INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/343

REPUBLIC OF MOLDOVA

November 2016

REQUESTS FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF MOLDOVA

In the context of the Requests for an Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 7, 2016, following discussions that ended on July 15, 2016, with the officials of the Republic of Moldova on economic developments and policies underpinning the IMF arrangements. Based on information available at the time of these discussions, the staff report was completed on October 26, 2016.
- A **Statement by the Executive Director** for the Republic of Moldova.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the Republic of Moldova*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Moldova*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

© 2016 International Monetary Fund

Press Release No. 16/491
FOR IMMEDIATE RELEASE
November 7, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Approves US$178.7 million Arrangements Under the Extended Fund Facility and the Extended Credit Facility for the Republic of Moldova

On November 7, 2016 the Executive Board of the International Monetary Fund (IMF) approved three-year arrangements under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) with the Republic of Moldova to support the country's economic and financial reform program. The cumulative access under the arrangements is SDR 129.4 million (about US$178.7 million, or 75 percent of the Republic of Moldova's quota).

An amount equivalent to SDR 26 million (about US$35.9 million) will be made available to the Moldovan authorities immediately following the approval of the arrangements. The remaining amount will be phased in over the duration of the program, subject to five semi-annual program reviews.

Following the Executive Board discussion on Moldova, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, said:

"The Moldovan authorities have developed a comprehensive program—to be supported by a three-year arrangement under the Extended Fund Facility and the Extended Credit Facility—to strengthen the economy and address key vulnerabilities. The program aims at reinforcing the recent economic stabilization and advancing a broad structural reform agenda, particularly in the financial sector. Strong commitment to sound policies and a significant improvement in economic governance will be crucial to raising long-term growth prospects.

"Significant upfront progress has been made in enhancing the resilience of the banking sector and address weaknesses that gave rise to the 2014 crisis. Following the recent strengthening of the legal and regulatory frameworks, efforts should now focus on effective implementation and timely enforcement actions to end supervisory forbearance in the face of shareholder or manager misconduct. An effective and independent court system and central bank will be critical to support these efforts.

"Fiscal policy has been recently constrained by falling revenues and tight financing. The 2016 budget deficit is set to widen modestly to support the nascent recovery, as debt remains sustainable despite the high fiscal cost of the banking crisis. Fiscal policy will need to be

anchored in a sound medium-term framework and supported by measures to strengthen the revenue base and prioritize social and infrastructure spending.

“Monetary policy has been appropriate, geared toward maintaining low inflation in the context of a flexible exchange system. Since late 2015, inflationary pressures have significantly abated, allowing the National Bank of Moldova to loosen its tight monetary policy stance. Swift rehabilitation of the banking sector will be instrumental in unlocking healthy credit growth to productive sectors.

“Structural reforms along priorities defined in the National Developmental Strategy will improve competitiveness, attract investment, diversify the export structure, and achieve sustainable and inclusive economic growth. Strengthening the AML/CFT framework, the oversight of the National Anti-Corruption Center, and the framework for asset disclosure for senior officials will provide a further impulse to governance and transparency.

“International support under the framework of the Fund-supported program would lend financial and technical assistance as Moldova engages in deep reforms in the financial sector, give the authorities space to pursue a more balanced fiscal policy, and contribute to the build-up of international reserves.”

ANNEX

Recent Economic Developments

The economy is recovering from the recession of 2015. A modest growth of about 2 percent is expected for 2016, supported by private consumption but dampened by the continuing investment decline, as financing remains tight.

Inflation has decelerated sharply in 2016, reflecting downwards adjustments of energy tariffs, a slowdown in international food prices, and a stabilization of the leu after its sharp depreciation in the first half of 2015. Inflation is expected to remain close to the lower bound of the central bank’s target range of 5 ± 1.5 percent for the rest of the year.

Budget execution has been constrained by weaker-than-expected revenues and grants and tight financing. Given the relatively large recurrent spending, adjustment has continued to fall mainly on already modest capital investment.

The current account continues to narrow, largely on the back of import compression. Remittances have fallen further relative to their level in 2015, but pressures on the foreign exchange market have recently abated, and NBM has been able to increase its international reserves.

Program Summary

The key objective of the program is to tackle upfront the urgent governance and stability issues in the banking sector. The program is thus centered on a successful rehabilitation of systemically important banks and radical improvements to the regulatory, supervisory, and contingency frameworks for banks, including through a demonstrated fundamental shift in the enforcement and sanctioning regime. The financial sector has been under stress for a number of years now, and a key priority would be to bring about an exit from the crisis, so that banks can resume normal financial intermediation.

Prior actions have put the financial sector on stronger footing and reduced fiscal risks, giving the program a better chance of success. They were aimed at (i) demonstrating a clear shift in the enforcement regime; (ii) completing the management team and oversight bodies of the NBM; (iii) starting the process of dismantling opaque ownership structures and related-party lending; with broader and stronger legal powers granted to the supervisor; (iv) improving crisis management capacity; and (v) eliminating past channels for fraudulent change in ownership of shares. In the energy sector, given accumulated intra-firm debt and arrears, a near-term priority was to restore financial viability to firms in the energy sector and move toward greater transparency of regulatory decisions. Finally, the terms of the securitization of the government guarantees issued for liquidity provision in the failed banks have appropriately strengthened the central bank while not squeezing unduly priority public expenditure in the near and medium term.

Against the backdrop of a negative output gap and a current account narrower than its long-term norm, the program gives space for fiscal policy to make use of available margins to boost public investment, as monetary policy settings are loosened more gradually in light of financial sector risks. The ECF/EFF will, in that context, safeguard fiscal sustainability by anchoring annual budgets in a sound medium-term framework, focusing on revenue mobilization, expenditure prioritization, elimination of public payment arrears, utility tariff reform, and tougher monitoring of SOEs.

The program is also expected to catalyze significant support from external donors.

Table 1. Moldova: Selected Economic Indicators, 2010–17 1/

	2010	2011	2012	2013	2014	2015	2016	2017
							Projection	
I. Real sector indicators	(Percent change, unless otherwise indicated)							
Gross domestic product								
Real growth rate	7.1	6.8	-0.7	9.4	4.8	-0.5	2.0	3.0
Demand	9.1	8.2	0.4	6.2	3.6	-3.2	1.7	2.5
Consumption	7.3	7.3	0.9	5.2	2.7	-1.1	2.4	1.4
Private	9.5	9.3	1.0	6.5	3.2	-2.3	0.9	1.7
Public	-1.1	-1.0	0.6	-0.8	-0.8	-0.4	9.8	-0.4
Gross capital formation	17.2	13.0	1.8	3.3	10.0	-1.2	-1.8	10.1
Private	20.3	16.4	1.6	2.7	7.7	-2.4	1.0	3.6
Public	4.2	-3.3	3.4	6.4	22.4	4.5	-14.3	44.0
Net Exports of goods and services	-14.8	-12.1	-2.8	0.0	0.3	11.7	-0.9	-0.6
Exports of goods and services	13.7	27.4	1.7	10.7	1.0	2.3	1.4	8.0
Imports of goods and services	14.3	19.7	2.2	5.5	0.4	-4.3	1.2	5.1
Nominal GDP (billions of Moldovan lei)	71.9	82.3	88.2	100.5	112.0	122.2	132.7	142.8
Nominal GDP (billions of U.S. dollars)	5.8	7.0	7.3	8.0	8.0	6.5	6.7	7.0
Consumer price index (average)	7.4	7.6	4.6	4.6	5.1	9.6	6.9	4.9
Consumer price index (end of period)	8.1	7.8	4.0	5.2	4.7	13.5	3.5	4.7
Unemployment rate (annual average, percent)	7.4	6.7	5.6	5.1	3.9	4.9	4.7	4.5
Poverty headcount ratio at national poverty lines (percent)	21.9	17.5	16.6	12.7	11.4			
Saving-investment balance	(Percent of GDP)							
Foreign saving	9.4	12.8	8.4	5.8	6.5	5.0	3.5	5.0
National saving	13.2	10.5	15.3	17.2	18.2	19.3	18.8	19.1
Private	11.5	9.3	13.7	15.4	15.7	17.6	18.3	16.2
Public	1.8	1.2	1.6	1.8	2.6	1.7	0.5	2.8
Gross investment	22.6	23.3	23.6	22.9	24.7	24.2	22.4	24.1
Private	18.7	19.8	20.1	19.4	20.4	19.8	18.8	19.0
Public	3.9	3.5	3.6	3.6	4.3	4.5	3.6	5.1
II. Fiscal indicators (general government)								
Primary balance	-1.9	-1.7	-1.6	-1.4	-1.4	-1.5	-2.2	-2.3
Overall balance	-2.6	-2.5	-2.3	-1.9	-1.9	-2.3	-3.5	-3.7
Stock of public and publicly guaranteed debt	30.5	29.0	30.9	29.6	36.0	45.0	45.7	46.86
III. Financial indicators	(Percent change, unless otherwise indicated)							
Broad money (M3)	13.4	10.6	20.8	26.5	5.3	-3.0	9.8	...
Velocity (GDP/end-period M3; ratio)	1.9	2.0	1.8	1.6	1.7	1.9	1.9	...
Reserve money	8.9	21.8	19.7	27.0	6.3	7.1	5.7	...
Credit to the economy	12.7	15.0	16.1	18.8	-3.3	3.2	-0.3	...
Credit to the economy, percent of GDP	37.4	37.6	40.7	42.5	36.8	34.9	32.0	...
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)							
Current account balance	-545	-900	-610	-460	-520	-322	-236	-350
Current account balance (percent of GDP)	-9.4	-12.8	-8.4	-5.8	-6.5	-5.0	-3.5	-5.0
Remittances and compensation of employees (net)	1,273	1,733	1,893	2,098	1,937	1,386	1,316	1,409
Gross official reserves	1,718	1,965	2,515	2,821	2,157	1,757	2,075	2,433
Gross official reserves (months of imports)	3.4	3.9	4.7	5.4	5.4	4.7	5.1	5.5
Exchange rate (Moldovan lei per USD, period avge)	12.4	11.7	12.1	12.6	14.0	18.8	20.0	...
Exchange rate (Moldovan lei per USD, end of period)	12.2	11.7	12.1	13.1	15.6	19.7	20.5	...
Real effective exch.rate (average, percent change)	-6.1	5.9	4.1	-2.3	-3.0	-3.4	-2.0	...
Real effective exch.rate (end-year, percent change)	7.3	9.4	-2.9	-3.7	1.6	-2.5	-1.6	...
External debt (percent of GDP) 2/	80.9	76.9	82.7	84.5	84.9	98.9	100.4	101.2
Debt service (percent of exports of goods and services)	17.8	15.8	15.0	17.6	15.5	13.6	26.1	22.0

Sources: Moldovan authorities; and IMF staff estimates.
1/ Data exclude Transnistria.
2/ Includes private and public and publicly guaranteed debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

October 26, 2016

REQUESTS FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

EXECUTIVE SUMMARY

Context. Since late 2014, Moldova's economy has been hit by a number of domestic and external shocks. Chief among them is the exposure of extensive and well-orchestrated fraud in the banking system, resulting in the closure of three banks at a public cost of 10 percent of GDP. During the following period, confidence collapsed, external concessional financing largely froze, and international reserves fell by one-third, prompting significant tightening of monetary conditions. Domestic political turmoil, marked by three changes in government, constrained solutions and delayed collaboration with the international community on possible financial support.

Program request and objectives. The authorities have now formulated a comprehensive program to repair the banking system and advance reforms to consolidate the incipient stabilization and restore external confidence. To support their efforts, they request a three-year Extended Arrangement under the Extended Fund Facility (EFF)/Extended Credit Facility (ECF) blended financial assistance program with cumulative access of SDR 129.4 million (75 percent of quota). In particular,

- The program tackles upfront the urgent governance and stability issues in the banking sector, an area where past Fund advice has had limited traction over the past several years, even as problems intensified. It is centered on the rehabilitation of systemically important banks and far-reaching improvements to the regulatory, supervisory, and contingency frameworks for banks, including a demonstrated shift in enforcement actions and sanctioning of non-compliant banks.
- Decisive implementation of the program will help unlock support from bilateral and multilateral creditors. Over the program period, external support is expected to reach US$825 million. This would give the authorities space to pursue a more balanced fiscal policy and address pressing social and infrastructure investment needs, and allow them to build up their reserve buffer.
- The program supports broad reforms in line with the authorities' developmental and poverty reduction objectives, and namely improving the business climate and promoting competition, reducing financing costs by strengthening the financial sector, and increasing energy efficiency and ensuring the financial sustainability of the sector.

Approved By
Thanos Arvanitis and Mark Flanagan

Discussions were held in Chişinău during July 5–15, 2016, and concluded in Washington on July 26, 2016. The mission met with Prime Minister Filip, Deputy Prime Minister Calmîc, Minister of Finance Armaşu, Governor of the National Bank of Moldova Cioclea, and other senior officials and representatives of financial institutions, labor unions, diplomatic community, and international organizations. The mission team comprised I. Vladkova-Hollar (Head), V. Prokopenko, K. Kirabaeva, A. Khachatryan (Res. Rep.) (all EUR), D. Fayad (SPR), F. Jirasavetakul (FAD), and E. R. Karlsdottir (MCM). V. Volociuc (OED) and J. Gordon (EUR) participated in some discussions. N. Jovanovic, A. Madaraszova, A. Rhee, and C. Rubio (all EUR), and the local office in Chişinău assisted the mission team.

CONTENTS

CONTEXT 4

RECENT ECONOMIC DEVELOPMENTS 4

PROGRAM OBJECTIVES AND POLICIES 6

A. Financial Sector: Strengthening Institutions and the Policy Framework 8
B. Fiscal Policy: Safeguarding Sustainability 12
C. Monetary and Exchange Rate Policy 16
D. Structural Policies 18

PROGRAM MODALITIES 20

E. Access, Phasing and Conditionality 20
F. Capacity to Repay the Fund and Risks to the Program 22

STAFF APPRAISAL 23

BOXES
1. Effects of the Banking Crisis on the Economy 5
2. Supervisory Actions Against Shareholders Acting in Concert 10
3. Moldova's Fiscal Rule and Its Escape Clause 14
4. Monetary Developments in the Wake of the Banking Crisis 17

FIGURES
1. Real Sector Developments 25
2. Fiscal Developments, 2009–16 26
3. Money, Prices, and Interest Rates, 2011–16 27

4. External Sector Developments, 2009–16 28

TABLES

1. Selected Economic Indicators, 2010–21 29
2. Balance of Payments, 2010–21 30
3a. General Government Budget, 2010–21 (Millions of Moldovan lei, unless otherwise indicated) 31
3b. General Government Budget, 2010–21 (Percent of GDP, unless otherwise indicated) 32
4. Accounts of the National Bank of Moldova and Monetary Survey, 2010–16 33
5. Financial Soundness Indicators, 2009–16 34
6. Indicators of Fund Credit, 2011–20 35
7. Schedule of Reviews and Disbursements 36

ANNEXES

I. Risk Assessment Matrix 37
II. Debt Sustainability Analysis 38
III. Agriculture in Moldova 53
IV. External Stability Assessment 54

APPENDIX

Letter of Intent 57
Attachment I. Memorandum of Economic and Financial Policies 60
Attachment II. Technical Memorandum of Understanding 75

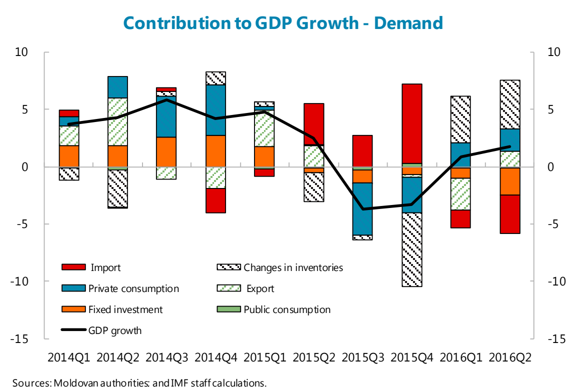
CONTEXT

1. **Since late 2014, Moldova was hit by a number of adverse internal and external shocks**. A sharp deterioration in the external environment led to a decline in foreign exchange inflows from exports and remittances, offset only partially by falling import prices and a depreciation of the exchange rate. However, chief among these shocks was the massive and well-orchestrated fraud in the banking system, stemming from opaque shareholder structures, bank governance failures, and weak supervision. In its aftermath, three banks have been resolved at a public cost of 10 percent of GDP, external concessional financing has been largely frozen, international reserves fell by one-third, and monetary conditions had to be tightened significantly. Domestic political turmoil, marked by three changes in government, as well as the sudden resignation of the Governor of the National Bank of Moldova (NBM) in September 2015, constrained solutions and delayed the dialogue with the international community.

2. **Despite a sharp decline in poverty in recent years, Moldova remains one of the poorest countries in Europe and structural reforms are needed to promote sustainable growth**. Income per capita, US$2,220 in 2015, is the lowest in Europe and less than half the average income per capita in the CIS region (US$5,079). Key structural gaps from a cross-country perspective[1] broadly correspond to the priorities laid out in the National Development Strategy—these include education, infrastructure, the financial sector, business climate, energy consumption, the pension system, and the judicial framework.

RECENT ECONOMIC DEVELOPMENTS

3. **The economy is recovering from the 2015 recession and expected to post modest growth of about 2 percent in 2016**. Following a contraction of 0.5 percent in 2015 (Box 1), economic activity expanded by 1.3 percent in the first half of 2016. Growth has been supported by private consumption (2.2 percent) and a buildup of inventory stocks, but dampened by the continuing investment decline (-6.7 percent) as financing remains tight. Following a decline in the first quarter of 2016, exports recovered in the second quarter (3 percent), however the contribution of net exports to growth was still negative. On the production side, manufacturing and trade supported growth in the first half, while a stronger contribution from agriculture is expected in the second half of the year. Unemployment remains low (4 percent in the second quarter of 2016), reflecting widespread labor migration and low labor force participation.

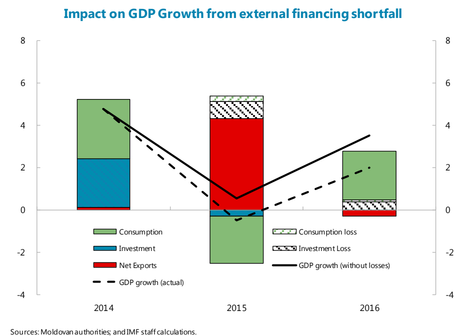


[1] Please see IMF Country Report No. 16/19.

Box 1. Effects of the Banking Crisis on the Economy

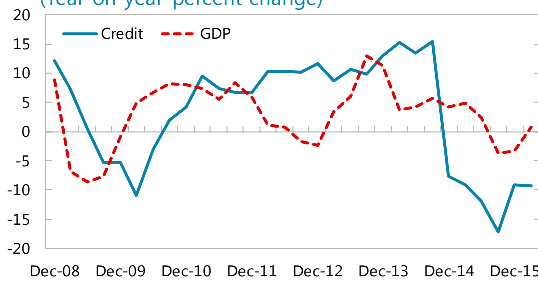
Notwithstanding its scale and duration, the direct impact of the banking crisis on economic activity was somewhat limited. While isolating the effects of the crisis is difficult, as it coincided with other shocks including a strained external environment and very low growth in key trading partners, the following channels were at work.

- **"Sudden stop" of external financing and the fiscal adjustment channel**. Serious economic governance concerns resulted in a "sudden stop" of donor financing. As a result, the shortfall in external financing constrained public consumption and public investment, despite the substantial switch to domestic financing through T-bill issuance. The resulting budget consolidation, assuming a multiplier of one,[1] has likely lowered growth by around 1.1 percent in 2015 and 1.5 percent in 2016.



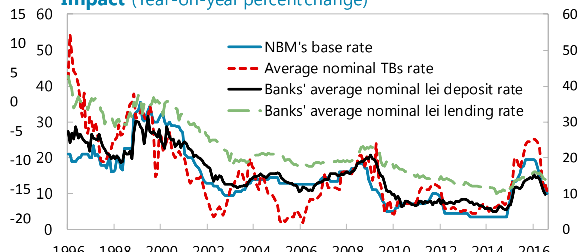
- **Wealth effects**. Neither households nor corporates have taken any direct losses from uninsured deposits following the banking resolutions, given the authorities' decision to issue a blanket guarantee.

Credit and GDP Growth
(Year-on-year percent change)



Sources: Haver and IMF staff calculations.

Interest Rates Dynamics Reflect Tighter Monetary Policy to Cope with Bank Resolution Monetization Impact (Year-on-year percent change)



Sources: National bank of Moldova and IMF staff

- **Domestic credit channel**. The decline of bank loans after the crisis reflected mostly a reduction in fraudulent loans in the three failed banks, as well as tighter banking regulation and oversight for new loans. On the demand side, the massive injection of liquidity into the banking system through insolvent banks (see Box 4), required that the NBM aggressively sterilize the monetization of emergency lending and tighten monetary policy through increasing policy rates and mandatory reserves. The resulting strongly positive real lending rates facing the private sector have likely also constrained credit demand. Nonetheless, credit from the banking system has had a limited impact on economic growth, which is primarily driven by agriculture and financed by remittances.

---

[1] This assumption is consistent with multipliers used in other program countries and recent literature findings that fiscal multipliers are higher in recession. "Coping with High Debt and Sluggish Growth", WEO, October 2012 and—Growth Forecast Errors and Multipliers, IMF Working Paper 13/1.

4. Inflation has decelerated sharply in 2016. The rapid fall in inflation from its peak of 13.5 percent in December 2015 to 3 percent in September 2016 reflects lower energy and international food prices, and a stabilization of the currency after its sharp depreciation in the first half of 2015, in addition to a high base effect. With favorable harvest prospects, inflation is expected

to remain close to the lower bound of the central bank's target range of 5 ± 1.5 percent for the rest of the year.

5. **Budget execution through July was constrained by weaker-than-expected revenues and tight financing**. While the approved budget projected an annual increase in VAT revenues of nearly 12 percent, VAT revenues increased only by 2 percent (y/y) during the first seven months of 2016. Over the same period, external grants declined by 77 percent (y/y), and external budget support loans remained frozen pending approval of a Fund-supported program. Given the relatively large recurrent spending, adjustment has continued to fall mainly on already modest capital investment: less than one-third of budgeted capital investment has been executed during the first six months. The stock of arrears has gradually declined but remained at around ¼ percent of GDP at end-July.

6. **The current account continues to narrow, largely on the back of import compression**. As of July 2016, exports of goods and services have increased by 0.5 percent (y/y), while imports of goods have contracted by 7.9 percent (y/y) with the decline in global commodity prices and still weak domestic demand. Remittances continue to contract relative to their level in 2015. Overall, these trends are expected to broadly continue in the second half of the year, and the current account is projected to narrow to 3.5 percent of GDP by end-2016.

7. **Pressures on the foreign exchange market seem to have abated**. After a depreciation of abound 8.9 percent in the first half of 2015, the currency has broadly stabilized, and the real rate is now considered broadly in line with fundamentals. International reserves have increased recently to about US$3.1 billion (about 5.2 months of prospective imports, 133.5 percent of ARA metric). Weak demand for foreign currency driven by a decline in imports, combined with a seasonal increase in the supply of foreign exchange from remittances have allowed the NBM to purchase about US$370 million since the beginning of the year, mostly over the last few months.

PROGRAM OBJECTIVES AND POLICIES

8. **The program aims to tackle upfront the urgent governance and financial stability issues, and advance structural reforms to pave the way for stronger growth and poverty reduction**. The financial sector has been under stress for a number of years now, and a key priority would be to bring about an exit from the crisis, so that banks can resume normal financial intermediation. To this end, the program is centered around a successful rehabilitation of systemically important banks and far-reaching improvements to the regulatory, supervisory, and contingency frameworks for banks, including through a fundamental shift in the enforcement and sanctioning regime. Program measures support government efforts in achieving a number of objectives specified in the National Development Plan, namely improving the business climate and promoting competition reducing financing costs for productive sectors, and ensuring the financial sustainability of the energy sector.

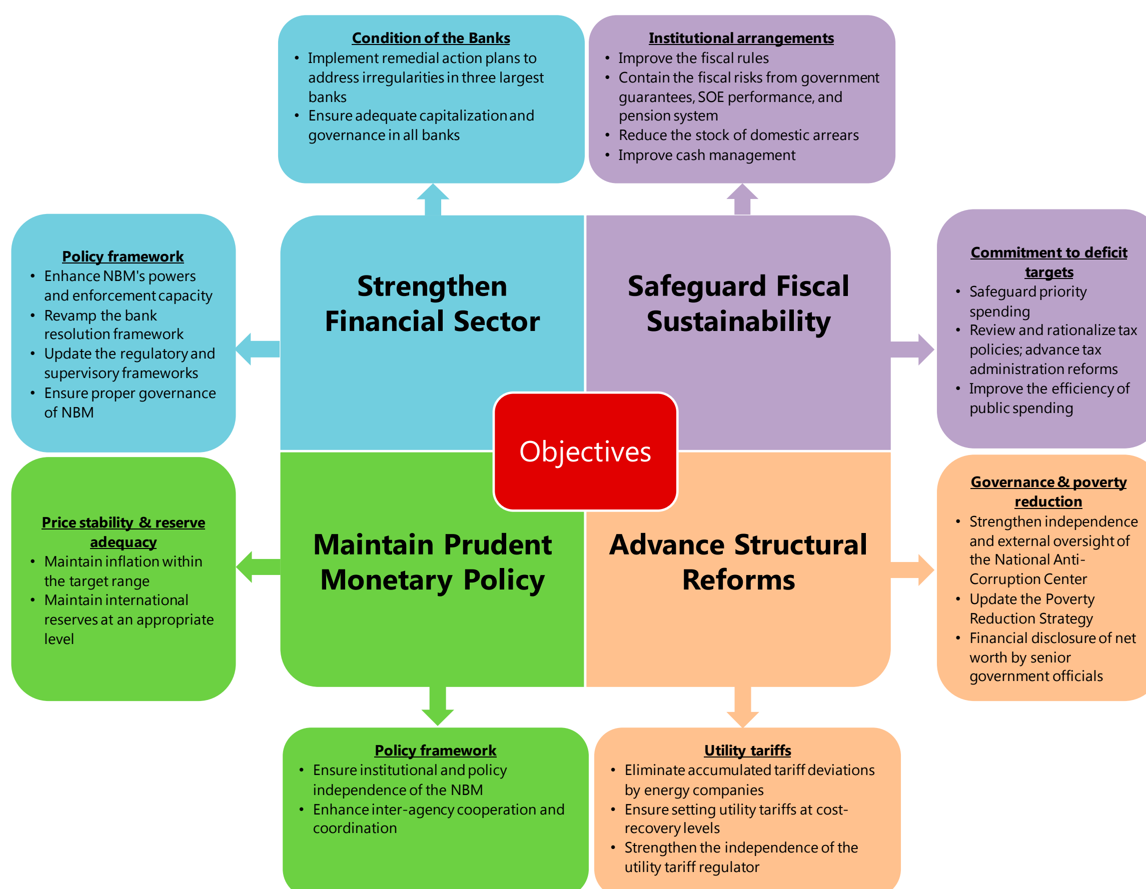
9. The macroframework projects a gradual return to a balanced growth path:

- *Growth*. Financial sector repair, together with a gradual fiscal adjustment while increasing public investment, sound monetary policy, structural reforms, particularly in utility and SOE sectors, and external financial support are expected to lift economic growth toward its potential by 2019. Restoring effective financial intermediation and relaxing binding domestic and external financing constraints should promote a resumption in both private and public investment following two consecutive years of contraction. Reforms aimed at improving governance and business climate will have a more gradual payoff. The program assumes growth rising to 3.8 percent in the medium term, at a discount to the almost 6 percent average growth achieved over 2000–08, supported largely by capital accumulation. The labor force contribution will remain subdued given labor migration and adverse demographic trends.

- *Inflation*. Inflation is projected to remain in its target range over the medium term, as the current deflationary shocks are mostly transitory.

- *External position*. As domestic demand recovers, the current account deficit is expected to widen some 1½ percentage points to about -5.1 percent of GDP, broadly consistent with the estimated current account norm. FDI flows are projected to finance slightly under half of the deficit—also assumed to remain initially subdued relative to historical performance.

Program Objectives, Policy Areas, and Key Measures



10. The outlook is subject to several risks (see the Risk Assessment Matrix). Beyond the external shocks, including due to risks of weaker growth in Russia, the baseline of a gradual normalization already in 2016 is contingent on the successful implementation of the bank rehabilitation strategy, which preserves confidence, prevents any further fraudulent activity, and minimizes macroeconomic costs. There is a risk that successful implementation of the banking sector strategy could be undermined by continued judicial interference in NBM regulations and by weak enforcement of the legal protection of NBM staff executing duties in good faith. Underlying all this is the assumption that the political volatility of the last two years will not reemerge in relation with the presidential elections and that the political commitment to reform the banking sector runs deeper than the vested interests.

A. Financial Sector: Strengthening Institutions and the Policy Framework

Background

11. Moldovan banks have long suffered from opaque shareholder structures, related-party lending, and poor internal governance and risk management. This has led to abuse of some banks by their shareholders—a key illustration of which was the failure of Banca de Economii, Banca Sociala, and Unibank in 2014.[2] To preserve the assets of the three largest remaining banks (60 percent of system total), the NBM placed these banks under special supervision in July 2015 and required special external audits to ascertain their condition. The audits found similar weaknesses in shareholder transparency, internal governance, compliance with regulation and lending practices as in the intervened banks.

12. The bank scandal also exposed serious weaknesses in the regulatory environment and oversight. Enforcement actions by the supervisor were rare and, when taken, were not been commensurate with the seriousness of the deficiencies. Small fines did not materially affect incentives for bankers, and in some cases *de jure* compliance was followed by *de facto* defiance (e.g., removed managers were reappointed as advisors).

13. The incomplete crisis resolution framework limited intervention options. As identified in the 2014 FSAP update, the resolution framework in place was weak, essentially limiting the response to either early intervention (which was often thwarted by court action and lobbying by vested interests) or liquidation (which becomes less desirable in cases of large banks, given the significant systemic financial stability risks and the high costs it entailed).

Policies

14. The program aims to ensure long-term financial stability by fostering sound financial institutions, operating within a strong regulatory and supervisory environment. The policies

[2] For a discussion of the challenges posed by the shareholder structure, please see the 2014 Second PPM report (http://www.imf.org/external/pubs/cat/longres.aspx?sk=42530.0) and for a summary of the evolution of the 2014 crisis, please see the 2015 Article IV report (http://www.imf.org/external/pubs/cat/longres.aspx?sk=43631.0).

focus on four key areas: (i) taking enforcement actions to address already identified breaches of NBM regulations; (ii) identifying Ultimate Beneficial Owners (UBOs) and related parties, unwinding related-party lending and enhancing governance in the banking sector; (iii) revamping the resolution framework, preparing contingency plans and restructuring banks; and (iv) improving the NBM's governance and resources. As prior actions under the program (MEFP Table 1), important legal and regulatory amendments have been adopted, enforcement actions taken, and action plans for identification of UBOs and related parties approved, with a particular focus on the largest banks in the system. However, vested interests are still powerful and continuous political support, together with judicial reforms, will be essential to ensure full program implementation.

