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Transnistrian Economic Review is a quarterly publication about the main economic and political developments in the eastern districts of the Republic of Moldova. Its readers are policymakers, CEOs of domestic and international companies and banks, representatives of the international institutions and foreign embassies, political parties and economic journalists who work on both banks of the Nistru River.

Economic Convergence Indicator (ECI) measures the closeness between the economy of the Transnistrian region and that on the right bank of the Nistru River. The indicator is computed on the basis of similar economic indicators for both areas. The index encompasses the following parameters: indicators related to the number of the population (volume of investments, agricultural production, export and import of goods, the M3 monetary aggregate), CPI and the real exchange rate MDL/PRB (find more details in Annex A).

List of acronyms and abbreviations

ECI – Economic Convergence Indicator; y-o-y – year on year; q-o-q – quarter on quarter; m-o-m – month on month; e-o-p – end of period; p.p. – percentage points; Q3:15 – third quarter 2015; Jan:15 – January 2015; NBM – National Bank of Moldova; NBS – National Bureau of Statistics; RB – Republican Bank of the Transnistrian region; MED – Ministry of Economic Development of the Transnistrian region; MDL – Moldovan Leu; PRB – “Transnistrian Ruble”; CPI – Consumer Price Index. DCFTA – The Deep and Comprehensive Free Trade Area.

EXPERT-GRUP is a Moldovan independent think-tank whose mission is to create a working environment in which free and non-trivial thinking thrives in order for the institution to be a leading source of unbiased economic analysis and to effectively advocate for innovative ideas and solutions to the economic problems that Moldova encounters along its path of economic transformation, societal development and European integration.

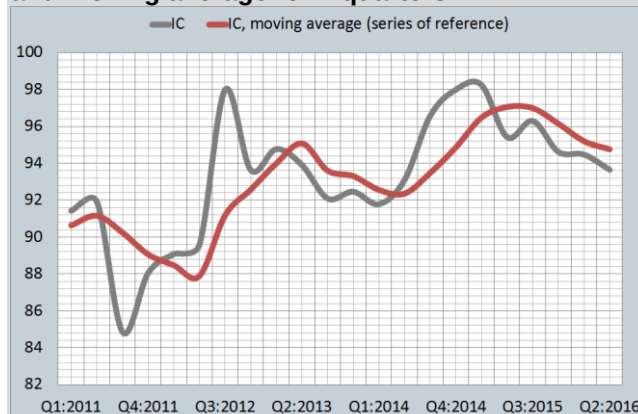
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Economic Convergence Indicator between the Left and Right Banks of the Nistru River

For 4 consecutive quarters, the economies on both banks of the Nistru river have been diverging from the economical point of view. In Q2:2016, the convergence indicator fell to 94.8% (97.1% in Q2:2015) due to the more acute deterioration of the economic situation in the Transnistrian region, compared to that on the right bank. Structurally, these developments were caused by a more negative dynamics of the domestic demand and imports, as well as of the agricultural sector in the Transnistrian region, compared to the right bank.

Economic Convergence Indicator (ECI), raw data and moving average for 4 quarters



Source: NBM, NBS, RB, MED, EG estimation

The Transnistrian economic crisis worsens due to the lower domestic demand, coupled with the erosion of competitiveness on foreign markets. After compressing by about one-fifth in 2015, the Transnistrian economy does not seem to resume soon its relaunch stage. The most worrying signals come from the domestic demand, external demand and investments. Thus, on the background of the dramatic reduction of households' income, including remittances, and the shortages of foreign currency, in Q2:16 the imports fell by about one-third y-o-y. The high level of social and economic uncertainty in the region led to the emigration of capital to Ukraine and the right bank of the Nistru River, and a 20% decline in the capital formation in Q2:16, y-o-y. During the same period, exports dropped by approximately 5% y-o-y, largely due to keeping a fixed "exchange rate of the Transnistrian ruble", which continues to erode the competitiveness of exporters from the region.

