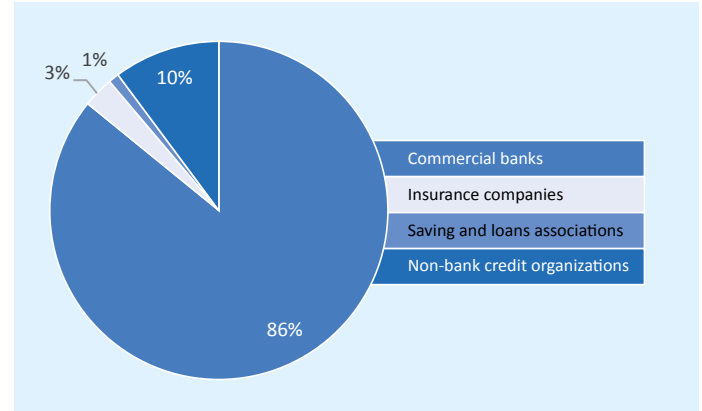


Overview of the financial sector in Moldova



The financial sector in Moldova mostly consists of commercial banks that hold around 86% of total financial sector assets. Non-bank credit organizations that provide small size loans to low income borrowers hold around 10% of total financial sector assets. Other financial institutions such as insurance companies, saving and loan associations are small and do not play a significant role in financial intermediation in Moldova. The present analysis will focus on commercial banks.

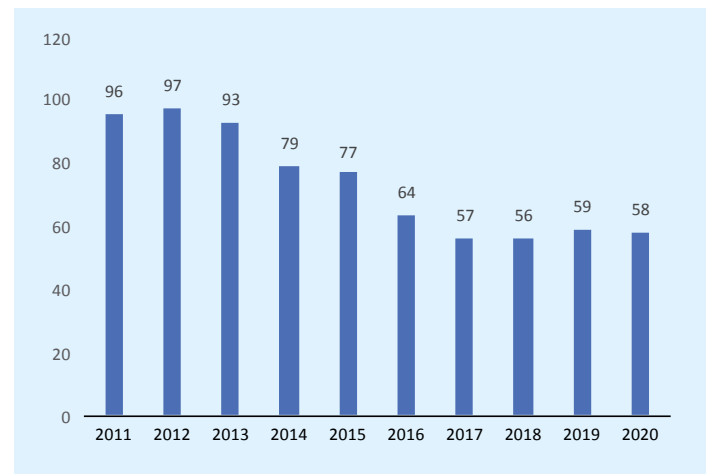
Figure 1. The structure of the financial sector in Moldova, December 2019



Source: Financial stability report for 2019, National Bank of Moldova

After the banking crisis in 2014, the size of the banking sector declined considerably since the crisis was followed by the removal of bad assets from the balance sheets of banks. As a result, total assets of the banking sector declined from 84% of GDP in 2014 to 44% in 2019. In 2020, however, banking sector assets grew and reached 52% of GDP, which is still one of the lowest among the BSTDB member countries and in the wider region. The ratio of loans to GDP at 23% is also one of the lowest. The concentration in the banking sector is relatively high with 4 banks holding around 80% of total banking sector assets. Foreign participation in commercial banks in Moldova has increased markedly in the last 5 years and currently, the share of the banking sector's assets controlled by foreign investors is more than 70%.

Figure 2. Total loan to deposit ratio in Moldova and regional comparison (%)



Source: Financial Soundness Indicators, IMF database

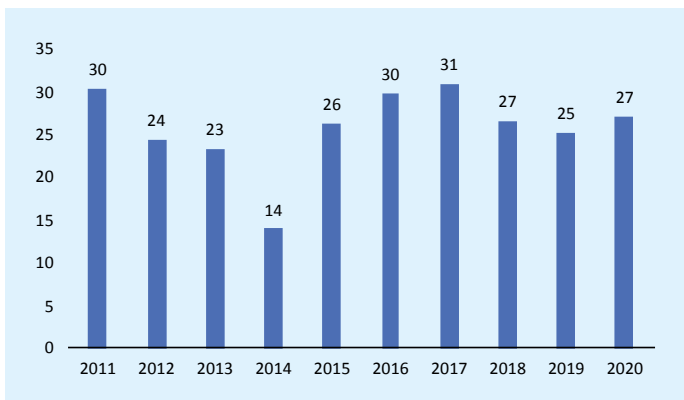


Source: Source: Financial Soundness Indicators, IMF database

Lending to the private sector remains weak in Moldova and amounts to only 43% of banks assets, while the share of liquidity in total assets is large with more than 50% of total assets. As a result, the volume of loans equals 58% of deposits, which is one of the lowest among BSTDB member countries. The latter indicates the challenges that the banking sector in Moldova faces to provide full-fledged financial intermediation to the economy. Funding of the banking sector almost entirely depends on deposits that account for 93% of the total liabilities of the system. The largest part of deposits is attracted from the retail sector, accounting for 59% of total liabilities.

The banking sector in Moldova maintains strong capital buffers. During the crisis in 2014 the CAR dropped below the required minimum and reached 14%. Since then the banking sector's capitalization has recovered and in the following 6 years CAR has stayed above 25%. In 2020 it improved further compared to the previous year and reached 27% by the end of the year. The solid capital position points to the strong shock absorbing capacity of the banking system.

