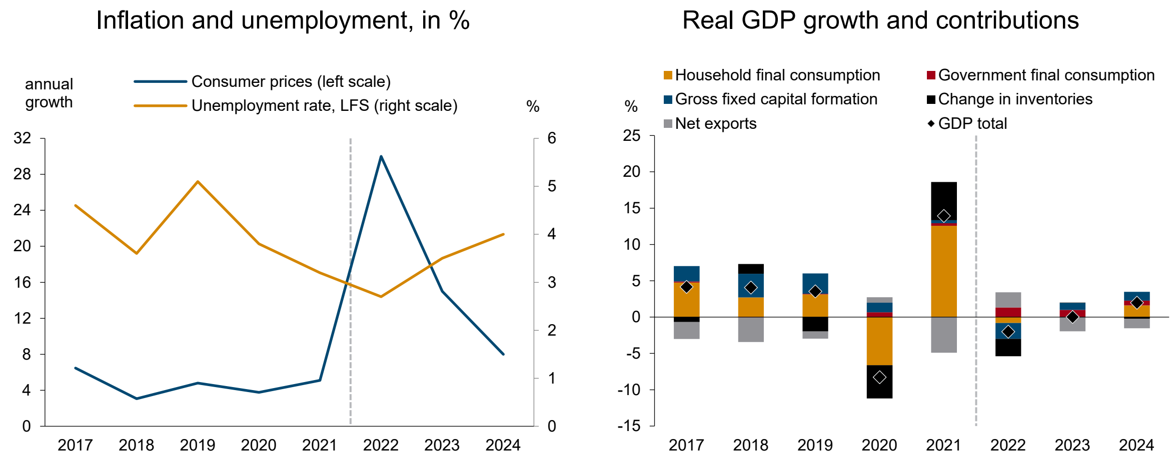
MOLDOVA: Outlook worsens as war in neighbourhood persists

GÁBOR HUNYA

The effects of the prolonged Russian invasion of Ukraine, skyrocketing food and energy prices, trade disruptions, the influx of refugees and declining public confidence have all worsened Moldova's economic prospects. GDP is certain to decline in 2022 and to stagnate in 2023. Increased funding by international donors and creditors is necessary for the country to cope with the economic challenges and to keep the current Western-oriented leadership in power.

Figure 6.13 / Moldova: Main macroeconomic indicators



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

The economy stagnated in the first half of 2022 and is certain to contract over the remainder of the year. Household consumption stayed flat, despite the remarkable demand generated by refugees from Ukraine, which contributed 0.7% to GDP growth. Retail trade contracted, while on-the-farm consumption expanded, thanks to the extraordinarily high yields of the previous year that were stockpiled. Investment activity shrank, as the construction industry was hit by soaring prices for energy and building materials: the private housing construction boom came to an end, though corporate investment continued to expand. Increased government consumption mitigated the decline.

Net exports made a positive contribution to growth in the first six months, on account of rapidly expanding exports and less-dynamic imports. Exports of agricultural and food products benefited from the stockpiling that followed last year's bumper harvest. Russia banned fruit imports from Moldova in August, but EU quotas were increased. The low crop yields triggered by drought in 2022 will curtail food production and exports next year and will also depress domestic consumption. Farmers are also suffering from high fuel and fertiliser prices. They have benefited from relief on the excise duty on fuel and from certain other subsidies; but that has gone only some way toward compensating them.

Inflation has accelerated in 2022, from 6% in January to 34.3% in August. Gas prices have trebled since the beginning of the year, as the main supplier Gazprom has been adjusting prices monthly to the spot-market rates since September 2021. Domestic household gas tariffs are regulated, but they have been changing month by month, based on the market price. Food prices have doubled in the course of the year in response to global trends and elevated foreign demand. As a response to the price hikes, imports of natural gas from Russia diminished in the first half year, and gas was partly replaced by oil products in the energy mix. Biofuel and wood will increase their share of heat production during the winter. Still, gas remains the main source of heat and of power generation. Gazprom has repeatedly threatened Moldova that it will cease supplies unless the country pays some of its accumulated debt. Romania has promised to help if Gazprom does fully halt the supply.