	Aug 2016	Sep 2016	Oct 2016	Nov 2016	Dec 2016	Jan 2017	Feb 2017	Mar 2017	Apr 2017	May 2017	Jun 2017	Jul 2017	Aug 2017	Sep 2017	Oct 2017	Nov 2017	Dec 2017
Three largest banks (59.8 percent of system assets)																	
Supervisory actions on already identified irregularities																	
Functional Supervisory Boards																	
UBO identification		*Plan*	*Identification*														
Identification of and plans to unwind related-party (RP) lending																	
Full-scope on-site inspection																	
4–5 largest banks that are not subsidiaries of foreign banking groups (7.8 percent of system assets)																	
UBO identification		*Plan*	*Identification*														
Identification of and plans to unwind related-party lending																	
Full-scope on-site inspection																	
Remaining banks—local banks (1.2 percent) and foreign banks (31.2 percent) of system assets																	
UBO identification		*Plan*	*Identification*														
Identification of and plans to unwind related-party lending																	
Full-scope on-site inspection																	

Enforcement actions

15. The NBM has taken strong up-front actions to address irregularities identified in bank audits, on-site inspections, and off-site supervision. In particular, the NBM:

- *Removed unfit shareholders in the two largest banks*. The NBM has now blocked or cancelled the shares of shareholders of the two largest banks which were found to have acted in concert in violation of the Law on Financial Institutions (Box 2). All potential new significant shareholders (those with equity stakes greater than 1 percent) will be subject to fit-and-proper certification, in line with NBM regulations.

- *Placed a large bank under temporary management*. Following the blocking of over 60 percent of second largest bank's shares, the NBM took control of the bank on October 20, 2016, to protect depositors and preserve value. The bank's management has been replaced, and a new external diagnostic of the bank will be launched.

- *Strengthened bank governance structures*. The NBM has ensured that all banks have a functional Supervisory Board, with fit-and-proper Board members in line with international best practices (MEFP ¶6). This addresses a long-standing vulnerability in one key bank which has been

operating without a Supervisory Board—and therefore without a proper governance and risk management structure—since September 2014.

- *Requested and approved time-bound remedial action plans*. The two banks that remain under special supervision are now following time-bound remedial action plans that aim to address by end-January 2017 all deficiencies detected in the Special Audit reports. The NBM has developed an interactive supervisory process for monitoring the plans and will conduct full-scope on-site inspections in these banks by end-February 2017. Once compliant with all NBM regulations, banks will exit the special supervision regime, and enforcement actions will be taken against non-compliant banks by end-March 2017 (MEFP ¶8).

Box 2. Supervisory Actions Against Shareholders Acting in Concert

The NBM's newly established Shareholder Transparency Unit (STU) has determined that a group of shareholders of the system's two largest banks, MAIB and MICB, were acting in concert for the benefit of a yet unidentified beneficial owner. The shares were acquired without the appropriate approval of the NBM and in violation of the law.

In **MAIB** these shareholders held 43 percent of total shares.[1] With powers provided in the Law on Financial Institutions (LFI), these shares were blocked in December 2015 and March 2016, and the shareholders were ordered to sell them within a period of 90 days.[2] Since the shares were eventually not sold, MAIB was ordered to cancel these shares and issue a like amount of new shares, which were listed on the Moldova Stock Exchange in late September—with the sales proceeds to be paid to the cancelled shareholders. All new investors, irrespective of size will need NBM approval to acquire the shares.

If no buyers are found within a specified period, the shares will be repurchased by MAIB at face value. Based on the reported book value of capital, the transaction will only marginally reduce MAIB's capital.

In **MICB**, the STU established that over 60 percent of shareholders were acting in concert. In line with the newly adopted Bank Recovery and Resolution Law, there was sufficient ground for the NBM to take control, paving the way for placing MICB in temporary management on October 20, 2016.

Blocked and cancelled MAIB shareholders have already initiated legal actions against the supervisory action, which could create uncertainty about its finality and about ownership rights to these shares. To mitigate some of that uncertainty, the authorities amended the LFI to ensure that in the event of court ruling against the supervisory action, recourse will only be in the form of monetary compensation and not trigger the reversal of the share cancellation.

---

[1] 1 percent of these shares are in litigation and, while blocked they are not yet cancelled.

[2] Law No. 550 of 1995, Article 15[6] on non-compliance with the shareholders' quality requirements.

Identification of UBOs and related parties

16. Identification of UBOs and related parties, and monitoring and unwinding of above-limit loans to related parties is a critical part of the program.

- *Stronger legal powers to identify related parties*. The authorities adopted amendments to the LFI and NBM law strengthening the definitions of related parties ("affiliates") and granting the NBM explicit powers to presume any person as a bank's related party on the basis of objective criteria, unless the banks are able to prove otherwise. The new powers should significantly shorten the identification process and provide economic incentives to the banks and related parties to submit information.
- *UBO identification*. The NBM has prepared a plan for full identification of UBOs of bank shares. The diagnostics will be concluded by end-December 2016 for the three largest banks and end-June 2017 for the remaining banks (MEFP ¶10).
- *Identification and unwinding of related-party lending*. The NBM has adopted regulations on the criteria and the governance of a process for conducting the related party diagnostics. Following the UBO identification process and onsite inspections, related parties will be identified and/or presumed in line with the NBM's new powers. The banks will be required to submit a plan to unwind above-limit exposures within a period of up to two years (MEFP ¶ 11).
- *Better registration of ownership of shares and securities*. New modern legislation on a Central Security Depository (CSD) has been adopted. Once operational, the CSD will reduce the scope for fraudulent changes in bank ownership, which have in the past exploited the lack of cooperation between 10 existing private depositories (MEFP ¶ 12).

Revamping the resolution framework and planning for contingencies

17. The recent adoption of a new Bank Recovery and Resolution Law (BRRL) allows the authorities to resolve any contingency in an orderly fashion. Based on the European Bank Recovery and Resolution Directive (BRRD), the BRRL provides for broad intervention and resolution powers. To adjust to the current environment in Moldova, however, the enactment of some of the BRRD features are temporarily postponed, notably the creation of a resolution fund and conditioning an 8 percent bail-in before providing public funds in resolution.

18. To mitigate potential risks, the authorities have prepared contingency plans for the three largest banks. Fallback contingency strategies make use of the powers provided under the new BRRL and include measures that ensure that depositors and macroeconomic stability are protected. The strategies will be developed further as the related-party diagnostics move toward completion, and aim to avoid any further use of public funds (MEFP ¶14).

19. The National Committee for Financial Stability (NCFS) has been strengthened. The government's decision on NCFS of October 12, 2016, streamlined the composition of NCFS by excluding prime minister, state chancellor, and the head of economy and budget committee of parliament from its members, and assigned NBM as the secretariat of the NCFS. These changes should help the NCFS to perform its tasks more effectively without undue political influence.

Upgrading the regulatory and supervisory framework

20. Sanctions for breaches of banking regulations, including AML/CFT, have been increased. The maximum monetary fines have been increased substantially. Sanctioned bank directors, managers and employees are now banned from holding any positions in the financial sector for at least 10 years. Furthermore, any persons (including shareholders) can now be held pecuniary liable for the failure of a bank (MEFP ¶17).

21. Once the key financial stability risks are taken off the table, the program will seek to complete the overhaul of the supervisory and regulatory framework, focusing on:

- *Strengthening the implementation of the AML/CFT framework*. In particular: (i) strengthen AML/CFT supervision and conduct targeted risk-based on-site inspections of the banking sector to ensure that AML/CFT preventive measures are effectively implemented by banks, and (ii) take supervisory action as appropriate in response to possible breaches of compliance with AML/CFT requirements identified.

- *Preparing a strategy for addressing remaining deficiencies identified in the BCP Assessment of the 2014 FSAP* (MEFP ¶18), and namely improving the supervision of risk and risk management processes.

- *Strengthening the safety net*. With the current coverage level of 6,000 MDL (US$300), the Deposit Guarantee Fund's (DGF) contribution to financial stability is negligible. To change this, the authorities will raise the coverage level and establish backup funding for the DGF.

- *Establishing a policy for placement of public sector deposits*. The Ministry of Finance will define its procedures for procurement rules in contracting banks for public funds management, and refrain from giving privileged access to public sector funds.

Enhancing NBM Governance

22. The governance of the NBM is being enhanced, supported by sufficient resources and legal protection. Members of the supervisory council and audit committee have been selected and both bodies are operating, and the Executive Board of the NBM has been strengthened by filling the two vacant deputy governor positions (*prior actions*). However, the NBM is understaffed, and there is priority in retaining and recruiting supervisors, lawyers and other experts. The authorities are committed to ensure appropriate resources to carry out the financial sector agenda. To this end, the NBM law has been amended to enable a review of the NBM's remuneration system (MEFP ¶19). Legal protection for NBM staff carrying out their duties in good faith has been embedded now in the NBM law, and must be actively ensured.

B. Fiscal Policy: Safeguarding Sustainability

23. The program seeks to strengthen fiscal sustainability in a balanced and growth-enhancing manner, increasing space for priority social and capital expenditure. Even with the

substantial public costs of the banking sector crisis, the risk of debt distress in Moldova remains relatively low. Therefore, the fiscal strategy aims to (i) target a fiscal path that ensures medium-term debt sustainability; (ii) provide adequate resources for priority social and capital expenditure to reduce poverty and enhance growth; and (iii) focus on containing fiscal risks from the financial system, energy sector, SOEs, and government guarantees.

24. The 2016 deficit is set to widen modestly to support the nascent recovery, amidst difficult external and financial conditions. The headline cash deficit target of 3.2 percent of GDP in 2016 is expected to be met, including through expenditure rationalization, restraint of the wage bill and containment of other current spending, while safeguarding priority spending on capital investment (MEFP ¶26). Despite excise tax increases and the introduction of wealth taxes on large real estate holdings, weak domestic demand and limited disbursement of external grants—to be unblocked only upon approval of a Fund program—have constrained available resources.

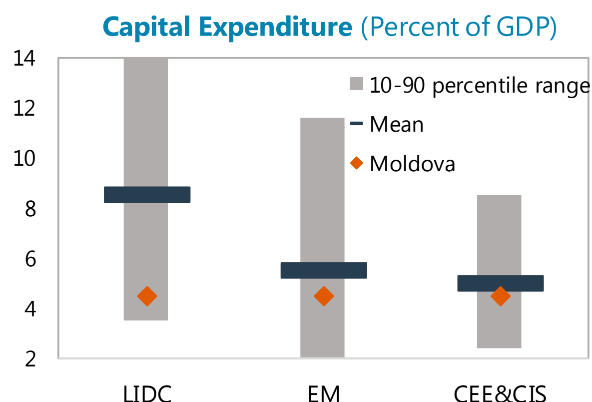
25. Binding financing constraints have given rise to public payment arrears, which will be addressed by early 2017. With the unblocking of external budget support, the authorities are committed to gradually eliminate the stock of domestic arrears (indicative target). Supported by technical assistance from the IMF, the authorities will also work on diagnosing the cause of persistent arrears at both the central and local government levels, and strengthen public financial management to prevent their reappearance.

26. The medium-term framework is built around a gradual fiscal consolidation path that brings the headline deficit down to 2.9 percent of GDP by 2019. The medium-term anchor—the Fiscal Responsibility Law (FRL)—limits the overall deficit, excluding grants, to 2.5 percent of GDP by 2018, with an escape clause for public capital investment funded by external concessional sources (Box 3). In light of the projected low risk of debt distress, the program supports the use of the escape clause given the need for social spending and growth-enhancing investment. A credible path to achieving the headline 2.9 percent deficit target will be mapped out in the Medium-Term Budget Framework for 2017–19 (***structural benchmark***).

27. The medium-term fiscal framework will be supported by measures to strengthen revenue and preserve space for social and development objectives (MEFP ¶30):

- *Strengthening the tax base*. Drawing on recent FAD TA, the authorities plan to review and rationalize VAT, CIT, and PIT exemptions. This includes simplifying and unifying the CIT regime, streamlining VAT exemptions and the two VAT-reduced rates, as well as developing plans to reduce underreporting taxable income and wages. The mechanism of real estate valuation will be revised to broaden the tax base for real estate taxes. Tax administration reform will improve tax compliance through the unification of the state tax administration as well as by enhancing the performance of the large tax payer office and the high-wealth individual program.

Box 3. Moldova's Fiscal Rule and Its Escape Clause

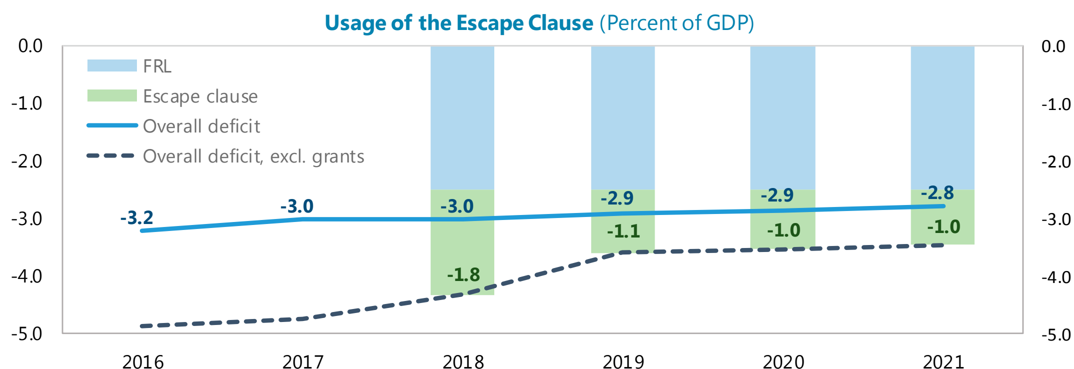


Source: IMF staff calculations.

The Fiscal Responsibility Law (FRL) contains important elements to strengthen the medium-term fiscal framework of Moldova, including a fiscal policy rule defined as a general government budget deficit target, excluding grants of 2.5 percent of GDP to be achieved by 2018. Exceeding the deficit ceiling is allowed under an ***escape clause for public capital investment*** funded by external concessional sources and when there is adequate domestic absorption capacity.

Given the relatively low level of public capital expenditure in Moldova, the authorities intend to use this escape clause for additional public capital investment, while remaining committed to ensure a sustainable fiscal path for public debt. This is in line with a headline fiscal deficit of about 2.9 percent of GDP (or 3.1 percent on an augmented basis, ¶26) in 2019.

With external grants projections of around 1.2 percent of GDP in 2018 and 0.7 percent of GDP in the medium term, the proposed fiscal deficit path implies the use of the escape clause of about 1.7 percent of GDP in 2018 and 1 percent of GDP thereafter.



Source: IMF staff calculations.

- *Improving the efficiency of spending*. The rationalization of public sector wages is a crucial part of the authorities' structural reform plan to make public administration more efficient and competitive. This requires a thorough review of core functions of public administration and an examination of the incentive structures. In addition to the public sector wage bill, following the recent FAD TA recommendations, the authorities intend to rationalize a number of non-targeted categorical social benefits. Fiscal savings from these adjustments should be directed toward (existing) targeted social spending and capital expenditure.

28. The authorities will also strengthen the framework to monitor and contain fiscal risks, especially those stemming from on-lending arrangements with government guarantees, part of which will be brought into the budget deficit concept.

- *An augmented fiscal deficit*, that includes net lending to state-owned enterprises (SOEs) as a budgetary expenditure item, will be used to monitor explicitly on-lending agreements with external creditors to SOEs (MEFP ¶29 and text table).

	2016	2017	2018	2019	2020	2021
Overall fiscal balance	-3.2	-3.0	-3.0	-2.9	-2.9	-2.8
Onlending to SOEs	0.3	0.4	0.4	0.2	0.2	0.2
Augmented fiscal balance (incl. onlending to SOEs)	-3.5	-3.4	-3.4	-3.1	-3.0	-2.9

- *On-lending arrangements through commercial banks to the private sector do not carry an equivalent risk to the state budget*, and hence are only monitored as part of public guarantees in the debt sustainability analysis. Nevertheless, the authorities will tighten the evaluation framework for entering into such contracts—including the capacity of particular sectors to absorb large inflows.

- *Moldova's risk of debt distress remains low even accounting for the augmented deficit*. In line with the previous assessment at end-2015, all indicators for public debt remain well below the debt thresholds under the baseline, standard bound tests, and alternative scenarios as well as under the probability approach. The magnitude of the standard contingency shock is sufficient to capture the size of a combined shock from the financial and energy sectors.

29. Measures will also be taken to improve cash and debt management:

- *The authorities are committed to improve cash management*. In particular, strengthening the link between central government transfers and budget executions of local governments will help reduce the interest costs on the central government budget.

- *Regarding debt management, financial instruments are limited and concentrated at the short end of the maturity spectrum*. The government securities market is illiquid, with very low trading on the secondary market. Some improvement in communication between the Ministry of Finance and the NBM on high-frequency liquidity forecasting has taken place in recent months, but more needs to be done to institutionalize these improvements.

30. Over the course of the program, a number of structural reforms will aim to strengthen fiscal institutions and reduce fiscal risks (MEFP ¶31):

- *Law on Public Finance and Fiscal Responsibility* (FRL). The authorities are committed to reviewing the parameterization of the fiscal target and the escape clause so as to better accommodate social and development objectives all while strengthening the fiscal anchor in the FRL by explicitly linking it with debt sustainability and cyclical trends.

- *Fiscal risks*. The authorities will publish a Fiscal Risk Statement (FRS) with the annual budget starting with the 2018 budget, which would help quantify implicit and explicit fiscal risks related to the public sector.

  - *State-owned enterprises*. On-lending to SOEs is monitored explicitly through the augmented deficit target. In addition, to prevent the emergence of fiscal risks from SOEs, the parliament will adopt the law to conduct a formal annual audit of all SOEs' financial results (starting with the largest 15 enterprises in early 2017).

  - *Utility tariff adjustment*. The authorities will contain fiscal risks stemming from the energy sector by adjusting electricity and district heating tariffs towards cost-recovery levels (Section on Structural Reforms and MEFP ¶32–33) and by implementing a transparent and credible private sector solution to the accumulated tariff debt.

- *Social Security System*. Given trends in outward migration and demographics, as well as the system's very low replacement rate, a balance has to be struck between the fiscal and social sustainability of the pension system. The authorities are currently undertaking a comprehensive analysis of the current pay-as-you-go system. Planned reforms in these areas include increasing the retirement age, improving coverage and compliance, and introducing a more systematic indexation of pension benefits without ad-hoc increases (MEFP ¶31).

C. Monetary and Exchange Rate Policy

Background

31. Abating inflationary pressures and excess supply of foreign exchange have allowed the NBM to start loosening the tight monetary policy stance and build up its international reserves. A faster-than-expected decline in inflation on the back of weak domestic demand, prompted NBM to lower its base (policy) rate in several steps from 19.5 percent in February 2016 to 9.5 percent as of late September (Box 4 describes monetary developments in the wake of the banking crisis). Nevertheless, the interest rates remain strongly positive in real terms, and the reserve requirement on leu deposits is still at a record high of 35 percent.

Policies

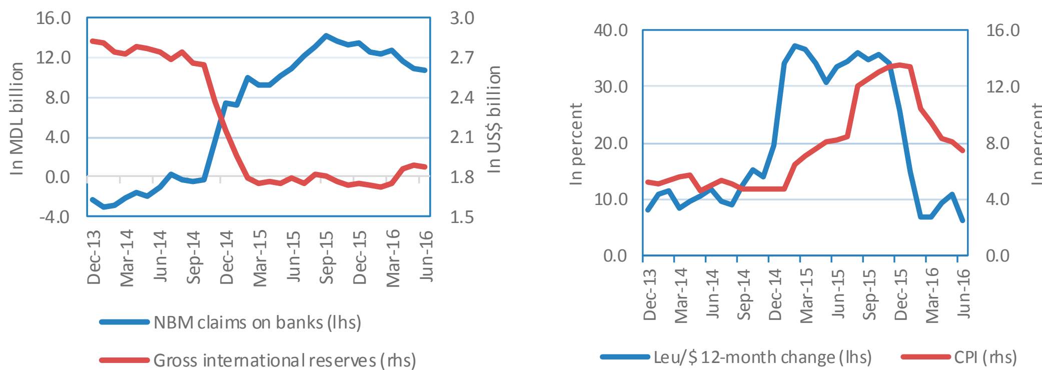
32. The NBM remains committed to containing inflation within the target band. While there are some near-term inflationary risks, notably related to adjustment in utility tariffs, inflation is expected to continue to decelerate in the environment marked by weak credit growth and subdued domestic demand this year. Inflation is expected to stabilize under 5 percent in 2017. This provides space for gradual and cautious cuts in the policy rate in the coming months as long as the external environment remains supportive to meet the international reserve targets. In light of the ongoing financial system rehabilitation, there is some uncertainty about the transmission mechanism of monetary policy, posing a challenge for correctly calibrating instruments to achieve inflation goals. This will be kept under careful review during the program.

33. The program also seeks to maintaining adequate international reserve coverage to guard against external shocks, while supporting exchange rate flexibility. The program's performance criterion on net international reserves is based on reaching the upper end of the

recommended range for the IMF composite measure of reserve adequacy for floating exchange rate regimes, which is 150 percent. The authorities and staff agree that NBM should allow the exchange rate to adjust with market conditions and should limit interventions in support of the lei to smoothing disorderly exchange rate volatility. Recent interventions on the foreign currency market have been effective in absorbing seasonal excess supply of foreign exchange and influencing inflation dynamics; however, purchases should not aim to systematically resist appreciation pressures.

Box 4. Monetary Developments in the Wake of the Banking Crisis

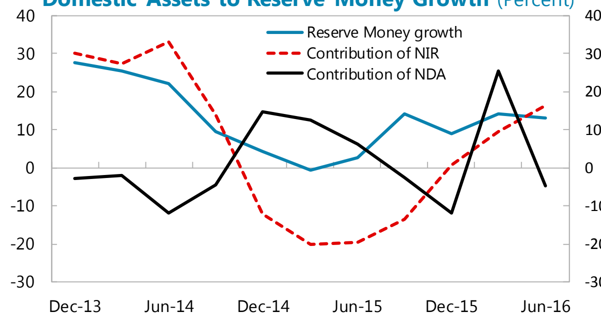
Between October 2014 (last month before the banking crisis) and October 2015, NBM's claims on banks have ballooned from almost zero to over MDL 13 billion (11 percent of 2015 GDP). This liquidity injection led to significant pressures on the foreign exchange market. The leu depreciated by 36 percent during the above-referenced period despite the extraordinary amount of NBM interventions, with the sale of around US$900 million, or one third of all gross reserves. A weak external environment, especially the recession in Russia, has further impacted on the supply of foreign currency. The leu depreciation contributed to a rapid increase in inflation, which overshot the upper bound of the target range (6.5 percent) in early 2015.



Sources: National Bank of Moldova and IMF staff calculations. Sources: National Bank of Moldova and IMF staff calculations.

In response to increasing inflation, the NBM tightened significantly its monetary policy. The NBM's base (policy) rate was increased in several steps from 3.5 percent in November 2014 to 19.5 percent in August 2015. The reserve requirement ratio on leu-denominated liabilities was also increased in several steps from 14 percent in December 2014 to 35 percent in September 2015. Sharp policy tightening helped contain inflationary pressures and preserve macroeconomic stability.

Contributions of Net International Reserves and Net Domestic Assets to Reserve Money Growth (Percent)



Sources: National Bank of Moldova and IMF staff calculations.

34. The institutional and policy independence of the NBM is a pre-condition for successful inflation targeting. This requires, *inter alia*, a viable balance sheet of the NBM, which was hit by the massive emergency liquidity provision to the troubled banks that are now under liquidation. In this regard, the recent adoption of the Law on securitization of emergency lending should help ensure that the NBM's post-resolution cash flow and capital position allow it to fulfill its mandate of maintaining price stability. In October 2016, government securities were issued in the amount of MDL 13.3 billion (US$672 million) to execute guarantees given for emergency loans extended by the NBM to insolvent banks. Maturities range from one to 25 years; the bonds bear a fixed annual interest rate of 1.4 percent for maturities up to 10 years, and 5.3 percent for longer maturities.

35. The program also envisages several technical improvements to the existing inflation targeting framework. The authorities aim to enhance collaboration and coordination between Ministry of Finance, Ministry of Economy, and NBS with a view to enhance the consistency of macroeconomic data and projections, focusing on discussions of the growth outlook, the drivers of inflation, the inflation outlook, and implications for the inflation objective. Efforts are also under way to improve coordination between the Ministry of Finance and NBM of government debt and liquidity management, including forecasting of aid and privatization inflows.

D. Structural Policies

Utility sector

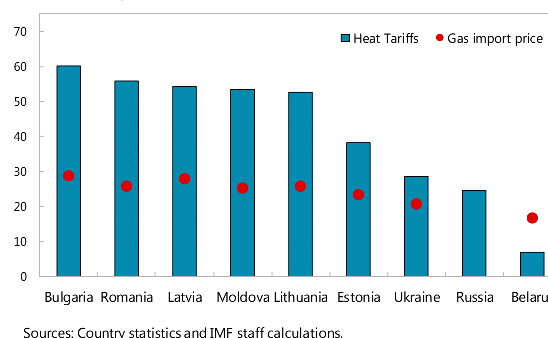
36. Utility companies will be brought onto a sound footing, including through tariffs set at cost recovery to avoid further accumulation of arrears with energy suppliers, reduce fiscal risks, and ensure an adequate level of investment in the sector.

- **The regulator (ANRE) approved and published the mechanism for gradual repayment of financial deviations accumulated by electricity distribution companies through a sequence of tariff supplements** *(prior action)*. While the electricity tariffs were increased to the cost-recovery levels in 2015, these increases did not cover financial deviations accumulated over 2014–15. Authorities recognized the outstanding deviations of MDL 2.2 billion (US$110 million), and adopted a repayment schedule through annual tariff supplements over 2017–20, starting from the first quarter of 2017.

- While the adopted heating tariff brings Termoelectrica close to its current operating cost recovery, further steps are needed to ensure adequate investment and address a large stock of historical debt. In September 2016, ANRE approved an 8.2 percent increase in the heating tariff, against the operator's requested increase of 27.4 percent. The approved tariff increase appears sufficient to ensure a small positive cash flow from operations, but the process revealed deficiencies in the methodology as it pertains to rules on asset valuation and investment allowances. An action plan to improve the tariff-setting methodology in the heating sector by end-year has been agreed with the World Bank. As a part of this plan, this new methodology will be applied to tariff decisions in early 2017—a pre-condition for two key projects to proceed:

restructuring of Termoelectrica's debt to Moldovagaz (about US$140 million) and a heating sector efficiency improvement project with the World Bank.

Heating Tariffs for Households
(US$/Gigacalorie)



Sources: Country statistics and IMF staff calculations.

- The authorities continue to provide financial support to vulnerable households through social assistance programs, Ajutor Social and Heating Allowance, and will work on improving the targeting of this support and its effective coverage. To mitigate the effect of higher energy tariffs on low income households, adequate resources will be allocated in the 2017 budget.

37. The introduction of an automatic utility tariff adjustment mechanism will prevent political influence in tariff setting. In close cooperation with the World Bank, a transparent mechanism should be developed and implemented to prevent any discretionary delays and ensure timely adjustments of utility tariffs to the cost-recovery levels (***structural benchmark***). In cooperation with the Energy Community Secretariat, the authorities should work on improving energy sector regulation, in particular, to ensure that procedures for the appointment of directors are fully transparent and merit-based and establish clear performance indicators on the basis of which independent audits can be conducted (MEFP ¶33).

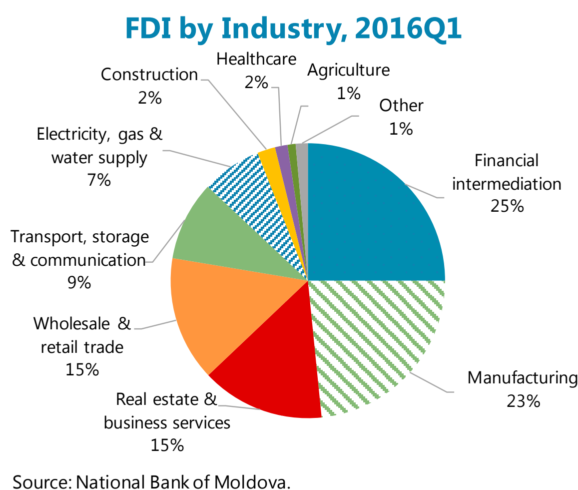
Governance

38. Strengthening economic governance and transparency is a top priority and a necessary foundation for robust economic growth. Weak governance and corruption in a broad range of areas, including implementation of laws and regulations and effectiveness of the judiciary, undermine public confidence in government, discourage foreign investment by raising the costs of doing business, and ultimately constrain economic growth. The authorities are committed to taking stronger actions to address these challenges, strengthening the asset disclosure framework for senior officials and ensuring a robust external oversight process for the National Anti-Corruption Center (MEFP ¶34). In addition, strengthening the implementation of the AML/CFT framework would complement anti-corruption efforts, notably by ensuring that the legal frameworks for anti-corruption and AML/CFT are in line with international standards.

Business climate

39. Encouraging more foreign direct investment (FDI) can play a crucial role in improving the country's productivity and supporting developmental objectives articulated in the Moldova 2020 strategy. In 2015 FDI reached 3.3 percent of GDP, still significantly below the pre-crisis levels of 11–12 percent. Two thirds of foreign investments are concentrated in service sectors,

with financial intermediation taking a lead. Agriculture, a vital sector for the economy,[3] attracts only 1 percent. Facilitating FDI in export-oriented sectors is instrumental for improving competitiveness and promoting balanced growth. The energy sector and road infrastructure would also benefit greatly from FDI inflows.



Source: National Bank of Moldova.

40. Improving the investment climate is essential for attracting higher FDI inflows. The main challenges associated with investing in Moldova relate to weak governance and corruption. The bottlenecks in agriculture also include limited supply capacity, highly fragmented farm structure, and restrictions on land ownership for foreigners. Relatively low development of human capital also contributes to the limiting factors. The government has launched a number of initiatives aimed at promoting competition policies and streamlining the regulatory framework, e.g., reforms of the customs administration and risk-based inspection implementation.

PROGRAM MODALITIES

E. Access, Phasing and Conditionality

41. The authorities' program will be supported by a three-year ECF/EFF blended arrangement[4] with access of SDR 129.4 million (75 percent of quota, US$182.7 million). The authorities are expected to have protracted BOP needs, given the breadth of the structural reform agenda, particularly as it pertains to the financial sector, and time that will be needed to build up strong reserve buffers to provide cover against external shocks. The overall size of the external financing package, estimated at US$825 million for the three-year period under the program, would allow reserves to be built up to the top end of the Fund's ARA metric: providing insurance against external shocks with high standard deviations not properly captured by the ARA metric, and particularly sharp declines in remittances. Some of the Fund's disbursements will be used for budget support but reflect an underlying BOP need, and the program is designed so that an amount equivalent to foreign exchange purchases from the Fund will be used to meet that BOP need. The program is fully financed and is expected to catalyze:

[3] Annex III provides background information on agriculture in Moldova.

[4] With GNI per capita of around US$2,220 in FY2015, which is above the IDA operational cutoff of US$1,185, Moldova can be classified as a presumed blender.

