INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/398

REPUBLIC OF MOLDOVA

December 2017

2017 ARTICLE IV CONSULTATION AND SECOND REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF MOLDOVA

In the context of the combined Article IV Consultation and Second Reviews under the Extended Fund Facility and Extended Credit Facility Arrangements, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 20, 2017 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 20, 2017, following discussions that ended on November 7, 2017, with the officials of the Republic of Moldova on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility and Extended Credit Facility Arrangements. Based on information available at the time of these discussions, the staff report was completed on December 6, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Moldova.

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

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

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

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Press Release No. 17/514
FOR IMMEDIATE RELEASE
December 20, 2017

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IMF Executive Board Completes the Second Review Under the ECF and EFF Arrangements for the Republic of Moldova and Concludes 2017 Article IV Consultation

On December 20, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] and the second review under the Extended Credit Facility (ECF)[2] and Extended Fund Facility (EFF)[3] Arrangements for the Republic of Moldova. Completion of this review makes available SDR 15.7 million (about US$ 22.2 million). The ECF/EFF arrangements in a total amount of SDR 129.4 million (about US$ 183.1million, or 75 percent of the Republic of Moldova's quota) was approved on November 7, 2016 (see Press Release No 16/491).

Moldova has experienced a period of relative macroeconomic and financial stability since the 2014 banking crisis. Growth has returned and, while moderating somewhat, is expected to be around 3 percent next year. Inflation is forecast to return to target in 2018, following a pickup in 2017. The banking sector has been stable, the fiscal performance has improved and Moldova's external position has strengthened. The outlook, however, is still subject to substantial risks.

The program is broadly on track, but continued reform efforts are needed to accelerate growth and improve living standards. Important progress has been made towards cleansing the financial sector, though with delay, including by strengthening supervisory and regulatory frameworks and increasing management and ownership transparency. However, significant challenges remain to put the banking system on a more sound footing. Beyond the financial sector, sound macroeconomic policies and structural reforms are critical to lift

[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.
[2] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems. For more details see http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/04/Extended-Credit-Facility.
[3] The EFF was established to provide support of comprehensive programs that include policies of the scope and character required to correct structural imbalances over an extended period. For more details see http://www.imf.org/en/about/factsheets/sheets/2016/08/01/20/56/extended-fund-facility

potential growth, create jobs, and reduce poverty. Policy priorities include addressing weak governance, corruption, and infrastructure gaps, strengthening the effectiveness of monetary policy, ensuring transparency and cost recovery in the energy sector and, further tackling the shadow economy and the relatively low development of human capital.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

"Moldova continues to make important progress in strengthening macroeconomic and financial stability. This is supported by continued program implementation focused on decisively repairing the financial system, improving governance and the business climate, and attracting foreign and domestic investment. As significant challenges still remain, it is important that these efforts continue to further entrench recent gains and raise potential growth and living standards.

"Monetary policy should continue to focus on maintaining price stability in the context of a flexible exchange rate. The inflation targeting framework should be bolstered by refining the forecasting process, improving coordination across agencies, and strengthening communications, including by adhering to a regular calendar of monetary policy decisions.

"The 2018 budget and medium-term fiscal framework allow for growth-friendly priority public investment and social spending, while safeguarding debt sustainability. Looking forward, firm control over current spending and the wage bill will be important to prevent the latter from increasing in percent of GDP and unduly constraining priority spending. Efforts should also be made to improve public investment efficiency, take a measured approach to scaling up, and eliminate arrears at the local level.

"Important progress is being made in repairing the financial sector, including improving transparency in ownership and management, strengthening supervisory and regulatory frameworks, and carrying out bank level diagnostics. Nevertheless, significant challenges remain for progress to become irreversible. Efforts should continue to aim at facilitating the transfer ownership of "problem" shares in the largest banks to fit and proper shareholders, the certification of incoming shareholders and managers in line with the law, and continued clean-up of banks' balance sheets and improvement in their risk management. Increased supervisory resources focused on key risks can support these efforts.

"Structural reforms remain indispensable for sustained growth and poverty reduction. Priorities include: improving the business climate to attract private investment to broaden the recovery and support economic diversification, targeted labor market reforms, investment in human capital, and efforts to reduce the shadow economy. In the energy sector, efforts should continue to focus on ensuring cost recovery and greater transparency."

Executive Board Assessment[4]

Executive Directors welcomed the macroeconomic and financial stability experienced in Moldova over the past two years, and the progress achieved under the program. They cautioned, however, that the recent gains are not yet irreversible and downside risks to the medium-term outlook remain. In this regard, Directors emphasized the importance of preserving fiscal sustainability, strengthening the effectiveness of monetary policy, and implementing reforms to decisively repair the financial system, improve governance and the business climate. These are critical to attract foreign and domestic investment and raise potential growth and living standards.

Directors commended the authorities for successfully reducing inflation and reiterated that monetary policy should continue to focus on maintaining price stability in the context of a flexible exchange rate regime. They concurred that a pause in rate cuts was appropriate at this juncture, given incipient inflationary pressures. Directors encouraged the authorities to strengthen the monetary transmission mechanism and bolster the inflation targeting framework, including by refining the forecasting process to strengthen outputs and decision making, improving coordination across agencies, and strengthening internal and external communications. They also encouraged the authorities to avoid resisting exchange rate movements that are driven by fundamentals.

Directors welcomed the 2018 budget and medium-term fiscal framework, which allow for growth-friendly public investment and social spending while safeguarding debt sustainability. They emphasized the need to continue to exercise firm control over current spending and the wage bill to avoid unduly constraining priority investments and social spending. Strengthening public investment management and efficiency was also encouraged.

Directors welcomed the important progress in repairing the financial sector, including improving transparency in ownership and management, strengthening supervisory and regulatory frameworks, and conducting bank-level diagnostics. Nevertheless, they cautioned that significant challenges remain. In this regard, Directors urged completion of the reform agenda aimed at improving governance and stability. Critical next steps include transfer of ownership of problem shares in the largest banks to fit and proper shareholders, and continued clean-up of banks' balance sheets and improvement in their risk management procedures to allow effective financial intermediation. Increased supervisory resources focused on key risks can support these efforts. Directors called for continued efforts to strengthen the AML/CFT framework.

Directors emphasized that steady implementation of structural reforms is indispensable for sustainable growth and poverty reduction, particularly in light of demographic pressures. Priorities include encouraging capital accumulation, targeted labor market reforms and investment in human capital, economic diversification, and reducing the shadow economy.

[4] 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.

Directors also underscored the importance of transparency and cost recovery in the energy sector.

It is expected that the next Article IV consultation with the Republic of Moldova will be held in accordance with the Executive Board decision on the consultation cycles for members with Fund arrangements.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

December 6, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND SECOND REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS

KEY ISSUES

- **Following the 2014 crisis, Moldova has experienced a period of relative economic and financial stability, but still faces significant challenges.** Growth has returned, inflation pressures have been contained, and fiscal performance has improved. Financial sector rehabilitation is underway, but further steps are needed to strengthen banks' governance and balance sheets, which are critical to restore credit growth. Faster growth is needed if Moldova is to lift per capita income, which is the lowest in the region.

- **To accelerate growth and improve living standards while maintaining macroeconomic stability, policies should continue to focus on:** (i) decisively strengthening the banking sector to facilitate deeper financial intermediation; (ii) bolstering the inflation targeting framework to help improve the transmission mechanism, while continuing to allow for exchange rate flexibility; (iii) maintaining fiscal discipline, while providing for growth-friendly priority public investment and safeguarding debt sustainability; and (iv) advancing structural reforms for sustainable and inclusive growth.

- **In terms of program performance, progress is being made, but more is needed to ensure that the benefits of reform are fully realized.** Since the last review, all performance criteria for end-June were met and a number of important policy measures have been taken. This includes facilitating ownership transfer of the largest bank to fit and proper investors and streamlining the shareholder removal process; as well as adoption of a 2017 Budget amendment and 2018 Budget consistent with program targets. However, given the complexities in financial sector reforms, a number of structural benchmarks were missed and have been reset, in line with the program's reform priorities.

- **Staff supports the completion of the second review.** The aggregated purchase and disbursement available upon completion of this review would be equivalent to SDR 15.7 million, bringing the total disbursements and purchases under the Extended Credit Facility and Extended Fund Facility to the equivalent of SDR 57.4 million.

Approved By
Thanos Arvanitis and Mark Flanagan

Discussions were held in Chişinău during October 25–November 7, 2017. The mission met with Prime Minister Filip, Deputy Prime Minister Calmîc, Minister of Finance Armaşu, Governor of the National Bank of Moldova Cioclea, and other senior officials and representatives of financial institutions, labor unions, diplomatic community, and international organizations. The mission team comprised Ben Kelmanson (Head), Armine Khachatryan Koralai Kirabaeva, Volodymyr Tulin (Res. Rep.), Rima A. Turk (all EUR), Edda Rós Karlsdóttir (MCM), Emmanouil Kitsios (FAD), and Niamh Sheridan (SPR). Veronica Volociuc (OED) participated in the discussions. Silvia Domit, Chasta Piatakovas and Alaina Rhee (all EUR) and staff from the local office in Chişinău assisted the mission.

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CONTEXT

1. **Moldova has deep seated economic problems that were compounded by large-scale banking fraud.** In particular, the capital stock per capita and total factor productivity levels (TFP) are very low, the private sector is relatively underdeveloped, and the informal economy is very large.[1] Income per capita and average wages are among the lowest in Europe, with the gap increasing over time. Emigration from Moldova is very high, with the authorities estimating that some 350,000 Moldovans live and work abroad, often in the informal sector. These developments have been exacerbated by the 2014 banking crisis that led to a recession. Against this backdrop, sound macroeconomic policies and structural reforms are critical to lift potential growth, create jobs, and reduce poverty.

2. **Since the last Article IV consultation, Moldova has experienced a period of relative political and macro-financial stability, and successfully agreed an IMF-supported program.** Growth has returned, inflation has been relatively contained, the banking sector has been stable, and the external position has strengthened. The IMF-supported program is broadly on track despite political tensions arising from the current coexistence of a center-right government (in office since January 2016) and a president from the socialist party (elected later that year). Nonetheless, this balance could be tested in the run up to the 2018 parliamentary elections, which, recent polls indicate will be hotly contested.

3. **A number of policy recommendations from the last Article IV consultation have been implemented.** In particular, the authorities have: implemented macroeconomic policies that helped strengthen the external position; pursued wide ranging efforts to restore the health of the banking system, including strengthening the regulatory, supervisory and safety net frameworks, and underpinning the independence of the NBM; and, pursued structural reforms aimed at enhancing the economy's resilience to shocks.

4. **Discussions focused on medium term challenges facing Moldova and conditions for completing the second review.** Staff policy advice as well as program design remains focused on delivering a system of sound financial institutions operating within regulatory, supervisory, and contingency frameworks that are supported by strong enforcement and sanctioning regimes. This focus on financial sector issues is complemented by continued focus on policies to consolidate macroeconomic stability and deepen broader structural reforms to support growth.

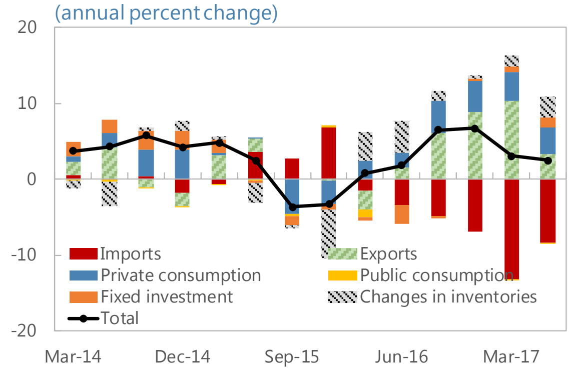
RECENT ECONOMIC DEVELOPMENTS

5. **Growth momentum is moderating (Figure 1).** Supported by stronger policies, the economy recovered quickly from the 2015 recession and growth peaked in late 2016. Real GDP

[1] See International Monetary Fund (IMF), 2016, "Regional Economic Issues: Central, Eastern and Southeastern Europe", chapter II. How to Get Back on the Fast Track? (https://www.imf.org/en/Publications/REO/EU/Issues/2017/01/07/Central-Eastern-and-Southeastern-Europe)

expanded by 2.8 percent year-on-year in 2017H1, supported by a recovery of investment and continued buildup of inventory stocks. However, net exports were a larger than expected drag on growth, as imports outpaced exports driven in part by the appreciation of the Leu. On the production side, services—including domestic trade and construction—were the largest contributors to output growth, whereas industrial production remained subdued and agricultural output slowed relative to the good harvest year in 2016. Unemployment fell to 3.5 percent in Q2, reflecting continued decline in labor force participation, although official statistics may underestimate labor market conditions. Notwithstanding considerable measurement uncertainty, staff assesses the output gap to be slightly negative.

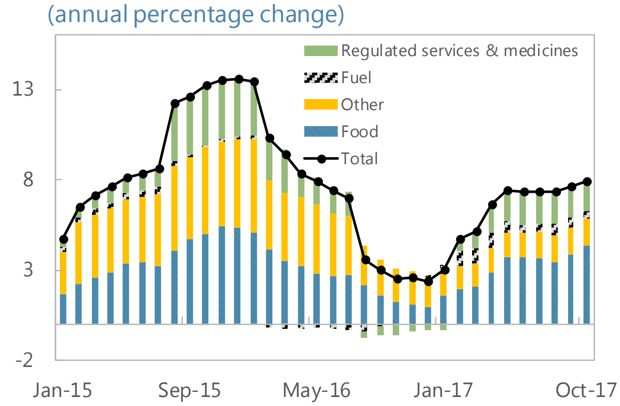
Contributions to Real GDP Growth
(annual percent change)



Sources: Moldovan authorities and IMF staff calculations.

6. **Despite higher headline inflation, underlying inflation remains stable.** Headline inflation declined quickly from 13½ percent at end-2015 to around 2½ percent at end-2016, but accelerated by more than expected in 2017. Inflation was 7.3 percent in June, exceeding the program's inner consultation band and triggering an informal consultation with Fund staff, and reached 7.9 percent in October. The inflation surprise was driven by food prices and a one-off adjustment to health care costs, while increases in oil and other regulated prices were in line with expectations; and inflation excluding food, energy and regulated prices (a measure of underlying inflation pressure) remained stable.

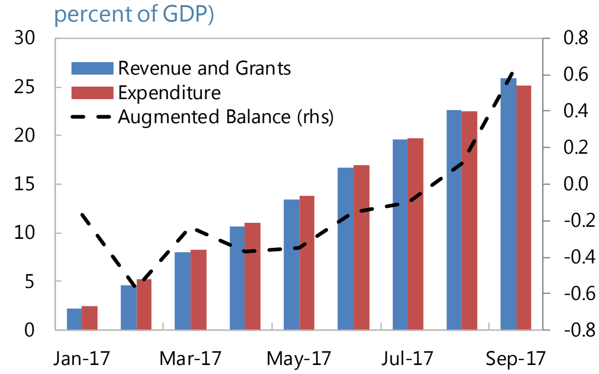
Contributions to CPI Inflation
(annual percentage change)



Sources: National Bank of Moldova and IMF staff calculations.

7. **The fiscal deficit for 2017 is likely to be narrower than initially projected, following better than expected revenue performance and spending delays (Figure 2).** Stronger than planned tax revenue performance and broad under-execution of spending led to an augmented fiscal surplus of 0.6 percent of projected GDP in September. Revenue over-performance is largely due to higher than expected trade activity, higher average wage growth, and tax and customs reforms payoffs. Under-execution of spending relates to

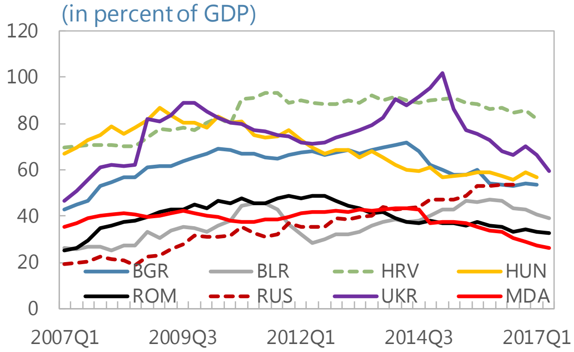
General Government Budget Balance
(Cumulative from the beginning of calendar year, in percent of GDP)



Sources: National Authorities, and IMF staff calculations implementation delays in road transportation projects, reorganization of ministries and external financing uncertainty.

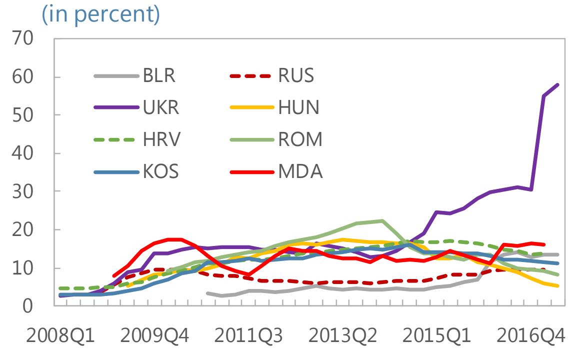
8. Steady progress has been made in rehabilitating the banking system, but challenges remain and nominal credit growth continues to be weak (Figure 3). Following the failure of three banks in 2014, bank credit to the economy dropped significantly to 26 percent of GDP in 2017Q2—down from an average of 40 percent of GDP over the 2008–2013 period—the lowest among regional countries (see text figure). This decline is mostly due to a reduction in fraudulent corporate loans associated with the bank fraud, and is partially offset by growth in the unsupervised non-bank credit sector which has grown significantly, albeit from a low base. All remaining banks are highly liquid and are assessed to meet minimum capital requirements.

Bank Credit to the Economy
(in percent of GDP)



Sources: National Bank of Moldova, IMF FSI's, Haver, and IMF staff calculations.

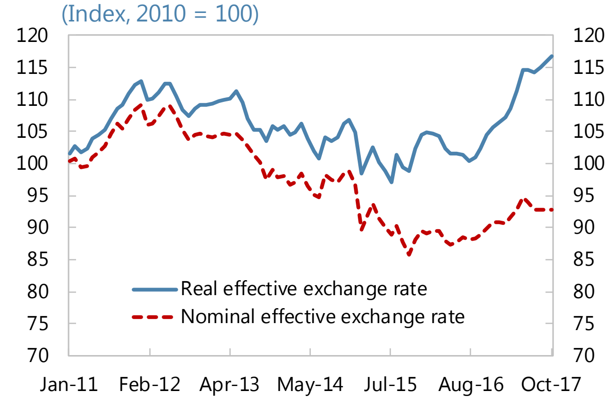
NPLs to Total Loans
(in percent)



Sources: National Bank of Moldova, IMF FSI's, Haver, and IMF staff calculations.

9. The Leu has appreciated recently and foreign reserves are accumulating (Figure 4). The Leu has strengthened amid renewed capital inflows which, along with a pick-up in inflation, have contributed to an appreciation in the real effective exchange rate since October 2016. Foreign reserves have increased to US$2.7 billion at end-October (from US$2.2 billion at end-2016) to stand at 144 percent of the Fund's reserve adequacy metric. Remittance flows, which cover about half the trade deficit, remained strong but have yet to recover to pre-crisis levels.

Exchange Rates
(Index, 2010 = 100)



Sources: National authorities; and IMF staff calculations.

10. Overall, the external position is assessed to be broadly in line with fundamentals. The current account and real effective exchange rate are estimated by the EBA-lite methodology to be close to levels implied by fundamentals, while the net international investment position has broadly stabilized in 2017. At the same time, reserve coverage has strengthened, and is projected to be 147.6 percent of the Fund's reserve adequacy metric at end-2017 (see Annex I).

ECONOMIC OUTLOOK AND RISKS

11. Growth is likely to soften in the near-term but still remain robust. Growth is forecast to reach 3.5 percent in 2017 and 3.0 percent in 2018, down from 4.6 percent in 2016. The expected slowdown is largely driven by easing consumption into 2018 and less favorable agricultural output following two good harvest years, while the investment recovery and the external environment continue to support growth.

12. Inflation is forecast to slow in the near term. Despite the recent increase, CPI inflation is forecast to return to the NBM target in the coming months, and average around 4.5 percent in 2018. This inflation slowdown is expected to be driven by the unwinding of the impact from price level shocks to food, energy and regulated prices, along with a softer near-term growth outlook. Underlying inflation is forecast to remain stable in 2018. The risks to inflation remain two-sided. On the upside, there could be second round effects from recent price-level shocks–although there has been mixed evidence of pass-through to underlying inflation in the past– while the outlook for regulated prices ahead of the upcoming election could pose downside risks.

13. Growth is expected to recover to 4 percent in the medium term, but to remain at this level strong macroeconomic policies and reforms will be needed. Modest fiscal deficits, focused particularly on raising public investment, would continue to provide support to the economy. Stronger banks and improved financial intermediation remain critical to encourage credit to productive sectors. The exchange rate should continue to act as a buffer against shocks. This policy combination should support investment and improve capital allocation in the economy, promoting more balanced growth in the medium-term, and rising incomes. The risk of debt distress remains low, with favorable dynamics envisaging a decline in both total external and public and publicly guaranteed debt (Annex II).

14. Beyond external shocks (Annex III), the outlook is subject to substantial downside risks. Moldova is vulnerable to external shocks, including structurally weak growth, or a significant slowdown in key trading partners, which would reduce export demand and lower remittances, thereby weakening both growth and the fiscal position. Domestically, program implementation could be tested in the run-up to parliamentary elections at end-2018, in the face of demands for populist decisions. Also, continued progress on banking sector reforms, including improved governance and risk management that would allow banks to normalize financial intermediation, hinges on sustained political commitment to strengthen the sector and tackle vested interests. More broadly, without addressing infrastructure gaps and improving the efficiency of investment, potential growth could be slowed in light of adverse demographic trends and lower global TFP contributions.[2] Furthermore, without ongoing regulatory and institutional reforms, including to address weak governance, corruption, and relatively low development of human capital, progress will not be made in improving the investment climate and combating the shadow economy.

[2] See Selected Issues Chapter "Public Investment, Efficiency and Growth: The Case of Moldova" (www.imf.org).

The authorities broadly agreed with the medium-term outlook and risks facing Moldova. While they see greater downside risks to inflation in 2018, they echoed the medium-term challenges related to demographics, governance, and the need for wide-ranging institutional reforms. As priorities, they envisage a focus on education reform, strengthening the rule of law, and renewed support for road infrastructure investment. They also believe that the medium-term growth outlook can be stronger and that the reform agenda can be delivered despite the forthcoming elections.

ARTICLE IV DISCUSSIONS: ADDRESSING MEDIUM-TERM CHALLENGES TO RAISE GROWTH

15. **To accelerate growth and improve living standards, macroeconomic and financial stability should be supported by deep structural reforms.** In this regard, Article IV discussions focused on three interrelated policy priorities. First, consolidating macroeconomic stability by strengthening the effectiveness of monetary policy while ensuring exchange rate flexibility, and preserving fiscal sustainability with a growth-friendly spending orientation; second, decisively cleansing the banking system and strengthening the regulatory and supervisory environment to safeguard macro-financial stability and encourage financial intermediation; and third, structural policies should support stronger investment and TFP growth by continuing to focus on strengthening governance, improving infrastructure, raising the quality of human capital, and facilitating private sector activity.

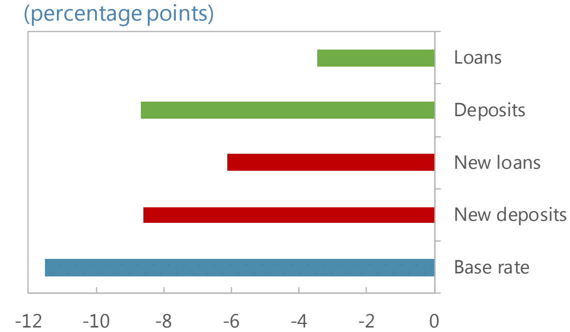
A. Strengthening the Effectiveness of Monetary and Exchange Rate Policies

The framework should remain focused on anchoring inflation at around target, while continuing to allow exchange rate flexibility.

Background

16. **Despite successfully containing inflation pressures since 2014, the weak and uncertain transmission mechanism complicates the conduct of monetary policy.** Tight monetary policy in 2014–15 helped ease pressures and maintained confidence (Figure 5). On the back of receding inflation pressures, the NBM embarked on a series of policy rate cuts since February 2016, however these have not translated into commesurate reductions in market rates. Over this period, the interest rate on new loans (deposits) declined by only 6¼ (9½) percentage points, reducing the average rate on the stock of bank loans (deposits) by

Change in National Currency Interest Rates from January 2016 to September 2017
(percentage points)



Sources: National Bank of Moldova and IMF staff calculations.

3½ (8.7) percentage points. This reflects, *inter alia*, the incomplete financial system rehabilitation, which has weakened the transmission mechanism of monetary policy, posing a challenge to correctly calibrate instruments to achieve inflation goals. High risk premia for Moldovan firms including from weak financial infrastructure, (e.g., short track record with a credit registry) may hamper the transmission mechanism.

17. Structural liquidity remains high in the banking system. Partly as a legacy from the crisis, but also in light of the on-going restructuring efforts, banks have significant liquidity buffers. These have further increased in 2017 by the NBM's intervention policy, which was especially heavy in the third quarter, with purchases amounting to US$403.7 million. To address structural excess liquidity, the NBM has maintained required reserves ratio on leu and foreign currency deposits at record highs of 40 and 14 percent, respectively.

Policy Discussions

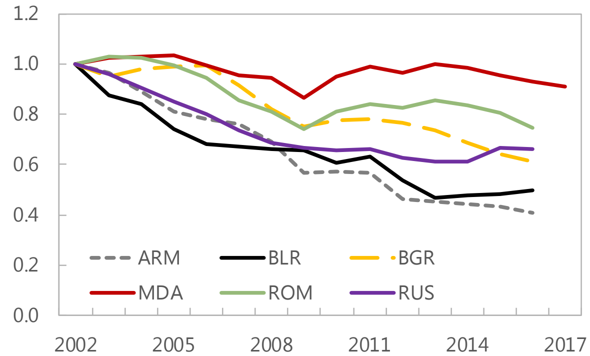
18. The authorities' inflation objectives remain appropriate, and to secure them, a pause in rate cuts is needed at this juncture. Aiming for inflation at 5 percent (±1½ percent) will help reduce uncertainty and anchor private sector decisions over the medium-term. At present, the stance of monetary policy is likely less accommodative than implied by the policy rate: lending rates have fallen by less than the policy rate due to the ongoing banking sector restructuring and, despite falling through 2016, the real interest rate based on inflation projections remains above pre-crisis levels. Going forward, the current elevated inflation rate and long and variable transmission mechanism mean a pause in policy rate cuts is appropriate at this stage until inflation moves more firmly towards target. The NBM reaffirmed its strong commitment to achieving the inflation target and stands ready to change the stance as the inflation outlook evolves (SMEFP ¶8).

19. Measures should also be taken to bolster the inflation targeting framework, helping to anchor expectations and improve the transmission mechanism (SMEFP ¶9)**.** Efforts under way to rehabilitate the banking system will help improve the transmission mechanism and reduce the liquidity overhang over time. Staff welcomes efforts to enhance collaboration and information sharing, including the Memorandum of Understanding signed between the NBM and the Ministry of Finance on liquidity management and policy coordination. Further strengthening internal policy communication is key to ensuring that monetary policy benefits as much as possible from strengthened synergies across departments and with NBM management. To enhance external communications and better anchor inflation expectations, staff recommends adhering to a regular calendar for monetary policy decisions and announcements, while improving the analytical focus and forward-looking nature of inflation reports.

20. The flexible exchange rate regime should remain the first line of defense against external shocks. With reserves being restored to more adequate levels, intervention should be limited to smoothing excessive exchange rate volatility. As unit labor costs remain relatively high, continued implementation of structural reforms is crucial to boost productivity and improve external competitiveness while allowing a gradual increase in real wages.

Unit Labor Costs

(Index, 2002 = 100)



Sources: WEO, Haver, and IMF staff calculations.

The authorities noted their commitment to their inflation targeting and flexible exchange rate regime framework. They project that inflation will likely fall below target in the absence of early, decisive policy action. They are working towards further strengthening the inflation targeting regime, including the inflation forecasting process, internal and external communications, and coordination with other agencies.

B. Preserving Fiscal Sustainability in a Growth-Friendly Environment

Fiscal discipline and debt sustainability should be preserved, while providing space for growth-friendly priority public investment and social spending.

Background

21. The authorities have focused on improving revenue performance, including through the unification of tax administration. The main state and territorial tax inspectorates were merged into a single legal entity—the State Tax Service (STS). This tax administration reform has supported an increase in compliance, and revenues from the corporate income tax and VAT have grown by 22 percent and 18 percent respectively over the same period in 2016. The authorities expect further efficiency gains from improvements in information technology infrastructure that would help simplify the taxpayer registration process and consolidate taxpayer information in a single electronic file. More broadly, the authorities have engaged in important efforts to address "envelope wages" (wages paid unofficially) and the shadow economy. Box 1 outlines the tax and customs efforts undertaken and planned by the authorities aimed at addressing these issues, though the long-term effect of such reforms is uncertain.

Box 1. Tackling the Shadow Economy

Moldova's shadow economy is sizable. Moldova has revised its tax and customs policy to help address the shadow economy. Measures to help simplify the tax administration process and facilitate compliance include developing a single tax return on wages, automating the taxpayer registration process, creating a single taxpayer account with a unified treasury code, and introducing a special regime for IT companies—one of the sensitive sectors in unofficial payments.

Information sessions organized by the STS to enhance compliance are targeting employers and employees belonging to sectors and companies with high risk of informal activity. Information campaigns also focus on reporting individual income from unregistered market activity and house leasing. The authorities intend to use enhanced monitoring of the general electronic register of VAT invoices and the register of ownership changes to mitigate VAT fraud. They plan in 2018 to make use of electronic tax invoices by certain economic entities mandatory.

Also on the administrative side, the 2016 inter-ministerial plan on reducing "envelope salaries" was revised to facilitate joint audits by the STS, the Labor Inspection, and the Department of Police, while tax audits have aimed to strengthen the detection of VAT frauds and untaxed wages. The authorities aim to further strengthen the compliance risk management and audit functions of the STS, with emphasis on the large taxpayers and high wealth individuals (SMEFP ¶15). In parallel, the customs service has intensified efforts to tackle the smuggling of goods—particularly cigarettes—which would facilitate legal transactions and the official recording of imports.

While wide ranging steps have been taken to bring the informal economy out of the shadows, additional measures (beyond tax and customs) can produce a more comprehensive package of reforms to incentivize informal workers to transition to the formal sector. Better functioning of the labor market critically depends on improving the efficiency of funds allocated for education, providing a stronger focus on vocational training.

