IMF Country Reports 16/19

The Republic of Moldova: Staff Report for the 2015 Article IV Consultation and Third Post-Program Monitoring Discussions-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Moldova

INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/19

THE REPUBLIC OF MOLDOVA

January 2016

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF MOLDOVA

In the context of the Staff Report for the 2015 Article IV Consultation and Third Post-Program Monitoring Discussions, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 16, 2015 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 16, 2015, following discussions that ended on October 6, 2015, with the officials of the Republic of Moldova on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 1, 2015.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Moldova.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release 16/16
FOR IMMEDIATE RELEASE
January 20, 2016

IMF Executive Board Concludes 2015 Article IV Consultation and Third Post-Program Monitoring with Moldova

On December 16, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and Third Post-Program Monitoring[1] with Moldova.

Political uncertainty, large-scale bank fraud, an unsupportive external environment, and adverse weather conditions have taken a heavy toll on Moldova. In that light, economic growth, at 3.6 percent, came in surprisingly strong in the first half of 2015 and was largely driven by net exports. Inflation, at 12.5 percent in September, has risen above its target range of 5 percent ± 1.5 percentage points, yet remains notably contained given the scale of liquidity injections in problem banks. Aggressively high policy rates and reserve requirements have helped reduce pressure on the exchange rate, reserves, and inflation.

Reserves fell by about a third between October 2014 and February 2015, but have been stable since. Net outflows in the financial account surged at end-2014, due to election uncertainty and the banking crisis, but the outflow in currency and deposits tapered off in the second quarter of 2015. Remittances declined by 19 percent in the first half of the year, but their effect on the current account was offset by a significant improvement in the trade balance, reflecting mainly the impact of lower energy prices and lower domestic demand.

The near term outlook is difficult. The economy is projected to contract by 1.75 percent in 2015, followed by a marginal recovery of around 1.5 percent in 2016. Remittances continue to decline, and a drought has sharply affected agricultural production, with lingering effects expected in 2016. Capital expenditure is weak. Financing constraints bind across the economy – credit growth remains negative, external budget support is falling, and yields on short-term government bills have risen from around 10 percent at end-2014 to over 23 percent.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Deep reform is needed in the financial sector. The closure of three insolvent banks in October is a welcome step forward. However, to preserve financial stability, a comprehensive review of the health of the remaining institutions is needed, as well as improvements in the regulatory, supervisory, and crisis management frameworks. Long-standing deficiencies in identifying ultimate beneficial ownership of banks need to be urgently corrected.

Executive Board Assessment[2]

Executive Directors expressed concern about the recent political, economic, and financial developments in the country, and cautioned that significant downside risks remain to the outlook. Directors regretted that delays in addressing long-identified governance issues in the banking sector ultimately led to large-scale fraud with substantial economic costs. While noting that macrofinancial stability has been broadly maintained despite this and other large domestic and external shocks, Directors urged the authorities to act decisively to address key vulnerabilities in the financial sector, pursue prudent macroeconomic policies, and deepen structural reforms.

Directors welcomed the recent closure of three insolvent banks, and stressed the importance of ensuring the soundness of the remaining financial institutions along with improvements in the regulatory and supervisory frameworks, including in the insurance and non-bank financial sectors and the AML/CFT framework. Directors called for strengthening the governance in the banking sector, and welcomed the external review of the supervisory process in the lead up to the banking crisis. Directors urged the authorities to swiftly enhance the independence, powers, and crisis management toolkits of both the National Bank of Moldova and the National Commission for Financial Markets.

With substantial fiscal costs of the banking sector resolution and the potential for further claims on public sector resources, Directors emphasized the need to pursue credible fiscal consolidation to ensure medium-term debt sustainability. They stressed the importance of containing current expenditures, especially pensions and the wage bill, improving revenue collection, and prioritizing investment projects financed by concessional lending. Directors welcomed the planned increase in targeted social assistance, and called for advancing structural fiscal reforms and reinvigorating the privatization agenda in order to strengthen fiscal institutions and reduce fiscal risks.

Directors agreed that the current monetary policy stance is appropriate and has helped contain the inflationary pressures arising from the massive liquidity injection to problem banks. They

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

considered that a gradual relaxation of the tight monetary policy stance would need to strike a balance between inflationary risks and risks to the real sector. Directors noted that the floating exchange rate has served Moldova well, and that official interventions in the foreign exchange market should be limited to preventing excessive exchange rate volatility, while stressing the need to rebuild foreign exchange reserves.

Directors underscored that steadfast implementation of structural reforms is essential to restore output growth and enhance the economy's resilience to potential shocks. Priority should be given to strengthening the quality of institutions and governance, ensuring in particular the independence of the judiciary system, a stable regulatory and operating environment, and a level playing field for private sector companies. Directors stressed the importance of ensuring cost recovery of the utility services and the independence of the energy sector regulator.

Moldova: Selected Economic Indicators, 2012–16 1/

	2012	2013	2014	2015	2016
				Projection	
Real sector indicators	(Percent change, unless otherwise indicated)				
Gross domestic product					
Real growth rate	-0.7	9.4	4.8	-1.8	1.5
Demand	0.4	6.2	3.4	-4.8	0.8
Consumption	0.9	5.2	2.4	-2.6	1.0
Private	1.0	6.5	3.0	-3.0	2.5
Public	0.6	-0.8	-0.6	-0.2	-6.6
Gross capital formation	1.8	3.3	10.1	-15.0	0.0
Private	-3.9	-2.7	4.5	-13.3	3.5
Public	21.6	19.8	22.6	-18.4	-7.0
Nominal GDP (Billions of Moldovan lei)	88.2	100.5	112.0	119.8	133.8
Nominal GDP (Billions of U.S. dollars)	7.3	8.0	8.0	6.3	6.3
Consumer price index (Average)	4.6	4.6	5.1	9.7	12.0
GDP deflator	7.9	4.1	6.3	9.2	10.0
Average monthly wage (Moldovan lei)	3,478	3,765	4,172	4,575	5,122
Unemployment rate (Annual average, percent)	5.6	5.1	3.9	6.0	5.5
Saving-investment balance	(Percent of GDP)				
Foreign saving	8.3	5.7	7.1	6.9	6.8
National saving	15.4	17.3	17.6	14.5	14.7
Private	11.1	12.0	10.9	10.8	11.3
Public	4.3	5.3	6.7	3.7	3.4
Gross investment	23.6	22.9	24.7	21.4	21.5
Fiscal indicators (General government)					
Primary balance (excl. one-off items)	-1.4	-1.3	-1.3	-2.5	-1.7
Overall balance (excl. one-off items)	-2.2	-1.8	-1.7	-3.4	-3.2
Overall balance (incl. one-off items) 2/	-2.2	-1.8	-1.7	-15.1	-3.2
Stock of public and publicly guaranteed debt	31.1	29.7	37.5	51.9	49.8
Financial indicators	(Percent change, unless otherwise indicated)				
Broad money (M3)	20.8	26.5	5.3	12.9	…
Velocity (GDP/end-period M3; ratio)	1.8	1.6	1.7	1.6	…
Reserve money	19.7	27.0	6.3	10.6	…
Credit to the economy	16.1	18.8	-3.3	8.2	…
External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)				
Current account balance	-602	-452	-562	-434	-429
Current account balance (Percent of GDP)	-8.3	-5.7	-7.1	-6.9	-6.8
Gross official reserves	2,515	2,821	2,157	1,787	1,784
Gross official reserves (Months of imports)	4.7	5.4	5.4	4.3	4.1
Exchange rate (Moldovan lei per USD, period average)	12.1	12.6	14.0	18.8	21.3
Real effective exchange rate (Average, percent change)	4.1	-2.3	-3.0	-1.5	-0.5
External debt (Percent of GDP) 3/	82.4	83.9	85.5	106.9	105.0
Debt service (Percent of exports of goods and services)	15.1	17.1	17.0	24.5	24.1

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.
2/ Includes banking sector resolution costs in 2014-15.
3/ Includes private and public and publicly guaranteed debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS

December 1, 2015

KEY ISSUES

Context: Moldova has been in the midst of political, economic, and financial turmoil since late 2014. On October 29, 2015, the government led by Mr. Streleţ (already the third cabinet in 2015) was dismissed by a no confidence vote in Parliament. Political instability has been amplified by the revelation of a large-scale fraud in the financial sector. This resulted in a collapse of three large banks, with a cost to the budget of around 12 percent of GDP and a significant loss in reserves. The homegrown problems occurred at the time of difficult external environment, marked by a recession in Russia.

Financial sector: Deep reform is needed in the financial sector. The recent closure of three insolvent banks is a welcome step forward. However, to preserve financial stability, a comprehensive review of the health of the remaining institutions is needed, as well as improvements in the regulatory, supervisory, and crisis management frameworks. Long-standing deficiencies in identifying ultimate beneficial ownership of banks need to be urgently corrected, together with a re-certification of bank owners and managers as fit-and-proper.

Fiscal policy: Lowering the budget deficit to its medium-term target is required to ensure debt sustainability. This should be accompanied by structural fiscal reforms aiming at strengthening fiscal institutions and reducing fiscal risks.

Monetary and exchange rate policy: Aggressive monetary tightening since late 2014 has helped contain pressures on the foreign exchange market and on inflation. Once inflation expectations start to fall towards the targeted level, the stance can be gradually eased. The authorities should continue to allow exchange rate flexibility in the face of external shocks, strengthen the inflation targeting regime, and boost reserves.

Structural reforms: Delays in utility tariff adjustments created cascading losses and debts across the entire energy sector, and lack of transparency in regulation endangers investment in this key sector. Advancing structural reforms, particularly through strengthening the quality of institutions and governance, is a priority for growth and poverty reduction.

Approved By
James Gordon and Mary Goodman

Discussions were held in Chişinău during September 22-October 6, 2015. The mission met with President Timofti, Prime Minister Streleţ, Deputy Prime Minister and Minister of Economy Bride, Minister of Finance Arapu, Governor of the National Bank of Moldova Drăguţanu, and other senior officials and representatives of financial institutions, labor unions, diplomatic community, and international organizations. The mission team comprised I. Vladkova-Hollar (Head), V. Prokopenko, J. Yoo, A. Khachatryan (Res. Rep.) (all EUR), F. Jirasavetakul (FAD), P. Lohmus (MCM), and P. Xie (SPR). Ms. Volociuc (OED) attended many of the meetings. The mission cooperated closely with World Bank staff. K. Kirabaeva, N. Jovanovic, J. Swirszcz, A. Madaraszova (all EUR), and the staff from the IMF office in Chişinău assisted the mission.

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CONTEXT

1. **The political environment in Moldova has been very volatile**. EU-leaning parties obtained a narrow majority in the November 2014 Parliamentary elections, suggesting a structural and economic agenda that would reinforce the Association Agreement with the EU signed in July 2014. However, the three pro-European parties could not form a stable coalition, which led to multiple changes in government. Following the dissolution of a minority coalition in June, a majority coalition government led by Prime Minister Streleţ faced growing anti-corruption protests. The coalition received a blow after the October 15 arrest of Vlad Filat, the leader of the Liberal Democratic Party to which Streleţ also belongs. Filat was arrested on charges of embezzlement of $260 million, linked to the bank fraud of $1 billion that was uncovered in late 2014. The government was dismissed with a no confidence vote in Parliament on October 29, 2015, after only three months in office, and remains in caretaker capacity until a new coalition can be formed.

2. **A fragile banking system with non-transparent ownership is a clear threat to macro-financial stability**. Three banks—Banca de Economii (BEM), Banca Sociala, and Unibank—representing a third of the system were closed in October 2015, after being under special administration of the National Bank of Moldova (NBM) for almost one year. A first stage forensic audit revealed a well-orchestrated fraud by seemingly unrelated shareholders and highlighted the shortcomings in the regulatory and supervisory frameworks, many of which were clearly articulated in the 2014 FSAP update. A generalized run on deposits has been avoided largely because of a full payout on withdrawn deposits, but there are concerns about the health of some banks.

3. **The external environment is not supportive**. Moldova's close linkages with CIS countries, particularly Russia, have weighed on growth and the external accounts, contributing to a depreciation of the nominal exchange rate of the leu against the US dollar by about 27 percent since the beginning of 2015. Restrictions on Moldovan agricultural and food exports to Russia have been only partially lifted in 2015, and the capacity to diversify away to European markets requires substantial investment in improving quality and sanitary standards. Concessional official financial flows to the public sector are drying up as a result of policy inaction and governance concerns.

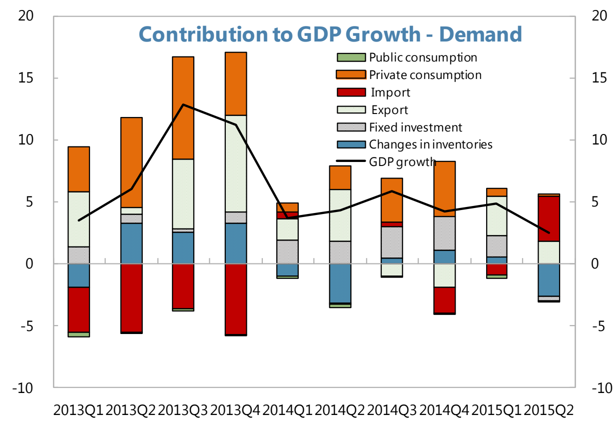
4. **Implementation of fiscal and financial sector policies has generally been weak**. In line with staff advice at the time of the last Article IV consultation, monetary policy was tightened once inflationary pressures emerged. In contrast, staff advice for resisting pre-election pressures for spending increases went unheeded—significant wage increases and the continuation of pension top-ups adopted in the run-up to the parliamentary elections of November 2014 have undermined previous fiscal adjustment efforts. Staff warning at the last Article IV consultation about the urgent need to address weaknesses in bank governance also went unheeded, with the long delay in addressing the deteriorating condition of the three insolvent banks[1] significantly increasing the

[1] Concerns about BEM were raised starting with the fifth review of the last IMF program in 2012.

resolution costs. The collapse of these banks has cost the state around 12 percent of GDP and a large loss of foreign exchange reserves.

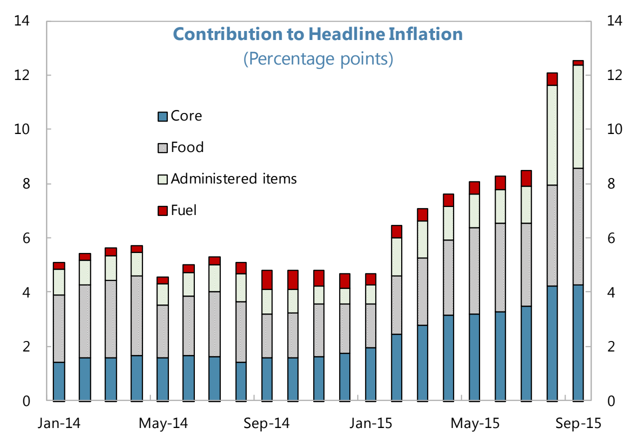
RECENT ECONOMIC DEVELOPMENTS

5. In light of the large domestic and external shocks, reported economic growth in the first half of 2015 was surprisingly strong. Economic growth came in at 3.6 percent, largely driven by net exports. Buoyant exports reflected decumulation of agricultural stocks from last year's good harvest, but have also likely benefited to some degree from real currency depreciation; some reorientation of exports to the EU has helped offset the effect of trade restrictions from Russia. Private consumption has been weak, despite large wage and pension increases, as remittances from Russia dropped in the first half of the year.



Sources: Moldovan authorities; and IMF staff calculations.

6. Inflation has risen above its target range, yet remains notably contained given the massive liquidity injection in problem banks. Aggressively high policy rates and reserve requirements counteracted the monetization of deposits in the three failed banks, and while core inflation has pushed up, the main contributors to the year on year increase in CPI index (12½ percent as of September) have been food prices and an increase in utility tariffs.



Sources: Moldovan authorities; and IMF staff calculations.

7. Reserve buffers were reduced by the impact of external shocks and capital flight, but reserves have been stable since March. International reserves have declined by US$ 900 million to US$ 1.77 billion, with most of the loss concentrated between October 2014 and February 2015. Net outflows in the financial account surged at end-2014, due to the election uncertainty and the banking crisis. The outflow in currency and deposits continued in Q1 2015, but tapered off in the second quarter. The y-o-y decline in remittances widened further to 19 percent in the first half of 2015, compared to 7 percent in 2014. However, offsetting this decline was a significant improvement in the trade balance, reflecting mainly the impact of lower energy prices and lower domestic demand.

ECONOMIC OUTLOOK AND RISKS

8. The economy is projected to contract by 1¾ percent in 2015, followed by a marginal recovery of around 1½ percent in 2016. Moldova's growth performance remains highly dependent on external transfers and climatic conditions (the agricultural and agro-processing sectors remain the backbone of the Moldovan economy). Both factors constrain the outlook for the remainder of 2015—remittances continue to decline, and a drought has sharply affected agricultural production, with lingering effects expected in 2016. Capital expenditure is weak. Financing constraints bind across the economy—credit growth remains negative, external budget support is falling, and yields on short-term government bills have risen from around 10 percent at end-2014 to over 23 percent while rollover rates fell sharply through mid-October.

9. The near term outlook is difficult. Inflation will remain above its target range throughout 2016, as supply side shocks from utility tariffs and drought-driven food price increases play out. While this does not preclude a gradual normalization of monetary policy over time, inflation expectations and currency depreciation expectations would have to start coming down first. Lower gas import prices will help remove some of the pressure on the balance of payments, but the pace of reserve accumulation is weak and reserve adequacy measures suggest the need to rebuild external buffers (Annex II). Higher interest costs from debt issued for banking sector resolution will limit fiscal space for social and developmental objectives.

10. The baseline scenario assumes that current political instability can be overcome, allowing comprehensive reforms to proceed. While the authorities broadly agreed with the need for the reforms described in this staff report, the prospect for the implementation of such reforms depends centrally on political events. The fall-out from the banking sector fraud does not yet appear to have been fully felt. The resignation of the Governor and first deputy Governor in late September 2015 could leave a governance gap at the NBM, pending appointments by Parliament, at a time when strong leadership on monetary and financial policies is critical to ensure macroeconomic stability. More generally, underpinning the baseline scenario is an expectation that a comprehensive set of reforms will be implemented, enabling the return of confidence in the economy, and a resumption of external financing– the key risk, therefore, is the postponement of a decisive policy action due to continued political instability. Such a scenario would result in significantly lower economic growth, higher government debt, and a larger drawdown of international reserves (Annex I).

11. The baseline scenario is also subject to other significant downside risks. Further spillovers from Russia and Ukraine, should tensions escalate, could come through remittances, trade, and confidence channels (see Annex II). Weaknesses in the financial sector may extend beyond the recently closed banks; if so, balance sheet repair will preclude a recovery of credit. Prolonged inaction on utility tariffs, reflecting a volatile regulatory environment, may lead to significant underinvestment in the sector.

Authorities' views

12. **The authorities broadly agreed with the baseline outlook, although they saw potential for stronger growth in 2016**. The authorities were cognizant of the need to implement structural reforms, which they saw as being in Moldova's best interest, and committed to a dialogue with international partners that would unlock assistance in delivering on those reforms. In their baseline scenario, where external financing is not constrained, they envisaged a focus on public investment, a renewed push for privatization, and a resumption of FDI, all of which, they argued, would support growth in the order of about 3 percent in 2016.

POLICY DISCUSSIONS

A. Financial Sector

13. **The Moldovan banking system has undergone a period of major distress**. As noted above, three banks constituting around one third of the system's assets collapsed in late 2014 as a result of large-scale fraudulent transactions that went unaddressed despite warning signs (Box 1). The generalized bail out—which included domestic interbank deposits, deposits of related parties, and very large deposits where money laundering concerns arise—dramatically increased the cost of the crisis. The decision to bailout deposits in the amount of MDL 14.2 billion (around 12 percent of GDP) led to a massive injection of liquidity and a large loss of foreign exchange reserves which—in conjunction with an acceleration of inflation following the exchange rate depreciation—prompted aggressive monetary tightening.

14. **While the collapse of the three banks did not generate a system-wide crisis, there are concerns about the health of some banks.** In July, the NBM instructed the three largest remaining banks to undergo special diagnostic studies. The objective of these studies, which are conducted by external independent audit companies, is to review internal risk management policies and practices in banks, to assess the quality of bank assets and the corresponding adequacy of provisions, and to scrutinize the shareholders' structure with a view to assess whether the ultimate beneficial owners are properly identified and disclosed.[2] In the meantime, the NBM has dispatched special supervisory teams to these banks.

15. **The insurance sector too has been rattled by irregularities.** A large insurance carrier has not been honoring "green card"[3] insurance obligations**.** Over the medium run, actuarial projections suggest that some insurance companies are likely to have insufficient provisions for their life insurance portfolios. A number of seemingly non-arm's length transactions between insurance companies and banks with presumed common ownership warrant close surveillance**.** The authorities

[2] As of November 19, the special diagnostic studies are close to completion in two large banks; the contract initiating the work in the third bank was signed on November 13.

[3] International third-party insurance for motor vehicles.

have launched criminal investigation into fraud in the "green card" guarantee fund– unauthorized transactions resulted in about MDL 19 million (just under US$1 million) of losses for the National Bureau of Motor Insurers (NBMI).

Box 1. Moldova: The Origins and Evolution of the Banking Crisis

Three large banks—Banca de Economii (BEM), Banca Sociala and Unibank—collapsed as a result of their long-lasting abuse by the shareholder(s). The first stage forensic audit report (the "Kroll report"), documents that starting in August 2012, these banks were subject to significant shareholder change, which had the effect of transferring ownership to a series of seemingly unconnected individuals and entities. A preliminary review of the transactions in each of the banks suggest a deliberate attempt to maximize exposure to the related entities—which reached nearly MDL 18 billion (or about US$1 billion) before the banks collapsed.

Dubious lending activities of these banks were largely known, but supervisory action was slow to come. These banks had, for a significant period of time, exhibited very high credit and liquidity risk, weak corporate governance, and poor risk management practices. A pattern of interbank lending among these banks as well as with some foreign banks for which there was no apparent economic rationale, appears to have been aimed at concealing violations of prudential rules, including on liquidity and related party lending. While the supervisory authorities duly noted these and other suspicious activities, efforts to address them were inadequate. In addition, the enforcement of some regulations was obstructed by numerous court decisions.

Supervisory forbearance and government decisions increased the ultimate resolution costs to the budget. For example:

- With already a substantial volume of public sector deposits in BEM, the authorities continued to support the bank's liquidity by coercing deposits of large state-owned enterprises into BEM well into late 2014.
- In response to significant liquidity pressures at BEM in early November 2014, the National Committee for Financial Stability (NCFS) approved a secret government decree that authorized issuance of a state guarantee to the NBM to provide liquidity to banks in an amount up to MDL 9.4 billion (this figure was further increased to MDL 14.5 billion in 2015) in order to compensate for withdrawal of bank deposits, including interbank deposits. Following the adoption of this decree, BEM resorted to significant domestic interbank borrowing.
- The decree under which liquidity was provided specifically disallowed facilitating the withdrawal of related party deposits, deposits where there were money laundering concerns, and placements and liabilities due to non-resident financial institutions. It called for the establishment of a special commission to review deposits in excess of MDL 500,000 to ensure their eligibility. Nonetheless, over the course of a few months, the overwhelming majority of such deposits were cleared for payout, with no appetite to shift the burden of proof of eligibility to depositors.
- Special administration had been in place in these banks for over 10 months before their licenses were withdrawn on October 16, 2015. The costs could have been lowered by starting the liquidation process significantly earlier.

Staff's views

16. Restoring stability in the financial system will require a broad strategy with deep reforms in the near and medium term. Policies would need to focus on ensuring the soundness of the remaining banks and strengthening the regulatory, supervisory, and safety net frameworks. The supervisory framework in the insurance sector deserves special attention. In addition, care should be taken to adequately supervise and regulate the risks arising from the rapid growth in non-bank financial institutions. Priorities include:

- **Close the three failed banks and initiate asset recovery procedures**. On October 16, in line with Fund recommendations, the NBM withdrew the licenses of the three insolvent banks—a welcome step in the right direction. This has ringfenced the resolution cost for these three institutions and halted the creation of liquidity associated with monetization of deposits. The remaining assets should be liquidated and asset recovery procedures should be promptly initiated.

