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Republic of Moldova: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criterion and Augmentation of Access—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Moldova

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and requests for a waiver of a performance criterion and augmentation of access, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criterion and Augmentation of Access, prepared by a staff team of the IMF, following discussions that ended on October 25, 2006, with the officials of the Republic of Moldova on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 30, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff supplement of December 13, 2006 updating information on recent developments;

- a Press Release summarizing the views of the Executive Board as expressed during its December 15, 2006 discussion of the staff report that completed the request and review; and

- 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 be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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REPUBLIC OF MOLDOVA

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criterion and Augmentation of Access

Prepared by the European Department
(In consultation with other departments)

Approved by Juha Kähkönen and Anthony R. Boote

November 30, 2006

- Discussions for the first review under the PRGF arrangement took place in Chisinau during October 11–25, 2006. The staff team included T. Richardson (head), N. Gigineishvili, M. Piatkowski (all EUR), C. Gust (PDR) and J. Mathisen (resident representative). V. Munteanu, Advisor to the Executive Director, participated in the discussions.

- The three-year PRGF was approved on May 5, 2006 (IMF Country Report No. 06/184), with cumulative access of SDR 80.08 million (65 percent of quota), phased in equal, semi-annual tranches. SDR 11.44 million was disbursed on program approval.

- The attached Letter of Intent and Memorandum of Economic and Financial Policies (Attachments I and II) lay out the authorities' economic program for 2007. The authorities have requested completion of the first review and a waiver for nonobservance of an end-September performance criterion. In light of the external shocks faced by Moldova and the authorities' adjustment efforts, they have also requested a front-loaded augmentation of access (from 65 to 90 percent of quota), with two-thirds of the additional access available upon completion of this review, and the remainder on completion of the second review.

- The authorities' Economic Growth and Poverty Reduction Strategy (EGPRSP) annual evaluation report was submitted to the IMF and World Bank Executive Boards in April 2006, along with the associated Joint Staff Advisory Note (IMF Country Report No. 06/185 and IMF Country Report No. 06/186).

- Technical assistance and IFI relations are taken up in the appendices. A PSIA mission has provided assistance in identifying short-term social safety net support to poor households hit by higher utility tariffs.

- The mission met with members of parliament, NGOs, the financial sector, and the policy and academic community. The authorities have agreed to publication of the program documents.

Contents Page

Appendices

Attachments

List of Acronyms

ANRE	National Agency for Energy Regulation
BEM	Banca de Economii
BoP	Balance of payments
CAR	Capital adequacy ratio
CG	Consultative group of donors
DfID	UK Department for International Development
EBRD	European Bank for Reconstruction and Development
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
ENPI	EU European Neighborhood Policy Instrument
EUR	IMF European Department
FAD	IMF Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
IFC	International Finance Corporation
LOI	Letter of Intent
MCC	US Millennium Challenge Corporation
MFA	EU Macro-Financial Assistance
MEFP	Memorandum on Economic and Financial Policies
MTEF	Medium Term Expenditure Framework
NBFI	Nonbank financial institution
NBM	National Bank of Moldova
NCFM	National Commission on the Financial Market
NIR	Net international reserves
NPLs	Nonperforming loans
PFM	Public finance management
PRGF	IMF Poverty Reduction and Growth Facility
PRSC	World Bank Poverty Reduction Support Credit
PSIA	Poverty and Social Impact Analysis
SIDA	Swedish International Development Cooperation Agency
SF	Social Fund
tcm	thousand cubic meters
UNDP	United Nationals Development Program

EXECUTIVE SUMMARY

Moldova is facing serious external shocks that will have long-lasting effects. Citing phytosanitary concerns, Russia has banned imports of Moldovan wine, while at the same time import prices for natural gas are rising sharply. These developments are projected to have a combined negative effect on growth of 2-3 percentage points per annum in 2006-07, and open a gap in the balance of payments of about 9½ percent of GDP in 2007.

Despite these shocks, program conditionality has largely been met during the first six months of the PRGF arrangement. All quantitative performance criteria and indicative targets were met with the exception of the international reserves target, which was missed because of the shocks. Structural conditionality was also broadly met, and the authorities have shown considerable program ownership.

The discussions focused on the appropriate strategy to deal with the external shocks. The agreed strategy involves a combination of adjustment and financing that aims to preserve macroeconomic stability and priority social spending, while channeling stepped up foreign assistance to badly needed public investment. To address the impact of the shocks, the authorities will continue to pass higher energy prices through to consumers, while raising compensation to poor households. At the same time, they will implement growth-enhancing structural reforms while reorienting exports to other markets. Exchange rate flexibility is expected to safeguard competitiveness.

Fiscal and monetary policy will support the macroeconomic strategy. The targeted deficit for 2007 and the medium term remains at ½ percent of GDP. This budgetary stance strikes a balance between supporting the external adjustment, bolstering growth, and complementing monetary policies that aim at bringing underlying inflation back to the single-digit path expected in the original program.

Financial sector development is to be promoted by encouraging foreign competition in the banking system, and by strengthening the capital position of the NBM. The authorities are moving ahead with plans to put their share in Banca de Economii on the market, and they intend to modernize the NBM's capital arrangements, including through a capital injection, to allow it to carry out its duties more effectively.

The main risks to the program come from possible further deterioration in trade relations with Russia connected with the Transnistria dispute.

Staff supports completion of the review, granting a waiver for nonobservance of the NIR target, and augmentation of access under the program. Supplementary measures by the authorities, coupled with likely new donor financing, provide assurance that the program will be implemented and that its objectives remain achievable.

I. Introduction

1. **Board approval in May of the new PRGF-supported program was a signal event for Moldova**. After four years without an active program, the arrangement, which has broad political support, reflected Moldova's goal of deeper integration into European structures.

2. **Since May, however, Moldova has suffered two serious external shocks**. Natural gas prices have risen more rapidly than previously expected, and Russia has banned imports of Moldovan wine, citing phytosanitary concerns. These shocks come against the background of deteriorating political relations between Moldova and Russia over the breakaway Moldovan territory of Transnistria. The shocks, which are expected to have long-lasting effects, have significantly altered the macroeconomic assumptions of the original program.

3. **The focus of this review, therefore, was to identify an appropriate strategy under the PRGF arrangement to deal with the macroeconomic impact of the shocks**.

II. Background

4. **The original program envisaged rapid economic growth to reduce poverty, supported by macroeconomic policies aimed at reducing inflation and improving the external outlook**. Real GDP growth was forecast at 5-6 percent per annum, with inflation falling to single digits and international reserves rising to 3 months of imports. Key themes of the structural reform agenda were financial sector development and public finance reforms aimed at reducing the footprint of the state in the economy.

5. **The two external shocks experienced since the start of the program are serious and long-lasting**:

- **The wine ban is likely to be the larger of the two shocks during the program period**. Russia has traditionally absorbed 80-90 percent of Moldovan wine exports, or about 10 percent of GDP, and prospects for an early resumption of wine exports are dim.[1] Wine exports are not expected to recover to 2005 value levels before 2009. About one quarter of the lost sales to Russia could find other markets in 2007, with the fraction rising over time.[2] But more rapid reorientation of wine exports to new markets, particularly to the west, seems unlikely, given European tastes and trade

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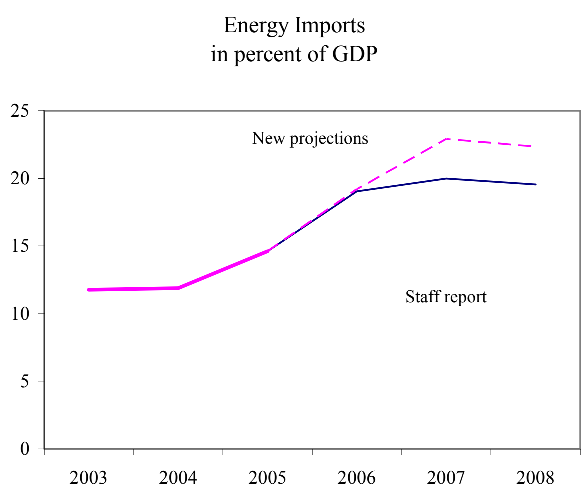
[1] At the time of the Board meeting in May, the authorities expected the wine ban to be resolved quickly, and thus have no lingering BoP effects.

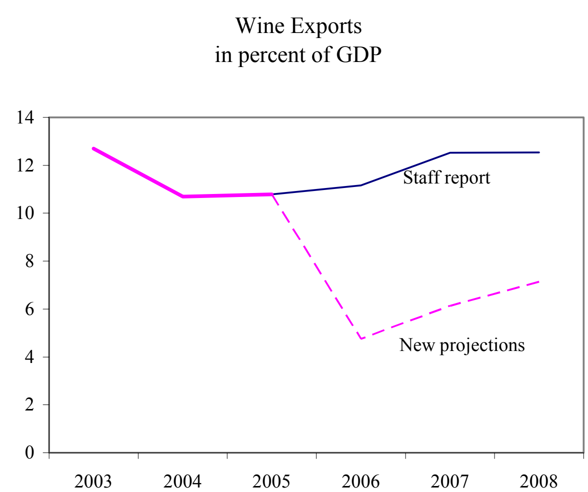
[2] Moldova has sought to address Russian concerns about the quality of exported wine by establishing a system to certify wine exports. The World Bank and other donors are considering assistance projects to help Moldova strengthen its quality assurance framework for agricultural exports, including wine.

policies. Relative to the baseline in the May staff report, the BoP impact of the wine ban is about 6½ percent of GDP in 2006-07, falling to about 5 percent by 2009.

- **After two steep jumps in 2006, staff projects natural gas import prices to move permanently to European levels in early 2007**. Gazprom raised prices for Moldova to \$110/tcm in January 2006, and to \$160/tcm in July. Although the authorities hope to secure continuation of the current price for 2007, the private sector is factoring in a stiff increase, and staff forecasts a price of \$220/tcm from January. Compared to the baseline in the May staff report (which assumed average prices of \$120/tcm, \$130/tcm, and \$140/tcm in 2006-08, respectively), the BoP impact of the gas price shocks is about 3 percent of GDP in 2007-08, falling to 2½ percent by 2009.

Moldova: BoP Impact of External Shocks, 2003–08





Sources: Moldova authorities; and Fund staff estimates

6. **The shocks are expected to have major negative effects on the external position, growth, and inflation:**

- **Taken together, the impact on the BoP of these shocks is very large**; staff forecast the direct effect on the BoP to rise from 6½ percent of GDP in 2006 to 9½ percent of GDP in 2007, falling gradually thereafter.

- **Staff therefore expects a deceleration in growth to 3 percent per annum in 2006-07**, relative to growth of 5-6 percent projected in the program.

- **The first round effect of higher gas prices on headline inflation will be 1½ percentage points**, and this effect comes on top of underlying inflationary pressure that by mid-summer was already exceeding program expectations (before the shocks). Thus, headline inflation in 2006 is expected to be 12 percent (December-to-

December), falling to 10 percent in 2007 (as opposed to 9 percent and 8 percent, respectively, in the original program).

7. **Against this backdrop, fiscal policy has performed well in 2006**. The general government overperformed relative to the deficit originally expected during the first half, owing mainly to healthy value-added tax receipts on imports. Part of the excess revenue in the first half was allocated to long-overdue public investment (such as rural infrastructure) and compensation to households for higher energy tariffs, with the remainder going to reduce the deficit for the year as a whole (to ½ percent of GDP from the originally programmed 0.8 percent) to support disinflation.[3] By the end of the third quarter, it became clear that—as in previous years—the budget would overperform for 2006 as a whole. A surplus of ¾ percent of annual GDP was recorded for the first nine months (compared to a programmed deficit of ¾ percent of GDP), which led staff and the authorities to project an overperformance. A roughly balanced general government budget position is likely, which the authorities noted would be supportive of monetary policy.

8. **The authorities have begun to tighten monetary policy in the face of continued poor performance of inflation.** Their goal has been to accommodate the first-round effects of higher natural gas prices, while keeping underlying inflation close to the original program path. In this, they have only been partially successful; while the transmission mechanism is weak because of high dollarization, the stance of monetary policy has been somewhat inconsistent, owing to weaknesses in coordination between the NBM and the Ministry of Finance. Inflationary pressures were mounting even before the shocks hit, and interest rates on government and NBM paper have been negative in real terms throughout the year. In light of these developments, the NBM has begun to tighten the stance of monetary policy, bringing reserve money growth down to about 6½ percent by end-September and aiming for a small nominal contraction by year-end.

9. **Rumors of financial sector instability fed some pressure on the exchange rate in May-June, but this pressure has subsequently eased**. The authorities believe the rumors were connected with the Transnistria dispute, and they forcefully denied them at the time, while selling a modest amount of foreign exchange to calm the market. Some banks began to hoard foreign exchange, and households moved to reduce holdings of lei assets (though deposit growth continued, albeit in foreign exchange). By autumn, the pressure had eased, but the authorities argued that these rumors, coupled with the effects of the shocks, made it impossible to meet the NIR targets at end-June and end-September.

10. **Available evidence thus far suggests that the banking system will prove resilient in the face of the wine ban**. At end-September, loans to the wine sector were 12 percent of

[3] The wine ban and higher natural gas prices will reduce corporate profits and therefore tax revenues, but this effect will occur chiefly in 2007, not 2006, because of filing and settlement rules.

total loans (7 percent of total assets), and stress tests conducted by the NBM show that even if all of those assets were to be downgraded to substandard or lower categories, all but one of Moldova's 15 banks would remain well above the 12 percent CAR (with the weakest bank being relatively small, but still having assets above 11 percent).[4] Ironically, Moldova's lack of financial system development may have served to insulate banks from the effects of the wine ban, since they are very well-capitalized and highly liquid (partly because of limitations on lending in foreign exchange).

11. **Program conditionality has largely been met, despite the difficult external environment**. With the exception of NIR, all quantitative performance criteria and indicative targets for end-June and end-September were met, and the nonobservance of the reserve target stems from the external shocks (Table 8). Structural reform progress was also broadly satisfactory. All of the structural performance criteria through end-September were observed (Table 9). With two exceptions, the structural benchmarks were also observed: (i) the authorities are preparing a strategy to strengthen bankruptcy procedures, but are in search of appropriate foreign technical assistance to complete the draft, and (ii) the draft law on management and divestiture of public assets is to be submitted to parliament with a delay to take account of comments from development partners.

III. Policy Discussions and 2007 Program

12. **The discussions focused on two key issues:**

- Identifying the appropriate mix of financing and adjustment in response to the shocks, and

- Specifying macroeconomic and structural policy measures to support the adjustment and promote growth.

A. Mix of Financing and Adjustment

13. **The authorities and staff jointly estimated that the shocks had opened significant BoP gaps**. Assuming no additional donor assistance, unchanged reserve accumulation (relative to the original program), and fiscal and monetary policies as described below, the shocks would open annual financing gaps of 3-7 percent of GDP during 2006–08.

14. **The authorities understand that, since the shocks will have long-lasting effects, Moldova will need to adjust, with financing designed to smooth the transition**. Importantly, the private sector has already begun to adjust, as higher natural gas prices are being passed through to consumers. Staff projects that the financing gap can be closed

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[4] However, for some banks tier 1 capital would fall below the minimum required for their current license categories.

through monetary and exchange rate policies combined with additional financing with an unchanged fiscal position. In particular, the nominal exchange rate is projected to depreciate by almost 10 percent in 2007, leading to nonenergy import compression of 2–3 percent of GDP over 2007-09, compared to the estimates in the original program. Further, the monetary tightening needs to be significant to deliver headline inflation of 10 percent (December-to-December), given that exchange rate pass-through effects are large as a result of dollarization.

Moldova: BoP Impact of Twin External Shocks (Relative to May Staff Report)
(In millions of USD)

	2006	2007	2008	2009
Impact of shocks on the BoP				
Impact of wine ban	-203	-204	-186	-183
Impact of higher energy prices	-5	-93	-97	-95
Total	**-208**	**-297**	**-283**	**-278**
(in percent of GDP)	*6.6*	*9.3*	*8.2*	*7.1*
BoP gap (assuming no additional donor assistance and unchanged reserve accumulation)	**-88**	**-220**	**-235**	**-174**
(in percent of GDP)	*2.8*	*6.9*	*6.8*	*4.4*
Financing for BoP gap	**88**	**220**	**235**	**174**
o/w Lower reserve accumulation	**62**	**132**	**162**	**145**
Increase in donor assistance	**27**	**88**	**73**	**29**
Grants	6	63	68	36
Loan disbursements (excluding IMF)	-9	10	5	-7
Possible IMF augmentation	30	15	0	0
Residual BoP gap to be filled	**0**	**0**	**0**	**0**
Memo items				
Change in non-energy imports	33	-55	-101	-112

Source: IMF staff estimates

15. **At least for the program period, additional financing to close the BoP gap seems to be available**, assuming the authorities do their part by undertaking the needed reforms. This financing would take three forms:

- **Stepped-up assistance by donors** is likely. The Netherlands has recently provided a grant of €2.5 million, while the World Bank is expected to disburse a $10 million Poverty Reduction Strategy Credit in early 2007. The EU is considering grants of about €45 million over 2007-08 under their Macro-Financial Assistance program, supplemented in 2007 and beyond by the European Neighborhood Policy Instrument. Other bilateral donors are thought to be considering new assistance to Moldova, notably the US, where on November 7 the Millennium Challenge Corporation approved a request for Compact status that makes Moldova eligible for sizable grants over several years. The World Bank and the European Commission will host a consultative group meeting on December 12 to firm up donor commitments;

- **An augmentation of access** from 65 to 90 percent of quota under the PRGF arrangement would help smooth adjustment and allow the authorities broadly to maintain the 2005 level of reserve coverage. It would also help catalyze possible donor contributions.

- **Reduced reserve accumulation**, relative to the program, would cover part of the gap. Increased exchange rate flexibility underpins the authorities' adjustment strategy, reducing somewhat the urgency of reserve accumulation. After the shocks of 2006, Moldova would now be in a position to attain the targeted three months of import cover in 2009, rather than 2008 as originally programmed.

Medium-Term Outlook: Program and New Baseline Scenarios, 2004–08

	2004	2005	2006		2007		2008	
	Act.	Est.	Prog.	Revised proj.	Prog.	Revised proj.	Prog.	Revised proj.
				(Percent change)				
Real GDP	7.4	7.1	6.0	3.0	5.0	3.0	5.0	5.0
Inflation (end of period, y-o-y)	12.6	10.0	9.0	12.0	8.0	10.0	7.0	8.0
Real effective exchange rate	12.8	-1.3	1.0	1.8	0.1	-6.5	2.3	-2.9
Reserve money	39.7	31.8	16.0	-5.6	...	9.7	...	...
				(In percent of GDP, unless otherwise noted)				
Current account balance	-2.0	-8.3	-5.4	-10.4	-5.5	-7.2	-5.4	-4.2
Wine exports	10.7	10.8	10.6	4.8	10.7	6.1	10.8	7.1
Energy imports	11.9	14.6	18.2	19.2	17.1	22.9	16.0	22.4
Gross official reserves, months of imports	2.1	2.2	2.5	2.3	2.8	2.4	3.1	2.7
General Government								
Revenues	35.4	39.5	38.4	40.3	38.3	42.4	37.7	41.0
Expenditures	34.6	37.9	39.2	40.3	38.8	42.9	38.2	41.6
Balance	0.8	1.7	-0.8	0.0	-0.5	-0.5	-0.5	-0.5
GDP, billions of lei	32.0	36.8	42.6	42.0	48.6	46.6	54.7	53.2

Sources: Moldovan authorities; and Fund staff projections.

B. Fiscal Policy

16. **The authorities project a general government deficit for 2007 of ½ percent of GDP**, consistent with the MTEF and unchanged from the outlook in IMF Country Report No. 06/184 (MEFP¶12). Both sides agreed that this struck an appropriate balance between supporting external adjustment and counter-cyclically promoting growth. The authorities emphasized that an unchanged fiscal position already requires corrective actions: the shocks will reduce

Moldova: Fiscal Impact of External Shocks
(in percent of GDP)

	2006	2007
Revenue impact of wine ban	-0.2	-0.2
Expenditure impact of higher gas prices	0.2	1.0
Combined impact of shocks on general govt. balance	0.4	1.2

Source: IMF staff calculations.

revenue (especially corporate profit taxes) and necessitate new spending (both for natural gas consumption by the government and for additional compensation to poor households). The authorities also noted that a wider deficit would have untoward consequences for inflation and the balance of payments, and thus they are seeking additional donor financing and taking new measures, chiefly on the expenditure side.

17. **To adhere to the agreed deficit ceiling, the 2007 budget scales back planned increases in public sector wages**. While it comes against the backdrop of upcoming local elections, the freeze on wage increases—which will save about 1 percent of GDP—also follows large increases in 2006. Because of the uncertainty associated with the volume and timing of grant assistance, the authorities have also identified contingency measures which they could apply if needed to maintain the deficit target or close the BoP gap (MEFP¶13).[5] In particular, they would cancel or defer capital investment projects to protect social spending.

18. **Staff acknowledged that the finances of the Social Fund (SF) have stabilized somewhat**. The SF has been a particular cause of concern owing mainly to ad hoc pension increases in late 2004. The authorities noted their intention to maintain the statutory indexation formula (linking benefit increases to the simple average of wage and consumer price index growth), which contributes to the stability of SF finances as long as real wages are growing.

C. Monetary and Exchange Rate Policies

19. **The authorities agreed that tighter monetary policies are needed to reduce inflation**. Specifically, their monetary program for 2007 limits reserve money growth to 10 percent, with broad money growth of 15 percent (MEFP¶17). The authorities also agreed to strive for greater consistency in the policy stance, including through enhanced coordination of fiscal and monetary policies (a joint MoF-NBM liquidity committee was established in October 2006). They thus expect real interest rates on NBM paper to be consistently positive by early December.

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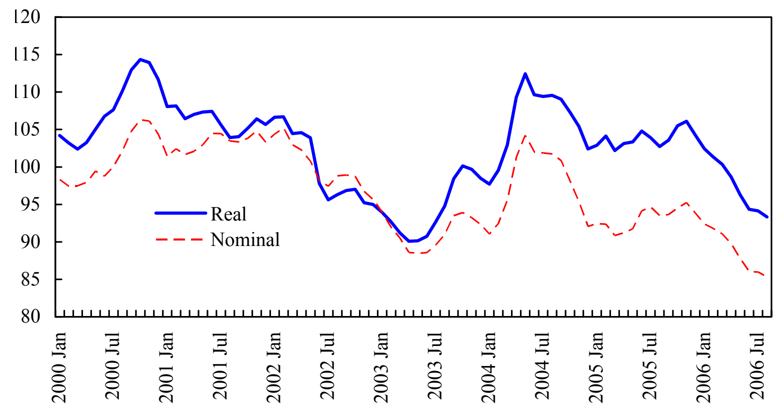
[5] Specifically, the authorities agreed to revisit the fiscal stance at the time of the second review if new BoP financing gaps emerge, or if the inflation and macroeconomic outlook changes significantly.

