MOLDOVA: Solid growth with prospects with elevated risks

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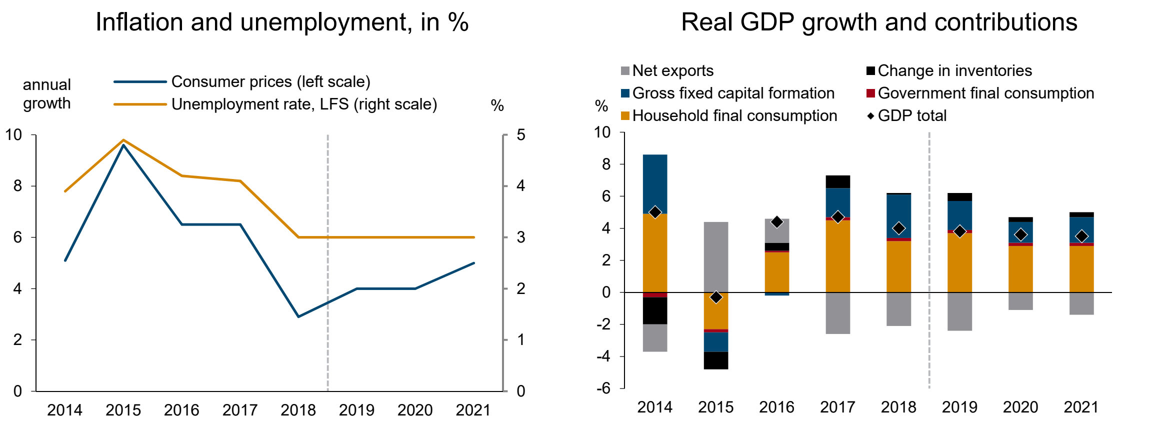
Economic growth of 4% or more for the third consecutive year in 2018 has corrected for the setbacks suffered during the bank-fraud related crisis in 2015. Inflation has come down and the local currency stabilised. Economic prospects are positive but cumbersome coalition building following inconclusive recent elections can delay necessary reforms.

Figure 6.13 / Moldova: Main macroeconomic indicators



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

Moldova is the least developed in terms of per capita GDP among the countries covered by wiiw (GDP per capita at PPP: EUR 5100). Agriculture has a relatively high contribution to GDP, 12%, and even more to employment, 40%. Manufacturing contributes to GDP with only 21%, with the rest accounted for by services mostly in non-tradeable sectors. Moldova's transition to a market economy has suffered several setbacks since the disintegration of the former Soviet Union. The latest such event was a bank fraud in 2015 when about USD 1 billion (13% of GDP) was stolen from the banking system. However, the economy has stabilised in recent years and the banking sector underwent restructuring under an IMF-led programme. The country is involved in a frozen conflict with the secessionist territory Transnistria[31] (or Pridnestrovian Moldavian Republic, PMR, recognised only by Russia). Here, relations have stabilised, the borders are easy to cross and allow for a lot of legal and illegal trade. The area enjoys the benefits of Moldova's DCFTA with the EU while having free trade with and financial support from Russia.

[31] The website of the National Bureau of Statistics of the Republic of Moldova notes that 'Information for Moldova is presented without data on the districts on the left side of the river Nistru and municipality Bender', meaning without Transnistria.

Private consumption was a key component of Moldovan economic growth in 2018. Consumption received a boost in October from the implementation of the flat tax on personal income, 12% instead of 7-18% before. The rate of social security contributions paid by private-sector employers has been reduced from 23% to 18%. In addition, the payroll reform in the public sector has brought substantial salary increases allowing for further consumption growth in 2019.

Gross fixed capital formation also contributed positively to economic growth last year. During January-September 2018, a 13.5% increase in investment was recorded; the construction of roads and residential buildings in particular boomed. The construction industry was the fastest growing segment of the economy (up by 15%) while industrial production grew by a more modest 3.7%, and agriculture by 2.5%.

The foreign trade deficit widened by 27% and only 47% of the imports could be covered by exports in 2018. Both exports and imports of goods expanded rapidly, by 11.6% and 19.3%, respectively. Higher oil and gas prices as well as increasing imports of production goods were the main reasons for the expansion of imports and of the trade deficit. An appreciation of the local currency also played a role.

The weak and narrow export base is a long-standing problem for Moldova. Agricultural products constitute the main category of exports, although their share fell below one quarter of the total in 2018. Diverse manufactured goods comprise a similar share. The third main category is transport equipment products, which have grown more strongly than other commodity groups in recent years, and accounted for almost 22% of the total.