- **Follow up on possible breaches of compliance with banking regulation**. The NBM, in its supervisory capacity, and based on the findings of the first stage forensic audit, should follow up on possible breaches of compliance with banking regulations, including on transparency of beneficial ownership, fit and proper requirements, and AML/CFT.

- **Scrutinize the health of the remaining banks**. Staff welcomed the NBM's initiative in organizing a comprehensive review of the three largest remaining banks. Conducted by reputable audit firms, such a review should identify any potential capital shortfall and provide the basis for determining recapitalization and/or restructuring needs. If the review identifies capital shortfalls, the current bank shareholders should be asked to provide fresh capital.

- **Improve the regulatory and supervisory frameworks**. Progress in implementing the recommendations of the 2014 FSAP has been limited—strengthening the legal protection of central bank staff acting in good faith is a recent positive step. The legislation that gives the Ministry of Justice power to modify the context of NBM and National Commission for Financial Markets (NCFM) regulations should be revised to remove such powers. Particular attention should be paid to adequate fit-and-proper certification of bank owners, directors, and managers as well as ensuring the establishment and consequent proper treatment of economic relationships between banks and borrowers. The recent creation of a separate unit in NBM for identifying ultimate beneficial owners is encouraging.

- **Enhance the bank resolution and safety net frameworks**. The NBM should be assigned the role of resolution authority and given more resolution options, particularly powers for establishing a bridge bank. Parliamentary oversight over the issuance of debt to support banks needs to be restored. The deposit insurance scheme should be revamped in line with the FSAP recommendations, particularly in getting greater assurance of back-up funding and enhanced information-sharing between the Deposit Guarantee Fund and NBM.

- **Strengthen supervision and regulation of non-bank financial institutions, and particularly the insurance sector**. Legislation to restore the powers of the NCFM—struck down by a Constitutional Court ruling in December 2012—should be enacted to enable coordinating regulatory effort with the NBM. The NCFM should be equipped with stronger and more efficient tools to regulate the insurance sector, but staff is of the view that supervisory powers for the rest of the non-bank financial sector should likely rest with the NBM.

The authorities' views

17. The authorities broadly shared staff's views on the steps needed to stabilize and strengthen the financial sector. There was no disagreement on the wide-ranging financial sector reform agenda. The authorities also expressed a strong interest in conducting an independent evaluation of the supervisory activity in the period over which the banking crisis unfolded, aimed at identifying weaknesses in the supervisory processes that allowed BEM group problems to remain unaddressed for a long time. The authorities were receptive to the staff's suggestion to conduct a thorough review of the fit-and-proper requirements, with a view to identify and address possible shortcomings and re-evaluate bank directors, managers, and significant owners. They requested Fund TA to review the fit-and-proper certification, improve the resolution framework, and design an action plan once the bank diagnostic studies are completed.

B. Fiscal Policy

18. Budget execution through September was constrained by weaker-than-expected revenues and tight financing. Substantially lower-than-expected revenues, particularly VAT and excises have been partly masked by buoyant import-related taxes due to currency depreciation and one-off non-tax revenues (profit transfer from NBM and proceeds from auctioning IT licenses). Grants have notably fallen, by nearly 42 percent y-o-y, as external donors have stepped back. Domestic financing has been constrained by very high interest rates and sharply increasing reserve requirements. The resulting adjustment on the expenditure side has fallen mainly on capital investment: only half of the budgeted capital expenditure has been executed during the first nine months of 2015. Available data indicates that the shortfall is not being filled by recourse to domestic arrears.

Budget Execution, January-September 2015

(Millions of Moldovan lei, unless otherwise indicated)

Budget Execution, January-September 2015

(Millions of Moldovan lei, unless otherwise indicated)

	Outturn 2014	Amended Budget 2015	Outturn - through September 2015			
				(percent of budget)	(percent change, y/y)	(percent change, real growth)
Total revenues and grants	42,456	44,295	31,823	71.8	4.5	0.5
Tax revenues	33,937	37,122	27,069	72.9	10.7	1.2
of which: CIT & PIT	4,878	5,371	4,030	75.0	15.0	1.6
of which: VAT	12,852	14,240	10,068	70.7	9.6	1.0
of which: Social & health fund contributions	10,787	12,015	8,802	73.3	13.3	1.4
Non-tax revenues	3,050	3,407	2,323	68.2	-10.4	-1.1
Grants	4,134	2,359	1,400	59.3	-41.9	-4.6
Others	1,335	1,407	1,031	73.2	3.6	0.4
Total expenditures	44,403	48,418	32,687	67.5	7.1	0.8
Current expenditures	35,083	39,567	27,921	70.6	11.2	1.2
of which: Wages and salaries	9,088	10,484	7,727	73.7	16.2	1.8
of which: Goods and services	9,652	10,592	6,807	64.3	3.3	0.4
of which: Interest payments	624	1,094	697	63.7	56.5	6.1
of which: Transfers	15,224	16,830	12,288	73.0	11.1	1.2
Capital expenditures	9,489	8,977	4,957	55.2	-10.5	-1.1
Net lending	-169	-127	-191	150.8	58.4	6.3
Overall balance	-1,947	-4,123	-865	21.0		

Source: Ministry of Finance; and IMF staff calculations.

19. A supplementary 2015 budget sent to Parliament in late October established a lower cash deficit target. The revised budget takes account of the tightening of financing conditions and lower revenues by revising down spending on goods and services and capital investment. The new cash deficit target, at 3.4 percent of GDP, remains contingent on the disbursement of a US$60 million tranche of a budget support loan from the Government of Romania, which awaits ratification in the Romanian Parliament.

Staff's views

20. Looking ahead, staff reiterated the need to anchor the budget deficit path to a level that is consistent with medium-term debt sustainability. The government guarantees associated with the banking sector bailout are projected to bring public debt up from 37 percent of GDP in 2014 to about 52 percent at end-2015. As a result, debt sustainability becomes more vulnerable to shocks, including potential capital needs for the rest of the banking system and from the accumulated energy tariff debt, should it end up being securitized (Box 3).

21. The fiscal framework needs to be strengthened to serve as a solid medium-term anchor. In line with past advice and with the Law on Public Finance and Fiscal Responsibility (FRL), staff advised narrowing the deficit to 1½ percent of GDP by 2020. This would be equivalent to a deficit of about 2½ percent of GDP excluding grants—a level that can be financed without recourse to exceptionally high official assistance, and consistent with placing public debt as a share of GDP on a sustainable path. Strengthening the FRL (¶24) would help ensure that it provides an adequate fiscal anchor.

22. A front-loaded fiscal consolidation path is needed in order to put public debt on a downward trend. Staff advised an overall deficit target of 3.2 percent of GDP in 2016, compared to a projected 3.4 percent of GDP in 2015. This would require a primary balance reduction of about 0.9 percentage point of GDP given the expected increase in interest costs (Box 2 and Table 3). Containing expenditures on the public sector wage bill will be essential if this is to be achieved. On the revenue side, some near term gains could be achieved from alignment of excises closer to the EU standards, and increasing and standardizing the CIT rate. With the expected increase in targeted social assistance, efforts should be made to prioritize capital expenditure.

23. A commitment to fiscal consolidation should be embedded in the Medium-Term Budget Framework (MTBF) for 2016–18.

- ***On the revenue side***, efforts to broaden the tax base and enhance revenue mobilization will be critical. As recommended by IMF technical assistance, potential measures include rationalizing CIT and PIT exemptions, updating the real estate valuations for tax purposes, improving tax compliance (for instance through enhancing the performance of the large tax payer office, efforts to reduce underreporting on income, and addressing the fragmentation of the local and state tax administration), and strengthening the efficiency of revenue administration.

- ***Concerning expenditure policies***, rationalization and efficiency gains should be pursued, particularly with respect to the wage bill (including through the size of public employment) and other current spending. Adjustment should be carefully calibrated to safeguard priority social spending as well as to prioritize public investment projects with highest potential economic and social returns.

24. Staff also called for advancement of structural fiscal reforms in order to strengthen fiscal institutions and reduce fiscal risks. Specifically:

- **Fiscal policy stance**. The authorities should improve the simple fiscal anchor that was introduced in the Fiscal Responsibility Law (FRL) by explicitly linking it with debt sustainability. In particular, the FRL should make clearer the circumstances under which the fiscal policy stance could be relaxed to safeguard social safety nets and address infrastructure needs.

- **Local government budgets**. Amendments to the Law on Local Public Finance (LPF), which aim to enhance local government efficiency, were fully implemented in January 2015. Reforms to further ensure fiscal responsibility at the local government level are crucial to safeguard the overall fiscal discipline and macroeconomic stability. These include the introduction of binding debt limits on local governments and a mechanism to monitor and enforce these limits. Staff also encouraged the authorities to strengthen the public investment management process at the local level.

- **Social security system**. Given trends in outward migration and demographics, as well as the very low replacement rate, a balance has to be struck between the fiscal and social sustainability of the pension system. Reforms in this area should include increasing the retirement age, improving coverage and compliance, and introducing a more systematic indexation of pension benefits without periodic ad-hoc increases.

- **Performance of State-Owned Enterprises (SOEs)**. Staff supported the authorities' privatization efforts and emphasized that successful privatization depends significantly on having a clear action plan. In addition, to prevent the emergence of fiscal risks from SOEs, the authorities should develop a regular monitoring mechanism to assess their financial performance.

25. Strengthening debt and cash management is imperative. Financial instruments are limited and concentrated in the short end of the maturity spectrum. The government securities market is illiquid, with very low trading activity on the secondary market. Communication between the Ministry of Finance and NBM on high frequency liquidity forecasting is weak. Staff recommended measures aimed at establishing an effective government securities market infrastructure and at developing a more sophisticated cash management function. This would have important knock-on effects on the implementation of monetary policy.

Box 2. Moldova: Government Debt Issued for Banking Sector Resolution

Several considerations need to be taken into account in designing the government bonds used for conversion of NBM's emergency lending to the closed banks. The crucial element is the interest rate. The main concern is that a below market interest rate may severely undercapitalize the NBM, whereas an interest rate closer to the prevailing market level would require a significant compression of primary expenditures. A compromise solution is required to balance these concerns. The objective is to minimize the cost to the budget, but to ensure that bonds provide sufficient interest income to enable the NBM to properly fulfill its mandate of maintaining price stability and financial stability.

Staff's baseline projection for the interest costs on government debt related to banking sector of around ½ percent of GDP in 2016 assumes the issuance of MDL 14 billion of securities with an effective annual interest rate of 5 percent. In consultation with the NBM, and taking into consideration the evolution of the NBM balance sheet, staff estimates that this interest rate would be sufficient to adequately compensate the NBM for the cost of withdrawing excess liquidity (taking also into account the revenue from other earning assets and noninterest income), while containing to some extent the fiscal implications of higher debt service. Given the difficulty in ascertaining the exact impact of staff's proposal on central bank capital, staff recommended that the authorities revisit the legal framework governing the distribution of NBM profits, if, as a result, capital levels need to be rebuilt.

The authorities' views

26. The authorities broadly agreed with staff on the need to strengthen the revenue base. The authorities highlighted their efforts to boost revenues, and emphasized some of the fiscal measures planned for 2016, including CIT and PIT reforms, and property tax reforms. They considered informality and under-reporting of wages to be a key challenge to raising the revenue take, and were considering tax policy changes that could reduce incentives to under-report.

27. However, the authorities considered staff's recommended fiscal path to be too tight, emphasizing large social and infrastructure needs and deemphasizing debt sustainability risks. The authorities argued strongly that that the medium-term deficit target should allow for additional expenditure as long as additional project financing is available. They considered such spending to be essential to poverty reduction, filling infrastructure gaps, and institution strengthening, and noted that public sector indebtedness levels are not yet a binding concern.

C. Monetary and Exchange Rate Policy

28. The monetary stance has aimed to counter external spillovers and monetization of deposit liabilities in the failed banks. The sharp depreciation of the Russian ruble contributed to a nominal depreciation of the leu against the US dollar by almost 25 percent between September 2014 and March 2015, despite the sale by NBM of around a third of its reserves. Capital flight, given uncertainty related to the outcome of parliamentary elections and fraudulent transactions in problem banks, added to pressures on the currency and reserves. Although the leu has remained broadly stable since March 2015, the NBM continued to tighten aggressively in order to absorb the liquidity released into the system from the monetization of deposits in the three failed banks. Thus, on the heels of earlier tightening, the NBM increased its policy rate in several steps to 19.5 percent, and the reserve requirement ratio on leu-denominated liabilities from 14 percent to 35 percent.

29. The growth in reserve money has been contained. The massive step up in liquidity provision by the NBM to the insolvent banks—from zero in September 2014 to over MDL 12 billion in recent months—has not resulted in a significant increase in reserve money: much of the initial money creation was effectively sterilized through the NBM supplying foreign exchange to the banks.

Text Table. NBM: Selected Indicators (in M DL billion)

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Credit to banks	-0.5	7.4	9.3	11.0	14.3
Banks' reserves	8.3	10.2	9.2	10.4	13.3
NFA	32.7	27.5	25.5	26.5	28.5
Reserve money	25.8	27.7	24.6	26.6	29.9

30. Competitiveness is broadly adequate, but building up external buffers would require restoring confidence as well as substantial upgrades in export quality. Model-based evidence does not point to significant exchange rate misalignment in 2015—the REER depreciation observed since late 2014 narrowed the estimated degree of overvaluation relative to last Article IV (Annex III). The provisions of the Deep and Comprehensive Free Trade Area (DCFTA), under implementation since September 2014, should provide a boost to exports and GDP. However, reaping these gains will require substantial improvement in quality and standards for Moldovan exports.

Staff's views

31. Monetary policy currently faces a delicate balance. Recent strong policy tightening was appropriate to contain inflationary pressures and preserve macroeconomic stability. In the very short term, significant inflationary risks remain given the planned substantial adjustment in utility tariff. Tight monetary policy stance is therefore appropriate in the current context. Going forward, there will be a need to carefully balance inflationary risks against real sector risks, in order to avoid triggering a strong negative macro-financial loop. So far, the effect of sharply tighter policy settings has not led to a systemic deterioration of the banks' loan portfolio, although ever-greening may mask problems in asset quality.

32. The NBM should continue allowing the exchange rate to adjust with market conditions. The NBM should limit interventions in support of the leu to smoothing disorderly exchange rate volatility. The inflow of remittances and export earnings is now forecast to be more subdued, driven by developments in Russia. Lower remittances and exports imply a depreciation of the equilibrium real exchange rate to which the economy will need to adjust, including through exchange rate depreciation.

33. There is room to improve the existing inflation targeting framework. The monetary transmission mechanism has undoubtedly been impeded in the context of a distressed banking system, and restoring financial stability should improve transmission. However, there is a need for improving the understanding and modeling of the transmission of policy rates to lending and deposit rates, and implementing organizational changes to enhance the monetary policy decision making process. Particular emphasis should be placed on improving coordination with the Treasury with respect to short-term liquidity and cash management—this could have helped mitigate the liquidity crunch in T-bill auctions in the second half of the year.

The authorities' views

34. Views on the appropriateness of the monetary policy stance were polarized. The NBM emphasized that monetary tightening—particularly the maintenance of the strongly positive policy interest rate despite the increase in inflation—has been necessary to contain inflationary expectations and to prevent deposit outflows. The NBM also agreed with staff's recommendation on limiting interventions in the foreign exchange market, noting that recent interventions have been infrequent and targeted to maintaining liquidity in the market, for example in the face of bulky fx purchases. However, all other interlocutors disagreed with the view that monetary policy settings are broadly appropriate – they considered liquidity and credit conditions too tight and argued that monetary policy settings have been very damaging to growth.

D. Structural Reforms

35. Advancing structural reform is indispensable in order to boost potential growth and reduce poverty. A cross country comparison across the spectrum of available indicators provides clear evidence of areas where reforms need to advance: (i) quality of institutions, and particularly in the independence of the judiciary, diversion of public funds, favoritism, and efficiency of the legal framework, areas where Moldova ranks almost last among the 144 surveyed countries; (ii) infrastructure, and in particular the quality of roads (where Moldova also ranks in the bottom 10 countries in the world; and (iii) health, education, and training. These weaknesses are consistent with the developmental priorities set in the government's *National Development Strategy Moldova 2020*, and are being addressed by a number of programs with development partners.

Competitiveness Index Ranking
(1-lowest ranking among the considered countries)

	Moldova	Serbia	Ukraine	Bulgaria	Croatia	Albania	Romania	Hungary	Russia	Macedonia	Turkey	Poland	Montenegro	Czech Republic
Institution	3	2	1	4	8	5	7	9	6	14	11	13	12	10
Judiciary independence	1	5	2	3	8	4	10	13	6	11	7	14	9	12
Favoritism	2	4	6	1	5	10	7	3	9	14	12	11	13	8
Efficiency of legal framework	2	4	3	5	1	10	11	6	9	12	14	8	13	7
Infrastructure	3	5	8	6	12	1	2	11	14	4	10	9	7	13
Road quality	1	5	2	6	14	11	4	12	3	8	13	9	7	10
Port quality	1	2	3	12	14	6	4	7	8	5	13	9	11	10
Macroeconomic environment	9	1	3	13	4	2	11	7	14	10	8	6	5	12
Health and education	1	5	11	10	8	7	2	6	9	3	4	12	14	13
Higher education/ traning	1	2	11	4	7	5	6	8	12	3	10	14	9	13
Good market efficiency	4	1	2	10	3	6	7	9	5	14	13	11	8	12
Anti-monopoly policy	2	3	1	4	8	5	9	10	6	12	14	13	7	11
Agricultural policy	2	3	6	5	1	12	11	9	4	14	10	8	13	7
Labor market efficiency	6	2	7	11	3	4	5	9	14	10	1	8	12	13
Capacity to retain talent	3	2	5	1	4	11	6	8	10	7	12	9	13	14
Capacity to attract talent	4	1	6	2	3	11	9	8	14	5	10	7	12	13
Financial Market	5	3	4	9	6	1	8	7	2	13	10	14	11	12
Trading across borders (WB)	3	4	2	12	7	5	10	9	1	8	6	14	13	11

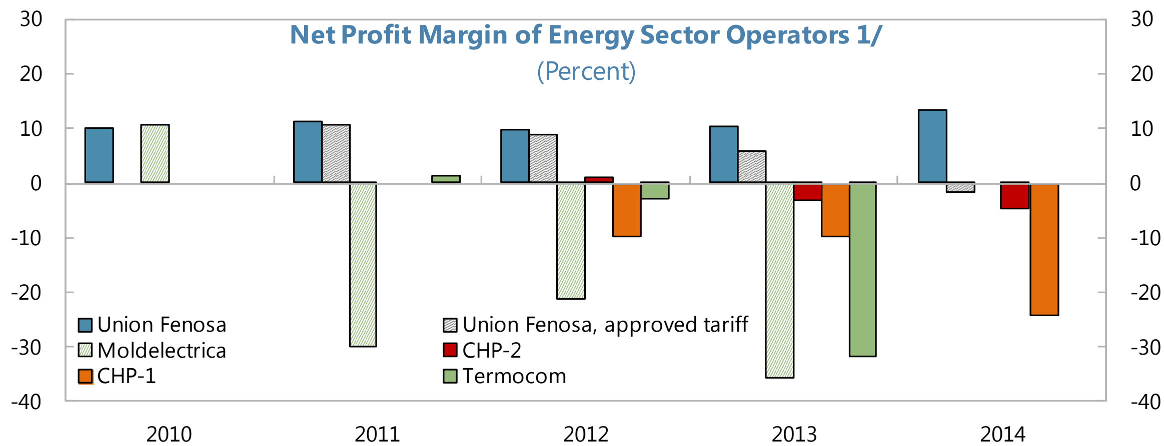
Source: WEF Global Competitiveness Index, 2014-2015; World Bank Doing Business 2015; and IMF staff calculations.
Note: In each category, countries in Central, Eastern, and Southeastern Europe, excluding Euro area, are ranked in order of low competitiveness. The areas in which countries are less competitive are highlighted in red. Within each broad area, selected sub-areas are where Moldova ranks particularly low.

36. Another important area for structural reforms relates to utility companies. Setting utility tariffs at cost-recovery levels is necessary for preventing quasi-fiscal costs and ensuring the financial viability of energy companies, which would contain the risk of service disruptions and help attract investments in the energy infrastructure. The energy regulator (ANRE) has not adjusted the tariffs for over three years, which resulted in an accumulated financial deviation and rising intercompany payment arrears (Box 3).

Box 3. Moldova. Utility Tariffs, Tariff Debt, and Mitigating Strategies

Utility tariffs in Moldova are currently below cost-recovery levels. With imported inputs representing the bulk of costs for energy producers, pressure on costs rose substantially in 2014 with the sharp currency depreciation. Despite requests by energy operators, tariffs, however, have remained unchanged until July 18, 2015, when the regulator (ANRE) announced an increase in electricity (37 percent) and gas (15.4 percent) tariffs. On November 6, 2015 ANRE reinstated tariff adjustment after a two-month suspension, during which companies were required to undergo an audit to validate the adopted tariff increases.

The July tariff increases do not cover financial deviations accumulated since 2012. The accumulated losses of utility companies are estimated to be around MDL 2 billion. Addressing the stock of financial deviations would require an even larger upfront tariff adjustment. In principle, a reasonable solution could involve amortizing the accumulated tariff debt through a gradual tariff adjustment, starting with the recognition of the size of the obligation and announcing a schedule for future tariff increases. In practice, however, the weak rule of law and concerns about political capture of the regulator constrains the viability of this approach. Consequently, companies are advocating securitization that would ultimately add to either contingent, or, more likely, direct state liabilities.

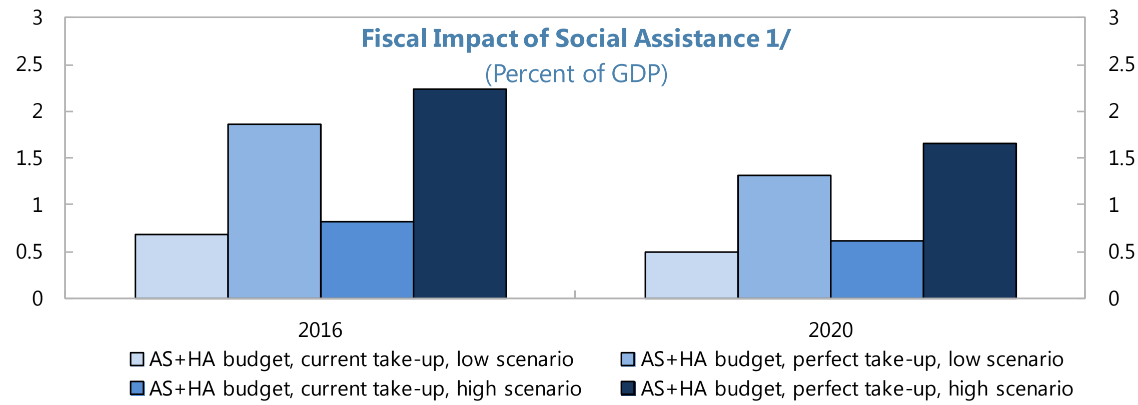


Source: World Bank.

1/ The profit reported by Union Fenosa is based on assumed revenue calculated based on tariffs, according to the regulation, but not approved by ANRE. Union Fenosa does not report losses, but instead has increased its receivables.

Tariff adjustments towards the cost-recovery levels will increase the need for social assistance. The relevant social assistance programs (Ajutor Social and Heating Allowance) are generally well targeted. According to the World Bank's estimates, the spending on these programs would have to increase to around 0.5 percent of GDP in 2015 and to at least 0.7 percent of GDP in 2016 to properly compensate for the tariff adjustment.

Box 3. Moldova. Utility Tariffs (concluded)



Source: World Bank.

1/ The low scenario is based on the restoration of the suspended July electricity and gas tariff increases and the corresponding adjustment of the heating tariff. It also assumes tariff adjustments in line with inflation thereafter. In the high scenario, tariff increases additionally reflects commodity price and exchange rate pass through, future investment costs, financial deviations accumulated over the past years, as well as estimated companies' asset revaluation.

