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Acronyms and abbreviations used:

y-o-y – year on year; q-o-q – quarter on quarter; m-o-m – month on month; e-l-y – versus end of last year, e-o-p – end of period; Q1:18 – first quarter 2018; Jan:18 – January 2018; NBS – National Bureau of Statistics; NEA – National Employment Agency; NBM – National Bank of Moldova; MDL – Moldovan leu (national currency); FDI – foreign direct investments; p.p. – percentage points.

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Top 5 Positive and Negative Trends of 2018 and Top 5 Economic Challenges for 2019

The 2018 economic year was marked by the mix between some positive economic trends, which were rather shallow, and negative trends that evidenced profound developmental constraints. Even if at first sight we notice a positive and steady economic growth of about 4%, accompanied by moderate inflation and slight revival of private investment activity, the recovery rates are far too slow, taking into account the low baseline, being insufficient for an actual convergence with the countries in the region. In addition, informal employment continues to grow and the agricultural sector – the most important employer of the country (in terms of share in total employment) – is stagnating, which indicates the poor quality of economic growth and its limited impact on improving the quality of life. Though the reforms in the financial and banking sector speed up, the level of financial intermediation continues to decline and banks continue to be more interested in crediting the Government than the real sector. Despite stabilisation of public finances in the context of increased budget revenues, the fiscal reform and infrastructure projects financed from public money will significantly weaken the Government's financial position and the budget deficit could grow substantially in 2019 with negative repercussions on economic growth.

The most worrisome trend of 2018 is the erosion of the anti-money laundering framework, which affected even more the relations between the Government and development partners. This is related to the Law on Voluntary Compliance and Tax Incentives (capital amnesty) and the Law which allows obtaining Moldovan citizenship against investments. Both laws have been promoted 'as a package' back in 2016, and approved in 2018, despite the multiple concerns expressed by the civil society and development partners. Besides their content, which contradicts the spirit of the Association Agreement and the Memorandum of Understanding with the IMF, the way these laws were promoted raised even more concerns. To be precise, they were promoted with minimal, if not no decision-making transparency, no substantive/real consultation with civil society, and the Law on 'Capital Amnesty' was promoted at a record speed (the draft law was registered with the Parliament on 24 July and adopted on 27 July 2018, automatically in both readings).

For 2019, the Government should consider a number of imminent challenges. Year 2019 will be influenced by parliamentary and local elections, which could destabilise the public finance system because of the multiple electoral policies, which started in 2018, with a negative budgetary impact both at central (e.g. infrastructure projects) and local (e.g. reform tax) levels. In this regard, a key challenge will be to maintain the stability of the public finance system at a minimal cost for the economy (continuing to massively finance the budget deficit on account of banking resources will further undermine lending and private investment). Therefore, essential budgetary moderation is necessary in order not to compromise the modest economic growth the country achieved over the recent years. Another major challenge is to improve the relations with development partners, particularly to resume the financial relations with the European Union and to fully implement the Memorandum with the IMF. In this respect, the Government needs to accelerate the main undertaken reforms and not to allow any derogation from the provisions and, particularly, from the spirit of the EU Association Agreement. Another major challenge results from expansion of the Ukraine's Nistru Hydropower Complex, which poses fundamental risks to the country's economic and energy security. The Moldovan Government needs to take, hence, a stronger and more pro-active position in relation to the Ukrainian authorities in order to avoid these risks.

Harnessing the EU Deep and Comprehensive Free Trade Area (DCFTA) was the most positive trend noticed in 2018, which needs to be further developed in 2019. During its implementation, trade with EU has been steadily growing and balancing out, offsetting fully the losses on the CIS market; it has generated real jobs, budget revenues, investment and overall economic growth. In 2019, authorities should make every effort to maintain this trend and make a more effective use of the DCFTA provisions (in particular, addressing the issues related to the access of products of animal and non-animal origin).

1. Progress of reforms in the financial-banking system

2018 marks an increased implementation of the reform agenda in the banking system. Besides the positive outcomes for banks, the transition to the new regulatory and supervisory regime (Basel III) also gives hopes that events similar to those that resulted in some rigged banks will not repeat. Thus, once the Law on Banking Activity entered into force on January, 1, 2018, the regulator's toolbox was supplemented with the most modern practices of banking supervision, risks mitigation and maintaining financial stability in case a intervention is needed. Moreover, the Law also sets much clearer conditions for banks' operation, risk assessment and management of some destabilising elements that had a strong presence during the past years. Implementation of Basel III requirements was complemented by other actions, the most important ones being: (i) increasing the level of depositor protection, (ii) launching the work of the Single Central Securities Depository, (iii) approving the framework for co-operation and coordination of financial crises, (iv) strengthening the mechanism of preventing and combating money laundering, and (v) improving the regulation of non-banking credit organisations.

