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2014 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS—STAFF REPORT; PRESS RELEASE; 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 2014 Article IV Consultation and First Post-Program Monitoring Discussions, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 23, 2014, following discussions that ended on April 30, 2014, 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 June 5, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Press Release** summarizing the views of the Executive Board as expressed during its June 23, 2014 consideration of the staff report that concluded the Article IV Consultation with the Republic of Moldova.
- A **Statement by the Executive Director** for the Republic of Moldova.

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

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June 5, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS

KEY ISSUES

Context: Moldova largely achieved the main objectives of the combined ECF/EFF supported program that expired on April 30, 2013. The economy has strongly recovered from the drought-related contraction in 2012 but will slow down in 2014. Key risks to the near-term outlook relate to financial stability, fiscal policy slippages in the run up to the 2014 parliamentary elections, a further slowdown in activity in main trading partners, and intensification of geopolitical tensions.

Financial sector policies: Corporate governance in the banking sector is a major concern. In line with FSAP recommendations, significant weaknesses in the legal and regulatory frameworks must be urgently addressed to ensure stability and soundness of the financial sector.

Fiscal policy: Moldova has achieved a substantial degree of fiscal consolidation in recent years, but this trend is now reversing. Resisting pre-election pressures for selective spending increases and returning to the path of fiscal consolidation would reduce reliance on exceptionally-high donor support. Structural fiscal reforms would help safeguard sustainability.

Monetary and exchange rate policy: Monetary policy has been successful in maintaining inflation within the NBM's target range. Going forward, the NBM needs to remain ready to adopt a tightening bias if inflationary pressures start emerging. There is room to strengthen the inflation targeting regime.

Structural reforms: The implementation of structural reforms outlined in the National Development Strategy (NDS) Moldova 2020—especially in the business environment, physical infrastructure, and human resources development areas—would help boost potential growth and reduce poverty.

Approved By
Aasim M. Husain and Dhaneshwar Ghura

Discussions were held in Chişinău during April 22–30, 2014. The missions met with Prime Minister Leanca, Deputy Prime Minister Lazar, Minister of Finance Arapu, Minister of Labor and Social Protection Buliga, Minister of Justice Efrim, Minister of Agriculture and Food Industry Bumacov, Minister of Education Sandu, Governor of the National Bank of Moldova Dragutanu, and other senior officials and representatives of financial institutions, labor unions, business, diplomatic community, and international organizations. The mission team comprised M. Alier (Head), V. Prokopenko, A. Buzaushina, A. Khachatryan (Res. Rep.) (all EUR), O. Adedeji (SPR), S. Cevik (FAD), and S. Gray (MCM). N. Jovanovic and J. Swirszcz (both EUR), and the local office in Chişinău assisted the mission.

CONTENTS

TABLES

ANNEXES

APPENDICES

CONTEXT

1. **Moldova's remarkable recovery from the severe recession of 2009 was largely the result of sound macroeconomic and financial policies and structural reforms.** Despite a small contraction in 2012, Moldova's economic performance was among the strongest in the region during 2010–13. Economic activity grew cumulatively by about 24 percent; consumer price inflation was brought under control; and real wages increased cumulatively by about 13 percent. This expansion was made possible by adequate macroeconomic stabilization measures and ambitious structural reforms implemented in the wake of the crisis under a Fund-supported program (Box 1). In November 2013, Moldova initialed an Association Agreement with the EU which includes provisions establishing a Deep and Comprehensive Free Trade Area (DCFTA).

2. **A political crisis in early 2013 led to policy slippages in the fiscal and financial areas.** The political crisis that broke out in early 2013 was resolved with the appointment of a government supported by a pro-European center-right/center coalition in May 2013. However, delays in policy implementation prevented completion of the final reviews under the ECF/EFF arrangements. Parliamentary elections are scheduled for late 2014 and local elections for early 2015. The elections are expected to be highly contested.

3. **Despite a sharp decline in poverty in recent years, Moldova remains one of the poorest countries in Europe and structural reforms are needed to promote sustainable growth.** Based on the Europe and Central Asia (ECA) regional poverty line of US$5/day (PPP), 55 percent of the population was poor in 2011. While this was significantly lower than 94 percent in 2002, Moldova's poverty rate is still more than double the ECA average of 25 percent. The NDS—Moldova 2020, which was published in November 2012, focuses on several critical areas to boost economic development and reduce poverty.[1] These include education, infrastructure, financial sector, business climate, energy consumption, pension system, and judicial framework.

[1] The NDS (EBD/13/52) and the associated IMF-World Bank Joint Staff Advisory Note (EBD/13/53) were circulated to the Boards of the IMF and World Bank on August 1, 2013.

Box 1. Implementation of Past IMF Policy Recommendations

In the last few years, in the context of a Fund program, Moldova established a solid track record of implementing Fund advice. In particular, a significant fiscal adjustment aimed at restoring sustainability was achieved, inflation has been kept under control, and structural reforms were advanced. The record has been weaker regarding implementation of advice related to the banking sector, including the past FSAP advice. Data provision is broadly adequate for surveillance, and Moldova subscribes to the SDDS.

2010-13: Extended Credit Facility (ECF)/Extended Fund Facility (EFF)[1]

The ECF/EFF supported program was implemented broadly on schedule with the timely completion of the first five reviews. Although the last program review was not completed due to disagreements on fiscal and financial sector policies, the central program objectives were achieved. The overall budget deficit was reduced from 6.3 percent of GDP in 2009 to 2.2 percent of GDP in 2012, and government debt was brought to about 30 percent of GDP. The relatively elevated inflation was brought to the mid-single digits in the context of the introduction of an inflation targeting regime. International reserves were rebuilt. Structural reforms were advanced in several areas, such as energy, education, social assistance, and the financial sector.

2012: Article IV Consultation

Since the last Article IV consultation in 2012, macroeconomic policies and structural reforms have been broadly in line with Fund recommendations whereas implementation of advice on financial sector reforms has been weak. The overall budget deficit has remained on a declining trend but mostly as a result of the under-execution of investment projects, while measures adopted during last year's political crisis increased current spending. The NBM's monetary policy stance has remained appropriate, which helped to keep inflation within the NBM's target range and increase international reserves. Financial stability has been preserved, although the condition of Banca de Economii (BEM) continued to deteriorate and subsequent steps to stabilize its financial situation were not in line with Fund's advice. Amendments to the Law on Financial Institutions were passed in line with Fund program understandings. However, implementation has been slow, in part because of legal challenges.

[1] Approved in January 2010, the ECF/EFF was supported by access totaling SDR 369.6 million (300 percent of quota) split equally between the two facilities. The actually disbursed amount was SDR 320 million (around US$500 million). The program expired in April 2013. On August 28, 2013, the Executive Board adopted a decision expecting Moldova to engage in Post-Program Monitoring (PPM) with the Fund.

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

4. **The Moldovan economy has strongly recovered from the drought-related contraction in 2012** (Figures 1–4). Following a decline of 0.7 percent in 2012, the economy expanded by 8.9 percent in 2013, led by strong rebound in agriculture and related industries, private consumption and exports. Inflation remained within the NBM's target range of 5 percent ± 1.5 percentage points. The overall budget deficit narrowed to 1.8 percent of GDP in 2013 from 2.2 percent of GDP in 2012, partly reflecting the under execution of investment projects. The external accounts continued to improve, with the current account deficit narrowing to about 5½ percent of GDP, reflecting strong export performance, contained import growth, and still strong inflow of remittances. International reserves increased to US$2.8 billion (5 months of imports or 105 percent of short-term debt). The real effective exchange rate (REER) depreciated by 3½ percent. Although estimates point to possible modest overvaluation of the real exchange rate, external competitiveness appears broadly adequate as reflected in strong sustained export performance (Annex I).

5. **However, the near-term economic outlook is weak.** In 2014, output growth is expected to moderate to 2¼ percent, mainly due to a slowdown in agriculture and related industries and weaker economic activity in main trading partners (in particular Russia and Ukraine). Inflation is projected to remain stable at about 5¼ percent with the impact of the recent depreciation of the leu being offset by delays in adjusting utility prices. The current account deficit is projected to widen to about 7½ percent of GDP, resulting from a slowdown in export growth and a decline in remittances, following the completion of construction projects relating to the Sochi Olympic Games in Russia.

6. **Domestic and external risks are to the downside.** Main risks to the near-term outlook relate to serious vulnerabilities and governance issues in the banking sector, policy slippages in the run up to the elections, intensification of geopolitical tensions in the region (Box 2), and a further slowdown in activity in main trading partners (see Risk Assessment Matrix). Moldova remains highly vulnerable to fluctuations in remittances from workers abroad (24 percent of GDP), exports to the Commonwealth of Independent States (CIS) and European Union (EU) (88 percent of total exports), and donor support (about 10 percent of government spending). The main transmission channels through which adverse exogenous shocks could impact the Moldovan economy are: remittances (also due to potentially returning migrants), external trade, and capital flows. Staff's spillover analysis suggests that further strengthening of fiscal and external buffers would be critical for mitigating the impact of external shocks, particularly in light of the Moldova's strong links and synchronized business cycle with trading partners (Annex II).

Authorities' views

7. **The authorities had divergent views on the short-term outlook and the possible impact of recent geopolitical tensions in the region.** The Ministry of Economy (MoE) argued that it was premature to reassess the near-term outlook due the lack of new data. Under some scenarios

Moldova could benefit from geopolitical developments and growth could be even higher than the 4 percent assumed in the budget. In contrast, the NBM expressed concerns about the slowdown in the Russian economy, the latest data on remittances, and the outlook for agriculture. In their view output in 2014 is likely to be flat or decline. Consequently, the NBM's inflation projections, in particular, for the second half of the year are lower than the staff's projections. The authorities agreed that, on balance, risks to the outlook are to the downside, and on the transmission channels and policy responses as outlined in the Risk Assessment Matrix.

Box 2. Potential Impact on Moldova from Recent Regional Geopolitical Tensions

The impact of recent regional geopolitical developments on the Moldovan economy will depend on whether the crisis spreads beyond Ukraine, trade tensions with Russia escalate, and trade routes and gas supply are disrupted. The impact would be partly mitigated if donors support were to increase. An adequate policy response would require facilitating the absorption of the external shock in the near term and increased integration into global trade and energy markets over the medium term.

The direct impact of the economic crisis in Ukraine on the Moldovan economy is likely to be fairly limited due to the modest trade and financial linkages. Ukraine's share of Moldovan exports is about 6 percent and remittances from Ukraine represent around 1 percent of GDP. On the financial side the direct impact would be negligible due to the very limited cross-border financial relations.

A further slowdown in the Russian economy and/or an escalation of trade tensions with Russia would have a significant impact on Moldova. Russia's share of Moldovan exports is about 26 percent and remittances from Russia represent about 15 percent of Moldova's GDP. Furthermore, the Moldovan banking system is heavily reliant on funding from Russian banks. A disruption on interbank funding from Russian banks to Moldovan banks could significantly destabilize the already fragile banking system. In addition, Russia is an important source of FDI to Moldova (about 10 percent of the total stock of FDI).

A disruption of trade routes and gas supply can severely impact the economy. The CIS's share in Moldovan exports is about 40 percent and all land routes to CIS countries pass through Ukraine. Similarly, Moldova is heavily reliant on Russian gas transported via pipelines in Ukraine (over 90 percent of total gas consumption). There are limited options in the short term to substitute gas imports from Russia.

An adequate policy response and additional donor support would help mitigate the impact of this shock. In the near term, prudent macroeconomic policies could help the absorption of the shock, including by letting the exchange rate adjust and allowing automatic stabilizers work in full, ideally in the context of additional donor support. Policies to facilitate the absorption of returning migrants into the local labor market will also be important. Over the medium term, increased integration into global trade and energy markets would help reduce the impact of shocks in any single trading partner.

POLICY DISCUSSIONS

A. Maintaining Financial System Stability

Staff's views

8. **Risks to systemic financial stability are significant due to governance problems in the banking system**. Although indicators show that banks are well capitalized, profitable, and liquid, though the share of nonperforming loans (NPLs) remains relatively high (Table 5) significant risks exist suggesting that cautious reliance should be placed on the indicators.[2] There are indications of active concealment of banks ultimate beneficial owners and controllers. Some ultimate beneficial owners may be able to disguise their control in order to circumvent NBM's vetting process and to conceal related party lending. There are also concerns that reported liquid assets of some banks may actually be encumbered, which would make the actual liquidity ratios worse than reported. Staff urged the authorities to implement the FSAP recommendations, in particular those related to enforcement of regulatory requirements (Annex III).

9. **The ability of regulators to take action is constrained.** A Constitutional Court (CC) ruling issued last year substantially reduced the powers of the NBM by authorizing any court to suspend decisions of the NBM (except the ones on liquidation of banks and cancelation of licenses) until the end of the court process. In December, Parliament approved legislation that addressed the implications of the CC ruling on NBM decisions with a more specific focus on those related to monetary and exchange rate policies. The NBM's independence to effectively carry out most of its functions as bank supervisor remains to be fully restored. A separate CC ruling limits the independence and effective operation of the National Commission for Financial Markets (supervisor of nonbank financial institutions). Staff underscored the importance of respecting the independence of regulators from political interference and advised to urgently pass legislation to fully restore the NBM and NCFM's regulatory powers. Legal protection of board members and employees of these agencies should also be strengthened. In turn, these agencies need to resolutely enforce regulatory requirements. In particular, the NBM must re-evaluate bank shareholders to ensure disclosure of ultimate beneficial owners and controllers. Staff noted that enforcement of the AML/CFT framework needs to be strengthened.

10. **The condition of BEM, the fourth largest bank with an extensive branch network, and two mid-sized banks believed to be affiliated remains fragile**. These three banks, which combined comprise 28 percent of banking system assets, equivalent to about 20 percent of GDP,

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[2] In March 2014, the aggregate capital adequacy ratio stood at 23.5 percent, above the required minimum of 16 percent. Banking sector profitability was good with return on equity at 8.6 percent and liquidity remained high with liquid assets representing 34.7 percent of total assets. The resolution of NPLs has been relatively slow as banks have been reluctant to write-off bad loans due to problems with the repossession and sale of collateral. The NPL ratio stands at 13.2 percent.

have large interbank exposures among themselves and also large exposures to several Russian banks. Staff recommended that the NBM maintain a high level of scrutiny of BEM's operations, and monitor developments in liquidity indicators in these banks on a daily basis, including interbank exposures. Welcoming the launch of a diagnostic study of BEM's financial situation by an external auditor, staff stressed the importance of ensuring that BEM shareholders and management cooperate fully with the auditor. Staff noted that despite the dilution of the government's share following its recapitalization in August 2013, the Ministry of Finance needs to ensure strong representation at the BEM's board in order to safeguard public interest given that the government still owns 33 percent of this systemically-important bank that has large public sector deposits. Staff advised to initiate inspections in the other two banks without delay and, in due course, carry out an assessment of the financial situation in all other banks. Any bank found in breach of regulatory requirements based on these studies should expeditiously submit time-bound plans to address any shortcomings. In addition, staff recommended that the NBM limit deposit growth in banks paying above-market deposit rates to attract depositors and banks that may experience significant problems, for example by requiring these banks to pay a higher deposit insurance premium. Staff also recommended that the government refrain from providing additional privileged access of public sector deposits to some banks. As the situation permits, the government should gradually transfer public sector deposits from commercial banks to the NBM.

11. **Staff urged the authorities to develop contingency plans in line with best international practice.** Staff noted that it was especially important to improve the coordination between the various authorities (especially NBM and MoF), and to close gaps in the statutory powers required for least-cost bank resolution (for example, there is no statutory power for the government to provide funding or guarantees quickly). Staff urged the authorities to put in place a process of regular inter-agency cooperation. Staff noted that the deposit insurance framework would benefit from enhancements in several areas, particularly getting greater assurance in the provision of back-up funding and better information sharing between the Deposit Guarantee Fund and NBM.

Authorities' views

12. **The authorities shared staff's concerns regarding governance in the banking system and agreed on the importance of having independent financial regulators.** They agreed on the importance of implementing some of the FSAP recommendations, in particular on the need to pass legislation to fully restore the regulatory powers of the NBM and the NCFM. More generally, the NBM has prepared a draft action plan for implementing the FSAP recommendations and is awaiting reactions from other stakeholders. However, there was no consensus among the authorities on other key recommendations, for instance on the adequate degree of legal protection of NBM staff.

13. **The authorities agreed with staff's views regarding BEM's financial situation and that of banks believed to be affiliated to it but had divergent views on the way forward.** They agreed with the recommendation of maintaining a high level of scrutiny of these banks, which—according to the NBM—has already been in effect in recent months. They agreed that, despite some delays, the external auditor's diagnostic study of BEM will provide a good basis to request BEM's

shareholders to put in place a plan to become compliant with regulatory requirements. In contrast with staff views, the authorities considered that shareholders should be given ample time to come up with a solution. There was some disagreement among the authorities on the design of a contingency framework, including with regard to which institution—the government or the NBM—should shoulder any costs arising from bank resolution or recapitalization.

B. Safeguarding Fiscal Sustainability

Staff's views

14. **Moldova has achieved an impressive degree of fiscal consolidation in recent years, but fiscal discipline has weakened recently and public debt is again on an upward trend**. The overall budget deficit excluding grants was reduced from 8.4 percent of GDP in 2009 to 3.9 percent in 2012. In 2013, fiscal consolidation efforts waned and the deficit excluding grants remained broadly unchanged despite a significant under execution of investment projects and buoyant revenues on the back of strong growth. In 2014-15 a significant deterioration in the fiscal position is projected—with the budget deficit excluding grants widening to 5½ percent of GDP and 6½ percent, respectively—reflecting significant wage and pension increases (in addition to those granted last year in the midst of the political crisis), the cost of new ad hoc tax benefits, a normalization in the execution of investment projects, and weaker economic activity. As a result public and publicly guaranteed is debt is projected to increase to 41½ percent of GDP in 2019 from 30 percent in 2013.

Headline and Structural Fiscal Balances of the General Government, 2009-19

(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Prel.			Projection			
Revenue and grants	38.9	38.3	36.6	37.9	37.0	38.4	37.6	36.7	36.5	36.4	36.4
of which: Grants	2.1	2.8	2.1	1.8	2.1	2.9	2.0	1.3	1.1	1.0	1.0
Expenditure and net lending	45.3	40.8	39.0	40.1	38.7	41.0	42.2	41.5	41.6	41.3	41.0
of which: Capital expenditure	5.0	4.8	5.2	6.3	7.1	7.9	7.9	7.4	7.4	7.2	7.1
Overall balance (incl. grants)	-6.3	-2.5	-2.4	-2.2	-1.8	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
Overall balance (excl. grants)	-8.5	-5.3	-4.5	-3.9	-3.8	-5.4	-6.6	-6.1	-6.2	-5.8	-5.7
Structural overall balance (excl. grants) 1/	-6.4	-4.8	-5.2	-2.6	-4.3	-5.3	-4.9	-4.3	-4.2	-4.1	-4.1
Fiscal impulse 2/	0.8	-1.7	0.9	-2.1	1.6	0.2	0.8	-0.1	-0.2	-0.1	0.0
Memorandum items:											
Output gap 1/	-4.1	-1.0	1.6	-2.9	1.1	0.2	0.2	0.2	0.0	0.0	0.0
Public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.9	31.8	32.8	34.7	36.7	39.4	41.5

Source: Ministry of Finance; National Bureau of Statistics; and IMF staff calculations.

1/ Structural fiscal balances and the output gap are expressed in percent of potential GDP. Due to data limitations and rapidly changing structure of the economy and fiscal parameters, estimates of the output gap and structural budget balances should be treated cautiously.

2/ Fiscal impulse is defined as the change in the structural primary balance including grants in percent of potential GDP.

15. **Debt sustainability analysis indicates that there is no room to deviate from prudent policies and reliance on exceptionally high external assistance represents a vulnerability.** Staff noted that while the relatively low level of public debt makes the current deficit level sustainable in the near term, the updated debt sustainability analysis (DSA) indicates that public debt remains

vulnerable to shocks, including the potential recapitalization needs of the banking system (See Debt Sustainability Analysis). Staff recommended reducing the budget deficit to a level sustainable without recourse to exceptionally high official assistance.[3] In particular, as a medium-term objective, the authorities should aim at reducing the budget deficit excluding grants to about 2½ percent of GDP (consistent with an overall budget deficit of 1½ percent) over the medium term. This would put government debt as share of GDP on a downward trajectory, be consistent with the projected financing availability, and prevent permanent expenditure increases that were financed in the near term by temporary donor support.

Fiscal Indicators Under Alternative Scenarios, 2012-2019
(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Baseline Scenario											
Revenues	38.9	38.3	36.6	37.9	37.0	38.4	37.6	36.7	36.5	36.4	36.4
of which: Grants	2.1	2.8	2.1	1.8	2.1	2.9	2.0	1.3	1.1	1.0	1.0
Expenditures	45.3	40.8	39.0	40.1	38.7	41.0	42.2	41.5	41.6	41.3	41.0
of which: Capital expenditure	5.0	4.8	5.2	6.3	7.1	7.9	7.9	7.4	7.4	7.2	7.1
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
excluding grants	-8.5	-5.3	-4.5	-3.9	-3.8	-5.4	-6.6	-6.1	-6.2	-5.9	-5.6
Government debt	31.7	30.2	28.8	31.0	29.8	31.8	32.8	34.7	36.7	39.4	41.5
Memorandum items:											
Real GDP growth 1/	-6.0	7.1	6.8	-0.7	8.9	2.2	3.5	4.0	4.0	4.0	4.0
Current account balance	-9.5	-9.6	-12.3	-7.7	-5.5	-7.4	-8.2	-8.1	-8.0	-7.9	-7.7
Active Scenario											
Revenues						38.3	37.8	37.2	37.0	37.0	36.9
of which: Grants						2.8	2.0	1.3	1.1	1.0	1.0
Expenditures						40.4	40.0	39.2	38.7	38.5	38.3
of which: Capital expenditure						7.9	7.6	7.6	7.8	7.9	8.0
Overall balance						-2.1	-2.3	-2.0	-1.7	-1.5	-1.5
excluding grants						-5.0	-4.3	-3.3	-2.8	-2.5	-2.4
Government debt						31.6	30.3	29.5	28.4	28.2	27.7
Memorandum items:											
Real GDP growth 1/						1.8	4.6	5.5	5.2	5.1	5.0
Current account balance						-7.2	-7.2	-6.9	-6.8	-6.7	-6.5

Sources: Ministry of Finance; National Bureau of Statistics; and IMF Staff Estimates.

1/ In percent.

16. **Staff recommended gradual adjustment to achieve the medium fiscal objective.** Staff advised to allow automatic stabilizers operate in case revenues turn out lower than projected due to the weaker economic outlook, but to strictly adhere to the expenditure ceiling in the 2014 budget, especially by refraining from granting wage and pension increases beyond those envisaged in the budget. Staff encouraged the authorities to signal commitment to fiscal consolidation in the context of the Medium-Term Budget Framework (MTBF) for 2015–17 by setting the overall budget deficit for

[3] Although the expected signature of the DCFTA with the EU is likely to result in increased donor funding over the medium term, Moldova's difficulties to qualify for financial assistance from the US Millennium Challenge Corporation's next funding cycle underscores the economy's vulnerability to external donor support.

2015 at 2¼ percent of GDP (compared to 2.6 percent in the 2014 budget) and a gradual reduction of ¼ percent of GDP per year thereafter. Staff suggested the following measures to achieve the 2015 objective: (i) limiting wage increases, which have sharply exceeded those in the private sector, to projected average inflation (0.3 percent of GDP); (ii) freezing expenditures in goods and services, excluding healthcare (0.4 percent of GDP); (iii) increasing the excise tax on tobacco products in line with the objective of narrowing the gap with regional levels and the EU average (0.2 percent of GDP); and (iv) updating the real estate valuations for tax purposes (0.1 percent of GDP). Staff encouraged the authorities to prioritize public investment and improve revenue mobilization through fighting tax avoidance and evasion, including by addressing existing tax expenditures (in the CIT, PIT, property/land tax, and VAT) and resisting pressures to grant additional ad hoc tax benefits that erode the tax base. Staff warned against delaying utility tariffs adjustment, given that in a number of utility companies the level of tariff is already below the cost recovery. It is estimated that the needed adjustment in heating and utility tariffs is about 10 percent. Staff also noted that generalized price subsidies are regressive and costly to the budget; instead the government should consider strengthening targeted social support.

