THE REPUBLIC OF MOLDOVA FINANCIAL SYSTEM ADJUSTMENT TO THE EUROPEAN MONETARY ORDER

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Abstract: *The aspirations of the Republic of Moldova to become an EU member state send an essential message to both the national economy and the financial system; the accession process will mark the economic and financial developments of the Republic of Moldova. Also, this message reinforces the conclusion that economic - mainly financial - integration must be carefully monitored and managed but not delayed. Such a conclusion confers a severe responsibility on all participants in the Moldovan financial system. As a result, the purpose of the publication is to analyze the financial system of the Republic of Moldova from the perspective of the European monetary order to identify its non-conformities. For this purpose, a three-dimensional matrix is built, correlating the EU criteria regarding the national financial systems with those of the Republic of Moldova. As a result of the analysis, it was highlighted that the ability of the Moldovan financial sector to provide financial services largely depends on the support of financial infrastructure institutions. Therefore, infrastructure institutions are needed, which could, on the one hand, reduce risks and vulnerabilities and, on the other hand, ensure the efficient functioning of the financial system.*
The matrix's design not only elucidated the existing inconsistencies but also enabled the identification of potential solutions. These solutions not only correspond to the EU requirements but also hold promise for the future, instilling a sense of hope about the potential of the Moldovan financial system. This study concludes that although the Moldovan financial system's configuration is essentially in agreement with EU norms, there are still inconsistencies that need to be corrected.

Keywords: *financial system, financial infrastructure, European Monetary Order.*

JEL Classification: *E44, E58, F02.*

INTRODUCTION

In recent decades, the world has known a tendency to strengthen regional economic integration processes. This is largely explained by the growing processes of globalization, in which individual countries strive to combine economic and financial potential within the framework of regional integration. Integration processes cover the entire complex of economic relations, but its financial level has become the object of special interest of economists and politicians of different countries in recent years. The strengthening of globalization processes, which lead, among other things, to global monetary and financial crises, makes it necessary to cooperate with individual groups of countries in the monetary field to strengthen the stability of national financial systems.

Globalization is a multifaceted process: a broader interpretation of the concept of "globalization" affects all areas of international public life, including economic, political, social relations, as well as ecological, security, religious and cultural issues. However, in this study, we will focus on the financial sphere of integration. It should be noted that integration implies the transition of quantitative growth of international flows of capital, goods and labor (internationalization) into a qualitative change of their interaction.

The impetus for the globalization of financial markets was given, first of all, by the rapid development of scientific and technological progress, which made it possible to transmit huge flows of information in the shortest possible time at a relatively low cost (Issing, 2000). Secondly, this is the liberalization of the economy, expressed in the liberalization of trade as a result of the efforts of the GATT/WTO, thanks to which trade barriers have fallen by almost 80% in the last 50 years, as well as the financial liberalization associated with the emergence of a system of exchange rates floating exchange rates and the shift from "organized" systems of solving individual countries' balance of payments deficits through IMF loans to direct borrowing of international liquidity in financial markets. Thus, financial liberalization with the direct participation of the achievements of scientific and technological progress suddenly pushed the development of world financial markets.

Globalization has other, qualitative manifestations, the study of which is necessary for a complete understanding of the trends that appear in the world economy. In particular, the following consequences of the impact of globalization are highlighted: increased global competition, increased dynamism of the world economy, increased instability of the world economy, increased income inequality between countries (Prasad et al, 2003).

THE FINANCIAL SYSTEM OF THE REPUBLIC OF MOLDOVA TRANSITION TO THE EUROPEAN MONETARY ORDER

The most successful example of consistent movement towards economic, monetary and financial integration is the European Union (EU). Integration in Europe began more than half a century ago under the conditions of a rather difficult economic situation in which the European states found themselves after the Second World War. And although the integration processes of European countries have never been without clouds, accompanied by difficulties of both economic and political nature, it must be recognized that, over several decades, European states have accumulated a unique experience of integration, in the process of establishing the European monetary order, the study of which remains one of the most important tasks of economic science.

Immediately after the Second World War, the economies of Western Europe needed to be restored. There were serious problems with inflation, shortages of food, raw materials and energy resources. At the same time, European capital markets were virtually inactive, and many banks significantly reduced operations. All this took place against the background of a severe shortage of "real money" and the growing role of the United States in the international monetary system (Mongelli, 2008).

