MOLDOVA: Recovery depends on weather conditions and foreign assistance

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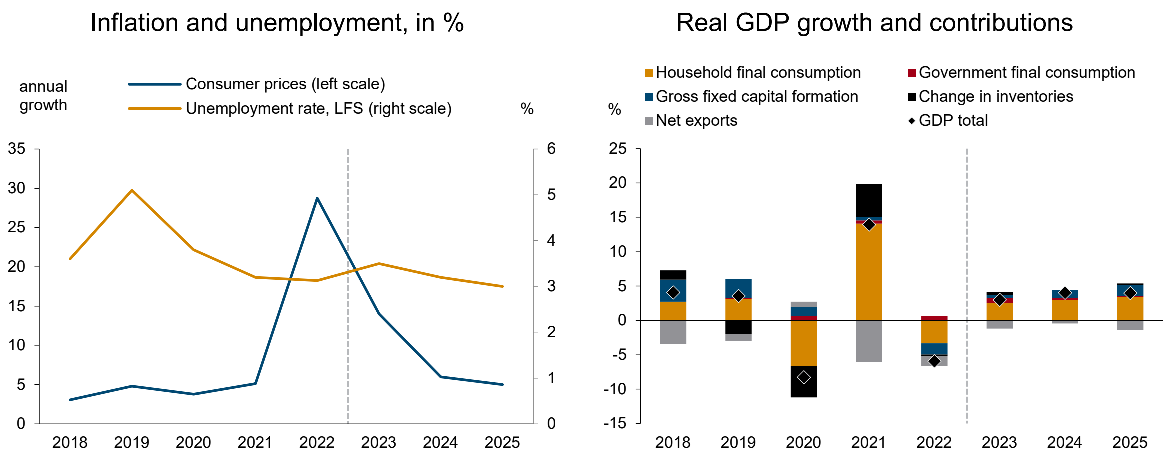
The energy crisis, soaring inflation and extreme drought were the main reasons for the economic contraction in 2022 (GDP down by 5.9%). There should be an improvement across the board in 2023, thanks to elevated external assistance, rapid structural adjustment and better weather conditions (GDP to rise by 3.5%). In the absence of negative external shocks, and with determined efforts to foster EU integration, the economy will grow by about 4% in the coming years.

Figure 5.13 / Moldova: Main macroeconomic indicators



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

Moldova's economic performance over the past three years has been characterised by large fluctuations, which makes it hard to predict the future with any great certainty. There was an extreme contraction in GDP in COVID-afflicted 2020 (-8.3%), followed by a very rapid recovery in 2021 (13.9%) and another steep decline in 2022 (-5.9%). It is a particular feature of the country that weather-related ups and downs in agricultural production can add to the impact of external shocks and other factors in the business cycle. The year 2022 was an extreme case, as agriculture contributed -5.6 percentage points to the development of GDP, while the negative contribution of industry was by and large compensated for by services. The economy was further depressed by a severe energy crisis and soaring inflation, so that all the demand components of GDP (bar government consumption) contributed to the contraction. The recession most probably bottomed out in Q4 2022, when GDP was 10.6% down on the same period the previous year. Many of the problems will continue in 2023, but if the weather conditions are average for the country, that would in itself facilitate an economic recovery of 2-3%.

The inflation track changed fundamentally in October 2021. The price of the main energy source – imported natural gas from Russia – increased sevenfold within just a few months. Gazprom switched from long-term price setting at below European prices to dynamic price setting based on actual market prices. With the effects of the war in Ukraine, a bad harvest and an overall inflationary international environment to boot, prices rocketed in 2022. Moldova also underwent a radical change in terms of the relative price structure, making energy a more important cost factor than before. The energy situation was further complicated by the gas shortages brought about by Gazprom's patchy delivery (which can be regarded as a component of Russia's hybrid war on the country).

Integration with the Romanian (and thereby the European) gas and electricity networks has helped overcome the worst of the situation, but occasional blackouts are unavoidable. Purchases from the EU can provide a lasting alternative to Russian gas imports via the pipeline through Ukraine. Following the overall switch to new sources in Q1 2023, Russian deliveries were confined to the separatist region of Transnistria. For the rest of the country, however, this did not end dependence on Russia: a significant part of the gas delivered to Transnistria fuels the power station there, which is the main source of electricity for the country as a whole. It is also used by the country's only steel plant, which is important for the domestic supply and moreover exports to the EU. In order to gain total independence from the unreliable Russian deliveries, further investments in transport infrastructure and renewable energy will be necessary, as well as improved relations between the two parts of the country.

