

Real Economy is a quarterly economic review, tracking the most important economic evolutions and policy developments. Its readers are economic journalists, policy-makers, representatives of local and foreign companies and commercial banks, as well as international institutions, embassies and political parties.

Acronyms and abbreviations used:

y-o-y – year on year; q-o-q – quarter on quarter; m-o-m – month on month; e-y – versus end of last year, e-o-p – end of period; Q1:18 – first quarter 2018; Jan:18 – January 2018; NBS – National Bureau of Statistics; NEA – National Employment Agency; NBM – National Bank of Moldova; MDL – Moldovan leu (national currency); FDI – foreign direct investments; p.p. – percentage points.

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Early Warning Index (EWI)

The EWI is formed by aggregating eight indicators: average air temperature, quantity of precipitations, export of goods, remittances to individuals, new loans granted to legal entities, freight transport, revenues from compulsory health insurance premiums, budget expenditures. More details on the calculation methodology can be found on the web site of EXPERT-GRUP.

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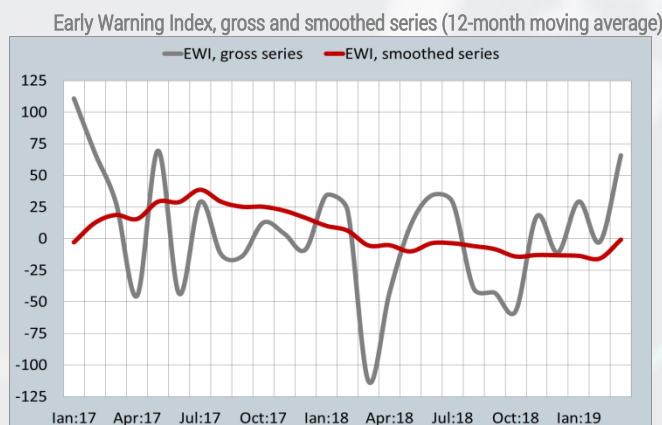
Evolution of the Early Warning Index (EWI)

In spite of the economic stabilization after a period of deceleration, the economic conditions could worsen during the second half of the year. We've noticed a certain change in how the Early Warning Index (EWI), calculated quarterly by Expert-Grup, evolved during the first months of this

year. After decreasing for a long period of time, the index changed its trajectory and started to grow. Thus, a number of monitored economic indicators show certain positive developments, but the risks persist. In particular, in Q1:19, the exports of goods started to grow again after the downward trends registered at the end of 2018. The lending to the private sector also grew in Q1:19 and in the context of the election campaign the Government increased the budget spending that had certain positive but temporary effects on consumption and economic growth. As a result, we expect a positive trajectory in the first half of the year: in Q1:19 the Gross Domestic Product could increase by about 4% y-o-y, and in Q2:19 the growth could exceed 5%.

At the same time, a series of risks for the economic growth persist on the background of external developments and adverse effects of the expansionary policies promoted by the Government in the electoral context. The remittances of Moldovan migrants have been decreasing since Aug:18. The lower inflows of foreign currency alongside a high trade balance deficit led to the depreciation of the national currency. The depreciation was also fostered by the higher budget spending in the electoral context, which stimulated the domestic demand and boosted imports, which implicitly resulted in a larger trade balance deficit. This development, along with the low harvests of many agricultural crops in 2018 will fuel the inflationary dynamics in 2019, which will generate important challenges for the central bank. The annual rate of inflation increased from 2.2% in Jan:19 to 3.2% in Apr:19 and by the end of the year it may reach 8-9%. Note that in addition to inflationary pressures, the Government's expansionary policies will also push the budget deficit up – trend already visible in Q1:19. The greater inflationary risks and imbalanced public finances could result in tougher economic policies during the post-election period: the Government might increase the taxes, cut on budget expenditures and/or take more loans from banks, which will increase the cost of domestic Government debt and have negative effects on loans granted to the real sector. These developments will have adverse effects on economic dynamics, which may slow down in the second half of 2019 and throughout 2020.

Perpetuation of political instability is another risk factor for the economic growth. This is due to the suspension of many projects by private investors and development partners until the formation of the new Government, and the delayed reforms and economic stabilisation measures that are needed during the post-election period.



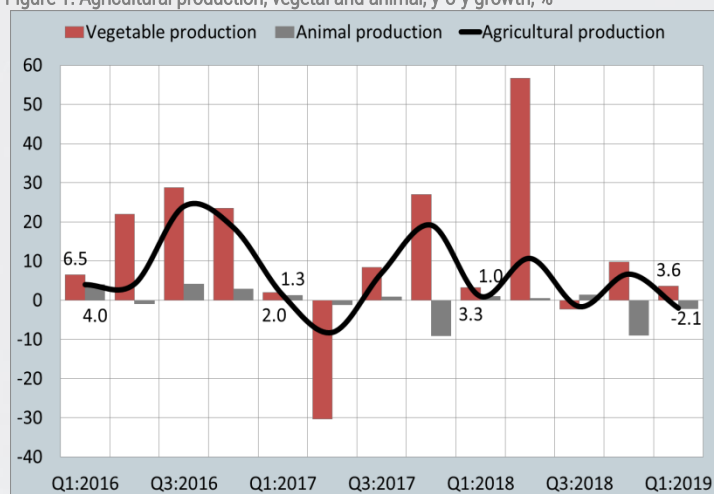
Source: NBM, NBS, EG calculations

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Main Economic Trends in Jan-Apr:19

