Appendix I. Letter of Intent

Chişinău

March 24, 2017

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

Dear Ms. Lagarde:

1. Moldova has made an ambitious start in implementing its ECF/EFF-supported program. We met all quantitative performance criteria, all but one indicative target, and 5 of 6 structural benchmarks. Financial and economic stability are starting to return following a period of significant economic and political turmoil, with growth rebounding more strongly than expected. Looking forward, our economy is projected to grow by 4.5 percent in 2017, and by around 4 percent over the medium term. This growth is vital to the creation of jobs and poverty reduction. Nevertheless, challenges remain.

2. Our fundamental goal remains unchanged, namely to protect long term financial stability by delivering a system of sound financial institutions operating within a strong regulatory and supervisory environment. To support these objectives, we will implement wide ranging measures, with a particular focus at this stage on financial sector and energy related issues. Notably:

3. In the **financial sector** we will take action to strengthen the governance and financial conditions of banks by bringing full transparency to bank shareholders, certifying the fit and proper status of bank owners and administrators, identifying related party lending, and ensuring compliance with regulatory and capital requirements. We will also act to further enhance our regulatory and supervisory frameworks, and to improve the infrastructure of the financial system.

4. In the **energy sector** we will continue to work on eliminating accumulated debt by energy companies and improving tariff setting methodologies, in order to ensure transparency and cost recovery. We will also enhance the independence of the energy regulator by improving the transparency and accountability of the regulator's management selection and decision making processes.

5. Regarding **fiscal policy**, our 2017 budget and medium term budget framework are consistent with our commitments under the program. We will continue to develop the tax system, so that it yields stable revenue, and is uncomplicated, efficient, and transparent, while paying due attention to fairness and equity. Our medium term fiscal strategy is focused on strengthening revenues, improving expenditure efficiency, and reforms that would generate additional revenue for much needed capital and social spending.

6. To support our efforts to **reduce poverty** and achieve sustainable and inclusive growth our Economic Development Document specifies priority areas (education, business climate, energy consumption and efficiency, agriculture, export diversification) and sets the corresponding objectives. Our commitments under the program are aligned with the key development priorities outlined in the document: improving access to financing and promoting credit, improving the energy sector efficiency, strengthening governance and transparency. This program of the Government continues to enjoy broad political support, and our reform efforts are backed by a Parliamentary majority. Our own rigorous efforts, along with the financial and technical support of our international partners, will be critical to continuing to rebuild confidence and support broad-based inclusive growth.

7. On the basis of our performance to date, our ongoing commitment to the objectives of the program, the specific commitments outlined in the attached Supplementary MEFP, and recently implemented upfront actions, we request the completion of the first review under the blended Extended Credit Facility and Extended Fund Facility arrangements; establishment of Quantitative Performance Criteria and Indicative Targets through December 2017 (Table 1); modification of performance criteria on the cash deficit and NIR; establishment of Structural Benchmarks through end-December 2017 (Table 2); and associated disbursement of SDR 15.7 million.

8. The Moldovan authorities remain firmly committed to achieving the targets and benchmarks outlined in the Memorandum of Economic and Financial Policies (MEFP) of October 24, 2016, and as updated in the Supplementary Memorandum of Economic and Financial Policies (SMEFP) (attached here). We believe that these strong policies will keep Moldova on the path to achieve the program objectives. Nonetheless, the government stands ready to take additional measures that may be adequate for the successful implementation of the program. The government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the MEFP in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring our progress.

9. Maintaining our commitment to the policy of transparency, we consent to the publication of this letter, the attached SMEFP, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/

Pavel Filip

Prime Minister, Government

of the Republic of Moldova

/s/

Octavian Calmîc

Deputy Prime Minister

Minister of Economy

/s/

Octavian Armaşu

Minister of Finance

/s/

Sergiu Cioclea

Governor

National Bank of Moldova

Attachments: Supplementary Memorandum of Economic and Financial Policies

Technical Memorandum of Understanding

Attachment I. Supplementary Memorandum of Economic and Financial Policies

I. Recent Developments and Outlook

1. **Recent macroeconomic performance has been stronger than expected**. Economic growth in 2016, which reached 6.3 percent in the third quarter (yoy), was buoyed by a good harvest and strong exports. Inflation decelerated sharply to 2.4 percent (yoy) at end-2016 (from 13.5 percent in 2015), to just outside the inner band of the consultation clause, but is expected to pick up in the near term to return to the inflation-targeting corridor (5 percent ±1.5 pp). The augmented overall deficit reached 2.1 percent of GDP, (compared to 3.5 percent projected), on the back of lower spending and higher excise and trade taxes. The current account deficit continued to narrow driven by a surge in agriculture-related exports.