Improving the legal framework on bank shareholders' transparency has led to the entry of some strategic investors of good reput on the domestic banking market. At the same time, the historical features of the domestic banking sector, such as low shareholders' transparency and poor corporate governance, tend to dissipate. This improvement is also reflected by the withdrawal of special supervision regime in one of the systemic banks, with the entry of a transparent investor and full functionality of the management bodies ensured. Also, most likely, this regime will be soon withdrawn from another major bank, which recently finished the procedure of attracting a good quality strategic investor. Finally, the risks of not knowing the beneficial owners of bank shares or fraudulent takeover (raider attacks) diminished significantly since the spring of 2018, when the Single Central Securities Depository became operational. This depository aims to create an efficient pattern of keeping record of securities so as to confer safety and integrity to owners, to protect their rights and increase transparency of shareholders up until beneficial owners are exactly known, for both banks and other public interest entities (for example, insurance companies).

2. Macro-financial stabilisation

The macro-financial situation has stabilised, banks are capitalised better, and the central bank is better equipped to manage potential risks. The annual inflation rate steadily decreased and the 2018 average is estimated at about 3.5% - a level below 5% interval targeted by NBM (+/-1.5 p.p.). However, according to the forecasts, the annual inflation rate will return to the target interval in the next year, confirming the appropriateness of the current monetary policy. One of the major causes of 2018 inflation downturn was the appreciation of the national currency: on average, MDL appreciated by about 10% against USD and 5% against EUR. This appreciation resulted from growing foreign currency inflows, especially in the context of remittances increasing by over 10% and exports of goods and services by about 10%. In this context, NBM continued to actively intervene on the domestic currency market by purchasing foreign currency worth over USD 300 million in order to avoid even greater appreciation of the national currency. This strengthened the foreign exchange reserves, which reached record values exceeding USD 3 billion (exceeding short-term foreign debt, and sufficient to cover about 5 consecutive months of imports). It will allow NBM to manage more efficiently the potential currency risks that could derive from the increasing current account deficit of over 10% of GDP - the most worrying macroeconomic trends that pose some challenges for the next year. In this respect, establishment of the Financial Stability Committee at NBM is welcomed. It aims to strengthen the institutional framework in order to ensure financial stability.

3. Higher budget revenues than planned

In 2018, the state of public finance continued to improve despite the abundance of internal and external risks. During the year, revenue growth rates were double-digit, about 11-12% y-o-y. This dynamics of budget revenue allowed NPB to be executed with surplus. The successful combination of both cyclical and institutional factors gave rise to the favorable situation in public finance this year. Cyclical factors are related to economic growth, registered over the last two years, which contributed to revenue growth after a decline during the 2014-2015 economic crisis. Institutional factors are related to the peculiarities of budget planning process and to the progress achieved by the Tax and Customs Services. The budget planning factor was materialized by the fact that revenues were planned below the potential level, which should have been correlated with the anticipated economic growth rates. In fact, the current revenue collection level in 2018 returned to the long-term trend, established before the 2014-2015 crisis. However, modernisation of the control mechanisms of the Tax and Customs Services, as well as their efforts to ensure as much revenue as possible in an election year (pressure on businesses to pay taxes in advance cannot be excluded) were important contributors to budget revenue growth.

Nonetheless, the situation at the local level worsened. Revenues to the budgets of administrative-territorial units evolved at a much slower pace, reflecting poor economic and demographic situation at level of territorial communities, especially of the small rural ones. This is a worrying dynamics, notably in the context of increasing financial dependence of local public authorities on the central administration, associated with the ascending political clientelism (especially in proximity of 2019 Parliamentary and local elections).

There are imminent risks for the next year. Even if the suspension of EU budget support and financial assistance did not have major repercussions on public finance in 2018, further suspension could generate important costs next year. This is due to the forecast budget deficit growth in the electoral context of 2019.

4. The positive impact of the Deep and Comprehensive Free Trade Area between the Republic of Moldova and the EU

Despite the difficult economic and political background, DCFTA managed to produce the first tangible results and the EU strengthened its position as the main sales market for Moldova. Thus, Moldova's exports to EU increased by 22% in the first three years of DCFTA implementation. This trend also continues in 2018: during the first 10 months, exports to EU increased by 22.9% y-o-y. In addition, EU strengthened its position as the most important sales market for Moldovan exporters: the EU share in the total Moldovan exports increased from 53.3% in 2014 to 65.8% in 2017, reaching 69.5% after the first ten months of 2018.

