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Republic of Moldova: 2006 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Moldova

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with the Republic of Moldova and its request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on February 10, 2006, with the officials of the Republic of Moldova on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 20, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of May 5, 2006 updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its May 5, 2006, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of the Republic of Moldova.

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

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper Annual Evaluation Report 2005
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*
Poverty Reduction Strategy Paper Annual Evaluation Report 2005
Statistical Appendix
Technical Memorandum of Understanding*
*Also included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Staff Report for the 2006 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Ajai Chopra and Anthony R. Boote

April 20, 2006

Mission dates	December 1–15, 2005, and February 1–10, 2006
Team	T. Richardson (head), M. Cuc, A. Angelovska-Bezoska, N. Giginieshvili (all EUR), D. Chua (FAD), C. Gust (PDR), and J. Mathisen (resident representative).
Area covered by the consultation	As in the past, the consultation covered only the government-controlled areas on the "right bank" of the Dniestr River, and did not consider the areas not under the government's control on the "left bank," hereinafter referred to as Transnistria.
PRGF	The authorities are requesting financial assistance under a three-year PRGF arrangement in the amount of SDR 80.08 million (65 percent of quota) with equally-phased, semiannual disbursements.
Exchange system	Moldova has accepted the obligations of Article VIII, Sections 2, 3 and 4, of the Fund's Articles of Agreement. Its exchange system remains free of restrictions on payments and transfers for current international transactions (Appendix I).
Donor coordination	The mission liaised with the World Bank (which fielded a parallel mission to discuss a possible PRSC, Appendix II), the EBRD (Appendix III), the UNDP and other donors, particularly the European Commission (which also fielded a parallel mission).
Data	National Bureau of Statistics (http://www.statistica.md/), National Bank of Moldova (http://www.bnm.org/english/index_en.html), Ministry of Finance (www.moldova.md). Despite some weaknesses, data provision is adequate for surveillance, and Moldova is close to subscription to the SDDS (Appendix IV).
Outreach and publication	The mission met with members of parliament, trade unions, industry, the financial sector, NGOs, and the academic community. A press briefing was held at the end of the mission and—for the first time—the Concluding Statement was published (http://www.imf.org/external/np/ms/2005/121605.htm). The authorities have agreed to publication of the staff report and all program documents.

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List of Acronyms

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BEM	Banca de Economii
BoP	Balance of Payments
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
EU	European Union
FAD	Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
MEFP	Memorandum of Economic and Financial Policies
MTEF	Medium-Term Expenditure Framework
MDGs	Millennium Development Goals
NBM	National Bank of Moldova
NPLs	Nonperforming Loans
PER	Public Expenditure Review
ODA	Overseas Development Assistance
SF	Social Insurance Fund
SIDA	Swedish International Development Agency
SOE	State-Owned Enterprise
TCM	Thousand Cubic Meters
TSA	Treasury Single Account
UNDP	United Nations Development Program
VAT	Value Added Tax

EXECUTIVE SUMMARY

Moldova's European aspirations have renewed the impetus for reforms. Reelection of the government in 2005 on a pro-Europe, pro-reform platform has done much to build a consensus on the need to accelerate reforms and seek a new IMF arrangement. The European Union-Moldova Action Plan, signed in February 2005, provides a platform consistent with the authorities' EGPRSP for advancing a broad agenda of measures designed to improve Moldova's long-run growth prospects.

The policy discussions focused on the following themes:

- ***The need to maintain macroeconomic stability in the face of external uncertainties***. There was agreement on the need to target single-digit inflation in the context of rising prices for energy imports, as well as strong remittance inflows and growing foreign aid. Staff felt that the fiscal stance (deficit well below 1 percent of GDP) was appropriate, and there was agreement on the need to allow greater exchange rate flexibility. The authorities stand ready to tighten monetary policy if necessary to achieve their inflation objective.

- ***The importance of financial sector stability and development***. There was consensus on the need to enhance the independence of the National Bank of Moldova, including by establishing price stability as its primary objective, and to promote competition in the banking system as a means of improving the efficiency of financial intermediation. Staff argued that transparency of ownership in the banking sector should be enhanced, and welcomed the long-awaited arrival in Moldova of significant foreign banking institutions. In this context, there was agreement that the time has arrived to develop an exit strategy for the state-owned Banca de Economii (BEM).

- ***The large unfinished agenda of structural reforms***. The authorities are committed to completing the transition process by advancing reforms designed to delineate what should be the appropriate role of the government in the economy. Key measures underway include: modernization of the tax administration; regulatory and public administration reform; improving corporate governance and transparency for state-owned enterprises (as well as reinvigorated privatization); and trade liberalization.

Staff supports the authorities' request for a new three-year PRGF arrangement. The accompanying Letter of Intent and Memorandum of Economic and Financial Policies contain policy commitments appropriate to maintain macroeconomic stability and to accelerate the economic reform agenda.

I. Introduction

1. **Elections in March–April, 2005 returned President Voronin of the Communist Party to power**, albeit with a slimmer majority than during his first term. The government ran on a pro-European platform, promising faster reforms and placing much emphasis on the signing in February 2005 of an Action Plan agreed with the European Union that is consistent with the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP). At the same time, relations with Russia remain difficult, given the on-going impasse over Transnistria.[1]

2. **Moldova's newfound European aspirations have provided much-needed impetus to the authorities' stabilization and reform efforts.** In concluding the 2004 Article IV consultation, the Executive Board noted that Moldova would need to demonstrate a track record of improved policy implementation before discussions on a new PRGF-supported program could begin. Following the elections, staff urged the authorities to establish this track record by taking the following concrete actions:

- Maintaining tight fiscal policy (deficit of no more than ½ percent of GDP in 2005);
- Tightening monetary policy to credibly target single-digit inflation by end-2005; and
- Accelerating structural reforms, particularly in the areas of public administration reform, modernization of fiscal and public enterprise management, and trade policy liberalization.

Implementation of these actions through September was sufficient to demonstrate the authorities' strengthened policy efforts, opening the way for discussions in December and February on a new IMF-supported program.

3. **These discussions culminated in a request for a new three-year PRGF arrangement**. Consistent with their Economic Growth and Poverty Reduction Strategy (EGPRSP), the proposed program emphasizes maintenance of macroeconomic stability in the face of continued strong foreign exchange inflows, as well as development of the financial sector and structural reforms aimed at advancing the transition process by clarifying the role of the state in the economy.

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[1] See Box 1 of (IMF Country Report No. 05/48).

Box 1. Implementation of Past Fund Policy Recommendations

As suggested by the disappointing performance under the 2001–03 PRGF arrangement, responsiveness to Fund advice has been mixed over the years. This said, in 2004–05, the authorities seemed to internalize some of the messages of previous consultations.

Receptivity to IMF advice has been stronger in the core areas of fiscal, monetary, and financial sector polices than on structural issues. The stance of fiscal policy has generally been tight, while the monetary authorities have now begun to place greater emphasis on the inflation objective.

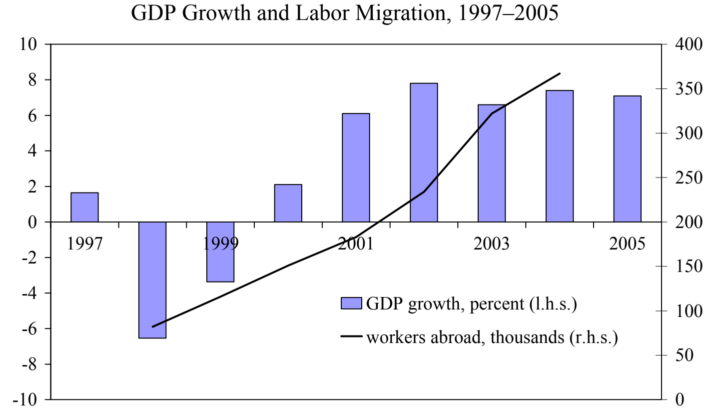
Until recently, structural reforms had stalled, but with the signing of the EU-Moldova Action Plan, there are renewed signs of progress. In the financial sector, the authorities have sought to implement a number of recommendations from the FSAP, including those aimed to bolster transparency in ownership structures. They are moving ahead with fiscal management and public administration reforms, and seek to improve the business environment by eliminating unnecessary regulations.

II. BACKGROUND

4. **Moldova was hit hard by the regional financial crisis in 1998**. The former Soviet Union had been the destination for about two thirds of Moldovan exports, and when these markets contracted sharply, Moldova faced a significant demand shock. The cumulative GDP loss reached 10 percent during 1998–99, and the poverty rate rose to over 70 percent in 1999 (from 47 percent in 1997). The exchange rate depreciated sharply, leading external debt to rise by almost 50 percentage points of GDP during 1997–2000.

5. **The adverse developments led many Moldovans to seek employment opportunities abroad**—both in the EU and in nearby countries with considerably higher wages. The number of migrants rose sharply after 1998, and continued to grow even after the Moldovan economy began to recover.[2] Further, the pace of transition-related structural reforms tapered off sharply after 2001, leading to a deterioration in the business environment that also prompted out-migration.

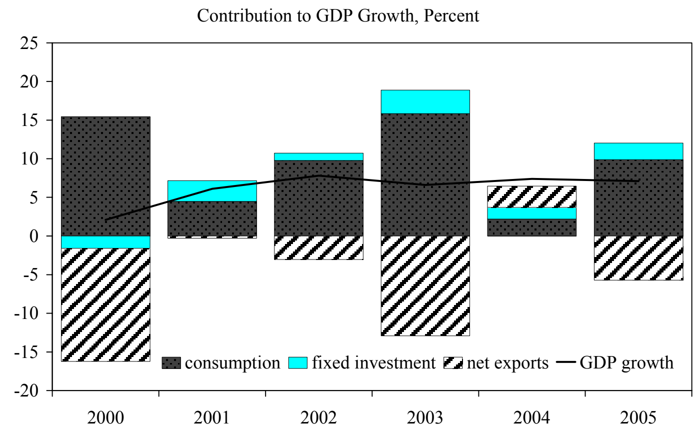
GDP Growth and Labor Migration, 1997–2005



Sources: Moldovan authorities; and Fund staff

[2] See M. Cuc, E. Lundbäck and E. Ruggiero, *Migration and Remittances in Moldova*, International Monetary Fund, 2005.

6. **Remittances have underpinned the robust growth of recent years**. The growth has been driven by consumption and private housing construction. Annual import growth has averaged almost 23 percent over the past five years, leading the trade deficit to nearly double as a share of GDP (to 40 percent in 2005). At the same time, remittances have also fueled inflationary pressures, creating challenges for the monetary authorities, who must operate in financial markets that remain fairly thin.



Sources: Moldovan authorities; and Fund staff

Key Macroeconomic Indicators—Comparison
(Average 2000–05)

	Real GDP Growth (In percent)	CPI Inflation (In percent)	General Government Balance (In percent of GDP)	Current Account Balance (In percent of GDP)
Moldova	**6.2**	**13.8**	**0.1**	**-5.1**
Other CIS:				
Russia	6.8	15.9	3.3	11.1
Ukraine	7.4	11.4	-1.7	5.8
Georgia	6.2	5.5	-1.5	-6.9
Romania	5.1	23.1	-2.3	-6.6
Bulgaria	5.0	6.2	0.2	-8.5
Serbia and Montenegro	5.1	36.5	-1.6	-8.1
FYR Macedonia	1.9	2.5	-1.5	-4.6
Albania	5.7	2.7	-6.0	-4.7

Source: WEO.

7. **There are signs that the current growth model is reaching its limit**. Labor shortages have begun to emerge in some sectors, and delayed investment has hampered modernization in others. Moreover, fairly gradual financial sector development has meant that intermediation is weak, which—coupled with the weak business environment—has further complicated Moldova's growth outlook.

8. **Migration has tended to ameliorate poverty**, as those working abroad supported their families by providing strong and growing remittances. These inflows rose from below 10 percent of GDP before the 1998 crisis to over 30 percent in 2005. Poverty levels fell correspondingly, declining to 28 percent by 2004. However, progress toward the Millennium Development Goals in other areas has been mixed. While Moldova's achievements have

been notable in reducing infant mortality and increasing access to improved water supplies, relatively less progress has been noted recently in raising secondary school enrollment ratios, improving access to sanitation, or combating HIV/AIDS.

Human Development Indicators

	2000	2002	2004
Population with income below $2.15 per day, percent	64.5	39.8	27.8
Gini coefficient 1/	0.34	0.34	...
Life expectancy at birth, years	67.8	67.0	...
Infant mortality rate (per 1,000)	23.3	18.2	15.3
Maternal mortality ratio (per 100,000 births)	27.1	28.0	23.5
Mortality rate associated with tuberculosis (deaths per 100,000 people)	16.9	15.8	16.8
Population with sustainable access to an improved water source, percent	37.8	38.5	44.5
Population with access to improved sanitation, percent	41.1	41.7	43.6

Sources: Moldovan Ministry of Economy and Trade; and World Bank Development Indicators database.

1/ Higher value indicates greater inequality.

III. Recent Economic Developments

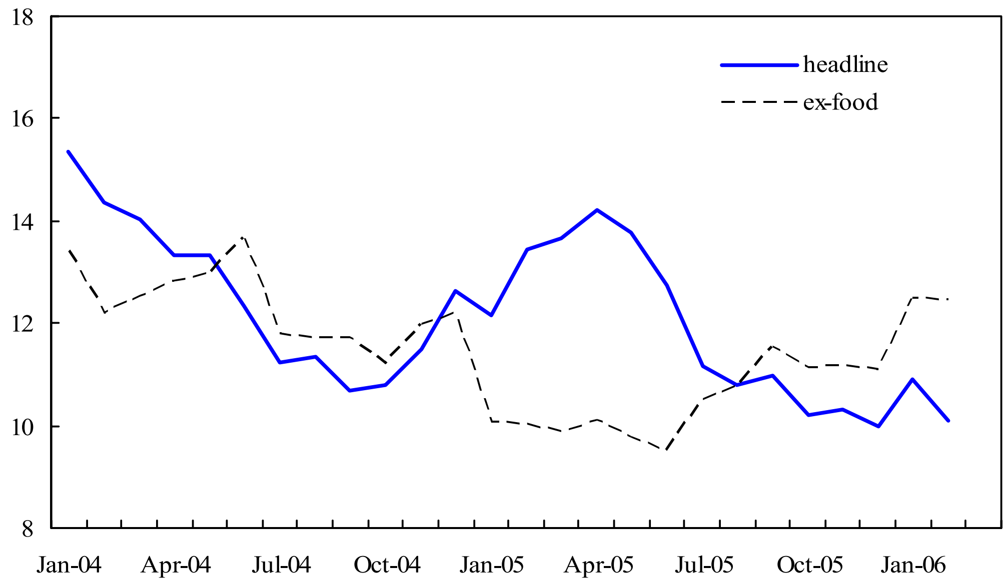
9. **Higher energy prices complicated the macroeconomic picture in 2005**. Although overall GDP growth remained strong at 7 percent, its composition shifted further away from the traded sector, which was particularly affected by the rise in petroleum prices. The slowdown in export growth and the higher energy import bill contributed to a worsening in the current account balance. Inflation performance improved despite the higher energy prices, falling to 10 percent (y-o-y) in December 2005 (from a peak of 14 percent in April), aided by a slower growth in prices for food products, and a stronger macroeconomic policy discipline.

10. **Fiscal and monetary policy were tightened.** Substantial overperformance on the VAT translated into a stronger fiscal stance (a surplus of 1.7 percent of GDP). In turn, the NBM stepped up sales of NBM certificates, as well as making more active use of deposit auctions. Sterilization efforts intensified in the second and third quarters before easing in the fourth quarter, as the NBM moderated its foreign exchange purchases in light of an energy-related weakening in the BoP position. The NBM's balance on sterilization operations rose from an average of 1.1 percent of GDP in 2004 to an average of 2.9 in 2005.[3] As a result, reserve money growth slowed during the year, falling to 16½ percent at end-September, before rising seasonally in December. At the same time, broad money growth remained strong (at 35 percent for the year as a whole). Lending and deposit rates have remained high, despite plentiful liquidity on the T-bill and interbank markets—suggesting that competition in the financial sector is weak.

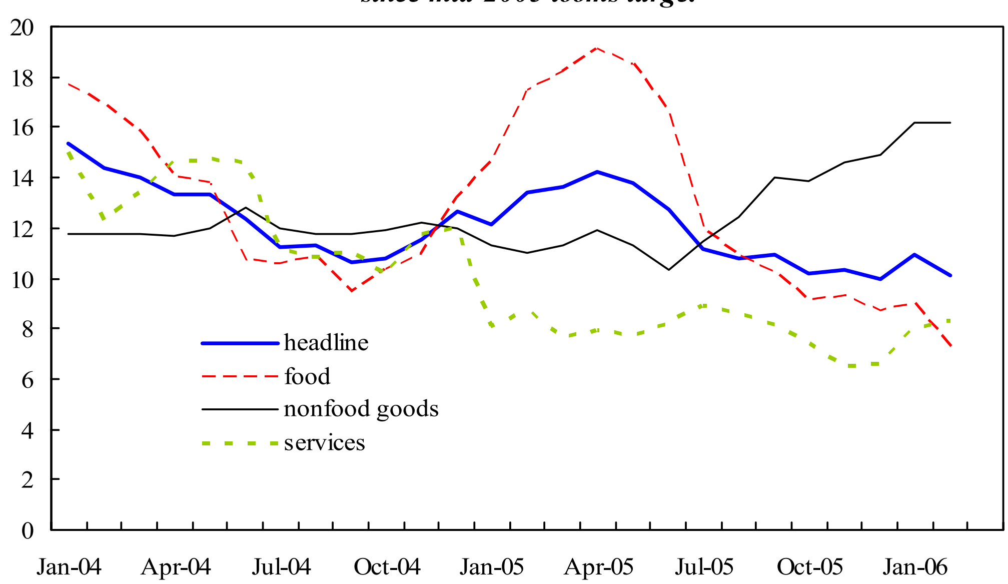
[3] The cost of these operations was about Lei 50 million (0.1 percent of GDP) in 2005, compared with an estimated realized NBM profit of about Lei 160 million.

Inflation, January 2004–March 2006

Headline inflation has been on a downward trend since April 2005...



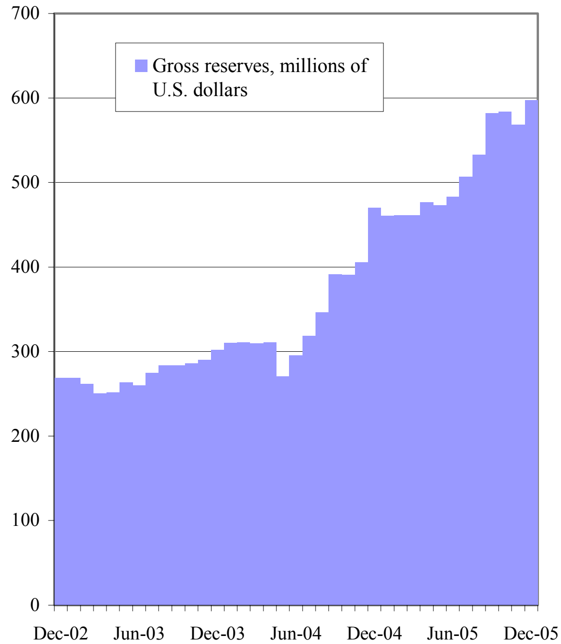
...but the acceleration in price increases for nonfood goods, mainly fuel, since mid-2005 looms large.



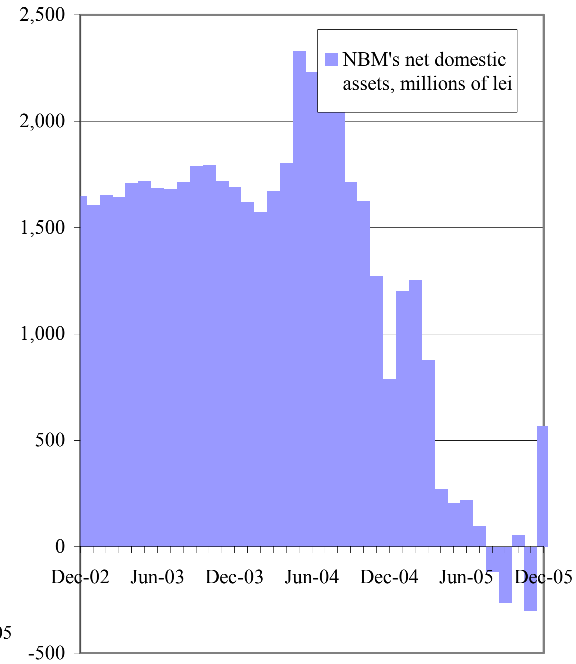
Source: Moldovan authorities.

Monetary Developments

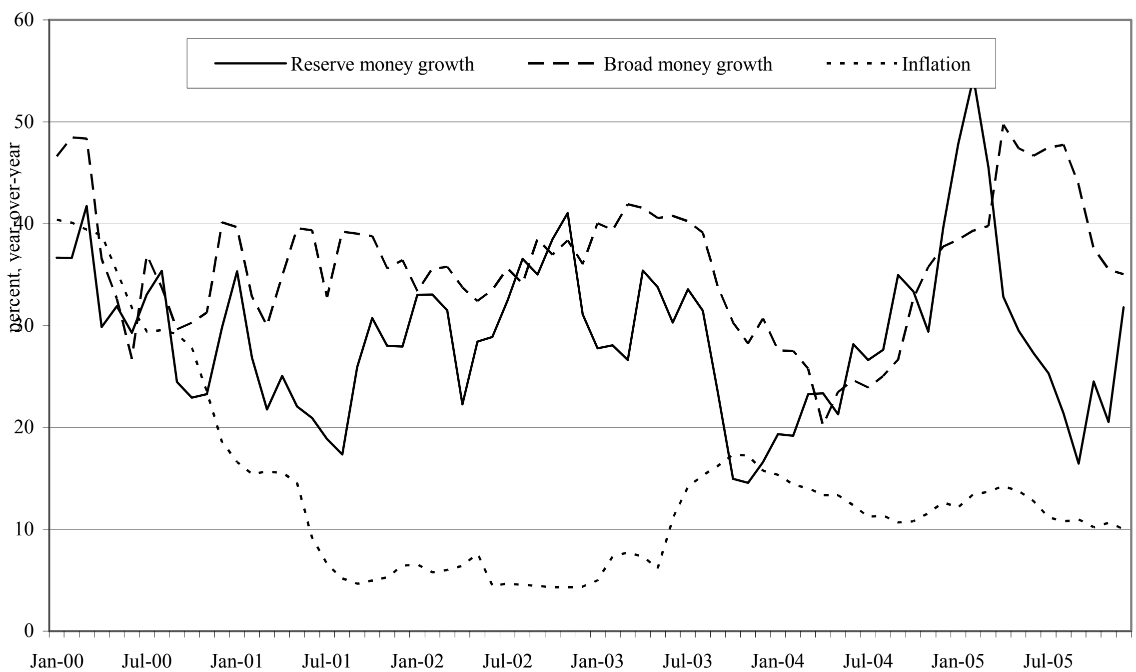
The NBM has been accumulating reserves in 2004 and 2005



... but stepped-up sterilization...



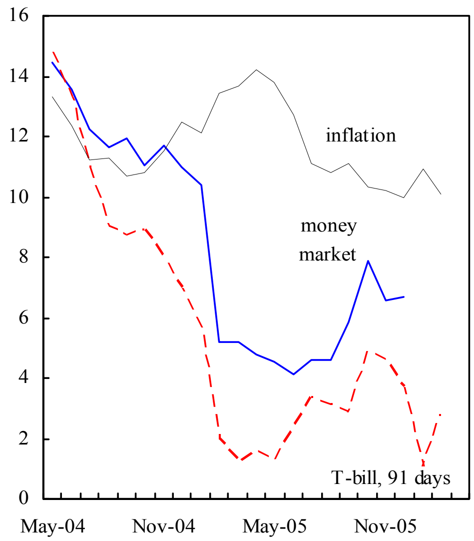
... has brought reserve money growth down, although continued rapid broad money growth may entail some inflationary risks.



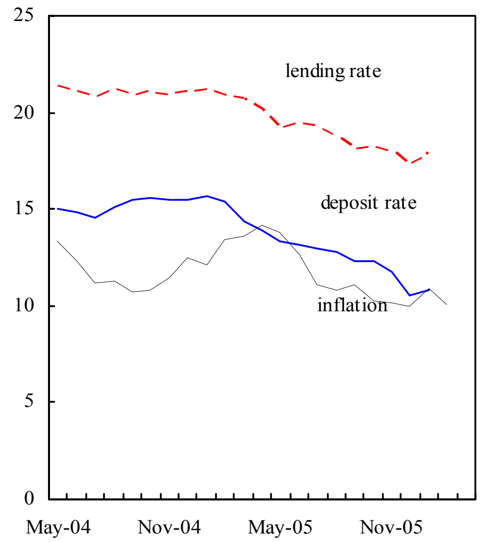
Sources: National Bank of Moldova; and Fund staff calculations.

Interest Rates, 2004–06
(Percent)

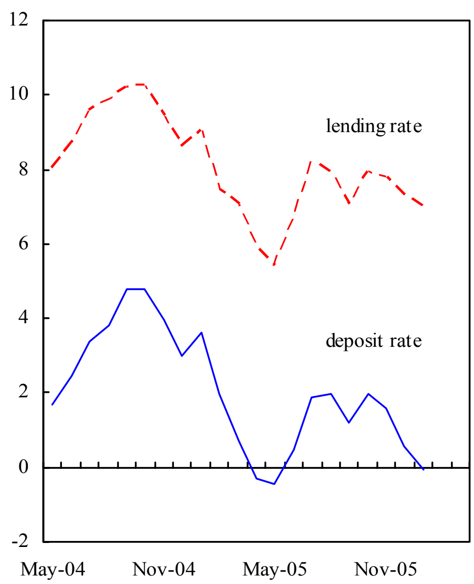
Excess liquidity in 2005 drove interbank rates lower...



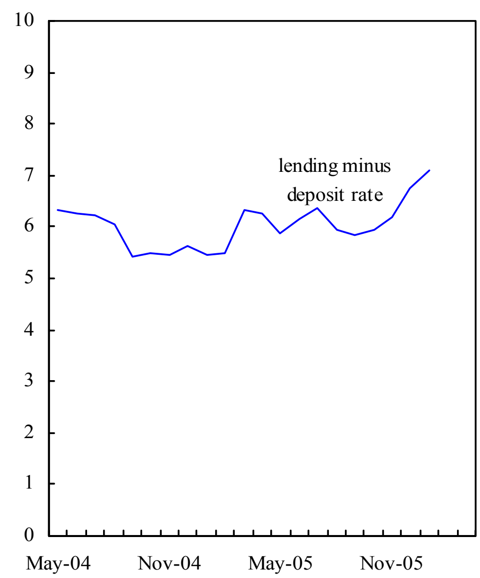
... but private sector borrowing costs declined more slowly...



... and with inflation declining in H1 2005, rose in real terms...



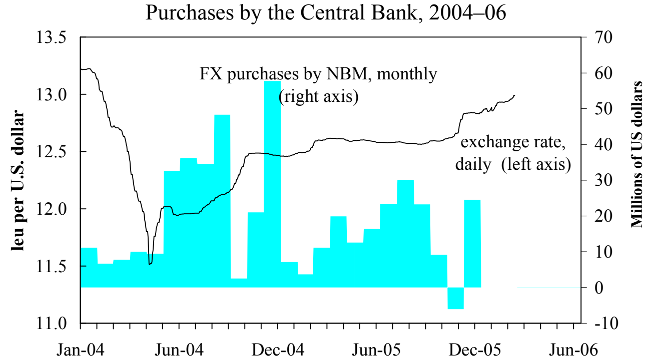
... while spreads remained wide.



Sources: NBM; and Fund staff calculations.

11. **Moldova appears to follow an asymmetric, managed floating exchange rate regime.** Since mid-2004, downward pressure on the currency has been accommodated but upward pressure was absorbed by the NBM through purchases of foreign exchange.[4] The leu appreciated in real effective terms in 2004, but with a weaker BoP and lower inflation than in key trading partners, this tendency leveled off in 2005. International reserves have grown as well (doubling in dollar terms since end-2003), though as a share of imports they remain modest at about 2.2 months.

