

## Overview

- Economic growth slows down to around 4% in 2018; for 2019 a growth of 3.8% is expected
  - Demand side: Positive contribution of consumption and investment
  - Supply side: Growth in manufacturing, retail trade and construction sector
- Inflation declines to 3.0% in 2018 due to external factors; prices are on average stable
- Strong Leu, but appreciation trend of 2017 came to an end in 2018
- Positive contribution from rising remittances stopped
- Double-digit growth in exports and imports in 2018; 69% of exports go to the EU
- Budget deficit expected to amount to 1.9% in 2018 and 2.8% of GDP in 2019; deficit remains manageable despite parliamentary elections on 24 February 2019

## Topics

- **Monetary policy normalisation in leading economies.** So far no impact on Moldova, due to low foreign debt and prudent policy in recent years; nevertheless need to be cautious
- **Perspectives of agricultural insurance.** Current system had only limited success, we recommend a simple alternative or a gradual reform
- **Household over-indebtedness.** Some microfinance institutions contribute to increasing household over-indebtedness through irresponsible lending
- **Effect of the DCFTA.** Strong exports growth to the EU, higher FDI from EU

# Basic indicators

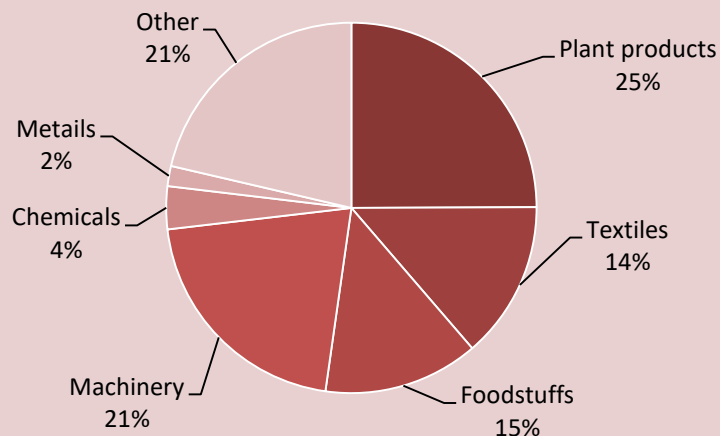
	Moldova	Georgia	Belarus	Ukraine	Russia
GDP, USD bn	11.4	16.7	56.9	126.4	1,576.5
GDP/capita, USD	3,227*	4,506	6,020	2,964	10,950
Population, m	3.5*	3.7	9.5	42.6	144.0

Source: IMF, estimation for 2018; \*According to the census of 2014 only slightly less than 3 m inhabitants; based on this census GDP per capita amounts to ca. USD 3.815 USD

