November 29, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Mr. de Rato:

On behalf of the government and the National Bank of Moldova, we are pleased to present the attached Memorandum of Economic and Financial Policies (MEFP) for 2007. The MEFP outlines our objectives for the coming year, and it emphasizes steps to address the economic impact of the external shocks we are facing. It was drawn from our Economic Growth and Poverty Reduction Strategy and is fully consistent with our commitments under the European Union-Republic of Moldova Action Plan.

The government and the National Bank believe that the policies described below will permit us to achieve the objective of the program, which remains to create the conditions for sustainable and inclusive economic growth that reduces poverty and facilitates Moldova's integration into the European neighborhood. Nevertheless, we are prepared to take additional measures that may become appropriate for this purpose at the time of the second review, including revisiting the stance of fiscal and monetary policies in the light of actual inflation developments, or an emerging gap in the balance of payments.

We hereby request completion of the first review under the PRGF arrangement, and we also request a waiver for nonobservance of the performance criterion on international reserves at end-September. This nonobservances stems from the significant external shocks faced by Moldova in 2006-07. Owing to the seriousness of these shocks, moreover, we hereby request augmentation of access under the arrangement, to a total amount of SDR 110.88 million (90 percent of quota). We request that two thirds of the additional access be made available at this time, with the remaining additional access to be made available upon completion of the second review. Thus, we request that an amount equal to SDR 31.97 million be disbursed following completion of this review.

We will communicate to the IMF the information needed to monitor progress in implementing the program, and will conduct discussions with the Fund for the second review under the PRGF arrangement before end-June 2007. We anticipate that the third review under the PRGF arrangement will be conducted on the basis of end-September 2007 data and be completed before end-December 2007.

We are committed to transparency, and thus we authorize the IMF to disseminate the MEFP and the associated Technical Memorandum of Understanding, as well as staff report that will be examined by the IMF Executive Board.

Sincerely yours

/signed/
Vasile Tarlev
Prime Minister
Government of the Republic of Moldova

/signed/
Mihail Pop
Minister
Ministry of Finance

/signed/
Leonid Talmaci
Governor
National Bank of Moldova

Attachments: Memorandum of Economic and financial Policies for 2007
Technical Memorandum of Understanding

Memorandum of Economic and Financial Policies for 2007

November 29, 2006

A. Introduction

1. Over the last six years, Moldova's macroeconomic performance was characterized by a sustained output recovery that had a significant impact on poverty reduction. During 2000-2005 real GDP increased by 43 percent, while the rate of absolute poverty decreased by 38.7 percent over the period 2000-2005. Inflation remained modest at the level of 10 percent in 2005, though slightly higher than forecast reflecting a combination of external and internal factors. Furthermore the exchange rate of the national currency remained relatively stable and the National Bank's reserves grew considerably. Robust economic growth and prudent external borrowing allowed the ratio of public and publicly-guaranteed debt to fall from 94.8 percent of GDP in 2000 to about 28.2 percent of GDP in 2005. These accomplishments were possible due to a combination of appropriate monetary and tight fiscal policies, as well as tax reforms aiming at improving tax administration.

2. In 2006 the development of the national economy has been adversely affected by the combination of a number of external developments. These include unfavorable climatic conditions for agricultural output, a prohibition of exports of certain commodities to the Russian Federation combined with difficulties in accessing other export markets, a doubling in the prices for energy resources imported from Russia, and a significant increase in the international prices for energy resources. While consultations are currently underway with the Russian authorities in order to rectify bilateral trade issues, the combined effect of the above-mentioned external shocks has already had an adverse effect on the economy's output and external balance.

3. This Memorandum is a supplement to the Memorandum of Economic and Financial Policies for 2006-2008 and it sets forth the strategic objectives and priorities of the Republic of Moldova for 2007.

B. Recent developments

4. Despite Moldova's successful socio-economic performance over the last few years, the results of the first six months of the current year highlight the fact that a number of the problems noted in paragraph 2 above may be detrimental to Moldova's further growth and development. Over the first six months of 2006 the volume of exports and the volume of industrial output have registered decreases while there has been an acceleration in inflationary pressures.

5. The negative influence of external factors in 2006 has undermined the government's efforts to fully accomplish its economic and welfare objectives. Over the first six months of 2006 Moldova's real GDP growth slowed to 5 percent in comparison to the same period of the previous year. At the same time, at the end of September the rate of inflation (September 2006 over September 2005) reached 14.4 percent. Furthermore the economy's external vulnerability increased during the first half of 2006. The volume of exports decreased by 7.7 percent, while the volume of imports increased by 15.5 percent, resulting in a growth of the trade deficit of 39.1 percent.

