International Monetary Fund

Republic of Moldova
and the IMF

Republic of Moldova: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:
IMF Executive Board Completes the Second Review Under the ECF and EFF Arrangements for the Republic of Moldova and Concludes 2017 Article IV Consultation
December 20, 2017

December 5, 2017

The following item is a Letter of Intent of the government of the Republic of Moldova, which describes the policies that the Republic of Moldova intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the Republic of Moldova, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Country's Policy Intentions Documents

Chişinău, December 5, 2017

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

1. Moldova continues to move ahead with an ambitious reform program, supported by the Fund's Extended Fund Facility and Extended Credit Facility Arrangements. We met all quantitative performance criteria, all but one indicative target, and 8 of 16 structural benchmarks, although some with delay. We are extending our period of economic and financial stability, with continued growth and sound fiscal performance. Looking forward, growth is projected to be 3 percent in 2018, and around 4 percent over the medium term. Faster and more inclusive growth will be vital to creating jobs and improving living standards for all of our people. But challenges remain.

2. Our short-term goals remain unchanged – namely to consolidate economic and financial stability, by cleansing the financial sector, and enabling a strong regulatory and supervisory environment. To support these objectives, we will continue to pursue a comprehensive reform agenda:

- In the **financial sector**, we will ensure ownership and control of our banks by fit and proper shareholders, strengthen the framework for shareholder removal, complete and follow-up on bank diagnostics, and ensure the integrity of legal records in the newly-created security depository. We will also act to further strengthen our regulatory and supervisory frameworks, including for non-bank financial institutions.

- Our **fiscal policy** remains in line with our program commitments while also prioritizing public investment and social spending. Over the medium term, we will focus on strengthening tax revenues, improving our fiscal framework, and improving the efficiency of our spending.

- In the **energy sector**, we will work to develop a new tariff methodology in line with the Energy Law in order to ensure transparency and cost recovery, and remain committed to eliminating accumulated debt to energy companies. We strive to ensure transparent and consultative processes with all stakeholders.

3. More broadly, we continue to pursue an ambitious development agenda aimed at poverty reduction, inclusive growth, and human development. These objectives will be underpinned by our efforts to reform the public sector, strengthen the rule of law, and improve public infrastructure investment. Education reform is also key to building the human capital needed to support future growth. This program of reforms, along with other measures envisaged in our Fund-supported program, continues to enjoy broad political support and is backed by a Parliamentary majority. Our own efforts, combined with the financial support and technical assistance of our international partners, remain vital to achieving these ambitious goals.

4. On the basis of our performance to date, our ongoing commitment to the objectives of the program, the specific commitments outlined in the attached Supplementary MEFP, and recently implemented upfront actions, we request the completion of the second review under the blended Extended Credit Facility and Extended Fund Facility arrangements and associated disbursement and purchase of an aggregated amount equivalent to SDR 15.7 million; establishment of Quantitative Performance Criteria and Indicative Targets through December 2018 (Table 1); and establishment of Structural Benchmarks through 2018 (Table 2).

5. The government remains strongly committed to the implementation of the program and stands ready to take additional measures that may be adequate for the successful implementation of the program. The government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the SMEFP in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring our progress. Maintaining our commitment to the policy of transparency, we consent to the publication of this letter, the attached SMEFP and TMU, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/
Pavel Filip
Prime Minister, Government
of the Republic of Moldova

/s/
Octavian Calmîc
Deputy Prime Minister
Minister of Economy

/s/
Octavian Armaşu
Minister of Finance

/s/
Sergiu Cioclea
Governor
National Bank of Moldova

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

Supplementary Memorandum of Economic and Financial Policies

I. Recent Developments and Outlook

1. **Macroeconomic performance continues to be solid, although the pace of growth has moderated.** Annual growth in 2017 is projected to be 3.5 percent, on the back of robust domestic demand stemming from consumption growth and recovery of investment. Inflation accelerated to 7.6 percent in September, which is outside the inner band of inflation consultation clause. The augmented fiscal balance recorded a surplus of 0.6 percent in the first 9 months of 2017, on the back of strong growth in tax revenues and a slow pace of capital outlays. The current account widened to around 6 percent of GDP in the first half of 2017, with surging import growth outpacing domestic demand. With robust inflows, the leu appreciated by 10.9 percent (yoy) vis-à-vis the U.S. dollar, while gross reserves rose to 2,629 million U.S. dollars at end September.

