Appendix I. Letter of Intent

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

Chişinău, June 15, 2018

Dear Ms. Lagarde:

1. Moldova is maintaining its efforts to drive ahead with our ambitious reform program, supported by the Fund's Extended Fund Facility and Extended Credit Facility Arrangements. We met all quantitative performance criteria and 9 of 11 structural benchmarks. We continue to extend our period of economic growth and financial stability, with growth picking up in 2017 to 4.5 percent, and expected to remain solid into 2018. This growth remains essential to job creation and poverty reduction. Despite these important developments, challenges remain.

2. We remain committed to consolidating economic and financial stability, through cleansing the financial sector, strengthening our regulatory and supervisory environment, and raising growth and employment. We will continue to pursue a wide-ranging reform agenda:

- In the **financial sector**, we will update the framework for removing shareholders in banks, take action to address related party lending, improve banks' corporate governance, operationalize the new central securities depository, and verify the integrity of share registration. We will also strengthen further our regulatory and supervisory frameworks, including for non-bank financial institutions.

- Our **fiscal policy** remains in line with program objectives. Our priorities include public investment and social spending, tax and customs reforms, and improving the efficiency of spending.

- In the **energy sector** we will continue to improve transparency, predictability and good governance, including by working closely with relevant sector stakeholders. New tariffs in the electricity sector will be fully based on the new methodology and will also reflect past financial deviations.

3. 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 third review under the blended

Extended Credit Facility and Extended Fund Facility arrangements; modification and establishment of Quantitative Performance Criteria and Indicative Targets through March 2019 (Table 1); establishment of Structural Benchmarks through end-December 2018 (Table 2); and associated disbursement of SDR 24.0 million.

4. The authorities remain strongly committed to the implementation of the program and stands ready to take additional measures that may be adequate for the successful implementation of the program. The government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the 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. 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/
Chiril Gaburici
Minister of Economy
and Infrastructure

/s/
Octavian Armaşu
Minister of Finance

/s/
Sergiu Cioclea
Governor
National Bank of Moldova

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

Attachment I. Supplementary Memorandum of Economic and Financial Policies

I. Recent Developments and Outlook

1. **Macroeconomic performance remains solid.** Growth surprised on the upside and held up at 4.5% in 2017, supported by strong domestic demand and a positive external environment. Domestic demand picked up sharply, largely driven by private consumption and investment growth that turned positive for the first time since the 2014 crisis. Stronger domestic demand was offset by a larger drag from net trade, with imports picking up by more than exports. As expected, inflation has slowed back towards the NBM target. CPI inflation peaked at 7.9 percent in late 2017 and declined to 2.8 percent in May 2018, largely driven by changes to regulated and food prices. During the reporting period, the base inflation was evolving around 5%, at the center of the NBM inflation target corridor.

2. **The fiscal balance overperformed program targets.** The augmented overall deficit reached 1 percent of GDP compared with 3.1 percent envisaged in the 2017 Budget amendment, mainly due to a broad under-execution of capital and current spending as well as higher than expected revenues. The wage bill remained below the program ceiling. Domestic state arrears declined, marginally exceeding the December target by about 0.002 percent of GDP. Priority social spending was below the indicative floor by about 0.03 percent of GDP in December, mainly due to lower than projected number of beneficiaries on account of lower registered unemployment and increased pension payments to cover minimum subsistence levels.

3. **Growth is forecast to remain solid in 2018, while inflation slows.** Growth is expected to remain strong, at around 3¾ percent in 2018. Rising real incomes, continued remittance inflows, previous monetary policy easing, and stronger public investment will support domestic demand, while net trade will remain a drag, partly driven by the appreciation of the leu and weaker agricultural exports. Despite stronger-than-expected growth, inflation is projected to slow sharply. CPI inflation is forecast to reach the lower end of the range around the NBM's target in 2018, as previous shocks to food and regulated prices dissipate, new tariff cuts feed through, and further exchange rate appreciation weighs on domestic prices.