6. In order to maintain macroeconomic and fiscal stability, in July 2006 the Government tightened its fiscal stance by submitting a revised state budget and state social insurance budget for 2006 to the Parliament. The overall effect of these amendments was to reduce the general government budget deficit by Lei 163.8 million, to around 0.5 percent of GDP, compared to 0.8 percent as previously agreed in the program. During the first nine months of the year, the general government registered a surplus of Lei 317 million (0.8 percent of GDP), easily meeting the deficit target for end-September. However, the execution of the state social insurance budget remains a source of concern, as its deficit for 2006 will be higher than originally projected. In order to protect low income population groups and maintain public services the revised budget provided for additional funds to cover the costs of the increase in the tariffs for natural gas.

7. Throughout 2006 the National Bank of Moldova has maintained a floating exchange rate regime and has limited its interventions on the currency market to smooth out excessive fluctuations in the exchange rate of the national currency. During the first three quarters of 2006, the nominal exchange rate of the national currency depreciated against the US dollar and the Euro by 3.6 and 11.2 percent, respectively. In real terms, the leu strengthened by 4.5 percent vs. the dollar, however, owing to inflation that was higher than expected. While the increase in inflation stems primarily from higher energy prices, monetary factors have also played a role. As a result, the National Bank of Moldova has revised its monetary projections with the aim of reducing inflation over the period ahead. Interest rates for government securities and NBM certificates have increased significantly as a result, but remain negative in real terms.

8. To date the Government has accomplished the priority actions set forth in the program. In particular, the following actions which were foreseen to be undertaken by September 30 of this year were accomplished:

- The strategy on developing the tax service was approved, along with a plan for the strategy's implementation.

- Amendments were made to the Regulation of the Ministry of Finance regarding the financial reporting and monitoring of state enterprises and corporations where Government holds more than 51 percent of the outstanding shares. The results of the analysis which was undertaken for 2005 were included in the budget documentation to the budget draft for 2007.

- An action plan was elaborated on transferring the management of the revenues of special funds, special means, state social insurance budget and mandatory medical insurance funds to the Single Treasury Account (STA). The plan specifies the activities to be implemented in 2006 and during 2007.

- In August 2006 the Government submitted the draft law on public debt, state guarantees and state on-lending to the Parliament for examination and approval.

- The Government developed and approved the MTEF for 2007-2009.

- From February to September 2006, the Council of Creditors signed new restructuring agreements for a total amount of Lei 99.96 million.

- The requirement that grain exports must be transacted on the Moldovan Commodity Exchange was eliminated as of September 30, 2006.

- The Law on the National Bank of Moldova was amended and approved by the Parliament. The law clarifies that monetary policy aims at maintaining price stability and strengthens the independence of the National Bank of Moldova.

- In the context of the strategy for reforming the Central Public Administration, the Code of Ethics for public servants was developed and approved by the Government.

- The envisaged amendments to the law on the state enterprise were approved by the Parliament.

- The law on main principles and mechanisms for the regulation of entrepreneurship activity was approved by the Parliament.

- The amendments to the law on insolvency were approved by the Parliament.

C. Program objectives

9. The main objectives of the Government for 2007 remain unchanged, despite the large external shocks we are facing. Our goals are to ensure macroeconomic stability and sustainable economic growth by creating a favorable investment climate, stimulating small and medium enterprises, rehabilitating infrastructure, promoting exports, and creating new employment opportunities while providing a safety net for the vulnerable groups in the

population. These objectives are clearly articulated in the Economic Growth and Poverty Reduction Strategy (EGPRSP) that will continue to be implemented in the course of 2007. Furthermore the attainment of these objectives are clearly reflected in the Government's Action Program, and they will facilitate the efficient implementation of the EU-Moldova European Neighbourhood Policy Action Plan, while being conducive to the attainment of Moldova's Millennium Development Goals.

10. We understand that sacrifice will be needed to achieve these goals, given the large external shocks we now confront. Insofar as many of these shocks are expected to have long-lasting effects, we are taking measures to adjust macroeconomic policies appropriately. We are also accelerating growth-enhancing structural reforms to ensure that the Moldovan economy quickly returns to its robust long-run growth path. Additional financing from the international community will facilitate smoothing the social and economic cost of addressing these challenges, but it will not delay our efforts to adjust to the new economic circumstances.

