GUVERNUL REPUBLICII MOLDOVA

GOVERNMENT OF THE REPUBLIC OF MOLDOVA

Nr. 01-79-4200

Chişinău, April 26, 2022

Letter of Intent

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

Dear Ms. Georgieva,

1. Our country's economic ties and proximity to Ukraine, Russia, and Belarus exacerbates an already complex macroeconomic situation. The approval of a program supported by the IMF Extended Credit Facility and Extended Fund Facility (ECF-EFF) arrangements in December 2021 provided the much-needed impetus to our reform momentum amid energy price shocks and the COVID-19 pandemic. However, the beginning of the war in Ukraine has led to significant spillovers to our economy, reorienting our efforts to managing the influx of refugees, maintaining financial confidence, and safeguarding social cohesion. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) from April 26, 2022, we reconfirm our firm commitment to sound policies and the objectives of the ECF-EFF program. Nonetheless, we need additional assistance because the onset of the war on our borders worsens the outlook for the economy.

2. The war in Ukraine has interrupted our positive economic performance trajectory. Moldova's economic performance in 2021 was solid, as growth surpassed expectations amid a lingering pandemic, surging inflation, and energy shocks. The central bank increased the policy rate to anchor inflation expectations. At the same time, the general government deficit narrowed significantly, inter alia, reflecting economic recovery and sizeable external support, and contributing to significant fiscal buffers and low public debt at the onset of the current crisis. We also accumulated significant external buffers with gross foreign exchange reserves closing off the year above five months of prospective imports providing a substantial cushion against exchange rate pressures and market volatility.

3. As a result of the war on our borders, we are witnessing a deterioration of our external and fiscal accounts, erosion of our reserve buffers, and buildup of financing needs. We have undertaken far-reaching measures and declared a state of emergency on February 24, promptly instituting measures to manage the flow of refugees. We scaled up humanitarian support leveraging our fiscal buffers as the first line of defense. We have utilized a portion of our foreign exchange reserves to counteract market pressures and limit excessive exchange rate volatility. However, we expect the

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economy to stagnate and have identified additional balance of payments financing needs over 2022–23, to be covered with IMF and donor' assistance.

4. We have strived to keep the program on track despite a challenging context. We met three out of the four structural benchmarks for March timely, relating to publishing a report on the execution of investment projects, requiring SOEs to submit standardized financial statements, and completing a solvency assessment for insurance companies. However, extended stakeholders' consultations implied the Law on Prosecution Services was approved with a short delay in April. We comfortably met the indicative fiscal target for end-March. Still, the floor on net international reserves was narrowly breached due to much needed support to the markets to preserve financial stability. While surging inflation has triggered the Inflation Consultation Clause, we believe external factors, including energy and food supply shocks, remain the key drivers and expect inflation to revert to its band in 2023. We reiterate our strong commitment to retain the contours and overarching objectives of our program. However, to support our efforts considering the challenging external environment, we request an augmentation in the amount of SDR 194.26 million (112.6 percent of quota, of which SDR 64.79 million under the ECF and SDR 129.47 million under the EFF), an approval of an immediate disbursement/purchase in the amount of SDR 108.15 million (62.70 percent of quota, of which SDR 64.75 million under the ECF and 43.40 million under the EFF), rephasing to allow more frequent monitoring of the highly volatile landscape, as well as modifications of end-June performance criteria and the setting of the new quantitative program criteria.

5. We believe that the solid policies and measures outlined in the attached update of the MEFP are appropriate to achieve the program objectives for sustaining the economic recovery and the major structural and development reforms needed to transform it. We stand ready to take additional measures, as appropriate, to achieve these objectives. We will consult with IMF staff before adopting such measures, or in advance of revisions to the policies contained in this MEFP, or before adopting new measures that would deviate from program goals, consistent with IMF policies on such consultations. In line with our commitment to transparency, we authorize the IMF to publish this letter, the MEFP and its attachments, and the accompanying staff report.

Sincerely yours,

N. Gavrilița

Natalia Gavrilița
Prime Minister

Andrei Spînu
Deputy Prime Minister,
Minister of Infrastructure and Regional Development

Octavian Armașu
Governor
National Bank of Moldova

D. Budi

Dumitru Budianschi
Minister of Finance

Sergiu Gaibu
Minister of Economy

Attachments: Memorandum of Economic and Financial Policies (MEFP)
Consultation with the IMF Executive Board on the Missed Inflation Target Under the ICC
Technical Memorandum of Understanding (TMU)

Appendix I. Letter of Intent

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Attachment I. Memorandum of Economic and Financial Policies

I. Macroeconomic Developments and Outlook

1. The war in Ukraine and international sanctions on Russia and Belarus worsened an already complex economic and social landscape. Since fall 2021, high and volatile gas prices have complicated the policy environment amid a lingering pandemic. Additionally, the war has resulted in significant spillovers to the economy, with a cumulative influx of refugees at about 15 percent of the population. In this complex context, we are exhausting our fiscal buffers as the first line of defense to bridge the humanitarian and energy security needs. Foreign exchange market pressures have come to the fore necessitating central bank interventions to over 10 percent of foreign exchange (FX) reserves. The current account deficit continues to widen due to a significant trade exposure to Russia and Ukraine (about 22 percent and 12 percent of total imports and exports of goods and services, respectively) and high international commodity prices. Confidence effects weigh on banks' liquidity and willingness to invest in government securities, with the resulting negative impact on private consumption and investment.

2. The escalation of shocks generates significant financing needs and challenges social cohesion. We project a balance-of-payment (BOP) financing requirement of US$1.7 billion in 2022-24—largely on account of worsening current account balance due to lower growth in our trading partners triggered by the war and associated sanctions hurting exports of goods and services —to be financed with an ECF-EFF augmentation and external assistance. We expect to use our FX reserves to tame excessive exchange rate volatility and secure external financing to bolster our external buffers. Funding our urgent energy, humanitarian, and developmental needs implies greater reliance on external financing from the IMF (increasing total access under the ECF/EFF by SDR 194.6 million to SDR 594.6 million), the World Bank (US$290 million), the European Union (EUR 180 million in grants and loans), and the Agence Française de Développement (EUR 65 million). A EUR 300 million credit line from the EBRD, earmarked for gas purchases from the spot market, would also help mitigate energy security risks

3. Moldova entered the crisis with strong buffers.

- *Growth.* The economy posted an impressive 13.9 percent growth in 2021, notwithstanding a lingering pandemic and energy crisis. With improved mobility, domestic demand rebounded strongly mainly on account of robust private consumption, supported by strong remittances and robust growth in wages and consumer credit.

- *Inflation.* CPI inflation increased steadily to 13.9 percent in December 2021, driven by surging energy, commodity, and food prices on global markets, as well as accelerating core inflation on account of a recovery in domestic demand.

- *Fiscal position*. The general government deficit narrowed to 2.6 percent of GDP in 2021 compared to the approved 6.0 percent of GDP under the program. Revenue and grants overperformed reflecting the solid economic recovery and sizeable external support, including from the IMF and the EU. Despite prioritizing later in the year through a supplementary budget energy subsidies, minimum pensions, unemployment and health sector support, spending was modest, reflecting large under-execution and low absorption rates. Subsequently, government cash buffers increased to about 4.9 percent of GDP while public debt reached 33.8 percent of GDP.

- *External*. While the ongoing recovery and high commodity prices have worsened Moldova's external position, significant international reserves mitigate external vulnerabilities. The current account deficit widened to 11.7 percent of GDP in 2021 while gross foreign exchange reserves closed off the year at US$3.9 billion (5.5 months of prospective imports of goods and services), providing substantial cushion against exchange rate pressures and market uncertainty.

- *Monetary and financial policies*. Beginning July 2021, the National Bank of Moldova (NBM) shifted to a tightening cycle and hiked the base rate by 600 basis points on account of a worsening inflation outlook. The interest corridor was narrowed by 1 percentage point to incentivize savings. At early stages of the pandemic, the NBM provided temporary forbearance for loans subject to payment deferments, while the National Commission for Financial Markets (NCFM) issued guidance to lower effective interest rates and institute loan payments deferrals for non-bank financial institutions. As of today, all these temporary measures have been fully phased out.

4. **However, the confluence of the war in Ukraine, rising energy prices, and lingering pandemic will significantly weaken near-term economic prospects.** The economy is expected to stagnate in 2022, with growth projected at 0.3 percent in 2022 compared to the pre-war forecast of 4.5 percent. Shored by higher food and energy prices, inflation is projected to average 22 percent in 2022, imposing a difficult tradeoff for the NBM to strike the appropriate balance between monetary tightening and supporting economic recovery. We expect the general government deficit to reach 7.2 percent of GDP in 2022 compared to 6 percent of GDP envisaged in the approved budget. The additional fiscal impulse and disruptions in trade would lead to a further widening of the current account deficit to 13 percent of GDP with FX reserves dropping to US$3.3 billion or 4.5 months of prospective imports.