Figure 1. Agricultural production, vegetal and animal, y-o-y growth, %

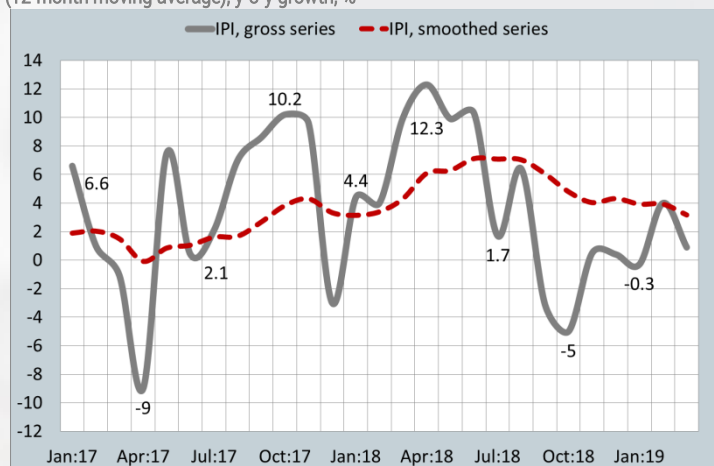


Source: NBS, EG calculations

AGRICULTURE

In Q1:19, the agricultural output decreased by 2% y-o-y as a result of the livestock sector shrinking by 2.1% y-o-y. In Q1:19, the livestock products accounted for 99% of the agricultural output. The shrinking livestock sector resulted in lower production of meat (-3.2% y-o-y) and milk (-0.5% y-o-y). The livestock output dropped due to the decreasing number of animals of all species, except for pigs. At the same time, in Q1:19, the vegetable output grew by 3.6% y-o-y.

Figure 2. Industrial Production Index (IPI), gross and smoothed series (12-month moving average), y-o-y growth, %



Source: NBS, EG calculations

INDUSTRY

Industrial activity is slowing down. In Q1:19 the industrial output increased marginally, by only 1.5% y-o-y. The energy sector shrank by 2.1% and 'dragged down' the industrial production. On the other hand, the highest growth (80.2% y-o-y) was registered in the mining industry. The production of the processing industry increased by only 4.7% y-o-y, mainly thanks to the automotive, rubber and plastic products sectors.

Figure 3. Turnover of trade in 2018, y-o-y growth, %

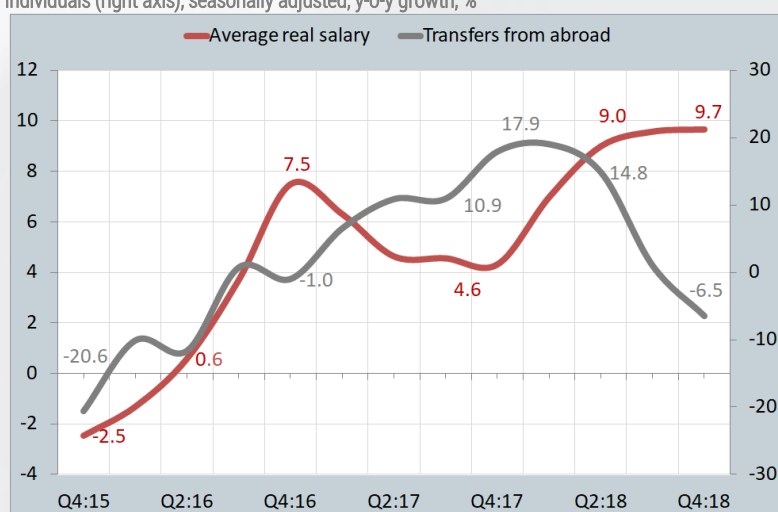


Source: NBS, EG calculations

DOMESTIC TRADE IN GOODS AND SERVICES

In 2018, the domestic trade had a positive dynamics due to the higher demand. The delivery of both goods and services increased. In 2018, the largest turnover growth was recorded for services provided to the population. The wholesale and retail trade grew as well, but at lower rates. However, the financial result related to services provided to enterprises increased marginally. In 2019, the dynamics could decelerate on the background of the forecast slowdown in economic growth.

