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# Annual Report 2014

Annual Report, 2014 [1]

# Summary

## External environment

Many important events recorded in 2014 have transformed the trajectory of the world economy. The decrease in oil prices in the second half of the year was placed at the forefront, which has turned the economies of petroleum exporting countries upside down. The year of 2014 was also characterized by excessive volatility on foreign exchange markets, it should be noted the significant movements of monetary policy, such as the end of the quantitative easing programme (QE3) by the Federal Reserve System and the interest rates decrease to zero lower bound by the European Central Bank. The decrease in global demand, fed by reduced activity of the emerging countries, had a contracting impact on raw materials prices. In 2014, the harvest of agricultural products worldwide, especially that of wheat and other cereals, reached the maximum level in the recent years, which generated the decrease in food prices and increased the trade, in an attempt to supply the depleted stocks in recent years.

The economic activity in the region was jeopardised by the development of Russian economy, given the gradual application of economic sanctions by the EU and other developed economies. In the first half of the year, the region has faced persistent disinflationary pressures, while by the end of the year, the depreciation of currencies in the region has triggered the intensification of inflationary pressures with major impact in the first months of 2015. The regional crisis has been also deepened by the embargoes imposed by the Russian Federation to some economies, including the Republic of Moldova, which led to losses in food industry sector and partial reorganisation of external regional trade. However, monetary authorities in the region adopted restrictive monetary policies against the background of increased inflationary pressures and an excessive volatility on foreign exchange markets, which are currently to the detriment of economic growth stimulation.

## Economic developments

In 2014, the economy of the Republic of Moldova recorded a positive development, but lower than in 2013, GDP increasing by 4.6 percent. In the first half of the year, the economic growth was sustained in most part, by the significant increase in exports. In the second half of the year, domestic demand was the primary factor of the positive dynamics of economic activity. However, this was mitigated considerably by contracting exports following the imposition of restrictions by the Russian Federation for domestic products. Overall, in 2014, household final consumption increased by 2.9 percent against the background of increasing disposable income. Investments registered a more pronounced dynamic, thus, gross fixed capital

formation increased by 10.1 percent compared with 2013. Government consumption recorded a contraction of 0.6 percent. Despite the increase in domestic demand, imports have increased slightly only by 0.4 percent. The annual growth rate of exports was also modest, increasing by 1.1 percent. Similarly to 2013, agriculture had a substantial impact on GDP growth in 2014, achieving an increase by 8.2 percent and fostering industry growth by 7.2 percent. In 2014, the economically active population increased, while unemployment decreased.

## Inflation

In 2014, the National Bank of Moldova has created the necessary conditions for the inflation to fall within the range of ± 1.5 percentage points from the target of 5.0 percent. Thus, during the last 35 months, inflation has fallen within the range of variation. In early 2014, the annual inflation rate continued the upward dynamics since the second half of 2013, increasing from 5.1 percent in January to 5.8 percent in April. This dynamics was determined mainly by the developments in food prices and core inflation under the pressure of depreciation of the national currency against the U.S. dollar observed in autumn 2013. Later, under the influence of reducing the annual growth rate of food prices in the context of a good agricultural year, the CPI annual rate experienced a modest dynamics. Thus, following a significant fall in inflation to lower band of the range in May 2014, reaching a level of 4.7 percent, in the summer months, it recorded an average annual rate of 5.1 percent. In late 2014, along with more pronounced materialization of the consequences of a rich harvest of fruits and vegetables, and the embargo on some local products, the annual average rate has returned to the lower band of the range from the inflation target, registering a value of 4.8 percent.

## Monetary policy

Quantifying the macroeconomic situation, trends and projections of macroeconomic indicators in the medium term, inflation outlook in the short and medium term, with possible uncertainties and challenges during the reference period, as well as to anchor disinflationary pressures, the National Bank of Moldova has promoted during 2014 an incentive monetary policy under a reduced aggregate demand.

In December 2014, the monetary policy was affected by the complexity of risk balance, both internal and external, with a gradual accentuation of inflationary risks. In this context, the National Bank of Moldova had to adopt gradual monetary policy tightening measures to reduce inflationary pressures from regulated prices and national currency depreciation. Against this background, within the meetings held on December 11 and December 29, 2014, the members of the Council of Administration of the NBM decided by unanimous vote to increase the base rate by 1.0 and 2.0 percentage points respectively, from 3.5 to 6.5 percent.

Subsequently, within the meetings of the Council of Administration of the NBM of January 29 and February 17, 2015, the process of policy rate growth continued as the depreciation trend of the national currency has intensified, adopting two decisions of increasing the base rate by 2.0 and 5.0 percentage points, respectively, from 6.5 to 13.5 percent. In order to sterilize the excess liquidity formed in the last months of 2014 and improve the transmission mechanism of monetary policy decisions, the Council of Administration decided within the meeting of January 29, 2015 to raise the required reserves ratio attracted in MDL and non-convertible currency from the level of 14.0 to 18.0 percent of the base.