11. The economic difficulties faced by the Republic of Moldova during 2006 have had a negative impact on the living standards of the population, and it is not possible at this stage to predict how large their effect will be or how long they will persist. Hence, the Government and the National Bank remain committed to take further actions if needed in order to mitigate the adverse effects of the current economic difficulties and avoid possible future disturbances in the country's social and economic development.

D. Fiscal policy

12. The fiscal stance for 2007 will remain tight because we understand that macroeconomic stability underpins public confidence in the overall program. We intend to maintain the cash deficit at a level that will not exceed the 2006 limits. In this context, the government will limit expenditures in order to attain a cash deficit for the general government (as agreed in the program and reflected in the Law on the 2007 Budget) of Lei 233 million (0.5 percent of GDP).

13. During 2007, it is envisaged that revenues of the general government will remain above 40 percent of GDP. In the event of shortfalls in donor financing envisaged in the budget for 2007, we will amend the budget to preserve the agreed deficit target and close the balance of payments gap, although doing so may require reductions in priority expenditures—including public investment. If additional funds are forthcoming from external donors, the Government intends to channel those to finance infrastructure projects—which is an area emphasised in the latest Annual Evaluation report of the EGPRSP. The additional capital investment will re-habilitate the economy’s capital stock, and will have significant positive externalities for Moldova’s growth and development prospects.

14. The accounts payable of the budget system will be maintained at current limits and no further increases will be allowed. As a result of the successful restructuring of the external state debt in 2006 with bilateral creditors through the Paris Club, the Government has committed to commence repayment of external arrears and fully honor its liabilities on rescheduled debt service.

15. One of the major challenges for the Government is decreasing the vulnerability of the Republic of Moldova to shocks resulting from increases in the prices of energy resources. The authorities will ensure that tariffs for natural gas and electricity remain at full cost recovery levels for all categories of consumers, and heating and water supply tariffs are gradually adjusted to full cost recovery levels for all categories of consumers. To this end, by early December, we intend to pass legislation shifting the responsibility for setting heating and water supply tariffs from municipalities to the national energy regulator. If the cost of energy continues to grow, the Government will commit additional budget resources to offset the increases in the costs of operations of public institutions resulting from these increases, as well as protect the vulnerable groups of the population, while preserving the agreed general government deficit target. We are firmly committed to ensure that the poorest members of society are protected against the most severe effects of the energy price increases, including through targeted compensation and lifeline tariffs.

16. In order to improve the financial sustainability of the Social Fund budget the Government will continue the reform in the pension system for farmers by strengthening the link between contributions and benefits. Work will also continue in implementing the individual accounting system of state social insurance contributions by the integration of data regarding contributions in the Social Fund data base. To ensure the financial stability of the social insurance budget, by the end of 2008 the benefits and pensions will be calculated on the basis of the social insurance contributions transferred to the Social Fund budget by the applicant.

E. Monetary and Financial Policies

17. In 2007, National Bank of Moldova will continue to implement a prudent monetary policy in order to maintain price stability and achieve the inflation objective of 10 percent (December-to-December). The program envisages that the monetary base will increase by 9.7 percent over the year to end-December 2007, and that interest rates will become positive in real terms. This objective will be reached by means of regulating the monetary base through changes in indirect instruments of monetary policy, with increased emphasis on repo and reverse repo operations.

18. In 2007, the National Bank of Moldova will continue the maintenance of a floating exchange rate regime and will only intervene on the foreign exchange market in order to reduce the excessive fluctuations of the exchange rate. Our primary monetary policy objective is the maintenance of price stability.

19. We are considering a move to formal inflation targeting framework at some point in the future. Although we understand that Moldova is not yet ready for formal inflation targeting, we are taking steps to improve the framework for monetary policy in the meantime. For example, to assist the attainment of the inflation objective, a joint advisory body—the Committee on Liquidity Management—has been set up comprising representatives of the National Bank of Moldova and the Ministry of Finance. The Committee on Liquidity Management will meet not less than once a month or as needed in order to improve the predictability of monetary policy. In this context, beginning with

the 2008 budget, the annual budget law will no longer oblige the NBM to roll over government T-bills; the Committee on Liquidity Management will take up these questions, and the Ministry of Finance and the NBM will conclude a Memorandum of Understanding on the amount of these securities that can be brought to market during the budget year.

