

## Overview

- Consumption and agriculture support unexpectedly high GDP increase of 4.1% in 2016
- GDP expected to increase by 4.5% in 2017, partly due to higher public investment
- National Bank to reach inflation target of 5% +/-1.5 percentage points in 2017
- Stable exchange rate reflects regained macroeconomic stability
- Remittances on the rise, except for those originating from Russia
- External trade increases significantly in 2017 in the context of economic recovery
- Very low budget deficit of 1.8% of GDP in 2016, due to lack of financing
- Public investment increases significantly in the context of the IMF programme; this causes a justifiable increase of the budget deficit to 3.7% of GDP

## Topics

- **Cluster development.** The creation of clusters can contribute to industrial development and FDI attraction
- **External trade.** Extension of trade with CIS is desirable, but should not happen at the expense of trade with the EU; criticism of the DCFTA is unfounded
- **Banking sector.** Recommendations how to absorb excess liquidity in the banking sector

# Basic indicators

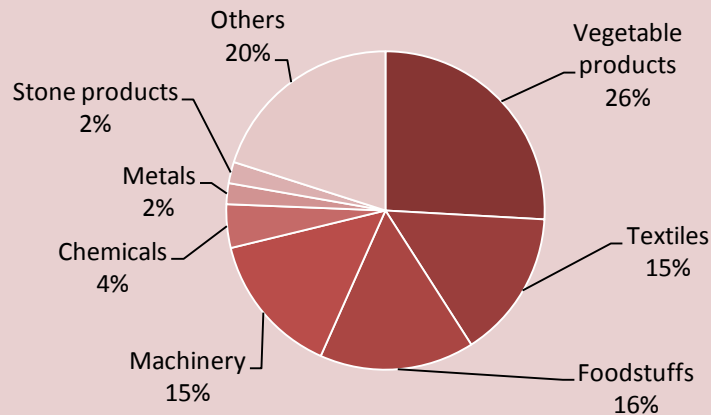
	Moldova	Ukraine	Belarus	Georgia	Russia
GDP, USD bn	7.4	95.9	54.7	13.7	1,560.7
GDP/capita, USD	2,089*	2,262	5,787	3,715	10,886
Population, m	3.5*	42.4	9.5	3.7	143.4

Source: IMF, estimation for 2017; \*According to the census of 2014 only slightly less than 3 m inhabitants; based on this census GDP per capita amounts to ca. USD 2,470.

