THE WORLD BANK
IBRD • IDA

MOLDOVA
Economic Update
Spring 2020

After a robust 3.6 percent growth in 2019, the economy is expected to contract in 2020 amid the unprecedented negative shocks due to the coronavirus pandemic. The fiscal deficit and public debt will widen as government steps in to protect lives, firms and households. While mitigating the crisis impact takes priority, focus on structural policies is needed to accelerate recovery.

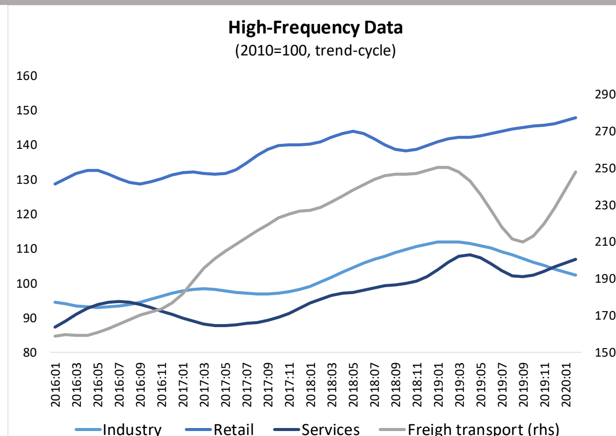
Recent Economic Developments

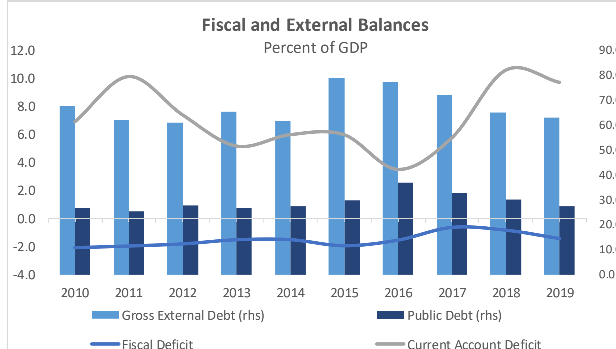
Even before the COVID-19 shock, the economy slowed down sharply in the last quarter of 2019. 2019 growth, at 3.6 percent, was underpinned by strong domestic demand led by wage increases, remittances, credit expansion and rising public spending. Yet growth declined sharply to 0.2 percent in the last quarter as agriculture and electricity production plunged, with a slowdown in exports and investments. Preliminary data indicate a rebound by February 2020, with industry (+6.3 percent yoy), freight transportation (+9.7 percent), retail trade (+16 percent), and exports of goods (+2.3 percent) leading growth. Nevertheless, a significant contraction from March onwards is expected as COVID-19 containment measures and the state of emergency were introduced.

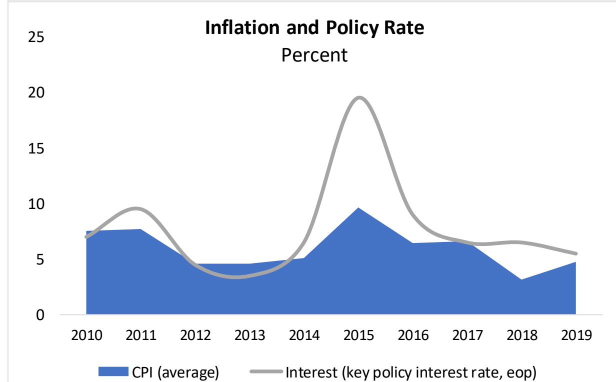
Monetary policy relaxed prior to the crisis outbreak and continues its dovish stance. In anticipation of disinflationary pressures, the policy rate was cut to 5.5 percent in December. On the back of weaker domestic demand and downward spillover from international commodity prices, the inflation rate declined to 5.9 percent in March 2020. To ensure adequate liquidity, the central bank lowered the reserve requirement rate by over 6 pp down to 34 percent and cut the policy rate further to a historic low of 3.25 percent. The crisis will weigh on financial markets. While the banking system is well capitalized, new loans have decreased by 8.3 percent since the peak in December 2019. The inflow of new deposits has decreased by one-third, but the overall deposit stock is still 2.5 percent above the end-2019 level suggesting a sustained confidence in the banking sector.

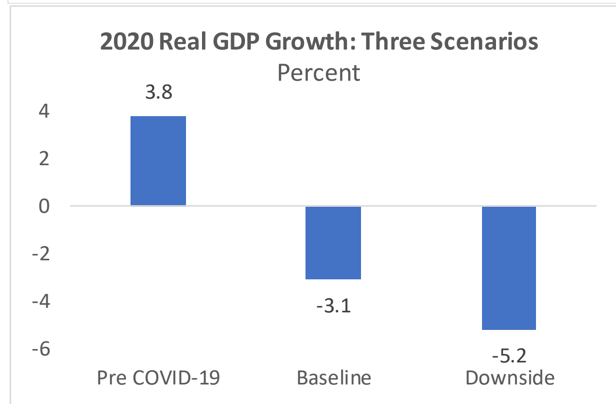
The current account deficit declined prior to the crisis but is again set to widen. It tightened by one pp to 9.7 percent of GDP in 2019 as exports growth exceeded those of imports in the second half of 2019. A sharp drop in exports and remittances, however, will widen the deficit back to above 10 percent of GDP in 2020. Net FDIs, one of the global crisis transmission channels, are set to remain low in 2020 as a result of the COVID-19 crisis. Due to a sharp decrease in foreign inflows from March 2020, end-April reserves depleted by 6 percent (USD2.9 billion) but are still covering more than 5 months of imports.

