MOLDOVA: Emerging from depression

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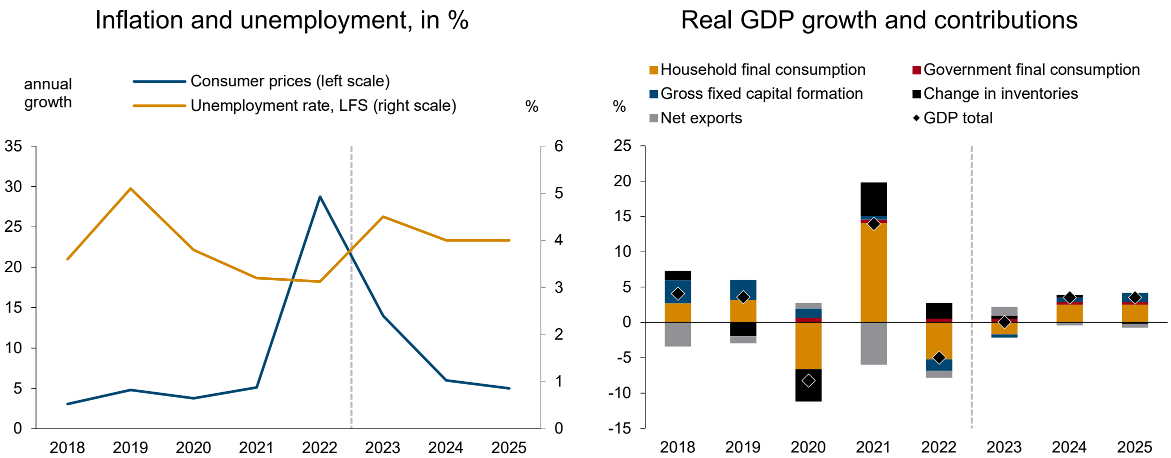
After two years of decline, GDP will finally recover in H2 2023. The harvest will be better than last year, and that will have a positive impact on incomes, exports and the food industry. Sharp disinflation will help consumption recover. The future prospects look even brighter, as Moldova has managed to switch its trade flows, including energy supplies, from Russia to the West. The country can rely on multinational institutions to finance its fiscal and current account deficits.

Figure 6.13 / Moldova: Main macroeconomic indicators



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

Moldova has managed to absorb two fundamental shocks over the past two years. It has decoupled from the Russian energy supply, though this did cause temporary shortages and significant price hikes, which increased the relative cost of energy. And it has also coped with last year's very poor harvest that was triggered by extreme weather conditions, which came on top of skyrocketing international food prices. Economic depression and declining living standards were the result. Energy and fuel subsidies to the poor and to farmers have helped the country deal with these shocks. Generous financial and political support from the West has also been indispensable for the country's survival.

The economic slump continued in H1 2023, with GDP down by 2.3%. Household consumption fell by 5.6% year on year, and public consumption suffered a minor contraction. Gross capital formation was positive as rising stocks outpaced the 5.8% contraction in fixed capital formation. Investments in machinery and equipment picked up, but housing construction fell sharply. Net exports made a positive contribution to growth, based on marginally higher exports and smaller imports than a year before. The

GDP decline decelerated only marginally in Q2 from the previous quarter. Q2 was worse than Q1 in respect of final consumption and investments, but net exports compensated for this thanks to a rapid contraction in imports.

Manufacturing production fell by close to 10% in H1. This was mainly due to food production (which was short of raw materials in the wake of the bad 2022 harvest) and to low domestic demand (in the face of elevated retail prices). But the production of machinery and equipment increased, thanks to deepening integration in international value chains and growing Ukrainian demand. The slump and structural change in manufacturing were reflected in falling exports and a shift in their structure to more sophisticated products.

The labour supply expanded in H1 2023. The participation rate increased, but it still accounted for only 45% of the working-age population. The unemployment rate also increased – to 3.8% in H1 2023, from 2.2% a year before. Part of this change may be statistical, as the Labour Force Survey achieved better coverage of the unemployed.

Having fallen steadily for a year and a half, in Q2 real incomes recovered by 1.3% year on year. Declining inflation and recovering agricultural incomes could be the main reasons for this. The harvest of summer grains was much better than last year, and so farmers saw an improvement in their incomes.

