

Economic vulnerability Index of the Republic of Moldova

December, 2024

The index was developed based on the findings of the report “Assessing Macroeconomic Trends and Prospects of the Republic of Moldova”, elaborated by the Independent Analytical Center “Expert-Grup”, with the support of CASE (Poland), funded by OSF.

The index provides a structured assessment of the key sources of vulnerability of the Moldovan economy, which are assessed on a scale from 1 (minimum vulnerability) to 5 (maximum vulnerability), based on the collective expert judgement at Expert-Grup. Each identified vulnerability source is assessed taking into account the most important mitigating factors, which are also assessed on a scale from 1 to 5 based on collective expert judgement. Unlike the vulnerability sources, the scores for mitigating factors face a “plus” sign, because they are supposed to compensate fully or partially the negative vulnerability sources with positive mitigating factors. The difference between both scores equals the residual vulnerability: the vulnerability that remains after taking into account the mitigating factors. In most cases, the residual vulnerability has a negative sign because the vulnerability sources are stronger compared to mitigating factors, requiring an urgent policy response from the Government.

Vulnerability	Score (1-5)	Mitigating factor(s)	Score (1-5)	Residual vulnerability	Score (1-5)
<u>Strong dependence on imported energy</u> Moldova is almost fully dependent on imported natural gas and 2/3 dependent on imported electricity.	-5	On the gas market, given the increase in prices after the beginning of the war, and insufficient supply from Russia starting from the fall of 2022, Moldova had to purchase gas on the international markets. At the same time, after the Russian attacks on Ukraine's energy infrastructure, Moldova found itself unable to import electricity from Ukraine. It had to purchase electricity from the EU which had major implications for domestic tariffs. Moreover, only the synchronization in record time in March 2022 of the Ukrainian and Moldovan energy systems with the	+2	Energy dependence remains a critical vulnerability of the Moldovan economy, with major social, economic and geopolitical implications. Since Moldova has limited energy resources, it can meet only a fraction (less than 16%) of the total demand from domestic sources and is highly dependent on imported energy such as oil and gas. Obsolete infrastructure and low energy efficiency of the residential, governmental and commercial sectors harm energy intensity, cause a high rate of energy poverty and a negative impact on economic performance.	-3

		European energy system (ENTSO-E) allowed to avoid electricity blackouts. Also, Moldova is committed to invest more in energy efficiency and renewable energy, which reached the share of 20% of domestic consumption of electricity in January 2025.			
<u>Eroding economic growth potential</u> While in the period 2004-2013, average economic growth amounted to 4.6% per year, in the period 2014-2023 average annual growth slowed down to only 2.2%. GDP is projected to grow at around 2.5-3.5% in 2024-2025. This is not enough to ensure convergence to other countries in Eastern and Central Europe. The economic growth model is running out of steam, given emigration of working age population and limited investments.	-4	- In 2024, the Government approved the National Strategy for Economic Development 2030. - The economic growth, despite its deceleration, will remain positive as projected for the next few years.	+1	The transition to the new growth model that would be based on higher value added and efficiency is uncertain, as the National Strategy for Economic Development 2030 was approved only in 2024. It remains to be seen to which extent this Strategy will transpose into concrete policies and programs with tangible impact for the economy. In the meantime, the economic growth prospects suggest that the GDP growth of Moldova will continue to slowdown.	-3
<u>Budgetary imbalances</u> In 2023, the budgetary deficit exceeded 5% of GDP, as a result of increasing pressures on the public spending in order to mitigate the social consequences of the inflationary crisis of 2022. In 2024 it remained high, being estimated at over 4% of GDP and is set to remain at around 4% of GDP in 2025.	-4	The Government is committed to improve the fiscal and budgetary discipline, and reduce the budgetary deficit as a share of GDP in the upcoming years.	+1	- Growing pressures on the system of public finances, because of slowing economic growth coupled with high economic informality, persisting social problems, population ageing and infrastructure bottlenecks. - Public revenues are largely based on indirect taxes. This set-up in tax collection makes the country more vulnerable to external shocks, with indirect taxes having higher volatility.	-3
<u>High current account deficit in the context of small and open economy</u>	-4	The role of services in Moldova's external trade is growing, with services accounting for 41.6% of total	+1	The trade in goods deficit has been around 30% as a ratio to GDP during the last 10 years (29.5% in 2023) with	-3

