POLICY BRIEFING 02|2020

German Economic Team

MOLDOVA

Banking Sector Monitoring Moldova

Assessment of past reforms and Corona crisis impact

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Summary

General assessment

- The banking system has successfully recovered following the banking fraud scandal in 2014/2015 due to reforms which improved central bank independence and banking sector supervision. These reforms must be preserved to not risk the progress achieved over the past years.

Development of main banking sector indicators

- **Loan growth** positive since end of 2017 suggests that clean up of bad loans has been finished
- **Capital adequacy ratio (CAR)** with 28% in May 2020 shows that banks are well capitalised when facing possible losses resulting from Corona crisis. But high CAR may also be a sign that banks are underleveraged – problematic in light of demand for liquidity loans during Corona crisis
- **Profits** increased considerably over last years insulating banks against possible losses from Corona. In fact, August 2020 figures show decrease in profits with full year likely to be similar to 2017
- **Share of non-performing loans** declined from 18% in 2017 to 8.5% at the end of 2019 as the banking system enters Corona crisis with healthier loan portfolios. May 2020 figures show slight increase of NPL to 8.9% which is unproblematic for the system
- **Foreign shareholders** have acquired controlling stakes in top 4 banks. Investments were a direct result of successful banking sector reforms. Investors brought improved corporate governance, compliance and new financial products.
- **Financial intermediation** of bank assets and lending to the real sector improved over the last years but remains low in comparison to middle income countries in the EU
- **Lending by non-bank financial institutions (NBFI)** increased in 2019 raising concerns from anti-money laundering and consumer protection perspective as NBFI only lightly regulated

Introduction

Banking sector monitoring: review of key financial sector indicators in order to assess the health of the banking sector

General assessment of sector health

- Has the banking sector recovered following the banking fraud scandal in 2014/2015?
- Have reforms been successful?
- How does Moldova's banking sector compare to other countries in the region?

Impact of Corona crisis

- What is the likely impact resulting from the Corona crisis?
- Are Moldovan banks prepared for the fall-out resulting from the Corona crisis?

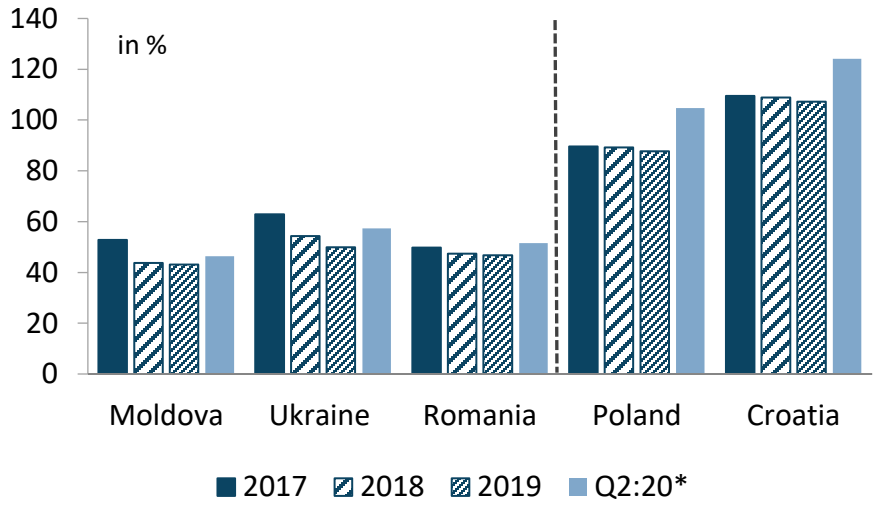
Structure

Assessment of banking sector based on key indicators

1. Development of bank assets
2. Number of banks and market shares
3. Foreign ownership and concentration
4. Lending to the real sector
5. Loan growth
6. Interest rates
7. Non performing loans (NPL)
8. Deposits
9. Capital buffers
10. External debt
11. Bank profits
12. Excess liquidity in the banking sector
13. Non-bank financial institutions
14. Corona impact

1. Development of bank assets

Bank assets to GDP



Source: Central banks of different countries, eop

Assets to GDP ratio

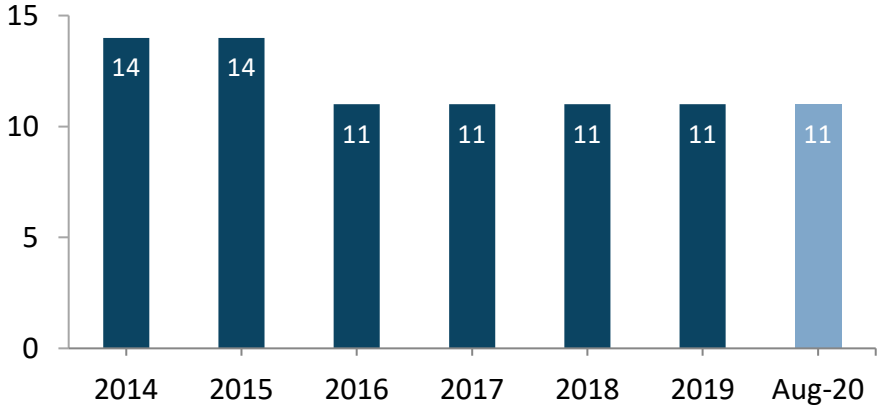
- Bank assets to GDP declined from 53% in 2017 to 43% in 2019
- But Q2:2020 saw increase in asset ratio-> 43.1% to 46.4%
- Similar trend of bank assets decline in Ukraine, Romania and even in Poland and Croatia in 2019, but increase in Q2:2020
- Decline in Moldova was mainly linked to the faster growth of GDP over this period of time
- Increase of lending during Corona crisis may explain increase of asset ratio