The net effect of the DCFTA on total exports is estimated at around USD 410 million for 2015-2017. Looking at the econometric estimates and analysing the factors that influenced Moldovan exports to the EU (inertia of previous years, economic trends in the EU, domestic supply and national currency exchange rate fluctuations) and excluding the effect of the DCFTA, the exports could have been smaller by about USD 410 million. Thus, half of the increase in exports to the EU during 2015-2017 was exclusively due to the DCFTA – a noticeable effect, given that the estimation was made only four years after it was established. This undoubtedly confirms the benefits from

Despite all speculation, the agri-food sector benefited the most from the DCFTA, as exports of agri-food products increased by 44% compared with the industrial sector, the exports of which increased at a slower pace – by 11% during the first 3 years of implementation. Thus, one of the key concerns before signing the DCFTA – that trade liberalization would adversely affect the agri-food sector due to its low competitiveness – disappeared. The fears and speculations about the invasion of commodities imported from the EU vanished, as well. Thus, agri-food imports decreased by 4%, while industrial imports – by 15% in the first years of implementation. This determined the reduction of the trade balance deficit by almost 45%. Therefore, domestic products have become more competitive on the EU market during the implementation of DCFTA: (for more details: <https://www.expert-grup.org/en/biblioteca/item/1687-impactul-economic-dupa-4-ani-de-implementare-a-acordului-de-asociere-rm-ue/1687-impactul-economic-dupa-4-ani-de-implementare-a-acordului-de-asociere->

In addition to boosting exports, DCFTA also had deeper macroeconomic implications, driving economic growth, budget revenue, imports, investments and employment. DCFTA's contribution to increasing the exports to EU – estimated at around USD 410 million in 2015-2017, resulted in a 7-percent increase in the Gross Domestic Product (by USD 1.5 billion), a 11-percent increase in fixed capital investments (by USD 360 million), a 5-percent increase in budget revenue (by USD 400 million) and to an increase in employment by 15 thousand people (for more details: <https://www.expert-grup.org/en/biblioteca/item/1687-impactul-economic-dupa-4-ani-de-implementare-a-acordului-de-asociere-rm-ue/1687-impactul-economic-dupa-4-ani-de-implementare-a-acordului-de-asociere-rm-ue>).

5. Relaunching, though moderate, of private investments

After a few years of stagnation, the investment process warmed up a little in 2018. During Jan-Sep:18, private investments grew by 6.6% y-o-y, after dropping by 24.4% in 2017 versus 2013. The decline of that time was driven by the financial crisis and by the low business confidence. In 2018, thanks to greater domestic demand, also determined by the explosive increase in public investments (+30.2% in 2017 and 83% y-o-y in Jan-Sep:2018) the businesses' turnover increased which, in its turn, led to more private investments. Thus, while in 2017 the turnover increased in real terms by 3.7%, in 2018 – there were signs that indicate the prolongation of this positive trend: in Jan-Oct:18, the turnover from domestic trade of goods and services increased by 5.3% y-o-y. The dynamics of the investment process highlights two aspects. First, after a long period of shrinking, the growth rate of private investment from 2018 is unsatisfactorily low. The recovery could take some years (the 2013 level can be reached only if in the next three years private investment will increase by 7-8% per year). The second aspect refers to the high level of uncertainty related to private sector investment dynamics. The 2019 year will be marked by the implementation of tax reform: the lower social contributions will be paid by employers and as result investment should increase. Nonetheless, there's no way for the tax reform to tackle the fundamental issues that affect investments, such as corruption or inefficient justice. Along with political uncertainty generated by the election process, these factors will constrain investment activity.

Top 5 Negative Trends of 2018

1. Weakening of the anti-money laundering framework

On 27 July 2018, the Parliament passed the Law on Voluntary Compliance and Tax Incentives (capital amnesty). This law provides that any citizen of the Republic of Moldova who hides or undervalues his/her assets (money, real estate, securities, shares, vehicles both in the country and abroad) can legalize them against a fee. This tax was initially set at 3% of the amount of legalized capital, but was later increased to 6% following the Parliament meeting of 8 November 2018. We must mention that the law was passed in spite of criticism from the civil society and development partners. Such criticism led to the cancellation of a similar initiative in December 2016. This time, however, the law was passed much more insistently and in a hurry. Thus, no ex-ante impact analysis was carried out, no de facto public consultations were held on this matter. The law was passed at record speeds (the draft law was registered with the Parliament on 24 July and passed on 27 July 2018, automatically in both readings).