The importance of economic policies is shadowed by political economy considerations. This is noticed especially in the case of dilemma regarding the controlled depreciation of the "transnistrian ruble". The truth is that the preconditions for keeping the "exchange rate" fixed at the current level are based on false premises, both in terms of economic policy and political economy. In particular, this policy is wrongly believed as protecting people's incomes, for several reasons. First, the foreign-exchange black market is getting bigger, and "the Transnistrian ruble" has already depreciated there, de facto, by up to 50%. Second, due to the shortage of foreign currency in the region and the impossibility of domestic production to compensate the large reduction in imports, more and more people from the region are forced to go shopping on the right bank of the Nistru River. Taking into account the transport costs, losses from "currency exchange" and the time spent on shopping, the formal deflation of -0.2% reported at the end of April becomes a hidden inflation with major repercussions on poverty levels in the region. In this context, we believe that an urgent, but controlled and dosed depreciation of the "Transnistrian ruble" is necessary, by about 15% by the end of the year, and by additional 25% during 2017 in order to eliminate the black capital market and reanimate the exports. In parallel, active measures to boost investments are needed.

Disclaimer

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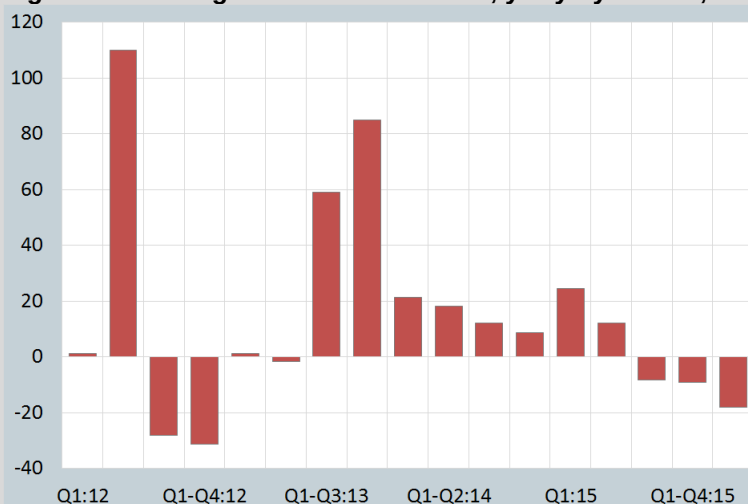
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Resilient nations.*

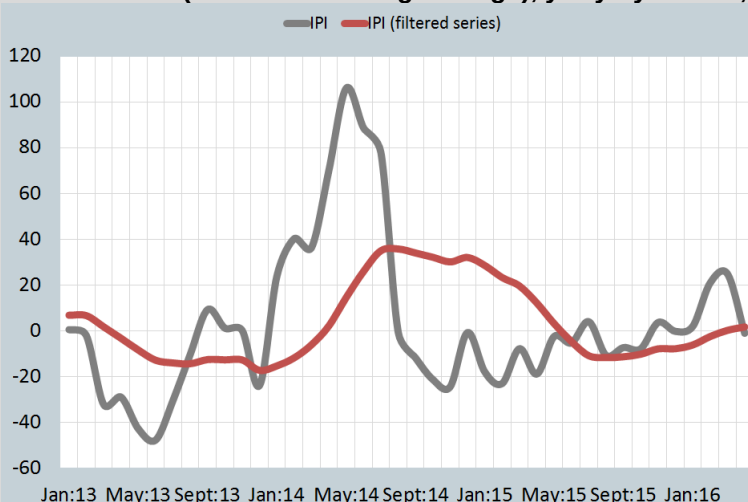
■ Main Economic Trends in the Transnistrian Region

Figure 1. Total Agricultural Production, y-o-y dynamics, %



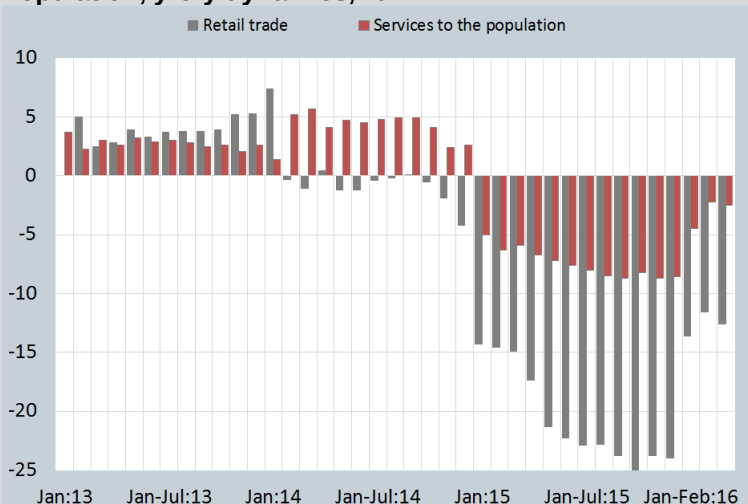
Source: MED

Figure 2. Industrial Production Index (IPI), raw series and filtered series (12-month moving average), y-o-y dynamics, %



