

Overview

- Economic growth at 3.5% in 2017
- Weaker growth of 3.0% expected in 2018 due to decreased consumption demand
- Inflation at 6.6% in average during 2017; lower forecast for 2018
- Appreciation of the Leu reflects macroeconomic stability and positive economic situation
- Very good performance of external trade during 2017; two-digit increase in imports and exports
- Budget deficit at 3.1% of GDP in 2017; lower than expected due to increased revenues

Topics

- **Banking sector.** Stabilisation reached after banking fraud, crediting of the private sector still decreasing
- **Foreign direct investment.** Role of FDI for the economy so far underestimated, as a study of GET Moldova has shown
- **Economic reforms.** Comprehensive reforms to be assessed positively; too early for final assessment
- **Increasing tax revenues.** Increase in tax revenues can at least partly be attributed to reforms; positive example for structural reforms

Basic indicators

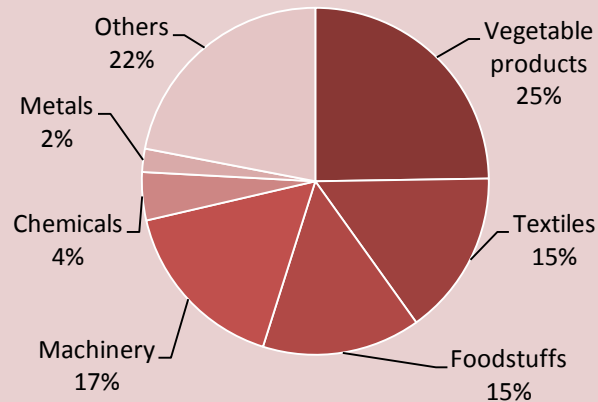
	Moldova	Ukraine	Belarus	Georgia	Russia
GDP, USD bn	7.9	104.1	52.8	15.2	1,469.3
GDP/capita, USD	2,240*	2,459	5,585	4,123	10,248
Population, m	3.5*	42.3	9.5	3.7	143.4

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 2,650.