5. **Adverse risks to the outlook remain significant**. A sharper-than-anticipated increase in energy prices or disruptions in energy supply could impair public and private balance sheets. Uncertainty surrounding energy security due to imminent electricity contract renewal or limited progress in the audit for Moldovagaz could disrupt supplies and exert sizeable fiscal costs. Escalation of the war in Ukraine could hurt confidence, exert pressure on the Moldovan leu, undermine domestic securities markets, and culminate into system-wide deposit runs. Our first line of defense against these considerable risks is our steadfast implementation of the reforms. Additional resources from the IMF, other multilateral and bilateral partners, and donors should help anchor confidence in the face of negative shocks.

6. Our commitment to the program remains strong despite the challenging environment. Since the approval of the program in December, we have maintained continuous engagement with the Fund on policy developments on the ground. Our structural reform agenda is progressing apace, with all end-March structural benchmarks implemented. Specifically, we were able to complete the solvency assessment for insurance companies to support the migration to Solvency II framework. We have successfully issued guidelines to all central government SOEs to submit standardized quarterly financial statements for 2019–2021 by end-April. We have prepared a draft report on the execution of investment projects undertaken by extrabudgetary funds in 2021 and have successfully strengthened the law on prosecution, in consultation with the IMF and other stakeholders.

II. Policy Framework

7. The government's economic policies maintain focus on the overarching objectives of creating the conditions for sustainable and inclusive long-term growth. We have not lost sight of our program goals of sustaining the economic recovery, launching an ambitious governance and institutional reforms agenda, and addressing pressing developmental needs. Despite the current crisis, the strategy, to which we committed at the onset of the program, remains our policy blueprint. We reaffirm our program objectives, while pursuing a realistic timeframe to reach them. Once the crisis dissipates, our efforts will be redirected towards a set of macro-critical policies and ambitious structural reforms to bolster the rule of law, reduce corruption, and strengthen fiscal and financial governance, facilitate external financing, and create a solid foundation for strong and inclusive growth.

A. Fiscal Policy

8. Our fiscal policy aims at mounting a response to the compounding shocks of war in Ukraine, energy insecurity, high inflation, and persistent pandemic while taking steps to address development goals.

- We had initially allocated in the approved budget for 2022, among other things, support for gas supplies and compensation for households (0.7 percent of GDP), unemployment schemes and agricultural subsidies (0.4 percent of GDP), and health sector (0.3 percent of GDP), including a significant allocation to the capital budget (3.7 percent of GDP). However, recent adverse developments have overtaken the key assumptions underpinning the projections.
- Accordingly, we adopted new revenue and spending measures. We approved a supplementary budget in line with the macroeconomic framework agreed with the IMF staff to bring the general budget deficit to 7.2 percent of GDP subject to financing availability (**prior action**). We allocated more support to secure energy supplies and cushion households and businesses (1.2 percent of GDP, relatively higher-than-approved budget), to provide humanitarian needs, including shelter, medicine, food, and additional wage costs (0.4 percent of GDP). We also

replenished the flexible emergency funds in the budget by 0.3 percent of GDP to provide an important buffer should energy prices increase further or other shocks materialize. The deficit will be financed by funding from our development partners, notably the EU's macro-financial assistance and grants, World Bank's development policy financing, the IMF, bilateral donors, and domestic sources.

- We fully recognize that elevated downside risks call for identifying contingency measures, which we are preparing in consultation with IMF staff. Spiraling inflation would necessitate social protection to avert declining living standards. Trade disruptions with Russia, Ukraine, Belarus, and other affected countries would undermine the revenue base, depressing consumption. Further, the increasing uncertainty in the financial sector could impose financing constraints in domestic markets for securities. In the event that further shocks materialize and additional support for vulnerable groups is required, we will reprioritize spending within the budget and reduce capital expenditures to support priority spending needs.

9. We remain committed to fiscal sustainability while pursuing our developmental goals. The nominal depreciation and response to the triple shocks will increase public debt towards 45 percent of GDP, the level anchoring the program. While we expect spending needs to be elevated next year, the outlook for financing is again uncertain and we will therefore target a deficit of 5.1 percent of GDP in 2023. The policy stance underpinning this target is likely to represent a premature tightening of support and we will seek to ease this to the extent that additional financing becomes available. We are committed to a declining path over the medium term once the triple shocks dissipate to retain sufficient buffers against contingent liability risks and shocks. In line with this objective, our medium-term budget framework will target general government deficits of about 3½-4½ percent of GDP in 2024–2026. Underpinning this will be development-focused spending—prioritizing capital spending on roads, energy diversification, and water, investments in health and education, as well as supporting SME growth and job creation—supported by reforms to mobilize domestic revenues, enhance spending efficiency, domestic market development, and strengthen fiscal governance and transparency.

Reforms to Strengthen Revenue Mobilization

10. Tax policy and tax and customs administration reforms remain a key priority. In consultation with IMF staff, we plan to:

- **Publish a comprehensive tax expenditure analysis of VAT and income taxes (end-June 2022 structural benchmark)** to identify tax relief provisions to be phased out to eliminate abusive practices, tax system inefficiencies, and mobilize revenues. Towards this objective, and with support of the IMF technical assistance, we have already prepared a draft report inventorying tax expenditures and establishing a baseline tax system from which we can begin to assess policy reforms. We will also institutionalize tax expenditure reviews as part of our annual state budget planning process starting in 2022.

- **Continue strengthening tax administration.** We will continue to improve the organizational structure and capacity of the State Tax Service (STS) in line with IMF TA, including by (i) operationalizing the integrated taxpayer register **(end-June 2022 structural benchmark)**; (ii) strengthening STS capacity to investigate and refer tax crimes for prosecution by signing relevant protocols, addressing gaps in legislation, and organizing training and technical assistance from the IMF; (iii) launching the automatic exchange of information with the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes by September 1, 2023; and (iv) introducing a General Anti-Avoidance Rule provision in the tax code to counter domestic and international abusive tax practices.

- **Continue phasing out the favorable treatment of carbon emissions.** Road fuel excises are adjusted annually by nominal GDP growth with a view to converge towards minimum EU levels by 2025. After the pandemic and energy crises subside, we will review the energy sector taxation regime, following a thorough assessment of social and economic considerations.

- **Advance customs reforms in a number of important areas.** The Parliament approved a new customs code in August 2021, developed in consultations with the EU, that aims to align our customs regulations and procedures with international best practices and bring it closer to EU directives effective January 1, 2023. In line with our commitments with the EU and to strengthen deterrence capacity of anti-smuggling policies, we amended the relevant legislation (i) to reduce the legal threshold for determining smuggling as a criminal offence and raised administrative fines for such violations, and (ii) to define the smuggling offense base to include duties, taxes, and other fees. We also intend to ratify the WHO Protocol to Eliminate Illicit Trade in Tobacco Products in the course of this program, with the aim of reducing revenue leakages and smuggling.

- **We will leverage the AML/CFT regime to strengthen tax compliance.** Existing AML/CFT tools, such as for identifying the beneficial owners of entities and accounts, can be used to enhance corporate transparency, to facilitate detection and enforcement of tax offences and incidences of abusive profit shifting (including to non-transparent offshore jurisdictions), and to trigger tax controls. In this regard, we aim to improve the exchange of information between authorities and the quality of beneficial ownership information and strengthen the cooperation between the tax authority, financial intelligence unit, and law enforcement bodies.

Reforms to Improve Budget Quality and Fiscal Transparency

11. We firmly believe in the importance of transparent budgeting. To that effect, we will prioritize the following actions:

- **Institutionalize spending reviews.** We see spending reviews as critical for identifying the scope for efficiency improvements and cost effectiveness in key sectors. We completed a spending review for the education sector in 2018, are finalizing a report for the review for the agricultural sector, and have launched a spending review in the health sector. We will implement relevant recommendations from the completed spending reviews.

- **Strengthen fiscal responsibility framework and budget transparency.** We will review the performance of our fiscal responsibility framework in place since 2018 with a view to reduce the procyclicality of the deficit rule, limit escape clauses, and strengthen fiscal oversight and budget transparency. To this end, we are regularly monitoring and publishing on the Ministry of Finance webpage the information about budgetary allocations on refugee-related spending.

- **Strengthen public procurement**. In November 2020, we amended secondary legislation on procurement to require provision and publication of beneficial owner information as part of the regular package of documents submitted for tenders. We also published a report on pandemic-related spending for 2020, including beneficial owner entities contracting with the government. In June 2021, we also published an audit report by the Court of Accounts on the use of health resources to combat the pandemic in 2020. We now publish the beneficial ownership information of all entities contracting with public authorities on the website of the Public Procurement Agency. We intend to roll out a new e-procurement system to cover all public procurements by January 1, 2023, with a view to support transparent public procurement processes and delivering cost-efficient services. The government also intends to approve a roadmap for the next four years by approving the Public Procurement Development Program, with a view to further harmonize the national regulatory framework with the Acquis Communautaire, finalize the secondary regulatory framework, develop the capacity of public procurement specialists, and promote centralized public procurement.

