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THE FINANCIAL SYSTEM CHALLENGES OF THE REPUBLIC OF MOLDOVA IN THE PANDEMIC COVID 19 CONTEXT

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ABSTRACT

This study's main objective is to analyze the challenges faced by the Republic of Moldova in the economic crisis, which was caused by the COVID 19 pandemic. The vulnerabilities of the Republic of Moldova's economy and especially its financial system are related mainly to the specifics of the country's economy, which is small, open, with a continuing current account deficit and a strong subordination to international financial flows.

This study's conclusions consist in the fact that the external risks related to the COVID19 pandemic can be transmitted in the economy of our country through two channels. First, due to uncertain financial conditions in the international economy, difficulties with international financing may arise. Secondly, the vulnerabilities in the economies of the Republic of Moldova's trading partners will undoubtedly influence the slowdown in exports of goods and services.

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Introduction. In the conditions of globalization, the challenges faced by the economy of the Republic of Moldova are becoming more and more pronounced. Solving these complex challenges requires creating the foundations for implementing progressive structural changes in the economy, capable of contributing to sustainable economic development.

The financial system's fundamental mission is to provide financial services, which must meet the economy and society's requirements in increasing the level of investment and social stability. The degree of development of the financial system is influenced, on the one hand, by international macro-financial developments, and on the other hand, by the real economic possibilities of the Republic of Moldova.

If we refer to both the world economy and the world's states' national economies, the main item in 2020 is the health crisis caused by COVID 19. The shock to the global economy at COVID-19 was much more significant, faster, and more severe than that caused by the global financial crisis of 2008 and even the Great Depression. In the case of the mentioned crises, the effect has accumulated in about three years. The equally severe macroeconomic and financial consequences of the current crisis have materialized in a few weeks. To overcome the pandemic, a large number of countries in the world have had to introduce a series of restrictions, most of which related to the closure or slowdown of economic activities, as well as unprecedented measures regarding cross-border traffic. These actions could not but affect the value chain of production, which in turn harmed global demand. Thus, uncertain expectations about the near future of the global economy have intensified.

Purpose of the study: This publication aims to analyze the impact of the health crisis caused by the COVID 19 pandemic on the national financial systems of developing countries on the example of the Republic of Moldova.

Literature review. Following the Western Balkans Regular Economic Report, the escalating COVID-19 outbreak constitutes both a supply and a demand shock whose full magnitude, duration, financial, fiscal, and social ramifications are still unclear. The rapid global spread of the virus has reached pandemic proportions and prompted a flurry of emergency measures— rate cuts, liquidity support, tax deferrals, travel bans, mandatory closure of businesses, limitations on gatherings—to contain the spread, mitigate disruption to economic activity, and avert a dislocation in financial markets. [1]

According to Baret et al, with ongoing shocks to the supply and demand, there is potential for further market disruption. [2]

The COVID-19 pandemic, Tobio, and Natalucci notes, has caused an unprecedented human resource and health crisis. The measures needed to limit the spread of the virus have triggered an economic recession, and at the same time, there is massive uncertainty about its depth and duration. In some cases, volatility has risen to levels last seen during the global financial crisis amid uncertainty about the pandemic's economic impact. [3]

Materials and Methods. The dramatic tightening of global financial conditions since the onset of the COVID-19 outbreak – along with a fundamentally deteriorating economic outlook – has led to a massive shift to the left in the statistical distribution of global growth projections for next year. These situations indicate significant risks of deteriorating economic growth and financial stability. [3]

