

Economic Reality

monthly publication of analysis and forecast, no. 2

In this edition read about:

- *Evolution of the Moldavian economy during March-April*
- *Is the energy conservation law applying in the relations Termocom–Chisinau town hall?*
- *How the policies should not be planned in conditions of financial resources scarcity*
- *Should the state subsidize the losses of swine breeders?*
- *Is the extension of irrigated areas an inevitable benefit?*
- *How realistic is a crisis in the Moldavian banking system?*
- *Fundamental factors of the global prices increase for food*

Expert-Grup

April 2008

This publication is elaborated with the support of the Institute for Open Society (Budapest, Hungary)

To this edition contributed:

Valeriu Prohnițchi (coordinator)

Alexandru Gamanji

Alex Oprunenco

Ana Popa

EXPERT-GRUP is an independent analytic center specialized in economic and social policies research and consulting. EXPERT-GRUP has no political affiliations and commercial goals and is independently establishing its institutional strategy. The mission of the center is to contribute plenary to the economical, political and social development and to the international competitiveness of the Republic of Moldova.

Contact data: Mailing address: MD-2012, Republic of Moldova, Chisinau, 133, Columna street, office 1
Phone: ++373 22 921776, ++373 22 930014; Fax: ++373 22 211599
Email: info@expert-grup.org Web: www.expert-grup.org

Summary: Moldavian economy during March-April 2008

The available statistical data for the period of March-April show that the Government led by Zinaida Greceanii has inherited from the Tarlev Government an economy which is recovering from the shocks suffered during 2005-2007, but which is still exposed to significant macroeconomic risks. Some of the risks can be moderated through instruments of internal economic policy; other risks have a global nature and are situated out of the national authorities influence.

During January-February the industry set on a strong ascending trend, registering an increase of 9.6%. According to our estimates, in March the industry accelerated its growth to approximately 11.0%, a process which will continue in the near future. Due to more favorable climate conditions, a continuous flow of wine exports to Russia and capitalization of the opportunities offered by the Autonomous Trade Preferences, in 2008 the industry could achieve an annual growth of over 20%.

The weather conditions from the beginning of the current year are really promising and encourage optimistic expectations for a good agricultural year. After the collapse in 2007, when the agricultural production reduced until the level of the year of 2000, in 2008 the agriculture has all the chances for registering a record-growth. However, the growth will have a recovery character and the absolute production volume will not exceed the registered historical limits.

The inflation remains to be the most significant risk for the economy on the short-term period. Although, in March the price increase was less than in February, in annual expression the inflation (15.4%) has reached the highest quote since December 2003. Due to Moldavian economy openness the good agricultural yield will essentially moderate, but will not definitively eliminate, the inflationary pressures in the current year. Due to the price increase with over 4% in the first semester, the inflationist forecasts already revised by the IMF and Government could be revised once again in the semesters II and III.

In spite of the price increase, the population's behavior oriented towards consumption didn't show negative tendencies. Quite opposite, the constant inflow of remittances from emigrants ensures a purchasing power which even accelerates the price increase for consumption goods. During January-February of the current year the remittances of Moldovan emigrants through the banking system has grown with 48% in comparison with January-February 2007, exceeding the volume of 186 million USD. If the growth rate holds on, it is possible that in 2008 the volume of remittances will exceed the level of 1,6 billion USD.

The dispute regarding the heating energy tariff between Chisinau municipality town hall and SA "Termocom" is descending more and more visibly to a political conflict.

Although the tariff imposed by town hall is obviously unreal, it is necessary an independent audit of SA "Termocom" in order to establish its real value.

Tab 1. Heating energy tariff, domestic consumers, December 2007 – February 2008

City	Tariff, MDL/Gcal
Chisinau	233
Balti	540
Bucuresti	546
Iasi	620
Suceava	980
Kiev	180
Odessa	358

Sources: Expert-Grup calculations on the basis of ANRE.RO for cities from Romania and official websites of Kiev and Odessa cities.

Is the energy conservation law valid in the Chisinau municipality?

The relation between Chisinau municipality and the joint-stock company "Termocom" can serve as an inspiration material for a comedy producer, as well as for a director of an absurd theatre. The situation is really abnormal especially if we take into account the fact that SA "Termocom" is a production enterprise which is formally subordinated to the Chisinau Municipality town hall and Chisinau Municipal Council, namely both conflict parties are part of the same camp. The existence of the institutional linkage dictates that, on the one hand "Termocom" must take into account the municipal authorities' policy, but on the other hand, the municipal authorities must understand that SA "Termocom" is an economic agent which supplies public services and not a philanthropic foundation.

The bone of contention is the tariff value that is an economic issue. The tariff of 233 lei is obviously unreal and much below the tariffs from cities in the region (tab.1). In Kiev the tariff is essentially smaller even in comparison with Chisinau, but there the situation is the result of some political reasons as well. Like in Kiev, in Chisinau the conflict got, due to the contribution of both parties, an evident political connotation. It is the interest of Chisinau Municipality citizens is that the conflict will remain in the economic sphere and it will be exclusively solved with juridical instruments.

