April 2008
IMF Country Report No. 08/139

Republic of Moldova: 2007 Article IV Consultation and Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Moldova

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the combined discussion of the 2007 Article IV consultation with the Republic of Moldova and the third review under the three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation and third review under the three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on December 21, 2007, 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 February 20, 2008. 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 on the joint World Bank/IMF Debt Sustainability Analysis.

- A Public Information Notice (PIN) and Press Release summarizing the views of the Executive Board as expressed during its March 12, 2008 discussion of the staff report that concluded the Article IV consultation and the request, respectively.

- A statement by the Executive Director for the Republic of Moldova.

The document(s) listed below have been or will be separately released

Selected Issues Paper
Statistical Appendix
Poverty Reduction Strategy Paper
Joint Staff Advisory Note of the Poverty Reduction Strategy Paper

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Staff Report for 2007 Article IV Consultation and the Third Review under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Juha Kähkönen and Anthony R. Boote

February 20, 2008

Executive Summary

Much is going well. The authorities have established a good track record of economic stability, despite shocks. Growth is picking up, investment is replacing remittances as the main driver of growth, export performance is improving, and poverty has fallen.

Improved growth prospects have brought new challenges. Capital inflows have been accompanied by strong appreciation pressures, and a widening trade deficit. Moldova has few policy levers to cope with these pressures, with fiscal policy constrained by development needs and monetary policy limited by weak transmission mechanisms.

The policy discussions focused on:

- **The need to consolidate disinflation in the face of growing external pressures.** There was consensus on the need to entrench price stability as the primary objective of the National Bank of Moldova, allow greater exchange rate flexibility, and further tighten monetary policy if necessary to achieve the objective of single digit inflation.

- **The appropriate balance of fiscal policy between supporting disinflation and development.** There was agreement that improved fiscal prospects provided an opportunity to boost reforms to create additional space for pro-growth and pro-poor spending, and to modernize the public administration to better manage resources.

- **The need to bolster the transition process.** The FSAP update points to the need to deepen financial reforms. Structural measures underway target the business climate, advancing the privatization process, especially of large state enterprises, and streamlining of the regulatory environment.

Performance under the Third Review has been satisfactory, despite slippages.

List of Acronyms

AML	Anti-Money Laundering
ANRE	National Agency for Energy Regulation
ATP	Autonomous Trade Preferences
BEM	Banca de Economii
CFT	Countering the Financing of Terrorism
CIT	Corporate income tax
DSA	Debt sustainability analysis
EBRD	European Bank for Reconstruction and Development
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
EIB	European Investment Bank
FAD	IMF Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
IFC	International Finance Corporation
IT	Inflation Targeting
JSAN	Joint Staff Assessment Note
LOI	Letter of Intent
MFA	EU Macro-Financial Assistance
MEFP	Memorandum on Economic and Financial Policies
MTEF	Medium Term Expenditure Framework
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NBM	National Bank of Moldova
NDS	National Development Strategy
NCFM	National Commission on the Financial Market
PA	Prior Action
PC	Performance Criterion
PER	Public expenditure review
PIT	Personal income tax
PRSC	World Bank Poverty Reduction Support Credit
PSIA	Poverty and Social Impact Analysis
REER	Real Effective Exchange Rate
SB	Structural Benchmark
SIDA	Swedish International Development Agency
STI	State Tax Inspectorate
TA	Technical Assistance
tcm	thousand cubic meters

Main Source of Economic Data for the Republic of Moldova	
Data in the staff report reflect information received by January 31, 2008, from the following sources:	
National Bank of Moldova	www.nbm.org
National Bureau of Statistics of Moldova	www.statistica.md
Ministry of Finance of Moldova	www.minfin.md
Ministry of Economy and Trade of Moldova	www.mec.md
International Financial Statistics	www.isspm.org

Contents Page

Attachments

I. Introduction

1. **Much is going well, but Moldova is increasingly facing many of the strains experienced by other countries undergoing transition.** Since the 2006 Article IV consultation, the authorities have established a good track record of macroeconomic stability, despite successive shocks, and the Russian ban on wine imports. Investment is picking up, and is beginning to replace remittances as the main driver of growth. Improved growth prospects have also brought new challenges, with strong appreciation pressures from foreign exchange inflows complicating the disinflation objective. Structural reforms aimed at advancing the transition process and improving the competitiveness of the economy have become correspondingly more urgent.

2. **Political pressures are growing with the upcoming national elections in 2009.** The ruling communist party of President Voronin, reelected in 2005 on a pro-Europe, pro-reform platform, lost support in the capital city of Chişinău in the June 2007 local elections. Politics have yet to noticeably influence macroeconomic policy, however, apart from disputes at the municipal level, particularly on heating tariffs.

3. **The external environment has improved**. An advantageous autonomous trade preferences (ATP) agreement with the EU is expected to come into force in March 2008, and wine exports to Russia are resuming. The successor to the EU-Moldova Action Plan is expected to be negotiated in mid-2008.

4. **The authorities remain committed to the PRGF-supported program.** European aspirations and prospects of growing financial assistance from the EU and international donors continue to drive reform. Program implementation under the Third Review has been satisfactory, despite some slippages.

Box 1. Implementation of Past Fund Policy Recommendations [1/]

The authorities' responsiveness to Fund advice in earlier Article IV consultations has been good, as reflected in the completion of two reviews under the program. Macro policies have been prudent, though monetary policy has been less aggressive than Fund recommendations. Implementation of structural reforms has also been successful with only minor slippages. As a result, the authorities have managed to maintain macroeconomic stability, even in the face of a series of significant shocks.

1/ See PIN for 2006 Article IV Consultations at http://www.imf.org/external/np/sec/pn/2006/pn0654.htm

II. Recent Developments

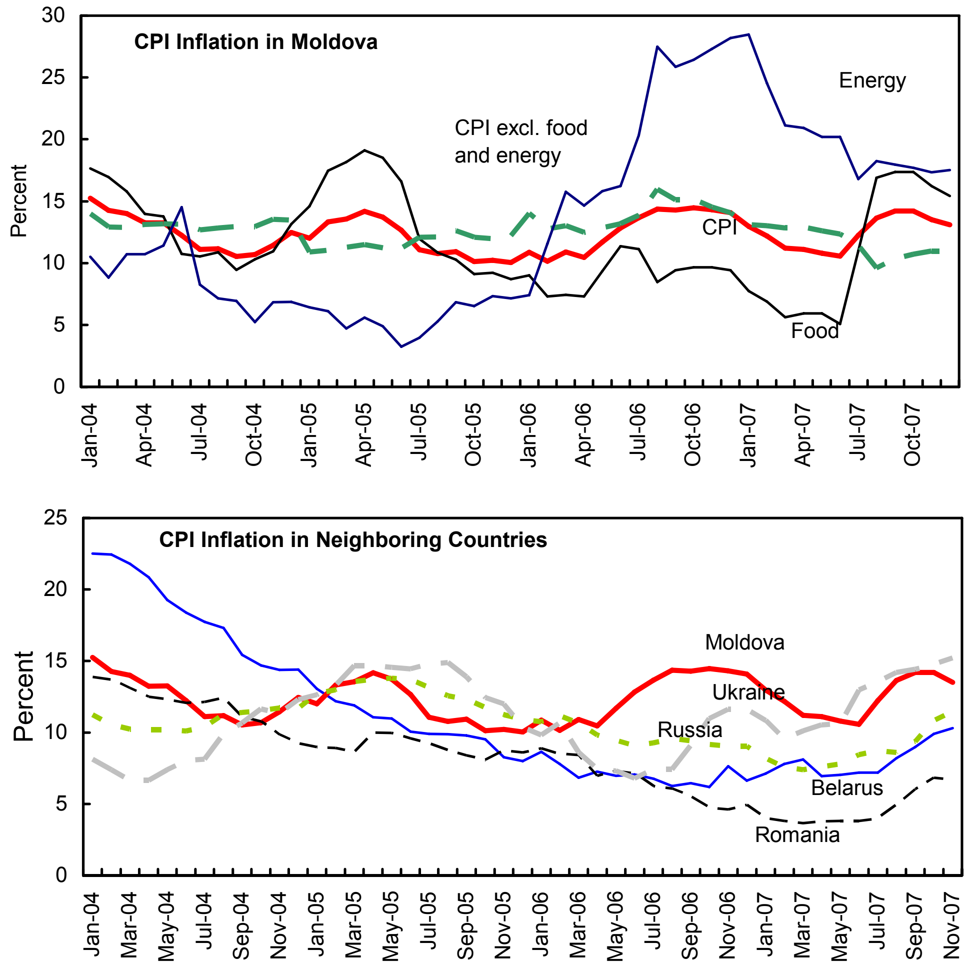
5. **The economy is doing well, but has been set back by consecutive shocks.** Moldova was hit hard by the regional financial crisis in 1998, with the poverty rate doubling to

70 percent in 1999, and substantial outward migration. The subsequent recovery was setback by Russia's ban on imports of Moldovan wine in March 2006, a doubling of natural gas prices by Russia's Gazprom in 2006, and a drought in 2007, which led to a sharp drop in agricultural output.

- **Growth has been resilient.** Strong non-agricultural output maintained overall growth at a projected 5 percent in 2007, supported by robust exports and higher investment.

- **Disinflation has been set back by the drought.** Good progress by the National Bank of Moldova (NBM) in reducing inflation since 2006 was reversed by a spike in food prices. After having already met the end-year target of 10 percent by June, headline inflation ended the year at 13 percent.[1]

Inflation

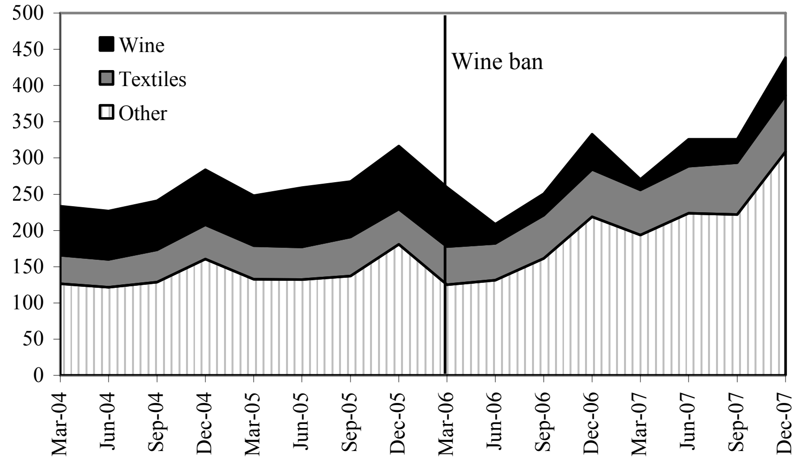


Source: Moldovan authorities; IFS; and Fund staff calculations.

[1] The pass-through from higher prices for imported natural gas has been small, since 90 percent of natural gas is consumed by households and its CPI share is only 2 percent.

- **The current account deficit narrowed**. The current account deficit improved to 10 percent of GDP in 2007 from 12 percent in 2006. A deterioration in the merchandise trade balance due to strong import growth has been offset by stronger net income flows and transfers. A resumption of wine exports to Russia in October was a major positive development, although volumes are likely to recover only slowly.

Export Shares
(millions of US$)

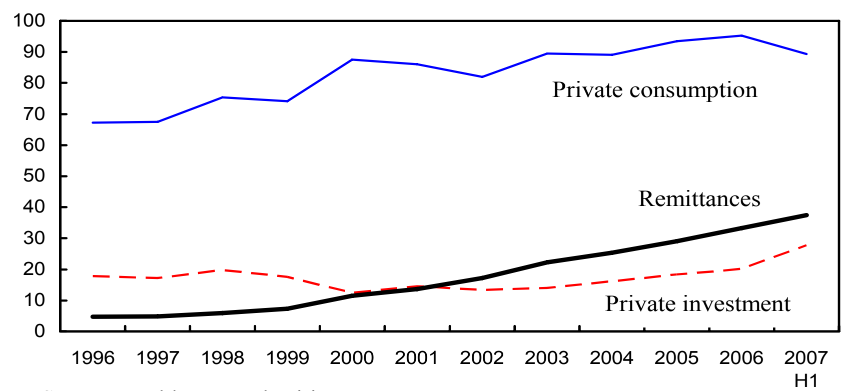


Source: Moldovan authorities and IMF staff estimates.

6. **The pattern of growth is also changing, with developments in Moldova increasingly mirroring those in other transition economies:**

- **Growth is increasingly been driven by investment.** There are signs that the earlier model of consumption-driven growth financed by remittances is shifting. While large inflows of remittances continue, information from the banks and investment data suggest that they are increasingly flowing into investment rather than consumption (Box 2). FDI has also picked up and is estimated to have reached 12 percent of GDP in 2007, up from 7 percent in 2006.

Macroeconomic Trends, 1996–2007
(share of GDP)



Source: Moldovan authorities.

Box 2. Remittances and Investment in Moldova [1/]

A large proportion of remittances should probably be reclassified as investment in Moldova. Remittances are defined as personal transfers by non-resident workers (those abroad for more than a year), often involve related persons, and appear in the current account. Transfers by non-residents to buy goods or services, however, should be classified under the financial account—what the money is intended for matters.

The authorities have initiated the process of reclassifying remittances. Recent analysis of disaggregated data by the NBM revealed some very large transactions, accounting for a substantial proportion of total money transfers. It is likely that these were intended as payments for goods or services, but were channeled as personal transfers due to lower transaction and administrative costs. This revision might ensure a better consistency with survey data on remittances. A recent 2006 household survey estimates that overall remittances (including compensation of employees) were less than half of those recorded in the BoP, implying that other transfers may be intended for investment. The table shows 2007 BoP numbers, plus what is implied if some 50 percent of remittances were to be reclassified.

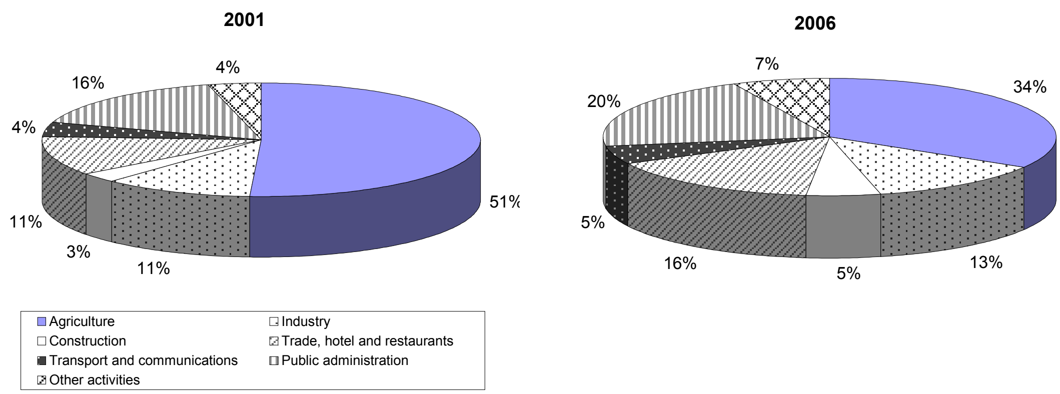
2007 Balance of Payments Flows

	US$ millions (est.)	Percent of GDP	Percent of GDP (half of remittances reclassified)
Remittances	825	19.5	9.8
Current Account	-424	-10.1	-19.9
Financial Account	857	20.3	30.1

1/ The headline remittances number quoted for Moldova, about one-third of GDP, includes both remittances and compensation of employees (wages paid to Moldovans living abroad for less than one year).

- **The structure of the economy is also changing**. Construction and trade are growing rapidly, while agricultural employment has declined. There has been a shift of employment within the industrial sector away from winemaking into manufacturing, particularly to textiles, where Moldova’s low labor costs continue to provide a comparative advantage. This has led to an increase in private sector employment and a recent slowdown in emigration.

Employment Structure by Sectors of Economy
(shares in total employment)



Source: Moldovan authorities

- **Poverty has fallen.** Migration has ameliorated poverty as remittances have been channeled to the poor. Rural wages have also increased due to tighter labor markets. Overall poverty has fallen to 30 percent in 2007 with notable improvements in access to water supplies and reducing infant mortality. New estimates indicate that extreme poverty is lower than previously thought (at less than 5 percent, compared with an earlier estimate of 16 percent in 2005). The recent drought may have led to some reversal of some of these gains, despite donor and government efforts to address the social consequences.

7. **Strong growth performance has presented new challenges:**

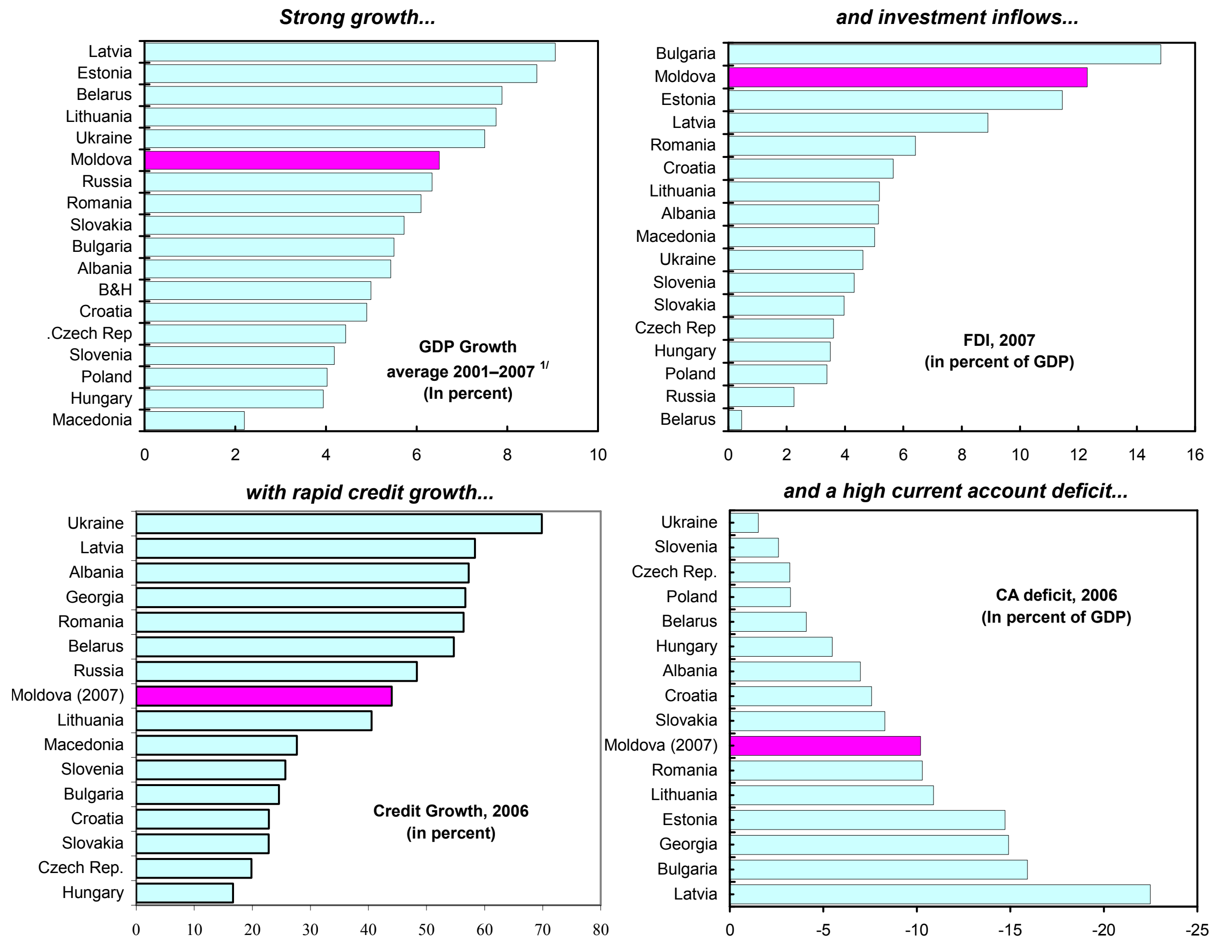
- **A surge in capital inflows, driven by FDI.** Net capital inflows topped 20 percent of GDP in 2007, up from 8 percent in 2006, and would be higher if remittances were to be reclassified.

- **Strong appreciation pressures.** The strengthening of the real effective exchange rate has raised concerns about competitiveness, while large sterilization costs have weakened the financial position of the central bank.

- **A weakening of the trade balance.** While export growth has been robust, imports have grown faster than expected, fuelled by remittances and stronger FDI. The deterioration in the underlying current account position has been masked by remittances.

8. **While the trends are similar to those in other transition countries, Moldova has fewer effective policy levers to address these pressures.** Fiscal policy is constrained by Moldova's low-income and high development needs, while the effectiveness of monetary policy is limited due to weak transmission mechanisms.

Moldova in Transition: Looks Familiar?



Source: WEO and Fund staff projections.
1/ Average rates are used to partly offset impact of the regional drought in 2007.

9. **The policy response has been mixed:**

- **Fiscal policy has been restrained.** Fiscal performance remained strong in 2007, with the end-year deficit of 0.3 percent of GDP below the programmed deficit of 0.5 percent. Revenue performance was driven by higher VAT on imports, while expenditures were kept in line with budget commitments.

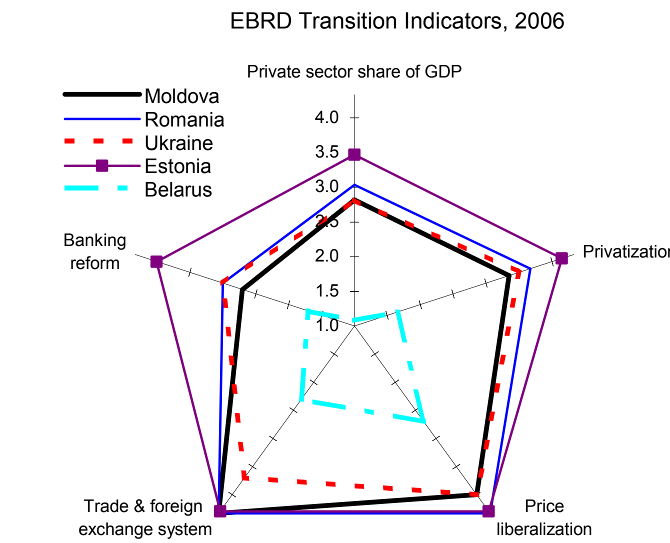
General Government Fiscal Balance, 2003-07
(in percent of annual GDP)

	2003	2004	2005	2006	2007
Outturn	0.2	0.8	1.7	0.3	-0.3
Initial budget	-0.7	-0.9	-0.9	-0.5	-0.5

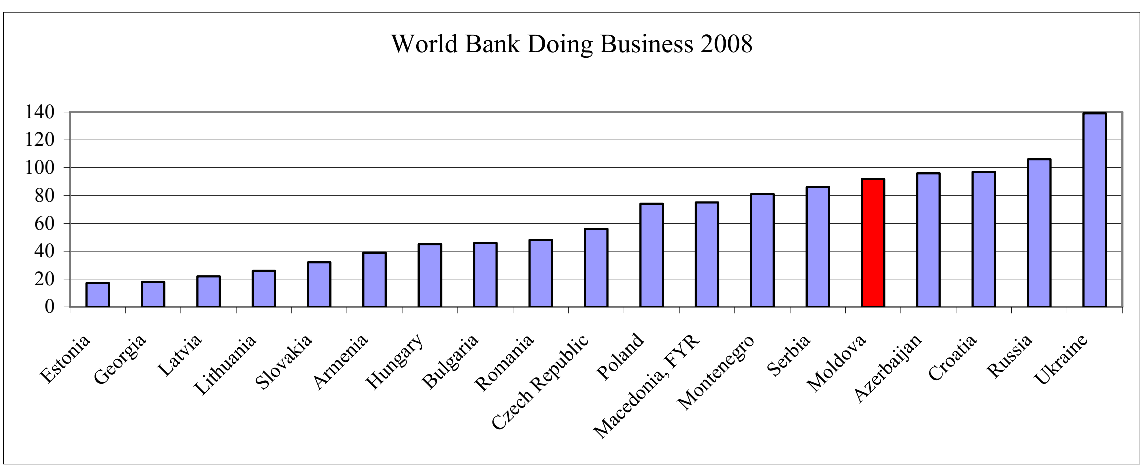
Sources: Moldovan authorities and Fund staff estimates.

- **Monetary policy has been playing catch-up.** Despite the tightening in early 2007, strong inflows of foreign exchange led to a surge in reserve money, and the end-year ceiling was breached (Figure 1). Faced with mounting inflationary pressures due to second-round effects of the drought, the NBM raised reserve requirements from 10 to 15 percent at end-September, accompanied by an increase in the sterilization rate of 2.5 percentage points to 16 percent. The NBM accelerated the build-up of reserves, which by end-2007 reached US$1.3 billion, well in excess of US$1 billion projected at the Second Review, limiting the strong appreciation of the leu (Figure 2).

10. **The structural reform agenda also remains long, despite recent efforts.** Moldova continues to perform poorly under EBRD transition and World Bank "Doing Business" indicators, and slipped from 86 to 97 in the 2007 World Economic Forum competitiveness rankings due to the weak business environment. Given the poor ratings, the authorities have been making considerable efforts to strengthen market reforms. Key measures underway comprise regulatory and public administration reforms, including utility tariff reform, establishment of the National Commission for Financial Markets (NCFM), improved business legislation through the use of a 'Guillotine law', modernization of the tax administration, a new privatization law, and financial sector restructuring.



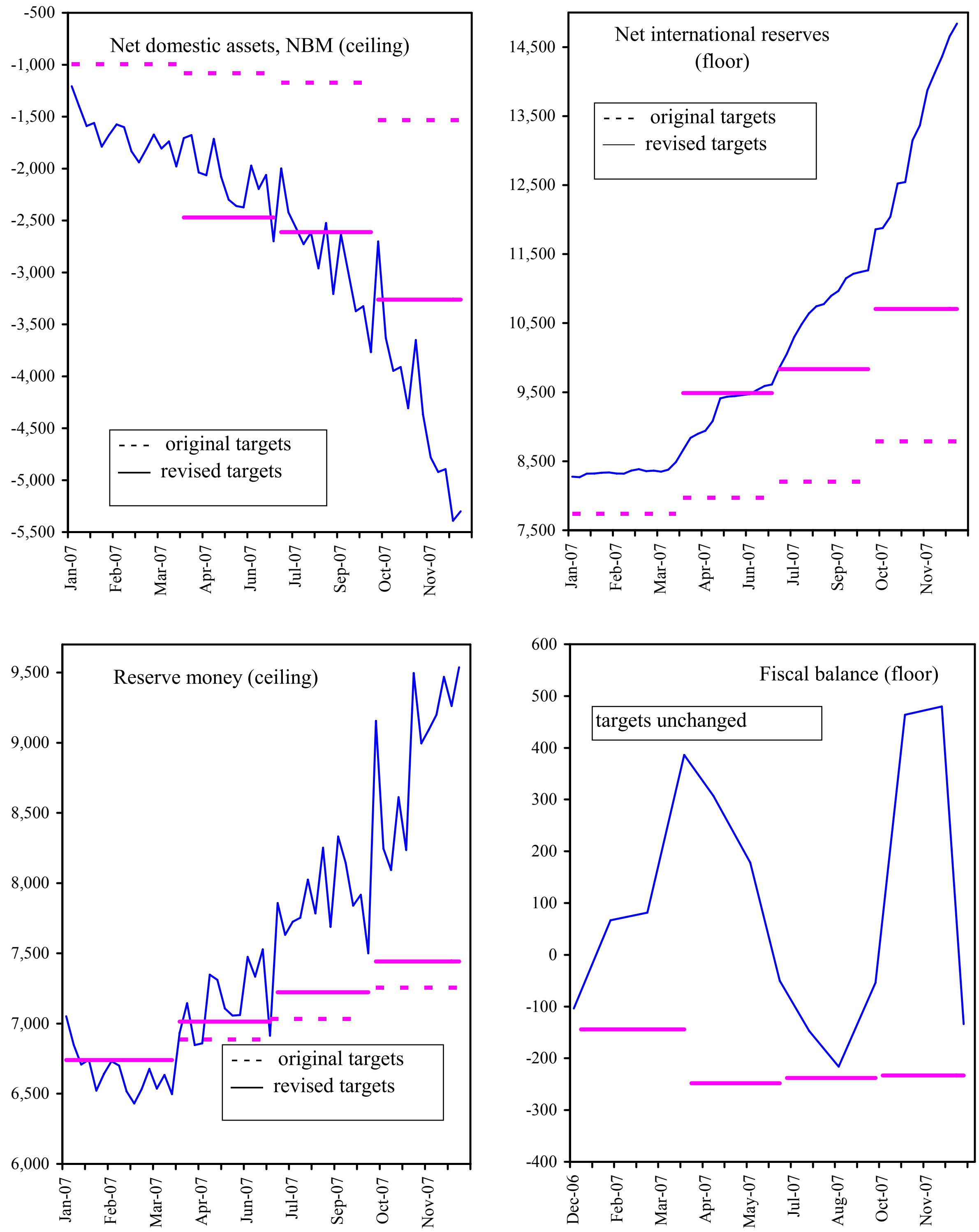
Source: EBRD Transition Report 2006.
Note: Transition indicators range from 1 (little change from centrally planned economy) to 4.33 representing the standards of an industrialised market economy).