Staff views

37. Weak governance and ineffective bureaucracy significantly affect economic outcomes in Moldova, including resource allocation and growth. To contain public resource mismanagement, Moldova needs to strengthen the rule of law and ensure credibility and accountability of its institutions. A streamlined and more competent bureaucracy would be critical in transforming the relationship between the public and private sector, which is severely tarnished. Donor interest in supporting these reforms is strong. However, stronger domestic ownership of such reforms is needed in order to make real progress.

38. Poverty has decreased sharply since 2010, but further gains will be limited without structural reforms. The headcount poverty rate (11.4 percent in 2014) has recently met the target set in the national development strategy, aided by strong growth in agriculture. Social payments through the well-targeted Ajutor Social and heating allowance program also played a positive role in achieving this outcome. However, the shocks that hit the Moldovan economy in late 2014 and 2015 and their impact on disposable income, growth, and fiscal space will likely erode some of the gains in poverty reduction. A carefully calibrated fiscal strategy, containment of fiscal risks, macroeconomic stabilization and decisive structural reform will be needed to bolster sustainable growth and make further progress in reducing poverty.

39. The setting of utility tariffs should be based on a transparent assessment of costs, and the scope for political pressure on the regulator should be removed. ANRE's decision to reinstate tariff adjustments adopted in July 2015 is a welcome first step. The future tariff adjustments should be made timely and cover amortization and other production and distribution costs.[4] For the recovery of the accumulated financial deviation, a gradual adjustment over several years would be appropriate to limit the impact of tariff increases on the population. Communication about the schedule and rationale of planned tariff adjustments and the available social assistance should also be improved. Finally, the regulatory independence of ANRE should be strengthened, including by simplifying and depoliticizing its budget approval process by the parliament.

40. Over the medium term, structural reforms are essential to reorient the growth model from consumption towards productivity-enhancing investment and exports. Reforms focused on adapting education and skills to the labor market needs, enhancing labor productivity, and increasing employment would help reduce reliance on remittances and promote human resource development.

Authorities' views

41. The authorities shared staff's views on the importance of structural reforms. The authorities expressed their commitment to implementing the reforms described in the NDS Moldova 2020, and agreed that strengthening the rule of law would require special attention. Regarding the utility tariffs, the authorities emphasized the need to conduct independent audits of the utility companies in order to assess the deviation of the existing tariffs from the cost-recovery levels before reinstating the tariff adjustment.

POST-PROGRAM MONITORING

42. Moldova is expected to meet its repayment obligations to the Fund. The Fund's exposure is projected to gradually decline from 7.5 percent of GDP (272.4 percent of quota) in 2015 to 0.8 percent of GDP (36.3 percent of quota) by 2020. Total debt service to the Fund would peak at 3.0 percent of export in 2017 (or 1.4 percent of GDP). The updated Debt Sustainability Analysis suggests that the risk of debt distress is low, although this conclusion is highly dependent on Moldova's CPIA[5] rating which is currently at the lower-end of the strong policy performance category. Standard indicators paint a mixed picture on the adequacy of reserves. The large stock of private external debt – about half of it short-term--poses additional risk, mitigated by the fact that it represents fairly stable trade credit and intercompany borrowing related to direct investment. Given Moldova's vulnerability to exogenous shocks, the difficult near term outlook, and significant

[4] Regarding the electricity tariffs, to prevent delays in necessary tariff adjustments, the law on the electricity sector should retain a clause that introduces an automatic adjustment in case ANRE fails to act within the timeframe specified by the law.

[5] CPIA is the World Bank's Country Policy and Institutional Assessment index. The score (ranging from 1-lowest to 6 - highest) reflects the quality of a country's policies and institutions (for example, the framework for poverty reduction, sustainable growth, and the effective use of development assistance). Any moderate deterioration in macroeconomic management and institutions could affect the risk rating.

downside risks, implementing good macroeconomic and financial policies will be critical to ensure continued capacity to pay.

STAFF APPRAISAL

43. Political uncertainty, large-scale bank fraud, a recession in Russia, and adverse weather conditions have taken a heavy toll on Moldova. Even assuming that political volatility recedes and reforms proceed, as assumed in the baseline, the near term outlook is challenging. Output is expected to decline by about 1¾ percent in 2015, followed by a marginal recovery in 2016. Inflation will remain above its target range throughout 2016, and with still elevated expectations on inflation and currency depreciation, normalization of tight policy settings would likely only come gradually. Lower gas import prices will help remove some of the pressure on the balance of payments, but the baseline pace of reserve accumulation is weak and reserve adequacy measures are mixed. Higher interest costs from debt issued for banking sector resolution will limit fiscal space for social and developmental objectives.

44. Nonetheless, macrofinancial stability has been broadly maintained in the face of large shocks, and the authorities are drawing lessons from the bank failures. The effects of the large-scale monetization of deposits associated with the bank bail-outs were contained, thanks to an aggressively tight monetary policy which sought to prevent further capital flight and a loss of faith in the currency. The closure of the three insolvent banks in the system was welcome, albeit long overdue. The NBM has appropriately launched comprehensive reviews of the largest remaining banks that are critical to ascertaining the health of the rest of the banking system. Staff also welcomes the authorities' initiative to conduct an independent expert review of the supervisory process that led to the bank failures and their openness to Fund TA on reviewing the fit-and-proper certification process.

45. Absent continuation of policies to address key vulnerabilities, the situation would likely deteriorate further. A deepening of the banking crisis or pressure to loosen monetary settings prematurely would weaken the exchange rate and international reserves and generate inflationary pressures. The lack of credible policies would not be supportive of a resumption of external financing, and would compound balance of payments pressures as well as constrain the capacity of the budget to execute priority expenditure. Growth prospects would be impaired.

46. The baseline reform scenario is subject to significant additional downside risks. A further slowdown in Russia could weaken the baseline. The increase in government debt by 12 percent of GDP from the bank bailout reduces Moldova's capacity to accumulate additional debt needed for long-term capital expenditures; in this context, prudency is required with respect to policies that could generate quasi-fiscal debt. If the ongoing comprehensive bank reviews identify capital shortfalls that cannot be met by private capital injection, there may be further claims on public resources as the system is restructured.

47. Strengthening the regulatory, supervisory, and safety net frameworks is critical for preserving financial stability. The recommendations of the 2014 FSAP update should guide the reform agenda. Of particular importance is (i) building an action plan following the finalization of the comprehensive reviews of the asset quality, risk management, and ownership structure of the three largest banks, and (ii) conducting a thorough and independent review of the regulations and procedures on fit-and-proper tests of ultimate beneficial owners, directors, and managers of banks, followed by a re-certification in accordance with the revised framework. It is imperative to enhance the independence, powers, and crisis management toolkits of both the NBM and the NCFM so as to ensure effective supervision of the entire financial sector; prompt supervisory action is likely needed in the insurance sector. Following through on findings of the forensic audit reports of transactions in the three failed banks will also be important—from an asset recovery perspective, as well as to introduce accountability.

48. With substantial public costs of the banking crisis resolution, fiscal consolidation to ensure medium-term sustainability becomes imperative. Against this background, measures to achieve frontloaded consolidation in 2016 and a deficit of 3.2 percent of GDP are needed to safeguard a credible path towards deficit target of around 1½ percent of GDP by 2020. The Fiscal Responsibility Law and the Law on Local Public Finance need to be strengthened to help achieve medium-term fiscal objectives. A reinvigorated privatization agenda can secure financing for additional productivity enhancing capital projects, at a pace consistent with the economy's absorption capacity.

49. Monetary policy is appropriately focused on controlling the inflationary impact of massive liquidity injection to problem banks and maintaining confidence in the currency. Short-term inflationary pressures remain high due to the prospective utility tariff adjustment, and still high expectations of currency depreciation. Decisions on gradually normalizing the stance should carefully strike a balance between inflationary risks and risks to the real sector. The floating exchange rate regime has served Moldova well, and has helped to mitigate the impact of external pressures and domestic shocks. Going forward, the NBM should limit its interventions in the foreign exchange market and intervene only to prevent disorderly exchange rate volatility.

50. Reinvigorating the structural reform agenda is critical to restore output growth, and enhance the economy's resilience to shocks. The adjustment of tariffs to bring utility companies to a cost recovery level was a welcome step to stop the cascading buildup of energy sector debts. The stock of past financial deviations should be dealt with in a transparent way, avoiding buildup of public sector contingent liabilities. Other structural measures aimed at creating a level playing field for private sector companies are critical to enhance competitiveness, attract investment, and diversify the export structure—these will also help rebuild foreign reserve buffers. Protecting human capital, which is essential for long-term sustainable growth, calls for acceleration of reforms in health, social and education systems.

51. It is proposed that the next Article IV consultation with Moldova be held on the standard 12-month cycle.

Table 1. Moldova: Selected Economic Indicators, 2010–20 1/

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
								Projection			
I. Real sector indicators	(Percent change, unless otherwise indicated)										
Gross domestic product											
Real growth rate	7.1	6.8	-0.7	9.4	4.6	-1.8	1.5	3.5	3.9	4.3	4.5
Agricultural	7.4	5.2	-20.1	46.6	7.8	-10.0	..	..	..	..	..
Non-agricultural	7.1	7.0	2.0	4.7	4.2	-0.6	..	..	..	..	..
Demand	9.1	8.2	0.4	6.2	3.4	-4.8	0.8	3.2	3.2	3.7	3.9
Consumption	7.3	7.3	0.9	5.2	2.4	-2.6	1.0	3.4	2.9	3.3	3.1
Private	9.5	9.3	1.0	6.5	3.0	-3.0	2.5	3.9	3.0	3.4	2.9
Public	-1.1	-1.0	0.6	-0.8	-0.6	-0.2	-6.6	0.3	2.1	2.8	4.4
Gross capital formation	17.2	13.0	1.8	3.3	10.1	-15.0	0.0	2.7	4.7	5.6	7.7
Private	18.5	11.3	-3.9	-2.7	4.5	-13.3	3.5	5.5	6.4	7.8	8.5
Public	12.4	19.3	21.6	19.8	22.6	-18.4	-7.0	-3.7	0.6	-0.3	5.3
Net Exports of goods and services	-14.8	-12.1	-2.8	0.0	0.3	13.2	1.5	-2.4	-1.0	-1.8	-2.0
Exports of goods and services	13.7	27.4	1.7	10.7	1.1	4.6	6.3	3.9	7.4	7.1	8.0
Imports of goods and services	14.3	19.7	2.2	5.5	0.4	-3.7	3.0	3.2	4.7	4.9	5.5
Nominal GDP (billions of Moldovan lei)	71.9	82.3	88.2	100.5	111.8	119.8	133.8	146.8	160.1	175.4	192.4
Nominal GDP (billions of U.S. dollars)	5.8	7.0	7.3	8.0	8.0	6.3	6.3	6.7	7.1	7.6	8.3
Consumer price index (average)	7.4	7.6	4.6	4.6	5.1	9.7	12.0	7.4	6.1	5.5	5.0
Consumer price index (end of period)	8.1	7.8	4.0	5.2	4.7	13.5	9.7	6.3	5.5	5.0	5.0
GDP deflator	11.1	7.2	7.9	4.1	6.3	9.2	10.0	6.0	5.0	5.0	5.0
Average monthly wage (Moldovan lei)	2,972	3,194	3,478	3,765	4,172	4,575	5,122	5,504	5,837	6,190	6,565
Average monthly wage (U.S. dollars)	240	272	287	299	297	239	240	250	259	269	282
Unemployment rate (annual average, percent)	7.4	6.7	5.6	5.1	3.9	6.0	5.5	5.0	5.0	4.0	4.0
Poverty headcount ratio at national poverty lines (percent)	21.9	17.5	16.6	12.7	11.4						
Saving-investment balance	(Percent of GDP)										
Foreign saving	9.4	12.1	8.3	5.7	7.1	6.9	6.8	6.0	5.8	5.4	5.3
National saving	13.2	11.1	15.4	17.3	17.6	14.5	14.7	15.5	16.1	16.6	17.2
Private	10.6	8.3	11.1	12.0	10.9	10.8	11.3	11.9	12.1	12.6	13.0
Public	2.6	2.9	4.3	5.3	6.7	3.7	3.4	3.6	4.0	4.0	4.2
Gross investment	22.6	23.3	23.6	22.9	24.7	21.4	21.5	21.5	21.8	22.0	22.5
Private	17.9	18.1	17.4	15.9	16.2	14.4	14.9	15.3	15.8	16.3	16.8
Public	4.8	5.2	6.3	7.1	8.5	7.1	6.6	6.2	6.0	5.8	5.8
II. Fiscal indicators (general government)											
Primary balance	-1.8	-1.6	-1.4	-1.3	-1.3	-2.5	-1.7	-1.3	-0.9	-0.7	-0.6
Overall balance	-2.5	-2.4	-2.2	-1.8	-1.7	-3.4	-3.2	-2.6	-2.0	-1.7	-1.5
Stock of public and publicly guaranteed debt	30.5	29.0	31.1	29.7	37.5	51.9	49.8	47.8	45.6	43.1	40.0
III. Financial indicators	(Percent change, unless otherwise indicated)										
Broad money (M3)	13.4	10.6	20.8	26.5	5.3	12.9	...	...	...	...	...
Velocity (GDP/end-period M3; ratio)	1.9	2.0	1.8	1.6	1.7	1.6	...	...	...	...	...
Reserve money	8.9	21.8	19.7	27.0	6.3	10.6	...	...	...	...	...
Credit to the economy	12.7	15.0	16.1	18.8	-3.3	8.2	...	...	...	...	...
Credit to the economy, percent of GDP	37.4	37.6	40.7	42.5	36.9	37.3	...	...	...	...	...
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)										
Current account balance	-545	-852	-602	-452	-562	-434	-429	-398	-408	-412	-440
Current account balance (percent of GDP)	-9.4	-12.1	-8.3	-5.7	-7.1	-6.9	-6.8	-6.0	-5.8	-5.4	-5.3
Remittances and compensation of employees (net)	1,273	1,549	1,715	1,898	1,768	1,244	1,353	1,489	1,611	1,731	1,859
Gross official reserves	1,718	1,965	2,515	2,821	2,157	1,787	1,784	1,808	1,812	1,812	1,805
Gross official reserves (months of imports)	3.4	3.9	4.7	5.4	5.4	4.3	4.1	3.8	3.6	3.3	3.1
Exchange rate (Moldovan lei per USD, period avge)	12.4	11.7	12.1	12.6	14.0	19.0	21.3	22.0	22.5	23.0	23.2
Exchange rate (Moldovan lei per USD, end of period)	12.2	11.7	12.1	13.1	15.6	21.0	21.8	22.5	23.0	23.5	23.5
Real effective exch.rate (average, percent change)	-6.1	5.9	4.1	-2.3	-3.0	-1.5	-0.5	0.0	0.0	0.0	0.0
Real effective exch.rate (end-year, percent change)	7.3	9.4	-3.1	-3.4	1.6	-2.3	0.0	0.0	0.0	0.0	0.0
External debt (percent of GDP) 2/	81.5	77.6	82.4	83.9	85.5	106.9	105.0	104.5	99.7	96.5	91.7
Debt service (percent of exports of goods and services)	17.8	15.8	15.1	17.1	17.0	24.5	24.1	20.8	25.5	26.0	25.2

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Table 2. Moldova: Balance of Payments, 2010–20

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projection					
Current account balance	-545	-852	-602	-452	-562	-434	-429	-398	-408	-412	-440
Merchandise trade balance	-2,219	-2,869	-2,924	-2,982	-2,912	-2,011	-2,110	-2,213	-2,355	-2,500	-2,687
Exports	1,590	2,278	2,229	2,466	2,352	1,965	2,019	2,156	2,358	2,547	2,770
Of which: wine and alcohol	178	178	215	231	194	150	154	166	179	191	203
Imports	-3,810	-5,147	-5,153	-5,449	-5,264	-3,976	-4,130	-4,369	-4,712	-5,047	-5,457
Services balance	-23	31	9	16	-32	-30	-21	-11	-5	0	8
Exports of services	680	861	902	988	959	793	824	878	955	1,029	1,118
Imports of services	-704	-830	-893	-972	-990	-823	-846	-889	-960	-1,029	-1,111
Income balance	505	572	814	861	796	444	550	580	608	651	696
Compensation of employees	684	863	957	1,062	991	683	751	825	886	961	1,035
Income on direct and portfolio investment	-134	-238	-87	-140	-135	-182	-144	-153	-163	-175	-190
Income on other investment	-45	-54	-56	-62	-61	-57	-57	-91	-114	-134	-149
Current transfer balance	1,193	1,415	1,499	1,654	1,586	1,164	1,153	1,246	1,343	1,437	1,544
Remittances	589	686	757	836	776	561	602	664	725	770	824
Budget transfers	112	114	131	154	208	171	94	90	87	89	93
Other transfers	492	615	610	664	602	432	456	492	531	578	626
Capital and financial account balance	371	750	693	570	-259	18	369	422	421	444	455
Capital account balance	-28	-30	-37	-35	-62	-67	-49	-52	-56	-60	-65
Financial account balance	399	779	730	606	-197	85	418	474	476	504	520
Foreign direct investment balance	204	268	175	207	166	213	204	212	220	230	242
Portfolio investment and derivatives	0	0	21	10	14	4	4	14	15	16	17
Other investment balance	194	512	533	389	-377	-131	211	248	242	259	261
Loans	77	178	282	207	-65	-9	169	167	131	151	135
General government, net	4	27	62	26	47	101	142	146	100	118	101
Private sector, net	73	152	220	182	-113	-110	28	21	31	33	33
Other capital flows	117	333	252	181	-311	-123	41	81	111	108	126
Errors and omissions	64	77	85	68	-68	-65	0	0	0	0	0
Overall balance	-111	-25	176	186	-889	-480	-60	24	12	33	16
Financing	111	25	-176	-186	889	480	60	-24	-12	-33	-16
Gross international reserves (increase: "-")	-294	-278	-498	-282	538	370	3	-24	-4	1	7
Use of Fund credit, net	175	153	139	-22	-29	-41	-74	-90	-89	-85	-78
Monetary authorities	53	129	139	-22	-29	-35	-50	-63	-62	-58	-56
Purchases	61	135	155	0	0	0	0	0	0	0	0
Repurchases	-8	-6	-16	-22	-29	-35	-50	-63	-62	-58	-56
General government	122	24	0	0	0	-6	-25	-27	-27	-27	-22
Purchases	122	24	0	0	0	0	0	0	0	0	0
Repurchases	0	0	0	0	0	-6	-25	-27	-27	-27	-22
Exceptional financing	231	150	183	117	380	82	86	60	51	52	54
Other donors	0	0	0	0	0	68	45	30	30	0	0
Memorandum items:			(Percent of GDP, unless otherwise indicated)								
Gross official reserves (millions of U.S. dollars) 1/	1,718	1,965	2,515	2,821	2,157	1,787	1,784	1,808	1,812	1,812	1,805
Months of imports of good and services	3.4	3.9	4.7	5.4	5.4	4.3	4.1	3.8	3.6	3.3	3.1
Percent of short term debt and CA deficit	62.3	69.6	89.3	85.9	63.6	55.1	56.4	53.2	50.8	48.7	45.3
Pct of short-term debt at remaining maturity	91.3	91.1	107.5	105.5	77.4	68.0	69.0	63.2	59.7	56.9	54.5
Pct of the IMF composite measure (floating) 2/	159.0	163.6	168.9	167.1	129.6	115.0	111.6	108.6	104.1	99.6	94.7
Current account balance	-9.4	-12.1	-8.3	-5.7	-7.1	-6.9	-6.8	-6.0	-5.8	-5.4	-5.3
Goods and services trade balance	-38.6	-40.4	-40.0	-37.2	-37.0	-32.6	-34.0	-33.4	-33.2	-32.8	-32.4
Export of goods and services	39.1	44.7	43.0	43.3	41.6	44.0	45.4	45.5	46.7	46.9	47.0
Import of goods and services	-77.6	-85.2	-83.0	-80.4	-78.5	-76.6	-79.4	-78.9	-79.9	-79.7	-79.5
Foreign direct investment balance	3.5	3.8	2.4	2.6	2.1	3.4	3.2	3.2	3.1	3.0	2.9
			(Percent change of amounts in U.S.dollars, unless otherwise indicated)								
Exports of goods	19.9	43.2	-2.2	10.7	-4.6	-16.5	2.8	6.7	9.4	8.0	8.7
Exports of services	1.1	26.5	4.8	9.5	-2.9	-17.4	4.0	6.5	8.7	7.8	8.7
Imports of goods	16.3	35.1	0.1	5.7	-3.4	-24.5	3.9	5.8	7.9	7.1	8.1
Imports of services	-1.3	17.9	7.6	8.9	1.9	-16.9	2.8	5.2	8.0	7.2	7.9
Remittances and compensation	13.2	21.7	10.7	10.7	-6.9	-29.6	8.8	10.0	8.2	7.5	7.4
Remittances	-6.1	16.4	10.4	10.4	-7.1	-27.8	7.5	10.3	9.1	6.3	7.0
Compensation of employees	37.5	26.3	10.9	11.0	-6.7	-31.1	9.9	9.8	7.4	8.5	7.7
Debt service (pct of exports of goods and services)	17.8	15.8	15.1	17.1	17.0	24.5	24.1	20.8	25.5	26.0	25.2

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

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

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

Table 3a. Moldova: General Government Budget, 2010–20

(Millions of Moldovan lei, unless otherwise indicated)

