

■ Key messages of the publication

Transnistrian Economic Reality is a periodical publication that identifies the most important economic and political developments in the eastern districts of the Republic of Moldova. Its readers are policymakers, CEOs of domestic and international companies and commercial banks, representatives of the international institutions and foreign embassies, political parties and economic journalists working on both sides of the Dniester River.

List of acronyms and abbreviations

y-o-y – year on year; q-o-q – quarter on quarter; m-o-m – month on month; e-o-p – end of period; p.p. – percentage points; Q4:22 – fourth quarter 2022; Jan:22 – January 2022.

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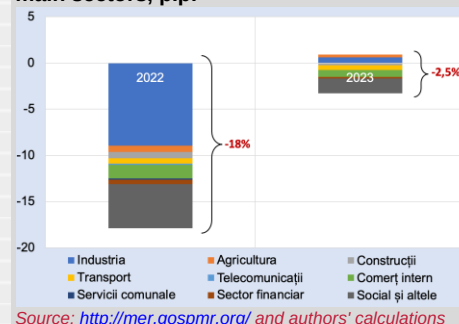
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Contacts:

Republic of Moldova, Chisinau municipality
45 Bernardazzi Street, MD-2005
Phone : +373 22929994
E-mail: info@expert-grup.org

The Transnistrian economy is expected to shrink by about 18% in 2022 and by about 2.5% in 2023. The decline is expected to be caused mainly by a reduction of about one third in the volume of industrial production, which accounts for about 30% of the region's economy, against the background of the temporary reduction of natural gas supplies from Gazprom and the temporary suspension of electricity supplies to the right bank, as well as a reduction in the activity of other major industrial enterprises.

Figure 1. GDP forecast and contribution of main sectors, p.p.



Another major economic and social challenge for the region is the reduced propensity to consume and invest against the background of the war in Ukraine, the energy crisis and negative economic dynamics on the right bank and in neighbouring countries. Domestic trade and HoReCa activity in the region, which indirectly measures the population's propensity to consume, is set to shrink by at least 10% against the background of heightened uncertainty, reduced employment rate and falling population's income. Thus, in 2022, the real average wage in the region is expected to fall by about 3-5%, the number of employees - by about 11 thousand people, and the labour demand of the real sector - by about 1000 people. Firms' investment appetite is very low, with the volume of investments in fixed capital expected to fall by around 35% in 2022. This in turn will exacerbate the problem of the low competitiveness of the region's economy, which relies on the low cost of gas and electricity, and undermine economic growth in the medium to long term.

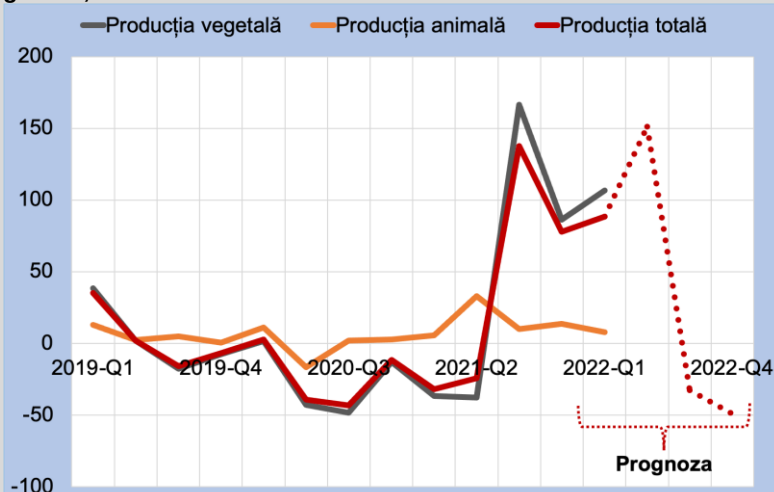
Authorities in the region have a limited range of tools to intervene to mitigate shocks. Even before the crises in 2022, the region's budget was unbalanced: at the end of 2021, the share of the budget deficit in GDP was about 12% (the maximum allowable level is 3%), covered by domestic loans and non-reimbursable financing from the Russian Federation. In 2022-2023 the financing of the budget deficit will be extremely problematic due to the economic difficulties in the Russian Federation, the domestic economic crisis, but also the substantial reduction in budget receipts against the background of the disruption of electricity supplies to the right bank, the reduction in natural gas supplies, the slowdown in economic activity and the increasing propensity to tax evasion. For example, at the end of the third quarter, 2022, the volume of arrears to the region's public budget increased by 16% compared to the beginning of the year, and the number of active businesses registered with local tax authorities decreased by 15 units (unofficial figures could be more dramatic).