2. **Looking forward, growth will be supported by domestic and external factors**. Growth prospects for 2017 have been marked up to 4.5 percent (from 3.0), in light of expected stronger agricultural performance in the first half of the year and better external prospects. Over the medium term, the economy is projected to grow close to the potential rate of 3.9 percent. Repairing financial intermediation and promoting credit to productive sectors of the economy should support such growth. Inflation is expected to return to the target range in the first quarter of 2017 as domestic demand continues to strengthen. Planned adjustments of administered prices, higher international food and oil prices, and a low base effect in addition to stronger domestic demand will leave inflation at 6.5 percent by year end (5.5 percent on average). The external outlook is expected to strengthen, in part anticipating an improvement of trade with Russia.

II. Policy Framework

A. Financial Sector Policies

3. **Our fundamental goal remains unchanged, namely to protect long term financial stability by delivering a system of sound financial institutions operating within a strong regulatory and supervisory environment**. This will allow banks to assume their proper role in supplying credit to productive sectors, supporting stronger economic growth. To this end, we have:

- conducted onsite inspections in two of the three largest banks. The inspections included a review of the status of implementation of remedial action plans, which were adopted earlier following the special diagnostic studies. The third large bank, currently under NBM temporary administration (early intervention regime), was submitted to an assessment of assets, liabilities, and equity by an external appraiser, as provided for in the law.

- continued to make progress in increasing shareholder transparency in the two largest banks. Specifically, NBM, having previously blocked and cancelled the shares of non-transparent shareholders: (i) identified the remaining qualified shareholders (shareholder holding ≥1 percent of total shares); and (ii) sought that blocked shares and shares issued to replace cancelled shares be sold to fit and proper investors in the largest bank. Prospective investors have concluded the due diligence of one bank under intensive supervision, with a view to conclude the transaction by end-April 2017.

- increased our capacity to identify credit concentration. In particular, we have developed an interface to the newly created public credit registry, which enables the monitoring of credit exposures of large economically interconnected groups.

4. Looking forward, our efforts will build on these achievements, and will seek to:

- Strengthen governance and financial condition of banks

  a. We will finalize **the identification of the UBOs** of all qualified shareholders (>1%) in the three largest banks. We will conduct additional fit-and-proper assessment in cases where identified UBOs present suspicions. With regard to shareholders with unidentified UBOs, we will take appropriate supervisory actions **(prior action)**. Such actions may initially include imposing financial penalties and further limiting activities of the bank, but can escalate to blocking the shares from voting and dividend payments, and ordering shareholders to dispose of the shares.

  b. In light of the blocking and cancellation of significant amounts of shares, efforts are underway to verify that a quorum of fit and proper shareholders is in place in the two large banks. This includes investigations of the identity of all shareholders with 0.5 percent or larger stakes in the respective banks.

  c. We reiterate our existing commitments to ensure the identification of UBOs of all qualified shareholders (>1 percent) in second and third tier banks by end-June 2017 and end-August 2017 respectively **(modified structural benchmarks)**.

d. We are committed to ensure **fit-and-proper certification** of incoming bank investors, directors, and managers. From end-April 2017, the NBM will require affidavits from incoming shareholders and managers as part of their fit-and-proper tests.

e. Based on the findings of recent onsite inspections in two large banks and the external assessment of assets, liabilities, and equity in a bank in the early intervention regime, NBM will complete a capital assessment of these banks and take appropriate enforcement and corrective supervisory actions for breaches of banking regulations, including AML/CFT **(structural benchmark, end-April and end-June 2017, respectively)**. The banks will continue to be under NBM intensive supervision until they have: (i) fully implemented remedial action plans from 2016; (ii) adopted plans to unwind above-limit large and related-party exposures; and (iii) their blocked shares or shares issued to replace cancelled shares have been disposed of.

f. NBM in coordination with MOF, and consultation with the National Committee on Financial Stability, as necessary, will adopt a strategy to allow a large bank to exit temporary administration (early intervention regime) **(prior action)**. The final stages of the strategy will be executed by end-July **(structural benchmark)**.

