ERSTE GROUP

Country Report

Republic of Moldova – December 2008

Good economic growth in 2008 driven by private consumption, despite international turmoil

Current account deficit growth to moderate next year

Monetary policy should remain tight until disinflation is firmly re-established

2008 budget deficit prudent approach

Republic of Moldova – attractive business destination for series of investment related facilities

Banking system - good level of liquidity

Country Report

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Basic Data	**Area**	33,843 sq km
	Location	Landlocked country in Eastern Europe, northeast of Romania
	Capital city	Chişinău
	Nationality	Moldovan
	Population	3.4mn, excluding the estimated Transdniestrian population of 580,000
	Ethnic groups	Moldovan (83.7%), Ukrainian (6.6%), Russian (1.7%), Gagauz (4.5%), Bulgarian (1.7%), Romanian (1.4%), other (0.4%)
	Main religions	Christian Orthodox (93.3%), Baptist (1%), others
	Languages	Romanian (officially known as Moldovan), Russian, Ukrainian, Gagauz
	Terrain	Highland predominating the central part, rolling steppe, gradual hilly slopes south to Black Sea
	Climate	Temperate continental, moderate winters, warm summers
	Natural resources	Lignite, phosphorites, gypsum, arable land, limestone
	Agriculture products	Vegetables, fruits, wine, grain, sugar beets, sunflower seed, tobacco, beef, milk
	Industries	Sugar, vegetable oil, food processing, agricultural machinery, foundry equipment, refrigerators and freezers, washing machines, hosiery, shoes, textiles
	Currency	Moldovan leu (MDL)

Macroeconomic indicators

	2006	2007	2008e	2009f
Nominal GDP (local currency, mn)	**44,069**	**51,319**	**57,876**	**65,452**
Population (mn)	**3.6**	**3.6**	**3.4**	**3.4**
GDP per capita (local currency)	**12,241**	**14,255**	**17,022**	**19,250**
Real GDP (growth y/y %)	**4.8**	**3.0**	**5.3**	**4.9**
Private consumption (growth y/y %)	**7.8**	**3.4**	**7.7**	**7.9**
Fixed capital formation (growth y/y %)	**12.2**	**20.3**	**22.4**	**20.7**
Nominal wages (Local currency)	**1,697**	**2,065**	**2,420**	**2,860**
Nominal wages (growth y/y %)	**28.7**	**21.7**	**17.2**	**18.2**
Retail sales (growth y/y %)	**6.9**	**8.0**	**10.0**	**11.7**
Industrial production (growth y/y %)	**-4.8**	**-1.3**	**3.0**	**2.1**
CPI (y/y, average %)	**12.7**	**12.3**	**12.5**	**10.8**
CPI (y/y, year-end %)	**14.1**	**13.1**	**11.1**	**9.8**
Unemployment (BIM, %)	**7.4**	**5.1**	**4.0**	**4.0**
Exports FOB (USD, mn)	**1,052**	**1,342**	**1,650**	**1,890**
Imports CIF (USD, mn)	**2,693**	**3,690**	**4,600**	**5,390**
Trade balance FOB-CIF (% of GDP)	**48.9**	**55.5**	**57.4**	**60.1**
Foreign direct investment (% of GDP)	**6.8**	**10.2**	**16.1**	**9.5**
Current account balance (% of GDP)	**-11.4**	**-15.6**	**-15.3**	**-15.0**
Government budget balance (% of GDP)	**1.2**	**0.3**	**0.5**	**0.5**
Public debt (% of GDP)	**29.6**	**24.2**	**18.1**	**13.0**
Foreign debt to GDP (w/o inter-company lending) -%	**56.5**	**65.4**	**67.5**	**70.5**
Central bank intervention rate, year-end	**14.5**	**16.0**	**17.0**	**15.5**
Short-term interest rate (3-month) average	**11.2**	**15.0**	**17.9**	**17.5**
Short-term interest rate (3-month) year-end	**14.31**	**16.26**	**19.5**	**16.5**
Local currency/USD average	**13.1340**	**12.1362**	**11.2565**	**11.2427**
Local currency/USD year-end	**12.9050**	**11.3192**	**10.8391**	**11.1315**
Local currency/EUR average	**16.4927**	**16.5986**	**15.1963**	**14.6155**
Local currency/EUR year-end	**16.9740**	**16.6437**	**14.6328**	**14.4710**

Source: NIS, NBM, BCR Research

Politics

Political profile	Government structure	- Parliamentary republic - Chief of state: President Vladimir Voronin - Head of government: Prime Minister Vasile Tarlev - Moldova has a unicameral Parliament with 101 seats
	Electoral system	- The president is elected by indirect vote by the members of the Parliament to serve a 4-year term - In Parliament, 101 members are elected by popular vote via proportional representation to serve 4-year terms
	Structure of Parliament	- Communist Party – 56 seats - Democratic Moldova Bloc – 34 seats - Popular Christian Democratic Party – 11 seats

Political scene dominated by pro-Russian Communist Party

The Republic of Moldova has been an independent state since August 27, 1991. Although independent from the USSR, Russian forces remained on Moldovan territory east of the Dniester River, supporting the Slavic majority population (mostly Ukrainians and Russians) who proclaimed a "Transdniestrian" republic. Trans-Dniester unilaterally declared independence from Moldova in 1990. There was fierce fighting there as Trans-Dniester tried to gain independence following the collapse of the USSR and the declaration of Moldovan sovereignty. The violence ended with the introduction of Russian peacekeepers. Trans-Dniester's independence was never recognized. It still houses a stockpile of old Soviet military equipment and a contingent of troops of the Russian 14th army. Withdrawal began under international agreements in 2001, but was halted when the Trans-Dniester authorities blocked the dispatch of weapons. Subsequent agreements to resume the process fell through as relations between Moscow and Chisinau cooled.

The Moldovan Parliament granted autonomous status to the Turkish-language speaking Gagauz region in the southwest of the republic in late 1994. It has powers over its own political, economic and cultural affairs.

The relations between the Republic of Moldova and the European Union are based on a Partnership and Cooperation Agreement from November 28, 1994.

In 2000, the Constitution was reformed by reducing the powers of the president and transforming Moldova into a parliamentary democracy. The first elections to the new Parliament were held in 2001, which gave an outright victory to the Communist Party, which received more than 50% of the votes and 71 out of 101 deputies in the Moldovan Parliament. The head of the Communist Party, Vladimir Voronin, was elected president. In the same elections, the PPCD Party (Popular Christian Democratic Party) and EPP political family members obtained only 8% of the popular vote (11 seats in the Parliament). Parliamentary elections in 2005 were observed by the OSCE/ ODIHR mission and observers from the European Parliament. The Communist Party won with a reduced majority, taking only 56 seats. The PPCD obtained 10 seats and Iurie Rosca, the chairman of the party became vice president of parliament. The Communist leader, Vladimir Voronin, was again elected president.

