

## **THE REPUBLIC OF MOLDOVA – MID-RUN MACROECONOMIC OPPORTUNITIES AND CHALLENGES**

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**Abstract:** In recent years, the economy of the Republic of Moldova has been confronted with the consequences of the unprecedented global exogenous shocks, the coronavirus pandemic, and the intensification of geopolitical tensions. The volume of GDP grew for the second year in a row in 2024, but at a slowing annual pace of 0.5%, according to the estimates of the International Monetary Fund (2025). Therefore, in 2024, the volume of economic activity was only 1.3% higher than the pre-pandemic level in 2019. This paper applies standard econometric tools (the Hodrick-Prescott filter) and uses the estimates and forecasts of the International Monetary Fund (2025) for the period 1993 - 2025 in order to assess the macroeconomic developments and the medium-run opportunities and challenges for the economy of the Republic of Moldova. According to our results, the economy of the Republic of Moldova would record an annual growth pace below its potential for the fourth year in a row in 2025. On the other hand, the annual potential growth pace changed the trend in 2024, after hitting the lowest level since the beginning of the 2000s. However, this annual potential growth pace would persist at lower levels compared to the pre-pandemic period in the coming years, in a context dominated by several structural challenges, including the decline of the population and the high levels of the twin deficits (the budget deficit and the current account deficit).

**Keywords:** the economy of the Republic of Moldova, potential output, structural reforms

**JEL Classification:** C 22, E 17, O 47

### **1. Introduction**

The economy of the Republic of Moldova has recently been significantly impacted by the consequences of global exogenous shocks, including the coronavirus pandemic (the worst health crisis in the world in over 100 years) and the intensification of geopolitical tensions.

One can notice the severe deterioration of the investment climate, as the geopolitical tensions distorted the supply chains and increased the production costs, as emphasized by Augusztin et. al (2023).

The gross fixed capital formation contracted by annual rates of 6.8% in 2022 and 1.3% in 2023, according to the database of the National Bureau of Statistics of the Republic of Moldova (2025). At the same time, the estimates of the International Monetary Fund (2025) indicate the decline of the total investment / GDP ratio to a record low level of 20.1% in 2023.

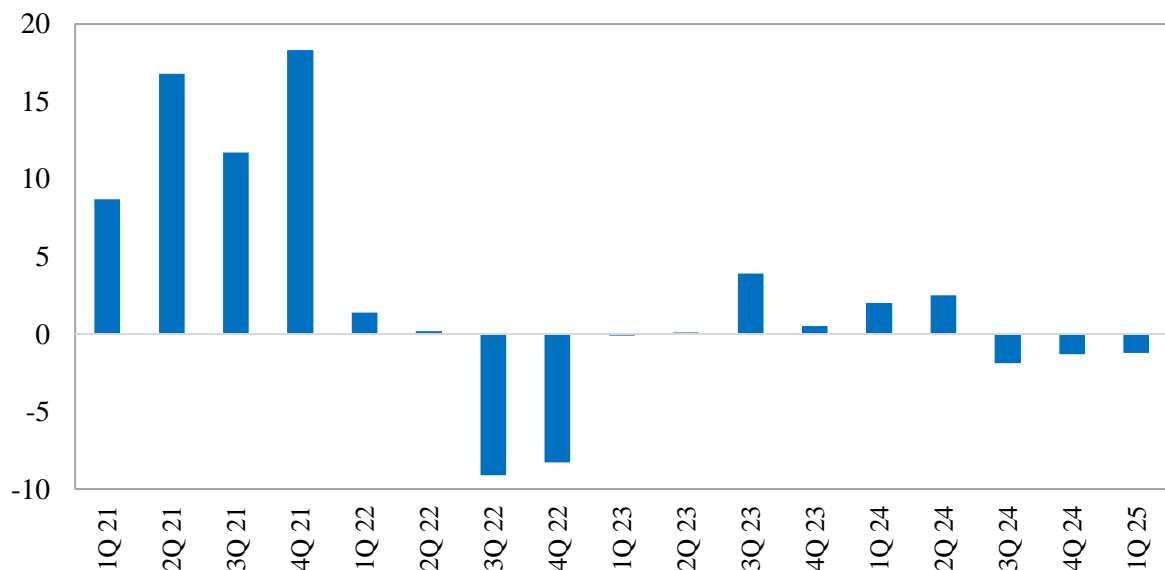
The contraction of the fixed investments determined the deterioration of the labour market climate, the employment rate increasing to 4.6% in 2023, the highest level since 2019, according to the database of the International Monetary Fund (2025).

