

## Authors:

- Adrian Lupusor
- Alexandru Fala
- Ana Popa

**Transnistrian Economic Review** is a quarterly publication about the main economic and political developments in the eastern districts of the Republic of Moldova. Its readers are policymakers, CEOs of domestic and international companies and banks, representatives of the international institutions and foreign embassies, political parties and economic journalists who work on both banks of the Nistru River.

**Economic Convergence Indicator (ECI)** measures the closeness between the economy of the Transnistrian region and that on the right bank of the Nistru River. The indicator is computed on the basis of similar economic indicators for both areas. The index encompasses the following parameters: indicators related to the number of the population (volume of investments, agricultural production, export and import of goods, the M3 monetary aggregate), CPI and the real exchange rate MDL/PRB (find more details in Annex A).

## List of acronyms and abbreviations

ECI – Economic Convergence Indicator; y-o-y – year on year; q-o-q – quarter on quarter; m-o-m – month on month; e-o-p – end of period; p.p. – percentage points; Q3:15 – third quarter 2015; Jan:15 – January 2015; NBM – National Bank of Moldova; NBS – National Bureau of Statistics; RB – Republican Bank of the Transnistrian region; MED – Ministry of Economic Development of the Transnistrian region; MDL – Moldovan Leu; PRB – “Transnistrian Ruble”; CPI – Consumer Price Index. DCFTA – The Deep and Comprehensive Free Trade Area.

**EXPERT-GRUP** is a Moldovan independent think-tank whose mission is to create a working environment in which free and non-trivial thinking thrives in order for the institution to be a leading source of unbiased economic analysis and to effectively advocate for innovative ideas and solutions to the economic problems that Moldova encounters along its path of economic transformation, societal development and European integration.

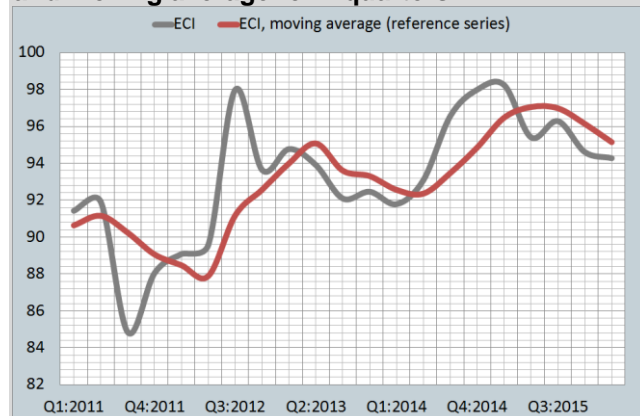
## Contact data:

Republic of Moldova, Chisinau Municipality  
45 Puskin St., 2<sup>nd</sup> floor, MD-2005  
Telephone: +373 22 929 994  
E-mail: [info@expert-grup.org](mailto:info@expert-grup.org)

## Economic Convergence Indicator between the Left and Right Banks of the Nistru River

*The economies on both banks of the Nistru River began to distance themselves from the point of view of their structures.* Thus, starting with Q3:15, when the Economic Convergence Indicator (ECI) reached the highest level of 97%, a divergence process may be noticed. In Q1:16, ECI was 95.1% and decreased by 1.9 p.p. compared to the values recorded in Q3:15.

**Economic Convergence Indicator (ECI), raw data and moving average for 4 quarters**



Source: NBM, NBS, RB, MED, EG estimation

*The main causes of structural divergence between both economies relate to the constraints the Transnistrian companies and population face, whose situation is getting worse at a higher pace compared to the right bank of the Nistru River.* Particularly, the increase of economic uncertainty in the region has reduced the investment activity: in Q1:16 the capital formation decreased by 15% y-o-y (we estimate that on the right bank of the Nistru River the decline was 3 times lower). As for the foreign trade, both economies experiences harsh slumps, although imports dropped more in the Transnistrian region, due to the dramatic reduction of households' incomes.

*While both economies face severe economic and social problems, the Transnistrian economy has virtually no mechanisms of adjustment to economic shocks.* While on the right bank of the Nistru River, the economic shock was, at some extent, cushioned by the floating exchange rate regime (25% depreciation of MDL in 2015), the Transnistrian economic situation was aggravated by administrative fixing of “the exchange rate of the Transnistrian ruble” to the US dollar, and by the less diversified foreign trade. As a result, in 2015, the Transnistrian economy contracted by 20.2%, while the economy on the right bank of the Nistru River - by 0.5%.

