

The Monetary and Foreign Exchange Policy of the National Bank of Moldova for 2002

(Rectified by the Council of Administration of the National Bank of Moldova, decision no. 315 of 12.12.2002)

The monetary and the foreign exchange policy and the main directions of NBM activity set with the view to fulfilling the basic attributions of the National Bank of Moldova for 2002 are worked out on the basis of provisions stipulated in the Law on the National Bank of Moldova.

The Forecast of the social and economic development of the Republic of Moldova for the years 2002 – 2004 and the agreements on financial and economic policies concluded between the Government of the Republic of Moldova, the National Bank of Moldova and the international financial bodies served as macroeconomic framework for policy implementation.

Trends in 2001

The monetary and foreign exchange policy worked out by the National Bank of Moldova for the year 2001 was directed towards inflation reduction and maintenance of favorable conditions on the foreign exchange, financial and credit markets. The evolution of Gross Domestic Product (GDP), the condition of the state balance of payments and prices' dynamics were in line with the macroeconomic forecast on the basis of which the Monetary and Foreign Exchange policy of the National Bank of Moldova for 2001 was worked out and implemented.

Macroeconomic Situation

The monetary and foreign exchange policy of the National Bank of Moldova for 2001 provided the reduction of the annual inflation rate down to 10% at the end of the year. Consumer prices slightly increased as compared with the previous year: the cumulative inflation for the 11 months of the current year constituted 4.3% as against 17.6% for the same period of the year 2000. The annual average inflation rate (November 2001 against November 2000) was 10.7%, which is inferior to the one registered in the similar period of 2000 (33.5%). On the background of increasing GDP and the ultimate larger demand for money in economy, the rise of monetary offer did not determine inflationary pressures. The relatively stable evolution of the exchange rate of the national currency has also contributed to the maintenance of a low prices' level.

The monetary and foreign exchange Policy for 2001 provided the increase of GDP with an annual tempo of 5% and its ultimate nominal value of MDL 19300 millions. During the first 9 months of 2001 GDP registered a real increase of 3.8% as compared to the same period of 2000 and totaled 12930 millions in current prices. Due to the positive evolution of the economy real sector during the current year, GDP is expected to register in 2001 a real growth of up to 7%.

The Law on the Budget for 2001 provided a national public budgetary deficit of 1.5% of GDP. This indicator for the first nine months of the reported year constituted effectively 0.4% of GDP.

The current account of the balance of payments for the first nine months of the current year registered a deficit of USD 91.2 millions, which is by USD 5.8 millions less than in the same period of 2000. The larger proceeds of Moldovan residents working abroad (by USD 40.2 millions) had also a major impact on the attenuation of current account deficit. The tempo of goods' and services' export increase (15.3%) exceeded the one of import increase (10.6%) and determined the rise of the level of imports' coverage with exports' up to 66.1%.

Foreign exchange market

The evolution of the foreign exchange market during the 11 months of the current year may be characterized as relatively stable with non-significant fluctuations of the exchange rate.

The condition of the foreign exchange market allowed the National Bank to intervene on the market as purchaser of foreign currency and to maintain state international reserves at a level of 2.6 months of import coverage.

The evolution of the real and the real effective exchange rates during the first 11 months of 2001 proves the depreciation trend observed as against in December 2000. Thus, at the end of November 2001 the real exchange rate of MDL as against USD depreciated by 2.4% as compared to the end of the previous year.

The real effective exchange rate, which reflects MDL modification in real terms as against main currencies of trade partners, depreciated by 4.5% during the first 11 months of 2001 favoring local exporters.

Banking system

The increase by 13.3% of the total regulated capital provides evidence of NBM commitment to further consolidate the banking system. The total value of banking assets during the first 10 months of 2001 increased by 20.9% and totaled at the end of the reported period MDL 5645.1 millions. This increase was largely determined by the larger value of credits to national economy.

The period of January-September 2001 is characterized by a relative performance of the credit portfolio, within which the weight of unfavorable credits in total credit portfolio reduced by 12.5 p.p. as compared to the end of the previous year. The weight of standard and supervised credits in total credit portfolio increased from 79.4% at the beginning of the reported period to 87.5% at the end of the 3d quarter of 2001. The value of credit loss provisions against total credits constituted 8.91% in September, decreasing by 2.81 p.p. as on 31.12.2000.