The recent changes to the electoral laws will trigger specific changes in the Moldovan political landscape. The electoral laws influence the shape of the political system.

The major changes concern the increase in the electoral threshold from 4% to 6%, the prohibition to form pre-electoral blocks, the granting of a certain amount of time for political advertising in the public-owned media and the prohibition of parliamentarians holding dual citizenship.

The increase in the electoral threshold and the banning of the electoral blocks will make the smaller parties rethink their strategies and result in a number of party mergers. Doctrine similarities are not a pre-condition for party mergers. However, there is no guarantee that, after the elections, the new parties will not split again. A recently launched opinion poll showed that only five political parties might enter the future Parliament at present: the Communist Party, Alliance Moldova Noastră, the Liberal Party, the Liberal-Democrats and the Democratic Party. It is highly unlikely that the Christian Democrats, Liberal Party, Moldova Noastră Alliance or Communists will merge with other parties.

Economy

Economic growth up 5.4% in 1H, while private consumption and gross capital formation remained strong

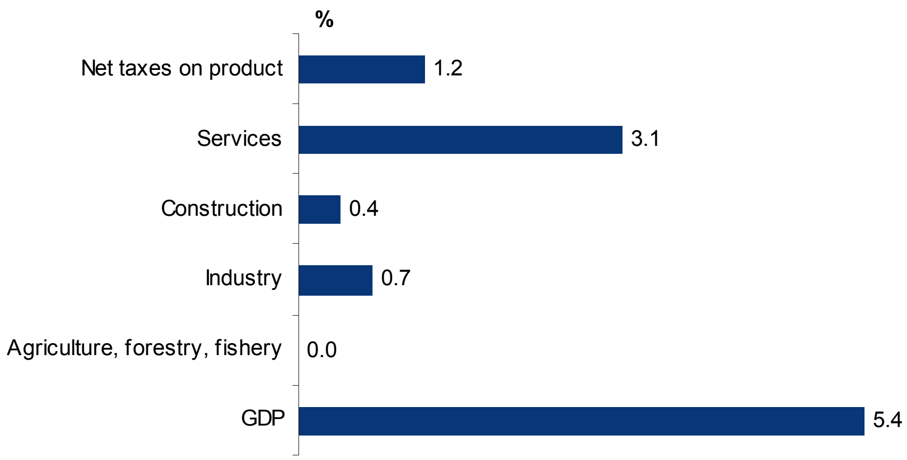
The estimated GDP for the first semester of 2008 amounted to MLD 28,778mn, with current prices increasing in real terms by 5.4% y/y. These figures indicate a rebound in the economic growth, which advanced beyond market expectations. This year, economic growth is expected to reach a sound 5.3%, with risks still coming from the unstable international conditions.

In terms of GDP formation, we have to note the positive contribution of services and industry, which hold a combined share of 71.4% of GDP. The gross value added in the services sector advanced 5.5%, while industry went up by 4.5%, the level seen in the first semester of 2007. The gross value added in construction picked up to 5.5%, while agriculture, forestry and fishery, which hold a substantial share of GDP (26.2%), reduced their activity volume by 0.7%.

Indirect taxes reported a significant increase of net taxes in 1H08 compared to the same year-earlier period (+7.4%).

Analysis of the factors that contributed to the 5.4% growth of GDP reflects the considerable contribution of services (+3.1%) and industry (+0.7%), besides indirect taxes (+1.2%). Despite its significant growth, construction contributed only 0.4%, as a result of its relatively low share in GDP (5.7%).

Contributions of main industries to GDP formation in 1H08



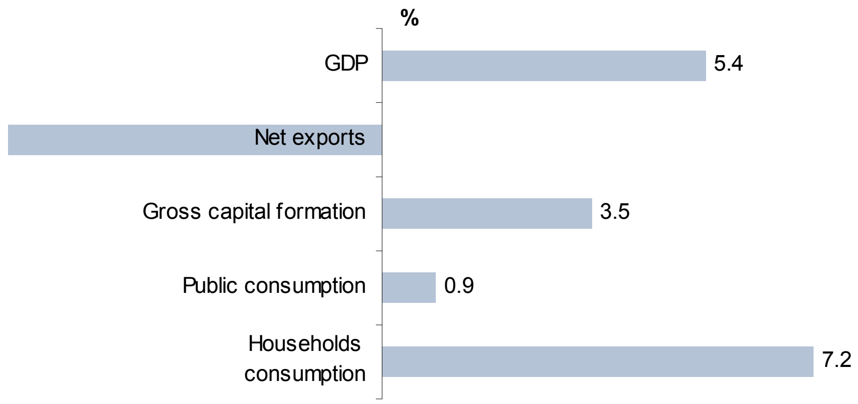
The evolution of the gross domestic product in terms of expenditure shows a significant growth of domestic demand (+6.8%), driven by household consumption (+7.5%) and gross fixed capital formation (+11.9%).

In the first half of 2008, households' actual individual final consumption was positively influenced by the increase in retail trade (+11.5%) and of transportation and communication services (+11.1%).

The evolution of the gross fixed capital formation (+11.9%) in the first half of 2008 was driven by the increase in investments, mainly in equipment (+14.8%).

Foreign trade displayed a mixed picture: imports of goods increased by 3.6%, while exports dropped by 5.7%, deepening net exports' negative contribution to GDP formation.

Contributions of components to GDP growth in 1H08

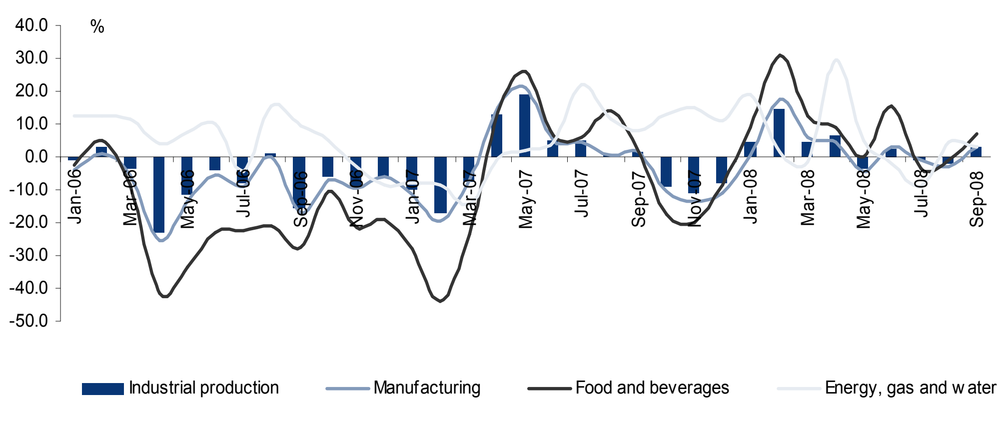


We expect foreign trade to increase its negative contribution to GDP growth, due to the brisk advance of imports in the coming period. These will be boosted by the strong investment demand, a stimulative real effective exchange rate for the local currency and faster consumption compared to domestic production growth capacity.

