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REPUBLIC OF MOLDOVA

December 2014

SECOND POST-PROGRAM MONITORING DISCUSSIONS—STAFF REPORT; STAFF STATEMENT; PRESS RELEASE; STATEMENT BY THE EXECUTIVE DIRECTOR

In the context of the Second Post-Program Monitoring Discussions, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 8, 2014, following discussions that ended on October 8, 2014, with the officials of the Republic of Moldova on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 18, 2014.
- A **Staff Statement** of December 8, 2014, updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its December 8, 2014, consideration of the staff report that concluded the Second Post-Program Monitoring Discussions with the Republic of Moldova.
- A **Statement by the Executive Director** for the Republic of Moldova.

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

SECOND POST-PROGRAM MONITORING DISCUSSIONS

November 18, 2014

KEY ISSUES

Governance in the banking system remains poor and the condition of some large banks is fragile. The budget faces a tight financing situation, and—without corrective measures—the deficit is projected to widen significantly in 2015. Russia's new restrictions on imports from Moldova are exacerbating the ongoing slowdown in activity, easing inflationary pressures, and weakening export performance.

Discussions mainly focused on policies to address the significant risks in the banking sector, return to a path of fiscal consolidation, and boost potential growth and preserve external stability.

Financial sector. The recommendations of the recent FSAP should be implemented, in particular regarding the enforcement of regulatory requirements. A plan to deal with weak banks needs to be developed.

Fiscal policy. Returning to a path of fiscal consolidation, with a view to lower reliance on exceptionally high donor support over the medium term is important. This objective can be achieved by containing the budget deficit below 3 percent of GDP in 2015, gradually reducing it 1½ percent by 2018.

Monetary policy. The supportive monetary policy stance should be maintained but the NBM should stand firm against pressures to facilitate its financing of the budget. Exchange rate movements driven by fundamentals should not be resisted.

Structural reforms. Structural reforms are needed to boost potential output growth and reduce vulnerabilities. Strengthening external stability requires efforts to diversify export products and markets, and sources of financing.

Approved By
Aasim M. Husain and Dhaneshwar Ghura

Discussions were held in Chisinau during September 25–October 8, 2014. The missions met with Prime Minister Leanca, Deputy Prime Minister Candu, Minister of Finance Arapu, Minister of Labor and Social Protection Buliga, Governor of the National Bank of Moldova Dragutanu, and other senior officials and representatives of financial institutions, labor unions, business, diplomatic community, and international organizations. The mission team comprised M. Alier (Head), V. Prokopenko, K. Kirabaeva, A. Khachatryan (Res. Rep.) (all EUR), O. Adedeji (SPR), J. Quill (MCM), and S. Cevik (FAD). N. Jovanovic and J. Swirszcz (both EUR), and the local office staff in Chisinau assisted the mission.

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ANNEXES

CONTEXT

1. **The political calendar has affected economic policies and generated uncertainty about Moldova's outlook.** Parliamentary elections are scheduled for November 30, 2014 and local elections for mid-2015. In the current environment of regional geopolitical tensions, the elections will be highly contested. The intense political competition in the run-up to the elections has prompted policy reversals, hindered the response to increasing vulnerabilities in the banking sector, and stalled the reform agenda.

2. **In June, Moldova signed an Association Agreement with the EU which includes provisions establishing a Deep and Comprehensive Free Trade Area (DCFTA)**. The DCFTA envisions an immediate elimination of both sides' export duties. On import duties, the process will be "asymmetric": while EU import tariffs on most imports from Moldova were lifted immediately, those on key EU products entering Moldova will be removed over five to ten years. Russia has introduced several restrictions on import of Moldovan products. In September, Moldova also signed a free trade agreement with Turkey, which is expected to enter into effect in 2015.

RECENT DEVELOPMENTS AND OUTLOOK

3. **Russia's restrictions on imports from Moldova are projected to exacerbate the ongoing slowdown in activity**. While economic activity indicators in the first half of 2014 were slightly better than expected at the time of the 2014 Article IV consultation (reflecting good performance of agriculture), a more pronounced decline in growth in key trading partners, moderating agricultural output, and Russia's additional restrictions on imports of Moldovan food products (Annex I) are holding back economic activity in the second half of 2014.[1] In 2014, GDP is projected to grow by 2 percent, compared to 8.9 percent in 2013. Over the medium term, activity is projected to recover with the implementation of free trade agreements with the EU and Turkey. In 2014, despite the expected easing of food price pressures, inflation is projected to remain within the National Bank of Moldova's (NBM) target range of 5 percent ± 1.5 percentage points. However, it is projected to pick up next year, reflecting long overdue utility tariff increases after the elections, before converging to the middle of the target range.

4. **The level of international reserves remains adequate despite the projected deterioration in the current account position**. While there was a collapse in wine exports to Russia during the first half of 2014, agricultural producers have been able to find new markets for their products in the EU and other CIS countries. Also, remittances have remained stronger than anticipated so far in 2014. However, uncertainties related to geopolitical tensions and forthcoming

[1] Russia's ban on Moldovan food products affects 4 percent of total exports (2 percent of GDP). Russia has also introduced a 7.8 percent import duty on imports of Moldovan agricultural products (previously exempt). Some of these products rely heavily on the Russian export market (up to one half of output).

elections have engendered capital outflows and holdings of foreign currencies, culminating in the depreciation of the leu by about 12½ percent vis-à-vis the US dollar since end-2013. International reserves have declined to US$2.7 billion but remain adequate by standard metrics (text table). The current account deficit is projected to widen to 7¼ percent in 2015, reflecting a projected decline in remittances growth and a recovery in imports, as economic and political uncertainties subside.

Reserve Adequacy Measures

	2009	2010	2011	2012	2013	2014	2015
Gross official reserves (millions of U.S. dollars) 1/	1480.3	1717.7	1965.3	2515.0	2820.1	2700.0	2587.6
Months of imports of good and services	3.9	3.4	3.9	4.7	5.2	4.8	4.3
Percent of short-term debt at remaining maturity	88.6	91.3	90.2	106.7	104.0	100.1	92.0
Percent of short-term debt at remaining maturity plus current account deficit	66.3	62.2	69.1	88.7	87.9	77.5	69.6
Percent of the IMF composite measure (flexible)	156.1	159.0	163.6	196.4	191.7	181.6	167.3

Sources: Moldovan authorities; and IMF staff estimates and projections

1/ Includes revaluation changes, which were not captured by changes of gross official reserves in the BOP.

5. **Risks to the economic outlook are tilted to the downside**. The main risks relate to serious vulnerabilities and governance problems in the banking system, a protracted economic activity slowdown in key trading partners, further intensification of geopolitical tensions in the region, and additional policy slippages in the run up to the elections (see Box 3, Risk Assessment Matrix). Moldova's economy and external stability are highly vulnerable to the ongoing regional geopolitical tensions. Although re-orientation of exports is under way, Moldovan producers are still in the process of adopting EU standards and therefore additional exports to the EU are unlikely to be sufficient to fully match the slowdown in exports to Russia in the near term.

Authorities' views

6. **The authorities have divergent views on the short-term macroeconomic outlook**. The Ministry of Economy (MoE) expected a softer impact of restrictions on Moldova's exports and remittances and therefore envisaged higher output growth of 3 percent in 2014. In contrast, the NBM expressed concerns about the slowdown in the Russian economy, weakening domestic demand, and the outlook for agriculture. According to NBM, output growth is likely to be flat or slightly negative in 2014. The NBM's inflation projections are broadly in line with the staff's projections. The authorities agreed with the staff's assessment of risks to the outlook, the transmission channels, and policy responses.

POLICY DISCUSSIONS

7. **Policy discussions mainly focused on**: (i) safeguarding systemic financial stability by strengthening the regulatory and supervisory framework, governance and dealing with weak banks; (ii) ensuring sustainability of the public finances; and (iii) reinvigorating the structural reform agenda.

A. Financial Sector Policy

Staff's views

8. **Reported bank performance indicators are mixed and there are concerns about their accuracy**. As of end-June 2014, the aggregate capital adequacy ratio stood at 19.9 percent, above the required minimum of 16 percent but significantly lower than in past years. However, some banks reported remarkably high ratios of nonperforming loans, several banks were loss-making, and some were complying with the capital requirements by very narrow margins, with one mid-size bank undercapitalized. The reported level of liquid assets appears unreliable as some assets may be encumbered through undisclosed side agreements.

9. **The condition of several banks is weak and requires the urgent attention of authorities to contain risks**. Staff recommended the NBM to continue maintaining a high level of scrutiny over the operations and liquidity positions of weak banks—some of which have large interbank exposures among themselves—and limit deposit growth in banks that are offering deposit rates significantly above the average market rates. Staff advised the authorities to refrain from providing privileged access of public sector deposits to individual banks. Efforts should be made to strengthen the framework to deal with problem and vulnerable banks. In this regard, staff noted the authorities' recent decision to amend the legal framework dealing with bank resolution and crisis management but expressed concern that these amendments as approved might open room for potential abuse. In particular, the legal amendments approved in October 2014 include crisis management provisions which allow the government to issue public debt or guarantees to protect financial institutions without parliamentary approval or oversight of these transactions; the NBM in turn could in principle be asked to provide emergency lending to troubled banks without invocation of special administration.

10. **Legislation restoring the NBM's regulatory powers was recently enacted but enforcement of regulatory requirements remains weak.** The recent FSAP found that there were serious governance problems in several banks, including the largest ones, the ability of regulators to take action was constrained, and the crisis management framework was weak (SM/14/146 and EBS/14/67). In August 2014, legislation restoring the NBM's powers that were limited by a Constitutional Court ruling last year was adopted, but in practice it has not been effective and the courts continue to block some NBM decisions.[2] In addition, legislation to strengthen legal protection of NBM staff and directors, as well as legislation to restore the powers of the National Commission for Financial Markets (NCFM), has not been enacted.

11. **Overall, little progress has been made in implementing the recent FSAP recommendations.** The recommendations aim at strengthening the financial stability framework, bank governance and supervision, the crisis resolution framework, deposit insurance system, and financial market infrastructure (Box 1). Following the FSAP mission, the NBM developed a draft

[2] Soon after the law entered into effect, a court suspended a NBM regulation on large exposures.

action plan covering the recommendations under its responsibilities, as well as those under other institutions. The NBM intends to embed a number of recommendations that are its sole responsibility in the NBM Strategic Plan for 2014–2015, and develop separate plans to address the recommendations in FSAP technical notes. In contrast, there has been no progress on cross-institutional discussions concerning agreement of assigned responsibilities and a timetable for implementation of recommendations spanning other institutions. Staff also noted that a number of the subcomponents of the NBM's strategic plan require further elaboration. The measures need to be detailed and prioritized. Staff strongly recommended to ensure disclosure of banks' ultimate beneficial owners and controllers to the NBM and reassess whether they meet fit and proper criteria, and to strengthen the effective implementation of the AML/CFT framework (Box 2).

Box 1. Key Recommendations of the FSAP

The February 2014 FSAP update mission found that risks to systemic financial stability were significant. Despite some progress in addressing the recommendations of the previous FSAP of 2008 and the satisfactory reported performance of banks, serious governance problems were identified in several banks, including the largest ones, the ability of the regulators to take action was found to be constrained, and the crisis management framework was weak. Key FSAP recommendations to address these issues included:

- *Financial Stability Framework*. Amend the Law on NBM and Law on NCFM, and other legislation as required, to provide NBM and NCFM with the ability to enforce supervisory and regulatory actions in a timely manner (addressing, for instance, problems ensuing from the Constitutional Court rulings of October 2013).
- *Bank Governance*. Re-evaluate bank shareholders to ensure disclosure of ultimate beneficial owners.
- *Banking Supervision*. Amend the Law on NBM to provide full legal protection to all NBM employees in case of lawsuits for action in good faith.
- *Crisis Resolution*. Develop a comprehensive financial crisis resolution contingency plan, and identify necessary amendments to the legislation.
- *Deposit Insurance System*. Enhance funding of the deposit Guarantee Fund (DGF) by developing a target fund methodology; amending legislation to provide a line-of-credit to the DGF from the Ministry of Finance; and amending the Law on DGF Law and Law on NBM to include the NBM as an additional source of back-up funding for the DGF.
- *Financial Market Infrastructure*. Develop a comprehensive risk management framework for the National Securities Depository.