The Deep and Comprehensive Free Trade Areas (DCFTA) entered into force in July 2016 as part of the Association Agreement with the EU. A restructuring of export destinations from the CIS to the EU has taken place subsequently. The recurring Russian embargoes (lifted for the time being) on food products and wine have accelerated the process. Almost 69% of exports went to the EU in 2018 (up from 66% a year earlier). The main export destination is Romania; its share rose from 25% to 29%; Italy is second with 12%. The previous main partner, Russia, ranks only third with 8% in 2018, down from 11% in the previous year. Imports have a different structure: Romania supplies only about 15%, 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 has stagnated at 50%; Germany (8%) and Italy (7%) are the main source countries beyond Romania. China has reached a share of more than 10% in recent years, while Turkey's has declined to 7%. The commodity structure of imports is more stable than of exports. 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.

The current account deficit has widened on account of the larger goods shortfall to more than 7% of GDP. Remittances are important to moderate the deficit. They amount to 20% of GDP, the seventh highest rate in the world according to the World Bank. Seeking temporary work abroad was widespread also in the 1990s when the CIS was the main destination. Citizens have enjoyed visa-free entry into the EU since 2015 and the EU replaced Russia as the main destination of jobseekers abroad. Despite the current account deficit, inflows of foreign currency allowed some appreciation of the Moldovan leu and moderated inflation below 3% in 2018. This is below the lower band of the central bank rate of 3.5%. The National Bank kept the policy rate at 6.5% for the second consecutive year in 2018, and expects inflation to approach the policy rate by the end on 2019.

The lending activity of banks increased in 2018 and the level of non-performing loans declined for the first time since the banking crisis. A major step in the banking sector restructuring took place on 18 February 2019 when Moldindconbank, one of the largest banks in the country that had belonged to oligarch Veaceslav Platon (one of the persons involved in the 2015 bank fraud and sentenced to 25 years in jail), was bought by the Public Property Agency before being sold to the Bulgaria-based Doverie United Holding.

The domestic labour market is distorted due to widespread employment abroad. It is characterised by both low employment and unemployment rates. Currently employment is rising and unemployment declining (reaching 3% in 2018 on average) on account of the economic recovery, giving a boost to wages (12%) and consumption.

The 24 February parliamentary elections produced no clear winner. According to preliminary results, the pro-Russian Socialists of President Dodon won 35 seats in the next parliament, Vladimir Plahotniuc's ruling Democratic Party (pro-EU in words) 30 seats, ACUM ('Now') – a coalition of two pro-European parties – 26 seats, and the conservative Shor Party seven seats. Three independent candidates will receive the remaining seats. While any two of the three leading parties can form a majority, coalition-building will be cumbersome and snap elections cannot be excluded. This was the first elections organised under new rules which allocate only half of the parliamentary seats based on national party lists, the other half being distributed to the winners of single constituencies. Electoral reform and delays in the democratisation process prompted the EU to freeze development aid to Moldova (EUR 100 million) saying that disbursement can take place only if elections are declared fair by observers. The European Parliament called Moldova 'a state captured by oligarchic interests'. International observers have recognised the results of the elections, but investigations are going on concerning voting fraud and misuse of public resources.

Balancing between the EU and Russia may not be desirable, but is a practically viable option to serve the national interest amid conflicting foreign pressures. More important than business orientation would be improvements in business conditions and the rule of law. FDI has started to discover the country in the areas of the manufacturing of automotive parts and IT services. The government has initiated some important improvements such as the setting up of industrial parks, enlarging the Danube port and of border crossings which can attract investors even if the general standard of infrastructure is poor.

Some slowdown of growth and acceleration of inflation are expected during the forecast period. The fiscal measures introduced in late 2018 will generate more household consumption in 2019 and keep the level of GDP growth just below 4%. A slowdown to 3.5% is expected in the following years due to sluggish external demand and cooling of the construction boom. Current low inflation and the stable currency are the results of financial stabilisation in the wake of the 2015 crisis, and it can be expected that the country returns to somewhat higher inflation and moderate depreciation.

