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Economic effects of possible remittances shocks from Russia

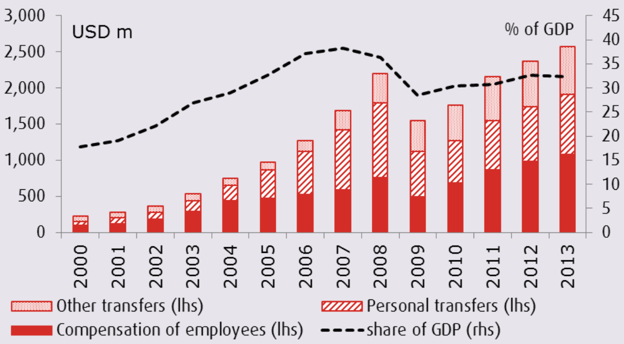
Remittances from Russia are an important source of income for Moldova. In 2013, Moldova received USD 1.5 bn in remittances from Russia, equivalent to 19% of GDP and making up 60% of the USD 2.6 bn total remittances received by Moldova. Concerns exist that remittances from Russia may significantly decline in the near future, due to the economic slowdown in Russia and the possibility of political pressure being exerted on Moldova by the Russian government. A reduction in remittances would severely affect consumption expenditures in Moldova, corresponding to a loss in the standard of living of the population. A shock in remittances would, however, not lead to a strong decline in GDP and would have only a moderate impact on public finances.

Key to absorption of a possible remittances shock is the current monetary policy of inflation targeting. Implying a flexible exchange rate, this policy enables a rebalancing of the current account in the wake of a possible shock. Also, the Moldovan government should strive to provide alternative working opportunities for Moldovans currently working in Russia. This includes negotiating quotas for immigrants with potential host countries and strategies to boost domestic employment in Moldova.

Large economic importance of remittances

Moldova remains one of 5 countries in the world most dependent on remittances. Having steadily risen in importance as a source of income until the 2009 global economic crisis, annual remittances to Moldova have now stabilised at around 32% of GDP.

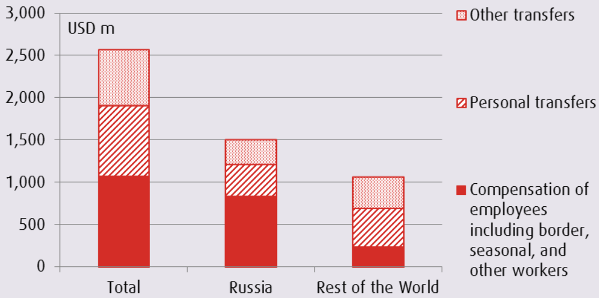
Net remittances to Moldova, 2000-2013



Source: National Bank of Moldova, own calculations

Russia remains by far the most important sending country for remittances to Moldova. Due to the large community of around 250,000 Moldovans working permanently or seasonally in Russia, the country accounted for USD 1.5 bn or 60% of total remittances to Moldova in 2013.

Remittances from Russia, 2013



Source: National Bank of Moldova, own calculations

Remittances, although not a component of GDP as they stem from production abroad, are an important source of household income and external financing of the Moldovan economy. Whereas imports amounted to 84% of GDP in 2012, exports only amounted to 46% of GDP in the same year, rendering the Moldovan economy highly dependent on remittances for the financing of imports.

Causes of possible remittances shocks

Both economic and political factors give cause for concern about remittances from Russia. The Russian economy is presently experiencing an economic slowdown, with the IMF forecasting growth rates of 0.2% for 2014 and 1% for next year. In conjunction with the end of the construction activities related to the Sochi Winter Olympic Games, the slowdown may have a significant effect on the incomes of Moldovans working in Russia.

Also, a remittances shock may be caused by deliberate political measures taken by the Russian government in order to exert pressure on Moldova, which is expected to sign an Association Agreement, including a Deep and Comprehensive Free Trade Agreement, with the EU by the end of June.

Economic effects of possible remittances shocks

According to our calculations, remittances shocks would have a relatively weak impact on GDP and public finances, while consumption expenditures by Moldovans would be severely affected. We consider different hypothetical shock magnitudes, as potential shock sizes will be determined by different factors in a dynamic political and economic framework. A 10% reduction in remittances from Russia, corresponding to USD 153 m, would lead to a nearly equivalent loss of consumption expenditures of USD 150 m per year. However, the GDP effect would be limited to a 0.34% decline in yearly GDP, corresponding to USD 27 m.

Macroeconomic effects of remittances shocks

Shock: Reduced remittances from Russia		Effects					
		GDP		Consumption		Public Revenues	
%	USD m	USD m	%	USD m	% of GDP	USD m	% of GDP
-5.0	-76	-14	-0.17	-75	-0.95	-14	-0.18
-10.0	-153	-27	-0.34	-150	-1.90	-28	-0.36
-25.0	-382	-67	-0.84	-377	-4.75	-71	-0.89

Source: Own Calculations

The GDP effect of a remittances shock is strongly moderated by the openness of the Moldovan economy. A remittance shock propagates mainly through a reduction in consumption expenditures. As about 60% of Moldovan consumption expenditures are spent on imported goods and services, the effect of the demand decline on domestic production is significantly reduced. A large share of the shock will thus result in a reduction of imports, without affecting the Moldovan GDP.

The effect on public finances, resulting mainly from the impact of the consumption decline on VAT revenues, is similar to the effect on GDP: a 10% decrease in remittances from Russia would lead to a deficit increase by 0.36% of GDP.

Implications for monetary and fiscal policy

As a remittance shock would be transmitted through the current account, exchange rate policy is crucial in dealing with such kind of a shock. If remittances are reduced, imports must be reduced, too, so that a large-scale increase of the current account deficit can be avoided.

Currently, the exchange rate of the Moldovan Lei is flexible as a result of the monetary policy of inflation targeting. Although allowing the Lei to depreciate following a remittance shock would increase the shock's impact on the standard of living, the National Bank of Moldova would be well-advised to let this happen. Attempts to artificially stabilise the exchange rate when dealing with a large current account shock would quickly deplete the international reserves of the National Bank and would endanger its international financing position.

Fiscally, on the other hand, the relatively moderate impact of a possible remittances shock on public revenues suggests that, unless a very large shock of 25% or more occurs, the government could be able to avoid a fiscal tightening.

Alternative income sources should be developed

The Moldovan government should also prepare strategies for the creation of employment opportunities for Moldovan workers who stand at risk of losing their employment in Russia. Finding new sources of income for these people will at the same time moderate the impact of a shock on household incomes as well as its macroeconomic effects.

Two broad strategies are available, which should be pursued in parallel: Negotiating additional quotas for Moldovan labour migrants to third countries and creating more employment within Moldova. While the latter is not without difficulties, a sudden increase of the relatively scarce labour supply in highly price-competitive Moldova could, combined with suitable retraining schemes, be actively marketed in a drive to attract more foreign direct investment.

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Note:
A more comprehensive analysis of the topic is provided by the Policy Paper PP/03/2014 "Remittances from Russia: Macroeconomic implications of possible negative shocks"

Download at: www.get-moldau.de

German Economic Team Moldova (GET Moldova)
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