Source: RB, EG estimates

Figure 3. Retail Trade and Services Rendered to the Population, y-o-y dynamics, %



Source: MED

AGRICULTURE

The total agricultural production continued its downward trend in Q1:16, caused by the decrease in animal production by 21.7% y-o-y. Thus, as the livestock decreased last year, the production of eggs and milk shrank by 60.7% and 14.1% y-o-y, respectively. However, the more pronounced growth in the vegetable sector (by 49.5% in Q1:16 y-o-y) will ensure a positive dynamics of the animal production in the following quarters.

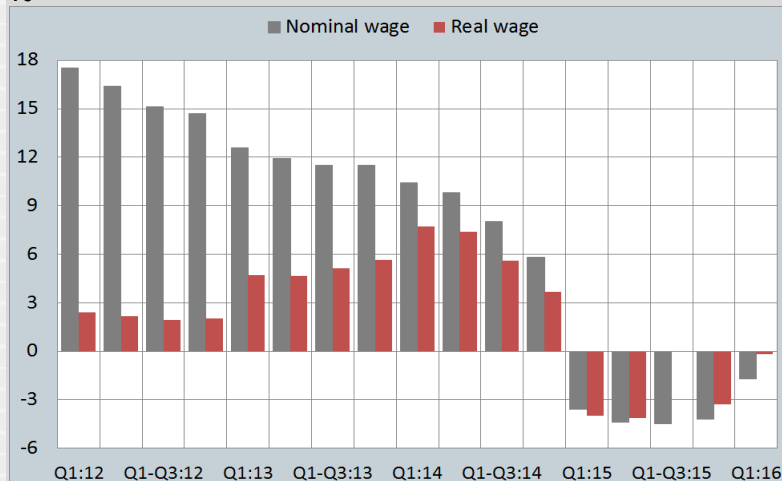
INDUSTRY

After the significant progress, recorded by the industrial sector in Q1:16, in April the industrial production decreased again y-o-y. These fluctuations emphasize the vulnerability of the regional economy, highly focused on several sectors. The decrease was determined by the massive drop in production in the two main industries: energy and metallurgical. At the same time, the share of light industry, food industry and less important industries increased sharply during the same

INTERNAL TRADE

Though the pace of decline in domestic trade was smaller in 2016, such a prolonged period of recession reveals the long-term repercussions of the crisis in the region. Thus, in Jan-Apr:16, the turnover in retail trade and services to the population dropped by 12.6% and 2.3% y-o-y respectively. The continuous erosion of people's incomes and lower imports as a result of the foreign-exchange crisis underpin these trends.

Figure 4. Average Nominal and Real Wage, y-o-y dynamics, %

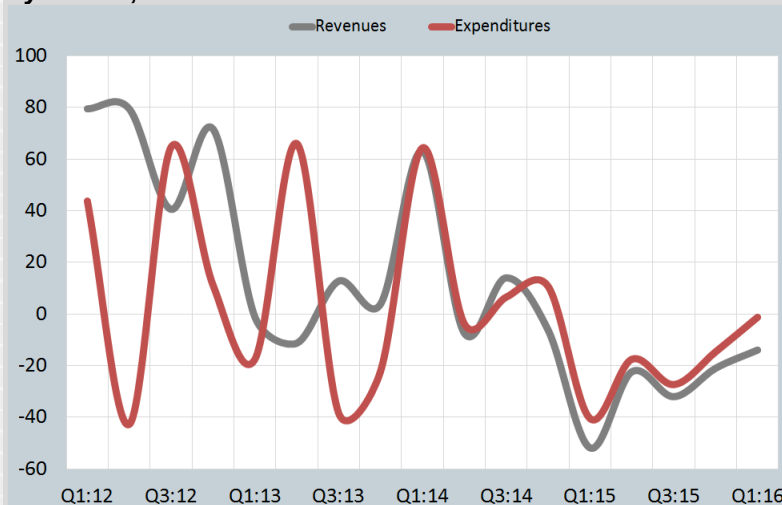


Source: MED, EG calculations

INCOME OF THE POPULATION

The growth in salaries and pensions was “cushioned” by the deflation in the region. Thus, in Q1:16, the real wage decline was more moderate compared to the drop in nominal wage: by -0.2% compared to -1.7% y-o-y, and the pensions even increased slightly. However, the fewer jobs and the dynamics of transfers from abroad decrease people's incomes, with a negative impact on the domestic trade and individual deposits.

