

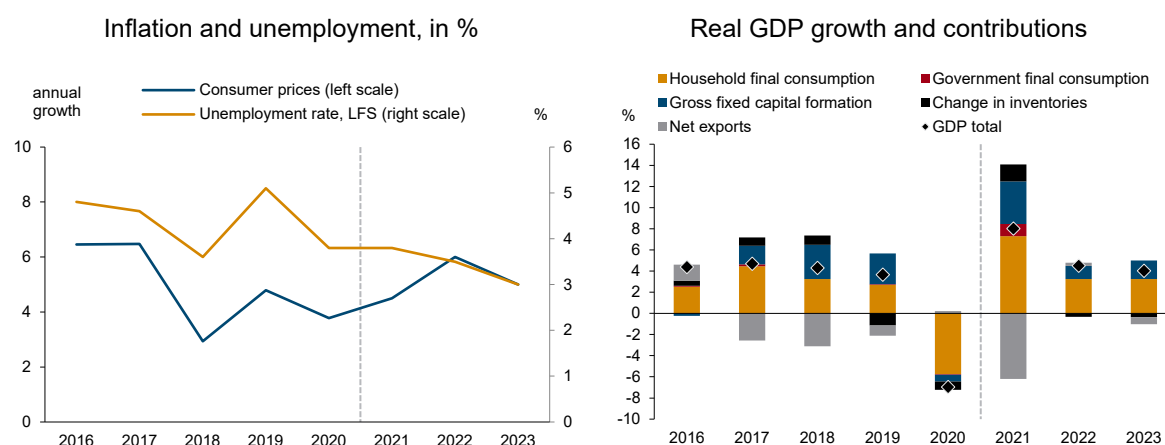


## MOLDOVA: Reorientation towards the West

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The economy will grow by 8% in 2021, against the 7% contraction of the previous year, bringing real GDP back to the pre-crisis level of 2019. The new western-oriented and reform-minded government enjoys overwhelming support in parliament and is able to attract ample foreign funds to finance the expansion of the fiscal and current account deficits.

**Figure 4.13 / Moldova: Main macroeconomic indicators**



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**GDP bounced back in the first half of 2021 by 11.7%, from the depressed level of the previous year, when it fell by 7.2%.** The current recovery has been very uneven by activity and use categories. Household consumption grew by more than 11%, and gross fixed capital formation expanded by 20% – far more rapid growth than the decline a year previously. Net exports, on the other hand, made a huge negative contribution to GDP growth, counteracting the expansion of domestic demand. We expect the same trends to continue in the second half of 2021, albeit at a more modest rate (largely due to base effects) leading to overall GDP growth of 8% in 2021.

**Industrial production expanded by 14% in the first half of 2021, after a decline of 7% in the same period of 2020.** The production of consumer goods grew rapidly, while it was slower in the main export industries, including food and car parts. Falling production and the declining export of agricultural products were the result of a bad harvest in 2020. The production of iron and steel and of electricity from Transnistrian plants rose significantly, buoyed by international demand. The foreign trade balance may improve in the second half of the year on account of a bumper grain harvest, which promises a recovery in agricultural exports. Nevertheless, the export structure will continue to shift to machinery and transport

equipment, which accounted for 25% of exports in the first half of the year. The main export market is the EU, with 70% – most prominently Romania, which offers an expanding market for Moldovan products.

**Improved economic performance has supported public revenues, which, in turn, have been spent on underpinning the economic recovery.** In early October, parliament adopted amendments increasing revenue and expenditure, but reducing the deficit target of the 2021 budget. The fiscal deficit may still rise, in view of the needs announced by various public institutions. Spending on health needs to increase to treat the rising number of COVID patients; meanwhile, compensation is to be paid to users of gas for the price rises, and VAT has been reduced for the accommodation and catering sector.

**Inflation came close to the central bank target of 5% in August 2021, having started from almost zero in January.** The National Bank of Moldova reacted by changing the aim of monetary policy from mitigating the impact of the pandemic to fighting inflationary pressures generated by accelerating domestic demand and imported inflation. The bank hiked its base rate in three consecutive months to 5.5% in October. As well as restricting credit growth, the depreciation of the local currency has been reversed by this move.

**Until Q3 2021, Moldova had been only moderately affected by the rise in international gas prices, but this is now set to change.** Prices are regulated by agreement with Russia's Gazprom, and that agreement is due to be extended in October. The price in Q4 2021, as set by the agreed formula, will be double the Q1 level, or about half of the expected spot price. The calculated tariff hike for customers will be 35%, and the government promises some compensation for vulnerable consumers. Moldovagaz has called on consumers to reduce their consumption of gas and to use alternative fuels, wherever possible, which means that it is reckoning on bottlenecks in supply. The gas pipeline connecting Moldova to Romania (fed from Russia via TurkStream) has become operational, allowing for a diversification in supply of up to half of Moldova's needs. However, Moldova does not wish to exploit the new alternative, as it wants to improve relations with Ukraine (which is dependent on transit revenue). The government may have to change its mind if that is the condition that Gazprom lays down for a new contract to be signed.

