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German Economic Team

NEWSLETTER

MOLDOVA

War in Ukraine: Moldova to face severe economic shock

Moldova's economy will be severely affected by the war in Ukraine and sanctions against Russia. Exports to Russia are likely to drop by USD 190 m (1.6% of GDP) due to disrupted transport corridors. The main exports to Russia, apples and medicines, cannot easily be reoriented to other markets.

Another important impact channel are remittances, which play an important role in the Moldovan economy. While remittances from Russia have been decreasing, they are still significant at 2.7% of GDP. We expect remittances to drop by USD 129 m in 2022 (1% of GDP).

In addition, Moldova is fully dependent on gas imports from Russia. The war creates a risk of disruptions to gas transit through Ukraine. In such a scenario, Moldova could face sizable electricity shortages.

Furthermore, the war has increased food and energy prices, which will fuel Moldova's already high inflation. As such, monetary policy needs to remain tight, leaving little room to support economic activity. This, in turn, will put a further burden on the fiscal budget, which is already strained by the refugee influx and the various compensations in the energy sector. Therefore, financial support from external partners will play a key role for Moldova in this situation.

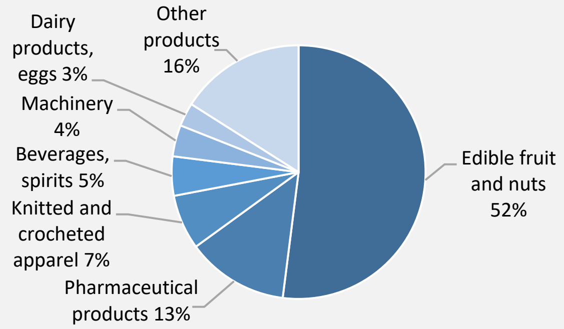
Introduction

The Russian invasion and war in Ukraine will have significant effects not only on the two countries involved, but also on the rest of the region. Due to the massive sanctions against Russia, the Russian economy is expected to shrink by 10% and face a high inflation of 20% in 2022. This, in turn, will impact the Moldovan economy in several ways: Moldovan exports to Russia and remittances sent from Russia to Moldova are both likely to decrease significantly.

Full disruption of exports to Russia likely

In 2021, exports to Russia accounted for around 8.8% of Moldovan exports, making the country an important trade partner. The most important exports are agricultural products, especially apples, but also other fruit, and pharmaceutical products. Exports to Ukraine are likely to be disrupted as well, but since they only account for a small share of Moldovan exports, our analysis focuses on Russia.

Structure of Moldovan exports to Russia



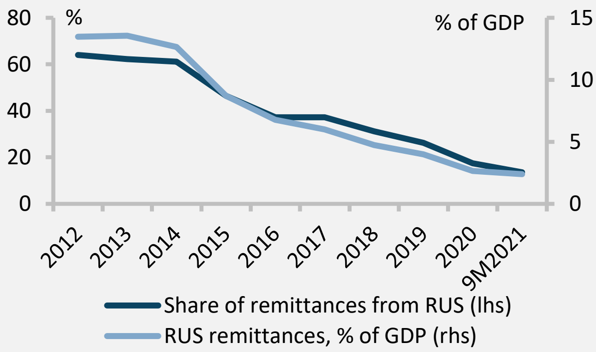
Source: National Bureau of Statistics, own estimates

We analyse the impact a full disruption of exports to Russia would have on the Moldovan economy. While the extent of export disruptions will depend on the length of the war, a full disruption scenario is likely given the lack of feasible transport routes to Russia. We find that losses would amount to USD 190 m or 1.6% of GDP for 2022 in this scenario. This includes a complete loss for exports of apples and pharmaceuticals, the two most important export products, which cannot be reoriented to other destinations in the short term. For exports of plums, grapes, and cherries, a full reorientation to the EU would be possible, especially if current EU tariff rate quotas on these products were increased.

Remittances from Russia to drop significantly

Remittances are an important factor for the Moldovan economy and a key driver of private consumption. While the share of remittances from Russia has been on a downward trend for years, it was still equal to around 2.7% of GDP in 2020.

Personal remittances inflows from Russia



Sources: National Bank of Moldova, IMF, own calculations

We estimate that the expected downturn of the Russian economy and Western sanctions on Russia could reduce remittances sent from Russia to Moldova by around 50% in 2022. This would mean an overall drop in remittances by USD 129 m or 1% of GDP.

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Energy imports from Russia: a key risk factor

Moldova is a country highly dependent on energy imports. Particularly gas is important here, which has a 56% share in total energy supply and is 100% imported from Russia via Ukraine. Should the gas transit through Ukraine be disrupted due to the war, Moldova could import gas from Romania, albeit potentially at higher prices. Also, volumes would not be sufficient to cover both consumer demand and electricity generation.

Moldovan energy supply and imports from Russia

	Share in TES*	Gross import share	RUS share in imports	RUS share in TES*
Solid fossil fuels	3%	90%	91%	2%
Oil and oil products	25%	100%	9%	2%
Natural gas	56%	100%	100%	56%
Renewables	17%	-	-	-

*Sources: IEA, Eurostat, own calculations; *Total Energy Supply*

Electricity generation in Moldova is also highly dependent on gas, 75% of which is currently produced by Transnistria-based MGRES powerplant. Due to the emergency synchronisation with ENTSO-E on 16 March, Moldova is now able to import electricity not only from Ukraine, but also from Romania, which increases the stability of the system. Nevertheless, should the gas supply be disrupted, Moldova could face electricity shortages.

In addition to these supply-related risks, global oil and gas prices have increased significantly since the start of the war. Due to its import dependence, Moldova will face considerably higher expenses for energy as a result. Assuming prices stay at the current levels, we estimate that Moldova could face a balance of payments shock of 3.5% of GDP due to the massive increase of both oil and gas prices.

Implications for monetary and fiscal policy

These negative economic effects will hit Moldova during an already difficult time. Even before the war in Ukraine, inflation in Moldova was at a very high level of 18.5% in Feb-22. The war has led to further increases in food and energy prices. As these items account for a large share of the Moldovan CPI basket, inflationary pressure is expected to further increase. The National Bank has thus increased its inflation forecast for 2022 to 21.9%. In such an environment, monetary policy will need to remain tight to address inflation and thus cannot be used to support the economy.

In addition, upholding expansionary fiscal policy measures such as the recent subsidies for higher energy prices will become more difficult, as the war puts a strain on the budget. Firstly, weaker economic activity will lead to lower revenues. Secondly, further expenditures related to caring for refugees from Ukraine are expected. To address these challenges, Moldova needs additional financial support from international partners. Several donors, including the IMF, have already made additional funds available. As a result, Moldova's budget deficit will likely amount to 7.5% of GDP in 2022.

Outlook

After a strong economic recovery in 2021 with GDP growth of 13.9%, the Moldovan economy will be heavily affected by the war in neighbouring Ukraine. Instead of the pre-war forecast growth rate of 4.5%, Moldova is likely to grow by only 0.3%. In light of the current stagflation and strong fiscal pressure, international support is badly needed.

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This newsletter is based on the Policy Briefing: Economic implications for Moldova of the war in Ukraine and sanctions against Russia.

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Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*