MOLDOVA

Highlights

- **The economy is on the path to recovery in 2021.** On the back of growing global demand and private consumption, gross domestic product (GDP) grew by 11.7 per cent year-on-year in the first half of 2021.
- **Inflation accelerated sharply in the third quarter of 2021.** The acceleration took place after a lengthy period of relatively subdued inflation during most of 2020 and the first half of 2021, prompting an appropriate monetary policy response.
- **The financial sector continued to harmonise regulation with international standards.** The National Bank of Moldova (NBM) approved a new regulation that gradually introduces leverage indicators for banks, while the process of adopting the Solvency II Directive is advancing in parallel with an overhaul of the insurance sector.

Key priorities for 2022

- **The authorities should advance the structural reform agenda, and improve governance and the business climate.** Key priorities in the short term include enabling an independent and professional judiciary, strengthening public institutions and continuing the fight against corruption.
- **Harmonisation of financial sector regulation with international standards needs to continue.** The NBM's independence should be strengthened by ensuring the legal irrevocability of its monetary and supervisory decisions.
- **Policies to support a resilient recovery from the Covid-19 pandemic should be prioritised.** Climate-awareness policies are needed to maintain competitiveness on an increasingly climate-aware European Union (EU) market. Policies regarding equality of opportunities and improving living standards are crucial to reduce emigration flows and foster growth prospects for the economy.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.7	4.3	3.7	-7.0	7.0
Inflation (average)	6.6	3.1	4.8	3.8	3.0
Government balance/GDP	-0.6	-0.8	-1.4	-5.1	-4.3
Current account balance/GDP	-5.7	-10.6	-9.3	-7.5	-8.5
Net FDI/GDP [neg. sign = inflows]	-1.4	-2.3	-3.9	-1.3	-1.9
External debt/GDP	70.6	64.1	62.2	70.8	n.a.
Gross reserves/GDP	29.0	26.1	25.6	31.8	n.a.
Credit to private sector/GDP	18.7	18.4	19.2	22.1	n.a.

CONTINUES

Covid-19: macroeconomic implications

The economy is recovering in 2021 on the back of gradually increasing investments and reviving household consumption. The Covid-19 pandemic caused a deep GDP contraction of 7.0 per cent in 2020, with domestic consumption, investments and exports all registering substantial declines. In 2021 a recovery is under way, supported by growing global demand and private consumption. The automotive value chain led an export growth of 13.8 per cent year-on-year in nominal US dollar terms in the first half of 2021. In addition, money transfers have been exceptionally high in the first six months of 2021, increasing by more than 23.0 per cent year-on-year. This supported the recovery of economic activity, with 11.7 per cent growth year-on-year in the first half of 2021. Following higher food and oil prices and depreciation of the exchange rate, inflation accelerated from almost zero in January to 6.7 per cent in September 2021. The recent acceleration of inflation above the target rate of 5.0 per cent prompted the NBM to raise the base rate three times since July 2021, by a total of 2.85 percentage points, to 5.5 per cent in October 2021.

The stable macroeconomic position allowed for important fiscal support during the Covid-19 crisis. The current account deficit narrowed from 9.3 per cent of GDP in 2019 to 7.5 per cent in 2020, mainly financed by debt instruments, thus keeping international reserves at comfortable levels. International reserve assets amounted to US$ 4.0 billion in September 2021, covering more than seven months of imports. The relatively stable macroeconomic position before the Covid-19 crisis and access to US$ 235 million of the International Monetary Fund (IMF)'s rapid financing facility obtained at the onset of the Covid-19 pandemic helped the economy to cope with the pandemic shock. On the back of the economic contraction and fiscal costs of the policy support package aimed to reduce the impact of the pandemic, public debt increased from 28.3 per cent of GDP in 2019 to 34.8 per cent in 2020. The relatively low debt and availability of external financing allowed Moldova the fiscal space for a comprehensive support package.

The economy is expected to rebound in the short term, despite uncertainties. We expect GDP to grow by 7.0 per cent in 2021, helped by a recovery of global demand, followed by 4.0 per cent in 2022. The recovery of the economy depends on the roll-out of vaccines and a rebound of consumer and investor confidence. Since Moldova is integrated into the global supply chain of the automotive industry, the path of recovery is likely to be similar to the overall global recovery.

