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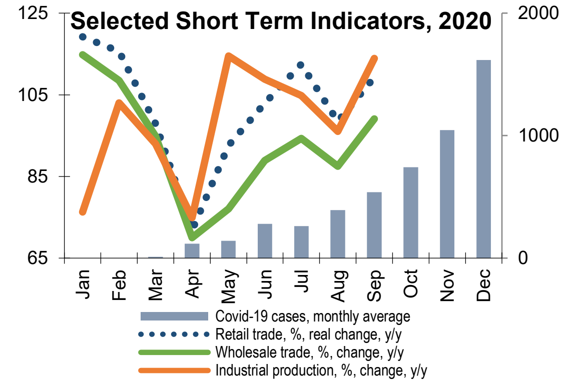
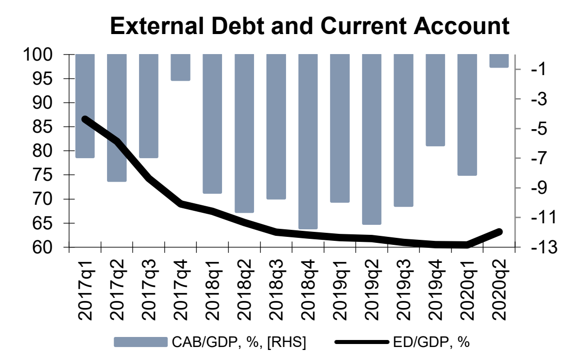
MOLDOVA
Economic Update
Winter 2020

- ***COVID-19 and the recent drought have drastically worsened the outlook for Moldova with a significant economic contraction expected in 2020, and a slow recovery in 2021.***
- ***The uncertainty surrounding the duration of the pandemic and its economic and social ramifications could further constrain firms, workers and households, hampering the recovery.***
- ***Poverty is expected to increase as households face the impact of the crisis, including loss of employment and earnings, a reduction in remittances receipts, and the return of vulnerable migrants from abroad who might struggle to find employment.***

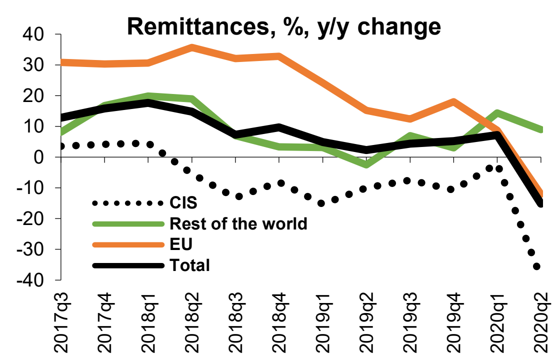


Recent Economic Developments

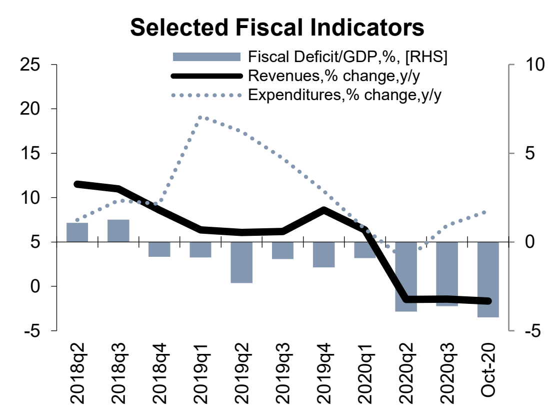
The pandemic has hit an already decelerating economy. Following a subdued growth in the second half last year, and exacerbated by the pandemic, the economic activity plummeted in the first three quarters of 2020, driven primarily by a reduction in households' consumption and stocks. On the supply side, the lockdown measures have halted trade and industrial production while a severe drought has impacted agriculture. Employment dropped to a five-year low. Since the end of the lockdown, the economy has gradually started recovering, but most of the short-term indicators remain in negative territory.



The monetary stance has reached a record low. On the back of falling oil prices and domestic demand, inflation has decelerated markedly in 2020, breaching the lower band of the corridor in August. In response, the National Bank cut the prime rate 5 times to a new record low of 2.65 percent. The reserve requirement ratio in Leu was reduced to 32 percent from a record high of 42.5 percent in 2019.



A large import compression has led to an improvement in the current account deficit (CAD). In the first half of 2020, lower energy prices and weak domestic demand have resulted in a contraction in imports by 16.4 percent, which has more than compensated the decline in export (-7.4 percent) and in remittances (-4.6 percent). As a result, the CAD has narrowed to 4.4 percent of GDP is almost 2.5 times smaller than during the same period in 2019. The deficit was mainly financed by debt instruments, predominantly public. By September, external debt reached around 65 percent of GDP, 3 percentage points higher than in 2019. At the same time, foreign reserves are at a comfortable 15-year high at US$3.5 billion.



The fiscal stance has deteriorated as the economy plunged into recession. By end-October, revenues decreased by 1.7 percent, with corporate income tax and VAT on imports being the main drivers. Public spending increased as the authorities introduced COVID-19 mitigation measures. With the priority given to social spending, public investment contracted by more than 4 percent. As a result, the fiscal deficit will reach 4.5 percent of GDP, pushing the public and publicly guaranteed debt up by 4 percentage points to 31.4 percent of GDP.