## Trade structure

### Export

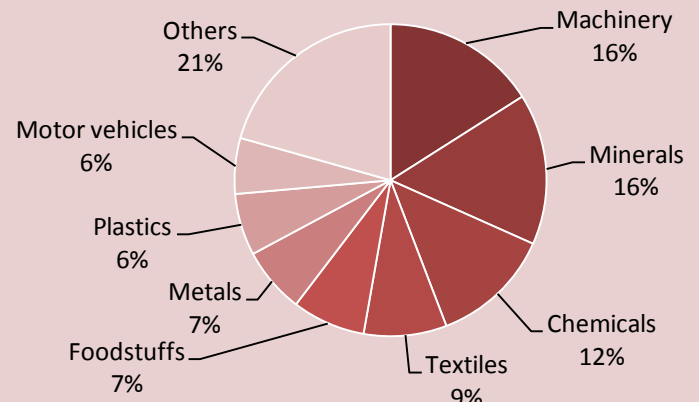
EU 65% | Russia 11% | Others 24%



Source: National Bureau for Statistics; 2016, Note: Trade in goods

### Import

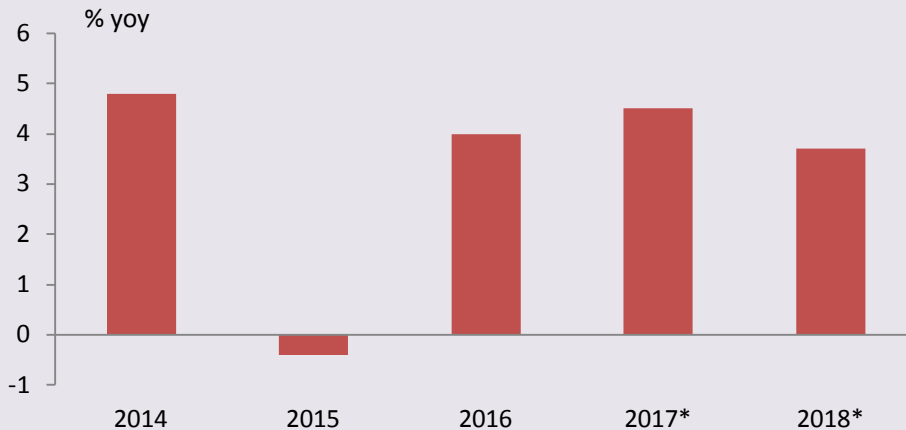
EU 49% | Russia 13% | Others 38%



Source: National Bureau for Statistics; 2016, Note: Trade in goods

# Economic growth

## Real GDP growth



Source: IMF, \*Forecast

## Investment



Source: IMF, \*Forecast

## GDP

- 2016: Growth of 4.1% stronger than expected
- Key drivers: Stable private consumption and a good harvest
- 2017: GDP to increase by 4.5%

## Investment

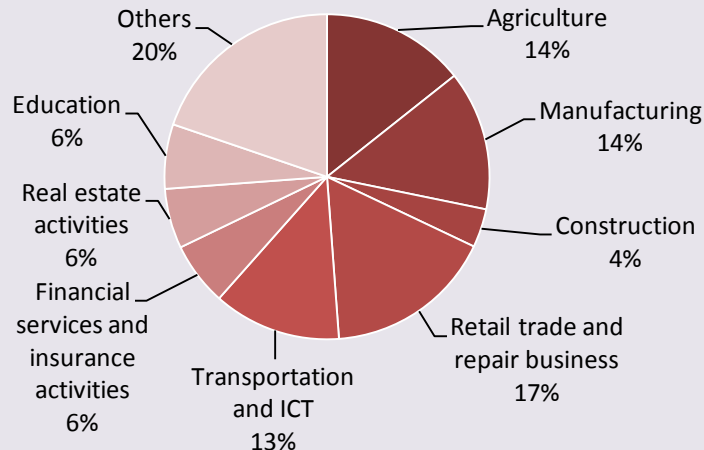
- 2016: Decrease of public investment due to fiscal bottlenecks
- 2017: Strong increase in public investment, also due to international financing
- Expectation of private investment to increase, in spite of low crediting of the real sector by the banking sector

## Conclusion

- While the recovery was mainly based on consumption and agriculture in 2016, public investment plays an important role in 2017

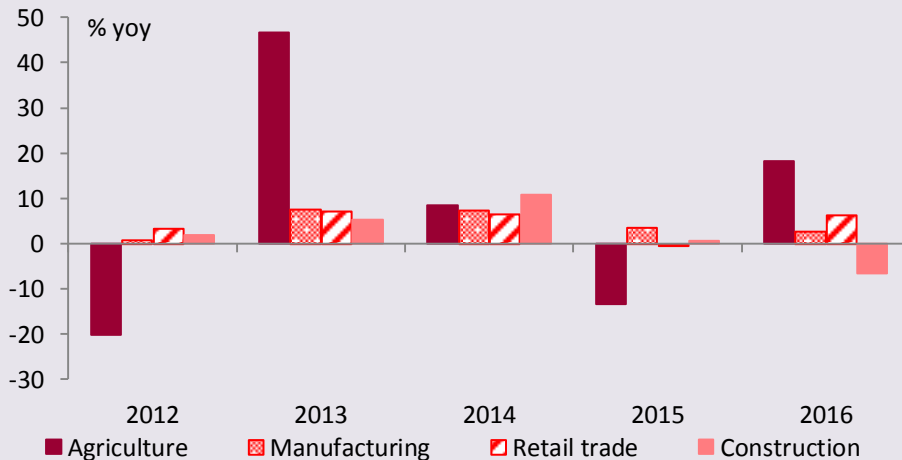
# Sectoral perspective

## Composition of GDP in 2016



Source: National Bureau for Statistics

## Sectoral dynamics



Source: National Bureau for Statistics

## Structure

- The three most important economic sectors are retail trade with 17%, agriculture and manufacturing with both 14%