22. Investment spending under-execution continues, but progress is being made with public administration reform. While the rehabilitation of national roads remains among the main infrastructure priorities for the authorities, implementation delays were observed in capital projects (Figure 6). Under-execution was in part due to heavy reliance on external financing the timing of which can be uncertain and delays in project appraisal, selection, and implementation. More specifically, delays in road infrastructure spending in 2017 also related to bottlenecks in implementation by contractor companies, further underscoring the importance of high quality project appraisal and selection processes. In parallel, consolidation is taking place in the central public administration and the restructuring of line ministries. While further quantitative assessment would be helpful, the goals of the public administration reform are discussed in Box 2.

Box 2. Advancing Public Administration Reform

The government is undertaking a public administration reform focused on consolidating the central public administration, reorganizing ministries to optimize staffing, and introducing a single wage system for the budget sector (SMEFP ¶15). The objectives of the reform include improving the decision-making processes, and reducing bureaucracy and the cost of running the government. The Center for Reform Implementation (CRI) created in January 2017 is tasked with implementing the reform and evaluating its progress. To date, the CRI has coordinated the new Law on Government, the new Government structure and creation of the Agency of Public Property. In 2017, the number of ministries was reduced from 16 to 9, and the staff count declined by around 40 percent, with estimated savings of 94 million lei. The reorganization of governmental bodies and authorities subordinated to the ministries will reduce these staff positions further, generating additional expected savings of 150 million lei. The objective of the new government structure is to depoliticize the functioning of the ministries by eliminating Deputy Ministers and strengthening the role of the State Secretaries. The Public Property Agency aims to improve the business environment and investment attractiveness by better managing public property. Finally, the Agency of Public Services created in April 2017 is intended to serve as the one-stop shop for citizens and businesses, and use e-Governance tools to make public services more accessible and transparent.

To complete public administration reform, the central administration reform will be followed by administrative-territorial and local public administration reforms. The local public administration reform will aim at unifying some of the municipalities to streamline funding and improve project implementation. A comprehensive quantitative assessment of the impact of the public administration reform has not yet been undertaken.

Policy Discussions

23. **Prudent fiscal and borrowing policies remain essential to maintain economic and financial stability.** An augmented overall deficit of about 3.3 percent of GDP in 2018, gradually declining to 2.8 percent over the medium-term will allow space for priority investment and social spending. It will also keep public debt firmly anchored around 44 percent of GDP, preserving Moldova's low risk of debt distress (see Annex II), which is appropriate given its vulnerability to external shocks.

24. **Staff supports efforts to improve public investment while keeping current spending contained.** Raising Moldova's growth potential critically rests on improving the efficiency of infrastructure spending and public investment procedures. To this end, the authorities should seek to strengthen public investment management, applying more rigorous project appraisal and implementation monitoring mechanisms to prevent delays and cost overruns. In the meantime—given absorptive capacity constraints and heavy reliance on donor support— a measured approach to scaling up investment is warranted (see footnote 2). More broadly, capital spending should increasingly seek to rely on domestic funding sources to mitigate financing uncertainty. In the near term, the authorities plan to focus infrastructure spending on rehabilitating the road network and, over the medium-term, reform the railway system and enhance energy security and reliability, including in gas (SMEFP ¶15). Current spending should remain contained, and in this regard the

public wage bill should be managed to avoid it increasing in percent of GDP and unduly constraining priority spending. Equally important is ensuring that public administration reform and reorganization of ministries do not slow spending that is critical to address infrastructure needs.

25. The authorities continue to strengthen their fiscal framework. Staff welcomes the authorities' plan to publish their first Fiscal Risk Statement in 2018, which will focus on key fiscal risks including those related to local governments and SOEs. Staff also welcomes efforts to streamline the Fiscal Responsibility Framework by simplifying the budgetary process and suspending current payments from the budget to corresponding budgetary authorities until they clear their arrears by year end.

The authorities agreed with the need to pursue growth friendly fiscal policies while preserving debt sustainability and supporting investment and priority social spending. The authorities concurred with the proposed fiscal targets and see the 2018 budget as appropriate, balancing the need for sound fiscal policy and meeting investment and other priority needs. The authorities are actively strengthening revenues, partly by shrinking the shadow economy, in order to provide resources to meet priority needs. The authorities welcomed suggestions to strengthen public investment procedures and are already pursuing efforts to strengthen their fiscal framework.

C. Rehabilitating the Financial Sector to Support Credit Growth

Safeguarding macro-financial stability requires decisive cleansing of the banking sector, to allow institutions to normalize financial intermediation and thereby support the real economy.

Background

26. A wide-ranging reform agenda is being pursued to strengthen supervisory and regulatory frameworks. Following the 2014 bank fraud, the authorities initiated a set of reforms aimed at improving the governance and stability of the financial sector (Figure 7). The agenda was wide-ranging, including efforts to improve transparency in ownership and management, strengthen supervisory and regulatory frameworks, and undertake bank level diagnostics. More recently, the voting rights of non-transparent and otherwise unfit shareholders were suspended and the system's second largest bank was placed under temporary administration. Since then, the authorities have taken a number of additional steps to address governance and stability issues:

- **International standards and best practices are being introduced into law.** The Bank Recovery and Resolution Law was introduced in October 2016 and a new Banking Law was approved in October 2017 (to take effect on January 1, 2018). The authorities have also more than tripled the deposit insurance coverage (effective as of January 1, 2018) and are preparing internal NBM guidelines for the provision of Emergency Liquidity Assistance (ELA). In parallel, draft laws governing non-bank credit organizations and anti-money laundering /combatting the financing of terrorism (AML/CFT) were submitted to parliament. Further, the authorities are taking steps to strengthen the Financial Intelligence Unit's independence and operational capacity and to improve domestic cooperation.

- **Comprehensive bank diagnostics are underway**. Full scope **onsite inspections** have been conducted in five out of the seven banks that are not part of foreign banking groups, finding that banks, despite being compliant with minimum regulatory capital requirements, need improved governance, risk management, internal audits and controls. Subsequently, these banks were ordered to take remedial actions, including to recognize and provision against legacy credit risk associated with poor underwriting, which translates into increased reported non-performing loans. **Related party reviews** were conducted in the three largest banks, with the assistance of an international firm. The findings indicated related party exposures well in excess of prudential limits, although the related risk to capital is contained because these exposures are already largely provisioned. A newly established Coordination Committee within the NBM, which reports directly to a Deputy Governor, has been tasked to prepare recommendations to the executive board based on these reviews.

- **The NBM's governance, legal protection, and independence has been strengthened.** A new supervisory board was established in 2016, legal support is provided for staff facing investigations, and staff remuneration is better aligned with market terms.

27. The transfer of bank ownership to fit and proper shareholders has faced delays. The NBM removed non-transparent and otherwise non-compliant shareholders from the management of two systemic banks during December 2015 - October 2016. In March 2017, the NBM fined a large non-compliant shareholder in a third systemic bank and directed disinvestment of the shares. Nevertheless, delays in transferring such "problem" shares to new owners have arisen for multiple reasons, some legal/technical/procedural associated with sale to potential buyers, some—likely—due to vested interests. Currently, two of the three banks are controlled by incumbent shareholders and are subject to NBM's daily monitoring, while one bank has been under NBM's temporary administration since October 2016.

28. More broadly, banks continue to have a limited role in supporting economic growth. As in other banking crisis cases, the resumption of lending to the domestic economy often takes time. This is all the more likely in cases where financial intermediation was previously hampered by governance challenges. Slow resumption of lending has both supply and demand components. Better risk management in the banks, including stricter loan provisioning and tighter underwriting standards (including the refusal to accept undeclared income as a future source for loan repayments), while a vital part of the effort to strengthen the banking system, are reported as holding back credit supply. On the demand side, political uncertainty and concerns about the absence of rule of law are cited as restricting factors, although borrowers' repayment capacity is reported as stable or improving. As a result, and in view of continued cleansing and rehabilitation of the financial sector, credit growth remains negative. In this environment, loans to households and businesses from non-bank credit organizations increased significantly between end-2012 and 2017, with their share in total lending to the economy increasing from 7.1 to 15.5 percent according to the authorities' estimates.

Policy Discussions

29. Transfer of bank ownership to fit and proper shareholders is essential to safeguard financial stability and facilitate new sound lending to the economy. Certification of incoming shareholders and managers in line with law will be critical to ensure transparency of banks' ownership. Also, continued clean-up of banks' balance sheets will enable banks to take on a more active role in providing credit to the real economy, while adhering to best practices in credit risk management. To support this development, supervisory resources need to be increased and efforts focused on key risks, including by adopting standards for banks' management of insider and related party risk.

30. In addition, further efforts are needed to consolidate financial sector rehabilitation, including:

- **Strengthening the financial safety net.** Further reforms are needed to support crisis preparedness and management, including to (i) ensure backup funding for the Deposit Guarantee Fund (DGF), expand its coverage to corporates, and allow the DGF to support the transfer of liabilities in liquidation; (ii) strengthen the operational framework for ELA, its governance and oversight; and (iii) improve the bank liquidation framework to facilitate orderly exit in the event of failed banks.

- **Bolstering the AML/CFT framework.** Following Moldova's first ML/FT National Risk Assessment, the authorities have adopted a time-bound National Action Plan (NAP) to mitigate ML/FT risks. Bringing the legal and regulatory framework into line with the Financial Action Task Force (FATF) standards, notably with respect to confiscation and provisional measures and identification of beneficial ownership by reporting entities, and effectively implementing a risk-based approach to AML/CFT supervision should support financial sector integrity and development.

- **Addressing risks from growth of non-bank financial institutions.** While the authorities' focus has appropriately been on cleansing and restructuring the banking system, the mostly unregulated non-bank credit organizations have grown significantly. Potential financial stability risks include contagion effects via banks' funding of non-banks and increased borrowing from households and corporates. Adoption and effective implementation of the draft legislation on non-bank credit organizations, will help mitigate potential risks and allow for consumer protection. Furthermore, it will be important to move forward with reforms of the regulatory framework of the insurance sector, including by introducing solvency II.

The authorities broadly shared staff's views and expressed their firm commitment to complete the rehabilitation of the banking system. They noted their wide-ranging efforts in the last two years to restore financial stability and actions they plan to take in the coming months, including: (i) the transfer of bank control to fit and proper shareholders and managers; (ii) exit of a systemic bank from temporary administration; (iii) operationalizing the new central securities depository (CSD) and verification of the integrity of share registration; (iv) completion of onsite inspections, identification of related parties and management of their risk; (v) enforcement actions in cases of supervisory shortcomings; and (vi) initiation of the asset recovery process from the 2014 fraud.

D. Advancing Structural Reforms for Sustainable and Inclusive Growth

With labor migration and other demographic challenges, structural reforms are essential to raise medium-term growth prospects.

Background

31. Despite moderate economic growth in the past two decades, Moldova's per capita income lags that in Europe and other regional countries. The country remains highly reliant on the agriculture sector and remittances, which have been insufficient to raise income standards and create jobs. Agriculture accounts for a third of employment and, together with the agro-processing sectors, for about one third of GDP. While remittances play an important role in reducing poverty, especially in rural areas, they are also associated with low labor participation and high reservation wages.

32. Unfavorable demographics weigh on growth and intensify pressures on social protection programs, pensions and health care. Moldova's population declined over the past two decades, with the official population estimate at 3.55 million and the 2014 census estimate below 3 million. It is also expected to decline by more than 15 percent by 2050.[3] The working age population started to decline steadily since 2012, in part due to net emigration, and the share of older workers has risen significantly since the 1990s.[4] These factors will not only weigh on labor's contribution to potential growth, but also put greater pressure on health care and pension spending over time.

33. Potential growth is further held back by headwinds to investment. While comparable to other CIS countries, public investment and the capital stock in Moldova are significantly lower than in Eastern Europe. As for private investment, the main challenges are weak governance and corruption, low human capital and large infrastructure gaps.

Policy Discussions

34. Encouraging capital accumulation and enhancing the efficiency of public investment are crucial to raising medium-term growth prospects. Bolstering the investment climate would encourage private investment, which would help increase the economy's productive capacity amidst unfavorable demographic and TFP trends. Improving the efficiency of public investment can further raise potential growth and address infrastructure gaps, even where fiscal space is limited.[5]

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[3] United Nations, World Population Prospects, 2017 Revision

[4] The number of persons aged 60 years and over per 100 inhabitants has increased from 13 in late 1990s to 17.2 in 2016.

[5] See Selected Issues Chapter "Public Investment, Efficiency and Growth: The Case of Moldova" (www.imf.org).

35. Labor market reforms and human capital development would help address demographic pressures. While the authorities are piloting some employment-inducing measures, further policy action is needed to make the labor market more inclusive, such as by developing and implementing customized employment and training measures for target groups that are most in danger of social exclusion (e.g., young people). It is also important to promote return migration (particularly of the highly educated); provide training tailored to the needs of returnees and ensure effective recognition of the skills gained abroad; and better leverage remittances.[6] To open entrepreneurial activities to returnees, providing a level playing field for small businesses and enhancing their access to finance would be critical. Additionally, fostering human capital development through better prioritization, screening and monitoring of education projects could help bring firms and workers out of the shadows, reduce poverty, and promote more inclusive growth (see footnote 3).

36. Further measures are needed to bring the informal economy out of the shadows. Moldova has one of the largest degrees of informality in Europe, which weighs on growth through several channels, including sub-optimal financial deepening, provision of public goods, limiting incentives for companies to expand, and quantity and quality of the labor force. The policy response must be multi-pronged. Recent measures aimed at improving tax compliance (Box 1) are welcome and further progress is needed to reduce regulatory and administrative barriers; and improve government effectiveness, transparency, and accountability. These include promoting transparency of ownership structures, strong enforcement of competition rules, improved regulatory frameworks for infrastructure and finance industries and clearer recruitment procedures for civil servants.

37. A more diverse economy would also help support medium-term growth. Enhancing competitiveness and attracting FDI can help increase economic diversification. Moldova's FDI inflows remain subdued and concentrated. FDI was 2 percent of GDP in 2016, 10 percentage points below pre-crisis levels. And while the enactment of the Deep and Comprehensive Free Trade Area (DCFTA) agreement could increase opportunities, it will require broad regulatory and institutional reforms to prepare domestic products for more competitive markets.

The authorities broadly agreed with the medium-term challenges facing Moldova. They are committed to pursuing a wide-ranging agenda aimed at accelerating growth and supporting job creation and policy reduction. They are implementing initiatives such as "Prima Casa" to support first time home buyers, taking steps to address the shadow economy and strengthen human capital, and pursuing the DCFTA to help diversify the economy.

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[6] See International Monetary Fund (IMF), 2016, Staff Discussion Note "Emigration and Its Economic Impact on Eastern Europe." (https://www.imf.org/external/pubs/ft/sdn/2016/sdn1607.pdf)

PROGRAM DISCUSSIONS: SUSTAINING THE MOMENTUM OF REFORM

38. Program discussions focused on measures to keep the program on track and achieve its objectives.

A. Financial Sector Policies

39. The identification of all banks' ultimate beneficial owners (UBOs) and the sale/transfer of "problem" shares in three systemic banks has advanced notably in recent months, and is expected to be completed in the first half of 2018. The authorities are committed to certifying all incoming shareholders and managers in line with the law.

- *Largest bank – Moldagroindbank (MAIB):* An early November 2017 Constitutional Court decision on irreversibility of the cancellation of 43 percent of outstanding shares, clarified legal risks potentially faced by incoming shareholders. To facilitate the sale of new shares issued to replace cancelled ones, the authorities have further committed to mitigate risks best borne by the state, including by (i) amending the law on state property ownership to allow the state to step in as an intermediate owner to safeguard financial stability, provided there is a pre-agreed back-to-back purchase and sale agreement with a committed fit and proper investor (**prior action**); and (ii)making use of a clearly defined contract-based indemnity. Against this backdrop, a consortium of reputable foreign investors, which concluded its due diligence already in February 2017, has reiterated its interest in acquiring the bank's newly issued shares. This is now expected to be completed by end-April 2018.

- *Second largest bank – Moldinconbank (MICB):* A late September 2017 appeals court decision, clarified that suspended shares—63 percent of total outstanding shares—are available for sale, allowing the NBM to implement its strategy to allow the bank to exit temporary administration (**reset structural benchmark, end-June 2018**). The NBM has a contingency plan in place, should this approach face substantive impediments or delays that would undermine financial system stability.

- *Third largest bank – Victoriabank (VB):* The NBM has received a formal application from a foreign commercial bank to acquire shares from a non-compliant shareholder, who also has submitted a formal notification to the NBM of its intention to sell (39 percent of total outstanding shares) as well as any shares from other remaining shareholders. The shares are expected to be sold by end-February 2018. In the unlikely case this deal does not go through, the NBM will take action, in line with the law, to remove the non-compliant shareholder.

- *Four non-systemic banks:* Investigations into concerted activities, and fitness and probity of shareholders are set to be finalized by end-March 2018 **(reset structural benchmark)**, upon which the NBM will take enforcement actions, in line with the law.

40. The shareholder removal process will be further streamlined to address governance issues. Delays in the sale of "problem" shares have magnified risks embedded in the current shareholder removal framework, including the risk of decapitalization stemming from banks' obligation to buy back unsold "problem" shares to compensate removed shareholders. To mitigate legal and decapitalization risks, procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, will be transposed into law (**prior action, previous structural benchmark),** (see SB 10 Table 10 Country Report No. 17/102). Subsequently, the authorities will, in consultation with the Fund, adopt a new framework for removing concerted or otherwise unfit shareholders (**reset structural benchmark, end-April 2018)**.

41. The transfer of share registration will help ensure integrity of legal records. In line with the agreed methodology and procedures for verification of the integrity of legal records of security holders, the National Commission for Financial Markets (NCFM) will complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign **(reset structural benchmark, end-March, 2018)**—part of the verification procedure contemplated in the law. Once share registration is transferred to the CSD, the scope for fraudulent changes in bank ownership will be significantly reduced.

42. Bank diagnostics and related enforcement actions are being finalized, and bank management is being strengthened. NBM is preparing to act on the findings of recent related party reviews in three large banks **(structural benchmark, end-January 2018)**. To this end the NBM is preparing: (i) internal procedures for presuming a party related to a bank, based on the objective criteria adopted in November 2016, and (ii) guidelines to assist banks in managing their related party risk, the latter of which will be issued for consultation with the banks **(structural benchmark, end-June 2018)**. Full scope onsite inspections in two small domestic banks that are not part of foreign banking groups will be finalized by end-January 2018 **(reset structural benchmark)** and in banks that are part of foreign groups by end-May 2018 **(reset structural benchmark).** To support confidence in banks' management, the NBM will request all banks to perform a self-assessment of corporate governance **(structural benchmark end-August 2018**).

43. Investigation into the 2014 bank fraud is moving to the recovery phase. A consortium of international firms is concluding its investigation and is due to submit a final report to the authorities. The main findings will be summarized in a report that will be made public, and a strategy with time-bound actions to recover assets will be adopted (**structural benchmark end-December, 2017**).

B. Monetary and Fiscal Policies

44. Monetary policy continues to aim to achieve the inflation target. While the authorities remain committed to their inflation targeting regime the outlook for inflation has been updated to reflect recent developments and the path for the inflation consultation clause updated accordingly (see also paragraphs 6 and 12). During the informal consultation, the authorities explained that this was due primarily to an overshooting of food prices and one off health care costs. In light of the supply side factors underlying the overshooting of inflation staff and the NBM updated the quarterly path of the inflation consultation clause.

45. Fiscal targets for June and September 2017 were met with comfortable margins. Budget execution over-performed relative to program targets, owing to stronger than planned revenue performance and lower than expected execution of spending and on-lending to SOEs (text table). Domestic state arrears remained below the indicative ceiling in June, but exceeded the September target by 2 million lei (about 0.001 percent of GDP). The wage bill remained within the program ceilings, while priority social spending exceeded the indicative floors in June and September.

Moldova: General Government, June and September 2017
(Cumulative from the beginning of calendar year; millions of Moldovan lei)

	June		Sep	
	Actual	Target	Actual	Target
1. Quantitative performance criteria [1/]				
Ceiling on the ***augmented*** cash deficit of the general government	233	3,670	-957.9	5,485
Of which: on-lending agreements with external creditors to state-owned enterprises	132	410	204	808
2. Indicative targets				
Ceiling on the stock of accumulated domestic government arrears	12	26	15	13
Ceiling on the general government wage bill	6,283	6,358	9,155	9,292
Floor on priority social spending of the general government	8,515	8,450	12,862	12,766

Source: IMF Staff estimates
1/ Indicative targets for September 2017.

46. The 2017 Budget amendment approved by parliament (prior action) locks in some of the over performance and safeguards the end-year target, while providing space for priority spending. The amendments focused on providing space for capital and priority social spending, while accommodating mandated wage increases. Measures include one-off growth-enhancing capital spending projects and poverty-reducing measures resulting in higher priority social spending by about 295 mil lei (about 0.2 percent of GDP). The amended budget aims at an augmented deficit target of 3.1 percent of GDP, consistent with the ceiling of 3.7 percent of GDP (SMEFP ¶13). Within the lower deficit, the supplementary budget also provides for legally mandated salary increases in the education and justice sectors, overtime compensation, and Customs Service and Border Police staffing needs, all of which result in a wage bill that is higher than initially programmed by 197 mil lei (about 0.1 percent of GDP). The wage bill and priority social spending targets have been modified accordingly to accommodate higher spending in these areas, in light of the low level of public sector wages and ongoing public administration reforms. The authorities are on track to clear state arrears this year, and are supporting stronger controls on arrears going forward by amendments to the Law on Public Finances and Fiscal Accountability. The end-December target for on-lending to state owned enterprises is being reduced in light of updated information from external creditors.

47. A 2018 Budget in line with program targets is expected to be approved by Parliament (prior action). The draft budget submitted to parliament is consistent with the agreed deficit target of 5,264 million lei (SMEFP ¶14), 3.3 percent of GDP. Revenue measures include increasing the excise rates on tobacco, petroleum, and alcoholic products, and expanding the wealth tax base for property worth more than 1.5 million lei by also including vehicles. The budget provides for much needed infrastructure investment—such as the rehabilitation of the roads network—and increased priority social spending mainly related to essential expenditures in health and pensions.

C. Energy Sector Reforms

48. **The authorities are taking steps to strengthen the legislative and institutional frameworks in the energy sector.** They continue to collaborate with key stakeholders (the World Bank, Energy Community Secretariat, and private sector participants,) on energy sector reforms. In September, Parliament approved the new Energy Law, which aims to enhance the transparency and accountability of the executive board of ANRE (the regulator) (SMEFP ¶16). The government and Regulator (ANRE) are in the process of adopting secondary legislation to ensure full implementation.

49. **In the electricity sector, greater transparency and accountability in the tariff-setting process will help avoid further legal disputes and enhance the regulator's independence.** In November, the Energy Community Secretariat initiated dispute settlement proceedings against the Republic of Moldova for non-compliance with the Treaty establishing the Energy Community. Yet, the authorities remain committed to eliminating debt accumulated by energy companies and improving tariff-setting methodologies, to ensure transparency and cost-recovery in the sector. Among others, this includes: (i) a commitment to recover recognized accumulated financial deviations by energy companies, and (ii) adopting a new tariff methodology **(structural benchmark, mid-February 2018)** fully based on the Electricity law and taking into consideration differences in the assessment of financial deviations from April 2017–February 2018. Adoption of the new methodology by end-February is intended to allow sufficient time for consultation and data collection ahead of determining new tariffs in Spring 2018 (SMEFP ¶17).

50. **In the heating sector, the authorities aim to finalize the implementation of the action plan agreed between ANRE and the WB.** This includes (i) determination of the amount of financial deviation and of the recovery mechanisms, and (ii) working out legal aspects of the application of heat loss methodology, based on the recommendations of the WB from early-2017 (SMEFP ¶17). The authorities will also continue the dialogue with Gazprom and other stakeholders regarding the restructuring of heating sector debt with Moldovagaz.

PROGRAM FINANCING AND MODALITIES

A. Program Monitoring and Financing

51. **Program monitoring will continue to be guided by semi-annual reviews, semi-annual and continuous performance criteria and indicative targets, and structural benchmarks.** The attached Letter of Intent (LOI) and Supplementary Memorandum of Economic and Financial Policies (SMEFP) describe the authorities' progress in implementing their economic program and updated program conditionality is presented in SMEFP Tables 2 and 3. A revised Technical Memorandum of Understanding (TMU) is also attached. The authorities committed to implementing four prior actions for the completion of this review:

- Amend the laws on State Property Ownership and other relevant laws to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors to safeguard financial stability.
- Replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law.
- Adopt amendments to the 2017 Budget consistent with the current augmented deficit ceiling. Completed on November 15.
- Adopt the 2018 Budget in line with existing program commitments.

52. Conditionality is proposed for the period ahead. Given the important progress in core program areas, six structural benchmarks in the financial sector that posed considerable political and technical challenges were reset for later dates, aligning them better with the authorities' implementation capacity while ensuring the achievement of program objectives.

53. The program remains fully financed, although the timing of external support has been revised. The size of the remaining external financing package, estimated at US$322 million for the period until the end of the program, will allow reserves to remain close to the top end of the Fund's ARA metric (146.2 by end-2018). Some delays have been experienced in the agreement and disbursements of the EC Macrofinancial Assistance (MFA), however, the MFA MOU was approved by the Commission in November, and decisions on individual disbursements will be made based on Moldova's execution of agreed actions and a political assessment by the European Commission. The Romanian authorities disbursed the third tranche of €40million in September 2017.

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

54. Moldova is expected to meet its repayment obligations to the Fund. Exposure to the Fund will reach 5.3 percent of GDP in 2017, before declining to 4.0 percent of GDP by the end of the proposed ECF/EFF (Table 7). Total debt service to the Fund will reach 0.1 percent of total exports in 2017, and will gradually decline to 0.08 percent of total exports by 2022. Moldova has a strong track record in repayments to the Fund as indicated by timely repurchases to date, and risks of debt distress remain low.

55. Notwithstanding the authorities' commitment, risks to the program remain significant. Reform momentum could be dampened if political divisions start to erode program ownership, and/or as vested interests impede reforms. This risk is more pronounced in the financial sector which, combined with the extent of vulnerabilities, motivates the heavy focus of program conditionality on the financial sector. In the energy sector, there remains a fiscal risk related to accumulated intra-firm debt and arrears as well as non-transparent regulatory decisions.

56. An updated safeguards assessment of the NBM was completed in February 2017. The safeguards framework at the central bank was earlier strengthened through legal reforms which established a new governance structure with independent oversight over NBM management. Transparency and accountability practices adhere to international standards, and the NBM continues to maintain sound operational controls. The authorities continue to implement the recommendations of the 2017 safeguards assessment. The NBM has enhanced its internal oversight on reserves management and is updating emergency lending regulations on which they recently received technical assistance.

STAFF APPRAISAL

57. Macroeconomic and financial stability are providing a crucial foundation to carry out reforms that are critical to reduce vulnerabilities and pave the way for strong and sustainable growth. Following the authorities' efforts in the last two years, the Moldovan economy has stabilized, the economic outlook has improved, the external position has strengthened, and the financial sector is on a clear rehabilitation path. However, this progress is not irreversible, and pressures from vested interests as well as the electoral calendar could derail recent gains. It is now critical that the authorities press ahead with reforms aimed at decisively cleansing the financial system, improving governance and the business climate, and attracting foreign and domestic investment to raise potential growth and living standards.

58. Monetary policy should continue to be focused on maintaining price stability in the context of a flexible exchange rate. The monetary authorities successfully reduced inflation after it peaked following the crisis, and the focus should remain on bringing inflation back to target despite the challenges of a weak and uncertain transmission mechanism, and susceptibility to supply side shocks. To support this, the authorities should further bolster the inflation targeting framework by (i) refining the forecasting process to strengthen outputs and monetary decision making, (ii) improving coordination across agencies, and (iii) strengthening internal and external communications, including by adhering to a regular calendar of monetary policy decisions. The flexible exchange rate regime should be the first line of defense against external shocks, and intervention should be limited to smoothing excessive volatility. The authorities should avoid resisting exchange rate movements that are driven by fundamentals.

59. Fiscal policy remains solid, but can be strengthened further to support priority spending while maintaining sustainability. The 2018 budget and medium-term fiscal framework are consistent with program targets and would allow for growth-friendly priority public investment, social spending, while safeguarding debt sustainability. Care should be taken to manage the wage bill to prevent it from increasing in percent of GDP and unduly constraining priority investments and social spending. Efforts should also be made to improve the efficiency of public investment by strengthening the institutional fiscal framework, applying more rigorous project appraisal, and monitoring mechanisms to prevent delays and cost overruns. A measured approach to scaling up is warranted to avoid hitting capacity constraints. Once central government arrears are cleared this year, further efforts should be made to eliminate arrears at the local level.

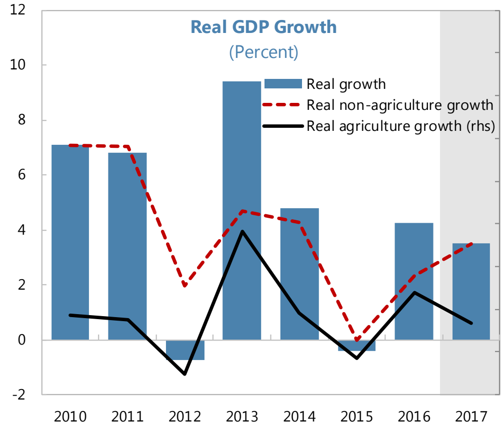
60. The authorities are making important progress in cleansing the financial sector, but the corner is not yet turned. The authorities are pursuing an ambitious set of reforms aimed at improving the governance and stability of the financial sector. While important progress has been made regarding transparency in ownership and management, strengthening supervisory and regulatory frameworks, and bank level diagnostics, significant challenges remain. Only by decisively completing the reform agenda can the corner be turned, and progress become irreversible. Critical next steps include (i) transfer of ownership of "problem" shares in the largest banks to fit and proper shareholders, (ii) certification of incoming shareholders and managers in line with the law, and (iii) continued clean-up of banks' balance sheets and improvement in their risk management procedures to allow effective financial intermediation. Increased supervisory resources focused on key risks can support these efforts.

61. Steady implementation of structural reforms is indispensable for sustainable growth and poverty reduction. Moldova's lagging per capita income, and weak social development indicators underscore the need for faster and more inclusive growth. A comprehensive agenda of structural reforms is needed to meet this challenge. Priorities include: (i) encouraging capital accumulation and enhancing the efficiency of public investment through bolstering the investment climate and improving the institutional framework for public investment; (ii) labor market reforms through targeted employment and training efforts; (iii) economic diversification, supported by enhanced competitiveness and deeper FDI; and (iv) actions to reduce the shadow economy through tax and customs administration efforts along with reducing regulatory and administrative barriers and improved government effectiveness and accountability. To ensure transparency and cost recovery in the energy sector, the authorities should continue to work on eliminating accumulated debt by energy companies, recognize accumulated financial deviations, and achieve greater transparency and certainty in the tariff-setting methodologies.

