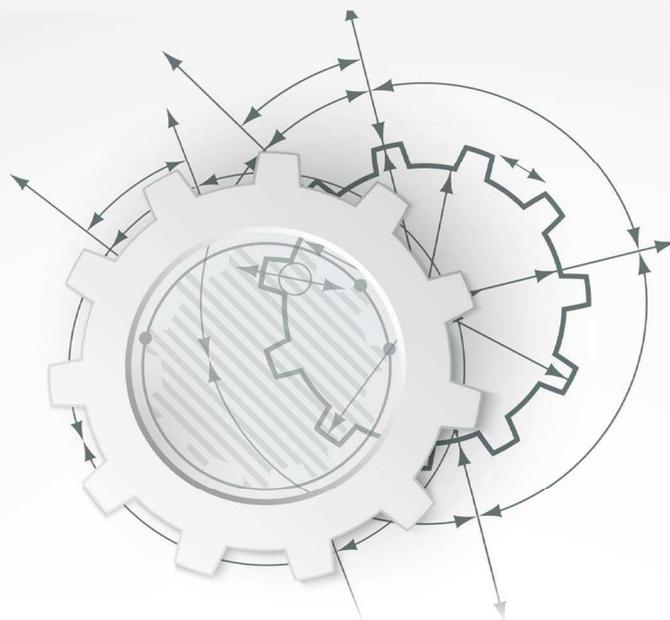
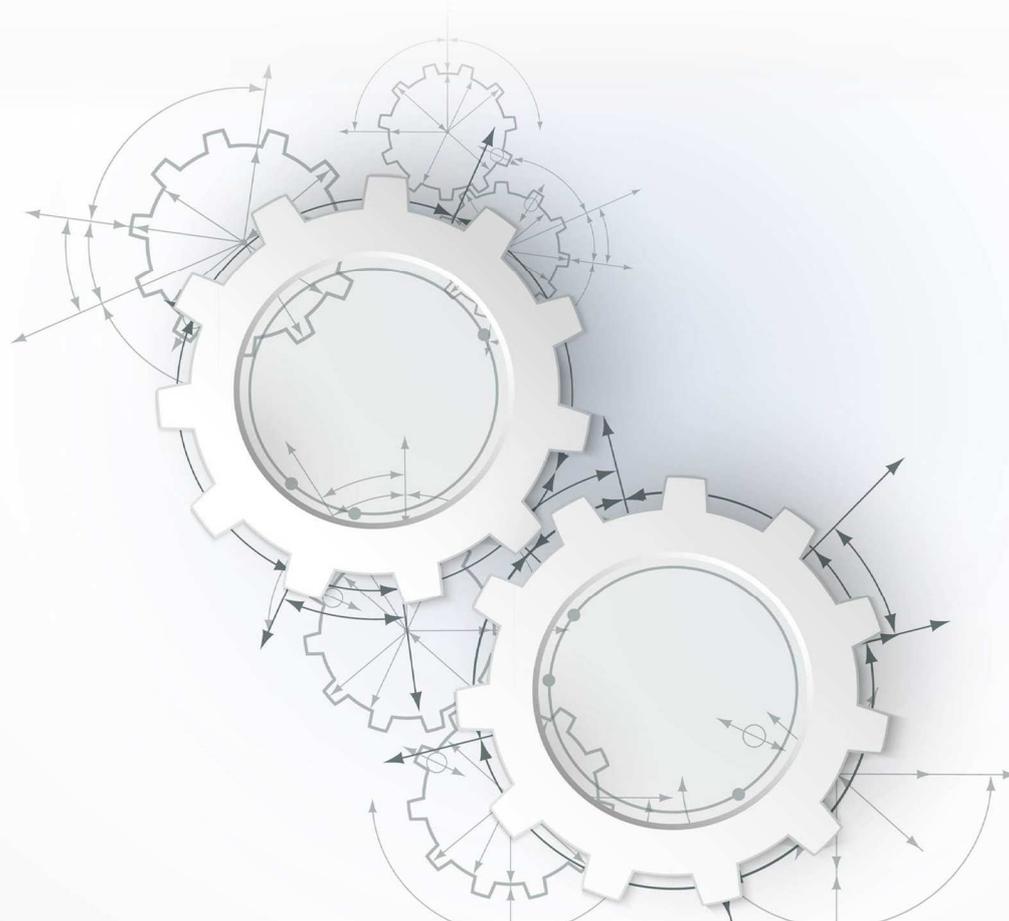




National
Bank of
Moldova



FINANCIAL STABILITY REPORT for 2019



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LIST OF ABBREVIATIONS

AIPS	Automated Interbank Payment System
CIS	Commonwealth of Independent States
CNB	Certificates of the National Bank of Moldova
CSNS	Clearing system with net settlement
DEB	Decision of the Executive Board of the NBM
DGFBS	Deposit guarantee fund in the banking system
DSTI	Debt service ratio to total income (debt service to income)
ESRB	European Systemic Risk Board
EU	European Union
EUR	The single European currency (euro)
OFEP	Open foreign exchange position
FX	Foreign Currency
GB	Government bonds
IFRS	International Financial Reporting Standard
IHH	The Herfindahl-Hirschman index
IMF	International Monetary Fund
LE	Legal entity
LTV	The ratio between loans and the value of the pledge (loan-to-value)
MDL	Moldovan Leu
MoF	The Ministry of Finance
MR	Mandatory reserves
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NFMC	National Financial Market Commission
NFSC	National Financial Stability Committee
NP	Natural persons (individuals)
NPL	Non-performing loans
O-SII	Systemically important institution
PPGED	Public and publicly guaranteed external debt
RHS	Right hand scale
ROA	Return on assets
ROE	Return on equity
r.p.y.	Reported to previous year
RTGS	Real-time gross settlement system
SBR	State budget revenue
SCA	Savings and Loan Association
SCD	The Single Central Depository of Securities
SRS	Securities registration system
SS	State securities
TB	Treasury bills
USD	U.S. Dollar
XDR	Special drawing rights (XDR)

NOTES

The Financial stability report was prepared by the Financial Stability Division, under the coordination of the First Deputy Governor of the NBM, Vladimir Munteanu. The team that prepared the report thanks the colleagues from the Financial Markets Department, the Payment Systems Department, the Regulation and Authorization Department, the Banking Supervision Department, the Reporting and Statistics Department, for the information and comments submitted. The report was examined by the Executive Committee of the National Bank of Moldova and approved at the meeting of November 12, 2020.

SUMMARY

During 2019, the financial system of the Republic of Moldova was characterized by a high level of resilience, with uneven evolutions of the risks to which it is exposed.

Economic growth continued amid internal vulnerabilities (volatile inflation) and external vulnerabilities (negative current and capital account balances, slowing global growth as a result of trade tensions, fiscal problems in some EU countries and Brexit), the financial system, partly contributing to the recovery of the economic situation. The growth of banks' credit portfolio has accelerated, continuing the upward trend set in the previous year. Lending to the population (individuals) continued the upward trend, increasing the funding provided by both the banking and non-banking sectors.

The banking sector has achieved satisfactory financial performance, maintaining strong positions of profitability and solvency. Banks have maintained adequate capitalization in the process of implementing Basel III standards. In 2019, the growth of banking sector credit has accelerated, continuing the upward trend set in the previous year. Banks continued their efforts to reduce bad loans in their portfolios, with a non-performing loan rate of 8.5 percent at the end of the year. However, credit risk continues to pose the most significant threat to the stability of the banking sector, highlighting the importance of maintaining sufficient capital positions to absorb estimated losses even in the most pessimistic scenarios of assets quality deterioration.

During 2019, banks registered a favorable liquidity position, and the liquidity surplus in the banking sector narrowed due to the increase in the targeting of liquid assets for lending, thus, in 2019 the positive trend of the degree of banking intermediation established in 2018 continued.

The accelerated evolution of the non-bank lending sector continued, exceeding the growth rate of the national economy, but, compared to previous years, non-bank lending to population increased at a lower rate than bank lending. Thus, there continue to be premises for the accumulation of risks in the non-bank lending sector and for the increase of the general level of the households' indebtedness. The credit risk associated with foreign currency loans remains high, with the potential to contribute to increasing the exposure of borrowers, to weakening their financial situation and, respectively, to increasing the risk of non-repayment of loans in the event of unfavorable exchange rate fluctuations.

Continuing the process of aligning national legislation with international standards is key to promoting a safe, stable and transparent financial sector. Thus, the NBM continued the elaboration/ modification of normative acts for the execution of the Law no. 202/2017 on the activity of banks, namely the Regulation on large exposures was approved, amendments were made to the Regulation on bank transactions with its affiliates persons and to the Regulation on banks liquidity, the list of jurisdictions that do not implement international transparency standards has been amended. At the same time, a new regulation on AIPS was approved, the regulations for non-bank payment service providers were improved and the legal framework related to the foreign exchange field was improved. As regards the regulatory framework applicable to the non-banking sector, the Regulation on the classification of assets by non-banking lending organizations has been approved.

1. ECONOMIC AND REAL CONTEXT

1.1. Economic developments

During 2019, the economy of the Republic of Moldova registered economic growth, being influenced by multiple internal and external factors, such as economic growth in the EU (+1.7 percent) and CIS (+2.0 percent), the entry into force of new regulations and instruments, according to Basel III standards, and exchange rate stability. However, factors such as the decrease of foreign transfers through the banking system, rising unemployment and exacerbating the budget deficit have signaled the emergence of vulnerabilities with a mitigation effect on positive economic trends.

Table 1.1.1. The main macroeconomic indicators of the Republic of Moldova

Name of the indicator	The value in 2019	Change compared to 2018
GDP, current prices	MDL 210,351 million	+3,6%
Annual inflation rate	7,1%	+6,1 pp
MDL / USD exchange rate	MDL 17.2305	+0,4%
MDL / EUR exchange rate	MDL 19.2060	-1,3%
Reserve assets	USD 3 059,6 million	+2,2%
The deficit of the National Public Budget	MDL -5 920,0 million	+231,9%
Government debt	MDL 52 772,2 million	+1,5%
Current account balance ¹	USD -1 119,1 million	-5,6%
Coverage of imports with exports of goods and services	55,2%	+1,2 pp
Net international investment position	USD -4 985,7 million	+22,4 %
Unemployment rate	4,3%	+43,3 pp
Net personal remittances / GDP	12,8%	-0,2 pp

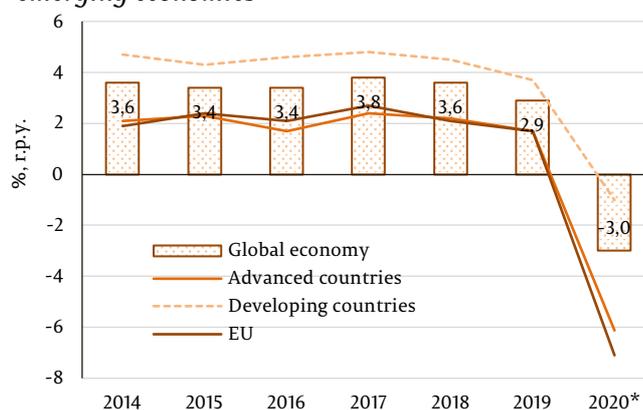
Source: developed by NBM based on NBM, NBS data

Since 2010, the global economy has registered a robust annual growth, the positive dynamics continuing in 2019, but with a moderate growth of 2.9 percent. Growth was largely driven by positive developments in the GDP dynamics of emerging Asian economies, in particular growth by China, India and the ASEAN-5 countries² which continued to be the locomotive of world economic growth, while in the US economic stimulus measures and financial market records continued to be a mechanism for economic growth, so that the country recorded a GDP increase of 2.3 percent.

At the same time, tensions between the US and China, as well as the multiple rounds of "tariff war" that took place between these two countries during the year, have produced a slowing effect on world economic growth. The slowdown that began in the first half of the year intensified later with the decrease in the volume of industrial production.

In the EU, however, economic growth has continued at a slower pace. Thus, at the end of 2019, the annual growth reached the value of 1.2 percent, being 0.9 pp lower than that recorded in the previous year. Weak external demand, fiscal problems in some Member States and Brexit were the dominant factors in slowing EU growth.

Chart 1.1.1. The most pronounced annual GDP growth at the end of 2019 was recorded in the group of emerging economies



* - IMF forecast

Source: prepared by the NBM based on IMF data

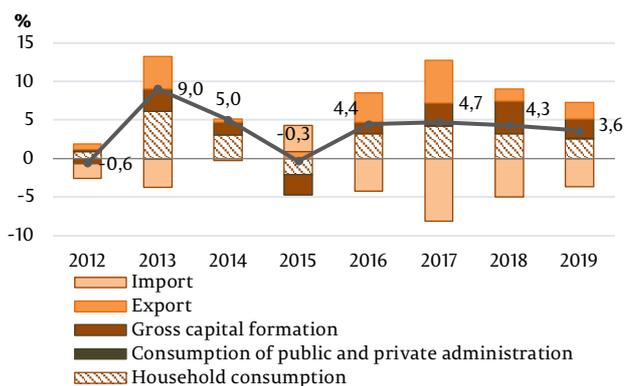
In 2019, the GDP of the Republic of Moldova registered an increase in real terms of 3.6 percent, this dynamic being by 0.7 pp lower than in 2018 (Chart 1.1.2).

Economic growth was more pronounced in the second quarter, following the activation of the construction and retail sectors from the end of the first quarter of the year, maintaining a high level of performance until the end of the reporting period. At the same time, positive but lower contributions were generated by growth in the fields of industry (extractive industry, manufacturing, electricity and thermal energy production and supply), information and

¹ International account indicators (BP, PII, DE) are calculated according to the MBP6 methodology.

² Indonesia, Malaysia, Philippines, Thailand, Vietnam

Chart 1.1.2. GDP growth in 2019 registered a lower level, due to the low performance of the determining factors



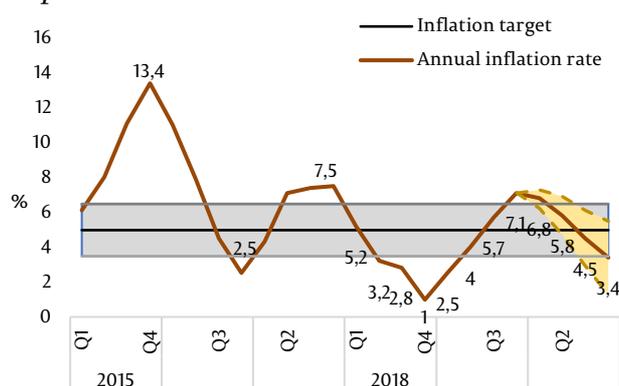
Source: developed by the NBM based on NBS data

communications. At the same time, a negative impact on GDP growth has been generated by the agriculture, forestry and fishery sectors, but also by public administration and defense, compulsory social insurance, education, health and social assistance.

In 2019, the disposable income of the population experienced a favorable dynamic, reaching the value of MDL 2,880.6 per month per person, that being an increase by 20.9 percent compared to the previous year. Thus, the growth rate of disposable income was much higher than that recorded in 2018 of 6.2 pp. This increase was mainly determined by income from wages and social benefits, the structure of the main components of disposable income remaining unchanged.

In 2019, the average inflation rate was 4.8 percent, being 1.7 pp more than in 2018. During that period, the annual inflation rate registered an upward trend, increasing from 2.2 percent in January 2019 to 7.5 percent in December 2019 (Chart 1.1.3). For the period 2020-2021, a downward trajectory of the average inflation rate is expected until the first quarter of 2021, with a subsequent relaunch until the end of the forecast horizon. Starting with the fourth quarter of 2020, the annual inflation rate will be below the established range of variation, returning to it by the fourth quarter of 2021.

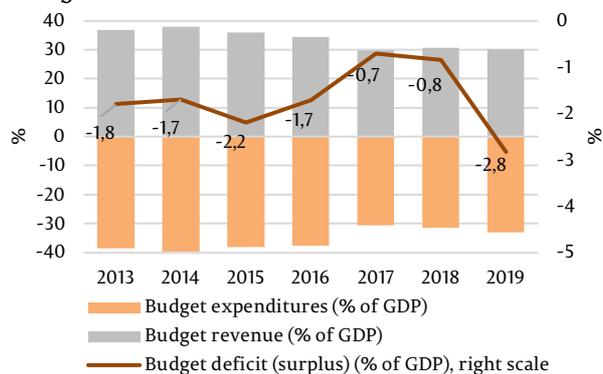
Chart 1.1.3. The annual inflation rate is on a sharp upward trajectory, with the annual inflation rate expected to decline in 2020



Source: NBM

The indicators of the national public budget registered a deterioration during 2019, so that the deficit of the national public budget constituted MDL 5,920.0 million or 2.8 percent of GDP. The budget deficit increased significantly compared to 2018, both in nominal values and as a share in GDP (Chart 1.1.4).

Chart 1.1.4. The deficit of the national public budget in 2019 deteriorated in relation to GDP



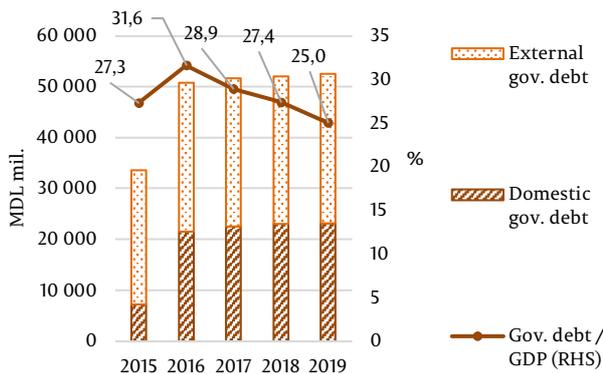
Source: developed by the NBM based on NBS data

1.2. Government debt

According to the MoF data as of December 31, 2019, the sustainability indicators of the government debt fall within the recommended limits and do not produce additional risks on the macroeconomic stability of the country.

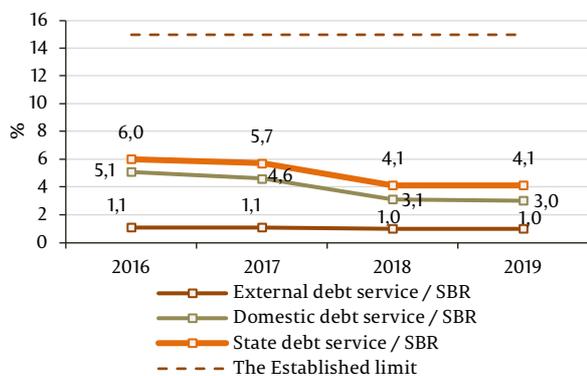
Compared to the end of 2018, at the end of 2019 the share of government debt in GDP decreased by 2.4 pp, and the share of the government debt service in the state budget revenues remained constant at 4.1 percent (Chart 1.2.1 and Chart 1.2.2).

Chart 1.2.1. The government debt increased by 0.9 percent compared to the previous year and amounted to MDL 52,494 million



Source: developed by the NBM based on MoF data

Chart 1.2.2. The government debt service in relation to the total revenues of the state budget (SBR) did not register significant changes



Source: developed by the NBM based on MoF data

The government debt balance amounted to MDL 52,494.3 million, increasing by MDL 481.7 million or by 0.9 percent compared to the end of 2018, due to the increase of the external government debt balance by MDL 372.1 million and the domestic one by MDL 109.6 million (Chart 1.2.1).

Chart 1.2.3. The volume of SS traded continued its downward trend in 2019



Source: NBM

The increase in the domestic government debt balance was conditioned by domestic positive net financing of SS issued on primary market during the reporting year, whereas the external debt increase – by positive net external financing and by the evolution of the foreign exchange rate of the national currency to USD.

SS issuances

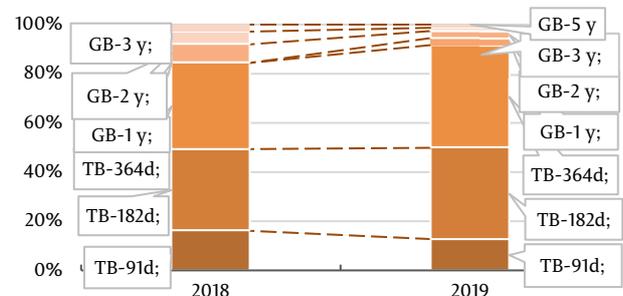
During 2019, through the 49 auctions, MoF offered on the primary market for sale state securities in the amount of MDL 11,225.5 million. The demand for SS accounted for MDL 12,456.4 million, being higher than the supply by MDL 1,230.9 million or about 1.1 times.

As a result, SS were traded at the purchase price of MDL 9,327.1 million, which is MDL 452.3 million less than the volume of SS traded in the same period of 2018. At the same time, the maturing SS in the reference period were repurchased in the amount of MDL 8,987.5 million, of which MDL 345.5 million was issued for the creation of a liquidity reserve.

During the reporting period, 7 types of SS continued to be issued on the primary market: treasury bills with a maturity of 91, 182 and 364 days, as well as government bonds with a maturity of 1, 2, 3 and 5 years.

The major share in SS traded on the primary market is treasury bills with a maturity of 364 days (41.6 percent), followed by treasury bills with a maturity of 182 days (37.3 percent) and those with a maturity of 91 days (12.7 percent). (Chart 1.2.4).

Chart 1.2.4. Treasury bills with a maturity of up to 1 year continue to hold the majority share in SS traded in 2019



Source: developed by the NBM based on MoF data

In 2019, in connection with the demand mainly for short-term SS, the traded volume of GBs for 2, 3 and 5 years amounted to MDL 263.9 million (2.8 percent of the total traded volume), MDL 131.6 million (1.4 percent) and MDL 120.9 million, respectively (1.3 percent), which compared to the same period of 2018 decreased by MDL 464.8 million, MDL 597.1 million and MDL 607.8 million, respectively.

The volume of SS purchased by non-banking investors increased compared to the same period of 2018 by MDL 220.9 million, registering MDL 1,767.5 million, and their share in the total traded volume was 19.0 percent. However, commercial banks continue to be the main investors in SS, with a share of 81.0 percent in total SS purchased. Among the most active primary dealer banks, which have purchased SS on the primary market since the beginning of 2019, are: B.C. "Victoriabank" S.A., BC "Moldindconbank" S.A., and BC "Moldova - Agroindbank" S.A.

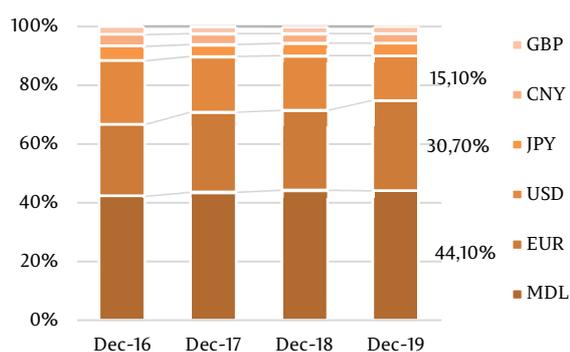
The main types of risks associated with the cost of government of the Republic of Moldova identified as market risks are:

- 1) Foreign currency risk;
- 2) Refinancing risk;
- 3) Interest rate risk.

Foreign currency risk

FX risk is one of the main categories of risks associated with the government debt portfolio, affecting both its cost and volume. At the end of the reporting year, external government debt, denominated in foreign currency, represented 55.9 percent of the government debt portfolio belongs (Chart 1.2.5).

Chart 1.2.5. The government debt in foreign currency did not undergo structural changes during 2019



Source: developed by the NBM based on MoF data

Thus, in 2019, the share of external government debt increased by 0.2 pp.