EXPERT-GRUP does not dispose of the necessary information for the right tariff size evaluation and it is not competent to carry out this extra-complex assignment (although, once again, the table 1 suggests that the tariff of 233 lei/Gcal for Chisinau does not correspond to the reality). However, we would like to propose a series of recommendations which could contribute to the univocal conflict solving and which would reduce the pressures in Municipality and SA "Termocom" relations in the long run:

- *The premise for conflict solving is the understanding of the fact that the Parliament of the Republic of Moldova has not yet abrogated the energy conservation law. In other words, the energy does not appear from nothing, and its production implies costs which must be carried out by somebody. If nobody wants to carry out the costs, the energy will not appear.*
- *In order to understand what are the real expenditures carried out for thermic energy production, it is necessary to undertake a performance audit and an independent financial audit (in the best case, by an international company with an excellent reputation). "The economic analysis" made by any mixed commission created by the municipality and "Termocom" will bring no results since both parties have conflicting interests, dictated by various constraints (social and political for Municipality, economic and political for enterprise).*
- *On the basis of performance and financial audit, it will be simply to identify the real expenditures carried out by the enterprise in order to supply its services. The tariff must cover only the expenditures which objectively are necessary for thermic energy supply, for enterprise*

administration and development. All “additional” assets or non-performances in the SA “Termocom” balance sheet must be alienated.

- The major objective of SA “Termocom” must be the supply of qualitative services in the framework of a performed economic activity. It is only possible when a real tariff is paid off. Obviously, many of consumers will not be able to pay this tariff. But the social protection must not be carried out by SA “Termocom”. This is the task of Chisinau Town hall together with the Government of the Republic of Moldova.
- The social protection policy must be based on a set of clear criteria in order to identify the beneficiaries and to avoid the universal generosity. Can a tariff of 540 lei per Gcal be affordable for an urban family composed of 4 members, with a total income of 8000 lei per month and which consumes in the cold part of the year in order heat up an apartment with 3 rooms approximately 1.2-1.5 Gcal monthly? Obviously, there shouldn't be any problems related to paying this tariff. But a pensioner who lives with an income of 800 lei per month naturally there must be a support from the town hall and Government.
- The consumers are unsatisfied not only with the tariff size, but with the quality of the supplied services as well. Many householders are forced to pay for the heat which they do not consume de facto. This problem can be solved only with signing direct contracts between SA “Termocom” and its beneficiaries and changing the system of heat delivery and evidence. Obviously, this perspective displeases SA “Termocom” which invokes the juridical and technical “impossibility” for such solution. The juridical deadlock can be easily solved by modifying “The Regulation regarding Thermic Energy Delivery and Utilization”¹ and the Law regarding the locative fund condominium². Concerning the technical impossibility, it is not technical, but rather financial one, and it is not impossibility, but rather a difficulty. SA “Termocom” invokes enormous costs related to the replacement of vertical branch pipe of the heating networks with a horizontal one for heat carrier delivery to each apartment separately, as well as to the heat energy counters installation. However, a rigorous financial evaluation of the reform hasn't been done until nowadays, and without such an evaluation it is impossible to elaborate an investment plan.

We should not forget that the energy conservation and saving policy allows us to save money as well! A particular progress was realized by SA “Termocom”, the losses being diminished from 36% in 2001 till 20% in 2005³, but still, a fifth of the heating energy is used for melting down the snow instead of warming up the apartments. In the same time, undertaking actions for energy conservation in buildings and apartments represents the common responsibility of the town hall and householders. Up to present there haven't been noticed some major and visible actions in this respect.

¹ Approved after the Decision of the Government of the Republic of Moldova nr. 434 from 19.04.1998.

² The law of the Republic of Moldova nr, 1696-II from 13.10.2002.

³ <http://www.termocom.md/producere.htm>.

Example of policies planning in conditions of financial resources scarcity

Alter the Christmas stuffiness, budgetary incomes collection has improved beginning with February...

Public financial resources collection in February-March seems to have marginally improved in comparison with January 2008. Thus, if after a long winter holidays the incomes to the national public budget in the first month increased by only 1.4% in comparison with the planned level, in February incomes collection improved, the plan being performed at the level of 106.3%.

... but the expenditures execution is still under the desired level. Adoption of a Regulation regarding the budgets based on programmes could improve, on a long-run, expenditures execution...

Concerning expenditures execution, the situation does not differ essentially from that of the previous years. In most of the sectors, the allocated financial resources are not used at the planned level, which demonstrates the existence of particular problems in budgetary execution. In this context, in March was adopted an apparently minor decision and which didn't attracted our attention as well in the previous publication of the Economic Reality. This is about the adoption by the Ministry of Finance of a Regulation regarding the way of elaboration, supervision and reporting the budgets according to some programs⁴. The regulation establishes the rules and principles regarding the programs, goals, objectives and performance indicators definition and elaboration of budgets afferent to programs. Obviously, the regulation will not have an immediate beneficial impact on the public budget execution, especially in the situation when there are still few public authorities which practice the budgeting based on program and performance.