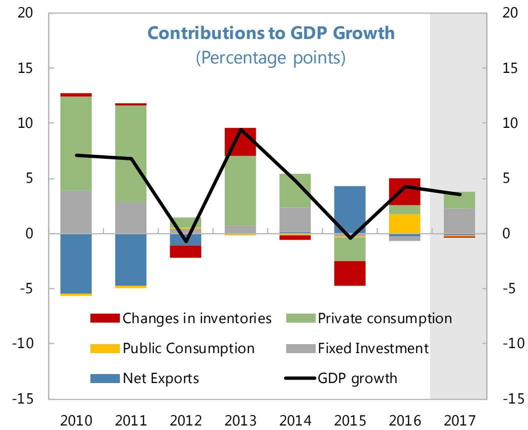
62. Staff recommends that the next Article IV be completed on the 24-month cycle in accordance with the Executive Board decision on the consultation cycles for members with Fund arrangements, and supports the authorities' request for the completion of the second review under the ECF/EFF-supported program and associated disbursement/purchase.

Figure 1. Moldova: Real Sector Developments, 2010–17

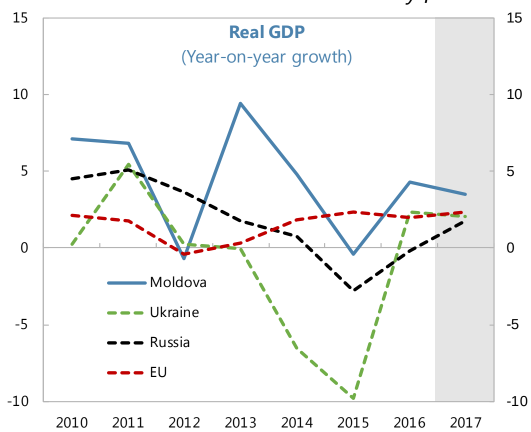
Growth is expected to soften on account of more subdued agricultural output, …



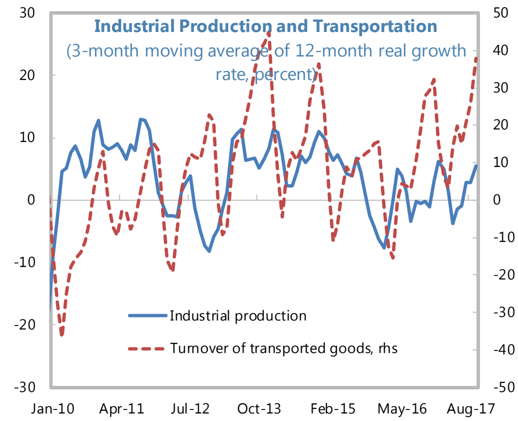
.. supported by recovery in investment.



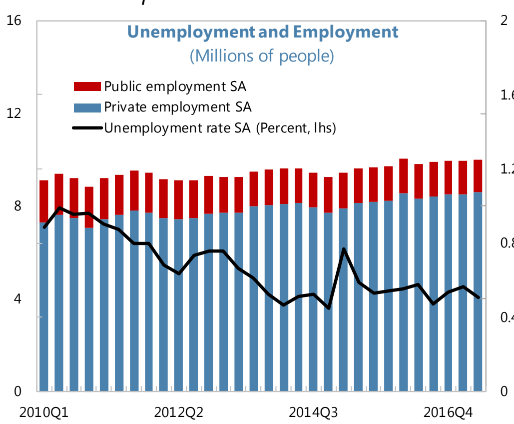
The external environment remains broadly favorable.



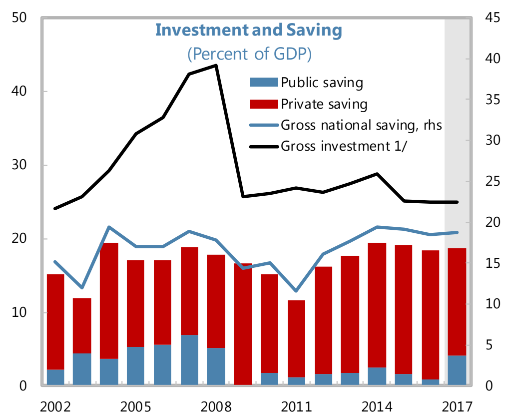
Short-term activity indicators have been mixed.



The unemployment rate remains low as labor migration remains widespread.



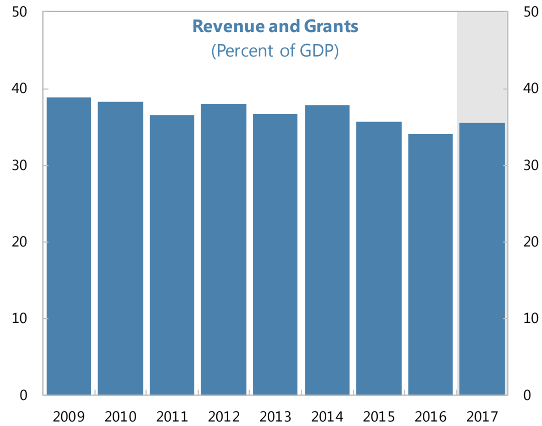
Improvements in investment were primarily driven by recovery of public capital expenditure.



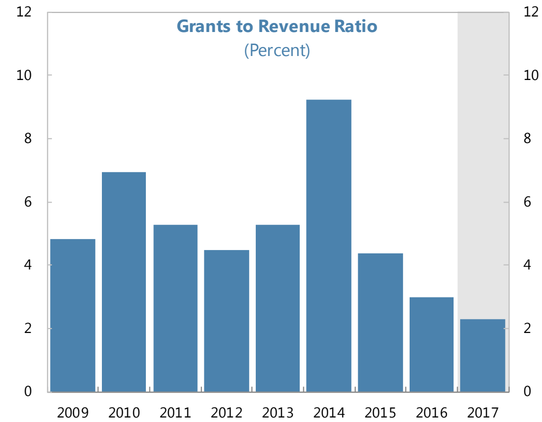
Sources: National Bureau of Statistics of the Republic of Moldova and IMF staff calculations.

Figure 2. Moldova: Fiscal Developments, 2009–17

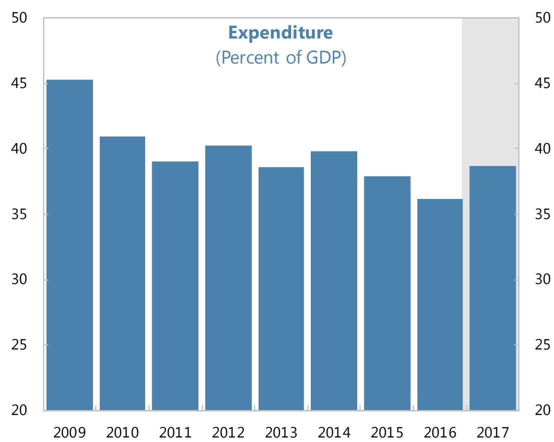
Total revenues are expected to increase…



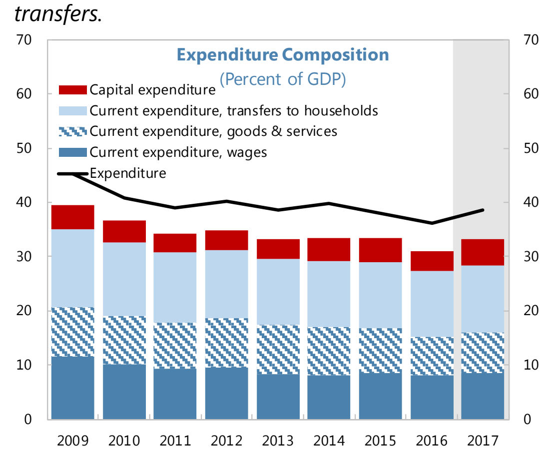
…despite lower than projected grants.



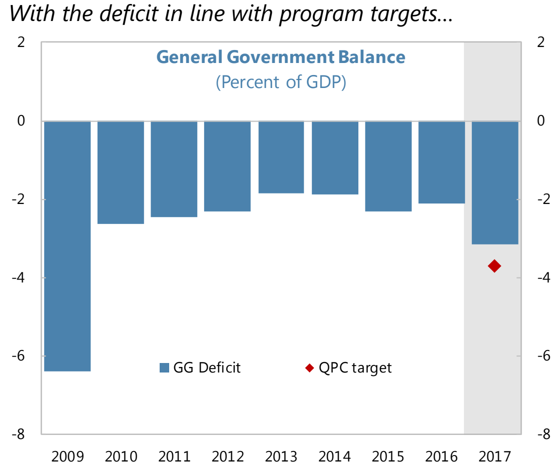
Increased revenue provided space for increased spending…



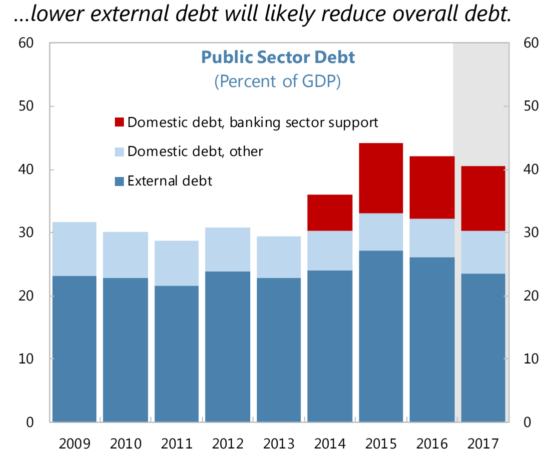
…directed towards capital expenditure and priority social transfers.



With the deficit in line with program targets…



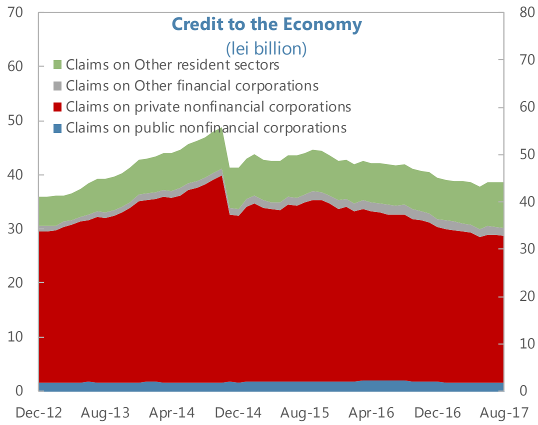
…lower external debt will likely reduce overall debt.



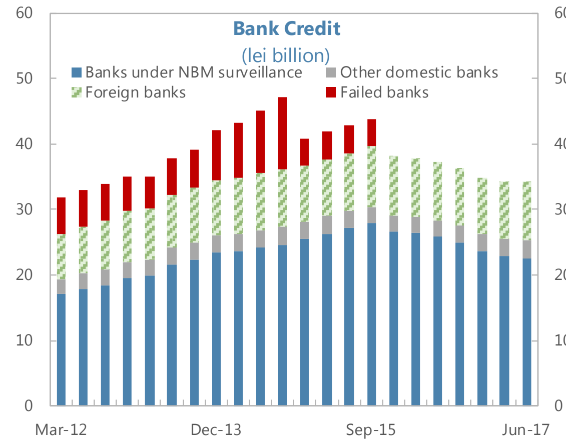
Sources: Moldovan authorities and IMF staff calculations.

Figure 3. Moldova: Credit Developments, 2013–17

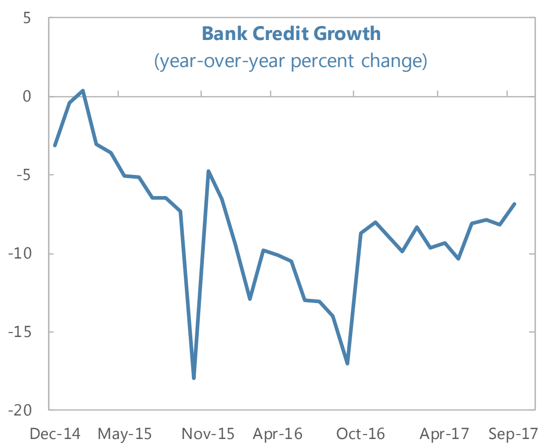
Credit to the economy has dropped because of lower lending to corporates …



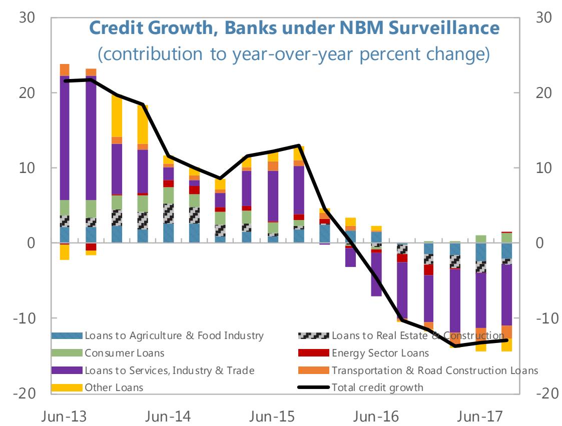
… notably by banks under NBM intensive supervision and temporary administration.



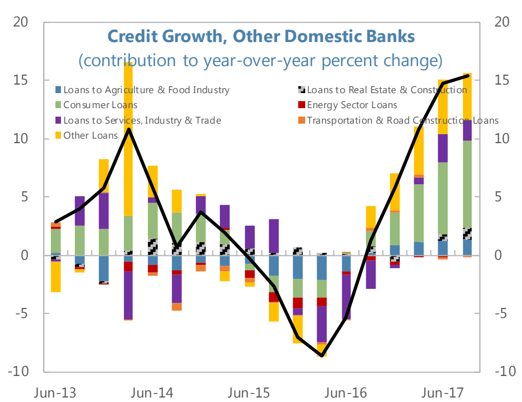
Bank credit growth remains negative, …



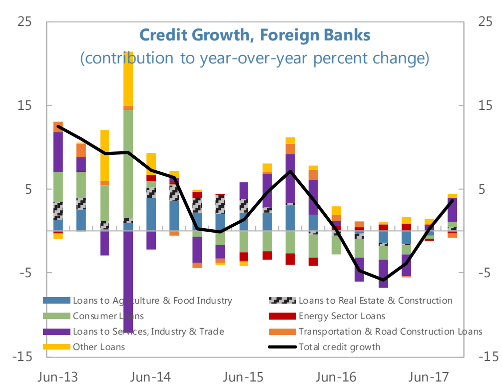
… as it continues to decline for three systemic banks under NBM intensive supervision and temporary administration.



In the meantime, consumer lending and loans to services, industry, and trade are rising for other domestic banks, …



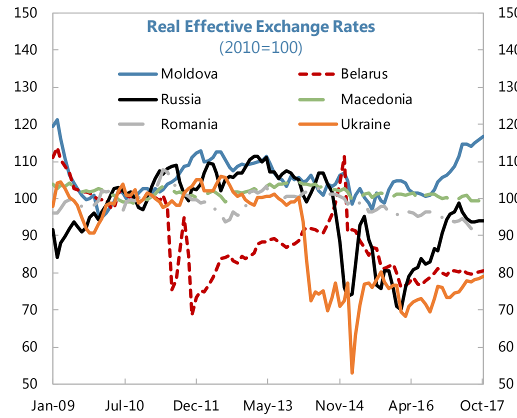
… and credit by foreign banks has stopped contracting, …



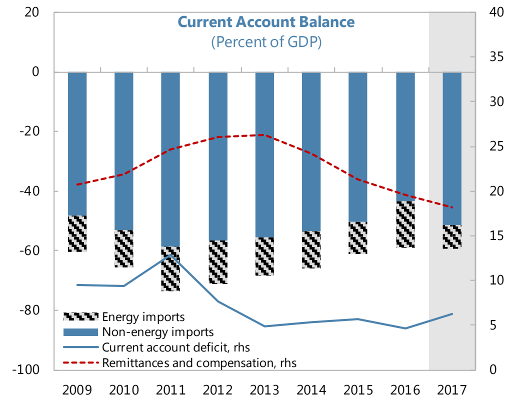
Sources: National Bank of Moldova and IMF staff calculations.

Figure 4. Moldova: External Sector Developments, 2009–17

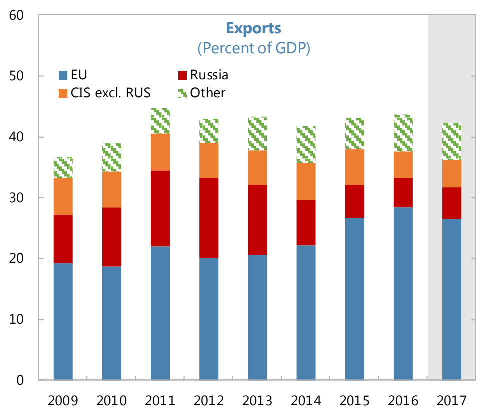
The real effective exchange rate appreciated during 2017.



Non-energy imports picked up in 2017, contributed to a wider current account deficit.

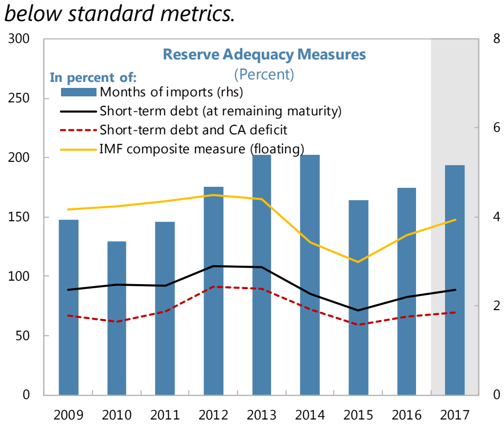


During the first half of 2017, exports declined as a share of GDP ...

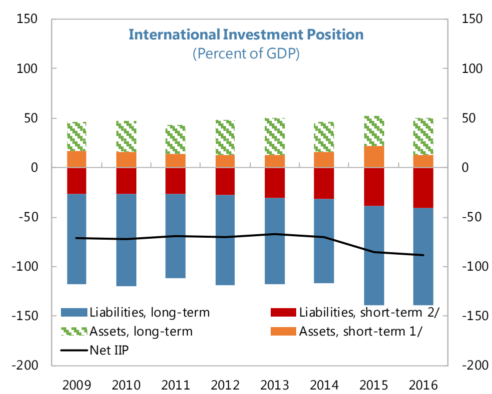


... reflecting lower exports to the EU.

Reserves are adequate based on the IMF's composite measure, although reserve coverage to short-term debt is below standard metrics.



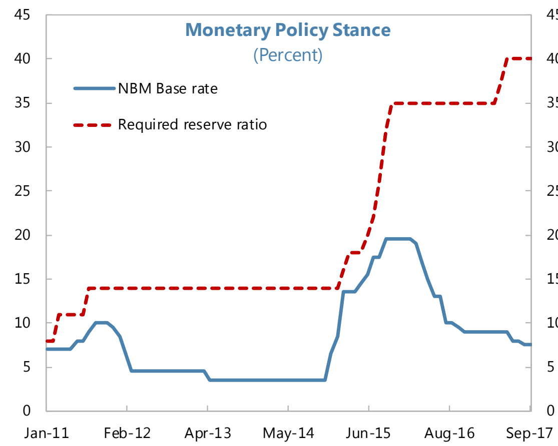
The net IIP was largely unchanged in 2016, although the maturity of assets lengthened.



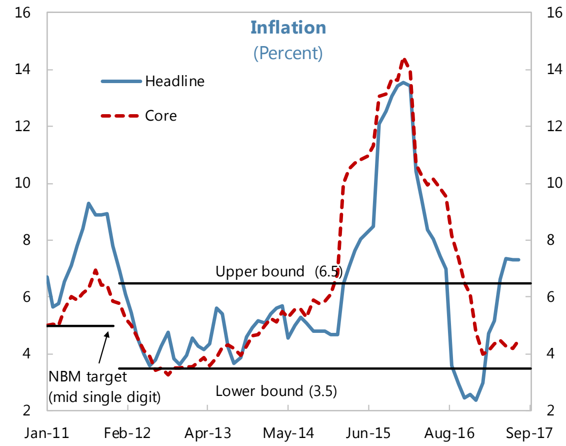
Sources: National Bank of Moldova and Fund staff calculations.

Figure 5. Moldova: Money, Prices, and Interest Rates, 2011–17

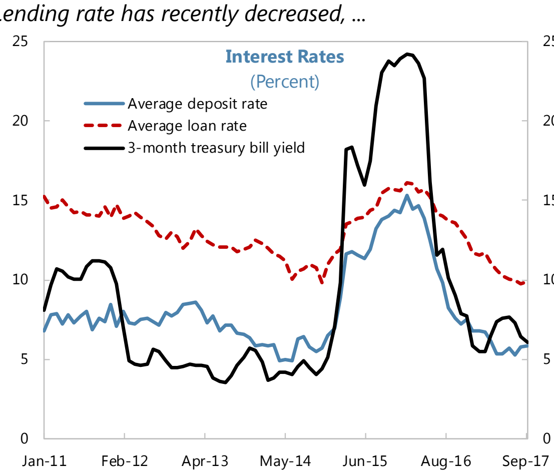
Tight monetary policy in 2014-15 …



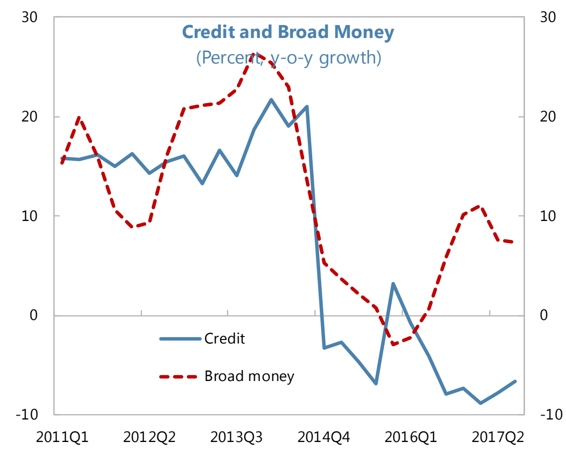
… helped ease inflationary pressures, although headline inflation recently exceeded the target range.



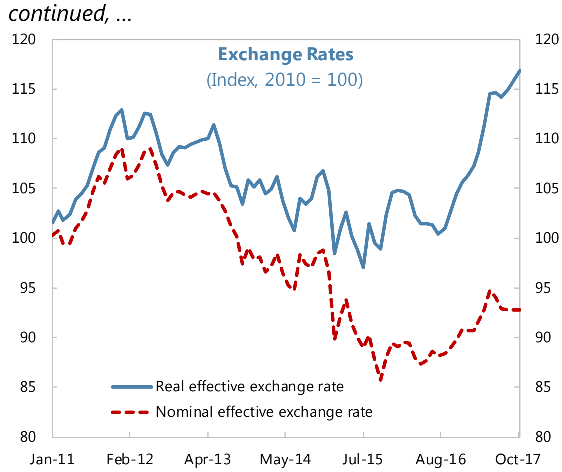
Lending rate has recently decreased, …



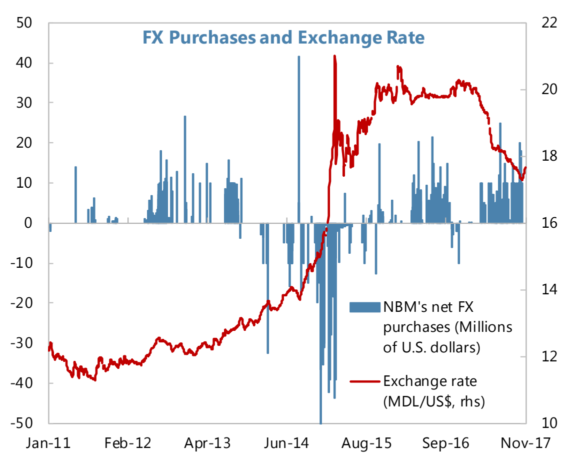
… although credit growth remains negative.



In the meantime, exchange rate appreciation has continued, …

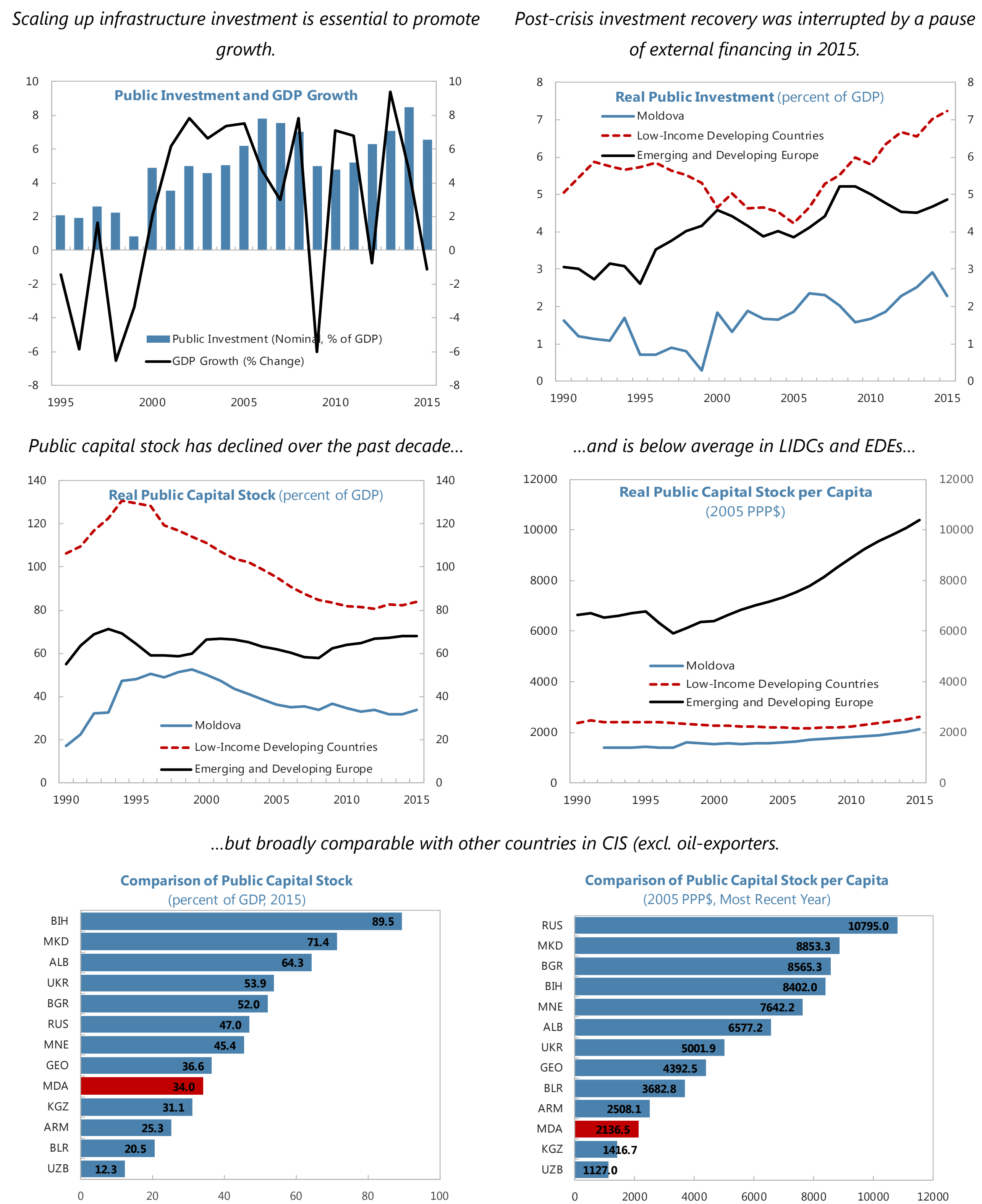


… helping build international reserves.



Sources: National Bank of Moldova and Fund staff calculations.

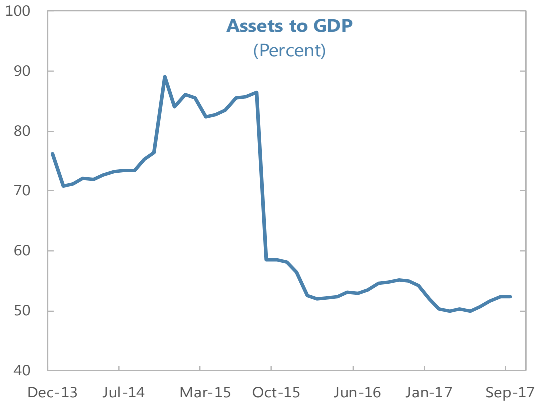
Figure 6. Moldova: Public Investment



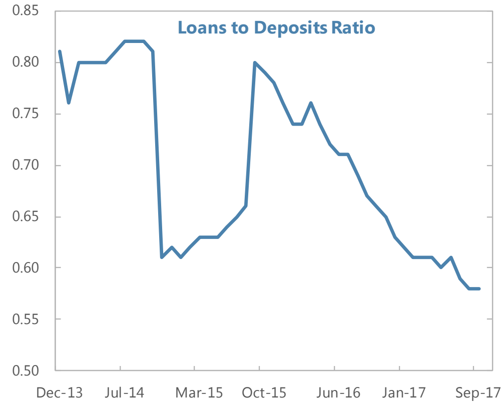
Sources: IMF FAD Public Investment Management Template.

Figure 7. Moldova: Banking Sector Developments, 2013–17

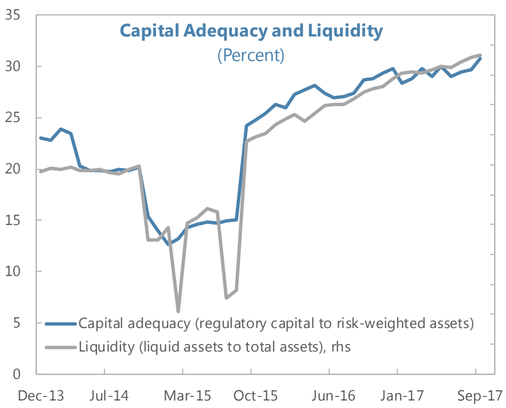
The size of the banking sector shrunk because of the end-2014 fraud, …



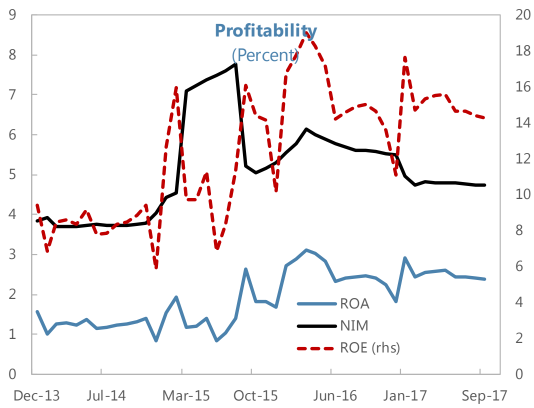
… which has adversely affected developments in loans to deposits.



