# The impact of the bank credits on the sustainable development of the real sector in the Republic of Moldova

## *Impactul creditelor bancare asupra dezvoltării durabile a sectorului real în Republica Moldova*

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**Abstract**

*The reformation and consolidation of the credit system is one of the factors that can stimulate national economic growth. In this context, the presentation is emphasizing the problems and proposals referring to the consolidation and sustainable development of the real sector through the bank credits. As well, it remarks the possibilities of decentralization of the national credit system, through the diversification of the types of credit institutions and financial products, both in urban and rural areas that could cover the financial necessities of all branches and spheres of the national economy.*

**Keywords:** *bank credits, real sector, interest rate, sustainable development, bad credits, volume of credits*

**Rezumat**

*Reforma şi consolidarea sistemului de creditare sunt factori ce ar putea stimula creşterea economică naţională. În acest context, articolul dat accentuează problemele şi propunerile referitoare la consolidarea şi dezvoltarea durabilă a sectorului real prin acordarea de credite bancare. Totodată, relevă posibilităţile de descentralizare a sistemului naţional de creditare, prin diversificarea tipurilor de instituţii de creditare, cât şi a produselor financiare acordate, atât în sfera urbană, cât şi în cea rurală, ce ar putea acoperi necesităţile financiare ale tuturor sferelor economiei naţionale.*

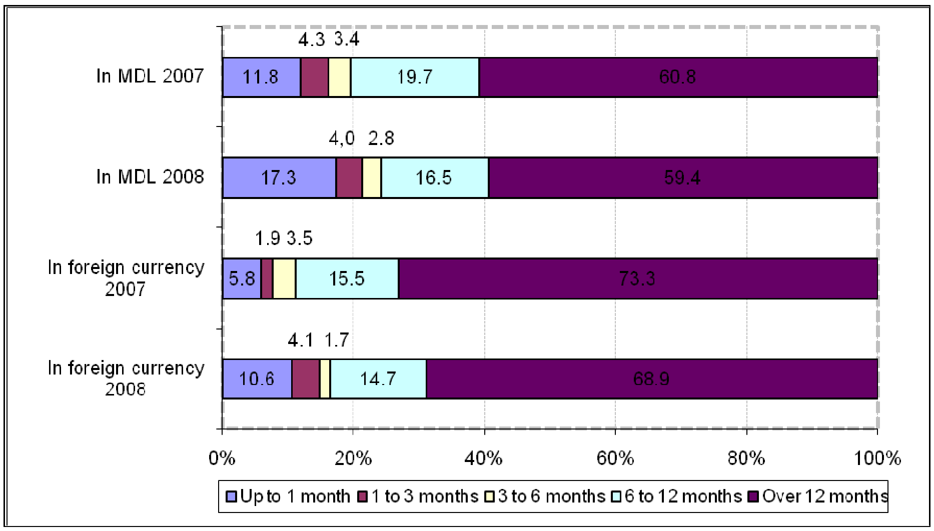
**Cuvinte-cheie:** *credite bancare, sector real, rata dobânzii, dezvoltare durabilă, credite neperformante, volumul creditelor*

**JEL Classification:** E50, O23

Banks exert a fundamental influence on capital allocation and economic growth. Underdeveloped economies with a low level of financial intermediation and small, illiquid financial markets may be unable to channel savings efficiently. In comparison, more bank-oriented countries have experienced considerably higher growth rates. This has lead to the idea that banks, in their lending capacity have an important function in the economy, because in developing countries, the real sector, and not only always requires funds for investment. Therefore, considering to the needs on the market, were created credit instruments that are further used by businesses in their current or long-term affairs. These can be classified according to various criteria: term, collateral and purpose. The most important credits available to businesses in Moldova, according to their term are: long term loans to firms and short term ones, the later include self-liquidating inventory loans, working capital loans and overdraft.

In 2008 the evolution of credits market was determined by an increased demand of credits in the national economy. The total balance of credits extended to economy to 25122.6 million lei at the end of 2008, increasing by 20.3%, or by 4238.8 million lei versus the end of 2007 (according to IMF methodology, out of total credits to economy (including interest calculate don credits) are excluded interbank credits and credits to the Government). However, the volume of credits both in national and in foreign currency has diminished; this can be observed in the following graph.

**Chart 1. Structure and volume of term credits** (%)




Source*: National Bank of Moldova : Statistics (http://bnm.md/md/statistics)*

The volume of credits in national currency increased by 18.0% and equalled to 17127.2 million lei. Within the maturity structure, credits with terms of over 12 months prevailed and recorded an increase by 1341.6 million lei (15.2%), to the level of 10166.2 million lei, which is 59.4% of total credits in national currency extended in 2008. The volume of credits with terms of up to 1 month advanced by 1250.5 million lei (73.0%), and held the weight of 17.3%.

The volume of credits in foreign currency amounted in 2008 to 10684.6 million lei, decreasing by 10.8% versus the previous year. Simultaneously, their equivalent in foreign currency increased by USD 41.9 million (4.2%) and constituted USD 1028.4 million.