2. **In the near term, growth will continue to be supported by both domestic and external factors.** Growth in 2018 is projected to moderate to 3.0 percent, in part due to a softening of consumption and base effects. Inflation is projected to decelerate throughout 2018 largely driven by supply-side factors. Over the medium term, the economy is projected to grow around 3.9 percent, held back by demographic factors. With sustained recovery of external demand from key trading partners supporting growth, effective financial intermediation—facilitated by ongoing decisive financial sector cleansing—will be key to supporting activity.

II. Policy Framework

A. Financial Sector Policies: Rehabilitating the Banking Sector

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

3. **We are finalizing comprehensive diagnostics of commercial banks, a crucial step in cleansing the sector.** This involves:

- **Full scope onsite inspections** are concluded in five out of the seven banks that are not part of foreign banking groups. Consequent enforcement actions included orders to reclassify assets, increase prudential loan loss provisions and to improve governance and risk management. Sanctions were imposed and warnings issued to all relevant bank managers. All inspected banks met the minimum regulatory requirements. Onsite inspections in the remaining two small domestic banks will be finalized by end-January 2018 (**reset structural benchmark**) and in banks that are part of foreign groups by end-May 2018 (**reset structural benchmark**).

- **Related party reviews** were conducted with the assistance of an international firm in the three largest banks, while those in non-systemic banks are performed during NBM's full scope on-site inspections. A newly established Coordination Committee within NBM, which reports directly to a Deputy Governor, is tasked to prepare recommendations to the executive board.

4. **Our efforts to obtain full shareholder transparency have faced delays.** Delays have arisen for multiple reasons, including challenges in exchange of information across jurisdictions, and NBM staff's workload associated with litigation cases in national and foreign courts. We aim to finalize by end-March 2018 our investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks (**reset structural benchmark**), followed by appropriate enforcement actions.

5. **We have approved a new Banking Law that will support our shift to risk and principle-based supervision.** The law introduces international standards and takes effect on 1 January 2018. The law will be promulgated and published by end-November 2017. Supporting regulations are already drafted and will be approved in stages in line with NBM's detailed time-bound action plan for publication and implementation. An updated strategy for implementation of the Basel III (EU CRDIV/CRR) standards was published in June 2017.

6. **We have adopted a time-bound national Action Plan to address the findings of the first ML/FT National Risk Assessment (NRA) for Moldova.** The Plan includes detailed measures across sectors and institutions, also strengthening competent bodies' capacity to fight against money laundering and combat the financing of terrorism. We plan to enhance the independence and operational capacity of the Financial Intelligence Unit, and clarify its mandate and engagement with other competent bodies. A new law on AML/CFT was submitted to parliament and passage is expected this year.

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

i. **Transfer of systemic banks' control to fit and proper shareholders and managers:**

a. In the third largest bank, the receipt by the NBM of a formal application from a foreign commercial bank to purchase, and a formal notification to the NBM by the non-compliant shareholder to sell, marked critical progress in our efforts to obtain transparency of ownership. By late-November, the NBM made its determination of the fitness and the probity of the applicant. If these shares are not sold by end-February 2018, we will take actions in line with law, including by suspending the non-compliant shareholder's rights.

b. For the largest bank, a recent Constitutional Court ruling on the irreversibility of share cancellation clarified legal risks faced by incoming shareholders. To facilitate the sale of shares issued to replace cancelled shares of concerted or otherwise unfit bank shareholders, we will appropriately mitigate legal risk best borne by the state, including by (i) approving amendments to the law on state property ownership, the law on Joint Stock Companies, and/or other relevant laws, to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors in order to safeguard financial stability (**prior action**), and (ii) by use of sale and purchase agreement and clearly defined contract-based indemnities. To allow the transaction for the largest bank, the NCFM will prolong the auction period of shares in the largest bank by an additional period of 6 months. Against this backdrop, a consortium of foreign investors, which concluded its due diligence already in February 2017, has reiterated their interest in acquiring the bank's newly issued shares. The transaction is expected to be finalized by end-April 2018.