## Trade structure

### Export

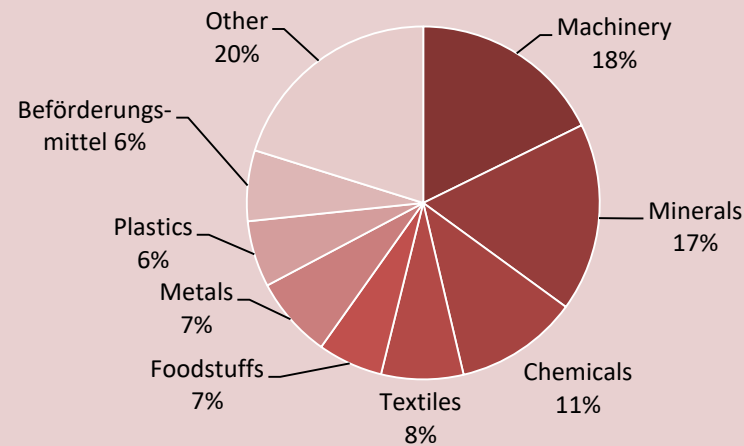
EU 69% | Russia 8% | Other 23%



Source: National Bureau for Statistics; 2018 Note: Trade in goods

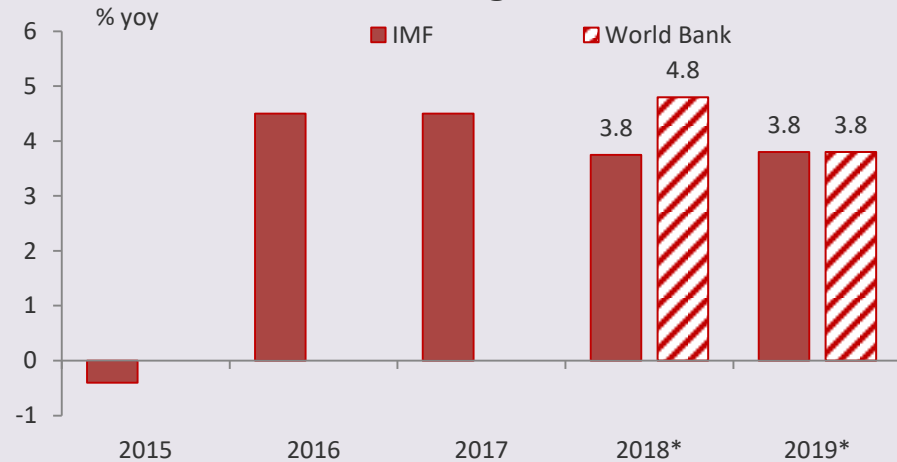
### Import

EU 50% | Russia 12% | Other 38%



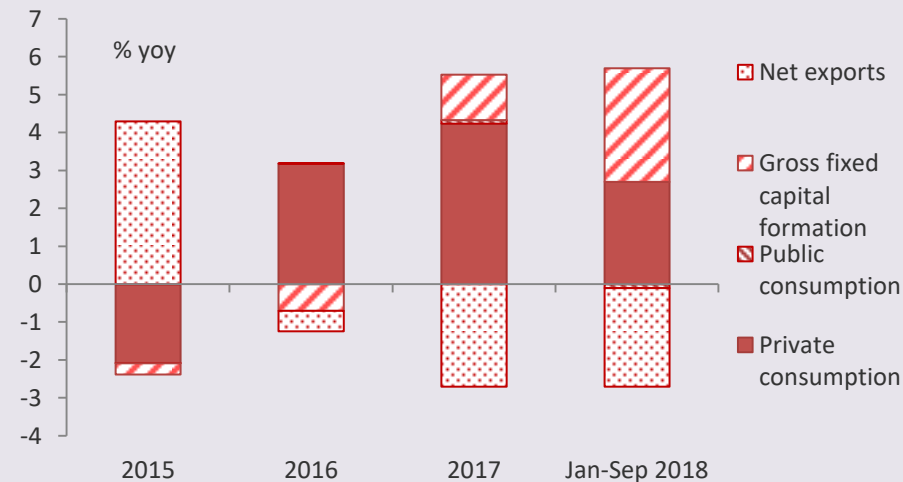
# Economic growth

## Real GDP growth



Source: National Bureau of Statistics; \*Estimate/Forecast

## Contribution to economic growth (real terms)



Source: National Bureau for Statistics

## GDP 2018

- Growth forecasts between 3.8 and 4.8%, we expect a slight growth slowdown to a good 4%
- In Jan-Sep of 2018 4.0% growth compared to Jan-Sep of 2017
- Growth driven by
  - Private consumption
  - Investments
- Contribution of net exports negative due to robust growth of imports based on strong Leu

## Outlook

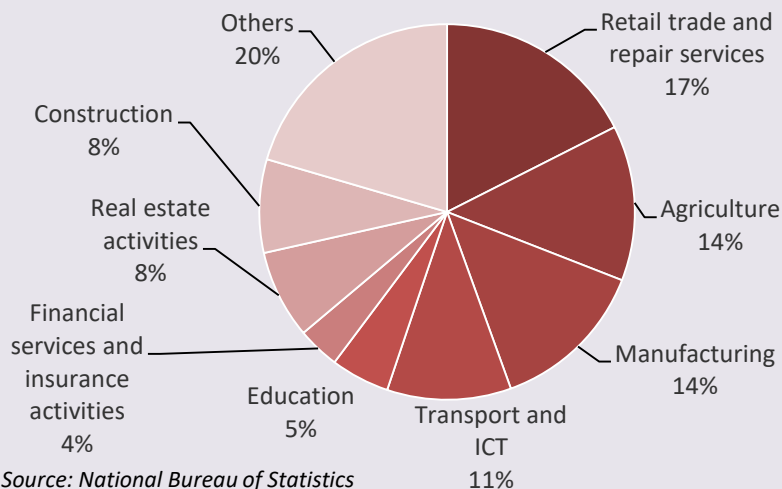
- Growth to remain at 3.8% despite favourable external conditions (growth in EU and CIS)
- Growth is hampered not only by population decline but also by weaknesses in the judiciary and the education system