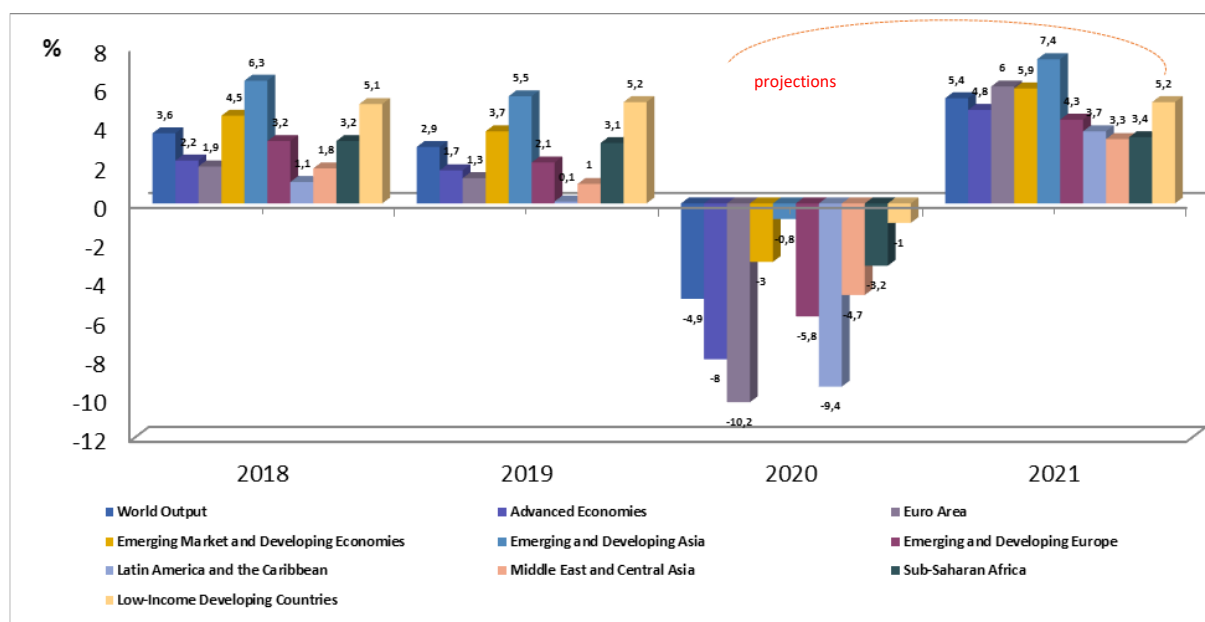


Fig. 1. Economic growth in selected groups of countries
 Source: [4]

If we briefly analyze the global economic situation, before the COVID 19 crisis, we can see that the global economy's growth has moderated and amounted in 2019 to 2.9% (3.6% in 2018), in 2020 of up to 3.5%. But unfortunately, the COVID 19 pandemic brought its corrections. Thus, in June 2020, the IMF reviews the growth prospects of the world economy. According to the World Economic Outlook Update, global economic growth is forecast at -4.9% in 2020, 1.9 percentage points below the April 2020 World Economic Outlook (WEO) forecast. The COVID-19 pandemic had a more negative impact on business in the first half of 2020 than anticipated, and the recovery expected to be more gradual than previously forecast. In 2021, global growth projected at 5.4%. Overall, this would leave GDP for 2021 about 6.5% lower than in previous COVID-19 projections in January 2020. The negative impact on low-income households is particularly acute, hindering significant progress in extreme poverty reduction in the world, the 1990s. [4]

Regarding the impact of macro-financial developments on the Republic of Moldova's national financial system, the most significant vulnerabilities are related to global uncertainties following the COVID 19 pandemic. Currently, it is undeniable that the pandemic is not only a health crisis but also an economy. The most significant risks in this regard are related to the possible incapacity of the non-financial sector to pay, which can lead to the transformation of the health crisis into a financial crisis,

which by its nature is contagious. At the same time, it should be noted that, unlike the financial crisis of 2008, the international financial system has made a qualitative leap as a result of the new financial regulations, and it remains to see how it will withstand the pressures caused by prolonged global economic stress.

Results and discussion. The Republic of Moldova is a country with a small, open economy, a continuous current account deficit, and a strong subordination face to international financial flows. Our country's economy can be characterized by a series of structural features, which expose it a lot to external developments. For these reasons, any imbalances in the global economy trigger more pronounced external vulnerabilities in the Republic of Moldova.

One of the most prominent characteristics of our country is the dependence on remittances. The Republic of Moldova is one of the top ten countries globally with the largest shares of remittances in GDP, being also the first in Europe in this regard. Simultaneously, the graph shows that the inverse relationship between the share of remittance in GDP and the value of GDP per capita is well outlined.

