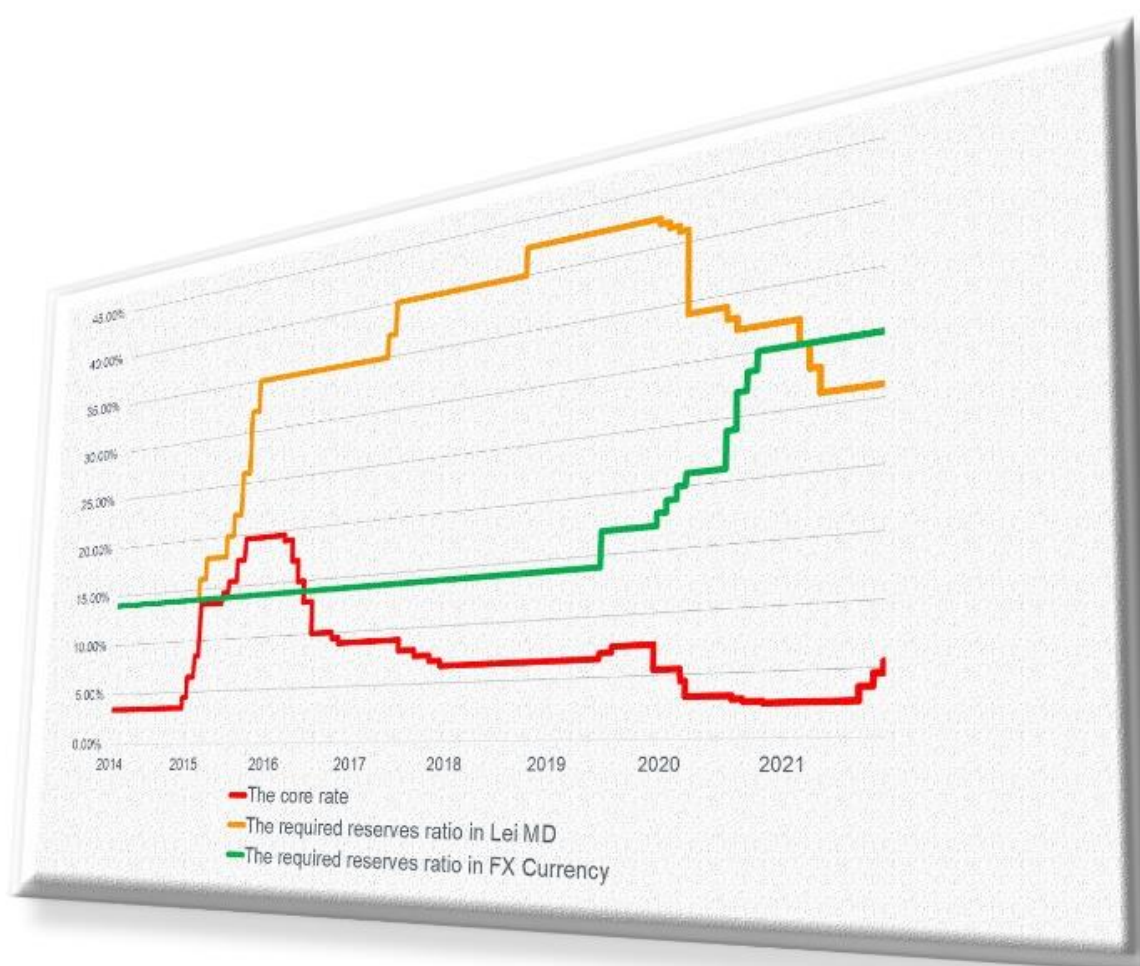




National
Bank of
Moldova

INFLATION REPORT



No.1, FEBRUARY 2022

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ISBN 978-9975-3335-9-7
ISBN 978-9975-3242-9-8 (PDF)

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Note

The report was elaborated based on the latest macroeconomic information from the internal and external environment.

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy, Ministry of Finance,

Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

State Hydrometeorological Service.

Likewise were selected certain statistical data provided by the international community and by the Central Banks of the neighboring states.

The calculation of the statistical data was carried out by the National Bank of Moldova.

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Pursuant to the provisions of art. 4 para. (1) of Law no. 548/1995 on the National Bank of Moldova (republished in the Official Gazette of the Republic of Moldova, 2015, no. 297-300, art. 544, with subsequent amendments) the fundamental objective of the National Bank of Moldova is to ensure and maintain price stability.

This objective is achieved in the light of the monetary policy framework associated with the direct inflation targeting regime. The quantitative target is to maintain inflation, measured by the consumer price index at 5.0% per year with a possible deviation of ± 1.5 percentage points.

*National Bank of Moldova appreciates the role of transparency and predictability of monetary policy in strengthening institutional credibility and ensuring inflation target. In this context, the **Inflation Report** is the main communication tool, which reflects the latest analyzes of the situation in the internal and external environment, the evolution of the inflation process and economic activity, along with aspects related to the conduct of monetary policy.*

At the same time, the Report incorporates the inflation forecast for the eight-quarter horizon, as well as the risks and uncertainties associated with this projection.

Summaries of the minutes of the meetings of the NBM Executive Board on the promotion of monetary policy are part of the Report, which are published six months after the decision in accordance with the NBM's medium-term monetary policy strategy (approved by the Decision of the Executive Board of the National Bank of Moldova no. 303 of December 27, 2012).

According to art. 69 para. (2) the Inflation Report shall be submitted to Parliament and the Government within 45 days of the end of the quarter.

The Inflation Report no. 1, February 2022 was discussed and approved at the meeting of the NBM Executive Board on February 11, 2022.