20. **Staff noted the importance of exchange rate flexibility to close the BoP gap** (MEFP¶18). The authorities recognize that the weaker BoP outlook calls for exchange rate flexibility, and they expect the leu to depreciate by about 6½ percent in real effective terms during 2007.[6]

Effective Exchange Rate Index; 2002=100



Sourse: IMF staff calculations

D. Financial Sector Stability and Development

21. **Weak financial sector development is a key bottleneck to growth**. Thus, the authorities have sought to attract reputable foreign banks to Moldova. Société Générale is in the process of acquiring a mid-sized Moldovan bank, as did Italy's Veneto Bank last spring. Erste Bank's subsidiary, Banca Comerciala Romana, has a branch in Moldova, and Raiffeisen has opened a representative office with an eye toward either an acquisition or a greenfield investment. In most cases, these banks have injected capital and begun to modernize banking practices. Nevertheless, the authorities agree that greater banking sector transparency will be essential to further financial sector development. They have requested an FSAP update to take stock of recent developments in this area.

22. **The authorities are making progress toward privatization of Banca de Economii (BEM) to a strategic banking investor**. They are about to announce the winner of a competitive international tender to assess the value of the bank, and they expect this valuation to take place in 2007 once the bank's audited accounts are complete. They plan to request the assistance of the IFC in preparing the bank for privatization, which could take place shortly after the evaluation is complete (MEFP¶22). In the meantime, they have committed to refrain from providing any preferential treatment to the bank.

23. **The authorities propose to create a consolidated supervisor for the nonbank financial institutions** (NBFIs). The mission supported this initiative, emphasizing that the

[6] While professing to pursue a managed float, the NBM has often resisted pressure to appreciate, while usually accommodating downward pressure on the leu.

new National Commission on the Financial Market (NCFM) be operationally independent and firmly committed to preserving financial system stability. It is expected that the new supervisory authority will remedy a number of weaknesses in the supervision of NBFIs that were identified by the previous FSAP. For example, licensing of insurance companies and savings and loan associations is now handled by the Licensing Chamber, while prudential supervision is done by the Ministry of Finance. Under the authorities' program, legislation will be adopted that unifies supervision and licensing in the new authority after a transitional period (MEFP¶21).[7] The World Bank, the IMF, and the Netherlands are cooperating in the provision of technical assistance to the new NCFM.

24. **The authorities intend to modernize financial relations between the MoF and the NBM, with the goal of enhancing the latter's independence and accountability** (MEFP¶¶19-20). The steps they intend to take will support the goals of the amendments to the NBM law passed in July, and will emphasize several points:

- The Ministry of Finance and the NBM will negotiate a service agreement clarifying the fees to be charged for banking services provided to government agencies, and the remuneration which is paid on government deposits in the treasury account in the NBM.

- The law on the NBM will be amended to establish that the target level of capital of the NBM should grow dynamically with its balance sheet. Moreover, since the current level of NBM capital is well below the appropriate level, by end-2007 the government will inject at least Lei 250 million in liquid assets.[8]

- Finally, to strengthen the NBM's ability to manage liquidity using indirect instruments of monetary policy, the Ministry of Finance and the NBM will agree on a plan to securitize—in the form of marketable government paper—the remaining Lei 2.2 billion in outstanding NBM claims on government.

E. Structural Reforms

25. **The authorities' structural reform agenda for 2007 emphasizes growth-enhancing measures as the appropriate policy response to the external shocks**. In the first instance, these measures aim to clarify (and eventually reduce) the role of the state in the economy—thus improving the business environment.

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[7] As a transitional measure, the NCFM will have the right to suspend—but not withdraw—licenses of NBFIs that violate prudential norms.

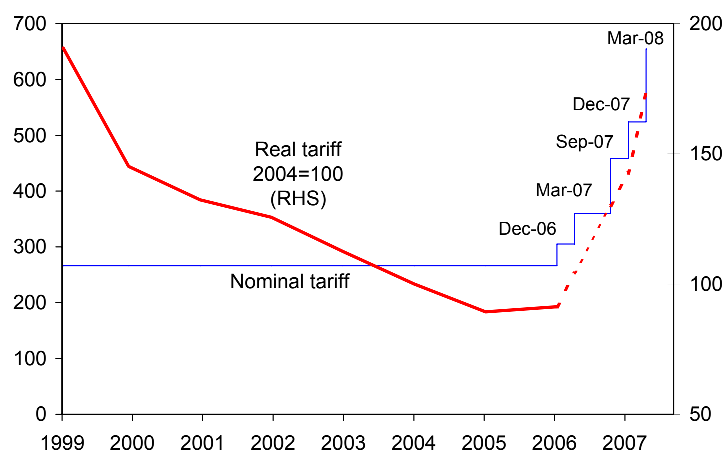
[8] Under the TMU, the program fiscal deficit ceiling will be adjusted by the amount of the capital injection.

26. **The authorities' program for 2007 envisages several growth-enhancing structural reforms aimed at promoting exports and FDI by improving the business environment and governance**. The authorities have developed a comprehensive investment and export promotion strategy (MEFP¶24). The regulatory reform strategy (MEFP¶¶29-30) dovetails with the public administration reform by clarifying and reducing the role of the state in the economy. Public finance management reforms (MEFP¶¶31-32) are meant to improve cash management and enhance the effectiveness of monetary policy (by moving accounts of general government agencies to the treasury system).[9] The authorities also intend to accelerate the privatization process (MEFP¶34), and to explore new methods of instilling private sector techniques in public infrastructure projects—though they are well aware of the dangers of incurring contingent liabilities in PPP agreements (MEFP¶25). A number of other structural reforms that are important for improving Moldova's growth prospects are being taken up by other development partners.[10]

27. **The authorities are looking for donor support to facilitate implementation of their tax administration modernization strategy**, which aims to reduce costs of compliance with tax law while limiting opportunities for corruption. The authorities developed the strategy with assistance from FAD, and are moving now to the implementation stage. They are looking to external partners for support with project management and in financing the next stage of the reform (MEFP¶33).

28. **The authorities have passed natural gas price increases through to consumers, but heat and water tariffs remain below cost-recovery levels**. Although the authorities are committed to maintaining tariffs for gas and electricity at cost-recovery levels, tariff setting responsibility for heat and water has rested with the municipalities since the late 1990s, and tariffs have not been increased since 1999.

Moldova: Tariffs for Central Heat, 1999-2008
(in lei per Gcal)



Note: Average tariffs for Chisinau and Balti. Real tariffs for 2007-08 based on staff projections.
Source: Moldovan authorities; and Fund staff estimates

[9] FAD's regional PFM advisor for Southeastern Europe has provided peripatetic support to these reforms.

[10] For example, the EU is pressing for judicial reform in the context of their Action Plan, the US Millennium Challenge Corporation is emphasizing anti-corruption efforts, and the World Bank, UNDP, and SIDA are concentrating on the public administration review.

Thus, the authorities have proposed legislation to locate tariff setting responsibility for heat and water with ANRE, the national agency for energy regulation (MEFP¶15). However, because tariffs are currently so far below cost-recovery levels, the authorities plan to raise them in steps, specifically to 55 percent of cost recovery by end-2006, to 70 percent by end-September 2007, and to full cost recovery by end-March 2008.

29. **Against this background of higher energy prices, the recent PSIA mission found that the existing system of categorical social assistance was poorly targeted**, making large errors of inclusion and exclusion.[11] Although a better-targeted system is in preparation (with assistance from DfID and other donors), the authorities do not expect it to be in place before 2008. The mission's main concern, shared by the authorities, was that while planned reforms will reduce errors of inclusion, little is being done to capture currently excluded worthy recipients. Thus, in addition to the categorical social assistance program, as a short term measure the government has introduced a lifeline tariff system for increases in natural gas tariffs this winter. FAD is expected to field a follow-up PSIA mission in December that—in cooperation with other organizations—will seek to help identify other short term measures to address the most serious poverty implications of higher tariffs.

F. Debt Sustainability

30. **The authorities have concluded bilateral agreements with two of five Paris Club creditors**, and are close to agreement with the others.[12] The Paris Club agreement in May helped to preserve external debt sustainability by rescheduling on Houston terms those maturities falling due from May 1, 2006, to December 31, 2008, and 30 percent of outstanding arrears at end-2006. The remainder of the arrears will be repaid by end-December 2008.

31. **The external shocks do not appear to have changed fundamentally the debt sustainability analysis presented in May**. A new joint Bank-Fund Debt Sustainability Analysis will be done at the time of the second review, but in interim staff assesses the increased risk to debt sustainability from slower growth and a less favorable BoP outlook to be modest, assuming additional assistance to Moldova is provided on grant terms.

G. Risks to the Program

32. **The main risks to the program stem from uncertainties over the external outlook**, including significant external risks beyond the wine ban and higher natural gas

[11] There are 11 categories of beneficiaries, including veterans, the disabled, and pensioners. The recent PSIA report estimates that 55 percent of assistance goes to households from the upper 60 percent of income distribution, while more than 80 percent of the poorest households do not receive any benefits.

[12] Staff will provide an update before the Board meeting.

prices. These include potentially higher imported electricity costs (from Ukraine), the impact on Moldovan exports of Romania and Bulgaria's accession to the EU, and trade disruptions linked to the Transnistria dispute (including recent closings of key rail crossings). Moreover, the effectiveness of monetary policy in bringing down inflation in Moldova remains somewhat untested. Further, although at present the financial sector seems likely to weather the impact of the external shocks, this stability could diminish if the external environment deteriorates beyond current projections.

H. Safeguards Assessment

33. **An updated safeguards assessment of the NBM was completed on October 13, 2006**. The assessment found that the NBM has made progress in strengthening its safeguards framework, but certain weaknesses remain. To further improve the NBM's safeguards, the assessment recommended:

- The IMF program data compilation procedures be formalized to delineate responsibilities of the involved departments, and the Internal Audit Department should include regular audits of the process in its audit plans.

- The NBM Law be amended to better align profit distribution rules with recapitalization requirements, and formalize the financial relationship between the NBM and the Ministry of Finance.

The authorities have already taken initial steps toward the implementation of these recommendations, which will be monitored by staff in the course of the PRGF arrangement.

I. Program Issues

34. **The authorities would like to extend the 2004-06 Economic Growth and Poverty Reduction Strategy (EGPRSP) for another year**. They believe that many of the current strategy's objectives remain appropriate, but equally important, this approach would allow them to harmonize the EGPRSP timetable with that of the EU-Moldova Action Plan, which is set to be renewed for 2008-10. Harmonization of the two processes could result in a single, coordinated monitoring system for both sets of commitments (MEFP¶36). The mission supported this approach, following the lead of the World Bank, UNDP, and other partners, who noted that limited administrative capacity was now being spread thin in reporting on two parallel processes (one of which is coordinated by the Ministry of Economy and Trade, and the other by the Ministry of Foreign Affairs).

35. **The authorities have requested a waiver for nonobservance of the end-September NIR target**, missed as a result of external shocks suffered since the program was approved. The waiver would seem justified by the scope of corrective actions (additional adjustment measures, including stepped-up structural reforms) the authorities are taking to address the twin external shocks.

36. **They have also requested an augmentation of access under the program—from 65 to 90 percent of quota.** They have asked that the additional access be front-loaded, with two-thirds to be disbursed at the time of the first review and the remainder to be disbursed at the second review. The augmentation, which would not undermine Moldova's capacity to repay the Fund, could also have a catalytic effect on other donors.

37. **Financing assurances for the additional grant assistance are effectively in place,** and are expected to be confirmed at the December 12 donor meeting.

IV. Staff Appraisal

38. **Moldova has maintained strong reform momentum despite serious external shocks since the PRGF arrangement was approved**. The authorities have faced slowing growth, rising inflation and a threat to financial sector stability—challenges that could have caused them to lose heart and turn away from reform. But the authorities have responded instead by making additional adjustment efforts and seeking new financing—thereby not losing sight of their ultimate goal of creating a modern, market-based economy.

39. **Indeed, these shocks will have long-lasting effects, and thus they demand an adjustment effort on the part of the Moldovan economy**. Prices for key tradable goods—natural gas and wine—have shifted, meaning that a reduction in non-energy imports is inevitable, and that efforts to redirect exports to other markets are essential. Households and industry are already adjusting, as is the public sector. Staff welcomes the authorities' decision to continue passing through higher energy prices to natural gas and electricity tariffs, and commends their intention to introduce stepped adjustments to heating and water tariffs. The authorities are urged to move with alacrity to improve the targeting and efficiency of the social assistance system, which will require the assistance of donors and other international organizations.

40. **International assistance can partly cushion the cost of adjustment, but the adjustment itself cannot be delayed.** Stepped-up grant assistance from Moldova's international development partners can help prevent reductions in priority social spending or further delays in long-overdue infrastructure spending. But donors will need to be assured that their temporary assistance is facilitating, rather than delaying, Moldova's adjustment to new external realities. Staff is confident that the authorities have grasped this point.

41. **Staff agrees with the authorities that the unchanged fiscal policy stance strikes the appropriate balance between supporting adjustment, disinflation and growth**. Their projection of budgetary balance for end-2006 is appropriate in the face of continued high inflation. The 2007 budget, which maintains the MTEF deficit target of 0.5 percent of GDP in 2007, preserves priority social spending while largely allocating higher grant assistance to public investment. The decision to freeze planned wage increases took courage, particularly in an election year. Continued wage restraint is desirable prior to the next stage of the public administration reform. Over the medium term, Moldova needs to reduce the size of

government, which at over 40 percent of GDP is out of line with that of other countries at its level of per capita income.

42. **A more consistent conduct of monetary policy will be needed to produce inflation in single-digit territory**. The NBM is urged to make more effective use of indirect tools of monetary policy to bring real interest rates on short-term securities back into positive territory. Greater exchange rate flexibility underscores the importance of a tighter monetary policy stance in the face of high dollarization.

43. **Financial relations between the government and the NBM need to be modernized**. The capital position of the NBM should be strengthened to support the recent amendments to the NBM law, which enhanced its legal and operational independence. Just as it is important for Moldova to invest in physical infrastructure like roads, the authorities need to invest in Moldova's financial infrastructure.

44. **The wine ban threatened financial sector stability, but it also revealed that forceful supervision can prevent a crisis**. The NBM is to be commended for effective supervision of the banking sector, and is urged to keep a close eye on developments related to the wine sector, where the growth of NPLs could accelerate if the import ban on wine persists. The arrival of foreign banks will promote financial sector development, but the NBM is urged to make use of its independence to aggressively promote transparency in bank ownership. Staff welcomes the request for an FSAP update, which would assess the extent to which the NBM requires that owners be "fit and proper" and affiliated parties are considered as such for prudential purposes.

45. **The authorities should bring BEM to market shortly after completion of the independent valuation**. As long as relations between BEM and the government are on commercial terms, there is no special benefit to retaining the bank in state hands. On the other hand, the need for stepped-up banking sector competition is acute; early privatization of BEM to a strategic banking investor would promote financial sector development, and thus contribute to Moldova's growth and poverty reduction.

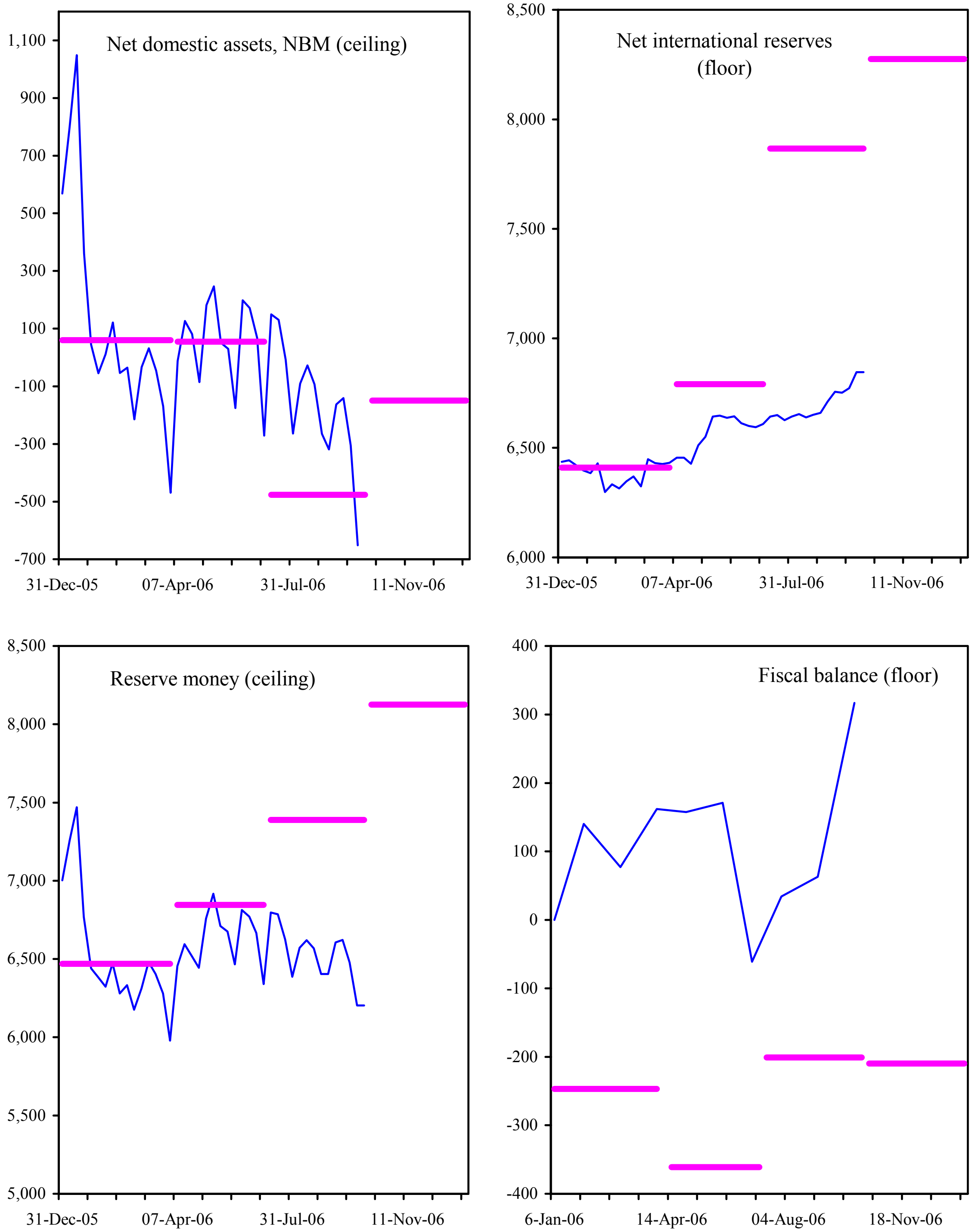
46. **The decision to establish a consolidated supervisory authority for the NBFI sector is welcome**. Supervision of this sector is currently inadequate, chiefly because the supervisory bodies have not had the power to revoke licenses of firms in violation of prudential regulations. Staff urges that the new NCFM be accorded full operational independence, including the right to withdraw licenses if necessary. The transitional mechanism allowing the NCFM to suspend licenses is a reasonable short-term compromise, but in time the NCFM must follow best international practice and have full licensing authority.

47. **Faced with external shocks, staff agrees that the focus should be on accelerating growth-enhancing structural reforms, including privatization and measures to**

strengthen goverance. Progress with regulatory and public administration reform and tax administration modernization are welcome, as is reform of civil service hiring rules.

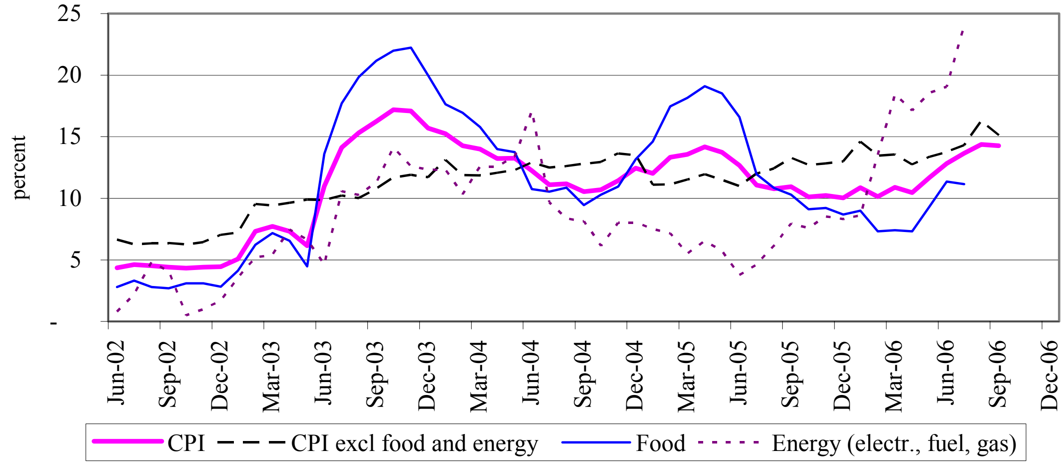
48. **Moldova's performance under the PRGF arrangement thus far has been strong, particularly in light of the external shocks**. Based on the policy commitments in the attached MEFP, staff supports Moldova's request for completion of the first review and a waiver for the missed NIR target at end-September. Staff also supports the proposed augmentation of access under the program, which will contribute to macroeconomic stability by bolstering market confidence in the NBM's ability to weather the shocks.

Figure 1. Moldova: PRGF Performance, 2006
(In millions of lei, unless indicated otherwise)

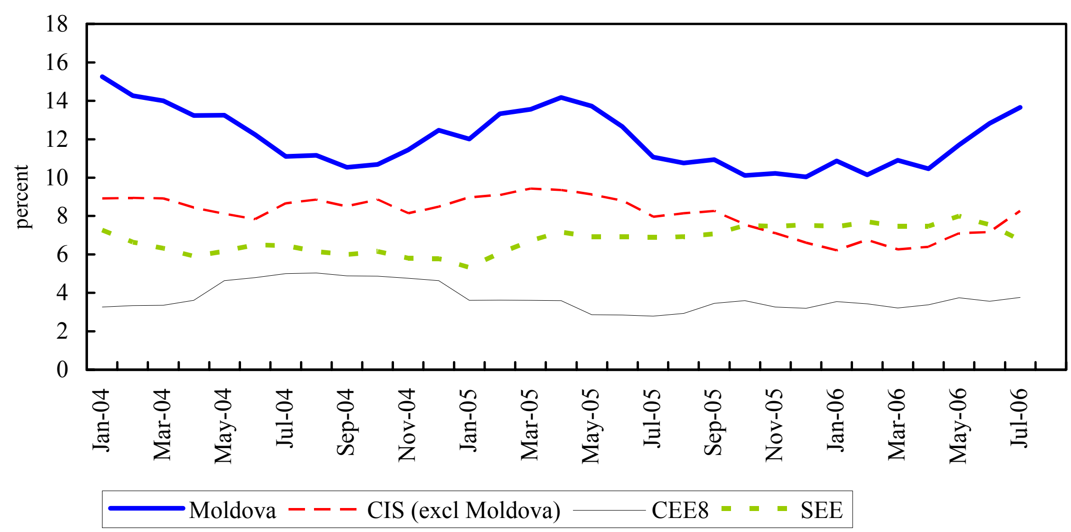


Sources: Moldovan authorities; and Fund staff calculations.