*One of the most important decisions that the regional authorities should adopt in 2016 relate to the policy dilemma between depreciating the “Transnistrian ruble”, on the one side, and increasing the restrictions on the circulation of foreign currency, on the other side.* Given that the foreign currency reserves in the region are not enough to cover even one week of imports (about 11-12 million USD), and the demand for foreign currency in the region exceeds several times the supply, maintaining the “Transnistrian ruble exchange rate” fixed against USD becomes impossible without the rise of “black FX market” and major losses for exporters. On the eve of the presidential elections, the authorities may opt for administrative measures (restrictions on foreign currency circulation in the region) rather than economic measures (gradual and controlled depreciation). In this context, we emphasize that administrative measures will not solve the fundamental cause of the problem - low and continuously shrinking competitiveness. Therefore, the right option should be the gradual depreciation of “the ruble”, while improving the business climate, increasing investment in infrastructure and implementing the economic provisions of the EU Association Agreement.

## Disclaimer

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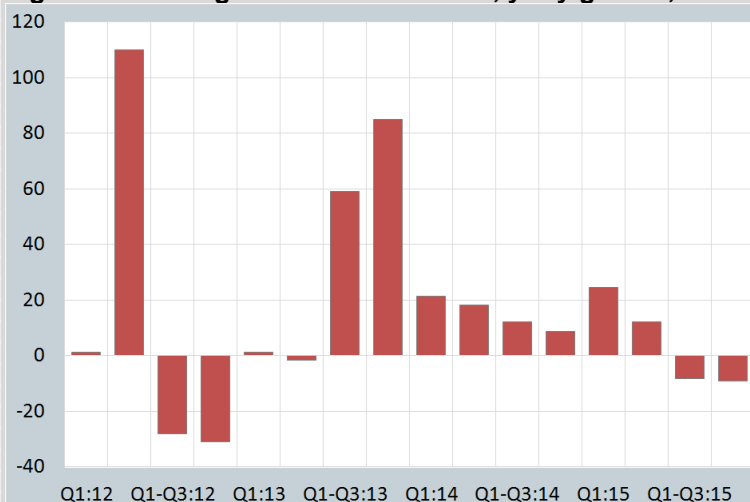
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Resilient nations.*

# ■ Main Economic Trends in the Transnistrian Region

**Figure 1. Total Agricultural Production, y-o-y growth, %**

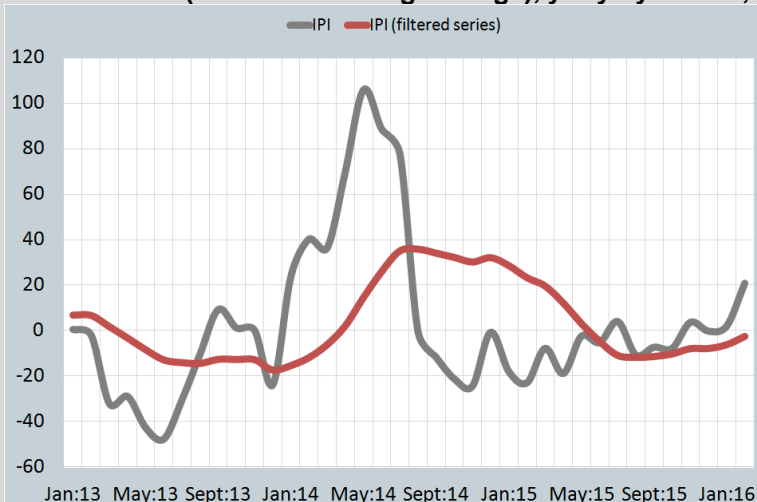


Source: MED

## AGRICULTURE

**After an unfavorable 2015 year, the agricultural sector will resume, with a recovery growth in 2016.** However, due to the drought, more animals were slaughtered in 2015 (by **30.7%** more y-o-y), so that the livestock decreased (especially cattle and poultry). This, in its turn, could affect the production of milk and eggs. However, if the weather conditions are favorable, we expect an increase in crop and livestock production beginning with Q2:16.

**Figure 2. Industrial Production Index (IPI), raw series and filtered series (12-month moving average), y-o-y dynamics, %**