II. Policy Framework

A. Financial Sector Policies: Rehabilitating the Banking Sector

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

4. We continue to make progress towards cleansing and rehabilitating the banking system. In particular:

i. The transfer of ownership from a non-compliant shareholder in Victoriabank to a strategic investor was a major milestone. The new management has been certified as fit and proper by the NBM. The new majority shareholders are implementing appropriate corporate governance, risk management, and controls that will enable an ensuing lifting of special supervision regime.

ii. Negotiations on the acquisition of the 41.09% percent share in MAIB by an EBRD-led consortium have been concluded, following the adoption of laws to facilitate pre-agreed back-to-back purchase and sale of shares in systemic banks by the Government. Agreement on the terms of the pre-contract for the sale and purchase agreement paves the way for the initiation of the back-to-back purchase and sale transaction.

iii. In MICB, following cancellation of suspended shares, new shares were issued, in line with the provisions of the Article 11^1 of the Law on Capital Markets. These new shares were valued by a reputable international firm and are now exposed for sale on the stock exchange.

iv. NBM's Executive Board adopted decisions on Related Party (RP) Reviews for the three largest banks, ordered these banks to submit time-bound plans for unwinding RP exposures, and the relevant department has accepted those plans.

v. Full-scope onsite inspections have been (a) finalized in the remaining two banks that are not part of the foreign banking groups and (b) undertaken in the banks that are part of foreign banking groups.

vi. Following the on-site inspections, NBM is finalizing RP Reviews in four banks that are not part of the foreign banking groups.

vii. The NBM has finalized the investigations into concerted activities and fitness and probity of shareholders in non-systemic banks. Based on these investigations, the NBM Executive Board decisions are being prepared.

viii. The NBM has instructed all banks to conduct a self-assessment of corporate governance.

5. **The New Banking Law came into force on January 1, 2018.** The Law introduced international standards and is in line with EU CRD IV/CRR Directives on prudential requirements for credit institutions and their supervision. Supporting regulations are already drafted and will be approved in stages, in line with the NBM's time-bound action plan for publication and implementation.

6. **Central Securities Depository (CSD):** We have completed the verification of the legal records of all banks and insurance companies. On March 14, 2018, the NBM Executive Board approved a set of actions to be taken for the establishment of the CSD, after which state registration took place. The CSD is designed to guarantee the safety of securities, ensure the transparency of financial markets, and help develop new financial market instruments. It will facilitate the NBM in achieving its objective of ensuring the shareholders' transparency in the licensed banks.

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

i. **NBM will allow a systemic bank to exit temporary administration in an orderly manner (reset structural benchmark, end-October-2018).** This will entail a private sector solution following the price valuation and exposure of the newly issued shares for sale at the stock exchange. We have a contingency plan in place, should this approach face substantive impediments or delays that would undermine financial stability.

ii. **We will identify the UBOs of all domestic banks.** We will apply legal enforcement actions vis-à-vis concerted shareholders. We will remove unfit shareholders in domestic non-systemic banks before end-March 2019 (**proposed structural benchmark**). To ensure timely removal of unfit shareholders and, in consultation with Fund staff, we will adopt legal amendments to the new shareholder removal model to incentivize effective and timely action **(prior action)**.

Related party reviews. NBM will ensure that credible time-bound action plans are in place for unwinding RP exposures for all domestic banks that are not part of foreign groups before end-July 2018 (**proposed structural benchmark**). We are developing and will issue for consultation with the banks guidelines for RP risk management programs **(structural**

benchmark, end-June 2018). We will publish these guidelines, including policies, procedures, and systems for identification of RPs' operations.

iii. **Operationalizing the new CSD and verification of the integrity of share registration.** The CSD will become fully operational by end-October 2018. Following this, the operationalization of the software platform for government securities will allow the transfer of their registry from NBM to the CSD. Banks and Insurance companies' registries will be transferred to the CSD in October. We have established a Supervisory Board to ensure effective oversight and operations. We will develop a methodology to oversee the transfer of registries.

