

# ECONOMIC MONITOR

## MOLDOVA

### Overview

- » Only moderate economic recovery after strong recession in 2022
  - 2023: GDP estimated to grow by 2.0%, driven by agricultural production
  - 2024: growth forecast at 3.9% due to stronger private consumption
  - However, downward revisions likely for both years
- » NBM successfully targeted inflation, which reached 4.2% in Dec-23 - back in the tolerance band
- » Recent appreciation of Moldovan leu; negative effect on international competitiveness of MDA firms
- » Lower than expected budget deficit of 5.0% of GDP in 2023 due to budget under-execution; slightly decreasing to 4.6% of GDP in 2024 planned
- » Overall decline in foreign trade in goods over 2023 due to lower trade activities linked to UKR (re-export of fuel and UKR agro products); at the same time, strong service exports
- Stabilisation of the macroeconomic situation, however lack of growth drivers

### Special issues

- » **EU-MDA trade.** Key products for negotiations over tariff rate quotas (TRQs) are plums and pork
- » **Reference currency.** Switching from the US dollar to euro would lead to savings in the real economy
- » **Economic growth and labour market.** Declining potential growth in recent years, however, there are opportunities within the labor market to enhance its contribution

# Basic indicators

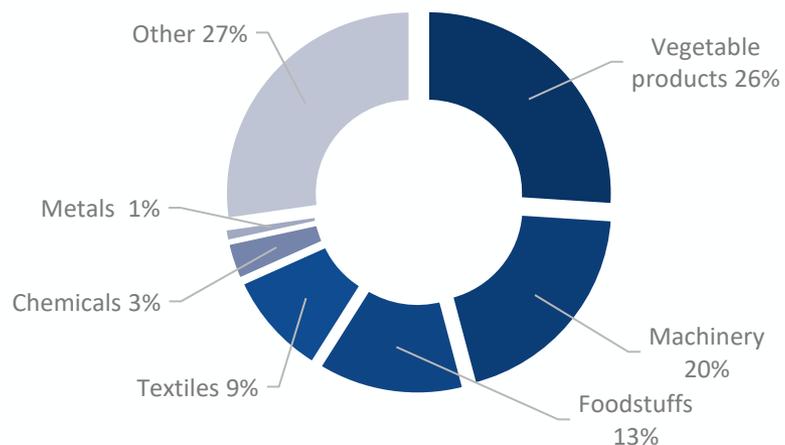
	Moldova	Ukraine	Romania	Georgia	Russia
GDP, USD bn	16	173	350	30	1,863
GDP/capita, USD	6,411	5,225	18,413	8,165	13,006
Population, m	2.5	33.2	19.0	3.7	143.2

Sources: IMF, National Bureau of Statistics; Note: estimates for 2023

## Trade structure

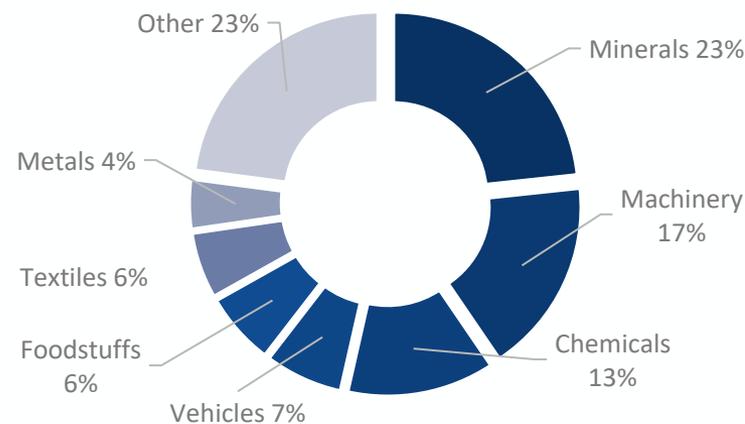
### Exports

EU 62% | UKR 16% | RUS 4% | TUR 3% | Other 18%



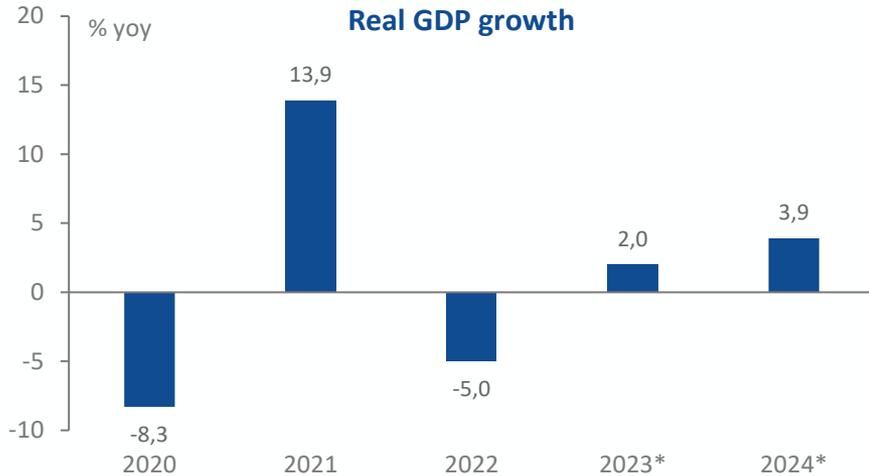
### Imports

EU 47% | UKR 12% | CHN 11% | RUS 4% | Other 25%



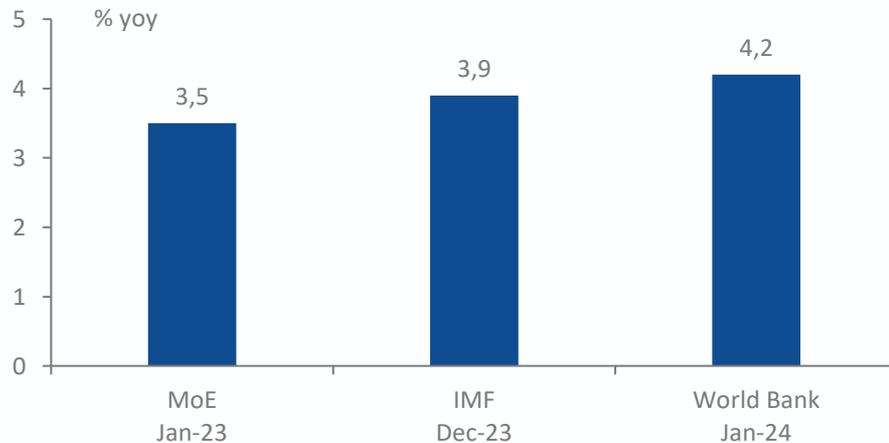
Source: National Bureau of Statistics, data for 11M,2023, Note: trade in goods