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



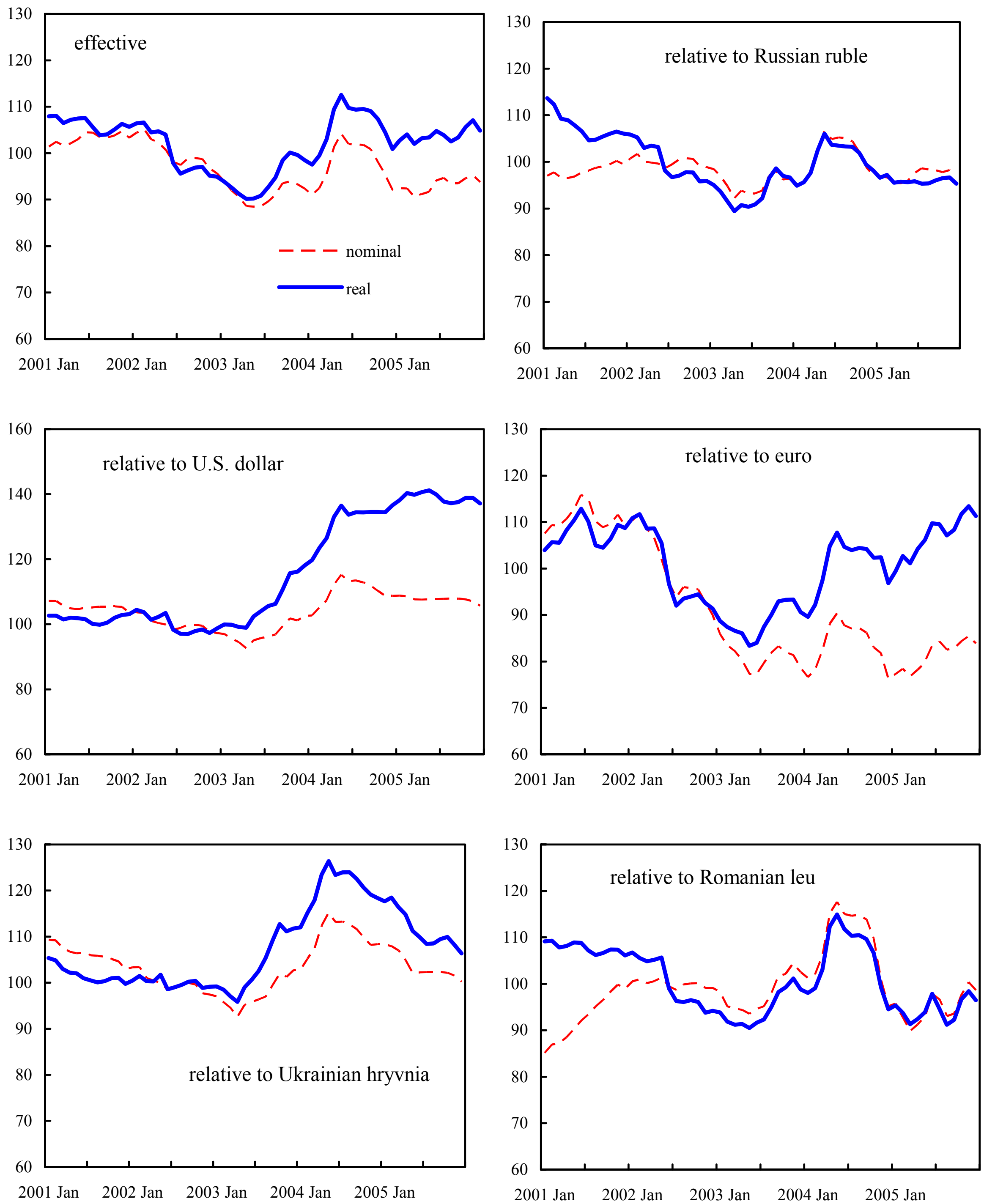
Source: National Bank of Moldova.

12. **The current account deficit deteriorated significantly in 2005, owing in large part to the impact of higher energy prices.** Energy (particularly fuel oil) imports rose in value terms by about 50 percent in 2005 (about 3.5 percent of GDP), while export growth slowed modestly. Moldova's chief exports are agricultural products, particularly wine, most of which is shipped to Russia. There were periodic episodes of trade disruption with Russia, reportedly on phyto-sanitary grounds, for meat and fruits and vegetables. Nevertheless, the overall impact of these limitations on Moldova's balance of payments is unclear, arguably because exporters have found indirect ways to deliver commodities to Russian markets (e.g., through Ukraine or Belarus).

13. **The external debt outlook continued to improve, although arrears were accumulated to Paris Club creditors**. External debt fell as a share of GDP from over 100 percent in 2001 to about 55 percent by 2005, owing largely to strong growth and real exchange rate appreciation, as well as prudent borrowing and several favorable restructuring arrangements. Although the authorities began to service interest falling due to Paris Club creditors in 2004, principal falling due has not been paid (Annex). Moreover, the authorities have not serviced the debt attributed to Transnistria that they assumed under a 2000 agreement with Russia.

[4]Based on data for November 2004-November 2005, Moldova was reclassified a de facto peg in the Annual Report on Exchange Arrangements in January 2006.

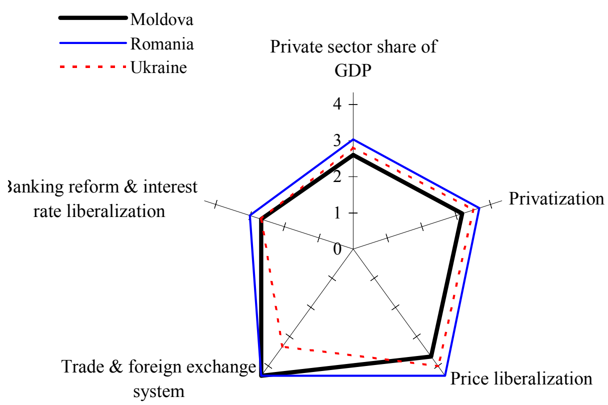
Nominal and Real Effective Exchange Rates, Jan 2001–Dec 2005
(Index, 2002=100)



Source: IMF, Information Notice System.

14. **The authorities began to step up their structural reform efforts in 2005**. Many of the measures taken were aimed at preparing the agenda for the new program, including an initial functional review of the public administration, an inventory of state assets and an assessment of the privatization process, and preparation of a public finance management reform with World Bank support. Nevertheless, the authorities acknowledged that in some areas they are well behind their peers in Southeastern Europe and even the CIS, and it is to address this fact that they have sought a new PRGF arrangement.

EBRD Transition Indicators, 2005



Source: EBRD Transition Report 2005.
Note: Transition indicators range from 1 (little change from centrally planned economy) to 4.33 (representing the standards of an industrialised market economy).

IV. Policy Discussions

15. **The three main themes of the consultation—and the issues the program aims to address—are the following:**

- ***Supporting growth and poverty reduction by maintaining macroeconomic stability***, particularly in the face of strong inflows of remittances and sharply higher prices for imported energy;

- ***Improving the performance of the financial sector***, including by building on the lessons of last year's FSAP; and

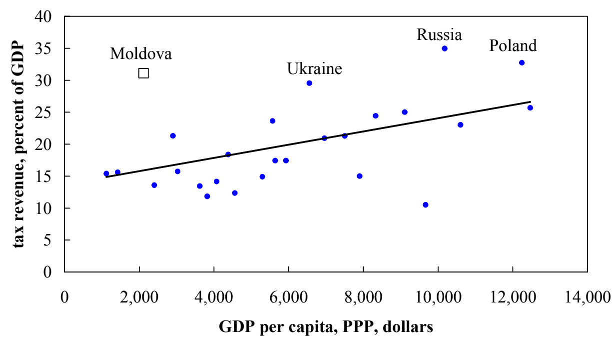
- ***Clarifying the role of government in the economy***, thus advancing the transition process.

A. Moldova's Growth and Poverty Reduction Strategy

16. **Consistent with the EGPRSP, the authorities' key medium-term objective is to create the conditions for durable, private sector-led, pro-poor growth**, taking advantage of Moldova's favorable location and strong inflows of remittances from abroad. The authorities acknowledged that macroeconomic stability is a necessary condition for growth, and thus for poverty alleviation. They were also concerned that growth in recent years has emphasized consumption at the expense of investment, and thus may not prove durable. They pointed to the need to rebuild infrastructure that has deteriorated over the 15 years of transition, particularly rural roads and gas distribution. In response to the mission's emphasis on private sector investment and the need to improve the business environment, the authorities pointed to their efforts to eliminate needless regulations (the "guillotine initiative" —see section III.D) and reduce the tax burden.

17. **The authorities have prepared an annual progress report for their EGPRSP.**[5] They want to avoid duplication of effort by monitoring the EGPRSP in a way consistent with the European Union-Moldova Action Plan (Box 2). The authorities' intention is that the update evaluates the past year's results in light of poverty reduction and economic development objectives. Staff endorsed the elements of the two initiatives that aim to create modern institutions and a more transparent regulatory environment, which should contribute to meaningful economic progress. Staff considered that the EGPRSP update presented a good opportunity to review the scope and effectiveness of government in Moldova, suggesting a modest downsizing of underlying current spending in 2006 and over the medium term as the appropriate way to create more room for private sector expansion, and thus foster growth. The authorities agreed, noting that the World Bank is preparing a new Public Expenditure Review (PER), and that they are in the early stages of a comprehensive public administration reform aimed in part at a significant downsizing of the government apparatus.

Government Size and GDP per Capita, Emerging Markets, 2004



Sources: FAD database; and Moldovan authorities.

B. Macroeconomic Framework

18. **Growth is expected to slow gradually in 2006 and over the medium term**, partly in response to higher oil prices, as well as emerging labor shortages. Under the program, real GDP growth is projected to fall to 6 percent in 2006, and to 5 percent over the medium term. But achieving even this outcome will depend on a continued recovery in investment, particularly of the private sector.

19. **There was agreement that monetary and fiscal policies should aim for a measured pace of disinflation**. The program envisages an inflation objective of 9 percent (y-o-y) in 2006, falling to 7 percent by 2008, despite continued high and rising inflows of remittances (up to $1.3 billion a year by 2008) and foreign aid that will complicate achievement of this moderate goal (MEFP ¶16). The authorities argued that achieving a more ambitious inflation objective would likely come at the expense of slower growth, delays in achieving the MDGs (Table 7), or both.[6] At the same time, the authorities noted the limits to each of the levers available to them:

[5] See the companion paper and JSAN, as well as the original EGPRSP (IMF Country Report No. 04/395 www.scers.md) and JSAN IMF Country Report No. 04/396).

[6] See the discussion in The Macroeconomics of Managing Increased Aid Inflows—Experiences of Low-Income Countries and Policy Implications (www.imf.org).

Box 2. The EU-Moldova Action Plan

The EU-Moldova Action Plan was signed in February 2005, and it covers a wide range of issues, including democratization, health standards, legal reform and economics.* In the economic area, it is broadly consistent with the EGPRSP, and includes the following key elements:

Administrative reform and reform of the judiciary

- Adopting an ethics code for civil servants, judges and law enforcement bodies.
- Implementing a working program for regulatory reform.
- Amending laws concerning the independence and impartiality of the judiciary.
- Introducing administrative reform of local governments.

Macroeconomic stability and poverty reduction

- Developing a Medium-term Expenditure Framework (MTEF) consistent with the EGPRSP and in agreement with the IMF.
- Improving public finance management, including appropriate audit of budget revenue and expenditures.
- Making progress toward an agreement with the IMF on a credible economic program.
- Developing a comprehensive strategy to modernize the tax administration.
- Upgrading and extending the treasury system, including by integrating into the single treasury account the social and health funds.

Improving investment climate

- Screening of national legislation to identify barriers to business establishment and progressively abolish them.
- Taking steps to reduce over-regulation, improve transparency and predictability and reduce further the burden of licensing and inspection regimes.
- Setting up a dialogue on regulation, enterprise and industrial policy with foreign investors.
- Enhancing the prudential regulatory framework for financial markets and supervision to bring it in line with that in the EU.
- Creating a national agency for competition protection, providing it with sufficient budgetary means to carry out its mandate.

Trade promotion

- Harmonizing legislation and procedures with EU norms on certification and control of origin of goods in Moldova.
- Preparing a plan of steps toward fulfillment of EU requirements on animal health and for the processing of animal products, and for hygiene in food processing.

See http://europa.eu.int/comm/external_relations/moldova/intro/index.htm.

Medium-Term Outlook, 2001–08

	2001	2002	2003	2004	2005	2006	2007	2008
						Projections		
	(Percent change; unless otherwise indicated)							
Real GDP	6.1	7.8	6.6	7.4	7.1	6.0	5.0	5.0
Inflation (end of period, y-o-y)	6.4	4.4	15.7	12.6	10.0	9.0	8.0	7.0
	(In percent of GDP, unless otherwise noted)							
Foreign saving	2.5	4.4	6.8	2.7	5.6	5.4	5.5	5.4
National saving	14.2	12.0	11.7	18.5	18.7	17.2	17.7	17.9
Private	12.4	10.0	6.6	12.9	10.6	13.2	13.0	13.2
Public	1.9	2.0	5.2	5.5	8.1	4.0	4.7	4.7
Gross investment	16.7	16.3	18.6	21.2	24.4	22.6	23.1	23.3
Private	14.6	13.4	14.0	16.2	18.0	17.8	17.9	18.1
Public	2.2	2.9	4.6	5.0	6.4	4.8	5.2	5.2
Current account balance	-2.5	-4.4	-6.8	-2.7	-5.6	-5.4	-5.5	-5.4
External debt stock	105.1	100.8	88.7	63.8	54.7	51.3	49.7	47.3

Sources: Moldovan authorities; and Fund staff projections.

- ***Monetary policy*** will shoulder the brunt of the disinflation effort, but thin financial markets limit the NBM's ability to sterilize large inflows.

- ***Fiscal policy*** can provide only limited support for achievement of the inflation objective as Moldova remains the poorest country in Europe, with extensive infrastructure development needs, much of which are financed by external assistance through the budget.[7] Staff noted, however, that there is still scope to contain the growth of current spending.

- The authorities agreed that greater flexibility in the ***exchange rate*** regime would contribute to the disinflation effort but noted that, in the near term, upward pressure on the exchange rate stemming from remittances is likely to be offset by the impact of higher energy prices.

20. **Energy price rises are a major downside risk to the outlook.** Fuel oil import prices rose by an estimated 44 percent in 2005, and natural gas prices have increased by about 40 percent in early 2006. For the past several years, Moldova purchased natural gas from Russia at about $80/thousand cubic meters (tcm), well below the prices faced by Western and Central Europe, but higher than paid by other countries in the former Soviet Union. A price of $110/tcm was agreed upon for the first half of 2006. A price of $160/tcm, originally proposed by Russia, would add about 2 percentage points of GDP to the underlying trade deficit, and lead to higher inflation and somewhat slower growth in 2006.

[7] Excluding foreign-financed project spending, the general government is expected to run a primary surplus of almost 2 percent of GDP in 2006.

Fiscal policy

21. **There was agreement that the underlying budget deficit (after grants) should be no more than 0.5 percent of GDP for the medium term** (Box 3). The 2006 budget foresees a slightly larger deficit (0.8 percent of GDP), owing to the disbursement of an EU grant of about 0.3 percent of GDP in the last days of 2005. With general government debt falling to about one third of GDP in 2006 (from over 80 percent in 2001), a slightly higher deficit would not jeopardize medium-term fiscal sustainability. Nevertheless, while noting that demand-management considerations militate against a higher deficit, the authorities were anxious to note that further large energy price increases could give rise to a need to revisit the agreed fiscal stance (MEFP ¶18).

Fiscal Outlook, 2002–08
(In percent of GDP)

	2002	2003	2004	2005	2006	2007	2008
					Projections		
Revenue	29.6	34.0	35.4	39.5	38.4	38.3	37.7
Expenditure	31.5	33.3	34.6	37.9	39.2	38.8	38.2
Primary	29.4	31.2	32.7	36.6	37.7	37.4	37.1
Wages	9.5	9.6	7.8	7.9	9.0	8.8	8.3
Goods and services	6.9	6.2	7.8	8.2	8.8	8.9	8.7
Transfers	9.5	10.3	11.6	14.2	14.1	14.4	14.9
Capital	2.9	4.6	5.0	6.4	5.2	5.3	5.3
Other	0.6	0.5	0.5	0.0	0.5	0.1	0.0
Interest	2.2	2.1	1.9	1.3	1.5	1.4	1.1
Other, including statistical discrepancy	0.6	-0.4	0.1	0.1	0.0	0.0	0.0
Overall balance	-1.4	0.2	0.8	1.7	-0.8	-0.5	-0.5
Primary balance	0.7	2.3	2.7	3.0	0.6	0.9	0.6

Sources: Moldovan authorities; and Fund staff projections.

22. **The fiscal target in 2006 is substantially looser than the outturn for 2005**. Staff expressed concern regarding the swing in the deficit (from a surplus of 1.7 percent of GDP in 2005 to a deficit of 0.8 percent of GDP in 2006), noting that it would complicate achievement of the authorities' macroeconomic objectives. The authorities noted that much of the swing in the fiscal stance stems from one-off factors, including the disbursement of a grant from the EU in the last days of December, for which expenditures were already allocated in the 2006 budget (adding 0.6 percent of GDP to the fiscal swing), and a change in the composition of imports that

Fiscal Balance, 2003–05
(In percent of GDP)

	2003	2004	2005
Outturn	0.2	0.8	1.7
Initial budget	-0.7	-0.9	-0.9

Sources: Moldovan authorities; and Fund staff estimates.

should stem the VAT overperformance.[8] The authorities also noted that, with the energy-related weakening in the BoP, there was likely to be less need for the budget to support the goals of monetary policy. Finally, staff acknowledged that the authorities have persistently overperformed against their budget deficit targets in recent years, suggesting that the balance of risks in this case implies the 2006 deficit outturn will likely be much better than allowed in the budget.

Box 3. Fiscal Space and the 2006 Budget

After a precipitous drop in the late 1990s, public sector spending has recovered in recent years. Although some in Moldova, including a few foreign donors, would like to see a further expansion in the "fiscal space" available for poverty reduction, this needs to be balanced against the concern that the private sector is being crowded out, to the detriment of Moldova's long-run growth prospects.

Thus, in line with the theme to clarify and limit the role of the state in the economy, staff supported the 2006 budget provision to reduce the overall tax burden through lower direct tax rates. The authorities argued that lower rates on direct taxes will encourage businesses and individuals to leave the shadow economy, while shifting incidence toward consumption. The corporate income tax rate has been reduced from 18 percent to 15 percent, and the individual income tax rates from 9, 14, and 20 percent to 8, 13, and 18 percent, respectively. At the same time, the VAT tax base has been broadened through removal of some of the exemptions, and specific excise rates have been indexed to inflation.

23. **With strong Presidential support, the authorities agreed to pass on the cost of higher energy imports to households and enterprises**. Thus, natural gas tariffs were raised by 40 percent in February, broadly consistent with the increase in natural gas prices for the first quarter. At this level of natural gas prices (about $110/tcm), the authorities agreed to cover the cost of any additional budgetary transfers to low income households within the existing fiscal envelope (MEFP ¶22). Further sharp price increases might call for a revision of the macroeconomic framework, as well as efforts to improve targeting of social transfers to help the poor.[9]

24. **Revenue growth is expected to continue being driven by robust indirect taxes** (MEFP ¶19). More than half of the 6½ percent of GDP increase in tax revenue from 2002 to 2005 stemmed from VAT, excises (in both cases, most of which come from imports), and duties.[10] This trend represents, in effect, one way that a portion of Moldova's strong remittance inflows is being channeled to the budget, and thereby to poverty reduction and infrastructure development, since import growth has itself largely been financed by remittances.

[8] With much higher natural gas imports, the structure of imports is shifting from consumption goods to energy, which is subject to lower VAT rates.

[9] FAD plans to field a poverty and social impact analysis mission later in the year to examine this question.

[10] Imports rose by 14 percentage points of GDP over that period.

25. **Looking ahead, the authorities are committed to modernizing the system of tax administration**, aiming to improve the efficiency of tax collection by reducing compliance costs and by greater reliance on indirect means of assessing tax obligations (MEFP ¶21). With technical assistance from the IMF, they are preparing a comprehensive tax administration reform strategy—as required under the EU-Moldova Action Plan. Further, the authorities concurred with staff that the Council of Creditors (a political body headed by the prime minister, which periodically restructures tax and other debts) should be replaced by an apolitical system relying on State Tax Inspectorate and the bankruptcy courts, as appropriate (MEFP ¶39).

26. **There was agreement that expenditure restraint would be important to ensure sustainable public finances and a competitive business environment over the medium term**. The composition of expenditure will remain heavily tilted toward social spending (chiefly education, health and pensions), which is expected to rise modestly, from 24 percent of GDP in 2005 to about 25 percent of GDP in 2008 (inclusive of the health and social insurance funds), thus comprising almost ⅔ of general government expenditures. The authorities favor an increase in infrastructure investment, but are looking to stepped-up inflows of donor assistance to avoid having to compromise the social policy objectives of the EGPRSP (or relax the fiscal stance).

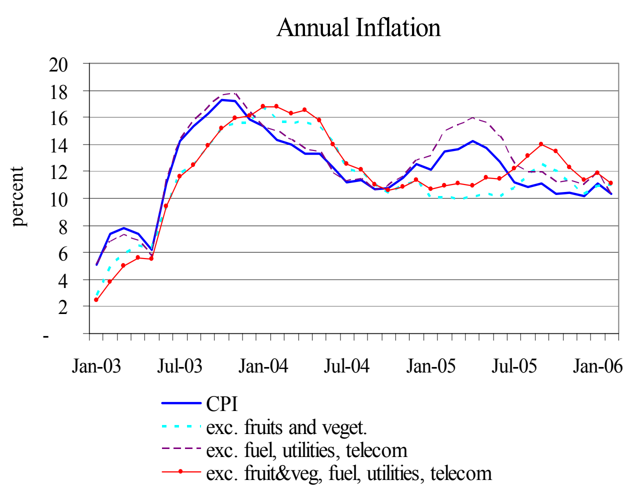
27. **The 2006 budget contains a significant increase in public sector wages**. Staff argued against the increase, which is estimated at about 1 percent of GDP, on the grounds that it would make the authorities' plans for higher infrastructure investment more difficult.[11] However, the authorities countered that the new law on budget sector wages reestablished order in a budget sector wage structure that had become internally inconsistent through years of ad hoc increases for individual sectors, and that it involved a significant element of catch-up. They also pointed to the difficulty in retaining qualified staff, and suggested that without an increase in remuneration they could not credibly combat corruption in the public sector. Nevertheless, looking to 2007–08, the authorities agreed to limit public sector wage growth to the envelope set by the MTEF and agreed with the IMF.

28. **The finances of the social insurance fund (SF) have been a particular area of concern**. In a pre-election move, pensions were increased by an average of 25 percent in November 2004, with the result that the SF ran a deficit throughout 2005. The authorities took some measures on the revenue side, and increased transfers from the central government budget, to cover most of the shortfall. Although SF finances should stabilize in 2006—owing to additional revenue measures (mainly in agriculture), as well as a pension indexation formula that links benefits to both CPI and wage growth—staff argued that a structural imbalance is growing in the SF. Population aging, combined with large numbers of Moldovans working abroad (and not captured in the SF tax net), means that Moldova's pay-as-you-go pension system is forced to maintain high payroll tax rates. This tax on labor in turn provides an additional incentive to worker exodus. The authorities agreed, therefore, to develop a plan during 2006 to put the SF on a sustainable financial basis over the medium term (MEFP ¶23).

[11] Data on the economic classification of general government expenditures are unfortunately not very reliable.

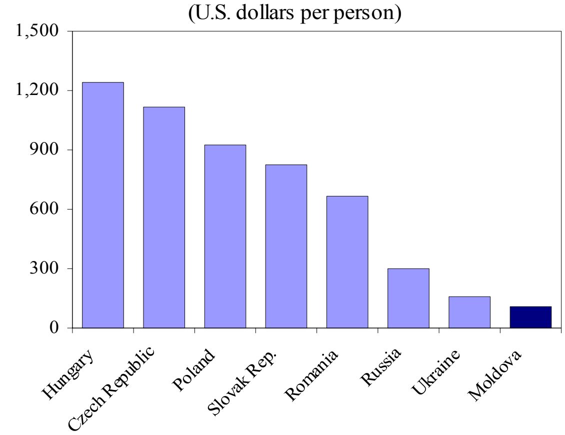
Monetary and exchange rate policy

29. **There was agreement on the need to aim for single-digit inflation** (MEFP ¶24). With this in mind, the NBM is orienting monetary policy toward an inflation objective of 9 percent in 2006 (December-to-December), gradually declining to 7 percent in 2008. Officials noted, however, the uncertain impact of the pass through of higher imported energy prices, and the dominance of food in the CPI basket, which could complicate meeting the objective.



30. **Staff argued that greater flexibility in the exchange rate—in both directions—would support the inflation objective**, and help Moldova cope with potential shocks. The authorities noted staff views, but reiterated that they do not intervene except to smooth out fluctuations on the market. Nevertheless, despite what appears to be a "fear of floating," there was agreement that significant upward pressure on the leu was unlikely in 2006, given likely attendant weakness in the trade balance from higher energy prices. Thus, rebuilding reserves to a level equivalent to at least three months of imports would not be practical in 2006, though it would remain an objective for later in the program period. Based on empirical work suggesting the leu remains below its equilibrium real rate, staff and the authorities agreed that competitiveness is adequate.[12] Additionally, despite strong wage growth in recent years, Moldovan salary levels remain well below neighboring countries.

Average Monthly Dollar Wages, 2005
(U.S. dollars per person)

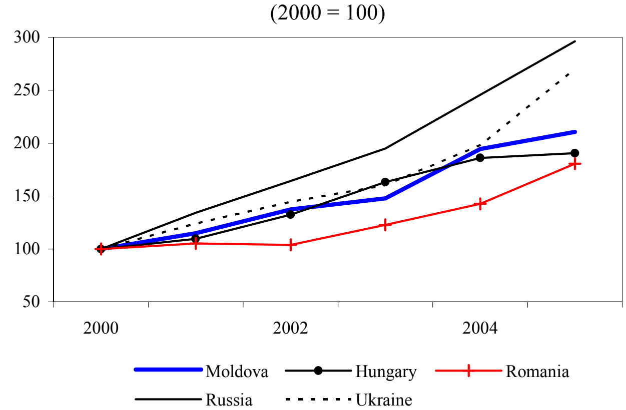


Sources: AMECO; and Fund staff estimates.

[12] Measures of the equilibrium real exchange rate continue to show that the leu has some room to appreciate, although recent energy price increases imply that this margin has narrowed. See M. Cuc, "External Competitiveness," Chapter 3 of *Republic of Moldova: Selected Issues* (IMF Country Report No. 05/54).

31. **There was agreement that the NBM needs to continue using the levers available to it in order to mop up liquidity stemming from robust inflows** (MEFP ¶25). The NBM stepped up its use of deposit auctions and began sales of its own paper for this purpose in early 2005, and will aim for base money growth of about 16 percent (December-to-December) in 2006.[13] The authorities also agreed to move the remaining central government deposits out of the commercial banks into the treasury account in the NBM. In addition, during 2006 the authorities will explore the option of securitizing the pre-2004 stock of government debt to the NBM (equal to Lei 1.7 billion), in order to enhance the NBM's ability to conduct open-market operations. The NBM will stand ready to tighten monetary policy further, if necessary, in order to achieve their inflation objective.

Unit Labor Costs in Common Currency
(2000 = 100)



Sources: AMECO; WEO; and Fund staff calculations.