Trade structure

Export

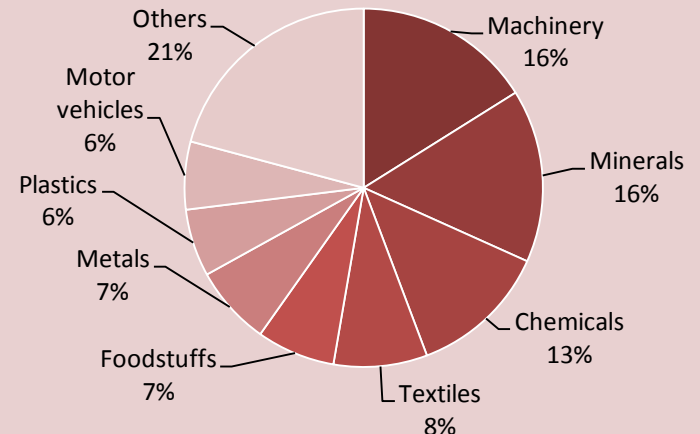
EU 65% | Russia 11% | Others 24%



Source: National Bureau for Statistics; Jan-Sep 2017, Note: Trade in goods

Import

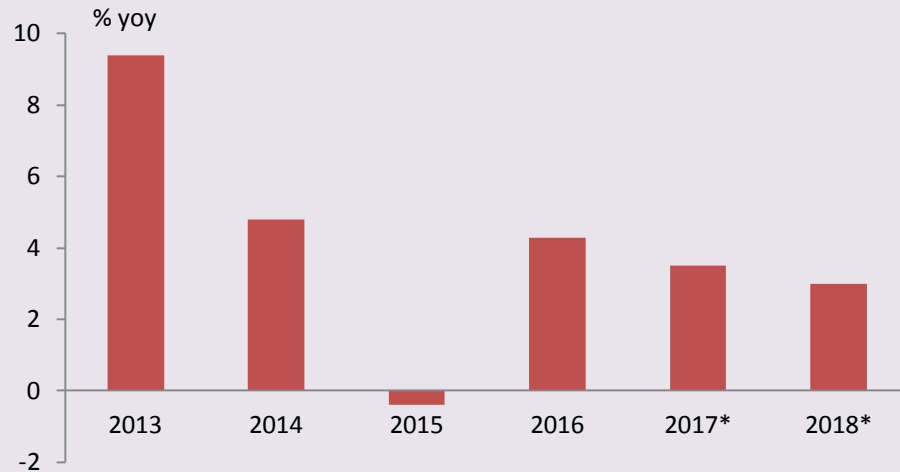
EU 50% | Russia 11% | Others 39%



Source: National Bureau for Statistics; Jan-Sep 2017, Note: Trade in goods

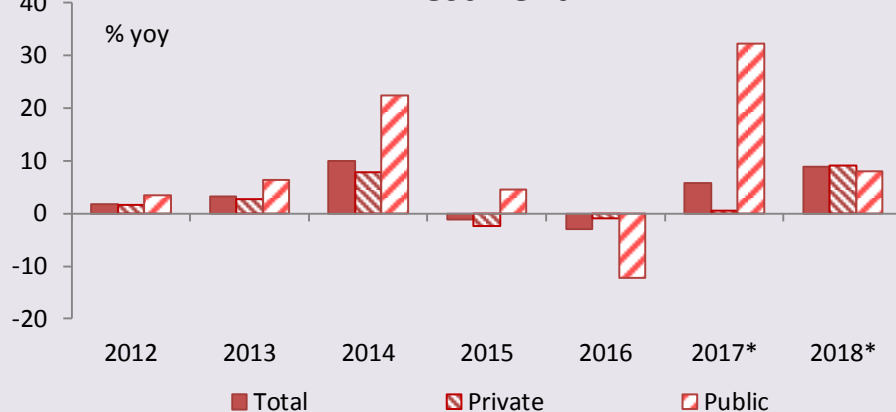
Economic growth

Real GDP growth



Source: IMF, *Forecast from Dec 2017

Investment



Source: IMF, *Forecast Dec 2017

GDP

- 2017: Growth at 3.5% slightly lower than in previous year
- Reason: Good harvest, but weaker growth of agriculture than in 2016
- Consumption robust during 2017
- 2018: Economic growth expected at 3.0%

Investment

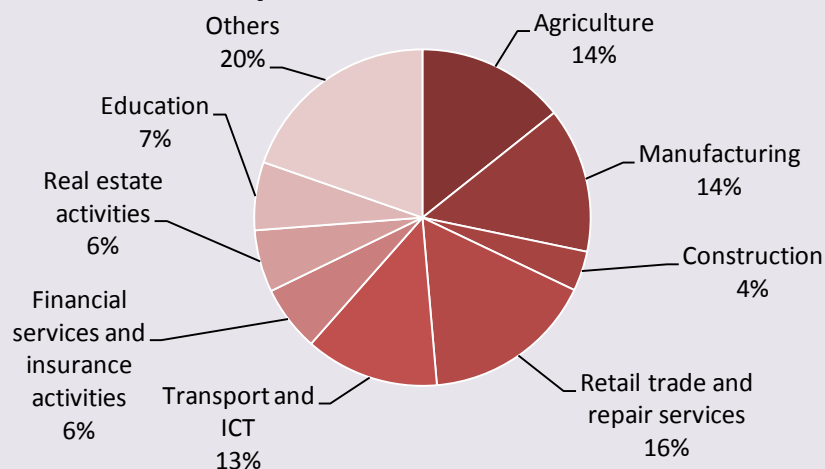
- 2017: Strong growth compared to 2016
- Reason: Significant increase of public investment, also due to international support
- 2018: Private investment expected to increase

Conclusion

- Weaker economic performance in 2017 due to lower growth in agriculture

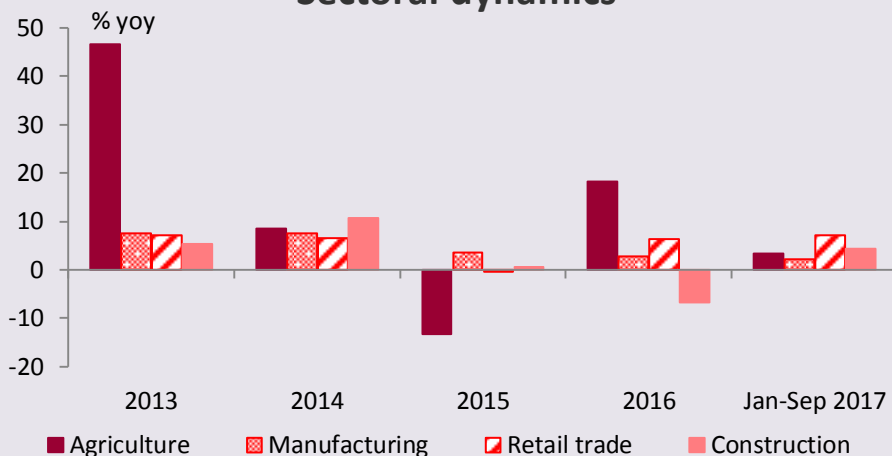
Sectoral perspective

Composition of GDP in 2016



Source: National Bureau of Statistics

Sectoral dynamics



Source: National Bureau of Statistics

Structure

- Retail trade (16%), agriculture and manufacturing (both 14%) are the three most important economic sectors