Capital amnesty is inconsistent with anti-money laundering objectives and puts at risk the recently initiated reforms in this area. Taking into account that the Republic of Moldova has recently been the victim of at least two large-scale frauds (the 'stolen billion' from the banks and the 'laundromat' – the laundering of about USD 22 billion through local banks), the risk is that the capital amnesty will legalize the crimes committed recently and will compromise investigations into these matters. This risk is even greater given that the Law on Combating Money Laundering and the Financing of Terrorism was adopted relatively recently (December 2017) and, thus, not enough time has passed to ensure its good implementation (e.g. the institutional framework is under development, and banks are still adapting to the new anti-money laundering requirements). What is more, the 'capital amnesty' law gives very little time for legalization applications to be submitted (only 1-2 months, depending on the type of asset) and, therefore, banks and other relevant institutions might not have enough time to fully implement the anti-money laundering law (e.g. verifying the origin of money or integrity of beneficiaries). Another problem is that the legalization fee remains very small (despite its increase from 3% to 6%), given that the individuals income tax is twice as high (12%). This suggests clear discrimination of those who comply compared to those who have not complied not only in terms of legal liability, but also in terms of financial effort, this capital amnesty being one of the most generous in the world. Finally, the capital amnesty applied in a country with such a high perception of corruption (ranked 122 out of 180 states, according to Transparency International's 2017 Corruption Perceptions Index) could further encourage corruption because it creates an environment favourable for those who benefit from corruption.

The law that allows the acquisition of Moldovan citizenship against investments aggravates the risks of money laundering, especially if analyzed „in package” with the capital amnesty. On 31 May 2018, the Parliament made several amendments to the Citizenship Law that became effective on 10 October 2018. The amendments were meant to supplement the provisions passed in 2017 regarding the conditions for obtaining Moldovan citizenship by foreign citizens. Thus, for an investment of EUR 250,000 in the real estate sector or in state securities or for a non-reimbursable contribution of EUR 100,000 to the state budget, any foreign citizen can acquire the Moldovan citizenship. Thus, the law amended in 2018 allows giving citizenship on the basis of a maximum of 5000 applications (there may also be multi-member families per application), although it initially provided for 5000 people. Moldovan citizenship can be acquired without the applicant having to give up his/her existing citizenship (although the law initially provided that the applicants had to renounce their original citizenship) and the first and last names of the applicants will not be made public (although the ordinary procedure stipulates that the first and last names of the people who acquire Moldovan citizenship are to be published in the Official Gazette). On the whole, this law prepared the possibilities for individuals from other countries to easily get the Moldovan citizenship and use it to legalize and launder the illegally-gained proceeds, because they will be able to benefit from the above-mentioned capital amnesty. This risk is further aggravated by the quite permissive conditions for acquiring Moldovan citizenship under the law: little time for application review (30 days, while it can take several years in other countries that apply similar tools), no mechanisms to monitor the investments made after citizenship acquisition, and the investment areas (real estate and state securities) do not necessarily involve considerable efforts in terms of job creation or added value (on the contrary – they can encourage speculative investments that can have a negative impact on macrofinancial stability).

These developments have further worsened the relationship of the Government with development partners. The European Union, the World Bank and the International Monetary Fund have repeatedly expressed their reserve about the above-mentioned measures, as they contravene the provisions of the Association Agreement, interfere with the fight against corruption, the financial sector reforms and, in general, with good governance practices. Thus, the respective package of laws pulled Moldova farther away from the possibility to receive budget support and financial assistance from the EU, which were suspended in 2018.

2. More widespread informal employment

In 2018, the rise in informal employment took momentum and beat the historic anti-record. During this year, the share of informal employment in the national economy increased to its highest level since 2003, when it began to be measured. By the end of the current year, the share of informal employment could reach the level of 38-40% of the total employed population, while the maximum level recorded in 2003 was 38%. In fact, the dynamics of employment in the national economy in recent years has been entirely dependent on the creation of informal jobs, predominantly in the agricultural sector practiced by households. These trends are indicative of the fact that the structural changes in the national economy failed. They are turning into big challenges for sustainable development and economic convergence with the countries of the region. Also this year there were adopted policies aiming to reduce informal employment, but having mostly fiscal character. In particular, one single income tax rate was introduced and employers' share in social contributions was reduced. These measures could help, to some extent, reduce informal employment in existing companies, but won't help those practicing subsistence farming. Exactly this category of informal employees has steadily grown over the recent years. In order to switch them to formal jobs, there are needed additional efforts to boost investment in non-agricultural sectors and to implement deeper structural reforms.