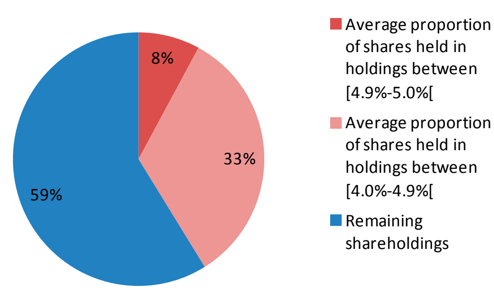
Box 2. Improving the Transparency of Banks' Beneficial Owners to Support Banking Sector Soundness

The lack of transparency of ultimate beneficial owners and controllers of banks in Moldova has been a persistent problem. The issue has received special attention since 2011 "raider attacks" on domestic banks in light of the risk that criminals and their associates capture financial institutions and misuse them for illicit purposes, including money laundering and fraud. Additionally, the lack of ownership transparency impedes the identification of related party exposures with significant implications for legal compliance and risks to financial stability.

Recommendations provided in the context of a 2011 LEG Technical Assistance (TA) led to improvements in the legal framework. The TA suggested a number of reforms, including strengthening banking supervision and corporate governance rules, AML measures related to fit and proper requirements, and enforcement powers. Since then, the NBM strengthened the legal framework, especially the Law on Financial Institutions (LFI), in line and sometimes beyond the BCP and FATF standards requirements. These included requiring prior approval of the NBM for bank share acquisitions exceeding 5 percent of shares, subsequent notification to the NBM for additional acquisitions which would increase the acquirer's holding by more than 1 percent of shares, and requiring banks to publish a list of the shareholders and their beneficial owners on their websites, which has come into force in October 2014.

Major challenges remain. According to the recently published forms on shareholders and beneficial owners of banks operating in Moldova, 41 percent of shares of the five main deposit taking institutions are in groupings between 4 and 4. 99 percent of shareholding, immediately below the 5 percent holding threshold requiring NBM prior approval. This illustrates the feasibility of structuring shareholdings around the LFI requirements to avoid scrutiny from the NBM. In addition, these banks each indicate that more than 25 percent of their shares are beneficially owned by foreign individuals, which raises additional challenges in terms of verification.

Shareholding of Moldova's 5 main deposit taking banks



Source: NBM; public information on banks' websites and staff estimates Agroindbank, Moldindconbank, Banca de Economii, VictoriaBank Banca Sociala

Efforts should be pursued to ensure effective verification of beneficial ownership. The NBM currently lacks effective tools to verify the information disclosed by banks and to determine whether shareholders are acting in concert below the specified shareholding thresholds. In this context, and as suggested in the 2011 TA and in the 2014 FSAP, the burden of proof for providing verifiable information on beneficial owners could be imposed on the proposed acquirer/shareholder and measures should be taken to address the opaque share registry system. Increased cooperation with foreign counterparts, and particularly financial intelligence units and supervisors, should be pursued to enable the NBM to effectively verify beneficial ownership when foreign legal entities and individuals are involved, and conduct adequate suitability assessments. It is also important that access to information on criminal records and ongoing investigations on beneficial owners is systematically obtained, both internally and from foreign counterparts.

Authorities' views

12. **The authorities acknowledged that there are weaknesses in some banks and agreed that addressing them is a priority**. The authorities agreed with the staff's recommendation to

continue close monitoring of weak banks and to require any bank in breach of prudential requirements to swiftly submit time-bound plans to address shortcomings. The authorities also agreed that further efforts are needed to strengthen the contingency framework. In this regard, they noted that the recent legal amendments should provide tools to tackle potential banking distress. They noted staff concerns about the possibility for abuse but argued that these amendments were the best they could get approved before a new parliament is formed. The authorities acknowledged that further legal changes will be needed to assure appropriate checks-and-balances once the parliament reconvenes and stated that any NBM emergency lending secured by state securities or guarantees would require the invocation of special administration.

13. **The authorities agreed with staff that implementing FSAP recommendations should be a priority, especially those related to enforcement of prudential regulations**. However, they noted that, as illustrated by the courts' suspension of the regulation on large exposures, without comprehensive judiciary reform it will remain challenging to enforce bank regulations, in particular those related to banks' ultimate beneficial owners and controllers. The authorities will continue seeking expertise and technical assistance to address judiciary reform.

B. Fiscal Policy

Staff's views

14. **Fiscal discipline has weakened ahead of the elections**. Following a substantial adjustment in 2010-13, Moldova's fiscal position is projected to deteriorate significantly, with the budget deficit excluding grants projected to widen from 3.8 percent of GDP in 2013 to 5.4 percent in 2014 and, in the absence of measures, to 7.1 percent in 2015. This reflects significant pre-election increases in wages and pensions, some ad hoc tax benefits, and weaker economic activity. The authorities have also introduced measures to compensate those affected by trade restrictions. The actual deterioration in the fiscal position in 2014 is largely masked by one-off revenues received for telecom license fees (about 1 percent of GDP). The headline deficit in 2014 is further improved by grants brought forward by the EU from 2015–16 (0.5 percent of GDP) in response to the authorities' request to ease financing constraints. The conditionality needed to secure some of the support from other donors was not met which put pressure on deficit financing. There have been calls for the NBM to facilitate domestic debt placements, including by lowering reserve requirements, but the NBM has resisted.

15. **Fiscal consolidation is needed to ensure medium-term sustainability and lower reliance on exceptionally high donor support**. Under the current policies, the budget deficit would remain at an elevated level over the medium term, leading to an increase in public debt from 30 percent of GDP in 2013 to about 45 percent in 2019. As reported in the Debt Sustainability Analysis (DSA) conducted at the time of the last Article IV mission, despite this projected increase in public debt, Moldova's risk of debt distress remains low, but with heightened overall risk, especially due to the potential recapitalization needs of the banking system. Staff advised that fiscal policy should aim at narrowing the deficit to 1½ percent of GDP by 2018. This would be equivalent to a deficit of about 2½ percent of GDP excluding grants, which is set as a target deficit under the recently adopted Law

on Public Finance and Fiscal Responsibility (FRL), and would put public debt as a share of GDP on a downward trend, ensuring consistency with projected financing availability.

16. **Staff recommended a front-loaded fiscal adjustment in 2015, followed by a gradual annual reduction of ¼–½ percent thereafter until 2018 (text table).**[3] Staff welcomed the draft 2015 budget prepared by the Ministry of Finance (MoF), which seeks to reduce the general government budget deficit to below 3 percent of GDP (around 4½ percent excluding grants), but emphasized that achieving this objective would require a balanced combination of expenditure and revenue measures with a yield of about 2½ percent of GDP, including: wage moderation (Annex II), prioritization of public investment, and increases in tobacco excises in line with Moldova's commitment of narrowing the gap with regional levels and the EU average. At the same time the adjustment in expenditures should be carefully calibrated to protect needed social and capital spending. In 2016-18, the adjustment can be achieved limiting wage increases to expected inflation, tax administration gains, and structural fiscal reforms; in particular, reforms to social security, local governments, and public administration.

17. **Strengthening the fiscal policy framework will facilitate the adjustment over the medium term (Annex III).** Following a pilot implementation in 2014, the full rollout of fiscal decentralization is planned to take place in 2015, which will pose a challenge to fiscal consolidation. Staff urged the authorities to improve controls on local government finances, including enhancing revenue-raising capacity at the local level, and to close gaps in monitoring local public enterprises, many of which are financially unviable, according to a recent study by the Court of Accounts. Staff also called on strengthening the FRL by adopting a more explicit link to public debt sustainability, reducing pro-cyclicality of fiscal policy rules, and providing an adequate accountability framework across all layers of government. Finally, staff encouraged the authorities to move forward with the unification of the currently fragmented tax administration system, which has inhibited reform efforts.[4]

[3] Given Moldova's large infrastructure needs, staff suggested that the fiscal objectives could in principle be relaxed to accommodate specific productivity-enhancing investment projects if financing on reasonable terms is secured, and the additional investment is consistent with the economy's absorption capacity.

[4] There are 36 state tax inspectorates that form the State Tax Service of Moldova, with the Main State Tax Inspectorate performing a central coordinating role.

Fiscal Indicators Under Alternative Scenarios, 2012-2019
(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019
Baseline Scenario								
Revenues	37.9	36.8	39.3	37.0	36.4	36.2	36.1	36.1
of which: Grants	1.8	2.1	3.3	1.7	1.3	1.1	1.0	1.0
Expenditures	40.1	38.6	41.4	42.4	42.5	42.4	42.0	41.8
of which: Capital expenditure	6.3	7.1	8.1	8.0	8.3	8.3	7.9	7.7
Overall balance	-2.2	-1.8	-2.2	-5.5	-6.0	-6.2	-5.8	-5.7
excluding grants	-3.9	-3.8	-5.4	-7.1	-7.4	-7.3	-6.9	-6.7
Government debt	31.0	29.7	31.3	33.4	36.5	39.0	42.0	44.7
Memorandum items:								
Real GDP growth 1/	-0.7	8.9	2.0	3.5	3.8	4.0	4.0	4.0
Current account balance	-8.3	-5.7	-5.3	-7.3	-7.7	-7.7	-7.5	-7.2
Active Scenario								
Revenues			39.3	38.0	37.5	37.2	37.0	36.7
of which: Grants			3.3	1.7	1.4	1.1	1.1	1.0
Expenditures			41.4	40.9	40.0	39.2	38.5	38.2
of which: Capital expenditure			8.1	6.9	6.9	6.7	6.4	6.5
Overall balance			-2.2	-2.9	-2.5	-2.0	-1.5	-1.5
excluding grants			-5.5	-4.6	-3.8	-3.1	-2.6	-2.5
Government debt			31.3	31.7	31.5	30.0	29.1	28.4
Memorandum items:								
Real GDP growth 1/			2.0	2.5	4.0	4.5	5.0	5.0
Current account balance			-5.3	-6.2	-6.4	-6.4	-6.1	-5.9

Sources: Ministry of Finance; National Bureau of Statistics; and IMF Staff Estimates.

1/ In percent.

Authorities' views

18. **The authorities expressed their commitment to the medium-term fiscal objectives envisaged in the FRL.** At the same time, they argued that given the social and infrastructure needs Moldova should spend as much as it can without recourse to inflationary financing or accumulation of arrears. The authorities noted that the draft 2015 budget prepared by the MoF is a first step towards achieving these objectives and consistent with projected financing availability. The measures being considered by the MoF to achieve the deficit target in 2015 are broadly in line with those recommended by staff. On structural fiscal reform initiatives, the authorities agreed with the staff's proposal to strengthen the FRL to ensure the credibility of the medium-term fiscal objective and accountability across all layers of government in view of the country's fiscal decentralization strategy. To this end, the authorities stated their intention to making necessary legislative changes and putting in place an action plan to adopt policies and procedures recommended by staff. In particular, the authorities underscored the importance of strengthening the fiscal decentralization framework to ensure that it achieves its objectives while not jeopardizing macroeconomic stability. They expressed in receiving additional technical assistance in this area.

C. Monetary and Exchange Rate Policy

19. **The NBM has maintained a loose monetary policy stance in response to its pessimistic assessment of the economic outlook.** Since April 2013, with inflation hovering around 5 percent, the NBM has maintained the base (policy) rate at the historical low of 3.5 percent. The NBM has intervened in the foreign exchange market on several occasions (with net sales of about US$182 million) to mitigate rapid nominal exchange rate adjustments. The aggregate annual growth in bank credit to the economy has been stable at about 18 percent since end-2013, with significant variations across the individual banks. In response to calls for support, the NBM introduced changes to regulatory requirements on classification of bank loans to sectors affected by Russia's trade restrictions.

Staff's views

20. **The current monetary policy stance is appropriate in light of the ongoing slowdown in economic activity and calls to facilitate financing of the budget should continue to be resisted**. The sharper than expected slowdown in economic activity, the disinflationary pressures on food prices stemming from Russia's restriction on food imports, and the lack of evidence of an acceleration in credit growth justify the current accommodative monetary policy stance. However, there is little room for any further easing given the expected acceleration of inflation due to tariff adjustments after the elections, the pressures on the exchange rate market, and the already historically low—and significantly negative in real terms—NBM base rate. Staff noted that financing of the budget would contravene the provisions in the NBM Law on transactions with the government and compromise the independence of the central bank. Staff also recommended the NBM to carefully assess the impact of regulatory changes to support productive sectors as these could negatively impact an already fragile banking sector.

