The World Bank in Moldova

Country Snapshot

An overview of the World Bank's work in Moldova

April 2019

MOLDOVA	2018
Population, million	3.55
GDP, current US$ billion	11.3
GDP per capita, current US$	2,724
Life Expectancy at birth, years (2018)	73.2

At a Glance

- Supported by the normalization of financial conditions, economic growth in Moldova remained robust in 2018, although below the historical average.
- The pace of growth, averaging 3.7 percent, will remain subdued in the coming years in the face of weaker foreign and domestic demand.
- Against the backdrop of political uncertainty in the aftermath of the 2019 parliamentary elections, demographic trends, low productivity, and vulnerability to external shocks will remain the main challenges to medium-term growth prospects.

Country Context

Moldova is a small lower-middle-income economy. Although it is the poorest country in Europe, Moldova has made significant progress in reducing poverty and promoting inclusive growth since the early 2000s.

The economy has expanded by an average of 5 percent annually, driven by consumption and fueled by remittances. The latter account for a quarter of GDP, among the highest share in the world.

European integration has anchored successive governments' policy reform agendas, but reforms that are good on paper have yet to materialize. A vulnerable political system, polarized society, adverse external environment, and skills mismatch in the labor market, along with climate-related shocks, are Moldova's biggest economic challenges.

Transparency, accountability, and corruption are crucial concerns. Business confidence is low, and the macroeconomic framework remains vulnerable. External budget support, based on an agreement with the International Monetary Fund, has a high level of conditionality.

Continued economic stabilization, the advancement of key economic reforms, and the creation of a rule-based environment for businesses are the country's key goals.

Moldova's large-scale out-migration, combined with decreasing fertility rates, has led to an alarming decline in the population and increased the share of elderly people. This puts pressure on the pension system and limits the country's long-term competitiveness. In the near term, the formation of a new government and local elections will dominate the political agenda while important reforms may stumble.

The World Bank and Moldova

The current Country Partnership Framework (CPF) supports Moldova's transition to a new,more sustainable, and inclusive development and growth model through a mix of analytics, advice, and financing.

Grounded in the National Development Strategy, the CPF incorporates the three top-most priorities of the Systematic Country Diagnostic:

(a) strengthening the rule of law and accountability in economic institutions;

(b) improving inclusive access to and the efficiency and quality of public services; and

(c) enhancing the quality and relevance of education and training for job-relevant skills.

These priorities define and inform the CPF's focus areas of economic governance, service governance, and skills development, supplemented by climate change as a cross-cutting theme.

A mid-term strategy assessment, with adjustments for the evolving country context—a Performance and Learning Review—is to be completed in fall 2019.

Key Engagement

The World Bank and the International Finance Corporation (IFC) are working together to improve the governance and quality of public services, enhance the business environment, foster private sector development, increase the productivity of firms, and create decent jobs.

The program supports investments in human capital and anticorruption measures, enhanced transparency, secured property rights, and stable financial and legal institutions.

Results are expected to include: a more transparent business regulatory framework, better advice and financing for small businesses and farmers, more efficient and accessible public services, an improved state budget allocation process, more effective energy sector regulation, a better functioning district heating system, improved financial reporting in state-owned enterprises, systematic asset declaration by public officials, a strengthened stolen asset recovery regime, rehabilitated and inclusive schools, better primary care, and infrastructure improvements.

WORLD BANK PORTFOLIO

No. of Projects: 10
Lending: $391.3 Million
IBRD: $88.1 Million
IDA: $303.2 Million

For example, the recently approved US$35 million Land Registration and Property Valuation Project will benefit Moldovan citizens, investors, and government institutions with more secure property rights and better developed real estate markets.

Improved fairness in the property registration and valuation system will guarantee citizens equal opportunities in exercising their property rights and enable Moldovan authorities to conduct mass registration and valuation nationwide with no direct costs to citizens and businesses.