3. Reducing the role of the banking sector in financing the economy

During 2018, the banking sector continued to downgrade its presence in terms of financing the national economy.

Although the lending activity increased somewhat, it is more a recovery trend, far below the economic growth of the recent years. The share of bank loans to GDP fell to 22% in Q3:18, i.e. shrinking at least by 10 pp compared to the period before the 2014-2015 crisis. Nevertheless, banks remain profitable, which further indicates a large margin used in lending activity and some circumstantial revenues raised following the implementation of the monetary policy (in 2018, about 30% of banks' interest income was obtained on the basis of mandatory reserves, overnight deposits or NBM certificates issued for liquidity absorption purposes). This business model adopted by most banks highlights a series of constraints regarding the lending process. With regard to loans supply, the enhanced level of regulation and supervision in the context of Basel III, seems to hold banks back from taking the credit risk. At the same time, there is a tendency to direct loans to less risky sectors of economy but with a modest impact on the productive capacity of the economy (e.g. consumption loans or the state-guaranteed real estate loans). More than that, the Government remains the most preferred customer as procuring Government securities is a stable and low-risk operation. On the other hand, the demand for loans from solvable companies remains low, as evidenced by the anaemic investment activity of private operators. The high level of uncertainty over the political and economic prospects translates into preponderant investments for replacing depreciated capital from own resources and the postponement of large projects that would require borrowed funds from banks, respectively.

Animated by the banks' situation and by a low level of regulation, non-bank financing sky-rocketed. The most recent statistics showed that during a very short period of time, non-banking credit organisations practically doubled their share on the lending market even if the terms of loans are, often, draconian (effective interest rates exceed 25% per year in most cases). This process caused a change in the national saving-investment mechanism, entailing potentially negative effects though. Thus, the temporary free capital in the economy seeks higher returns than the bank deposits could offer at present, which leads to its migration to sectors lacking a protection/guarantee scheme. On the other hand, in the intermediation process, these resources are directed towards higher risk categories of clients than banks. Even though non-banking credit organisations contribute to expanding access to finance for some non-bank customers, the operational gaps such as poor governance, low supervision or attraction of camouflaged deposits from individuals, can lead to an accumulation of excessive risks in this sector. What is more, the lack of complete information on the chain of customers' indebtedness can amplify the degree of household debtors' over-indebtedness, with a potential negative adjustment of final consumption over time.

4. Perpetuating the issue of limited access of crops to external markets

Although Moldovan fruit exports increased this year, farmers face a major crisis, as their export potential is much higher. Fruit exports to CIS countries saw some increase, but export prices on these markets are off-putting, as they continue to drop, and the subjective nature of exports, as only some Moldovan companies are allowed to export to the Russian market makes this market less and less attractive. Still, we must be aware that the prospects of increasing exports to this destination could be further reduced because of Russia's policy to substitute fruit imports and to plant, instead, new orchards (especially apples and plums orchards).

Although the export of fruits to the EU increased recently, the quantities directed to this market are still quite small. It is worth mentioning that exports of the main categories of fruits (apples, grapes, plums) to the EU, under preferential conditions, are quantitatively limited by quotas, but only two categories (plums and grapes) were fully used beginning with the first year of DCFTA implementation. In spite of this fact, so far, the quotas have not been increased due to the new realities brought about by several objective factors (restrictions of the Russian Federation, surplus production, etc.). At the same time, the quota for apples has been used to a very little degree. Such an evolution could be explained by the occurrence of their surplus on the EU domestic market with the application of restrictions by the Russian Federation for imports from the EU, but also by the assortment and conditions provided by national producers.

The desire to find new sales markets is not enough if there are no clear visions regarding the development of the horticulture sector. Although ideas about potential markets for Moldovan fruits (such as Canada, India, China, Egypt, Israel, Indonesia, etc.) have been regularly brought up of late, these ideas never went beyond discussion level and actual measures to export to these markets were not taken. The collaboration of producers' organisations with the state authorities is not good – there are issues in identifying and supporting the harvesting of performing varieties for which there is a high demand on foreign markets and in promoting public-private partnerships and encouraging cooperation in agriculture (storage, processing, export, etc.).