iv. **Financial safety nets.** We are working to further strengthen our crisis prevention and contingency planning. To this end, we are reviewing our legal and operational frameworks for emergency liquidity assistance, deposit insurance, and bank liquidation, with the intention of adopting reforms by end-year 2018. Designed to complement the Bank Recovery and Resolution Law, these reforms will be developed in consultation with the Fund.

v. **Capital conservation policy.** Our supervisory powers, such as dividend payout restrictions and capital add-ons, will be exercised based on the degree of impact of regulatory capital requirements, such as in the context of transition to Basel III and other risk exposures identified by the NBM.

vi. **Non-bank financial institutions.** In the insurance sector, we will ensure strong governance, transparency, and financial strength of the sector. In collaboration with other international partners, we are also reviewing the regulatory framework with the intention of aligning with European standards in this domain.

B. Monetary and Exchange Rate Policies

8. **We will continue to implement monetary policy within an inflation-targeting framework and a flexible exchange rate regime**. Inflation is expected to slow further in 2018, as the effect of the exchange rate appreciation and price level shocks to food and regulated prices more than offsets the impact from higher growth and previous monetary policy easing. In the near term, monetary policy will remain on hold, looking through first-round effects from transitory changes to food and regulated prices.

9. **We will not resist exchange rate movements driven by fundamentals, intervening in the foreign exchange market only to smooth excessive volatility.** Moldova's vulnerability to external shocks requires having a flexible exchange rate as an efficient shock absorber. We will

engage in two-sided interventions in the foreign exchange market to smooth excessive volatility. The NIR targets set under the program are consistent with this commitment.

10. Enhancing communication within and outside NBM is essential for efficient policy implementation. The reduction in the number of monetary policy decisions will be accompanied by a set of broader measures. Priorities include: (i) refining the forecasting process to strengthen outputs and monetary decision-making, (ii) improving coordination across agencies, and (iii) strengthening internal and external communications, including by adhering to a regular calendar of monetary policy decisions.

11. 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.

12. The NBM will consider possible improvements to the liquidity management and reserve remuneration frameworks.

C. Fiscal Policy

13. Our 2018 fiscal plans are consistent with our commitments under the program.

i. **Budget amendment.** We will adopt amendments to budget 2018 consistent with the augmented deficit ceiling of 5,681 mil. lei (3.5 percent of GDP) **(prior action)**. The amended budget maintains our focus on investment and priority social spending. Additional spending on road projects of about 303.1 mil. lei will be financed using cash balances from grants received in 2017 that had been expected in 2018.

ii. **Tax and customs reforms.** The revised revenue projections in the amended budget reflect improved macroeconomic conditions, better than expected collection, and sustained dividends from on-going reforms in the Customs and State Tax Services. Tax administration initiatives were taken in January 2018 to further improve revenue collection. These include increasing the information submitted to the State Tax Service (STS) by financial institutions, as well as expanding information sources used to improve compliance and better detect tax fraud. In line with these initiatives, we have amended the Criminal Procedures Code to enable investigation of tax crimes by the STS**.**

iii. **Wages and pensions.** Our public wage bill will be 14,030 million lei, somewhat higher than initially planned, mainly to accommodate (i) legally mandated public salary increases; (ii) increases in medical insurance contributions; (iii) commitments related to donor projects; and (iv) inclusion of seven public sector agencies as budgetary institutions. The amended budget for the Social Fund includes funds to cover pension indexation.

iv. **Domestic arrears.** We remain committed to eliminating audited state arrears and approving legislation to reduce local government arrears that are currently beyond the control of the central government. We aim to improve the monitoring of arrears and prevent their accumulation, including by amending Article 67 of the Law on Public Finances and Fiscal Accountability with immediate effect subject to parliamentary approval during the Spring 2018 session.

14. The budget for 2019 and Medium-Term Budget Framework (MTBF) will be in line with agreed program objectives.

i. We are committed to adopting the MTBF 2019–21 in June 2018 that will preserve Moldova's low risk of public debt distress, while at the same time facilitating growth-enhancing public investment and other high priority spending.

ii. We are planning to adopt the 2019 budget in July in line with revenues, the wage bill, and deficit parameters of the MTBF.