c. We will review the general legislative framework for purchase and sale of shares in regulated Joint Stock Companies to assess the need to make amendments.

ii. **Exit of a systemic bank from temporary administration:** Following a prolonged period of legal uncertainty, a late September 2017 appeal court decision clarified that all suspended shares in this bank are available for sale, and the sequester on such shares was lifted in October 2017. Those shareholders have three months to divest their stakes. After this period, in line with the law, we will take appropriate supervisory actions to remove the shareholders of any remaining suspended shares. This provides the bank with a venue to exit from temporary administration in an orderly manner (**reset structural benchmark end-June 2018**)**.** We have a contingency plan in place, should this approach face substantive impediments or delays that would undermine financial stability of the system.

iii. **Shareholder cancellation framework.** Given the complexities involved in improving this framework, we will take a two-step approach: (i) to mitigate legal and decapitalization risks, we will replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law **(prior action, previous structural benchmark).** Consequently, to streamline the shareholder removal process and address governance issues, we will, in consultation with the Fund, (ii) adopt a new framework for removing concerted and otherwise unfit shareholders (**reset structural benchmark, end-April 2018)**.

iv. **Fit and proper certification and banks' corporate governance.** We remain committed to ensure fit and proper certification of incoming shareholders and managers. To further rebuild confidence in banks' management and, consistent with our action plan to implement the new Banking Law, we will request all banks to perform a self-assessment of corporate governance by **(structural benchmark end-August 2018)**. We will conduct supervisory assessments during offsite and onsite inspections, to be finalized by April 2019.

v. **Related party reviews.** The NBM will: (i) draft guidelines for related party (RP) risk management to help the banks in their efforts to strengthen internal processes; and (ii) adopt internal procedures and methodology for presuming a party related to a bank. On the basis of this, and on our assessment of related parties, the largest three banks will be ordered **(structural benchmark by end January 2018)** to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement, and by end-July for smaller banks. Going forward, we will further develop and issue for consultation with the banks our guidelines for RP risk management programs **(structural benchmark for end-June 2018).** We are also enhancing our electronic examination system to capture characteristics meeting each of the regulatory criteria for presuming a person related to a bank.

vi. **Central Securities Depository (CSD):** In line with the agreed methodology and procedures for verification of the integrity of legal records of security holders, we will complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign **(reset structural benchmark, end-March, 2018)**. In support of this, we will revise the Law on Establishment of CSD (2016) and adopt a government decree, which together will (i) clarify the responsibilities and financing mechanisms and (ii) establish an action plan and timeline for completing the public awareness campaign and verification process.

vii. **Recovery of assets:** We are reviving our efforts to recover assets from the 2014 bank fraud. The consortium of international firms has concluded its investigation and will submit its final report by end-November. We have requested that the firms prepare an analytical report, outlining the main findings. We will publish this report and adopt a strategy with time-bound actions to recover assets (**structural benchmark end-December, 2017**). We will ensure that the legal notifications necessary to avoid the expiration of statutes of limitation that could undermine either asset recovery, or sanctioning of (former) managers and shareholders of banks, have been made.

viii. **Financial safety nets.** We are working to further strengthen our crisis prevention and contingency planning. To this end, we are reviewing our legal and regulatory frameworks for Emergency Liquidity Assistance (ELA), deposit insurance, and bank liquidation, with the intention of adopting reforms by end-year 2018. As an interim measure, we have raised the retail deposit insurance coverage from MDL 6,000 to MDL 20,000 (effective as of January 1, 2018) and NBM has drafted internal guidelines for ELA. Designed to complement the Bank Recovery and Resolution Law, these reforms will be developed in consultation with the Fund.

ix. **Non-bank financial institutions.**

a. We aim to adopt, by end-year 2017, a new law to govern the fast-growing micro-credit sector, seeking to ensure rules and supervision, corporate governance, risk management, control functions, and internal audit. The law also establishes the grounds for consumer protection.

b. In cooperation with our development partners, we are also reviewing the regulatory framework for the insurance sector, with the intention of moving towards the European Solvency II legislative program.

