

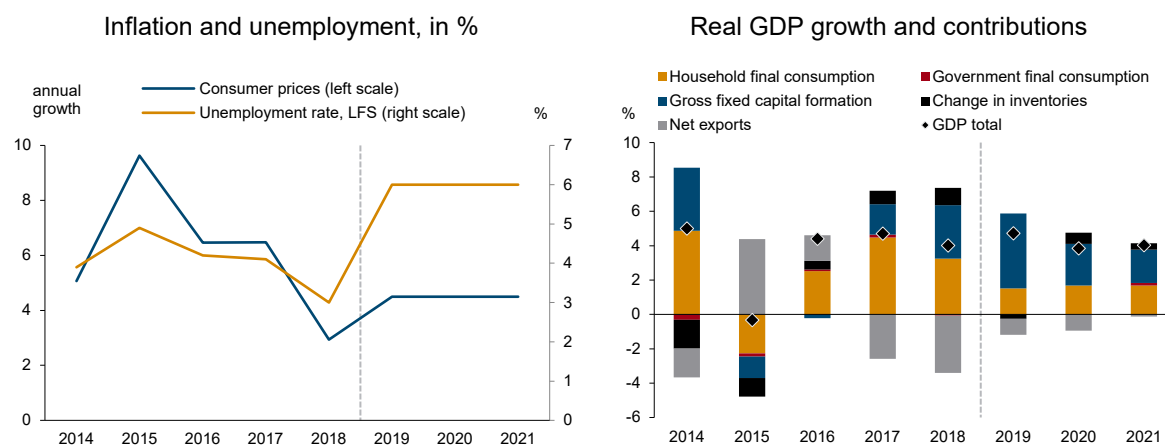


MOLDOVA: Solid growth amidst fragile political consolidation

GÁBOR HUNYA

Economic growth should accelerate to about 5% in 2019 on account of booming investments. After correcting for the current overheating, growth is expected to hover at around 4% in the coming years. A resumption of transfers from the IMF and EU will stabilise external financing. The current government coalition of pro-EU and pro-Russian parties has strong external support but may clash on domestic reforms.

Figure 5.13 / Moldova: Main macroeconomic indicators



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

Real GDP soared by 5.2% in the first half of 2019, making Moldova the fastest growing economy in the CESEE region covered by wiiw. Investments have become the most important factor of growth contributing 4.4 percentage points. Gross fixed capital formation expanded by 20% and investment outlays increased by 26.8% in real terms compared to the corresponding period of the previous year. Public investments soared by 50% but they only contributed less than 7% to total investment outlays. One third of the private sector investments went into machinery and equipment which supports the restructuring of production and export expansion.

Manufacturing production has put on the brakes expanding by only 1.3% in the first half of 2019. Agriculture and food industry were in decline due to adverse weather conditions. The production of light industry goods and general machinery also declined while the production of car components continued its rapid expansion. Foreign car suppliers which had invested in Romania have moved part of their production to Moldova due to it having lower labour costs.

The negative contribution of net exports to growth is shrinking. Exports of goods expanded somewhat more than imports, still the export revenues covered only 37% of imports in the first seven months of 2019. A slow upgrading of the commodity structure of exports gives hope that the current account deficit may shrink in the future. The exports of machinery and transport equipment products have grown more strongly than other commodity groups and accounted for almost 25% of the total. Agricultural and food products, as well as diverse manufactured goods, comprise similar but declining shares. A reorientation of exports from the CIS to the EU, which has taken place since the Deep and Comprehensive Free Trade Areas (DCFTA) with the EU came into force in 2016, has slowed down. Two thirds of exports went to the EU and 15% to the CIS in the first seven months of 2019. Both are lower shares than in the previous year while the share of other countries expanded mainly on account of Turkey. Romania is the most important export destination with 28% of the total, supported by geographic and cultural proximity. This country is approaching the end of an overheated growth period which may have a negative impact on Moldovan exporters.