15. To support our medium-term fiscal objectives, we will take measures to strengthen our institutional fiscal frameworks.

i. **Spending Reviews.** We will fully integrate spending reviews into our MTBF and annual budget processes starting with the MTBF 2021–23. To this end, we plan to amend Law no. 181 on Public Finance and Fiscal Responsibility with a provision on spending reviews. We are piloting a spending review in the education sector as a first step to institutionalize the full spending review to better evaluate our spending needs.

ii. **Wages.** We plan to unify the salary system in the budgetary sector as of 2019, to improve workforce management and make government compensation more transparent. We will carefully assess the budgetary impact of the new wage grid prior to its implementation, in consultation with the Fund and benefitting as needed from ILO advice. To accommodate a smooth transition to the new system and prevent fiscal slippages, we stand ready to implement the reform in gradual steps. Our wage bill in 2019 will be 14,947 mil lei, with 246 mil lei designated to facilitate the first phase of the reform.

iii. **Public investment.** To address priority infrastructure needs and promote growth-enhancing investment, we plan to rehabilitate the road network, reform the railway system, and enhance energy security and reliability. To prevent delays and cost overruns, we aim to strengthen our budgetary processes and public investment management, including by integrating capital expenditure in our spending review process.

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

v. **Tax reform.** We intend to revise the structure of the PIT and social contribution rates in consultation with the Fund to strengthen the sustainability of the national budget and pension system, promote employment, and reduce labor emigration.

vi. **Public debt management.** The development of the domestic government bond market remains one of our debt management objectives for 2018–21. To support this, the Ministry of Finance will seek to enhance its communication with state securities market participants and extend the maturity of state securities.

D. Structural Reforms

16. Greater transparency, predictability, and good governance in the energy sector remain our priority. Preventing legal disputes and enhancing the regulator's independence will support medium-term growth by reducing uncertainty and improving the business environment.

i. In the electricity sector, new tariffs will be fully based on the February 2018 methodology and will also reflect differences in the assessment of financial deviations from April 2017-February 2018 (**proposed structural benchmark**, **end-June 2018**).

ii. In the heating sector, we will support—in consultation with relevant stakeholders—the full implementation of the action plan agreed between ANRE and the WB, including by approving the new tariff-setting methodology and procedures related to asset valuation and depreciation principles; approving a revised methodology for determining heat losses; determining the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.

iii. We will continue to support collaboration between stakeholders on energy-related issues. Cooperation between the independent energy regulator and relevant stakeholders such as the Energy Community Secretariat, electricity distribution companies and the World Bank proved fruitful in developing the new electricity tariff methodology. We believe such cooperation is vital to ensuring transparency and predictability in the sector.

17. **We will continue to take measures to strengthen economic governance.** We will continue to shrink the shadow economy building on recent progress, reduce regulatory and administrative burdens, and implement judicial reforms. We will make efforts to improve the business environment through more permissive approaches, while ensuring sound financial sector supervision; strong tax, customs, and AML/CFT frameworks; and implementation of Moldova's commitments under the DCFTA and the EU Association agreements.

18. **Recovery of assets.** The final Kroll investigation documents have been transmitted to the Anticorruption Prosecutor's Office, which will serve as basis for asset recovery. The Moldovan investigation bodies remain committed to recover the stolen funds. To that end, the General Prosecutor's Office will publish a high-level asset recovery strategy, setting out a time-bound action plan for the recovery of stolen assets (**prior action**) that will include an outline of responsible agencies and their coordination, as well as reporting requirements, without jeopardizing ongoing recovery efforts.

19. **AML/CFT framework**. The new AML Law was published in the official Gazette in February 2018. Consequently, the AML Agency (SPCSB) has been strengthened as an independent entity under the government with operational capacity. This institutional set-up, together with upcoming regulatory and legislative changes will enable the authorities to better address ML/TF risks. We will amend the legal AML/CFT framework to ensure effective application of proportionate and dissuasive sanctions for AML/CFT violations by banks or other reporting entities in line with FATF standards. We will also issue regulations, such as those on identification of suspicious transactions and activities, on terrorism financing, and on politically exposed persons. Our AML/CFT framework will be assessed by MONEYVAL in October 2018. MoUs on cooperation and exchange of information across all relevant domestic agencies are being concluded.