Unrestructured industry delivers modest results

In the first nine months of 2008, industrial production was up 2.8% y/y, supported by all three industrial sectors: mining and quarrying (+8.6%), manufacturing (+2.2%) and electric and thermal energy, gas and water supply (+6.4%).

Industrial production (y/y development)



The highest growths were registered in the branches with important weights in manufacturing: manufacturing of cement (by 14.4%), manufacturing of alcoholic beverages (by 37.1%), milk products (by 7.4%), steam and hot water supply (by 15.1%), production, processing and preserving of meat and meat products (by 8.4%), manufacture of bread and pastry products (by 9.7%), furniture manufacturing (by 17.5%) and food and beverages (by 7.4%).

At the same time, the impact of the significant growth on the total increase of manufacturing was diminished by falls in other areas such as the manufacture of apparel (by 12.6%), processing and preserving of fruits and vegetables (by 15.3%), manufacture of paper and paperboard (by 22.4%), manufacture of beer (by 18.4%), manufacture of vegetable and animal oils and fats (by 9.9%), manufacture of tobacco products (by 15.6%) and manufacture of glass and glass products (by 8.9%).

A possible boost for industrial production could come in 2008 from the following:

- Favorable weather conditions, which would positively impact agricultural production, particularly in the wine industry and alcoholic beverages. In the first six months of the year, these sectors' growth rates stood at 59% and 43.7%, respectively, but - on average for 2008 - this increase will probably be around 30-40%, without reaching the level seen in 2006. Also, in spite of a modest increase of 2.7% in the first six months in the conservation of fruits and vegetables, a good harvest would allow a recovery of this gap.
- Opening of the wine market and a partial recovery of it by Moldovan producers. This would contribute to an increase in the volume of production and growth in other sectors of industry associated with the production of wine and alcoholic beverage exports.
- The European regional relocation trend seen in the textile industry and manufacture of garments from EU countries towards the East, due to the low costs of human resources. Unfortunately, Moldova has not taken advantage of this movement. In the first five months, this sector recorded a decrease of 10%. This could also be due to the unattractive investment conditions compared with other countries in the region (Ukraine, Belarus).

Labor market

Unemployment rate decrease based on strong rebound in economic activity

The labor market faces several long-term challenges: an insufficient wage increase, the lack of a skilled labor force (according to company demand) and incoherent measures adopted by authorities for improving education quality.

The unemployment rate fell to 3% in June 2008, helped by the rebound of economic activity. The unemployment rate among women was 0.7 percentage points lower than among men (2.7% vs. 3.4%). The unemployment rate for people aged 15-24 years was 7%, but 5% for people aged 15-29 years.

In the first nine months of 2008, the average net wage was MDL 2,458, up 24.7% y/y. In the public sector, the average net wage amounted to MDL 2,325, reaching MDL 3,083 in the real sector.

The highest salaries are in financial intermediation (MDL 5,336), the lowest in fishery with MDL 1,241.

According to an agreement signed with the IMF, the Moldovan authorities plan to cut wage spending in the public sector from 9.5% of GDP in 2007 to 9.4% of GDP in 2008.

Public sector wages are high in an international comparison, particularly in the education sector. The public wage is also above CIS countries' averages: at a projected 9.9% of GDP in 2007, it is 2.4pp higher than in peer countries. The 2008 wage increase, although scaled back, will continue to crowd out essential spending if downsizing is not considered. Public sector wages lag behind the private sector and a poorly designed pay structure creates difficulties in attracting and retaining skilled employees.

Wages by sectors - % of the country average

	2003	2004	2005	2006	2007	8M 2008
Agriculture	55	57	56	53	52	52
Industry	145	138	135	124	124	120
Constructions	139	152	152	144	147	140
Trade	84	91	90	88	98	97
Hotels and restaurants	96	92	90	88	88	85
Transportation and communications	164	163	163	151	147	144
Financial intermediations	328	295	262	228	219	222
Real estate transactions	126	125	127	121	126	128
Public administration	118	109	103	127	116	110
Education	69	64	67	72	65	67
Health and social security	64	76	74	78	82	89

A negative trend has also appeared in agriculture, where the average net wage is the lowest in the country. A lot of workers prefer to migrate to the Baltic states or Russia, where the monthly average salary for a tractor driver is EUR 800-1,000. The labor force decline in agriculture can also be explained by migration to cities, especially to Chisinau. Industry, energy and construction are also important sectors with a negative labor force balance.

Despite the continuous decrease of the unemployment rate from 11.1% in 1999 to 7.4% in 2006 and 5.1% in 2007, the decline can also be explained based on migration to Western Europe, especially for young employees. This trend was sustained by the Work&Travel program promoted by university centers.

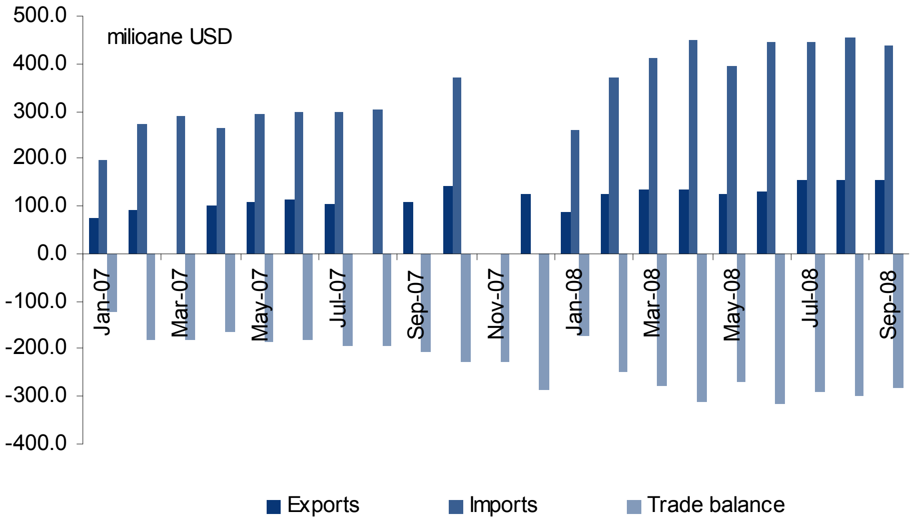
The overall labor supply seems sufficient to facilitate the ongoing labor transformation process, although pension reform might speed up the tightening of the labor market. Efforts should therefore probably focus on mitigating any emerging sectoral labor shortages that might occur, possibly by attracting non-resident workers and ensuring cross-sectoral labor flexibility.