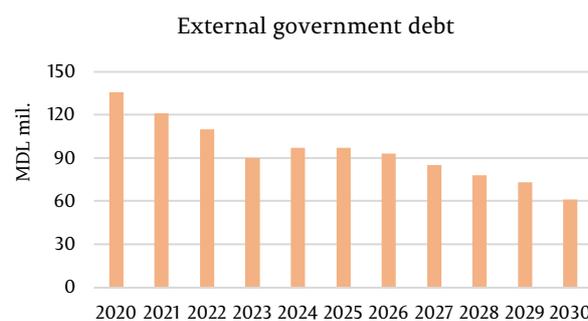
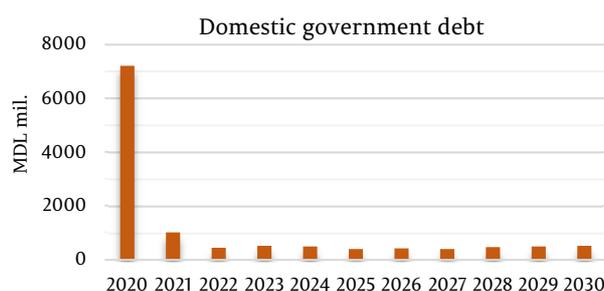
The structure of government debt by currencies, with the breakdown of the SDR basket, highlights the vulnerability of the government debt portfolio to EUR and USD currencies, which implies the need for continuous monitoring of FX risk. Thus, the share of government debt in EUR and USD represents 45.8 percent of the government debt portfolio (Chart 1.2.5).

Refinancing risk

Domestic and external government debt repayment profile

The forecast for the domestic government debt repayment profile shows the peak of payment in 2020, conditional on the fact that the domestic government debt consists mainly of instruments with a short repayment term. According to the MoF data, in 2020, there will be reimbursed SS with a maturity of four years, in the total amount of MDL 240.0 million, in compliance with the Law no. 235/2016 regarding the issuance of state bonds for enforcement by the MoF of payment obligations derived from the state guarantees no. 807 of November 17, 2014 and no. 101 of April 1, 2015.

Chart 1.2.6. The forecast of domestic government debt repayment shows the dominant position of short-term debt, while the repayment of external government debt will peak in 2020



Source: MoF

The short-term domestic government debt segment, which is ment to be refinanced each year through new SS issues, represents a significant risk for the state budget, in the context of possible increases in interest rates on the domestic market.

The analysis of the external government debt shows a gradual decrease in the amount of claims starting with 2020 and until 2023, after which the external government debt will stabilize, continuing to have a dynamic of decrease.

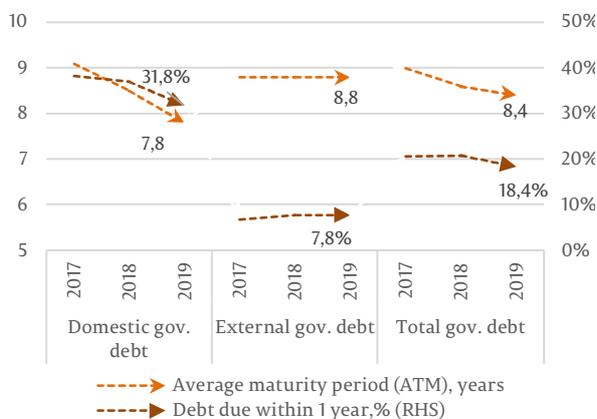
The average maturity period and the debt due in one year.

At the end of the reporting year, 31.8 percent of the domestic government debt is due to mature within a year, which anticipates the accumulation of interest rate risk at the subsequent financing of the state budget deficit.

Compared to the previous year, the domestic government debt due in one year decreased by 5.2 pp, which is explained by the increase in the share of bonds with a maturity of 3 and 5 years in circulation, but also as a result of the reissue of converted SS in the NBM portfolio, during 2019, mainly at a maturity of 2 years, which will expire in 2021. At the same time, the average maturity period decreased by 0.7 years.

External government debt, due to long-term instruments, falls within safe limits, such that 7.8 percent of it will mature within a year.

Chart 1.2.7. The average maturity period of the government debt decreased by about 2 months

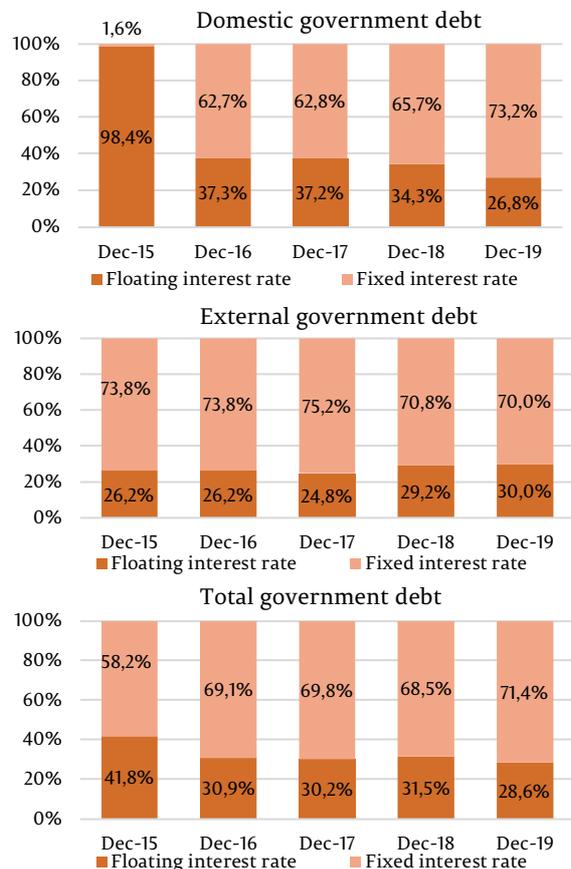


Source: Prepared by the NBM based on MoF data

Interest rate risk

As of December 31, 2019, 73.2 percent of the domestic government debt (+7.5 pp compared to the previous year) was represented by fixed interest rate debt.

Chart 1.2.8. The government debt is largely fixed interest



Source: Prepared by the NBM based on MoF data

This increase was influenced by the increase in the share of domestic government bonds in circulation at a fixed interest rate (1, 2, 3 and 5 years). Thus, on December 31, 2019, the instruments with a fixed interest rate and a circulation term of more than one year are government bonds with a maturity of 1, 2, 3 and 5 years, SS for the execution by the MoF of payment obligations derived from state guarantees, but also SS converted into the NBM portfolio with a maturity of 2 years.

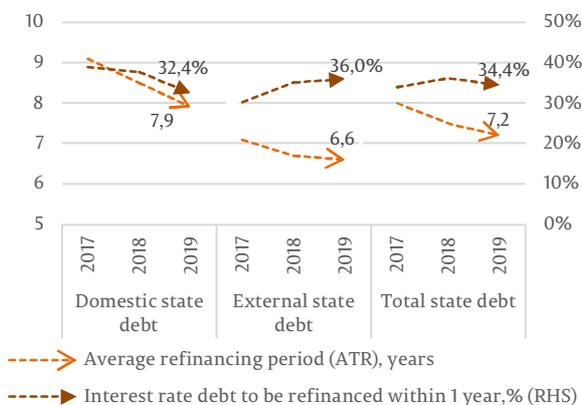
Analyzing the structure of external government debt by types of interest rate, there is a slight increase in the share of external government debt with floating interest rate. Thus, it constituted 30.0 percent of the total external government debt, being 0.8 pp more compared to the end of 2018.

Regarding the total government debt, the share of debt with floating interest rate represents 28.6 percent and reflects a decrease of 2.9 pp compared to the end of 2018. The relatively high share of floating rate debt (both in external and domestic government debt) presents interest rate risk as well as refinancing risk mainly due to instruments with a maturity of up to one year.

Average reset period³ and the debt to be repaid in one year.

External government debt is most exposed to interest rate risk, as 36.0 percent of external government debt is to be repaid at new interest rates are to be reset within one year. Thus, an increase in interest rates on international financial markets will directly affect the costs of external government debt. Interest rates on external government debt are reset, on average, over 6.6 years, 0.1 years less compared to the end of 2018.

Chart 1.2.9. External government debt presents an accumulation of interest rate reset risk against the background of repayment of fixed interest loans



Source: Prepared by the NBM based on MoF data

However, the domestic government debt registers at the situation of December 31, 2019 a decrease of the debt with the interest rate to be reset within a year by 5.3 pp compared to the value recorded at the end of 2018, which is largely explained by the re-issuance in 2019 of converted SS, located in the NBM portfolio, with longer maturities. Interest rates on domestic government debt are reset, on average, over 7.9 years, 0.6 years less compared to the end of 2018.

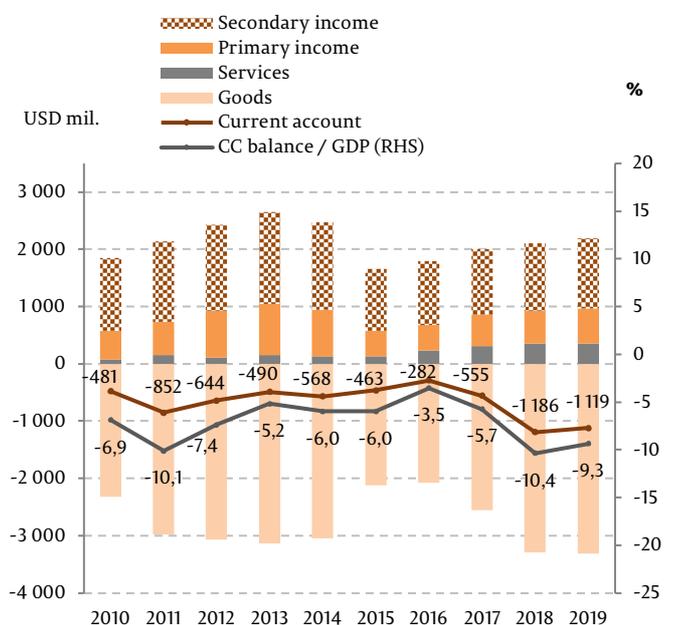
As for the government debt as a whole, although the period of resetting the entire portfolio is 7.2 years (decreasing by 0.3 years compared to 2018), still 34.4 percent of it is to be reset at new interest rates within one year, thus highlighting the exposure of the government debt portfolio to interest rate risk.

1.3. The evolution of the external sector

The current account deficit of the balance of payments of the Republic of Moldova decreased by 5.6 percent in 2019 due to the increase of the primary and secondary income surplus. The negative balance of the international investment position deepened by 22.4 percent, and the gross external debt increased, in absolute value, by 1.3 percent compared to the beginning of 2019.

During the reference period, the balance of the current account of the balance of payments of the Republic of Moldova registered a deficit of 1,119.07 million USD, which decreased by 5.6 percent compared to the one recorded in 2018 (Chart 1.3.1).

Chart 1.3.1. Current account deficit narrows due to rising surplus of primary and secondary incomes



Source: NBM

³ The average refinancing period indicator is all the safer the higher its value, as is the refinancing risk indicator - the average maturity period.

As a share of GDP, the deficit was 9.3 percent, down 1.1 pp compared to 2018. The source of the current account deficit was foreign trade in goods, with the other components recording increasing surplus balances, excluding services, whose balance decreased (but remained in surplus).

The deficit of foreign trade in goods recorded in the balance of payments (excluding goods after / for processing) amounted to USD 3,311.76 million, deepening by 0.5 percent, as imports increased more (USD +160.61 million) than exports (USD +142.85 million), compared to 2018.

The increase in the import of goods, fueled by the increase in gross fixed capital formation and the increase in final consumption of households, slowed down during the year, reaching stagnation in the fourth quarter of 2019. This is explained by the fact that, although the population's income increased in 2019, in the second half of the year the growth rates of salaries and pensions decreased. Although prices of imported goods decreased, the value of imports increased due to the increase in physical volumes. The value of imports from the EU (according to the country of delivery principle) increased by 3.3 percent, and that of imports from the CIS registered a negative dynamic (-1.4 percent). Imports from other countries increased by 7.5 percent compared to 2018.

Despite the unfavorable evolution of prices for exported goods, the value of exports also increased due to the increase in physical volumes. Geographically, the largest contribution to export growth came from the category "other countries" (other than EU and CIS), exports to them increasing by 26.6 percent compared to 2018. Due to the modest growth rates of some of the main trading partners, Moldova's exports to EU countries increased by only 1.8 percent, and to CIS countries - by 4.6 percent. In agriculture, heavy rains with hail from the summer of 2019 were felt, which affected sunflower, wheat and corn crops (as a result, in the fourth quarter of 2019 exports of these crops also decreased).

The decrease in the positive balance of services by 1.3 percent, to USD 350.63 million, was caused by the increase in imports and the slowdown in the increase in exports of services.

The latter was largely linked to declining exports of transport services. We are also seeing a steady and sharp decline in exports of telecommunications services. The export of raw material processing services increased during 2019, but it should be noted that in the second half of the year it had a negative dynamic. The impact was overshadowed by the significant increase in exports of IT and other business services.

The surplus of primary revenues increased in 2019 by 9.7 percent compared to 2018, to USD 621.07 million. Remuneration of resident employees for work performed by non-resident employers increased by 2.2 percent, while decreases in investment income (-8.1 percent), especially income from portfolio investments and other investments.

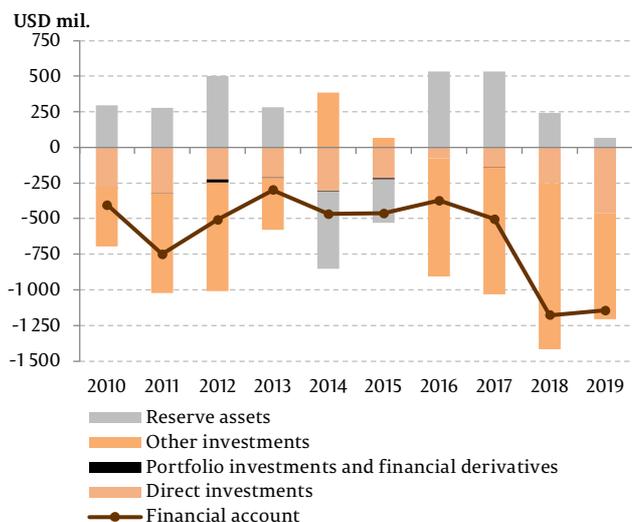
The positive balance of secondary revenues amounted to USD 1,220.99 million, increasing by 2.9 percent compared to 2018. Personal transfers received from abroad by Moldovan residents increased by 5.7 percent. The volume of technical assistance and grants received in international cooperation also increased significantly (+ 24.7 percent compared to 2018).

The capital account recorded a negative balance of USD 49.88 million, which deteriorated by 41.0 percent compared to 2018. The balance of the capital account was determined by the net capital outflows registered by the private sector (USD 70.81 million), while the inflows of external assistance received by the public administration for financing investment projects amounted to USD 20.95 million.

Due to the negative current and capital account balances, the national economy faced the need for external financing in the amount of USD 1,168.95 million (9.8 percent of GDP).

In 2019, the financial account resulted in net capital inflows amounting to USD 1,141.02 million (Chart 1.3.2) as a result of the net increase of residents' liabilities to non-residents by USD 599.17 million generated by actual transactions, while the residents' external financial assets registered a net decrease in by USD 541.85 million.

Chart 1.3.2. The financial account resulted in net capital inflows as a result of net inflows from direct and other investments, while the increase in reserve assets led to capital outflows



Note: (+) net outflows, (-) net capital inflows

Source: NBM

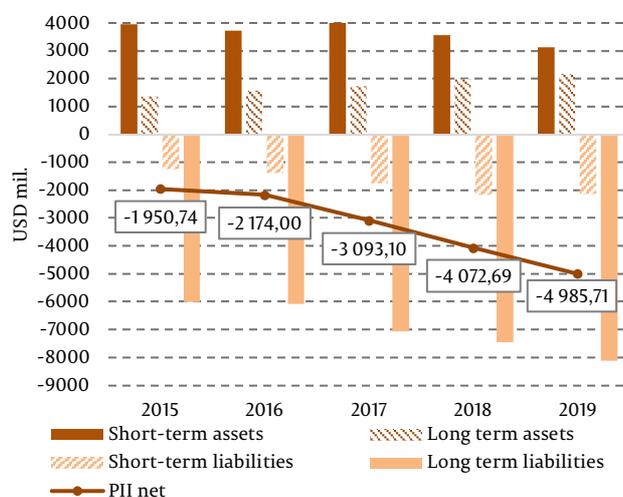
Liabilities increased, in particular, due to the net increase in commitments in the form of direct investments by USD 501.61 million. In the case of liabilities in the form of external loans, there were recorded net withdrawals in the amount of USD 96.13 million (withdrawals - USD 571.25 million, repayments USD -475.12 million). The public administration, including the local one, contracted in 2019 new foreign loans amounting to USD 149.26 million, the repayments made by the general government in the same period amounted to USD 125.50 million. NBM received USD 18.48 million from the IMF, but repaid USD 55.38 million from previously contracted loans. Licensed banks made net repayments in the amount of USD 21.54 million, and the other sectors - net withdrawals of USD 130.81 million. Liabilities also increased by USD 10.76 million as a result of residents receiving net trade credits and advances from non-resident trading partners. At the same time, cash and deposit liabilities registered a net decrease of USD 4.86 million, due to withdrawals of funds from non-residents' accounts opened in resident commercial banks.

The decrease in financial assets was determined by the net decrease of assets in the form of cash and deposits by USD 537.56 million (of which the assets of licensed banks increased by USD 46.33 million, and the assets of other sectors decreased

by USD 583.89 million, still one of the main sources of financing the current account deficit). Non-resident trading partners made net payments amounting to USD 116.81 million in trade loans and advances previously granted by Moldovan residents, thus diminishing external financial assets. At the same time, the net increase of the official reserve assets of the NBM by USD 60.49 million during 2019 influenced the total assets in the sense of growth. Residents' external assets in the form of direct investments also increased by USD 40.09 million. Similarly, residents' external assets in the form of loans to non-residents increased by USD 7.39 million in net worth. Residents' external assets in the form of portfolio investments increased by USD 4.55 million in net value, determined by the investments of banks licensed in debt securities.

International investment position of the Republic of Moldova, as of 31.12.2019, amounted to USD -4,985.71 million, the debit balance deepening compared to the end of 2018 by 22.4 percent (Chart).

Chart 1.3.3. The international investment position amplifies the net debit balance



Source: NBM

External financial assets amounted to USD 5,290.47 million, down 4.5 percent since the beginning of the year, and liabilities - USD 10,276.18 million, up 6.9 percent.

Short-term liabilities were covered by short-term assets in the proportion of 145.1 percent (-19.7 pp compared to the situation at the end of 2018).

The largest share in the stock of external financial assets continued to correspond to reserve assets (57.8 percent). During 2019, the stock of official reserve assets increased by 2.2 percent compared to the stock at the beginning of the year, amounting to USD 3,059.63 million as of December 31, 2019. The volume of official reserve assets meets all adequacy criteria: (i) covering at least 3 months of imports of goods and services (covering 5,6 months of actual imports); (ii) full coverage of short-term external debt by reserves (they covered 141.7 percent); (iii) coverage of 20 percent of the M2 money supply (covered 83.4 percent); (iv) coverage of 100-150 percent of the amount: 30 percent of short-term debt + 15 percent of other commitments + 5 percent of M2 + 5 percent of exports of goods and services (covered 196.9 percent).

The stock of commitments in the form of direct investments increased significantly during the year (+ 15.9 percent) and totaled 4,733.94 million USD, representing 46.1 percent of total external liabilities.

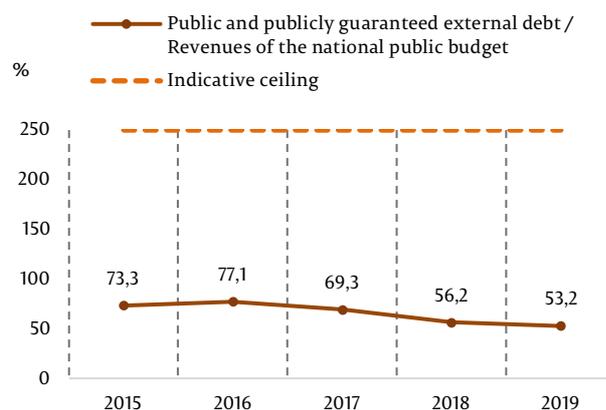
Gross external debt. At the end of 2019, the gross external debt of the Republic of Moldova amounted to USD 7,416.08 million, which represents 62.0 percent of GDP. It increased by 1.3 percent in absolute value, but decreased by 1.9 pp relative to GDP due to growing GDP.

Most of the gross external debt belongs to long-term debt (71.1 percent), which amounted to USD 5,269.57 million at December 31, 2019, up 2.0 percent from the beginning of the year. Short-term external debt decreased by 0.5 percent during the year and amounted to USD 2,146.51 million as of December 31, 2019.

At the end of 2019, the unsecured private external debt amounted to USD 5,496.93 million, increasing by 2.1 percent compared to the end of 2018.

Public and Public Guaranteed External Debt (PPGED) accounted for 25.9 percent of total external debt, amounting to USD 1,919.15 million (-0.6 percent since the beginning of the year).

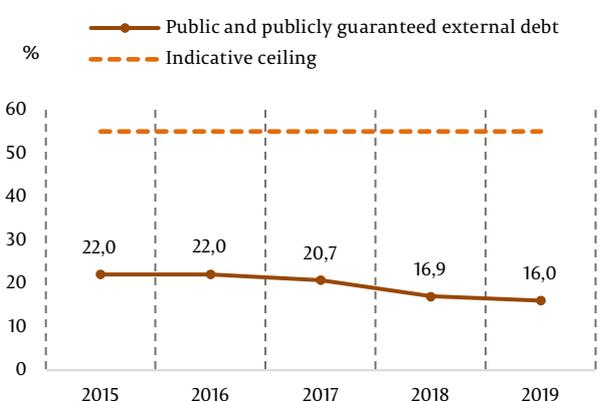
Chart 1.3.4. PPGED compared to the revenues of the national public budget decreased compared to 2018, being well below the ceiling of 250 percent



Source: NBM

PPGED has remained sustainable, with all indicators of external indebtedness being within the limits set by the World Bank and the IMF⁴: PPGED to the national public budget revenues decreased to 53.2 percent (Chart), and relative to GDP - up to 16.0 percent (Chart).

Chart 1.3.5. PPGED relative to GDP decreased compared to 2018, well below the 55 percent ceiling



Source: NBM

1.4. Private sector indebtedness

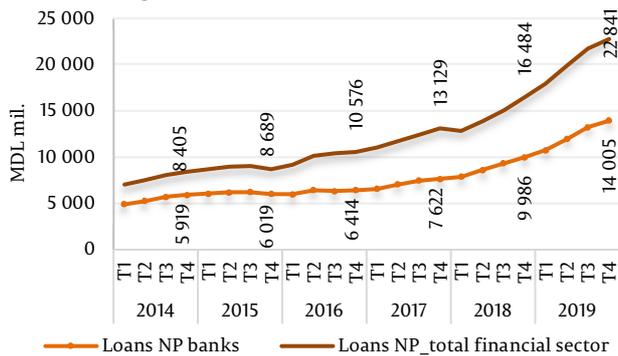
The indebtedness of the households towards banks has continued the ascending evolution during the last periods, registering a more accentuated growth during the second quarter, 2019. At the same time, the loan portfolio of non-financial corporations relative to GDP is declining and at a relatively low level compared to other European countries.