21. **Exchange rate movements driven by fundamentals should not be resisted.** Staff supported the NBM's approach to intervene to prevent disorderly exchange rate adjustments and advised against interventions to resist the trend. Staff noted that the recent depreciation of the currencies of main trading partners and Russia's restrictions on Moldovan imports are likely to put pressure on the leu in the near term and letting the exchange rate adjust would help mitigate the impact on of these external developments on activity.

Authorities' views

22. **The authorities were in agreement with staff**. The NBM noted that it expected significant deflationary pressures in 2014 and 2015 on the back of weakening domestic demand but it will remain vigilant of inflation developments and adjust policies as needed. The depreciation of the leu against the US dollar this year was perceived to be driven by external factors. The authorities concurred with the staff's recommendation that interventions on the foreign exchange market should continue to aim at preventing disorderly exchange rate adjustments while not resisting the trend.

D. Structural Policies

Staff's views

23. **Structural reforms are critical to boost output growth and reduce vulnerabilities.** They would create conditions for the economy to grow faster, improve its competitiveness, and diversify its production and export structure.[5] Reinvigorating the structural reform agenda would place Moldova in a better position to benefit from recently signed free trade agreements. Consistent with the authorities' National Development Strategy *Moldova 2020*, special attention should be given to the following areas: (i) business environment; (ii) physical infrastructure development; (iii) human resource development; and (iv) public administration and social security reform. Refocusing the education system to labor market needs would play an important role in raising productivity, job creation and reversing migration trends. To illustrate the potential benefits of stepped up structural reforms combined with a return to the path of fiscal consolidation (in line with the one recommended in paragraph 16) to keep public debt on a downward trend, staff's alternative scenario indicates that potential output would be boosted over the medium term, the external accounts would be stronger, and external buffer in the form of international reserves would be kept at a comfortable level instead of steadily declining (Figure 1).

Authorities' views

24. **The authorities agreed with the staff's position on the importance of diversifying output and export structure**. In this regard, the authorities reiterated their commitment to improving the business environment, physical infrastructure, and human resource development. The Ministry of Economy is placing emphasis on implementing the key elements of the strategy for enhancing competitiveness of the Moldovan economy, which focuses on labor skills, physical infrastructure, access to finance, innovation and technology, and quality standards. Specific projects aimed at attracting investment and ensuring export competitiveness include developing road infrastructure and maintenance improvement; reducing high costs associated with goods' border crossing, service delivery, and labor mobility; enhancing efficiency of customs administration; and improving public services delivery. The authorities broadly agreed with the alternative scenario, they noted the fiscal adjustment underpinning that scenario is in line with the requirements in the FRL. However, in their view growth could be further accelerated if financing on adequate terms were obtained to deal with the large infrastructure gaps.

CAPACITY TO REPAY THE FUND

25. **Moldova's capacity to repay the Fund remains strong but it faces rising downside risks**. The DSA conducted for the 2014 Article consultation concluded that the risk of debt distress is low

[5] Moldova's exports are highly concentrated geographically (exports to CIS and EU are about 88 percent of the total) and private transfers remittances (24 percent of GDP) are a major source of financing for large trade deficits.

and external debt is projected to stay on a downward trajectory. A metric-based approach and other traditional measures point to the adequacy of reserves. The Fund's exposure, currently SDR 369 million (300 percent of quota), peaked at 9.4 percent of GDP in 2012 and is projected to continue declining over the medium term. Total debt service to the Fund would reach 1.3 percent of total exports (around 0.6 percent of GDP) in 2015 and peak at 2.3 percent of exports in 2017 (1.1 percent of GDP). Moldova's relatively high external debt to GDP ratio, emanating largely from high private external debt relative to GDP, poses some risk. Moldova remains vulnerable to a number of shocks, including an escalation of geopolitical tensions in the region that could lead to a disruption of trade routes and gas supplies, and serious vulnerabilities in the banking system. The materialization of shocks could adversely affect the economy and the fiscal position, culminating in reduced creditworthiness and ability to repay the Fund.

STAFF APPRAISAL

26. **Trade restrictions and uncertainties related to the elections have exacerbated the slowdown in economic activity**. In 2014, output growth is projected to decelerate to about 2 percent, reflecting a moderation in agriculture production, weaker economic activity in main trading partners, and the impact of Russia's restrictions on imports of Moldovan products. In 2015, growth is projected to recover to 3½ percent as recently negotiated free trade agreements enter into effect and domestic demand recovers with the dissipation of election-related uncertainties. Inflation is projected to remain within the NBM's inflation target range. After narrowing for three consecutive years, the current account deficit is projected to widen in 2015 as a consequence of a recovery in imports, and a projected decline in remittances growth.

27. **Domestic and external risks are to the downside**. Key risks to the near-term outlook relate to serious vulnerabilities and governance issues in the banking sector, additional policy slippages in the run up to the elections, a further slowdown in activity in main trading partners, and intensification of geopolitical tensions. The comfortable level of international reserves and low public debt are important buffers but need to be combined with prudent policies and decisive enforcement of banking sector regulations to mitigate the impact of these risks.

28. **Strengthening the regulatory framework and decisive enforcement are critical to maintain systemic financial stability**. Continued difficulty faced by NBM to perform its regulatory and supervisory functions, despite the approval of legislation addressing the Constitutional Court's concerns, is worrisome and finding a solution is imperative. Equally important is to strengthen the legal protection of NBM staff. It is also important to empower the National Commission for Financial Markets to carry out all its duties. More generally, recent FSAP recommendations should be expeditiously implemented to better equip financial sector regulators to perform their functions in order to protect the stability of the banking system. Priority must be given to ensuring adequate fitness and propriety of banks' ultimate beneficial owners and controllers; enforcing regulatory requirement regarding related party lending, capital adequacy, and liquidity requirements; and strengthening the implementation of the anti-money laundering framework. Reporting of accurate data on bank performance and financial condition must be enforced.

29. **Prompt action is required to deal with weak banks**. A strategy to deal with vulnerable banks should aim at minimizing financial stability risks at the least cost to the state. As a first step, the NBM should take actions at its disposal to limit deposit and loan growth in weak banks, while the government should refrain from providing additional privileged access of these banks to public sector deposits (including those of state owned enterprises). In addition, the framework to deal with problem and vulnerable banks should be strengthened in order to limit the potential for abuse. Legal amendments recently approved by the government need to be revised to restore adequate parliamentary oversight on the issuance of debt to support banks and to require the NBM to introduce special administration when there are indications of solvency problems in the banks receiving such loans.

30. **Fiscal consolidation is needed to ensure medium-term sustainability and lower reliance on exceptionally-high donor support**. In 2014, the general government deficit will widen, mainly reflecting large wage and pension increases. In 2015, the draft budget prepared by the MoF rightly aims at keeping the general government budget deficit below 3 percent. Achieving this objective will require a balanced combination of expenditure and revenue measures with a yield of about 2½ percent of GDP, including wage restraint, expenditure rationalization, and prioritization investment projects. Going forward, fiscal policy should aim at narrowing the deficit to 1½ percent of GDP (about 2½ percent excluding grants) by 2018. This level of deficit would put public debt as a share of GDP on a downward trend and ensure consistency with projected financing availability. The ongoing fiscal decentralization must be closely monitored to ensure that it does not jeopardize the medium-term fiscal objectives.

31. **The NBM has successfully achieved its price stability objectives in the context of an inflation targeting framework and a flexible exchange rate regime**. The NBM's current monetary policy stance is appropriate in light of the ongoing slowdown in economic activity and deflationary pressures. Going forward, the NBM needs to remain vigilant and be ready to adjust policies. Exchange rate flexibility has helped mitigate the impact of external pressures. The NBM's interventions in the foreign exchange market should therefore continue aiming at preventing disorderly exchange rate adjustments while not resisting the trend.

32. **Structural reforms are critical to boost potential output growth, and reduce vulnerabilities.** These reforms would create the conditions for the economy to grow faster, improve its competitiveness, and diversify its production and export structure. Reinvigorating the structural reform agenda would place Moldova in a better position to benefit from recently signed free trade agreements. In line with the National Development Strategy *Moldova 2020*, special attention should be given to: (i) business environment; (ii) physical infrastructure development; (iii) human resource development; and (iv) public administration and social security reform. Refocusing the education system to labor market needs would play an important role in raising productivity, job creation, and reversing migration trends.

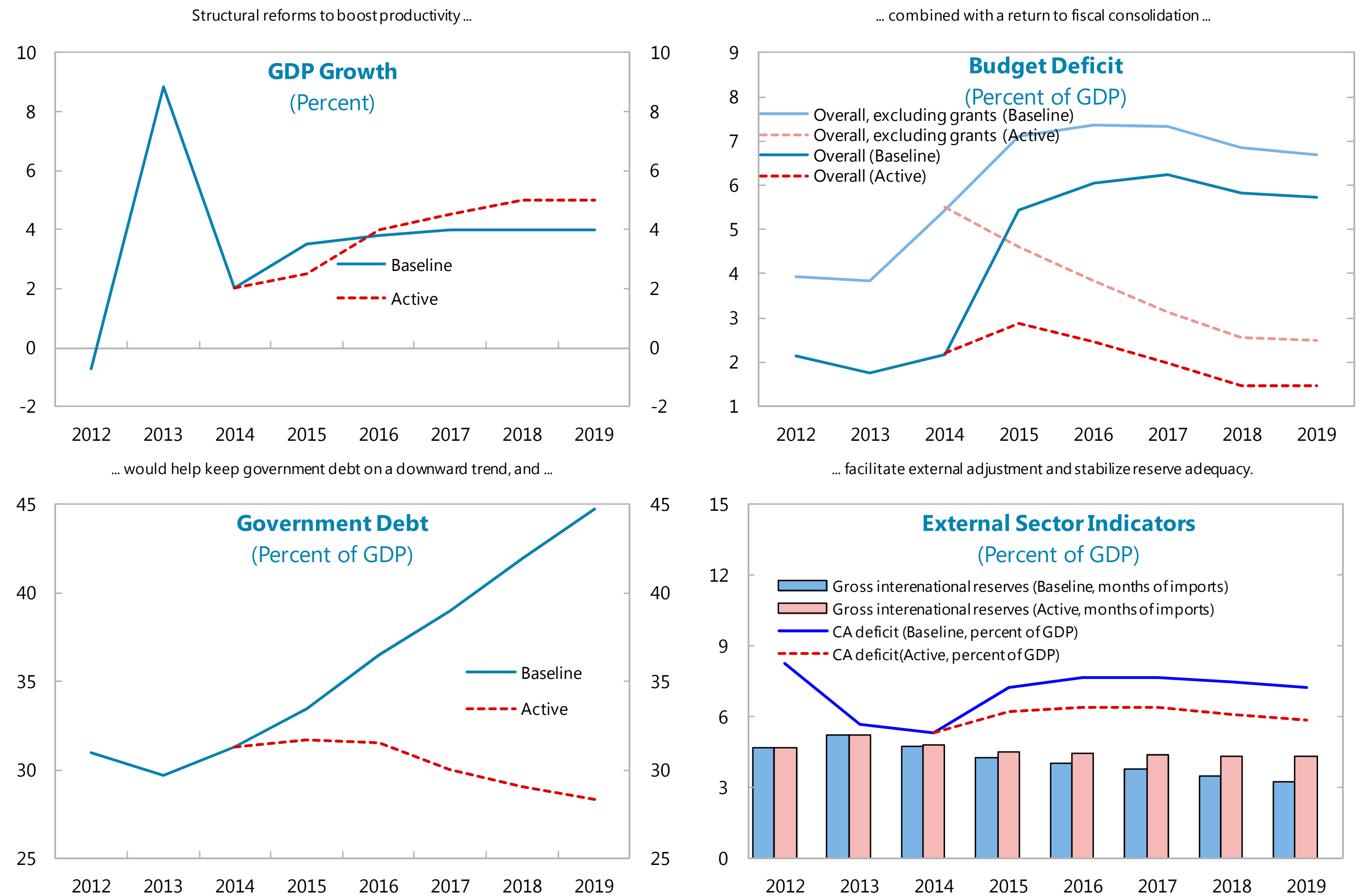
Box 3. Risk Assessment Matrix 1/

(Scale – high, medium, or low)

Source of Risks	Relative Likelihood[2]	Impact if Realized	Policy Response
Sustained tensions between Russia and Ukraine	**Medium** Geopolitical tensions in Ukraine and any related slowdown of the Russian economy would worsen the external outlook for Moldova	**High** A disruption of trade routes and gas supply, a drop in exports, or a decline in remittances could severely impact the economy	• Accelerate diversification of external trade products and markets, and energ sources • Let the exchange rate adjust to facilitat absorption of the external shock • Prudent macroeconomic policies to further strengthen external buffers; allow automatic fiscal stabilizers full pla • Strengthen monitoring of bank exposures to exchange rate and cross border risks.
Protracted period of slower growth in the EU	**High** Lower-than-anticipated potential growth and persistently low inflation due to a failure to fully address legacies of the financial crisis, leading to secular stagnation	**High** Lower export demand, falling remittances and other financial flows (e.g., trade credits) would induce lower growth, higher budget deficit, exchange rate pressures, and banking sector difficulties	• Let fiscal automatic stabilizers work • Let the exchange rate adjust to facilitat absorption of the external shock • Speed up structural reform to increase competitiveness
Deterioration of Moldova's banking system soundness e.g. as a consequence of weak governance	**High** Reemergence of problems at individual banks, and/or soaring system-wide NPLs can undermine the banking system soundness	**High** Credit supply would dwindle, and the government might need to intervene to prevent or resolve bank failures	• Enforce shareholder and beneficial ownership transparency and suitability requirements • For banks in trouble, intervene in large systemically important ones and liquidate small ones • Step up anti-corruption and AML/CFT efforts
Decline in official external financing	**Low** Budget cuts in Europe or setbacks in Moldova could worsen donor's sentiment and curtail donor aid	**Medium** Scaling down of development projects and budget financing	• In the context of prudent fiscal policy look for alternative funding sources for priority projects
Political cycle	**High** Intensifying political competition ahead of the parliamentary and local elections could lead to populist initiatives, delaying or reversing reforms	**Medium** Deteriorating business climate would harm investment, competitiveness, and defer poverty reduction and would lead to fiscal slippages	• Restore prudent macroeconomic policies • Accelerate structural reforms

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.
[2] In case the baseline does not materialize.