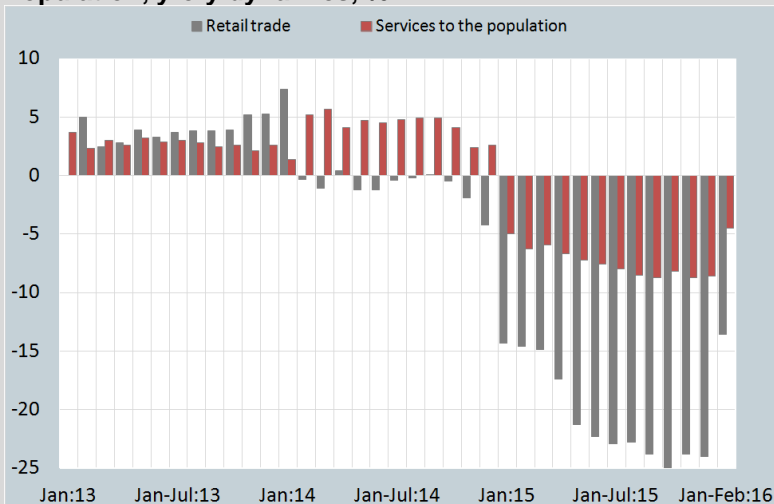


Source: RB. EG estimates

## INDUSTRY

**At the first glance, 2016 started well for the region's industry with an 11.3% growth y-o-y in Jan-Feb:16.** However, the biggest contribution came from the steel industry, which grew by **97.7%**, due to the fact that Rîbnîța metallurgical plant did not operate during the same period of 2015. Only the food and chemical industries grew at a slower pace. At the same time, the energy industry shrank by **2.3%** y-o-y due to lower supplies of energy to the region and to Chisinau.

**Figure 3. Retail Trade and Services Provided to the Population, y-o-y dynamics, %**

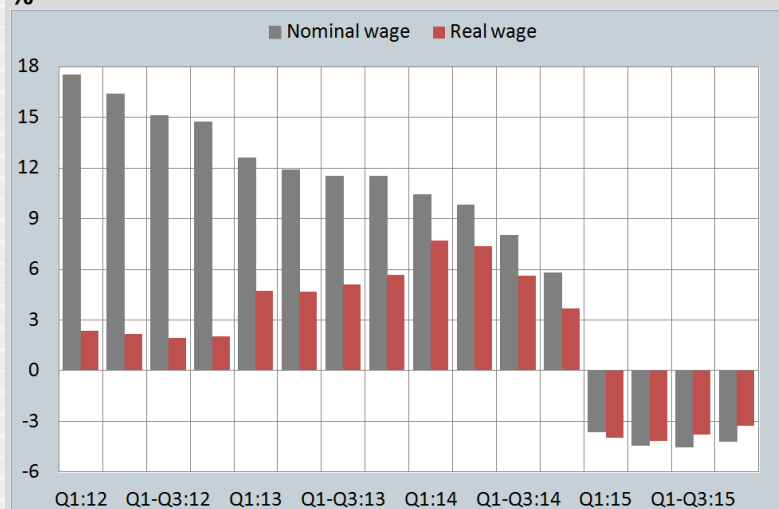


Source: MED

## INTERNAL TRADE IN GOODS AND SERVICES

**The lowest point in the development of foreign trade has been overcome, with the pace of its decline decreasing in the beginning of 2016.** Thus, the turnover in the retail trade went down by **13.6%** y-o-y in Jan-Feb:16, and even less for foodstuffs, which helped improve the situation in the food industry during the given period. Services provided to the population decreased by **4.5%** y-o-y during the same period.

**Figure 4. Average Nominal and Real Wage, y-o-y dynamics, %**

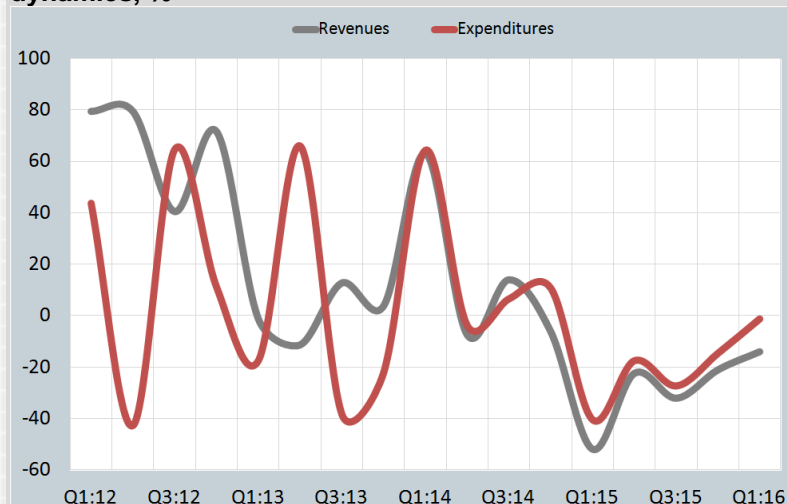


Source: MED, EG calculations

## INCOME OF THE POPULATION

**The salaries in the region continued to decline, decreasing by 2.4% in Jan-Feb:16 y-o-y.** However, the decline is lower than in 2015 and for several activities the wages have grown: communications, computing information systems and some activities from non-productive budgetary sectors. But the lower number of employed persons and increasing salary arrears will continue to affect the incomes of population.