Regional Comparison

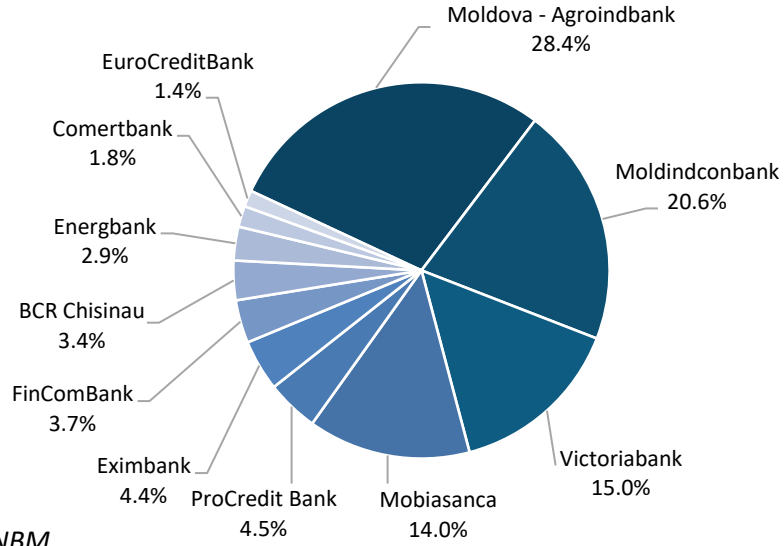
- Moldovan bank system much smaller than Poland (105% assets to GDP) and Croatia (120%), but similar size as in Ukraine and Romania
- Financial intermediation still quite low

2. Number of banks and market shares

Number of banks



Banking sector assets, Aug-2020



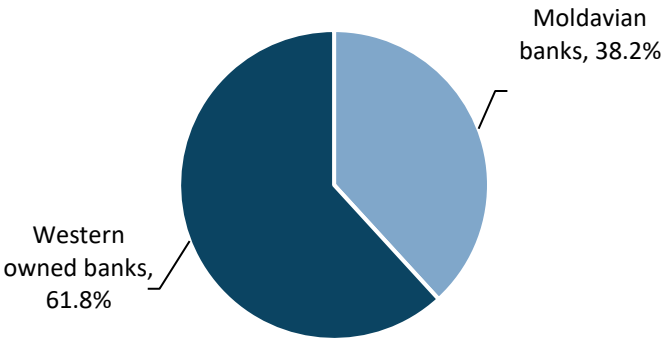
Source: NBM

- 2015: insolvency of three banks involved in banking fraud scandal reduced number of banks operating in Moldova. But, number of banks has remained unchanged since
- Several Western or Eastern European shareholders have acquired controlling stakes in Moldova's top 4 banks:
  - MAIB: EBRD (among others)
  - MICB: Bulgarian shareholder Doverie Invest JSC
  - Victoria: Banca Transilvania, Bucharest
  - Mobiasbanca: now OTP of Hungary, previously Societe Generale Group

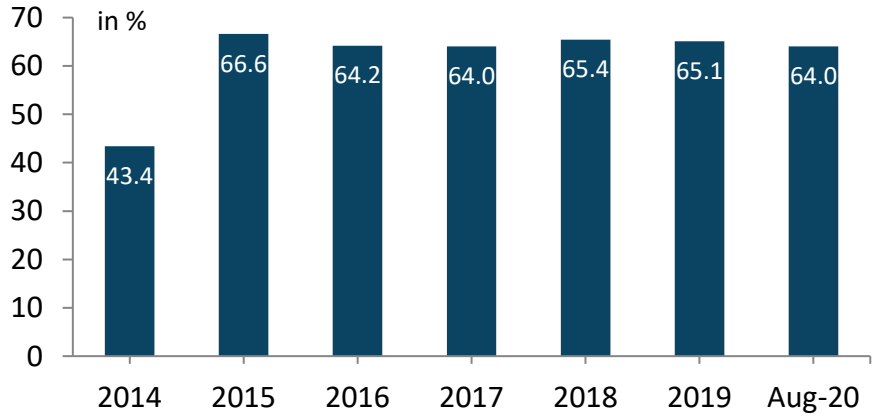
➢ **Result: recapitalisation, new business models and products, more transparency and better compliance**

3. Foreign ownership and concentration

Market share by ownership



Share of top 3 banks



Share of banks in foreign ownership:

- In August 2020 foreign-owned banks held a market share (share of assets) of 62%
- Significant increase since 2017 when foreign-owned banks held only 25% of market share
- In fact, the four leading banks are now controlled by EU shareholders

Concentration

- The three largest banks (in descending order) are: MAIB, MICB, Victoria
- Together they have a market share of 64%
- Smaller, mainly domestic-owned banks (Energbank, Comertbank) have individual market shares of less than 5% of market
- 80% of banking assets belong to systemic banks, about 20% to small banks.

➢ **Increased market share of foreign-owned banks reflects return of trust to Moldova's banking sector, which was previously shunned by foreign investors.**

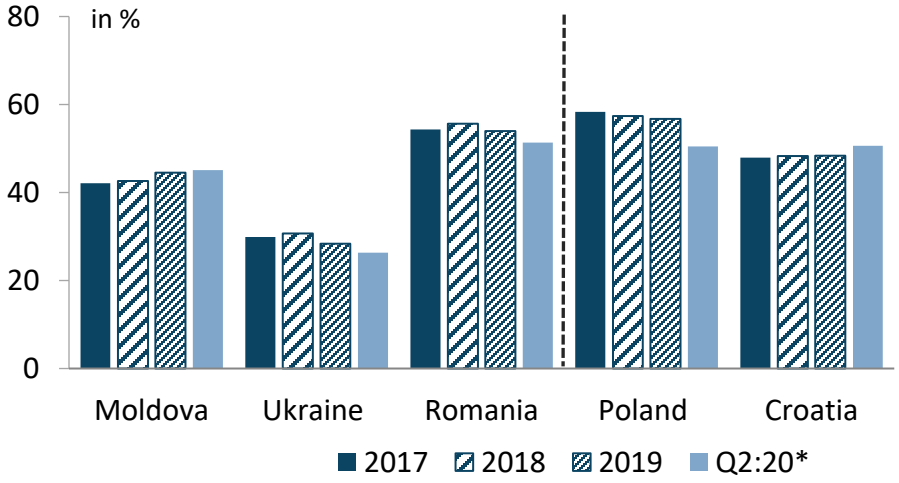
➢ **However, some recent legal actions (also in connection with Victoria Bank) may undermine central bank independence and banking supervision. Those activities have raised concerns of foreign investors and risk to undo the positive effects of past reforms.**

