

Economic rebound despite political uncertainty

After a deep contraction of GDP amounting to 7.0% in 2020 due to the twin shocks of COVID-19 and the drought, the Moldovan economy is expected to rebound in 2021. Based on our macroeconomic model, we predict a growth rate of 4.8% for the year. Growth is driven mainly by a recovery of private consumption as well as exports.

Inflation remained stable throughout the crisis in Moldova and decreased to 0.4% at the end of 2020. It is expected to pick up only moderately in 2021 with the economic recovery, with an expected average annual inflation rate of 2.5%. Similarly, the exchange rate as well as foreign exchange reserves continue to be stable, supported by both resilient remittances as well as donor lending.

The budget deficit is forecast to shrink to 4.0% of GDP from 5.1% in 2020. However, while the EU just announced a large recovery package of EUR 600 m, uncertainty regarding external financial assistance remains due to conditionalities on structural reforms. Therefore, it is possible that the actual budget deficit may be lower due to a lack of external financing.

Thus, the economic outlook for Moldova in 2021 is solid while uncertainty remains around the political future of the country ahead of the snap parliamentary elections in July.

Background

Political uncertainty continues in Moldova ahead of the parliamentary elections on 11 July. After several failed attempts of appointing a new Prime Minister, the Moldovan parliament was dissolved in April. As a result, the extent of fiscal support as a response to the economic crisis has been limited. Despite this, the Moldovan economy has recovered quite fast after the twin shocks of COVID-19 and the drought in 2020.

Solid rebound expected after sharp decline in 2020

In 2020, GDP declined by 7.0% in Moldova as a result of the twin shocks. Based on our macroeconomic model, we predict a solid economic rebound for 2021 with 4.8% GDP growth. This recovery is mainly driven by a strong increase in private consumption and exports. The recovery in investment growth remains somewhat weaker amid the political uncertainty, with gross fixed capital formation expected to contribute 1.2 pp. to GDP growth in 2021.

On the supply side, a strong agricultural year is expected to support the export dynamics. In addition, catch up effects for private consumption are likely to contribute to a recovery in the services sector.

GDP growth and its contributions



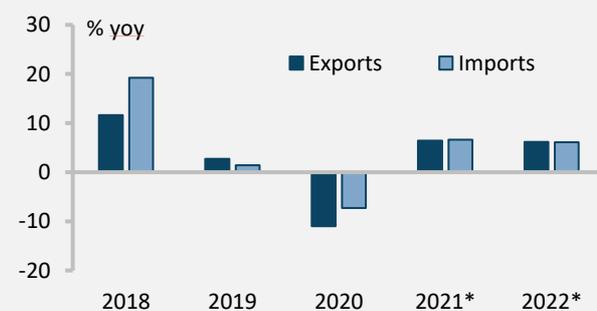
Source: GET forecast

Strong recovery of foreign trade expected for 2021

Moldova's foreign trade suffered severely under the twin shocks in 2020. For 2021, we expect a partial recovery. With a 6.4% increase compared to 2020, exports will remain below the pre-crisis level. The recovery will mainly be driven by agricultural and food products as well as manufacturing.

Imports are expected to grow stronger than exports with 6.6% mainly due to strong domestic private consumption. Due to the much larger size of imports, the net effect of foreign trade on GDP is expected to be negative (-2.3 pp. of GDP growth).

Development of foreign trade



Sources: National Bureau of Statistics, *GET forecast

Inflation low at the end of 2020, expected to pick up

Inflation remained relatively stable throughout the crisis and declined to 0.4% in December 2020. With economic recovery it is expected to moderately pick up throughout the year and reach an average of 2.5% in 2021. However, as inflationary pressure remains low, the National Bank of Moldova (NBM) has not started to tighten its monetary policy.

The policy rate remains at 2.65% since November 2020 and the rate of required reserves for liabilities in leu has been lowered even further. The rate of required reserves for liabilities in leu is thus now lower than for

those in foreign currency. NBM has used these measures to increase liquidity and thus stabilise the economy.

Another stabilising factor for the economy were remittance flows, which proved to be very resilient throughout the crisis. After an initial drop at the beginning of the COVID-19 pandemic, remittances to Moldova went back to levels similar to 2019. Furthermore, an on-going trend of Western integration could be observed regarding remittances, as transfers from EU countries increased and those from CIS countries decreased.

Money transfers from abroad in favour of individuals



Source: National Bank of Moldova; note: also includes transfers other than migrant remittances

Considering the importance of remittances for the economy and many households, their resilience could also contribute to a quick recovery. In addition, the inflow of foreign currency through remittances has helped keep the Moldovan leu relatively stable throughout the crisis. Similarly, foreign exchange reserves remain high (USD 3.8 bn in April 2021) on the back of donor lending.

Budget deficit to decrease again

2020 was the first time in several years that Moldova had a considerable budget deficit, which amounted to 5.1% of GDP. This deficit could be realized due to the availability of external financial assistance made available as part of COVID-19 emergency response by the EU and the IMF. Nevertheless, considering the amount of financing available, the deficit was relatively low, due to uncertainty regarding future financing options.

Indeed, the Ministry of Finance did not include any significant external financing into the 2021 budget. While a lower budget deficit of 4.0% is expected for the year by the World Bank, the actual deficit may therefore be considerably lower.

In the meantime, the EU just announced an “Economic Recovery Plan” for Moldova, which includes macro-financial assistance, grants and investments of up to EUR 600 m over the next three years. However, this assistance package is contingent on the fulfilment of several conditionalities, including reforms in the justice sector

and fight against corruption. Therefore, it is unclear when the first disbursement will be made and if it would have any influence on the 2021 budget.

Outlook

Considering the deep economic contraction in 2020, the Moldovan economy looks resilient with a solidly positive outlook for 2021, despite uncertainty around the political situation ahead of the elections. Whether the expected growth prospects will be realised depends on several factors, including continuing successful containment of COVID-19, the vaccination campaign as well as the reform-orientation of a new government, which could unlock external financial assistance.

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