International Monetary Fund

Republic of Moldova
and the IMF

Press Release:
IMF Executive Board Approves US$574 million ECF/EFF Arrangements for Moldova
January 29, 2010

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

Republic of Moldova: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

January 14, 2010

Chişinău, January 14, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Mr. Strauss-Kahn:

The attached Memorandum of Economic and Financial Policies (MEFP) lays out the economic objectives, policies, and measures of the Government of Moldova for 2010–12. These objectives and policies are consistent with our Economic Stabilization and Recovery Plan, our engagements with the European Union, and our National Development Strategy. Based on our balance of payments needs and the policies described in the MEFP we request the approval of a blend of two three-year Fund arrangements—the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF)—in the amount of the equivalent of SDR 369,600 million (300 percent of quota) in total for the period January 2010 through January 2013.

The overarching objective of the Government and the National Bank of Moldova is to improve the well-being of the population by promoting sustainable growth and reducing poverty. To this end, the policies set forth in the attached memorandum aim at ensuring macroeconomic stability, growth recovery, and financial sector development, improving the business environment, including through reduction of the footprint of the state in the economy, and strengthening the social safety net. In addition, in consultation with the IMF, we will take additional measures that may become appropriate for reaching these objectives.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. The Moldovan authorities will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with the information it requests for monitoring progress during program implementation. We will also consult the Fund on our economic policies after the expiration of the arrangement, in line with Fund policies on such consultations, while we have outstanding purchases in the upper credit tranches.

Sincerely yours,

/s/
Vladimir Filat
Prime Minister
Government of the Republic of Moldova

/s/
Valeriu Lazăr
Deputy Prime Minister
Minister of Economy

/s/
Veaceslav Negruţa
Minister
Ministry of Finance

/s/
Dorin Drăguţanu
Governor
National Bank of Moldova

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

ATTACHMENT II: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2010–12

January 14, 2010

I. BACKGROUND

1. **During 2006-2008, Moldova's economy grew strongly, but showed signs of overheating.** Growth averaged about 5 percent, and reached nearly 8 percent in 2008, boosted in part by remittances and foreign investment. The strong domestic demand, however, kept inflation in double digits during most of this period, and the current account deficit reached 17–18 percent of GDP. While fiscal policy maintained a small budget deficit and kept public debt low within the framework of an economic program supported by a PRGF arrangement with the IMF, it did not build up sufficient fiscal buffers against growing macroeconomic imbalances.

2. **The global economic crisis led to a sharp rebalancing of the economy, putting considerable strains on society.** In the first half of 2009, weak demand in trading partners led to a severe downturn in exports and worker remittances. The balance of payments moved from a surplus of US$144 million to a deficit of US$556 million over the same period as foreign direct investment and other capital inflows fell dramatically. While GDP dropped by 7.8 percent, domestic demand declined even faster, and the current account contracted to 11.2 percent of GDP. Alongside, deflation pressures have emerged, with the 12-month inflation registering -0.7 percent in November. The poverty level and unemployment rose significantly.

3. **The crisis and pre-election spending hikes resulted in a large fiscal gap.** Over the first nine months, public revenue dropped over 10 percent relative to 2008 due mainly to a drop in VAT receipts, nontax revenue, and foreign trade taxes. At the same time, current fiscal expenditure increased by over 13 percent, driven by large increases in wage and pension commitments well above available budget resources in the run-up to the April elections. The fiscal deficit increased from 1 percent of GDP in 2008 to about 6 percent of GDP in January-September 2009, financed mainly by a drawdown of previously accumulated balances in budget accounts and heavy domestic borrowing.

4. **Facing sustained depreciation pressures, the NBM sold about a third of its international reserves defending the leu in early 2009.** The sales (over US$500 million) also led to sharp withdrawal of liquidity, thereby tightening monetary conditions despite falling inflation. Moreover, despite some 8 percent depreciation in January-April, the exchange rate strengthened vis-à-vis trading partners, negatively affecting the competitiveness of Moldova's exports. Since May the foreign exchange market stabilized and the NBM replenished a fraction of its foreign reserves (about US$290 million), cut its base rate from 11 to 5 percent and lowered reserve requirements from 17½ to 8 percent, bringing commercial banks lending rates down. Nonetheless, at 17–20 percent the lending

rates remain very high in real terms, contributing—together with the depressed economic conditions—to a sharp drop in demand for credit. The supply of credit has also tightened, as banks seem to prefer to channel the released liquidity into T-bills.