Figure 4. Average real salary (left axis) and transfers from abroad in favor of individuals (right axis), seasonally adjusted, y-o-y growth, %

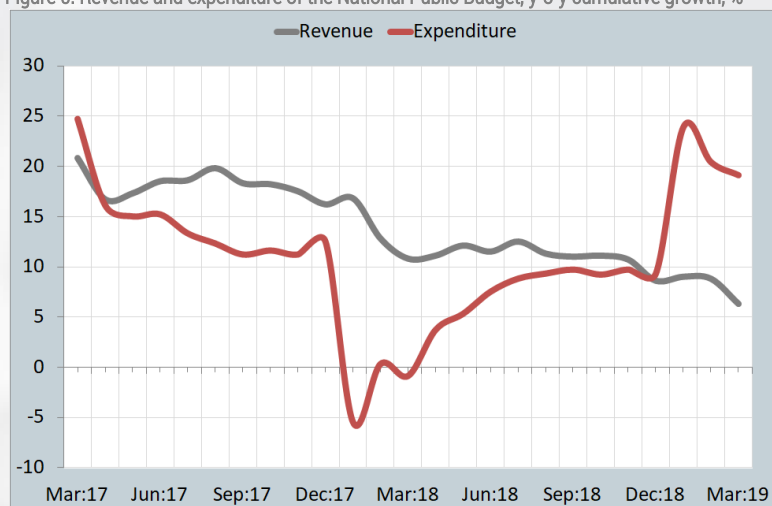


Source: NBS, EG calculations

INCOME AND EXPENDITURES OF THE POPULATION

The growth rates of household income have slowed down by the end of 2018. The slowdown in aggregate income growth was caused by the decreasing remittances to individuals, although the depreciation of MDL mitigated these effects. On the contrary, wages showed impressive growth rates up to the end of the year, but this spurt is rather cyclical than sustainable (wages grow faster than labour productivity).

Figure 5. Revenue and expenditure of the National Public Budget, y-o-y cumulative growth, %

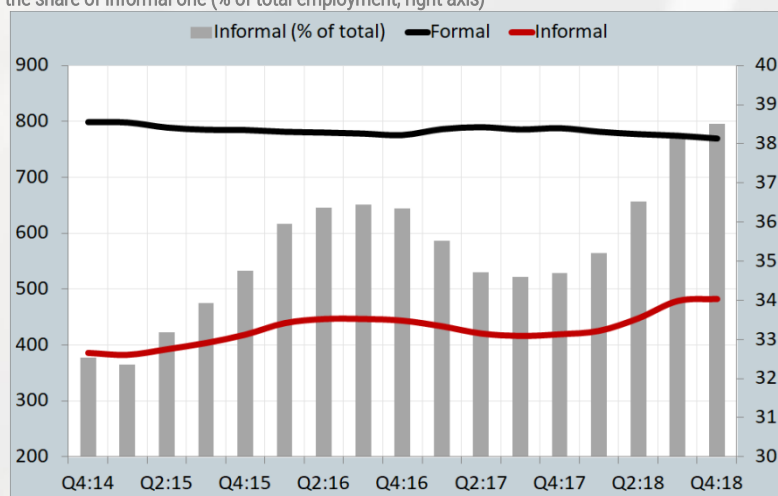


Source: Ministry of Finance

PUBLIC FINANCE

At the beginning of 2019, public finances began to feel the impact of the electoral initiatives from the previous year. The budget revenue started to grow significantly at slower rates, mainly due to the tax cut reform. At the same time, the expenditures recorded double-digit growth rates in the first months of 2019, including as a result of the wage reform that envisaged a substantive increase in staff costs in the public sector.

Figure 6. Dynamics of the seasonally adjusted formal and informal employment (thousand, left axis) and the share of informal one (% of total employment, right axis)

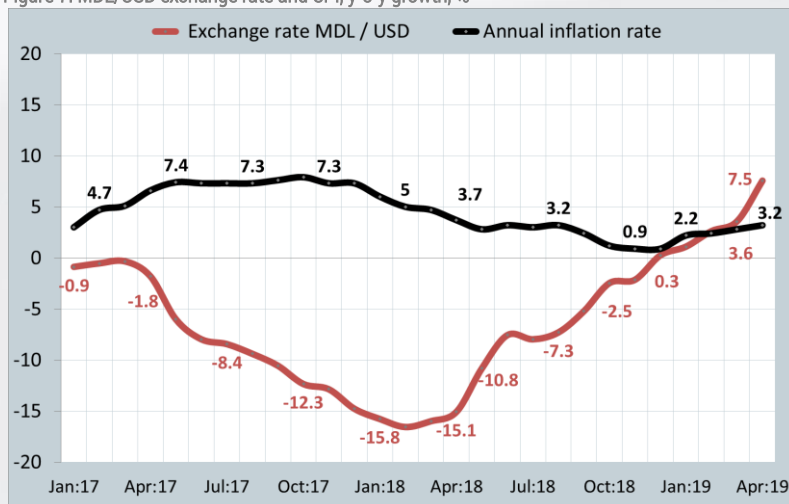


Source: NBS, EG calculations

LABOUR MARKET

The labour market is characterised by a rapid expansion of employment, boosted mostly by the informal one. In 2018, the employment (42%) and unemployment (3%) rates reached the best values in the past ten years. However, the dynamics of informal employment continued to play the leading role in this performance. In 2018, the share of informal employment in the total employed population reached the highest values in the last decade (38%).