## Dynamics

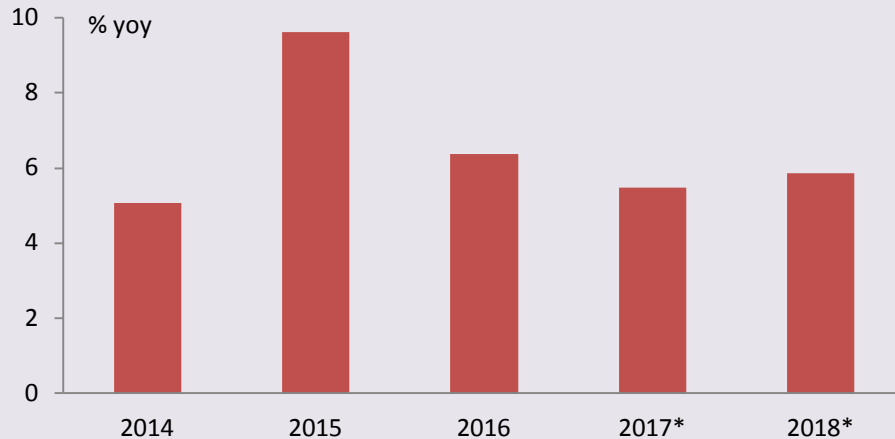
- Strong growth of agriculture in 2016 (18.2%) after drought in 2015
- Also retail trade increases significantly (6.4%)
- Manufacturing also slightly positive (2.8%)
- Decrease of construction sector (-6.7%) reflects low private and public investment in 2016

## Conclusion

- Good harvest and positive development in retail trade support unexpectedly strong growth in 2016
- Investment increases in 2017, with a positive impact on the construction sector

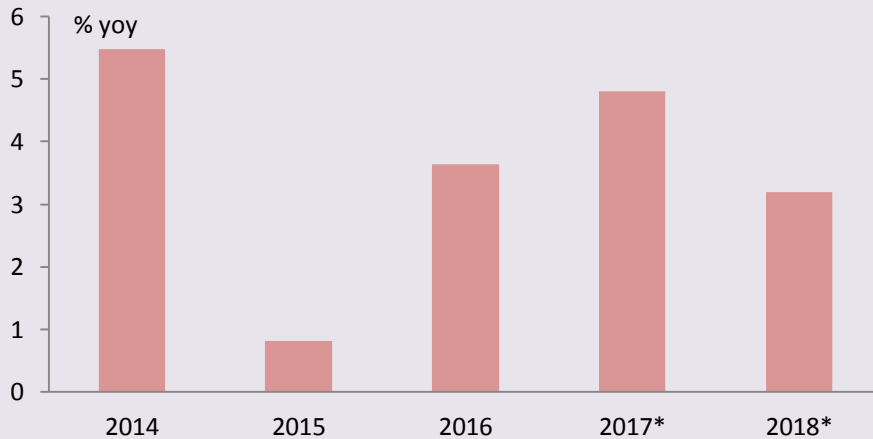
# Inflation and wages

## Inflation



Source: IMF, \*Projection; Note: Annual average (consumer prices)

## Real wages



Source: IMF, \*Projection

## Inflation

- Decreasing inflation during 2016, annual average at 6.4% significantly lower than 9.6% in 2015
- But: Since beginning of 2017 continuous increase to 7.4% in May 2017
- Reason: Increase of global commodity prices
- However: Target corridor of National Bank of 5%  $\pm$  1.5 percentage points is expected to be met

## Real wages

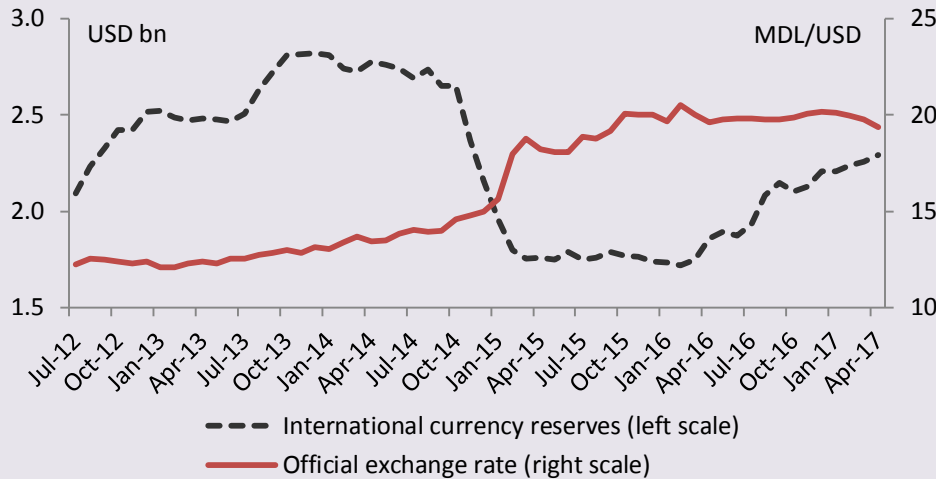
- Increasing real wages in 2016 (3.6%) after low growth in 2015 (0.8%)
- Also in 2017 and 2018 a moderate increase in real wages is expected, which should further support consumption