Figure 2. Moldova: Inflation



Inflation in Moldova and Neighbouring Regions 1/

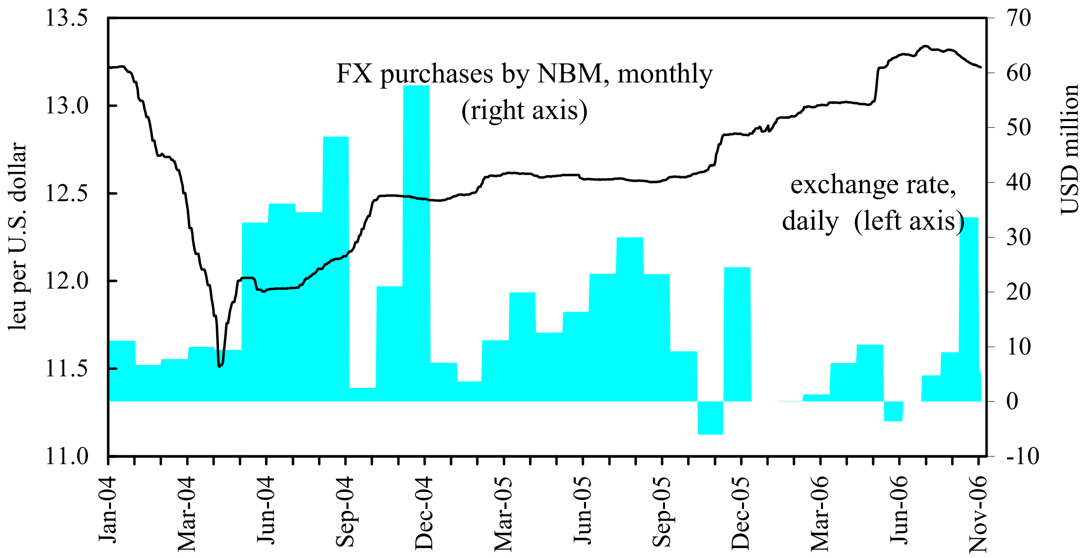


1/ CIS excludes Turkmenista, Uzbekistan and Tajikistan
CEE8 includes Czech Rep, Hungary, Poland, Slovakia, Slovenia and Baltics
SEE includes Romania, Bulgaria, Macedonia, Serbia and Montenegro, and Croatia

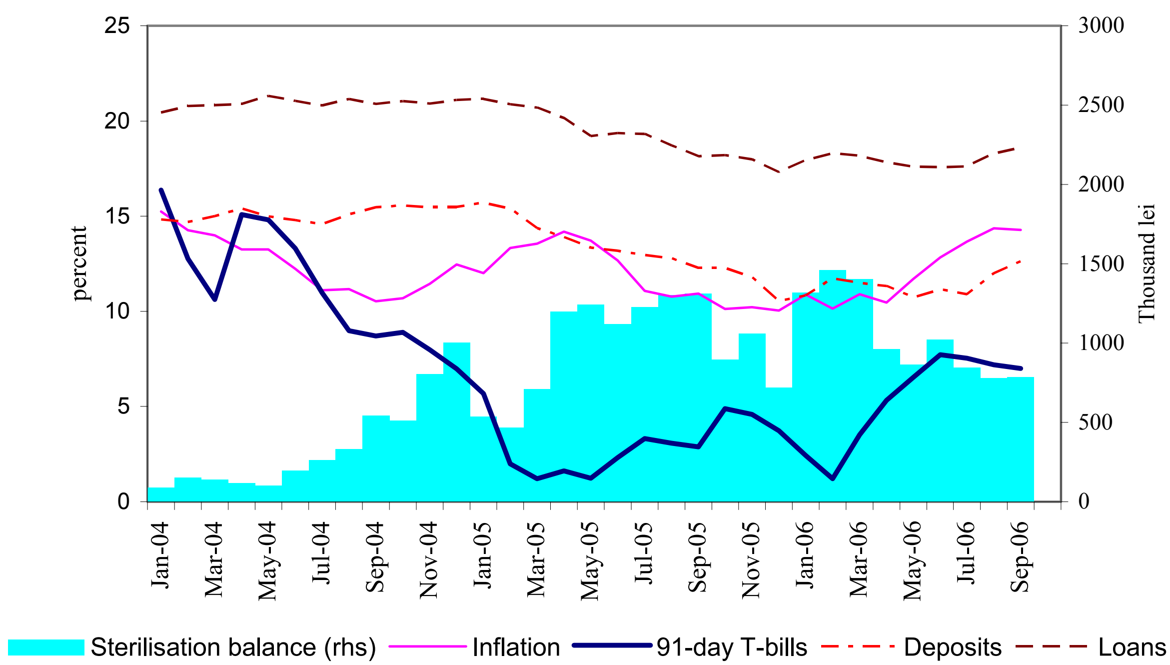
Source: Moldovan authorities; and Fund staff estimates and calculations

Figure 3. Moldova: Liquidity Conditions

Leu/U.S. Dollar Exchange Rate and Foreign Exchange Purchases by the Central Bank, 2004–06

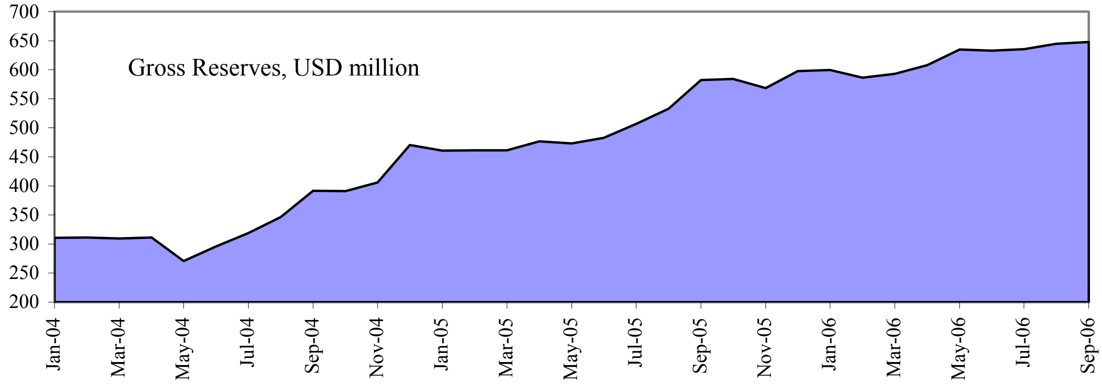


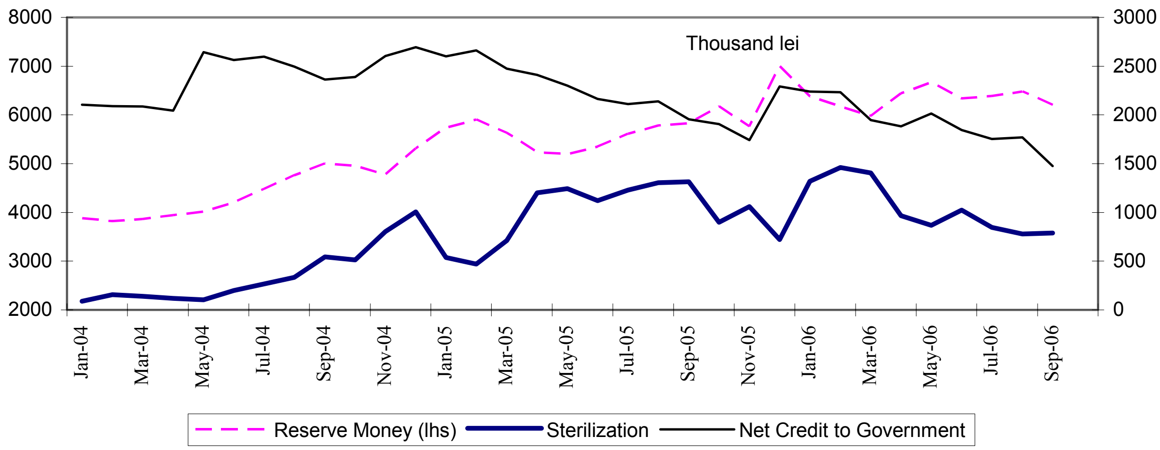
Interest Rates and Central Bank Sterilisation Operations

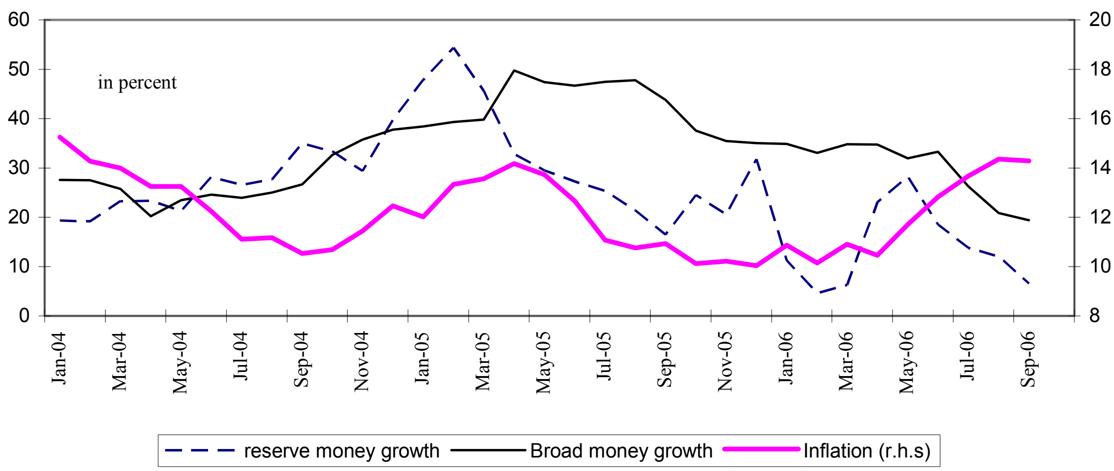


Source: Moldovan authorities

Figure 4. Moldova: Monetary Developments







Sources: Moldovan authorities; and Fund staff estimates

Table 1. Moldova: Selected Indicators, 2004–08 1/

	2004	2005	2006		2007		2008	
		Est.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.
I. Real sector indicators			(Percent change; unless otherwise indicated)					
Gross domestic product								
Real growth rate	7.4	7.1	6.0	3.0	5.0	3.0	5.0	5.0
Nominal GDP (millions of lei)	32,032	36,755	42,585	41,953	48,648	46,603	54,745	53,195
Nominal GDP (millions of U.S. dollars)	2,598	2,917	...	...	...	...	...	...
Consumer Price Index (average)	12.5	11.9	9.4	12.3	8.7	10.5	7.5	8.9
Consumer Price Index (end of period)	12.6	10.0	9.0	12.0	8.0	10.0	7.0	8.0
GDP deflator	8.0	7.1	9.3	10.8	8.8	7.8	7.2	8.7
Average monthly wage (lei)	1,116	1,330	...	...	...	...	...	...
Average monthly wage (U.S. dollars)	91	105	...	...	...	...	...	...
Saving-investment balance			(In percent of GDP)					
Foreign saving	2.0	8.3	5.4	10.4	5.5	7.2	5.4	4.2
National saving	19.2	16.1	17.2	13.0	17.7	16.2	17.9	18.8
Private	13.6	8.0	13.2	7.4	13.0	10.5	13.2	13.8
Public	5.5	8.1	4.0	5.6	4.7	5.7	4.7	5.0
Gross investment	21.2	24.4	22.6	23.5	23.1	23.4	23.3	23.1
Private	16.2	18.0	17.8	17.9	17.9	17.2	18.1	17.6
Public	5.0	6.4	4.8	5.5	5.2	6.2	5.2	5.5
II. Fiscal Indicators (general government)			(In percent of GDP)					
Primary balance (cash)	2.7	3.0	0.6	1.3	0.9	1.0	0.6	0.7
Overall balance (cash)	0.8	1.7	-0.8	0.0	-0.5	-0.5	-0.5	-0.5
Overall balance (commitments)	0.5	1.7	-0.8	0.1	-0.5	-0.5	-0.5	-0.5
Overall balance (commitments), excluding foreign-financed projects	2.0	2.6	0.3	1.0	0.8	1.0	0.3	0.3
Stock of general government debt 2/	47.2	39.0	33.5	32.8	30.3	32.2	27.7	29.5
III. Financial indicators			(Percent change; unless otherwise indicated)					
Broad money (M3)	37.7	35.0	29.4	19.4	...	14.7	...	...
Velocity (GDP/end-period M3; ratio)	2.7	2.3	2.1	2.2	...	2.2	...	...
Reserve money	39.7	31.8	16.0	-5.6	...	9.7	...	...
Credit to the economy	22.2	35.0	25.6	26.1	...	13.3	...	...
IV. External sector indicators			(In millions of U.S. dollars, unless otherwise indicated)					
Current account balance	-52.9	-241.9	-177.8	-330.7	-203.2	-229.4	-228.3	-145.4
Current account balance (percent of GDP)	-2.0	-8.3	-5.4	-10.4	-5.5	-7.2	-5.4	-4.2
Remittances and compensation of employees (net)	660	934	1,104	1,156	1,214	1,283	1,323	1,411
Gross official reserves 3/	470	597	750	688	931	799	1,124	962
Gross official reserves (months of imports)	2.1	2.2	2.5	2.3	2.8	2.4	3.1	2.7
Exchange rate (MDL/$) period average	12.3	12.6	...	...	...	...	...	...
Exchange rate (MDL/$) end of period	12.5	12.8	...	...	...	...	...	...
Real effective exchange rate, change (percent)	12.8	-1.3	1.0	1.8	0.1	-6.5	2.3	-2.9
External debt/GDP (percent) 4/	63.8	54.7	51.3	51.6	49.7	55.1	47.3	53.7
Debt service/exports of goods and services (percent) 4/	21.0	20.3	14.5	16.7	12.9	14.4	12.8	14.1
Social indicators, reference year								
Per capita GNI, U.S. dollars: 880 (2005)	Population below poverty line, percent: 30.2 (2005)							
Life expectancy, male, years: 64.9 (2005)	Life expectancy, female, years: 71.9 (2005)							

Sources: Moldovan authorities; and Fund staff estimates.

1/ Data exclude Transnistria.
2/ Public and publicly guaranteed debt.
3/ For 2005, includes the positive effect of reclassification of $43 million.
4/ Includes private and public debt.

Table 2. Moldova: Balance of Payments, 2004–08
(In millions of U.S. dollars; unless otherwise indicated)

	2004	2005	2006		2007		2008	
		Est.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.
Current account	-52.9	-241.9	-177.8	-330.7	-203.2	-229.4	-228.3	-145.4
Merchandise trade balance	-754.2	-1,190.8	-1,432.6	-1,667.6	-1,583.3	-1,827.4	-1,738.8	-1,945.3
Exports of goods	994.1	1,104.4	1,240.0	1,042.7	1,401.2	1,194.9	1,555.3	1,345.0
of which: wine and alcohol	277.9	314.7	353.4	150.4	399.3	195.5	431.4	245.7
Imports of goods	-1,748.2	-2,295.2	-2,672.6	-2,710.4	-2,984.5	-3,022.3	-3,294.1	-3,290.3
of which: energy	-308.6	-426.4	-603.0	-608.0	-637.7	-730.7	-672.7	-769.5
non-energy	-1,439.7	-1,868.8	-2,069.5	-2,102.4	-2,346.8	-2,291.6	-2,621.4	-2,520.8
Balance of services	-18.7	-20.2	15.6	-6.9	17.6	21.4	19.5	38.7
Exports of services	355.1	423.9	542.6	517.2	613.1	592.7	680.5	667.1
Imports of services	-373.8	-444.2	-527.0	-524.1	-595.5	-571.3	-661.0	-628.4
Income (net)	356.2	423.8	562.0	543.5	617.6	603.5	679.0	677.9
Compensation of employees	438.9	541.8	673.2	634.2	740.5	703.9	807.2	774.3
Income on direct and portfolio investment	-49.8	-91.7	-66.4	-63.3	-74.6	-63.8	-83.8	-68.8
Income on other investment	-33.0	-26.3	-44.8	-27.3	-48.3	-36.6	-44.3	-27.6
Current transfers (net), *of which:*	363.9	545.3	677.2	800.3	744.9	973.0	811.9	1,083.2
Remittances, net	220.6	392.0	430.6	521.3	473.7	578.7	516.3	636.5
Official transfers, *of which:*	50.6	45.7	55.6	62.1	61.2	124.1	67.3	135.3
identified foreign grants	...	...	...	9.6	...	5.3	...	0.0
EU Food Security Program	...	...	...	6.3	...	5.3	...	0.0
Netherlands	...	...	...	3.3	...	0.0	...	0.0
prospective foreign grants	...	...	...	0.0	...	47.4	...	57.5
Capital and financial account	78.2	211.1	316.7	276.8	343.5	287.5	349.2	267.1
Capital account	-18.3	-16.9	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0
Financial account	96.5	228.0	324.7	284.8	351.5	295.5	357.2	275.1
Direct investment	87.4	225.5	217.0	221.6	242.3	223.3	280.9	240.9
Portfolio investment (net)	-9.8	-7.0	-10.0	-9.8	-10.0	-10.0	-10.0	-10.0
Other investments	18.4	11.0	117.7	73.0	119.2	82.3	86.3	44.2
Other capital flows	4.9	-10.1	55.0	20.0	55.0	20.0	55.0	20.0
Errors and omissions 1/	124.5	127.1	0.0	73.0	0.0	0.0	0.0	0.0
Overall balance	149.8	96.3	138.9	19.1	140.4	58.1	120.9	121.7
Financing	-149.8	-96.3	-232.3	-48.8	-202.3	-72.8	-212.5	-125.4
Use of Fund credit 2/	-21.6	-21.4	-23.5	9.2	-20.8	11.9	-19.8	12.9
Change of gross official reserves (increase -)	-148.0	-128.6	-152.6	-63.6	-181.5	-110.8	-192.7	-163.1
Exceptional financing, *of which*	19.8	53.8	-56.3	5.5	0.0	26.1	0.0	24.8
accumulation of arrears on public debt	42.4	26.2	9.3	11.9	0.0	0.0	0.0	0.0
clearance of arrears	-54.9	-0.4	-65.6	-68.1	0.0	0.0	0.0	0.0
prepayment/buyback	-51.3	-5.5	0.0	0.0	0.0	0.0	0.0	0.0
cancellation of debt	-70.1	-23.9	0.0	0.0	0.0	0.0	0.0	0.0
rescheduling, net of arrears repayment	-9.3	0.0	0.0	61.7	0.0	26.1	0.0	24.8
Financing gap	...	...	93.2	29.7	61.9	14.7	91.6	3.7
Memorandum items:								
Gross official reserves 3/	470.2	597.4	750.0	688.4	931.5	799.3	1,124.2	962.4
in months of imports of goods and services	2.1	2.2	2.5	2.3	2.8	2.4	3.1	2.7
Prospective IMF augmentation	...	...	...	29.7	...	14.7	...	...
Nominal GDP	2,597.9	2,917.2	...	...	...	...	...	...
Current account balance (percent of GDP)	-2.0	-8.3	-5.4	-10.4	-5.5	-7.2	-5.4	-4.2
G&S trade balance (percent of GDP)	-29.7	-41.5	-42.7	-52.9	-42.0	-56.6	-41.0	-55.4
Exports G&S (percent of GDP)	51.9	52.4	53.7	49.3	54.0	56.0	53.3	58.5
Exports G&S growth (percent)	27.4	13.3	16.2	2.1	13.0	14.6	11.0	12.6
Imports G&S (percent of GDP)	-81.7	-93.9	-96.4	-102.2	-96.0	-112.7	-94.3	-113.9
Imports G&S growth (percent)	22.8	29.1	18.7	18.1	11.9	11.1	10.5	9.0
Remittances and compensation of employees (net)	659.5	933.8	1,103.8	1,155.5	1,214.2	1,282.6	1,323.5	1,410.9
Total debt service/exports G&S (percent)	21.0	20.3	14.5	16.7	12.9	14.4	12.8	14.1
External debt stock (percent of GDP) 4/	63.8	54.7	51.3	51.6	49.7	55.1	47.3	53.7
Natural gas import price, $/1000 m3	66.4	68.8	120.0	132.9	130.0	220.0	140.0	220.0
External arrears	50.6	56.3	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Revised projection for 2006 shows the actual number for the first half of the year.
2/ Does not include augmentation.
3/ Includes revaluation changes, which are not captured by changes of gross official reserves in the BoP.
4/ Including energy arrears.