The dependence on Russia is higher on the import side. Romania supplies only about 14% of the imports to Moldova, a share that has not changed much over recent years. Russia has maintained a share of 12% and Ukraine 10% – countries that are the main suppliers of energy and raw materials. The share of the EU is around 50% while China has reached a share of 10% and Turkey 7% in goods imports. Raw materials, energy carriers and chemical products comprise one third of the imports, almost one quarter are transport equipment and another third is comprised of various manufactured goods. It is important to note that although Moldovan statistics do not comprise data for the breakaway territory of Transnistria, companies from the latter have established subsidiaries in Moldova and enjoy the benefits of free trade with the EU.

The current account deficit of about 10% of GDP has imposed a challenge to external financing. The balances on the primary and the secondary incomes are positive but cover less than two thirds of trade deficits. This includes the remittances of about 18% of GDP transferred home by one quarter of the 3.55 million total population who live abroad. Capital inflows were severely inadequate thus the depletion of reserves financed most of the deficit in the first quarter of the year.

EU and IMF funding resumed thus a more solid financing is expected for the second half of the current year and beyond. The government signed an agreement with the EU promising assistance worth USD 45 million of which USD 16 million has already been disbursed. This is an important break-through as the EU had suspended financial support a year before amid concerns about a backsliding in the rule of law and democracy situation. While the government has succeeded to initiate several reform steps, the Association Implementation Report published on September 12 calls for further efforts in fighting corruption and in making improvements in the rule of law. Moldova has also benefitted from USD 46 million from the IMF this year under the current programme which would have expired in October but will be extended till March 2020.

Government and IMF reached an understanding on fiscal measures needed to correct the fiscal loosening from 2018 which led to rising budgetary pressures in 2019. The first semester of 2019 general government deficit expanded to 2.3% after a surplus achieved in the first six months of 2018. However the budget has been amended under the IMF agreement in July. The pressure on the pension fund has been reduced as the retirement age was increased by 6 months

from 1 July 2019, to 63 years for men and to 58½ years for women. The 2020 budget reckons with a 2% of GDP deficit and provides advantages to spending on investments and supporting poorer people.

The annual inflation rate has been on the rise all through the year reaching 5.5% in August year-on-year. Unfavourable weather conditions and buoyant private demand boosted the prices of fruits and vegetables. The national bank expects the annual rate of inflation to increase to 8% by the end of this year and then diminish in 2020. Therefore it increased the base rate to 7.5% leaving the deposit and lending facility in a symmetrical corridor of ± 3 p.p. to the base rate.

Population and employment are lower than supposed earlier – this is the result of recent corrections and changes in definition. Population data now cover only those who have lived in the country for at least 9 months in the past 12 months. By this, the country's population has been reduced from 3.54 million to 2.70 million in 2018. The difference increased the number of those living abroad. The number of employed persons also fell as the auxiliary agricultural workers producing for self-consumption only has been taken out of the statistics (see new LFS data in the country table). As a result, the participation rate of people above 15 years fell from 48.6% to 43.4% in the second quarter of 2019. The impact on the unemployment rate is also remarkable, as it increased from 3% to 6%.

The parties that came out second and third in the February 2019 elections, the pro-EU bloc ACUM and the pro-Russian Party of Socialists, formed a coalition in June. The Russian and US governments and the EU have given strong support to this unlikely couple as a sign of lowering tension in the region. Balancing between the EU and Russia is a viable option to safeguard the external stability of Moldova, but may not be enough to solve inherent conflicts between the coalition partners. As of now, there is a fruitful cooperation between the President, socialist party Igor Dodon, negotiating price discounts with Gazprom and the Prime Minister from ACUM, Maria Sandu, making reformist statements in the West. However, the two parties disagree on a number of issues including the status of Transnistria.

The current overheated dynamics of investments and economic growth cannot be maintained for the coming years, but a fairly robust growth rate of around 4% seems realistic. Fiscal austerity, privatisation and reforms of the business environment may suppress demand initially but do support longer-term growth.