20. **We remain committed to achieving sustainable and more inclusive growth.** Improving competitiveness and attracting foreign investment are key to fostering technological advancement and raising investment in infrastructure and human capital. In this context, we will continue reforms in education, health, and social policies, thereby raising human capital and helping counter migration and demographic pressures.

E. Program Monitoring

21. **The program will continue to be monitored through semi-annual reviews, prior actions, quantitative and performance criteria, indicative targets, and structural benchmarks**. The quantitative performance criteria, inflation consultation clause, 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	QPC
Table 2	Prior actions and structural benchmarks
Table 3	Status of structural benchmarks

Table 1. Moldova: Quantitative Performance Targets, June 2018–March 2019

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

	Dec 2017			Mar 2018		Jun 2018		Sept 2018	Dec 2018	Mar 2019
		Adjusted				EBS/17/130	Revised		Proposed	
	Target	Target 5/	Actual	Target	Actual	Target	Target	Target	Target	Target
1. Quantitative performance criteria [1/]										
Ceiling on the ***augmented*** cash deficit of the general government	5,513	5,308	1,444	1,339	-1,099	3,548	4,290	4,986	5,681	1,985
Of which: on-lending agreements with external creditors to state-owned enterprises	504	504	299	170	32	257	275	309	618	30
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [2/]	2,131	2,131	2,463	2,368	2,518	2,349	2,431	2,592	2,629	2,752
2. Continuous performance criteria										
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0	0	0	0	0	0
3. Indicative targets										
Ceiling on the stock of accumulated domestic government arrears [3/]	0	0	3	0	7	0	0	0	0	0
Ceiling on the general government wage bill	12,657	12,657	12,506	3,287	3,282	7,244	7,616	10,935	14,030	3,968
Floor on priority social spending of the general government	17,660	17,660	17,615	4,598	4,461	9,463	9,291	13,985	19,280	4,873
Floor on project spending funded from external sources [4/]	N/A	N/A	N/A	262	98	647	433	1,366	2,963	148
4. Inflation Consultation Bands (in percent)										
Outer Band (upper limit)	9.0	9.0		7.8		5.6	5.2	5.0	5.0	5.8
Inner Band (upper limit)	8.0	8.0		6.8		4.6	4.2	4.0	4.0	4.8
Center point	7.0	7.0	7.3	5.8	4.7	3.6	3.2	3.0	3.0	3.8
Inner Band (lower limit)	6.0	6.0		4.8		2.6	2.2	2.0	2.0	2.8
Outer Band (lower limit)	5.0	5.0		3.8		1.6	1.2	1.0	1.0	1.8

1/ Indicative targets for September 2018 and March 2019.

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

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

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

5/ Adjusted for shortfall between the total amount of actually disbursed and programmed onlending from external creditors to SOEs as per the TMU.

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

	Measure		Timeframe
Prior Actions for Board Consideration of the Review			
1	Adopt amendments to budget 2018 consistent with the augmented deficit ceiling.		
2	The General Prosecutor's Office to publish a high-level asset recovery strategy, setting out a time-bound action plan for the recovery of stolen assets.		
3	Adopt legal amendments to the new shareholder removal model to incentivize effective and timely action.		
Structural Benchmarks 1/			
Financial Sector			
1	NBM to allow a systemic bank to exit temporary administration in an orderly manner.	Modified	End-October 2018
2	NBM to remove unfit shareholders in domestic non-systemic banks.	New	End-March 2019
3	NBM to ensure that credible time-bound action plans are in place for unwinding RP exposures for all domestic banks that are not part of foreign groups.	New	End-July 2018
Energy sector			
4	In the electricity sector, new tariffs will be fully based on the February 2018 methodology and will also reflect differences in the assessment of financial deviations from April 2017-February 2018	New	End-June 2018