17. **Advancing structural reforms would help strengthen fiscal institutions and safeguard fiscal sustainability.** The authorities have taken steps to strengthen the fiscal policy framework by adopting or drafting legislation on local public finances, public debt and state guarantees, and fiscal responsibility. However, staff argued that further reforms are needed to safeguard long-term fiscal sustainability, improve public financial management, increase resilience to political cycles, and set the stage for further development of domestic capital markets (Annex IV). In particular:

- *Social secuirty reform.* Reform of the social security system is needed to put its finances on a sustainable path, deal with demographic pressures, and reverse the decline in the replacement rate. Staff recommended adjusting past earning to halt the drop of the replacement rate, increasing retirement age, increasing contributions from self-employed and farmers, and refraining from ad-hoc pension increases.

- *Fiscal decentralization.* The fiscal decentralization model needs to be reformed to improve efficiency and safeguard medium-term fiscal sustainability. Staff recommended introducing binding debt limits on sub-national governments and consolidating the number of local governments.

- *Fiscal responsibility legislation.* The draft Fiscal Responsibility Law (FRL) need be revised to ensure that it provides an adequate fiscal anchor. Staff noted that expenditure initiatives approved last year and ad hoc tax benefits recently granted underscore the importance of adopting a fiscal policy anchor to prevent fiscal policy from being driven by financing availability and eroding much-needed fiscal buffers against exogenous shocks. Staff recommended a fiscal policy rule setting the general government budget deficit excluding grants of 2½ percent of GDP, combined with a rule limiting growth of total expenditures (excluding targeted social assistance). Given the large infrastructure needs, staff suggested that the fiscal objectives could in principle be relaxed to accommodate specific productivity-enhancing investment projects if financing on reasonable terms is secured, and the additional investment is consistent with the economy's absorption capacity.

Authorities' views

18. **The authorities agreed with the importance of fiscal sustainability but noted that addressing social and infrastructure needs is a priority if enough financing is available.** The authorities argued that fiscal policy should be guided by financing availability given that most of the financing is in the form of loans for projects that are supported and monitored by donors. They believed these projects are essential to making progress in poverty reduction, filling infrastructure gaps, and institution building. The authorities expect the intended additional wage and pension increases to be covered with fees from auctioning telecom licenses in 2014 and by additional privatization proceeds in the following years. Regarding the medium term, the authorities considered staff's projections for permanent donor support to be on the low side and explained their expectation for a substantial increase following the signing of the DCFTA. As for utility tariff increases, the authorities noted that given the large adjustments in tariffs in recent years payment discipline is suffering and further increases at this moment would actually lead to an increase in losses of public enterprises. They also noted that for 2014 they negotiated lower electricity and gas prices with their foreign suppliers.

19. **The authorities shared staff's views on the role of structural reforms in ensuring medium term fiscal sustainability.** They noted that achieving the development goals in the NDS *Moldova 2020* will put pressure on capital spending in the coming years and donor financing will be insufficient. The authorities saw domestic revenue mobilization and development of a domestic debt market as a key element in their plan to ensure an adequate level of funding for the development initiatives. Their plans include tax policy and administration reforms aimed at broadening the tax base, fighting tax avoidance and evasion, and increasing the fairness of the tax system. They also argued that targeted tax benefits are essential to attracting FDI and generating employment, and noted that there is significant competition in the region in granting such benefits. The authorities concurred that reforming the social security and healthcare systems and the decentralization model are important to improve the quality of services provided to the population and support medium-term fiscal sustainability. However, they noted that these reforms need to be carefully planned to ensure that these objectives are met. They intend to continue working closely with their development partners on these reforms. Similarly, the authorities agreed that the draft laws on local public finance and on fiscal responsibility can be strengthened.

C. Monetary and Exchange Rate Policy

Staff's views

20. **The NBM has maintained an accommodative monetary policy stance reflecting its concern about inflation breaching the lower bound of the target range**. In April 2013, the NBM

cut the base (policy) rate by 100 basis points to 3.5 percent.[4] Due to the muted response of lending rates and bank credit, further monetary policy easing was carried out in the summer by stepping up unsterilized foreign exchange purchases to boost liquidity, absorb seasonal foreign currency inflows, and increase international reserves. In 2013, the NBM purchased US$300 million. In early 2014, in response to downward pressures on the leu, the NBM sold about US$80 million. The growth of bank credit to the economy increased to about 19 percent at December–2013.

21. **Going forward, the mission recommended the NBM to remain vigilant and be ready to adjust policies, including by adopting a tightening bias to counter emerging inflation risks.** The mission noted that while disinflationary pressures have subsided, with headline and core inflation on the rise and over the mid-point of the target range (5 percent), second-round effects of the recent nominal exchange rate depreciation and looser fiscal policy are expected to further contribute to rising inflation. Moreover, headline inflation has been artificially contained (by about ½–1 percentage point) due to unchanged utility tariffs. On the other hand, the projected slowdown in activity and the lack of evidence of a substantial acceleration in credit growth justify to wait-and-see before starting the tightening cycle.

22. **Staff recommended maintaining a cautious approach toward interventions to ensure continued exchange rate adjustments in line with fundamentals.** Recent interventions to ease pressures on the leu were appropriate since they were aimed at preventing disorderly exchange rate adjustments. The mission noted that although the level of international reserves is broadly adequate by most metrics, further opportunistic reserve accumulation will improve Moldova's resilience to external shocks. In particular, the mission suggested that sustaining about 100 percent coverage of short-term debt would be critical for external stability (in line with the reserve adequacy in 2008 before the global financial crisis), given the geographical concentration of exports, few export items and significant dependency on personal transfers (remittances and compensation of employees), and increased vulnerabilities in the financial sector.

23. **Over the medium term, the success of the inflation targeting regime hinges on strengthening the monetary transmission mechanism.** This will require fostering the development of the interbank money market (once the current weaknesses in the banking system are addressed) to make the interbank interest rates more responsive to changes in the NBM base rate. The mission recommended developing a plan to address the large liquidity surplus in the banking system, which would improve signaling of monetary policy instruments.[5] Strengthening coordination between the treasury cash flows and NBM's operations would also be important, as well as developing a benchmark yield curve for government debt.

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[4] The NBM had previously cut the base rate by 550 bp between November 2011 and February 2012.

[5] The main reasons for the liquidity surplus are: (i) a very thin interbank money market which forces banks to hold additional liquidity; (ii) institutional factors (including difficulties in valuation and realization of collateral) that increase the risk of bank lending and limit banks' willingness to expand loan portfolios; and (iii) the need to repair banks' balance sheets after the surge in NPLs in 2009.

Authorities' views

24. **The authorities agreed with staff's assessment but felt that there was no need to adopt a tightening bias in the short term**. According to the NBM, the significant slowdown in economic growth they project would result in significant deflationary pressures. At the same time, the NBM acknowledged that these pressures would be offset to some extent by increased consumption due to the planned wage and pension increases later in 2014, and the likely adjustment in utility prices early next year. Overall, the authorities agreed with staff's proposed approach of wait-and-see but be ready to tighten if inflationary pressures emerge. The authorities also agreed with staff's recommendations about interventions on the foreign exchange market and strengthening inflation targeting regime.

D. Structural Reforms

Staff's views

25. **Steady implementation of structural reforms is critical to boost potential growth and reduce poverty**. The strong pace of growth observed since the mid–2000s was driven by domestic consumption fueled by remittances. The authorities' medium-term growth model, as presented in the NDS *Moldova 2020*, aims at an appropriate shift towards one based on raising investment and increasing productivity and competitiveness. This would also help Moldova reduce its dependence on remittances. Staff recommended giving special attention to the following areas: (i) business environment; (ii) physical infrastructure development; (iii) human resource development; and (iv) public administration reform (Annex V). Refocusing the education system to labor market needs would play an important role in raising productivity, job creation and reversing migration trends.

26. **Structural reforms to increase financial intermediation over the longer term would also be important**. The fundamental features of the banking sector in Moldova are weak financial intermediation (loans represent only 43 percent of GDP) and weak risk management practices. The lack of access to finance has been identified by the OECD as the top business constraint for firms in Moldova.[6] The entry of new strategic investors (that are subject to appropriate and effective scrutiny by the relevant authorities) in the market would boost competition and optimize financing costs. Staff recommended complementing steps to improve collateral execution (e.g., lifting limitations on the sale of repossessed collateral) and adding new sources of information to the existing credit bureau. Staff also noted the important role that the development of non-bank financial institutions can play to help achieve more competition for household savings and business financing.

Authorities' views

27. **The authorities shared staff's views and affirmed their commitment to implement the structural reforms described in the NDS *Moldova 2020*.** The authorities agreed that special

[6] OECD, Competitiveness and Private Sector Development, Republic of Moldova, 2011.

attention needs to be paid to improving the business environment, physical infrastructure, and human resource development. The authorities recognized that the DCFTA poses challenges to Moldovan economy in the short term, because Moldovan businesses will need to adopt EU standards and regulations and will face increased competition. In this regard, the Ministry of Economy, with technical assistance from the EU, has prepared a Roadmap for Enhancing Competitiveness of Moldova aimed at addressing issues related to labor skills, physical infrastructure, access to finance, innovation and technology, and quality standards. The Ministry of Education is working on a comprehensive reform and has prepared a Sector Development Strategy for 2014-20, which aims at increasing public spending efficiency in the education sector and aligning curricula of vocational schools with labor market needs.

28. **The authorities also shared staff's views on importance of structural reforms to increase financial intermediation over the longer term.** The NBM is working on a draft law on consumer lending, which would establish a unified benchmark lending rate. Although this law aims mainly at consumer protection, a transparent benchmark rate should help improve transmission of the monetary policy and stimulate financial intermediation.

POST-PROGRAM MONITORING

29. **Moldova's capacity to repay the Fund remains strong overall**. External debt is projected to stay on a downward trajectory. A metric-based approach and other traditional measures point to the adequacy of reserves. The Fund's exposure peaked at 9.4 percent of GDP in 2012 and is projected to continue declining over the medium term. Total debt service to the Fund would reach 1.3 percent of total exports (around ½ percent of GDP) in 2015 and peak at 2.3 percent of exports in 2017 (1.1 percent of GDP). Moldova's relatively high external debt to GDP ratio, emanating largely from high private external debt relative to GDP, poses some risk. Moldova remains vulnerable to a number of shocks, including an escalation of geopolitical tensions in the region that could lead to a disruption of trade routes and gas supplied. The materialization of shocks (identified in RAM) could adversely affect the economy, culminating in reduced creditworthiness and ability to repay the Fund.

STAFF APPRAISAL

30. **Economic activity is projected to slow down significantly after a strong recovery last year.** The economy expanded by 8.9 percent in 2013, led by a strong rebound in agriculture and related industries. In 2014, output growth is expected to decelerate to 2¼ percent, reflecting a moderation in agriculture production and weaker economic activity in main trading partners.

31. **Domestic and external risks are to the downside.** Key risks to the near-term outlook relate to serious vulnerabilities and governance issues in the banking sector, fiscal policy slippages in the run up to elections, a further slowdown in activity in main trading partners, and intensification of geopolitical tensions. Strong buffers, in the form of high international reserves and low public debt, combined with prudent policies would help mitigate the impact of these risks.

32. **Significant weaknesses in the legal and regulatory frameworks must be urgently addressed to ensure stability and soundness of the financial sector.** Expeditious passage of legislation is needed to empower the NBM and NCFM to take effective regulatory and supervisory actions, by having in place adequate procedures for court suspension of regulatory and supervisory decisions (taking into account the CC ruling) and without staff fearing criminal prosecution or civil liability for carrying out their duties. In turn, the NBM and NCFM must resolutely and effectively implement the legal norms pertaining to identification and adequate fit-and-proper requirements of ultimate beneficial owners and controllers in banks, which should also help enhance the monitoring of related-party transactions and overall risk management framework of banks. The enforcement of the anti-money laundering framework also needs to be strengthened.

33. **Prompt action is required by regulators to improve banking sector fundamentals.** In particular, resolute enforcement of capitalization and liquidity requirements is important to reduce vulnerabilities**.** Following the recapitalization of Banca de Economii (BEM) by minority shareholders, the NBM needs to maintain a very high level of scrutiny of its operations until the bank effectively resolves its high share of nonperforming assets, reduces interbank exposures, and it is verified that it is in compliance will all regulatory norms. Despite the dilution of the government's share, the Ministry of Finance needs to ensure strong representation at the BEM's board in order to safeguard public interest. Moreover, the NBM should abstain from regulatory forbearance and the government from providing commercial banks privileged access to additional public sector deposits. Banks that fail to meet regulatory requirements must be required by the NBM to develop and implement a time-bound plan to address the shortcomings.

34. **Fiscal policy should be geared towards a gradual reduction of the budget deficit to a level compatible with the official assistance available over the medium term.** The projected increase in the budget deficit excluding grants in 2014 (5½ percent of GDP) represents a step in the opposite direction. While the deficit could be allowed to widen in the near term to accommodate revenue shortfalls stemming from weaker economic activity, the expenditure envelope envisaged in the 2014 budget should be maintained. In particular, pressures to grant ad hoc tax benefits and to increase salaries and pensions should be resisted even if one-off revenues materialize. Going forward, fiscal policy should aim at narrowing the deficit to 1½ percent of GDP (about 2½ percent excluding grants) by 2018. This level of deficit would put public debt as a share of GDP on a downward trend and be consistent with projected financing availability.

35. **Over the medium term, fiscal consolidation needs to be supported by structural fiscal reforms.** Administrative reform is paramount to enhance efficiency of the public sector and improve the quality of services delivered to the population. The fiscal decentralization model should be strengthened by tightening sub-national governments' debt limits and consolidating the number of local governments. Social security reform is also essential to put the pension fund on a sound financial basis, deal with demographic pressures, and reverse the decline in pension benefits relative to wages. Utility tariffs need to be adjusted to cost-recovery levels to avoid further accumulation of arrears with energy suppliers and ensure an adequate level of investment in the

sector. The draft law on fiscal responsibility is a welcome step but needs to be strengthened in order to provide an adequate fiscal anchor.

36. **Monetary policy has been successful in maintaining inflation within the target range.** In the context of disinflationary pressures, the NBM's current monetary policy stance has remained appropriate, and the build-up of international reserves in 2013 is welcome as it strengthened Moldova's resilience to external shocks. Going forward, the NBM needs to remain ready to adjust policies, including adopting a tightening bias to counter emerging inflation risks.

37. **Steady implementation of structural reforms is critical to boost potential growth and reduce poverty.** The National Development Strategy—*Moldova 2020* aims at an appropriate shift to a medium-term growth model based on raising investment and increasing productivity and competitiveness. In order to achieve these goals, special attention needs to be paid to improving the business environment, physical infrastructure, and human resources development. Refocusing the education system to labor market needs would play an important role in raising productivity, job creation and reversing migration trends.

38. It is proposed that the next Article IV consultation with Moldova be held on the standard 12-month cycle.

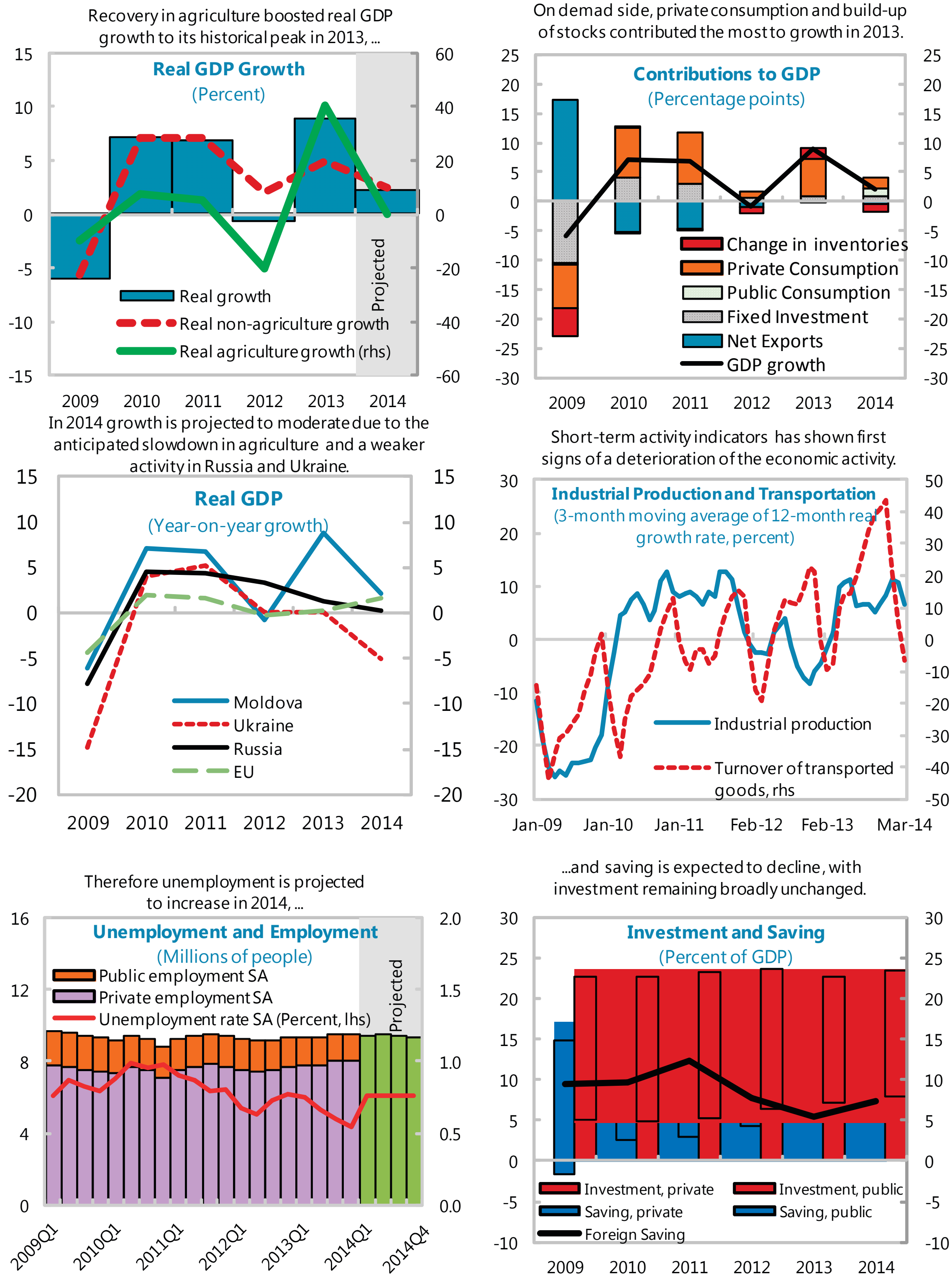
Moldova: Risk Assessment Matrix 1/

(Scale – high, medium, or low)

Source of Risks	Relative Likelihood[2]	Impact if Realized	Policy Response
1. **A sharp increase in geopolitical tensions surrounding Russia/Ukraine that creates significant disruptions in global financial, trade and commodity markets**	**Medium** The intensification of geopolitical tensions related to the developments in Ukraine and any related slowdown of the Russian economy would inevitably worsen the external outlook for Moldova	**High** A disruption of trade routes and gas supply and a decline in remittances could severely impact the economy	• Accelerate diversification of external trade products and markets, and energy sources • Let the exchange rate adjust to facilitate absorption of the external shock • Continue prudent macroeconomic policies to further strengthen external buffers; allow automatic fiscal stabilizers full play • Strengthen monitoring of bank exposures to exchange rate and cross border risks.
2. **Protracted period of slower European growth**	**High** Larger than expected deleveraging or negative surprise on potential growth	**High** Lower export demand (from EU and CIS), falling remittances and other financial flows (e.g., trade credits) would induce lower growth, higher budget deficit, exchange rate pressures, and banking sector difficulties	• Let fiscal automatic stabilizers work • Let the exchange rate adjust to facilitate absorption of the external shock • Speed up structural reform to increase competitiveness
3. **Deterioration of Moldova's banking system soundness e.g. as a consequence of weak governance**	**High** Reemergence of problems at individual banks, and/or soaring system-wide NPLs can undermine the banking system soundness	**High** Credit supply would dwindle, and the government might need to intervene to prevent or resolve bank failures	• Enforce shareholder and beneficial ownership transparency and suitability requirements • For banks in trouble, intervene in large systemically important ones and liquidate small ones • Step up anti-corruption and AML/CFT efforts
4. **Decline in official external financing**	**Low** Budget cuts in Europe or setbacks in Moldova could worsen donor's sentiment and curtail donor aid	**Medium** Scaling down of development projects and budget financing	• In the context of prudent fiscal policy look for alternative funding sources for priority projects
5. **Political cycle**	**High** Intensifying political competition ahead of the 2014 parliamentary elections could lead to populist initiatives, delayings or reversing structural reforms	**Medium** Deteriorating growth prospects and business climate would harm investment, competitiveness, and defer poverty reduction and would lead to fiscal slippages	• Restore prudent macroeconomic policies • Accelerate structural reforms

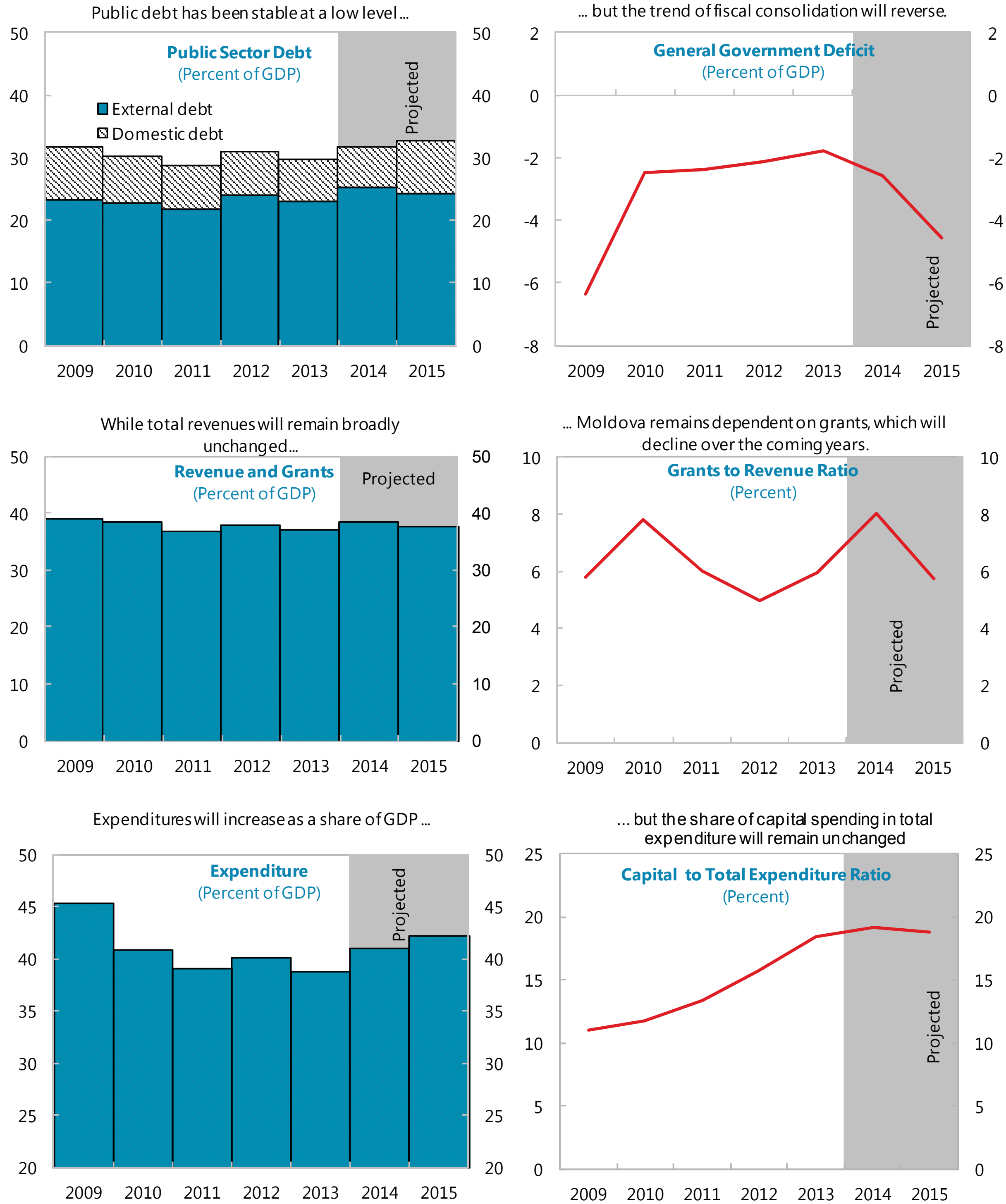
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.
[2] In case the baseline does not materialize.