Table 3. Moldova: General Government Budget, 2004–08
(In millions of lei; unless otherwise indicated)

	2004	2005	2006		2007		2008	
		Est.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.
Revenues and grants	11,324	14,519	16,333	16,893	18,634	19,779	20,620	21,833
Revenues	10,162	12,823	15,026	15,280	17,227	17,526	19,421	19,744
Tax revenues	9,545	11,888	14,137	14,176	16,266	16,479	18,384	18,707
Profit tax	780	709	878	975	1,084	989	1,247	1,089
Personal income tax	797	962	1,040	1,051	1,192	1,124	1,383	1,328
VAT	3,428	4,623	5,838	5,796	6,645	6,882	7,451	7,977
Excises	910	1,172	1,155	1,004	1,222	1,228	1,329	1,345
Foreign trade taxes	496	681	685	764	810	940	873	1,087
Other taxes	317	327	329	336	413	395	449	432
Social Fund contributions	2,493	2,972	3,686	3,723	4,248	4,154	4,844	4,642
Health Fund contributions	326	442	526	526	651	768	807	807
Non-tax revenues	617	935	890	1,104	961	1,047	1,037	1,037
Grants	125	460	219	440	315	1,079	96	986
Budget support grants	0	0	0	127	154	77	0	0
Foreign financed projects grants	125	0	219	313	161	309	96	97
Prospective foreign grants	...	...	...	...	...	693	...	889
Revenues of special funds	1,036	1,237	1,088	1,174	1,092	1,174	1,103	1,103
Expenditure and net lending	11,092	13,937	16,683	16,892	18,869	20,012	20,899	22,106
Current expenditure	9,537	11,636	14,677	14,617	16,362	17,143	18,083	19,225
Wages	2,507	2,952	4,132	3,970	4,284	4,455	4,523	5,308
Goods and services	2,485	2,964	3,725	3,595	4,248	4,698	4,690	4,934
Interest payments	612	471	627	537	670	676	586	631
Transfers	3,727	5,232	5,949	6,194	6,910	6,965	8,033	8,063
Other current expenditure	206	17	245	321	250	348	251	288
Net lending	-57	-39	-40	-43	-21	-24	-28	-50
Capital expenditure	1,613	2,340	2,046	2,319	2,529	2,893	2,844	2,931
Contingent on foreign grants	...	...	...	...	...	693	...	889
Primary expenditure	10,481	13,467	16,056	16,355	18,200	19,335	20,313	21,475
Statistical discrepancy	28	53	0	-1	0	0	0	0
Overall surplus(+)/deficit(-) (cash)	260	634	-350	0	-236	-233	-279	-273
Primary balance (cash)	872	1,105	277	537	434	443	308	358
(excl. project loan spending)	1,150	1,432	771	966	1,058	1,147	727	777
Change in arrears (+, increase)	102	4	0	-30	0	0	0	0
Domestic expenditure	-9	4	0	0	0	0	0	0
External interest	111	0	0	0	0	0	0	0
Overall surplus(+)/deficit(-) (commitments)	158	630	-350	30	-236	-233	-279	-273
Primary balance (commitments)	974	1,109	277	507	434	443	308	358
(excl. project loan spending)	1,252	1,436	771	936	1,058	1,147	727	777
Financing	-260	-634	350	-1	236	233	279	273
Budget financing	-530	-961	-144	-388	-389	-470	-140	-146
Central government	-429	-943	-323	-555	-419	-630	-165	-171
Net domestic	592	-597	212	79	-146	-390	-194	55
Net foreign	-1,044	-380	-1,342	-662	-595	-395	-612	-250
Privatization	23	34	28	28	26	155	24	24
Financing gap	0	0	779	0	297	0	618	0
Local governments	6	151	100	100	30	40	25	25
Social fund	-67	5	78	67	0	120	0	0
Health fund	-39	-174	0	0	0	0	0	0
Project loans	270	327	494	387	625	703	419	419
Memorandum item:								
GDP	32,032	36,755	42,585	41,953	48,648	46,603	54,745	53,195

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

Table 3 (continued). Moldova: General Government Budget, 2004–08
(In percent of GDP; unless otherwise indicated)

	2004	2005	2006		2007		2008	
		Est.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.	IMF Country Report 06/184	Proj.
Revenues and grants	35.4	39.5	38.4	40.3	38.3	42.4	37.7	41.0
Revenues	31.7	34.9	35.3	36.4	35.4	37.6	35.5	37.1
Tax revenues	29.8	32.3	33.2	33.8	33.4	35.4	33.6	35.2
Profit tax	2.4	1.9	2.1	2.3	2.2	2.1	2.3	2.0
Personal income tax	2.5	2.6	2.4	2.5	2.5	2.4	2.5	2.5
VAT	10.7	12.6	13.7	13.8	13.7	14.8	13.6	15.0
Excises	2.8	3.2	2.7	2.4	2.5	2.6	2.4	2.5
Foreign trade taxes	1.5	1.9	1.6	1.8	1.7	2.0	1.6	2.0
Other taxes	1.0	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Social Fund contributions	7.8	8.1	8.7	8.9	8.7	8.9	8.8	8.7
Health Fund contributions	1.0	1.2	1.2	1.3	1.3	1.6	1.5	1.5
Non-tax revenues	1.9	2.5	2.1	2.6	2.0	2.2	1.9	1.9
Grants	0.4	1.3	0.5	1.0	0.6	2.3	0.2	1.9
Budget support grants	0.0	0.0	...	0.3	...	0.2	...	0.0
Foreign financed projects grants	0.4	0.0	...	0.7	...	0.7	...	0.2
Prospective foreign grants	...	...	...	...	...	1.5	...	1.7
Revenues of special funds	3.2	3.4	2.6	2.8	2.2	2.5	2.0	2.1
Expenditure and net lending	34.6	37.9	39.2	40.3	38.8	42.9	38.2	41.6
Current expenditure	29.8	31.7	34.5	34.8	33.6	36.8	33.0	36.1
Wages	7.8	8.0	9.7	9.5	8.8	9.6	8.3	10.0
Goods and services	7.8	8.1	8.7	8.6	8.7	10.1	8.6	9.3
Interest payments	1.9	1.3	1.5	1.3	1.4	1.5	1.1	1.2
Transfers	11.6	14.2	14.0	14.8	14.2	14.9	14.7	15.2
Other current expenditure	0.6	0.0	0.6	0.8	0.5	0.7	0.5	0.5
Net lending	-0.2	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1
Capital expenditure	5.0	6.4	4.8	5.5	5.2	6.2	5.2	5.5
Contingent on foreign grants	...	...	...	...	...	1.5	...	1.7
Primary expenditure	32.7	36.6	37.7	39.0	37.4	41.5	37.1	40.4
Statistical discrepancy	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall surplus(+)/deficit(-) (cash)	0.8	1.7	-0.8	0.0	-0.5	-0.5	-0.5	-0.5
Primary balance (cash)	2.7	3.0	0.6	1.3	0.9	1.0	0.6	0.7
(excl. project loan spending)	3.6	3.9	1.8	2.3	2.2	2.5	1.3	1.5
Change in arrears (+, increase)	0.3	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Domestic expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External interest	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall surplus(+)/deficit(-) (commitments)	0.5	1.7	-0.8	0.1	-0.5	-0.5	-0.5	-0.5
Primary balance (commitments)	3.0	3.0	0.6	1.2	0.9	1.0	0.6	0.7
(excl. project loan spending)	3.9	3.9	-0.3	2.2	2.2	2.5	1.3	1.5
Financing	-0.8	-1.7	0.8	0.0	0.5	0.5	0.5	0.5
Budget financing	-1.7	-2.6	-0.3	-0.9	-0.8	-1.0	-0.3	-0.3
Central government	-1.3	-2.6	-0.8	-1.3	-0.9	-1.4	-0.3	-0.3
Net domestic	1.8	-1.6	0.5	0.2	-0.3	-0.8	-0.4	0.1
Net foreign	-3.3	-1.0	-3.2	-1.6	-1.2	-0.8	-1.1	-0.5
Privatization	0.1	0.1	0.1	0.1	0.1	0.3	0.0	0.0
Financing gap	0.0	0.0	1.8	0.0	0.6	0.0	1.1	0.0
Local governments	0.0	0.4	0.2	0.2	0.1	0.1	0.0	0.0
Social fund	-0.2	0.0	0.2	0.2	0.0	0.3	0.0	0.0
Health fund	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Project loans	0.8	0.9	1.2	0.9	1.3	1.5	0.8	0.8
Memorandum item:								
GDP (millions of lei)	32,032	36,755	42,585	41,953	48,648	46,603	54,745	53,195

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

Table 3a. Moldova: General Government Budget, 2005–07
(In millions of lei; unless otherwise indicated)

	2005	2006							2007			
		Q1		Q2		Q3		Q4	Q1	Q2	Q3	Q4
		Prog.	Act.	Prog.	Act.	Prog.	Act.	Proj.	Proj.			
Revenues and grants	14,519	3,194	3,576	7,139	7,696	11,558	12,400	16,893	3,955	8,766	14,070	19,779
Revenues	12,823	2,950	3,275	6,620	7,059	10,599	11,201	15,280	3,442	7,727	12,364	17,526
Tax revenues	11,888	2,694	3,008	6,069	6,452	9,875	10,293	14,176	3,140	7,080	11,513	16,479
Profit tax	709	259	309	454	572	634	780	975	292	511	715	989
Personal income tax	962	208	237	464	504	745	790	1,051	225	502	805	1,124
VAT	4,623	1,032	1,128	2,448	2,492	4,071	4,222	5,796	1,217	2,885	4,799	6,882
Excises	1,172	199	199	476	436	803	731	1,004	212	506	854	1,228
Foreign trade taxes	681	122	202	291	382	478	600	764	167	399	656	940
Other taxes	327	45	50	130	142	228	225	336	54	156	273	395
Social Fund contributions	2,972	709	756	1,555	1,659	2,540	2,548	3,723	798	1,753	2,862	4,154
Health Fund contributions	442	121	128	252	264	376	397	526	176	368	549	768
Non-tax revenues	935	256	267	551	607	723	908	1,104	302	648	851	1,047
Grants	460	65	59	124	124	174	189	440	320	613	858	1,079
Budget support grants	0	0	0	0	0	0	0	127	77	0	77	77
Foreign financed project grants	0	65	59	124	124	174	189	313	92	176	246	309
Prospective foreign grants	...	...	...	...	...	...	...	...	...	346	...	693
Revenues of special funds	1,237	179	242	394	513	786	1,010	1,174	193	426	848	1,174
Expenditures and net lending (cash)	13,937	3,441	3,396	7,555	7,757	11,862	12,083	16,892	4,099	9,014	14,308	20,012
National Economy	1,964	365	370	782	938	1,403	1,615	2,501	435	933	1,673	2,319
Social sphere	4,019	1,013	1,074	2,113	2,511	3,187	3,729	5,076	1,205	2,514	3,779	5,353
Education	2,697	688	738	1,441	1,743	2,106	2,510	3,357	859	1,798	2,627	3,625
Health care	464	99	98	214	249	354	408	540	107	231	382	544
Other	858	226	238	458	520	728	811	1,179	238	485	769	1,184
Interest payments	471	137	131	264	201	440	307	537	152	300	487	676
Other expenditures	2,722	618	534	1,616	1,281	2,516	2,086	2,792	736	1,735	2,802	3,895
Social Fund expenditures	3,692	987	973	2,100	2,069	3,306	3,304	4,502	1,138	2,421	3,811	5,088
Health Fund expenditures	1,108	336	332	703	783	1,046	1,058	1,528	443	925	1,378	2,012
Net lending	-39	-15	-17	-23	-26	-37	-15	-43	-9	-14	-22	-24
Statistical discrepancy	53	0	-18	0	-5	0	-1	0	0	0	0	0
Overall surplus(+)/deficit(-) (cash)	634	-247	162	-417	-66	-303	317	0	-144	-248	-238	-233
(excl. project loan spending)	961	-116	263	-186	109	58	575	429	42	80	277	470
Primary balance (cash)	1,105	-110	293	-153	135	137	624	537	8	51	250	443
(excl. project loan spending)	1,432	20	394	78	310	498	882	966	194	380	764	1,147
Change in arrears (+, increase)	4	0	1	0	-90	0	-30	-30	0	0	0	0
Domestic expenditure	4	0	1	0	-90	0	-30	-30	0	0	0	0
External interest	0	0	0	0	0	0	0	0	0	0	0	0
Overall surplus(+)/deficit(-) (commitments)	630	-247	161	-417	24	-303	347	30	-144	-248	-238	-233
Primary balance (commitments)	1,109	-110	292	-153	225	137	654	567	8	51	250	443
(excl. project loan spending)	1,436	20	393	78	400	498	912	996	194	380	764	1,147
Financing	-634	247	-162	417	66	303	-317	0	144	248	238	233
Budget financing	-961	116	-263	186	-109	-58	-576	-388	-40	-71	-234	-470
Central government	-943	-38	-291	-127	-326	-358	-696	-555	-88	-272	-571	-630
Net domestic	-597	29	-215	212	-189	57	-497	71	-154	-203	-457	-390
Net foreign	-380	-69	-72	-995	-141	-1,155	-220	-653	67	-109	-194	-395
Privatization	34	2	-4	14	5	23	21	28	0	40	80	155
Financing gap	0	0	0	642	0	717	0	0	0	0	0	0
Local governments	151	61	2	105	61	126	120	100	-15	-39	-5	40
Social fund	5	128	73	259	138	255	0	67	113	203	298	120
Health fund	-174	-35	-46	-50	18	-81	0	0	-51	37	44	0
Project loans	327	130	100	231	175	362	259	387	184	319	472	703
Memorandum item:												
GDP (millions of lei)	36,755	...	...	...	...	...	...	41,953	...	...	...	46,603

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

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2005–07
(In millions of lei; unless otherwise indicated)

	2005	2006				2006	2007			
		Q1	Q2	Q3	Q4	IMF Country Report	Q1	Q2	Q3	Q4
					Proj.	06/184		Proj.		
National Bank of Moldova										
Net foreign assets	6,434	6,591	7,026	7,359	7,553	8,276	8,334	8,698	9,072	10,179
NFA (convertible)	6,436	6,576	7,024	7,349	7,553	8,276	8,334	8,698	9,072	10,179
NFA (convertible) in program exchange rates	6,436	6,432	6,609	6,845	7,380	8,276	7,737	7,967	8,207	8,789
Gross reserves	7,666	7,719	8,410	8,611	9,494	9,624	9,782	10,611	10,871	12,303
Reserve liabilities	-1,230	-1,143	-1,385	-1,262	-1,942	-1,348	-1,448	-1,913	-1,799	-2,124
Net domestic assets	569	-613	-686	-1,155	-940	-150	-1,594	-1,812	-2,039	-2,924
Net domestic assets in program exchange rates	569	-469	-271	-652	-768	-150	-997	-1,081	-1,174	-1,535
Net claims on general government	2,291	1,945	1,845	1,475	1,761	2,062	1,607	1,516	1,205	565
Credit to banks	-1,186	-1,923	-1,639	-1,556	-1,250	-1,628	-1,300	-1,300	-950	-600
Other items (net)	-536	-635	-892	-1,074	-1,451	-584	-1,900	-2,028	-2,295	-2,889
Reserve money	7,003	5,978	6,340	6,204	6,612	8,126	6,740	6,886	7,033	7,255
Currency in circulation	4,571	4,541	4,924	4,777	5,091	5,815	5,190	5,302	5,416	5,586
Banks' reserves	2,431	1,437	1,415	1,427	1,521	2,311	1,550	1,584	1,618	1,669
Required reserves	795	846	841	840	865	1,036	903	936	963	983
Excess reserves	1,635	591	573	586	656	1,275	648	648	655	685
Monetary Survey										
Net foreign assets	7,421	7,687	8,582	8,995	9,537	9,175	10,394	10,787	11,186	12,394
NFA (convertible)	7,418	7,649	8,578	8,998	9,537	9,175	10,394	10,787	11,186	12,394
of which: commercial banks	982	1,073	1,553	1,649	1,985	900	2,060	2,088	2,114	2,215
NFA (non-convertible)	3	38	4	-3	0	0	0	0	0	0
Net domestic assets	8,405	8,628	9,208	8,841	9,361	11,299	9,199	9,360	9,495	9,282
Net claims on general government	1,387	1,162	1,409	863	1,435	1,747	1,323	1,306	1,158	1,170
Credit to economy	9,990	10,762	11,520	12,319	12,594	12,552	13,012	13,431	13,850	14,269
Other items (net)	-2,972	-3,296	-3,720	-4,341	-4,668	-3,001	-5,136	-5,377	-5,513	-6,156
Broad Money (M3)	15,827	16,315	17,790	17,835	18,898	20,474	19,594	20,147	20,682	21,676
Broad Money (M2: excluding FCD)	11,126	11,066	11,592	11,308	11,746	15,211	12,133	12,502	12,820	13,148
Currency in circulation	4,571	4,541	4,924	4,744	5,091	5,815	5,190	5,302	5,416	5,586
Total deposits	11,256	11,774	12,866	13,091	13,806	14,659	14,404	14,844	15,266	16,090
Domestic currency deposits	6,554	6,524	6,659	6,551	6,655	9,397	6,943	7,200	7,404	7,562
Foreign currency deposits (FCD)	4,701	5,249	6,198	6,527	7,152	5,263	7,461	7,645	7,862	8,528
Memorandum items:										
Reserve money growth (percent change; quarterly)	20.3	-14.6	6.0	-2.1	6.6	...	1.9	2.2	2.1	3.1
Reserve money growth (percent change; annual)	31.8	6.3	18.5	6.5	-5.6	16.0	12.7	8.6	13.4	9.7
Broad money growth (percent change; quarterly)	6.0	3.1	9.0	0.3	6.0	...	3.7	2.8	2.7	4.8
Broad money growth (percent change; annual)	35.0	34.8	33.3	19.4	19.4	29.4	20.1	13.2	16.0	14.7
Credit to economy, (percent change, annual)	35.0	41.2	41.9	37.2	26.1	...	20.9	16.6	12.4	13.3
Net credit to government, (percent change, annual)	-15.0	-21.4	-14.7	-24.5	-23.1	-10.0	-17.4	-17.8	-18.3	-67.9
Gross international reserves (millions of U.S. dollars)	597.4	593.1	633.5	618.5	688.4	750.0	683.3	731.2	740.0	799.3
Net international reserves (millions of U.S. dollars)	501.6	505.3	532.6	528.0	547.6	644.9	582.1	599.4	617.5	661.3
Velocity (M3; end of period)	2.3	2.3	2.2	2.2	2.2	2.1	2.2	2.2	2.2	2.2
Broad money multiplier	2.3	2.7	2.8	2.9	2.9	2.5	2.9	2.9	2.9	3.0
Share of foreign currency deposits in all deposits	41.8	44.6	48.2	49.9	51.8	35.9	51.8	51.5	51.5	53.0

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

Table 5. Moldova: Financial Sector Indicators, 2000–06
(End-of-period; in percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006 H1
Size							
Number of banks	20	19	16	16	16	16	15
Total assets of the banking system (in percent of GDP)	29	31	35	38	42	49	48
Credit to nongovernment sector (in percent of GDP)	14	16	19	22	23	27	27
Capital adequacy							
Capital adequacy ratio 1/	49	43	36	32	31	27	26
Liquidity							
Liquidity ratio 2/	67	60	56	48	53	50	50
Asset quality 3/							
Nonperforming loans as a share of total loans	21	10	8	6	7	5	5
Non-performing loans, net of loan loss provisions / tier one capital	15	5	3	2	3	2	0
Loans under supervision as a share of total loans	30	31	35	35	34	39	42
Non-performing and loans under supervision as a share of total loans	51	41	43	42	41	44	48
Profitability							
Return on equity	25	14	17	20	18	15	18
Return on assets	7	4	4	4	4	3	3
Non-interest income / Total income	39	35	40	38	35	34	31
Interest rates							
Domestic currency average lending rate	32	26	19	19	21	17	18
Domestic currency average deposit rate	24	18	13	14	16	11	11
Interest rate spread, domestic currency	9	8	7	5	6	7	6
Foreign currency average lending rate	15	12	12	11	11	11	11
Foreign currency average deposit rate	5	3	3	4	5	5	5
Interest rate spread, foreign currency	10	9	9	7	6	5	7
91 day T-bill (effective nominal yield)	25	8	11	18	7	4	8
Foreign currency deposits							
Share of foreign currency deposits in broad money	28	28	31	34	31	30	35
Share of foreign currency deposits in all deposits	49	45	47	50	45	42	48

Source: National Bank of Moldova.

1/ Total regulatory capital over total risk-weighted assets.
2/ Liquid assets over total deposits.
3/ Uncertainty regarding the ultimate beneficial owners of banks suggests caution is in order regarding the reliability of this data.

Table 6: Moldova: Localized Millennium Development Goals (EGPRSP)

	2000	2001	2002	Most recent	Targets: 2006	2010	2015
Goal: Eradicate extreme poverty and hunger							
Target: Reduce by half the proportion of persons with daily income below 2.15 USD (PPP) over the period 1997-2015							
▪ Population with income below $2.15 (PPP) a day (%)	64.5	52.4	39.8	27.8 (2004)	28.0	23.0	18.0
Goal: Achieve universal access to secondary school education							
Target: Ensure equal opportunities for all children to study in secondary schools							
▪ Net enrollment ratio in secondary education (%)	87.0	86.8	87.9	88.5 (2004)	88.9	93.8	100.0
Goal: Reduce child mortality							
Target: Reduce by two-thirds the under-five mortality rate over the period 1990-2015							
▪ Under-five mortality rate (per 1,000)	23.3	20.3	18.2	15.3 (2004)	15.0	11.9	8.4
▪ Infant mortality rate (per 1,000 live births)	18.3	16.3	14.7	12.2 (2005)	12.1	9.6	6.3
▪ Immunization , measles (% of children under 2 years old)	98.6	99.4	99.1	n/a	100.0	100.0	100.0
Goal: Improve maternal health							
Target: Reduce the maternal mortality ratio by three-fourths over the period 1990-2015							
▪ Maternal mortality ratio (per 100,000 births)	27.1	43.9	28.0	18.6 (2005)	23.0	21.0	13.3
▪ Births attended by skilled health personnel (%)	98.0	99.0	99.0	n/a	100.0	100.0	100.0
Goal: Combat HIV/AIDS, tuberculosis and malaria							
Target: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS							
▪ HIV/AIDS incidence (per 100,000 people)	4.1	5.5	4.7	8.53 (2005)	4.0	3.5	3.2
▪ HIV incidence among 15-24 year-olds	11.9	10.9	9.7	11.7 (2005)	4.9	4.2	4.0
Target: Have halted by 2015, and begun to reverse, the incidence of tuberculosis and malaria							
▪ Mortality rate associated with tuberculosis (deaths per 100,000 people)	16.9	15.0	15.8	18.5 (2005)	13.9	12.0	7.0
Goal: Ensure environmental sustainability							
Target: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources							
▪ Proportion of land areas covered by forest (%)	10.5	10.5	11.4	12.6 (2004)	11.0	12.1	13.2
▪ Ratio of area protected to maintain biological diversity (%)	2.0	2.0	2.0	1.96 (2004)	2.1	2.2	2.4
Target: Halve, by 2015, the proportion of people without sustainable access to improved water sources							
▪ Population with sustainable access to an improved water source (%)	37.8	38.1	38.5	44.5 (2004)	47.7	57.0	68.5
Target: Achieve a significant increase of the share of people with access to improved sanitation							
▪ Population with access to improved sanitation (%)	41.1	40.0	41.7	43.6 (2004)	56.0	73.3	90.0

Sources: Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) 2004-06, Government of the Republic of Moldova, June 2004; and the Ministry of the Economy.

