Monetary and Foreign Exchange Policy
of the National Bank of Moldova for 2004

The monetary and foreign exchange policy and the main directions of the NBM activity set with the view to fulfilling the basic attributions of the National Bank of Moldova for 2004 are worked out on the basis of provisions stipulated in the Law on the National Bank of Moldova. The medium-term expenses program for 2004 – 2006 represents the macroeconomic framework.

I. Macroeconomic Trends, Banking System and Monetary Policy for 2003 Assessment

The monetary and foreign exchange policy worked out by the National Bank of Moldova for 2003 provided the establishment of favorable conditions of the monetary, credit and foreign exchange markets relevant for a macroeconomic stability and economic growth. The evolution of Gross Domestic Product (GDP), the condition of the state balance of payments and price dynamics denoted slight dissimilarities with the macroeconomic forecast used as a pillar for the outlines and implementation of the Monetary and Foreign Exchange Policy of the National Bank of Moldova for 2003.

Macroeconomic Situation

Gross Domestic Product (GDP) in January – September 2003 increased by 6.2%. The growth was due to the enlargement by 5.4% of gross added value, including the one by 11.5% in industry and by 11.4% in services sector; the same indicator in the agricultural sector denoted a reduction by 10.3% as compared to the same period of the previous year.

The final consumption during the first 9 months of 2003 increased by 10.9% (as compared to 10.2% in the same period of 2002). Gross fixed capital formation registered an increase of 17.4% as against 3.6% in the similar period of the previous year. The weight of final consumption in GDP accounted for 110.6%; of gross capital formation – 18.7%; of net export – minus 29.2% (the ratio of imports to GDP increased from 72.1% up to 82.0% in January – September 2003).

The condition of the state balance of payments for the first nine months of 2003 registered an enlargement of foreign trade with goods to USD 1482.2 million. The growth rate of exports with goods and services for the mentioned period constituted 23.0%; the growth rate of imports was 29.2%. As a result, the trade balance deficit amounted to USD 377.5 million, by 41.5% more than in the same period of the previous year. The current account deficit as at the end of the 3rd quarter amounted to USD 88.8 million, or by USD 37.8 million more than in the same period of 2002.

State external debt as at the 3rd quarter-end amounted to USD 1393.7 million, including public debt – USD 989.6 million and private debt – USD 404.1 million.

Consolidated budget revenues during the first 9 months of 2003 amounted to 4600.0 million lei; budget expenditures – to 4232.7 million lei. The consolidated budget surplus totaled 367.3 million lei.

Consumer Price Index in January – November 2003 accounted for 114.9%, inclusive for food products – 119.0%; for non-food products – 110.4%; and for services – 112.5%.

Foreign Exchange Market

During the first 11 months of 2003 the evolution of the foreign exchange market was affected by a number of internal and external factors that generated certain short-term fluctuations of the exchange rate. In January-November 2003 the official exchange rate of the national currency as against USD appreciated by 3.8%.

The foreign exchange net outflow during the 1st quarter of 2003 determined, like in previous years, a sharper depreciation of MDL against USD. However, the increase by the National Bank of Moldova of required reserves ratio and the reduction of the open foreign exchange position ratio, as well as the period of non-using of foreign currency purchased by resident economic agents, tempered the market. During the 2nd, 3rd quarters and the first two months of the 4th quarter of 2003 the official exchange rate of MDL against USD denoted an appreciation trend. Under such conditions, the NBM intervened in the market as a purchaser of foreign currency; the value of acquisition amounted to USD 76.2 million in April – November. As a result, foreign exchange reserves increased by 8.0% or from USD 268.9 million as on 31.12.2002 to USD 290.4 million as on 30.11.2003. At October-end the coverage of imports by international reserves accounted for 2.6 months.

Banking System

The consolidation of the banking system continued in January – October. The total regulatory capital during this period increased by 319.4 million lei, or by 18.8% as against the end of 2002. Total assets of the banking sector amounted to 9604.8 million lei in October 2003, registering an increase of 21.3% as compared to December 2002.

The lowering of the weight of unfavorable credits in total credit portfolio from 7.7% to 6.0% determined the improvement of the credit portfolio in the first three quarters of 2003.

In January – October 2003 the weight of interest-bearing assets increased by 6.3 p.p. to 78.9% of total assets, or 7580.7 million lei. As a result, in the first ten months of the year commercial banks reported net income of 382.8 million lei, or by 23.1% more than in the same period of 2002.