Figure 5. Central Budget Revenue and Expenses, y-o-y dynamics, %

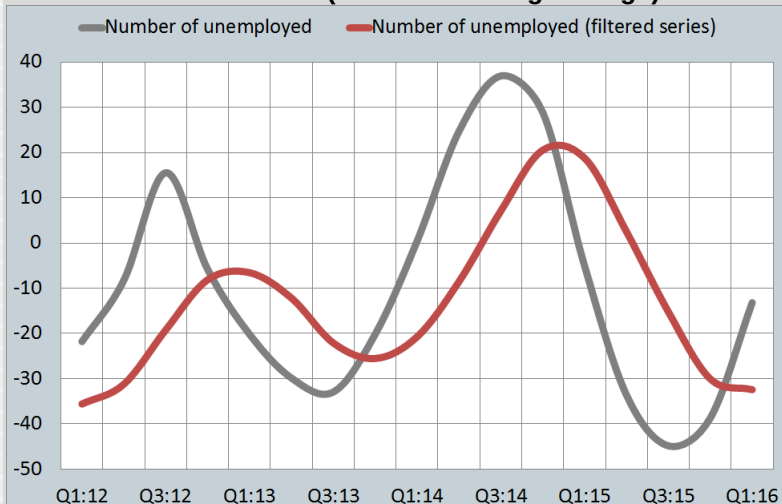


Source: Ministry of Finance

PUBLIC FINANCE

Since April, the dynamics of public finances seems to have stabilized, as a result of the very low comparison base of 2015. Thus, the revenues of the “republican budget” decreased in Jan-Apr:16 by -0.2% y-o-y, while the taxes and duties collected from the largest taxpayers continued to shrink. At the same time, the expenses of the “republican budget” increased by 4.2% and already exceed by 55% the revenues collected for the same period.

Figure 6. Changes in the Number of the Unemployed, raw series and filtered series (4-month moving average)