In these difficult conditions for Europe, integration processes emerged, which after a few decades led the European countries to one of the highest stages of integration – the economic and monetary union.

The evolution of integration in Europe has gone through several stages. The following five stages of the post-war economic development of Western Europe are widely recognized:

1. 1945-1957 - restoration of the economy undermined during the war;
2. 1957-1974 - manifestation of centripetal tendencies in Western European countries;
3. 1974-1985 - the weakening of integration processes under the influence of world economic crises;
4. 1985-1992 - long-term economic recovery, deeper integration, consolidation of Western Europe's position in the world;
5. since 1992 - the deepening of interstate and supranational regulatory activities in the monetary, financial and foreign exchange sphere.

The ECB defines financial integration as the state of the market for a given set of financial instruments and services when all potential participants in such a market (ECB, 2007):

- are governed by a single set of rules in their activities of buying or selling financial instruments or services;
- have equal access to financial instruments and services;
- they have equal working conditions in this market.

At the same time, the concept of market is used here in a broad sense, covering all possible transactions of exchange of financial instruments or services through both organized and unorganized markets.

Regarding the definition of a single set of rules, a clarification can be found in one of Jean-Claude Trichet speeches (since then, this concept has not been deciphered in any other speech of the ECB president): "The term" rules" specified in the ECB's definition of "financial integration" is used in a broad sense and includes legal norms such as laws and regulations, orders of supervisory authorities, market agreements and rules of self-regulatory organizations as well as business standards. and practices related to the financial infrastructure markets". It is quite difficult to assume that all these legal norms will ever be uniform for all EU member countries (and today there are already 27) or at least largely unified or harmonized. Rather, over time, the EU definition of financial integration will be guided by a narrower interpretation of a single set of rules or with some reservations (BIS, 2008). Despite the broad content of a single set of rules and a certain abstractness of the concept of equal working conditions, in general, the official definition of financial integration has its advantages - it exhausts the legal aspects of creating a financial union. Assuming that a European living in Spain could apply for a mortgage from a Greek bank in the same way as a resident of Athens, or buy Finnish government bonds and then sell Al Italia shares, while remaining in his native Madrid , and his working conditions will be exactly the same as they were in Germany, Portugal or any other EU member state, and throughout the EU there is only one set of rules governing these business operations, then in fact it can be argued that a single market with its unique legal infrastructure was created.

In other words, if the conditions specified in the given characteristics of the financial market are met, the EU receives a legally homogeneous financial market where any participant has access to any stock market (NYSE Euronext, Deutsche Börse, etc.), bonds (MTS-Group, Luxembourg SE, etc.), derivatives (NYSE Euronext. liffe, Eurex, etc.), only while you are at your computer, at home or in the office, in the same way as the potential possibility of receiving any loan from any bank throughout the EU.

Changes in the European monetary order began to manifest themselves after the global financial crisis of 2008, when the so-called QE policy was launched, which lasted until 2022. As a result, the Euro system's balance sheet quadrupled in the Low for Long period (Davoine et al., 2024). One of the basic objectives of the Eurozone during this period was to prevent fragmentation, as a result of the various challenges that must be addressed by the EU states (Candelon et al, 2024).

We must note, in this context, that in the financial sector, according to Benoît CŒURÉ, the Basel Committee on Banking Supervision and the Financial Stability Board supported cross-border cooperation (CŒURÉ, 2024).

Low for Long period led to a reduction of the leverage effect and the simplification of the balance sheet structure as a result of the new regulations.