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List of acronyms

ANRE	National Agency for Energy Regulation
CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECB	European Central Bank
EU	European Union
EUR	Single European Currency
FAO	Food and Agriculture Organization of the United Nations
FCC	Freely convertible currency
FRS	Federal Reserve System
GDP	Gross Domestic Product
HoReCa	Hotel, Restaurant and Catering
IMF	International Monetary Fund
LB	Local budgets
MDL	Moldovan leu
MHIF	Mandatory health insurance fund
NATO	North Atlantic Treaty Organization
NBC	Certificates issued by the National Bank of Moldova
NBM	National Bank of Moldova
NBR	National Bank of Romania
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
OPEC	Organization of the Petroleum Exporting Countries
OPEC+	OPEC cooperation with oil producers outside OPEC in an attempt to reduce production and increase the price of oil
PMI	Purchasing Manager's Index
REER	Real effective exchange rate of the national currency
RUB	Russian ruble
SB	State budget
SS	State Securities
SSIB	State social insurance budget
USA	United States of America
USD	US Dollar

Summary

In the fourth quarter of 2021, the annual inflation rate continued, at a faster pace than expected (Inflation Report no. 4, 2021), the upward trajectory observed since the first part of 2021. Thus, it increased from 6.7% in September 2021 to 13.9% in December 2021. As a result, in the fourth quarter of 2021 it was above the upper limit of the range of 5.0% \pm 1.5 percentage points. At the same time, the average annual inflation rate in the fourth quarter of 2021 was 11.7%, 6.8 percentage points higher than in the previous quarter. The acceleration of prices in the above-mentioned period was due to the increase in prices for food, oil, natural gas and other raw materials on the international market, which was partly reflected in the increase in the prices of these products on the local market, but especially in adjusting gas and heat tariffs in November 2021. At the same time, rising inflation was supported by persistent demand pressures in the context of increasing disposable income of the population. The inflationary pressures associated with the above-mentioned factors were slightly attenuated by the exchange rate dynamics.

Over the next period, the upward trajectory of the annual CPI rate will continue as a result of rising food and other raw materials prices in the regional market. A pronounced impact on the CPI is to be determined by the full reflection of tariff adjustments by the NBS in the first part of 2022. The increase in gas and heat tariffs, the further increase in import prices for gas, as well as possible increases in other tariffs will lead to upward pressure on prices on several subcomponents of the CPI. As in previous periods, the subsequent dynamics of the CPI remain marked by the uncertainty of the timing and magnitude of some tariff adjustments in the context of the sharp rise in energy prices in the regional market, but also by the impact of weather conditions on food prices in the internal market.

The year 2021 ended on a negative note, the world economy being affected both by the continuation of the COVID-19 pandemic and by the increase of pro-inflationary pressures. In November 2021, the Omicron variant of the SARS-CoV-2 virus was detected, which spread rapidly worldwide, leading to new social and economic constraints. At the same time, production costs have continued to rise, given that world supply does not meet consumer demand. This has led several countries to take pro-inflationary pressures into account and take steps to counter them. The Federal Reserve has decided to increase rates more substantially and faster, with the average forecast anticipating three increases in 2022. This led to an appreciation of the US dollar, especially against the euro, given the delay in the ECB's reaction to the 5.0% annual inflation in the euro area in December 2021. The escalation of geopolitical tensions over the Ukraine-Russia conflict has led to the depreciation of both the Ukrainian hryvnia and the Russian ruble. The US Congress is currently preparing a new package of economic sanctions for Russia. Oil prices have risen sharply because OPEC+'s ability to increase oil production is limited in the short term and a prompt response to rising world oil demand is not possible. Gas prices in Europe rose sharply in mid-December 2021 after Gazprom no longer reserved transit capacity through Poland. It later became known that demand in Asia had fallen, and that more shale gas vessels in the United States had been relocated to European ports, so that natural gas prices had fallen. Concerns over a possible currency crisis in Turkey have risen in the region, but measures taken by President Recep Tayyip Erdogan have raised short-term confidence in the Turkish lira and the government's ability to handle rising prices.

After the sharp acceleration of April-June 2021, economic activity continued the positive dynamics, but at a more modest pace. The positive evolution was supported, mainly, by the domestic demand from the population and the positive economic dynamics in the region. Thus, in the third quarter of 2021, GDP was 8.3% higher than in the similar period of 2020, the respective dynamics being, however, lower than the one anticipated in the Inflation Report no. 4, 2021. At the same time, the seasonally adjusted series reflects a 3.3% decrease in GDP compared to the second quarter of 2021. In this context, according to estimates, the effect of aggregate demand on prices was less pronounced than anticipated in the Inflation Report no. 4, 2021. The positive dynamics of GDP was mainly due to the increase in household consumption and exports. However, a significant part of the domestic demand led to an increase in imports, which attenuated the domestic economic dynamics. On the supply side, more significant positive developments were recorded in agriculture, trade and industry. The sharp increase in economic

activity was partly reflected in the dynamics of labor market indicators. Thus, in the third quarter of 2021 both the economically active and the employed population registered an increase compared to the similar period of the previous year. At the same time, the unemployment rate as well as the underemployment rate registered a downward dynamics. Most of the operational indicators available in October and November 2021 continued to show pronounced positive developments, but overall less intense compared to those of the third quarter of 2021, thus outlining prospects for a positive GDP dynamics at the end of 2021.