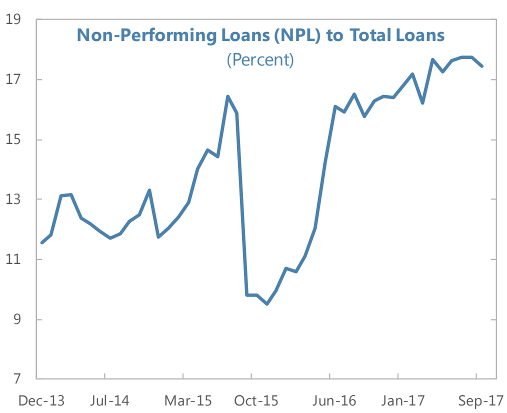
Bank liquidity is rising, and reported capital buffers are being rebuilt, …



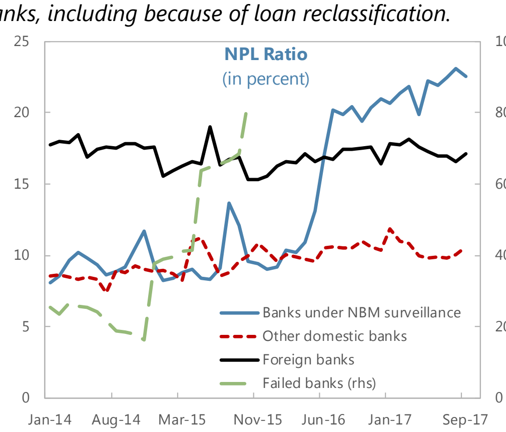
… while profitability levels are maintained.



In the meantime, loan portfolio quality has deteriorated sharply with the continued cleansing of the banking sector



While reported NPLs of domestic and foreign banks are stable, they have risen significantly in three systemic banks, including because of loan reclassification.



Sources: National Bank of Moldova and Fund staff calculations.

Table 1. Moldova: Selected Economic Indicators, 2014–22 1/

	2014	2015	2016	2017		2018		2019	2020	2021	2022
				1st Review	Est.	*1st Review*	Proj.	Proj.	Proj.	Proj.	Proj.
(Percent change, unless otherwise indicated)											
Real sector indicators											
Gross domestic product											
Real growth rate	4.8	-0.4	4.3	*4.5*	3.5	*3.7*	3.0	3.8	3.8	3.9	3.9
Demand	3.6	-3.2	3.1	*4.7*	3.3	*3.4*	3.5	3.9	3.0	3.2	3.2
Consumption	2.7	-1.1	2.8	*3.6*	3.0	*3.4*	2.4	3.0	2.9	2.9	2.9
Private	3.2	-2.3	3.6	*2.4*	2.0	*3.8*	2.2	3.2	3.0	3.1	3.0
Public	-0.8	-0.4	-1.3	*9.8*	8.3	*1.9*	3.3	2.4	2.3	2.2	2.2
Gross capital formation	10.0	-1.2	-2.8	*9.2*	5.8	*3.5*	8.8	7.6	3.8	4.4	4.6
Private	7.7	-2.4	-0.7	*2.3*	0.5	*3.0*	9.0	4.0	4.5	6.5	5.0
Public	22.4	4.5	-12.1	*44.0*	32.3	*5.4*	7.9	21.0	1.4	-2.3	3.3
Investment (including inventories)	7.3	-11.8	4.5	*9.6*	4.6	*3.4*	8.8	7.6	3.8	4.5	4.7
Real growth rate of fixed investment	10.0	-1.2	-2.8	*9.2*	5.8	*3.5*	8.8	7.6	3.8	4.4	4.6
Net Exports of goods and services	0.3	11.7	-1.2	*1.6*	-2.5	*-2.4*	-5.3	-4.2	-0.1	-0.7	-0.6
Exports of goods and services	1.0	2.3	9.3	*4.1*	12.5	*3.1*	6.1	4.2	4.7	0.7	1.0
Imports of goods and services	0.4	-4.3	5.9	*1.9*	8.6	*2.8*	5.8	4.2	2.9	0.7	0.8
Nominal GDP (billions of Moldovan lei)	112.0	122.6	134.9	*148.3*	148.7	*161.9*	160.1	174.5	190.2	207.5	226.3
Nominal GDP (billions of U.S. dollars)	8.0	6.5	6.8	*7.4*	8.0	*7.7*	9.1	9.7	10.3	10.8	11.2
Consumer price index (average)	5.1	9.6	6.4	*5.9*	6.5	*5.4*	4.3	4.8	4.9	5.0	5.0
Consumer price index (end of period)	4.7	13.5	2.4	*6.5*	7.0	*5.5*	3.5	5.0	5.0	5.0	5.0
GDP deflator	6.4	9.8	5.6	*5.5*	6.5	*5.3*	4.5	5.0	5.0	5.0	5.0
Average monthly wage (Moldovan lei)	4,172	4,611	5,084	*5620.0*	5,700	*6140.0*	6,150	6,675	7,275	7,925	8,650
Average monthly wage (U.S. dollars)	297	245	255	*281.0*	307	*293.1*	348	371	393	414	429
Unemployment rate (annual average, percent)	3.9	4.9	4.2	*4.3*	4.2	*4.2*	4.2	4.1	4.1	4.0	4.0
Poverty headcount ratio at national poverty lines (percent)	11.4	...	...	...	...	...	...	...	...	...	...
(Percent of GDP)											
Saving-investment balance											
Foreign saving	5.3	5.7	4.6	*5.0*	6.3	*4.9*	5.4	5.2	5.1	5.3	5.1
National saving	19.4	18.4	17.7	*18.2*	16.3	*18.2*	18.2	19.3	19.4	19.2	19.5
Private	16.9	16.7	16.8	*15.5*	12.3	*16.4*	15.4	18.5	18.1	18.2	14.4
Public	2.6	1.7	0.8	*2.7*	4.1	*1.8*	2.8	0.8	1.3	0.9	5.2
Gross investment	24.7	24.1	22.3	*23.1*	22.6	*23.1*	23.7	24.5	24.5	24.4	24.6
Private	20.4	19.7	18.6	*18.1*	17.7	*17.9*	18.7	18.7	18.8	19.2	19.4
Public 2/	4.3	4.4	3.7	*5.1*	4.9	*5.2*	5.0	5.9	5.7	5.2	5.2
Fiscal indicators (general government)											
Primary balance	-1.4	-1.5	-0.8	*-2.4*	-1.8	*-2.1*	-2.2	-2.7	-2.5	-1.7	-1.6
Overall balance	-1.9	-2.3	-2.1	*-3.7*	-3.1	*-3.3*	-3.3	-3.9	-3.7	-2.9	-2.8
Overall balance (baseline, no policy adjustment)	-1.9	-2.3	-2.1	*-3.7*	-3.1	*...*	-3.3	-3.9	-3.7	-2.9	-2.8
Stock of public and publicly guaranteed debt	36.0	44.8	42.1	*44.3*	40.6	*45.2*	42.1	44.2	44.0	43.6	43.6
(Percent change, unless otherwise indicated)											
Financial indicators											
Broad money (M3)	5.3	-3.0	10.2	*11.3*	11.3	...	...	...	...	...	...
Velocity (GDP/end-period M3; ratio)	1.7	1.9	1.9	*1.9*	1.9	...	...	...	...	...	...
Reserve money	6.3	7.1	12.1	*8.8*	19.4	...	...	...	...	...	...
Credit to the economy	-3.3	3.2	-7.4	*3.7*	-1.9	...	...	...	...	...	...
Credit to the economy, percent of GDP	36.8	34.8	29.2	*27.6*	26.0	...	...	...	...	...	...
(Millions of U.S. dollars, unless otherwise indicated)											
External sector indicators											
Current account balance	-422	-372	-315	*-369*	-504	*-381*	-493	-508	-521	-571	-570
Current account balance (percent of GDP)	-5.3	-5.7	-4.6	*-5.0*	-6.3	*-4.9*	-5.4	-5.2	-5.1	-5.3	-5.1
Remittances and compensation of employees (net)	1,929	1,386	1,329	*1,401*	1,456	*1,440*	1,591	1,744	1,868	1,977	2,084
Gross official reserves	2,157	1,757	2,206	*2406*	2,611	*2605*	2,778	2,775	2,678	2,664	2,719
Gross official reserves (months of imports)	5.4	4.4	4.7	*5.5*	5.2	*5.7*	5.2	4.9	4.5	4.3	4.3
Exchange rate (Moldovan lei per USD, period avge)	14.0	18.8	19.9								
Exchange rate (Moldovan lei per USD, end of period)	15.6	19.7	20.0								
Real effective exch.rate (average, percent change)	-3.0	-3.4	2.1								
Real effective exch.rate (end-year, percent change)	1.6	-2.5	1.5								
External debt (percent of GDP) 3/	84.9	99.2	97.2	*94.7*	86.7	*94.9*	83.7	84.1	83.3	82.6	83.1
Debt service (percent of exports of goods and services)	14.4	12.5	11.6	*20.3*	10.7	*26.2*	11.2	10.1	10.1	12.5	13.3

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes externally financed on-lending to SOEs as of 2016.

3/ Includes private and public and publicly guaranteed debt.

Table 2. Moldova: Balance of Payments, 2014–22

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

	2014	2015	2016	2017		2018		2019	2020	2021	2022
				1st Review	Est.	1st Review	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-422	-372	-315	-369	-504	-381	-493	-508	-521	-571	-569
Merchandise trade balance	-2,900	-1,995	-1,945	-1,971	-2,397	-1,961	-2,494	-2,662	-2,819	-2,907	-2,998
Exports	2,354	1,985	2,061	2,271	2,370	2,419	2,559	2,723	2,876	3,057	3,250
Imports	-5,254	-3,980	-4,006	-4,242	-4,767	-4,380	-5,053	-5,385	-5,695	-5,965	-6,248
Services balance	-33	2	77	74	113	63	117	153	157	72	40
Exports of services	974	829	893	909	1,027	934	1,141	1,236	1,316	1,202	1,144
Imports of services	-1,007	-827	-816	-835	-914	-871	-1,024	-1,083	-1,158	-1,131	-1,104
Income balance	824	453	463	430	556	439	587	648	690	738	794
Compensation of employees	991	700	643	700	724	708	793	870	923	977	1,033
Income on direct and portfolio investment	-106	-195	-135	-178	-116	-155	-145	-145	-154	-163	-168
Income on other investment	-61	-52	-45	-92	-51	-114	-61	-77	-79	-76	-71
Current transfer balance	1,687	1,168	1,090	1,098	1,224	1,078	1,297	1,352	1,451	1,527	1,594
Remittances	938	686	685	700	732	732	798	874	945	1,001	1,051
Budget transfers	317	151	102	101	179	76	155	168	177	180	184
Other transfers	431	331	303	297	313	270	344	310	329	347	359
Capital and financial account balance	-157	109	647	404	829	423	425	512	499	607	658
Capital account balance	-12	-35	-37	-52	-36	-54	-32	-48	-51	-54	-56
Financial account balance	-145	143	684	456	864	477	457	560	550	661	714
Foreign direct investment balance	158	155	89	175	98	177	101	119	126	134	139
Portfolio investment and derivatives	8	5	0	3	4	4	4	4	6	8	8
Other investment balance	-311	-16	595	279	762	296	352	438	417	520	567
Loans	-2	64	33	137	89	170	164	324	229	235	264
General government, net	103	104	63	128	81	149	161	256	189	197	224
Private sector, net	-105	-40	-30	9	8	21	3	67	40	37	40
Other capital flows	-310	-80	562	141	673	126	188	114	188	285	303
Errors and omissions	-67	-51	90	0	0	0	0	0	0	0	0
Overall balance	-646	-315	422	35	323	41	-68	4	-22	36	88
Financing gap	…	…	196	250	172	242	322	76	0	0	0
Financing	646	314	-422	-35	-323	-41	68	-4	22	-36	-88
Gross international reserves (increase: "+")	-538	-306	531	200	406	199	166	-3	-97	-14	55
Use of Fund credit, net	-29	-42	-37	-43	-46	-19	-20	-49	-75	-50	-33
Monetary authorities	-29	-35	-37	-43	-45	-19	-20	-49	-54	-48	-33
Purchases	0	0	12	17	17	39	41	7	0	0	0
Repurchases	-29	-35	-49	-60	-63	-58	-61	-57	-54	-48	-33
General government	0	-6	0	0	0	0	0	0	-21	-2	0
Purchases	0	0	24	26	26	25	27	27	0	0	0
Repurchases	0	-6	-24	-26	-27	-26	-27	-27	-21	-2	0
Exceptional financing	137	49	-13	0	0	0	0	0	0	0	0
Other donors	0	0	160	208	128	177	254	42	0	0	0
European Commission	0	0	47	110	27	117	194	12	0	0	0
World Bank	0	0	45	0	0	60	60	30	0	0	0
Romania	0	0	68	99	101	0	0	0	0	0	0
	(Percent of GDP, unless otherwise indicated)										
Memorandum items:											
Gross official reserves (millions of U.S. dollars) 1/	2,157	1,757	2,206	2,406	2,611	2,605	2,778	2,775	2,678	2,664	2,719
Months of imports of good and services	5.4	4.4	4.7	5.5	5.2	5.7	5.2	4.9	4.5	4.3	4.3
Percent of short term debt and CA deficit	71.9	59.3	65.8	65.4	69.9	70.8	71.5	69.2	61.2	57.2	60.9
Pct of short-term debt at remaining maturity	85.5	71.1	82.7	79.0	88.5	81.5	89.9	84.1	74.2	69.0	69.6
Pct of the IMF composite measure (floating) 2/	128.4	112.4	134.9	143.8	147.6	149.3	146.2	136.7	125.4	118.5	115.4
Current account balance	-5.3	-5.7	-4.6	-5.0	-6.3	-4.9	-5.4	-5.2	-5.1	-5.3	-5.1
Goods and services trade balance	-36.7	-30.6	-27.6	-25.6	-28.5	-24.6	-26.2	-25.9	-25.9	-26.2	-26.3
Export of goods and services	41.7	43.2	43.6	42.9	42.4	43.4	40.9	40.8	40.8	39.3	39.1
Import of goods and services	-78.4	-73.8	-71.2	-68.5	-70.9	-68.0	-67.1	-66.7	-66.7	-65.5	-65.5
Foreign direct investment balance	2.0	2.4	1.3	2.4	1.2	2.3	1.1	1.2	1.2	1.2	1.2
	(Percent change of amounts in U.S.dollars, unless otherwise indicated)										
Exports of goods	-4.7	-15.7	3.8	10.2	15.0	6.5	8.0	6.4	5.6	6.3	6.3
Exports of services	-1.9	-15.0	7.8	1.6	15.0	2.8	11.0	8.3	6.5	-8.6	-4.9
Imports of goods	-3.9	-24.3	0.7	6.7	19.0	3.3	6.0	6.6	5.8	4.7	4.7
Imports of services	4.0	-17.9	-1.2	1.4	12.0	4.3	12.0	5.7	7.0	-2.4	-2.4
Remittances and compensation	-8.3	-26.9	-0.1	5.2	6.8	2.8	9.0	9.6	8.1	5.8	5.0
Remittances	-8.3	-26.9	-0.1	2.2	6.8	4.5	9.0	9.6	8.1	5.8	5.0
Compensation of employees	-7.8	-29.4	-8.1	8.4	12.5	1.1	9.6	9.7	6.1	5.8	5.8
Debt service (pct of exports of goods and services)	14.4	12.5	11.6	20.3	10.7	26.2	11.2	10.1	10.1	12.5	13.3

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, 2014–22

(Millions of Moldovan lei, unless otherwise indicated)

	2014	2015	2016	2017		2018		2019	2020	2021	2022
			Prelim	*1st Review*	Est.	*1st Review*	Proj.	Proj.	Proj.	Proj.	Proj.
Revenues and grants	42,456	43,670	45,947	*51,616*	52,857	*55,938*	56,999	59,017	63,999	69,692	75,967
Revenues	38,542	41,764	44,574	*48,887*	51,644	*53,775*	54,212	58,181	63,247	68,872	75,073
Tax revenues	36,284	38,758	42,502	*46,812*	49,255	*51,069*	51,895	55,967	61,037	66,552	72,636
Personal income	2,447	2,745	3,182	*3,334*	3,570	*3,728*	3,852	4,180	4,556	4,963	5,417
Corporate income	2,431	2,808	3,363	*3,617*	4,105	*3,950*	4,481	4,965	5,500	6,101	6,655
Property tax	346	359	404	*501*	531	*536*	543	549	552	589	619
VAT	12,852	13,714	14,564	*15,986*	16,797	*17,184*	17,294	18,480	20,056	21,851	23,927
Excises	3,428	3,844	4,546	*5,254*	5,645	*5,456*	5,903	6,406	7,070	7,668	8,324
Foreign trade	1,457	1,328	1,452	*1,333*	1,569	*1,582*	1,585	1,719	1,869	2,026	2,204
Other	2,536	1,835	1,722	*1,651*	1,779	*1,802*	1,772	1,796	1,957	2,135	2,330
Social Fund contributions	8,372	9,269	10,031	*11,578*	11,628	*12,872*	12,546	13,617	14,841	16,167	17,646
Health Fund contributions	2,414	2,855	3,240	*3,560*	3,633	*3,958*	3,920	4,254	4,637	5,051	5,513
Non-tax revenues	2,259	3,006	2,072	*2,075*	2,389	*2,706*	2,317	2,214	2,210	2,321	2,437
NBM profit transfers	125	889	0	*0*	0	*0*	0	0	0	0	0
Grants	3,914	1,906	1,373	*2,729*	1,212	*2,163*	2,787	836	751	820	894
Budget support	1,606	0	953	*1,769*	476	*1,577*	2,189	217	186	203	222
Project	2,307	1,906	420	*960*	736	*586*	598	619	565	617	673
Expenditure and net lending	44,572	46,502	48,774	*57,086*	57,525	*61,202*	62,264	65,762	71,123	75,652	82,325
Current expenditure	39,752	41,059	43,773	*49,553*	50,184	*52,830*	54,288	55,514	60,223	64,893	70,652
Wages	9,088	10,530	10,967	*12,461*	12,657	*13,192*	13,769	14,391	15,555	16,828	18,206
Goods and services	9,960	10,151	9,498	*11,316*	11,277	*12,357*	11,645	12,568	13,566	14,800	16,146
Interest payments	624	1,099	1,812	*2,023*	2,083	*2,170*	1,962	2,264	2,487	2,509	2,805
Domestic	395	832	1,477	*1,551*	1,685	*1,638*	1,540	1,684	1,803	1,703	1,839
Foreign	229	268	334	*473*	398	*532*	422	580	684	806	966
Transfers	14,920	16,903	18,198	*20,130*	20,098	*21,235*	21,628	21,051	23,476	25,360	27,830
Transfers to economy 1/	1,358	2,126	1,799	*2,146*	1,983	*2,343*	2,134	2,326	2,535	2,766	3,017
Transfers to households	13,562	14,777	16,399	*17,984*	18,116	*18,892*	19,494	18,725	20,941	22,594	24,812
Other current expenditure	5,161	2,376	3,299	*3,622*	4,068	*3,877*	5,285	5,240	5,139	5,396	5,666
Capital expenditure	4,819	5,443	5,000	*7,534*	7,341	*8,372*	7,975	10,248	10,900	10,759	11,673
Of which: SOEs onlending projects			340	*1,203*	504	*1,432*	550	2,242	1,755	1,400	1,527
One-off revenue and expenditure items 2/	0	0	-13,341	*0*	0	*0*	0	0	0	0	0
Augmented overall balance (incl. one-off items) 3/	-2,116	-2,832	-16,168	*-5,470*	-4,668	*-5,264*	-5,264	-6,745	-7,124	-5,960	-6,358
Augmented overall balance (excl. one-off items) 3/	-2,116	-2,832	-2,827	*-5,470*	-4,668	*-5,264*	-5,264	-6,745	-7,124	-5,960	-6,358
Augmented primary balance (excl. one-off items) 3/	-1,577	-1,816	-1,131	*-3,569*	-2,709	*-3,384*	-3,591	-4,783	-4,795	-3,616	-3,727
Financing (excl. one-off items)	2,116	2,832	107	*2,563*	2,312	*2,592*	2,489	5,730	7,124	5,960	6,358
Budget financing	164	260	-1,431	*49*	1,116	*-1,588*	-1,574	713	1,541	64	18
Central government	131	133	-451	*82*	1,268	*-1,588*	-1,380	713	1,541	64	18
Net domestic	-78	17	-127	*1,508*	2,305	*560*	87	3,128	3,804	2,072	1,693
Net foreign (excl. project loans)	-241	-437	-710	*-1,856*	-1,481	*-2,348*	-2,210	-2,530	-2,299	-2,158	-1,825
Privatization	191	35	279	*220*	64	*200*	261	115	36	150	150
Others	259	518	108	*210*	380	*0*	482	0	0	0	0
Local governments	0	0	-794	*-126*	-372	*0*	-194	0	0	0	0
Privatization	236	19	18	*0*	7	*0*	2	0	0	0	0
Social Fund	-9	37	-96	*0*	126	*0*	0	0	0	0	0
Health Fund	42	90	-91	*93*	93	*0*	0	0	0	0	0
Net project loans	1,707	2,333	1,538	*2,514*	1,196	*4,180*	4,063	5,017	5,583	5,897	6,340
Of which: Onlending (through commercial banks)	0	0	-38	*-1,400*	-1,299	*-761*	-642	-1,739	0	0	0
Financing gap	0	0	2,719	*2,907*	2,356	*2,672*	2,775	1,015	0	0	0
World Bank	…	…	889	*0*	0	*1,257*	1,061	540	0	0	0
IMF	0	0	480	*511*	490	*534*	473	482	0	0	0
Others	…	…	1,350	*2,396*	1,866	*881*	1,241	-8	0	0	0
Financing for one-off items											
Government securities issued	0	0	13,341	0	0	*0*	0	0	0	0	0
					(Millions of Moldovan lei)						
Memorandum items:											
Public and publicly guaranteed debt	40,367	54,943	56,793	*65,883*	60,353	*73,431*	67,376	77,119	83,602	90,553	98,740
General Government debt	33,690	47,166	49,594	*59,614*	54,767	*67,261*	62,108	72,633	80,009	87,761	96,470
Domestic debt	13,375	20,809	21,520	*24,608*	25,452	*25,168*	25,933	29,061	30,865	32,937	34,630
Domestic expenditure arrears	98	744	101	*0*	0	*0*	0	0	0	0	0
External debt	20,217	25,613	27,973	*35,007*	29,315	*42,094*	36,175	43,572	49,144	54,824	61,841
Other 4/	6,677	7,777	7,199	*6,269*	5,585	*6,169*	5,268	4,486	3,593	2,792	2,269

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

1/ As of 2016, capital transfers are excluded from transfers to economy and recorded under capital expenditure.

2/ Includes banking sector resolution costs in 2016.

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

4/ Includes mainly central bank liabilities to the IMF.

Table 3b. Moldova: General Government Budget, 2014–22

(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017		2018		2019	2020	2021	2022
				1st Review	Est.	*1st Review*	Proj.	Proj.	Proj.	Proj.	Proj.
Revenues and grants	37.9	35.6	34.1	*34.8*	35.5	*34.6*	35.6	33.8	33.7	33.6	33.6
Revenues	34.4	34.1	33.0	*33.0*	34.7	*33.2*	33.9	33.3	33.3	33.2	33.2
Tax revenues	32.4	31.6	31.5	*31.6*	33.1	*31.5*	32.4	32.1	32.1	32.1	32.1
Personal income	2.2	2.2	2.4	*2.2*	2.4	*2.3*	2.4	2.4	2.4	2.4	2.4
Corporate income	2.2	2.3	2.5	*2.4*	2.8	*2.4*	2.8	2.8	2.9	2.9	2.9
Property tax	0.3	0.3	0.3	*0.3*	0.4	*0.3*	0.3	0.3	0.3	0.3	0.3
VAT	11.5	11.2	10.8	*10.8*	11.3	*10.6*	10.8	10.6	10.5	10.5	10.6
Excises	3.1	3.1	3.4	*3.5*	3.8	*3.4*	3.7	3.7	3.7	3.7	3.7
Foreign trade	1.3	1.1	1.1	*0.9*	1.1	*1.0*	1.0	1.0	1.0	1.0	1.0
Other	2.3	1.5	1.3	*1.1*	1.2	*1.1*	1.1	1.0	1.0	1.0	1.0
Social Fund contributions	7.5	7.6	7.4	*7.8*	7.8	*8.0*	7.8	7.8	7.8	7.8	7.8
Health Fund contributions	2.2	2.3	2.4	*2.4*	2.4	*2.4*	2.4	2.4	2.4	2.4	2.4
Non-tax revenues	2.0	2.5	1.5	*1.4*	1.6	*1.7*	1.4	1.3	1.2	1.1	1.1
NBM profit transfers	0.1	0.7	0.0	*0.0*	0.0	*0.0*	0.0	0.0	0.0	0.0	0.0
Grants	3.5	1.6	1.0	*1.8*	0.8	*1.3*	1.7	0.5	0.4	0.4	0.4
Budget support	1.4	0.0	0.7	*1.2*	0.3	*1.0*	1.4	0.1	0.1	0.1	0.1
Project	2.1	1.6	0.3	*0.6*	0.5	*0.4*	0.4	0.4	0.3	0.3	0.3
Expenditure and net lending	39.8	37.9	36.1	*38.5*	38.7	*37.8*	38.9	37.7	37.4	36.5	36.4
Current expenditure	35.5	33.5	32.4	*33.4*	33.7	*32.6*	33.9	31.8	31.7	31.3	31.2
Wages	8.1	8.6	8.1	*8.4*	8.5	*8.1*	8.6	8.2	8.2	8.1	8.0
Goods and services	8.9	8.3	7.0	*7.6*	7.6	*7.6*	7.3	7.2	7.1	7.1	7.1
Interest payments	0.6	0.9	1.3	*1.4*	1.4	*1.3*	1.2	1.3	1.3	1.2	1.2
Domestic	0.4	0.7	1.1	*1.0*	1.1	*1.0*	1.0	1.0	0.9	0.8	0.8
Foreign	0.2	0.2	0.2	*0.3*	0.3	*0.3*	0.3	0.3	0.4	0.4	0.4
Transfers	13.3	13.8	13.5	*13.6*	13.5	*13.1*	13.5	12.1	12.3	12.2	12.3
Transfers to economy 1/	1.2	1.7	1.3	*1.4*	1.3	*1.4*	1.3	1.3	1.3	1.3	1.3
Transfers to households	12.1	12.1	12.2	*12.1*	12.2	*11.7*	12.2	10.7	11.0	10.9	11.0
Other current expenditure	4.6	1.9	2.4	*2.4*	2.7	*2.4*	3.3	3.0	2.7	2.6	2.5
Capital expenditure	4.3	4.4	3.7	*5.1*	4.9	*5.2*	5.0	5.9	5.7	5.2	5.2
Of which: SOEs onlending projects			0.3	*0.8*	0.3	*0.9*	0.3	1.3	0.9	0.7	0.7
One-off revenue and expenditure items 2/	0.0	0.0	-9.9	*0.0*	0.0	*0.0*	0.0	0.0	0.0	0.0	0.0
Augmented overall balance (incl. one-off items) 3/	-1.9	-2.3	-12.0	*-3.7*	-3.1	*-3.3*	-3.3	-3.9	-3.7	-2.9	-2.8
Augmented overall balance (excl. one-off items) 3/	-1.9	-2.3	-2.1	*-3.7*	-3.1	*-3.3*	-3.3	-3.9	-3.7	-2.9	-2.8
Augmented primary balance (excl. one-off items) 3/	-1.4	-1.5	-0.8	*-2.4*	-1.8	*-2.1*	-2.2	-2.7	-2.5	-1.7	-1.6
Financing (excl. one-off items)	1.9	2.3	0.1	*1.7*	1.6	*1.6*	1.6	3.3	3.7	2.9	2.8
Budget financing	0.1	0.2	-1.1	*0.0*	0.8	*-1.0*	-1.0	0.4	0.8	0.0	0.0
Central government	0.1	0.1	-0.3	*0.1*	0.9	*-1.0*	-0.9	0.4	0.8	0.0	0.0
Net domestic	-0.1	0.0	-0.1	*1.0*	1.5	*0.3*	0.1	1.8	2.0	1.0	0.7
Net foreign (excl. project loans)	-0.2	-0.4	-0.5	*-1.3*	-1.0	*-1.5*	-1.4	-1.5	-1.2	-1.0	-0.8
Privatization	0.2	0.0	0.2	*0.1*	0.0	*0.1*	0.2	0.1	0.0	0.1	0.1
Others	0.2	0.4	0.1	*0.1*	0.3	*0.0*	0.3	0.0	0.0	0.0	0.0
Local governments	0.0	0.0	-0.6	*-0.1*	-0.2	*0.0*	-0.1	0.0	0.0	0.0	0.0
Privatization	0.2	0.0	0.0	*0.0*	0.0	*0.0*	0.0	0.0	0.0	0.0	0.0
Social Fund	0.0	0.0	-0.1	*0.1*	0.1	*0.0*	0.0	0.0	0.0	0.0	0.0
Health Fund	0.0	0.1	-0.1	*0.0*	0.1	*0.0*	0.0	0.0	0.0	0.0	0.0
Net project loans	1.5	1.9	1.1	*1.7*	0.8	*2.6*	2.5	2.9	2.9	2.8	2.8
Of which: Onlending (through commercial banks)	0.0	0.0	0.0	*-0.9*	-0.9	*-0.5*	-0.4	-1.0	0.0	0.0	0.0
Financing gap	0.0	0.0	2.0	*2.0*	1.6	*1.7*	1.7	0.6	0.0	0.0	0.0
World Bank			0.7	*0.0*	0.0	*0.8*	0.7	0.3	0.0	0.0	0.0
IMF	0.0	0.0	0.4	*0.3*	0.3	*0.3*	0.3	0.3	0.0	0.0	0.0
Others			1.0	*1.6*	1.3	*0.5*	0.8	0.0	0.0	0.0	0.0
Financing for one-off items											
Government securities issued	0.0	0.0	9.9	*0.0*	0.0	*0.0*	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Public and publicly guaranteed debt	36.0	44.8	42.1	*44.3*	40.6	*45.2*	42.1	44.2	44.0	43.6	43.6
General Government debt	30.1	38.5	36.8	*40.0*	36.8	*41.4*	38.8	41.6	42.1	42.3	42.6
Domestic debt	11.9	17.0	15.9	*16.6*	17.1	*15.5*	16.2	16.7	16.2	15.9	15.3
Domestic expenditure arrears	0.1	0.6	0.1	*0.0*	0.0	*0.0*	0.0	0.0	0.0	0.0	0.0
External debt	18.0	20.9	20.7	*23.4*	19.7	*25.9*	22.6	25.0	25.8	26.4	27.3
Other 4/	6.0	6.3	5.3	*4.2*	3.8	*3.8*	3.3	2.6	1.9	1.3	1.0

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

1/ As of 2016, capital transfers are excluded from transfers to economy and recorded under capital expenditure.