## Conclusion

- Inflation again in target corridor, successful monetary policy in spite of difficult conditions
- Increasing real wages support consumption

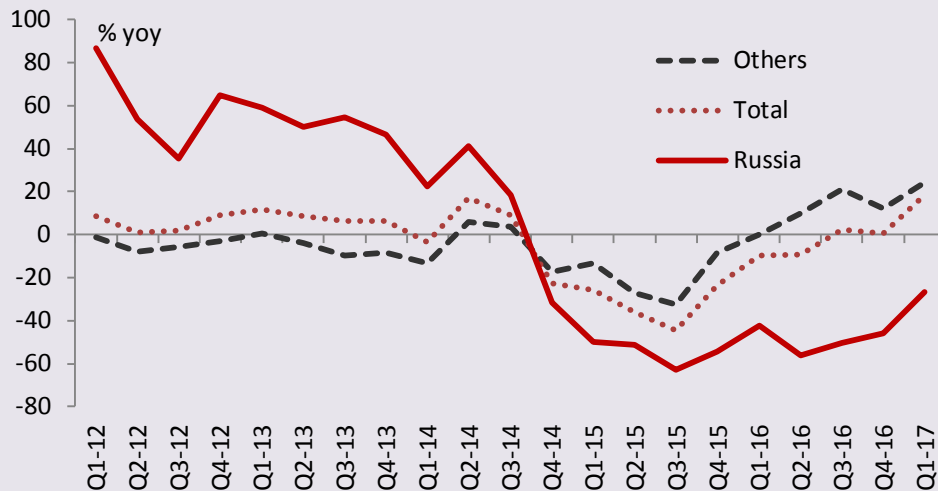
# Exchange rate and remittances

## Exchange rate and currency reserves



Source: National Bank of Moldova

## Remittances



Source: National Bank of Moldova

## Exchange rate and currency reserves

- Exchange rate stable since end of 2015
- Since beginning of 2017: Appreciation of 10% in relation to US dollar
- Appreciation pressure in 2017 makes increase in currency reserves possible
- 5.5 months import coverage at end of May 2017

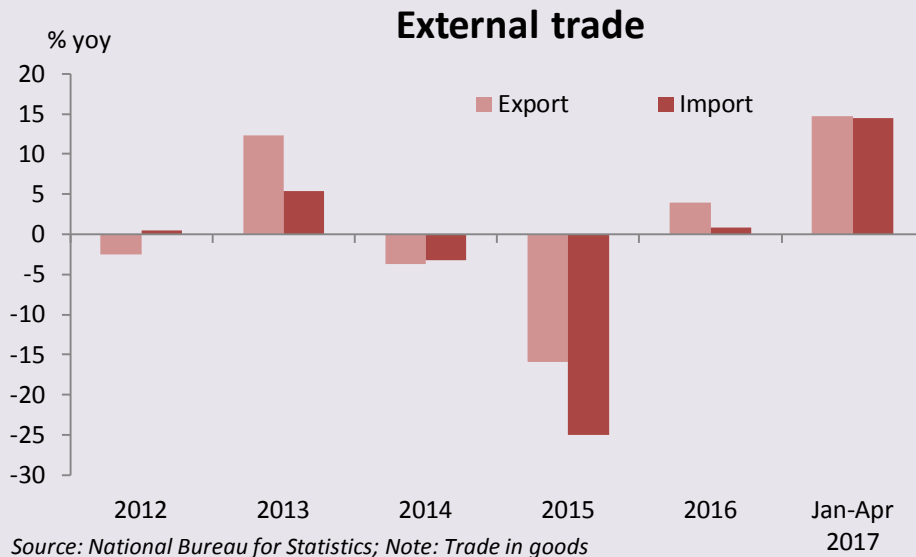
## Remittances

- Only slight decrease in remittances in 2016, growth since 2017
- Remittances from Russia continue to decrease