## Conclusion

- Growth slows down
- Structural reforms necessary for higher growth

# Sectoral perspective

**Composition of GDP in 2017**



## Agriculture

- Minus 0.2% in Jan-Sep 2018 year-on-year; stagnation after two years of growth

## Manufacturing

- Growth of 5.3% in Jan-Sep 2018
- Increase also due to FDI inflows

## Retail trade

- Growth of 5.8% in Jan-Sep 2018
- Reflects robust development of private consumption

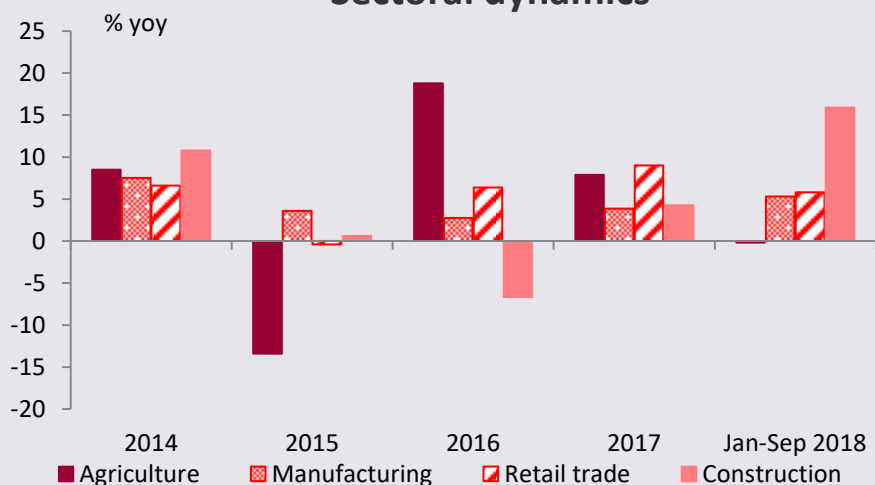
## Construction

- Strong growth of 15.9% linked to growth of investments

## Conclusion

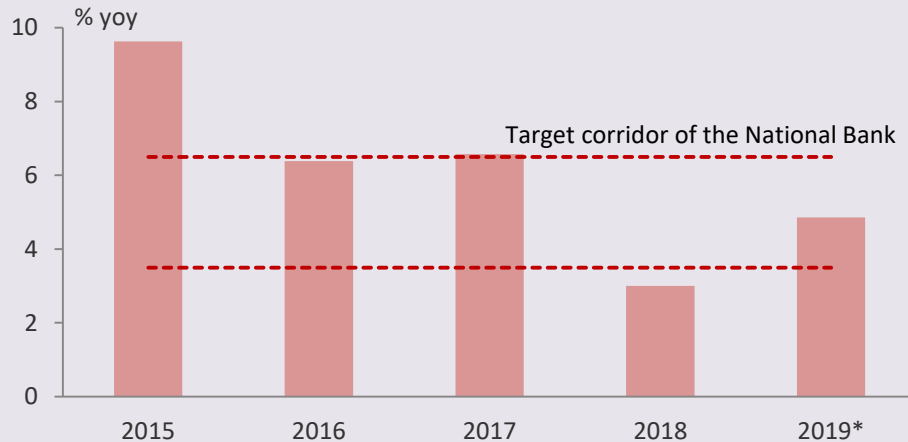
- Growth based on manufacturing, retail trade and construction

**Sectoral dynamics**



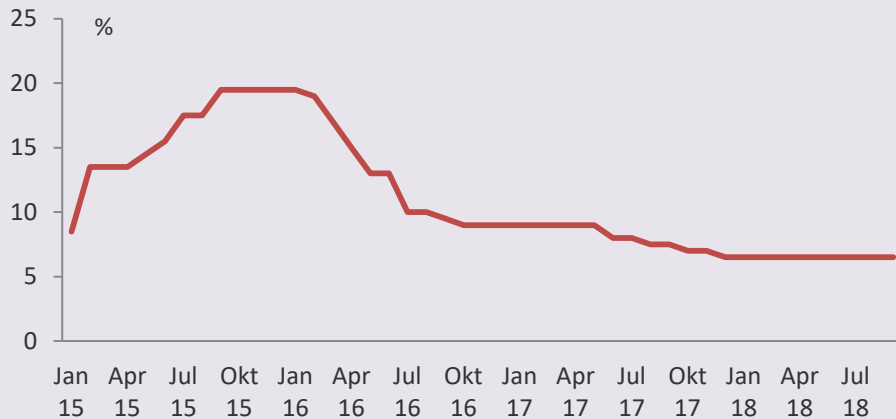
# Inflation und monetary policy

## Inflation



Source: National Bureau of Statistics; \* IMF forecast; Note: Annual average (consumer prices)