Figure 7. MDL/USD exchange rate and CPI, y-o-y growth, %

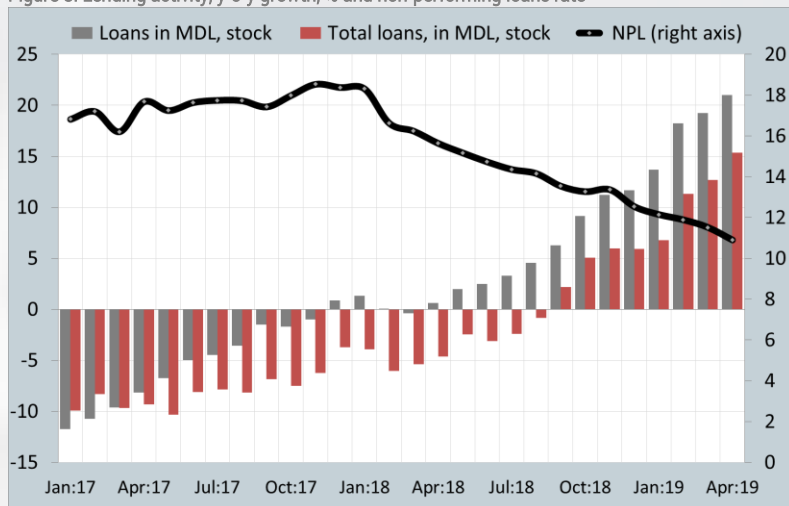


Source: NBM, NBS, EG calculations

PRICES AND MONETARY POLICY

Following the descending trajectory of the previous year, the annual inflation has been on an upward trend since January 2019. The recent increases in prices for food products and fuel determine high inflationary expectations for the rest of 2019. Moreover, the depreciation of the Moldovan leu cause some concerns in the society. The negative gap between supply and demand of foreign currency and the appreciation of euro on the external markets leads to strong fluctuations of the MDL/USD exchange rate.

Figure 8. Lending activity, y-o-y growth, % and non-performing loans rate

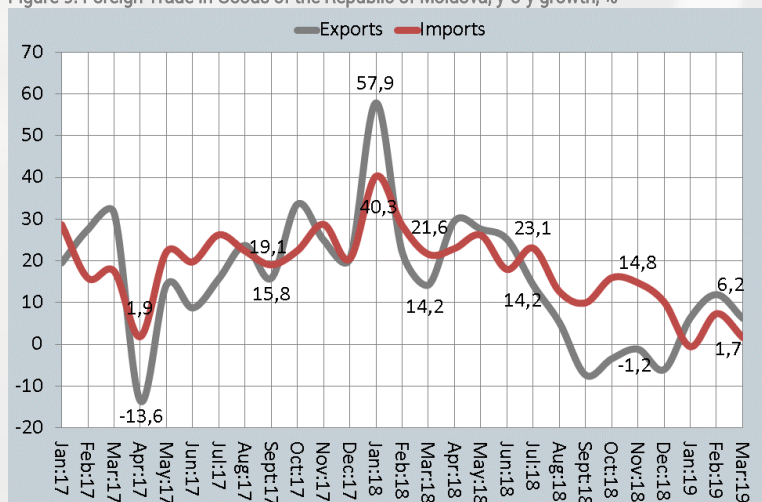


Source: NBM, EG calculations

BANKING SYSTEM

After three years of weak evolutions, the intermediation activity of banks tends to improve. Even so, the increase in the stock of loans is mainly supported by individuals, while business entities are still hesitant about investments and bank loans. As a result, the loan resources are increasingly migrating to sectors with a modest impact on the quality of economic growth, such as consumer loans or real estate loans.