➢ **Concentration has increased but still enough players to ensure sufficient competition**

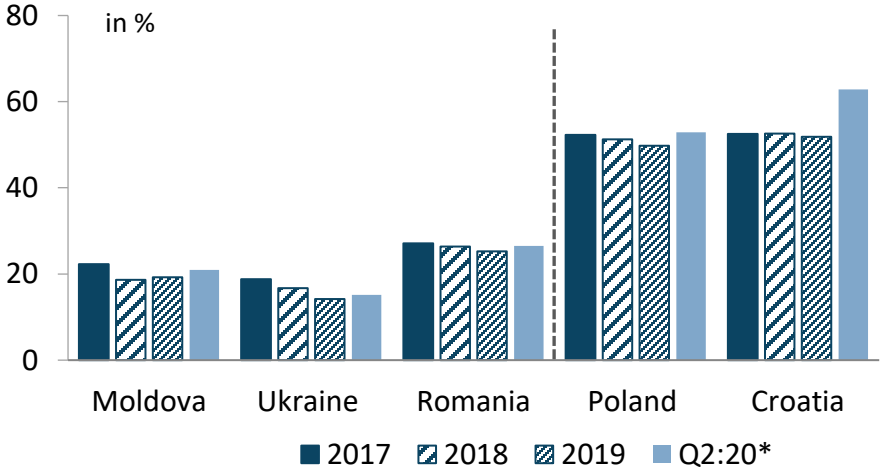
Source: NBM

4. Lending to the real sector

Private sector loans to bank assets



Private sector loans to GDP



Source: Central banks of different countries

Private sector loans as share of bank assets

- Lending to the real economy gradually increased over the last years reaching 45% of banks assets in 2020 (up from 42% in 2017) based on loan share of bank assets
- But overall still low loans to asset ratio because of excess liquidity, which inflates assets
- Indeed, Ukraine, Romania, Poland have higher credit ratios – although also with declining trends

Private sector loans to GDP

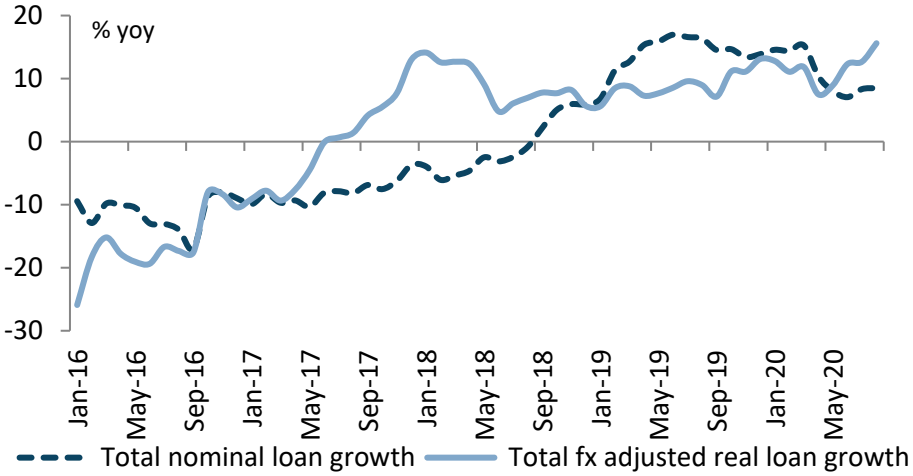
- When comparing the ratio of loans to GDP in Moldova, a slight increase in mid-2020 to 20.9% from 19.2% in 2019 can be observed, despite a declining regional trend, except in Croatia
- Increased lending demand and/or GDP decline in wake of Corona crisis may explain increase in 2020
- However, the level of lending is low in comparison to middle income countries in the EU

➢ **Increased lending to real sector observed, but overall low level remains an issue**

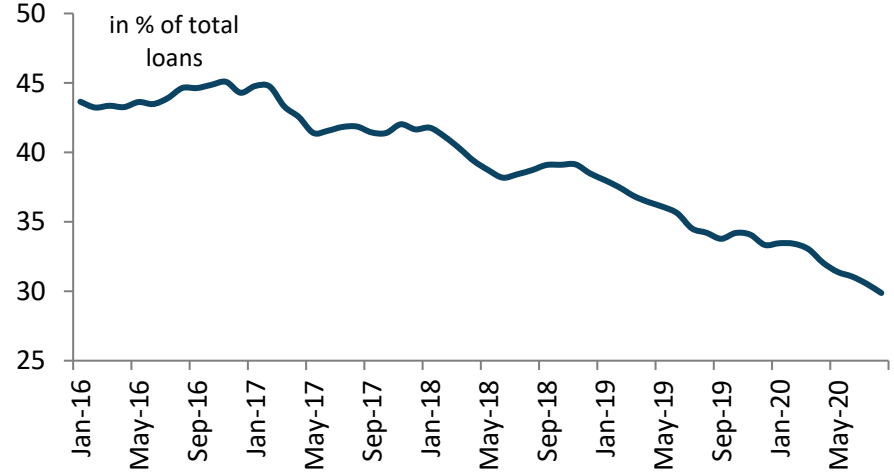
➢ **Unclear if banks are over-cautious or if there is a lack of good projects**