## Policy rate



Source: National Bank of Moldova

## Inflation

- 2018: Average inflation of 3.6%
- Nov. 2018: Inflation at 0.9%, thus very low
- Reasons: Only slowly rising food prices and reduction of regulated prices (e.g. electricity and gas)
- Inflation outside of National Bank's target corridor of  $5 \pm 1.5\%$

## Monetary policy

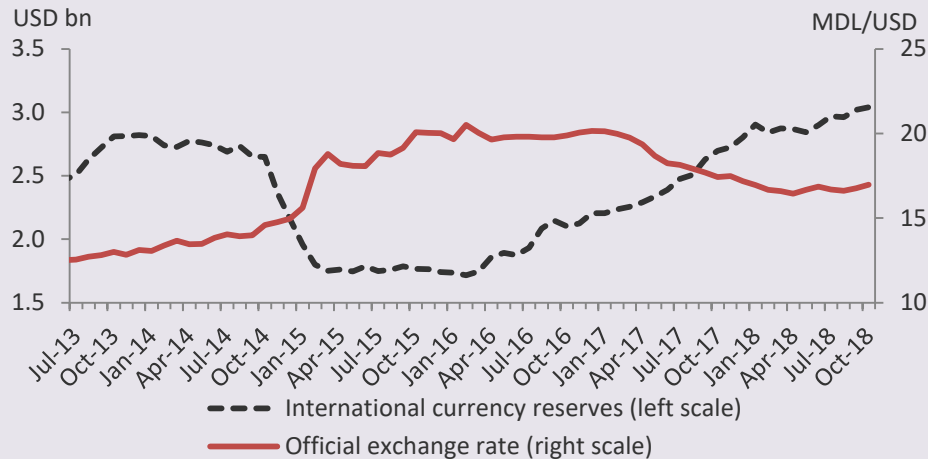
- Reasonable inflation allows key interest rate to remain unchanged at 6.5% since the end of 2017
- Low key interest rate advantageous for financial sector and real economy

## Conclusion

- Prices largely stable, very low inflation caused by external factors
- Stability also reflected in unchanged key interest rate with positive effects for the real economy

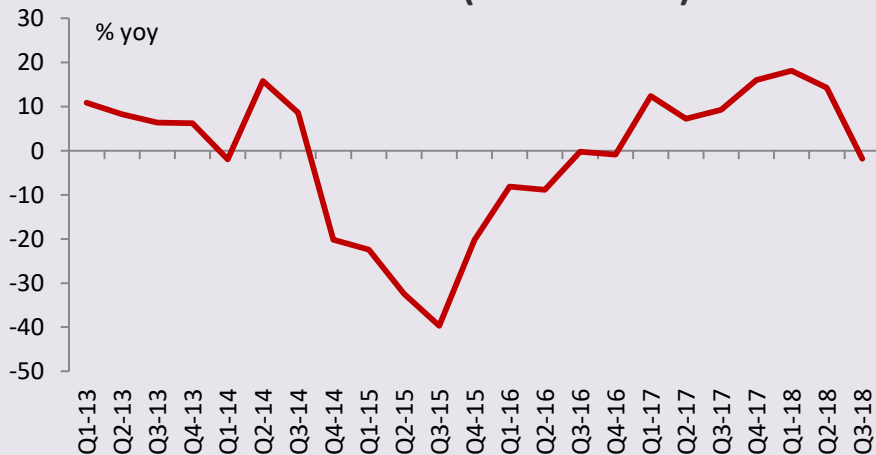
# Exchange rate and remittances

## Exchange rate and currency reserves



Source: National Bank of Moldova

## Remittances (in US dollar)



Source: National Bank of Moldova

## Exchange rate

- Exchange rate stabilised at 17 MDL/USD after ca. 20% appreciation in 2017
- Positive: Build-up of currency reserves continues
- Import coverage: Over 5 months