Figure 1. Moldova: Selected Economic Indicators Under the Baseline and Active Scenario, 2012–19



Sources: Moldovan authorities; and IMF staff estimates.

Table 1. Moldova: Selected Economic Indicators, 2009–19 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Prel.	Projection					
I. Real sector indicators	(Percent change, unless otherwise indicated)										
Gross domestic product											
Real growth rate	-6.0	7.1	6.8	-0.7	8.9	2.0	3.5	3.8	4.0	4.0	4.0
Agricultural	-9.9	7.4	5.2	-20.1	40.6	1.7	4.0	4.0	4.0	4.0	4.0
Non-agricultural	-5.6	7.1	7.0	2.0	4.9	2.0	3.4	3.8	4.0	4.0	4.0
Demand	-15.1	9.1	8.2	0.4	6.2	1.2	3.6	3.6	3.4	2.9	3.4
Consumption	-6.9	7.3	7.3	0.9	5.2	1.5	4.3	3.2	3.3	3.1	3.3
Private	-8.0	9.5	9.3	1.0	6.5	0.0	3.3	3.2	3.1	2.8	3.2
Public	-2.0	-1.1	-1.0	0.6	-0.8	9.6	9.1	3.4	4.1	4.0	4.0
Gross capital formation	-30.9	17.2	13.0	1.8	3.3	4.7	2.8	5.5	4.1	2.3	3.6
Private	-32.0	18.5	11.3	-3.9	-3.0	-0.6	3.5	3.8	4.0	4.0	4.0
Public	-26.4	12.4	19.3	21.6	20.5	16.4	1.4	8.9	4.4	-0.9	2.8
Nominal GDP (billions of Moldovan lei)	60.4	71.9	82.3	88.2	100.3	108.3	118.1	129.2	141.5	154.5	168.7
Nominal GDP (billions of U.S. dollars)	5.4	5.8	7.0	7.3	8.0	7.8	8.1	8.6	9.2	9.9	10.6
Consumer price index (average)	0.0	7.4	7.6	4.6	4.6	4.7	5.1	5.8	5.3	5.0	5.0
Consumer price index (end of period)	0.4	8.1	7.8	4.0	5.2	4.1	6.0	5.5	5.0	5.0	5.0
GDP deflator	2.2	11.1	7.2	7.9	4.5	5.8	5.4	5.4	5.3	5.0	5.0
Average monthly wage (Moldovan lei)	2,748	2,972	3,194	3,478	3,765	4,150	4,440	4,860	5,320	5,810	6,340
Average monthly wage (U.S. dollars)	247	240	272	287	299	297	303	325	348	372	397
Unemployment rate (annual average, percent)	6.4	7.4	6.7	5.6	5.1	5.6	5.4	5.3	5.2	5.2	5.2
Saving-investment balance	(Percent of GDP)										
Foreign saving	9.5	9.6	12.1	8.3	5.7	5.3	7.3	7.7	7.7	7.5	7.2
National saving	13.1	13.0	11.1	15.4	17.2	18.3	16.2	15.9	15.8	15.5	15.6
Private	14.8	10.4	8.3	11.1	11.9	12.2	13.6	13.7	13.8	13.5	13.6
Public	-1.7	2.6	2.9	4.3	5.3	6.0	2.5	2.2	2.0	2.0	2.0
Gross investment	22.6	22.6	23.3	23.6	22.9	23.5	23.4	23.6	23.4	23.0	22.8
Private	17.6	17.9	18.1	17.4	15.8	15.4	15.4	15.3	15.2	15.1	15.1
Public	5.0	4.8	5.2	6.3	7.1	8.1	8.0	8.3	8.3	7.9	7.7
II. Fiscal indicators (general government)											
Primary balance	-5.1	-1.8	-1.6	-1.4	-1.3	-1.6	-4.8	-5.4	-5.4	-4.9	-4.6
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.2	-5.5	-6.0	-6.2	-5.8	-5.7
Stock of public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.8	31.3	33.4	36.5	39.0	42.0	44.7
III. Financial indicators	(Percent change, unless otherwise indicated)										
Broad money (M3)	3.2	13.4	10.6	20.8	26.5	14.8	16.0	...	...	...	...
Velocity (GDP/end-period M3; ratio)	1.8	1.9	2.0	1.8	1.6	1.5	1.4	...	...	...	...
Reserve money	-10.1	15.9	18.4	22.9	31.9	11.4	13.7	...	...	...	...
Credit to the economy	-4.9	12.7	15.0	16.1	18.8	10.9	9.4	...	...	...	...
Credit to the economy, percent of GDP	39.5	37.4	37.6	40.7	42.6	43.7	43.8	...	...	...	...
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)										
Current account balance	-516	-559	-852	-602	-453	-411	-586	-661	-708	-739	-763
Current account balance (percent of GDP)	-9.5	-9.6	-12.1	-8.3	-5.7	-5.3	-7.3	-7.7	-7.7	-7.5	-7.2
Remittances and compensation of employees (net)	1,124	1,273	1,549	1,715	1,897	1,943	1,956	1,976	2,016	2,058	2,100
Gross official reserves	1,480	1,718	1,965	2,515	2,820	2,700	2,588	2,581	2,558	2,531	2,518
Gross official reserves (months of imports)	3.9	3.4	3.9	4.7	5.2	4.8	4.3	4.0	3.8	3.5	3.2
Exchange rate (Moldovan lei per USD, period avge)	11.1	12.4	11.7	12.1	12.6	14.0	14.7	15.0	15.3	15.6	16.0
Exchange rate (Moldovan lei per USD, end of period)	12.3	12.2	11.7	12.1	13.1	14.7	14.8	15.0	15.4	15.7	16.1
Real effective exch.rate (average, percent change)	5.4	-7.4	5.3	4.5	-3.3	-2.1	-0.6	0.8	0.2	0.0	0.0
External debt (percent of GDP) 2/	80.2	82.0	77.6	82.5	83.2	85.8	85.2	83.6	81.2	79.3	76.6
Debt service (percent of exports of goods and services)	20.1	17.6	15.8	15.7	17.7	18.9	18.6	19.9	18.0	18.8	20.4

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Table 2. Moldova: Balance of Payments, 2010–19

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Prel.	Projection					
Current account balance	-559	-852	-602	-453	-411	-586	-661	-708	-739	-763
Merchandise trade balance	-2,219	-2,870	-2,924	-2,982	-3,009	-3,142	-3,212	-3,313	-3,396	-3,492
Exports	1,590	2,277	2,229	2,466	2,492	2,649	2,937	3,201	3,494	3,814
Of which: wine and alcohol	178	178	211	248	223	282	323	341	366	392
Imports	-3,810	-5,147	-5,153	-5,449	-5,501	-5,791	-6,149	-6,514	-6,890	-7,306
Services balance	-64	32	9	15	16	21	26	24	22	19
Exports of services	700	861	902	988	996	1,047	1,130	1,204	1,283	1,368
Imports of services	-764	-830	-893	-972	-981	-1,025	-1,104	-1,180	-1,262	-1,348
Income balance	505	572	813	861	900	873	861	861	861	870
Compensation of employees	684	863	957	1,062	1,087	1,094	1,106	1,128	1,151	1,175
Income on direct and portfolio investment	-134	-238	-87	-140	-147	-161	-176	-190	-205	-216
Income on other investment	-45	-54	-57	-61	-40	-60	-69	-76	-85	-89
Current transfer balance	1,219	1,415	1,499	1,653	1,681	1,662	1,664	1,720	1,774	1,840
Remittances	589	686	757	836	856	861	870	888	906	925
Budget transfers	135	123	140	164	214	171	136	148	158	170
Other transfers	494	606	602	654	611	630	658	684	710	745
Capital and financial account balance	371	750	693	570	198	466	658	719	745	778
Capital account balance	-28	-30	-37	-35	-27	-28	-30	-32	-35	-37
Financial account balance	399	779	729	605	225	495	688	752	780	815
Foreign direct investment balance	204	268	175	207	179	239	319	382	453	483
Portfolio investment and derivatives	0	0	21	10	7	7	7	8	9	0
Other investment balance	194	512	533	388	39	249	362	361	319	332
Loans	77	178	282	207	55	240	314	304	263	278
General government, net	4	27	62	26	86	202	241	228	185	219
Private sector, net	73	152	220	182	-31	38	72	76	77	59
Other capital flows	117	333	251	181	-16	9	48	58	56	54
Errors and omissions	78	77	86	71	0	0	0	0	0	0
Overall balance	-111	-25	176	188	-213	-119	-3	11	6	15
Financing	111	25	-176	-188	213	119	3	-11	-6	-15
Gross international reserves (increase: "-")	-294	-278	-498	-284	120	112	6	23	27	13
Use of Fund credit, net	175	153	139	-22	-25	-45	-82	-98	-97	-92
Monetary authorities	53	129	139	-22	-25	-12	-20	-29	-29	-39
Purchases	61	135	155	0	0	0	0	0	0	0
Repurchases	-8	-6	-16	-22	-25	-12	-20	-29	-29	-39
General government	122	24	0	0	0	-34	-61	-69	-68	-53
Purchases	122	24	0	0	0	0	0	0	0	0
Repurchases	0	0	0	0	0	-34	-61	-69	-68	-53
Exceptional financing	231	150	183	117	118	52	78	64	64	63
Memorandum items:			(Percent of GDP, unless otherwise indicated)							
Gross official reserves (millions of U.S. dollars) 1/	1,718	1,965	2,515	2,820	2,700	2,588	2,581	2,558	2,531	2,518
Months of imports of good and services	3.4	3.9	4.7	5.2	4.8	4.3	4.0	3.8	3.5	3.2
Percent of short term debt and CA deficit	62.2	69.1	88.7	87.9	77.5	69.6	68.6	65.1	60.7	60.2
Pct of short-term debt at remaining maturity	91.3	90.2	106.7	104.0	100.1	92.0	91.2	85.2	79.4	77.9
Pct of the IMF composite measure (floating) 2/	159.0	163.6	196.4	191.7	181.6	167.3	158.6	149.6	141.3	135.3
Current account balance	-9.6	-12.1	-8.3	-5.7	-5.3	-7.3	-7.7	-7.7	-7.5	-7.2
Goods and services trade balance	-39.3	-40.4	-40.0	-37.2	-38.6	-38.7	-36.9	-35.6	-34.1	-32.9
Export of goods and services	39.4	44.7	43.0	43.3	45.0	45.8	47.1	47.6	48.3	49.1
Import of goods and services	-78.7	-85.2	-83.0	-80.6	-83.5	-84.5	-84.0	-83.2	-82.5	-81.9
Foreign direct investment balance	3.5	3.8	2.4	2.6	2.3	3.0	3.7	4.1	4.6	4.6
		(Percent change of amounts in U.S.dollars, unless otherwise indicated)								
Exports of goods	19.9	43.2	-2.1	10.7	1.0	6.3	10.9	9.0	9.2	9.2
Exports of services	4.0	23.0	4.8	9.5	0.9	5.0	8.0	6.6	6.6	6.6
Imports of goods	16.3	35.1	0.1	5.7	1.0	5.3	6.2	5.9	5.8	6.0
Imports of services	7.1	8.6	7.7	8.9	0.8	4.6	7.7	6.9	6.9	6.9
Remittances and compensation	13.2	21.7	10.7	10.6	2.4	0.6	1.0	2.0	2.1	2.1
Remittances	-6.1	16.4	10.4	10.3	2.4	0.6	1.0	2.0	2.1	2.1
Compensation of employees	37.5	26.3	10.9	10.9	2.4	0.6	1.0	2.0	2.1	2.1
Debt service (pct of exports of goods and services)	17.6	15.8	15.7	17.7	18.9	18.6	19.9	18.0	18.8	20.4

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

1/ Includes revaluation changes, which were not captured by changes of gross official reserves in the BOP.