Foreign trade

Foreign trade balance continued decline in recent years

In the first nine months of 2008, exports reached USD 1,203.3mn, up 30.4% y/y. However, this considerable increase is overshadowed by import indicators. The total value of imported goods amounted to USD 3.67bn, up 45.1% vs. the first nine months of 2007. The Moldovan economy has broken another negative record. Within the last nine months, the negative balance of trade amounted to USD 2.5bn, which is 53.6% higher y/y. For the year-end, we expect Moldova's trade deficit to exceed the psychologically important barrier of USD 2.8bn for the first time.

Exports, imports and trade deficit – monthly evolution

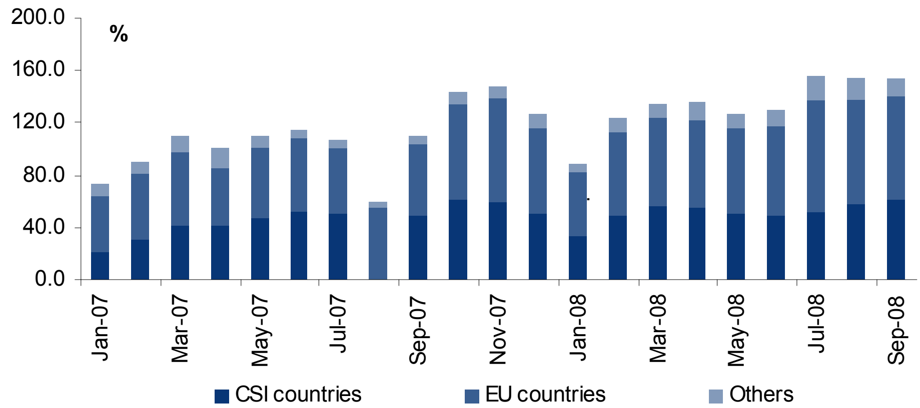


After January 2007, the European Union became the main market for Moldovan products. Within the first nine months of the year, more than half of Moldova's total exports were oriented to European countries. Despite the long-awaited autonomous trade preference regime granted by the EU for exports of Moldovan production adopted in March 2008, the EU 27 member states have had about the same share in the structure of Moldovan exports as in the previous years.

The limited range of export products (only sugar, wine and grains are in demand), outdated production facilities and poor manufactured goods have been constantly eroding the competitiveness of Moldovan products on international markets. As a result, about 70% of domestic trade is covered by imported goods.

Since January 2006, the EU has offered Moldova extended preferences within the GSP Plus system. According to those preferences, 7,200 commodity items can be exported to the common European market with duty-free treatment and about another 2,000 with a considerable discount on import taxes. But Moldova is able to benefit from these preferences only to a very limited extent, because the range of Moldovan exports comprises 700-800 commodity items. That is why neither the EU preferences, nor similar facilities offered by Switzerland, Japan and Turkey (just like the free trade regime within CEFTA and CIS) have any effect.

Moldova exports development, by country



Exports could show a somewhat better performance for 2008, especially in the food product, beverage and tobacco segment, based on the increasing number of Moldovan wine companies that have permission to export to Russia, higher prices of food products and a more supportive agricultural sector after two years of recession.

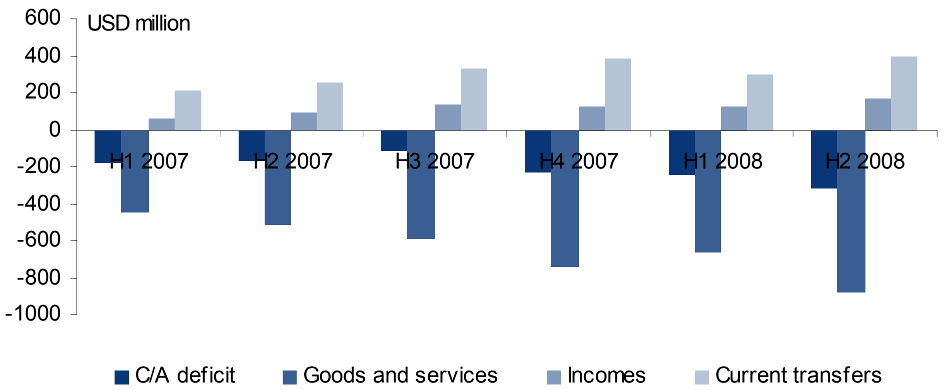
As for imports, we anticipate a slight slowing of the growth pace of food and vegetable products. On the other hand, the import of energy resources, machinery and appliances, chemical products and transport units will remain at a very high level. The main risks associated with trade deficit expansion remain the developments on the energy product markets, the increased demand for imported products and the appreciation of the national currency against the USD and EUR.

Current account deficit

Current account deficit/GDP ratio will temper at around 15% in 2008

The current account deficit expanded by 64.3% y/y in the first six months of 2009, rising to USD 565mn (11.1% of GDP) following the trade balance deterioration.

Current account deficit – quarterly evolution



The balance of services posted a surplus of USD 12.4mn, down 46.4% vs. June 2007.

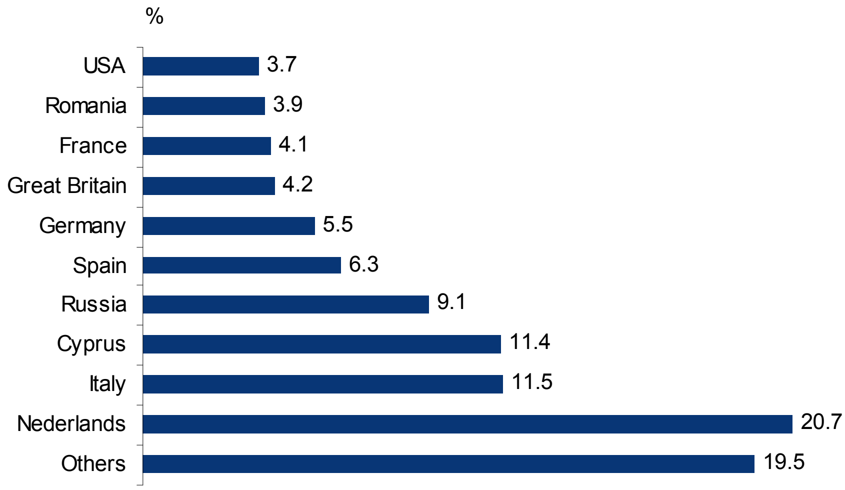
While the tourism-travel deficit rose by more than 2x, reaching USD 39.2mn, the transportation sector and "Other services" reported surpluses of USD 37mn and USD 14.7mn, respectively.

The income balance generated a deficit of USD 289.8mn in the first six months, up 93.1% y/y.