Table 5.13 / Moldova: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 ¹⁾ | 2018 January-June | 2019 | 2019 Forecast | 2020 Forecast | 2021 |
|--|-------|-------|-------|--------------------|----------------------|-------|------------------|------------------|-------|
| Population, th pers., average ²⁾ | 2,835 | 2,802 | 2,755 | 2,706 | . | . | 2,640 | 2,600 | 2,560 |
| Gross domestic product, MDL bn, nom. | 145.8 | 160.8 | 178.9 | 192.3 | 82.5 | 90.9 | 210 | 228 | 248 |
| annual change in % (real) | -0.3 | 4.4 | 4.7 | 4.0 | 4.6 | 5.2 | 4.7 | 3.8 | 4.0 |
| GDP/capita (EUR at PPP) | 5,700 | 5,900 | 6,200 | 6,900 | . | . | . | . | . |
| Consumption of households, MDL bn, nom. | 125.4 | 136.4 | 150.8 | 161.6 | 71.7 | 75.4 | . | . | . |
| annual change in % (real) | -2.5 | 2.9 | 5.3 | 3.8 | 2.8 | 1.8 | 1.8 | 2.0 | 2.0 |
| Gross fixed capital form., MDL bn, nom. | 35.4 | 35.7 | 39.9 | 46.6 | 19.2 | 23.6 | . | . | . |
| annual change in % (real) | -4.8 | -0.9 | 8.0 | 14.0 | 9.8 | 20.3 | 18.0 | 10.0 | 8.0 |
| Gross industrial production | . | . | . | . | . | . | . | . | . |
| annual change in % (real) | 0.6 | 0.9 | 3.4 | 3.7 | 8.5 | 1.3 | 1.5 | 2.0 | 2.0 |
| Gross agricultural production | . | . | . | . | . | . | . | . | . |
| annual change in % (real) | -13.4 | 18.6 | 9.1 | 2.5 | . | . | . | . | . |
| Construction industry | . | . | . | . | . | . | . | . | . |
| annual change in % (real) | -12.7 | -8.1 | 3.6 | 10.3 | . | . | . | . | . |
| Employed persons, LFS, th, average ³⁾ | 1,204 | 1,220 | 1,208 | 1,252 | . | 865 | 860 | 880 | 900 |
| annual change in % ³⁾ | 1.6 | 1.3 | -1.0 | 3.7 | . | . | . | 2.0 | 2.0 |
| Unemployed persons, LFS, th, average ³⁾ | 62.1 | 53.3 | 51.6 | 38.4 | . | 56 | 50.0 | 60.0 | 60.0 |
| Unemployment rate, LFS, in %, average | 4.9 | 4.2 | 4.1 | 3.0 | . | 6.1 | 6.0 | 6.0 | 6.0 |
| Reg. unemployment rate, in %, eop | 2.1 | 2.3 | 2.1 | 1.7 | 1.6 | 1.2 | . | . | . |
| Average monthly gross wages, MDL ⁴⁾ | 4,538 | 4,998 | 5,587 | 6,322 | 6,138 | 7,113 | 7,300 | 8,000 | 8,700 |
| annual change in % (real, gross) | 1.2 | 3.7 | 5.0 | 9.9 | 9.6 | 10.3 | 10.0 | 5.0 | 4.0 |
| Average monthly net wages, MDL | 3,752 | 4,103 | 4,564 | 5,220 | . | . | 6,000 | 6,600 | 7,200 |
| annual change in % (real, net) | 0.7 | 2.7 | 4.5 | 11.0 | . | . | 10.0 | 5.0 | 4.0 |
| Consumer prices, % p.a. | 9.6 | 6.5 | 6.5 | 2.9 | 4.1 | 3.1 | 4.5 | 4.5 | 4.5 |
| Producer prices in industry, % p.a. | 6.3 | 4.5 | 3.3 | 0.4 | 1.1 | 1.0 | 1.0 | 2.0 | 2.0 |
| General governm. budget, nat.def., % of GDP | . | . | . | . | . | . | . | . | . |
| Revenues | 30.0 | 28.6 | 29.8 | 30.2 | 33.7 | 32.4 | 31.0 | 31.0 | 31.5 |