**Figure 5. Central Budget Revenue and Expenses, y-o-y dynamics, %**

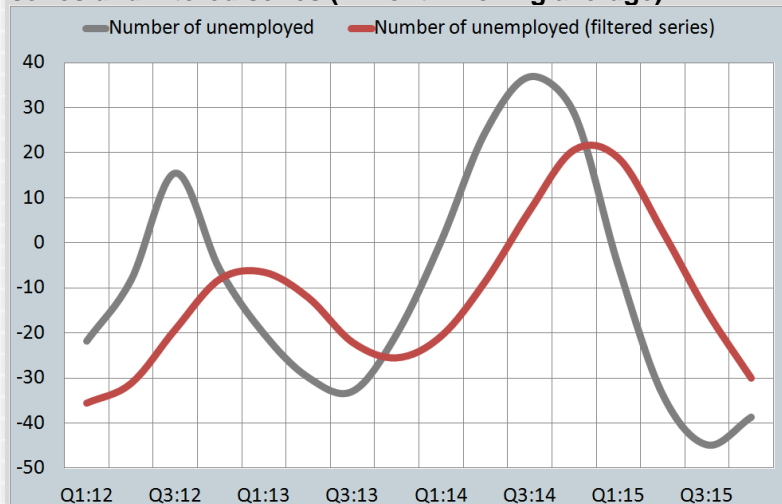


Source: Ministry of Finance

## PUBLIC FINANCE

**The salary and pension arrears accumulated in 2015, and the current economic problems encountered by the region will result in a difficult budgetary year.** The budget collections decreased in Q1:16 by **15.7%** for the national budget, by **8.8%** for the local budgets, and by **6.4%** for the social insurance fund. The amount of taxes and duties collected from the largest taxpayers has also decreased. At the same time, expenses decreased slower and already exceed by **60%** the collected revenue.

**Figure 6. Changes in the Number of the Unemployed, raw series and filtered series (4-month moving average)**

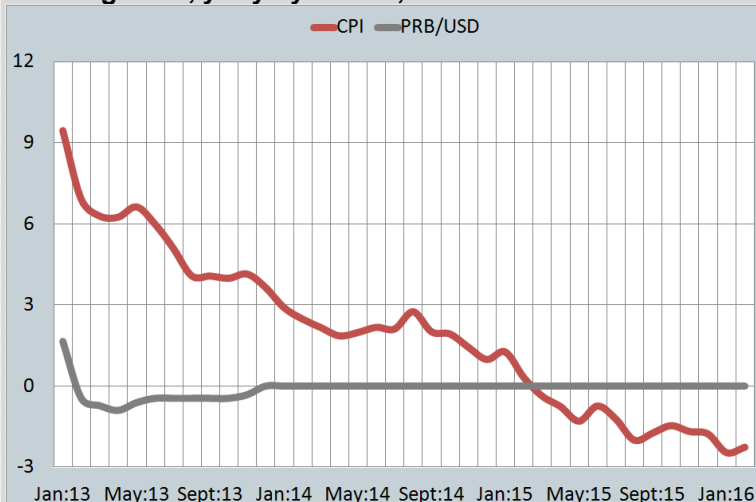


Source: MED, EG calculations

## LABOUR MARKET

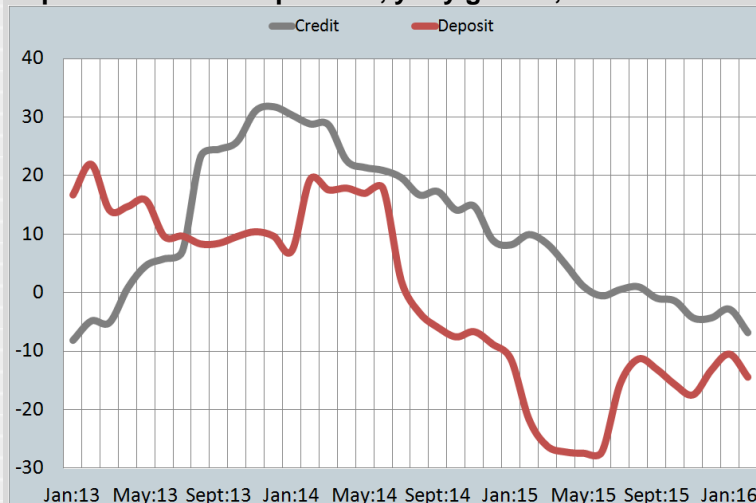
**The negative developments present on the labour market in 2015 seem to continue this year, as well.** Thus, in Jan-Feb:16 the number of jobs shrank by other **2.2%** since the beginning of the year. The decline was more significant in agriculture, constructions and industrial sectors. But even more has reduced the number of man-hours actually worked in industry - by **10.3%** in Jan-Feb:16 y-o-y - indicating deeper problems in some industries and higher technical unemployment.

