MOLDOVA

Table 1	2018
Population, million	3.5
GDP, current US$ billion	11.4
GDP per capita, current US$	3226
Lower middle-income poverty rate ($3.2)[a]	1.1
Upper middle-income poverty rate ($5.5)[a]	16.3
Gini index[a]	25.9
School enrollment, primary (% gross)[b]	91.8
Life expectancy at birth, years[b]	71.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

Real GDP growth is expected to increase by 3.8 percent in 2018 compared to the 4.6 percent average growth in the last decade. The pace of growth will remain subdued in the coming years in the face of weaker foreign and domestic demand. Adverse demographic trends, low productivity and vulnerability to external shocks constitute the main challenges to long-term growth. US$5.5/day poverty, roughly constant at 16.3 percent during 2015-2017, is projected to decrease slowly over the forecast period.

Recent developments

Against the background of strengthening fundamentals and financial situation, in 2018, growth remained solid. Real GDP increased by 4.0 percent during the first three quarters in 2018, compared to 4.5 percent in 2016 and 4.7 percent in 2017. Tax cuts, strong wage increases, and remittances supported real growth of disposable income, resulting in a 2.7 percentage points contribution of private consumption to growth. On the back of lower inflation, favorable interest rates underpinned investment growth, resulting in a 4-percentage points contribution from capital formation. With strong domestic demand and stronger Leu, imports expanded quicker (+8.9 percent), resulting in a negative contribution to growth (-2.6 percentage points) from net exports. On the production side, favorable financial conditions and government programs in the sector, expanded the construction sector adding 1.2 percentage points to growth. The growth in disposable income supported the wholesale and retail trade, which combined with industry added another 2 percentage points to growth. After two years of good yields, the agricultural sector subtracted 0.3 percentage points.

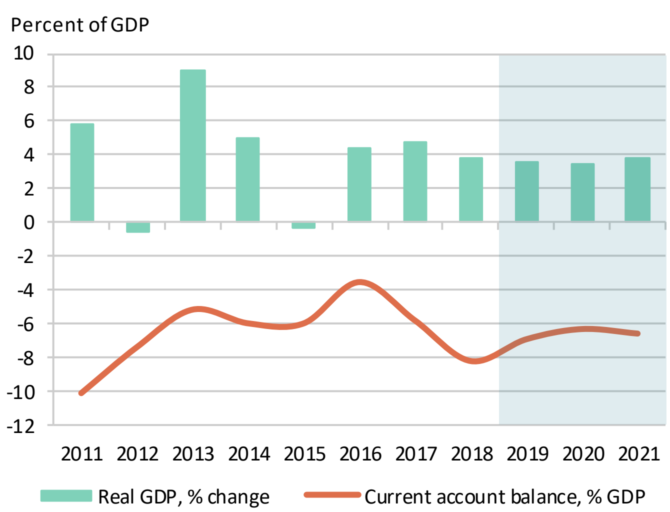
Consumer inflation has been below the lower target of the corridor of 5 percent (+/- 1.5 percent) since April 2018. A high base effect, lower administrative prices, relatively weaker demand, agricultural supply and lower imported inflation contributed to the observed decline. In addition, excess liquidity resulting from low financial intermediation persists in the system. As a response, authorities maintained the reserve requirement to a record high of 40 percent, while keeping the base rate at 6.5 percent since end-2017. The Leu strengthened against USD during 2018, supported by remittances and export growth.

Due to robust imports, in the first three quarters the current account deficit increased to 10.3 percent of GDP, from 8.3 percent in 2017. With FDI inflows accounting for only 2.1 percent of GDP, external debt remained the main source of current account deficit financing. Against this background, by end-February 2019 foreign reserves amounted to 2.9 billion, after reaching a record high of 3.05 billion USD in November 2018, still covering more than 5 months of imports.

Despite recovery in growth, labor markets improved slowly, with key indicators largely stable during 2016-2017, and improving throughout 2018, with falling unemployment rate, and increasing activity and employment rates. Real wages increased by almost 10 percent y/y in Q4 of 2018, benefiting from lower inflation that protected purchasing power. Consistent with these developments, the PPP US$5.5/day poverty rate remained roughly constant during 2015-2017, as the effects of the recession lingered, although a downward poverty trend is projected to have resumed in 2018. Overall inequality continues to decline, but spatial disparities remain and poverty is overwhelmingly rural (80 percent of total poor population).