5. Loan growth

Loan growth



Share of foreign currency loans



Source: NBM

Loan growth

- Sharp decline of loan growth after bank fraud scandal as banks wrote off bad debt and cleaned up their loan books
- But at the end of 2017 loan growth has turned positive and value of outstanding loans has increased continuously since
- Loan growth seems to have picked up in 2020

➢ **Positive loan growth since end of 2017 suggests that clean-up of bad loans has been finished**

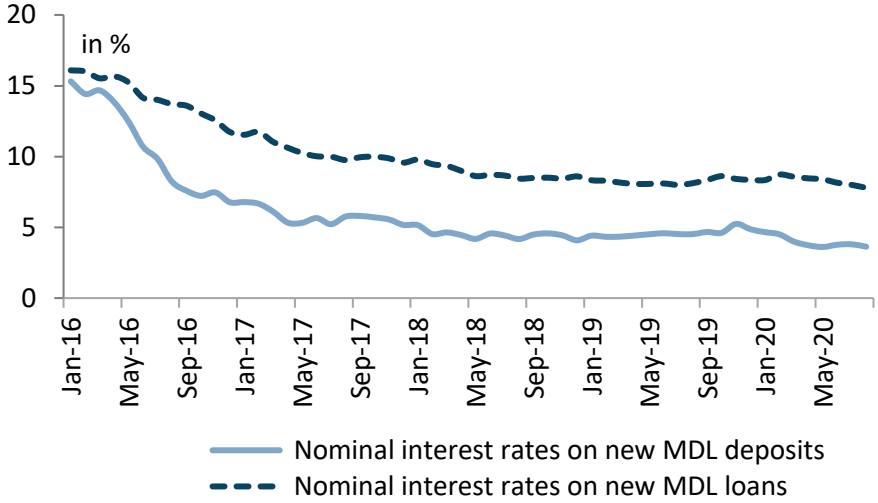
Foreign currency loans

- Share of foreign currency loans decreased significantly to 30% in mid 2020, from 45% in Jan. 2017
- Thus, lending in foreign currency grew slower than lending in domestic currency
- Banks more cautious to lend in foreign currency, often only to clients who receive sufficient income in foreign currency

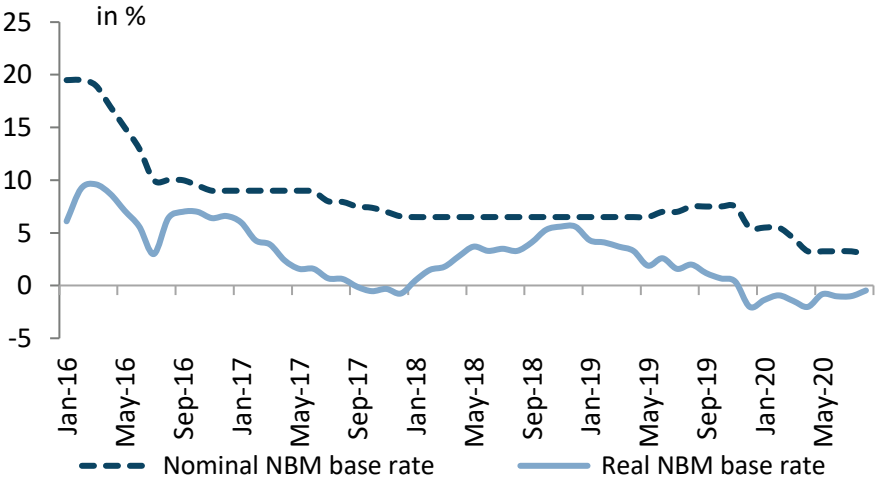
➢ **Declining share of foreign currency loans reduces exposure to currency risks**

6. Interest rates

Interest rates on new loans and deposits



NBM base rate



Source: NBM, own calculations based on NBM data

Nominal interest rates

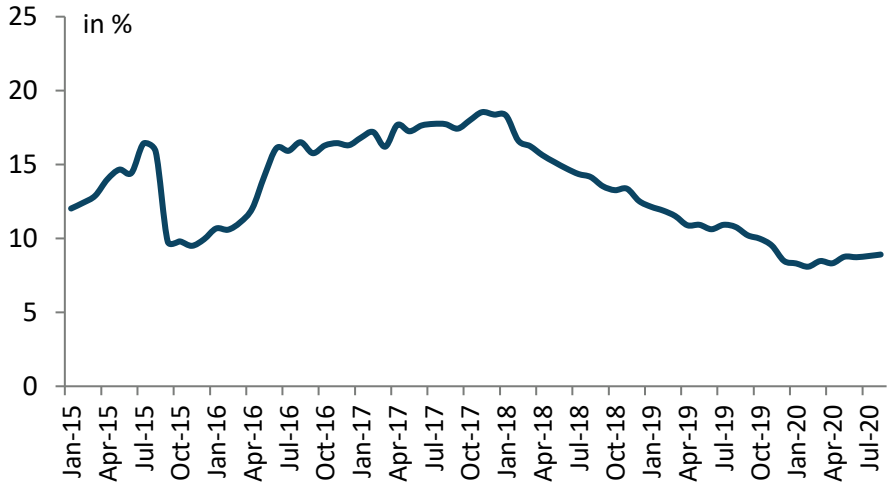
- Base rate hike after bank scandal in order to contain inflation pushed up nominal interest in 2015/2016
- However, nominal interest rates have declined considerably since, to currently 3.6% nominal interest rate on MDL deposits and 7.8% nominal interest rate on new MDL loans
- Monetary loosening in wake of Corona crisis aimed at lowering interest rates
- Difference between deposit and loan interest rates (net interest margin) with 3.6% still quite comfortable for banks, supporting their profitability