Figure 9. Foreign Trade in Goods of the Republic of Moldova, y-o-y growth, %

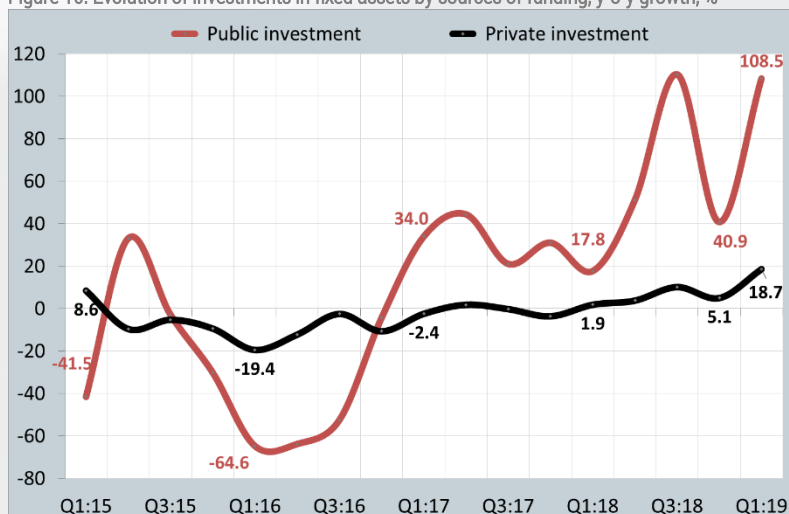


Source: NBS

FOREIGN TRADE

The structure of trade flows confirms the perpetuation of competitiveness shortcomings. The export growth was largely determined by the expanded production capacities of industries operating on the basis of inward processing arrangements (in particular, the automotive industry), as well as of some agri-food products (grains and oilseeds) with a rather low value added. On the other hand, the higher prices for mineral fuels resulted in greater imports in 2019. However, due to domestic currency depreciation and lower consumption, imports also slow down.

Figure 10. Evolution of investments in fixed assets by sources of funding, y-o-y growth, %

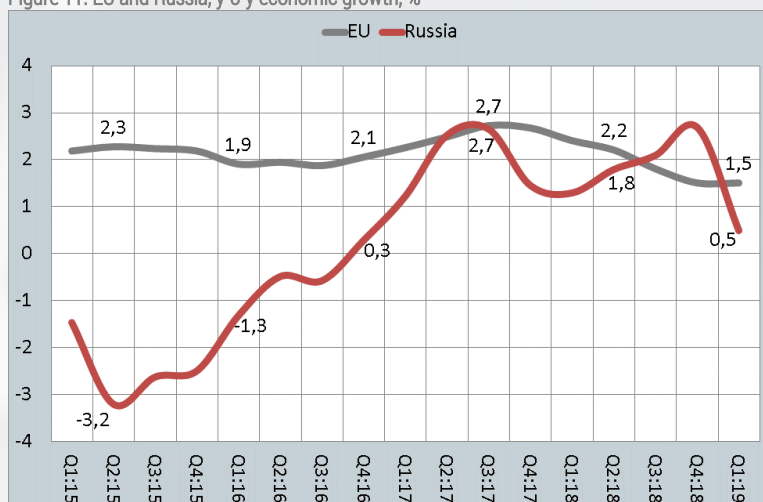


Source: NBS, EG calculations

INVESTMENT ACTIVITY

After a period of stagnation, a revitalization of the investment process was registered at the end of 2018, beginning of 2019. Thus, gross fixed capital formation is largely determined by public investment programs, some of which have a strong electoral tint (e.g. the program 'Good Roads for Moldova' or 'Chişinău Arena'). On the other hand, companies are still cautious, an increase in investment activity being expected in the following period due to the first results of the tax reform.

Figure 11. EU and Russia, y-o-y economic growth, %

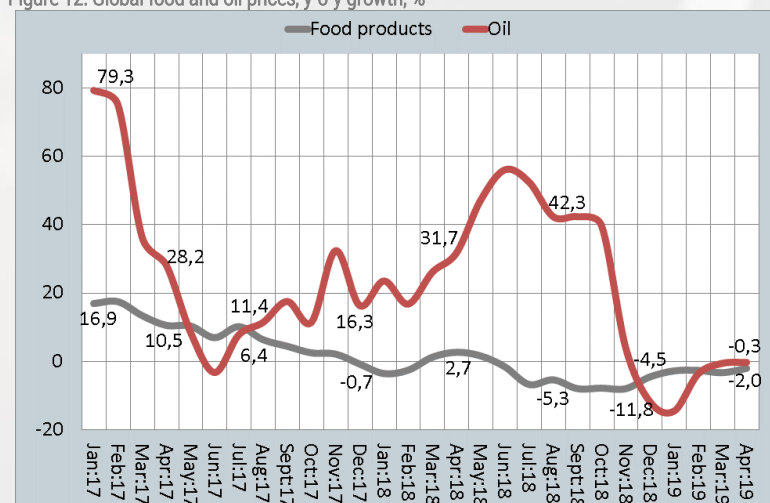


Source: EUROSTAT, Federal State Statistics Service of Russia

EXTERNAL ENVIRONMENT

The external environment reveals an economic slowdown. Russia's economy recorded the lowest growth rate in the past 16 months, being influenced by the greater VAT and accelerated inflation, which had negative effects on the population's consumption. Similarly, in a less favorable external environment, the European economy lost momentum, being mostly affected by the expected economic slowdown in China, domestic political turmoil and increasing global protectionism.

Figure 12. Global food and oil prices, y-o-y growth, %



Source: FAO, IMF

GLOBAL MARKETS

Oil price started to grow again, being influenced by maintaining of OPEC production limits, the economic situation in Venezuela, and the sanctions against Iran. This growth also pushed up the price of sugar, by supporting local production of ethanol in Brazil (to the detriment of exports). Prices for dairy and meat products also increased in the context of the drought in Oceania and the spread of African swine fever. At the same time, prices for grains and vegetable oils decreased due to favorable prospects for crop harvest this year.