# Economic growth



Sources: IMF, \*estimate/forecast

## Comparison of real GDP forecasts for 2024



Source: Respective institutions

## 2023

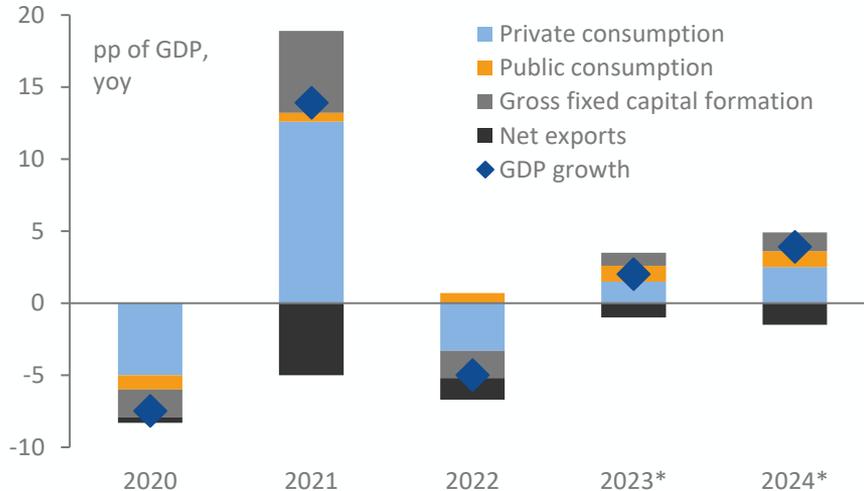
- » According to the IMF, GDP grew by 2.0%
- » Main driver: pick-up in agricultural production
- » However, estimation likely to be revised downwards

## 2024

- » GDP forecast to grow by 3.9% (IMF)
- » Main drivers:
  - Resumed private consumption due to low inflation
  - Strong harvest in 2023 still expected to boost growth in 2024
- » However, here again, a downward revision is probable
- » Only moderate economic recovery after deep war-related 2022 recession

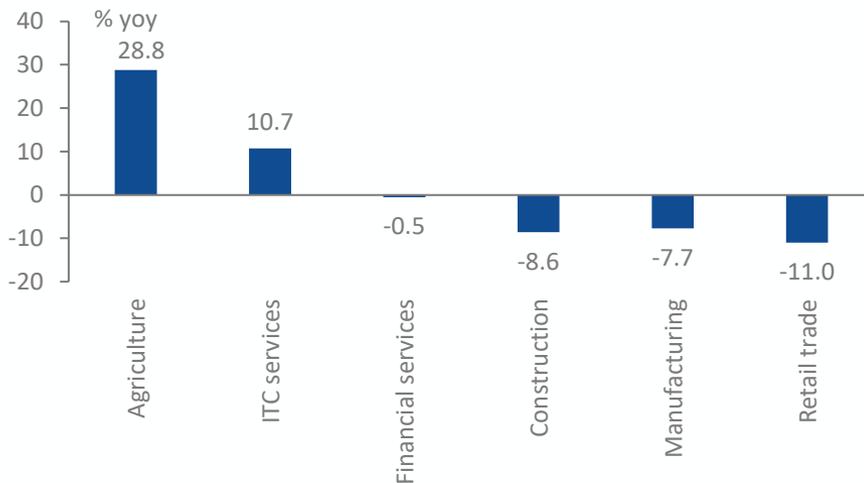
# GDP: demand and supply

## Contribution to real GDP growth



Source: National Bureau of Statistics, IMF \*estimates/forecast

## Sectoral dynamics



Source: National Bureau of Statistics, data for 9M23

## Demand-side dynamics

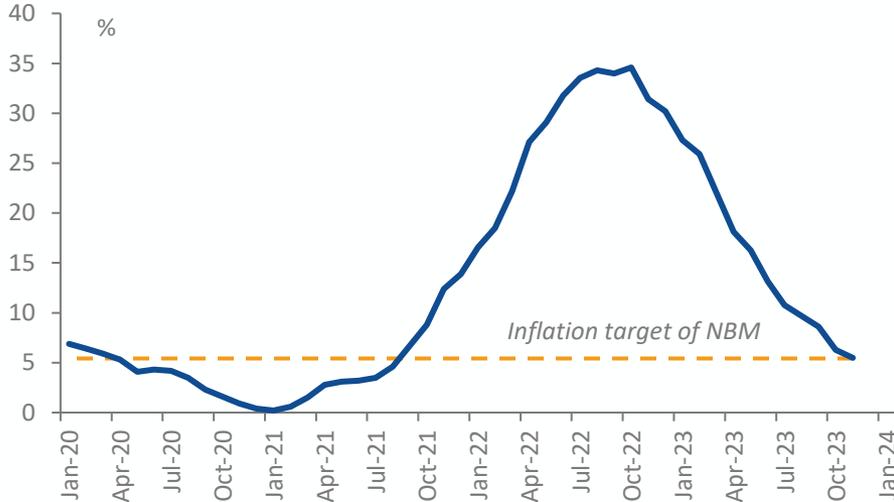
- » 2023: all factors contributed to a similar extent to modest growth, except for net exports
- » 2024: private consumption to drive GDP growth, net export deficit to remain

## Supply-side dynamics 9M2023

- » Positive development in agriculture due to better harvest
- » Dynamics in the IT sector remain positive due to strong exports
- » Negative development in manufacturing and construction reflecting the weak investment activity
- » Retail trade is also weaker
- Private consumption as the key driver of higher economic growth this year