	2010	2011	2012	2013 1/	2014	2015		2016	2017	2018	2019	2020
						Amended Budget	Proj.	Projection				
Revenues and grants	27,537	30,138	33,476	36,908	42,456	44,295	44,095	48,540	52,547	56,875	61,787	67,713
Revenues	25,538	28,434	31,894	34,835	38,322	41,936	41,829	46,103	50,770	55,352	60,203	66,058
Tax revenues	22,261	25,301	28,261	31,599	33,937	37,122	37,024	42,481	46,796	51,016	55,456	60,849
Corporate income	484	571	1,967	2,053	2,431	2,734	2,734	3,265	3,597	3,924	4,385	4,811
Personal income	1,545	1,769	2,027	2,206	2,447	2,637	2,637	2,944	3,303	3,683	4,104	4,503
VAT	9,146	10,464	10,672	12,174	12,852	14,240	14,239	16,064	17,989	19,893	21,759	23,875
Excises	2,074	2,667	2,894	3,508	3,428	3,675	3,675	4,488	4,904	5,294	5,798	6,362
Foreign trade	1,080	1,179	1,287	1,417	1,457	1,248	1,248	1,411	1,492	1,648	1,800	1,975
Other	459	452	468	498	536	574	574	803	881	962	1,053	1,156
Social Fund contributions	5,985	6,563	7,150	7,776	8,372	9,182	9,083	10,171	10,987	11,700	12,408	13,614
Health Fund contributions	1,487	1,636	1,798	1,967	2,414	2,833	2,834	3,337	3,644	3,912	4,149	4,553
Non-tax revenues	1,696	1,457	1,943	1,945	3,050	3,407	3,398	2,051	2,250	2,455	2,689	2,950
Revenues of special funds and means	1,581	1,676	1,690	1,291	1,335	1,407	1,407	1,571	1,723	1,880	2,059	2,259
Grants	2,000	1,704	1,582	2,074	4,134	2,359	2,266	2,437	1,776	1,524	1,584	1,655
Domestic	81	31	33	36	87	92	92	102	112	123	134	147
External	1,919	1,673	1,549	2,038	4,047	2,267	2,174	2,335	1,664	1,401	1,449	1,508
Budget support	1,327	923	760	704	1,606	391	342	1,843	1,332	1,155	1,195	1,243
Project	584	663	735	1,242	2,307	1,849	1,832	492	332	246	255	265
Expenditure and net lending	29,326	32,101	35,374	38,673	44,403	48,418	48,218	52,826	56,299	60,154	64,802	70,663
Current expenditure	25,986	27,889	29,960	31,659	35,083	39,567	39,856	44,116	47,373	50,659	54,889	59,776
Wages	7,317	7,700	8,506	8,296	9,088	10,484	10,428	10,841	11,808	12,882	14,108	15,480
Goods and services	6,735	7,302	7,861	8,810	9,652	10,592	10,872	11,465	12,232	13,161	14,155	15,532
Health Fund	3,368	3,616	3,838	4,084	4,479	5,072	5,086	5,678	6,230	6,796	7,443	8,167
Other	3,367	3,687	4,023	4,727	5,173	5,520	5,787	5,786	6,002	6,365	6,712	7,365
Interest payments	558	673	694	527	624	1,094	1,162	2,169	1,991	1,927	1,891	1,974
Domestic	374	486	504	324	395	812	807	1,688	1,506	1,331	1,196	1,209
Foreign	184	188	191	203	229	282	356	481	485	595	695	765
Transfers	11,082	11,925	12,486	13,586	15,224	16,830	16,819	19,067	20,726	22,034	24,045	26,066
Transfers to economy	1,094	1,057	1,228	1,337	1,619	1,448	1,442	1,610	1,766	1,927	2,110	2,316
Transfers to households	9,988	10,868	11,258	12,249	13,605	15,382	15,377	17,457	18,959	20,107	21,934	23,751
Social Fund	8,603	9,214	9,740	10,716	12,007	13,629	13,632	15,608	16,973	18,000	19,712	21,418
Other transfers	1,385	1,654	1,518	1,533	1,598	1,754	1,745	1,849	1,987	2,107	2,222	2,333
Other current expenditure	295	289	412	440	496	568	575	575	617	655	690	725
Net lending	-90	-62	-139	-106	-169	-127	-119	-133	-146	-160	-175	-192
Capital expenditure	3,431	4,273	5,553	7,120	9,489	8,977	8,482	8,843	9,072	9,655	10,087	11,078
Externally financed	1,203	1,559	2,147	2,455	4,014	4,398	4,227	4,309	4,396	4,088	4,229	4,401
Statistical discrepancy	0	0	0	0	0		0	0	0	0	0	0
One-off revenue and expenditure items 2/	0	0	0	0	0	0	-14,000	0	0	0	0	0
Overall balance (incl. one-off items)	-1,789	-1,963	-1,897	-1,765	-1,946	-4,123	-18,123	-4,285	-3,753	-3,279	-3,015	-2,949
Overall balance (excl. one-off items)	-1,789	-1,963	-1,897	-1,765	-1,946	-4,123	-4,123	-4,285	-3,753	-3,279	-3,015	-2,949
Primary balance (excl. one-off items)	-1,307	-1,338	-1,265	-1,354	-1,440	-3,113	-3,045	-2,210	-1,864	-1,463	-1,245	-1,109
Financing (excl. one-off items)	1,789	1,963	1,897	1,765	1,946	4,123	4,123	4,285	3,753	3,279	3,015	2,949
Budget financing	1,186	1,087	361	398	150	1,617	1,719	468	-311	-563	-960	-1,186
Central government	1,019	661	282	40	-128	1,313	1,302	333	-386	-638	-1,035	-1,261
Net domestic	-520	880	294	643	-78	314	406	36	-312	150	114	395
Net foreign (excl. project loans) 3/	1,441	-355	-145	-697	-241	879	845	170	-194	-909	-1,269	-1,777
Privatization	98	136	132	93	191	120	50	127	120	120	120	120
Local governments	11	322	-36	167	245	154	229	135	75	75	75	75
Social Fund	213	125	34	65	-9	51	88	0	0	0	0	0
Health Fund	-57	-21	81	126	42	100	100	0	0	0	0	0
Project loans	619	897	1,413	1,213	1,707	2,506	2,394	3,817	4,064	3,842	3,975	4,136
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0
Financing for one-off items												
Government securities issued	0	0	0	0	0	0	14,000	0	0	0	0	0
Memorandum items:				(Millions of Moldovan lei)								
Public and publicly guaranteed debt	21,909	23,874	27,409	29,865	41,889		62,144	64,500	71,063	71,013	76,775	75,228
General Government debt	19,303	19,886	21,649	23,915	35,211		53,889	57,381	64,672	66,205	72,943	72,866
Domestic debt	5,305	5,842	6,159	6,676	13,375		21,040	21,076	20,688	20,764	20,802	21,123
Domestic expenditure arrears	230	164	62	89	98		0	0	0	0	0	0
External debt	13,768	13,880	15,428	17,150	21,739		32,849	36,305	43,984	45,441	52,140	51,743
Other 4/	2,607	3,987	5,760	5,950	6,677		8,255	7,120	6,391	4,808	3,832	2,362

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

1/ In 2013, a change in the scope of government reduces both revenue and expenditure by about 0.5 percent of GDP.
2/ Includes banking sector resolution costs in 2014-15.
3/ Includes direct budget support from the IMF of SDR 80 million in 2010 and SDR 15 million in 2011.
4/ Includes mainly central bank liabilities to the IMF.

Table 3b. Moldova: General Government Budget, 2010–20

(Percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013 1/	2014	2015		2016	2017	2018	2019	2020
						Amended Budget	Proj.	Projection				
Revenues and grants	38.3	36.6	37.9	36.7	38.0	36.9	36.8	36.3	35.8	35.5	35.2	35.2
Revenues	35.5	34.5	36.1	34.7	34.3	34.9	34.9	34.5	34.6	34.6	34.3	34.3
Tax revenues	31.0	30.7	32.0	31.4	30.4	30.9	30.9	31.7	31.9	31.9	31.6	31.6
Corporate income	0.7	0.7	2.2	2.0	2.2	2.3	2.3	2.4	2.5	2.5	2.5	2.5
Personal income	2.1	2.1	2.3	2.2	2.2	2.2	2.2	2.2	2.3	2.3	2.3	2.3
VAT	12.7	12.7	12.1	12.1	11.5	11.9	11.9	12.0	12.3	12.4	12.4	12.4
Excises	2.9	3.2	3.3	3.5	3.1	3.1	3.1	3.4	3.3	3.3	3.3	3.3
Foreign trade	1.5	1.4	1.5	1.4	1.3	1.0	1.0	1.1	1.0	1.0	1.0	1.0
Other	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Social Fund contributions	8.3	8.0	8.1	7.7	7.5	7.6	7.6	7.6	7.5	7.3	7.1	7.1
Health Fund contributions	2.1	2.0	2.0	2.0	2.2	2.4	2.4	2.5	2.5	2.4	2.4	2.4
Non-tax revenues	2.4	1.8	2.2	1.9	2.7	2.8	2.8	1.5	1.5	1.5	1.5	1.5
Revenues of special funds	2.2	2.0	1.9	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Grants	2.8	2.1	1.8	2.1	3.7	2.0	1.9	1.8	1.2	1.0	0.9	0.9
Domestic	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
External	2.7	2.0	1.8	2.0	3.6	1.9	1.8	1.8	1.1	0.9	0.8	0.8
Budget support	1.8	1.1	0.9	0.7	1.4	0.3	0.3	1.4	0.9	0.7	0.7	0.6
Project	0.8	0.8	0.8	1.2	2.1	1.5	1.5	0.4	0.2	0.2	0.1	0.1
Expenditure and net lending	40.8	39.0	40.1	38.5	39.7	40.3	40.2	39.5	38.4	37.6	36.9	36.7
Current expenditure	36.1	33.9	34.0	31.5	31.4	33.0	33.3	33.0	32.3	31.6	31.3	31.1
Wages	10.2	9.4	9.6	8.3	8.1	8.7	8.7	8.1	8.0	8.0	8.0	8.0
Goods and services	9.4	8.9	8.9	8.8	8.6	8.8	9.1	8.6	8.3	8.2	8.1	8.1
Interest payments	0.8	0.8	0.8	0.5	0.6	0.9	1.0	1.6	1.4	1.2	1.1	1.0
Domestic	0.5	0.6	0.6	0.3	0.4	0.7	0.7	1.3	1.0	0.8	0.7	0.6
Foreign	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.3	0.4	0.4	0.4
Transfers	15.4	14.5	14.2	13.5	13.6	14.0	14.0	14.3	14.1	13.8	13.7	13.5
Transfers to economy	1.5	1.3	1.4	1.3	1.4	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Transfers to households	13.9	13.2	12.8	12.2	12.2	12.8	12.8	13.0	12.9	12.6	12.5	12.3
Other current expenditure	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Net lending	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital expenditure	4.8	5.2	6.3	7.1	8.5	7.5	7.1	6.6	6.2	6.0	5.8	5.8
Externally financed	1.7	1.9	2.4	2.4	3.6	3.7	3.5	3.2	3.0	2.6	2.4	2.3
One-off revenue and expenditure items 2/	0.0	0.0	0.0	0.0	0.0	0.0	-11.7	0.0	0.0	0.0	0.0	0.0
Overall balance (incl. one-off items)	-2.5	-2.4	-2.2	-1.8	-1.7	-3.4	-15.1	-3.2	-2.6	-2.0	-1.7	-1.5
Overall balance (excl. one-off items)	-2.5	-2.4	-2.2	-1.8	-1.7	-3.4	-3.4	-3.2	-2.6	-2.0	-1.7	-1.5
Primary balance (excl. one-off items)	-1.8	-1.6	-1.4	-1.3	-1.3	-2.6	-2.5	-1.7	-1.3	-0.9	-0.7	-0.6
Financing (excl. one-off items)	2.5	2.4	2.2	1.8	1.7	3.4	3.4	3.2	2.6	2.0	1.7	1.5
Budget financing	1.6	1.3	0.4	0.4	0.1	1.3	1.4	0.3	-0.2	-0.4	-0.5	-0.6
Central government	1.4	0.8	0.3	0.0	-0.1	1.1	1.1	0.2	-0.3	-0.4	-0.6	-0.7
Net domestic	-0.7	1.1	0.3	0.6	-0.1	0.3	0.3	0.0	-0.2	0.1	0.1	0.2
Net foreign (excl. project loans) 3/	2.0	-0.4	-0.2	-0.7	-0.2	0.7	0.7	0.1	-0.1	-0.6	-0.7	-0.9
Privatization	0.1	0.2	0.1	0.1	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Local governments	0.0	0.4	0.0	0.2	0.2	0.1	0.2	0.1	0.1	0.0	0.0	0.0
Social Fund	-0.1	0.0	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Health Fund	0.3	0.2	0.0	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Project loans	0.9	1.1	1.6	1.2	1.5	2.1	2.0	2.9	2.8	2.4	2.3	2.1
Financing for one-off items												
Government securities issued	0.0	0.0	0.0	0.0	0.0	0.0	11.7	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Public and publicly guaranteed debt	30.5	29.0	31.1	29.7	37.5		51.9	49.8	47.8	45.6	43.1	40.0
General Government debt	26.9	24.1	24.5	23.8	31.5		45.0	44.5	43.5	42.6	40.9	38.8
Domestic debt	7.4	7.1	7.0	6.6	12.0		17.6	15.8	14.1	13.0	11.9	11.0
Domestic expenditure arrears	0.3	0.2	0.1	0.1	0.1		0.0	0.0	0.0	0.0	0.0	0.0
External debt	19.2	16.9	17.5	17.1	19.5		27.4	28.7	29.4	29.6	29.0	27.8
Other 4/	3.6	4.8	6.5	5.9	6.0		6.9	5.3	4.4	3.0	2.2	1.2

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

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

2/ Includes banking sector resolution costs in 2014-15.

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

4/ Includes mainly central bank liabilities to the IMF.

5/ The budget numbers are expressed as a share of IMF's GDP projections.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2010–15

(Millions of Moldovan lei, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015 Proj.
National Bank of Moldova						
Net foreign assets	18,372	19,146	24,690	30,969	27,540	30,637
NFA (convertible)	18,386	19,188	24,693	31,006	27,539	30,657
Gross reserves	20,877	23,025	30,339	36,829	33,676	37,588
Reserve liabilities	2,490	3,836	5,647	5,823	6,137	6,932
Net domestic assets	-4,286	-1,992	-4,159	-4,891	182	16
Net claims on general government	-1,067	323	192	476	-270	-298
Credit to banks	-2,675	-2,514	-3,451	-2,340	7,427	14,691
Other items (net)	-544	199	-900	-3,027	-6,975	-14,377
Reserve money	14,086	17,154	20,531	26,078	27,722	30,653
Currency in circulation	10,108	10,895	13,241	17,550	17,500	18,801
Banks' reserves	3,978	6,259	7,285	8,515	10,222	11,852
Required reserves	2,671	4,450	5,202	6,346	6,290	12,776
Other reserves	1,307	1,809	2,082	2,169	3,932	-923
Monetary survey						
Net foreign assets	18,121	16,450	23,141	31,550	43,153	54,655
NFA (convertible)	18,376	16,845	23,427	31,731	37,497	47,738
Of which: commercial banks	-11	-2,344	-1,266	725	9,958	17,082
Foreign assets of commercial banks	4,615	3,538	4,778	10,496	19,005	26,459
Foreign liabilities of commercial banks	-4,626	-5,881	-6,044	-9,770	-9,047	-9,377
NFA (non-convertible)	-254	-395	-286	-181	5,656	6,917
Net domestic assets	18,930	24,527	26,372	31,081	22,820	19,825
Net claims on general government	-187	1,512	1,004	1,387	821	1,227
Credit to economy	26,915	30,963	35,948	42,691	41,273	44,642
Moldovan lei	15,529	17,174	20,624	25,347	25,173	25,272
Foreign exchange	11,387	13,788	15,324	17,343	16,100	19,371
in U.S. dollars	937	1,175	1,270	1,328	1,031	921
Other items (net)	-7,799	-7,948	-10,580	-12,996	-19,274	-26,045
Broad money (M3)	37,051	40,977	49,513	62,632	65,973	74,480
Broad money (M2: excluding FCD)	24,771	28,265	34,915	45,117	43,220	44,776
Currency in circulation	10,108	10,865	13,241	17,550	17,509	18,801
Total deposits	26,944	30,113	36,272	45,081	48,464	55,680
Domestic currency deposits	14,662	17,400	21,674	27,567	25,711	25,976
Foreign currency deposits (FCD)	12,280	12,712	14,599	17,514	22,753	29,704
in U.S. dollars	1,010	1,083	1,210	1,341	1,457	1,412
Memorandum items:						
Reserve money growth (percent change; annual)	8.9	21.8	19.7	27.0	6.3	10.6
Broad money growth (percent change; annual)	13.4	10.6	20.8	26.5	5.3	12.9
Credit to economy (percent change, annual)	12.7	15.0	16.1	18.8	-3.3	8.2
in lei	17.6	10.6	20.1	22.9	-0.7	0.4
in foreign exchange ($ equivalent)	8.0	25.4	8.1	4.6	-22.4	-10.7
Gross international reserves (millions of U.S. dollars)	1,718	1,962	2,515	2,821	2,157	1,787
Percent of domestic-currency broad money	84	81	87	82	78	84
Net international reserves (millions of U.S. dollars)	1,513	1,626	2,047	2,375	1,764	1,457
Broad money multiplier	2.6	2.4	2.4	2.4	2.4	2.4

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

Table 5. Moldova: Financial Soundness Indicators, 2009–15

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

	2009	2010	2011	2012	2013	2014				2015		
	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep
Size												
Number of banks	15	15	15	14	14	14	14	14	14	14	14	11
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	76.2	78.7	80.0	82.1	97.5	98.3	101.0	69.3
Total bank assets (percent of GDP)	66.1	58.8	57.9	66.1	76.3	78.5	74.3	73.5	87.3	85.7	87.0	58.7
Capital adequacy												
Capital adequacy ratio	32.3	30.1	30.4	24.8	23.4	23.5	19.9	19.8	13.2	14.3	14.7	24.2
Liquidity												
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	25.7	27.3	27.4	28.1	21.1	24.8	27.4	26.9
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	51.9	54.4	55.6	57.8	65.5	66.8	66.8	49.8
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.6	50.2	49.3	48.6	32.2	37.1	41.0	54.0
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.8	34.7	34.3	34.2	21.6	25.2	27.1	38.8
Asset quality												
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	42.2	43.3	45.1	47.2	40.8	42.0	42.8	39.6
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.9	5.7	5.4	5.8	4.8	5.4	6.2	3.9
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	11.6	13.2	11.9	12.3	11.7	12.9	14.4	9.8
Provisions to non-performing loans	59.2	63.2	65.0	73.5	83.6	76.7	84.4	81.8	88.4	84.3	77.0	86.8
Profitability												
Return on equity	-2.1	3.0	11.5	5.6	9.4	8.6	8.2	8.5	6.1	9.7	8.9	16.1
Return on assets	-0.4	0.5	2.0	1.1	1.6	1.3	1.2	1.3	0.9	1.2	1.1	2.6
Foreign currency assets and liabilities												
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	51.0	51.8	52.9	54.1	49.5	51.7	48.9	55.9
Foreign currency denominated assets in total assets	40.2	40.8	40.5	40.9	44.7	44.2	44.6	46.1	47.0	51.2	50.4	45.3
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	44.7	46.3	48.6	51.9	52.1	56.4	56.0	55.4
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	40.4	40.1	39.4	40.2	39.8	40.5	42.7	44.0

Source: National Bank of Moldova.

Table 6. Moldova: Indicators of Fund Credit, 2009–2020

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
							Projection					
Fund obligations based on existing credit												
(millions of SDRs)												
Principal	9.7	5.5	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.7	1.7	1.6	1.5	1.2	1.0	0.9	0.5
Fund obligations based on existing and prospective credit												
Principal	9.7	5.5	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4
Charges and interest	0.5	0.3	0.8	1.2	1.7	1.7	1.6	1.5	1.2	1.0	0.9	0.5
Total obligations based on existing and prospective credit												
Millions of SDRs	10.3	5.8	4.7	11.7	15.8	21.0	30.7	54.0	64.7	63.4	59.9	53.9
Millions of U.S. dollars	15.8	8.9	7.4	18.0	24.1	31.9	43.0	76.1	91.8	90.0	85.0	76.5
Percent of exports of goods and services	0.8	0.4	0.2	0.6	0.7	1.0	1.6	2.7	3.0	2.7	2.4	2.0
Percent of debt service 2/	18.0	11.9	8.5	19.7	23.7	31.1	46.3	55.9	53.7	46.5	40.8	33.0
Percent of GDP	0.3	0.2	0.1	0.2	0.3	0.4	0.7	1.2	1.4	1.3	1.1	0.9
Percent of gross international reserves	1.1	0.5	0.4	0.7	0.9	1.5	2.4	4.3	5.1	5.0	4.7	4.2
Percent of quota	8.3	4.7	3.8	9.5	12.9	17.0	24.9	43.8	52.5	51.5	48.6	43.8
Outstanding Fund credit based on existing and prospective credit												
Millions of SDRs	98.2	212.6	308.7	398.2	384.0	364.7	335.6	283.1	219.6	157.2	98.1	44.8
Millions of U.S. dollars	151.3	324.3	487.3	609.9	583.6	553.9	470.4	398.7	311.7	223.0	139.3	63.5
Percent of exports of goods and services	7.6	14.3	15.5	19.5	16.9	16.7	17.1	14.0	10.3	6.7	3.9	1.6
Percent of debt service 2/	172.7	434.8	556.7	667.0	575.0	539.3	506.9	293.1	182.3	115.2	66.8	27.4
Percent of GDP	2.8	5.6	6.9	8.4	7.3	7.0	7.5	6.4	4.7	3.1	1.8	0.8
Percent of gross international reserves	10.2	18.9	24.8	24.2	20.7	25.7	26.3	22.3	17.2	12.3	7.7	3.5
Percent of quota	79.7	172.6	250.6	323.2	311.7	296.0	272.4	229.8	178.3	127.6	79.7	36.3
Net use of Fund credit (millions of SDRs)	-9.7	114.5	96.1	89.5	-14.2	-19.3	-29.1	-52.6	-63.5	-62.5	-59.0	-53.4
Disbursements and purchases 3/	0.0	120.0	100.0	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	9.7	5.5	3.9	10.5	14.2	19.3	29.1	52.6	63.5	62.5	59.0	53.4
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	2,000	2,271	3,139	3,131	3,454	3,311	2,758	2,844	3,034	3,313	3,576	3,888
Debt service (millions of U.S. dollars) 2/	87.6	74.6	87.5	91.4	101.5	102.7	92.8	136.0	171.0	193.7	208.4	232.0
Nominal GDP (millions of U.S. dollars) 2/	5,438	5,813	7,018	7,283	7,985	7,962	6,265	6,268	6,665	7,098	7,623	8,265
Gross International Reserves (millions of U.S. dollars)	1,480	1,718	1,965	2,515	2,821	2,157	1,787	1,784	1,808	1,812	1,812	1,805
Average exchange rate: SDR per U.S. dollars	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Quota (millions of SDRs)	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2	123.2

Sources: IMF staff estimates and projections.

1/ Assume repurchases are made on obligations schedule.

2/ Total debt service includes IMF repurchases and repayments.

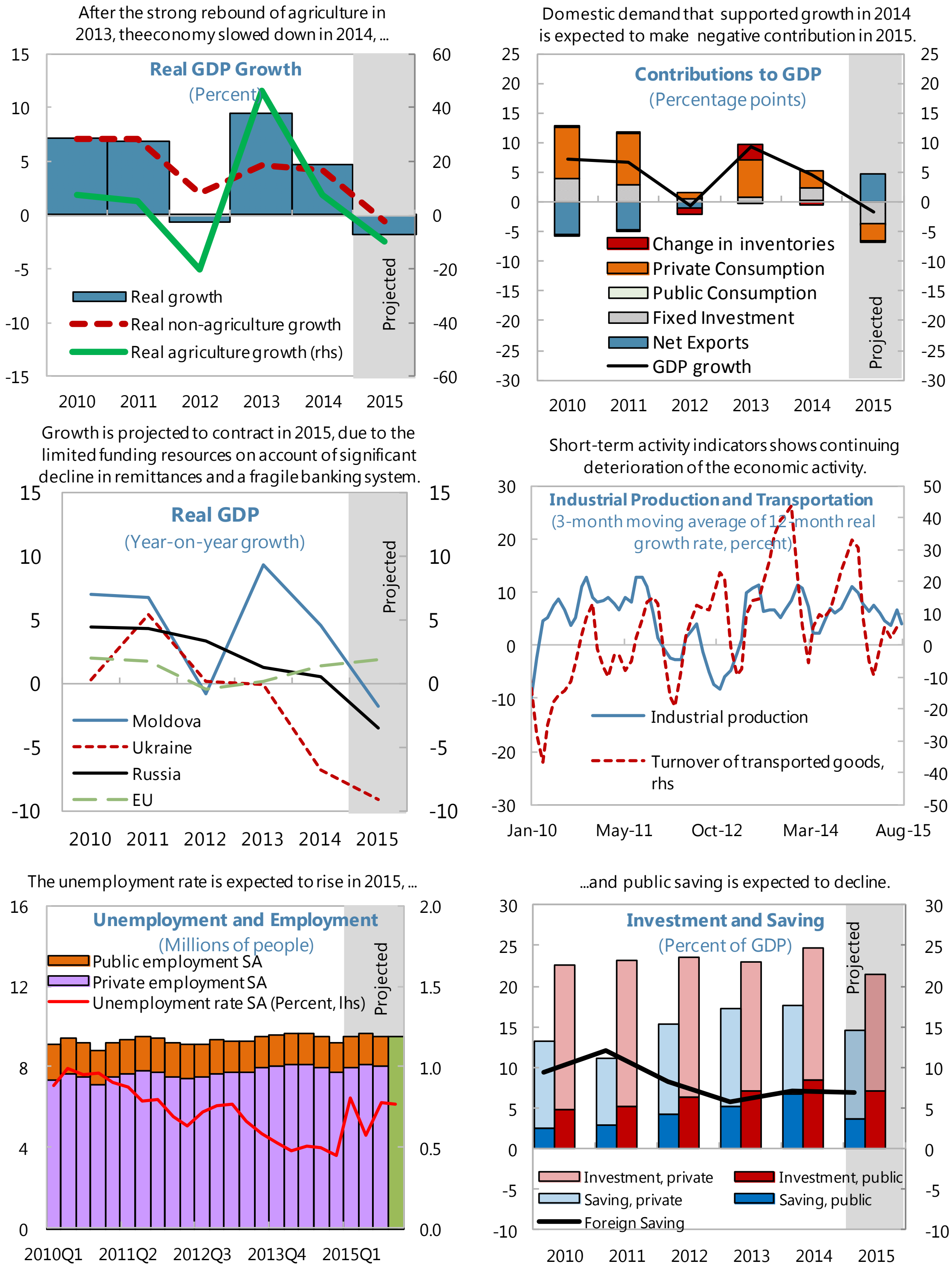
3/ In 2009, does not include Moldova use of the SDR allocation of SDR 117.71 million.