Dynamics

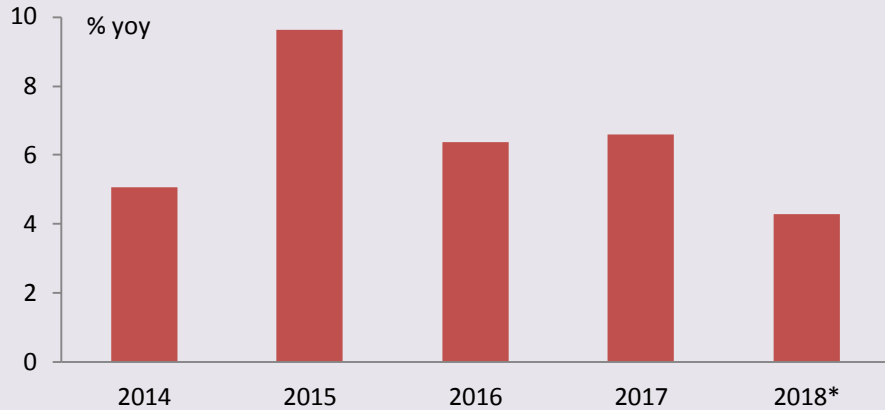
- Agriculture growth at 3.3% during Jan-Sep 2017 due to good harvest, but not comparable to growth during 2016
- Significant increase (7.1%) of retail trade
- Manufacturing also slightly positive (2.2%)
- Recovery of construction sector (4.3%) reflects increasing investment

Conclusion

- Weaker overall growth due to lower growth rate in agriculture
- Retail trade benefits from robust consumption

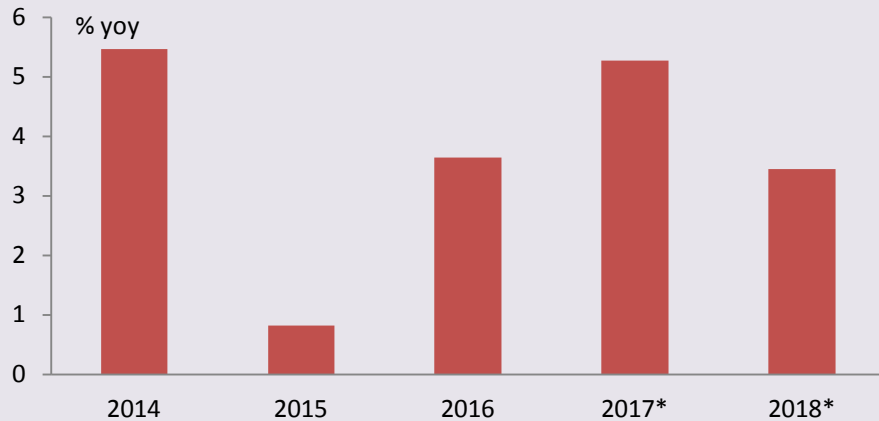
Inflation and wages

Inflation



Source: IMF, *Forecast Dec 2017; Note: Annual average (consumer prices)

Real wages



Source: IMF, *Forecast Dec 2017

Inflation

- 2017: Average inflation at 6.6%
- However, strong dynamics: Surprisingly strong increase to 7.9% in October vs 2.4% end 2016
- Reason: Increase of food prices and one-off adaption of health costs
- Core inflation remains stable