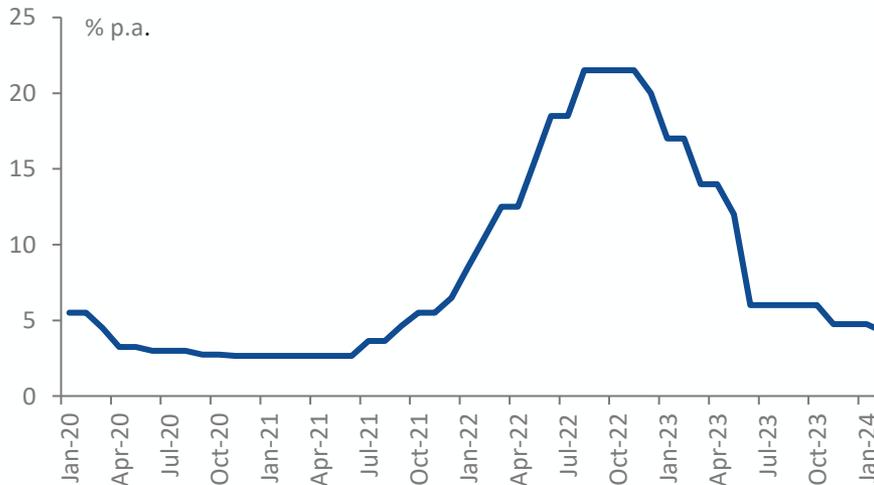
# Inflation and monetary policy

## Inflation rate



Source: NBM, Note: end of period

## Policy rate of NBM



Source: NBM, Note: end of period

## Inflation

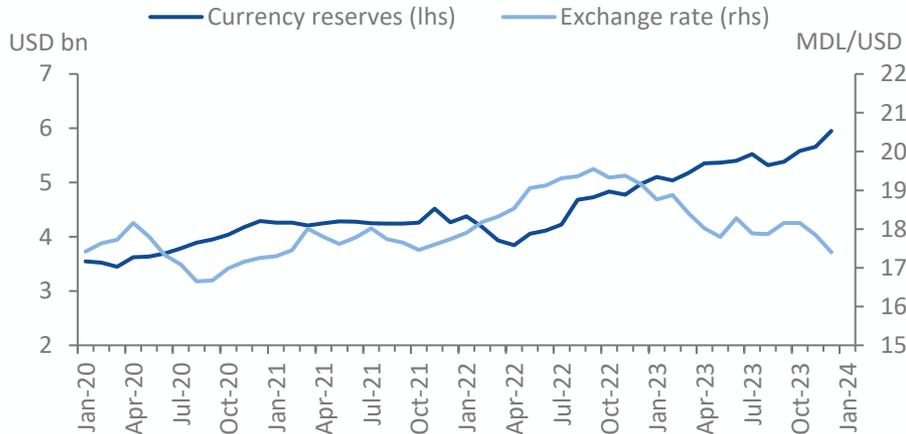
- » Strong decline after peak in 2022
  - Oct-22: 34.6%
  - Dec-23: 4.2%
- » Reasons
  - NBM textbook monetary policy reaction to inflation
  - Food and fuel prices back to pre-war levels

## Monetary policy

- » Dec-22: start of decreasing policy rate
- » Policy rate went gradually down from 21.5% in Nov-22 to 4.25% in Feb-24
- » Shift from tight monetary policy to an easing cycle
- Price stability regained; NBM successful in bringing inflation back to its target

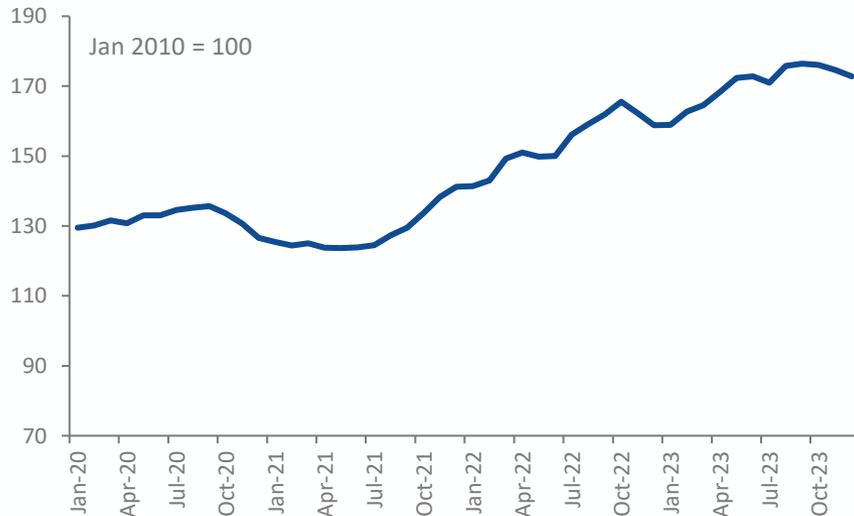
# Exchange rate

## Exchange rate and currency reserves



Source: NBM, end of period

## Real effective exchange rate



Source: IMF, based on consumer price index; note: higher value denotes a real effective appreciation

## Exchange rate and currency reserves

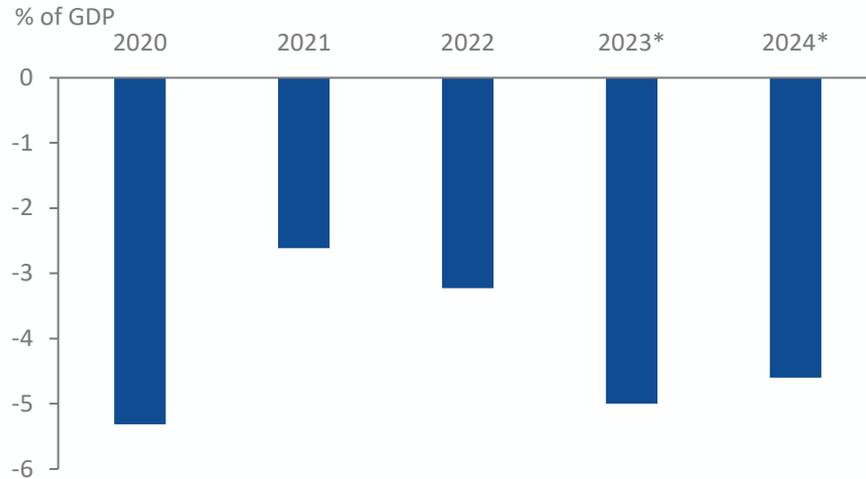
- » In Dec-23 the leu appreciated 9% yoy against the US dollar
- » In parallel, there is continued upward trend in currency reserves
- » NBM purchased FX in response to appreciation pressure

## Real effective exchange rate

- » High inflation in 2022 led to a real effective appreciation
- » Potential danger of a loss in international competitiveness
- » IMF estimation: 20-25% overvaluation, with a projected decrease in the coming years
- Strong leu and higher currency reserves; real effective exchange rate to be monitored