Key policy developments in Q1-Q2:18

POLICY DEVELOPMENTS	EXPERT-GRUP COMMENT
30 December 2018. The Russian Government adopted a new regulatory act that refers to five categories of products of Moldovan origin that will enjoy zero rate of customs duty when imported in the Russian Federation.	Trade relations between the Republic of Moldova and the Russian Federation have been unclear for a long time. The latter can generate at any time new 'surprises' for Moldovan exports. Most of the time, however, these initiatives arise either when it is necessary to penalise the uncoordinated actions of the Chisinau authorities (such as the signing of the EU Association Agreement), or to obviously support certain local political exponents. Thus, this evolution of the trade cooperation between the Republic of Moldova and the Russian Federation (aimed at exempting certain Moldovan products from the customs duties) fits perfectly into the stated logic. However, this 'goodwill' act of the Russian Federation did not inspire too much trust in the context of an electoral period. In addition, despite the agitation this initiative generated, the net economic effect could be limited (given that the other components remain intact), especially when these exemptions are temporary (1 January – 30 June 2019) and target only the categories of seasonal products. Specifically, as regards its scale, this initiative would have an impact on 41% of total annual exports of such products to the Russian Federation's market (taking as reference period the exports from similar periods of 2015-2017). In absolute terms, however, this initiative – if expressed as the amount of customs duties which will not be paid during the exemption period (i.e. 1 January - 30 June 2019) could reach up to USD 3 million (with the same reference period of 2015-2017). However, the evolution of exports of the main categories of products that are exempted from customs duties clearly proves that producers' biggest problem are not the customs duties, but the non-transparent procedure (preparing lists) allowing only certain companies to export to the Russian Federation, which makes it possible for intermediaries to infiltrate into the distribution channels (thus influencing the purchase price). In these circumstances, the change in rhetoric in the discussions with the Russian Federation on this issue would be more appreciable.
7 March. The Government assumed the responsibility before the Parliament for nine draft laws with an economic and fiscal impact.	First, the procedure of assuming responsibility raises questions. According to the Constitution, the Government assumes the responsibility before the Parliament. However, on 7 March 2019, the new Parliament was not constituted, or after the elections of 24 February the mandates of the new MPs were not valid yet. This happened on 9 March 2019. The Government also assumed responsibility for the laws aimed at increasing the budget social spending. For example, it was proposed to amend the 'Law No 156/1998 on Public Pension System' by introducing a

POLICY DEVELOPMENTS	EXPERT-GRUP COMMENT
	new indexation formula. According to the new approach, pensions will be indexed with the average rate of inflation over the past 3 years. The old indexation formula took into account only the inflation registered during the previous year. Also, the 'Draft Law on the provision of one-off support to beneficiaries of pensions and state social allowances' was submitted and it stipulates that the beneficiaries whose monthly income does not exceed MDL 2,000 shall be granted a one-off support in the amount of MDL 600. In the context of the recent budget developments, the way the Government assumes the responsibility raises concerns. In Q1:19, the budget revenue grew at slower rates in real terms (taking into account the inflation rate). Thus, in Jan:19 the increase constituted 6.7% y-o-y, in Feb:19 the increase was 6% y-o-y, and in Mar:19 a slight decrease of 0.2% was recorded. At the same time, although a decline in the actual growth rate of expenditures is observed, it is still much higher than the growth of income. Thus, between Jan:19 and Mar:19 the growth of expenditures decreased from 21.2% to 13.7% y-o-y. It is obvious that the proposed legal amendments will increase the public spending and will create additional pressure on the budget balance.
7 March. The Government, by assuming the responsibility, amends the Law on Public Procurement to exclude the mandatory procurement of medicines and medical devices within the MTender system.	Starting with 1 October 2018, the use of the new Automated Informational System 'State Register of Public Procurements' MTender become mandatory for Moldovan contracting authorities. So far, the functionalities of this system were not developed sufficiently as to cover all areas and peculiarities of public procurement. It was therefore decided to make an exception for the Center for Centralized Public Procurement in Health, which is responsible for the procurement of medicines and medical devices. According to the decision approved on 7 March, MTender system will become mandatory for this institution starting with 1 January 2021. It is assumed that the functionalities of MTender system would be adjusted until that date. However, the fundamental issue is not the exception per se for medicines and medical devices, but the degree of implementation and perspectives of the MTender system. First of all, the implementation of the MTender system is still uncertain because in addition to the current technical deficiencies, the regulatory acts that would ensure a normal activity of the electronic public procurement system are not approved on time. For example, after the approval of the MTender technical concept in August 2018, the Government was expected to approve three important regulations. Only two were approved and the Regulation on the Methodology for Calculating and Applying Tariffs When Using MTender has not been approved so far. Thus, the activity of private platforms and charging payments for participating in the procurement process is uncertain without the said Regulation.

