MOLDOVA

Highlights

- **Recent economic growth has been robust.** Gross domestic product (GDP) grew by 4.0 per cent in 2018, supported by strong domestic demand and growing exports. A similar trend continued in the first half of 2019 when the growth rate accelerated to 5.2 per cent.
- **Reforms have largely come to a halt.** The political stalemate following the inconclusive parliamentary elections in February 2019 led to a caretaker government with limited powers and little appetite for reform.
- **Governance reforms continued in the banking sector.** Foreign investors entered the second-largest bank in the country. In parallel, the National Bank of Moldova (NBM) has lifted the intensive supervision regimes for Victoriabank and Moldova-Agroindbank, which had been in place since June 2015.

Key priorities for 2020

- **The new government should address deficiencies in the system of governance.** Particular emphasis should be given to fighting corruption and vested interests, irrespective of political affiliations, ensuring the independence of the judiciary and de-politicising state institutions.
- **Relations with the international financial institutions (IFIs) need to be maintained.** In particular, the implementation of structural reforms and macroeconomic policies agreed under the International Monetary Fund (IMF) programme is crucial for maintaining investor confidence and for receiving financial support from international development partners.
- **Independence of the NBM needs to be respected and its capacities strengthened.** The NBM needs to finalise the restructuring and cleaning of the banking sector without compromising fit and proper criteria for the banks' shareholders. Fully transcribing international standards for the supervision of banking and non-banking sectors needs to remain high on the agenda.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-0.3	4.4	4.7	4.0	3.8
Inflation (average)	9.7	6.4	6.6	3.0	4.9
Government balance/GDP	-1.9	-1.8	-0.8	-1.1	-3.0
Current account balance/GDP	-6.0	-3.5	-5.7	-10.6	-9.1
Net FDI/GDP [neg. sign = inflows]	-2.8	-0.9	-1.5	-2.4	-4.2
External debt/GDP	78.4	76.8	72.1	65.2	n.a.
Gross reserves/GDP	22.7	27.3	29.0	26.2	n.a.
Credit to private sector/GDP	25.9	21.4	18.6	18.3	n.a.

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Macroeconomic performance

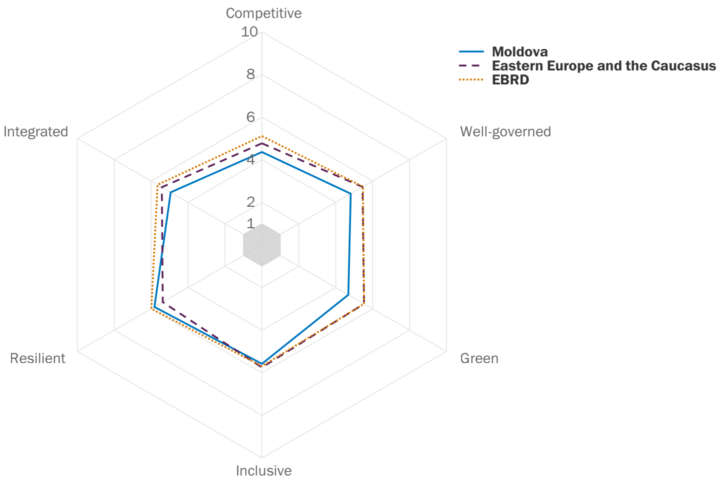
Economic output continued to expand at a solid pace. GDP grew by 4.0 per cent in 2018 and accelerated to 5.2 per cent year-on-year in the first half of 2019. Output expansion in 2018 was driven by a strong increase of investments in fixed assets on the back of construction-sector growth and by household consumption, which was supported by strong growth in real wages and a steady inflow of remittances. Capital investments increased by 14.0 per cent while household consumption grew by 3.8 per cent in 2018. Net exports contributed negatively to economic growth as the expansion of imports outpaced that of exports. While exports strengthened from 4.8 per cent growth to 6.9 per cent year-on-year in the first half of 2019, capital investments remained the main contributor to economic development, growing at 20.3 per cent. Growth of household consumption continued in the same period, albeit at a slower pace.