**The pandemic-related lockdown had little lasting negative impact on the labour market.** People were not fired, but instead worked part time; and most of them returned to full time when the restrictions ended. Employment has expanded, and unemployment remained low in both 2020 and 2021, although – given the widespread refusal to be vaccinated – many who usually work abroad have had to stay at home. The economic situation of Moldovans who live and work abroad long term improved in the first half of 2021, so that remittances increased by 17%, year on year, amounting to 14% of GDP.

**The EU-oriented government that came to power following the July 2021 elections has a comfortable majority in parliament.** The Russia-oriented opposition (and Russia itself) seems to be tolerating the political reorientation. The government has avoided confrontation with the Russian-speaking population in Moldova and the Russian-backed separatist part of the country, Transnistria. Normal relations with Russia are required for Moldova to keep the gas flowing, to restore the access of its food products to the Russian market, and to represent the interests of its migrant citizens in Russia. But Moldova is also interested in improving its relationship with Ukraine – and even more so with the EU. This political reorientation is not without its risks, as Russia has the capacity to undermine stability in Moldova if it perceives the status quo to be in danger.

**Top priorities for the new government in the domestic arena are strengthening the rule of law and combating corruption.** As initial steps, several state institutions have been brought under the control of parliament and new leaders have been appointed. The selection of judges has become more transparent, and the division between the branches of the judiciary has been clarified. In early October, the government suspended and detained the opposition-backed prosecutor general on charges of corruption. Germany has agreed to support the development of reforms in the public sector to the tune of EUR 10m.

**The government's readiness to reform is being rewarded by the EU and other international donors.** On 15 September, the European Commission released non-reimbursable funds of EUR 36m – an instalment of the EUR 600m to support the three-year Economic Recovery Plan approved in June. A further EUR 50m is expected in October. The European Bank for Reconstruction and Development has decided to offer Moldovan railways a loan worth EUR 23.5m to modernise its infrastructure. The country will also receive a EUR 24.8m loan from the World Bank to finance the purchase of COVID-19 vaccines. Moldova is entitled to USD 236m of special financing that the International Monetary Fund (IMF) approved for its members in August, to be used to finance the state budget deficit. The former government of Moldova abrogated the reform programme that was a precondition for the disbursement of funds under the stand-by agreement reached with the IMF in September 2020. A new deal is currently under negotiation and should provide the necessary underpinning for the balance of payments.

**The pandemic is proving a lasting drag on the economy and society.** The number of new cases of COVID-19 and the number of deaths from it are both on the rise, but (as of early October) are still significantly lower than the peak reached in March 2021. Steps are required to lift the vaccination rate above the current level of 30% – a figure that is due partly to popular resistance, but also to inadequate vaccination capacity. The government has introduced thresholds for the incidence of COVID-19 infections, as recommended by the World Health Organization, by which population settlements are grouped into four alert levels, based on the incidence of COVID-19 infections. Restrictions are triggered automatically when certain incidence levels are reached.

**In 2022 and 2023, Moldova's economy will return to a growth rate of 4-4.5%, the average for the previous years.** Investments will increase to support economic growth, while the trade deficit will contract due to less robust household demand and a consolidation of external demand. Modernisation and growth can be sustained by improving public governance and attracting more abundant capital inflows within the context of a stable political environment.