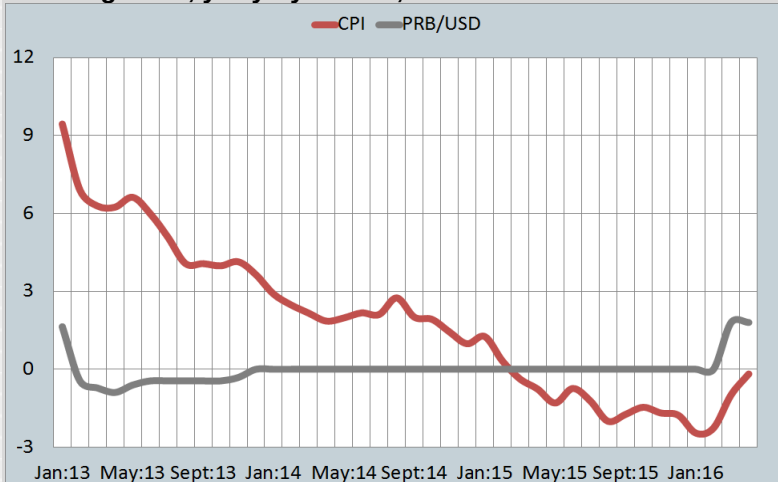


Source: MED, EG calculations

LABOUR MARKET

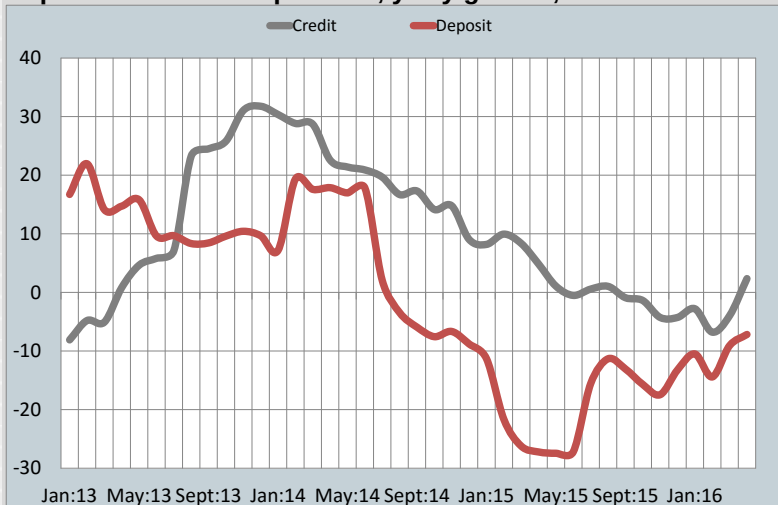
In Q1:16, the employed population decreased by 3.3% y-o-y, while the number of the registered unemployed dropped by 13.2%. In Jan-Apr:16, the number of employed population (without the SME sector) decreased y-o-y in industry (-5.9%), agriculture (-9.9%), constructions (-30.8%), and trade (-2.5%). The newly accumulated salary arrears had a decreasing trend. In May, a loan, provided by Sheriff company, was used to pay all the salary arrears.

Figure 7. Consumer Price Index (CPI) and PRB/USD Exchange rate, y-o-y dynamics, %



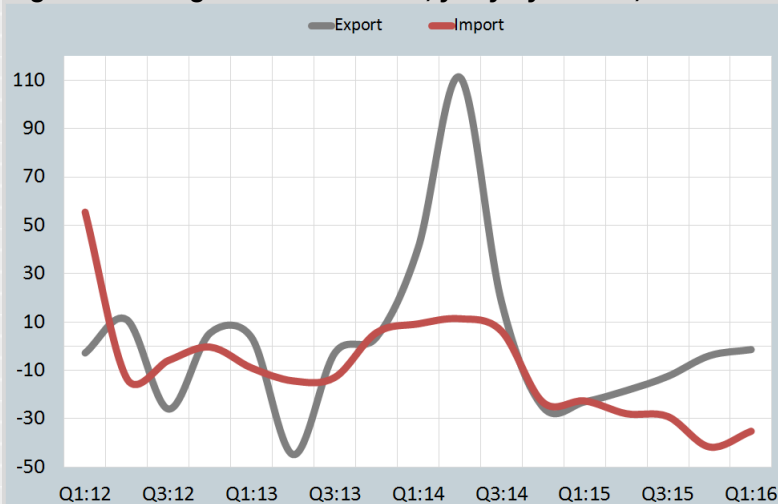
Source: RB

Figure 8. Loans for the Real Sector and the Population, and Deposits from the Population, y-o-y growth, %



Source: RB

Figure 9. Foreign Trade in Goods, y-o-y dynamics, %



Source: RB, MED

PRICES AND “MONETARY POLICY”

*In Apr-Mai:16, the region continued to be dominated by the effects of the foreign-exchange crisis. After the slight devaluation on March 16, 2016 of the “Transnistrian ruble” against the USD, the “regional currency” continued its depreciation against Euro and Russian ruble. At the same time, the deflating processes stabilized in 2016. In Mar-Apr:16, the prices grew, in particular for foodstuff, and the annual deflation constituted **-0.2%** at the end of April.*

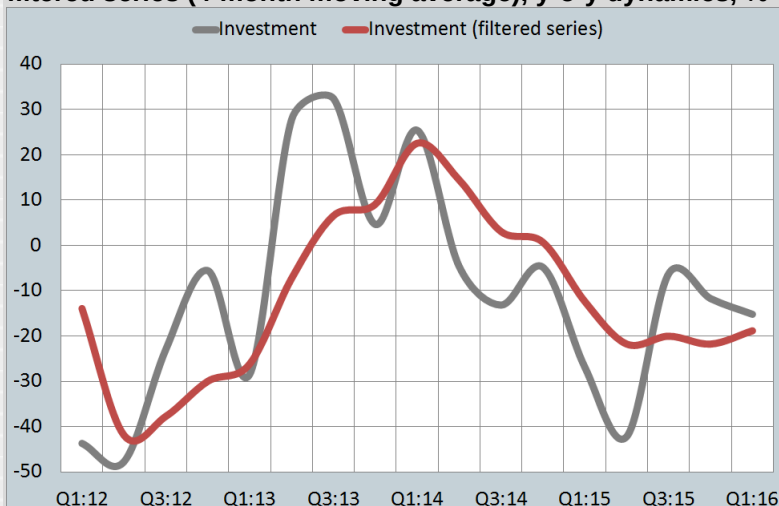
BANKING SYSTEM

*After the downward trend of the lending activity started in Sep:15, it grew by **2.4%** in Apr:16 y-o-y. This advance was caused by the **11.9%** increase in the loans to businesses, while the loans to individuals decreased by **11.8% y-o-y**. It is too early to anticipate that the trend will reverse, as long as people's deposits continue to fall (by **7.2%** in Apr:16 y-o-y), and the mandatory reserves' rate was recently raised by 2 p.p.*