32. **The authorities and staff agreed that NBM independence needs to be strengthened**. They noted that the NBM law at present requires the bank to strive for "stability of the national currency," which can be interpreted to mean either the exchange rate or inflation. To clarify this problem of dual objectives, the authorities are amending the NBM law to specify that price stability is the Bank's primary objective (MEFP ¶24). The revised law will also enhance NBM independence by prohibiting direct credit to government, and by strengthening the independence of NBM board members in the performance of their normal duties.[14]

Trade policy

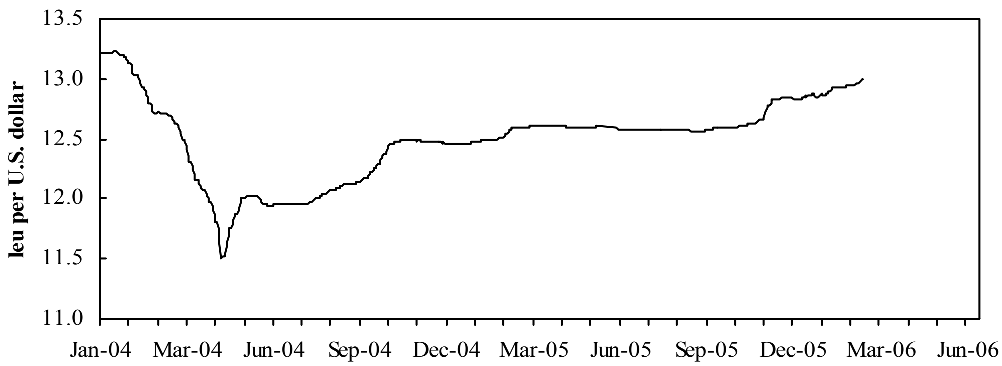
33. **Moldova, a WTO member, has a relatively open trade regime**. The unweighted average import duty is 5.7 percent, and imports of goods are equal to about three fourths of annual GDP. However, export restrictions, particularly for grain products, have long been controversial. Under the program, the authorities have agreed to eliminate the restriction that grain exports must formally be transacted on the privately owned Moldovan Commodity Exchange (MEFP ¶40), and they report that informal restrictions have been lifted on the mode of transportation (e.g., by rail, rather than by truck) for exports. The authorities argued that the main reason for these restrictions was to combat tax evasion (underinvoicing),

[13] In 2005, for the first time, the government began to repay loans previously extended by the NBM, and beginning in 2006, it will no longer oblige the NBM to make quarterly transfers of profits (with transfers coming instead after the end of the financial year, on the basis of audited accounts).

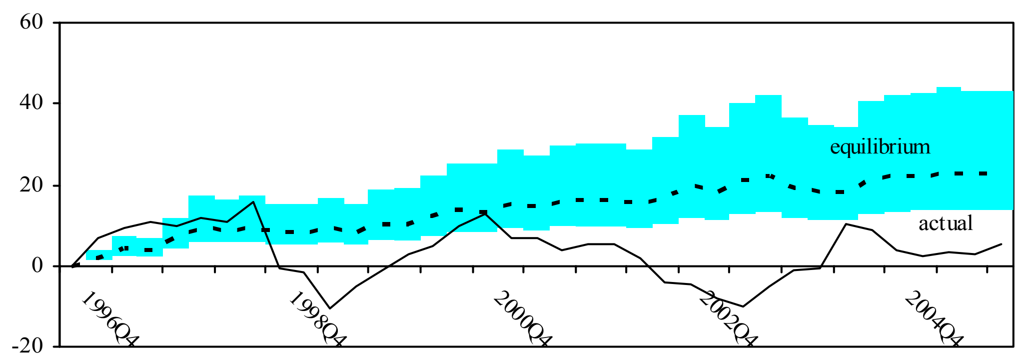
[14] At the next opportunity, the authorities intend to propose amending the Constitution to include an explicit reference to the independence of the National Bank, and clarify its role in the conduct of monetary policy.

Leu/U.S. Dollar Exchange Rate and Real Effective Exchange Rate

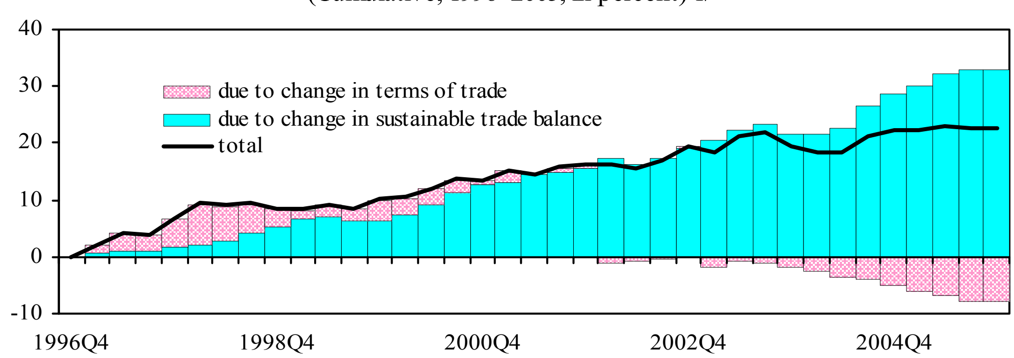
Leu/U.S. Dollar Exchange Rate, 2004–06



Change in REER and Equilibrium REER,
1996–2005 (Cumulative, in percent)



Change in Equilibrium REER—Decomposition
(Cumulative, 1996–2005, in percent) 1/



1/ Elasticity of transformation (0.95) and elasticity of substitution (0.81) values are averages calculated from Devarajan et al. (1999).

Sources: NBM; and Fund staff calculations.

and they noted that, with the development of a comprehensive new tax administration modernization strategy, the export restrictions were no longer necessary.

34. **The authorities noted their concern that the impending EU accession of Bulgaria and Romania could have an adverse impact on Moldova's export prospects**. While Bulgaria absorbs a relatively small proportion of Moldovan products (less than 1 percent), Romania is the destination for about 10 percent of total exports. The chief commodities sold by Moldova to Romania have been agricultural products, and textiles, most of which will face higher duties when Romania joins the EU. The authorities have reached an agreement on GSP+ treatment with the EU, and are seeking to negotiate concessional access to EU markets for some of the products excluded by GSP+.

Debt strategy

35. **The authorities have prepared a strategy for normalizing relations with external creditors**. Arrears stood at $56 million at end-2005 (2 percent of GDP), and are owed mostly to Russia, with smaller amounts due to the U.S., Japan, Germany and Italy. The authorities hope to use the resources in an escrow account established in the 2005 and 2006 budgets (equal to Lei 200 million, or $15.6 million) to clear a portion of their arrears, which are expected to rise to $65 million by end-April 2006. They hope to secure a rescheduling for the remainder, along with a flow rescheduling of debt service falling due during the program period.[15] Preliminary indications from donors suggest that the residual financing gap for 2006 can be filled. Nevertheless, the authorities understand that additional fiscal adjustment would be needed, should projected aid flows not materialize.

36. **The results of the updated low-income country DSA, done jointly by Bank and Fund staff, indicate that Moldova faces short-term liquidity difficulties, rather than a structural debt sustainability problem**. Reengagement of the IFIs and the international donor community with fresh concessional financing and possibly rescheduling of its external debt, including arrears, would alleviate the liquidity problem and free up resources for other development needs.

C. Financial Sector Stability and Performance

37. **Financial stability indicators remain generally strong**. Capital adequacy and liquidity ratios are sound, and NPLs remain well under 10 percent, although loans "under supervision" remain high at about 39 percent (Table 6). Banking system profitability is robust, but there are signs for concern. Dollarization is high at over 40 percent of deposits (slightly less than 20 percent of which are denominated in euros), and monetization and financial sector development remain modest, but not out of line with Moldova's level of per capita income.

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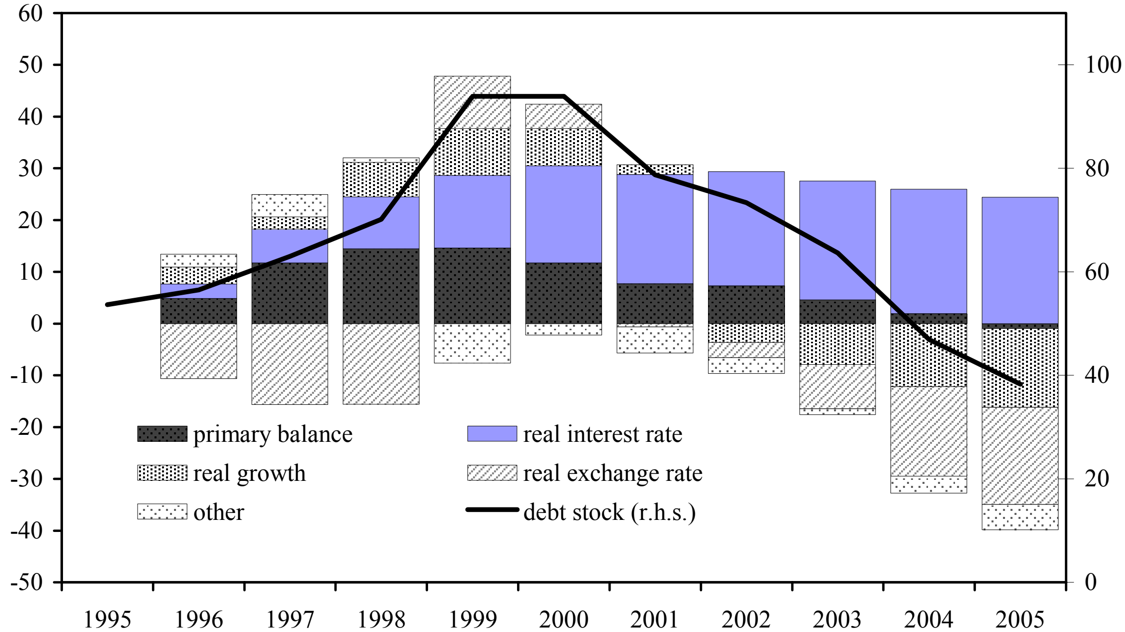
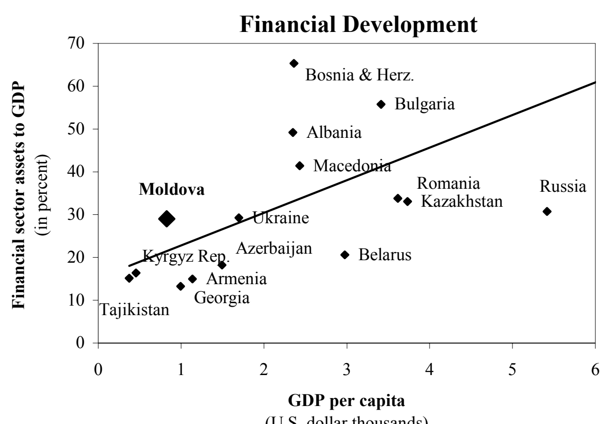
[15] In the program, staff have assumed rescheduling of about ¾ of the arrears at end-April.

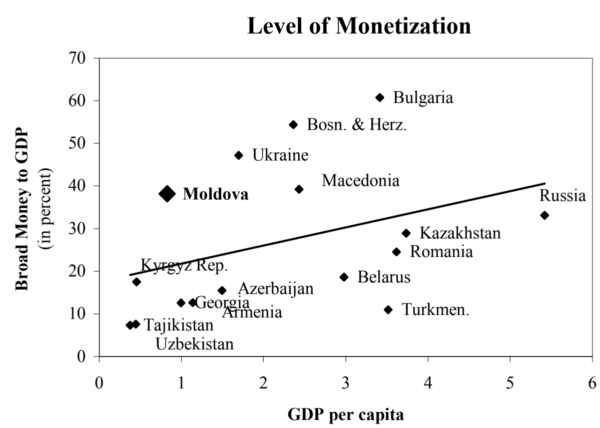
Public and Publicly Guaranteed Debt, 1995–2005
Debt stock and cumulative change in public debt/GDP ratio: decomposition



Sources: Moldovan authorities; and Fund staff calculations.



Source: WEO.



Source: WEO.

38. **Last year's FSAP pointed to a lack of transparency in bank ownership, a concern echoed by the EBRD.**[16] Opaque ownership increases the possibility that the NBM will miss instances of related-party lending. In response, the authorities have sought to

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[16] EBRD, *Transition Report 2005: Business in Transition*, November 2005.

implement a number of the FSAP recommendations (MEFP ¶26). Under the legislation passed in 2005, the threshold above which owners of banks must meet the "fit and proper" test was lowered from 10 percent to 5 percent. Although this change applies only to *new* shareholders, not retroactively, it does apply when existing shareholders buy or sell any shares, and thus should increase transparency over time.

39. **There was agreement on the importance of promoting competition in the Moldovan banking system**. High levels of profitability, while welcome, indicate that entrance by foreign banks might stimulate Moldovan banks to enhance services and thus facilitate intermediation. While the authorities noted that the Moldovan legal framework accommodates the entry of foreign banks, there was an acknowledgement that foreign banks are now more welcome than in the past. In this regard, staff welcomed the fact that several western European banks were establishing a presence in Moldova.[17]

40. **The government's announcement of its medium-term objective of privatizing Banca de Economii (BEM) to a strategic banking investor is an important step** (MEFP ¶27). With a large branch network, strong household deposit base, and healthy loan portfolio, staff argued that putting BEM in the hands of an experienced international bank would do much to promote competition in the banking system. During 2006, the authorities will select on a competitive basis an internationally-reputable company to perform a valuation of the bank; the valuation will be done in 2007, after which the bank will be brought to market. In the meantime, the authorities will refrain from affording BEM any special treatment, including in the form of tax preferences, prudential forbearance, or placement of government deposits.

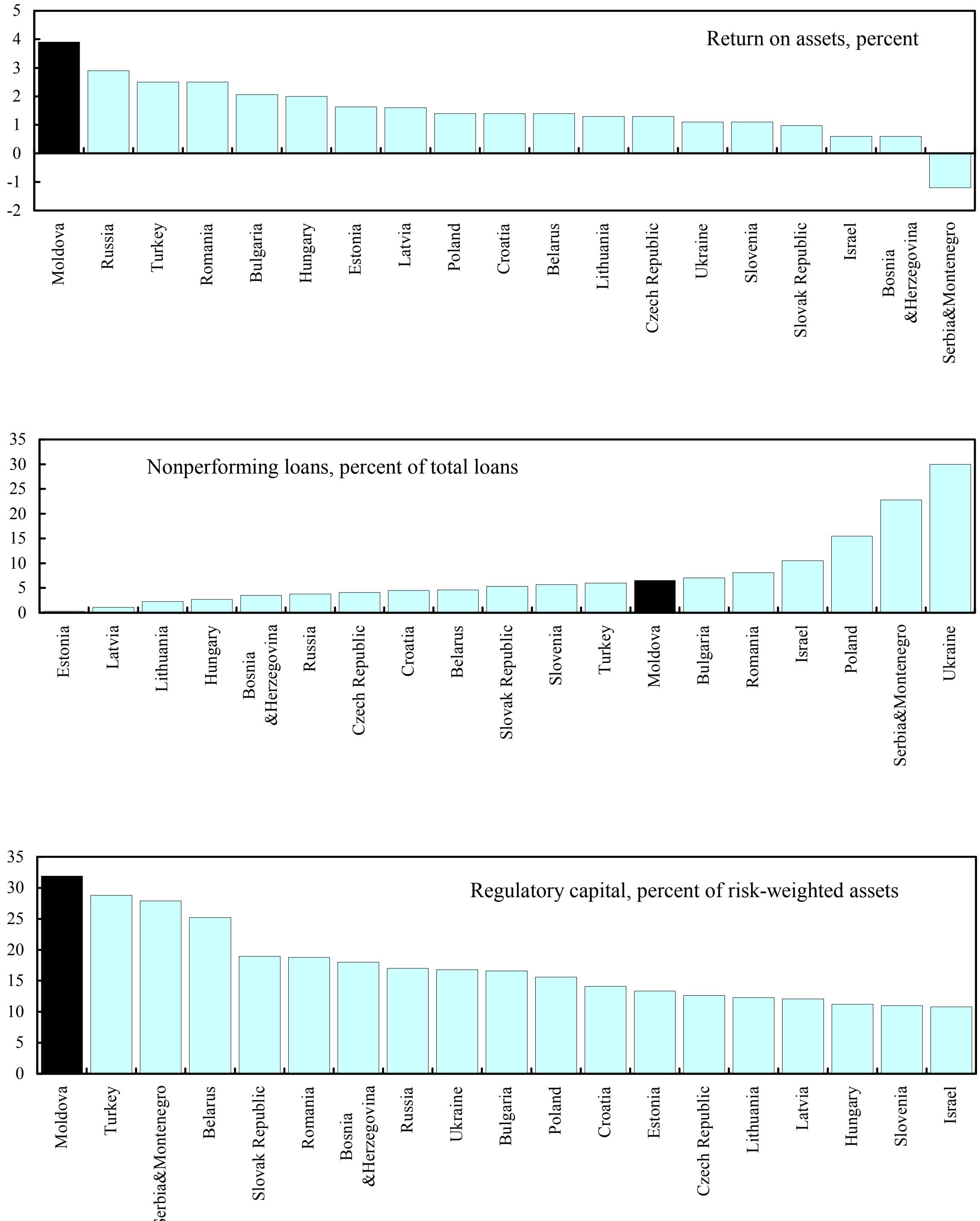
41. **The authorities are taking steps to enhance the effectiveness of their AML/CFT regime** (MEFP ¶28). They agreed to pass legislation requiring banks to report on suspicious transactions carried out between nonresidents, and they plan to respond to recommendations in the January 2005 MONEYVAL evaluation by preparing a thorough reform of the AML framework, for which they plan to request IMF technical assistance.

D. Structural Reform Agenda

42. **There was agreement that the authorities' macroeconomic and development objectives required implementation of an ambitious structural reform agenda**. By making progress on a set of reforms aimed at improving the business environment and clarifying the role of the state in the economy, the authorities felt they could also improve their credibility and thus demonstrate program ownership. Most of the reforms envisaged in the government's program fall in the category of steps designed to bring the 15-year transition process nearer to closure by establishing what the government should do, and what should be left to the private sector. For example, they are embarking on a multi-year effort to modernize the public administration, with assistance from international development partners

[17] Raiffeisen has opened a representative office in Chisinau, and one other bank is said to be acquiring an existing bank.

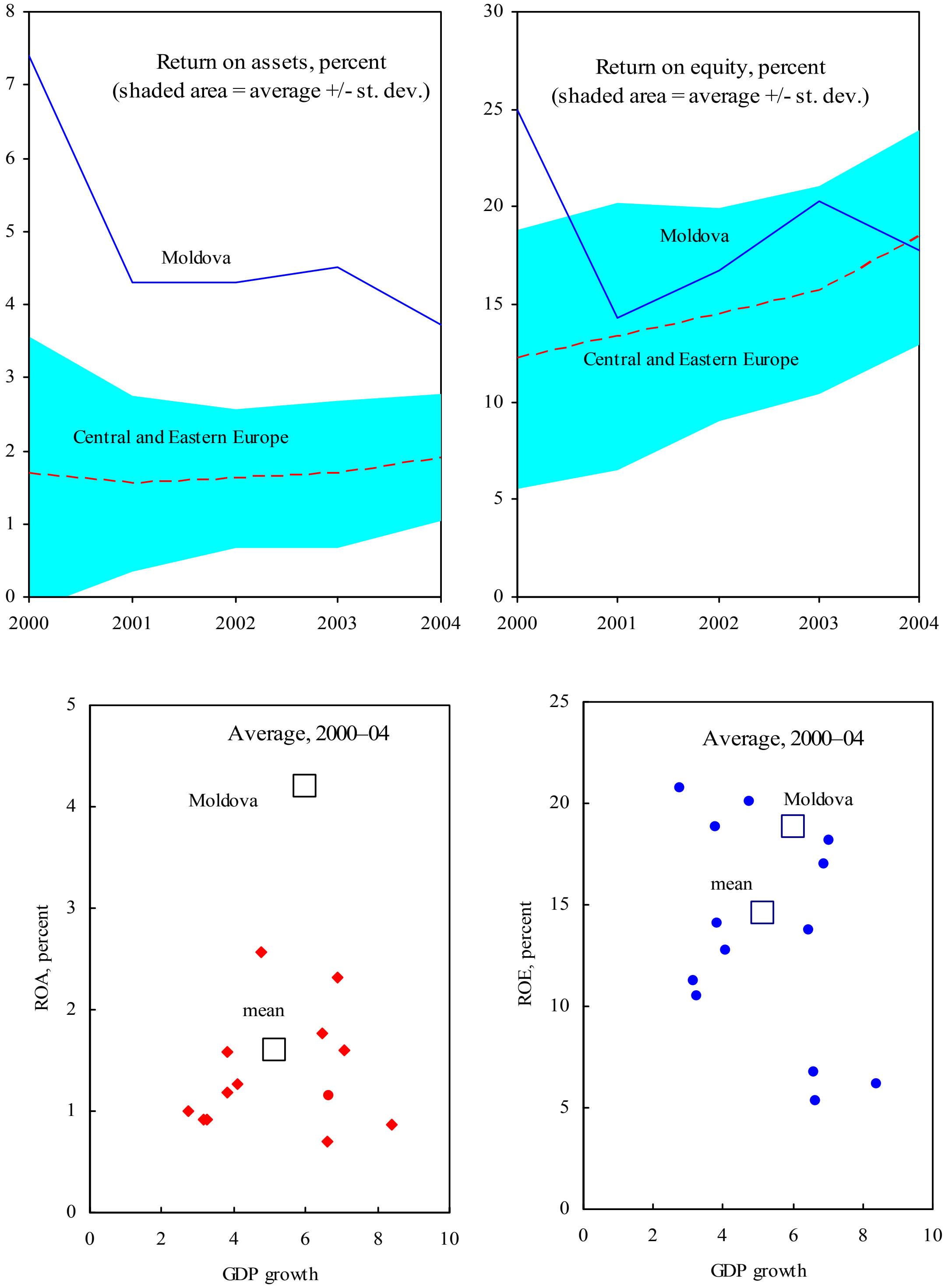
Financial Soundness Indicators, 2004



Source: Fund staff estimates and calculations.

Banking System Profitability, 2000–04

(Comparison with Emerging Markets in Central and Eastern Europe)



Source: NBM; and Fund staff estimates and calculations.

like the World Bank, UNDP and SIDA (MEFP ¶30). This effort, which aims to downsize in certain areas to make room for the staffing increases in other areas needed to bring Moldova's institutions in line with European norms, will begin with detailed functional reviews of all central government agencies during 2006. At the same time, the legal framework for the civil service is being modernized—with the aim of reducing corruption—via legislation meant to prevent conflicts-of-interest and to ensure the civil service is managed on apolitical grounds (MEFP ¶31).

43. **The authorities see their regulatory reform as being integral to the public administration reform** (MEFP ¶32). By eliminating unnecessary barriers to business activity, the regulatory reform should permit redeployment of civil servants to higher priority tasks (while eliminating the temptation for corruption). Key features of the reform include simplifying procedures for business registration and eliminating the need for many licenses and permits. Under their "guillotine" procedure, over 1000 regulations were examined by a committee including representatives of the business community and civil society, and over 100 were eliminated outright. The next step in this process is to apply the "guillotine" to the laws that gave rise to these regulations in the first place, and to introduce a regulatory impact assessment system to ensure that they do not simply reappear (MEFP ¶33).

44. **Public expenditure management is to be modernized in the context of a comprehensive World Bank project**. The IMF's Fiscal Affairs Department (FAD) is assisting with some aspects of this effort, chiefly related to treasury management and budget classification. In this context, there was agreement that the remaining commercial bank accounts of budget units (and the Social and Health Funds) should—in stages—be moved to the treasury single account (TSA) in the NBM (MEFP ¶35). FAD is also assisting the authorities to implement a system to track poverty-related spending through the treasury.

45. **The authorities agreed that management of state-owned enterprises (SOE) should be brought into line with best international practice**. In this, they benefited from participation in the second stage of FAD's pilot study on extending coverage of fiscal indicators to the SOE sector.[18] The authorities have developed a plan to introduce corporate governance principles in those SOEs that remain unincorporated, and to introduce greater transparency regarding the financial performance of all SOEs. In particular, management of SOEs that are not corporatized will be shifted from the branch ministries to Boards on which the ministries of finance and economy comprise a majority (MEFP ¶36). Beginning with the 2008 budget process, detailed information on SOE financial performance will be presented to parliament, which thereby will be better placed to assess whether dividends should be paid or whether the SOEs should in fact be privatized (MEFP ¶37).

V. PROGRAM ISSUES

46. **The authorities are requesting access to Fund resources under a three-year PRGF arrangement**. Consistent with Moldova's balance of payments need, cumulative

[18] IMF, "Public Investment and Fiscal Policy—Lessons from the Pilot Country Studies," April 1, 2005 (http://www.imf.org/external/np/pp/eng/2005/040105a.htm).

access would equal 65 percent of quota (SDR 80 million) under the proposed program (Table 9).[19] Disbursements would be phased in equal semiannual tranches (Table 11) on completion of reviews. The program would be monitored by quantitative performance criteria on net international reserves and net domestic assets of the NBM, the general government cash deficit,[20] and nonconcessional foreign borrowing. Intermediate quarterly indicative targets have been set for these variables, as well as reserve money. Proposed structural performance criteria and benchmarks are in the Fund's areas of expertise and are critical to achievement of the macroeconomic objectives of the program; they focus on the financial sector, tax administration, public finance and enterprise management, and trade liberalization (MEFP Table 1). These measures are aimed at ensuring macroeconomic stability, clarifying the role of the state in the economy (thus bringing the transition process nearer to closure), and stimulating financial sector development to promote growth.

Box 4. Medium-term Risks and Vulnerabilities

Staff expects growth to slow over the medium term, falling to about 5 percent per annum, given the impact of higher energy prices and emerging labor market shortages. Preventing a further deceleration depends on maintaining macroeconomic stability and on an acceleration in the implementation of structural reforms designed to improve the business environment. Much also depends on Moldova's ability to regularize its external debt outlook in 2006. Other significant risks include:

- Natural gas prices could rise rapidly to European levels;
- Farm exports to neighboring countries could be disrupted, possibly owing to a breakdown in talks on Transnistria;
- The authorities might again place greater weight on exchange rate stability than on disinflation; and
- Implementation of the program reform agenda could once again prove disappointing.

47. **The proposed program entails significant political and implementation risks, but these are much reduced in comparison with the past** (Box 4). The political environment is stable, the current government now has four years of experience in managing the economy, and the next round of elections are several years away. Moreover, Moldova's European aspirations provide comfort that the reform agenda will be advanced as planned. Nevertheless, in light of the disappointing experience with the 2001–03 PRGF arrangement, the program entails a relatively large number of prior actions, structural performance criteria,

[19] There is uncertainty regarding the amount of likely rescheduling by the Paris Club, and the amount of new financing from donors (including the EU and the World Bank). Additional financing would be used in the first instance to support infrastructure spending needed for poverty reduction, and then to bolster reserves, while shortfalls in relief—or donor financing—would be absorbed through further fiscal adjustment.

[20] Inclusive of externally-financed project loans, as well as grants.

and benchmarks designed to safeguard Fund resources by anchoring disbursements to reform implementation.[21]

VI. Staff Appraisal

48. **Moldova's growth performance over the past five years has been good**. Growth was financed in part by strong inflows of remittances from Moldovans working abroad, blunting the impact of continued structural impediments. While the fact that so many Moldovans felt the need to leave the country to earn a living partly reflects lack of economic opportunities at home, their remittances provided income support to their families, contributing to lower levels of poverty and improved performance towards the MDGs.

49. **The challenge now is to build on these favorable developments and set the stage for robust growth over the medium term**. In this context, the EU-Moldova Action Plan is crucial to sustain the needed consensus on the authorities' ambitious reform agenda. Moldova's European aspirations lie behind the renewed emphasis on reforms in recent years. Further, the Action Plan is consistent with the EGPRSP, and it will be important for the authorities to find ways to implement and monitor both plans in a way that avoids taxing their limited administrative capacity.

50. **The proposed macroeconomic framework is appropriately ambitious, targeting a gradual reduction of inflation from high single-digit levels at present**. It is nevertheless subject to uncertainties and risks, including significantly higher prices for imported natural gas, and the authorities will need to stand ready to adjust policies if needed to deliver their inflation objective. Deeper financial markets, stemming from greater competition in the banking sector, will help to ensure that the authorities can make use of the levers at their disposal, including deposit auctions, sales of central bank paper, and open-market operations with government securities.

51. **The authorities also need to be prepared to allow greater exchange rate flexibility—in both directions—to minimize risks to the disinflation path**. More flexibility in the exchange rate will help ensure that external competitiveness remains adequate, while also providing a buffer against external shocks. Amending the law on the National Bank to establish price stability as its key objective is therefore a welcome step, but it will then be important to align Moldova's de facto exchange rate regime with its de jure regime.

52. **Modest fiscal deficits are an appropriate compromise in the face of competing pressures**. Although on macroeconomic grounds the stance of fiscal policy needs to be tight to support the inflation objective and limit the BoP deterioration, Moldova is a poor country with extensive development needs. Deficits of 0.8 percent of GDP in 2006, falling to 0.5 percent over the medium term, balance macroeconomic considerations and debt sustainability against the need for concessional foreign borrowing for infrastructure development. In this regard, the authorities' efforts to reduce the tax burden and modernize

[21] The NBM is subject to a new Safeguards Assessment, which will be completed before the first review.

tax administration are welcome. Still, with expenditures at almost 40 percent of GDP, the size of government in Moldova is large when compared with other countries at a similar level of per capita income. Hence, the large increase in public sector wages in 2006 was regrettable, and the authorities are urged to ensure that, for the medium term, the wage profile remains consistent with the MTEF, and thus with their growth objectives. Moreover, repeating the fiscal overperformance of recent years—by expenditure restraint and saving any excess revenue—appears feasible and would help support the disinflation objective. By reducing the footprint of the state in the economy, the authorities can limit corruption and help make Moldova an attractive destination for investment. In this context, it will be important to ensure that assistance to the poor to deal with higher energy prices is well-targeted.