The upward evolution trend of the national economy on the background of reduced inflationary pressures and relative stability of the foreign exchange market during the first 11 months of the reported year determined a superior increase of both demand for credits and value of deposits in MDL as compared to same indices in foreign currency. Thus, the value of new credits in MDL provided during the reported period amounted to MDL 2654.9 millions, which is by 49.0% more than in 2000. The reduction by 4.6 p.p. of the weighted average interest rate (calculated for January – November) down to 28.7% was one factor that contributed to the larger value of provided credits. Credits with a term of more than 6 months held 55.3% of total credits and were extended at an average interest of 28.6% (as against 32.3% in 2000). The value of credits provided in foreign currency increased by 24.7% as compared to 2000 and amounted to USD 109.1 millions. The weighted average interest rate during the reported period reduced by 2.4 p.p. and constituted 14.3%. Over 6-month credits held 69.9% of total credits in foreign currency.

The value of deposits in national currency increased by 48.6% as against in 2000 and amounted to MDL 1200.6 millions; the weighted average interest rate reduced by 3.7 p.p. (21.0%). Deposits attracted for a term of over 3 months held the largest weight (68.3% as against 50.3% in 2000) in total value; thus, deposits with a longer term become more attractive. Deposits in foreign currency simultaneously increased by 46.1% as against in 2000 and totaled USD 144.4 millions; the weighted average interest rate was 4.0%. Thus, the tempo of increase of deposits in national currency was superior to the one related to deposits in foreign currency and proved the further consolidation of public confidence in the national currency and banking system on the background of a favorable evolution of macroeconomic indicators.

Dynamics of monetary indicators

Money supply (M3) raised by 29.0% during the first 11 months of 2001, registering a more remarkable increase in the second half of 2001. During the first half of the year money supply increased by 10.7% as against 16.5% in the period of July to November. This evolution was determined by the larger offer of foreign currency on the domestic market.

Under such circumstances, the National Bank of Moldova performed acquisitions of foreign currency during the first 11 months of 2001 in an amount of USD 71.5 millions; the largest transactions were held in the 3d quarter. In conditions of reduced external financing, the Government and the National Bank had the possibility to pay foreign debts in due times and to maintain NBM international reserves at a level of 2.6-month import coverage.

The monetary and foreign exchange policy of the National Bank of Moldova for 2001 provided a non-significant reduction of the state debt to NBM by MDL 15 millions. Based on the Law on Rectification of the Law on the Budget for 2001, the National Bank provided to the Government loans to finance the budgetary deficit for foreign debt servicing.

This situation determined the increase by 17.5% of money supply during the first 11 months of the current year. Ultimately, the increase by 10.0% of monetary multiplier (following the reduction of liquidity coefficient from 0.72 to 0.59) resulted in the increase by 29.0% of money supply (M3). The larger monetary offer by the banking system had a prevalent impact on the evolution of credits to economy. Thus, the tempo of increase of the balance of credits to economy (33.6%) exceeded by 4.6 p.p. the one of money supply increase. Credits provided in national currency held 59.1% of total credits to economy. The increase of money supply during the reported period was quite considerable in real terms, constituting 23.6%, including credits to economy – 28.0%. The evolution of credits to economy in the first half of the year was in line with the one provided in the monetary and foreign exchange Policy of the National Bank of Moldova for 2001, registering an increase of 11.0%. The dynamics of credits provision to economy had a more accelerated trend in the period of July to November (by 20.3%) due to the aggregate effect of a number of factors:

- The partial reduction of required reserves (from 13% in January to 10% in October 2001) that determined additional liquidity directed towards crediting activity;
- The reduction of inflationary expectations and the real GDP growth;
- The reduction of interest rates on the monetary market: the decrease of the NBM basic rate on 2-month REPO operations (from 27% in December 2000 to 13.5% in November 2001);
- The reduction of interest rates on the financial market: the decrease of the average monthly weighted yield on SS on the primary market (from 20.0% in January 2001 to 10.43% in November currency year) and the increase of the average weighted monthly maturity from 76 days to 128 days;
- The simultaneous reduction of average weighted interest rates on means attracted by the banking system in national currency (from 23.9% in December 2000 to 18.1% in November current year).

The policy of interest rates followed by the National Bank of Moldova was based on the analysis of dynamics resulted from inflationary processes, monetary and macroeconomic indicators and the situation on the financial market. The target of this policy is the maintenance of real interest rates at a low positive level that would stimulate the increase of credit demand by the economy real sector. Within this context, the National Bank of Moldova worked out a series of recommendations for commercial banks.

As a result, the average interest rates on credits provided in national currency in November 2001 reduced by 4.5 p.p. as compared to December 2000 and the ones on credits in foreign currency – by 1.6 p.p.

In the structure of money supply during the first 11 months of the reported year cash in circulation increased by 14.1%; the total deposits' balance increased by 39.7% (including deposits in national currency – by 44.1%). Deposits in MDL by individuals recorded a significant increase of 75.7%; out of this, time deposits held 94.2% of the total value. These figures denoted the prevalent orientation of public savings towards placements in national currency. At the same time, following the animation of the economic activity and the larger demand for money for operational reasons, deposits in national currency by legal entities recorded the same upward trend, increasing by 17.5% during the reported period.

