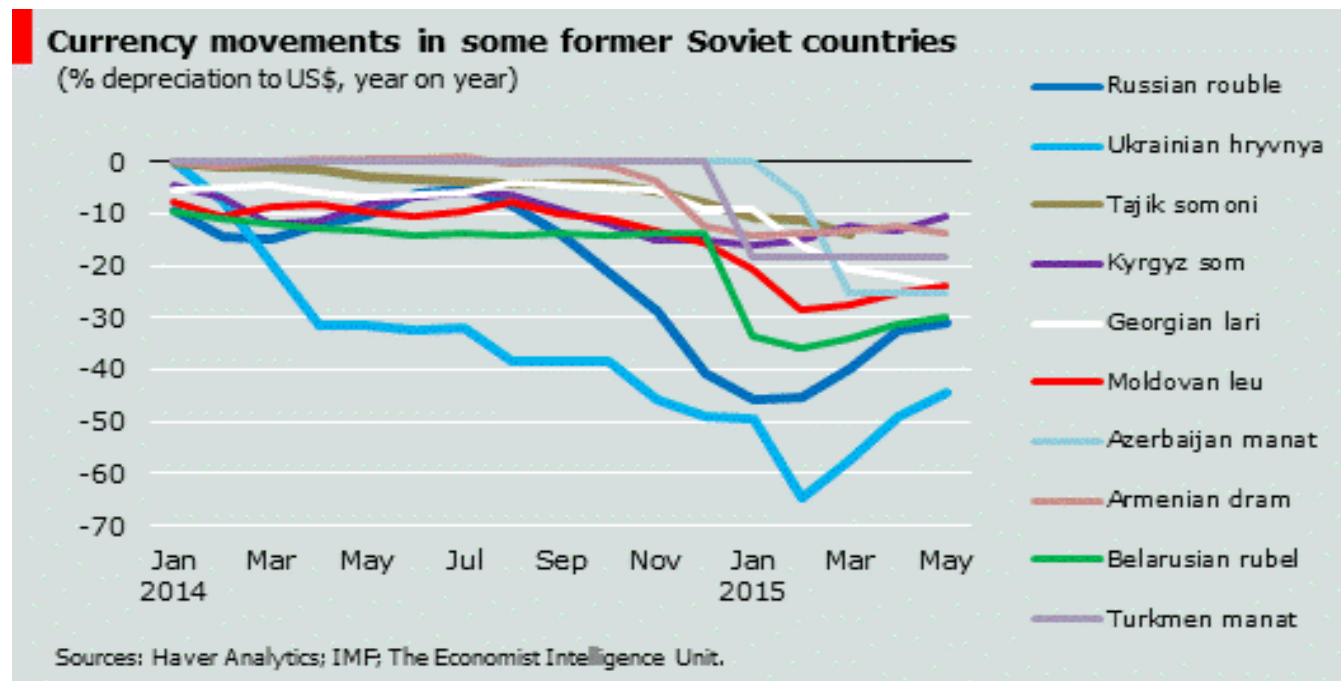


Macro 2015 conference, Chisinau

Policy responses to internal & external financial shocks



July 10th 2015

David Dalton

© Economist Intelligence Unit

I. The problem: Two big financial shocks

Regional currency crisis

Nutshell: Slowing Russian economy hit by EU sanctions & oil price fall triggers rouble plunge.

For Moldova, 2013 exports to Russia = 8% GDP; remittances = 16% GDP. Food & wine bans, plus stricter labour rules, alongside economic slowdown, rouble crash.

- Leu appreciates to rouble
- Exports to Russia lose competitiveness
- Remittances fall steeply in Q4, from lower earnings & revaluation

Domestic bank fraud

Nutshell: Huge, dubious bank transactions in late 2014 exacerbate leu plunge in 2015.