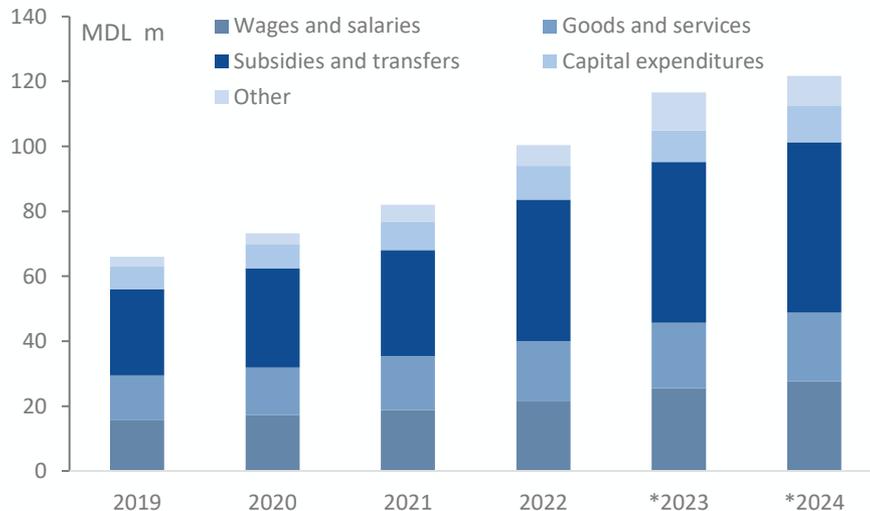
# Public finances

## Budget balance



Source: IMF, \*estimate/forecast

## Public expenditure



Source: IMF, \*estimate/forecast

## Budget

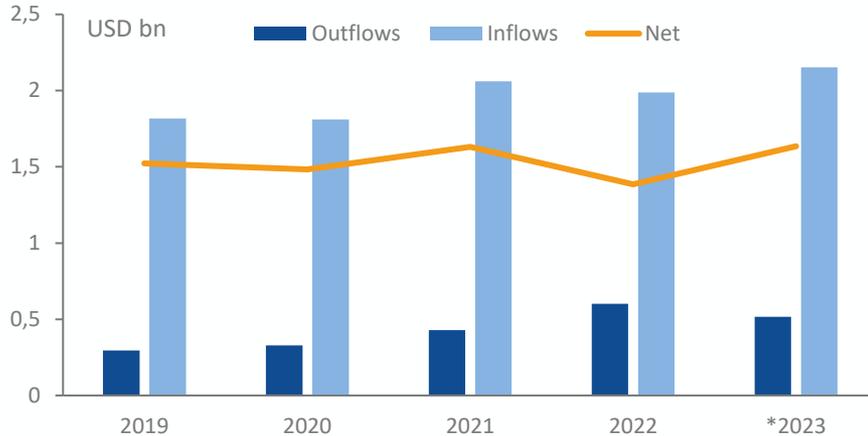
- » 2023: deficit is expected to reach 5.0% of GDP (below the planned 6.0%) led by
  - Budget under-execution: only 70% of planned investment implemented, energy subsidy savings, reduced wage bill
  - But also lower revenues due to decreased imports leading to a reduction in VAT revenues
- » 2024 target: deficit of 4.6% of GDP
  - Focus on energy security, civil service capacity constraints, private sector development and infrastructure investment

## Public investment

- » Capital expenditure of around 3.1% of GDP is too low for MDA meeting medium-term development goals
- » Investment under-execution is a recurrent problem, improvements necessary to support economic growth

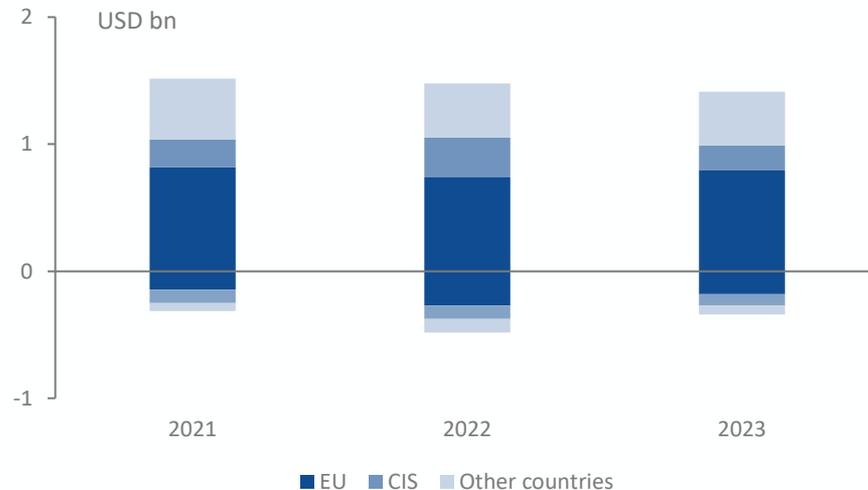
# Remittances

## Remittances



Source: NBM, end of period, \* estimate/forecast

## Geographical structure of remittances (net)

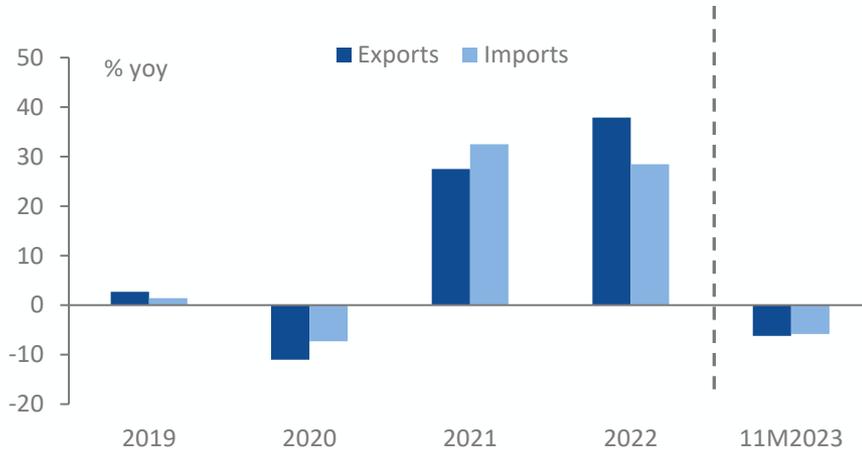


Source: NBM, Note: 9M data respectively

- » Remittances of high importance for MDA economy/consumption, ca. 13% of GDP
- » Recent development of net remittances
  - 2022: -17% yoy; strong decline
  - 2023: 18% yoy, full recovery
- » Reason for decline in 2022:
  - Only slight decline of inflows
  - But: strong increase of outflows
- » Higher outflows in 2022
  - Mainly in 1H-2022
  - Especially to the EU (+87% yoy)
  - Possible interpretation: UKR refugees send money back home and/or rise in migration to the EU in the context of the Russian war in UKR
- » Stable remittances inflows support consumption; high outflows in 1H-2022 might reflect intensified migration

# External trade: goods

## Foreign trade in goods

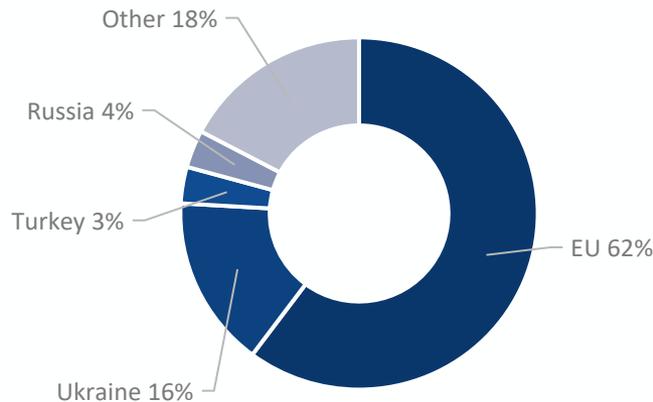


Source: National Bureau of Statistics

## Exports of goods

- » 11M2023: -6.2 % yoy
- » Lower exports in oilseeds and oleaginous fruits (-2.8%), oils, fats and waxes of animal or vegetable origin (-3.0%) & fuel (-2.0%)
- » At the same time: stronger exports (2.2%) of electrical machinery
- » The EU is by far the most important export destination