... and clean the Government collection of inconsistent "strategies" and "conceptions", la last example of such a document being the Conception of maritime transport development...

However, on a long-run, this regulation can be useful for elaboration of some documents of realistic strategic planning at the branch, sector or national level and stopping inflation by futile "strategies" during recent years. An example of such "strategy" is the Concept of Maritime Transport Development in the Republic of Moldova, adopted by the Government⁵. A new Government which respects its reputation can not adopt such an inconsistent document, without any perspective and which is written, simply, unscholarly. One of its stipulations states that "the main goal of maritime transportation development is the adjustment to requirements and exactingnesses imposed by the modernization, optimization, as well as its integration in the framework of transportation branch complex". We would like to relieve some of the "important actions" from the Conception:

- *Improvement of the internal waterways and of the exploitation parameters of hydro-technical constructions;*
- *Increase in the internal waterways length, guaranteed fairway depth and its signaling;*
- *Navy modernization and its supplementation with new and modern sails;*
- *Harbor reconstruction and naval activities reforming;*

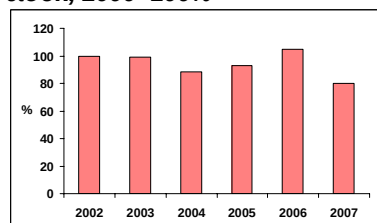
⁴ Order of the Ministry of Finances of the Republic of Moldova no. 19 from 16 February 2008, published in the Official Monitor no. 45-46 from 4 March 2008.

⁵ Adopted by the Government Decision no. 453 from 24 March 2008

... in which the ambitious objectives are not accompanied by any action plan

These are only 4 from all 20 "planned" measures, but for which there is no money provided! Whereas for waterways improvement only several millions of Euro would be necessary. In spite of the unavailability of an investment plan, the maritime transport problems solving is proposed to be accomplished within 2 stages: the first one (2008-2009) is designed for "solving the problems related to internal maritime transport development and reformation through coordination and activity interaction between public administration and economic agents". The second stage (2009-2011) has a much more clear formulation, supposing "the accession to the European and world transportation system". And there is no action plan, no responsible persons, no performance indicator or ecologic impact evaluation. The last sentence from the Conception fully shows the author's "strategic ingenuity": "one of the basic instruments for realization the present strategy is the national and regional development programs of the internal maritime transport".

Figure 1. Evolution of swine live stock, 2000=100%



Source: Ministry of Agriculture and Alimentary Industry

Subsidizing nutriment for swines: pro or contra?

In April this year the Association of Swine Producers from the Republic of Moldova announced its intention to request subsidies from the Government from the State budget. How legitimate is this demarche?

In the Republic of Moldova about 45-50% of meat production represents the share of swine producers⁶. In spite of the fact that in 2006 the swine number exceeded with 4.6% the value from 2002, in 2007 it was with 20% smaller (fig. 1). The drought from 2007 leaded to the price increase for nutriment and production costs. Therefore, it is hardly that the nutriment prices on the regional market will go down in the near future. Although the prices for swine products are rising, the prices for production factors are rising as well. As a result, the obtained profit does not allow procuring the same volume of resources, consumed in the previous production cycle. In the same time, the registered losses by the Moldovan producers are determined by their reduced competitiveness as well. The low competitiveness of this sector is confirmed by the fact that the swine daily weight increase at the growth stage fluctuates between 100-300 g, in comparison with around 500-600 g. in Romania⁷ and Ukraine⁸ or 1000 g in Denmark. The question is why and how long the budget must

⁶ According to NBS data

⁷ www.naturalresearch.ro/files/nutricom1.pdf

⁸ Расширяя горизонты. Бюллетень компании Оллтек-Украина. No. 4, 2006, pag. 8-9

If the Government would subsidize only ¼ of nutriment costs for swine, it would cause annual budgetary spending of 600-800 million lei...

subsidize internationally uncompetitive producers? And why it should compensate the costs and losses incurred only by swine producers, and not that of beef or poultry producers?

A simple calculation shows that if the authorities would subsidize the nutriments for swine producers as well (at least 25% from the annual consumption of a swine), then it would be necessary a sum of approximately 600 – 800 million lei (1.45% of GDP)⁹. It is improbable that in the near future the State will afford undertaking such financial assignment. And the Moldovan consumer, although it sounds strangely, goes without economic nationalism (which does not exist anywhere as a matter of fact), and chooses first of all the cheapest meat.