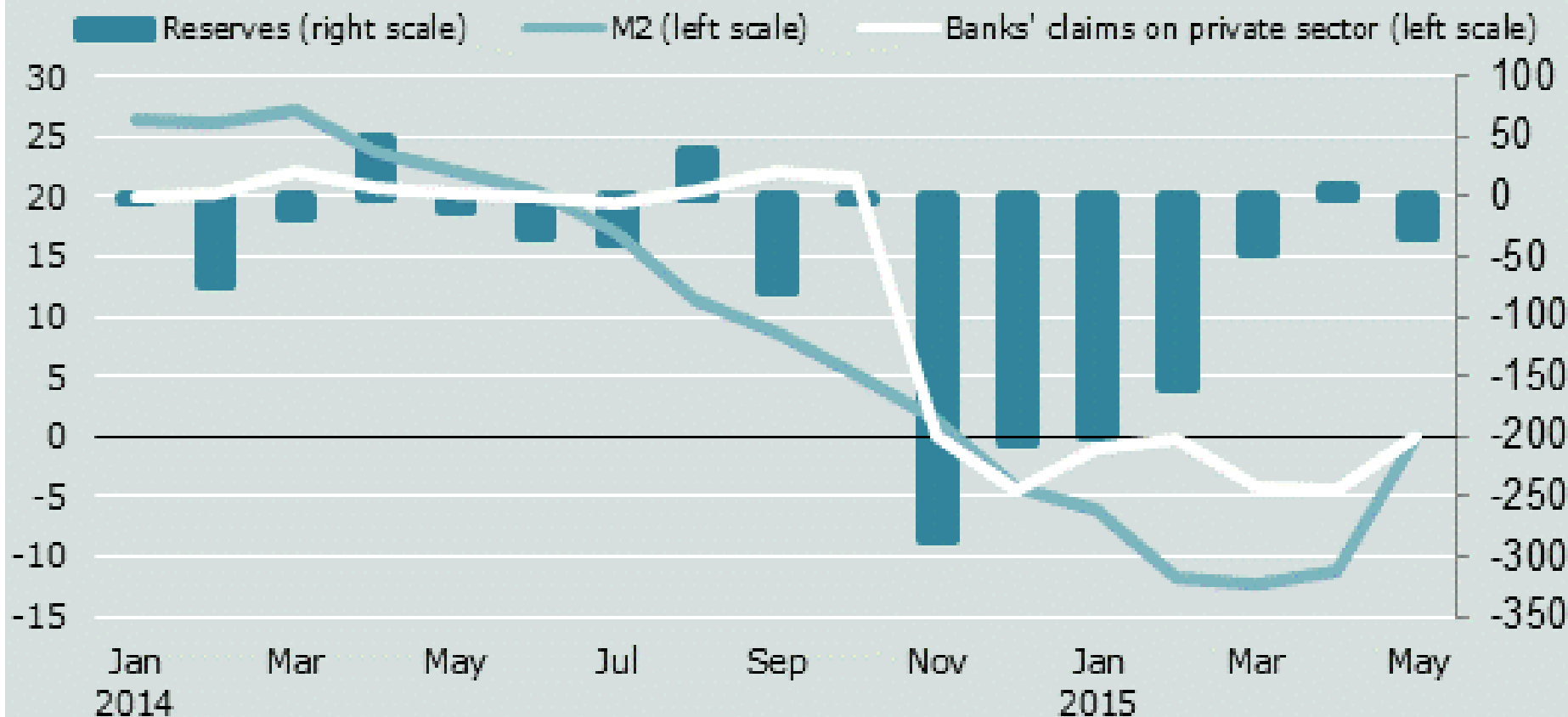
For Moldova:

- NBM steps up interventions from late 2014 to soften leu fall as rouble weakens
- Shortage of FX from this & bank fraud exacerbates leu fall as domestic FX demand rises
- Reserves sink
- Monetary policy tightened sharply to bring money demand to line with reduced money supply