⁴ Note: Indicative ceilings based on the CPIA (Country Policy and Institutional Assessment) score developed by the World Bank. In 2019, the IDA resource allocation index of the Republic of Moldova was 3.72, so the ceilings were set at: 55 percent for the ratio between public and publicly guaranteed external debt (PPGED) and GDP, 240 percent for the ratio between PPGED and exports, 250 percent for the ratio between PPGED and national public budget revenues, 21 percent for the ratio between PPGED service and exports and 23 percent for the ratio between DEPPG service and national public budget revenues.

The indebtedness of the households

In 2019, the upward trend in lending to individuals continued (+38.6 percent), the value of attracted loans increasing both in the banking and non-banking segments. However, compared to previous years, the bank lending to household sector registered a higher growth rate (+ 40.2 percent) compared to the non-banking sector (+ 36.0 percent).

Chart 1.4.1. Lending to individuals by the banking sector registered a faster growth rate compared to the non-banking sector



Source: NBM, NCFM

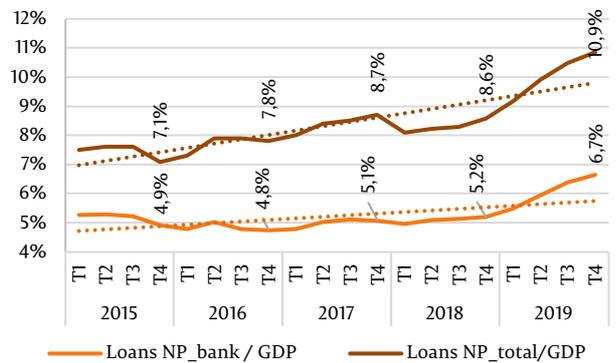
According to the results of the bank lending survey, the increase in bank lending was stimulated both by supply factors (slight easing of lending standards, largely for consumer loans in national currency) and by demand factors (increasing financing needs of households). At the same time, the persistence of competition both between banks and with NCOs favors the easing of lending conditions for consumers, thus having a stimulating effect on the household lending.

The share of total households' loans increased to 10.9 percent of GDP in 2019. Bank lending to the population relative to GDP increased by 1.5 pp constituted 6.7 percent (Chart 1.4.2).

However, this indicator continues to be lower compared to most countries in the region.

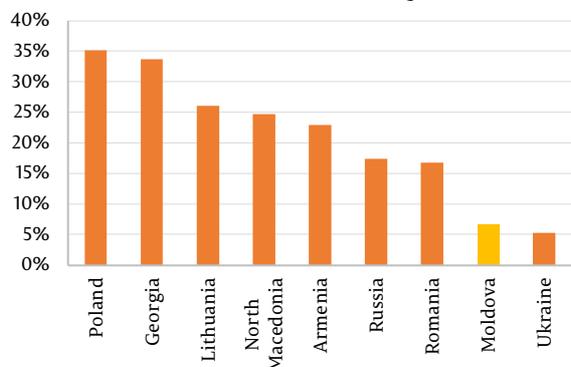
The structure by destination of loans granted to the population by banks at the end of 2019 shows that 48.7 percent of the total balance of loans was intended for current consumption. This indicator shows an increase of 33.0 percent compared to the end of 2018.

Chart 1.4.2. The share of total household indebtedness relative to GDP has increased, amid the acceleration of household lending at a higher rate of economic growth



Source: NBM, NCFM, NBS

Chart 1.4.3. In the Republic of Moldova, GDP lending to GDP is one of the lowest in the region



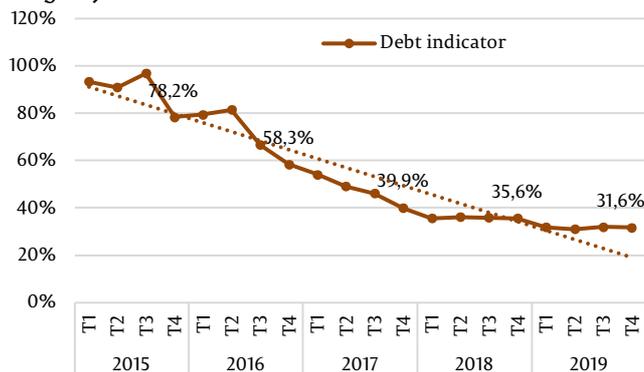
Source: www.ceicdata.com

At the same time, in recent years, following the improvement of access to the real estate market, including due to the "First House" program, there is a continuous increase in the share of loans granted to households for the purchase or construction of real estate. Thus, in 2019 the balance of loans granted on this segment increased by 58.0 percent, holding the share of 44.6 percent of total loans to individuals.

Aggregate bank debt indicator⁵ of the households continued the decreasing trend characteristic of the last years, however in a more temperate rhythm. At the end of 2019, it accounted for 31.6 percent (Chart 1.4.4), decreased by 4.0 pp compared to the similar period of the previous year.

⁵ The aggregate debt indicator represents the ratio between the value of the average monthly installments to be paid for the remaining balance of loans to the value of disposable income per capita.

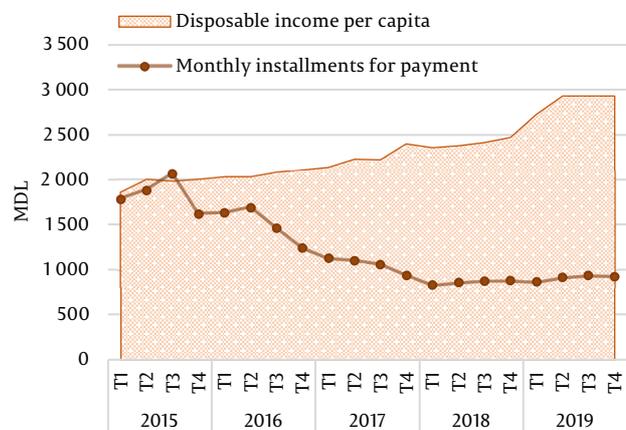
Chart 1.4.4. During 2019, the level of indebtedness of households in the Republic of Moldova decreased slightly



Source: NBM, NBS

The decrease in the degree of indebtedness was determined by the relatively high increase in the disposable income of the population, against the background of the increase of salaries in both the budgetary and the private sector. At the same time, the average monthly installments to pay off the remaining balance of loans increased modestly (Chart 1.4.5).

Chart 1.4.5. In 2019, the disposable income of the population increased more significantly compared to the monthly installments for payment

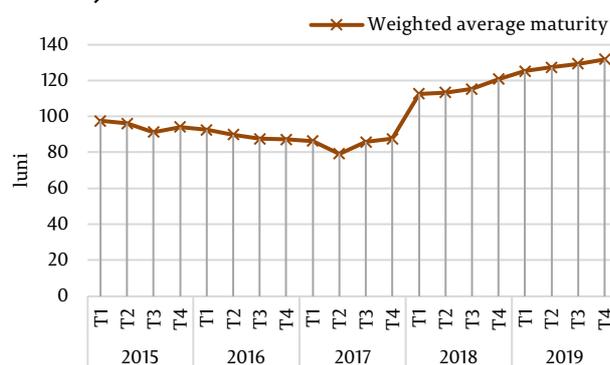


Source: NBM, NBS

In these circumstances, there is an improvement in the ability of debtors to pay in relation to assumed financial obligations, which facilitates the use of financial products among households.

In 2019, the weighted average of the maturities of loans granted to households continued to increase. As of December 2019, the weighted average maturity on the portfolio of households is 132 months or about 11 years, about one year more than the value of the previous year (Chart 1.4.6).

Chart 1.4.6. As a result of the implementation of long-term lending programs, the weighted average maturity continued to increase



Source: NBM

To be noted that loans with a significant balance and long maturity, such as mortgages, have a major influence on the weighted average of residual maturities. In this way, the final result eliminates the quantitative factor of consumer loans, with short maturities, which could distort the interpretation of the analyzed indicator.

Given that a significant part of the households' credit goes to the non-banking sector, in order to minimize the risk of over-indebtedness of individuals, a number of adjustments were made to the Law on NCOs. Thus, in the middle of 2020, enter into force the provisions limiting the total costs of the non-bank loan offered to individuals (for a term of less than 2 years and / or in which the initial amount disbursed is up to MDL 50.0 thousand) to the amount does not exceed the amount disbursed under the contract.

At the same time, another important legislative change in this regard concerns the obligation of the NCO to present information regarding debtors to at least one of the credit history bureaus which, in turn, will be required to exchange information among them. These provisions will allow a better estimation of the risk profile of debtors, but also the maintenance of a sustainable degree of indebtedness.

Box 1. Financial education project

In 2019, at national level, the NBM launched the financial education project “Learn! Make sense of money”. It aims to improve the capacity of the population to be aware of financial risks and opportunities, so that, when faced with related situations, they have to make the right decisions in managing their income.

Organized activities and information materials

disseminated address the most important financial concepts and products such as annual effective interest rate, consumer loans, car leasing, insurance, inflation, etc. to ensure the highest possible level of financial knowledge among the population. Financial education is essential for consumer protection, prevention of possible risks, including households over-indebtedness, but also to ensure the equilibrium of the financial system.

Indebtedness of non-financial companies

Non-financial companies are mainly credited by the banking sector, the share of loans granted by it to non-financial companies at the end of 2019 being 93.6 percent of loans granted by banks and NCOs.

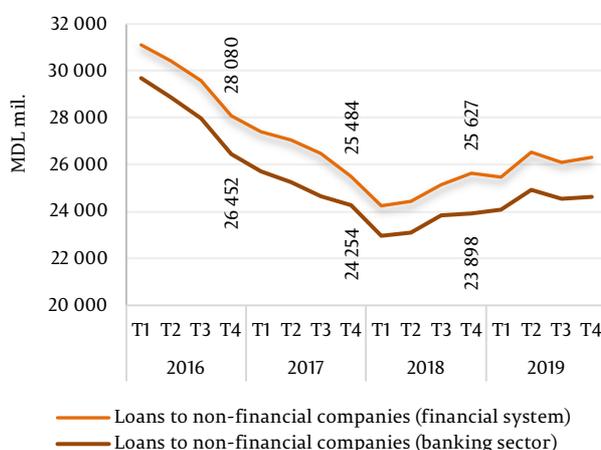
At the end of 2019, the indebtedness of non-financial companies towards banks showed a slight increase after the decreasing trend registered during 2016-2018. Thus, during the reporting year, the gross balance of loans granted to non-financial companies by banks increased by 3.0 percent (MDL -724.7 million compared to the end of the previous year). According to the data of the bank lending survey, the increase was determined by a slight relaxation of lending standards during the year, caused mainly by the conditions of active competition in the banking services market. At the same time, the respondent banks mentioned a moderate increase in demand from enterprises, generated by financing needs.

At the same time, the volume of loans granted by NCOs to non-financial companies is slightly lower than the previous year (-2.9 percent), which moderated the increase in financing from the banking sector.

Banking intermediation in the non-financial companies segment in 2019 remains at a low level of 11.7 percent of GDP, decreasing by 0.9 pp compared to the end of 2018. Total lending to non-financial companies accounted for 12.5 percent of GDP, showing lower values compared to 2018. The decrease in value occurred mainly in the first quarter of 2019 and was determined, on the one hand, by the decrease in the stock of loans granted to non-financial companies by banks and, on the other hand, by the nominal increase in GDP. However, there is a growing trend in lending to non-financial companies towards the end of 2019.

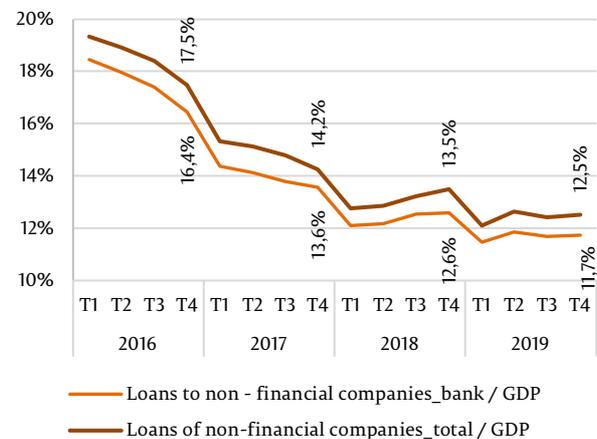
The share in GDP of total loans granted to non-financial companies in the Republic of Moldova is lower than the level registered by other European countries.

Chart 1.4.7. Banks continue to present the major source of financing for non-financial companies during 2019



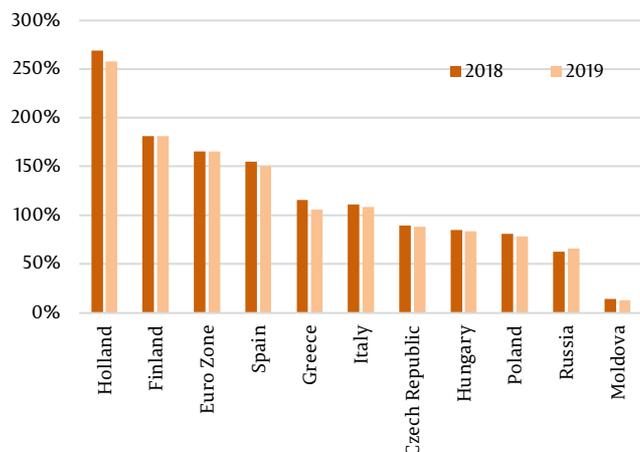
Source: NBM, NCFM

Chart 1.4.8. The share in GDP of loans granted by the banking and non-banking sector continues the decreasing trend during the reporting year



Source: NBM, NCFM, NBS

Chart 1.4.9. The balance of total loans to non-financial companies relative to GDP in the Republic of Moldova was much lower than in European countries



Source: BIS, NBM calculations

Analyzing the degree of indebtedness of non-financial companies for 2019, the average share⁶ of current liabilities in the capital of companies was 71.0 percent. At the same time, about 58.7 percent of companies reported loans contracted to banks or financial leasing. The average share of bank loans and financial leasing in total current liabilities was 50.0 percent.

A high level of indebtedness for creditors means higher risks related to the invested funds.

Setting the indicator as "high" or "low" depends on several factors, such as the type and size of the company's industry, the degree of default risk, the "age" of the company. Thus, some activities involve significant initial investments, financed by debt; other activities are seasonal and at different stages of production the degree of indebtedness varies.

⁶ Weighted average based on the size of the assets of the companies included in the sample. The sample incorporated companies that recorded positive capital during the reporting period.

2. RISKS OF THE BANKING SECTOR⁷

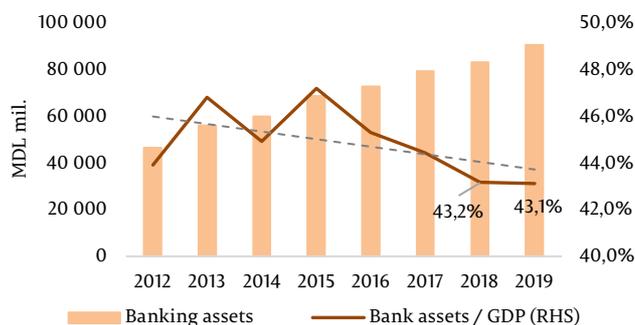
2.1. The banking sector

During 2019, the banking sector continued to be characterized by a satisfactory financial performance, maintaining its solid positions of profitability and solvency.

The domestic banking sector includes 11 banks that hold the license issued by the NBM. During 2019, the banking sector continued to attract foreign investment (Box 2), thus the share of foreign capital reached the level of 87.1 percent of the banks' share capital, 68.0 percent of the total banking assets being controlled by foreign investors. The largest shares of bank assets were held by shareholders from Bulgaria (15.8 percent), Hungary (13.2 percent), the United Kingdom (11.7 percent), the Netherlands (11.7 percent), followed by Italy (4.8 percent), Germany (4.4 percent) and others.

At the end of 2019, the volume of total assets of the banking sector recorded MDL 90,599.4 million, increasing by 9.1 percent compared to 2018. In relation to GDP, the volume of banking assets did not change significantly, amounting to 43.1 percent (compared to 43.2 percent in 2018), thus moderating the downward trend recorded in recent years. (Chart 2.1.1).

Chart 2.1.1. The ratio between bank assets and GDP moderated its downward trend against the background of a similar growth rate of the two indicators



Source: NBM

The financing of the economy through the banking sector continues to be low, respectively, it is largely supported by equity, external lending or the non-bank financial sector.

The banking sector is heterogeneous, with criteria such as size, substitutability and interconnection varying from one bank to another. In order to limit the systemic impact, the NBM annually determines the banks that are systemically important institutions and applies additional capital requirements for them (details in subchapter 3.1). Thus, at the end of 2019, 4 banks were identified as systemically important institutions (O-SII), the composition of which has not changed compared to previous years (Table 2.1.1).

Table 2.1.1. Ranking of banks that are systemically important institutions

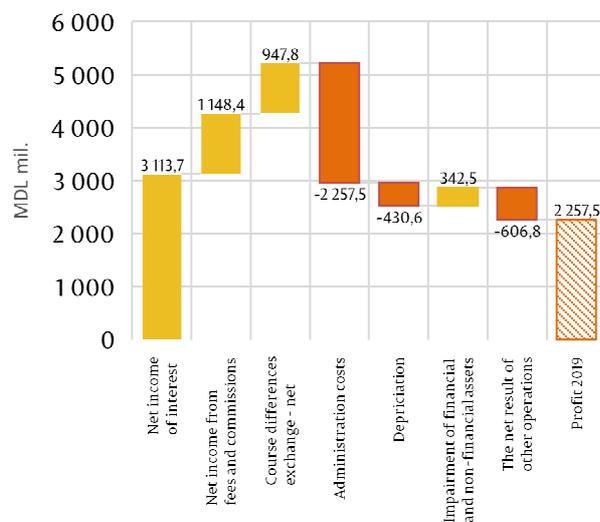
Place based on score	Name of the bank
1	BC „MOLDOVA - AGROINDBANK” S.A.
2	BC „Moldindconbank” S.A.
3	B.C. „VICTORIABANK” S.A.
4	„MOBIASBANCA – OTP Group” S.A.

Source: NBM

From the perspective of the volume of assets, the group of systemically important banks holds 78.6 percent of the total banking assets.

The banking sector ended 2019 with an aggregate profit of MDL 2,257.5 million, recording an annual increase of 55.5 percent (2018: MDL 1,451.6 million).

Chart 2.1.2. The profitability of the banking sector increased in 2019, the main source of bank profit was interest income



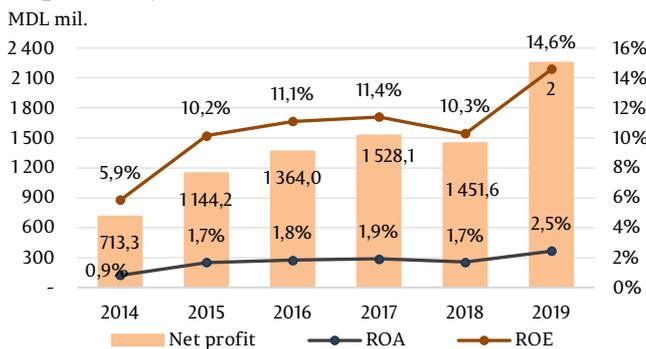
Source: NBM

⁷ Since the elaboration of the report, some bank data related to 2019 have been or will be modified as a result of the audit. Data from previous years are final data from the audit.

The positive dynamics of the profit was generated by the increase of total revenues by 7.7 percent, simultaneously with the decrease of total expenses by 6.9 percent compared to 2018.

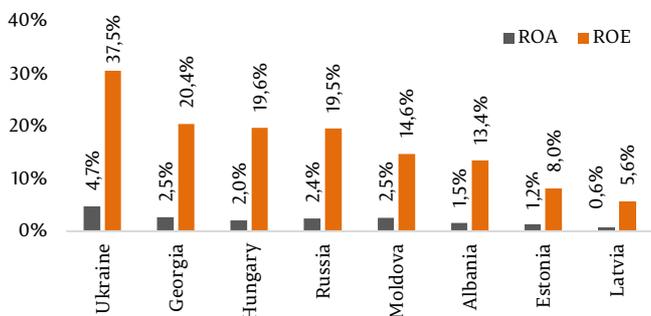
In this context, the values of the main profitability indicators of the banking sector ROA and ROE, increased and amounted to 2.5 percent and 14.6 percent, respectively (Chart 2.1.3).

Chart 2.1.3. The banking sector recorded higher values of indicators of return on equity and assets compared to previous years



Source: NBM

Chart 2.1.4. Compared to other states in the region, the banking sector in the Republic of Moldova recorded an average profitability in terms of ROA and ROE

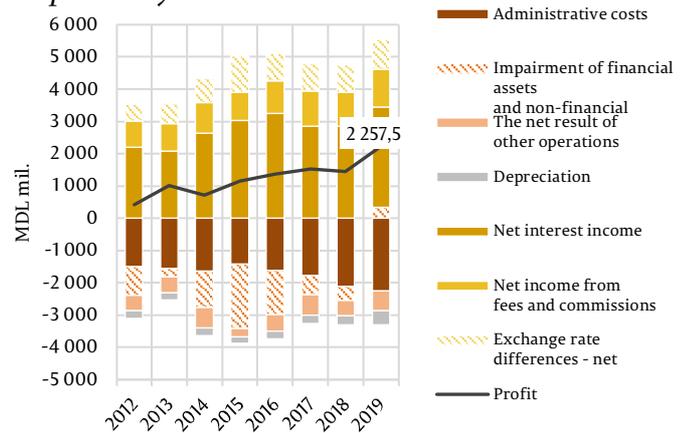


Source: NBM, IMF

Overall, the interest income structure reflects that banks' business strategies continue to focus on both lending and investment activities that provide liquidity as well as relatively high and stable returns (SS and CNB).

Interest income (the main component of operating income) increased in 2019 by 4.7 percent (MDL +204.4 million). This dynamic was determined by the increase of interest income related to loans granted to individuals (MDL +228.2 million).

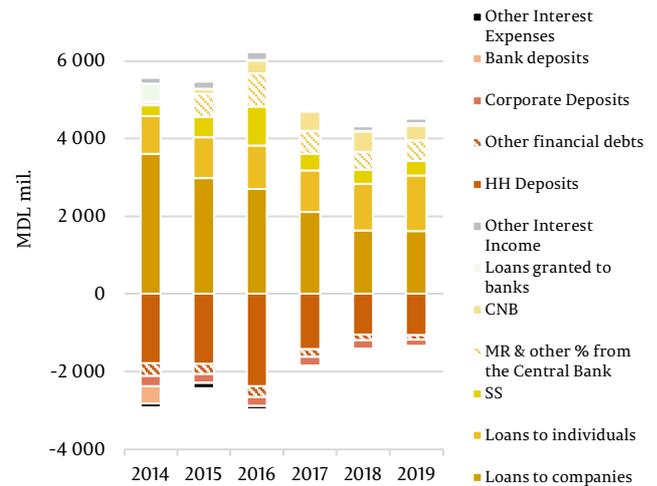
Chart 2.1.5. Banking profit reveals a structure similar to previous years



Source: NBM

On the other hand, interest income on loans to legal entities decreased (MDL -16.8 million), but continues to have the largest share of total interest income (35.9 percent).