Real wages

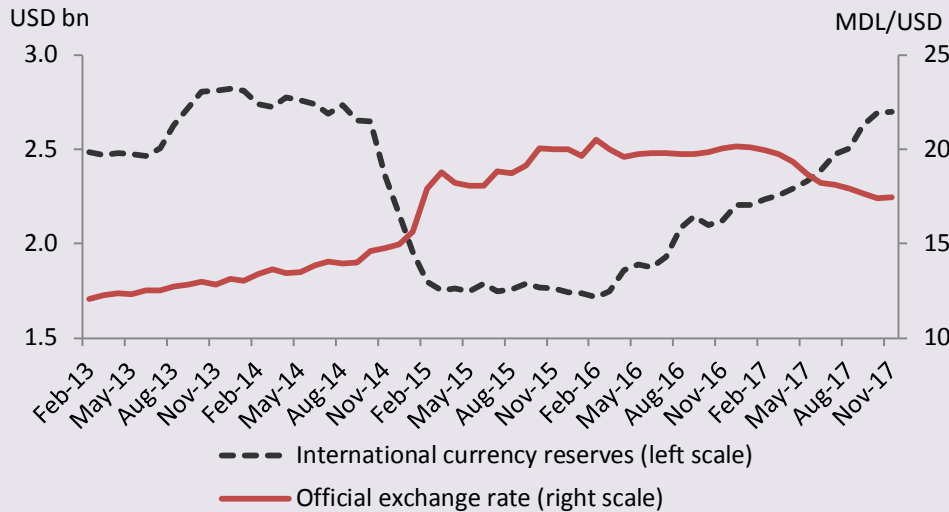
- Speeding up of real wage growth in 2017 (ca. 5.3%) supported consumption
- Continued moderate increase of real wages expected for 2018

Conclusion

- Relatively high inflation in 2017 caused especially by one-off effects
- Increasing real wages reflect good situation on the labour market

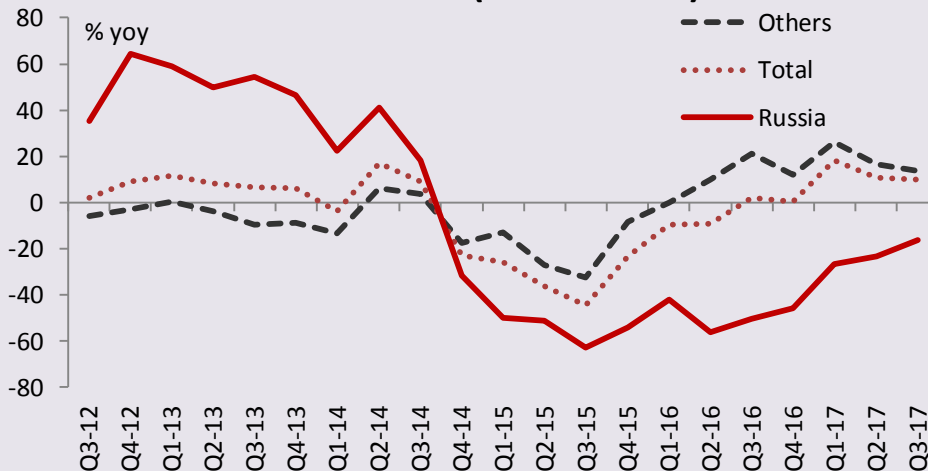
Exchange rate and remittances

Exchange rate and currency reserves



Source: National Bank of Moldova

Remittances (in US dollar)



Source: National Bank of Moldova

Exchange rate and currency reserves

- Exchange rate without major fluctuations in 2016
- Since beginning of 2017: Appreciation of ca. 15% vs US dollar
- Appreciation pressure positive for currency reserves, significant increase
- 5 months import coverage at the end of 2017

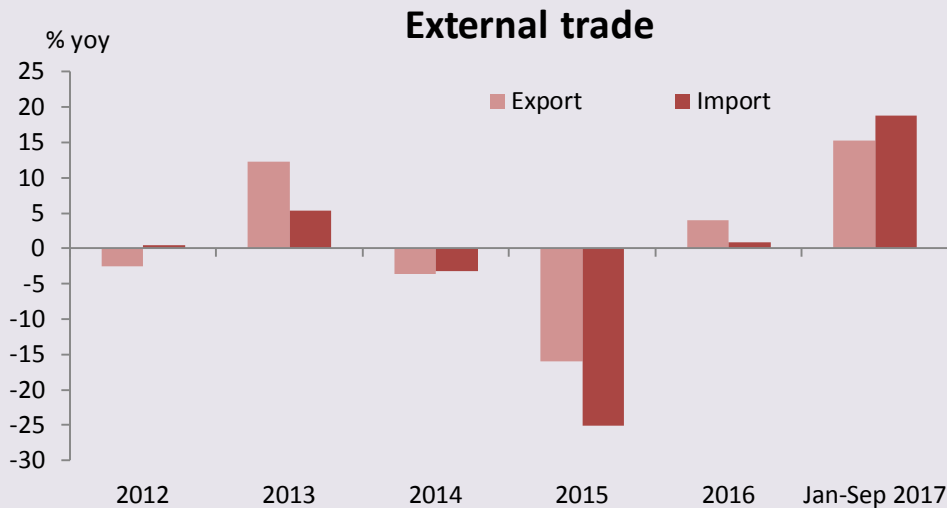
Remittances

- Return to strong growth since 2017
- Remittances from Russia continue to decrease

