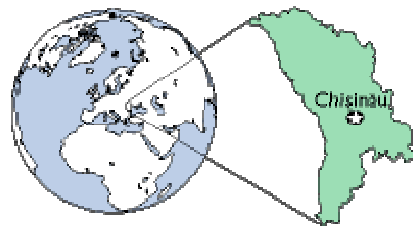


COUNTRY REVIEW

Moldova



4 July 2011

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EULER HERMES COUNTRY RISK GRADE: D

EULER HERMES COUNTRY RISK LEVEL: HIGH

Country Risk Grades are on a scale of AA, A, BB, B, C, D

Country Risk Levels are on a scale of LOW, MEDIUM, SENSITIVE, HIGH

COUNTRY PROFILE

| | |
|---------------------|---|
| Capital city: | Chisinau |
| GDP: | USD 5,810 mn (2010) |
| Population: | 3,564 mn (2010e) |
| GDP per capita: | USD 1,630 (2010e) |
| Currency: | Moldovan leu (MDL) |
| Form of state: | Republic |
| Head of government: | Acting President Marian LUPU (since 30 December 2010) |
| Next elections: | Legislative: 2014, unless Parliament fails to elect a president |

Systemic political risk remains very high, owing to weak democratic institutions, the unresolved status of Transdniestria and difficult relations with Russia. The separatist Transdniestria region in the east of the country has remained under OSCE supervision and is, in practice, relatively lawless. Russian troops, which supported the Slavic majority population in the breakaway region during a brief civil war in 1992, have remained on Moldovan territory despite an agreement for their withdrawal in 1994. Frustrated by Russia's stance on this and a number of other issues, the government has abandoned its former ally and adopted a more Westward-looking stance. However, the lack of genuine political or economic reforms will limit significantly closer ties with the EU in the medium term. Moldova has been in a political stalemate and a constitutional crisis since April 2009 when the then ruling Communist Party (CPM) lost a general election to four opposition parties which formed a new coalition, the Alliance for European Integration (AIE). However, the AIE was short of the three-fifths majority required to secure a president and remained so in two extra-term elections in July 2009 and November 2010, such that four presidential votes in parliament all failed to elect a president as the AIE and the CPM have not been able to compromise on a single candidate.

The economy has severe structural weaknesses, including an almost non-existent industrial base, low investment, a narrow export base focused on agricultural products with Russia and Romania as major destinations, heavy dependence on energy imports, and excessive reliance on workers' remittances which amounted to 31% of GDP in 2008. These elements leave the country highly vulnerable to external shocks. Since 2005, such shocks have occurred several times in the form of temporary Russian trade bans on important Moldovan exports (meat, crops, wine) as well as drastic price increases of gas imports from Russia. As a result, falling export receipts and sharply rising import costs, together with rising import demand fuelled by inflows of remittances, caused a further widening of the trade deficit from 29% of GDP in 2004 to over 50% in 2006-2008 (in 2010 the deficit was about 40%). Accordingly, the current account deficit surged from 2% of GDP in 2004 to a worrisome 16% in 2008 and is forecast to remain double-digit in 2011-2012. Moreover, real GDP growth fell from 7.5% in 2005 to 3% in 2007. After recovering to 7.8% in 2008, growth was hit by another shock, the global economic crisis, which caused a 6% contraction of GDP in 2009. Following the rebound to 6.9% growth in 2010, we expect GDP to expand by a more moderate annual 4-5% in 2011-2012.

Annual average inflation was 7.4% in 2010 and is expected to be a similar level in 2011, as yr/yr inflation was 7% in May. Successive loan agreements with the IMF have helped to mitigate downward pressure on the local currency (the leu), finance Moldova's budgets and support overall foreign exchange reserves. In May 2011, an IMF mission granted preliminary approval of the fourth tranche under Moldova's current three-year arrangement launched in January 2010, commenting that the program was largely on track, although the ceilings on accumulation of domestic arrears and reserve money were missed. In 2010, the fiscal deficit was reduced to 2.5% of GDP and public debt stood at about 30% of GDP. In June 2011, FX reserves stood at USD1.9bn, sufficient to cover around four months of imports, but insufficient to cover all external debt payments falling due within one year. Moreover, workers' remittances inflows which suffered a 40% decline in 2009 in the wake of the global crisis have not yet recovered. Total external debt remains high at around 80% of GDP or 200% of export earnings. The external debt-service ratio has climbed again to about 20%.

The business environment is below average. Areas of particular concern are corruption and legal uncertainty. The banking sector is underdeveloped with a relatively high share of non-performing loans in total loans (13.3% at end-2010).