➢ **Lower cost of borrowing may explain some of the loan growth observed in the last years**

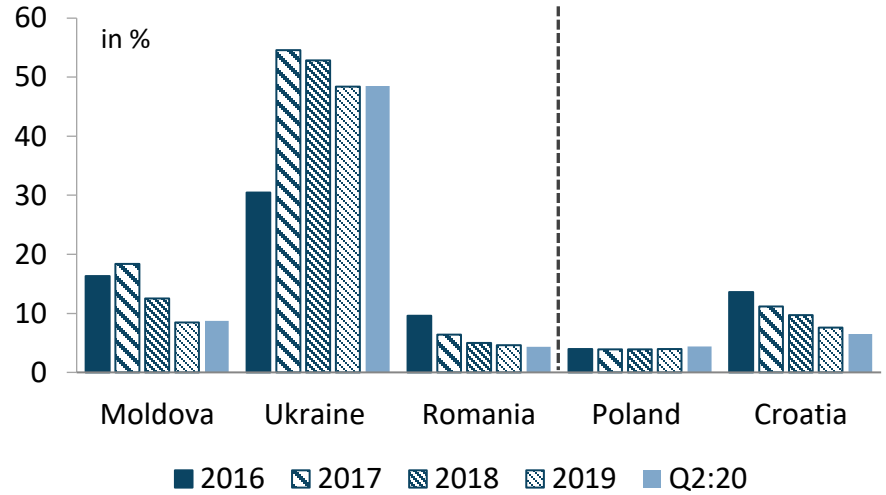
➢ **Increased loan lending and solid interest margin support profit growth**

7. Non performing loans (NPL)

NPLs as a share of assets subject to credit risk



NPL in regional comparison



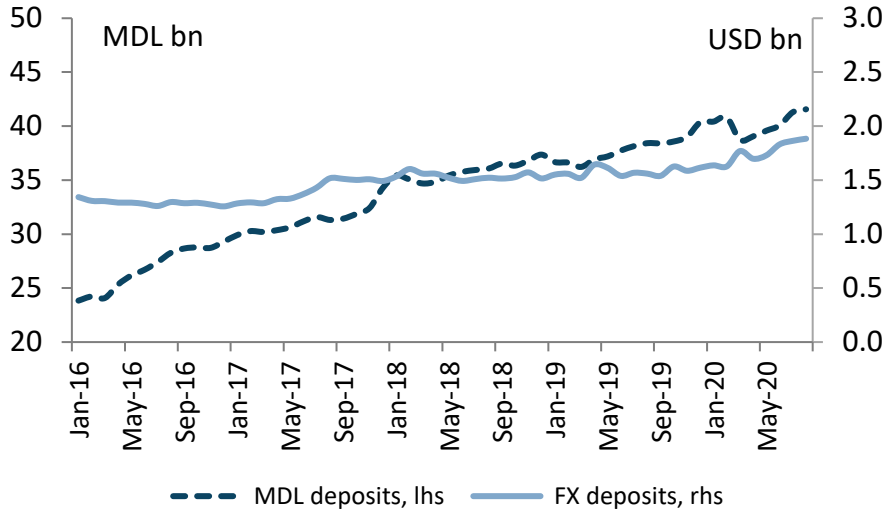
Source: IMF, NBM

- Share of non-performing loans declined steadily from 18% in 2017 to 8.5% at the end of 2019
- However, increase to 8.9% in mid-2020 possibly due to fall-out of Corona-crisis
- This is the result of consolidation of leading banks as new foreign bank owners and NBM apply much stricter risk policy
- In regional comparison, Moldova with about 8% NPL rate much better than Ukraine, but higher than in Romania, Poland and Croatia
- Value of non-performing loans declined most in agriculture sector

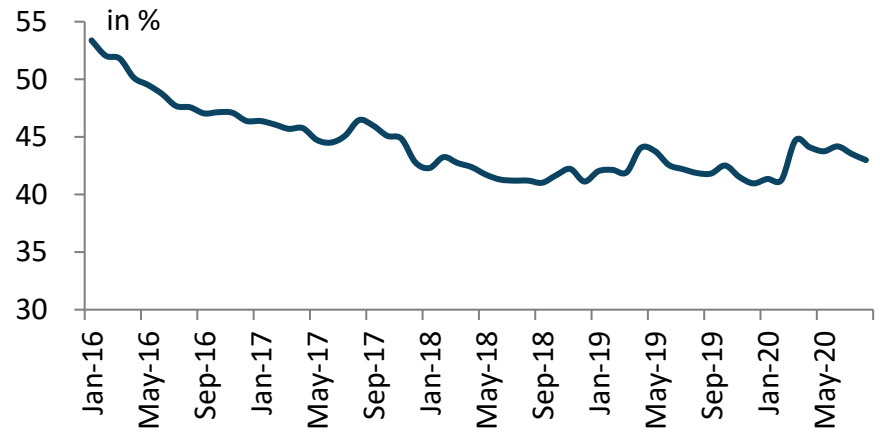
- **Declining NPL share points to successful clean-up of loan portfolios after bank fraud and improved lending standards**
- **Low NPL share means Moldovan banking sector enters Corona Crisis with healthier loan portfolios**
- **Recent increase so far not problematic**

8. Deposits

Bank deposits



Deposit dollarisation ratio



- Overall MDL deposits have increased by about 17% since 2017 exceeding MDL 41 bn by mid-2020
- Meanwhile FX-deposits have only increased modestly since 2017 standing at USD 1.9 bn in mid–2020
- Consequence: decrease of deposit dollarisation ratio from about 56% in 2015 at the height of the bank fraud scandal to 42% in 2019 signaling increased confidence in national currency
- Loan to deposit ratio more or less stable at about 60%

➢ **Increasing deposits and declining share of FX deposits suggest increased confidence in the Moldovan banking system**