2/ Includes banking sector resolution costs in 2016.

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

4/ Includes mainly central bank liabilities to the IMF.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2011–17

(Millions of Moldovan lei, unless otherwise indicated) 1/

	2011	2012	2013	2014	2015	2016	2017
							Est.
National Bank of Moldova							
Net foreign assets	19,146	24,690	30,969	27,540	27,826	37,695	40,649
NFA (convertible)	19,188	24,693	31,006	27,539	27,850	38,041	41,336
Gross reserves	23,025	30,339	36,829	33,676	34,536	44,078	46,284
Reserve liabilities	3,836	5,647	5,823	6,137	6,686	6,037	4,948
Net domestic assets	-1,992	-4,159	-4,891	182	1,863	-4,419	-929
Net claims on general government	323	192	476	-270	-1,163	10,397	9,033
Credit to banks	-2,514	-3,451	-2,340	7,427	13,399	-5,915	-5,120
Other items (net)	199	-900	-3,027	-6,975	-10,373	-8,901	-4,842
Reserve money	17,154	20,531	26,078	27,722	29,689	33,276	39,721
Currency in circulation	10,895	13,241	17,550	17,500	15,509	17,274	19,199
Banks' reserves	6,259	7,285	8,515	10,222	13,335	15,007	20,522
Required reserves	4,450	5,202	6,346	6,290	11,521	13,494	16,852
Other reserves	1,809	2,082	2,169	3,932	1,814	1,513	3,670
Monetary survey							
Net foreign assets	16,450	23,141	31,550	43,153	48,815	61,523	68,099
NFA (convertible)	16,845	23,427	31,731	37,497	43,317	55,633	61,655
Of which: commercial banks	-2,344	-1,266	725	9,958	15,466	17,593	20,319
Foreign assets of commercial banks	3,538	4,778	10,496	19,005	22,205	22,274	24,496
Foreign liabilities of commercial banks	-5,881	-6,044	-9,770	-9,047	-6,739	-4,681	-4,176
NFA (non-convertible)	-395	-286	-181	5,656	5,499	5,889	6,443
Net domestic assets	24,527	26,372	31,081	22,820	15,191	8,997	10,378
Net claims on general government	1,512	1,004	1,387	821	-177	12,586	12,564
Credit to economy	30,963	35,948	42,691	41,273	42,593	39,455	38,713
Moldovan lei	17,174	20,624	25,347	25,173	24,091	21,657	22,245
Foreign exchange	13,788	15,324	17,343	16,100	18,503	17,798	16,467
in U.S. dollars	1,175	1,270	1,328	1,031	941	891	929
Other items (net)	-7,948	-10,580	-12,996	-19,274	-27,226	-43,044	-40,899
Broad money (M3)	40,977	49,513	62,632	65,973	64,006	70,520	78,476
Broad money (M2: excluding FCD)	28,265	34,915	45,117	43,220	39,261	46,430	52,061
Currency in circulation	10,865	13,241	17,550	17,509	15,509	17,274	19,199
Total deposits	30,113	36,272	45,081	48,464	48,497	53,245	59,278
Domestic currency deposits	17,400	21,674	27,567	25,711	23,751	29,155	32,862
Foreign currency deposits (FCD)	12,712	14,599	17,514	22,753	24,745	24,090	26,415
in U.S. dollars	1,083	1,210	1,341	1,457	1,259	1,206	1,490
Memorandum items:							
Reserve money growth (percent change; annual)	21.8	19.7	27.0	6.3	7.1	12.1	19.4
Broad money growth (percent change; annual)	10.6	20.8	26.5	5.3	-3.0	10.2	11.3
Credit to economy (percent change, annual)	15.0	16.1	18.8	-3.3	3.2	-7.4	-1.9
in lei	10.6	20.1	22.9	-0.7	-4.3	-10.1	2.7
in foreign exchange ($ equivalent)	25.4	8.1	4.6	-22.4	-8.7	-5.4	4.3
Gross international reserves (millions of U.S. dollars)	1,962	2,515	2,821	2,157	1,757	2,206	2,611
Percent of domestic-currency broad money	81	87	82	78	88	95	89
Net international reserves (millions of U.S. dollars)	1,635	2,047	2,375	1,764	1,417	1,904	2,332
Broad money multiplier	2.4	2.4	2.4	2.4	2.2	2.1	2.0

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, 2009–17

	2009	2010	2011	2012	2013	2014	2015	2016				2017		
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep
Size														
Number of banks	15	15	15	14	14	14	11	11	11	11	11	11	11	11
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	76.2	97.5	69.1	69.7	70.6	72.7	72.9	74.0	75.0	77.5
Total bank assets (percent of GDP)	66.1	58.8	57.9	66.1	76.3	87.0	56.7	51.8	52.5	54.1	54.2	49.9	50.6	52.3
Capital adequacy														
Capital adequacy ratio	32.3	30.1	30.4	24.8	23.4	13.2	26.2	27.8	27.0	28.7	30.1	29.7	28.9	30.7
Liquidity														
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	25.7	21.1	28.7	29.5	31.8	34.3	35.9	37.2	38.5	41.3
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	51.9	65.5	50.2	50.1	52.2	54.3	54.8	55.6	56.2	58.2
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.6	32.2	57.2	58.9	60.8	63.3	65.5	67.0	68.5	71.0
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.8	21.6	41.5	42.3	45.0	47.2	49.2	50.3	51.3	53.2
Asset quality														
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	42.2	40.8	38.2	37.9	37.2	36.3	34.8	34.2	34.2	33.8
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.9	4.8	3.8	4.2	6.0	5.7	5.7	5.5	6.0	5.9
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	11.6	11.7	9.9	11.1	16.1	15.8	16.4	16.2	17.6	17.4
Provisions to non-performing loans	59.2	63.2	65.0	73.5	83.6	88.4	85.5	86.4	73.6	78.7	81.8	84.9	83.8	83.6
Profitability														
Return on equity	-2.1	3.0	11.5	5.6	9.4	6.1	12.8	15.7	14.2	15.0	12.0	15.3	14.6	14.3
Return on assets	-0.4	0.5	2.0	1.1	1.6	0.9	2.1	2.6	2.3	2.5	2.0	2.6	2.4	2.4
Foreign currency assets and liabilities														
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	51.0	49.5	52.8	51.7	49.3	47.4	46.8	46.2	44.9	46.4
Foreign currency denominated assets in total assests	40.2	40.8	40.5	40.9	44.7	47.0	42.5	41.6	41.5	39.6	38.9	38.0	37.5	38.5
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	44.7	52.1	52.5	51.8	48.8	47.0	46.5	45.7	44.5	46.0
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	40.4	39.8	42.1	43.4	43.5	44.6	44.3	43.3	41.6	41.4

Source: National Bank of Moldova.

Table 6. Moldova: Schedule of Reviews and Disbursements 1/

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

Source: IMF staff estimates.

1/ Moldova's quota is SDR 172.5 million.

Table 7. Moldova: Indicators of Fund Credit, 2011–22 1/

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Projection					
Fund obligations based on existing credit (millions of SDRs)												
Principal	3.9	10.5	14.2	19.3	29.1	52.5	63.5	62.5	59.0	53.4	35.3	20.1
Charges and interest	1.3	1.2	1.6	1.6	1.5	1.5	2.4	2.8	2.4	2.0	1.6	1.3
Fund obligations based on existing and prospective credit												
Principal	3.9	10.5	14.2	19.3	29.1	52.5	63.5	65.8	62.4	56.3	37.9	25.5
Charges and interest	0.8	1.2	1.7	1.7	1.6	1.5	2.4	3.3	3.3	3.0	2.6	2.3
Total obligations based on existing and prospective credit												
Millions of SDRs	4.7	11.7	15.8	21.0	30.7	54.1	65.9	69.1	65.7	59.3	40.5	27.8
Millions of U.S. dollars	7.2	18.5	24.4	32.0	48.4	82.8	100.1	104.9	99.8	90.0	61.5	42.2
Percent of exports of goods and services	0.2	0.6	0.7	1.0	1.7	2.8	2.9	2.8	2.5	2.1	1.4	1.0
Percent of debt service 2/	8.3	20.3	24.0	31.2	52.5	66.5	55.1	43.6	37.7	34.2	24.6	18.6
Percent of GDP	0.1	0.3	0.3	0.4	0.7	1.2	1.2	1.2	1.0	0.9	0.6	0.4
Percent of gross international reserves	0.4	0.7	0.9	1.5	2.8	3.8	3.8	3.8	3.6	3.4	2.3	1.6
Percent of quota	3.8	9.5	12.9	17.0	24.9	31.3	38.2	40.0	38.1	34.4	23.5	16.1
Outstanding Fund credit based on existing and prospective credit												
Millions of SDRs	308.7	398.2	384.0	364.7	335.6	309.1	277.0	262.6	227.5	174.2	138.9	115.7
Millions of U.S. dollars	472.4	628.8	592.0	556.4	529.8	473.4	421.0	399.0	345.8	264.7	211.1	175.8
Percent of exports of goods and services	15.0	20.1	17.1	16.7	18.8	16.0	12.4	10.8	8.7	6.3	5.0	4.0
Percent of debt service 2/	544.5	687.7	582.7	541.7	574.1	380.4	231.6	165.9	130.7	100.4	84.5	77.3
Percent of GDP	6.7	8.6	7.4	7.0	8.1	7.0	5.3	4.4	3.6	2.6	1.9	1.6
Percent of gross international reserves	24.0	25.0	21.0	25.8	30.2	21.5	16.1	14.4	12.5	9.9	7.9	6.5
Percent of quota	250.6	323.2	311.7	296.1	272.4	179.2	160.6	152.2	131.9	101.0	80.5	67.1
Net use of Fund credit (millions of SDRs)	96.1	89.5	-14.2	-19.3	-29.1	-52.5	-32.1	-17.8	-38.4	-56.3	-37.9	-25.5
Disbursements and purchases 3/	100.0	100.0	0.0	0.0	0.0	0.0	31.4	48.0	24.0	0.0	0.0	0.0
Repayments and repurchases	3.9	10.5	14.2	19.3	29.1	52.5	63.5	65.8	62.4	56.3	37.9	25.5
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	3,143	3,135	3,462	3,329	2,813	2,954	3,397	3,700	3,959	4,191	4,260	4,394
Debt service (millions of U.S. dollars) 2/	86.8	91.4	101.6	102.7	92.3	124.5	181.8	240.5	264.6	263.6	249.7	227.3
Nominal GDP (millions of U.S. dollars) 2/	7,018	7,283	7,985	7,983	6,514	6,773	8,018	9,055	9,694	10,280	10,834	11,227
Gross International Reserves (millions of U.S. dollars)	1,965	2,515	2,821	2,157	1,757	2,206	2,611	2,778	2,775	2,678	2,664	2,719
Average exchange rate: SDR per U.S. dollars	0.7	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Quota (millions of SDRs)	123.2	123.2	123.2	123.2	123.2	172.5	172.5	172.5	172.5	172.5	172.5	172.5

Sources: IMF staff estimates and projections.

1/ Assume repurchases are made on obligations schedule.
2/ Total debt service includes IMF repurchases and repayments.
3/ In 2009, does not include Moldova use of the SDR allocation of SDR 117.71 million.

Table 8. Moldova: Quantitative Performance Targets, December 2017–December 2018

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

	Jun 2017		Sept 2017		Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018
	Target	Actual	Target	Actual	Target	Target	Target	Target	Target
1. Quantitative performance criteria [1/]									
Ceiling on the ***augmented*** cash deficit of the general government	3,670	233	5,485	-958	5,513	1,339	3,548	3,996	5,264
Of which: on-lending agreements with external creditors to state-owned enterprises	410	132	808	204	504	170	257	365	550
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [2/]	1,843	2,053	1,962	2293	2,131	2,368	2,349	2,409	2,487
2. Continuous performance criteria									
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0	0	0	0	0
3. Indicative targets									
Ceiling on the stock of accumulated domestic government arrears [3/]	26	12	13	15	0	0	0	0	0
Ceiling on the general government wage bill	6,358	6,283	9,292	9,155	12,657	3,287	7,244	10,535	13,769
Floor on priority social spending of the general government	8,450	8,515	12,766	12,862	17,660	4,598	9,463	14,227	19,134
Floor on project spending funded from external sources [4/]			N/A		N/A	262	647	1,713	3,540
4. Inflation Consultation Bands (in percent)									
Outer Band (upper limit)	7.7		8.2		9.0	7.8	5.6	5.5	5.5
Inner Band (upper limit)	6.7		7.2		8.0	6.8	4.6	4.5	4.5
Actual / Center point	5.7	7.3	6.2	7.6	7.0	5.8	3.6	3.5	3.5
Inner Band (lower limit)	4.7		5.2		6.0	4.8	2.6	2.5	2.5
Outer Band (lower limit)	3.7		4.2		5.0	3.8	1.6	1.5	1.5

1/ Indicative targets for September 2017, and March, September, and December 2018.

2/ The NIR target is set as specified in the TMU.

3/ As of January 2017, domestic expenditure arrears exclude local governments.

4/ N/A - target is new for 2018, and thus applicable only going forward.

Table 9. Moldova: Proposed Prior Actions and Structural Benchmarks Under the ECF/EFF

	Measure		Timeframe
Prior Actions for Board Consideration of the Review			
Financial sector			
1	Amend the laws on State Property Ownership, Joint stock Companies, and other relevant laws to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors to safeguard financial stability.		
2	Replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law.		
Fiscal sector			
3	Adopt the amendments to the 2017 Budget consistent with the current augmented deficit ceiling.		
4	Adopt the 2018 Budget in line with existing program commitments.		
Structural Benchmarks 1/			
Financial Sector			
1	Finalize onsite inspections in:		
	1a) two small domestic banks that are not part of foreign banking group	Modified	End-January 2018
	1b) banks that are part of foreign groups	Modified	End-May 2018
2	Finalize investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks	Modified	End-March 2018
3	NBM to allow a systemic bank to exit temporary administration in an orderly manner.	Modified	End-June 2018
4	Adopt a new framework for removing concerted and otherwise unfit shareholders, to streamline the process and address governance issues.	Modified	End-April 2018
5	NBM to instruct all banks to conduct self-assessment of corporate governance.	New	End-August 2018
6	NBM to order the largest three banks to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement.	New	End-January 2018
7	NBM to develop and issue for consultation with the banks guidelines for RP risk management programs.	New	End-June 2018
8	NCFM to complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign.	Modified	End-March 2018
9	Government to publish an analytical report prepared by an independent investigator on the 2014 bank fraud, and adopt a strategy with time-bound actions to recover assets.	New	End-December 2017
Energy sector			
10	Develop approve, and publish a new tariff methodology, in line with the new Energy law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSO.	New	Mid-February 2018

1/ Additional structural benchmarks will be set at the time of subsequent program reviews.

Table 10. Moldova: Status of Existing Structural Benchmarks Under the ECF/EFF

	Measure	Timeframe	Status
Structural Benchmarks			
Financial Sector			
1	Complete identification of UBOs of		
	1a the fourth and fifth largest banks that are not subsidiaries of foreign banking groups	End-June 2017	Modified
	1b all remaining banks	End-August 2017	Modified
2	Take appropriate enforcement action against any of the three largest banks for non-compliance with regulatory requirements		
	2a) Two large banks under intensive supervision	End-April 2017	Met with delay
	2b) A large bank under temporary administration	End-June 2017	Met
3	Complete an assessment of all banks to confirm compliance with capital requirements		
	3a) Two large banks under intensive supervision	End-April 2017	Met with delay
	3b) A large bank under temporary administration	End-June 2017	Met with delay
4	Execution of the final stages of a strategy to allow a large bank to exit temporary administration	End-July 2017	Modified
5	Enhance NBM's internal database for bank claims to capture relevant characteristics for identifying exposures to related party	End-June 2017	Not met
6	With external assistance, conduct thematic reviews of related party exposures in the three largest banks	End-August 2017	Met
7	Conduct full-scope on-site inspections in banks that are not subsidiaries of foreign banking groups, applying new procedures for identifying related party exposures	End-December 2017	Modified
8	Adopt a methodology for verification of legal records of shareholders of financial institutions	End-May 2017	Met with delay
9	Complete verification of legal records of shareholders of all banks and insurance companies, in line with the new methodology	End-December 2017	Modified
10	Amend the legal framework for removing shareholders who act in concert without prior supervisory approval	End-April 2017	Modified
Fiscal sector			
11	Adopt the medium-term budget framework 2018-20	End-May 2017	Met with delay
Energy sector			
12	In cooperation with the World Bank, improve the tariff-setting methodology in the heating sector, including	End-June 2017	Not met
	12a) Revision and/or clarification of asset valuation and depreciation principles, methodologies and procedures;		
	12b) Revision and formal approval of methodology for determination of heat losses;		
	12c) Determination of the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.		
13	In cooperation with the Energy Community Secretariat, improve energy sector regulation, including making procedures for the appointment of ANRE directors to be fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audit.	End-June 2017	Met with delay

Table 11. Moldova: External Financing Requirements and Sources, 2016–19

(Millions of U.S. dollars)

	2016	2017	2018	2019
		Projection		
Identified financing sources	942	1054	692	759
Financing requirements	606	819	848	838
of which: fiscal financing requirements	33	61	111	131
Change in gross reserves (increase = +)	531	406	166	-3
Financing gap	195	170	322	76
Official Financing	195	170	322	76
Identified program financing	160	126	254	42
European Commission	47	26	194	12
World Bank	45	0	60	30
Romania	68	101	0	0
Fund Program	35	44	68	34
of which: budget support	24	26	27	27

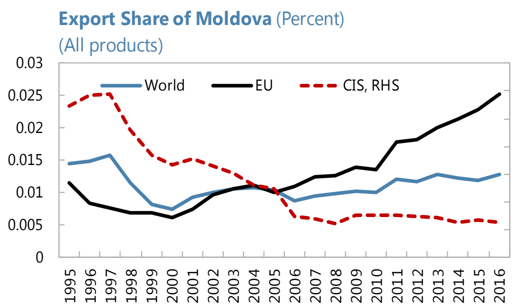
Sources: Moldovan authorities and IMF staff projections.

Annex I. External Sector Assessment

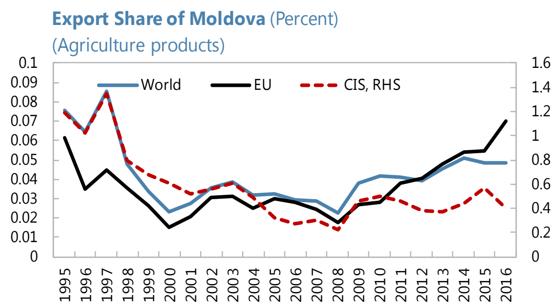
The external position is assessed to be broadly in line with fundamentals, based on the EBA-lite methodology. Reserves are adequate based on the IMF's composite metric, although reserve coverage of short-term debt, at 76.3 percent, is below standard metrics.

1. The current account deficit is projected to have widened during 2017 to 6.3 percent of GDP (from 4.6 percent in 2016). The current account is projected to narrow in 2018 to 5.4 percent and then gradually decline to about 5.0 percent in the medium-term. The deterioration during 2017 reflects rapid growth in non-energy imports which outpaced strong growth in exports. Remittances are projected to have picked up slightly during 2017 but remain well below 2014 levels. Moldova's export markets are gradually becoming more diversified, with participation in European markets more than doubling over the past 10 years. On the other hand, its share with its main trading partners, the CIS, continues to decline. A similar pattern is observed for agricultural exports.

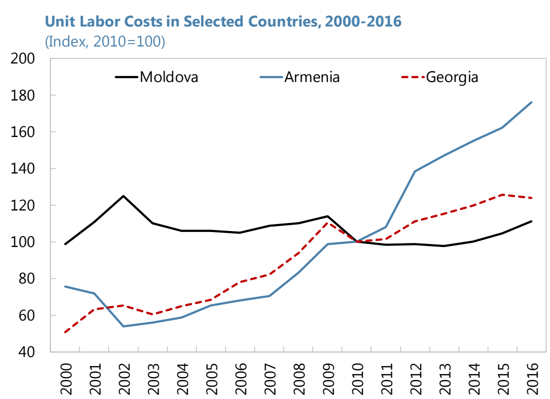
External Sector Developments



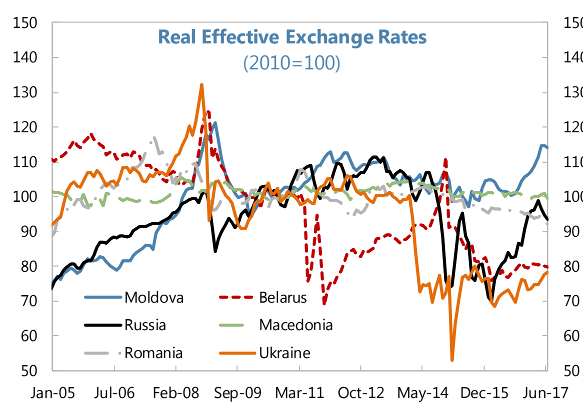
Sources: UNCTAD and IMF staff estimates



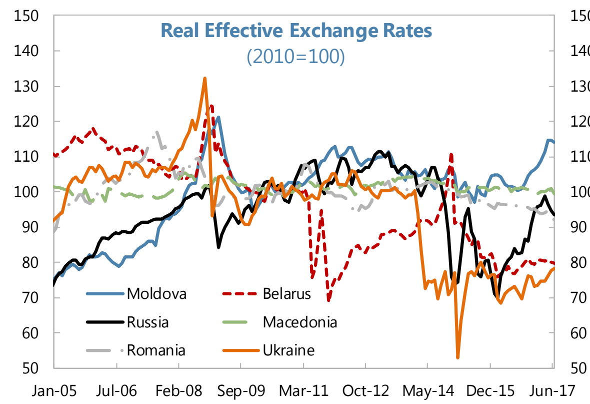
Sources: UNCTAD and IMF staff estimates



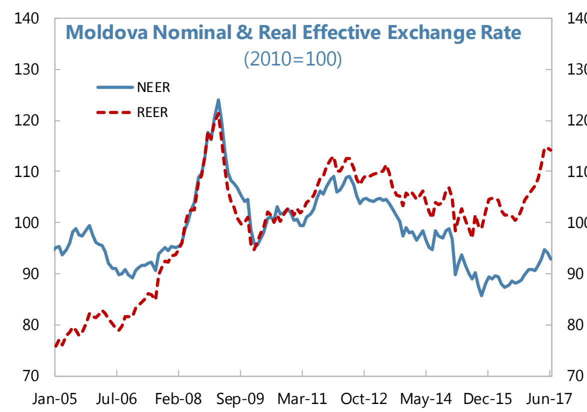
Sources: IMF staff calculations.



2. The real exchange rate has appreciated strongly since early 2017, reflecting the relative political and macro-financial stability. Since March 2017, the NEER and REER appreciated by about 1.3 percent and 5 percent, respectively. Unit labor costs (ULC) adjusted significantly after the 2009 global financial crisis, but began increasing again after 2014. Nevertheless, ULC growth is lower than in neighboring Armenia and Georgia.



3. The real effective exchange rate is assessed as being broadly in line with fundamentals. Results from applying the EBA-lite methodology suggests that the current account is broadly in line with fundaments. The cyclically-adjusted current account balance is -6.5 percent of GDP and is marginally larger than the norm by 0.4 percent of GDP, including a policy gap. Based on an elasticity of -0.39, this implies a slight over-valuation of about 1.0 percent. The REER exchange rate approach suggests a larger misalignment but is almost entirely driven by a large unexplained residual. The external sustainability approach suggests over-valuation between 6.6 and 9.6 percent depending on the assumed benchmark for the NIIP. Based on these metrics and assessment of other indicators, staff views the exchange rate to be broadly in line with fundamentals.



External Balance Assessment Results

	CA/GDP			REER
	Norm	Projections	Gap	Misalignment
		(in percent of GDP)		(percent)
EBA-lite current account 1/	-6.1	-6.5	-0.4	1.0
of which: policy gaps 2/	...	...	1.3	
External sustainability approach 3/	-3.9	-6.5	-2.6	6.6
External sustainability approach 4/	-2.7	-6.5	-3.8	9.6
EBA-lite real exchange rate equation 5/	...	...	...	19.6
of which: residual				20.6

1/ Staff's estimate of the cyclically adjusted norm for 2017, based on October 2017 EBA-lite estimates. The cyclical contributions (based on the EBA-lite model) is 0.2 percent of GDP. Assumed elasticity is -0.39.

2/ Policy gaps refer to policy distortions that can arise either from domestic policies or as a result of the policies of other countries.

3/ Based on maintaining NIIP at current level.

4/ Based on at target of -60 percent of GDP for NIIP.

5/ Misalignment based on October 2017 EBA-lite estimates.

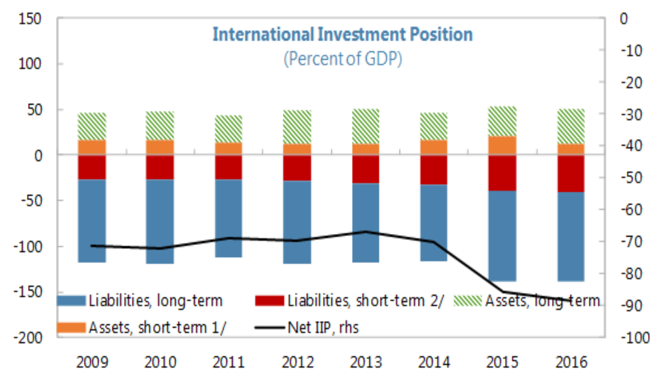
Reserve Adequacy Measures

	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Projection			
Gross official reserves (millions of U.S. dollars) 1/	2,156.6	1,756.8	2,205.9	2,611.4	2,777.6	2,774.6	2,677.6	2,663.6	2,718.6
Months of perspective imports of goods and services	5.4	4.4	4.7	5.2	5.2	4.9	4.5	4.3	4.3
Percent of short-term debt at remaining maturity	85.5	71.1	82.7	88.5	89.9	84.1	74.2	69.0	69.6
Percent of broad money	45.9	51.8	62.3	61.7	57.2	52.8	47.5	44.4	43.2
Percent of IMF composite measure (flexible)	128.4	112.4	134.9	147.6	146.2	136.7	125.4	118.5	115.4

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.

4. Reserves increased during 2017 as the exchange rate appreciated. Gross international reserves are projected to increase to USD 2.61 billion at end-2017 (from USD 2.2 billion at end-2016), some 147.6 percent of the Fund's reserve adequacy metric (assuming flexible exchange rate). Standard reserve adequacy indicators paint a somewhat mixed picture at end-2017. Import coverage is projected to remain well above the standard 3-month benchmark, as is the ratio with respect to broad money, however, coverage of short-term debt on remaining maturity remains below the standard threshold of 100 percent. Staff advise that, under the current exchange rate and inflation targeting regimes, foreign exchange interventions should be limited to the purpose of smoothing excessive foreign exchange market volatility. The NIIP had sharply deteriorated during 2015, stabilized in 2016 and declined further in the first half of 2017 primarily reflecting increased FDI liabilities, trade credits and government loans, offsetting increased international reserves.



Annex II. Debt Sustainability Analyses

Based on an assessment of public external debt, Moldova's risk of debt distress remains low.[1] Overall public debt dynamics are sustainable but with a small increase in the debt level in the near term due to increased capital spending. Private sector debt is relatively high for a low-income country. In view of the country's significant vulnerability to exogenous developments fiscal discipline remains critical to ensure sustainability. As Moldova has high levels of remittances, this DSA employs the remittance-augmented approach.[2]

Background

1. Moldova's total external debt is projected to reach 86.7 percent of GDP by end-2017, down from 97.2 percent of GDP at end-2016. The reduction largely reflects the strong appreciation of the nominal exchange rate during 2017 (by an estimated 11.3 percent) amid renewed capital inflows. Private external debt is relatively high for a low- income country and amounts to 63.3 percent of GDP, and is primarily comprised of trade credits and FDI-related loans. Public and publicly-guaranteed (PPG) external debt is held mainly by multilateral and bilateral donors, and is mostly medium and long term, and on concessional terms.[3]

2. The total PPG debt-to-GDP ratio is projected to decline to 40.6 percent at end 2017, largely reflecting a reduction in external debt. Domestic debt increased rapidly during 2015 and 2016 due to the issuance of a state guarantee to the National Bank of Moldova (NBM) to provide emergency liquidity to the banking sector. Currently, 20 percent of PPG domestic debt are long-term debt securities issued to the NBM. Other domestic debt is mainly short-term and held by the banking system.

3. External private sector debt is high but has declined since 2015. The main driver of the decline is a decrease in overseas borrowing by the banking sector reflecting the impact of the

[1] This full DSA is prepared jointly by IMF and World Bank staff, in consultation with the Moldovan authorities, using the debt sustainability framework for low-income countries approved by the Boards of both institutions, and in accordance with the staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries. (http://www.imf.org/en/publications/policy-papers/issues/2016/12/31/staff-guidance-note-on-the-application-of-the-joint-bank-fund-debt-sustainability-framework-pp4827)

[2] Remittances are 11 percent of GDP and 25 percent of exports of goods and nonfactor services on average between 2014 and 2016.

[3] PPG debt covers gross debt of the general government, while debt of state-owned enterprises is not included unless it is explicitly guaranteed by the government. Both on-lending to the private sector (operationalized through commercial banks) and to SOEs are part of public guarantees and are included. In line with the DSA guidelines, public debt includes liabilities towards the IMF.

banking crisis. However, most external debt relates to the non-bank sector and about half of non-bank debt is short-term, and consists of trade credits, arrears, and other debt liabilities, most for the import of natural resources. Similar to other Central and Eastern European countries, private borrowing in Moldova stems mainly from foreign-owned companies borrowing from their parent companies abroad.