Monetary aggregates dynamics

The evolution of monetary indicators during the first eleven months of 2003 was similar to that of the relevant period of 2002. In January – November 2003 money supply M3 increased by 23.7%, with a highest growth rate in July – September. The average monthly growth rate of the M3 monetary aggregate for the eleven months of 2003 accounted for 1.9% as compared to 2.5% in 2002.

The expansion of M3 money supply was due to the dynamics of its components, especially to the increased currency in circulation and deposits in foreign currency.

Currency in circulation increased by 17.3% as at the end of November 2003 (as compared to 31.12.2002).

During the eleven months of 2003 monetary base increased by 13.2% as against the end of 2002 and amounted to 3694.4 million lei.

The growth rate of deposits in foreign currency decreased from 45.6% as for eleven months of 2002 down to 38.7% at the end of November 2003. Deposits in national currency during the reported period increased by only 16.8% as compared to the end of 2002 (29.1% in January – November 2002).

Credits to economy as at November-end 2003 amounted to 5920.0 million lei, or by 42.1% more than at the end of 2002.

Implementation of Monetary Policy Instruments

With the view to influencing interest rates in the monetary market in 2003, the National Bank of Moldova promoted a transparent policy in establishing interest rates on instruments of monetary regulation. The NBM interest rates policy was based on the analysis of inflationary trends, of monetary and macroeconomic indicators and of financial market conditions.

In 2001 the National Bank of Moldova initiated the process of reduction of interest rates on monetary policy instruments; this process continued in the 1st quarter of 2003, too. During the first three months of the year the base rate was at 9.5%, being at the lowest level for the last three years. Starting with the 2nd quarter, with the view to preventing inflationary pressures, the National Bank of Moldova has applied a more restrictive policy. At March-end the base rate was increased to 10.5%, and then in August, September and November up to 11.0%, 12.0% and 13.0% respectively. In 2003 the National Bank of Moldova increased the interest rate on Lombard facility twice: in August – by 0.5 p.p. to the level of 14.0% and in November – by 2.0 p.p. up to 16.0% per year. At the same time the NBM increased the interest rate on long-term credits from 10.5% to 11.5% as on 30.11.2003. The interest rate on overnight credits was increased in November 2003 from 16.5% to 17.0% per year.

The National Bank of Moldova amplified in 2003 sterilization of liquidity surplus. Simultaneously with activities related to accepting deposits from banks, open market operations with state securities and imposing the reserve requirements, the NBM has initiated, starting with September 2003 the implementation of a new instrument – overnight credits.

Selling repos with state securities held the major weight within open market operations. The total volume of these operations in January – November 2003 amounted to 306.8 million lei. The average weighted rate on selling repos with state securities varied within 4.75 % to 18.0%; the medium term constituted 23 days.

The NBM accepted deposits from banks on a competitive basis through deposit auctions held by the NBM. The total value of deposits accepted during the eleven months of 2003 amounted to 20.0 million lei. The interest rates on accepted deposits varied from 2.5% to 3.0%; the medium term of transaction constituted 12.5 days.

In order to obtain short-term liquidity and with the view to duly maintain required reserves as established, commercial banks resorted to Lombard facilities and overnight credits, the number of transactions of which consisted around 100 during eleven months of 2003.

The required reserves' management in January – November 2003 was determined by the conditions of the internal financial market. With the view to mitigating speculative pressures upon national currency in the foreign exchange market and to reducing excess liquidity in the banking system, the National Bank of Moldova increased in April 2003 the ratio of required reserves from 10.0% to 12.0%.

II. Monetary and Foreign Exchange Policy for 2004

As according to the Law of the Republic of Moldova 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 conductive 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, towards inflation reduction and further consolidation of the banking sector.