Moldova has undergone sharp disinflation since the end of 2022. The annual rate of consumer price inflation (CPI) fell from 30% in December 2022 to 10% in August 2023. The high inflation in 2022 was a result of the energy price adjustments and food price shocks, which had trickled down through the whole economy. Contracting domestic demand, falling energy prices and recovering food production have all put the brakes on inflation in 2023. As a result, the central bank has switched from a very restrictive to an accommodative stance. The policy rate has stood at 6% since June 2023, down from 20% in December 2022. Real interest rates on new loans have come down to low positive levels, though the volume of new loans has picked up only modestly. The local currency has appreciated against the euro, and that has also contributed to disinflation.

The shrinking foreign trade deficit indicates that the current account gap must also be contracting (though at the time of writing there are no data available for Q2). The central bank's foreign exchange reserves reached more than six months' worth of imports at the end of July, up from five months' worth a year before.

The geographical structure of foreign trade has undergone important changes. Romania is Moldova's most important partner, while Ukraine has become its second most important in terms of exports, and its third most important in terms of imports (after China). Russia's share in imports fell to 4% in H1 2023 – from 14% the year previously. Gas imports have by and large been switched away from Russia to other suppliers. Diversification of sources and subsidies on the cost of imported energy have improved economic stability in general. Integration with the Romanian gas and electricity networks is helping to avoid any serious shortages. Investments are in hand to increase the capacity of the interconnections, which is necessary to increase the stability of supply. Management of the gas transmission network was recently removed from the Gazprom-controlled Moldovagaz and given to Vestmoldtransgaz, a company owned by the Romanian gas transport system operator Transgaz and the European Bank for Reconstruction and Development. Russian gas is, however, still being supplied to

Transnistria, which is the heavy-industry and energy-generation hub of Moldova. Gazprom charges the central government for these deliveries. Unpaid bills are a disputed issue and could result in disruption to gas deliveries.

Fiscal policy has been more expansionary than last year. The deficit may reach 5% of GDP in 2023, but there is no pressure to stabilise. The country is under an International Monetary Fund (IMF) programme, the conditions of which focus on disinflation and institutional reform, rather than on fiscal prudence. The government has limited access to the international financial markets, but generous foreign aid and loans from multinational and bilateral donors provide advantageous financing. The IMF estimates that the total external financing gap will be USD 803m in 2023, to be covered by disbursements from the IMF, World Bank and the EU, together with aid and credit lines from individual governments. Nevertheless, government debt will amount to only a modest 36% of GDP by the end of the year.

H2 2023 will see an upturn in the economy, and it is likely that 2023 will end with around 0% GDP growth for the year as a whole. Household consumption will recover due to declining inflation and improving rural income. The harvest will be better than last year, and that will have a positive impact on exports and on the food industry, thus generating further income. The energy crisis of last winter may not recur: most of the necessary gas has already been purchased and is being stored in Ukraine and Romania. Moldova's future prospects look even brighter, as the country has digested the structural shocks related to the shift in its trade linkages from Russia to the West. The benefits of deepening EU integration in return for institutional reforms are starting to be felt. As one element of these reforms, anti-corruption bodies have started their activities.

Political stability is not in any imminent danger, despite serious menaces. Russia's efforts at disruption are serious, but the Moldovan government has taken steps to curtail the Russian presence in the country by restricting access to media that spreads Russian propaganda and by reducing the Russian embassy staff. Pro-Russian political parties are also restricted in their operations, although one of them could win the local election in the province of Gagauzia, which is populated by a Russian-speaking minority of Turkic origin. Tensions with Transnistria have not escalated recently, as the separatist region has no long-term alternative to economic integration with the rest of the country. As a first step, the Moldova Steel Works in Transnistria has started to pay the environmental pollution tax to the central government, in exchange for getting a certificate allowing it to export to the EU. NATO considers it unlikely that Russia would intervene militarily in Transnistria. The pro-Western Moldovan government is maintaining its neutrality and has no intention of joining NATO. However, poor living conditions and increased poverty make it vulnerable to popular unrest. The government has announced that social and military stability will attract greater political attention and fiscal support. The results of the local elections on 5 November will be the first test of public support.