Authorities in the region will have to resort to budgetary optimisations in parallel with the tightening of fiscal pressure and controls. Given that the tax burden in the region is relatively low (at the end of 2021 the share of budget revenue in GDP was only 18%) and the volume of tax arrears is increasing, the authorities in the region will most likely increase some taxes or levies as well as intensify tax controls to make private companies honour their tax obligations. As regards the optimisations, there will be a freeze on expenditures and capital investment, optimisation of the work of public institutions, interruptions to hot water supplies, measures to save electricity, etc. in order to ease the pressure on the region's budget.

In addition to the acute economic and social crises, 2022 has also exacerbated the demographic problem. At the end of 2021, the number of live births was 9% lower and the number of deaths - 24% higher than in 2020. At the same time, the ratio of deaths to live births has steadily increased over the last few years from 1.6 at the end of 2018 to 2.9 in 2021-2022 (for every person born there are 3 deaths). This problem is aggravated by the phenomenon of emigration, which has intensified in 2022 against the background of the war in Ukraine and the economic and social crises in the region. This trend will accelerate population ageing, undermining the region's potential and natural rate of economic growth. Especially in a situation where only about 53% of the population is of working age (the share has been gradually decreasing over the last few years) and more than half of the working age population is economically inactive.

■ Main economic trends in the Transnistrian region

Figure 1. Inflation-adjusted global agricultural production, y-o-y growth, %

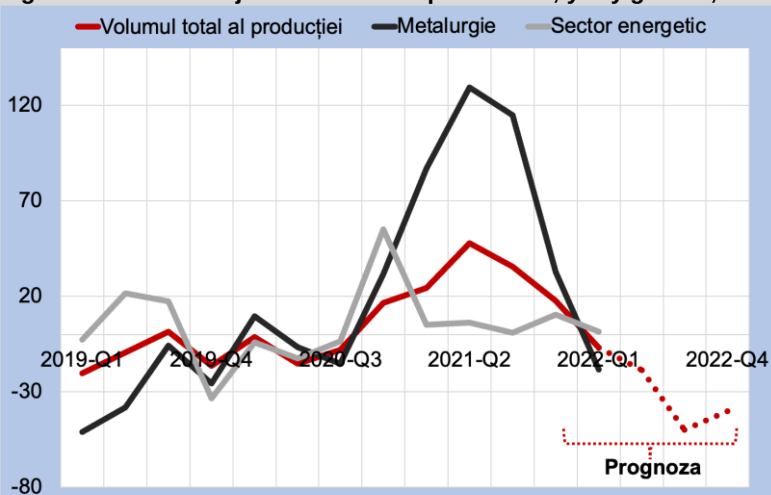


Source: <http://mer.gospmr.org/> and the authors' calculations

AGRICULTURE

After the drought of 2020, when agricultural production, in real terms, fell by 23%, the impact of which was also felt in the first half of 2021, the agricultural sector entered the recovery phase from the third quarter of 2021. This trend continues into 2022, with an offsetting growth in real terms of 89% (y-o-y) in the first quarter, 2022. This was mainly on account of crop production (+107%, y-o-y), while the livestock sector remained in a phase of relative stagnation observed over the last few years. Nonetheless, the catching-up effect from the lower taxable amounts will be exhausted in the second half of 2022, with a projected decline of around 6% for the whole of 2022 and a stagnation for 2023.