- **Enhance disclosure and management of fiscal risks.** We have made progress in identifying and reporting fiscal risks and published a fiscal risk statement as an addendum to our budget documents starting 2018. In 2020, we have expanded it to include key PPPs, large SOEs, and government guarantees under the Prima Casa housing support program. We will continue to improve the coverage, monitoring, inter-agency coordination, and reporting quality of contingent liabilities in our fiscal risk statements going forward (see SOE reforms).

- **Strengthen debt and cash management.** Despite recent progress, especially with respect to data quality and inter-agency coordination, financial instruments are limited and concentrated in short-term maturities, and the government securities market remains shallow. To develop the debt market for government securities and facilitate domestic financing, we will review the legal foundation underlying debt management, strengthen our operational capacity, and take steps to further develop the primary dealer system and develop a new platform for retail investors.

Reforms to Make Expenditures Efficient, Sustainable, and Growth-Friendly

12. We aim to improve the outcomes of our public services to support our growth and equity objectives. We will:

- **Strengthen our public investment management (PIM) framework to enhance the execution and quality of public investment and close large infrastructure gaps.** Our PIM framework is broadly in line with good international practices, but inconsistent application and narrow coverage significantly limit its effectiveness. Guided by the 2019 PIMA report recommendations, we aim to strengthen the planning, allocation, and implementation stages of our PIM cycle. To this end: (i) in March, we published on the Ministry of Finance webpage five reports on the execution of investment projects undertaken by the developmental funds (Regional Development Fund, Road Fund, Environment Fund, Energy Efficiency Fund, and foreign-financed projects) in the previous fiscal year (**end-March 2022 structural benchmark)**, with a requirement to update these reports annually as part of the budgetary preparation and reporting; and (ii) we will amend legislation and regulations to expand the coverage of the existing PIM framework to include projects implemented by the state budget, externally funded projects, and development funds (**end-September 2022 structural benchmark)**.

- **Strengthen the unitary pay system in the budgetary sector.** We plan to undertake an analysis of the unitary pay system in the budgetary sector to improve the wage-compression ratio, strengthen the budgetary process, and address critical staffing needs. Towards this objective, and leveraging recommendation of recent IMF technical assistance, we plan to improve reporting of public funds going towards employee expenses to include public institutions, continue to consolidate reference values in the government pay scheme, and review the cost-of-living adjustment mechanism for public sector pay. In December 2021, we launched a fully operational comprehensive IT-based staff registry, as a pilot, covering employees of the Ministry of Finance and the STS; and are working on expanding the system to cover the Customs Service, the Financial Inspectorate, and the Public Procurement Agency. We will expand the coverage of a comprehensive IT-based staff registry to all central government employees (**end-June 2022 structural benchmark**).

- **Ensure the sustainability of the pension system.** Our pension system has significant challenges, including a narrow contribution base, an ageing population and falling replacement ratios, and a deteriorating deficit due to double indexation and policy reversals. We corrected the policy slippage of reducing the retirement ages for men from 63 to 62 years and for women from 59 to 57 years, which had put our pension system under significant pressure, by repealing in parliament the relevant legislation. In consultation with international partners, we also modified the indexation formula to ensure viable replacement ratios. Also, we raised the minimum pension by 68 percent to MDL 2,000 in October 2021 to align with the calculated subsistence level. In April 2022, we raised the pension components below the average monthly salary by 14 percent, in line with inflation, and topped up all pensions by a fixed amount computed as half of real GDP growth applied to the amount of average pension. In consultation with the World Bank, we intend to continue broadening the contribution base to address sustainability risks.

- **Enhance social assistance programs.** Despite our efforts to increase allocations to social spending, outlays on social assistance remain low (about 1 percent of GDP), and poverty remains high (around 15 percent). Only 40 percent of payments are means-tested, leaving many poor households without support and creating leakages. In consultation with the World Bank, we initiated the reform of the Ajutorul Social program which strives to increase the allocations and improve the targeting of social assistance programs, by shifting resources from categorical (including ad-hoc categorical payments) to means-tested payments, and by increasing the coefficients given to the most vulnerable members of recipient families, and by making remote application to means-tested programs operational. We commit to updating our Poverty Reduction and Strategy Paper (PRSP) by end-December 2022.

- **Scale up investment in disaster and climate risk mitigation and response.** Moldova's systemically important agricultural sector continues to be vulnerable to natural disasters, with imminent risks to the livelihoods of numerous producers and households. In cooperation with the World Bank, we will explore measures to strengthen the sector's resilience, including by building farmers' capacity for sustainable agricultural practices and climate adaptation measures, expanding access to irrigation, adopting drought-resistant crop varieties and anti-hail protection, and developing innovative insurance schemes.

- **Strengthen gender equality efforts.** Gender difference in labor force participation is relatively small, but the share of women who are inactive has been on the rise, the wage gap remains significant, and women are concentrated in poorly remunerated public-sector jobs. We intend to implement a range of family-friendly policies to provide better childcare services and facilitate earlier return to work for parents. We will work with U.N. agencies and other stakeholders to analyze measures to enhance parental leave and childcare policies, and to remove gender-biased distortions.

B. Monetary Policy

13. Inflation exceeded the outer band of the Inflation Consultation Clause in March 2022, triggering a consultation with the IMF Executive Board. The acceleration in inflation was inevitable given predominantly supply-side pressures that developed in early-2022, including escalating international food and energy prices and substantial adjustments in domestic energy tariffs. The spillovers from the war in Ukraine is also putting pressure on the Moldovan leu, which depreciated since the intensification of the conflict, with significant pass-through to domestic prices of imported goods. Despite significant tightening of monetary and liquidity conditions, the NBM and IMF staff share the view that high inflation is likely to persist into the third quarter of the 2022 before easing gradually. With the recalibration and modification of the inflation consultation band, inflation is expected to fall within the consultation band in April, and is projected to return to the target by the second half of 2023.

14. The NBM has moved swiftly to provide a comprehensive response to rising inflation and external pressures.

- ***Policy rate.*** On January 13, February 15, and March 15, we increased the policy rate by 2 percentage points each time to 12.5 percent to combat the accelerating and persistent inflation which reached 18.5 percent in February. The NBM stands ready to continue tightening monetary policy stance in a data-dependent manner to address second round effects from rising commodity prices and anchor expectations.

- ***Reserve requirements.*** As part of the efforts to temper inflationary pressures, we raised the reserve requirement ratio for MDL and non-convertible currencies by 2 percentage points to 28 percent in January but have maintained required reserves for foreign currency at 30 percent. The NBM stands ready to continue to adjust reserve requirements for MDL, if needed.

- ***Foreign exchange intervention.*** Given the exceptionally challenging market conditions, the NBM has undertaken sizeable foreign exchange sales equivalent to 10 percent of FX reserves to limit excessive exchange rate volatility. We are mindful that the scope and duration of the war-induced confidence pressures and energy and food inflation remain uncertain. We face a difficult policy context involving the need to ensure that banks have sufficient liquidity while also having to preserve buffers to forestall emerging shocks in a complex environment. We therefore stand ready to allow necessary exchange rate adjustment and will continue to manage reserves conservatively, limiting interventions to counteracting excessive exchange rate volatility while also actively communicating our intervention strategy to the market.

- ***Contingency measures*.** While remaining committed to the outlined policy approach, in the face of unprecedented uncertainties, the NBM stands ready to undertake necessary contingency measures should severe downside risks materialize and endanger macroeconomic and financial stability. In consultation with IMF staff, these measures would be used in combination with a broader macroeconomic adjustment package.

C. Financial Sector Policies

15. Financial sector stability is a necessary condition for achieving our economic objectives. Despite the severity of pressures due to the war in Ukraine, the banking system has remained broadly stable. Since the war began in February through end-March, individuals withdrew close to 10 percent of their bank deposits in FX and MDL, while corporates mostly switched their portfolio to FX. However, the system-wide liquidity coverage ratio remains above the prescribed level at 80 percent by end-March and according to recent NBM stress tests, banks can withstand significant withdrawals of liabilities. With a capital adequacy ratio of 26 percent at end-March, banks remain well capitalized to withstand significant loan losses. Nonperforming loans appear manageable at 6.7 percent, however a significant worsening of debtor balance sheets from the adverse effects of the war in Ukraine and sanctions on Russia and Belarus on the supply chains and rising energy costs could erode capital buffers for some banks. We will closely monitor banks' liquidity pressure and are committed to upgrade and activate the ELA framework and undertake other contingency measures to address the buildup of liquidity risk. To conserve the capital position of banks in an environment of heightened uncertainty, we will issue and maintain guidance on limiting dividend payouts until the shock is weathered.