Incoming remittances (including amounts transferred by Moldovans working abroad) reached USD 489.1mn in the first 6M, up 37.1% y/y. At the same time, outflows grew by 73.5%, from USD 36.3mn to USD 63mn, so that net transfers were 48.7% higher than in June 2007 (USD 696.6mn).

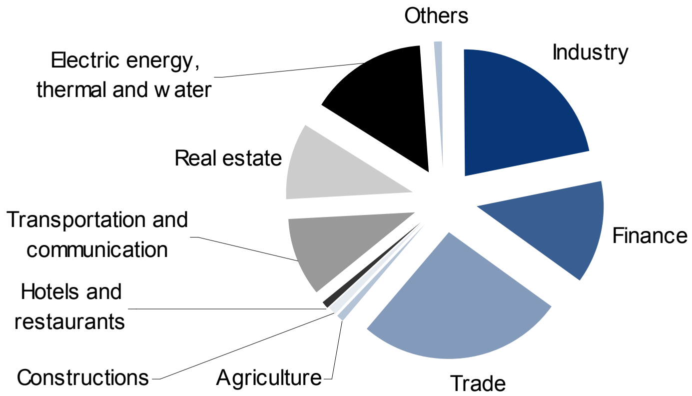
FDI rose by 69.9% y/y to USD 300mn, while the coverage rate of the C/A deficit was 53.1%.

FDI stock by country of origin (2007)



In light of the latest developments, we estimate a C/A deficit per GDP ratio of around 15.3% in 2008.

FDI inflows by activity (2007) - %



The Moldovan Parliament has shown a strong commitment to attracting foreign investment and consequently has implemented significant reforms to achieve this aim. With its geo-political position and labor force related advantages, as well as the business orientation of its local authorities, Moldova could look attractive on the world's tax map in 2008. Starting this year, all legal entities apply the 0% corporate income tax rate.

Inflation

Inflation likely to accelerate at end of year, due to administrative price adjustment

Unlike developed countries, where for the last two years inflation was an unpleasant surprise, Moldova has a rich history of high prices and a psychological immunity to increases.

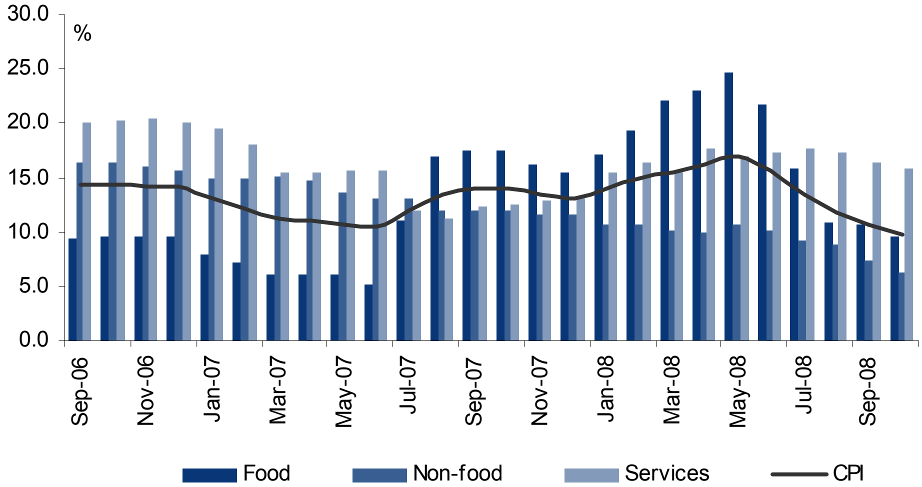
Prices increased suddenly in 2003, due to the drought that year, and then again in 2007. However, the maximum CPI level has not reached the level of 2003.

The main reason is that, starting with 2004, the CPI methodology was modified. The share of food products in CPI was diminished from 48.8% in 2004 to 31.71% in 2007. Consequently, the increase in food prices did not have a major effect on CPI, but was strongly felt by poor people (estimated at around 1mn people).

In the first six months of 2008, CPI advanced by 9.8% y/y, on the back of a service tariff rise (+15.6%, mainly due to the utility price adjustment). Food product prices grew by 9.6% y/y, while non-food products went up by 6.3% y/y.

The effect of this growth had a speculative impact on the price growth in Moldova, such that the price for sugar increased initially by 50% and never came back to its previous level, even though domestic production covered the entire domestic demand. The cement crisis on the regional level affected Moldova as well, bringing growth in prices of more than 60% for imported products, which drove prices up for local cement production.

CPI development



For 2008, we expect CPI to stand slightly above 11% higher than the National Bank of Moldova's target (10%). Domestic food product prices will fall, due to the good harvest, while prices of derivative products of petroleum and transportation, as well for products and services, may ease the inflationary pressures, given the latest developments in the international oil price. However, for the autumn months and for December, we expect more obvious growth in prices, due to the hikes of administrative services (gas, heating and water), including utilities.

The National Bank stated that it has the ability to stop inflation at 10% until the end of the year, but we expect a number of negative factors to increase the impact of inflation: food product prices rose significantly in the past few months and the higher dependence of the Moldovan economy on imported products and the lack of an efficient economy will translate into higher prices. Even some domestic products, because of the lack of competitiveness, are more expensive than imports, e.g. agricultural products during the spring.

Fiscal policy

2008 budget – prudent approach

The deficit target of 0.5% of GDP set for 2008 is consistent with the disinflation objective, implying higher negative domestic financing than in 2007.
As the privatization efforts are not expected to significantly increase the budget revenues, expenditures will rely heavily on foreign sources from international financial institutions (IMF, World Bank, etc.). Despite the worldwide growth slowdown, overall revenue estimates are conservative, particularly revenue from VAT, even though the budget has been squeezed by corporate and personal

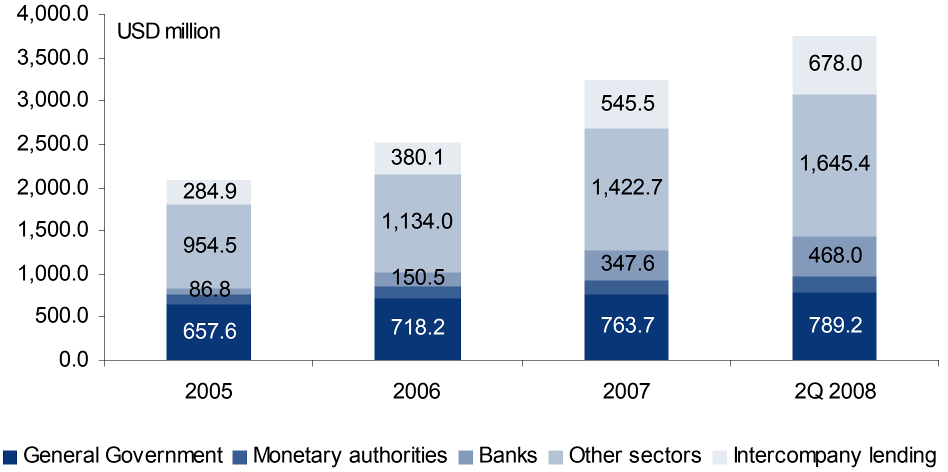
income tax cuts. The authorities proposed to spend any revenue surplus, now estimated at up to 1% of GDP, on investment. However, fiscal policy should remain tight and any spending of the surplus is conditional on single-digit inflation being firmly re-established. The previously announced wage increase was scaled back, with the public sector wage projected to slightly decline from 9.5% of GDP in 2007 to 9.4% in 2008, which is below the planned ceiling of 10% of GDP, but still high for the region.