Figure 2. Inflation-adjusted industrial production, y-o-y growth, %

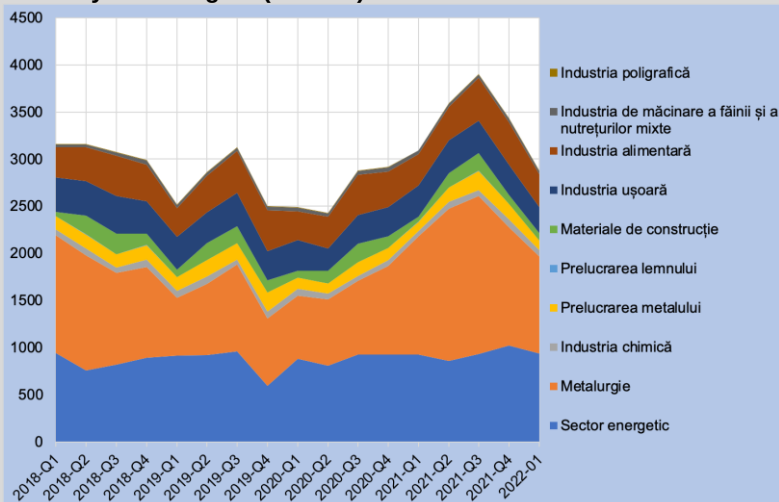


Source: <http://mer.gospmr.org/> and the authors' calculations

INDUSTRY

After a robust recovery in industrial production in the post-pandemic period (+30% in 2021), propelled by the engine of the region's industry - metallurgical industry - the industrial complex has entered a recessionary phase. According to the latest available data, in the first quarter, 2022, industrial production volume declined by 7% y-o-y, adjusted to inflation. The main cause is the undermining of logistic chains against the background of the war in Ukraine, which particularly affected sectors dependent on imported raw materials and/or export-oriented: metallurgy (-18.4 y-o-y) and light industry (-16.3% y-o-y).

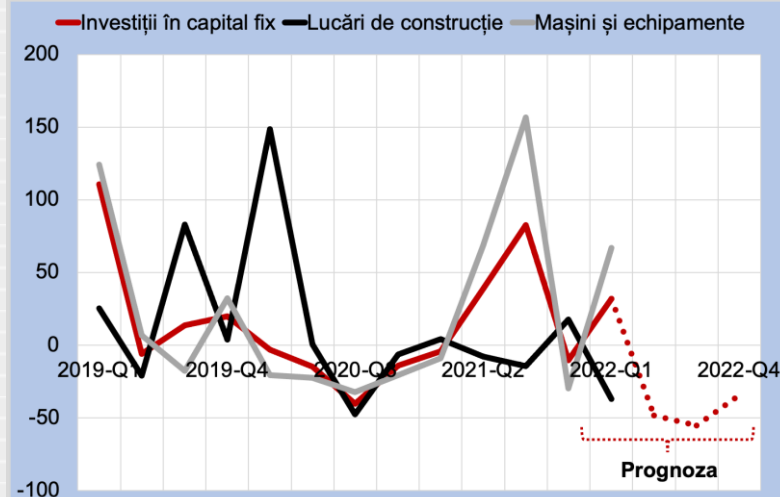
Figure 3. Inflation-adjusted industrial production expressed in the currency of the region (roubles)



Source: <http://mer.gospmr.org/> and the authors' calculations

For the whole of 2022, a recession of around -30% is forecast, followed by stagnation in 2023 (a tiny growth of around 1.6-2.0% is forecast in 2023). The downturn could be even more pronounced in the event of a worsening of the energy crisis: reduction of natural gas supplies from Gazprom, resulting in reduced or even halted electricity supplies to the right bank of the Dniester River, and shutdown or reduced activity of factories in the region. Note that even before the energy, logistics and security crises in 2022, the industrial sector in the region was in a deep and long-lasting structural crisis (for example, it entered the pandemic after an 11% recession in 2019 in real terms). Therefore, 2022-2023 will be extremely difficult years for the industry, with no visible signs of sustainable recovery.

Figure 4. Inflation-adjusted volume of investments, expressed in the currency of the region (roubles)