20. It is our intention to modernize financial relations between the Ministry of Finance and the National Bank by making them more transparent. Thus, the two institutions are undertaking a series of steps over the coming year or two:

- We have agreed on a service agreement between the two institutions that spells out the fees charged for services provided by the NBM, and also the level of remuneration provided on accounts of the general government for balances on the treasury account in the NBM.
- Insofar as the level of National Bank capital is below the desirable level, by March 31, 2007, we will submit to parliament a draft amendment to the NBM law to establish that capital of the NBM should grow dynamically with the size of the Bank's balance sheet. Specifically, the amendments, which we expect to pass in parliament by September 30, 2007, will establish that the appropriate level of NBM capital is at least 10 percent of monetary liabilities of the NBM.
- To ensure that the level of NBM capital is relatively quickly restored to adequacy, by December 31, 2007, the government will inject at least Lei 250 million in liquid assets (such as direct appropriations from the budget and/or marketable government securities) to NBM capital, though the capital injection will not be counted against the budget deficit ceiling agreed under the program. Moreover, beginning with the 2008 budget, the proportion of the NBM's net income transferred to the state budget will be no more than 50 percent, if the level of capital remains below the target threshold.
- Finally, to ensure that the NBM has adequate financial strength to manage monetary policy in the years ahead, by end-September 2007 the government and the NBM will adopt a plan to securitize the remaining outstanding stock of NBM claims on government, with the expectation that the securitization will take place during the first quarter of 2008.

21. We hope to accelerate development of the nonbank financial sector in Moldova as a means of stimulating growth throughout the country. As a result, by March 31, 2007, we will adopt legislation establishing the National Commission on the Financial Market (NCFM).

The NCFM will be financially and operationally independent, and once it has reached full operating capacity, it will acquire the right to issue and withdraw licenses for all the nonbank financial sectors it supervises. As a transitional measure, in the meantime, the law on the NCFM will specify that—in the event of violations of prudential norms—the NCFM will have the right to suspend the licenses of economic agents it supervises, and that this suspension may not be revoked without the NCFM's approval. The new agency will be established by June 30, 2007, and be fully operational no later than September 30, 2008. We have requested an FSAP update, which in part would review our reforms in this area and propose measures to help Moldova comply with best European and international practice.

22. As a first step toward privatizing Banca de Economii (BEM) to a strategic banking investor, by December 31, 2006, we will select one of the foreign companies participating in the tender announced on April 28, 2006, to conduct an independent assessment of the market value of BEM. Although it could take somewhat longer, we hope the evaluation will be completed by September 30, 2007. We intend to solicit the support of international financial institutions to prepare to bring BEM to market shortly after completion of the evaluation. In the meantime, the government and the NBM will continue to refrain from providing preferential treatment to the bank, including as regards taxation, prudential regulation, or access to resources.

F. Structural reforms

23. The external shocks faced by Moldova require that we accelerate our structural reforms in order to return as quickly as possible to rapid economic growth. Thus, in 2007 we intend to undertake bold measures to improve the functioning of the public sector and enhance the business environment. We will place special attention on measures aimed at promoting exports and diversifying export markets.

Trade policy and investment promotion

24. To improve the investment climate and enhance the capacity of the Republic of Moldova to access external markets, the Government will implement its Strategy of investment attraction and export promotion for 2006-2015. Actions to be undertaken for the promotion of trade in 2007 include: (i) working towards the establishment of an Asymmetric Free Trade Agreement with the EU; (ii) carrying out a detailed study regarding the economic implications of Romania's accession to the EU for Moldova, (iii) establishing accredited laboratories for testing and quality assurance in line with EU standards, beginning with wine and extending to other agricultural products in 2008; and (iv) implementing the reform on granting entrepreneurial permits, including through the development of simplified methods of accounting for small and medium trade units.

25. To ensure the creation of technical infrastructure in line with EU standards, the Government will prepare in 2007 the draft Law on the public-private partnership that will provide a large range of tools and mechanisms of collaboration and interaction between the public and the private sector aiming at funding public investment, including for infrastructure, while ensuring that any contingent liabilities incurred in this process are transparently reported upon to financial markets, as well as to parliament.