## Conclusion

- Stable exchange rate reflects regained macroeconomic stability
- Increasing remittances should support domestic demand
- Decreasing importance of remittances from Russia

# External trade



## Import

- 2016: Almost unchanged compared to 2015
- However: Significant increase in imports in Jan-Apr 2017 (14%)

## Export

- 2016: Moderate growth of 4%
- EU with 65% by far the most important market
- Jan-Apr 2017: Increase of 15%, especially strong increase in vegetable products

## Export dynamics by goods categories, Jan-Apr 2017

	Change, USD m	% change yoy	Contribution to growth, %
Vegetable products	33.4	24%	38%
Machinery	16.0	18%	18%
Motor vehicles	14.5	189%	17%
Foodstuffs	8.6	10%	10%
Textiles	6.3	6%	7%
Others	8.7	5%	10%
<b>Total</b>	<b>87.4</b>	<b>15%</b>	<b>100%</b>

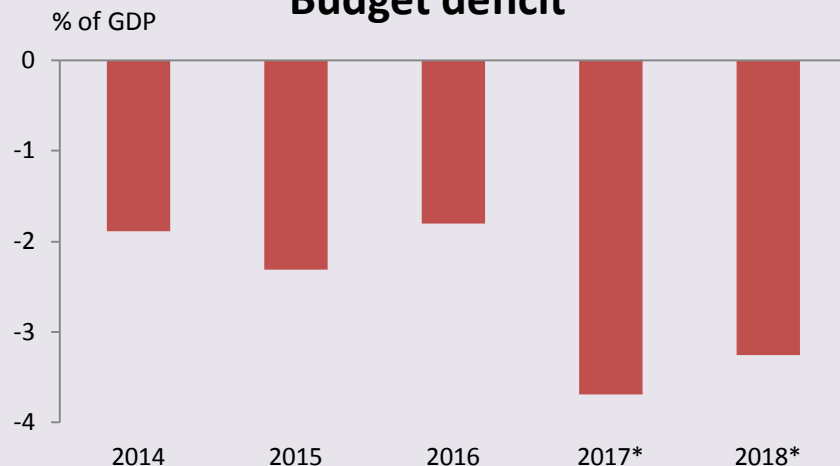
Source: National Bureau for Statistics

## Outlook

- Imports to increase in the context of the general economic recovery; IMF expects an increase of 7%
- Also increase in exports expected
- Furthermore: exports to Russia and the CIS are expected to increase

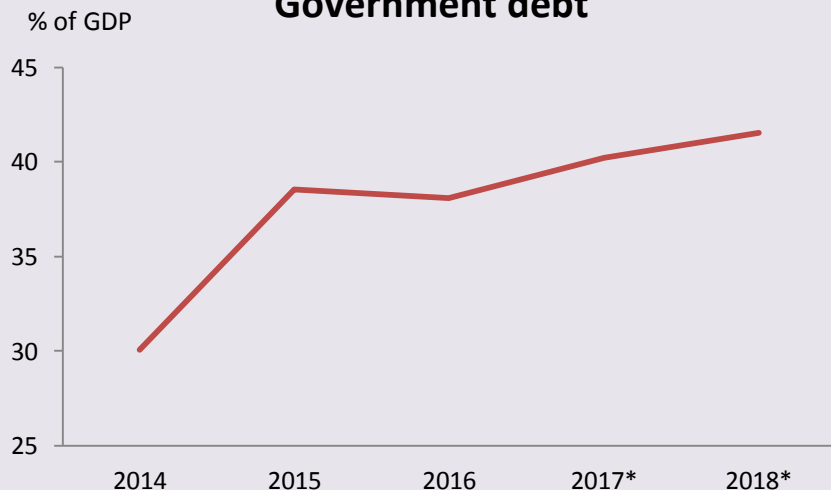
# Public finances and government debt

## Budget deficit



Source: IMF; \*Forecast

## Government debt



Source: IMF; \*Forecast

## Budget deficit

- 2016: Deficit at 1.8% significantly lower than expected
- Reason: Low investment against the backdrop of lacking support by international donors
- Social expenditures and wages for public employees as expected; no cuts