Table 6.13 / Moldova: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020 Forecast	2021
Population, th pers., average	3,556	3,554	3,552	3,549	3,540	3,520	3,500	3,500
Gross domestic product, MDL bn, nom.	133.5	145.8	160.8	178.9	192.0	207	223	242
annual change in % (real)	5.0	-0.3	4.4	4.7	4.0	3.8	3.6	3.5
GDP/capita (EUR at PPP)	4,400	4,500	4,600	4,800	5,100	.	.	.
Consumption of households, MDL bn, nom.	118.5	125.4	136.4	150.8	161.1	.	.	.
annual change in % (real)	5.4	-2.5	2.9	5.3	3.8	4.4	3.5	3.5
Gross fixed capital form., MDL bn, nom.	34.6	35.4	35.7	39.9	44.8			
annual change in % (real)	15.9	-4.8	-0.9	8.0	12.0	8.0	6.0	7.0
Gross industrial production								
annual change in % (real)	7.3	0.6	0.9	3.4	3.7	3.0	3.0	2.0
Gross agricultural production								
annual change in % (real)	8.6	-13.4	18.6	8.6	0.0	.	.	.
Construction industry								
annual change in % (real)	-1.3	-12.7	-8.1	3.6	14.5	.	.	.
Employed persons, LFS, th, average	1,185	1,204	1,220	1,208	1,270	1,310	1,340	1,370
annual change in %	1.0	1.6	1.3	-1.0	5.2	3.0	2.0	2.0
Unemployed persons, LFS, th, average	47.5	62.1	53.3	51.6	40.0	40.0	40.0	40.0
Unemployment rate, LFS, in %, average	3.9	4.9	4.2	4.1	3.0	3.0	3.0	3.0
Reg. unemployment rate, in %, eop	1.7	2.1	2.3	1.9	1.4	.	.	.
Average monthly gross wages, MDL	4,090	4,538	4,998	5,587	6,320	7,200	7,900	8,600
annual change in % (real, gross)	5.9	1.2	3.7	5.2	9.9	10.0	5.0	4.0
Average monthly net wages, MDL	3,399	3,752	4,103	4,564	5,200	5,900	6,400	7,000
annual change in % (real, net)	5.3	0.7	2.7	4.5	11.0	10.0	5.0	4.0
Consumer prices, % p.a.	5.1	9.6	6.5	6.5	2.9	4.0	4.0	5.0
Producer prices in industry, % p.a.	5.5	6.3	4.5	3.3	0.4	2.0	3.0	3.0
General governm. budget, nat.def., % of GDP								
Revenues	31.8	30.0	28.6	29.8	30.2	31.0	31.0	31.0
Expenditures	33.3	31.8	30.1	30.5	31.0	32.0	32.0	33.0
Deficit (-) / surplus (+)	-1.5	-1.9	-1.6	-0.6	-0.8	-1.0	-1.0	-2.0
General gov.gross debt, nat.def., % of GDP 2)	20.8	23.3	31.8	29.1	27.9	1.0	2.0	3.8
Stock of loans of non-fin.private sector, % p.a.	.	.	.	-3.3	6.0	.	.	.
Non-performing loans (NPL), in %, eop 3)	11.7	10.0	16.4	18.4	12.5	.	.	.
Central bank policy rate, %, p.a., eop 4)	6.50	19.50	9.00	6.50	6.50	6.00	6.00	6.00
Current account, EUR mn 5)	-428	-417	-257	-499	-700	-900	-800	-900
Current account, % of GDP	-6.0	-6.0	-3.5	-5.8	-7.2	-8.3	-6.8	-7.4
Exports of goods, BOP, EUR mn 5)	1,369	1,357	1,398	1,649	1,800	2,000	2,200	2,400
annual change in %	-4.2	-0.9	3.0	18.0	9.1	11.1	10.0	9.1
Imports of goods, BOP, EUR mn 5)	3,660	3,269	3,284	3,930	4,500	5,200	5,600	6,100
annual change in %	-3.5	-10.7	0.5	19.7	14.5	15.6	7.7	8.9
Exports of services, BOP, EUR mn 5)	861	884	958	1,104	1,300	1,500	1,600	1,800
annual change in %	0.1	2.7	8.4	15.3	17.7	15.4	6.7	12.5
Imports of services, BOP, EUR mn 5)	765	765	751	823	900	1,000	1,100	1,200
annual change in %	2.6	0.0	-1.8	9.6	9.4	11.1	10.0	9.1
FDI liabilities, EUR mn 5)	258	195	86	143	200	.	.	.
FDI assets, EUR mn 5)	31	7	12	10	0	.	.	.
Gross reserves of NB excl. gold, EUR mn 5)	1,770	1,606	2,107	2,346	2,628	.	.	.
Gross external debt, EUR mn 5)	5,306	5,550	5,924	5,835	6,323	7,200	7,900	8,200
Gross external debt, % of GDP	75.5	81.8	77.0	66.6	65.0	66.0	67.0	68.0
Average exchange rate MDL/EUR	18.63	20.90	22.05	20.83	19.84	19.0	19.0	20.0

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

1) Preliminary and wiiw estimates. - 2) Excluding government garantied debt. - 3) Substandard, doubtful and compromised credit portfolio. - 4) Overnight (refinancing) operations rate of National Bank. - 5) Converted from USD.

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