian capital company Grawe is activating on the market by administrating the private pensions funds. In this context, company's reputation, the social-economic guarantees and advantages offered for long-term perseverance of savings will actually determine a part of the present day bank services' users to go for this alternative, just like the majority of EU population does. It should be noted that its harness will be strongly influenced in the near future by the possible Parliament adoption of the Law on mandatory life insurance (a measure to reduce the pressure on state social insurance budget), as well as by the increased level of population informing.

Financial Markets

In May the Ministry of Finance offer for state securities on the primary market was 1,5 times lower

than the actual demand of the banks. For example, the bank request with total value of 412 mil. was covered only 63%. At the same time the share of state securities purchased by non-banking investors has registered a rise of 0,6% out of the total volume placed on the market compared to April. It should be noted that the average effective rate of state securities interest with one year maturity accounted for 11,71%, and with two years maturity – 13,1%; by 0,36% more compared to April. Thus, we conclude that the segment of the financial market is one of the most attractive and liquid investment assets of legal entities.

Unlike the state securities market, the bank shares market has enjoyed a stable demand. In May the issuers' transferable securities admitted into circulation gave the top position to Moldova-Agroindbank JSC again, with a total volume of 1037634 shares, the nominal value of each counting for 200 lei. Thus, for instance on May 31st, according to the demand and supply, the market price for the bank's transferable securities on the Stock Exchange as a result of 0,12% sale out of the total volume of the emission, reached 1425 lei per share. The fact that Moldova-Agroindbank JSC is still keeping its leading role on the capital market indicates an increase in bank's stability and capitalization. At the same time, high nominal values of the shares were registered for the following commercial banks: Investprivatbank, Banca Socială and Moldindconbank – 100 lei per each.

On the 1st of June, the National Commission for Securities has approved the Regulation regarding the procedure of capital legalization on the transferable securities market and has completed the Regulation regarding the activity of assessing stocks and shares and the afferent assets, approved through NCS Decision nr. 36/9 dated 27.12.2001. Thus, the given normative acts served as basis for implementing the legislation provisions regarding the capital legalization.

Following the public debates and examinations undertaken by a number of governmental agencies and experts, NCTS has also approved the draft of the Corporative Ruling Code. The novelty of the document is that potential investors will pay more for a share in a well administrated company, in accordance with the corporative ruling plan of the EU which stipulates that the new initiatives in the field of corporative ruling should clearly define the responsibilities of the management structures. In this context, not all of the local joint stock companies

have a viable financial and marketing policy due to unfavorable market circumstances. There is also a lack of suitable evaluation methods of the opportunities of the joint stock companies' reorganization.

At the same time, the most important event that occurred on the 7th of June and will directly influence the financial market starting with 01.10.2008 refers to the Parliament approval of the legislative amendments for establishing the National Commission of Financial Market, as a result of NCTS reorganization and fusion of authorities that presently regulate and supervise the subjects on financial non-banking market. The responsibilities of the new structure should be very clear due to the statute of a joint authority for licensing, regulating and supervising the non-banking financial market, which also undergoes systemic restructuring and the subjects (insurance companies, associations of savings and borrowings, etc.) that cope with continuous regulation difficulties. The commission's activity is going to be fully financed from the budget comprising taxes collected from the market subjects and approved through Parliament decision. The Court of Accounts is going to carry out the economical-financial audit of the institution.

The efficient functioning of the respective institution will depend on its management, professionalism and number of personnel.

Foreign Trade

During the first six months of the current year, the foreign trade was marked by some foreseeable evolutions, taking into account the regional changes due to Romania and Bulgaria joining EU and the uncertainty regarding the exports on the Russian market.

According to our estimations, during January-June 2007, the export of goods was 20-23% higher compared to the same period of the previous year. The imports were 40% than the respective period from 2006. As a result, the commercial deficit in January-June increased and reached approximately 1,025 billion USD, being 1,5 higher compared to January-June 2006. At the same time, the level of imports' coverage with exports decreases progressively, accounting 37% during the given period.

Exports' analysis reveals the change in their geographical positioning: an increase of exports to EU markets (Romania, Germany, Italy, Switzerland,

etc.) and a decrease to Russia and Belarus markets. The drop of wine exports to Russia was partially attenuated by higher exports to Ukraine, Belarus, Romania, Poland, and Kazakhstan – countries where the highest share of exports of alcoholic beverages from Moldova is currently oriented.