Furthermore, the unprecedented high level of regional geopolitical tensions also has an impact on the medium-term macroeconomic performance of the Republic of Moldova, according to the World Bank (2024).

At the same time, the intensification of the inflationary pressures (double-digit annual inflation in 2022 and 2023) harmed the real disposable income of the population, as underlined

by the International Monetary Fund (2022). The household consumption contracted by annual rates of 4.0% in 2022 and 0.5% in 2023, according to the estimates of the National Bureau of Statistics of the Republic of Moldova (2025).

More than five years since the outbreak of the coronavirus pandemic and more than three years following the intensification of the geopolitical tensions in Eastern Europe, the economic climate in the Republic of Moldova continues to be difficult. According to the database of the National Bureau of Statistics of the Republic of Moldova, the economic activity contracted for the third quarter in a row in 1Q 2025, by an annual rate of 1.2%, as represented in Figure 1.



**Figure 1. The economic activity in the Republic of Moldova (% , annual rate)**

Source: representation of the author based on the estimates of the National Bureau of Statistics of the Republic of Moldova (2025)

The macroeconomic climate in the Republic of Moldova is forecasted to maintain tough in the coming quarters, the experts of the International Monetary Fund (2025) forecasting a growth pace of only 0.6% in 2025.

In this paper, standard econometric tools are implemented, and the database of the International Monetary Fund (2025) is used in order to estimate the annual potential growth pace in the Republic of Moldova during the period 1993 – 2025. The purpose is to assess the macroeconomic developments and to identify the main opportunities and challenges for the economy of the Republic of Moldova in the medium run.

The rest of the paper has the following structure: the next chapter presents the methodology; the main results are analysed in the third chapter; the conclusions are drawn in the last chapter.

## **2. Methodology**

In this paper, we apply the Hodrick–Prescott filter in order to estimate the evolution of the annual potential growth pace in the Republic of Moldova during the period 1993 – 2025.

Several methods were developed by experts in order to distinguish between the structural and cyclical components of the macroeconomic indicators, one of the most used being the filter of Hodrick and Prescott (1997).

This method is based on the following formula

$$\mathbf{Min} \sum_{t=1}^T (\ln Y_t - \ln Y_t^*)^2 + \lambda \sum_{t=2}^{T-1} ((\ln Y_{t+1}^* - \ln Y_t^*) - (\ln Y_t^* - \ln Y_{t-1}^*))^2 \quad (1)$$

In this formula,  $Y_t$ ,  $Y_t^*$  and  $\lambda$  are the macroeconomic indicator, its trend component and a smoothness parameter. In our analysis  $Y_t$ ,  $Y_t^*$  represent the GDP and the potential GDP of the Republic of Moldova, expressed as annual rates.

As regards the smoothness parameter, as can be noticed from formula (1), the higher its value, the larger the gap between the GDP and its trend component. Hodrick and Prescott (1997) recommend a value of 100 for implementation while working with annual observations.

Among the main advantages of using this standard econometric tool to distinguish between the structural and cyclical components of the macroeconomic indicators is the transparency, according to Bouthevillain et al. (2001) and de Castro Souza (2005).

On the other hand, we also mention several disadvantages of this methodology, as underlined by de Castro Souza (2005): arbitrariness, imposition of symmetry on the gap (between the macroeconomic indicator and its structural component), and the end-of-sample bias.