5. **While the financial system remains stable, the recession has taken its toll on credit quality, and one bank has been closed.** The decline in credit and capital increases in various banks have brought the average risk-weighted capital adequacy ratio of the system to 32.7 percent in November 2009, well above the required minimum of 12 percent. Liquidity remains abundant as well. Stress tests conducted by the NBM confirm that most banks' portfolios are robust to various risks. However, the share of nonperforming loans in total loans increased by over 10 percentage points from the beginning of the year, amounting to 16.6 percent in November 2009, and one medium-size bank (Investprivatbank) became insolvent in June. The insolvency of Investprivatbank resulted from a number of factors, including high portfolio concentration in recession-hit sectors and a number of risk management irregularities not reported to the NBM. Although individual depositors were paid in full, the bank has yet to be resolved pending the results of the valuation of its portfolio and tangible assets.

6. **The NBM has responded by stepping up supervision and regulation.** Banks have been requested to undergo a diagnostic study performed by an independent reputable audit firm to assess the quality of their assets and review their risk management methods. The NBM has also initiated close and enhanced monitoring of bank activity on the basis of monthly bank reports on financial soundness indicators and stress tests. To reduce the risk related to banks' large exposures and exposures to related parties, the NBM amended the respective regulations, reducing the limit of net exposures related to any person or a group of persons from 25 to 15 percent of capital, and the gross exposure related to any affiliated person or a group of affiliated persons from 20 to 10 percent of capital. It has also advised banks to: (i) increase the level of transparency of the ownership structure of banks; (ii) put in place well-defined liquidity management policies; and (iii) undertake stress tests to identify potential vulnerabilities.

7. **The impact of the crisis was exacerbated by delays in implementation of market-oriented reforms and properly targeted social safety nets for the poor.** A number of sectors of the national economy were excessively regulated with high barriers to entry and low competition. Consequently, domestic prices vastly exceeded international prices on many consumer products. Utility tariffs generally remained well below cost-recovery levels, leading to substantial arrears and underinvestment in these sectors. The introduction of the targeted social assistance system was delayed, posing undue hardship to many vulnerable groups while the budget allocation for the existing "nominal" (category-based) compensation social assistance scheme was exhausted by mid-2009.

8. **In response to the economic crisis, we have launched an Economic Stabilization and Recovery Plan,** which puts forward strong measures intended to help enterprises and

households overcome the economic crisis. The plan's measures, a large part of which are included in this Memorandum, aim to stabilize public finances, restart economic growth, and protect vulnerable households. We have already implemented some first steps, aimed at promoting a market-based economy and improving the business climate to build a sustainable foundation for strong economic growth:

- **To create a modern European public administration, a series of reforms have been launched to streamline and enhance the efficiency of the civil service.** Several agencies and ministries have been closed, consolidated in existing structures, or reorganized to enhance the capacity to provide high-quality service delivery while minimizing the burden imposed on the private sector.

- **To provide a boost to trade and promote competition, we have removed many formal and informal export and import restrictions.** Specifically, we removed restrictions on wine, grapes, and grain exports that account for a sizable part of our exports. We have also abolished mandatory certification of every single shipment of imports, which should help improve the availability and lower the costs of imported goods.

- **Our plan is calibrated to alleviate the impact on the most vulnerable.** We expect the economic crisis to impact poverty indicators significantly, especially since 30 percent of households are recipients of remittances, which are expected to decrease more than 35 percent in 2009. Under such conditions, our goal is to balance public finances while protecting the most vulnerable households and supporting economic recovery.

II. Program Objectives for 2010–12

9. **The program for which we request Fund assistance aims to restore fiscal and external sustainability, preserve financial stability, and support growth.** To these ends, our macroeconomic policies are built around four pillars: (i) fiscal policies to reverse the structural deterioration in 2008–2009 over the next three years while safeguarding public investment and social spending priorities; (ii) flexible monetary and exchange rate policies to keep inflation under control, facilitate adjustment to shocks, and rebuild foreign reserves; (iii) ensuring financial stability by strengthening the legal framework for bank resolution and close monitoring of the financial sector, accompanied by swift actions if and when necessary; and (iv) structural reforms to unlock and raise the economy's potential.

10. **Starting from an unfavorable position in 2009, our program aims to restore fiscal sustainability by 2012.** After our decisive actions to bring expenditure closer to available resources, the 2009 budget deficit would be limited to 9 percent of GDP. We intend to build on this effort, lowering the headline deficit to 3 percent in 2012. These targets will be achieved mainly by steady, reform-based reduction of current expenditure to levels that are in line with Moldova's resources, while public investment will be raised and the social

safety net enhanced. Moreover, revenue measures to broaden the tax base and modernize tax administration should raise revenue and support the adjustment.

11. **Our macroeconomic objectives for 2010 are cautiously optimistic, influenced by the expected gradual recovery in our trading partners.** We expect the recession to be over by the first quarter of 2010, and the annual growth rate to reach 1½ percent. Monetary policy would aim to achieve a 5 percent inflation rate by year-end, a level we believe is appropriate for Moldova given the relatively high inflation in some major trading partners. The current account deficit would widen modestly to 10¼ percent of GDP from 9 percent in 2009 as imports are boosted by higher prices of imported energy and a recovery in investment.