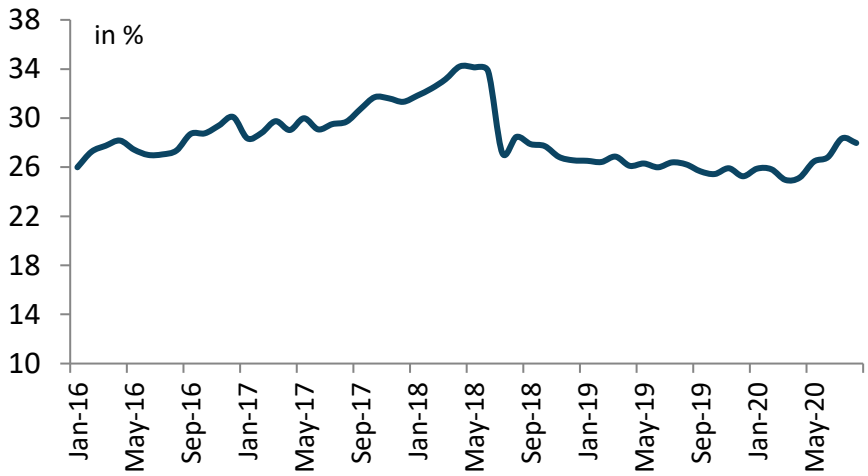
➢ **Latest data suggest no increased withdrawal of deposits or run on deposits in light of Corona crisis**

➢ **In fact, increase in both MDA and FX deposits**

Source: NBM, own calculations, excl. deposits from other banks

9. Capital buffers

Capital adequacy ratio



Source: NBM

Capital adequacy ratio (CAR)

- Decrease of capital buffer since mid 2018 with CAR declining from 34% to 25% at the end of 2019 mainly due to the transition to Basel III standards for capital calculation
- Increase in 2020 to 28% reflecting pre-cautionary measures
- However, still comfortably above the minimum capital requirement for banks which is currently set at 10% plus different capital buffers*
- Indeed, data suggest that CARs in Moldova have increased substantially due to the withdrawal of the license of 3 problematic banks as a result of the banking fraud scandal and increase of capital in the context of prudent regulations

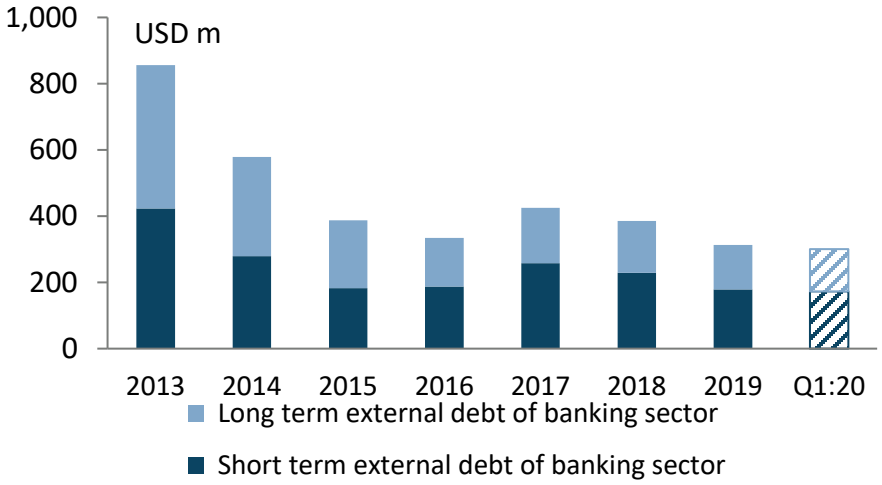
➢ **High capital buffers suggest banks are well capitalized when facing losses resulting from the Corona crisis**

➢ **Indeed, data suggest that banks may even be somewhat underleveraged**

**starting with March 2019, capital buffers for systemically important institutions (O-SII) vary between 0.5% and 1.5%. Also, the systemic risk buffer varies between 1 and 3%.*

10. External debt

External debt of banking sector

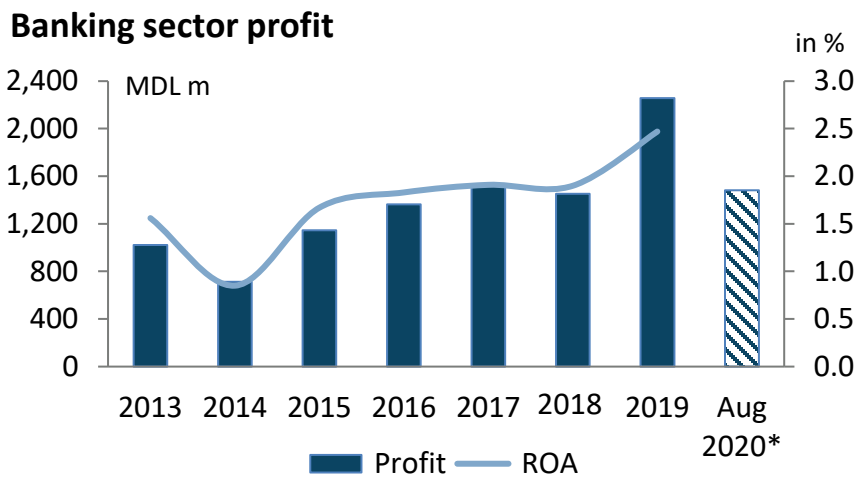


Source: NBM, end of period

- Although level of external debt increased in 2017, generally falling trend over past years can be observed
- Decreasing lending by IFIs to commercial banks and by commercial banks to private clients due to FX risk (bad experience of lending in Swiss franc in Poland and Hungary) explain falling trend
- 2019: level of external debt reached USD 313 m; 1st quarter 2020 data suggest level of external debt in 2019 will be similar as in 2018
- Excess liquidity in MDL, no significant need for external debt