Note: Higher ranking indicates worse business climate.
Source: World Bank Doing Business 2008 report, www.doingbusiness.org

Figure 1. PRGF Performance, 2007

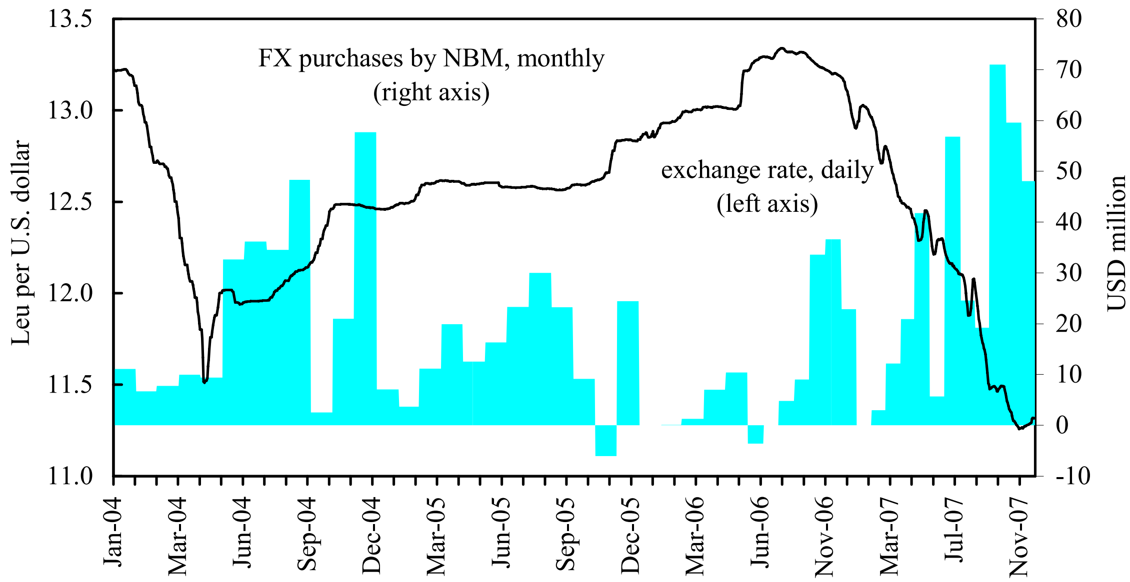
(In millions of lei, unless indicated otherwise)



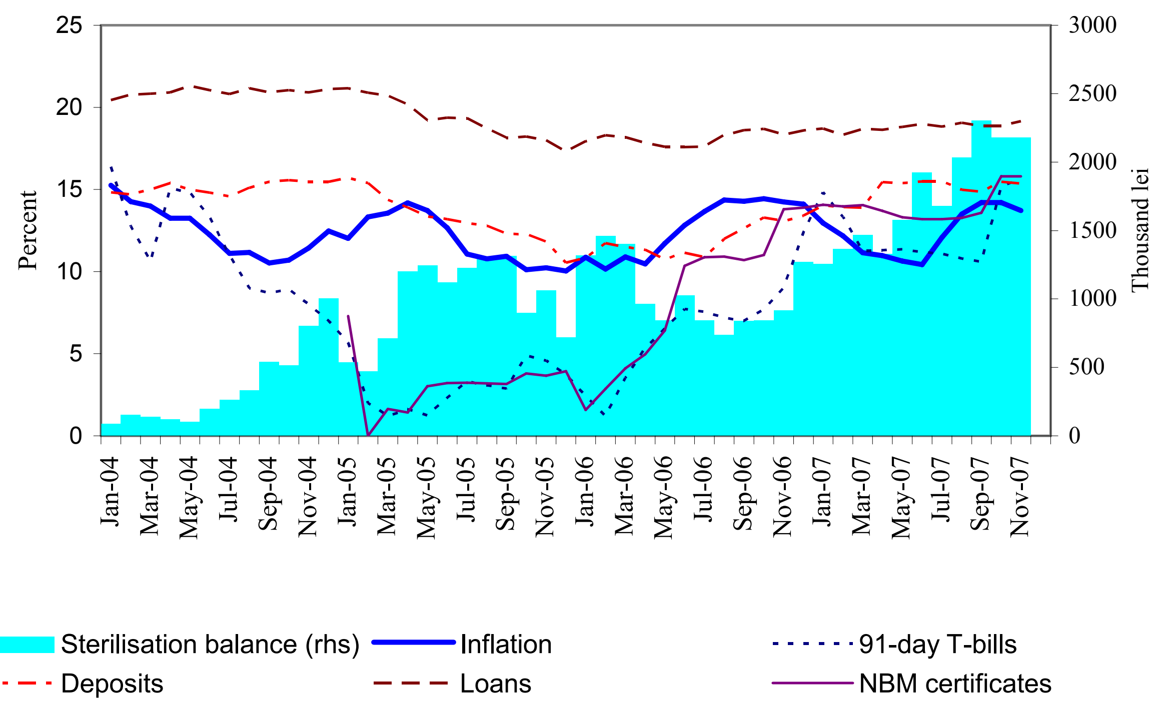
Sources: Moldovan authorities; and Fund staff calculations.

Figure 2. 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.

III. Performance under the Third Review

11. **Performance has been satisfactory, with some slippages.** All end-September quantitative PCs were observed. A quantitative benchmark on non-accumulation of domestic expenditure arrears was missed as Chişinău failed to fully pay the heating subsidies it decided to grant to households. The indicative target on reserve money has also been missed as the National Bank of Moldova (NBM) has pursued the multiple objectives of inflation, low interest rates and exchange rate stability in the face of strong foreign exchange inflows.

12. **All structural PCs have been met.** There has been good progress in strengthening the independence of the central bank, improving financial sector supervision, and enhancing public finance management.

13. **But some structural benchmarks were missed.** The end-September structural benchmark (SB) on the adoption of the methodology for a targeted social assistance system was implemented with a slight delay. Reform of the heating sector suffered delays. The end-September structural benchmark on increasing tariffs for heat and water to 70 percent of cost recovery was missed. Tariffs for water were increased to full cost recovery in October, but the increase in tariffs for heat was delayed pending further work on a municipal social assistance scheme. An SB on transferring the tariff-setting responsibility for heat and water to ANRE, the independent national regulator, was not implemented owing to uncertainty whether the transfer would comply with the constitutional division of rights between local and central governments. As a compensatory measure, heat tariffs paid to utilities were raised to full cost-recovery of lei 540 in January (prior action).

14. **Previous concerns about the weakening of the AML regime related to the passage of a capital amnesty law have been addressed through the new AML law and by fixing loopholes in the capital amnesty law.** Revisions to associated laws aimed at bringing them in conformity with the international standards have been prepared with the help of the IMF and bilateral partners.

IV. Outlook

15. **The macroeconomic outlook for 2008 and beyond appears favorable**. Growth is projected to pick-up to in 2008 and 2009, reflecting stronger investments and the unraveling of the shocks, and then slow to around 6 percent in the medium-term. While rising FDI and domestic investments, and some weakening of private savings, are expected initially to feed imports, export recovery and strong transfers should help contain the current account deficit at about 10 percent of GDP. At the same time, large capital inflows are projected to more than compensate for the current account deficit, boost reserve accumulation and add to appreciation pressures. With appropriately tight macroeconomic policies, inflation is projected to gradually decline to mid-single digits by 2010–11, and help maintain Moldova's competitive margin.

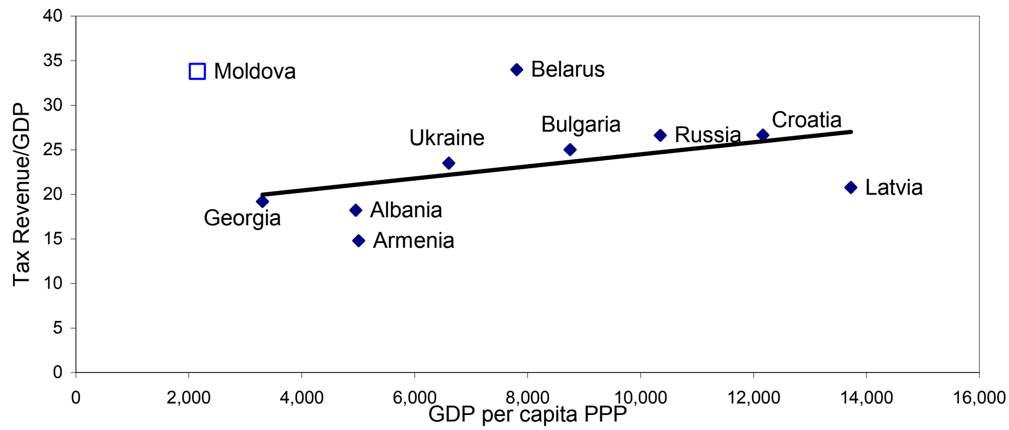
Medium-Term Outlook, 2005–12

	2005	2006	2007	2008	2009	2010	2011	2012
			Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
			(Percent change, unless oterwise indicated)					
Real GDP	7.5	4.0	5.0	7.0	8.0	7.5	7.0	6.5
Inflation (end of period, y-o-y)	10.0	14.1	13.4	9.0	7.0	6.0	5.0	5.0
Real effective exchange rate	-1.3	0.0	11.0	...	...	...	...	...
Reserve money	31.8	-7.0	46.4	20.0	...	...	...	...
			(In percent of GDP, unless otherwise noted)					
Current account balance	-10.3	-12.0	-9.7	-10.3	-10.8	-11.3	-11.1	-10.8
Wine exports	10.8	5.6	4.0	4.2	4.4	4.9	5.7	6.6
Energy imports	14.6	16.2	15.4	15.3	13.8	12.9	12.4	11.8
Remittances	29.1	33.3	36.6	37.6	35.9	32.8	29.8	27.7
Gross official reserves, months of imports	2.2	2.2	3.0	3.2	3.6	4.0	4.4	4.7
General Government								
Revenues	38.6	40.5	43.3	41.1	40.5	40.0	39.6	39.0
Expenditures	37.0	40.3	43.6	41.6	41.0	40.5	40.1	39.5
Balance 1/ 2/	1.3	0.2	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5
GDP, billions of lei	37.7	44.1	51.3	58.8	68.2	76.0	83.6	91.3

Sources: Moldovan authorities; and Fund staff projections.
1/ Excludes injection of 0.6 percent of GDP to NBM capital in late 2006.
2/ In 2005 there was a statistical discrepency of -0.2 percent of GDP.

16. **While the authorities see upside risks to the outlook, the mission emphasized that the current favorable environment is still fragile, even if Moldova was little affected by the recent international financial turmoil.** Staff stressed that coming late to transition, Moldova could benefit from the experience of other countries in the region that have faced growing current account and inflationary pressures. In particular, smooth convergence will require maintaining a strong fiscal anchor to bring inflation down quickly and to allow more policy flexibility when Moldova faces inevitably declining private savings, mounting capital inflows, and appreciation pressures. At about 43 percent of GDP, the size of the government is excessive for a country at Moldova's level of development, and limits growth potential. Gradual retrenchment of the public sector over the medium term will be essential to provide room for the private sector. At the same time, a look at Moldova's neighbors clearly shows the importance of structural reforms and a healthy financial sector, for boosting longer-term growth prospects.

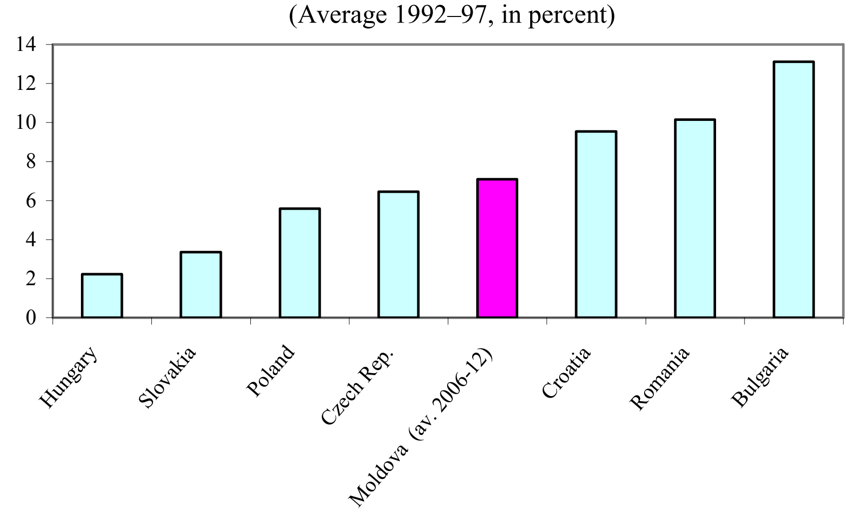
Government Size and GDP per capita, Emerging Europe, 2006



Source: WDI, WEO, GFS, and Moldovan authorities.

17. **While the authorities agreed that the current exchange rate is broadly in line with fundamentals, they expressed concerns about possible loss of export competitiveness due to continued appreciation**. However, a range of indicators shows that there is scope for further appreciation without undermining competitiveness (Box 3). The trend appreciation of the real exchange rate in Moldova mirrors the experiences of neighboring CEE countries during transition in 1990s, reflecting high rates of return and the beginning of the convergence process.

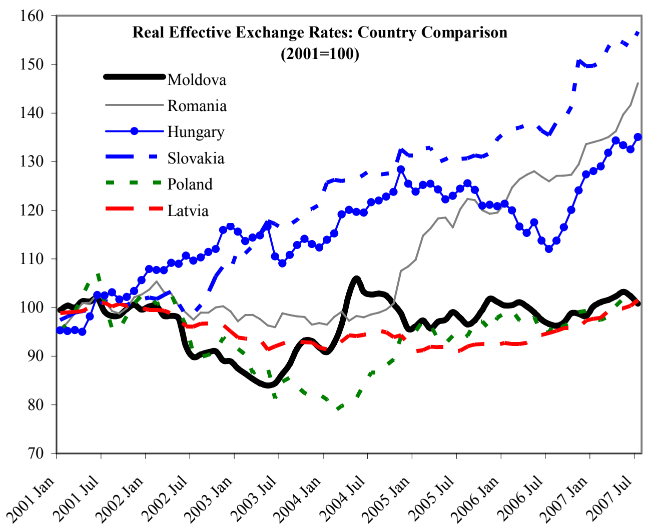
REER Appreciation
(Average 1992–97, in percent)



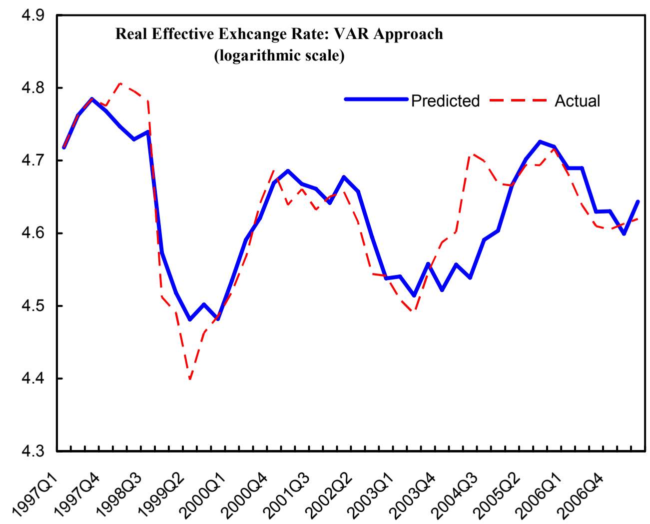
Source: Fund staff estimates and projections.

Box 3. Competitiveness and the Equilibrium Exchange Rate

Estimates of the equilibrium rate vary within a wide range, and have the usual caveats, but seem to suggest that the exchange rate is broadly in line with fundamentals. A standard econometric analysis suggests that the real effective exchange rate moves broadly in line with fundamentals. The CPI-based REER is roughly unchaned from the 2001 level; the macroeconomic balance approach indicates the exchange rate is overvalued by about 7 ½ percent; while an estimate of the equilibrium rate based on wage costs for transition countries indicates a modest overvaluation. Data also suffer from problems. The coefficients for the macroeconomic balance approach are from the advanced-country CGER exercise (Moldova has insufficient data), and transition economies exhibit very different characteristics. In addition, Moldova recently suffered from a series of external shocks that adversely affect the medium-term current account, and an exchange rate devaluation to bring it into balance would be necessarily biased upwards.

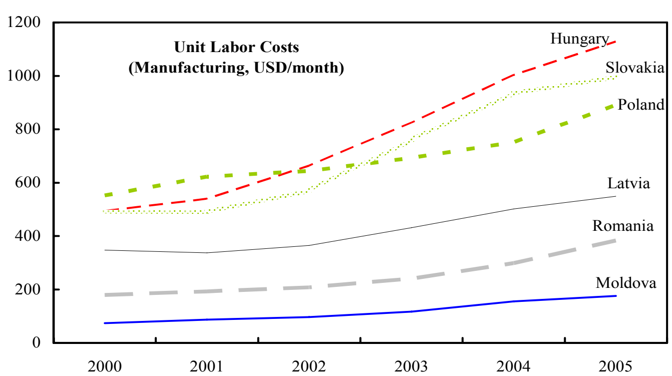


Sources: WEO; Fund staff calculations.

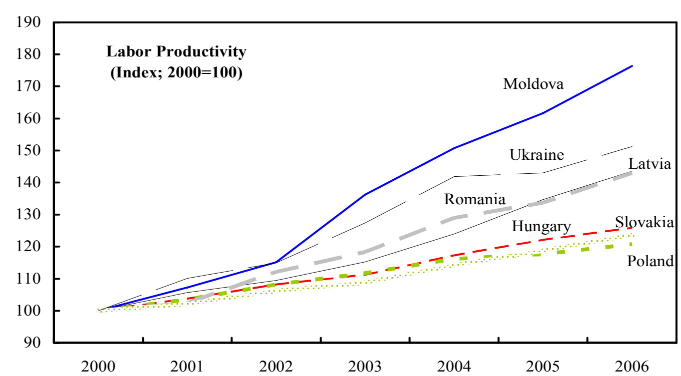


Source: Fund staff calculations.

Despite appreciation pressures, competitiveness is still high. Unit labor costs remain low and productivity is growing fast compared with new EU member states. Moldova is one of the few countries in the region that continues to attract investments in textiles and other low value-added industries. This assessment dovetails with a recent business survey, where only 5 of 33 companies viewed excessive strengthening of the leu as a major obstacle to business development. The large appreciation has not hampered robust export growth (30 percent y-o-y to November, and 43 percent excluding wine).



Sources: ILO; Moldovan authorities; and Fund staff estimates



Sources: WEO; and Fund staff estimates

18. **The improved macroeconomic outlook further decreases the low risk of debt distress.** Since July 1, 2007, Moldova is classified as a low middle-income country and above the IDA cutoff. This implies a shift in World Bank financing towards a blend of IDA and IBRD funds—a move included in the July DSA. The debt-sustaining non-interest current account deficit is estimated at 17.1 percent of GDP, compared with the expected outturn in 2007 of 8.1 percent of GDP. Although the priority remains to attract concessional financing, the debt ceiling was raised at the time of the Second Review to accommodate loans from the EBRD and EIB for roads, and for a health project financed by the Council of Europe Development Bank.[2] Given the outlook, absorptive capacity is likely to be more of a constraint than debt sustainability.

V. Policy Discussions

19. **The Article IV consultation was a timely opportunity to focus on medium-term policies and the reform agenda.** The program is at the half-way point, and it is clear that the country is facing different problems than at the time of the last Article IV consultation. Key areas for discussion were:

- how to strengthen macroeconomic stability and resume disinflation in the face of strong capital inflows and appreciation pressures;
- the appropriate fiscal framework given development needs, including the importance of creating fiscal space through strengthened capital budgeting, and enhancing public sector efficiency by balancing employment with the need to attract high quality staff;
- how to promote financial deepening, drawing on the FSAP update, and boost structural reforms to strengthen competitiveness; improve the business climate, accelerate privatization, and
- the implementation of a targeted social assistance system to alleviate poverty, a core objective of the three-year PRGF arrangement.

A. Strong Challenges for Monetary and Exchange Rate Policy

20. **There was consensus on the need to make price stability the overarching objective of monetary policy, despite lingering appreciation concerns.** Strong appreciation pressures and capital inflows have complicated monetary policy, and the NBM has been faced with hard choices, as it is not possible to juggle inflation, exchange rate and

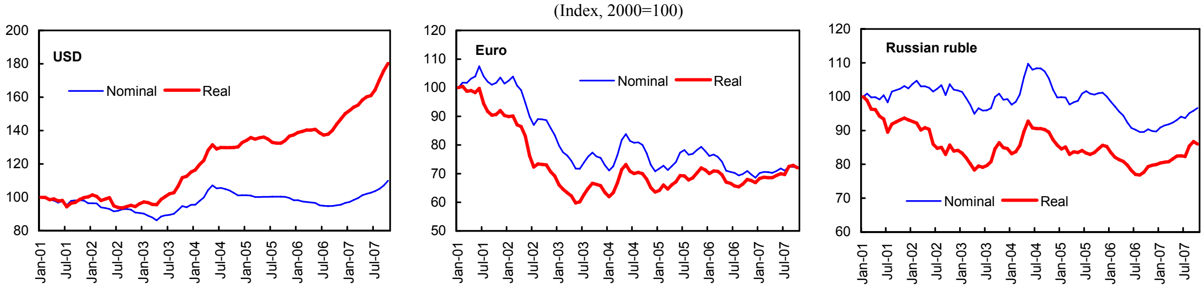
[2] Both projects are co-financed by IDA, and the authorities hope to raise additional co-financing to raise the concessionality of later disbursements.

interest rate goals. The FSSA stressed that lack of clarity about the central bank objectives has caused difficulties in policy implementation. However, staff noted that the NBM had recently strengthened its *de-facto* independence, establishing disinflation as its central objective, with a planned move to an inflation targeting framework over the medium-term. Further, it was agreed that:

- **Monetary policy should remain tight until disinflation is firmly reestablished**. The mission and the authorities agreed that real interest rates on sterilization operations need to stay substantially positive until monetary pressures are eased. Moreover, an early further tightening should be considered if disinflation does not quickly resume. The 2008 monetary program proposes to lock in the overperformance in 2007 on NDA and NIR, and tighten reserve money to ensure the objective of single-digit inflation is achieved.

- **More exchange rate flexibility is needed to shoulder some of the burden of monetary tightening**. While the authorities expressed some concern about the impact of the strengthening of the real effective exchange rate on competitiveness, staff argued that the exchange rate has some scope for further appreciation. Moreover, although the leu has strengthened against the dollar, appreciation of the nominal effective rate has been less pronounced. The joint understanding was reached that the NBM will only intervene to smooth excessive exchange currency fluctuations, and that any required recapitalization of the NBM due to high sterilization costs will be covered from the budget.[3]

Nominal and Real Exchange Rates
Jan. 2001–Aug. 2007
(Index, 2000=100)



Source: IMF staff calculations

21. **There was agreement on the need to bolster these short-term policy changes with structural measures to strengthen the weak monetary transmission mechanism and build confidence.** These focused on measures to reduce excess liquidity and strengthen the NBM signaling function (Box 4):

[3] In 2007 the NBM suffered large unrealized losses due to appreciation. However, thanks to the strengthened capital structure of the central bank, no recapitalization will be needed.

- **To ease liquidity pressures,** the accounts of the Social Fund, the Health Fund and local budgets have been moved from commercial banks to the treasury single account at the NBM at end-2007, while the introduction of zero-balancing accounts is planned by end-June 2008. At the same time, the planned securitization of the government debt to NBM in the first quarter of 2008 will provide the central bank with an additional liquidity management tool.

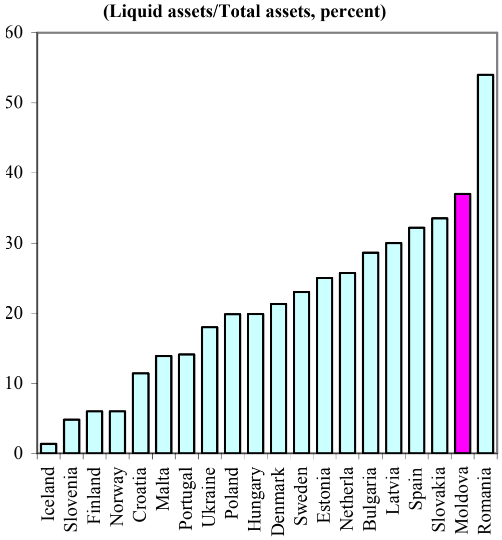
- **Markets appear uncertain about NBM's true objectives.** To further improve policy effectiveness, the NBM intends to step up its policy communication strategy, streamline existing monetary instruments by adopting a base rate as its main policy rate by end-March 2008, and shifting sterilization operations to shorter maturities (MEFP ¶10).

- **The National Bank of Moldova and IMF staff organized an international conference in December on strengthening the monetary transmission process.** The conference drew on the experience of countries in the region.

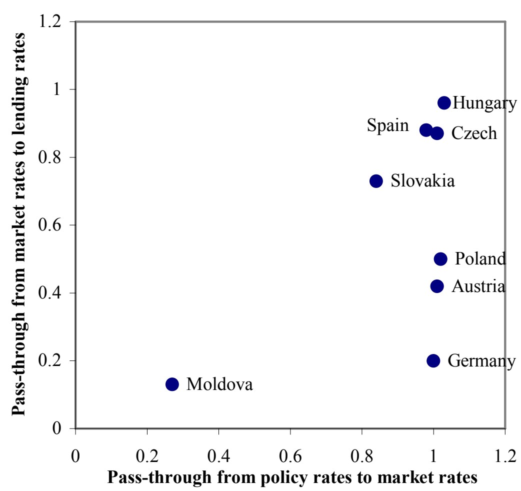
Box 4. Interest Rate Channel of Monetary Transmission in Moldova [1/]

Staff analysis indicates that the interest rate channel of transmission in Moldova is weak compared with more advanced European economies. The pass-through coefficient from the policy rate to money market rates is estimated at 0.27, while in more mature markets these are closer to unity. Pass-through from the money market to retail lending rates is also weak with a coefficient estimate of only 0.14 versus the average of 0.65 for the sample of selected countries in the region. Moldova appears to be a clear outlier. Its financial markets are segmented and there is no a well-established benchmark yield curve.

Banking Sector Liquidity, 2005
(Liquid assets/Total assets, percent)



Pass-Through in Selected European Countries



The main impediment to interest rate transmission in Moldova is excess liquidity. Unless the liquidity overhang is eliminated, transmission is likely to remain weak. Other factors undermining pass-through appear to be (i) the perceived uncertainty about monetary policy objectives, which undermines credibility of the NBM and weakens its signaling function; (ii) underdeveloped financial markets with an incomplete term structure of interest rates; and (iii) the lack of banking competition.

1/ See *Selected Issues* Chapter I, 'In Search of Monetary Transmission in Moldova'.

B. Fiscal Policy in the Face of Conflicting Needs

22. **The authorities were concerned with striking a balance between development spending and disinflation needs.** It was agreed that fiscal policy for 2008 would remain tight, while increasing spending on health and social assistance and protecting key investment projects, particularly on much-needed roads, where EBRD and EIB are supporting the government. In the medium-term, while keeping the budget deficit at 0.5 percent of GDP, the authorities plan to provide for greater fiscal space for social and investment spending through downsizing, reduction in spending inefficiencies, and strengthened tax administration.

Improving Structure of Expenditures, 2006-10
(in percent of annual GDP)

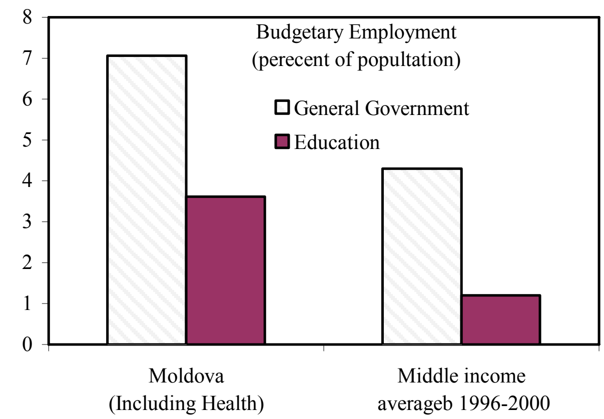
	2006	2007	2008	2009	2010
Expenditure, total	40.3	43.6	41.6	41.0	40.5
Wages	9.4	9.5	9.4	9.2	8.9
Goods and services	8.4	9.3	9.1	9.0	8.9
of which: health insurance fund	3.4	3.7	4.5	4.6	4.9
Interest payments	1.0	1.2	1.2	0.9	0.7
Transfers	13.7	15.9	14.5	14.4	14.4
of which: social insurance fund	9.9	10.2	10.7	10.6	10.6
Capital expenditure	7.9	7.7	7.5	7.5	7.5

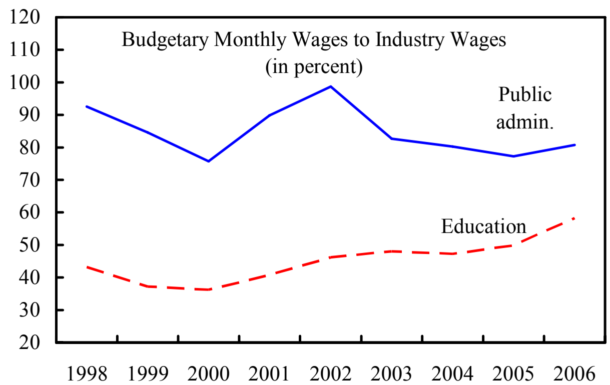
Sources: Moldovan authorities and Fund staff projections.