2/ The IMF composite measures are calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP. Official reserves are recommended to be in the range of 100-150 percent.

Table 3A. Moldova: General Government Budget, 2009–19

(Millions of Moldovan lei, unless otherwise indicated)

	2009	2010	2011	2012	2013 1/	2014	2015		2016	2017	2018	2019
						Proj.	Draft Budget	Proj.		Projection		
Revenues and grants	23,518	27,537	30,138	33,476	36,908	42,511	44,266	43,687	47,069	51,226	55,828	60,837
Revenues	22,230	25,538	28,434	31,894	34,835	38,952	42,446	41,737	45,362	49,672	54,240	59,195
Tax revenues	19,343	22,261	25,301	28,261	31,599	34,620	38,717	38,087	41,372	45,281	49,416	53,890
Corporate income	443	484	571	1,967	2,053	2,371	2,670	2,670	2,907	3,184	3,475	3,795
Personal income	1,465	1,545	1,769	2,027	2,206	2,398	2,707	2,707	2,907	3,184	3,475	3,795
VAT	7,596	9,146	10,464	10,672	12,174	13,051	14,903	14,548	15,862	17,403	18,942	20,676
Excises	1,540	2,074	2,667	2,894	3,508	3,674	4,340	4,185	4,402	4,779	5,250	5,699
Foreign trade	908	1,080	1,179	1,287	1,417	1,550	1,577	1,577	1,721	1,874	2,046	2,217
Other	420	459	452	468	498	565	567	567	620	679	742	810
Social Fund contributions	5,595	5,985	6,563	7,150	7,776	8,527	9,243	9,123	9,986	10,931	11,938	13,027
Health Fund contributions	1,377	1,487	1,636	1,798	1,967	2,484	2,711	2,711	2,967	3,248	3,547	3,871
Non-tax revenues	1,028	1,696	1,457	1,943	1,945	2,974	2,317	2,239	2,446	2,700	2,978	3,289
Revenues of special funds and means	1,859	1,581	1,676	1,690	1,291	1,359	1,412	1,412	1,544	1,691	1,846	2,016
Grants	1,288	2,000	1,704	1,582	2,074	3,559	1,820	1,950	1,707	1,554	1,588	1,641
Domestic	150	81	31	33	36	47	6	6	7	8	8	9
External	1,138	1,919	1,673	1,549	2,038	3,512	1,814	1,944	1,700	1,546	1,580	1,632
Budget support 2/	804	1,327	923	760	704	1,643	708	763	1,171	981	993	1,005
Project	334	584	663	735	1,242	1,862	1,096	1,181	529	565	586	628
Other public institutions	0	8	87	54	91	7	10	10	11	12	13	15
Expenditure and net lending	27,352	29,326	32,101	35,374	38,673	44,850	47,702	50,126	54,869	60,058	64,846	70,482
Current expenditure	24,376	25,986	27,889	29,960	31,659	36,188	39,891	40,813	44,291	48,508	52,866	57,619
Wages	7,000	7,317	7,700	8,506	8,296	9,414	10,771	11,373	12,439	13,623	14,873	16,241
Goods and services	6,069	6,735	7,302	7,861	8,810	10,196	10,802	10,968	11,996	13,138	14,343	15,662
Health Fund	3,071	3,368	3,616	3,838	4,084	4,672	4,895	4,940	5,403	5,917	6,460	7,054
Other	2,998	3,367	3,687	4,023	4,727	5,524	5,907	6,028	6,593	7,220	7,883	8,608
Interest payments	843	558	673	694	527	677	814	814	971	1,344	1,661	2,057
Domestic	639	374	486	504	324	410	502	502	636	852	1,141	1,510
Foreign	204	184	188	191	203	267	313	313	334	492	520	546
Transfers	10,160	11,082	11,925	12,486	13,585	15,475	16,884	17,037	18,207	19,661	21,179	22,774
Transfers to economy	1,197	1,094	1,057	1,228	1,337	1,536	1,456	1,456	1,592	1,743	1,903	2,078
Transfers to households	8,963	9,988	10,868	11,258	12,249	13,940	15,429	15,582	16,615	17,917	19,276	20,696
Social Fund	7,608	8,603	9,214	9,740	10,716	12,250	13,738	13,738	14,598	15,709	16,864	18,063
Other transfers	1,356	1,385	1,654	1,518	1,533	1,690	1,691	1,844	2,017	2,209	2,411	2,633
Other current expenditure	303	295	289	412	440	425	620	620	678	743	811	885
Net lending	-28	-90	-62	-139	-106	-140	-118	-118	-129	-141	-154	-169
Capital expenditure	3,004	3,431	4,273	5,553	7,120	8,803	7,928	9,431	10,707	11,691	12,134	13,031
Domestically financed	2,274	2,228	2,714	3,406	4,665	5,605	4,625	5,888	6,440	7,053	7,699	8,408
Externally financed	730	1,203	1,559	2,147	2,455	3,198	3,303	3,543	4,267	4,639	4,434	4,624
Grants	334	584	663	735	1,242	1,862	1,096	1,181	529	565	586	628
Loans	396	619	897	1,413	1,213	1,336	2,207	2,362	3,738	4,074	3,848	3,996
Overall balance	-3,829	-1,789	-1,963	-1,897	-1,764	-2,346	-3,436	-6,439	-7,801	-8,832	-9,018	-9,645
(excl. project loan spending)	-3,434	-1,170	-1,066	-485	-552	-1,010	-1,229	-4,077	-4,062	-4,758	-5,170	-5,650
Primary balance	-3,055	-1,307	-1,338	-1,265	-1,320	-1,738	-2,705	-5,708	-6,919	-7,607	-7,516	-7,800
(excl. project loan spending)	-2,660	-689	-441	148	-107	-401	-498	-3,346	-3,181	-3,534	-3,669	-3,805
Financing	3,829	1,789	1,963	1,897	1,764	2,346	3,436	6,439	7,801	8,832	9,018	9,645
Budget financing	3,434	1,186	1,087	361	398	1,010	1,489	4,077	4,062	4,758	5,170	5,650
Central government	2,971	1,019	661	282	39	681	1,389	3,948	3,987	4,683	5,095	5,575
Net domestic	1,125	-520	880	294	643	624	751	3,634	4,828	6,132	6,917	7,542
Net foreign (excl. project loans) 3/	1,774	1,441	-355	-145	-697	-183	408	84	-1,041	-1,649	-2,022	-2,168
Privatization	72	98	136	132	93	240	230	230	200	200	200	200
Local governments	245	11	322	-36	167	0	100	129	75	75	75	75
Social Fund	26	213	125	34	65	79	0	0	0	0	0	0
Health Fund	193	-57	-21	81	126	250	0	0	0	0	0	0
Project loans	396	619	897	1,413	1,213	1,336	2,207	2,362	3,738	4,074	3,848	3,996
Memorandum items:					(Billions of Moldovan lei)							
Public and publicly guaranteed debt	19,590	21,909	23,874	27,409	29,865	33,886		39,510	47,160	55,192	64,848	75,422
General Government debt	17,600	19,303	19,886	21,649	23,915	27,548		33,306	41,159	49,506	59,500	70,575
Domestic debt	5,105	5,305	5,842	6,159	6,676	7,013		10,184	14,812	20,744	27,461	34,803
Domestic expenditure arrears	459	230	164	62	89	0		0	0	0	0	0
External debt	12,037	13,768	13,880	15,428	17,150	20,535		23,122	26,347	28,762	32,039	35,773
Other 4/	1,990	2,607	3,987	5,760	5,950	6,338		6,204	6,001	5,686	5,348	4,846

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

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.

2/ In 2009, an EU project grant of €15 million was reclassified as budget support given that no actual expenditure took place.

3/ Includes direct budget support from the IMF of SDR 80 million in 2010 and SDR 15 million in 2011.

4/ Includes mainly central bank liabilities to the IMF.

Table 3B. Moldova: General Government Budget, 2009–19

(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013 1/	2014	2015		2016	2017	2018	2019
						Proj.	Draft Budget	Proj.		Projection		
Revenues and grants	38.9	38.3	36.6	37.9	36.8	39.3	37.1	37.0	36.4	36.2	36.1	36.1
Revenues	36.8	35.5	34.5	36.1	34.7	36.0	35.5	35.3	35.1	35.1	35.1	35.1
Tax revenues	32.0	31.0	30.7	32.0	31.5	32.0	32.4	32.2	32.0	32.0	32.0	31.9
Corporate income	0.7	0.7	0.7	2.2	2.0	2.2	2.2	2.3	2.3	2.3	2.3	2.3
Personal income	2.4	2.1	2.1	2.3	2.2	2.2	2.3	2.3	2.3	2.3	2.3	2.3
VAT	12.6	12.7	12.7	12.1	12.1	12.1	12.5	12.3	12.3	12.3	12.3	12.3
Excises	2.5	2.9	3.2	3.3	3.5	3.4	3.6	3.5	3.4	3.4	3.4	3.4
Foreign trade	1.5	1.5	1.4	1.5	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Other	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Social Fund contributions	9.3	8.3	8.0	8.1	7.8	7.9	7.7	7.7	7.7	7.7	7.7	7.7
Health Fund contributions	2.3	2.1	2.0	2.0	2.0	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Non-tax revenues	1.7	2.4	1.8	2.2	1.9	2.7	1.9	1.9	1.9	1.9	1.9	1.9
Revenues of special funds	3.1	2.2	2.0	1.9	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Grants	2.1	2.8	2.1	1.8	2.1	3.3	1.5	1.7	1.3	1.1	1.0	1.0
Domestic	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	1.9	2.7	2.0	1.8	2.0	3.2	1.5	1.7	1.3	1.1	1.0	1.0
Budget support 2/	1.3	1.8	1.1	0.9	0.7	1.5	0.6	0.6	0.9	0.7	0.6	0.6
Project	0.6	0.8	0.8	0.8	1.2	1.7	0.9	1.0	0.4	0.4	0.4	0.4
Other public institutions	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	45.3	40.8	39.0	40.1	38.6	41.4	40.0	42.4	42.5	42.4	42.0	41.8
Current expenditure	40.3	36.1	33.9	34.0	31.6	33.4	33.4	34.6	34.3	34.3	34.2	34.2
Wages	11.6	10.2	9.4	9.6	8.3	8.7	9.0	9.6	9.6	9.6	9.6	9.6
Goods and services	10.0	9.4	8.9	8.9	8.8	9.4	9.0	9.3	9.3	9.3	9.3	9.3
Interest payments	1.4	0.8	0.8	0.8	0.5	0.6	0.7	0.7	0.8	0.9	1.1	1.2
Domestic	1.1	0.5	0.6	0.6	0.3	0.4	0.4	0.4	0.5	0.6	0.7	0.9
Foreign	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Transfers	16.8	15.4	14.5	14.2	13.5	14.3	14.1	14.4	14.1	13.9	13.7	13.5
Transfers to economy	2.0	1.5	1.3	1.4	1.3	1.4	1.2	1.2	1.2	1.2	1.2	1.2
Transfers to households	14.8	13.9	13.2	12.8	12.2	12.9	12.9	13.2	12.9	12.7	12.5	12.3
Other current expenditure	0.5	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Net lending	0.0	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital expenditure	5.0	4.8	5.2	6.3	7.1	8.1	6.6	8.0	8.3	8.3	7.9	7.7
Domestically financed	3.8	3.1	3.3	3.9	4.7	5.2	3.9	5.0	5.0	5.0	5.0	5.0
Externally financed	1.2	1.7	1.9	2.4	2.4	3.0	2.8	3.0	3.3	3.3	2.9	2.7
Grants	0.6	0.8	0.8	0.8	1.2	1.7	0.9	1.0	0.4	0.4	0.4	0.4
Loans	0.7	0.9	1.1	1.6	1.2	1.2	1.8	2.0	2.9	2.9	2.5	2.4
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.2	-2.9	-5.5	-6.0	-6.2	-5.8	-5.7
(excl. project loan spending)	-5.7	-1.6	-1.3	-0.5	-0.5	-0.9	-1.0	-3.5	-3.1	-3.4	-3.3	-3.3
Primary balance	-5.1	-1.8	-1.6	-1.4	-1.3	-1.6	-2.3	-4.8	-5.4	-5.4	-4.9	-4.6
(excl. project loan spending)	-4.4	-1.0	-0.5	0.2	-0.1	-0.4	-0.4	-2.8	-2.5	-2.5	-2.4	-2.3
Financing	6.3	2.5	2.4	2.2	1.8	2.2	2.9	5.5	6.0	6.2	5.8	5.7
Budget financing	5.7	1.6	1.3	0.4	0.4	0.9	1.2	3.5	3.1	3.4	3.3	3.3
Central government	4.9	1.4	0.8	0.3	0.0	0.6	1.2	3.3	3.1	3.3	3.3	3.3
Net domestic	1.9	-0.7	1.1	0.3	0.6	0.6	0.6	3.1	3.7	4.3	4.5	4.5
Net foreign (excl. project loans) 3/	2.9	2.0	-0.4	-0.2	-0.7	-0.2	0.3	0.1	-0.8	-1.2	-1.3	-1.3
Privatization	0.1	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Local governments	0.4	0.0	0.4	0.0	0.2	0.0	0.1	0.1	0.1	0.1	0.0	0.0
Social Fund	0.3	-0.1	0.0	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Health Fund	0.0	0.3	0.2	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Project loans	0.7	0.9	1.1	1.6	1.2	1.2	1.8	2.0	2.9	2.9	2.5	2.4
Memorandum items:												
Public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.8	31.3		33.4	36.5	39.0	42.0	44.7
General Government debt	29.1	26.9	24.1	24.5	23.8	25.4		28.2	31.9	35.0	38.5	41.8
Domestic debt	8.4	7.4	7.1	7.0	6.7	6.5		8.6	11.5	14.7	17.8	20.6
Domestic expenditure arrears	0.8	0.3	0.2	0.1	0.1	0.0		0.0	0.0	0.0	0.0	0.0
External debt	19.9	19.2	16.9	17.5	17.1	19.0		19.6	20.4	20.3	20.7	21.2
Other 4/	3.3	3.6	4.8	6.5	5.9	5.9		5.3	4.6	4.0	3.5	2.9