Figure 1. Moldova: Real Sector Developments, 2009–14



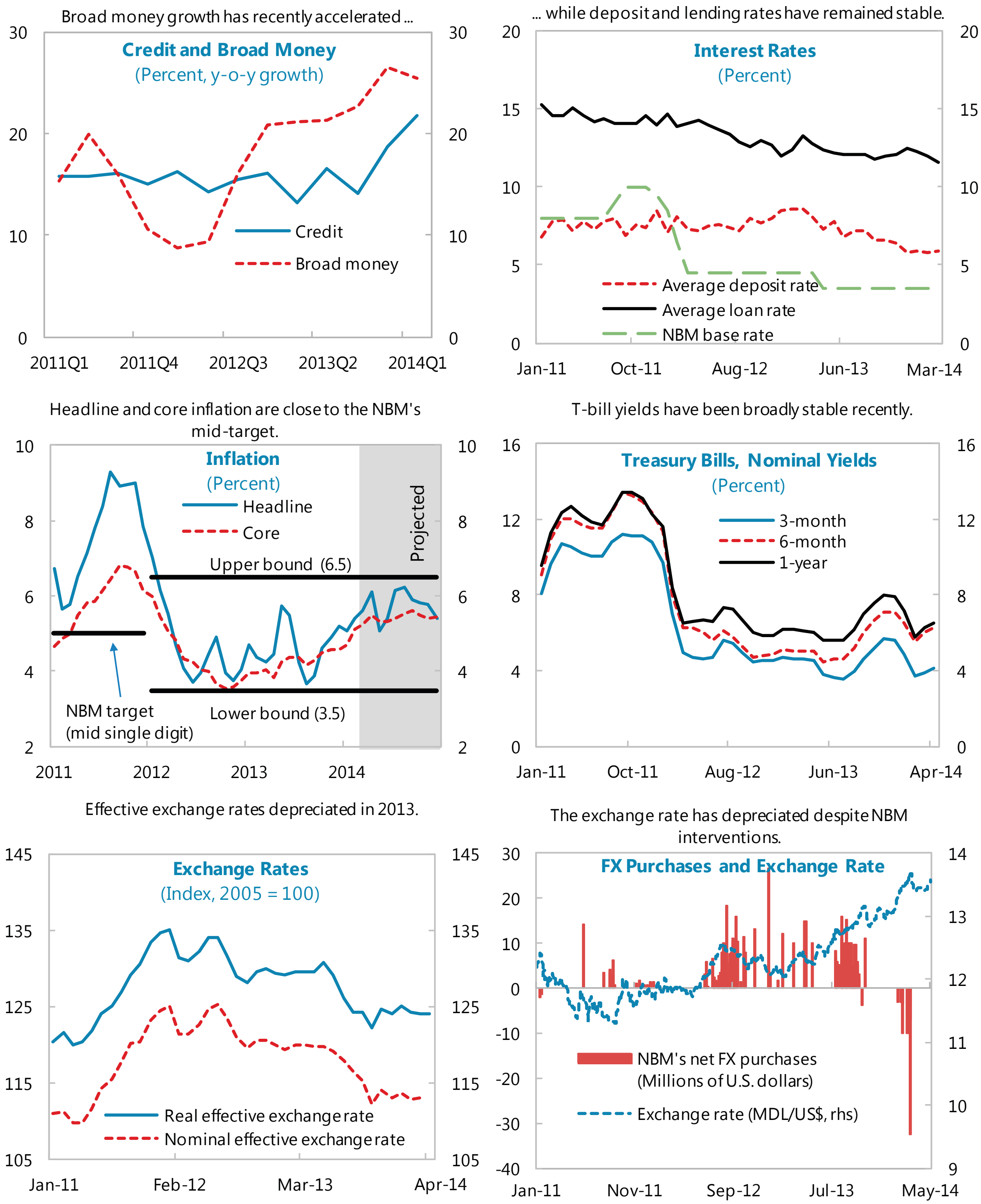
Sources: Moldovan authorities; National Bureau of Statistics of the Republic of Moldova; and IMF staff calculations.

Figure 2. Moldova: Fiscal Developments, 2009–14



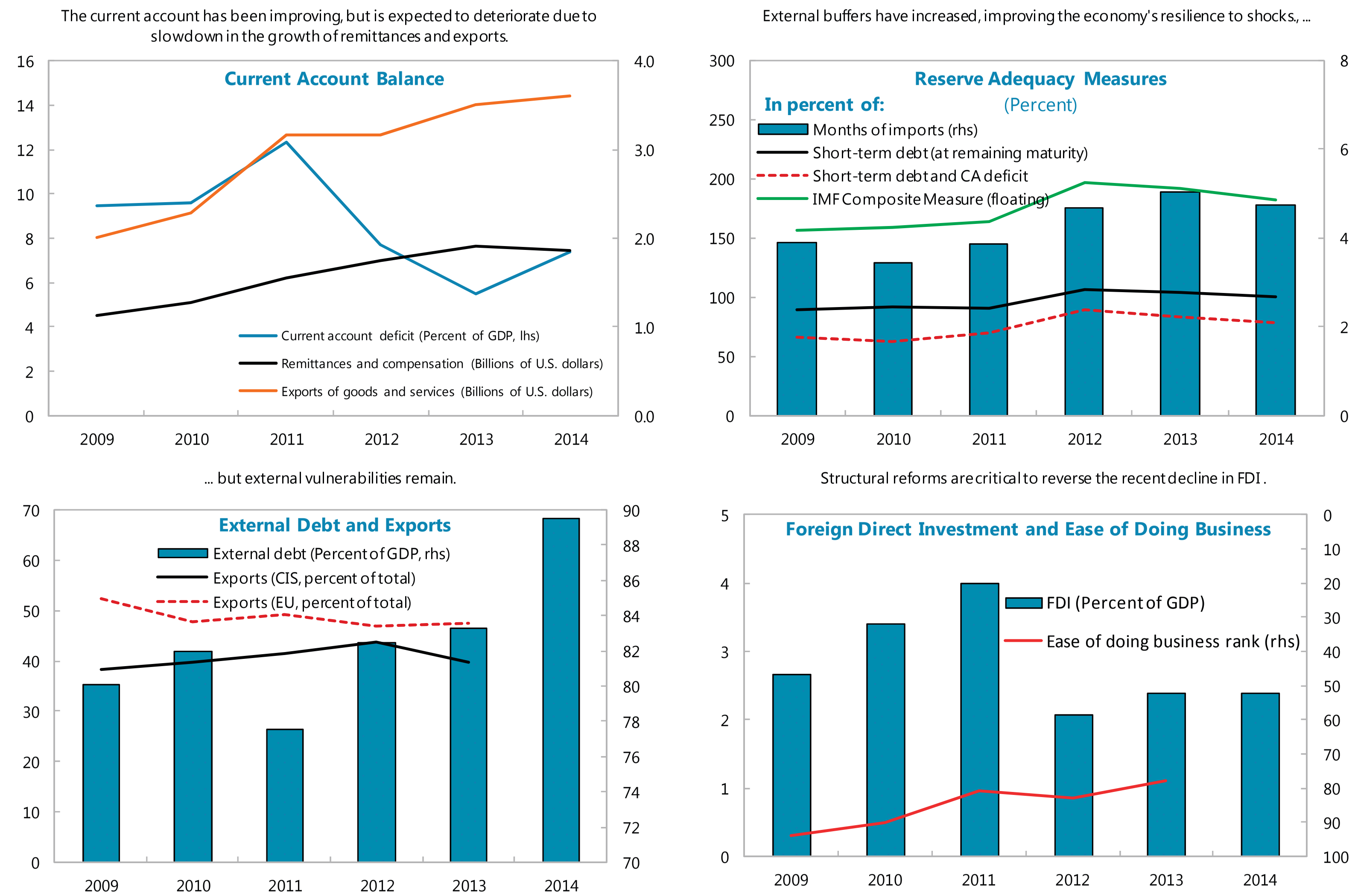
Sources: Moldovan authorities; and IMF staff calculations.

Figure 3. Moldova: Money, Prices, and Interest Rates, 2011–14



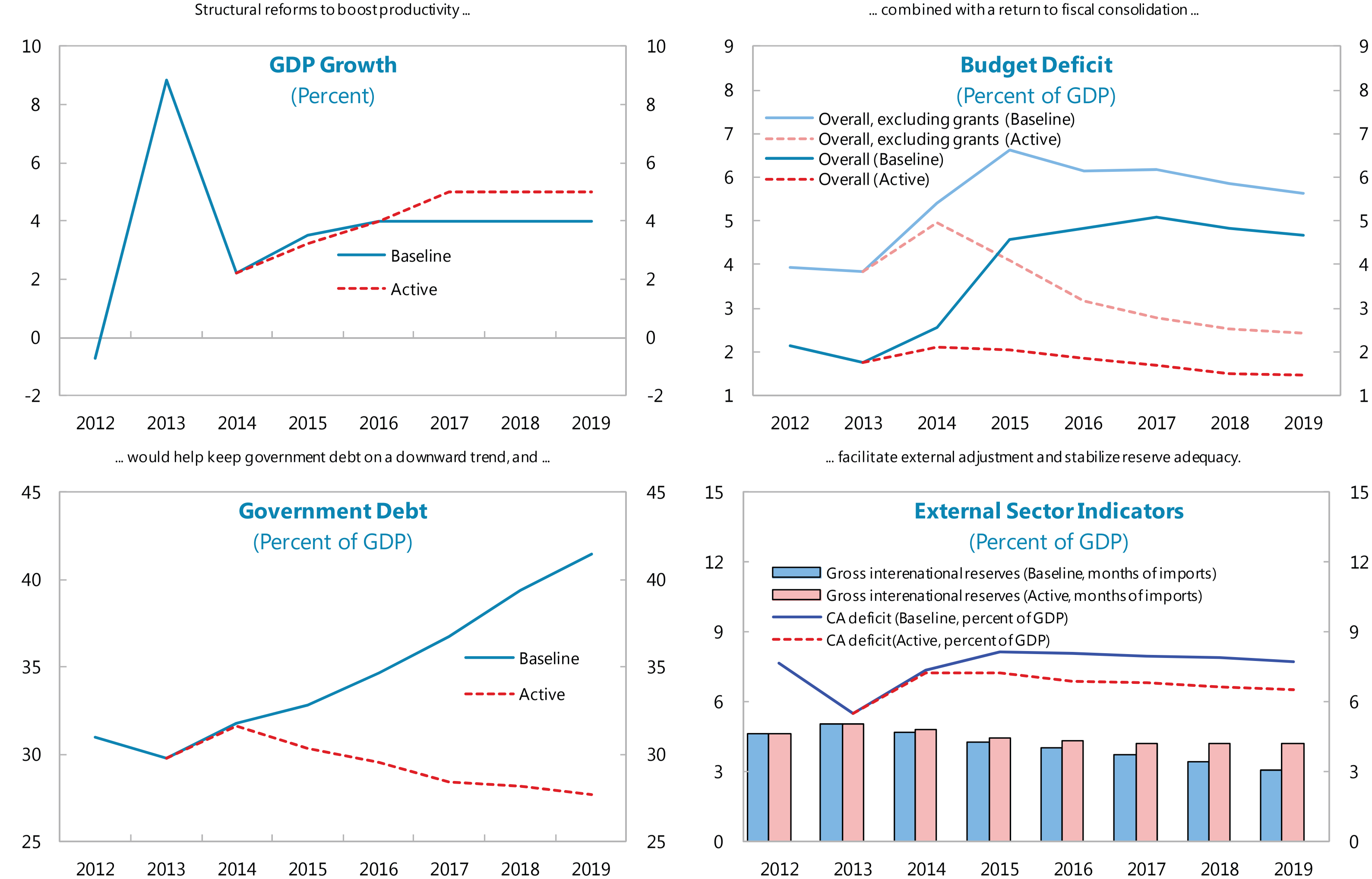
Sources: National authorities; and IMF staff calculations.

Figure 4. Moldova: External Sector Developments, 2009–14



Sources: World Bank, *Doing Business Report*, 2010-14; National Bank of Moldova; Moldovan Authorities; and IMF staff and calculations.

Figure 5. Moldova: Selected Economic Indicators Under the Baseline and Active Scenario, 2012–19



Sources: Moldovan authorities; and IMF staff estimates.

Table 1. Moldova: Selected Economic Indicators, 2009–19 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Prel.	Projection					
I. Real sector indicators	(Percent change, unless otherwise indicated)										
Gross domestic product											
Real growth rate	-6.0	7.1	6.8	-0.7	8.9	2.2	3.5	4.0	4.0	4.0	4.0
Agricultural	-9.9	7.4	5.2	-20.1	40.6	0.0	4.0	4.0	4.0	4.0	4.0
Non-agricultural	-5.6	7.1	7.0	2.0	4.9	2.5	3.4	4.0	4.0	4.0	4.0
Demand	-15.1	9.2	8.3	0.4	6.2	2.1	2.4	2.6	3.2	3.2	3.3
Consumption	-6.9	7.3	7.5	0.9	5.2	2.8	3.0	2.8	3.1	3.2	3.2
Private	-8.0	9.6	9.4	1.0	6.5	1.9	1.9	2.6	2.9	3.1	3.1
Public	-2.0	-1.1	-0.7	0.6	-0.8	7.2	8.3	3.5	3.7	3.9	4.0
Gross capital formation	-30.9	17.2	13.0	1.8	3.3	3.8	2.2	1.5	4.0	2.7	3.4
Private	-32.1	18.5	11.3	-3.9	-3.7	0.5	1.0	3.5	4.0	4.0	4.0
Public	-26.4	12.4	19.3	21.6	22.4	11.0	4.5	-2.2	4.1	0.2	2.2
Nominal GDP (billions of Moldovan lei)	60.4	71.9	82.3	88.2	99.9	108.7	118.8	130.6	143.3	156.6	171.1
Nominal GDP (billions of U.S. dollars)	5.4	5.8	7.0	7.3	7.9	7.6	8.1	8.7	9.2	9.8	10.4
Consumer price index (average)	0.0	7.4	7.6	4.6	4.6	5.7	6.0	6.3	5.8	5.3	5.0
Consumer price index (end of period)	0.4	8.1	7.8	4.0	5.2	5.4	6.5	6.0	5.5	5.0	5.0
GDP deflator	2.2	11.1	7.3	7.9	4.0	6.5	5.6	5.7	5.5	5.1	5.0
Average monthly wage (Moldovan lei)	2,748	2,972	3,194	3,478	3,765	4,080	4,450	4,880	5,330	5,820	6,355
Average monthly wage (U.S. dollars)	247	240	272	287	299	286	304	325	344	364	387
Unemployment rate (annual average, percent)	6.4	7.4	6.7	5.6	5.1	6.0	5.8	5.6	5.5	5.5	5.5
Saving-investment balance	(Percent of GDP)										
Foreign saving	9.5	9.6	12.3	7.7	5.5	7.4	8.2	8.1	8.0	7.9	7.7
National saving	13.1	13.0	11.0	16.0	17.1	16.0	14.8	14.3	14.4	14.3	14.3
Private	14.8	10.4	8.1	11.7	11.7	10.6	11.5	11.7	12.1	11.9	11.9
Public	-1.7	2.6	2.9	4.3	5.3	5.4	3.3	2.6	2.4	2.3	2.4
Gross investment	22.6	22.6	23.3	23.6	22.6	23.3	23.0	22.4	22.4	22.2	22.0
Private	17.6	17.9	18.1	17.4	15.5	15.5	15.1	15.0	15.0	15.0	15.0
Public	5.0	4.8	5.2	6.3	7.1	7.9	7.9	7.4	7.4	7.2	7.1
II. Fiscal indicators (general government)											
Primary balance	-5.1	-1.8	-1.6	-1.4	-1.3	-1.9	-3.9	-4.0	-4.0	-3.7	-3.4
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
Stock of public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.9	31.8	32.8	34.7	36.7	39.4	41.5
III. Financial indicators	(Percent change, unless otherwise indicated)										
Broad money (M3)	3.2	13.4	10.6	20.8	26.5	15.9	16.4	…	…	…	…
Velocity (GDP/end-period M3; ratio)	1.8	1.9	2.0	1.8	1.6	1.5	1.4	…	…	…	…
Reserve money	-10.1	15.9	18.4	22.9	31.9	13.4	14.0	…	…	…	…
Credit to the economy	-4.9	12.7	15.0	16.1	18.8	11.3	11.4	…	…	…	…
Credit to the economy, percent of GDP	39.5	37.4	37.6	40.7	42.7	43.7	44.6	…	…	…	…
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)										
Current account balance	-516	-559	-863	-559	-438	-564	-662	-700	-737	-774	-806
Current account balance (percent of GDP)	-9.5	-9.6	-12.3	-7.7	-5.5	-7.4	-8.2	-8.1	-8.0	-7.9	-7.7
Remittances and compensation of employees (net)	1,124	1,273	1,549	1,745	1,913	1,864	1,839	1,892	1,950	2,010	2,073
Gross official reserves	1,480	1,718	1,965	2,515	2,820	2,751	2,621	2,599	2,551	2,511	2,409
Gross official reserves (months of imports)	3.9	3.4	3.9	4.7	5.0	4.7	4.3	4.0	3.7	3.4	3.1
Exchange rate (Moldovan lei per USD, period avge)	11.1	12.4	11.7	12.1	12.6	…	…	…	…	…	…
Exchange rate (Moldovan lei per USD, end of period)	12.3	12.2	11.7	12.1	13.1	…	…	…	…	…	…
Real effective exch.rate (average, percent change)	5.4	-7.4	5.3	4.5	-3.4	-3.5	0.4	0.8	0.3	0.0	0.0
External debt (percent of GDP) 2/	80.2	82.0	77.6	82.5	83.6	90.0	87.8	86.2	84.9	84.2	82.3
Debt service (percent of exports of goods and services)	20.1	17.6	15.7	15.6	17.5	18.6	19.5	22.5	21.2	22.4	24.1

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Table 2. Moldova: Balance of Payments, 2010–19

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Prel.	Projection					
Current account balance	-559	-863	-559	-438	-564	-662	-700	-737	-774	-806
Merchandise trade balance	-2,219	-2,869	-2,924	-2,979	-3,114	-3,159	-3,205	-3,316	-3,422	-3,543
Exports	1,590	2,277	2,228	2,470	2,541	2,726	2,974	3,217	3,486	3,773
Of which: wine and alcohol	178	181	215	231	259	279	309	323	346	371
Imports	-3,810	-5,146	-5,152	-5,449	-5,655	-5,885	-6,179	-6,534	-6,908	-7,316
Services balance	-64	-3	-21	-3	-1	4	9	6	3	0
Exports of services	700	881	936	1,029	1,061	1,109	1,184	1,258	1,338	1,423
Imports of services	-764	-884	-957	-1,031	-1,062	-1,106	-1,175	-1,252	-1,335	-1,422
Income balance	505	572	840	885	842	803	804	815	822	836
Compensation of employees	684	863	985	1,076	1,048	1,034	1,064	1,096	1,130	1,165
Income on direct and portfolio investment	-134	-238	-88	-130	-145	-162	-177	-190	-203	-213
Income on other investment	-45	-54	-57	-61	-61	-69	-83	-91	-105	-116
Current transfer balance	1,219	1,438	1,546	1,658	1,709	1,690	1,692	1,758	1,823	1,901
Remittances	589	686	760	838	816	805	828	854	880	907
Budget transfers	135	139	157	163	216	187	135	146	157	168
Other transfers	494	613	629	658	677	698	729	758	786	826
Capital and financial account balance	371	750	660	538	438	510	682	725	768	735
Capital account balance	-28	-30	-34	-45	-27	-28	-30	-32	-34	-36
Financial account balance	399	779	694	583	465	538	712	757	803	771
Foreign direct investment balance	204	268	155	203	195	268	325	380	440	470
Portfolio investment and derivatives	0	0	21	10	7	7	7	8	8	0
Other investment balance	194	512	518	370	264	263	379	369	354	302
Loans	77	178	267	196	257	243	283	245	256	260
General government, net	4	27	62	26	129	111	121	96	81	125
Private sector, net	73	152	204	171	128	132	162	149	175	135
Other capital flows	117	333	251	174	7	20	96	123	98	42
Errors and omissions	78	88	75	88	0	0	0	0	0	0
Overall balance	-111	-25	176	188	-126	-152	-18	-12	-5	-71
Financing	111	25	-176	-188	126	152	18	12	5	71
Gross international reserves (increase: "-")	-294	-278	-498	-284	69	130	22	48	40	102
Use of Fund credit, net	175	153	139	-22	-25	-45	-81	-98	-97	-91
Monetary authorities	53	129	139	-22	-25	-12	-20	-29	-29	-38
Purchases	61	135	155	0	0	0	0	0	0	0
Repurchases	-8	-6	-16	-22	-25	-12	-20	-29	-29	-38
General government	122	24	0	0	0	-33	-61	-69	-68	-53
Purchases	122	24	0	0	0	0	0	0	0	0
Repurchases	0	0	0	0	0	-33	-61	-69	-68	-53
Exceptional financing	231	150	183	117	81	67	78	63	62	60
Memorandum items:	(Percent of GDP, unless otherwise indicated)									
Gross official reserves (millions of U.S. dollars) 1/	1,718	1,965	2,515	2,820	2,751	2,621	2,599	2,551	2,511	2,409
Months of imports of good and services	3.4	3.9	4.7	5.0	4.7	4.3	4.0	3.7	3.4	3.1
Percent of short term debt and CA deficit	62.0	70.2	89.2	82.9	77.9	69.8	67.4	61.7	56.4	51.1
Pct of short-term debt at remaining maturity	91.3	90.2	106.7	104.2	99.8	89.3	85.9	77.7	71.3	66.5
Pct of the IMF composite measure (floating) 2/	159.0	163.6	196.4	191.7	182.3	165.4	154.6	143.2	133.7	123.0
Current account balance	-9.6	-12.3	-7.7	-5.5	-7.4	-8.2	-8.1	-8.0	-7.9	-7.7
Goods and services trade balance	-39.3	-40.9	-40.4	-37.6	-40.8	-38.9	-36.8	-35.8	-34.9	-34.0
Export of goods and services	39.4	45.0	43.4	44.1	47.2	47.3	47.9	48.4	49.2	49.8
Import of goods and services	-78.7	-85.9	-83.9	-81.7	-88.1	-86.2	-84.7	-84.2	-84.1	-83.8
Foreign direct investment balance	3.5	3.8	2.1	2.6	2.6	3.3	3.7	4.1	4.5	4.5
	(Percent change of amounts in U.S.dollars, unless otherwise indicated)									
Exports of goods	19.9	43.2	-2.2	10.9	2.9	7.3	9.1	8.2	8.3	8.2
Exports of services	4.0	25.9	6.2	9.9	3.1	4.6	6.7	6.3	6.3	6.3
Imports of goods	16.3	35.1	0.1	5.8	3.8	4.1	5.0	5.7	5.7	5.9
Imports of services	7.1	15.7	8.3	7.7	3.0	4.1	6.3	6.5	6.6	6.6
Remittances and compensation	13.2	21.7	12.7	9.6	-2.6	-1.3	2.9	3.1	3.1	3.1
Remittances	-6.1	16.4	10.8	10.2	-2.6	-1.3	2.9	3.1	3.1	3.1
Compensation of employees	37.5	26.3	14.1	9.2	-2.6	-1.3	2.9	3.1	3.1	3.1
Debt service (pct of exports of goods and services)	17.6	15.7	15.6	17.5	18.6	19.5	22.5	21.2	22.4	24.1