Therefore, we consider that the increase in branch efficiency must be accomplished based not on subsidies, but rather on production and labor organization, forming of some more advantageous relations between the swine producers and nutriments suppliers, meat producers and market participants. Implementation of a competition strategy for swine producers is necessary for reduction the growing foreign producers influence. They frequently use price competition, oriented towards financial bankruptcy of the competitors in the internal market. Therefore, the local companies must make use qualitative competition advantages, oriented towards attracting clients with higher usage value and meat products differentiation.

We observe that nowadays the swine producers and the swine processing enterprises are competing, instead of cooperating, on the swine products market. The initiation of integrationist processes will lead to production expansion and interconnection of various technological process stages.

... and which in the near future will not be possible to allocate. Therefore, the producers should take into consideration new strategies of vertical integration in order to increase their competitiveness and to reduce the costs.

The advantage of production integration, processing and commercialization of swine products is obvious: management optimization, strengthening the hold over the market, possibility for implementation of advanced technologies, guaranteed supply of raw materials, productions risks reduction and improvement in utilization of production potential. The closed technologic cycle will allow for swine products commercialization without intermediaries. It will ensure the increase in production profitability. Another advantage of the agro-industrial group (holding)¹⁰ creation is related to the development of nutriment production, besides meat production. The result will consist in production costs diminishing and elimination of the useless sentimental expectations of producers from the State budget.

Expansion of the irrigated areas: an inevitable benefit?

Recently, in framework of the European Commission Alimentary Security Programme and with the support of the Project 2KR of Japanese Government, Republic of Moldova benefited from 104 agricultural machinery units for small scale irrigation which will

⁹ Together with the sum of 270 million lei allocated for subsidize for the current year, total quantum of subsidize would reach the figure of 1 billion lei (equivalent with the losses of the sector of zooculture as a result of the drought from 2007)

¹⁰ All the economic units, members of the agro-industrial holding can preserve their juridical, organizational and economic independence

permit the farmers to expand the irrigated areas with 1.7 thousands hectares. With this occasion, the Ministry of Agriculture and Alimentary Industry (MAAI) announced that in the first stage (2008-2015) of realization the Programme for Profitability and Irrigation Network Extension, the area of irrigated territories will be extended with approximately 218 thousand hectares. This objective is stipulated in the National Strategy for Durable Development of the Agro-Industrial Complex of the Republic of Moldova for the period 2008-2015 (p. 4.3 "Special measures for fighting drought"), approved in March 2008¹¹. How economically realistic is this objective? And is irrigation the only measure for minimizing the impact of the potential drought to which Moldova is exposed?

The stated the objective to increase till 2015 with 218 thousand hectares the irrigated agrarian area...

In Moldova the area destined for agricultural activity constitutes 58,3% (1974,1 thousand hectares) of the country's territorial fund (3384,6 thousand hectares). We have to mention that according to any international standards, this represents a very big share which compromises the ecological equilibrium, intensifies the negative effects of droughts, soils degradation and territories desertification.

... inspite of a lack of financial ressources ...

The authorities want that the irrigated territories to make up for approximately 14%¹² till 2015. There exists many arguments that this objective is too ambitious and probably, erroneous. Even in the recently approved strategy it is mentioned that the real possibilities for profitable extension of irrigation in the next 10 years are limited to an area of 100 thousand hectares (it includes the meadows, partially meadows of internal rivers, high cliffs of these rivers with regular chernozems). On the other side, in the strategy action plan appears the figure of 218 thousand hectares, covered by new irrigation systems. The paradox is that the sum of 2575.0 thousand hectares designed for these aims, appears in the chapter "Uncovered Financial Sources". Thus, it is unclear where the financial resources designed for the accomplishment of the objective stated by the strategy will come from.

Secondly, a significant danger is linked with utilization of low quality water for irrigation. Nowadays, even for an irrigated area of 34 thousand hectares, a significant part of used water has a mineralization grade higher with 1 g/l. It leads to soils saltiness, with the risk of ulterior exclusion from the agrarian circuit¹³

... and without taking into account all the factors which determine the irrigation necessity

Thirdly, analyzing the report "Rural productivity in Moldova: Managing Natural Vulnerability"¹⁴, we conclude that the economic efficiency of the irrigation rehabilitation remains to be evaluated based on the individual principle for each scheme particularly since it depends on many factors. Particularly, this is related to the height to which the water should be pumped; crop characteristics, since cultures with high value (grapes,

¹¹ HG No. 282 from 11.03.2008

¹² Program of rehabilitation and irrigation network extension in the Republic of Moldova for the period 2008-2025

¹³ The water for irrigation must correspond to some chemical indicators: mineralization degree – less then 1g/l; reaction (pH) – 6,5-8,3; chlorine amount: less then 3 mg/l; sodium absorption proportion (SAR) – 1-3 units; magnesium indicator (PMg) – less then 50%; soda amount – less then 1,0 mg.

¹⁴ <http://www.worldbank.org.md>. This report was prepared by a mixed team of the World Bank and United Nations Organization FAO.

In order to reduce the impact of the further droughts, besides an advanced irrigation system, must be introduce more superior agrarian technologies...