4. Moldova is a strong performer for the purpose of determining the debt burden thresholds under the Debt Sustainability Framework (DSF). Moldova's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 3.73 over the last three years (2014–16), which places the country in the strong performance category, as it was last year.[4]

Underlying Assumptions

5. Economic performance is expected to remain solid over the medium term, with steady growth, moderate inflation and a gradual narrowing of the current account deficit (text table). Moldova has experienced a period of relative stability during 2016 and 2017, as the recovery from the banking crisis continues. Economic growth was 4.3 percent in 2016 and is estimated to have moderated to 3.5 percent during 2017. Notwithstanding considerable uncertainty, staff assesses the output gap to be slightly negative. Over the medium-term, growth is expected to pick up and average about 3.9 percent. Core inflation remains subdued although headline inflation increased above the NBM's target band, driven by higher than projected growth in food prices and one-off healthcare tariff adjustments that contributed over 1 percent to headline inflation. Over the medium-term, inflation is expected to remain anchored at 5 percent—the authorities' inflation target. These projections are broadly in line with those in the previous DSA.

[4] Moldova's 2013–15 CPIA was 3.78. As noted in the Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (http://www.imf.org/en/publications/policy-papers/issues/2016/12/31/staff-guidance-note-on-the-application-of-the-joint-fund-bank-debt-sustainability-framework-pp4419) , for countries where, following the release of the new annual CPIA score, the updated three-year moving average CPIA rating breaches the applicable CPIA boundary, the country's performance category would change immediately only if the size of the breach exceeds 0.05. If the size of the breach is at or below 0.05, the country's performance category would change only if the breach is sustained for two consecutive years.

Key Macroeconomic Projections

	2016	2017	2018	2019	2020	2021	2022
GDP Growth Rate	4.3	3.5	3.0	3.8	3.8	3.9	3.9
CPI Inflation rate	6.4	6.5	4.3	4.8	4.9	5.0	5.0
Primary balance (percent of GDP)	-0.8	-1.8	-2.2	-2.7	-2.5	-1.7	-1.6
Current account balance (percent of GDP)	-4.6	-6.3	-5.4	-5.2	-5.1	-5.3	-5.1

Sources: Moldovan authorities; and IMF staff projections.

6. The fiscal position is projected to remain solid over the medium term, with stable revenues and disciplined expenditure. Recovery in the banking sector and accumulation of foreign reserves supports a stable medium-term outlook. Fiscal revenue over-performance during 2017 is largely due to higher than expected trade activity, higher average wage growth, and tax and customs reforms payoffs, while under-execution of spending relates to implementation delays in road transportation projects, reorganization of ministries and external financing uncertainty.

I. External Debt Sustainability Analysis

7. External public debt ratios remain below the thresholds under the baseline and stress scenarios. In the baseline scenario, the PV of PPG debt-to-GDP-plus-remittances is 20.5 percent in 2019 and then declines slowly, reflecting among other things, prudent borrowing strategy of the government and limitations of absorption capacity for external projects. Consequently, in the long term, the PV of PPG debt-to-GDP-plus-remittances is projected to improve gradually to about 18.7 percent in 2027 and around 14.4 percent in 2037. Under the alternative scenario in which exports grow at their historical average minus one standard deviation in 2017–18, the PV of PPG debt to GDP peaks at 34.4 percent in 2019, before declining to 27.9 and 17.0 percent in 2027 and 2037, respectively. Meanwhile, if the key variables remained at their historical averages, the PV of PPG debt to GDP would be around 24 percent in the long run. The PV of PPG debt-to-exports-plus-remittances as well as to revenue increase relatively more under the alternative and bound test scenarios, but none of them breach the threshold. These results are based on the current projection of authorities' borrowing path and assume continuous prudence in fiscal policies and external adjustment in line with the authorities' commitments under the IMF-supported program.

8. While the external risk rating is determined by the PPG external debt, large private external debt pose some additional risk. Private sector debt is about 70 percent of total external debt at end-2016 and is expected to gradually decline over the medium-term. Non-bank debt is about

93 percent of private sector debt, of which half is short-term debt (largely comprised of trade credits and arrears related to imports of energy resources), implying a vulnerability to rollover risk. Non-bank medium and long-term loans are 47 percent of private sector debt and about half of these loans are owed to direct investors.

II. Public Sector Debt Sustainability Analysis

9. The macroeconomic outlook has been revised to reflect changes in near- and medium-term projections compared to the previous DSA assessment. The augmented budget deficit (accounting for on-lending to SOEs as an additional budgetary item) is projected to increase from 2.1 percent of GDP in 2016 to 3.1 percent of GDP in 2017, then decline to around 2.8 percent of GDP by 2020. The increased budget deficit in 2019 and 2020 is due to infrastructure investments on railways, electricity and gas. Over the long run, the primary deficit is assumed to average about 1.1 percent of GDP.

10. Under the baseline scenario the PPG debt-to-GDP ratio is sustainable. Debt is projected to increase by about 2 percentage points in 2018 and 2019 – before declining over the medium and long term, reflecting sustainable public debt dynamics. The domestic PPG debt-to-GDP ratio is projected to decline, while the increase in the external PPG debt-to-GDP ratio is mainly driven by an increase in on-lending agreements. With the macroeconomic assumptions outlined above, the planned (augmented) primary budget deficit path is projected below the level that would stabilize the debt-to-GDP ratio. As a result, Moldova's total PPG debt is expected to decline gradually and continuously from its peak in 2019 of 44.2 percent to 43.6 percent in 2022 and 31.4 percent by end–2037. Other sustainability indicators confirm a similar long-term trend under the baseline scenario. PV of debt-to-GDP is projected to remain well below the benchmarks for heightened public debt vulnerabilities for the strong policy performance category.

11. Prudent fiscal and borrowing policies are essential for preserving the low risk rating. Permanently lower GDP growth could potentially raise the public debt level above the threshold in the longer run (by 2037) with the PV of debt reaching up 84 percent of GDP. In the other alternative scenarios, the PV of debt-to-GDP remains below the indicative thresholds. A 10 percent of GDP increase in other debt creating flows in 2018 would result in an increase in the PV of debt-to-GDP ratio that would reach 32 percent of GDP in 2037. For example, such risks could stem from contingencies airing in the banking system of for accumulated energy sector debts.

Conclusion

12. The DSA indicates that Moldova's risk of debt distress remains low, in line with the previous assessment. External indicators for public debt remain well below the debt thresholds under the

baseline, standard bound tests, and alternative scenarios as well as under the probability approach. However, significant private external debt poses potential roll-over risks. While being sensitive to exchange rate depreciation and a sudden increase in other debt creating flows, Moldova's overall public debt dynamics are projected to remain on a sustainable path under the baseline and alternative scenarios.

13. Pursuing prudent fiscal policy and advancing structural reforms remain necessary to ensure debt sustainability. Due to the country's sensitivity to exogenous developments, debt sustainability critically depends on sound macroeconomic management and continuing progress on institutional and structural reforms that would help raise the economy's growth potential and reduce its vulnerability to shocks. Furthermore, development of the domestic debt market could further strengthen the outlook for debt sustainability, especially considering the country's development needs and significant dependence on foreign assistance in the form of grants and concessional loans. For example, efforts to lengthen the average maturity of domestic debt and deepen the secondary market would help reduce the PPG domestic debt roll-over and interest rate risks.

Table 1. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2014–37 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-2022 Average	2027	2037	2023-2037 Average
External debt (nominal) 1/	**84.9**	**99.2**	**97.2**			**86.7**	**83.7**	**84.1**	**83.3**	**82.6**	**83.1**		**77.3**	**70.4**	
of which: public and publicly guaranteed (PPG)	24.0	27.2	26.1			23.5	25.9	27.5	27.7	27.8	28.3		25.5	19.4	
Change in external debt	0.4	14.3	-2.0			-10.5	-3.0	0.4	-0.8	-0.7	0.5		-1.2	-0.5	
Identified net debt-creating flows	3.3	22.5	-0.5			2.2	2.0	1.0	0.8	1.0	0.7		0.9	1.0	
Non-interest current account deficit	**4.5**	**5.0**	**4.1**	**8.5**	**4.6**	**5.7**	**4.8**	**4.5**	**4.2**	**4.4**	**4.1**		**3.9**	**4.1**	4.0
Deficit in balance of goods and services	36.7	30.6	27.6			28.5	26.2	25.9	25.9	26.2	26.3		26.3	26.1	
Exports	41.7	43.2	43.6			42.4	40.9	40.8	40.8	39.3	39.1		39.5	40.3	
Imports	78.4	73.8	71.2			70.9	67.1	66.7	66.7	65.5	65.5		65.8	66.5	
Net current transfers (negative = inflow)	-21.1	-17.9	-16.1	-21.2	3.3	-15.3	-14.3	-14.0	-14.1	-14.1	-14.2		-14.2	-14.2	-14.2
of which: official	-4.0	-2.3	-1.5			-2.2	-1.7	-1.7	-1.7	-1.7	-1.6		-1.6	-1.6	
Other current account flows (negative = net inflow)	-11.1	-7.7	-7.4			-7.6	-7.2	-7.5	-7.5	-7.7	-8.0		-8.1	-7.9	
Net FDI (negative = inflow)	**-2.0**	**-2.4**	**-1.3**	**-4.4**	**3.9**	**-1.2**	**-1.1**	**-1.2**	**-1.2**	**-1.2**	**-1.2**		**-1.2**	**-1.2**	-1.2
Endogenous debt dynamics 2/	**0.8**	**19.9**	**-3.2**			**-2.2**	**-1.6**	**-2.2**	**-2.2**	**-2.2**	**-2.1**		**-1.8**	**-1.8**	
Contribution from nominal interest rate	0.8	0.7	0.6			0.6	0.7	0.8	0.8	0.9	1.0		1.1	0.8	
Contribution from real GDP growth	-4.1	0.4	-4.1			-2.9	-2.3	-3.0	-3.0	-3.1	-3.1		-2.9	-2.6	
Contribution from price and exchange rate changes	4.1	18.7	0.3			-12.2	-7.6	...	...	...	...		...	...	
Residual (3-4) 3/	**-3.0**	**-8.2**	**-1.5**			**-12.7**	**-5.0**	**-0.6**	**-1.7**	**-1.6**	**-0.3**		**-2.1**	**-1.5**	
of which: exceptional financing	-2.1	-1.0	-1.7			-0.3	-1.4	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	
PV of external debt 4/	...	...	94.1			83.6	79.4	78.9	77.8	77.1	77.5		72.2	66.7	
In percent of exports	...	...	215.8			197.2	194.4	193.3	190.9	196.1	198.0		182.7	165.4	
PV of PPG external debt	**...**	**...**	**22.9**			**20.3**	**21.6**	**22.3**	**22.3**	**22.3**	**22.7**		**20.4**	**15.8**	
In percent of exports	**...**	**...**	**52.5**			**47.9**	**52.8**	**54.7**	**54.6**	**56.6**	**58.1**		**51.7**	**39.1**	
In percent of government revenues	**...**	**...**	**69.4**			**58.4**	**63.8**	**67.0**	**66.9**	**67.0**	**68.5**		**61.9**	**47.9**	
Debt service-to-exports ratio (in percent)	**13.4**	**10.9**	**9.1**			**8.4**	**9.1**	**8.2**	**8.8**	**11.4**	**12.8**		**13.8**	**8.4**	
PPG debt service-to-exports ratio (in percent)	**2.1**	**1.7**	**1.7**			**3.0**	**4.2**	**4.6**	**4.9**	**4.7**	**4.4**		**4.8**	**4.4**	
PPG debt service-to-revenue ratio (in percent)	**2.5**	**2.2**	**2.2**			**3.7**	**5.1**	**5.7**	**6.0**	**5.6**	**5.2**		**5.8**	**5.4**	
Total gross financing need (Billions of U.S. dollars)	2.9	2.7	2.7			3.1	3.4	3.5	3.7	4.1	4.3		6.3	13.9	
Non-interest current account deficit that stabilizes debt ratio	4.1	-9.4	6.0			16.2	7.8	4.1	5.1	5.1	3.7		5.1	4.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.8	-0.4	4.3	3.6	4.8	3.5	3.0	3.8	3.8	3.9	3.9	3.7	3.9	3.9	3.9
GDP deflator in US dollar terms (change in percent)	-4.6	-18.1	-0.3	4.3	14.0	14.4	9.6	3.1	2.2	1.4	-0.3	5.1	2.9	2.9	2.9
Effective interest rate (percent) 5/	0.9	0.7	0.6	1.2	0.4	0.8	0.9	1.0	1.0	1.1	1.2	1.0	1.5	1.2	1.3
Growth of exports of G&S (US dollar terms, in percent)	-3.9	-15.5	5.0	8.4	19.1	15.0	8.9	7.0	5.9	1.6	3.2	6.9	7.2	7.2	7.1
Growth of imports of G&S (US dollar terms, in percent)	-2.7	-23.2	0.3	6.8	23.0	17.8	7.0	6.4	6.0	3.5	3.6	7.4	7.1	7.1	7.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	37.8	36.4	37.7	35.8	32.8	31.5	35.3	28.7	19.1	26.1
Government revenues (excluding grants, in percent of GDP)	34.4	34.1	33.0			34.7	33.9	33.3	33.3	33.2	33.2		33.0	32.9	33.0
Aid flows (in Billions of US dollars) 7/	0.3	0.1	0.2			0.1	0.3	0.2	0.1	0.1	0.1		0.1	0.2	
of which: Grants	0.3	0.1	0.1			0.1	0.2	0.0	0.0	0.0	0.0		0.1	0.1	
of which: Concessional loans	0.1	0.0	0.1			0.1	0.1	0.1	0.1	0.0	0.0		0.1	0.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.2	3.7	2.3	1.6	1.3	1.3		1.1	0.8	1.0
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			49.3	52.2	43.5	42.6	40.9	40.0		38.6	33.0	37.3
Memorandum items:															
Nominal GDP (Billions of US dollars)	8.0	6.5	6.8			8.0	9.1	9.7	10.3	10.8	11.2		15.6	30.6	
Nominal dollar GDP growth	0.0	-18.4	4.0			18.4	12.9	7.1	6.0	5.4	3.6	8.9	7.0	7.0	6.9
PV of PPG external debt (in Billions of US dollars)			1.5			1.7	1.9	2.1	2.3	2.4	2.5		3.2	4.8	
(PVt-PVt-1)/GDPt-1 (in percent)						2.3	2.9	2.2	1.2	1.2	1.3	1.8	0.9	0.6	0.9
Gross workers' remittances (Billions of US dollars)	0.9	0.7	0.7			0.7	0.8	0.9	0.9	1.0	1.1		1.5	2.9	
PV of PPG external debt (in percent of GDP + remittances)	...	...	20.8			18.6	19.8	20.5	20.4	20.4	20.8		18.7	14.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	42.7			39.4	43.5	44.8	44.6	45.8	46.9		41.8	31.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.4			2.5	3.5	3.8	4.0	3.8	3.6		3.9	3.5	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

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 2. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to-GDP+remittances ratio								
Baseline	18.6	19.8	20.5	20.4	20.4	20.8	**18.7**	14.4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	19	21	22	22	22	23	**24**	25
A2. New public sector loans on less favorable terms in 2017-2037 2	19	21	22	23	23	24	**25**	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	19	20	22	22	22	22	**20**	15
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	18.6	24.9	34.4	34.0	33.8	34.3	**27.9**	17.0
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	19	23	27	27	27	27	**25**	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	19	17	16	16	16	16	**16**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	19	22	27	27	27	28	**24**	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	19	26	27	27	27	27	**25**	19
PV of debt-to-exports+remittances ratio								
Baseline	39	43	45	45	46	47	**42**	32
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	39	45	47	48	50	51	**55**	56
A2. New public sector loans on less favorable terms in 2017-2037 2	39	45	48	50	52	55	**55**	53
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	39	43	44	44	45	46	**41**	31
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	39	64	102	100	102	104	**84**	50
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	39	43	44	44	45	46	**41**	31
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	39	37	33	35	36	37	**35**	30
B5. Combination of B1-B4 using one-half standard deviation shocks	39	44	54	55	56	57	**50**	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	39	43	44	44	45	46	**41**	31
PV of debt-to-revenue ratio								
Baseline	58	64	67	67	67	69	**62**	48
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	58	67	71	72	73	74	**80**	81
A2. New public sector loans on less favorable terms in 2017-2037 2	58	66	72	75	77	80	**81**	80
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	58	66	72	72	72	74	**67**	52
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	58	80	112	112	111	113	**92**	57
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	58	77	92	91	92	94	**85**	66
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	58	56	52	52	52	54	**52**	45
B5. Combination of B1-B4 using one-half standard deviation shocks	58	73	94	94	94	96	**85**	62
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	58	87	91	91	91	93	**84**	65

Table 2. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (concluded)

(In percent)

Debt service-to-exports+remittances ratio								
Baseline	2	3	4	4	4	4	**4**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	2	4	4	4	4	4	**4**	5
A2. New public sector loans on less favorable terms in 2017-2037 2	2	3	4	4	4	4	**5**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	2	3	4	4	4	4	**4**	4
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	2	4	6	7	6	6	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	2	3	4	4	4	4	**4**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	2	3	3	4	4	3	**3**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	4	4	5	4	4	**5**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	2	3	4	4	4	4	**4**	4
Debt service-to-revenue ratio								
Baseline	4	5	6	6	6	5	**6**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	4	5	6	6	6	5	**6**	7
A2. New public sector loans on less favorable terms in 2017-2037 2	4	5	6	6	6	6	**7**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	4	5	6	7	6	6	**6**	6
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	4	5	6	7	7	7	**9**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	4	6	8	8	8	7	**8**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	4	5	5	6	5	5	**5**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	4	6	7	8	7	7	**8**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	4	7	8	8	8	7	**8**	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	23	23	23	23	23	23	**23**	23

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 a an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014–37
(in percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	36.0	44.8	42.1			40.6	42.1	44.2	44.0	43.6	43.6		37.9	31.4	
of which: foreign-currency denominated	24.0	27.2	26.1			23.5	25.9	27.5	27.7	27.8	28.3		25.5	19.4	
Change in public sector debt	6.5	8.8	-2.7			-1.5	1.5	2.1	-0.2	-0.3	0.0		-1.1	-0.6	
Identified debt-creating flows	8.1	10.6	-1.8			-3.5	0.4	0.9	0.8	0.0	0.5		-0.5	-0.5	
Primary deficit	1.3	1.4	0.8	1.3	1.6	1.7	2.0	2.5	2.4	1.6	1.5	2.0	1.1	0.8	1.1
Revenue and grants	37.9	35.6	34.1			35.5	35.6	33.8	33.7	33.6	33.6		33.4	33.3	
of which: grants	3.5	1.6	1.0			0.8	1.7	0.5	0.4	0.4	0.4		0.4	0.4	
Primary (noninterest) expenditure	39.2	37.0	34.8			37.2	37.6	36.3	36.0	35.2	35.1		34.5	34.1	
Automatic debt dynamics	1.5	3.5	-2.4			-5.2	-1.4	-1.6	-1.6	-1.5	-1.0		-1.6	-1.2	
Contribution from interest rate/growth differential	-1.6	-0.3	-1.7			-1.3	-1.0	-1.5	-1.6	-1.7	-1.6		-1.4	-1.0	
of which: contribution from average real interest rate	-0.2	-0.5	0.1			0.1	0.1	0.1	0.0	0.0	0.0		0.1	0.2	
of which: contribution from real GDP growth	-1.4	0.1	-1.8			-1.4	-1.2	-1.5	-1.6	-1.7	-1.6		-1.5	-1.2	
Contribution from real exchange rate depreciation	3.1	3.8	-0.7			-3.8	-0.4	-0.1	0.0	0.2	0.6		...	...	
Other identified debt-creating flows	5.2	5.7	-0.2			0.0	-0.2	-0.1	0.0	-0.1	-0.1		0.0	0.0	
Privatization receipts (negative)	-0.4	0.0	-0.2			0.0	-0.2	-0.1	0.0	-0.1	-0.1		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	5.6	5.7	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-1.7	-1.8	-0.9			2.0	1.1	1.2	-1.0	-0.3	-0.5		-0.6	-0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	38.9			37.4	37.8	39.0	38.5	38.1	38.0		32.9	27.7	
of which: foreign-currency denominated	...	...	22.9			20.3	21.6	22.3	22.3	22.3	22.7		20.4	15.8	
of which: external	...	...	22.9			20.3	21.6	22.3	22.3	22.3	22.7		20.4	15.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.0	8.9	8.8			10.0	13.9	14.3	15.3	13.5	13.5		12.7	13.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	114.4			105.3	106.2	115.3	114.4	113.5	113.3		98.5	83.3	
PV of public sector debt-to-revenue ratio (in percent)	...	...	117.9			107.7	111.6	117.0	115.7	114.9	114.6		99.7	84.3	
of which: external 3/	...	...	69.4			58.4	63.8	67.0	66.9	67.0	68.5		61.9	47.9	
Debt service-to-revenue and grants ratio (in percent) 4/	4.7	5.3	6.7			8.2	12.9	13.7	13.9	10.1	9.7		9.6	9.1	
Debt service-to-revenue ratio (in percent) 4/	5.2	5.5	7.0			8.4	13.5	13.9	14.0	10.2	9.8		9.7	9.2	
Primary deficit that stabilizes the debt-to-GDP ratio	-5.1	-7.4	3.5			3.2	0.5	0.4	2.6	1.9	1.6		2.2	1.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.8	-0.4	4.3	3.6	4.8	3.5	3.0	3.8	3.8	3.9	3.9	3.7	3.9	3.9	3.9
Average nominal interest rate on forex debt (in percent)	0.9	0.8	1.0	1.3	0.4	1.4	1.5	1.6	1.6	1.6	1.7	1.6	2.1	2.6	2.2
Average real interest rate on domestic debt (in percent)	-0.5	-3.3	1.2	1.1	5.5	1.2	1.5	1.4	1.1	0.5	0.6	1.1	0.4	0.5	0.4
Real exchange rate depreciation (in percent, + indicates depreciation)	14.4	15.9	-2.5	-0.7	13.6	-15.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.4	9.8	5.6	7.9	3.9	6.5	4.5	5.0	5.0	5.0	5.0	5.2	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	8.0	-5.9	-2.0	0.0	3.4	10.7	4.0	0.3	2.9	1.5	3.6	3.9	3.5	3.8	3.7
Grant element of new external borrowing (in percent)	...	...	...	...	...	37.8	36.4	37.7	35.8	32.8	31.5	35.3	28.7	19.1	...

Sources: Country authorities; and staff estimates and projections.

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

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

3/ Revenues excluding grants.

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

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

Table 4. Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2017–37

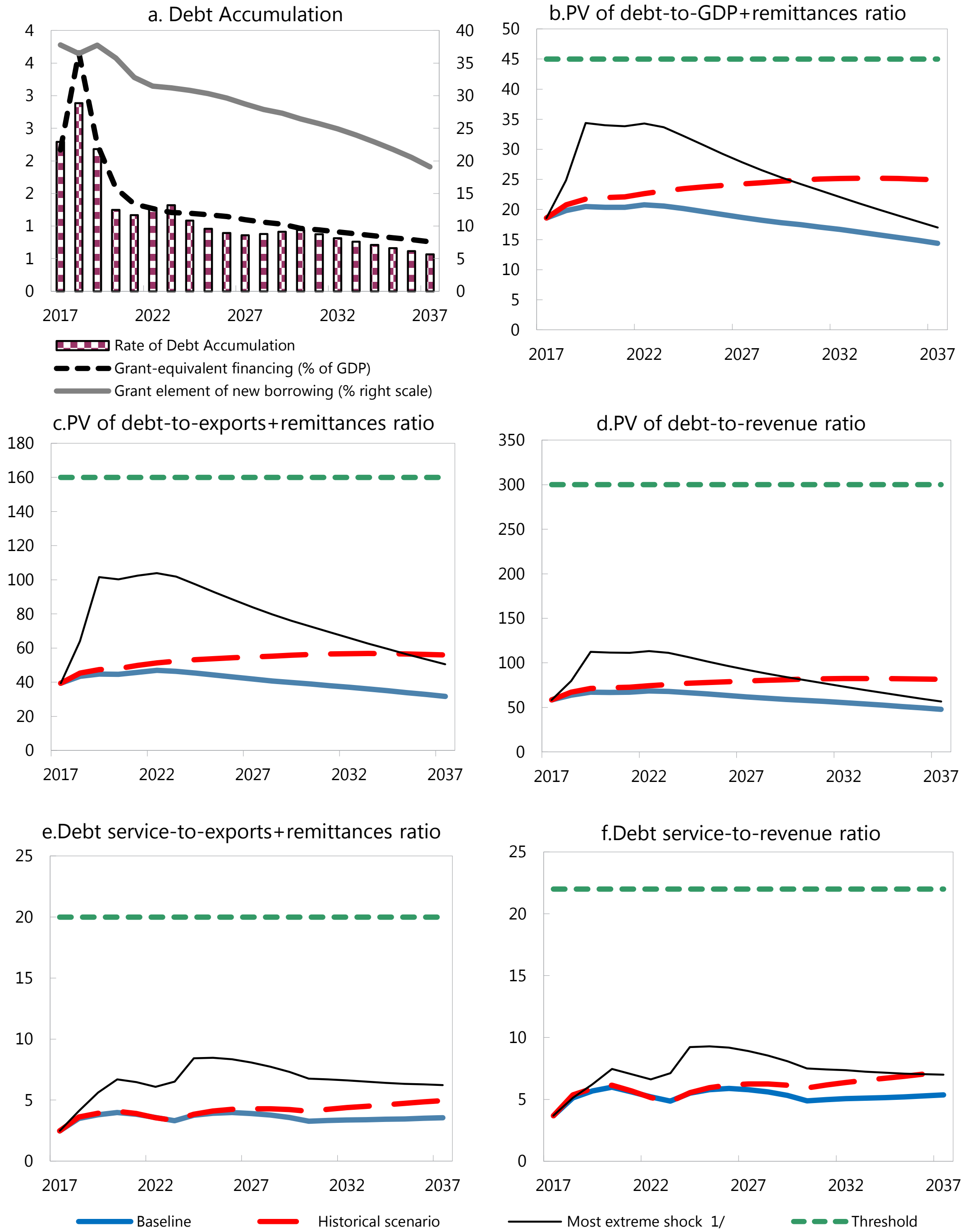
	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	37	38	39	38	38	38	33	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	37	37	37	36	36	36	31	30
A2. Primary balance is unchanged from 2017	37	38	38	37	37	37	33	33
A3. Permanently lower GDP growth 1/	37	38	41	41	42	44	50	84
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	37	40	46	48	50	52	56	65
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	37	39	40	39	39	39	34	28
B3. Combination of B1-B2 using one half standard deviation shocks	37	39	40	41	42	43	42	44
B4. One-time 30 percent real depreciation in 2018	37	46	46	45	44	44	38	33
B5. 10 percent of GDP increase in other debt-creating flows in 2018	37	45	46	46	45	45	39	32
PV of Debt-to-Revenue Ratio 2/								
Baseline	105	106	115	114	114	113	98	83
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	105	104	111	108	106	106	93	89
A2. Primary balance is unchanged from 2017	105	106	113	110	110	110	99	99
A3. Permanently lower GDP growth 1/	105	108	120	122	126	131	150	251
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	105	113	136	142	148	155	168	195
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	105	108	118	117	116	116	101	85
B3. Combination of B1-B2 using one half standard deviation shocks	105	108	119	122	124	127	126	132
B4. One-time 30 percent real depreciation in 2018	105	128	136	133	132	132	114	100
B5. 10 percent of GDP increase in other debt-creating flows in 2018	105	127	137	136	135	135	117	95
Debt Service-to-Revenue Ratio 2/								
Baseline	8	13	14	14	10	10	10	9
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	8	13	14	14	10	9	9	9
A2. Primary balance is unchanged from 2017	8	13	14	14	10	10	9	10
A3. Permanently lower GDP growth 1/	8	13	14	14	11	11	12	19
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	8	13	15	16	12	11	13	17
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	8	13	14	14	10	10	10	9
B3. Combination of B1-B2 using one half standard deviation shocks	8	13	14	14	11	10	11	12
B4. One-time 30 percent real depreciation in 2018	8	14	16	17	13	12	13	13
B5. 10 percent of GDP increase in other debt-creating flows in 2018	8	13	14	15	11	10	11	10

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.

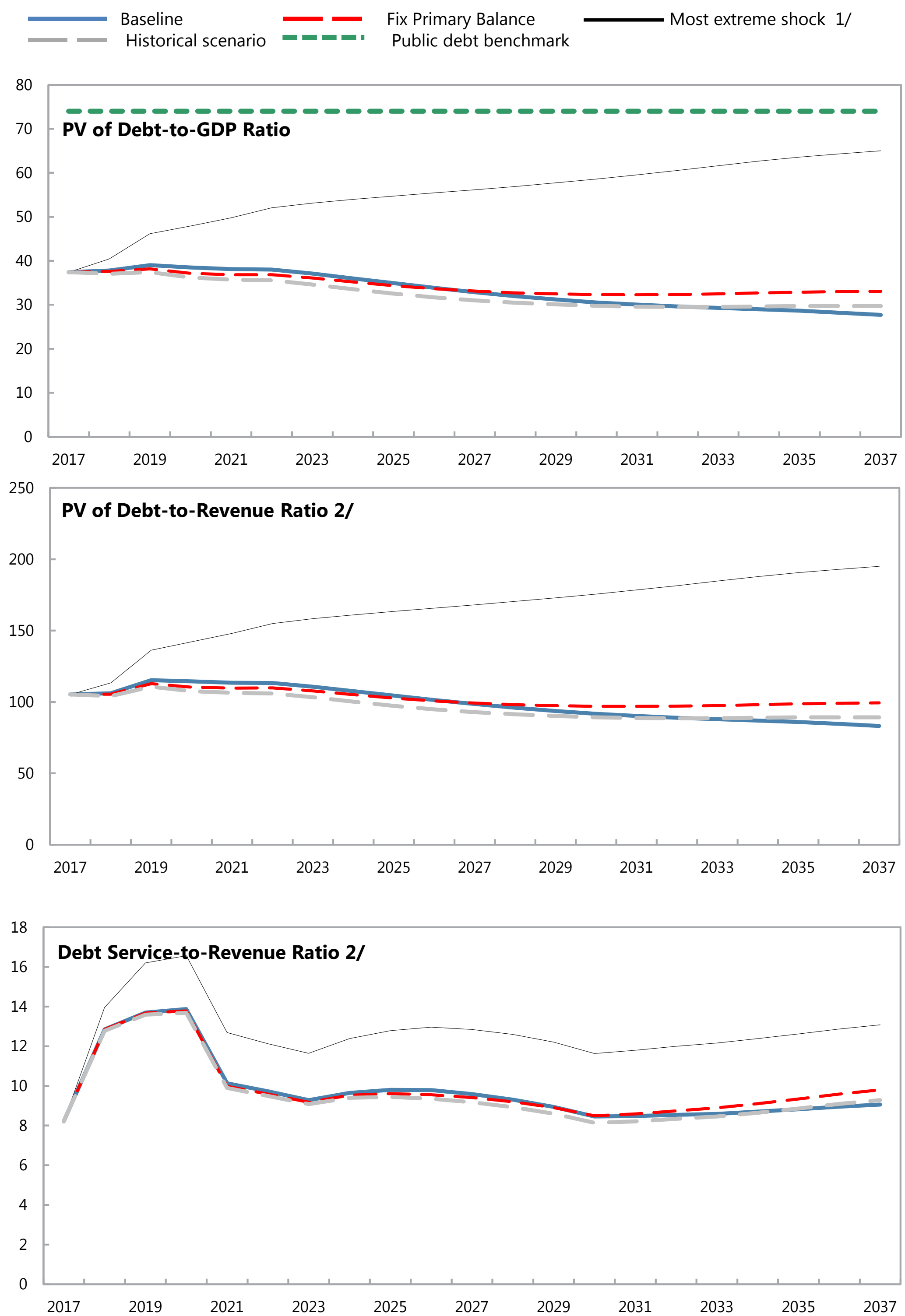
2/ Revenues are defined inclusive of grants.