16. We remain committed to further strengthening the institutional autonomy and governance of the NBM, in consultation with the IMF. In this regard, we are strongly committed to fully implement safeguards recommendations. In particular, we have shared with the IMF staff draft amendments of relevant legislation to strengthen provisions for **(end-June 2022 structural**

benchmark): (i) procedures and criteria for the appointment, resignation, and dismissal of the Governor and Deputy Governors and members of the Supervisory Board; (ii) prohibiting influence from public and private parties; and (iii) clarifying managerial responsibilities for the governor and the executive board.

17. We are fully committed to preserving recent banking sector reforms. To this end, we will ensure that preservation of the actions undertaken in the process of the removal of shareholders that do not fulfill the fitness and probity criteria—including those acting in concert—is reinforced. We are determined to bring perpetrators of the fraud to justice through an independent and comprehensive investigation, prosecution, and judicial process. In this context, we recognize financial stability risks arising from legal proceedings against banks as legal entities. Against this background, we are strengthening our crisis management arrangements by complementing discussions on financial stability and fiscal risks in the banking system at the level of the National Committee for Financial Stability (NCFS) with also considering these risks at the level of the Supreme Security Council. We have prepared—and will regularly update and discuss in the NCFS—comprehensive contingency plans to (i) ensure that all provisions and capital charges applied to banks due to pending legal decisions are in line with IFRS and NBM regulations; (ii) require credible and time-bound capital restoration plans in cases where capital falls below prudential limits alongside other supervisory corrective actions; and (iii) if necessary, implement resolution actions identified by competent authorities to preserve financial stability in line with the Bank Recovery and Resolution Law (BRRL).

18. We completed the transparency of shareholders and beneficial owners process in one non-systemic bank. Even though the implementation of steps prescribed by the shareholder removal legal framework were suspended at an early stage, the strengthened framework for the finality of supervisory decisions allowed for the process to be finalized, ensuring new fit-and-proper ownership in this bank. The NBM will take all necessary steps in ensuring proper corporate governance and professional management of the bank.

19. We are determined to strengthen our financial supervision, including by bolstering our financial crisis management and macroprudential frameworks in line with the FSSR recommendations. To this end, in 2023, the NBM will prepare a targeted review of the BRRL and the relevant secondary legislation, in line with good practices as appropriate to Moldova and based on IMF staff recommendations, to identify shortcomings, introduce more flexibility to the MREL requirement, the conditions of access to the resolution fund, and the participation of the DGF in the financing of the resolution measures **(end-June 2023 structural benchmark).** We also plan to conduct a comprehensive review of the bank liquidation framework with a view to strengthen liquidation procedures. The NBM plans to allocate more staff in the Financial Stability department to enhance monitoring of systemic risks. We will also close gaps in the macroprudential framework, including by (i) amending the NBM Law to provide an explicit legal mandate for financial stability by end-June 2022, and (ii) strengthening NBM's macroprudential toolkit to introduce caps on loan-to-value (LTV) and debt-service-to-income (DSTI) ratios for financial institutions by end-June 2022. The NBM also intends to update the macro-solvency stress testing framework. Also, by end-June 2022, we will amend the NBM Act, the Law on Bank Activity, and other relevant legislation to ensure that the NBM is able to conduct its supervisory work without being curtailed by inappropriate deadlines or other impediments to proper financial sector supervision which were introduced by the 2019 Administrative Code.

20. We pledge to bolster financial safety nets. We will enhance the DGF's capability to pay out insured deposits in case of future bank failure, including by conducting stress tests for both the DGF and banks. We will strengthen the resolution preparedness of the NBM for the implementation of the Bridge Bank Tool and Bail-in tool, including preparation of operational plans, and bolster inter-agency cooperation. In line with IMF TA recommendations, we will approve secondary ELA regulations to enhance rules for collateral eligibility, risk controls, and internal procedures **(end-June 2022 structural benchmark)**.

21. We are improving oversight of the non-bank sector's viability, corporate governance, and risk management practices. We have prepared draft amendments to Law 192/1998 (previously draft Law 186), to strengthen provision safeguarding the MCFM's autonomy, and plan to adopt them shortly. Going forward, our immediate focus remains in line with the prior commitment to transfer the regulatory and supervisory responsibilities for the oversight of non-bank credit organizations, savings and lending associations, and insurance companies to the NBM effective July 1, 2023. We are enhancing intra-authority coordination to intensify preparations, including via a comprehensive action plan prescribing steps to clarify the legal framework, advance capacity building, foster business continuity, implement necessary regulatory changes, and manage communication.

- ***Nonbank credit organizations.*** The Non-Bank Credit Organization (NBCO) loans have edged up more recently, accounting for 15 percent of financial sector assets. Despite having no net open currency positions, the large share of FX lending at about 30 percent of total loans exposes them indirectly to exchange rate credit risk and funding from non-residents to maturity and liquidity risks, as sudden funding interruptions could undermine rollover efforts. We have strengthened the law on non-bank credit institutions to facilitate responsible lending by including provisions for due diligence on debtors' repayment capacity and collateralization levels. Towards this objective, we will approve legislations on loan-to-value (LTV) and debt-service-to-income (DSTI) ratios for NBCO's by end-June 2022.

- ***Insurance Companies.*** We finalized the comprehensive solvency assessment by a reputable auditing firm for all insurers issuing green cards **(end-March 2022 structural benchmark)**. In April 2022, we adopted a new law on insurance and reinsurance activity to transpose Pilar II (corporate governance) and Pilar III (reporting standards) of the solvency II framework. We plan to conduct gap analysis for all insurers to evaluate their readiness for the subsequent implementation of Pilar I. Further, the law on Motor Third Party Liability Insurance was approved by the parliament in the first reading at end-March. We are committed to implement resolution steps for insolvent insurers to safeguard assets.

22. We plan to strengthen the regulatory framework for capital markets. Towards this objective, we plan to consolidate supervision of capital markets by transferring the supervisory competencies of the Central Securities Depository (CSD) from the NBM to the NCFM. As a first step we will set up an intra-agency coordination committee to prescribe the process for supervision, ownership and governance of the CSD under the new regulatory framework for capital markets.

23. We will develop a comprehensive National Financial Inclusion Strategy (NFIS). We will develop an inter-agency committee with a mandate to develop, implement, and monitor an NFIS. We will target strategies that focus on the development of inclusive financial products and leverage digital services to provide cost-effective financial services for consumers and SMEs. We also intend to augment existing laws to strengthen consumer protection, especially with regards to contract clauses that cover disclosures and define consumer rights. We will bolster the enforcement of consumer protection laws by providing the pertinent agencies with appropriate resources and improving coordination between those agencies.

24. We are committed to protecting our financial sector from illicit financial flows. Towards this end, we will continue to strengthen our Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regime, particularly by addressing vulnerabilities identified in the 2019 MONEYVAL assessment. To enhance the ability of financial institutions to play their role of gatekeepers, we have been conducting outreach to the sector on better understanding risks, the implementation of a risk-based approach, and more effective application of preventive measures focusing on suspicious transactions reporting, politically exposed persons, and the identification of beneficial owners. We commit to continuing these efforts, including through targeted supervisory activities. We will also strengthen the capacity of regulatory authorities and improve the coordination among all relevant actors, including regulatory authorities, law enforcement, and private sector. We have adopted a National AML/CFT Strategy for 2020–2025 and will update our National Risk Assessment, develop the accompanying action plan, and publish the results.

D. State Owned Enterprises and Energy Sector Reforms

25. Reforming the SOE sector remains a priority to improve efficiency and contain fiscal risks. Our SOE sector undermines competition, productivity, and private investment, while posing significant fiscal risks. The sector suffers from weak performance associated with poor governance and oversight, noncommercial mandates, and weak capacity and independence of supervisory boards. As a first step, to enhance oversight capacity and fiscal risk monitoring, the Public Property Agency requested in February all SOEs at the central government level to submit quarterly financial statements (**end-March 2022 structural benchmark**), which will be regularly shared with the Ministry of Finance. We will undertake a comprehensive assessment of the financial position of all SOEs operating at the central government level, with a view to identify corrupt practices and legacy contracts that contribute to SOEs fiscal costs. Towards this objective, we have identified SOEs that are economically active (169 out of 268) and we will work with these entities on improving the quality of data reporting. This will be facilitated by adjusting the relevant legal and regulatory framework. The government will develop and adopt a state-ownership strategy—for all SOEs operating at the central government level—to identify public enterprises to undergo reorganization, privatization or liquidation, as well as plans to strengthen their governance (**end-September 2022 structural benchmark**). Going forward, we will expand fiscal and financial monitoring of SOEs to the local government level.

26. We have responded swiftly to the energy crisis, but the recurring shocks call for frontloading energy security efforts. Going forward, tariff adjustments will be a critical element of the policy response to possible further import price increases, with additional fiscal support subject to the availability of resources in the budget.