26. The development of the small and medium enterprises sector (SME) is one of the core elements that will lead to economic development and poverty reduction in Moldova. To support SMEs, in the course of 2007, we will implement the actions set forth in the Strategy for the development of small and medium enterprises for 2006-2008 which were approved by the government in May 2006 and the provisions of the Law on supporting the small and medium enterprises sector. These clarify the status of SMEs and provide mechanisms for their support by means of the creation of special funds which will be financed by the government as well as donors.

Public administration reform

27. The first stage of the functional review in the context of the central public administration reform has been completed. It covered ministries and key central public

administration authorities, and the decision making process in central public administration. The second functional review will be carried out by the end of 2006 and will cover public authorities at the central level that were not included in the first stage, and will extend down to the local levels of central public administration. Based on the results of the functional review the following actions will be taken in 2007: i) finalizing mandates of institutions and authorities subject to their functional review, as well as ii) modifying their regulations in order to re-assign relevant tasks and competencies. To improve the decision making process, a central policy coordination and analysis unit will be created within the government Apparatus, and after taking into account the experiences of pilot units activities which were set up in 6 ministries, policy assessment, monitoring and analysis units may also be set up in other ministries.

28. The government intends to establish a unit at the central level empowered to improve staff policies and procedures in the field of civil service. During 2007, an automatic information system will be designed, namely the Register of public functions and civil servants. Also, practical guidelines will be developed covering the recruitment, selection and promotion of civil servants based on merit.

Regulatory reform

29. Throughout 2007, the second stage of the regulatory reform will continue. The Government will implement the National Strategy of Regulatory Reform, according to which the system of granting permits for entrepreneurial activity will be streamlined and elements of the “One-stop Shop” procedure will be introduced in the activity of public authorities, including through their electronic interconnection to facilitate the exchange of electronic data. To enhance the degree of transparency in the elaboration of laws and regulatory acts, in 2007 the Regulatory Impact Assessment (RIA) methodology will be applied, which envisages the delegation of these functions to the central public administration authorities.

30. The Government will make efforts to streamline the procedure of businesses closures. In this regard action will be taken to decrease the time and reduce to a minimum the need for

businessmen to present certificates and other documents in order to close a business. We will also introduce a "One-stop Shop" procedure for business closure.

Public Finance Management and Tax Administration

31. The Government will continue the process of strengthening public finances by promoting the necessary reforms which are indispensable to reform budget institutions and adjust our legislative framework to EU requirements and standards.

32. In 2007, based on an approved action plan, the Ministry of Finance in cooperation with the National House for Social Insurance and the National Company for Health Insurance, will implement a system which will allow management of the revenues of the state social insurance budget as well as those of the compulsory health insurance funds through the State Treasury, which will ensure the zeroing of balances held with commercial banks. In the preparation of the state budget for 2008, the government intends to continue eliminating special funds.

33. Building on the strategy on developing the tax service developed with IMF assistance, during the first quarter of 2007 the government will establish a high level steering committee to oversee the reform and ensure broad political support. The steering committee will include members from outside the State Tax Inspectorate (STI). At the same time, the STI will establish a modernization task force in its headquarters to manage the reform and work with external donors.

Privatization and management of public property

34. Based on the Law on the management and denationalization of public property that is expected to be adopted by end-December 2006, the Government will prepare a draft list of regulatory acts that will be prepared and implemented in the field of public property

management. The government will report to parliament with the draft 2008 budget on the financial performance in 2006 of the public enterprise sector (both 100 percent state-owned enterprises, and joint stock companies with majority state ownership).

35. In order to enhance the procedure of restructuring insolvent enterprises, the Council of Creditors will be liquidated by end-2006, and the responsibility of monitoring tax and non-tax debts will be taken over by the State Tax Inspectorate and the courts at the beginning of 2007.

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36. Moldova is fully committed to implementing the EU-Moldova European Neighborhood Action Plan which was signed in February 2005. The plan covers almost all political, economic and social aspects of Moldova and is in line with EGPRSP objectives. Following the Government decision to extend the term of EGPRSP implementation to end-2007, we remain committed to draft a new version of the EGPRSP for a medium term in 2007 following the envisaged participatory process. Given that the EU-Moldova European Neighborhood Action Plan is also due to be finalized in 2007, we will ensure that the revised documents will be elaborated in parallel so as to ensure consistency and the mutual benefit of both documents. Moreover, and in order to avoid the duplication of efforts, the Government intends to coordinate the implementation, monitoring and assessment of both documents in a consistent manner based on periodic consultations with the European Commission, the World Bank, the IMF and other stakeholders.