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

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

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

Table 3a. Moldova: General Government Budget, 2009–19

(Millions of Moldovan lei, unless otherwise indicated)

	2009	2010	2011	2012	2013 1/	2014		2015	2016	2017	2018	2019
						Budget	Proj.	Projection				
Revenues and grants	23,518	27,537	30,138	33,476	36,908	40,442	41,798	44,627	47,941	52,304	57,043	62,196
Revenues	22,230	25,538	28,434	31,894	34,835	37,974	38,677	42,201	46,230	50,749	55,452	60,553
Tax revenues	19,343	22,261	25,301	28,261	31,599	34,737	35,359	38,589	42,238	46,346	50,615	55,246
Corporate income	443	484	571	1,967	2,053	2,309	2,229	2,495	2,768	3,080	3,368	3,678
Personal income	1,465	1,545	1,769	2,027	2,206	2,399	2,370	2,613	2,899	3,223	3,525	3,849
VAT	7,596	9,146	10,464	10,672	12,174	13,234	13,829	15,113	16,524	18,049	19,717	21,424
Excises	1,540	2,074	2,667	2,894	3,508	3,777	3,985	4,280	4,630	5,155	5,622	6,204
Foreign trade	908	1,080	1,179	1,287	1,417	1,503	1,633	1,747	1,882	2,052	2,237	2,460
Other	420	459	452	468	498	504	504	551	606	664	727	793
Social Fund contributions	5,595	5,985	6,563	7,150	7,776	8,570	8,426	9,191	10,079	11,008	12,020	13,126
Health Fund contributions	1,377	1,487	1,636	1,798	1,967	2,442	2,384	2,600	2,851	3,114	3,400	3,713
Non-tax revenues	1,028	1,696	1,457	1,943	1,945	1,882	1,963	2,132	2,366	2,619	2,885	3,176
Revenues of special funds and means	1,859	1,581	1,676	1,690	1,291	1,354	1,354	1,480	1,627	1,785	1,951	2,131
Grants	1,288	2,000	1,704	1,582	2,074	2,469	3,121	2,425	1,710	1,555	1,591	1,643
Domestic	150	81	31	33	36	10	10	10	11	13	14	15
External	1,138	1,919	1,673	1,549	2,038	2,459	3,111	2,415	1,699	1,542	1,577	1,628
Budget support 2/	804	1,327	923	760	704	1,047	1,160	979	1,167	973	984	992
Project	334	584	663	735	1,242	1,404	1,942	1,436	532	570	594	636
Other public institutions	0	8	87	54	91	9	9	10	11	12	13	14
Expenditure and net lending	27,352	29,326	32,101	35,374	38,673	43,243	44,564	50,072	54,251	59,595	64,624	70,214
Current expenditure	24,376	25,986	27,889	29,960	31,659	35,473	36,135	40,794	44,689	49,096	53,559	58,350
Wages	7,000	7,317	7,700	8,506	8,296	9,086	9,491	11,472	12,610	13,835	15,128	16,520
Goods and services	6,069	6,735	7,302	7,861	8,810	10,038	10,094	11,030	12,124	13,301	14,545	15,883
Health Fund	3,071	3,368	3,616	3,838	4,084	4,679	4,664	5,096	5,602	6,146	6,720	7,339
Other	2,998	3,367	3,687	4,023	4,727	5,359	5,430	5,934	6,522	7,156	7,825	8,544
Interest payments	843	558	673	694	527	720	741	857	1,152	1,623	1,975	2,388
Domestic	639	374	486	504	324	459	459	540	815	1,124	1,443	1,828
Foreign	204	184	188	191	203	261	282	317	337	499	532	560
Transfers	10,160	11,082	11,925	12,486	13,585	15,158	15,340	16,922	18,239	19,718	21,234	22,821
Transfers to economy	1,197	1,094	1,057	1,228	1,337	1,370	1,327	1,450	1,594	1,749	1,913	2,089
Transfers to households	8,963	9,988	10,868	11,258	12,249	13,789	14,012	15,472	16,644	17,969	19,321	20,732
Social Fund	7,608	8,603	9,214	9,740	10,716	12,137	12,355	13,661	14,654	15,785	16,934	18,125
Other transfers	1,356	1,385	1,654	1,518	1,533	1,651	1,657	1,811	1,990	2,183	2,387	2,607
Other current expenditure	303	295	289	412	440	471	470	513	564	619	677	739
Net lending	-28	-90	-62	-139	-106	-129	-129	-140	-154	-169	-185	-202
Capital expenditure	3,004	3,431	4,273	5,553	7,120	7,898	8,557	9,418	9,716	10,669	11,250	12,065
Domestically financed	2,274	2,228	2,714	3,406	4,665	5,063	5,078	5,548	6,099	6,691	7,317	7,990
Externally financed	730	1,203	1,559	2,147	2,455	2,835	3,480	3,870	3,618	3,977	3,933	4,076
Grants	334	584	663	735	1,242	1,404	1,942	1,436	532	570	594	636
Loans	396	619	897	1,413	1,213	1,431	1,537	2,434	3,086	3,408	3,340	3,439
Overall balance	-3,829	-1,789	-1,963	-1,897	-1,764	-2,800	-2,776	-5,445	-6,310	-7,291	-7,581	-8,017
(excl. project loan spending)	-3,434	-1,170	-1,066	-485	-552	-1,369	-1,238	-3,012	-3,225	-3,883	-4,241	-4,578
Primary balance	-3,055	-1,307	-1,338	-1,265	-1,320	-2,141	-2,095	-4,642	-5,240	-5,780	-5,750	-5,812
(excl. project loan spending)	-2,660	-689	-441	148	-107	-710	-558	-2,209	-2,154	-2,373	-2,410	-2,373
Financing	3,829	1,789	1,963	1,897	1,764	2,800	2,776	5,445	6,310	7,291	7,581	8,017
Budget financing	3,434	1,186	1,087	361	398	1,369	1,238	3,012	3,225	3,883	4,241	4,578
Central government	2,971	1,019	661	282	39	1,073	994	2,717	2,930	3,588	3,946	4,283
Net domestic	1,125	-520	880	294	643	621	476	3,078	3,773	5,057	5,811	6,308
Net foreign (excl. project loans) 3/	1,774	1,441	-355	-145	-697	212	278	-562	-1,044	-1,669	-2,066	-2,225
Privatization	72	98	136	132	93	240	240	200	200	200	200	200
Local governments	245	11	322	-36	167	75	25	75	75	75	75	75
Social Fund	26	213	125	34	65	120	120	120	120	120	120	120
Health Fund	193	-57	-21	81	126	100	100	100	100	100	100	100
Project loans	396	619	897	1,413	1,213	1,431	1,537	2,434	3,086	3,408	3,340	3,439
Memorandum items:					(Billions of Moldovan lei)							
Public and publicly guaranteed debt	19,590	21,909	23,874	27,409	29,865		34,540	38,974	45,258	52,612	61,648	70,933
General Government debt	17,600	19,303	19,886	21,649	23,915		28,196	32,800	39,229	46,851	56,177	65,951
Domestic debt	5,105	5,305	5,842	6,159	6,676		7,013	10,006	13,875	18,866	24,624	30,486
Domestic expenditure arrears	459	230	164	62	89		0	0	0	0	0	0
External debt	12,037	13,768	13,880	15,428	17,150		21,183	22,795	25,354	27,985	31,553	35,465
Other 4/	1,990	2,607	3,987	5,760	5,950		6,344	6,174	6,029	5,762	5,471	4,982

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

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.
2/ In 2009, an EU project grant of €15 million was reclassified as budget support given that no actual expenditure took place.
3/ Includes direct budget support from the IMF of SDR 80 million in 2010 and SDR 15 million in 2011.
4/ Includes mainly central bank liabilities to the IMF.

Table 3b. Moldova: General Government Budget, 2009–19

(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013 1/	2014		2015	2016	2017	2018	2019
						Budget	Proj.			Projection		
Revenues and grants	38.9	38.3	36.6	37.9	37.0	37.1	38.4	37.6	36.7	36.5	36.4	36.4
Revenues	36.8	35.5	34.5	36.1	34.9	34.8	35.6	35.5	35.4	35.4	35.4	35.4
Tax revenues	32.0	31.0	30.7	32.0	31.6	31.9	32.5	32.5	32.3	32.4	32.3	32.3
Corporate income	0.7	0.7	0.7	2.2	2.1	2.1	2.1	2.1	2.1	2.2	2.2	2.2
Personal income	2.4	2.1	2.1	2.3	2.2	2.2	2.2	2.2	2.2	2.3	2.3	2.3
VAT	12.6	12.7	12.7	12.1	12.2	12.1	12.7	12.7	12.7	12.6	12.6	12.5
Excises	2.5	2.9	3.2	3.3	3.5	3.5	3.7	3.6	3.5	3.6	3.6	3.6
Foreign trade	1.5	1.5	1.4	1.5	1.4	1.4	1.5	1.5	1.4	1.4	1.4	1.4
Other	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Social Fund contributions	9.3	8.3	8.0	8.1	7.8	7.9	7.8	7.7	7.7	7.7	7.7	7.7
Health Fund contributions	2.3	2.1	2.0	2.0	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Non-tax revenues	1.7	2.4	1.8	2.2	1.9	1.7	1.8	1.8	1.8	1.8	1.8	1.9
Revenues of special funds	3.1	2.2	2.0	1.9	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Grants	2.1	2.8	2.1	1.8	2.1	2.3	2.9	2.0	1.3	1.1	1.0	1.0
Domestic	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	1.9	2.7	2.0	1.8	2.0	2.3	2.9	2.0	1.3	1.1	1.0	1.0
Budget support 2/	1.3	1.8	1.1	0.9	0.7	1.0	1.1	0.8	0.9	0.7	0.6	0.6
Project	0.6	0.8	0.8	0.8	1.2	1.3	1.8	1.2	0.4	0.4	0.4	0.4
Other public institutions	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	45.3	40.8	39.0	40.1	38.7	39.7	41.0	42.2	41.5	41.6	41.3	41.0
Current expenditure	40.3	36.1	33.9	34.0	31.7	32.5	33.2	34.3	34.2	34.3	34.2	34.1
Wages	11.6	10.2	9.4	9.6	8.3	8.3	8.7	9.7	9.7	9.7	9.7	9.7
Goods and services	10.0	9.4	8.9	8.9	8.8	9.2	9.3	9.3	9.3	9.3	9.3	9.3
Interest payments	1.4	0.8	0.8	0.8	0.5	0.7	0.7	0.7	0.9	1.1	1.3	1.4
Domestic	1.1	0.5	0.6	0.6	0.3	0.4	0.4	0.5	0.6	0.8	0.9	1.1
Foreign	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Transfers	16.8	15.4	14.5	14.2	13.6	13.9	14.1	14.2	14.0	13.8	13.6	13.3
Transfers to economy	2.0	1.5	1.3	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Transfers to households	14.8	13.9	13.2	12.8	12.3	12.7	12.9	13.0	12.7	12.5	12.3	12.1
Other current expenditure	0.5	0.4	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Net lending	0.0	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital expenditure	5.0	4.8	5.2	6.3	7.1	7.2	7.9	7.9	7.4	7.4	7.2	7.1
Domestically financed	3.8	3.1	3.3	3.9	4.7	4.6	4.7	4.7	4.7	4.7	4.7	4.7
Externally financed	1.2	1.7	1.9	2.4	2.5	2.6	3.2	3.3	2.8	2.8	2.5	2.4
Grants	0.6	0.8	0.8	0.8	1.2	1.3	1.8	1.2	0.4	0.4	0.4	0.4
Loans	0.7	0.9	1.1	1.6	1.2	1.3	1.4	2.0	2.4	2.4	2.1	2.0
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.6	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
(excl. project loan spending)	-5.7	-1.6	-1.3	-0.5	-0.6	-1.3	-1.1	-2.5	-2.5	-2.7	-2.7	-2.7
Primary balance	-5.1	-1.8	-1.6	-1.4	-1.3	-2.0	-1.9	-3.9	-4.0	-4.0	-3.7	-3.4
(excl. project loan spending)	-4.4	-1.0	-0.5	0.2	-0.1	-0.7	-0.5	-1.9	-1.6	-1.7	-1.5	-1.4
Financing	6.3	2.5	2.4	2.2	1.8	2.6	2.6	4.6	4.8	5.1	4.8	4.7
Budget financing	5.7	1.6	1.3	0.4	0.4	1.3	1.1	2.5	2.5	2.7	2.7	2.7
Central government	4.9	1.4	0.8	0.3	0.0	1.0	0.9	2.3	2.2	2.5	2.5	2.5
Net domestic	1.9	-0.7	1.1	0.3	0.6	0.6	0.4	2.6	2.9	3.5	3.7	3.7
Net foreign (excl. project loans) 3/	2.9	2.0	-0.4	-0.2	-0.7	0.2	0.3	-0.5	-0.8	-1.2	-1.3	-1.3
Privatization	0.1	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Local governments	0.4	0.0	0.4	0.0	0.2	0.1	0.0	0.1	0.1	0.1	0.0	0.0
Social Fund	0.3	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Health Fund	0.0	0.3	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Project loans	0.7	0.9	1.1	1.6	1.2	1.3	1.4	2.0	2.4	2.4	2.1	2.0
Memorandum items:												
Public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.9		31.8	32.8	34.7	36.7	39.4	41.5
General Government debt	29.1	26.9	24.1	24.5	23.9		25.9	27.6	30.0	32.7	35.9	38.6
Domestic debt	8.4	7.4	7.1	7.0	6.7		6.5	8.4	10.6	13.2	15.7	17.8
Domestic expenditure arrears	0.8	0.3	0.2	0.1	0.1		0.0	0.0	0.0	0.0	0.0	0.0
External debt	19.9	19.2	16.9	17.5	17.2		19.5	19.2	19.4	19.5	20.1	20.7
Other 4/	3.3	3.6	4.8	6.5	6.0		5.8	5.2	4.6	4.0	3.5	2.9

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

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.
2/ In 2009, an EU project grant of €15 million was reclassified as budget support given that no actual expenditure took place.
3/ Includes direct budget support from the IMF of SDR 80 million in 2010 and SDR 15 million in 2011.
4/ Includes mainly central bank liabilities to the IMF.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2009–14 1/

(Millions of Moldovan lei, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014 Proj.
National Bank of Moldova						
Net foreign assets	16,305	18,372	19,146	24,690	30,969	34,305
NFA (convertible)	16,313	18,386	19,188	24,693	31,006	34,378
Gross reserves	18,210	20,877	23,025	30,339	36,829	40,501
Reserve liabilities	1,896	2,490	3,836	5,647	5,823	6,123
Net domestic assets	-5,849	-6,257	-4,801	-7,056	-7,715	-7,924
Net claims on general government	-583	-1,067	323	192	476	425
Credit to banks	-3,690	-4,646	-5,323	-6,349	-5,164	-5,569
Other items (net)	-1,576	-544	199	-900	-3,027	-2,780
Reserve money	10,456	12,115	14,345	17,634	23,254	26,381
Currency in circulation	8,849	10,108	10,895	13,241	17,550	19,398
Banks' reserves	1,604	2,007	3,450	4,387	5,691	6,983
Required reserves	1,042	1,295	2,387	2,918	3,650	4,482
Excess reserves	563	712	1,063	1,469	2,041	2,501
Monetary survey						
Net foreign assets	16,225	18,121	16,450	23,141	31,550	37,206
NFA (convertible)	16,363	18,376	16,845	23,427	31,731	37,440
Of which: commercial banks	50	-11	-2,344	-1,266	725	3,063
Foreign assets of commercial banks	5,377	4,615	3,538	4,778	10,496	14,642
Foreign liabilities of commercial banks	-5,327	-4,626	-5,881	-6,044	-9,770	-11,579
NFA (non-convertible)	-138	-254	-395	-286	-181	-234
Net domestic assets	16,459	18,930	24,527	26,372	31,081	35,382
Net claims on general government	1,107	-187	1,512	1,004	1,387	1,863
Credit to economy	23,884	26,915	30,963	35,948	42,691	47,535
Moldovan lei	13,202	15,529	17,174	20,624	25,347	28,593
Foreign exchange	10,682	11,387	13,788	15,324	17,343	18,942
in U.S. dollars	867	937	1,175	1,270	1,328	1,287
Other items (net)	-8,532	-7,799	-7,948	-10,580	-12,996	-14,016
Broad money (M3)	32,684	37,051	40,977	49,513	62,632	72,587
Broad money (M2: excluding FCD)	20,942	24,771	28,265	34,915	45,117	52,045
Currency in circulation	8,849	10,108	10,865	13,241	17,550	19,398
Total deposits	23,835	26,944	30,113	36,272	45,081	53,190
Domestic currency deposits	12,092	14,662	17,400	21,674	27,567	32,647
Foreign currency deposits (FCD)	11,742	12,280	12,712	14,599	17,514	20,542
in U.S. dollars	953	1,010	1,083	1,210	1,341	1,395
Memorandum items:						
Reserve money growth (percent change; annual)	-10.1	15.9	18.4	22.9	31.9	13.4
Broad money growth (percent change; annual)	3.2	13.4	10.6	20.8	26.5	15.9
Credit to economy (percent change, annual)	-4.9	12.7	15.0	16.1	18.8	11.3
in lei	-10.7	17.6	10.6	20.1	22.9	12.8
in foreign exchange	3.3	6.6	21.1	11.1	13.2	9.2
Gross international reserves (millions of U.S. dollars)	1,480	1,718	1,965	2,515	2,820	2,751
Percent of domestic-currency broad money	87	84	81	87	82	78
Net international reserves (millions of U.S. dollars)	1,326	1,513	1,626	2,047	2,375	2,335
Broad money multiplier	3.1	3.1	2.9	2.8	2.7	2.8

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

1/ Monetary accounts are presented at actual exchange rates, unless otherwise indicated.

Table 5: Moldova: Financial Soundness Indicators, 2009–14

(End-of-period; percent, unless otherwise indicated)

	2009	2010	2011	2012	2013				2014
	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar
Size									
Number of banks	15	15	15	14	14	14	14	14	14
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	59.9	63.5	69.1	76.2	78.7
Total bank assets (percent of GDP)	66.1	58.8	57.9	66.1	65.5	66.0	68.8	76.3	78.5
Capital adequacy									
Capital adequacy ratio	32.3	30.1	30.4	24.8	25.4	23.3	23.3	23.4	23.5
Liquidity									
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	19.8	19.8	22.3	25.7	27.3
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	40.5	43.6	46.1	51.9	54.4
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.0	45.4	48.4	49.6	50.2
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.1	31.2	32.3	33.8	34.7
Asset quality									
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	35.0	37.8	39.1	42.2	43.3
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.6	4.8	4.9	4.9	5.7
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	13.0	12.7	12.4	11.6	13.2
Provisions to non-performing loans	59.2	63.2	65.0	73.5	80.4	80.5	82.3	83.6	76.7
Profitability									
Return on equity	-2.1	3.0	11.5	5.6	10.9	9.3	10.5	9.4	8.6
Return on assets	-0.4	0.5	2.0	1.1	1.9	1.6	1.8	1.6	1.3
Foreign currency assets and liabilities									
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	48.2	48.3	50.6	51.0	51.8
Foreign currency denominated assets in total assests	40.2	40.8	40.5	40.9	40.7	41.3	41.9	44.7	44.2
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	40.3	39.1	43.1	44.7	46.3
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	43.4	42.9	42.8	40.4	40.1

Source: National Bank of Moldova.

Table 6. Moldova: Indicators of Fund Credit, 2009–20 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projection							
Fund obligations based on existing credit												
(millions of SDRs)												
Principal	9.7	5.5	3.9	10.5	14.2	14.8	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.3	1.4	2.3	2.1	1.8	1.4	1.0	0.6
Fund obligations based on existing and prospective credit												
Principal	9.7	5.5	3.9	10.5	14.2	14.8	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.3	1.4	2.3	2.1	1.8	1.4	1.0	0.6
Total obligations based on existing and prospective credit												
Millions of SDRs	10.3	5.8	4.7	11.7	15.5	16.2	31.4	54.6	65.2	63.8	60.0	54.0
Millions of U.S. dollars	15.8	8.9	7.4	18.0	23.5	24.9	48.7	85.4	102.5	100.4	94.4	84.9
Percent of exports of goods and services	0.8	0.4	0.2	0.6	0.7	0.7	1.3	2.1	2.3	2.1	1.8	1.5
Percent of debt service 2/	18.1	11.9	8.5	19.7	22.5	25.2	46.9	59.2	51.1	45.0	39.4	32.0
Percent of GDP	0.3	0.2	0.1	0.2	0.3	0.3	0.6	1.0	1.1	1.0	0.9	0.8
Percent of gross international reserves	1.1	0.5	0.4	0.7	0.8	0.9	1.9	3.3	4.0	4.0	3.9	3.4
Percent of quota	8.3	4.7	3.8	9.5	12.5	13.1	25.5	44.3	52.9	51.8	48.7	43.8
Outstanding Fund credit based on existing and prospective credit												
Millions of SDRs	98.2	212.6	308.7	447.8	384.0	364.7	335.6	283.1	219.6	157.2	98.1	44.8
Millions of U.S. dollars	151.4	324.5	487.4	685.9	583.2	561.5	521.0	442.6	345.4	247.1	154.3	70.4
Percent of exports of goods and services	7.6	14.2	15.4	21.7	16.7	15.6	13.6	10.6	7.7	5.1	3.0	1.3
Percent of debt service 2/	172.8	435.0	556.8	750.1	558.7	569.0	501.2	306.8	172.0	110.8	64.4	26.6
Percent of GDP	2.8	5.6	6.9	9.4	7.3	7.4	6.4	5.1	3.7	2.5	1.5	0.6
Percent of gross international reserves	10.2	18.9	24.8	27.3	20.7	20.4	19.9	17.0	13.5	9.8	6.4	2.8
Percent of quota	79.7	172.6	250.6	363.5	311.7	296.1	272.4	229.8	178.3	127.6	79.7	36.3
Net use of Fund credit (millions of SDRs)	-9.7	114.5	96.1	89.5	-14.2	-14.8	-29.1	-52.6	-63.5	-62.5	-59.0	-53.4
Disbursements and purchases 3/	0	120	100	100	0	0	0	0	0	0	0	0
Repayments and repurchases	9.7	5.5	3.9	10.5	14.2	14.8	29.1	52.6	63.5	62.5	59.0	53.4
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	2,000	2,291	3,159	3,164	3,499	3,602	3,835	4,158	4,476	4,824	5,196	5,548
Debt service (millions of U.S. dollars) 2/	87.6	74.6	87.5	91.4	104.4	98.7	103.9	144.3	200.8	223.1	239.7	265.0
Nominal GDP (millions of U.S. dollars) 2/	5,438	5,813	7,018	7,283	7,935	7,628	8,109	8,686	9,242	9,803	10,428	11,199
Gross International Reserves (millions of U.S. dollars)	1,480	1,718	1,965	2,515	2,820	2,751	2,621	2,599	2,551	2,511	2,409	2,531
Average exchange rate: SDR per U.S. dollars	0.6	0.7	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Quota (millions of SDRs)	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2

Sources: IMF staff estimates and projections.

1/ Assume repurchases are made on obligations schedule.

2/ Total debt service includes IMF repurchases and repayments.

3/ In 2009, does not include Moldova use of the SDR allocation of SDR 114.3 million.