Table 7. Moldova: Selected Localized Millennium Development Goals and Progress Indicators, 2005–2014

	First Observation	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Goal 1: Reduce extreme poverty and hunger											
Target 1A: Halve, between 1990 and 2015, the proportion of people living on less than $1.90 a day											
▪ Poverty gap at $1.90 a day (2011 PPP) (%)	3.3 (1992)	3.3	0.6	0.3	0.3	0.2	0.1	0.0	0.0		0.0
Target 1C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger											
▪ Prevalence of underweight, weight for age (% of children under 5)	3.2 (2005)	3.2	...	...	...	...	...	...	2.2	...	...
Goal 2: Achieve universal primary education											
Target 2A: By 2015, all children can complete a full course of primary schooling, girls and boys											
▪ School enrollment, primary (% net)	89.1 (2000)	91.0	87.8	87.6	87.7	87.5	87.6	87.8	87.9	87.9	...
Goal 3: Promote gender equality and empower women											
Target 3A: Eliminate gender disparity in education preferably by 2005, and at all levels by 2015											
▪ Ratios of girls to boys in tertiary education	0.9 (1995)	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.8	...
Goal 4: Reduce child mortality											
Target 4A: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate											
▪ Mortality rate, under-5 (per 1,000 live births)	33.1 (1990)	19.7	18.7	18.1	17.7	17.4	17.2	16.9	16.7	16.4	16.1
Goal 5: Improve maternal health											
Target 5A: Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio											
▪ Maternal mortality ratio (per 100,000 births)	61.0 (1990)	25.0	...	...	...		41.0	...	...	21.0	...
Target 5B: Achieve, by 2015, universal access to reproductive health						...					
▪ Contraceptive prevalence (% of women ages 15-49)	73.7 (1997)	67.8	...	...	...	...	...	...	59.5	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases											
Target 6A: Have halted by 2015 and begun to reverse the spread of HIV/AIDS											
▪ Prevalence of HIV, total (% of population ages 15-49)	0.3(2000)	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Target 6B: Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it											
▪ Antiretroviral therapy coverage (% of people living with HIV)	0 (2000)	1.0	2.0	4.0	5.0	7.0	8.0	11.0	13.0	15.0	18.0
Target 6C: Have halted by 2015 and begun to reverse the incidence of malaria and other diseases											
▪ Tuberculosis death rate (per 100,000 people)	5.6 (1990)	20.0	19.0	19.0	17.0	17.0	16.0	14.0	14.0	14.0	...
Goal 7: Ensure environmental sustainability											
Target 7C: Halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation											
▪ Population with sustainable access to an improved water source (percent)	84.3 (1992)	86.2	86.4	86.7	86.9	87.1	87.4	87.6	87.9	88.1	88.4
Goal 8: Develop a global partnership for development											
Target 8F: In co-operation with the private sector, make available the benefits of new technologies, especially information and communications											
▪ Internet users per 100 Population	0 (1990)	14.6	19.6	20.5	23.4	27.5	32.3	38.0	43.4	45.0	46.6

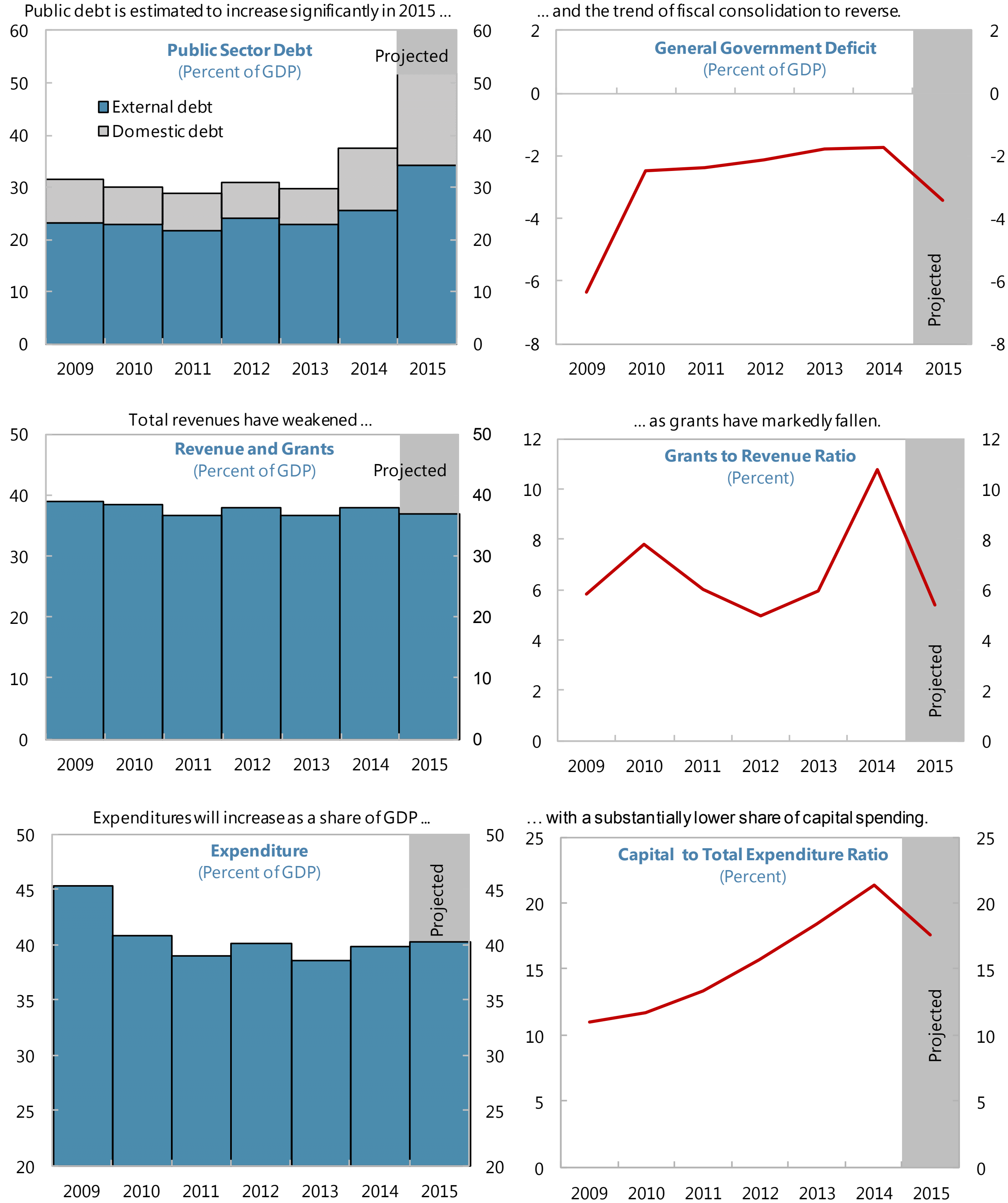
Source: World Bank, Millennium Development Goals database.

Figure 1. Moldova: Real Sector Developments, 2012–15



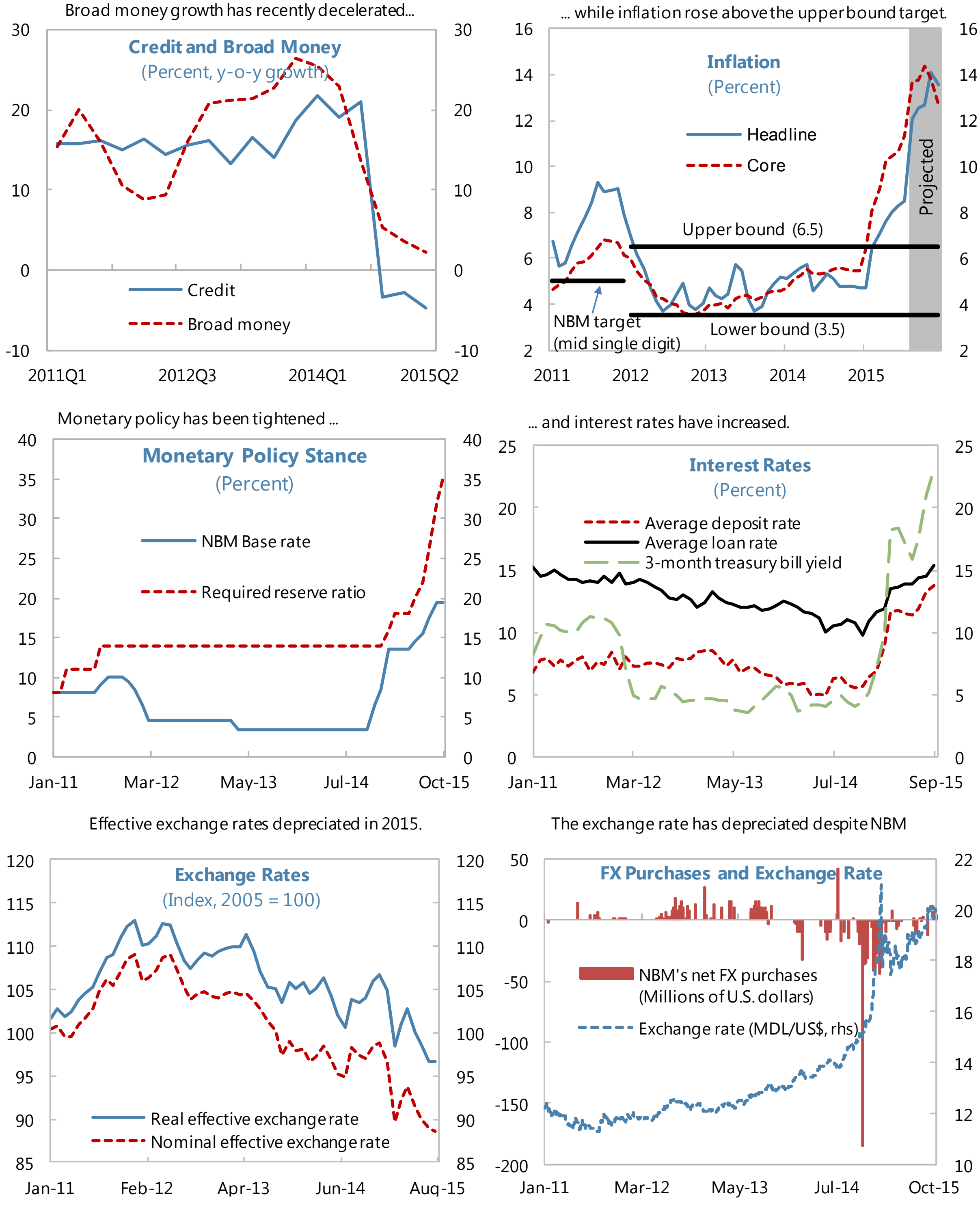
Sources: Moldovan authorities; National Bureau of Statistics of the Republic of Moldova; and IMF staff calculations.

Figure 2. Moldova: Fiscal Developments, 2009–15



Sources: Moldovan authorities; and IMF staff calculations.

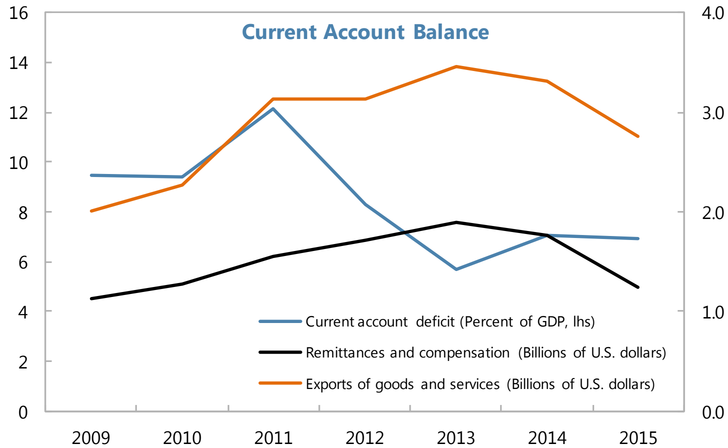
Figure 3. Moldova: Money, Prices, and Interest Rates, 2011–15



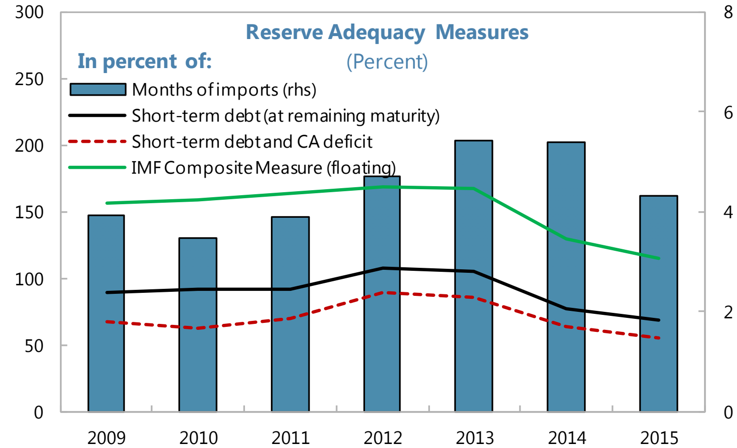
Sources: National authorities; and IMF staff calculations.

Figure 4. Moldova: External Sector Developments, 2009–15

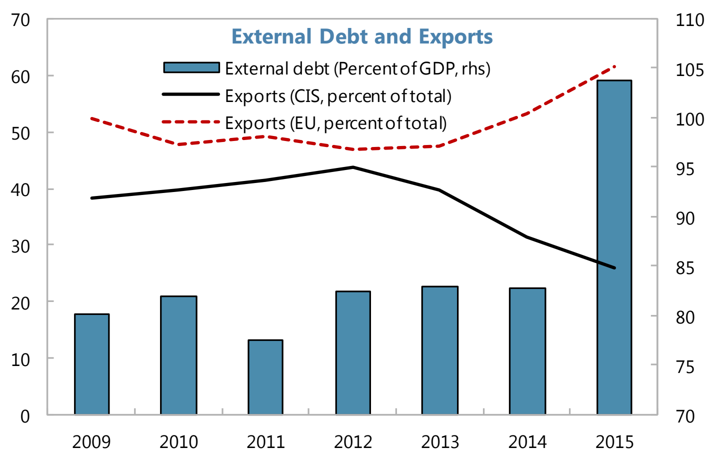
The improvements in current account balance were interrupted in 2014 mainly due to the decline in remittance. In 2015, it is expected to improve slightly benefited from lower price of energy imports.



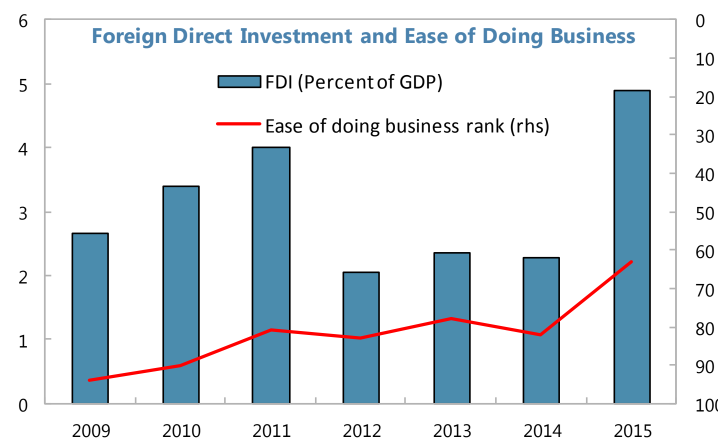
External buffers have declined sharply due to external shocks and capital flight, impairing the economy's resilience to shocks.



Exports growth in EU markets has been offsetting the negative impact of trade restriction from Russia. However, external vulnerabilities increase accompanied with exchange rate depreciation.



FDI in terms of GDP is expected to recover largely due to decline in nominal GDP in US dollars because of depreciation. Structural reforms are critical to keep the recovery in FDI.



Sources: World Bank, *Doing Business Report*, 2010-14; National Bank of Moldova; Moldovan Authorities; and IMF staff and calculations.

Annex I. "No Reform" Scenario

A "no reform" scenario leaves Moldova with low growth and weaker external buffers. Economic growth would be around 1½ percentage points lower than in the baseline, reflecting significantly lower investment, particularly private investment, and stagnating productivity. A more depreciated exchange rate, related to higher uncertainties and a loss of confidence in the leu, would contribute to a higher inflation. A financing mix that includes less concessional donor financing and a greater reliance on domestic issuance would further squeeze room for primary expenditure, but debt would remain elevated. While the current account deficit would improve with weaker domestic absorption, the drop in donor financing and foreign direct investments would negatively affect international reserves.

Selected Economic Indicators Under Alternative Scenarios, 2012–20

(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Baseline Scenario									
Real GDP growth 1/	-0.7	9.4	4.6	-1.8	1.5	3.5	3.9	4.3	4.5
Inflation	4.6	4.6	5.1	9.7	12.0	7.4	6.1	5.5	5.0
Overall balance	-2.2	-1.8	-1.7	-3.4	-3.2	-2.6	-2.0	-1.7	-1.5
Government debt	31.0	29.6	37.4	51.9	49.8	47.8	45.6	43.1	40.0
Current account balance	-8.3	-5.7	-7.1	-6.9	-6.8	-6.0	-5.8	-5.4	-5.3
Reserves 2/	2,515	2,821	2,157	1,787	1,784	1,808	1,812	1,812	1,805
"No Reform" Scenario									
Real GDP growth 1/	-0.7	9.4	4.6	-1.8	0.0	2.0	2.5	3.0	3.0
Inflation	4.6	4.6	5.1	9.7	12.7	9.5	6.2	5.5	5.0
Overall balance	-2.2	-1.8	-1.7	-3.4	-1.9	-2.3	-2.4	-2.5	-2.6
Government debt	31.0	29.6	37.4	51.9	49.1	47.8	46.3	44.7	43.1
Current account balance	-8.3	-5.7	-7.1	-6.9	-5.7	-4.4	-3.2	-3.1	-3.2
Reserves 2/	2,515	2,821	2,157	1,787	1,625	1,533	1,510	1,480	1,421

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

1/ In percent.

2/ Millions of U.S. dollars.

Annex II. Risk Assessment Matrix 1/

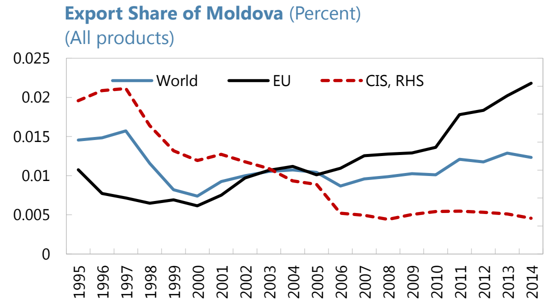
(Scale – high, medium, or low)

Source of Risks	Relative Likelihood[2]	Impact if Realized	Policy Response
1. **Geopolitical fragmentation erodes the globalization process and fosters inefficiency**	**Medium** Russia/Ukraine: the mounting conflict depresses business confidence and heightens risk aversion, amid disturbances in global financial, trade, and commodity markets	**High** A disruption of trade routes and gas supply, a drop in exports, or a decline in remittances could severely impact the Moldovan economy	• Accelerate diversification of external trade products and markets, and energy sources • Let the exchange rate adjust to facilitate absorption of the external shock • Strengthen external buffers • Strengthen monitoring of bank exposures to exchange rate and cross border risks.
2. **Structurally weak growth in the Euro area**	**High** Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and accumulation of financial imbalances	**High** Lower export demand, falling remittances and other financial flows (e.g., trade credits) would induce lower growth, higher budget deficit, exchange rate pressures, and banking sector difficulties	• Let the exchange rate adjust to facilitate absorption of the external shock • Speed up structural reform to increase competitiveness
3. **Deterioration of financial condition in some large banks**	**High** Some of the large banks suffer from governance-related problems	**High** Credit supply would decline, the costs of dealing with bank distress would rise further, and a generalized loss of confidence may emerge	• Liquidate insolvent banks promptly • Enforce shareholder and beneficial ownership transparency and suitability requirements • Step up anti-corruption and AML/CFT efforts

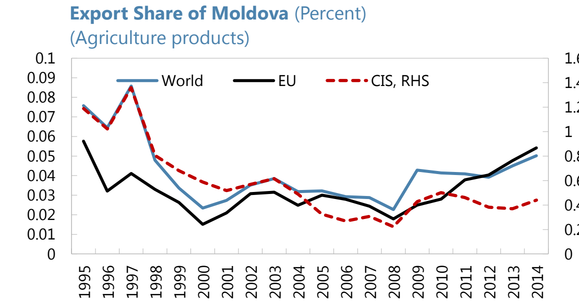
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate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

Annex III. External Stability Assessment

1. **Moldova's share in global trade increased steadily with more diversified export markets.** Between 2005 and 2014, Moldova's share in global trade increased by near 30 percent to 0.013 percent of world trade, as its participation in European markets strengthened. However, its position in Commonwealth of Independent States (CIS) has declined to around 0.1 percent from 0.2 percent of CIS trade. This pattern also holds for agricultural exports.

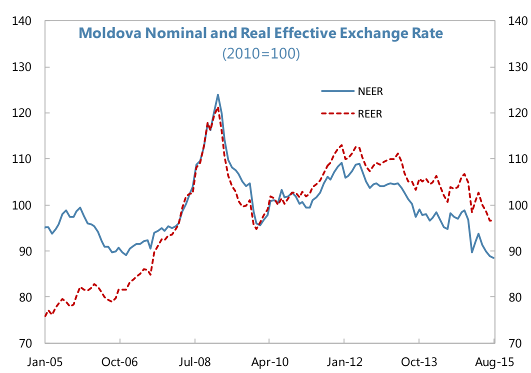


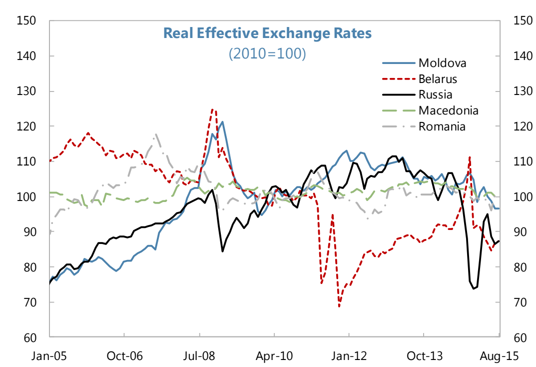
Sources: UNCTAD and IMF staff estimates



Sources: UNCTAD and IMF staff estimates

2. **The real exchange rate has remained broadly stable, but depreciated over the more recent period.** In 2014, weak external demand from CIS countries (especially Russia)—together with capital outflow triggered by worries on banking system instability and policy uncertainty—have weighed on growth and the external accounts. The NEER and REER have depreciated by about 8.7 percent and 7.5 percent since October 2014.





3. **Model-based evidence does not point to significant exchange rate misalignment in 2015.** After the depreciation observed in late 2014 to August 2015, results from applying the EBA-lite methodology suggests that the leu is slightly overvalued (2 percent), as the underlying current account balance (-6.9 percent of GDP) exceeds the norm by a margin of 1.4 percent of GDP. The degree of overvaluation has narrowed relative to last Article IV staff report of June 2014.

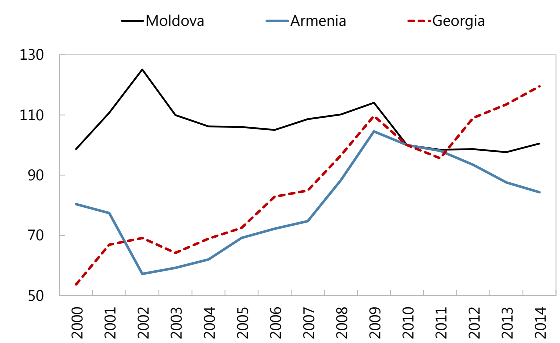
External Sector Position: Estimates of overvaluation of the leu

Current Account Balance (underlying)	-6.9%
Current Account Norm	-5.5%
Current Account Gap	-1.4%
Elasticity	-0.72
REER overvaluation estimates	2.0%

Source: IMF staff estimates

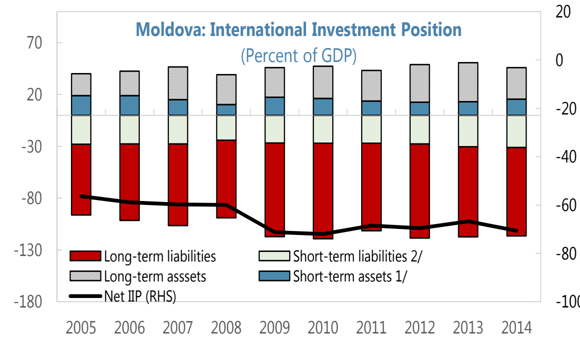
4. Unit labor costs (ULC) adjusted significantly after the 2009 crisis, but have increased more recently as wages rose. ULCs in Moldova declined by 11.9 percent since 2009. However, this trend reversed in 2014, and ULCs rose 2.9 percent.