- *Budget support from the World Bank of about US$45 million in 2016, with subsequent smaller Development Policy operations in 2017–19*. The current budget support operation is pending from November 2014 and will be able to proceed following Board approval of a Fund program.

- *Macro-Financial Assistance (MFA) from the EU of €97.4 million over 2017–18*, of which €40 million in grants and €57.4 million in concessional loans. Tranches of sector-specific support, for which various triggers have met, will also be unblocked upon program approval in 2016, and will thereafter be subject to meeting performance metrics.

- *Budget sectoral grants from the EU at about €94 million over 2017–18.*

- *Bilateral budget support from Romania of about €150 million*. The Romanian authorities made the first disbursement of €60 million in August 2016, following the announcement of a staff-level agreement on a program with the IMF.

External Financing Requirements and Sources, 2016–19

(Millions of U.S. dollars)

	2016	2017	2018	2019
		Projection		
Identified financing sources	942	895	1104	1091
Financing requirements	829	839	1087	1128
of which: fiscal financing requirements	265	407	316	279
Change in gross reserves (increase = +)	318	358	205	92
Financing gap	205	302	189	129
Identified program financing	169	257	121	95
European Commission	56	126	91	48
World Bank	45	30	30	47
Romania	68	101	0	0
Fund Program	37	44	68	34
of which: budget support	25	27	27	27

Sources: Moldovan authorities; and IMF staff projections.

42. Program monitoring will be guided by semi-annual reviews, semi-annual and continuous performance criteria and indicative targets, and structural benchmarks.

- *Quantitative PCs* include a ceiling on the augmented overall cash deficit of the general government, and a floor on NIR, as well as continuous PCs on the stock of domestic arrears and the assumption by the government of losses or liabilities and making of payments on behalf of utilities and other companies. To ensure a healthy expenditure mix, the program also employs indicative ceiling on the general government wage bill and floor on social spending. An indicative target on the non-accumulation of domestic payment arrears will be converted into a

continuous PC based on the recommendations of forthcoming technical assistance.[5] Monetary conditionality would be embedded in the inflation consultation clause. The inflation consultation bands are set symmetrically around the projected path the 12-month percentage change in the headline inflation, while ensuring medium-term consistency with the NBM's inflation target.[6]

- *Structural benchmarks in the near term are focused on the fiscal and financial sector areas, later shifting to areas that will support growth*. Action would be required to further contain fiscal risks and improve the bank regulatory, supervisory, and crisis management frameworks, guided by a comprehensive set of recommendations from the FSAP update. Conditionality would then shift toward boosting competitiveness, with a focus on the business climate and ensuring inclusive growth.

43. An updated safeguards assessment is in progress and is expected to be completed by the first review. The assessment will evaluate the new governance arrangements at the NBM and its current control framework. The NBM publishes its financial statements that are prepared and independently audited in accordance with international standards.

F. Capacity to Repay the Fund and Risks to the Program

44. Moldova is expected to meet its repayment obligations to the Fund. Exposure to the Fund will reach 6.4 percent of GDP in 2016, before declining to 4.1 percent of GDP by the end of the proposed ECF/EFF (Table 6). Total debt service to the Fund will reach 3.2 percent of total exports in 2017. Moldova has a strong track record in repayments to the Fund as indicated by timely repurchases to date, and risks of debt distress remain low.

45. Risks to the program are expected to be mitigated by steadfast policy implementation.

- *As noted above, reserve buffers will help mitigate the external risk*, while internal imbalance risks—including in the event of political disruptions—are expected to be contained by Moldova's policy framework. Policies will remain anchored by an inflation-targeting framework—under which monetary policy was tightened appropriately and significantly during the height of the crisis—and a tighter and more coherent fiscal control framework

- *Prior actions have put the financial sector on stronger footing*. Given the extent of vulnerabilities in the banking sector, heavy reliance on difficult and extensive prior actions was essential to give the program a good chance of success. To that end, prior actions (MEFP Table 1) were aimed at (i) demonstrating a clear shift in the enforcement regime (PA1–PA3) (ii) completing the

[5] Moldova's DSA suggests a low risk of external debt distress, and fiscal conditionality is in place to control the evolution of debt, so the use of debt conditionality is not warranted.

[6] The inflation consultation bands will be drawn symmetrically around the projected path of headline CPI inflation. The authorities would need to consult with staff on the appropriate policy response if the headline CPI inflation were to go outside the inner band of +/- 1 percentage point around the central target path. A formal consultation with the IMF Executive Board would be required if the headline CPI inflation were to go outside the outer band of +/- 2 percentage points around the central target path.

management team and oversight bodies of the NBM (PA5), (iii) starting the process of dismantling opaque ownership structures (PA4) and related party lending (PA9), with broader and stronger legal powers granted to the supervisor (PA8 and PA11); (iv) improving crisis management capacity (PA6–7); and (v) eliminating past channels for fraudulent change in ownership of shares (PA10).

- *Prior actions have also reduced fiscal risks from the energy sector, preserving fiscal space for public investment*. In the energy sector, given accumulated cascading intra-firm debt and arrears, a near-term priority was to restore financial viability to firms in the energy sector (PA 12 and 13) and move toward greater transparency of regulatory decisions (PA 12 and 14). However, more remains to be done, particularly as it pertains to resolving long-term arrears in the sector.

STAFF APPRAISAL

46. Long-standing vulnerabilities in the financial sector came to a head in late 2014. The banking scandal brought to the fore weaknesses rooted deeply in shareholder intransparency, bank governance failures, and weak supervision. While small depositors were fully protected during the banks' resolution in 2015, preserving financial stability, so were related parties. In the end, the public cost of the crisis resolution of around 10 percent of GDP was particularly heavy for a low-income country, like Moldova. Moreover, the crisis precipitated an economic downturn and significant loss of confidence and of international reserves.

47. Signs of stabilization early this year should not distract from the need for strong policy action. Growth has started to return, pressures on the foreign exchange market have let up, and inflation has come down, allowing the central bank to lower rates by 9½ percentage points since the beginning of the year. However, to sustain the recovery, drastic measures are required to strengthen institutions, rehabilitate the financial system, restore policy credibility, and attract investment. Vested interests remain strong, public trust in the government has been eroded, and the political system is still reeling from the fallout of the crisis.

48. A significant improvement in economic governance is indispensable for the long-term development of Moldova. The focus of efforts to improve governance should shift from a narrow emphasis on the adoption of laws and regulations to their effective implementation to ensure greater political accountability and transparency, effectiveness of the judiciary system, and the respect for the rule of law. In this regard, formal investigations regarding the stolen money are still ongoing, and it is important that they are fully carried out and those responsible for the fraud be brought to court.

49. The financial sector is the first key battleground for the authorities to demonstrate their resolve to improve economic governance. Building on the strong upfront actions, the authorities will need to continue to affect a clear shift in the enforcement regime, and uproot the expectation of supervisory forbearance. UBOs and related parties should be fully identified, and special audits should be conducted in all banks to ensure their compliance with prudential and

AML/CFT requirements. The heavy agenda and the likely legal challenges by vested interests to a proactive supervisor require a bolstering of the resources and protection of NBM staff. Insulating the NBM from political interference, together with judicial reforms, will be essential to ensure successful implementation. Judicial interference in NBM's decisions, which has been long documented, including in the FSAP, should be resisted.

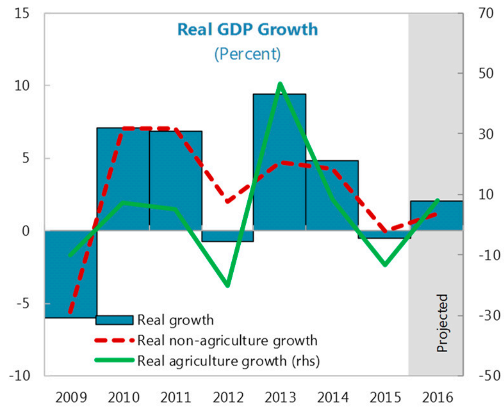
50. Strong policies should supplement governance reforms. Public debt has now increased considerably, and although it is still sustainable, it is important that fiscal policy is anchored in a sound medium term framework, and focused on revenue mobilization, expenditure prioritization, and elimination of public payment arrears. In addition, utility tariff reform and tougher monitoring of SOEs should proceed in order to promptly reduce fiscal risks. This would ensure meeting the program objective of a more balanced fiscal policy which addresses pressing social and infrastructure investment needs. Monetary policy should continue to focus on maintaining low inflation and rebuilding reserves. In the context of abating inflationary pressures, the recent loosening of monetary policy was appropriate. Nonetheless, the transmission mechanism is likely impaired under current banking sector stress, and will remain impaired until the restructuring of weak banks is complete. The buildup of international reserves creates a buffer that improves Moldova's resilience to potential external pressures. In this regard, commitment to continued exchange rate flexibility is essential.

51. Risks to the program are significant. The process of improving public governance will be lengthy, requiring significant efforts to stay the course—this is especially relevant for banks, but holds true for all public institutions. In particular, despite significant safeguards that have been put in place, on-site inspections are yet to be completed in two of the three banks, and there is a risk that diagnostics could reveal further asset quality and governance issues that will need to be addressed. While fiscal policy has been calibrated to allow space for productive public investment, this hinges on minimizing fiscal risks, and preventing a migration of private sector liabilities onto public sector balance sheets. Given longstanding concerns with respect to judicial corruption in Moldova, risks remain to the effective implementation of some of the proposed measures.

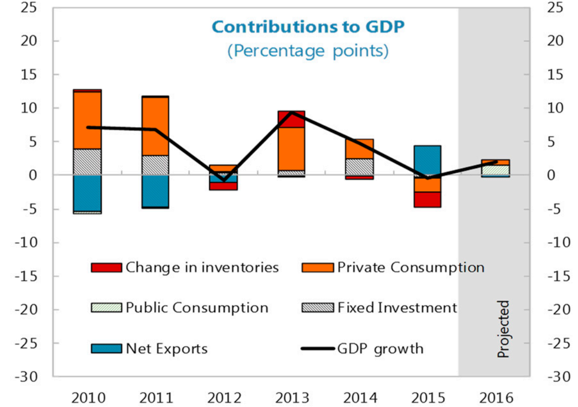
52. Nonetheless, in view of the authorities' recent policy actions and commitments ahead, Fund support is warranted. The large number of prior actions reflected not weak domestic ownership, but the need to reestablish a credible track record in dealing head-on with problems that have been left unaddressed for many years, and at least since 2014. International support, under the framework of a Fund program, would lend a credible financial and technical backstop for continued deep reforms in the financial sector. On this basis, and on the strength of the completed prior actions, staff supports the authorities' request for an extended arrangement under the EFF and an arrangement under the ECF with cumulative access amounting to SDR 129.4 million.

Figure 1. Moldova: Real Sector Developments

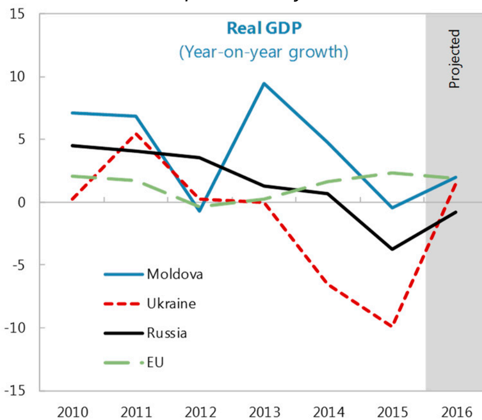
The economy is projected to modestly recover in 2016…



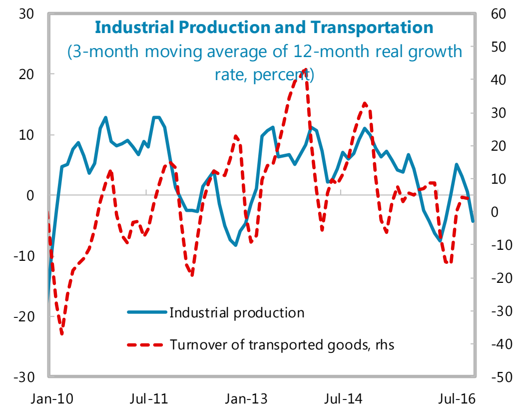
…supported by domestic demand.



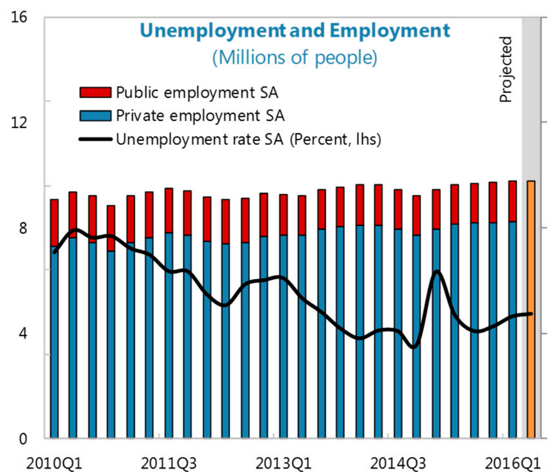
Improved growth outlook of main trading partners contributes to the output recovery in 2016.



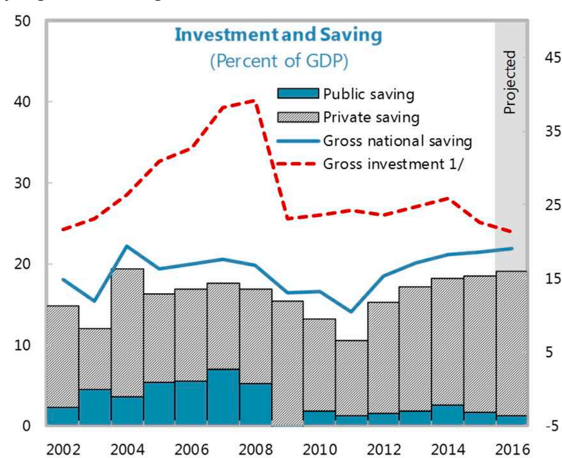
Short-term activity indicators indicate a pick-up of the economic activity.



The unemployment rate remains low as migration acts as a shock-absorber.



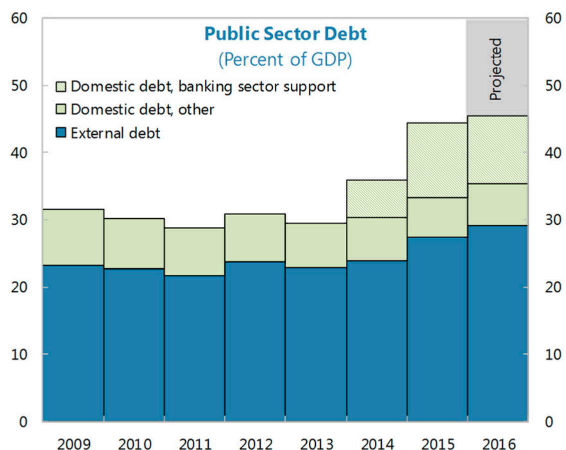
Public saving is expected to decline in 2016, constrained by tight financing.



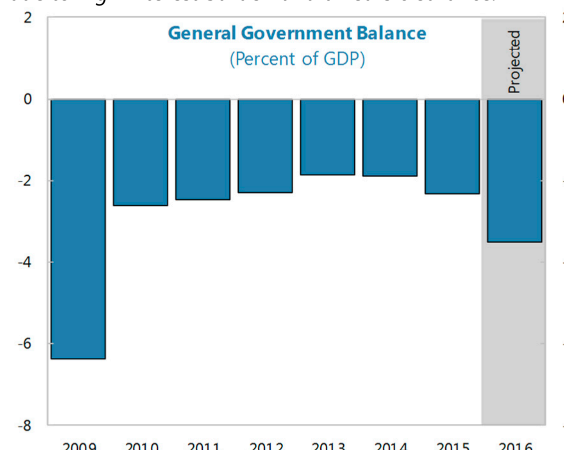
Sources: Moldovan authorities; National Bureau of Statistics of the Republic of Moldova; and IMF staff calculations.

Figure 2. Moldova: Fiscal Developments, 2009–16

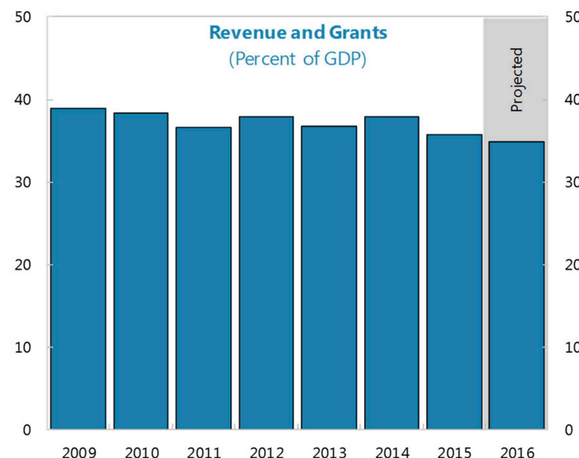
Public debt has increased substantially in recent years …



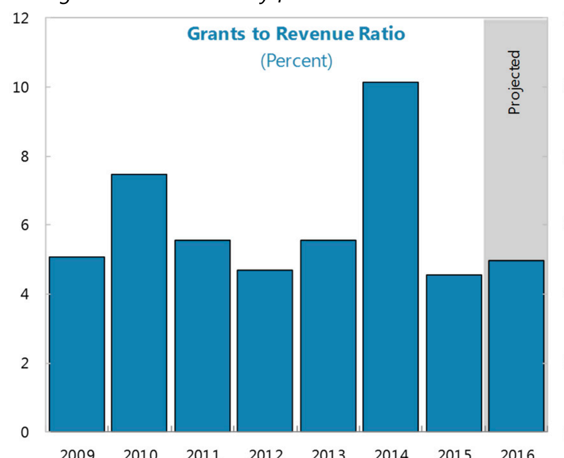
… and the trend of fiscal consolidation reversed (mainly due to high interest burden and arrears clearance.



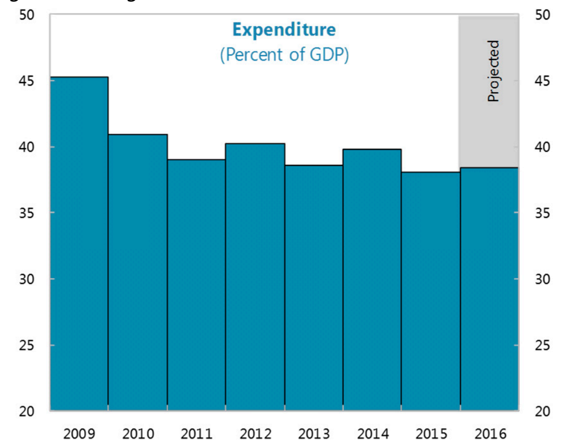
Total revenues have weakened …



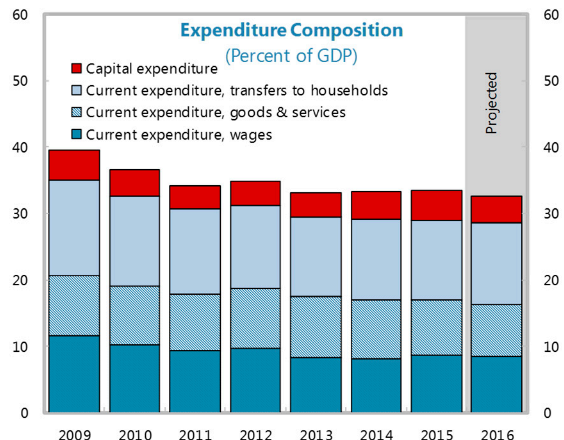
… as grants have markedly fallen.



Expenditures have been constrained by weak revenues and tight financing …



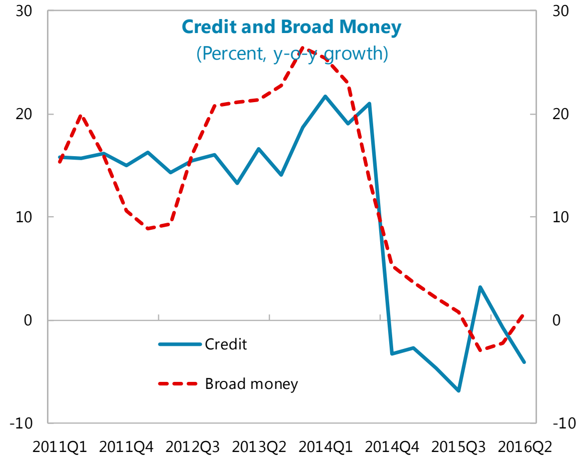
… with adjustment falling mainly on capital expenditure.



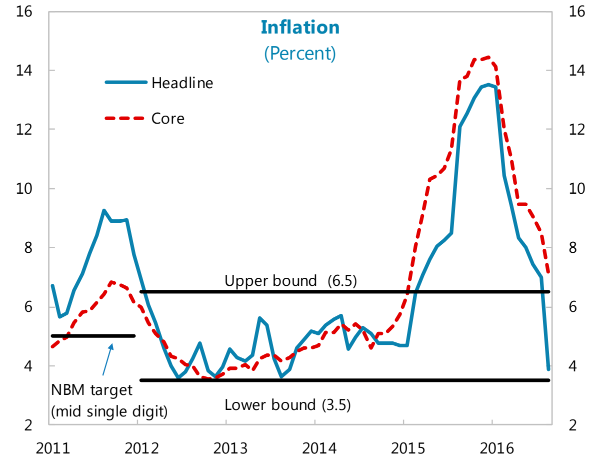
Sources: National authorities; and IMF staff calculations.

Figure 3. Moldova: Money, Prices, and Interest Rates, 2011–16

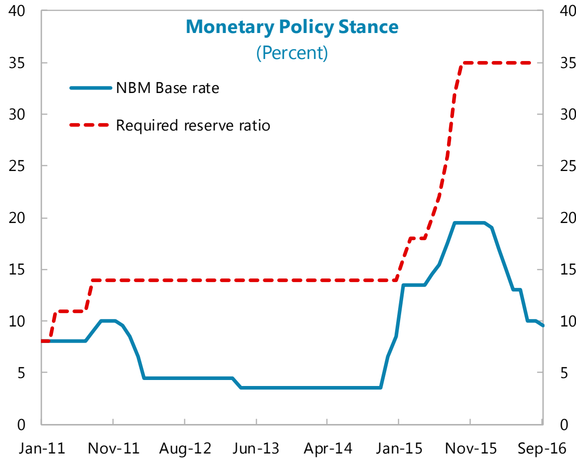
Credit growth remains weak...



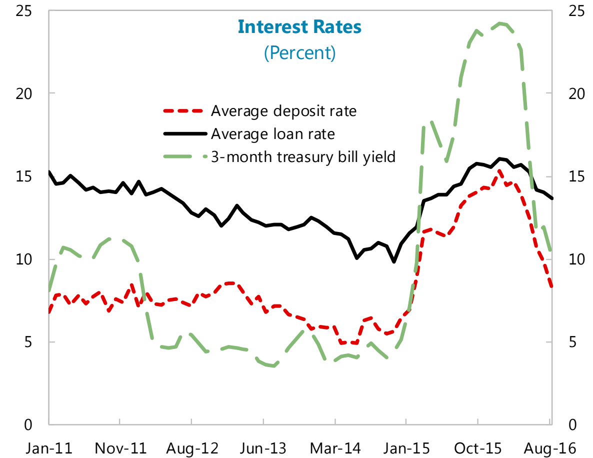
... and inflation is decelerating sharply.



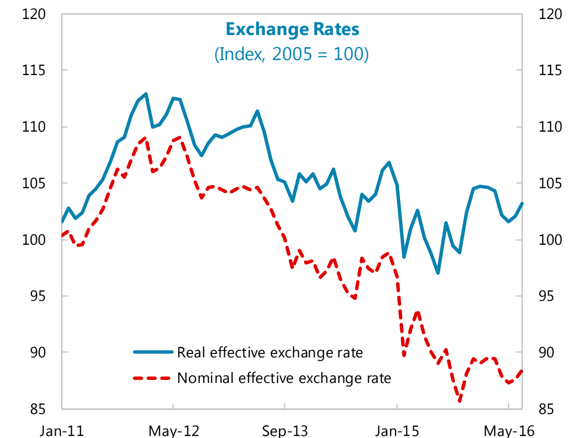
This prompted some monetary loosening...



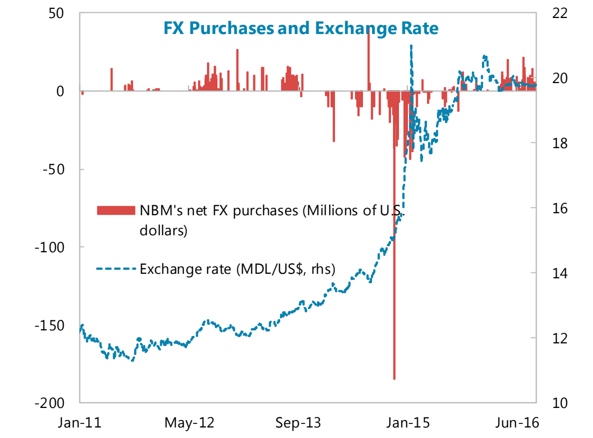
... but interest rates remain elevated.



Effective exchange rates started appreciating ...



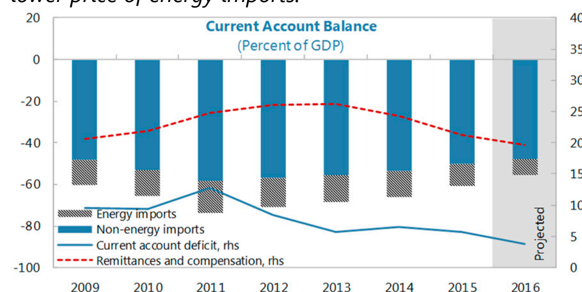
... allowing NBM to build up international reserves.



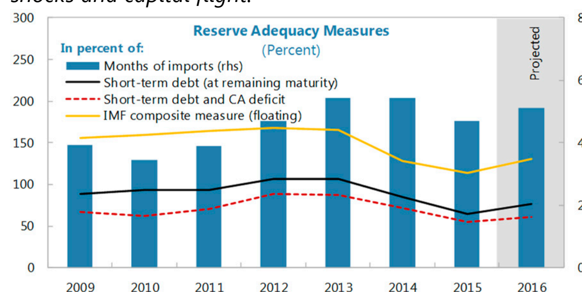
Sources: National authorities; and IMF staff calculations.

Figure 4. Moldova: External Sector Developments, 2009–16

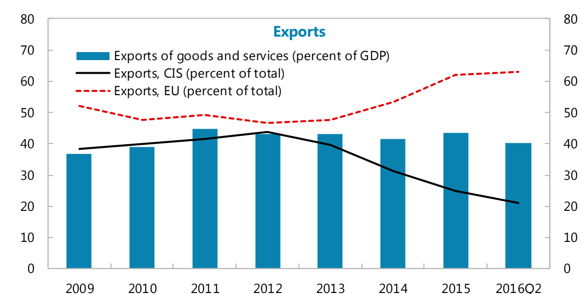
CA is expected to improve slightly in 2016, benefiting from lower price of energy imports.



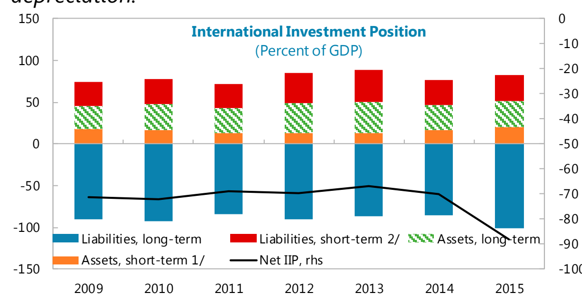
External buffers have declined sharply due to external shocks and capital flight.



Exports growth in EU markets has been offsetting the negative impact of trade restriction from Russia.



FDI in terms of GDP is expected to recover largely due to decline in nominal GDP in US dollars because of depreciation.



Sources: National Bank of Moldova; Moldovan Authorities; and IMF staff and calculations.

1/ Short-term assets include portfolio investment, financial derivatives, trade credits and currency and deposits.

2/ Short-term liabilities include portfolio investment, financial derivatives, trade credits, short-term loans by banks and other sectors, currency and deposits, short-term other liabilities by general government, banks and other sectors.