Chart 2.1.6. In 2019, the interest income related to loans to individuals increased



Source: NBM

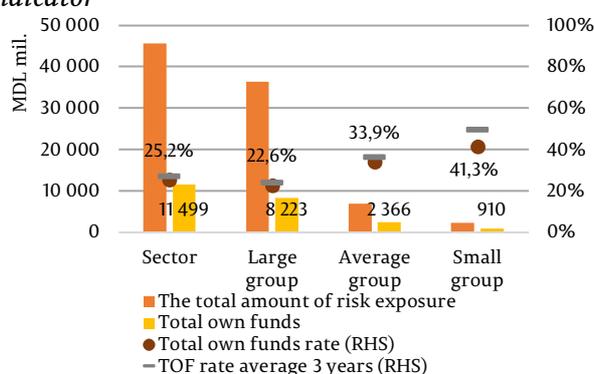
Interest income not related to the loan portfolio (SS, MR, CNB and other interest received from the NBM) decreased by MDL 47.9 million compared to 2018, and holds a share of 28.6 percent of total interest income. This decrease was caused by the decrease in revenues related to investments in CNB (MDL -144.0 million). At the same time, interest income related to SS (MDL +13.0 million) and MR (MDL +83.2 million) increased.

Regarding the expenses related to the operational activity, in 2019 there was registered a decrease in interest expenses by 4.3 percent (MDL -62.2 million) and an increase in expenses on fees and commissions by 24.8 percent (MDL +147.2 million).

At the same time, there was a significant decrease in expenses for the depreciation of financial assets (MDL -532.6 million) and non-financial assets (MDL -241.5 million), which led to the banking sector financial result increase. It should be noted, however, that this development is not related to the core business of banks, but was mainly due to the repayment of loans and the takeover of assets in exchange for the repayment of loans.

The banking sector is characterized by a consistent level of the capitalization indicator, which significantly exceeds the regulated minimum level. Thus, the capital surplus reflects the resilience of the banking sector in case of potential losses and ensures the growth of lending activity.

Chart 2.1.7. The banking sector continues to be characterized by a high level of capitalization indicator



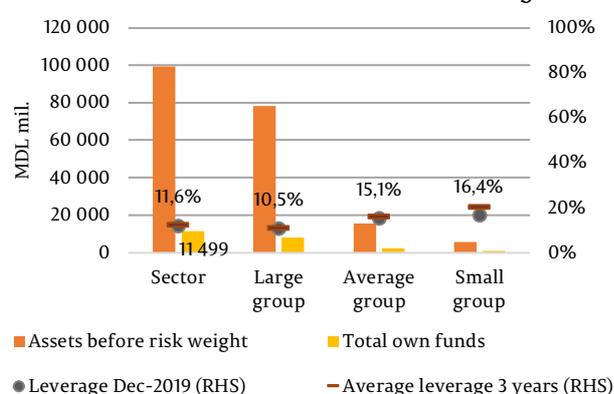
Source: NBM

At the end of 2019, the total own funds on the banking sector amounted to MDL 11 498.6 million (Chart 2.1.7), thus registering an increase of MDL 610.3 million (5.3 percent) compared to 2018. The increase of own funds was determined by the inclusion in their calculation of the intermediate profits obtained by banks.

The total own funds rate in the banking sector at the end of the reference year was 25.2 percent, a slight decrease compared to 2018 (26.5 percent), on the background of a more significant increase in the total amount of risk exposures compared to own funds (Chart 2.1.7).

For 2019, the macroprudential leverage effect of the banking sector registered the value of 11.6 percent (Chart 2.1.8), being well above the minimum level of 3 percent to be applied at EU level starting in mid-2021.

Chart 2.1.8. Leverage is high, with banks holding sufficient own funds to finance bank lending



Source: NBM

Box 2. Changing the shareholding of systemic banks

During 2019, there were some changes in the shareholding structure of three systemic banks:

BC „MOLDOVA-AGROINDBANK” S.A. Previously, the consortium of investors formed by EBRD, Invalda INVL and Horizon Capital through "HEIM PARTNERS LIMITED" became the holder of the 41.09 percent stake in the share capital of BC "MOLDOVA-AGROINDBANK" S.A. Subsequently, on 28.02.2019, the Executive Committee of the National Bank of Moldova issued the prior approval for the acquisition of qualified holding

in the amount of 48.37 percent of the share capital of BC "MOLDOVA-AGROINDBANK" S.A. by the group of persons consisting of "HEIM PARTNERS LIMITED" and 5 other shareholders of the bank under the usufruct agreement.

BC „MOLDINDCONBANK” S.A. By the Decision of the Executive Committee of the National Bank of Moldova of 22.01.2019 was issued the prior approval for the acquisition by "Doverie - Invest" S.A. (Bulgaria) of qualified holding, the overall share of which reaches and exceeds the

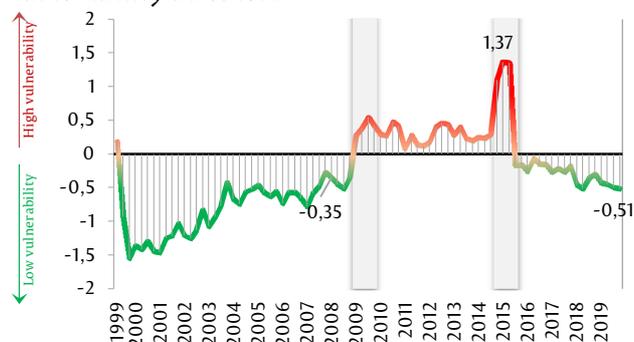
level of 50 percent in the share capital of BC „MOLDINDCONBANK” S.A. In February 2019, the package of shares in the amount of 63.89 percent of the share capital of BC "MOLDINDCONBANK" S.A. was acquired, pursuant to Law no. 121/2007 on the administration and denationalization of public property, by the Public Property Agency. Subsequently, on 19.03.2019 "Doverie - Invest" S.A. acquired the mentioned package of shares by participating in the auction, organized at the Stock Exchange of Moldova. During the year, the shareholder of the bank "Doverie – Invest" SA increased its qualified holding to 77.63 percent, as a result of the closing of the offer to take over the bank's shares (13.73 percent) and the acquisition of the holding from others. shareholders of the bank (0.01 percent).

MOBIASBANCA - OTP Group S.A. On July 10, 2019, the Executive Board of the National Bank

approved the purchase by OTP Bank Nyrt. (Hungary), of qualified holding, the share of which exceeds the level of 50 percent of the share capital of the Commercial Bank "MOBIASBANCA - Groupe Societe Generale" S.A. As a result, on 25.07.2019 OTP Bank Nyrt. acquired the status of direct holder of qualified holding in the amount of 96.69 percent of the bank's share capital as a result of the registration of the ownership right over mentioned holding. Subsequently, the shareholder OTP Bank Nyrt. increased its qualified holding to 98.26 percent as a result of the continuation of the offer to take over the bank's shares (1.57 percent). At the same time, the official name of the bank was changed to MOBIASBANCA - OTP Group S.A. following the submission of the proposal by the new shareholder OTP Bank Nyrt.

Vulnerability analysis of the banking sector determines the general level of vulnerability of the banking sector based on developments in the main financial indicators of banks. During 2019, the banking sector recorded downward developments in the general vulnerability index⁸, staying below the vulnerability threshold⁹. At the end of the year, the banking sector accumulated a general vulnerability index of (-0.51), returning to the level recorded in 2008. The general vulnerability index was determined by a high level of capitalization and liquidity of the banking sector, as well as by an improvement in the quality of banking assets.

Chart 2.1.9. The vulnerability index registered lower values than in previous years and was below the vulnerability threshold

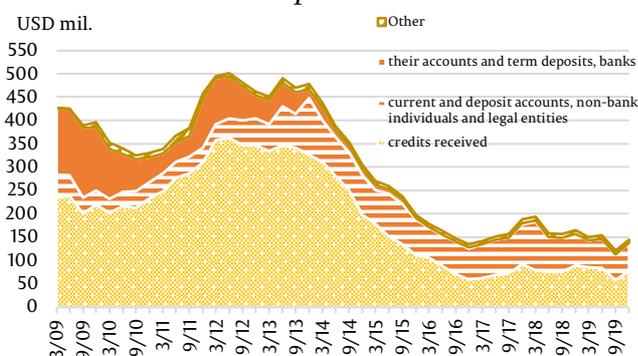


Source: NBM calculations

Vulnerabilities of the banking sector to non-residents

In 2019, the FX debts of banks to non-residents decreased slightly, reducing both the external loans received by the banking sector and the accounts of non-resident customers. Therefore, the banks' income from external credit have increased insignificantly compared to the banks' servicing external debt. As a result, the balance of loans received, especially from foreign founders, decreased by 13.2 percent to 77.2 million USD - a level much lower than the years before the banking crisis (Chart 2.1.10 and Chart 2.1.11).

Chart 2.1.10. Foreign exchange attracted from non-residents decreased compared to 2018

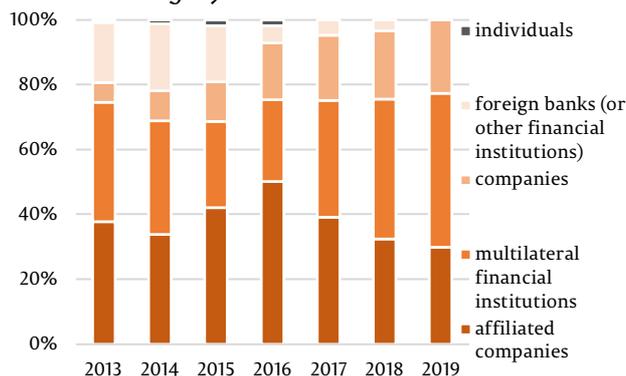


Source: NBM

⁸ Aggregate indicator, calculated as a weighted amount based on the scores of financial soundness indicators.

⁹ The value of the general vulnerability index is equal to 0, so the negative values denote a low level of financial vulnerability, while a positive value of the index indicates a higher financial vulnerability.

Chart 2.1.11 Multilateral financial institutions were the main category of creditors



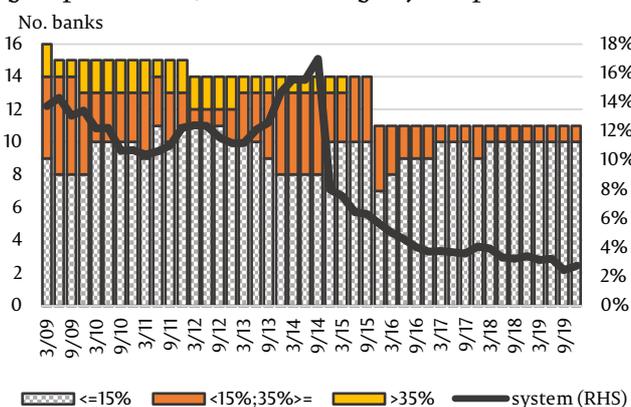
Sursa: DMFAS

A larger inflow of foreign currency was observed from the current and deposit accounts of non-resident non-bank customers, mainly legal entities, whose balances decreased by 11.1 percent to USD 59.8 million.

Other types of debt related to non-residents remained insignificant from both the quantity and evolution criteria.

Under these conditions, the exposure of local banks through foreign currency attracted from non-residents continued to shrink, reaching relatively insignificant values (Chart 2.1.12).

Chart 2.1.12. Exposure to non-residents by foreign currency in relation to total capital and debt, by groups of banks, decreased slightly compared to 2018



Source: NBM

At the end of the reference year, they constituted 2.7 percent in relation to total capital and debts (compared to 2018: 3.4 percent; 2017: 4.0 percent; 2016: 3.7 percent).

According to the situation at the end of the reporting year, 10 of the banks remain exposed through the foreign exchange resources attracted from non-residents in total capital and debts in

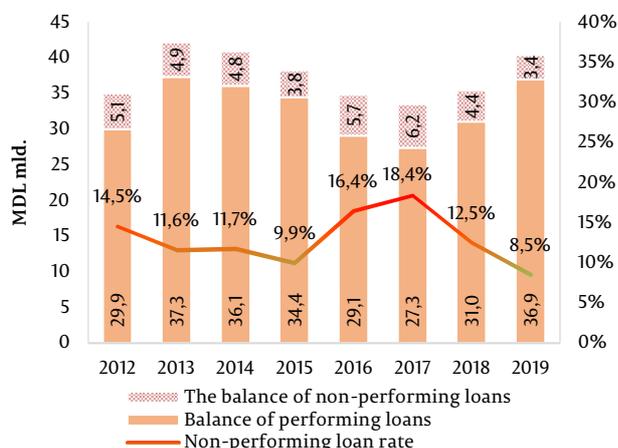
reasonable proportions of up to 15 percent (minimum - 0.2 percent, maximum - 4.2 percent). Only a bank founded by foreign investors ranks between 15 percent and 35 percent.

2.2. Credit risk

In 2019, the growth of bank credit accelerated, continuing the upward trend set in the previous year. The total balance of loans increased by 13.9 percent, while the volume of new loans increased by 17.5 percent. The balance of non-performing loans registered a significant decrease of 22.9 percent, the rate of non-performing loans being 8.5 percent at the end of 2019.

The total gross loan portfolio of banks in the Republic of Moldova increased during 2019 by almost MDL 5.0 billion (13.9 percent), at the end of the period the total balance amounting to MDL 40.4 billion (2018: MDL 35.5 billion). At the same time, the stock of non-performing loans decreased by 22.9 percent (MDL 1.0 billion), which led to a decrease in the rate of non-performing loans in the total portfolio to 8.5 percent (2018: 12.5 percent).

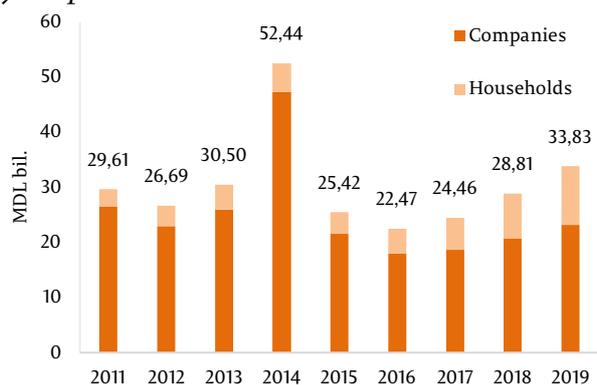
Chart 2.2.1. The growth of bank credit accelerated in 2019



Source: NBM

Analyzing the volume of new loans granted in 2019 (Chart 2.2.2), a maintenance of growth rate is observed. Thus, the volume of new loans granted by banks during the year increased by 17.5 percent (2018: 17.8 percent). Loans to the population (MDL +2 692.3 million) contributed more to this increase, while loans to companies registered a more moderate increase (MDL +2,335.1 million).

Chart 2.2.2. The total volume of new loans increased by 17.5 percent in 2019



Source: NBM

The currency structure of new loans is characterized by a sharp increase in loans issued in the national currency (+22.5 percent).

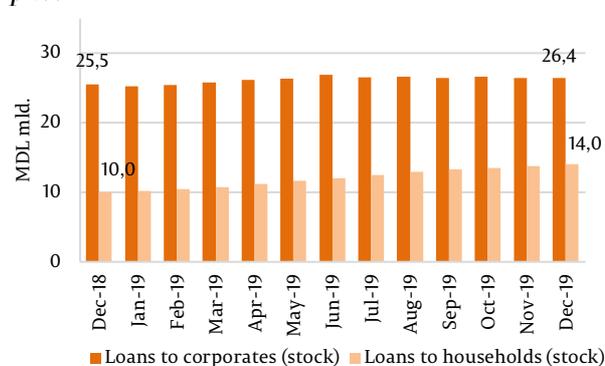
Table 2.2.1. By type of debtor and loan currency, the sharpest increase in 2019 marked the volume of new loans to NP

% , r.p.y.	MDL	FX	TOTAL
TOTAL LE	13,34%	8,98%	11,24%
TOTAL NP	35,21%	-19,31%	33,54%
TOTAL	22,52%	8,30%	17,45%

Source: NBM

In the separate analysis of loans by type of debtor (Chart 2.2.3), there is an increased trend of lending to households, simultaneously with the return of the balance of loans to legal entities on a positive trend in annual terms, after 4 consecutive years of decline. Thus, the balance of loans to households increased by 40.2 percent

Chart 2.2.3. Lending to corporates returned to a positive trend in annual terms, and lending to the households continued to increase at an accelerated pace



Source: NBM

(MDL 4,018.3 million), and loans to legal entities - by 3.6 percent (MDL 904.6 million) compared to 2018.

Therefore, the share of loans to households in total loans increased to 34.7 percent (2018: 28.2 percent).

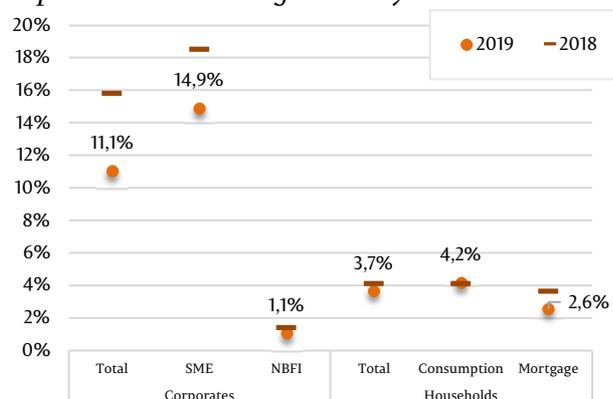
This trend is also confirmed by the results of the bank lending survey¹⁰. During the period under review, banks continued to focus efforts to expand their portfolio in the household sector. According to survey respondents, the competition pressure has led to an increase in the supply of loans for this segment, simultaneous with an increase of the demand from borrowers, mainly due to the applicants' financing needs.

At the same time, the lending standards for granting loans to corporates remained at a relatively similar level to that at the end of 2018, marking, however, in the fourth quarter of 2019, the first signs of relaxation in the last 3 years.

This trend was determined by the competition pressure, but also by the risk perception.

Compared to previous periods, the risk perception related to the loans granted to companies decreased, the similar evolution being reflected in the significant improvement of the quality of the respective loans (Chart 2.2.4). At the same time, demand for loans from both corporates and households has maintained an upward trend.

Chart 2.2.4. The rate of non-performing loans of corporates decreased significantly in 2019

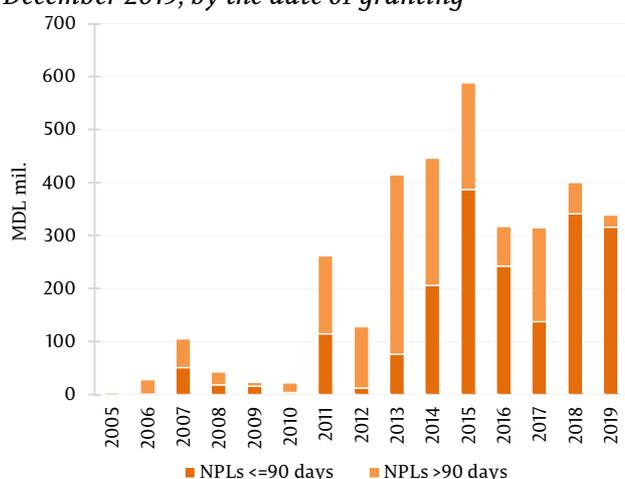


Source: NBM

¹⁰ The survey on bank lending conducted during 2019 in which all banks participated.

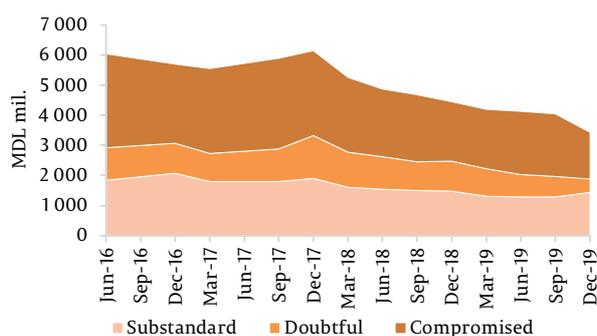
The persistence of non-performing exposures during the period of economic imbalances from 2014-2015 continued to have a significant impact on the quality of the corporate loan portfolio in banks' balance sheets. Of the total balance of non-performing loans, as of December 2019, loans granted in 2013-2015 amounted to 42.3 percent. As for the non-performing loans from 2016-2019, they were classified as non-performing by banks, mainly based on criteria other than the number of days past due, which indicates a more prudent and anticipatory approach in the quality assessment process of loans (Chart 2.2.5).

Chart 2.2.5. Breakdown of non-performing loans as of December 2019, by the date of granting



Source: NBM

Chart 2.2.6. Banks have continued their efforts to reduce non-performing loan portfolios

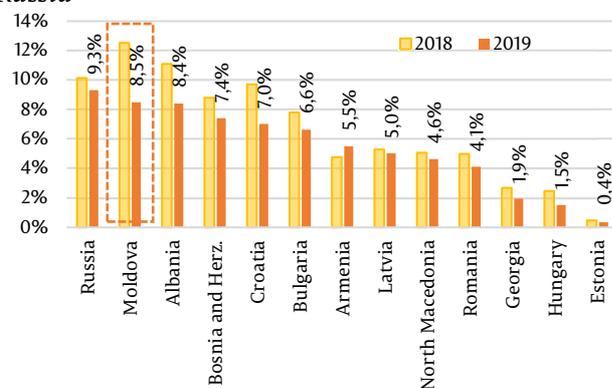


Source: NBM

The structure of non-performing loans by risk categories shows that banks continue their efforts to reduce non-performing loan portfolios. Non-performing loans are mainly concentrated in the "compromised" risk category (Chart 2.2.6) which at the end of 2019 had a share of 44.7 percent of total non-performing loans by sector.

Thus, the rate of non-performing loans in the domestic banking sector was at a higher level compared to the rates of countries in the region¹¹ (Chart 2.2.7), with the exception of Ukraine, which registered 52.8 percent, and Russia.

Chart 2.2.7. The rate of non-performing loans in the Republic of Moldova was higher compared to the rates of countries in the region, except for Ukraine and Russia



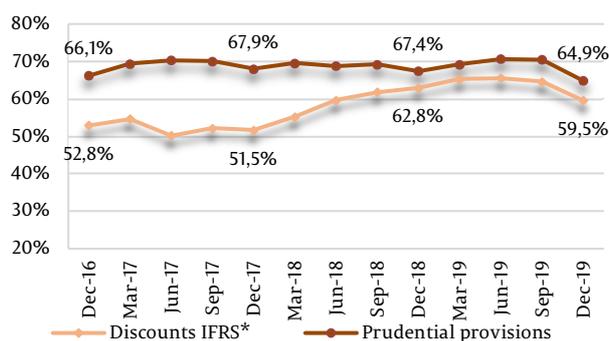
Source: IMF

However, the coverage of non-performing loans with prudential provisions remained at a comfortable level during the year under review, registering the value of 64.9 percent as of December 2019 (Chart 2.2.8). This indicator marked a relatively sharp decrease in the fourth quarter following the write off of the loans classified in the most unfavorable (compromised) risk category in banking portfolios.

¹¹ The method of determining and defining the notion of "performing loans" differs between states, as do the regulations on scrapping non-performing loans in banks' balance sheets. In the banks of the Republic of Moldova, the classification of loans is carried out in accordance with the Regulation on the classification of assets and conditional liabilities, approved by the Decision of the Board of Directors of the NBM no. 231/2011, (the provisions of which are considered to have a more conservative approach in relation to the practices of other states) which stipulates that when assessing conditional assets and liabilities the bank will take into account some qualitative aspects related to the debtor, the main ones being:

- the current financial position of the counterparty assessed in terms of the ability to honor commitments;
- counterparty's ability to pay based on historical financial developments and future cash flow estimates;
- the current trading value of the object of the pledge and its degree of liquidity on the market of the Republic of Moldova;
- the counterparty's business environment, the state of the economic sector in which it operates and its position in this sector;
- the financial situation and ability to pay of the person who constitutes a personal guarantee (surety) or of the insurer;
- other factors that may affect the counterparty's compliance with the contractual conditions.