We expect fiscal policy for 2008 to remain tight, with increasing spending on health and social assistance and protecting key investment projects, particularly on infrastructure, where the EBRD and EIB are supporting the government. In the medium term, while keeping the budget deficit at 0.5% of GDP, the authorities plan to provide for greater fiscal space for social and investment spending through downsizing, reduction in spending inefficiencies and strengthened tax administration.

External debt

In 2008, external debt is expected to fall to below 70% of GDP

The gross external debt of the country amounted to USD 3,752.4mn at the end of 2Q08, of which short-term liabilities reached 36.1%. The liabilities of companies (other than banks) held the highest weight in total external debt, 43.8%.



The public external debt and guaranteed public debt advanced by 3.7% in 2008, standing at USD 973.4mn. The external non-guaranteed private debt was USD 2,779.1mn, up 16.5% y/y.

Loans and securities amounted to USD 2,606.2mn, amounting to 69.5% of total external liabilities.

The direct non-governmental debt saw an increase of 3.1%. The governmental sector benefited from USD 21.8mn from previously contracted credits.

The stock of commitments guaranteed by the government at the end of 2007 diminished by 3.7% y/y. New credits under the government's guarantee were not extended.

The private sector benefited from new loans worth USD 270.8mn, of which USD 105.6mn was contracted by banks, the rest in loans – by economic agents from other sectors.

Monetary policy

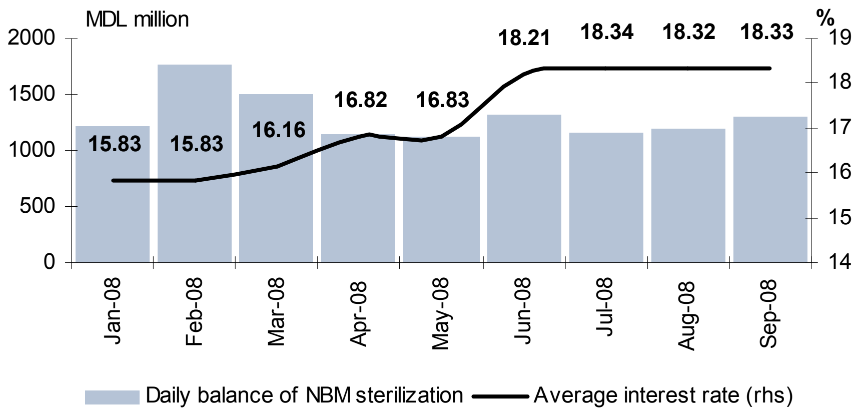
Monetary policy should remain tight until disinflation is firmly re-established

In 2008, the National Bank of Moldova continued to pursue its main objective of price stability, while the monetary policy stance remained tight, with the aim to resume disinflation. As the inflation outlook worsened in the first nine months of 2008, the central bank made two key rate increases, from 16% to 18.5%. Consequently, the minimum reserve requirements were raised for both local and foreign-denominated liabilities from 15% to 22% at the end of September.

Once the disinflation process was firmly re-established, the NBM decided to cut the key interest rate by 1.5pp to 17%, along with minimum reserve requirement decrease from 22% to 20.5%.

Open market operations continued to represent the main liquidity management instrument. During 2007, the NBM carried out the following modifications regarding the application of the main liquidity management operations: deposit attraction was suspended starting with 2Q07; the excess liquidity sterilization was mainly performed via auctions for Certificates of the NBM.

NBM sterilization operations



In September 2008, the NBM organized 19 auctions to sell certificates. This year, the average weighted interest rate on sterilization operations increased significantly, reaching 18.33% per year in September 2008.

The minimum value of the daily balance of sterilizations during the reporting period was MDL 763.6mn, while the maximum value was MDL 1,702.8mn. The daily average balance of sterilization operations increased in September 2008 by MDL 113.7mn compared to the previous month and totaled MDL 1,302.6mn.

The NBM will maintain a flexible exchange rate regime to ease the burden on monetary policy tightening. If inflows of foreign exchange and appreciation pressures persist, the NBM will intervene only to smooth excessive fluctuations of the national currency, while allowing markets to determine the exchange rate. We expect foreign exchange reserves to reach USD 1.7bn, or at least three months of imports, by the end of 2008.

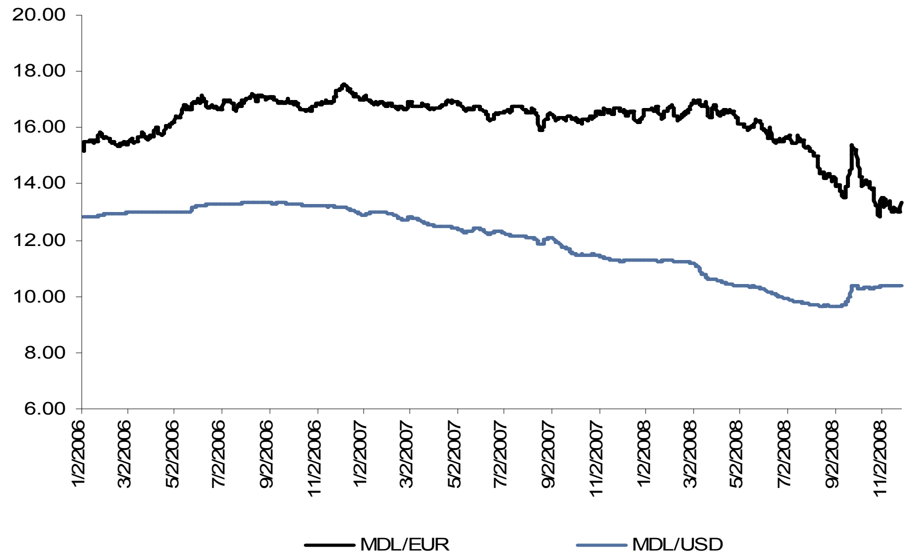
FX and Money Market

In 1H08, MDL was world's second best-performing currency

In the first six months of 2008, the Moldovan leu gained 17% against the dollar and 15% against the euro, as the central bank raised the key interest rate to 18.5% as the inflation outlook worsened.