Moldova is a small open economy, with the ratio of external trade in goods and services to GDP oscillating around 90% in the last decade (95% in 2023), which makes it particularly vulnerable to economic and political shocks and fluctuations. Since its independence, Moldova has always recorded current account deficits (-12% to GDP in 2023). The start of war in Ukraine in 2022 triggered a worsening of Moldova's current account, driven primarily by terms of trade shocks.		exports of goods and services, and 15.7% of total imports (2023). Moldova is a net exporter of services and the services surplus has increased from 1.1% of GDP in 2009 to 5.4% in 2023. The increase in services exports recorded in 2022 was mainly connected with travel services, the exports of which grew because of a large inflow of Ukrainian refugees. However, the main driver of services exports growth over the last years was the IT sector.		no significant improvements. Exports of goods averaged at approximately 20% as a share of GDP (20.7% in 2023), and imports of goods – around 50% (50.3% in 2023). The growth in both exports and imports in 2022 was primarily driven by re-exports (mostly mineral fuels re-exported to Ukraine). The growth in imports of goods was also caused by a substantial hike in prices, particularly for fuels and fertilizers (overall, import prices went up by 18% on average, while export prices grew by 12% as of 2021).	
<u>Decline in FDI stock as a share of GDP</u> The accumulated stock of FDI as a ratio to GDP is slowly going down (from 47.1% in 2009 to 33.5% in 2023), because of a faster growth in GDP. The growth in FDI stock was slower, given high security risks, uncertainty and complicated business environment.	-3	There is some positive dynamics in FDI inflows despite numerous shocks and constraints over the last years (the FDI stock in USD at the end of 2023 was 2.2 times larger than at the end of 2009).	+1	Moldova continues to lose the competition for FDIs with other countries in the Central and Eastern Europe.	-2
<u>Trade dependence on Ukraine, Belarus and Russia, which causes trade disruptions because of the war in Ukraine</u> In 2021, the share of Moldova's imports from Russia, Ukraine and Belarus cumulatively amounted to 26%. Moreover, a significant part of Moldova's imports from other countries went via the port of Odesa. With the lack of access to this logistical hub, many importers were forced to change import routes, which led to a substantial increase in logistical and transportation costs, which eventually translated into higher prices for consumers. In 2021 Moldova's	-4	Moldova becomes more anchored into the EU market. The share of Moldova's exports of goods to EU increased from 61% in 2021 to 68% in 2024 (January-November).	+2	Trade disruptions still have an important dent on the overall trade performance, fueling logistical costs, disrupting the logistical chains and hurting the national economy in general.	-2

cumulative exports to Russia, Ukraine and Belarus amounted to 13.9%. Even though trade relations with Ukraine have intensified since the outbreak of the war, Moldova has lost part of its exports to Russia and Belarus.					
<u>High reliance on remittances, which are declining</u> If personal remittances received from abroad by Moldovan residents reached 34% of GDP in 2007, then in 2023 they only amounted to 12%. Before 2022, this dynamic was caused by a more rapid pace of GDP growth, as remittances increased in USD nominal terms between 2017 and 2021. In 2022 and 2023, remittances decreased both in relative and absolute terms.	-3	- High adequacy of central bank reserves, which helps maintaining country's financial stability when remittances decrease. This is the reason why the drop in remittances in 2022 and 2023 did not translate into currency depreciation. - Geographical reorientation of remittances from Russia to EU. After a sharp depreciation of the Russian ruble in 2015, remittances from Russia halved and never rebounded. At the same time, the granting of the visa-free regime by the EU to Moldovan nationals in 2014 facilitated labour migration to the EU. These factors combined induced a shift in the geographic patterns of remittances. Today, the EU accounts for more than half (58% in 2023) of remittances received by Moldova.	+2	Moldova's exposure to remittances remains high, which could pose important pressure on the economic growth and balance of payments given their volatility and declining trend.	-1
<u>Increasing public indebtedness and raising costs of servicing the state debt</u> In 2023, the public debt-to-GDP ratio amounted to 35.9%, up from 27.9% in 2019, as a result of shocks and crises during 2020-2023. As a result, the debt servicing costs relative to state budget revenues reached 8.9%, while in previous	-3	- Moldova's public debt has always been within sustainable range, even in times of various internal and external shocks. In fact, Moldova remains one of the least indebted countries in the region. - The increase in debt-to-GDP ratio was primarily on the account of external debt, which implies lower	+2	- Public debt is increasing primarily on the account of social public expenditures rather than investments, which raises concerns about the sustainability of this trend. - The exchange rate risk is fueled by increasing stock of external public debt.	-1

