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EBS/93/177
Supplement 2

CONFIDENTIAL

December 16, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Republic of Moldova - Request for Stand-By Arrangement and
Purchase Under the Systemic Transformation Facility

The attached supplement to the paper on Moldova's request for a stand-by arrangement and for a purchase under the systemic transformation facility (EBS/93/177, Supplement 1, 11/24/93) has been prepared on the basis of additional information. Draft decisions appear on page 5.

Mr. Ouanes (ext. 38970) is available to answer technical or factual questions relating to this paper prior to the Board discussion tomorrow, Friday, December 17, 1993.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Commission of the European Communities (CEC), and the Organisation for Economic Cooperation and Development (OECD), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Staff Report for Request for Stand-by Arrangement and
Purchase Under the Systemic Transformation Facility

Prepared by European II and Policy Development and Review Departments
(In consultation with other Departments)

Approved by John Odling-Smee and Mark Allen

December 16, 1993

This supplement updates the information provided in the Staff Report (EBS/93/177, supplement 1) on economic developments, status of the implementation of the prior actions, and financing assurances.

I. Recent Economic Developments

The energy shortage which developed in the fall has become more serious reflecting a number of adverse developments including a slower-than-expected disbursement in the loans from Russia and Romania; ^{1/} a colder-than-normal winter; and reduced coal imports from the Ukraine. As a result, overall energy import volumes have been significantly lower than programmed prompting the Government to take draconian measures to conserve energy. Preliminary data on the CPI indicate that the monthly inflation rate hovered around 38 percent in both October and November. This considerably higher-than-programmed inflation rate was due, in large part, to panic buying and the associated sharp increase in the demand for the U.S. dollar following unsubstantiated rumors that the introduction of the national currency involved some confiscatory elements.

Based on the most recent monetary data available (end-October for the banking system and end-November for the National Bank of Moldova (NBM)), the monetary program appears to be on track. The net domestic asset position of the NBM as of end-November was broadly in line with the program. The banking system claims on the general Government were also in line with the program as of end-October. More recent data on the NBM claims on the general Government indicate, however, that credit to the Government may be

^{1/} As of end November only Rrub 15 billion have been disbursed out of the Rrub 50 billion committed. There were, however, large arrears vis-à-vis-Russia on account of imports of natural gas. As regards the Romanian energy loan, about half was disbursed by end-November.

running slightly higher than programmed. The authorities fully recognize the need for vigilance and the NBM has instituted a system of monitoring the Government's position with the commercial banking system on a weekly basis, with a view to ensuring adherence to the end-December ceiling. With the sharp increase in the NBM's financing rate on November 19, 1993--from 170 to 250 percent--it is expected that the demand for credit will moderate significantly in December.

In the fiscal area, available information on the implementation of the budget for 1993 shows a continued strengthening in revenue collections in October despite a sharp rise in tax arrears. This, together with a restrained growth in expenditures, resulted in a cumulative deficit for the first ten months of 1993 of about Mrub 130 billion, broadly in line with the program. However, because of a much-lower-than-programmed foreign financing in October and November, recourse to the banking system has been slightly higher than anticipated.

In the external sector, preliminary information suggests that lower-than-envisaged energy imports were largely offset by lower exports to Russia, attributable to delays in lifting the excise taxes imposed on Moldova's exports to Russia. 1/ The exchange rate of the Moldovan coupon against the U.S. dollar weakened considerably in the period immediately preceding the introduction of the leu amidst rumors that the currency reform would include confiscatory elements. It fell from Mrub 3,480 per US\$ in the beginning of November to about Mrub 5,000 per US\$ by mid-November. However, as the authorities intensified the information campaign and as it became clear that there were no confiscatory features, the exchange rate recovered to about Mrub 4,000 per US\$ by end-November and following its introduction, the leu quickly strengthened in the Chisinau Interbank Foreign Currency Exchange (CIFCE) market. As of December 14, the fixing rate for the Moldovan leu appreciated to Mlei 3.70 2/ per US\$ and the cash rate in the exchange bureaux was even more appreciated--about Mlei 3.3 per US\$-- (Chart 1). The authorities have, with technical assistance from the Fund, drafted a new foreign exchange law and have begun overhauling existing foreign exchange regulations with the view to ensuring current account convertibility as envisaged under the program.