Chart 2.2.8. The coverage of non-performing loans with prudential provisions was maintained at a comfortable level



Source: NBM
* IFRS discounts for all loans

The NBM regularly performs stress tests on credit risk in order to quantify the resilience of the banking sector. The solvency of banks is tested by univariate impact assessment of deterioration of the quality of the credit portfolio on the amount of own funds and capital adequacy ratio.

It should be noted that the results of the stress tests are not a forecast, but a simulation of the scenarios to answer the question "what if?". In this sense, a stress scenario related to direct credit risk was simulated.

The results of the simulations show that the banking sector, as a whole in the medium severity scenario, shows a solid resilience of all banks registering an indicator of the own funds rate above the regulated minimum level of 10.0 percent, except for one systemically important bank.

Thus, credit risk continues to pose the most significant threat to the stability of the banking sector, highlighting the importance of maintaining sufficient capital positions to absorb estimated losses even in the most pessimistic scenarios of assets quality deterioration.

Box 3. Lending in foreign currency.

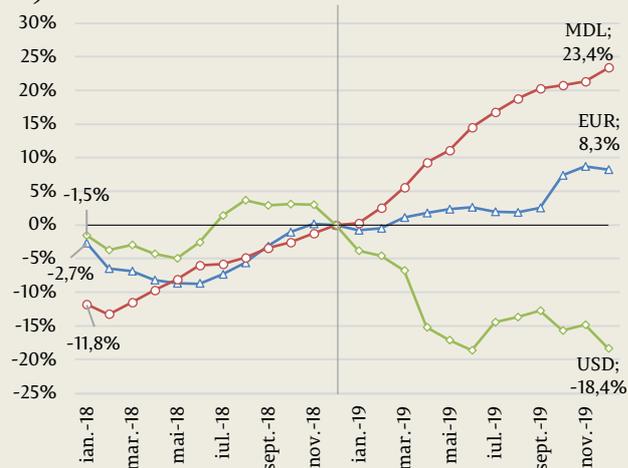
Considering the risks associated to the FX loans, and since financial system shall possess a better ability to recover promptly after shocks caused by unfavorable evolution of the FX rate, which affects the debtors' capacity to honor their FX debts, a special attention is accorded to FX loans.

During 2019, the evolution of loans in EUR and USD had the opposite trends. During the year, the preferences of companies to take loans in EUR intensified, resulting in an increase in the balance by 8.3 percent. On the other hand, loans in USD have become less demanded by the business environment, their balance in the total banking system portfolio decreased by 18.4 percent compared to the end of 2018 (Chart 2.2.9.).

Thus, the analysis of non-performing loans in dynamics reveals that the "cleaning" of the portfolios was done, mainly, on the segment of FX loans granted to companies. At the same time, the lowest rate of non-performing loans was still recorded by loans in national currency granted to the population, which partly explains the focusing of the banking sector on lending to this segment during recent years.

The risk profile of FX lending, although improved compared to previous periods, is at an unfavorable level compared to loans in national

Chart 2.2.9. Loan growth rate, by currencies (2018.12 = 0%)

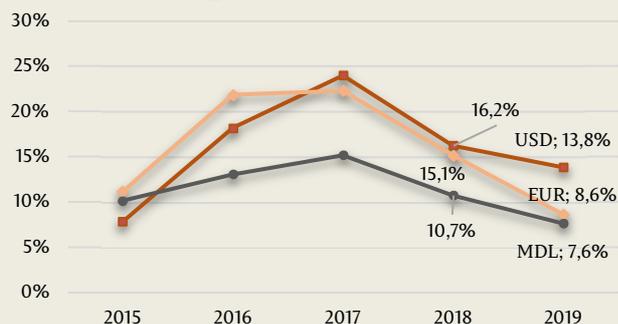


Source: NBM

currency, which indicates the importance of maintaining prudent policies on FX lending, especially in the case of debtors who receive income in MDL and are not insured against FX risk, respectively.

The rate of non-performing loans denominated in national currency decreased to 7.6 percent as of December 2019 (Dec-2018: 10.7 percent), while in the case of FX exposures the favorable dynamics was more significant, decreasing up to 9.9 percent (Dec-2018: 15.5 percent), of which the rate of loans in EUR was 8.6 percent and that of loans in USD - 13.8 percent (Chart 2.2.10).

Chart 2.2.10. Non-performing loan rates marked favorable trends in 2019

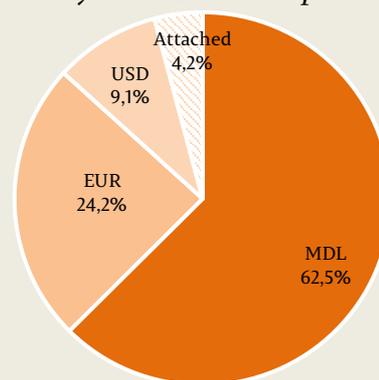


Source: NBM

In 2019, the volume of new FX and FX-attached loans continued the increase established in 2018 after 3 years of decrease (8.3 percent r.p.y., equivalent in MDL). Loans in MDL were significantly more requested by corporates, but also by the population, the increase in the volume of new loans granted registering a solid increase of 22.5 percent. This evolution is also explained by the increase in the supply from the banks, by their rising focus to lending to individuals in the national currency.

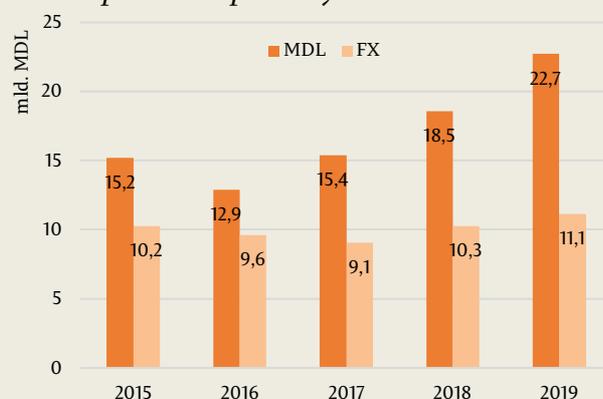
As of the end of 2019, FX loans held a share of 33.3 percent of the total portfolio. MDL loans attached to foreign currency amounted to MDL 1,677.3 million, which represents 4.1 percent of the total gross loan portfolio.

Chart 2.2.11. The share of FX loans and loans attached to foreign currency decreased to 37.5 percent



Source: NBM

Chart 2.2.12. The volume of new loans in MDL and in foreign currency increased in 2019 by 22.5 percent and 8.3 percent respectively



Source: NBM

2.3. Liquidity risk

During 2019, banks registered a favorable liquidity position, and the liquidity surplus in the banking sector narrowed due to the increase in the channeling of liquid assets for lending. Thus, during that period, the positive trend of the degree of banking intermediation established in 2018 continued. Liquidity stress testing exercises did not identify liquidity problems in banks.

Liquid assets held by banks, although still recording excessive values, recorded a reduction compared to 2018, due to the more active use of resources attracted by banks for lending purposes.

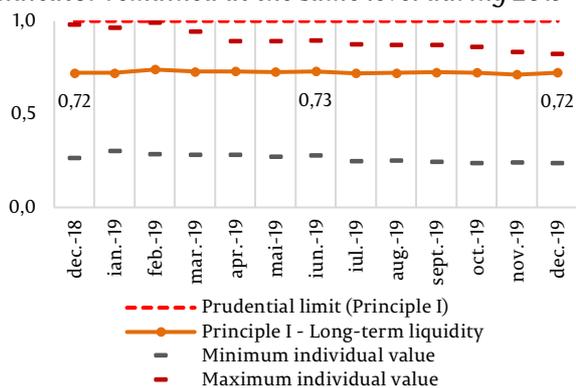
The gradual narrowing of the liquidity surplus was reflected in the evolution of the NBM's monetary policy operations. Thus, the volume of operations intended for liquidity absorption

decreased by about 34 percent compared to 2018, a situation also reflected in the annual average of the stock of CNB investments, which decreased from MDL 8,356.8 million, a level recorded in 2018 to MDL 5 500.1 million in 2019.

Following the NBM's selling interventions on the FX market during January-February, the daily balance of CNB reached the maximum value of MDL 7,368.3 million and the minimum value of MDL 4,124.7 million in the second half of March. The balance of CNB investments, at the end of 2019, amounted to MDL 5,396.1 million.

Liquidity indicators are at comfortable levels in terms of the liquidity risk of the banking sector. Thus, the long-term liquidity indicator (principle I) calculated for the banking sector remained almost at the same level throughout the year.

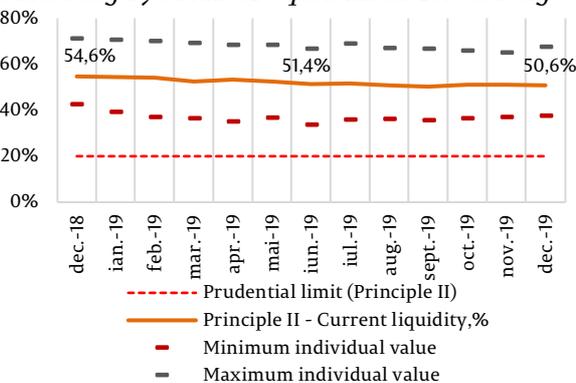
Chart 2.3.1. The aggregate long-term liquidity indicator remained at the same level during 2019



Source: NBM

At the same time, after 4 consecutive years of growth and a slowdown in the upward trend in 2018, the current liquidity indicator (principle II) marked a decrease in annual terms, thus indicating the activation of the lending process by the banking sector, the excess liquid assets being more actively channeled for financing the population and economic agents. The developments of liquidity indicators on individual banks show a higher volatility compared to the aggregate trend by sector, but all fall within the regulated limits.

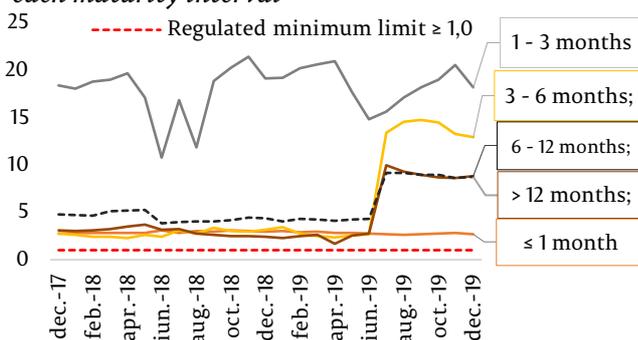
Chart 2.3.2. The current liquidity indicator recorded decreasing values due to the increase in the channeling by banks of liquid assets for lending



Source: NBM

The values of the liquidity indicator on maturity bands (principle III) were placed well above the limit established for each band, increasing for all bands, except for the shortest intervals (<1 month; 1-3 months). It should be mentioned that the liquidity level for maturity bands over 3 months registered significant increases due to the change in the method of calculating the indicator (DEB of NBM no. 142 of May 14, 2019).

Chart 2.3.3. The liquidity indicator on maturity bands is placed well above the prudential limit of 1, set for each maturity interval



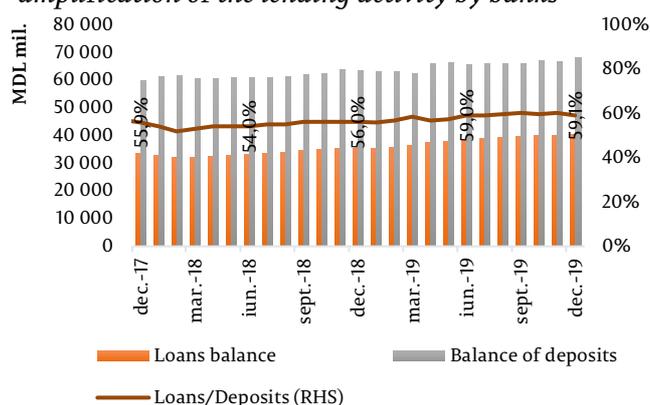
Source: NBM

This change was generated as a result of the liquidity analysis performed for systemically important banks, as well as the calculation of the impact by applying the new calculation method, the result of which led to a significant increase in assets with a maturity of more than 3 months.

During 2019, financial intermediation marked positive developments, the banking sector continuing to increase the efficiency of the use of attracted resources (deposits) to finance the economy (loans). This fact is confirmed by the evolution of the “loans / deposits” indicator, the value of which continued the growth established in 2018 on the background of the amplification of the lending activity by banks (Chart 2.3.4), in annual terms, the balance of loans registering for the first time in the last 4 years a relative superior evolution compared to the increase of the balance of deposits (13.9% vs 7.7%).

In the separate analysis by customers, the “loans / deposits” ratio on the individuals’ segment recorded a “jump” from 24.0 percent to 30.7 percent during 2019, the individuals sector remaining further on the net creditor position of the banking sector. At the same time, the corporate sector remains the net debtor of banks, with a rate of 116.4 percent of the “loans / deposits” ratio (2018: 117.4 percent).

Chart 2.3.4. The loans / deposits ratio continued the growth established in 2018 on the background of the amplification of the lending activity by banks

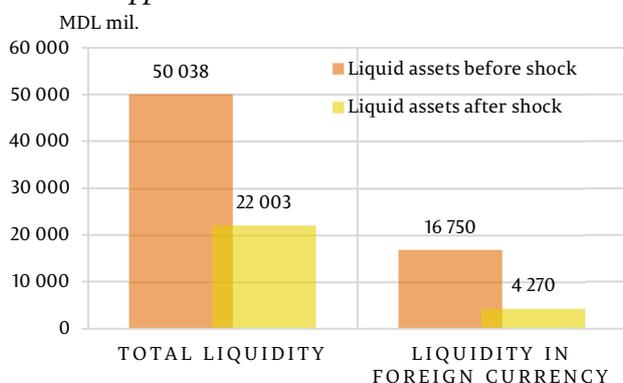


Source: NBM

Liquidity stress testing exercises. During 2019, simulations of stress scenarios were performed to assess the ability of banks to meet both their current and long-term obligations.

In this context, inflows of liquid assets over the one-month horizon were calculated, simultaneously with non-uniform withdrawals of deposits by type of depositors (individuals, legal entities, banks).

Chart 2.3.5. The banking sector remains liquid in the simulated scenarios, having sufficient liquidity even after the application of shocks



Source: NBM

The results obtained did not identify liquidity deficits at individual or sector level.

The liquidity risk of the domestic banking sector is currently low and the liquidity position provides a sufficient buffer to cope with significant potential withdrawals of deposits.

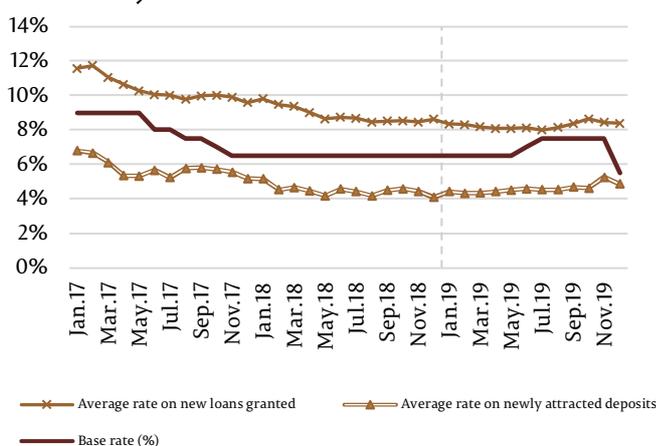
2.4. Market risk

During 2019, the base rate applied to the main monetary policy operations of the NBM decreased to the level of 5.5 percent. At the same time, the increase of interest rates on the primary market of government securities at the beginning of 2019 was determined by the increased demand from investors, later during this period there was a more pronounced activity compared to the previous year. During 2019, the ratio between the open foreign exchange position (OFEP) and the own funds of the banking sector in the Republic of Moldova was within prudential limits, and the potential impact of the sector's direct exposure to exchange rate volatility was reduced.

Evolution of the base rate

During 2019, three changes to the base rate were made. Thus, at the end of 2019, the base rate was at the level of 5.50 percent, with the maximum value of 7.50 percent recorded in July-November. The weighted average monthly interest rates on new attracted deposits and new loans granted during the year followed a linear trend, with the values at the beginning and end of the year being at the level of 8.30 percent. At the same time, the weighted average interest rate on new deposits attracted in the national currency increased by 0.46 pp, amounting to 4.88 percent as of December 2019.

Chart 2.4.1. During 2019, the base rate increased in the second quarter with a subsequent decrease at the end of the year



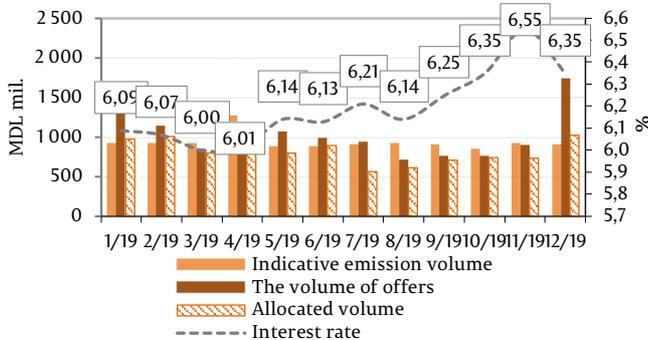
Source: NBM

Interest rates on SS

The evolution of interest rates on the primary market of government securities reflected the combined influences exerted during 2019 to compress the excess liquidity in the banking sector, implicitly, the interest shown by investors for this type of investments and changes in the base rate of NBM.

In the first eight months of 2019, the average monthly rate of SS was relatively stable, hovering around 6.00 percent (Chart 2.4.2).

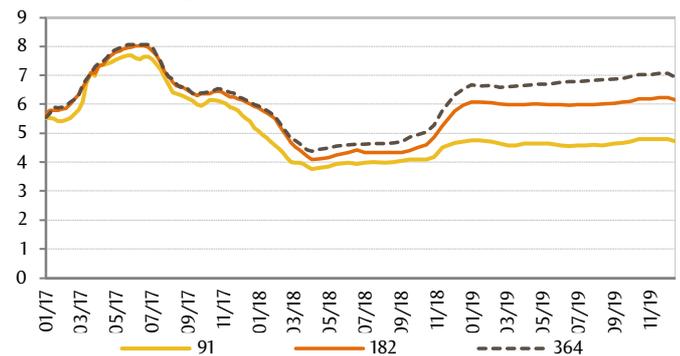
Chart 2.4.2. According to the monthly dynamics of the primary market indicators of SS, in March 2019 the minimum rate of 6.01 percent was registered, and the maximum value of 6.55 percent was registered in November 2019



Source: NBM

Between September and November, it was on a rapid upward trend, reflecting the significant decrease in demand for SS from investors (during this period the ratio between the volume of bids submitted and the volume announced for placement being subunit) and the increasing changes in NBM rates. In December, given the decrease in the NBM base rate and the significant increase in demand for these securities, the SS interest rate returned to a downward trend. The interest rates on SS registered in 2019, values located, mainly, in the lower part of the interest rate corridor established by the NBM. The analysis of the evolution of these installments in the maturity division shows a distancing of the interest rates related to the securities of 182 days and 364 days compared to those with a maturity of 91 days (Chart 2.4.3), which is explained both by the increase by the MoF in the management year of the indicative volume of issues to SS with longer maturities, and by the frequent adjudication of these SS in volumes that exceeded those announced for auctions.

Chart 2.4.3. Interest rates on SS with a maturity of up to one year registered low volatility during 2019



Source: NBM

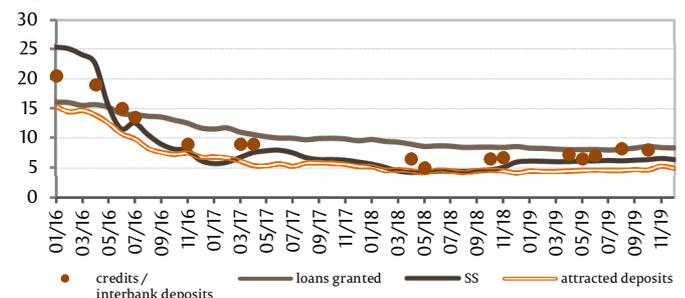
Thus, the interest rates of government securities with a maturity of up to one year increased, but their amplitude was different depending on the maturity, being more pronounced in the longer term.

The average annual interest rate on government securities with a maturity of up to one year awarded in 2019 amounted to 6.19 percent compared to 4.76 percent in 2018.

In the hierarchy of returns on the financial market, the priority was still maintained by interest rates on loans to the economy. Marked by a significant increase at the end of 2018, interest rates related to SS rose towards the middle of the corridor formed by rates related to loans and deposits attracted to the economy, oscillating within it until the end of the year. The gap between interest rates on loans and deposits narrowed slightly during 2019 (Chart 2.4.4).

In the specific conditions of 2019, investors, expressing their aversion to risk, opted for SS with a term of up to one year (Chart 1.2.4).

Chart 2.4.4. Both the interest rates registered on the banking market and the interest rate related to SS recorded relatively uniform developments during 2019

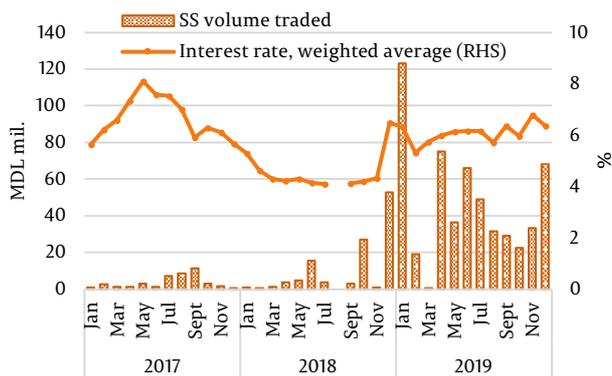


Source: NBM

As a result, the share of securities with a maturity of 182 and 364 days increased to the detriment of government bonds, whose share decreased on all maturities. Thus, the average maturity of the issued securities was reduced from 365 to 301 days.

Unlike during the previous years, in 2019, there was a revival of the secondary market of SS, with increases in all indicators (Chart 2.4.5).

Chart 2.4.5. According to the quantitative indicators of the secondary market of SS, there is a pronounced activation compared to the dynamics of the previous year



Source: NBM

The total volume of secondary market transactions exceeded the level of half a billion lei, amounting to MDL 586.4 million, compared to MDL 116.1 million in the previous year. The maximum monthly value (MDL 123.1 million) was registered in January, and the maximum interest rate - in November (6.77 percent).

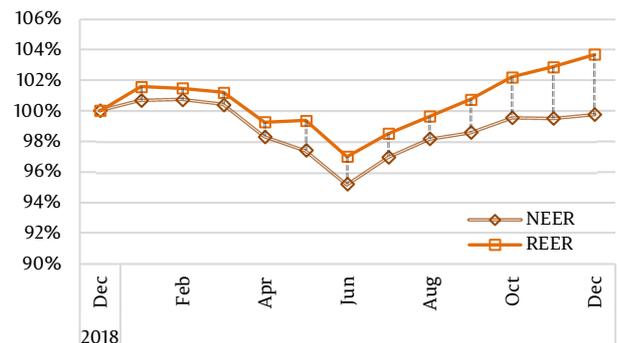
Yields of government securities with a maturity of up to one year traded on the secondary market followed, in general, the trend of the primary market of SS, being influenced only by the term of transactions. The average annual interest rate amounted to 6.17 percent (2018: 5.24 percent), the weighted average term being 245 days (2018: 191 days).

Regarding the structure of SS traded on the secondary market, the interest of the participants in the securities with a longer maturity is observed. In this context, it is worth mentioning that the volume of GB (2 years and 3 years) traded on the secondary market increased from 0.5 million MDL in 2018 to 33 million MDL in 2019. Minimum term of traded treasury bills was 43 days, and the most important share went to securities with a residual maturity of 183 to 364 days (47.5 percent).