12. **Over the medium term, we expect the economy to recover to its potential, while inflation is kept low and stable.** Growth is expected to reach 5 percent by 2012, led by a rebound in investment and exports, with remittances slowly growing back to their 2008 level. Inflation should remain in mid-single digits, anchored by growing credibility and transparency of monetary policy. The current account deficit would stabilize around 10 percent of GDP—a level that should be readily financed by FDI and official assistance. It will be helped by the fiscal consolidation and improvements in competitiveness brought by structural reforms and increased exchange rate flexibility, while reserves should remain at adequate levels.

III. Policies for 2010

A. Fiscal Policy

13. **We intend to reduce the general government deficit to 7 percent in 2010 mainly by rationalizing current expenditure**. A key challenge is to rein in the ballooning wage bill in the budget sector that would have reached an unaffordable 15.3 percent of GDP in 2010 on unchanged policies; the measures listed below would limit it to 11.7 percent of GDP. A second important objective is to reduce spending on goods and services by about 0.7 percentage point of GDP. Finally, we will cut low-priority subsidies to the real sector by 0.4 percentage points of GDP. On the revenue side, we have raised indirect taxes to obtain an additional 1.1 percentage point of GDP, while the reduction in the budget sector wage bill would lead to a loss of 0.4 percentage points of GDP relative to unchanged policies. The main policy measures are listed below.

Main measures to reduce spending:

a. *Amend the Budget System Wage Law 355 to modify wage increases that are unaffordable in the current environment:* (i) postpone the 20 percent raise for civil servants, the military, and staff of defense, security, and public order bodies until 2012; (ii) reschedule the wage increases for education sector employees so as to be implemented more gradually over 2009–2011; (iii) postpone all kinds of wage increases scheduled for 2010 to 2012–13. These measures would generate savings of 1.8 billion lei in 2010 (2.8 percent of GDP) relative to unchanged policies.

b. *Freeze budgetary sector employment* to 232,000 employees, cutting staff positions that are permanently vacant, and reduce the budgeted 2010 wage bill by three percent on account of temporary vacancies, for total savings of about 400 million lei (0.6 percent of GDP).

c. *Continue implementation of a plan adopted by the previous government to optimize the number of employees in the budgetary sector.* In 2010, we will eliminate at least 4,000 positions, which will cut wage costs by about 50 million lei for the year and about 100 million lei on a full-year basis.

d. *Apply a 20 percent average reduction in budget allocations for low-priority goods and services*; to avoid arrears, enhance controls of the procurement process with a view to prevent the assumption of unaffordable commitments.

e. Reduce agricultural subsidies to 350 million lei, which is 300 million lei (0.4 percent of GDP) less than the 2009 allocation.

Main measures to enhance revenue:

f. *Raise excise tax rates* on a number of products (including gasoline, diesel, tobacco products, liquor, cosmetics, luxury cars, etc.) closer to the levels of neighboring countries. This will increase revenue in 2010 by about 600 million lei (0.9 percent of GDP);

g. *Raise the VAT rate* on natural gas from 5 to 6 percent. Net of the effect of VAT regime simplifications in agriculture, the budget will gain about 135 million lei (0.2 percent of GDP);

To ensure adequate budget financing in 2010, we request that the equivalent of SDR 95 million (about US$150 million) from the total access under the arrangement, split between the first three tranches as shown in the attached Table 1, be used for budget support. This request is motivated by Moldova’s lack of access to international capital markets and the limited absorption capacity of the domestic market for government securities, already near saturation after the heavy domestic borrowing in 2009.

We will pass the amended 2009 budget and the 2010 budget, as well as the amendments to Budget System Wage Law 355 as **prior actions** to our request for an IMF arrangement. We stand ready to implement additional fiscal measures to achieve the targeted budget deficit in the event revenues deteriorate or financing will not come as expected.

14. **To facilitate the return to fiscal sustainability in the medium term, we will also adopt measures that will have an effect after 2010.** Specifically,

a. We will *reinstate the corporate income tax* with a low single rate (10 percent) and a broad, uniform base across sectors and regions. In order not to raise the tax burden on companies before the economy recovers from the crisis, this measure will apply to income earned from 2012 onwards. We are announcing it now to give time to companies to prepare. We will need technical assistance from the IMF to ensure best practice in defining the tax base with a view to minimize the burden on investment activity while ensuring uniform treatment of various economic agents.

b. Within the context of our education reform, we will *optimize the network of education institutions*, closing in 2010 four vocational schools and freezing the enrollment in three pedagogical colleges (to be closed in 2012); moreover, we will advance the consolidation of financial autonomy of universities.