53. **Improving public sector management is a priority**. Moldova needs to carry forward public finance management reforms, such as the extension of the single treasury account and greater transparency in the budget process. These reforms will ensure that public resources are managed well and in a transparent way, which will also provide comfort to donors. In this regard, establishing a system to track poverty-related expenditures is very welcome.

54. **Modernization of public enterprise management is a key element of the authorities' reform agenda**. Steps to revitalize the privatization process and strengthening corporate governance in those firms where the state retains a majority share are commendable. Improved transparency regarding the financial performance of the public enterprise sector will help build ownership for the privatization process, as parliament and the public understand the true opportunity cost of keeping taxpayer resources tied up in poorly performing state enterprises.

55. **The authorities are right to focus on financial sector performance as a key bottleneck to growth**. Although financial sector stability indicators are healthy, it may derive as much from a lack of competition and dynamism in the Moldovan banking system as from prudential motives. Thus, ensuring greater transparency in banking ownership remains an important priority. Without a clear understanding of who are the ultimate beneficial owners of banking sector assets, the NBM is in a weak position to guard against risky practices, such as related-party lending, that could lead to financial sector instability. Strengthening the independence of the NBM should also help it to aggressively supervise financial institutions, even if their owners have politically-powerful connections.

56. **The recent arrival of foreign banks in Moldova is welcome but long-overdue, as it will bring new technology and fresh capital, as well as stimulate competition in the Moldovan financial sector**. The authorities' decision to privatize BEM to a strategic banking investor is an important step in this direction. In the meantime, by avoiding the use of BEM for quasi-fiscal purposes, or providing it with any special treatment, the authorities will see that there is little point in retaining state ownership of it.

57. **Improving the AML/CFT regime will be an important corollary to the steps to promote financial sector development**. Strengthening the AML law by requiring banks to report on suspicious transactions carried out between nonresidents will ensure that Moldova does not become a destination for criminal funds, which would have damaged the reputation

of the Moldovan banking system. Over time, a more fundamental reform of the AML/CFT regime is needed.

58. **As a small, open economy facing a challenging balance of payments outlook, Moldova cannot afford restrictions on exports**. The decision to remove the requirement that grain exports be transacted on the Moldovan Commodity Exchange is therefore welcome. Efforts to combat underinvoicing should focus on more traditional steps by the State Tax Inspectorate, including use of indirect methods of assessing tax liabilities.

59. **The authorities are urged to resolve their external arrears problem expeditiously**. Establishing an escrow account in the 2005 and 2006 budgets was a welcome step toward regularizing financial relations with creditor countries. Looking ahead, it will be important to ensure that prudent debt management practices are followed, particularly once financing availability picks up following the regularization of arrears.

60. **Overall, the proposed program is appropriately ambitious**. The authorities have demonstrated a good track record of implementation during 2005, and the support of the international community—particularly the European Union in the form of the EU-Moldova Action Plan—is reinforcing ownership at the highest levels for the proposed reform agenda. Civil society has been consulted through the EGPRSP process, and the Moldovan public seems supportive of the authorities' efforts to bring Moldovan institutions in line with European norms. On this basis, staff recommends approval of the authorities' request for the use of Fund resources under the three-year PRGF arrangement.

61. It is proposed that the next Article IV consultation with Moldova take place within 24 months subject to the provisions of the decision on consultation cycles in program countries.

Table 1. Moldova: Selected Indicators, 2001–08 1/

	2001	2002	2003	2004	2005	2006	2007	2008
					Est.		Projections	
I. Real sector indicators			(Percent change; unless otherwise indicated)					
Gross domestic product								
Real growth rate	6.1	7.8	6.6	7.4	7.1	6.0	5.0	5.0
Nominal GDP (millions of lei)	19,052	22,556	27,619	32,032	36,755	42,585	48,648	54,745
Nominal GDP (millions of U.S. dollars)	1,480	1,662	1,981	2,598	2,917	...	...	...
CPI Inflation (average)	9.8	5.3	11.7	12.5	11.9	9.4	8.7	7.5
CPI Inflation (end of period, y-o-y)	6.4	4.4	15.7	12.6	10.0	9.0	8.0	7.0
Average monthly wage (lei)	519	704	912	1,116	1,330	...	...	...
Average monthly wage (U.S. dollars)	40	52	65	91	105	...	...	...
II. Fiscal Indicators (general government)			(In percent of GDP)					
Primary balance (cash)	3.8	0.7	2.3	2.7	3.0	0.6	0.9	0.6
Overall balance (cash)	-0.4	-1.4	0.2	0.8	1.7	-0.8	-0.5	-0.5
Overall balance (commitments)	-0.5	-0.5	-0.2	0.5	1.7	-0.8	-0.5	-0.5
Overall balance (commitments), excluding foreign-loan-financed projects	0.5	0.9	1.0	1.4	2.6	0.3	0.8	0.3
Stock of general government debt 2/	80.1	74.8	60.3	47.2	39.0	33.5	30.3	27.6
III. Financial indicators			(Percent change; unless otherwise indicated)					
Broad money (M3)	36.4	36.0	30.7	37.7	35.0	29.4	...	...
Velocity (GDP/end-period M3; ratio)	4.0	3.4	3.2	2.7	2.3	2.1	...	...
Reserve money	27.9	31.1	16.6	39.7	31.8	16.0	...	...
Credit to the economy	35.4	35.2	44.4	22.2	35.0	25.6	...	...
IV. External sector indicators								
Current account balance (millions of U.S. dollars)	-37.0	-72.5	-135.2	-70.6	-164.3	-177.8	-203.2	-228.3
Current account balance (percent of GDP)	-2.5	-4.4	-6.8	-2.7	-5.6	-5.4	-5.5	-5.4
Remittances (compensation plus transfers), net (millions	203	290	445	666	905	1,104	1,214	1,323
Gross official reserves (millions of U.S. dollars) 3/	229	269	302	470	597	750	931	1,124
Gross official reserves (months of imports)	2.1	1.9	1.7	2.1	2.2	2.5	2.8	3.1
Exchange rate (MDL/$) period average	12.9	13.6	13.9	12.3	12.6	...	...	...
Exchange rate (MDL/$) end of period	13.1	13.8	13.2	12.5	12.8	...	...	...
Real effective exchange rate, change (percent)	-1.2	-6.1	-5.4	13.1	-0.1	1.0	0.1	2.3
External debt/GDP (percent) 4/	105.1	100.8	88.7	63.8	54.7	51.3	49.7	47.3
Debt service/exports of goods and services (percent) 4/	24.6	27.9	19.8	21.3	20.2	14.5	12.9	12.8

Social indicators, reference year

Per capita GDP, U.S. dollars: 766 (2004) **Population below poverty line, percent**: 26.5 (2004)

Life expectancy, male, years: 64.5 (2003) **Life expectancy, female, years**: 71.6 (2003)

Sources: Moldovan authorities; and Fund staff estimates.

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

Table 2. Moldova: Balance of Payments, 2001–08
(In millions of U.S. dollars; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008
					Est.	Projections		
Current account	-37.0	-72.5	-135.2	-70.6	-164.3	-177.8	-203.2	-228.3
Merchandise trade balance	-315.1	-377.8	-623.0	-754.2	-1,162.0	-1,432.6	-1,583.3	-1,738.8
Exports of goods	564.6	659.7	805.1	994.1	1,093.5	1,240.0	1,401.2	1,555.3
Imports of goods	-879.7	-1,037.5	-1,428.1	-1,748.2	-2,255.5	-2,672.6	-2,984.5	-3,294.1
Of which : energy	-201.1	-194.2	-232.8	-308.6	-455.9	-603.0	-637.7	-672.7
Non-energy	-678.6	-843.3	-1,195.3	-1,439.7	-1,799.6	-2,069.5	-2,346.8	-2,621.4
Balance of services	-37.9	-40.3	-45.5	-37.0	1.9	15.6	17.6	19.5
Exports of services	170.9	216.7	254.2	336.7	441.1	542.6	613.1	680.5
Imports of services	-208.8	-257.0	-299.8	-373.8	-439.2	-527.0	-595.5	-661.0
Income (net)	95.8	109.4	229.2	356.7	440.7	562.0	617.6	679.0
Compensation of employees	123.0	189.0	294.0	445.0	551.8	673.2	740.5	807.2
Income on direct and portfolio investment	17.5	-38.5	-31.3	-55.0	-58.3	-66.4	-74.6	-83.8
Income on other investment	-44.6	-41.1	-33.6	-33.3	-52.7	-44.8	-48.3	-44.3
Current transfers (net)	220.1	236.3	304.2	363.9	555.1	677.2	744.9	811.9
Of which: remittances, net	79.8	100.6	151.2	220.6	353.0	430.6	473.7	516.3
Capital and financial account	-3.7	47.8	49.2	93.1	182.5	316.7	343.5	349.2
Capital account	-20.7	-15.3	-12.8	-10.9	-9.0	-8.0	-8.0	-8.0
Financial account	17.0	63.1	62.0	103.9	191.5	324.7	351.5	357.2
Direct investment	52.9	132.2	78.2	77.3	175.0	217.0	242.3	280.9
Portfolio investment (net)	-7.1	-27.4	-23.8	-9.8	-10.0	-10.0	-10.0	-10.0
Other investments	-28.8	-41.7	7.6	35.8	26.4	117.7	119.2	86.3
Loans	8.1	-11.4	-7.4	37.3	17.6	62.7	64.2	31.3
Government	-14.3	-12.6	-25.1	-19.1	-28.1	-9.0	2.2	-14.8
Disbursements	15.3	20.4	22.9	22.7	23.5	38.5	47.9	32.1
Amortization	-29.6	-33.0	-48.0	-41.8	-51.7	-47.5	-45.6	-46.9
Private net	22.4	1.2	17.7	56.5	45.8	71.6	62.0	46.1
Other capital flows	-36.9	-30.3	14.9	-1.5	8.8	55.0	55.0	55.0
Errors and omissions	16.1	-22.5	70.3	121.7	110.0	0.0	0.0	0.0
Overall balance	-24.6	-47.1	-15.7	144.1	128.2	138.9	140.4	120.9
Financing	24.6	47.1	15.7	-144.1	-128.2	-232.3	-202.3	-212.5
Use of Fund credit	-2.4	-5.5	-22.3	-21.6	-21.4	-23.5	-20.8	-19.8
Change of gross official reserves (increase -)	-9.5	-27.0	-14.1	-148.0	-127.2	-152.6	-181.5	-192.7
Exceptional financing	36.4	79.6	52.0	25.5	20.4	-56.3	0.0	0.0
o/w accumulation of arrears on public debt	10.4	33.6	44.6	42.4	26.2	9.3	0.0	0.0
Financing gap 1/	...	...	...	...	...	93.4	61.9	91.6
Expected EU Assistance	...	...	...	...	...	11.0	15.0	10.0
World Bank PRSC	...	...	...	...	...	2.0	4.0	4.0
IMF	...	...	...	...	...	32.7	32.7	32.7
Residual 2/	...	...	...	...	...	47.7	10.2	44.9
Memorandum items :								
Gross official reserves (millions of U.S. dollars)	228.5	268.8	302.3	470.2	597.4	750.0	931.5	1,124.2
in months of imports of goods and services	2.1	1.9	1.7	2.1	2.2	2.5	2.8	3.1
Nominal GDP (millions of U.S. dollars)	1,480.3	1,661.8	1,980.6	2,597.9	2,917.2	...	...	...
Current account balance (percent of GDP)	-2.5	-4.4	-6.8	-2.7	-5.6	-5.4	-5.5	-5.4
G&S trade balance (percent of GDP)	-23.8	-25.2	-33.8	-30.5	-39.8	-42.7	-42.0	-41.0
Exports G&S (percent of GDP)	49.7	52.7	53.5	51.2	52.6	53.7	54.0	53.3
Exports G&S growth (percent)	14.7	19.1	20.9	25.6	15.3	16.2	13.0	11.0
Imports G&S (percent of GDP)	-73.5	-77.9	-87.2	-81.7	-92.4	-96.4	-96.0	-94.3
Imports G&S growth (percent)	12.0	18.9	33.5	22.8	27.0	18.7	11.9	10.5
Remittances (compensation plus transfers), net (millions of U.S. dollars)	202.8	289.6	445.2	665.6	904.8	1,103.8	1,214.2	1,323.5
Total debt service/exports G&S (percent)	24.6	27.9	19.8	21.3	20.2	14.5	12.9	12.8
External debt stock (percent of GDP) 3/	105.1	100.8	88.7	63.8	54.7	51.3	49.7	47.3
External arrears (millions of U.S. dollars)	17.5	42.9	86.1	50.6	56.3	0.0	0.0	0.0

Sources: National Bank of Moldova and Fund staff estimates.

1/ After 200m lei drawdown from escrow account (to partially clear arrears)
2/ Including possible Paris Club rescheduling.
3/ Including energy arrears.

Table 3. Moldova: General Government Budget, 2001–08 1/
(Millions of lei; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008
					Est.	Projections		
Revenues and grants	5,556	6,668	9,383	11,324	14,519	16,333	18,634	20,620
Revenues	5,394	6,537	8,328	10,162	12,823	15,026	17,227	19,421
Tax revenues	4,645	5,827	7,597	9,545	11,888	14,137	16,266	18,384
Profit tax	350	428	578	780	709	878	1,084	1,247
Personal income tax	348	468	623	797	962	1,040	1,192	1,383
VAT	1,498	2,034	2,792	3,428	4,623	5,838	6,645	7,451
Excises	681	658	888	910	1,172	1,155	1,222	1,329
Foreign trade taxes	234	333	477	496	681	685	810	873
Other taxes	231	263	259	317	327	329	413	449
Social Fund contributions	1,304	1,644	1,978	2,493	2,972	3,686	4,248	4,844
Health Fund contributions	...	...	2	326	442	526	651	807
Non-tax revenues	749	710	731	617	935	890	961	1,037
Grants	163	130	73	125	460	219	315	96
Revenues of special funds 1/	...	...	982	1,036	1,237	1,088	1,092	1,103
Expenditures and net lending (cash) 1/	5,605	7,114	9,201	11,092	13,937	16,683	18,869	20,899
National Economy	319	417	999	1,351	1,964	1,945	2,223	2,004
Social sphere	1,795	2,489	3,503	3,341	4,019	4,528	4,566	4,747
Education	923	1,240	1,841	2,169	2,697	2,905	3,073	3,256
Health care 2/	542	792	1,068	403	464	503	461	425
Other	329	457	594	770	858	1,120	1,032	1,067
Interest payments	797	486	580	612	471	627	670	586
Other expenditures	926	1,251	1,898	2,139	2,722	3,682	4,219	4,925
Social Fund expenditures	1,373	1,900	2,261	2,769	3,692	4,414	5,292	6,249
Health Fund expenditures	...	...	12	938	1,108	1,528	1,921	2,416
Net lending	-17	-78	-52	-57	-39	-40	-21	-28
Balance of special funds 1/	23	44	...	...	...	...	...	...
Statistical discrepancy	0	80	-116	28	53	0	0	0
Overall surplus(+)/deficit(-) (cash)	**-67**	**-322**	**66**	**260**	**634**	**-350**	**-236**	**-279**
Primary balance (cash)	730	164	646	872	1,105	277	434	308
(excl. project loan spending)	920	498	984	1,150	1,432	771	1,058	727
Change in arrears (+, increase)	29	-202	122	102	4	0	0	0
Domestic expenditure	-15	-294	-58	-9	4	0	0	0
External interest	44	92	180	111	0	0	0	0
Overall surplus(+)/deficit(-) (commitments)	**-96**	**-120**	**-56**	**158**	**630**	**-350**	**-236**	**-279**
Primary balance (commitments)	745	458	704	881	1,101	277	434	308
(excl. project loan spending)	935	792	1,042	1,159	1,428	771	1,058	727
Financing	67	322	-66	-260	-634	350	236	279
Budget financing	-123	-12	-404	-530	-961	-144	-389	-140
Central government	-123	246	-313	-429	-943	-323	-419	-165
Net domestic	413	417	109	592	-597	212	-146	-194
Net foreign	-621	-315	-473	-1,044	-380	-1,342	-595	-612
Privatization	85	144	51	23	34	28	26	24
Financing gap	**0**	**0**	**0**	**0**	**0**	**779**	**297**	**618**
Local governments	...	-75	-24	6	151	100	30	25
Social fund	...	-184	-68	-67	5	78	0	0
Health fund	0	...	0	-39	-174	0	0	0
Project loans	190	334	338	270	327	494	625	419
Memorandum item:								
GDP (millions of lei)	19,052	22,556	27,619	32,032	36,755	42,585	48,648	54,745

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ 2006 is the staff's projection based on the authorities' 2006 budget. Revenues and expenditures of special funds shown on a gross basis from 2003.
2/ From 2004, excludes expenditure of the Health Fund, which is shown as a separate item.

Table 3 (continued). Moldova: General Government Budget, 2001–08 1/
(In percent of GDP; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008
					Est.	Projections		
Revenues and grants	29.2	29.6	34.0	35.4	39.5	38.4	38.3	37.7
Revenues	28.3	29.0	30.2	31.7	34.9	35.3	35.4	35.5
Tax revenues	24.4	25.8	27.5	29.8	32.3	33.2	33.4	33.6
Profit tax	1.8	1.9	2.1	2.4	1.9	2.1	2.2	2.3
Personal income tax	1.8	2.1	2.3	2.5	2.6	2.4	2.5	2.5
VAT	7.9	9.0	10.1	10.7	12.6	13.7	13.7	13.6
Excises	3.6	2.9	3.2	2.8	3.2	2.7	2.5	2.4
Foreign trade taxes	1.2	1.5	1.7	1.5	1.9	1.6	1.7	1.6
Other taxes	1.2	1.2	0.9	1.0	0.9	0.8	0.8	0.8
Social Fund contributions	6.8	7.3	7.2	7.8	8.1	8.7	8.7	8.8
Health Fund contributions	...	...	...	1.0	1.2	1.2	1.3	1.5
Non-tax revenues	3.9	3.1	2.6	1.9	2.5	2.1	2.0	1.9
Grants	0.9	0.6	0.3	0.4	1.3	0.5	0.6	0.2
Revenues of special funds 1/	...	...	3.6	3.2	3.4	2.6	2.2	2.0
Expenditures and net lending (cash) 1/	29.4	31.5	33.3	34.6	37.9	39.2	38.8	38.2
National Economy	1.7	1.8	3.6	4.2	5.3	4.6	4.6	3.7
Social sphere	9.4	11.0	12.7	10.4	10.9	10.6	9.4	8.7
Education	4.8	5.5	6.7	6.8	7.3	6.8	6.3	5.9
Health care 2/	2.8	3.5	3.9	1.3	1.3	1.2	0.9	0.8
Other	1.7	2.0	2.2	2.4	2.3	2.6	2.1	1.9
Interest payments	4.2	2.2	2.1	1.9	1.3	1.5	1.4	1.1
Domestic	1.8	0.6	1.2	1.2	0.5	0.8	0.7	0.5
Foreign	2.4	1.5	0.9	0.7	0.8	0.7	0.6	0.5
Other expenditures	4.9	5.5	6.9	6.7	7.4	8.6	8.7	9.0
Social Fund expenditures	7.2	8.4	8.2	8.6	10.0	10.4	10.9	11.4
Health Fund expenditures	...	...	...	2.9	3.0	3.6	3.9	4.4
Net lending	-0.1	-0.3	-0.2	-0.2	-0.1	-0.1	0.0	-0.1
Balance of special funds 1/	0.1	0.2	...	...	...	...	...	...
Statistical discrepancy	-0.2	0.4	-0.4	0.1	0.1	...	...	...
Overall surplus(+)/deficit(-) (cash)	**-0.4**	**-1.4**	**0.2**	**0.8**	**1.7**	**-0.8**	**-0.5**	**-0.5**
Primary balance (cash)	3.8	0.7	2.3	2.7	3.0	0.6	0.9	0.6
(excl. project loan spending)	4.8	2.2	3.6	3.6	3.9	1.8	2.2	1.3
Change in arrears (+, increase)	0.2	-0.9	0.4	0.3	0.0	0.0	0.0	0.0
Domestic expenditure	-0.1	-1.3	-0.2	0.0	0.0	0.0	0.0	0.0
External interest	0.2	0.4	0.7	0.3	0.0	0.0	0.0	0.0
Overall surplus(+)/deficit(-) (commitments)	**-0.5**	**-0.5**	**-0.2**	**0.5**	**1.7**	**-0.8**	**-0.5**	**-0.5**
Primary balance (commitments)	3.9	2.0	2.5	2.7	3.0	0.6	0.9	0.6
(excl. project loan spending)	4.9	3.5	3.8	3.6	3.9	1.8	2.2	1.3
Financing	0.4	1.4	-0.2	-0.8	-1.7	0.8	0.5	0.5
Budget financing	-0.6	-0.1	-1.5	-1.7	-2.6	-0.3	-0.8	-0.3
Central government	-0.6	1.1	-1.1	-1.3	-2.6	-0.8	-0.9	-0.3
Net domestic	2.2	1.9	0.4	1.8	-1.6	0.5	-0.3	-0.4
Net foreign	-3.3	-1.4	-1.7	-3.3	-1.0	-3.2	-1.2	-1.1
Privatization	0.4	0.6	0.2	0.1	0.1	0.1	0.1	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**1.8**	**0.6**	**1.1**
Local governments	...	-0.3	-0.1	0.0	0.4	0.2	0.1	0.0
Social fund	...	-0.8	-0.2	-0.2	0.0	0.2	0.0	0.0
Health fund	0.0	...	...	-0.1	-0.5	0.0	0.0	0.0
Project loans	1.0	1.5	1.2	0.8	0.9	1.2	1.3	0.8
Memorandum item:								
GDP (millions of lei)	19,052	22,556	27,619	32,032	36,755	42,585	48,648	54,745

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ 2006 is the staff's projection based on the authorities' 2006 budget. Revenues and expenditures of special funds shown on a gross basis from 2003.
2/ From 2004, excludes expenditure of the Health Fund, which is shown as a separate item.

Table 3a. Moldova: General Government Budget, 2004–06 1/
(Millions of lei; unless otherwise indicated)

	2004	2005	2006			
		Est.	Q1	Q2	Q3	Q4
			Projections			
Revenues and grants	11,324	14,519	3,194	7,139	11,558	16,333
Revenues	10,162	12,823	2,950	6,620	10,599	15,026
Tax revenues	9,545	11,888	2,694	6,069	9,875	14,137
Profit tax	780	709	259	454	634	878
Personal income tax	797	962	208	464	745	1,040
VAT	3,428	4,623	1,032	2,448	4,071	5,838
Excises	910	1,172	199	476	803	1,155
Foreign trade taxes	496	681	122	291	478	685
Other taxes	317	327	45	130	228	329
Social Fund contributions	2,493	2,972	709	1,555	2,540	3,686
Health Fund contributions	326	442	121	252	376	526
Non-tax revenues	617	935	256	551	723	890
Grants	125	460	65	124	174	219
Revenues of special funds 1/	1,036	1,237	179	394	786	1,088
Expenditures and net lending (cash) 1/	11,092	13,937	3,441	7,555	11,862	16,683
National Economy	1,351	1,964	365	782	1,403	1,945
Social sphere	3,341	4,019	1,013	2,113	3,187	4,528
Education	2,169	2,697	688	1,441	2,106	2,905
Health care 2/	403	464	99	214	354	503
Other	770	858	226	458	728	1,120
Interest payments	612	471	137	264	440	627
Other expenditures	2,139	2,722	618	1,616	2,516	3,682
Social Fund expenditures	2,769	3,692	987	2,100	3,306	4,414
Health Fund expenditures	938	1,108	336	703	1,046	1,528
Net lending	-57	-39	-15	-23	-37	-40
Balance of special funds 1/	...	...	0	0	0	0
Statistical discrepancy	28	53	0	0	0	0
Overall surplus(+)/deficit(-) (cash)	**260**	**634**	**-247**	**-417**	**-303**	**-350**
Primary balance (cash)	872	1,105	-110	-153	137	277
(excl. project loan spending)	1,150	1,432	20	78	498	771
Change in arrears (+, increase)	102	4	0	0	0	0
Domestic expenditure	-9	4	0	0	0	0
External interest	111	0	0	0	0	0
Overall surplus(+)/deficit(-) (commitments)	**158**	**630**	**-247**	**-417**	**-303**	**-350**
Primary balance (commitments)	881	1,101	-110	-153	137	277
(excl. project loan spending)	1,159	1,428	20	78	498	771
Financing	-260	-634	247	417	303	350
Budget financing	-530	-961	116	186	-58	-144
Central government	-429	-943	-38	-127	-358	-323
Net domestic	592	-597	29	212	57	212
Net foreign	-1,044	-380	-69	-995	-1,155	-1,342
Privatization	23	34	2	14	23	28
Financing gap	**0**	**0**	**0**	**642**	**717**	**779**
Local governments	6	151	61	105	126	100
Social fund	-67	5	128	259	255	78
Health fund	-39	-174	-35	-50	-81	0
Project loans	270	327	130	231	362	494
Memorandum item:						
GDP (millions of lei)	32,032	36,755	...	...	...	42,585

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ 2006 is the staff's projection based on the authorities' 2006 budget.