... and to ensure an adequate areas management in order to diminish erosion and other forms of degradation

There exist dubieties that the official living wage of 1099 lei for 2007 would even guarantee the existence of a human being in the Republic of Moldova ...

vegetables, apples) would better justify the investments in irrigation rehabilitation then in the case of corn or barley; physical situation of the previous irrigation units; irrigation technique in the case of agrarian households which will be applied. Unfortunately, there is no program of irrigation rehabilitation which took totally into account these factors¹⁵.

The above arguments confirm that the irrigation areas extension brings benefits only when several factors are in place. Since the current evaluations are outdated and are not correlated with a detailed study of individual schemes, the real dimension of irrigated areas which are economically viable will remain unknown until updated feasibility studies are made. Special measures must be made in order to diminish the effects of future droughts on agriculture and advanced agro-technique technologies in particular and to minimize soil erosion.

The advanced agro-techniques technologies permit soil humidity retention (minimal ploughing or vegetable layer maintenance), utilization of varieties resistant to drought, optimization of dissemination and planting periods (according to agro-meteorological forecasts), plus elimination of uncultivated plants, which would reduce the evaporation and transpiration caused by plants¹⁶. An increasing role for their analysis and implementation belongs to the agrarian consulting services which in Moldova are, de facto, inaccessible for regular producers.

In order to decrease the areas exposed to erosion (42.7% of territories or 901 thousand hectares), it is necessary to improve the areas management. It can be made by realization of some financial benefits on the long-run (namely due to fruitful trees utilization). The vegetation coverage of territories can be modified, areas afforestation and reafforestation¹⁷ inclusively.

How realistic is the cost of living?

On the 2nd of April, the National Bureau of Statistics published the cost of living amount for 2007, which amounted to 1099.4 lei on average per month per person. On the 2nd of August 2006 the Government elaborated the project of a new regulation of the cost of living calculation, which remained to be enforced starting with 1 January 2007. However, the cost of living it is still calculated on the basis of the Government decision of No. 902 from 28.08.2000. To what extent the living wage level reflects the real necessities of the population?

According to the Regulation adopted through the Government decision no. 902 from 28.08.2000, "living wage calculation consists of value evaluation of material goods and services included in the minimal consumption basket". Therefore, for foodstuffs it is

¹⁵ In 1996, Irrigation National Program (INP) made the screening of the existent covered areas at the chapter of financial viability, eventually recommending 82,7 thousand hectares for rehabilitation, estimated at approximately 53,5 million USD, at a medium cost of 645 USD/hectare. In 2001, a program project for the aquatic sector suggested the rehabilitation of a theoretic area without any budgetary resources.

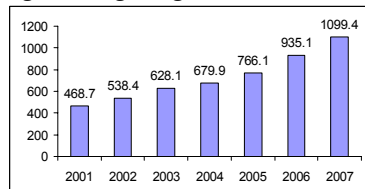
¹⁶ These technologies have been made public already in the framework of a project of FAO, implemented since August 2007

¹⁷ Reafforestation and care cost is about 1000 USD/hectare for the first several years until a forest is created.

... this is because of the structure of the alimentary basket which is included in the living wage...

... as well as due the essential price increase in 2007

Fig.2 Living wage evolution, lei



Source: NBS

The price increase was more moderated in March in comparison with February 2008, but in the annual expression it reached the highest level since December 2003 ...

applied the normative-statistical method¹⁸, and for non-food ones and for services – utilization of the real structure of population's consumption expenditures according to the survey of household's budgets.

The Academy of Sciences of the Republic of Moldova elaborated some recommendations for cost of living calculation regarding the calories consumption depending on age, sex and type of activity performed by the population¹⁹. In the same time, the Academy of Sciences of the Republic of Moldova argued if would be taken into consideration the average of an equivalently adult person instead of the average living wage per person, then the minimum of average calories consumption per equivalently adult person would be 3004 calories/person/day²⁰. These calories are related to a work execution with a medium physical and intellectual effort, but in the case of work with intense physical effort it is necessary up to 6720 calories/day.

According to the international norms, the population must consume more meat, fish, fruits and vegetables and less cereal products and potatoes. In the Republic of Moldova, the population ensures its subsistence especially based on cereal products and potatoes – in 2007 the prices for potatoes decreased with 50,7%, specifically due to imports from Poland and Belarus, whereas the prices for other alimentary products increased: seed oil – with 50.7%, fresh fruits – 30%, eggs – 25%, dairy products – 24.4% etc.

The price increase in 2007 for non-food products caused the reduction of population's purchasing power as well. The prices increased also for communal-locative services by 19.9%, public alimentation services – by 28.4\$, reparation and buildings care – by 15.4% etc. In these conditions it is hard to understand how the increase in 2007 of the living wage by 17.6% in comparison with 2006 (fig. 2), could ensure the same living level as in 2006, at least according to the price increase for alimentary and non-alimentary products and services, which are indispensable for ensuring the population's vital capacity and health at a minimum level. Moreover, in the case of poor categories of population, around 70% from the real consumption structure consists of alimentary products, whose prices increased mostly.