B. Monetary and Exchange Rate Policy

15. **Monetary policy will continue to focus on steering inflation toward the NBM target, and there is scope for further easing in the short run.** The recent drop in inflation provides an opportunity to keep it at single digits in the period ahead, thereby providing a nominal anchor for the economy. At the same time, the large undershooting of the NBM's 2009 inflation target amid signs of deflation is worrisome. On balance, also taking into account the possible risk to inflation stemming from the expected recovery of energy prices and demand, these trends suggest that some monetary policy easing would be desirable, provided it does not compromise the 2010 inflation objectives.

16. **More generally, there is a need for a clear, credible, and operational monetary policy framework, which should be communicated to the public and supported by further capacity building.** To this effect, by March 31, 2010 the NBM's Council of Administration will adopt such a framework along with an action plan for its implementation with well-defined objectives, responsibilities, and deadlines to guide the necessary operational and communication efforts. Meanwhile, the NBM will restart open market operations, work toward enhancing its forecasting and analytical capacity, and promote transparency through regular communication with the public regarding the objectives and instruments of monetary policy. Starting in January 2010, the NBM will publish quarterly reports providing analyses of monetary policy performance as well as forecasts of inflation and key macroeconomic indicators. The NBM and the NBS will agree on a methodology and division of responsibilities for compiling and publishing core inflation, so that regular publication of monthly core inflation could begin no later than January 2010.

17. **Meanwhile, the NBM's intervention in the foreign exchange market will be aimed only at counteracting erratic fluctuations without resisting trends.** Recent developments have underscored Moldova's vulnerability to external shocks, justifying

occasional foreign exchange market intervention. However, resisting sustained trends should be avoided because it raises output and fiscal costs of economic adjustment and wastes reserves. In this context, the NBM will promote a policy of sufficiently flexible exchange rate and will use intervention as an exceptional tool in times of heightened volatility.

18. **Taking advantage of the easing of global financial tensions, the NBM is replenishing its foreign exchange reserves.** Specifically, net international reserves as defined in the TMU are being raised to US$1300 million to maintain a comfortable buffer against external shocks (**prior action**). This will broadly correspond to a cover of 4½ months of 2010 imports in terms of gross reserves. This coverage—expressed in an already depressed level of imports—seems appropriate given the still high downside risks to external stability. The ensuing injection of liquidity is also in line with the goal of short-run monetary policy easing and the need to support bank credit to the real sector.

C. Safeguarding Financial Stability

19. **The NBM has identified the need for legal amendments to strengthen its ability to resort to early intervention in problem banks and address possible legal challenges to such actions.** To this end, by February 15, 2010 the Cabinet will approve and submit to parliament a set of amendments to the Law on Financial Institutions that will strengthen the tools available to resolve problem banks (**structural benchmark**). The amendments will, in particular:

- Introduce a framework for early intervention through official administration whereby the NBM can bring troubled banks under its control with the goal of rehabilitating or resolving them quickly and efficiently;
- Strengthen the framework for carrying out purchase and assumption transactions;
- To the extent not covered under existing legislation, authorize and regulate the use of bridge banks and other similar instruments as a resolution mechanism; and
- Provide for NBM oversight of both official administrators and liquidators.

In light of the existing regime, the authorities will also review, in collaboration with Fund staff, the risks of litigation that may diminish the effectiveness of the bank resolution measures. Where necessary and appropriate, the amendments will include measures balancing adequate accountability through judicial review with need for effective bank resolutions that help preserve financial stability and provide insured depositors with speedy access to their funds.

Before April 15, 2010, the Cabinet will approve and submit to parliament a set of amendments to the Law about guaranteeing the deposits of physical persons in the banking system (LGD) that provides depositors with early access to their deposit funds in the event of a bank failure (**structural benchmark**). The amendments will, in particular:

- Authorize early payment to insured depositors by the Deposit Guarantee Fund (DGF) based on bank records rather than on a lengthy validation process by the liquidator;
- Authorize the use of DGF funds to facilitate a purchase and assumption transaction;
- Provide for coordination and information-sharing between the DGF and the NBM and ensure confidentiality of information by revising procedures on appointment and qualifications for membership on the DGF board.

20. **The NBM will continue to monitor closely bank liquidity and foreign exchange activity**. To this end, it will perform monthly stress testing of each bank and will assess the banks' internal control systems and capacity to manage risks. The results of the stress tests and the ongoing independent diagnostics study of banks' portfolios will be used to determine the need for capital injections so that banks' CAR remain safely above the statutory ratio of 12 percent throughout the course of the program. The NBM will collect and share with Fund staff the results of the ongoing diagnostic studies in all banks that use conservative methods of asset valuation previously advised by Fund staff (**structural benchmark**).