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

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.
2/ In 2009, an EU project grant of €15 million was reclassified as budget support given that no actual expenditure took place.
3/ Includes direct budget support from the IMF of SDR 80 million in 2010 and SDR 15 million in 2011.
4/ Includes mainly central bank liabilities to the IMF.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2009–14 1/

(Millions of Moldovan lei, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014 Proj.
National Bank of Moldova						
Net foreign assets	16,305	18,372	19,146	24,690	30,969	33,610
NFA (convertible)	16,313	18,386	19,188	24,693	31,006	33,596
Gross reserves	18,210	20,877	23,025	30,339	36,829	39,714
Reserve liabilities	1,896	2,490	3,836	5,647	5,823	6,118
Net domestic assets	-5,849	-6,257	-4,801	-7,056	-7,715	-7,704
Net claims on general government	-583	-1,067	323	192	476	425
Credit to banks	-3,690	-4,646	-5,323	-6,349	-5,164	-3,183
Other items (net)	-1,576	-544	199	-900	-3,027	-4,946
Reserve money	10,456	12,115	14,345	17,634	23,254	25,905
Currency in circulation	8,849	10,108	10,895	13,241	17,550	20,314
Banks' reserves	1,604	2,007	3,450	4,387	5,691	5,591
Required reserves	1,042	1,295	2,387	2,918	3,650	4,223
Excess reserves	563	712	1,063	1,469	2,041	1,368
Monetary survey						
Net foreign assets	16,225	18,121	16,450	23,141	31,550	38,147
NFA (convertible)	16,363	18,376	16,845	23,427	31,731	38,308
Of which: commercial banks	50	-11	-2,344	-1,266	725	4,712
Foreign assets of commercial banks	5,377	4,615	3,538	4,778	10,496	15,581
Foreign liabilities of commercial banks	-5,327	-4,626	-5,881	-6,044	-9,770	-10,869
NFA (non-convertible)	-138	-254	-395	-286	-181	-162
Net domestic assets	16,459	18,930	24,527	26,372	31,081	33,724
Net claims on general government	1,107	-187	1,512	1,004	1,387	2,011
Credit to economy	23,884	26,915	30,963	35,948	42,691	47,349
Moldovan lei	13,202	15,529	17,174	20,624	25,347	29,690
Foreign exchange	10,682	11,387	13,788	15,324	17,343	17,659
in U.S. dollars	867	937	1,175	1,270	1,328	1,201
Other items (net)	-8,532	-7,799	-7,948	-10,580	-12,996	-15,636
Broad money (M3)	32,684	37,051	40,977	49,513	62,632	71,870
Broad money (M2: excluding FCD)	20,942	24,771	28,265	34,915	45,117	50,489
Currency in circulation	8,849	10,108	10,865	13,241	17,550	20,314
Total deposits	23,835	26,944	30,113	36,272	45,081	51,556
Domestic currency deposits	12,092	14,662	17,400	21,674	27,567	30,174
Foreign currency deposits (FCD)	11,742	12,280	12,712	14,599	17,514	21,382
in U.S. dollars	953	1,010	1,083	1,210	1,341	1,454
Memorandum items:						
Reserve money growth (percent change; annual)	-10.1	15.9	18.4	22.9	31.9	11.4
Broad money growth (percent change; annual)	3.2	13.4	10.6	20.8	26.5	14.8
Credit to economy (percent change, annual)	-4.9	12.7	15.0	16.1	18.8	10.9
in lei	-10.7	17.6	10.6	20.1	22.9	17.1
in foreign exchange	3.3	6.6	21.1	11.1	13.2	1.8
Gross international reserves (millions of U.S. dollars)	1,480	1,718	1,965	2,515	2,820	2,700
Percent of domestic-currency broad money	87	84	81	87	82	79
Net international reserves (millions of U.S. dollars)	1,326	1,513	1,626	2,047	2,375	2,284
Broad money multiplier	3.1	3.1	2.9	2.8	2.7	2.8

Sources: National Bank of Moldova; and IMF staff estimates and projections.

1/ Monetary accounts are presented at actual exchange rates, unless otherwise indicated.

Table 5. Moldova: Financial Soundness Indicators, 2009–14

(End-of-period; percent, unless otherwise indicated)

	2009 Dec	2010 Dec	2011 Dec	2012 Dec	2013 Dec	2014 Mar	2014 Jun
Size							
Number of banks	15	15	15	14	14	14	14
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	76.2	78.7	80.0
Total bank assets (percent of GDP)	66.1	58.8	57.9	66.1	76.3	78.5	77.0
Capital adequacy							
Capital adequacy ratio	32.3	30.1	30.4	24.8	23.4	23.5	19.9
Liquidity							
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	25.7	27.3	27.4
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	51.9	54.4	55.6
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.6	50.2	49.3
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.8	34.7	34.3
Asset quality							
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	42.2	43.3	45.1
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.9	5.7	5.4
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	11.6	13.2	11.9
Provisions to non-performing loans	59.2	63.2	65.0	73.5	83.6	76.7	84.4
Profitability							
Return on equity	-2.1	3.0	11.5	5.6	9.4	8.6	8.2
Return on assets	-0.4	0.5	2.0	1.1	1.6	1.3	1.2
Foreign currency assets and liabilities							
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	51.0	51.8	52.9
Foreign currency denominated assets in total assests	40.2	40.8	40.5	40.9	44.7	44.2	44.6
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	44.7	46.3	48.6
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	40.4	40.1	39.4

Source: National Bank of Moldova.

Table 6. Moldova: Indicators of Fund Credit, 2009–20 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projection							
Fund obligations based on existing credit												
(millions of SDRs)												
Principal	9.7	5.5	3.9	10.5	14.2	4.3	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.3	0.4	2.1	1.9	1.6	1.2	0.9	0.5
Fund obligations based on existing and prospective credit												
Principal	9.7	5.5	3.9	10.5	14.2	4.3	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.3	0.4	2.1	1.9	1.6	1.2	0.9	0.5
Total obligations based on existing and prospective credit												
Millions of SDRs	10.3	5.8	4.7	11.7	15.5	4.8	31.2	54.5	65.1	63.7	59.9	53.9
Millions of U.S. dollars	15.8	8.9	7.4	18.0	23.5	7.3	48.5	85.2	102.3	100.1	94.3	84.7
Percent of exports of goods and services	0.8	0.4	0.2	0.6	0.7	0.2	1.3	2.1	2.3	2.1	1.8	1.5
Percent of debt service 2/	18.1	11.9	8.5	19.7	22.5	7.3	42.2	59.1	51.0	44.9	39.3	32.3
Percent of GDP	0.3	0.2	0.1	0.2	0.3	0.1	0.6	1.0	1.1	1.0	0.9	0.7
Percent of gross international reserves	1.1	0.5	0.4	0.7	0.8	0.3	1.9	3.3	4.0	4.0	3.7	3.3
Percent of quota	8.3	4.7	3.8	9.5	12.5	3.9	25.4	44.2	52.8	51.7	48.7	43.7
Outstanding Fund credit based on existing and prospective credit												
Millions of SDRs	98.2	212.6	308.7	447.8	384.0	364.7	335.6	283.1	219.6	157.2	98.1	44.8
Millions of U.S. dollars	151.4	324.5	487.4	685.9	583.2	561.5	521.0	442.6	345.4	247.1	154.3	70.4
Percent of exports of goods and services	7.6	14.2	15.5	21.9	16.9	16.1	14.1	10.9	7.8	5.2	3.0	1.2
Percent of debt service 2/	172.8	435.0	556.8	750.1	558.7	561.3	453.7	307.0	172.0	110.7	64.3	26.8
Percent of GDP	2.8	5.6	6.9	9.4	7.3	7.2	6.5	5.1	3.7	2.5	1.5	0.6
Percent of gross international reserves	10.2	18.9	24.8	27.3	20.7	20.8	20.1	17.1	13.5	9.8	6.1	2.8
Percent of quota	79.7	172.6	250.6	363.5	311.7	296.1	272.4	229.8	178.3	127.6	79.7	36.3
Net use of Fund credit (millions of SDRs)	-9.7	114.5	96.1	89.5	-14.2	-4.3	-29.1	-52.6	-63.5	-62.5	-59.0	-53.4
Disbursements and purchases 3/	0	120	100	100	0	0	0	0	0	0	0	0
Repayments and repurchases	9.7	5.5	3.9	10.5	14.2	4.3	29.1	52.6	63.5	62.5	59.0	53.4
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	2,000	2,291	3,138	3,131	3,454	3,488	3,696	4,067	4,405	4,778	5,182	5,675
Debt service (millions of U.S. dollars) 2/	87.6	74.6	87.5	91.4	104.4	100.0	114.8	144.2	200.8	223.2	239.9	262.4
Nominal GDP (millions of U.S. dollars) 2/	5,438	5,813	7,018	7,283	7,969	7,759	8,063	8,632	9,245	9,883	10,561	11,394
Gross International Reserves (millions of U.S. dollars)	1,480	1,718	1,965	2,515	2,820	2,700	2,588	2,581	2,558	2,531	2,518	2,531
Average exchange rate: SDR per U.S. dollars	0.6	0.7	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Quota (millions of SDRs)	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2

Sources: IMF staff estimates and projections.

1/ Assume repurchases are made on obligations schedule.

2/ Total debt service includes IMF repurchases and repayments.

3/ In 2009, does not include Moldova use of the SDR allocation of SDR 114.3 million.