Figure 1. Moldova: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2017–37 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 2027. In figure b, it corresponds to an Exports shock; in c. to an Exports shock; in d. to an Exports shock; in e. to an Exports shock and in figure f. to an Exports shock.

Figure 2. Moldova: Indicators of Public Debt Under Alternative Scenarios, 2017–37 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 2027.

2/ Revenues are defined inclusive of grants.

Annex III. Risk Assessment Matrix 1/

Source of Risks	Impact if realized	Policy response
Policy and geopolitical uncertainties:		
Regional political instability: Political instability could undermine economic activity by creating economic uncertainty and eroding investor and consumer confidence.	An escalation in political instability could lead to further changes in trade patterns and commodity markets, pattern of remittances, and capital flows, with significant impacts on the Moldovan economy.	➢ Exchange rate flexibility should be main response to external shocks. ➢ Continue to build fiscal space to respond to adverse shocks and strengthen external buffers. ➢ Accelerate structural reforms to increase external competitiveness and diversify international trade and energy sources.
Weaker-than-expected global growth:		
Structurally weak growth in key advanced and emerging economies: Low productivity growth (U.S., the Euro Area, and Japan), a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation (the Euro Area, and Japan) undermine medium-term growth in advanced economies. **Significant slowdown in other large EMs/frontier economies:** Resource misallocation and policy missteps exacerbate the impact of declining productivity and potential growth. In addition, turning of the domestic credit cycle generates disorderly household and corporate deleveraging, with potential spillbacks to advanced economies	Lower export demand, declining remittances and other financial flows (such as trade credits or grants) would lower growth, weaken the fiscal position, and exacerbate difficulties in the banking sector.	➢ Exchange rate flexibility should be the main response to external shocks. ➢ Continue to build fiscal space to respond to adverse shocks and strengthen external buffers. ➢ Accelerate structural reforms to increase external competitiveness, diversify the economy and boost productivity.
Domestic risks:		
Political risks. Program implementation could be tested in the run-up to parliamentary elections end-2018. **Financial sector risks.** Progress on banking sector reforms, including improved governance and risk management, hinges on continued political commitment to strengthen the sector and tackle vested interests.	Delays in cleansing and restructuring the sector could result in lower business sentiment, and decline of FDI and business confidence. As a result, the costs of dealing with bank distress could increase and credit supply would decline, dampening growth	➢ Apply promptly appropriate tools under the new resolution framework. ➢ Enforce shareholder and beneficial ownership transparency. ➢ Deal with the restructuring of banks with unfit and improper management and shareholders. ➢ Enhance regulator's independence. ➢ Step up anti-corruption and AML/CFT efforts.
Broader reform risks. Addressing infrastructure gaps, improving investment efficiency, increasing the quality of human capital along with regulatory and institutional reforms, are needed to increase potential growth and combat the shadow economy.	Insufficient progress in implementing key structural reforms would weaken growth, with adverse impacts on emigration, the investment climate and the size of the shadow economy.	➢ Early successes from steadfast implementation of reforms can help build support for further 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. Note: Colored boxes on the left-hand side represent shock likelihood in case the baseline does not materialize, and color boxes in the center represent the severity of impact. Red = High, Orange = Medium, and Green = Low.

Appendix I. Letter of Intent

Chişinău, December 5, 2017

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

1. Moldova continues to move ahead with an ambitious reform program, supported by the Fund's Extended Fund Facility and Extended Credit Facility Arrangements. We met all quantitative performance criteria, all but one indicative target, and 8 of 16 structural benchmarks, although some with delay. We are extending our period of economic and financial stability, with continued growth and sound fiscal performance. Looking forward, growth is projected to be 3 percent in 2018, and around 4 percent over the medium term. Faster and more inclusive growth will be vital to creating jobs and improving living standards for all of our people. But challenges remain.

2. Our short-term goals remain unchanged – namely to consolidate economic and financial stability, by cleansing the financial sector, and enabling a strong regulatory and supervisory environment. To support these objectives, we will continue to pursue a comprehensive reform agenda:

- In the **financial sector**, we will ensure ownership and control of our banks by fit and proper shareholders, strengthen the framework for shareholder removal, complete and follow-up on bank diagnostics, and ensure the integrity of legal records in the newly-created security depository. We will also act to further strengthen our regulatory and supervisory frameworks, including for non-bank financial institutions.

- Our **fiscal policy** remains in line with our program commitments while also prioritizing public investment and social spending. Over the medium term, we will focus on strengthening tax revenues, improving our fiscal framework, and improving the efficiency of our spending.

- In the **energy sector**, we will work to develop a new tariff methodology in line with the Energy Law in order to ensure transparency and cost recovery, and remain committed to eliminating accumulated debt to energy companies. We strive to ensure transparent and consultative processes with all stakeholders.

3. More broadly, we continue to pursue an ambitious development agenda aimed at poverty reduction, inclusive growth, and human development. These objectives will be underpinned by our efforts to reform the public sector, strengthen the rule of law, and improve public infrastructure investment. Education reform is also key to building the human capital needed to support future growth. This program of reforms, along with other measures envisaged in our Fund-supported

program, continues to enjoy broad political support and is backed by a Parliamentary majority. Our own efforts, combined with the financial support and technical assistance of our international partners, remain vital to achieving these ambitious goals.

4. On the basis of our performance to date, our ongoing commitment to the objectives of the program, the specific commitments outlined in the attached Supplementary MEFP, and recently implemented upfront actions, we request the completion of the second review under the blended Extended Credit Facility and Extended Fund Facility arrangements and associated disbursement and purchase of an aggregated amount equivalent to SDR 15.7 million; establishment of Quantitative Performance Criteria and Indicative Targets through December 2018 (Table 1); and establishment of Structural Benchmarks through 2018 (Table 2).

5. The government remains strongly committed to the implementation of the program and stands ready to take additional measures that may be adequate for the successful implementation of the program. The government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the SMEFP in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring our progress. Maintaining our commitment to the policy of transparency, we consent to the publication of this letter, the attached SMEFP and TMU, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

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

/s/
Octavian Calmîc
Deputy Prime Minister
Minister of Economy

/s/
Octavian Armaşu
Minister of Finance

/s/
Sergiu Cioclea
Governor
National Bank of Moldova

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

Attachment I. Supplementary Memorandum of Economic and Financial Policies

I. Recent Developments and Outlook

1. **Macroeconomic performance continues to be solid, although the pace of growth has moderated.** Annual growth in 2017 is projected to be 3.5 percent, on the back of robust domestic demand stemming from consumption growth and recovery of investment. Inflation accelerated to 7.6 percent in September, which is outside the inner band of inflation consultation clause. The augmented fiscal balance recorded a surplus of 0.6 percent in the first 9 months of 2017, on the back of strong growth in tax revenues and a slow pace of capital outlays. The current account widened to around 6 percent of GDP in the first half of 2017, with surging import growth outpacing domestic demand. With robust inflows, the leu appreciated by 10.9 percent (yoy) vis-à-vis the U.S. dollar, while gross reserves rose to 2,629 million U.S. dollars at end September.

2. **In the near term, growth will continue to be supported by both domestic and external factors.** Growth in 2018 is projected to moderate to 3.0 percent, in part due to a softening of consumption and base effects. Inflation is projected to decelerate throughout 2018 largely driven by supply-side factors. Over the medium term, the economy is projected to grow around 3.9 percent, held back by demographic factors. With sustained recovery of external demand from key trading partners supporting growth, effective financial intermediation—facilitated by ongoing decisive financial sector cleansing—will be key to supporting activity.

II. Policy Framework

A. Financial Sector Policies: Rehabilitating the Banking Sector

Strengthening bank governance and risk management, and decisive cleansing of the banking system remain our overarching goals towards safeguarding macro-financial stability and effective financial intermediation for stronger and inclusive growth.

3. **We are finalizing comprehensive diagnostics of commercial banks, a crucial step in cleansing the sector.** This involves:

- **Full scope onsite inspections** are concluded in five out of the seven banks that are not part of foreign banking groups. Consequent enforcement actions included orders to reclassify assets, increase prudential loan loss provisions and to improve governance and risk management. Sanctions were imposed and warnings issued to all relevant bank managers. All inspected banks met the minimum regulatory requirements. Onsite inspections in the remaining two small domestic banks will be finalized by end-January 2018 (**reset structural benchmark**) and in banks that are part of foreign groups by end-May 2018 (**reset structural benchmark**).

- **Related party reviews** were conducted with the assistance of an international firm in the three largest banks, while those in non-systemic banks are performed during NBM's full scope on-site inspections. A newly established Coordination Committee within NBM, which reports directly to a Deputy Governor, is tasked to prepare recommendations to the executive board.

4. **Our efforts to obtain full shareholder transparency have faced delays.** Delays have arisen for multiple reasons, including challenges in exchange of information across jurisdictions, and NBM staff's workload associated with litigation cases in national and foreign courts. We aim to finalize by end-March 2018 our investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks (**reset structural benchmark**), followed by appropriate enforcement actions.

5. **We have approved a new Banking Law that will support our shift to risk and principle-based supervision.** The law introduces international standards and takes effect on 1 January 2018. The law will be promulgated and published by end-November 2017. Supporting regulations are already drafted and will be approved in stages in line with NBM's detailed time-bound action plan for publication and implementation. An updated strategy for implementation of the Basel III (EU CRDIV/CRR) standards was published in June 2017.

6. **We have adopted a time-bound national Action Plan to address the findings of the first ML/FT National Risk Assessment (NRA) for Moldova.** The Plan includes detailed measures across sectors and institutions, also strengthening competent bodies' capacity to fight against money laundering and combat the financing of terrorism. We plan to enhance the independence and operational capacity of the Financial Intelligence Unit, and clarify its mandate and engagement with other competent bodies. A new law on AML/CFT was submitted to parliament and passage is expected this year.

7. **Looking forward, we will concentrate our efforts and actions in the following areas:**

i. **Transfer of systemic banks' control to fit and proper shareholders and managers:**

   a. In the third largest bank, the receipt by the NBM of a formal application from a foreign commercial bank to purchase, and a formal notification to the NBM by the non-compliant shareholder to sell, marked critical progress in our efforts to obtain transparency of ownership. By late-November, the NBM made its determination of the fitness and the probity of the applicant. If these shares are not sold by end-February 2018, we will take actions in line with law, including by suspending the non-compliant shareholder's rights.

   b. For the largest bank, a recent Constitutional Court ruling on the irreversibility of share cancellation clarified legal risks faced by incoming shareholders. To facilitate the sale of shares issued to replace cancelled shares of concerted or otherwise unfit bank shareholders, we will appropriately mitigate legal risk best borne by the state, including by (i) approving amendments to the law on state property ownership, the law on Joint Stock Companies, and/or other relevant laws, to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors in order to safeguard financial stability (**prior action**), and (ii) by use of sale and purchase agreement and clearly defined contract-based indemnities. To allow the transaction for the largest bank, the NCFM will prolong the auction period of shares in the largest bank by an additional period of 6 months. Against this backdrop, a consortium of foreign investors, which concluded its due diligence already in February 2017, has reiterated their interest in acquiring the bank's newly issued shares. The transaction is expected to be finalized by end-April 2018.

c. We will review the general legislative framework for purchase and sale of shares in regulated Joint Stock Companies to assess the need to make amendments.

ii. **Exit of a systemic bank from temporary administration:** Following a prolonged period of legal uncertainty, a late September 2017 appeal court decision clarified that all suspended shares in this bank are available for sale, and the sequester on such shares was lifted in October 2017. Those shareholders have three months to divest their stakes. After this period, in line with the law, we will take appropriate supervisory actions to remove the shareholders of any remaining suspended shares. This provides the bank with a venue to exit from temporary administration in an orderly manner (**reset structural benchmark end-June 2018**)**.** We have a contingency plan in place, should this approach face substantive impediments or delays that would undermine financial stability of the system.

iii. **Shareholder cancellation framework.** Given the complexities involved in improving this framework, we will take a two-step approach: (i) to mitigate legal and decapitalization risks, we will replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law **(prior action, previous structural benchmark).** Consequently, to streamline the shareholder removal process and address governance issues, we will, in consultation with the Fund, (ii) adopt a new framework for removing concerted and otherwise unfit shareholders (**reset structural benchmark, end-April 2018)**.

iv. **Fit and proper certification and banks' corporate governance.** We remain committed to ensure fit and proper certification of incoming shareholders and managers. To further rebuild confidence in banks' management and, consistent with our action plan to implement the new Banking Law, we will request all banks to perform a self-assessment of corporate governance by **(structural benchmark end-August 2018)**. We will conduct supervisory assessments during offsite and onsite inspections, to be finalized by April 2019.

v. **Related party reviews.** The NBM will: (i) draft guidelines for related party (RP) risk management to help the banks in their efforts to strengthen internal processes; and (ii) adopt internal procedures and methodology for presuming a party related to a bank. On the basis of this, and on our assessment of related parties, the largest three banks will be ordered **(structural benchmark by end January 2018)** to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement, and by end-July for smaller banks.

Going forward, we will further develop and issue for consultation with the banks our guidelines for RP risk management programs **(structural benchmark for end-June 2018).** We are also enhancing our electronic examination system to capture characteristics meeting each of the regulatory criteria for presuming a person related to a bank.

vi. **Central Securities Depository (CSD):** In line with the agreed methodology and procedures for verification of the integrity of legal records of security holders, we will complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign **(reset structural benchmark, end-March, 2018)**. In support of this, we will revise the Law on Establishment of CSD (2016) and adopt a government decree, which together will (i) clarify the responsibilities and financing mechanisms and (ii) establish an action plan and timeline for completing the public awareness campaign and verification process.

vii. **Recovery of assets:** We are reviving our efforts to recover assets from the 2014 bank fraud. The consortium of international firms has concluded its investigation and will submit its final report by end-November. We have requested that the firms prepare an analytical report, outlining the main findings. We will publish this report and adopt a strategy with time-bound actions to recover assets (**structural benchmark end-December, 2017**). We will ensure that the legal notifications necessary to avoid the expiration of statutes of limitation that could undermine either asset recovery, or sanctioning of (former) managers and shareholders of banks, have been made.

viii. **Financial safety nets.** We are working to further strengthen our crisis prevention and contingency planning. To this end, we are reviewing our legal and regulatory frameworks for Emergency Liquidity Assistance (ELA), deposit insurance, and bank liquidation, with the intention of adopting reforms by end-year 2018. As an interim measure, we have raised the retail deposit insurance coverage from MDL 6,000 to MDL 20,000 (effective as of January 1, 2018) and NBM has drafted internal guidelines for ELA. Designed to complement the Bank Recovery and Resolution Law, these reforms will be developed in consultation with the Fund.

ix. **Non-bank financial institutions.**

a. We aim to adopt, by end-year 2017, a new law to govern the fast-growing micro-credit sector, seeking to ensure rules and supervision, corporate governance, risk management, control functions, and internal audit. The law also establishes the grounds for consumer protection.

b. In cooperation with our development partners, we are also reviewing the regulatory framework for the insurance sector, with the intention of moving towards the European Solvency II legislative program.

B. Monetary and Exchange Rate Policies

8. **We will continue to implement monetary policy within an inflation-targeting framework, complemented by exchange rate flexibility.** We remain committed to our inflation target of 5 percent with a range of +/- 1.5 percentage points, which will be monitored via a consultation clause with bands set around the central projection (Table 1). We expect inflation to decelerate in 2018, as the impact of supply-side shocks in food and energy gradually taper off. We expect the monetary policy loosening cycle to end around end 2017, and stand ready to change our monetary policy stance as the inflation outlook evolves.

9. **We are committed to strengthening the effectiveness of our inflation targeting framework.**

i. We will further improve the quality of our inflation forecasts by reducing the frequency of forecast rounds thereby lengthening the analysis period, allowing for more comprehensive assessment. We will also seek to enhance cooperation and information sharing between NBM, and the Ministry of Finance to enhance the consistency of macroeconomic data and projections, liquidity forecasting, and cash management, and sterilization of aid and privatization inflows. To this effect, a MoU on liquidity management and policy coordination was signed between the NBM and the Ministry of Finance. In addition, we will follow-up on past Technical Assistance to develop the secondary market for government securities and interbank money market.

ii. We will further strengthen internal and external policy communications. We will follow-up on Technical Assistance to ensure that monetary policy formulation benefits as much as possible from strengthened synergies across departments and with NBM management. As part of our efforts to strengthen external communications and anchor inflation expectations, we will adhere to a regular calendar for monetary policy decisions and announcements; we will also seek to enhance the analytical focus and forward-looking nature of our inflation reports.

10. **The efficiency of NBM's inflation targeting framework is conditional upon its institutional and operational independence, which requires, *inter alia*, a viable balance sheet.** To this end, we commit not to amend the law regulating the securitization of emergency loans extended by NBM to now failed banks. Once the NBM's statutory capital level reaches 10 percent of monetary liabilities, NBM profit transfers to government will be used to repurchase these securities, starting with the longer dated tranches, allowing for a reduction in domestic public debt. We will also consider using these securities for mopping up bank liquidity via outright sales and reverse repo transactions to address structural excess liquidity.

11. **We will not resist exchange rate movements driven by fundamentals, intervening in the foreign exchange market only to smooth excessive volatility.** Moldova's vulnerability to external shocks requires having a flexible exchange rate as an efficient shock absorber. We will engage in two-sided intervention in the foreign exchange market to smooth excessive volatility only. The NIR targets set under the program are consistent with this commitment.

12. **Looking forward, we will explore potential impediments to financial intermediation.** Unlocking credit growth, which has been negative since the 2014 crisis, requires measures to strengthen bank governance and risk management, and will be critical to support the real economy. In addition, we will evaluate the effectiveness of financial sector infrastructure and related legislation with a view to eliminate potential obstacles to effective intermediation.

C. Fiscal Policy

13. **Our 2017 budget is consistent with commitments under the program.**

a. **Budget.** Our budget position is sound. Our cash surplus in September reached 1,162.1 million lei (about 0.8 percent of GDP), reflecting revenue over-performance—despite lower grants—and under-execution of spending partly due to delays in road projects and uncertain external financing, and also associated with the reorganization of central government. We adopted amendments to budget 2017 consistent with the current augmented deficit ceiling (**prior action**).

b. **Tax and customs policy.** In 2017, we (i) raised excise rates on cigarettes and oil products to gradually adjust them to the minimum amounts in EU directives, (ii) increased tax rates for real estate, and (iii) established the State Tax Service as the single tax administration authority.

c. **Tax and customs administration.** Our strong revenue performance is partly the result of reforms in tax and customs authorities; in particular, centralization of the State Tax Service and optimization of the customs service.

d. **Wages and pensions.** Our public wage bill will be 12,657 million lei, somewhat higher than the initial plan due to legally mandated salary increases in the education and justice sectors, overtime compensation, and Customs Service and the Border Police staffing needs. Improved budget performance allowed us to advance the valorization plans under the pension reform law adopted in December 2016 to take place in November of 2017, rather than in April 2018.

e. **Priority needs.** In line with our commitments described in the previous SMEFP (¶10), we saved rather than spent the revenue over-performance reported during the first half of the year. In the 2017 budget amendment, this over-performance allowed additional one-off capital spending (such as completion of construction works and procurement of equipment and IT systems), and higher social expenses (such as raising pensions to cover the minimum subsistence level and increasing spending on heating and maternity leave allowances).

f. **Domestic arrears.** We remain committed to eliminating the stock of audited state arrears by end-2017, despite marginally exceeding the end-September 2017 indicative target. We have intensified the inspection of the repayment of arrears, imposing fines where needed. More broadly, we aim to improve our monitoring of arrears and prevent their accumulation, including by amending Article 67 of the Law on Public Finances and Fiscal Accountability.

14. **The budget for 2018 and Medium-Term Budget Framework are in line with the agreed objectives.**

a. **Budget 2018.** We will adopt a 2018 budget, consistent with our commitments under the program **(prior action)**. The budget allows for needed increase in investment and priority social spending, and aims at an augmented deficit ceiling of 5,264 million lei.

b. **Tax and customs policy.** Measures adopted for 2018 include: increasing the excise rates on tobacco, petroleum, and alcoholic products; increasing the wealth tax base for property worth more than 1.5 million lei by also applying it to movable property (such as cars), and by excluding the area of 120 square meters as a criterion for property taxes.

c. **Social spending.** We will continue to improve the targeting and effective coverage of our social assistance programs, Ajutor Social and Heating Allowance, as well as enhance employability prospects for vulnerable groups, such as individuals with disabilities.

d. **Investment.** For 2018, our priority is to improve implementation capacity for public infrastructure investment. In particular, our emphasis in the short-term will be the rehabilitation of our roads network. Over the medium-term, we plan to support investment projects that aim at (i) improving the efficiency of the centralized heat supply system, (ii) increasing energy security and reliability, including in gas, and (iii) reforming our railway system.

15. **To support our medium-term fiscal objectives, we will take the following measures:**

- **Fiscal Responsibility Framework.** We plan to remove Article 49 of the Law on Public Finances and Fiscal Accountability to simplify the annual budget process. To improve fiscal risk management, we intend to amend paragraph (5) of Article 80 to rearrange the order of debt repayment.

- **Fiscal risk statement (FRS).** To improve the transparency of fiscal policy and risks assessment starting with the 2018 budget, we will publish a FRS accompanying our annual budget documents. We plan to extend and strengthen the analysis of the risks published in future reports, and continue to seek TA to support these efforts.

- **Public administration reform and wages.** We are currently reforming the public administration system to improve its efficiency, including by consolidating the central public administration, reducing the authorized staff ceiling of the ministries from 2,053 to 1,158 staff units, and introducing a single wage system for the budget sector.

- **Shadow economy.** As part of a comprehensive strategy to reduce activity in the shadow economy, we will improve our compliance risk management, especially for the large taxpayers and high wealth individuals, and strengthen the audit function. Subject to suitable amendments to the Criminal Procedure Code, we intend to expand the current Division of Violations Discovery and Review under the STS to include criminal investigation attributes. To curb tax evasion, we intend to make mandatory the use of the electronic tax invoice by certain groups of economic agents and improve our tax administration by automating the taxpayer registration process and consolidating taxpayer information in a single electronic file.

- **State-owned enterprises (SOEs).** To improve the operational efficiency of SOEs and JSCs with state capital, we plan to organize the SOE and municipal enterprises into joint-stock companies or public institutions. As part of this effort, we will assess the economic and financial viability as well as a medium-term business plans to confirm the viability of their core operations.

D. Structural Reforms

16. **We continue to collaborate with all stakeholders, including private sector participants, donor community, WB, and Energy Community Secretariat in our energy reform efforts.** Parliament approved the new Energy Law in September completing with delay the related structural benchmark and the government and ANRE are in the process of adopting secondary legislation to ensure full implementation. This law includes procedures for the appointment of ANRE directors, so that they are fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audits.

17. **Greater transparency and accountability in the tariff-setting process remains our priority.** This will help avoid legal disputes and enhance the regulator's independence.

- In the electricity sector, we will continue to work on eliminating debt accumulated by energy companies and improving tariff-setting methodologies, to ensure transparency and cost-recovery. To this end:

  i. The recognized accumulated financial deviations by energy companies (currently estimated around MDL 1.75 billion) will be recovered via tariff adjustments in accordance with the signed agreement and ANRE decision No. 201/2016.

  ii. In line with the new Electricity law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSOs, we will develop approve, and publish a new tariff methodology **(structural benchmark, mid-February 2018)**. This will provide sufficient time for consultations and data gathering before tariffs are set in spring 2018. The new tariffs will be fully based on the new methodology and will also reflect differences in the assessment of financial deviations from April 2017-February 2018.

- In the heating sector, we will finalize the implementation of the action plan agreed between ANRE and the WB including: (i) determination of the amount of financial deviation and of the recovery mechanisms; and (ii) working out further the legal aspects of the application of heat loss methodology based on the WB recommendation from early-2017.

- We will continue our dialogue with Gazprom and other stakeholders to move forward with the restructuring of Termoelectrica's debt with Moldovagaz, supported by the WB.

18. **We will continue taking steps to strengthen economic governance as a critical element to achieve sustainable and inclusive growth.** We remain committed to shrink the shadow economy, reduce regulatory and administrative burdens, and implement judicial and institutional changes for better enforcement and accountability. Measures to enhance competitiveness and attract foreign investment are key to promoting growth, including technological advancement, and investment in infrastructure and human capital. In this context, we will continue reforms in education, health, and social policies, thereby raising human capital and helping counter migration and demographic pressures.

E. Program Monitoring

19. **The program will continue to be monitored through semi-annual reviews, prior actions, quantitative performance criteria, indicative targets, and structural benchmarks**. The quantitative performance criteria and indicative targets are set out in Table 1, and further specified in the Technical Memorandum of Understanding (TMU). The prior actions, along with proposed structural benchmarks, are set out in Table 2.

Table 1. Moldova: Quantitative Performance Targets, June 2017–December 2018

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

	Jun 2017		Sept 2017		Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018
	Target	Actual	Target	Actual	Target	Target	Target	Target	Target
1. Quantitative performance criteria [1/]									
Ceiling on the ***augmented*** cash deficit of the general government	3,670	233	5,485	-958	5,513	1,339	3,548	3,996	5,264
Of which: on-lending agreements with external creditors to state-owned enterprises	410	132	808	204	504	170	257	365	550
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [2/]	1,843	2,053	1,962	2293	2,131	2,368	2,349	2,409	2,487
2. Continuous performance criteria									
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0	0	0	0	0
3. Indicative targets									
Ceiling on the stock of accumulated domestic government arrears [3/]	26	12	13	15	0	0	0	0	0
Ceiling on the general government wage bill	6,358	6,283	9,292	9,155	12,657	3,287	7,244	10,535	13,769
Floor on priority social spending of the general government	8,450	8,515	12,766	12,862	17,660	4,598	9,463	14,227	19,134
Floor on project spending funded from external sources [4/]			N/A		N/A	262	647	1,713	3,540
4. Inflation Consultation Bands (in percent)									
Outer Band (upper limit)	7.7		8.2		9.0	7.8	5.6	5.5	5.5
Inner Band (upper limit)	6.7		7.2		8.0	6.8	4.6	4.5	4.5
Actual / Center point	5.7	7.3	6.2	7.6	7.0	5.8	3.6	3.5	3.5
Inner Band (lower limit)	4.7		5.2		6.0	4.8	2.6	2.5	2.5
Outer Band (lower limit)	3.7		4.2		5.0	3.8	1.6	1.5	1.5

1/ Indicative targets for September 2017, and March, September, and December 2018.

2/ The NIR target is set as specified in the TMU.

3/ As of January 2017, domestic expenditure arrears exclude local governments.

4/ N/A - target is new for 2018, and thus applicable only going forward.

Table 2. Moldova: Proposed Prior Actions and Structural Benchmarks Under the ECF/EFF

	Measure		Timeframe
Prior Actions for Board Consideration of the Review			
Financial sector			
1	Amend the laws on State Property Ownership, Joint stock Companies, and other relevant laws to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors to safeguard financial stability.		
2	Replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law.		
Fiscal sector			
3	Adopt the amendments to the 2017 Budget consistent with the current augmented deficit ceiling.		
4	Adopt the 2018 Budget in line with existing program commitments.		
Structural Benchmarks 1/			
Financial Sector			
1	Finalize onsite inspections in:		
	1a) two small domestic banks that are not part of foreign banking group	Modified	End-January 2018
	1b) banks that are part of foreign groups	Modified	End-May 2018
2	Finalize investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks	Modified	End-March 2018
3	NBM to allow a systemic bank to exit temporary administration in an orderly manner.	Modified	End-June 2018
4	Adopt a new framework for removing concerted and otherwise unfit shareholders, to streamline the process and address governance issues.	Modified	End-April 2018
5	NBM to instruct all banks to conduct self-assessment of corporate governance.	New	End-August 2018
6	NBM to order the largest three banks to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement.	New	End-January 2018
7	NBM to develop and issue for consultation with the banks guidelines for RP risk management programs.	New	End-June 2018
8	NCFM to complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign.	Modified	End-March 2018
9	Government to publish an analytical report prepared by an independent investigator on the 2014 bank fraud, and adopt a strategy with time-bound actions to recover assets.	New	End-December 2017
Energy sector			
10	Develop approve, and publish a new tariff methodology, in line with the new Energy law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSO.	New	Mid-February 2018

1/ Additional structural benchmarks will be set at the time of subsequent program reviews.