5. Agriculture stagnation

In 2018, the growth in agriculture went back again to a moderate speed. In Jan-Aug:18 the amount of precipitation decreased by 19.3% y-o-y, which affected several crops. As a consequence, in Jan-Sep:18 the crops production decreased by 0.2% y-o-y. At the same time, the livestock sector increased marginally by only 1% y-o-y. The decrease in the crop production sector caused a stagnation of agricultural production (+0.2% y-o-y during Jan-Sep:18) and decrease of gross value added (-0.2% y-o-y during Jan-Sep:18). We do not anticipate the overall trend to change by the end of the year, although we forecast that the Gross Value Added (GVA) achieved in the agricultural sector could increase by 0.6% in 2018, which would be a negligible contribution to economic growth (by only +0.08 pp).

In general, agriculture continues to struggle with profound structural problems (undercapitalisation and low technologisation), being highly dependent on climate shocks that are more and more frequent. Because of the bad weather, this sector is either shrinking or stagnating every three years. Negative developments were recorded in 2012 (-22.3%), in 2015 (-13.4%) and in 2018. The increases in 2013 and 2016 – by 39.1% and by 18.6%, respectively – were due to the recovery effect and to the low basis of comparison recorded in 2012 and 2015 when the sector shrank. At the same time, the frequent repetition of the situation when agriculture pulls the economic outcome down is indicate the weakness of other economic sectors that develop relatively slowly. This allows agriculture to maintain a high influence on the economy, despite the structural problems it faces. Thus, over the last 10 years, the share of agriculture in GVA varied insignificantly (between 14-16%).

Top 5 Economic Challenges in 2019

1. Finalizing the Moldova-IMF Agreement

The Agreement on monitoring of the economic and financial program supported by the IMF will end in 2019. Launched at the end of 2016, this Agreement is still the main anchor of the Government, both in terms of commitments to strengthen economic and financial stability, and in terms of dialogue with external partners. So far, the reform actions have not deviated significantly from the agreed program, which was confirmed by the positive assessments of the evaluation missions and by the permanent disbursements. Thus, the rehabilitation of the banking system, the stability of public finances or maintenance of a low price growth rate are the most frequently mentioned achievements. However, several arrears have accumulated at the same time, which could lead to new risks. These relate to the perpetuation of some structural impediments that hinder stronger and longer-lasting economic growth that would have, otherwise, higher impact on standards of the quality of life. Also, the achieved objectives are not yet fully irreversible, which leads to the emergence of new risks, among which the weaker role of the banking system in financing the economy, the deterioration of the competitive environment or the instability of the energy sector taking into account that transparency and governance are not fully insured.

The fact that the agreement with the IMF comes to an end is even more unsettling as the Government has manifested the desire to move beyond the assumed commitments. Thus, even if any reform that impacts the economic and financial environment was supposed to be coordinated with Fund representatives, the Government has voted a series of initiatives that could undermine banks' ability to prevent accepting money coming from suspicious sources. The most eloquent example is still the 'capital amnesty', which fits neither into the logic of the development of the financial system, nor in the context of the implementation of the new legislation preventing and combating money laundering. As a result, the ending of the IMF Agreement and, implicitly, the policy monitoring, is regarded as one of the key challenges and concerns for the coming year. The experience of 2012-2015 makes one believe that a situation in which there's no agreement with the IMF, coupled with a political crisis, is a dangerous combination for the country's economy and security, as the upcoming period is not expected to be different considering that a few months from now parliamentary elections will be held, while the recovery of the stolen money does not advance.

2. Maintaining the stability of public finances in an election year

The positive dynamics of public finance this year could be temporary, as several risks are expected in 2019. The Government weakened its financial position for the next year because of the tax policy changes and the new budgetary commitments it undertook. In 2018, the Government adopted a package of tax and institutional reforms with a negative impact on short-term revenues (even if net impact is positive in the medium and long term), assuming new expenditure obligations with immediate effect. They will not have a major negative impact in 2018, but the situation could be different in 2019. The worsening fiscal imbalances, on the backdrop of less foreign assistance, could increase the level of indebtedness of the state. The fears of not getting foreign assistance came true, and the failure to raise the planned tax and fees revenues will result in the government borrowing additional funds from the domestic market, or even in the possibility to increase taxes (including VAT). Our projections show that in 2019 the budget deficit will be between MDL 3,200 million (1.5% of GDP in an optimistic scenario) and MDL 6,300 million (3% of GDP in a pessimistic scenario). What is more, political objectives could cause essential corrections to this model, with a deficit over 4.0-5.0% of GDP being possible (for more details, go to: <https://www.expert-grup.org/en/biblioteca/item/1714-mega-editia-a-xix-a-economia-in-centuri-de-siguranta-urmeaza-un-an-electoral/1714-mega-editia-a-xix-a-economia-in-centuri-de-siguranta-urmeaza-un-an-electoral?category=178>).