B. Monetary and Exchange Rate Policies

8. **We will continue to implement monetary policy within an inflation-targeting framework, complemented by exchange rate flexibility.** We remain committed to our inflation target of 5 percent with a range of +/- 1.5 percentage points, which will be monitored via a

consultation clause with bands set around the central projection (Table 1). We expect inflation to decelerate in 2018, as the impact of supply-side shocks in food and energy gradually taper off. We expect the monetary policy loosening cycle to end around end 2017, and stand ready to change our monetary policy stance as the inflation outlook evolves.

9. **We are committed to strengthening the effectiveness of our inflation targeting framework.**

i. We will further improve the quality of our inflation forecasts by reducing the frequency of forecast rounds thereby lengthening the analysis period, allowing for more comprehensive assessment. We will also seek to enhance cooperation and information sharing between NBM, and the Ministry of Finance to enhance the consistency of macroeconomic data and projections, liquidity forecasting, and cash management, and sterilization of aid and privatization inflows. To this effect, a MoU on liquidity management and policy coordination was signed between the NBM and the Ministry of Finance. In addition, we will follow-up on past Technical Assistance to develop the secondary market for government securities and interbank money market.

ii. We will further strengthen internal and external policy communications. We will follow-up on Technical Assistance to ensure that monetary policy formulation benefits as much as possible from strengthened synergies across departments and with NBM management. As part of our efforts to strengthen external communications and anchor inflation expectations, we will adhere to a regular calendar for monetary policy decisions and announcements; we will also seek to enhance the analytical focus and forward-looking nature of our inflation reports.

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

11. **We will not resist exchange rate movements driven by fundamentals, intervening in the foreign exchange market only to smooth excessive volatility.** Moldova's vulnerability to external shocks requires having a flexible exchange rate as an efficient shock absorber. We will engage in two-sided intervention in the foreign exchange market to smooth excessive volatility only. The NIR targets set under the program are consistent with this commitment.

12. **Looking forward, we will explore potential impediments to financial intermediation.** Unlocking credit growth, which has been negative since the 2014 crisis, requires measures to strengthen bank governance and risk management, and will be critical to support the real economy. In addition, we will evaluate the effectiveness of financial sector infrastructure and related legislation with a view to eliminate potential obstacles to effective intermediation.

C. Fiscal Policy

13. **Our 2017 budget is consistent with commitments under the program.**

a. **Budget.** Our budget position is sound. Our cash surplus in September reached 1,162.1 million lei (about 0.8 percent of GDP), reflecting revenue over-performance—despite lower grants—and under-execution of spending partly due to delays in road projects and uncertain external financing, and also associated with the reorganization of central government. We adopted amendments to budget 2017 consistent with the current augmented deficit ceiling (**prior action**).

b. **Tax and customs policy.** In 2017, we (i) raised excise rates on cigarettes and oil products to gradually adjust them to the minimum amounts in EU directives, (ii) increased tax rates for real estate, and (iii) established the State Tax Service as the single tax administration authority.

c. **Tax and customs administration.** Our strong revenue performance is partly the result of reforms in tax and customs authorities; in particular, centralization of the State Tax Service and optimization of the customs service.

d. **Wages and pensions.** Our public wage bill will be 12,657 million lei, somewhat higher than the initial plan due to legally mandated salary increases in the education and justice sectors, overtime compensation, and Customs Service and the Border Police staffing needs. Improved budget performance allowed us to advance the valorization plans under the pension reform law adopted in December 2016 to take place in November of 2017, rather than in April 2018.

e. **Priority needs.** In line with our commitments described in the previous SMEFP (¶10), we saved rather than spent the revenue over-performance reported during the first half of the year. In the 2017 budget amendment, this over-performance allowed additional one-off capital spending (such as completion of construction works and procurement of equipment and IT systems), and higher social expenses (such as raising pensions to cover the minimum subsistence level and increasing spending on heating and maternity leave allowances).

f. **Domestic arrears.** We remain committed to eliminating the stock of audited state arrears by end-2017, despite marginally exceeding the end-September 2017 indicative target. We have intensified the inspection of the repayment of arrears, imposing fines where needed. More broadly, we aim to improve our monitoring of arrears and prevent their accumulation, including by amending Article 67 of the Law on Public Finances and Fiscal Accountability.