POLICY DEVELOPMENTS	EXPERT-GRUP COMMENT
	Second, the approval of the exception for medicines and medical devices will affect the transparency in this area. The exception, though justified by the technical deficiencies in organising procurement procedures in MTender, did not have to extend on transparency issues. The correct approach would have been to publish on MTender the contracts and information relevant to the procurement of medicines and medical devices concerning the transition period until 1 January 2021. So, during this period, MTender had to operate at least as a register of procurement procedures for medicines and medical devices, which would ensure transparency in the field. Finally, the issue of integrating low-value contracts into MTender remains unresolved. At the end of the previous year, the thresholds for low-value contracts were doubled, but there is no obligation to apply MTender for these contracts. At the same time, the recording and monitoring of the low-value contracts is still the weak link of the public procurement system in the Republic of Moldova, as there is no system for their accurate recording. Thus, the non-mandatory application of MTender for low-value contracts, at least as a register, will increase the corruption risks in the public procurement system in the near future.
18 March. During the auctions conducted on the regulated market of the Stock Exchange, the Public Property Agency sold 63.9% of the shares of CB Moldindconbank.	Selling of 63.9% of CB Moldindconbank to a private investor completed the process of increasing the shareholders' transparency for all systemic domestic banks. Thus, after the Public Property Agency has acquired the bank shares (same case for CB Moldova-Agroindbank), they were sold to the single investor who obtained prior permission from the NBM. It is about the Bulgarian company 'DOVERIE UNITED-HOLDING AD' – an entity supervised by Bulgarian financial authorities, which operates in various economic fields, including in the construction, pharmaceutical and insurance industries. The transaction price amounts to about MDL 764 million, including the transaction cost of about MDL 4 million incurred by the Government. Being the last option for the authorities, this transaction prevented the bank from purchasing the unsold shares, which would have major implications on the Bank's ability to comply with the prudential limits in force. At the same time, the prior permission granted by the central bank implies that all aspects of transparency, competence, reputation and especially those relating to the origin of money and the ability of the new shareholder to support the bank with additional capital were positively assessed. Moreover, during the supervisory process, the regulator has a range of more robust intervention tools than a few years ago, namely those aimed at ensuring an efficient mechanism of corporate governance and at increasing the accountability of managers. Therefore, currently, there are sufficient mechanisms to control the banks' activity, including the systemic ones like the CB Moldindconbank.
5 May. The National Bureau of Statistics	The presented data show the acceleration of inflationary trends. Although

POLICY DEVELOPMENTS	EXPERT-GRUP COMMENT
published the data on inflation for the first four months of 2019.	in Jan-Apr.19 the annual inflation rate was below the lower limit of the corridor set by the NBM of 3.5%, if this trend is maintained by the end of the year the price growth rate could exceed the upper level of the corridor of 6.5 %. The following factors will influence the positive dynamics of inflation: depreciation of the national currency, increase in both the import and regulated prices. In Jan-Apr.19 the prices for potatoes (+30.7% y-o-y) and vegetables (+25.8 y-o-y) grew the most. Partially, this evolution was caused by the unfavourable weather conditions that diminished the harvest in 2018, both in the Republic of Moldova and in the region. Thus, potato output in Moldova decreased by 11.3%, while the vegetable output decreased by 7.4%. In Belarus, the main exporter of potatoes to the Republic of Moldova, the output decreased by 8.6%. At the same time, although the increase in price for potatoes is based on objective factors, there are suspicions regarding the excessive prices. It is not excluded that certain business entities decided to take advantage of lower potato output and carry out anticompetitive actions by including excessive profit margins in the price of potatoes.
16 May. During a press briefing, the governor of NBM, Octavian Armasu presented the second report on inflation for 2019. Meanwhile, during the same press briefing they spoke about the amount of money that was recovered after the bank fraud.	According to the NBM forecast, the annual inflation rate will increase by the end of this year and will exceed the target range. The inflation growth will be determined by the CPI components, in particular by food prices, core inflation and regulated prices. Also, fuel prices could increase, but there are no external preconditions for any significant fluctuations. On this background, the NBM forecasts an inflation rate of about 8% for the end of 2019 and the beginning of 2020. Such inflation expectations will result undoubtedly in important challenges for the central bank, which could tighten the monetary policy by raising the base rate. This will surely result in greater interest rates both for loans and deposits. The same could happen in case of the interest rate for loans under 'Prima Casa' program. Even if the government already expects that the loan prices will increase and has recently lowered the maximum margin that can be applied by banks (from 3% to 2%), it does not have too many options once the reference rate (calculated as the weighted average of interests on new deposits in national currency for a period of 6-12 months) will increase. Since the launch of the program, the reference rate has been below 5% on the background of a favorable macroeconomic environment and low inflation. However, as the inflation will raise up to 8%, it is less likely that funding costs for banks will remain the same, and above all, that depositors will accept negative real interest rates on deposits. At the same time, some statistical data regarding the recovery of money after the bank fraud were presented during the conference of 16 May. Thus, four years and a half after the launch of the investigations, about MDL 2.285 billion were recovered, including MDL 850 million from persons convicted for participation in the bank fraud. It is about the money