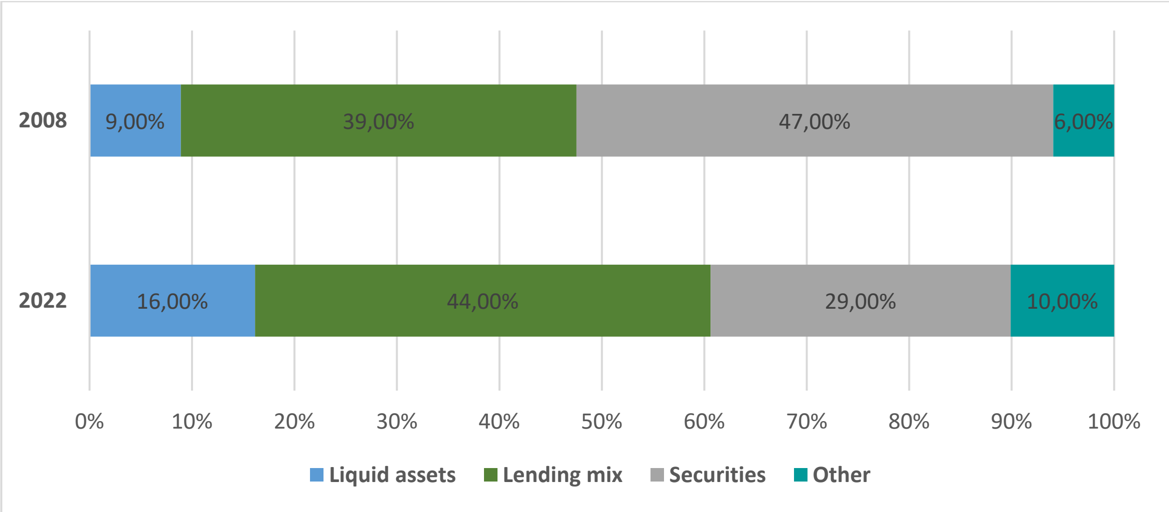

Figure 1. The dynamics of the balance sheet structure of European banks
Source: (Davoine et al, 2024)

And in the Republic of Moldova, the balance sheets registered changes, as a result of the Basel 3 regulations. Thus, the lending mix decreased from 63.91% to 54.29%, but there was also an increase in securities from 7.41% in 2016, to 18.42% in the year 2022. We must mention that almost 18.4% is represented by Debt.

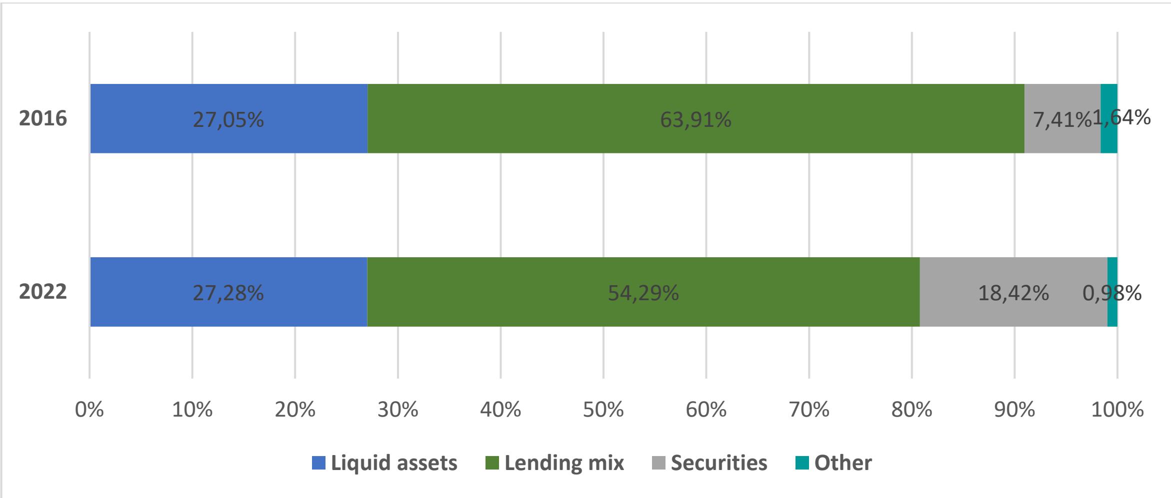

Figure 2. The dynamics of the balance sheet structure of Moldovan banks
Source: (NBM, 2022)

Changes in financial systems following the international financial crisis have had substantial effects on business models for institutions in the European financial system. Thus, the trend of decreasing the share of banks and increasing that of other financial institutions in the European financial system is taking shape.