years this indicator was at the level of 4-5%.		interest rate and higher maturity compared to domestic debt.		- The domestic state debt is problematic because of high costs for servicing it and short maturities. - Increasing public indebtedness can limited the access to concessional loans and fuel the costs for servicing the external debt.	
<u>Rapid growth of micro-lending activity of the non-bank credit organizations, exposing the population and firms to high interest rates and over-indebtedness</u> Micro-lending grew from around 2% of consumer lending in 2010 to approximately 30% ten years later. The NBCOs have taken advantage of a lighter regulatory touch to pursue more aggressive strategies, with many NBCOs having far less capital or assets than banks which do comparable lending. The relative profitability of these organizations also has attracted more resources into the industry, which then led to more credit being extended.	-3	- Introduction into the Moldovan legislation of the principle of responsible lending and fixing maximum interest rate thresholds.	+2	These intermediation services do not come without consequences. NBCOs provide financing at much higher costs than banks do (the estimated interest rate is double that of banks), exacerbating problems of consumer indebtedness. Another challenge is the enforcement of responsible lending regulation in the sector of NBCOs, which, coupled with low financial literacy of the population, fuel the risk of over-indebtedness.	-1
<u>High reliance on indirect taxes</u> Over 2/3 of budgetary revenues come from indirect taxes (primarily, VAT), which tend to be more volatile compared to direct taxes. Hence, any volatility in imports, exchange rate or consumption patterns directly impact the budgetary revenues.	-2	- Public debt remains within sustainable level and is projected to decline in the upcoming years. - In times of crisis, the external budgetary support can be an important and sometimes a critical stabilizing factors for public finances.	+1	Budgetary revenues remain volatile because of this structural peculiarity, which undermine the medium- and long-term budgetary planning.	-1
<u>Inflation risks as a result of high dependence on imports of energy and consumer products</u>	-3	- In the absence of internal and external shocks, the NBM was successful in the implementation of	+2	Although, the identified vulnerability is well mitigated by the monetary authority, it tends to have major social	-1

Usually, the NBM has been successful in taming inflation pressures and keeping it aligned to its target of 5% (+/- 1.5 p.p.). However, in case of import price shocks (e.g. energy crisis of 2022), the NBM instruments can be used only to mitigate secondary effects of inflationary spike, which can bring inflation well-above the target in a very short period of time.		the monetary policy strategy adopted in 2012 with the inflation target. - NBM has the necessary capacities and instruments to ensure a proper anti-inflationary monetary policy. - NBM enjoys a relatively high degree of independence which helps it manage inflationary pressures. - NBM is well-capitalized.		costs. With about 1/3 of the population being below poverty line and over 40% of consumption being represented by foodstuff and non-alcoholic beverages (15% average in EU), the Moldovan population is highly exposed to any inflation spikes.	
<u>Maturity mismatch between banks' assets and liabilities</u> Banks overwhelmingly attract short term-resources (about 76% of total new deposits attracted in 2023 were with a maturity of up to one year), limiting bank capacity to grant long-term loans (in 2023 only 7% of the volume of credits granted to businesses had a maturity of 5 years or over).	-2	Banking sector is well capitalized and highly liquid. In the last decade, the increase in the stock of credit was surpassed by the increase in stock of deposits, thus the ratio between loans and deposits decreased from 0.81 in 2013 to 0.56 in 2023, pointing on the one hand to low credit penetration, and, on the other hand, to high liquidity.	+2	The vulnerability is fully addressed. There are no major risks for banking sector stability. Still, the price for this stability is the low credit penetration in the economy, which undermines a more rapid economic growth.	0