**Figure 7. Consumer Price Index (CPI) and PRB/USD Exchange rate, y-o-y dynamics, %**



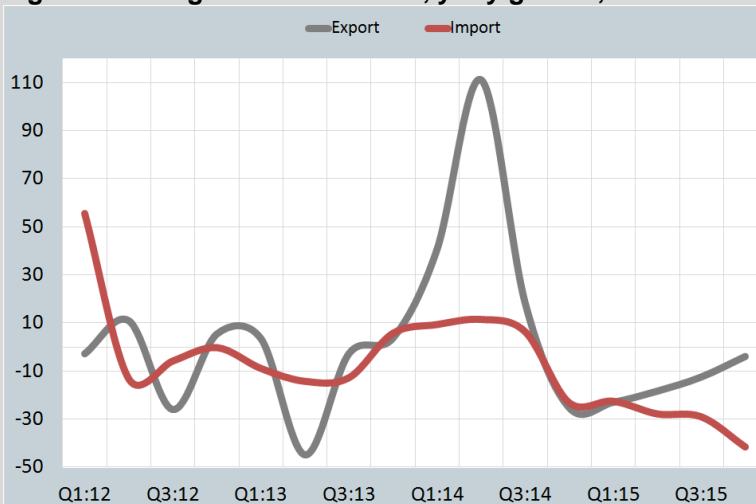
Source: RB

**Figure 8. Loans for the Real Sector and the Population, and Deposits from the Population, y-o-y growth, %**



Source: RB

**Figure 9. Foreign Trade in Goods, y-o-y growth, %**



Source: RB, MED

## PRICES AND “MONETARY POLICY”

*The crisis on the foreign exchange market continued to worsen in 2016.* “The RMN ruble” depreciated by **5.8%** against the EURO and by **10.1%** against the RUR from the beginning of the year. Besides, the region is facing a shortage of foreign currency. After foreign reserves were used for salaries and pensions at the end of 2015, and the so-called central bank participated in the currency auctions, these have dropped to **USD 12.35 million** in March (by **62%** from the beginning of the year).

## BANKING SYSTEM

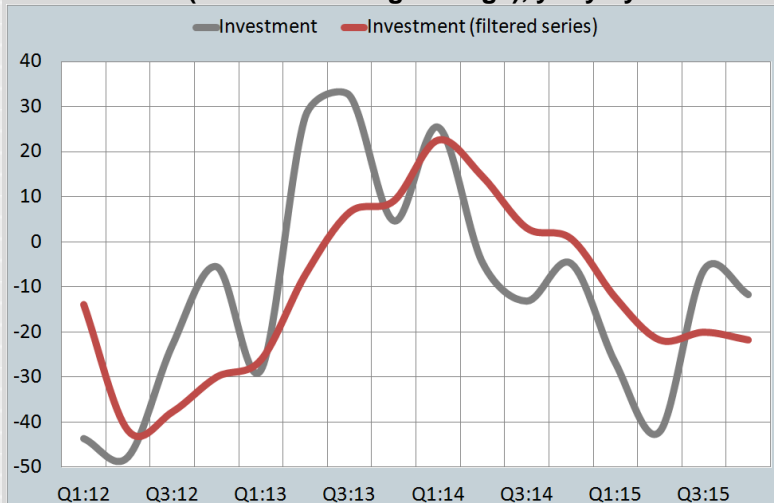
*The activity in the banking system reveals that the crises continues in the region.* Given that people’s incomes are still declining, the individual deposits have also decreased by **12.5%** y-o-y in Jan-Feb:16. The loans granted decreased by **4.8%** in the same period. If in 2015 only loans to natural persons decreased, then in Feb:16 the loans to business sector followed suit, which could put additional pressure on the already very vulnerable real sector.

## FOREIGN TRADE

*In Jan-Feb:16 the exports dropped by 8.7% and import - by 36.8% y-o-y.* Trade with CIS countries was affected the most. At the same time, exports to other destinations grew by **17.3%**, mainly to EU countries, USA and Turkey. This growth is partially covered by resuming the work of Rîbnița Metallurgical Plant. The imports dropped mainly due to the decreasing imports of fossil fuel as a result of lower demand due to the shrinking production.