➢ **External debt rather limited equalling 3-4% of GDP and as such does not constitute a major source of risk in case of exchange rate volatility**

11. Bank profits



** Projection for full year based on August 2020 data*
Source: NBM, end of period

- Significant increase of banking sector profits amounting to MDL 2.3 bn in 2019, up by 55% compared to 2018
- Profitability as measured by return on assets (ROA) also increased markedly to 2.5% in 2019 compared to 1.7% in 2018, same tendency also regarding return on equity (ROE) with 10.3% in 2018 and 14.6% in 2019
- Decreasing expenditures in the banking system one source of profits. Additionally, declining losses (write-offs) from non-performing loans as banks have become more prudent and cleaned up their loan books
- However, projections based on August 2020 data suggest worsening profit situation as Corona impact increases losses

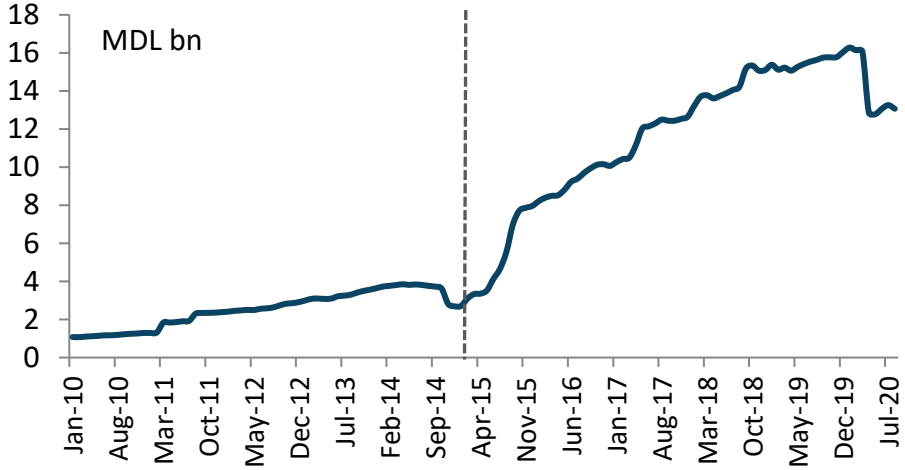
➢ **Good profit situation underlines improved financial health of banks**

➢ **High level of profits means banking sector as a whole has some buffers in the face of the economic fall-out of the Corona crisis**

➢ **2020 profits will be lower but still at reasonably high level**

12. Excess liquidity in banking sector

MDL required reserves



Estimated cost of absorption (as of August 2020)

Instrument	Absorption, MDL m	Interest rate, %	Cost per year, MDL m
Required reserves	13,061	0.46	60.8
NBM certificates	5,407	3.07	165.99
	18,468		**226.79**
Overnight deposits	170	0.25	0.43

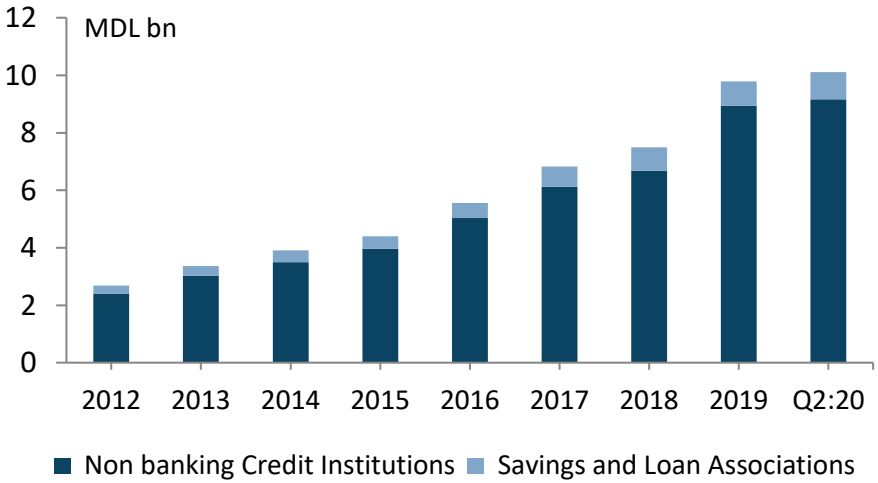
Source: NBM, own estimates

- Liquidity in the banking sector high but slightly decreasing stock of NBM certificates (MDL 6.7 bn to MDL 5.4 bn in August 2020)
- Growing overnight deposits of sector from January 2019 to March 2019, then decreasing, and from August 2019 again increasing, in second half of 2020 again decreasing to MDL 170 m as a result of withdrawing of deposits due to Corona crisis
- Cost of absorption as of Aug. 2020 approx. 0.23 bn MDL, significantly decreased from 2019 levels due to cut of policy rate and required reserve ratio

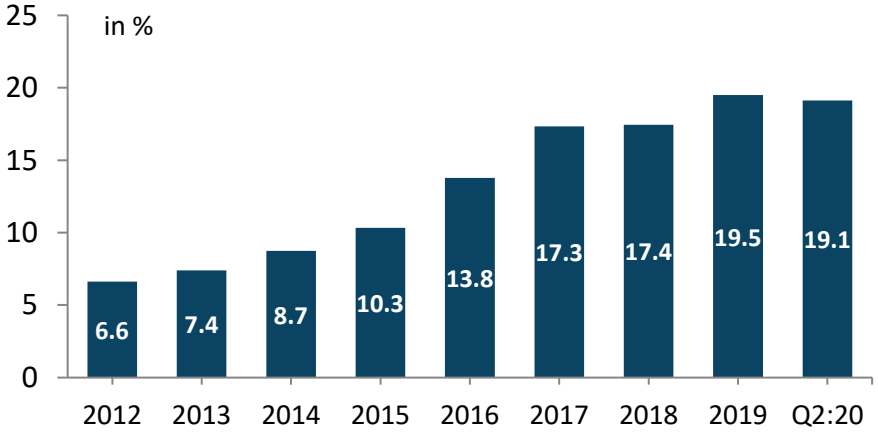
➢ **High liquidity of banking sector is positive and key to overcome possible shortfalls in case of higher demand of population or corporates for liquidity in particular in light of Corona crisis**