Table 1. Moldova: Selected Economic Indicators, 2010–21 1/

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Projection					
I. Real sector indicators	(Percent change, unless otherwise indicated)											
Gross domestic product												
Real growth rate	7.1	6.8	-0.7	9.4	4.8	-0.5	2.0	3.0	3.6	3.7	3.8	3.8
Demand	9.1	8.2	0.4	6.2	3.6	-3.2	1.7	2.5	2.2	2.6	2.7	2.8
Consumption	7.3	7.3	0.9	5.2	2.7	-1.1	2.4	1.4	2.2	2.3	2.5	2.6
Private	9.5	9.3	1.0	6.5	3.2	-2.3	0.9	1.7	2.1	2.3	2.2	2.3
Public	-1.1	-1.0	0.6	-0.8	-0.8	-0.4	9.8	-0.4	2.4	2.4	3.8	3.8
Gross capital formation	17.2	13.0	1.8	3.3	10.0	-1.2	-1.8	10.1	4.4	3.1	4.7	3.7
Private	20.3	16.4	1.6	2.7	7.7	-2.4	1.0	3.6	3.6	3.7	3.8	3.8
Public	4.2	-3.3	3.4	6.4	22.4	4.5	-14.3	44.0	7.6	0.9	8.0	3.5
Net Exports of goods and services	-14.8	-12.1	-2.8	0.0	0.3	11.7	-0.9	-0.6	2.8	1.5	1.0	0.5
Exports of goods and services	13.7	27.4	1.7	10.7	1.0	2.3	1.4	8.0	8.0	7.8	7.8	7.1
Imports of goods and services	14.3	19.7	2.2	5.5	0.4	-4.3	1.2	5.1	3.7	4.1	4.3	4.1
Nominal GDP (billions of Moldovan lei)	71.9	82.3	88.2	100.5	112.0	122.2	132.7	142.8	155.3	169.2	184.4	201.0
Nominal GDP (billions of U.S. dollars)	5.8	7.0	7.3	8.0	8.0	6.5	6.7	7.0	7.4	7.8	8.3	8.7
Consumer price index (average)	7.4	7.6	4.6	4.6	5.1	9.6	6.9	4.9	4.9	4.9	5.0	5.0
Consumer price index (end of period)	8.1	7.8	4.0	5.2	4.7	13.5	3.5	4.7	5.0	5.0	5.0	5.0
GDP deflator	11.1	7.2	7.9	4.1	6.4	9.6	6.5	4.5	5.0	5.0	5.0	5.0
Average monthly wage (Moldovan lei)	2,972	3,194	3,478	3,765	4,172	4,611	4,934	5,322	5,770	6,271	6,823	7,424
Average monthly wage (U.S. dollars)	240	272	287	299	297	245	247	262	274	290	307	323
Unemployment rate (annual average, percent)	7.4	6.7	5.6	5.1	3.9	4.9	4.7	4.5	4.4	4.3	4.2	4.2
Poverty headcount ratio at national poverty lines (percent)	21.9	17.5	16.6	12.7	11.4							
Saving-investment balance	(Percent of GDP)											
Foreign saving	9.4	12.8	8.4	5.8	6.5	5.0	3.5	5.0	5.4	5.2	5.2	5.1
National saving	13.2	10.5	15.3	17.2	18.2	19.3	18.8	19.1	19.1	19.4	19.8	20.1
Private	11.5	9.3	13.7	15.4	15.7	17.6	18.3	16.2	16.5	16.9	16.6	16.7
Public	1.8	1.2	1.6	1.8	2.6	1.7	0.5	2.8	2.7	2.5	3.2	3.3
Gross investment	22.6	23.3	23.6	22.9	24.7	24.2	22.4	24.1	24.6	24.6	25.0	25.1
Private	18.7	19.8	20.1	19.4	20.4	19.8	18.8	19.0	19.3	19.4	19.5	19.6
Public	3.9	3.5	3.6	3.6	4.3	4.5	3.6	5.1	5.3	5.2	5.5	5.5
II. Fiscal indicators (general government)												
Primary balance	-1.9	-1.7	-1.6	-1.4	-1.4	-1.5	-2.2	-2.3	-2.3	-1.9	-1.9	-1.9
Overall balance	-2.6	-2.5	-2.3	-1.9	-1.9	-2.3	-3.5	-3.7	-3.4	-3.1	-3.1	-3.0
Stock of public and publicly guaranteed debt	30.5	29.0	30.9	29.6	36.0	45.0	45.9	46.9	47.7	47.3	46.9	46.7
III. Financial indicators	(Percent change, unless otherwise indicated)											
Broad money (M3)	13.4	10.6	20.8	26.5	5.3	-3.0	9.8	...	...	...	...	...
Velocity (GDP/end-period M3; ratio)	1.9	2.0	1.8	1.6	1.7	1.9	1.9	...	...	...	...	...
Reserve money	8.9	21.8	19.7	27.0	6.3	7.1	5.7	...	...	...	...	...
Credit to the economy	12.7	15.0	16.1	18.8	-3.3	3.2	-0.3	...	...	...	...	...
Credit to the economy, percent of GDP	37.4	37.6	40.7	42.5	36.8	34.9	32.0	...	...	...	...	...
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)											
Current account balance	-545	-900	-610	-460	-520	-322	-236	-350	-401	-408	-429	-443
Current account balance (percent of GDP)	-9.4	-12.8	-8.4	-5.8	-6.5	-5.0	-3.5	-5.0	-5.4	-5.2	-5.2	-5.1
Remittances and compensation of employees (net)	1,273	1,733	1,893	2,098	1,937	1,386	1,316	1,409	1,504	1,624	1,742	1,870
Gross official reserves	1,718	1,965	2,515	2,821	2,157	1,757	2,075	2,433	2,638	2,730	2,745	2,778
Gross official reserves (months of imports)	3.4	3.9	4.7	5.4	5.4	4.7	5.1	5.5	5.6	5.3	5.0	4.7
Exchange rate (Moldovan lei per USD, period avge)	12.4	11.7	12.1	12.6	14.0	18.8	20.0	20.4	21.0	21.7	22.3	23.0
Exchange rate (Moldovan lei per USD, end of period)	12.2	11.7	12.1	13.1	15.6	19.7	20.5	20.9	21.5	22.2	22.8	23.5
Real effective exch.rate (average, percent change)	-6.1	5.9	4.1	-2.3	-3.0	-3.4	-2.0	-1.0	-0.3	-0.1	0.0	0.0
Real effective exch.rate (end-year, percent change)	7.3	9.4	-2.9	-3.7	1.6	-2.5	-1.6	-0.6	-0.2	0.0	0.0	0.0
External debt (percent of GDP) 2/	80.9	76.9	82.7	84.5	84.9	98.9	100.4	101.2	100.3	95.9	90.9	86.4
Debt service (percent of exports of goods and services)	17.8	15.8	15.0	17.6	15.5	13.6	26.1	22.0	27.7	28.0	25.9	23.7

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Table 2. Moldova: Balance of Payments, 2010–21

(Millions of U.S. dollars, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
							Projection					
Current account balance	-545	-900	-610	-469	-534	-322	-238	-358	-417	-433	-464	-490
Merchandise trade balance	-2,219	-2,876	-2,936	-2,999	-2,900	-1,959	-1,815	-1,967	-2,124	-2,276	-2,438	-2,582
Exports	1,590	2,282	2,233	2,470	2,354	1,985	1,884	2,078	2,262	2,475	2,713	2,938
Imports	-3,810	-5,158	-5,169	-5,469	-5,254	-3,944	-3,700	-4,045	-4,387	-4,751	-5,151	-5,520
Of which: energy imports	-733	-1,047	-1,040	-1,046	-998	-697	-520	-582	-620	-662	-705	-756
Services balance	-23	31	9	16	-31	5	27	25	31	39	47	51
Exports of services	680	861	902	985	969	822	801	847	908	975	1,046	1,107
Imports of services	-704	-830	-893	-969	-1,000	-817	-774	-822	-876	-936	-999	-1,056
Income balance	505	577	817	872	825	461	462	442	486	560	599	653
Compensation of employees	684	869	961	1,074	991	700	668	706	751	812	866	933
Income on direct and portfolio investment	-134	-238	-87	-139	-106	-192	-161	-170	-148	-117	-124	-131
Income on other investment	-45	-54	-56	-63	-60	-47	-45	-94	-118	-136	-144	-149
Current transfer balance	1,193	1,368	1,499	1,642	1,572	1,171	1,089	1,143	1,190	1,245	1,329	1,388
Remittances	589	865	933	1,023	938	686	645	694	737	787	840	889
Budget transfers	112	107	129	151	204	150	100	86	71	55	60	48
Other transfers	492	396	438	468	430	335	344	363	381	404	428	451
Capital and financial account balance	371	769	692	568	-229	22	425	503	522	480	530	526
Capital account balance	-28	-19	-37	-35	-62	-67	-33	-35	-37	-39	-33	-44
Financial account balance	399	789	729	603	-167	88	459	538	559	519	563	570
Foreign direct investment balance	204	268	175	214	158	165	139	142	145	149	166	174
Portfolio investment and derivatives	0	0	21	10	14	3	7	8	8	8	9	9
Other investment balance	194	521	532	380	-339	-79	313	389	406	361	389	387
Loans	77	170	282	202	-17	30	158	217	223	163	189	188
General government, net	4	18	62	26	69	89	118	163	167	104	128	125
Private sector, net	73	152	220	177	-85	-59	40	54	56	59	62	62
Other capital flows	117	351	251	178	-322	-110	155	172	183	198	199	199
Errors and omissions	64	93	94	87	-77	-55	0	0	0	0	0	0
Overall balance	-111	-37	176	186	-841	-355	187	146	105	47	65	36
Financing gap	…	…	…	…	…	…	205	302	189	129	0	0
Financing	111	37	-176	-186	841	355	-224	-190	-173	-175	-65	-36
Gross international reserves (increase: "-")	-294	-275	-498	-282	538	306	-318	-358	-205	-92	-41	-40
Use of Fund credit, net	175	153	139	-22	-29	-41	-42	-45	-21	-50	-76	-50
Monetary authorities	53	129	139	-22	-29	-35	-42	-45	-20	-50	-55	-48
Purchases	61	135	155	0	0	0	12	18	41	7	0	0
Repurchases	-8	-6	-16	-22	-29	-35	-54	-63	-61	-57	-55	-48
General government	122	24	0	0	0	-6	0	0	0	0	-21	-2
Purchases	122	24	0	0	0	0	25	27	27	27	0	0
Repurchases	0	0	0	0	0	-6	-25	-27	-27	-27	-21	-2
Exceptional financing	231	159	183	117	332	90	4	0	0	0	51	54
Other donors	0	0	0	0	0	0	169	257	121	95	0	0
European Commission	0	0	0	0	0	0	56	126	91	48	0	0
World Bank	0	0	0	0	0	0	45	30	30	47	0	0
Romania	0	0	0	0	0	0	68	101	0	0	0	0
Memorandum items:				(Percent of GDP, unless otherwise indicated)								
Gross official reserves (millions of U.S. dollars) 1/	1,718	1,965	2,515	2,821	2,157	1,757	2,075	2,433	2,638	2,730	2,770	2,810
Months of imports of good and services	3.4	3.9	4.7	5.4	5.4	4.7	5.1	5.5	5.6	5.3	5.1	4.8
Percent of short term debt and CA deficit	62.1	70.6	87.9	86.7	72.7	54.8	61.0	66.3	69.3	69.2	67.5	74.5
Pct of short-term debt at remaining maturity	92.9	93.1	106.2	106.4	84.4	64.2	76.7	80.3	81.9	81.4	79.4	77.4
Pct of the IMF composite measure (floating) 2/	159.0	163.6	168.1	165.0	128.4	113.4	130.1	145.9	150.8	150.2	148.3	146.9
Current account balance	-9.4	-12.8	-8.4	-5.9	-6.7	-5.0	-3.6	-5.1	-5.7	-5.5	-5.6	-5.6
Goods and services trade balance	-38.6	-40.5	-40.2	-37.4	-36.7	-30.1	-26.9	-27.7	-28.4	-28.6	-28.9	-29.0
Export of goods and services	39.1	44.8	43.0	43.3	41.6	43.2	40.4	41.7	43.0	44.2	45.4	46.3
Import of goods and services	-77.6	-85.3	-83.2	-80.6	-78.3	-73.3	-67.3	-69.3	-71.3	-72.8	-74.2	-75.3
Foreign direct investment balance	3.5	3.8	2.4	2.7	2.0	2.5	2.1	2.0	2.0	1.9	2.0	2.0
			(Percent change of amounts in U.S.dollars, unless otherwise indicated)									
Exports of goods	19.9	43.5	-2.1	10.6	-4.7	-15.7	-5.1	10.3	8.9	9.4	9.6	8.3
Exports of services	1.1	26.5	4.8	9.2	-1.6	-15.1	-2.7	5.8	7.1	7.4	7.3	5.9
Imports of goods	16.3	35.4	0.2	5.8	-3.9	-24.9	-6.2	9.3	8.4	8.3	8.4	7.2
Imports of services	-1.3	17.9	7.6	8.5	3.3	-18.3	-5.3	6.3	6.6	6.8	6.7	5.7
Remittances and compensation	13.2	36.2	9.2	10.8	-8.0	-28.1	-5.2	6.6	6.3	7.4	6.7	6.8
Remittances	-6.1	46.7	7.9	9.7	-8.3	-26.9	-6.0	7.6	6.2	6.7	6.8	5.8
Compensation of employees	37.5	27.1	10.5	11.8	-7.8	-29.4	-4.5	5.7	6.4	8.2	6.7	7.6
Debt service (pct of exports of goods and services)	17.8	15.8	15.0	17.6	15.4	13.6	26.1	22.0	27.7	28.0	25.9	23.7

Sources: National Bank of Moldova; and IMF staff estimates.

1/ Includes revaluation changes, which were not captured by changes of gross official reserves in the BOP.

2/ The IMF composite measures are calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP. Official reserves are recommended to be in the range of 100-150 percent.

Table 3a. Moldova: General Government Budget, 2010–21

(Millions of Moldovan lei, unless otherwise indicated)

	2010	2011	2012	2013 1/	2014	2015	2016	2017	2018	2019	2020	2021
							Projection					
Revenues and grants	27,537	30,138	33,476	36,908	42,456	43,670	46,350	50,443	54,926	59,348	65,209	71,191
Revenues	25,627	28,553	31,981	34,962	38,542	41,764	44,158	47,986	52,904	58,201	63,964	69,835
Tax revenues	23,122	26,107	29,430	32,677	36,284	38,758	42,143	45,872	50,687	55,875	61,523	67,271
Personal income	1,545	1,769	2,027	2,206	2,447	2,745	3,107	3,344	3,634	4,026	4,388	4,823
Corporate income	484	571	1,967	2,053	2,431	2,808	3,313	3,614	3,960	4,314	4,702	5,125
Property tax	283	284	303	317	346	359	423	471	528	607	661	721
VAT	9,146	10,464	10,672	12,174	12,852	13,714	14,527	15,656	17,318	19,273	21,538	23,652
Excises	2,074	2,667	2,894	3,508	3,428	3,844	4,267	4,788	5,429	6,021	6,604	7,198
Foreign trade	1,080	1,179	1,287	1,417	1,457	1,328	1,270	1,402	1,604	1,795	2,005	2,185
Other	1,038	975	1,333	1,259	2,536	1,835	1,774	1,909	2,076	2,261	2,464	2,686
Social Fund contributions	5,985	6,563	7,150	7,776	8,372	9,269	10,203	11,131	12,230	13,322	14,520	15,825
Health Fund contributions	1,487	1,636	1,798	1,967	2,414	2,855	3,260	3,557	3,908	4,257	4,640	5,057
Non-tax revenues	2,505	2,445	2,552	2,285	2,259	3,006	2,016	2,114	2,216	2,326	2,442	2,564
NBM profit transfers	336	30	35	114	125	889	0	0	0	0	0	0
Grants	1,911	1,586	1,495	1,946	3,914	1,906	2,192	2,457	2,022	1,147	1,245	1,356
Budget support	1,327	923	760	704	1,606	0	1,194	1,706	1,434	1,041	1,135	1,237
Project	584	663	735	1,242	2,307	1,906	997	751	589	106	110	120
Expenditure and net lending	29,417	32,163	35,513	38,779	44,572	46,502	51,018	55,956	60,190	64,547	70,775	77,095
Current expenditure	26,578	29,296	32,347	35,175	39,752	41,059	46,255	48,525	51,701	55,539	60,420	65,701
Wages	7,317	7,700	8,506	8,296	9,088	10,530	11,323	11,924	12,702	13,629	14,854	16,189
Goods and services	6,414	7,010	7,985	9,260	9,960	10,151	10,373	11,165	11,907	12,970	14,065	15,259
Interest payments	558	673	694	527	624	1,099	1,820	2,032	1,850	2,071	2,216	2,336
Domestic	374	486	504	324	395	832	1,417	1,543	1,315	1,435	1,541	1,589
Foreign	184	188	191	203	229	268	403	488	535	636	676	747
Transfers	10,714	11,660	12,208	13,293	14,920	16,903	19,188	20,109	21,755	23,298	25,392	27,675
Transfers to economy	957	1,020	1,111	1,119	1,358	2,126	2,745	2,564	2,788	3,037	3,310	3,607
Transfers to households	9,757	10,640	11,097	12,173	13,562	14,777	16,443	17,545	18,967	20,261	22,082	24,067
Other current expenditure	1,577	2,253	2,953	3,800	5,161	2,376	3,552	3,296	3,485	3,571	3,892	4,242
Capital expenditure	2,839	2,867	3,166	3,604	4,819	5,443	4,762	7,432	8,489	9,008	10,355	11,394
Of which: SOEs onlending projects							396	1,207	580	263	287	312
One-off revenue and expenditure items 2/	0	0	0	0	0	0	-13,341	0	0	0	0	0
Augmented overall balance (incl. one-off items) 3/	-1,879	-2,024	-2,037	-1,871	-2,116	-2,832	-18,009	-5,513	-5,264	-5,198	-5,566	-5,904
Augmented overall balance (excl. one-off items) 3/	-1,879	-2,024	-2,037	-1,871	-2,116	-2,832	-4,668	-5,513	-5,264	-5,198	-5,566	-5,904
Augmented primary balance (excl. one-off items) 3/	-1,394	-1,400	-1,404	-1,426	-1,577	-1,816	-2,938	-3,576	-3,513	-3,232	-3,460	-3,684
Financing (excl. one-off items)	1,879	2,024	2,037	1,871	2,116	2,832	1,927	1,435	3,590	3,605	5,566	5,904
Budget financing	1,260	1,128	624	658	409	499	-279	-1,809	-168	-715	1,239	1,543
Central government	1,093	702	545	299	131	133	-276	-1,809	-168	-715	1,239	1,543
Net domestic	-520	880	294	644	-78	17	117	-266	1,886	2,448	3,818	3,754
Net foreign (excl. project loans)	1,441	-355	-145	-697	-241	-437	-712	-1,744	-2,254	-3,363	-2,729	-2,360
Privatization	98	136	132	93	191	35	320	200	200	200	150	150
Others	75	41	263	260	259	518	0	0	0	0	0	0
Local governments	11	322	-36	167	245	239	-34	0	0	0	0	0
Social Fund	213	125	34	65	-9	37	30	0	0	0	0	0
Health Fund	-57	-21	81	126	42	90	0	0	0	0	0	0
Net project loans	619	897	1,413	1,213	1,707	2,333	2,205	3,245	3,757	4,320	4,327	4,360
Of which: Onlending (through commercial banks)	0	0	0	0	0	0	-451	-1,276	-1,449	-709	-773	-833
Financing gap	0	0	0	0	0	0	2,741	4,078	1,674	1,593	0	0
World Bank							898	611	631	1,012	0	0
IMF							492	546	565	582	0	0
Others							1,351	2,921	478	0	0	0
Financing for one-off items												
Government securities issued	0	0	0	0	0	0	13,341	0	0	0	0	0
Memorandum items:						(Millions of Moldovan lei)						
Public and publicly guaranteed debt	21,909	23,874	27,261	29,722	40,367	54,943	60,666	66,819	74,078	80,040	86,547	94,052
General Government debt	19,303	19,886	21,500	23,772	33,690	47,220	53,473	60,427	67,939	74,824	82,429	90,923
Domestic debt	5,305	5,842	6,159	6,676	13,375	20,809	21,519	21,253	22,889	25,137	28,955	32,709
Domestic expenditure arrears	230	164	62	89	98	744	466	0	0	0	0	0
External debt	13,768	13,880	15,280	17,008	20,217	25,667	31,489	39,174	45,050	49,687	53,474	58,214
Other 4/	2,607	3,987	5,760	5,950	6,677	7,723	7,193	6,392	6,139	5,215	4,118	3,130

Sources: Moldovan authorities; and IMF staff estimates and projections.

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.

2/ Includes banking sector resolution costs in 2016.

3/ Augmented balance includes externally financed on-lending to SOEs.

4/ Includes mainly central bank liabilities to the IMF.

Table 3b. Moldova: General Government Budget, 2010–21

(Percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013 1/	2014	2015	2016	2017	2018	2019	2020	2021
							Projection					
Revenues and grants	38.3	36.6	37.9	36.7	37.9	35.7	34.9	35.3	35.4	35.1	35.4	35.4
Revenues	35.6	34.7	36.2	34.8	34.4	34.2	33.3	33.6	34.1	34.4	34.7	34.8
Tax revenues	32.2	31.7	33.4	32.5	32.4	31.7	31.8	32.1	32.6	33.0	33.4	33.5
Personal income	2.1	2.1	2.3	2.2	2.2	2.2	2.3	2.3	2.3	2.4	2.4	2.4
Corporate income	0.7	0.7	2.2	2.0	2.2	2.3	2.5	2.5	2.6	2.6	2.6	2.6
Property tax	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4
VAT	12.7	12.7	12.1	12.1	11.5	11.2	10.9	11.0	11.2	11.4	11.7	11.8
Excises	2.9	3.2	3.3	3.5	3.1	3.1	3.2	3.4	3.5	3.6	3.6	3.6
Foreign trade	1.5	1.4	1.5	1.4	1.3	1.1	1.0	1.0	1.0	1.1	1.1	1.1
Other	1.4	1.2	1.5	1.3	2.3	1.5	1.3	1.3	1.3	1.3	1.3	1.3
Social Fund contributions	8.3	8.0	8.1	7.7	7.5	7.6	7.7	7.8	7.9	7.9	7.9	7.9
Health Fund contributions	2.1	2.0	2.0	2.0	2.2	2.3	2.5	2.5	2.5	2.5	2.5	2.5
Non-tax revenues	3.5	3.0	2.9	2.3	2.0	2.5	1.5	1.5	1.4	1.4	1.3	1.3
NBM profit transfers	0.5	0.0	0.0	0.1	0.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Grants	2.7	1.9	1.7	1.9	3.5	1.6	1.7	1.7	1.3	0.7	0.7	0.7
Budget support	1.8	1.1	0.9	0.7	1.4	0.0	0.9	1.2	0.9	0.6	0.6	0.6
Project	0.8	0.8	0.8	1.2	2.1	1.6	0.8	0.5	0.4	0.1	0.1	0.1
Expenditure and net lending	40.9	39.1	40.3	38.6	39.8	38.1	38.4	39.2	38.8	38.2	38.4	38.4
Current expenditure	37.0	35.6	36.7	35.0	35.5	33.6	34.9	34.0	33.3	32.8	32.8	32.7
Wages	10.2	9.4	9.6	8.3	8.1	8.6	8.5	8.3	8.2	8.1	8.1	8.1
Goods and services	8.9	8.5	9.1	9.2	8.9	8.3	7.8	7.8	7.7	7.7	7.6	7.6
Interest payments	0.8	0.8	0.8	0.5	0.6	0.9	1.4	1.4	1.2	1.2	1.2	1.2
Domestic	0.5	0.6	0.6	0.3	0.4	0.7	1.1	1.1	0.8	0.8	0.8	0.8
Foreign	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4
Transfers	14.9	14.2	13.8	13.2	13.3	13.8	14.5	14.1	14.0	13.8	13.8	13.8
Transfers to economy	1.3	1.2	1.3	1.1	1.2	1.7	2.1	1.8	1.8	1.8	1.8	1.8
Transfers to households	13.6	12.9	12.6	12.1	12.1	12.1	12.4	12.3	12.2	12.0	12.0	12.0
Other current expenditure	2.2	2.7	3.3	3.8	4.6	1.9	2.7	2.3	2.2	2.1	2.1	2.1
Capital expenditure	3.9	3.5	3.6	3.6	4.3	4.5	3.6	5.2	5.5	5.3	5.6	5.7
Of which: SOEs onlending projects							0.3	0.8	0.4	0.2	0.2	0.2
One-off revenue and expenditure items 2/	0.0	0.0	0.0	0.0	0.0	0.0	-10.1	0.0	0.0	0.0	0.0	0.0
Augmented overall balance (incl. one-off items) 3/	-2.6	-2.5	-2.3	-1.9	-1.9	-2.3	-13.6	-3.9	-3.4	-3.1	-3.0	-2.9
Augmented overall balance (excl. one-off items) 3/	-2.6	-2.5	-2.3	-1.9	-1.9	-2.3	-3.5	-3.9	-3.4	-3.1	-3.0	-2.9
Augmented primary balance (excl. one-off items) 3/	-1.9	-1.7	-1.6	-1.4	-1.4	-1.5	-2.2	-2.5	-2.3	-1.9	-1.9	-1.8
Financing (excl. one-off items)	2.6	2.5	2.3	1.9	1.9	2.3	1.5	1.0	2.3	2.1	3.0	2.9
Budget financing	1.8	1.4	0.7	0.7	0.4	0.4	-0.2	-1.3	-0.1	-0.4	0.7	0.8
Central government	1.5	0.9	0.6	0.3	0.1	0.1	-0.2	-1.3	-0.1	-0.4	0.7	0.8
Net domestic	-0.7	1.1	0.3	0.6	-0.1	0.0	0.1	-0.2	1.2	1.4	2.1	1.9
Net foreign (excl. project loans)	2.0	-0.4	-0.2	-0.7	-0.2	-0.4	-0.5	-1.2	-1.5	-2.0	-1.5	-1.2
Privatization	0.1	0.2	0.1	0.1	0.2	0.0	0.2	0.1	0.1	0.1	0.1	0.1
Others	0.1	0.0	0.3	0.3	0.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Local governments	0.0	0.4	0.0	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Social Fund	-0.1	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Health Fund	0.3	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net project loans	0.9	1.1	1.6	1.2	1.5	1.9	1.7	2.3	2.4	2.6	2.3	2.2
Of which: Onlending (through commercial banks)							-0.3	-0.9	-0.9	-0.4	-0.4	-0.4
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	2.1	2.9	1.1	0.9	0.0	0.0
World Bank							0.7	0.4	0.4	0.6	0.0	0.0
IMF							0.4	0.4	0.4	0.3	0.0	0.0
Others							1.0	2.0	0.3	0.0	0.0	0.0
Financing for one-off items												
Government securities issued	0.0	0.0	0.0	0.0	0.0	0.0	10.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Public and publicly guaranteed debt	30.5	29.0	30.9	29.6	36.0	45.0	45.7	46.8	47.7	47.3	46.9	46.8
General Government debt	26.9	24.1	24.4	23.7	30.1	38.7	40.3	42.3	43.7	44.2	44.7	45.2
Domestic debt	7.4	7.1	7.0	6.6	11.9	17.0	16.2	14.9	14.7	14.9	15.7	16.3
Domestic expenditure arrears	0.3	0.2	0.1	0.1	0.1	0.6	0.4	0.0	0.0	0.0	0.0	0.0
External debt	19.2	16.9	17.3	16.9	18.0	21.0	23.7	27.4	29.0	29.4	29.0	29.0
Other 4/	3.6	4.8	6.5	5.9	6.0	6.3	5.4	4.5	4.0	3.1	2.2	1.6

Sources: Moldovan authorities; and IMF staff estimates and projections.

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.

2/ Includes banking sector resolution costs in 2016.

3/ Augmented balance includes externally financed on-lending to SOEs.

4/ Includes mainly central bank liabilities to the IMF.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2010–16

(Millions of Moldovan lei, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016
							Proj.
National Bank of Moldova							
Net foreign assets	18,372	19,146	24,690	30,969	27,540	27,826	36,257
NFA (convertible)	18,386	19,188	24,693	31,006	27,539	27,850	36,414
Gross reserves	20,877	23,025	30,339	36,829	33,676	34,536	42,529
Reserve liabilities	2,490	3,836	5,647	5,823	6,137	6,686	6,115
Net domestic assets	-4,286	-1,992	-4,159	-4,891	182	1,863	-4,865
Net claims on general government	-1,067	323	192	476	-270	-1,163	12,131
Credit to banks	-2,675	-2,514	-3,451	-2,340	7,427	13,399	-2,948
Other items (net)	-544	199	-900	-3,027	-6,975	-10,373	-14,048
Reserve money	14,086	17,154	20,531	26,078	27,722	29,689	31,392
Currency in circulation	10,108	10,895	13,241	17,550	17,500	15,509	16,576
Banks' reserves	3,978	6,259	7,285	8,515	10,222	13,335	14,816
Required reserves	2,671	4,450	5,202	6,346	6,290	11,521	13,471
Other reserves	1,307	1,809	2,082	2,169	3,932	1,814	1,346
Monetary survey							
Net foreign assets	18,121	16,450	23,141	31,550	43,153	48,815	59,462
NFA (convertible)	18,376	16,845	23,427	31,731	37,497	43,317	53,380
Of which: commercial banks	-11	-2,344	-1,266	725	9,958	15,466	16,966
Foreign assets of commercial banks	4,615	3,538	4,778	10,496	19,005	22,205	23,071
Foreign liabilities of commercial banks	-4,626	-5,881	-6,044	-9,770	-9,047	-6,739	-6,104
NFA (non-convertible)	-254	-395	-286	-181	5,656	5,499	6,082
Net domestic assets	18,930	24,527	26,372	31,081	22,820	15,191	10,804
Net claims on general government	-187	1,512	1,004	1,387	821	-177	14,416
Credit to economy	26,915	30,963	35,948	42,691	41,273	42,593	42,481
Moldovan lei	15,529	17,174	20,624	25,347	25,173	24,091	23,250
Foreign exchange	11,387	13,788	15,324	17,343	16,100	18,503	19,231
in U.S. dollars	937	1,175	1,270	1,328	1,031	941	938
Other items (net)	-7,799	-7,948	-10,580	-12,996	-19,274	-27,226	-46,093
Broad money (M3)	37,051	40,977	49,513	62,632	65,973	64,006	70,266
Broad money (M2: excluding FCD)	24,771	28,265	34,915	45,117	43,220	39,261	44,940
Currency in circulation	10,108	10,865	13,241	17,550	17,509	15,509	16,576
Total deposits	26,944	30,113	36,272	45,081	48,464	48,497	53,691
Domestic currency deposits	14,662	17,400	21,674	27,567	25,711	23,751	28,365
Foreign currency deposits (FCD)	12,280	12,712	14,599	17,514	22,753	24,745	25,326
in U.S. dollars	1,010	1,083	1,210	1,341	1,457	1,259	1,235
Memorandum items:							
Reserve money growth (percent change; annual)	8.9	21.8	19.7	27.0	6.3	7.1	5.7
Broad money growth (percent change; annual)	13.4	10.6	20.8	26.5	5.3	-3.0	9.8
Credit to economy (percent change, annual)	12.7	15.0	16.1	18.8	-3.3	3.2	-0.3
in lei	17.6	10.6	20.1	22.9	-0.7	-4.3	-3.5
in foreign exchange ($ equivalent)	8.0	25.4	8.1	4.6	-22.4	-8.7	-0.3
Gross international reserves (millions of U.S. dollars)	1,718	1,962	2,515	2,821	2,157	1,757	2,075
Percent of domestic-currency broad money	84	81	87	82	78	88	95
Net international reserves (millions of U.S. dollars)	1,513	1,635	2,047	2,375	1,764	1,417	1,776
Broad money multiplier	2.6	2.4	2.4	2.4	2.4	2.2	2.2

Sources: National Bank of Moldova; and IMF staff estimates and projections.

Table 5. Moldova: Financial Soundness Indicators, 2009–16

(End of period; percent, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015				2016
	Dec	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar
Size											
Number of banks	15	15	15	14	14	14	14	14	11	11	11
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	76.2	97.5	98.3	101.0	69.3	69.1	69.7
Total bank assets (percent of GDP)	66.1	58.8	57.9	66.1	76.3	87.0	80.6	82.9	56.9	56.7	52.4
Capital adequacy											
Capital adequacy ratio	32.3	30.1	30.4	24.8	23.4	13.2	14.3	14.7	24.2	26.2	27.8
Liquidity											
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	25.7	21.1	24.8	27.4	26.9	28.7	29.5
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	51.9	65.5	66.8	66.8	49.8	50.2	50.1
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.6	32.2	37.1	41.0	54.0	57.2	58.9
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.8	21.6	25.2	27.1	38.8	41.5	42.3
Asset quality											
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	42.2	40.8	42.0	42.8	39.6	38.2	37.9
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.9	4.8	5.4	6.2	3.9	3.8	4.2
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	11.6	11.7	12.9	14.4	9.8	9.9	11.1
Provisions to non-performing loans	59.2	63.2	65.0	73.5	83.6	88.4	84.3	77.0	86.8	85.5	86.4
Profitability											
Return on equity	-2.1	3.0	11.5	5.6	9.4	6.1	9.7	8.9	16.1	12.8	15.7
Return on assets	-0.4	0.5	2.0	1.1	1.6	0.9	1.2	1.1	2.6	2.1	2.6
Foreign currency assets and liabilities											
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	51.0	49.5	51.7	48.9	55.9	52.8	51.7
Foreign currency denominated assets in total assests	40.2	40.8	40.5	40.9	44.7	47.0	51.2	50.4	45.3	42.5	41.6
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	44.7	52.1	56.4	56.0	55.4	52.5	51.8
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	40.4	39.8	40.5	42.7	44.0	42.1	43.4

Source: National Bank of Moldova.