Conclusion

- Appreciation reflects stability and positive economic situation
- Increasing remittances support domestic demand

External trade



Source: National Bureau of Statistics; Note: Trade in goods

Import

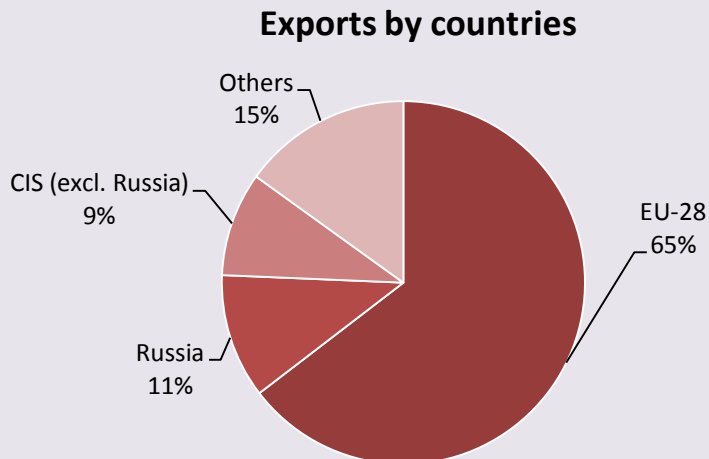
- Jan-Sep 2017: Increase in imports (19%)
- Reasons additional to increased demand:
 - Tax reform: New standards of goods valuation, less smuggling
 - Energy imports from Ukraine; previously energy purchases from Transnistria

Export

- Jan-Sep 2017: Strong increase of 15%
- More exports of vegetable products and cable harnesses
- Strong relation between investment from the EU and export of cable harnesses

Outlook

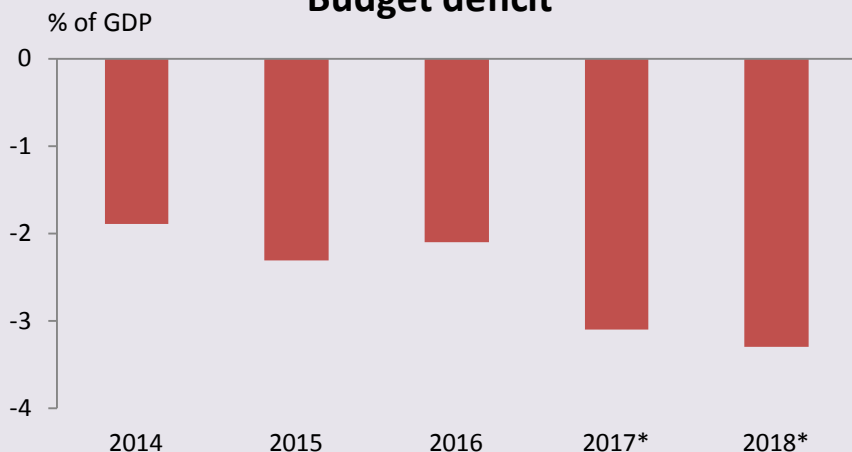
- Exports are to increase further in 2018, but with lower speed (8%)
- Also lower growth of imports expected (6%)