A significant share of the price shock suffered in 2021/2022 can be regarded as a one-off event, so that inflation will come down to single digits in the second half of 2023. Inflation peaked in October 2022 at 34%, and by March 2023 it had moderated to 22%. Gas import prices have declined in accordance with Gazprom's pricing mechanism. Food prices are expected to fall, too, once the new harvest is gathered in.

The National Bank of Moldova (NBM) has followed a two-pronged anti-inflationary policy. It increased the policy rate several times in 2022 and also intervened on the currency market to keep the exchange rate stable. Inflation has been subsiding since December, and so the NBM has cut the policy rate from 21.5% in November 2022 to 14% in March 2023. Commercial lending rates have been below the refinancing rate (negative in real terms), but the volume of new credits has hardly grown in real terms. We expect further monetary easing, as support for economic growth has appeared as one of the targets of NBM policy.

For years Moldova has suffered from high current account deficits, 15.8% of GDP in 2022. The weakness of the export sector has been a perennial problem, which other countries have corrected through industrial investments, mainly foreign direct investment. Given its almost unlimited access to EU markets, Moldova's exports may, however, grow faster than GDP over the forecasting period, while its imports will maintain their share in GDP. Services exports provide an alternative to goods, especially in the ICT sector, which is a net foreign revenue earner. Remittances amount to USD 1.4-1.6bn annually, and this finances a diminishing share of the expanding goods and services deficit (35% in 2022). The rest must come from international institutional sources, as the country has very limited access to private foreign financing.

International donors financed most of the fiscal gap of 3.3% of GDP in 2022. The budget deficit was lower than expected, on account of a surge in inflation-related revenue. However, it will widen in 2023 because of lower inflation and more pledged external financing, and in spite of measures to improve tax collection. Due to the elevated risks, the government will have limited access to the financial markets in the coming years, too; government debt will thus not rise much, remaining at about 36% of GDP. The IMF estimates that the total external financing gap will be USD 803m in 2023 (up a third on 2022), to be covered by disbursements of USD 333m from the IMF and the World Bank; USD 173m from other official bilateral donors; and USD 297m from the EU.

The government is firm in pursuing a pro-Western policy, but progress is being hindered by the tense political situation. The war in the neighbourhood and declining living standards are sources of popular unrest. Russia offers an indirect threat to stability – not only because Gazprom is using gas deliveries as a political weapon, but also because domestic pro-Russian forces have repeatedly provoked anti-government demonstrations in Chișinău. The tension with Transnistria is also heightened from time to time. None of this has succeeded in changing the political orientation of the government, but it did lead to a reshuffle under a new prime minister in February 2023. Social and military stability are expected to receive more political prominence and fiscal support than before.

In the absence of further negative external shocks, and reckoning on average weather conditions, the country should embark on the path to recovery in 2023. Increasing exports and improving terms of trade should support a narrowing of the current account deficit to 12% of GDP. As from 2024, economic growth of about 4% can be achieved, depending on the external environment and weather conditions. Growth could be even more rapid in the event of generous foreign assistance and improved public governance. If EU Pre-Accession Assistance is opened up to Moldova, that could bring a lot of additional financing.

There are major downside risks to this forecast. Elevated political and economic uncertainty will prevail for as long as the war in Ukraine persists. Though perhaps not very likely, Russia's hybrid warfare could destabilise the country and alter its political orientation. Popular dissatisfaction – also not entirely independent of Russia's influence – could have a similar effect. Any serious breach of the conditions set by external donors would reduce external resources for growth and hinder structural change.