g. We will further enhance our capacity and efforts to identify related parties by: (i) adopting new review and investigation procedures to support NBM in applying its newly acquired powers to presume relatedness **(prior action)**; (ii) enhancing our electronic examination system to capture characteristics meeting each of the criteria for presuming relatedness **(structural benchmark, end-June 2017)**; and (iii) ensuring that the identity of cancelled shareholders and any relevant relationships is preserved in our supervisory records.

h. We will conduct thematic reviews of related party exposures in the three largest banks assisted by international reputable experts/companies **(structural benchmark, end-August 2017)**. The reviews will apply the new procedures for inspection and investigation. To recognize any residual risk to capital and ensure appropriate discipline, we will formally determine the presumed related parties and exposures.

i. Full scope onsite inspections of smaller banks that are not part of foreign banking groups will be conducted applying the above procedures for related party identification by end-December 2017 **(structural benchmark)**. Full scope inspections in remaining banks that are part of foreign banking groups, will be concluded by end-March 2018.

- Enhance the regulatory and supervisory frameworks:

j. We will continue implementing a strategy for addressing remaining deficiencies identified in the BCP assessment of the 2014 FSAP. Based on the legal powers provided in July 2016, we have drafted new regulations on large exposures, internal governance and risk management, and external audits. We have also drafted a new regulation regarding fit and proper tests and certification of bank administrators.

k. We will amend the legal framework for removing shareholders who act in concert without prior supervisory approval **(structural benchmark, end-April 2017)**. The objective is to: (i) mitigate legal risks for banks and other stakeholders (ii) prevent decapitalization of banks below prudential norms, and (iii) allow for more time and price flexibility in the sales process (to increase the likelihood of private sector solutions).

l. We will amend laws/regulations to ensure adequate treatment of cancelled shareholders in resolution, and ii) that deposits of affiliates that are not significant shareholders, members of decision making bodies and their affiliates, can be paid out or transferred to a good bank in resolution (**prior action**).

- Other:

m. Improving the safety, efficiency and soundness of the securities settlement and registry infrastructure. We will adopt legislation to align relevant laws with the Law on Central Security Depository (CSD) **(prior action)**. In preparation for transferring information from the 11 private registrars to the CSD, NCFM, in consultation with the NBM, will develop and adopt by end-May 2017 a comprehensive methodology and procedures for verification of the integrity of legal records of shareholders, including through a public awareness campaign **(structural benchmark)**. The legal records of all banks and insurance companies will be verified in line with the new procedures by end-2017 (**structural benchmark, end-December 2017**). We have developed an action plan to make the CSD operational and aim to achieve this by March 2018.

n. The second phase of investigation of the 2014 bank fraud is ongoing. At our request, the consortium of firms Kroll and Steptoe & Johnson has been carrying out an investigation of the embezzlement of funds from 3 large banks that collapsed in 2014. The relatively slow pace of investigation, which started in late 2015, reflects the complex and sophisticated nature of the fraudulent schemes that involved a very large number of transactions with hundreds of entities from multiple jurisdictions. Based on the results of investigation, we will prepare by end-April 2017 a strategy to recover some of the stolen assets.

B. Monetary and Exchange Rate Policies

5. **Our monetary policy will continue to be implemented within an inflation-targeting framework, complemented by exchange rate flexibility**. We expect some further elevation of inflationary pressures later in 2017, but remain committed to maintaining inflation within the target range of 5 percent +/- 1.5 percentage points. We will continue to evaluate the outlook for inflation. We stand ready to pursue a tightening bias should inflation start rising faster than projected. We will consider using the full range of policy tools at our disposal, including increasing the base rate, reserve requirements, and reverse repos. The recently agreed cash buffer (¶10) will also play a supportive role in absorbing structural excess liquidity.

6. **We continue to strive to improve our inflation targeting framework, but challenges remain**. In particular, we are working to strengthen our operational framework, forecasting abilities, and policy communications. This will include enhanced cooperation and information sharing between NBM, Treasury, and debt management department, as well as measures to develop the secondary market for government securities and interbank money market, in line with past MCM technical assistance (TA). To support these efforts, we will seek follow up Fund TA.

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

8. **We will not resist exchange rate movements driven by fundamentals, and NBM's intervention in the foreign exchange market will be aimed only at smoothing volatility**. Moldova's vulnerability to external shocks points to the need to have a flexible exchange rate arrangement, serving as an efficient absorber of shocks. In this context, the NBM will adhere to flexible exchange rate policies and will intervene in the market to smooth sporadic volatility. The NIR targets set under the program are consistent with these commitments.