## Exports by country



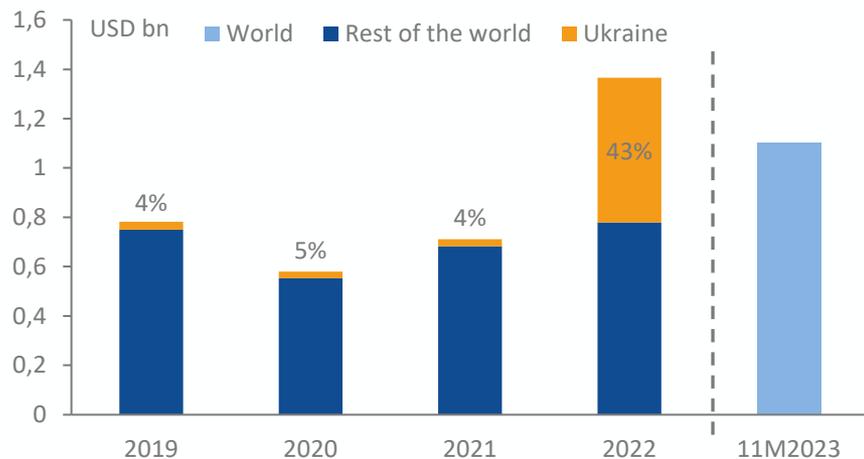
Source: National Bureau of Statistics, data for 11M2023

## Imports of goods

- » 11M2023: -5.8% yoy
- » Lower imports of fuel (-2%) , gas (-3%) and electricity (-1%)
- » However: stronger imports of electrical machinery (+0.9%) and road vehicles (+0.8%)
- » Decline in overall trade in goods in 2023; mainly due to lower energy imports and reduced re-exports (see next slide)

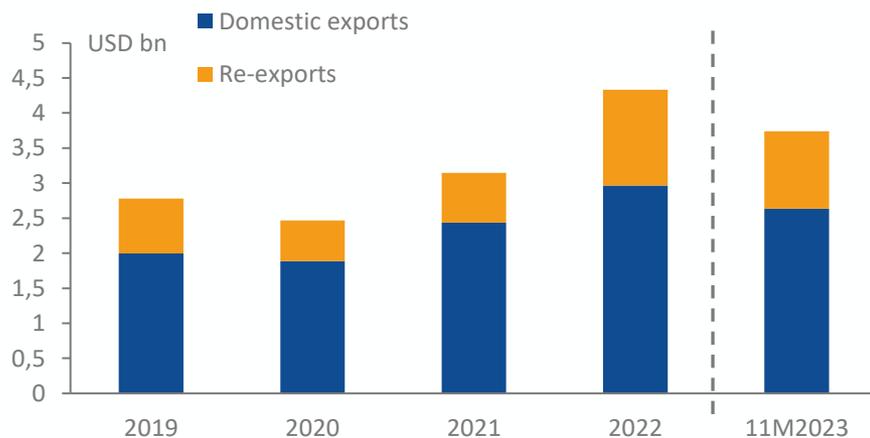
# Re-exports

## Re-exports from Moldova



Source: UN Comtrade, Moldova National Bureau of Statistics

## Domestic exports vs re-exports



Source: UN Comtrade, Moldova National Bureau of Statistics

## MDA as an intermediary country

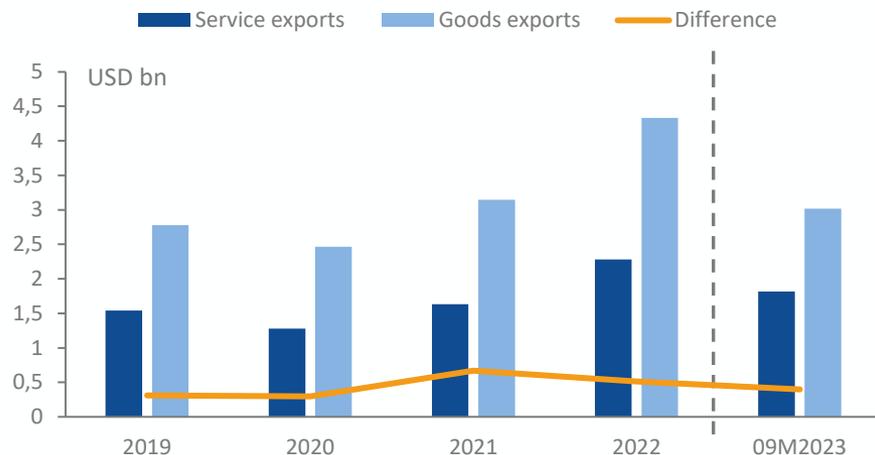
- » Due to the war, MDA became in 2022 a major intermediary country for UKR trade with the EU
- » MDA imported fuel and re-exported it to UKR; this is well recorded
- » MDA imported oil seeds, fats/oils and cereals from UKR and re-exported it to the EU; this trade is partly unrecorded
- » Consequence: large increase of MDA re-exports and overall exports in 2022

## Development in 2023

- » Detailed data on exports and the destination of re-exports not available yet
- » But there are signs that re-exports (recorded and unrecorded) linked to UKR went down
- » In particular: lower exports of oil seeds, fats/oils and fuel (see previous slide)
- » This explains – at least partly – the likely drop in overall exports in 2023
- Decrease in exports in 2023 to a large extent due to lower re-exports linked to UKR; not necessarily due to lower domestic exports

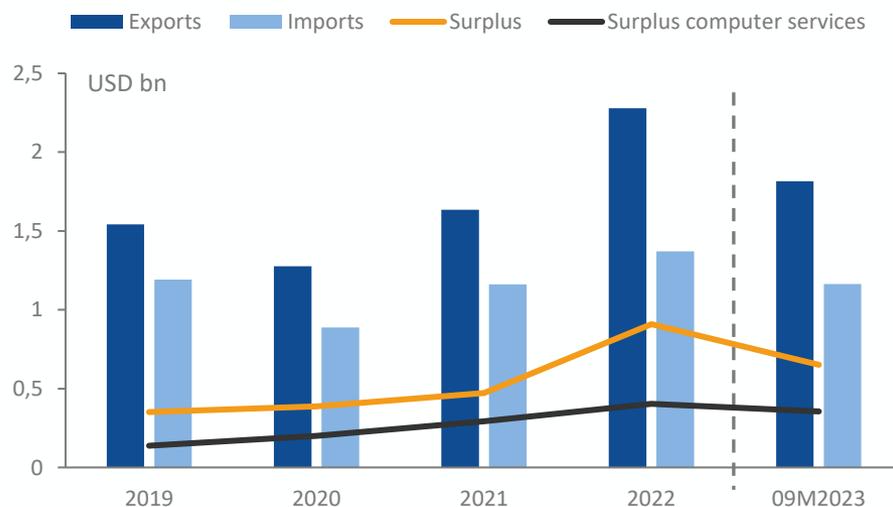
# Trade in services

## Service and goods exports



Source: NBM

## Balance of services



Source: NBM

- » Positive development of services' exports in 2022 and 2023
- » In contrast to trade in goods, service trade has a persisting surplus
  - In 9M2023, surplus made up 4% of GDP