Table 7. Moldova: External Financing Requirements and Sources, 2004–08

(In millions of U.S. dollars)

	Actual		IMF Staff Projection		
	2004	2005	2006	2007	2008
1. Gross financing requirements	439.3	571.9	649.8	581.3	576.9
External current account deficit (exc. official transfers)	103.4	287.5	392.8	353.5	280.8
Debt amortization	111.4	133.5	134.7	128.8	146.0
Medium and long term debt	111.4	133.5	134.7	128.8	146.0
Public sector	41.8	40.7	80.5	78.3	79.6
Multilateral 1/	40.5	24.6	19.9	17.8	19.8
Bonds and notes					
Other	1.3	16.1	60.6	60.5	59.7
Commercial banks					
Corporate private sector	69.6	92.8	54.2	50.5	66.4
Short-term debt 2/					
Repayment of arrears	54.9	0.8	68.0	0.0	0.0
Gross reserves accumulation	148.0	128.6	63.6	110.8	163.1
IMF repurchases and repayments	21.6	21.4	-9.2	-11.9	-12.9
2. Available financing	439.3	571.9	649.8	581.3	576.9
Foreign direct investment (net)	87.4	225.5	221.6	223.3	240.9
Debt financing from private creditors	102.7	129.9	112.5	112.5	112.5
Medium- and long-term financing	102.7	129.9	112.5	112.5	112.5
To public sector					
of which: balance of payments financing 3/					
To commercial banks					
To corporate private sector	102.7	129.9	112.5	112.5	112.5
Short-term financing					
of which: balance of payments financing 3/					
Official creditors 4/	73.3	69.2	124.0	214.8	205.1
Multilateral 1/	70.7	68.2	112.5	158.4	147.6
of which: balance of payments financing 3/					
Bilateral	2.6	1.0	11.4	56.4	57.5
To public sector	2.6	1.0	11.4	56.4	57.5
of which: balance of payments financing 3/					
prospective grants			0.0	47.4	57.5
To private sector					
Accumulation of arrears (exceptional)	42.4	26.2	11.9	0.0	0.0
Financing gap	...	...	29.7	14.7	3.7
Other flows 5/	133.6	121.1	150.1	16.0	14.7
Memorandum item:					
Total balance of payments financing 3/	0.0	0.0	29.7	14.7	0.0
Prospective IMF augmentation	...	...	29.7	14.7	...

1/ Excluding the IMF.
2/ Original maturity of less than 1 year. Stock at the end of the previous period.
3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.
4/ Includes both loans and grants.
5/ Includes all other net financial flows, and errors and omissions.

Table 8. Moldova: Quantitative Performance Criteria and Indicative Targets, March 31, 2006 – December 31, 2006 1/

	31-Dec-05	31-Mar-06		30-Jun-06		30-Sep-06		31-Dec-06		
	Actual 2/	Indicative targets	Actual	Indicative targets	Actual	Performance criteria	Actual	Indicative targets		
								Prog	Proj 3/	Proj 4/
1. Quantitative performance criteria										
				(In millions of lei)						
Floor for general government fiscal balance 5/	634	-247	...	-417	...	-303	...	-350	-210	*-210*
Adjusted floor for general government fiscal balance		*-217*	*162*	*-361*	*-66*	*-201*	*317*	*-243*	...	...
Ceiling on net domestic assets of the NBM (level)	569	60	-469	55	-271	-477	-652	-150	-453	-768
Floor on net international reserves of the NBM (level)	6,436	6,410	6,432	6,791	6,609	7,866	6,845	8,276	7,113	7,380
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	...	0	0	0	0	0	0	0	0	0
2. Continuous performance criteria										
Ceiling on accumulation of external payment arrears	...	...	0	0	0	0	0	0	0	0
				(In millions of lei)						
3. Indicative targets										
Ceiling on reserve money (level)	7,003	6,470	5,978	6,846	6,340	7,390	6,204	8,126	6,612	6,612
Ceiling on change in domestic expenditure arrears of the general government	...	0	0	0	0	0	0	0	0	0
				(In millions of lei, unless noted otherwise)						
4. Baseline assumptions										
Concessional external debt financing	327	130	100	231	175	362	259	494	387	387
in millions of dollars	...	10	8	18	14	28	20	39	29	29
Privatization receipts	176	9	-4	30	5	50	21	68	28	28

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2006 refer to cumulative flows from end-2005, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 12.832/US$ for March - September 2006, and on the exchange rate of MDL 13.2911/US$ afterwords.
2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.
3/ Based on old program exchange rates.
4/ Based on new program exchange rates.
5/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 125 million. In the case of shortfalls, the limits will be decreased by the full amount.

Table 8a. Moldova: Proposed Quantitative Performance Criteria and Indicative Targets, Dec 31, 2006 –December 31, 2007 1/

	31-Dec-06 Indicative targets 2/ Proj	31-Mar-07 Performance criteria	30-Jun-07 Indicative targets	30-Sep-07 Indicative targets	31-Dec-07 Indicative targets
1. Quantitative performance criteria					
			(In millions of lei)		
Floor for general government fiscal balance 3/	-210	-144	-248	-238	-233
Ceiling on net domestic assets of the NBM (level)	-768	-997	-1,081	-1,174	-1,535
Floor on net international reserves of the NBM (level)	7,380	7,737	7,967	8,207	8,789
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	0	0	0	0	0
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears	0	0	0	0	0
			(In millions of lei)		
3. Indicative targets					
Ceiling on reserve money (level)	6,612	6,740	6,886	7,033	7,255
Ceiling on change in domestic expenditure arrears of the general government	0	0	0	0	0
			(In millions of lei, unless noted otherwise)		
4. Baseline assumptions					
Concessional external debt financing	387	184	319	472	703
in millions of dollars	29	14	24	35	53
Privatization receipts	28	0	40	80	155

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2007 refer to cumulative flows from end-2006, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 13.2911/US$.

2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 146million. In the case of shortfalls, the limits will be decreased by the full amount.

Table 9. Moldova: Status of Structural Performance Criteria and Benchmarks

	Measure	Due	Status	Note
	Agreed in 2006 program			
	Performance Criteria			
1.	Neither Government nor the NBM will provide preferential treatment to Banca de Economii (whether the tax treatment, access to general government deposits, or prudential forbearance)	Continuous	Observed	
2.	Submission to Parliament of amendments to the Law on State Enterprise establishing corporate governance conditions similar to joint stock companies	30-Jun-06	Observed	The draft amendments to the Law on State Enterprises #146-XIII of June 16, 1994, to include corporate governance principles similar to those of joint stock companies was approved by the Governemt Decision #531 of May 18, 2006, and was submitted to Parliament on Jun 20, 2006.
3.	Parliamentary passage of amendments to the Law on the NBM, establishing price stability as the Bank's core objective, prohibiting direct lending to government, strengthening independence of NBM board members in performance of their tasks and duties, and giving the NBM full authority for monetary policy.	31-Jul-06	Observed	Draft Law on Amending the Law on NBM was submitted to Parliament on Mar 31, 2006 and was passed in the second reading on June 30, 2006.
4.	From February to September 2006 the Council of Creditors to sign new restructuring for a total amount of debt not to exceed Lei 100 million, and with full repayment of each restructured debt not not to exceed January 1, 2009.	30-Sep-06	Observed	During Feb-Sep. 2006 the Council of Creditors concluded memorandum agreements for the amount of 99.96 million lei.
5.	Government adoption of a tax administration reform strategy and implementation plan which has the overall aim of reducing the administrative burden of the tax system and strengthening revenue collection, and which would specifically include a risk-based approach to audit and enforcement, improvements to the VAT refund process, and the use of indirect methods of assessing tax liability, including as a means of combating underinvoicing in external trade.	30-Sep-06	Observed	The draft strategy was reviewed by FAD TA mission, and was approved by the government on Sep 27, 2006

Table 9 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

	Measure	Due	Status	Note
	Structural Benchmarks			
6.	Pass higher imported natural gas prices through to consumers (households and enterprises) by ensuring that tariffs are set at cost-recovery levels, while maintaining the current system of targeted compensation.	Continuous	Observed	By decision #206 of February 14, 2006 "On Natural Gas", ANRE - the national energy regulator - raised the natural gas tariffs for consumers to ensure full pass-through.
7.	Establishment of a system responsible for conducting regulatory impact assessments of new legislation and regulations	30-Sep-06	Observed	Draft Methodology and Guide to Regulatory Impact Assessment have been prepared, approved by the State Commission for Entrepreneurship Activity Regulation on Sep 15, and then by the government on Sep 27.
8.	Preparation of a plan to transfer special (own) revenue accounts of budget units, and of expenditure accounts of the Social and Health Funds, to the Treasury (e.g., zeroing out the balances in the commercial banks) in 2007	30-Sep-06	Observed	The plan was prepared and signed jointly by the MoF and the NBM on Sep. 29.
9.	Elimination of the requirement that grain exports must be transacted on the Moldovan Commodity Exchange.	30-Sep-06	Observed	The requirement that grain exports must be transacted on Moldovan Commodity Exchange has been abolished by the Govenment Decision #946 of Aug. 18, 2006.
10.	Government adoption of a strategy to strengthen bankruptcy procedures	30-Sep-06	Not Observed	A draft strategy has been drafted, but the authorities are looking for international technical assistance to complete the draft.
11.	Submission to parliament of a law on management and divestiture of public assets (including a public enterprise reporting framework based on the 2001 Government Finance Statistics manual), and of amendments to the Law on Public Debt requiring mandatory reporting to ministry of finance of all SOE debts.	30-Sep-06	Not Observed	The draft law on management and divestiture of state assets is to be submitted to Parliament with delay to take account of comments from development partners. The draft law on public debt was approved by government and approved by Parliament in first reading on Nov. 23, 2006.
12.	Preparation of a plan to put the Social Fund on a sustainable financial basis (for the 2008 budget)	31-Dec-06	Pending	The authorities have requested technical assistance to prepare this plan.
13.	Submission to Parliament of draft laws on civil service	31-Dec-06	Pending	Draft law has been prepared and is being discussed in government.
14.	Council of Creditors formally abolished, with STI to assume responsibility for monitoring tax debts and the corresponding courts to handle non-tax debts	31-Dec-06	Pending	STI is preparing to take on this responsibility.
15.	Completion of detailed functional reviews of all central public administration ministries and agencies	31-Dec-06	Pending	Functional reviews have been completed, and are to be discussed in government and with donors during November.
16.	Announce winner of tender for independent valuation of BEM	31-Dec-06	Pending	At least two reputable firms have submitted bids.
17.	Parliamentary approval of the law on management and divestiture of state assets and the law on public debt	31-Dec-06	Pending	

Table 10 . Moldova: Capacity to Repay the Fund, 2005-2015

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Baseline scenario										
Fund disbursements 1/											
In millions of SDR	-	43.4	33.1	22.9	11.4	-	-	-	-	-	-
In millions of U.S. dollars	-	62.0	47.4	32.7	16.4	-	-	-	-	-	-
In percent of quota	-	35.2	26.9	18.6	9.3	-	-	-	-	-	-
Projected repayments/repurchases and charges 1/											
In millions of SDRs	16.3	18.1	16.0	14.9	12.5	6.1	4.5	13.2	16.9	21.4	22.5
In millions of U.S. dollars	24.1	25.9	22.8	21.3	17.9	8.8	6.4	18.9	24.2	30.6	32.1
In percent of exports of G&S	1.6	1.7	1.3	1.1	0.8	0.4	0.2	0.6	0.7	0.8	0.8
In percent of total debt service	22.6	25.9	24.8	23.8	20.9	12.9	9.5	23.8	27.1	33.8	43.5
In percent of quota	13.2	14.7	12.9	12.1	10.2	5.0	3.6	10.7	13.7	17.4	18.2
In percent of gross international reserves	4.0	3.8	2.9	2.2	1.5	0.6	0.4	1.0	0.9	0.9	0.9
Fund credit outstanding 1/											
In millions of SDRs	66.8	93.8	112.4	121.4	121.0	115.5	111.6	98.9	82.4	61.4	39.2
In millions of U.S. dollars	95.5	134.0	160.6	173.5	173.0	165.1	159.5	141.3	117.8	87.8	56.1
In percent of exports of G&S	6.2	8.6	9.0	8.6	7.6	6.6	5.8	4.7	3.5	2.4	1.4
In percent of quota	54.2	76.1	91.2	98.5	98.2	93.8	90.6	80.3	66.9	49.8	31.8
In percent of gross international reserves	16.0	19.5	20.1	18.0	14.7	12.0	9.9	7.5	4.2	2.7	1.5
Memorandum items											
Disbursements under 2006-08 PRGF (before augmentation)		22.9	22.9	22.9	11.4						
Exports of G&S (in millions of U.S. dollars)	1,528.3	1,559.9	1,787.6	2,012.1	2,264.9	2,491.4	2,740.5	3,014.6	3,332.9	3,684.9	4,074.0
Debt service (in millions of U.S. dollars)	106.4	99.9	91.9	89.4	85.4	68.0	67.7	79.6	89.4	90.5	73.8
Quota (in millions of SDR)	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2
Quota (in millions of U.S. dollars)	182.1	176.1	176.1	176.1	176.1	176.1	176.1	176.1	176.1	176.1	176.1
Gross international reserves (in millions of U.S. dollars)	597.4	688.4	799.3	962.4	1180.0	1373.1	1615.5	1891.3	2776.1	3227.5	3743.3
SDR/U.S. dollar (period average)	0.68	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
SDR/U.S. dollar (eop)	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70

1/ Based on existing and prospective drawings

Source: Fund staff calculations

Table 11. Moldova: Reviews and Disbursements Under the Three-Year PRGF Arrangement

Date	Action	Disbursement
May 5, 2006	Board approval of the three-year arrangement	SDR 11.44 million
On or after December 10, 2006	Complete first review based on end-September 2006 performance criteria	SDR 31.97 million
On or after June 10, 2007	Complete second review based on end-March 2007 performance criteria, and adopt conditions and disbursements for the second year of the arrangement	SDR 21.71 million
On or after December 10, 2007	Complete third review based on end-September 2007 performance criteria	SDR 11.44 million
On or after June 10, 2008	Complete fourth review based on end-March 2008 performance criteria, and adopt conditions and disbursements for the third year of the arrangement	SDR 11.44 million
On or after December 10, 2008	Complete fifth review based on end-September 2008 performance criteria	SDR 11.44 million
On or before May 4, 2009	Complete sixth review based on end-March 2009 performance criteria	SDR 11.44 million

APPENDIX I: MOLDOVA—FUND RELATIONS

(As of October 31, 2006)

I. **Membership Status**: Joined August 12, 1992; Article VIII

II. **General Resources Account**:	**SDR million**	**Percent of Quota**
Quota	123.20	100.00
Fund holdings of currency	148.62	120.63
Reserve tranche position	0.01	0.00

III. **SDR Department**:	**SDR million**	**Percent of Allocation**
Holdings	0.49	N/A

IV. **Outstanding Purchases and Loans**:	**SDR million**	**Percent of Quota**
Extended arrangements	25.42	20.63
PRGF arrangements	37.31	30.29

V. **Latest Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
PRGF	5/5/2006	5/4/2009	80.08	11.44
PRGF	12/21/2000	12/20/2003	110.88	27.72
EFF	05/20/1996	05/19/2000	135.00	87.50

VI. **Projected Obligations to Fund**[13]**:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	0.92	14.53	13.88	11.79	5.54
Charges/Interest	0.44	1.25	0.70	0.26	0.09
Total	1.37	15.78	14.58	12.05	5.64

[13] Disbursements made after November 28, 2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayments under the Supplemental Reserve Facility are scheduled to be repaid on the expectations schedule.

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the National Bank of Moldova (NBM) is subject to an assessment with respect to the PRGF arrangement approved on May 5, 2006, and its subsequent augmentation requested in November 2006. The assessment was completed on October 13, 2006 and it concluded that safeguards in place at the NBM appear adequate. However, certain vulnerabilities were identified in the governance and control system, which will be addressed through implementing the safeguards assessment recommendations.

VIII. **Exchange Arrangement**:

Moldova has accepted the obligations of Article VIII, Sections 2, 3 and 4, of the Fund's Articles of Agreement. Its exchange system remains free of restrictions on payments and transfers for current international transactions.

Moldova's exchange rate regime was reclassified from a de facto peg (to the U.S. dollar) to a managed float in April 2006.

Prior to the introduction of the Moldovan leu on November 29, 1993, the Russian ruble (supplemented by NBM-issued ruble denominated coupons) was the legal tender in Moldova. The government introduced the leu at a conversion rate of one leu equal to 1,000 Moldovan rubles and an exchange rate of one dollar equal to lei 3.85. The leu remained broadly stable around MDL 4.75/$ until mid-October 1998. It has since depreciated against the dollar and traded at MDL 12.97=$1 on February 28, 2006.

Foreign exchange was initially traded on the Chişinău Interbank Foreign Currency Exchange (CIFCE). Operations of the CIFCE started at the beginning of 1993, and daily auctions commenced in early February 1995. An active foreign exchange cash market exists within authorized banks and foreign exchange bureaus. From November 16, 1993 through end-October 1998, the U.S. dollar exchange rate established in the CIFCE was the official exchange rate quoted by the NBM. Since November 2, 1998, the official rate as announced by the NBM is determined as the weighted average of all daily market transactions. The NBM quotes exchange rates of the leu for other currencies on the basis of the leu-U.S. dollar rate and the cross-rate relationships between the U.S. dollar and the currencies concerned in the international market.

IX. **Article IV Consultation**:

The last Article IV consultation was concluded on May 5, 2006 (IMF Country Report Nos. 06/184 and 06/187).

X. **FSAP Participation**:

Moldova received an FSAP mission in May 2004; the FSSA was presented to the Board at the time of the 2004 Article IV discussions.

XI. **Use of Fund Resources**:

On February 4, 1993, Moldova purchased Fund resources totaling SDR 13.5 million, equivalent to 15 percent of quota under the Compensatory and Contingency Financing Facilities (CCFF). This was followed by a first drawing under the Systemic Transformation Facility (STF) of SDR 22.5 million, equivalent to 25 percent of quota, which was approved by the Board on September 16, 1993. On December 17, 1993 the Board approved a purchase of Fund resources under a stand-by arrangement (SBA) in the amount of SDR 51.75 million and the drawing of the second tranche of the STF totaling SDR 22.5 million. On December 19, 1994, Moldova made a second purchase under the CCFF totaling SDR 12.2 million, equivalent to 13.5 percent of quota, in conjunction with the second review of the SBA that expired at end-March 1995. The Board approved a successor SBA for Moldova in an amount totaling SDR 58.50 million (equivalent to 65 percent of quota) on March 22, 1995. Three purchases, totaling SDR 32.4 million (equivalent to 36 percent of quota), were made under the arrangement. An Extended Arrangement amounting to SDR 135 million (equivalent to 150 percent of old quota) was approved by the Executive Board on May 20, 1996. At the time of the third review, the program was extended by one year to May 19, 2000. While the fourth review was completed, the program expired on May 19, 2000 without the completion of the scheduled last review because parliament rejected twice an important program condition. Five purchases totaling SDR 87.5 million (equivalent to 97 percent of old quota) were made under the EFF arrangement. A PRGF arrangement was approved on December 21, 2000 in the amount of SDR 110.88 million (equivalent to 90 percent of quota). SDR 9.24 million was disbursed on December 29, 2000, followed by SDR 9.24 million on February 23, 2001, and SDR 9.24 million on July 26, 2002. The arrangement expired in December 2003 with only one review completed. A new PRGF arrangement was approved on May 5, 2006 in the amount of SDR 80.08 million (equivalent to 65 percent of quota). SDR 11.44 million was disbursed on May 10, 2006.

XII. **Resident Representative**:

Mr. Mathisen began his assignment in December 2005.

XIII. **Resident Advisors**:

An FAD resident advisor, Mr. Agarwal, completed a posting to support the development of the treasury in June 1998. Peripatetic return visits were conducted through 1999. During 1998, Mr. and Mrs. Faulk were assigned as resident advisors on banking supervision at the NBM. During 1999, they paid various follow- up visits as external experts. In July 1999, an FAD resident tax administration advisor, Mr. Vandenberghe, was extended for a third six month period to support the development of a large taxpayer unit. His contract ended in mid-2000. In January 2007, a resident advisor on monetary policy implementation and liquidity management is expected to take up a short-term assignment at the NBM.

XIV. **Short-Term Assistance**:

Mr. Antao conducted regular visits to assist the ministry of finance on macroeconomic analysis since mid-1997. From April 1996 to July 1998, Mr. Richards paid regular visits as a regional balance of payments statistics advisor to Moldova, Armenia, and Georgia.
Mr. Van Sluys and Dr. Peeraer visited Chişinău on several occasions in 1998/99 to assist in the area of supervision of commercial bank's foreign exchange activities. Mr. Thompson has been advising the NBM on accounting issues since 1999 and visited Moldova regularly during the past three and a half years, including for preparation of the NBM international audits. Mr. Ponomarenko visited Moldova several times in 2002–04 to assist the Department of Statistics and Sociology (DSS) in the area of national accounts. Mr. Astin has been visiting Moldova regularly to help the DSS reform the methodology for the CPI and PPI.

XV. **Technical Assistance**:

The following table summarizes the technical assistance missions provided by the Fund to Moldova since January 2001.[14]

Moldova: Technical Assistance Provided by the Fund, 2001–2006

Department	Subject/Identified Need	Timing	Counterpart
LEG	Free economic zone legislation	Jan./Feb. 2001	MoE
FAD	Expenditure policy	May 2001	MoF
LEG	Bankruptcy law	June 2001	MoE
LEG	Banking legislation	June 2001	NBM
MAE	TA assessment/evaluation	October 2001	NBM
MAE	Payments system; liquidity projection and monetary policy framework; central bank accounting and internal audit; and bank supervision.	May 2002	NBM
MFD	Payments system	Missions 2003 and 2004	NBM
STA	National accounts	March 2002, Dec. 2002, March 2003, Apr. 2004	DSS
STA	Price statistics	Nov. 2003, Sept 2004, Nov. 2005, July 2006	DSS
STA	Money and banking statistics	April 2004	NBM
MFD/LEG	Anti-money laundering	April 2004, Aug. 2006	MDA Gov. NBM
FAD	Modernization of the LTU and VAT	May 2004	MoF
MFD	Foreign exchange regulation and banking supervision	December 2004	NBM
STA	Money and banking statistics	May 2005	NBM, DSS
MFD	Internal audit (National Bank)	June 2005	NBM
STA	SDDS	November 2005	NBM, DSS , MOF
MFD	Central bank independence, monetary policy, and monetary operations	December 2005	NBM
FAD	Public finance management	March 2006, Oct. 2006	MOF
FAD	Tax administration	July 2006	MOF
MCM	Central bank recapitalization and normalizing relations between the central bank and ministry of finance	August 2006	NBM, MOF

[14] For technical assistance before 2001, see previous reports.

MCM	Improving monetary policy operations, creating preconditions for an inflation targeting framework and analyzing financial sector stability	September 2006	NBM
MCM	Development of the foreign exchange system	September 2006	NBM

Note: MoF: Ministry of Finance; NBM: National Bank of Moldova; MoE: Ministry of Economy; DSS: Department of State Statistics

APPENDIX II: MOLDOVA—IMF-WORLD BANK RELATIONS

(As of November 16, 2006)

Country Director: Mr. Paul Bermingham Telephone: +380 44 490 06671

A. Partnership in Moldova's Development Strategy

1. Moldova's development agenda is set out in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP). The EGPRSP was presented to the Boards of the International Development Association (IDA) and the IMF in November 2004. In April 2006, the Moldovan authorities prepared the first Annual Evaluation Report (AER). The Joint Staff Advisory Note (JSAN) provided the government with advice on future implementation of the EGPRSP. The document describes the participatory process underpinning the development of the strategy, provides a diagnostic of poverty, and presents sector programs and policy measures for sustainable economic growth and poverty.

