Moldova

Highlights

- **The economy continues to struggle.** Output fell further in the first half of 2023 after a steep decline in 2022, and inflation decelerated to 8.6 per cent in September 2023.
- **Digital transformation is advancing.** A new government digital strategy aims to develop the information technology (IT) sector, improve the efficiency of government services, enable remote identification and simplify online business registration for foreign investors.
- **Structural reforms have accelerated.** Having been granted European Union (EU) candidate country status in June 2022, the authorities have made important progress in addressing the nine priorities identified in the European Commission's opinion on the application for membership. As a result, in November 2023 the European Commission recommended that the European Council open accession negotiations with Moldova once all priorities have been fully addressed.

Key priorities for 2024

- **Administrative and institutional capacities need strengthening in advance of EU accession negotiations.** The authorities should ramp up ongoing public administration and judicial-system reform efforts to further reduce corruption and eliminate the influence of oligarchs in the political system.
- **The authorities should continue to undertake legislative reform to support the digitalisation of public services.** Building on the success of new platforms to promote e-government, the necessary legislative and regulatory framework should be put in place to enable systemic digitalisation across all layers of government.
- **Energy-sector reform should continue, to further integrate the domestic energy market into the EU single market.** Enhancing energy security remains a priority given the country's location. The authorities should advance policy action with the EU to enable competitive energy trading with European partners and reduce the country's dependency on a single source of energy supply.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.6	-8.3	13.9	-5.0	0.0
Inflation (average)	4.8	3.8	5.1	28.7	13.3
Government balance/GDP	-1.5	-5.3	-2.6	-3.2	-6.0
Current account balance/GDP	-9.4	-7.7	-12.4	-17.1	-12.1
Net FDI/GDP [neg. sign = inflows]	-4.1	-1.3	-2.7	-3.7	-1.5
External debt/GDP	61.2	70.1	63.8	65.9	n.a.
Gross reserves/GDP	26.1	32.8	28.5	30.8	n.a.
Credit to private sector/GDP	19.6	22.9	23.3	22.5	n.a.

Macroeconomic developments and policy response

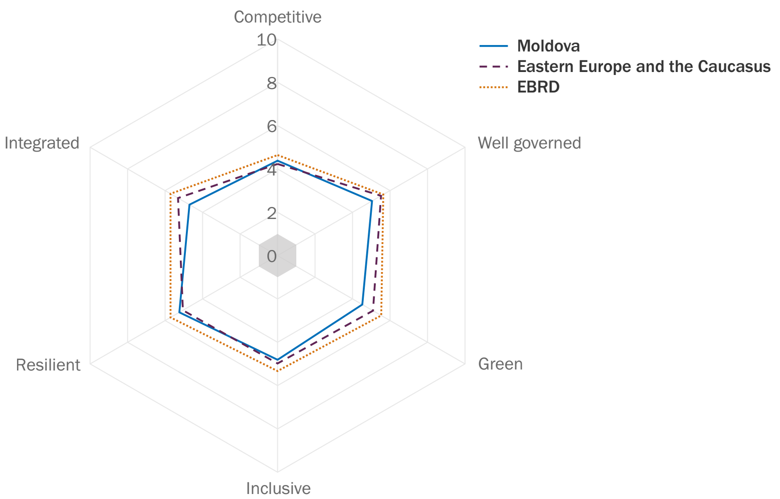
The economy is struggling to exit from a negative spiral. Moldova is one of the economies hardest hit by the war on Ukraine, with gross domestic product (GDP) falling by 5 per cent in 2022. Soaring inflation (peaking at 34.6 per cent in October 2022) and tight monetary policy stifled domestic demand, while a severe drought led to a steep decline in agricultural production. These negative trends continued in the first half of 2023, when GDP contracted by 2.3 per cent year on year, mainly due to a further 5.6 per cent fall in private consumption. Industrial output dropped 7.6 per cent year on year during the same period and exports of goods declined 10.9 per cent. With imports remaining flat, the current account deficit-to-GDP ratio remained at double-digit levels. On a more positive note, the combination of more stable energy prices and tight monetary policy contributed to a sharp deceleration in the annual inflation rate, to 8.6 per cent in September 2023, allowing the National Bank of Moldova to cut the policy rate to 6 per cent.

Fiscal pressures have increased as a result of the Ukraine war. In December 2022 parliament approved a 12.5 per cent increase in government expenditure in 2023, targeting higher public-sector wages and pensions and expanding standard-of-living support for the most vulnerable. In the past year, the Moldovan authorities have provided social assistance, public education, emergency healthcare services and temporary accommodation to 117,000 Ukrainian refugees. They have also introduced energy subsidies for vulnerable Moldovan households through the Energy Vulnerability Reduction Fund. Financial support for agricultural producers in rural areas increased 17 per cent year on year between January and July 2023. Since November 2022 micro, small and medium-sized agricultural producers can apply for a 100 per cent subsidy for diesel used, while large agricultural enterprises can receive a 30 per cent subsidy for energy used. All of these measures led to a fiscal deficit of 3.2 per cent of GDP in 2022 and 2.8 per cent of GDP in the first half of 2023.