2/ From 2004, excludes expenditure of the Health Fund, which is shown as a separate item.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2003–06
(Millions of lei; unless otherwise indicated)

	2003	2004	2005				2006			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
							Projections			
National Bank of Moldova										
Net foreign assets	2,112	4,523	4,748	5,130	6,087	6,433	6,410	6,791	7,866	8,276
NFA (convertible)	2,113	4,285	4,386	4,710	6,087	6,436	6,410	6,791	7,866	8,276
Gross reserves	3,996	5,860	5,819	6,075	7,329	7,666	7,523	8,080	9,022	9,624
Reserve liabilities	-1,883	-1,575	-1,433	-1,365	-1,242	-1,230	-1,113	-1,289	-1,155	-1,348
Net domestic assets	1,692	791	878	221	-264	569	60	55	-477	-150
Net claims on general government	2,172	2,696	2,476	2,162	1,955	2,291	2,218	2,143	2,035	2,062
Credit to banks	-21	-1,169	-1,017	-1,487	-1,754	-1,186	-1,686	-1,610	-2,000	-1,628
Other items (net)	-459	-737	-581	-455	-465	-536	-472	-479	-512	-584
Reserve money	3,804	5,313	5,626	5,351	5,823	7,002	6,470	6,846	7,390	8,126
Currency in circulation	2,740	3,700	3,656	3,895	4,350	4,571	4,646	5,032	5,450	5,815
Banks' reserves	1,064	1,611	1,970	1,455	1,468	2,431	1,824	1,814	1,940	2,311
Required reserves	819	708	618	625	713	795	842	831	921	1,036
Excess reserves	245	903	1,352	830	756	1,635	982	983	1,019	1,275
Monetary Survey										
Net foreign assets	2,800	4,896	5,183	5,673	6,958	7,335	7,490	7,781	8,766	9,175
NFA (convertible)	2,726	4,686	4,808	5,225	6,924	7,332	7,490	7,781	8,766	9,175
of which: commercial banks	613	401	422	515	837	895	1,080	990	900	900
NFA (non-convertible)	74	211	375	448	34	6	0	0	0	0
Net domestic assets	5,709	6,823	6,920	7,673	7,976	8,492	8,669	9,815	10,357	11,299
Net claims on general government	1,823	2,307	2,295	2,266	1,871	1,388	1,566	1,902	1,725	1,747
Credit to economy	6,055	7,399	7,619	8,118	8,977	9,990	10,217	10,732	11,619	12,552
Other items (net)	-2,169	-2,883	-2,994	-2,711	-2,872	-2,886	-3,114	-2,819	-2,987	-3,001
Broad Money (M3)	8,509	11,720	12,103	13,346	14,933	15,827	16,159	17,595	19,123	20,474
Broad Money (M2: excluding FCD)	5,622	8,137	8,433	9,258	10,506	11,126	11,404	12,545	13,873	15,211
Currency in circulation	2,740	3,700	3,656	3,895	4,350	4,571	4,646	5,032	5,450	5,815
Total deposits	5,768	8,019	8,447	9,450	10,583	11,255	11,513	12,563	13,673	14,659
Domestic currency deposits	2,881	4,437	4,776	5,363	6,156	6,554	6,758	7,513	8,423	9,397
Foreign currency deposits (FCD)	2,887	3,583	3,670	4,087	4,427	4,701	4,755	5,050	5,250	5,263
Memorandum items:										
Reserve money growth (percent change; quarterly)	2.7	6.3	5.9	-4.9	8.8	20.3	-7.6	5.8	7.9	10.0
Reserve money growth (percent change; annual)	16.6	39.7	45.5	27.3	16.4	31.8	15.0	27.9	26.9	16.0
Broad money growth (percent change; quarterly)	3.8	12.9	3.3	10.3	11.9	6.0	2.1	8.9	8.7	7.1
Broad money growth (percent change; annual)	30.7	37.7	39.8	46.7	43.8	35.0	33.5	31.8	28.1	29.4
Credit to economy, (percent change, annual)	44.4	22.2	23.5	29.1	31.1	35.0	34.1	32.2	29.4	25.6
Net credit to government, (percent change, annual)	6.6	24.1	18.6	-15.7	-17.2	-15.0	-10.4	-0.9	4.1	-10.0
Gross international reserves (millions of U.S. dollars)	302.3	470.2	461.2	482.8	582.1	597.4	586.3	629.7	703.1	750.0
Net international reserves (millions of U.S. dollars)	159.8	343.8	347.6	374.3	483.4	501.6	499.5	529.2	613.0	644.9
Velocity (M3; end of period)	3.2	2.7	2.8	2.6	2.4	2.3	2.3	2.1	2.0	2.1
Broad money multiplier	2.2	2.2	2.2	2.5	2.6	2.3	2.5	2.6	2.6	2.5
Share of foreign currency deposits in all deposits	50.1	44.7	43.5	43.3	41.8	41.8	41.3	40.2	38.4	35.9

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

Table 5. Moldova: Energy Imports, 2003–08 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008
			Est.		Projections	
Energy imports, total	**232.8**	**308.6**	**455.9**	**603.0**	**637.7**	**672.7**
Natural gas	79.5	83.6	115.8	194.3	221.0	249.9
Billion m^3	1.2	1.3	1.5	...	...	...
Price per 1000 m^3, USD	64.2	66.4	75.8	...	...	...
Fuel, total	143.4	215.7	331.8	400.5	408.6	414.7
Fuel oil	2.7	3.1	4.8	5.8	5.9	6.0
Thousand tons	21.5	19.6	21.0	22.2	23.4	24.5
Price per ton, USD	126.5	159.8	229.5	261.3	253.9	245.4
Diesel	65.5	101.1	155.5	187.6	191.4	194.3
Thousand tons	284.8	303.3	324.8	344.3	361.5	379.6
Price per ton, USD	229.9	333.2	478.6	545.0	529.5	511.9
Gasoline	51.3	79.6	122.4	147.8	150.8	153.0
Thousand tons	202.6	212.4	227.4	241.1	253.1	265.8
Price per ton, USD	253.2	374.8	538.3	613.0	595.6	575.8
Other	24.0	31.9	49.1	59.2	60.4	61.4
Coal	9.9	9.3	8.3	8.3	8.1	8.0
Thousand tons	266.8	185.0	198.1	210.0	220.5	231.5
Price per ton, USD	37.1	50.0	42.0	39.3	36.6	34.7
Memorandum items:						
Energy imports, percent of GDP	11.8	11.9	15.6	18.2	17.1	16.1

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

Table 6. Moldova: Financial Sector Indicators, 2000–05
(End-of-period; in percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005
Size						
Number of banks	20	19	16	16	16	16
Total assets of the banking system (in percent of GDP)	29	31	35	38	42	49
Credit to nongovernment sector (in percent of GDP)	14	16	19	22	23	27
Capital adequacy						
Capital adequacy ratio 1/	49	43	36	32	31	27
Liquidity						
Liquidity ratio 2/	67	60	56	48	53	52
Asset quality 3/						
Non-performing loans as a share of total loans	21	10	8	6	7	4
Nonperforming loans, net of loan loss provisions / tier one capital	15	5	3	2	3	-3
Loans under supervision as a share of total loans	30	31	35	35	34	39
Non-performing and loans under supervision as a share of total loans	51	41	43	42	41	43
Profitability						
Return on equity	25.0	14.3	16.7	19.7	17.8	17.3
Return on assets	7.4	4.3	4.3	4.4	3.7	3.2
Non-interest income / Total income	39.2	35.5	40.1	37.6	35.2	33.8
Interest rates						
Domestic currency average lending rate	32	26	19	19	21	17
Domestic currency average deposit rate	24	18	13	14	16	11
Interest rate spread, domestic currency	9	8	7	5	6	7
Foreign currency average lending rate	15	12	12	11	11	11
Foreign currency average deposit rate	5	3	3	4	5	5
Interest rate spread, foreign currency	10	9	9	7	6	5
91 day T-bill (effective nominal yield)	25	8	11	18	7	4
Foreign currency deposits						
Share of foreign currency deposits in broad money	28	28	31	34	31	30
Share of foreign currency deposits in all deposits	49	45	47	50	45	42

Source: National Bank of Moldova

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

Table 7: Moldova: Localized Millennium Development Goals (EGPRSP)

	2000	2001	2002	Most recent	Targets: 2006	2010	2015
Goal: Eradicate extreme poverty and hunger							
Target: Reduce by half the proportion of persons with daily income below 2.15 USD (PPP) over the period 1997-2015							
▪ Population with income below $2.15 (PPP) a day (%)	64.5	52.4	39.8	27.8 (2004)	28.0	23.0	18.0
Goal: Achieve universal access to secondary school education							
Target: Ensure equal opportunities for all children to study in secondary schools							
▪ Net enrollment ratio in secondary education (%)	87.0	86.8	87.9	87.5 (2003)	88.9	93.8	100.0
Goal: Reduce child mortality							
Target: Reduce by two-thirds the under-five mortality rate over the period 1990-2015							
▪ Under-five mortality rate (per 1,000)	23.3	20.3	18.2	15.3 (2004)	15.0	11.9	8.4
▪ Infant mortality rate (per 1,000 live births)	18.3	16.3	14.7	12.2 (2004)	12.1	9.6	6.3
▪ Immunization , measles (% of children under 2 years old)	98.6	99.4	99.1	n/a	100.0	100.0	100.0
Goal: Improve maternal health							
Target: Reduce the maternal mortality ratio by three-fourths over the period 1990-2015							
▪ Maternal mortality ratio (per 100,000 births)	27.1	43.9	28.0	23.5 (2004)	23.0	21.0	13.3
▪ Births attended by skilled health personnel (%)	98.0	99.0	99.0	n/a	100.0	100.0	100.0
Goal: Combat HIV/AIDS, tuberculosis and malaria							
Target: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS							
▪ HIV/AIDS incidence (per 100,000 people)	4.1	5.5	4.7	6.2 (2004)	4.0	3.5	3.2
▪ HIV incidence among 15-24 year-olds	11.9	10.9	9.7	9.7 (2004)	4.9	4.2	4.0
Target: Have halted by 2015, and begun to reverse, the incidence of tuberculosis and malaria							
▪ Mortality rate associated with tuberculosis (deaths per 100,000 people)	16.9	15.0	15.8	16.8 (2004)	13.9	12.0	7.0
Goal: Ensure environmental sustainability							
Target: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources							
▪ Proportion of land areas covered by forest (%)	9.6	9.6	10.3	10.3 (2004)	11.0	12.1	13.2
▪ Ratio of area protected to maintain biological diversity (%)	2.0	2.0	2.0	1.96 (2004)	2.1	2.2	2.4
Target: Halve, by 2015, the proportion of people without sustainable access to improved water sources							
▪ Population with sustainable access to an improved water source (%)	37.8	38.1	38.5	44.5 (2004)	47.7	57.0	68.5
Target: Achieve a significant increase of the share of people with access to improved sanitation							
▪ Population with access to improved sanitation (%)	41.1	40.0	41.7	43.6 (2004)	56.0	73.3	90.0

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

Table 8. Moldova: Public and Publicly Guaranteed External Debt, 2000–05
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005 Est.
PPG debt including arrears						
Total	1,047.0	982.3	1,015.7	1,039.4	915.1	821.4
Multilateral creditors	565.7	551.9	589.0	600.1	589.3	503.9
Bilateral creditors	270.1	261.7	261.8	278.0	291.4	290.5
Paris Club creditors 1/	241.8	235.6	242.4	260.2	273.7	272.8
non-Paris Club creditors	28.3	26.1	19.4	17.9	17.7	17.7
Commercial creditors	211.1	168.7	165.0	161.2	34.4	27.0
Unidentified (gap financing)	...	...	...	...	...	...
Arrears						
Total	6.7	17.5	42.9	86.1	50.6	56.3
EBRD	1.1	3.4	4.9	7.7	18.0	0.2
Bilateral creditors	2.3	7.3	7.1	23.6	32.6	56.1
Paris Club creditors 1/	2.3	5.3	7.1	18.7	32.6	56.1
non-Paris Club creditors	-	2.0	-	4.8	-	-
Commercial creditors	3.4	6.8	31.0	54.8	-	-
Scheduled principal payments						
Total	53.8	76.1	83.0	95.5	91.7	75.9
Multilateral creditors	44.0	37.7	49.6	60.9	66.5	48.9
Bilateral creditors	6.0	8.6	11.5	11.5	10.4	19.9
Paris Club creditors 1/	3.4	4.3	4.7	5.2	5.7	19.9
non-Paris Club creditors	2.6	4.3	6.7	6.3	4.7	-
Commercial creditors	3.8	29.9	22.0	23.0	14.8	7.2
Unidentified (gap financing)	-	...	...	...	...	...
Scheduled interest payments						
Total	52.4	50.7	42.3	36.6	32.0	30.5
Multilateral creditors	27.0	24.6	18.1	14.6	12.7	12.8
Bilateral creditors	10.0	13.5	13.7	14.0	14.8	15.3
Paris Club creditors 1/	8.8	12.3	13.1	13.7	14.6	15.0
non-Paris Club creditors	1.3	1.2	0.6	0.3	0.2	0.2
Commercial creditors	15.4	12.6	10.5	8.0	4.6	2.4
Unidentified (gap financing)	-	...	...	...	...	...
Accumulation of arrears						
Total	6.0	10.4	33.6	44.6	42.4	26.2
EBRD	1.1	2.5	2.3	3.6	11.0	2.4
Bilateral creditors	1.5	4.5	7.1	17.2	19.5	23.9
Paris Club creditors 1/	1.5	2.5	3.7	12.4	14.6	23.9
non-Paris Club creditors	-	2.0	3.4	4.8	4.8	-
Commercial creditors	3.4	3.4	24.2	23.8	11.8	-
Repayment of arrears						
Total	2.5	0.2	1.6	1.4	54.9	0.8
EBRD	2.4	0.2	0.8	0.8	1.9	0.3
Bilateral creditors	0.1	-	0.8	0.6	1.0	0.5
Paris Club creditors 1/	0.1	-	0.8	0.6	0.7	0.5
non-Paris Club creditors	-	-	-	-	0.3	-
Commercial creditors	-	-	-	-	52.0	-
Rescheduling, cancellation, buyback and other stock of debt operations 2/						
Total	-	-	5.4	-	130.7	29.4
EBRD	-	-	-	-	1.2	29.4
Bilateral creditors	-	-	5.4	-	9.3	-
Paris Club creditors 1/	-	-	-	-	-	-
non-Paris Club creditors	-	-	5.4	-	9.3	-
Commercial creditors	-	-	-	-	120.2	-

Source: Authorities and IMF staff estimates

1/ Includes Transnistrian debt
2/ Includes operations with arrears

Table 9. Moldova: Capacity to Repay the Fund, 2005–12

	2005	2006	2007	2008	2009	2010	2011	2012
		Baseline scenario						
Fund disbursements								
In millions of SDR	-	22.9	22.9	22.9	11.4	-	-	-
In millions of U.S. dollars	-	32.7	32.7	32.7	16.4	-	-	-
In percent of quota	-	18.6	18.6	18.6	9.3	-	-	-
Projected repayments/repurchases and charges								
In millions of SDRs	16.3	18.0	15.7	14.7	12.4	6.0	3.2	6.8
In millions of U.S. dollars	24.1	25.8	22.5	21.2	17.7	8.6	4.6	9.8
In percent of exports of G&S	1.6	1.4	1.1	0.9	0.7	0.3	0.2	0.3
In percent of total debt service	22.6	26.2	24.0	23.0	19.8	11.6	6.1	10.9
In percent of quota	13.2	14.6	12.8	12.0	10.0	4.9	2.6	5.5
In percent of gross international reserves	4.0	3.4	2.4	1.9	1.3	0.5	0.2	0.5
Fund credit outstanding								
In millions of SDRs	66.8	73.2	81.6	90.6	90.2	84.7	81.9	75.5
In millions of U.S. dollars	95.5	104.7	116.6	129.5	129.0	121.1	117.1	107.9
In percent of exports of G&S	6.2	5.9	5.8	5.8	5.2	4.4	3.9	3.3
In percent of quota	54.2	59.5	66.2	73.5	73.3	68.8	66.5	61.3
In percent of gross international reserves	16.0	14.0	12.5	11.5	9.7	7.6	6.3	5.0
Memorandum items								
Exports of G&S (in millions of U.S. dollars)	1,535	1,783	2,014	2,236	2,482	2,730	3,003	3,303
Debt service (in millions of U.S. dollars)	106.4	98.6	93.7	91.9	89.5	73.9	74.9	89.3
Quota (in millions of SDR)	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2
Quota (in millions of U.S. dollars)	182.1	176.5	176.6	176.8	176.8	176.7	176.7	176.7
Gross international reserves (in millions of U.S. dollars)	597	750	931	1,124	1,325	1,598	1,864	2,166
SDR/U.S. dollar (period average)	0.68	0.70	0.70	0.70	0.70	0.70	0.70	0.70
SDR/U.S. dollar (eop)	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70

Source: Fund staff calculations.

Table 10. Moldova: External Financing Requirements and Sources, 2004–08
(In millions of U.S. dollars)

	Actual		IMF Staff Projection		
	2004	2005	2006	2007	2008
1. Gross financing requirements	445.6	474.8	576.4	562.8	621.4
External current account deficit (exc. official transfers)	121.2	214.8	233.4	264.4	295.6
Debt amortization	99.9	110.6	101.7	96.1	113.3
Medium and long term debt	99.9	110.6	101.7	96.1	113.3
Public sector	41.8	51.7	47.5	45.6	46.9
Multilateral 1/	40.5	24.6	19.6	17.8	19.8
Bonds and notes					
Other	1.3	27.1	27.9	27.8	27.0
Commercial banks					
Corporate private sector	58.0	59.0	54.2	50.5	66.4
Short-term debt 2/					
Repayment of arrears	54.9	0.8	65.6	0.0	0.0
Gross reserves accumulation	148.0	127.2	152.6	181.5	192.7
IMF repurchases and repayments	21.6	21.4	23.5	20.8	19.8
2. Available financing	445.6	474.8	576.4	562.8	621.4
Foreign direct investment (net)	77.3	175.0	217.0	242.3	280.9
Debt financing from private creditors	114.7	104.8	112.5	112.5	112.5
Medium- and long-term financing	114.7	104.8	112.5	112.5	112.5
To public sector					
of which: balance of payments financing 3/					
To commercial banks					
To corporate private sector	114.7	104.8	112.5	112.5	112.5
Short-term financing					
of which: balance of payments financing 3/					
Official creditors 4/	73.3	74.1	126.8	141.7	132.1
Multilateral 1/	70.7	73.1	124.7	141.7	132.1
of which: balance of payments financing 3/					
Bilateral	2.6	1.0	2.1	0.0	0.0
To public sector	2.6	1.0	2.1	0.0	0.0
of which: balance of payments financing 3/					
To private sector					
Accumulation of arrears (exceptional)	42.4	26.2	9.3	0.0	0.0
Financing gap 5/	...	...	93.4	61.9	91.6
Expected EU Assistance	...	...	11.0	15.0	10.0
World Bank PRSC	...	...	2.0	4.0	4.0
IMF	...	...	32.7	32.7	32.7
Residual 6/	...	...	47.7	10.2	44.9
Other flows 7/	137.9	94.7	17.6	4.3	4.3
Memorandum item:					
Total balance of payments financing 3/	0.0	0.0	32.7	32.7	32.7

1/ Excluding the IMF.
2/ Original maturity of less than 1 year. Stock at the end of the previous period.
3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.
4/ Includes both loans and grants.
5/ After 200m lei drawdown from escrow account (to partially clear arrears)
6/ Including possible Paris Club rescheduling
7/ Includes all other net financial flows, and errors and omissions

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

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

MOLDOVA—DEBT SUSTAINABILITY ANALYSIS

A. Background

1. Moldova's total external debt at end-2005 is estimated at US$1.6 billion or 55 percent of GDP, down from 64 percent in 2004.[22] The public and publicly-guaranteed (PPG) external debt stock was reduced from 35 percent of GDP to 28 percent. It declined in dollar terms as well, partly because of appreciation of the US dollar with respect to other currencies (SDR, Euro, Yen), but also because of net repayments to creditors and cancellation of state guarantees on some of EBRD loans.[23] The NPV of external debt-to-exports is estimated to have fallen from 114 percent to 101 percent. Debt service indicators have also improved with the PPG debt service-to-exports ratio declining from 9 percent to 7 percent. Domestic currency public debt is modest at about 10 percent of GDP (end–2005).

B. External Debt Sustainability

2. The baseline projection shows further strengthening of the debt position throughout the period. The NPV of external debt-to-GDP ratio and debt-to-exports is expected to stabilize at about 8 percent and 16 percent, respectively, by 2025. The debt-service ratio is also projected to continue to decline and remain well within the debt burden thresholds as defined by the World Bank's CPIA-based classification.[24] The alternative scenarios and stress tests do not significantly alter the medium and long-term path of external debt dynamics indicating the robustness of the conclusions.

C. Public Debt Sustainability

3. The ratio of public debt to GDP has also declined significantly in recent years. Public debt is estimated to be 39 percent at end-2005, compared to 74.8 percent in 2002, reflecting strong growth and real exchange rate appreciation. Consistent with the authorities' medium term fiscal program, the baseline scenario projects a further decline in the debt-to-GDP ratio, with the NPV of public sector debt-to-GDP ratio declining to 10 percent by 2025. The alternative scenarios and stress tests also show declining ratios over time, with the exception of the alternative scenario with permanently lower GDP growth (2.7 percent long-run growth vs. 4 percent in the baseline) and the stress test with GDP growth at its 10-year historical average minus one standard deviation in 2006–07 (implying a growth rate of

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[22] This consists of $821 million in public and publicly guaranteed debt (28 percent of GDP) including $56.3 million in arrears (1.9 percent of GDP), $488 million in private debt (17 percent of GDP) and $286.6 million in energy arrears (10 percent of GDP). Private debt and energy arrears are estimates of the authorities.

[23] EBRD loans to Giurgiulesti Oil Terminal and Vininvest have been transferred to private investors in debt-for-equity swap transactions, thereby relieving the government of any obligations to the EBRD on these loans.

[24] According to the classification, Moldova is among poor performers, implying the following critical thresholds: NPV/exports = 100 percent, NPV/GDP = 30 percent, NPV/revenues = 200 percent, debt service/exports = 15 percent, debt service/revenues = 25 percent.

-3.4 percent for these two years). The results based on historical averages are not good proxies for expected future developments in Moldova, as this period covers the transition period as well as the 1998 regional financial crisis. Further, since the DSAs are static exercises, the results assume that spending would not adjust to this lower growth. However, the alternative scenario with permanently lower GDP growth emphasizes the importance for Moldova to continue to improve future growth prospects in order to maintain public debt sustainability.

D. Conclusions

4. Rather than a structural debt sustainability problem, Moldova faces short-term liquidity difficulties, which stem from the projected financing gaps and the stock of arrears owed to bilateral creditors, chiefly to Russia, the U.S. and Japan. Reengagement of IFI's and the international donor community with fresh concessional financing and possibly rescheduling of its external debt, including arrears, would alleviate the liquidity problem and free up resources for other development needs.

Table 1a. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2003–25 1/
(In percent of GDP, unless otherwise indicated)

	Actuals		Estimate	Historical Average 6/	Standard Deviation 6/	Projections									
	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2015	2025	2012-25 Average
External debt (nominal) 1/	**88.7**	**63.8**	**54.7**			**51.3**	**49.7**	**47.3**	**44.2**	**41.0**	**37.8**		**28.7**	**24.6**	
of which public and publicly guaranteed (PPG)	52.5	35.2	28.2			24.7	22.9	21.4	19.9	18.6	17.4		13.7	10.5	
Change in external debt	-12.2	-24.9	-9.1			-3.4	-1.7	-2.3	-3.2	-3.2	-3.2		-1.4	0.2	
Identified net debt-creating flows	-13.4	-21.3	-7.4			-4.1	-3.3	-3.5	-3.4	-3.6	-4.2		-2.8	-0.3	
Non-interest current account deficit	**4.3**	**0.4**	**3.2**	**2.5**	**2.8**	**3.3**	**3.4**	**3.5**	**3.7**	**3.5**	**3.4**	**3.5**	**3.6**	**3.5**	3.6
Deficit in balance of goods and services	33.8	30.5	39.8			42.7	42.0	41.0	39.9	38.9	38.2		37.7	37.7	
Exports	53.5	51.2	52.6			53.7	54.0	53.3	53.0	52.7	52.6		52.7	52.7	
Imports	87.2	81.7	92.4			96.4	96.0	94.3	92.9	91.6	90.8		90.4	90.4	
Net current transfers (negative = inflow)	-15.4	-14.0	-19.0	-14.2	3.8	-20.4	-20.0	-19.4	-18.9	-18.6	-18.4	-19.3	-18.3	-18.3	-18.3
Other current account flows (negative = net inflow)	-14.1	-16.1	-17.6			-19.0	-18.7	-18.1	-17.3	-16.8	-16.4		-15.8	-15.9	
Net FDI (negative = inflow)	**-3.9**	**-3.0**	**-6.0**	**-5.4**	**2.7**	**-6.5**	**-6.5**	**-6.7**	**-6.7**	**-6.7**	**-7.2**	**-6.7**	**-6.4**	**-4.1**	-5.6
Endogenous debt dynamics 2/	**-13.7**	**-18.7**	**-4.5**			**-0.8**	**-0.2**	**-0.3**	**-0.3**	**-0.3**	**-0.4**		**0.0**	**0.3**	
Contribution from nominal interest rate	2.5	2.3	2.4			2.1	2.1	1.9	1.8	1.7	1.5		1.1	1.2	
Contribution from real GDP growth	-5.6	-5.0	-4.0			-2.9	-2.3	-2.2	-2.1	-2.0	-1.9		-1.1	-0.9	
Contribution from price and exchange rate changes	-10.6	-16.1	-2.9			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**1.2**	**-3.5**	**-1.8**			**0.7**	**1.7**	**1.1**	**0.2**	**0.4**	**0.9**		**1.4**	**0.5**	
o/w exceptional financing	-2.6	-1.0	-0.7			1.7	0.0	0.0	0.0	-2.5	0.0		0.0	0.0	
NPV of external debt 4/	...	58.6	52.9			49.0	46.8	44.3	41.2	38.1	35.1		26.0	22.6	
In percent of exports	...	114.4	100.5			91.1	86.7	83.1	77.7	72.3	66.6		49.4	42.9	
NPV of PPG external debt	**...**	**30.0**	**26.3**			**22.3**	**20.1**	**18.4**	**16.9**	**15.7**	**14.7**		**11.0**	**8.5**	
In percent of exports	...	58.5	50.0			41.6	37.2	34.6	31.9	29.8	28.0		20.9	16.1	
Debt service-to-exports ratio (in percent)	19.8	21.3	20.2			14.5	12.9	12.8	13.2	12.5	12.0		8.9	8.8	
PPG debt service-to-exports ratio (in percent)	12.5	9.3	6.9			5.5	4.6	4.1	3.6	2.7	2.3		1.9	1.6	
Total gross financing need (billions of U.S. dollars)	217.3	216.2	227.8			151.6	142.6	154.0	184.7	172.8	143.4		150.9	715.5	
Non-interest current account deficit that stabilizes debt ratio	16.5	25.2	12.3			6.7	5.0	5.9	6.8	6.6	6.6		5.0	3.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.6	7.4	7.1	2.3	5.5	6.0	5.0	5.0	5.0	5.0	5.0	5.2	4.0	4.0	4.1
GDP deflator in US dollar terms (change in percent)	11.8	22.1	4.8	9.8	6.6	7.3	7.0	7.1	6.4	5.3	4.9	6.3	4.9	3.0	4.2
Effective interest rate (percent) 5/	2.9	3.5	4.3	3.7	0.5	4.3	4.6	4.3	4.2	4.1	3.9	4.2	4.0	5.3	4.5
Growth of exports of G&S (US dollar terms, in percent)	20.9	25.6	15.3	16.8	7.0	16.2	13.0	11.0	11.0	10.0	10.0	11.9	9.0	7.1	8.5
Growth of imports of G&S (US dollar terms, in percent)	33.5	22.8	27.0	22.9	7.3	18.7	11.9	10.5	10.0	9.1	9.2	11.6	9.0	7.1	8.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	28.2	37.8	30.0	31.4	34.9	14.6	29.5	14.6	14.6	14.6
Memorandum item:															
Nominal GDP (billions of U.S. dollars)	1980.6	2597.9	2917.2			3318.7	3728.2	4192.0	4685.0	5179.1	5706.4		8125.7	17777.7	

Source: Fund staff simulations.

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

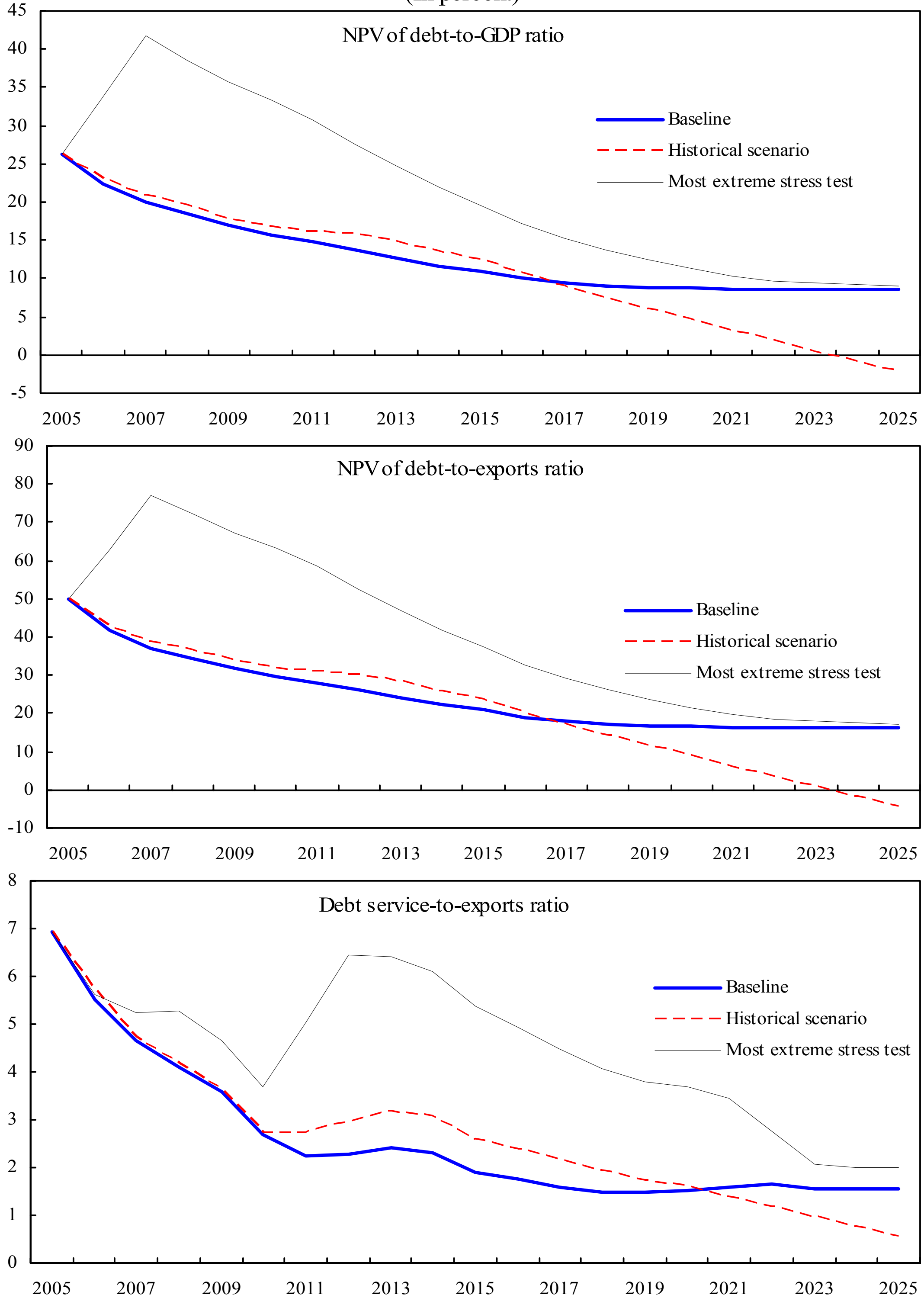
Table 1b. Moldova: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Estimate	Projections						
	2005	2006	2007	2008	2009	2010	2015	2025
NPV of debt-to-GDP ratio								
Baseline	26	22	20	18	17	16	11	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	26	23	21	19	18	17	12	-2
A2. New public sector loans on less favorable terms in 2006-25 2/	26	22	21	19	18	17	13	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	26	24	24	22	20	19	13	10
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	26	25	26	27	25	24	15	9
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2006-07	26	23	22	20	18	17	12	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	26	34	42	39	36	33	20	9
B5. Combination of B1-B4 using one-half standard deviation shocks	26	28	37	35	33	30	19	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	26	31	28	25	23	21	15	12
NPV of debt-to-exports ratio								
Baseline	50	42	37	35	32	30	21	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	50	43	39	37	34	32	23	-4
A2. New public sector loans on less favorable terms in 2006-25 2/	50	42	38	36	34	33	25	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	50	45	37	34	32	30	21	16
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	50	49	52	56	52	49	31	18
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2006-07	50	43	37	35	32	30	21	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	50	63	77	72	67	63	37	17
B5. Combination of B1-B4 using one-half standard deviation shocks	50	51	61	59	55	52	32	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	50	57	37	34	32	29	21	16
Debt service ratio								
Baseline	7	6	5	4	4	3	2	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	7	6	5	4	4	3	3	1
A2. New public sector loans on less favorable terms in 2006-25 2/	7	6	5	4	4	3	2	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	7	6	5	4	4	3	3	2
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	7	6	5	5	4	3	4	2
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2006-07	7	6	5	4	4	3	3	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	7	6	5	5	5	4	5	2
B5. Combination of B1-B4 using one-half standard deviation shocks	7	6	5	5	4	3	4	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	7	8	5	4	4	3	3	2
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	18	18	18	18	18	18	**18**	18

Source: Fund staff projections and simulations.