## Exports 9M2023

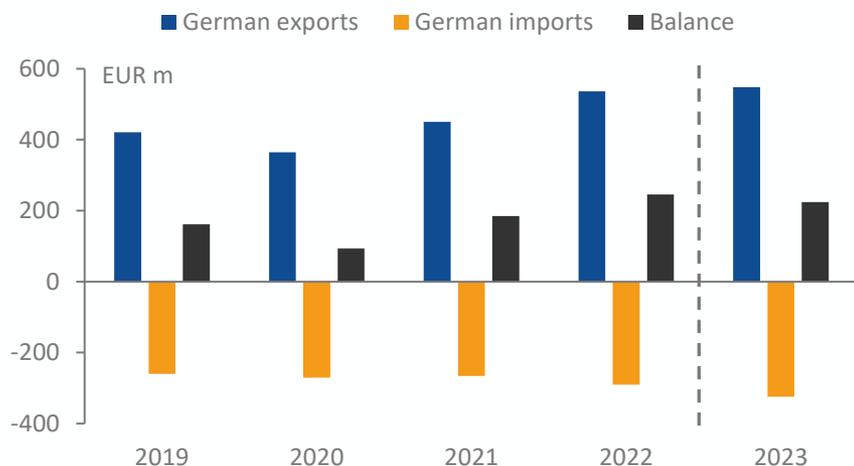
- Exports: +11.0% yoy
- Computer services made up 55.0% of the total surplus for 9M2023 in 2023, compared to 44.0% in 2022
- Computer service: 22% of total service exports

## Imports 9M2023

- Imports: +15.0% yoy
- Mostly caused by increased travel services
- Export of computer services contributes significantly to surplus in service trade

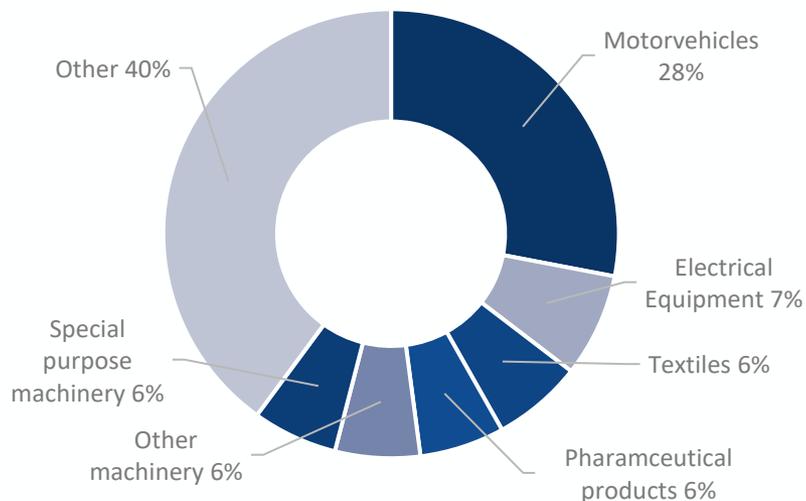
# Bilateral trade between Moldova and Germany

## German trade with Moldova



Source: Federal Statistical Office of Germany

## German exports to Moldova



Source: Federal Statistical Office of Germany; data for 2023

## 11M2023

- » German exports: EUR 548 m; +2 % yoy
- » German imports: EUR 324 m; +12% yoy

## Exports

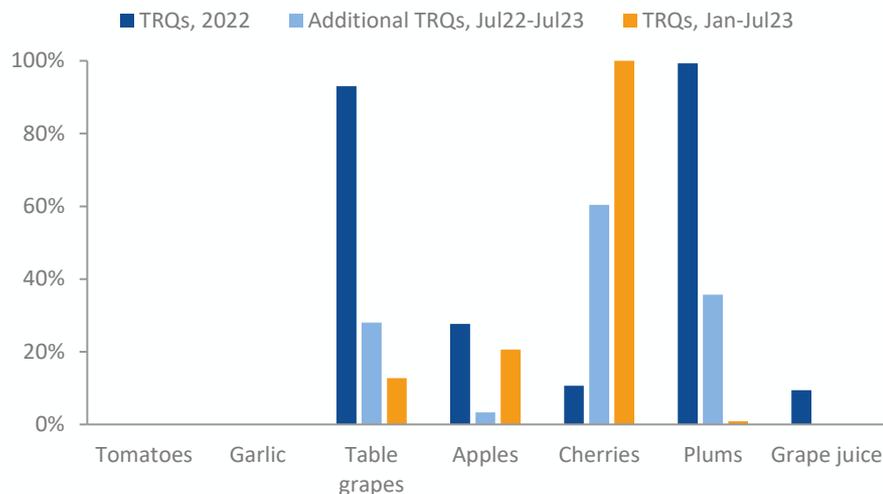
- » Main items include motor vehicles, special machinery (e.g., agricultural machinery) and textiles
- » Slight increase in exports mainly driven by motorvehicles

## Imports

- » Main products: clothing, furniture and electrical components for the automotive industry, as part of integrated value chains
- » Increase in imports mainly due to higher imports of oilseeds and oleaginous fruits and electrical machinery
- To some extent, bilateral trade reflects the existence of integrated value chains
- Reduction of German trade surplus with MDA for 2023

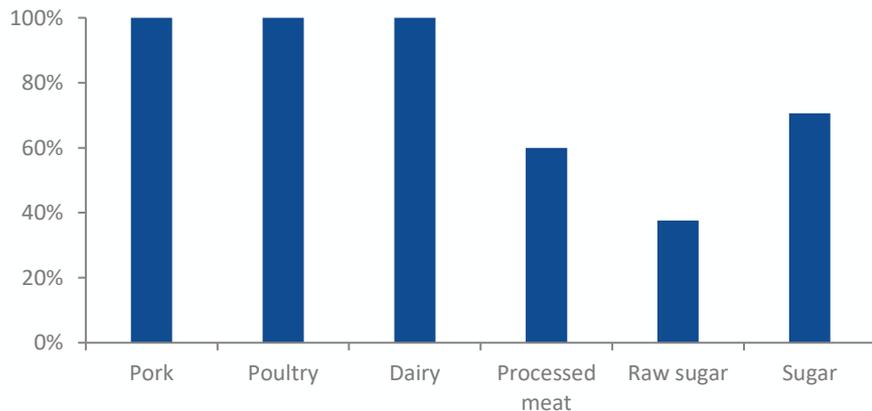
# Overview of tariff rate quotas in EU-Moldova trade

## Usage of EU TRQs on MDA products



Sources: Eurostat, European Commission Tariff Quota Consultation, own estimates

## Usage of MDA TRQs on EU products in 2022



Sources: WITS, Association Agreement, own estimates

## EU-MDA DCFTA (2014)

- » Large liberalisation of trade, but some barriers remain in agro-food
- » EU has tariff rate quotas (TRQs) for MDA products; so does MDA for EU products