D. Structural Reforms

21. **We strongly believe that implementing substantial reforms to improve the business climate will be crucial to secure an economic recovery.** To stimulate the domestic and foreign investment, a massive simplification of business regulation will be a key priority for the new government. Specifically, the government will:

- drastically reduce the number of categories of goods subject to mandatory compliance certification and licensing requirements and other types of authorizations imposed on business activities;

- enforce the one-stop shop policy to facilitate relations between companies and government without the need to interact with other government agencies;

- modernize the legal framework for construction authorization to reduce the duration and number of procedures related to obtaining construction permits;

- amend legislation on joint stock companies to bring it in line with best practice in investor protection;

- reduce the tax reporting burden by promoting the use of electronic statements;

- simplify procedures for business registration and liquidation;

- eliminate duplication of information requirements imposed by public agencies;

- substantially improve the regulatory framework of the sanitary and veterinary services.

22. **As part of our continuing efforts to reform the civil service,** we intend to introduce a new merit- and performance-based wage system for public sector employees. Given the current unemployment situation, the new system will be introduced in 2011 once the pressure of the crisis begins to unwind.

23. **We intend to reform the social insurance system with a view to improve its financial sustainability.** The policies to achieve these include: (i) from 2010, phasing out early retirement privileges for civil servants, judges, and prosecutors by raising retirement age by 6 months every year until they reach the regular retirement age; (ii) extending the requirement to pay social insurance contributions to all persons employed in Moldova in line with bilateral treaties; and (iii) improving in 2010 the mechanism for sick leave compensation to align it better with the incentives of employers and employees.

24. **We believe that the elimination of quasi-fiscal costs in the utility sector continues to be a key priority.** Heating tariffs in particular should not be subject to political influence and should instead reflect an accurate and transparent assessment of costs. Therefore, by end-2009 we will amend current legislation to ensure depoliticization of the tariff setting for heating by moving this responsibility to the National Agency for Energy Regulation (ANRE) (**prior action**). The new tariffs for heating, to be set by ANRE by January 14, 2010 will cover amortization and all variable costs <u>that are necessary to produce, transport, distribute, and supply heating</u>; moreover, it will be legally binding (**prior action**). We will also take steps to ensure independence of the regulator from the executive by transferring to parliament the power to appoint the ANRE's council of administration and approve its budget.

E. Protecting Low-Income Households

25. **To help mitigate the impact of the recession on the most vulnerable, we will strengthen the efforts to ensure full implementation of the new targeted social assistance scheme.** By March 31, 2010 the cabinet will approve a plan for the speedy expansion of the new targeted social assistance system with a view to cover at least 2/3 of all eligible recipients by end-2010 (adoption of the plan will be a **structural benchmark)**. An intensive communication campaign is already underway to promote enrollment of eligible households into the new system. The Guaranteed Minimum Income will be substantially increased to the expected 2010 extreme poverty level and new norms for determining eligibility will be approved by the Cabinet by end-January 2010. The 2010 budget allocation for social assistance, including unemployment benefits, will be raised by 36 percent to 630 million lei to ensure full financing of the new system. To minimize overlap of payments, we have accelerated phasing out the old "nominal" (category-based) untargeted system, discontinuing registration of new entrants and freezing the amount of benefits paid from January 1, 2010.

F. Safeguards Assessment

26. We recognize the importance of completing a safeguards assessment by the first review under the arrangement. The NBM commits to receiving a safeguards mission, and to provide that mission with all requested information without delay.

G. Program Monitoring

27. **The program will be monitored through semi-annual reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks.** The first review under the program is expected to be completed by June 30, 2010, and the second review—by December 31, 2010. Quantitative performance criteria (set for March 31, 2010 and September 30, 2010) include: (i) a ceiling on the general government deficit; (ii) a ceiling on the NBM's net domestic assets; (iii) a floor on the NBM's net international reserves; (iv) a ceiling on contracting or guaranteeing of nonconcessional external debt of the general government; and (v) non-accumulation of external payment arrears (continuous). Indicative targets are set for (i) a ceiling on reserve money; (ii) a ceiling on domestic expenditure arrears of the general government; (iii) a ceiling on the general government wage bill, and (iv) a floor on priority social spending. The indicators set as performance criteria will also serve as indicative targets at end-June 2010 and end-December 2010. The phasing of purchases under the arrangement and the review schedule are set out in Table 1 of this memorandum; the quantitative targets for end-March 2010, end-June 2010, end-September 2010, and end-December 2010, and continuous performance criteria are set out in Table 2; and the prior actions and structural benchmarks are set out in Table 3. Prior actions and structural benchmarks for the second review will be specified at the time of the first review. The understandings regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the TMU attached to this memorandum.

28. **In addition to the policies outlined in the attached MEFP, the government stands ready to take additional policy measures as appropriate to ensure the attainment of these objectives.** We will consult with the Fund on adoption of new measures and provide the Fund with the information it requests for monitoring progress during program implementation. We will also consult the Fund on our economic policies after the expiration of the arrangement, in line with Fund policies on such consultations.