Annex I. External Stability Assessment

1. **Indicators relating to the external sector have substantially improved during the past three years, reflecting improved external environment and prudent macroeconomic policies.** Some degree of improvement in economic performance in trading partners, fiscal consolidation, exchange rate flexibility, on-going trade liberalization with positive impact on exports, have contributed to improvement in external sector performance. With improved current account position and appreciable capital flows, the NBM has been able to build up reserves, and measures of competitiveness and quality of business environment show some improvement. Important vulnerabilities remain, however, and point to the importance of maintaining macroeconomic stability and putting in place structural measures that would help raise potential economic growth.

2. **There is no evidence of significant exchange rate misalignment.** Although results from three CGER-type methodologies suggest that the leu could be slightly overvalued, competitiveness appears broadly adequate. The macroeconomic balance approach points to a slight overvaluation in the range of 2.3 to 4.6 percent, as the underlying current account (7.7 percent of GDP) exceeds the norm (6.4 percent of GDP)[1] by a small margin. The external stability approach also points to a moderate overvaluation in the range of 5.0 to 9.7 percent. Consistent with the other two approaches, the equilibrium real exchange approach points to a moderate overvaluation of 6.9 percent. This mild overvaluation does not appear to affect external competitiveness, as strong export performance has been sustained.[2]

Moldova: Estimates of overvaluation of the Leu

Approach	Estimated overvaluation (Percent)
External sustainability	5.0 to 9.7
Macro balance	2.3 to 4.6
Equilibrium exchange rate	6.9

Source: IMF staff estimates.

[1] The current account norm is arrived at by evaluating the estimated panel regression model at medium run projections of its explanatory variables, while the underlying current account balance is equated to its medium run projection.

[2] Estimates of medium run export elasticity (-0.71 and -1.60); estimates of import elasticity (0.92 and 0.99). Export and import shares are set at 47 and 80 percent, respectively, as projected for 2019.

3. **Comprehensive reforms implemented during the past three years have contributed to some improvement in competitiveness and the business environment**.[3] Moldova's ranking in doing business report improved from 81 out of 189 countries in 2012 to 78 in 2013 and its ranking with respect to global competitiveness index was broadly stable during the same period. Despite moderate improvement, significant challenges remain. According to World Economic Forum, corruption, policy instability and access to finance constitute the most important impediments to doing business in Moldova. Structural reforms that focus on these areas, in the context of implementation of the Association agreement with the EU, would help with enhancing the competitiveness of the economy, with positive impact on economic diversification and employment generation.

Moldova: Position in International Rankings

Survey	Global Competitiveness Index	Doing Business Ranking[1]
Publisher	World Economic Forum	World Bank
Position in 2008	95 out of 134	108/103 out of 181
in 2009	n/a[2]	87/94 out of 183
in 2010	94 out of 139	99/90 out of 183
in 2011	93 out of 142	81 out of 183
in 2012	87 out of 144	81 out of 189
in 2013	89 out of 148	78 out of 189

[1] The survey updates methodology each year and recalculates the previous year ranking. The table shows new/old ranking.
[2] Moldova was excluded from ranking because of lack of data.

4. **A metric-based approach, which focuses on potential balance of payments pressures, point to the adequacy of reserves.** Other traditional measures of reserve adequacy support the conclusion reached with the use of metric approach. As at end–2013, measures of reserves adequacy outperformed the levels envisaged in the 2012 Article IV consultation.

Reserve Adequacy Measures

	2009	2010	2011	2012	2013	2014	2015
Gross official reserves (millions of U.S. dollars) 1/	1480.3	1717.7	1965.3	2515.0	2820.1	2751.3	2620.9
Months of imports of good and services	3.9	3.4	3.9	4.7	5.0	4.7	4.3
Percent of short-term debt at remaining maturity	88.6	91.3	90.2	106.7	104.2	99.8	89.3
Percent of short-term debt at remaining maturity plus current account deficit	66.3	62.0	70.2	89.2	82.9	77.9	69.8
Percent of the IMF composite measure (fixed)	115.6	118.0	120.8	139.4	136.8	129.7	116.5
Percent of the IMF composite measure (flexible)	156.1	159.0	163.6	196.4	191.7	182.3	165.4

Sources: Moldovan authorities; and IMF staff estimates and projections
1/ Includes revaluation changes, which were not captured by changes of gross official reserves in the BOP.

[3]These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage and standardized assumptions on business constraints and information availability.

Annex II. Spillover Assessment

Moldova continues to face high geographic concentration of its exports and private transfers constitute a significant source of financing for trade deficit. Because of its trade, remittances and financial linkages, Moldova's business cycle is synchronized with its trading partners. While improved fiscal and external positions have helped to put the Moldovan economy in a better position to conduct some countercyclical policies, it is critical to continue with prudent macroeconomic management that would aid with further enhancing fiscal and external buffers.

Stylized Facts on the Balance of Payments

1. **Over the last two decades, the Moldovan economy was hit by several external shocks emanating from trading partners and global developments,** including the Russian Crisis in 1998, food and fuel shocks in 2007–08, and the global financial crisis and the accompanying recession in 2008–09). The potential channels through which external shocks could impact on the Moldovan economy include trade, remittances, net capital inflows (including FDI). In addition, macroeconomic conditions in donor countries tend to play a key role in official aid flows.

2. **There has been significant geographical concentration of exports and imports, with moderate improvement in diversification.** Close to 40 percent of exports were destined to CIS countries during 2003–08, with Russia receiving 45 percent of this amount, Ukraine (28 percent), and Belarus (16 percent). During the same period, about 51 percent of total exports were shipped to the EU, with Romania, Italy, and Germany being the main trading partners. This is the result of continuous liberalization of trade between Moldova and the EU, including the granting of unilateral trade preferences to Moldova and the autonomous trade preference. The implementation of the Deep and Comprehensive Free Trade and Association Agreements with the EU is expected to produce enhanced export performance, and more product and geographical diversification in the medium to long term. The same main trading partners for exports, plus Turkey and China, are the main sources of imports to Moldova (Figure AII.1). Food dominates exports, while industrial products constitute the major share of imports.

3. **Large-scale labor emigration and the associated workers' transfers have contributed to shaping Moldova's economic landscape**. The rising trend in remittances and compensation of employees started on the back of the 1998 regional crisis, which encouraged a process of large-scale emigration. In 2003–08, remittances averaged about 29 percent of GDP and fell considerably during 2009–10, contributing to marked reduction in domestic demand and real GDP growth. As economic conditions in the source for countries for remittances improved, remittances

also increased and there was a sustained increase in output. Russia constitutes a significant source of remittances to Moldova and such a significant concentration comes with high exposure to developments in Russia (Figure AII.1).

Figure AII.1. Moldova: Geographical Patterns of Trade and Remittances

Structural Vector Autoregression

4. **The spillovers of external growth shocks on Moldova's economy and their transmission are quantified using impulse responses from a structural VAR (SVAR) model.** The VAR includes four domestic macroeconomic variables (real GDP, real effective exchange rate (REER), export volume, and private personal transfers (remittances and compensation of employees-to-GDP ratio) and an external activity variable, proxied either by an export-weighted average of Moldova's main trading partners' real GDP or by Russia's real GDP.[1] Structural shocks to the external activity variable are identified by a Cholesky decomposition, assuming that the external activity variable is contemporaneously exogenous to Moldova's economy. Furthermore, due to the small size of Moldova's economy, Moldova's variables are assumed to have no impact on external activity, not only contemporaneously but also with lags.

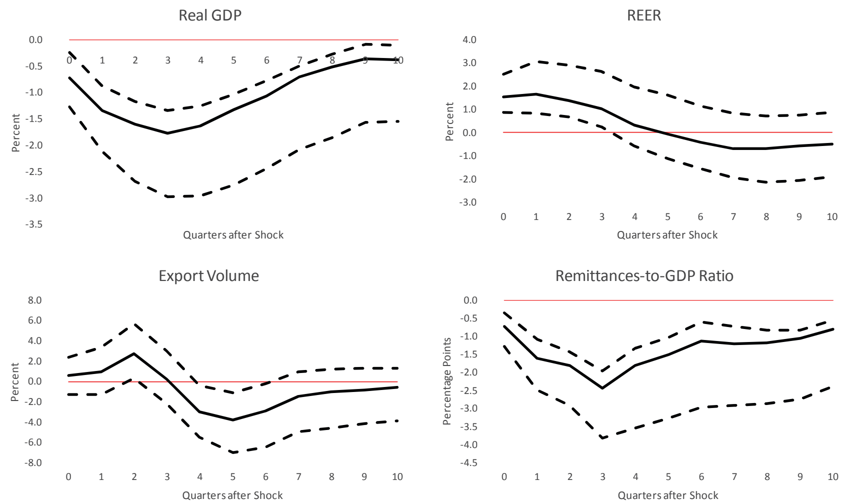
5. **Impulse response analysis suggests that external activity shocks have a sizable and lasting impact on Moldova's GDP.** A negative one-standard deviation shock to the level of Moldova's main trading partners' GDP (corresponding to a decrease of 0.8 percent) decreases Moldova's real GDP by about the same amount, namely by 0.7 percent on impact and by about 1.8 percent after three quarters. As shown in Figure AII.2, the impact is not only sizeable, but also long-lasting. The output collapse that Moldova experienced during the recent global financial crisis is evidence for this empirical result. As expected, after a negative activity shock abroad, Moldova's REER appreciates initially by about 1.5 percent. While exports' response on impact is not statistically significant, they decrease by about 4 percent a year after the shock. Remittances decline immediately, lowering remittances-to-GDP ratio by about 0.7 percentage points (pp) and reaching the maximum decline of 2.5 pp by three quarters after the shock.

6. **Given Russia's dominant role as Moldova's main trading partner and recent regional developments, the above SVAR framework is employed to analyze spillovers from a shock to Russia's GDP.** Figure AII.3 highlights that a negative one-standard deviation shock to Russia's real GDP (corresponding to -1.1 percent) would lead to a decrease of Moldova's GDP by half of the initial shock size, namely by 0.6 percent on impact. Moldova's GDP response reaches its dip of 1.5 percent two quarters after the shock. Impulse response analysis suggests that a negative shock to Russia's

[1] All variables except for remittances-to-GDP ratio are expressed in logarithms. The model is estimated using quarterly data (seasonally adjusted) for the period 2000Q1-2013Q2 with four lags. The data sources are IMF's Word Economic Outlook and Global Economic Environment Databases, Moldova's National Bureau of Statistics and National Bank. Variables were selected to determine the role of real sector linkages (exports and remittances) in transmitting exogenous activity shocks to domestic real activity (real GDP) and competitiveness (REER). While most conventional tests (Akaike Info and Schwarz Criteria) suggested including eight lags, four lags were chosen as a natural choice for quarterly data and also given the sample size.

GDP transmits to Moldovan economy faster and through the remittances rather than export channel. Remittances-to-GDP ratio decreases by about 2 pp already one quarter after the shock. Moldova's total exports are not found to be statistically significant, possibly due to the small size of Moldova's share in total Russia imports.

Figure AII.2. Moldova: Dynamic Responses of Domestic Variables to a Shock in Trading Partner's GDP 1/

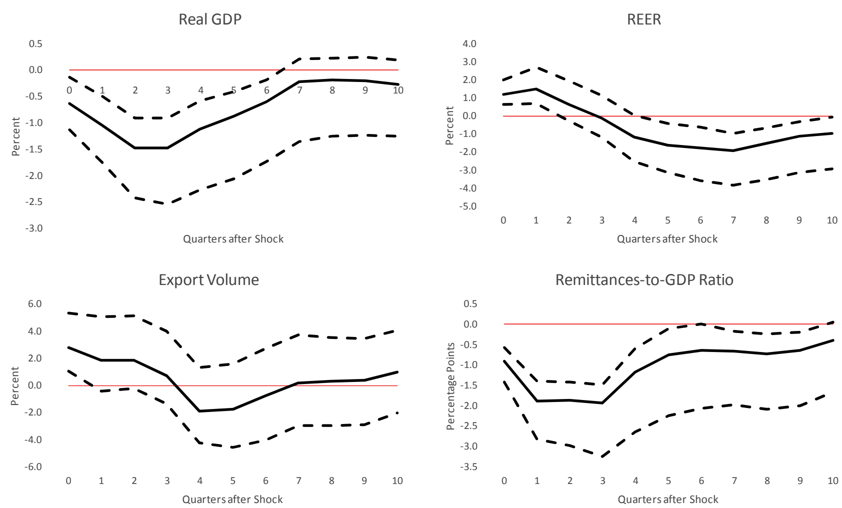


1/ Responses to a one-standard deviation shock to Moldova's trading partner's GDP (-0.8 percent).

Dashed lines correspond to 90 percent confidence intervals.

Source: IMF's staff estimates.

Figure AII.3. Moldova: Dynamic Responses of Domestic Variables to a Shock in Russia's GDP 1/



1/ Responses to a one-standard deviation shock to Moldova's trading partner's GDP (-1.1 percent).

Dashed lines correspond to 90 percent confidence intervals.

Source: IMF's staff estimates.

Application of the VELIC[2]

7. **Moldova's vulnerability to growth crisis has improved compared to the period before the global financial crisis and associated great recession**. The GDVI points to increasing risks of a sudden growth declines in the periods before the advent of the crisis, reflecting weak macroeconomic fundamentals (Figure AII.4). The index, however, appears to suggest an improved economic situation and improved ability to avoid growth collapse, emanating from enhanced fiscal and external sectors performance in recent years. The improvement in fiscal position combined with enhanced external buffers has helped to reduce inherent vulnerabilities to a sudden decline in growth, emanating from external shocks.

8. **A reduction in global growth by about ½ percentage point in 2014 would reduce Moldova's growth by close to 0.3 percent**[3]. The main transmission mechanisms are trade of goods and services (arising from reduced external demand and remittances) and lower FDI. The initial deterioration in the current account position, however, is mitigated by lower imports due to reduced growth and lesser energy costs. The lower output growth, on the other hand, results in higher fiscal deficit and debt, culminating in reduced fiscal space.[4] Incorporating fiscal adjustments yield less deterioration in fiscal indicators compared to no-adjustment scenario.

Conclusions and Policy Recommendation

9. **The Moldovan economy faces the challenges of few export products destined to small number of countries and further efforts are required to ensure economic transformation and diversification**. Trade deficit persists and it is being financed largely by private transfers, which shows the dependency of Moldova on the external environment. A key lesson that emerges from the analysis is the criticality of continuing with prudent macroeconomic policy that would aid in further strengthening fiscal and external buffers, thereby enhancing the resilience of the economy to external shocks, to which Moldova is highly exposed. A more regionally diversified trade structure

[2] The VELIC is a quantitative tool for identifying emerging risks and vulnerabilities in low-income countries (LICs). The recent round of the exercise, including summary results and methodologies are in Low-Income Countries Global Risks and Vulnerabilities Report (SM/13/257). For a comprehensive discussion on GDVI, see Dabla-Norris, E., and Y. Bal Gündüz, 2014, "Exogenous Shocks and Growth Crises in Low-Income Countries: A Vulnerability Index", *World Development*, Vol.59, pp.360-378.

[3] The scenario is based on four main drivers, a slightly weaker recovery in the US, a much more subdued recovery in the euro area, emerging market economies not recovering back to their pre-crisis growth paths, and a slightly less successful implementation of Japan's three-pronged recovery strategy.

[4] Fiscal space is calculated as the difference between the observed primary balance and the primary balance that, if maintained at the same level every year, would enable the country to achieve a specified public debt target by 2030.

would help to reduce Moldova's current vulnerabilities to economic developments in a few trading partners.

Figure AII.4: Moldova: Key Fiscal and External Variables: Baseline, Passive and Policy Adjustment to Shock Scenarios

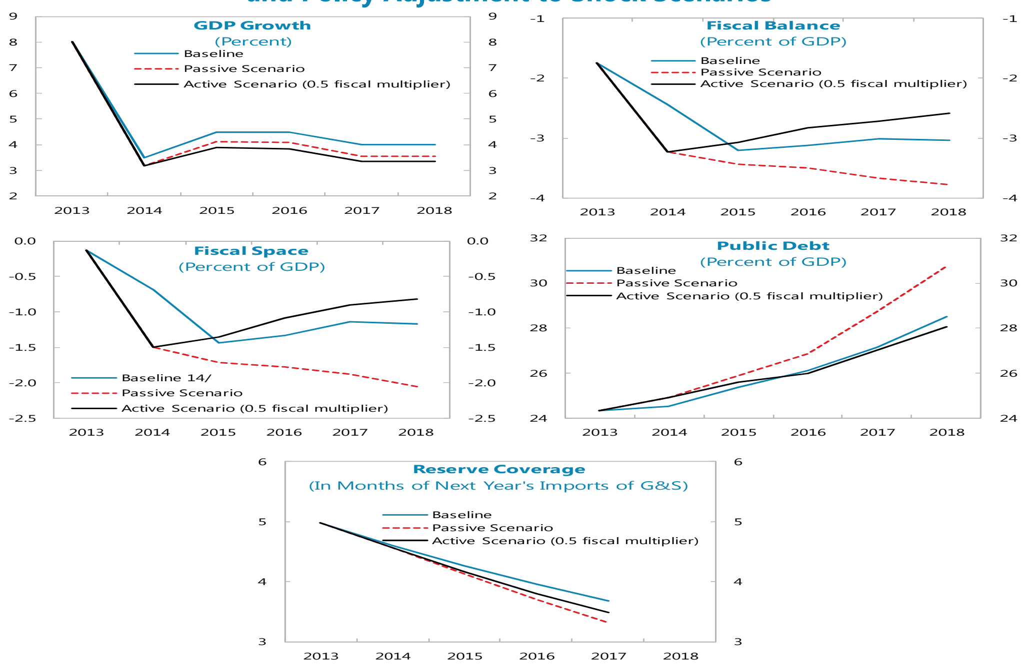
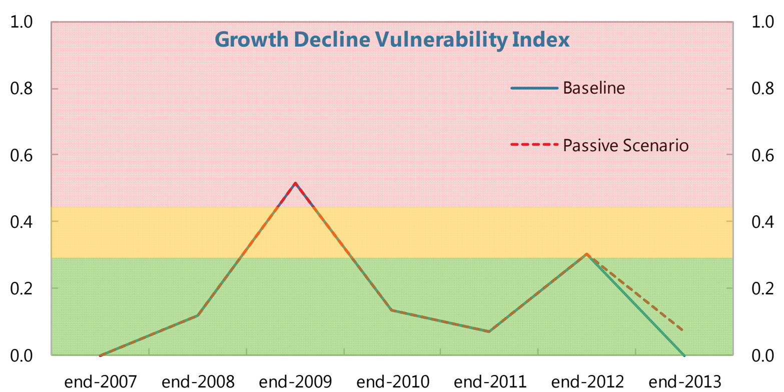


Figure AII.5: Moldova: Growth Decline Vulnerability Index



Source: IMF staff estimates.

Annex III. Key Findings and Recommendations of the FSAP

The recent FSAP update mission found that risks to systemic financial stability are significant.[1] Despite some progress in addressing the recommendations of the 2008 FSAP update and the satisfactory reported performance of banks, there are serious governance problems in several banks, including the largest ones, the ability of the regulators to take action is constrained, and the crisis management framework is weak.

Key Findings

- Moldova has taken several initiatives to address recommendations of the FSAP update of 2008. New regulations and instructions were issued in key supervisory areas, for example on asset classification of banks or bank capital adequacy. The NBM's quantitative analysis of banks was improved. A National Committee for Financial Stability (NCFS) was set up in 2010 to bring together key stakeholders in financial system stability.

- However, many important weaknesses remain. Considerable caution is needed in regard to the relatively benign performance indicators of banks. Ultimate beneficial ownership of several large banks has been actively concealed, which may disguise credit to related parties and large exposures. The latter already exceed regulatory norms by a wide margin in some banks. The liquidity position of some banks may also be worse than reported since some assets may be encumbered through undisclosed side agreements. In general, governance structures and internal oversight processes are not well developed, blurring the roles and responsibilities of owners and managers, and so put at risk safe banking operations.

- The FSAP stress test results showed that credit risk losses on the loan book represent the most important factor for the banking system. Potential credit risk losses were estimated to reach MDL 5 billion (or 7½ percent of GDP) under the most-stressed scenario. Market risk losses were not found significant since most bank loans are issued at floating interest rates, net open foreign exchange positions of banks are very small, and trading instruments are negligible in banks' investment portfolios.

- The regulatory framework for banks and non-bank financial institutions has a number of shortcomings. The ability of the National Bank of Moldova (NBM) and the National

[1] The FSAP update mission took place in February 2014. The previous FSAP update was conducted in 2008.

Commission for Financial Markets (NCFM) to enforce regulations has been seriously hampered by a series of court challenges. There is inadequate legal protection for supervisory staff. Even allowing for the legal constraints, the NBM has on some occasions failed to take corrective actions when faced with serious or persistent infringements by the banks.

- The crisis management framework is weak. The NCFS lacks focus and is not forward looking. There is little evidence of contingency planning and testing of processes and powers. Coordination between the member agencies is limited. There are also significant gaps and deficiencies in the statutory powers required for cost-effective bank crisis resolution. Several aspects of the deposit insurance scheme require strengthening, for example, a back-up funding facility for the Deposit Guarantee Fund should be put in place.

Key Recommendations

- *Financial Stability Framework.* Amend the Law on NBM and Law on NCFM, and other legislation as required, to provide NBM and NCFM with the ability to enforce supervisory and regulatory actions in a timely manner (addressing, for instance, problems ensuing from the Constitutional Court rulings of October 2013).

- *Bank Governance.* Re-evaluate bank shareholders to ensure disclosure of ultimate beneficial owners.

- *Banking Supervision.* Amend the Law on NBM to provide full legal protection to all NBM employees in case of lawsuits for action in good faith.

- *Crisis Resolution.* Develop a comprehensive financial crisis resolution contingency plan, and identify necessary amendments to the legislation.

- *Deposit Insurance System.* Enhance funding of the deposit Guarantee Fund (DGF) by developing a target fund methodology; amending legislation to provide a line-of-credit to the DGF from the Ministry of Finance; and amending the Law on DGF Law and Law on NBM to include the NBM as an additional source of back-up funding for the DGF.

- *Financial Market Infrastructure.* Develop a comprehensive risk management framework for the National Securities Depository.

Annex IV. Addressing Medium-Term Fiscal Challenges

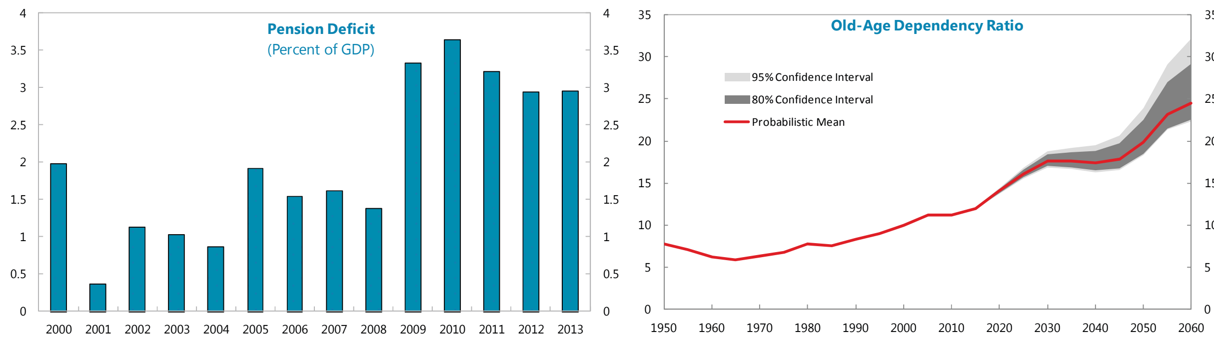
Moldova is facing significant risks associated with excessive fiscal decentralization and bourgeoning healthcare and pension spending. The authorities need to develop a new design of intergovernmental relations that would empower subnational governments without endangering fiscal discipline at the national level, and to adopt parametric reforms to secure long-term sustainability of the healthcare and pension systems. In this context, the draft FRL and planned improvements to the local public finance law are welcome steps, seeking to anchor policy decisions to a sustainable path.