Source: <http://mer.gospmr.org/> and the authors' calculations

INVESTMENTS

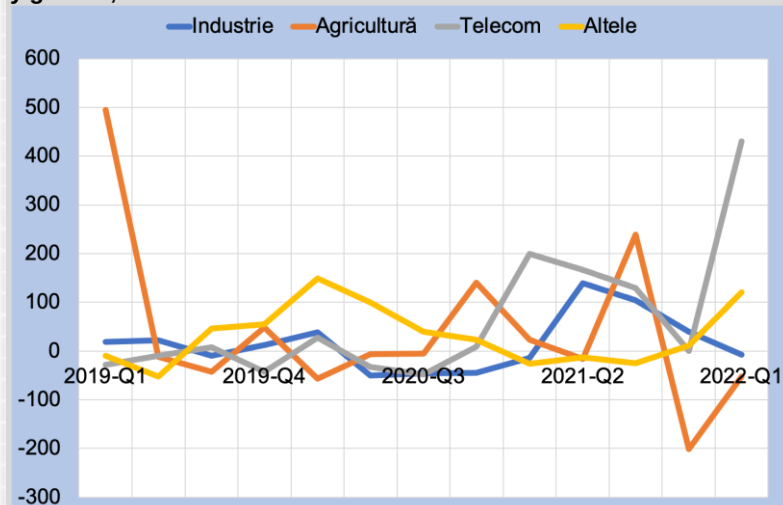
Overall, investment activity in the region has always been highly volatile, reflecting the high level of uncertainty in the region and the exposure of the local economy to various shocks. Investment activity has recovered in the post-pandemic period, marking an increase, in real terms, of 21.7% in 2021 after a decline of 20.8% in 2020. However, the crises in 2022, notably related to the war in Ukraine and the energy crisis, will mark an even more pronounced reduction in investment activity compared to the 2020 crisis. Even though in the first quarter, 2020, the volume of fixed capital investment was 32% higher y-o-y, in 2022 a reduction of around 35% is forecast, which could continue in 2023, with a 10% decline forecast in real terms. Another major factor for the reduction of investment in 2022-2023 is budget austerity in the region under pressure from the energy and economic crises in 2022.

The squeeze on investment activity will mainly come from the sectors with the highest shares in total investment - industry and agriculture - with the overlap of several shocks combined with long-standing structural problems. Thus, already at the beginning of 2022, until the war in Ukraine and the energy crisis, these sectors have already significantly reduced their volume of fixed capital investment: -52.5% in agriculture and -7.3% in industry for the first quarter of 2022, in real terms, y-o-y.

TRANSPORT

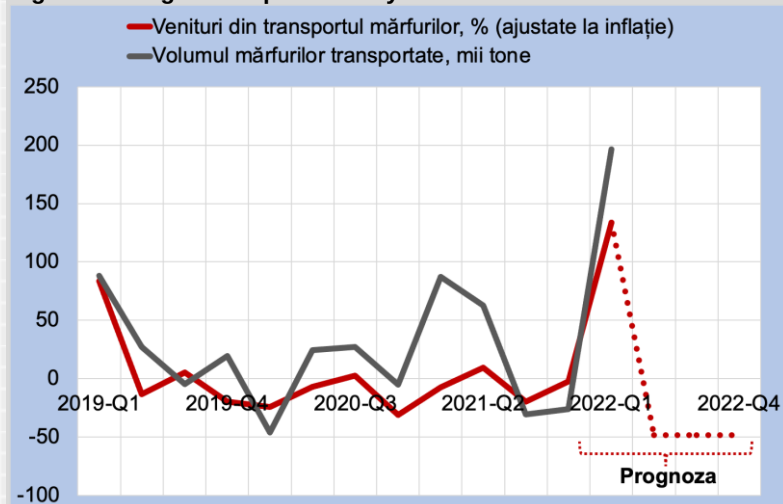
Transport activity has been very volatile over the last few years, reflecting the economic volatility in the region. Against the background of the war in Ukraine and the economic crisis in the region, the volume of goods transported is forecast to decrease by about 32% in real terms in 2022. This decrease could continue in 2023 (-31%), due to the anticipated perpetuation of the economic crisis next year. The faster growth in the volume of transported goods compared to transport revenue suggests the prevalence of relatively low-value primary product transport, revealing the low level of competitiveness and added value of production in the region.

Figure 5. Investment volume by main sectors, inflation-adjusted y-o-y growth, %



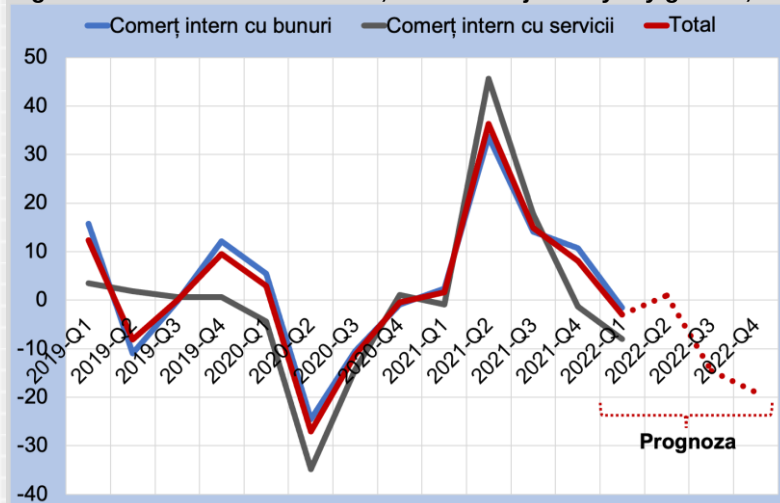
Source: <http://mer.gospmr.org/> and the authors' calculations