Table 1. Moldova: Disbursements, Purchases, and Timing of Reviews Under the ECF/EFF Arrangements 1/

Date of availability	Conditions	Amount (millions of SDRs)			Percent of quota		
		Total	ECF	EFF	Total	ECF	EFF
January 29, 2010	Board approval of the arrangements	60.00	40.00	20.00	48.70%	32.5%	16.2%
June 30, 2010	Observance of end-March 2010 performance criteria and completion of first review	60.00	40.00	20.00	48.70%	32.5%	16.2%
December 31, 2010	Observance of end-September 2010 performance criteria and completion of second review	50.00	40.00	10.00	40.58%	32.5%	8.1%
June 30, 2011	Observance of end-March 2011 performance criteria and completion of third review	50.00	20.00	30.00	40.58%	16.2%	24.4%
December 31, 2011	Observance of end-September 2011 performance criteria and completion of fourth review	50.00	16.96	33.04	40.58%	13.8%	26.8%
June 30, 2012	Observance of end-March 2012 performance criteria and completion of fifth review	50.00	13.92	36.08	40.58%	11.3%	29.3%
December 31, 2012	Observance of end-September 2012 performance criteria and completion of sixth review	49.60	13.92	35.68	40.26%	11.3%	29.0%
	Total:	369.60	184.80	184.80	300.0%	150.0%	150.0%

Sources: IMF staff estimates and projections.

Note: A total of SDR 95 million of access under the ECF will be disbursed to the account of the Ministry of Finance at the National bank of Moldova for budget support. This amount will be spread over the first three purchases as follows: (i) SDR 40 million from the first purchase; (ii) SDR 40 million from the second purchase, and (iii) SDR 15 million from the third purchase.

1/ Moldova's quota is SDR 123.2 million

Table 2. Moldova: Quantitative Performance Criteria and Indicative Targets, September 2009–December 2010

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

	2009		2010			
	Sept. 30	Dec. 31	March 31	June 30	Sept. 30	Dec. 31
		Projected	Performance criteria	Indicative	Performance criteria	Indicative
1. Quantitative performance criteria						
Ceiling on the overall cash deficit of the general government 1/	2,880	5,368	1,161	2,254	3,308	4,474
Ceiling on net domestic assets of the NBM (stock) 2/ 3/	-1,491	-5,090	-5,834	-6,411	-6,661	-5,867
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) 2/ 3/	980	1,300	1,351	1,407	1,436	1,430
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (millions of U.S. dollars) 2/	…	…	65	125	125	125
2. Continuous performance criteria						
Ceiling on accumulation of external payment arrears (millions of U.S. dollars) 2/	0	0	0	0	0	0
3. Indicative targets						
Ceiling on reserve money (stock) 3/	9,544	10,900	10,784	10,889	10,999	11,716
Ceiling on change in domestic expenditure arrears of the general government 4/	454	0	0	0	0	0
Ceiling on the general government wage bill	5,081	7,193	1,888	3,905	5,665	7,531
Floor on priority social spending of the general government 5/	6,369	8,779	2,161	4,504	7,005	9,317
Memorandum items:						
EC Macro Financial Assistance budgetary grants (millions of euros)	0	0	0	25	25	50
Official external budget support and project grants and loans from the European Commission and the World Bank (millions of U.S. dollars)	48	97	33	126	169	243
Foreign-financed project loans	293	518	175	441	924	1117

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

1/ Adjusters apply to the ceiling on the overall cash deficit of the general government in accordance with TMU (TMU paragraphs 21-23).
2/ Program target based on the program exchange rates set in the TMU (TMU paragraph 3).
3/ Adjusters apply to ceiling on net domestic assets, floor on net international reserves and ceiling on reserve money in accordance with TMU (TMU paragraphs 24-25).
4/ Definition specified in the TMU (TMU paragraph 17). Amounts shown at end-September and end-December 2009 refer to stocks at that time.
5/ The priority social spending of the general government is defined as the sum of essential recurrent expenditures directed to social assistance (TMU paragraph 19).