Table 1. Proposed Prior Actions, Performance Criteria and Benchmarks
(All conditions agreed in 2006 MEFP retain force)

Prior Actions

Parliamentary passage of law transferring rate setting for heat and water to ANRE. (¶ 15)

Letter to International Finance Corporation of the World Bank requesting assistance in preparing to put the state's share in Banca de Economii on the market following the independent evaluation that the authorities hope will be completed by September 30, 2007. (¶ 22)

Structural Performance Criteria

Continuous

The Government and the NBM will continue to refrain from providing preferential treatment to Banca de Economii (including tax treatment, prudential regulation and access to resources). (¶ 22)

December 31, 2006

Increase of tariffs for heat and water to at least 55 percent of the cost-recovery level, with an increase in compensation to poor households to reduce effect on them. (¶ 15)

March 31, 2007

Submission to parliament of draft law setting the required level of NBM capital at 10 percent of monetary liabilities of the Bank and increasing the potential share of net income retained by the NBM to 50 percent, if the level of capital remains below the target threshold. (¶ 20)

Structural Benchmarks

Continuous

Tariffs for consumption of natural gas and electricity to remain at cost-recovery levels. (¶ 15)

December 31, 2006

Adoption of service agreement modernizing financial relations between Ministry of Finance and National Bank. (¶ 20)

March 31, 2007

Parliamentary passage of law on NCFM establishing that, until the NCFM is fully operational, the NCFM has the right to suspend licenses of nonbank financial institutions it supervises on grounds of violation of prudential norms, and that the suspension of these licenses cannot be revoked unless NCFM agrees that prudential regulations are being met. (¶ 21)

June 30, 2007

NCFM established and sufficiently operational to supervise the nonbank financial sector, including suspension of licenses for violation of prudential norms. (¶ 21)

September 30, 2007

Parliamentary passage of law setting the required level of NBM capital at 10 percent of monetary liabilities of the Bank, and increasing the potential share of net income retained by the NBM to 50 percent . (¶ 20)

Draft 2008 budget to be prepared on assumption that the proportion of NBM net income transferred to the state budget will be no more than 50 percent, if the level of capital remains below the target threshold. (¶ 20)

Increase of tariffs for heat and water to at least 70 percent of the cost-recovery level, with further increase in compensation to poor households to reduce effect on them. (¶ 15)

Government and the NBM to adopt a plan to securitize the remaining outstanding stock of NBM claims on government. (¶ 20)

December 31, 2007

Government to inject at least Lei 250 million in liquid assets (such as direct appropriations from the budget and/or marketable government securities) to NBM capital. (¶ 20)

Transfer of balances on accounts of Social Fund and Health Fund to Single Treasury Account in NBM, with only daily zero-balance operations remaining in commercial banks. (¶ 32)

TECHNICAL MEMORANDUM OF UNDERSTANDING[1]

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

I. PROGRAM ASSUMPTIONS

2007

2. Loan disbursements of $58 million.

3. Receipts to the state government budget of privatization proceeds in the amount of MDL 155 million in 2007.

4. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at the program exchange rate. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at MDL 13.2911/$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates prevailing at end-September 2006 (USD/€ = 1.2660, USD/£= 1.8702, SDR/USD = 0,6773).

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

II. REPORTING REQUIREMENTS

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

[1] This Technical Memorandum of Understanding applies only to quantitative targets set for 2007. For 2006, the previous TMU, which was part of the PRGF program approved by the IMF Executive Board in May 2006, remains binding.

III. Program Targets and Definitions

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves
December 31, 2006	7.380 (indicative target)
March 31, 2007	7,737 (performance criterion)
June 30, 2007	7,967 (indicative target)
September 30, 2007	8,207 (indicative target)
December 31, 2007	8,789 (indicative target)

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

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

(In millions of lei)

Position on	Maximum level NDA	Maximum level Reserve Money (Indicative target)
December 31, 2006	-768 (indicative target)	6,612
March 31, 2007	-997 (performance criterion)	6,740

June 30, 2007	-1,081 (indicative target)	6,886
September 30, 2007	-1,174 (indicative target)	7,033
December 31, 2007	-1,535 (indicative target)	7,255

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

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

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

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

	Cash balance
Cumulative change from December 31, 2005	
December 31, 2006 (indicative target)	-210
Cumulative change from December 31, 2006	
March 31, 2007 (performance criterion)	-144
June 30, 2007 (indicative target)	-248
September 30, 2007 (indicative target)	-238
December 31, 2007 (indicative target)	-233

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

of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed investment projects).[2] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed investment projects.