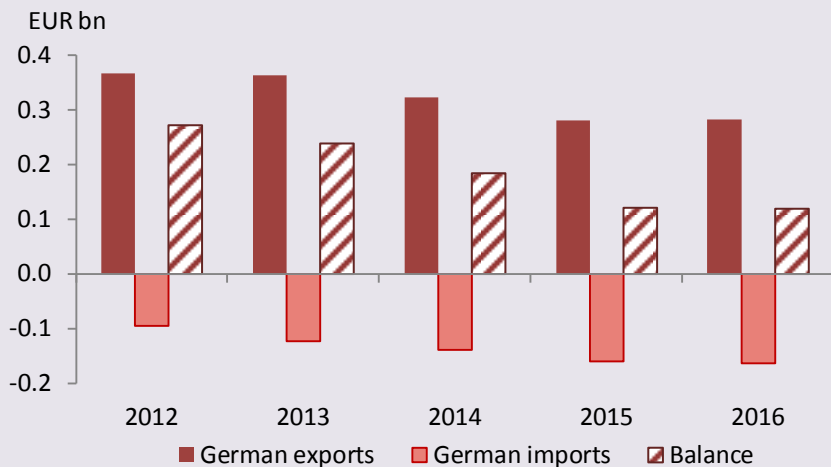
## Outlook

- Higher budget deficit in 2017 after pensions reform, which regulates uniform contribution rules for the whole public sector
- New “cash buffer” at the National Bank causes government debt to increase by up to MDL 2 bn
- IMF programme provides important space for public investment
- Implementation of reforms in the context of the IMF programme is essential for sustainability of state budget



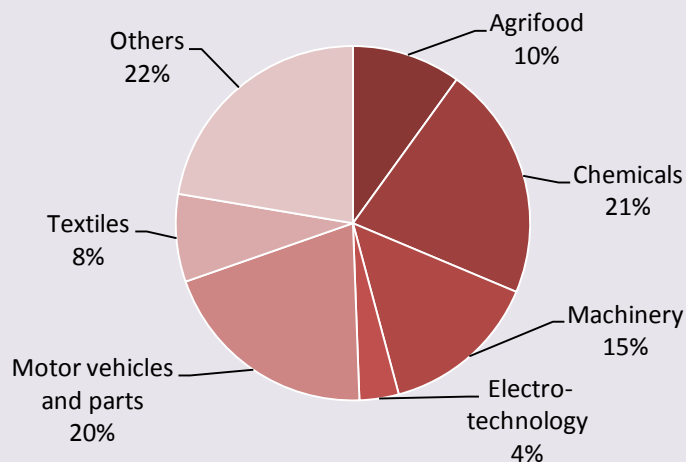
# Bilateral trade between Germany and Moldova

## German trade with Moldova



Source: German Federal Statistics Office

## German exports to Moldova 2016



Source: German Federal Statistics Office

## Bilateral trade volume

- 2016: EUR 447 bn
- Only slight increase compared to 2015 (1%)
- But: Increase by 15% yoy in Jan-Apr 2017

## German exports to Moldova

- No increase in 2016, but significant growth by 20% in Jan-Apr 2017
- Focus on export of investment goods