In our paper, we used the database of the International Monetary Fund (2025), from the Spring edition of the World Economic Outlook. We took into account the annual rate of GDP of the Republic of Moldova, with estimates for the period 1993 – 2024, while for the year 2025, we considered the forecasts of the experts of the International Monetary Fund (2025).

As we worked with annual data, we considered a value of 100 for the smoothness parameter.

The econometric software E-Views was used to apply the Hodrick-Prescott method in this analysis.

### **3. Main results**

According to the results of the econometric analysis, the annual potential growth pace in the Republic of Moldova has presented a downward trend since 2006, from around 5.3% to less than 2% at present.

Several factors determined this unfavourable dynamic of the annual pace of the potential GDP in the Republic of Moldova over the past two decades in our view, among them we mention:

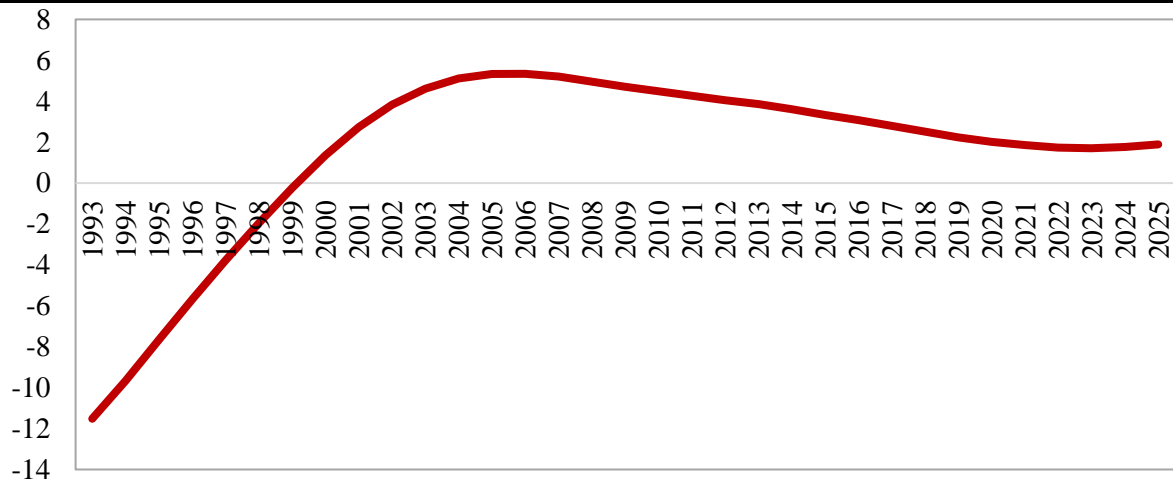
1. the outbreak of the Great Financial Crisis in 2007 - 2008 (the worst economic and financial crisis in the world since the end of WWII) and its consequences;
2. the intensification of the risk perception in the region from 2014, given the regional geopolitical developments;
3. the outbreak of the coronavirus pandemic and its consequences;
4. the crisis in Ukraine (starting 2022) and its consequences;
5. the supply-side shocks, including the energy crisis.

We point out that the annual growth pace of the potential output in the Republic of Moldova decelerated from around 5.3% before the outbreak of the Great Financial Crisis in 2007-2008 to less than 4.0% in 2013 (3.8%), as represented in the following chart (Figure 2).

However, this downward trend was more pronounced from 2014, when the risk perception intensified in the context of the outbreak of geopolitical tensions in the region. The annual rate of the potential output deteriorated from 3.8% in 2013 to 3.6% in 2014 and 2.3% in 2019, the year before the outbreak of the coronavirus pandemic, as can be noticed from Figure 2.

This downward trend continued until 2023, to only 1.7%, the lowest level since the year 2000, according to our econometric estimates.