## Remittances

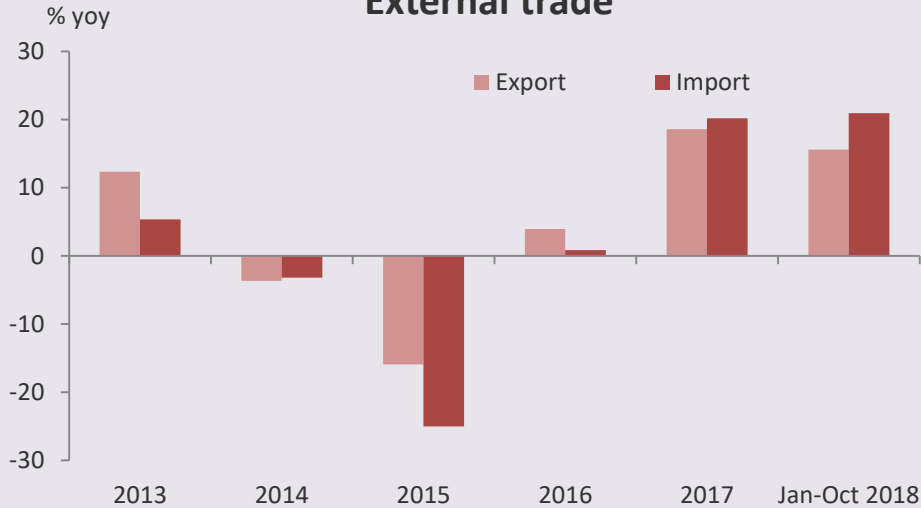
- Strong decline between 2014 and 2016
- Growth trend since 2017 stopped in Q3-2018
- High level of 2013 not reached yet
  - Jan-Sep 2013: USD 1.16 bn
  - Jan-Sep 2018: USD 0.95 bn

## Conclusion

- Exchange rate stable after appreciation in 2017
- Positive contribution from growing remittances stopped for now

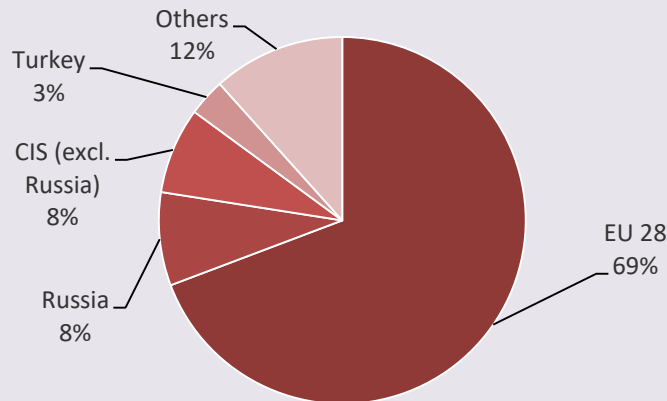
# External trade

## External trade



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

## Exports by regions



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

## Import

- In Jan-Oct 2018 growth of 21% or USD 817 m year-on-year
- The main reason is the strong Leu

## Export

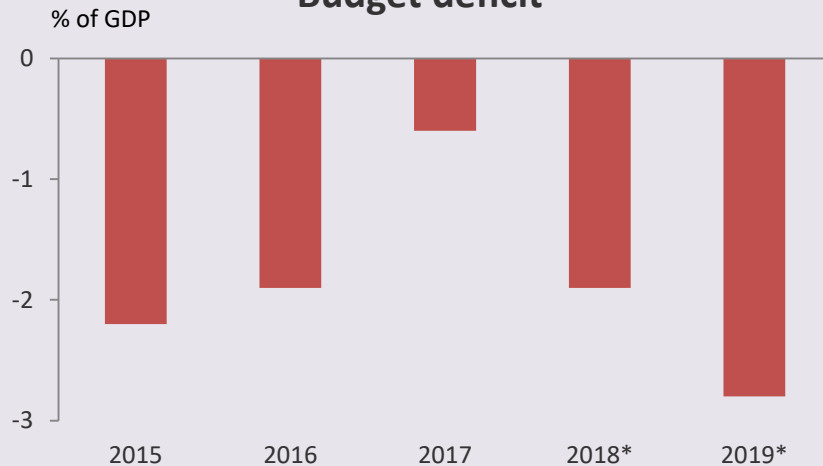
- Jan-Oct 2018 increase of 16% or USD 299 m year-on-year
- Main drivers
  - Machinery (especially cable harnesses) USD 144 m; 48% of total increase
  - Vegetable products USD 58 m; 19% of total increase

## Exports by regions

- EU: USD +287 m in Jan-Oct 2018; 96% of total increase
- CIS: USD -31 m, mainly due to less exports to Russia (USD -26 m)
- Importance of the EU as export market continues to grow; EU amounts now to 69% of goods exports