The food inflation and its impact on various categories of population

In comparison with February, the rate of prices increase in March reduced to the level of 1.1%. Thus, the cumulative inflation for the first 3 months of the year constitutes 4.1%. Although, we are still at the end of the current year's first semester, it seems that the authorities' optimism regarding the annual inflation maintenance within the limits of a single figure has disappeared. Thus, it is no

¹⁸ Which supposes the application of scientifically argued norms of alimentary products consumption to the minimum alimentary basket formation

¹⁹ These levels of caloric consumption were used in order to assess a minimal requirement per person of 2282 calories/person/day (minimum used as well by the Ministry of Economy and Trade)

²⁰ Annex 3 of NPD, www.scers.md

...and most of the official estimations exceed the limit of 11%

more speaking about the annual inflation for 2008 of 10% as it is stipulated in the Memorandum with IMF regarding the economic and financial policies, macroeconomic forecasts indicating figures exceeding the level of 11%. The recent report of the International Monetary Fund – World Economic Outlook – anticipates the annual inflation in the Republic of Moldova of 11.4% at the end of 2008. In the same time, we can find even higher figures from the Ministry of Economy and Trade, which speaks about an inflation of 11.8% in 2008.

Taking into consideration the National Bank efforts from 2007 and beginning of 2008 and the Government commitment to accomplish the provisions of the Memorandum with IMF, the pessimistic forecasts from the beginning of the current year are really alarming. Taking into consideration the global trends, as well as the national economy peculiarity, in 2008 there are many factors of pressure on prices in the Republic of Moldova. The most important are following:

- *The inflation of food affected the global markets. During the last year the prices for the main cereals: wheat, rice, corn almost doubled, which has an impact over all the products which we consume. Specifically this is happening with price increase in the Republic of Moldova. Living in a net importer country of many foodstuffs, we can not avoid the impact of growing global prices. In this case, the national currency appreciation serves as an “amortization means” which slows down the price increase rate for alimentary products.*
- *In the same time, the drought from the summer 2007 affected the prices for local agrarian production, which will be felt until the new agricultural crop at least. However, we can not estimate lower prices for agricultural production, even in case of favorable climacteric conditions, since the prices for the seeds are very high in this year.*
- *The high consume which affects the prices for non-alimentary products as well. Although, the transfers from abroad were less in the first two months of the current year in comparison with the last months of 2007, it is a seasonal phenomenon which occurred during many years. In the same time are increasing the deposits of individuals at the commercial banks, as a result they offer consumption credits with more advantageous conditions.*
- *Pressures related to the increase in prices for imported energy resources. In the second trimester, the price for natural gases delivered to consumers didn't increase, even if its import prices increased. It was possible due to the exchange rate MDL/USD, which was less then it was expected at the previous tariff establishment. However, the existence of the possibility of price increase for electricity turns out to be significant inflationary pressures.*

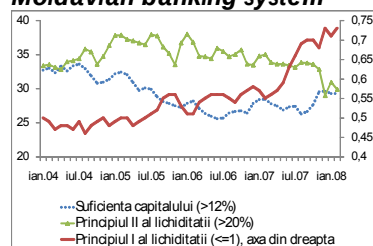
Taking into account the fact that in the first three months the prices for alimentary products has increase by 7,4% it is clear that the inflation affects first of all the poor layers of population

Thus, the inflation for alimentary products is the most significant one, the prices for these products increased by 7.4% from the beginning of the year. It mostly affects the consumers' categories for low incomes. The last data regarding the Consumption Price Index published by NBS in April were revised using the shares of consumption expenditures of household budgets for 2007. According to these data, in 2008 the share coefficient of alimentary products constitutes 35% in comparison with 31.72% in

2007. In the same time, in 2006, for example, the share of expenditures for alimentary products in total of expenditures for the poorest three quintiles of population constituted over 50%. Thus, for these categories of consumers, the annual inflation of 13.1% in 2007 is not a real one, since they feel a much more significant inflation. These categories of population will be the most affected in 2008, with price increases felt well over the limits of a single figure only in one semester of the year.

The rumors that a significant crisis could appear in the banking system lack any basis...

Fig.3 The evolution of stability and liquidity indicators in the Moldavian banking system



Source: NBM

... in spite of existence of some unfavorable trends of liquidity indicators...

Is Moldovan banking crisis possible?

There are rumours in some quarters that Moldovan banking system is on the verge of a crisis. The data analysis shows that the rumors do not have sound foundations; however some negative tendencies are visible. Although, in spite of these negative trends the situation is far from what could be defined as "crisis" or "pre-crisis".