FX risk: exchange rate dynamics

In 2019, the Moldovan leu (MDL) lost value against the USD, but strengthened against the EUR. Thus, the depreciation of MDL against USD was 0.40 percent according to the year-end exchange rate and 4.60 percent according to the average exchange rate and the appreciation against EUR - of 1.30% and 0.90%, respectively.

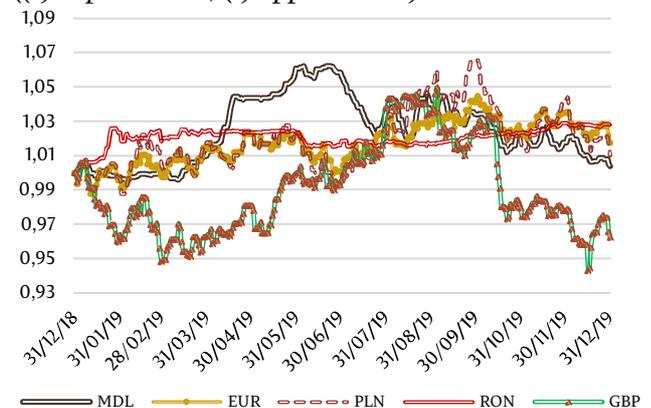
Chart 2.4.6. During 2019, the effective exchange rates of the national currency registered an appreciation evolution in the first half of the year, after which they return to the ascending slope until the end of the year (Dec. 2018 = 100 percent)



Source: NBM

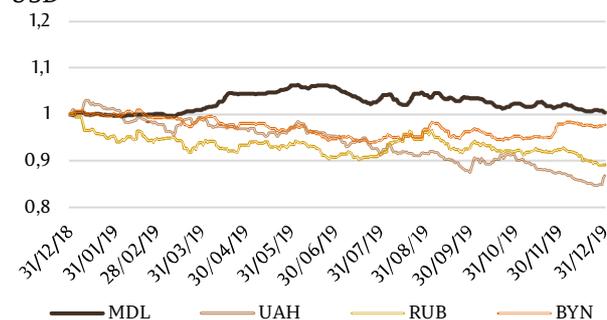
Regarding the evolution of the currencies of the main trading partners of the Republic of Moldova, some of them depreciated against the USD, while others, mainly those in the CIS bloc, strengthened their position against the USD (Charts 2.4.7, 2.4.8). Under these conditions, the MDL depreciated slightly, by 0.3 percent, compared to the basket of the currencies of the main trading partners, weighted at their shares in the foreign trade of the Republic of Moldova (NEER).

Chart 2.4.7. The currencies of the main trading partners in the EU area appreciated against the USD ((+) depreciation; (-) appreciation)



Source: NBM

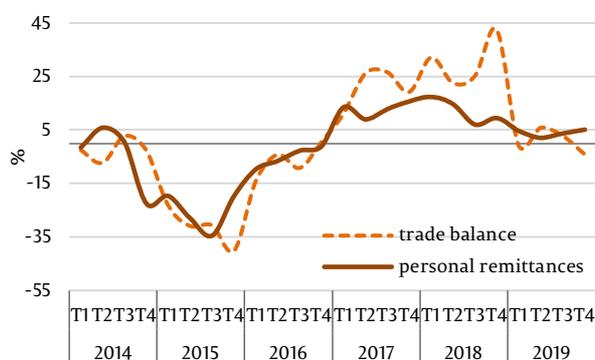
Chart 2.4.8. The currencies of the trading partner countries in the CIS area also appreciated against the USD



Source: NBM

Unlike previous years, in 2019, on the domestic market there was a shortage of foreign currency generated by both objective and subjective factors. In this context, the annual growth rate of personal remittances slowed to 4.0 percent compared to 12.0 percent in 2018, and the trade balance of goods and services deteriorated negligibly, by 0.9 percent (Chart 2.4.9), in the context of an increase in imports¹² and exports tempered to 3.6 and 5.8 percent, respectively.

Chart 2.4.9. The slowdown in the growth of remittances in 2019 took place against the background of the moderate decrease in the trade balance

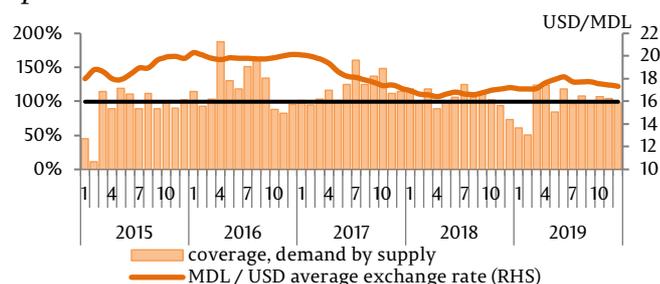


Source: NBM

During the year, there were other currency flows that influenced the conditions on the foreign exchange market, both on the side of foreign exchange supply and demand. Thus, higher inflows of foreign direct investment were recorded, but dividend payments to foreign founders reached a new all-time high.

Depreciation pressures on MDL were stronger in the first half of the year, driven by growing seasonal demand from foreign importers energy resources and economic agents for payments in the form of dividends.

Chart 2.4.10. On the local market, during 2019 (except January, February and May), the supply of foreign exchange demand by supply fluctuated around 100 percent



Source: NBM

At the same time, the demand for foreign exchange intensified against the background of the pronounced tendency of individuals and economic agents to accumulate foreign currency during the parliamentary electoral round, marked by uncertainties.

In these circumstances, in 2019 the net supply of foreign currency from individuals decreased by 1.8 percent, to USD 2,089.4 million, and the net demand for foreign currency from economic agents increased by 5.3 percent, up to the value of USD 2,178.6 million. Therefore, the degree of coverage of the net demand through the net foreign exchange offer decreased to 95.9 percent compared to 102.8 percent in 2018, creating premises for the net sales interventions of USD 5 million made by the NBM on the whole year (approx. USD 64 million net sales in H1 2019 and approx. USD 59 million net purchases in H2 2019).

Net interest margin

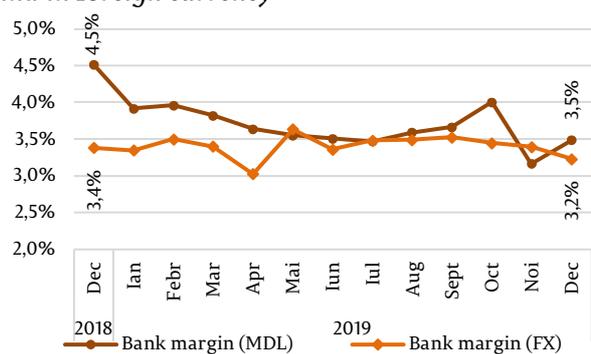
In the context of the minimal change in interest rates on the credit and deposit market, the profitability of banks decreased slightly during the reporting period.

Thus, the bank interest margin on operations in the national currency decreased by 1.0 pp compared to the level of December 2018, registering 3.5 percent in December 2019. At the same time, the bank interest margin on foreign currency operations decreased by 0.2 pp

compared to the level of December 2018, amounting to 3.2 percent in December 2019.

¹² Date BNM, balanța de plăți compilată potrivit metodologiei BPM6

Chart 2.4.11. In 2019, the bank interest margin decreased both for operations in national currency and in foreign currency

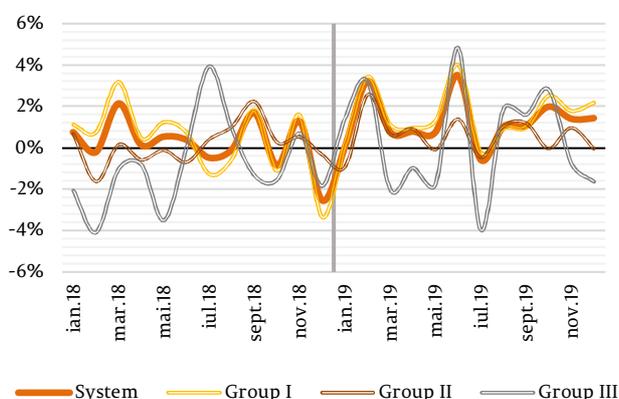


Source: NBM

Indirect FX risk

At the end of 2019, the OFEP per sector was long, standing at 1.4 percent of the total own funds per sector. Compared to the end of 2018, the OFEP ratio increased by 4.0 pp. The evolution of the OFEP ratio by sector was largely influenced by the performance of the group of systemically important banks (Chart 2.4.12), registering long position during most of the year.

Chart 2.4.12. For most of 2019, the banking sector was in a long open foreign exchange position, while respecting prudential limits

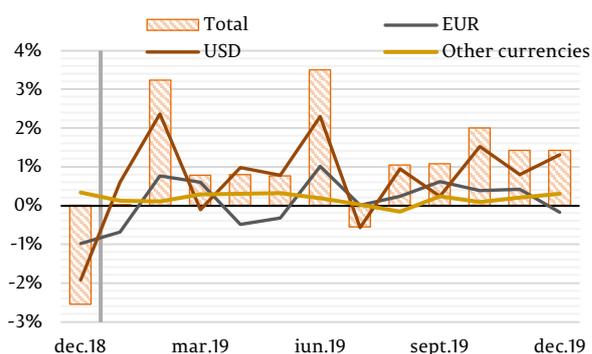


Source: NBM

In the group¹³ analysis of banks as of 31.12.2019, the group I of banks by assets registered a long OFEP, the OFEP ratio being 2.2% (+5.5 p.p compared to the similar period of the previous year). At the same time, groups II and III ended the year with a short OFEP, the ratio between OFEP and total own funds being at the level of -0.04 and 1.63 percent respectively.

¹³ Group I - banks holding assets worth more than 7,000 million MDL; Group II - banks holding assets in the range of 7,000 million MDL - 2,000 million MDL; Group III - banks holding assets of less than MDL 2,000 million

Chart.2.4.13. The volatility of the foreign exchange position was largely generated by the evolution of assets and liabilities held in EUR and USD



Source: NBM

The OFEP ratio on currencies shows that at the end of 2019 the banking sector registered long positions for USD and other held currencies, at the same time for EUR being registered a short position. Thus, in the case of USD and other currencies, the OFEP ratio recorded values of 1.30 percent and 0.31 percent respectively, and for EUR the OFEP ratio reached the value of 0.18 percent (Chart.4.13).

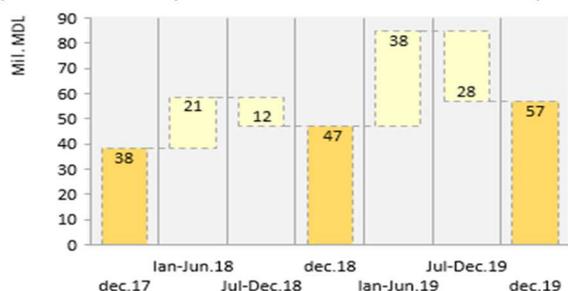
2.5. Risk of contagion

At the end of 2019, the domestic banking sector registers a low level of contagion risk in terms of interbank placements both in domestic banks and in foreign banks. Banks' portfolios remain to be diversified, the concentration indicator being below the maximum allowable level.

In monitoring systemic risks, a key aspect is the analysis of the degree of interconnection of credit institutions and the identification of the resulting routes of contagion. The main ways of spreading the contagion effect can be bilateral transactions or relations between banks (direct contagion) and transactions and exposures of credit institutions to the common sectors (indirect contagion).

The net interbank placements of the banks of the Republic of Moldova in the domestic banking sector at the end of 2019 amounted to MDL 57.0 million, increasing by MDL 10.0 million compared to similar period from last year (Chart 2.5.1).

Chart 2.5.1. The volume of net investments of local banks in the domestic banking sector did not register significant changes, at the same time increasing

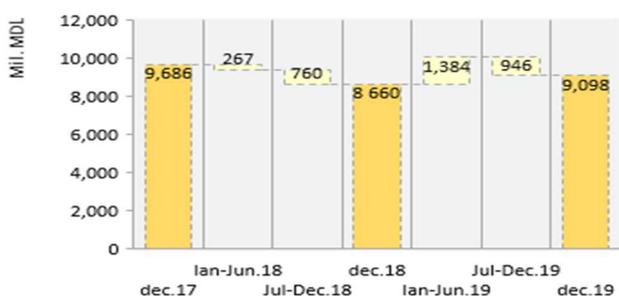


Source: NBM

However, due to the low amount of net interbank placements of banks in the domestic banking sector, the results of the stress test did not identify cases of direct contagion within this sector.

The volume of banks' investments in foreign banks amounted to MDL 9,098.2 million, an increase of MDL 438.7 million compared to the end of the previous year (Chart 2.5.2).

Chart 2.5.2. The balance of net placements of local banks in foreign banks increased compared to the end of 2018

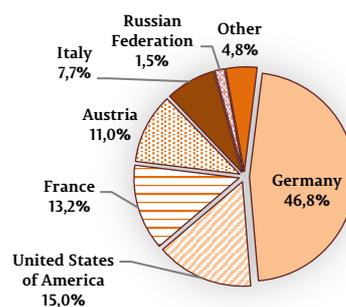


Source: NBM

About 95.2 percent of those placements were made in banks in Germany, the United States, France, Austria, Italy and the Russian Federation (Chart 2.5.3). Thus, given the increase in the balance of placements in foreign banks, banks are to consider the evolution of counterparty exposure to international shocks.

From the perspective of joint exposures to economic sectors, the analysis was performed on sectoral concentration of banks' portfolios, taking

Chart 2.5.3. At the end of the reporting year, banks' placements abroad were largely concentrated in European countries and the United States

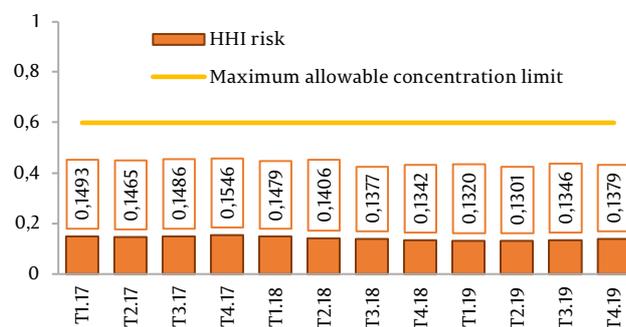


Source: NBM

into account the risks associated with each sector by applying a risk amplifier¹⁴ characteristic of each sector.

A low level of risk-adjusted concentration indicator (Chart 2.5.4) shows a relatively high diversification of the portfolio and, at the same time, a high level of discipline on the part of debtors operating in the respective sector.

Chart 2.5.4. The sectoral concentration of the loan portfolio granted by banks remains low



Source: NBM

Although the analysis performed, certain concentration levels were identified¹⁵ at the individual level, even the most concentrated portfolio is well below the allowable maximum concentration limit¹⁶.

Under these conditions, the National Bank will continue to monitor individual and aggregate concentration indicators in order to detect early possible risks that could lead to the materialization of the risk of contagion.

¹⁴ The risk amplifier used does not assess the volatility of each sector in relation to the country's economy, but considers the existence of a risk taking into account the sectoral structure of banks' portfolios.

¹⁵ The level of concentration was determined by amplifying the variable that determines the level of concentration (Herfindahl-Hirschman index) in a sector, with the level of non-performing loans corresponding to this sector.

¹⁶ The maximum allowable concentration limit is the maximum value of the concentration level recorded by any bank that has not resulted in recovery or resolution procedures.

3. MACROPRUDENTIAL POLICY

3.1. Applied macroprudential instruments

In the domestic financial sector, the level of systemic financial risk is considered to be low. This is due to the slow recovery of lending, which shows no signs of overheating. During the year, all banks continued to comply with capital buffer requirements.

Capital conservation buffer is designed to ensure that banks build capital buffers out of times of stress, reserves that can be used to cover losses that may arise from banking activity. The requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements.

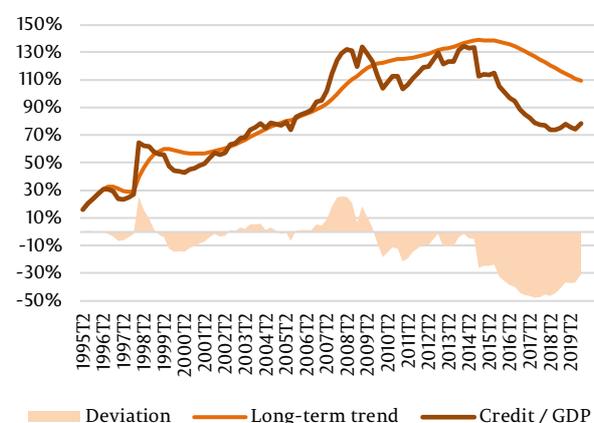
The implementation of the aforementioned capital buffer at the level of the domestic banking sector was established by the Regulation on capital buffers of banks, and the rate of capital buffer was set at 2.5 percent of the total amount of risk exposures of banks. The decision to fully activate the buffer was taken based on the high capitalization level of the banks at the time of the application of the new capital requirements (in line with Basel III).

The countercyclical capital buffer aims to increase the resilience of the banking sector to the potential losses caused by the contraction of aggregate lending, after an excessive increase. The buffer is constituted during the period of excessive increase of the credit in order to absorb the potential losses and can be released in the contraction phase.

In 2019 there was a reversal of the negative trend of the dynamics of the Credit / GDP indicator as the credit cycle in the Republic of Moldova continued to evolve according to a positive trend, started in 2018. Thus, the growth rate of lending exceeded that of GDP growth during the year, causing a modest increase in the Credit / GDP indicator.

However, the significant negative deviation of this indicator from its long-term trend shows that new loans to the private sector can still be easily absorbed into the economy.

Chart 3.1.1. The year 2019 continues to be characterized by the significant deviation of the Credit / GDP ratio from its long-term trend, although there are signs of recovery



Source: NBM calculations based on NBM and NBS data

According to the results of the latest revaluation, based on the data available for the fourth quarter of 2019, the value of the credit / GDP (quarterly) ratio was 78.41 percent, and the percentage deviation from its long-term trend was 28.3 percentage points (increasing compared to the quarter III 2019).

The described situation denotes the current absence of cyclical systemic risks related to excessive credit growth and confirms the opportunity to keep the countercyclical capital buffer rate for the Republic of Moldova at minimum level. Thus, the rate of the capital countercyclical buffer for the Republic of Moldova was set at the level of 0 percent.

Regarding the countercyclical buffer rates set by the relevant authorities in other countries, in the EU only 13 countries have determined capital countercyclical buffer rates between 0.25 percent and 2.5 percent (Chart 3.1.2). To be noted that the EU states have applied the countercyclical buffer, mainly to counteract the risks resulting from the development of the residential real estate market or the overheating of lending.

Chart 3.1.2. Countercyclical capital buffer rates set by EU countries

Country	Date of the last decision	Buffer rate,%
Norway	19/12/2019	2.5
Sweden	24/10/2019	2.5
Czech Republic	28/11/2019	2
Denmark	16/12/2019	2
Iceland	20/12/2019	2
Slovakia	21/10/2019	2
United Kingdom	13/12/2019	2
Bulgaria	20/12/2019	1.5
Ireland	12.03.2019	1
Lithuania	20/12/2019	1
France	30/9/2019	0.5
Luxembourg	30/12/2019	0.5
Germany	30/12/2019	0.25

* the rate being 0 percent for the other countries not included in the chart

Source: CERS

Systemic risk buffer is used to prevent and reduce long-term non-cyclical systemic risk or macroprudential risk. The introduction of this buffer is appropriate in the conditions of an uncertain character of the regional and international context, but also in order to manage the risks associated with the transition period.

Taking into account the persistence of potential systemic risks, as well as the volatile macroeconomic situation, the rate of the systemic risk buffer remained unchanged.

Thus, the rate of 1 percent was set for all banks and applied to exposures located in the Republic of Moldova. Additionally, starting from the limited financing capacities of some categories of investors, until 31.12.2020, the systemic risk buffer rate was increased by 2 pp in the case of banks whose capital is held, directly and / or indirectly, in a proportion of more than 50 percent cumulatively, by persons who meet the following criteria:

- are not financial sector entities;
- are residents of the states / have their headquarters in the states where supervision and prudential regulation requirements at least equivalent to those applied in the Republic of Moldova, determined by the normative acts of the NBM, do not apply;

- are not subject to supervision by the supervisory authorities of the banking sector or the capital market in those countries.

For direct and / or indirect holdings in the capital of banks, held by multilateral development banks, determined by the normative acts of the NBM, the criteria listed above do not apply.

The buffer for the systemically important institutions (O-SII buffer) seeks to ensure a greater degree of protection in the case of systemically important institutions, institutions with the potential to destabilize the financial system if they face financial difficulties.

The results of the studies conducted during 2019 identified four banks that have accumulated a score that exceeds the threshold of systemic importance, namely: B.C. „MOLDOVA-AGROINDBANK” S.A., B.C. „Moldindconbank” S.A., B.C. „VICTORIABANK” S.A. and Mobiasbanca - OTP Group S.A. These banks play a key role in the national banking sector, holding 78.6 percent of the assets of the banking sector, 79.3 percent of loans granted by banks and 81.1 percent of deposits attracted by the banking sector from individuals and legal entities. Thus, in order to reduce the probability of occurrence of financial difficulties on the part of the systemic banks and to reduce their moral hazard, the NBM established rates of the O-SII buffer, on an individual basis, depending on the scores¹⁷ accumulated by the each bank (Table 3.1.1).

Table 3.1.1. O-SII buffer rates

Name of the bank	Buffer rate
BC „MOLDOVA-AGROINDBANK” S.A.	1,50%
BC „Moldindconbank” S.A.	1,00%
B.C. „VICTORIABANK” S.A.	1,00%
MOBIASBANCA – OTP Group S.A.	0,50%

Source: NBM

In 2019, banks did not need additional capital to comply with the macro-prudential measures on additional capital requirements, their level of capitalization being above the minimum level of

¹⁷ According to the Methodology for identifying O-SII type companies in the Republic of Moldova, approved by the Decision of the Executive Committee of the NBM no.192 of 31.07.2018.

capital requirements (regarding both own funds rate and capital buffers).

3.2. National Financial Stability Committee

In 2019, the National Committee for Financial Stability (NCFS) became operational. It was established by approving the Law no. 209/2018. The objective of the NCFS is to coordinate the implementation of macro-prudential policy, the prevention, reduction or elimination of risks that threaten financial stability at the system level, as well as the management of systemic financial crisis situations.

With the approval of the Law, the framework, obligations and responsibilities of NCFS were established in order to reduce the risks that threaten financial stability, but also to coordinate the process of preparation and management of systemic crises. Furthermore, financial stability is a condition in which the financial system can withstand shocks without disrupting the activity of intermediation and efficient allocation of savings to financing. In order to ensure financial stability, it is necessary to identify the main sources of risk and vulnerabilities, such as the inefficiency of redirecting financial resources attracted from depositors to investors, the incorrect assessment or management of financial risks by intermediaries, etc.

The role of such a committee is to identify, monitor and recommend the necessary actions to eliminate or reduce systemic risks.

The European Systemic Risk Board (the authority responsible for the macro-prudential oversight of the EU financial system and the prevention and reduction of systemic risks) recommends the establishment of a set of macro-prudential instruments to be effectively applied by the relevant macro-prudential authorities.

Macroprudential authorities should have within their scope of recommendation the necessary macroprudential instruments, as well as the possibility of periodically renewing the set of instruments set in accordance with international practices.