Table 6.13 / Moldova: Selected economic indicators

	2020	2021	2022 1)	2022	2023	2023	2024	2025
				January-June			Forecast	
Population, th pers., average	2,635	2,596	2,539	.	.	2,580	2,560	2,530
Gross domestic product, MDL bn, nom.	199.7	242.1	274.2	120.3	133.9	296	322	343
annual change in % (real)	-8.3	13.9	-5.0	0.5	-2.3	0.0	3.5	3.5
GDP/capita (EUR at PPP)	8,200	10,020	10,180	.	.	.	.	.
Consumption of households, MDL bn, nom.	162.2	199.6	229.4	96.8	110.3	.	.	.
annual change in % (real)	-7.9	17.3	-6.3	-3.1	-5.6	-2.0	3.0	3.0
Gross fixed capital form., MDL bn, nom.	49.8	58.3	61.8	27.3	27.4	.	.	.
annual change in % (real)	5.6	1.9	-6.8	-7.7	-3.4	-2.0	3.0	6.0
Gross industrial production								
annual change in % (real)	-5.5	12.1	-5.1	0.7	-7.8	-4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	-27.2	57.9	-29.8	.	.	.	.	.
Construction industry								
annual change in % (real)	11.8	-0.3	-13.9	-11.6	-8.0	.	.	.
Employed persons, LFS, th, average 2)	834.2	843.4	862.3	853.7	882.5	880	890	900
annual change in %	-4.4	1.1	2.2	4.1	3.4	2.0	1.0	1.0
Unemployed persons, LFS, th, average 2)	33.1	28.2	27.7	23.6	43.2	40	40	40
Unemployment rate, LFS, in %, average 2)	3.8	3.2	3.1	2.7	4.7	4.5	4.0	4.0
Reg. unemployment rate, in %, eop	2.9	2.3	2.4	1.5	1.4	.	.	.
Average monthly gross wages, MDL	7,943	8,980	10,447	9,969	11,831	12,000	13,200	14,600
annual change in % (real, gross)	5.8	7.6	-9.6	-8.4	-1.2	1.0	4.0	5.0
Average monthly net wages, MDL	6,617	7,635	8,900	.	.	10,200	11,400	12,700
annual change in % (real, net)	6.1	9.8	-9.5	.	.	1.0	5.0	6.0
Consumer prices, % p.a.	3.8	5.1	28.7	24.3	20.2	14.0	6.0	5.0
Producer prices in industry, % p.a.	2.6	8.4	26.5	23.0	19.3	12.0	5.0	4.0
General governm. budget, nat. def., % of GDP								
Revenues	31.4	32.0	33.4	34.7	35.1	35.0	35.0	34.0
Expenditures	36.7	33.9	36.6	37.5	40.5	40.0	39.0	37.0
Deficit (-) / surplus (+)	-5.3	-1.9	-3.2	-2.8	-5.3	-5.0	-4.0	-3.0
General gov. gross debt, nat. def., % of GDP	34.2	32.6	35.0	29.2	.	36.0	36.0	35.0
Stock of loans of non-fin. private sector, % p.a.	13.2	22.6	8.5	19.1	2.7	.	.	.
Non-performing loans (NPL), in %, eop 3)	7.4	6.1	6.4	6.7	7.1	.	.	.
Central bank policy rate, %, p.a., eop 4)	2.65	6.50	20.00	18.50	6.00	6.00	5.00	4.00
Current account, EUR m 5)	-778	-1436	-2161	.	.	-1,610	-1,390	-1,280
Current account, % of GDP	-7.7	-12.4	-15.7	.	.	-10.3	-8.2	-7.1
Exports of goods, BOP, EUR m 5)	1,706	2,165	3,517	.	.	3,610	3,790	3,980
annual change in %	-9.8	26.9	62.4	.	.	2.6	5.0	5.0
Imports of goods, BOP, EUR m 5)	4,420	5,706	8,251	.	.	8,230	8,480	8,900
annual change in %	-8.9	29.1	44.6	.	.	-0.3	3.0	5.0
Exports of services, BOP, EUR m 5)	1,121	1,381	2,161	.	.	2,370	2,610	2,820
annual change in %	-18.7	23.2	56.4	.	.	9.7	10.1	8.0
Imports of services, BOP, EUR m 5)	772	982	1,302	.	.	1,350	1,400	1,460
annual change in %	-26.7	27.3	32.6	.	.	3.7	3.7	4.3
FDI liabilities, EUR m 5)	138	331	562	.	.	470	.	.
FDI assets, EUR m 5)	5	8	53	.	.	0	.	.
Gross reserves of CB excl. gold, EUR m 5)	3,079	3,442	4,202	3,434	4,483	.	.	.
Gross external debt, EUR m 5)	6,620	7,735	8,891	.	.	10,300	11,400	12,300
Gross external debt, % of GDP	65.4	66.9	64.5	.	.	66.0	67.0	68.0
Average exchange rate MDL/EUR	19.74	20.93	19.90	20.20	19.89	19.0	19.0	19.0

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.