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

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

	Measure	Timeframe	Status
Financial Sector			
1	Finalize onsite inspections in:		
	1a) two small domestic banks that are not part of foreign banking group	End-January 2018	Met with delay
	1b) banks that are part of foreign groups	End-May 2018	Not met
2	Finalize investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks	End-March 2018	Met
3	NBM to allow a systemic bank to exit temporary administration in an orderly manner.	End-June 2018	Reset to end-October 2018
4	Adopt a new framework for removing concerted and otherwise unfit shareholders, to streamline the process and address governance issues.	End-April 2018	Met with delay (1)
5	NBM to instruct all banks to conduct self-assessment of corporate governance.	End-August 2018	Met
6	NBM to order the largest three banks to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement.	End-January 2018	Met with delay
7	NBM to develop and issue for consultation with the banks guidelines for RP risk management programs.	End-June 2018	Met
8	NCFM to complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign.	End-March 2018	Met
9	Government to publish an analytical report prepared by an independent investigator on the 2014 bank fraud, and adopt a strategy with time-bound actions to recover assets.	End-December 2017	Met with delay (2)
Energy sector			
10	Develop approve, and publish a new tariff methodology, in line with the new Energy law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSO.	Mid-February 2018	Met with delay

(1) This structural benchmark became a prior action for Board consideration of the Review.
(2) The Government published an analytical report prepared by an independent investigator on the 2014 bank fraud; adoption of a strategy with time-bound actions to recover assets was established as a prior action for Board consideration of the third program review.

Attachment II. Technical Memorandum of Understanding

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

A. Quantitative Program Targets

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

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

Indicative targets are set on:

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

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

B. Program Assumptions

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

C. Institutional Definitions

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

D. Program Definitions

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

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

- **Reserve liabilities of the NBM** are defined as use of Fund credit by the NBM, convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year, and convertible currency liabilities of the NBM to residents, excluding to the general government and the mandatory FX reserves of domestic banks in the NBM. Liabilities arising

[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).

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 US2,292.6 as of end- September 2017.

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

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

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

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

[3] Debt is defined as in footnote 4.

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.

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

[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.

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 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,

[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.

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

	2018			2019
	Jun	Sep	Dec	Mar
Outer Band (upper limit)	5.2	5.0	5.0	5.8
Inner Band (upper limit)	4.2	4.0	4.0	4.8
Center point	**3.2**	**3.0**	**3.0**	**3.8**
Inner Band (lower limit)	2.2	2.0	2.0	2.8
Outer Band (lower limit)	1.2	1.0	1.0	1.8

F. Adjusters

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

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

20. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by the amount of any shortfall between the total amount of actually disbursed and programmed budget support from external donors, including MFA (grants and loans) from the European Commission. The upward adjustments for 2018 is capped at the equivalent of MDL 596 million and MDL 894 million, respectively for grants and loans, valued at the 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 on-lending from external creditors to SOEs.[7] The latter is specified in the text table below.

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

Programmed Onlending to SOEs and Adjustments to Augmented Fiscal Deficit

	2018 - Cumulative				2019
	Q1	Q2	Q3	Q4	Q1
Onlending to SOEs (programmed amount, millions of U.S. dollars)	1.9	16.3	18.3	36.7	1.8
Maximum downward adjustment on the augmented overall cash deficit (millions of Moldovan lei) 1/ 2/	32.0	274.9	308.5	618.1	30.4

1/ The adjustments for the year 2018 is evaluated at the exchange rate: 16.83 MDL/USD (the forecast of the Ministry of Economy).
2/ The adjustments for the year 2019 are evaluated at the exchange rate: 16.99 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 US$30 million and US$45 million respectively, valued at the program exchange rates. NIR targets will also be adjusted upward (downward) by the surplus (shortfall) in IMF budget support purchases relative to the baseline projection reported in Table 3.

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
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 three 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 outstanding debt, 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	State: Monthly, within three weeks of the end of each month Other: 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