14. **The budget for 2018 and Medium-Term Budget Framework are in line with the agreed objectives.**

a. **Budget 2018.** We will adopt a 2018 budget, consistent with our commitments under the program **(prior action)**. The budget allows for needed increase in investment and priority social spending, and aims at an augmented deficit ceiling of 5,264 million lei.

b. **Tax and customs policy.** Measures adopted for 2018 include: increasing the excise rates on tobacco, petroleum, and alcoholic products; increasing the wealth tax base for property worth more than 1.5 million lei by also applying it to movable property (such as cars), and by excluding the area of 120 square meters as a criterion for property taxes.

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

d. **Investment.** For 2018, our priority is to improve implementation capacity for public infrastructure investment. In particular, our emphasis in the short-term will be the rehabilitation of our roads network. Over the medium-term, we plan to support investment projects that aim at (i) improving the efficiency of the centralized heat supply system, (ii) increasing energy security and reliability, including in gas, and (iii) reforming our railway system.

15. **To support our medium-term fiscal objectives, we will take the following measures:**

- **Fiscal Responsibility Framework.** We plan to remove Article 49 of the Law on Public Finances and Fiscal Accountability to simplify the annual budget process. To improve fiscal risk management, we intend to amend paragraph (5) of Article 80 to rearrange the order of debt repayment.

- **Fiscal risk statement (FRS).** To improve the transparency of fiscal policy and risks assessment starting with the 2018 budget, we will publish a FRS accompanying our annual budget documents. We plan to extend and strengthen the analysis of the risks published in future reports, and continue to seek TA to support these efforts.

- **Public administration reform and wages.** We are currently reforming the public administration system to improve its efficiency, including by consolidating the central public administration, reducing the authorized staff ceiling of the ministries from 2,053 to 1,158 staff units, and introducing a single wage system for the budget sector.

- **Shadow economy.** As part of a comprehensive strategy to reduce activity in the shadow economy, we will improve our compliance risk management, especially for the large taxpayers and high wealth individuals, and strengthen the audit function. Subject to suitable amendments to the Criminal Procedure Code, we intend to expand the current Division of Violations Discovery and Review under the STS to include criminal investigation attributes. To curb tax evasion, we intend to make mandatory the use of the electronic tax invoice by certain groups of economic agents and improve our tax administration by automating the taxpayer registration process and consolidating taxpayer information in a single electronic file.

- **State-owned enterprises (SOEs).** To improve the operational efficiency of SOEs and JSCs with state capital, we plan to organize the SOE and municipal enterprises into joint-stock companies or public institutions. As part of this effort, we will assess the economic and financial viability as well as a medium-term business plans to confirm the viability of their core operations.

D. Structural Reforms

16. **We continue to collaborate with all stakeholders, including private sector participants, donor community, WB, and Energy Community Secretariat in our energy reform efforts.** Parliament approved the new Energy Law in September completing with delay the related structural benchmark and the government and ANRE are in the process of adopting secondary legislation to ensure full implementation. This law includes procedures for the appointment of ANRE directors, so that they are fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audits.

17. **Greater transparency and accountability in the tariff-setting process remains our priority.** This will help avoid legal disputes and enhance the regulator's independence.

- In the electricity sector, we will continue to work on eliminating debt accumulated by energy companies and improving tariff-setting methodologies, to ensure transparency and cost-recovery. To this end:

    i. The recognized accumulated financial deviations by energy companies (currently estimated around MDL 1.75 billion) will be recovered via tariff adjustments in accordance with the signed agreement and ANRE decision No. 201/2016.

    ii. In line with the new Electricity law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSOs, we will develop approve, and publish a new tariff methodology **(structural benchmark, mid-February 2018)**. This will provide sufficient time for consultations and data gathering before tariffs are set in spring 2018. The new tariffs will be fully based on the new methodology and will also reflect differences in the assessment of financial deviations from April 2017-February 2018.

- In the heating sector, we will finalize the implementation of the action plan agreed between ANRE and the WB including: (i) determination of the amount of financial deviation and of the recovery mechanisms; and (ii) working out further the legal aspects of the application of heat loss methodology based on the WB recommendation from early-2017.