The structure of the Committee aims to ensure the diversity of opinions and includes the Governor of the National Bank, the Minister of

Finance, the Minister of Economy and Infrastructure, the Chairman of the National Financial Market Commission and the Executive Director of the Deposit Guarantee Fund in the banking system. In its extended form, in addition to the mentioned composition, the NCFS has the following members: first deputy-governor of the NBM, deputy-governor of the NBM responsible for banking supervision, deputy-governor of the NBM responsible for banking resolution, head of the NBM subdivision responsible for financial stability.

During 2019, the NCFS met in four meetings.

There were discussed the current situation and developments in the financial system, the current situation of the DGFBS, as well as the risk mitigation actions taken or initiated by member authorities in the supervised and regulated sectors. Mainly, the topics referred to the transition of the banking sector to the prudential requirements in line with the provisions of Basel III, the implementation of capital buffers applicable to banks and the adjustment of the regulatory framework in the field of non-bank credit organizations (NCO).

Following the meetings, recommendations were issued to the authorities who are represented in the NCFS, but also to the Government. It should be mentioned that in accordance with the provisions of Law no. 209/2018, the recommendations are issued according to the “execute or explain” principle. The recommendations addressed the issues related to:

- examining the possibility of implementing macro-prudential instruments to correlate lending with the borrower's financial capacity in all segments of the financial system, in order to protect borrowers from the risk of over-indebtedness;
- recovery of the situation found in the field of credit bureaus, in order to oblige the reporting of information by the NCO for the exchange and access to information between banks and NCOs on debtors' indebtedness;
- strengthening the regulatory framework of the NCO sector, including the secondary one for managing the risks arising from FX loans, those related to the vulnerability of debtors, and

introducing new instruments focused on preventing foreign exchange and over-indebtedness of individual borrowers;

- take the necessary steps by the Government to strengthen the capacity of the Agency for Consumer Protection and Market Surveillance in the field of financial services, considering existing shortcomings in the current framework for the protection of the rights of consumers of financial services.

It should be mentioned that the provisions of Law no. 209/2018 stipulates that the addressee undertakes, within the limits of his competences, the measures and actions that are necessary to comply with the NCFS recommendations, or justifies the decision not to adopt them.

4. RISKS OF THE NON-BANKING SECTOR

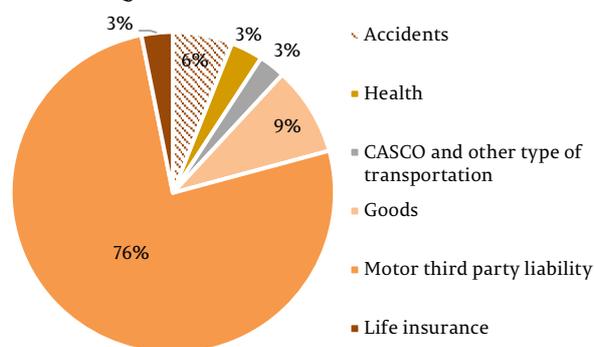
4.1. Insurance sector

In 2019, insurance companies increased the volume of gross written premiums, at the same time, 6 out of 14 companies reported losses. Assets have suffered a reduction compared to 2018, due to the withdrawal of the licenses of some insurers, and the decrease of the assets of some companies in the financial remediation procedure.

In 2019, 14 licensed insurance companies were active on the insurance market.

The insurance market is a moderately concentrated market¹⁸, the HHI market concentration index as of 31.12.2019 being equal to 1776. The top five companies by size of assets held 77.2 percent of total assets, the top five companies by size of compensation paid - 66.6 percent of the volume of compensation paid, and the top five companies by volume of premiums received - 65.9 percent of the total premiums collected. Insurance companies had 862,555 insurance contracts, 76.0 percent representing motor third party liability insurance contracts (Chart 4.1.1).

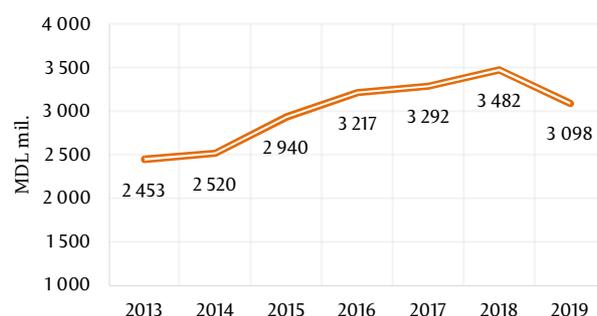
Chart 4.1.1. The motor third party liability insurance contracts represented over two thirds of the total contracts registered at the end of 2019



Source: prepared by the NBM based on NCFM information

In 2019, insurers reported, total per market, net losses amounting to MDL 14.91 million, out of which eight insurers reported net profit amounting to MDL 75.99 million and six - net losses amounting to 90.89 million MDL, following the increase of expenses incurred in 2019.

Chart 4.1.2. The total assets of the insurance companies have decreased compared to 2018, due to the withdrawal of the licenses of some insurers

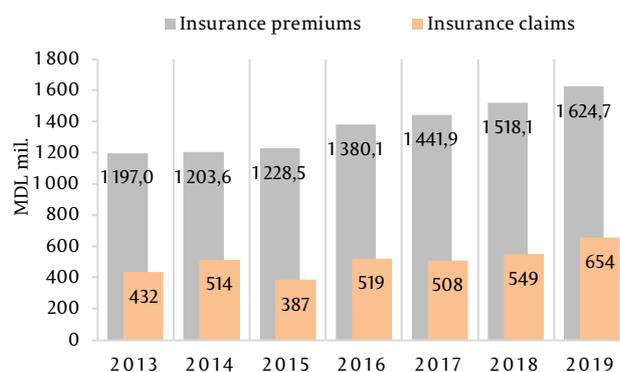


Source: prepared by the NBM based on NCFM information

The annual volume of gross written insurance premiums (including those received in reinsurance) increased, the volume of gross written premiums at the end of 2019 amounting to 1,624.7 million MDL (Chart 4.1.3).

The annual volume of claims and the amounts of insurance paid by insurance companies increased slightly compared to the volume recorded in 2018, constituting 40.2 percent of the gross insurance premiums written (2018: 36.2 percent).

Chart 4.1.3. Both the volume of premiums written and the volume of claims paid by insurance companies increased in 2019

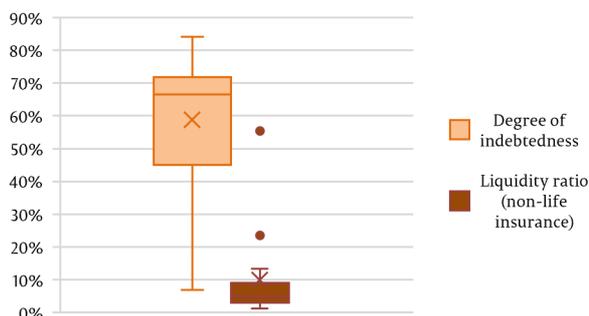


Source: prepared by the NBM based on NCFM information

The indebtedness of insurance companies is on the rise over the last five years, increasing from 51.9 percent (second quarter 2013) to 63.6 percent (fourth quarter 2019).

¹⁸ The Herfindahl-Hirschmann Index (HHI) is calculated as the sum of the squares of the market shares of all market participants, and the concentration level is determined according to the scale: HHI <100 - perfect competition, 100 <HHI <1500 - an unconcentrated market, 1500 <HHI < 2500 - a moderate concentration, HHI > 2500 - a high concentration

Chart 4.1.4. The liquidity ratio of the insurance companies registered a relatively small dispersion, simultaneously with a wider dispersion of the degree of indebtedness



Source: prepared by NBM based on the NCFM data

However, their current level of indebtedness is low, with the paid-up statutory capital of companies representing, on average, 33.4 percent of the volume of assets (minimum value = 5.5 percent).

4.2. Non-bank credit sector

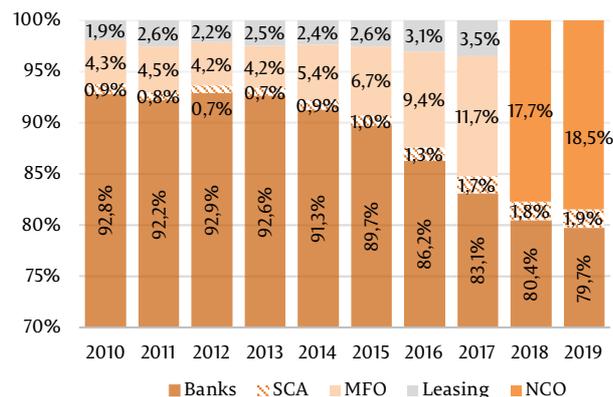
The non-bank credit sector continued to expand in all subcomponents, with an increase in assets and loan portfolios. The risk of over-indebtedness and credit risk related to FX loans remain the main risks of the non-bank credit sector. In order to reduce the risks associated with the activity of the NCO, measures shall be taken to strengthen the supervisory and regulatory framework for this financial segment.

The non-bank credit sector is represented by NCOs and SCAs.

Analyzing the structure of the loan portfolio granted by banks, NCOs and SCAs (Chart 4.2.1), there is an increasing trend of the share of non-banking financial institutions in the financial system, determined in 2019 by an higher increase in their loan portfolio compared to the banks' portfolio.

In total, the loan portfolio of non-bank financial companies constitutes 20.3 percent of the total loan portfolio in the financial sector.

Chart 4.2.1. Share of loan portfolios and loans granted by NCOs and SCAs¹⁹ has increased



Source: prepared by the NBM based on information from the NBM, NCFM and NBS

Savings and Loan Associations (SCAs)

As of 31.12.2019, 238 associations hold licenses to carry out the activity of SCAs. In recent years, the number of associations has decreased by 61 units, continuing to decline (Chart 4.2.2).

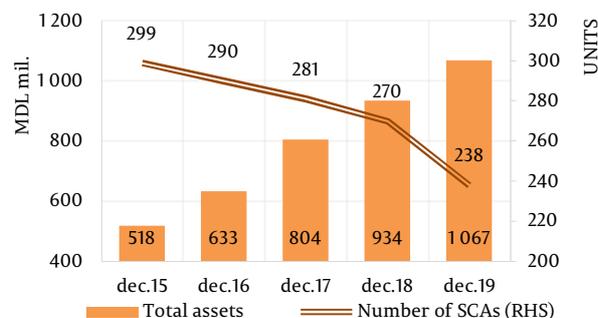
Regarding the level of market concentration, SCAs show relatively low values compared to other representatives of the non-banking financial market.

The HHI concentration index registers low values (31.12.2019 = 378), which characterizes the market as a non-concentrated one.

During 2019, the total number of SCA depositors expanded by 4.8 percent, while the number of members and beneficiaries decreased by 1.3 percent and 4.1 percent respectively.

At the end of 2019, the volume of total SCA assets amounted to MDL 1,067.5 million, registering an increase compared to the end of 2018 (Chart 4.2.2).

Chart 4.2.2. The volume of SCA assets increased, while the number of SCAs decreased



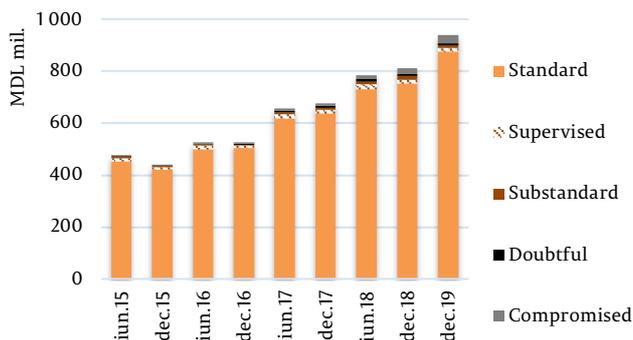
Source: prepared by NBM based on the NCFM data

¹⁹ Share in total loans and borrowings by banks, SCAs and NCOs

The maximum share in the structure of the SCA's assets belongs to the loans granted, these constituting 88.0 percent of the total value of the assets.

The total value of loans granted to SCA members amounted to MDL 939.1 million according to the situation as of 31.12.2019, increasing by 15.9 percent compared to the previous year (Chart 4.2.3).

Chart 4.2.3. The volume of loans granted by SCAs has been increasing and the quality of the portfolio is high

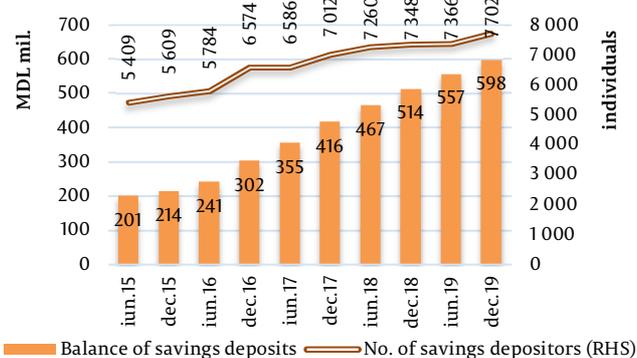


Source: developed by the NBM based on NCFM data

The quality of the SCAs loan portfolio maintains a high level of performance, 94.7 percent of loans being classified in performing categories (2018: 94.5 percent).

SCAs are financed in proportion of 56.1 percent from the savings, 10.8 percent from the loans received, and the share of equity represents 31.0 percent of total liabilities. The consolidated value of savings deposits attracted from SCA members (category B) amounted to MDL 598.4 million.

Chart 4.2.4. The volume of savings deposits attracted by SCAs, as well as the number of depositors continued to increase



Source: developed by the NBM based on NCFM data

The largest share is held by short-term savings deposits, up to one year (57.9 percent of total savings deposits, 2018: 62.8 percent).

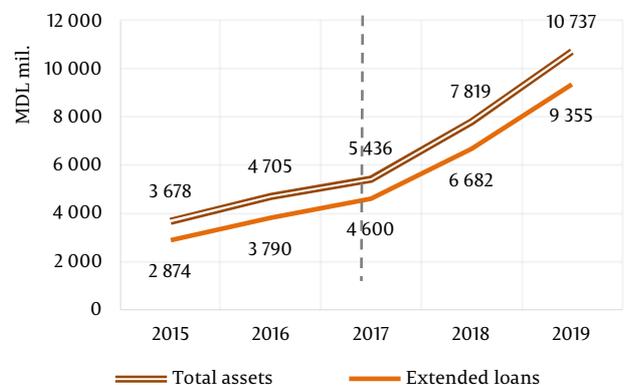
The aggregate value of the SCA leverage marked high values (31.0 percent as of 31.12.2019), and at the individual level there are 3 associations that registered negative values of equity, the rest maintaining a leverage level of over 5 percent.

The activity of the SCA during 2019 had positive evolutions and moderate risks.

Non-bank credit organizations (NCOs)

At the end of the year, 160 NCOs (2018: 176 NCOs) out of 165 registered NCOs submitted their activity reports to the NCFM. The size of the NCOs varies considerably, with the top 10 organizations holding 65.8 percent of total assets, 68.6 percent of total loans, including financial leasing, and 83.7 percent of the total number of debtors. The value of NCOs total assets amounted to MDL 10,737.1 million at the end of the reference year, of which 87.1% represented the loan portfolio (Chart 4.2.5).

Chart 4.2.5. The value of NCOs assets increased mainly due to the increase in the volume of attracted loans, but also to the increase in equity

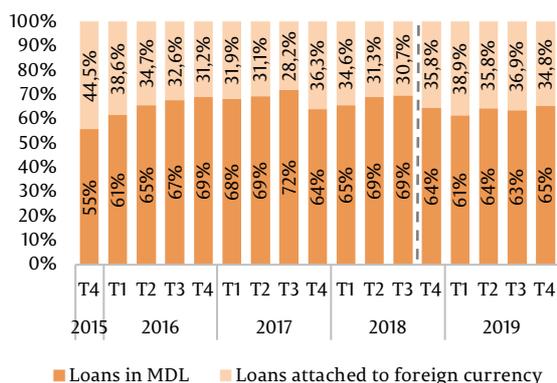


Source: developed by the NBM based on NCFM data

Thus, the value of the loan portfolio amounted to MDL 9,355.1 million. Compared to the similar period of the previous year, the value of the loan portfolio increased by MDL 2,672.9 million (40.0 percent).

According to the information reported by NCOs, currently, about 65 percent of loans are granted in MDL, and 35 percent - attached to foreign currency.

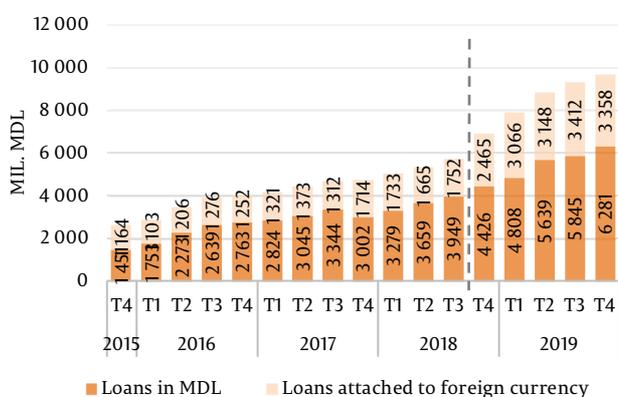
Chart 4.2.6. Although the balance of loans attached to foreign currency has increased significantly, their share remains relatively constant



Source: developed by the NBM based on NCFM data

Loans granted by NCOs attached to foreign currency amounted to MDL 3,357.5 million (34.8 percent of the total value of loans granted by NCOs), increasing compared to previous periods. Loans attached to foreign currency granted to individuals, who are considered to be more sensitive to foreign exchange risk, represent 26.1 percent of the total portfolio.

Chart 4.2.7. More than one third of NCOs loan portfolio is attached to foreign currency

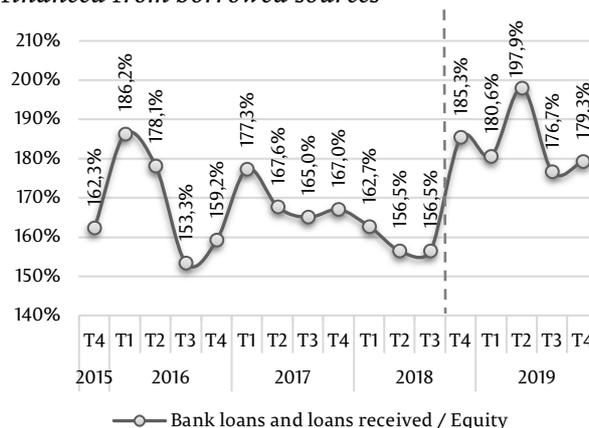


Source: developed by the NBM based on NCFM data

NCOs are financed in proportion of 31.9 percent from own sources (MDL 3,429.2 million), and in proportion of 57.3 percent - from loans and borrowings (MDL 6,147.3 million). The share of equity in the assets remained practically at the same level compared to 2018, both the capital and the volume of assets marking similar growth trends by about 37 percent y.o.y.

Thus, the leverage indicator of NCOs, calculated as equity / total assets ratio, at the end of 2019, was 31.9 percent; however, at the individual level at the end of 2019, 12 organizations reported

Chart 4.2.8. At the aggregate level, NCOs are mainly financed from borrowed sources



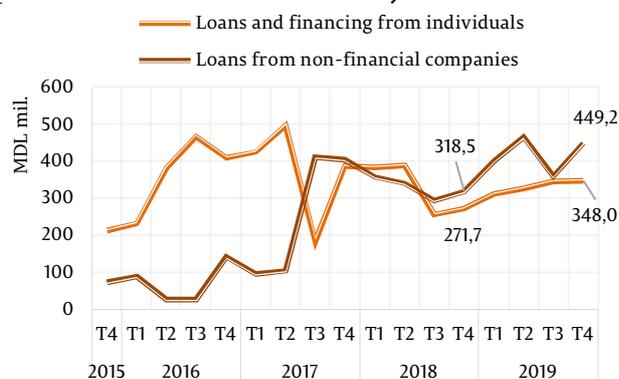
Source: developed by the NBM based on NCFM data

negative equity or low (less than 5 percent) leverage level (2018: 33 NCOs).

Particular attention should be paid to repayable sources, calculated by deducting (i) bank loans, (ii) loans (from non-residents, other financial organizations), (iii) dividend debt, (iv) trade credit, and advances, (v) provisions for loan losses and (vi) equity from NCOs' liabilities. Thus, we obtain, broadly speaking, the value of the obligations towards natural persons and non-financial companies, attracted by the NCOs, which can be characterized as loans or other repayable means.

The total value of repayable loans attracted from individuals and non-financial legal entities, at the end of 2019, amounted to MDL 797 million (of which about MDL 348.0 million were funds attracted from individuals, and MDL 449, 2 million - from non-financial legal entities).

Chart 4.2.9. The value of repayable financing is increasing, at the end of 2019 representing about 11.9 percent of the sources borrowed by NCOs



Source: developed by the NBM based on NCFM data

Rapid developments in the expansion of the non-bank lending sector pose a number of risks:

- The indebtedness of the population and the weakening of its financial situation, with the possibility of impoverishment in the event of a financial crisis and the chaining of financial blockages.
- Credit risk related to FX loans remains a major risk that may increase the exposure of borrowers and, respectively, increase the risk of non-repayment of loans in the event of unfavorable exchange rate fluctuations. Considering that the FX risk affects all the debtors of the financial sector at the same time, the materialization of this risk can have a major systemic character.

It should be noted that during 2019 measures were taken to mitigate the risks related to the non-bank lending sector reported in previous years' reports. Thus, the draft law for amending some legislative acts (approved on 27.02.2020) comes to protect debtors from the risk of over-indebtedness, but also to strengthen the supervisory framework.

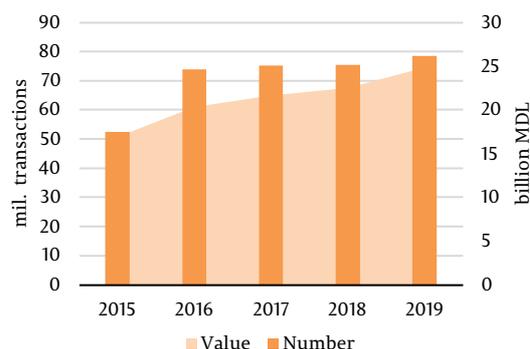
4.3. Non-bank payment service providers

As of 31.12.2019, seven non-bank payment service providers were active in the Republic of Moldova, including one payment company, one postal service provider and five electronic money issuing companies.

The National Bank supervises the activity of non-bank payment service providers by performing offsite and onsite inspections. During 2019, four inspections were carried out, three of which were onsite and one offsite inspection.

During 2019, 78.5 million payment transactions were performed through non-bank payment service providers, 4.0 percent more than in 2018, in the total amount of 24.9 billion MDL, with 10.6 percent more than in 2018.

Chart 4.3.1. The number and value of payments made through non-bank payment service providers is increasing in 2019



Source: NBM

Table 4.3.1. Evolution of the main indicators of the activity of non-bank payment service providers

No.	Financial indicators	31.12. 2018	31.12.2019	Annual dynamics
1	Number of transactions, millions of transactions	75,5	78,5	4,0%
2	Total value of transactions, MDL billion	22,5	24,9	10,6%
3	Total assets, MDL mil.	563,5	558,1	-1,0%
4	Equity, MDL mil.	180,5	215,4	19,3%
5	Net profit (loss), MDL mil.	53,5	73,3	37,0%

Source: NBM

5. PAYMENT SYSTEMS AND SETTLEMENTS OF SYSTEMIC SIGNIFICANCE IN THE RM

In order to maintain financial stability, the National Bank constantly monitors and evaluates the payment and settlement systems in order to guarantee their stability and efficiency.