Unit Labor Costs in Selected Countries, 2000-2014
(Index, 2010=100)



Sources: IMF staff calculations.

Moldova: International Investment Position
(Percent of GDP)



Source: NBM and IMF staff calculations.
1/ Short-term assets include portfolio investment, financial derivatives, trade credits and currency and deposits.
2/ Short-term liabilities include portfolio investment, financial derivatives, trade credits, short-term loans by banks and other sectors, currency and deposits, short-term other liabilities by general government, banks and other sectors.

5. The reserve position is fragile as reserves declined substantially from a position of strength. Moldova's negative Investment International Position (IIP) widened in 2014 to 70.6 percent of GDP. Decrease in long-term assets, especially decline in gross reserves is the major contributor. Gross international reserves declined to USD 2.1 billion at end-2014, falling 20 percent from end-2013 levels, with most of the USD 538 million lost in the last two months of the year. Standard reserve adequacy indicators paint a mixed picture at end-2014—import coverage remains well above the standard 3 month benchmark, as does coverage under the composite measure for flexible exchange rate regimes. However, coverage of short-term debt on remaining maturity has deteriorated substantially, from over 105 percent in 2013 to around 77 percent. Coverage has fallen further in 2015—another USD387 million were lost by the end of September 2015. In terms of liabilities, short-term liabilities accounted for 26.8 percent of total and almost 39 percent of total liabilities consisted of FDI, equivalent to over 45 percent of GDP at end-2014.

6. Looking forward, structural reform aimed at upgrading quality and standards should have important payoffs to exports and growth. In June 2014, Moldova signed an Association Agreement with the EU which includes provisions establishing a Deep and Comprehensive Free Trade Area (DCFTA). The DCFTA envisions an immediate elimination of both sides' export duties and has been under provisional implementation since September 2014.

Significant positive impacts are expected on GDP over the long-run. However, such gains require substantial improvement in quality and standards for Moldovan exports, which will take place only gradually.

Staff assessment

7. Overall external stability is vulnerable to adverse external economic developments and rigorous policies are needed to mitigate the impact of external shocks. The deterioration in macrofinancial stability and negative spillovers from trading partners has weakened external buffers. The main external risks arise from a protracted economic slowdown in key trading partners (mainly Russia), further intensification of geopolitical tensions, limited scope for near-term diversification to new export markets as Russia's restrictions on imports from Moldova persist, and further declines in remittances, given the magnitude of these flows. Strengthening competitiveness would require policies aimed at building policy buffers (e.g. fiscal, structural financial, social) and strengthen Moldova's ability to withstand adverse external shocks. Policies aimed at export diversification, shift towards higher end of supply chain and improvement of investment climate should help to create a conducive environment for fostering growth and competitiveness.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS—INFORMATIONAL ANNEX

December 1, 2015

Prepared By	The European Department (in consultation with other departments and the World Bank)

CONTENTS

FUND RELATIONS

(As of October 31, 2015)

Membership Status: Joined August 12, 1992; Article VIII

General Resources Account:	**SDR million**	**Percent of Quota**
Quota	123.20	100.00
Fund holdings of currency	263.15	213.60
Reserve tranche position	0.01	0.00

SDR Department:	**SDR million**	**Percent of Allocation**
Net cumulative allocation	117.71	100.00
Holdings	3.48	2.96

Outstanding Purchases and Loans:	**SDR million**	**Percent of Quota**
ECF arrangements	200.03	162.36
Extended arrangements	139.95	113.60

Latest Financial Arrangements:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
ECF	1/29/2010	4/30/2013	184.80	170.88
EFF	1/29/2010	4/30/2013	184.80	149.12
ECF[1]	5/5/2006	5/4/2009	110.88	88.00

[1] Formerly PRGF.

Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	4.34	52.54	63.47	62.46	59.03
Charges/Interest	0.39	1.45	1.24	0.98	0.87
Total	4.73	53.99	64.71	63.44	59.90

Safeguards Assessments:

An update safeguards assessment of the National Bank of Moldova (NBM) conducted in the context of the ECF/EFF arrangements approved by the Board on January 29, 2010 was completed on June 3, 2010. The assessment found that the NBM had strengthened its safeguards framework since the May 2006 assessment by implementing the majority of recommendations. However, the update assessment noted the need for independent oversight of the bank and recommended changes to the central bank's law to strengthen the governance framework. While the NBM Law has been amended to address these recommendations, it has yet to establish the newly created Supervisory Council and independent Audit Committee in practice.

Exchange Arrangements:

Moldova has accepted the obligations of Article VIII, Sections 2, 3 and 4, of the Fund's Articles of Agreement. Its exchange system remains free of restrictions on payments and transfers for current international transactions.

Moldova's exchange rate regime is classified as "floating". The NBM intervenes in the domestic foreign exchange interbank market in order to smooth out sharp exchange rate fluctuations of the Moldovan leu against the dollar. At the same time, the NBM interventions are not aimed at changing the trend of the exchange rate determined by the market. The NBM publishes the information on its interventions.

The official exchange rate of the Moldovan leu to the U.S. dollar announced by the NBM is determined as the weighted average of daily noncash market transactions performed on the interbank market. The NBM quotes exchange rates of the leu for other currencies on the basis of the leu-U.S. dollar rate and the cross-rate between the U.S. dollar and these currencies.

Article IV Consultations:

The previous Article IV consultation was concluded on June 23, 2014. The staff report (Country Report No. 14/190) was published.

FSAP Participation:

Moldova received an FSAP mission in May 2004; the FSSA (Country Report No. 05/64) was presented to the Board at the time of the 2004 Article IV discussions. An FSAP update mission visited Moldova in October 2007; the FSSA update (Country Report No. 08/274) was presented to the Board with the 2007 Article IV Consultation report. A second FSAP update mission visited Moldova in March 2014; the FSSA update was presented to the Board with the 2014 Article IV Consultation report. In October 2015, the authorities consented to the publication of the FSSA.

Resident Representative:

Ms. Armine Khachatryan assumed her duties as Resident Representative in August 2013.

Technical Assistance Provided by the Fund, 2011–15:

Department	Subject/Identified Need	Timing
FAD	PFM reforms	January 2011
FAD	Tax compliance strategy	February 2011
FAD	Expenditure rationalization	February 2011
MCM	Forecasting and policy analysis (a series of short-term missions by a TA advisor)	March 2011–ongoing
FAD	Tax policy	April 2011, March 2013
FAD	VAT issues	June 2011, December 2011
MCM	Crisis preparedness	April 2011, May 2012
FAD	Improving the Large Taxpayer Office	September 2011, January 2012,May 2012
LEG	Risk based approach to banking supervision and AML/CFT	September 2011
STA	Improvement of the consumer price index	November 2011, October 2012, November 2013
LEG	Banking law	December 2011
LEG	Legal framework for SOEs	November 2012
FAD	Medium-Term Budget Framework	January 2012
FAD	Taxation of high-wealth and high income individuals. large taxpayer compliance management	January, February, May 2012
STA	Improvement of fiscal data in line with GFSM 2001	March 2012
STA	Resident advisor on capacity building, national accounts, price and external trade statistics in the NBS	April 2012-October 2014
MCM	Analysis of the financial situation of a state-controlled bank	June 2012, January 2013
LEG/MCM	Securities clearance and settlement system	January 2013, September 2013
FAD	Taxation of agriculture	May 2013
MCM	Government bond market	April 2013
FAD	Revenue administration	February 2014
MCM/LEG	Bank resolution / contingency planning	March 2014, December 2014
FAD	Tax administration reform	June 2014
STA	Consumer Price Index	June 2014, October 2015
FAD	Revenue administration	May 2015
MCM	Debt management	May 2015

RELATIONS WITH THE WORLD BANK GROUP

(As of October 23, 2015)

1. Moldova's National Development Strategy (NDS)—Moldova 2020 sets eight strategic priorities. These are justice and fight against corruption; national education system aligned with labor market requirements; pensions; business environment; roads infrastructure; accessible and inexpensive finance; energy efficiency; and agriculture and rural development. The NDS is intended to prioritize state interventions to deliver the overarching goal of bringing about qualitative economic development and poverty reduction. It was adopted by the Parliament as national law. The NDS and its consolidated action plan include some measures to reduce inequality and address key crosscutting themes, such as social inclusion and gender equality, environmental preservation, climate change and disaster events, and reintegration of localities from the left bank of the Nistru River (Transnistria).

2. Aligned with the NDS, the World Bank Group (WBG) Country Partnership Strategy (CPS) for FY14–17, discussed by the Board on September 5, 2013, will provide Moldova with US$570 million over this period (US$450 million on IBRD&IDA [International Bank for Reconstruction and Development & International Development Association, together known as the World Bank or WB] terms, plus US$120 million IFC [International Finance Corporation] commitments). It will support Moldova in reducing poverty and boosting shared prosperity by capturing the full benefits of openness and integration with the European Union and the broader global economy. Three pillars are proposed, which will help Moldova diversify and expand its endowment of institutional, human, and natural capital:

- *Increasing Competitiveness*: continued institutional reforms for a business enabling environment and governance, access to finance, transparency in the financial sector, and targeted activities to help improve companies' competitiveness are needed to reduce barriers and to translate economic openness into concrete benefits of more jobs and higher income.

- *Enhancing Human Capital and Minimizing Social Risks:* the widening gap with EU28 in education and health outcomes needs to be progressively closed. Demographic challenges need to be addressed, and vulnerabilities can be tackled by strengthening social protection systems.

- *Promoting a Green, Clean and Resilient Moldova:* the debilitating effects of climatic events on agriculture and rural livelihoods need to be addressed, natural resource management improved, and energy security and efficiency achieved to ensure sustainable development.

3. The CPS has governance and gender lenses, and a calibrated engagement in localities from Transnistria will be considered in close consultation with the authorities of the Republic of Moldova.

4. This CPS continues to address governance issues at the country, sectorial and operational levels across the strategy. Interventions will be pursued to improve the business enabling environment; enhance public administration reform and quality of public service delivery; and improve public financial management and procurement systems. The CPS will use a governance filter to ensure that governance is systematically tackled in all operations (analytical and advisory activities and lending); it will also support enhanced involvement of Civil Society Organizations through the Global Partnership for Social Accountability to which Moldova has opted in. At the operational level, WBG will ensure the highest fiduciary standards in projects it supports while helping the Government to strengthen country systems. This CPS is informed by a gender assessment, the outcomes of which are discussed at the concept stage of each relevant new operation (Advisory Services and Analytics and lending).

5. A mid-term CPS review is currently conducted. This CPS Performance and Learning Review will aim to confirm, together with country authorities, the proposed strategic pillars and will make any required adjustments to the lending and analytical program and the results framework through the end of FY17.

6. The WB's current portfolio includes eight projects and one budget support operation. Total commitments amount to US$255.3 million. The disbursement ratio for FY15 stands at 26.8 percent. Trust Funds (TFs) provide co-financing to IDA operations, finance carbon operations, and provide other forms of support, including for Advisory Services and Analytics. The size of the active TF portfolio is US$26.3 million.

7. Alongside IDA and IBRD resources, IFC operations in Moldova will continue to focus on investment and advisory activities that enable private sector growth and diversification. IFC's committed portfolio in Moldova stands at US$63.6 million (US$60.6 million outstanding). Portfolio composition is 96 percent loans and 4 percent equity and quasi-equity. There are currently no non-performing loans (NPLs) of a total of 14 projects. IFC is targeting yearly commitments of US$12.5 million, not including mobilization. This level of investment will be maintained over the next several years, seeking to leverage IFC investments with additional mobilization.

8. The net exposure of MIGA in Moldova amounts to US$20.3 million in four projects. All projects support foreign banks' subsidiaries in the country, including micro-finance organizations and leasing operations. MIGA's continuing support to these projects signals MIGA's efforts to underwrite projects in Moldova, encourage inward foreign direct investment, and add to the WBG's strategy of encouraging private sector development in the country.

STATISTICAL ISSUES

(As of November 18, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. Over the last several years, with technical assistance from the Fund the authorities have improved statistics in several areas, including national accounts, fiscal and monetary data, consumer prices, external trade and balance of payments. Technical assistance is ongoing in the area of price and national accounts statistics.
National Accounts: National accounts statistics are prepared by the National Bureau of Statistics (NBS) based on the concepts and methods of the *System of National Accounts 1993 (*1993 *SNA).* Estimates do not include the Transnistria region for which data have not been collected since 1991. GDP is estimated from the production and the expenditure sides, annually and quarterly. GDP volume measures are chain-linked and presented with 2010 as the reference year. The annual data are revised—in two stages—as updated information becomes available. Starting from January 2014, short-term activity indicators are re-classified according to CAEM Rev. 2. Work is on-going to implement the *2008 SNA* and to further improve the compilation of quarterly and annual national accounts.
Price statistics: The NBS publishes monthly CPI and PPI data and began publications of the core CPI from 2010. The weights of the CPI basket are updated on an annual basis to reflect adjustment in consumer expenditures. On-going technical assistance has improved the reliability of the CPI weights and continues to work with the NBS to expand CPI coverage to include owner-occupied housing.
Government finance statistics: Moldova reports annual government finance statistics (GFS) based on *Government Finance Statistics Manual 2001 (GFSM 2001)* methodology for publication in the *Government Finance Statistics Yearbook (GFSY).* The data are on a cash basis and cover above as well as below the line operations and financial balance sheet of the general government sector. With the support of Fund TA, the authorities introduced regular dissemination of monthly *GFSM 2001* based data for the budgetary central government units.
Monetary statistics: Monetary and financial statistics are broadly in line with recommendations of the *Monetary and Financial Statistics Manual* and of a generally good quality. The NBM compiles and submits monetary data using Standardized Report Forms (SRFs). Monetary data are reported by the NBM on a regular basis and are being published in the *International Financial Statistics*. The NBM also report Financial Soundness Indicators (FSIs) on a quarterly basis, which are posted on the FSI webpage.

External sector statistics: The balance of payments statistics have been compiled fully in line to the sixth edition of *Balance of Payments and International Investment Position Manual (BPM6*) starting with data for 2011. Meanwhile international investment position statistics (IIP) as well as balance of payments time series prior to 2011 are on *BPM5* basis.. Besides the balance of payments and IIP statistics, Moldova disseminates other external sector statistics (EES) datasets such as external debt statistics, international reserves statistics, and coordinated direct investment survey. All ESS datasets are compiled and disseminated with prescribed SDDS periodicity and timeliness.	
II. Data Standards and Quality	
Moldova subscribed to the SDDS in May 2006.	A data ROSC report was published in March 2006.

Moldova: Table of Common Indicators Required for Surveillance

(As of November 18, 2015)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items:	
						DataQuality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	11/16/2015	11/16/2015	D/M	D	D/M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/16/2015	11/16/2015	W/M	W	M		
Reserve/Base Money	11/16/2015	11/16/2015	W	W	M	O, LO, O, O	LO, O, O, O, O
Broad Money	11/16/2015	11/16/2015	W	W	M		
Central Bank Balance Sheet	11/16/2015	11/16/2015	W	W	M		
Consolidated Balance Sheet of the Banking System	11/16/2015	11/16/2015	W	W	M		
Interest Rates[2]	11/16/2015	11/16/2015	W	W	W		
Consumer Price Index	October 2015	11/16/2015	M	M	M		
Revenue, Expenditure, Balance and Composition of	September 2015	October 2015	M	M	M	O, LO, LO, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]–	September 2015	October 2015	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	September 2015	October 2015	M	M	M		
External Current Account Balance	Q2 2015	10/22/2015	Q	Q	Q	LO, LO, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	September 2015	October 2015	M	M	M		
GDP/GNP	Q1 2015	06/17/2015	Q	Q	Q	O, LO, LO, O	LO, O, LO, O, O
Gross External Debt	12/31/2014	October 2015	Q	Q	Q		
International Investment Position	12/31/2014	10/22/2015	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, state social security funds, and health insurance funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

[7] Reflects the assessment provided in the data ROSC or the Substantive Update (published 03/2006, and based on the findings of the mission that took place during July 17-19, 2005) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS—DEBT SUSTAINABILITY ANALYSIS

December 1, 2015

Approved By
Mary B. Goodman and James Gordon (IMF), and Ivailo Izvorski (IDA)

Prepared by Staff of the International Monetary Fund and the International Development Association

Based on an assessment of public external debt, Moldova's risk of debt distress remains low.[1 2 3] *Overall public debt dynamics are sustainable but with a significantly higher debt level in the near term. Private external debt is unusually high for a low-income country. In view of the country's vulnerability to exogenous developments and the banking crisis, fiscal discipline is critical to ensure debt sustainability.*

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[1] This full DSA is prepared jointly by IMF and World Bank staff, in consultation with the Moldovan authorities, using the debt sustainability framework for low-income countries approved by the Boards of both institutions, and in accordance with the new staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292).

[2] The inclusion of the overall risk is in line with the staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292). This assessment reflects the high level of external private sector debt.

[3] Moldova's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 3.82 over the last three years (2012-2014), which places the country at the lower-end of the strong policy performance category.

BACKGROUND

1. **Moldova's total external debt is estimated to be about 107 percent of GDP at end-2015, compared to 85½ percent of GDP at end-2014.** Private external debt (as a share of GDP), which accounts for about 70 percent of total external debt, is projected to increase by 12½ percentage points, while public and public-guaranteed (PPG) external debt to GDP is projected to increase by 9 percentage points. PPG external debt is held mainly by multilateral and bilateral donors, and is mostly medium- and long-term.

2. **Total PPG debt-to-GDP is estimated to increase by 14½ percentage points to 52 percent by end-2015.**[4] While more than half of PPG debt is external, the share of PPG domestic debt has increased rapidly in the past two years due to the issuance of a state guarantee to the NBM to provide liquidity to the banking sector. As the guarantees become callable, the PPG domestic debt structure is expected to change significantly due to long-term government securities to be issued to the NBM, which will make up about 67 percent of PPG domestic debt. The rest of PPG domestic debt is mainly short-term and held by the banking system.

3. **Private sector debt is high compared with other low-income countries.**[5] The stock of external private sector debt has decreased in 2014 after a decade of accumulation, reaching USD 4.8 billion at end–2014, mostly due to a decrease in long-term bank loans. Because of concerns over the problem banks, the banking system, as a whole, faced difficulties in rolling over debt. As a result, the banks' share of total private external debt dropped to 8 percent by end-2014 compared with 9½ percent by end-2013. The share of medium- and long-term debt in total external private debt was about 53 percent, at end-2014. The majority of non-bank debt is short-term, and consists of trade credits, arrears and other debt liabilities, mostly for the import of natural resources.[6] Similar to other Central and Eastern European (CEE) countries, private borrowing in Moldova stems mainly from foreign-owned companies borrowing from their parent companies abroad.

4. **Moldova has recently become a strong policy performer for the purpose of determining the indicative debt burden thresholds under the Debt Sustainability Framework (DSF).** Moldova's rating

[4] PPG debt covers gross debt of the general government, while debt of state-owned enterprises is not included unless it is explicitly guaranteed by the government. In line with the DSA guidelines, public debt includes liabilities towards the IMF. Small differences with the macro-framework can be mostly explained by the fact that the DSA debt does not include arrears. In addition, small differences in the primary surplus arise because, in the DSA, it is calculated as the overall balance net of interest payments. On the other hand, in the macro-framework, it is calculated as the overall balance net of interest payments and earnings.

[5] By end-2014, the average private external debt amounted around 30 percent of GDP in twelve PRGT eligible countries that, like Moldova, currently meet the income or market access criteria for graduation. The private external debt of Moldova is substantially higher – by end-2014, it stood at 70 percent of GDP, only below that of Mongolia (133 percent) and Grenada (78 percent).

[6] Arrears (mainly in the gas sector) increased from USD 136.8 million in 2013 to around USD 172.3 in 2014. Other debt liabilities (mainly from other energy sectors) increased from USD 537.7 million in 2013 to USD 653.7 million in 2014.

on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 3.82 (on a scale of 1 to 6) over the last three years (2012–2014), which places the country at the lower-end of the strong policy performance category. The corresponding benchmark levels associated with heightened public debt vulnerabilities are presented in Table 1.[7] [8]

Table 1. Debt Thresholds for Strong Policy Performers under the Debt Sustainability Framework

PPG External Debt Thresholds

PV of PPG external debt, in percent of		PPG External debt service, in percent of	
GDP + remittances	45	Exports + remittances	20
Export + remittances	160	Revenue	22
Revenue + remittances	300		
Public Debt Benchmark			
PV of total public debt, in percent of GDP	74		

Source: Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for low-income countries (SM/13/292).

UNDERLYING ASSUMPTIONS

5. **The macroeconomic outlook has been revised to reflect changes in near- and medium-term projections compared to the previous DSA assessment.** In 2014, the Moldovan economy grew by 4.6 percent, driven in large part by a robust performance in agricultural production. However, year-on-year exports started declining in the third quarter of 2014 because of weaker economic activity in key trading partners and the trade restriction imposed by Russia.[9] In 2015, growth is projected to contract by 1.8 percent, mainly reflecting these on-going negative external factors together with a sharp decline in remittances, and tight domestic and external financing conditions. Despite the anticipated slowdown in growth, headline inflation is projected to increase to 9.7 percent, significantly higher than that in the previous DSA, due to larger than expected currency depreciation and excess liquidity in the banking sector. The current account deficit is expected to improve in 2015, mainly explained by a sharp reduction in imports due to lower energy prices. However, capital flows recorded in the capital and financial accounts are expected to recover, but remain substantially lower than the pre-2014 level because of tightening external financing conditions. Therefore, the reserve position in 2015 is expected to deteriorate further to finance the current account deficit. The fiscal position in 2015 is projected to be weak as banking system

[7] See the staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292).

[8] Since Moldova's CPIA score is at the lower end of the strong policy performers, any moderate deterioration in macroeconomic management and institutions could push the country into a lower category (e.g. when the next CPIA updates are published in July 2016). Such a re-classification would reduce the debt threshold levels and may affect the assessment of debt sustainability. For the medium policy performers, the PPG external debt threshold is 36 percent and the public debt benchmark is 56 percent.

[9] For more details on trade restrictions, see "Republic of Moldova: 2014 Second PPM Monitoring Discussions – Staff Report", IMF Country Report No. 14/346, Annex I.

risks have materialized, and tax revenues have slowed with economic activity. Over the medium and long term, main macroeconomic projections improve gradually and continuously, similar to what have been previously projected.

Table 2. Moldova: Evolution of Selected Macroeconomic Indicators, 2014–2019

(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019
Real GDP growth (Percent)						
Previous DSA	2.2	3.5	4	4	4	4
Current DSA	4.6	-1.8	1.5	3.5	3.9	4.3
Nominal GDP (Billions of U.S. dollars)						
Previous DSA	7.6	8.1	8.7	9.2	9.8	10.4
Current DSA	8	6.3	6.3	6.7	7.1	7.6
Overall fiscal balance						
Previous DSA	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
Current DSA	-1.7	-3.4	-3.2	-2.6	-2	-1.7
Current account balance						
Previous DSA	-7.4	-8.2	-8.1	-8	-7.9	-7.7
Current DSA	-7.1	-6.9	-6.8	-6	-5.8	-5.4

Source: Staff estimates and projections.

Note: For the previous DSA, see IMF Country Report No. 14/190

Box 1. Macroeconomic Assumptions behind the DSA

Real GDP is projected to decline by 1.8 percent in 2015, due to weaker economic activity in Russia and Ukraine, a sharp decline in remittances (associated with the recession in Russia), and slow credit growth to the private sector. Over the medium term, FDI is expected to recover following the signing of the DCFTA with the EU, as well as advances in structural reforms will help sustain the economy's potential growth rate at around 4-4½ percent.

