

**Monetary and Foreign Exchange
Policy
of the National Bank of Moldova for 2001**

The monetary and foreign exchange policy and the main activity directions, set with the view to fulfill the attributions of the National Bank of Moldova for 2001, are worked out based on provisions stipulated in the Law on the National Bank of Moldova.

The macroeconomic framework includes the Forecast of Social and Economic Development of the Republic of Moldova for 2001-2003 and the Agreement on Economic and Financial Policies concluded between the Government of the Republic of Moldova, the National Bank of Moldova and the international financial institutions.

Tendencies in 2000

The monetary and foreign exchange policy worked out by the National Bank for 2000 has as target the reduction of inflation, stabilization of the foreign exchange market, consolidation of the banking system in the context of a relative macroeconomic stability. Yet, the GDP dynamics, the evolution of the balance of payments, especially the trade balance, price developments, pace of economic reforms in 2000 differ from the macroeconomic forecast and have a significant impact on the preconditions for implementation of the monetary and foreign exchange policy of the National Bank of Moldova for 2000.

Macroeconomic Situation

The monetary and foreign exchange policy of the National Bank of Moldova for 2000 sets the end-of-year inflation target at the level of 15 percent, while inflation in November 2000 as against November 1999 constituted 23.5 percent and the estimation for the end of 2000 is about 20 percent. This is due to the impact of both non-monetary factors – administrative

increase of prices for services, imported inflation following the oil prices' increase on the international markets that affected production costs, and monetary factors – reserve money increase, especially as a result of foreign exchange purchases by the National Bank of Moldova.

During the first 9 months of 2000 real GDP increased by 1 percent as compared to the same period of 1999. Accordingly to the estimations, real GDP shall remain at the 1999 level. The estimated decrease of real GDP during the 4th quarter of the current year may be partially the result of drought impact on the agricultural sector despite the rising re-launch in the industrial and transportation sectors as compared to the same period of the previous year.

The current account of the balance of payments for the first 9 months of 2000 increased as compared to the same period of the previous year and registered a deficit of US\$ 72.6 million. This situation was conditioned by the double increase of the trade balance deficit as against the same period of 1999.

Imports of goods and services increased at a larger extent as compared to the exports and lead to the decrease of the ratio of imports' coverage by exports to 65 percent in the first 9 months of 2000.

Foreign Exchange Market

The foreign exchange market evolved during eleven months of the current year on the background of a relative stability and registered non-significant fluctuations of the exchange rate.

The MDL reference rate as against \$US during the year registered a slight appreciation tendency in real terms. At the end of November 2000 the reference exchange rate appreciated in real terms by 7 percent as compared to the end of the previous year. This tendency was determined by the increase of foreign exchange supply on the foreign exchange market as the result of larger direct investments, portfolio investments, workers' remittances from abroad and foreign loans to the private sector.

Due to foreign exchange market developments, the National Bank of Moldova was able to intervene as buyer of foreign exchange and increased the international reserves by 5.2 percent during the first 11 months of the current year, reaching the level covering 2.5 months of imports.

Banking Sector

Banking sector development and consolidation during the first 11 months of the current year was achieved (conforming to) through higher minimum normative capital requirements, provision stipulated in the Monetary and Foreign Exchange Policy of the NBM for 2000, and the improvement of the quality of commercial banks management.

The economic and financial situation of commercial banks improved. Banking assets have diversified, the credit portfolios and the net income considerably increased.

Monetary Aggregates

Money supply (M3) increased by 33.3 percent during the first 11 months of 2000: the most noticeable increase was registered during the 2nd half of the year. During the 1st half of 2000 money supply increased by 11.4 percent, while during July to November – by 19.7 percent. This evolution was the result of the considerable supply of foreign exchange on the domestic market, determined by the following factors:

- privatization of several units (entities) of the energy sector;
- repatriation of foreign exchange export proceeds;
- increase of minimum capital requirements of commercial banks during 2000, which lead to essential inflows of capital from foreign investors;
- significant workers' remittances from abroad during July – August 2000.

In these circumstances NBM's foreign exchange purchases amounted \$US 51.6 million during the first 11 months of 2000; the largest transactions were registered during summer months. This enabled the Government and the National Bank to serve the foreign debt promptly and allowed the National Bank to increase international reserves.

Net Foreign Assets (convertible) of the NBM increased during the first 11 months of the current year by 5.8 times, the ones of the banking sector – by 3 times. The NBM international reserves increased by 5.2 percent, which allowed the consolidation of international reserves up

to the level of about 2.5 import months coverage. The international reserves on the commercial banks increased by 6.6 percent.