Table 6. Moldova: Indicators of Fund Credit, 2011–20 1/

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projection					
Fund obligations based on existing credit											
(millions of SDRs)											
Principal	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4	31.5
Charges and interest	0.8	1.2	1.7	1.7	1.6	1.4	1.4	1.2	1.0	0.7	0.4
Fund obligations based on existing and prospective credit											
Principal	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4	35.3
Charges and interest	0.8	1.2	1.7	1.7	1.6	1.8	1.9	2.1	1.8	1.5	1.2
Total obligations based on existing and prospective credit											
Millions of SDRs	4.7	11.7	15.8	21.0	30.7	54.4	65.3	64.4	61.2	55.1	36.8
Millions of U.S. dollars	7.4	18.0	24.1	31.9	43.0	76.6	92.7	91.3	86.8	78.2	52.2
Percent of exports of goods and services	0.2	0.6	0.7	1.0	1.5	2.9	3.2	2.9	2.5	2.1	1.3
Percent of debt service 2/	8.5	19.7	23.7	31.1	46.6	57.6	49.8	42.8	35.5	30.4	22.0
Percent of GDP	0.1	0.2	0.3	0.4	0.7	1.2	1.3	1.2	1.1	0.9	0.6
Percent of gross international reserves	0.4	0.7	0.9	1.5	2.4	3.7	3.8	3.5	3.2	2.8	1.9
Percent of quota	3.8	9.5	12.9	17.0	17.8	31.5	37.8	37.3	35.5	32.0	21.3
Outstanding Fund credit based on existing and prospective credit											
Millions of SDRs	308.7	398.2	384.0	364.7	335.6	309.1	277.0	262.6	227.5	174.2	138.9
Millions of U.S. dollars	487.3	609.9	583.6	553.9	470.4	435.3	393.2	372.6	322.9	247.2	197.1
Percent of exports of goods and services	15.5	19.5	16.9	16.7	16.8	16.2	13.4	11.8	9.4	6.6	4.9
Percent of debt service 2/	556.7	667.0	575.0	539.3	509.8	327.4	211.5	174.6	132.2	96.2	83.2
Percent of GDP	6.9	8.4	7.3	6.9	7.2	6.5	5.6	5.1	4.1	3.0	2.3
Percent of gross international reserves	24.8	24.2	20.7	25.7	26.8	21.0	16.2	14.1	11.8	9.0	7.1
Percent of quota	250.6	323.2	311.7	296.0	194.6	179.2	160.6	152.2	131.9	101.0	80.5
Net use of Fund credit (millions of SDRs)	96.1	89.5	-14.2	-19.3	-29.1	-26.6	-32.1	-14.5	-35.0	-53.4	-35.3
Disbursements and purchases 3/	100.0	100.0	0.0	0.0	0.0	26.0	31.4	48.0	24.0	0.0	0.0
Repayments and repurchases	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4	35.3
Memorandum items:											
Exports of goods and services (millions of U.S. dollars)	3,143	3,135	3,457	3,313	2,807	2,685	2,925	3,170	3,449	3,758	4,045
Debt service (millions of U.S. dollars) 2/	87.5	91.4	101.5	102.7	92.3	133.0	185.9	213.5	244.2	257.1	236.8
Nominal GDP (millions of U.S. dollars) 2/	7,018	7,283	7,985	7,983	6,493	6,651	7,019	7,378	7,811	8,286	8,730
Gross International Reserves (millions of U.S. dollars)	1,965	2,515	2,821	2,157	1,757	2,075	2,433	2,638	2,730	2,745	2,778
Average exchange rate: SDR per U.S. dollars	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Quota (millions of SDRs)	123.2	123.2	123.2	123.2	172.5	172.5	172.5	172.5	172.5	172.5	172.5

Sources: IMF staff estimates and projections.

1/ Assume repurchases are made on obligations schedule.

2/ Total debt service includes IMF repurchases and repayments.

3/ In 2009, does not include Moldova use of the SDR allocation of SDR 117.71 million.

Table 7. Moldova: Schedule of Reviews and Disbursements 1/

	Available on or after	Amount of Purchase (millions of SDRs)			Percent of Quota		Conditions
		Total	ECF	EFF	ECF	EFF	
1.	November 7, 2016	26.0	8.7	17.3	5	10	Board approval of the Arrangement
2.	March 20, 2017	15.7	5.2	10.5	3	6	Observance of end-December 2016 performance criteria and completion of first review
3.	September 20, 2017	15.7	5.2	10.5	3	6	Observance of end-June 2017 performance criteria and completion of second review
4.	March 20, 2018	24.0	8.0	16.0	5	9	Observance of end-December 2017 performance criteria and completion of third review
5.	September 20, 2018	24.0	8.0	16.0	5	9	Observance of end-June 2018 performance criteria and completion of fourth review
6.	March 20, 2019	24.0	8.0	16.0	5	9	Observance of end-December 2018 performance criteria and completion of fifth review
	Total	129.4	43.1	86.3	25	50	

Source: IMF staff estimates.

1/ Moldova's quota is SDR 172.5 million.

Annex I. Risk Assessment Matrix 1/

Source of Risks	Impact if realized	Policy response
Economic fallout from political fragmentation:		
Russia/Ukraine: the mounting conflict depresses business confidence and heightens risk aversion, amid disturbances in global financial, trade, and commodity markets.	A disruption of trade routes and gas supply, a drop in exports, or a decline in remittances could severely impact the Moldovan economy.	➢ Accelerate diversification of external trade products and markets, and energy sources ➢ Let the exchange rate adjust to facilitate absorption of the external shock ➢ Strengthen external buffers ➢ Speed up structural reform to increase competitiveness
Rise in populism and nationalism in large economies: especially those with near-term elections—could slow down or even reverse policy coordination and collaboration; international trade liberalization; financial, and labor flows; and lead to unsustainable policies, weighing on global growth and exacerbating financial market volatility.	Lower export demand, falling remittances and other financial flows (e.g., trade credits, grants) would induce lower growth, higher budget deficits and exchange rate pressure.	
Weaker-than-expected global growth and persistently lower energy prices:		
Structurally weak growth in key advanced and emerging economies (Euro area): weak demand, low productivity growth, and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to lower medium-term path of potential growth and exacerbating legacy financial imbalances especially among banks.	Lower export demand, falling remittances and other financial flows (e.g., trade credits, grants) would induce lower growth, higher budget deficit, exchange rate pressures, and banking sector difficulties	➢ Let the exchange rate adjust to facilitate absorption of the external shock ➢ Speed up structural reform to increase competitiveness ➢ Accelerate the diversification of external trade products and markets
Significant slowdown in other large EMs/frontier economies (Russia): lower oil prices, fiscal consolidation and tight financial conditions will keep the Russian economy in recession in 2016 (staff forecasts).		
Domestic risks affecting implementation of the financial sector agenda:		
On-site inspections reveal further asset quality and governance issues.	Credit supply would decline, the costs of dealing with bank distress would rise further, and a generalized loss of confidence may emerge.	➢ Apply promptly appropriate tools under the new resolution framework ➢ Enforce shareholder and beneficial ownership transparency and suitability requirements ➢ Step up anti-corruption and AML/CFT efforts
Judicial interference continues to obstruct NBM supervisory actions.		

[1/] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.
Note: Colored boxes on the left hand side represent shock likelihood in case the baseline does not materialize, and color boxes on the right hand side represent severity of impact. Red = High, Orange = Medium, and Green = Low.

Annex II. Debt Sustainability Analysis

Based on an assessment of public external debt, Moldova's risk of debt distress remains low.[1] *Overall public debt dynamics are sustainable despite a small increase in the debt level in the near term. Private external debt is unusually high for a low-income country. In view of the country's significant vulnerability to exogenous developments and the effects of the banking crisis, fiscal discipline is critical to ensure debt sustainability.*

Background

1. Moldova's total external debt is estimated to reach 100½ percent of GDP by end-2016, compared to 85 percent of GDP in 2014 and 99 percent at end-2015. Private external debt (as a share of GDP), which accounts for about 71 percent of total external debt, is projected to remain stable in 2016, while public and public-guaranteed (PPG) external debt is projected to increase by around 2 percentage points. PPG external debt is held mainly by multilateral and bilateral donors, and is mostly medium and long term.

2. Total PPG debt-to-GDP increased by 9 percentage points to 45 percent at end-2015, and is estimated to be around 46 percent at end–2016. While about two-thirds of PPG debt is external, the share of PPG domestic debt increased rapidly in the past two years due to the issuance of a state guarantee to the NBM to provide emergency liquidity to the banking sector. As the guarantees became callable, the PPG domestic debt structure changed significantly, with about 62 percent of it being the long-term debt securities issued to the NBM. The rest of PPG domestic debt is mainly short term and held by the banking system.

3. External private sector debt to GDP is high, albeit starting to decline.[2] The stock of external private sector debt has decreased in 2015 after a decade of accumulation, reaching US$4.6 billion at end-2015, mostly due to a decrease in long-term bank loans. Because of concerns over the problem banks, the banking system, as a whole, faced difficulties in rolling over debt. As a result, the banks' share of total private external debt dropped to 5¼ percent by end-2015 compared with 9¾ percent by end-2014. The share of medium- and long-term debt in total external private debt was about 52¾ percent at end-2015. About half of non-bank debt is short-term, and consists of trade credits, arrears and other debt liabilities, mostly for the import of natural resources.[3] Similar

[1] This full DSA is prepared jointly by IMF and World Bank staff, in consultation with the Moldovan authorities, using the debt sustainability framework for low-income countries approved by the Boards of both institutions, and in accordance with the new staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries.

[2] See Table 2, page 49.

[3] Arrears (mainly in the gas sector) increased from US$136.8 million in 2013 to around US$172.3 million in 2014. Other debt liabilities (mainly from other energy sectors) increased from US$537.7 million in 2013 to US$653.7 million in 2014.

to other Central and Eastern European (CEE) countries, private borrowing in Moldova stems mainly from foreign-owned companies borrowing from their parent companies abroad.

4. Moldova has recently become a strong policy performer for the purpose of determining the debt burden thresholds under the Debt Sustainability Framework (DSF). Moldova's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 3.78 (on a scale of 1 to 6) over the last three years (2013–15), which places the country at the lower end of the strong policy performance category. The corresponding benchmark levels associated with heightened public debt vulnerabilities are presented in the text table.[4] [5]

Debt Thresholds for Strong Policy Performers Under the Debt Sustainability Framework

PPG External Debt Thresholds			
PV of PPG external debt, in percent of:		PPG of external debt service, in percent of:	
GDP + remittances	45	Exports + remittances	20
Export + remittances	160	Revenue	22
Revenue + remittances	300		
Public Debt Benchmark			
PV of total public debt (in percent of GDP)	74		

Source: Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for low-income countries.

Underlying Assumptions

5. The macroeconomic outlook has been revised to reflect changes in near- and medium-term projections compared to the previous DSA assessment. In 2015, the Moldovan economy contracted by 0.5 percent, mainly reflecting negative climatic and external factors together with a decline in remittances, and tight domestic and external financing conditions. As both domestic and external environments remain challenging, the economy is projected to recover modestly in 2016 (with real GDP growth of 2 percent), supported by the rebound in agriculture. Inflation decelerated sharply in early 2016, but has remained above the NBM's target range. This was due to downward adjustments of energy tariffs and a slowdown in food prices. The average inflation is projected to be around 6.8 percent for 2016, taking into account energy tariff adjustments toward the cost-recovery levels take place. The current account deficit is expected to improve in 2016, mainly explained by a sharp reduction in imports due to lower energy prices. Capital flows recorded in the capital and financial accounts are expected to recover gradually over the medium term to the pre-2014 level and allow for an improvement of the reserve position. The fiscal position in 2016 is project to be comparable to the previous assessment, with the cash-based primary deficit of 1.9 percent of GDP

[4] See the staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries.

[5] Since Moldova's CPIA score is at the lower end of the strong policy performers, any moderate deterioration in macroeconomic management and institutions could push the country into a lower category (e.g., when the next CPIA updates are published). Such a reclassification would reduce the debt threshold levels and may affect the assessment of debt sustainability. For the medium policy performers, the PPG external debt threshold is 36 percent and the public debt benchmark is 56 percent.

(or the augmented primary deficit of 2.2 percent of GDP).[6] For the first seven months of 2016, the stock of arrears has declined by about 0.4 percent of GDP. Without further arrears accumulation, this implies a primary deficit of around 1.5 percent of GDP on an accrual basis.

Box. Macroeconomic Assumptions Behind the DSA

Real GDP is projected to grow 2 percent in 2016, mostly supported by the rebound in agriculture, with remittances remaining subdued. Normalizing the flow of credit in the economy and addressing structural bottlenecks will support potential growth rate at around 4 percent in the medium term.

Inflation is expected to decelerate to 6.8 percent in 2016, reflecting downward adjustments of energy tariffs and a slowdown in food prices. Over the medium term, headline inflation is expected to be around 5 percent, in line with the NBM's target.

Exports of goods and services (in U.S. dollars) are expected to decline by 4.4 percent in 2016, mainly driven by declining unit-value prices of exports. Exports of goods and services, as a ratio of GDP, are projected to reach 40.4 percent in 2016, compared to 43.2 percent in 2015. Over the medium and long term, exports are expected to be supported by structural reforms related to the business environment improvement, better quality and standards of agricultural exports (with supports from other international financial institutions), and cross-border trade liberalization with the EU. As a result, exports as a ratio of GDP are projected to reach 46.3 and 47.7 percent in 2021 and 2036, respectively.

Imports of goods and services (in US dollars) are projected to contract by 6 percent in 2016 due to the decline in global commodity prices and moderate domestic demand (arising from the decline in remittances growth). Imports, as a ratio of GDP, are projected to decline from 73.3 percent in 2015 to 67.3 percent in 2016, and recover to 75.3 percent in the medium term. With favorable external adjustments, imports of goods and services, as a ratio of GDP, are projected to remain at this level in 2036.

Remittances are expected to decline to 19.8 percent of GDP in 2016, mainly due to the recession in Russia and the depreciation of the ruble. In the medium term, remittances are expected to recover to 21.4 percent of GDP, owing to the recovery in the remittance-sourcing countries. In the long term, as the economy develops, the number of migrants is expected to decline due to better domestic employment opportunities, and loss of ties of migrants who remain abroad with the home country. As a result, remittances as a ratio of GDP are projected to gradually decline to 20.5 percent by end-2036.

The current account deficit is projected to narrow in the medium term (5.1 percent of GDP in 2021), following the projected improvement from 3.5 percent in 2016. The current account deficit is expected to remain stable at about 5.2 percent of GDP through 2036. It will be financed by FDI, which is expected to be at about 2.1 percent of GDP in the long run. The reserve level, as a share of GDP, is projected to increase to 31.8 percent in 2021 and stabilize at 34.3 percent of GDP by end-2036.

The overall budget deficit is projected to increase from 2.3 percent of GDP in 2015 to 3.2 percent of GDP in 2016, then decline to around 2.9 percent of GDP by 2019, reflecting the authorities' efforts to ensure fiscal sustainability as specified under the Law on Public Finance and Fiscal Responsibility (FRL) with the use of the escape clause for public capital investment funded by external concessional sources (from 2018 onward). Taking into account on-lending to SOEs as an additional budgetary item, this is equivalent to the augmented budget deficit of about 3.5 percent of GDP in 2016, which gradually declines to 3.1 percent of GDP by 2019. The increased budget deficit in 2016 is due to high interest payments, as well as the reduction of the stock of arrears accumulated in 2015. Over the long run, the primary balance is assumed to be around -1 percent of GDP.

[6] For the program's purpose to appropriately monitor fiscal risks, the augmented primary balance deficit (as presented in the staff report) includes on-lending to SOEs as an additional budgetary item.

Box. Macroeconomic Assumptions Behind the DSA (concluded)

Financing assumptions reflect a shift away from concessional financing. Grant-equivalent financing is projected to increase from 3 percent of GDP expected in 2016 to 3.6 percent of GDP in 2017 before declining to 1.7 percent of GDP in 2021 and further to 1.2 percent of GDP over the long run.

The long-run trend reflects assumptions of declining concessional lending and increasing commercial borrowing (which has a negative weight on the calculation of the grant element of new external borrowing that is shown in Figure 1A), while maintaining the total new external borrowing of 2.5 percent of GDP. Correspondingly, the grant element of new borrowing increases from 29.8 percent in 2016 to 31.5 percent in 2021, and is expected to gradually decline to around 20.8 percent in the long run.

External and Public Debt Sustainability

A. External Debt Sustainability Analysis

6. All external public debt ratios are below the thresholds under the baseline and stress tests scenarios. Under the baseline scenario, the PV of debt-to-GDP and remittances would increase significantly from 25¼ percent in 2015 to 26¾ percent in 2016, and peak at 28½ percent in 2018. This increase in the near term reflects currency depreciation as well as an increase in on-lending agreements with external creditors and an increase in multilateral borrowing as the IMF program is in place.[7] In the long term, the PV of debt-to-GDP and remittances would improve gradually and continuously to around 21½ and 14½ percent in 2026 and 2036, respectively. Under the alternative scenario in which exports grow at their historical average minus one standard deviation in 2017–18, the PV of debt-to-GDP and remittances would peak at 43 percent in 2018, before declining to 30 and 15¼ percent in 2026 and 2036, respectively. Meanwhile, if the key variables remained at their historical averages, the PV of debt to GDP and remittances would continuously increase to around 26 percent in the long run. The PV of debt-to-exports and remittances as well as to revenue would also increase relatively more under the alternative and bound test scenarios, but none of them breach the threshold. This result assumes significant fiscal and external adjustments expected over the medium term, reflecting the authorities' commitment to undertake necessary fiscal and structural reforms.

7. All external public debt ratios of the baseline and stress tests scenarios remain well below the thresholds under the probability approach. The alternative scenario where export growth is set to its historical average minus one standard deviation in 2017–18 results in a near breach of the debt threshold as the peak of the PV of debt-to-GDP in 2018 falls within 10 percent band around the 45 percent threshold. The near breach of the debt threshold under this alternative scenario calls for an analysis which focuses on the evolution of the probability of debt distress over time (incorporating the country's individual CPIA score and average GDP growth rate) in addition to

[7] As discussed in the staff report, both on-lending to the private sector (operationalized through commercial banks) and to SOEs are part of public guarantees and are included in the PPG debt in the DSA.

the evolution of debt burden indicator. The projected probabilities of debt distress associated with various debt burden indicators remain well below their respective thresholds both under the baseline scenario and stress tests.

8. **While the external risk rating is determined by the PPG external debt, large private external debt poses additional risks**. Private external debt accounted for around 71½ percent of the total external debt in 2015 and it is expected to decline to around 59½ percent in the medium term (text table). Since short-term debt makes up almost half of private external debt, it might be vulnerable to roll-over risks. In addition, about 91½ percent of medium- and long-term private external debts are owned by non-banks private sector, which poses additional risks to official foreign reserves.

9. **Furthermore, while exports, remittances, and fiscal revenues are projected to be adequate for the PPG external debt service, the liquidity risk remains**. Under the baseline scenario, the PV of PPG external debt service to exports and remittances is expected to increase to 3½ percent in 2016 and peak at 5½ percent in 2019 before declining to around 3¼ percent by end-2036. Similarly, the PV of PPG external debt service to revenues would peak in 2019 and then gradually decline until the end of the projection period. None of the debt service indicators breach the debt service threshold, but some liquidity pressures could emerge. The decline in remittances reflects a downside risk to the external DSA due to the recession in Russia and the depreciation of the ruble.

Breakdown of External Debt, 2013–21

(Millions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Proj.			
Total External Debt	6,682	6,581	6,344	6,622	7,044	7,343	7,495	7,536	7,546
Total PPG	1,758	1,722	1,698	1,887	2,178	2,378	2,479	2,531	2,606
Multilateral	1,572	1,550	1,506	1,646	1,864	2,109	2,274	2,394	2,522
World Bank	603	594	599	675	747	823	896	957	1,012
IMF	772	703	628	597	553	533	485	410	360
EC, EIB, CEDB	128	166	187	244	416	631	804	966	1,119
EBRD	40	56	58	86	101	72	38	6	-26
IFAD	64	62	62	66	68	68	69	70	70
Bilateral	180	171	192	184	157	113	51	-16	-68
Paris Club	168	146	138	131	123	111	97	78	56
Paris Club: ODA	54	50	47	44	40	35	30	24	19
Paris Club: non-ODA	99	78	73	69	64	57	48	37	23
Other Official Bilateral	12	25	54	53	34	2	-46	-94	-125
Commercial	5	1	0	0	0	0	0	0	0
Publicly guarenteed assumed debt/private debt	2	0	0	56	157	156	153	152	152
Total Private	4,924	4,859	4,645	4,736	4,865	4,965	5,016	5,006	4,941
Loans	2,801	2,653	2,510	2,540	2,564	2,560	2,500	2,381	2,204
Short terms	111	56	61	66	71	86	104	123	131
Banks	43	37	37	51	55	66	80	95	101
Other private sectors	69	19	24	15	16	20	24	28	30
Medium and Long terms	2,689	2,597	2,449	2,475	2,493	2,474	2,396	2,258	2,072
Banks	433	301	205	383	386	383	371	349	321
Other private sectors	2,256	2,296	2,244	2,092	2,108	2,091	2,025	1,909	1,752
Other short term	2,123	2,206	2,135	2,195	2,301	2,405	2,517	2,624	2,737
Currency and deposits	371	234	101	108	114	121	128	135	143
Trade credits	1,067	1,137	1,147	1,200	1,300	1,397	1,502	1,602	1,707
Other debt liabilities	686	836	887	887	887	887	887	887	887

Source: Country authorities; and staff estimates and projections

B. Public Sector Debt Sustainability Analysis

10. Under the baseline scenario, the PPG debt-to-GDP ratio is projected to increase by about 0.9 to 1 percentage point of GDP annually during 2016–18—before declining over the medium and long term, reflecting sustainable public debt dynamics. The PPG debt-to-GDP ratio would increase from 45 percent in 2015 to about 46, 47 and 48 percent of GDP in 2016, 2017, and 2018, respectively. The domestic PPG debt-to-GDP ratio is projected to decline, while the increase in the external PPG debt-to-GDP ratio is mainly driven by the currency depreciation as well as an increase in on-lending agreements and an increase in multilateral borrowing (given that the IMF program is in place). With the macroeconomic assumptions outlined above, the recommended (augmented) primary budget deficit path is projected to move towards the path which is below the level that would stabilize the debt-to-GDP ratio. As a result, Moldova's total PPG debt is expected to decline gradually and continuously from its peak in 2018 to 47 percent in 2021 and 32 percent by end-2036. Other sustainability indicators confirm a similar long-term trend under the baseline scenario. PV of debt-to-GDP is projected to increase slightly to 47½ percent in 2016, and then gradually improve to 46 percent and 30¾ percent in 2021 and 2036, respectively. These PV of debt projections are below the benchmark level of 74 percent associated with heightened public debt vulnerabilities for the strong policy performance category. Similarly, the PV of debt-to-revenue and grants ratio is projected to initially increase to 135.3 percent of GDP in 2016, and decline continuously to 130½ percent and 86¾ percent by 2021 and end-2036 respectively.

11. While the inclusion of domestic debt does not alter the assessment of Moldova's overall risk of debt distress, it emphasizes the importance of prudent fiscal and borrowing policies for the preservation of the low risk rating. Under all standard alternative scenarios presented in the DSA, the PV of public debt-to-GDP is projected to be well below the benchmark level of 74 percent. However, some alternative scenarios would raise the public debt level faster than others. For example, a 30 percent real depreciation in 2017 would have the strongest impact in the short run with the PV of debt-to-GDP ratio reaching 60 percent in 2017. Similarly, a 10 percent of GDP increase in other debt creating flows in 2017 would cause the PV of debt-to-GDP to peak at 55 percent in 2017–18. For example, such risks could stem from contingencies for the rest of the banking system and for the accumulated energy tariff debt.

C. The Authorities' View

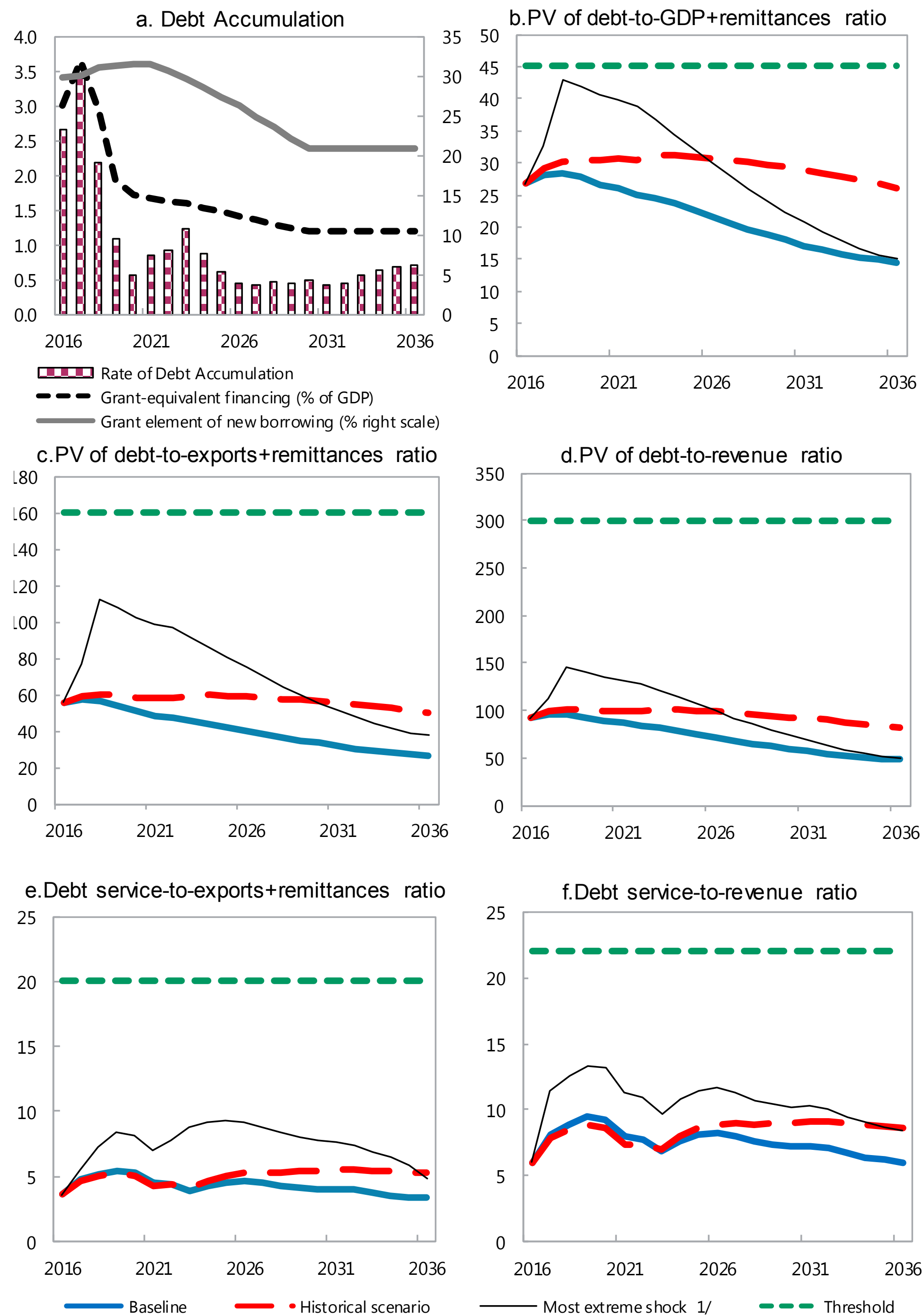
12. The authorities concurred with the staff assessment, and noted the importance of fiscal and external sustainability. The authorities acknowledged that maintaining prudent fiscal policies over the medium term would help protect against potential fiscal risks and liabilities, and hence would strengthen debt sustainability. They also agreed that it is necessary to strengthen the framework to monitor and contain fiscal risks. In addition, as guided by the FRL, the authorities stressed the need for flexibility to be able to finance capital investment in particular when projects are financed by concessional lending. These public investment projects are essential to making progress in poverty reduction, filling infrastructure gaps, and institution strengthening.

D. Conclusion

13. The DSA indicates that Moldova's risk of debt distress remains low, in line with the previous assessment at end-2015. All external indicators for public debt remain well below the debt thresholds under the baseline, standard bound tests, and alternative scenarios as well as under the probability approach. However, significant private external debt poses roll-over risks to debt sustainability. Likewise, while being more sensitive to exchange rate depreciation and a sudden increase in other debt creating flows, Moldova's overall public debt dynamics are projected to remain on a sustainable path under the baseline scenario and alterative scenarios.

14. Pursuing prudent fiscal policy and advancing structural reforms remain necessary to ensure debt sustainability. Due to the country's sensitivity to exogenous developments and the banking crisis, debt sustainability critically depends on sound macroeconomic management and continuing progress on institutional and structural issues that would help unlock the economy's growth potential and reduce its vulnerability to shocks. Furthermore, the limited development of the domestic debt market poses financing risks, especially considering the country's development needs and significant dependence on foreign assistance in the form of grants and concessional loans. Efforts to lengthen the average maturity of domestic debt and deepen the secondary market would help reduce the PPG domestic debt roll-over and interest rate risks.

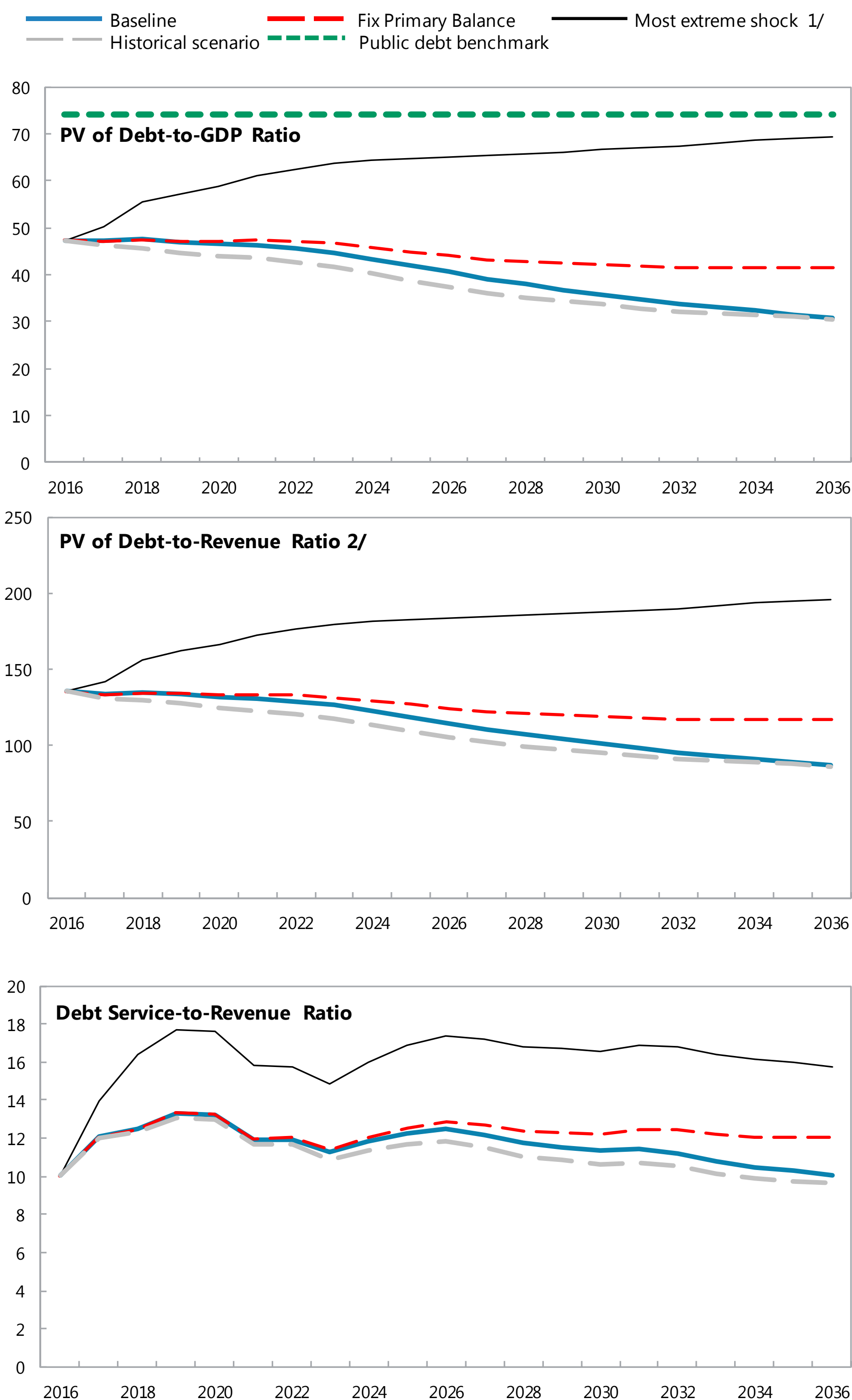
Figure 1A. Moldova: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.