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	obtained after the shares of the CB Moldova-Agroinbank and CB Moldindconbank, which were involved in criminal cases, were sold in Q4:18 and Q1:19, respectively. However, from here on, there is no clear perspective on recovering the other amount of about MDL 11.8 billion, as well as on making accountable all the persons involved in the bank fraud. Moreover, we still do not know how the money granted by the NBM to those three banks were used, what role the other banks had, or how the famous filters were applied.
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Statistical Annexes

Table 1. Key Monthly Indicators

Indicator	Apr:18	May:18	Jun:18	Jul:18	Aug: 18	Sep:18	Oct:18	Nov:18	Dec:18	Jan:19	Feb:19	Mar:19	Apr:19
Industrial production, y-o-y growth, %	12.3	9.9	10.3	1.7	6.4	-3.1	-5	0.5	0.4	-0.3	4.0	0.9	n.a.
Retail trade, y-o-y growth, %	12.0	5.7	3.9	11.1	6.9	9.8	7.6	7.9	7.5	n.a.	n.a.	n.a.	n.a.
Services provided to the population, y-o-y growth, %	13.3	12.5	12	7.6	10.7	18.8	18.4	14.1	5.2	n.a.	n.a.	n.a.	n.a.
Export of goods, y-o-y growth, %	29.6	27.6	25.2	14.2	5.2	-7.4	-3.5	-1.2	-6.1	6.3	11.9	6.2	n.a.
Import of goods, y-o-y growth, %	23.0	26.2	18.0	23.1	12.7	10.0	16.0	14.8	10.2	-0.5	7.4	1.7	n.a.
Official reserve assets, USD million	2,869.3	2,846.5	2,899.8	2,970.4	2,963.2	3,021.2	3,011.3	3,014.6	2,995.2	2,908.6	2,793.9	2,824.3	n.a.
Budget revenue, y-o-y growth, %*	11.1	12.1	11.5	12.5	11.3	11.0	11.1	10.7	8.6	9.0	8.8	6.3	n.a.
CPI, y-o-y growth, %	3.7	2.8	3.2	3.0	n.a.	2.4	1.2	0.9	0.9	2.2	2.4	2.8	3.2
IPPI, y-o-y growth, %	1.0	0.3	0.2	-0.1	n.a.	-0.2	-0.3	-0.4	-0.1	0.4	0.2	0.8	1.4
Nominal exchange rate MDL/USD (e-o-p)	16.53	16.85	16.84	16.58	16.71	16.86	17.13	17.23	17.14	17.10	17.16	17.31	17.89
Money transferred from abroad, y-o-y growth, %	14.2	16.1	13.5	6.4	2.0	-5.2	-10.6	-2.4	-6.5	-4.8	-5.9	-1.7	n.a.
Monetary aggregate M2, y-o-y growth, %	13.0	13.6	13.1	11.9	n.a.	13.5	11.8	12.0	10.0	7.9	7.2	7.6	11.2
NBM base interest rate, %	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Bank deposits interest rate, %	4.46	4.20	4.58	4.44	n.a.	4.51	4.59	4.45	4.10	4.43	4.35	4.36	4.4
Bank loans interest rate, %	9.00	8.63	8.72	8.67	n.a.	8.50	8.52	8.45	8.61	8.34	8.30	8.17	8.0
Share of non-performing loans in total loans, %	15.6	15.2	14.7	14.4	n.a.	13.5	13.3	13.4	12.5	12.2	11.9	11.5	10.9

Source: NBS, NBM, EG estimates

Table 2. Main quarterly indicators

Indicator	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18	Q2:18	Q3:18	Q4:18	Q1:19
Real GDP growth rate, y-o-y, %	3.2	2.6	5.3	6.4	3.7	5.2	3.4	3.9	n.a.
Agricultural production, y-o-y growth, %*	1.1	-5.0	3.7	9.1	1.0	7.2	0.2	2.5	-2.0
Construction work, y-o-y growth, %*	1.7	2.7	2.1	2.3	-1.7	4.2	15.6	14.5	n.a.
Investments in long-term assets, y-o-y growth, %*	-1.2	2.5	2.4	1.3	2.9	7.4	13.5	12.3	n.a.
Net inflow of FDI, million USD	39.7	35.1	70.8	4.1	99.8	24.8	16.4	47.8	n.a.
Real salary, y-o-y growth, %	6.8	5.8	3.5	4.7	7.7	9.5	8.9	13.2	n.a.
Unemployment rate, %	3.8	6.3	3.5	3.4	3.3	3.0	2.2	2.9	n.a.
Employment rate, %	38.5	37.7	42.6	42.4	39.2	45.0	46.2	39.0	n.a.

Note: * – cumulative; (e) – estimate;

Source: NBS, NBM, EG estimates