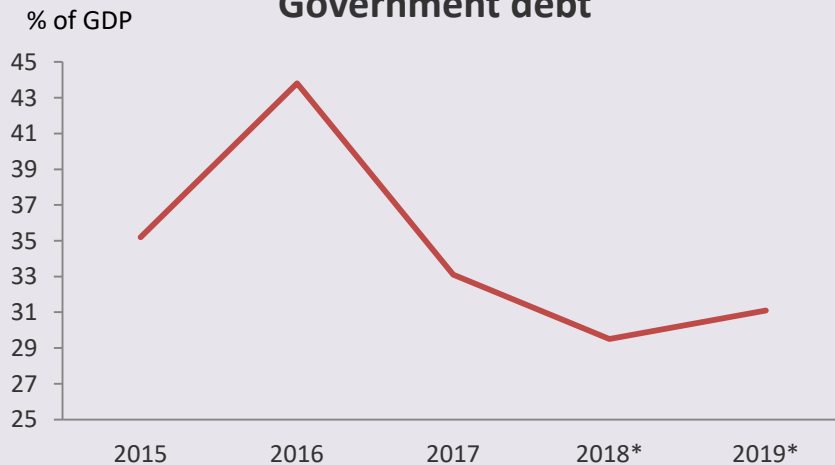
# Public finances and government debt

## Budget deficit



Source: World Bank, \*Forecast

## Government debt



Source: World Bank, \*Forecast

## Budget deficit

- 2018: Revenue development positive; Jan-Oct: +11% year-on-year
- Reasons: tax and customs reforms in 2016/17 and economic growth
- However: Controversial reform of income tax in 2018 leads to lower revenues starting from Oct 2018
- At the same time: significant increase in expenditures, especially subsidies and wages, but also investment
- Deficit to remain within target of IMF agreement, World Bank expects -1.9% of GDP in 2018

## Outlook

- Higher deficit of about 2.8% of GDP expected in 2019 (World Bank estimate)
- Deficit remains manageable despite easing of fiscal policy in the run-up to parliamentary elections on 24 February 2019



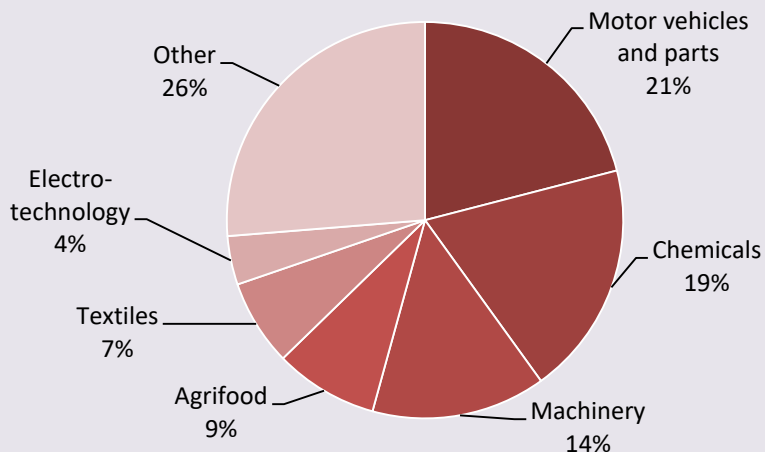
# Bilateral trade between Germany and Moldova

## German trade with Moldova



Source: German Federal Statistics Office, \*own estimation

## German exports to Moldova



Source: German Federal Statistics Office; 2017

## Bilateral trade volume

- 2018: record volume of EUR 646 m expected; increase of 14% compared to 2017

## German exports to Moldova

- Exports rose in Jan-Nov 2018 by 12%, thus slowing momentum within the year
- High share of capital goods in exports

## German imports from Moldova

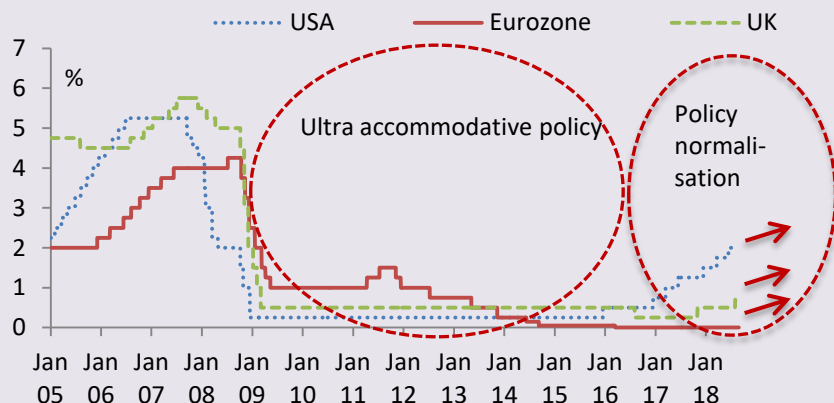
- Strong increase of 17% in Jan-Nov 2018 compared to same period in previous year
- Imports grow significantly faster than exports, but still high German trade surplus