9. **Looking forward, we will explore potential impediments to sound bank lending**. Strengthening the governance, risk management and financial condition of the banking sector will be critical in order to resume credit growth to the private sector, which has been flat or even

negative in the past two years. In addition, we will evaluate the effectiveness of financial sector infrastructure with a view to eliminating potential obstacles to effective intermediation. In particular, NCFM and NBM, in cooperation with other State agencies, if needed, will aim to improve the functioning of credit information bureau, and optimize policies and procedures on collateral valuation and repossession.

C. Fiscal Policy

10. Our 2017 budget is consistent with our commitment under the program. The budget aims for an augmented deficit of 5,513 million lei or 3.7 percent of GDP, underpinned by a tax policy effort of about 0.4 percent of GDP, in line with revenue commitments for 2017. Tax and customs measures to be implemented in 2017 aim at increasing revenues and simplifying taxation, including by: (i) raising the excise tax rates on various products imported to Moldova and delivered domestically; (ii) increasing tax rates for real estate, and (iii) establishing the State Tax Service as the single tax administration authority. On the expenditure side, our public wage bill is above the indicative target described in the MEFP of October 24, 2016. This is mainly due to the pension reform law approved in December 2016, which brings the entire public sector under common contribution rules. The net effect on our general government deficit is expected to be limited as the increase in the public sector wage bill will be substantially offset by higher social insurance proceeds.

- *Wages and pensions*. Our public wage bill will be 12,461 million lei, somewhat above the indicative target of 11,924 million lei due to the pension reform. We initiated the reform of our pension system to make it more equitable, sustainable, and transparent. The pension reform law adopted in December 2016 (i) introduces a new benefit formula that strengthens the link between contributions and benefits to improve coverage and compliance; (ii) gradually increases the retirement age to reach 63 for men by 2019 and for women by 2028; (iii) subjects all public sector wages to the same contribution and benefit rules; and (iv) introduces a basic pension to combat old age poverty.

- *Priority spending*. We remain committed to protecting priority social spending **(indicative target)**. We will continue directing resources to provide financial support to vulnerable households through social assistance programs, *Ajutor Social*, and Heating Allowance, and improve the targeting and effective coverage of this support. As regards much needed capital expenditures, the government will continue its efforts to protect capital investment and spending related to activities agreed with foreign donors to safeguard external financing in the coming years.

- *Domestic arrears*. We intend to strengthen our legal and regulatory framework and improve our cash and debt management to clear domestic expenditure arrears by end-December 2017, in line with our commitments described in the MEFP of October 24, 2016 **(indicative target)**. To this effect, we commit to review and strengthen our reporting and monitoring framework of local governments to ensure continuous and timely monitoring of local fiscal risks. We plan to review regulations and seek technical assistance to address (i) the use of short-term debt by local governments, including a requirement to be fully repaid by year-end; (ii) mandatory timing for local budget rectification to ensure that emerging problems in local budgets are addressed as early as possible; (iii) measures that will apply if these requirements are not met.

- *Public Administration Reform*. We have launched a comprehensive public administration reform program to be completed in the fall of 2017, in time to be implemented in the 2018 budget. We have established a Center for Reforms to help us design this and other critical reforms. To this end, we will start from a sector-by-sector rationalization of public wages and employment, and an examination of incentive structures and their setting mechanisms.

- *Cash management*. With a view to improve cash management, as well as to reduce refinancing risks, it is proposed to create a cash buffer. This buffer implies an increase in the stock of the state debt in the amount of up to MDL 2 billion, increasing the balance of funds in the treasury accounts at the end of 2017. The establishment of *s*uch a cash buffer will also play a supportive role in NBM's efforts and responsibility to absorb structural excess liquidity. The use of the buffer will be strictly limited and described in the agreement between MOF and NBM.

- *Prudent budgeting*. We will continue to maintain a prudent approach to budget management. We plan to save, rather than spend, any revenue performance above our budgeted revenue projections. This will be reviewed later in 2017 during our budget adjustment process, with any increase of expenditures arising from revenue over performance, based on a thorough cost-benefit analysis.