Inflation is expected increase to 9.7 percent in 2015, driven by a currency depreciation and large excess liquidity in the banking sector. Weakening currency and increases in utility tariffs are expected to keep inflation elevated in 2016. Over the medium term, headline inflation is expected to be around 5 percent, in line with the NBM's target.

Exports of goods and services (in US dollars) are expected to decline by 16.7 percent in 2015, mainly driven by declining unit-value prices of exports, in particular of agricultural products. However, exports of goods and services, as a ratio of GDP, are projected to reach 44 percent in 2015, compared to 41.6 percent in 2014. This expected increase in exports, as a share of GDP, is mainly due to the recent depreciation of the leu. Over the medium and long term, exports are supported by structural reforms related to the business environment improvement, improvement in quality and standards of agricultural exports (with supports from other international financial institutions), and cross border trade liberalization to European markets. As a result, exports as a ratio of GDP are projected to reach 47 and 48.5 percent in 2020 and 2035, respectively.

Imports of goods and services (in US dollars) are projected to contract by 23.3 percent in 2015 due to a large decline in global commodity prices and moderate domestic demand (arising from the large decline in remittances growth). Imports, as a ratio of GDP, are projected to decline from 78.5 percent in 2014 to 76.6 percent in 2015, and recover to 79.5 percent in the medium term. With favorable external adjustments, imports of goods and services, as a ratio of GDP, are projected to reach 80 percent in 2035.

Remittances are expected to decline to 19.9 percent of GDP in 2015, mainly due to the recession in Russia and the depreciation of the Ruble. In the medium term, remittances are expected to recover to 22.5 percent of GDP, owing to the recovery in the remittance-sourcing countries. In the long term, as the economy develops, the number of migrants is expected to decline due to better domestic employment opportunities, and migrants who remain abroad would lose ties with the home country. As a result, remittances as a ratio of GDP are projected to gradually decline to 21.5 percent by end-2035.

The current account deficit is projected to narrow in the medium term (5.3 percent of GDP in 2020), following the projected improvement from 6.9 percent in 2015. This reflects a recovery in exports and curbed import demand as discussed above. The current account deficit is expected to remain stable at about 5.6 percent of GDP in 2035. It will be financed by FDI, which is expected to remain at about 3.1 percent of GDP in the long run. The reserve level, as a share of GDP, is projected to decline to 21.8 percent in 2020 and stabilize at 22.5 percent of GDP by end-2035.

The overall budget deficit is projected to increase from 1.7 percent of GDP in 2014 to 3.4 percent in 2015 (or 15.1 percent in 2015, when the costs of the banking sector resolution are included), then decline to 2 percent in 2018 and 1½ percent by 2020, reflecting the authorities' strong commitments to ensure fiscal sustainability as specified under the Law on Public Finance and Fiscal Responsibility (FRL). The increased budget deficit in 2015 is due to revenue deterioration due to a weak external outlook, the full-year effect of selective spending from pre-election pressure during 2014. Over the long run, the primary balance is assumed to be around -0.8 percent of GDP.

Box 1. Macroeconomic Assumptions behind the DSA (concluded)

The fiscal cost of banking sector resolution is incorporated into the analysis of debt sustainability. The baseline scenario assumes the issuance of 14 billion leu of securities by end-2015 with an effective annual interest rate of 5 percent, which is estimated to be sufficient to adequately compensate the NBM for the cost of withdrawing excess liquidity while containing, to some extent, the fiscal implications of higher debt service. Half of the securities are assumed to have a maturity of 10 years, while the other half have a 30-year maturity, both with a 5-year grace period for repayments of principal. These assumptions imply the interest payments of around 0.4 to 0.5 percent of GDP over the medium term.

Financing assumptions reflect a shift away from concessional financing. Grant-equivalent financing is projected to increase slightly from 2.9 percent of GDP in 2015 to 3.1 percent in 2016, before declining to 1.8 percent in 2020, and 1.3 percent over the long run. The long-run trend reflects assumptions of declining concessional lending and increasing in commercial borrowing (which has a negative weight on the calculation of the grant element of new external borrowing that is shown in Figure 1A), while maintaining the total new external borrowing of 2½ percent of GDP. Correspondingly, the grant element of new borrowing increases from 29.7 percent in 2015 to 31.5 percent in 2020, and is expected to gradually decline to 18.5 percent in the long run.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

6. **All external public debt ratios remain well below the indicative thresholds under the baseline and stress tests scenarios.**[10] Under the baseline scenario, the PV of debt-to-GDP and remittances would increase significantly from 17½ percent in 2014 to 24½ percent in 2015, and would gradually decline to around 20 percent in the medium term.[11] The increase in the near term reflects a currency depreciation as well as an increase in multilateral borrowing. In the long term, the PV of debt-to-GDP and remittances would improve continuously to around 18 and 13½ percent in 2025 and 2035, respectively. Under the alternative scenario in which exports grow at their historical average minus one standard deviation in 2016-17, the PV of debt-to-GDP and remittances would peak at 32½ percent in 2017, before declining to 22¾ and 13¾ percent in 2025 and 2035, respectively. A 30-percent real depreciation in 2016 would result in a similar increase in the PV of debt-to-GDP and remittances in the medium term. Meanwhile, if the key variables remained at their historical averages, the PV of debt to GDP and remittances would continuously increase to around 31 percent in the long run. The PV of debt-to-exports and remittances as well as to revenue would also increase relatively more under the alternative and bound test scenarios, but none of them breach the threshold. This result is an indication of the significant fiscal and external adjustments proposed in the medium term. At the same time, it underscores the need for reforms.

7. **While the external risk rating is determined by the PPG external debt, large private external debt poses additional risks.** Private external debt accounted for around 72 percent of the total external debt in 2014 and it is expected to remain at around 68 percent in the medium term (Text Table 3). Since short-term debt makes up almost half of private external debt, it might be vulnerable to roll-over risks. In addition, more than 85 percent of medium- and long-term private external debt is owed by the non-bank private sector, which poses additional risks to official foreign reserves.

8. **Furthermore, while exports, remittances, and fiscal revenues are projected to be adequate for the PPG external debt service, liquidity risks remain.** Under the baseline scenario, the PV of PPG external debt service to exports and remittances is expected to increase to 2½ percent in 2015 and peak at 4½ percent in 2020 before declining to around 3 percent by end-2035. Similarly, the PV of PPG external debt service to revenues would peak in 2020 and then gradually decline until the end of the projection period. None of the debt service indicators breach the debt service threshold, but some liquidity pressures could emerge. The decline in remittances reflects a downside risk to the external DSA due to the recession in Russia and the depreciation of the Ruble. After improving in 2012 and 2013, the current account

[10] Remittances in Moldova are substantial, with the three-year (2012-2014) averages of 21.7 percent of GDP and 46.4 percent of exports of goods and services. Following the staff guidance note on the application of the joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (SM/13/292), the baseline scenario incorporates remittances and uses the adjusted PPG external debt thresholds as presented in Text Table 1.

[11] In Moldova, remittances are classified as either workers' remittances or compensation of employees. Both categories are included in the DSA (under "income" and "current transfers").

deteriorated again, which interrupted the reserves build-up of NBM, impairing the economy's resilience to adverse exogenous shocks.

Table 3. Moldova: Breakdown of External Debt, 2012–20

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

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Proj.			
Total External Debt	6,007	6,632	6,604	6,440	6,718	7,034	7,262	7,423	7,585
Total PPG	1,756	1,769	1,820	1,889	2,097	2,311	2,397	2,417	2,419
Multilateral	1,522	1,552	1,591	1,644	1,866	2,095	2,199	2,244	2,277
World Bank	618	605	625	638	717	824	876	924	964
IMF	794	772	703	636	625	597	570	489	414
EC, EIB, CEDB	88	115	161	246	352	453	529	605	669
EBRD	23	32	57	67	109	153	155	155	157
IFAD	54	64	67	71	72	73	74	75	76
Bilateral	201	152	130	122	114	104	91	72	51
Paris Club	172	141	121	115	108	101	90	77	62
Paris Club: ODA	48	42	40	37	35	32	28	24	20
Paris Club: non-ODA	116	98	81	78	74	69	62	53	42
Other Official Bilateral	28	11	9	7	5	3	1	-5	-11
Commercial	19	17	14	13	13	13	13	13	13
Publicly guarenteed assumed debt/private del	15	49	85	110	104	98	94	87	78
Total Private	4,251	4,862	4,784	4,552	4,621	4,723	4,865	5,006	5,166
Loans	2,473	2,752	2,612	2,502	2,530	2,552	2,582	2,615	2,649
Short terms	49	95	61	39	43	46	49	53	57
Banks	19	43	41	30	33	35	38	41	44
Other private sectors	31	53	20	9	10	10	11	12	13
Medium and Long terms	2,423	2,657	2,551	2,463	2,487	2,506	2,533	2,562	2,592
Banks	402	423	343	381	385	388	392	396	401
Other private sectors	2,022	2,234	2,208	2,082	2,102	2,118	2,141	2,166	2,191
Other short term	1,778	2,110	2,172	2,049	2,091	2,172	2,283	2,391	2,517
Currency and deposits	145	371	234	75	75	80	86	92	96
Trade credits	988	1,050	1,071	1,103	1,140	1,212	1,313	1,410	1,528
Other debt liabilities	645	689	867	871	876	880	884	889	893

Source: Country authorities; and staff estimates and projections

B. Public Sector Debt Sustainability Analysis

9. Under the baseline scenario, the PPG debt-to-GDP ratio is projected to increase significantly in 2015 and gradually decline over the medium and long term, reflecting sustainable public debt dynamics. Total nominal PPG debt-to-GDP ratio would increase from 37½ percent in 2014 to about 52 percent in 2015 (or 46 percent in PV terms). The increase in the domestic PPG debt-to-GDP ratio is mainly explained by the costs of the banking sector resolution, while the increase in the external PPG debt-to-GDP ratio is driven by the currency depreciation.[12] With the macroeconomic assumptions outlined above, the recommended primary budget deficit path is projected to be below the level that would stabilize the debt-to-GDP ratio. As a result, Moldova's total PPG debt is expected to gradually decline from its peak in 2015 to 40 percent in 2020 and 22½ percent by end-2035. Other sustainability indicators confirm a similar long-term trend under the baseline scenario. PV of debt-to-GDP is projected to deteriorate from 32½ percent in 2014 to 45¾ percent in 2015, and then gradually improve to 34½ percent and 18¾ percent in 2020 and 2035 respectively. These PV of debt indicators are below the benchmark level of 74 percent associated with heightened public debt vulnerabilities for the strong policy performance category. Similarly, the PV of debt-to-revenue and grants ratio is projected to initially increase to 131¼ percent in 2015, and decline continuously to 100½ and 54½ percent by 2020 and end-2035, respectively.

10. **While the inclusion of domestic debt does not alter the assessment of Moldova's overall risk of debt distress, it emphasizes the importance of prudent fiscal and borrowing policies for the preservation of the low risk rating.** Under all standard alternative scenarios presented in the DSA, the PV of public debt-to-GDP is projected to be well below the benchmark level of 74 percent. However, some alternative scenarios would raise the public debt level faster than others. For example, a 30-percent real depreciation in 2016 would have the strongest impact in the short run with the PV of debt-to-GDP ratio being above 50 percent in 2016–17. Similarly, a 10-percent of GDP increase in other debt creating flows in 2016 would cause the PV of debt-to-GDP to peak at 51 percent in that year. Such a shock is of a similar order of magnitude as what may arise from the combination of additional contingent liabilities needed from the rest of the banking system and from the accumulated energy tariff debt.

C. The Authorities' View

11. **The authorities concurred with the staff assessment, and noted the importance of fiscal sustainability.** The authorities acknowledged that maintaining prudent fiscal policies over the medium term would help protect against potential fiscal risks and liabilities, and hence would strengthen debt sustainability. However, they also stressed the need for flexibility to be able to finance capital investment in particular when projects are financed by concessional lending. They emphasized that these projects are essential to making progress in poverty reduction, filling infrastructure gaps, and institution strengthening.

CONCLUSION

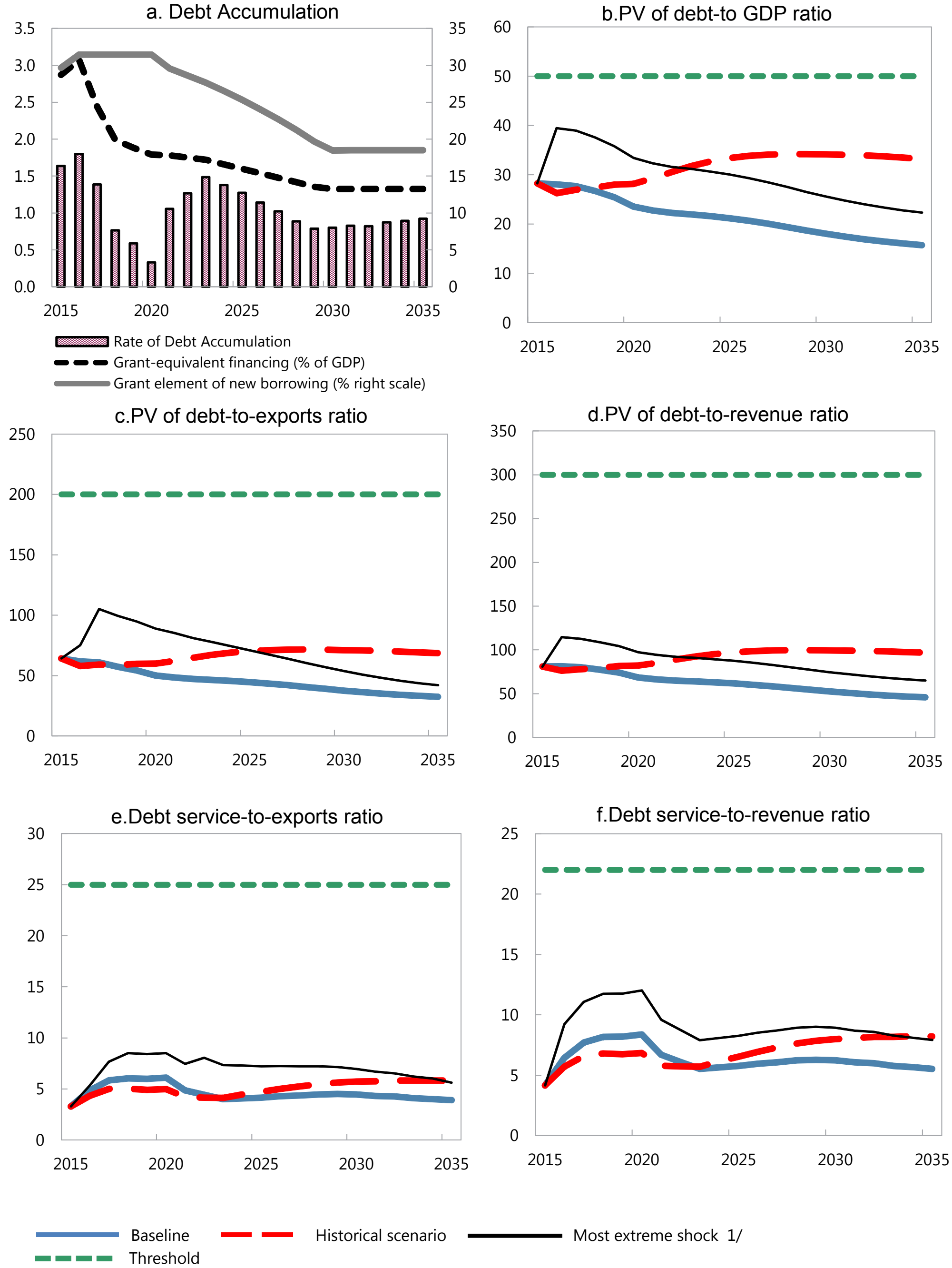
12. **The DSA indicates that Moldova's risk of debt distress remains low, in line with the 2014 assessment.** All external indicators for public debt remain well below the debt thresholds under the baseline, standard bound tests, and alternative scenarios. However, significant private external debt poses roll-over risks to debt sustainability. Likewise, while being more sensitive to exchange rate depreciation and

[12] The total increase in the domestic PPG debt arising from the banking sector resolution is expected to be around 14 million leu or 11¾ percent of GDP. About 45 percent of this amount was issued as a state guarantee to the NBM in 2014, while the remainder was issued in 2015 (see "Other identified debt-creating flows" in Table 2A).

a sudden increase in other debt creating flows, Moldova's overall public debt dynamics are projected to remain on a sustainable path under the baseline scenario and alterative scenarios.

13. Pursuing prudent fiscal policy and advancing structural reforms remain necessary to ensure debt sustainability. Due to the country's sensitivity to exogenous developments and the banking crisis, debt sustainability critically depends on sound macroeconomic management and continuing progress on institutional and structural issues that would help unlock the economy's growth potential and reduce its vulnerability to shocks. Furthermore, the limited development of the domestic debt market poses financing risks, especially considering the country's development needs and significant dependence on foreign assistance in the form of grants and concessional loans. Efforts to lengthen the average maturity of domestic debt and deepen the secondary market would help reduce the PPG domestic debt roll-over and interest rate risks.

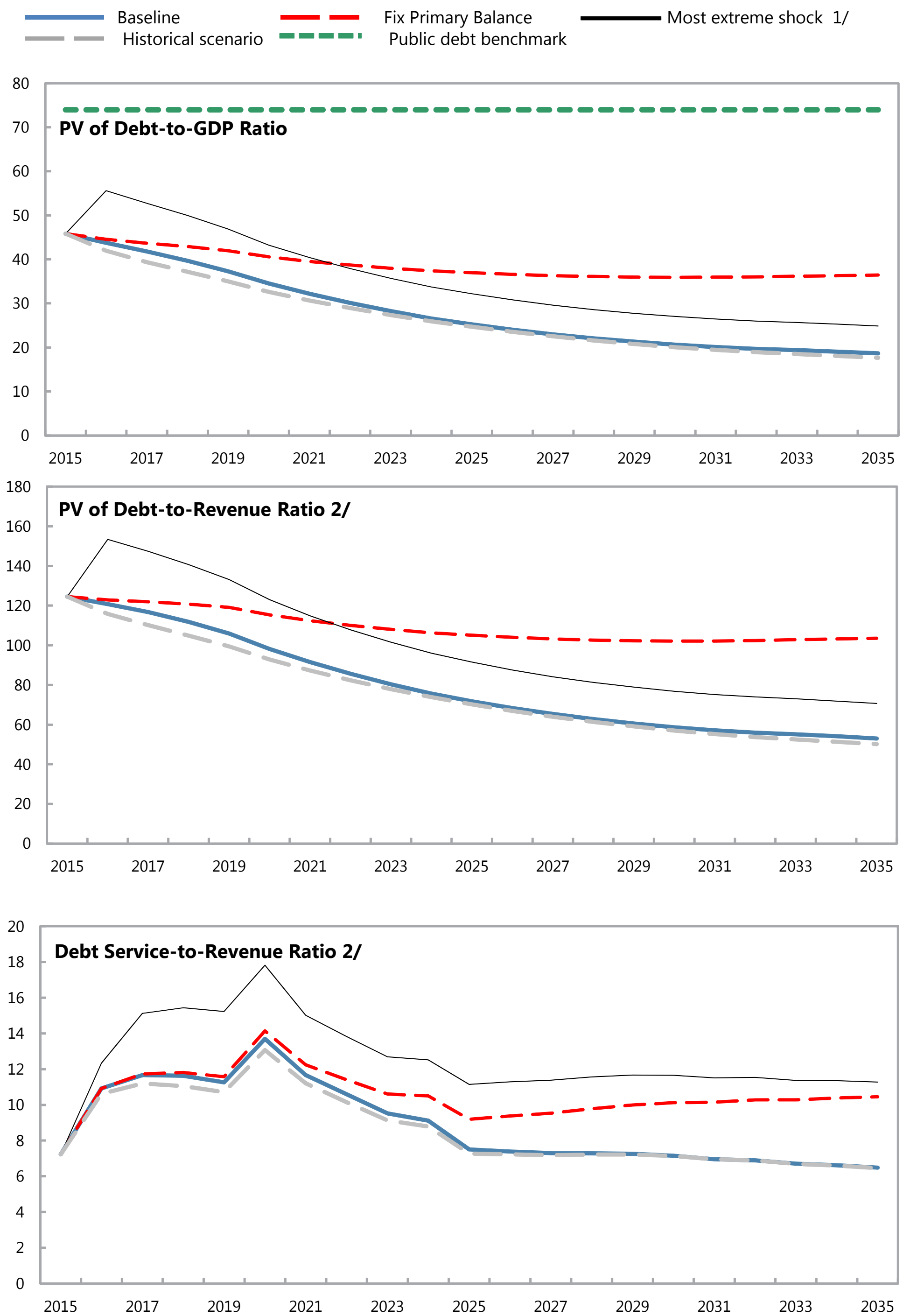
Figure 1. Moldova: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Moldova: Indicators of Public and Publicly Guaranteed Debt Under Alternatives Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 1A. Moldova: External Debt Sustainability Framework, Baseline Scenario, 2012–2035 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**82.4**	**83.9**	**85.5**			**106.9**	**107.8**	**104.6**	**101.2**	**96.9**	**91.5**		**80.3**	**68.0**	
of which: public and publicly guaranteed (PPG)	24.0	23.0	25.4			34.3	34.0	33.7	32.6	31.2	29.0		26.1	19.5	
Change in external debt	4.8	1.5	1.6			21.4	0.8	-3.2	-3.4	-4.3	-5.3		-1.9	-0.8	
Identified net debt-creating flows	3.0	-4.2	3.3			5.5	2.0	-0.8	-1.2	-1.6	-1.6		-1.3	-0.7	
Non-interest current account deficit	**7.4**	**5.0**	**4.4**	**9.3**	**4.1**	**5.5**	**5.2**	**4.2**	**3.7**	**3.2**	**3.0**		**3.3**	**4.7**	3.7
Deficit in balance of goods and services	40.0	37.2	37.0			32.6	34.0	33.4	33.2	32.8	32.4		32.1	31.5	
Exports	43.0	43.3	41.6			44.0	45.4	45.5	46.7	46.9	47.0		47.5	48.5	
Imports	83.0	80.4	78.5			76.6	79.4	78.9	79.9	79.7	79.5		79.6	80.0	
Net current transfers (negative = inflow)	-20.6	-20.7	-19.9	-21.8	2.8	-18.6	-18.4	-18.7	-18.9	-18.9	-18.7		-18.4	-17.9	-18.2
of which: official	-1.8	-1.9	-2.6			-2.7	-1.5	-1.3	-1.2	-1.2	-1.1		-1.1	-1.1	
Other current account flows (negative = net inflow)	-12.1	-11.5	-12.7			-8.5	-10.4	-10.5	-10.6	-10.8	-10.7		-10.4	-8.9	
Net FDI (negative = inflow)	**-2.4**	**-2.6**	**-2.1**	**-5.6**	**3.7**	**-3.4**	**-3.2**	**-3.2**	**-3.1**	**-3.0**	**-2.9**		**-2.9**	**-3.1**	-2.9
Endogenous debt dynamics 2/	**-1.9**	**-6.5**	**1.0**			**3.4**	**0.0**	**-1.7**	**-1.8**	**-1.8**	**-1.7**		**-1.7**	**-2.3**	
Contribution from nominal interest rate	0.9	0.7	0.8			1.4	1.6	1.8	2.1	2.3	2.3		2.1	0.8	
Contribution from real GDP growth	0.5	-7.1	-3.9			2.0	-1.6	-3.5	-3.8	-4.1	-4.0		-3.8	-3.2	
Contribution from price and exchange rate changes	-3.4	-0.2	4.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.8**	**5.7**	**-1.7**			**15.9**	**-1.2**	**-2.4**	**-2.2**	**-2.7**	**-3.7**		**-0.6**	**-0.1**	
of which: exceptional financing	-2.5	-1.5	-4.8			-1.3	-1.4	-0.9	-0.7	-0.7	-0.7		-0.7	-0.6	
PV of external debt 4/	...	...	80.8			100.9	101.8	98.6	95.3	91.1	86.1		75.4	64.2	
In percent of exports	...	...	194.2			229.3	224.3	216.5	204.2	194.2	182.9		158.8	132.4	
PV of PPG external debt	**...**	**...**	**20.7**			**28.3**	**28.0**	**27.7**	**26.7**	**25.5**	**23.6**		**21.2**	**15.7**	
In percent of exports	**...**	**...**	**49.8**			**64.2**	**61.8**	**60.9**	**57.3**	**54.3**	**50.1**		**44.6**	**32.4**	
In percent of government revenues	**...**	**...**	**60.3**			**81.0**	**81.4**	**80.1**	**77.4**	**74.2**	**68.6**		**61.8**	**45.8**	
Debt service-to-exports ratio (in percent)	**14.3**	**16.4**	**16.0**			**24.5**	**24.2**	**21.0**	**25.7**	**26.1**	**25.3**		**19.0**	**8.8**	
PPG debt service-to-exports ratio (in percent)	**2.2**	**2.3**	**2.1**			**3.3**	**4.9**	**5.9**	**6.0**	**6.0**	**6.1**		**4.2**	**3.9**	
PPG debt service-to-revenue ratio (in percent)	**2.6**	**2.9**	**2.5**			**4.2**	**6.4**	**7.7**	**8.2**	**8.2**	**8.4**		**5.8**	**5.5**	
Total gross financing need (Millions of U.S. dollars)	2584.2	2584.0	2916.4			3041.7	2902.3	2835.7	3110.4	3277.5	3435.3		4681.1	10446.4	
Non-interest current account deficit that stabilizes debt ratio	2.6	3.5	2.7			-15.9	4.4	7.3	7.1	7.5	8.3		5.2	5.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-0.7	9.4	4.6	4.4	4.7	-1.8	1.5	3.5	3.9	4.3	4.5	2.7	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	4.6	0.2	-4.7	7.7	11.4	-19.9	-1.4	2.7	2.5	3.0	3.8	-1.6	2.9	2.9	2.9
Effective interest rate (percent) 5/	1.2	0.9	0.9	1.4	0.4	1.3	1.5	1.8	2.1	2.4	2.6	2.0	2.8	1.3	2.4
Growth of exports of G&S (US dollar terms, in percent)	-0.3	10.3	-4.1	10.8	17.4	-16.7	3.1	6.7	9.2	8.0	8.7	3.2	8.3	8.3	8.3
Growth of imports of G&S (US dollar terms, in percent)	1.2	6.2	-2.6	13.5	20.9	-23.3	3.7	5.7	7.9	7.1	8.1	1.5	8.1	8.1	8.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	29.7	31.5	31.4	31.5	31.5	31.5	31.2	25.3	18.5	22.4
Government revenues (excluding grants, in percent of GDP)	36.1	34.7	34.3			34.9	34.5	34.6	34.6	34.3	34.3		34.3	34.3	34.3
Aid flows (in Millions of US dollars) 7/	206.5	196.5	347.7			118.5	114.2	80.6	67.5	68.8	71.1		104.9	228.3	
of which: Grants	130.6	164.7	294.5			118.5	114.2	80.6	67.5	68.8	71.1		104.9	228.3	
of which: Concessional loans	75.9	31.8	53.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.9	3.1	2.4	2.0	1.9	1.8		1.6	1.3	1.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			55.3	53.0	47.7	46.8	46.9	46.9		42.3	39.3	41.1
Memorandum items:															
Nominal GDP (Millions of US dollars)	7283.4	7984.9	7962.4			6264.9	6267.7	6664.9	7098.1	7622.9	8264.7		12192.0	26537.5	
Nominal dollar GDP growth	3.8	9.6	-0.3			-21.3	0.0	6.3	6.5	7.4	8.4	1.2	8.1	8.1	8.1
PV of PPG external debt (in Millions of US dollars)			1480.6			1610.8	1723.4	1810.1	1860.9	1902.6	1927.8		2559.0	4132.8	
(PVt-PVt-1)/GDPt-1 (in percent)						1.6	1.8	1.4	0.8	0.6	0.3	1.1	1.3	0.9	1.0
Gross workers' remittances (Millions of US dollars)	1367.5	1499.7	1377.9			992.8	1058.7	1156.2	1255.9	1348.2	1450.7		2106.2	4439.8	
PV of PPG external debt (in percent of GDP + remittances)	...	...	17.6			24.4	24.0	23.6	22.7	21.6	20.0		18.1	13.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	35.1			47.2	45.0	44.1	41.5	39.4	36.5		32.7	24.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.5			2.4	3.6	4.2	4.4	4.4	4.4		3.1	2.9	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1B. Moldova: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to-GDP+remittances ratio								
Baseline	24	24	24	23	22	20	**18**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	24	23	24	24	25	25	**30**	31
A2. New public sector loans on less favorable terms in 2015-2035 2	24	24	24	24	23	22	**23**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	24	24	24	23	22	21	**19**	14
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	24	26	32	31	30	28	**23**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	24	24	25	24	23	21	**19**	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	24	24	24	23	22	21	**18**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	24	20	20	20	19	17	**16**	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	24	32	31	30	29	27	**24**	18
PV of debt-to-exports+remittances ratio								
Baseline	47	45	44	42	39	36	**33**	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	47	43	45	45	46	47	**58**	60
A2. New public sector loans on less favorable terms in 2015-2035 2	47	45	46	44	43	41	**41**	40
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	47	44	43	41	39	36	**32**	24
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	47	53	71	67	64	61	**49**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	47	44	43	41	39	36	**32**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	47	45	45	43	40	38	**33**	24
B5. Combination of B1-B4 using one-half standard deviation shocks	47	39	39	38	36	34	**31**	25
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	47	44	43	41	39	36	**32**	24
PV of debt-to-revenue ratio								
Baseline	81	81	80	77	74	69	**62**	46
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	81	76	78	79	82	82	**97**	97
A2. New public sector loans on less favorable terms in 2015-2035 2	81	82	83	82	80	77	**78**	75
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	81	81	83	80	77	71	**64**	48
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	81	90	110	107	103	97	**78**	47
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	81	82	86	83	79	74	**66**	49
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	81	81	82	79	76	71	**63**	45
B5. Combination of B1-B4 using one-half standard deviation shocks	81	70	69	67	64	59	**56**	44
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	81	115	113	109	104	97	**88**	65