- We will continue our dialogue with Gazprom and other stakeholders to move forward with the restructuring of Termoelectrica's debt with Moldovagaz, supported by the WB.

18. **We will continue taking steps to strengthen economic governance as a critical element to achieve sustainable and inclusive growth.** We remain committed to shrink the shadow economy, reduce regulatory and administrative burdens, and implement judicial and institutional changes for better enforcement and accountability. Measures to enhance competitiveness and

attract foreign investment are key to promoting growth, including technological advancement, and investment in infrastructure and human capital. In this context, we will continue reforms in education, health, and social policies, thereby raising human capital and helping counter migration and demographic pressures.

E. Program Monitoring

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

Table 1. Moldova: Quantitative Performance Targets, June 2017–December 2018

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

	Jun 2017		Sept 2017		Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018
	Target	Actual	Target	Actual	Target	Target	Target	Target	Target
1. Quantitative performance criteria [1/]									
Ceiling on the ***augmented*** cash deficit of the general government	3,670	233	5,485	-958	5,513	1,339	3,548	3,996	5,264
Of which: on-lending agreements with external creditors to state-owned enterprises	410	132	808	204	504	170	257	365	550
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) [2/]	1,843	2,053	1,962	2293	2,131	2,368	2,349	2,409	2,487
2. Continuous performance criteria									
Ceiling on accumulation of external payment arrears (millions of U.S. dollars)	0	0	0	0	0	0	0	0	0
Ceiling on absorption by the government of losses or liabilities and making of payments on behalf of utilities and other companies	0	0	0	0	0	0	0	0	0
3. Indicative targets									
Ceiling on the stock of accumulated domestic government arrears [3/]	26	12	13	15	0	0	0	0	0
Ceiling on the general government wage bill	6,358	6,283	9,292	9,155	12,657	3,287	7,244	10,535	13,769
Floor on priority social spending of the general government	8,450	8,515	12,766	12,862	17,660	4,598	9,463	14,227	19,134
Floor on project spending funded from external sources [4/]			N/A		N/A	262	647	1,713	3,540
4. Inflation Consultation Bands (in percent)									
Outer Band (upper limit)	7.7		8.2		9.0	7.8	5.6	5.5	5.5
Inner Band (upper limit)	6.7		7.2		8.0	6.8	4.6	4.5	4.5
Actual / Center point	5.7	7.3	6.2	7.6	7.0	5.8	3.6	3.5	3.5
Inner Band (lower limit)	4.7		5.2		6.0	4.8	2.6	2.5	2.5
Outer Band (lower limit)	3.7		4.2		5.0	3.8	1.6	1.5	1.5

1/ Indicative targets for September 2017, and March, September, and December 2018.

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

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

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

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

	Measure		Timeframe
Prior Actions for Board Consideration of the Review			
Financial sector			
1	Amend the laws on State Property Ownership, Joint stock Companies, and other relevant laws to facilitate pre-agreed back-to-back purchase and sale to fit and proper investors to safeguard financial stability.		
2	Replace the procedures for share cancelation, issuance, and sale of newly issued shares currently in institution-specific NCFM decisions, by amending the Capital Market Law, the Law on Financial Institutions, and the newly approved Banking Law.		
Fiscal sector			
3	Adopt the amendments to the 2017 Budget consistent with the current augmented deficit ceiling.		
4	Adopt the 2018 Budget in line with existing program commitments.		
Structural Benchmarks 1/			
Financial Sector			
1	Finalize onsite inspections in:		
	1a) two small domestic banks that are not part of foreign banking group	Modified	End-January 2018
	1b) banks that are part of foreign groups	Modified	End-May 2018
2	Finalize investigations into concerted activities, and fitness and probity of shareholders in non-systemic banks	Modified	End-March 2018
3	NBM to allow a systemic bank to exit temporary administration in an orderly manner.	Modified	End-June 2018
4	Adopt a new framework for removing concerted and otherwise unfit shareholders, to streamline the process and address governance issues.	Modified	End-April 2018
5	NBM to instruct all banks to conduct self-assessment of corporate governance.	New	End-August 2018
6	NBM to order the largest three banks to submit time-bound plans for full compliance with NBM executive board decisions on RP improvement.	New	End-January 2018
7	NBM to develop and issue for consultation with the banks guidelines for RP risk management programs.	New	End-June 2018
8	NCFM to complete the verification of the legal records of all banks and insurance companies, including through a public awareness campaign.	Modified	End-March 2018
9	Government to publish an analytical report prepared by an independent investigator on the 2014 bank fraud, and adopt a strategy with time-bound actions to recover assets.	New	End-December 2017
Energy sector			
10	Develop approve, and publish a new tariff methodology, in line with the new Energy law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSO.	New	Mid-February 2018