- ***Natural gas.*** Import prices—partly indexed to spot natural gas prices—have increased sharply. We increased domestic gas prices in January to reflect the imported price. We provided direct support to residential consumers up to 150 m^3 and up to 500 m^3 for non-residential clients in a transparent way. To protect the most vulnerable populations, we will continue leveraging existing well-targeted social assistance programs and plan to build a new framework before the next winter season by October 2022. We will also focus on improvements in energy efficiency. In agreement with the Energy Community Secretariat, ANRE will issue the final certification for the unbundled gas Transmission System Operator (TSO), by August 2023. We have updated the contingency plan and policy options to be prepared for a scenario in which energy prices continue to soar and/or there are significant disruptions in supply.

- ***Electricity.*** We provided a direct compensation to the Central Electricity Supplier (single buyer of renewable and cogenerated electricity linked to district heating) to mitigate the impact of rising prices. Complex negotiations with the key electricity provider are on-going. The onset of the war has led to supply and price uncertainties which complicate the contract extension discussions. We are exploring alternative electricity supplies from Ukraine or Romania, but capacity might be constrained and prices would be very high. We completed the legislative and regulatory frameworks towards full unbundling of the electricity sector. The 2020 Wholesale Electricity Market Rules (including a functioning balancing mechanism for electricity exchanges) entered into pilot phase on January 1, 2022, and the window for testing was extended to April 30' 2022, due to the emergency situation. The recent trial synchronization of the Moldovan Power System with the ENTSO-E Continental Europe is an important step towards improving the security of electricity supply.

E. Rule of Law and Anti-Corruption

27. Strengthening the rule of law and addressing corruption remain critical priorities. Our predominant aim is to implement reforms to lay the foundation for strong rule of law in Moldova. Towards this end, our immediate goals include cleansing the system and developing a rigorous framework to preserve the independence and accountability of judicial actors, which is critical to addressing corruption, reducing avenues for political influence, instilling more trust in our court system, and improving access to and delivery of justice. We will ensure that due process is in place to hold corrupt actors and government officials accused of using public office for private gain fully accountable. These priorities are contained in our Strategy on Judicial Independence and Integrity, which was adopted by Parliament in early-December 2021. We commit to carrying out these reforms in line with constitutional principles and internationally recognized norms and standards. We are also committed to combatting high-level corruption, eliminating bad actors in the public sphere, and to strengthening the integrity, capacity, and independence of key anti-corruption institutions.

28. We recognize the importance and need to strengthen the independence, integrity, and effectiveness of the judiciary. We will continue to modernize our judicial system in line with recommendations by international bodies and experts. We endeavor to continue reforms to the current system of recruitment, appointment, evaluation, promotion, and disciplining of judges. Towards this objective, in March 2022, we passed legislation governing an extraordinary assessment of the judicial sector based on a transparent process, formulated in consultation with relevant international bodies, and have commenced this process. We will also continue to increase the transparency and accessibility of information available to the public on judicial activities, including by curtailing the use of closed hearings, removing the closed-door policy of the Superior Council of Magistrates (SCM) decision-making, and ensuring SCM decisions to be accompanied by reasoned explanations. Recent constitutional amendments pave the way for important reforms to the SCM in line with recommendations by the Venice Commission, namely on the removal of ex officio members. Transforming the Supreme Court of Justice (SCJ) into a court of cassation with a view to improve the quality of case law remains one of our top priorities. We will continue ongoing reforms to optimize and consolidate our court system by addressing inefficiencies, improving court management and strengthening dispute resolution systems.

29. We are committed to enhancing the capacity and integrity of our prosecution service. To improve the effectiveness and accountability of the prosecution service, we recently passed amendments relating to the extraordinary assessment of the Prosecutor General. To ensure that such evaluations are conducted in accordance with principles enshrined in our constitution, we will develop specific criteria and procedures with the necessary safeguards in place and in consultation with international partners. Reforms are needed to improve the current system of evaluating and disciplining prosecutors, including by streamlining disciplinary proceedings and removing the inspectorate of prosecutors from under the office of the Prosecutor General. Our ultimate objective is to strengthen the independence, accountability, and capacity of the Superior Council of Prosecutors (SCP) as the prosecutorial governance body.

30. We are fully committed to tackling entrenched corruption by strengthening the anti-corruption legal framework. In September 2020, we amended the Criminal Code to ensure that the main corruption offences are classified as serious offences. As a result of these amendments, extended statute of limitations and application of protection measures for witnesses and other participants in criminal procedures would be possible in connection with these offences. To ensure that application of sanctions in corruption cases is proportionate, effective, and dissuasive, consistent with international norms and standards, and in consultation with Fund staff, we have started a comprehensive process to amend the Criminal and Criminal Procedure Codes to add clear criteria and procedures for the application of plea bargaining and other sentence reduction or mitigation provisions and to prohibit the reduction of a term of imprisonment in corruption cases below the statutory minimum (**end-December 2022 structural benchmark**).

31. We will promote the integrity, capacity and independence of key anti-corruption institutions to effectively detect, investigate, and prosecute high-level corruption. In consultation with Fund staff, and taking into account opinions of the Venice Commission, in April 2022, we improved the selection process for the head of the Anti-Corruption Prosecution Office (APO) by amending the Law on the Prosecution Service **(end-March 2022 structural benchmark)** to: (i) allow legal professionals without prosecutorial experience to apply for the position of head of the APO; and (ii) establish a commission comprised of members with impeccable reputation and high professional and moral qualities to vet candidates for the APO head in a balanced, transparent, and fair manner using objective criteria stipulated by law. The recently amended Law on Prosecution Service requires that at least half of the commission's members be respected experts with recognized ethical standards and experience in anticorruption prosecution, including with relevant experience in other countries and that the commission include representatives of civil society, with appropriate experience or a record of advocacy in corruption cases. We will expeditiously initiate the process for the selection of the head of the APO, in accordance with the amended Law on the Prosecution Service. To this end, we will establish the special pre-selection committee, which will include experts with international experience, and appoint an individual with the necessary professional skills and irreproachable reputation to head of the APO by the end of 2022 (**end-December 2022 structural benchmark**). We will also amend relevant legislation to narrow the mandates of the APO and NAC to high-level corruption involving investigation or prosecution of (i) public officials of high office and (ii) corruption "in large proportions" or "resulting in serious consequences", as defined by the Moldova Criminal Code **(end-December 2022 structural benchmark)**. We will also intensify scrutiny of high-level officials' sources of wealth, including assets held abroad, leveraging the asset declaration regime and the illicit enrichment offence.

32. We remain resolute in achieving progress on asset recovery from the 2014 banking fraud through criminal justice efforts and channels and cooperation with foreign counterparts, including on the establishment of joint investigative teams. We will bolster coordination among all domestic stakeholders under the leadership of the State Security Council.

F. Economic Statistics

33. We remain committed to improve the quality of our economic statistics. Our efforts continue to be geared towards enhancing the production and dissemination of economic statistics which remain vital for effective macroeconomic policy and decision making. However, the operational capacity of the National Bureau of Statistics is hampered inter alia by (i) limited human and financial resources; (ii) inadequacy of the ICT system; (iii) gaps in the legislative framework regarding the access to personal data from administrative and private data sources for statistical purposes; (iv) poor inter-institution coordination within the National Statistical System (NSS). To this end, we will develop a new multi-year strategic planning document for further development of the

NSS that covers improvements in the production and dissemination of official statistics to enhance the quality and accessibility of statistical data. We will develop legal framework for statistical production in line with relevant EU standards, in particular to enable access to personal data from administrative and private sources for statistical purposes. We plan to strengthen coordination within the NSS and allocate adequate resources to improve data collection and processing.

G. Program Monitoring

34. The heightened uncertainty and pressing financing needs necessitate frequent program monitoring. For 2022, it is proposed to set up reviews, prior actions, quantitative and performance criteria, indicative targets, structural benchmarks, and an inflation consultation clause for end-April, end September, and end-December. The quantitative performance criteria, inflation consultation clause, and indicative targets are set out in Table 1, as specified in the Technical Memorandum of Understanding (TMU) attached to our Letter of Intent dated April 26, 2022. The prior actions, along with proposed structural benchmarks, are set out in Table 2.

Table 1. Moldova: Quantitative Performance Targets, April 2022 – December 2022

	2022						2023	
	March 1/		April	June	September	December	March 1/	June
	Prog. Target	Actual	Prog. Target	Prog. Target	Prog. Target	Prog. Target	Prog. Target	Prog. Target
1. Quantitative performance criteria 1/								
Ceiling on the cash deficit of the general government	1,705	1,206	4,523	9,845	14,521	19,781	3,155	6,715
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) 2/	3,447	3,260	3,162	2,761	2,515	2,692	2,806	2,946
2. Continuous performance criteria								
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0	0	0
3. Indicative targets								
Ceiling on the general government wage bill	4,900	4,778	6,967	11,102	16,505	21,485	5,485	12,020
Floor on targeted social spending undertaken by the general government 3/	835	620	805	905	1,055	1,546	980	1,217
Floor on developmental spending undertaken by the general government 4/	5,976	7,192	9,103	12,617	19,390	28,958	6,093	13,290
4. Inflation Consultation Bands (in percent)								
Outer Band (upper limit)	7.0		29.0	32.5	29.5	19.5	12.4	8.0
Inner Band (upper limit)	6.5		27.5	31.0	28.0	18.0	10.9	6.5
Center point	5.0	22.2	26.0	29.5	26.5	16.5	9.4	5.0
Inner Band (lower limit)	3.5		24.5	28.0	25.0	15.0	7.9	3.5
Outer Band (lower limit)	3.0		23.0	26.5	23.5	13.5	6.4	2.0

1/ Indicative targets for March 2022 and March 2023.