The National Bank of Moldova (NBM) has responded to the inflation with aggressive monetary tightening. It increased its base rate from 8.5% in January to 21.5% in August and kept it flat in September. The liquidity of banks was curtailed also by an increase in the mandatory reserve requirement to 40%. The cost of borrowing rose not only for the population, but also for the government, as it also borrows domestically. Inflation is expected to peak in November at 36% and the base rate may hit 23%. Inflation may subside in subsequent months, due to base effects and declining demand. To counteract the adverse effects of inflation on the population, the government has given various groups of public-sector employees pay rises, has provided one-off assistance to pensioners and has prescribed a hike in the minimum wage in the private sector. Nevertheless, real wages declined by more than 8% in the first six months of 2022, and no recovery is in sight for the rest of the year.

The Moldovan leu is relatively stable against the main foreign currencies. Against the US dollar it has depreciated by about 9% so far this year, but has appreciated against the euro, reflecting the change in the EUR/USD exchange rate. As an anti-inflationary measure, the NBM regularly intervenes on the forex market to prevent shocks and excessive volatility.

Economic prospects are bleak, as the military conflict in Ukraine goes on and foreign financing does not look generous. The positive effects of the 2021 bumper harvest have petered out, which will have repercussions for consumption, industrial production and exports over the next 12 months. Agriculture and the food industry – which together provide a living for a third of the population – will suffer from elevated input prices, including fuel and fertilisers, even if the weather conditions improve next year. The gas supply will remain at the mercy of Gazprom, although alternative import routes will gradually become available. Purchasing power will be further eroded by wage restraint in the public sector and by declining revenues in the private sector. Fiscal revenues will barely expand, thus social benefits and support for small producers cannot possibly increase in real terms. Remittances – a major source of income for the population – are losing their purchasing power under the conditions of a stable exchange rate. Even without any further international price shocks, inflation will remain in double digits in 2023. The international aid already pledged and the available credit lines enable the economy to just keep going and provide basic support for refugees. Taking all factors into consideration, we forecast a recession over the next four quarters on a yearly basis, which may be followed by a modest upturn (from a low base) in the second half of 2023.

The erosion of living conditions has brought people out onto the streets, and the political tension may increase further if the winter is a harsh one. Thousands of protesters, the largest crowd for two years, gathered in Chisinau on 18 September to protest about high inflation and fuel prices and to demand the resignation of the government. Opposition parties friendly towards Russia are benefiting from the social discontent and are doing their best to undermine popular support for the EU-friendly government. Therefore, increased funding from international donors and creditors is necessary for the country not only to cope with the economic challenges, but also to keep the current leadership in power. The disbursement of EU and IMF funds needs to gather momentum, and new donor agreements must be reached.

Relations with the separatist region of Transnistria have settled down, since Russia has apparently given up trying to stoke conflict in Moldova's immediate neighbourhood. The Russia-friendly separatists tried in vain to increase tension in mid-2022, in order to provoke Russian intervention. But since then, they have come to realise that Transnistria's economic interests are linked to the rest of Moldova, rather than just to the cash and gas flowing from Russia. Transnistria does not have direct land access to Russia and can only trade with the West. Moldova draws two thirds of its electricity from the Russian-owned power station in Transnistria, which burns Russian gas but has no market other than the rest of the country. Meanwhile, the Chisinau government has taken steps to diversify supply, which may reduce its purchases from Transnistria and put the region under pressure. A further major cash cow for Transnistria is its steel plant, which needs to export its products and depends on transit through Moldova. Transnistrian companies are also facing some important challenges on Moldova's road to the adoption of EU rules. The Chisinau government recently renewed the steel plant's environmental certificate, but the special treatment it enjoys cannot go on for ever: the EU may not tolerate the competitive advantage enjoyed by Moldovan steel, produced using Russian gas that Transnistria receives free of charge from Gazprom. Mutual dependence could draw Moldova's regions together.