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

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

	Measure	Timeframe	Status
Structural Benchmarks			
Financial Sector			
1	Complete identification of UBOs of		
	1a the fourth and fifth largest banks that are not subsidiaries of foreign banking groups	End-June 2017	Modified
	1b all remaining banks	End-August 2017	Modified
2	Take appropriate enforcement action against any of the three largest banks for non-compliance with regulatory requirements		
	2a) Two large banks under intensive supervision	End-April 2017	Met with delay
	2b) A large bank under temporary administration	End-June 2017	Met
3	Complete an assessment of all banks to confirm compliance with capital requirements		
	3a) Two large banks under intensive supervision	End-April 2017	Met with delay
	3b) A large bank under temporary administration	End-June 2017	Met with delay
4	Execution of the final stages of a strategy to allow a large bank to exit temporary administration	End-July 2017	Modified
5	Enhance NBM's internal database for bank claims to capture relevant characteristics for identifying exposures to related party	End-June 2017	Not met
6	With external assistance, conduct thematic reviews of related party exposures in the three largest banks	End-August 2017	Met
7	Conduct full-scope on-site inspections in banks that are not subsidiaries of foreign banking groups, applying new procedures for identifying related party exposures	End-December 2017	Modified
8	Adopt a methodology for verification of legal records of shareholders of financial institutions	End-May 2017	Met with delay
9	Complete verification of legal records of shareholders of all banks and insurance companies, in line with the new methodology	End-December 2017	Modified
10	Amend the legal framework for removing shareholders who act in concert without prior supervisory approval	End-April 2017	Modified
Fiscal sector			
11	Adopt the medium-term budget framework 2018-20	End-May 2017	Met with delay
Energy sector			
12	In cooperation with the World Bank, improve the tariff-setting methodology in the heating sector, including	End-June 2017	Not met
	12a) Revision and/or clarification of asset valuation and depreciation principles, methodologies and procedures;		
	12b) Revision and formal approval of methodology for determination of heat losses;		
	12c) Determination of the amount of tariff deviation (accumulated deficit) and of the recovery mechanisms.		
13	In cooperation with the Energy Community Secretariat, improve energy sector regulation, including making procedures for the appointment of ANRE directors to be fully transparent and merit-based, and establishing clear performance indicators to provide a basis for future independent audit.	End-June 2017	Met with delay

Attachment II. Technical Memorandum of Understanding

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

A. Quantitative Program Targets

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

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

Indicative targets are set on:

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

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

B. Program Assumptions

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

6.6445, RUB/US$ = 64.1755, SDR/US$ = 0.711134876. The holdings of monetary gold will be valued at US$1,320.75 per one troy ounce.

C. Institutional Definitions

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

D. Program Definitions

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

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

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

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

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

adjustments for program purposes are made. On this basis, and consistent with the definition above, the stock of NIR of the NBM amounted to US2,292.6 as of end- September 2017.

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

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

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

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

9. **Government securities in the form of coupon-bearing instruments** sold at face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. On

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

[3] Debt is defined as in footnote 4.

redemption date, the sales value (face value) will be recorded as amortization, and the coupon payments will be recorded as domestic interest payments.

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

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

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

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

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

14. The **priority social spending of the general government** is defined as the sum of essential recurrent expenditures including pension[6] and unemployment insurance payments from the Social Insurance Fund (BASS, 9008/00286), the *Ajutor Social* (social assistance program 9015/00320) and heating allowance (9015/00322) during the cold season from the central government budget, as well as 94 percent of health expenditures from the main fund of the Health Insurance Fund.