## Conclusion

- Positive development continues: strong increase in trade volume in 2018
- Somewhat declining momentum in German exports to Moldova

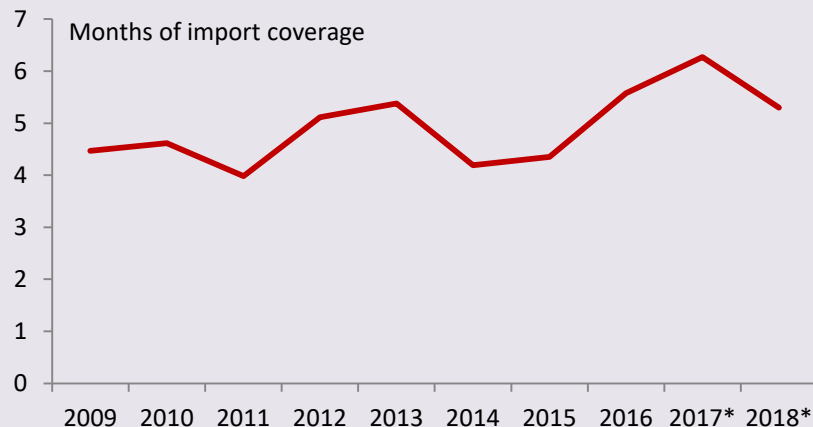
# Monetary policy normalisation and its impact on Moldova

## Key central bank interest rates



Source: HSH Nordbank

## Foreign exchange reserves



Source: World Bank, IMF; \*own calculation, own estimation

## Background

- In response to the 2007/08 financial crisis, leading central banks cut key interest rates to an unprecedented low level
- Ultra accommodative monetary policy has achieved its goals and now leads to risk of price bubbles
- Leading central banks have begun to normalise monetary policy
- Normalisation has a negative impact on emerging markets such as Argentina and Turkey

## Impact on Moldova

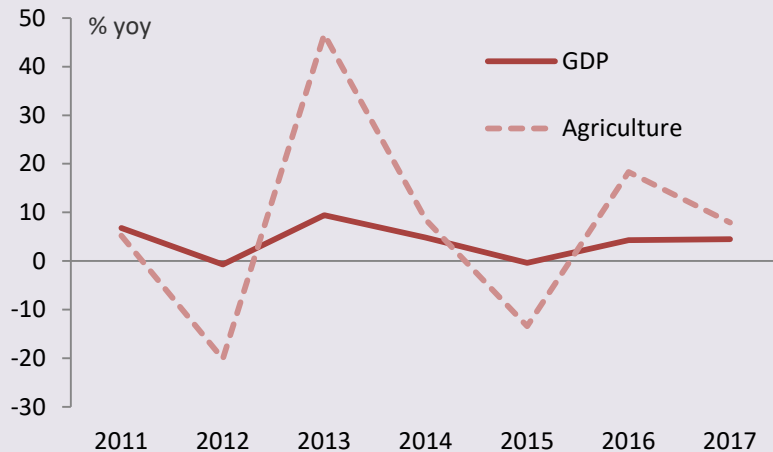
- No impact observed so far, for two main reasons
- Low short-term external debt; practically no "hot money" in the country
- Macroeconomic policy prudent over the last two years

## Recommendations by GET Moldova

- Despite lack of impact so far, a continued accumulation of foreign currency reserves and a prudent fiscal policy advisable

# Perspectives of an agricultural insurance in Moldova

## Growth of GDP and agriculture



Source: National Bureau of Statistics

## Background

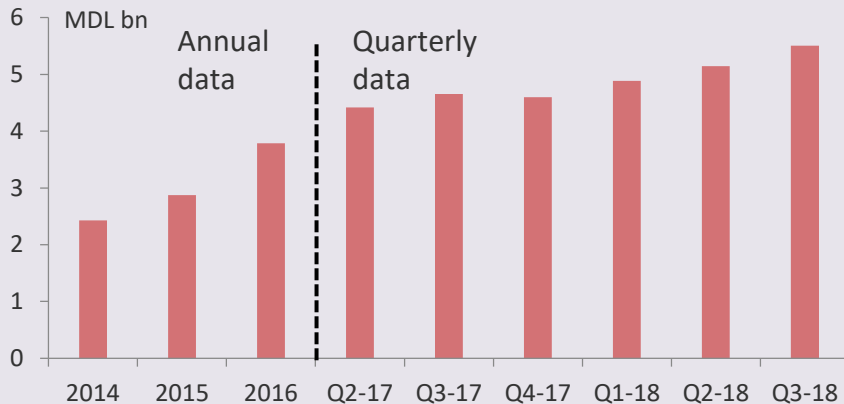
- Agriculture very important for Moldova:
  - In 2017 it represented 14% of GDP, 32% of employment and 31% of exports
- At the same time dependent on weather conditions
- Risk management needed to stabilise farmers' incomes
- An internationally widespread strategy: subsidised agricultural insurance (AI)
- In Moldova a subsidised AI since 2004 in place, but very low participation rate (2-3% of the agricultural area)