The redirection of Moldova's exports towards West indicates a successful exploration of the opportunities offered by EU market by the local producers as well as the efforts undertaken by the authorities to promote Moldovan products on this market. The exports structure reveals the highest share for textiles, vegetal products, food products, beverages and tobacco, common metals and metal items, equipment and machinery, vegetal oils and fats, furs and leather.

Unfortunately, it is not really clear when the wine exports to Russia will restart. In June, some rumors appeared that exports will be mediated by a single Russian state company - „Soiuzplodoimport”. Moldovan producers should pay royalty for the services and the Russian part would commit itself to promote our wines on the Russian market. We are tempted to believe that Russia will import Moldova alcoholic beverages according to the political principles – only from the enterprises fully controlled by Russians (even the names of the respective companies confirm their Russian origin), which have recently sent samples of their alcoholic production to be verified in Moscow (Kvint, „Букет Молдавии” winery from Dubasari, Дионис Клуб-Интертрейд, „Vismos” JSC and „Călărăși Divin” JSC)

The analysis of imports structure reveals that the highest share goes for the materials necessary to capitalize the economy that is mineral products, followed by common metals and metal items, transport means and materials and chemical products. At the same time, the increase of food consumption due to the rise of remittances flow has led to an increase in imports for durable goods, food products, beverages and tobacco, textile materials and textile items, pharmaceutical products, etc., which are mainly meant for individual consumption.

Actually, the large-scale imports should worry mostly the local producers, as their place on the market is in danger, taking into account the fact that consumers are more tempted to choose imported industrial materials which are of higher quality and of a rather diverse range. In this context, the trends of imports evolution would be even more worrisome in the second half of the year, when it is most probable to experience a rise in petrol and electric energy price

provided currently by Ukraine (which has already requested by the end of June a price of 3 cents/kwh as compared to 2,7 cents/kwh which we have at the present moment).

Global Markets

During June the price for WTI brand **oil** remained volatile with a trend of endearment, balancing between 65-70 USD/barrel. For the first time since 2006, the level of 69 USD/barrel was over passed. During May the price for oil was modeled by several controversial trends. USA commercial oil reserves and the end of the strike in Nigeria have acted for price downwards orientation and the persistence of oil deficit in USA, the geopolitical risk in Middle East and the nationalization policy for the oil branch in Venezuela announce by the President Hugo Chavez have gone for price upwards channeling. Moreover, the International Agency for Energy has revised its forecasts for oil global consumption for an increase with 2% (approximately 420 th. barrels per day). The experts estimate that the prices will remain volatile in the near future and the trend for a slight price rise will persist¹.

The forecasts for **wheat** yields in 07/08 continue to remain negatively affected by the adverse weather conditions (an extremely dry spring), especially in Ukraine, the southern regions of Russia and the South-Eastern Europe. The forecasts for Canada harvest were also revised downwards, mainly due to the reduction of crop areas. The expectancies are more optimistic for USA and Australia. Thus, the wheat global production is downwards revised with 7 mil. tones, reaching the level of 614 mil. tones, which is actually with 21 mil. tones more than in 2006. At the same time the global consumption is also revised downwards with 5 mil. tones, taking into account the estimations of consumption decrease in CIS. The Ukrainian Government has established some shares for grain export from Ukraine that will be in force until the 1st of October 2007 and will influence even more the prices on the regional market, including the one from the Republic of Moldova.

In June 2007 the **dollar** rate against **euro** is characterized by contradictory trends. The first half of the month witnessed a tendency to correct the rate, respectively to strengthen dollar position which was already observed by the end of May. Investors' arrangements were mainly modeled by the expectancies to have a revival of the American economy, an increase in the profitability of treasury

¹ Source: The Economist, International Energy Agency, Reuters, RBC.

bonds based on the going up incertitude of the emerging economies and by the improvement of the indicators referring to consumption. At the same time, the markets were relatively indifferent towards the economic evolutions registered on the European continent, waiting for the cyclic increase factors to be in the near future on the American part. But the second half of June was marked by a new wave of the unique currency enhancement. Again, the main attention was granted to the economic situation of the United States. Thus, the data referring to the worsening of the economic feeling in Europe, firstly in Germany (ZEW, IFO) were actually ignored by the traders. On the contrary, the data from the United States referring to the continuous worsening on the real estate market, the reduced probability for Fed interest increase and the downwards revision of the economic growth in the first quarter showed that the expectancies for „economic revival” of the American economy proved to be rather premature. Thus, the dollar again started to give way to the European money, decreasing down to 1,357 as compared to euro. The majority of experts anticipate some volatile evolutions of the exchange rate in the near future, that will count for \$1,35/1€.²