Figure 6. Freight transport activity



Source: <http://mer.gospmr.org/> and the authors' calculations

Figure 7. Domestic trade volume, inflation-adjusted y-o-y growth, %

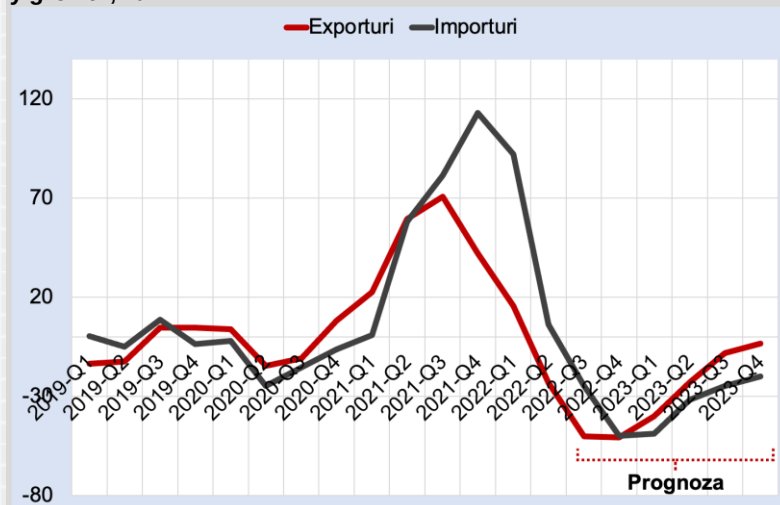


Source: <http://mer.gospmr.org/> and the authors' calculations

DOMESTIC TRADE

Domestic trade reflects the cooling of domestic demand and the region's economy as a whole, after a moderate recovery in 2021 (+13.2% in real terms) that offset the decline in the pandemic period (-8.5% in 2020 in real terms). Against the background of the crisis in 2022, domestic trade in both goods and services is set to decline due to lower population income and consumption. In the first quarter, 2022, trade has already declined by 3% y-o-y, especially trade in services (-8% y-o-y) which is most prone to economic shocks. For the whole of 2022, domestic trade is forecast to fall by 10%.

Figure 8. Dynamics of foreign trade in goods, inflation-adjusted y-o-y growth, %



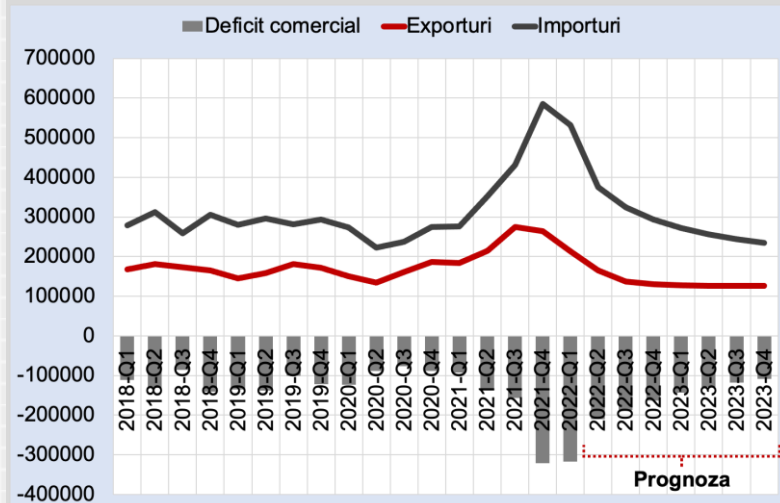
Source: <http://mer.gospmr.org/> and the authors' calculations

FOREIGN TRADE

Foreign trade recovered quickly from the crisis in 2020 when exports contracted by 3.6% and import, by 12.3%, with robust growth in 2021 of 48.4% in exports and 63% in imports. However, for 2022, against the background of the economic, energy and security crises, export and import volumes are set to fall by around 31% and 7% respectively—a decline that will persist throughout 2023.