As a result of qualitative improvement of the money supply structure, the ratio between the M3 liquid component (money in circulation and sight deposits) and the amount of time deposits in national currency plus the ones in foreign currency significantly reduced from 1.27 in December 2000 to 0.96 in November 2001.

Consequently, the dollarization index of deposits reduced as according to the trend stipulated in the monetary and foreign exchange Policy of the National Bank of Moldova for 2001 from 0.49 to 0.45 in December 2001 and denoted a slower increase of deposits in foreign currency recalculated in USD (24.6%) as compared to the one of deposits in MDL (52.9%).

The reduction by 11.65% of money velocity (M3) from 4.55 in December 2000 to 4.02 in December 2001 determined a larger demand for money resources and reduced inflationary expectations. Money supply dynamics proves the continuation of the process of economy satiety with money following the increase of the monetization level from 22.0% at the end of 2000 to 24.9% in December 2001.

Policy for 2002

As according to the Law on the National Bank of Moldova, the main objective of the National Bank of Moldova is to achieve and maintain the stability of the national currency by establishing monetary, credit and foreign exchange market conditions conducive to market-based principles. To achieve this target the National Bank of

Moldova works out and promotes a monetary and foreign exchange policy directed towards prices' stability and, ultimately, to inflation reduction.

The macroeconomic framework that stays at the basis of the monetary and foreign exchange Policy of the National Bank of Moldova for 2002 includes the Forecast for the social and economic development of the Republic of Moldova for the years 2002 – 2004 and the economic and financial agreements concluded between the Republic of Moldova, the National Bank of Moldova and the international financial bodies. The stipulated main indicators provide as follows:

- a) the annual inflation rate of 10%;
- b) the real GDP growth by 6% for 2002;
- c) the deficit of the national public budget of 1.4% of GDP;
- d) the average estimated exchange rate for 2002 at the level of MDL 13.5 for USD1;
- e) the consolidation of state international reserves up to a level sufficient to cover around 3 import months.

Based on these macroeconomic indicators and taking into consideration the upward trends in the evolution of the national economy, the National Bank of Moldova sets out the following indicators and objectives of the monetary and foreign exchange Policy for 2002:

1. The Monetary Program for 2002 provides as follows:

- a) the increase of money supply by 34.0% and its final value of MDL 6393.4 millions at the end of the year, based on a GDP value of MDL 22100 millions and money velocity of 3.46;*
- b) the increase of monetary basis by 32.2% and its final value of MDL 3290.0 millions, based on the stipulated value of money supply and of monetary multiplier of 1.94;*
- c) the increase of the value of credits to economy by 33% and its final value of MDL 4185 millions at the end of 2002 with the view to establishing premises for a sustainable economic growth;
- d) the national economy monetization level of 28.9% at the end of 2002 which presupposes an increase of money demand determined by the GDP real growth of 6%.*

2. Premises for the implementation of the monetary program for 2002 are as follows:

- a) the reduction of the liquidity coefficient from 0.65 as estimated for the end of 2001 to 0.59 in 2002;
- b) the relevant increase of the monetary multiplier from 1.93 to 2.16 to the end of 2002;

- c) the gradual decrease of deposits dollarization index from 0.45 to 0.37 following the stabilization of public confidence in the national currency and the attenuation of inflationary expectations.

3.The National Bank of Moldova:

- a) *shall extend in 2002 credits to the Government to finance the budget deficit with the view to external debt servicing in accordance with the Law on Modification and Completion of the Law on the Budget for 2002;*
- b) shall re-conclude credits previously granted under the pledge of state securities within the limits stipulated *in the Law on Modification and Completion of the Law on the Budget for 2002* at a market interest rate and the maturity in 2003;
- c) shall accept the further re-issuance by the Ministry of Finance of state securities previously transmitted to NBM against loans concluded by the state during the previous years in the amount of MDL 400 millions for a maximum term of 180 days;
- d) may provide in 2002 to the Ministry of Finance loans to cover temporary cash discrepancy within quarterly limits of the monetary program.

4.As fiscal agent of the state, the National Bank of Moldova shall contribute to the placement of dematerialized state securities (SS) through primary market auctions, shall render services as depository for issued securities and shall establish relevant conditions for an advantageous development of a SS market that would allow the state to make borrowings under acceptable conditions and the market operators to hold a liquid, attractive and efficient instrument and to have simple and secure access to both the primary and secondary markets.