13. Non banking financial institutions (NBFI)

Lending by NBFI



NBFI loans as % of bank loans



Source: NBM

Lending by non-banking financial institutions

- Lending by NBFI such as micro-finance institutions has significantly increased to MDL 10 bn in mid-2020
- But, lending growth has slowed in 2020 and the share of NBFI loans declined slightly compared to 2019
- But, at about 19% NBFI lending rate doubled since 2015
- NBFI much lighter regulated than fully licensed banks. As such, increase of NBFI lending reflects regulatory arbitrage in the face of increased regulation of the banking sector since the bank fraud scandal
- Increased lending is mainly a concern from anti money laundering and consumer protection perspective
- As NBFI are not allowed to take deposits, systemic risk is contained for now

14. Possible impact from Corona crisis

- The Moldovan banking system has made significant progress over the past years following the banking fraud scandal in 2014/2015
- The Corona crisis, however, poses a major challenge for European banks and also for their peers in Moldova. Although it is too early to assess the full impact of the Corona crisis on Moldovan banks the following fall-out is likely:
  1. As the share of non-performing loans of the banking system will grow as a result of a worsening financial situation of corporate and individual clients, banks will have to make higher loan/loss provisions, which will decrease profitability of the banking sector
  2. Banks might review their business models, give clients grace periods for repayment of loans, decrease costs since revenues will shrink and decrease prices for banking products in order not to lose clients
  3. Since the four biggest Moldovan banks are owned by Western or Eastern European shareholders, support of the main shareholders for their subsidiaries is key for the stability of the whole banking system.
  4. Down grading of banks by rating agencies might happen and result in higher refinancing costs and additionally decrease profitability of the banking sector. However, mid 2020 figures show that profits of banks have decreased but are still at a satisfactory level

➢ **While these are serious challenges, the higher capitalisation and enhanced stability of the Moldovan banking system means banks better prepared for the challenges of the Corona crisis**

Annex: Banking sector statistics

Balance sheet data	2013	2014	2015	2016	2017	2018	2019	Aug-20
Total assets, MDL m	76,190	93,877	68,790	72,830	79,465	83,077	90,599	94,656
growth in % yoy	30.98	23.21	-26.72	5.87	9.11	4.54	9.06	4.48
in % of GDP	75.80	83.78	56.45	54.16	52.80	43.70	43.12	46.40
Total loans, MDL m	42,177	40,842	38,188	34,761	33,473	35,453	40,345	42,726
growth in % yoy	20.57	-3.17	-6.50	-8.97	-3.71	5.91	13.80	5.90
in % of GDP	41.96	36.45	31.34	25.85	22.26	18.66	19.20	20.94
Loans to private enterprises, MDL m	37,292	34,923	32,169	28,347	25,851	25,467	26,371	27,335
growth in % yoy	28.50	-6.35	-7.89	-11.88	-8.81	-1.49	3.55	3.65
in % of GDP	37.10	31.17	26.40	21.08	17.19	13.40	12.55	13.40
Loans to households, MDL m	4,885	5,919	6,019	6,414	7,622	9,986	14,005	15,392
growth in % yoy	-18.06	21.16	1.68	6.58	18.83	31.01	40.24	9.90
in % of GDP	4.86	5.28	4.94	4.77	5.07	5.26	6.67	7.54
Loans in foreign currency, MDL m	17,343	16,269	16,088	15,397	13,943	13,643	13,460	12,766
growth in % yoy	15.92	-6.19	-1.11	-4.29	-9.44	-2.15	-1.34	-5.16
in % of GDP	17.26	14.52	13.20	11.45	9.27	7.18	6.41	6.26
Loans in foreign currency (% of total loans)	41.12	39.83	42.13	44.29	41.66	38.48	33.36	29.88

Source: NBM

Annex: Bank sector statistics

Balance sheet data	2013	2014	2015	2016	2017	2018	2019	Aug-20
Total deposits, MDL m	47,667	51,727	50,039	54,667	59,897	63,463	68,914	72,892
growth in % yoy	43.06	8.52	-3.26	9.25	9.57	5.95	8.59	5.77
in % of GDP	47.43	46.16	41.07	40.65	39.83	33.40	32.80	35.73
Deposits from households, MDL m	31,349	34,591	35,018	37,669	39,623	41,677	45,599	47,555
growth in % yoy	24.12	10.34	1.23	7.57	5.19	5.18	9.41	4.29
in % of GDP	31.19	30.87	28.74	28.01	26.35	21.93	21.70	23.31
Total loans (% of total deposits)	88.48	78.96	76.32	63.59	55.88	55.86	58.54	58.62
Structural information								
Number of banks	14	14	11	11	11	11	11	11
Market share of state-owned banks (% of total assets)	11.20	14.84	-	-	-	-	-	-
Market share of foreign-owned banks (% of total assets)	17.01	14.74	24.40	26.06	43.13	41.67	61.70	61.80
Profitability and efficiency								
Return on Assets (RoA)	1.56	0.85	1.67	1.97	1.91	1.9	2.47	1.52
Return on Equity (RoE)	9.42	5.86	10.16	11.95	11.42	11.6	14.63	8.76
Capital adequacy (% of risk weighted assets)	23.02	13.92	26.31	30.08	31.32	26.55	25.25	27.96
Non-performing loans (% of total loans, eop)	11.56	11.73	9.95	16.31	18.38	12.54	8.49	8.92

Source: NBM

About the German Economic Team

The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

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