In the fourth quarter of 2021, the revenues of the national public budget recorded increases, being by 29.3% above the level recorded in the similar period of 2020. Expenditures of the national public budget increased, being 9.4% above the level recorded in the fourth quarter of 2020. At the same time, on the state securities market, allocated during the fourth quarter of 2021, interest rates remained on the upward trend.

In the fourth quarter of 2021, excessive liquidity amounted to 3.6 billion lei, decreasing compared to the previous quarter by 0.7 billion lei.

Monetary aggregates in the fourth quarter of 2021 registered a positive dynamic in annual terms. At the same time, the main contribution to this development was largely due to the change in the volume of deposits in national currency and in foreign currency.

During the fourth quarter of 2021, three meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions took place. Following the assessment of the balance of internal and external risks and the short- and medium-term inflation outlook, the Executive Board of the National Bank of Moldova decided to increase the base rate applied to the main monetary policy operations by 1.85 percentage points to 6.50% annually.

The average interest rates on the balance of loans in national currency increased by 0.12 percentage points compared to the previous quarter, those on the balance of deposits increased by less than 0.03 percentage points. Average interest rates on loans and foreign currency deposits continued their downward trend.

Recent developments indicate the persistence of external pro-inflationary pressures. Oil prices are hovering around USD 90/barrel, and some experts predict that USD 100/barrel for Brent oil will be reached soon. European gas quotations remain at very high levels, and recent events have shown the fragility of the energy system to supply shocks. The precarious harvest of certain crops and the increase of logistics, transport, energy and financing costs will continue to contribute to the increase of quotations for food products on the international market in 2022, which will gradually moderate towards 2023. In order to counter pro-inflationary pressures, it is expected that emerging economies will continue and advanced ones will begin to tighten monetary conditions.

The annual inflation rate will increase rapidly by the third quarter of 2022, then decline sharply by the end of the forecast horizon¹. The annual inflation rate from the first quarter onwards will continue to be above the upper limit of the range and will return only in the second quarter of next year.

The annual rate of *core inflation* will have an upward trend during the current year, subsequently decreasing continuously until the end of the forecast period². The annual pace of *food prices* will continue to increase significantly in the first quarter of 2022, after which it will decrease significantly until the end of the forecast period. The annual rate of regulated prices will continue to increase sharply until the second quarter of this year, after which it will decrease rapidly. From the second quarter of next year until the end of the forecast horizon, it will record negative values. The annual rate of *fuel prices* will slow down considerably over the entire forecast period.

Aggregate demand will also increase in positive terms in the first quarter of the forecast, after which it will continue to decline, but will be pro-inflationary over the entire forecast horizon. This trajectory will be largely supported by a positive fiscal momentum, a revival of external demand and stimulating interest rates, although overall monetary conditions will be restrictive.

Real monetary conditions will be restrictive over the entire forecast period, with a negative impact on aggregate demand.

The current *inflation forecast*, compared to the previous inflation report, has been significantly revised upwards over the entire comparable period³. The current forecast for the annual rate of *core inflation*

¹Quarter IV 2023.

²Quarter I 2022 – quarter IV 2023.

³Quarter I 2022 – quarter III 2023.

has increased considerably over the entire comparable period. The annual rate of *food prices* has been reconfigured, revised upwards for the first quarter of 2022 and the last two quarters of the comparable period. Starting with the second quarter of 2022, for four consecutive quarters, the annual rate of food prices has been revised downwards. The current forecast of the annual rate of *regulated prices* has been significantly revised upwards for the comparable period, except for the last two quarters. The forecast for the annual rate of *fuel prices* was increased for the entire comparable period.

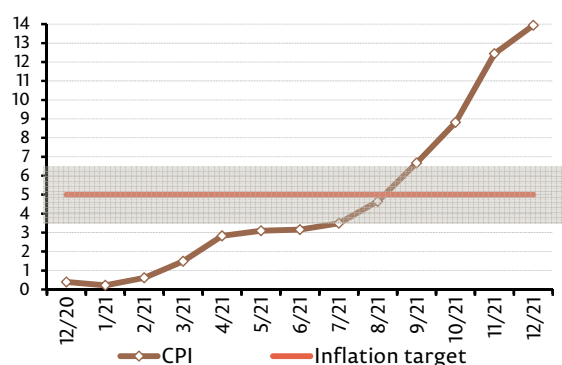
Most central banks continue to raise monetary policy rates. Thus, between February 1-11, 2022, the following monetary authorities increased the monetary policy rates: The Central Bank of Armenia increased its refinancing rate from 7.75 to 8.0% on February 1 (+0.25 percentage points), and the Bank of England on February 3 increased the base rate from 0.25 to 0.5% (+0.25 percentage points), the National Bank of the Czech Republic on February 3 increased the two-week repo rate from 3.75 to 4.50% (+0.75 percentage points), on February 4, the National Bank of Poland increased the reference rate from 2.25 to 2.75% (+0.5 percentage points), the Central Bank of Iceland on February 8 increased the key interest rate from 2.0 to 2.75% (+0.75 percentage points), the National Bank of Romania on February 9 increased the monetary policy interest rate from 2.0 to 2.5% (+0.5 percentage points), the Bank of Russia on February 11 increased the base rate from 8.5 to 9.5% (+1.0 percentage points).

