NEWSLETTER

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Stable situation, but growth not high enough

The Moldovan economy grew by 4.5% in 2017. For the current year, it is expected to grow by only 3.8%. Just like in 2017, private consumption is the primary growth driver on the demand side, while the supply-side it is retail sales and manufacturing.

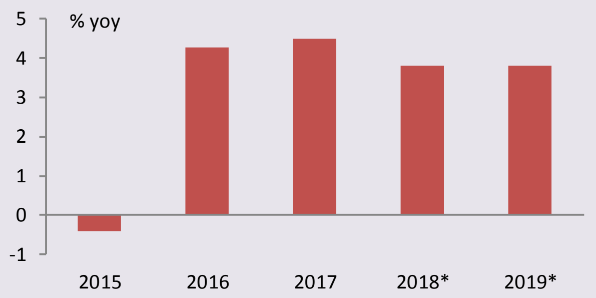
The macroeconomic situation is stable. Inflation is expected to fall below 5% and the Leu continues its appreciation against the US dollar, which started in the beginning of 2017. Exports as well as imports show double-digit growth, which is mainly due to increasing trade with the EU. The budgetary deficit increases from scarcely 1% of GDP in 2017 to 3.2% in 2018 but does not jeopardise fiscal stability. The planned additional expenditures are in fact meaningful investments.

Nevertheless, despite the stable situation, it must be concluded that the expected economic growth for 2018 and the following years of less than 4% is too low for a country like Moldova. To realise the economic growth potential, structural reforms e.g. in the judiciary and in education are necessary.

Consumption based growth

The Moldovan economy grew by 4.5% in 2017. Growth was higher than expected due to a very strong last quarter. The primary growth driver on the demand side was private consumption, mainly based on growing remittances but also on rising wages.

Real GDP growth



*Source: IMF, Ministry of Economy, *Forecast*

Economic growth is expected to slow down to 3.8% in 2018. In this year's first quarter it amounted to 3.7%. Just like in the previous year, it is based on private consumption. Increasing investments also positively contribute.

On the supply side, growth is fuelled by retail trade and manufacturing sector. Retail trade benefits from increasing private consumption, while the manufacturing sectors profits from increasing inflows of FDI. It remains to be seen how agriculture develops in the course of the year. In summary, the expected growth of the Moldovan economy doesn't impress much.

Stable inflation

The inflation rate amounted to 6.6% in average during 2017 and therefore exceeded the National Bank's target corridor of 5 ± 1.5%. The reason for the relatively high inflation rate is to be found in non-monetary factors such as an increase in food and fuel prices as well as health care costs. For 2018, an inflation rate of 4.1% is expected and hence within the span of the target corridor.

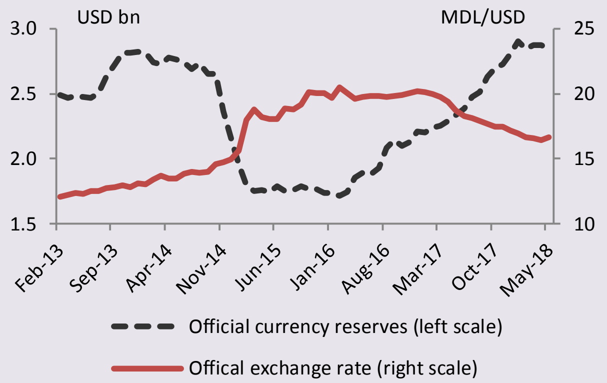
The non-monetary factors that caused the increase in inflation during 2017 do not exert as much influence anymore, causing the inflation to decline in 2018. This development enabled the National Bank to gradually lower the base rate from 9.0% to 6.5% already in 2017.

To sum up, the inflation rate is now on an adequate level, and the National Bank's medium-term inflation targeting provides for price stability.

Leu appreciation and higher remittances

Since early 2017, the Leu has appreciated against the US dollar by approx. 20%.

Exchange rate and official currency reserves



Source: National Bank of Moldova

On one hand, this development supports imports, as they become cheaper. At the same time, the appreciation pressure enables the country to build up currency reserves, which already cover for 6 months of imports. Since 3 months of import coverage are considered to be the minimum, the official currency reserves are adequate.

Also in 2017, remittances have started growing due to the relative good economic development in the EU and the economic recovery in the CIS region. Growing remittances are of key importance for private consumption and amount to approx. 20% of GDP.

External trade increases significantly

Imports and exports continue their growth that started in 2017. From January to April 2018, imports increased by 27%, caused by growing demand attributable to the appreciation of the Leu and growing remittances.

Exports, too, continued two-digit growth, increasing 29% in January and April 2018. However, the regional differences of export growth are remarkable. The increase of exports to the EU amounted to 38%. This development is highly correlated with FDI flows from the EU to Moldova.

Exports January - April 2018

Region	Jan-Apr 2018, USD m	USD m, yoy	% yoy
EU-28	595	+165	+38%
CIS	143	0	0%
Russia	*74*	*-7*	*-9%*
Ukraine	*25*	*+9*	*+58%*
Other	140	+31	+28%
Total	**878**	**+196**	**+29%**

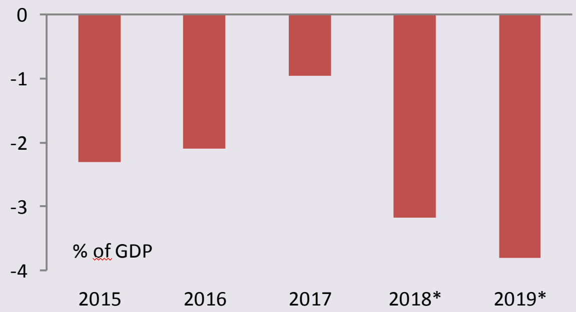
Source: National Bureau of Statistics; Note: trade in goods

In contrast, exports to the CIS region have not changed at all. However, there was a shift in the export dynamics to the CIS region: exports to Ukraine grew by 58%, while exports to Russia dropped despite Russia's economic recovery. Hence, there is an export shift not only away from the CIS to the EU, but also within the CIS.

The planned budget deficit remains manageable

Last year's budget deficit of almost 1% of GDP was lower than expected. On the one hand, tax and customs reforms and growth have generated higher revenues than expected. On the other hand, among other reasons the re-organisation of government institutions has stalled road construction projects and other investments.

Budget deficit



*Source: IMF, *Forecast*

Due to these developments and the appreciation of the Leu, public debt has fallen to 38% of GDP in 2017. In 2018 revenues continue to evolve positively; in January to May 2018 they increased by 12.1% compared to the previous year. However, also higher public spending is planned including road construction and social expenditures. These investments are reasonable. The planned rise of the deficit up to 3.2% remains manageable and is in line with the IMF-programme.

Outlook

All important macroeconomic indicators show a stable economic situation. Inflation isn't too high, the Leu appreciates and currency reserves build up. Remittances and trade both grow significantly. Public finances do not give cause for concern.

Despite this stable situation, economic growth is expected to remain under 4% in the medium- and long-term. This is too low for a country with a GDP per capita like Moldova.

Major barriers to growth are factors difficult to influence, such as the shrinking of the working age population. But by reforming e.g. the judiciary and the education system, improvements can be made. Such structural reforms are necessary to raise and realise Moldova's growth potential in the long-term.

Author

Woldemar Walter, walter@berlin-economics.com

Editors

Dr Ricardo Giucci, Woldemar Walter

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Berlin Economics

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