11. Our Medium-Term Budget Framework for 2018–20 will be in line with program targets (structural benchmark). We have initiated the process for MTBF 2018-20, which we plan to complete by May 2017. We are determined to maintain a prudent fiscal policy and debt profile, while at the same time focusing our resources on social spending and growth-enhancing public spending. For this, we intend to use the escape clause for public capital investment funded by external concessional sources in line with commitments in the MEFP of October 24, 2016. The medium-term fiscal strategy is focused on:

- *Strengthening our revenues*. We will pursue a multifaceted strategy, including broadening the tax base, addressing the shadow economy, and advancing tax administration reforms and tax compliance. We also intend to revise the mechanism of real estate valuation in the cadaster. We commit to review and rationalize various exemptions and/or reduced rates on VAT, excises, CIT, PIT, and property taxes. We will also maintain our focus on enhancing the performance of the large taxpayers office (LTO) and the high wealth individuals (HWI) program. These efforts will also help us to gradually reduce our reliance on external grants.

- *Improving the efficiency of spending and directing fiscal savings from these adjustments toward capital expenditure and targeted social spending*. We intend to unify various non-targeted categorical social benefits to reduce administrative costs and avoid benefits overlap, and direct resources to the existing means-tested programs (*Ajutor Social* and Heating Allowance). We will strengthen these means-tested programs by using more active information campaigns to improve the take-up ratio, indexing the benefits over time, and introducing measures to limit the work disincentives over the medium-term. We intend to improve the efficiency of our spending in the education sector to better align the school network and employment levels with our changing demographics. On health spending, we plan to better design and implement a providers' payment system to improve performance in the sector.

- *Fiscal structural reforms*. We are committed to improve our fiscal rules to provide space for social and development objectives while ensuring fiscal sustainability. We will revisit the fiscal anchor in the Public Finance and Fiscal Responsibility Law and also strengthen our rules by explicitly linking it with debt sustainability. We will seek TA to start preparing and then publish a Fiscal Risk Statement (FRS), accompanying our annual budget documents (starting with the 2018 budget), as a tool to help improve the transparency of fiscal policies and associated risks. We will strengthen monitoring on a quarterly basis of on-lending agreements from external creditors to state-owned enterprises, and will tighten the evaluation framework for entering into such contracts to mitigate fiscal risks. We will develop a regular monitoring mechanism to assess the financial performance of SOEs, and seek to improve the governance and transparency of these enterprises.

D. Structural Reforms

12. We continue to work on eliminating debt accumulated by energy companies and improving tariff-setting methodology, to ensure transparency and cost-recovery.

i. The district heating tariff will be increased by an estimated minimum of 5 percent to allow for adequate investments and current payment obligations, subject to an agreement between ANRE and World Bank **(prior action)**.

- To ensure the sustainability of the system going forward, we will also improve regulations in the heating sector, in line with ANRE's Action Plan agreed with the World Bank **(structural benchmark, end-June 2017)**, including:

  a. Revision and/or clarification of asset valuation and depreciation principles, methodologies and procedures;

  b. Revision and formal approval of methodology for determination of heat losses;

  c. Determination of the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.

- We will continue to work closely with Termoelectrica, Moldovagaz and the World Bank on restructuring the Termoelectrica's debt accumulated with Moldovagaz, estimated at about US$140 million.

ii. In the electricity sector, we plan to adopt the first tariff supplement according to ANRE decision no. 201, adopted on July 15, 2016, on gradual repayment of accumulated financial deviations to electricity distribution companies. The base tariff adjustment will be made based on the existing methodology. If the base electricity tariff is adjusted based on amendments to the existing methodology, such amendments should be coordinated with, and not opposed by, the Energy Community Secretariat based on the Energy Community law **(prior action)**.

- In close cooperation with the Energy Community Secretariat, we will work on improving the regulatory framework in the energy sector. ANRE, in discussion with stakeholders, is in the process of amending: (i) the methodology for determination, calculation, and approval of the electricity distribution and regulated electricity tariffs and, (ii) the methodology on calculation and determination of regulated gas supply tariffs.

iii. The new Energy Law, expected to be adopted by June, 2017, envisages to improve procedures for the appointment of ANRE directors, so that they are fully transparent and merit-based, and establish clear performance indicators to provide a basis for future independent audits **(structural benchmark end-June 2017)**.

iv. We will continue to provide financial support to vulnerable households through the social assistance programs, *Ajutor Social* and Heating Allowance, and work on improving the targeting of this support and its effective coverage.

13. We view strengthening economic governance and transparency as a top priority and a necessary foundation for robust economic growth. We are committed to taking strong actions to address weak governance and corruption in a number of areas, including enforcement of laws and regulations and effectiveness of the judiciary. These actions are necessary to build public confidence in government, encourage foreign investment, in order to support sustainable economic growth.