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

Figure 1. Moldova: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2005–25
(In percent)



Source: Fund staff projections and simulations.

Table 2a. Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario, 2002–25
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate						Projections			
	2002	2003	2004	Historical Average 5/	Standard Deviation 5/	2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	2011-25 Average
Public sector debt 1/	74.8	60.3	47.2			39.0	33.5	30.4	27.7	25.2	23.1		15.9	11.8	
of which foreign-currency denominated	62.2	49.8	35.6			28.7	24.7	23.0	21.4	19.9	18.6		13.7	10.4	
Change in public sector debt	-5.3	-14.4	-13.1			-8.2	-5.5	-3.1	-2.8	-2.5	-2.1		-1.3	-0.2	
Identified debt-creating flows	-8.0	-16.8	-11.6			-6.8	-4.6	-3.3	-3.0	-2.4	-1.9		-0.7	-0.2	
Primary deficit	-0.4	-2.8	-2.6	0.4	3.6	-2.9	-0.6	-0.9	-0.6	-0.3	-0.2	-0.9	0.2	0.3	0.2
Revenue and grants	29.8	34.0	35.4			39.5	38.4	38.3	37.7	37.7	37.8		38.4	38.4	
of which : grants	0.6	0.3	0.4			1.3	0.5	0.6	0.2	0.3	0.2		0.2	0.2	
Primary (noninterest) expenditure	29.4	31.2	32.7			36.6	37.7	37.4	37.1	37.3	37.6		38.6	38.7	
Automatic debt dynamics	-7.0	-13.9	-8.9			-3.9	-3.9	-2.3	-2.4	-2.0	-1.7		-1.0	-0.5	
Contribution from interest rate/growth differential	-5.6	-5.0	-4.1			-3.4	-2.1	-1.3	-1.3	-1.2	-1.1		-0.6	-0.3	
of which : contribution from average real interest rate	0.2	-0.4	0.1			-0.3	0.1	0.3	0.2	0.1	0.1		0.1	0.1	
of which : contribution from real GDP growth	-5.8	-4.6	-4.2			-3.1	-2.2	-1.6	-1.4	-1.3	-1.2		-0.7	-0.5	
Contribution from real exchange rate depreciation	-1.4	-8.9	-4.8			-0.5	-1.8	-1.0	-1.1	-0.8	-0.6		...	...	
Other identified debt-creating flows	-0.6	-0.2	-0.1			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
Privatization receipts (negative)	-0.6	-0.2	-0.1			-0.1	-0.1	-0.1	-0.1	-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)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.6	2.4	-1.5			-1.4	-0.9	0.3	0.3	0.0	-0.2		-0.5	0.0	
NPV of public sector debt	64.5	49.9	40.0			34.7	26.4	22.9	19.0	16.6	14.8		11.2	9.5	
of which foreign-currency denominated	52.0	39.3	28.4			24.4	17.6	15.5	12.8	11.4	10.4		9.0	8.2	
of which external	52.0	39.3	28.4			24.4	17.6	15.5	12.8	11.4	10.4		9.0	8.2	
Gross financing need 2/	1.4	-0.2	-0.8			0.4	6.8	6.0	5.6	5.2	4.7		3.4	2.6	
NPV of public sector debt-to-revenue ratio (in percent) 3/	216.8	146.9	113.0			87.9	68.8	59.7	50.5	44.1	39.2		29.2	24.8	
of which external	174.8	115.8	80.3			61.8	45.9	40.4	34.0	30.2	27.4		23.4	21.3	
Debt service-to-revenue ratio (in percent) 3/ 4/	7.2	6.2	5.4			8.6	9.8	8.0	6.9	6.1	5.0		2.9	2.5	
Primary deficit that stabilizes the debt-to-GDP ratio	5.0	11.7	10.5			5.4	4.9	2.2	2.2	2.1	1.9		1.5	0.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.8	6.6	7.4	1.4	5.5	7.1	6.0	5.0	5.0	5.0	5.0	5.5	4.0	4.0	4.1
Average nominal interest rate on forex debt (in percent)	3.8	3.2	2.5	3.4	0.7	3.0	2.9	3.0	2.6	2.4	2.2	2.7	2.1	2.8	2.4
Average real interest rate on domestic currency debt (in percent)	-9.0	-8.9	1.1	-2.5	5.9	-3.4	-0.6	0.7	1.0	1.0	1.1	0.0	2.4	4.8	3.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.2	-15.0	-10.3	-7.4	6.8	-1.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.8	14.9	8.0	18.0	11.0	7.1	9.3	8.8	7.2	6.1	5.1	7.3	4.9	4.0	4.3
Growth of real primary spending (deflated by GDP deflator, in percent)	25.5	13.3	12.6	0.4	16.8	19.9	9.1	4.2	4.1	5.7	5.9	8.1	4.2	4.0	4.3

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

1/ Includes general government gross debt.
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 including 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.

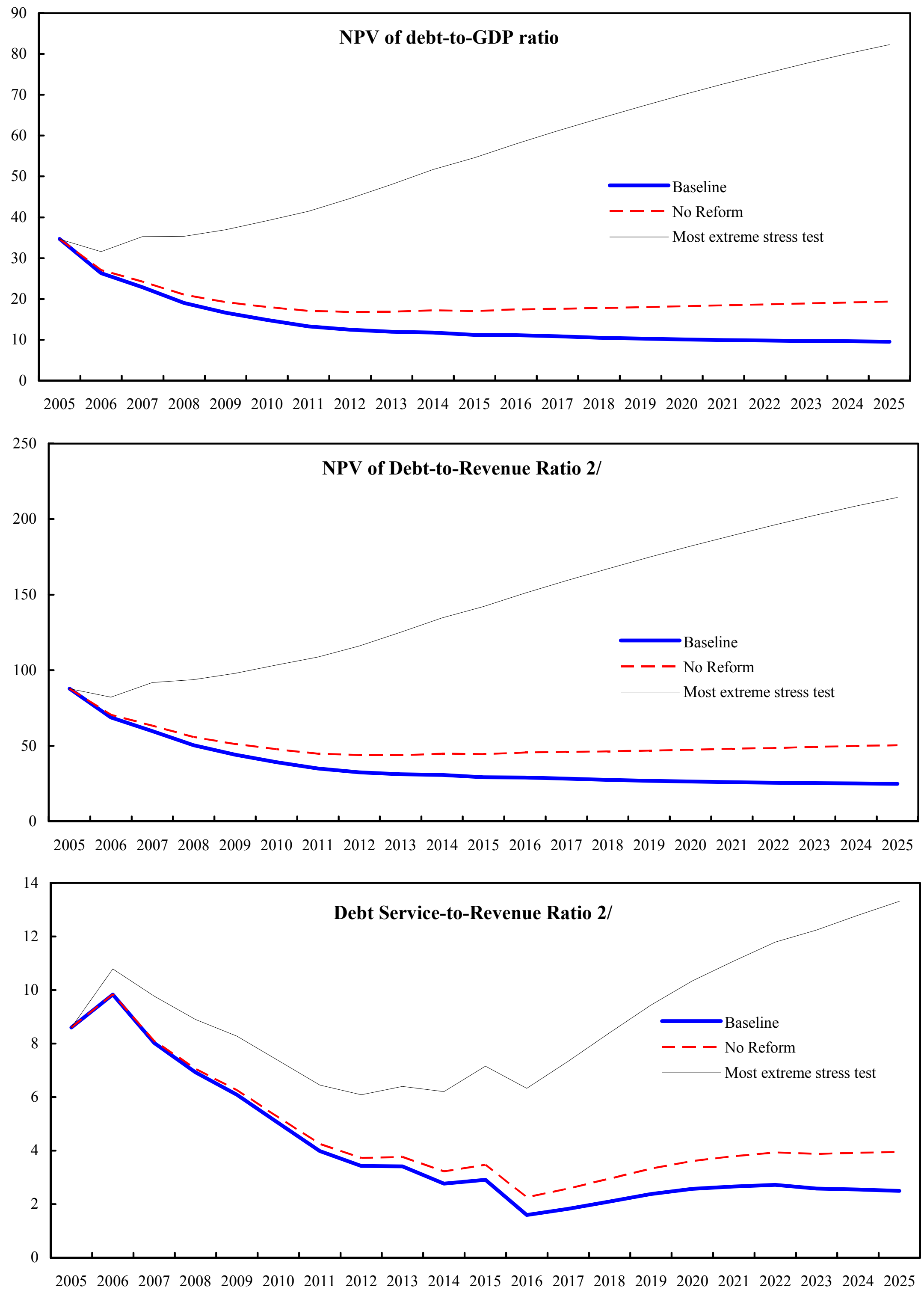
Table 2b. Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2005–25

	Estimate	Projections						
	2005	2006	2007	2008	2009	2010	2015	2025
NPV of debt-to-GDP ratio								
Baseline	35	26	23	19	17	15	11	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	35	28	25	22	20	19	15	11
A2. Lower primary balance 1/	35	27	24	21	19	18	17	19
A3. Permanently lower GDP growth 2/	35	27	24	22	21	21	30	78
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-07	35	32	35	35	37	39	55	82
B2. Primary balance is at historical average minus one standard deviations in 2006-07	35	30	29	25	22	20	15	12
B3. Combination of B1-B2 using one half standard deviation shocks	35	30	30	25	22	20	15	12
B4. One-time 30 percent real depreciation in 2006	35	34	30	24	21	19	15	12
B5. 10 percent of GDP increase in other debt-creating flows in 2006	35	34	30	25	23	20	15	12
NPV of debt-to-revenue ratio 3/								
Baseline	88	69	60	50	44	39	29	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	88	72	66	59	53	49	38	30
A2. Lower primary balance 1/	88	71	63	56	51	48	44	50
A3. Permanently lower GDP growth 2/	88	70	64	57	55	54	78	202
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-07	88	82	92	94	98	103	142	214
B2. Primary balance is at historical average minus one standard deviations in 2006-07	88	77	76	66	58	53	39	31
B3. Combination of B1-B2 using one half standard deviation shocks	88	78	77	66	58	52	39	30
B4. One-time 30 percent real depreciation in 2006	88	90	78	65	57	50	38	31
B5. 10 percent of GDP increase in other debt-creating flows in 2006	88	88	78	67	60	54	40	31
Debt service-to-revenue ratio 3/								
Baseline	9	10	8	7	6	5	3	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	9	10	9	8	7	6	4	4
A2. Lower primary balance 1/	9	10	8	7	6	5	3	4
A3. Permanently lower GDP growth 2/	9	10	8	7	7	6	5	11
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-07	9	11	10	9	8	7	7	13
B2. Primary balance is at historical average minus one standard deviations in 2006-07	9	10	8	7	7	5	4	3
B3. Combination of B1-B2 using one half standard deviation shocks	9	10	9	8	7	6	4	3
B4. One-time 30 percent real depreciation in 2006	9	10	9	8	7	6	3	3
B5. 10 percent of GDP increase in other debt-creating flows in 2006	9	10	9	7	7	5	4	3

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

1/ Assumes that the primary balance is at baseline minus 1 percentage points of GDP starting in 2006.
2/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
3/ Revenues are defined inclusive of grants.

Figure 2. Moldova: Indicators of Public Debt Under Alternative Scenarios, 2005–25 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2015.
2/ Revenue including grants.

MOLDOVA—FUND RELATIONS
(As of February 28, 2006)

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

II. **General Resources Account**:	**SDR million**	**Percent of Quota**
Quota	123.20	100.00
Fund holdings of currency	156.85	127.31
Reserve tranche position	0.01	0.00

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

IV. **Outstanding Purchases and Loans**:	**SDR million**	**Percent of Quota**
Extended arrangements	33.65	27.31
PRGF arrangements	27.72	22.50

V. **Latest Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
PRGF	12/21/2000	12/20/2003	110.88	27.72
EFF	05/20/1996	05/19/2000	135.00	87.50
Stand-by	03/22/1995	03/21/1996	58.50	32.40

VI. **Projected Obligations to Fund**[25]**:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	11.00	14.53	13.88	11.79	5.54
Charges/Interest	1.19	1.04	0.57	0.18	0.04
Total	12.19	15.56	14.44	11.98	5.58

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

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the National Bank of Moldova (NBM) is subject to an assessment with respect to the proposed PRGF arrangement, which should be completed by the first program review. The necessary documentation has been received and the assessment is under way.

The NBM was subject to a safeguards assessment in conjunction with the PRGF Arrangement that expired on December 20, 2003. The previous assessment was completed on June 12, 2002, and determined that the NBM's procedures and controls to manage resources, including IMF disbursements, were not adequate in all areas of the IMF's safeguards framework. Specific remedial actions to address identified vulnerabilities were recommended and the authorities confirmed that all proposed priority measures have been implemented.

VIII. **Exchange Arrangement**:

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

Moldova's exchange rate regime was reclassified as a de facto peg (to the U.S. dollar) in January 2006.

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

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

IX. **Article IV Consultation**:

Moldova is currently on a 12-month consultation cycle. The last Article IV consultation was concluded on February 7, 2005 (IMF Country Reports Nos. 05/48 and 05/53).

X. **FSAP Participation**:

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

XI. **Use of Fund Resources**:

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

XII. **Resident Representative**:

Mr. Mathisen began his assignment in December 2005.

XIII. **Resident Advisors**:

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

XIV. **Short-Term Assistance**:

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

XV. **Technical Assistance**:

The following table summarizes the technical assistance missions provided by the Fund to Moldova since January 1999.[26]

Moldova: Technical Assistance Provided by the Fund, 1999–2004

Department	Subject/Identified Need	Timing	Counterpart
MAE	Monetary and foreign exchange operations; and banking, accounting, and auditing issues.	April/May 1999	NBM
STA	Government financial statistics	August 1999	MoF
FAD	Tax administration	May 2000	MoF
FAD	Customs administration	June 2000	MoF
MAE	Monetary policy management; payment system; foreign exchange operations; and banking supervision.	September 2000	NBM
LEG	Banking legislation	October 2000	NBM
LEG	Free economic zone legislation	Jan./Feb. 2001	MoE
FAD	Expenditure policy	May 2001	MoF
LEG	Bankruptcy law	June 2001	MoE
LEG	Banking legislation	June 2001	NBM
MAE	TA assessment/evaluation	October 2001	NBM
MAE	Payments system; liquidity projection and monetary policy framework; central bank accounting and internal audit; and bank supervision.	May 2002	NBM
MFD	Payments system	Missions 2003 and 2004	NBM
STA	National accounts	March 2002, Dec. 2002, March 2003, Apr. 2004	DSS
STA	Price statistics	Nov. 2003, Sept 2004, Nov. 2005	DSS
STA	Money and Banking Statistics	April 2004	NBM
MFD/LEG	Anti Money Laundering	April 2004	MDA Gov., NBM
FAD	Modernization of the LTU and VAT	May 2004	MoF
MFD	Foreign Exchange Regulation and Banking Supervision	December 2004	NBM
STA	Money and Banking Statistics	May 2005	NBM, DSS
MFD	Internal Audit, National Bank	June 2005	NBM
STA	SDDS	November 2005	NBM, DSS , MOF
MFD	Central Bank Independence, Monetary Policy, and Monetary Operations	December 2005	NBM

Note: MoF: Ministry of Finance; NBM: National Bank of Moldova; MoE: Ministry of Economy.

[26] For technical assistance before 1999, see previous reports.

MOLDOVA—IMF-WORLD BANK RELATIONS
(As of March 8, 2006)

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

A. Partnership in Moldova's Development Strategy

1. The government and other major stakeholders consider poverty reduction to be the major development challenge facing Moldova. In May 2004 the government completed a full Poverty Reduction Strategy Paper, calling it—the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) to emphasize the centrality of growth to poverty reduction. The document describes the participatory process underpinning the development of the strategy, provides a diagnostic of poverty, and presents sector programs and policy measures for sustainable economic growth and poverty reduction. The Joint Staff Advisory Note assessing the EGPRSP was discussed by the Boards of the World Bank and the IMF in November 2004.

2. The IMF has taken the lead in assisting Moldova in promoting and maintaining macroeconomic stability through prudent monetary and financial policies. In this regard the Fund has encouraged the Moldovan authorities to implement a policy reform agenda that would attract the needed level of concessional foreign financing from bilateral and multilateral creditors and encourage the international community to reschedule Moldova's external debt to enhance debt sustainability. The Fund has supported Moldova's economic reform program since 1993. A three-year program under the PRGF facility was approved in December 2000. The first PRGF review was not completed until Mid-2002 as a result of disruptions stemming from a change in government in early 2001. Several attempts to complete the second review have failed owing to the incomplete implementation of agreed actions. The program expired at the end of 2003, leaving ¾ of the available funds undisbursed.

3. The World Bank has taken the lead in the policy dialogue on a number of structural issues relevant to economic growth and poverty reduction, including private sector development, infrastructure, health, education, social protection, and agricultural sector reforms. A range of instruments is used to conduct this dialogue. Since 1994, four structural adjustment operations have been carried out, which aimed at supporting structural reforms in the areas of financial discipline, cash privatization, de-monopolization and privatization of the energy sector and telecom, and urban and rural land markets. The First Structural Adjustment Loan ($60 million) was approved in December 1994. The Second Structural Adjustment Loan and Credit ($100 million, of which IDA credit of $45 million) was approved in 1997. The third tranche was cancelled and replaced with a $40 million Structural Adjustment Credit (approved on June 24, 1999). The second tranche of the SAC was accompanied by a $10 million budget support grant from the Dutch Government. A supplement of $5 million was disbursed in December 2001 to help the government fill a financial gap created by ice storm damages of November 2000. A Third Structural Adjustment Credit ($30 million) was approved in June 2002. Lack of progress in structural reforms resulted in the credit expiring in September 2003 with 2/3 of the credit undisbursed. Adjustment operations have been combined with sector projects in rural finance, energy,

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

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

B. IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads

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

6. In **health**, the ongoing *Health Investment Fund Project* is focused on improving the health status of the Moldovan population and increasing the quality and efficiency of public health services by improving access to essential services by the poor. The *Moldova AIDS Control Project* aims at improving Moldova's health status and assists in achieving the health-related Millennium Development Goals by reducing mortality, morbidity, and transmission of HIV/AIDs.

7. In **education,** the *Quality Education in Rural Areas Project, builds upon recently closed General Education Project and* supports the Government's education program to enhance the quality of teaching and learning, increase access and equity, improve the efficiency in public spending for education, and strengthen education planning and monitoring.

8. With regards to **infrastructure** development, the Bank is concentrating on upgrading basic utility services impacting the population at large and the poor in particular. The *Energy*

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

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

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

11. While the Bank has taken the lead in the areas described above, the IMF has a strong interest in these areas since many of these reforms are critical to achieving macroeconomic stabilization and enhancing growth prospects. Accordingly, there is a high degree of consultation and coordination between the two institutions on these matters.

Areas of shared responsibility

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

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

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

Areas in which the IMF leads

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

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

C. The World Bank Group Strategy

17. The Bank has developed a Country Assistance Strategy for Moldova for the period of FY04-FY08. The main objective of the new CAS is to support the implementation of the government's EGPRSP and capitalize on the gains of previous assistance programs. Board discussion of the CAS took place in December 2004. A CAS Progress Report will be presented for the Executive Board's review in FY07. It will assess the implementation of the Strategy and discuss possible adjustments to the program for the remaining period of the CAS.

MOLDOVA—RELATIONS WITH THE EBRD

(As of 28 February 2006)

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

Forty four projects have been signed totaling €209.4 million of EBRD resources, including: (i) a wine export promotion project, which is targeting the main Moldovan wineries and glass producer, through restructuring of the sector (€24.6 million) and equity investment into a glass producer (€6.4 million); (ii) an energy efficiency project for upgrading the heating distribution networks in Chisinau (€7.8 million); (iii) several credit lines and equity investment for Moldova-Agroindbank for on-lending to small and medium enterprises (€29.3 million in total); (iv) several credit lines, a co-financing facility and equity investment for Victoriabank (€12.5 million in total); (v) a credit line and a co-financing facility for Mobiasbanca (€4.2 million); (vi) credit lines for Moldinconbank and Banca Sociala (€9.2 million in total);(v) a project for linking Moldovan satellite earth stations to the Eurovision Network (€0.8 million); (vi) a road rehabilitation loan (€9.6 million); (vii) partial financing for construction of a new oil terminal at Giurgulesti (€9.6 million); (viii) credit facilities for micro enterprises through local banks (€2.9 million); (ix) rehabilitating Chisinau's water services (€17.6 million); (x) Chisinau Airport Modernization (€7.4 million); (xi) trade facilitation program for Victoriabank, Moldova-Agroindbank, Moldindconbank, Mobiasbanca and Banca Sociala (regional TFP—€10.2 million in total); (xii) equity participation in and a loan to ProCredit and a loan to Rural Finance Corporation – two micro-finance companies (€3.2 million in total); and (xiii) equity participation and loan financing for three privatized power distribution companies (€26.9 million).

In addition to banking projects, some 72 Technical Cooperation projects have been completed or approved (totaling €12.6 million).

MOLDOVA—STATISTICAL ISSUES

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

2. Moldova has been a GDDS participant since February 2003. The authorities have expressed interest in subscribing to the SDDS and nominated a national SDDS coordinator in August 2005. An SDDS mission from STA visited Chisinau (November 16–23, 2005) to assess Moldova's data dissemination practices and advise authorities on subscription to the SDDS. Moldova is making good progress in implementing the recommendations of the SDDS mission.

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

4. **Price statistics** still have several shortcomings. Price collection for the CPI and PPI is limited geographically and new observations are not imputed. The weights of the CPI basket, underestimate the share of durable goods. The PPI is not a transaction price index, and covers a small population of industrial establishments. The industrial production index is compiled from data in constant prices adjusted to price changes by establishments themselves.

5. **Labor market statistics** remain inadequate for analyzing macroeconomic developments: (i) unemployment data following ILO methodology are not available; and (ii) wage data do not include fringe benefits, which form an important part of workers' compensation.

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

published due to serious data issues. Authorities have addressed these shortcomings and data for 2004 will be published in the *2005 GFS Yearbook.*

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

8. **Monetary and financial statistics** have improved, following a series of technical assistance missions from the Fund. A new chart of accounts for the NBM was introduced in 1996 and commercial banks adopted a new chart of accounts and moved to IAS effective January l, 1998. A monetary and financial statistics mission in April 2004 found that while monetary data were broadly in line with international statistical standards and of a generally good quality, shortcomings remained in the compilation of some monetary statistics aggregates. A follow-up in May 2005 found that the authorities implemented most of the April 2004 mission's recommendations, assisted the authorities in implementing the new standardized report forms (SRFs), and initiated work toward establishing and Integrated Monetary Database (IMD) for joint use by EUR and STA. The authorities reported test data in the SRFs, which are being processed by STA.

MOLDOVA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of March 15, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	3/15/06	3/15/06	D/M	M	D/M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	3/10/06	3/14/06	W	W	W
Reserve/Base Money	3/10/06	3/14/06	W	M	M
Broad Money	3/3/06	3/19/06	W	M	M
Central Bank Balance Sheet	3/10/06	3/14/06	W	M	M
Consolidated Balance Sheet of the Banking System	3/3/06	3/14/06	W	M	M
Interest Rates[2]	2/28/06	3/10/06	M	M	M
Consumer Price Index	Feb. 2006	3/10/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Jan. 2006	2/20/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Jan. 2006	2/20/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Jan. 2006	2/20/06	M	M	M
External Current Account Balance	Q3 2005	Dec. 2005	Q	Q	Q
Exports and Imports of Goods and Services	Jan. 2006	11/09/05	M	M	M
GDP/GNP	Q4 2005	3/5/06	Q	Q	Q
Gross External Debt	Q3 2005	Dec. 2005	Q	Q	Q

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

PRESIDENT OF THE REPUBLIC OF MOLDOVA

Chisinau, April 6, 2006

DEAR MR. DE RATO,

I would like to take this opportunity to express my support for the economic program prepared by the Government and the National Bank of Moldova. The Memorandum of Economic and Financial Policies is based on the medium-term objectives established in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP), and is consistent with the Republic of Moldova-European Union Action Plan.

The Memorandum of Economic and Financial Policies aims to ensure macroeconomic stability, which is a precondition for economic growth, and to promote structural economic reforms designed to improve the attractiveness of the Republic of Moldova as a destination for investment. Without economic growth, it will not be possible to achieve our poverty reduction objectives, including Moldova's Millennium Development Goals.

Moldova's international and European aspirations clearly depend on our ability to raise living standard and reform the public institutions in accordance with the European standards. With this goal in mind, I pledge my continuing support for the economic reform efforts outlined in the Memorandum of Economic and Financial Policies.

Sincerely yours,

Signature
Vladimir VORONIN

MR. RODRIGO DE RATO
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND
Washington D.C. 20431
U.S.A.

April 14, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

On behalf of the government and the National Bank of Moldova, we are pleased to submit herewith the Memorandum of Economic and Financial Policies (MEFP). The main objectives of our program over the medium-term are set out in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) and in the Republic of Moldova–European Union Action Plan, and aim at achieving the Millennium Development Goals. These plans envisage creating conditions for sustainable and inclusive economic growth that reduces poverty.

In support of our medium-term program, we hereby request a new three-year arrangement under the Poverty Reduction and Growth Facility in a total amount of SDR 80.08 million (equivalent to 65 percent of Moldova's quota). We request that the first disbursement under the arrangement, in an amount equivalent to SDR 11.44 million, be made available following the approval of the new PRGF arrangement by the Executive Board of the IMF.

We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but are prepared to take any other measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of these measures, in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation.

We will communicate to the IMF the information needed to monitor progress in implementing the program. Reviews with the IMF will be conducted throughout the period of the arrangement to evaluate the macroeconomic and structural reform policies and implementation of the program and to reach new understandings, as necessary. The first review will cover the progress made during the first six months of the program and is expected to take place before end-January 2007.

We are committed to disseminating the MEFP as well as the Technical Memorandum of Understanding and authorize the IMF to publish its staff report, which will be examined by the Executive Board.