Table 3. Moldova: Status of Existing Structural Benchmarks Under the ECF/EFF

	Measure	Timeframe	Status
	Structural Benchmarks		
	Financial Sector		
1	Complete identification of UBOs of		
	1a the fourth and fifth largest banks that are not subsidiaries of foreign banking groups	End-June 2017	Modified
	1b all remaining banks	End-August 2017	Modified
2	Take appropriate enforcement action against any of the three largest banks for non-compliance with regulatory requirements		
	2a) Two large banks under intensive supervision	End-April 2017	Met with delay
	2b) A large bank under temporary administration	End-June 2017	Met
3	Complete an assessment of all banks to confirm compliance with capital requirements		
	3a) Two large banks under intensive supervision	End-April 2017	Met with delay
	3b) A large bank under temporary administration	End-June 2017	Met with delay
4	Execution of the final stages of a strategy to allow a large bank to exit temporary administration	End-July 2017	Modified
5	Enhance NBM's internal database for bank claims to capture relevant characteristics for identifying exposures to related party	End-June 2017	Not met
6	With external assistance, conduct thematic reviews of related party exposures in the three largest banks	End-August 2017	Met
7	Conduct full-scope on-site inspections in banks that are not subsidiaries of foreign banking groups, applying new procedures for identifying related party exposures	End-December 2017	Modified
8	Adopt a methodology for verification of legal records of shareholders of financial institutions	End-May 2017	Met with delay
9	Complete verification of legal records of shareholders of all banks and insurance companies, in line with the new methodology	End-December 2017	Modified
10	Amend the legal framework for removing shareholders who act in concert without prior supervisory approval	End-April 2017	Modified
	Fiscal sector		
11	Adopt the medium-term budget framework 2018-20	End-May 2017	Met with delay
	Energy sector		
12	In cooperation with the World Bank, improve the tariff-setting methodology in the heating sector, including 12a) Revision and/or clarification of asset valuation and depreciation principles, methodologies and procedures; 12b) Revision and formal approval of methodology for determination of heat losses; 12c) Determination of the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.	End-June 2017	Not met
13	In cooperation with the Energy Community Secretariat, improve energy sector regulation, including making procedures for the appointment of ANRE directors to be fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audit.	End-June 2017	Met with delay

Attachment II. Technical Memorandum of Understanding

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

A. Quantitative Program Targets

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

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

Indicative targets are set on:

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

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

B. Program Assumptions

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

6.6445, RUB/US$ = 64.1755, SDR/US$ = 0.711134876. The holdings of monetary gold will be valued at US$1,320.75 per one troy ounce.

C. Institutional Definitions

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

D. Program Definitions

5. **NIR of the NBM** are defined as gross reserves in convertible currencies minus reserve liabilities in convertible currencies.

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

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

For program monitoring purposes, the stock of reserve assets and reserve liabilities of the NBM shall be valued at program exchange rate, as described in paragraph 3 above. The data source for gross reserves and liabilities is the Monetary Survey published by NBM in Moldovan Lei, from which the

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

adjustments for program purposes are made. On this basis, and consistent with the definition above, the stock of NIR of the NBM amounted to US2,292.6 as of end- September 2017.

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

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

7. The overall cash deficit of the general government is cumulative from the beginning of a calendar year and will be monitored from the financing side at the current exchange rate established by NBM at the date of transaction. Accordingly, the cash deficit is defined, as the sum of net credit of the banking system to the general government (as defined in paragraph 6), the general government's net placement of securities outside the banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[3] for direct budgetary support and for project financing minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets.

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

9. **Government securities in the form of coupon-bearing instruments** sold at face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. On

[2] For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1711, 1712, 1713, 1731, 1732, 1733, 1735, 1761, 1762, 1763, 1801, 1802, 1805, 1807, 2264, 2709, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801, 2802, 2811, 2820, and the group of accounts 2100.

[3] Debt is defined as in footnote 4.

redemption date, the sales value (face value) will be recorded as amortization, and the coupon payments will be recorded as domestic interest payments.

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

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

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

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

(continued)

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

14. The **priority social spending of the general government** is defined as the sum of essential recurrent expenditures including pension[6] and unemployment insurance payments from the Social Insurance Fund (BASS, 9008/00286), the *Ajutor Social* (social assistance program 9015/00320) and heating allowance (9015/00322) during the cold season from the central government budget, as well as 94 percent of health expenditures from the main fund of the Health Insurance Fund.

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

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

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

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

16. **Absorption of losses or liabilities by the government and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling of zero on

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

[6] The pensions include the following subprograms and activities (excluding distribution expenditures and commission fee for cash withdrawals): 9004 with activities 00258–00266, 00277, 00298, 00344, 9005 with activity 00360, and 9010 with activity 00253.

absorption by the public sector of losses or liabilities from outside the budgetary sector. Absorption of losses or liabilities is defined as direct payment by the government of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as accumulated stock of the financial deviation of the utility companies, debt-for-equity swaps or a write-off of tax obligations or other state claims.

E. Inflation Consultation Mechanism

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

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

Inflation Consultation Bands

	2017	2018			
	Dec	Mar	Jun	Sep	Dec
Outer Band (upper limit)	9.0	7.8	5.6	5.5	5.5
Inner Band (upper limit)	8.0	6.8	4.6	4.5	4.5
Actual / Center point	**7.0**	**5.8**	**3.6**	**3.5**	**3.5**
Inner Band (lower limit)	6.0	4.8	2.6	2.5	2.5
Outer Band (lower limit)	5.0	3.8	1.6	1.5	1.5

F. Adjusters

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

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

20. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by the amount of any shortfall between the total amount of actually disbursed and programmed budget support and MFA (grants and loans) from the European Commission. The upward adjustment for 2017 and 2018 is capped at the equivalent of MDL 511 million and MDL 585 million, respectively, valued at the program exchange rates; and

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

Programmed Onlending to SOEs and Adjustments to Augmented Fiscal Deficit

	2017	2018 - Cumulative			
		Q1	Q2	Q3	Q4
Onlending to SOEs (programmed amount, millions of U.S. dollars)	28.0	9.6	14.5	20.7	31.1
Maximum downward adjustment on the augmented overall cash deficit (millions of Moldovan lei) 1/ 2/	504.1	170.3	256.9	365.2	550.1

1/ The adjustmenst for the year 2017 are evaluated at t he exchange rate: 18.0 MDL/USD (the forecast of the Ministry of Economy).
2/ The adjustmenst for the year 2018 are evaluated at t he exchange rate: 17.68 MDL/USD (the forecast of the Ministry of Economy).

22. The floor on **NIR of the NBM** will be lowered by any shortfall in the official external grants and loans capped in total at the equivalent of €40 million respectively, valued at the program exchange rates.

G. Reporting Requirements

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

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

Table 1. Moldova: Data to be Reported to the IMF

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

REPUBLIC OF MOLDOVA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND SECOND REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS—INFORMATIONAL ANNEX

December 6, 2017

Prepared By

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

CONTENTS

FUND RELATIONS

(As of October 31, 2017)

Membership Status: Joined August 12, 1992; Article VIII

General Resources Account:	**SDR million**	**Percent of Quota**
Quota	172.5	100.0
Fund holdings of currency	299.31	173.52
Reserve tranche position	0.01	0.00

SDR Department:	**SDR million**	**Percent of Allocation**
Net cumulative allocation	117.71	100.00
Holdings	0.99	0.84

Outstanding Purchases and Loans:	**SDR million**	**Percent of Quota**
ECF Arrangements	134.52	77.98
Extended Arrangements	126.81	73.51

Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
EFF	11/07/2016	11/06/2019	86.30	27.80
ECF	11/07/2016	11/06/2019	43.10	13.90
ECF	1/29/2010	4/30/2013	184.80	170.88

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

		Forthcoming			
	2017	**2018**	**2019**	**2020**	**2021**
Principal		62.46	59.03	53.36	35.29
Charges/Interest	0.68	2.62	2.22	1.82	1.48
Total	0.68	65.08	61.25	55.18	36.76

Safeguards Assessments:

The safeguards framework at the central bank was earlier strengthened through legal reforms which established a new governance structure with independent oversight over NBM management. Transparency and accountability practices adhere to international standards, and the NBM continues to maintain sound operational controls. The authorities continue to implement the recommendations of the 2017 safeguards assessment. The NBM has enhanced its internal oversight on reserves management and is updating emergency lending regulations on which they recently received technical assistance.

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 multiple currency practice or 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 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 December 16, 2015. The staff report (Country Report No. 16/19) was published.

FSAP Participation:

Moldova has undertaken three FSAP assessments:

- 2004 – main mission May 2004; FSSA (Country Report No. 05/64) presented to the Board at the time of the 2004 Article IV discussions and published in February 2005.
- 2007 – main mission October 2007; FSSA (Country Report No. 08/274) presented to the Board with the 2007 Article IV Consultation report and published in August 2008.
- 2014 – main mission March 2014; FSSA (Country Report 16/70) presented to the Board with the 2014 Article IV Consultation report and published in February 2016.

Resident Representative:

Mr. Volodymyr Tulin assumed his duties as Resident Representative on August 21, 2017.

Technical Assistance, 2015–17		
Department Counterpart	**Subject**	**Timing**
MCM	Bank Resolution	April 2015, December 2015, October 2016, November 2016, February 2017
MCM	Debt Market Development & Integration of Debt and Cash Management	May 2015, February, 2016
STA	Consumer Price Index	October 2015, January 2016
LEG	Legal Frameworks for CSD/CCP and Cent	February 2016, April 2016, November 2016
MCM	Establishing Single Securities Depository	February 2016
MCM	Review of fit-and-proper rules and bank diagnostics	March 2016, December 2016
MCM	Currency Management	April 2016
FAD	Expenditure Rationalization	June 2016
MCM	Resolution Framework	August 2016
FAD	Tax and revenue administration	September 2016, January 2017, February 2017, March 2017, May 2017, January 2018
MCM	Ultimate Beneficial Owner and Related Party Identification	February 2017
FAD	Risk Management	March 2017
FAD	Fiscal risks and spending revision	March 2017
MCM	Deposit Insurance	April 2017
FAD	Improving Compliance Risk Management of Large Taxpayers	April 2017
FAD	Reforming Customs Challenges in Building Rapprochement with the EU Customs Systems	May 2017
FAD	Challenges in Budgeting - Next Steps to Improve Budget Institutions	May 2017
MCM	Related Party Diagnostics and Reviews	June 2017, September 2017, November 2017
MCM	Strengthening the Forecasting and Policy Analysis System, and Improving Central Bank Communications	June 2017, September 2017
FAD	Review of Taxation Policies for Personal Income and Vehicle Ownership	July 2017
MCM	Emergency Liquidity Assistance	September 2017
FAD	Improving the High Wealth Individual Compliance Program	October 2017
FAD	TADAT assessment	October 2017

RELATIONS WITH THE WORLD BANK GROUP

(As of October 31, 2017)

1. **Aligned with the National Development Strategy (Moldova 2020), the World Bank Group (WBG) Country Partnership Framework (CPF) for FY18–21, discussed by the Board on July 27, 2017, will support Moldova's transition towards a new, more sustainable and inclusive development and growth model through a mix of analytics, advice and financing.** The CPF incorporates the three top priorities identified in the Systematic Country Diagnostic namely: (a) strengthening the rule of law and accountability in economic institutions; (b) improving inclusive access to and the efficiency and quality of public services; and (c) enhancing the quality and relevance of education and training for job-relevant skills. These three priorities define and inform the CPF's three focus areas of:

- *Strengthening economic governances: This pillar will focus on enhancing the quality and implementation of investment climate regulation, strengthening the management of public sector assets, and enhancing financial sector governance and stability in order to de-risk private sector investment for job-creation.*

- *Improving service governance: This pillar will focus on increasing the efficiency and quality of inclusive access to selected public services, including health, energy, and road transport in order to address social exclusion, persistent poverty and vulnerability to shocks, especially in rural areas.*

- *Enhancing skills development: This pillar will focus on promoting the acquisition of strong generic skills through the education cycle (including enhancing the efficiency of the primary and secondary education), and aligning the education system with labor market demand to enhance its quality and relevance and address persistent skills mismatches in the labor market.*

The three areas are supplemented by climate change—a World Bank Group corporate priority—as a cross-cutting theme. Greater adaptation, resilience and response to climate change will help address Moldova's substantial vulnerability to climate-related shocks. All CPF focus areas are informed by the 2017 Country Gender Action Plan, which identifies key inequalities to be addressed during the CPF period. Finally, the CPF adopts a citizen engagement approach which will be focused on improving the quality of the engagement process and maintaining the current levels of compliance and implementation.

2. **As part of the recently concluded budget support operation, the World Bank Group supported a number of reforms to make business regulations more transparent and less burdensome, improve bank regulation and supervision and to spend public money more efficiently.** It worked in close cooperation with the IMF in the area of financial sector reforms and on the macro-fiscal framework. This cooperation continues also in the new budget support operation under preparation which focuses on the economic governance pillar of the CPF and complements the ongoing IMF program under the EFF and the ECF.

3. The WB's current portfolio includes ten projects and one budget support operation under preparation. Total investment project commitments amount to US$378.5 million. The size of the active TF portfolio, which finances analytical and advisory work and provides co-financing to IDA operations, is about US$25 million.

4. 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's committed portfolio in Moldova stands at US$39.9 million (US$36.4 million outstanding) and includes 11 projects. Portfolio composition is 93 percent loans and 3 percent equity and quasi-equity.

5. The net exposure of MIGA in Moldova amounts to US$25.4 million in four projects. All projects support 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.

RELATIONS WITH THE EBRD

(As of November 30, 2017)

6. EBRD's active portfolio in Moldova totals ca. EUR 470 million for 43 active projects. Private sector share of the portfolio is 44 percent. Annual business investment in the recent years has been in the range of EUR 100 million for approximately 10 operations.

7. Under its Moldova country strategy 2014–17, EBRD:

- *Assisted FDI - supported international automotive companies' expanding operations in Moldova; supported foreign-owned, export-oriented local companies to restructure and scale-up.*
- *Through its partner banks, provided funds to private businesses and issued trade guarantees. Multi-level policy dialogue tackled transparency and governance in the banking sector, directly and jointly with other development partners.*
- *Supported SME capacity-building through advisory projects.*
- *Helped improve investment climate through technical assistance-supported policy dialogue and continued support of Economic Council of Prime Minister.*
- *Promoted European standards: provided loan to a local bank under the EU4Business-EBRD Credit line to help domestic SMEs converge with EU quality standards to take full advantage of DCFTA opportunities.*

- *Addressed energy security: jointly with the EU and EIB, extended funding in support of the Chisinau-Ungheni (Romania) gas pipeline to increase interconnections with the EU, enhance Moldova's energy security and promote competition in the gas sector.*

- *Provided loans to continue with the road rehabilitation; supported the road maintenance sector reform.*

- *Progressed in promoting private sector participation and efficiency in municipal infrastructure, in particular in the urban transport sector: (1) helped Balti Trolleybus company to realize efficiency gains and upgrade fleet; (2) launched projects to regionalize water/wastewater services, upgrade district heating services.*

- *Is launching a pilot electronic procurement project.*

8. EBRD's ability to reach its full potential in supporting SMEs was constrained by the adverse conditions in Moldova's banking sector and the ensuing paucity of eligible partner institutions. Efforts to unlock the banking sector in concert with IMF, EU and other IFIs will continue in the new strategy period. The implementation of infrastructure projects remained constrained by limited local implementation capacity. Accelerating implementation of already signed projects will be an important task in the new strategy period. EBRD also remains constrained in its ability to engage with Moldova's second-tier municipalities, largely due to borrowing restrictions.

9. Key themes and priorities under EBRD's Moldova country strategy 2017–2022 (to be approved by the EBRD Board of Directors in November of 2017) include the following:

- *Improving Governance and strengthening Resilience by leading in the restructuring of the banking sector; and enhancing energy security : (i) banking reform advocacy together with IMF and EU; (ii) lending products to healthy client banks (DCFTA, MSME, energy efficiency etc); (iii) co-investment with reputable investors to expand investable banks' universe; (iv) selective support of non-bank financial institutions; (v) support of cross-border electricity interconnections, incl. integration with ENTSO-E; (vi) wholesale electricity market infrastructure development; (vii) support to renewables; (viii) cross-border gas pipeline implementation; and (ix) policy dialogue – Third Energy Package.*

- *Enhancing Competitiveness by supporting private firms in building capacity, and promoting commercialization of public utilities and infrastructure: (i) EU4Business credit lines with eligible banks; (ii) direct support to viable corporates; (iii) support of FDI, incl. in free economic zones; (iv) business climate improvement (Economic Council); (v) water/ wastewater, public utilities, solid waste; (vi) transport infrastructure rehabilitation, including railways; (vii) pre-privatization and privatization support; and (viii) energy / resource efficiency – directly or through client banks.*

STATISTICAL ISSUES

(As of November 30, 2017)

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, and external trade. 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 System of National Accounts 1993 (1993 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. GDP volume measures are chain-linked and presented with 2010 as the reference year. The annual data are revised—in two stages—as updated information becomes available. Starting from January 2014, short-term activity indicators are re-classified according to CAEM Rev. 2. Work is on-going to implement the 2008 SNA and to further improve the compilation of quarterly and annual national accounts, also with the support of technical assistance delivered by the IMF.
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 transactions and stock positions of the general government sector. With the support of Fund TA, the authorities introduced regular dissemination of monthly and semi-annual *GFSM 2001* based data for the central government units. No monthly GFS are currently reported to the IMF's Statistics Department (STA).
Monetary statistics: Monetary and financial statistics are compiled broadly in line with the Monetary and Financial Statistics Manual. The NBM reports monetary and financial statistics monthly, using Standardized Report Forms (SRFs) for the central bank, other depository corporations, and other financial corporations, and monetary data based on these SRFs are published in the International Financial Statistics. The NBM also reports Financial Soundness Indicators (FSIs) on a quarterly basis which include 11 core and 7 encouraged indicators for deposit takers. FSIs are posted on the FSI webpage.

External sector statistics: The balance of payments and international investment position (IIP) statistics have been compiled fully in line with the sixth edition of Balance of Payments and International Investment Position Manual (BPM6): balance of payments starting with data for 2009, and IIP starting with data for 2013. The time series prior to the years indicated above are on BPM5 basis. Besides the balance of payments and IIP statistics, Moldova disseminates other external sector statistics (EES) datasets such as external debt statistics, international reserves statistics, and coordinated direct investment survey. All ESS datasets are compiled and disseminated with prescribed SDDS periodicity and timeliness.	
II. Data Standards and Quality	
Moldova subscribed to the SDDS in May 2006.	A data ROSC report was published in March 2006.

Moldova: Table of Common Indicators Required for Surveillance

(As of December 1, 2017)

	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	August 2017	9/18/2017	D/M	D	D/M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	September 2017	10/31/2017	W/M	W	M		
Reserve/Base Money	11/16/2015	11/16/2015	W	W	M	O, LO, O, O	LO, O, O, O, O
Broad Money	11/16/2015	11/16/2015	W	W	M		
Central Bank Balance Sheet	11/16/2015	11/16/2015	W	W	M		
Consolidated Balance Sheet of the Banking System	11/16/2015	11/16/2015	W	W	M		
Interest Rates[2]	11/16/2015	11/16/2015	W	W	W		
Consumer Price Index	September 2017	10/23/2017	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3]-General Government[4]	September 2015	October 2015	M	M	M	O, LO, LO, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	September 2015	October 2015	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	September 2015	October 2015	M	M	M		
External Current Account Balance	Q2/2017	9/29/2017	Q	Q	Q	LO, LO, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	September 2015	October 2015	M	M	M		
GDP/GNP	Q4/2016	6/6/2017	Q	Q	Q	O, LO, LO, O	LO, O, LO, O, O
Gross External Debt	12/31/2014	October 2015	Q	Q	Q		
International Investment Position	Q2/2017	9/29/2017	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.

Statement by the Staff Representative on the Republic of Moldova
December 20, 2017

This statement provides information that has become available since the issuance of the staff report on December 7, 2017. The thrust of the staff appraisal remains unchanged.

1. **All three remaining prior actions for this review have now been completed.** On December 15, 2017, the Moldovan Parliament passed legislation in the following areas:

    i. Amended the laws on State Property Ownership and other relevant laws to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors to safeguard financial stability;
    ii. Replaced the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law and the newly approved Banking Law; and
    iii. Adopted the 2018 Budget in line with existing program commitments.

2. **Data releases since the staff report was issued to the Board have generally been positive.** Growth in Q3 was stronger than expected, with annual GDP growth picking up to 5.4 percent (from 2.5 percent in Q2 and 3.1 percent in Q1), driven by faster household consumption and a lower drag from net trade, as real export growth ticked up and real import growth slowed. The latest nominal trade data were also positive. CPI inflation eased from 7.9 percent to 7.3 percent in November—as food and regulated price inflation slowed—in line with expectations.

Statement by Anthony De Lannoy, Executive Director for Republic of Moldova
December 20, 2017

The Moldovan authorities thank staff for the dedicated and constructive discussions during the Second Review under the IMF Program and on the 2017 Article IV Consultation, as well as for the continuous helpful technical assistance.

The authorities' reform agenda will continue to be supported by the Fund's Extended Fund Facility and Extended Credit Facility arrangements, which enjoy broad political support and are backed by a Parliamentary majority. The program remains broadly on-track. All end-June performance criteria were met by significant margins. Although with some delays, many structural benchmarks were implemented as well. The short-term objectives of the program - consolidating the economic and financial stability, by cleansing the financial sector, and enabling a strong regulatory and supervisory environment- remain the authorities' priorities. For the completion of the second review, several upfront actions in banking and fiscal areas have been implemented successfully.

Recent Economic Developments and Outlook

Economic stabilization has been underway since 2016. Following 0.5 percent y-o-y economic contraction in 2015, real GDP grew by 4.3 percent y-o-y in 2016. In 2017, it is expected to increase by 3.5 percent supported mainly by robust private consumption and recovery of investment. The budget position is sound. Disciplined fiscal policies and revenue overperformance enabled additional priority spending, while public debt remains sustainable. Unemployment is low reflecting, however, widespread labor migration and low labor force participation. Inflation has been above the upper limit of the central bank's target of 5 percent +/- 1.5 percentage points since April and accelerated to 7.3 percent in November. The inflationary pressures are projected to ease as supply side shocks unwind, leading inflation to return to target in early 2018. Gross reserves increased substantially, to 2,726 million US dollars in November, thus ensuring import coverage to over 5 months.

The outlook is positive and the authorities conservatively assume a GDP growth of 3 percent in 2018 and 4 percent over the medium term. Growth will be ensured by a dynamic development of public investment, more active promotion of exports to the EU market and higher foreign direct investments on the back of improved financial intermediation and business climate. The fiscal deficit will remain in line with program parameters while the risk of debt distress will stay low. With improved external competitiveness, the current account deficit, projected to reach 6.3 percent of GDP for this year, will gradually decline to 5.0-5.4 percent of GDP over the next five years.

Public Finances

Lower than programmed capital spending and 15 percent higher budget revenue was reflected in a cash surplus in September of 0.6 percent of GDP. Higher revenues have been ensured primarily by improved tax administration, supported through the implementation of the long-awaited tax administration reform and measures to tackle the shadow economy. Although public capital expenditure increased significantly compared to last year, the authorities believe it will not reach fully the cascaded objectives for 2017, mainly due to slower implementation of foreign financed projects. With this, the augmented fiscal deficit for 2017 will undershoot the planned level and reach 3.1 percent of GDP versus 3.7 percent projected.

The recently approved 2018 budget will target the agreed level of augmented fiscal deficit of 3.3 percent of GDP and it is in line with the fiscal rule as required by the Fiscal Responsibility Law. The budget was built under the assumption of a 7.8 percent increase in revenues, expected to be generated largely by further improved fiscal discipline and tax collection and higher taxes and fees, due to better macroeconomic conditions, as well as anticipated grants. Accordingly, a boost in revenues will make it possible to further expand the spending in priority areas such as public investment (mostly in infrastructure of national and local roads and development in agriculture), education and social protection.

Although the fiscal position is solid, Moldova's spending and investment needs - which are crucial to supporting future growth and competitiveness – continue to be greater than the available resources. While increased from about 10 percent in 2016, the share of capital expenditure in total spending runs modest and will amount to about 13 percent of total budget spending in 2017-18. Over the medium term, considering the expected sizable decrease in budget support grants, the fiscal consolidation efforts will be crucial to create additional fiscal space to meet a greater array of domestically expenditure needs, including the growth-enhancing public spending. For this purpose, the Medium-Term Budget Framework (2018-20) is built around a gradual fiscal consolidation path through broadening and deepening the tax base and enhancing tax compliance, as well as ensuring a resourceful management of the public finances.

The authorities' efforts and political capital will be further channeled into endorsing fiscal-structural reforms which should position the economy in a better state for the future. These reforms will encompass curbing tax evasion and further enhancing the tax administration, transparency, compliance risk management and audit function. With the objective to mitigate the risks and improve the transparency of fiscal policies and associated risks, the authorities published their first Fiscal Risk Statement (FRS) which accompanied the 2018 budget. With the view to enhance the public procurement process, the E-Procurement platform, now in pilot mode, is expected to be launched in 2018, while the recently created National Agency of Solving Complaints represents an important step towards further improving the public procurement system. Additionally, the authorities embarked on drafting new Tax and Customs Codes which will be brought in line with the EU directives, including in terms of regulating excises and VAT. Given the ageing and shrinking of the work force the pension reform, effective as of April, 2017, foresees increasing the retirement age to 63 from 2019 for men and from 2028 for women, improving coverage and compliance, and introducing a systematic indexation of pension benefits without ad-hoc increases. It also envisages bringing the entire public sector under a single contribution scheme.

Financial sector

The banking sector is overall well capitalized and profitable. However, banking assets grew soberly against the background of a reduction in the loan portfolio and high current liquidity indicators. The poor quality of earlier issued loans is one of the main challenges faced by the banks, although high capital adequacy and profitability levels create adequate reserves for possible risks. To this end, the banks will continue to implement the agreed remedy plans with the aim to enhance the monitoring and reporting frameworks, and strengthening the bank governance and internal credit risk policies.

The National Bank of Moldova (NBM) kept focusing on improving the soundness of financial institutions, with the primary goal to strengthen the banks' governance, financial conditions and risk management. From this perspective, important progress has been achieved with the transfer of bank ownership to fit-and-proper shareholders. The NBM's efforts in gaining full shareholder transparency are moving from the larger banks to smaller ones. Solidification of the related party identification process is another priority for the NBM in unwinding of related-party lending, which is expected to be completed on a twofold dimension – enhanced legal, procedure and policy framework alongside the improved IT operational toolkit.

While substantial effort was made with preparing for the transfer of systemic banks' control to fit and proper shareholders, a foreign strategic investor announced already its intention to acquire an initial stake of over 39 percent in the third-largest bank with a possibility to further expand its presence. In the meantime, a group of reputable foreign investors maintains their interest in the largest bank, while the authorities put all efforts to make the transaction possible in the Spring of next year. In that vein, amendments to a set of laws have been approved in order to facilitate the sale of shares and ensure irreversibility of the previous cancelled shares. Looking ahead, the NBM's linked actions will be channeled at setting a new framework centered at further removing the concerted and unfit shareholders from the banking sector, and ensuring the fit and proper certification of incoming shareholders and managers.

Enhancing the legal framework, including through its alignment to the EU standards was high in the NBM reform agenda. The recently approved new banking law, developed in line with Basel III (EU CRD IV/ CRR) standards, is the core piece of legislation for setting in place a better prudential and supervisory framework in the banking system, including through shifting to risk and principle-based supervision. The law, to be implemented gradually and starting in January 2018, will boost the banking system's resilience and make it attractive to foreign investors. Furthermore, great focus will be placed on the promotion of the already drafted secondary regulatory framework and the implementation of COREP reporting system.

Moreover, following the approval of several amendments to the legislation to align it with the 2016 Law on Central Security Depository (CSD), including to streamline the transition period to a single CSD, the authorities undertook additional measures to ensure efficiency and soundness of the securities settlement and registry infrastructure. They developed a comprehensive methodology for verification of integrity of legal records of shareholders. The verification itself will be backed by an appropriate financing mechanism and procedures, which will support the related public awareness campaign, to be completed by March 2018. Meanwhile, the CSD logistic and organizational activities are being rolled out.

Monetary and Exchange Rate Policies

Following a sharp deceleration during 2016, inflation gained pace in the first half of 2017 engendered mainly by higher food prices due to adverse weather conditions during the Spring, energy prices and the tariffs' rises on some regulated services. While the inflationary pressure was less pronounced in Q3, the annual inflation mounted above the target, being however placed within the interval delimited by the outer bands stipulated in the inflation consultation mechanism. The appreciation of the leu against the US dollar played an important role in absorbing the inflationary pressure. In the NBM's view, with the dissipation of the supply-side shocks, the annual inflation rate will decline rapidly and may fall below 5 percent in 2018.

In response to these estimates, the NBM lowered gradually the policy rate by 250 basis points to 6.5 percent. Also, in order to sterilize the persistent excess liquidity (upheld by subdued financial intermediation combined with a recovery in deposits) and improve the transmission mechanism of monetary policy decisions, the NBM increased the reserve requirement ratio to a record high of 40 percent. Despite this increase, the excess liquidity remains substantial, which could be converted eventually into commercial loans given the favorable interest rates. Nevertheless, the banks' credit portfolio is still modest, although there are signs of lending recovery in the recent months, largely in domestic currency.

The NBM advanced with enhancing the liquidity forecasting framework through improving the accuracy and consistency of macroeconomic data. The formalization of the data exchange between the Ministry of Finance and the NBM represents a part of these strides and envisages the exchange of information on the cash flow to the central budget and projections within the single treasury account (STA).

In line with the inflation targeting framework, the NBM maintains a flexible exchange rate, with interventions aimed at absorbing the seasonal excess supply and preventing disorderly exchange rate movements without resisting market trends. The abundance in foreign exchange over the year allowed the NBM to restore its international reserves, following the significant losses experienced with the banking crisis.

Business environment and reforms agenda

Far-reaching structural reforms, including in line with the Deep and Comprehensive Free Trade Agreement with the EU and as part of the recently adopted Country Partnership Framework with the World Bank, are vital to make the country more resilient, more stable and successful. The implementation of such reforms requires robust state institutions. Consequently, the authorities embarked on restructuring the state apparatus with the aim to ensure a sound structure to better promote and implement the government's reform agenda alongside the rationalization of public wages and employment. They reduced the number of ministries from 16 to 9 and replaced the Deputy Ministers with non-political state secretaries, while the next phase of the reform will aim at optimizing agencies subordinated to the government.

The authorities have been working recently to foster investments and address the accumulated challenges in the real sector in order to unleash sustainable private sector-driven growth. An important step in this regard will be the adoption of recently discussed measures to ease the regulatory environment for business, although significant bottlenecks in doing business persist. The contractual relationships between the employer and the employee have been liberalized. The overlapping controls against the same risk criteria were excluded and the number of control bodies has been reduced from 58 to 18. The total number of permits and licenses required to start and conduct a business was cut by about a quarter, while the burden of reporting on salary payments and related taxes was lessened by consolidating the number of reports. Moreover, the implementation of “single window” solutions is ongoing and substantial progress has been achieved in simplifying the procedures for orderly liquidation of business.

The authorities put a lot of emphasis on diversification and safeguarding energy security, which will contribute to reducing riskiness of investment in the country. As such, in addition to the new laws on electricity and natural gas adopted in 2016, the Parliament adopted the new Energy Law in July 2017, aimed at strengthening the political, functional and financial independence of the regulator - an important step for the implementation of the EU’s Third Energy Package.

Concluding remarks

The authorities remain fully committed to safeguarding the attained macroeconomic and financial stability. They will continue to extend the track record of sound and prudent economic policies, as well as tackle the challenges and reduce vulnerabilities through keeping policy implementation on track. The Fund-supported program remains an important tool to achieve these goals.