Trade Partners

In **Russia** the economy continues to register a solid increase, registering in January-May 2007 a rise of 7,7% compared to the same period from 2006. Similar to the beginning of the current year, this increase is based on the solid investment demand (+20,8%), dynamic expansion of the construction sector (+25,2%) and industry (+7,4%, the trend for industrial increase slow down was reversed in May). It should be mentioned that the industrial increase is mainly fueled by the boom from the constructions sector, the most solid rise being registered for the industries linked to constructions. The demand for consumption remains to be powerful, and the exports continue to go up with slower pace (only +8,7%), which is obvious on the basis of imports robustness (+40,1%)³. The increase of available real revenues (+12%) and real wages (+17,9%)⁴ has fueled the en detail trade expansion with 14%⁵.

During January-June 2007 the **Ukrainian** economy has maintained its alert increase pace: +7,9% as compared to the same period from 2006. The expansion of the private consumption (+28,1%) and exports (+35,3) serves as pillars that support the growth based on the rise in real wages (+12,1%). The economic evolutions are favored by the circumstances occurring on the chemical and metallurgical products market, fiscal relaxation and flexible exchange rate. On the other part, agriculture faced a rather weak increase in this period, and the drought conditions were heavily affecting the grain yields and probably will induce even a more difficult situation in this sector. The Ukrainian Government has perceived the given situation as an impending risk for Ukraine food security and has imposed specific shares for grain exports. The experts are rather skeptical regarding this measure, believing that the reduced harvest will nevertheless be sufficient to ensure the country's food security, and the market mechanisms would allow establishing a competitive price on the internal market. But an eventual rise of the price for the grain would induce a real nightmare for the political elite which are preparing themselves for parliamentary elections in autumn of the current year. At the same time, it is certain that these measures of the Ukrainian Government will contribute to price rise for grains on the regional market⁶.

Table 3 Economic indicators of Moldova's main trade partners

	GDP, %		Industrial production, %	Inflation, %	Unemployment, %
	Last data	2007, prog nosis			Last data
Russia	7,9 01-05/07	6,3	7,4 01-05/07	4,7 01-05/07	6,9 05/2007
Ukraine	7,9 01-05/07	6,2	12,1 01-05/07	1,9 01-05/07	8,0 Q1/2007
Romania	6,0 Q1/2007	6,5	6,4 01-05/07	3,9 05/07	7,3 05/07
Germany	3,6 Q1/06	2,2	4,0 04/07	2,0 05/07	6,6 05/07
Italy	2,3 Q1/07	1,7	0,8 04/07	1,5 05/07	6,2 Q1, 2007

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

The **European Union** continues to enjoy good economic perspectives which are supported by the internal consumption demand and the demand for corporative investments. The en detail trade

² Reuters, RBC, Global Insight Inc., The World Bank.

³ The increase of imports continues to v be fueled by the high demand for consumption and investments and also by the real appreciation of the Russian ruble as against the American dollar and the European money.

⁴ Nevertheless, the speed of real wages expansion over passes the productivity one – a fact that can have adverse effects on the competitiveness of producers from Russia and also the maintenance for ruble appreciation trend.

⁵ Ministry of Trade and Economic Development, Институт Экономики Переходного Периода, The Institute of Economy and Transition.

⁶ Інститут економічних досліджень (Institute for Economic Research and Policy Consulting), Міжнародний центр перспективних досліджень (International Centre for Policy Studies), Експерт-Україна (Expert-Ukraine).

registered an increase of 0,4% in euro zone. This expansion rate is registered by the trade with „food products, tobacco, alcoholic beverages”. The trade, however, has developed more dynamically in the new member states Lithuania, Estonia and Slovakia, and even has regressed a little in the case of the old members, including Germany with 1,9%. At the same time, the appreciation of the European currency had a marginal impact upon the external trade due to perseverance of high demand for the European exports; thus the **euro zone** registered a surplus of the trade balance of 1,8 billion euro in April 2007. Nevertheless, the majority of experts wait for rather slower increase rates during the second half of the year within the euro zone.

The **Romanian** economy continues to follow an increasing trend. The growth is supported by the positive dynamics in industry (+6,4% in January-May, 2007), en detail trade (+7,6%) and services (+1,3%). At the same time, the managers' expectancies regarding the evolution from June-August are rather positive for all the major sectors of Romanian economy: industry, constructions, retail trade and services, although the perspective for new employment in industry is limited⁷.



⁷ Source: Financial Week, Capital, Current, The Economist.