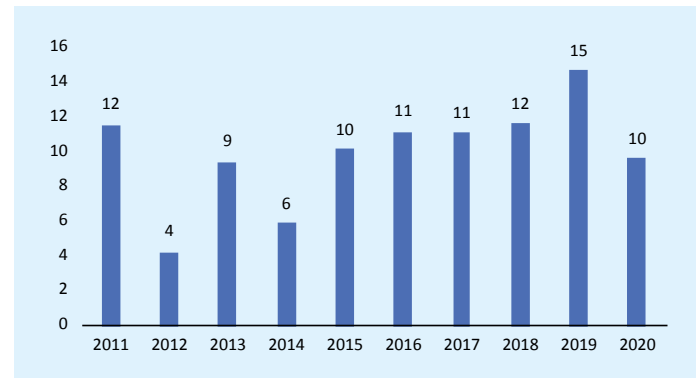
Figure 3. Regulatory capital to risk-weighted assets (%)



Source: Financial Soundness Indicators, IMF database

The profitability of the banking sector has been increasing since 2014 and return on equity (ROE) reached 15% in 2019. As was expected, the pandemic crisis had a negative impact on the banking sector's profitability with ROE declining to 10% in 2020. In the last 6 years, the ROE of the banking system averaged 11%, which is relatively low compared to countries with similar credit ratings.

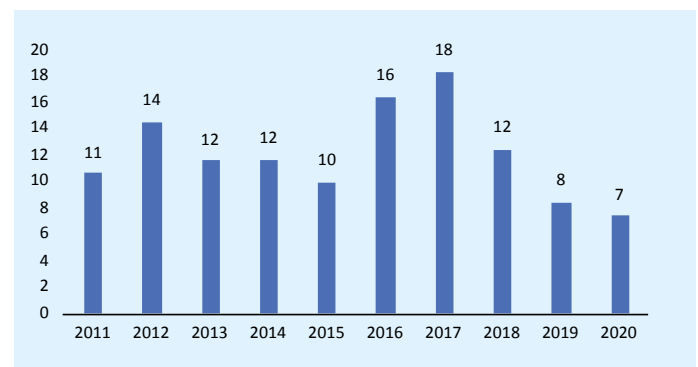
Figure 4. Return on Equity (%)



Source: Financial Soundness Indicators, IMF database, NBG website

One of the challenges of the banking sector in Moldova is a relatively high level of NPLs that stood at 7% of total gross loans at the end of 2020. NPLs have jumped up to 18% of total gross loans in 2017 mainly due to the introduction of stricter standards of bad loan recognition. Since then NPLs have declined and came down to 7% in 2020, reflecting successful clean-up of banks' loan portfolios. Despite the decline, NPLs are still relatively high compared to other peer countries. During the pandemic crisis, temporary loan servicing holidays have been implemented by all banks for loans to individuals, and a targeted approach has been used for loans to corporations. As a result, the current level of NPLs may not fully capture the actual quality of credit portfolio and the full impact of the pandemic on the loans has yet to be seen.

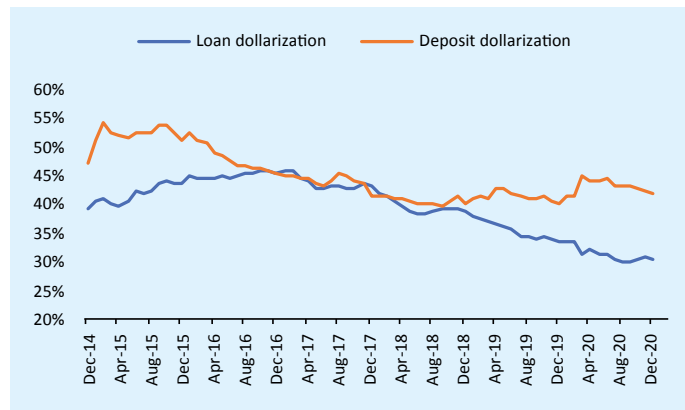
Figure 5. Non-performing Loans to Total Gross Loans (%)



Source: Financial Soundness Indicators, IMF database

Dollarization is another challenge for the banking sector in Moldova. In the last 6 years following the banking crisis of 2014 dollarization has declined both for loans and deposits. Despite the pandemic, it declined further in 2020 and reached 30% for loans and 42% for deposits by the end of the year. A decrease in dollarization of loans and deposits might be a reflection of increased confidence in the national currency on the one hand and reduced FX exposure of the sector on the other, but the current levels remain elevated.