Macroeconomic stability was maintained, despite challenges. Following an exchange rate appreciation of 16.8 per cent in 2017, the current account deficit widened in the subsequent year to 10.6 per cent of GDP on the back of a strong increase in imports, mitigated somewhat by a solid inflow of remittances and exports receipts. This trend of a widening deficit continued in the first quarter of 2019, albeit at a slower pace. After broad stability in 2018, exchange rate pressures reappeared in the first half of 2019 but stabilised by mid-year. International reserves, at US$ 2.9 billion at the end of September 2019, provide more than five months of imports coverage. A persistent strengthening of demand has put upward pressure on prices. Consumer price inflation increased from 0.9 per cent in December 2018 to 6.3 per cent in September 2019. To keep inflationary pressures under control, the NBM increased the main policy rate twice in mid-2019, from 6.5 per cent in June 2019 to 7.5 per cent in July.

Financial-sector health continues to improve. The four-year cumulative contraction of 20.6 per cent in the banking sector loan portfolio has bottomed out and the clean-up of the sector, after the massive fraud in 2014, has moved to an advanced stage. The stock of loans provided to the private sector increased by 5.9 per cent in 2018 and by 16.3 per cent year-on-year in August 2019. The recovery was led by the growth of household loans, which expanded by a strong 31.0 per cent in 2018 and by 41.2 per cent year-on-year in August 2019. Growth of corporate credits was still in negative territory in 2018 but has turned to a modest 6.8 per cent growth year-on-year in August 2019.

Swift implementation of governance-oriented reforms would boost the economic outlook. The new coalition-based government is well placed to address governance and other constraints, thus giving an impetus to economic growth. At the same time, Moldova continues to face longstanding structural and demographic challenges, including a lack of economic diversification and the ongoing emigration of a large proportion of the population. We forecast Moldova's real GDP to grow by 3.8 per cent in 2019 and by 4.0 per cent in 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

Months of political uncertainty have halted most reforms. After the stalemate, which was brought by general elections held on 24 February 2019, the government was eventually formed at the beginning of June. Taking into account the period of pre-election campaigning, Moldova had functioned for almost half a year with a caretaker government with limited powers and little appetite for reform.

Relations with the IFIs and the EU (European Union) are being restored. After a stand-off between the IMF and the previous government on the fourth and fifth reviews of the Extended Credit Facility and Extended Fund Facility, scheduled for September 2018 and March 2019, respectively, the new government reached staff-level agreement with the IMF team in July 2019. The IMF executive board completed the fourth and fifth reviews in September 2019, enabling the disbursement of a US$ 46.1 million tranche. It was concluded that the programme remained broadly on track. In addition, there were signals that the EU will resume the Macro Financial Assistance (MFA) for Moldova. MFA was put on hold in 2018 after parliament had approved an ill-conceived capital amnesty and legislative revisions to reduce criminal liability for certain economic crimes, and following the invalidation by the judiciary of the results of the Chisinau mayoral election, which was won by the opposition candidate.

Governance reforms continued in the banking sector. Shares in Moldindconbank, Moldova's second-largest bank, were sold to a strategic foreign investor in February 2019. Moldindconbank is the third and last systemic bank in the country to be acquired by a foreign investor. Nevertheless, in April 2019, the NBM decided to extend its temporary administrator mandate at Moldindconbank for a further six months. At the same time, the NBM has lifted the intensive supervision regimes for Victoriabank and Moldova-Agroindbank, which were in place since June 2015.

The NBM continued to strengthen banking regulation. Basel III is being implemented gradually by transposing international standards and best practices into the field of banking-sector supervision. The introduction of the Internal Capital Adequacy Assessment Process and the Supervisory Review and Evaluation Process methodology in 2019 represents a fundamental step in implementing a future-oriented risk-based supervision process using professional reasoning. This should improve the whole supervisory framework and provide the possibility for the early detection of bank risks and deficiencies, thus strengthening the stability of the banking sector.

The authorities have launched an e-procurement system. The new system, in place since late 2018, provides transparency, openness and accountability. It constitutes an important effort to transform the way in which public funds are spent and to step up the fight against corruption. The benefits of e-procurement also include improvements in market access and competition, promotion of integrity, information cost reduction and easier access to information. The new electronic system, MTender, has been introduced in all key central government ministries and 100 subordinated entities.