

Economic situation at the end of the year

Economic growth will amount to a good 4% in 2018. A slight slowdown is expected for 2019; GDP is forecasted to grow by 3.8%. Growth is driven by consumption and investment. On the supply side, manufacturing, construction and retail trade are contributing to growth; agriculture stagnates.

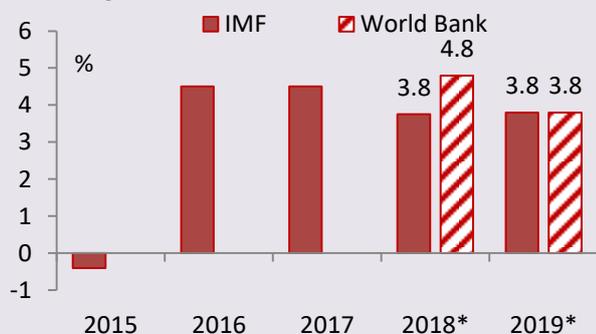
Inflation will fall to around 3.6% in 2018 due to external factors. Thus, prices are largely stable. The Moldovan Leu remains strong; this leads to growth of imports, which will rise by around 21% in 2018. Exports are also rising at a double-digit rate of around 16%. Trade integration with the EU continues; about 69% of exports are going to the EU market. The fiscal deficit in 2018 is expected to be only 1.9% of GDP despite the upcoming parliamentary elections. For 2019 a deficit of 2.8% of GDP is expected, thus, it will remain manageable.

Overall, economic growth will remain at roughly the same level as in previous years. Reforms are needed for a higher growth – especially in the judiciary and the education system. The banking sector and the tax administration show how such reforms can work. The international community should provide the necessary support after the parliamentary elections on 24 February in order for that to be achieved. At the same time, clear conditions must be a prerequisite for this support.

Slight slowdown in growth

Growth forecasts differ for 2018. According to the IMF's World Economic Outlook, growth is expected to amount to 3.8%, while more recent figures from the World Bank forecast 4.8%. We expect growth to be a good 4%. In the first three quarters it was 4.0%.

Real GDP growth



Source: National Bureau of Statistics; *Forecast

On the demand side, it is mainly driven by private consumption and investment. The contribution of net exports is negative due to the strong growth of imports. This in turn is based on the strong Leu.

On the supply side, growth is mainly based on manufacturing, construction and retail trade. In the first three quarters of 2018, manufacturing grew by 5.3%, retail trade by 5.8% and the construction sector even by 15.9%. Rising FDI inflows are having a positive impact on the manufacturing sector, robust consumption is contributing to growth in the retail sector and growing investments is the main reason for growth in the construction sector. In contrast, agriculture stagnated with a slight minus of 0.2%.

For 2019, both the IMF and the World Bank expect relatively low growth of 3.8%, despite the expected favorable external conditions – especially in the EU and the CIS. Important obstacles to growth include not only the decline in the population, but also weaknesses in the judiciary and the education system.

Prices are largely stable

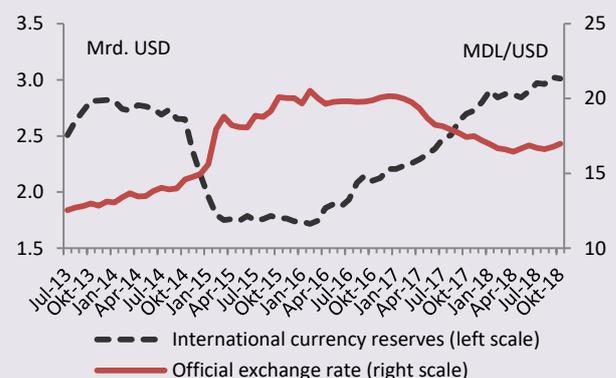
Inflation is expected to be on average at low 3.6% in 2018. In November, it was only 0.9% compared to the same month of the previous year. The reasons for low inflation are slowly rising food prices and the reduction of regulated prices, e.g. for electricity and gas. Nevertheless, the target corridor of the National Bank of 5% ± 1.5 percentage points is expected to be met. Thus, prices – on average – are largely stable.

This reasonable inflation made it possible for the National Bank to leave the policy rate unchanged at 6.5% since the end of 2017. This low policy rate contributes to lower market interest rates. As such, it is advantageous for the financial sector and the real economy.

Strong Leu, but no further appreciation

The exchange rate has stabilised at about 17 MDL per USD after a 20% appreciation in 2017. Very positive is the continuous build-up of currency reserves, which now equal more than 5 months of import coverage.

Exchange rate and currency reserves



Source: National Bank Moldova

Remittances growth, which started in beginning of 2017 and this way supported consumption, stopped in the third quarter of 2018. It remains to be seen whether this is a trend reversal or just an outlier. In any case, remittances stood at USD 0.95 bn in the first three quarters of 2018 and were, thus, below the high level of the first three quarters in 2013, when USD 1.16 bn were transferred, according to National Bank data.

Strong growth in foreign trade

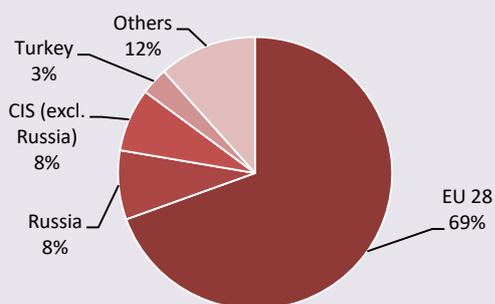
From January to October 2018, imports grew by 21% compared to the same period of 2017, which corresponds to an increase of USD 817 m. The main reason for this growth is the strong Leu.

Exports grew by 16% compared to the same period of 2017, an increase by USD 299 m. Main drivers are machinery exports (especially cable harnesses) and exports of plant products. Machinery exports increased by USD 144 m, which corresponds to 48% of the total increase. Plant products rose by USD 58 m.

Exports to the EU increased by USD 287 m between January and October, this amounts to 96% of the total increase. Exports to the CIS, on the other hand, fell by USD 31 m, mainly due to a USD 26 m drop in exports to Russia.

The importance of the EU as an export market therefore continues to grow; it is now the target for 69% of goods exports.

Exports by regions



Source: National Bureau of Statistics; Note: Trade in goods; Jan-Oct 2018

Budget deficit remains manageable

Revenues are developing very positively, they grew in January to October 2018 by 11% year-on-year. We see the reasons in the tax and customs reforms in 2016/17 and in economic growth.

However, the controversial income tax reform in 2018 leads to lower revenues starting from October 2018. At the same time, there is a significant increase in spending, especially in subsidies and wages, but also in investment.

The budget deficit is expected to remain within the limits of the IMF programme in 2018. The World Bank expects a deficit of 1.9% of GDP.

For 2019, the World Bank expects a deficit of 2.8%. Despite the loosening of fiscal policy in the run-up to the parliamentary elections on 24 February 2019, it remains manageable, which is a positive development.

Conclusion

The year 2018 is comparable to 2016 and 2017 in terms of the level of overall growth. The economic situation is stable; however, 4% growth is relatively low for a country like Moldova. Structural reforms in the judiciary and education system are needed to make higher growth possible. On the other hand, there are also positive aspects that should not be ignored. Examples are developments in the banking sector and in the tax administration that show that reforms are possible. Another positive development is the prudent macroeconomic policy of recent years, which, among other things, has contributed to the fact that the normalisation of monetary policy in the developed economies so far had little effect on Moldova. It would be desirable to add further positive examples. Therefore, the international community should provide the necessary support also after elections. At the same time, clear conditions must be defined as prerequisite for this support.

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