## Further liberalisation

- » EU recently relaxed TRQs for MDA, but only for one year; positive effect, but no effect on investment and productivity, i.e. no long-term effect
- » MDA requested a permanent abolishment of EU TRQs
- » Response EU: in principle possible, but only if MDA takes “corresponding measures”
- » Task for GET: quantification of the effect of TRQ relaxation as a basis for negotiations
- » Relevant/fully used TRQs:
  - EU TRQs: grapes, plums, and cherries
  - MDA TRQs: pork, poultry, and dairy

# Estimation of the effect of TRQs relaxation

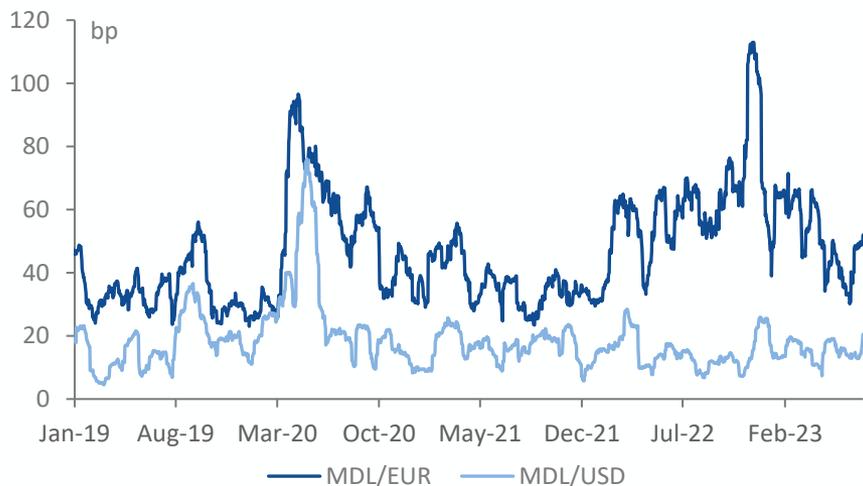
	Additional duty-free exports, USD m	Loss in revenues from import duties, USD m	Impact on producers
<b>Impact of the EU TRQ abolishment</b>			
Table grapes	2.8	0.3	minor
Fresh plums	25.1	1.6	noticeable
Fresh cherries	3.0	0.4	minor
<b>Total</b>	<b>30.9</b>	<b>2.3</b>	
<b>Impact of the MDA TRQ increase by 25%</b>			
Pork	3.4	1.2	some
Poultry	1.7	0.3	minor
Dairy	0.5	0.1	minor
<b>Total</b>	<b>5.6</b>	<b>1.6</b>	

Sources: Eurostat, WITS, ITC Trade Map, NBS, UN Comtrade, own estimates

- » **EU TRQs abolishment:** limited increase of MDA exports of grapes and cherries expected, due to quality and varieties issues; however, MDA is a large producer of plums (100 tt pa, equivalent to 7% of EU output) and offers plums in the same season as EU members (direct competitor); yearly exports would increase by USD 25 m, hurting producers aiming for intra-EU trade, e.g., ESP
- » **Increase of MDA TRQs by 25%:** no major problems for poultry and dairy, as imports from EU would substitute imports from UKR; but it would create some problems for MDA pork producers
- **Key products for negotiations are plums and pork**

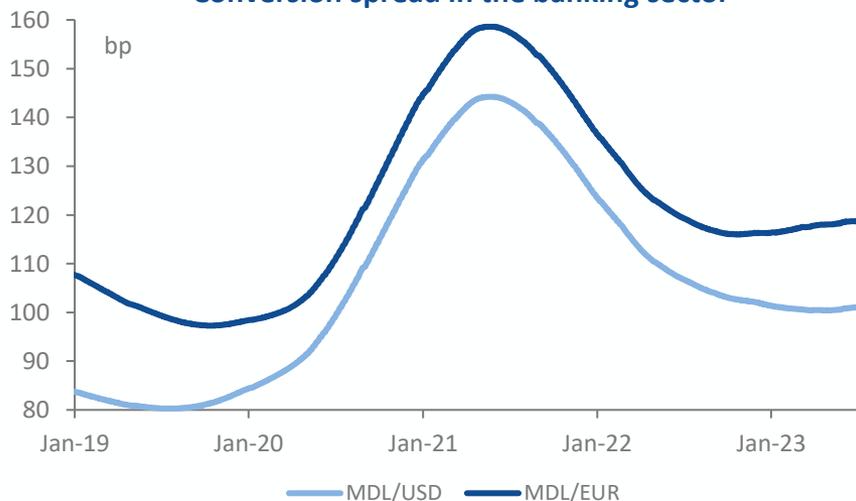
# The choice of the reference currency and its implications

## Volatility of MDL/EUR and MDL/USD official exchange rate



Source: NBM. Volatility calculated as monthly standard deviation of daily log returns

## Conversion spread in the banking sector



Source: curs.md, simple annual moving average of the rates of MICB, Victoriabank, and MAIB

## Reference currency

- » Definition: foreign currency used by a central bank for exchange rate smoothing and FX interventions
- » The National Bank of Moldova uses the US dollar as reference currency

## Implications of using the US dollar

- » MDL/USD official rate less volatile than MDL/EUR
- » Volatility, 6M2023:
  - MDL/USD: 15 bp; MDL/EUR: 52 bp
- » Exchange rate conversion spread for MDL/USD lower than for MDL/EUR
- » Conversion spread, 2016-2022:
  - 91.8 bp for MDL/USD rate
  - 113.5 bp for MDL/EUR rate
- Transaction costs for exchanging money higher for euro than for US dollar

# Proposal: switching the reference currency to the euro

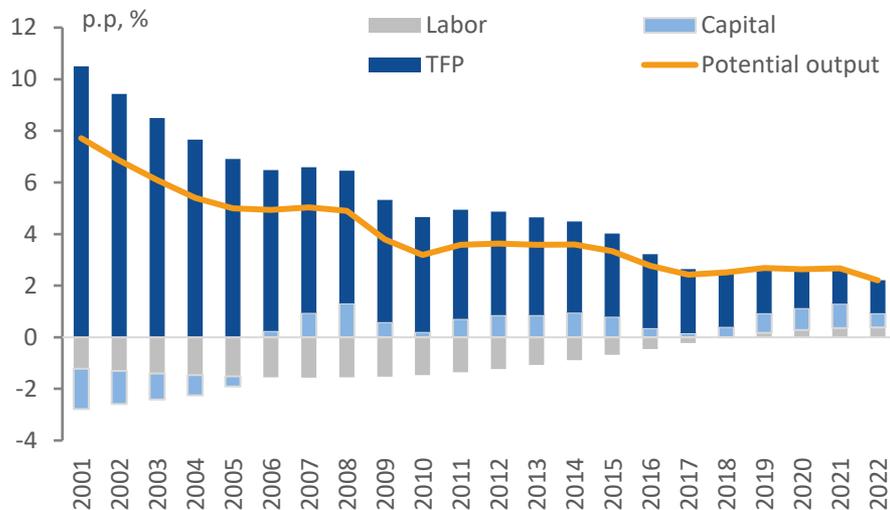
- » In the past, the use of the US dollar as a reference currency was only natural, given MDA's strong trade links with CIS countries
- » However, in the meantime the situation has changed: the EU is by far Moldova's main trading partner and the major source of its remittances and FDI
- » Furthermore, the euro is used for settling most of Moldova's foreign trade
- » Moreover, the euro is the main foreign currency for bank loans and deposits within the country
- **Against this background, we recommend to switch Moldova's reference currency from the US dollar to the euro**
- » According to our estimates, the proposed switch will lead to savings to the Moldovan real economy of **USD 11.7 m** per year
- » This sum is likely to grow with further EU integration of Moldova
- » Furthermore: such a switch could be implemented in the short term