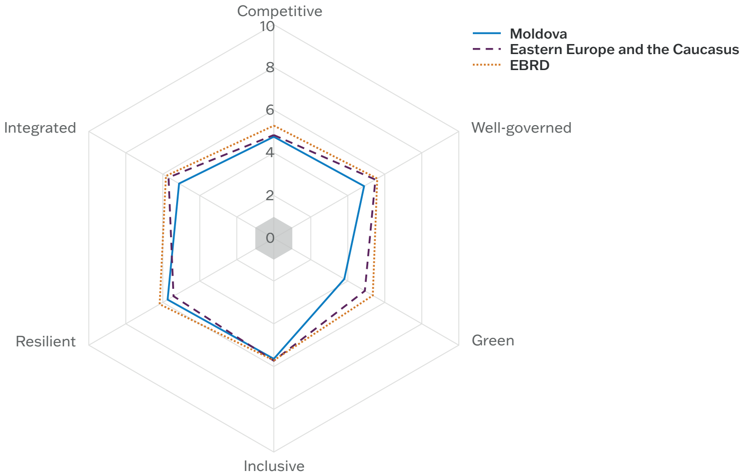
Policy response to Covid-19

The initial emergency policy response amounted to 2 per cent of GDP in 2020. It was focused on tax deferrals, a temporary increase in social benefits, monetary policy easing and liquidity provision. Further measures included a reduced value added tax (VAT) rate for the hospitality sector, faster tax reimbursements, subsidised lending to small and medium-sized firms and payroll compensation for firms that ceased operation during the state of emergency. Social assistance for vulnerable groups included expanded unemployment benefits and targeted social help. The NBM allowed banks to defer loan payments and reduced the local currency reserve requirements to support liquidity in the banking sector. The NBM further recommended banks to refrain from paying dividends, thus strengthening their capital positions.

Moldova's budget policy for 2021 prioritises support for the health sector and farmers. Medical staff, most of whom are financed by the National Medical Insurance Fund, will receive a 30 per cent salary increase. Furthermore, salary-related tax subsidies will continue and people who lost their jobs during the Covid-19 pandemic will be able to access grants.

CONTINUES

Assessment of transition qualities (1-10)



Structural reform developments

The retirement age has been lowered, threatening the sustainability of public finances. In December 2020 the previous parliament adopted a number of laws which have been criticised by the international community, among which was a lowering of the retirement age. While most of the laws have been ruled as unconstitutional by the Constitutional Court or sent back to parliament by the president, the law on pension age will enter into force in 2022, with women retiring at age 57 and men at 62. It is not yet clear how the new parliamentary majority will deal with the law but international institutions, including the IMF, have flagged the potentially serious macroeconomic and fiscal implications. Meanwhile, the retirement age for women increased by six months to 59.5 years in July 2021, in line with the provisions of the previous law.

The NBM continued to strengthen the prudence and soundness of the banking system. In December 2020 the Executive Board approved a new regulation that introduces leverage indicators for banks. Banks will now report quarterly information on these leverage indicators to the NBM and, after analysing data over three years, the NBM will set a minimum level to limit the risk of over-indebtedness of the banking sector.

The government adopted a comprehensive reform agenda for the insurance sector. In October 2020 the government adopted the law elaborated by the National Commission for Financial Markets focusing on the partial transposing of the Solvency II Directive, which covers provisions on supervision, prudential measures, corporate governance and risk management. It also imposes minimum capital requirements and increased transparency for licensing insurance companies. The law comes at a time when a number of insurers have declared insolvency, while the state has recently regained majority control of one of the key players in the sector.

CONTINUES

Digitalisation has been prioritised and advanced on a number of fronts. The new government has a Vice Prime Minister for digitalisation, responsible mainly for the digitisation of public administration. The public procurement platform, MTender, has been updated in terms of access to information, in line with open government data principles, but more progress is expected to develop all functionalities in line with the previously adopted law. Also, the NBM has implemented an automated information technology tool to assist in anti-money laundering and terrorist financing, a first in the region. In general, the use of e-government platforms, including the online signature, has significantly increased since the outbreak of the Covid-19 pandemic.

A limit on cash transactions has been imposed to curb informality. Since the beginning of 2021 there is a ceiling of MDL 100,000 (€4,700) per month in cash transactions, or €470 per transaction between firms regardless of their ownership and legal form. The measure intends to stimulate transactions through banks and cards, thus limiting the potential for informal payments and employment. Exceptions include settlements with citizens and economic actors purchasing agricultural products, and individuals who are not engaged in entrepreneurial activities.