12. The **quarterly limits on the overall cash deficit of the general government** are cumulative and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government (excluding the change in the stock of government securities issued to recapitalize the central bank), the general government's net placement of securities outside the domestic banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[3] for direct budgetary support and for specific projects minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets, after deduction of the costs directly associated with the sale of these assets.

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

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

15. The term **debt** has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000).[4] This performance criterion applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received.

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

[3] Debt is defined as in footnote 3 in the section on limits on external debt.

[4] Debt is defined as a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual

(continued)

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

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

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

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

IV. Adjusters

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

21. In case disbursements of external loans exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding

obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

magnitude up to a cumulative cap of lei 146 million. In case of shortfalls, the limits will be decreased by the full amount.

22. The limits on the overall cash deficit of the general government will be increased by the amount of paid in cash for recapitalization of the NBM or by the face value of government securities issued for the same purpose.

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

	31-Dec-05	31-Mar-06		30-Jun-06		30-Sep-06		31-Dec-06		
	Actual 2/	Indicative targets	Actual	Indicative targets	Actual	Performance criteria	Actual	Prog	Indicative targets Proj 3/	Proj 4/
1. Quantitative performance criteria										
					(In millions of lei)					
Floor for general government fiscal balance 5/	634	-247		-417		-303		-350	-210	*-210*
Adjusted floor for general government fiscal balance		*-217*	*162*	*-361*	*-66*	*-201*	*317*	*-243*		
Ceiling on net domestic assets of the NBM (level)	569	60	-469	55	-271	-477	-652	-150	-453	-768
Floor on net international reserves of the NBM (level)	6,436	6,410	6,432	6,791	6,609	7,866	6,845	8,276	7,113	7,380
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	...	0	0	0	0	0	0	0	0	0
2. Continuous performance criteria										
Ceiling on accumulation of external payment arrears	...	...	0	0	0	0	0	0	0	0
					(In millions of lei)					
3. Indicative targets										
Ceiling on reserve money (level)	7,003	6,470	5,978	6,846	6,340	7,390	6,204	8,126	6,612	6,612
Ceiling on change in domestic expenditure arrears of the general government	...	0	0	0	0	0	0	0	0	0
					(In millions of lei, unless noted otherwise)					
4. Baseline assumptions										
Concessional external debt financing	327	130	100	231	175	362	259	494	387	387
in millions of dollars	...	10	8	18	14	28	20	39	29	29
Privatization receipts	176	9	-4	30	5	50	21	68	28	28

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2006 refer to cumulative flows from end-2005, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 12.832/US$ for March - September 2006, and on the exchange rate of MDL 13.2911/US$ afterwords.

2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ Based on old program exchange rates.

4/ Based on new program exchange rates.

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

Table 1a. Moldova: Proposed Quantitative Performance Criteria and Indicative Targets, Dec 31, 2006 –December 31, 2007 1/

	31-Dec-06 Indicative targets 2/ Proj	31-Mar-07 Performance criteria	30-Jun-07 Indicative targets	30-Sep-07 Indicative targets	31-Dec-07 Indicative targets
1. Quantitative performance criteria					
			(In millions of lei)		
Floor for general government fiscal balance 3/	-210	-144	-248	-238	-233
Ceiling on net domestic assets of the NBM (level)	-768	-997	-1,081	-1,174	-1,535
Floor on net international reserves of the NBM (level)	7,380	7,737	7,967	8,207	8,789
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	0	0	0	0	0
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears	0	0	0	0	0
			(In millions of lei)		
3. Indicative targets					
Ceiling on reserve money (level)	6,612	6,740	6,886	7,033	7,255
Ceiling on change in domestic expenditure arrears of the general government	0	0	0	0	0
			(In millions of lei, unless noted otherwise)		
4. Baseline assumptions					
Concessional external debt financing	387	184	319	472	703
in millions of dollars	29	14	24	35	53
Privatization receipts	28	0	40	80	155

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2007 refer to cumulative flows from end-2006, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 13.2911/US$.

2/ All variables are stocks, except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 146million. In the case of shortfalls, the limits will be decreased by the full amount.

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

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

Disbursements of grants and loans by creditor	Monthly, within three weeks of the end of each month

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