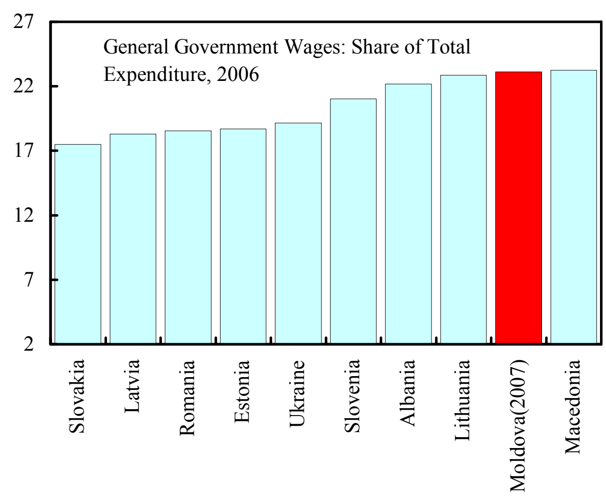
23. **The 2008 budget is prudent.** The deficit target of 0.5 percent of GDP is consistent with the disinflation objective, implying higher negative domestic financing than in 2007. Negative domestic financing is likely to increase even further given the upside risks to privatization revenue. Despite the worldwide growth slowdown, overall revenue estimates are conservative, particularly revenue from VAT on remittance-financed imports, even though the budget has been squeezed by corporate and personal income tax cuts. The authorities proposed to spend any revenue overperformance, now estimated by staff at up to 1 percent of GDP, on investment. However, staff underscored that fiscal policy should remain tight and any spending of the overperformance be conditional on single digit inflation being firmly re-established. The authorities agreed to discuss any budget rectification in the framework of the Fourth Review (MEFP ¶6). The previously announced wage increase was scaled back, with the public sector wage bill projected to decline from 9.5 percent of GDP in 2007 to 9.4 percent in 2008, which is below the program ceiling of 10 percent of GDP, but still high for the region (Box 5). In support of the NBM's efforts to bring inflation down to single digits, the quarterly profile of the fiscal program in 2008 envisages a balanced budget for the first half of the year.

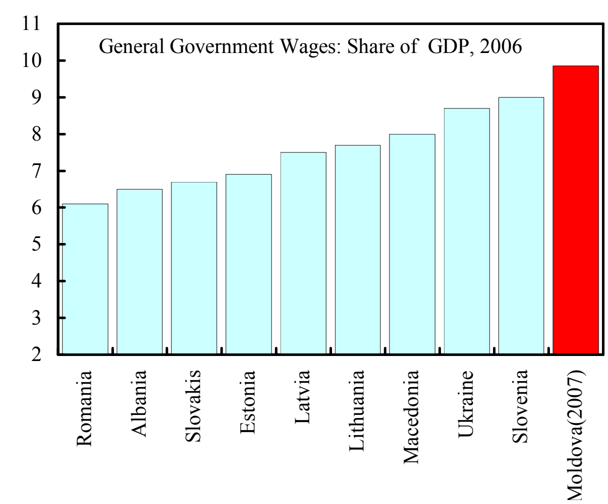
Box 5. Cooperation with World Bank on Public Administration Reform

Staff is working closely with the Bank on public administration reform. The ongoing World Bank Public Expenditure Review has identified the implementation of a transparent and uniform remuneration scheme and consolidation of school and health care networks as key reform areas. The number of budget sector workers is high by international comparison, particularly in the education sector. The public wage bill is also above regional averages: at a projected 9.9 percent of GDP in 2007, it is 2.4 percentage points higher than in peer countries. The 2008 wage increase, although scaled back, will continue to crowd out essential spending if downsizing is not considered. Public sector wages lag behind the private sector and a poorly designed pay structure creates difficulties in attracting and retaining skilled employees. The public sector rationalization plan under the PRGF is key for strengthening the link between the medium-term expenditure framework and public administration reform. Civil service reform is already part of the PRGF.









Sources of Deficit Financing, 2006-08
(in percent of annual GDP)

	2006	2007	2008
Deficit financing	(0.2)	0.3	0.5
Central government	(0.7)	0.4	0.4
Net domestic	(0.6)	(0.3)	(0.4)
Net foreign	(0.5)	0.3	0.6
Privatization	0.4	0.4	0.2
Local governments	0.6	(0.0)	0.1
of which: privatization	0.5	0.4	0.1

Note: Net foreign financing includes project loans.

Sources: Moldovan authorities and Fund staff projections.

24. **Policy discussions on the medium-term framework focused on the need to create fiscal space given pressing development needs:**

- **Staff welcomed the authorities' intention to retain a fiscal deficit anchor of 0.5 percent of GDP, as reflected in the medium-term expenditure framework.** While the DSA shows there would be room for modest additional borrowing, the fiscal anchor would support macroeconomic stability, and offset the projected decline in private savings, in line with the experience of other transition economies. At the same time, the authorities plan to create additional fiscal space to maintain social and investment spending, allowing a reduction in the overall footprint of the state.

- **It was agreed that strong revenue prospects provide a good opportunity for decisive reform of the public sector.** In line with recommendations of the World Bank's 2007 Public Expenditure Review, the authorities' objectives are to reduce the size of public employment, especially in education, to consolidate school and health care networks and improve quality of service and education standards, and design a transparent and uniform remuneration scheme to closely align pay with skills (Box 5). The government's medium-term action plan for rationalizing the public sector employment envisages downsizing of employment by 10,000 by 2010, with an initial reduction of 3,000 in 2008. As a first step towards development and implementation of a new wage grid, essential to rationalizing employment and increasing the quality of public services, by end-September 2008 the government—with the assistance of the WB and/or other donors—plans to approve a draft law, which will consolidate all forms of remuneration in base pay for civil servants, with a view to implementing it in 2009 (MEFP ¶7, ¶8). The rationalization of public sector employment and wage grid reform is estimated to reduce the wage bill by about 0.2 percent of GDP annually.

- **The mission welcomed the authorities' strategy for strengthening tax administration.** The reform effort in this area has been prompted by a tax amnesty implemented in May 2007, against staff advice, which canceled pre-2007 tax arrears and halted tax audits for the same period. The MEFP outlines the reform plan, which has been recently revised in accordance with the recommendations of the FAD TA mission. The key component of the reform is to strengthen tax enforcement and tax arrears management by upgrading the IT systems, developing prompt measures for forced arrears collection, and streamlining procedures for writing off uncollectible arrears. At the same time, all functions for assessing and collecting arrears, which are now spread among several entities, will be consolidated in the State Tax Inspectorate (STI), which will also be reorganized along functional lines (MEFP ¶9).

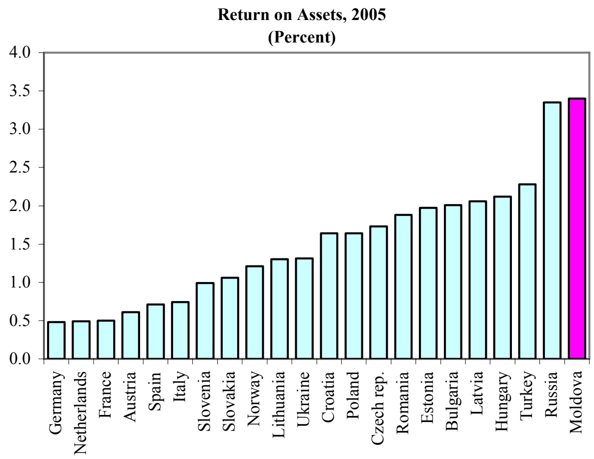
- **Staff stressed that timely implementation of a new targeted social assistance system will be key to reduce poverty**. As noted in FAD's poverty and social impact assessment (PSIA) report, the current system of social assistance based on social categories is poorly targeted.[4] The new, means-tested system, whose methodology was adopted in early October, and which is scheduled to be implemented by end September 2008 (MEFP ¶27), promises to considerably improve targeting at an additional cost of about 0.2 percent of GDP in 2008.

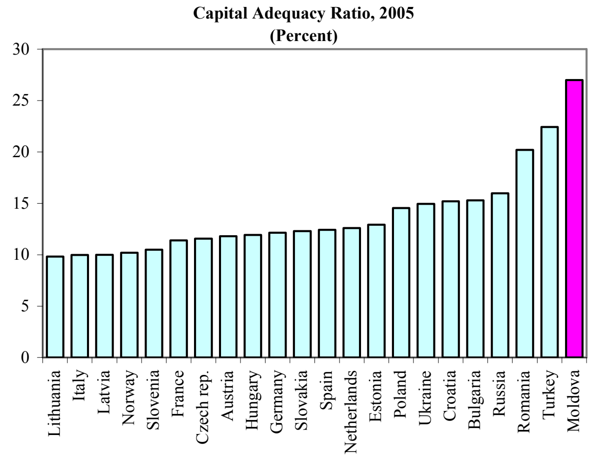
C. Strengthening the Financial Sector

25. **Overall, Moldova's banking sector appears stable and vulnerabilities manageable.** Robust capitalization and liquidity constitute a first-line buffer in case of possible distress, but may also indicate weaknesses in operating and risk management capacity. Rapid credit growth, partially funded through a decline in banks' foreign assets, and high dollarization also need to be carefully monitored. In addition, high profitability of banks and high intermediation spreads suggest that competition may be inadequate. Ironically, underdevelopment and weak integration in international financial markets have helped Moldovan banks to weather external disturbances exceptionally well. The banking sector has proved to be remarkably resilient to external shocks, and the recent global liquidity squeeze had virtually no impact.

26. **At the same time, the FSAP update highlighted the difficulty in introducing effective market reforms.** Despite considerable efforts to strengthen the financial sector over past years, it continues to lag behind its peers in intermediating savings. Total assets and private sector credit have doubled since 2001, but at 54 percent and 31 percent of GDP respectively, the share of the financial sector in the economy is still small compared with more advanced countries in the region. More recently, a number of strategic foreign banks have started to show a keen interest in Moldova, but insufficient transparency of bank ownership continues to hamper development.

[4] The 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.





Source: IMF and Moldovan authorities

Summary of Key FSAP Update Recommendations

Create the framework for effective cooperation between the supervisors	(i) Sign Memoranda of Understanding between the NBM and the NCFM and separately between the central bank and all subsectoral supervisors. (ii) Develop the joint handling of some of the supervisory databases
Improve the effectiveness of bank supervision	(i) Issue guidelines for the implementation of consolidated accounting requirements. (ii) Continue to make efforts to identify the beneficial owners of banks. (iii) Improve the capacity in the NBM to adapt stress testing scenarios to the changing circumstances.
Improve liquidity management	(i) Develop the capacity to better forecast and manage liquidity. (ii) Further increase the transparency of monetary operations.
Start the effective operation of the NCFM	(i) Review and redefine, as needed, the licensing process for intermediaries under the NCFM. (ii) Ensure the necessary NCFM funding through the government budget, as needed. (iii) Upgrade existing staff technical capacity to implement and enforce insurance legislation. (iv) Move to a modern Central Securities Depository structure, including the registrar functions (and RTGS payments) for at least the listed companies.
Implement, with the leadership of the NBM, the National Net Settlement Service for leu transactions	

27. **Under the program, there was agreement on the importance of strengthening the supervisory and regulatory framework for the financial system, and promoting the transparency of bank ownership.** To preserve independence and regulatory powers of financial sector supervisors, all entities regulated and supervised by the NBM and the NCFM have been excluded from the Law # 235 on Core Principles of Regulating Entrepreneurial Activities, which streamlines regulations of entrepreneurial activities (PA). Similarly, the draft licensing law, which was recently submitted to Parliament, will also be amended to that effect by end-March 2008 (PC). Further, to address the remaining weaknesses in transparency of bank ownership, the NBM will step up its efforts in identifying beneficial owners and study best international practices, especially those of EU countries, in applying 'fit and proper' test for significant shareholders (MEFP ¶16).

28. **The staff were encouraged by the authorities' commitment to accelerate the privatization of the majority state-owned Banca de Economii (BEM) to a strategic banking investor, long seen as critical for enhancing competition.** As mandated under the program, the authorities held an international tender for selecting a consulting company for the bank evaluation. However, in consultation with staff, negotiations have subsequently been revoked because of the winner's unwarranted demands for exclusive proprietary rights to share information obtained during the evaluation and to advise on the sale of the bank after evaluation. Instead, the authorities have decided to skip this stage and will announce a new tender for a privatization advisor by end-March 2008, and will select a winner by end-September with a six-month timeframe for bringing BEM to market (MEFP ¶14). In the meantime, they will continue to abstain from granting any preferential treatment to the bank.

D. Boosting Structural Reforms

29. **The authorities showed strong commitment to advancing transition by bolstering reforms designed to improve the investment climate and clarify the role of the state in the economy.** Important initiatives include: the ongoing regulatory reform, which is intended to streamline the procedures for business licensing and registration in the non-financial sector, including setting-up a one-stop shop service, and optimizing the institutional structure and functions of controlling bodies to reduce business harassment; revision of insolvency legislation and development of bankruptcy procedures in accordance with best international practices; strengthening competition legislation and the effectiveness of the National Agency for Protecting Competition; implementation of the Strategy for Attracting Investments and Promoting Exports; strengthening product quality testing capacity and further liberalizing foreign trade by removing quantitative restrictions on imports of meat and dairy; and adoption of the law on public-private partnerships (PPP).

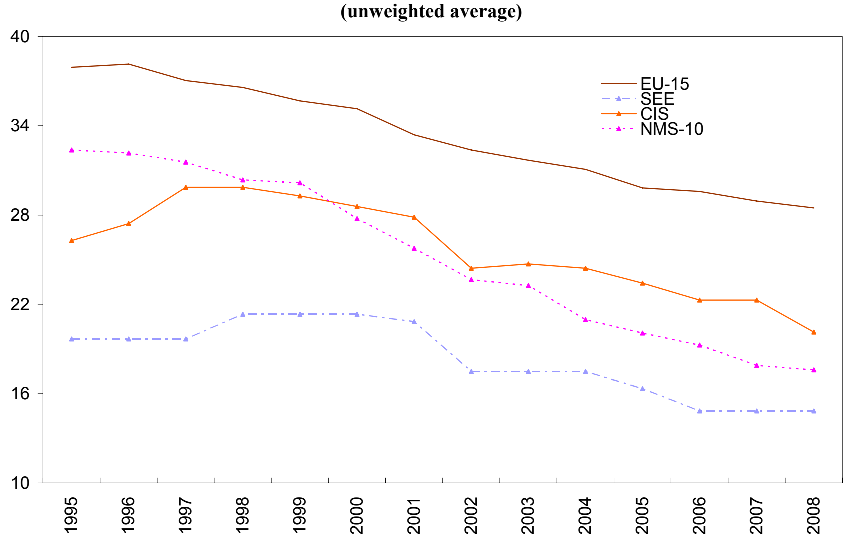
30. **Staff noted that the zero-rated CIT is not likely to bring new FDI without improvements in the business climate.** With declining CIT rates in other countries in the

region, the relative importance of the overall institutional quality is likely to increase further (Box 6).

Box 6. Zero Corporate Income Tax in Moldova and its Implications for Tax Competition[1/]

Global economic integration has intensified tax competition over mobile capital. This led to significant declines in corporate income tax (CIT) rates in Western and Eastern Europe during the last decade. Further cuts in CIT are likely to continue in the near future (in 2008 alone, ten countries in Europe reduced corporate tax rates). The declining CIT rates raised concerns about tax competition and the resulting "race to the bottom", which could undermine public investment and social spending.

CIT rate in EU-15 and Eastern Europe
(unweighted average)



The Moldovan zero CIT could encourage further cuts in CIT. Countries in Eastern Europe strategically respond to changes in CIT rates in the region. Corporate tax in the region are likely to further decline. Evidence suggests that FDI flows in the region will not be much affected, because taxes seem to have only secondary importance in attracting FDI. However, revenues are likely to decline. More positively, the shift in the composition of tax revenue towards consumption and labor taxes may increase economic efficiency, but at the cost of a decline in equity.

1/ See Selected Issues Paper Chapter II, 'Zero Corporate Income Tax in Moldova: Tax Competition and its Implications for Eastern Europe'.

31. **In a welcome initiative, the authorities have decided to revitalize the stalled privatization process.** The authorities recently published privatization list is a strong statement that they are committed to private sector development and reducing the role of the state. However, they were concerned that spending of privatization proceeds was constrained by the fiscal deficit limits under the program. In response, staff reiterated the importance of reducing inflation to single digits for macroeconomic stability and noted that quick progress on disinflation would already have provided more room for spending by the time privatization revenues materialized. At the same time, staff concurred that transparent

privatization efforts that target strategic investors could become a catalyst for growth and provide a powerful signal of business-friendly policies.

32. **The mission welcomed the government's decision to sell remaining large state enterprises, where private involvement can bring new investment and provide a catalyst for growth.** Specifically, they plan to reopen the privatization of Moldtelecom, the incumbent telecommunications operator. There is evidence that Moldtelecom's privileged position distorts the telecommunication market. The World Bank has indicated its willingness to support the government's efforts in this area, suggesting that consideration of privatization should be situated within a wider reform process that includes measures to bolster competition and liberalize the market to ensure distortions are removed. The authorities agreed to a structural benchmark on selecting an advisor to look at the modalities for possible privatization through an open tender by end-September 2008 (MEFP ¶19).

33. **The implementation of utility tariff reform became controversial for heating, threatening the financial viability of the utility, Termocom.** In line with past program conditionality, the regulator, ANRE, now calculates the cost-recovery tariff using appropriate inputs and normal rate-of-return methodology. However, it is the municipality that sets the actual tariffs paid to the utilities. In January 2007, the municipality of Chişinău set heat tariffs at cost recovery, but subsidized households. The municipality subsequently disputed the inputs to the methodology, arguing that the cost recovery tariff was lower (implying lower subsidies needed for households). In December 2007 the municipality canceled its earlier decision to raise tariffs and subsidize households, resulting in a build-up of arrears to Termocom. Heat tariffs have been restored to their previous cost-recovery level of lei 540 in January 2008 following a court decision. To avoid future disruptions in the heating sector, the authorities request a continuous structural benchmark that heat tariffs received by utilities be set at cost-recovery following the ANRE methodology, and that in cases of disputes, a lower tariff than provided by ANRE would imply new domestic expenditure arrears under the program (MEFP ¶27). To ease the burden on the poor, an interim municipal assistance scheme will be put in place until the introduction of a new targeted social assistance system in September 2008.

34. **The authorities at times have shown a tendency to intervene in the trade regime through administrative measures, though the regime remains generally open.** Moldova is a WTO member and benefits from both a free trade agreement with CIS countries and, from March 2008, an ATP with the EU. With world grain prices rising and volatile, several proposals to ban or limit wheat exports have been floated. In addition, the cumbersome new system for approving meat and dairy imports implemented in early 2007 is a worrying signal to potential foreign investors.[5] The authorities agreed to a structural benchmark to remove the

[5] Companies face weekly quantitative restrictions on imports, and have to reapply for permission. This has led to shell companies being set up, and approvals are regarded as politically influenced and opaque.

existing restrictions on meat and dairy, and to refrain from imposing any new restrictions in the future.

35. **With the program at a halfway stage, discussions focused on key reforms for the remainder of the PRGF arrangement**. It was agreed that high priority should be given to consolidation of the independence of the financial regulators with appropriate amendments to the 'Guillotine law' (PA) and licensing law (PC). Other core conditionality focuses on addressing the deteriorating financial condition of the heating sector, which has also undermined the fiscal position of the general government, the ongoing privatization of Banca de Economii to enhance competition in the banking sector and strengthen the monetary transmission process, and the rationalization of the public sector. On the latter, key measures include initial reforms of the payroll and the downsizing needed to achieve the overall spending objectives in the medium-term framework, as well as the privatization of the remaining two large state enterprises (BEM and Moldtelecom) which tie up substantial state resources and hamper competition in key strategic sectors.

VI. Program Issues

36. **The authorities request to drop two structural benchmarks under the program.** Given the strengthened independence of ANRE, which sets natural gas and electricity tariffs according to normal rate-of-return methodology, and the demonstrated effectiveness of the system for these items, it is proposed to drop a continuous SB that these tariffs remain at cost-recovery levels.[6] On the transfer of tariff-setting responsibility for heat to ANRE, the missed end-September SB, the authorities indicated that it does not comply with the constitutional division of rights between local and central governments. The staff agreed to propose dropping this condition from the program, but pointed out that unless the effectiveness of the current system in setting tariffs for heat and water at cost-recovery is demonstrated, the Fourth Review would return to this issue. The new structural conditionality for the review is summarized in the text table.

37. **The authorities have prepared the National Development Strategy (NDS), which will replace the EGPRSP.** The medium-term objectives of the NDS are: (1) strengthening democracy based on the rule of law and respect for human rights; (2) settling the Transnistrian conflict and reintegration; (3) enhancing competitiveness and the business environment; (4) enhancing employment and promoting social inclusion; and (5) developing regions. Staff discussed measures under the PRGF arrangement to support competitiveness and the business environment as well as the new social assistance system. The Bank has greater expertise in labor market and rural development issues. The JSAN, prepared jointly staffs of the IMF and the WB, summarizes the assessment.

---

[6] The agreement with Gazprom calls for a gradual increase in gas import prices to European levels by 2011.

Prior Actions, Performance Criteria and Structural Benchmarks

Measure	Due	Status	Note
Proposed prior actions			
Amend the Law #235 to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.		Implemented	The amendments to the Law#235 were passed by Parliament in February 2008.
Heat tariffs received by utilities will be set at cost-recovery of lei 540, following the ANRE methodology.		Implemented	Heat tariffs were restored to cost-recovery in January 2007.
Proposed performance criteria			
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		
Announce tender for privatization advisor to Banca de Economii.	31-Mar-08		New condition
Adoption of legislation to (i) give the STI the right to write-off uncollectible tax arrears and (ii) shift all tax audit, assessment, and collection powers to STI.	31-Mar-08		New condition, modified from the end-March 2008 SB in the 2007 program.
Adopt a new Licensing Law to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.	31-Mar-08		New condition
Sign the contract with the privatization advisor for Banca de Economii with a six-month time frame for bringing the bank to market.	30-Sep-08		New condition
Proposed structural benchmarks			
Heat tariffs received by utilities remain at cost recovery. A lower tariff than provided by ANRE methodology would imply new domestic expenditure arrears under the program.	Continuous		New condition
Outstanding stock of NBM claims on government fully securitized.	31-Mar-08		
Introduction of a system whereby the State Treasury ensures that the balances in commercial banks of the social insurance budget (BASS) and the mandatory health insurance fund are zero-ed out on a daily basis.	30-Jun-08		
Remove quantitative restrictions on imports of meat and dairy products.	30-Jun-08		New condition
Introduce the targeted social assistance system throughout Moldova.	30-Sep-08		
The government approval of a draft law, which will consolidate all forms of remuneration in base pay for civil servants, with a view to implementing it in the 2009 budget year.	30-Sep-08		New condition
Selection of an advisor through an open tender to assess the modalities for the possible privatization of Moldtelecom.	30-Sep-08		New condition
Reduce public employment by 3000 people.	31-Dec-08		New condition

VII. Staff Appraisal

38. **Much has been achieved despite the shocks:**

- **Growth remains robust**. Investment is picking up, and is beginning to replace remittances as the main driver of the economy. Poverty has fallen, and Moldova has been reclassified as a middle-income country.

- **The PRGF arrangement remains on track.** Program implementation under the Third Review has been satisfactory, and the authorities' policies for 2008 are appropriately ambitious, with a welcome pick-up in the pace of structural reforms, despite the upcoming elections.

39. **But much remains to be done, and the challenges are considerable:**

- **Moldova's progress has not come without tests.** Transition has brought with it strong capital inflows, appreciation pressures, and a widening trade deficit.

- **The authorities have few policy levers to address these pressures.** The impact of monetary policy is compromised by a weak transmission mechanism, and fiscal policy is burdened with large development needs.

40. **Monetary policy needs to play a major and strengthened role.** Inflation at 13 percent at end 2007 is higher than we had hoped, even accounting for the drought. Continued strong foreign exchange inflows and reserve money growth suggest the upside risks to inflation remain. The recent tightening by the National Bank and its commitment to establish price stability as its sole objective is therefore welcome. However, it needs to be prepared to allow greater exchange rate flexibility, and to tighten its policy rate further if disinflation does not resume.

41. **Overall, vulnerabilities of the financial sector appear manageable, but reforms to deepen financial markets will be important to help strengthen the effectiveness of monetary policy.** In line with the FSAP update, these should focus on strengthening the supervisory and regulatory framework, restructuring of the central bank with a view to eventual introduction of inflation targeting, and promoting transparency of bank ownership. The privatization of the majority state-owned bank should also help inject greater competition into the system. The authorities should ensure that implementation of the new AML/CFT law is effective.

42. **Fiscal policy has to play its part.** The 2008 budget does a reasonable job in balancing development needs with disinflation. Modest fiscal deficits are an appropriate compromise. Nevertheless, the budget should remain tight until single digit inflation is firmly established, with the scope for higher development expenditure assessed at the time of the

next review. Revenue performance will be helped by robust VAT on imports, which is likely to partly offset the impact of the earlier tax cuts. Social spending has been raised, investment remains high, and the effects of the recent wage increases limited.

43. **Strong revenue prospects provide an opportunity for decisive public sector reform.** The authorities' plans for reducing the size of the public sector, introducing a transparent and attractive remuneration system, and consolidating education and health care networks, are all important steps to ensure the efficient management of scarce public resources and establish a modern public administration.

44. **The authorities' commitment to strengthen tax administration is welcome.** The reforms, which draw on Fund technical assistance, should help avoid reemergence of the problems with tax arrears that we saw at the time of the last review.

45. **The structural reform agenda remains long.** Moldova continues to score unfavorably on most transition indicators. The second 'Guillotine law' is an important initiative to improve business licensing, but just as important will be planned measures to curtail discretionary powers of officials and to revitalize the privatization process to promote private sector-based growth.

46. **The instinct for state intervention is nevertheless strong.** This is seen most clearly in the trade sector where numerous initiatives have obstructed the normal workings of the trade system. The authorities have undertaken to remove recently imposed import restrictions, but attitudes are likely to take longer to change.

47. **Modernization of the energy sector should remain high on the authorities' agenda.** The establishment of cost recovery tariffs in the heating sector will help alleviate the weak financial condition of the energy sector, and staff have encouraged the authorities to work with the Bank on broader energy reforms.

48. **The staff assessment of the exchange rate raises no major concerns regarding external sustainability, with room to accommodate appreciation pressures.** The current exchange rate appears to be broadly in line with fundamentals. With considerably lower labor costs and higher productivity growth compared to the region, there is scope for further appreciation without undermining competitiveness.

49. **The staff recommends completion of the third review.** Performance under the program has been satisfactory, and policies for 2008 remain appropriately ambitious.

50. It is proposed that the next Article IV consultation with Moldova remain on a 24-month cycle in line with the provisions of the decision on consultation cycles in program countries.

Table 1. Moldova: Selected Indicators, 2005–10 1/

	2005	2006		2007		2008		2009		2010
		IMF CR No 07/45	Prel.	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	Proj.
I. Real sector indicators				(Percent change; unless otherwise indicated)						
Gross domestic product										
Real growth rate	7.5	3.0	4.0	5.0	5.0	5.0	7.0	5.0	8.0	7.5
Nominal GDP (billions of lei)	37.7	42.0	44.1	49.7	51.3	56.0	58.8	62.9	68.2	76.0
Nominal GDP (billions of U.S. dollars)	3.0	3.2	3.4	4.0	4.2	4.6	5.3	5.2	6.5	7.4
Consumer Price Index (average)	11.9	12.3	12.7	10.6	12.6	9.3	11.4	7.5	7.9	6.5
Consumer Price Index (end of period)	10.1	12.0	14.1	10.0	13.4	8.0	9.0	7.0	7.0	6.0
GDP deflator	9.3	10.8	12.5	7.4	10.9	7.4	7.1	6.8	7.4	3.7
Average monthly wage (lei)	1,320	...	1695	...	...	...	...	...	...	...
Average monthly wage (U.S. dollars)	105	...	129	...	...	...	...	...	...	...
Saving-investment balance				(In percent of GDP)						
Foreign saving	10.3	10.4	12.0	8.9	9.7	8.2	10.3	7.1	10.8	11.3
National saving	14.3	13.0	15.9	18.9	20.3	20.2	20.0	21.9	19.6	19.0
Private	6.8	7.4	7.9	12.4	13.1	13.7	13.0	16.3	12.6	12.0
Public	7.5	5.6	8.0	6.5	7.2	6.5	7.0	5.6	7.0	7.0
Gross investment	24.6	23.5	27.9	27.7	30.0	28.4	30.3	29.0	30.4	30.4
Private	18.4	17.9	20.2	20.8	22.3	21.4	22.9	22.0	22.9	22.8
Public	6.2	5.5	7.8	7.0	7.7	7.0	7.5	7.0	7.5	7.5
II. Fiscal Indicators (general government)				(In percent of GDP)						
Primary balance (cash)	2.6	1.3	1.3	0.8	0.9	0.6	0.7	0.5	0.4	0.2
Overall balance (cash)	1.3	0.0	0.2	-0.5	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5
Overall balance (commitments)	1.3	0.1	0.3	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Overall balance (commitments), excluding foreign-financed projects	2.2	1.0	1.1	0.7	1.0	1.0	0.7	0.8	0.5	0.4
Stock of general government debt	38.0	32.8	34.6	31.1	29.2	26.0	22.1	22.8	18.7	16.3
III. Financial indicators				(Percent change; unless otherwise indicated)						
Broad money (M3)	35.0	19.4	23.6	18.2	39.8	...	21.5	...	...	...
Velocity (GDP/end-period M3; ratio)	2.4	2.2	2.3	2.2	1.9	...	1.8	...	...	...
Reserve money	31.8	-5.6	-7.0	14.3	46.4	...	20.0	...	...	...
Credit to the economy	35.0	26.1	37.8	17.4	51.7	...	22.0	...	...	...
IV. External sector indicators				(In millions of U.S. dollars, unless otherwise indicated)						
Current account balance	-307	-331	-404	-354	-410	-379	-552	-370	-698	-842
Current account balance (percent of GDP)	-10.3	-10.4	-12.0	-8.9	-9.7	-8.2	-10.3	-7.1	-10.8	-11.3
Remittances and compensation of employees (net)	869	1,156	1,119	1,343	1,548	1,531	2,008	1,743	2,329	2,441
Gross official reserves 2/	597	688	775	994	1,334	1,264	1,743	1,595	2,193	2,640
Gross official reserves (months of imports)	2.2	2.3	2.2	2.9	3.0	3.3	3.2	3.9	3.6	4.0
Exchange rate (MDL/$) period average	12.6	13.3	13.1	12.5	12.1	12.2	11.0	12.1	10.5	10.2
Exchange rate (MDL/$) end of period	12.8	13.8	13.1	12.3	11.3	12.1	10.8	12.1	10.4	10.2
Real effective exchange rate, change (percent)	-1.3	1.8	0.0	6.1	11.0	6.2	16.3	4.2	8.5	5.7
External debt/GDP (percent) 3/	56.2	51.6	57.4	49.1	58.8	43.3	55.0	39.1	53.4	53.2
Debt service/exports of goods and services (percent)	16.5	16.7	18.7	13.1	8.8	13.2	11.1	13.8	12.7	15.1
Social indicators, reference year										
Per capita GNI, U.S. dollars: 880 (2005)										
Life expectancy, male, years: 64.9 (2005)										

Sources: Moldovan authorities; and Fund staff estimates.