II. Results: Money supply contracts

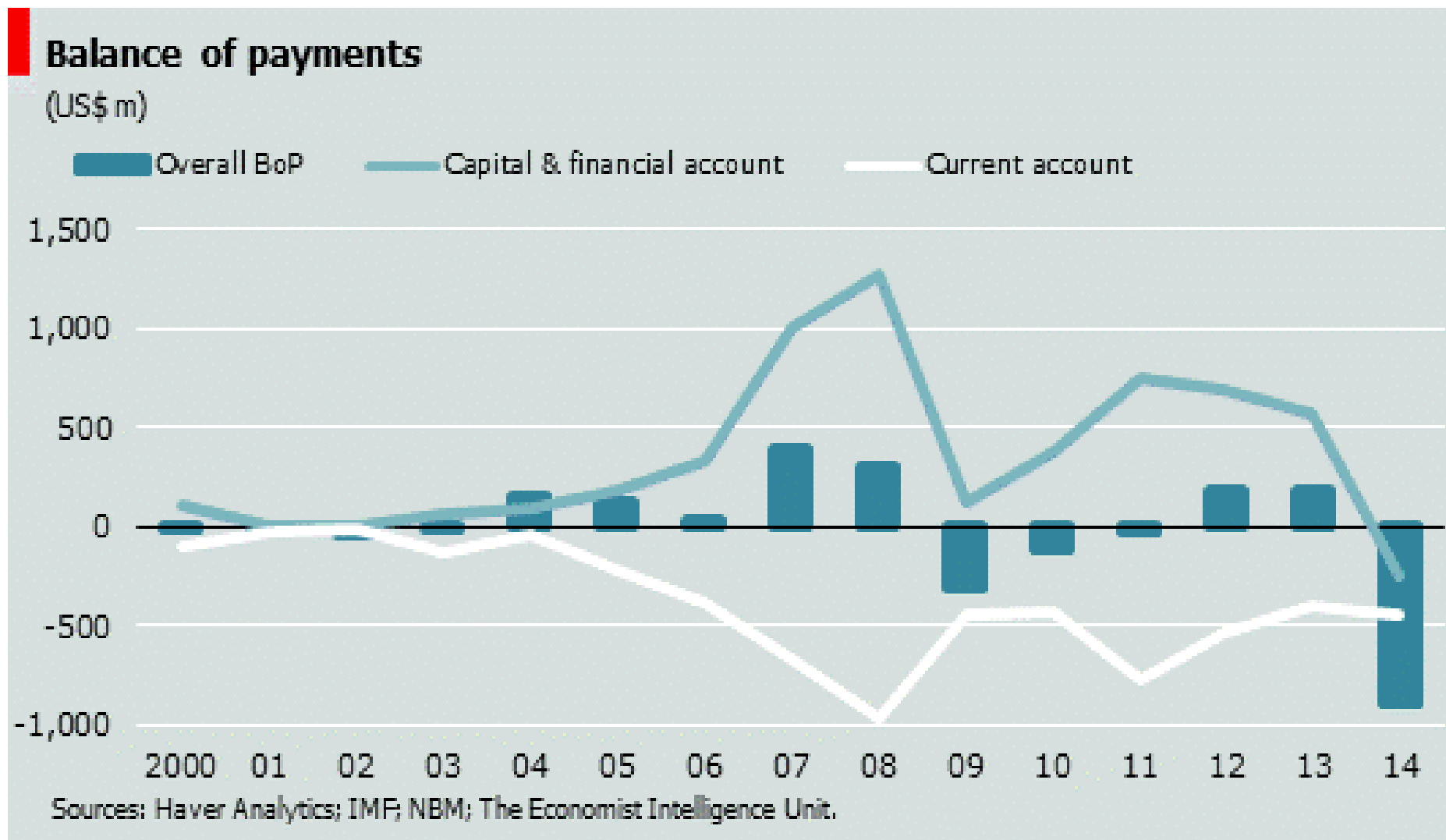
Money supply, credit and reserves

(% change year on year, but mom US\$ change for reserves)



Sources: Haver Analytics; IMF; NBM; The Economist Intelligence Unit.