Chapter 1

Inflation development

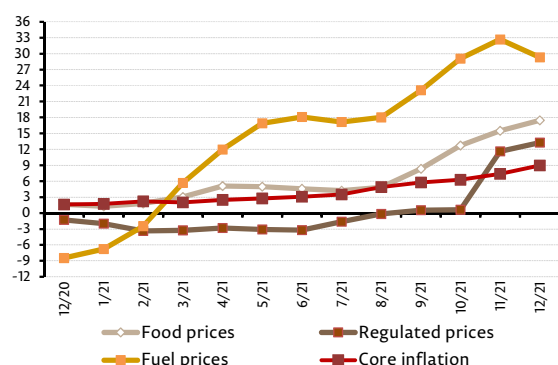
1.1 Consumer price index

Chart 1.1: The annual rate of the CPI (%)



Source: NBS, NBM

Chart 1.2: The annual rate of the main subcomponents of the CPI (%)



Source: NBS

In the fourth quarter of 2021, the annual inflation rate continued at a faster pace than expected (Inflation Report no. 4, 2021), upward trajectory observed over the previous year, mainly due to rising prices for food, oil and other raw materials on the international market, which led to increased costs on some subcomponents of the CPI and the adjustment of gas and heat tariffs, but also as a result of persistent demand pressures, supported by increased disposable income of the population. During the fourth quarter of 2021, the annual inflation rate continued to be above the upper limit of the inflation target range. Volatility and the sharp rise in international food and oil prices, together with the uncertainty of rising gas prices, favored a positive deviation in the fourth quarter of 2021 compared to the level anticipated in the Inflation Report no. 4, 2021. Between October and December 2021, the annual inflation rate continued, with a more pronounced pace, the upward trend observed since the first months of 2021. Thus, it increased from 6.7% in September 2021 to 13.9% in December 2021. As a result, in the fourth quarter of 2021 it was above the upper limit of the range of 5.0% \pm 1.5 percentage points. At the same time, the average annual inflation rate in the fourth quarter of 2021 was 11.7%, being 6.8 percentage points higher than in the previous quarter. The acceleration of prices in the above-mentioned period was due to the increase in prices for food, oil, natural gas and other raw materials on the international market, which was partly reflected in the increase in the prices of these products on the local market, but especially in adjusting gas and heat tariffs in November 2021. At the same time, rising inflation was supported by persistent demand pressures in the context of increasing disposable income. The inflationary pressures associated with the above-mentioned factors were slightly offset by the dynamics of the exchange rate.

In the next period, the upward trajectory of the annual rate of CPI will continue in the context of rising prices for food and other raw materials on the regional market. At the same time, starting from the fact that the NBS reflected the compensated increase of the tariffs for gas in the network and thermal energy in November and December 2021, a pronounced impact on the CPI will be determined by its full coverage in the first part of 2022. The increase in gas and heat tariffs, the further increase in import gas prices, as well as possible increases in other tariffs will lead to upward pressure on several

sub-components of the CPI. As in previous periods, the subsequent dynamics of the CPI remain marked by the uncertainty of the timing and magnitude of the adjustment of tariffs in the context of the sharp rise in prices for energy resources on the regional market, but also the impact of weather conditions on domestic food prices.

Core inflation

In the fourth quarter of 2021, core inflation continued its upward trajectory in early 2021, averaging 7.5% or 2.8 percentage points higher than in the previous quarter (Chart 1.4).

The inflationary path was marked mainly by the increase in prices for "clothing", "furniture", "building materials". And in the segment "recreation and culture" we can see a significant increase in prices.

On the side of the fundamental factors, there were, although more moderate, influences from the recovery of the final consumption of the population. At the same time, the positive dynamics of the payroll fund, both for the real and the budgetary sector, together with the rapid rise in lending, especially of individuals for new loans for consumption and real estate, has had a positive impact on aggregate demand, leading to the shaping of inflationary pressures from the components of core inflation.

Core inflation has continued to receive persistent cost pressures. These, largely due to the upward trajectory of the quotations of raw materials and energy products, were distinctive features of the current economic context.

Clothing and footwear have become significantly more expensive. Rising raw material prices on international markets have led to higher prices for goods produced or imported into our country.

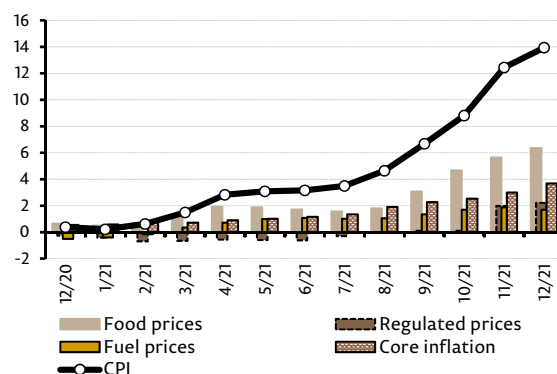
The price for the manufacture of furniture continues to be affected by the explosion of prices for the core raw material. Global wood market trends are also reflected in the Moldovan market, which is largely dependent on imports from Ukraine, Belarus and Russia.

The significant increase in prices for construction materials recorded in the last few months, reflects the avalanche of their price increases internationally, with the recovery of economies amid the easing of restrictive measures related to COVID-19.

The pressures exerted by the prices of international tourist service packages, especially at the end of the year, a holiday period for a large part of the population, together with the increase of participation fees for sports events, the increase in the price of photographic services, especially influenced by the specifics of December, with the development of a series of festive events dedicated to the winter holidays, led to a significant increase in prices in the recreation and culture segment.