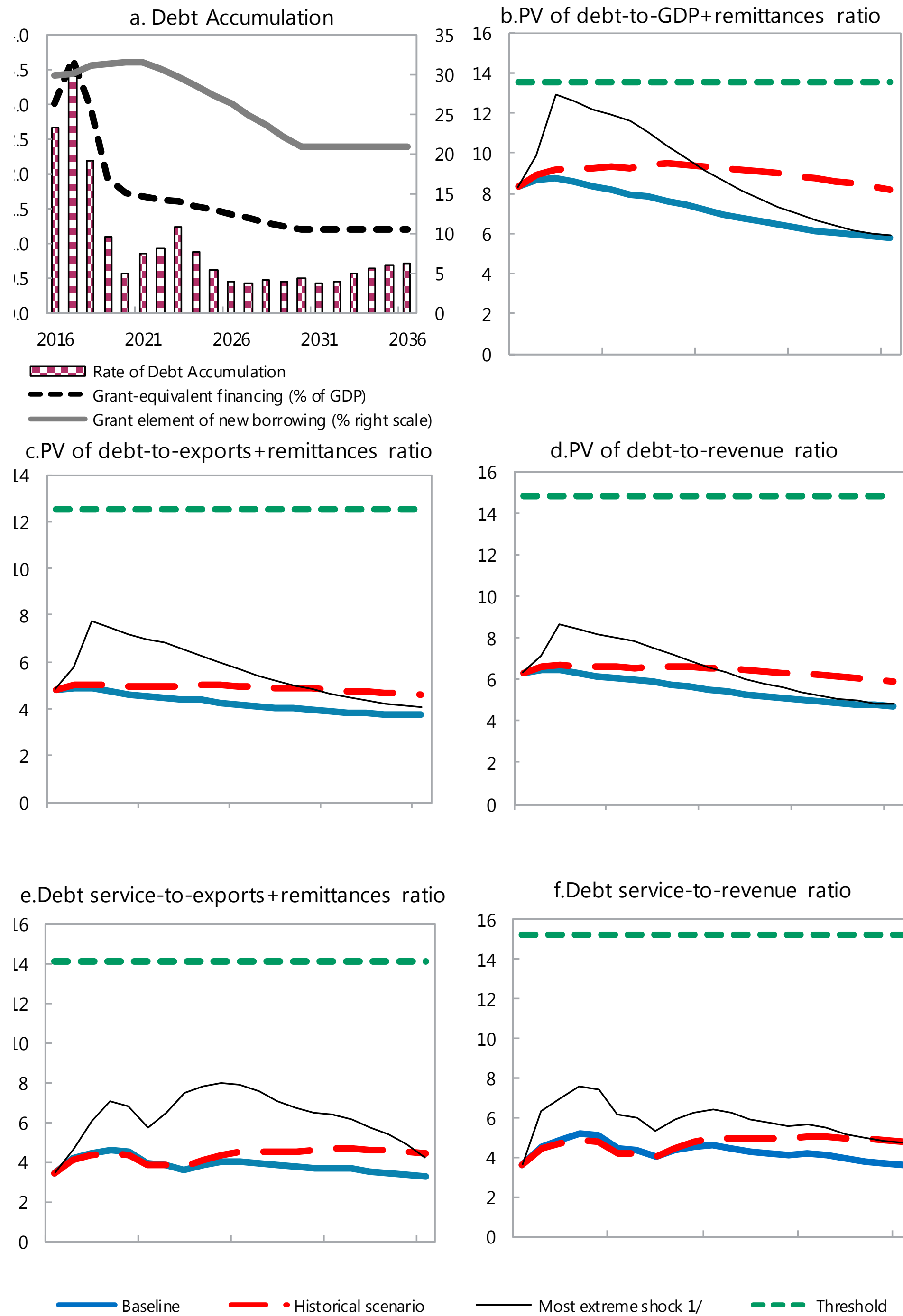
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to an Exports shock; in c. to an Exports shock; in d. to an Exports shock; in e. to an Exports shock and in figure f. to a one-time depreciation shock.

Figure 2A. Moldova: Indicators of Public Debt Under Alternative Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026.
2/ Revenues are defined inclusive of grants.

Figure 3A. Moldova: Probability of Debt Distress of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to an Exports shock; in c. to an Exports shock; in d. to an Exports shock; in e. to an Exports shock and in figure f. to a one-time depreciation shock.

Table 1A. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2013–36 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-2021 Average	2026	2036	2022-2036 Average
External debt (nominal) 1/	84.5	84.9	98.9			100.4	101.2	100.3	96.7	91.6	87.1		74.4	60.1	
of which: public and publicly guaranteed (PPG)	22.8	24.0	27.3			29.1	31.9	33.0	32.5	31.2	30.5		25.3	17.9	
Change in external debt	1.8	0.4	14.0			1.5	0.9	-1.0	-3.6	-5.0	-4.5		-2.4	-1.7	
Identified net debt-creating flows	-4.2	3.2	20.5			-0.5	0.1	0.1	-0.2	-0.3	-0.2		0.4	0.9	
Non-interest current account deficit	5.1	4.4	2.9	8.9	4.4	2.3	3.4	3.5	3.1	3.1	3.0		3.2	4.5	3.5
Deficit in balance of goods and services	37.4	36.7	30.1			26.9	27.7	28.4	28.7	28.9	29.0		28.7	28.0	
Exports	43.3	41.5	43.2			40.4	41.7	43.0	44.2	45.4	46.3		46.8	47.7	
Imports	80.7	78.2	73.3			67.3	69.3	71.3	72.8	74.2	75.3		75.5	75.8	
Net current transfers (negative = inflow)	-20.7	-19.8	-18.0	-21.7	2.9	-16.4	-16.3	-16.2	-16.0	-16.1	-16.0		-15.8	-15.3	-15.7
of which: official	-1.9	-2.6	-2.3			-1.5	-1.2	-1.0	-0.7	-0.7	-0.5		-0.7	-0.7	
Other current account flows (negative = net inflow)	-11.6	-12.5	-9.2			-8.2	-8.0	-8.7	-9.5	-9.6	-9.9		-9.6	-8.2	
Net FDI (negative = inflow)	-2.7	-2.0	-2.5	-5.2	3.8	-2.1	-2.0	-2.0	-1.9	-2.0	-2.0		-1.9	-2.1	-2.0
Endogenous debt dynamics 2/	-6.6	0.8	20.2			-0.7	-1.2	-1.5	-1.4	-1.4	-1.3		-0.9	-1.5	
Contribution from nominal interest rate	0.7	0.8	0.8			1.3	1.6	1.9	2.1	2.1	2.0		1.9	0.7	
Contribution from real GDP growth	-7.1	-4.1	0.5			-1.9	-2.9	-3.4	-3.5	-3.5	-3.3		-2.7	-2.2	
Contribution from price and exchange rate changes	-0.2	4.1	19.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	6.0	-2.9	-6.5			1.9	0.7	-1.0	-3.4	-4.8	-4.3		-2.8	-2.6	
of which: exceptional financing	-1.5	-4.2	-1.4			-0.9	-1.2	-0.9	-0.6	-0.6	-0.6		-0.6	-0.6	
PV of external debt 4/	...	...	100.7			101.9	101.7	100.1	96.2	91.1	86.6		73.9	58.8	
In percent of exports	...	...	233.0			252.4	244.0	232.9	217.9	200.9	186.8		158.0	123.2	
PV of PPG external debt	...	...	29.2			30.7	32.4	32.8	32.0	30.7	30.0		24.8	16.7	
In percent of exports	...	...	67.5			76.0	77.7	76.3	72.5	67.7	64.7		53.0	34.9	
In percent of government revenues	...	...	85.4			92.2	96.4	96.2	93.0	88.6	86.2		71.4	47.9	
Debt service-to-exports ratio (in percent)	17.3	15.0	12.8			26.1	22.1	28.1	28.3	26.2	24.0		18.8	8.0	
PPG debt service-to-exports ratio (in percent)	2.6	2.6	2.4			4.9	6.5	7.0	7.4	7.1	6.0		6.1	4.4	
PPG debt service-to-revenue ratio (in percent)	3.3	3.2	3.1			6.0	8.1	8.9	9.4	9.3	8.0		8.3	6.0	
Total gross financing need (Millions of U.S. dollars)	2623.4	2924.9	2641.3			2912.1	3003.5	3375.1	3563.3	3694.7	3809.1		4638.4	8371.4	
Non-interest current account deficit that stabilizes debt ratio	3.3	4.1	-11.2			0.8	2.5	4.5	6.7	8.1	7.6		5.6	6.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	9.4	4.8	-0.5	3.7	4.8	2.0	3.0	3.6	3.7	3.8	3.8	3.3	3.8	3.8	3.8
GDP deflator in US dollar terms (change in percent)	0.2	-4.6	-18.3	5.2	14.0	0.4	2.5	1.5	2.0	2.2	1.5	1.7	2.9	2.9	2.9
Effective interest rate (percent) 5/	0.9	0.9	0.7	1.3	0.3	1.3	1.7	2.0	2.2	2.3	2.4	2.0	2.6	1.2	2.3
Growth of exports of G&S (US dollar terms, in percent)	10.3	-4.2	-15.3	8.0	19.2	-4.4	9.0	8.4	8.8	9.0	7.6	6.4	7.1	7.1	7.0
Growth of imports of G&S (US dollar terms, in percent)	6.3	-3.0	-23.8	8.2	23.1	-6.0	8.8	8.1	8.1	8.1	6.9	5.7	6.9	6.9	6.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	29.8	30.0	31.0	31.2	31.5	31.5	30.8	26.2	20.8	23.9
Government revenues (excluding grants, in percent of GDP)	34.8	34.4	34.2			33.3	33.6	34.1	34.4	34.7	34.8		34.8	34.8	34.8
Aid flows (in Millions of US dollars) 7/	186.4	332.0	147.7			109.8	120.8	96.1	53.0	55.9	58.9		81.1	157.3	
of which: Grants	154.6	278.8	101.3			109.8	120.8	96.1	53.0	55.9	58.9		81.1	157.3	
of which: Concessional loans	31.8	53.2	46.4			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.0	3.6	2.9	1.9	1.7	1.7		1.4	1.2	1.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			48.6	44.7	44.8	41.2	43.0	43.7		40.5	37.6	39.2
Memorandum items:															
Nominal GDP (Millions of US dollars)	7984.9	7983.2	6492.8			6650.6	7019.4	7378.3	7810.9	8286.0	8730.2		12008.4	23299.8	
Nominal dollar GDP growth	9.6	0.0	-18.7			2.4	5.5	5.1	5.9	6.1	5.4	5.1	6.9	6.9	6.8
PV of PPG external debt (in Millions of US dollars)			1814.8			1986.9	2211.7	2364.7	2444.4	2488.9	2558.1		2949.6	3841.5	
(PVt-PVt-1)/GDPt-1 (in percent)						2.6	3.4	2.2	1.1	0.6	0.8	1.8	0.4	0.7	0.6
Gross workers' remittances (Millions of US dollars)	1501.4	1380.4	1021.7			989.3	1058.7	1122.1	1196.0	1276.7	1352.1		1809.5	3402.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	25.2			26.7	28.1	28.5	27.8	26.6	25.9		21.6	14.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	49.5			55.6	57.1	56.3	53.8	50.6	48.5		40.1	26.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.8			3.6	4.8	5.2	5.5	5.3	4.5		4.6	3.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
The high levels of residuals in the external DSA is mostly explained by exchange rate valuation.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1B. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36

(In percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of debt-to-GDP+remittances ratio								
Baseline	27	28	28	28	27	26	22	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	27	29	30	30	30	31	31	26
A2. New public sector loans on less favorable terms in 2016-2036 2	27	28	30	29	29	29	27	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	27	28	30	29	28	27	23	15
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	27	33	43	42	41	40	30	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	27	30	34	33	31	31	26	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	27	26	25	24	23	23	20	14
B5. Combination of B1-B4 using one-half standard deviation shocks	27	28	33	33	32	31	25	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	27	37	37	36	35	34	29	19
PV of debt-to-exports+remittances ratio								
Baseline	56	57	56	54	51	48	40	27
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	56	59	60	60	59	58	59	50
A2. New public sector loans on less favorable terms in 2016-2036 2	56	58	59	57	55	54	50	44
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	56	55	55	53	49	47	40	26
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	56	77	112	108	102	99	75	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	56	55	55	53	49	47	40	26
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	56	51	48	47	44	43	37	26
B5. Combination of B1-B4 using one-half standard deviation shocks	56	56	66	66	62	60	49	30
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	56	55	55	53	49	47	40	26
PV of debt-to-revenue ratio								
Baseline	92	96	96	93	89	86	71	48
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	92	99	101	101	100	100	99	81
A2. New public sector loans on less favorable terms in 2016-2036 2	92	97	100	99	96	95	89	80
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	92	98	103	99	94	92	77	52
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	92	112	145	140	135	132	99	50
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	92	105	118	114	108	105	88	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	92	89	85	82	78	76	65	47
B5. Combination of B1-B4 using one-half standard deviation shocks	92	100	119	115	110	107	87	54
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	92	133	133	128	122	119	100	67

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

Table 1B. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36 (concluded)

(In percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
Debt service-to-exports+remittances ratio								
Baseline	4	5	5	5	5	4	5	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	4	5	5	5	5	4	5	5
A2. New public sector loans on less favorable terms in 2016-2036 2	4	5	5	6	6	5	5	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	4	5	5	5	5	4	5	3
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	4	6	7	8	8	7	9	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	4	5	5	5	5	4	5	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	4	5	5	5	5	4	4	3
B5. Combination of B1-B4 using one-half standard deviation shocks	4	5	6	6	6	5	6	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	4	5	5	5	5	4	5	3
Debt service-to-revenue ratio								
Baseline	6	8	9	9	9	8	8	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	6	8	8	9	9	7	9	9
A2. New public sector loans on less favorable terms in 2016-2036 2	6	8	9	10	10	9	9	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	6	8	10	10	10	9	9	7
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	6	8	9	11	11	9	12	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	6	9	11	12	12	10	10	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	6	8	9	9	9	8	8	6
B5. Combination of B1-B4 using one-half standard deviation shocks	6	9	10	11	11	9	10	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	6	11	13	13	13	11	12	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	21	21	21	21	21	21	21	21

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2A. Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013–36

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2013	2014	2015	Average 5/	Standard Deviation 5/	2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	29.6	36.0	45.0			45.7	46.8	47.7	47.3	46.9	46.8		41.1	32.0	
of which: foreign-currency denominated	22.8	24.0	27.3			29.1	31.9	33.0	32.5	31.2	30.5		25.3	17.9	
Change in public sector debt	-1.3	6.5	8.9			0.7	1.1	0.9	-0.4	-0.4	-0.1		-1.5	-0.6	
Identified debt-creating flows	-0.5	8.1	10.8			0.8	1.0	0.4	-0.1	-0.1	0.0		-0.5	-0.3	
(Augmented) Primary deficit	1.3	1.3	1.4	1.2	1.7	2.2	2.3	2.0	1.7	1.7	1.6	1.9	1.3	0.8	1.1
Revenue and grants	36.7	37.9	35.7			34.9	35.3	35.4	35.1	35.4	35.4		35.4	35.4	
of which: grants	1.9	3.5	1.6			1.7	1.7	1.3	0.7	0.7	0.7		0.7	0.7	
(Augmented) Primary (noninterest) expenditure	38.1	39.2	37.2			37.1	37.7	37.4	36.8	37.0	37.1		36.7	36.2	
Automatic debt dynamics	-1.5	1.5	3.6			-1.1	-1.2	-1.5	-1.6	-1.7	-1.6		-1.8	-1.1	
Contribution from interest rate/growth differential	-2.7	-1.5	-0.2			-0.8	-0.9	-1.5	-1.7	-1.7	-1.7		-1.5	-1.0	
of which: contribution from average real interest rate	-0.1	-0.2	-0.4			0.1	0.5	0.1	0.1	0.0	0.0		0.0	0.2	
of which: contribution from real GDP growth	-2.7	-1.4	0.2			-0.9	-1.3	-1.6	-1.7	-1.7	-1.7		-1.6	-1.2	
Contribution from real exchange rate depreciation	1.2	3.1	3.9			-0.3	-0.3	0.0	0.0	0.0	0.2		...	...	
Other identified debt-creating flows	-0.3	5.2	5.7			-0.2	-0.1	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
Privatization receipts (negative)	-0.3	-0.4	0.0			-0.2	-0.1	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	5.6	5.8			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.8	-1.7	-1.8			0.0	0.0	0.5	-0.3	-0.2	-0.1		-1.0	-0.3	
Other Sustainability Indicators															
PV of public sector debt	...	...	46.8			47.3	47.3	47.5	46.9	46.4	46.2		40.5	30.7	
of which: foreign-currency denominated	...	...	29.2			30.7	32.4	32.8	32.0	30.7	30.0		24.8	16.7	
of which: external	...	...	29.2			30.7	32.4	32.8	32.0	30.7	30.0		24.8	16.7	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.2	9.2	9.3			11.5	12.4	11.4	11.9	12.7	13.7		16.3	16.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	131.0			135.3	133.8	134.4	133.6	131.3	130.5		114.4	86.7	
PV of public sector debt-to-revenue ratio (in percent)	...	...	137.0			142.0	140.7	139.5	136.2	133.8	133.1		116.7	88.4	
of which: external 3/	...	...	85.4			92.2	96.4	96.2	93.0	88.6	86.2		71.4	47.9	
Debt service-to-revenue and grants ratio (in percent) 4/	4.9	5.3	6.1			10.0	12.1	12.5	13.3	13.2	11.9		12.5	10.0	
Debt service-to-revenue ratio (in percent) 4/	5.2	5.8	6.4			10.5	12.7	13.0	13.6	13.5	12.2		12.7	10.2	
Primary deficit that stabilizes the debt-to-GDP ratio	2.7	-5.1	-7.5			1.4	1.3	1.1	2.1	2.0	1.8		2.8	1.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	9.4	4.8	-0.5	3.7	4.8	2.0	3.0	3.6	3.7	3.8	3.8	3.3	3.8	3.8	3.8
Average nominal interest rate on forex debt (in percent)	0.9	0.9	0.8	1.4	0.5	1.1	1.6	1.7	1.8	1.7	1.8	1.6	1.9	2.8	2.3
Average real interest rate on domestic debt (in percent)	1.0	-0.5	-3.1	0.3	6.0	0.1	2.4	1.1	1.2	1.1	0.5	1.1	0.4	0.5	0.5
Real exchange rate depreciation (in percent, + indicates depreciation)	5.6	14.3	16.1	-1.4	13.8	-1.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.1	6.4	9.6	8.7	4.1	6.5	4.5	5.0	5.0	5.0	5.0	5.2	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	5.5	8.0	-5.7	0.8	3.7	1.8	4.6	2.8	2.0	4.5	3.9	3.3	3.2	3.7	3.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	29.8	30.0	31.0	31.2	31.5	31.5	30.8	26.2	20.8	...

Sources: Country authorities; and staff estimates and projections.

1/ Public sector debt covers gross debt of the general government. Debt of state-owned enterprises is not included unless it is explicitly guaranteed by the government.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2B. Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2016–36

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	47	47	48	47	46	46	41	31
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	47	46	46	45	44	44	37	31
A2. Primary balance is unchanged from 2016	47	47	47	47	47	47	44	41
A3. Permanently lower GDP growth 1/	47	48	49	50	51	53	60	92
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	47	50	55	57	59	61	65	69
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	47	48	49	48	48	47	41	31
B3. Combination of B1-B2 using one half standard deviation shocks	47	48	49	50	50	51	50	47
B4. One-time 30 percent real depreciation in 2017	47	60	59	58	57	56	49	39
B5. 10 percent of GDP increase in other debt-creating flows in 2017	47	55	55	54	54	54	47	35
PV of Debt-to-Revenue Ratio 2/								
Baseline	135	134	134	134	131	131	114	87
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	135	131	129	127	124	123	105	86
A2. Primary balance is unchanged from 2016	135	133	134	135	133	134	124	117
A3. Permanently lower GDP growth 1/	135	136	139	142	144	149	168	258
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	135	142	156	162	166	172	183	195
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	135	135	138	137	134	134	117	88
B3. Combination of B1-B2 using one half standard deviation shocks	135	135	139	141	142	144	141	132
B4. One-time 30 percent real depreciation in 2017	135	169	167	165	161	159	139	110
B5. 10 percent of GDP increase in other debt-creating flows in 2017	135	156	156	155	152	151	132	98
Debt Service-to-Revenue Ratio 2/								
Baseline	10	12	12	13	13	12	12	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	10	12	12	13	13	12	12	10
A2. Primary balance is unchanged from 2016	10	12	12	13	13	12	13	12
A3. Permanently lower GDP growth 1/	10	12	13	14	14	13	15	22
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	10	13	14	15	15	14	17	19
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	10	12	13	13	13	12	13	10
B3. Combination of B1-B2 using one half standard deviation shocks	10	12	13	14	14	13	14	14
B4. One-time 30 percent real depreciation in 2017	10	14	16	18	18	16	17	16
B5. 10 percent of GDP increase in other debt-creating flows in 2017	10	12	13	14	14	13	14	11

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Annex III. Agriculture in Moldova

1. Agriculture is the main driver of economic growth, accounting for 32 percent of employment and, together with the agro-processing sectors, for about one-third of GDP. The agricultural output is characterized by high volatility due to climate-related shocks and low-market competitiveness. The main challenges include underdeveloped land markets, uncompetitive cost structure, inadequate and poor infrastructure, and lack of access to financing.

2. Low profitability of the agriculture sector is driven by the dominance of low-value crops. While the share of utilized agricultural land is fairly high at -70 percent out of total arable land, over 80 percent of the cultivated area is dedicated to low-value crops (cereals, oilseeds, and fodder crops). The high value crops, such as apples and walnuts, face significant supply constraints due to long periods of underinvestment.

3. Fragmented farm structure, together with cumbersome land and property registration procedures further contribute to low competitiveness. The farm sector consists of two major groups: (i) incorporated peasant farms and large-scale enterprises; and (ii) household plots. A legacy of a privatization process in 1990s, many plots are too small to become commercially viable and are owned by multiple of individuals.

4. Attracting more FDI to agriculture-related sectors would encourage export-oriented growth and improve competitiveness. The main impediments to attracting FDI are limited supply capacity and restrictions on land ownership. The ownership of agricultural land and forestry is restricted to Moldovan citizens and legal entities without foreign capital.[1] While lease contracts and transfers are allowed for foreigners, some lease terms and procedures are not clearly specified in the Law. Investors wishing to lease land for agricultural purposes also face land fragmentation issues.

5. Streamlining the regulation on international certifications would further facilitate export of agricultural goods. Not many producers hold internationally recognized quality certifications and implement food traceability. At the same time, many international certification efforts are unnecessarily duplicated, increasing the time and cost of trade and also creating an opportunity for corruption in imports.

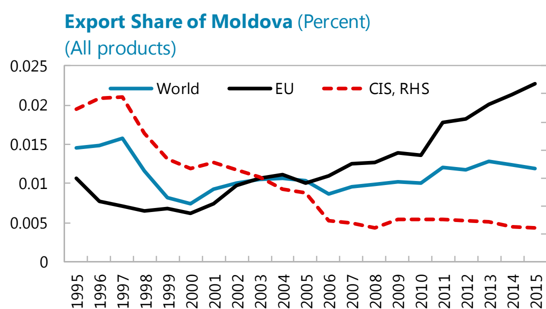
6. Improving competitiveness and productivity in the sector would help to alleviate poverty. The rural population is particularly vulnerable to high-output volatility as most of them depend on agriculture for their livelihoods. The share of population in rural areas living below national poverty line was 18.8 percent in 2013, compared to 4.6 percent in urban areas.

---

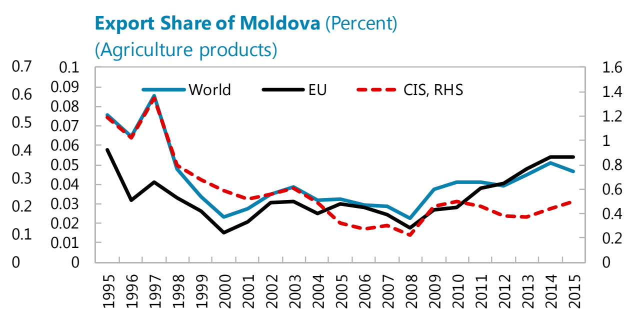
[1] Some foreign investors are reported to own agricultural land due to ambiguity in the current legislation which neither explicitly allows nor prohibits the acquisition of agricultural land by secondary affiliates (local companies owned by foreign affiliates).

Annex IV. External Stability Assessment

1. Moldova's share in global trade has stabilized in the past two years, with more diversified export markets. Although Moldova's participation in European markets has more than doubled over the past 10 years, Moldova's position with its main trading partners, the CIS, has decreased further in 2015 to 0.1 percent, from 0.3 percent 10 years ago. Nevertheless, Moldova's share of agricultural product exports in the CIS has grown to 0.5 percent in 2015.

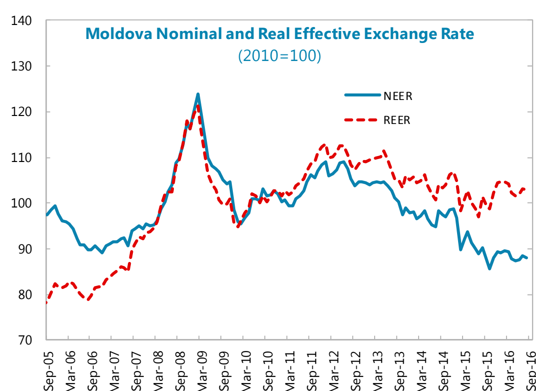


Sources: UNCTAD and IMF staff estimates

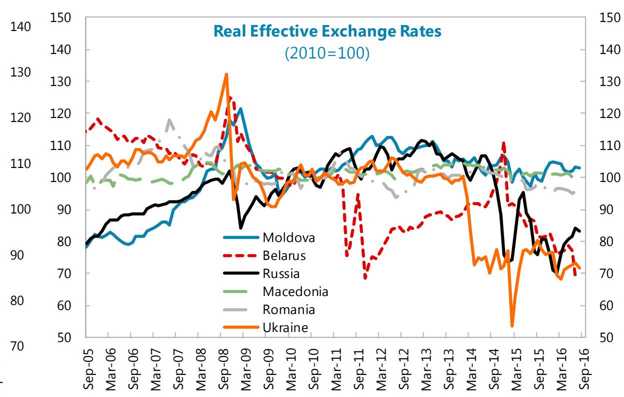


Sources: UNCTAD and IMF staff estimates

2. The real exchange rate has remained broadly stable. In 2015, weak external demand from CIS countries and low remittances (especially Russia) have weighed on growth and the external accounts. The nominal effective exchange rate depreciated some 8.9 percent between end-December 2014 and March 2015, with the REER depreciating by about 7.5 percent over that same period. The foreign exchange market has stabilized more recently, as have the NEER and REER.



Source: INS Dataset.



Source: INS Dataset.

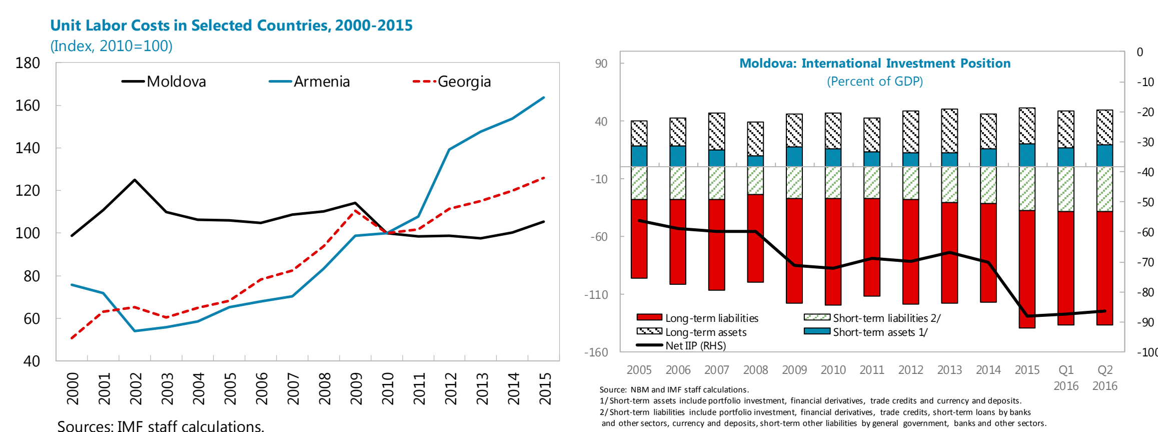
3. Model-based evidence points to a slight undervaluation of the real effective exchange rate in 2016. After the depreciation observed in late 2014 to August 2015, results from applying the EBA-lite methodology suggests that the leu is slightly undervalued (5.1 percent), as the underlying current account balance (-3.8 percent of GDP) is narrower than the estimated current account norm by a margin of 2.8 percent of GDP. Staff's projection of the medium term CA level (-5.6 percent of GDP) is at about the level of the cyclically adjusted CA Norm (-5.5 percent of GDP).