- *Anti-corruption measures*: The new asset disclosure framework, expected to become fully operational in 2018, will strengthen oversight of financial disclosure by senior government officials and high wealth individuals. We will also strengthen the implementation of the AML/CFT framework to complement anticorruption efforts. In particular, we will work on ensuring that the legal frameworks for anticorruption and AML/CFT are in line with international standards, particularly with regard to the criminalization of corruption and preventive measures for politically exposed persons. We will continue to implement reforms that improve the independence, effectiveness, transparency, and accountability of the judiciary and of the anti-corruption institutions.

E. Poverty Reduction

14. Our Economic Development Document outlines our strategy to strengthen growth and reduce poverty. We are in the process of undertaking an assessment of our "Moldova 2020" National Development Strategy, with the objective of updating it and aligning it with the UN Sustainable Development Goals. We aim to finalize the assessment of "Moldova 2020" by mid-May 2017, subsequently to have the updated strategy adopted by the parliament.

F. Program Monitoring

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

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

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

	Dec 2016		2017			
	Target	Actual	Mar	Jun	Sep	Dec
1. Quantitative performance criteria [1/]						
Ceiling on the ***augmented*** cash deficit of the general government	4,668	2,827	1,844	3,670	5,485	5,513
Of which: on-lending agreements with external creditors to state-owned enterprises	396	340	107	410	808	1,203
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [2/]	1,833	1,894	1,818	1,843	1,962	2,131
2. Continuous performance criteria						
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0	0
3. Indicative targets						
Ceiling on the stock of accumulated domestic government arrears [3/]	466	101	35	26	13	0
Ceiling on the general government wage bill	11,323	10,967	2,850	6,358	9,292	12,461
Floor on priority social spending of the general government	16,182	16,012	4,000	8,450	12,766	17,365
4. Inflation Consultation Bands (in percent) [1/]						
Outer Band (upper limit)	5.5		6.2	7.7	8.2	8.5
Inner Band (upper limit)	4.5		5.2	6.7	7.2	7.5
Actual / Center point	3.5	2.4	4.2	5.7	6.2	6.5
Inner Band (lower limit)	2.5		3.2	4.7	5.2	5.5
Outer Band (lower limit)	1.5		2.2	3.7	4.2	4.5

1/ Indicative targets for March and September.

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

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

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

	Measure		Timeframe
	Prior Actions for Board Consideration of the Review		
	Financial sector		
1	Take appropriate supervisory actions with regard to shareholders with unidentified UBOs of the three largest banks. (MEFP ¶4a)	New	
2	Adopt a strategy to allow a large bank to exit temporary administration. (MEFP ¶4f)	New	
3	Adopt new supervisory procedures for applying powers to presume any person as a bank's related party on the basis of objective criteria. (MEFP ¶4g)	New	
4	Amend the laws to ensure adequate treatment of cancelled shareholders in resolution; and that deposits of affiliates that are not significant shareholders, members of decision making bodies and their affiliates, can be paid out or transferred to good bank in resolution. (MEFP ¶4l)	New	
5	Adopt the secondary legislation to enable a proper functioning of the CSD. (MEFP ¶4m)	New	
	Energy Sector		
6	Increase the district heating tariff by an estimated minimum of 5 percent to allow for adequate investments and current payment obligations, subject to an agreement between ANRE and World Bank. (MEFP ¶13)	New	
7	Increase the 2017 electricity tariffs that would maintain cost recovery and include the first tariff supplement, as a part of gradual repayment of the recognized financial deviations accumulated by electricity distribution companies. The base tariff adjustment will be made based on the existing methodology. If the base electricity tariff is adjusted based on amendments to the existing methodology, such amendments should be coordinated with, and not opposed by, the Energy Community Secretariat. (MEFP ¶13)	New	
	Structural Benchmarks 1/		
	Financial Sector		
1	Complete identification of UBOs of	Modified	
	1a the fourth and fifth largest banks that are not subsidiaries of foreign banking groups		end-June 2017
	1b all remaining banks		end-August 2017
2	Take appropriate enforcement action against any of the three largest banks for non-compliance with regulatory requirements	Modified	
	2a Two large banks under intensive supervision		end-April 2017
	2b A large bank under temporary administration		end-June 2017
3	Complete an assessment of all banks to confirm compliance with capital requirements	New	
	3a Two large banks under intensive supervision		end-April 2017
	3b A large bank under temporary administration		end-June 2017
4	Execution of the final stages of a strategy to allow a large bank to exit temporary administration	New	end-July 2017
5	Enhance NBM's internal database for bank claims to capture relevant characteristics for identifying exposures to related party	New	end-June 2017
6	With external assistance, conduct thematic reviews of related party exposures in the three largest banks	Modified	end-August 2017
7	Conduct full-scope on-site inspections in banks that are not subsidiaries of foreign banking groups, applying new procedures for identifying related party exposures	Modified	end-December 2017
8	Adopt a methodology for verification of legal records of shareholders of financial institutions	New	end-May 2017
9	Complete verification of legal records of shareholders of all banks and insurance companies, in line with the new methodology	New	end-December 2017
10	Amend the legal framework for removing shareholders who act in concert without prior supervisory approval	New	end-April 2017
	Fiscal sector		
11	Adopt the medium-term budget framework 2018-20	New	end-May 2017
	Energy sector		
12	In cooperation with the World Bank, improve the tariff-setting methodology in the heating sector, including	New	end-June 2017
	12a Revision and/or clarification of asset valuation and depreciation principles, methodologies and procedures;		
	12b Revision and formal approval of methodology for determination of heat losses;		
	12c Determination of the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.		
13	In cooperation with the Energy Community Secretariat, improve energy sector regulation, including making procedures for the appointment of ANRE directors to be fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audit. (MEFP ¶13)	New	end-June 2017