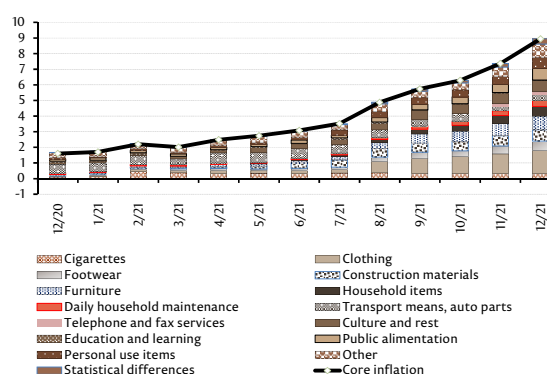
In addition, inflationary pressures specific to the management of the health crisis (costs of sanitary materials, disinfectants, etc.), which are more acutely felt in the areas of activity most exposed to direct human contact (referring to services included in core inflation, cultural and recreational services, HoReCa sector).

Chart 1.3: The evolution of the annual inflation (%) and subcomponents contribution (percentage points)



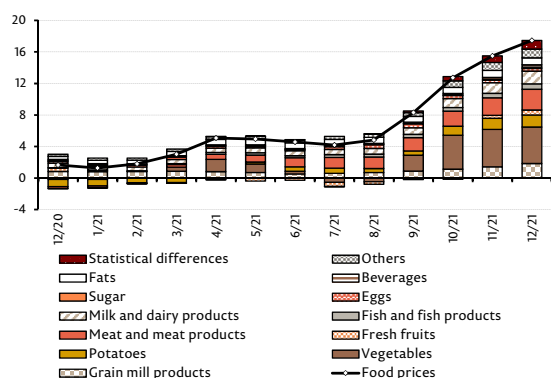
Source: NBS, NBM calculation

Chart 1.4: The contribution of subcomponents (percentage points) to the annual dynamics of core inflation (%)



Source: NBS, NBM calculations

Chart 1.5: The contribution of components (percentage points) to the annual dynamics of food prices (%)



Source: NBS, NBM calculations

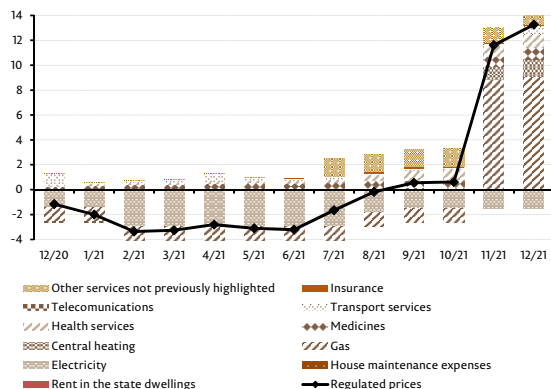
Food prices

During the fourth quarter of 2021, there was a sharp acceleration in the annual rate of food prices, thus, it stood at 17.5% in December 2021 or 9.2 percentage points higher than in September 2021 (Chart 1.5). It should be noted that during the summer months the annual rate of food prices recorded a relatively stable trajectory, determined by the rich domestic agricultural harvest of 2021, and with the substitution of some local products with those of import⁴ we witnessed a sharp correction in prices and, as a result, a significant acceleration in the annual rate of food prices. At the same time, against the background of the sharp increase in prices for energy resources at the international level, we have witnessed a significant adjustment of prices for fuel and gas in the network for economic agents on the domestic market. In this context, transport and production costs increased significantly, so that most economic agents significantly adjusted the marketing prices of the products⁵. The increase in inflationary pressures on food prices was also determined by the increase/maintenance of high commodity prices at the international level⁶ against the background of the rapid revival of external aggregate demand. Thus, inflationary pressures on the "milling and bakery products" and "fats" groups have increased significantly and, as a result, the price for these products on the domestic market is constantly rising.

In the international market, the annual rate of food prices continues to grow at a high rate of growth, generating inflationary pressures on the domestic market as well. In the fourth quarter of 2021, their annual rate recorded an average level of 27.3%, 5.3 percentage points lower than in the third quarter of 2021 and about 20.3 percentage points higher than the level at the end of 2020.

In the fourth quarter of 2021, the contribution of food prices to the formation of the annual inflation rate increased by 3.4 percentage points to 5.6 percentage points.

Chart 1.6: The contribution of components (percentage points) to the annual dynamics of regulated prices (%)



Source: NBS, NBM calculations

Regulated prices

After more than a year of developments close to zero or even negative values, the annual rate of prices for regulated goods and services has registered a considerable evolution in the last two months of 2021. Thus, the annual rate of regulated prices was 13.3% in December 2021, being 12.7 percentage points higher than in September 2021. At the same time, the average annual rate of regulated prices in the fourth quarter of 2021 was 8.5%, 8.9 percentage points higher than in the third quarter of 2021. The respective dynamics was mainly determined by the increase of the prices for the gas in the network and the central heating by 81.2% and 23.7% respectively, cumulatively for the months of November and

⁴The vegetable group being the most significantly affected.

⁵The first side effects are noticed in the processed products: milling and bakery products, dairy products, meat and meat preparations, fats and sweets.

⁶Wheat, sunflower, corn.

December 2021. In this regard, on November 9, 2021, ANRE, based on the calculations presented by S.A. "Moldovagaz" approved a tariff of 10,260 lei/1,000 m³ (excluding VAT) for natural gas supplied at the points of exit from the low pressure natural gas distribution networks, in force since November 1, 2021, which it subsequently adjusted to the value of 10,196 lei/1,000 m³ (excluding VAT), with effect from January 1, 2022⁷. However, it was amended by ANRE on January 28, 2022⁸. Thus, currently for household consumers the price of a cubic meter of gas has increased from 4.64 lei to 15.18 lei (including VAT) or by 227.2%.