Source: National Bureau of Statistics, Jan-Sep 2017

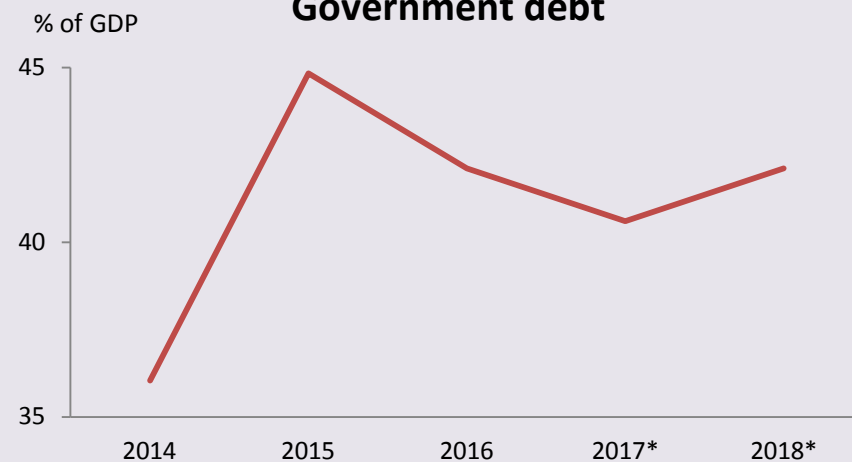
Public finances and government debt

Budget deficit



Source: IMF, *Forecast Dec 2017

Government debt



Source: IMF, *Forecast Dec 2017

Budget deficit

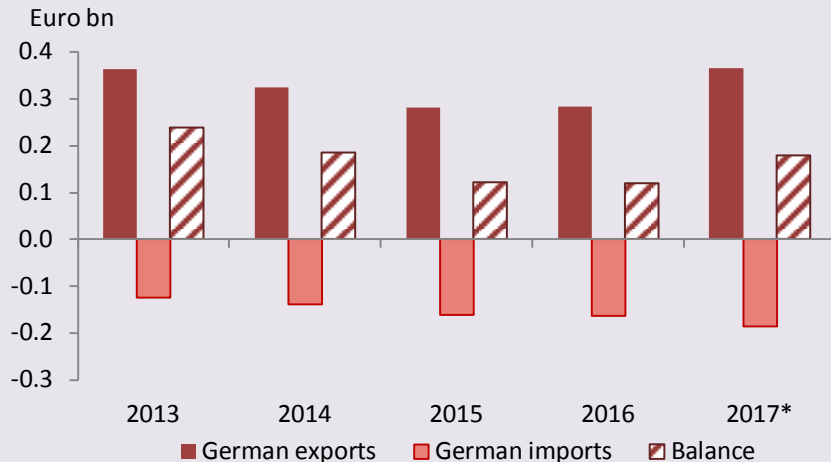
- 2017: At 3.1% lower than expected
- Reason: Higher revenues, partly due to reforms in tax administration and customs (see also slide 13)
- Also lower expenditures due to delay in road construction projects and reorganisation of the government

Outlook

- Deficit to amount to 3.3% of GDP in 2018, this is in accordance with the IMF programme
- These numbers include much needed infrastructure reforms, e.g. road construction, and higher social expenditures
- However, risk of higher expenditures, as parliamentary elections are to be held in November 2018

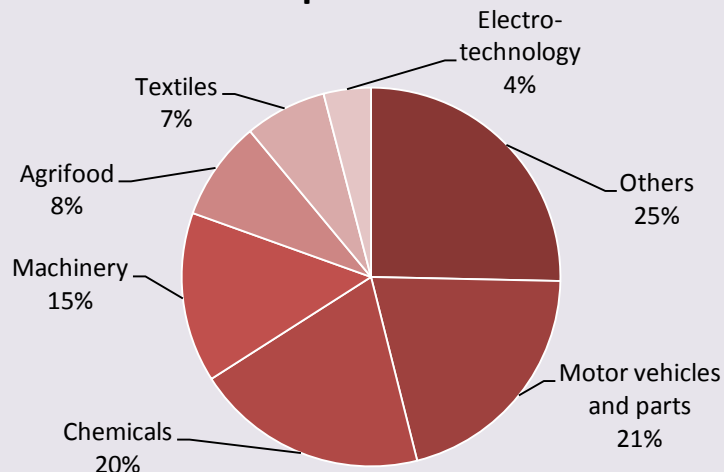
Bilateral trade between Germany and Moldova

German trade with Moldova



Source: German Federal Statistics Office, *Forecast based on data for Jan-Sep 2017

German exports to Moldova



Source: German Federal Statistics Office; Jan-Sep 2017

Bilateral trade volume

- 2017: EUR 551 m
- Significant increase (23%) vs 2016
- Strong dynamics after weak performance in the last years

German exports to Moldova

- Exports increased by 29% in 2017 vs 2016
- Investment goods profit from investments in Moldova