Instruments of the monetary policy

5. The efforts of the National Bank of Moldova in 2002 shall be directed towards establishing a relevant functioning of the flexible system of held instruments provided to efficiently implement the promoted monetary and foreign exchange policy. This system is stipulated in line with the fluctuations of the macroeconomic environment and the structure of the internal financial market. The National Bank of Moldova shall continue to use different indirect monetary instruments with the view to managing rates and liquidities of the banking system: open market operations, including SS selling / buying, REPO and REPO reverse operations with SS, Lombard facility, deposit acceptance and provision of overnight credits. Open market operations shall be performed within the limits of monetary issuance stipulated under p.1 b).

6.The monetary and foreign exchange policy of the National Bank of Moldova for 2002 shall be directed towards the gradual reduction of interest rates on the credit market following the increase of monetary offer and the reduction of inflationary

expectations determined by the consistent achievement of medium-term inflation target. The interest rates policy of the National Bank of Moldova shall have as target the maintenance of real interest rates at a low positive level that would ensure a relevant decrease of nominal rates in economy and the reduction in price of credit recourses for the real sector. NBM shall continuously monitor the evolution of interest rates policy promoted by banking institutions for national economy crediting and shall insist upon the correlation of interest rates with macroeconomic indicators. With the view to managing interest rates, the National Bank shall further use the 2-month SS purchasing REPO rate as basic rate, which shall serve as reference point while setting the interest rates for the other monetary instruments as follows:

- the interest rate on overnight credits (the highest applied rate);
- the Lombard Facility;
- the interest rate on deposits accepted by NBM (the lowest applied rate).

At the same time, NBM shall set the interest rate on long-term credits.

7. The National Bank of Moldova provides *the maintenance during 2002 of required reserves at the level of 10.0%* of means attracted by commercial banks, contributing in such a way to the estimate increase of the value of means available for national economy crediting.

Foreign exchange Policy

8. The foreign exchange Policy of the National Bank of Moldova for 2002 provides the further freely floating regime of the national currency and the setting of the official exchange rate on the basis of prevalent exchange rates on the foreign exchange market.

9. Within this context, the National Bank of Moldova shall not assume the liability to permanently intervene on the foreign exchange market; yet, NBM holds the right to perform forex interventions under conditions of urgent necessities to attenuate excessive fluctuations of the real exchange rate and to influence its evolution with the view to creating favorable conditions for export growth. Instruments of foreign exchange policy shall include direct selling/buying of foreign currency with the view to gradually implementing reverse forex operations of forex swap type.

10. The foreign exchange Policy of the National Bank of Moldova for 2002 shall be continuously directed towards the maintenance of international reserves at a level acceptable to cover at least 3 import-months and the further state foreign debt servicing.

11. Under circumstances of international economic recession that determined the reduction of interest rates, the National Bank of Moldova shall continue to allocate its

forex assets in investment instruments that conform the liquidity and security requirements.

Banking Supervision

12. With the view to stimulating a prudent development of the banking sector, the National Bank of Moldova shall promote a policy of continuous consolidation of the banking system, of market discipline and competitiveness as follows:

- a) the consolidation of the banking system shall be achieved through continuous maintenance of set requirements and improvement of standards on absolute capital evaluation and coverage of related risks for each separate bank. With the view to averting the shortage of capital sufficiency, the National Bank shall support processes of banking association and merging;
- b) the prudential development of the banking activity shall be supported through further maintenance of set requirements towards banking administrators and the increase of banking internal control capacity to determine and manage risks;
- c) with the view to ensuring transparency and to consolidating credibility in the banking system, the National Bank of Moldova shall set equal activity conditions for all the banks and shall determine the commercial banks to disclose sufficient information on their activity and the evolution of their economic and financial indicators;
- d) the National Bank of Moldova shall systematically evaluate the internal and external banking modifications and development trends that may have an impact on local banking activity. With the view to non-admitting systemic crisis and to promoting financial stability, the National Bank shall intervene through regulation and supervision methods.
- e) The National Bank of Moldova shall, within the limits of vested attributions and competence, further supervise the banks, having as target the control over the elaboration and implementation of programs on money laundering prevention and the conformation of banking activity with the current legislation.

Payments System

13. With the view to efficiently managing the banking system liquidity, to reducing risks and to improving the functioning of the payments' system, the National Bank of Moldova shall undertake measures directed towards:

- a) implementation of the automated system of interbank payments based on real time gross settlements;

- b) provision of services related to final settlement of participating banks' positions in internal interbank payments' systems different from the NBM payments' system, whatever the types of used payment instruments;
- c) facilitating of current payment instruments' development based on modern technologies (including banking cards) and the implementation of new payment instruments;
- d) development of an automated system for liquidity management for the payments' system;
- e) elaboration of the payments' system normative framework by regulating the use of electronic payment documents.

Note: The monetary and foreign exchange Policy of the National Bank of Moldova for 2002 is based on a continuous performance of the IMF program, the further World Bank crediting, the complete financing from foreign donors and the reception of proceeds from privatization.