The monetary and foreign exchange policy of the National Bank of Moldova for 2004 is worked out based on the following main indicators:

a) inflation rate of 8% - 10%[1];
b) real GDP growth by 5% for 2004;
c) average estimated exchange rate for 2004 at the level of 15.2 MDL for 1 USD;

Based on these macroeconomic indicators, the National Bank of Moldova sets out the following indicators and objectives of the Monetary and Foreign Exchange Policy for 2004:

1. The Monetary Program for 2004 provides as follows[2]:
   a) increase of the money supply (M2) by 24.1% till the end of the year and M2 money supply velocity of 4.49;
   b) increase of the monetary base by 23.1%, based on programmed value of M2 money supply and increase of M2 money supply multiplier to 1.46, amounting the value of 4702.7 million lei;
   c) increase of the volume of credits to economy by 42.0% till the end of 2004.
2. Premises for the implementation of the monetary program for 2004 are as follows:
   a) reduction of liquidity ratio from 0.52 as estimated for the end of 2003 to 0.49 in 2004;
   b) relevant increase of M2 money supply multiplier from 1.44 to 1.46 to the end of 2004.
3. The National Bank of Moldova:
   a) shall not extend credits to the Government in 2004 to finance the state budget deficit;

[1] As in accordance with NBM estimates
[2] Calculations are based on the estimates as for the end of 2003

b) shall re-conclude credits previously extended under the pledge of state securities at market interest rates within the limits stipulated in the Law on the Budget for 2004, establishing the maturity in 2005;
c) shall accept the further re-issuance by the Ministry of Finance of state securities (at market rates) previously transmitted to the NBM against loans concluded by the state during previous years in the amount of 400.0 million lei under conditions stipulated in the Law on the State Budget for 2004;
d) may extend in 2004 to the Ministry of Finance loans to cover temporary cash discrepancy in line with 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, marketing assistance, and services as depository for issued securities.

Instruments of Monetary Policy

5. In order to implement the Monetary Policy for 2004 the National Bank of Moldova shall, under transparent conditions, further apply same market instruments used with the view to managing the banking system liquidity: open market operations, including repos and reverse repos with state securities, attraction of deposits from banks, imposing of the reserve requirements, Lombard facilities, overnight credits and deposits.

6. In promoting the interest rates policy relevant to instruments applied on the internal financial market, the National Bank of Moldova shall consider the conditions of the monetary and foreign exchange markets, the analysis of the national economic situation, the dynamics of inflationary processes and the forecast of macroeconomic indicators. The NBM shall aim to set a base rate at a low positive level by influencing the rates on monetary market instruments through its own operations.

With the view to promoting the interest rates policy, the National Bank of Moldova shall further apply the interest "corridor" method: the highest rate shall be applied on overnight credits, the lowest one – on overnight deposits.

The rate on 2-month SS purchasing repos shall be considered as the base NBM rate to be used as a pillar for the determination of interest rates on other instruments included in the rates' "corridor".

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

7. During 2004 the National Bank of Moldova shall gradually reduce the ratio of required reserves down to 9.0% of the banks' attracted liabilities as to contribute to the increase of resources to be directed to the real sector of economy and the decrease of the cost of lending for borrowers. All that shall provide a larger accessibility of credits to economic agents.

Foreign Exchange Policy

8. The Foreign Exchange Policy of the National Bank of Moldova for 2004 provides the further free-floating exchange rate regime and the establishing of the exchange rate based on the prevailing exchange rates in the forex market.

9. Within this context, the NBM reserves the right to make foreign exchange interventions if needed to attenuate excessive fluctuations of the exchange rate. Instruments of the foreign exchange policy shall include direct purchases of foreign currency, forex swap operations and forward transactions.

10. The Foreign Exchange Policy of the National Bank of Moldova for 2004 shall be continuously directed towards the maintenance of international foreign exchange reserves at a level acceptable to cover at least 3 months of imports. The NBM shall place its foreign exchange assets in investment instruments that comply with security and liquidity requirements.

Banking Supervision

11. With the view to maintaining a stable and consolidated banking system, the National Bank of Moldova shall promote a relevant coherent policy, providing as follows:

a) the maintenance of required minimal capital as to bring the capital of banks conducting international transactions in line with standards applied in the European Union;
b) the supervision over implementation by commercial banks of adequate and efficient internal control systems aimed at increasing banking competitiveness and mitigating banking activity risks, including larger transparence of banks' shareholders;
c) the support of banking sector security by promoting relevant requirements regarding the diversification of risks related to banking active operations, establishment of provisions to cover activity risks, maximum limits on exposures to risks resulted from agreements concluded with affiliated persons and provision of "large" credits in accordance with international best practices;
d) the consolidation of market discipline and credibility within the banking sector following periodical examination of information and data disclosed by banks and, if needed, application of relevant measures to ensure the completeness, timeliness and correctness of disclosed data.

Note: The National Bank of Moldova reserves the right to review certain monetary indicators for 2004 in case of re-launching the financing of the Republic of Moldova by international financial institutions and external donors.