As the interest rate differential remains highly attractive while deposits are available to foreign investors through local banks and there are no capital account restrictions, the NBM has yet to observe any kind of carry trade activity.

MDL exchange rate evolution against EUR and USD



Strong remittances from Moldovans working abroad, which have been growing steadily over the past seven years (reaching 35% of GDP in 2006), exerted further appreciation pressure. Although the central bank law clearly defines price stability as the primary objective of monetary policy, the attempts to balance multiple, and often conflicting, objectives of inflation, exchange rate stability and low interest rates, have led to partly sterilized foreign exchange interventions and liquidity excess.

For the remaining part of this year, we see higher volatility of the FX rate, generally triggered by energy imports amidst the liquidity crunch on international markets. We expect the single currency to end the year in the 15.2 zone, while for 2009 we anticipate a rally of the MLD, finishing at 14.6 if the international and regional context remains stable.

The money market includes three segments: T-bills, NBM certificates and the direct interbank market. T-bills, which are auctioned weekly, are mostly 91-day papers, although 182- and 364-day bills are also sold in small amounts. The outstanding stock is only 3.6% of GDP and is owned mainly by commercial banks, while the share of non-bank investors is less than 2%. NBM certificates are currently offered to banks at pre-announced interest rates in 7-day, 14-day and 28-day maturities. There is virtually no secondary trading in T-bills or NBM certificates.

Due to excess liquidity, both papers are primarily used as short-term investment vehicles, rather than a liquidity management tool. The T-bill segment is the smallest, with an average monthly turnover of MDL 176mn, followed by the interbank market at about MDL 1.3bn, which is dominated by overnight and up to 14-day interbank loans. With increased sterilization needs, monthly sales of certificates increased from about MDL 550mn in 2006 to more than MDL 2bn in 2007.

Business climate

Moldova – attractive business destination for series of investment-related facilities

At present, one of the major tasks of the government is to attract investments and create a favorable business climate for all investors, both foreign and local ones. The Moldovan authorities plan to stimulate business activity and improve the investment climate, focusing on the geographic position of the country, its skilled labor resources, fertile soil and participation of the country in free trade zones of the CIS countries and the countries of southeastern Europe.

The investment attractiveness of Moldova is also due to the fact that, since June 2001, the country has been a member of the WTO and of the Stability Pact. Moldova has also signed a Partnership and Cooperation Agreement with the EU. The country has access to the markets through the General System of Preferences (GSP+) with the EU, Switzerland, Japan and others. Therefore, the EU has granted free access, without payment of customs duties, to their own home markets for 7,200 groups of goods.

Recently adopted legislative acts (the law on investments in entrepreneurship activity, the law on microfinance organizations, the law on electronic document and digital signature, the law on electronic trade and the law on Leasing) and the new drafts of the laws in the field of economy have one single purpose – to ensure a more balanced and predictable economic policy of the state and simplify the establishment and operation of the enterprises, as well as stimulate new investments.

Free economic zones are attractive for investment projects in industry, providing a range of tax and customs privileges and state warranties to their residents. At present, the volume of the investments attracted to free economic zones has topped USD 76mn.

In addition, the "Giurgiulesti" International Free Port, which is now being built, is an attractive destination for investment.

The domestic tax legislation in force provides for a series of investment related facilities, mainly concerning:

a) corporate income tax

b) value added tax (VAT)

Corporate income tax

The current standard corporate income tax rate is 15%, while in 2008 it was reduced to 0%. The most attractive corporate income tax incentives are:

Value Added Tax

The standard VAT rate is 20% and reduced VAT rates are 8% and 5%. Several operations are subject to a 0% VAT rate and VAT exemption.

Under the Moldovan VAT provisions in force during 2007, certain goods are subject to reduced VAT rates, namely 8% and 5%.

Therefore, the supply of bread and milk, as well as of certain bakery and dairy products (except for baby food, which is VAT-exempt), are subject to the reduced 8% VAT rate. Furthermore, the same rate applies to the import and supply of drugs (including those produced in drugstores) and sugar produced from sugar beet.

Natural and liquefied gas, either imported or supplied on the territory of Moldova, is subject to the 5% reduced VAT rate.

Zero VAT rate. Under Moldovan VAT provisions, the 0% VAT rate is applied to: The export of goods and services; All kinds of international transportation for passengers and commodities (including expeditionary services); Goods and services imported and/or supplied to international organizations for the performance of technical assistance projects in accordance with the relevant treaties to which Moldova is a party; Goods and services delivered to Free Economic Zones from outside the customs territory of Moldova, delivered from the Free Economic Zones outside the customs territory of Moldova, delivered to Free Economic Zones from the remaining part of the customs territory of Moldova and delivered between the residents of different Free Economic Zones of Moldova, etc.

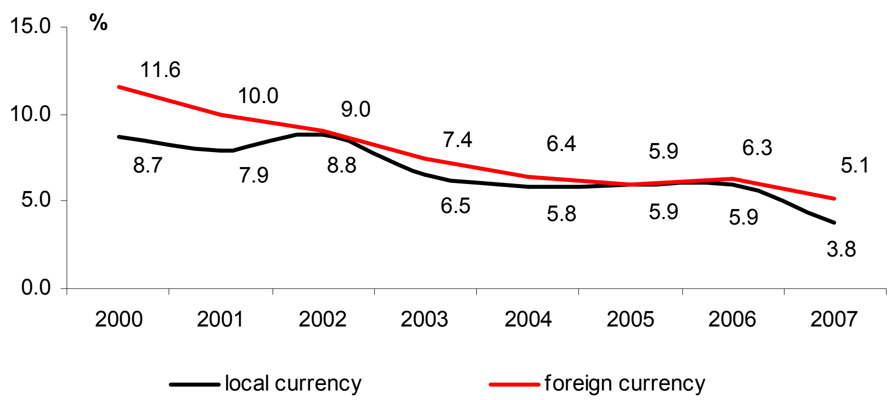
VAT exemptions. Among other applicable VAT exemptions, the following ones are in place: Dwellings, land, rental thereof, except for the commission fees related to such transactions; Food and non-food merchandise for children; State property purchased as part of the privatization process; Financial services; Commercial and intermediary transactions on the securities market; Insurance and reinsurance operations, except for intermediary services thereof (starting with January 1, 2008, the latter shall be VAT-exempt); Import of fiscal stamps for further marking of excisable goods; Goods released on the customs territory under transit, transformation under customs surveillance, bonded warehouse regimes, etc.; Import of goods for non-commercial purposes, whose customs value does not exceed EUR 50, etc.