FOREIGN TRADE

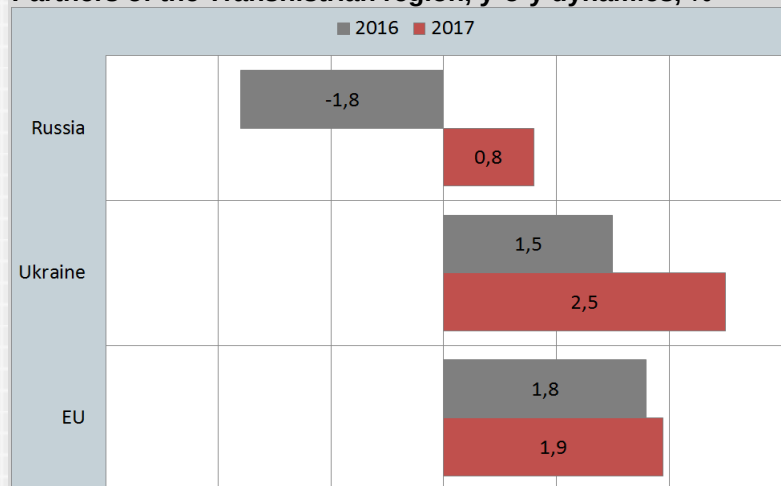
*The foreign trade continues its negative dynamics, though accompanied by geographical reorientation. The total exports shrank by **5.4%** in Jan-Apr:16 y-o-y, with a **15.4%** decrease of exports to CIS and **16%** increase - to other destinations. The exports to many EU states increased (Romania, Germany, Serbia, Slovenia, Czech Republic), as well as to Ukraine. At the same time, the lower domestic production caused a decline in imports, in particular of mineral fuels and metals.*

Figure 10. Investments in Fixed Capital, raw series and filtered series (4-month moving average), y-o-y dynamics, %



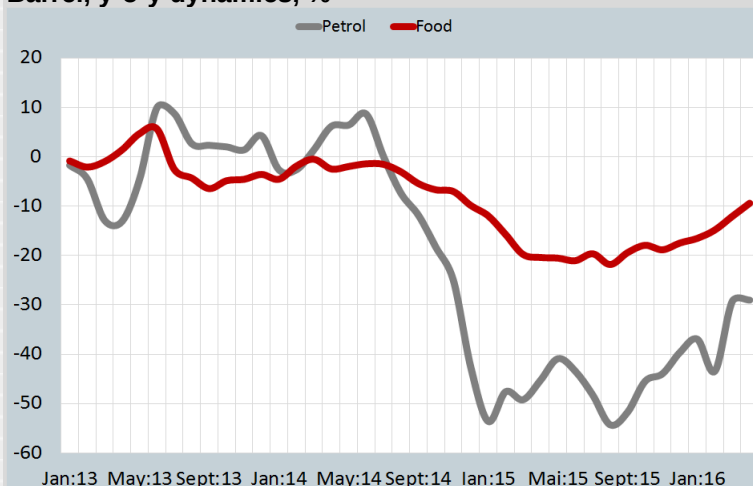
Source: MED, EG estimates

Figure 11. Economic Growth Forecast for the Main Trade Partners of the Transnistrian region, y-o-y dynamics, %



Source: IMF

Figure 12. World Food Price Index and Average Price per Oil Barrel, y-o-y dynamics, %



Source: IMF, FAO, UN

INVESTMENT ACTIVITY

The investment activity is continuously shrinking due to the lack of resources in both public and private sector, and low confidence of businesses. In Q1:16, the capital investments decreased by **15.2 %** y-o-y, with a strong drop in construction and installation works (by **38.6%**), as well as investments in machinery, equipment and facilities (by **8.3%**).