1/ Data exclude Transnistria.

2/ For 2005, includes the positive effect of reclassification of $43 million.

3/ Includes private and public debt.

Table 2. Moldova: Balance of Payments, 2005–12
(In millions of U.S. dollars; unless otherwise indicated)

	2005	2006	2007		2008		2009		2010	2011	2012
		Prel.	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	Proj.	Proj.	Proj.
Current account	-307	-404	-354	-410	-379	-552	-370	-698	-842	-932	-997
Merchandise trade balance	-1,191	-1,591	-1,908	-2,213	-2,174	-2,895	-2,402	-3,367	-3,724	-3,812	-4,025
Exports of goods	1,104	1,053	1,209	1,367	1,374	1,873	1,550	2,514	2,896	3,334	3,667
of which: wine and alcohol	315	187	226	171	294	223	375	286	329	379	417
Imports of goods	-2,295	-2,644	-3,116	-3,580	-3,547	-4,768	-7,952	-5,881	-6,621	-7,146	-7,693
of which: energy	-426	-545	-638	-650	-706	-820	-742	-894	-960	-1,033	-1,090
non-energy	-1,869	-2,099	-2,478	-2,930	-2,841	-3,949	-3,210	-4,987	-5,660	-6,113	-6,602
Balance of services	-20	-6	-7	41	-10	107	-10	134	203	285	329
Exports of services	424	482	540	598	567	742	596	801	923	1,062	1,168
Imports of services	-444	-488	-547	-557	-577	-635	-606	-667	-720	-777	-840
Income (net)	359	400	515	635	593	785	696	896	904	896	894
Compensation of employees	477	523	627	723	715	938	814	1,088	1,140	1,164	1,187
Income on direct and portfolio investment	-92	-109	-80	-85	-94	-107	-106	-130	-149	-168	-185
Income on other investment	-26	-14	-32	-4	-28	-46	-12	-62	-87	-100	-109
Current transfers (net), *of which:*	545	794	1,046	1,127	1,211	1,452	1,347	1,639	1,776	1,700	1,806
Remittances, net	392	596	716	825	816	1,070	929	1,241	1,301	1,328	1,355
Official transfers, *of which:*	46	59	169	140	218	194	226	194	179	158	141
Budget grants	...	24	84	63	120	107	129	110	92	66	58
Capital and financial account	211	272	545	828	636	949	702	1,131	1,298	1,401	1,510
Capital account	-17	-23	-23	-16	-23	-16	-15	-16	-16	-16	-16
Financial account	228	294	568	844	659	965	717	1,147	1,314	1,417	1,526
Direct investment	225	223	351	521	415	627	469	768	880	945	1,013
Portfolio investment (net)	-7	-5	-5	-5	-5	-5	-5	-5	-5	-5	-5
Other investments	11	76	221	327	249	342	252	383	438	477	518
Errors and omissions	192	117	0	130	0	0	0	0	0	0	0
Overall balance	96	-15	191	547	257	397	-332	433	456	470	513
Financing	-96	15	-191	-547	-257	-397	-332	-433	-456	-470	-513
Use of Fund credit 1/	-21	41	27	11	13	12	-1	16	-8	-6	-19
Change of gross official reserves (increase -)	-129	-141	-219	-558	-270	-409	-331	-449	-448	-464	-494
Exceptional financing:	54	115	0	0	0	0	0	0	0	0	0
Operations with PPG debt	17	27	0	0	0	0	0	0	0	0	0
Accumulation of arrears on public debt	18	26	0	0	0	0	0	0	0	0	0
Financing gap	...	0	0	0	0	0	0	0	0	0	0
Memorandum items :											
Gross official reserves 2/	597	775	994	1,334	1,264	1,743	1,595	2,193	2,640	3,104	3,598
in months of imports of goods and services	2.3	2.2	2.9	3.0	3.3	3.2	3.9	3.6	4.0	4.4	4.7
IMF augmentation (Dec 2006)	...	...	...	...	...	...	...	...	...		
Nominal GDP	2,988	3,356	3,983	4,227	4,607	5,343	5,213	6,485	7,436	8,360	9,206
Current account balance (percent of GDP)	-10	-12	-9	-10	-8	-10	-7	-11	-11	-11	-11
G&S trade balance (percent of GDP)	-41	-48	-48	-51	-48	-52	-46	-50	-47	-42	-40
Exports G&S (percent of GDP)	51	46	44	46	42	49	41	51	51	53	53
Exports G&S growth (percent)	15	1	14	28	11	33	11	27	15	15	10
Imports G&S (percent of GDP)	-92	-93	-92	-98	-90	-101	-87	-101	-99	-95	-93
Imports G&S growth (percent)	30	14	-17	32	13	31	11	21	12	8	8
Remittances and compensation of employees (net)	869	1,119	1,343	1,548	1,531	2,008	1,743	2,329	2,441	2,491	2,543
Total debt service/exports G&S (percent)	17	19	13	9	13	11	14	13	15	17	19
External debt stock (percent of GDP) 3/	56	57	49	59	43	55	39	53	53	52	51
Natural gas import price, $/1000 m3	69	120	170	170	185	193	190	213	221	228	0
External energy arrears	287	321	321	321	321	321	321	321	321	321	321
External PPG arrears	56	0	0	0	0	0	0	0	0	0	0

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

1/ Includes prospective disbursements.

2/ Includes revaluation changes, which are not captured by changes of gross official reserves in the BoP.

3/ Including energy arrears.

Table 3. Moldova: General Government Budget, 2005–10
(In millions of lei; unless otherwise indicated)

	2005	2006		2007		2008		2009		2010
		IMF CR No 07/45	Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	Proj.
Revenues and grants	14,519	16,893	17,845	20,886	22,220	22,242	24,163	24,819	27,646	30,398
Revenues	12,823	15,280	16,044	18,338	19,781	19,382	21,470	21,549	24,959	27,958
Tax revenues	11,888	14,176	14,889	16,928	18,154	17,979	20,020	19,998	23,291	26,104
Profit tax	709	975	1,079	1,143	1,388	400	418	500	500	600
Personal income tax	962	1,051	1,128	1,243	1,329	1,345	1,294	1,508	1,569	1,749
VAT	4,623	5,796	6,194	7,122	7,587	7,705	8,885	8,530	10,130	11,265
Excises	1,172	1,004	1,071	1,246	1,392	1,359	1,501	1,505	1,764	1,962
Foreign trade taxes	681	764	828	856	899	949	1,050	1,048	1,237	1,376
Other taxes	327	336	342	373	368	420	441	456	494	549
Social Fund contributions	2,972	3,723	3,691	4,204	4,350	4,840	5,257	5,350	6,046	6,773
Health Fund contributions	442	526	558	743	841	960	1,175	1,100	1,551	1,830
Non-tax revenues	935	1,104	1,154	1,410	1,627	1,403	1,450	1,551	1,668	1,854
NBM profit transfers	74	163	163	313	313	153	0	200	0	0
Grants	460	440	315	1,046	919	1,461	1,175	1,730	1,161	940
Budget support grants	0	127	62	687	571	935	779	899	688	637
Foreign financed projects grants	0	313	253	359	348	525	396	651	473	303
Other foreign grants	...	...	...	0	0	0	0	180	0	0
Revenues of special funds	1,237	1,174	1,486	1,501	1,520	1,400	1,518	1,540	1,526	1,500
Expenditure and net lending	13,937	16,892	17,739	21,119	22,353	22,523	24,447	25,129	27,987	30,777
Current expenditure	11,641	14,617	14,312	17,717	18,448	18,671	20,126	20,796	22,924	25,101
Wages	3,000	3,970	4,123	4,966	4,875	5,405	5,517	5,957	6,245	6,769
Goods and services	2,899	3,595	3,703	4,851	4,779	4,507	5,357	5,145	6,145	6,769
of which: health insurance fund	1,108	1,528	1,485	1,938	1,895	2,564	2,646	3,057	3,143	3,695
Interest payments	471	537	455	645	635	607	692	627	616	551
Domestic	193	276	224	471	410	444	524	371	389	345
Foreign	277	261	231	174	200	162	168	256	226	206
Transfers	5,012	6,194	6,032	7,234	8,159	8,102	8,510	8,993	9,844	10,936
Transfers to economy	962	1,134	1,293	1,242	1,624	1,391	1,613	1,544	1,877	2,010
Transfers to households	4,050	5,060	4,739	5,992	6,535	6,711	6,897	7,449	7,967	8,926
of which: social insurance fund	3,692	4,502	4,383	5,088	5,216	5,960	6,276	6,612	7,217	8,026
Other current expenditure	259	321	0	22	0	50	50	75	75	76
Net lending	-39	-43	-61	-63	-60	-65	-66	-55	-55	-61
Capital expenditure	2,335	2,319	3,488	3,465	3,965	3,917	4,387	4,387	5,117	5,737
Statistical discrepancy	-89	-1	-5	...	...	...	...	...	...	...
Overall surplus(+)/deficit(-) (cash)	492	0	101	-233	-134	-280	-284	-310	-341	-380
Primary balance (cash)	...	537	555	412	476	326	409	317	275	171
Change in arrears (+, increase) 1/	4	-30	-13	0	150	0	0	0	0	0
Overall surplus(+)/deficit(-) (commitments)	488	30	114	-233	-284	-280	-284	-310	-341	-380
Financing	-492	-1	-101	233	134	280	284	310	341	380
Budget financing	-819	-388	-502	-346	-346	-535	-416	-498	-364	-336
Central government	-943	-555	-725	-457	-272	-560	-476	-522	-414	-386
Net domestic	-597	79	-253	-268	-148	-242	-245	-84	-110	-43
Net foreign (exlc. project loans)	-380	-662	-641	-343	-324	-341	-321	-462	-403	-443
Privatization	34	28	168	155	200	24	90	24	100	100
Financing gap	...	0	0	0	0	0	0	0	0	0
Local governments	151	100	267	40	-20	25	41	25	50	50
of which: privatization	...	...	227	80	207	25	41	0	0	0
Social Fund	5	67	30	120	87	0	20	0	0	0
Health Fund	-174	0	-74	-50	-142	0	0	0	0	0
Project loans	327	387	401	579	480	815	699	808	705	716
Memorandum item:										
GDP (billions of lei)	37.7	42.0	44.1	49.7	51.3	56.0	58.8	62.8	68.2	76.0
Augmented deficit 1/	...	...	-149	...	...	...	...	...	...	...
General government debt (billion of lei)	14.3	13.8	15.2	15.5	15.0	14.6	13.0	14.3	12.7	12.4
o.w. external debt	10.5	9.9	11.4	11.6	11.2	10.7	9.5	10.4	9.1	8.7

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

1/ Includes lei 250 mln of NBM recapitalization.

Table 3 (continued). Moldova: General Government Budget, 2005–10
(In percent of GDP; unless otherwise indicated)

	2005	2006		2007		2008		2009		2010
		IMF CR No 07/45	Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Proj.	IMF CR No 07/275	Proj.	Proj.
Revenues and grants	38.6	40.3	40.5	42.0	43.3	39.7	41.1	39.5	40.5	40.0
Revenues	34.1	36.4	36.4	36.9	38.5	34.6	36.5	34.3	36.6	36.8
Tax revenues	31.6	33.8	33.8	34.1	35.4	32.1	34.0	31.8	34.1	34.3
Profit tax	1.9	2.3	2.4	2.3	2.7	0.7	0.7	0.8	0.7	0.8
Personal income tax	2.6	2.5	2.6	2.5	2.6	2.4	2.2	2.4	2.3	2.3
VAT	12.3	13.8	14.1	14.3	14.8	13.7	15.1	13.6	14.9	14.8
Excises	3.1	2.4	2.4	2.5	2.7	2.4	2.6	2.4	2.6	2.6
Foreign trade taxes	1.8	1.8	1.9	1.7	1.8	1.7	1.8	1.7	1.8	1.8
Other taxes	0.9	0.8	0.8	0.8	0.7	0.8	0.8	0.7	0.7	0.7
Social Fund contributions	7.9	8.9	8.4	8.5	8.5	8.6	8.9	8.5	8.9	8.9
Health Fund contributions	1.2	1.3	1.3	1.5	1.6	1.7	2.0	1.8	2.3	2.4
Non-tax revenues	2.5	2.6	2.6	2.8	3.2	2.5	2.5	2.5	2.4	2.4
NBM profit transfers	0.2	0.4	0.4	0.6	0.6	0.3	0.0	0.3	0.0	0.0
Grants	1.2	1.0	0.7	2.1	1.8	2.6	2.0	2.8	1.7	1.2
Budget support grants	0.0	0.3	0.1	1.4	1.1	1.7	1.3	1.4	1.0	0.8
Foreign financed projects grants	0.0	0.7	0.6	0.7	0.7	0.9	0.7	1.0	0.7	0.4
Other foreign grants	...	...	...	0.0	0.0	0.0	0.0	0.3	0.0	0.0
Revenues of special funds	3.3	2.8	3.4	3.0	3.0	2.5	2.6	2.5	2.2	2.0
Expenditure and net lending	37.0	40.3	40.3	42.5	43.6	40.2	41.6	40.0	41.0	40.5
Current expenditure	30.9	34.8	32.5	35.6	35.9	33.3	34.2	33.1	33.6	33.0
Wages	8.0	9.5	9.4	10.0	9.5	9.6	9.4	9.5	9.2	8.9
Goods and services	7.7	8.6	8.4	9.8	9.3	8.0	9.1	8.2	9.0	8.9
Interest payments	1.2	1.3	1.0	1.3	1.2	1.1	1.2	1.0	0.9	0.7
Transfers	13.3	14.8	13.7	14.6	15.9	14.5	14.5	14.3	14.4	14.4
Other current expenditure	0.7	0.8	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Net lending	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital expenditure	6.2	5.5	7.9	7.0	7.7	7.0	7.5	7.0	7.5	7.5
Statistical discrepancy	-0.2	0.0	0.0	...	...	...	...	...	...	...
Overall surplus(+)/deficit(-) (cash)	1.3	0.0	0.2	-0.5	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5
Primary balance (cash)	2.6	1.3	1.3	0.8	0.9	0.6	0.7	0.5	0.4	0.2
Change in arrears (+, increase) 1/	0.0	-0.1	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Overall surplus(+)/deficit(-) (commitments	1.3	0.1	0.3	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Financing	-1.3	0.0	-0.2	0.5	0.3	0.5	0.5	0.5	0.5	0.5
Budget financing	-2.2	-0.9	-1.1	-0.7	-0.7	-1.0	-0.7	-0.8	-0.5	-0.4
Central government	-2.5	-1.3	-1.6	-0.9	-0.5	-1.0	-0.8	-0.8	-0.6	-0.5
Net domestic	-1.6	0.2	-0.6	-0.5	-0.3	-0.4	-0.4	-0.1	-0.2	-0.1
Net foreign (exlc. project loans)	-1.0	-1.6	-1.5	-0.7	-0.6	-0.6	-0.5	-0.7	-0.6	-0.6
Privatization	0.1	0.1	0.4	0.3	0.4	0.0	0.2	0.0	0.1	0.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local governments	0.4	0.2	0.6	0.1	0.0	0.0	0.1	0.0	0.1	0.1
of which: privatization	...	...	0.5	0.2	0.4	0.0	0.1	...	...	...
Social Fund	0.0	0.2	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Health Fund	-0.5	0.0	-0.2	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0
Project loans	0.9	0.9	0.9	1.2	0.9	1.5	1.2	1.3	1.0	0.9
Memorandum item:										
GDP (billions of lei)	37.7	42.0	44.1 #	49.7	51.3 #	56.0	58.8	62.8	68.2	76.0
Augmented deficit 1/	...	...	-0.3	...	...	...	...	...	...	...

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

1/ Includes lei 250 mln of NBM recapitalization.

Table 3a. Moldova: General Government Budget, 2007–08
(In millions of lei; unless otherwise indicated)

	2007							2008			
	Q1	Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Actual	Proj.	Proj.	Proj.	Proj.
Revenues and grants	4,911	9,831	9,907	15,060	15,335	20,886	22,220	5,167	10,836	16,774	24,164
Revenues	4,583	8,781	9,203	13,289	13,941	18,338	19,781	4,692	9,763	14,992	21,471
Tax revenues	3,966	7,768	8,252	12,072	12,712	16,928	18,154	4,492	9,265	14,194	20,021
Profit tax	550	732	844	897	1,088	1,143	1,388	278	378	398	418
Personal income tax	295	585	604	905	930	1,243	1,329	320	621	922	1,294
VAT	1,543	3,175	3,325	5,061	5,251	7,122	7,587	1,899	3,986	6,242	8,885
Excises	260	544	578	881	972	1,246	1,392	280	623	1,048	1,501
Foreign trade taxes	223	411	430	621	610	856	899	261	501	712	1,050
Other taxes	53	149	148	258	236	373	369	64	177	282	441
Social Fund contributions	866	1,813	1,941	2,916	3,038	4,204	4,350	1,120	2,419	3,744	5,257
Health Fund contributions	176	360	383	533	587	743	841	270	559	844	1,175
Non-tax revenues	617	1,013	951	1,217	1,229	1,410	1,627	200	498	798	1,450
NBM transfers	313	313	313	313	314	313	313	0	0	0	0
Grants	65	495	120	681	299	1,046	919	212	491	688	1,175
Budget support grants	1	312	4	380	113	687	571	112	292	391	779
Foreign financed projects grants	64	183	116	302	186	359	348	100	199	297	396
Other foreign grants	...	0	0	...	...	...	0	0	0	0	0
Revenues of special funds	264	555	584	1,090	1,095	1,501	1,520	263	583	1,094	1,518
Expenditures and net lending (cash)	4,525	10,078	9,955	15,298	15,390	21,119	22,354	5,017	10,836	16,874	24,448
National Economy	647	1,289	1,512	2,130	2,485	2,951	3,698	530	1,160	1,963	2,763
Social sphere	1,385	2,800	3,168	4,194	4,622	5,880	6,911	1,694	3,509	5,287	7,371
Education	866	1,763	1,978	2,711	2,855	3,936	4,248	1,088	2,331	3,613	4,927
Health care	117	244	285	381	448	593	744	145	284	415	658
Other	402	793	905	1,102	1,318	1,351	1,919	461	894	1,259	1,786
Interest payments	141	282	295	453	467	645	610	203	354	526	693
Other expenditures	819	1,771	1,767	2,893	2,707	4,130	4,082	613	1,694	2,325	4,250
Social Fund expenditures	1,148	2,353	2,400	3,742	3,812	5,088	5,216	1,411	2,955	4,697	6,276
Health Fund expenditures	403	909	854	1,400	1,316	1,938	1,895	585	1,200	1,927	2,646
Net lending	-18	-27	-40	-48	-19	-63	-61	-19	-35	-51	-66
Unidentified expenditure	0	702	0	534	0	550	0	0	0	200	515
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0	0
Overall surplus(+)/deficit(-) (cash)	386	-248	-48	-238	-54	-233	-134	150	0	-100	-284
Primary balance (cash)	528	34	247	216	413	412	476	353	354	426	409
Overall surplus(+)/deficit(-) (commitments)	225	-248	-200	-238	-160	-233	-240	150	0	-100	-284
Financing	-386	248	49	238	53	233	134	-150	0	100	284
Budget financing	-463	4	-196	-128	-303	-346	-345	-320	-350	-382	-415
Central government	-108	112	18	-282	-63	-456	-271	-330	-370	-412	-475
Net domestic	-41	163	85	-186	73	-268	-148	-290	-218	-308	-243
Net foreign (exlc. project loans)	-78	-102	-102	-187	-178	-343	-324	-80	-223	-184	-322
Privatization	12	52	35	92	42	155	200	40	70	80	90
Financing gap	0	-1	0	0	0	0	0	0	0	0	0
Local governments	-390	-294	-210	-140	-277	40	-20	10	20	30	41
of which: privatization	55	55	127	70	153	80	207	10	20	30	41
Social Fund	109	199	125	294	208	120	87	0	0	0	20
Health Fund	-73	-13	-129	0	-171	-50	-142	0	0	0	0
Project loans	76	244	245	366	356	579	480	170	350	482	699
Memorandum item:											
GDP (billions of lei)	...	...	...	...	...	49.7	51.3	...	...	...	58.8

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

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2006–08
(In millions of lei; unless otherwise indicated)

	2006	2007							2008			
		Q1	Q2		Q3		Q4		Q1	Q2	Q3	Q4
		Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Actual	IMF CR No 07/275	Proj.	Proj.	Proj.	Proj.	Proj.
National Bank of Moldova												
Net foreign assets	8,140	8,164	9,098	9,126	9,376	10,679	10,142	13,254	13,474	14,207	15,305	17,007
NFA (convertible)	8,159	8,175	9,098	9,148	9,376	10,701	10,142	13,280	13,474	14,207	15,305	17,007
NFA (convertible) in program exchange rates	8,260	8,500	9,483	9,664	9,830	11,334	10,705	14,882	15,359	16,403	17,918	20,160
Gross reserves	10,005	9,843	11,110	10,780	11,264	12,531	12,210	15,096	15,286	15,987	17,154	18,828
Reserve liabilities	-1,846	-1,668	-2,012	-1,632	-1,887	-1,830	-2,069	-1,816	-1,811	-1,780	-1,849	-1,821
Net domestic assets	-1,628	-1,667	-2,084	-2,214	-2,153	-1,522	-2,698	-3,717	-3,828	-4,226	-4,750	-5,564
Net domestic assets in program exchange rates	-1,728	-2,003	-2,468	-2,752	-2,606	-2,178	-3,261	-5,345	-5,713	-6,422	-7,363	-8,717
Net claims on general government	1,683	1,556	1,744	1,652	1,367	1,528	545	-92	-417	-396	-507	-479
Credit to banks	-2,031	-2,308	-2,797	-2,939	-2,413	-2,462	-2,053	-3,014	-2,864	-3,340	-3,740	-4,440
Other items (net)	-1,280	-915	-1,031	-928	-1,107	-588	-1,190	-610	-547	-489	-503	-645
Reserve money	6,512	6,497	7,014	6,912	7,223	9,156	7,443	9,537	9,646	9,981	10,555	11,443
Currency in circulation	5,146	4,923	5,401	5,433	5,562	6,072	5,731	6,665	6,849	7,086	7,494	8,125
Banks' reserves	1,366	1,573	1,613	1,478	1,661	3,083	1,712	2,872	2,797	2,894	3,061	3,319
Required reserves	936	958	1,009	1,081	1,057	1,218	1,137	1,998	2,378	2,505	2,647	2,905
Excess reserves	430	615	604	398	604	1,865	575	874	419	389	414	414
Monetary Survey												
Net foreign assets	9,466	9,214	10,096	9,761	10,370	10,743	11,130	11,705	11,896	12,641	13,743	15,458
NFA (convertible)	9,511	9,322	10,096	9,909	10,370	11,008	11,130	11,855	12,096	12,841	13,943	15,658
of which: commercial banks	1,352	1,147	998	761	993	307	989	-1,425	-1,378	-1,366	-1,362	-1,349
Foreign assets of commercial banks	3,157	3,576	3,870	3,445	4,223	3,388	4,545	2,370	2,418	2,474	2,512	2,564
Foreign liabilities of commercial banks	-1,805	-2,429	-2,872	-2,684	-3,229	-3,081	-3,557	-3,796	-3,797	-3,839	-3,874	-3,913
NFA (non-convertible)	-45	-108	0	-148	0	-265	0	-150	-200	-200	-200	-200
Net domestic assets	10,092	10,734	11,319	12,349	11,661	14,024	11,990	15,639	15,796	16,288	16,826	17,768
Net claims on general government	1,273	793	775	927	670	706	1,040	578	289	361	270	353
Credit to economy	13,768	14,821	15,421	16,472	16,020	18,555	16,167	20,884	21,834	22,834	24,034	25,481
Other items (net)	-4,949	-4,880	-4,877	-5,050	-5,030	-5,237	-5,217	-5,823	-6,327	-6,907	-7,478	-8,065
Broad Money (M3)	19,558	19,948	21,415	22,110	22,031	24,767	23,120	27,344	27,692	28,929	30,569	33,226
Broad Money (M2: excluding FCD)	12,485	12,716	13,808	14,231	14,373	15,867	15,208	18,397	18,562	19,427	20,531	22,433
Currency in circulation	5,146	4,856	5,401	5,422	5,562	5,928	5,731	6,665	6,849	7,086	7,494	8,125
Total deposits	14,412	15,092	16,014	16,688	16,469	18,839	17,389	20,679	20,843	21,842	23,075	25,102
Domestic currency deposits	7,324	7,826	8,407	8,778	8,811	9,918	9,477	11,714	11,714	12,341	13,037	14,308
Foreign currency deposits (FCD)	7,073	7,233	7,607	7,879	7,658	8,900	7,912	8,947	9,129	9,501	10,038	10,794
Memorandum items:												
Reserve money growth (percent change; quarterly)	5.0	-0.2	8.0	6.4	3.0	32.5	3.0	4.2	1.1	3.5	5.8	8.4
Reserve money growth (percent change; annual)	-7.0	8.7	10.6	9.0	16.4	47.6	14.3	46.4	48.5	44.4	15.3	20.0
Broad money growth (percent change; quarterly)	9.7	2.0	7.4	10.8	2.9	12.0	4.9	10.4	1.3	4.5	5.7	8.7
Broad money growth (percent change; annual)	23.6	22.3	20.4	24.3	23.5	38.9	18.2	39.8	38.8	30.8	23.4	21.5
Credit to economy, (percent change, annual)	37.8	37.7	33.9	43.0	30.0	50.6	17.4	51.7	47.3	38.6	29.5	22.0
Net credit to government, (percent change, annual)	-26.6	-20.0	-5.4	-10.4	-7.3	3.6	-67.6	-105.5	-126.8	-124.0	-133.2	418.8
Gross international reserves (millions of U.S. dollars)	775.3	786.1	0.1	879	913	1,027	994	1,334	1,377	1,454	1,576	1,743
Net international reserves (millions of U.S. dollars)	632.2	652.9	733.7	746	760	871	826	1,173	1,214	1,292	1,406	1,575
Velocity (M3; end of period)	2.3	2.3	2.2	2.2	2.3	2.03	2.15	1.86	1.85	1.81	1.78	1.77
Broad money multiplier	3.0	3.1	3.1	3.2	3.0	2.7	3.1	2.9	2.9	2.9	2.9	2.9
Share of foreign currency deposits in all deposits	49.1	47.9	47.5	47.2	46.5	47.2	45.5	43.3	43.8	43.5	43.5	43.0

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

Table 5: Financial Sector Indicators, 2001–07
(End-of-period; in percent, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007 Q3
Size							
Number of banks	19	16	16	16	16	15	15
Total assets of the banking system (in percent of GDP)	31	35	38	42	48	52	59
Credit to nongovernment sector (in percent of GDP)	16	19	22	23	27	26	36
Capital adequacy							
Capital adequacy ratio 1/	43	36	32	31	27	28	26.7
Liquidity							
Liquidity ratio 2/	60	56	48	51	48	44	45
Asset quality							
Nonperforming loans as a share of total loans	10	8	6	7	5	4	4
Profitability							
Return on equity	14	17	20	18	15	21	25
Return on assets	4	4	4	4	3	3	4
Interest rates							
Domestic currency average lending rate	26	19	19	21	17	19	19
Domestic currency average deposit rate	18	13	14	16	11	13	15
Interest rate spread, domestic currency	8	7	5	6	7	5	4
Foreign currency average lending rate	12	12	11	11	11	11	11
Foreign currency average deposit rate	3	3	4	5	5	6	6
Interest rate spread, foreign currency	9	9	7	6	5	5	5
Foreign currency deposits							
Share of foreign currency deposits in broad money	28	31	34	31	30	36	36
Share of foreign currency deposits in all deposits	45	47	50	45	42	49	47

Source: National Bank of Moldova.