Table 3. Moldova: Prior Actions and Structural Benchmarks 1/

Measure	Due	Status	Objective
Prior actions			
Parliamentary passage of an amended 2009 budget with a deficit target in line with the MEFP (¶10).	PA	Done	To bring budget allocations in line with available resources.
Parliamentary passage of a 2010 budget with a deficit target in line with the MEFP (¶13).	PA	Done	To facilitate macroeconomic stability and mitigate rising fiscal sustainability risks.
Parliamentary passage of amendments to Budget System Wage Law 355 to bring wages in line with the wage bill allocation in the 2010 budget and with the MEFP (¶13).	PA	Done	To ensure the credibility of the budget and rationalize spending on wages to increase resources available for investment and social protection.
The NBM's net international reserves, as defined in the TMU, will amount to US$1300 million by end-December (¶18).	PA	Done	To provide for an adequate level of reserves and enhance market confidence by offsetting in part the loss of reserves in early 2009.
Parliamentary passage of legislation transfering to ANRE the authority to set tariffs for heat directly, rather than indirectly through the municipalities as at present (¶24).	PA	Done	To depoliticize tariff setting and foster cost recovery in the district heating sector.
The new heating tariff, to be set by ANRE by January 14, 2010, will cover at least amortization and all variable costs and will be legally binding (¶24).	PA	Done	To alleviate fiscal risks stemming from inadequate tariffs.
Structural Benchmarks			
Cabinet approval and submission to parliament of amendments to the Law on Financial Institutions to strengthen the tools available to resolve problem banks (¶19).	15-Feb-10		To facilitate speedy resolution of problem banks.
The NBM will collect and share with Fund staff the results of the ongoing diagnostic studies in all banks that use conservative methods of asset valuation previously agreed with Fund staff (¶20).	15-Feb-10		To identify banking system vulnerabilities.
The Cabinet will adopt a plan for the speedy expansion of the new targeted social assistance system with a view to cover at least 2/3 of all eligible recipients by end-2010 (¶25).	31-Mar-10		To rectify a fragmented system and improve efficiency of welfare benefits during the recession.
Cabinet approval and submission to parliament of amendments to the Law about guaranteeing the deposits of physical persons in the banking system that provides depositors with early access to their deposit funds in the event of a bank failure (¶19).	15-Apr-10		To allow insured depositors early access to deposit funds and thus strengthen confidence in the banking system.

1/ Paragraph numbers refer to the corresponding paragraphs of the MEFP.

ATTACHMENT III: TECHNICAL MEMORANDUM OF UNDERSTANDING

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

A. Quantitative Program Targets

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

- the ceiling on the overall cash deficit of the general government;
- the ceiling on the net domestic assets (NDA) of the National Bank of Moldova (NBM);
- the floor on the net international reserves (NIR) of NBM;
- the ceiling on contracting or guaranteeing of nonconcessional external debt of the general government;
- the ceiling on accumulation of external payment arrears of the central government (continuous).

Indicative targets are set on:

- the ceiling on reserve money;
- the ceiling on change in domestic expenditure arrears of the general government;
- the ceiling on the general government wage bill;
- the floor on priority social spending of the general government.

B. Program Assumptions

3. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at program exchange rates. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at 12.3000 MDL/US$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates as of end-September 2009 published on the IMF web site

http://www.imf.org, including US$/EUR = 1.4643, JPY/US$ = 89.7700, CHF/US$ = 1.0290, US$/GBP = 1.6113, CNY/US$ = 6.8290, SDR/US$ = 0.631164.

C. Institutional Definitions

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

D. Program Definitions

5. **Net international reserves (NIR) of the 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 by the NBM, and convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year. Liabilities arising from use of Fund credit by the NBM do not include liabilities arising from the use of SDR allocation and use of Fund credit by the general government. Excluded from reserve liabilities are liabilities with original maturities longer than one year.

6. **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. For the purpose of assessing compliance with the program targets, the value of reserve money will be calculated as arithmetic average of its values for the last 5 working days before and including the program test date.

7. **Net foreign assets (NFA) of the NBM** are defined as gross reserves in convertible currencies (defined in paragraph 5) 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.

8. **Net domestic assets (NDA) of the NBM** is defined as the difference between reserve money (defined in paragraph 6) and net foreign assets (NFA) of the NBM. For the purpose of assessing compliance with the program targets, the value of NDA will be calculated as arithmetic average of its values for the last 5 working days before and including the program test date.

9. For the purposes of calculating overall cash deficit of the general government, **net credit of the banking system** to the general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed projects).[1] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed projects.

10. The **ceilings on the overall cash deficit of the general government** are cumulative from the beginning of calendar year and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government, 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[2] 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.

---

[1] For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1731, 1732, 1733, 1735, 1761, 1762, 1763, 1801, 1802, 1805, 1807, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801 and 2802.

[2] Debt is defined as in footnote 3.

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

12. **External debt ceilings** apply to the contracting or guaranteeing by the general government or any other agency acting on behalf of the general government of (i) short-term external debt (with an original maturity of up to and including one year) and (ii) non-concessional medium- and long-term debt with original maturities of more than one year. Debt denominated in currencies other than the U.S. dollar shall be converted to the U.S. dollars using program assumptions on bilateral exchange rates. The debt ceilings will not apply (i) to loans classified as international reserve liabilities of the NBM, (ii) to changes in indebtedness resulting from refinancing credits and rescheduling operations of existing debt, (iii) to credits from international financial institutions (IFIs), includng credits extended by the Fund.

