

Economic outlook for 2022 clouded by high inflation

Moldova's economy grew strongly in 2021 by an estimated 7.5%, thus constituting a full recovery after the economic decline due to the pandemic and drought in 2020. In 2022, GDP is expected to grow more moderately by 4.5%. However, this outlook is clouded by considerable downside risks related to high inflation.

Inflation picked up strongly in 2021 and stood at 16.6% in Jan-22. Further increases are expected for 2022 with a forecast of 18.8% for the average annual inflation rate. As a response, the National Bank of Moldova has tightened monetary policy and increased its policy rate to 10.5% in Feb-22. In addition, required reserves on deposits in Leu were increased. In our view, the monetary policy reaction of the National Bank to date has been appropriate considering the severity of the challenge.

The exchange rate remained relatively stable so far. However, as inflation increased, the Moldovan Leu appreciated in real terms. This constitutes a considerable challenge for Moldova's competitiveness and underlines the importance of addressing inflation.

The budget deficit is expected to increase to 6.0% of GDP in 2022. This increase has been agreed as part of the new IMF programme and is financed by new donor assistance, including from the IMF and the EU.

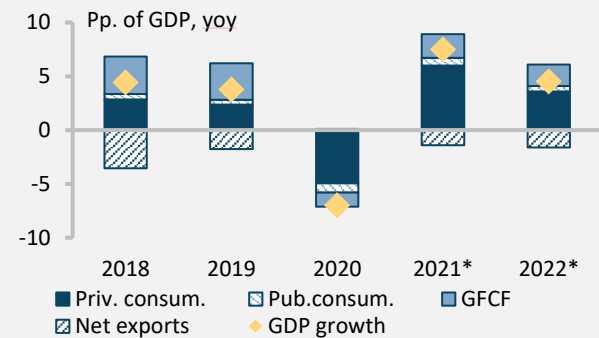
Full economic recovery in 2021, but outlook muted

After the twin shocks of the pandemic and drought in 2020, which led to a contraction of GDP by 7%, the Moldovan economy has fully recovered. While the IMF estimates GDP growth at 7.5% for 2021, actual growth is likely to be somewhat higher. This recovery is mainly driven by a strong increase in private consumption and gross exports.

On the supply side, the services sector had the largest contribution to growth, as pandemic-related restrictions were lifted, and consumption rebounded. In addition, a stronger than expected agricultural year supported growth and exports.

For 2022, the IMF forecasts GDP growth at 4.5% yoy. However, this forecast is marked by high uncertainty. Considerable downside risks are related to restrictive monetary policy to address high inflation.

GDP growth and its contributions

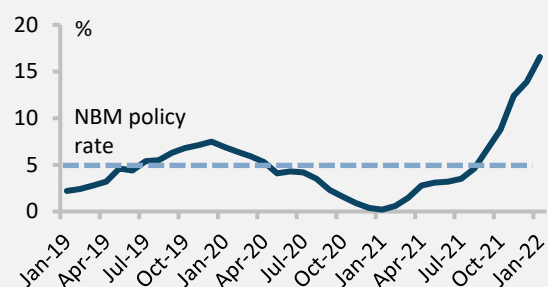


Source: IMF, *estimate/forecast, Gross fixed capital formation (GFCF)

Inflation on a strong upward trend

After low and stable inflation levels in 2020, the inflation rate has started to pick up rapidly from Q3-2021. The main drivers of inflation in Moldova have been on the supply side - an increase in international food prices and a strong spike in energy prices following the gas crisis, which led to a much higher import price for Moldova and thus higher tariffs for consumers. On the demand side, increased consumption in the wake of economic recovery, rising wages and increased bank lending as well as remittances have contributed to inflation. In January 2022, the inflation rate reached 16.6%. Nevertheless, further increases are expected with an annual average forecast of 18.8% for 2022.

Inflation rate (CPI)



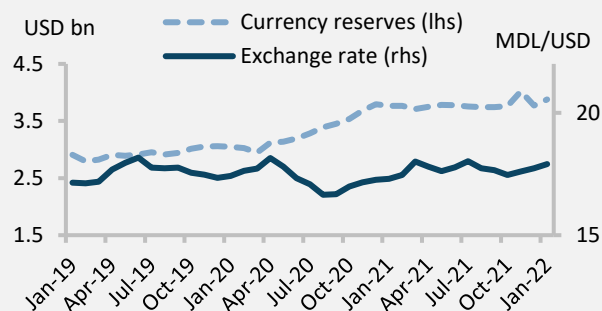
Source: National Bank of Moldova

The National Bank has responded to rising inflation with several policy rate hikes, from 2.65% in June 2021 to 10.5% in February 2022. In addition, required reserves, the most important monetary policy tool in Moldova, were increased from 26% to 28% for liabilities in Moldovan Leu. This measure is expected to absorb some of the excess liquidity in the economy and limit inflation. While these measures are appropriate in our view, further tightening may be required if inflation continues to rise.

Real appreciation a problem for competitiveness

Throughout 2021 the exchange rate to the US dollar has remained relatively stable. Foreign currency reserves are high on the back of donor lending. In January 2022, import coverage amounted to 6.4 months. This puts the National Bank of Moldova in a fairly good position to execute additional interventions to stabilise the exchange rate if needed.

Exchange rate and currency reserves



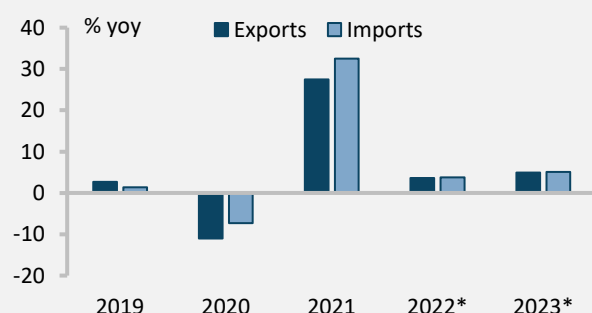
Source: National Bank of Moldova

At the same time, the high inflation has led to a real effective appreciation of 10.3% yoy in 2021. As real appreciation makes Moldovan exports more expensive and creates considerable challenges for competitiveness, this represents another important reason for addressing inflation.

Foreign trade growth to slow down in 2022

Foreign trade recovered well in 2021 with high growth rates for both exports (27.5%) and imports (32.5%). For exports, growth was mainly driven by the agriculture and manufacturing sectors. On the import side, energy prices and an increase in capital goods imports drove growth. The outlook for 2022 is more moderate as positive base effects will be absent.

Development of foreign trade



Sources: National Bureau of Statistics, *GET forecast

Public finances

In 2021, the budget deficit amounted to 5.2% of GDP and was thus similar to 2020. For 2022, a deficit of 6.0% of GDP is planned in accordance with the new IMF programme. This includes among other things expenditures for compensations to households and companies for higher gas prices. Financing of the deficit is ensured by new donor loans, especially the IMF programme signed in December 2021 amounting to USD 558 m and EU macro financial assistance of EUR 150 m. As a result, government debt is expected to increase further to 39.5% of GDP in 2022, which is moderate in international comparison.

Outlook

After an economic recovery much stronger than expected in 2021, Moldova is facing considerable challenges related to the effects of high inflation. Therefore, the economic outlook for 2022 is characterised by uncertainty and considerable downside risks. Consequently, addressing inflation should be the immediate economic policy priority.

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