At the same time, it should be mentioned that the volume of credits with terms of 6 to 12 months reduced by 29.9 million lei, or by 1.0% and their weight constituted 16.5% in 2008.

The analysis of credits supply from the banking system to the national economy at the end of 2008 reveals that credits extended to industry and trade posted the highest weight, and constitute 12275.2 million lei (48.9% of total at the end of 2008), increasing by 19.9%, or by 2039.3 million lei.

The weight of credits for real estate, construction and development recorded 36.9% (994.7 million lei) versus the end of 2007. Their weight advanced by 1.8 percentage points, and constituted 14.7% of total (table no. 1). As compared to the end of 2007, the weight of consumer credits diminished (by 1.3 percentage points, to the level of 12.9%), despite their 9.9%-increase (293.9 million lei).

**Credits breakdown by branches** (MDL million)

**Table 1**

| | As of 31.12.2007 MDL million | Weight in 2007 (%) | As of 31.12.2008 MDL million | Weight in 2008 (%) | Absolute growth MDL million | Relative growth (%) |
|---|---|---|---|---|---|---|
| Credits to agriculture and food industry | 2918.70 | 14.0 | 3344.52 | 13.3 | 425.8 | 14.6 |
| Credits for real estate, construction and development | 2692.87 | 12.9 | 3687.62 | 14.7 | 994.7 | 36.9 |
| Consumer credits | 2962.21 | 14.2 | 3256.13 | 12.9 | 293.9 | 9.9 |
| Credits to energy and fuel industry | 427.84 | 2.1 | 499.13 | 2.0 | 71.3 | 16.7 |
| Credits to industry/trade | 10235.92 | 49.0 | 12275.23 | 48.9 | 2039.3 | 19.9 |
| Credits for road construction and transportation | 469.43 | 2.2 | 396.70 | 1.6 | -72.7 | -15.5 |
| Other loans | 1176.80 | 5.6 | 1663.24 | 6.6 | 486.4 | 41.3 |
| Total | 20883.77 | 100.0 | 25122.59 | 100.0 | 4238.8 | 20.3 |

*Source: National Bank of Moldova : Statistics (http://bnm.md/md/statistics)*

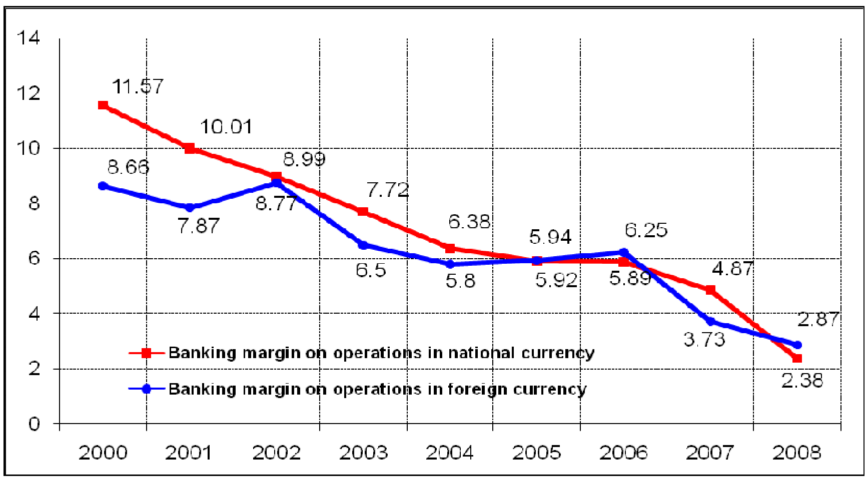
During the year of 2008 the banking margin (the difference between the average interest rate on credits and deposits) continued the descendant trend recorded in the period of 2000-2007. Thus, the banking margin related to operations in national currency diminished by 0.86 percentage points, to the level of 2.87 percentage points, while that related to transactions in foreign currency reduced by 2.49 percentage points, and constituted 2.38 percentage points in 2008 (chart no. 2).

In 2008 the banking margin recorded a more emphasized reduction than its average descendant trend during the previous years. In the period of 2000-2007 the average reduction rate of the banking margin for the operations in national currency 10.0%, while for those in foreign currency –10.2%, in 2008 the banking margin for the operations in national currency diminished by 23.1% and for those in foreign currency – by 51.1%.

The financial sector development can make an important contribution to economic growth and poverty reduction. This is especially likely to be true in developing countries, whose financial sectors are likely to be particularly underdeveloped, and without it, economic development may be constrained, even if other necessary conditions are met.

By increasing the savings rate and the availability of savings for investment, facilitating and encouraging inflows of foreign capital, and optimizing the allocation of capital between competing uses, financial sector development can boost long-run growth through its impact on capital accumulation and on the rate of technological progress.

**Chart 2. Evolution of banking margin on operations in national currency and in foreign currency** (percentage points)




*Source: National Bank of Moldova : Statistics (http://bnm.md/md/statistics)*

Though the scale may be different, access to financial services can reduce poverty through the same channels that affect overall growth: by increasing investment and productivity resulting in greater income generation, and by facilitating risk management thus reducing vulnerability to shocks.

