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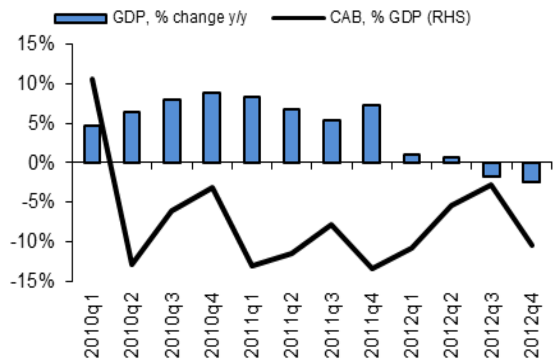
THE WORLD BANK

MOLDOVA Economic Update

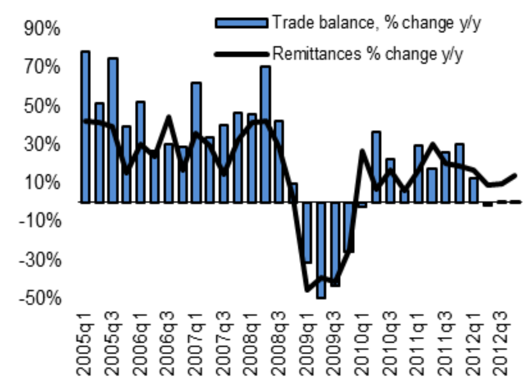
April 10, 2013

- *Weak external demand and marked decline in agricultural production in 2012 have led to a recession in Moldova.*
- *While real GDP growth is projected to rebound to 3 percent in 2013, significant risks remain.*
- *Political uncertainty is delaying much-needed economic reforms and is putting at risk gains made so far.*

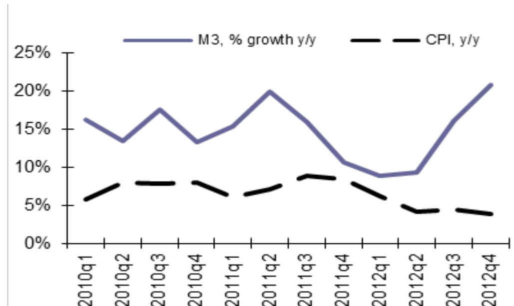


Recent Economic Developments

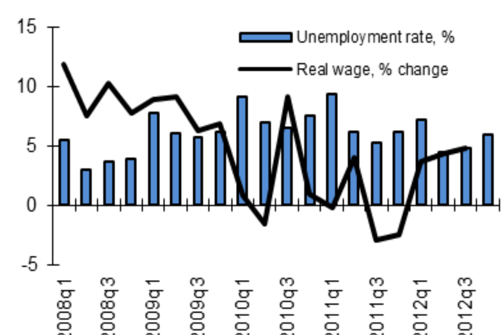
In 2012, real GDP declined by 0.8 percent and Moldova entered into a recession in the second half of the year. The economy was hit by two shocks: slowdown in external demand and severe drought. Crisis in the Eurozone led to lower demand for exports and remittances from Europe. Meanwhile, the agriculture sector was affected by a drought that caused value added to decline by 23 percent, with grain harvest halved. This was offset to a small extent by a minor increase in value added in the industrial sector by 0.5 percent y/y. In addition, robust growth of remittances from the CIS countries (+18 percent y/y) and increase in real wages fuelled increase in consumption by 0.9 percent. So far, the picture is mixed in 2013: there is some improvement in few key indicators (such as exports and remittances), but a decline in industry.



While the current account improved in 2012, FDI inflows fell. The current account deficit declined from 11.3 percent of GDP in 2011 to 7 percent of GDP in 2012. With the balance of goods and services largely unchanged in annual terms, the lower current account deficit came from growth in remittances from CIS countries. Meanwhile, net FDI halved from 4 percent of GDP in 2011 to 2.2 percent in 2012, matching the low 2009 inflows in nominal terms. With FDI falling, the current account deficit was financed by private sector borrowing and official financing to the public sector. Gross external debt increased by 12.7 percent y/y. A combination of lower current account deficit and higher external borrowing allowed the National Bank of Moldova (NBM) to accumulate foreign exchange reserves of USD 2.5 billion, exceeding 4 months of imports.