1/ Total regulatory capital over total risk-weighted assets.
2/ Liquid assets over total deposits.

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

	2002	2003	2004	2005	2006	Targets 2010	Targets 2015
Goal: Reduce extreme poverty and hunger							
▪ Population with consumption below $4.3 (PPP) a day (percent) 1/					34.5	29.0	23.0
▪ Proportion of people under the absolute poverty line 1/	40.4	29.0	26.5	29.1	30.2	25.0	20.0
▪ Proportion of people under the extreme poverty line 1/	26.2	15.0	14.7	16.1	4.5	4.0	3.5
Goal. Achieve universal access to general secondary education							
▪ Gross enrollment ratio in general secondary education (percent)	94.1	94.7	93.2	93.5	92.4	95.0	98.0
▪ Literacy rate for the 15-24 year-old population 1/					99.5	99.5	99.5
▪ enrollment rate for pre-school programs for 3-6 year-old children	41.3	43.1	45.8	49.2	53.0	75.0	78.0
▪ enrollment rate for pre-school programs for 6-7 year-old children	66.5	78.8	69.1	75.6	81.7	95.0	98.0
Goal: Reduce child mortality							
▪ Infant mortality rate (per 1,000 live births) 1/					18.5	16.3	13.2
▪ Under-five mortality rate (per 1,000) 1/					20.7	18.6	15.3
▪ Immunization , measles (percent of children under 2 years old)	98.6	98.6	...	98.2	94.0	>96%	>96%
Goal: Improve maternal health protection							
▪ Maternal mortality ratio (per 100,000 births)	28.0	21.9	23.5	18.6	16.0	15.5	13.3
▪ Births attended by skilled health personnel (percent)	99.0	...	98.2	...	...	99.0	99.0
Goal: Combat HIV/AIDS, tuberculosis and other diseases							
▪ HIV/AIDS incidence (per 100,000 people)	5.5	4.7	6.2	8.5	10.0	9.6	8.0
▪ HIV incidence among 15-24 year-olds	9.7	6.1	9.7	11.7	13.3	11.2	11.0
▪ Mortality rate associated with tuberculosis (deaths per 100,000 people)	**15.9**	16.4	16.8	18.9	18.6	15.0	10.0
Goal: Ensure environmental sustainability							
▪ Proportion of land areas covered by forest (percent)	**10.3**	10.5	10.6	10.7	...	12.1	13.2
▪ Ratio of area protected to maintain biological diversity (percent)	**1.96**	1.96	1.96	1.96	4.65	4.65	4.65
▪ Share of population with access to improved water sources (percent)	**38.5**	39.7	44.5	45.0	46.0	59.0	65.0
▪ the share of population with access to sewage	**31.3**	31.7	32.8	43.8	44.0	50.3	65.0

1/ The methodology was changed from 2006.

Sources: Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) 2004-06, EGPRSP Monitoring Unit

Table 7. Moldova: External Financing Requirements and Sources, 2004–10
(In millions of U.S. dollars)

	Actual			IMF Staff Projection			
	2004	2005	2006	2007	2008	2009	2010
1. Gross financing requirements	447.2	636.9	844.8	1188.8	1257.1	1440.3	1577.4
External current account deficit (exc. official transfers)	110.6	352.5	462.2	550.7	746.2	891.6	1021.2
Debt amortization	112.0	133.5	147.8	57.7	80.0	81.8	100.4
Medium and long-term debt	112.0	133.5	147.8	57.7	80.0	81.8	100.4
Public sector	41.8	40.7	61.1	36.9	39.1	32.6	43.3
Multilateral 1/	40.5	24.6	18.7	16.9	20.1	20.9	21.9
Bonds and notes							
Other	1.3	16.1	42.4	20.0	19.0	11.6	21.5
Commercial banks							
Corporate private sector	70.2	92.8	86.7	20.8	40.9	49.3	57.0
Short-term debt 2/							
Repayment of arrears	54.9	0.8	70.0	0.0	0.0	0.0	0.0
Gross reserves accumulation	148.0	128.6	140.8	558.4	409.4	449.4	447.6
IMF repurchases and repayments	21.6	21.4	24.1	22.0	21.5	17.4	8.2
2. Available financing	447.2	636.9	844.8	1188.8	1257.1	1440.3	1577.4
Foreign direct investment (net)	82.4	225.5	223.0	521.4	627.4	768.4	880.4
Debt financing from private creditors	114.2	129.9	170.6	179.2	191.7	207.0	222.6
Medium and long-term financing	114.2	129.9	170.6	179.2	191.7	207.0	222.6
To public sector							
of which: balance of payments financing 3/							
To commercial banks							
To corporate private sector	114.2	129.9	170.6	179.2	191.7	207.0	222.6
Short-term financing							
of which: balance of payments financing 3/							
Official creditors 4/	74.9	69.2	155.2	237.2	301.4	310.2	249.3
Multilateral 1/	72.3	68.2	128.4	170.4	188.3	182.8	147.4
of which: balance of payments financing 3/							
Bilateral	2.6	1.0	26.7	66.8	113.1	127.4	101.9
To public sector	2.6	1.0	26.7	66.8	113.1	127.4	101.9
of which: balance of payments financing 3/							
prospective grants				0.0	0.0	0.0	0.0
To private sector							
Accumulation of arrears (exceptional)	42.4	26.3	60.1	0.0	0.0	0.0	0.0
Financing gap	...	...	0.0	0.0	0.0	0.0	0.0
Other flows 5/	133.3	186.1	235.9	251.0	136.6	154.6	225.0
Memorandum item:							
Total balance of payments financing 3/	...	...	65.3	33.2	33.8	33.8	0.0
Prospective IMF augmentation	...	...	...	...	...	...	...

Sources: Moldovan authorities; and Fund staff estimates.

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: Capacity to Repay the Fund, 2005–16

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Baseline scenario						
Fund disbursements 1/												
In millions of SDR	-	43.4	21.7	22.9	22.9	-	-	-	-	-	-	-
In millions of U.S. dollars	-	62.0	32.7	33.8	33.8	-	-	-	-	-	-	-
In percent of quota	-	35.2	17.6	18.6	18.6	-	-	-	-	-	-	-
Projected repayments/repurchases and charges 1/												
In millions of SDRs	16.3	18.1	14.5	14.5	11.8	5.5	3.9	10.5	8.7	8.7	8.7	7.5
In millions of U.S. dollars	24.1	27.4	21.5	21.5	17.4	8.2	5.8	15.5	12.8	12.8	12.8	11.1
In percent of exports of G&S	1.6	1.8	1.1	0.8	0.5	0.2	0.1	0.3	0.2	0.2	0.2	0.1
In percent of total debt service	22.6	32.1	27.7	26.1	26.4	11.6	7.7	16.3	11.8	11.5	13.4	12.3
In percent of quota	13.2	14.7	11.8	11.8	9.6	4.5	3.2	8.5	7.0	7.0	7.0	6.1
In percent of gross international reserves	4.0	3.5	1.6	1.2	0.8	0.3	0.2	0.4	0.3	0.3	0.2	0.2
Fund credit outstanding 1/												
In millions of SDRs	66.8	93.8	101.0	110.0	121.0	115.5	111.6	98.9	82.4	61.4	39.2	18.2
In millions of U.S. dollars	95.5	141.4	149.0	162.3	178.7	170.5	164.7	146.0	121.7	90.6	57.9	26.9
In percent of exports of G&S	6.2	9.2	7.6	6.2	5.4	4.5	3.7	3.0	2.3	1.5	0.9	0.4
In percent of quota	54.2	76.1	81.9	89.2	98.2	93.7	90.6	80.3	66.9	49.8	31.8	14.8
In percent of gross international reserves	16.0	18.2	11.2	9.3	8.2	6.5	5.3	4.1	2.8	1.8	1.0	0.4
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	1,536	1,965	2,615	3,315	3,819	4,396	4,836	5,401	6,032	6,738	7,526
Debt service (in millions of U.S. dollars)	106.4	85.1	77.5	82.1	65.8	70.8	74.8	95.6	108.5	111.5	95.9	90.2
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	123.2
Quota (in millions of U.S. dollars)	182.1	185.8	181.9	181.9	181.9	181.9	181.9	181.9	181.9	181.9	181.9	181.9
Gross international reserves (in millions of U.S. dollars)	597	775	1334	1743	2193	2640	3104	3598	4302	5053	5920	6702
SDR/U.S. dollar (period average)	0.68	0.66	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68
SDR/U.S. dollar (eop)	0.70	0.66	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68

Source: Fund staff calculations

1/ Based on existing and prospective drawings

Table 9. 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
December 15, 2006	Complete first review based on end-September 2006 performance criteria	SDR 31.97 million
June 25, 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

Table 10. Moldova: Status of Structural Performance Criteria and Benchmarks

	Measure	Due	Status	Note
	Included 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 governmet 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 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 liabilities, including as a means of combatting 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 10 (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 MoF of all SOE debts.	30-Sep-06	Not Observed (implemented with delay)	The draft law on management and divestiture of state assets was 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	Observed	The plan for strengthening the Social Fund's financial situation was approved on Dec 27, 2006.
13. Submission to parliament of draft laws on civil service.	31-Dec-06	Not Observed	Draft law has been prepared, but the authorities (in consultation with staff) decided to postpone submission to parliament to take advantage of OECD-SIGMA TA in Q1 2007. The consultation process has taken longer than expected, partly due to the local elections in June, but parliamental approval is expected in late 2007.
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	Observed	STI has taken on this responsibility.
15. Completion of detailed functional reviews of all central public administration ministries and agencies.	31-Dec-06	Observed	Functional reviews were completed. In Nov. 06 DAI Europe company presented the final report on functional analysis plus five sectorial reports, based on which a group of experts from the PAR Unit is elaborating recommendations to be submitted for the government.
16. Announce winner of tender for independent valuation of BEM.	31-Dec-06	Observed	Deloitte was announced the winner.
17. Parliamentary approval of the law on management and divestiture of state assets and the law on public debt	31-Dec-06	Not Observed (implemented with delay)	The draft law was passed in first reading on Dec 28, 2006. Because of the controversy in parliament over the negative list of companies to be privatized, the law passed in second reading is May 2007 as a prior action for the second review.

Table 10 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

Measure	Due	Status	Note
Included in 2007 program			
Prior actions			
1. Parliamentary passage of law transferring rate setting for heat and water to ANRE.		Observed	
2. Letter to International Finance Corporation of the World Bank requesting assistance in preparing to put the state's share in Banca de Economii to the market following the independent evaluation that the authorities hope will be completed by September 30, 2007.		Observed	
Performance Criteria			
3. 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	
4. 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.	31-Dec-06	Not observed (implemented with delay)	On January 25 Chisinau City council raised tariffs for enterprises and government, but decided to subsidize tariffs for households, retroactive to January 1. Households consume 71 percent of the district heat, at the old tariff of Lei 233/Gcal, while enterprises and government are assessed the full tariff of Lei 540/Gcal. The weighted average is thus Lei 321/Gcal, or about 59 percent of cost recovery.
5. 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.	31-Mar-07	Observed	Law #382-XVI on amendments to the NBM Law was approved on Dec 7, 2006.

Table 10 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

	Measure	Due	Status	Note
	Structural Benchmarks			
6.	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.	31-Dec-07	Observed	A supplementary budget in Dec-2006 contains this provision.
7.	Tariffs for gas and electricity to be set at cost-recovery levels.	Continuous	Observed	
8.	Adoption of service agreement modernizing financial relations between Ministry of Finance and National Bank.	31-Dec-06	Observed	The agreement between the NBM and the MoF was signed on Dec 12, 2006.
9.	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 licences cannot be revoked unless NCFM agrees that prudential regulations are being met.	31-Mar-07	Not observed (implemented with delay)	Draft legislation was submitted to parliament in late March and passed in first reading in early May. The law passed on June 7, 2007 (see # 16 below). The Netherlands government is providing TA.
10.	NCFM established and made sufficiently operational to supervise the nonbank financial sector, including suspension of licenses for violation of prudential norms.	30-Jun-07	Not observed	Because of the delay with the passage of the NCFM law, this measure was pushed back to August 2007, but was made a structural PC (see # 19).
11.	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 .	30-Sep-07	Observed	Law #382-XVI on amendments to the NBM Law was approved on Dec 7, 2006.
12.	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.	30-Sep-07	Observed	The draft 2008 budget assumes no transfer of NBM net income due to expeted large unrealized losses from revaluation.
13.	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.	30-Sep-07	Not observed	Water tariffs were increased to full cost-recovery with a small delay on Oct. 11. The increase in heating tariffs was delayd pending furhter work on a municipal social assistance scheme.
14.	Government and the NBM to adopt a plan to securitize the remaining outstanding stock of NBM claims on government.	30-Sep-07	Observed	The NBM and the MoF adopted a plan, which envisages gradual securitization of the remaining stock of the NBM cliams on the government until end-March 2008, in conformity with #28.
15.	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.	31-Dec-07		At the time of the second review, the measure was divided into two parts since due to technical constraints more time was needed for introduction of zero-balance accounts. See #27 and #30.

Table 10 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

Measure	Due	Status	Note
New measures in 2007 program			
Prior actions			
16. 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. The law will also specify that the NCFM will become fully operational no later than September 30, 2008, by which time it will fully acquire the right to issue and revoke licenses.		Observed	The draft Law wa passed on June 7, 2007. Was a structural benchmark for end-March 2007, which was not observed.
17. Parliamentary passage of the law on divestiture and management of state assets.		Observed	The draft law was passed in second reading in May 2007. Was a structural benchmark for end-Dec 2006, which was not observed.
Performance Criteria			
18. 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	
19. As a follow-up to the measures taken under the prior action, implementation of all actions necessary to establish the NCFM, including the appointment of a chairman, and to grant the NCFM the operational ability to suspend licenses of nonbank financial institutions in violation of prudential norms.	31-Aug-07	Observed	Was a structural benchmark for end-June 2007. A new chairman and a management board were appointed in July 2007.
20. Government adoption of a medium term concept paper on rationalization of public employment consistent with the aim of limiting the general government wage bill to no more than 10 percent of GDP.	30-Sep-07	Obesrved	
21. Adoption of an action plan to improve tax arrears management which we expect to implement by March 31, 2008, and which would involve enhancing a tax arrears accounting system to permit distinction of arrears on the basis of vintage, introducing prompt and unconditional measures to ensure forced collection of arrears, passing legislation for shortening and streamlining the procedure for writing off uncollectible tax arrears, and consolidating all domestic tax assessing and collecting activities in one agency.	30-Sep-07	Obesrved	

Table 10 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

	Measure	Due	Status	Note
	Structural Benchmarks			
22.	Tariffs for consumption of natural gas and electricity to remain at cost-recovery levels.	Continuous	Observed	Given the strengthened independence of the energy regulator, the mission porposes to drop this measure.
23.	Draft 2008 budgetary documentation to include information on the financial performances for 2006 of state-owned enterprises and joint stock companies in which the state is holding a majority stake.	30-Sep-07	Observed	Information on the financial performances of state-owned enterprises and joint stock companies was included with the draft budget already in 2007.
24.	Parliamentary passage of legislation ensuring that ANRE establishes tariffs for heat and water directly, rather than indirectly through the municipality as at present.	30-Sep-07	Not observed	There appears to be legal uncertainty as to whether the transfer would comply with the constitutional division of rights between central and local governments. Since Chisinau follows the ANRE methodology and thus objectives of the condition were met, staff is proposing to drop it from the program conditionality.
25.	Government will adopt the methodology for a targeted social assistance system	30-Sep-07	Not observed (implemented with delay)	The methodology was approved by the government on Oct. 3, 2007.
26.	In accordance with the decision of the municipal council Nr.64/2 from January 25, 2007, the difference between the amount paid by households and the cost recovery tariff to be covered from the municipal budget.	30-Sep-07	Not observed	Around lei 150 million still remains to be paid.
27.	Transfer of balances on accounts of Social Fund and Health Fund to Single Treasury Account in NBM.	31-Dec-07	Observed	By the government decision of September 21, 2007 the remaining balances on the accounts of Social Fund, Health Fund and territorial budgets have been transferred to STA in the NBM on December 29, 2007.
28.	Outstanding stock of NBM claims on government fully securitized.	31-Mar-08		
29.	Implementation of the system to modernize tax arrears management, including an enhanced tax arrears accounting system to permit distinction of arrears on the basis of vintage, introducing prompt and unconditional measures to ensure forced collection of arrears, passing legislation for shortening and streamlining the procedure for writing off uncollectible tax arrears, and consolidation of all tax assessing and collecting activities in one agency.	31-Mar-08		Following the FAD TA recommendations, the condition has been modified; see #35.
30.	Introduction of a system whereby the State Treasury ensures that the balances in commercial banks of the social insurance budget (BASS) and the mandatory health insurance fund are zero-ed out on a daily basis.	30-Jun-08		
31.	Introduce the targeted social assistance system throughout Moldova.	30-Sep-08		

Table 10 (cont). Moldova: Status of Structural Performance Criteria and Benchmarks

Measure	Due	Status	Note
Proposed measures for 2008 program			
Prior actions			
32. Amend the Law #235 to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.		Observed	
33. Heat tariffs received by utilities will be set at cost-recovery at lei 540, following the ANRE methodology.		Observed	
Performance Criteria			
34. Announce tender for privatization advisor to Banca de Economii.	31-Mar-08		
35. Adoption of legislation to (i) give the STI the right to write-off uncollectible tax arrears and (ii) shift all tax audit, assessment, and collection powers to STI.	31-Mar-08		Modified from # 29, in line with FAD recommendations.
36. Adopt a new Licensing Law to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.	31-Mar-08		
37. Sign a contract with a privatization advisor for Banca de Economii with a six-month time frame for bringing the bank to market.	30-Sep-08		
Structural Benchmarks			
38. Heat tariffs received by utilities remain at cost recovery. A lower tariff than provided by ANRE methodology would imply new domestic expenditure arrears under the program.	Continuous		
39. Remove quantitative restrictions on imports of meat and dairy products.	30-Jun-08		
40. The government approval of a draft law, which will consolidate all forms of remuneration in base pay for civil servants, with a view to implementing it in the 2009 budget year.	30-Sep-08		
41. Selection of an advisor through an open tender to assess the modalities for the possible privatization of Moldtelecom.	30-Sep-08		
42. Reduce public employment by 3000 people.	31-Dec-08		

Table 11. Moldova: Quantitative Performance Criteria and Indicative Targets, December 31, 2006–December 31, 2007 1/ 2/

	31-Dec-06		31-Mar-07		30-Jun-07			30-Sep-07			31-Dec-07		
	Indicative				Indicative			Indicative					
	IMF CR No 07/45	Actual	IMF CR No 07/45	Actual	IMF CR No 07/45	IMF CR No 07/275	Actual	IMF CR No 07/45	IMF CR No 07/275	Actual	IMF CR No 07/45	IMF CR No 07/275	Prel.
1. Quantitative performance criteria													
	(In millions of lei unless noted otherwise)												
Floor for general government fiscal balance	-210	...	-144	...	-248	-248	...	-238	-238	...	-233	-233	...
Adjusted floor for general government fiscal balance 3/ 4/	-488	-149	-44	386	...	-374	-48	...	-400	-54	...	-485	-134
Ceiling on net domestic assets of the NBM (level)	-768	-1,728	-997	-2,003	-1,081	-2,468	-2,752	-1,174	-2,606	-2,178	-1,535	-3,261	-5,345
Floor on net international reserves of the NBM (level)	7,380	8,260	7,737	8,500	7,967	9,483	9,664	8,207	9,830	11,334	8,789	10,705	14,882
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (Euro million)	0	0	0	0	0	69	...	0	69	69	0	69	60
EBRD/EIB road project	...	...	...	...	...	60	...	...	60	60	...	60	60
CEB health loan	...	...	...	...	...	9	...	...	9	9	...	9	0
Other						0	...	...	0	0	...	0	0
2. Continuous performance criteria													
Ceiling on accumulation of external payment arrears	0	0	0	0	0	0	0	0		0	0	0	0
	(In millions of lei)												
3. Indicative targets													
Ceiling on reserve money (level)	6,612	6,512	6,740	6,497	6,886	7,014	6,912	7,033	7,223	9,156	7,255	7,443	9,537
Ceiling on change in domestic expenditure arrears of the general government	0	0	0	161	0	0	152	0	0	60	0	0	150
Ceiling on the general government wage bill	...	4,123	...	1,093	...	2,430	...	...	3,635	3,518	...	4,966	4,966
	(In millions of lei, unless noted otherwise)												
4. Baseline assumptions													
Concessional external debt financing	387	401	184	76	319	244	369	472	366	480	703	579	603
in millions of dollars	29	31	13	6	22	20	30	32	30	40	46	44	53
Privatization receipts	28	168	0	67	40	107	161	80	162	195	155	235	407

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2007 refer to cumulative flows from end-2007, 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 concessional 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 200 million. In the case of shortfalls, the limits will be decreased by the full amount.

4/ In accordance with the TMU, the 2006 deficit limit was increased by MDL 250 mln - by the amount of paid in cash for recapitalization of the NBM.

5/ See MEFP ¶19 and TMU ¶15.

Table 11 (cont.). Moldova: Quantitative Performance Criteria and Indicative Targets, December 31, 2007–December 31, 2008 1/ 2/

	31-Dec-07	31-Mar-08	30-Jun-08	30-Sep-08	31-Dec-08
			Indicative	Indicative	Indicative
		Proj.	Proj.	Proj.	Proj.
1. Quantitative performance criteria					
		(In millions of lei unless noted otherwise)			
Floor for general government fiscal balance	...	150	0	-100	-284
Adjusted floor for general government fiscal balance 3/	-134	...	...	...	...
Ceiling on net domestic assets of the NBM (level)	-5,345	-5,713	-6,422	-7,363	-8,717
Floor on net international reserves of the NBM (level)	14,882	15,359	16,403	17,918	20,160
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (Euro million)	60	9	9	9	9
EBRD/EIB road project	60	0	0	0	0
CEB health loan	0	0	0	0	0
Other	0	9	9	9	9
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)	9,537	9,646	9,981	10,555	11,443
Ceiling on change in domestic expenditure arrears of the general government	150	0	0	0	0
Ceiling on the general government wage bill	4,966	1,286	2,714	4,138	5,517
		(In millions of lei, unless noted otherwise)			
4. Baseline assumptions					
Concessional external debt financing	603	170	350	591	808
in millions of dollars	53	15	31	53	73
Privatization receipts	407	50	90	110	131

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2008 refer to cumulative flows from end-2007, 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 concessional 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 200 million. In the case of shortfalls, the limits will be decreased by the full amount.

ATTACHMENT I

February 19, 2008

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) for 2008 describes policies and measures we intend to implement this year and for which we request the support of the International Monetary Fund under the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). These policies are consistent with our National Development Strategy (NDS) as well as with the action plan agreed between the European Union and the Republic of Moldova.

Now that the external shocks have receded, the government and the National Bank believe that all efforts should focus on the core goals of the program, which are to promote sustainable growth and reduce poverty. To this end, the policies set forth in the attached memorandum aim at ensuring macroeconomic stability and financial sector development, and improving the business environment, including through reduction of the footprint of the state in the economy. In addition, in consultation with the Fund, we will take additional measures that may become appropriate for reaching these objectives.

We implemented all end-September performance criteria under the program, as well as prior actions for this review, and hereby request completion of the third review under the PRGF arrangement.

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 fourth review under the PRGF arrangement before end-May 2008. We anticipate that the fourth review under the PRGF arrangement will be conducted based on end-March 2008 data and be completed before end-June 2008. The Fifth Review will be based on end-September 2008 data, to be completed by the year-end.

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 2008
Technical Memorandum of Understanding

ATTACHMENT II. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

February 19, 2008

A. Introduction

1. Building on the progress achieved over the past 2 years under the program supported by the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), this memorandum summarizes our strategic priorities for 2008 and sets forth policies and reform objectives.

2. Despite severe external shocks suffered by Moldova in 2006, macroeconomic developments this year have been favorable. The national economy grew by 8 percent in the first half of 2007, though it slowed thereafter due to a weak harvest caused by the summer drought. As a result, we expect GDP growth to reach 5 percent for the year, up from 4 percent in 2006. Export performance has been encouraging and the recovery is likely to accelerate further as wine exports to Russia resumed from the fourth quarter of 2007. While imports grew even faster, fuelled by rapidly increasing FDI and strong remittances, the current account deficit has still narrowed due to improvements in net income and transfers. Successful disinflation in the first six months of 2007 was set back by the drought. At 13.1 percent CPI inflation remains high for the region. Strong inflows of foreign exchange and the global weakening of the US dollar led to an appreciation of the leu, which strengthened by 12 against the dollar and by 2 percent against the Euro since the beginning of the year.

B. Performance under the Program

3. Except for a few instances, the government and NBM have implemented the measures under the updated Memorandum on Economic and Financial Policies (MEFP) of June 14, 2007. In particular, by September 30 the following actions have been completed:

a. On May 4, 2007 the parliament of Moldova approved the Law on Public Property Management and Divestiture. Furthermore, the government approved resolutions on (i) privatization of state-owned public land; (ii) measures to implement the Law on Public Property Management and Divestiture; and (iii) the structure and regulation of the Public Property Agency under the Ministry of Economy and Commerce;

b. On June 7, 2007, parliament approved Law #129-XVI, which effective July 6, 2007, established the National Commission for Financial Markets (NCFM) to take on the responsibility for supervision of insurance and capital markets, non-state pension funds, and loan and savings associations. To make the new body operational, parliament appointed the administrative board and the management of the NCFM, which in turn approved the organizational structure on August 3, 2007;

c. The concept paper on "Rationalization of the Number of Employees in the Budgetary Sector for 2008-2010" was approved on September 28, 2007, imposing a limit on the public sector wage bill of 10 percent of GDP. Since then the paper has been further revised to include a time-bound plan to downsize public employment, implementation of a new wage system for public servants, and an assessment of the fiscal impact;

d. On September 28, 2007, the prime-minister approved an action plan for improving the tax arrears management. We have further updated the plan based on recommendations of the FAD TA mission;

e. The draft 2008 Budget Law approved by the government on September 27, 2007 includes an assessment on financial performance in 2006 of state-owned enterprises and joint stock companies in which the state is the majority shareholder.

f. The plan for converting government's debt into state securities was adopted by the Ministry of Finance on September 10, 2007 and by the National Bank of Moldova on September 12, 2007.

At the same time, four structural benchmarks were not observed:

- The end-September structural benchmark on adoption of the targeted social assistance system was implemented on October 3, 2007. The government approved the draft Law on Social Assistance, which aims at ensuring a guaranteed minimum monthly income to vulnerable households based on proxy means testing;
- The passage of the legislation ensuring that ANRE establishes tariffs for heat and water directly, rather than indirectly through the municipality, was not implemented because of legal uncertainty about the conformity of this measure with the constitutional division of responsibilities between local and central governments;
- Tariffs for water were raised to cost-recovery in October, but the heating tariffs in Chisinau were not increased.
- The municipal budget made only partial payment for the difference between the amount paid by households for heat and the cost recovery level. At end-September the arrears equaled about lei 50 million, down from lei 160 in April.

C. Program Objectives

4. The government's medium-term objectives are outlined in the newly developed Strategy for 2008-2011 (NDS), which will replace the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP). Unlike earlier practices in developing national strategies, this document focuses on a well-defined list of strategic priorities, both economic and political. The draft NDS Strategy includes five fundamental priorities:

- strengthen a modern democratic state, based on the principle of rule of law;
- settle the Transnistrian conflict and promote the reintegration of the country;
- enhance national economic competitiveness;
- develop human resources, raise the employment level, and promote social inclusion, and;
- promote regional development.

In addition to setting out our medium-term priorities, one of the NDS goals is to integrate in one single strategy the key external commitments of the Republic of Moldova (without substituting bilateral policy papers) and to establish a single system to monitor the fulfillment of these commitments.

5. The main objective for 2008 remains unchanged: facilitating poverty reduction by ensuring macroeconomic stability and sustainable economic growth. We hope to achieve this objective by modernizing the public service and reducing state involvement in the economy, developing the financial sector, creating a favorable investment environment, encouraging the development of small and medium businesses, rehabilitating infrastructure, promoting exports, creating new jobs and providing social protection to vulnerable categories of the population. These objectives – that incorporate the achievement of the Millennium Development Goals – are reflected in the NDS.

D. Fiscal Policy

6. Fiscal policy for 2008 will remain tight, given continuing high inflation and the need to ensure macroeconomic stability and build confidence in the program. The government will keep a budget deficit of 0.5 percent of GDP. Any budget rectification will be discussed in the framework of the fourth review. Our priority is to channel overperformance to investments, which have a minimal inflationary impact.

7. While budget wages have been increased by 45 percent in 2006 and 12 percent in 2007, they remain insufficient for attracting and keeping qualified employees, many of whom have opted for a job in the private sector or abroad. To improve competitiveness of the public sector, wages will be increased by another 23 percent in 2008, though the total wage bill will be kept below 10 percent of the GDP, owing to a phasing in of the increases. However, we realize that raising salaries will not increase public sector effectiveness unless accompanied by bold reforms. For that purpose, the government

plans to start implementation of the medium-term action plan for rationalizing the structure of employment in the budget sector for 2008-2010. which envisages:

- downsizing of employment by 10 thousands by 2010, with a initial reduction of 3 thousands in 2008, and
- the government approval of a draft law, which will consolidate all forms of remuneration in base pay for civil servants by end-September 2008, with a view to implementing it in the 2009 budget year.