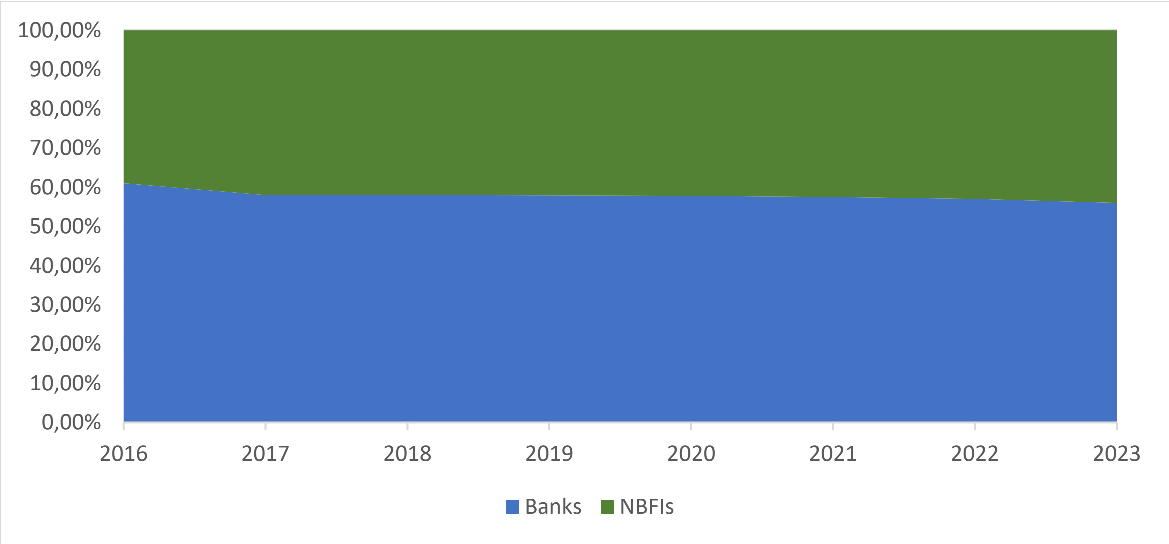

Figure 3. The structure of the European financial system
Source: (Davoine et al, 2024)

And in the financial system of the Republic of Moldova, there is a slow tendency to decrease the share of the assets of the banking system, in total assets of the financial system. However, we must mention that the share of the banking system in the Republic of Moldova remains extremely high, approximately 85%.

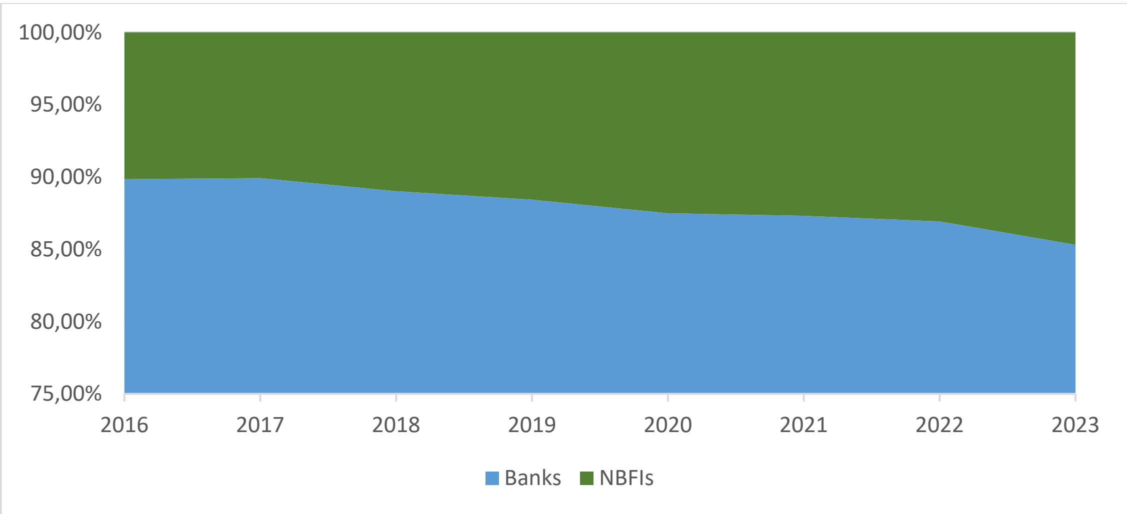

Figure 4. The structure of the Moldovan financial system
Source: (NBM, 2023)

The profound changes made in the world economy require the institutions of the financial system to review their business models. In this context, the need to elucidate the risks of the institutions of the financial system is imposed in order to be able to foresee the challenges and therefore achieve efficiency results.
The table below shows the directions for the transition to the New Monetary Order and proposals for different segments of the financial system, developed by the consulting company Oliver Wyman. At the same time, in the last column I introduced the analysis of the segments of the financial system in the Republic of Moldova, to see how they fit into the New Monetary Order of the EU.