13. For program purposes, the definition of **debt** is set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274, adopted on August 24, 2000 and revised on August 31, 2009).[3] This definition applies also to commitments contracted or guaranteed for which value has not been received, and to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from this definition are normal import-related credits, defined as liabilities that arise from the direct extension, during the normal course of trading, of credit from a supplier to a purchaser—that is, when payment of goods and services is made at a time that differs from the time when ownership of the underlying goods or services changes. Normal import credit arrangements covered by this exclusion are self-liquidating; they contain pre-specified limits on the amounts involved and the times at which payments must be made; they do not involve the issuance of securities.

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

[3] 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 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.

(involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor.

15. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs) and taking into account all details of the loan agreement, inlcuding maturity, grace period, payment schedule, upfront commision, and management fees. 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. Grant element of the loan can be calculated using the concessionality calculator available at the IMF web site http://www.imf.org .[4] For program purposes, a debt is **concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the CIRRs published by the OECD.

16. 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 central government, or the NBM, or any agency acting on behalf of the central government. The **ceiling on new external payments arrears** shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

17. For the purposes of the program, general government **expenditure arrears** are defined as non-disputed (in or out of court) payment obligations that are due but not paid for more than 30 days. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Arrears between the state, local government, and social and health insurance budgets, are not counted towards the expenditure arrears' ceiling on the general government.

---

[4] Currently available at http://www.imf.org/external/np/pdr/conc/calculator/default.aspx.

18. The **general government wage bill** will be defined as sum of budget spending on wages and salaries of public sector employees. This will include current spending reported in line "Wages" of the general government budget according to the program classification of the annual budget except for salaries of the social and health funds' employees.[5]

19. The priority **social spending of the general government** is defined as the sum of essential recurrent expenditures for social assistance, unemployment insurance, and pension payments as well as 95 percent of health expenditures.

E. Adjusters

20. The adjusters set in this TMU apply for assessing compliance with the program's quantitative targets starting from end-March 2010. They will not apply for (i) assessing compliance with the prior actions for the Board consideration of the request for a new program arrangement and (ii) evaluating the actual outcome of 2009.

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

22. The **ceiling on the overall cash deficit** of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by the full amount of any shortfall (excess) between actually disbursed and programmed Macro Financial Assistance budgetary grants from the European Commission (EC).

23. The **ceiling on the overall cash deficit** will be adjusted downward (upward)—that is, the deficit target will be reduced (increased)—for any lower (higher) than programmed disbursement of foreign-financed project loans as specified in Table 2 of the MEFP. Owing to monitoring lags, the downward adjustment is capped at a quarter of the programmed amount of foreign-financed project loans. The upward adjustment is capped at the equivalent of US$25 million, evaluated at program exchange rates.

24. The ceiling on **reserve money** will be adjusted downward (upward) and the ceiling on **NDA of NBM** will be adjusted downward (upward) symmetrically for any reduction (increase) in the required reserve ratio on the deposits of commercial banks denominated in lei. The adjustment amount will be calculated by multiplying the change in the required

[5] For the calculation of the total general government wage bill the following accounts for central government, local government, and special funds from the Treasury system in the Ministry of Finance will be used: 111, 112, and 116.

reserve ratio by the amount of commercial banks' deposits and liabilities in lei subject to reserve requirements.

25. The floor on **NIR of the NBM** will be lowered and the ceiling on **NDA of NBM** will be raised symmetrically by any shortfall in the official external grants and loans from the EC and World Bank capped up to an equivalent of US$50 million. For the purpose of this definition, the program exchange rates will apply for calculating the amounts of the grants and loans.

F. Reporting Requirements

26. Macroeconomic data necessary for assessing compliance with performance criteria and indicative targets and benchmarks will be provided to Fund staff including, but not limited to data as specified in Table 1. The authorities will transmit promptly to Fund staff any data revisions.

Table 1. 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
General government wage bill	Monthly, within three weeks of the end of each month
Number of budgetary sector positions by ministry	Monthly, within three weeks of the end of each month
Number of employees in the budgetary sector by ministry, and their respective wage bill	Monthly, within three weeks of the end of each month
Expenditure on social assistance as stipulated under activity 457 of social payments paid from the social fund budget	Monthly, within three weeks of the end of each month
Expenditure on pensions and unemployment benefits, and health expenditures as reported by NSIH and NHIC respectively	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

Table 1. Moldova: Data to be Reported to the IMF (continued)

Item	Periodicity
Balance of Payments (to be provided by the NBM)	
Current and capital account data.	One quarter after the end of the previous quarter
Transfers of individuals from abroad through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF and NBM)	
Information on all new external loans contracted by the 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
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.