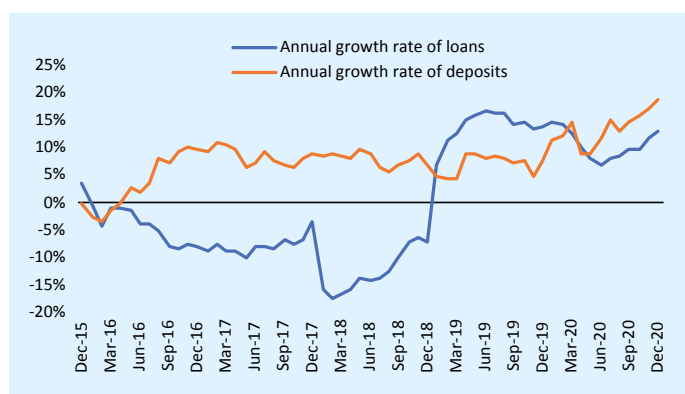
Figure 6. Evolution of dollarization in the banking sector



Source: National Bank of Moldova

Credit growth figures in Moldova for the last 5 years were affected by the massive clean up of balance sheets of banks from bad loans that took place after the banking crisis in 2014. As a result, the growth rate of outstanding loans on banks' balance sheets went into negative territory in 2016-2018. Lending resumed growth only in 2019, and, despite the pandemic crisis, continued to grow in 2020 at an annual growth rate reaching 13% by the end of the year. In contrast to loans, deposit growth was quite strong in the last 5 years, averaging around 8% per year. In 2020, deposit growth accelerated even further and reached 19% by the end of the year. Stronger growth in deposits relative to credits led to an accumulation of large liquidity buffers in the system. The ratio of liquid assets to short term liabilities increased from 92% in 2015 up to 242% by the end of 2020.

Figure 7. Growth rates of loans and deposits

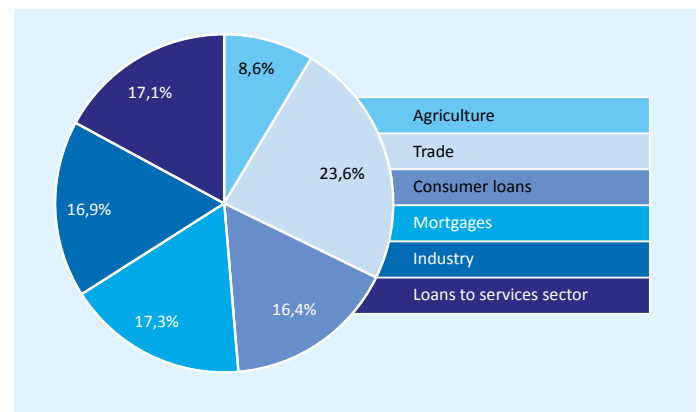


Source: National Bank of Moldova

Around 66% of the credit portfolio of the banking system is exposure to the corporate sector with the trade sector having the largest share at 24%. The share of agriculture in the total credit portfolio is relatively low at 9%. Loans to households account for 34% of bank loans, and they are distributed evenly between consumer loans and mortgages.

The banking sector in Georgia has been growing rapidly over the last 4 years, with both deposit and loan growth rates at double digit levels. Given the high level of dollarization in loans and deposits and exchange rate fluctuations, it would be more informative to look at growth rates excluding the exchange rate effect. Before the pandemic, loans were growing on average at around 17% in annual terms. Since the pandemic, however, the growth rate slowed and by the end of 2020, it was down to 9%. Deposits, on the other hand, grew rapidly in 2020, accelerating markedly in the second half of the year; by the end of 2020 deposit growth reached 21%. Growth in local currency deposits was particularly pronounced as the annual growth rate reached 41% by the end of the year.

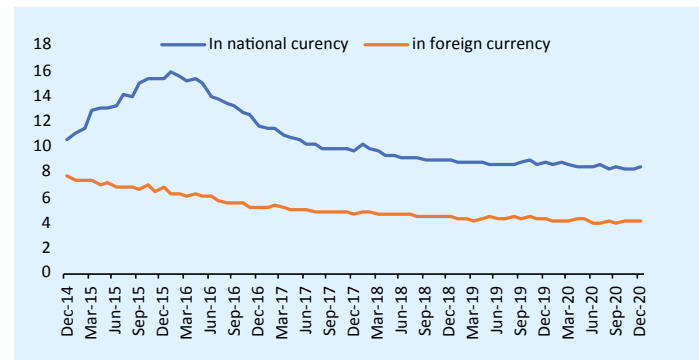
Figure 8. The structure of the credit portfolio, December 2020



Source: National Bank of Moldova

Since 2016 after peaking at 16%, annual interest rates on loans to corporates in national currency started to decline. This trend continued further in 2020 and the annual rate reached 8.4% by the end of 2020. Interest rates in foreign currency on loans to corporates have also declined and by the end of the last year, had fallen to 4.1%.

Figure 9. Interest rates on loans to corporates (%)



Source: National Bank of Moldova

To conclude the financial sector in Moldova is relatively small and is mostly represented by commercial banks. The banking sector has shrunk significantly after the crisis in 2014 and currently, the ratio of the banking sector assets to GDP in Moldova is among the lowest in BSTDB member countries. The banking sector has quite strong capital and liquidity buffers. Liquidity has increased significantly over the last 5 years, partly reflecting the slow growth of loans relative to deposits. The health of the banking sector has improved in the last 3 years as NPLs have declined to single digits, although the current level of NPLs is still elevated. Similar to most countries in the region, the high level of dollarization remains a challenge for the banking sector in Moldova.