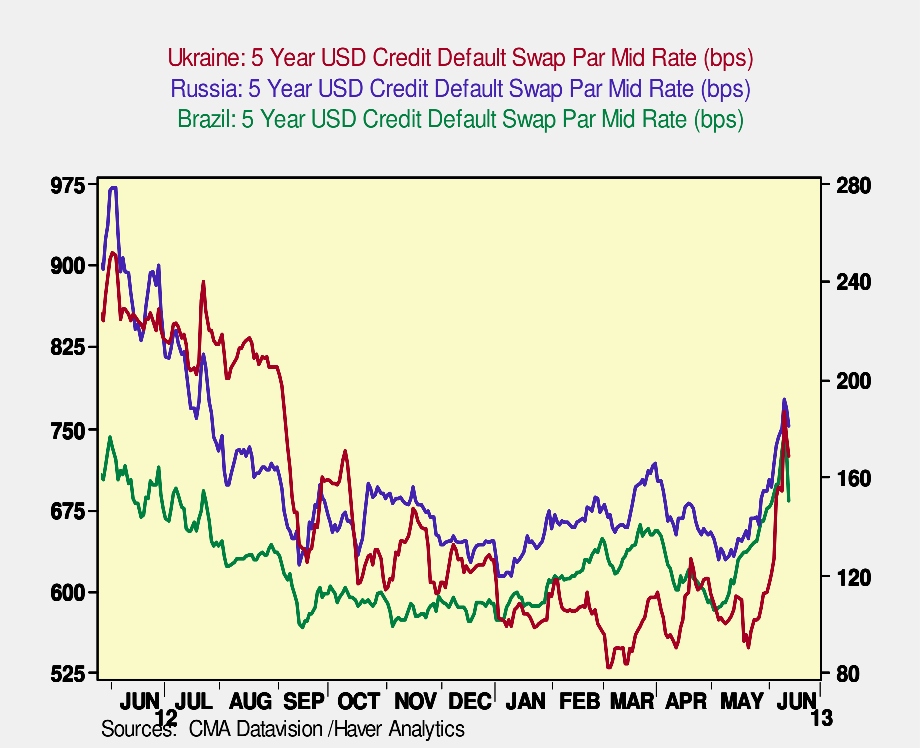
Macro 2013 conference, Chisinau

Short-term financial risks in Moldova



June 18th 2013

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Some conclusions first

- Moldova's banking system has been relatively **isolated** from direct financial turbulence externally and from impact on parent banks.
- After 2008-09 economic weakness left Moldova with **low debt burden**, in contrast to, say, the Baltics.
- **Regulation and supervision** looks like main short-term risk to banking stability, which has potential for knock-on effects on public finance and the currency.
- Leu float reduces currency risk, but chronic **external imbalance** could be more of a risk with remittances likely to fall with Russian weakening. Too fast currency **depreciation** could boost inflation, complicating monetary policy.

What is financial risk?

How believable is commitment to exchange assets as agreed?

If "not very":
- Relative asset prices can change unpredictably.
- Incentive to switch to increase wealth/ avoid wealth loss.

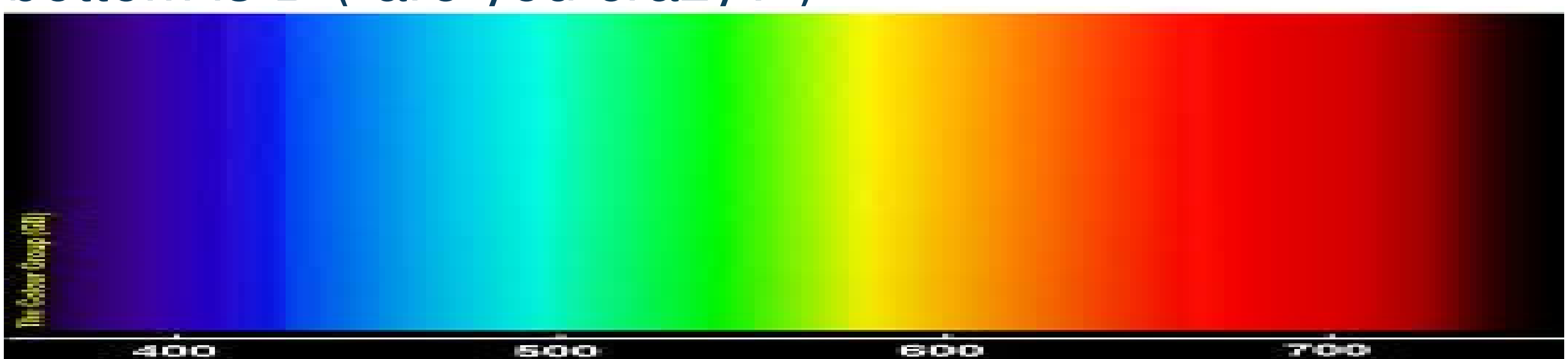
This is a financial crisis: this is what we're looking out for when we try to assess a country's financial risk.