## German imports from Moldova

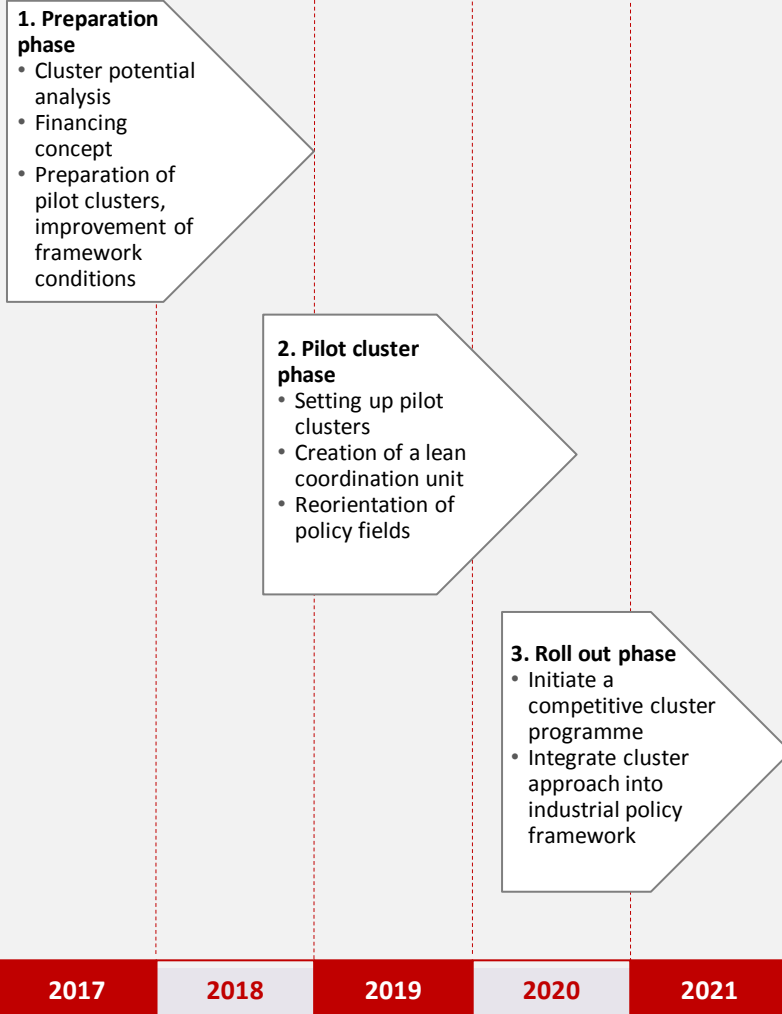
- 2016: Slight increase of imports from Moldova by ca. 2% in 2016
- Jan-Apr 2017: Significant increase by 5%

## Outlook

After standstill in 2016, German export is increasing again, profiting from economic recovery in Moldova

# Cluster development in Moldova

## Road Map for cluster support



Source: Own chart

## Background

- Government plans cluster initiative to strengthen competitiveness
- Aim: Support concentration of companies, scientific institutions and other stakeholders in related supply chains
- Plan: Develop sustainable platforms for cooperation, which have previously been financed mainly by international partners

**Potential:** IT, automotive and clothing industry

## Challenges

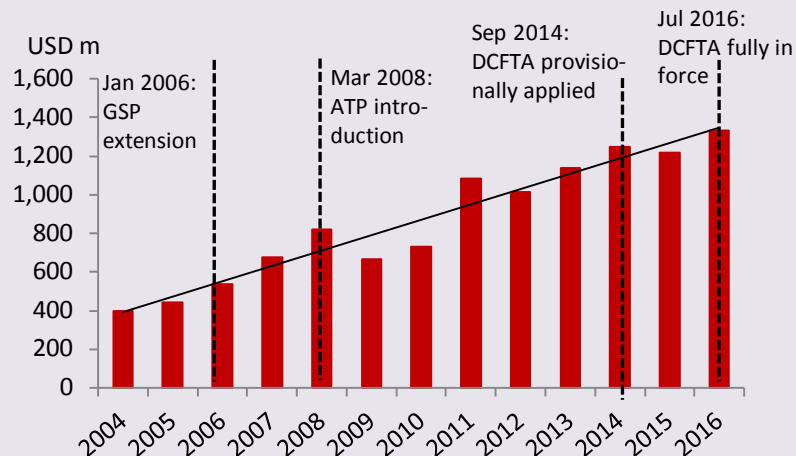
- Integration into the industrial policy framework
- Coordination between ministries and agencies
- Cooperation between the actors of the triple helix (government, business and academic institutions)

## Our view

- Gradual approach necessary
- First: Test approach in pilot clusters
- Finally: Introduce broad programme