| Expenditures | 31.8 | 30.1 | 30.5 | 31.0 | 32.6 | 34.7 | 33.0 | 32.5 | 33.0 |
| Deficit (-) / surplus (+) | -1.9 | -1.6 | -0.6 | -0.8 | 1.1 | -2.3 | -2.0 | -1.5 | -1.5 |
| General gov.gross debt, nat.def., % of GDP ⁵⁾ | 23.3 | 31.8 | 29.1 | 27.2 | . | . | 26.9 | 26.3 | 25.7 |
| Stock of loans of non-fin.private sector, % p.a. | . | . | -3.3 | 6.0 | -2.3 | 16.2 | . | . | . |
| Non-performing loans (NPL), in %, eop ⁶⁾ | 10.0 | 16.4 | 18.4 | 12.5 | 14.7 | 10.6 | . | . | . |
| Central bank policy rate, %, p.a., eop ⁷⁾ | 19.50 | 9.00 | 6.50 | 6.50 | 6.50 | 7.00 | 7.75 | 7.50 | 7.50 |
| Current account, EUR mn ⁸⁾ | -417 | -255 | -493 | -1026 | -410 | -488 | -1,030 | -1,000 | -970 |
| Current account, % of GDP | -6.0 | -3.5 | -5.7 | -10.6 | -10.0 | -10.6 | -9.8 | -9.2 | -8.2 |
| Exports of goods, BOP, EUR mn ⁸⁾ | 1,357 | 1,407 | 1,657 | 1,672 | 797 | 874 | 1,780 | 1,850 | 1,950 |
| annual change in % | -0.9 | 3.7 | 17.7 | 1.0 | 10.8 | 9.6 | 6.4 | 3.9 | 5.4 |
| Imports of goods, BOP, EUR mn ⁸⁾ | 3,269 | 3,285 | 3,928 | 4,462 | 2042 | 2274 | 4,730 | 4,870 | 5,070 |
| annual change in % | -10.7 | 0.5 | 19.6 | 13.6 | 11.9 | 11.4 | 6.0 | 3.0 | 4.1 |
| Exports of services, BOP, EUR mn ⁸⁾ | 884 | 964 | 1,113 | 1,250 | 567 | 661 | 1,400 | 1,520 | 1,640 |
| annual change in % | 2.7 | 9.0 | 15.5 | 12.3 | 8.6 | 16.6 | 12.0 | 8.6 | 7.9 |
| Imports of services, BOP, EUR mn ⁸⁾ | 765 | 759 | 837 | 944 | 440 | 487 | 1,070 | 1,160 | 1,220 |
| annual change in % | 0.0 | -0.8 | 10.3 | 12.8 | 9.8 | 10.6 | 13.3 | 8.4 | 5.2 |
| FDI liabilities, EUR mn ⁸⁾ | 203 | 80 | 137 | 264 | 97 | 372 | 230 | 260 | 350 |
| FDI assets, EUR mn ⁸⁾ | 7 | 12 | 10 | 36 | 1 | 19 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn ⁸⁾ | 1,608 | 2,110 | 2,349 | 2,630 | 2,499 | 2,558 | . | . | . |
| Gross external debt, EUR mn ⁸⁾ | 5,561 | 5,930 | 5,844 | 6,555 | 6,164 | 6,460 | 6,600 | 6,800 | 7,600 |
| Gross external debt, % of GDP | 79.7 | 81.3 | 68.0 | 67.7 | 63.6 | 61.5 | 63.0 | 63.0 | 64.0 |
| Average exchange rate MDL/EUR | 20.90 | 22.05 | 20.83 | 19.84 | 20.2 | 19.8 | 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. - 2) According to census May 2014, usual residence. - 3) From 2019 according to census May 2014 and further adjustments to international standards. Data not comparable with previous years. - 4) Quarterly data refer to all public enterprises and private enterprises with 4 and more employees. - 5) Excluding government guaranteed debt. - 6) Substandard, doubtful and compromised credit portfolio. - 7) Overnight (refinancing) operations rate of National Bank. - 8) Converted from USD.

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