Sincerely yours,

/s/	/s/
Vasile Tarlev	Leonid Talmaci
Prime Minister	Governor
Government of the Republic of Moldova	National Bank of Moldova

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

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

A. Introduction

1. The strong growth performance over the past four years has marked the transition from a decade of economic decline and rising poverty to a stage of robust growth and improving living standards. During the period of 2001–04, real GDP increased by more than 30 percent and the absolute poverty rate fell by 41 percent to a level of 27 percent in 2004. Inflation, although somewhat higher than desirable—owing to both internal and external factors—has been brought down to near single-digit levels. The exchange rate of the leu has remained stable and the reserves of the National Bank have increased considerably. Robust economic growth as well as prudent limits on external borrowing have reduced the ratio of public and publicly-guaranteed debt from 79 percent of GDP in 2000 to about 33 percent of GDP in 2005.

2. These achievements were made possible by maintaining prudent fiscal policies, focused on improving fiscal administration. Tax revenues increased by more than 6 percentage points of GDP from 2001 to 2005. Although corporate and personal income tax rates have gradually been reduced since 2002, revenue collections on these taxes have continued to increase, both in nominal and real terms.

3. Nevertheless, GDP per capita remains low, and living standards are far inferior to those in the European Union. This has triggered massive labor migration, and this phenomenon has given rise to new social and macroeconomic problems. According to the 2004 census, about 371,000 Moldovan citizens (19 percent of the labor force) now make their living abroad. Remittances, estimated at about 30 percent of GDP, stimulate consumption but also complicate the conduct of monetary and foreign exchange policy. A concomitant problem is the dilemma that labor migration poses for pension system finances, as the tax base for mandatory social insurance contributions is reduced accordingly.

4. In line with our Economic Growth and Poverty Reduction Strategy (EGPRSP) and the European Union-Republic of Moldova Action Plan, the government and National Bank are committed to promoting economic growth based on enhanced productivity and improved competitiveness. To this end, the authorities intend to accelerate the pace of structural reforms aimed at ensuring sustainable economic growth based on robust private sector investment, stronger competitiveness, an efficient public administration, and improvements in the businesses environment.

5. To implement the ambitious reform agenda discussed below, the authorities are counting on the technical and financial assistance of the international community.

B. Recent Macroeconomic Developments

6. Macroeconomic stability and robust growth continued during 2005. Real GDP grew by about 7 percent, while inflation fell to 10 percent (December-to-December). Fiscal policy remained tight, as general government revenues grew by almost 3 percentage points of GDP over the 2004 level. The surplus of the general government grew to about 1½ percent of GDP, in part because the government established a special account on which resources have been accumulated and aimed at reducing our arrears on external debt to Paris Club creditors. Moreover, in 2005 for the first time since independence, the government started to repay the

credits received previously from the National Bank of Moldova (in the amount of Lei 127 million, or 0.3 percent of GDP).

7. The budgetary process has been improved due to the implementation of our Medium-Term Expenditure Framework (MTEF), and by preparing estimates of the consolidated general government, including the state and local government budgets, the social insurance budget and the compulsory medical insurance budget, as well as extrabudgetary funds. In order to broaden the tax base, VAT exemptions have been eliminated on agriculture, as well as on the import and supply of pesticides and fertilizers, equipment, technology and complimentary parts. The VAT rate on medicine has been increased from zero percent to 8 percent.

8. In the absence of external financing for budget support, external debt service became a serious burden for the budget, reaching 40 percent of the total state budget revenues. Throughout 2003–05, the general government recorded primary surpluses of about 2½ percent of GDP, and Moldova's external debt indicators improved significantly. Although external arrears have been cleared to commercial and some bilateral official creditors, the government has not been in a position to make principal payments or clear arrears to Paris Club creditors.

9. The key challenge of monetary policy during 2005 was managing the pressure of foreign currency inflows. These inflows were mainly associated with remittances, and they had a significant impact on inflation and the exchange rate. During most of 2005, there was upward pressure on the leu, and it took considerable effort on the part of the NBM to bring inflation back down from near 15 percent in Q1 to almost single-digit levels by year-end (despite strong growth in energy sector prices).

10. The NBM maintains a floating exchange rate regime, intervening only to smooth out excessive volatility in the exchange rate. During 2005, the real effective exchange rate of the leu registered an appreciation of 2.4 percentage points, relative to December 2004. Reserves grew by almost $130 million in 2005, reaching 2.2 months of prospective imports at end-December.

11. At the same time, Moldova's external vulnerability continued to grow. Largely owing to the impact of higher energy prices, the trade balance deteriorated by almost 9 percentage points of GDP during 2005. This worsening was partially compensated by other items, leading to a growth in the current account deficit of about 4 percentage points of GDP. Diversification of Moldova's export markets remains limited, reflecting our continued dependence on traditional CIS markets, which in 2005 absorbed about 51 percent of total Moldovan exports (only about 30 percent went to EU markets). Trade relations were also complicated during 2005 by restrictions in Russia on imports of meat and farm product from Moldova .

12. Banking sector stability has been maintained over the past few years. Following the 2004 FSAP, parliament adopted amendments to the Law on the National Bank of Moldova and the Law on Financial Institutions aimed at bringing them more closely in line with European Union banking directives and modern central banking practices. The FSAP concluded that financial sector stability indicators are strong, and that, in general terms, Moldova respects the Basel core principles regarding effective banking supervision. Generally, the banking sector demonstrates impressive levels of revenues, capitalization and

liquidity, as well as a low level of nonperforming assets. The NBM's application of different analytical and stress tests have identified no systemic vulnerabilities of the banking sector.

C. Program Objectives

13. The main objectives of the government's program over the medium term are set out in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) and in the Republic of Moldova—European Union Action Plan, and aim at achieving the Millennium Development Goals. These plans envisage creating conditions ensuring sustainable and inclusive economic growth that reduces poverty in Moldova.

14. The government realizes that consumption currently represents the major source of GDP growth, and that productivity needs to become the driving force for growth. In turn, improvements in productivity and competitiveness can only be ensured by improving the investment climate, rehabilitating infrastructure—including through increasing public investment—while also divesting from and improving the management of state assets.

15. Developing and implementing a comprehensive structural adjustment program and ensuring the promotion of efficient policies in the future will be facilitated by the modernization of the central public administration, optimization of the decision-making process, strengthening the management of public finances and improving human resource management, including through the reform of the public sector wage system.

16. The macroeconomic program for the next three years aims at maintaining inflation in the single digit range, gradually reducing it to about 7 percent by end-2008. Except for 2006, the budget deficit will not exceed 0.5 percent of GDP, while the current account deficit is projected to be in the neighborhood of 5 percent of GDP. The NBM will aim to increase foreign exchange reserves to at least three months of imports by end-2008. The government is committed to normalize financial relations with Paris Club creditors, including by seeking a possible debt restructuring.

17. The government intends to closely monitor the evolution of poverty and to accelerate reforms of the social assistance system which, together with the help of international development partners and robust economic growth, will allow for the further poverty reduction consistent with the EGPRSP.

D. Fiscal Policy

18. Fiscal policy over the coming years will be directed toward encouraging economic growth and ensuring debt sustainability. The program envisages a budget deficit of 0.8 percent of GDP in 2006, followed by deficits that will not exceed 0.5 percent of GDP during 2007–08. Any funds released as a result of external debt restructuring through the Paris Club would be directed to poverty reduction. As in previous years, the government intends to attain a primary surplus in order to restore external debt sustainability. In this regard, continuous efforts will be undertaken to: (i) improve tax administration, (ii) rationalize discretionary expenditures, (iii) reduce tax exemptions, and (iv) improve access to concessional external resources. Nevertheless, despite the government's intention to maintain tight fiscal policy, the possibility of external shocks—such as a sudden jump in energy prices—could make it appropriate to review our deficit target, in consultation with the IMF staff.

19. Coming on the heels of strong revenue growth in 2004–05, tax receipts are expected to remain in the neighborhood of 32 percent of GDP during the next three years. While income tax rates were reduced in January 2006, VAT tax exemptions equal to Lei 300 million were cancelled, and excise tax rates for some goods were indexed to inflation. Overall general government revenues are expected to remain at about 37 percent of GDP throughout the program period.

20. An important objective of the medium-term expenditure framework is to identify resources for increased public investment. This objective will be accomplished through rationalization of budget expenditures in line with recommendations to be made in the public expenditure review being conducted in 2006 with the support of the World Bank, and by ensuring greater access to concessional external funding. Social expenditures are not expected to diminish throughout the program. Additionally, strategic budget planning will be strengthened to ensure financing of EGPRSP priorities.

21. The government is determined to develop and implement a comprehensive tax administration reform, with assistance of the IMF, that will aim to reduce the administrative burden of the tax system as a means of stimulating business development. The strategy, which will be adopted by September 30, 2006, will focus on a risk-based approach to audit and enforcement, improvements to the VAT refund process and will promote the use of indirect methods of assessing tax liability, including as a means of combating underinvoicing in external trade.

22. The authorities affirm their intention to promote pass-through of higher prices for imported energy products to the tariffs paid by households, enterprises, and budget institutions. Nevertheless, continued growth in energy prices could give rise to a demand for additional transfers to poorer households, which would need to be accommodated within the agreed deficit target. In this regard the government is looking for support from the IMF and the World Bank in the form of a poverty and social impact assessment of growing energy prices, as well as in the development of efficient subsidy mechanisms in this respect.

23. The finances of the state social insurance fund budget deteriorated in 2005, in part because of pension increases in late 2004. Thus, in January 2006 the government began to implement a reform of agricultural pensions, and included judges and prosecutors in the state social insurance system. The authorities are committed to continue with the implementation of individual record keeping of state social insurance contributions. In order to ensure the financial sustainability of the social insurance budget, by 2008 we plan to introduce a new system to estimate benefits, including pensions, based on an applicant's contributions to the social insurance budget. In the meantime, by December 31, 2006, the government—with technical assistance from the international financial institutions—will develop a plan to ensure that the finances of the Social Fund are placed on a sustainable basis over the medium term (beginning with implementation in the 2008 budget cycle).

E. Monetary and Financial Sector Policies

24. From 2006, the National Bank of Moldova will orient monetary policy toward maintaining price stability in the single-digit range, recognizing that as a result, interest rates may need to rise and exchange rate fluctuations could increase. At present, the Law on the National Bank assigns the NBM the responsibility of ensuring the stability of the national currency, which can be interpreted to mean either the exchange rate or the price level. To

eliminate this problem of dual objectives, by July 31, 2006, the Law on the National Bank will be amended to clarify that the Bank's primary objective and responsibility is price stability. The amended law will also bolster the independence of the National Bank by prohibiting direct credit to government, and by strengthening the independence of NBM board members in the performance of their tasks and duties. At the next opportunity, the authorities also intend to propose an amendment to the Constitution to include an explicit reference to the independence of the National Bank of Moldova, and to clarify the NBM's role in the conduct of monetary policy.

25. The authorities intend to tighten monetary policies in order to ensure achievement of the inflation objective for 2006. Base money is projected to grow at a rate of 16 percent (December-to-December), in the context of which the NBM will continue to make use of indirect methods of monetary policy, such as deposit auctions and open-market operations, to achieve the inflation objective. In support of this objective, by March 31, 2006, the central government will move the deposits of the state budget (which does not include the Social Fund, the Health Fund, the special revenue and extrabudgetary funds, and up to MDL 100 million set aside to clear arrears on external debt) from the commercial banks to the NBM. During 2006, the NBM will stand ready to further tighten the stance of monetary policy if, in consultation with the IMF staff, such tightening is deemed necessary to ensure achievement of the inflation objective. To enhance the NBM's ability to conduct open-market operations, the NBM and the government—with technical assistance from the IMF—will study the desirability of converting the pre-2004 stock of outstanding direct central bank credits to government into marketable securities with maturities that are consistent with budgetary debt sustainability.

26. The National Bank intends to ensure financial sector stability and to promote sustainable development in the banking sector. In particular, changes in financial sector legislation were adopted in 2005 aimed at implementing recommendations of the FSAP, including lowering the threshold above which shareholders in banks need to be assessed as *fit and proper*. The revised legislation requires that the *fit and proper* test applies to all changes in ownership, which will improve the ability of the NBM to guard against related-party lending and owners who act in concert.

27. As recommended by the FSAP, the government is developing an exit strategy for those banks where the state has a significant shareholding, including Banca de Economii (BEM). Thus, the government's intention is to privatize BEM to a strategic banking investor who will bring new technology, strengthened management and fresh capital to the bank, and stimulate competition in the Moldovan banking system. The government will begin this process with an independent evaluation of the market value of BEM, conducted by an internationally reputable firm (the tender to be announced May 1, 2006, with bids to be submitted by August 31, 2006, and the tender winner announced by year-end), and completed in 2007. In the meantime, neither the government nor the NBM will provide preferential treatment to the bank, including as regards taxation, prudential regulation, or access to resources.

28. The government and the National Bank of Moldova will continue implementation of the objectives set in EGPRSP and EU-Moldova Action Plan with respect to financial and banking sector. In particular, Moldova remains firmly committed to the global effort to combat money-laundering and the financing of terrorism (AML/CFT). In this regard, the

authorities plan to develop a comprehensive plan to strengthen our AML/CFT regime, for which we plan to request the assistance of MONEYVAL and the IMF. In the near term, by March 31, 2006, the AML/CFT law will be amended to require that suspicious transactions—regardless of whether they take place between residents or nonresidents—be reported by financial institutions to Moldova's financial intelligence unit (the CCECC).

F. Structural Reforms

29. The main principle of the program is clarification of the role of the state in the economy. With this in mind, the key pillars of the structural reform agenda of the government and the National Bank are: (i) public administration reform; (ii) regulatory reform; (iii) improvements in public finance management; and (iv) improving management and divestiture of public assets.

Public administration reform

30. A major effort in the context of structural reforms is the implementation of the central public administration reform, which has the objective of establishing an efficient central public administration that operates according to the principles of good governance applied by European Union member-states. The reform calls for the reorganization of central public administration, optimization of the decision-making process, and improvement of human resource management. A strategy for Central Public Administration Reform was developed during the second half of 2005 in a process that involved all of the key stakeholders, including international development partners, and adopted by the government in December. The Strategy calls for: (i) redefining the competencies and functions of central specialized authorities of public administration; and (ii) reconfiguring the structure of the central executive institutions to better achieve the government's priorities. The first stage of the reform—a preliminary functional analysis of key central ministries and public administration agencies, and the assessment of the decision-making process of the central public administration—has been done. The second stage will be a detailed functional analysis of the central public administration agencies that covers the remaining agencies (not covered in the first stage) and extends down to local levels of central public administration (to be completed by December 31, 2006). Based on the functional review, the government will propose changes in personnel levels for individual agencies, recognizing that some agencies may experience downsizing, while others could be increased—especially in order to facilitate cooperation with European institutions.

31. The Strategy envisages preparation of a draft law on the civil service that would regulate the following: (i) the functioning of the central administrative agency responsible for managing the civil service employment; (ii) the hiring and promotion of civil servants on a competitive basis; and (iii) the separation of political and administrative functions. The draft law will be submitted to parliament by December 31, 2006. The Strategy also envisages elaboration and government adoption of a Code of Ethics of a public functionary by September 30, 2006. The government affirms its intention to implement the law on budget sector wages gradually, within the resource limits foreseen in the annual budgets and agreed with the IMF staff.

Regulatory reform

32. Regulatory reform is an important element of the public administration reform, which has the objective of creating an open and flexible business environment with low costs to facilitate investments and innovations in business. This reform envisages two major stages: (i) deregulation and simplification; and (ii) consolidation of good regulation capacities of governmental institutions. To that end, a number of actions pertaining to the first stage were undertaken in 2003–05: (i) simplification and centralization of licensing procedures; (ii) simplification of the procedure for business registration; and (iii) reduction of conflicts of interest between the role of inspections and the interests of individuals working in inspecting agencies. Under this "guillotine" process, the number of authorizations, permits, licenses and certificates that entrepreneurs need in order to operate was significantly reduced (and most now need to be provided free of charge, within a fixed number of days). For example, the number of activities requiring authorizations and licenses was reduced from 360 to 49, and their term extended.

33. The government is developing a draft National Strategy designed to make the regulatory reform a continuous process, and which is to be approved by June 30, 2006. According to the Strategy, the second stage of the regulatory "guillotine" will begin with the approval by the parliament of the law on the basic principles and mechanisms of regulating entrepreneurial activity in the first half of 2006 and will be accomplished in early 2008. This law will provide for the revision and simplification of the legal framework regulating the entrepreneurial activity. The Strategy also envisages improving transparency and the application of laws and regulations by establishing a regulatory impact assessment (RIA) system by September 30, 2006. Likewise, using the example of the one-stop shop for the registration of enterprises, a similar mechanism will be put in place for licensing by September 30, 2006.

Public finance management

34. The government will continue to improve public finance management by undertaking reforms necessary to align Moldovan fiscal institutions and legislation to EU requirements. The government's Public Finance Management Project, implemented with the support of the World Bank and other development partners, aims to introduce best international practices of budget preparation, execution, reporting, accounting, financial control and audit, and developing an integrated public finance management information system.

35. In order to improve cash management, the government has closed the regional revenue accounts of the social fund in commercial banks, using instead the accounts established in the treasury. The government also plans to close the cash accounts of the State Tax Inspectorate in the commercial banks and establish a system to allow the treasury to monitor, on a monthly basis, all remaining accounts of budget institutions in the commercial banks (by March 31, 2006). In the meantime, by September 30, 2006, the government will prepare a plan—with technical assistance of the IMF—to transfer the expenditure accounts of the Social and Health Insurance Funds and the special (own) revenue accounts of budget institutions to the treasury (e.g., the remaining accounts in the commercial banks will be zeroed out on a daily basis) in 2007. By 2010, when the integrated public finance management information system is fully in place, payments of the Social and Health Insurance Funds will be executed by the treasury.

Privatization and state asset management

36. The government intends to improve the management of state assets and revitalize the privatization process. To this end, during 2005 the government carried out a full inventory and evaluation of the performance of state assets in the economy, and conducted a thorough analysis of the privatization methods that have been used in Moldova. On the basis of these studies, we have developed a concept paper on management and divestiture of public property that envisages corporatization of enterprises subject to privatization in the near term, and implementation of the principle of corporate governance in all other state enterprises. Although it is not intended to corporatize all state-owned enterprises immediately (owing to cost considerations), these firms will be placed in conditions similar to joint stock companies. For example, they will calculate and, if appropriate, pay dividends, and will be managed by a board on which the majority of members will be representatives of the ministry of finance and ministry of economy and trade.

37. In order to promote budgetary transparency, the ministry of finance will conduct an annual analysis of the financial results of state enterprises and joint stock companies with state participation, in conformity with the IMF's 2001 Government Finance Statistics manual. Beginning with the budget process for 2008, the analysis of the financial results of these enterprises cover all state enterprises and joint stock companies with a state share of more than 51 percent. The results of this analysis will be submitted to the parliament as background material to the Explanatory Note for the draft Law on the state budget. By September 30, 2006, the government will take a decision to create a unit in the ministry of finance with the aim of carrying out this work. To effect these changes, amendments to the Law of State Enterprise will be submitted to parliament by June 30, 2006 and passed by December 31, 2006. During the first half of 2008, the government will assess the results of these reforms, and if necessary will propose full corporatization of all state enterprises.

38. In order to accelerate the divestiture process, the government is considering a variety of mechanisms, including public-private partnerships. We intend to amend government decrees with the intention of streamlining the privatization process during the first quarter of 2006, and we plan to revise and submit to parliament an expanded list of enterprises to be included in the privatization program on the basis of the analysis conducted in 2005. Moreover, a draft law on managing and divestiture of public property (including a public enterprise reporting framework based on the 2001 Government Finance Statistics manual) and of amendments to the Law Public Debt requiring mandatory reporting to the Ministry of Finance of all state-owned enterprise debts, will be submitted to parliament by September 30, 2006, and passed by December 31, 2006.

39. The government believes that the procedure currently applied to restructuring insolvent enterprises through the Council of Creditors needs to be improved. With the aim of reducing the budgetary impact of tax arrears accumulated by unprofitable enterprises, as well as with the goal of eliminating unfair competition, the government intends to propose amendments to the Law of Insolvency (No. 632-XV dated November 14, 2001), which will envisage replacing the Council of Creditors with a new system for handling insolvency by the start of 2007. In the meantime, the government will establish September 30, 2006 as the deadline, after expiry of which the Council of Creditors will not approve new cases of debt restructuring. Moreover, from February to September of 2006, the Council of Creditors will sign new restructuring agreements for a total amount of debt not to exceed Lei 100 million,

and with full repayment of each of the restructured debt not to exceed three years. To this end, we shall consider new agreements those that did not yet enter post-moratorium phases, that is, agreements referring to completely new cases and to cases for which the Council of Creditors had not approved restructuring plans before January 31, 2006. The Council of Creditors will be abolished by December 31, 2006, and its responsibilities for monitoring previously approved restructuring agreements will be allocated to the State Tax Inspectorate and the corresponding courts. At the same time, the government intends to improve—with the assistance of IMF—the legislative, regulatory and institutional framework concerning bankruptcy procedures.

40. The government intends to develop a new strategy of promoting exports aimed at improving Moldova's ability to penetrate external markets. In particular, we hope to diversify our commodity markets by reducing tariff and non-tariff barriers impeding development of external trade. The Asycuda World Informational System has been implemented at all custom offices since August 1, 2005, and the government intends to develop a strategy for customs risk management with the aim of creating risk profiles. Similarly, the requirement that grain exports must be transacted on the Moldovan Commodity Exchange will be abolished by September 30, 2006, and similar requirements will not be introduced for other export products. In addition, there are no restrictions specifying the mode of transportation (trains vs. truck) for agricultural products. At the same time, planned improvements in tax administration (noted above) will strengthen the capacity of the State Tax Inspectorate to combat the problem of underinvoicing.

41. Moldova is fully committed to implementation of the EU-Moldova Action Plan, signed in February 2005. The Plan covers almost all of the areas of political, economic and social activities of the state, and is consistent with the EGPRSP. In order to avoid duplication of effort, the Government intends to coordinate the implementation and monitoring of both plans in a consistent manner, in consultation with the European Commission, the World Bank, the IMF and other stakeholders.

Table 1. Prior Actions, Performance Criteria and Benchmarks

Prior Actions

Observe all quantitative macroeconomic targets for end–March 2006.

Transfer of central government deposits (with the exception of the Health Fund, the Social Fund, the special revenue and extrabudgetary funds, and up to MDL 100 million set aside to clear arrears on external debt) from the commercial banks to the National Bank.

Submission to parliament of amendments to the law on the NBM, establishing price stability as the Bank's core objective, prohibiting direct lending to government, strengthening independence of NBM board members in the performance of their tasks and duties, and giving the NBM full authority for monetary policy.

Revocation of amendments to Article 5(3) of the AML law regarding transactions involving nonresidents, as introduced by law No. 255-XVI.

Closure of cash accounts of the State Tax Inspectorate and the regional revenue accounts of the Social Fund in the commercial banks, using instead the accounts established in the treasury, and implement a system whereby the treasury monitors all remaining commercial bank accounts of budget institutions (including customs) on a monthly basis.

Announce tender for independent evaluation of the value of BEM.

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Structural Performance Criteria		
Neither the government nor the NBM will provide preferential treatment to Banca de Economii (whether by tax treatment, access to general government deposits, or prudential forbearance)	¶27	Continuous
Submission to parliament of amendments to the Law on State Enterprise establishing corporate governance conditions similar to joint stock companies.	¶37	June 30, 2006
Parliamentary passage of amendments to the Law on the NBM, establishing price stability as the Bank's core objective, prohibiting direct lending to government, strengthening independence of NBM board members in the performance of their tasks and duties, and giving the NBM full authority for monetary policy.	¶24	July 31, 2006
From February to September 2006, the Council of Creditors to sign new restructuring agreements for a total amount of debt not to exceed Lei 100 million, and with full repayment of each of the restructured debt not to exceed three years.	¶39	Sept. 30, 2006

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Government adoption of a tax administration reform strategy and implementation plan which has the overall aim of reducing the administrative burden of the tax system and strengthening revenue collection, and which would specifically include a risk-based approach to audit and enforcement, improvements to the VAT refund process, and the use of indirect methods of assessing tax liability, including as a means of combating underinvoicing in external trade.	¶21	Sept. 30, 2006
Structural Benchmarks		
Pass higher imported natural gas prices through to consumers (households and enterprises) by ensuring that tariffs are set at cost-recovery levels, while improving the cost effectiveness of the current system of targeted compensation.	¶22	Continuous
Establishment of a system responsible for conducting regulatory impact assessments of new legislation and regulations.	¶33	Sept. 30, 2006
Preparation of a plan to transfer special (own) revenue accounts of budget units, and of expenditure accounts of the Social and Health Funds, to the treasury (e.g., zeroing out the balances in the commercial banks) in 2007.	¶35	Sept. 30, 2006
Elimination of the requirement that grain exports must be transacted on the Moldovan Commodity Exchange.	¶40	Sept. 30, 2006
Government adoption of a strategy to strengthen bankruptcy procedures.	¶39	Sept. 30, 2006
Submission to parliament of a law on management and divestiture of public assets (including a public enterprise reporting framework based on the 2001 Government Finance Statistics manual), and of amendments to the Law on Public Debt requiring mandatory reporting to ministry of finance of all SOE debts.	¶38	Sept. 30, 2006
Preparation of a plan to put the Social Fund on a sustainable financial basis (for the 2008 budget).	¶23	Dec. 31, 2006
Submission to parliament of draft laws on civil service.	¶31	Dec. 31, 2006
Council of Creditors formally abolished, with STI to assume responsibility for monitoring tax debts and the corresponding courts to handle non-tax debts.	¶39	Dec. 31, 2006
Completion of detailed functional reviews of all central public administration ministries and agencies.	¶30	Dec. 31, 2006

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Announce winner of tender for independent valuation of BEM.	¶27	Dec. 31, 2006
Parliamentary approval of the law on management and divestiture of state assets and the law on public debt.	¶38	Dec. 31, 2006

TECHNICAL MEMORANDUM OF UNDERSTANDING

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

I. PROGRAM ASSUMPTIONS

2006

2. Loan disbursements of $38.5 million.

3. Receipts to the general government budget of privatization proceeds in the amount of MDL 67.8 million in 2006.

4. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at the program exchange rate. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at MDL 12.832/$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates prevailing at end-2005.

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

II. REPORTING REQUIREMENTS

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

III. Program Targets and Definitions

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves (Performance criterion)
March 31, 2006	6,410
June 30, 2006	6,791
September 30, 2006	7,866
December 31, 2006	8,276

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

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

(In millions of lei)

Position on	Maximum level NDA (Performance criterion)	Maximum level Reserve Money (Indicative target)
March 31, 2006	60	6,470
June 30, 2006	55	6,846
September 30, 2006	-477	7,390
December 31, 2006	-150	8,126

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

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

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

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

	Cash balance (Performance criterion)
Cumulative change from December 31, 2004	
December 31, 2005	634
Cumulative change from December 31, 2005	
March 31, 2006	-247
June 30, 2006	-417
September 30, 2006	-303
December 31, 2006	-350

11. The **general government** is defined as comprising the central and local government budgets. The central government includes also the Social Insurance Fund, the Health

Insurance Fund, special and extrabudgetary funds, and foreign-financed investment projects. The local government includes also special and extrabudgetary funds. The authorities will inform the Fund staff of any new special or extrabudgetary funds that may be created during the program period to carry out operations of a fiscal nature and will ensure that these will be included in the general government. Excluded are any government-owned entities with a separate legal status. Net credit of the banking system to general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed investment projects).[27] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed investment projects.

12. The **quarterly limits on the overall cash deficit of the general government** are cumulative and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government (excluding the change in the stock of government securities issued to recapitalize the central bank), the general government's net placement of securities outside the domestic banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[28] for direct budgetary support and for specific projects minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets, after deduction of the costs directly associated with the sale of these assets. The calculation of the deficit as specified in this TMU may need to be reviewed, once planned amendments to the Chart of Accounts are introduced in April, 2006.

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

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

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

[28] Debt is defined as in footnote 29 in the section on limits on external debt.

15. The term **debt** has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000).[29] This performance criterion applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received.

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

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

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

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

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

IV. ADJUSTERS

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

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

22. The limits on net domestic assets of the NBM will be increased by the face value of government securities issued for recapitalization of the NBM and decreased by the face value of repayment of government securities previously issued for the same purpose.

