PRESS RELEASE

Monitoring successes and shortfalls in banking sector reform in Moldova

Berlin/Chișinău, 24.11.2020. Overall, the Moldovan banking sector is in a fairly good shape and has been significantly strengthened since the banking fraud scandal in 2014/15 by reforms strengthening regulation and central bank independence. Thus, it can be expected that the economic consequences of the Covid-19 pandemic will be manageable. This is the conclusion of a policy briefing by Per Fischer and Jörg Radeke on the state of Moldovas' banks.

The results of the briefing in detail:

1. **Development of bank assets:** In general, bank assets to GDP ratio declined from 53% to 43% from 2017 to 2019, while the Q2 2020 saw an increase in asset ratios from 43.1% to 46.4%. This pattern was not confined to Moldova, however, as Ukraine, Romania, Poland and Croatia observed a similar decline in 2019 and an increase in Q2 2020. The decline in Moldova was linked to the faster GDP growth in this period.
2. **Number of banks and market share:** Since the insolvency of three banks in 2015 the number of banks operating on the Moldovan market has remained stable. Several Western European banks have acquired stakes in Moldovan banks, which has led to recapitalisation, new business models, better transparency and compliance.
3. **Foreign ownership and concentration:** The market share of foreign-owned banks was 62%. This constitutes a significant increase since 2017. The four leading banks are now controlled by EU shareholders, which reflects a return of trust of foreign investors in the Moldovan banking sector. Uncertainties over recent legal actions, however, might compromise this regained trust and undermine the success of past reforms. The three largest Moldovan banks have a combined market share of 64%. Smaller and mainly domestically-owned banks have a market share of only 5%. However, there are still enough players in the Moldovan banking market to ensure sufficient competition.
4. **Loans to real economy:** The lending to the real sector has gradually increased over the course of the last years up to 45% in 2020. However, excess liquidity still prevents loans to asset ratio to increase. There is only a slight increase in loans to GDP (20.9% in mid-2020 from 19.2% in 2019).
5. **Loan growth:** There was a sharp decline in loan growth observable after the fraud scandal of 2014/15. However, positive loan growth was again present at the end of 2017, suggesting that the clean-up of bad loans had been finished. The lending in foreign currencies grew slower than the lending in domestic currency.
6. **Interest rates:** Low interest rates can explain some of the loan growth. Increased loan lending and solid interest margin support profit growth.
7. **Non-performing loans:** There was a steady and significant decline in non-performing loans from 18% (2017) to 8.5% (2019). The slight increase mid-2020 to 8.9% could be attributed to the Covid-19-crisis.
8. **Deposits:** Overall increase in Moldovan deposits have increased with a declining share of FX deposits, suggesting an increased confidence in the Moldovan banking sector. The recent Corona

crisis had no significant impact on deposit withdrawal, suggesting solid trust in the Moldovan banking sector.

9. **Capital buffers:** There has been a decrease in capital buffer since mid-2018. The Capital Adequacy Ratio (CAR) declined from 34% to 25% at the end of 2019, mainly due to Basel III transition. The 2020 increase to 28% reflects precautionary measures. Overall, high capital buffers suggest that Moldovan banks are well capitalized.
10. **External debt:** A general falling trend in the level of external debt can be observed. In Q1 2020 external debt stood at 3-4% /GDP, which does not constitute a major source of risk
11. **Bank profits:** The improved financial situation of Moldovan banks is underlined by the significant increase in banking sector profits
12. **Excess liquidity in banking sector:** There is high liquidity in the banking sector, which is a positive sign for possible higher liquidity demands by corporations or private households.
13. **Non-banking financial institutions (NFBI):** Increased lending from NFBIs reflects increased regulation of the banking sector and accompanying regulatory arbitrage by NFBIs. However, since NFBIs are not allowed to take deposits the risk is considered low for the moment.
14. **Covid-19 economic impact:** As with other sectors, the Covid-19 pandemic will have a significant impact. However, higher capitalisation and strengthened stability make the Moldovan banking system better prepared to overcome this challenge.

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