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## THE INFLUENCE OF THE NATIONAL BANK OF MOLDOVA ON BANKING SECTOR ACTIVITY IN THE CONTEXT OF COVID-19

### INFLUENȚA BĂNCII NAȚIONALE A MOLDOVEI ASUPRA ACTIVITĂȚII SECTORULUI BANCAR ÎN CONTEXTUL DE COVID-19

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**Rezumat.** Pandemia Covid-19 a destabilizat toate sectoarele economice la nivel mondial, fiind o provocare la fel și pentru sectorul bancar, pe care se bazează funcționarea tuturor proceselor economice, respectiv și nivelul de bunăstare a celor sociale. Banca Națională a Moldovei a intervenit cu o politică de suport și stimulare a sectorului bancar, utilizând așa instrumente ca rezervele minime obligatorii, regularea ratei de dobândă, oferirea posibilității unor modificări în contractele de credit entităților ce au suferit de consecințele pandemice. În aceasta lucrare, bazându-ne pe metode de cercetare precum metode general-științifice de cunoaștere, analiză logică, metoda documentară s.a., urmărind scopul general de determinare a influenței autorităților din Republica Moldova asupra sectorului bancar pentru suportul acestuia, considerînd rolul acestui sector ca baza funcționării economice și stabilității țării.

**Cuvinte cheie:** Banca Națională a Moldovei, rezerve obligatorii, rata dobînzilor, sectorul bancar

**JEL CLASSIFICATION:** E4, E5, G2

#### 1. INTRODUCTION

The COVID-19 pandemic has been an unexpected challenge for economics of all around the world, including both developed and developing countries. The lockdown-induced economic downturn, the ensuing anti-crisis measures by governments that launched broad government programs to support the economy, interruptions in global value supply chains, rising of prices, affected all sort of businesses in most countries and initiated many negative aspects which forced the authorities to implement measures regarding supporting of banking sector in order to maintain the economic stability.

All of the above, determined the purpose of this paper, which is to investigate the measures implemented by the National Bank of Moldova for improving banking sector activity and to analyze their positive and negative results.

#### 2. PROPOSED RESEARCH METHODS

Presented in this article investigation was implemented based on such research methods as: *general-scientific methods of cognition, logical analysis*, documentary method, analogy and grouping data method, graphical method, method of synthesis. Analyses are found on the data obtained from

Organization for Economic Co-operation and Development (OECD), National Bank of Moldova (NBM), European Central Bank (ECB) etc.

### **3. THE RESULTS OF RESEARCH**

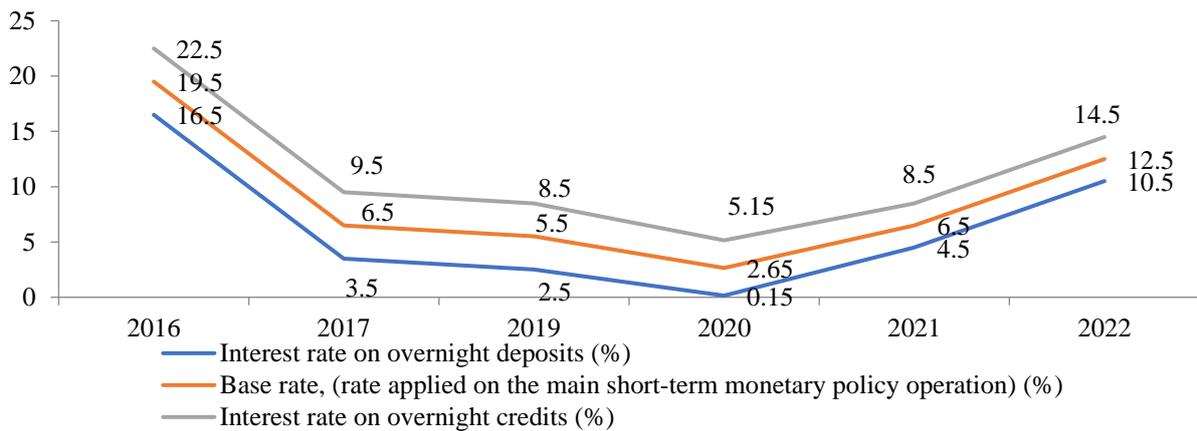
Banking sector faced many crisis during the history. In this regard, in order to minimize the risk of instability and ensure an efficient activity, banking sector has a strictly regulated legal framework, limits and procedures through which it is operating. The main role of the regulator of the banking sector in many countries is assigned to the Central Bank.