EBA-Lite Assessment
(percent)

CA-Actual	-3.8
CA-Norm	-6.6
CA-Gap	2.8
Elasticity	-0.56
Real Exchange Rate Gap	-5.1
CA-Fitted	-5.5
Residual	1.8
Policy gap	1.0
Cyclical contributions	-1.1
Cyclically-adjusted CA	-2.7
Cyclically-adjusted CA Norm	-5.5

Source: IMF staff estimates.

4. Unit labor costs (ULC) adjusted significantly after the 2009 crisis, but have increased more recently as wages rose. ULCs in Moldova declined by 7.6 percent since 2009. However, this trend reversed in 2014, and ULCs rose 2.8 percent in 2014 and 5.1 percent in 2015.



5. Reserves declined substantially in 2014 and 2015, from a position of strength. Moldova's negative Investment International Position (IIP) widened further in 2015 to 88 percent of GDP and in Q1 2016 at about 87.3 percent of GDP. The stagnation in gross reserves in percentage of GDP in 2015 is the major contributor of the relatively small increase in long-term assets, while long term liabilities increased further. Gross international reserves declined to US$1.76 billion at end-2015, falling 18 percent from end-2014 levels, with most of the US$400 million lost in the first two months of the year. Standard reserve adequacy indicators paint a mixed picture at end-2015—import coverage remains well above the standard three-month benchmark, as does coverage under the composite measure for flexible exchange rate regimes. However, coverage of short-term debt on remaining maturity has deteriorated substantially, from over 106.4 percent in 2013 to around 74.2 percent. Coverage has increased in 2016—US$371 million were built by the end of September 2016. In terms of liabilities, short-term liabilities accounted for 27.6 percent of total and

almost 38.6 percent of total liabilities consisted of FDI, equivalent to over 53.4 percent of GDP at end-2015.

Reserve Adequacy Measures

	2014	2015	2016	2017	2018	2019	2020	2021
			Projection					
Gross official reserves (millions of U.S. dollars) 1/	2156.6	1756.8	2074.8	2432.6	2637.9	2729.6	2770.2	2810.1
Months of perspective imports of goods and services	5.4	4.7	5.1	5.5	5.6	5.3	5.1	4.8
Percent of short-term debt at remaining maturity	84.4	64.2	76.7	80.3	81.9	81.4	79.4	77.4
Percent of short-term debt at remaining maturity plus current account deficit	72.7	54.8	61.0	66.3	69.3	69.2	67.5	74.5
Percent of the IMF composite measure (fixed)	95.9	86.7	99.8	112.0	115.6	114.9	113.1	111.8
Percent of the IMF composite measure (flexible)	128.4	113.4	130.1	145.9	150.8	150.2	148.3	146.9

Sources: Moldovan authorities; and IMF staff estimates and projections.

1/ Includes revaluation changes, which were not captured by changes of gross official reserves in the BOP.

Staff Assessment

6. **Overall external stability is vulnerable to adverse external economic developments and rigorous policies are needed to mitigate the impact of external shocks**. The deterioration in macrofinancial stability and negative spillovers from trading partners has weakened external buffers. The main external risks arise from a protracted economic slowdown in key trading partners (mainly Russia), further intensification of geopolitical tensions, limited scope for near-term diversification to new export markets as Russia's restrictions on imports from Moldova persist, and further declines in remittances, given the magnitude of these flows. Strengthening competitiveness would require policies aimed at building policy buffers (e.g., fiscal, structural financial, social) and strengthen Moldova's ability to withstand adverse external shocks. Policies aimed at export diversification, shift towards higher end of supply chain, and improvement of investment climate should help to create a conducive environment for fostering growth and competitiveness. Staff advise that, under the current exchange rate and inflation targeting regimes, foreign exchange interventions should be limited to the purpose of smoothing excessive foreign exchange market volatility.

Appendix. Letter of Intent

Chişinău
October 24, 2016

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Ms. Lagarde:

1. Weak governance in Moldova's financial sector, left unaddressed for years, enabled a large and well-orchestrated bank fraud in late 2014, with pronounced economic and social costs. The subsequent sharp stop in external concessional financing and the policy gridlock that resulted from the turnover of three consecutive governments last year complicated the policy response to an already challenging external environment. Against that backdrop, real GDP contracted by ½ percent in 2015, public and public-guaranteed debt rose by 11 percent of GDP, the exchange rate depreciated some 25 percent, international reserves fell by one-third, and monetary conditions had to be tightened significantly to prevent a sharp increase in inflation. The situation has stabilized in recent months, but remains fragile. A concerted effort, with the financial and technical support of our international partners, will be critical to restoring confidence and allowing for broad-based inclusive growth.

2. To address these challenges, we are committed to a comprehensive economic reform program that aims to decisively strengthen economic governance and transparency, and reduce risks. A sequence of near- and medium-term reforms will aim at ensuring the long-term safety and soundness of the financial system, through achieving transparent shareholder structures and good governance and risk management of the banks, and strengthening the resources, powers, and accountability of the supervisory and regulatory agencies. We aim to restore the capacity of the budget to support developmental and social goals, while preserving debt sustainability. We will strengthen the revenue base, and improve the efficiency of expenditure, directing fiscal savings to much needed capital expenditure and targeted social spending. We are committed to eliminating accumulated debts within the energy sector through transparent pricing solutions and to ensuring utility tariff-setting at cost-recovery levels, with appropriate social safety net safeguards for vulnerable population groups. We are working to improve the business environment, and will

continue to seek ways to demonstrate a regime shift when it comes to efforts to stamp out corruption, money-laundering, and fraud.

3. A number of key measures will be put in place immediately to demonstrate our commitment to program policies and objectives. These prior actions, which are described below and appear in Table 1, address long-standing issues in the financial sector, not just through bold changes to legislation and regulations, but also through early enforcement actions that will demonstrate a departure from the culture of supervisory forbearance. The program of the Government enjoys broad political support and our reform efforts are backed by a Parliamentary majority.

4. We request the support of the IMF for the ambitious reforms needed to achieve our program objectives. Based on our estimated balance of payments needs, we request the approval of blended Fund support in the form of a 36-month extended arrangement under the Extended Credit Facility and a 36-month arrangement under the Extended Fund Facility in the cumulative amount of SDR 129.4 million (75 percent of quota). The first disbursement will be SDR 26 million, of which the domestic currency counterpart of Fund purchases in the amount of SDR 18 million will be used to finance the budget deficit.

5. We believe that the strong policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP), many of which will be taken upfront, will resolutely put Moldova on a path consistent with achieving the program objectives. Nonetheless, the government stands ready to take additional measures that may be adequate for the successful implementation of the program. The government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the MEFP in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring our progress.

6. Continuing with our policy of transparency, we consent to the publication of this letter, the attached MEFP, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/
Pavel Filip
Prime Minister, Government
of the Republic of Moldova

/s/
Octavian Calmîc
Deputy Prime Minister
Minister of Economy

/s/
Octavian Armaşu
Minister of Finance
Ministry of Finance

/s/
Sergiu Cioclea
Governor
National Bank of Moldova

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

I. Macroeconomic Developments and Outlook

1. **Growth is low and not broad-based**. The economic recovery in 2016 hinges on a rebound in agriculture in the second half of the year, as remittances remain weak. The external conditions are still challenging, with growth in key trading partners improving only marginally. Investment—including public capital spending – has declined on tight financing conditions. Private consumption showed signs of improvement in the first quarter, but is likely to remain subdued in the near term due to lower real income and remittances.

2. **Inflation is declining and is likely to remain low**. Inflation declined sharply in the first half of the year reflecting downwards adjustments of energy tariffs, a slowdown in international food prices, and weak domestic demand. In the second half of the year, a high base effect and favorable prospects for harvest will contribute to further deceleration of inflation toward the lower bound of the NBM target range of 5 +/- 1.5 percent. Looser monetary policy settings since the beginning of the year and a gradual strengthening of domestic demand should stabilize inflation within its target range in the near-term.

3. **The current account deficit is narrowing but should gradually adjust to the medium term norm as growth recovers and reforms bear fruit**. Imports contracted more than exports in Q1 2016, with lower international energy prices playing an important role. This trend is expected to continue for the rest of 2016, resulting in an improvement of trade deficit and an overall narrowing of the CA deficit. In 2017, the rebound in agriculture will support a stronger recovery in exports, tempering the projected pick-up in imports as financing constraints are lifted and demand recovers.

II. Policy Framework for 2016–17

A. Financial Sector Policies

4. **An end goal of financial sector policies over the next 18 months is to protect long term financial stability by delivering a system of sound financial institutions operating within a strong regulatory and supervisory environment**. This will allow banks to exit special supervision, and restore their role in supplying credit to productive sectors, unlocking stronger economic growth. To this end, we are working on four fronts:

i. taking enforcement actions to address breaches with bank regulations identified in the special audits and ongoing onsite inspections in order to improve banks' internal governance and risk management;

ii. enhancing the National Bank of Moldova (NBM) powers and capacity to identify banks' ultimate beneficial owners and related-party lending in order to achieve a transparent shareholder structure in all banks in the system by end-June 2017;

iii. strengthening the regulatory, supervisory, and resolution framework in line with international standards; and

iv. enhancing the governance of the NBM itself, by completing the staffing of the Administrative and Supervisory Boards and Audit Committee, and reinforcing its human resources and operational capacity.

Enforcement actions to address breaches with banking regulations identified in the external special audits of 2015 and onsite supervisory inspections of 2016 and 2017

5. We have taken action against a total of 42 percent of shareholders in Moldova Agroindbank (MAIB) for acting in concert, in violation of the Law on Financial Institutions. These shares were canceled in March 2016 and June 2016, and on September 28, 2016 MAIB's treasury will put up for sale the same number of newly-issued shares. All potential new significant shareholders (those with equity stakes greater than 1 percent) will be subject to fit-and-proper certification, in line with LFI and NBM regulations.

6. We will take necessary actions to ensure the functionality of Victoriabank's supervisory board *(prior action)*. A critical step in improving governance will be restoring the functionality of the supervisory board, whose role is to supervise, develop and implement the bank's policy and to appoint the bank's executive board. To that end, we will: (i) follow international best practices in the fit-and-proper certification process of the three recently nominated board members, (ii) once there is a quorum, instruct the supervisory board to convene, in order to tackle the overdue agenda of approving the banks' audited financial statements for 2015 and to confirm (or change) the executive board. We aim for this process to be completed by first week of September 2016. In the event that shareholders obstruct the board's functionality we will use all powers at our disposal, including blocking the voting rights of relevant shareholders, and request that the remaining shareholders call an extraordinary shareholder meeting to appoint a new supervisory board.

7. The NBM will put MICB under temporary or special administration, as deemed appropriate, in order to address its irregularities *(prior action)*. In particular, the NBM administration will address problems related to nontransparent shareholder structure, internal governance, risk management, and compliance with prudential requirements, identified during the special supervision and the June 2016 on-site inspection. The aim of the temporary or special administration will be to determine the condition of the bank, preserve its franchise value, and ultimately implement a private sector-based solution.

8. The three banks under special supervision will be required to submit strong time-bound remedial action plans for NBM approval *(prior action)*. In line with the decrees issued in June 2016 (for MAIB and Victoriabank), and to be issued by end-August 2016 (for MICB), these banks must submit within 30 days specific and comprehensive remedial action plans to the NBM for approval. We are developing interactive supervisory processes for assessing, approving and monitoring the remedial action plans. We will conduct full-scope on-site inspections followed by an off-site verification of the action plan by end-February 2017 *(structural benchmark)*, after which banks in full compliance with the NBM regulations will exit the special supervision regime. By end-March 2017, we will take appropriate enforcement actions against non-compliant banks *(structural benchmark)*.

9. We will conduct full scope on-site inspections in all remaining banks by end-December 2017 *(structural benchmark)*. The fourth and fifth largest banks that are not subsidiaries of foreign banking groups, will be inspected before end-May 2017 and the remaining banks by end-December 2017 (formalized draft reports at minimum).

Enhance NBM's powers and enforcement capacity to identify banks' ultimate beneficial owners and related-party lending

10. We commit to properly identify banks' ultimate beneficial owners (UBOs) in the three largest banks by end-December 2016 and in all banks by end-June 2017 *(structural benchmarks)*. The UBOs of the fourth and fifth largest banks that are not subsidiaries of foreign banking groups, will be identified before end-March 2017. We have recently established a Shareholder Transparency Unit within the NBM. We are also well advanced in selecting a software system for registration, monitoring and analysis of shareholders and related parties, and expect the system to be fully operational by end-December 2017. Supported by near-term technical assistance from IMF, we will take the following steps:

- ***Legislative changes*** *(prior actions)*: We will adopt amendments to the LFI and NBM law allowing the NBM to use professional judgement based on objective criteria, to presume any person as a bank's related party unless the bank is able to prove otherwise. The law will also allow the NBM to develop and issue regulations on the criteria according to which it will identify a person as related party to a bank, and develop a process of related party diagnostics.

- ***Changes to regulations governing identification of UBOs*** *(prior action)*: The NBM will develop and issue regulations on (i) the criteria and governance of the process for identifying banks' ultimate beneficial owners and (ii) the conduct of related party diagnostics. Specifically, as part of these efforts we will review our methodology for assessing the financial standing of bank owners, including proof of the source of wealth.

- ***UBO identification plan***: The NBM will prepare a plan for full identification of all banks' UBOs *(prior action)*, with a target date of completion at end-December 2016 in the three largest banks and by end-June 2017 in all other banks.

11. The UBO identification process will be followed by an identification and unwinding of loans to related parties. We will instruct the three largest banks to submit, by end-January 2017, a plan to unwind any identified above-limit related party exposure within a period of two years, depending on the size of the exposures. Other banks will be required to submit plans at a later stage. NBM will finalize its diagnostics on related party lending by end-December 2017 *(structural benchmark)*. To help enforce plans on unwinding related party lending, we will amend the LFI to grant NBM the explicit power to deduct excess exposures to related parties from total regulatory capital when assessing capital adequacy.

12. To reduce the scope for fraudulent changes in bank ownership and in corporate securities we will adopt a new modern law on the Central Securities Depository *(prior action)*. A working group is well advanced in preparing the establishment of the Central Securities Depository (CSD) and we will hire a project manager by mid-October 2016. To enable the CSD to start operations for corporate securities, NCFM will enact the regulation that will determine the procedures of verification to be conducted in order to ensure the accuracy of such data as well as the measures to be taken, in case of inconsistencies between such registrar's records and any other document with legal value. By end-December 2016, NCFM shall confirm the integrity of the legal records of securities of 24 Public Interest Enterprises (PIE) that are traded on the MSE and include financial institutions.

Revamp the resolution framework and plan for contingencies

13. To ensure we could handle any contingencies in the banking sector in an orderly fashion, we will finalize and enact a Bank Recovery and Resolution Law and amend the related legislation *(prior action)*. We will amend the current draft Bank Recovery and Resolution Law to ensure that it contains adequately broad intervention and resolution powers in line with international best practices, together with transitional provisions to handle any weak institutions. The changes will include, but not be limited to, ensuring that NBM staff involved in bank resolution have legal protection when acting in good faith. We will also approve amendments to related laws to ensure consistency, notably the LFI, the NBM law and the law on the Deposit Guarantee Fund.

14. We are preparing contingency plans to mitigate potential risks. By end-August 2016, we will strengthen the special supervision regime of the three largest banks, including by restricting lending to related parties and shell companies, and increasing the frequency of banks' reporting on liquid assets and liabilities. Supported by technical assistance by IMF, we will take the following actions:

- **Prepare fallback contingency strategies for each of the three large banks, making use of the powers provided under the new Bank Recovery and Resolution Law** *(prior action)*. The final strategies will incorporate the findings of the related party diagnostics and will ensure depositors and macroeconomic stability are appropriately protected.

- **The Government stands ready provide resolution funding for systemic banks, if private funds are not forthcoming**. Public funds will be made available under strict conditions, including that existing shareholders are fully written down prior to public funds being used, and under the broad principle of preserving financial stability while minimizing the cost to tax payers. Public funds will not be used to protect shareholders' and related-party deposits. Any government guarantees will be issued only as a last-resort solution with the aim to restore public confidence in the systemic banks.

15. We will strengthen the financial sector safety net. We will also prepare for raising the insurance coverage limit of the Deposit Guarantee Fund (DGF) to better contribute to financial stability. Such changes will be accompanied with the establishment of backup funding and subrogation to the DGF of insured depositors' claims on failed banks after their payouts from the DGF.

16. The scope of judicial review will be clarified in the law. In July 2015, parliament adopted legal amendments ensuring that grounds for appeal of NCFM decisions are limited in line with

NBMs decisions. We will adopt legal amendments to ensure that in case of a reversal/annulment by the court of a NBM decision pertaining to banks' significant shareholders according to Art.15, 15 index 1 and index 6 of the LFI, this would result in monetary compensation and not in reversal of the NBM/bank decrees on share transfers/cancelations. Also, the draft Law on Bank Recovery and Resolution provides that in case that a court shall annul or reverse an NBM decision pertaining to crisis management measures, the effects of such decisions shall be upheld and the only redress available shall be monetary compensation. We will seek local expert legal counsel advice regarding the scope of judicial review of NBM decisions, as assessed against the constitutional provisions.

Update the regulatory and supervisory framework

17. We are significantly increasing sanctions so as to act as a proper deterrent *(prior action)*. We have drafted legal amendments to LFI proposing tenfold increases in monetary fines that may be imposed by the NBM; banning sanctioned bank directors, managers and employees from holding any positions in financial sector for a period of at least 5 years; and to hold managers of banks responsible for intentional actions that contributed to the banks' unsafe and unsound situation. Consistent with international best practice, we will amend the draft to hold bank managers or any other persons (including shareholders) pecuniary liable for the failure of a bank (including any significant prejudice to the bank's solvency and liquidity) and/or for its liquidation.

18. In parallel, we will seek to complete the overhaul of the supervisory and regulatory framework, focusing on:

- **Strengthening the implementation of the AML/CFT framework to complement anti-corruption efforts**. In particular: (i) ensure that the legal frameworks for anti-corruption and AML/CFT are in line with international standards, particularly with regard to the criminalization of corruption and preventive measures for politically exposed persons, (ii) ensure that the asset disclosure framework for senior officials covers assets beneficially owned, and (iii) strengthen AML/CFT supervision and conduct targeted risk-based on-site inspections of the banking sector to ensure that AML/CFT preventive measures are effectively implemented by banks and (iv) implement dedicated IT solution to improve the efficiency of AML/CFT supervision in the banking sector.

- **Preparing a strategy for addressing remaining deficiencies**. By end-2016 we will prepare an action plan for implementation of the key recommendation from the Basel Core Principle Assessment, conducted by IMF/WB staff in relation to the 2014 FSAP *(structural benchmark)*.

- **Establishing a policy for placement of public sector deposits**. The MoF will define procurement rules in contracting banks for public funds management, and refrain from giving privileged access to public sector funds.

Enhancing the governance of the NBM

19. We will ensure that the NBM has proper governance structures and appropriate resources to carry out the financial sector agenda. We will (i) complete the staffing of the Administrative and Supervisory Boards and also the Audit Committee of the NBM *(prior action)* and (ii) amend the NBM law and regulations necessary for the review of the NBM's remuneration system so that the NBM has sufficient resources and salary market competitiveness to attract qualified staff and complete its hiring program. In particular, the remuneration of the NBM staff should not be inferior to equivalent positions in the banking sector, or depending on their specificity, in other economic sectors.

B. Monetary and Exchange Rate Policies

20. Our monetary policy will continue to be implemented within an inflation-targeting framework, complemented by exchange rate (ER) flexibility. We have already started a relaxation of monetary policy conditions, although real interest rates remain strongly positive and the reserve requirement on leu deposits is still at high 35 percent. Unlocking credit growth, which continues to stagnate, will require monetary policy measures combined with efforts, described above, to revitalize the banking sector and achieve financial sector stability.

21. To signal our commitment to the inflation targeting regime, we are including an inflation consultation clause in the ECF/EFF, with central targets consistent with macroeconomic projections and growth outlook. There will be dual consultation bands around these targets. Should actual inflation be higher or lower than the inner consultation band of +/- 1 percent, the NBM will consult with IMF staff on the reasons for the deviation and taking into account compensating factors and proposed remedial actions if deemed necessary. Should actual inflation be higher or lower than the outer consultation band of +/- 2 percent, a consultation with the IMF Board will be triggered.

22. In this context, we will undertake broad-based assessment of the stance of monetary policy, taking into account potential deflationary pressures stemming from favorable prospects for agricultural output, weak domestic demand, compounded by the high base effect. If inflation continues to decelerate in the second half of 2016, there will be scope for further downward adjustment in the policy rate and/or reserve requirement ratios.

23. The efficiency of NBM inflation targeting framework is conditional upon its institutional and policy independence, which requires, inter alia, a viable balance sheet. To this end, we will finalize the procedures surrounding the bailout of the three failed banks. A Law will be adopted regulating the transfer of the securities to the NBM to securitize the emergency loans extended to these banks *(prior action)*. To limit unintended expansionary pressures, we will use all future NBM profit transfers to government to repurchase these securities, starting with the longer dated tranches, allowing for a reduction in domestic public debt.

24. Meanwhile, we will not resist exchange rate movements driven by fundamentals, and the NBM's intervention in the foreign exchange market will be aimed only at counteracting volatility. Moldova's vulnerability to external shocks points to the need to have flexible exchange rate arrangement that serves as an efficient absorber of shocks. In this context, the NBM will adhere to flexible exchange rate policies and will intervene in the market to smooth sporadic volatility. The NIR targets set under the program are consistent with these commitments.

25. We will continue improving our inflation targeting framework, forecasts of inflation and key macroeconomic indicators, as well as communication policies explaining monetary policy performance. In this context we will aim to enhance collaboration and coordination with MOF, MOE and NBS, to enhance the consistency of macroeconomic data, projections and ultimately macroeconomic framework, focusing among other things on discussions of the growth outlook, the drivers of inflation, the inflation outlook, and implications for the inflation objective. We will also consider stronger interactions between fiscal and monetary policies by improving coordination of liquidity forecasting and cash management, and sterilization of aid and privatization inflows.

C. Fiscal Policy

26. We remain fully committed to our 2016 fiscal deficit target of 4,272 million lei (or 3.2 percent of GDP) as approved in the budget law. On the revenue side, we have increased excise tax rates on various products and introduced wealth taxes on large real estate holdings. We have taken a few measures to strengthen customs administration, including the introduction of a risk management concept in the Custom Code and adjustments toward the European Union Integrated Customs Tariff (TARIC). Nonetheless, weak internal demand in the first half of the year has led to under-execution of VAT revenues. Disbursement of external budget support grants will fall short of budget projections by an estimated of MDL 1,502.4 million. Under these circumstances, meeting the deficit target would be achieved largely through expenditure prioritization as follows:

- *Restraint of the total wage bill increase*. In advance of a broad public administration reform to be implemented starting in 2017 (see MEFP ¶30), we will rely on temporary measures. We will partially eliminate unfilled positions in the central government (half of the difference between filled positions at end-2015 and total staffing positions in the approved budget), for identified savings of MDL 200 million.

- *Other spending containment*. Subsidies will be contained, in particular those to specific sectors for which external financing is not forthcoming (savings of MDL 772 million). Spending on goods and services will be carefully prioritized (specific measures of MDL 502 million have been identified).

- *Priority spending*. We will protect priority spending, such as capital investment and spending related to activities in the policy matrix agreed with foreign donors which would unlock external financing in the coming years.

- *Clearance of domestic arrears*. We have reduced the stock of domestic arrears from MDL 743.5 million at end-2015 to MDL 465.5 million in June 2016. We will continue reducing the stock of arrears by prioritizing their clearance according to transparent economic and financial criteria *(indicative target)*. While arrears have risen as a result of financing constraints over the last 18 months, we recognize that there is a persistent element of expenditure arrears that needs to be addressed. We will work on diagnosing the cause of persistent central government arrears, paying particular attention to the potential role that unrealistic budgeting, weak expenditure controls, inefficient cash management, or gaps in reporting may play in this regard. In addition, we will strengthen the legal frameworks for local governments by clearly defining their financial management responsibilities and sanctions for non-compliance.

- *Cash management*. To reduce interest costs on the central government budget, we will improve our cash management, in particular cash transfers between government budgets. We will monitor budget executions of government agencies and strengthen the link between central government transfers and these budget executions.

The 2016 budget law will be amended to be consistent with this deficit target and in line with the spending composition to safeguard priority spending *(prior action)*.

27. We intend to use any additional external budget support financing above programmed amounts to clear domestic arrears and reduce exceptionally high levels of domestic borrowing. Should additional external budget support financing become available in the second half of 2016, we are committed to using this additional financing to clear remaining

domestic payment arrears and reduce expensive domestic borrowing, which may help relieve some of the interest burden towards the end of the year.

28. We will prepare our 2017 Budget and the Medium-term Budget Framework for 2017–19 in line with program targets *(structural benchmark)*. We are determined to ensure a sustainable fiscal path for public debt in a balanced and growth-enhancing manner. We are guided by the medium-term fiscal anchor set in the Fiscal Responsibility Law (FRL), which limits the overall fiscal deficit excluding grants to 2.5 percent of GDP by 2018. Given the low risk of public debt distress and the need for social spending and growth-enhancing investment, we intend to use the escape clause for public capital investment funded by external concessional sources. In order to ensure delivery of the objectives of the escape clause, we will identify and protect the execution of key investment projects and/or programs which meet the criteria *(indicative target)*.

29. We will strengthen the framework for containing fiscal risks stemming from government guarantees. On-lending agreements with external creditors to state-owned enterprises will be monitored explicitly through an augmented fiscal deficit *(quantitative performance criterion)*, which will include net lending to SOEs as a budgetary expenditure. While on-lending arrangements through commercial banks to the private sector do not carry an equivalent risk to the state budget, but we will tighten the evaluation framework for entering into such contracts, including by taking into account the capacity of the sector to absorb large inflows.

30. Our medium-term fiscal strategy will be focused on:

- *Raising revenues by strengthening the tax base, gradually reducing reliance on external grants over time*. We will continue to develop the tax system, so that it yields a stable revenue, and is uncomplicated, efficient, and transparent, while paying due attention to fairness and equity. We will target an increase in tax revenues (including social and health insurance contributions) of about 1.4 percent of GDP through 2019. To that end,

- *We commit to review and rationalize various exemptions and/or discounts on VAT, excises, CIT, PIT, and property taxes*. We will redesign tax expenditures provided to various sectors in more efficient and equitable ways. For the agricultural sector, this includes a revision of tax incentives to enhance structural change in the sector through investment and better land utilization. Related to CIT, we will review the possibility to unify a number of different CIT rates. A simplified and unified tax regime and accounting system applied for individuals who are performing business and professional activities, with mandatory registration at the State Tax Service (STS) and cash register machines will be designed and established, in order to increase general level

of compliance. In addition, we intend to strengthen the VAT system and its tax base by streamlining exemptions and the two reduced rates. All the above-described measures are expected to yield an increase in tax revenues of about 1.2 percent of GDP by 2019. Also, we will increase excise taxes towards the level observed in the EU according to Association Agreement between Republic of Moldova and European Union.

- We are developing plans to reduce underreporting of taxable income and wages. We will adopt industry-based cash economy strategies, utilizing continued engagement with industry bodies and tax practitioners, advisory programs, promoting clear communications on areas of non-compliance, and sample and follow-up audit programs and prosecution.

- We intend to revise the mechanism of real estate valuation in the cadaster to broaden the tax base for real estate taxes.

- Advancing tax administration reforms is a key policy priority to improve tax compliance and revenue collection. In this regard, the government has recently approved a legal framework for unification of the state tax administration to replace the current fragmented arrangements, with expected implementation in 2017. Our focus will also be on enhancing the performance of the large taxpayer office (LTO) and the high wealth individual (HWI) program. For the LTO, this includes the expansion of its auditor workforce, establishing clear criteria for determining the status of large taxpayers, assigned affiliated companies of large taxpayers to the LTO irrespective of their turn over and revenue contribution, and profiling large taxpayers on areas of activity. For the HWI program, a revised concept should be adopted in order to increase the efficiency of it. Information sharing between the LTO and HWI is also important.

- ***Improving the efficiency of spending, directing fiscal savings from these adjustments toward capital expenditure and targeted social spending***

  - With the objective of making public administration more efficient and competitive, we will initiate structural reforms which include a sector-by-sector rationalization of public wages and employment, and an examination of the incentive structures and their setting mechanisms. In this context, we will initiate a thorough review of core functions of public servants not to undermine the capacity of Ministries to deliver on their core objectives.

  - We will rationalize a number of non-targeted categorical social benefits. We intend to consolidate various categorical social benefits to reduce administrative costs and avoid benefit overlap, and direct resources to the existing means-tested programs (namely, Ajutor Social and Heating Allowance). We will also strengthen these means-tested programs by

using more active information campaign to improve the take-up ratio, indexing theirs benefits over time, and introducing measures to limit the work disincentives over the medium term.

31. Over the course of the program, we will implement a number of structural reforms underpinning our fiscal strategy:

- *Fiscal Rules*. We are committed to work on improving the fiscal rules to provide space for social and development objectives while ensuring fiscal sustainability. We will carefully revisit the fiscal anchor in the FRL and also strengthen the fiscal rules by explicitly linking it with debt sustainability.

- *Fiscal Risks*. We will start preparing and will publish a Fiscal Risk Statement (FRS) accompanying the annual budget documents (starting with the 2018 budget) as a tool to help improve the transparency of fiscal policies and associated risks.

- *State-owned enterprises (SOEs)*. To prevent the emergence of fiscal risks from SOEs, we will develop a regular monitoring mechanism to assess their financial performance. Enhanced quarterly reporting from SOEs will be enforced from 2017, pending approval of the relevant government decision in 2016. Formal annual audits of the largest SOEs are carried out since 2015. Starting from 2017, such annual audits will be mandatory for all SOEs, according to the draft law on state and municipal enterprises, to be adopted by Parliament in 2016.

- *Utility tariff adjustment*. Broader measures (see MEFP ¶32) will safeguard the risks of transferring private sector losses to public sector balance sheets *(also an indicative target)*.

- *Social security system*. We intend to implement reforms to the current pension system to ensure the sustainability of the pension system as well as more equitable outcomes among different types of beneficiaries. To improve coverage and compliance, we aim to strengthen the link between contributions and pension benefits, particularly through our efforts at reducing informality (MEFP ¶30). Long-term sustainability of the pension system could also be achieved through an increase of the statutory retirement age and a more systematic indexation of pension benefits instead of ad-hoc increases. We are undertaking a comprehensive analysis of the current pay-as-you-go system.

D. Structural Reforms

32. We are committed to eliminate accumulated debt by energy companies and ensure setting utility tariffs at cost-recovery levels.

- In electricity sector, the accumulated tariff deviations by energy companies will be recovered via a tariff supplement. To this effect, government and Gas Natural Fenosa signed an Agreement that recognizes the amount of outstanding tariff deviations of MDL 1.75 billion and envisages a repayment through annually adjusted tariffs in equal installments over January 2017–December 2020 recovery period, with annual interest of 7.66 percent applied to the outstanding amount. The same structure will be applied to repayment of financial deviations accumulated by other electricity distribution companies (namely Red Nord-Vest, Red Nord, Furnizare Energie Electrica Nord). The decision by the regulator (ANRE) on the amount and timing of the first increase in 2017 will be made publicly available *(prior action)*.