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

3/ Includes heating allowance, payments under Ajutor Social and unemployment insurance programs.

4/ Includes health, educational, and infrastructure spending.

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

	Measure	Rationale	Timeframe	Status
Prior Actions				
1	Parliament to adopt amendments to the 2022 budget in line with the macro-framework agreed with IMF staff, to bring the 2022 general government deficit to 7.5 percent of GDP, subject to financing availability.	Support macroeconomic recovery and mitigate impact of the pandemic		
Structural Benchmarks				
Anti-Corruption and Rule of Law				
1	Amend relevant legislation, in consultation with Fund staff, and taking into account opinions of the Venice Commission, to: (i) allow legal professionals without prosecutorial experience to apply for the position of head of the APO; and (ii) establish a commission comprised of members with impeccable reputation and high professional and moral qualities to vet candidates for the APO head in a balanced, transparent, and fair manner using objective criteria stipulated by law.	Strengthen anti-corruption institutions	end-March 2022	Not met. Implemented in April.
2	Amend relevant legislation to narrow the mandates of the APO and NAC to high-level corruption involving investigation or prosecution of (i) public officials of high office and (ii) corruption "in large proportions" or "resulting in serious consequences", as defined by the Moldova Criminal Code.	Promote the integrity, capacity and independence of key anti-corruption institutions to effectively detect, investigate, and prosecute high-level corruption.	end-December 2022	
3	Amend the Criminal and Criminal Procedure Codes to add clear criteria and procedures for the application of plea bargaining and other sentence reduction or mitigation provisions and to prohibit the reduction of a term of imprisonment in corruption cases below the statutory minimum.	Strengthen enforcement of the anti-corruption legal framework	end-December 2022	
4	In accordance with the amended Law on Prosecution Service, establish the special pre-selection committee, which includes experts with international experience, and appoint an individual with the necessary professional skills and irreproachable reputation to the head of the Anti-Corruption Prosecution Office (APO).	Strengthen anti-corruption institutions.	end-December 2022	New structural benchmark.
Fiscal Governance				
5	Publish a comprehensive tax expenditure analysis of VAT and income taxes to identify tax relief provisions to be phased out.	Support fiscal consolidation and eliminate inefficiencies and inequities of the tax system	end-June 2022	
6	Publish a report on the execution of investment projects undertaken by extrabudgetary funds in the previous fiscal year.	Strengthen the public investment management framework	end-March 2022	Met.
7	Operationalize the integrated taxpayer register.	Strengthen tax administration	end-June 2022	
8	Expand the coverage of a comprehensive IT-based staff registry to all central government employees.	Strengthen the unitary pay system in the budgetary sector	end-June 2022	
9	Amend legislation and regulations to expand the coverage of the existing PIM framework to include projects implemented by the state budget, externally funded projects, and extrabudgetary funds.	Strengthen the public investment management framework	end-September 2022	
Financial Sector Oversight				
10	Finalize the comprehensive solvency assessment report by a reputable auditing firm for all insurers issuing green cards based on end-December 2020 data.	Rehabilitate the insurance sector	end-March 2022	Met.
11	Strengthen provisions for the institutional autonomy of the NBM; (i) the procedures and criteria for the appointment, resignation and dismissal of the Governor and Deputy Governors and members of the Supervisory Board; (ii) prohibiting influence from public and private parties; and (iii) clarifying managerial responsibilities for the governor and the executive board.	Strengthen the institutional autonomy and governance of the NBM	end-June 2022	
12	NBM to approve secondary ELA regulations to enhance rules for collateral eligibility, risk controls, and internal procedures.	Strengthen financial safety net	end-June 2022	
13	Prepare a targeted review of the BRRL and the relevant secondary legislation, in line with good practices as appropriate to Moldova and based on IMF staff recommendations, to identify shortcomings, introduce more flexibility to the MREL requirement, the conditions of access to the resolution fund, and the participation of the DGF in the financing of the resolution measures	Strengthen financial supervision	end-June 2023	New structural benchmark.
SOE and Regulatory Framework Reforms				
14	The Public Property Agency to require all SOEs at the central government level to submit quarterly financial statements.	Enhance oversight capacity over the SOE sector and strengthen fiscal risk monitoring	end-March 2022	Met.
15	The government will develop and adopt a state-ownership strategy—for all SOEs operating at the central government level—to identify public enterprises to undergo reorganization, privatization, or liquidation, as well as plans to strengthen their governance.	Improve SOE governance and reduce fiscal risks	end-September 2022	

Attachment II. Consultation with the IMF Executive Board on the Missed Inflation Target Under the Inflation Consultation Clause

Consultation on the Breach of the ICC Target in March 2022

National Bank of Moldova

April 29, 2022

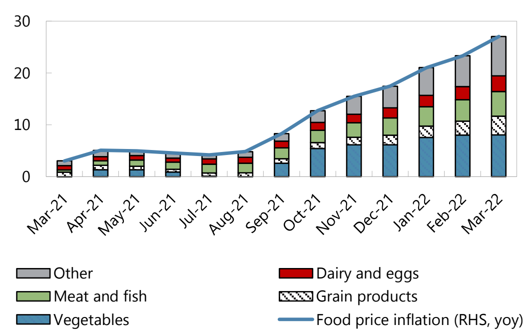
In March 2022, inflation (at 22.2 percent YoY) exceeded the upper bound of the 5 percent ±2 percentage points of the Inflation Consultation Clause (ICC) outer band, agreed under the 2021 ECF/EFF arrangement. This letter explains: (i) the reasons why inflation has breached the upper limit of the ICC band; and discusses; (ii) the policy response; and (iii) the outlook for inflation.

The reasons why inflation has breached the upper limit of the ICC band

1. Actual inflation deviated from the target primarily due to rising food prices, substantial adjustments in energy tariffs, and pent-up demand. We discuss these factors briefly below:

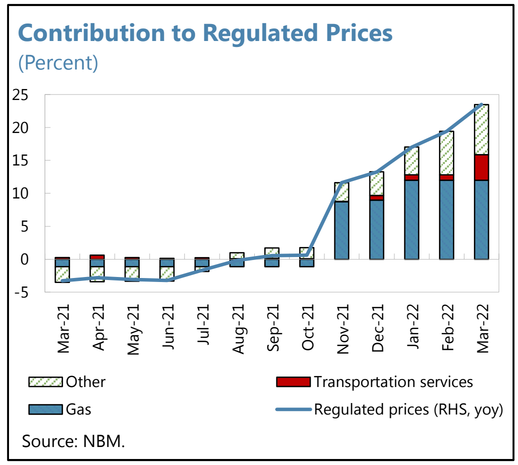
- **High global and domestic food prices.** Annual rate of the food price inflation in Moldova started to accelerate sharply in 4Q2021 and continued into 1Q2022. This was largely driven by the surge in global food prices which coincided with the substitution of local products (mainly vegetables) with imported goods on the domestic market. Factors that impacted global food prices directly include higher demand associated with post-pandemic recovery and poor harvests for certain crops, while those with an indirect impact included rising costs for energy and fertilizers. In March, food prices in Moldova grew by 27 percent yoy, with prices of vegetables soaring by 65 percent yoy and prices of basic goods increasing by more than 20 percent yoy. This acceleration also reflects the impact from the war in Ukraine, given that about a third of Moldova's food imports come from Russia and Ukraine. Given that food constitutes a large share in Moldova's CPI basket, these food price and supply shocks translate into higher inflation relative to many other countries.

Contributions to Food Price Inflation
(Percent)

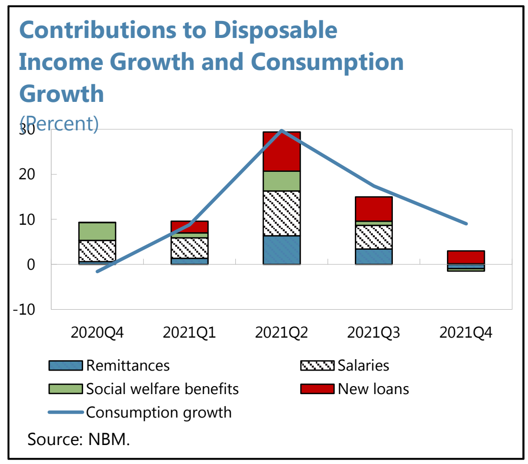


Source: NBM.