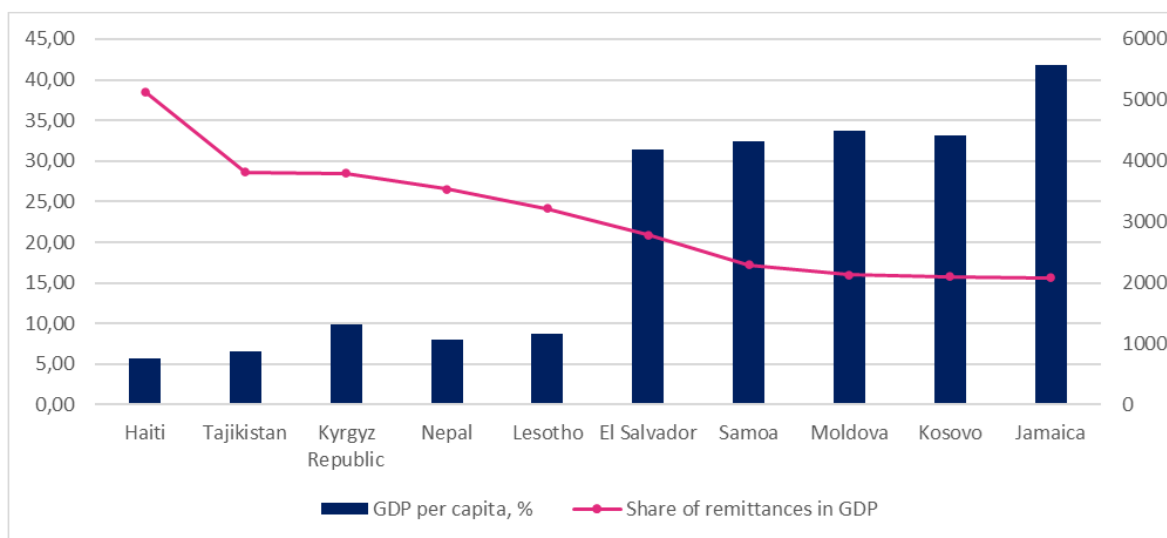
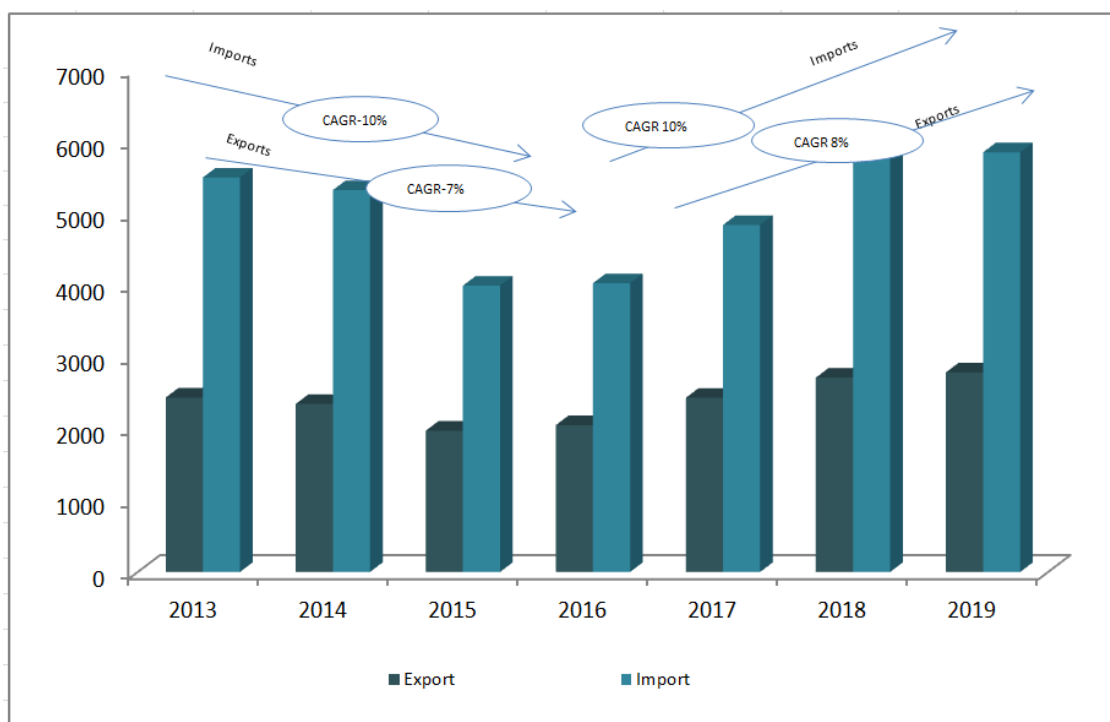