Medium Term Outlook

COVID-19 and the recent drought have drastically worsened the outlook for Moldova with an economic contraction expected in 2020 of a magnitude not seen since the great global recession in 2009. GDP is estimated to decline by 7.2 percent in 2020. Employment, earnings losses and declining remittances due to the lockdown in Moldova and its main economic partner are expected to hit households hard. Poverty is expected to increase one percentage point this year to about 13 percent. Most of the investment activity has been postponed or canceled due to uncertainty. Depressed global demand, combined with the recent drought, are expected to contain exports. On the other hand, imports are also expected to shrink due to anemic consumption throughout the year, resulting in positive contribution from net exports. On the production side, the combination of the pandemic and the severe drought is expected to affect most sectors of the economy.

Uncertainties around the evolution of the pandemic are expected to keep the economy below potential. Economic growth is expected to reach 3.8 percent in 2021, assuming more favorable conditions thanks to the development of vaccines. Consumer and investment confidence are expected to rebound on the back of the resumption of remittances, increase in social transfers, and accommodative monetary stance. Most sectors are also expected to rebound, though the 2019 levels are estimated to be reached only in 2022. The agricultural sector is estimated to strongly rebound after a bad yield this year. While the current account deficit is expected to narrow in 2020, it will gradually widen as the economy accelerates. Similarly, average inflation is expected to be below the target of 5 percent in 2020-2021, but to pick up as the recovery strengthens.

Fiscal deficits are expected to remain higher than historical levels in 2020-2021. The fiscal measures introduced to mitigate the impact of the pandemic are expected to push the fiscal deficit to 4.5 percent of GDP in 2020, higher than historical averages, but less than half of what was planned in the state budget law. Going forward, the fiscal stance is expected to be challenging due to a decline in revenues as businesses struggle and households suffer from weak job creation and wage growth. As a result, public debt is expected to increase rapidly, but still remaining low by international standards.

The outlook for Moldova is subject to significant downside risks. The fragile recovery relies not only on favorable conditions linked to a successful rollout of the vaccine, but also on the ability of the authorities to advance long-term structural reforms as they implement measures to support the medium-term recovery. With financing needs on the rise, driven by an increasing burden of wages and social transfers, it is key to ensure fiscal efficiency and access to external financing. The unfinished justice and governance reform agenda, together with a large footprint of the state in the economy, represent important structural impediments. Reforms in the non-banking financial sector, market and price regulations, anti-corruption and rule of law, and bolstering productivity are paramount for private sector resilience, sustainable economic recovery and shift to a new growth paradigm. The ***Special Note*** to this Economic Update discusses the impact on jobs, firms and households.

Table 1: Key Macroeconomic Indicators

	2014	2015	2016	2017	2018	2019	2020F	2021F	2022F
Nominal GDP, *MDL billion*	133.5	145.8	160.8	178.9	192.5	210.4	207.4	226.7	246.7
GDP, *% real change*	5.0	-0.3	4.4	4.7	4.3	3.6	-7.2	3.8	3.7
Consumption, *% real change*	4.4	-2.3	2.6	4.7	3.2	2.6	-6.8	2.4	2.7
Gross fixed Investment, *% real change*	10.0	-2.3	-2.8	5.2	14.5	12.9	0.2	7.6	8.5
Exports, *% real change*	0.9	2.6	9.8	10.9	7.2	7.3	-14.5	6.6	7.1
Imports, *% real change*	3.1	-5.8	2.8	11.0	9.7	6.7	-9.1	5.1	6.3
GDP deflator, *% change*	6.4	9.6	5.7	6.3	3.2	5.5	4.0	4.6	4.9
CPI, *% change, average*	5.1	9.7	6.4	6.6	3.0	4.7	3.6	4.2	5.0
Current account balance, *% GDP*	-6.0	-6.0	-3.5	-5.8	-10.6	-9.7	-6.0	-6.5	-7.1
Remittances, *% change, USD*	0.4	-24.5	-5.0	13.2	11.9	3.1	-4.8	5.4	4.1
Terms of Trade, *% change*	-2.1	5.1	3.0	0.5	-4.1	-0.5	0.2	0.1	-0.1
External Debt, *% GDP*	67.9	78.3	76.7	72.1	65.2	62.4	68.5	66.8	65.8
Budget revenues, *% GDP*	31.8	30.0	29.0	30.2	30.1	29.9	29.0	29.1	29.5
Budget expenditures, % GDP	33.3	31.8	30.5	30.8	31.0	31.4	33.5	31.5	31.4
Fiscal balance, % GDP	-1.5	-1.9	-1.6	-0.6	-0.8	-1.4	-4.5	-2.4	-2.0
Public and Guaranteed Debt, *% GDP*	27.2	29.6	36.9	32.7	30.1	27.4	33.2	35.1	36.2

Source: Moldovan authorities, World Bank projections

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