Table 6.13 / Moldova: Selected economic indicators

	2019	2020	2021 1)	2021	2022	2022	2023	2024
				January-June			Forecast	
Population, th pers., average	2,665	2,620	2,615	.	.	2,600	2,580	2,560
Gross domestic product, MDL bn, nom.	206.3	199.7	241.9	105.1	120.6	296	326	349
annual change in % (real)	3.6	-8.3	13.9	12.7	0.0	-2.0	0.0	2.0
GDP/capita (EUR at PPP)	9,050	8,410	10,270	.	.	.	.	.
Consumption of households, MDL bn, nom.	172.8	162.2	195.6	84.1	98.3	.	.	.
annual change in % (real)	3.7	-7.9	15.5	18.7	0.1	-1.0	0.0	2.0
Gross fixed capital form., MDL bn, nom.	48.3	49.8	58.5	26.2	27.5	.	.	.
annual change in % (real)	12.0	5.6	1.7	13.1	-7.3	-9.0	4.0	5.0
Gross industrial production								
annual change in % (real)	2.0	-5.5	12.1	14.2	0.5	-1.0	-2.0	3.0
Gross agricultural production								
annual change in % (real)	-1.6	-27.2	49.9	.	.	.	.	.
Construction industry								
annual change in % (real)	12.8	3.7	-0.3	17.1	-11.6	.	.	.
Employed persons, LFS, th, average 2)	872.4	834.2	843.4	820.3	853.7	870	890	900
annual change in %	9.9	-4.4	1.1	0.8	4.1	3.0	2.0	1.0
Unemployed persons, LFS, th, average 2)	46.9	33.1	28.2	33.6	23.6	20	30	40
Unemployment rate, LFS, in %, average 2)	5.1	3.8	3.2	4.0	2.7	2.7	3.5	4.0
Reg. unemployment rate, in %, eop	1.8	2.9	2.3	2.4	1.5	.	.	.
Average monthly gross wages, MDL	7,234	7,943	8,980	8,757	9,969	10,600	12,400	14,100
annual change in % (real, gross)	10.1	5.8	7.6	11.0	-8.4	-9.0	2.0	5.0
Average monthly net wages, MDL	6,010	6,617	7,635	.	.	9,000	10,600	12,000
annual change in % (real, net)	11.5	6.1	9.8	.	.	-9.0	2.0	5.0
Consumer prices, % p.a.	4.8	3.8	5.1	1.9	24.3	30.0	15.0	8.0
Producer prices in industry, % p.a.	1.8	2.6	8.4	6.6	23.0	28.0	12.0	5.0
General governm. budget, nat. def., % of GDP								
Revenues	30.5	31.4	32.0	33.3	34.6	34.0	33.0	33.0
Expenditures	32.0	36.7	33.9	36.5	37.4	39.0	37.0	36.0
Deficit (-) / surplus (+)	-1.5	-5.3	-1.9	-3.3	-2.8	-5.0	-4.0	-3.0
General gov. gross debt, nat. def., % of GDP	25.7	34.2	32.6	31.5	27.0	29.7	30.9	31.9
Stock of loans of non-fin. private sector, % p.a.	13.9	13.2	22.6	19.7	19.1	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.5	7.4	6.1	7.5	6.7	.	.	.
Central bank policy rate, %, p.a., eop 4)	5.50	2.65	6.50	2.65	18.50	23.00	12.00	6.00
Current account, EUR m 5)	-988	-778	-1436	-702	-898	-1,870	-2,310	-2,270
Current account, % of GDP	-9.4	-7.7	-12.4	-14.2	-15.0	-12.6	-14.2	-13.7
Exports of goods, BOP, EUR m 5)	1,892	1,706	2,165	853	1,795	4,020	4,650	4,930
annual change in %	13.1	-9.8	26.9	0.2	110.4	85.7	15.7	6.0
Imports of goods, BOP, EUR m 5)	4,850	4,420	5,706	2,527	3,702	8,660	10,030	10,430
annual change in %	8.7	-8.9	29.1	25.9	46.5	51.8	15.8	4.0
Exports of services, BOP, EUR m 5)	1,379	1,121	1,381	603	920	2,100	2,430	2,670
annual change in %	10.2	-18.7	23.2	12.3	52.7	52.0	15.7	9.9
Imports of services, BOP, EUR m 5)	1,053	772	982	420	555	1,330	1,460	1,540
annual change in %	10.9	-26.7	27.3	11.9	32.2	35.4	9.8	5.5
FDI liabilities, EUR m 5)	453	138	331	125	289	380	.	.
FDI assets, EUR m 5)	35	5	8	-7	30	0	.	.
Gross reserves of CB excl. gold, EUR m 5)	2,731	3,079	3,442	3,167	3,434	.	.	.
Gross external debt, EUR m 5)	6,458	6,626	7,741	6,991	8,259	10,100	11,600	12,000
Gross external debt, % of GDP	61.6	65.5	67.0	60.5	56.0	68.0	71.0	72.0
Average exchange rate MDL/EUR	19.67	19.74	20.93	21.29	20.20	20.0	20.0	21.0

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

1) Preliminary. - 2) 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.