An essential factor for the financial sector is resource allocation. The banking sector is activating according to principle of attracting resource as deposits and placing them as credits, receiving profit from the interest rate gap. The problem of the pandemic phenomena was affection of the credit/deposit portfolio of the banks. As a result of lock-down many business domains, such as food industry, tourism, entertainment industry could not continue its activity as it was before. People were losing their jobs and, according to a research made by Federation of American Scientists in April 2020, the unemployment rate reached 14.8% - the highest rate observed since data collection began in 1948 [2]. In this regard, people were not interested in making deposits, indeed, population was focused on collecting savings and planning its finance for the period of lock-down.

The Central Banks for the banking sector regulation, use such financial instruments as obligatory reserves regulation, interest rate regulation, open market operations etc. [1]. The ECB states that the key functions of the minimum reserve system are to stabilise money market interest rates and to enlarge the structural liquidity shortage of the banking system [3]. According to Fisher, the nominal interest rate is directly linked to the inflation rate and a high level of inflation supposes a high level of interest rate [4]. It affects the volume of borrowed money, and respectively, the perspectives of future economic growth.

The COVID-19 pandemic in the Republic of Moldova as well as all around the world, caused decreasing of economic development in all the business sectors, especially it affected HORECA segment. Investigation of the activity of the NBM as a regulator of national banking sector, demonstrates that it uses different financial instruments according to the international experience for adequate support provision.

In particular, the NBM widely uses such an instrument of regulation as interest rates. The high level of base rate at the beginning of analyzed period is explained by the need to reduce the level of inflation, which at the end of 2015 reached 13.4%. However, later, taking into account that the high level of the base interest rate leads to an increase in interest rates on loans issued by licensed banks in Moldova, resulting in an increase in the cost of investment capital, as well as the fact, that the inflation rate by June 2016 decreased to 7.4 %, the NBM began to reduce the base rate, initiating economic activity and growth (Figure 1.)

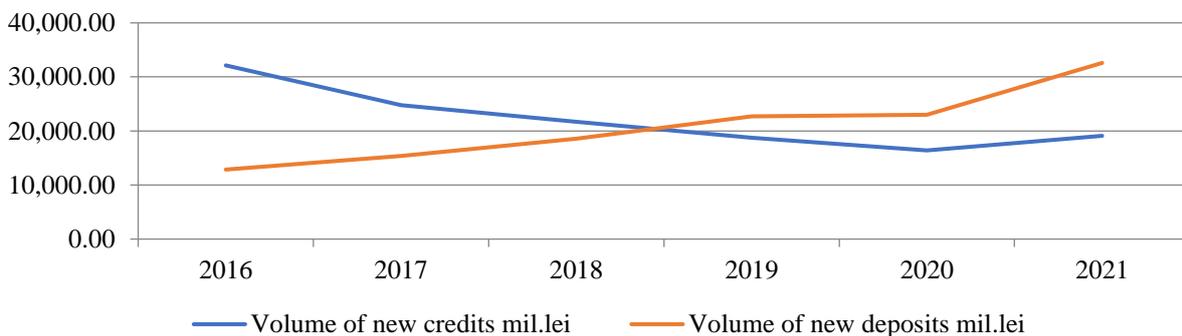


**Figure 1.** Evolution of base rate and overnight credits and deposits rates, 2016-2022, %

Source: elaborated by the author based on [www.bnm.com](http://www.bnm.com)

Starting from the 2020, when appeared the Covid-19 problem, authorities began to encourage banks to alleviate the situation of their borrowers (restructuring their debt, introducing credit holidays, etc.), and continued to help reduce the cost of bank loans by decreasing the base rate, which by January 2021 was reduced to 2.65%. However, later, in the fight against rising inflation, the authorities again began to raise the base rate, which increased to 12.5% in 2022. Simultaneously an unprecedented measure became the reduction of the gap between base rate and overnight deposit/credit rates from 3% to 2%.

The measures taken by the NBM largely affected the volume of deposits attracted by banks. which was about at the same level during 2019-2020 due to low interest rate on bank deposits. In this regard, people were not interested in making deposits, instead, population was focused on collecting savings and planning its finance for the period of lock-down. It is well demonstrated in the figure 2, that only starting from 2021, in the context of an increase in the base rate, it is notices a growth in the volume of deposits. It should also be noted that the additional interest of the population in placing money on deposits was initiated by an increased level of inflation, since income from deposits allows them to reduce inflation negative effects.