It is worth noting the persistence of the trade deficit, which reached a record level of around USD 707.3 million in 2021 and will remain at a similar level throughout 2022, with imports covering exports by only 40-44%. This deficit is mostly covered by direct financial support and 'energy subsidy' from the Russian Federation. Forecasts point to the persistence of this trade deficit, while its financing is becoming increasingly uncertain in the context of the geopolitical situation in the region and economic difficulties in the Russian Federation.

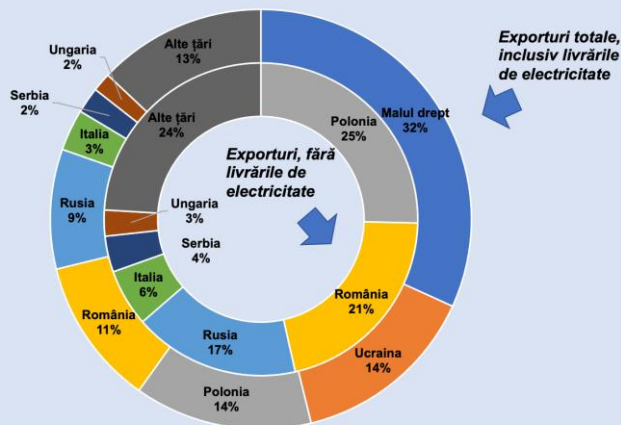
Figure 9. Volume of exports, imports and balance of trade in goods, thousands of US dollars



Source: <http://mer.gospmr.org/> and the authors' calculations

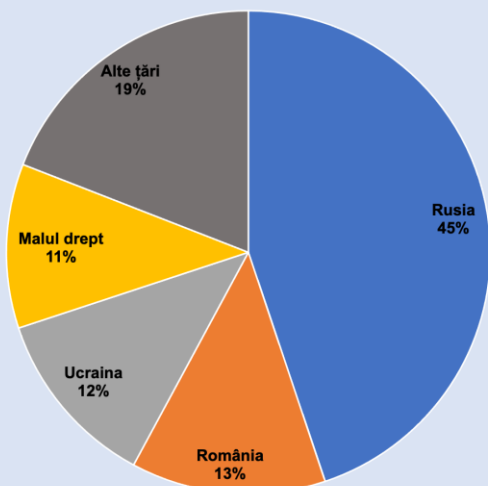
Other risks to foreign trade relate to the electricity supplies to the right bank of the Dniester being cut off, which accounts for more than a quarter of total 'exports' from the region.

Figure 10. Structure of exports from the Transnistrian region, %



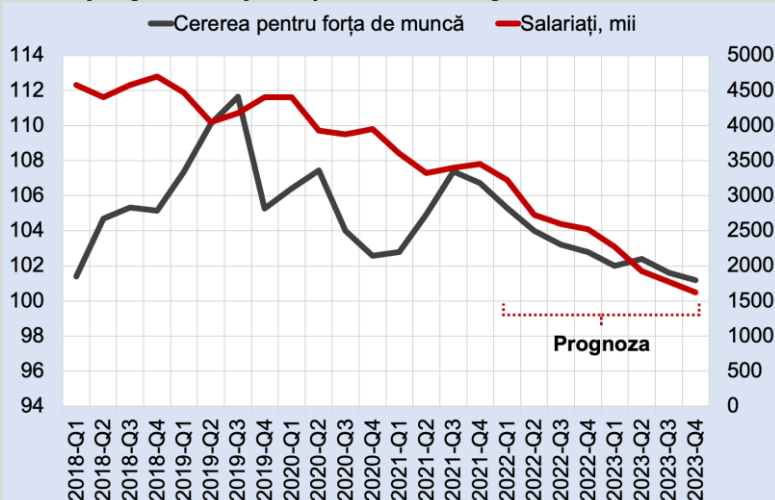
Source: <http://mer.gospmr.org/> and the authors' calculations

Figure 11. Structure of imports in the Transnistrian region, %



Source: <http://mer.gospmr.org/> and the authors' calculations

Figure 12. Number of employees and number of job applications officially registered by companies in the region



Source: <http://mer.gospmr.org/> and the authors' calculations

The reduction in the activity of the industrial complex, in particular the Moldovan Metallurgical Plant due to the reduction of natural gas supplies from Gazprom will directly affect commercial activity, especially exports (metal exports constitute almost half of the total volume of exports in the region). The war in Ukraine will also substantially affect the region's foreign trade, as Ukraine is an important trading partner for companies in the region. At the same time, exports to other destinations will be complicated by the undermining of logistic chains.