Modern growth theory identifies two specific channels through which the financial sector might affect long-run growth:

1. Through its impact on capital accumulation (including human as well as physical capital) and

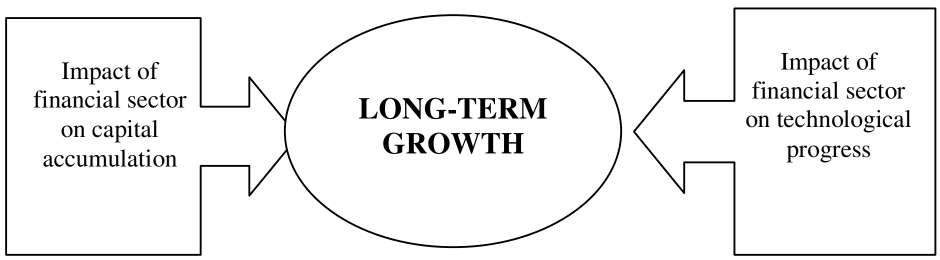
2. through its impact on the rate of technological progress.

These effects arise from the intermediation role provided by financial institutions which enable the financial sector to:

•mobilize savings for investment;

•facilitate and encourage inflows of foreign capital (including FDI, portfolio investment and bonds, and remittances); and

•optimize the allocation of capital between competing uses, ensuring that capital goes to its most productive use.




SAVINGS FOR INVESTMENT
INFLOWS OF FOREIGN CAPITAL
EFFICIENT ALLOCATION OF CAPITAL

**Figure 1. Impact of financial sector on long-term growth**

Finance is at the core of the development process. Efficient, well-functioning financial systems are crucial in channeling funds to the most productive uses and in allocating risks to those who can best bear them, thus boosting economic growth, improving opportunities and income distribution, and reducing poverty. Improving access and building inclusive financial systems is a goal that is relevant to economies at all levels of development. The challenge of better access means making financial services available to all, thereby spreading equality of opportunity and tapping the full potential in an economy. The challenge is greater than ensuring that as many firms as possible have access to basic financial services. It is just as much about enhancing the quality and reach of credit, savings, payments, insurance, and other risk management products in order to facilitate sustained growth and productivity, especially for small and medium-scale enterprises.

Despite the impressive growth of the banking sector in the last years, there seem to be serious impediments for businesses to access financial and credit resources, mainly due to excessive operating costs of banks reflected in high interest margins, and lack of development of other elements of the financial sector, such as leasing, insurance, and capital markets. The Government and the NBM should:

• Postpone the increasing of a deposit insurance scheme until the banking sector is further consolidated and more efficient.

• Enhance the payments system infrastructure, to reduce transaction costs and further de-monetize the financial system.

• Facilitate the functioning of an efficient credit information bureau system to support the development of cash-flow based credit policies and retail banking (this could be facilitated by the further development of a card-based payments system).

• Review the tax framework to remove impediments for leasing

• Improve the access of concerned parties to the pledge database by upgrading the technical parameters of the central register so that it can support faster access by more users (notaries and banks).

Besides, businesses encounter difficulties at other levels as well. Banks should properly consider the specifics of the economy of Moldova and create proper services, which would respond efficiently to the needs of firms. The conditions in Moldova should be made more favourable for SME's in terms of bank loans, as well. Another characteristic of the local banking system is the high cost of loans, which impedes firms to invest and further ensure growth. Banks do not only use price terms, but also inconvenient non-price requirements in making loans to the businesses. This burden can be avoided in the near future if banks can create efficient risk management systems and if competition in the financial sector increases. They should also relate lending costs to the general rates of return in the economy.

It is thus recommended that the real sector should have access to both local and external funding, because foreign banks coming to similar markets have increased competition and provided additional funds. This does not only lead to more attractive funding opportunities and smaller agency costs, but also encourages sustainable projects and contributes to the general growth of the economy. With higher competition on the financial market will appear appropriate products, with longer maturities and less rigid credit requirements.

At the level of banks, some improvements are also in place. First of all, in order to improve efficiency and to decrease losses, banks must invest in sound risk divisions. Only recently have some banks started to work on this aspect, when actually the truth is that banks can decrease the number of non-performing loans and operational risks only with their help. There is a variety of credit risk evaluation and management methods, which should be adopted by banks at different management levels. In addition to credit and operational risks, banks' performance may be affected by changes in interest rates. This particular problem can be solved if banks form adequately their loan portfolio and adopt efficient policies and procedures in case of losses. It is also essential to advise banks to build lasting relationships with important clients and to keep attracting new ones. As long as each investment opportunity is assessed correctly, banks may undertake riskier projects in order to increase their profitability.

Banks should become an essential instrument in the country's growth and should allocate capital in a truly sustainable way. They should also consider the opportunities present on a market like that of the Republic of Moldova, filled with remittances and consumers, and play an important role in the country's development.

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