At the same time, on November 20, 2021, ANRE approved the provisional prices for the electricity produced and the tariffs for the thermal energy delivered to the consumers, which entered into force on November 1, 2021⁹. Thus, the heat tariff for consumers connected to the centralized system managed by "Termoelectrica" increased from 1,122 lei/Gcal to 1,772 lei/Gcal or by 57.9%. Subsequently, a new tariff for thermal energy delivered to consumers by S.A. "Termoelectrica" in the amount of 1,689 lei/Gcal (excluding VAT) with effect from January 1, 2022 was approved¹⁰. On January 28, 2022, the respective tariff was revised once again and is currently in the amount of 2,169 lei/Gcal (excluding VAT)¹¹, with effect from January 1, 2022.

Subsequently, the Prime Minister, at the beginning of the Government meeting of January 26, 2022, announced that for domestic consumers of natural gas, the tariff in February and March for the first 150 m³ consumed, will not increase regardless of the ANRE decision¹². Thus, the first 50 m³ will cost 6.8 lei, and the next 100 m³ will cost 7.9 lei. In terms of thermal energy compensations, for the first gigacalory consumed, the Government will compensate 67% of the difference between the price in the billing month and the one in October 2021. Subsequently, it was announced that these compensations would be increased from January 2022 to 80%¹³. Therefore, after the end of the compensation period, the reflection of the impact of the above-mentioned tariff adjustment on the corresponding subcomponents of the CPI could continue.

At the same time, there was a significant impact during the quarter due to the increase in healthcare tariffs and drug prices.

Also, between October and December 2021 there were increases in fares for air passenger services and ritual services.

At the same time, several services of the Public Services Agency became cheaper, based on the Government Decision no. 966/2020 on the services provided by the Public Services Agency, published on October 15, 2021, with effect from November 1, 2021¹⁴. That decision was taken at the initiative of the Public Service Agency,

⁷<https://monitorul.gov.md/ro/monitor/2353>

⁸<https://www.anre.md/proiecte-supuse-aprobarii-3-28>

⁹<https://www.anre.md/anre-a-ajustat-preturile-provizorii-la-energia-electrica-produsa-si-tarifele-pentru-energia-termica-livrata-consumatorilor-3-355>

¹⁰<https://monitorul.gov.md/ro/monitor/2353>

¹¹<https://www.anre.md/proiecte-supuse-aprobarii-3-28>

¹²<https://stiri.md/article/social/official-tariful-pentru-primii-150-de-metri-cubi-de-gaze-nu-va-creste>

¹³https://www.ipn.md/ro/majorarea-compensatiilor-la-facturile/-pentru-energia-termica-votata-in-7967_1087320.html

¹⁴<https://monitorul.gov.md/ro/monitor/2327>

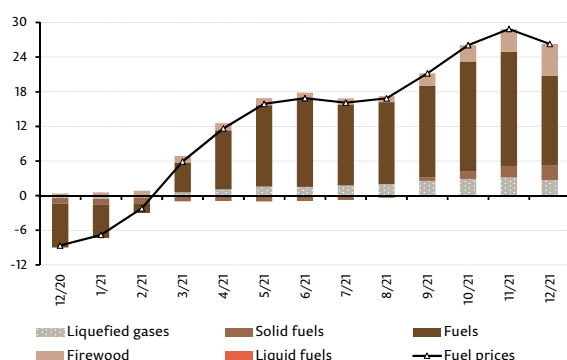
following an analysis of the costs and resources available. In this context, the service for marriage registration (the subcomponent of administrative fees, included in other services not highlighted above) became free for the population (the rate until adjustment was 260 lei).

Within the annual rate of regulated prices, a negative impact in the fourth quarter of 2021 continued to be exerted by the adjustment of the electricity tariff from January 26, 2021.

Over the next period, regulated prices will continue to rise, largely to fully reflect the November tariff adjustments, as well as their impact on tariffs on related services.

Combustibles and fuel prices

Chart 1.7: The contribution of components (percentage points) to the annual increase in fuel prices (%)



Source: NBS, NBM calculations

The annual rate of combustibles and fuel prices became more pronounced in the fourth quarter of 2021, in the context of rising oil prices and in the period October-December 2021.

Thus, the annual rate of combustibles and fuel prices increased from 23.1% in September 2021 to 29.3% in December 2021 under the influence of rising prices for "fuels" and "liquefied gases". The average annual rate of combustibles and fuel prices in the fourth quarter of 2021 was 30.4%, 10.9 percentage points higher than in the third quarter of 2021 (Chart 1.7). This development was mainly due to the increase in "fuel" prices as a result of the increase in petrol and diesel prices by PECO stations during that quarter, supported by the increase in international oil market prices in the fourth quarter of 2021 (by about 10.0%). It should be mentioned that, after a round of consultations on September 1, 2021, ANRE approved the Decision on amending some provisions of the Decision of the Council of Administration of ANRE no. 254 of 14.06.2021¹⁵. Thus, the wholesale prices became free, as well as the retail prices of liquefied gas, and ANRE publishes daily only the maximum retail prices of the main petroleum products of the standard type – gasoline and diesel.

During the fourth quarter of 2021, "liquefied gas" prices had a positive impact on the annual rate of combustibles and fuel prices. At the same time, prices for "solid fuels" and "wood, vines, etc." increased during that period, due to the sharp increase in demand for these subcomponents in the context of the increase in natural gas prices in the Republic of Moldova, but also to the considerable increase in prices on the international coal market recently.

In the coming period, combustibles and fuel prices will continue the upward trend, largely to reflect the pressures exerted by the current dynamics of oil prices, as well as excise adjustments.