Systems, an interruption in the activity of which could jeopardize the security and stability of the payment system and / or financial markets, are considered to be of systemic importance. Among the systems that fall under the supervision performed by the NBM, according to its attributions, two systems of systemic importance have been designated (Chart 5.1).

Chart 5.1. Systems of systemic importance that fall under the supervision of the NBM, at the end of 2019

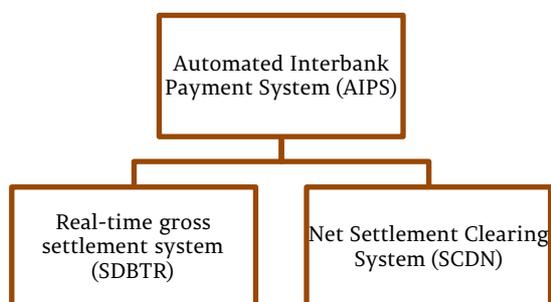
Automated interbank payment system	The single central securities depository system
<ul style="list-style-type: none"> system through which interbank payments are made in MDL on the territory of the Republic of Moldova, administered by the NBM 	<ul style="list-style-type: none"> securities settlement system, administered by "UNIQUE CENTRAL DEPOSITORY OF SECURITIES" S.A.

Source: NBM

5.1. Automated interbank payment system

During 2019, the system proved reliable, the availability of the system for participants amounting to 99.9 percent, operating on the technical platform operated by the NBM.

Chart 5.1.1. AIPS has been operational since 2006 and consists of 2 subsystems



Source: NBM

The potential for liquidity risk remains low, taking into account that during the analyzed period only two situations of blocking payments were recorded in the queues due to insufficient funds in the participants' accounts.

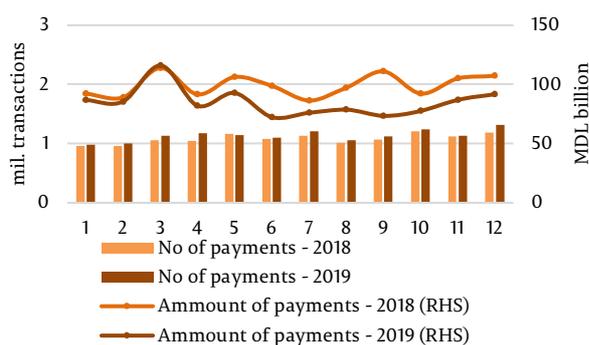
In order to manage the liquidity risk within AIPS, the National Bank grants to the banks intraday loans in the form of overdraft to the settlement account and overnight loans. During 2019, 12 applications for overnight credit were registered.

At the end of 2019, 17 participants were registered in AIPS, similar to the end of 2018.

The concentration²⁰ rate among participants has increased by 75,3 percent, compared to 74,6 percent registered in 2018.

In 2019, a total volume of 13.6 million transactions worth MDL 1.0 trillion was processed through AIPS, increasing in number by 4.7 percent and decreasing in value by 14.5 percent. compared to 2018. The decrease in the value of payments in AIPS was determined by the decrease in the value of payments initiated by participants in their own name and on their own account (overnight and monetary policy operations).

Chart 5.1.2. The value and number of payments processed under AIPS fluctuated during the period considered



Source: NBM

The maximum volume of payments settled in one day in AIPS was 98.9 thousand payments in 2019, there have been no difficulties regarding the processing capacity of the system.

²⁰ Calculated as the sum of the five largest individual participation quotas from the perspective of the value of payment orders settled.

Comparing the total value settled through the RTGS system in 2019 and the annual GDP of the Republic of Moldova (MDL 210,099.0 million), it is found that in the RTGS system the equivalent of the annual GDP in approximately 56 operational days is settled. This indicator reveals the importance of the RTGS system in the financial system of the Republic of Moldova. At Eurosystem level, real-time gross settlement system - Target2 processes a volume comparable to the annual GDP of the euro area in less than seven operational days.

During 2019, there were delayed connections and disconnections of system participants during the operational day, due to technical problems within their internal computer system, but which did not affect the critical processes in AIPS and other participants.

5.2 The single central depository of securities system

During 2019, the SCD system operated optimally from an operational point of view, the availability rate being 99.83 percent.

The SCD system is based on a modern direct processing technology, being connected to IAPS and offers an efficient infrastructure and services for the settlement of securities transactions and the registration of property rights over securities.

At the end of 2019, 240.4 million SS and CNB securities were registered in the SCD system at a nominal value of MDL 28.9 billion.

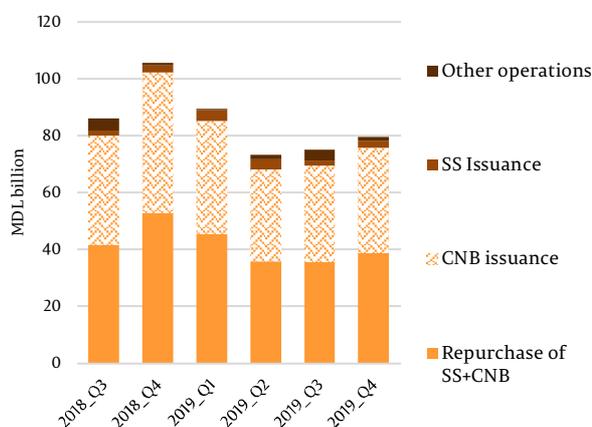
At the same time, at the end of the reference period, 290.6 million corporate securities in the total value of MDL 5.6 billion were registered in the SCD system.

During 2019, 6,382 transfer orders worth MDL 315.6 billion were settled in the SCD system. From May 2019, within the SCD system, transactions on the corporate securities market began to be settled, such as: stock exchange transactions, OTC transactions.

At the end of 2019, 20 participants were registered in the SCD system, with 7 more compared to the end of 2018.

In accordance with *Law no. 234/2016 on the Single Central Depository of Securities*, during 2019, the registry companies and issuers that kept the register of holders of securities independently submitted to SCD, until May 1, 2019, the registers of holders of securities of banks and insurance companies. The registers of the holders of securities of the entities admitted for trading on the regulated market and within a multilateral trading system, other than banks and insurance companies, were sent to SCD until December 15, 2019.

Chart 5.2.1. Value of securities transactions settled under the SCD system



Source: NBM

6. RECENT DEVELOPMENTS AND PERSPECTIVES

6.1. Regulations with implications for financial stability

The year 2019 was marked by multiple changes in the legislative and normative framework related to the financial system.

During 2019, in order to apply the provisions of Law no. 202/2017 on the activity of banks, the NBM:

- Approved the *Regulation on large exposures* which transposes the provisions of the European Framework. The Regulation sets out requirements for calculating the exposure value, maximum permissible limits on the risk of concentrating the bank's exposures to a related client or group of clients, concentrations in the exposure portfolio, and requirements for monitoring, managing and reporting large exposures.

The provisions of the regulation help to limit the concentration of credit risk and therefore to minimize the maximum losses that a bank could incur if the related counterparty or group of customers could encounter difficulties in meeting the obligations as a debtor.

- Amended the *Regulation on transactions of the bank with its affiliates*. The proposed changes and adjustments focused in particular on the following issues:

- bringing in line the terms and provisions in the context of Law no. 202/2017 and the Regulation on large exposures;

- improving the process of presuming certain persons as affiliated with the bank;

- review and improvement of the characteristics used by the National Bank to identify persons who have relations or carry out transactions with the bank and / or its affiliates, following the supervision practice;

- setting minimum requirements for internal regulations and risk management practices associated with transactions with bank affiliates.

- determination of the value of exposures to affiliates similar to those provided for in the Regulation on large exposures;

- Approved amendments to the *Regulation on the bank's liquidity*, which aimed to change the

method of calculating the liquidity indicator on maturity bands (Principle III), by determining the excess liquidity. As a result, the approval of the Bank's Liquidity Regulation allowed for adjusted reporting in accordance with the requirements of the legal framework for maintaining an adequate level of liquidity.

- Approved the *Regulation on the licensing of the bank and the bank branch of another state*. The regulation is based on the new provisions of Law no. 202/2017 which impose requirements on access to the activity of banks, including the licensing of banks and the regime of branches of banks in other states.

- Approved amendments to the *list of jurisdictions that do not implement international transparency standards*. The list was completed with 16 jurisdictions. The purpose of the amendments is the non-admission of direct or indirect acquisition / acquisition of holdings in a bank in the Republic of Moldova by persons resident in jurisdictions that do not implement international transparency standards, as well as the non-admission of establishment in the territory of the Republic of Moldova.

The NBM continues the elaboration of normative acts for the execution of Law no. 202/2017 on the activity of banks.

Aligning the banking legislation of the Republic of Moldova with international standards by improving the quantitative and qualitative mechanisms of bank management will contribute to promoting a secure and stable banking sector, increasing transparency, trust and attractiveness of the domestic banking sector for potential investors and creditors of banks, as well as for depositors and customers, in the development of new financial products and services.

Regarding the foreign exchange field, in 2019 the NBM promoted a series of normative acts (including amendments) aimed at improving the legal framework related to the foreign exchange field, in particular regarding some aspects related to the export and import of cash and traveler's checks from / in the Republic of Moldova by banks, as well as on issues related to the activity of foreign exchange units.

· The *Regulation on some aspects related to the export and import of cash and traveler's checks by banks* was approved, which replaces the old normative act, namely the Instruction on the introduction / withdrawal of cash in / from the Republic of Moldova by banks. The regulation aims to improve the normative framework of the NBM related to the export and import of cash from / to the Republic of Moldova by banks, following amendments to Law no. 62/2008 on foreign exchange regulation aimed at liberalizing foreign exchange operations and the National Bank decision and the Customs Service for the separate regulation of matters within the area of competence of each authority related to the export / import of cash by banks.

In 2019, a new *Regulation on the automated interbank payment system (AIPS)* was approved, which includes the general requirements for participation in AIPS, activity within AIPS, risk management related to the system, suspension and termination of activity within AIPS. At the same time, the new regulation allows the participation of non-bank payment service providers (payment companies, electronic money issuers and postal service providers) within AIPS.

In the context of the participation of non-bank payment service providers in AIPS, changes were made to the *Credit Transfer Regulation*, establishing their obligation to assign IBAN codes to users' accounts, reporting requirements for making and / or receiving each international transfer by providing copies of payment messages to the NBM.

In order to connect with the provisions of Law no. 208/2018 for the amendment and completion of some legislative acts and in the context of the implementation of the IT solution for streamlining the licensing, authorization and notification process, a new *Regulation on the activity of non-bank payment service providers* was approved.

In 2019, according to the provisions of Law no. 208/2018, the *Regulation on the lending activity of non-bank payment service providers* was approved according to which the area of activity of non-banking payment service providers has been extended, by allowing loans to be granted to their users, only if those credits are exclusively

related to payment services and only in the case of facilitating the execution of payment services.

In order to improve the regulations for non-bank payment service providers related to the requirements, conditions and restrictions on the acquisition / increase of qualified participations in their share capital, detailing the criteria for evaluating potential acquirers of qualified participations, as well as monitoring shareholder quality, the *Regulation on holdings in non-bank payment service providers* was approved.

The *Regulation on onsite inspections of non-bank payment service providers and the criteria for the application of remedial measures and sanctions* was approved, which contains provisions on informing providers on how to carry out onsite inspections, the rights and obligations of the parties, were also approved, issues related to the reporting of the results of controls, criteria for the application of remedial measures and sanctions.

In order to apply the provisions of art. 50 para. (6) and (7) of Law no. 114/2012 granting the right to the NBM to establish the value of fees for accepting payment cards, as well as the amount of fees for operations involving the use of AIPS, EB Decision no. 180/2019, which established the limits of the commission applied by providers for accepting payments with payment cards intended for the component budgets of the national public budget, as well as the tariffs applied by AIPS participants for payment orders received electronically and involving the use of AIPS.

The main advances made in 2019 in terms of the regulatory framework applicable to the non-bank lending and collective investment sector are: *Regulation on the classification of assets by non-bank lending organizations* (Decision no.60/4 of 16.12.2019), developed to ensure the implementation of Law no. 1/2018 on the NCO and which aims to establish the requirements applied to all entities regarding the establishment of provisions and the criteria for classifying receivables. The provisions of the Regulation apply by the NCOs (registered in the Register of Authorized NCOs) to classify and calculate the amount of provisions to cover losses for supervisory purposes, as well as to establish the allowable volume of deductions for tax purposes on credit risk assets under related contracts.

A conditionality included in the Supplementary Memorandum of Economic and Financial Policies between the IMF and the Republic of Moldova for 2019 is the implementation of express rules on non-bank lending, corresponding to the adoption of the Law amending some legislative acts (especially Law no. 1/2018 on non-bank lending organizations, Law no. 122/2008 on credit history offices, Law no. 202/2013 on credit agreements for consumers, Contravention Code of the Republic of Moldova no. 218/2008 and other laws), which aims to strengthen the financial stability of the non-bank lending sector and promote consumer protection and responsible lending practices in order to reduce the risks of over-indebtedness of the population and bring into line the laws related to the activity of non-bank lending organizations with the provisions of the Law nr.1 / 2018.

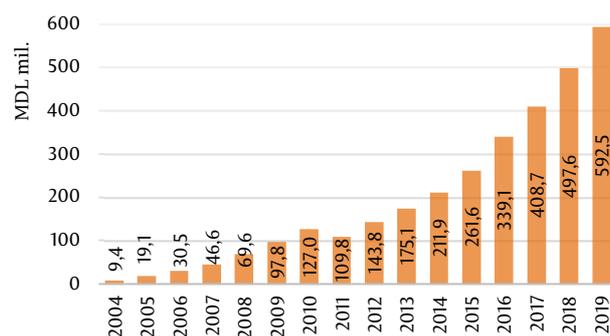
6.2. Banking sector deposits guarantee

In 2019, the available funds of DGFBS continued to consolidate, and the degree of capitalization²¹ of the Fund's resources reached 7.7 percent, thus being above the target level.

On the background of the increase of deposits in the banking sector, the increase of the deposit guarantee ceiling in 2018, as well as the investment activity, the available funds of DGFBS continued to consolidate.

Since the establishment of the Fund (July 1, 2004), financial funds have been accumulated in the total amount of MDL 642.8 million, of which MDL 50.3 million were paid in the period 2011-2018 for the guaranteed deposits following the withdrawal of the activity license of four banks. The Fund's resources were formed in proportion of 61.5 percent from the contributions of the banking sector, and 38.5 percent of the revenues related to the investment activity.

Chart 6.2.1. The available funds of the DGFBS continued to consolidate

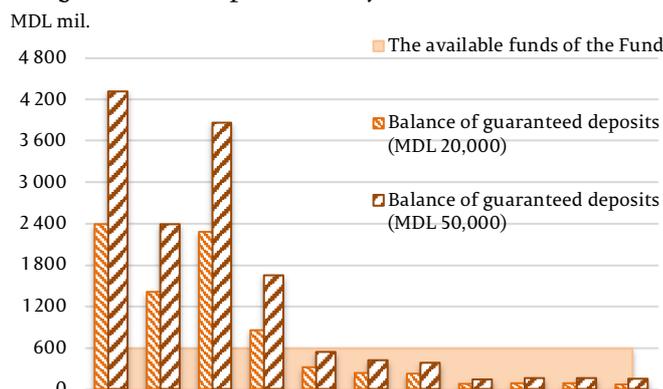


Source: Developed by the NBM based on DGFBS data

At the end of 2019, the available resources of DGFBS amounted to MDL 592.5 million, which represents 7.4 percent of the total guaranteed deposits registered in the banking sector. Considering the guarantee ceiling of MDL 20,000 applicable in 2019, they are sufficient to cover the guaranteed deposits simultaneously with five banks (three small and two medium) or of any bank, except the systemically important banks (Chart 6.2.2).

In 2019, due to the entry into force of legislative changes on the categories of deposits not guaranteed by the Fund, the level of coverage of depositors increased to 99.9 percent (2018: 87.8 percent), while the level of Deposit coverage continues to be low, accounting for 17.5 percent.

Chart 6.2.2. The Fund's resources are sufficient to cover the guaranteed deposits of any medium or small bank



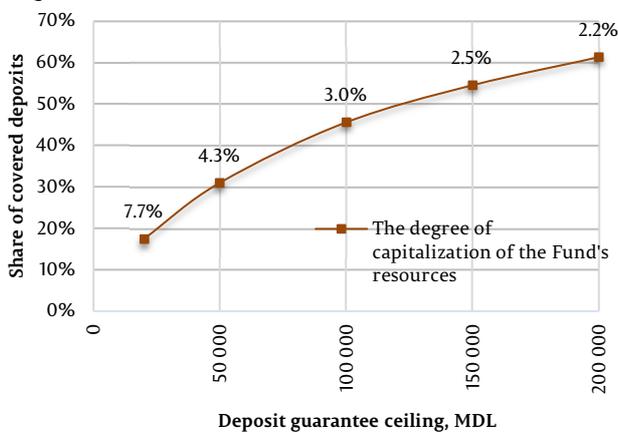
Source: Developed by the NBM based on DGFBS data

²¹ The ratio between the Fund's calculated financial means and the total amount of guaranteed deposits

Also, starting in 2020, a new deposit guarantee ceiling (MDL 50,000) enters into force, which also covers the deposits of legal entities.

According to FGDSB calculations, under a guarantee ceiling of MDL 50,000, the level of coverage of guaranteed deposits of individuals will reach the level of 31.1 percent. At the same time, the degree of capitalization of the Fund's resources will decrease to 4.3 percent of the total guaranteed deposits of individuals in the banking sector (Chart 6.2.3).

Chart 6.2.3. Increasing the guarantee ceiling contributes to increasing the coverage level of deposits, but leads to a decrease in the Fund's ability to meet its obligations

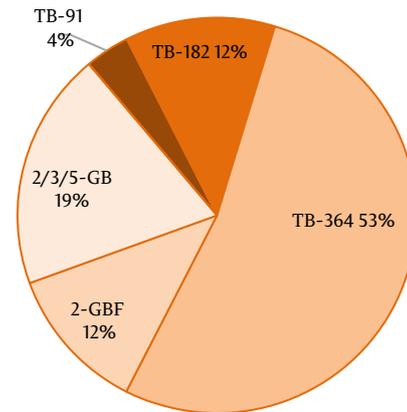


Source: Developed by the NBM based on DGFBS data

In 2019, the investment directions of the available resources of the Fund were changed, following the entry into force of the provision regarding the exclusion of the right to trade CNBs. Thus, the available funds were invested only in securities issued by the Government, mainly (69 percent) in treasury bills with a term of up to one year.

The value of the investment portfolio as of 31.12.2019 recorded MDL 555.6 million, increasing by 39.6 percent compared to the same period of the previous year. The average annual interest rate on investments made during the year was 6.3 percent, registering a slight decrease (-0.14 pp) due to the decrease in annual interest rates on the primary market of SS. The investment activity generated revenues during the year in the amount of MDL 19.2 million (-33.3 percent less than previous year).

Chart 6.2.4. The majority share in the structure of the investment portfolio at the end of 2019 was held by treasury bills with a term of up to one year



Source: DGFBS activity report for 2019

On the background of declining of interest rates related to SS, investments made during 2019 will generate more modest revenues in the next year.

ANNEXES

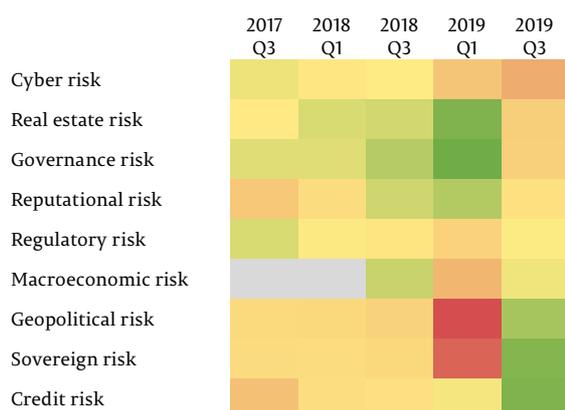
Systemic risk survey²²

According to respondents, the key risks that persist in the financial system are geopolitical risk and sovereign risk.

The probability of occurrence in the next 12 months of an event with a high impact on the system decreased during 2019. Also, in the medium term (1-3 years), the uncertainty regarding the occurrence of an adverse event decreased insignificantly compared to the situation in the previous survey.

At the end of 2019, 91 percent of respondents rated the likelihood of a high-impact event in the next 0-12 months as medium or low (Chart A.1).

Chart A.1. The dynamics show a leveling of the importance of various types of risks, except for the increase in the importance of cyber, real estate and governance risk

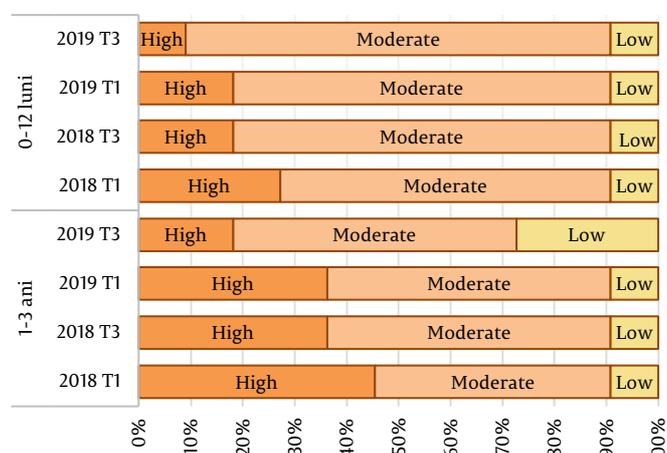


Note: Significance was calculated as the geometric mean of the probability of occurrence, the potential impact and the management capacity.

At the same time, the medium-term probability (1-3 years) shifted further compared to the end of the previous year.

Regarding the main sources of systemic risk, the *political field* and the *real economy* occupied the first position, for which 73 percent of the respondents opted. At the same time, 55 percent of respondents consider the *financial-banking field* as also an imminent source of systemic risk in 2019.

Chart A.2. The probability of occurrence of a high-impact event in the short term (<1 year) decreased, and in the medium term (in the next 1-3 years) decreased insignificantly



Source: NBM, Systemic Risk Survey

Banks rate the *current resilience of the financial system* as moderate (45 percent) and moderately high (45 percent), and in the future, for the next 6 months, respondents anticipate maintaining the current level of soundness.

Table A.1. The risk rating positioned geopolitical risk as the most important risk

	2019	Importance	Probability	Potential impact	Management capacity
Sovereign risk		3.19	2.45	3.91	4.00
Cyber risk		3.09	3.00	3.55	2.91
Macroeconomic risk		3.08	2.82	3.55	3.18
Credit risk		3.03	2.82	3.73	3.00
Regulatory risk		2.99	2.64	3.73	3.00
Geopolitical risk		2.94	2.73	3.27	3.55
Reputational risk		2.65	2.64	2.91	2.73
Governance risk		2.50	2.36	3.45	2.36
Real estate risk		2.49	2.18	2.82	2.73

Note: Significance was calculated as the geometric mean of the probability of occurrence, the potential impact and the management capacity. **Probability:** 1 - insignificant, 2 - low, 3 - medium, 4 - high, 5 - safe. **Potential impact:** 1 - insignificant, 2 - low, 3 - medium, 4 - high, 5 - extremely high. **Management capability:** 1 - very easy, 2 - relatively easy, 3 - relatively difficult, 4 - very difficult, 5 - unmanageable.

Source: NBM, Systemic Risk Survey

²²NBM conducts the Half-Yearly Systemic Risk Survey, in order to capture the opinion of risk managers within banks on major risks, to which the financial system is exposed. The report presents the aggregate results of the survey, based on the situation of September 30, 2019. The survey took place in October 2019, with the participation of 11 banks.