The liquidity crisis is the situation when the banks can not deal with payment requests of their customers or when are not able to manage their obligations in respect to their depositors. There is a series of indicators which can describe the banking security and liquidity level. From all indicators used within the banking activity from the Republic of Moldova, the most relevant to this subject are sufficiency of capital (which must exceed 12%), the proportion between the assets with placement duration of more then 2 years and financial resources attracted for a period of more then 2 years (also known as the 1st liquidity principle and that must not exceed the value of 1) and the proportion between the liquid assets and total assets (the 2nd liquidity principle, that must exceed the level of 20%).

According to the statistical data published by National Bank of Moldova (NBM) there is a negative trend of two indicators mentioned above (fig. 3). Particularly, it can be remarked that the liquidity rate calculated according to the 1st liquidity principle (long term liquidity coefficient) has grown rapidly from 0.55 in January 2007 up to 0.75 in December 2007, which remained at this level during January-February of the current year. We have to mention once again that this coefficient must be less or equal with 1, and that, virtually, the Moldavian banks have a maneuvering margin, but it is very limited and, therefore, an increased attention from NBM will be beneficial. On the other hand, the short term liquidity coefficient (the 2nd liquidity principle) shows a negative trend beginning with January 2006, when it reached the level of 38.01, to 28.98 in December 2007 and 29.91 in January 2008. Moreover, this indicator is still very far from the inferior limit imposed by NBM (20%). The banks situation is ensured by the fact that the capitalization level is at the level which exceeds twice the established minimum of NBM. Since July 2006, namely when started the inflow of foreign capital along

with foreign banks entrance on the local market this level continuously improved.

Thus, at the moment there are no real reasons to state that in the banking system a crisis might be looming. At the same time, we could not analyze the situation of some particular banks. Such an analysis could lead us to different results. At the same time, we have the full confidence for NBM capacity to adequately supervise the banking institutions and to undertake preventing measures for elimination of any risks.

Rapid price increase for aliments and agrarian products generated the new concept of "agflation" and which characterizes a global phenomenon ...

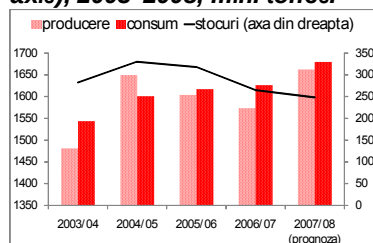
Farewell, cheap food era?

The vertiginous price increase for aliments became, recently, a hot topic. In a previous edition we were writing that the experts from the World Economic Forum identified the reduced alimentary security as being the most serious from the 4 risks which threaten the World in 2008. Recently, in the framework of a joint forum of the International Monetary Fund (IMF) and World Bank (WB), both institutions showed their concern regarding the price increase for food and solicited the world states to undertake common efforts to win through the possible food crisis in the developing world. At the same time, the IMF director Dominique Strauss-Kahn insists on the necessity of common efforts for managing the inflationary pressures, namely speaking about the foodstuffs. There is more and more talk about the new phenomenon of "agflation", namely about the price increase for food and agricultural products. Is it possible to put the "agflation" on leash? And did the era of cheap alimentary and agrarian products finish? To find answers on these questions it is necessary to state the causes of recent increase in food prices.

Causes of rise in food prices

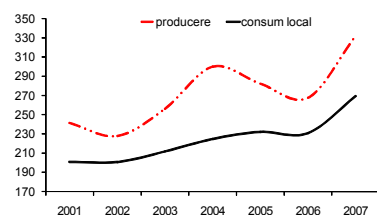
... determined by the rapid increase in global consumption in conditions of limited stocks...

Fig.4. Wheat production/consumption (left axis) and stocks volume (right axis), 2003–2008, mln. tones.



Source: International Grains Council, Grains Market Report, 28 March, 2008

Fig. 5. Corn production and consumption in USA, 2001-2007, mln. tones



Source: USDA, Feed Outlook, March, 2008

The trend of rise in food prices is based on several fundamental causes and some speculative.

The first fundamental cause is the increase in global demand for food as a result of the significant growth in the emerging economies, especially in China and India. Thus, as a result of continuous increase in wheat consumption, the global stocks are expected to be at the lowest level from the last 25 years. In the same time, it is seen an adjustment of the consumption structure in these countries towards the consumption of products with higher nutritional value, especially meat²¹ and dairy²² products. However, this readjustment implies much more quantities of cereals (for animals' nutrition) which, nowadays, are hardly covered by the production global capacity. Actually, the estimated increase of wheat production will not cover the expected consumption demand and the global stock will continue to decrease (fig. 4).

However, not only the "appetite" of developing countries causes the cereals record-consumption. Another culprit is the current frenzy of bio-fuel. Nowhere the situation is more relevant than in United States, where the Government significantly subsidizes the corn growing for energetic goals. It provokes obvious distortions on the market and stimulates farmers to plant corn instead of other cereals. Indeed, corn production in the United States considerably increased in 2007, even more rapidly than the local consumption (see fig.5). It is estimated that the demand for cereals in the framework of American program of bio-ethanol is equivalent with a half of uncovered global necessities of cereals. Finally, massive production of bio-fuel was considered by the UN special reporter for the right for alimentation Jean Ziegler, as a crime against humanity²³.