3. Continuation of the public procurement electronic system implementation

Significant steps were made over the recent years to implement an electronic procurement system, but its future is uncertain. In 2017, the Republic of Moldova began the implementation of the electronic public procurement system, with support from the European Bank for Reconstruction and Development. Since 2018, all contracting authorities had to use this system, entitled MTender. Among its key advantages can be mentioned maximum transparency for all stakeholders involved in procurement, flexibility for the business environment and existence of analytical and record-keeping tools for controlling authorities. However, there are risks that the reform will not go forward. The key risks have to do with the reluctance of several contracting authorities to use MTender due to some technical deficiencies and legal loopholes. The contracting authorities' unwillingness might be taken as a reason by certain interest groups to promote the idea of giving up the MTender system. In order to solve the problems that came up during the implementation phase, it is imperative that the responsible authorities (Ministry of Finance and Public Procurement Agency) together with the accredited platforms, increase the efforts meant to solve technical issues, but also provide technical assistance to contracting authorities. Also, in order to facilitate the implementation of the electronic system, it is necessary to adjust the existing regulatory framework in the field of procurement to the requirements of MTender as soon as possible.

4. Initiation of Nistru Hydropower Complex Expansion by Ukraine

On 12 November 2018, the Ukrainian Embassy in Chisinau informed the Government of the Republic of Moldova about the intention of the Ukrainian company, Ukrhydroenergo, to build three turbines at the Nistru Hydropower Complex. To gain a better understanding of the risks of this project, it is enough to analyse the developments of the 1980s when the Soviet Union decided to tap into the energy potential of the Nistru River. The Nistru Hydropower Complex was built for this purpose. It consists of Hydropower Plant No 1, the dam and the Naslavcea buffer lake, Hydropower Plant No 2, an artificial reservoir and a water storage hydropower plant. The impact study developed at the time of complex design revealed the catastrophic consequences of the operation of this energy complex. Also, in the first phase, after the dam was put into operation, the flow rate of the Nistru River dropped so that the water inflows in Chisinau and Odessa went below critical line. As a result, ecologists insisted back then to stop the project, and the project was thus forestalled. Over the recent years, several environmental organisations drew attention to the disastrous consequences that the new expansion of the Hydropower Complex could have. The gravest consequence to be expected is the degradation and destruction of the ecosystem in the lower Nistru River. There is also a real risk that around 8 million people (from the Republic of Moldova and Ukraine) living in the Nistru River basin will be left without their main source of water (however, the Moldovan population is much more exposed to this risk because it doesn't have water sources other than those of the Nistru River basin). This is accompanied by huge economic losses, as the costs of water used for production will increase significantly. The lack of a strong position of the Moldovan Government in this respect, along with the insistence of Ukrainian authorities, creates an imminent risk for the country's security. Its management will have to be an urgent priority of the new Government.

5. Negotiation of the Free Trade Agreement between the Republic of Moldova and China

During 2018, there were several rounds of negotiations on a Free Trade Agreement between the Republic of Moldova and the People's Republic of China. Thus, according to Ministry of Economy and Infrastructure (MoEI), this agreement will strengthen the trade and economic relations between both countries, will facilitate the access of Moldovan products to the Chinese market, and will also attract investments in the country's main economic sectors. Moreover, according to MoEI estimates, exports of Moldova to China could increase by 39.85% and the GDP could increase by 0.42% (without indicating the period). However, this initiative is taking place in a context where, in 2017, our country's imports from China were 27 times higher than the exports to this destination (USD 505 million vs. USD 19 million), and the trade balance with this country has been worsening continuously over the last few years. It is worth mentioning that one single product (wines) amounts to about 92% of total Moldovan exports to China. In these circumstances, usefulness of this agreement becomes even more ambiguous, given that China's tariff policy is already quite liberal for many products that could be of some interest to the Republic of Moldova. Currently, both rationale that underpinned this initiative and negotiation process itself remain unknown. Thus, the optimistic scenarios presented by the MoEI and the forecasts of higher exports and economic growth are not supported by any empirical calculations (at least such calculations were not made public), and the negotiation of the agreement is rather faulty. In this context, the major challenge for the authorities stems from the economic justification of the need for this agreement and the objective quantification of its impact on the national economy, while ensuring the transparency of the negotiation processes.