¹⁵<https://www.anre.md/noi-modificari-la-procedura-de-stabilire-a-preturilor-la-produsele-petoliere-3-309>

1.2 Inflation evolution and short-term forecast assessment from the Inflation Report no. 4, 2021

In the forecast round for October 2021, a sharp acceleration of the annual inflation rate was expected and an average value of 9.3% in the fourth quarter of 2021¹⁶. Inflation data for October-December 2021 show a higher trajectory than expected in the previous round of forecasts.

In the fourth quarter of 2021, the annual inflation rate was 11.7%, being 2.4 percentage points above the level anticipated in the forecast in the Inflation Report no. 4, 2021 (Table 1.1). This deviation was mainly determined by the dynamics of regulated prices, which since November 2021 was significantly above the expected values. Their annual rate in the fourth quarter of 2021 was 8.5%, 7.1 percentage points higher than expected in the context of adjustments for gas and heat tariffs. In this sense, the forecast in the Inflation Report no. 4, 2021 did not include the gas and heat tariff adjustments approved in November 2021 and whose value was not known at the time of making the forecast, a period of heightened uncertainty in the negotiations for the signing of the natural gas supply contract. However, the maximum impact of the tariff adjustment was estimated and reflected in the forecast as an asymmetric uncertainty interval. At the same time, the deviation of the actual data from the figures anticipated in the Inflation Report no. 4, 2021 was determined, but to a lesser extent, by an evolution beyond expectations of the other subcomponents. Thus, the annual rate of food prices was about 2.0 percentage points higher than the value of 13.2% anticipated in the previous round of forecasts, which is associated with the pronounced volatility and the upward trend in food prices on the foreign market in the context of rising commodity prices.

At the same time, in October-December 2021, the annual rate of fuel prices was 2.5 percentage points higher than the expected value of 27.9% in the context of uncertainty regarding the import price and the tariff for gas in the network that supported the sharp increase and above expectations for coal and wood prices. These significantly exceeded the seasonal increases observed in previous years for that period. However, the deviation was partially mitigated in the context of the changing oil price trend observed in late November and December. Core inflation in the fourth quarter of 2021 outlined a 0.9 percentage point higher than the expectations stated in the forecast round related to the

Table 1.1: The evolution and forecast of CPI and its components

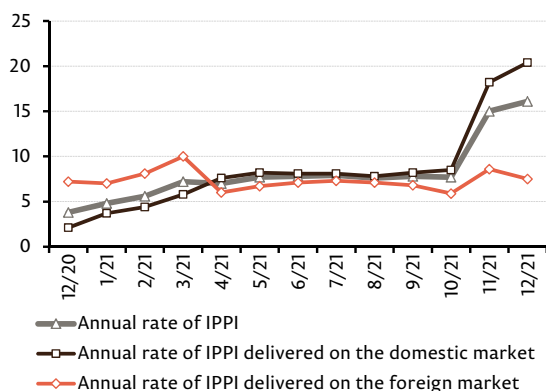
	De facto Q IV, 2021/ Q IV, 2020 (%)	Forecast IR 4, 2021* Q IV, 2021/ Q IV, 2020 (%)	Deviation (De facto- forecast) (p.p.)
CPI	11.7	9.3	2.4
Core inflation	7.5	6.6	0.9
Food prices	15.2	13.2	2.0
Regulated prices	8.5	1.4	7.1
Fuel prices	30.4	27.9	2.5

Source: NBS, NBM calculations
*IR 4, 2021 – Inflation Report no. 4, 2021

¹⁶Given the higher volatility of monthly values, but also some possible measurement errors, which normally should not influence monetary policy decisions, the short-term inflation forecast is made on a quarterly basis. That value is an input to the medium-term inflation projection, which is similarly quarterly and underpins monetary policy decisions. At the same time, it is reported in the inflation reports. However, actual monthly CPI data, as published by the NBS during the quarter, are analyzed and compared with the short-term forecast for the full quarter to assess whether the main anticipated assumptions are confirmed or whether there is a risk of pronounced deviations from the forecast. Therefore, the deviations between the actual data available for the months of the quarter and the short-term forecast of inflation must be interpreted accordingly, taking into account the assumptions/expectations for the remaining months of the quarter.

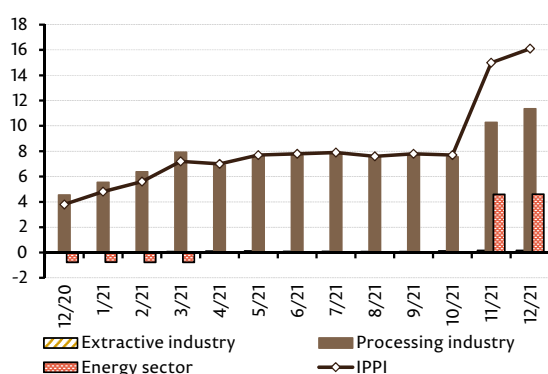
Inflation Report no. 4, 2021, mainly as a result of the unexpected increase in tariffs for mobile telephony services, but also of a more pronounced impact from the increase in costs.

Chart 1.8: Annual rate of prices in industry (%)



Source: NBS

Chart 1.9: Annual rate of prices in industry (%) and the contribution of its components classified by main branches (percentage points)



Source: NBS, NBM calculations

1.3 Industrial production prices

In the fourth quarter of 2021, the annual rate of prices in industry recorded an average level of 12.9%, or 5.1 percentage points higher than in the third quarter of 2021. In terms of structure, the annual rate of prices for products delivered on the domestic market had a sharp upward trajectory, and the rate of prices for products delivered on the foreign market was relatively stable (Chart 1.8).