Analyst asks: Will investors get their money back?
Country (Moldova) asks: Will this hit economic growth?

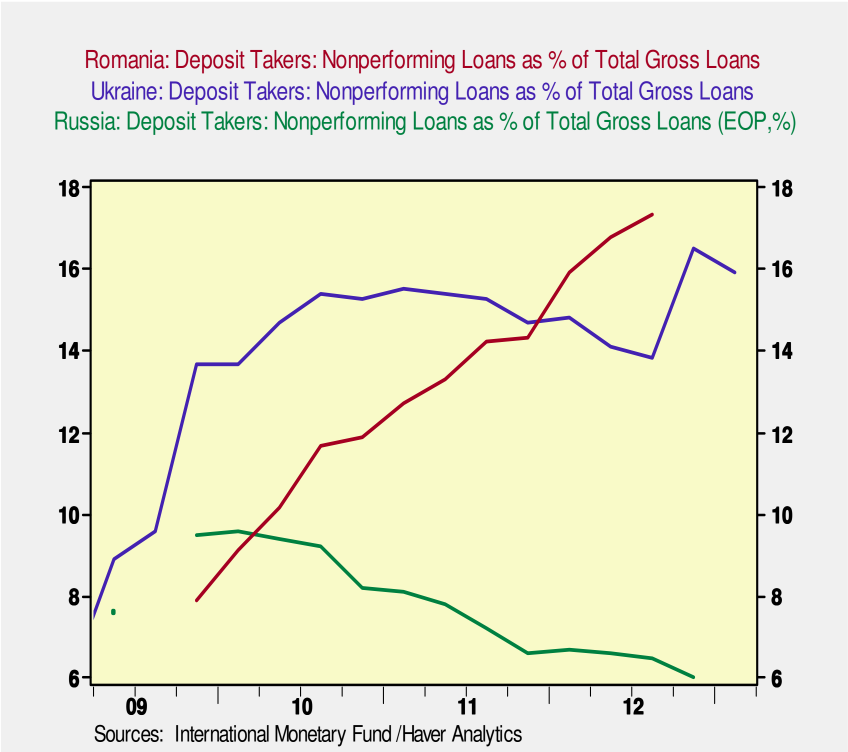
Big picture: Moldova rates a “B”

How is Moldova assessed?

- Moldova’s financial risk is rated "B", in the middle.
- Can meet its financial obligations and wants to, but is vulnerable to economic shocks.
- Same overall risk rating as Romania, Macedonia, Croatia; above Ukraine, below Russia.
- At the top is AAA (“of course, help yourself!”) and at the bottom is D (“are you crazy?”)



Bank risk I: pros and cons



Positive recent indicators: April

- Non-performing loans (NPLs) fell to 12.6% of all loans.
- Banking assets rose by 3.8% year on year (yoy)
- Tier 1 capital increased by 5.2% yoy
- Capital adequacy at 24.9% vs 16% minimum

But

- NPLs set to climb in wake of recession
- Net foreign banking assets still negative: Lei1.7bn in April 2013

Bank risk II: making the rules stick

- Recent cases raise concerns on bank **regulation and supervision**
- Even more important that in assessing bank risk than bad loans

Banca de Economii (BEM)

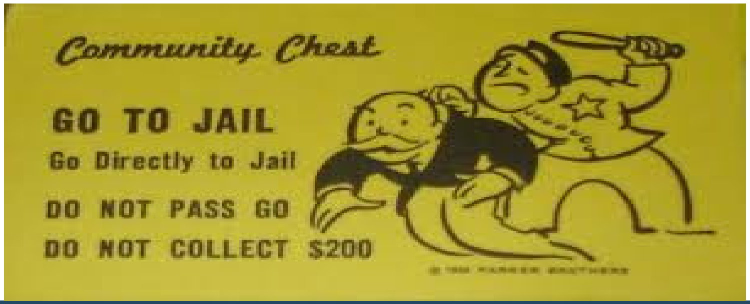
- In 2012 regulatory capital fell below set limits
- NPLs climbed to 55% of all loans from 32% in 2011
- Misdeeds or just poor lending