These decisions were aimed at anchoring inflation expectations in the context of maintaining the inflation close to the target of 5.0 percent, with a possible deviation of ± 1.5 percentage points.

Monetary conditions have been adjusted through the base rate policy, given the monetary policy objective, supported by a sound management of liquidity by the central bank. In the latter, market operations, standing facilities and required reserve mechanism continued to play the main role.

The set of monetary policy instruments used by the NBM in accordance with the operational framework has proved to be appropriate to the monetary policy implementation requirements. During 2014, the NBM continued to exercise control over liquidity in the banking system, given the gradual restriction of excess liquidity.

The operating regime of standing facilities (overnight deposits and credits) set for 2014 allowed banks to manage their liquidity efficiently and offered the NBM more flexibility in implementing the monetary policy.

In 2014, the required reserves mechanism exercised the function of monetary control which is closely correlated with the liquidity management by the NBM and remained at the level of 14.0 percent of the base. Towards the end of 2014, required reserves had a specific development, following the imposition of a special regime of required reserves during the moratorium to banks under special administration.

The NBM intervened on the domestic foreign exchange market during 2014, mainly as a seller of foreign currency, in the light of the monetary policy promoted by the National Bank and to mitigate excessive fluctuations of the exchange rate of the national currency against the U.S. dollar. Coverage of net foreign currency sales to legal entities by the net supply of foreign currency from individuals was negative throughout the year. It is noted that in 2014, in general, the foreign exchange market experienced a liquidity shortage in foreign currency, reaching a deep gap between demand and supply on the foreign exchange market compared to previous years. In the context of these developments and within the limits of the monetary policy pursued during 2014, the shortage of foreign currency on the domestic market was partly covered by net selling interventions of USD 418.1 million.

At the end of 2014, official reserve assets amounted to USD 2156.6 million, decreasing by 23.5 percent compared to the end of 2013 and covering about 3.8 months of imports (in 2013 covering 4.8 months of imports).

## Banking system

As at December 31, 2014, the banking sector of the Republic of Moldova included 14 banks licensed by the National Bank of Moldova, of which 4 are branches of foreign banks and financial groups.

The evolution of aggregate indicators for 2014 was strongly distorted by several particularly large transactions performed at B.C. Banca de Economii S.A., "BANCA SOCIALĂ" S.A. and B.C. "UNIBANK" S.A., which determined the National Bank of Moldova to establish special administration over B.C. Banca de Economii S.A. and "BANCA SOCIALĂ" S.A. by the Decision of the Council of Administration no.248 of November 27, 2014 and no.253 of November 30, 2014, respectively. Later on, National Bank has established special supervision over B.C. "UNIBANK" S.A. by the Decision no.275 of December 12, 2014 and subsequently special administration by the Decision no.296 of December 30, 2014.

Tier I capital on the banking system reached the level of MDL 8707.3 million, increasing by MDL 781.0 million compared to the end of 2013 (9.9 percent). As at December 31, 2014, the size of Tier I capital of banks corresponded to the established minimum standard (≥ MDL 200.0 million).

The Tier I capital increase in 2014 was due to the profit obtained in the amount of MDL 778.2 million and issues of shares by 4 banks in the amount of MDL 398.2 million. At the same time, BCR Chișinău S.A. issued shares on the account of subordinated debts with their subsequent transfer in the share capital of the bank in the amount of MDL 35.6 million. Simultaneously, the calculated amount but unreserved of the allowances for impairment losses on assets and conditional commitments increased by MDL 168.9 million (6.0 percent) and net intangible assets increased by MDL 41.6 million (15.7 percent). During the reporting year, five banks have paid dividends in total amount of MDL 254.4 million.

As at December 31, 2014, the average risk-weighted capital adequacy was 13.2 percent, decreasing by 9.8 percentage points compared to the end of 2013 and is below minimum allowable level of 16.0 percent. Two of the banks under special administration failed to comply with this indicator as at December 31, 2014, representing 2.6 and 3.2 percent respectively, while the average on sector, except banks under special administration, amounted to 21.7 percent.

The total assets of the sector were MDL 97584.4 million, increasing by MDL 21394.3 million (28.1 percent) compared with the end of 2013. Assets growth of the 11 banks (except those under special administration) was 4032.0 million (7.2 percent), but lower than the assets growth of the 3 banks under special administration, whose assets increased by MDL 17362.3 million (85.9 percent).

The share of net non-performing loans in total regulatory capital decreased by 2.3 percentage points, amounting to 14.2 percent as at December 31, 2014.

Return on assets and return on equity of licensed banks in 2014 recorded a level of 0.9 percent and 6.4 percent respectively, decreasing by 0.6 percentage points and 3.0 percentage points compared to the end of2013.
Net interest margin was 3.8 percent as at December 31, 2014, remaining almost at the level of 2013.

Long-term liquidity in the banking sector was 1.5, which is over the maximum allowable level. As at December 31, 2014, this indicator was respected by all banks, except one of the banks under special administration. Current liquidity in the banking sector was 21.6 percent, the limit of which being respected by all banks, except the 3 banks under special administration.

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