The new system will also strengthen the rule of law and accountability of institutions by enhancing property rights, increasing the transparency of property data, and improving the efficiency of the cadaster system.

Recent Economic Developments

Real GDP increased by 4.0 percent in 2018 compared to 4.5 percent in 2016 and 4.7 percent in 2017. Tax cuts, steep wage increases, and remittances supported the real growth of disposable income, resulting in a 3.2 percentage point contribution of private consumption to growth.

On the back of lower inflation, favorable interest rates underpinned investment growth, which contributed another 3.1 percentage points to growth.

With strong domestic demand and a stronger leu, imports expanded more quickly (+8.9 percent), resulting in a negative contribution to growth (-3.4 percentage points) from net exports.

A high base effect, lower administrative prices, relatively weaker demand, higher agricultural yields, and lower imported inflation contributed to the observed decline in the inflation rate, which averaged 3 percent in 2018.

Due to robust imports, in the first three quarters of 2018, the current account deficit increased to 10.3 percent of GDP from 8.3 percent in 2018. Against this background, by end-February 2019, foreign reserves amounted to US$2.9 billion, still covering more than five months of imports.

Despite the recent parliamentary elections, the fiscal position remained solid, mainly due to stronger revenues. As a result, the fiscal deficit totaled 0.8 percent of GDP, considerably lower than the planned level of -2.5 percent of GDP.

Economic Outlook

Against the background of lower remittances, the projected weaker foreign and domestic demand will decelerate economic growth below historical levels. Initially, the expansionary fiscal policy measures adopted in 2018—tax cuts, wage increases, and public transfers—and lower interest rates will underpin growth.

As fiscal stimuli fade away after the elections, consumer and business confidence, together with a sustained 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.

Despite relatively robust exports that are due mainly to the expansion of activities in free economic zones, the current account balance is projected to decrease because of expected slower economic activity.

The expansionary fiscal policy introduced before the elections, combined with more dynamic agricultural and regulated prices, will build up inflationary pressures, pushing inflation out of the corridor in the second half of 2019.

Nonetheless, in the medium term, the monetary stance is projected to remain adequate, and consumer inflation is envisaged to variate in the target corridor.

Deep structural reforms are needed to enable the emergence of new drivers of growth beyond consumption and remittances. The growth of disposable income, though still inclusive, was much lower during 2011–16 compared to 2006–13.

Adverse demographic trends, low productivity, and the country's vulnerability to external shocks constitute the main challenges to growth in the medium term.

Project Spotlight

District Heating Energy Improvement Project

The district heating system also supplies heat and hot water to public buildings and private entities.

The World Bank is helping Chisinau to modernize its district heating (DH) through the **District Heating Energy Improvement Project**, which works to enhance the reliability and quality of DH services for end consumers and contributes to the improved operational efficiency and financial viability of the DH company, Termoelectrica.

The DH system's modernization and rehabilitation, together with Termoelectrica's improved financial viability, is the most favorable way to ensure the system's efficient functioning and reduce the tariff pressures on consumers.

DH is the dominant form of heating in Moldova's capital city, Chisinau, where roughly 500,000 people, or about 70 percent of the city's population, rely on it. The DH system also supplies heat and hot water to public buildings and private entities.

Construction of a new pumping station, the modernization of another three large pumping stations, and the rehabilitation of 14.4 kilometers of pipelines have increased the efficiency of the heating supply, producing annual savings of US$3 million and reducing CO2 emissions by 8,200 tons/year.

More than 25,500 inhabitants have benefited from an improved heating and hot water supply at affordable prices as a result of the installation of 170 Individual Heat Substations (IHS) in residential buildings. An additional 25,000 beneficiaries at 28 public institutions benefited from the installation of 59 substations.

The reconnection of the first batch of 19 public institutions to DH and the installation of IHSs have improved heating services and increased Termoelectrica's heat sales by 21,507 Gcal/season, constituting approximately US$1.4 million per heating season.

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