1. **While providing autonomy to subnational governments, fiscal decentralization must also create incentives for administrative rationalization.** Fiscal decentralization can lead to efficiency gains and is not necessarily detrimental to performance at the national level, as long as its design is not based primarily on transfers from the central government. If subnational governments have responsibility for financing their expenditures through own revenues, decentralization can improve the quality and delivery of public services. With 32 regions (*rayons*) and over one thousand municipalities, the existing model in Moldova, however, has become highly inefficient, with a large number of subnational governments spending most of their resources on personnel and being dependent on transfers from the central government to deliver services. Accordingly, the authorities need to develop a new design of intergovernmental fiscal relations that would explicitly incorporate the principles of accountability and transparency and empower subnational governments without endangering fiscal discipline at the national level.

2. **Moldova's pay-as-you-go pension system is already on a financially unsustainable path and will face even greater demographic pressures over the longer term.** Following a 20 percent increase in pension benefits in 2009 and a supplementary pension payment granted in 2013, the social security deficit increased from 1.4 percent of GDP in 2008 to 3 percent in 2013. With the planned doubling of supplemental pension payment to about 600,000 pensioners, the pension deficit is projected to widen to 3.6 percent of GDP in 2014 and 3.8 percent in 2015, raising concerns about its sustainability over the medium term. The main problem is the dependency ratio—the number of contributing workers to pensioners—that stands at 1.3, compared to a financially sustainable rate of at least 4. Labor migration has led to a substantial decline in the workforce, and the dependency ratio is projected to further decline. Although the replacement rate—the ratio of average pension to average wage—is very low (28 percent, compared to an average of 43 percent in CEE/CIS countries), as a result of the aging population and high migration, pensioners already account for 20 percent of the country's population. In addition, the retirement age—62 years for

men and 57 years for women—is relatively low, compared to other countries. Although the contribution rate is at a level comparable to other countries, reported contribution-liable earnings are low and various groups, such as self-employed and farmers, are allowed to make flat social security contributions established at a level that translates into a contribution base significantly below the average wage.

Figure AIV.1. Moldova: Social Security System and Demographic Pressures



Sources: Ministry of Finance; and United Nations, Department of Economic and Social Affairs.

3. **A comprehensive reform agenda is necessary to offer socially-acceptable benefits, while ensuring long-term sustainability.** In order to increase pension benefits to a socially-acceptable level and to secure long-term sustainability of the pension system, a number of parametric reforms are needed: (i) no further ad-hoc increases in pension benefits; (ii) raising male and female retirement ages to 65, with indexation to advancements in life expectancy, to make any increase in benefits affordable; (iii) linking pension contributions by self-employed and farmers to the level of income declared for tax purposes, rather than an arbitrary minimum; and (iv) improving the compliance rates in terms of contribution to the pension system.

4. **Developing a rules-based fiscal framework would anchor policy decisions to a sustainable path.** The draft FRL contains important elements to strengthen the medium-term fiscal framework, including a fiscal policy rule defined as a general government budget deficit target of 3 percent of GDP excluding foreign-financed projects. Although the adoption of a binding fiscal rule—with escape clauses that require the correction of any deviation from the rule within three years—is encouraging, the proposed rule is too loose and not compatible with a level of the budget deficit that is sustainable over the medium term. For example, under the proposed rule, the overall budget deficit including foreign-financed projects would have been 5.8 percent of GDP in 2013. Furthermore, without sound counter-cyclical properties, it would make fiscal policy more procyclical and lead to excessive volatility in government spending.

5. **A fiscal rule should link fiscal policy to the objective of sustainability and behave in a countercyclical manner under normal macroeconomic conditions.** The draft FRL could be strengthened to provide better guidance for fiscal policy and medium-term planning. First, the proposed fiscal rule does not have an explicit link to public debt sustainability. Second, an overall budget balance rule alone would not constitute an appropriate fiscal policy stance over the economic cycle, and therefore would not help reduce spending volatility in the absence of an appropriate constraint on expenditures. Third, while an overall budget deficit target excluding foreign-financed projects helps isolate the fiscal aggregates on which the government has more policy control, the exclusion of such capital expenditure from the rule's coverage may distort budgetary classification and might not be consistent with the objective of aggregate demand management.

6. **The proposed fiscal rule can be fine-tuned to have countercyclical properties with a more explicit reference to public debt sustainability.** Although a structural fiscal balance target would provide an operational guideline for policymakers to formulate and maintain a countercyclical stance, its calculation is a challenging exercise. Accordingly, in view of capacity constraints in implementation, staff recommends a fiscal policy rule defined as a general government budget deficit of 2½ percent of GDP excluding grants together with an expenditure rule that limits the annual growth rate of total expenditures excluding targeted social assistance to potential GDP growth (which could be estimated using an econometric model or simply defined as, for example, a 10-year average). In view of the country's large infrastructure needs, the medium-term fiscal objective could in principle be relaxed to accommodate productivity-enhancing investment projects if financing on reasonable terms is secured, and the additional investment is consistent with the economy's absorption capacity.

7. **A fiscal policy rule needs to have sufficient flexibility to respond to shocks, while being supported by explicit enforcement procedures and corrective mechanisms.** The FRL should provide clarity in escape clauses, particularly in terms of the range and size of shocks, with an unambiguous guideline on the interpretation and determination of events such as natural disasters, to prevent unwarranted deviations from the fiscal rule. In addition to escape clauses, the FRL could have specifics on adjustment mechanisms and modalities of their enforcements when ceilings/floors are missed. Finally, the authorities should consider appointing an independent fiscal council with a mandate to evaluate ex post compliance with the fiscal rule and to assess macroeconomic forecasts and proposed fiscal policies, which would foster greater transparency and buttress credibility of the fiscal rule.

Annex V. National Development Strategy—Moldova 2020

The National Development Strategy (NDS)—known as "Moldova 2020"—was approved by the Parliament of the Republic of Moldova on July 11, 2012 and officially published on November 30, 2012. While the NDS provides a good basis for inclusive growth, its implementation will be key.

1. **The NDS unifies in one document the government's poverty reduction strategy and a vision of long-term sustainable economic development**. It appropriately aims at a shift from the current consumption-based growth model towards one based on raising investment and increasing productivity and competitiveness.

2. **The NDS presents a selective medium-term strategy that focuses on seven national development priorities:** (1) aligning the education system to labor market needs; (2) increasing public investment in national and local road infrastructure; (3) reducing financing costs by increasing competition in the financial sector and developing risk management tools; (4) improving the business climate, promoting competition policies, streamlining the regulatory framework and applying information technologies in public services for businesses and citizens; (5) reducing energy consumption by increasing energy efficiency and using renewable energy sources; (6) ensuring financial sustainability of the pension system; and (7) increasing quality and efficiency of justice and fighting corruption.

3. **While the NDS provides a good basis for inclusive growth in Moldova, special attention should be given to the following areas for its implementation and strengthening**. (i) *Business environment*. Priority should be given to improving corporate governance in the financial sector and the broader economy. In this regard, reform of the judiciary is essential to protect investors and foster investment. (ii) *Physical infrastructure development*. Priority should be given to investment in energy, telecommunications, transportation, water, and sanitation infrastructure, possibly with private sector partnerships. (iii) *Human resource development*. The NDS should ensure that the educational system is aligned with European standards and is responsive to labor market needs. Improving incentives to health care providers to both increase efficiency and deliver quality health services will be critical in Moldova's efforts to meet the MDGs. (iv) *Public administration reform*. Greater emphasis on civil service management reform is key to the success of other reforms. (v) *Monitoring and evaluation*. The successful implementation of the NDS will critically depend on continued efforts to strengthen the monitoring framework and capacity of key line ministries to develop and implement annual action plans, and integrate these actions into the medium-term expenditure framework.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

June 5, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS—INFORMATIONAL ANNEX

Prepared By

The European Department (in consultation with other departments and the World Bank)

CONTENTS

FUND RELATIONS

(As of April 30, 2014)

Membership Status: Joined August 12, 1992; Article VIII

General Resources Account:	**SDR million**	**Percent of Quota**
Quota	123.20	100.00
Fund holdings of currency	272.32	221.04
Reserve tranche position	0.01	0.00

SDR Department:	**SDR million**	**Percent of Allocation**
Net cumulative allocation	117.71	100.00
Holdings	2.25	1.91

Outstanding Purchases and Loans:	**SDR million**	**Percent of Quota**
ECF arrangements	230.43	187.96
Extended arrangements	149.12	121.04

Latest Financial Arrangements:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
ECF	1/29/2010	1/28/2013	184.80	170.88
EFF	1/29/2010	1/28/2013	184.80	149.12
ECF[1]	5/5/2006	5/4/2009	110.88	88.00

[1] Formerly PRGF.

Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal	14.81	29.10	52.54	63.47	62.46
Charges/Interest	1.36	2.30	2.09	1.76	1.38
Total	16.17	31.40	54.63	65.23	63.85

Safeguards Assessments:

An update safeguards assessment of the National Bank of Moldova (NBM) conducted in the context of the ECF/EFF arrangements approved by the Board on January 29, 2010 was completed on June 3, 2010. The assessment found that the NBM had strengthened its safeguards framework since the May 2006 assessment by implementing the majority of the related recommendations. However, the update assessment noted the need for independent oversight of the bank and also recommended changes to the central bank's law to strengthen governance and the framework for lending to local banks. The authorities agreed with the findings of the update assessment, but implementation of these recommendations to address the remaining weaknesses remains outstanding.

Exchange Arrangements:

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 is classified as "floating". The NBM intervenes in the domestic foreign exchange interbank market in order to smooth out sharp exchange rate fluctuations of the Moldovan leu against the dollar. At the same time, the NBM interventions are not aimed at changing the trend of the exchange rate determined by the market. The NBM publishes the information on its interventions.

The official exchange rate of the Moldovan leu to the U.S. dollar announced by the NBM is determined as the weighted average of daily noncash market transactions performed on the interbank and intrabank market. 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 between the U.S. dollar and these currencies.

Article IV Consultations:

The previous Article IV consultation was concluded on September 28, 2012. The staff report (Country Report No. 12/288) was published.

FSAP Participation:

Moldova received an FSAP mission in May 2004; the FSSA (Country Report No. 05/64) was presented to the Board at the time of the 2004 Article IV discussions. An FSAP update mission visited Moldova in October 2007; the FSSA update (Country Report No. 08/274) was presented to the Board with the 2007 Article IV Consultation report. A second FSAP update mission visited Moldova in March 2014; the FSSA update is being presented to the Board with the 2014 Article IV Consultation report.

Resident Representative:

Ms. Armine Khachatryan assumed her duties as Resident Representative in August 2013.

Technical Assistance Provided by the Fund, 2011–14:

Department	Subject/Identified Need	Timing
FAD	PFM reforms	January 2011
FAD	Tax compliance strategy	February 2011
FAD	Expenditure rationalization	February 2011
MCM	Forecasting and policy analysis (a series of short-term missions by a TA advisor)	March 2011–ongoing
FAD	Tax policy	April 2011, March 2013
FAD	VAT issues	June 2011, December 2011
MCM	Crisis preparedness	April 2011, May 2012
FAD	Improving the Large Taxpayer Office	September 2011, January 2012,May 2012
LEG	Risk based approach to banking supervision and AML/CFT	September 2011
STA	Improvement of the consumer price index	November 2011, October 2012, November 2013
LEG	Banking law	December 2011
LEG	Legal framework for SOEs	November 2012
FAD	Medium-Term Budget Framework	January 2012
FAD	Taxation of high-wealth and high income individuals. large taxpayer compliance management	January, February, May 2012
STA	Improvement of fiscal data in line with GFSM 2001	March 2012
STA	Resident advisor on capacity building, national accounts, price and external trade statistics in the NBS	From April 2012
MCM	Analysis of the financial situation of a state-controlled bank	June 2012, January 2013
LEG/MCM	Securities clearance and settlement system	January 2013, September 2013
FAD	Taxation of agriculture	May 2013
MCM	Government bond market	April 2013
FAD	Revenue administration	February 2014
MCM/LEG	Bank resolution / contingency planning	March 2014

RELATIONS WITH THE WORLD BANK GROUP

(As of April 9, 2014)

1. Moldova's National Development Strategy (NDS)—Moldova 2020 sets seven strategic priorities. These are justice and fight against corruption; national education system aligned with labor market requirements; pensions; business environment; roads infrastructure; accessible and inexpensive finance; and energy efficiency. The NDS is intended to prioritize state interventions to deliver the overarching goal of bringing about qualitative economic development and poverty reduction. It was adopted by the Parliament as national law. The NDS and its consolidated action plan include some measures to reduce inequality and address key crosscutting themes, such as social inclusion and gender equality, environmental preservation, climate change and disaster events, and reintegration of localities from the left bank of the Nistru River (Transnistria).

2. Aligned with the NDS, the World Bank Group (WBG) Country Partnership Strategy (CPS) for FY14–17, discussed by the Board on September 5, 2013, will provide Moldova with US$570 million over the next four years (US$450 million on IBRD&IDA [International Bank for Reconstruction and Development & International Development Association, together known as the World Bank] terms, plus US$120 million IFC [International Finance Corporation] commitments). It will support Moldova in reducing poverty and boosting shared prosperity by capturing the full benefits of openness and integration with the European Union and the broader global economy. Three pillars are proposed, which will help Moldova diversify and expand its endowment of institutional, human, and natural capital:

- *Increasing Competitiveness*: continued institutional reforms for a business enabling environment and governance, access to finance, transparency in the financial sector, and targeted activities to help improve companies' competitiveness are needed to reduce barriers and to translate economic openness into concrete benefits of more jobs and higher income.

- *Enhancing Human Capital and Minimizing Social Risks:* the widening gap with EU28 in education and health outcomes needs to be progressively closed. Demographic challenges need to be addressed, and vulnerabilities can be tackled by strengthening social protection systems.

- *Promoting a Green, Clean and Resilient Moldova:* the debilitating effects of climatic events on agriculture and rural livelihoods need to be addressed, natural resource management improved, and energy security and efficiency achieved to ensure sustainable development.

3. The CPS has governance and gender lenses, and a calibrated engagement in localities from Transnistria will be considered in close consultation with the authorities of the Republic of Moldova.

4. This CPS continues to address governance issues at the country, sectorial and operational levels across the strategy. Interventions will be pursued to improve the business enabling environment; enhance public administration reform and quality of public service delivery; and improve public financial management and procurement systems. The CPS will use a governance

filter to ensure that governance is systematically tackled in all operations (analytical and advisory activities and lending); it will also support enhanced involvement of Civil Society Organizations through the Global Partnership for Social Accountability to which Moldova has opted in. At the operational level, WBG will ensure the highest fiduciary standards in projects it supports while helping the Government to strengthen country systems. This CPS is informed by a gender assessment, the outcomes of which will be discussed at the concept stage of each relevant new operation (analytical and advisory activities and lending).

5. The World Bank's current portfolio includes seven investment financing projects and one budget support operation. Total commitments amount to US$189.9 million. The disbursement ratio for FY14 so far is 27.9 percent (as of May 7, 2014), and was 34.1 percent at the end of FY13. The ongoing IDA portfolio is broad ranging, with the highest concentration of operations in human development and agriculture and rural development, as well as in the financial and private sectors. Trust Funds (TFs) provide co-financing to IDA operations, finance carbon operations, and provide other forms of support, including for Analytical and Advisory Activities. The size of the active TF portfolio is US$35.8 million.

6. Alongside IDA and IBRD resources, IFC operations in Moldova will continue to focus on investment and advisory activities that enable private sector growth and diversification. IFC plans an annual funding envelope of about US$30 million. IFC exposure as of June 30, 2013, was US$90.3 million in 18 clients across the financial, manufacturing, agriculture, telecommunications, water, and energy sectors.

7. The net exposure of MIGA in Moldova at the end of 2012 amounted to US$17.8 million in four projects. All projects are in support of foreign banks' subsidiaries in the country, including micro-finance organizations and leasing operations. MIGA's continuing support to these projects signals MIGA's efforts to underwrite projects in Moldova, encourage inward foreign direct investment, and add to the WBG's strategy of encouraging private sector development in the country.

STATISTICAL ISSUES

(As of May 12, 2014)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. Over the last several years, with technical assistance from the Fund the authorities have improved statistics in several areas, including national accounts, fiscal and monetary data, consumer prices, external trade and balance of payments. Technical assistance is ongoing in the area of price and national accounts statistics.
National Accounts: National accounts statistics are prepared by the National Bureau of Statistics (NBS) based on the concepts and methods of the 1993 *SNA System of National Accounts (SNA).* 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. Starting in January 2014, short-term activity indicators are re-classified according to CAEM Rev. 2. National accounts will be published according to CAEM Rev.2, starting in Q1 2015. Work is on-going to implement the *2008 SNA* and to further improve the compilation of quarterly and annual national accounts.
Price statistics: The NBS publishes monthly CPI and PPI data and began publications of the core CPI from 2010. The weights of the CPI basket are updated on an annual basis to reflect adjustment in consumer expenditures. On-going technical assistance has improved the reliability of the CPI weights and continues to work with the NBS to expand CPI coverage to include owner-occupied housing.
Government finance statistics: Moldova reports annual government finance statistics (GFS) based on *Government Finance Statistics Manual 2001 (GFSM 2001)* methodology for publication in the *Government Finance Statistics Yearbook (GFSY).* The data are on a cash basis and cover above as well as below the line operations and financial balance sheet of the general government sector. With the support of Fund TA, the authorities introduced regular dissemination of monthly *GFSM 2001* based data for the budgetary central government units.

Monetary statistics: Monetary and financial statistics are broadly in line with recommendations of the *Monetary and Financial Statistics Manual* and of a generally good quality. The NBM compiles and submits monetary data using Standardized Report Forms (SRFs). Monetary data are reported by the NBM on a regular basis and are being published in the *International Financial Statistics*. The NBM also report Financial Soundness Indicators (FSIs) on a quarterly basis, which are posted on the FSI webpage.	
External sector statistics: The compilation methodology follows the fifth edition of the Balance of Payments Manual. The transition to the sixth edition of the Balance of Payments Manual is planned for Q3, 2014. 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.	
II. Data Standards and Quality	
Moldova subscribed to the SDDS in May 2006. Participation in the GDDS began in February 2003.	A data ROSC report was published in March 2006.

Moldova: Table of Common Indicators Required for Surveillance

(As of May 12, 2014)

	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]	Memo Items: Data Quality – Accuracy and reliability[8]
Exchange Rates	5/12/2014	5/12/2014	D/M	D	D/M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/30/2014	5/08/2014	W/M	W	M		
Reserve/Base Money	04/30/2014	5/08/2014	W	W	M	O, LO, O, O	LO, O, O, O, O
Broad Money	04/30/2014	5/08/2014	W	W	M		
Central Bank Balance Sheet	04/30/2014	5/08/2014	W	W	M		
Consolidated Balance Sheet of the Banking System	04/30/2014	5/08/2014	W	W	M		
Interest Rates[2]	5/12/2014	5/12/2014	W	W	W		
Consumer Price Index	March 2014	4/10/2014	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	March 2014	4/22/2014	M	M	M	O, LO, LO, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	March 2014	4/22/2014	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/31/2013	1/24/2014	M	M	M		
External Current Account Balance	Q4 2013	03/27/2014	Q	Q	Q	LO, LO, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Feb 2013	4/15/2014	M	M	M		
GDP/GNP	Q4 2013	03/17/2014	Q	Q	Q	O, LO, LO, O	LO, O, LO, O, O
Gross External Debt	12/31/2013	03/27/2014	Q	Q	Q		
International Investment Position	12/31/2013	03/27/2014	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, state social security funds, and health insurance 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

REPUBLIC OF MOLDOVA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS—DEBT SUSTAINABILITY ANALYSIS

June 5, 2014

Approved By
Dhaneshwar Ghura (IMF), Jeffrey D. Lewis and Roumeen Islam (World Bank)

Prepared by Staff of the International Monetary Fund and the World Bank

Moldova's risk of debt distress remains low based on an assessment of its public external debt, but with a heightened overall risk of debt distress, reflecting vulnerabilities related to domestic debt and private external debt.[1] *This finding is in line with the previous DSA, which was conducted as part of the 2012 Article IV consultation.*[2] *In view of the country's vulnerability to growth shocks and potential contingent liability arising from recapitalization needs of the banking system, continued fiscal discipline is critical to ensuring sustainability. There are also risks related to the high external debt to GDP ratio, emanating largely from unusually high private debt for a low-income country.*

[1] This full DSA was prepared jointly by IMF and World Bank staff, in consultation with the Moldovan authorities, using the debt sustainability framework for low-income countries approved by the Boards of both institutions, and in accordance with the new staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292). The inclusion of the overall risk is in line with the new staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292). This assessment reflects the high level of external private sector debt.

[2] IMF Country Report for Moldova (No. 12/288).

BACKGROUND

1. **Moldova's total external debt at end–2013 was 84.4 percent of GDP compared to 82.4 percent of GDP at end–2012.** [3] Public and public-guaranteed (PPG) external debt decreased by about 1 percentage point and private external debt increased by 3 percentage points.[4] Moldova's PPG debt at end–2013 was about 30 percent of GDP compared to 31 percent at end–2011. PPG debt is mainly external (¾ of total) and held by multilateral and bilateral donors that hold 98 percent of PPG external debt. Domestic debt (¼ of total) is mostly short term and about 66 percent is held by the domestic banking system. In contrast, PPG external debt is mostly medium- and long-term, and the high level of concessionality of official borrowing helps keep the external debt service manageable.

2. **Private sector debt is high for a low-income country**. The stock of external private sector debt has increased in recent years, reaching US$4.9 billion as at end–2013, mostly due to increased trade credit and commercial loans. There has been rising external exposure of the banking system, mainly on a long-term basis, and bank's share of total private external debt reached about 8.7 percent by end 2013. Medium and long-term's share of total external private debt was about 55 percent as at end-2013. The majority of non-bank debt is short term, and consists of trade credits, arrears and other payments liabilities, mostly for the imports of natural resources.[5] Private borrowing in Moldova, similar to other CEE countries are extended mainly to foreign-owned companies from their parents abroad.

UNDERLYING ASSUMPTIONS

3. **The macroeconomic outlook has been revised to reflect changes in near- and medium-term projections compared to the previous DSA assessment**. In 2013, the Moldovan economy expanded at an above-trend pace with real GDP growth reaching 8.9 percent, on the back of the strong recovery in agricultural production after the previous year's severe drought. This year, however, GDP is expected to grow at 2.2 percent, mainly reflecting the anticipated slowdown in agriculture and weaker external environment. Inflation is projected to remain within the central

[3] The current DSA includes intra-company lending as private external debt. Previously, it was classified as foreign direct investment (FDI) on the presumption that it constituted a form of equity investment. As a result of this reclassification, the external-debt-to GDP ratio at end-2013 was 84.4 percent of GDP compared to near 71.9 percent projected in the 2013 Article IV report.

[4] PPG debt covers gross debt of the general government, while debts of state-owned enterprises are not included unless they are explicitly guaranteed by the government. As of September 2013, the government-guaranteed portion of SOE debt amounted to 0.1 percent of GDP, while the total amount of SOE debt, including external borrowing and domestic loans from commercial banks, stood at about 2.4 percent of GDP. In line with the DSA guidelines, public debt includes liabilities to the IMF. Small differences relative to the macro framework reflect primarily that DSA debt does not include arrears. Similarly, small differences in the primary surplus are because in the DSA it is calculated as the overall balance net of interest payments while in the macro framework tables it is calculated as the overall balance net of interest payments and earnings.

[5] The arrears are a long standing issue related to energy imports from Russia.

bank's target range as in the previous assessment. The external positions were stronger in 2012 and 2013 compared to the previous assessment, resulting in stronger external buffers. In this regard, the medium-term current account deficit is projected to be narrower than in the 2012 Article IV consultation. The fiscal position is not projected to improve as much as envisaged in the previous DSA. Over the medium–to long–term, the baseline scenario now assumes a lower potential and actual output growth (Box 1), reflecting departure from policies agreed under the previous Fund-supported program on fiscal and financial sector policies.