2. The IMF has taken the lead in assisting Moldova in promoting and maintaining macroeconomic stability through prudent monetary and financial policies. In this regard the Fund has encouraged the Moldovan authorities to implement a policy reform agenda that would attract the needed level of concessional foreign financing from bilateral and multilateral creditors and encourage the international community to reschedule Moldova's external debt to enhance debt sustainability. The Fund has supported Moldova's economic reform program since 1993. The last three-year PRGF program was approved on May 5, 2006.

3. The World Bank has taken the lead in the policy dialogue on a number of structural issues relevant to economic growth and poverty reduction, including private sector development, infrastructure, health, education, social protection, and agricultural sector reforms.

4. On October 19, 2006 the Bank Executive Board approved a US$10.0 million *Poverty Reduction Support Credit (PRSC) for Moldova.* The credit, the first in a planned annual series, aims to support the Government's efforts to accelerate economic growth and improve the efficiency of its social programs and public administration. It directly supports implementation of Moldova's EGPRSP, as well as the EU-Moldova Action Plan. The PRSC will support selected areas of the Government reform agenda with the objective of: (i) improving the investment climate; (ii) improving the efficiency and management of public resources; and (iii) strengthening pension and social assistance systems. It is expected that the implementation of the reform program supported by the PRSC will contribute to improved business environment and investment climate, leading to an increase in the quality of growth and poverty reduction, particularly in the rural areas. A more professional civil service combined with increased transparency and accountability of public finances with improved public expenditure management and strategic allocation of resources is also an important part of the reform program supported by the Credit. Given the recent increases in the price of imported energy, the PRSC also supports the Government's efforts in

strengthening existing social safety nets for vulnerable groups by completing the 1999 pension reform and improving the targeting of social assistance programs.

5. Recent analytical work of the Bank includes a *Public Expenditure Management Review*, an *Investment Climate Assessment*, a *Country Procurement Assessment Review,* a *Country Financial Accountability Assessment, a Trade Diagnostic Study,* the second *Poverty Assessment,* an *Education Policy Note,* a *Health Policy Note, an Agricultural Note* as well as *Country Economic Memorandum* entitled *Moldova: Opportunities for Accelerated Growth.* Bank is also providing technical assistance to the government in the areas of *poverty monitoring*, *civil service reform and governance*, and *social protection*.

6. In a number of areas—social sectors, environment, infrastructure—the Bank takes the lead in the dialogue. The Bank also is leading the areas of support for the private sector development and agricultural sector reform and Bank analysis serves as input into the Fund program. In other areas—trade and customs reform, financial sector policies, public sector management—both institutions work together. Finally, in areas like fiscal, monetary, and exchange rate policies, and tax administration, the IMF takes the lead.

B. IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads

7. Areas in which the Bank leads the policy dialogue are social sectors, infrastructure, and environment. In the **social sphere**, the Bank has carried out *Poverty Assessments* to monitor and evaluate progress in alleviating poverty. A second poverty assessment has recently been completed. A *Social Protection Management Project* supports the implementation of comprehensive reform of the public pension system and the introduction of a regulatory framework for private pension funds. The project also supports the implementation of the new organizational structure for social insurance. The Bank has also supported two *Social Investment Fund (SIF) Projects* to assist in the building of local community and municipal capacity and skills through the rehabilitation of social infrastructure. The SIF also focuses on improving the delivery of social services, creating short-term employment and opportunities in rural areas by financing small-scale public works and supporting micro-business development.

8. In **health**, the ongoing *Health Investment Fund Project* is focused on improving the health status of the Moldovan population and increasing the quality and efficiency of public health services by improving access to essential services by the poor. The *Moldova AIDS Control Project* aims at improving Moldova's health status and assists in achieving the health-related Millennium Development Goals by reducing mortality, morbidity, and transmission of HIV/AIDS. An additional operation to help Moldova combat *Avian Influenza* was also approved in FY06

9. In **education,** the *Quality Education in Rural Areas Project builds upon recently closed General Education Project and* supports the Government's education program to

enhance the quality of teaching and learning, increase access and equity, improve the efficiency in public spending for education, and strengthen education planning and monitoring.

10. With regards to **infrastructure** development, the Bank is concentrating on upgrading basic utility services impacting the population at large and the poor in particular. The *Energy II Project* has two main components: (i) power system infrastructure—investments to upgrade and rehabilitate metering, dispatch and communications, selected priority rehabilitation of the electricity of the electricity transmission network, and institutional development and regulation of the electricity market; and (ii) heating supply and consumption—investments in improving heating supply and energy efficiency in selected public buildings. A *Pilot Water Supply and Sanitation Project* is aimed at enhancing the welfare of the population living in some of the poorest rural areas and medium-sized towns and cities by improving the quality, efficiency, and sustainability of water supply and sanitation services by rehabilitating and improving operations of selected water and sewage systems to increase service quality and efficiency, improving the financial viability and commercial practices of the participating utilities, and involving the private sector in the sector.

11. The Bank has supported a number of **environmental** projects. The *Agriculture Pollution Control Project* focuses on significantly increasing the use of environmentally friendly agricultural practices by farmers and agro-industry thereby reducing nutrient discharge from agricultural sources into the Danube River and Black Sea. A number of technical assistance activities are also under implementation. A *Biodiversity Strategy Development* is assisting the government in implementing Articles 6 and 8 of the Convention on Biological Diversity. The project also supports the formulation and adoption of strategies and actions for the protection and sustainable use of bio-diversity, through a participatory process involving the public and private sectors and local NGOs. Similarly, the recently closed *Biodiversity Conservation Project* addressed national environmental priorities of improved water quality and habitat management of the Nistru River.

12. In the area of **rural and agricultural development**, the Bank's *First Cadastre Project* has initiated the first cadastre, implemented a rural land registration system, and helped develop the institutional framework to complete and manage the legal cadastre in urban areas. The project helped establish a system of clear and enforceable ownership rights so as to promote the privatization of land the development of real markets in Moldova. The two *Rural Investment and Services Projects* increase rural incomes and living standards by promoting rural entrepreneurship, agricultural production, economic diversification, and trade in the rural areas. The projects provide public investment support to alleviate key institutional constraints in farmer's group formation, supporting development of marketing institutions and infrastructure for improved access to input and output markets, and developing a rural advisory service. The projects also provide investment and working capital at commercial terms to support a broad range of agribusiness.

13. While the Bank has taken the lead in the areas described above, the IMF has a strong interest in these areas since many of these reforms are critical to achieving macroeconomic

stabilization and enhancing growth prospects. Accordingly, there is a high degree of consultation and coordination between the two institutions on these matters.

Areas of shared responsibility

14. The Bank and Fund are working jointly in a number of areas:

15. **Private Sector Development.** While substantial progress in improving Moldova's business environment has been made, a challenging reform agenda remains. Both the Bank and the Fund have focused on this agenda in their assistance programs, including SAC III and PRGF arrangement and the surveillance exercise. The Bank has undertaken a number of studies, including the *Investment Climate Assessment*, the *Business Environment and Enterprise Performance Survey* (together with EBRD), a *Diagnostic Review of the Environment for Foreign Investment*, and a number of *Costs of Doing Business Surveys*, to gauge ongoing developments in this area and determine the most important impediments to private sector development. The Bank's *Private Sector Development II (PSD II) Project* strengthens the competitiveness of private and public enterprises in Moldova through the hands-on training of local managers abroad (human capital investment) and creation of a Competitiveness Center (market information and benchmarking). The *Competitiveness Enhancement Project* builds upon successes of the PSD II credit by providing support for the business environment improvement and modernization of the standardization and metrology system. The IFC has promoted financial sector development by extending credit lines to a number of private banks for on-lending to private sector. The Fund has focused on policies needed to maintain a stable macroeconomic environment and remove obstacles to growth, thus encouraging private sector activities. A number of technical assistance missions have been undertaken to improve banking legislation and banking supervision, including the joint *Financial Sector Assessment Program*.

16. In the area of **Public Sector Management**, the Bank's *Public Economic Management Review, Country Procurement Assessment Review* and *Country Financial Accountability Assessment* examine fiscal adjustment and reform efforts in the social sectors and suggest policy measures to strengthen public expenditure management and actions needed to build capacity for increased government effectiveness. The *Country Economic Memorandum* entitled *Moldova: Opportunities for accelerated growth* contains recommendations for improving the macroeconomic environment, enhancing the opportunities presented by the large inflow of remittances, creating a more dynamic and diversified private sector. The Bank's project *Trade and Transportation Facilitation in Southeast Europe* (part of the Stability Pact initiative), aims to strengthen and modernize the Customs Administration and other border control agencies with the objective reducing non-tariff costs to trade and transport and preventing smuggling and corruption at border crossings. The *Public Finance Management Project* will help the Moldovan Authorities to develop a budget planning and execution system by institutionalizing the medium-term expenditure planning and modernizing budget classification; will assist in upgrading the internal control and audit system in the central government bodies. The Fund has also provided technical assistance to

improve tax and customs administration, government financial statistics, and public expenditure policies.

Areas in which the IMF leads

17. The Fund takes the lead in the formulation and execution of fiscal and monetary policies, external policies, and issues involving economic and financial statistics. In the budgetary area, the Fund leads the dialogue on fiscal matters, taking the lead on tax policy and reforms.

18. In these areas the Bank takes into account the policy recommendations of the IMF and ensures that its own policy advice is consistent.

C. The World Bank Group Strategy

19. The main objective of the Country Assistance Strategy (CAS) for Moldova for the period of FY04-FY08 is to support the implementation of the government's EGPRSP and capitalize on the gains of previous assistance programs. Board discussion of the CAS took place in November 2004.

20. A CAS Progress Report was presented for the Executive Board's review on October 19, 2006. It assessed the implementation of the Strategy and discussed adjustments to the program for the remaining two years of the current CAS period. It was proposed to put in place an annual PRSC program of approximately US$10 million per operation, starting in FY07. The balance of the available IDA allocation would be made available for investment operations drawn from roads, health and social protection, and agriculture and rural development.

APPENDIX III: MOLDOVA—RELATIONS WITH THE EBRD

(As of November 1, 2006)

The EBRD's strategy in Moldova is aimed primarily at supporting private sector development in the country and increasing policy dialogue with the authorities. The EBRD is providing support to (i) the financial sector through credit lines, the participation in the equity of local banks, microfinance products, expansion of its trade facilitation program, and the provision of new financial products, such as leasing and mortgage financing; (ii) private enterprises through credit lines and co-financing with local banks, offering privatization and post-privatization support, facilitating FDI either by investing alongside strategic investors or assisting the development of local companies, and the expansion of programs that provide advisory services; and (iii) infrastructure through support for private operators, and public utilities with a special focus on improvement of the regulatory and operational environment. In the context of implementing Moldova's Economic Growth and Poverty Reduction Strategy and the EU-Moldova Action Plan, the Bank is working with other institutions in increasing its policy dialogue with the authorities on improving the business climate and regulatory environment in the country. The EBRD's Early Transition Country (ETC) Initiative provides specific financing instruments adapted to the needs of seven CIS countries, including Moldova, where post-Soviet transition from command to market economies and democracies has been slower.

Forty six projects have been signed totaling €201.5 million of EBRD resources, including: (i) a wine export promotion project, which is targeting the main Moldovan wineries and glass producer, through restructuring of the sector (€24.6 million) and equity investment into a glass producer (€6.4 million); (ii) an energy efficiency project for upgrading the heating distribution networks in Chisinau (€7.8 million); (iii) several credit lines and equity investment for Moldova-Agroindbank for on-lending to small and medium enterprises (€29.3 million in total); (iv) several credit lines, a co-financing facility and equity investment for Victoriabank (€12.5 million in total); (v) three credit lines and a co-financing facility for Mobiasbanca (€6.4 million); (vi) credit lines for Moldinconbank and Banca Sociala (€9.2 million in total);(v) a project for linking Moldovan satellite earth stations to the Eurovision Network (€0.8 million); (vi) a road rehabilitation loan (€9.6 million); (vii) partial financing for construction of a new oil terminal at Giurgulesti (€9.6 million); (viii) credit facilities for micro enterprises through local banks (€5.4 million); (ix) rehabilitating Chisinau's water services (€17.6 million); (x) Chisinau Airport Modernization (€7.4 million); (xi) trade facilitation program for Victoriabank, Moldova-Agroindbank, Moldindconbank, Mobiasbanca and Banca Sociala (regional TFP—€18.1 million in total); (xii) equity participation in and a loan to ProCredit and a loan to Rural Finance Corporation – two micro-finance companies (€3.2 million in total); and (xiii) equity participation and loan financing for three privatized power distribution companies (€26.9 million). In addition to banking projects, some 78 Technical Cooperation projects have been completed or approved (totaling €13.7 million).

APPENDIX IV: MOLDOVA—STATISTICAL ISSUES

21. Economic and financial data provided to the Fund are generally adequate for surveillance and program monitoring. In July 2005, a ROSC Data Module found that while the quality of macroeconomic statistics has improved significantly in many areas in the past few years, accuracy and reliability need to be enhanced further regarding compilation of fiscal and national accounts statistics.

22. Moldova has been a GDDS participant since February 2003, and became the 63rd subscriber to SDDS on May 2, 2006.

23. **National accounts statistics** are prepared according to the *1993 SNA* methodology. Estimates do not include the Transnistria region for which data have not been collected since 1991. GDP is estimated from the production and the expenditure sides, annually and quarterly. The data are prepared in current and constant (previous-year) prices, and annual data are revised—in two stages—as updated information becomes available. However, the quarterly data remain unadjusted, thus limiting their consistency with the revised annual data. Overall, the national accounts statistics need improvement in the following areas: (i) improving the accuracy of the data sources (quarterly reporting of all basic statistics on a discrete basis, industrial production index and price indices following international standards); (ii) benchmarking the annual and the quarterly data; and (iii) estimating the consumption of fixed capital in line with international standards.

24. **Price statistics** still have several shortcomings. Price collection for the CPI and PPI is limited geographically and new observations are not imputed. The weights of the CPI basket, underestimate the share of durable goods. The PPI is not a transaction price index, and covers a small population of industrial establishments. The most recent STA price statistics mission (mid-2006) found out that the main methodological issue of concern for the CPI was the biased treatment of seasonal products. The index captures only the downward part of seasonal fluctuations and misses the price “increases” at the beginning of the season. As for the current PPI compilation, international standards for data collection, validation, and calculation are not followed due mostly to lack of adequate resources. However, there are plans to implement a few improvements during the rebasing and selection of new respondent companies. Statistics Norway is expected to provide financial aid to hire short-term staff for the visits to new sample establishments.

25. The industrial production index is compiled from data in constant prices adjusted to price changes by establishments themselves.

26. **Labor market statistics** remain inadequate for analyzing macroeconomic developments: (i) unemployment data following ILO methodology are not available; and (ii) wage data do not include fringe benefits, which form an important part of workers’ compensation. The latter point could also have implications for the assessment of poverty levels in Moldova.

27. **Fiscal statistics.** A 1999 GFS technical assistance mission assisted the authorities in resolving data issues in the classification of accounts. Mission recommendations that still need to be implemented are: (i) improving the consolidation of general government data; (ii) reclassifying the financing data by type of debt holder and by type of debt instrument; and (iii) reporting of monthly fiscal data to STA for publication in *International Financial Statistics* by the MoF, based on correspondent accounts at the National Bank of Moldova (NBM). In addition, World Bank technical assistance was provided to improve the budgetary reports of local authorities as well as the Social Fund. The authorities reported data in the *GFSM 2001* format for publication in the *2003 GFS Yearbook*; however, they could not be published due to serious data issues. Authorities have addressed these shortcomings and data for 2004 will be published in the *2005 GFS Yearbook.*

28. **Balance of payments.** The compilation methodology follows the fifth edition of the *Balance of Payments Manual*. Problems remain related to: (i) under-reporting of imports and exports; (ii) collection of data on services; (iii) measurement of private capital inflows, including direct investment data; and (iv) treatment of transactions with Transnistria. Moldova disseminates quarterly international investment position statistics.

29. **Monetary and financial statistics** (MFS) have improved following a series of technical assistance missions from the Fund. A MFS mission in April 2004 found that while monetary data were broadly in line with international statistical standards and of a generally good quality, shortcomings remained in the compilation of some monetary statistics aggregates. A follow-up in May 2005 found that the authorities implemented most of the April 2004 mission's recommendations, assisted the authorities in implementing the standardized report forms (SRFs), and initiated work toward establishing an Integrated Monetary Database (IMD) for joint use by EUR and STA. The authorities report data in the SRFs to STA on a regular basis. MFS based on the SRFs will be published in the December 2006 issue of the quarterly *IFS Supplement on Monetary and Financial Statistics*.

MOLDOVA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of November 10, 2006)

	Date of latest observatio n	Date received	Frequency of Data[6]	Frequency of Reporting [6]	Frequency of Publication [6]
Exchange Rates	11/14/06	11/15/06	D/M	M	D/M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/10/06	11/15/06	W	W	W
Reserve/Base Money	11/10/06	11/15/06	W	M	M
Broad Money	10/31//06	11/15/06	W	M	M
Central Bank Balance Sheet	11/10//06	11/15/06	W	M	M
Consolidated Balance Sheet of the Banking System	10/31//06	11/15/06	W	M	M
Interest Rates[2]	10/31//06	11/15/06	M	M	M
Consumer Price Index	Oct. 2006	11/14/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sep. 2006	10/20/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Sep. 2006	10/20/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2006	10/20/06	M	M	M
External Current Account Balance	Q2 2006	Oct. 2006	Q	Q	Q
Exports and Imports of Goods and Services	Oct. 2006	11/07/05	M	M	M
GDP/GNP	Q2 2006	9/15/06	Q	Q	Q
Gross External Debt	Q3 2006	Oct. 2006	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

November 29, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Mr. de Rato:

On behalf of the government and the National Bank of Moldova, we are pleased to present the attached Memorandum of Economic and Financial Policies (MEFP) for 2007. The MEFP outlines our objectives for the coming year, and it emphasizes steps to address the economic impact of the external shocks we are facing. It was drawn from our Economic Growth and Poverty Reduction Strategy and is fully consistent with our commitments under the European Union-Republic of Moldova Action Plan.

The government and the National Bank believe that the policies described below will permit us to achieve the objective of the program, which remains to create the conditions for sustainable and inclusive economic growth that reduces poverty and facilitates Moldova's integration into the European neighborhood. Nevertheless, we are prepared to take additional measures that may become appropriate for this purpose at the time of the second review, including revisiting the stance of fiscal and monetary policies in the light of actual inflation developments, or an emerging gap in the balance of payments.

We hereby request completion of the first review under the PRGF arrangement, and we also request a waiver for nonobservance of the performance criterion on international reserves at end-September. This nonobservances stems from the significant external shocks faced by Moldova in 2006-07. Owing to the seriousness of these shocks, moreover, we hereby request augmentation of access under the arrangement, to a total amount of SDR 110.88 million (90 percent of quota). We request that two thirds of the additional access be made available at this time, with the remaining additional access to be made available upon completion of the second review. Thus, we request that an amount equal to SDR 31.97 million be disbursed following completion of this review.

We will communicate to the IMF the information needed to monitor progress in implementing the program, and will conduct discussions with the Fund for the second review under the PRGF arrangement before end-June 2007. We anticipate that the third review under the PRGF arrangement will be conducted on the basis of end-September 2007 data and be completed before end-December 2007.

We are committed to transparency, and thus we authorize the IMF to disseminate the MEFP and the associated Technical Memorandum of Understanding, as well as staff report that will be examined by the IMF Executive Board.

Sincerely yours

/s/
Vasile Tarlev
Prime Minister
Government of the Republic of Moldova

/s/
Mihail Pop
Minister
Ministry of Finance

/s/
Leonid Talmaci
Governor
National Bank of Moldova

Attachments: Memorandum of Economic and financial Policies for 2007
Technical Memorandum of Understanding

Memorandum of Economic and Financial Policies for 2007

November 29, 2006

A. Introduction

1. Over the last six years, Moldova's macroeconomic performance was characterized by a sustained output recovery that had a significant impact on poverty reduction. During 2000-2005 real GDP increased by 43 percent, while the rate of absolute poverty decreased by 38.7 percent over the period 2000-2005. Inflation remained modest at the level of 10 percent in 2005, though slightly higher than forecast reflecting a combination of external and internal factors. Furthermore the exchange rate of the national currency remained relatively stable and the National Bank's reserves grew considerably. Robust economic growth and prudent external borrowing allowed the ratio of public and publicly-guaranteed debt to fall from 94.8 percent of GDP in 2000 to about 28.2 percent of GDP in 2005. These accomplishments were possible due to a combination of appropriate monetary and tight fiscal policies, as well as tax reforms aiming at improving tax administration.

2. In 2006 the development of the national economy has been adversely affected by the combination of a number of external developments. These include unfavorable climatic conditions for agricultural output, a prohibition of exports of certain commodities to the Russian Federation combined with difficulties in accessing other export markets, a doubling in the prices for energy resources imported from Russia, and a significant increase in the international prices for energy resources. While consultations are currently underway with the Russian authorities in order to rectify bilateral trade issues, the combined effect of the above-mentioned external shocks has already had an adverse effect on the economy's output and external balance.

3. This Memorandum is a supplement to the Memorandum of Economic and Financial Policies for 2006-2008 and it sets forth the strategic objectives and priorities of the Republic of Moldova for 2007.

B. Recent developments

4. Despite Moldova's successful socio-economic performance over the last few years, the results of the first six months of the current year highlight the fact that a number of the problems noted in paragraph 2 above may be detrimental to Moldova's further growth and development. Over the first six months of 2006 the volume of exports and the volume of industrial output have registered decreases while there has been an acceleration in inflationary pressures.

5. The negative influence of external factors in 2006 has undermined the government's efforts to fully accomplish its economic and welfare objectives. Over the first six months of 2006 Moldova's real GDP growth slowed to 5 percent in comparison to the same period of the previous year. At the same time, at the end of September the rate of inflation (September 2006 over September 2005) reached 14.4 percent. Furthermore the economy's external vulnerability increased during the first half of 2006. The volume of exports

decreased by 7.7 percent, while the volume of imports increased by 15.5 percent, resulting in a growth of the trade deficit of 39.1 percent.

6. In order to maintain macroeconomic and fiscal stability, in July 2006 the Government tightened its fiscal stance by submitting a revised state budget and state social insurance budget for 2006 to the Parliament. The overall effect of these amendments was to reduce the general government budget deficit by Lei 163.8 million, to around 0.5 percent of GDP, compared to 0.8 percent as previously agreed in the program. During the first nine months of the year, the general government registered a surplus of Lei 317 million (0.8 percent of GDP), easily meeting the deficit target for end-September. However, the execution of the state social insurance budget remains a source of concern, as its deficit for 2006 will be higher than originally projected. In order to protect low income population groups and maintain public services the revised budget provided for additional funds to cover the costs of the increase in the tariffs for natural gas.