Statistical Annexes

Table 1. Key Monthly Indicators

Indicator	Dec:17	Jan:18	Feb:18	Mar:18	Apr:18	May:18	Jun:18	Jul:18	Aug:18	Sep:18	Oct:18	Nov:18	Dec:18
Industrial production, y-o-y growth, %	-3	4.2	4.1	10	12.5	10	10.3	1.7	6.4	-3.1	-4.9	n.a.	n.a.
Retail trade, y-o-y growth, %	-10.9	9.1	6.5	3.4	12	5.7	3.9	11.1	6.9	9.8	7.1	n.a.	n.a.
Services provided to the population, y-o-y growth, %	4.6	6.6	10.7	4.3	13.3	12.5	12	7.6	10.7	18.8	16.9	n.a.	n.a.
Export of goods, y-o-y growth, %	120.5	157.9	122.1	114.2	129.6	127.6	125.2	114.2	105.2	92.6	96.5	n.a.	n.a.
Import of goods, y-o-y growth, %	120.4	140.3	128.5	121.6	123.0	126.2	118.0	123.1	112.7	110.0	116.0	n.a.	n.a.
Official reserve assets, USD million	2,803.3	2,903.5	2,841.2	2,875.2	2,869.3	2,846.5	2,899.8	2,970.4	2,963.2	3,021.2	3,011.3	3,014.6	n.a.
Budget revenue, y-o-y growth, %*	16.2	16.8	12.8	10.8	11.1	12.1	11.5	12.5	11.3	11.0	11.1	10.7	n.a.
CPI, y-o-y growth, %	7.3	6.0	5.0	4.7	3.7	2.8	3.2	3.0	3.2	2.4	1.2	0.9	n.a.
IPPI, y-o-y growth, %	2.3	1.9	1.7	1.0	1.0	0.3	0.2	-0.1	-0.4	-0.2	-0.3	-0.4	n.a.
Nominal exchange rate MDL/USD (e-o-p)	17.10	16.72	16.69	16.47	16.53	16.85	16.84	16.58	16.71	16.86	17.13	17.23	n.a.
Money transferred from abroad, y-o-y growth, %	13.0	26.1	18.5	12.1	14.6	19.9	8.5	10.1	-3.7	-10.7	-4.5	n.a.	n.a.
Monetary aggregate M2, y-o-y growth, %	14.2	14.1	14.5	14.1	13.0	13.6	13.1	11.9	12.3	13.5	11.8	12.0	n.a.
NBM base interest rate, %	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	n.a.
Bank deposits interest rate, %	5.19	5.17	4.54	4.66	4.46	4.20	4.58	4.44	4.19	4.51	4.59	4.45	n.a.
Bank loans interest rate, %	9.58	9.80	9.47	9.35	9.00	8.63	8.72	8.67	8.45	8.50	8.52	8.45	n.a.
Share of non-performing loans in total loans, %	18.4	18.3	16.6	16.2	15.6	15.2	14.7	14.4	14.2	13.5	13.3	13.4	n.a.

Source: NBS, NBM, EG estimates

Table 2. Main quarterly indicators

Indicator	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18	T2:18	T3:18
Real GDP growth rate, y-o-y*, %	2.0	6.7	7.0	3.2	2.6	5.3	6.4	3.7	5.2	3.4
Agricultural production, y-o-y growth, %*	4.1	18.9	18.8	1.1	-5	3.7	9.1	1	7.2	0.2
Construction work, y-o-y growth, %*	-13.3	-9.6	-8.4	1.7	2.7	2.1	2.3	-1.7	4.2	15.6
Investments in long-term tangible assets, y-o-y growth, %*	-21	-17.6	-13.9	-1.2	2.5	2.4	1.3	2.9	7.4	13.5
Net inflow of FDI, USD million USD	-11.7	64.61	-7.18	39.71	35.12	70.82	4.13	99.83	24.82	n.a.
Real salary, y-o-y growth, %	0.4	5.2	10.5	6.8	5.8	3.5	4.7	7.7	9.5	8.9
Unemployment rate, %	6.2	4.0	2.9	3.8	6.3	3.5	3.4	3.3	3.0	2.2
Employment rate, %	37.6	43.8	43.5	38.5	37.7	42.6	42.4	39.2	45.0	46.2

Note: * – cumulative; (e) – estimate;

Source: NBS, NBM, EG estimates