Official creditors' external financing is helping to cover the twin deficits. In April 2023 the International Monetary Fund (IMF) approved the disbursement of US$ 96 million (€87.5 million) for immediate budgetary support out of a total US$ 795 million (€750 million) from the Extended Credit Facility (ECF)/Extended Fund Facility (EFF). In addition, the EU increased its macro-financial assistance (MFA) by €145 million in January 2023, while the World Bank paid out additional grant funding of US$ 43 million (€40.6 million) in May 2023 through its emergency response. On the back of significant capital inflows, the domestic currency appreciated 8 per cent from the beginning of 2023 and foreign reserves reached US$ 5 billion (€4.5 billion) at the end of July 2023, covering six months of imports. Public debt is moderate, at 33.7 per cent of GDP at the end of 2022, though is likely to have edged up by a few percentage points as a result of the new loans.

Geopolitical uncertainties are weighing on the short-term economic outlook. The government's expansionary fiscal policy in 2023 and the drop in inflation have not yet resulted in clear signs of an economic rebound. Nevertheless, the progress achieved on energy resilience and the expected rise in real incomes are likely to improve growth prospects in 2024. We, therefore, forecast GDP growth of 0 per cent in 2023, followed by growth of 3.5 per cent in 2024. The prospects for EU accession and associated reforms could drive a stronger recovery in the medium and long term.

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are focusing reform efforts on nine priorities identified by the European Commission when granting Moldova EU candidate country status. In November 2023 the European Commission noted that Moldova has made important progress on the nine priorities and has taken additional measures to complement and sustain these achievements. Therefore, the Commission recommended that the European Council open accession negotiations with Moldova once it complies in all nine areas.

Progress is under way on reducing the influence of oligarchs. The authorities have accepted the advice of the Venice Commission on implementing a systemic approach to removing the political influence of oligarchs. This approach covers the adoption, strengthening and integration of legal tools across different fields of law to prevent the influence and growth of oligarchs in the long term. The authorities have also submitted an action plan to the Venice Commission, outlining institutional and legal progress, as well as a plan to revise it every six months. The Venice Commission made recommendations on the implementation of the action plan, including measures on the consistent reform of the judicial system, conducting impact assessments and introducing additional or complementary legislation.

Anti-corruption measures have progressed, but there is parliamentary opposition to their scope. A new legislative process began in March 2023, setting out a clear division between the National Anti-corruption Centre and the Anti-corruption Prosecutor's Office to optimise coordination between the two main anti-corruption agencies. To simplify corruption case proceedings, the authorities partially amended the Criminal Procedure Code at the end of December 2022. However, in July 2023 parliament proposed amendments to limit the role of the Anti-corruption Prosecutor's Office to taking on only large-scale corruption cases (over €15,000 for bribery and €150,000 for damages).

Reforms to the judicial system continued, but judicial independence remains vulnerable. In August 2023 parliament passed a law on the Supreme Court of Justice under which it will become a court of cassation rather than an appeals court. Recent amendments to the judiciary's roles and responsibilities include changes to the status of judges, the code of criminal procedure and the code of civil procedure. However, vested interests and slow progress on passing these legal and regulatory amendments are hindering transparent judicial staff appointments and the budgetary independence of the anti-corruption agencies.

A new strategy for digital transformation is boosting digital technology applications in the public sector. In January 2023 the authorities launched the 2023-27 Strategy for Digital Transformation of the Republic of Moldova. Its main goals are to enhance IT sector competitiveness, expand access to digital services for the wider population and improve e-government services. In March 2023 parliament voted to discard legal constraints on foreign investors who want to open an online business in Moldova without a physical presence. Legislative amendments were made to allow remote identification of clients in the financial sector from July 2023. The authorities are also developing a digital platform to enable remote identification for e-government services.

Moldova's domestic energy sector is being integrated into the European market. Reducing dependence on energy imports from Russia has been a key target of energy-sector reform since the start of the war on Ukraine. Electricity trade capacity from continental Europe to Moldova increased to 1,050 MW in May 2023 through a new agreement with the European Network of Transmission System Operators for Electricity (ENTSO-E). The Moldovan authorities and the EU agreed in May 2023 that energy infrastructure projects in Moldova would be eligible to apply for EU grants under the bloc's energy infrastructure rules. Financial support from the European Bank for Reconstruction and Development (EBRD) also enabled the authorities to accumulate gas reserves for the coming winter.

Governance reforms of state-owned enterprises (SOEs) have advanced. In December 2022 the authorities adopted an ownership strategy identifying all SOEs at central government level that should be subject to reorganisation, privatisation or liquidation. It also published a plan to strengthen corporate governance. Later, amendments to the law were passed, enabling the Public Property Agency to monitor implementation by SOEs of corporate governance regulations, evaluate the performance of SOE board members and monitor the potential fiscal risks of SOEs. The authorities are also finalising an SOE privatisation plan.