The monetary and foreign exchange policy of the National Bank of Moldova for 2000 provided a 12 percent-reduction of the Government debt to the National Bank and an increase of credits to commercial banks. In accordance to the Budget Law rectification for 2000 the Government shall not reimburse 256 mil MDL due, by renewing loans previously extended in total amount of 1315.2 million MDL.

The NBM net credit to commercial banks during January – November 2000 reduced by 31.6 percent. During this period the weight of National Bank's credits in the total amount of credits to economy reduced to 3.6 percent as compared to 7.5 percent in 1999. By increasing the minimum capital and volume of attracted resources, commercial banks enlarged their lending of economy by 41 percent. Interest rates on credits in MDL and in foreign currency reduced by 3.2 and 2.6 percentage points respectively as compared to December 1999.

The larger amount of credits to economy registered in September denotes the seasonal character of credit demand. Thus, during January to August 2000 credits to economy increased by 14.7 percent, while during September to November – by 23 percent. Starting with 21 September 2000, in accordance with the NBM decision regarding the transfer of required reserves from special accounts with NBM to banks' correspondent accounts and starting with 1 November 2000 – the reduction of compulsory reserves requirement from 15 percent to 13 percent, the commercial banks' liquidity increased.

During the first 11 months money in circulation increased by 16.9 percent and deposits – by 46.8 percent. The deposit dollarization level registered an insignificant reduction – from 0.50 to 0.49, that denotes a slower increase of deposits in foreign currency recalculated in USD (35.7 percent) as compared to deposits in MDL (49.1 percent).

It should be mentioned that the nominal depreciation of the national currency as against USD during January to November 2000 constituted 6.5 percent, while the cumulative inflation rate amounted to 17.6 percent.

The November increase of money supply on the background of economic situation determined a higher monetization level of the economy as compared to the end of 1999 – 21

percent. The monetization level is estimated to increase in December 2000 as compared to December 1999 up to 22 percent.

Monetary Policy for 2001

In accordance with the Law on the National Bank of Moldova, the main objective of the National Bank is to achieve and maintain the stability of the national currency by establishing monetary, credit and exchange market conditions conducive to the based on principles of market economy. To achieve this objective, the National Bank of Moldova works out and conducts the monetary and foreign exchange policy. The main target of the monetary and foreign exchange policy for 2001 is to ensure price stability and ultimately to achieve reduction of inflation level.

The main parameters of Forecast of Social and Economic Development of the Republic of Moldova for 2001-2003, that served as basis for the Monetary and Foreign Exchange Policy for 2001 and that were accepted by international financial institutions, are as follows:

- a) reduction of annual inflation rate to 10 percent (at the end of the year);
- b) cessation of economic decline and resumption of economic growth at an annual GDP growth rate of 5 percent;
- c) reduction of public budget deficit to 1.5 percent of GDP;
- d) restraint of current account deficit to about 6 percent of GDP;
- e) international reserves shall cover about 3 months of imports.

In 2001 the NBM shall exert all its efforts to improving the functionality of the system of monetary instruments used by the National Bank for efficient implementation of the Monetary and Foreign Exchange Policy.

Following the consultations with the Government of the Republic of Moldova and taking into consideration the NBM main objective and the general situation of the national economy, public finances and balance of payments, the National Bank of Moldova sets for 2001 the following indicators and objectives of the monetary and foreign exchange policy:

1. The monetary Program for 2001 shall provide as follows:

- a) money supply shall increase by 22.6 percent and shall reach the value of 4354 mil MDL at the end of the year, considering the GDP in the amount of 19300 mil MDL and velocity of 4.43;
 - b) reserve money shall amount to 2235 mil MDL, considering the programmed value of money supply and the monetary multiplier of 1.95;
 - c) credits to national economy shall increase by 26 percent and shall reach at the end of the year the value of 2903 mil MDL with the view to create favorable conditions for economic re-launch. The weight of NBM credits to banks in the total amount of credits to economy is provided to grow from 4.3 percent in 2000 to 9.1 percent in 2001;
 - d) the national economy monetization level in 2001 shall reach 22.6 percent, that denotes a larger money demand conditioned by the GDP real growth by 5 percent and the reduction of inflation expectations.
2. The preconditions of implementation of the monetary program for 2001 are as follows:
- a) to reduce the liquidity coefficient from 0.74 in 2000 to 0.73 in 2001. Thus, the Government, by agreement with the National Bank of Moldova, is provided to follow up the implementation of measures for clearing settlements between economic agents, as a rule, minimizing the amount of cash settlements and reducing barter payments and netting operations;
 - b) to gradually reduce during the year the norm of required reserves to 8 percent of banks' attracted resources, continuing to use required reserves as a monetary tool which shall contribute to the decrease of deposits dollarization level, banking expenses reduction and the directing of additional credit resources to the real sector of economy;
 - c) to increase the multiplier from 1.81 to 1.95 on the basis of measures included in p.p. a) and b);
 - d) to gradually reduce the deposit dollarization level from 0.48 to 0.43 as a result of providing relative stability of the reference rate of MDL in 2001 and increasing public confidence in the national currency.