II. Status of Prior Actions

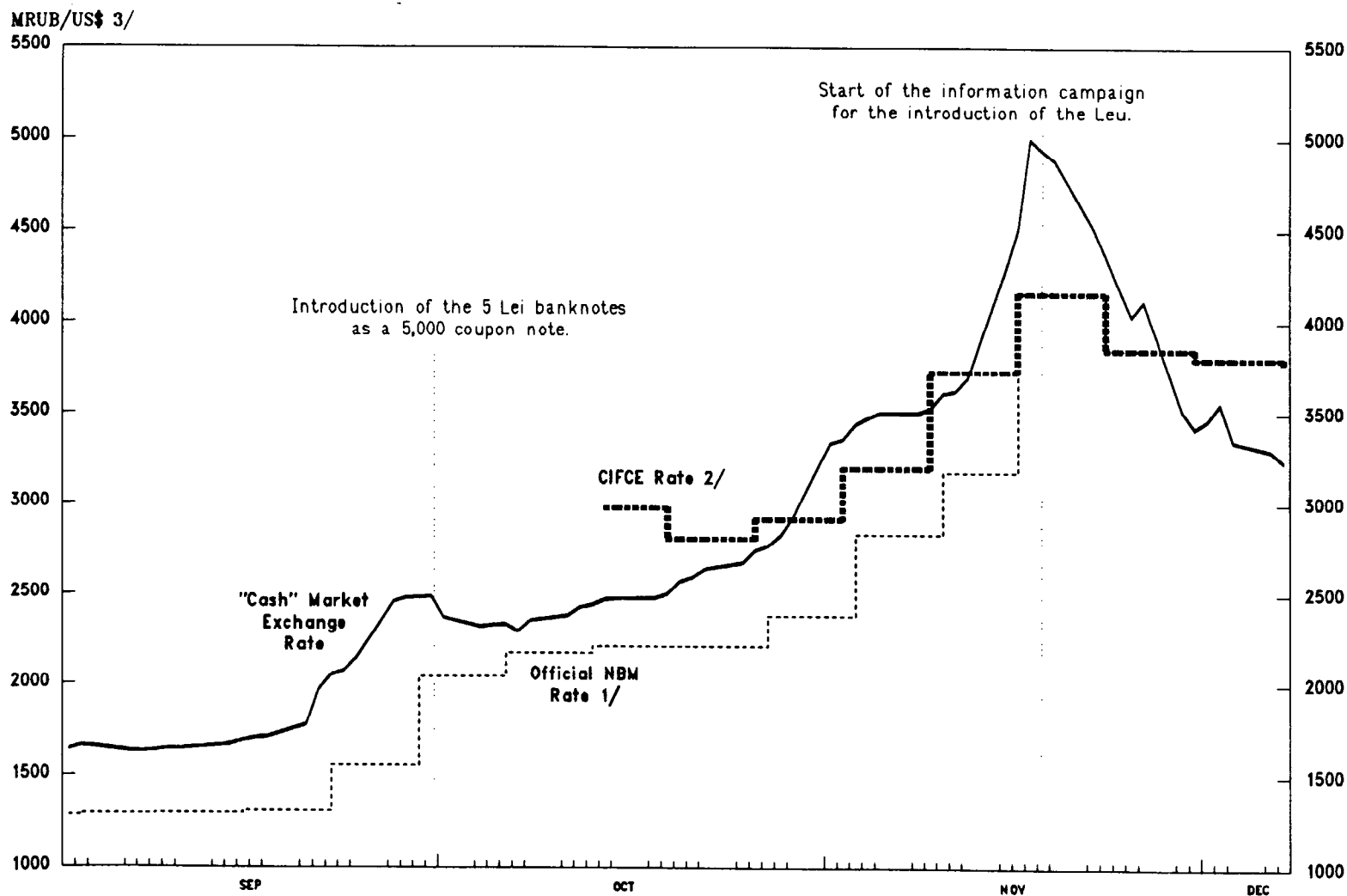
All prior actions envisaged under the program have been implemented. 3/ In the monetary area, the leu was introduced on

1/ The excises imposed on Moldova's exports to Russia were finally lifted on November 29, 1993.

2/ The conversion rate used is one leu (plural lei) for Moldovan coupon 1,000.

3/ The prior actions are listed in EBS/93/177, November 16, 1993, page 16.

CHART 1
Moldova
Exchange Rate Developments
September 1 - December 7, 1993



Source: National Bank of Moldova

1/ Starting November 17, 1993 the official rate of the Moldovan ruble against the U.S. dollar is the fixing rate of the CIFCE.

2/ Chisinau Interbank Foreign Currency Exchange (CIFCE).

3/ Starting November 29, 1993, the rates are expressed in MLei/\$1,000.

November 29, 1993, and all indications are that the operation was successful. The Fund staff has provided extensive technical assistance in this area including through a special MAE mission which visited Chisinau immediately prior to the introduction of the leu. While there were some minor problems including the shortage of small change, particularly the one ban coins (one ban is equivalent to 1/100 leu), the new leu was widely accepted and its exchange rate against the U.S. dollar quickly appreciated (Chart 1). As expected, the leu was accepted readily by the Gagauzi region ^{1/} but not by the Trans-Dniester region. The latter has reportedly ordered its own coupons and has in the meantime tightened administrative controls on the use of the old Soviet banknotes to avoid the dumping of old rubles. The authorities expressed hope that in the not too distant future the Trans-Dniester region will also adopt the leu as its currency.