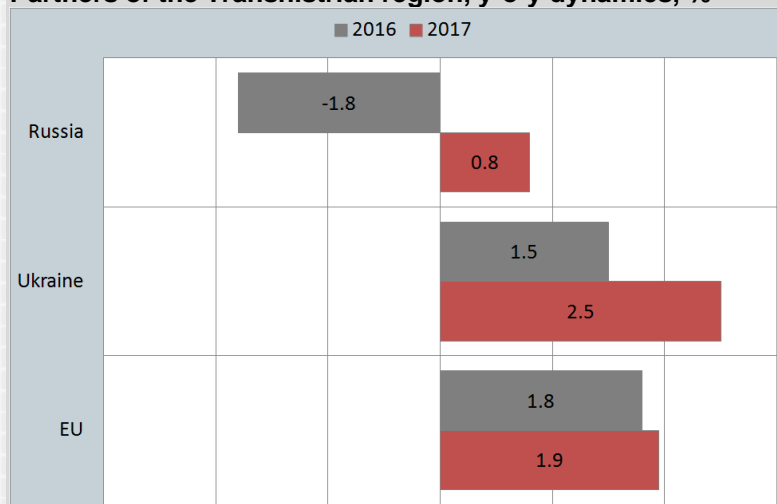


**Figure 10. Investments in Fixed Capital, raw series and filtered series (4-month moving average), y-o-y dynamics**



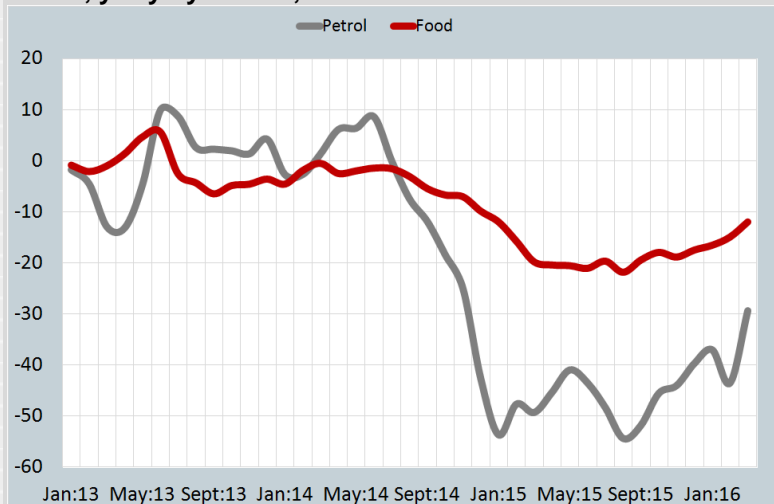
Source: MED, EG estimates

**Figure 11. Economic Growth Forecast and the Main Trade Partners of the Transnistrian region, y-o-y dynamics, %**



Source: IMF

**Figure 12. World Food Price Index and Average Price per Oil Barrel, y-o-y dynamics, %**



Source: IMF, FAO, UN

## INVESTMENT ACTIVITY

**The financial sources for investment will remain scarce in 2016.** First, the private sector is still recovering and needs time to become profitable and resume major investment projects. Under these circumstances, loans become too expensive, which is revealed by the dynamics of banks' lending activity. The budget sector crisis made the 2016 budget socially oriented (approx. 70% of the total expenditures), leaving few resources for investments in economy.

## TRADE PARTNERS

**The situation of the main partners is expected to be less problematic in 2016.** However, the Eastern partners still face major economic problems, and both exports to these destinations, remittances and especially the traditional support provided by Russia to the region may be weaker this year. At the same time, the gradual implementation of DCFTA provisions in the region could foster closer relations with the EU.

## GLOBAL MARKETS

**Preservation of low prices for food products will keep inflation low in 2016, too.** The FAO Food Price Index increased in Mar:16 by 1% m-o-m, largely due to higher global prices for sugar and partially for vegetable oil. The global oil price went up in Feb-Mar:16 to **USD 37.34** per barrel, but this trend could be temporary. Oil production in Russia decreased in Jan:16, and estimations show that this trend still continues.