Investments funded from budgetary sources decreased significantly, amounting to only **2.2% y-o-y** of the total investments.

TRADE PARTNERS

The expected growth of the main external partners, the region's geopolitical climate and economic and political situation will continue to encourage the reorientation of exports. Thus, in 2016 Romania continues to maintain its position of the main partner for the region's exports, and the share of other European countries is increasing. In addition, if the Ukrainian economy grows as predicted, the export to this destination is likely to augment.

GLOBAL MARKETS

The global agri-food prices have recently grown, in particular for sugar and vegetable oil, which have increased by about 15% since the beginning of the year. Though it could boost inflation in the region, currently there aren't any preconditions for a stronger growth of global prices in 2016. At the same time, the global fuel prices have increased by **11.5%** since the beginning of the year, placing additional pressures on already fragile Transnistrian economy. However, it is expected to stabilize in Q3-Q4:15.

■ Key Policy Developments

Policy Developments	EXPERT-GRUP Comments
28 April 2016. The list of products for which the prices will be regulated by the “Board for Prices and Antitrust Activity” in the region has been extended.	The draft Law on additional Government measures intended to minimize the side-effects of external economic shocks stipulates the extension of the list of products whose prices will be regulated by the “Board for Prices and Antitrust Activity” in the region since May 1. It includes 10 basic products, including meat, sugar, salt, and fish. On the one side, this measure aims at reducing the inflationary pressures in the region, which have worsened since April, in particular for food products, and represent a serious risk in an electoral year. On the other side, it causes additional pressures on the region’s market and may worsen the current food crisis. The extension of the list of regulated prices is rather an economic policy error and has a clear electoral flavor, similar to other recent actions.
29 April 2016. The “Ministry of Finance” from the region signed with Sheriff company an agreement on interest-free loan to pay the salary arrears in the budgetary sector for 2015.	Sheriff made this offer back on 5 April 2016. The authorities, in particular the de facto president of the region, have hesitated initially, as Sheriff is supporting the main political opposition party, as well as because the loan repayment terms are quite risky. However, due to the worsening economic crisis in the region, new salary arrears have been accumulated, and there were no possibilities to pay the 2015 ones, while the support from the Russian Federation is delayed. Thus, Sheriff’s offer was accepted, and 300 million “Transnistrian rubles” were transferred on the account of the “Ministry of Finance” on 4 May 2016. Additionally, an interest-free loan of 56 million “Transnistrian rubles” was accepted to pay the pension arrears, accumulated in 2015. Though initially there were doubts regarding the loan repayment terms, the official sources do not provide any information about the actually agreed terms between the de facto government and Sheriff. Non-official sources claim that the repayment deadline was postponed until November 2016, though the regional authorities requested to postpone it until the end of the current year. Thus, the deadline set before the so-called presidential elections from the region may impact their result. The conditions for loan repayment, in case of the depreciation of the region’s de facto currency, poses major risks for the region’s economy, unless the terms initially requested by Sheriff (i.e. the repayment of the loan in “Transnistrian rubles” at the exchange rate on the repayment date) have been changed. After the money were transferred, the de facto Ministry of Finance announced that it paid fully all the arrears until 24 May 2016.
5 June 2016. The de facto Government of the Transnistrian region made an initiative to decrease by 20% the gas and electricity prices for the rural population.	The reason of this initiative, which was approved by the de facto President of the region, is to support the population from 1 May to 31 October, in particular the public sector employees and pensioners, whose salaries and pensions will not be raised this year. Though the people’s income decreased, and the perspectives seem more and more gloomy, such initiative have an electoral purpose. Thus, the deep regional economic crisis is worsened this year by the major political processes and divergences on the eve of the so-called presidential elections.
6 June 2016. “The republican bank of the Transnistrian region” decided to introduce a fee of 10% on the procurement of foreign currency.	The foreign-exchange crisis continued, and even worsened during April-May. Thus, after the “republican bank of the Transnistrian region” remained without any foreign-exchange reserves in March, all the following foreign-exchange auctions were concluded without any sales of foreign currency. Moreover,

