

Stable growth on a moderate level

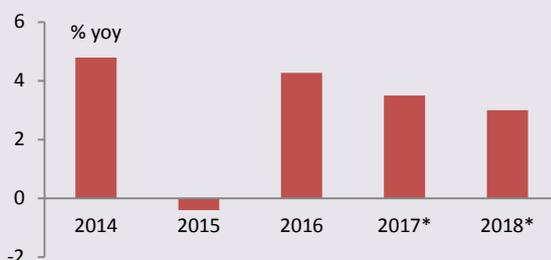
The economy grew by 3.5% in 2017, which is less than in the previous year. The primary reason for this lies in the lower growth rate of the agricultural sector. On the demand side the economy was supported by private consumption, which was enabled by increasing real wages and by resurging remittances. Inflation increased to 6.6% in 2017, which was also influenced by one-off effects. During the year, the Leu has appreciated by ca. 15% vs the US dollar, which reflects the favourable external economic position. The budget deficit was at 3.1% of GDP in 2017 and thus lower than expected, which is related especially to increased tax revenues.

The macroeconomic situation in Moldova can be considered stable. However, growth should be significantly higher in the medium and long term if Moldova is to catch up with more developed economies. The decreasing population will be a considerable impediment to such efforts. This trend is both a consequence and a reason for moderate economic growth rates. Thus it is all the more important that the recently launched reforms will be successfully implemented and expanded in order to provide a perspective for the Moldovan people.

Slightly slower growth in 2017

Economic growth amounted to ca 3.5% in 2017 and was thus a bit lower than in the previous year (4.3%). This was mainly due to more moderate growth rates of the agricultural sector. Even though the harvest in 2017 was good, growth in agriculture cannot be compared to the record jump in 2016. Consumption, however, performed well during 2017. For 2018, the IMF projects a slightly decreased GDP growth rate of 3%.

Real GDP growth



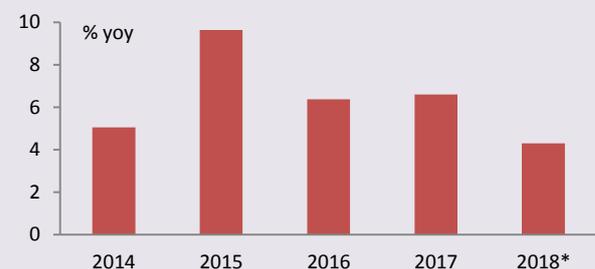
Source: IMF, *Forecast

Investment, which increased strongly in 2017, is worth a closer look. The hike was mainly due to public investment, which increased by more than 30% compared to 2016. The reason lies in the resumption of international financial support. For 2018 it is expected that also private investment will increase. This is of major importance, as private investment has shown a negative, respectively stagnating, trend after the banking scandal in 2014.

Higher inflation and real wages

The inflation rate amounted to 6.6% in average during 2017. At the same time, there were strong dynamics between end-2016 and October 2017, when inflation increased from 2.4% to 7.9% yoy. This strong increase can mainly be attributed to one-off effects. In particular, food prices increased significantly, which had a sizeable impact on the inflation rate. Core inflation, however, remained stable in 2017.

Inflation rate



Source: IMF, *Forecast; Note: annual average; consumer prices

In parallel, growth of real wages accelerated to 5.3% in 2017, which supported the positive development of private consumption. The reason for increasing real wages is the positive situation on the labour market. On the one hand, the population benefits directly from higher real wages. On the other hand, the high demand for labour makes it increasingly difficult for companies to find qualified personnel.

Real wages are expected to increase further in 2018, however, at a slower pace. In spite of these increases, Moldovan wages remain highly competitive in international comparison.

Leu appreciation and higher remittances

The Leu has appreciated by 15% vs the US dollar since early 2017, which reflects the positive external economic position. Since 2016, no major fluctuations in the exchange rate took place.

As a consequence of the stable situation and currency appreciation, the National Bank was able to significantly increase its currency reserves. At the end

of 2017 they corresponded to more than five months of import coverage. As a rule of the thumb a country should have currency reserves equal to at least three months import coverage. Thus, the external economic position has become more stable.

Exchange rate and currency reserves



Source: National Bank of Moldova

At the same time, remittances, which are of key importance for private consumption, developed positively. They have been increasing since the beginning of 2017, which supports consumption. However, interestingly enough, remittances from Russia continue to decrease.

External trade increased significantly

External trade has performed very well during 2017. On a US dollar basis, imports have increased by 19% compared to the previous year. This was mainly due to stronger demand, but also one-off effects as reforms of the customs administration (new standards and less smuggling) and temporary energy imports from Ukraine. Usually a significant share of Moldovan energy demand is covered from sources in the region of Transnistria and is thus not counted as imports.

Also, exports increased at two-digit rates of ca 15%. Especially exports of vegetable products and cable harnesses increased. Higher export values of cable harnesses are closely related to strong foreign direct investment in this sphere, especially from the EU. Also for 2018 external trade is expected to perform positively, however with slightly weaker dynamics.

Reasonable budget deficit

The budget deficit amounted to 3.1% in 2017; lower than expected. Strong performance of revenues, which can be attributed to reforms in tax administration, were one positive factor. Additionally, spending was lower than expected as road construction projects are delayed and government institutions were reorganised.

For 2018 the IMF projects a deficit of 3.3% of GDP, which is in line with the IMF programme. This number includes the much needed infrastructure reforms, especially road construction, but also higher social expenditures.

This forecast, however, is to be seen against the background of parliamentary elections, which will be held in 2018 and might contain the risk of higher spending.

Outlook

After the recession in 2015, the economy is growing again at moderate one-digit levels, which is expected to continue also in 2018. Despite this positive development it is clear that the country has to accelerate its growth rates if it wants to catch up with more developed economies. However, the moderate growth rates have to be seen also against the background of a declining population in the last decades. This trend is not fully reflected by official statistics and is both a consequence and the reason for weak economic growth at the same time.

Thus, it is all the more important that recent successful reforms in the fields of the banking sector, tax administration, customs and other spheres will be finalised and the reform process keeps moving. This will demand strong efforts not only from the government, but also from international partners, who should support the country, while demanding a continuation of the reform process. After all, reforms are the only way to sustainably improve the economic situation and provide a perspective for the Moldovan people.

Author

Woldemar Walter, walter@berlin-economics.com

Editors

Dr Ricardo Giucci, Woldemar Walter

A more comprehensive analysis is provided by the latest issue of our “[Economic Monitor Moldova](#)”.

[Subscribe / unsubscribe newsletter](#)

German Economic Team Moldova

www.get-moldova.de

The German Economic Team advises the Government of Moldova on economic policy issues since 2010. It is funded by the German Federal Ministry for Economic Affairs and Energy and implemented by the consulting firm Berlin Economics.



BE Berlin Economics GmbH | Schillerstraße 59 | 10627 Berlin
+49 30 / 20 61 34 64 - 0 | info@berlin-economics.com | [Impressum](#)