Table 5.13 / Moldova: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,664	2,635	2,615	2,600	2,580	2,560	2,530
Gross domestic product, MDL bn, nom.	206.3	199.7	242.1	272.6	309	338	362
annual change in % (real)	3.6	-8.3	13.9	-5.9	3.0	4.0	4.0
GDP/capita (EUR at PPP)	8,780	8,200	10,210	9,860	.	.	.
Consumption of households, MDL bn, nom.	172.8	162.2	199.6	229.4	.	.	.
annual change in % (real)	3.7	-7.9	17.3	-4.0	3.0	3.5	4.0
Gross fixed capital form., MDL bn, nom.	48.3	49.8	58.3	62.0	.	.	.
annual change in % (real)	12.0	5.6	1.9	-6.8	2.0	5.0	7.0
Gross industrial production							
annual change in % (real)	2.0	-5.5	12.1	-5.1	1.0	4.0	5.0
Gross agricultural production							
annual change in % (real)	-1.6	-27.2	57.9	-29.8	.	.	.
Construction industry							
annual change in % (real)	12.8	11.8	-0.3	-13.9	.	.	.
Employed persons, LFS, th, average 2)	872.4	834.2	843.4	862.3	870	880	890
annual change in %	9.9	-4.4	1.1	2.2	1.0	1.0	1.0
Unemployed persons, LFS, th, average 2)	46.9	33.1	28.2	27.7	30	30	30
Unemployment rate, LFS, in %, average 2)	5.1	3.8	3.2	3.1	3.5	3.2	3.0
Reg. unemployment rate, in %, eop	1.8	2.9	2.3	2.4	.	.	.
Average monthly gross wages, MDL	7,234	7,943	8,980	10,372	12,300	13,700	15,100
annual change in % (real, gross)	10.1	5.8	7.6	-10.3	4.0	5.0	5.0
Average monthly net wages, MDL	6,010	6,617	7,635	8,900	10,700	12,000	13,400
annual change in % (real, net)	11.5	6.1	9.8	-9.0	5.0	6.0	6.0
Consumer prices, % p.a.	4.8	3.8	5.1	28.7	14.0	6.0	5.0
Producer prices in industry, % p.a.	1.8	2.6	8.4	26.5	12.0	5.0	4.0
General governm. budget, nat. def., % of GDP							
Revenues	30.5	31.4	32.0	33.6	33.0	33.0	34.0
Expenditures	32.0	36.7	33.9	36.8	37.0	36.0	35.0
Deficit (-) / surplus (+)	-1.5	-5.3	-1.9	-3.3	-4.0	-3.0	-1.0
General gov. gross debt, nat. def., % of GDP	25.7	34.2	32.6	35.2	36.0	36.0	35.0
Stock of loans of non-fin. private sector, % p.a.	13.9	13.2	22.6	8.5	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.5	7.4	6.1	6.4	.	.	.
Central bank policy rate, %, p.a., eop 4)	5.50	2.65	6.50	20.00	9.00	5.00	3.00
Current account, EUR m 5)	-988	-778	-1436	-2161	-2,230	-1,970	-1,950
Current account, % of GDP	-9.4	-7.7	-12.4	-15.8	-14.4	-12.2	-11.3
Exports of goods, BOP, EUR m 5)	1,892	1,706	2,165	3,517	3,770	3,910	4,330
annual change in %	13.1	-9.8	26.9	62.4	7.2	3.7	10.7
Imports of goods, BOP, EUR m 5)	4,850	4,420	5,706	8,251	8,840	8,990	9,780
annual change in %	8.7	-8.9	29.1	44.6	7.1	1.7	8.8
Exports of services, BOP, EUR m 5)	1,379	1,121	1,381	2,161	2,310	2,490	2,760
annual change in %	10.2	-18.7	23.2	56.4	6.9	7.8	10.8
Imports of services, BOP, EUR m 5)	1,053	772	982	1,302	1,330	1,370	1,490
annual change in %	10.9	-26.7	27.3	32.6	2.1	3.0	8.8
FDI liabilities, EUR m 5)	453	138	331	562	.	.	.
FDI assets, EUR m 5)	35	5	8	53	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	2,731	3,079	3,442	4,202	.	.	.
Gross external debt, EUR m 5)	6,451	6,620	7,735	8,891	10,200	10,800	11,700
Gross external debt, % of GDP	61.5	65.4	66.9	64.9	66.0	67.0	68.0
Average exchange rate MDL/EUR	19.67	19.74	20.93	19.90	20.0	21.0	21.0

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

1) Preliminary and wiiw estimates. - 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.