German imports from Moldova

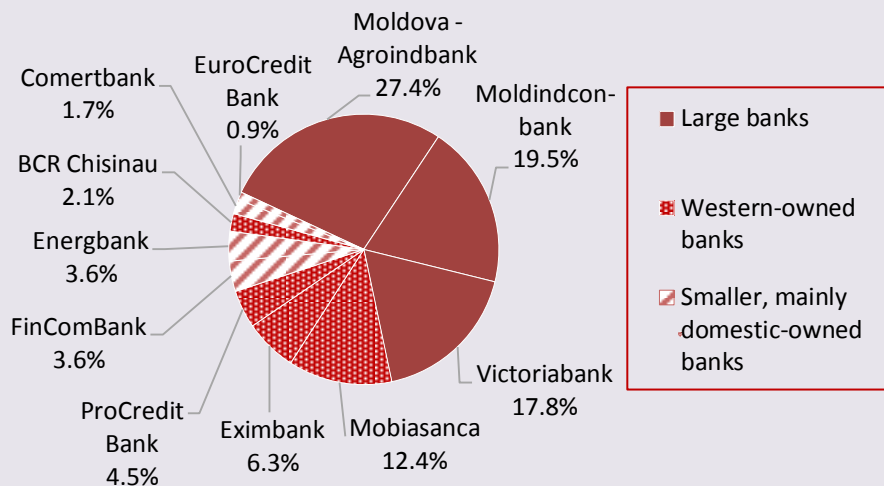
- 2017: Also strong increase (14%)

Conclusion

- After the standstill in 2016, significantly higher trade turnover in 2017, whereas especially exports of German investment goods increased

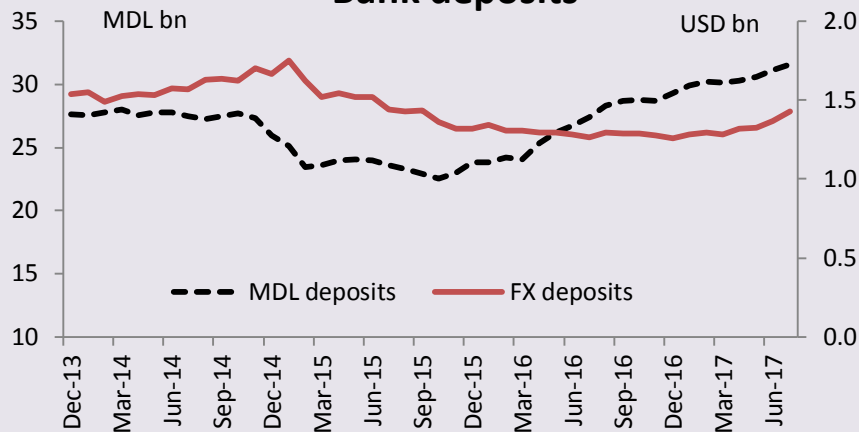
Developments in the Moldovan banking sector

Bank segments and market shares



Source: National Bank of Moldova, Data for July 2017

Bank deposits



Source: National Bank of Moldova

Changes in the sector after the fraud scandal

- Three of 14 banks liquidated
- Banking assets decreased from 84% of GDP in 2014 to 54% in 2016
- Concentration increased, three largest banks have now a share of 65% of total assets after 50% in 2013

Currently: Confidence returns

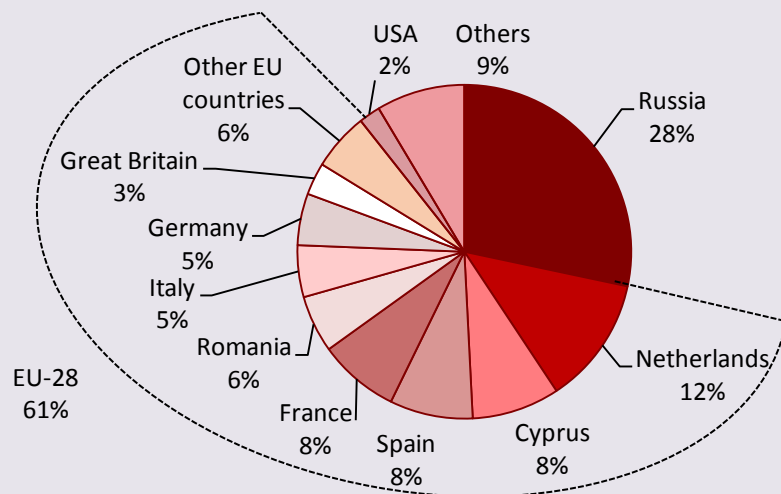
- „Flight“ to foreign currencies is over, dollarisation with 45% at the same level as prior to the fraud scandal
- Capital adequacy ratio higher than before the crisis after liquidation of three insolvent banks
- Increase in non-performing loans only due to stricter regulation
- Shares in problematic ownership blocked and partly sold

Conclusion

- Stabilisation achieved, but challenges remain, especially implementation of Basel III and crediting of the economy