Evolution of Selected Macroeconomic Indicators, 2012-2017

(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017
Real GDP growth (Percent)						
Previous DSA 1/	3.0	5.0	5.0	5.5	5.3	5.3
Current DSA	-0.7	8.9	2.2	3.5	4.0	4.0
Nominal GDP (Billions of U.S. dollars)						
Previous DSA 1/	7.6	8.2	9.0	9.8	10.6	11.7
Current DSA	7.3	7.9	7.6	8.1	8.7	9.2
Overall fiscal balance						
Previous DSA 1/	-1.3	-1.1	-1.0	-0.9	-0.8	-0.8
Current DSA	-2.2	-1.8	-2.6	-4.6	-4.8	-5.1
Current account balance						
Previous DSA 1/	-12.2	-11.7	-10.9	-10.4	-9.9	-9.5
Current DSA	-7.7	-5.5	-7.4	-8.2	-8.1	-8.0

Sources: IMF Staff Estimates and calculations.

1/ See IMF Country Report No. 12/288.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

4. **All external public debt ratios remain well below the thresholds under the baseline and stress scenarios**. In the alternative scenario in which key variables remain at their historical averages (2013–2033), the present value of debt-to-GDP and remittances ratio would reach 21 percent compared to 13 percent under the baseline scenario. The present value of debt-to-exports and remittances as well as to revenue would also increase substantially. This result is an indication of the significant fiscal and external adjustments that have taken place in recent years. At the same time, it underscores the importance for Moldova of staying on the path of sound economic policies and reforms.

Box 1. Macroeconomic Assumptions behind the DSA

Real GDP increased by 8.9 percent in 2013 and is projected to grow at 2.2 percent in 2014 driven by the anticipated slowdown in agriculture. An expected recovery in FDI following the signing of the DCFTA with the EU as well as advances in structural reforms will help sustain the economy's potential growth rate at 4 percent in the medium term.

Inflation is expected to average 5½–6 percent in 2014–15, reflecting robust domestic demand combined with increased utility tariffs. Headline inflation is expected to be 5 percent over the medium to long term in line with the NBM' mid-target.

Exports are expected to be a key source of economic growth. They are projected to further increase in the medium term in line with the recent trends and supported by structural reforms to improve the business environment, reduce the costs of doing business and enhance the provision of infrastructure. As a result, exports of goods and services are projected to reach 49.8 percent of GDP in 2033 (compared with 44.1 percent in 2013).

Imports are projected to grow as well, underpinned by intermediate imports needed for the exports, though the decline in the growth of remittances would contribute to moderating the growth of imports. Imports as a ratio of GDP are projected at 84percent of GDP in 2033.

Remittances grew rapidly in 2012 and 2013 due to construction-related activities in Russia and the social challenges associated with drought in Moldova in 2012. The growth of remittances is envisaged to slow in the medium term. In the long term, also, as the economy develops, more employment options are available domestically, and migrants abroad lose ties with the home country, remittances are projected to decline relative to GDP.

The current account deficit is projected to narrow slightly in the medium term, following the projected deterioration in 2014 and 2015, emanating largely from marked slowdown in the growth of remittances and stabilize at about 7.7 percent of GDP. It will be financed by FDI that is expected to reach close to about 4½ percent of GDP in the long run.

The overall budget balance is projected to be a deficit of 2.6 percent of GDP in 2014 and to increase to 4.7 percent by 2019, under the baseline scenario. Over the long run (2020–2033), the primary budget balance is assumed to be an average deficit of 2.9 percent of GDP.

Financing assumptions reflect a gradual shift away from concessional financing. Grant equivalent financing is projected to decline from 2.1 percent of GDP in 2018 to 1.4 percent in 2033. At the same time, the grant element of new borrowing is projected to fall from 37 percent to 22 percent during the same period.

5. **While fiscal consolidation, higher exports, and significant levels of remittances should ensure adequate resources for external public debt service, risks still exist**.[6] While none of the indicators of debt service breaches the threshold, some liquidity pressures could emerge. Significant private external debt and its short maturity represent a risk in case roll-over-rates were to decline sharply. On the positive side, the improvement in the current account position in 2012 and 2013 has allowed the NBM to build-up reserves, enhancing the economy's resilience to adverse exogenous shocks.

B. Public Sector Debt Sustainability Analysis

6. **Public debt dynamics appear to be sustainable under the baseline scenario, but the level of PPG total debt is projected to increase over the medium term**. With the current set of macroeconomic policies outlined above, the primary budget deficit path is projected to be wider than the level that would stabilize the debt-to-GDP ratio. Accordingly, Moldova's PPG total debt is expected to increase from 29.8 percent of GDP at the end of 2013 to 39.4 percent by end–2018 and 54.5 percent by 2033. Other sustainability indicators confirm this negative long-term trend under the baseline scenario. The PV of debt-to-GDP is projected to increase from 24.2 percent in 2013 to 32.6 percent in 2018 and 49 percent in 2033, albeit below the benchmark level of 56 percent.[7] Similarly, the PV of debt-to-revenue and grants ratio is projected to deteriorate from 65.4 percent in 2013 to 89.4 percent in 2018 and 134.6 percent by 2033.

7. **Moldova's public debt trajectory appears to be particularly vulnerable to growth and primary balance shocks**. Although Moldova's risk of debt distress remains low under the baseline scenario, standard alternative scenarios presented in the DSA framework highlight a number of significant vulnerabilities. For example, a permanent one standard deviation in real GDP growth under the baseline scenario would increase the PV of debt-to-GDP to 58 percent by 2033 and 107 percent in 2033, breaching the 56 percent benchmark level. Therefore, while the DSA framework points to a low risk of debt distress over the period 2014–19, stress tests indicate that the debt sustainability is vulnerable to exogenous (growth) shocks and potential fiscal risks. These results underscore the importance of maintaining prudent fiscal policies over the medium term.

8. **Potential recapitalization needs of the banking system represent an additional risk for the PPG total debt**. If the cost of bank recapitalization were 10 percent of GDP, the stock of public debt would increase to 41.8 percent of GDP in 2014. Although the PV of debt-to-GDP would be 32.5 percent in 2014, it would increase to 52 percent by 2033, marginally below the benchmark level of 56 percent (see Table 2a, Bound Test 5).

[6] In Moldova, remittances are classified as either current transfers or compensation of employees. Both categories are included in the DSA (under "current transfers").

[7] See Revisiting the Debt Sustainability Framework for Low-Income Countries for a discussion of public debt benchmarks. Moldova's three-year average score on the Bank's Country Policy and Institutional Assessment (CPIA) is 3.77, which places the country at the upper-end of the medium policy performance category.

C. The Authorities' View

9. **The authorities concurred with the staff assessment, and agreed that the introduction of a rule-based fiscal policy framework would help alleviate risks.** The authorities acknowledged that the current fiscal position (as discussed with the IMF 2014 Article IV mission in April 2014) does not improve debt sustainability. As a response, they proposed to introduce fiscal rules to anchor fiscal policy and thereby ensure debt sustainability over the long term. The authorities also noted that short-term debt is mostly related to trade credits and indicated that the country's ambitious development plan requires a sustained increase in borrowing. In this context, they would like to develop a long-term debt management strategy with a focus on exploring alternative sources of financing while maintaining a sustainable debt level. As part of the strategy to develop the domestic debt market, the authorities pointed out that the Treasury has started issuing long-term government bonds and that the NCFM has approved the trading of government securities (with maturity over one year) on the stock exchange.

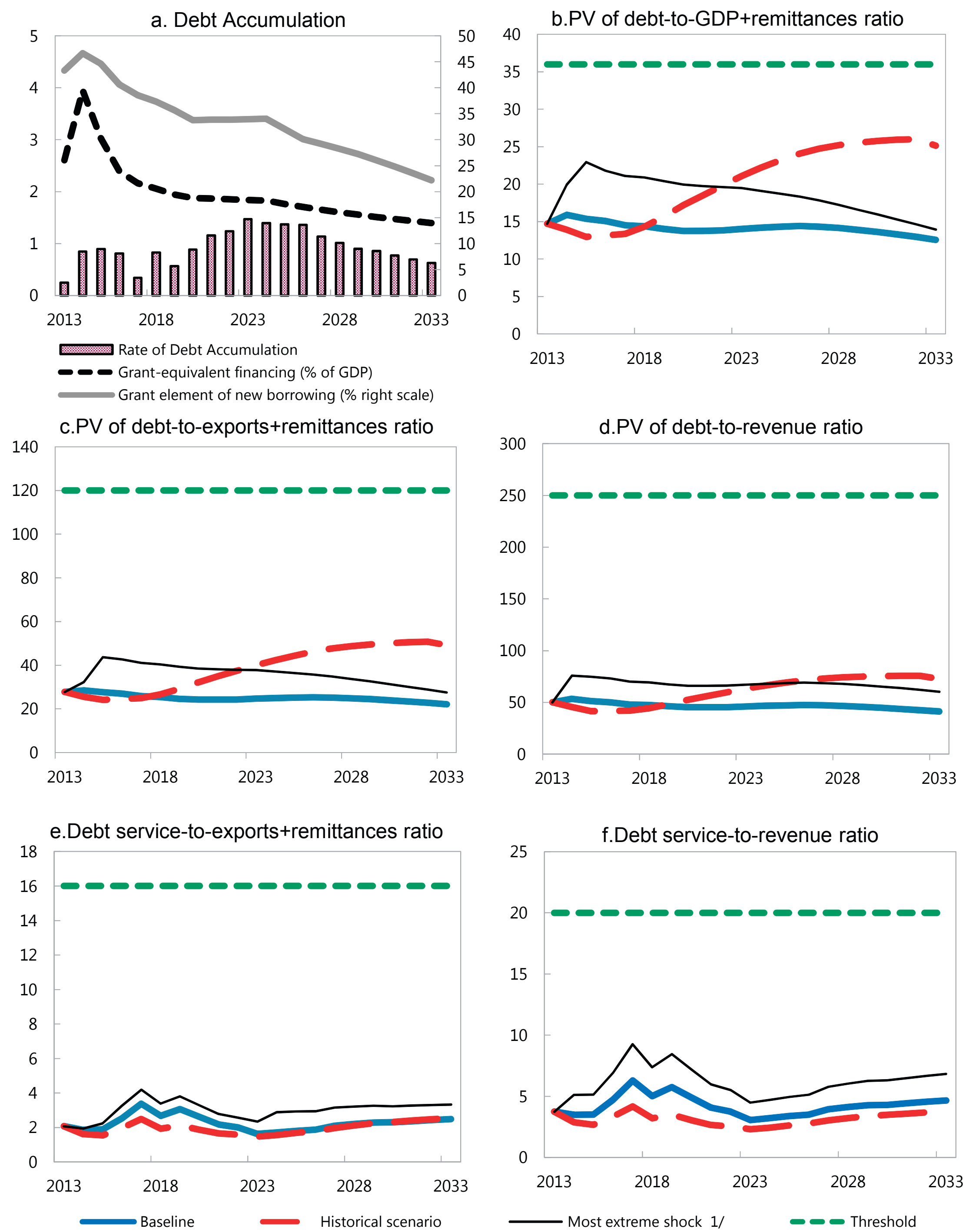
CONCLUSION

10. **The DSA indicates that Moldova's risk of debt distress remains low, in line with the 2012 assessment, but with heightened overall risk**. All external indicators for public debt remain well under the thresholds under the standard bound tests and alternative scenarios. However, significant private external debt poses roll over risks to debt sustainability. Similarly, although Moldova's public debt dynamics are projected to remain on a sustainable path under the baseline scenario, standard alternative scenarios presented in this assessment highlight particular sensitivity to assumptions on output growth and the path of fiscal policy.

11. **Pursuing prudent fiscal policy and advancing structural reforms are necessary to ensure debt sustainability**. In view of Moldova's sensitivity to exogenous developments, the debt sustainability critically depends on sound macroeconomic management and continued progress on institutional and structural issues that would help unlock the economy's growth potential and reduce its vulnerability to shocks. Furthermore, the limited development of the domestic debt market poses financing risks, especially considering the country's developments needs and significant dependence on foreign assistance in the form of grants and concessional loans. In this context, efforts to lengthen average maturity of domestic debt and deepen the secondary market would help reduce the PPG domestic debt rollover and interest rate risks.

12. **A reduction or reversal of trade credit and other private financial inflows could have an adverse impact on the economy**. A possible decline in banking sector liquidity in foreign countries or deterioration in banking sector confidence could lead to reduced availability of trade financing. In addition, deterioration in the economic conditions in Moldova's main economic partners—where the parent companies are located—could lead to some decline in external financing for the private sector. All these points to roll-over risks for the private sector.

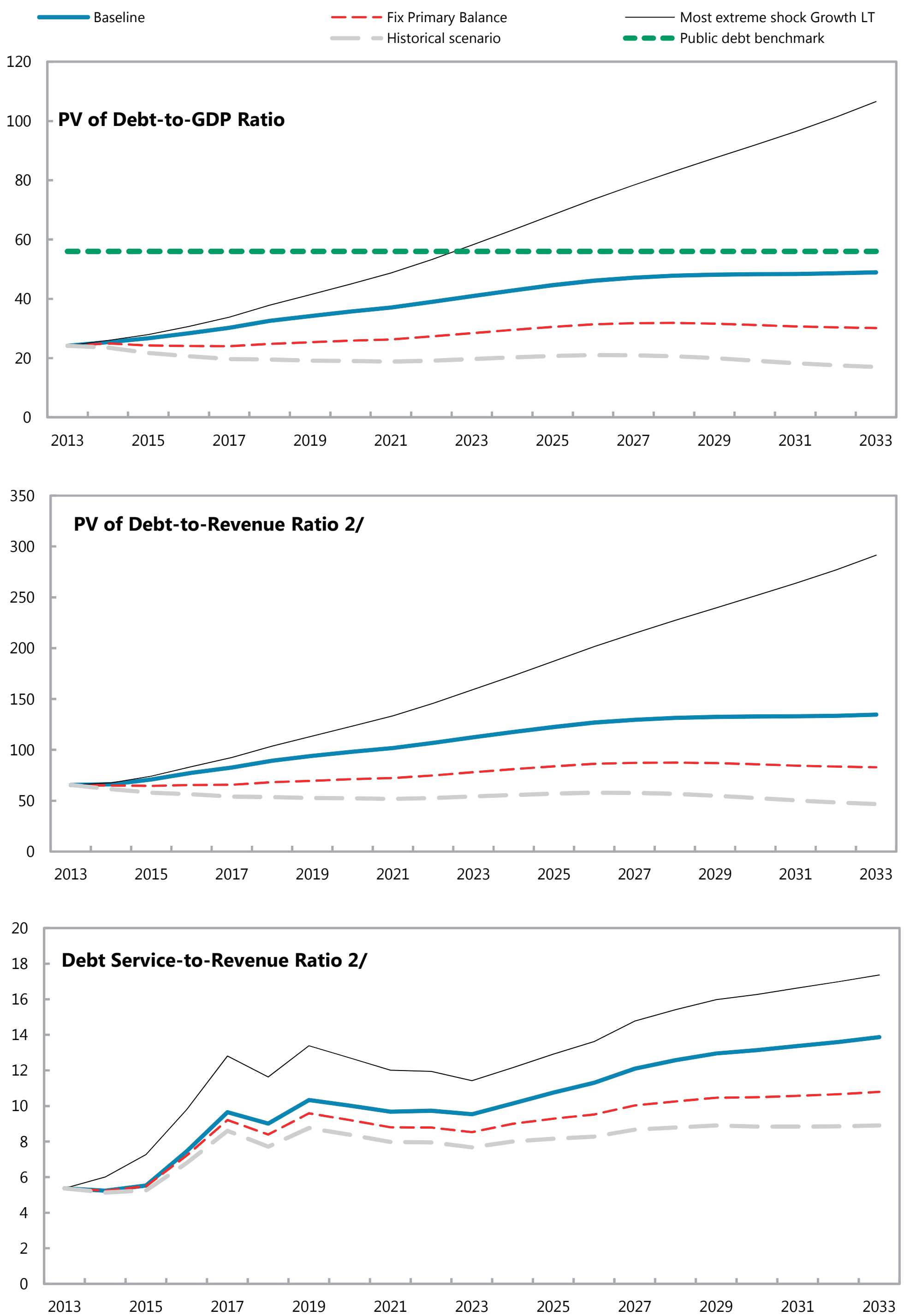
Figure 1. Moldova: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–2033 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2023. In figure b. it corresponds to a Non-debt flows shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Moldova: Indicators of Public Debt Under Alternative Scenarios, 2013–2033 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2023.
2/ Revenues are defined inclusive of grants.

Table 1. Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010–2033

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2010	2011	2012	Average 5/	Standard Deviation 5/	2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	30.2	28.8	31.0			29.8	31.8	32.8	34.7	36.7	39.4		48.5	54.8	
of which: foreign-currency denominated	22.8	21.7	24.0			23.1	25.3	24.4	24.0	23.6	23.6		23.9	20.4	
Change in public sector debt	-1.5	-1.4	2.2			-1.2	2.0	1.0	1.9	2.1	2.6		2.0	0.1	
Identified debt-creating flows	-3.3	-2.6	0.5			-0.4	2.6	1.7	2.2	2.5	2.2		1.0	1.1	
Primary deficit	1.7	1.6	1.4	-0.1	2.5	1.2	1.9	3.9	3.9	3.9	3.5	3.1	2.9	3.0	2.9
Revenue and grants	38.3	36.6	37.9			37.0	38.4	37.6	36.7	36.5	36.4		36.4	36.4	
of which: grants	2.8	2.1	1.8			2.1	2.9	2.0	1.3	1.1	1.0		1.0	1.0	
Primary (noninterest) expenditure	40.0	38.2	39.3			38.1	40.3	41.4	40.6	40.4	39.9		39.2	39.3	
Automatic debt dynamics	-4.5	-3.7	-0.6			-1.3	0.9	-2.0	-1.5	-1.2	-1.2		-1.8	-1.9	
Contribution from interest rate/growth differential	-2.3	-2.0	0.1			-2.5	-0.7	-1.1	-1.2	-1.1	-1.2		-1.7	-1.8	
of which: contribution from average real interest rate	-0.2	0.0	-0.1			0.0	-0.1	0.0	0.0	0.2	0.2		0.5	0.8	
of which: contribution from real GDP growth	-2.1	-1.9	0.2			-2.5	-0.6	-1.1	-1.3	-1.3	-1.4		-2.2	-2.6	
Contribution from real exchange rate depreciation	-2.2	-1.7	-0.7			1.2	1.7	-0.9	-0.2	-0.1	0.0		...	...	
Other identified debt-creating flows	-0.5	-0.4	-0.3			-0.3	-0.3	-0.2	-0.2	-0.2	-0.2		-0.1	0.0	
Privatization receipts (negative)	-0.5	-0.4	-0.3			-0.3	-0.3	-0.2	-0.2	-0.2	-0.2		-0.1	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.8	1.2	1.7			-0.8	-0.6	-0.6	-0.4	-0.4	0.4		1.0	-1.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	25.0			24.2	25.5	26.7	28.4	30.2	32.6		40.9	49.0	
of which: foreign-currency denominated	...	...	18.0			17.5	19.0	18.2	17.8	17.0	16.8		16.3	14.6	
of which: external	...	...	18.0			17.5	19.0	18.2	17.8	17.0	16.8		16.3	14.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	11.0	10.2	10.0			9.2	9.9	11.7	14.1	16.8	18.5		26.3	37.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	65.9			65.4	66.2	71.0	77.4	82.7	89.4		112.5	134.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	69.2			69.3	71.6	75.0	80.2	85.3	92.0		115.6	138.3	
of which: external 3/	...	...	49.9			50.1	53.4	51.3	50.2	48.1	47.6		46.2	41.3	
Debt service-to-revenue and grants ratio (in percent) 4/	6.0	6.4	5.7			5.4	5.2	5.5	7.5	9.7	9.0		9.5	13.9	
Debt service-to-revenue ratio (in percent) 4/	6.5	6.8	6.0			5.7	5.7	5.9	7.7	10.0	9.3		9.8	14.3	
Primary deficit that stabilizes the debt-to-GDP ratio	3.2	2.9	-0.8			2.4	-0.1	2.8	2.1	1.8	0.9		0.8	2.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.1	6.8	-0.7	4.4	4.5	8.9	2.2	3.5	4.0	4.0	4.0	4.4	5.0	5.0	4.9
Average nominal interest rate on forex debt (in percent)	1.3	1.2	1.0	1.7	0.4	1.1	1.0	1.1	1.2	1.8	1.8	1.3	2.0	2.2	2.1
Average real interest rate on domestic debt (in percent)	-3.4	1.8	0.6	0.6	6.7	1.2	0.3	2.0	2.3	2.5	2.4	1.8	2.3	2.4	2.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-10.1	-8.2	-3.1	-7.8	10.4	5.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	11.1	7.3	7.9	9.9	4.1	4.0	6.5	5.6	5.7	5.5	5.1	5.4	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	43.3	46.7	44.6	40.6	38.5	37.3	41.8	33.9	22.2	...

Sources: Country authorities; and staff estimates and projections.

1/ Gross public and publicly-guaranteed debt, excluding arrears. The primary budget balance in this analysis is defined as the overall balance net of interest payments.