7. Throughout 2006 the National Bank of Moldova has maintained a floating exchange rate regime and has limited its interventions on the currency market to smooth out excessive fluctuations in the exchange rate of the national currency. During the first three quarters of 2006, the nominal exchange rate of the national currency depreciated against the US dollar and the Euro by 3.6 and 11.2 percent, respectively. In real terms, the leu strengthened by 4.5 percent vs. the dollar, however, owing to inflation that was higher than expected. While the increase in inflation stems primarily from higher energy prices, monetary factors have also played a role. As a result, the National Bank of Moldova has revised its monetary projections with the aim of reducing inflation over the period ahead. Interest rates for government securities and NBM certificates have increased significantly as a result, but remain negative in real terms.

8. To date the Government has accomplished the priority actions set forth in the program. In particular, the following actions which were foreseen to be undertaken by September 30 of this year were accomplished:

- The strategy on developing the tax service was approved, along with a plan for the strategy's implementation.

- Amendments were made to the Regulation of the Ministry of Finance regarding the financial reporting and monitoring of state enterprises and corporations where Government holds more than 51 percent of the outstanding shares. The results of the analysis which was undertaken for 2005 were included in the budget documentation to the budget draft for 2007.

- An action plan was elaborated on transferring the management of the revenues of special funds, special means, state social insurance budget and mandatory medical insurance funds to the Single Treasury Account (STA). The plan specifies the activities to be implemented in 2006 and during 2007.

- In August 2006 the Government submitted the draft law on public debt, state guarantees and state on-lending to the Parliament for examination and approval.

- The Government developed and approved the MTEF for 2007-2009.

- From February to September 2006, the Council of Creditors signed new restructuring agreements for a total amount of Lei 99.96 million.

- The requirement that grain exports must be transacted on the Moldovan Commodity Exchange was eliminated as of September 30, 2006.

- The Law on the National Bank of Moldova was amended and approved by the Parliament. The law clarifies that monetary policy aims at maintaining price stability and strengthens the independence of the National Bank of Moldova.

- In the context of the strategy for reforming the Central Public Administration, the Code of Ethics for public servants was developed and approved by the Government.

- The envisaged amendments to the law on the state enterprise were approved by the Parliament.

- The law on main principles and mechanisms for the regulation of entrepreneurship activity was approved by the Parliament.

- The amendments to the law on insolvency were approved by the Parliament.

C. Program objectives

9. The main objectives of the Government for 2007 remain unchanged, despite the large external shocks we are facing. Our goals are to ensure macroeconomic stability and sustainable economic growth by creating a favorable investment climate, stimulating small and medium enterprises, rehabilitating infrastructure, promoting exports, and creating new employment opportunities while providing a safety net for the vulnerable groups in the population. These objectives are clearly articulated in the Economic Growth and Poverty Reduction Strategy (EGPRSP) that will continue to be implemented in the course of 2007. Furthermore the attainment of these objectives are clearly reflected in the Government's Action Program, and they will facilitate the efficient implementation of the EU-Moldova European Neighbourhood Policy Action Plan, while being conducive to the attainment of Moldova's Millennium Development Goals.

10. We understand that sacrifice will be needed to achieve these goals, given the large external shocks we now confront. Insofar as many of these shocks are expected to have long-lasting effects, we are taking measures to adjust macroeconomic policies appropriately. We are also accelerating growth-enhancing structural reforms to ensure that the Moldovan economy quickly returns to its robust long-run growth path. Additional financing from the international community will facilitate smoothing the social and economic cost of addressing these challenges, but it will not delay our efforts to adjust to the new economic circumstances.

11. The economic difficulties faced by the Republic of Moldova during 2006 have had a negative impact on the living standards of the population, and it is not possible at this stage to predict how large their effect will be or how long they will persist. Hence, the Government and the National Bank remain committed to take further actions if needed in order to mitigate the adverse effects of the current economic difficulties and avoid possible future disturbances in the country's social and economic development.

D. Fiscal policy

12. The fiscal stance for 2007 will remain tight because we understand that macroeconomic stability underpins public confidence in the overall program. We intend to maintain the cash deficit at a level that will not exceed the 2006 limits. In this context, the government will limit expenditures in order to attain a cash deficit for the general government (as agreed in the program and reflected in the Law on the 2007 Budget) of Lei 233 million (0.5 percent of GDP).

13. During 2007, it is envisaged that revenues of the general government will remain above 40 percent of GDP. In the event of shortfalls in donor financing envisaged in the budget for 2007, we will amend the budget to preserve the agreed deficit target and close the balance of payments gap, although doing so may require reductions in priority expenditures—including public investment. If additional funds are forthcoming from external donors, the Government intends to channel those to finance infrastructure projects—which is an area emphasised in the latest Annual Evaluation report of the EGPRSP. The additional capital investment will re-habilitate the economy's capital stock, and will have significant positive externalities for Moldova's growth and development prospects.

14. The accounts payable of the budget system will be maintained at current limits and no further increases will be allowed. As a result of the successful restructuring of the external state debt in 2006 with bilateral creditors through the Paris Club, the Government has committed to commence repayment of external arrears and fully honor its liabilities on rescheduled debt service.

15. One of the major challenges for the Government is decreasing the vulnerability of the Republic of Moldova to shocks resulting from increases in the prices of energy resources. The authorities will ensure that tariffs for natural gas and electricity remain at full cost recovery levels for all categories of consumers, and heating and water supply tariffs are gradually adjusted to full cost recovery levels for all categories of consumers. To this end, by early December, we intend to pass legislation shifting the responsibility for setting heating and water supply tariffs from municipalities to the national energy regulator. If the cost of energy continues to grow, the Government will commit additional budget resources to offset the increases in the costs of operations of public institutions resulting from these increases, as well as protect the vulnerable groups of the population, while preserving the agreed general government deficit target. We are firmly committed to ensure that the poorest members of society are protected against the most severe effects of the energy price increases, including through targeted compensation and lifeline tariffs.

16. In order to improve the financial sustainability of the Social Fund budget the Government will continue the reform in the pension system for farmers by strengthening the link between contributions and benefits. Work will also continue in implementing the individual accounting system of state social insurance contributions by the integration of data regarding contributions in the Social Fund data base. To ensure the financial stability of the social insurance budget, by the end of 2008 the benefits and pensions will be calculated on the basis of the social insurance contributions transferred to the Social Fund budget by the applicant.

E. Monetary and Financial Policies

17. In 2007, National Bank of Moldova will continue to implement a prudent monetary policy in order to maintain price stability and achieve the inflation objective of 10 percent (December-to-December). The program envisages that the monetary base will increase by 9.7 percent over the year to end-December 2007, and that interest rates will become positive in real terms. This objective will be reached by means of regulating the monetary base through changes in indirect instruments of monetary policy, with increased emphasis on repo and reverse repo operations.

18. In 2007, the National Bank of Moldova will continue the maintenance of a floating exchange rate regime and will only intervene on the foreign exchange market in order to reduce the excessive fluctuations of the exchange rate. Our primary monetary policy objective is the maintenance of price stability.

19. We are considering a move to formal inflation targeting framework at some point in the future. Although we understand that Moldova is not yet ready for formal inflation targeting, we are taking steps to improve the framework for monetary policy in the meantime. For example, to assist the attainment of the inflation objective, a joint advisory body—the Committee on Liquidity Management—has been set up comprising representatives of the National Bank of Moldova and the Ministry of Finance. The Committee on Liquidity Management will meet not less than once a month or as needed in order to improve the predictability of monetary policy. In this context, beginning with the 2008 budget, the annual budget law will no longer oblige the NBM to roll over government T-bills; the Committee on Liquidity Management will take up these questions, and the Ministry of Finance and the NBM will conclude a Memorandum of Understanding on the amount of these securities that can be brought to market during the budget year.

20. It is our intention to modernize financial relations between the Ministry of Finance and the National Bank by making them more transparent. Thus, the two institutions are undertaking a series of steps over the coming year or two:

- We have agreed on a service agreement between the two institutions that spells out the fees charged for services provided by the NBM, and also the level of remuneration provided on accounts of the general government for balances on the treasury account in the NBM.

- Insofar as the level of National Bank capital is below the desirable level, by March 31, 2007, we will submit to parliament a draft amendment to the NBM law to establish that capital of the NBM should grow dynamically with the size of the Bank's balance sheet. Specifically, the amendments, which we expect to pass in parliament by September 30, 2007, will establish that the appropriate level of NBM capital is at least 10 percent of monetary liabilities of the NBM.

- To ensure that the level of NBM capital is relatively quickly restored to adequacy, by December 31, 2007, the government will inject at least Lei 250 million in liquid assets (such as direct appropriations from the budget and/or marketable government securities) to NBM capital, though the capital injection will not be counted against the budget deficit ceiling agreed under the program. Moreover, beginning with the 2008 budget, the proportion of the NBM's net income transferred to the state budget will be no more than 50 percent, if the level of capital remains below the target threshold.

- Finally, to ensure that the NBM has adequate financial strength to manage monetary policy in the years ahead, by end-September 2007 the government and the NBM will adopt a plan to securitize the remaining outstanding stock of NBM claims on government, with the expectation that the securitization will take place during the first quarter of 2008.

21. We hope to accelerate development of the nonbank financial sector in Moldova as a means of stimulating growth throughout the country. As a result, by March 31, 2007, we will adopt legislation establishing the National Commission on the Financial Market (NCFM). The NCFM will be financially and operationally independent, and once it has reached full operating capacity, it will acquire the right to issue and withdraw licenses for all the nonbank financial sectors it supervises. As a transitional measure, in the meantime, the law on the NCFM will specify that—in the event of violations of prudential norms—the NCFM will have the right to suspend the licenses of economic agents it supervises, and that this suspension may not be revoked without the NCFM's approval. The new agency will be established by June 30, 2007, and be fully operational no later than September 30, 2008. We have requested an FSAP update, which in part would review our reforms in this area and propose measures to help Moldova comply with best European and international practice.

22. As a first step toward privatizing Banca de Economii (BEM) to a strategic banking investor, by December 31, 2006, we will select one of the foreign companies participating in the tender announced on April 28, 2006, to conduct an independent assessment of the market value of BEM. Although it could take somewhat longer, we hope the evaluation will be completed by September 30, 2007. We intend to solicit the support of international financial institutions to prepare to bring BEM to market shortly after completion of the evaluation. In the meantime, the government and the NBM will continue to refrain from providing preferential treatment to the bank, including as regards taxation, prudential regulation, or access to resources.

F. Structural reforms

23. The external shocks faced by Moldova require that we accelerate our structural reforms in order to return as quickly as possible to rapid economic growth. Thus, in 2007 we

intend to undertake bold measures to improve the functioning of the public sector and enhance the business environment. We will place special attention on measures aimed at promoting exports and diversifying export markets.

Trade policy and investment promotion

24. To improve the investment climate and enhance the capacity of the Republic of Moldova to access external markets, the Government will implement its Strategy of investment attraction and export promotion for 2006-2015. Actions to be undertaken for the promotion of trade in 2007 include: (i) working towards the establishment of an Asymmetric Free Trade Agreement with the EU; (ii) carrying out a detailed study regarding the economic implications of Romania's accession to the EU for Moldova, (iii) establishing accredited laboratories for testing and quality assurance in line with EU standards, beginning with wine and extending to other agricultural products in 2008; and (iv) implementing the reform on granting entrepreneurial permits, including through the development of simplified methods of accounting for small and medium trade units.

25. To ensure the creation of technical infrastructure in line with EU standards, the Government will prepare in 2007 the draft Law on the public-private partnership that will provide a large range of tools and mechanisms of collaboration and interaction between the public and the private sector aiming at funding public investment, including for infrastructure, while ensuring that any contingent liabilities incurred in this process are transparently reported upon to financial markets, as well as to parliament.

26. The development of the small and medium enterprises sector (SME) is one of the core elements that will lead to economic development and poverty reduction in Moldova. To support SMEs, in the course of 2007, we will implement the actions set forth in the Strategy for the development of small and medium enterprises for 2006-2008 which were approved by the government in May 2006 and the provisions of the Law on supporting the small and medium enterprises sector. These clarify the status of SMEs and provide mechanisms for their support by means of the creation of special funds which will be financed by the government as well as donors.

Public administration reform

27. The first stage of the functional review in the context of the central public administration reform has been completed. It covered ministries and key central public administration authorities, and the decision making process in central public administration. The second functional review will be carried out by the end of 2006 and will cover public authorities at the central level that were not included in the first stage, and will extend down to the local levels of central public administration. Based on the results of the functional review the following actions will be taken in 2007: i) finalizing mandates of institutions and authorities subject to their functional review, as well as ii) modifying their regulations in order to re-assign relevant tasks and competencies. To improve the decision making process, a central policy coordination and analysis unit will be created within the government

Apparatus, and after taking into account the experiences of pilot units activities which were set up in 6 ministries, policy assessment, monitoring and analysis units may also be set up in other ministries.

28. The government intends to establish a unit at the central level empowered to improve staff policies and procedures in the field of civil service. During 2007, an automatic information system will be designed, namely the Register of public functions and civil servants. Also, practical guidelines will be developed covering the recruitment, selection and promotion of civil servants based on merit.

Regulatory reform

29. Throughout 2007, the second stage of the regulatory reform will continue. The Government will implement the National Strategy of Regulatory Reform, according to which the system of granting permits for entrepreneurial activity will be streamlined and elements of the "One-stop Shop" procedure will be introduced in the activity of public authorities, including through their electronic interconnection to facilitate the exchange of electronic data. To enhance the degree of transparency in the elaboration of laws and regulatory acts, in 2007 the Regulatory Impact Assessment (RIA) methodology will be applied, which envisages the delegation of these functions to the central public administration authorities.

30. The Government will make efforts to streamline the procedure of businesses closures. In this regard action will be taken to decrease the time and reduce to a minimum the need for businessmen to present certificates and other documents in order to close a business. We will also introduce a "One-stop Shop" procedure for business closure.

Public Finance Management and Tax Administration

31. The Government will continue the process of strengthening public finances by promoting the necessary reforms which are indispensable to reform budget institutions and adjust our legislative framework to EU requirements and standards.

32. In 2007, based on an approved action plan, the Ministry of Finance in cooperation with the National House for Social Insurance and the National Company for Health Insurance, will implement a system which will allow management of the revenues of the state social insurance budget as well as those of the compulsory health insurance funds through the State Treasury, which will ensure the zeroing of balances held with commercial banks. In the preparation of the state budget for 2008, the government intends to continue eliminating special funds.

33. Building on the strategy on developing the tax service developed with IMF assistance, during the first quarter of 2007 the government will establish a high level steering committee to oversee the reform and ensure broad political support. The steering committee will include members from outside the State Tax Inspectorate (STI). At the same time, the STI will establish a modernization task force in its headquarters to manage the reform and work with external donors.

Privatization and management of public property

34. Based on the Law on the management and denationalization of public property that is expected to be adopted by end-December 2006, the Government will prepare a draft list of regulatory acts that will be prepared and implemented in the field of public property management. The government will report to parliament with the draft 2008 budget on the financial performance in 2006 of the public enterprise sector (both 100 percent state-owned enterprises, and joint stock companies with majority state ownership).

35. In order to enhance the procedure of restructuring insolvent enterprises, the Council of Creditors will be liquidated by end-2006, and the responsibility of monitoring tax and non-tax debts will be taken over by the State Tax Inspectorate and the courts at the beginning of 2007.

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36. Moldova is fully committed to implementing the EU-Moldova European Neighborhood Action Plan which was signed in February 2005. The plan covers almost all political, economic and social aspects of Moldova and is in line with EGPRSP objectives. Following the Government decision to extend the term of EGPRSP implementation to end-2007, we remain committed to draft a new version of the EGPRSP for a medium term in 2007 following the envisaged participatory process. Given that the EU-Moldova European Neighborhood Action Plan is also due to be finalized in 2007, we will ensure that the revised documents will be elaborated in parallel so as to ensure consistency and the mutual benefit of both documents. Moreover, and in order to avoid the duplication of efforts, the Government intends to coordinate the implementation, monitoring and assessment of both documents in a consistent manner based on periodic consultations with the European Commission, the World Bank, the IMF and other stakeholders.

Table 1. Proposed Prior Actions, Performance Criteria and Benchmarks
(All conditions agreed in 2006 MEFP retain force)

Prior Actions

Parliamentary passage of law transferring rate setting for heat and water to ANRE. (¶ 15)

Letter to International Finance Corporation of the World Bank requesting assistance in preparing to put the state's share in Banca de Economii on the market following the independent evaluation that the authorities hope will be completed by September 30, 2007. (¶ 22)

Structural Performance Criteria

Continuous

The Government and the NBM will continue to refrain from providing preferential treatment to Banca de Economii (including tax treatment, prudential regulation and access to resources). (¶ 22)

December 31, 2006

Increase of tariffs for heat and water to at least 55 percent of the cost-recovery level, with an increase in compensation to poor households to reduce effect on them. (¶ 15)

March 31, 2007

Submission to parliament of draft law setting the required level of NBM capital at 10 percent of monetary liabilities of the Bank and increasing the potential share of net income retained by the NBM to 50 percent, if the level of capital remains below the target threshold. (¶ 20)

Structural Benchmarks

Continuous

Tariffs for consumption of natural gas and electricity to remain at cost-recovery levels. (¶ 15)

December 31, 2006

Adoption of service agreement modernizing financial relations between Ministry of Finance and National Bank. (¶ 20)

March 31, 2007

Parliamentary passage of law on NCFM establishing that, until the NCFM is fully operational, the NCFM has the right to suspend licenses of nonbank financial institutions it supervises on grounds of violation of prudential norms, and that the suspension of these licenses cannot be revoked unless NCFM agrees that prudential regulations are being met. (¶ 21)

June 30, 2007

NCFM established and sufficiently operational to supervise the nonbank financial sector, including suspension of licenses for violation of prudential norms. (¶ 21)

September 30, 2007

Parliamentary passage of law setting the required level of NBM capital at 10 percent of monetary liabilities of the Bank, and increasing the potential share of net income retained by the NBM to 50 percent . (¶ 20)

Draft 2008 budget to be prepared on assumption that the proportion of NBM net income transferred to the state budget will be no more than 50 percent, if the level of capital remains below the target threshold. (¶ 20)

Increase of tariffs for heat and water to at least 70 percent of the cost-recovery level, with further increase in compensation to poor households to reduce effect on them. (¶ 15)

Government and the NBM to adopt a plan to securitize the remaining outstanding stock of NBM claims on government. (¶ 20)

December 31, 2007

Government to inject at least Lei 250 million in liquid assets (such as direct appropriations from the budget and/or marketable government securities) to NBM capital. (¶ 20)

Transfer of balances on accounts of Social Fund and Health Fund to Single Treasury Account in NBM, with only daily zero-balance operations remaining in commercial banks. (¶ 32)

TECHNICAL MEMORANDUM OF UNDERSTANDING[15]

1. This Technical Memorandum of understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative benchmarks as shown in Table 1), 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.

V. PROGRAM ASSUMPTIONS

2007

2. Loan disbursements of $58 million.

3. Receipts to the state government budget of privatization proceeds in the amount of MDL 155 million in 2007.

4. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at the program exchange rate. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at MDL 13.2911/$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates prevailing at end-September 2006 (USD/€ = 1.2660, USD/£= 1.8702, SDR/USD = 0,6773).

5. To calculate the adjustments for disbursements from external sources exceeding the programmed amounts, the actual exchange rate at the time of the disbursement will be used. To calculate the adjustments for shortfalls of disbursement, the assumed exchange rate in the program for that disbursement will be used.

VI. REPORTING REQUIREMENTS

6. Macroeconomic data necessary to assess performance criteria and indicative benchmarks to measure performance will be provided to Fund staff with including, but not limited to data as specified in Table 2. The authorities will transmit promptly to Fund staff any data revisions.

[15] This Technical Memorandum of Understanding applies only to quantitative targets set for 2007. For 2006, the previous TMU, which was part of the PRGF program approved by the IMF Executive Board in May 2006, remains binding.

VII. Program Targets and Definitions

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves
December 31, 2006	7.380 (indicative target)
March 31, 2007	7,737 (performance criterion)
June 30, 2007	7,967 (indicative target)
September 30, 2007	8,207 (indicative target)
December 31, 2007	8,789 (indicative target)

7. **Net international reserves of the NBM** in convertible currencies are defined as gross reserves 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 and controlled by the NBM, including holdings of securities denominated in convertible currencies that are freely usable for settlement of international transactions, calculated using program assumptions on bilateral exchange rates. Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term non-financial assets, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, assets in nonconvertible currencies, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options). Reserve liabilities in convertible currencies are defined as use of Fund credit, and convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year. Excluded from reserve liabilities are liabilities with original maturities longer than one year.

Ceilings on Reserve Money and the Net Domestic Assets (NDA)
of the NBM

(In millions of lei)

Position on	Maximum level NDA	Maximum level Reserve Money (Indicative target)
December 31, 2006	-768 (indicative target)	6,612
March 31, 2007	-997 (performance criterion)	6,740

June 30, 2007	-1,081 (indicative target)	6,886
September 30, 2007	-1,174 (indicative target)	7,033
December 31, 2007	-1,535 (indicative target)	7,255

8. **Reserve money** is defined as currency in circulation (outside banks), vault cash of banks, total required reserves, and balances on correspondent accounts of banks in the NBM in lei.

9. **Net domestic assets of the NBM** are defined as the difference between reserve money (defined in paragraph 8) and net foreign assets of the NBM.

10. **Net foreign assets of the NBM** are defined as gross reserves in convertible currencies (defined in paragraph 7) plus foreign assets in nonconvertible currencies, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets, and net other foreign assets, minus foreign exchange liabilities of the NBM to nonresidents.

Floor on the Overall Cash Balance of the General Government
(In millions of lei)

	Cash balance
Cumulative change from December 31, 2005	
December 31, 2006 (indicative target)	-210
Cumulative change from December 31, 2006	
March 31, 2007 (performance criterion)	-144
June 30, 2007 (indicative target)	-248
September 30, 2007 (indicative target)	-238
December 31, 2007 (indicative target)	-233

11. The **general government** is defined as comprising the central and local government budgets. The central government includes also the Social Insurance Fund, the Health Insurance Fund, special and extrabudgetary funds, and foreign-financed investment projects. The local government includes also special and extrabudgetary funds. The authorities will inform the Fund staff of any new special or extrabudgetary funds that may be created during the program period to carry out operations of a fiscal nature and will ensure that these will be included in the general government. Excluded are any government-owned entities with a separate legal status. Net credit of the banking system to 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 investment projects).[16] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed investment projects.

12. The **quarterly limits on the overall cash deficit of the general government** are cumulative and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government (excluding the change in the stock of government securities issued to recapitalize the central bank), the general government's net placement of securities outside the domestic 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[17] for direct budgetary support and for specific projects minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets, after deduction of the costs directly associated with the sale of these assets.