Although the fiscal deficit remained contained in 2019, it will expand rapidly in the wake of the pandemic. In the first quarter of 2020, collections by the fiscal service decreased by 3.6 percent y-o-y. In April, authorities adopted a set of supportive measures to counteract the pandemic with an estimated cost of 2.4 percent of GDP. Latest amendments to the budget project a deficit of 7.6 percent of GDP (compared to 1.4 in 2019) with a large surge in foreign financing. Public and publicly guaranteed debt is envisaged to increase by 5.7 pp to 33.1 percent, still a moderate level.









Medium-Term Outlook

The unfolding economic crisis will lead to a contraction of the Moldovan economy in 2020. If the coronavirus outbreak is largely contained by mid-2020 with a recovery thereafter, in the baseline scenario by year-end the economy will still have to deal with a recession of 3.1 percent. The economic lockdown and travel restrictions will lead to a sharp deterioration in activity in Q2 with a severe drop in disposable income. A fall in remittances will further depress private consumption. Despite adopted monetary and fiscal measures, heightened uncertainties and confidence will reduce investment. Disruption of supply chains and recession in key economic partners will further strain exports. On the production side, the outbreak is reducing domestic output, with HORECA, construction, transport and manufacturing being most affected. Drought may lead to a drop in agriculture output. Public revenues will fall considerably, while health and social expenses and fiscal stimulus will spur expenditures but not enough to compensate for the lost domestic demand due to the COVID-19 crisis. The projected deficit for the baseline scenario is assessed at 5.8 percent, below the official plans as further prioritization of expenditures and financing may be needed. On the back of weak domestic demand, lower commodity prices and a higher base effect, disinflationary pressures will prevail against accommodative economic policies, moderate depreciation, supply shocks and poor agricultural yields. The inflation rate is therefore set to decrease gradually in 2020, bouncing back at the beginning of 2021 as demand recovers. The current account deficit is expected to widen on the background of subdued FDIs and remittances. The economy is expected to bounce back to around 4 percent in 2021 and to moderate at 3.6 percent in 2022. Increased social needs and unemployment, as well as fiscal stimulus through public investment, will bring fiscal deficits above the historical average in the years to come.

The downside risks to the baseline scenario are high. The prolonged disruption of economic activities until August 2020 would cause growth to fall by 5.2 percent, the biggest drop since 2009. Weaker growth will further strain public finances faced by already large financing needs at 15 percent of GDP. A higher number of returning migrants, high social spending needs and high unemployment may put additional strain on labor market conditions and create further fiscal pressures. A swift recovery would require strong financial intermediation, that could be affected by higher firms' bankruptcy rates and lower deposits. Large public financing needs will compete with the private sector for resources, increasing the risk of crowding-out. Lower global growth, FDIs and remittances, and disrupted supply-chains could weigh further on the growth outcome. Finally, the agricultural sector is already exposed to adverse weather conditions, with impacts yet to materialize.

Mitigating the near-term impact of the crisis is urgent, but it is also important to keep in focus long-term policy priorities of addressing low and declining human capital, weak competition policy and judiciary, declining productivity, and rising emigration. In the short run, the authorities should focus on securing medical supplies and staffing, measures to slow the spread of the virus and reduce the peak load on health systems, securing fiscal stability and access to finance, keeping the financial sector stable while ensuring adequate liquidity, protecting the affected people and helping businesses to survive and retain workers. The *Special Topic Note* gives some insights on firms' performance and policies needed to ensure a swift and equitable recovery.

Table 1: Key Macroeconomic Indicators, Baseline Scenario

	2017	2018	2019	2020f	2021f	2022f
Nominal GDP, *MDL billion*	178,881	192,509	210,099	212,536	233,365	253,901
GDP, *% real change*	4.7%	4.3%	3.6%	-3.1%	4.0%	3.6%
Consumption, *% real change*	4.8%	4.0%	2.7%	-0.2%	2.7%	2.8%
Gross Fixed Investment, *% real change*	11.6%	15.6%	9.4%	-14.9%	8.9%	8.7%
Exports, *% real change*	10.9%	7.2%	7.3%	-6.0%	6.0%	6.5%
Imports, *% real change*	11.0%	9.7%	6.7%	-5.5%	5.0%	6.1%
GDP deflator, *% change*	6.3	3.2	5.4	4.4	5.6	5.0
CPI, *% change, average*	6.6	3.1	4.7	3.6	5.5	4.1
Current account balance, *% GDP*	-5.7	-10.6	-9.7	-10.2	-9.5	-8.6
Remittances, *% change, USD*	3.3	9.4	1.4	-15.0	7.8	3.9
Net FDI, *% of GDP*	1.5	2.4	4.5	1.4	3.5	3.7
External Debt, *% GDP*	72.2	65.2	63.1	68.9	69.4	70.9
Budget revenues, *% GDP*	29.8	30.1	30.0	28.3	28.9	29.3
Budget expenditures, % GDP	30.5	31.0	31.4	34.1	32.6	32.1
Fiscal balance, % GDP	-0.6	-0.8	-1.4	-5.8	-3.8	-2.8
Public and Publicly Guaranteed Debt, *% GDP*	32.7	30.2	27.5	33.1	35.2	35.9

Source: Moldovan authorities, World Bank projections

Contact: Marcel Chistruga (mchistruga@worldbank.org), Natasha Rovo (nrovo@worldbank.org), Sanja Madzarevic Sujster (smadzarevic@worldbank.org) www.worldbank.org/en/country/moldova