Table 1. Industry-specific issues and calls for action (summary)

	Transition to New Monetary Order	Calls for action UE	The state of the Moldovan financial system
Banks	- Best return on equity (RoE) in years, boosted by NIM increase, with loans repriced faster than deposits and deposits volatility historically low. - NIM expected to quickly return to premise levels, due to competitive pressure and regulatory factors. - Unrealized losses on assets (notably fixed-income assets) held to maturity constraining balance sheet rotation and causing liquidity risk.	- Monitor carefully cost-of-risk, especially for players exposed to more vulnerable business areas (such as leveraged finance). - Reactivate asset-liability management (ALM) capabilities, notably leveraging advanced pricing techniques for deposit steering. - Ensure approaches to the management of interest rate risk in the banking book (IRRBB) allow banks to deliver balance sheet and earnings stability, examine liquidity reserves, and revamp crisis preparedness. - As devalued assets mature, use additional balance sheet capacity for productive lending to the economy, also aiming to regain market share (such as from NBFIs).	In the Republic of Moldova, a very high ROE was also recorded, which was stimulated both by the increase in NIM and by interest rates at debts. In this context, mostly call for action for the EU can also be used in the case of the Republic of Moldova.
Insurers	- Higher liquidity risk, with surge in net inflows in some cases forcing insurers to realize losses. - In the longer term, expected improvement in solvency and profitability. - Business-model sustainability ultimately depends on invested assets to generate positive real returns, which requires real economic growth.	- Work on retention, focusing sales efforts and using reserves to improve competitiveness - Focus on collection to rebalance portfolio, such as with alternative guaranteed policies (short-term, temporary) and with unit-linked policies exposed to higher-yielding assets classes.	For the insurance sector in the Republic of Moldova, it is important to revise the business model from the perspective of sustainability. At the same time, during the last period, a tendency to increase profitability is observed. Thus, the ROE of the insurance sector in 2023 was 19.5%, 11.5 percentage points more than in 2022. ROA was 6.3%, 3.88 percentage points more than in 2022 (NBM, 2023 a). These results were recorded against the background of a modest GDP growth of only 0.7%.

Private equity	- Significant inflows of investor funds in search of yield during the Low for Long period, further boosted by significant return prospects - During the hiking period, uncertain prospects of target and portfolio companies due to uncertain economic outlook, limited deal volume - Due to higher cost of debt, limited availability of leverage negatively impacting valuation of exit transactions - Significant volumes of dry powder available	- As market-driven excess returns have come to an end given the challenging environment, need to refocus target selection and portfolio management processes on value creation - Hone capabilities to invest into companies in need of restructuring due to the current higher interest rate and high uncertainty environment, as these might come with significant upside potential - Establish continuation funds to allow for extending the holding period of well-performing assets or those in need of further patience, while providing liquidity to PE investors	Private equity is almost unnoticed in the financial system of the Republic of Moldova, its assets constituting less than 1%. This is a big problem of the national economy, considering the role of the capital market in financing the economy.

Source: (Davoine et al, 2024)

CONCLUSIONS

As a rule, the periods in which, predominantly, researchers reflect on the monetary order are those related to catastrophic phenomena. Thus, in the last two decades we witnessed a discordant financial crisis whose aftereffects were felt for a long time, but also an unprecedented pandemic crisis.

Discussions regarding a new shaping of the international and respective EU monetary order, in order to return to a "new normal", after the measures taken in response to the outbreak of the subprime financial crisis gained momentum in 2019, both among decision-makers, as well as in academic research circles. Leading central banks have begun strategic reviews, which should have reached a conclusion before the end of 2020. These developments have reflected, on the one hand, advances in theory, empirical evidence and experience in economic policy. The relatively good evolution of financial systems during the pandemic crisis is due, not least, to the international monetary order rebuilt following the subprime financial crisis. On the other hand, new concerns have arisen regarding the development of FinTech and monetary digitization, which likewise require a new supervisory and regulatory framework. However, the Covid-19 pandemic has created a new situation in the international financial monetary system, which has delayed the path to a "new normal" in the international financial architecture. The Italian Presidency of the G20 and the non-profit organization Reinventing Bretton Woods Committee reopened, on 10 May 2021, the debates on the international financial architecture through a virtual platform entitled: "Towards a more resilient international financial architecture".

Under these conditions, the economy of the Republic of Moldova, being a small and open one, is subject to all the processes carried out within the international financial monetary system. The complex phenomena registered in the architecture of the international financial monetary system have repercussions in the functioning of the financial system of the Republic of Moldova. Moreover, good practices from the financial systems of the EU countries are extremely important for the Republic of Moldova in the context of the EU accession process.

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