## ■ Key Policy Developments

Policy Developments	EXPERT-GRUP Comments
<p><b>1 March 2016</b> The foreign-exchange reserves of the region fell to USD 12.35 million and the foreign currency crisis is worsening.</p>	<p>The significant reduction of exports in 2015 and early 2016 and the artificially maintained exchange rate of the "RMN ruble" against the US dollar caused a major shortage of US dollars. After the so-called central bank used a part of the foreign-exchange reserves to pay salaries and pensions at the end of 2015, and participated in several currency auctions in 2016, the foreign exchange reserves fell to USD 12.35 million in Mar:16, a level that does not cover the region's imports for one week (the minimum admissible level is four months of import). This situation has prompted the de facto President to sign on 4 March 2016 a decree on stabilization measures on the foreign exchange market which stipulates, inter alia, the following measures: (i) organize foreign currency auctions by the so-called central bank no more than once a week, (ii) allow businesses to buy foreign currency to make their contractual payments only on the basis of a positive opinion, issued by an interdepartmental commission. But due to lack of foreign currency supply on the market, these measures did not have any effect. Eventually, the decree was repealed following an initiative of the de facto MPs, sent to the regional prosecutor's office. In late March, the de facto president issued another decree obliging the Transnistrian exporters to sell 7% of their foreign exchange earnings. The current situation has a strong impact on businesses, both importers (some of them could not pay for delivery of the ordered goods), manufacturers using imported raw materials, and the exporters, who are already affected by the decreasing exports, and are forced additionally to sell a part of the earned foreign currency at an unfavourable exchange rate.</p>
<p><b>16 March 2016.</b> The "RMN ruble" depreciated against USD for the first time since November 2012.</p>	<p>The worsening crisis on the foreign exchange market and increasing dissatisfaction of business entities, who have requested the depreciation of the "Transnistrian ruble", were followed by some important actions. First, "RMN ruble" depreciated against the US dollar from 11.1 to 11.3, a level which still falls within the currency corridor set for this year (11.0 - 11.3 rubles for 1 USD). The Tiraspol authorities already acknowledge that the exchange rate was maintained artificially, but cannot reach a consensus on gradual depreciation of "the regional currency" to avoid sudden impoverishment of the population, especially in an electoral year. At the same time, due to the shortage of foreign currency in the region, the exchange rate on the black market has reached 16 rubles for 1 USD. Devaluation of the ruble is debated intensely, and the regional bank proposed to establish the corridor from 14 to 16 rubles for 1 US dollar, a level that was not accepted by the "Supreme Soviet", and a compromise corridor of 12.25 - 12.75 rubles for 1 USD is discussed, which requires a further rather rigid policy, and cannot be a long-term solution. This remains one of the basic constraints to the economic recovery of the region.</p>
<p><b>1 April 2016.</b> The price of electricity supplied to Moldova was reduced</p>	<p>After Ukraine cut off the electricity supply to Moldova in November 2014 due to war, in 2015 the Kuchurgan power station delivered approx. 70% of the energy needed on the right bank of the Nistru river. However, in 2016 Ukraine renewed its intention to provide electricity to Moldova, for quite an attractive price. As a result, the price of the energy supplied by Tiraspol was re-</p>

Policy Developments	EXPERT-GRUP Comments
	<p>negotiated and reduced by 28%. Though the price reduction will have a significant impact on the regional economy overall, and the budget revenue and foreign exchange market in particular, the continuation of energy supply to the right bank of the Nistru River remains a lifeline for the Transnistrian region, given that the energy industry is the main industrial branch in the region, accounting for about 50% of the industrial production and exports of the region.</p>
<p><b>5 April 2016.</b> Sheriff Company offered to the de facto government of the Transnistrian region an interest-free loan of USD 26 million to pay the salary arrears.</p>	<p>Sheriff Company's proposal is to provide an interest-free loan of USD 26 millions to pay the arrears of budgetary salaries. Although the executive welcomed the proposal and is reviewing it, there are many aspects yet to be discussed, including (i) reimbursement of the loan until October appears to be impossible, "the government" opting for its repayment by the end of the year, and (ii) repayment of the loan in "RMN ruble" at the exchange rate of the repayment date, which can create additional difficulties, given that maintenance of the exchange rate seems rather unreal. Moreover, the de facto president of the Transnistrian region does not want to take this loan in an electoral year, given that the Sheriff company supports the main political party that is in opposition to him. However, an interest-free loan of 56 million RMN rubles was accepted on 14 April from Sheriff company to pay the pension arrears. But, given the electoral year, this offer also has electoral purposes, especially that the guarantees offered to the company by the state are not mentioned. If, however, the loan is accepted, it will be an unprecedented action that can have significant consequences if a consensus regarding the terms and reimbursement method is not reached (especially on the currency and the exchange rate).</p>
<p><b>12 April 2016.</b> The excise duties on fuel and the import fees on some food products were reduced.</p>	<p>The decree was signed by the de facto president of the Transnistrian region on 8 April 2016, and provides for the reduction of excise duties on fuel imports by 10% and of special taxes on imports for meat, dairy products, fish and bakery products. Initially, it is planned to decrease them over a shorter period, until 1 July 2016, but after examining the effectiveness of the taken measures, this period could be extended. The measures were motivated by their goal to reduce the pressure on "foreign exchange market" and ensure a competitive environment in the region. Even if the demand for fuel may increase as a result of this action, and support certain categories (i.e. farmers), and the low import fees would allow entry of cheaper products into the region, where the regional currency depreciation is inevitable, this could favour primarily certain businesses, which have actually proposed these amendments. Moreover, Agroprombank bank, owned by Sheriff, has offered to provide an interest-free loan of USD 10 million to the republican bank, which has virtually remained without foreign-exchange reserves, provided that the taxes on some food products are reduced. The proposal has not yet been accepted by the regional bank, because the amount is too small to have an impact on "the foreign-exchange market".</p>
<p><b>13 April 2016.</b> The Law on the National Budget and the Law on the Single Fund of state insurance were adopted in the last reading</p>	<p>This year the budget was adopted again with a record deficit, including due to the salary and pension arrears from the previous year. The consolidated budget revenues amount to 3,457 billion of "RMN rubles" (USD 306 million), while the expenses - 4.67 billion of "RMN rubles" (USD 413 million). Approximately 62% of the budget expenditures have a social destination, particularly for</p>