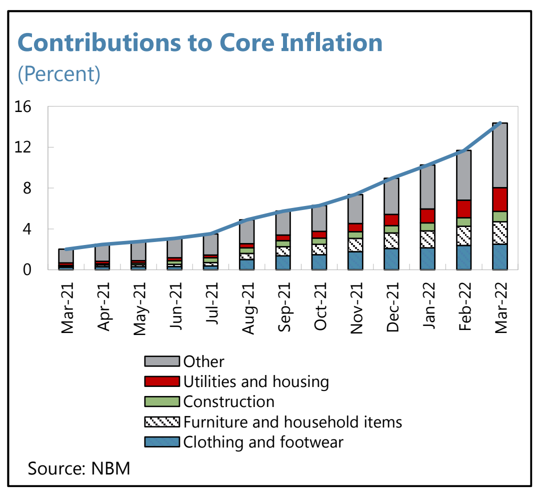
- **Substantial adjustments in energy prices in response to surging import prices.** Moldova's tariff for natural gas was increased in November 2021 and then again in January 2022, following the steep increase in international natural gas prices and the new import contract with Gazprom agreed in 4Q2021. As a result, regulated prices spiked in November and continued to rise through 1Q2022, also reflecting the impact of tariff increases on related services (including central heating, transport, and other services).



- **Stronger private consumption as economic recovery from the pandemic started to take root.** Private consumption recovered strongly in 2021 in line with the post-pandemic economic rebound. This positive evolution of consumption was supported by the increase of the disposable income of the population, but also by the relaxation of the credit conditions from the previous periods. As a result, the main sources of financing of household consumption in 2021 were salaries and loans, complemented by remittances which also recorded positive growth rates in 2021. These developments continued in early 2022.

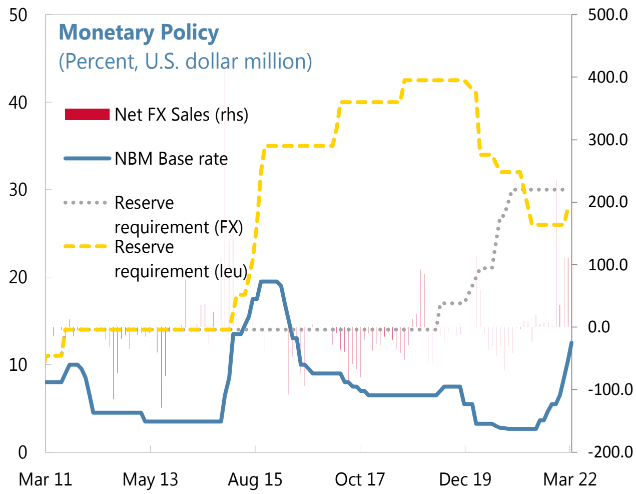


2. **Cost pressures have persistently pushed up core inflation since mid-2021, but this trend accelerated since November 2021.** Rising raw material prices on international markets have led to higher prices for goods produced in or imported into Moldova. This is having a large impact on clothing and furniture subcomponents of core inflation. The latter subcomponent also reflects interruptions in imports from Ukraine, Belarus and Russia since February 2022. In addition, there have been significant increases in prices for construction materials recorded in the last few months of 2021 that continued in 2022, reflecting accelerating prices increases internationally but also the recovery from the pandemic.



Policy Response

3. Beginning July 2021, we shifted to a tightening cycle and begun to hike the base rate on account of a worsening inflation outlook. With inflation picking up in the second half of 2021, and in anticipation of further price increase toward the end of the year, we gradually tightened our monetary policy starting in July. The policy rate was increased by a cumulative 285 basis points between July and December 2021 (from 2.65 percent to 6.5 percent). Such policy response was appropriate and aimed at containing demand-driven price increase, and anchor inflation expectations. We also intervened moderately on the FX market to limit depreciation pressures on the domestic currency. However, additional supply-side factors emanating from adjustments of regulated prices and other utility tariffs to the gas price hikes, continued to push inflation up.



Source: National Bank of Moldova.

4. Since the beginning of the year, monetary policy has tightened further. In response to further acceleration of inflationary pressures in the first months of 2022, the NBM base rate was increased by a cumulative 600 basis points as of March (three consecutive 200 basis points increase in January, February, and March). As of mid-April 2022, the central bank policy rate stands at 12.5 percent. We also raised the reserve requirements for MDL deposits by 2 percentage points. In addition, depreciation pressures on our currency, the result of spillovers from the war in Ukraine and sanctions against Russia and Belarus, triggered significant FX interventions in February and March. These interventions mitigated depreciation pressures, although risks remain elevated.

Outlook for inflation

5. High inflation is expected to persist in the near term. Driven by further increases in food and energy prices, depreciation pressures, as well as tariff adjustments (including in electricity, transport, and gas), we project a persistent upward trend of inflation, with the peak to be reached in the third quarter of this year. We forecast inflation to stand at about 26 percent in April and to increase further in May. We project inflation to fall close to the NBM's target band only by end-2023.

6. We are carefully monitoring inflationary pressures and risks, and we stand ready to apply monetary instruments to bring inflation back to the target range. In line with our inflation objective, we will continue adjusting our monetary policy stance with the goal to bring inflation back to the target. We will continue implementing data-driven policy decisions and increase the policy rate in the coming months, if needed. We will use other instruments at our disposal (including reserve requirements and FX interventions) to reinforce our policy response, should it be deemed necessary.

7. Volatile commodity prices and the current uncertain environment resulting from the war in Ukraine are key challenges for monetary policy formulation in Moldova. We are also monitoring signs of accelerating second round effects of rising food and energy prices, which may be substantial and longer lasting, should spillovers from the conflict in Ukraine further exacerbate. Furthermore, unprecedented uncertainties blur our assessment of inflationary risks, complicating our monetary policy decisions. We also face trade-offs between tightening monetary policy in response to inflationary pressures, containing financial stability risks, and maintaining banking system liquidity and supporting a slowing economic activity. While appropriate as an immediate crisis response, we acknowledge that FX interventions should be limited to preventing a disorderly adjustment of the exchange rate and curbing excess volatility. Noting risks of significant FX pass-through from depreciation to inflation, going forward, we will rely further on exchange rate adjustments as a shock absorber and aim to preserve sufficient FX buffers to cope with future shocks.

Attachment III. Technical Memorandum of Understanding

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

A. Quantitative Program Targets

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

- the floor on the net international reserves (NIR) of NBM;
- the ceiling on the cash deficit of the general government;
- the ceiling on accumulation of external payment arrears of the general government (continuous).

Indicative targets are set on:

- the ceiling on the general government wage bill;
- the floor on targeted social assistance spending undertaken by the general government;
- the floor on developmental spending undertaken by the general government.

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

B. Program Assumptions

3. For program monitoring purposes, all foreign currency-related assets will be valued in U.S. dollars at program exchange rates. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at 17.6627/US$ (the official rate as of September 30, 2021). Gold holdings will be valued at US$1,801.50 per troy ounce, the average price during January-September 2021 obtained from the IMF website on primary commodity prices.[1] Assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at their respective exchange rates of September 30, 2021, as reported in the following table.

[1] https://www.imf.org/en/Research/commodity-prices.

Program Exchange Rates for ECF-EFF Arrangements
(as of September 30, 2021)

Exchange Rate	Program Rate
U.S. dollar / Euro	1.1579
U.S. dollar / Swiss franc	0.9365
U.S. dollar / Pounds sterling	1.3435
U.S. dollar / Japanese yen	111.9100
U.S. dollar / Australian dollar	0.7206
U.S. dollar / Canadian dollar	1.2741
U.S. dollar / Chinese renminbi	6.4634
U.S. dollar / Russian ruble	72.6642
U.S. dollar / SDR	0.7098

Source: https://www.imf.org/external/np/fin/data/param_rms_mth.aspx

C. Institutional Definitions

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

D. Program Definitions

5. **NIR of the National Bank of Moldova (NBM)** are defined as gross reserves in convertible currencies minus reserve liabilities in convertible currencies[2].

- For program monitoring purposes, **gross reserves** of the NBM are defined as readily available external assets that are controlled by the NBM for meeting balance of payments financing needs and for intervention in exchange markets. They include monetary gold, holdings of SDRs, reserve position in the Fund, and holdings of foreign exchange in convertible currencies that are readily available for intervention in the foreign exchange market or in the securities issued by sovereigns, IFIs and agencies, with a minimum credit rating for such securities of AA- and

[2] For these purposes, convertible currencies include the Euro, Chinese Renminbi, Japanese Yen, Pound Sterling, U.S. Dollars, Swiss Franc, and the Australian and Canadian Dollars.

deposits in counterparts with a minimum rating of A-.[3] Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term non-financial assets, funds disbursed by international institutions and foreign governments assigned for on-lending and project implementation, assets in non-convertible currencies, NBM's claims on resident banks and nonbanks, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options).