3. The National Bank of Moldova shall as follows:

- a) not provide credits to the Government in 2001 to finance the state budget deficit. The Government shall reimburse previously extended credits in the amount of 15 million MDL;
- b) renew loans previously extended and collateralized with T-bills within the limits stipulated in the Law on the Budget for 2001 at market rates, setting the maturity for 2002;
- c) accept in 2001 the further re-issuance by the Ministry of Finance of T-bills, previously transmitted to the National Bank as against credits contracted by the Government during the period 1993 - 1995 in the amount of 360.7 mil MDL with the maximum term of 180 days. The NBM shall convert in T-bills the loans extended to the Government in the amount of 39.3 mil MDL at market interest rate;
- d) may extend loans to the Ministry of Finance to cover temporary cash discrepancy within the quarterly limits of the monetary program.

4. In 2001 the National Bank of Moldova shall, simultaneously with the further development of monetary policy instruments - open market operations and Lombard facility, implement new instruments of monetary regulation, as follows:

- a) shall refinance commercial banks through reverse REPO of T-bills with a maturity up to 2 months;
- b) shall implement the mechanism of overnight credit and shall continue to use the Lombard facility (with maturity up to 5 days), which shall contribute to the efficient banks' liquidity management and functioning of the system of payments in real time;
- c) shall implement the mechanism of deposit facility;
- d) shall conduct an interest rate policy, targeted at maintaining the real interest rates at a low positive level, thus stimulating real sector's demand for credits and, respectively, contributing to the economic growth. In order to steer the interest rates, the National Bank of Moldova shall use the REPO rate with 2

months maturity as a base rate for setting up the interest rates for other monetary instruments, using the rule that the highest rate shall be applied on overnight credits and the lowest – on deposits.

5. The National Bank shall, by agreement with the Government, optimize the legal framework in order to stimulate the attraction of credit resources to the real sector of economy.
6. As fiscal agent of the state, the National Bank of Moldova shall contribute to the placement of dematerialized T-bills at real market prices by performing T-bills selling auctions on the primary market, by providing marketing assistance to the Ministry of Finance and by rendering services as the depositor of issued securities.
7. With the view to developing and maintaining the liquidity of the T-bills market and taking into consideration the increase of banks' capital and of attracted resources, the National Bank of Moldova shall increase the participating norms of banks-Primary Dealers on the primary and secondary markets as follows:
 - starting with 1 January 2001 to 3% and 1% respectively;
 - starting with 1 July 2001 to 4% and 1.5% respectively;
8. The foreign exchange policy of the National Bank of Moldova for 2001 shall, having as main objective the stability of the national currency, further provide free float of the national currency and setting the reference rate of the national currency on the basis of preponderant rates on the foreign exchange market.
9. The National Bank of Moldova shall, while conducting the foreign exchange policy, reserve the right to perform foreign exchange interventions in case of stringent necessity to smooth excessive fluctuations of the real exchange rate and to influence the exchange rate with the view to creating favorable conditions for economic growth.
10. The monetary and foreign exchange policy for 2001 shall follow the target of maintaining international reserves at a level, sufficient to cover about three months of import. Such situation shall allow to serve the Government foreign debt and to ensure the efficiency of the monetary and foreign exchange policy.
11. The National Bank of Moldova shall further conduct the policy of banking system consolidation without resorting to the increase of the minimum capital as follows:

- a) shall encourage commercial banks with the view to conforming their activity to requirements towards the minimum normative capital;
 - b) shall gradually modify requirements towards the structure of the normative capital with the view to improving the estimation of banks' capitalization level, to improving the information quality and to implementing stipulations of the new Capital Adequacy Framework in conformity with international standards;
 - c) shall contribute to the development of the market discipline and to the improvement of the banking competitiveness through implementation of requirements towards information disclosure by banks;
 - d) shall encourage commercial banks towards qualitative development of internal control systems, reporting procedures and transaction accounting;
 - e) shall further improve the mechanism of banking supervision and develop the efficiency of its influence upon the process of elimination of negative occurrences in the banking practice.
12. The National Bank shall facilitate the efficient functioning of the interbank settlement system, which would provide the efficient banks and economic agents' liquidity management through implementation of an automated system of interbank settlements in real time.
13. The National Bank of Moldova considers that the proposed macroeconomic objectives may be achieved within the context of urging the process of national economy restructuring, the revival of economic activity and the consolidation of fiscal discipline.