Table 4.13 / Moldova: Selected economic indicators

	2018	2019	2020 <sup>1)</sup>	2020 January-June	2021	2021 Forecast	2022 Forecast	2023
Population, th pers., average	2,708	2,665	2,620	.	.	2,560	2,500	2,500
Gross domestic product, MDL bn, nom.	192.5	210.4	206.4	88.3	104.2	236	259	283
annual change in % (real)	4.3	3.7	-7.0	-7.2	11.7	8.0	4.5	4.0
GDP/capita (EUR at PPP)	8,590	9,130	8,770	.	.	.	.	.
Consumption of households, MDL bn, nom.	160.5	174.1	167.2	71.0	80.6	.	.	.
annual change in % (real)	3.9	3.2	-6.9	-9.7	11.3	9.0	4.0	4.0
Gross fixed capital form., MDL bn, nom.	46.8	53.0	51.9	21.7	27.5	.	.	.
annual change in % (real)	14.5	11.9	-2.4	-6.6	20.1	16.0	5.0	7.0
Gross industrial production								
annual change in % (real)	3.7	2.0	-5.5	-7.3	14.1	10.0	6.0	5.0
Gross agricultural production								
annual change in % (real)	2.9	-1.9	-27.1	.	.	.	.	.
Construction industry								
annual change in % (real)	17.6	12.8	3.7	.	.	.	.	.
Employed persons, LFS, th, average <sup>2)</sup>	794.1	872.4	834.2	813.9	820.4	840	850	860
annual change in %	-0.8	9.9	-4.4	-5.9	0.8	1.0	1.0	1.0
Unemployed persons, LFS, th, average <sup>2)</sup>	29.6	46.9	33.1	35.2	33.6	30	30	30
Unemployment rate, LFS, in %, average <sup>2)</sup>	3.6	5.1	3.8	4.2	4.0	3.8	3.5	3.0
Reg. unemployment rate, in %, eop	1.7	1.8	2.9	4.0	2.4	.	.	.
Average monthly gross wages, MDL	6,268	7,234	7,943	7,741	8,757	9,000	10,000	11,000
annual change in % (real, gross)	9.0	10.1	6.2	3.2	11.0	9.0	5.0	5.0
Average monthly net wages, MDL	5,142	6,010	6,617	.	.	7,500	8,300	9,200
annual change in % (real, net)	9.4	11.5	6.1	.	.	9.0	5.0	5.0
Consumer prices, % p.a.	2.9	4.8	3.8	5.5	1.9	4.5	6.0	5.0
Producer prices in industry, % p.a.	0.3	1.8	2.6	2.7	6.6	7.0	4.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	30.1	29.9	29.7	32.9	33.5	33.0	33.0	33.0
Expenditures	31.0	31.4	38.2	36.8	36.8	39.0	39.0	38.0
Deficit (-) / surplus (+)	-0.8	-1.4	-8.5	-3.9	-3.3	-6.0	-6.0	-5.0
General gov.gross debt, nat.def., % of GDP	27.2	25.1	33.1	.	.	35.0	37.9	39.7
Stock of loans of non-fin.private sector, % p.a.	6.0	13.9	13.2	8.1	19.7	.	.	.
Non-performing loans (NPL), in %, eop <sup>3)</sup>	12.5	8.5	7.4	8.7	7.5	.	.	.
Central bank policy rate, %, p.a., eop <sup>4)</sup>	6.50	5.50	2.65	3.25	2.65	5.50	5.50	5.50
Current account, EUR m <sup>5)</sup>	-1026	-993	-783	-204	-713	-1,080	-850	-720
Current account, % of GDP	-10.6	-9.3	-7.5	-4.5	-14.6	-9.6	-6.9	-5.6
Exports of goods, BOP, EUR m <sup>5)</sup>	1,672	1,892	1,706	851	853	1,940	2,120	2,230
annual change in %	1.0	13.1	-9.8	-2.6	0.2	13.7	9.3	5.2
Imports of goods, BOP, EUR m <sup>5)</sup>	4,462	4,850	4,420	2006	2527	5,340	5,400	5,460
annual change in %	13.6	8.7	-8.9	-11.9	26.0	20.8	1.1	1.1
Exports of services, BOP, EUR m <sup>5)</sup>	1,251	1,379	1,121	537	597	1,280	1,490	1,620
annual change in %	12.4	10.2	-18.7	-18.4	11.3	14.2	16.4	8.7
Imports of services, BOP, EUR m <sup>5)</sup>	950	1,065	785	384	426	910	950	990
annual change in %	12.7	12.2	-26.3	-21.1	11.1	15.9	4.4	4.2
FDI liabilities, EUR m <sup>5)</sup>	248	453	138	9	70	250	.	.
FDI assets, EUR m <sup>5)</sup>	29	35	5	6	-9	0	.	.
Gross reserves of CB excl. gold, EUR m <sup>5)</sup>	2,628	2,731	3,079	2,826	3,167	.	.	.
Gross external debt, EUR m <sup>5)</sup>	6,448	6,653	6,875	6,947	7,144	7,600	8,600	9,100
Gross external debt, % of GDP	66.5	62.2	65.8	66.5	63.6	68.0	70.0	71.0
Average exchange rate MDL/EUR	19.84	19.67	19.74	19.5	21.3	21.0	21.0	22.0

Note: All series excluding data on districts from the left side of the river Nistru and municipality Bender.

1) Preliminary. - 2) Based on May 2014 census and the new methodology in line with the Integrated European Social Statistics Regulation (IESS). - 3) Substandard, doubtful and loss credit portfolio. - 4) Overnight (refinancing) operations rate. - 5) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.