Policy Developments	EXPERT-GRUP Comments
	<p>the payment of pensions and salaries. To cover the planned deficit of 1/3 of revenue, the MPs take into account several sources, including higher accumulation of excise duties and income from privatization, that are unlikely to be collected, given that the foreign trade is declining, and the economic crisis makes the region unattractive to investors. Meanwhile, the humanitarian aid from the Russian Federation is delayed, which requires the authorities to explore other sources of funding. This situation demonstrates the need for tax reforms in the region.</p>

## ■ Annex A: Methodology for calculating the economic convergence indicator

The convergence indicator represents an aggregate indicator that allows for the quantification of the degree of closeness between the economy in the Transnistrian region and that in the right bank of Nistru River. To calculate the indicator, data series that reflect the development of the same economic variables on both banks of Nistru River were used.

The primary information was about the quarterly statistics regarding the development of similar indicators on both banks of Nistru River. The following indicators were used as raw data: volume of investments, agricultural production, export and import of goods, CPI, M3 monetary aggregate stock at the end of the third quarter and the exchange rates PRB/USD and MDL/USD.

To ensure the comparability of data from the two areas, i.e. for the volume of investments, agricultural production, export and import of goods, CPI, M3 monetary aggregate – several iterations were made. The M3 monetary aggregate was represented as the arithmetic mean of stocks at the end of two consecutive quarters. Q1:2010 was taken as the baseline. To eliminate the influence of prices, the indicators were expressed in the values of the baseline; to this end, CPI was taken as deflator. The real growth indices were calculated against Q1:2010 on the basis of the adjusted series. To find the reference variable for every data set, the indicators from Q1:2010 were expressed in USD. To calculate the terms of the set, the values of the indicators from the reference period were multiplied by the real growth indices. The formula hereunder was used for the estimation:

$$X_Q = X_{0,USD} \cdot I_{T/0}$$

where:

$X_Q$  - the value of the variable on the quarter  $Q$ ;

$X_{0,USD}$  - the variable from the reference period (Q1:2010=1, USD exchange rate in Q1:2010);

$I_{Q/0}$  - the real growth index of the variable  $X$

The dynamic line that represented the development of CPI was also turned into a fixed-base chronological series, where Q1:2010=1. To find out what is the nominal MDL/PRB exchange rate, the MDL/USD and PRB/USD rates were cross-multiplied. The real MDL/PRB exchange rate was calculated by multiplying the nominal MDL/PRB exchange rate by the ratio between the CPI in the Transnistrian region and the CPI to the right of Nistru River. Q1:2010 is the reference period for the real exchange rate.

The adjusted series were related to the population on both banks. To eliminate the seasonal effects from the chronological series, 4-quarterly moving averages were calculated.

The index can have values starting with zero and to infinity. The values under 1 indicate that in the region on the left bank of the Nistru River the indicators grow quicker in comparison with the increase registered in the region on the right bank of the river, or that the decrease of economic parameters from the Transnistrian region is smaller in comparison with the decrease in the rest of the country. If the values are above 1 – the situation is the other way around.

The indicator of convergence is calculated on the basis of the index. The value of the indicators shall be found out according to the formula hereunder:

$$\text{Indicatorul de convergență} = 100 - 100 \cdot \sqrt{(\ln \text{Indice})^2}$$

The increase of the indicator means that the economies on both banks of Nistru River come closer. The maximum value that the indicator can have is 100 – which means that convergence was reached.