NEWSLETTER

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Current situation and trends in the Moldovan banking sector

The bank fraud in 2014 has changed the sector significantly. It has shrunk, as banking assets in relation to GDP decreased from 84% in 2014 to 54% in 2016. Concentration increased – the three largest banks now have a market share of 65% of total assets, in 2013 the share was 50%. A regional comparison, however, shows that the smaller size and the higher concentration do not pose a problem. Still, the banking scandal had harmed confidence in the sector.

Most indicators show, however, that confidence is recovering. The temporary "flight" to foreign currencies is over and the dollarisation is now at 45%, which is the same level as prior to the bank fraud. After the liquidation of the three insolvent banks, the capital adequacy ratio is now higher than prior to the crisis and the ratio of non-performing loans is increasing only due to stricter regulation. Additionally, the effort of the National Bank to increase transparency is bearing fruits. Shares in the largest banks have been blocked and are partly reissued.

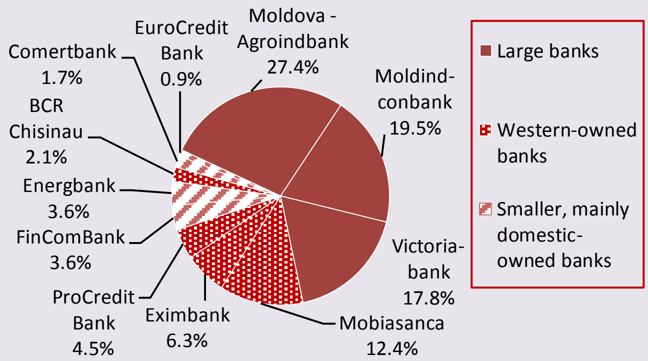
At the same time, the problem of weak crediting of the private sector remains unsolved. The reasons are to be found on the supply as well as on the demand side: On the one hand there is a lack of qualified projects; on the other hand banks have little incentive to provide loans, as interest rates on government bonds and certificates of the National Bank are high. In this situation the sale of the blocked shares of the largest banks to international strategic investors would help stimulate the credit business.

Developments since 2014

In consequence of the bank fraud at the end of 2014, which had resulted in the collapse of three Moldovan banks and the disappearance of up to UDS 1 bn, the sector has experienced significant changes. After the bankruptcy of the involved banks in 2014, only 11 of formerly 14 banks exist today. Banking assets in relation to GDP have decreased from almost 84% in 2014 to 54% in 2016. At the same time, concentration increased: The share of the three largest banks in total assets now amounts to 65% after less than 50% in 2013. However, it is necessary to look at the numbers in the right context.

The decrease of assets is a result of the removal of the three insolvent banks' "inflated" assets. Thus, this process might be interpreted as a clean-up of the banking sector, similar to what has happened in Ukraine. A regional comparison shows that the ratio of assets to GDP is close to that of Ukraine and Romania. Thus, the smaller size of the sector is not a problem.

Bank segments and market shares



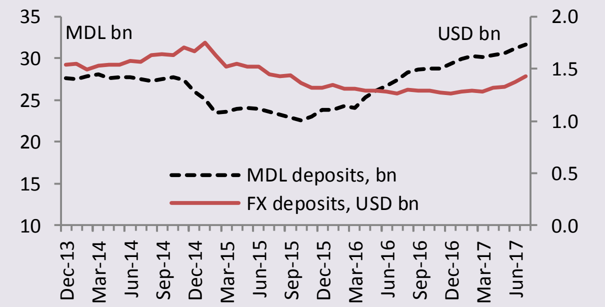
Source: National Bank of Moldova, Note: Data for July 2017

Also, concentration is not a problematic issue. The three largest banks hold a market share of 65%. But at the same time, there are four banks in Western ownership, which also play a significant role with around 25% of total assets. Furthermore, the market share of "Western" banks has been continuously increasing since the end of 2015.

Confidence is recovering

The banking fraud had undermined confidence into the sector. Even though no bank run had occurred at the end of 2014 and in early 2015, deposits had shifted from Leu to US dollar and Euro.

Deposits



Source: National Bank of Moldova

However, currently, most indicators signal that confidence is coming back. Since the fourth quarter of 2015, Leu deposits are increasing: They were at 22.6 bn in October 2015 and reached 31.6 bn in July 2017. This is also reflected by the dollarisation rate, which had been at 46% at the end of 2014 (including Euro). After reaching 57%, it is now down again at the pre-crisis level of 45%.

Another sign of stabilisation is the positive development of the capital adequacy ratio (CAR), which indicates the ratio of equity capital to the risk-weighted credit exposure. The minimum CAR for Moldovan banks is 16%. Traditionally, the actual system-wide CAR is significantly higher than the minimum requirement. However, in January 2015 it had decreased to 12.7%, thus falling below the regulatory minimum. After the removal of the three insolvent banks from the system in November 2015, it had increased significantly and is now at almost 30% far above the minimum CAR and also above the pre-crisis level.

It is also worthwhile to take a look at non-performing loans (NPLs, loans that are not serviced or serviced with delay). Their ratio has been increasing continuously after the liquidation of the three banks and is above 16% since 2016. The reasons for this development are higher standards and improved supervision. Thus, the situation has not worsened, but standards have been tightened.

Another contribution towards stabilisation was the effort of the National Bank to increase transparency regarding the ultimate ownership in the banking sector. Since June 2015 the three largest banks have been put under intensive supervision by the National Bank. 43.1% of assets of the Agroindbank (MAIB), the largest bank, have been blocked, annulled and finally reissued since December 2015. They can now be purchased. Also 63.9% of assets of Moldindconbank (MICB), the second largest bank, have been blocked in October 2016. The bank has been put under the so-called early intervention regime of the National Bank. This implies that the National Bank's consent is required for all important decisions of the management. These measures of the National Bank have significantly contributed to increased transparency and rehabilitate the sector.

Crediting of the economy still problematic

In spite of the progress and reforms there are still unsolved problems – the weak crediting of the economy being one of them. The ratio of credit to private sector in relation to total assets amounted to only 48% in 2016. This is a very low level compared to other countries in the region like Romania (57%), Poland (66%) or Croatia (59%). Reasons are low demand due to a lack of qualified projects, but also high interest rates on government bonds and certificates of the National Bank, which dampen the banks' incentive to provide loans to the private sector. Thus, a crowding-out is taking place. Additionally, the sector suffers from structural problems like difficulties with loan recovery. Indeed, the volume of outstanding loans has been falling continuously since 2014. This trend has slowed down in 2016/17, but still it does not seem that the bottom has been reached yet.

Outlook

The banking sector has successfully stabilised after the fraud despite the difficult situation. The reforms aim first of all at the recovery of confidence and a transparent ownership structure. At the same time, regulations are tightening also in other fields in order to avoid a repetition of a scandal similar to the one in 2014. In 2018, Basel III standards for the regulation of the banking sector are to be introduced. Compared to the current regulation – Basel I – this is a large step requiring major adjustment efforts especially from the domestic banks. At the same time, crediting of the private sector has to be improved. In this context new strategic investors for the blocked shares of the largest banks, who can rely on good experience in the banking business, would be of crucial importance.

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A more comprehensive analysis is provided by the Policy Briefing PB/05/2017 „Banking Sector Monitoring Moldova“.

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