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 2. Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2013–2033

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	24	25	27	28	30	33	41	49
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	24	24	22	21	20	20	20	17
A2. Primary balance is unchanged from 2013	24	25	24	24	24	25	28	30
A3. Permanently lower GDP growth 1/	24	26	28	31	34	38	58	107
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	24	27	30	34	37	41	56	74
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	24	26	26	28	30	32	40	49
B3. Combination of B1-B2 using one half standard deviation shocks	24	25	25	27	29	32	42	53
B4. One-time 30 percent real depreciation in 2014	24	35	35	36	37	39	45	53
B5. 10 percent of GDP increase in other debt-creating flows in 2014	24	33	33	35	37	39	47	52
PV of Debt-to-Revenue Ratio 2/								
Baseline	65	66	71	77	83	89	113	135
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	65	61	58	56	54	54	54	47
A2. Primary balance is unchanged from 2013	65	65	65	66	66	68	78	83
A3. Permanently lower GDP growth 1/	65	67	74	84	93	104	159	291
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	65	69	81	92	101	112	154	203
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	65	67	69	75	81	88	111	134
B3. Combination of B1-B2 using one half standard deviation shocks	65	65	65	73	79	87	115	146
B4. One-time 30 percent real depreciation in 2014	65	90	93	97	101	106	124	147
B5. 10 percent of GDP increase in other debt-creating flows in 2014	65	85	89	95	100	107	128	144
Debt Service-to-Revenue Ratio 2/								
Baseline	5	5	6	7	10	9	10	14
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	5	5	5	7	9	8	8	9
A2. Primary balance is unchanged from 2013	5	5	5	7	9	8	9	11
A3. Permanently lower GDP growth 1/	5	5	6	8	10	10	11	22
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	5	5	6	8	11	10	11	18
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	5	5	6	7	10	9	9	14
B3. Combination of B1-B2 using one half standard deviation shocks	5	5	6	7	10	9	10	14
B4. One-time 30 percent real depreciation in 2014	5	6	7	10	13	12	11	17
B5. 10 percent of GDP increase in other debt-creating flows in 2014	5	5	6	8	10	10	10	15

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

Table 3a. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2010–2033 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2013-2018			2019-2033
	2010	2011	2012			2013	2014	2015	2016	2017	2018	Average	2023	2033	Average
External debt (nominal) 1/	**81.6**	**77.6**	**82.4**			**84.4**	**90.8**	**87.9**	**86.3**	**85.0**	**84.4**		**78.5**	**68.0**	
of which: public and publicly guaranteed (PPG)	22.8	21.7	24.0			23.1	25.3	24.4	24.0	23.6	23.6		23.9	20.4	
Change in external debt	-0.8	-4.1	4.8			2.0	6.4	-2.9	-1.6	-1.3	-0.6		-1.2	-1.0	
Identified net debt-creating flows	0.7	-5.8	2.5			-3.9	2.7	1.6	0.7	0.3	-0.1		-0.6	-0.2	
Non-interest current account deficit	**8.7**	**11.3**	**6.8**	**8.8**	**4.8**	**4.8**	**5.6**	**6.1**	**6.0**	**5.8**	**5.6**		**5.4**	**6.0**	5.4
Deficit in balance of goods and services	39.3	40.9	40.4			37.6	40.8	38.9	36.8	35.8	34.9		34.3	34.3	
Exports	39.4	45.0	43.4			44.1	47.2	47.3	47.9	48.4	49.2		49.8	49.8	
Imports	78.7	85.9	83.9			81.7	88.1	86.2	84.7	84.2	84.1		84.0	84.0	
Net current transfers (negative = inflow)	-21.0	-20.5	-21.2	-20.9	4.1	-20.9	-22.4	-20.8	-19.5	-19.0	-18.6		-18.1	-18.1	-18.1
of which: official	-2.3	-2.0	-2.2			-2.1	-2.8	-2.3	-1.6	-1.6	-1.6		-1.6	-1.6	
Other current account flows (negative = net inflow)	-9.6	-9.2	-12.4			-11.9	-12.8	-12.0	-11.3	-11.0	-10.7		-10.8	-10.2	
Net FDI (negative = inflow)	**-3.6**	**-4.1**	**-2.3**	**-5.9**	**3.6**	**-2.8**	**-2.7**	**-3.6**	**-4.0**	**-4.4**	**-4.8**		**-4.7**	**-4.8**	-4.7
Endogenous debt dynamics 2/	**-4.4**	**-13.0**	**-1.9**			**-5.9**	**-0.2**	**-0.9**	**-1.2**	**-1.0**	**-0.9**		**-1.3**	**-1.4**	
Contribution from nominal interest rate	0.9	1.0	0.9			0.8	1.8	2.1	2.1	2.2	2.3		2.4	1.8	
Contribution from real GDP growth	-5.5	-4.6	0.5			-6.7	-1.9	-3.0	-3.3	-3.2	-3.2		-3.7	-3.2	
Contribution from price and exchange rate changes	0.1	-9.4	-3.4			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-1.5**	**1.8**	**2.3**			**6.0**	**3.7**	**-4.6**	**-2.3**	**-1.6**	**-0.5**		**-0.6**	**-0.8**	
of which: exceptional financing	-2.4	-1.9	-3.2			-1.9	-2.4	-1.4	-0.9	-0.7	-0.8		-0.4	-0.2	
PV of external debt 4/	...	...	76.4			78.8	84.5	81.7	80.0	78.5	77.6		70.9	62.2	
In percent of exports	...	...	175.8			178.6	179.0	172.8	167.2	162.1	157.6		142.6	125.0	
PV of PPG external debt	**...**	**...**	**18.0**			**17.5**	**19.0**	**18.2**	**17.8**	**17.0**	**16.8**		**16.3**	**14.6**	
In percent of exports	**...**	**...**	**41.5**			**39.6**	**40.2**	**38.6**	**37.1**	**35.2**	**34.2**		**32.9**	**29.4**	
In percent of government revenues	**...**	**...**	**49.9**			**50.1**	**53.4**	**51.3**	**50.2**	**48.1**	**47.6**		**46.2**	**41.3**	
Debt service-to-exports ratio (in percent)	**17.8**	**15.9**	**15.5**			**17.4**	**18.4**	**18.6**	**21.0**	**19.7**	**19.9**		**18.0**	**17.6**	
PPG debt service-to-exports ratio (in percent)	**3.4**	**3.0**	**2.9**			**3.0**	**2.6**	**2.6**	**3.5**	**4.6**	**3.6**		**2.2**	**3.3**	
PPG debt service-to-revenue ratio (in percent)	**3.8**	**3.9**	**3.5**			**3.7**	**3.5**	**3.5**	**4.7**	**6.3**	**5.0**		**3.1**	**4.7**	
Total gross financing need (Millions of U.S. dollars)	2037	2471	2592			2596	3090	3143	3307	3384	3558		4404	7645	
Non-interest current account deficit that stabilizes debt ratio	9.5	15.4	2.0			2.7	-0.8	9.0	7.6	7.0	6.2		6.6	6.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.1	6.8	-0.7	4.4	4.5	8.9	2.2	3.5	4.0	4.0	4.0	4.4	5.0	5.0	4.9
GDP deflator in US dollar terms (change in percent)	-0.2	13.0	4.6	11.6	10.7	0.1	-5.9	2.7	3.0	2.3	2.0	0.7	2.3	2.3	2.3
Effective interest rate (percent) 5/	1.2	1.5	1.2	1.6	0.3	1.0	2.0	2.5	2.5	2.7	2.9	2.3	3.2	2.8	3.3
Growth of exports of G&S (US dollar terms, in percent)	14.5	37.9	0.2	14.3	18.0	10.6	2.9	6.5	8.4	7.6	7.8	7.3	7.4	7.4	7.4
Growth of imports of G&S (US dollar terms, in percent)	14.7	31.9	1.3	17.1	21.0	6.1	3.7	4.1	5.2	5.9	5.9	5.1	7.4	7.4	7.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	43.3	46.7	44.6	40.6	38.5	37.3	41.8	33.9	22.2	29.9
Government revenues (excluding grants, in percent of GDP)	35.5	34.5	36.1			34.9	35.6	35.5	35.4	35.4	35.4		35.4	35.4	35.4
Aid flows (in Millions of US dollars) 7/	225.6	200.3	206.5			196.5	299.5	233.1	180.3	174.0	177.7		214.4	353.1	
of which: Grants	161.7	145.2	130.6			164.7	218.4	165.6	113.8	100.3	99.6		133.3	272.0	
of which: Concessional loans	63.9	55.1	75.9			31.8	81.1	67.5	66.5	73.7	78.1		81.1	81.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.6	4.0	3.0	2.4	2.2	2.1		1.8	1.4	1.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			79.1	76.1	71.3	60.2	55.7	54.0		51.8	47.7	50.2
Memorandum items:															
Nominal GDP (Millions of US dollars)	5813	7018	7283			7935	7628	8109	8686	9242	9803		13872	28315	
Nominal dollar GDP growth	6.9	20.7	3.8			8.9	-3.9	6.3	7.1	6.4	6.1	5.2	7.4	7.4	7.3
PV of PPG external debt (in Millions of US dollars)			1319			1336	1403	1471	1537	1566	1642		2257	4121	
(PVt-PVt-1)/GDPt-1 (in percent)						0.2	0.8	0.9	0.8	0.3	0.8	0.7	1.5	0.6	1.0
Gross workers' remittances (Millions of US dollars)	1083	1299	1389			1495	1493	1503	1557	1612	1666		2285	4664	
PV of PPG external debt (in percent of GDP + remittances)	...	...	15.1			14.7	15.9	15.4	15.1	14.5	14.4		14.0	12.6	
PV of PPG external debt (in percent of exports + remittances)	...	...	28.8			27.8	28.5	27.7	27.0	25.9	25.4		24.7	22.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.0			2.1	1.9	1.9	2.5	3.4	2.7		1.6	2.5	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. The difference between end-period and average exchange rates account for the difference in external debt ratio presented in Table 1 (SEI) and the DSA.

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 PV of private sector debt is equivalent to its face value.

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

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

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

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

Table 3b. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–2033

(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
PV of debt-to-GDP+remittances ratio								
Baseline	15	16	15	15	15	14	**14**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	15	14	13	12	13	13	**18**	21
A2. New public sector loans on less favorable terms in 2013-2033 2	15	16	16	16	16	17	**19**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	15	16	16	16	15	15	**15**	13
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	15	17	22	21	20	20	**19**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	15	15	15	14	14	14	**13**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	15	20	23	22	21	21	**19**	14
B5. Combination of B1-B4 using one-half standard deviation shocks	15	13	11	11	11	11	**11**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	15	21	21	21	20	20	**19**	17
PV of debt-to-exports+remittances ratio								
Baseline	28	28	28	27	26	25	**25**	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	28	25	23	23	24	25	**35**	41
A2. New public sector loans on less favorable terms in 2013-2033 2	28	29	29	30	29	30	**34**	38
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	28	28	28	27	26	25	**25**	22
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	28	32	44	43	41	40	**38**	28
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	28	28	28	27	26	25	**25**	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	28	37	42	39	38	37	**34**	25
B5. Combination of B1-B4 using one-half standard deviation shocks	28	26	23	23	22	21	**21**	21
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	28	28	28	27	26	25	**25**	22
PV of debt-to-revenue ratio								
Baseline	50	53	51	50	48	48	**46**	41
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	50	45	40	40	39	42	**55**	61
A2. New public sector loans on less favorable terms in 2013-2033 2	50	54	54	55	55	56	**64**	71
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	50	53	54	53	51	50	**49**	43
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	50	58	72	70	68	67	**63**	46
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	50	48	48	47	45	45	**44**	39
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	50	64	74	73	70	69	**64**	46
B5. Combination of B1-B4 using one-half standard deviation shocks	50	42	36	36	34	34	**34**	34
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	50	76	75	73	70	69	**67**	60

Table 3b. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–2033 (concluded)

(In percent)

				Debt service-to-exports+remittances ratio				
Baseline	2	2	2	3	3	3	**2**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	2	2	2	2	2	2	**1**	2
A2. New public sector loans on less favorable terms in 2013-2033 2	2	2	2	3	4	3	**2**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	2	2	2	3	3	3	**2**	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	2	2	2	3	4	3	**2**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	2	2	2	3	3	3	**2**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	2	2	2	3	4	3	**2**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	2	3	3	**1**	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	2	2	2	3	3	3	**2**	2
				Debt service-to-revenue ratio				
Baseline	4	3	3	5	6	5	**3**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	4	3	3	3	4	3	**2**	3
A2. New public sector loans on less favorable terms in 2013-2033 2	4	3	4	5	7	5	**3**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	4	4	4	5	7	5	**3**	5
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	4	3	4	5	7	6	**4**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	4	3	3	4	6	5	**3**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	4	3	4	5	7	6	**4**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	4	3	3	4	5	4	**2**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	4	5	5	7	9	7	**4**	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	27	27	27	27	27	27	**27**	27

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

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

IMF Executive Board Concludes 2014 Article IV Consultation and First Post-Program Monitoring with the Republic of Moldova

On June 23, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and First Post-Program Monitoring (PPM) with the Republic of Moldova.[1]

Moldova largely achieved the main objectives of the economic program supported by a combined Extended Credit Facility/Extended Fund Facility (ECF/EFF that expired on April 30, 2013. The country's economic performance was among the strongest in the region during 2010–13. This was made possible by adequate macroeconomic stabilization measures and ambitious structural reforms implemented in the wake of the crisis under the Fund-supported program.

The Moldovan economy recovered strongly from the drought-related contraction of 2012, but activity will significantly slow in 2014 due to a moderation in agriculture production and related industries and weaker economic activity in main trading partners. Inflation is projected to remain within the National Bank of Moldova's (NBM) inflation target range of 5 percent ± 1.5 percentage points. The external accounts temporarily improved in 2013 but will deteriorate in 2014. The current account deficit is projected to widen to about 7.5 percent of GDP resulting from a slowdown in export growth and a decline in remittances.

Moldova achieved an impressive degree of fiscal consolidation under the program, but the gains have since eroded. The overall budget balance was reduced in 2013 to 1.8 percent of GDP compared 6.3 percent in 2009, but on current policies is projected to widen to 2.6 percent in 2014 and 4.6 percent in 2015. As a result, public and publicly-guaranteed debt that reached 30 percent of GDP in 2014 is projected to be on an upward trend over the medium term.

[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.

Risks to systemic financial stability have built up due to severe governance problems in the banking system. The ability of regulators to take action is constrained by Constitutional Court rulings that reduced the powers of the NBM and limited the independence and effective operation of the National Commission for Financial Markets (NCFM).

Executive Board Assessment[2]

Executive Directors welcomed Moldova's strong economic performance and progress on poverty reduction in recent years underpinned by sound policies. To consolidate these gains against the backdrop of significant downside risks, Directors encouraged the authorities to avoid a weakening of policies, reduce vulnerabilities, and deepen structural reforms.

Directors agreed that significant weaknesses in the banking system require decisive action to ensure the stability and soundness of the financial sector. They urged the authorities to build consensus and act on the recommendations of the Financial Sector Assessment Program (FSAP), including to swiftly pass legislation fully restoring the regulatory and supervisory powers of the National Bank of Moldova (NBM) and the National Commission for Financial Markets. The legal protection of their board members and staff needs to be strengthened. Directors also recommended resolutely enforcing compliance with prudential requirements and strengthening governance in the banking sector, including by ensuring the disclosure of the ownership structure. Directors supported maintaining the high level of scrutiny of Banca de Economii's operations until the bank complies with regulatory norms. They noted that banks that fail to meet regulatory requirements should be required to implement a time-bound plan to address the shortcomings. A further strengthening of crisis management and the anti-money laundering regime is also warranted.

Directors commended the authorities' fiscal consolidation in recent years. Nonetheless, they cautioned that the significant wage and pension increases and ad hoc tax benefits being planned risk reversing the gains. They encouraged the authorities to pursue a gradual reduction in the budget deficit to a level compatible with projected official assistance over the medium term. They stressed the importance of mobilizing revenue and advancing structural fiscal reforms, including in social security and fiscal decentralization, as well as adopting a fiscal responsibility law to provide an adequate fiscal anchor.

Directors commended the success of NBM in keeping inflation within the target range in the past two years. They considered the current monetary stance to be appropriate but

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[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

recommended vigilance to any inflation risks. They welcomed occasional interventions by the NBM on the foreign exchange market to boost international reserves and reduce volatility, while stressing the importance of allowing the exchange rate to adjust to external pressures.

Directors underscored that steady implementation of structural reforms is critical to boost potential growth and reduce poverty. To increase productivity and improve competitiveness, priority should be given to improving the business environment, investing in infrastructure, and strengthening human resource development.

Moldova: Selected Economic Indicators, 2011–15 1/

	2011	2012	2013	2014	2015
				Projection	
Real sector indicators	(Percent change, unless otherwise indicated)				
Gross domestic product					
Real growth rate	6.8	-0.7	8.9	2.2	3.5
Demand	8.3	0.4	6.2	2.1	2.4
Consumption	7.5	0.9	5.2	2.8	3.0
Private	9.4	1.0	6.5	1.9	1.9
Public	-0.7	0.6	-0.8	7.2	8.3
Gross capital formation	13.0	1.8	3.3	3.8	2.2
Private	11.3	-3.9	-3.7	0.5	1.0
Public	19.3	21.6	22.4	11.0	4.5
Nominal GDP (Billions of Moldovan lei)	82.3	88.2	99.9	108.7	118.8
Nominal GDP (Billions of U.S. dollars)	7.0	7.3	7.9	7.6	8.1
Consumer price index (Average)	7.6	4.6	4.6	5.7	6.0
GDP deflator	7.3	7.9	4.0	6.5	5.6
Average monthly wage (Moldovan lei)	3,194	3,478	3,765	4,080	4,450
Unemployment rate (Annual average, percent)	6.7	5.6	5.1	6.0	5.8
Saving-investment balance	(Percent of GDP)				
Foreign saving	12.3	7.7	5.5	7.4	8.2
National saving	11.0	16.0	17.1	16.0	14.8
Private	8.1	11.7	11.7	10.6	11.5
Public	2.9	4.3	5.3	5.4	3.3
Gross investment	23.3	23.6	22.6	23.3	23.0
Fiscal indicators (General government)					
Primary balance	-1.6	-1.4	-1.3	-1.9	-3.9
Overall balance	-2.4	-2.2	-1.8	-2.6	-4.6
Stock of public and publicly guaranteed debt	29.0	31.1	29.9	31.8	32.8
Financial indicators	(Percent change, unless otherwise indicated)				
Broad money (M3)	10.6	20.8	26.5	15.9	16.4
Velocity (GDP/end-period M3; ratio)	2.0	1.8	1.6	1.5	1.4
Reserve money	18.4	22.9	31.9	13.4	14.0
Credit to the economy	15.0	16.1	18.8	11.3	11.4
External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)				
Current account balance	-863	-559	-438	-564	-662
Current account balance (Percent of GDP)	-12.3	-7.7	-5.5	-7.4	-8.2
Gross official reserves	1,965	2,515	2,820	2,751	2,621
Gross official reserves (Months of imports)	3.9	4.7	5.0	4.7	4.3
Exchange rate (Moldovan lei per USD, period avge)	11.7	12.1	12.6	…	…
Real effective exch.rate (Average, percent change)	5.3	4.5	-3.4	-3.5	0.4
External debt (Percent of GDP) 2/	77.6	82.5	83.6	90.0	87.8
Debt service (Percent of exports of goods and services)	15.7	15.6	17.5	18.6	19.5

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Statement by Mr. Snel and Mr. Manchev on Republic of Moldova
June 23, 2014

Our Moldovan authorities highly appreciate the informative and candid exchange of views with the mission during the 2014 Article IV consultation and First Post-Program Monitoring (PPM). They acknowledge that Moldova's recovery from the severe recession of 2009 was largely the result of consistent implementation of sound macroeconomic policies and structural reforms, supported by the last ECF/EFF combined arrangement. The authorities remain committed to prudent macroeconomic policies, and thank staff for their appraisal. They remain attentive to the Fund's advice and recommendations, but emphasize that the highly uncertain and volatile external and domestic environments pose challenges, which make it difficult to achieve the broad political and social consensus desperately needed for smooth and timely policy implementation.

Amid the uncertainty, the authorities make decisive efforts to maintain macroeconomic and financial stability and to make progress in increasing competitiveness and reducing poverty. Monetary policy has been successful in maintaining inflation within the target range of 5 percent +/- 1.5 percentage points. In line with the inflation targeting framework, the National Bank of Moldova (NBM) maintains a flexible exchange rate with limited interventions in the domestic foreign exchange market to absorb seasonal excess supply, and prevent disorderly exchange rate movements without resisting market trends. In the context of disinflationary pressures, the NBM's monetary policy stance has remained appropriate in building-up international reserves to strengthen resilience to external shocks In consultation with the IMF, the authorities have prepared amendments to the Law on the NBM to strengthen its role as a regulator and supervisor, but it appears that more time is needed to reach consensus in the Parliament and adopt the amendments.

The 2014 the overall government budget deficit target of 2.6 percent of GDP, including grants, accommodates an increase in resources for social programs, and provides room to catch up on investment projects which were underexecuted in 2013. The aim of these public policies is to steadily make well-targeted social programs and infrastructural improvements the mainstay of the poverty alleviation strategy in line with the National Development Strategy (NDS) "Moldova 2020".

The authorities' near-term plan includes three main pillars: (1) maximum utilization of the available donor financing, knowledge and institutional support following the technical completion of a Deep and Comprehensive Free Trade Area (DCFTA) with the EU, without deviating from the medium-term budget deficit target; (2) increased attention to social issues, thereby reducing the number of people at risk of poverty or social exclusion through targeted adjustments in public sector wages, and a move toward well-targeted social programs; and (3) improving governance of the banking system through implementing some of the FSAP recommendations.

The remarks below provide additional clarification on: (1) recent macroeconomic developments; (2) fiscal sustainability; (3) the banking system restructuring; and (4) structural reforms.

Recent Macroeconomic Developments

The near-term outlook is highly unpredictable, and the authorities are well aware that a disruption of the regional trade routes and/or gas supply can adversely impact the economy. Recent economic trends have demonstrated Moldova's distinctive vulnerability to adverse economic developments in the existing main trading partners. In the first four months of 2014 exports have slowed down by 1.9 percent (y/y), following a decline in exports to the main partner – the CIS countries - by 9.3 percent (y/y). At the same time, imports have declined faster - by 3.9 percent (y/y), and the trade balance has improved by 5.5 percent (y/y). Remittances from Moldovan workers abroad, which are about one quarter of GDP, have declined, mainly reflecting the slowdown of the Russian economy.

The recent geopolitical and regional developments have also provided Moldova with a unique opportunity to diversify its trade and financial flows, and thus achieve better economic sustainability. The establishment of DCFTA may become a turning point for the low-income economy. Moldova's exports to the EU have grown by 9.3 percent (y/y) in January-April, and imports from the EU by 2.4 percent (y/y). In addition, the committed donor support has reached historically high levels, and is currently equivalent to about 10 percent of total annual budget spending.

These developments, together with a sizable short-term fiscal stimulus to boost domestic demand, have allowed Moldova's industrial production to grow by 6.3 percent in the first quarter (y/y), and investment by 3 percent (y/y). Agricultural production has also responded positively to a combination of fiscal stimulus and increased official financing. It has grown by 7.4 percent in the first quarter (y/y). Yet, the authorities are not complacent and stand ready to respond through further integration into global and energy markets in order to reduce the impact of shocks in any single trading partner in the medium term.

Fiscal Sustainability

The 2014 budget provides resources to strengthen the authorities' flagship social programs for the poorest— "Ajutor Social" and heating allowance—in line with their commitment to enhance poverty reduction. The authorities have already increased the heating allowance by 25 percent and the minimum monthly income guaranteed by the state (Ajutor Social) by 9 percent. More favorable electricity and gas prices have been negotiated with foreign suppliers to alleviate expenditure pressures. Provisions in the budget have been made to ensure that adequate resources become available to protect the purchasing power of retirees, teachers and some other vulnerable groups.

Given the high uncertainty of the outlook, the authorities are fully committed to the Medium-Term Budget Framework for 2015–17, and have implemented a number of revenue mobilization measures. They recognize the importance of structural reforms in ensuring the medium-term fiscal sustainability, and prepare to enhance privatization and strengthen market competition when conditions improve in the next few years. With a view to achieve greater efficiency in the energy sector, and in close cooperation with the World Bank, the authorities have launched a comprehensive restructuring of the centralized heating system in the Municipality of Chisinau. In line with obligations in the context of signing the DCFTA with the EU, and to protect local producers from unfair competition stemming from more advantageous tax regimes in neighboring countries, the authorities have intensified efforts to fight smuggling and corruption.

Since the onset of the global crisis, the authorities have been facing the daunting task of striking the right balance between fiscal consolidation and supporting economic growth. They have already taken steps to strengthen the fiscal policy framework by adopting or drafting legislation on local public finances, public debt and state guarantees, and fiscal responsibility. The authorities share staff's view that further reforms would be needed to safeguard long-term fiscal sustainability, improve public financial management, increase resilience to political cycles, and set the stage for further development of domestic capital markets. Over the medium term, their fiscal policy will continue to be guided by the objective of reducing the budget deficit to a level that can be sustained without exceptionally high donor support. The ultimate objective of the authorities' macroeconomic policies remains raising living standards and reducing poverty by creating the conditions for strong and balanced economic growth.

The Banking System Restructuring

The authorities are aware that since the global crisis erupted, the Moldovan banking system has been operating in a challenging environment. It requires strengthening of the regulatory framework, corporate governance, and the authorities' capacity for risk management. However, building the necessary political consensus and passing adequate legislation to fully restore the regulatory power of the NBM and National Commission for Financial Markets has proved to be difficult and will take more time, despite the sizable TA from the Fund. The authorities will also need more time to discuss the recent FSAP recommendations, and prepare a comprehensive action plan involving all stakeholders concerned.

Meanwhile, the NBM has imposed enhanced scrutiny of the most affected banks, while attempting to consolidate the diverging views on the way forward to strengthen risk management and corporate governance in the sector. Based on the terms of reference agreed with IMF and World Bank staff, the ailing Banca de Economii has hired an internationally reputable auditor. A diagnostic study has been recently prepared to facilitate the resolution of impaired assets and compliance with regulatory norms. The authorities continue to maintain a strong representation at the BEM's Board to safeguard the public interest. The NBM also remains vigilant of developments in other banking institutions and stands ready to expeditiously address emerging weaknesses with the available instruments.

Structural Reforms

The authorities remain committed to the structural reforms described in the NDS "Moldova 2020". They recognize that adoption of the DCFTA may pose short-term challenges to the economy. Against this background, the authorities have developed, together with the EU, a Roadmap for Enhancing Competitiveness of Moldova, which is also in line with staff's recommendations. The authorities have also prepared an Education Sector Development Strategy for 2014–20, aimed at increasing public spending efficiency in the sector and aligning the curricula of vocational schools with labor market needs.