8. Part of the savings from the optimization of staffing will be used towards improving the quality of public service. Moldovan authorities are to develop annual plans for the implementation of the program with plans for 2008 completed by end-March 2008, which should include, but not be limited to budget sector staff inventory; review of wage and non-wage payments to staff; and assessment of sector needs for highly qualified staff. Restructuring in the education sector will focus on rationalization of educational establishments.

9. To promote foreign and domestic investments in 2007, we announced a major reform of the corporate income tax system, as well as a wide-ranging amnesty of tax arrears and a liberalization of capital legalization regulations. We are aware that these reforms imply certain risks, in particular with respect to budget revenues. To address these concerns, we intend to speed up the implementation of Tax Administration Strengthening Strategy. The plan, which was adopted in September 2007, has now been updated to reflect recommendations of the FAD TA mission. It aims at strengthening the tax arrears management system, which will improve accounting of tax arrears to allow distinction of arrears by vintage, introduce a set of prompt unconditional measures for forced arrears collection, amend the current legislation to ensure a shorter, more streamlined procedure for writing-off uncollectible tax arrears, and consolidate all functions for assessment and collection of arrears in a single agency. The State Tax Inspectorate (STI) will be reorganized along functional lines, beginning with headquarters. By March 2008, we will adopt legislation to allow STI to write off uncollectible tax arrears. At the same time, we will develop a modern accounting and information technology platform, and ensure adequate resources for these reforms.

E. Monetary Policy

10. In 2008 the National Bank of Moldova will continue to pursue its main objective of price stability. The monetary policy stance will remain tight with the aim to resume disinflation and achieve single digit levels by the year-end (December-to-December). For that purpose, real interest rates on sterilization operations will be kept sufficiently positive in real terms until disinflation is well entrenched. Moreover, we stand ready to promptly increase reserve requirements and/or interest rates at the first signs of reversal of trend disinflation. Liquidity pressures are expected to be further eased by the transfer

of the remaining deposits of the Social Fund, the Health Fund and territorial budgets from commercial banks to the Treasury Single Account at the NBM at end-2007, and the introduction of full zero-balancing by end-June 2008. To further improve effectiveness of monetary policy, the NBM will streamline its instruments by adopting a base rate as a main policy rate to remove the ambiguity between the two rates, and shifting sterilization operations to shorter maturities. At the same time, the planned securitization of the government debt to NBM in the first quarter of 2008 will provide the central bank an additional liquidity management tool.

11. The NBM will maintain a flexible exchange rate regime to ease the burden on monetary policy tightening. If inflows of foreign exchange and appreciation pressures persist, the NBM will intervene only to smooth excessive fluctuations of the national currency, while allowing markets to determine the exchange rate. We expect foreign exchange reserves to reach USD 1.7 billion, or at least 3 month of imports, by the end of 2008. While continued appreciation of the leu and growing sterilization costs may weaken the financial position of the NBM, we are committed to the disinflation objective, which will not be compromised for NBM profitability considerations. Any need to recapitalize the NBM will be met by the government in accordance with the NBM law. The NBM will develop an early warning system that it will use to detect potentially disruptive economic developments, including large capital flows

12. We are planning to move to a formal inflation targeting (IT) framework at an appropriate time in the future. Although we are aware that Moldova is not yet ready to implement IT, we are nevertheless undertaking intermediary steps to improve the current framework of monetary policy and lay the foundation for a new regime. Starting with the 2008 Budget, the Budget Law will no longer oblige the NBM to roll over state securities, including those acquired through securitization. Instead, the NBM and the Ministry of Finance will conclude yearly agreements on the annual redemption of state debt to the NBM. We will further improve our communication strategy and policy transparency to raise public awareness of risks to inflation and to strengthen the signaling function of the NBM. To help us achieve our objectives, we have requested technical assistance—a long-term advisor— from the Fund in monetary research and capacity building for monetary policy implementation. As a first step, in line with MCM TA recommendations, the NBM will restructure its research and monetary policy department, and will hire new qualified staff.

13. The NBM will extend its supervision over all parts of the payment system, including those that are operating outside the central bank

F. Financial Sector Reforms

14. In order to strengthen competition in the banking system, we intend to accelerate privatization of Banca de Economii (BEM) to a strategic banking investor. Our previous plan to perform an independent valuation of the bank prior to bringing it to market has stalled due to unwarranted demands by the selected evaluation advisor. Instead, we have

now decided to hire directly a privatization advisor. For that purpose, by end-March 2008 we will announce a tender for selecting a privatization advisor and by end-September 2008 will sign a contract with the winner with a 6-month timeframe for bringing BEM to market. In the meantime, the government and the NBM will continue to abstain from granting preferential treatment to the bank, including as regards taxation, prudential regulation or access to resources.

15. The establishment of the NCFM in June 2007 as a regulatory and supervisory body for the non-bank financial sector was the first step aiming at strengthening this segment of the financial market. We will ensure a solution for the stable financing of the NCFM, and financial sector supervisory/regulatory agencies will be required to conclude formal agreements of cooperation with each other. The medium-term goal is to promote development of capital and insurance markets, the market for non-state pension funds, and the micro-credit institutions by reducing risks and vulnerabilities, increasing transparency, updating the regulations in conformity with the best international practices, and encouraging introduction of new financial products. To this end, we intend to request technical assistance from international financial institutions.

16. The government and the NBM will continue to strengthen the supervisory and regulatory framework for the financial system and ensure transparency to promote stability and steady development. Following the recommendations of the recent FSAP update, to preserve independence and adequate powers of financial sector regulators, all entities licensed, regulated and supervised by the NBM and/or the NCFM have been excluded from the provisions of the law #235 on the Core Principles of Regulating Entrepreneurial Activity, which was adopted by Parliament at end-2007. Similarly, the draft licensing law now before Parliament will also exclude the financial sector and delegate the full licensing authority in this area to the NBM and the NCFM. Further, to strengthen transparency of bank ownership and control, following FSAP update recommendations, we will step-up our efforts in identifying beneficial owners of banks and will study best international practices, especially those of EU countries, in applying '*fit and proper*' tests for significant shareholders.

17. The parliament of Moldova has adopted a new Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) Law (drafted with the assistance of the IMF and other partners). We will continue revision of associated laws to bring the AML/CFT framework of Moldova in conformity with the international standard. With the assistance of the IMF and others, we intend to strengthen the capacity of the Financial Intelligence Unit, as well as of the NBM in preventing and combating money laundering and the financing of terrorism, and streamline AML/CFT procedures to reduce the burden of compliance.

G. Other Structural Reforms

18. External shocks faced by the Republic of Moldova during the last two years have revealed the country's limitations with regard to competitiveness and resilience towards potential macroeconomic risks. Government agenda for 2008 will include structural measures aimed at building the economy's resilience to external shocks and laying a

sustainable foundation for strong inclusive growth. In this context, the central public administration reform, as well as the reform of the business regulatory framework will continue, while measures will be taken to encourage private sector investment.
To increase competitiveness, special attention will be paid to improving the quality of infrastructure. To that effect, we will ensure that public investment in infrastructure is sustained at a high level.

Privatization, Trade Policy and Investment Promotion

19. A component of our strategy will be the acceleration of the privatization of public assets to attract know-how and promote private sector development. A clear statement of our commitment to private sector development will be the selection of an advisor through an open tender by end-September 2008 to assess the modalities for the possible privatization of Moldtelecom. Our objective is to continue the privatization of state assets through a competitive and transparent process. Any adjustor for the use of possible excess privatization revenues will be discussed with the IMF during the fourth and subsequent reviews. In the meantime, in line with the recommendations of the IMF, OECD guidelines, and international best practice, we will seek technical assistance from international institutions to strengthen financial discipline of remaining state enterprises, set up procedures to select management of state enterprises through a competitive process.

20. By the end of this year, Moldova will benefit from an autonomous trade preferences regime with the EU. For businesses to benefit from the new trade regime, the government will make efforts to improve the quality of management systems in Moldova. In this context, a number of actions will be undertaken: (i) the National Program for the Development of Technical Regulations by Converting the Relevant Normative Acts of the EU will be fully implemented; (ii) the structure of the laboratories for testing and ensuring the product quality will be assessed and a strategic plan for further strengthening and development of the laboratories will be developed; (iii) the National Training Program for Businessmen in Quality Management, Modern Techniques for Ensuring the Quality of Produced Goods (ISO), and Systems for Ensuring Safety at Enterprises (HACCP) will be developed and implemented; (iv) guidance manuals for consumers will be developed to increase public awareness and literacy in quality standards.

21. The National Competition Protection Agency will adopt a clear definition of state aid, to avoid confusion of such terms as subsidies, subventions, tax facilities, to set clear rules for granting state aid in 2008.

22. To encourage investment inflow into the national economy in 2008, Government will make efforts to implement the actions set by the 2008 Action Plan for the Implementation of the Strategy for Attracting Investments and Promoting Export for 2006-2015. Strengthening of small and medium business is one of the key elements that will contribute to economic growth and poverty reduction in the Republic of Moldova. To support SME development, the Organization for SME Sector Development was established, and its capacity will continue to be built next year. During 2008 Government

will continue implementation of the actions set in the Strategy for SME Development Support and will ensure compliance with the provisions of the SME Law.

23. To diversify ways to attract investments, the Law on Industrial Parks was approved. Thus, based on the performance indicators for investment attraction to the North, Center, and South regions we are planning to establish the first pilot industrial parks in 2008 in several settlements in these regions. These projects will have a minor impact on the budget, and will be implemented in a way that will eliminate any economic distortions. Government will be looking for ways to attract private investors in the process of industrial parks' management.

24. The government approved the law on public-private-partnerships (PPP) in December 2007. Parliament will adopt the law by end-July 2008, and the PPP unit will be fully operational by the end of 2008. In addition to reporting to parliament any contingent liabilities that could be introduced through this mechanism, and assessing the potential fiscal impact that would be included in the budget, we intend to consult with the IMF before concluding any significant PPP arrangements.

25. The non-accumulation of external payments arrears, as defined in the TMU, will constitute a continuous performance criterion, as will our commitment not to impose or intensify restrictions on current payments, introduce multicurrency practices, including bilateral payments agreements that are inconsistent with Article VIII, or imposing or intensifying import restrictions for balance of payments reasons. The government will remove the recently imposed quantitative import restrictions on meat and dairy products by June 2008.

Enhancing the Business Environment and Regulatory Reform

26. With the aim to improve the business climate, the government intends to streamline the regulatory environment in the non-financial sector by substantially reducing excessive licensing, permit and authorization requirements; burdensome and loosely regulated activities of controlling bodies; and proliferation of public services provided for fees. In particular, the new licensing law that will be effective by March 2008, will establish a more liberal, consolidated and transparent licensing system valid for all licensing authorities except for the NBM and the NCFM, and set up a free of charge access for the public (through the internet) to register licenses. At the same time, Government will take steps to optimize the institutional structure and the functions of the state control bodies, focusing mostly on supervision of activities in the non-financial sector without on-site visits, and carrying out inspections only if information is gathered during supervision that shows that enterprises are violating current legislation. Starting with 2008, all informative notes accompanying new draft acts will include regulatory impact analyses. In addition, during 2008 one stop-shop services will be launched for relevant public services. Insolvency legislation will be reviewed taking into account the best international bankruptcy practices.

27. Tariffs for natural gas and electricity have stayed at cost-recovery levels, for all consumer categories. Moreover, as energy prices change, these tariffs will also adjust accordingly in line with the ANRE methodology. As a prior action, tariffs for heat will be set at the cost-recovery level according to the ANRE methodology. As originally planned, the new system of targeted social benefits will be put in place by September 30, 2008. As an interim measure, appropriate social assistance for those that cannot afford the higher tariffs will be put in place

Table 1. Prior Actions, Performance Criteria and Structural Benchmarks

Measure	Due	Status	Note
Proposed prior actions			
Amend the Law #235 to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.		Implemented	The amendments to the Law#235 were passed by Parliament in February 2008.
Heat tariffs received by utilities will be set at cost-recovery of lei 540, following the ANRE methodology.		Implemented	Heat tariffs were restored to cost-recovery in January 2007.
Proposed performance criteria			
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		
Announce tender for privatization advisor to Banca de Economii.	31-Mar-08		New condition
Adoption of legislation to (i) give the STI the right to write-off uncollectible tax arrears and (ii) shift all tax audit, assessment, and collection powers to STI.	31-Mar-08		New condition, modified from the end-March 2008 SB in the 2007 program.
Adopt a new Licensing Law to exclude all entities licensed, regulated and supervised by the NBM and/or the NCFM from its provisions.	31-Mar-08		New condition
Sign the contract with the privatization advisor for Banca de Economii with a six-month time frame for bringing the bank to market.	30-Sep-08		New condition
Proposed structural benchmarks			
Heat tariffs received by utilities remain at cost recovery. A lower tariff than provided by ANRE methodology would imply new domestic expenditure arrears under the program.	Continuous		New condition
Outstanding stock of NBM claims on government fully securitized.	31-Mar-08		
Introduction of a system whereby the State Treasury ensures that the balances in commercial banks of the social insurance budget (BASS) and the mandatory health insurance fund are zero-ed out on a daily basis.	30-Jun-08		
Remove quantitative restrictions on imports of meat and dairy products.	30-Jun-08		New condition
Introduce the targeted social assistance system throughout Moldova.	30-Sep-08		
The government approval of a draft law, which will consolidate all forms of remuneration in base pay for civil servants, with a view to implementing it in the 2009 budget year.	30-Sep-08		New condition
Selection of an advisor through an open tender to assess the modalities for the possible privatization of Moldtelecom.	30-Sep-08		New condition
Reduce public employment by 3000 people.	31-Dec-08		New condition

ATTACHMENT III. TECHNICAL MEMORANDUM OF UNDERSTANDING

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.

I. PROGRAM ASSUMPTIONS

2008

2. Loan disbursements of $73.5 million.

3. Receipts to the general government budget of privatization proceeds in the amount of MDL 131 million in 2008.

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 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.

II. 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.

III. PROGRAM TARGETS AND DEFINITIONS

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves
March 31, 2008	15,359
June 30, 2008	16,403 (indicative target)
September 30, 2008	17,918 (indicative target)
December 31, 2008	20,160 (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)
March 31, 2008	-5,713 (performance criterion)	9,646
June 30, 2008	-6,422 (indicative target)	9,981
September 30, 2008	-7,363 (indicative target)	10,555
December 31, 2008	-8,717 (indicative target)	11,443

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

9. **Net domestic assets of the NBM** is 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, 2007	
March 31, 2008 (performance criterion)	150
June 30, 2008 (indicative target)	0
September 30, 2008 (indicative target)	-100
December 31, 2008 (indicative target)	-284

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).[1] 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[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 5 in the section on limits on external debt.

13. The **quarterly limits on the general government wage bill** are cumulative and measured as the sum of total salaries, bonus payments and other types of remuneration, social security contributions to the National Social Insurance House, and contributions to the National Health Insurance Company paid to all employees in the general government sector as defined in paragraph 11, excluding wages paid to employees of the National Social Insurance House and the National Health Insurance Company. For 2007, the general government wage bill based on such a definition amounted to 4,970 million lei.[3]

Ceiling on the General Government Wage Bill
(In millions of lei)

	Indicative Target
Cumulative change from December 31, 2007	
March 31, 2008	1,286
June 30, 2008	2,714
September 30, 2008	4,138
December 31, 2008	5,517

14. **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.

15. **External-debt limits** apply to the contracting or guaranteeing of (i) short-term non-concessional 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. The limit is zero with the exception of the health project financed by €9 million from the Council of Europe Development Bank (CEB). In 2007, the ceiling was raised for a road project to be partly financed by €30 million from the European Investment Bank (EIB) and by €30 million from the European Bank for Reconstruction and Development (EBRD). The first phases of the EBRD and EIB road project (in the amount of €12.5 million each) will not have grant co-financing, but the second phases (in the amount of €17.5 million each) are expected to include grant co-financing sufficient to bring the overall level of concessionality on the second phases of the project to at least the target level of 35 percent. 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

[3] 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, 1161.

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.

Ceilings on Contracting or Guaranteeing of Non-concessional External Debt of the General Government
(In millions of Euro)

	CEB Health Project	Other
Cumulative change from December 31, 2007		
March 31, 2008 (performance criterion)	9	0
June 30, 2008 (indicative target)	9	0
September 30, 2008 (indicative target)	9	0
December 31, 2008 (indicative target)	9	0

16. 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).[4] 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.

17. 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.

18. **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.

[4] 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.

19. 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.

20. 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.

IV. Adjusters

21. In the event that privatization receipts exceed the program assumptions, the limits on the overall cash deficit of the general government will not be increased.

22. 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 magnitude up to a cumulative cap of lei 200 million. In case of shortfalls, the limits will be decreased by the full amount.

23. 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, December 31, 2007–December 31, 2008 1/ 2/

	31-Dec-07	31-Mar-08	30-Jun-08	30-Sep-08	31-Dec-08
			Indicative	Indicative	Indicative
		Proj.	Proj.	Proj.	Proj.
1. Quantitative performance criteria					
	(In millions of lei unless noted otherwise)				
Floor for general government fiscal balance	...	150	0	-100	-284
Adjusted floor for general government fiscal balance 3/	-134	...	...	...	...
Ceiling on net domestic assets of the NBM (level)	-5,345	-5,713	-6,422	-7,363	-8,717
Floor on net international reserves of the NBM (level)	14,882	15,359	16,403	17,918	20,160
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (Euro million)	60	9	9	9	9
EBRD/EIB road project	60	0	0	0	0
CEB health loan	0	0	0	0	0
Other	0	9	9	9	9
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)	9,537	9,646	9,981	10,555	11,443
Ceiling on change in domestic expenditure arrears of the general government	150	0	0	0	0
Ceiling on the general government wage bill	4,966	1,286	2,714	4,138	5,517
	(In millions of lei, unless noted otherwise)				
4. Baseline assumptions					
Concessional external debt financing	603	170	350	591	808
in millions of dollars	53	15	31	53	73
Privatization receipts	407	50	90	110	131

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2008 refer to cumulative flows from end-2007, 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 concessional 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 200 million. 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
General government wage bill	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

Item	Periodicity
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.

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Debt Sustainability Analysis

Prepared by the staffs of the International Development Association
and the International Monetary Fund

Approved by Luca Barbone and Carlos Braga (World Bank)
and Juha Kähkönen and Anthony Boote (IMF)

February 20, 2008

The joint Bank-Fund low-income country debt sustainability analysis (LIC DSA) indicates that Moldova's risk of debt distress is low. The public DSA suggests that Moldova's overall public sector debt dynamics are sustainable in light of the current size and the evolution of the domestic debt stock.[1]

A. Background

1. **Moldova's debt situation has improved since the last DSA in mid-2007, mostly due to GDP growth**. At the time of the inception of the PRGF arrangement in May 2006, short-term financing needs stemmed from the projected financing gaps from external shocks and the stock of arrears owed to bilateral creditors (mainly Russia, the US and Japan). The latter concerns were subsequently resolved through Paris Club rescheduling in May 2006. Debts covered under the agreement were 33 percent of Moldova's total debt stock, based on end-April 2006 numbers.[2] However, the reduction in external debt from this deal was not as dramatic as it had been from 2000–2005: external debt was 124 percent of GDP in 2000 (with public debts totaling 95 percent of GDP), falling to 56 percent of GDP in 2005 (27 percent of GDP for public debt).[3]

2. **Prospects for continuing official donor assistance are good.** In response to the twin external shocks—doubling of energy prices and Russia's ban on imports of Moldovan wine—large commitments were made by donors at the December 2006 Consultative Group

[1] The DSA has been produced in consultation with the EBRD. Moldova is now above the threshold for IDA-only eligibility, and should also no longer be judged as a weak performer, given improved CPIA ratings.

[2] Moldova owed Germany, Italy, Japan, Russia, and the US a total of $274 million, out of $822 million.

[3] The rapid fall in debt to GDP was mainly due to strong GDP growth; the nominal amount of debt remained relatively constant.

meeting (primarily grants and technical assistance) and are beginning to materialize, although disbursements in 2007 were slower than hoped for. Moldova has also qualified for grants from the Millennium Challenge Corporation, reducing the pressure to borrow for growth-enhancing investments.

3. **A significant fraction of external debt is on concessional terms, and will remain so.** Table 1 illustrates the preponderance of debt owed to multilateral lenders on concessional terms and the likely evolution from future disbursements. Most borrowing in the near term is forecast to be on concessional terms, either directly or through integrated loan arrangements that incorporate grants. Over the longer term, as Moldova becomes an IDA-IBRD blend country, borrowing will continue to be primarily from multilateral lenders, but will become less concessional. Loans from commercial creditors make up a very small fraction of the total.

Table 1: External Public Debt Profile

	2007		2008-27 2/	
	Total	Concessional 1/	Average	Concessional 1/
Debt stock (US$):	920.3	423.1	979.9	503.4
Multilateral	592.3	423.1	636.2	434.8
World Bank	409.6	277.3	555.9	373.8
IMF	155.0	132.6	62.8	55.8
Others	27.7	13.1	17.5	5.2
Bilateral	314.9	0.0	343.0	68.6
Commercial	13.1	0.0	0.7	0.0
New disbursements (US$):	97.0	89.7	50.4	19.7
Multilateral	93.3	89.7	46.2	15.5
World Bank	46.2	46.2	36.2	8.7
IMF	33.2	33.2	3.6	3.6
Others	13.9	10.3	6.4	3.2
Bilateral	3.7	0.0	4.2	4.2
Commercial	0.0	0.0	0.0	0.0

1/ Concessional loans have a minimum grant element of 35 percent.
2/ Simple average.

4. **Private external debt is growing, with loans associated with FDI becoming more important.** Private external debt can be divided between regular loans (classified as liabilities under other capital in the capital account), loans associated with FDI transactions, and energy arrears. In 2001 new disbursements from FDI-linked loans comprised 35 percent of new borrowing, but by 2007 the proportion was 67 percent (based on the first three quarters). Private debt is also increasingly denominated in euros – 20 percent in 2006 compared with only 6 percent in 2002. This is a welcome trend, given the natural hedge from remittances denominated in euros and the strengthening trade linkages.

5. **The increase in energy prices led to private external arrears.** There is a large outstanding stock of historic debt from unpaid energy bills (mostly from the 1990s between Moldovagaz and suppliers, totaling $320 million at end-2006), but in recent years current payments at least have been made. However, while electricity and natural gas tariffs are set at cost recovery, tariffs for heat are below that level causing Moldovagaz to run arrears of about $34 million to Gazprom in 2006, and early indications are that arrears will continue in 2007. Heating tariffs are now set by municipalities to be at cost-recovery levels, as determined by an independent regulator.

B. Underlying Assumptions

6. **The macroeconomic framework has changed substantially since the last DSA.** The main cause has been a shift away from remittances as the driver of growth, as developments in Moldova increasingly mirror those in other transition economies, and growth prospects improve. Investments have begun to grow strongly - FDI in 2007 nearly doubled as a percent of GDP, from 6.6 in 2006 to 12.4 percent in 2007. Private debt over the medium-term is also forecast to grow substantially, supported by improvements in the business climate. The government has established a good track record of macroeconomic stability, improved the supervisory framework, and is streamlining the regulatory environment.

7. **Box 1 summarizes the medium-term macroeconomic assumptions underlying the DSA.** Growth prospects have improved, driven by higher investments. Inflation should subside to single-digit levels by end-2008, with additional benefits to the business environment and poverty. Export growth will be supported by the resumption of wine exports to Russia and the recent autonomous trade preferences agreement with the EU. However, remittances will continue to finance the trade deficit. Moldova has one of the highest proportions of overall remittances (including remittances and compensation of employees) to GDP in the world, 37 percent in 2007, and investments have begun to grow strongly. FDI in 2007 nearly doubled as a percent of GDP, from 6.6 in 2006 to 12.4 percent in 2007. Nominal growth of remittances (in US$) has averaged 40 percent since 2001, reaching a peak of 54 percent in 2003 and subsiding to 38 percent in 2007. Strong growth in the euro area provides incentives to work abroad, but border crossings are now complicated by the accession of Romania to the EU at the beginning of 2007 (because of new visa requirements).

8. **The overall fiscal deficit is expected to remain at about 0.5 percent of GDP over the medium term, permitting modest primary surpluses to accumulate**. High levels of remittances and investments should continue to feed import growth, VAT and excises on which will bolster revenue. Recent policies, such as an increase in civil service wages are expected to be offset by a medium-term rationalization of public sector employment. Despite the increase in donor assistance for capital expenditures over the next few years, there is not a large growth dividend built into the baseline scenario. Indeed, growth of 6 percent over the medium term is roughly what Moldova had after the Russian crisis and before the shocks of 2006 and 2007.

Box 1. Moldova – Macroeconomic Assumptions

The macroeconomic assumptions have improved since the last DSA: growth will remain strong, inflation will subside, with continuing current account deficits and primary government surpluses.

Real GDP growth is projected at 5 percent in 2007, rising to 7 percent or above in 2008-09, and gradually declining thereafter. While this is higher than the historical average, the past decade included two years of severe recession in the aftermath of the Russian crisis of 1998 causing average growth rates to fall and volatility to rise. In the post-crisis period (2001–2006) real growth averaged 6.6 percent.

Inflation is projected to subside to the single-digit range by end-2008, falling to three percent by 2027 (as measured by the GDP deflator). This is considerably lower than the historical average of 16 percent, but measures taken under the program should ensure the National Bank of Moldova keeps a tight rein on monetary policy.

The **current account** is projected to continue to be supported by strong remittances, which in 2007 are estimated to have reached 37 percent of GDP. As remittances largely feed into consumption and imports, changes in flows largely net out with respect to the current account deficit. The improved prospects for the business environment have also raised capital inflows, in particular direct investment. Exports, which were down sharply after the Russian ban on wine, are growing strongly, both in wine (especially now that exports to Russia have resumed), and in other goods.

The **overall fiscal balance** is expected to remain negative, but with a small deficit. Grant assistance from donors, especially the European Union, is projected to increase, as are project loans that flow through the budget. This fiscal stance reflects the need to increase capital investment and social spending over the medium-term.

C. External Debt Sustainability

9. **External public debt and debt-service ratios remain well below the thresholds in the baseline and historical scenarios.** External debt and debt-service to exports ratios are well within the relevant limits, despite the continuing effects of the Russian ban on wine (Figure A1). Included in the baseline are higher disbursements of concessional loans over the next four years. An alternative scenario (A2 in Table A2) that examines the effects of less concessional terms on loans indicates no breach of the thresholds either.

10. **In staffs view, the most worrisome possibility is a fall in transfers.**[4] This alternative scenario (B4 in Table A2) shows the effects of a shock of one standard deviation below the historical average of net non-debt generating inflows in 2008-09 (which are primarily remittances in Moldova at this point). This illustrates Moldova's reliance on remittances. The baseline scenario assumes that remittances plateau at the current percent of GDP. However, should the labor environment abroad become less welcoming, or a

[4] The most extreme shock, the combination of other bound tests (B5), also shows a temporary breach of the threshold for the NPV of debt-to-GDP ratio. However, staff judge this scenario to be less likely in practice than the scenario incorporating a fall in transfers.

slowdown in Russia or the EU (the two main destinations) occur, migrants may find it more difficult to maintain their level of support to dependants in Moldova. On the other hand, as remittance flows tend to be much less volatile than other types of inflows, such as portfolio investment, the chances for them to reverse appear slim.[5] Under this scenario, the threshold for the NPV of debt-to-GDP ratio is breached in 2009. Despite this temporary breach, staffs still characterize Moldova as a low risk of debt distress, given the good track record of macroeconomic stability the authorities have established in the face of shocks. Note also that given the robust increased in remittances experienced in the last three years, the magnitude of the shock is most likely exaggerated.

Table 2: Policy-Based External Public Debt Burden Indicators

	Thresholds 1/			
	Weak	Medium	2007	2008-27 2/
NPV of external debt in percent of:				
Exports	100	150	32.5	9.9
GDP	30	40	15.1	5.1
Revenues	200	250	36.4	12.1
External Debt Service in percent of:				
Exports	15	25	4.0	1.3
Revenues	25	30	4.4	1.5

1/ Policy-dependent thresholds as used in the joint IMF-World Bank LIC DSA framework for weak or medium performers. Moldova's ratings have recently improved to medium, with classifications based on three-year moving averages.
2/ Simple average.

D. Public Debt Sustainability

11. **Public debt and debt-service to revenue ratios remain well below the appropriate thresholds in both the baseline and historical scenarios.** Public domestic debt has remained steady at about 25 percent of total public debt, and is held primarily by the National Bank of Moldova. While there are no thresholds as to the appropriate level, the proportion held domestically is likely to increase in the future as domestic financial markets become more developed. As there were primary surpluses in recent years, the historical scenario shows how quickly all public debt could be paid off: the debt and debt-service ratios all become negative before 2020. In practice, this is unlikely to occur, especially considering Moldova's significant and widely-recognized needs to upgrade infrastructure and make other capital investments to lay the foundation for future growth.

[5] While the annual growth rate of remittances has been over 30 percent since 2001, experiences from other countries do not imply equal risks of large negative growth. In addition, remittance growth in the first quarter of 2007 is estimated at 29 percent, and the robust growth in the euro area is an upside risk.