Moldova Agroindbank (MAIB)

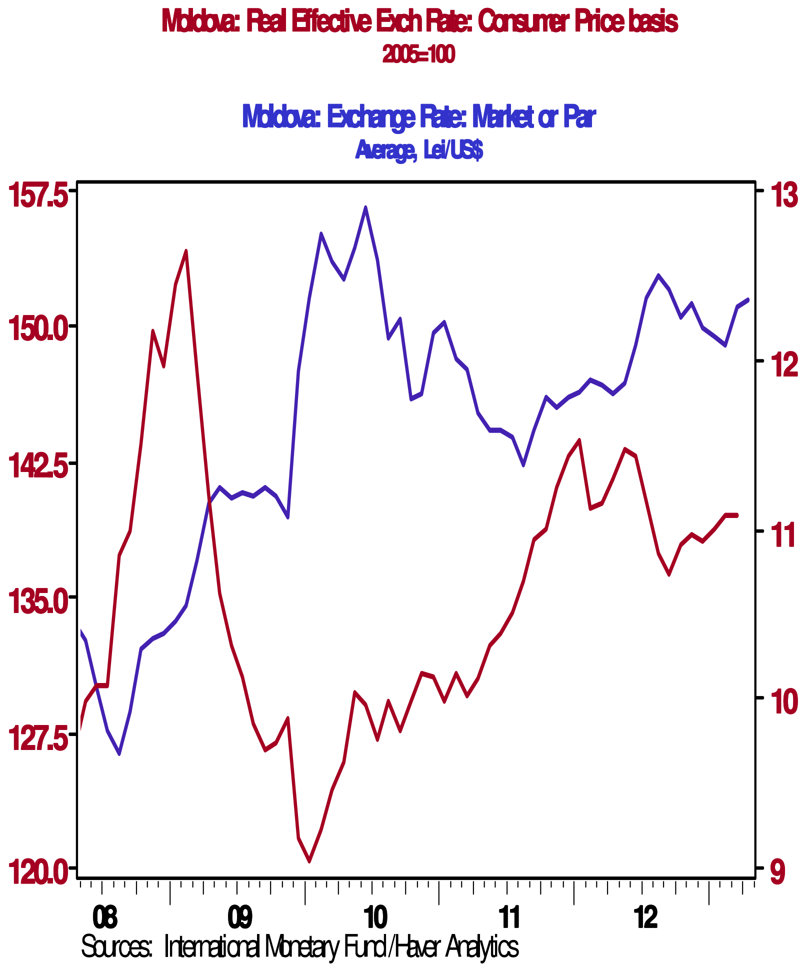
- 30% of shares bought by foreign-registered firms, all less than 5%, so no need for NBM permission.
- Spontaneous upsurge in foreign investor interest in Moldovan banks or attempt to get round the law?

Possible impact

- BEM raises prospect of increased strain on public finances.
- MAIB highlights risks of design and enforcement of banking rules
- Both are big enough enough to undermine confidence in banking sector: hit saving and lending when external conditions look grim.
- Currency and debt crises often originate from problems in banking system.



Currency risk I: weakening outlook?



Leu: dynamics and outlook

- US dollar has strengthened
- Exports up in Q1 2013
- Remittances slowed at end-Q1
- Investment: won't recover much in EU
- NBM base rate down to 3.5% in April
- ➢ Leu fell from Lei12:US$1 to Lei12:5US$1 from February to June
- ➢ Could produce faster leu depreciation

Currency risk II: mixed picture

Exchange rate regime

- Managed float
- Less risky than fixed: less distortion, less imbalance

Foreign-exchange (FX) reserves

- US$2.46bn in May: up 2% over 4 months
- FX to short-term debt is lower than for EMs and “B”s, but it >100%
- Import cover about the same: 4.5 months

Current account

- Deficit came down in 2012 in the recession
- But persistently large external deficit is a key risk to currency stability
- 8.5% of GDP over 4 years, 5.4% for “B”s, 1.6% for EMs

This is because of chronic trade deficit, linked energy and remittances. These can only be addressed over the long term.