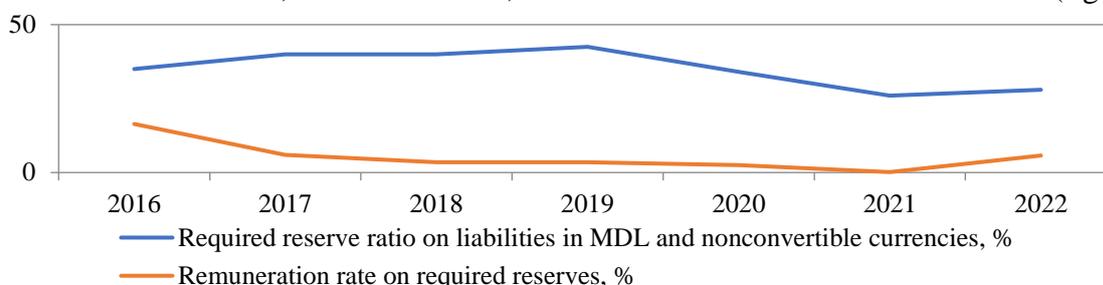


**Figure 2.** Evolution of volume of new deposits and credits, 2016-2022, mil.lei

Source: elaborated by the author based on [www.bnm.com](http://www.bnm.com)

Decreasing of the base rate by BNM made money cheaper for licensed banks and, respectively for their clients – physical persons and economic entities, resulted in increasing of volume of crediting.

Lending activities of licensed banks in the Republic of Moldova were also stimulated by the decrease in the required reserve ratio to 26%, which lasted from mid-2021, freeing up significant financial resources for banks, and the increase in the yield on reserves provided banks with financial support to a large extent. However, inflation growth in 2021 initiated an increase in the required reserve rate in 2022 to 28%, at the same time, the remuneration rate was also increased (figure 3).



**Figure 3.** Dynamic of required reserves and remuneration rate, 2016-2022, %

Source: elaborated by the author based on [www.bnm.com](http://www.bnm.com)

At the same time, the authorities were taking activities for supporting the people via banking sector through implementation of possibilities of contract changes. For example, the executive board of the NBM has approved a decision allowing licensed banks to defer or change the due dates of payments and / or the amounts of payments due by June 30, 2020 to loans to economic agents. The amendment of these deadlines was considered not to have the effect of automatically classifying those appropriations in a tougher category than the one existing at the time of the adoption of this Decision [7]. The decision refers to legal persons whose financial situation has been temporarily affected as a result of the state of emergency and the economic consequences generated by COVID-19.

Also the BNM following international practice and taking into consideration decisions taken by most central banks in the European Union, approved a decision recommending that licensed banks refrain from distributing dividends to shareholders and other forms of capital distribution until at least September 30, 2020 [5]. The conserved capital could be used to absorb any deterioration in the quality of the credit portfolio and to support the financing of the business environment and the population. In this context, banks were encouraged to continue to promote appropriate policies on the recognition and coverage of non-performing exposures and to carry out sound capital and liquidity planning as well as robust risk management.

Simultaneously the banking sector activity was influenced by the increase in the volume of government securities issues from 7914 mil. lei in 2018 to 18168 mil. lei in 2021, growth of external debt to 8.5 bln. dollars, which amounted to 66.1% of national GDP, as well as an increase in the M3 monetary aggregate from 64,643 mln.lei in 2016 to 113,011 mln.lei in 2021.

## CONCLUSIONS AND RECOMMENDATIONS

In the context of the crisis caused by the COVID-19 pandemic, which affected the country's economic situation and taking into account the importance of banks in performing their financial intermediation function, the National Bank of Moldova as regulator of national banking sector, had a significant impact on banking sector activity. The measures implemented by the authorities and instruments used for banking sector stabilization and support of financial and economic stability was based on the best international experience.

In this regard, it was noticed that regulation of the base interest rates in the Republic of Moldova strongly influenced the inflation rate evolution, as well as dynamic of crediting costs, resulted in increase of the volume a number of new credits. Also by decreasing the minimum mandatory reserves the National Bank was trying to support the banks, especially, since 2020. This strategy was aimed on releasing the resources of commercial bank in order to use them for future crediting of economic agents. The positive impact on the economic agents' activity had restructuring of their loan contracts executed by licensed banks in according of NBM recommendations. Banks refrain from distributing dividends and other forms of capital gave commercial banks the opportunity to absorb deterioration in the quality of their credit portfolios and supported the financing the economic agents and the population.

As a recommendation, I would like to suggest that the NBM take an even more responsible approach to making decisions regarding its monetary policy, given the fact that measures that help to reduce inflation can significantly increase the cost of loans, resulting in a decrease in investment activity and in decline in economic growth.

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