Annex I. Trade Restrictions

Following the ratification of the DCFTA with the EU in July 2014, Moldova has faced increasing restrictions on trade with Russia. In mid-July, the Russian authorities suspended imports of fruits and limited imports of meat from Moldova. In early August, Russia introduced import duties on certain products from Moldova, including vegetables, wheat and sugar. Those moves followed the ban on imports to Russia of Moldovan wines, which had been in place from September 2013. More recently, Russia has also banned the importation of meat from Moldova.

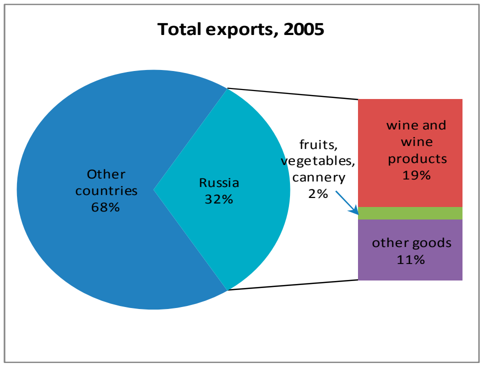
Restrictions on Moldovan Exports to Russia

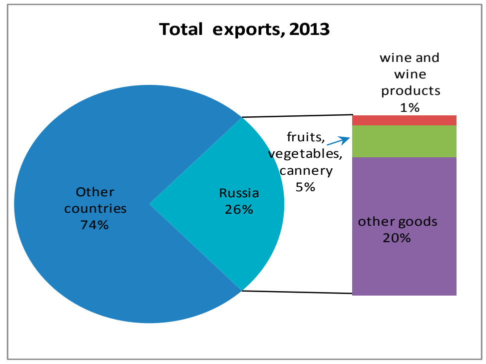
Products	Type of restriction	Effective date
Wine and wine products	Ban	September 2013
Meat and meat products, including pork, beef, sheep, and horse	Ban and/or restrictions on packaging	April 2014, then lifted Re-introduced in July 2014
Canned agricultural products	Ban	July 2014
Fresh fruits, including apples, plums, apricots, peaches	Ban	July 2014
19 agricultural products, including wine, meat, vegetables, fruits, grain	Import duty (7.8 percent instead of a zero rate)	September 2014

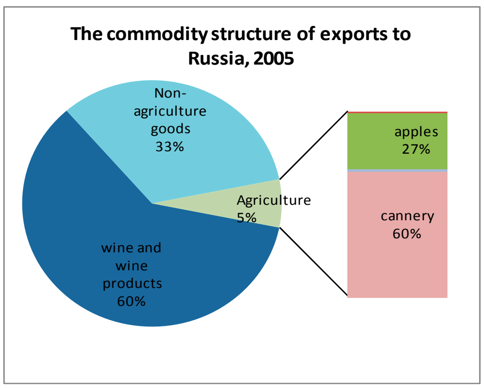
The share of Russia in Moldova's total exports has declined over time but remains significant. During the period 2005–13, the share of exports to Russia declined by 6 percentage points, with EU becoming an increasing trading partner. The increased shift to EU reflected continuous trade liberalization between Moldova and EU. Despite increased geographical diversification of exports, Russia still accounts for about 26 percent of Moldova exports.

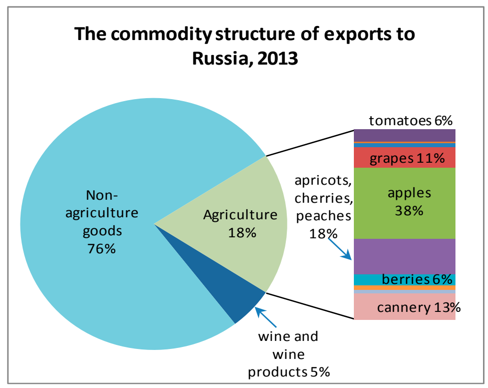
Trade restrictions are likely to adversely impact on export performance. In 2013, almost one fifth of Moldovan exports to Russia were agricultural goods. As a result of restrictions, the exports of these goods to Russia are estimated to decline by about US$120 million. In addition, the export of wines could decline by about US$35 million.

However, the actual impact could turn out to be lower. Agricultural producers affected by the sanctions have been able to find new markets for their products in the EU and other CIS countries. There could also be increased export of some products to other destinations, including Turkey.









In any case, the authorities have put in place several initiatives to help contain the impact of restrictions on domestic economic performance. The MoF has introduced a direct income support and product purchases in the amount of 238 million lei (about 0.2 percent of GDP) and a tax holiday for the affected sectors until November 30, 2014. The NBM relaxed the classification of bank loans extended to agricultural enterprises to ease the impact of trade restrictions on banks.

Annex II. Public Sector Wages

Public sector wages in Moldova have been increasing significantly faster than the average wage in the rest of the economy. Public sector wages have increased by almost 50 percent on a cumulative basis during 2010–14, partly as a result of *ad hoc* increases granted ahead of the elections. This has brought the average public sector wage from 65 percent of the average private sector wage in 2010 to 82 percent in 2014. Furthermore, the ratio of average public sector wage to GDP per capita—a key measure of affordability—is estimated to reach 1.5 in 2014, compared to an average of 1 in the neighboring countries. This surge in public sector wages seems to be in excess of productivity gains in the public sector or the economy.

The government's wage bill is set to increase from 8.3 percent of GDP in 2013 to an estimated 8.7 percent in 2014 and 9.6 percent in 2015. While this level would be significantly lower than the peak of 11.6 percent of GDP in 2009, it is well above the average level for low-income countries and in the neighboring countries. Furthermore, the general government wage bill absorbs about 30 percent of tax revenues and accounts for 23 percent of total expenditures, exacerbating budget rigidities and limiting fiscal policy flexibility. Accordingly, moderating wage growth in line with productivity gains would create greater fiscal space for vital investment spending and targeted social programs, and help improve Moldova's international competitiveness.

Wage increases in the public sector will have a direct and permanent effect on the social security system. Pension benefits are adjusted in line with wage increases granted to those in active duty, and also to surviving spouses and family members. This adds to the ultimate fiscal cost of salary increases in the public sector.

Rationalizing public sector wages should be part of a broader reform strategy to make public administration more efficient. The general government wage bill needs to be brought down to a sustainable level. Given the significant deterioration in the fiscal position, an across-the-board freeze in nominal wages should be a temporary measure in the near term. Over the medium term, the objective should be making public administration more efficient and ensuring competitiveness with private sector wages for corresponding skills in order to retain and attract high-quality staff in the public sector. To this end, the civil service remuneration should aim at moving towards a merit-based system.

Annex III. Strengthening the Fiscal Framework

Moldova is engaged in ambitious reforms of the fiscal policy framework. The introduction of a rule-based fiscal framework aims at anchoring medium-term policy decisions. The ongoing fiscal decentralization aims at improving the quality and delivery of public services. While these initiatives are welcome, further work is needed in order to achieve the stated objectives and minimize the associated risks.

The FRL needs to be amended to have a more explicit link to public debt sustainability and to reduce pro-cyclicality. Staff suggested the following combination of fiscal policy rules:

- a ceiling on the general government deficit excluding grants of 2½ percent of GDP;
- a ceiling on expenditure growth, excluding targeted social assistance, equal to the nominal growth rate of potential GDP; and
- a requirement to include a debt sustainability analysis as part of annual budget documentation to anchor the fiscal policy stance in a given year to public debt sustainability over the medium term. Staff also recommended amendments to the FRL to make clearer the circumstances under which increased sources of external financing for capital investment projects would allow for deviations from the deficit rule.

Fiscal decentralization needs to be strengthened to avoid potential risks to public finances across all levels of government. In particular, staff recommended:

- establishing a legally-binding financial reporting framework for local public enterprises for more effective oversight;
- clarifying the ownership of public assets between the central government and local governments;
- establishing an expenditure rule for local governments; and
- amending the debt limits to ensure compliance with the national fiscal rules

Statement by the IMF Staff Representative on the Republic of Moldova
December 8, 2014

1. **This statement reports on key developments since the staff report was finalized. Developments in the banking sector underscore the importance of steadfast actions to stem the governance problems in the banking sector and to adopt a sound strategy to deal with weak banks. The information does not alter the thrust of the staff appraisal.**

2. **In the November 30 elections, the Liberal, Democrat, and Liberal Democrat parties combined secured the majority of seats in parliament.** Negotiations are ongoing and it is unclear whether a coalition will be formed only by these parties or a broader coalition will be formed.

3. **On November 28–30, the National Bank of Moldova (NBM) introduced special administration in Banca de Economii (BEM) and Banca Sociala (BS), a bank believed to be affiliated with BEM.** The intervention was prompted by these banks failing to provide required information to the NBM and a series of suspicious transactions. The NBM has provided emergency loans to these banks in an amount equivalent to 3½ percent of GDP. The banks will honor deposits of individuals up to Lei 500,000 (about US$33,000) and of public entities, and domestic interbank claims. The latter implies support to other banks outside the BEM group that would have faced difficulties given their large exposures to the intervened banks. Staff is monitoring closely the developments in the banking system.

4. **Since end-October the NBM sold US$324 million of international reserves, about two-thirds of which occurred following the intervention in BEM and BS.** The nominal exchange rate remained broadly stable against the US dollar, and despite recent sales, reserve coverage remains adequate.

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

IMF Executive Board Concludes Second Post-Program Monitoring Discussions with the Republic of Moldova

On December 8, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the second post-program monitoring discussions with the Republic of Moldova.[1]

Output growth is projected to decelerate to about 2 percent in 2014, reflecting a moderation in agriculture production, weaker economic activity in main trading partners, and the impact of Russia's restrictions on imports of Moldovan products. In 2015, growth is projected to recover to 3½ percent as recently negotiated free trade agreements enter into effect and domestic demand recovers with the dissipation of election-related uncertainties. Inflation is projected to remain within the National Bank of Moldova's (NBM) inflation target range. After narrowing for three consecutive years, the current account deficit is projected to widen in 2015 as a consequence of a recovery in imports, and a projected decline in remittances growth.

Fiscal discipline has weakened ahead of the elections. Following a substantial adjustment in 2010-13, Moldova's fiscal position is projected to deteriorate significantly, with the budget deficit excluding grants projected to widen from 3.8 percent of GDP in 2013 to 5.4 percent in 2014 and, in the absence of measures, to 7.1 percent in 2015. This reflects significant pre-election increases in wages and pensions, some ad hoc tax benefits, weaker economic activity, and measures to compensate those affected by trade restrictions.

Severe governance problems in the banking system continue to represent a risk to financial stability. Legislation restoring the NBM's powers was recently enacted but enforcement of regulatory requirements on banks remains weak. Legislation to restore the regulatory powers of the National Commission for Financial Markets (NCFM) still needs to be enacted.

Executive Board Assessment[2]

[1] Post-Program Monitoring provides for more frequent consultations between the Fund and members whose arrangement has expired but that continue to have Fund credit outstanding, with a particular focus on policies that have a bearing on external viability. There is a presumption that members whose credit outstanding exceeds 200 percent of quota would engage in Post-Program Monitoring.

Executive Directors noted that weaker economic activity in trading partners, trade restrictions, and uncertainties related to the elections have exacerbated the economic slowdown, and that risks are to the downside. They urged the authorities to pursue prudent macroeconomic and financial sector policies as well as deep structural reforms to reduce vulnerabilities and boost potential output growth.

Directors underscored the urgency of addressing vulnerabilities in the banking sector, and strengthening the financial sector regulatory framework and its enforcement. Regretting limited progress, they stressed the importance of swiftly implementing recent FSAP recommendations. The regulatory and supervisory powers of the National Bank of Moldova (NBM) and the National Commission for Financial Markets should be fully restored, and the legal protection of their staff should be strengthened. Directors also recommended enhancing governance in the banking sector, including by improving the transparency of banks' ultimate beneficial owners. They called on the authorities to maintain a high level of scrutiny over weak and vulnerable banks, to enhance the bank resolution and crisis management framework, and to rapidly resolve the banks recently intervened.

Directors noted that fiscal discipline has recently weakened, mainly reflecting large wage and pension increases. They welcomed the authorities' intention to keep the general government budget deficit below 3 percent of GDP in 2015, and underscored that further fiscal consolidation will be needed over the medium term to ensure sustainability and lower reliance on exceptionally high donor support. This will require a balanced combination of revenue and expenditure measures, including wage restraint, expenditure rationalization while protecting social spending, and prioritization of investment projects. Directors called for close monitoring of the ongoing fiscal decentralization to ensure that it does not jeopardize the medium-term fiscal objectives.