## Recommendations by GET Moldova

- Option 1: Abolition of agricultural insurance subsidies in favour of a simple direct payment system
- Option 2: Gradual reform of the existing system
  - Reform of the outdated regulatory framework
  - Training for farmers and administration
  - Investments in data systems and agricultural insurance design

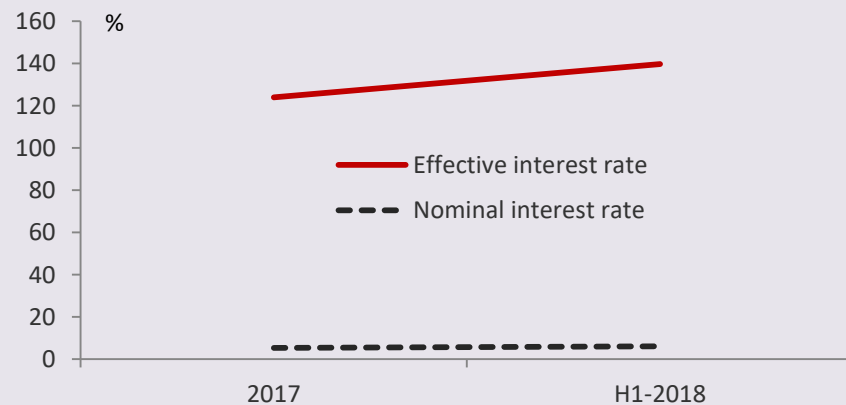
# Household over-indebtedness

## Loans by micro-financial institutions



Source: National Commission for Financial Markets; includes loans to businesses (ca.17%)

## Interest rates of a micro-financial institution



Source: National Commission for Financial Markets

## Background

- Household over-indebtedness intensively discussed topic in Moldova
- GET Moldova, together with the National Financial Markets Commission, collected data on over-indebtedness caused by micro-financial institutions

## Results

- There is no system-wide problem of over-indebtedness of customers of micro-financial institutions
- However, some institutions seem to have a business model based on irresponsible lending
- Features of irresponsible lending: very high interest rates and little checking of creditworthiness
- Result: high rate of non-performing loans, which correlates heavily with over-indebtedness
- Problem: these institutions are growing very fast

## Recommendation

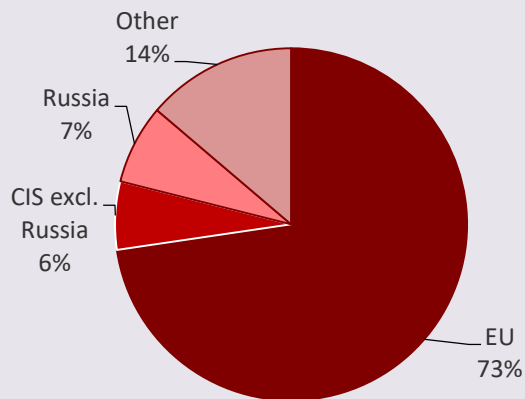
- Business model of relevant institutions should be analysed more closely, if necessary regulation should be toughened

# Effect of the DCFTA



Source: UNComtrade, National Bureau of Statistics, \*own estimation

## Exports by regions (without classical re-exports)



Source: UNComtrade, National Bureau of Statistics, own estimation

## Background

- Sep 2014: Provisional application of the DCFTA
- Jul 2016: Complete entry into force
- Analysis of effects of 4 years DCFTA on exports and investments

## Results

- Exports developed positively
  - Since 2013 increase by 62% to USD 1.85 bn in 2018 (excl. re-exports)
  - Importance of EU market increased from 52% to 73%
  - Increase of exports of plant products and industrial products (cable harnesses)
- Strongly growing FDI from EU in 2017 and 2018
- Employment growth in automotive and expert reports point to strong investment activity from EU
- Positive effect of DCFTA on both export and FDI

# 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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