

Economic situation in Moldova improving significantly

The Moldovan economy has to a large extent regained stability and returned to a growth track. The lack of financial support by international donors and low investment had created a difficult environment for growth in 2016. However, GDP increased surprisingly strongly by 4.3%, driven mainly by a good harvest and stable private consumption. In 2017, growth is expected to accelerate slightly. This year, especially stronger public investment – made possible by resumed international support – plays a key role.

Important macroeconomic indicators develop positively: Inflation stabilised already in 2016 and amounted to 6.4% after 9.6% the year before. Its level is expected to meet the target corridor of the National Bank also this year. The exchange rate is relatively stable since end-2015. Since the beginning of this year, remittances are increasing again; also import and export perform well. The budget deficit will amount to acceptable 3.7% of GDP in 2017.

In spite of the surprisingly good development, Moldova has not yet unleashed its full growth potential. For this to happen, structural reforms are necessary similar to those currently conducted in the banking sector with support of the IMF.

Consumption and a good harvest drive growth in 2016

After slightly negative growth during the crisis in 2015, the Moldovan economy grew much stronger than expected with 4.3% in 2016. This positive development was mainly driven by two factors: On the one hand, the agricultural sector contributed more than 2 percentage points to growth due to a good harvest. On the other hand, private consumption contributed strongly. Also this year growth is expected to continue with the IMF projecting a 4.5% increase of GDP.

Real GDP growth



Source: IMF, *Forecast

It is interesting to take a closer look at investment over 2016/2017: In 2016 public and private investment was much lower than in 2015, with public investment decreasing by more than 10% yoy. The reason for this were fiscal bottlenecks, as the state had no access to capital markets and international donors provided close to no financial support after the bank fraud.

International support was resumed by the end of 2016 in the context of the new IMF programme. Because of new financing, a strong increase in public investment is expected in 2017: The IMF forecasts a plus of 44% compared to 2016. Also private investment is expected to increase slightly, although crediting of the private sector continues to be low. While the recovery was mainly driven by consumption and agriculture in 2016, investment plays a key role in 2017.

Inflation stabilised after the crisis

Inflation decreased significantly during 2016 amounting to 6.4% on average. This was a strong improvement compared to 2015, when it had amounted to 9.6% on average. However, inflation increased again – driven by commodity prices – during the last months reaching around 7.4% between May and July. Still, this year inflation is expected to meet in average the target corridor of the National Bank of 5% ± 1.5%.

Due to lower inflation, real wages increased more strongly. In 2016 they grew by 3.6% after only 0.8% in 2015. Also during 2017 and 2018 real wages are expected to increase moderately, what should further support consumption. From an investor's perspective wages remain very competitive with the current gross monthly average wage amounting to an equivalent of ca. EUR 250.

Stable exchange rate and remittances

After the bank fraud in 2014, the Leu devaluated strongly. Since end-2015 the exchange rate is relatively stable. This reflects the regained macroeconomic stability and supports trust into the economy. An appreciation pressure has even caused the Leu to increase its value versus the US dollar by ca. 10% since the beginning of 2017. Due to this stability currency reserves have been increasing. They amounted to 5.5 months import coverage at the end of June. Generally, a country's currency reserves should cover at least 3 months of imports.

Exchange rate and currency reserves



Source: National Bank of Moldova

Positive news comes also from remittances, which continue to play a key role for the Moldovan economy. After a strong decrease during 2015 and a slight decrease in 2016 they are increasing significantly since the first quarter of 2017. This should also strengthen domestic demand. Remittances from Russia are an exception: They continue to decrease strongly which leads to a diminishing role of Russian remittances.

External trade recovering

Also external trade is performing well. After a strong decrease in 2015 and low dynamics during 2016, export increased in the first half of 2017 by 14% yoy, import even by 17%. A closer look at the goods structure of exports reveals that the recovery trend is mainly driven by vegetable products and machinery, whereas machinery exports are mainly cable harnesses destined almost exclusively to the EU. Positive news is that not only exports to the EU (with 65% being by far the most important market for Moldovan exports) are increasing, but also to the CIS region and the rest of the world.

Size of budget deficit acceptable

The budget deficit in 2016 was at 1.8% of GDP significantly lower than expected. The main reason for this was lower investment spending related to lacking support by international donors. Social expenditures and public wage expenditures were, however, on their expected level. This year the budget deficit is expected to increase and reach 3.7% of GDP. One reason for this is increasing public investment. Another reason concludes in the pension reform which introduces uniform contribution rules for the whole public sector, thus making the system more transparent and fair, which is in line with the IMF programme. The IMF programme in general is an important anchor for a sustainable budget and provides the opportunity for public investment in the short perspective as it catalyses support by international organisations.

Outlook

After the crisis in 2015 the Moldovan economy returned on a growth trajectory, which it is expected to follow at similar speed also after 2017 according to current projections. Especially increasing investment gives reason for hope. There are signs that, after public investment, also private sector investment and its crediting by the banking sector will increase, which is a necessary precondition for future growth.

At the same time one has to mention that significantly higher growth rates are possible and necessary if Moldova wants to catch up with more developed economies. For this, structural reforms are inevitable. The current reforms in the banking sector show how this can be achieved. These reforms are conducted in cooperation with the IMF in order to avoid a repetition of the bank fraud of 2014. For sustainable high growth other fields of the Moldovan economy have to be reformed in a similar fashion.

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