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

	Stocks 2/ 31-Dec-05	31-Mar-06 Indicative targets	30-Jun-06 Indicative targets	30-Sep-06 Performance criteria	31-Dec-06 Indicative targets
1. Quantitative performance criteria					
			(In millions of lei)		
Ceiling on net domestic assets of the NBM (level)	569	60	55	-477	-150
Floor for general government fiscal balance 3/	634	-247	-417	-303	-350
Floor on net international reserves of the NBM (level)	6,436	6,410	6,791	7,866	8,276
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	...	0	0	0	0
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears 4/	...	...	0	0	0
			(In millions of lei)		
3. Indicative target					
Ceiling on reserve money (level)	7,002	6,470	6,846	7,390	8,126
Ceiling on change in domestic expenditure arrears of the general government	...	0	0	0	0
			(In millions of lei, unless noted otherwise)		
4. Baseline assumptions					
Concessional external debt financing	327	130	231	362	494
in millions of dollars	...	10	18	28	39
Privatization receipts	176	9	30	50	68

Sources: Moldovan authorities; and Fund staff estimates.

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

2/ Except general government fiscal balance and concenssional external debt borrowing, which are flows.

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

4/ The requirement becomes effective with the approval of the Fund program.

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

Item	Periodicity
Fiscal data (to be provided by the MoF)	
General budget operations for revenues, expenditure and financing (functional and economic).	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Privatization receipts received by the budget (in lei and foreign exchange, net of divestiture transactions costs).	Monthly within three weeks of the end of each month
Monetary data (to be provided by the NBM)	
Monetary survey of the NBM	Weekly within one week of the end of each week
Monetary survey for the whole banking system	Weekly within two weeks of the end of each week
Net claims on general government (NBM and commercial banks)	Weekly within two weeks of the end of each week
Financial indicators of commercial banks (from NBM's Banking Supervision)	Monthly within four weeks of the end of each month
Foreign exchange cash flows	Monthly, within two weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily within 12 hours of the end of each day
NBM's sterilization operations	Weekly within one week of the end of each week
Interbank transactions (volumes, average rates)	Weekly within one week of the end of each week
Balance of Payments (to be provided by the NBM)	
Current and capital account data.	Quarterly within six weeks of the end of each quarter
Transfers/remittances through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF)	
Information on all new external loans contracted by the government or government guarantee.	Monthly within three weeks of the end of each month
Total debt service due by creditor, and debt service paid.	Monthly within three weeks of the end of each month
Disbursements of grants and loans by creditor	Monthly, within three weeks of the end of each month

Item	Periodicity
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly within two weeks of the end of each month.
National accounts by sector of production, in nominal and real terms.	Quarterly within three months of the end of each quarter.
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly within two months of the end of each month.

Statement by the IM Staff Representative
May 5, 2006

1. **This statement summarizes developments in Moldova since the issuance of the staff report for the 2006 Article IV consultation and request for a three-year arrangement under the PRGF**. The additional information does not change the thrust of the staff appraisal.

2. **Recent economic data have been broadly in line with projections**. Year-on-year inflation accelerated to 10.9 percent in March, reflecting the pass-through of higher natural gas import prices to domestic consumers (domestic natural gas rates increased by close to 40 percent in March). The NBM has kept the stance of monetary policy tight; at end-March, reserve money was up by only 6.3 percent year-on-year, with the reduction coming through stepped-up sterilization operations. Excess liquidity has continued to decline, and short-term interest rates have moved up. The general government reported a surplus of 0.4 percent of GDP in the first quarter, against a projected deficit of 0.6 percent of GDP.

3. **Preliminary data for the 2005 balance of payments show a larger deterioration in the current account than was estimated in the staff report**. According to these preliminary data, the current account deficit was 10½ percent of GDP, compared with 5½ percent of GDP in the staff report. However, in previous years preliminary data have also indicated a large current account deficit that was subsequently revised downward (by an average of 3 percent of GDP in 2001-04), so historical experience suggest that a similar revision is likely to occur when these data are finalized during the summer. In particular, errors and omissions are large and positive at 6.6 percent of GDP, suggesting that some inflows have yet to be classified.

4. **Although the final current account data for 2005 are likely to demonstrate a more positive outcome, the deterioration underscores staff concerns about the risks to Moldova's balance of payments going forward**. These risks have been exacerbated by a recent ban by Russia on imports of Georgian and Moldovan wine and spirits, reportedly on public health grounds. In the case of Moldova, wine and spirits comprise about 30 percent of total exports, of which more than three-fourths traditionally go to Russia. The authorities hope to resolve this dispute in the near future, and in the meantime are keeping a close eye on financial sector stability, as about 15 percent of outstanding bank credit is related to the wine sector.

5. **Official creditors have provided financing assurances**. It is expected that the Paris Club will take up Moldova's request for debt rescheduling after the IMF Board meeting.

6. **All prior actions have been implemented**. All end-March quantitative targets were met by comfortable margins, except for the floor on reserves, which was met with a small margin. Government accounts were transferred from commercial banks to the NBM as planned, and cash accounts of the State Tax Inspectorate and the regional revenue accounts of the Social Fund in the commercial banks were closed. The AML law was amended to revoke the changes passed late in 2005. Revisions to the NBM law were submitted to Parliament, and the government announced a tender for an independent evaluation of BEM in the April 29, 2006, issue of *The Economist*.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 06/54
FOR IMMEDIATE RELEASE
May 15, 2006

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

IMF Executive Board Concludes 2006 Article IV Consultation with the Republic of Moldova

On May 5, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Moldova.[1]

Background

Economic growth has continued to be robust, although the drivers of growth—household consumption and construction—remain heavily dependent on inflows of remittances (now equal to some 30 percent of GDP), as well as strong wage growth. Real GDP growth in 2005 was over 7 percent, as it has been since early in the decade. Inflation has gradually abated. After peaking at over 14 percent in April 2005, it fell to 10 percent (year-on-year) in December, despite a sharp pickup in energy prices in mid-2005.

Fiscal policy has remained tight. The general government posted a cash surplus of about 1.7 percent of GDP in 2005, about twice the level of 2004, and considerably tighter than the deficit predicted in the revised 2005 budget (½ percent of GDP). The main factors driving this fiscal performance were better-than-expected Value Added Tax revenues, delays in implementing foreign-financed project investments, disbursement of a grant from the European Union on December 29 for which expenditures had been included in the 2006 budget, and some spending restraint on the part of the government.
Monetary policy was tightened in 2005, despite continued strong inflows of remittances. Sterilization efforts were stepped up in the second and third quarters before easing in the fourth quarter, as the balance of payments weakened in light of higher energy prices and

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

the National Bank of Moldova (NBM) moderated its foreign exchange purchases. The NBM's balance on sterilization operations rose from an average of 1.1 percent of GDP in 2004 to an average of 2.9 in 2005, reaching 3.5 percent of GDP at end-February 2006. As a result, reserve money growth slowed during the year, falling to 16½ percent at end-September, before rising seasonally in December. At the same time, broad money growth remained strong (at 35 percent for the year as a whole). Lending and deposit rates have remained high, despite plentiful liquidity on the T-bill and interbank markets. Financial sector soundness indicators have remained generally strong, reflecting partly strong economic performance of the recent years.

Moldova appears to follow an asymmetric, managed floating exchange rate regime. Since early 2004, it would appear that downward pressure is accommodated while upward pressure is absorbed by the NBM through purchases of foreign exchange. The leu appreciated in real effective terms in 2004, but with a weaker balance of payments and lower inflation than in key trading partners, this tendency leveled off in 2005. Reserves have grown as well, doubling in dollar terms since end-2003, though as a share of imports they remain modest at about 2.2 months.

The trade balance deteriorated significantly in 2005, owing in large part to the impact of higher energy prices. Energy (particularly fuel oil) imports rose in value terms by about 50 percent in 2005 (to about 5 percent of GDP), while export growth slowed modestly. The structural reform agenda has been reinvigorated by Moldova's aspirations for closer integration with Europe. The European Union–Moldova Action Plan, signed in February 2005, provides, along with the authorities' EGPRSP, a road map for advancing a broad reform agenda, including in areas public administration, public expenditure management, and management of state enterprises.

Executive Board Assessment

Executive Directors welcomed the strong economic growth and significant poverty reduction in recent years, the moderation of inflation, and the strengthened fiscal position, and commended Moldova's authorities for their commitment to structural reforms and balanced macroeconomic policies. At the same time, they noted that growth has been fueled mainly by domestic spending, which was financed by workers' remittances. Directors agreed that maintaining macroeconomic stability in light of robust inflows of remittances while diversifying the economy and bringing poverty further down remain the key challenges going forward. They also stressed the importance of improving the business environment to support greater private sector investment and thus to help reverse the large migration of labor and strengthen the external position.

Directors commended the authorities for their disciplined macroeconomic policies and considered that the short-term fiscal stance constituted an appropriate balance between the objective of supporting disinflation and meeting the need for larger public investment and social spending. Looking ahead, most Directors encouraged the authorities to repeat the fiscal overperformance of recent years, though some Directors favored devoting revenue in excess of budgeted amounts to poverty reduction and infrastructure spending if the macroeconomic environment permits it.

Directors welcomed the authorities' efforts to modernize public sector management to improve the efficiency of government operations. They observed given the large size of the government, that the public administration reform currently underway should lead to a leaner, more focused, and transparent government structure. While Directors welcomed the decision to fully pass through energy price changes, they expressed concern about the large increases in public sector wages in 2006 and urged the authorities to ensure that the wage profile remains consistent with priorities identified in the medium-term expenditure framework.

Directors welcomed the decline in inflation during 2005. Nevertheless, they noted that inflationary pressures remain, particularly in light of the increasing energy prices and the tightening labor market, and urged the authorities to be prepared to tighten monetary policy. Directors also encouraged the authorities to permit greater exchange rate flexibility to minimize risks to the disinflation path and facilitate the economy's resilience to balance-of-payments shocks. In this context, they welcomed the authorities' decision to amend the National Bank law to establish price stability as its key objective and stressed that this legislative change needs to be matched by steps in monetary policy implementation.

Directors welcomed the authorities' renewed push for structural reforms and underscored their importance to sustain the economic revival and maintain external competitiveness. They stressed the importance to improve the environment for private initiative and investment also by reducing licensing and registration requirements and other administrative barriers and strengthen the legal and institutional framework and governance. They encouraged the authorities to accelerate implementation of the structural policies envisaged in their EGPRSP to encourage investment, reverse the current emigration trend, and use the strategy to make progress in achieving the Millennium Development Goals. Directors also noted that the EU-Moldova Action Plan—which is consistent with the EGPRSP—will serve as a useful roadmap for the ambitious reform agenda.

Directors noted that financial sector stability indicators were largely positive, but urged the authorities to address remaining vulnerabilities. They emphasized the crucial importance of financial sector development to underpin economic and employment growth. Directors considered that Moldova's financial sector, and the economy more broadly, would benefit from a presence of reputable international banking institutions. In this context, they welcomed the authorities' intention to privatize Banca de Economii. Directors also commended the authorities for strengthening the Anti-Money Laundering/Combating Financing of Terrorism framework and their objective of bringing it in line with best practices over the medium term.

Directors welcomed the sustained improvement in Moldova's external debt position and expressed hope that Moldova will be able to normalize its relations with Paris Club creditors and restructure its stock of arrears in the near future, underscoring that this would facilitate access to fresh donor financial support.

Directors were encouraged by Moldova's subscription to the Fund's Special Data Dissemination Standard as an important step to further improve transparency, timeliness, and comprehensiveness of economic and financial data.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Republic of Moldova: Selected Economic Indicators

	2003	2004	2005 Est.	2006 Proj.
	(Percent change: unless otherwise indicated)			
Production and Prices				
Nominal GDP (in MDL millions)	27,619	32,032	36,755	42,585
Real GDP growth	6.6	7.4	7.1	6.0
Consumer prices (end of period)	15.7	12.6	10.0	9.0
	(In percent of GDP)			
Public finance (general government)				
Overall balance (cash)	0.2	0.8	1.7	-0.8
Primary balance	2.3	2.7	3.0	0.6
	(Percent change: unless otherwise indicated)			
Money and credit				
Broad money (M3)	30.7	37.7	35.0	29.4
Credit to the economy	44.4	22.2	35.0	25.6
External sector				
Current account balance (in percent of GDP	-6.8	-2.7	-5.6	-5.4
Total external debt (in percent of GDP)	88.7	63.8	54.7	51.3
Total debt service (in percent of exports of goods and services)	19.8	21.3	20.2	14.5
Gross official reserves (in millions of dollars)	302	470	597	750

Sources: Moldovan authorities; and IMF Staff estimates.

Press Release No. 06/91
FOR IMMEDIATE RELEASE
May 5, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF approves US$118.2 Million Arrangement Under the Poverty Reduction and Growth Facility with Moldova

The Executive Board of the International Monetary Fund (IMF) today approved a new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for an amount equivalent to SDR 80.08 million (about US$118.2 million) for Moldova. The approval of the arrangement enables Moldova to draw the equivalent of SDR 11.44 million (about US$16.9 million) immediately.

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

"Moldova's macroeconomic performance in the past year has been encouraging. Growth remained robust and inflation was brought down to near single-digit levels. The fiscal position remained strong and the external debt position improved. Emerging risks to the balance of payments outlook—stemming primarily from energy import price increases—have been contained thus far. The outlook for growth remains encouraging, but this requires continued polices to safeguard macroeconomic stability and make progress in improving the investment climate and modernizing its economic infrastructure.

"The authorities' Economic Growth and Poverty Reduction Strategy Paper and the Moldova-EU Action plan provide a solid basis for the medium-term policy framework that will support conditions for durable, private sector-led, and pro-poor growth.

"The macroeconomic framework which underpins the authorities' program is appropriately ambitious, aiming for further gradual disinflation in the coming years. To achieve this objective, monetary policy will need to accommodate greater exchange rate flexibility to minimize risks to the disinflation path and to provide a buffer against external shocks. The authorities' decision to amend the National Bank law to establish price stability as its key objective is a welcome step and will support a forward-looking monetary policy implementation. The fiscal program strikes the appropriate balance between the objective of supporting disinflation and meeting the country's extensive developmental needs. Moreover, it will be important to maintain a disciplined path of public sector wage increases in line with the medium-term expenditure framework.

"The program envisages ambitious structural reforms. Public sector management will be strengthened through improved corporate governance of state enterprises, privatization and public administration reform, while the business environment will be enhanced through the modernization of bankruptcy procedures, the streamlining of regulations, and the removal of restrictions on grain exports. The financial sector will be strengthened by improvements in transparency, a reduction in government interference, and the promotion of greater competition, including through the support of market access for reputable foreign banks. Strict implementation of the measures should facilitate renewed inflows of external assistance to the Republic of Moldova, and thus contribute to stronger economic growth and poverty reduction, " Mr. Kato said.

ANNEX

Recent Economic Developments

Higher energy prices complicated the macroeconomic picture in 2005. Although overall GDP growth remained strong at 7 percent, its composition shifted further away from the traded sector, which was particularly affected by the rise in petroleum prices. Despite the higher energy prices inflation performance improved, falling to 10 percent (year-on-year) in December 2005.

Fiscal and monetary policy were tightened. Substantial over performance on the value added tax translated into a stronger fiscal policy stance (a surplus of 1.7 percent of GDP).

Since mid-2004, downward pressure on the currency has been accommodated but upward pressure was absorbed by the national Bank of Moldova through purchases of foreign exchange. International reserves have grown as well, though as a share of imports they remain modest.

The current account deficit deteriorated significantly in 2005, owing in large part to the impact of higher energy prices. Energy (particularly fuel oil) imports rose in value terms by about 50 percent in 2005 (about 3.5 percent of GDP), while export growth slowed modestly.

The external debt outlook continued to improve, although arrears were accumulated to Paris Club creditors. External debt fell as share of GDP from over 100 percent in 2001 to about 55 percent by 2005, owing largely to strong growth and real exchange rate appreciation, as well prudent debt management and several favorable restructuring arrangements.

Program Summary

The program is designed to address the following main objectives: support growth and poverty reduction by maintaining macroeconomic stability, particularly in the face of strong inflows of remittances and sharply higher prices for imported energy; improve the performance of the financial sector, including by building on the lessons of last year's financial sector Assessment Program; and clarify the role of the government in the economy, thus advancing the transition process.

The program is consistent with the European Union-Moldova Action Plan, signed in February 2005 and the authorities' Economic Growth and Poverty Reduction Strategy Paper, which provide for advancing a broad agenda of measures designed to improve Moldova's long-run growth prospects.

Growth is expected to slow somewhat in 2006 and over the medium term, partly in response to higher oil process, as well as emerging labor shortages. Under the program, real GDP growth is projected to fall to 6 percent in 2006, and to 5 percent over the medium term. Achieving this outcome will depend on a continued recovery in investment, particularly of the private sector.

The program envisages an inflation objective of 9 percent (year-on-year) in 2006, falling to 7 percent by 2008, despite continued high and rising inflows of remittances (up to $1.3 billion a year by 2008) and foreign aid that may complicate achievement of this goal.

The underlying budget deficit (after grants) should be no more than 0.5 percent of GDP for the medium term. The 2006 budget foresees a slightly larger deficit (0.8 percent of GDP), owing to an advanced disbursement of an EU grant of about 0.3 percent of GDP in the last days of 2005, for which the corresponding spending was already included in the 2006 budget.With general government debt falling to about one third of GDP in 2006 (from over 80 percent in 2001), a slightly higher deficit would not jeopardize medium-term fiscal sustainability.

Republic of Moldova: Selected Economic Indicators

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Sources: Moldovan authorities; and IMF staff estimates.

Statement by Jeroen Kremers, Executive Director for Republic of Moldova and Vladimir Munteanu, Advisor to Executive Director
May 5, 2006

On behalf of the Moldovan authorities, I would like to express appreciation to Management and staff for their continued support to Moldova in surmounting transition challenges. The authorities agree with the thrust of the staff appraisal, and believe that it adequately describes the economic developments in Moldova as well as the challenges facing the country.

Recent economic developments

Moldova's strong economic performance over the last four years has marked the progression from a decade of economic decline and rising poverty to a stage of robust growth and improving living standards. Real GDP increased by more than 30 percent during 2001-04, and the absolute poverty rate fell from about 70 percent in 1999 to 27 percent in 2004. Sound fiscal and monetary policies have helped to subdue inflation, maintain stability of the leu, and achieve budget surpluses, while robust growth in combination with prudent debt management have contributed to substantial improvement in Moldova's external debt indicators. Furthermore, Moldova's European aspirations have provided much-needed momentum to the authorities' structural reform efforts and commitment to combat corruption. These efforts were underpinned by signing in February 2005 the EU-Moldova Action Plan, and evidenced by improvement in Moldova's Corruption Perception Index (CPI) from 2.3 to 2.9[1]. At the same time, higher energy prices[2] and deterioration in trade terms contributed to a worsening in the external current account.

Notwithstanding encouraging economic performance since 2001, the GDP per capita remains low, and living standards are by far inferior to those in the European Union. This has triggered massive labor migration[3], and created additional social and macroeconomic problems.

Going forward, Moldova's challenge is to build on recent favorable developments and to set the stage for sustained growth in the medium term. While the near-term outlook remains fairly positive with the real GDP growth projected at 5-6 percent, and inflation expected to decline further, the authorities are not satisfied with the quality of growth and concur with staff that the current growth model is reaching its limit. Labor shortages in some sectors and delayed investments hindering development in others in the context of emerging, but still low institutional capacity, a weak financial intermediation and business environment are the main challenges facing the country. The government's priority is to address these challenges, which are rightly emphasized in the staff papers. To this extent, the authorities

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[1] In 2005 Moldova ranked 95 on Transparency International CPI, compared to 117 in 2004.

[2] Moldova relies fully on imported energy recourses which account for about 16 percent of GDP.

[3] According to the 2004 census, about 371,000 Moldovan citizens (19 percent of the labor force) now make their living abroad. The actual number of migrant workers is believed to be much higher.

have embarked on an ambitious reform agenda that is in line with the EU-Moldova Action Plan and with the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP).

Relations with the Fund

In the absence of a Fund supported program since mid-2004 the authorities have increasingly relied on Fund advice for their economic policies, and maintained macroeconomic indicators consistent with the IMF parameters. The authorities attach great value to a close relationship with the Fund and believe that their efforts aimed at creating conditions for a sustainable growth, as well as implementation of the EU-Moldova Action Plan, EGPRSP and achieving the Millennium Development Goals would be successful if complemented by an IMF supported PRGF Arrangement.

By implementing all prior actions, the authorities have reconfirmed their commitment to sound economic and financial policies. Moreover, this was the first time that the Memorandum of Economic and Financial Policies (MEFP) has been entirely prepared by the authorities, indicating their ownership of the program. Also, the President affirmed his strong support for the program by signing a letter to that effect. Against this background, they request support for a three-year PRGF program. In the spirit of transparency the authorities consented to publication of the staff report and all program documents in their Letter of Intent of April 14, 2006.

The new economic program represents a new stage in Moldova's transition to a market economy, its relations with the International Financial Institutions including the IMF, and its further integration in the global economy. In this vein, the government's macroeconomic program aims at deepening the reform agenda and maintaining inflation in the single digit range. The budget deficit will not exceed 1/2 percent of GDP, except slightly in 2006 when the deviation is explained by disbursement of an external grant on December 29, 2005, for which the corresponding spending was already included in the 2006 budget. The current account deficit is projected to be around 5 percent of GDP. However, the preliminary data for the 2005 balance of payments show a larger deterioration in the current account than was estimated in the staff report. The National Bank of Moldova (NBM) will maintain a tight monetary policy stance and aim to gradually increase foreign exchange reserves to at least three months of imports over the program period. Also, the government is committed to normalize financial relations with Paris Club creditors by seeking a possible debt restructuring.

Fiscal policy

Moldova has a good track record of fiscal consolidation by realizing budget surpluses during three consecutive years. These achievements were possible thanks also to improved tax administration that resulted in revenue increase by more than 6 percentage points of GDP from 2001 to 2005.

In 2005 fiscal policy remained tight, and the surplus of the general government grew to about 1½ percent of GDP, in part reflecting the accumulation of resources to reduce arrears to Paris Club creditors. The budgetary process has been improved with the implementation of the Medium-Term Expenditure Framework (MTEF). In order to broaden the tax base, VAT exemptions have been eliminated on agriculture, import of pesticides and fertilizers, equipment, technology and spare parts. The VAT rate on medicine has been increased from zero to 8 percent.

The authorities note staff's attention for a somewhat higher fiscal target (deficit of 0.8 percent of GDP) for 2006, but believe that this will not jeopardize fiscal sustainability, given that the 2005 large surplus was in part due to one-off factors. As in the past, the authorities intend to maintain tight fiscal policy and attain a primary surplus in order to further underpin external debt sustainability. If extra funds become available as a result of higher revenues or due to external debt restructuring, the authorities prefer to use them for poverty reduction and badly needed investment projects. However, the authorities understand that the budget has a role to play in disinflation, and will stand ready to tighten the stance of fiscal policy if needed, to ensure that the inflation objective is achieved. At the same time, the possibility of external shocks could make it appropriate to review the deficit target, in consultation with the IMF staff.

Looking ahead, the authorities are committed to further improve the efficiency of the tax administration system. With technical assistance from the Fund, a comprehensive tax administration reform strategy is under preparation as stipulated in the EU-Moldova Action Plan. Together with other measures this will create adequate conditions for the long-due replacement of the Council of Creditors with a new system relying on the state tax inspectorate and bankruptcy courts.

On the expenditure front, the authorities concur with staff that expenditure restraint is key to ensuring sustainable public finances and a competitive business environment over the medium term. An important objective of the medium-term expenditure framework is to identify resources for increased public investment. This objective will be accomplished through rationalization of budget expenditures, and by ensuring greater access to concessional external funding. At the same time, social expenditures are not expected to diminish throughout the program. While remaining committed to promote pass-through of higher prices for imported energy products to the final consumers, the authorities seek support from the IMF and the World Bank to assess the social impact from rising energy prices, as well as to develop efficient compensation mechanisms for the poor.

The authorities are concerned about the deterioration of the state social insurance fund finances in 2005, and remain committed to continue with the implementation of individual record keeping of state social insurance contributions. As a first step, in January 2006 the government began the implementation of the reform of agricultural pensions, and included judges and prosecutors in the state social insurance system.

External debt strategy

In the absence of external financing for budget support and given negative net cash flows during 2001-2005, external debt service became a serious burden for the budget, reaching no less than 40 percent of the total state budget revenues. Although external arrears have been cleared to commercial and some bilateral official creditors, the Government has not been in a position to make principal payments or clear arrears to Paris Club creditors. The government is committed to normalize financial relations with Paris Club creditors by seeking a possible debt restructuring. To this effect, funds have been accumulated in an escrow account since 2005 for the payment of a portion of arrears. Also, the authorities are preparing a new law that will introduce conditions for a more comprehensive debt management according to international standards.

While Moldova's debt indicators are projected to improve further, the country's external vulnerability continues to grow. Largely owing to the impact of higher energy prices, and uncertainties related to trade with the traditional partners, the trade balance deteriorated sharply as preliminary data for 2005 indicate. Diversification of Moldova's export markets remains limited, reflecting continued dependence on traditional CIS markets, which absorbed about half of Moldova's total exports. Given the impact on Moldova's Balance of Payments of the recent ban on imports of Moldovan wine to Russia, the authorities may request a downward revision of the program's target on NFA.

Monetary policy

The main challenge facing the NBM has been containing inflationary pressures, fueled by strong remittances[4] and increasing energy prices, while operating in rather thin financial markets. The NBM has tightened monetary policy in 2005, stepping up sterilization efforts**.** Reserve money growth slowed from 48 percent (year-on-year) at end-January to near 20 percent in the fourth quarter.

Under the Fund program, the NBM will orient monetary policy toward maintaining price stability in the single-digit range, by using all available instruments and allowing for greater exchange rate flexibility. The NBM has submitted to parliament amendments to the central bank law aimed to clarify that the Bank's primary objective is price stability. In support of this objective, the government has moved the deposits of the state budget from the commercial banks to the NBM, and has requested the Fund's assistance in exploring the option of securitizing the pre-2004 stock of Government debt to the NBM.

Safeguarding the NBM's independence and strengthening its financial soundness remain key. In this vein, and in line with Fund recommendations, the revised law will prohibit direct credit to the government and will strengthen the independence of the NBM board members. At the next opportunity, the authorities also intend to propose an amendment to the Constitution to include an explicit reference to the independence of the National Bank of Moldova, and to clarify its role in the conduct of monetary policy.

The financial sector remains generally sound, with strong capital adequacy and liquidity ratios, and robust profitability. In order to further ensure financial sector stability, and to enhance the sector's sustainable development, in line with the 2004 FSAP, parliament has adopted amendments to the Law on the National Bank of Moldova and the Law on Financial Institutions aimed at bringing them more in line with European Union standards and best international practices. These changes provide for an adequate framework to ensure greater transparency in bank ownership and should enhance the NBM's ability to guard against risky practices, in particular related party lending.

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

While financial sector stability indicators are healthy, the authorities concur with staff that there could be more competition to further stimulate and financial intermediation. Staff is correctly pointing out that arrival of foreign banks in Moldova would be beneficial, as this will bring new technology, fresh capital and stimulate competition. An important step in this direction is the authorities' decision to develop an exit strategy from banks with state-owned capital, including Banca de Economii.

Also, the authorities are taking steps to further enhance the effectiveness of the AML/CFT regime, among other measures by preparing a thorough reform of the AML framework in line with the MONEYVAL recommendations.

Structural reforms

The authorities recognize that the program's macroeconomic and development objectives require implementation of an ambitious reform agenda including clarification of the role of the state in the economy. In this context, the key pillars of the structural reform program are public administration reform, regulatory reform, improvements in public finance management, and enhancing management and divestiture of public assets.

An important effort in the context of structural reforms is the implementation of the central public administration reform, which aims at establishing an efficient central public administration that functions according to the principles of good governance applied by European Union member-states. An integral part of the public administration reform is the regulatory reform, which focuses on improving the business environment by eliminating impediments to business activity. The next step in this regard will be abolishing laws that led to the appearance of unnecessary regulations and introduction of a regulatory impact assessment system to prevent reappearance of these regulations.

In order to bring management of the state-owned enterprises in line with the best international practices, the authorities have developed a plan to introduce corporate governance principles in state-owned enterprise (SOE). To this end, they carried out a full inventory and evaluation of the performance of the state assets, and on this basis developed a concept paper on management and divestiture of public property.

Last but not least, the authorities attach great importance to combating corruption. A major aspect of this effort is modernization of the legal framework for civil service that will promote legislation aimed at preventing conflict-of-interests and ensuring that civil service is managed on apolitical grounds. Furthermore, on April 25 the Constitutional Court approved a draft law on modification of the Constitution, in order to require public functionaries to prove the legality of their assets.