Policy Developments	EXPERT-GRUP Comments
	during this period it was more difficult to find foreign currency even on the black market. As no consensus was reached regarding the depreciation of the region's currency and the demand for foreign currency has not been met for several months already, the de facto central bank decided to introduce a fee of 10% on the procurement of foreign currency. This fee replaces the suggested depreciation of 10%, but it will erode people's income, hence will not solve but only postpone the problem. However, this decision generated a number of dissatisfactions and conflicts among authorities which, on the one side, do not want the impoverish the population by depreciating the regional currency but, on the other side, can hardly withstand the pressures and keep on maintaining the exchange rate fixed to the USD, given the strong depreciation in the neighboring countries. Some other measures have been taken recently to stabilize the foreign-exchange market, but which have not yet produce any effect. Thus, on 20th of April 2016, the maximum amount of foreign currency allowed to be taken out of the country was decreased. So, individuals are allowed to take out of the country, without having to submit a special set of documents, up to USD 1000, compared to the previous threshold of USD 5000. Additionally, after some legal amendments of 30 May 2016, the local taxes can be paid both in the region's currency and foreign currency as well. Also, the de facto government suggested for the Transnistrian exporters to be obliged to sell 100% of the foreign currency receipts, as the current level of 25% does not meet the region's needs any more. Though this action would target specifically one company - Energocapital, it could affect the entire private sector. Meanwhile, the effects of the foreign-exchange crisis are transposed in a number of areas. Sheriff announced that because of the foreign exchange shortage it cannot import foodstuffs and oil. Though the Transnistrian authorities claim that there is no food crisis in the region, people have started to buy more from Moldova and Ukraine. The current situation reveals the huge failures of the regional economy, which has operated so far on the basis of some principles that run against the market economy rules.

■ Annex A: Methodology for calculating the economic convergence indicator

The convergence indicator represents an aggregate indicator that allows for the quantification of the degree of closeness between the economy in the Transnistrian region and that in the right bank of Nistru River. To calculate the indicator, data series that reflect the development of the same economic variables on both banks of Nistru River were used.

The primary information was about the quarterly statistics regarding the development of similar indicators on both banks of Nistru River. The following indicators were used as raw data: volume of investments, agricultural production, export and import of goods, CPI, M3 monetary aggregate stock at the end of the third quarter and the exchange rates PRB/USD and MDL/USD.

To ensure the comparability of data from the two areas, i.e. for the volume of investments, agricultural production, export and import of goods, CPI, M3 monetary aggregate – several iterations were made. The M3 monetary aggregate was represented as the arithmetic mean of stocks at the end of two consecutive quarters. Q1:2010 was taken as the baseline. To eliminate the influence of prices, the indicators were expressed in the values of the baseline; to this end, CPI was taken as deflator. The real growth indices were calculated against Q1:2010 on the basis of the adjusted series. To find the reference variable for every data set, the indicators from Q1:2010 were expressed in USD. To calculate the terms of the set, the values of the indicators from the reference period were multiplied by the real growth indices. The formula hereunder was used for the estimation:

$$X_Q = X_{0,USD} \cdot I_{T/0}$$

where:

X_Q - the value of the variable on the quarter Q;

$X_{0,USD}$ - the variable from the reference period (Q1:2010=1, USD exchange rate in Q1:2010);

$I_{Q/0}$ - the real growth index of the variable X

The dynamic line that represented the development of CPI was also turned into a fixed-base chronological series, where Q1:2010=1. To find out what is the nominal MDL/PRB exchange rate, the MDL/USD and PRB/USD rates were cross-multiplied. The real MDL/PRB exchange rate was calculated by multiplying the nominal MDL/PRB exchange rate by the ratio between the CPI in the Transnistrian region and the CPI to the right of Nistru River. Q1:2010 is the reference period for the real exchange rate.

The adjusted series were related to the population on both banks. To eliminate the seasonal effects from the chronological series, 4-quarterly moving averages were calculated.

The index can have values starting with zero and to infinity. The values under 1 indicate that in the region on the left bank of the Nistru River the indicators grow quicker in comparison with the increase registered in the region on the right bank of the river, or that the decrease of economic parameters from the Transnistrian region is smaller in comparison with the decrease in the rest of the country. If the values are above 1 – the situation is the other way around.

The indicator of convergence is calculated on the basis of the index. The value of the indicators shall be found out according to the formula hereunder:

$$\text{Indicatorul de convergență} = 100 - 100 \cdot \sqrt{(\ln \text{Indice})^2}$$

The increase of the indicator means that the economies on both banks of Nistru River come closer. The maximum value that the indicator can have is 100 – which means that convergence was reached.