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NEWSLETTER

German Economic Team

MOLDOVA

The economic impact of the Corona crisis

Amidst the global pandemic caused by the Corona virus, the government of Moldova was forced to enact strict containment measures in order to avert a public health crisis. While there are tentative signs that the spread of the virus is slowing, the toll on the economy is likely to be drastic.

German Economic Team estimates suggest that the decline in output and demand from the containment measures alone is likely to sum up to MDL 11.4 bn in the second quarter. If this were not enough, Moldova is also faced with a very unfavourable external environment amidst recessions of the economies of its main trading partners and collapsing remittances.

This double whammy of domestic and external shock is likely to lead to a large GDP decline of 6.3% in 2020 when compared to 2019 – worse than during the 2008/2009 financial crisis. To ensure a robust recovery, the government needs to provide further support measures and a stimulus package. To do so, it will need additional external financial assistance on top of the emergency loans secured already.

Background

The Corona crisis means the Moldovan economy is faced with two shocks: A domestic shock resulting from the strict containment measures enacted in order to avoid a spread of the pandemic and needed to prevent a public health crisis. While this has been effective to slow the spread of the virus, it came at the cost of suspending a large chunk of economic activity.

In addition, there will be an external shock as exports, remittances and foreign direct investments decline due the global economic crisis. To estimate the effect of this double shock onto the economy, GET has updated its macro-economic forecasting model. Understanding the economic impact is important to calibrate the policy response to the size to the economic crisis.

Domestic shock from containment measures

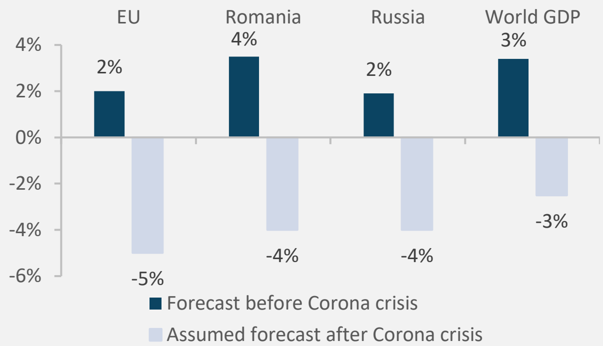
On 14th of March the government enacted strict containment measures including a closure of non-food retail, restaurants, hotels, schools and kindergartens. In addition, international travel was suspended and domestic transport significantly reduced. Even once the restrictions are lifted again, consumers and businesses alike will be very cautious to spend their money due to a lack of confidence.

Combined, the containment measures and lack of confidence will lead to a decline of output and demand of about MDL 11.4 bn in Q2 2020. Luckily, since a lot of the goods sold in shops and a large share of investments are imported, the actual GDP decline will be smaller as imports also decline.

External shock

In addition, the Moldovan economy will be hit by an external shock as its main trading partners are also mired in deep recessions. The International Monetary Fund expects global GDP to decline by 3% this year – a massive downgrade from the previous forecast of 3% growth. The EU's GDP may even decline by 5% and Russia's economy by 4%, which will reduce demand for Moldova's exports. Indeed, automotive supplies and textiles, which had seen an increasing share of Moldova's exports in the past, will be over-proportionately affected.

GDP forecasts of main trading partners before vs after Corona shock



Source: IMF Oct 2019, Russia: JP Morgan Russia, own assumptions

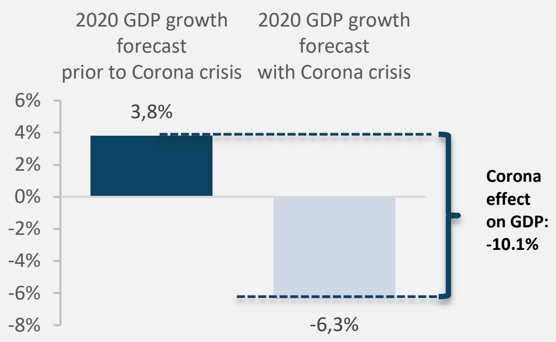
Furthermore, there is Moldova's reliance on remittances, which equalled 12% of GDP in 2019. During the financial crisis of 2008/2009 remittances inflows declined by 36% and it is unlikely that this crisis will leave remittances less affected as Russia and Italy – the two most important source countries – also experience deep recessions.

GDP dynamics in 2020

What does this mean for GDP in 2020? Based on an update of our macro-economic model incorporating the domestic and external shocks, we expect Moldova's GDP to decline by 6.3% in 2020. In comparison, before the emergence of the Corona crisis, GDP was expected to increase by 3.8% in 2020. Comparing both forecasts suggests that the Corona crisis will reduce Moldova's GDP by roughly 10%.

The second quarter of 2020 is likely to be the worst affected, with GDP declining by 8.3% in comparison to the first quarter of 2020.

GDP forecast and "Corona effect"

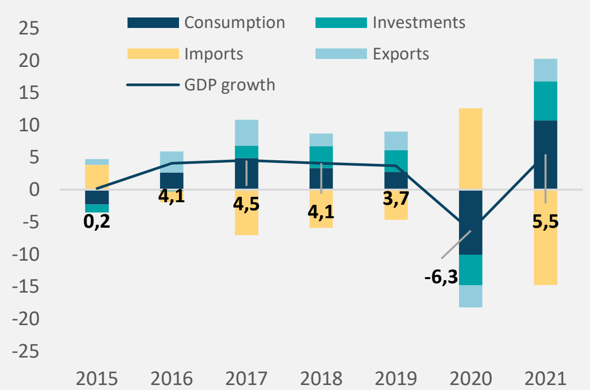


Source: own forecast

Outlook

Our current assumption is that the downturn is short-lived with GDP to increase again in the second half of the year as lockdown measures are lifted and confidence picks up. For 2021 we expect a robust recovery with real GDP growth of 5.5%.

GDP growth and growth contribution



Source: own forecast

However, this is by no means assured and the speed of the recovery and depth of downturn depend on government support measures provided over the coming months. Affected businesses need to be provided with liquidity in order to avoid a wave of insolvencies, which would otherwise reduce economic potential and slow down the recovery. Additionally, the government needs to start planning and communicating steps and criteria for ending the "economic lockdown" and outline its strategy on how to prevent another outbreak, as this will improve confidence of consumers and investors.

Additionally, given the size of the GDP decline, a significant fiscal stimulus is needed once the lockdown measures have been lifted in order to fill the demand gap left behind by the crisis.

It is positive that emergency loans from the IMF, EU and World Bank could be secured as this provides much needed funding to compensate collapsing tax revenues and to finance support measures. External funding is also important for restoring confidence. With that in mind, the government should proceed to unlock the macro-financial assistance offered by the European Union and a full-fledged IMF programme. A Russian loan would also provide a valuable source of financing, assuming the terms are acceptable.

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A more comprehensive analysis is provided by the study: The economic impact of the Corona Crisis on Moldova

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The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. It is funded by the Federal Ministry of Economics and Energy (BMWi) and implemented by the consulting firm Berlin Economics.