Table 1B. Moldova: Sensitivity Analysis is for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (Concluded)

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
Debt service-to-exports+remittances ratio								
Baseline	2	4	4	4	4	4	**3**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	2	3	4	4	4	4	**4**	5
A2. New public sector loans on less favorable terms in 2015-2035 2	2	4	4	5	5	5	**4**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	2	4	4	4	4	4	**3**	3
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	2	4	5	6	6	6	**5**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	2	4	4	4	4	4	**3**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	2	4	4	4	4	5	**3**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	4	4	4	5	**3**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	2	4	4	4	4	4	**3**	3
Debt service-to-revenue ratio								
Baseline	4	6	8	8	8	8	**6**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	4	6	7	7	7	7	**7**	8
A2. New public sector loans on less favorable terms in 2015-2035 2	4	6	8	8	9	9	**7**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	4	7	8	9	9	9	**6**	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	4	6	8	9	9	9	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	4	7	8	9	9	9	**6**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	4	6	8	8	8	8	**6**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	4	6	7	8	8	8	**5**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	4	9	11	12	12	12	**8**	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	20	20	20	20	20	20	**20**	20

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2A. Moldova: Public Sector Debt Sustainability Framework, Baseline Scenario. 2012–2035

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	31.1	29.7	37.5			51.9	49.8	47.8	45.6	43.1	40.0		30.1	22.4	
of which: foreign-currency denominated	24.0	23.0	25.4			34.3	34.0	33.7	32.6	31.2	29.0		26.1	19.5	
Change in public sector debt	2.1	-1.4	7.8			14.4	-2.1	-2.0	-2.2	-2.6	-3.0		-1.5	-0.4	
Identified debt-creating flows	0.4	-0.6	8.1			15.4	-1.3	-1.0	-1.3	-1.8	-2.3		-1.0	-0.2	
Primary deficit	1.4	1.2	1.2	0.7	2.1	2.5	1.5	1.1	0.7	0.6	0.4	1.1	0.8	0.9	0.8
Revenue and grants	37.9	36.7	38.0			36.8	36.3	35.8	35.5	35.2	35.2		35.2	35.2	
of which: grants	1.8	2.1	3.7			1.9	1.8	1.2	1.0	0.9	0.9		0.9	0.9	
Primary (noninterest) expenditure	39.3	38.0	39.2			39.3	37.8	36.9	36.3	35.8	35.6		36.0	36.1	
Automatic debt dynamics	-0.6	-1.5	1.6			6.7	-2.6	-1.9	-1.9	-2.2	-2.7		-1.7	-1.1	
Contribution from interest rate/growth differential	0.1	-2.7	-1.5			0.3	-1.1	-1.7	-1.8	-2.0	-1.9		-1.5	-0.9	
of which: contribution from average real interest rate	-0.1	-0.1	-0.2			-0.4	-0.4	0.0	0.0	-0.1	0.0		0.0	0.1	
of which: contribution from real GDP growth	0.2	-2.7	-1.3			0.7	-0.8	-1.7	-1.8	-1.9	-1.9		-1.5	-1.1	
Contribution from real exchange rate depreciation	-0.7	1.2	3.1			6.4	-1.5	-0.3	-0.1	-0.2	-0.8		...	...	
Other identified debt-creating flows	-0.3	-0.3	5.3			6.2	-0.2	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
Privatization receipts (negative)	-0.3	-0.3	-0.4			-0.2	-0.2	-0.1	-0.1	-0.1	-0.1		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	5.6			6.4	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.6	-0.7	-0.3			-1.0	-0.8	-1.0	-0.9	-0.8	-0.7		-0.5	-0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	32.7			45.8	43.8	41.8	39.7	37.3	34.5		25.2	18.7	
of which: foreign-currency denominated	...	...	20.7			28.3	28.0	27.7	26.7	25.5	23.6		21.2	15.7	
of which: external	...	...	20.7			28.3	28.0	27.7	26.7	25.5	23.6		21.2	15.7	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.9	9.0	8.9			10.9	10.5	9.9	8.9	8.2	8.6		6.0	5.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	86.2			124.6	120.7	116.8	111.8	105.9	98.1		71.7	53.0	
PV of public sector debt-to-revenue ratio (in percent)	...	...	95.5			131.3	127.1	120.8	114.9	108.7	100.6		73.5	54.4	
of which: external 3/	...	...	60.3			81.0	81.4	80.1	77.4	74.2	68.6		61.8	45.8	
Debt service-to-revenue and grants ratio (in percent) 4/	5.0	4.5	4.6			7.2	10.9	11.7	11.6	11.3	13.7		7.5	6.5	
Debt service-to-revenue ratio (in percent) 4/	5.2	4.8	5.1			7.6	11.5	12.1	11.9	11.6	14.0		7.7	6.7	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.7	2.6	-6.6			-11.9	3.6	3.0	3.0	3.1	3.5		2.3	1.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-0.7	9.4	4.6	4.4	4.7	-1.8	1.5	3.5	3.9	4.3	4.5	2.7	5.0	5.0	5.0
Average nominal interest rate on forex debt (in percent)	1.0	0.9	0.9	1.5	0.5	1.0	1.4	1.4	1.5	1.6	1.7	1.4	1.9	2.8	2.2
Average real interest rate on domestic debt (in percent)	0.4	0.8	-0.7	0.2	6.1	-2.9	-1.8	1.1	1.4	0.7	0.8	-0.1	0.9	0.8	0.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.0	5.5	14.1	-3.3	12.3	24.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.9	4.1	6.3	8.7	4.1	9.2	10.0	6.0	5.0	5.0	5.0	6.7	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	2.2	5.7	8.0	1.6	2.9	-1.6	-2.3	1.0	2.2	3.0	4.0	1.0	5.5	4.8	5.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	29.7	31.5	31.4	31.5	31.5	31.5	31.2	25.3	18.5	...

Sources: Country authorities; and staff estimates and projections.

1/ Public sector debt covers gross debt of the general government. Debt of state-owned enterprises is not included unless it is explicitly guaranteed by the government.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2B. Moldova: Sensitivity Analysis for Key Indicators of Public Debt 2015–2035

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	46	44	42	40	37	35	25	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	46	42	39	37	35	33	25	18
A2. Primary balance is unchanged from 2015	46	45	44	43	42	41	37	36
A3. Permanently lower GDP growth 1/	46	45	43	43	42	40	42	73
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	46	45	46	45	44	43	39	40
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	46	45	44	42	40	37	27	20
B3. Combination of B1-B2 using one half standard deviation shocks	46	44	43	41	39	36	27	22
B4. One-time 30 percent real depreciation in 2016	46	56	53	50	47	43	32	25
B5. 10 percent of GDP increase in other debt-creating flows in 2016	46	52	50	47	45	42	31	22
PV of Debt-to-Revenue Ratio 2/								
Baseline	125	121	117	112	106	98	72	53
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	125	116	110	105	99	93	70	50
A2. Primary balance is unchanged from 2015	125	123	122	121	119	115	105	104
A3. Permanently lower GDP growth 1/	125	123	121	120	118	114	119	205
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	125	124	129	128	126	121	110	114
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	125	124	123	118	112	104	77	56
B3. Combination of B1-B2 using one half standard deviation shocks	125	121	120	115	110	102	78	62
B4. One-time 30 percent real depreciation in 2016	125	153	147	141	133	123	91	71
B5. 10 percent of GDP increase in other debt-creating flows in 2016	125	143	138	133	127	118	88	62
Debt Service-to-Revenue Ratio 2/								
Baseline	7	11	12	12	11	14	8	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	7	11	11	11	11	13	7	6
A2. Primary balance is unchanged from 2015	7	11	12	12	12	14	9	10
A3. Permanently lower GDP growth 1/	7	11	12	12	12	15	10	16
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	7	11	12	12	12	15	10	11
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	7	11	12	12	12	14	8	7
B3. Combination of B1-B2 using one half standard deviation shocks	7	11	12	12	11	14	8	7
B4. One-time 30 percent real depreciation in 2016	7	12	15	15	15	18	11	11
B5. 10 percent of GDP increase in other debt-creating flows in 2016	7	11	12	13	12	14	9	8

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Statement by Menno Snel, Executive Director for the Republic of Moldova
and Veronica Volociuc, Alternate Executive Director
December 16, 2015

The Moldovan authorities would like to express their appreciation to staff for the constructive policy dialogue and valuable advice. The discussions were appropriately focused on policies to mitigate the consequences of the banking crisis and adverse weather conditions, as well as imbalances stemming from a difficult external environment. The authorities broadly agree with the staff's assessment and policy recommendations provided in the report.

The collapse of three large banks with significant costs for the government budget, together with the drought in the summer, the external unfavorable environment and limited external financing, had a considerable impact on macroeconomic and financial stability.

The authorities are in the process of developing a comprehensive Action Plan that will pave the way to implementing a wide-ranging reform agenda. The key priorities are: (i) ensuring stability of the financial sector, (ii) stabilizing and streamlining public finances, (iii) improving the business environment and (iv) increasing the efficiency of state institutions. The authorities expect that the implementation of this Action Plan will contribute to putting the economy on an upward trajectory starting as soon as next year. Nevertheless, reversing the current unstable political situation is regarded as key for promoting the reform agenda.

Recent Economic Developments and Outlook

After the record growth of 9.4 percent in 2013, the economy grew with 4.6 percent in 2014 and 3.6 percent in the first half of 2015. However, given the internal and external factors currently at play, the authorities expect negative growth (of -2 percent) by the end of this year.

The large liquidity injections to problem banks spurred inflation well above its target range. Nevertheless, strong monetary policy response was appropriate in containing pressures on the foreign exchange market and on inflation. Lower than initial projected imports, frozen external financing and increased cost of issuing state securities have taken a heavy toll on public finances.

The considerable drop in remittances was offset by an improvement in the trade balance mainly because of the lower energy prices. However, the external shocks and significant depreciation pressures on the domestic foreign exchange market have led to a reduction in international reserves of about 33 percent compared to end October 2014.

The authorities expect the economy to recover in the coming years (projecting 1.5-3.5 percent of growth for 2016-2018), largely supported by a gradual improvement of the financial sector and monetary policy conditions, prudent fiscal policy and reforms aimed at streamlining public expenditures, as well as implementation of a comprehensive structural reform agenda.

Banking sector

The collapse of three major banks

The full compensation of the withdrawn deposits from the three collapsed banks, together with the smooth transfer of deposits to other banks have helped limiting panic among depositors and avoiding a major bank run and large stress on the financial markets.

During the special administration period, measures were taken to recover the banks' assets, including through cooperation with the investigation authorities. Moreover, the National Bank of Moldova (NBM) appointed qualified experts to conduct financial investigations in these three banks. The first stage of the investigation was completed with the Kroll Report which identified the suspicious transactions and the persons involved. The second stage started in October 2015 and will focus on the bank assets to facilitate the asset recovery.

With the withdrawal of the licenses of these three banks on October 16, 2015, the NBM initiated the process of forced liquidation. The resources collected by the liquidators are predominantly used for repaying the banks' debt, including the emergency loans received from the NBM.

Need to further scrutinize the health of the remaining banks

The authorities acknowledge the importance to carefully monitor the health of the remaining banks. Although the financial soundness indicators show a positive picture, there are suspicions of nontransparent shareholder structures and potential engagement in high-risk lending operations. Therefore, the NBM imposed special supervision measures on the three largest remaining banks and required carrying out diagnostic studies by reputable audit firms. The findings of these studies will form the basis for designing strategies for potential recapitalization or restructuring. The recent Fund technical assistance on fit-and-proper certification will contribute to designing an action plan once the bank diagnostic studies are completed.

Enhancing the regulatory and supervisory framework

The latest improvements of the regulatory framework aim at increasing the transparency of the banks' ownership structure, strengthening the information disclosure and market discipline in the banking sector, tightening the ceiling of banks' concentration in the market and improving the structure and the quality of the banks' capital. As a follow-up to the 2014 FSAP recommendations, the reporting framework on potential transactions with affiliated or related persons and classification and review requirements for assets and contingent liabilities were improved.

Looking forward, the first draft of a new banking law is scheduled to be ready by the end of March, 2016. It envisages a further strengthening of the banking sector in line with the EU requirements regarding banking regulation and supervision.

Mid October, the Government approved amendments to the law to take away the Ministry of Justice's power to carry on the juridical expertise or modify regulations introduced by the NBM and the National Commission for Financial Market. The amendments stipulate strengthening the legal protection of central bank staff. These amendments are still subject to Parliamentary approval.

In order to increase the transparency of banks' shareholders, a special unit was established to ensure sound and prudent management. Specialized software is expected to be implemented to facilitate these efforts.

The Credit Risk Register will be launched in the first half of 2016 with the support of an international consortium. It will collect, store, process and analyze the information on bank loans, thus facilitating the monitoring of the quality of the banks' loan portfolios and enhancing the ability to swiftly react when credit risks occur.

The authorities are aware that restoring stability in the financial system will require stronger reforms. While further Fund TA will play a key role in reaching this objective, the design and implementation of the measures requires strong leadership and accountability from the authorities.

Monetary and Exchange Rate Policy

Since the end of 2014, the Moldovan leu depreciated and by the end of October 2015 it has lost 28.3 percent against the US dollar. The national currency was mostly exposed to depreciation pressures in the first two months of 2015 due to the amplified turmoil in the banking sector, as well as considerable external vulnerabilities, which negatively affected the export proceeds, remittances and other sources of foreign exchange inflow. The NBM's interventions in the foreign exchange market were focused on smoothening out the excessive fluctuations and discouraging potential speculative movements. In recent months the situation returned to normal, with the nominal exchange rate returning to a path driven by fundamentals, while the NBM's interventions have lowered significantly. Yet, the authorities agree that further interventions should be done exclusively to prevent potential disorderly exchange rate adjustments without hindering the exchange rate movements driven by fundamentals.

Despite a considerable reduction, reserves still provide 4-months of import coverage. The authorities underscore the need to enhance reserve buffers and stand ready to build reserves, when market conditions allow, without jeopardizing the general market trends.

The depreciation pressures alongside the expansionary fiscal policy spurred the annual inflation rate from 4.7 percent in December 2014 to 13.2 percent in October 2015. The NBM's upper bound (6.5 percent) of the inflation target was exceeded for several consecutive months. Hence, since end 2014, the NBM has tightened the monetary policy stance increasing its base rate several times, from 3.5 percent in December 2014 to 19.5 percent in November 2015. In order to sterilize the excess liquidity (stemming from large emergency loans provided to the problematic banks) and improve the transmission mechanism of monetary policy, the NBM raised the required reserves ratio attracted in lei and non-convertible currency from 14 to 35 percent. In the NBM's view, refraining from tightening of the monetary policy stance would have deteriorated the situation in the foreign exchange market and would have made it impossible to stabilize the market in such a short period of time.

The NBM plans to loosen monetary policy gradually starting next year, while remaining very cautious in order to not let supply side factors generate some unmanageable second round inflationary effects.

Fiscal policy

The authorities undertook important measures to mobilize additional fiscal revenues. Excise duties on fuel and tobacco products were increased, some VAT exemptions were eliminated, and deductible expenses for tax purposes were revised. Unfortunately, the budget revenues dropped considerably due to a sizeable decrease in VAT collection as a result of weaker external trade.

The external financing of the budget was partly suspended and the demand for state securities was low as a result of monetary policy tightening and the uncertain environment.

Consequently, the authorities made adjustments in the 2015 budget, approved by the Parliament on November 20, 2015, considerably correcting the budget revenue. Under these constraints, the authorities cut significantly the expenditure side, mainly capital expenditures (by 65.1 percent). The revised budget for the FY 2015 deficit is estimated at 3.4 percent of GDP (compared to 3.9 percent of GDP set in the initially approved 2015 budget).

Regarding the revenue side, for 2016, improvements in the evaluation and reevaluation of real property are foreseen, and the land tax will be raised. On the expenditure side, a new law on the public procurement system was approved by the Parliament and will become effective on May 1, 2016. Other priorities for the authorities are an automatic indexation of public sector wages and rationalization of spending on education /health and energy subsidies. A Fund TA mission in this regard will take place in the spring of 2016.

The outturn of the 2016 budget will depend on the available external financing, but the authorities consider that a larger deficit than projected by staff for the next year would provide extra room to support infrastructure projects in the pipeline, which are essential to boost additional economic growth. Moreover, larger social needs (0.5 percent of GDP) are foreseen to mitigate the impact of the recent increase in utility tariffs. The 2016 budget will be proposed once the new government takes office.

The Ministry of Finance designed a Public Debt Management plan for 2016-2018 which aims to further develop the domestic market of state securities. It focuses on enhancing the communication with market participants, to ensure transparency and predictability in the state securities market. Technical Assistance would be helpful for streamlining the system of primary dealers as well as monitoring and assessing their performance.

Structural reforms

The authorities remain committed to a reform agenda to support export-led economic growth. The Moldova 2020 National Development Strategy will remain the key pillar, which aims at improving the business climate and promoting easier access to finance for enterprises.

The authorities have recently substantially increased the tariffs on electricity and gas to address the cascading debts and losses in the energy sector. However, these increases do not fully cover the accrued financial deviations which are planned to be gradually addressed during the next years.

The authorities continue their efforts to further diversify energy supply and enhance energy efficiency. The new laws on electricity and natural gas, which are pending Parliamentary approval, will ensure the full transposition of the EU's Second Energy Package. In 2014, the Iaşi-Ungheni gas interconnector was launched. A pre-feasibility study on the construction of the connecting pipeline between Ungheni and Chişinău is scheduled for mid-2016. The authorities estimate that the technical project and the construction work of the pipeline could be done in the period 2016-May 2018, subject to external financing from the developing partners and international financial institutions. The new pipeline would provide much diversification opportunities. As a next step in enhancing the energy sector, the authorities will focus on implementation of the EU's Third Energy Package, strengthening the regulatory, institutional and operational framework, upgrading the energy infrastructure, improving energy efficiency and facilitating and promoting the use of renewable energy.

Going forward, the authorities are committed to deepen the regulatory reforms and strengthen the rule of law to encourage private investment.