Fig. 2. Share of remittances in GDP, 2019
 Source: [5]

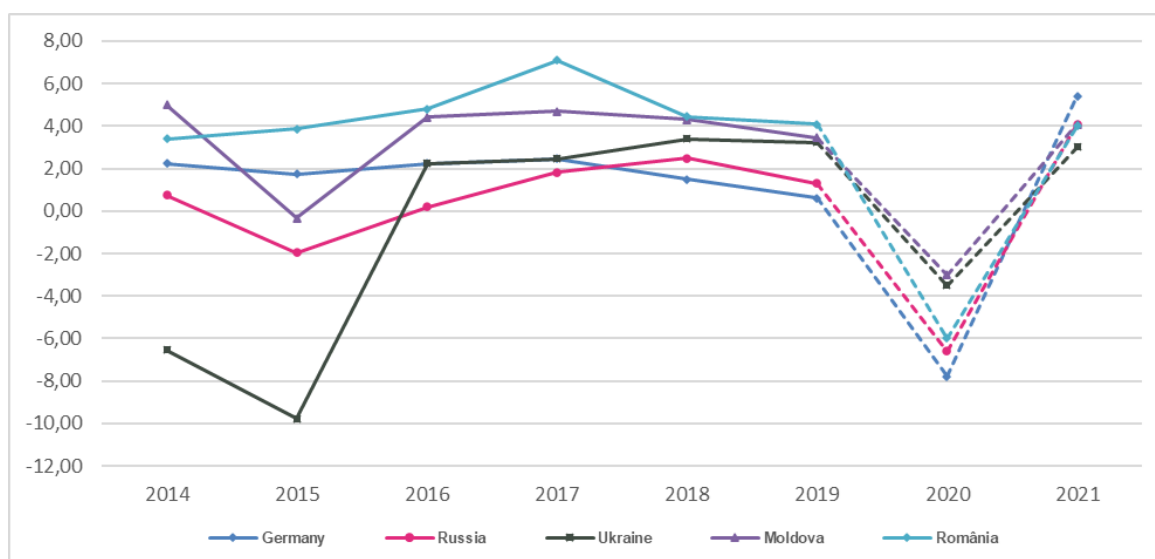
Current developments in the world economy under the COVID 19 pandemic are spreading risks to developing countries' financial systems. These risks can be transmitted in the economy of our country through several channels. First, due to uncertain financial conditions in the international economy, difficulties with international financing may arise. Secondly, the vulnerabilities in the economies of the Republic of Moldova's trading partners will undoubtedly influence the slowdown in exports of goods and services (according to official data in January-June 2020 / January-June 2019, exports accounted for 86% and imports 85.2), developments that will therefore lead to a deterioration of the external balance. This situation disadvantages the economy of our country, which is very dependent on international financial flows. The primary source of financial flows for the Republic of Moldova is the export of goods and products.

To analyze the evolution of exports and imports in the Republic of Moldova, we used the CAGR indicator. CAGR is an indicator of the compound annual growth rate (Compound Annual Growth Rate). Its value allows us to estimate the growth rate of any parameter, and most often, this calculated indicator is used to work with objects whose behavior is expressed by complex dependencies. The main advantage of CAGR is that it gives a simple estimate in the form of an average percentage of growth, and, accordingly, can be used for a quick analysis of the past period and obtaining the first predictive approximation.

If we analyze the evolution of exports and imports of the Republic of Moldova, through the CAGR indicator, we can see that two periods are outlined in the last seven years. The first period (2013-2015) of decrease of foreign trade, GACR constituting - 10% for imports and - 7% for exports, and its second period of increase (2016-2019) where CAGR was 10% for imports and 8 % of exports.