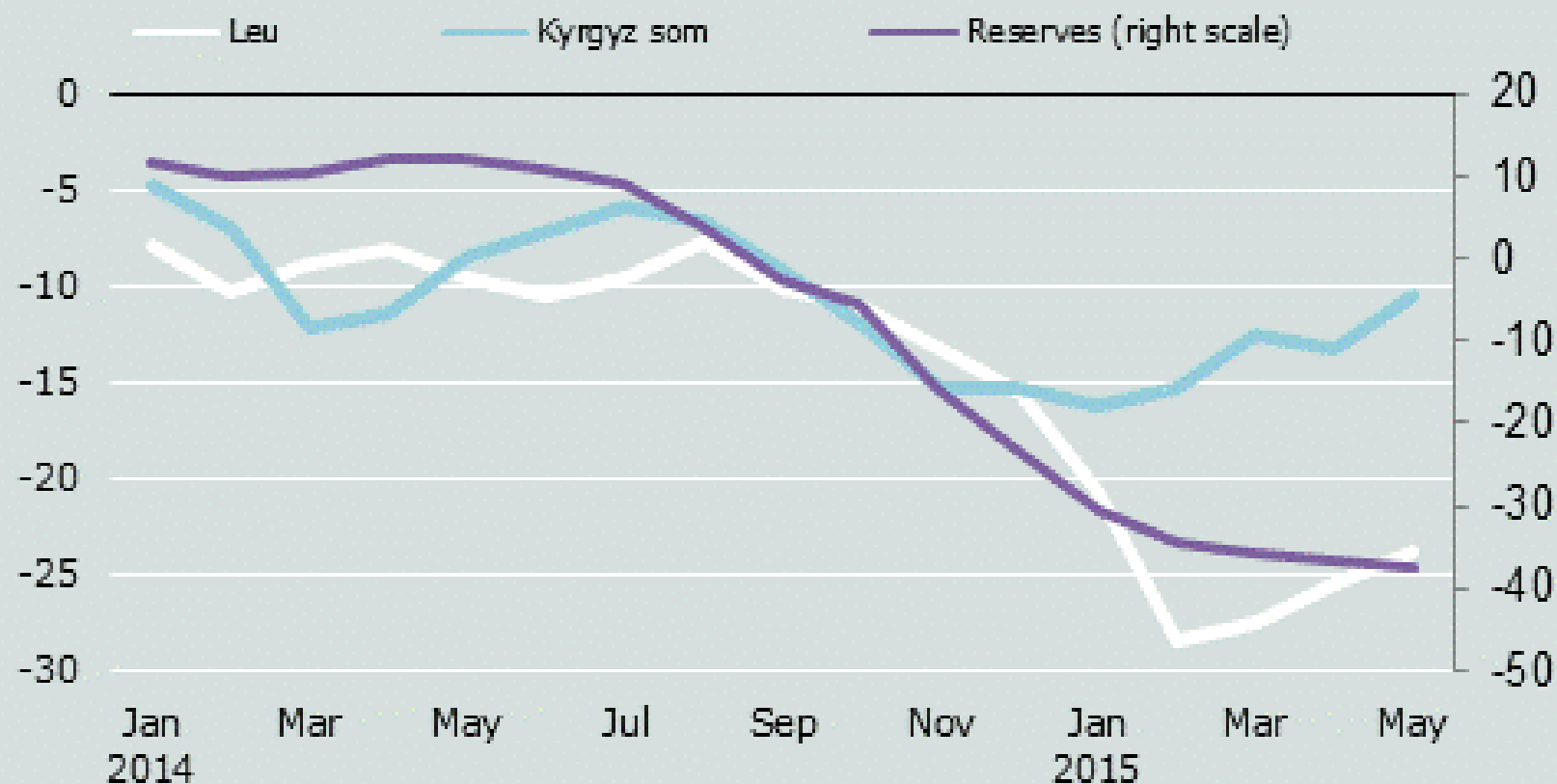
II. Results: BoP develops large shortfall



II. Results: Leu and reserves fall rapidly

Nominal currency movements and reserves

(% change or depreciation, year on year)



Source: Haver Analytics; IMF; NBM; The Economist Intelligence Unit.