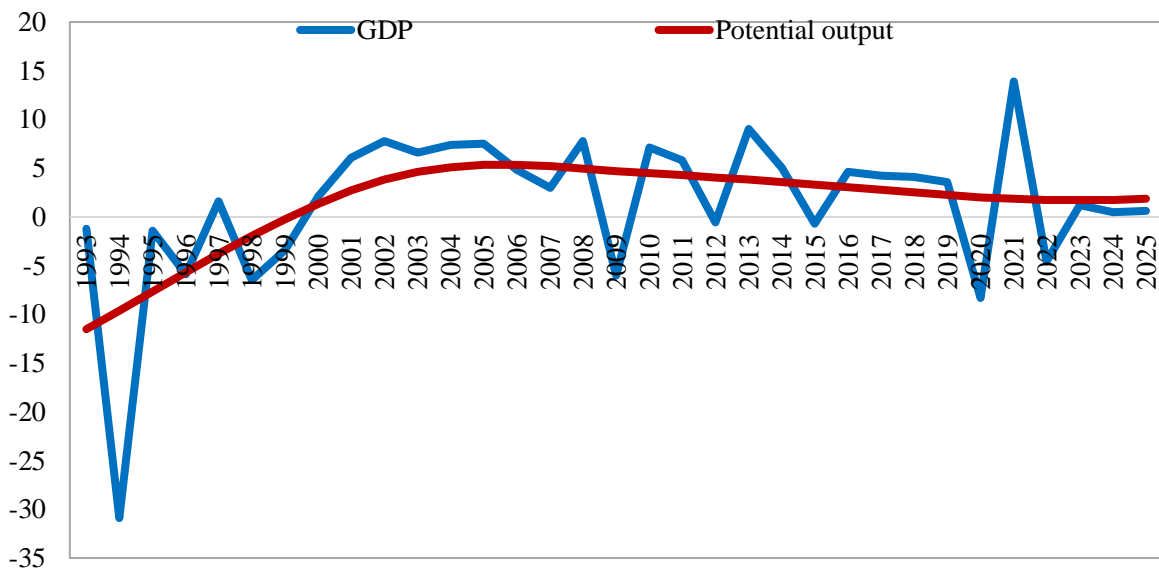
In recent years, this indicator stabilised at levels close to the lowest since the beginning of this century, below 2%.



**Figure 2. The potential output in the Republic of Moldova (% , annual rate)**

Source: representation of the author based on the econometric estimates using IMF data (2025)

Furthermore, the results also show the fact that the annual dynamic of the economic activity in the Republic of Moldova stood below its potential in 2022, 2023, and 2024 and is expected to continue this evolution in 2025, as can be noticed in Figure 3.



**Figure 3. GDP vs. potential output in the Republic of Moldova (% , annual rate)**

Source: representation of the author based on the econometric estimates using IMF data (2025)

We point out that the deterioration of the annual potential growth pace and the evolution of the economy by an annual pace below its potential in recent years contributed to the decline of the population of the Republic of Moldova. According to the estimates of the International Monetary Fund (2025), the population of the country diminished from 2.89 million in 2006 to 2.87 million in 2014, 2.64 million in 2020, and 2.36 million in 2025. The experts of this international financial institution forecast the continuity of this downward trend in the coming years, to 2.05 million in 2030.

### Conclusions

The results of our analysis confirm the fact that the macroeconomic climate in the Republic of Moldova continues to be affected by the consequences of the recent shocks, especially the regional geopolitical tensions. These contributed to the deterioration of the annual potential growth pace towards the lowest level since the beginning of this century, according to the results of our econometric estimates.

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In this context, structural reforms are needed in order to change the downward trend for the annual potential growth pace in the Republic of Moldova. In this respect, the experts of the World Bank (2025) recommended the reforms needed to increase labour participation, support energy independence, and improve climate resilience.

In our view the structural reforms included in the recently launched Moldova Growth Plan, a three-year programme of EUR 1.9bn, agreed with the European Union (European Commission, 2025), with a focus on developing the infrastructure (including hospitals), improving the energy security, increasing the access to financing of SMEs, and enhancing the access to the EU’s Single Market are going to improve the annual potential growth pace and to contribute to the adjustment of the twin deficits in the coming years.

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