## Yearly savings for real economy

Cash market	USD 5.6 m
Non-cash intrabank market	USD 6.1 m
Non-cash interbank market	0
<b>Total</b>	<b>USD 11.7 m</b>

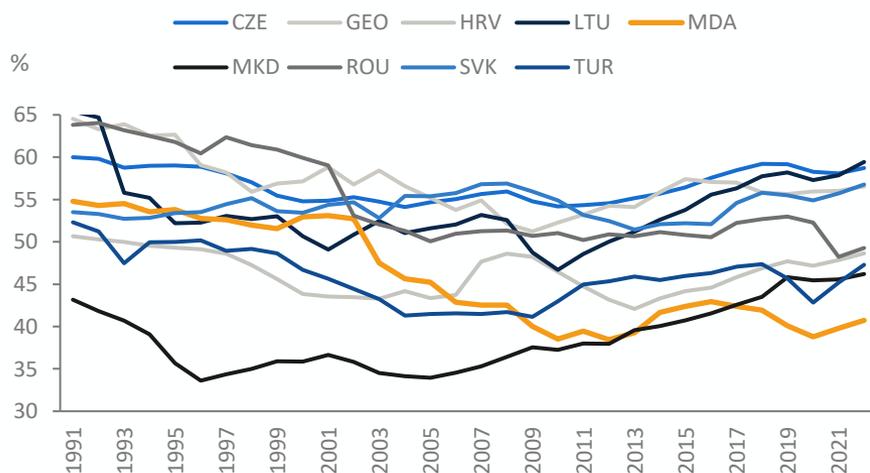
# Potential economic growth

## Decomposition of Moldova's potential growth



Source: own modelling

## Employment to population ratio over time: 15+

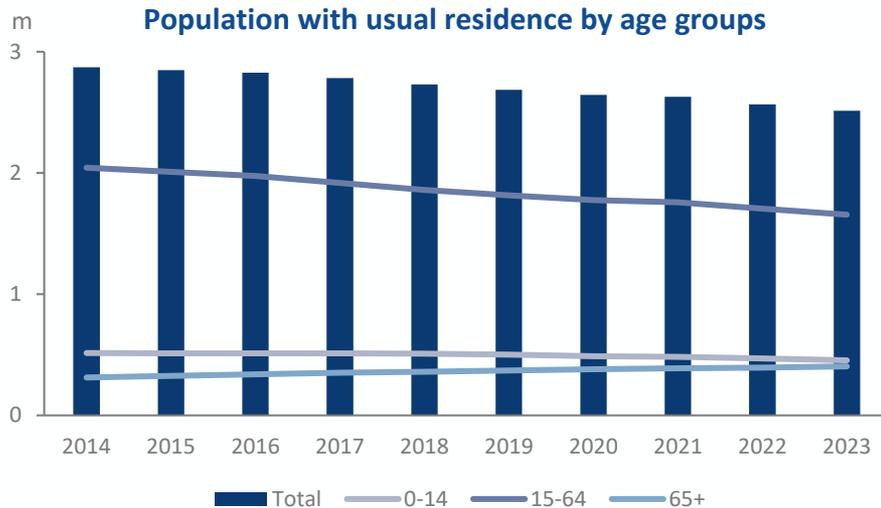


Source: Worldbank

## Potential growth trend

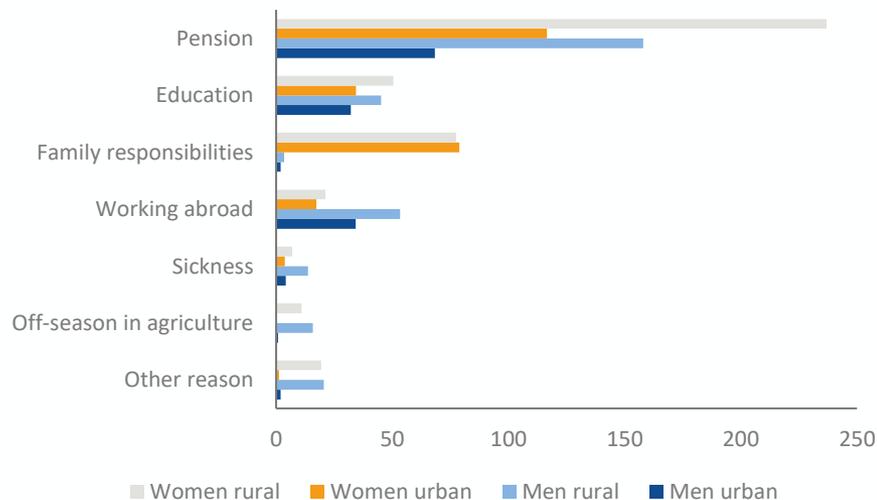
- » Post-2000, Moldova saw robust GDP growth despite limited investment in capital and a negative contribution from labour until 2017
- » Since then, potential growth has stabilized around 2.7% or lower
- » This is mainly due to the slowing total factor productivity (TFP) resulting from systemic changes
- » This indicates a saturation point in available development opportunities in several areas
- » Here focus on labour development
  - Significant decline in labour force in 2000s due to emigration
  - Positive contribution to growth since 2018
  - However, still Moldova's employment rate falls behind in regional comparison
- » Higher long-term economic growth needs structural reforms

# Opportunities in the labour market



Source: NBS data

## Economically inactive persons



Source: NBS data for 2022

## Population

- » Despite significant emigration in the 2000s, MDA has maintained consistent population levels since the 2014 census, reflecting only typical population demographics
- » Ukrainian refugees: About 120 thsd. recorded refugees, 31 thsd. requested asylum, but no significant effect in data yet

## Economically inactive persons

- » 126 thsd. persons work abroad
- » Additional 150 thsd. women are inactive due to family responsibilities
  - Kindergartens – mild constraint; elderly and disabled care – possibly a more serious problem in all communities

## State-owned enterprises (SOEs)

- » Additional labour could be available from SOEs due to strong overemployment suspected (new GET-study planned)
- Difficult to engage economically inactive people, overemployment in SOEs or UKR refugees could be an opportunity

# About the German Economic Team

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.*

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