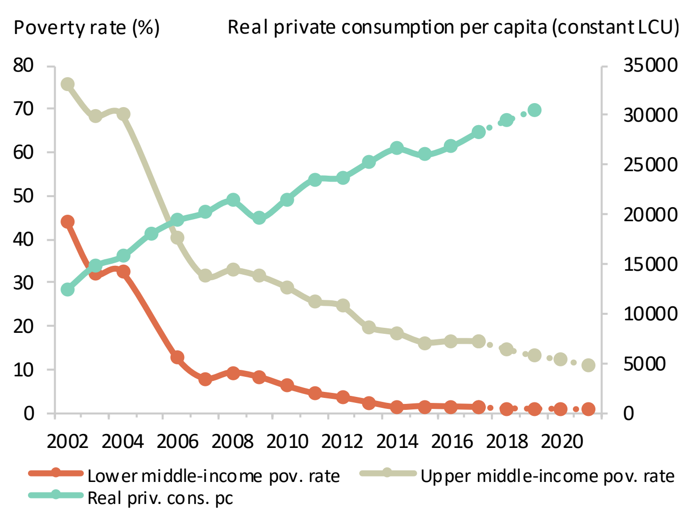
Despite of Parliamentary elections, fiscal position remained solid. Since mid-2017, public revenue growth has been strong as growth expanded. On back of buoyant trade and economic activity, total revenues increased by 8.6 percent, while expenditures

FIGURE 1 Moldova / Actual and projected real GDP growth and current account balance



Source: World Bank.

FIGURE 2 Moldova / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

increased by 9.3 percent. The fiscal deficit totaled 0.8 percent of GDP, considerably lower than the planned levels (-2.5 percent of GDP). As some capital expenditure were shifted closer to the 2019 parliament elections, the execution of the capital spending was 27 percent lower than the planned levels. Mainly due to stronger revenues, the public and publicly guaranteed debt decreased to 27 percent from 29.2 percent of GDP in 2017.

Outlook

Against the background of lower remittances, the projected weaker foreign and domestic demand, will decelerate economic growth below historical values. Initially, the expansionary fiscal policy measures adopted in 2018—tax cuts, increase in wages and public transfers—and lower interest rates will underpin growth. As fiscal stimuli fade away after elections, consumer and business confidence, together with the normalization of financial conditions, will continue to support private consumption and investment, resulting in an average growth of around 3.7 percent in the medium term. On the supply side, industry and non-tradable sectors will be the most dynamic, while contribution from agriculture is expected to be marginal provided favorable climatic conditions. Albeit relatively robust exports mainly due to expansion of activities in free economic zones, given slower projected economic activity, the current account balance is projected to decrease till 2020. With the reignition of economic activity it will increase thereafter, however still remaining below historical values. The expansionary fiscal policy introduced before the elections combined with more dynamic agricultural and regulated prices, will build up inflationary pressures pushing the inflation out of the corridor in the second half of 2019. Nonetheless, in medium term, the monetary stance is projected to remain adequate and consumer inflation is envisaged to variate in the target corridor.

Poverty is projected to decline, on account of improving economic and labor market conditions, but at a slower pace than in the past, on account of slower projected private consumption growth. Compared to the most recent survey estimate of 16.3 percent in 2017, the US$ 5.5/day poverty is projected to decline to 11 percent by 2021.

Risks and challenges

Moldova remains highly vulnerable to external shocks. Additionally, political uncertainty and vested interests undermine the reform agenda and the investment process. Extreme weather may affect agricultural output, impacting overall growth and poverty. The large share of the state in the economy, coupled with weak institutions and governance challenges, including in the financial sector, may pose additional risks. In the medium term, the fiscal position may deteriorate due to inefficient public spending, declining economic activity and increasing burden from the wage and social transfers bills. Deficit financing also constitutes a risk as it heavily relies on external financial sources, which may not materialize in the post-election period. With higher projected inflation, the government may find it costlier to finance the planned spending on the local market, with the risk of crowding-out the credit activity. Long-term challenges to economic growth include population ageing, large net migration, and the unsustainable growth model, characterized by remittances-driven consumption and low levels of productivity. Despite past poverty reduction, there is little visible convergence in recent years between bottom 40 and top 60 groups on some key dimensions such as educational attainment, or access to key services.

TABLE 2 Moldova / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.4	4.7	3.8	3.6	3.5	3.8
Private Consumption	2.9	5.3	3.6	3.2	3.1	3.7
Government Consumption	0.8	1.5	0.1	0.9	-0.1	0.3
Gross Fixed Capital Investment	-0.9	8.0	10.7	9.8	6.8	8.1
Exports, Goods and Services	9.8	10.9	7.5	5.5	6.3	7.5
Imports, Goods and Services	2.8	11.0	8.3	5.8	5.2	6.7
Real GDP growth, at constant factor prices	4.5	4.2	4.1	3.6	3.5	4.0
Agriculture	18.1	8.9	0.2	1.2	1.4	2.4
Industry	0.4	3.9	5.1	4.5	4.1	5.3
Services	3.7	3.4	4.5	3.8	3.6	3.8
Inflation (Consumer Price Index)	6.4	6.6	3.8	4.7	4.5	5.0
Current Account Balance (% of GDP)	-3.5	-5.8	-8.2	-6.9	-6.3	-6.6
Net Foreign Direct Investment (% of GDP)	1.0	1.5	1.8	1.7	1.6	1.4
Fiscal Balance (% of GDP)	-1.6	-0.6	-0.8	-2.7	-2.2	-2.0
Debt (% of GDP)	36.9	32.7	30.0	30.3	31.0	29.9
Primary Balance (% of GDP)	-0.4	0.5	0.0	-1.7	-1.2	-1.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.3	1.1	0.9	0.7	0.7	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	16.4	16.3	14.7	13.2	12.3	11.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on private consumption per capita in constant LCU.