*Fig. 3. Evolution of exports and imports in the Republic of Moldova
Source: [6]*



*Fig. 4. The economic growth of the main trading partners of the Republic of Moldova
Source: [4]*

Based on the importance of export flows generated in the Republic of Moldova, it is necessary to analyze the economic situation of the main trading partners of the country (Romania, Russian Federation, Germany, Ukraine).

If there are distortions in foreign trade, the external balance of the Balance of Payments of the Republic of Moldova will deteriorate, which will cause internal imbalances, which can be demonstrated by previous episodes of the evolution of our country's economy. If we analyze figure 4, we can see a period of declining inflows, accompanied by the decline in GDP. It follows that imbalances in foreign trade can have a material effect on GDP growth. Therefore, the Moldovan economy's current situation also creates risks for the Republic of Moldova's financial system.

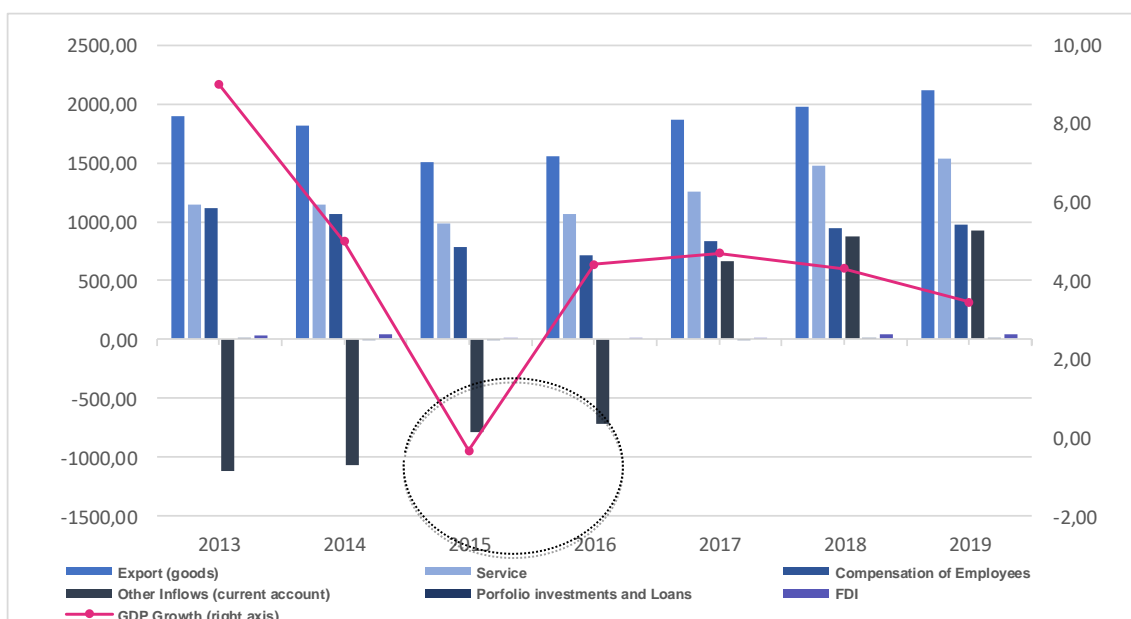


Fig. 5. Share of remittances in GDP, 2019
 Source: [6]

Conclusions. In the current context of the world economy, anticipating possible developments in the international financial phenomenon is becoming an integral part of assessing national financial systems' processes.

From the analysis carried out in the study, based on the current situation of the world economy's evolution under the impact of the COVID19 pandemic, it can be mentioned that persistent risks are not excluded. Therefore even worse results can be registered. If we refer to low- and middle-income countries, then they are the most vulnerable. Thus, even after the 2008 financial crisis, they needed a more extended period to recover due to external demand shocks fully. In this context, the biggest problem in these groups of countries is the lack of domestic financial resources to stimulate the economy. That is why the support provided by international financial institutions and countries with advanced economies to developing countries, among which our country also has enormous importance in mitigating the economic blow.

In the Republic of Moldova, as the disruption was highlighted, the financial flows have consequences on the increase of production. Therefore, to take into account the existing risks and understand the probability of negative results, it is appropriate to assess all external vulnerabilities.

Nevertheless, on the other hand, the pandemic crisis can also be an opportunity to implement structural measures that position our country in a new paradigm of economic growth, more resilient, innovative, and more elasticity to shocks.

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