Economic importance of FDI

FDI stock



Source: National Bank of Moldova, data for 2015

Importance of FDI companies for the economy

Share of companies with foreign capital in macroeconomic variables	
Number	7%
Employment	15%
Value added	23%
Corporate income tax	34%
Social security contributions	21%

Source: Own calculations

Background

- Due to the lack of data so far no systematic analysis of the economic importance of FDI
- Database developed by GET Moldova in cooperation with the National Bureau of Statistics

Results

- Companies with FDI account for 15% of employment and 23% of value added
- They are 71% more productive than domestic companies and pay higher wages
- FDI companies pay 34% of corporate income tax and 21% of social security contributions

Conclusion

- FDI play an important and so far underestimated role
- Efforts for FDI attraction should be intensified and conditions for existing FDI companies should be improved

Economic reforms

Comprehensive reforms have been launched in many fields and have partly already been implemented

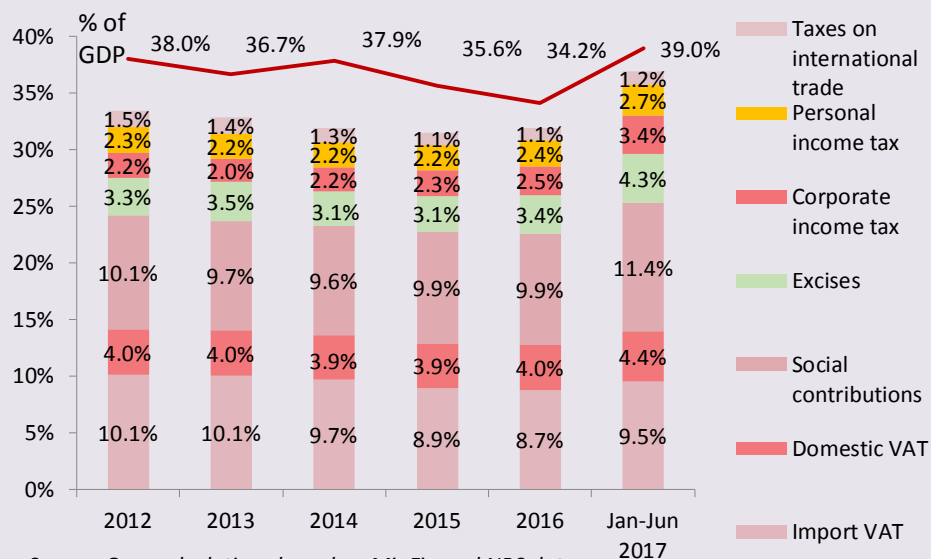
- Investment climate: Reduction of the bureaucratic burden and limitation of unannounced inspections, digitalisation of all inspections to improve transparency
- Public administration: Reduction of the number of ministries from 16 to 9, reduction of ministerial employees by almost one half, wage increase of 40-60% planned
- Pension: Increase of the pension age to 63 years, improved relation between contribution payments and pension amount, simplification of the system and elimination of privileges
- Public procurement: Introduction of electronic procurement, independent office for complaints, decentralisation, ex-post controls
- State administration and customs: Centralisation of tax administration, elimination of the independent juridical status of local tax offices, introduction of risk-based controls, reduction of the number of regional customs units, increase in wages

Our assessment

- Reforms are very comprehensive and the persons in charge seem to have a genuine interest in their successful implementation
- Positive development of tax revenues indicates first positive results
- Too early for a final assessment, long-term success remains to be seen

Increasing tax revenues – the role of reforms

Revenues as share of GDP



Source: Own calculations based on MinFin and NBS data

Reasons for revenue increase

Effective tax rate increase H1 2015 vs. H1 2017		Mainly due to			
		Progres- sion	Economic tax base growth	Reforms	
				Effective tax rate	Tax base growth
Personal income tax (PIT)	+0.3 pp	✓	✓		✓
Social security contributions	+0.2 pp		✓		✓
Corporate income tax (CIT)	+1.9 pp		✓	✓	✓
Domestic VAT	+0.8 pp		✓	✓	✓
Import VAT	+0.3 pp		✓		

Source: Own analysis

Background

- Increase in revenues in 2017 stronger than expected
- At the same time, tax administration and customs were subject to major reforms
- Question: Have the reforms contributed to increased revenues?

Our results

- Reform effect found for four out of five analysed tax types
- For import VAT reform effect cannot be excluded, but undetectable with our methodology

Conclusion

- Reforms have contributed to higher revenues
- Reforms have to be continued, e.g. still high bureaucratic burden for companies paying payroll taxes

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.

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