1/ Additional structural benchmarks will be set at the time of the second program review.

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

	Measure	Program deadline	Status
Structural Benchmarks			
Financial Sector			
1	Conduct full-scope on-site inspections in all banks:		
	1a Three largest banks, including off-site verification of remedial action plans	end-February 2017	Met
	1b The fourth and fifth largest banks that are not subsidiaries of foreign banking groups	end-May 2017	Modified
	1c Remaining banks	end-December 2017	Modified
2	Take appropriate enforcement actions against any of the three banks that have not complied with their remedial action plans.	end-March 2017	Modified
3	Complete identification of UBOs in all banks:		
	3a Three largest banks	end-December 2016	Not met and modified
	3b The fourth and fifth largest banks that are not subsidiaries of foreign banking groups	end-March 2017	Modified
	3c All remaining banks	end-June 2017	Modified
4	Prepare a strategy for addressing key remaining deficiencies identified in the BCP	end-December 2016	Met
5	Conclude the diagnostics on related party lending in all banks.	end-December 2017	Planned
Fiscal framework			
6	Adopt the 2017 budget in line with program targets.	end-November 2016	Met
7	Adopt a Medium Term Budget Framework for 2017–2019 in line with program targets.	end-November 2016	Met
Energy sector			
8	Develop a transparent mechanism to ensure timely adjustment of utility tariffs on the basis of costs to prevent any discretionary delays.	end-March 2017	Met

Attachment II. Technical Memorandum of Understanding

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

A. Quantitative Program Targets

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

- the floor on the net international reserves (NIR) of NBM;
- the ceiling on the augmented overall cash deficit of the general government, i.e., the overall cash deficit of the general government augmented by on-lending agreements with external creditors to state-owned enterprises (SOEs) (SMEFP ¶10);
- the ceiling on accumulation of external payment arrears of the general government (continuous).
- the ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies (continuous);

Indicative targets are set on:

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

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

B. Program Assumptions

3. For program monitoring purposes, all foreign currency-related assets will be valued in U.S. dollars at program exchange rates. The program exchange rate of the Moldovan leu (MDL) to the

U.S. dollar has been set at 19.8698 MDL/US$ (the official rate as of June 30, 2016). Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates as of end-June 2016 published on the IMF web site http://www.imf.org, including US$/EUR = 1.1102, JPY/US$ = 102.9, CHF/US$ = 0.976, US$/GBP = 1.3488, CNY/US$ = 6.6445, RUB/US$ = 64.1755, SDR/US$ = 0.711134876. The holdings of monetary gold will be valued at US$1,320.75 per one troy ounce.

C. Institutional Definitions

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

D. Program Definitions

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

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

- **Reserve liabilities of the NBM** are defined as use of Fund credit by the NBM, convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including

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

one year, and convertible currency liabilities of the NBM to residents, excluding to the general government and the mandatory FX reserves of domestic banks in the NBM. Liabilities arising from use of Fund credit by the NBM do not include liabilities arising from the use of SDR allocation.