Despite low growth, fiscal consolidation continued in 2012. General government deficit declined from 2.4 percent in 2011 to 2.1 percent in 2012, mainly due to strong growth in budget revenues (+11.2 percent) stemming from a re-introduction of corporate income tax (with the rate of 12 percent) and additional revenue measures introduced mid-year. In January-February 2013, continued robust expansion of budget revenues (14.9 percent) led to a further reduction of the budget deficit in y/y terms. However, following the 'no-confidence' vote on March 5, the Parliament adopted increases in pensions and wages of top civil servants that risk reversing recent gains in fiscal consolidation.



Medium Term Outlook

GDP growth is expected to rebound to 3 percent in 2013, driven by the recovery of agriculture. Growth in real GDP is projected to remain subdued in the first half of the year. Improved external conditions and recovery in the agriculture sector (explained in large part by a low statistical base in 2012) will likely lead to acceleration in growth in the second half of 2013. We project 4-5 percent growth over 2014-2015 with higher external demand for Moldova's exports that will be supported by higher consumer and investor confidence. We expect that prudent monetary policy will be maintained. Inflation is projected to remain in line with NBM target of 5 percent plus/minus 1.5 percent. We assume fiscal consolidation will continue once the political uncertainty is resolved.

Moldova is vulnerable to economic and natural shocks that are likely to be amplified by ongoing political uncertainty. As a small open economy, Moldova faces several potential risks, including worsening conditions in the Eurozone, a negative oil price shock that slows growth in Russia, and extreme weather conditions. The ongoing political uncertainty could exacerbate these risks as important structural reforms are delayed and populist measures undermine macroeconomic stability. This, in turn, could delay IFI financing. Meanwhile, uncertainty in the timeline of the new government and its economic priorities could lead to lower private capital flows, FDI and domestic investment. The changes in taxation in agriculture currently being discussed in Parliament could create fiscal and distributional problems. In addition, significant risks exist due to concerns about credit quality and capital adequacy at the majority state-owned bank (Banca de Economii, BEM). Given the systemic importance of BEM, delays in concerted actions by the Government and the NBM because of the ongoing political uncertainty could prove costly. Delays in structural reforms and populist macroeconomic policies could lead to a larger adjustment once the new government is in place.

Accelerated growth requires structural reforms. Moldova has made significant progress in many areas, but much remains to be done. The World Bank is currently preparing a new *Country Partnership Strategy* to support Moldova in boosting prosperity and reducing poverty by capturing the full benefits of openness and integration with the EU and the broader global economy. The strategy is intended to help Moldova to diversify and expand its endowment of institutional capital, human capital and natural capital.

Table 1: Key Macroeconomic Indicators

	2008	2009	2010	2011	2012	2013F	2014F	2015F
Nominal GDP, *MDL billion*	62.9	60.4	71.9	82.3	87.8	94.0	102.9	113.6
Real GDP, *% change*	7.8	-6.0	7.1	6.8	-0.8	3.0	4.0	5.0
Consumption, *% change*	5.8	-0.9	9.2	9.4	0.9	3.1	4.1	5.6
Gross Fixed Investment, *% change*	2.2	-30.9	17.2	13.0	0.4	3.6	4.3	5.8
Export, *% change*	3.4	-12.1	13.7	27.4	2.3	2.8	4.8	5.2
Import, *% change*	2.9	-23.6	14.3	19.7	2.5	3.2	4.5	6.1
GDP deflator, *% change*	9.2	2.2	11.3	7.2	7.6	5.3	5.2	5.2
CPI, *% average*	12.7	0.0	7.4	7.6	4.6	4.9	5.0	4.8
Current Account Balance, *% GDP*	-15.9	-8.2	-7.7	-11.3	-7.0	-7.4	-7.9	-8.9
Remittances, *% change, USD*	26.6	-36.2	12.6	18.2	10.8	7.0	4.0	4.0
Terms of Trade, *% change*	-7.6	0.1	0.0	-1.4	-0.8	0.6	0.5	0.8
Budget revenues, *% GDP*	40.6	38.9	38.3	36.6	38.2	38.4	38.2	38.0
Budget expenditures, *% GDP*	41.6	45.3	40.8	39.0	40.3	40.4	39.7	39.2
Fiscal balance, *% GDP*	-1.0	-6.3	-2.5	-2.4	-2.1	-2.0	-1.5	-1.2
External debt, *% GDP*	67.4	80.2	82.3	77.6	84.5	83.3	81.9	81.7
Public and Guaranteed Debt, *% GDP*	15.8	21.0	23.2	21.7	24.3	24.6	24.4	23.5

Source: Moldovan Authorities, WB projections

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