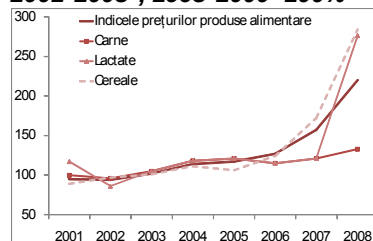
In addition for these two fundamental factors, price increase for foodstuffs was caused by two temporary factors. The first one is related to the turbulence on the global financial markets and vertiginous depreciation of the American currency. High inflation and plunge of the dollar caused an explosion of demand for raw materials. A record increase was recently observed on the soya, gold, platinum, iron ore markets as well. In this case, aliments constituted just a single element of the price increase chain observed on the raw materials global markets. Another temporary factor which aggravated the alimentary products situation was the weak crop from the last year caused by unfavorable weather conditions in the exporting countries and which led to wheat production decrease.

²¹ IFPRI, FAO, The Economist

²² www.capital.ro

²³ www.capital.ro

Fig.6. Evolution of alimentary prices and of the index of alimentary products (FAO) in 2001-2008*, 1998-2000=100%



Source: FAO, *Crop Prospects and Food Situation*, April 2008

*Note: for 2008 are used the data for March 2008

The majority of Governments reacted on price increase through administrative measures...

... which fundamentally can solve the situation

The new Moldavian Government considers as well that the intervention is necessary ...

Price increase for aliments causes social turbulences

During last years the prices for alimentary products increased dramatically (see fig. 6), prices for dairy products and cereals increased the most. Of course, as a result of price increase for such important products the reaction of population was immediate. The low-income countries' population bears the main brunt. A series of social turbulence related to price increase for alimentary products has already exploded in some countries from Latin America, Africa and South-Eastern Asia. According to some estimates, one-third increase in food prices will reduce the living standards in rich countries with 3%, but in poor countries with over 20%²⁴.

UN Organization for Alimentation and Agriculture even composed a list of 37 countries which face an alimentary crisis and which need external assistance. In this year the Republic of Moldova (the only European country in the list) is included in this list. However, we consider that in the case of Moldova it is related to an exceptional situation caused by the drought from 2007. The same report mentions the probability of Moldova's recovery in 2008.

The Governments' answer: on a wrong path ...

After noticing the price increase for such politically sensitive products, the Governments from many states interfered rapidly. In most cases these interferences have an administrative character and consist of a control of aliments' prices and some constraints of alimentary products exports. For example, Morocco, Egypt, México, China, Malaysia preferred to control the prices. India, Vietnam, Serbia, Kazakhstan, Ukraine opted for quotas establishment on exports. Russia applied both.

However, the majority of experts consider that the administrative solution for the problem does not bring desired results. Prices control distorts the market, discriminates the agricultural producers and can cause the deficit of alimentary products in the free trade. Imposing export quotas provokes tensions and deficit on global markets and, at the same time, can determine absurd results for farmers which produce more cereals than they can sell on the local market, and as a result they are forced to lose or to destroy the production surplus (recently a similar case happened in Ukraine) or to sell these products to some groups of local interest at underprices.

It is extremely important to remember these arguments since apparently came the turn of the Moldavian Government to become concerned by the galloping prices for alimentary products in the Republic of Moldova. The new Prime minister, Zinaida Greceanii, "... demanded from the responsible persons from Ministries of Economy and Trade and of Agriculture and Alimentary Industry to identify within a week the causes of recent price increase for alimentary products ... to propose solutions and market mechanisms for regulation of this situation". The Ministry of

²⁴ The Economist

... which could bring success only if it will accompanied by stimulation measures for the honest market competition

Economy and Trade together with the Ministry of Agriculture and Alimentary Industry will determine either this price increase is caused by some errors in market functioning and lack of a strong competition or not.

In this case we consider that the National Agency for Competition Protection must find out either the case of price increase for alimentary products is caused by some anti-competition arrangements or it is caused by a market failure, which are its motives and at what level of value chain it is happening. Is it the case of some intermediary groups which determine the exaggerated price increase, lack of adequate information of producers about sales market opportunities of agricultural production, etc.? At the same time, it remains to be assessed either the presence of "intermediaries" represents a violation of the legislation or a rational economic result of the market structure. Finally, it remains to be assessed either the Government can interfere at the national level, or the public administration institutions are responsible for this (for example, by reducing market local taxes).

In any case, we expect that the Government will resist to the temptation for undertaking populist administrative measures with a pre-electoral year. Regarding the protection of socially vulnerable population, the most suitable measure is the support offered directly to poor citizens (food stamps for example), and the farmer which suffered as a result of the drought must receive subsidies in the form of seeds in order to be capable to recover the normal production levels.