For program monitoring purposes, the stock of reserve assets and reserve liabilities of the NBM shall be valued at program exchange rate, as described in paragraph 3 above. The data source for gross reserves and liabilities is the Monetary Survey published by NBM in Moldovan Lei, from which the 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$1,894.2 million as of end-December 2016.

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

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

7. The overall cash deficit of the general government is cumulative from the beginning of a calendar year and will be monitored from the financing side at the current exchange rate established by NBM at the date of transaction. Accordingly, the cash deficit is defined, as the sum of net credit of the banking system to the general government (as defined in paragraph 6), the general government's net placement of securities outside the banking system, other net credit from the

[2] For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1711, 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, 3533 and the group of accounts 2100.

(continued)

domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[3] for direct budgetary support and for project financing minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets.

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

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

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

[3] Debt is defined as in footnote 4.

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

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

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

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

14. The **priority social spending of the general government** is defined as the sum of essential recurrent expenditures including pension[6] and unemployment insurance payments from the Social Insurance Fund (BASS, 9008/00286), the *Ajutor Social* (social assistance program 9015/00320) and

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

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

heating allowance (9015/00322) during the cold season from the central government budget, as well as 94 percent of health expenditures from the main fund of the Health Insurance Fund.

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

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

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

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

16. **Absorption of losses or liabilities by the government and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling of zero on absorption by the public sector of losses or liabilities from outside the budgetary sector. Absorption of losses or liabilities is defined as direct payment by the government of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as accumulated stock of the financial deviation of the utility companies, debt-for-equity swaps or a write-off of tax obligations or other state claims.

E. Inflation Consultation Mechanism

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

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

Inflation Consultation Bands

	2016	2017			
	Dec	Mar 1/	Jun	Sep 1/	Dec
Outer Band (upper limit)		6.2	7.7	8.2	8.5
Inner Band (upper limit)		5.2	6.7	7.2	7.5
Actual / Center point	**2.4**	**4.2**	**5.7**	**6.2**	**6.5**
Inner Band (lower limit)		3.2	4.7	5.2	5.5
Outer Band (lower limit)		2.2	3.7	4.2	4.5

1/ Indicative targets.

F. Adjusters

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

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

20. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by:

a. the amount of any shortfall between the total amount of actually disbursed and programmed budget support grants from the European Commission. The upward adjustment for 2016 is capped at the equivalent of MDL 220 million, valued at the program exchange rates; and

b. the amount of domestic expenditure arrears cleared upon availability of higher-than-programmed external budget support. For 2016, the programed external budget support equal to the equivalent of MDL 3,133 million, valued at program exchange rates.

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

Programmed Onlending to SOEs and Adjustments to Augmented Fiscal Deficit

	2016	2017 - Cumulative			
		Q1	Q2	Q3	Q4
Onlending to SOEs (programmed amount, millions of U.S. dollars)	17.2	5.3	20.1	39.6	59.0
Maximum downward adjustment on the augmented overall cash deficit (millions of Moldovan lei) 1/	339.6	107.4	410.3	807.5	1203.3

Note: 1/ The adjustments for the year 2017 are evaluated at the exchange rate: 20.4 MDL/USD (the forecast of the Ministry of Economy).

22. The floor on **NIR of the NBM** will be lowered by any shortfall in the official external grants and loans capped at the equivalent of €10 million and €20 million respectively, valued at the program exchange rates.

G. Reporting Requirements

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

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

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

Item	Periodicity
Fiscal data (to be provided by the MoF)	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
Number of budgetary sector positions and employees at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within four weeks of the end of each month
Social expenditure including pension and unemployment payments from the Social Insurance Fund, the *Ajutor Social* (social assistance program) and heating allowance for the cold season from the central government budget, and health expenditures from the main fund of the Health Insurance Fund	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Onlending to SOEs by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Onlending via commercial banks by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Monetary data (to be provided by the NBM)	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 (from NBM's Banking Supervision)	Monthly, within four weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange cash flows of NBM	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily, within 12 hours of the end of each day
NBM's sterilization operations	Weekly, within one week of the end of each week
Interbank transactions (volumes, average rates)	Weekly, within one week of the end of each week
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
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 private sector debt service due and debt service paid, by creditor	Quarterly, within three weeks of the end of each quarter
Disbursements of grants and loans by recipient sector (state/local/SOEs), and by creditor	Quarterly, within three weeks of the end of each quarter
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly, within two weeks of the end of each month
National accounts by sector of production, in nominal and real terms.	Quarterly, within three months of the end of each quarter
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly, within two months of the end of each month