12. **A recession in 2008-09 could potentially derail the positive trends depicted under the baseline scenario.** As shown in Figure A2 (and B1 in Table A4), a contraction in real GDP growth of 1.6 percent in 2008 and 2009 (equivalent to a growth shock of one standard deviation below the historical average growth rate) that is not accompanied by fiscal expenditure adjustment would imply that the debt-to-GDP ratio rises above 30 percent by 2011, with a continuing increase in that ratio over the remaining projection period. Under this scenario, with tax revenues falling with GDP, the failure to adjust nominal expenditures implies that these expenditures rise as a share of GDP and give rise to a relatively large and permanent primary deficit (4.5 percent of GDP) that would need to be financed. Adjusting this expenditure path, as shown in Figure A2 (and B2a in Table A4), will be critical to maintaining debt sustainability. Even if the expenditures are kept high during the recession to provide fiscal stimulus, a gradual post-recession expenditure adjustment that restores fiscal balances to closer to the baseline trajectory over the next five years will result in declining debt burden ratios. Recent history has shown the resilience of the Moldovan economy to external shocks. More importantly, policy makers have not hesitated to undertake fiscal adjustment to maintain their record of fiscal prudence.

E. Conclusions

13. **Moldova's external debt outlook is favorable, with a low risk of debt distress,** despite some temporary breaches in the threshold for the NPV of debt-to-GDP ratio under two scenarios.

14. **In the face of some severe shocks in 2006, the Moldovan authorities did not resort to excessive borrowing.** This led to an agreement with the Paris Club and commitments by the Consultative Group that have bolstered debt sustainability. Good macroeconomic management has also laid the groundwork for future investment-led growth, improving the situation further. Given Moldova's development needs, there appears to be room for modest additional borrowing for infrastructure and other high priority projects, as long as such borrowing remains prudent. Absorptive capacity will likely be a more binding constraint than debt sustainability, and since Moldova is now above the IDA-only threshold, opportunities for concessional borrowing should be appropriately examined in the context of the medium-term expenditure framework in the near term.

15. **There is a possibility some remittances should be reclassified as investments.** Recent analysis of disaggregated data by the NBM revealed some very large transactions, accounting for a substantial proportion of total money transfers, and the authorities have initiated the process of reclassifying remittances. It is likely that these were intended as payments for goods or services, but were channeled as personal transfers due to lower transaction and administrative costs. This revision might ensure a better consistency with survey data on remittances. A 2006 household survey conducted by CBS-Axa estimates that

overall remittances (including compensation of employees) were less than half of those recorded in the BoP, implying that other transfers may be intended for investment.

16. **However, a reclassification should not change the assessment of a low risk of debt distress.** The risk of a sudden fall in remittances would be mitigated, as financing sources would be more diversified. Although the impact of a recession or a slowdown in exports would be greater if a substantial fraction of remittances were reclassified as investments, growth would also be more robust, given a better basis on both consumption and investment. Moldova is well below the thresholds for the existing scenarios. However, when more information about the extent of a reclassification is available, these risks should be explored more fully.

17. **Although the risk is low, there are some vulnerabilities.** The external outlook remains dependent on remittances, which have expanded rapidly in recent years, but this is tempered by the increase in investments. An interruption in the ability of migrants to support dependents in Moldova, or a reversal of investment growth would significantly affect the sustainability of debt. In addition, the recent Financial Sector Assessment Program update pointed to the need to deepen financial reforms, which would improve the sector's ability to intermediate flows. Improving the business climate so that internal growth can attract migrants back into the country and maintain the pace of private investments would improve resilience. In addition, a temporary recession would cause the public fiscal situation to deteriorate rapidly. A smaller government as a proportion of GDP would be less likely to endanger debt sustainability.

Table A1. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2005-2027 1/
(In percent of GDP, unless otherwise indicated)

	Actual		Historical	Standard	Projections									
	2005	2006	Average 6/	Deviation 6/	2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
External debt (nominal) 1/	56.2	57.4	84.3	25.5	58.2	56.2	55.1	55.2	54.7	53.6	55.5	43.7	40.1	43.2
o/w public and publicly guaranteed (PPG)	27.4	25.9	53.4	26.1	21.2	17.4	15.0	13.4	12.3	11.2	15.1	6.5	2.4	5.4
Change in external debt	-8.0	1.2	-10.7	9.0	0.8	-2.0	-1.1	0.1	-0.4	-1.1	-0.6	-0.5	-0.1	-0.9
Identified net debt-creating flows	-5.7	-0.8	-12.1	7.7	-4.9	-4.6	-4.8	-4.1	-3.6	-3.4	-4.2	-1.8	-1.7	-1.8
Non-interest current account deficit	8.6	10.7	3.4	4.9	8.1	8.4	8.5	8.9	8.6	8.2	8.5	8.5	8.2	8.3
Deficit in balance of goods and services	40.5	47.6	32.4	8.9	51.4	52.2	49.9	47.5	42.4	40.4	47.3	40.4	40.4	40.4
Exports	51.1	45.8	50.5	2.5	46.5	48.9	51.1	51.5	52.8	52.8	50.6	52.8	52.8	52.8
Imports	91.7	93.3	82.9	7.9	97.9	101.1	101.0	99.0	95.2	93.2	97.9	93.2	93.2	93.2
Net current transfers (negative = inflow)	-18.2	-23.6	-16.6	3.4	-26.7	-27.2	-25.3	-23.9	-20.4	-19.7	-23.9	-19.7	-19.7	-19.7
o/w official	-2.0	-2.0	-3.1	1.2	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Other current account flows (negative = net inflow)	-13.7	-13.3	-12.4	3.2	-16.6	-16.7	-16.1	-14.7	-13.3	-12.4	-15.0	-12.2	-12.5	-12.3
Net FDI (negative = inflow)	-7.5	-6.6	-5.6	2.5	-12.3	-11.7	-11.9	-11.9	-11.3	-11.1	-11.7	-11.1	-11.1	-11.1
Endogenous debt dynamics 2/	-6.7	-4.8	-10.5	5.1	-0.7	-1.3	-1.5	-1.1	-0.9	-0.6	-1.0	0.8	1.2	0.9
Contribution from nominal interest rate	1.7	1.3	2.6	1.0	1.6	2.0	2.2	2.5	2.6	2.7	2.3	2.4	2.7	2.6
Contribution from real GDP growth	-4.2	-2.0	-5.0	1.8	-2.3	-3.2	-3.7	-3.6	-3.4	-3.2	-3.3	-1.6	-1.5	-1.6
Contribution from price and exchange rate changes	-4.2	-4.2	-8.0	4.8	…	…	…	…	…	…	…	…	…	…
Residual (3-4) 3/	-2.3	2.0	1.4	4.8	5.7	2.7	3.6	4.2	3.2	2.3	3.6	1.3	1.6	0.9
o/w exceptional financing	-1.8	-3.4	-2.6	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPV of external debt 4/	...	50.3			52.1	50.9	50.3	50.9	50.8	50.0	50.8	41.5	39.4	41.5
In percent of exports	...	109.9			112.0	104.1	98.5	98.8	96.2	94.7	100.7	78.6	74.6	78.6
NPV of PPG external debt	...	18.8			15.1	12.1	10.3	9.1	8.3	7.5	10.4	4.4	1.8	3.7
In percent of exports	...	41.2			32.5	24.7	20.1	17.6	15.8	14.3	20.8	8.4	3.3	7.0
In percent of government revenues	...	47.4			36.4	30.9	26.5	23.4	21.2	18.9	26.2	9.7	3.2	...
Debt service-to-exports ratio (in percent)	16.5	18.7	21.1	3.5	8.8	11.2	13.3	15.1	16.8	19.2	14.1	19.6	21.5	20.6
PPG debt service-to-exports ratio (in percent)	7.0	5.5	11.8	4.6	4.0	3.2	2.6	1.8	1.5	1.8	2.5	1.0	0.5	0.9
PPG debt service-to-revenue ratio (in percent)	9.5	6.4	19.0	9.4	4.4	4.0	3.5	2.5	2.1	2.4	3.1	1.1	0.5	...
Total gross financing need (billions of U.S. dollars)	283.6	422.3	199.5	123.0	-5.4	113.0	225.8	356.3	509.6	671.3	311.8	994.2	2320.2	1398.3
Non-interest current account deficit that stabilizes debt ratio	16.6	9.5	14.0	7.3	7.3	10.3	9.7	8.8	9.1	9.3	9.1	8.9	8.2	9.2
Key macroeconomic assumptions														
Real GDP growth (in percent)	7.5	4.0	3.3	4.9	5.0	7.0	8.0	7.5	7.0	6.5	6.8	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	7.0	8.0	10.2	6.3	20.0	18.1	12.4	6.4	4.9	3.2	10.8	4.0	3.0	3.4
Effective interest rate (percent) 5/	3.0	2.7	3.3	0.5	3.5	4.3	4.9	5.1	5.2	5.3	4.7	6.0	7.2	6.3
Growth of exports of G&S (US dollar terms, in percent)	14.8	0.5	15.9	8.6	28.0	33.1	26.8	15.2	15.1	10.0	21.3	8.2	7.1	7.6
Growth of imports of G&S (US dollar terms, in percent)	29.7	14.4	21.8	8.5	32.1	30.6	21.2	12.1	7.9	7.7	18.6	8.2	7.1	7.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	41.2	37.9	33.0	39.3	31.4	27.8	35.1	14.6	14.6	14.6
Aid flows (in billions of US dollars) 7/	61.7	57.9			54.2	57.2	49.3	38.8	36.6	47.6	47.3	32.7	47.9	41.9
o/w Grants	36.5	24.0			75.7	106.8	110.4	91.9	63.1	8.9	76.1	0.0	0.0	0.0
o/w Concessional loans	24.0	26.6			24.3	25.1	19.4	9.3	6.7	17.0	17.0	6.8	0.0	5.9
Grant-equivalent financing (in percent of GDP) 8/	...	...			2.6	2.7	2.3	1.6	1.1	0.3	1.8	0.0	0.0	0.0
Grant-equivalent financing (in percent of external financing) 8/	...	...			68.5	70.5	66.1	73.8	61.7	35.9	62.7	14.6	14.6	14.6
Memorandum items:														
Nominal GDP (billions of US dollars)	2988.3	3356.2			4227.3	5343.4	6484.6	7417.2	8324.5	9153.0		12833.7	27316.8	
(NPVt-NPVt-1)/GDPt-1 (in percent)					0.2	0.2	0.4	0.1	0.3	0.0	0.2	-0.1	-0.1	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

Table A2. Moldova: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	**2017**	2027
NPV of debt-to-GDP ratio								
Baseline	15	12	10	9	8	8	**4**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	15	13	12	11	10	9	**4**	3
A2. New public sector loans on less favorable terms in 2008-27 2/	15	12	11	10	9	9	**6**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	15	12	11	9	9	8	**5**	2
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	15	20	30	27	25	23	**14**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	15	14	13	11	10	9	**5**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	15	30	43	39	36	34	**20**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	15	33	55	50	47	44	**26**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	15	16	14	12	11	10	**6**	2
NPV of debt-to-exports ratio								
Baseline	32	25	20	18	16	14	**8**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	32	27	24	21	19	17	**8**	6
A2. New public sector loans on less favorable terms in 2007-26 2/	32	25	21	19	18	16	**11**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	32	25	20	18	16	14	**8**	3
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	32	50	86	77	69	65	**38**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	32	25	20	18	16	14	**8**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	32	62	83	75	68	64	**37**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	32	72	123	110	100	94	**56**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	32	25	20	18	16	14	**8**	3
Debt service-to-revenue ratio								
Baseline	4	4	3	2	2	2	**1**	0
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	4	4	4	3	2	2	**1**	0
A2. New public sector loans on less favorable terms in 2008-27 2/	4	4	4	3	2	2	**1**	1
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	4	4	4	3	2	2	**1**	0
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	4	4	4	4	3	4	**4**	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	4	5	4	3	3	3	**1**	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	4	4	5	5	4	4	**6**	1
B5. Combination of B1-B4 using one-half standard deviation shocks	4	4	6	6	5	5	**8**	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	4	5	5	3	3	3	**2**	1
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	19	19	19	19	19	19	**19**	19

Source: Staff projections and simulations.

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

Table A3.Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005-2027
(In percent of GDP, unless otherwise indicated)

	Actual				Estimate	Projections								
	2005	2006	Historical Average 5/	Standard Deviation 5/	2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
Public sector debt 1/	38.0	34.4	44.1	32.7	27.6	22.0	18.6	16.6	14.3	12.6	18.6	6.4	2.9	5.6
o/w foreign-currency denominated	27.9	25.8	35.0	29.7	20.3	16.0	13.3	11.6	10.1	8.9	13.4	4.7	1.7	3.9
Change in public sector debt	-9.3	-3.6	3.4	27.1	-6.8	-5.6	-3.4	-2.1	-2.2	-1.7	-3.6	-0.6	-0.2	-0.6
Identified debt-creating flows	-7.8	-5.7	-11.4	5.3	-8.0	-4.0	-3.4	-2.5	-2.3	-1.7	-3.6	0.5	1.1	0.6
Primary deficit	-2.8	-1.3	-0.7	3.3	-0.9	-0.7	-0.5	-0.5	-0.5	-0.5	-0.6	0.9	1.3	1.0
Revenue and grants	38.6	40.5	34.5	4.2	43.3	41.1	40.6	40.6	40.6	40.6	41.1	39.2	38.8	39.2
of which : grants	1.2	0.7	0.6	0.4	1.8	2.0	1.8	1.8	1.8	1.8	1.8	0.4	0.0	0.3
Primary (noninterest) expenditure	35.8	39.2	33.8	6.3	42.4	40.4	40.1	40.1	40.1	40.1	40.5	40.1	40.1	40.1
Automatic debt dynamics	-4.9	-4.1	-8.8	4.4	-6.7	-3.1	-2.7	-1.8	-1.7	-1.0	-2.8	-0.4	-0.2	-0.4
Contribution from interest rate/growth differential	-3.9	-2.2	-4.1	4.6	-2.0	-1.4	-1.4	-1.2	-1.0	-0.8	-1.3	-0.2	-0.1	-0.2
of which : contribution from average real interest rate	-0.6	-0.7	0.0	0.9	-0.3	0.4	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0
of which : contribution from real GDP growth	-3.3	-1.5	-2.5	2.4	-1.6	-1.8	-1.6	-1.3	-1.1	-0.9	-1.4	-0.3	-0.1	-0.2
Contribution from real exchange rate depreciation	-1.0	-1.9	-3.4	3.0	-4.7	-1.7	-1.3	-0.7	-0.7	-0.3	-1.6	...	...	-0.3
Other identified debt-creating flows	-0.1	-0.4	-0.9	1.0	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0
Privatization receipts (negative)	-0.1	-0.4	-0.9	1.0	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes	-1.5	2.1	1.9	3.3	1.2	-1.6	0.0	0.4	0.0	-0.1	0.0	-1.1	-1.3	-1.2
NPV of public sector debt	32.7	25.6	39.5	31.0	19.1	14.7	12.6	11.5	10.1	9.1	12.9	5.6	2.6	4.8
o/w foreign-currency denominated	22.6	17.0	30.3	28.1	11.8	8.7	7.3	6.5	5.9	5.4	7.6	3.8	1.4	3.1
o/w external	22.6	17.0	43.3	22.9	11.8	8.7	7.3	6.5	5.9	5.4	7.6	3.8	1.4	3.1
NPV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing need 2/	0.8	5.8	3.5	4.0	5.5	5.6	5.1	4.6	4.1	3.5	4.7	3.3	2.9	3.3
NPV of public sector debt-to-revenue and grants ratio (in percent)	84.8	63.1	123.1	104.9	44.1	35.9	31.2	28.3	25.0	22.4	31.1	14.3	6.7	12.2
NPV of public sector debt-to-revenue ratio (in percent)	87.6	64.3	126.0	107.9	46.0	37.7	32.6	29.6	26.1	23.4	32.6	14.5	6.7	152.7
o/w external 3/	60.7	42.7			28.4	22.3	18.9	16.8	15.1	13.9	19.3	9.9	3.6	7.8
Debt service-to-revenue and grants ratio (in percent) 4/	8.6	8.8	11.8	6.0	6.2	6.3	5.0	3.6	3.3	2.5	4.5	1.1	0.7	1.2
Debt service-to-revenue ratio (in percent) 4/	8.9	9.0	12.0	6.2	6.5	6.6	5.2	3.8	3.5	2.7	4.7	1.1	0.7	1.2
Primary deficit that stabilizes the debt-to-GDP ratio	6.5	2.3	6.4	4.0	5.8	4.9	2.9	1.6	1.8	1.3	3.1	1.5	1.5	1.6
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	7.5	4.0	3.3	4.9	5.0	7.0	8.0	7.5	7.0	6.5	6.8	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	3.0	2.7	3.2	0.6	1.6	1.6	2.3	2.1	2.0	2.0	1.9	2.0	2.2	2.1
Average real interest rate on domestic currency debt (in percent)	-5.3	-7.2	-3.6	5.2	0.3	6.4	3.4	1.9	1.9	1.9	2.6	1.9	1.9	1.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.0	-7.0			-19.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.3	12.5	15.6	10.1	10.9	7.1	7.4	5.7	5.7	5.7	7.1	5.7	5.7	5.7
Growth of real primary spending (deflated by GDP deflator, in percent)	17.5	14.0	4.2	16.8	13.4	2.0	7.3	5.0	5.0	5.0	6.3	4.0	4.0	4.0
Grant element of new external borrowing (in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...

Sources: Country authorities; and Fund staff estimates and projections.
1/ General government gross debt, excluding debt of public enterprises.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table A4.Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2007-2027

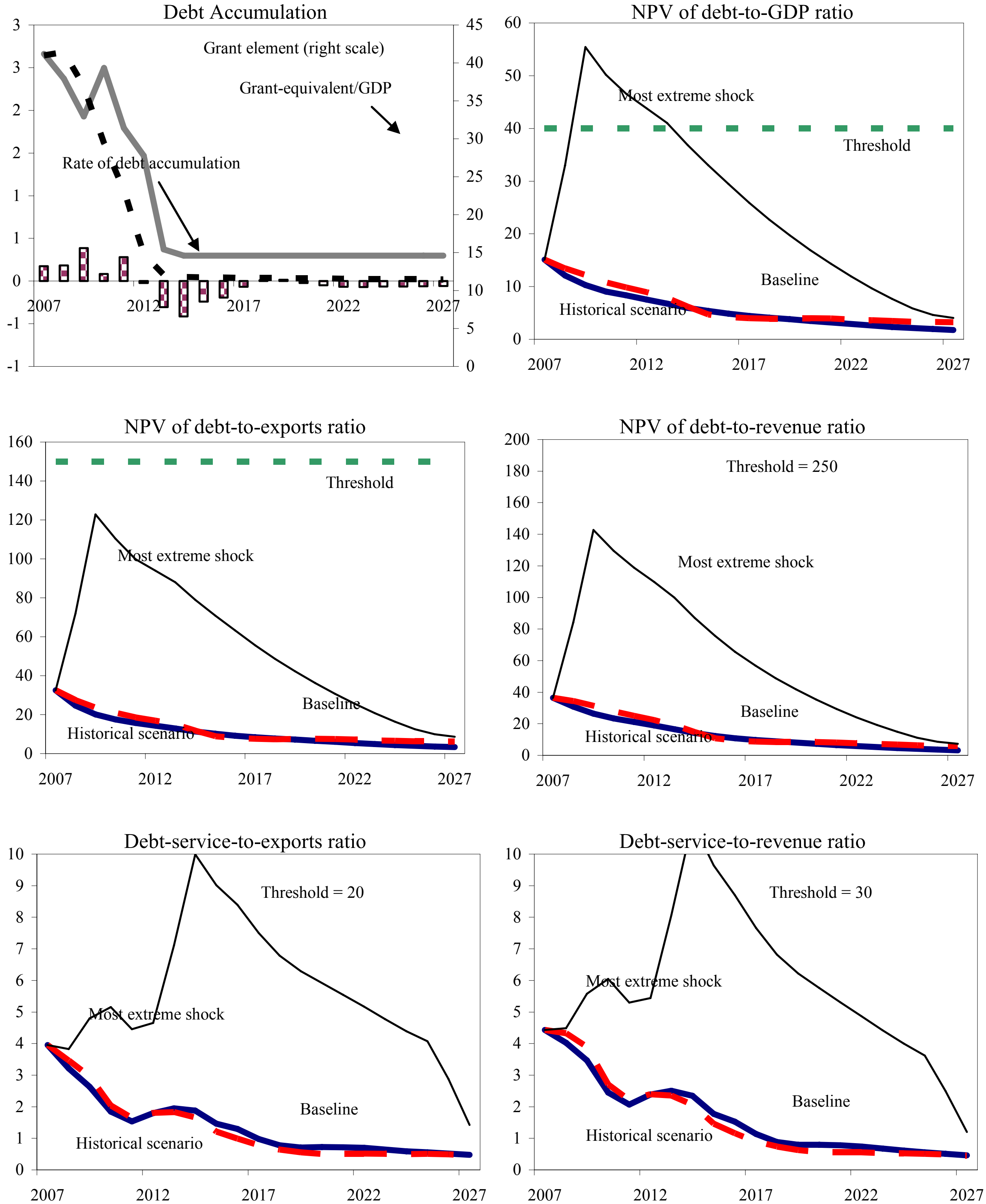
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	19	15	13	11	10	9	6	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	15	14	13	12	11	1	-17
A2. Primary balance is unchanged from 2007	19	15	12	11	9	8	-2	-17
A3. Permanently lower GDP growth 1/	19	15	14	13	12	11	12	43
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	19	19	25	29	31	33	45	63
B1a. Fiscal adjustment in the five years after B1.	19	19	25	29	31	33	32	23
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	19	18	18	16	13	10	-3	-19
B3. Combination of B1-B2 using one half standard deviation shocks	19	17	17	15	12	8	-5	-21
B4. One-time 30 percent real depreciation in 2008	19	19	16	14	11	8	-4	-19
B5. 10 percent of GDP increase in other debt-creating flows in 2008	19	24	21	19	17	16	11	6
NPV of Debt-to-Revenue Ratio 2/								
Baseline	44	36	31	28	25	22	14	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	44	37	33	31	29	26	3	-43
A2. Primary balance is unchanged from 2007	44	35	30	26	22	19	-4	-44
A3. Permanently lower GDP growth 1/	44	37	34	33	29	26	30	110
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	44	47	62	71	76	82	115	163
B1a. Fiscal adjustment in the five years after B1.	44	47	62	71	76	81	81	60
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	44	43	45	39	31	23	-8	-48
B3. Combination of B1-B2 using one half standard deviation shocks	44	42	42	36	28	20	-13	-54
B4. One-time 30 percent real depreciation in 2008	44	46	40	35	27	20	-10	-50
B5. 10 percent of GDP increase in other debt-creating flows in 2008	44	59	51	47	42	38	27	15
Debt Service-to-Revenue Ratio 2/								
Baseline	6	6	5	4	3	3	1	1
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	6	6	5	4	4	3	-1	-5
A2. Primary balance is unchanged from 2007	6	6	5	3	3	2	-1	-5
A3. Permanently lower GDP growth 1/	6	6	5	4	4	3	3	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	6	7	9	11	12	11	11	19
B1a. Fiscal adjustment in the five years after B1.	6	7	9	11	12	11	6	8
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	6	6	8	7	4	2	-2	-6
B3. Combination of B1-B2 using one half standard deviation shocks	6	7	7	6	4	1	-3	-6
B4. One-time 30 percent real depreciation in 2008	6	6	5	4	3	1	-2	-6
B5. 10 percent of GDP increase in other debt-creating flows in 2008	6	6	13	6	5	3	2	2

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

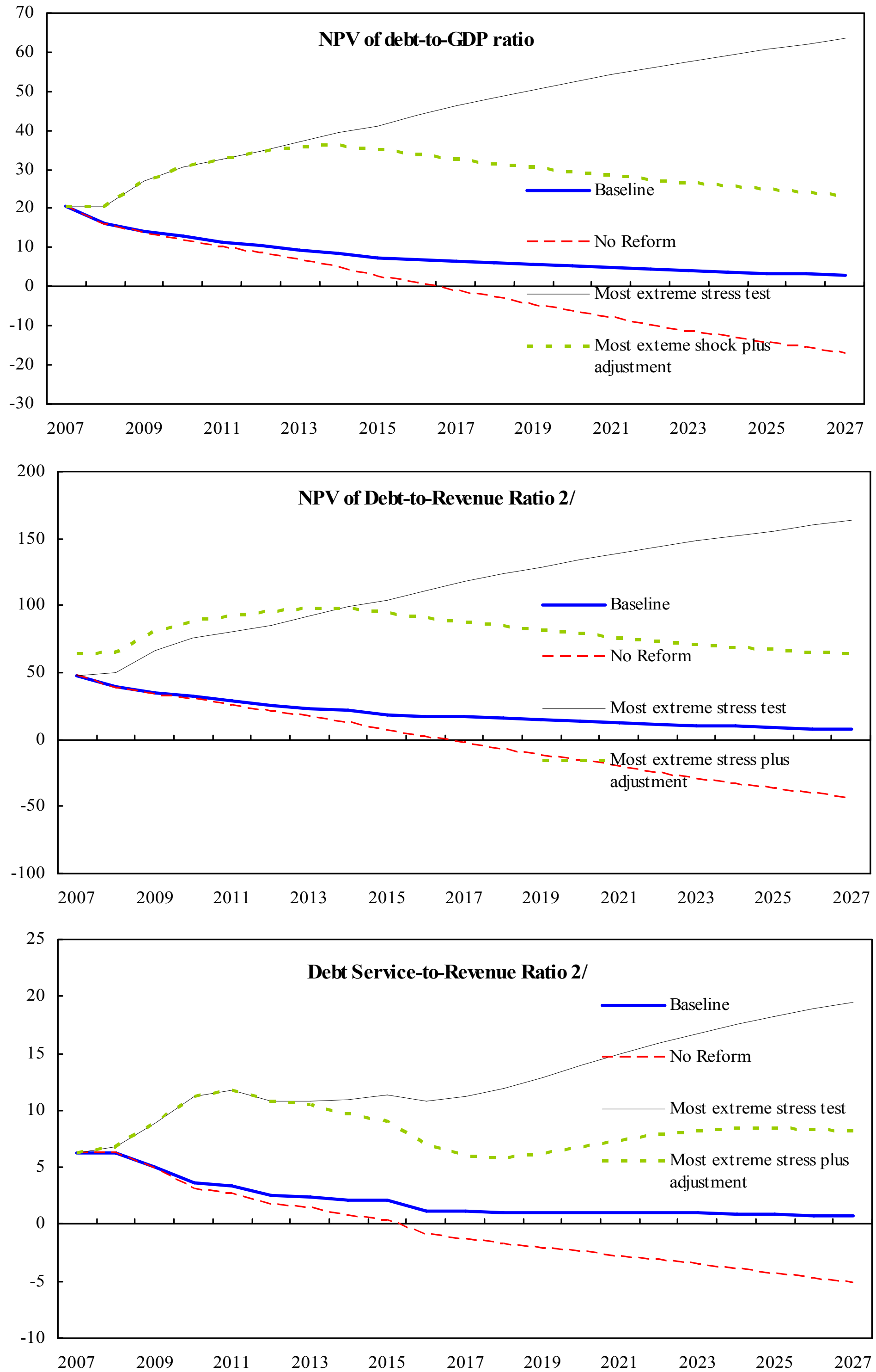
2/ Revenues are defined inclusive of grants.

Figure A1. Moldova: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2007-2027



Source: Staff projections and simulations.

Figure A2.Moldova: Indicators of Public Debt Under Alternative Scenarios, 2007-2027 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017.
2/ Revenue including grants.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Staff Report for 2007 Article IV Consultation and the Third Review under the Poverty Reduction and Growth Facility—Informational Annexes

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

February 20, 2008

Mission dates	December 5 – 21, 2007
Team	G. Justice (head), N. Gigineishvili, S. Hida, M. Piatkowski (all EUR), I. Asmundson (PDR) and J. Mathisen (resident representative).
Area covered by the consultation	The consultation covered only the government-controlled areas on the "right bank" of the Dniester River, and did not consider the areas not under the government's control on the "left bank," hereinafter referred to as Transnistria.
PRGF	The three-year PRGF arrangement was approved with the conclusion of the 2006 Article IV consultation on May 5, 2006. Cumulative access was SDR 80.08 million (65 percent of quota). Owing to external shocks faced by Moldova, and in light of the authorities' adjustment efforts, cumulative access was increased to SDR 110.88 million (90 percent of quota) at the first review on December 15, 2006, and SDR 31.97 million was disbursed at that time, and SDR 21.7 million following completion of the second review on July 13, 2007. Upon completion of the third review, a disbursement of SDR 11.44 million will become available.
Exchange system	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 (Annex I).
Donor coordination	The mission liaised with the World Bank (Annex II), the EBRD (Annex III), the UNDP and other donors, particularly the European Commission.
Data	National Bureau of Statistics (http://www.statistica.md/), National Bank of Moldova (http://www.bnm.org/english/index_en.html), Ministry of Finance (www.moldova.md). Despite some weaknesses, data provision is adequate for surveillance, and Moldova subscribes to the SDDS (Annex IV).
Outreach and publication	The mission met with members of parliament, trade unions, industry, the financial sector, NGOs, and the academic community. A press briefing was held at the end of the mission and—for the first time—the Concluding Statement was published (http://www.imf.org/external/np/ms/2007/123107.htm). The authorities have agreed to publication of the staff report and all program documents. The mission also held—in collaboration with the NBM—an international conference on monetary policy transmission.