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

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

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

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

16. **Absorption of losses or liabilities by the government and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling of zero on

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

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

absorption by the public sector of losses or liabilities from outside the budgetary sector. Absorption of losses or liabilities is defined as direct payment by the government of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as accumulated stock of the financial deviation of the utility companies, debt-for-equity swaps or a write-off of tax obligations or other state claims.

E. Inflation Consultation Mechanism

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

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

Inflation Consultation Bands

	2017	2018			
	Dec	Mar	Jun	Sep	Dec
Outer Band (upper limit)	9.0	7.8	5.6	5.5	5.5
Inner Band (upper limit)	8.0	6.8	4.6	4.5	4.5
Actual / Center point	**7.0**	**5.8**	**3.6**	**3.5**	**3.5**
Inner Band (lower limit)	6.0	4.8	2.6	2.5	2.5
Outer Band (lower limit)	5.0	3.8	1.6	1.5	1.5

F. Adjusters

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

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

20. The **ceiling on the augmented overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by the amount of any shortfall between the total amount of actually disbursed and programmed budget support and MFA (grants and loans) from the European Commission. The upward adjustment for 2017 and 2018 is capped at the equivalent of MDL 511 million and MDL 585 million, respectively, valued at the program exchange rates; and

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

Programmed Onlending to SOEs and Adjustments to Augmented Fiscal Deficit

	2017	2018 - Cumulative			
		Q1	Q2	Q3	Q4
Onlending to SOEs (programmed amount, millions of U.S. dollars)	28.0	9.6	14.5	20.7	31.1
Maximum downward adjustment on the augmented overall cash deficit (millions of Moldovan lei) 1/ 2/	504.1	170.3	256.9	365.2	550.1

1/ The adjustmenst for the year 2017 are evaluated at t he exchange rate: 18.0 MDL/USD (the forecast of the Ministry of Economy).
2/ The adjustmenst for the year 2018 are evaluated at t he exchange rate: 17.68 MDL/USD (the forecast of the Ministry of Economy).

22. The floor on **NIR of the NBM** will be lowered by any shortfall in the official external grants and loans capped in total at the equivalent of €40 million respectively, valued at the program exchange rates.

G. Reporting Requirements

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

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

Table 1. Moldova: Data to be Reported to the IMF	
Item	**Periodicity**
Fiscal data (to be provided by the MoF) General budget operations for revenues, expenditure and financing (economic and functional classifications)	Monthly, within three weeks of the end of each month
General government wage bill at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within three weeks of the end of each month
Number of budgetary sector positions and employees at the level of budgets (state budget, local budgets, Social Insurance Fund and Health Insurance Fund) and functional groups	Monthly, within four weeks of the end of each month
Social expenditure including pension and unemployment payments from the Social Insurance Fund, the *Ajutor Social* (social assistance program) and heating allowance for the cold season from the central government budget, and health expenditures from the main fund of the Health Insurance Fund	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Onlending to SOEs by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Onlending via commercial banks by type of onlending projects and external creditors (including loan disbursements and repayments)	Monthly, within three weeks of the end of each month
Monetary data (to be provided by the NBM) 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 position of commercial banks, including balance sheets, income statement, banking regulation indicators, capital, liquidity, data on credits and deposits (from NBM's Banking Supervision)	Monthly, within four weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange cash flows of NBM	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily, within 12 hours of the end of each day
NBM's sterilization operations	Weekly, within one week of the end of each week
Balance of Payments (to be provided by the NBM) Current, capital, and financial account data.	One quarter after the end of the previous quarter
Transfers of individuals from abroad through the banking system	Monthly, within four weeks of the end of each month
External debt data (to be provided by MoF)) Information on all new external loans contracted by the general government or guaranteed by the government.	Monthly, within three weeks of the end of each month
Total public and publicly guaranteed private sector debt service due and debt service paid, by creditor	Quarterly, within three weeks of the end of each quarter
Disbursements of grants and loans by recipient sector (state/local/SOEs), and by creditor	Quarterly, within three weeks of the end of each quarter
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly, within two weeks of the end of each month
National accounts by sector of production, in nominal and real terms.	Quarterly, within three months of the end of each quarter
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly, within two months of the end of each month