Directors commended the National Bank of Moldova for achieving its price stability objective, and considered the current monetary policy stance to be appropriate in light of the ongoing slowdown in economic activity. They called on the NBM to remain vigilant and to adjust policies as needed. Directors supported the NBM's approach to intervene to prevent disorderly exchange rate adjustments without resisting movements driven by fundamentals.

Directors encouraged the authorities to accelerate the pace of structural reforms. They noted that improving competitiveness and diversifying the production and export structure would place Moldova in a better position to benefit from recently signed free trade agreements. Consistent with the National Development Strategy Moldova 2020, special attention should be given to the

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

business environment, physical infrastructure development, human resource development, and public administration and social security reform. Refocusing the education system to match labor market needs would also play an important role.

Moldova: Selected Economic Indicators, 2011–15 1/

	2011	2012	2013	2014	2015
				Projection	
Real sector indicators	(Percent change, unless otherwise indicated)				
Gross domestic product					
Real growth rate	6.8	-0.7	8.9	2.0	3.5
Demand	8.2	0.4	6.2	1.2	3.6
Consumption	7.3	0.9	5.2	1.5	4.3
Private	9.3	1.0	6.5	0.0	3.3
Public	-1.0	0.6	-0.8	9.6	9.1
Gross capital formation	13.0	1.8	3.3	4.7	2.8
Private	11.3	-3.9	-3.0	-0.6	3.5
Public	19.3	21.6	20.5	16.4	1.4
Nominal GDP (Billions of Moldovan lei)	82.3	88.2	100.3	108.3	118.1
Nominal GDP (Billions of U.S. dollars)	7.0	7.3	8.0	7.8	8.1
Consumer price index (Average)	7.6	4.6	4.6	4.7	5.1
GDP deflator	7.2	7.9	4.5	5.8	5.4
Average monthly wage (Moldovan lei)	3,194	3,478	3,765	4,150	4,440
Unemployment rate (Annual average, percent)	6.7	5.6	5.1	5.6	5.4
Saving-investment balance	(Percent of GDP)				
Foreign saving	12.1	8.3	5.7	5.3	7.3
National saving	11.1	15.4	17.2	18.3	16.2
Private	8.3	11.1	11.9	12.2	13.6
Public	2.9	4.3	5.3	6.0	2.5
Gross investment	23.3	23.6	22.9	23.5	23.4
Fiscal indicators (General government)					
Primary balance	-1.6	-1.4	-1.3	-1.6	-4.8
Overall balance	-2.4	-2.2	-1.8	-2.2	-5.5
Stock of public and publicly guaranteed debt	29.0	31.1	29.8	31.3	33.4
Financial indicators	(Percent change, unless otherwise indicated)				
Broad money (M3)	10.6	20.8	26.5	14.8	16.0
Velocity (GDP/end-period M3; ratio)	2.0	1.8	1.6	1.5	1.4
Reserve money	18.4	22.9	31.9	11.4	13.7
Credit to the economy	15.0	16.1	18.8	10.9	9.4
External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)				
Current account balance	-852	-602	-453	-411	-586
Current account balance (Percent of GDP)	-12.1	-8.3	-5.7	-5.3	-7.3
Gross official reserves	1,965	2,515	2,820	2,700	2,588
Gross official reserves (Months of imports)	3.9	4.7	5.2	4.8	4.3
Exchange rate (Moldovan lei per USD, period avge)	11.7	12.1	12.6	14.0	14.7
Real effective exch.rate (Average, percent change)	5.3	4.5	-3.4	-2.1	-0.6
External debt (Percent of GDP) 2/	77.6	82.5	83.2	85.8	85.2
Debt service (Percent of exports of goods and services)	15.8	15.7	17.7	18.9	18.6

Sources: Moldovan authorities; and IMF staff estimates.
1/ Data exclude Transnistria.
2/ Includes private and public and publicly guaranteed debt.

Statement by Mr. Snel, Executive Director for the Republic of Moldova, and Ms. Volociuc, Advisor to the Executive Director December 8, 2014

The Moldovan authorities highly value the ongoing policy dialogue with the Fund. They are particularly grateful for the detailed analysis and the policy advice outlined in the Second Post Program Monitoring Report. They broadly agree with staff's assessment of the main risks facing the Moldovan economy.

The Moldovan authorities took big and often courageous steps toward closer ties with the EU by signing the Association Agreements on June 27, 2014, later ratified by the European Parliament (November 13, 2014). It must be clear that this is not only a symbolic moment for the Republic of Moldova: it will significantly deepen political and economic ties with the EU. The agreements include a Deep and Comprehensive Free Trade Area (DCFTA)[1], expected to bring economic benefits for Moldova by offering businesses access to the EU's single market. This will create business opportunities and bring higher standards of goods, better services, and increased competitiveness.

The Association Agreement with the EU constitutes a reform agenda for Moldova. The national action plan on implementing the Association Agreement with the EU, approved in June 2014, covers a period of three years and includes the key reform priorities, in order to ensure the political association and economic integration with the EU.

The strong reforms initiated by the Association Agreement with the EU will facilitate the implementation of the country's economic development goals as set out in the National Development Strategy "Moldova 2020" adopted by the Parliament in late-2012. It is the most important economic policy document of the Republic of Moldova aimed at shifting from an economic growth model based on consumption and imports to a qualitative model of economic growth based on production, investment and exports. The accomplishment of the strategy will provide incentives for sustainable growth and poverty reduction.

The authorities' priorities were validated by the outcome of the parliamentary elections which took place on November 30, 2014, showing that the electorate provided a substantial mandate to the Government to continue with reform implementations under the Association Agreement with the EU.

Outlook

Following the 2008–2009 crisis, the Moldovan economy expanded strongly in 2010–2011, supported by government reforms under a Fund-supported program. In 2012 GDP declined by 0.7 percent in response to the weakening external demand in the EU and unfavorable weather conditions. In 2013 real output rebounded by 8.9 percent supported by growing remittances, recovery of industrial exports and agricultural production. However, for

[1] Applicable for the Republic of Moldova starting with September 1, 2014.

2014 the output growth is expected to moderate to 2 percent. This is mainly due to deceleration in the second half of the year, which in turn results from a slowdown in agriculture and related industries and a weaker external environment with a negative influence on exports and remittances.

The regional instability resulted in a reshuffle of Moldova's external activity with a significant drop in exports to CIS countries (by 17 percent) and an increase of exports to the EU (15 percent). Business prospects are affected negatively by the restrictions imposed by the Russian Federation by the end of 2013—and extended in 2014—on the export of certain products, as well as by the removal of exemptions from customs duties on 19 categories of products in the context of the preparation and signing by the Republic of Moldova of the Association Agreement with the EU. According to estimates exports to Russia for 2014 will decrease by USD 145 million, which will have a significant negative (- 2 percent) effect on GDP growth compared to last year.

Although the current account deficit has improved markedly in the last years from more than 12.1 per cent of GDP in 2011 to about 5.7 percent in 2013, the external trade dynamic was affected by the Russian ban. The vulnerabilities of remittances and further uncertainties related to interactions with the Russian Federation pose important longer-term risks for the economy. The impact of economic sanctions will be largely determined by additional efforts of the industry and authorities to redirect exports to alternative markets, including by taking full advantage of the DCFTA with the EU. The free trade agreement signed on September 11, 2014 with Turkey, applicable from 2015, is expected to bring additional benefits.

Fiscal policy

Medium-term fiscal objectives are designed to achieve national public budget sustainability, by developing a predictable fiscal policy and keeping the budget deficit under control. For 2014 the budget deficit is projected to reach about 2.2 percent of GDP. For 2015, the Moldovan authorities aim to keep the general budget deficit below 3 percent of GDP. This is consistent with the Fiscal Responsibility Law (FRL) approved in 2014, which envisages that the overall budget deficit ceiling, excluding grants, shall not exceed 2.5 percent of GDP by 2018.

The Government of Moldova is engaged in an ambitious decentralization effort aimed at providing greater autonomy to its local public administrations (LPAs). The reform aims to improve both local revenue collection and better setting of medium term fiscal policy objectives across all levels of government.

Monetary policy

We agree with staff that the central bank has achieved its price stability objectives. During more than two-and-a-half years, the annual inflation rate has been maintained within a range of ± 1.5 percentage points from the target of 5.0 percent. The policy rate was gradually reduced and maintained at 3.5 percent since April 2013. The rise in prices included in the CPI index was mostly driven by increasing food prices, core inflation and depreciation of the local currency. This was partially covered by the interventions of the National Bank of Moldova (NBM), preserving an adequate level of reserves covering around 4.8 months of imports and fully covering the short-term debt at remaining maturity. The NBM's interventions in the foreign exchange market, in the context of significant depreciation of the national currency brought by the region's geopolitical tensions, were done in a cautious manner to ensure the exchange rate's adjustments to external pressures.

The NBM remains committed to further monitor and anticipate developments in the domestic and external markets, including the dynamics of consumption, remittances, foreign exchange market indicators and foreign trade outlook, so as to ensure price stability in the medium term through specific operational flexibility related to the inflation-targeting framework.

Financial sector

The banking sector on aggregate is well-capitalized, liquid, and profitable. The average risk-weighted capital adequacy per sector stood at 20 percent at the end of October (above the required 16 percent), while the liquidity ratio remained practically unchanged—34.8 percent. Although the ratio of nonperforming loans has gradually declined from its peak at 17.8 percent in mid-2010 to 12.5 percent, the authorities acknowledge the need to further address the still high level of NPLs. Moreover, the authorities maintain enhanced scrutiny of the banking sector and prepared supplementary measures to ensure concerted and urgent actions to address potential emerging weaknesses. Thus, in September 2014, the Government approved a range of amendments to several laws (on public debt, on the NBM and on financial institutions) in order to empower the government as well as the NBM to promptly intervene in case of a potential systemic financial crisis. Additionally, the NBM introduced on November 28, 2014 an external management in two banks (including Banca de Economii), which will be further controlled and corrected by the special NBM representative, thus ensuring proper functioning and integrity of the banks' assets, reducing their costs and safeguarding the banks' deposits.

At the same time, the authorities are aware that further consolidating the framework for prudential supervision of Moldovan banks and strengthening the proper functioning and operation of a sustainable and competitive banking sector can be achieved through implementation of ambitious reforms. A two-year twining project envisaged to start in 2015 under a consortium of the Central Bank of the Netherlands and the National Bank of Romania will deliver extensive assistance to the NBM to strengthen its capacity in the field of banking regulation and supervision in the context of EU requirements, including the implementation of BASEL III requirements.

Under extensive technical assistance provided by IFIs, the NBM continued to pursue improvements in corporate governance to strengthen governance of financial institutions and increase transparency of bank ownership. With the new October 2014 requirements of the NBM, banks are obliged to disclose all the information about shareholders or groups of persons acting in concert and owning substantial shares in a bank as well as the beneficial owners of such persons.

In order to implement this year's FSAP (February 17–March 2, 2014) recommendations, the NBM has prepared an action plan covering the recommendations envisaged by the Basel Core Principles Assessment and Bank Crisis Resolution.

Structural reforms

Significant efforts have been made to improve the business climate. Over the years, Moldova has carried out extensive reforms of its legal framework and it has managed to put in place a comprehensive legislative base for the transition to a market economy. In recent years Moldova adopted a new bankruptcy law, a new competition law, legislation on payment services and electronic money.

A step forward in reaching the NDS "Moldova 2020" was the adoption in October 2014 by the Government of the Strategy "Education 2020." Improving the quality, relevance and efficiency of the education system is essential for Moldova, as its economic growth and development will rely on the human capital that will help Moldova to create jobs, foster a thriving business environment, and attract investments.

Significant efforts to improve road, port and railway infrastructure, supported by the IFIs, should also reduce the cost of international trade and help Moldova capitalize on its transit potential. The Romania-Moldova gas pipeline inaugurated in August 2014 along with the integration of both countries' electricity grids will promote energy diversification for Moldova.

In order to remove the barriers for proper market functioning, the authorities declared a strong commitment to further cut red tape, decrease the regulatory burden, reduce corruption and stimulate competition for which they approved early 2014 "The Road Map for Improving Competitiveness". Recent changes in the regulatory environment for entrepreneurial activities helped the country to advance 19 positions from the previous year in the Doing Business 2015 rating, (currently ranked 63 of 189 countries). Moldova showed the best results in the field of property registration, according to which the country is placed 22nd in the world, and in getting credits—the 23rd.