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

6. For program monitoring purposes, the stock of reserve assets and reserve liabilities of the NBM shall be valued at program exchange rate, as described in paragraph 3 above. The data source for gross reserves and liabilities is the Monetary Survey published by NBM in Moldovan Lei, from which the adjustments for program purposes are made. On this basis, and consistent with the definition above, the stock of NIR of the NBM amounted to US$ 3708.75 million as of September 30, 2021.

7. For the purposes of calculating the cash deficit of the general government, **net domestic credit of the banking system** (NBM and commercial banks) to the general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed projects).[4] This definition will also exclude the securities issued under Law 235/2016 on the issuance of government bonds for execution of Ministry of Finance's payment obligations derived from the State Guarantees Number 807 of November 17, 2014 and Number 101 of April 1, 2015.

8. Monitoring of this definition will be based on NBM's monetary survey and Treasury data. The Ministry of Finance will provide data on foreign-financed projects and balances in all other adjustment accounts. On this basis, and consistent with the definition above, the stock of the net

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

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

domestic credit of the banking system shall be measured from below the line and as of September 30, 2021, amounted to MDL 8479.3 billion.

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

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

11. Definition of debt, for the purposes of the TMU, is set out in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), and also includes contracted or guaranteed and non-guaranteed commitments for which value has not been received. For program purposes, the term "debt" is understood to mean a current, that is, 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. Debt can take several forms; the primary ones being as follows:

i. Loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchange of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the loan funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii. Suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

iii. Lease agreements, that is, arrangements under which the lessee is allowed to use a property for a duration usually shorter than that of the life of the property in question, but without transfer of ownership, while the lessor retains the title to the property. For the purposes of this guideline, the debt is the present value (at the inception of the lease) of all the lease payments expected for the period of the agreement, except payments necessary for the operation, repair, and maintenance of the property.

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

13. For the purposes of the program, **external payments arrears** will consist of all overdue debt service obligations (i.e., payments of principal or interest, taking into account contractual grace periods) arising in respect of any debt contracted or guaranteed or assumed by the central government, or the NBM, or any agency acting on behalf of the central government. The **ceiling on accumulation of 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.

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

15. The **targeted social assistance spending undertaken by the general government** is defined as the sum of support for unemployment (9012/00322, 9012/0052, 9008/00519, and 9019/0052), the *Ajutor Social* (social assistance program 9015/00320), as well as the heating allowance during the cold season and the government's energy poverty policy (9015/00322) from the central government budget.

16. **Developmental spending undertaken by the general government** is defined as the sum of total capital spending envelop in the annual budget (including foreign-financed projects) and current spending in the areas of health and education (COFOG Functions 07 and 09).

E. Inflation Consultation Mechanism

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

17. The monetary conditionality will include a set of quarterly inflation targets measured as the inflation of the headline consumer price index (CPI) published by the Moldovan National Bureau of Statistics set within tolerance bands. The inner band is specified as +/- 1.5 percentage point around the central point. The outer band adds an additional +/- 1.5 percentage point to the inner band. Deviations from the bands would trigger a consultation with the staff or Executive Board which would focus on: (i) a broad-based assessment of the stance of monetary policy and whether the Fund-supported program is still on track; and (ii) the reasons for program deviations, taking into account compensating factors and proposed remedial actions if deemed necessary.

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

Inflation Consultation Bands

	2022				2023	
	April	June	September	December	March	June
Outer Band (upper limit)	29.0	32.5	29.5	19.5	12.4	8.0
Inner Band (upper limit)	27.5	31.0	28.0	18.0	10.9	6.5
Center point	**26.0**	**29.5**	**26.5**	**16.5**	**9.4**	**5.0**
Inner Band (lower limit)	24.5	28.0	25.0	15.0	7.9	3.5
Outer Band (lower limit)	23.0	26.5	23.5	13.5	6.4	2.0

F. Adjusters

19. The adjusters set in this TMU apply for assessing compliance with the program's quantitative targets starting from end-April 2022.

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

21. The **ceiling on the cash deficit of the general government** will be adjusted upward—that is, the deficit target will be increased—by the amount of any shortfall between the total amount of actually disbursed and programmed budget support from external donors, including MFA (grants) from the European Commission.

22. The **floor on NIR** of the NBM will be lowered by any shortfall in the official external grants and loans up to the equivalent of US$79.6 million and US$290.5 million respectively, in 2022, valued at the program exchange rates.

Programmed External Financing Flows [1/]
(Cumulative from the beginning of the calendar year)

	2022				2023	
	April	June	September [2/]	December	March [2/]	June
	Prog. Target	Prog. Target	Prog. Target	Prog. Target	Prog. Target	Prog. Target
Programmed external financing flows to adjust the floor on the NIR target (US$ million)	-	185	278	370	43	85
Programmed external financing flows to adjust the ceiling on the cash deficit (MDL million)	-	3,663	5,494	7,325	915	1,830

1/ Excluding IMF financing.
2/ Indicative targets for March and September.

G. Reporting Requirements

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

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

Item	Periodicity
Fiscal data (to be provided by the MoF)	Monthly, within three weeks of the end of each month
General budget operations for revenues, expenditure and financing (economic and functional classifications)	
General government wage bill at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within three weeks of the end of each month
Detailed breakdown of salaries of all SOEs and JSCs, by company.	Annually (2019, 2020 and 2021), and quarterly starting Q1 2022
Number of budgetary sector positions and employees at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within four weeks of the end of each month
Social expenditure including pensions, support for unemployment, the *Ajutor Social* (social assistance program), heating allowance for the cold season, and health expenditures from the Health Insurance Fund.	Monthly, within three weeks of the end of each month
Public and publicly guaranteed domestic debt, by instrument, and creditor:	
- Central government domestic debt	Monthly, within three weeks of the end of each month
- Local government domestic debt	Quarterly, within six weeks of the end of each quarter
Debt stock outstanding for all SOEs and JSCs, by company (to be provided by the PPA)	Annually (2019, 2020 and 2021), and quarterly starting Q1 2022
Domestic arrears, by creditor	Monthly, within three weeks of the end of each month
Arrears outstanding for all SOEs and JSCs, by company (to be provided by the PPA)	Annually (2019, 2020 and 2021), and quarterly starting Q1 2022
Onlending to SOEs by type of onlending projects and by external creditors (including loan disbursements and repayments).	Monthly, within three weeks of the end of each month
Breakdown of the borrowing by SOEs and JSCs, between the external project loans that are on-lent (transferred) directly from the budget (central government) to local authorities / line ministries, and other borrowing from commercial banks.	Monthly, within three weeks of the end of each month

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

Monetary data (to be provided by the NBM)	Weekly, within one week of the end of each week
Monetary survey of the NBM	
Monetary survey for the whole banking system	Weekly, within two weeks of the end of each week
Net claims on general government (NBM and commercial banks)	Weekly, within two weeks of the end of each week
Financial position of commercial banks, including balance sheets, income statement, banking regulation indicators, capital, liquidity, data on credits and deposits (NBM)	Monthly, within four weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange cash flows of NBM	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily, within 12 hours of the end of each day
NBM's sterilization operations	Weekly, within one week of the end of each week
• liquidity conditions in the foreign exchange market and banks' ability to maintain open foreign exchange positions	Daily data to be provided once every month, within 10 days of the end of each month.
• volatility of the MDL exchange rate against foreign currencies	
• gap between the rates of purchasing and selling MDL against the US dollar in the domestic foreign exchange market	
• change in the exchange rates of MDL against the US dollar quoted by foreign exchange offices	
• daily change in net opened currency position in all currencies, in total by banking system	
• interbank market volatility	
Balance of Payments (to be provided by the NBM)	One quarter after the end of the previous quarter
Current, capital, and financial account data.	
Transfers of individuals from abroad through the banking system	Monthly, within six weeks of the end of each month

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

External debt data (to be provided by MoF and NBM)	
Information on all new external loans contracted by the general government or guaranteed by the government.	Monthly, within three weeks of the end of each month
Total public and publicly guaranteed outstanding debt stock, outstanding debt service due, and debt service paid, by creditor (in line with the new Debt Template titled "Decomposition of Public Debt and Debt Service by Creditor" (shared with the Debt Department at MoF).	Quarterly, within six weeks of the end of each quarter
Disbursements of grants and loans by recipient sector (state/local/SOEs), and by creditor	State: Monthly, within three weeks of the end of each month Local/SOEs: Quarterly, within three weeks of the end of each quarter
Other data (to be provided by NBS, unless otherwise stated)	
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
Detailed financial performance of all state-owned enterprises and joint stock companies operating at the central government level, in line with the agreed input template (from the Public Property Agency).	Annual, within two months following the end of each year (unaudited), and no later than 6 months following the end of each year (audited).