Financial system

Banking system - good level of liquidity

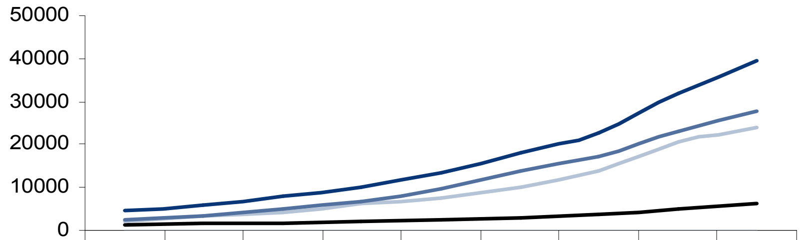
The Moldovan financial sector is dominated by the banking system. Until 2006, there was no significant competition in the banking system, with an undiversified range of products and high commissions. The entrance of foreign banks at the beginning of 2006 tightened competition in the sector and increased benefits for banks' customers. As a result, the banks' spreads on operations both in local and foreign currency started to narrow.

Banks' spreads evolution for domestic and foreign currency



As of the end of 2000, the banking system began to develop. Currently there are 16 joint stock banks licensed in Moldova, including three subsidiaries of foreign banks.

Banking system – main indicators



	2000	2001	2002	2003	2004	2005	2006	2007	Sep-08
Capital (MDL million)	1400	1641	1696	2029	2434	2818	3799	5227	6421
Total assets (MDL million)	4668	5977	7921	10283	13295	17939	22749	32002	39356
Loans (MDL million)	2293	3155	4266	6123	7686	10078	13831	20753	23897
Deposits (MDL million)	2489	3445	5118	6866	9502	13731	17243	23105	27921
Number of banks	20	19	16	16	16	16	15	16	16

Tier I Capital went up 22.1% to MDL 6,421mn as of end-September 2008, which reflected the continuous strengthening of the banking system, with the background of sustainable stability.

The weight of net credits in total assets grew to 60.7% at the end of September 2008, from 43.4% in 2000, while bad loans in total loans account for 4.6%.

The banking sector's concentration ratio remained quite high: the first five banks' large assets account for 64.2% of total banking assets, with the weight of liabilities at 57.5% and the total regulatory capital at 61.9%.

Banks reported, as of September 30, 2008, ROA of 4% and ROE of 24.8%.

The efficiency of banks' activity is characterized by their capacity to generate profits. The net income obtained by the banks in the first nine months of 2008 amounted to MDL 1,080,5mn, up 31.8% y/y, while the solvency ratio (>12%) reached 30.8% at the end of September 2008.

Aggregate monetary balance sheet of credit institutions

	Dec. 2007 MDL mn	Sept. 2008 MDL mn	Sept. 2008/ Dec. 2007 - %
ASSETS – TOTAL, of which	32,002.0	39,356.2	23.0
Non-governmental loans	20,883.8	25,417.4	21.7
- MDL loans	11,768.9	15,103.7	28.3
- FCY loans	9,114.9	10,313.7	13.2

	Dec. 2007 MDL mn	Sept. 2008 MDL mn	Sept. 2008/ Dec. 2007 - %
LIABILITIES – TOTAL, of which	32,002.0	39,356.2	23.0
Deposits from non-banking customers	20,661.9	25,179.6	21.9
Sight deposits	6,488.3	6,621.8	2.1
Term deposits	14,173.6	18,557.8	30.9
- MDL deposits	7,455.9	10,379.1	39.2
- FCY deposits	6,717.7	8,178.8	21.8

Source: NBM

Non-governmental loans expanded in the first 9M08 by 21.7%, on the back of MDL loans. FCY loans saw a moderate increase of 13.2%. Accordingly, MDL loans accounted for 59.4% as of September 30, 2008 (+3pp vs. December 2007).

In the first nine months of 2008, domestic deposits raised from non-bank customers tempered compared with December-September 2007 (+34.9%). However, such resources grew by 21.9%, mainly on the back of increasing amounts in MDL term deposits (+30.9%).

Average interest rates

In the first nine months of 2008, interest rates on new MDL corporate loans increased by 4.1pp, while for foreign currency-denominated loans, the growth was only 2.3pp.

New deposits in MDL were better remunerated compared with those in FCY (+4.72pp, compared with 3.64 pp).

The interest rate differential narrowed on the corporate side both for MDL and FX operations, with a more significant decrease on the FCY side (-1.4pp).

As for the retail segment, the interest rate differential drastically decreased for FX operations (-5.65pp), reaching only 1.92pp At the same time, for MDL operations, the spread slightly increased (by 0.6pp, reaching 3.52 as of the end of September, 2008).

Average interest rates on new loans and deposits of non-banks

	Dec. 2007	Sept. 2008
	MDL	**MDL**
Legal persons		
- Loans	18.92	22.97
- Term deposits	12.80	17.52
Spread	**6.12**	**5.45**
Individuals		
- Loans	19.24	23.06
- Term deposits	16.32	19.54
Spread	**2.92**	**3.52**

Source: NBM

	Dec. 2007	Sept. 2008
	FCY	**FCY**
Legal persons		
- Loans	10.66	12.95
- Term deposits	5.13	8.77
Spread	**5.53**	**4.18**
Individuals		
- Loans	14.33	12.95
- Term deposits	6.76	11.03
Spread	**7.57**	**1.92**

Source: NBM

With a capitalization of only USD 1bn, the capital market currently plays an insignificant role in the financial system. The number of companies listed on the stock exchange is consistently growing, alongside the total traded volume. Banks and companies operating in the food industry are of special interest on the stock market, accounting for 83% of market transactions.

Similar to the capital market, the insurance market is a limited sector with slow development and products in the early stages of development. Gross underwritten premiums remain insignificant, accounting for 1.27% of GDP. There are 30 operators on the Moldovan insurance market, but their number will probably decrease, due to the implementation of new sector consolidation policies. The market demand is mainly focused on insurance of business activity or legal accountability activities (89%). The population still generally neglects products for property or life insurance.

The micro-finance and leasing sector demonstrates somewhat stronger development. The group of micro-finance institutions consists of 530 visibly active Economy and Crediting Associations and three micro-finance institutions, that serve almost 85,000 customers from the agricultural, trade, construction and services sectors. Their clients are mainly small and new companies with limited experience in management and their field of activity. The loan portfolios of these institutions amounted to USD 12mn per year. With a potential market estimated at 128,000 small entrepreneurs and 503,000 agricultural companies, the potential of micro-financing expansion is obviously huge.

In its early stage, leasing activity was focused only on the corporate side, but thanks to new regulations adopted in 2005, the sector expanded to individuals and household goods. Real estate leasing activity is also developing rapidly, due largely to foreign operators entering the market. The waiver of some taxes for equipment bought via leasing has reduced the financial burden for entrepreneurs, prompting an increase in demand for equipment and industrial products, especially in construction and other branches with seasonal activities.

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