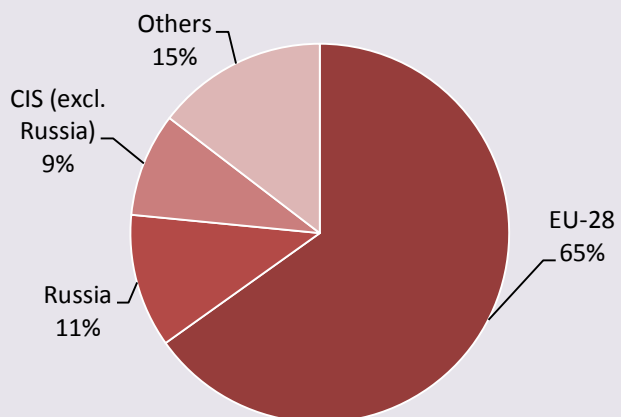
# Moldovan exports and the impact of the DCFTA

## Exports to the EU



Source: National Bureau for Statistics, Note: only trade in goods

## Exports by countries 2016



Source: National Bureau for Statistics

## Background

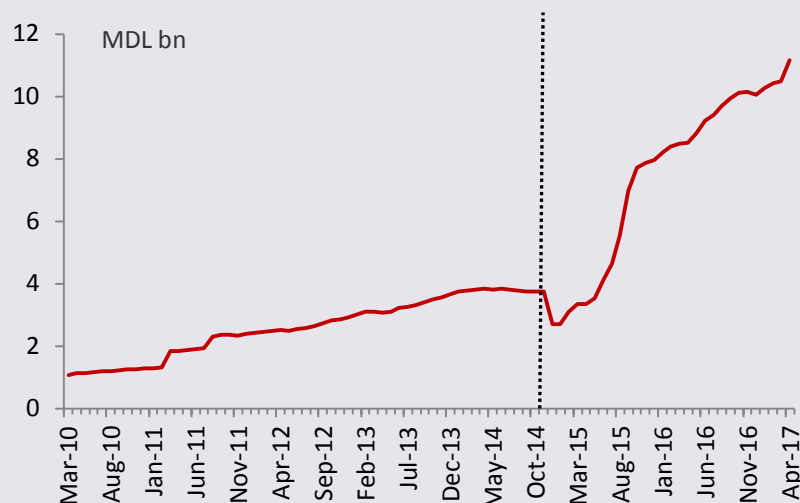
- Export to the EU increasing since 2004 (in average and in US dollar) by 10% annually
- Export growth supported by intelligent trade policy, application of DCFTA since 2014
- However: Criticism of the DCFTA by some political parties and demand for closer ties with Eurasian Economic Union (EAEU)

## Our view

- Good reasons for intensification of trade with EAEU, but not at the expense of trade with the EU
- Reasons:
  - i. 2/3 of Moldovan exports shipped to the EU
  - ii. EAEU GDP only 9% of EU GDP; less potential
  - iii. No need to choose between EU and EAEU, free trade with both sides possible
- Criticism unfounded, free trade with both sides should be main goal of trade policy

# Excess liquidity in the banking sector

## Required reserves for Lei deposits



Source: National Bank of Moldova

## Background

- Currently: Excess liquidity due to emergency loans of the National Bank (NBM) in 2014/2015
- Consequence: NBM has to absorb liquidity
- Minimum reserve requirement increased to 40%
- Significant issuance of NBM certificates
- Absorption costs > MDL 1 bn per year

→ Weakened financial position of NBM, negative impact on its independence

## Our recommendations

- Decrease yield on minimum reserves
- NBM should sell historic government bonds (MDL 2.3 bn)
- Certificates to be used only for fine tuning and to be sold in auctions
- If necessary: Ministry of Finance should support NBM in absorbing liquidity

## Absorption costs (as of March 2017)

Instrument	Absorption, MDL m	Interest rate	Annual costs*, MDL m
Minimum reserve requirement	10,500	5.2%	545
NBM certificates	5,800	9.0%	522
<b>Total</b>	<b>16,300</b>		<b>1,067</b>

Source: National Bank of Moldova, own calculations; \*own estimation

# German Economic Team Moldova



The German Economic Team Moldova (“GET Moldova”) supports the Moldovan Government in stabilising the economic development and designing the necessary reform processes since 2010.

In a continuous dialogue with high-ranking decision makers we identify current economic problems and present concrete recommendations for action based on our independent analysis.

Furthermore, GET Moldova supports the German government, German companies and other German organisations by providing know-how and detailed information on the economic situation in Moldova.

GET Moldova is financed by the German Federal Ministry of Economy and Energy.

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