II. Results: inflation rises, interest rates hiked

Inflation and interest rates



Sources: Haver Analytics; IMF; NBM; The Economist Intelligence Unit.

II. Results: Q1 GDP

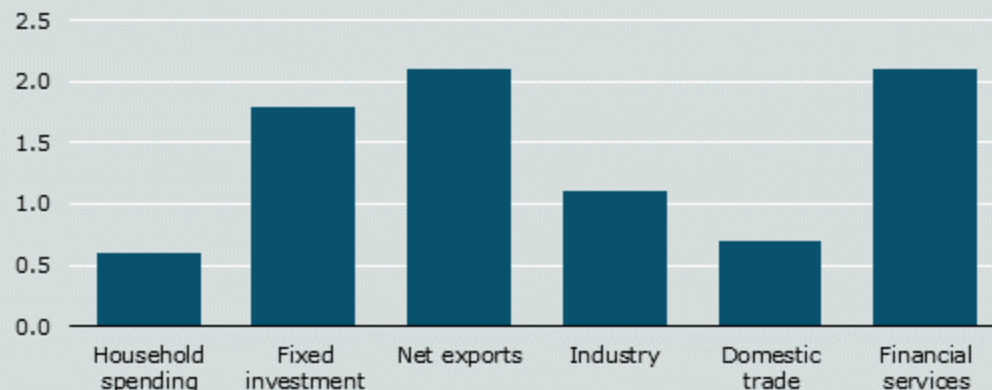
- BUT **GDP up 4.8% in Q1**, vs 4.6% in 2014, amid financial shocks, as geo-political struggles spill into domestic politics.

Why?

- Leu weakening keeps real exports and LC remittances growing as fall in \$ terms.
- Exports support industry, stimulating investment.
- LC remittance growth prevents sharper retail slowdown.
- Explanation financing growth?

Contributions to real GDP growth, Q1 2015

(percentage share)



Source: National Bureau of Statistics.

Export trends

(% change, year on year)



Sources: National Bureau of Statistics; Haver Analytics; The Economist Intelligence Unit.

III. Prospects: forecasts

2015

Mild contraction in C & I drives GDP slowdown, to about 1% in 2015.

Households at the centre of the storm:

- remittance falls deepen
- inflation still high
- consumer confidence low
- tight MP: credit costs & savings up

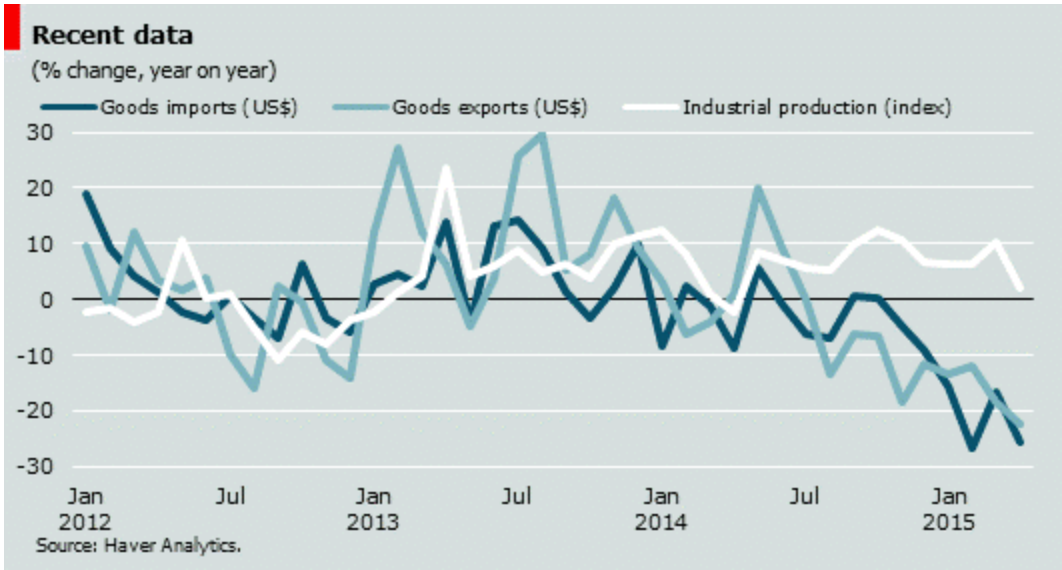
From weak consumer spending:

- manufacturers' sales hit:
- investment cutback as profits weaken, borrowing costs climb.

- Recessions in Russia & Ukraine.
- Food export prices fall sharply.
- Russian ban on EU food extended.
- Threat/ impact of Grexit.

Full impact of bank scandal includes

- missing loans
- spent reserves
- GDP output unrealised.



2016

- ✓ Foreign demand & export prices &
- ✓ continuing leu depreciation offset:
- ❖ higher energy costs
- ❖ continued tight MP.

2017

Stronger recovery in household demand awaits

- feed of external recovery to labour market &
- stronger remittances from Russia.

III. Prospects: forecast table

Moldova's economic outlook, 2015-17					
(% change, year on year)					
	2013	2014	2015	2016	2017
Growth environment					
Russia	1.3	0.6	-3.3	0.8	2.2
Romania	3.4	2.8	3.5	3.8	3.6
Italy	-1.9	-0.5	0.4	0.8	1.0
Food prices	-7.4	-5.3	-16.0	4.0	4.6
Inflationary environment					
Russia	6.8	7.8	14.0	5.5	5.2
Ukraine	-0.3	12.1	48.0	11.0	8.5
Romania	4.0	1.1	0.7	0.9	2.3
Oil prices	-2.8	-9.1	-39.1	15.0	15.3
Gas prices	2.7	-14.7	-17.4	4.7	6.7
EIU forecasts					
Real GDP	9.4	4.6	1.2	2.8	3.7
CPI	4.6	5.1	7.5	7.0	6.2
Lei:\$1 exchange rate	12.6	14.0	18.4	19.2	18.2
Source: The Economist Intelligence Unit.					

IV. Key risks

Banking risk

- low confidence depresses borrowing
- reduced financial intermediation
- climbing NPLs, higher provisioning, low capitalisation puts bank solvency at risk
- public finances strained by recapitalisation, deposit compensation

Domestic political paralysis/ stability

- politicians' gaze diverted from tackling economic slowdown & bank reform
- as East-West stand-off spills over at home, inaction on bank fraud stokes public protests

Monetary policy proves too tight

Wrong tools, with energy cost inflation, more leu weakening ahead?

Grexit?

- slower EU demand amid Russian recession
- undermines commodity prices, boosts capital flight, undercutting rouble.



V. What policies?

Exchange rates & monetary policy

What? Adjustable/ crawling peg as nominal anchor.

Why? Tight MP: mom inflation close to LT av.

Demand tools to tackle 2016-17 cost-push inflation could damage GDP

Minimising risks: Capital inflows low as share of GDP. Bank fraud will deter investment. Small financial Tobin tax to deter speculation? Credibility: coherent plan plus outside backing.

Fiscal policy

What? Automatic stabilisers. Tax breaks for employment/ investment in export sectors.

Why? Managed float & small capital market gives some room for fiscal expansion: more so with peg.

Financial sector reforms

What? Describe & publicise Moldova's political economy. Design institutional change. Back with sustained, popular social-political campaign.

Why? Problem is one of power, not bank rules.

US\$1bn bank fraud: political insiders with powerful foreign backers use control of parts of state to launder money through banks with impunity, at expense of Moldova's GDP.