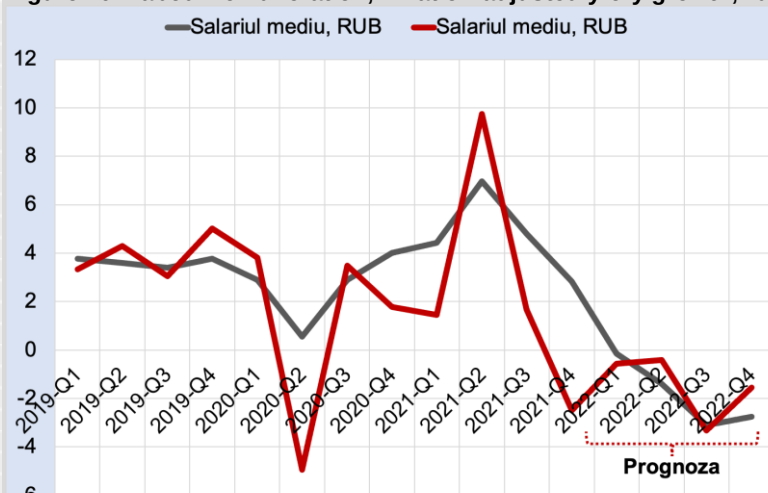
It is worth mentioning that, if we exclude electricity supplies to the right bank and Ukraine as part of the balancing system, the European Union is the main destination of genuine exports from the region, with a share of around 60-65% of total exports, the main partners being Romania, Italy and Hungary. Thus, some 2 400 companies from the region are registered with the authorities on the right bank of the Dniester River to benefit from the advantages of free trade with the EU under the Association Agreement.

As regards the imports, Russia is the main source, mainly of energy resources, whose share will decrease due to the reduction of natural gas supplies and the undermining of logistical supply chains.

LABOUR MARKET

The labour market has been shrinking in recent years under the influence of demographic and economic factors. Both labour demand and supply are on a continuous downward trend. The number of employees is declining throughout the analysis period, with a projected reduction of 3.7 thousand people at the end of 2022 compared to the end of 2021, and a similar reduction in 2023. In the context of the economic crisis, the number of job vacancies registered by companies has also reduced by about 1000 people, forecast for 2022 and will reduce by about 800 people, forecast for 2023.

Figure 10. Labour remuneration, inflation-adjusted y-o-y growth, %



Source: <http://mer.gospmr.org/> and the authors' calculations

WAGES

Both the average wage and the total wage fund in the region follow a downward trend from the second half of 2021, according to inflation-adjusted annual growth rates. Thus, after a real increase of 4.7% in the average wage and 2.4% y-o-y in the wage fund in 2021, both indicators will mark a decrease of around 2% and 1.5% respectively in 2022, continuing in 2023 with a reduction of 0.7% and 0.9% respectively. This trend will affect aggregate demand in the region and therefore complicate the economic recovery process.

Figure 12. CPI dynamics, annual growth



Source: <http://mer.gospmr.org/> and the authors' calculations

INFLATION

Over the period 2021-2022, the Consumer Price Index is on an accelerated upward trend, increasing from just 1.5% in the first quarter of 2021 to 14.5% in the third quarter of 2022. The main drivers are higher prices of imported products due to regional inflation and rising logistic costs. Foodstuffs, especially imported ones, had the highest increases in prices (+23.1% in Sep-22, y-o-y). In the forthcoming period, inflationary dynamics will continue due to imported inflation, the depreciation of the currency in circulation in the region and the likelihood of adjustment of tariffs on regulated services provided to the population, which are artificially maintained (they increased by only 4.7% in Sep-22, y-o-y).

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This publication is produced with the support of the 'Confidence-Building Measures' programme, funded by the European Union and implemented by the United Nations Development Programme. The views expressed in this document are those of the authors and do not reflect the views of the European Union or the United Nations Development Programme. The authors are also aware of the risks related to possible statistical data quality issues, which they have used with extreme caution.



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