Contents

ANNEX I: MOLDOVA—FUND RELATIONS

(As of December 31, 2007)

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	137.78	111.84
Reserve tranche position	0.01	0.00

III. **SDR Department**:	**SDR million**	**Percent of Allocation**
Holdings	0.10	N/A

IV. **Outstanding Purchases and Loans**:	**SDR million**	**Percent of Quota**
Extended arrangements	14.58	11.84
PRGF arrangements	86.37	70.11

V. **Latest Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
PRGF	5/5/2006	5/4/2009	110.88	65.12
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**[1]**:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	2009	2010	2011	2012
Principal	13.88	11.79	5.54	3.92	10.53
Charges/Interest	0.91	0.51	0.36	0.34	0.31
Total	14.78	12.31	5.91	4.25	10.84

[1] 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 concluded that safeguards in place at the NBM appear adequate, however, certain vulnerabilities were identified in the governance and control system. Recommendations made to address these vulnerabilities have been implemented according to information received from the authorities.

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 11.32=$1 on December 31, 2007.

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 Reports No. 06/184 and 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. An FSAP update mission visited in October 2007; the FSSA update is presented to the Board with the current Article IV Consultations report.

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 (IMF Country Report No. 06/184) in the amount of SDR 80.08 million (equivalent to 65 percent of quota). SDR 11.44 million was disbursed on May 10, 2006. An augmented arrangement was approved on December 15, 2006 (IMF Country Report No. 07/45) in the amount of SDR 110.88 million (equivalent to 90 percent of quota). SDR 31.97 million was disbursed on December 21, 2006, and SDR 21.71 million was disbursed on July 30, 2007, following completion of the second review on July 13, 2007 (IMF Country Report No. 07/275).

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. A MCM resident advisor on monetary policy implementation and liquidity management supported the NBM between January and June 2007. A new MCM resident advisor on inflation targeting is expected to take up post during 2008.

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. Mr. Tandberg, the Regional Public Finance Management Advisor for the Countries of Southeastern Europe, has been advising the Ministry of Finance on public finance management since 2006.

XV. **Technical Assistance**:

The following table summarizes the technical assistance missions provided by the Fund to Moldova since January 2002.[2]

Moldova: Technical Assistance Provided by the Fund, 2002–07

Department	Subject/Identified Need	Timing	Counterpart
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
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
FAD	Public finance management	October 2006	MoF
FAD	Tax policy reform; follow-up on tax reform implementation	March-April 2007	MoF

[2] For technical assistance before 2002, see previous reports.

LEG	AML/CFT law for Moldova	June 2007	MoE, NBM
FAD	Public finance management	June 2007	MoF
FAD	Tax administration	September 2007	MoF
MCM	Inflation targeting	September 2007	NBM

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

ANNEX II: MOLDOVA—IMF-WORLD BANK RELATIONS
(As of January 29, 2008)

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

A. Partnership in Moldova's Development Strategy

1. Moldova's development agenda for 2004 to 2007 had been set out in its 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 December 2007, following a broad-based, participatory consultation process, the Parliament approved the successor to the EGPRSP, i.e. the National Development Strategy (NDS). The President of Moldova promulgated the NDS in January 2008. The NDS will be presented to the Boards of the International Development Association (IDA) and the IMF in March 2008. The 2008 Joint Staff Advisory Note (JSAN) provides the government with advice on future implementation of the NDS. 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, aimed to support the Government's efforts to accelerate economic growth and improve the efficiency of its social programs and public administration. It directly supported implementation of Moldova's EGPRSP, as well as the EU-Moldova Action Plan. PRSC2 (US$10 million) is currently under preparation and will be presented to the IDA Board of Directors in April 2008. The PRSC program supports 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. On December 12, 2006, the World Bank together with the European Commission hosted a Consultative Group Meeting for Moldova. The meeting assessed progress in the implementation of the country's reform program and provided indications of additional external financing. Moldova's development partners expressed their support for the authorities' strategy and indicated financial support totaling more than US$ 1.2 billion (almost 1 billion €) over the next three years, of which 25 percent is in budgetary and balance of payment support.

6. 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,* a *Country Economic Memorandum and a Public Expenditure Review.* Bank is also providing technical assistance to the government in the areas of *poverty monitoring*, *public administration* and *civil service reform and governance*, and *social protection*.

7. In a number of areas—social sectors, environment, infrastructure—the Bank takes the lead in the dialogue. The Bank is also leading in the areas of support for the private sector development and agricultural sector reform. 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

8. 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 *Health and Social Assistance 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.

9. In **health**, the *Health and Social Assistance 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* is under implementation.

10. In **education,** the *Quality Education in Rural Areas Project* 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.

11. 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. The *Moldova Road Sector Program Support Project* was approved by the Board in FY07 and a *National Water Supply and Sanitation Project* is under preparation for Board consideration in May 2008.

12. 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. The Environmental Infrastructure Project was approved by the Board in FY07. The objectives of the project are to improve the quality of sanitary services in Northern Moldova and reduce the discharge of

pollutants, including nutrients into the Nistru River and demonstrate and disseminate cost-effective nutrient reduction strategies and technologies for municipal wastewater sources.

13. In the area of **rural and agricultural development**, the Bank's recently closed *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 (RISP1* and *RISP2)* 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. *Additional financing to RISP2* is under preparation for IDA Board consideration in June 2008. The purpose of the additional financing is to provide support to irrigation, especially in the wake of the devastating 2007 drought.

14. While the Bank has taken the lead in the areas of the structural reform described above, the IMF has a strong interest in these areas since many of them 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

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

16. **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* strengthened 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*. A joint IMF-World Bank FSAP Update has just recently been completed.

17. 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 recently closed Bank project *Trade and Transportation Facilitation in Southeast Europe* (part of the Stability Pact initiative), aimed 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* is helping the Moldovan Authorities to develop a budget planning and execution system by institutionalizing the medium-term expenditure planning and modernizing budget classification, and is assisting 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

18. 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.

19. 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

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

21. 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.

22. A CAS Completion and the 2009-2012 Country Partnership Strategy are currently under preparation, the latter of which will include a continuation of the annual PRSC program with a highly selective number of investment operations in the areas of the Bank's comparative advantage.

ANNEX III: MOLDOVA—RELATIONS WITH THE EBRD

(As of end 2007)

The EBRD's strategy in Moldova is aimed primarily at supporting private sector development in the country and increasing policy dialogue with the authorities. In particular, the Bank will pursue the following operational objectives:

I. The Bank will continue to pursue investment opportunities in all enterprise sectors including, without limitation, the food processing, manufacturing, information and communication technology (ICT), retail and property sectors. Well performing companies will be provided with direct financing including through ETC instruments. The Bank will facilitate foreign investment either by investing alongside foreign strategic investors or by assisting the development of local companies which in due course may attract foreign investment. Working capital may be provided to agribusinesses under the recently established warehouse receipt system. The Bank will continue to provide non-financial support to private enterprises through its Turn Around Management (TAM) and Business Advisory Services (BAS) programmes;

II. The Bank will provide its local partner banks with access to its SME and MSE credit lines, its Trade Facilitation Programme (TFP) as well as its Medium-sized Co-financing Facility (MCFF). The Bank will seek to extend its cooperation to new partner banks and will assist in the development and promotion of new financial instruments such as mortgage financing, leasing and energy efficiency credit lines. On the equity side, the Bank may consider further investment in banks, leasing companies and mortgage providers. The Bank will further enhance its support for the development of microfinance particularly (but not exclusively) in Moldova's regions. The Bank will explore opportunities to support the emergence of the non-banking financial sector;

III. Given Moldova's sovereign debt capacity constraints and the IMF's concessionality requirements, the Bank will - to the extent possible - co-finance public infrastructure projects with other IFIs and donors to ensure maximum leverage of grant and concessional financing. To enable Moldova to take full advantage of its new EU neighborhood status, the Bank will give priority to infrastructure projects that promote regional integration and interconnection with neighboring countries. The Bank is also committed to resume its municipal infrastructure lending provided sufficient grant financing can be attracted to address affordability constraints. The Bank will continue to support private infrastructure investments.

Fifty nine projects have been signed totaling €222.2 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); (xiii) equity participation and loan financing for three privatized power distribution companies (€26.9 million); (xiv) a loan (MMF) totaling €3.0 million and a credit line of €5 million to Banca Sociala to extend medium- to long-term loans of up to €500,000; (xv) equity and loan participation for SUN Communications (€1.9 and €3.7 million, sequentially); (xvi) a loan facility in the amount of up to €30 million, including €12.5 million for Phase 1 and an uncommitted EUR 17.5 million for Phase 2. ; (xvii) DLF Orhei Vit- a financing of new capital investments into the existing facilities and increased working capital needs of the Company through a €4 million facility.

In addition to banking projects, some 79 Technical Cooperation projects have been completed or approved (totaling €13.9 million).

ANNEX IV: MOLDOVA—STATISTICAL ISSUES

1. 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.

2. Moldova subscribed to the SDDS in May 2006, and became the sixth country which has graduated from the GDDS to the SDDS. Participation in the GDDS began in February 2003.

3. **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.

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

5. **Labor market statistics** have been substantially revised following the 2004 population census, substantially improving data reliability. While the methodology, training and practices of surveyors have improved, the most substantial revision was the expansion of sampling, thus achieving a more accurate reflection of the labor market situation. No comprehensive attempt has been made to revise the old series based on new methodology.

6. **Fiscal statistics.** In January 2008, the IMF Government Finance Statistics Advisor for Southeastern Europe at the Ljubljana *Center of Excellence in Finance* (CEF) visited Chisinau during January 21-25. The purpose of the visit was to develop an understanding of and assess the environment for the production of government finance statistics — both annual and subannual — according to the methodology of the *GFSM 2001* and to discuss with the authorities a work program for 2008 in that area. The authorities have indicated a

need to review the newly introduced budget classification, which will be undertaken in liaison with the CEF Public Finance Management Advisor**.** The Advisor also has requested the support of the MoF in reporting of monthly fiscal data (the *GFSM 2001* Statement of Sources and Uses of Cash) to STA for publication in *International Financial Statistics*. In addition, World Bank technical assistance has been provided to improve the budgetary reports of local authorities as well as the Social Fund. The authorities reported annual cash-based data through fiscal year 2006 in the *GFSM 2001* format for publication in the *2007 GFS Yearbook.*

7. **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. Besides the balance of payments statistics, Moldova disseminates quarterly international investment position and external debt statistics. Data on international reserves and foreign currency liquidity are disseminated monthly.

8. **Monetary and financial statistics are** broadly in line with international statistical standards and of a generally good quality. The NBM has compiled and submitted a complete set of monetary data beginning from December 2001 using Standardized Report Forms (SRFs). Monetary data are reported by the NBM on a regular basis and are being published in the *IFS Supplement*. An STA technical assistance mission is scheduled for April 2008 to assist in expanding the coverage of monetary statistics to include other financial corporations.

MOLDOVA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of February 1, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	1/30/2008	1/31/2008	D/M	D	D/M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	1/26/2008	1/30/2008	W/M	W	M		
Reserve/Base Money	1/26/2008	1/30/2008	W	W	M	O, LO, O, O	LO, O, O, O, O
Broad Money	1/18/2008	1/30/2008	W	W	M		
Central Bank Balance Sheet	1/26/2008	1/30/2008	W	W	M		
Consolidated Balance Sheet of the Banking System	1/18/2008	1/30/2008	W	W	M		
Interest Rates[2]	1/30/2008	1/30/2008	W	W	W		
Consumer Price Index	Dec. 2008	1/14/2008	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/31/2007	1/24/2008	M	M	M	O, LO, LO, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/31/2007	1/24/2008	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/31/2007	1/24/2008	M	M	M		
External Current Account Balance	Q3 2007	11/15/2008	Q	Q	Q	LO, LO, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Nov. 2007	1/11/2008	M	M	M		
GDP/GNP	Q3 2007	12/27/2007	Q	Q	Q	O, LO, LO, O	LO, O, LO, O, O
Gross External Debt	Q3 2007	10/28/2007	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).
[7] Reflects the assessment provided in the data ROSC or the Substantive Update (published 03/2006, and based on the findings of the mission that took place during July 17-19, 2005) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/37
FOR IMMEDIATE RELEASE
March 18, 2008

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

IMF Executive Board Concludes 2007 Article IV Consultation with the Republic of Moldova

On March 12, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Moldova.[1]

Background

Moldova is doing well, despite a series of consecutive shocks (the doubling of the price of imported natural gas and Russia's ban on imports of Moldovan wine in 2006, and a severe drought in 2007). Growth is estimated at 5 percent in 2007 and is projected to increase to 7 percent in 2008. Investment is picking up, and is beginning to replace remittances as the main source of growth—an encouraging sign that the earlier model of consumption-driven growth is changing.

Moldova increasingly faces the challenges experienced by other transition economies. Improved growth prospects have come with strong appreciation pressures from foreign exchange inflows, and a widening trade deficit. FDI has picked up and is estimated to have reached 12 percent of GDP in 2007, compared with 7 percent in 2006.

The main macroeconomic concern is inflation, which, at 13 percent, remains high for the region. A deterioration in the merchandise trade balance due to strong import growth has been offset by improvements in net income and transfers, with a small improvement in the current account

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

deficit to 12 percent of GDP. A resumption of wine exports to Russia in October was a major positive development, although volumes are likely to recover slowly.

Fiscal policy remained tight, ending 2007 with a modest deficit of 0.3 percent of GDP Strong revenue performance was driven by robust VAT on imports, while expenditure was kept in line with the budget. However, the tax cuts introduced in 2008 may undermine the favorable fiscal position.

Monetary tightening in 2007 was complicated by the strong inflow of foreign exchange. The National Bank of Moldova increased reserve requirements from 10 to 15 percent, and raised policy interest rates by 2.5 percentage points. Nevertheless, the possibility of second-round effects from the drought, liquidity pressures from growing remittances and FDI, and the continued strong growth in credit and broad money suggest that upside risks to inflation are not yet fully contained.

Executive Board Assessment

Executive Directors welcomed the improved growth prospects and decline in poverty in Moldova, and commended the authorities for their reform efforts and balanced macroeconomic policies. Developments in Moldova appear to mirror increasingly those in other transition economies, with large capital inflows, appreciation pressures on the national currency, and a widening trade deficit. Directors underscored the importance of maintaining macroeconomic stability and improving the business environment to support private sector development and to help reverse the emigration of labor.

Directors considered that inflation remains high relative to that in other countries in the region, even after accounting for the drought. They cautioned that with strong foreign exchange inflows and rapid credit and reserve money growth, upside risks to inflation remain. The recent monetary tightening by the National Bank of Moldova (NBM) was welcomed, as was its commitment to establish price stability as its sole monetary policy objective. Directors noted that with considerably lower labor costs and higher productivity growth in Moldova compared to the region, there is scope for further exchange rate appreciation without undermining competitiveness. They urged the central bank to allow greater exchange rate flexibility.

Directors commended the authorities for their disciplined fiscal policies. Modest deficits are an appropriate compromise to balance development and disinflation objectives. Directors welcomed the authorities' efforts to strengthen tax administration and to increase social and investment spending, while maintaining the deficit target. At the same time, they stressed that the budget should remain tight until low single-digit inflation is firmly reestablished, and that any spending related to potential overperformance on the revenue side should be conditional on achieving the inflation objective.

Directors welcomed the authorities' plans for reducing the size of the public sector, introducing a transparent and competitive remuneration system for the public service, and consolidating education and health care networks. These were seen as important steps toward a leaner government structure to ensure efficient management of scarce public resources, and to allow more room for pro-poor and pro-growth spending.

Directors welcomed the authorities' commitment to bolster structural reforms aimed at improving the investment climate and clarifying the role of the state in the economy. They were particularly encouraged by the efforts to streamline the business licensing and registration procedures, to improve the transparency of regulatory agencies and reduce red tape, and to strengthen bankruptcy procedures and competition legislation. Directors supported the government's decision to revitalize the privatization process, including the intention to sell remaining large state enterprises, which would help to reduce the weight of the state in the economy and provide a catalyst for private sector growth.

Directors considered modernization of the energy sector as a high priority. They welcomed the strengthened independence of the energy regulator and establishment of heat tariffs at a cost recovery level, which will be critical for the financial viability of the utilities. At the same time, they stressed that timely introduction of a new targeted social assistance scheme will be essential to ease the burden of higher tariffs on the poor.

Directors noted that the financial sector is stable, and urged the authorities to be vigilant in addressing the remaining vulnerabilities in the sector. Strengthening the supervisory and regulatory framework and increasing the transparency of bank ownership will be crucial to ensure the soundness of the banking system. Directors welcomed the authorities' efforts to accelerate privatization of Banca de Economii, which will help to enhance competition in the banking sector and attract additional banking expertise. They urged the authorities to ensure that the new AML/CFT law is implemented effectively.

.

Republic of Moldova: Selected Economic Indicators, 2005–10 1/

	2005	2006	2007	2008	2009	2010
		Prel.	Proj.	Proj.	Proj.	Proj.
I. **Real sector indicators**	(Percent change; unless otherwise indicated)					
Real growth rate	7.5	4.0	5.0	7.0	8.0	7.5
Nominal GDP (billions of lei)	37.7	44.1	51.3	58.8	68.2	76.0
Nominal GDP (billions of U.S. dollars)	3.0	3.4	4.2	5.3	6.5	7.4
Consumer Price Index (average)	11.9	12.7	12.6	11.4	7.9	6.5
II. **Fiscal Indicators (general government)**	(In percent of GDP)					
Primary balance (cash)	2.6	1.3	0.9	0.7	0.5	0.2
Overall balance (cash)	1.3	0.2	-0.3	-0.5	-0.4	-0.5
Stock of general government debt	38.0	34.6	29.2	22.3	18.8	16.5
III. **Financial indicators**	(Percent change; unless otherwise indicated)					
Broad money (M3)	35.0	23.6	39.8	21.5	...	...
Velocity (GDP/end-period M3; ratio)	2.4	2.3	1.9	1.8	...	...
Credit to the economy	35.0	37.8	51.7	22.0	...	...
IV. **External sector indicators**	(In percent of GDP, unless otherwise indicated)					
Current account balance (percent of GDP)	10.3	-12.0	-9.7	-10.3	-10.6	-11.3
Remittances and compensation of employees (net)	29.1	33.3	36.6	37.6	35.9	32.8
Gross official reserves (months of imports)	2.2	2.2	3.0	3.2	3.6	4.0
External debt/GDP (percent)	56.2	57.4	58.8	55.1	53.6	53.3

Sources: Moldovan authorities; and Fund staff estimates.

1/ data exclude Transnistria.

Press Release No. 08/49
FOR IMMEDIATE RELEASE
March 12, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the PRGF Arrangement with Moldova and Approves US$18.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Moldova's economic performance under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review enables the release of an amount equivalent to SDR 11.44 million (about US$18.6 million), which will bring the total disbursements to Moldova under the PRGF arrangement to SDR 76.56 million (about US$124.7 million). The PRGF arrangement was approved on May 5, 2006 (see Press release No. 06/91).

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

"Moldova's economic performance has been encouraging, despite a series of shocks. The authorities' reform efforts and balanced policies have helped maintain macroeconomic stability.

"Investment is starting to replace remittances as the main driver of growth in Moldova, an encouraging development. Continued prudent policies and renewed efforts to bolster structural reforms will help to smooth the transition to a more market-oriented, private sector-led economy. Accelerating measures aimed at improving productivity and the business climate and developing a well-targeted social assistance system are high priorities.

"Inflation is the main macroeconomic challenge. Monetary policy will need to remain tight until low single-digit inflation is firmly reestablished. Exchange rate flexibility and fiscal restraint will help achieve this objective.

"The projected modest fiscal deficits strike the right balance between development needs and the disinflation objective. At the same time, the authorities will need to be cautious about spending any revenue overperformance until inflation is firmly under control. It will also be important to rationalize the public sector—which is large by regional and international standards--and introduce a transparent and competitive public service remuneration scheme, while preserving public investment and poverty-reducing spending.

"The authorities' reform agenda is rightly focused on improving the investment environment and promoting financial sector development. In this regard, the intended streamlining of business licensing and registration and efforts to increase transparency of regulatory agencies and reduce red tape are welcome. The decision to revitalize the privatization process will help to scale back the influence of the state in the economy and support private sector-driven growth. A strengthening of the financial supervisory and regulatory framework will contribute to the soundness of the banking system," Mr. Kato said.

Statement by Age Bakker, Executive Director for the Republic of Moldova and Victor Yotzov, Advisor to Executive Director
March 12, 2008

The Moldovan authorities appreciate the continued constructive dialogue with the management and staff over the last several years. They attach great value to the close relationship with the Fund, whose advice continues to support the policy formation process in Moldova. Now that the external shocks of 2006 seem to have receded, the authorities remain firmly committed to stick to the core goals and policies agreed under the PRGF arrangement. Those policies are consistent with the National Development Strategy (NDS) as well as with the action plan agreed upon with the European Union. European aspirations and prospects of growing financial assistance from the EU and international donors continue to complement the authorities' reform efforts.

For the years to come, Moldova's overriding policy priority remains promoting sustainable growth and reducing poverty. To this end, the policies set forth for 2008 aim at further modernizing the public service and reducing state involvement in the economy, developing the financial sector, creating a favorable investment environment, encouraging the development of small and medium businesses, rehabilitating infrastructure, promoting exports, and creating new jobs and providing social protection to vulnerable categories of the population. As always, the authorities stand ready to take additional measures that may become appropriate for reaching these objectives.

Recent developments and performance under the program

Macroeconomic developments in 2007 were favorable despite the severity of the external shocks that the country suffered in the previous years. The economy grew strongly in the first half of 2007, but slowed somewhat in the second half due to a weak harvest caused by the summer drought. Nevertheless, excluding agriculture, growth remained robust. Importantly, its pattern appears to be changing: there are already signs that the earlier model of consumption-driven growth financed by remittances is shifting toward more sustainable investment-based growth. Export performance, too, has stepped up considerably and the recovery in the foreign sector is set to accelerate further as wine exports to Russia resumed late last year. Even though imports in 2007 grew faster than exports, fuelled by rapidly increasing FDI and strong remittances, the current account deficit has narrowed due to improvements in net income and transfers. Strong inflows of foreign exchange led to an appreciation of the leu, but the exchange rate remains broadly in line with fundamentals.

Recent favorable developments, however, have presented some challenges as well. The most important among them are the surge in net capital inflows and the associated appreciation pressures that complicate the conduct of monetary policy. On top of that, inflation continues to be stubbornly in double digits, which requires additional fiscal efforts. As similar trends have been observed and dealt with in other countries in the region and elsewhere, the authorities are willing, with the help of the Fund, to benefit from their experience so that negative consequences be mitigated to the extent possible.

Performance under the PRGF-supported program has been strong and except for a few instances, the authorities have implemented the measures as stated in the last Memorandum of Economic and Financial Policies. All end-September quantitative performance criteria were observed while only one quantitative benchmark was missed. All structural PCs have been met but some structural benchmarks were missed, partly due to technical reasons.

Given the strengthened independence of the National Agency for Energy Regulation (ANRE), and the demonstrated effectiveness of the system for these items, the authorities request to drop a continuous structural benchmark that electricity and natural gas tariffs remain at cost-recovery levels. The authorities would also like to indicate that the missed end-September structural benchmark on the transfer of tariff-setting responsibility for heat to ANRE does not comply with the constitutional division of rights between local and central governments and should therefore be dropped as well.

Fiscal Policy

Fiscal performance remained strong in 2007, as the year ended with a deficit of 0.3 percent of GDP which was below the programmed 0.5 percent. Revenue performance was driven by higher VAT on imports, while expenditures were kept in line with budget commitments. Notwithstanding this achievement, fiscal policy continues to be severely constrained by two conflicting needs – the need to substantially increase development spending in line with the approved NDS, and the need to subdue rising inflation. In this regard, the authorities and staff have agreed that fiscal policy should remain sufficiently tight until disinflation is entrenched. Spending of revenue overperformance will be contingent on bringing inflation down into the single-digit territory, and will be directed solely to investments. In line with the above, the 2008 budget was approved in accordance with the disinflation objective, implying higher negative domestic financing than in 2007. Negative domestic financing may increase even further if privatization proceeds exceed projections. Any budget rectification will be contemplated in the framework of the program and the upcoming fourth review.

In the medium-term, the authorities' plan is to keep the budget deficit at about 0.5 percent of GDP, while providing for greater fiscal space for social and investment spending through downsizing and reduction in spending inefficiencies. Further strengthening of tax administration is also given high priority.

With regard to downsizing the role of the state in the economy and rationalizing the structure of employment in the budget sector, the government just recently announced that it is cutting 10 thousand budget-sector positions by 2010, starting with 3 thousand in 2008. In addition, the authorities intend to pass a law that would consolidate all forms of remuneration in base pay for civil servants by end-September 2008, with a view to implementing it in the 2009 budget. Public sector wages will be further increased in 2008 in order to keep qualified workers, though the total wage bill as share of GDP is expected to remain unchanged owing to a phasing in of the future increases.

The biggest change in the 2008 budget is the major reform of the corporate income tax system, that cut the CIT rate to zero on reinvested profits, as well as a wide-ranging amnesty of tax arrears and a liberalization of capital legalization regulations that aim at promoting both foreign and domestic investment. The authorities are aware that these reforms may imply certain risks, in particular with respect to budget revenues, but they strongly believe that possible shortfalls will be compensated by improved tax collections. For that purpose, the authorities will speed up the implementation of Tax Administration Strengthening Strategy, including by reorganizing the State Tax Inspectorate. At the same time, the authorities intend to develop a modern accounting and information technology platform, and ensure adequate resources for these reforms.

Monetary Policy

Strong appreciation pressures caused by persistent inflows of foreign exchange have continued to complicate monetary policy in 2007, facing the monetary authorities with difficult choices. Despite the tightening up early in the year, reserve money continued to grow which prompted the central bank to raise reserve requirements to 15 percent at end-September, accompanied by an increase in the sterilization rate. The build-up of reserves at the end of the year exceeded US$ 1.3 billion which was well above what was projected under the program. Against this background, and in order to clear up any misinterpretations regarding its policy objectives, the NBM's independence has been strengthened, while disinflation was established as its central objective, with a planned move to an inflation targeting framework over the medium-term.

The authorities and staff agreed that monetary policy should remain tight until disinflation is firmly reestablished. To this end, the monetary program for 2008 envisages locking in the overperformance in 2007 on NDA and NIR, and tighten reserve money to ensure the objective of single-digit inflation is achieved. In addition, the NBM has declared readiness to promptly increase reserve requirements and/or interest rates at the first signs of reversal of trend disinflation. To further improve effectiveness of monetary policy, the NBM will streamline its instruments by adopting a base rate as a main policy rate to remove the ambiguity between the two rates, and shifting sterilization operations to shorter maturities. At the same time, the planned securitization of the government debt to NBM in the first quarter of 2008 will provide the central bank an additional liquidity management tool.

As regards the planned move to a formal inflation targeting framework, the authorities acknowledge they are still at an early stage of implementation. Nevertheless, they are undertaking important steps to improve the current framework of monetary policy and lay the foundation for a new regime. In particular, starting with the 2008 Budget, the Budget Law will no longer oblige the NBM to roll over state securities, including those acquired through securitization. Instead, the NBM and the Ministry of Finance will conclude yearly agreements on the annual redemption of state debt to the NBM. Further improvements are also envisaged with respect to the communication strategy and policy transparency, aiming to raise public awareness of risks to inflation as well as to strengthen the signaling function of the NBM. In this regard, the authorities have requested technical assistance from the Fund in monetary research and capacity building for monetary policy implementation.

Reform Agenda

With regard to financial sector reforms, the authorities continue to strengthen the supervisory and regulatory framework and ensure transparency to promote stability and steady development. Following the recommendations of the recent FSAP update all entities licensed, regulated and supervised by the NBM and/or the NCFM have been excluded from the provisions of the law #235 on the Core Principles of Regulating Entrepreneurial Activity. In addition, the authorities are prepared to step-up their efforts in identifying beneficial owners of banks and will study best international practices, especially those of EU countries, in applying '*fit and proper*' tests for significant shareholders.

With the assistance of the Fund, the parliament has recently adopted a new Anti-Money Laundering and Countering the Financing of Terrorism Law. Moreover, the authorities have committed to continue revision of associated laws to bring the AML/CFT framework in conformity with the international standard. The authorities' plan is to strengthen the capacity of the Financial Intelligence Unit, as well as of the NBM in preventing and combating money laundering and the financing of terrorism, and streamline AML/CFT procedures to reduce the burden of compliance.

The expected enforcement of the autonomous trade preferences regime with the EU is a major step forward. For businesses to benefit from the new trade regime, the government intends to put efforts to improve the quality of management systems. In addition, to encourage investment inflow into the national economy, the authorities plan to implement the actions set by the 2008 Action Plan for the Implementation of the Strategy for Attracting Investments and Promoting Export for 2006-2015. Strengthening of small and medium business is one of the key elements that will contribute to economic growth and poverty reduction. To support SME development, the Organization for SME Sector Development was established, and its capacity will continue to be built in 2008.

Finally, the authorities assign high priority to the acceleration of the privatization of public assets to attract know-how and promote private sector development. In this regard, the expected privatization of Moldtelecom is viewed as of crucial importance. The authorities' intentions are to continue the privatization of state assets through a competitive and transparent process. Furthermore, in order to strengthen competition in the banking system, the authorities intend to accelerate privatization of Banca de Economii (BEM) to a strategic banking investor. As the previous plan to perform an independent valuation of the bank prior to bringing it to market has stalled, the authorities have decided now to hire directly a privatization advisor. A tender for selecting a privatization advisor is expected to be announced by the end of March, and a contract for bringing BEM to market to be signed by end-September 2008. In the meantime, the government and the NBM will continue to abstain from granting preferential treatment to the bank, including as regards taxation, prudential regulation or access to resources.