- We will continue to work closely with the World Bank on restructuring the Termoelectrica's debt accumulated with Moldovagaz. We will increase the district heating tariff in August, sufficiently for Termoelectrica to cover its operational costs and investment expenditures required to maintain its infrastructure, meet the current payments for gas as well as to allow for the debt service obligation with Moldovagaz for the debt accumulated by the end-2015 *(prior action)*.

- We commit to regular and timely public reporting of submitted costs and requested tariff adjustments by energy companies as well as approved costs by the regulator (ANRE), starting with the publication on ANRE's website of the information underpinning the decision on Termoelectrica *(prior action)*.

- We will continue to provide financial support to vulnerable households through social assistance programs, Ajutor Social and Heating Allowance, and will work on improving the targeting of this support and its effective coverage. To mitigate the effect of higher energy tariffs on low income households, adequate resources will be allocated in the budget (see MEFP ¶8) *(indicative target)*.

33. We recognize the importance of timely utility tariff adjustments to ensure the financial viability of energy companies and to prevent a build-up of quasi-fiscal costs. With the assistance of the World Bank, we will work on developing and implementing a transparent mechanism to ensure timely adjustment of utility tariffs on the basis of costs, in case the regulator fails to act within the timeframe specified in the Laws on Electricity and Natural Gas (up to 180 days) *(structural benchmark)*. In collaboration with the energy community, we will continue to work on improving the institutional and technical functionality of ANRE to ensure a transparent and

predictable sector regulation. Specific efforts will be made to strengthen ANRE's budgetary independence and make the procedure for the appointment of directors fully transparent and merit-based. We will also work on improving communication about the schedule and rationale of planned tariff adjustments and the available social assistance for vulnerable groups.

34. We view strengthening economic governance and transparency as a top priority and a necessary foundation for robust economic growth. We recognize weak governance and corruption in a broad range of areas, including implementation of laws and regulations and effectiveness of the judiciary. These weaknesses undermine public confidence in government, discourage foreign investment by raising the costs of doing business, and ultimately constrain economic growth. We are committed to taking stronger actions to address these challenges. In addition to the extensive actions aimed to restore proper governance in the financial sector, we will adopt a financial disclosure of net worth by senior government officials and high wealth individuals, which would contribute to increased transparency and have positive spillover effects on the income taxation framework. We will also ensure that the National Anti-corruption Center is subject to a robust external oversight process and it can access all relevant information for its investigations, including of high level officials.

35. To facilitate higher potential growth and poverty reduction over medium-term, we intend to update our Poverty Reduction Strategy, reflecting changes in economic development since it was published in 2013.

E. Program Monitoring

36. The program will be monitored through semi-annual reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks. The prior actions along with proposed structural benchmarks are listed in Table 1. The list of the quantitative performance criteria and indicative targets are set in ¶2 of the Technical Memorandum of Understanding (TMU).

37. Given that financing from the IMF will be partly used to provide direct budget support, a framework agreement will be established between the government and the NBM on their respective responsibilities for servicing financial obligations to the IMF. As part of these arrangements, Fund disbursements will be deposited into the government's account at the NBM.

Table 1. Moldova: Prior Actions and Structural Benchmarks Under the ECF/EFF

	Measure	Status
Prior Actions for Board Consideration of the Arrangement		
Bank governance		
1	NBM to take necessary actions to ensure the functionality of Victoriabank's supervisory board.	Completed.
2	NBM to put MICB under temporary or special administration in order to address its irregularities.	Completed.
3	The three banks under special supervision (MAIB, MICB, and VB) will be required to submit strong time-bound remedial action plans for NBM approval.	Completed.
4	NBM will prepare an Ultimate Beneficiary Owner (UBO) identification plan.	Completed.
5	Complete the staffing of the Administrative and Supervisory Boards and also the Audit Committee of the NBM.	Completed.
Crisis management		
6	Parliament to enact a Bank Recovery and Resolution Law that gives adequate intervention and resolution powers to the NBM.	Completed.
7	NBM to prepare fallback contingency strategies for each of the three large banks, making use of the powers provided under the new Bank Recovery and Resolution Law.	Completed.
Regulatory and supervisory framework		
8	Parliament to adopt amendments to the LFI and NBM laws that grant legal powers to NBM to (i) presume any person as a bank's related party on the basis of objective criteria, unless the banks are able to prove otherwise; (ii) develop and issue regulations on the criteria according to which it will identify a person as related party to a bank, and develop a process of related party diagnostics; and (iii) deduct exposures to related parties from bank capital adequacy.	Completed.
9	NBM to adopt regulations on the criteria according to which it will identify related parties and develop processes for conducting related party diagnostics.	Completed.
10	Parliament to adopt the new law on the Central Securities Depository, consistent with the technical assistance on the law provided by the IMF.	Completed.
11	Parliament to adopt legislation increasing sanctions on managers, administrators, and shareholders of banks for wrongdoings.	Completed.
Energy Sector		
12	Publish the decision by the regulator (ANRE) on the amount and timing of the first tariff supplement in 2017 for recovery of the accumulated tariff deviations by energy companies.	Completed.
13	Increase the district heating tariff sufficiently for Termoelectrica to cover its operational costs and investment expenditures, as well as to meet the current payments for gas and its debt service obligation.	Completed.
14	Publish on ANRE's website the information underpinning the decision on Termoelectrica.	Completed.
Fiscal Policy		
15	Parliament to approve an amended 2016 budget law consistent with the program deficit target and in line with the spending composition needed to safeguard priority expenditure.	Completed.
16	Convert state guarantees to the NBM into marketable government securities with appropriate maturity and interest rate structures, in line with the Law on securitization of emergency lending.	Completed.
Structural Benchmarks 1/		
Financial Sector		
1	Conduct full-scope on-site inspections in all banks:	
	1a Three largest banks, including off-site verification of remedial action plans	end-February 2017
	1b The fourth and fifth largest banks that are not subsidiaries of foreign banking groups	end-May 2017
	1c Remaining banks	end-December 2017
2	Take appropriate enforcement actions against any of the three banks that have not complied with their remedial action plans.	end-March 2017
3	Complete identification of UBOs in all banks:	
	3a Three largest banks	end-December 2016
	3b The fourth and fifth largest banks that are not subsidiaries of foreign banking groups	end-March 2017
	3c All remaining banks	end-June 2017
4	Prepare a strategy for addressing key remaining deficiencies identified in the BCP assessment.	end-December 2016
5	Conclude the diagnostics on related party lending in all banks.	end-December 2017
Fiscal framework		
6	Adopt the 2017 budget in line with program targets.	end-November 2016
7	Adopt a Medium Term Budget Framework for 2017–2019 in line with program targets.	end-November 2016
Energy sector		
8	Develop a transparent mechanism to ensure timely adjustment of utility tariffs on the basis of costs to prevent any discretionary delays.	end-March 2017

1/ Additional structural benchmarks will be set at the time of the first program review.

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (prior actions, performance criteria and indicative benchmarks) established in the Memorandum of Economic and Financial Policies (MEFP) and describes the methods to be used in assessing the program performance with respect to these targets.

A. Quantitative Program Targets

2. The program will be assessed through performance criteria and indicative targets. Performance criteria are set with respect to:

- the floor on the net international reserves (NIR) of NBM;
- the ceiling on the augmented overall cash deficit of the general government, i.e., the overall cash deficit of the general government augmented by on-lending agreements with external creditors to state-owned enterprises (SOEs) (MEFP ¶29); and
- the ceiling on accumulation of external payment arrears of the general government (continuous).
- the ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies (continuous) (MEFP ¶31);

Indicative targets are set on:

- the ceiling on the general government wage bill;
- the floor on priority social spending of the general government;
- the ceiling on stock of accumulated domestic government arrears (continuous);
- the floor on project spending funded from external sources, to comply with the Article 15[1] of the Fiscal Responsibility Law, starting in 2017 for the 2018 budget.

In addition, the program will include a consultation clause on the 12-month rate of inflation.

B. Program Assumptions

3. For program monitoring purposes, all foreign currency-related assets will be valued in U.S. dollars at program exchange rates. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at 19.8698 MDL/US$ (the official rate as of June 30, 2016). Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates as of end-June 2016 published on the IMF web site http://www.imf.org, including US$/EUR = 1.1102, JPY/US$ = 102.9, CHF/US$ = 0.976, US$/GBP = 1.3488, CNY/US$ = 6.6445, RUB/US$ = 64.1755, SDR/US$ = 0.711134876. The holdings of monetary gold will be valued at US$1,320.75 per one troy ounce.

C. Institutional Definitions

4. The **general government** is defined as comprising the central government and local governments. The **central government** includes the state budget (including foreign-financed projects), state social insurance budget, and health insurance budget. The **local governments** include the local budgets (including foreign-financed projects). No new special or extrabudgetary funds will be created during the program period. Excluded from this definition are any government-owned entities with a separate legal status.

D. Program Definitions

5. **Net international reserves (NIR) of the National Bank of Moldova (NBM)** are defined as gross reserves in convertible currencies minus reserve liabilities in convertible currencies.

- For program monitoring purposes, **gross reserves** of the NBM are defined as monetary gold, holdings of SDRs, reserve position in the Fund, and holdings of foreign exchange in convertible currencies that are readily available for intervention in the foreign exchange market or in the securities issued by sovereigns, IFIs and explicitly guaranteed government agencies, with a minimum credit rating for such securities of AA-.[1] Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term non-financial assets, funds disbursed by international institutions and foreign governments assigned for on-lending and project implementation, assets in non-convertible currencies, NBM's claims on resident banks and nonbanks, and foreign assets pledged as collateral or otherwise encumbered, including claims in

[1] The credit rating shall be established by applying the average of ratings assigned by international rating agencies (Fitch, Moody's, and Standard & Poor's).

foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options).

- **Reserve liabilities of the NBM** are defined as use of Fund credit by the NBM, convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year, and convertible currency liabilities of the NBM to residents, excluding to the general government and the mandatory FX reserves of domestic banks in the NBM. Liabilities arising from use of Fund credit by the NBM do not include liabilities arising from the use of SDR allocation.

For program monitoring purposes, the stock of reserve assets and reserve liabilities of the NBM shall be valued at program exchange rate, as described in paragraph 3 above. On this basis, and consistent with the definition above, the stock of NIR of the NBM amounted to US$1,550 billion as of end-June 2016.

6. For the purposes of calculating overall cash deficit and augmented overall cash deficit of the general government, **net domestic credit of the banking system** (NBM and commercial banks) to the general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed projects).[2] This definition will also exclude the securities issued under Law 235/2016 on the issuance of government bonds for execution of Ministry of Finance's payment obligations derived from the State Guarantees Number 807 of November 17, 2014 and Number 101 of April 1, 2015.

Monitoring of this definition will be based on NBM's monetary survey and Treasury data. The Ministry of Finance will provide data on foreign-financed projects and balances in all other adjustment accounts that are elaborated in footnote 2. On this basis, and consistent with the definition above, the stock of the net domestic credit of the banking system shall be measured from below the line and as of end-June 2016 amounted to MDL 3,508 billion.

7. The overall cash deficit of the general government is cumulative from the beginning of a calendar year and will be monitored from the financing side at the current exchange rate established

[2] For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1711, 1713, 1731, 1732, 1733, 1735, 1761, 1762, 1763, 1801, 1802, 1805, 1807, 2264, 2709, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801, 2802, 2811, 2820, 3533 and the group of accounts 2100.

by NBM at the date of transaction. Accordingly, the cash deficit is defined, as the sum of net credit of the banking system to the general government (as defined in paragraph 6), the general government's net placement of securities outside the banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[3] for direct budgetary support and for project financing minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets.

8. **The ceiling on the augmented overall cash deficit of the general government** is the sum of the overall cash deficit (as defined in paragraph 7) and net on-lending to SOEs. Similar to the overall cash deficit, the net on-lending to SOEs is cumulative from the beginning of a calendar year and will be monitored from the financing side at the current exchange rate established by NBM at the date of transaction. That is, the net on-lending to SOEs is defined as the disbursements of on-lending financing from external creditors to SOEs minus their loan repayments.

9. **Government securities in the form of coupon-bearing instruments** sold at face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. On redemption date, the sales value (face value) will be recorded as amortization, and the coupon payments will be recorded as domestic interest payments.

10. For program monitoring purposes, the definition of **debt** is set forth in point no. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Decision No. 15688-(14/107) adopted on December 5, 2014).[4] This definition applies also to commitments contracted or guaranteed for which value has not been received, and to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from this definition are normal import-related credits, defined as liabilities that arise from the direct extension, during the normal course of trading, of credit from a supplier to a purchaser—that is, when payment of goods and services is made at a time that differs from the time when ownership of the underlying goods or services changes. Normal import credit arrangements covered by this exclusion are self-liquidating; they contain pre-specified limits on the amounts involved and

[3] Debt is defined as in footnote 4.

[4] The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

the times at which payments must be made; they do not involve the issuance of securities. External debt is defined by the residency of the creditor.

11. For purpose of the program, the **guarantee** of a debt arises from any explicit legal obligation of the general government or the NBM or any other agency acting on behalf of the general government to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor. As a result, onlending from external creditors to SOEs is treated as public guarantee (and hence, for the purpose of the program, is monitored explicitly from above-the-deficit line). On the other hand, onlending from external creditors to the private sector through commercial banks—which are collateralized and of which credit risks from the final borrower are explicitly borne by the commercial banks—are treated as contingent liabilities.

12. For the purposes of the program, **external payments arrears** will consist of all overdue debt service obligations (i.e., payments of principal or interest, taking into account contractual grace periods) arising in respect of any debt contracted or guaranteed or assumed by the central government, or the NBM, or any agency acting on behalf of the central government. The **ceiling on new external payments arrears** shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

13. The **general government wage bill** will be defined as sum of budget spending on wages and salaries of public sector employees—according to economic budgetary classification, including but not limited to employer pension contributions and other social security contributions, and other remunerations (such as bonus payments). This definition of the general government wage bill is in line with current spending reported in line "Wages" of the general government budget according to the program classification of the annual budget except for salaries of SOEs and health care providers that are compensated from the Health Insurance Fund (FAOAM) itself.[5]

[5] For the calculation of the total general government wage bill the following accounts for central government, local government, and special funds from the Treasury system in the Ministry of Finance will be used: category 210000 personnel expenditure.

14. The **priority social spending of the general government** is defined as the sum of essential recurrent expenditures including pension[6] and unemployment insurance payments from the Social Insurance Fund (BASS, 9008/00286), the *Ajutor Social* (social assistance program 9015/00320) and heating allowance (9015/3022) during the cold season from the central government budget, as well as 94 percent of health expenditures from the main fund of the Health Insurance Fund.

15. For the purposes of the program, general government **domestic expenditure arrears** are defined as non-disputed (in or out-of-court) payment obligations whose execution term has expired and became overdue. They can arise on any expenditure item, including debt service, wages, pensions, energy payments and goods and services.

The **overdue debt is a debt** arising from non-payment of obligations, which have a fixed payment term, and the actual payment has not been effected up to the set term. In cases when the contract does not have the term of payment of receivables, these shall be calculated according to the provisions of Article 80 Paragraph (2) of the Law on Public Finance and Fiscal Responsibility. The term indicated in the contract, for honoring the commitments of a legal entity or an individual towards a public institution shall not exceed 30 days from the date of receipt of funds in the settlement account (except for construction works and capital repairs).

Assessment and reporting of accounts receivable and accounts payable (arrears) shall be done based on the Methodology of Assessment and Reporting of Overdue Receivables and Overdue Accounts Payable (Arrears), approved through the Minister of Finance's Order No. 121 as of September 14, 2016.

Arrears between the state, local government, and social and health insurance budgets, are not counted towards the expenditure arrears' ceiling on the general government.

16. **Absorption of losses or liabilities by the government and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling of zero on absorption by the public sector of losses or liabilities from outside the budgetary sector. Absorption of losses or liabilities is defined as direct payment by the government of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as accumulated stock of the financial deviation of the utility companies, debt-for-equity swaps or a write-off of tax obligations or other state claims.

---

[6] The pensions include the following subprograms and activities, 9004 with activities 00258–00266, 0077, 00298, 9005 with activities 00360 and 9010 with activities 00253.

E. Inflation Consultation Mechanism

17. The monetary conditionality will include a set of quarterly inflation targets (measured as the inflation of the headline consumer price index (CPI) published by the Moldovan National Bureau of Statistics) set within tolerance bands. The inner band is specified as +/- 1 percentage point around the central point. The outer band is specified as +/- 2 percentage point around the central point. Deviations from the bands would trigger a consultation with the staff or Executive Board which would focus on: (i) a broad-based assessment of the stance of monetary policy and whether the Fund-supported program is still on track; and (ii) the reasons for program deviations, taking into account compensating factors and proposed remedial actions if deemed necessary.

Should the observed year-on-year rate of CPI inflation fall outside the inner bands specified for the end of each quarter (text table), the NBM will consult with IMF staff on the reasons for the deviation and the proposed policy response. Should the observed year-on-year rate of CPI inflation fall outside the outer bands specified for the end of each quarter (text table), the authorities will consult with IMF Executive Board on the reasons for the deviation and the proposed policy response before further purchases could be requested under the ECF/EFF.

Inflation Consultation Bands

	2016	2017			
	December Target	March Indicative	June Target	September Indicative	December Indicative
Outer Band (upper limit)	5.5	5.7	6.4	6.6	6.7
Inner Band (upper limit)	4.5	4.7	5.4	5.6	5.7
Actual/Center Point	3.5	3.7	4.4	4.6	4.7
Inner Band (lower limit)	2.5	2.7	3.4	3.6	3.7
Outer Band (lower limit)	1.5	1.7	2.4	2.6	2.7

F. Adjusters

18. The adjusters set in this TMU apply for assessing compliance with the program's quantitative targets starting from end-December 2016.

19. The **ceiling on the augmented overall cash deficit** of the general government will be increased by the amount paid in cash for the purposes of maintaining the financial sector stability or by the face value of government securities issued for the same purpose.

20. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by:

a. the amount of any shortfall between the total amount of actually disbursed and programmed budget support grants from the European Commission. The upward adjustment for 2016 is capped at the equivalent of MDL 220 million, valued at the program exchange rates; and

b. the amount of domestic expenditure arrears cleared upon availability of higher-than-programmed external budget support. For 2016, the programed external budget support equal to the equivalent of MDL 3,133 million, valued at program exchange rates.

21. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted downward—that is, the augmented deficit target will be tightened—by the amount of any shortfall between the total amount of actually disbursed and programmed onlending from external creditors to SOEs.[7] The latter is specified in the text table below.

Programmed Onlending to SOEs and Adjustments to Augmented Fiscal Deficit

	2016	2017—Cumulative			
		Q1	Q2	Q3	Q4
Onlending to SOEs (programmed amount, millions of U.S. dollars)	19.8	14.9	29.7	44.6	59.4
Maximum downward adjustment on the augmented overall cash deficit (millions of Moldovan lei) 1/	394.1	295.2	590.4	885.6	1,180.8

1/ The adjustments are evaluated at the program exchange rate.

22. The floor on **NIR of the NBM** will be lowered by any shortfall in the official external grants capped at the equivalent of €10 million, valued at the program exchange rates.

G. Reporting Requirements

23. **Macroeconomic data** necessary for assessing compliance with performance criteria and indicative targets and benchmarks will be provided to Fund staff including, but not limited to data as specified in this memorandum as well as in Table 2. The authorities will transmit promptly to Fund staff any data revisions.

[7] The SOEs explicitly included in this augmented deficit are Termoelectrica, Moldelectrica, Moldovan Railways, and CET-NORD.

Table 1. Moldova: Quantitative Performance Criteria, January–December 2017

(Cumulative from the beginning of calendar year; millions of Moldovan lei, unless otherwise indicated)

	2016	2017			
	Dec	Mar [2/]	Jun	Sept [2/]	Dec [2/]
1. Quantitative performance criteria					
Ceiling on the ***augmented*** cash deficit of the general government	4,668	1,766	3,525	5,485	5,513
Of which: on-lending agreements with external creditors to state-owned enterprises	396	302	603	905	1,207
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [1/]	1833	1798	1813	2045	2304
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0
3. Indicative targets					
Ceiling on the stock of accumulated domestic government arrears	466	383	300	150	0
Ceiling on the general government wage bill	11,323	2,674	6,003	8,720	11,924
Floor on priority social spending of the general government	16,182	3,729	7,873	12,077	17,230
3. Inflation Consultation Bands					
Outer Band (upper limit)	5.5	5.7	6.4	6.6	6.7
Inner Band (upper limit)	4.5	4.7	5.4	5.6	5.7
Actual / Center point	3.5	3.7	4.4	4.6	4.7
Inner Band (lower limit)	2.5	2.7	3.4	3.6	3.7
Outer Band (lower limit)	1.5	1.7	2.4	2.6	2.7

1/ The NIR target is set a program rate, MDL/US$ at 19.86 as of June 30, 2016.

2/ Indicative targets.

Table 2. Moldova: Data to be Reported to the IMF

Item	Periodicity
Fiscal data (to be provided by the MoF)	Monthly, within three weeks of the end of each month
General budget operations for revenues, expenditure and financing (economic and functional classifications)	
General government wage bill at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within three weeks of the end of each month
Number of budgetary sector positions and employees at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within three weeks of the end of each month
Social expenditure including pension and unemployment payments from the Social Insurance Fund, the *Ajutor Social* (social assistance program) and heating allowance for the cold season from the central government budget, and health expenditures from the main fund of the Health Insurance Fund	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Onlending to SOEs by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Onlending via commercial banks by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Monetary data (to be provided by the NBM)	Weekly, within one week of the end of each week
Monetary survey of the NBM	
Monetary survey for the whole banking system	Weekly, within two weeks of the end of each week
Net claims on general government (NBM and commercial banks)	Weekly, within two weeks of the end of each week
Financial position of commercial banks, including balance sheets, income statement, banking regulation indicators, capital, liquidity, data on credits and deposits (from NBM's Banking Supervision)	Monthly, within four weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange cash flows of NBM	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily, within 12 hours of the end of each day
NBM's sterilization operations	Weekly, within one week of the end of each week
Interbank transactions (volumes, average rates)	Weekly, within one week of the end of each week
Balance of Payments (to be provided by the NBM)	One quarter after the end of the previous quarter
Current, capital, and financial account data.	
Transfers of individuals from abroad through the banking system	Monthly, within six weeks of the end of each month
External debt data (to be provided by MoF and NBM)	
Information on all new external loans contracted by the general government or guaranteed by the government.	Monthly, within three weeks of the end of each month
Total public and publicly guaranteed private sector debt service due and debt service paid, by creditor	Monthly, within three weeks of the end of each month
Disbursements of grants and loans by recipient sector (state/local/SOEs), and by creditor	Monthly, within three weeks of the end of each month
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly, within two weeks of the end of each month
National accounts by sector of production, in nominal and real terms.	Quarterly, within three months of the end of each quarter
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly, within two months of the end of each month

Statement by Anthony De Lannoy, Executive Director for the Republic of Moldova and Veronica Volociuc, Advisor to the Executive Director
November 7, 2016

On behalf of the Moldovan authorities we thank staff for their constructive engagement during the negotiation of the proposed program for Moldova. The requested three-year Fund-supported program under the blended extended arrangement will play a catalytic role in pursuing the authorities' reform agenda. On their way towards reaching a Fund-supported program, the authorities undertook difficult and comprehensive economic and banking reforms. In particular, the authorities:

- Took strong upfront actions in the banking sector aimed at strengthening governance and improving the risk management and the shareholders' transparency.
- Improved the requirements governing the identification of ultimate beneficial owners; initiated the procedures to ensure better registration of ownership of share and securities and developed plans to initiate the full identification of ultimate beneficial owners.
- Enhanced the legal framework on identification of related parties and conducting the related-party diagnostic.
- Improved the bank resolution framework and upgraded the regulatory and supervisory framework, including through a considerable increase in sanctions for breaches of banking regulations including AML/CFT.
- Strengthened the National Committee for Financial Stability.
- Enhanced the governance of the National Bank of Moldova (NBM) by completing the staffing of the Administrative and Supervisory Boards and Audit Committee.
- Consolidated the fiscal position and developed the Medium-Term Budget Framework for 2017–19.
- Took measures to further contain the potential fiscal risks, including from the financial system and energy sector.

The large number of completed prior actions shows the authorities' decisiveness and commitment to the program policies and objectives and represents an important step towards stability. At the same time, the authorities acknowledge that more needs to be done to sustain the recovery, restore credibility, strengthen the institutions, rehabilitate the financial system and attract investments. This comprehensive program will anchor the authorities' reform agenda in order to achieve these objectives and ultimately lead to stronger growth and further poverty reduction. The program will also catalyze additional support from bilateral and multilateral creditors, which beyond supporting the building up of the reserve buffers, will create room to better address pressing social and infrastructure investments needs.

Macroeconomic development and outlook

The economy went into recession in the second half of 2015 due to a drought, an unfavorable external environment, repercussions of a large-scale bank scheme, and tight monetary policy. As a result, real GDP contracted by 0.5 percent. The unfavorable economic environment was embedded by prolonged political instability which ended with the taking office in January 2016 of a new government led by Pavel Filip.

Although the economic situation has stabilized in recent months, it remains fragile. The slight economic growth forecasted for the coming years will be driven mainly by growth in agriculture and consumption, as remittances remain weak. The authorities also expect an increase in exports in the coming years based on higher quality and broaden and diversified markets, while imports will be restored mainly thanks to the recovery of domestic demand.

Monetary policy

Inflation continues its downward trajectory, from a peak of 13.6 percent in December 2015. On average, inflation will drop to 6.3 percent this year, returning to its target range (5.0 percent, with allowed deviation of ± 1.5 p.p.). Over the medium term, inflation is projected to remain within the target range.

After reaching its peak at 19.5 percent in November 2015, the NBM reduced the base rate on several occasions—the latest in October to 9 percent. However, the monetary transmission mechanism remains weak since the monetary policy easing has not resulted in the expansion of banks' credit portfolios. The more prudent behavior of banks, still elevated interest rates and subdued domestic demand restrained credit to the economy, while the banks' increased profitability was largely generated by investments in higher yield government securities.

The floating exchange rate has served Moldova well, providing an adequate shock absorber by insulating the economy against large internal disturbances and external volatility.

Fiscal policy

The difficult economic situation led to significant complications for the country' public finances. It negatively affected tax revenues, while the interest cost for government debt increased considerably due to a higher risk premium and the hike of the base rate. Moreover, the revenues were significantly affected by the scaled back financial support from development partners. External financing remained low in 2016. The government reacted decisively by aligning expenditures with declining revenues. Spending has been prioritized and significantly cut (8.3 percent in real terms), most prominently in capital expenditures. The authorities target a deficit of 3.2 percent of GDP for this year.

Going forward, the fiscal plans, including the 2017 budget, will be formulated based on the Medium-Term Budget Framework for 2017–19 (approved in August). The framework aims

at ensuring a sustainable fiscal path for public debt in a balanced and growth-enhancing manner. Accordingly, the authorities target a budget deficit of 3 percent for the next two years and 2.9 percent for 2019. Although the Fiscal Responsibility Law limits the overall deficit, excluding grants, to 2.5 percent of GDP by 2018, the authorities are planning to use the escape clause in order to support capital investments financed through external concessional sources, with a focus on supporting key projects aimed at pursuing a pro-growth strategy of public spending.

With the restoration of external budget support, the public debt will rise from 43.4 percent of GDP in 2017 to 44.9 percent in 2019, which remains a sustainable level. Focusing on gradually reducing the reliance on external grants and preserving space for social and development objectives, the medium-term fiscal strategy envisages an increase of the tax revenues by about 1.4 percent of GDP through 2019. This is planned to be achieved through further strengthening the tax base, streamlining of various tax exemptions and reduced rates, enhancing tax compliance and revenue collection and improving the efficiency of spending.

Mindful that the current weak pension system represents a threat to fiscal sustainability, further reforms will be launched to make the pension system financially sustainable.

Financial sector

In October 2015, three banks were put under liquidation. Three other major banks (holding 65.6 percent of the sector assets) are kept under a special supervision regime since June 2015, allowing the NBM to avert further spillovers.

Overall the banking system is well capitalized and liquid, but a few banks experience weak asset quality. The share of non-performing loans in total loans reached 15.8 percent in September 2016. However, there is a large disparity of this indicator between banks. The largest share of the increase in NPLs is a consequence of tighter requirements for loan classification. The high level of risk-weighted capital adequacy ratio allowed banks to absorb the related losses.

The banking crisis has brought to the forefront the inefficiency and the gaps of the regulatory framework, including the lack of adequate tools for quick and efficient management of banks in difficulties, alongside serious weaknesses in the oversight. Hence, addressing these deficiencies is a top priority for the newly appointed management of the central bank. In recent months, decisive steps were taken in this regard.

A new comprehensive law on bank recovery and resolution was approved in September, which provides the authorities with adequate tools to prevent insolvency or, when insolvency occurs, to curtail the potential negative repercussions. For this purpose, the new law brings some novelties such as an early intervention mechanism and private sector tools to resolve the banks. Moreover, reforms in line with the 2014 FSAP recommendations, aim at improving the transparency and quality of the banks' shareholders, banks' corporate

governance and risk management and considerably increase the sanctions for banks' shareholders and management in case of wrongdoings. At the same time, the recently approved law on Central Security Depository will pave the way for better registration of ownership of shares and securities.

The banks under special supervision are currently implementing targeted remedial action plans which are based on the findings of special external audits. The measures aim at enhancing their core areas of activity, namely: monitoring shareholders and affiliated persons, corporate governance, lending, risk management and prevention of money laundering. In case of noncompliance, the central bank will act resolutely through taking appropriate enforcement measures.

Moreover, in two banks, the NBM removed unfit shareholders, by blocking respectively 43 and 64 percent of concertedly acting shareholders. These measures are in line with the NBM actions to increase the transparency of the bank's shareholders. In one bank the early intervention regime has been introduced. This will ensure the preservation of healthy and prudent management for the period of removal of deficiencies detected in the ownership structure. A new external diagnostic will be launched to identify the subsequent measures to be applied.

Going forward, the NBM will conduct full-scope on-site inspections and conclude identification of ultimate beneficial owners in all banks. Based on this and on the recently adopted regulations on identification of related parties and related-party lending, relevant diagnostics will be conducted in all banks as well. Additionally, by the end of the year, the NBM plans to design a strategy for addressing key remaining deficiencies in the banking sector identified in the BCP Assessment.

Structural reforms

In light of the structural trend of decreasing remittances, the current growth model based on remittances cannot ensure sustainable economic growth in the long term. Rebalancing the growth drivers requires sustainable progress in promoting higher private sector growth and job creation. The government's agenda has been centered on improving the overall business climate.

The authorities made progress in diversifying energy supply and improving energy efficiency. The feasibility study on the construction of the connecting gas pipeline between Ungheni and Chişinău has been completed and the authorities started the work on the technical design. In addition, the work on expanding the electricity interconnection with Romania is in progress. With the recent approval of the laws on Electricity and on Natural Gas under the EU's Third Energy Package, the government laid the foundation of unbundling the energy suppliers from producers and grids. Finally, the new law on Renewable Energy will enhance energy diversification and is expected to attract new investments.