13. **Government securities** in the form of zero-coupon obligations sold at a discount to face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. At the time of redemption, the sales value will be recorded as amortization, and the difference between amortization so defined and the face value will be recorded as domestic interest payments.

14. **External-debt limits** apply to (i) the contracting or guaranteeing of short-term non-concessional external debt (with an original maturity of up to and including one year) and (ii) contracting or guaranteeing of non-concessional medium- and long-term debt with original maturities of more than one year. Short-term debt includes all short term obligations, excluding import trade credits. Short-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at the exchange rate prevailing at the time of disbursement. Medium- and long-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at actual cross-exchange rates.

15. The term **debt** has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000).[18] This performance criterion applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received.

[16] 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, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801, 2802 and 2811.

[17] Debt is defined as in footnote 3 in the section on limits on external debt.

[18] Debt is defined as 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. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual

(continued)

16. For purpose of the program, the **guarantee** of a debt arises from any explicit legal obligation of the government or the NBM or any other agency acting on behalf of the government to service such a debt in the event of nonpayment by the recipient.

17. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs). The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. Under this definition, only loans with a grant element equivalent to 35 percent or more will be excluded from the borrowing limits. The debt limits will not apply to loans classified as international reserve liabilities of the NBM.

18. For the purposes of the program, external payments arrears will consist of all overdue debt-service obligations (i.e. payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the government of the Republic of Moldova, or the NBM, or any agency acting on behalf of the government of the Republic of Moldova. 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.

19. Expenditure arrears are defined as the difference between payment obligations due, and actual payments made. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Expenditure arrears for goods and services to suppliers are defined as obligations to suppliers, which are due but not paid for more than 30 days and are non-disputed. Arrears between the state budget, local government, social and health funds, and all extrabudgetary funds are not counted towards the expenditure arrears' ceiling on the general government.

VIII. ADJUSTERS

20. In the event that state government privatization receipts exceed the program assumptions, this will trigger consultations with Fund staff to agree on their use.

21. In case disbursements of external loans exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding

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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.

magnitude up to a cumulative cap of lei 146 million. In case of shortfalls, the limits will be decreased by the full amount.

22. The limits on the overall cash deficit of the general government will be increased by the amount of paid in cash for recapitalization of the NBM or by the face value of government securities issued for the same purpose.

Table 1. Moldova: Quantitative Performance Criteria and Indicative Targets, March 31, 2006 – December 31, 2006 1/

	31-Dec-05	31-Mar-06		30-Jun-06		30-Sep-06		31-Dec-06		
	Actual 2/	Indicative targets	Actual	Indicative targets	Actual	Performance criteria	Actual	Prog	Indicative targets Proj 3/	Proj 4/
1. Quantitative performance criteria										
				(In millions of lei)						
Floor for general government fiscal balance 5/	634	-247	...	-417	...	-303	...	-350	-210	*-210*
Adjusted floor for general government fiscal balance		*-217*	*162*	*-361*	*-66*	*-201*	*317*	*-243*	...	...
Ceiling on net domestic assets of the NBM (level)	569	60	-469	55	-271	-477	-652	-150	-453	-768
Floor on net international reserves of the NBM (level)	6,436	6,410	6,432	6,791	6,609	7,866	6,845	8,276	7,113	7,380
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	...	0	0	0	0	0	0	0	0	0
2. Continuous performance criteria										
Ceiling on accumulation of external payment arrears	...	...	0	0	0	0	0	0	0	0
				(In millions of lei)						
3. Indicative targets										
Ceiling on reserve money (level)	7,003	6,470	5,978	6,846	6,340	7,390	6,204	8,126	6,612	6,612
Ceiling on change in domestic expenditure arrears of the general government	...	0	0	0	0	0	0	0	0	0
				(In millions of lei, unless noted otherwise)						
4. Baseline assumptions										
Concessional external debt financing	327	130	100	231	175	362	259	494	387	387
in millions of dollars	...	10	8	18	14	28	20	39	29	29
Privatization receipts	176	9	-4	30	5	50	21	68	28	28

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2006 refer to cumulative flows from end-2005, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 12.832/US$ for March - September 2006, and on the exchange rate of MDL 13.2911/US$ afterwords.

2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ Based on old program exchange rates.

4/ Based on new program exchange rates.

5/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 125 million. In the case of shortfalls, the limits will be decreased by the full amount.

Table 1a. Moldova: Proposed Quantitative Performance Criteria and Indicative Targets, Dec 31, 2006 –December 31, 2007 1/

	31-Dec-06 Indicative targets 2/ Proj	31-Mar-07 Performance criteria	30-Jun-07 Indicative targets	30-Sep-07 Indicative targets	31-Dec-07 Indicative targets
1. Quantitative performance criteria					
			(In millions of lei)		
Floor for general government fiscal balance 3/	-210	-144	-248	-238	-233
Ceiling on net domestic assets of the NBM (level)	-768	-997	-1,081	-1,174	-1,535
Floor on net international reserves of the NBM (level)	7,380	7,737	7,967	8,207	8,789
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	0	0	0	0	0
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears	0	0	0	0	0
			(In millions of lei)		
3. Indicative targets					
Ceiling on reserve money (level)	6,612	6,740	6,886	7,033	7,255
Ceiling on change in domestic expenditure arrears of the general government	0	0	0	0	0
			(In millions of lei, unless noted otherwise)		
4. Baseline assumptions					
Concessional external debt financing	387	184	319	472	703
in millions of dollars	29	14	24	35	53
Privatization receipts	28	0	40	80	155

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2007 refer to cumulative flows from end-2006, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 13.2911/US$.

2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 146million. In the case of shortfalls, the limits will be decreased by the full amount.

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

Item	Periodicity
Fiscal data (to be provided by the MoF)	
General budget operations for revenues, expenditure and financing (functional and economic).	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
Privatization receipts received by the budget (in lei and foreign exchange, net of divestiture transactions costs).	Monthly within three weeks of the end of each month
Monetary data (to be provided by the NBM)	
Monetary survey of the NBM	Weekly within one week of the end of each week
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 indicators of commercial banks (from NBM's Banking Supervision)	Monthly within four weeks of the end of each month
Foreign exchange cash flows	Monthly, within two weeks of the end of each month
Foreign exchange operations (NBM data)	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)	
Current and capital account data.	Quarterly within six weeks of the end of each quarter
Transfers/remittances through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF)	
Information on all new external loans contracted by the government or government guarantee.	Monthly within three weeks of the end of each month
Total debt service due by creditor, and debt service paid.	Monthly within three weeks of the end of each month

Disbursements of grants and loans by creditor	Monthly, within three weeks of the end of each month
Item	**Periodicity**
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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criterion and Augmentation of Access

Supplementary Information

Prepared by the European Department
(In consultation with other departments)

Approved by Juha Kähkönen and Anthony R. Boote

December 13, 2006

1. **This supplement reviews developments in Moldova since the preparation of the staff report**. The additional information does not change the thrust of the staff appraisal.

2. **Recent economic developments have broadly been favorable**. Fiscal revenue has continued to exceed expectations, which will allow the government to strengthen the capital position of the NBM through a Lei 250 million injection in December.[1] Net of this operation—which is equivalent to about 0.6 percent of GDP— for 2006 as a whole the budget is expected to post a small surplus (about 0.2 percent of GDP). Foreign exchange inflows have exceeded expectations somewhat, and the leu has appreciated slightly. Nevertheless, at over 14 percent, 12-month inflation continues to be somewhat above expectations. As indicated in the staff report (¶19), interest rates on NBM instruments have been positive in real terms since early December.

3. **Some progress has been made in efforts to unblock imports of Moldovan wine to Russia**. An agreement was reportedly struck in late November between Russian President Putin and Moldovan President Voronin. Details remain unclear, though it is thought that Moldovan wine would enter Russia at only one customs post, and be subject to special quality assurance procedures.[2]

4. **While the reported agreement is surely good news, its impact on the Moldovan economy remains uncertain**. Even if the export mechanism is quickly established and proves efficient, lingering reputational effects will diminish Moldova's market share, and competition on the Russian market—where other suppliers have established a foothold—is now much stiffer. Staff projections had assumed the wine ban to have long-lasting effects,

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[1] The injection will achieve a program condition for end-2007 one year early (MEFP¶20).

[2] The Moldovans have established a laboratory to certify wine quality, and as of January 1, 2007, they will ban exports of wine in bulk, which were substantial, to prevent it from being blended with unsafe products abroad.

and these projections continue to seem broadly appropriate at this stage. In particular, staff still expects that wine exports to Russia in 2007 will increase by 30 percent over 2006 levels, but still be only 1/3 of the 2005 level.

5. **Prior actions for the First Review have been completed**. The authorities wrote to the IFC on December 4 to request assistance in privatizing Banca de Economii, and on December 12 parliament passed a law obliging that consumer tariffs for heat and water be set according to the methodology established by the independent energy regulator ANRE.

6. **Bilateral agreements have been reached with all five Paris Club creditors**. Under the terms of the May 12 Paris Club agreement, these negotiations were to be concluded by end-November. The last of these negotiations was concluded on November 27, and the Moldovan authorities made the first scheduled payment on November 1 to repay arrears to Paris Club creditors as per the agreement.

7. **Donors' financing assurances were confirmed at the December 12 Consultative Group meeting in Brussels**. Specific commitments made for 2007 totaled $51 million, slightly more than the $47 million needed to close next year's projected balance of payments gap. Overall, donors indicated financial support for Moldova totaling more than $1.2 billion over the next three years, of which about one quarter would be in the form of budgetary and balance of payments support.[3] Donors welcomed the progress made by Moldova in a number of areas, while also urging stepped-up action to improve the business environment and reduce government involvement in the economy.

[3] The press release at the conclusion of the donors' meeting is available at www.imf.md. See also the December 4, 2006, European Commission progress report on Moldova's performance under the European Neighborhood Policy at http://ec.europa.eu/world/enp/documents_en.htm#4.

Press Release No. 06/280
FOR IMMEDIATE RELEASE
December 15, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under PRGF Arrangement for Moldova and Approves Augmentation of Access and US$48.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of the economic reform and poverty reduction program of the Republic of Moldova under the Poverty Reduction and Growth Facility (PRGF) arrangement. The Executive Board also approved the augmentation of the three-year PRGF arrangement to a total amount equivalent to SDR 110.88 million (about US$167 million) from the original amount equivalent to SDR 80.08 million (about US$120.6 million). Completion of the review makes available a disbursement of an amount equivalent to SDR 31.97 million (about US$48.2 million) to Moldova.

The Executive Board also granted a waiver for the non-observance of the end-September 2006 quantitative performance criterion on net international reserves of the National Bank of Moldova.

The three-year PRGF arrangement was approved on May 5, 2006 (see Press release No. 06/91). So far, SDR 11.44 million (about US$17.2 million) has been disbursed.

Following the conclusion of the Executive Board discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Moldova's performance during the first six months of its PRGF-supported program has been encouraging, despite sharp increases in natural gas import prices and disruptions in wine exports to traditional markets, which have slowed growth, fueled inflation, and posed risks to the banking system. The authorities are to be commended for maintaining macroeconomic stability and strong momentum for needed reforms in the face of these external shocks.

"The authorities have already made commendable efforts to quickly adjust to the new external environment. They have passed through higher energy prices to consumers while seeking ways to compensate the poor. Prudent fiscal policy is helping to tame inflation while preserving social and infrastructure spending. A more consistent stance of monetary policy will be crucial to ease inflationary pressures. Continued exchange rate flexibility, complemented by measures to reduce administrative barriers and strengthen governance, will help enhance competitiveness. Good progress has been achieved in regulatory and public administration reforms. Elimination of the Council of Creditors and restrictions on grain exports are particularly welcome steps.

"The authorities' economic program for 2007 is designed to further mitigate the impact of external shocks on growth and poverty, and to bring inflation down to single digits. The fiscal deficit of ½ percent of GDP, programmed for 2007, strikes an appropriate balance between Moldova's development needs and disinflation objective. The National Bank of Moldova (NBM) intends to make more effective use of its monetary policy instruments to bring short-term real interest rates back into positive territory, thus curbing inflation expectations. The independence of the NBM will be further enhanced by strengthening its capital position.

"The structural reform agenda for 2007 will continue to focus on improving the business climate and promoting private sector-led growth. Public administration and regulatory reforms will clarify and reduce the role of the state in the economy. This will be coupled with the accelerated privatization process and more effective bankruptcy procedures. The financial sector will be strengthened by improving transparency and competition, including through the increased presence of foreign capital in the Moldovan banking sector, and the establishment of a consolidated supervisory body for non-bank financial institutions," Mr. Kato said.

Statement by Jeroen Kremers, Executive Director for Republic of Moldova and Vladimir Munteanu, Advisor to Executive Director
December 15, 2006

On behalf of the Moldovan authorities, we thank staff for the productive discussions since the program approval last May, and the resulting comprehensive set of papers and appraisal. The authorities attach great value to the close relationship with the Fund, whose advice continues to support the policy formation process in Moldova, in particular in light of the recent severe external shocks. Given the implementation of end-September program targets, the authorities request the completion of the first review, a waiver of the NIR performance criterion, and, in light of the large external shocks experienced since program approval, an augmentation of access.

Recent developments

Since the last Board discussion Moldova's economic development has continued its positive trend, building on the achievements of six consecutive years of strong growth and progressing from a decade of economic decline and rising poverty to sustained economic development and improving living standards[1]. Real GDP growth slowed down but still reached 5 percent in the first six months of 2006 in comparison with the same period of the previous year. Fiscal and monetary policies aimed at containing inflation, helped to achieve budget overperformance. The prudent fiscal stance in combination with careful debt management helped to maintain the substantial improvement in Moldova's debt sustainability, which has also been underpinned by last May's Paris Club agreement to reschedule Moldova's bilateral debt at Houston terms.

Advancing structural reforms, improving the business climate, enhancing institutional capacity and deepening the democratic process in line with the EU-Moldova Action Plan, remain on the top of the authorities' agenda. The progress in this regard has been evidenced by the fast growing number of SMEs, the steady - albeit still low compared to other countries in the region - increase in FDI, satisfactory implementation of the EU-Moldova Action Plan, Moldova's qualification for the Threshold Plan for participation in the US government's "Millennium Challenge Account" program, as well as the continued improvement in the country's Corruption Perception Index (CPI).

The positive momentum in the country's development, however, has been challenged by two serious external shocks: higher energy prices, including a two-fold increase in the price for natural gas in the first six months of the year, and the ban on Moldovan wine exports to Russia (which account for about 10 percent of GDP). This has led to a slowdown in economic growth and placed pressure on the government's efforts to meet its economic and social objectives. Subsequently, the authorities have revised the GDP growth projections for 2006 down to 4 percent from 6 percent initially envisaged in the program. This growth

[1] During 2000-2005 real GDP increased by about 43 percent, and the absolute poverty rate fell from over 70 percent in 1999 to 29 percent in 2005.

projection is somewhat higher than staff's estimate of 3 present in 2006, but the authorities remain confident that a 4 percent growth is achievable.

Higher energy prices in combination with a deterioration in terms-of-trade have contributed to a spike in inflation. End-September headline inflation (y-o-y) reached 14.4 percent, and put additional pressure on public finances and the exchange rate[2]. The shocks have also led to a further deterioration of Moldova's external position. The volume of exports has decreased by 7.7 percent, while the volume of imports increased by 15.5 percent, resulting in spite of buoyant remittances, in a current account deficit of about 10 percent of GDP. The overall impact of the shocks on the balance of payments during 2006-2007 is estimated at about 15 percent of GDP for the two years combined. In addition, the combined impact of the shocks has resulted in tighter conditions on the foreign exchange market, impeding the central bank's ability to meet the international reserves target. The proposed increased access under the PRGF and additional donor support will help to both boost reserves and fill the resulting financing gap.

In light of the shocks, the authorities are fully aware that to maintain hard-won macroeconomic stability, bold adjustment measures are needed. In this regard, they moved decisively to tightening the monetary and fiscal stance, while passing on to final consumers the increase in energy prices. Also, tariffs for heat and water will be gradually raised to cost-recovery level, while compensation to poor households will be further increased. These are difficult measures, in particular given Moldova's still high level of poverty and imperfect system for targeted compensations to the poor. Nevertheless, the authorities remain firmly committed to stay the course of adjustment and increase its capacity to ensure an efficient compensation scheme. Looking forward, along with the need to enhance the economy's resilience to further increases in energy prices, improving Moldova's attractiveness to foreign investments, diversifying the export base and export markets, as well as moving up the value added chain and increasing productivity remain key challenges.

Fiscal policy

Despite the adverse impact of the shocks, fiscal policy has continued to perform well, with revenues achieving an overperformance of about 1.5 percent of GDP vis-à-vis the program target, in large part due to improved tax administration and compliance. In the same context, the authorities attribute the increase in VAT collection on imports in part to enhanced control over the border segment between Transnistria and Ukraine, which was possible with the support from the EU. The authorities would have preferred to use these resources for public investment, in line with their Economic Growth and Poverty Reduction Strategy (EGPRSP), which has not been fully funded in recent years. However, only a part of the excess revenues has been allocated to this purpose, whereas the remainder will be used to compensate households for higher energy prices, and to reduce the budget deficit from the originally programmed 0.8 percent of GDP to 0.5 percent.

[2] The downward pressure on the exchange rate was more pronounced in the second quarter, but gradually subdued and reversed later.

The authorities acknowledge the importance of fiscal policy in maintaining overall macroeconomic stability, and remain committed to a prudent fiscal stance in 2007 and beyond. As a result of the shocks, the authorities anticipate a reduction in revenues, in particular in corporate profit tax, as well as an increase in the general government's energy bill. These constraints call for additional corrective measures, and the authorities intend to do this within the budget framework agreed under the program, maintaining the budget deficit at 0.5 percent of GDP. To this effect, they will scale back the increase in public sector wages envisaged for 2007. In addition, the parliament has amended a set of laws that will allow the authorities to ensure that heating and water supply tariffs are gradually adjusted to full cost-recovery levels.

At the same time, in the event of shortfalls in the budget for 2007, they stand ready to amend the budget to preserve the agreed deficit target, although it may require reductions in priority expenditures. In the same vein, if additional external funds become available, the government intends to channel those to finance infrastructure projects.

Looking forward, the authorities will continue to improve the efficiency of the tax administration system. With technical assistance from the Fund and bilateral donors, a comprehensive tax administration reform strategy was prepared in line with the EU-Moldova Action Plan requirements. Furthermore, the authorities remain committed to build on the progress made in the budget formation process by further improving the medium-term expenditure framework.

Monetary policy

Containing inflationary pressures, fueled by strong remittances[3] and increasing energy prices, has remained the main challenge facing the National Bank of Moldova (NBM) during 2006. A weak transmission mechanism as a result of high dollarization challenged the NBM's efforts to subdue inflation. In light of these developments, the central bank has considerably tightened its monetary policy, bringing the reserve money growth from 20 percent at the end of 2005 down to about 6.5 percent at the end of September, and aims at a nominal contraction of reserve money by about 6 percent by the end of the year. To strengthen its anti-inflationary efforts, the central bank has raised the base interest rate on several occasions, including three consecutive hikes during September-December to 14.5 percent, the highest level since October 2001.

In 2007, the NBM will continue to implement a prudent monetary policy maintaining price stability as its key objective, with the aim to reduce inflation to 10 percent (December-to-December). Interest rates will become positive in real terms. To achieve these goals, the emphasis on indirect monetary policy instruments will be increased, while continuing to maintain a floating exchange rate regime and limiting interventions on the foreign exchange market only in order to reduce excessive fluctuations. Greater exchange rate flexibility will also enhance the economy's ability to absorb external shocks.

[3] Remittances from Moldovans working abroad are estimated at about 30 percent of GDP.

The central bank's efforts to rein in inflation will be supported by improved coordination between monetary and fiscal policy, resulting from the creation of the Committee on Liquidity Management which comprises representatives of the National Bank of Moldova and the Ministry of Finance. Considering a move to a formal inflation targeting framework at some point in the future, the authorities are taking steps aimed at improving the framework for monetary policy with assistance from the Fund. Also, a series of steps has been undertaken in order to modernize and make more transparent financial relations between the Ministry of Finance and the National Bank.

Safeguarding the NBM's independence and strengthening its financial soundness remain key. With this in mind, the Parliament has approved, on December 7, 2006, the amendments to the Law on the National Bank of Moldova, which establish that the bank's capital should be maintained at 10 percent of its monetary liabilities, and grow dynamically with the size of its balance sheet (a March 31, 2007 Structural Performance Criterion). Moreover, it is expected that by the end of the year the government will inject Lei 250 million in liquid assets to NBM capital (a December 31, 2007 Structural Benchmark). Last but not least, to ensure the NBM's financial strength to manage monetary policy, the authorities will adopt a plan to securitize the remaining outstanding stock of NBM claims on government.

Financial sector

The financial sector remains generally sound, with strong capital adequacy and liquidity ratios, and robust profitability. The available evidence suggests that the banking system is resilient against the adverse impact of the wine ban. At the same time, the authorities concur with staff that a lack of competition and the resulting weak financial intermediation have been key bottlenecks to growth. In this regard, the authorities welcome the arrival of foreign banks in Moldova, and are confident that this will translate into improved competition and deeper financial intermediation. Privatization of Banca de Economii to a strategic banking investor will further foster this process.

While the banking sector has developed, the non-bank financial market is lagging behind. In this regard, the authorities have initiated, with assistance from the Netherlands and the Fund, the creation of a consolidated supervisor for the nonbank financial institutions. The new supervisory authority (National Commission on the Financial Market (NCFM)) will be operationally independent and firmly committed to preserving financial system stability, as well as financial sector development. It is also expected that it will remedy a number of weaknesses in the supervision of NBFIs that were identified by the previous FSAP.

Structural reforms

The authorities acknowledge that in order to surmount the current challenges and to ensure that Moldova returns to rapid economic growth, acceleration in the pace of implementation of structural reforms is critical. With this in mind, the government intends to undertake far-reaching measures to improve the functioning of the public sector and enhance the business environment. In the same spirit, special attention will be placed on measures aimed at broadening the export base and diversifying Moldova's export markets.

The development of SMEs is one of the core elements that will lead to economic development and poverty reduction in Moldova. In this regard, an action plan for 2006-2008 was adopted last May. In a broader context, the country's economic development will be supported by the ongoing ambitious regulatory reform, which is implemented hand in hand with the public administration reform. The latter aims at improving efficiency of the public sector and addressing red tape and corruption. Furthermore, the government will move ahead with the implementation of its strategy of investment attraction and export promotion. In this context, the authorities are working towards the conclusion of the Asymmetric Free Trade Agreement with the EU, while establishing accredited laboratories for testing and quality assurance of agricultural products, including wine, in line with EU standards.

To ensure technical infrastructure in line with EU standards, the government will prepare a draft of the Law on public-private partnership in 2007. This law will provide a large range of tools and mechanisms for collaboration and interaction between the public and the private sectors, which aim at funding public investment, including for infrastructure.