As noted above, the NBM's financing rate was raised to 250 percent on November 19, 1993, the exchange rate was unified, and starting on November 16, the NBM moved to a market determination of the official exchange rate based on the fixing session in the CIFCE which are now being held twice a week. Further, on November 30, 1993, the monetary program for the remainder of 1993 and for 1994 was signed by the President.

In the budgetary area, the final draft of the 1994 budget was approved by the Government on November 19, 1993, and after being reviewed by the relevant parliamentary commissions was signed into law by the President. The draft 1994 budget was reviewed by the staff and is consistent with the authorities' undertakings under the program to be supported by the requested stand-by arrangement. Compared to the version presented in the staff report, the 1994 budget includes the introduction of an excise tax on petroleum products which was budgeted to yield an additional Mrub 60 billion, equivalent to about 1 percent of GDP. However, this amount was earmarked for increasing capital expenditures leaving the overall budget deficit unchanged at 3.5 percent of GDP.

Other measures include a sharp increase in the prices of electricity and transport, and the liberalization of the price of some milk products. Together with the adjustment in the bread prices effected in September, these measures ensure that the decline in the subsidy element in key consumer goods is as programmed. Also, in line with the authorities' undertakings, the VAT was extended to non-CIS imports and a new customs duty schedule was introduced. Finally, the Government decided to broaden the scope of excises considerably more than anticipated under the program. In addition to extending excises to non-CIS imports, excises taxes were also introduced for a number of new commodities including nonalcoholic beverages, radio and video tape recorders, motorcycles, cars and tires, and a selected group of electrical appliances.

^{1/} The Gagauzi (a Christian Turkish people) are a minority population, mostly found in the south, accounting for about 4 percent of Moldova's population.

III. Financing Issues

Following the Paris Consultative Group meeting on October 26, 1993, a pledging session took place in Washington on December 15, 1993, to seek commitments to cover an estimated residual external financing requirement of US\$155 million. The response to the Moldovan request for financial support for its program was broad based and very positive. Participants were impressed by the strength of the program and by the resolve of the Moldovan authorities to persevere with reforms under difficult circumstances, as demonstrated by the implementation of all prior actions. Specific pledges were received for a total amount of US\$127 million, mostly in balance of payments support. This included ECU 45 million (US\$51 million) from the European Union, US\$40 million from Japan to be made available in cofinancing of the World Bank Rehabilitation Loan, US\$31.5 million from the United States, US\$2.5 million from The Netherlands, and US\$2 million from Turkey. In addition, a number of countries including most notably Russia and Romania indicated their intentions to provide additional financial support to Moldova in 1994. The size of these contributions would be determined by the outcome of the budget process in these countries. On this basis, and taking into account the anticipated disbursements by the EBRD, the staff believes that there are assurances that the program will be adequately financed.

IV. Staff Appraisal

The staff is satisfied that all prior actions under the program have been implemented and that developments to date are broadly consistent with the assumptions underlying program projections. The staff is gratified by the quick response and strong financial backing provided by creditors and donors in support of Moldova's economic program. This support should allow the program to be implemented as designed and needs to be matched by the authorities' vigorous implementation of the policy actions described in their Memorandum of Economic and Financial Policies. Strict adherence to the program will not only help achieve the key program objectives but will also be critical for maintaining credibility of the reforms both at home and abroad. At the same time, the staff believes that timely disbursement of committed financial resources to Moldova, particularly in the early and difficult phase of the adjustment process, will be essential. It will also help mitigate the substantial social costs of the necessary adjustment. The staff believes that the authorities' actions to date and the strong commitment of Moldova's leadership to reforms deserve the support of the international community. The authorities' program represents a substantial effort to stabilize the economy, strengthen the balance of payments, and to push ahead structural reforms. The staff, therefore, recommends Executive Board approval of the proposed draft decisions.

V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1. Request for stand-by arrangement

a. The Government of the Republic of Moldova has requested a stand-by arrangement for a fifteen-month period in an amount equivalent to SDR 51.75 million.

b. The Fund approves the stand-by arrangement set forth in EBS/93/177, Supplement 1.

2. Request for purchase under the Systemic Transformation Facility

a. The Fund has received a request by the Government of the Republic of Moldova for a purchase equivalent to SDR 22.5 million under the Decision on the Systemic Transformation Facility, (Decision No. 10348-(93/61), STF, adopted April 23, 1993).

b. The Fund approves the purchase in accordance with the request.

c. The Fund waives the limitation in Article V, Section 3 (b) (iii).