Analyzing the evolution of the annual rate of prices in industry by main branches, it is clear that its sharp upward dynamics was determined by developments in the manufacturing industry and the energy sector (Chart 1.9). Prices in the energy sector rose significantly (by about 64% during the fourth quarter of 2021) amid the global energy crisis. At the same time, as a result of the significant increase in prices for energy resources and raw materials, prices in the manufacturing industry also reacted against the background of a significant increase in cost components. Thus, the annual rate of prices in the manufacturing industry increased by 2.2 percentage points to 10.7% in the fourth quarter of 2021.

The upward trend in the annual rate of prices in the manufacturing industry was largely due to the rise in prices in the "food industry", in the production of "other non-metallic mineral products", in the "other"¹⁷ component and in the production of "textiles". Prices in the extractive industry increased by 7.4%, generating a contribution of 0.2 percentage points to the dynamics of prices in the industry.

¹⁷"Manufacture of furniture", "Processing of wood, manufacture of wood and cork products, except furniture".

Chapter 2

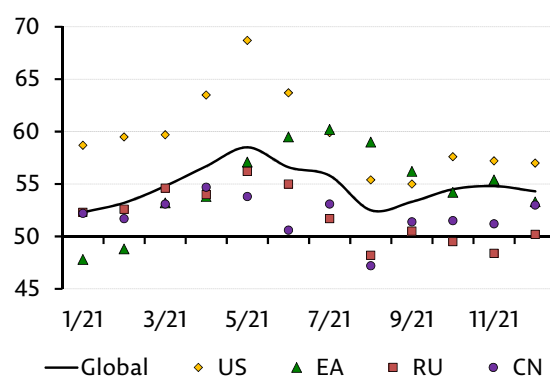
External environment

2.1 World economy, financial and commodity markets

The year 2021 ended on a negative note, the world economy being affected both by the continuation of the COVID-19 pandemic and by the increase of pro-inflationary pressures. In November 2021, the Omicron variant of the SARS-CoV-2 virus was detected, which spread rapidly worldwide, leading to new social and economic constraints. At the same time, production costs have continued to rise, given that world supply does not meet consumer demand. This has led several countries to take pro-inflationary pressures into account and take action to counter them. The Federal Reserve System has decided to increase rates more substantially and faster, with the average forecast anticipating three increases in 2022. This led to an appreciation of the US dollar, especially against the euro, given the delay in the ECB's reaction to the 5.0% annual inflation in the euro area in December 2021. The escalation of geopolitical tensions over the Ukraine-Russia conflict has led to the depreciation of both the Ukrainian hryvnia and the Russian ruble. The US Congress is currently preparing a new package of economic sanctions for Russia. Oil prices have risen sharply because the short-term capacity of OPEC+ to increase oil production is limited and a prompt response to rising world oil demand is not possible. The price of natural gas in Europe rose significantly (approximately USD 2,000/1,000 m³) in mid-December 2021, after Gazprom no longer reserved transit capacity through Poland. It became known later that demand in Asia had fallen and that several US shale gas vessels had been relocated to European ports, so that natural gas prices had fallen to about USD 1,000/1,000 m³. Concerns over a possible currency crisis in Turkey have risen in the region, but measures taken by President Recep Tayyip Erdogan have raised short-term confidence in the Turkish lira and the government's ability to handle rising prices.

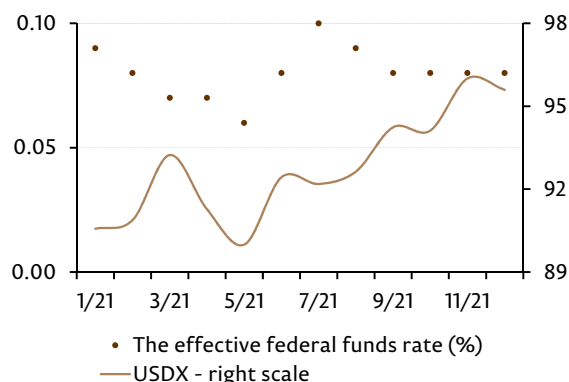
The values of the **PMI indices** in recent months show a stable temperate recovery of the world economy (Chart 2.1). The detection of the Omicron variant of the SARS-CoV-2 virus and the rapidity with which it spreads led to a hasty reaction from some authorities, with new social and economic restrictions being imposed. Subsequently, the risks of Omicron infection were minimized, which was also reduced by restrictions. Rising geopolitical tensions and the risk of new economic sanctions have also affected the Russian economy's economic prospects, but rising gas and oil prices are expected to sustain the Russian economy as always. There is also a faster pace of activity in emerging economies due to tightening monetary conditions and

Chart 2.1: Evolution of PMI indices



Source: Markit

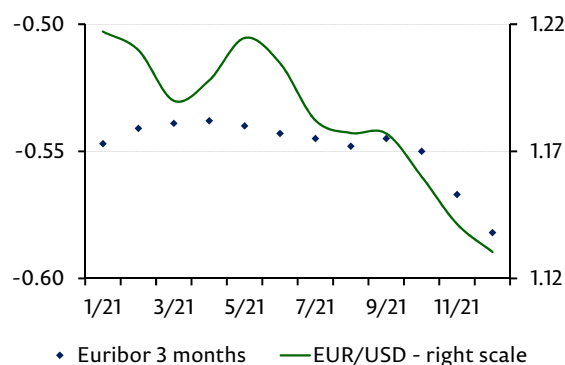
Chart 2.2: Evolution of the USD index (DXY)* in the context of FRS monetary policy



Source: FRS, Bloomberg

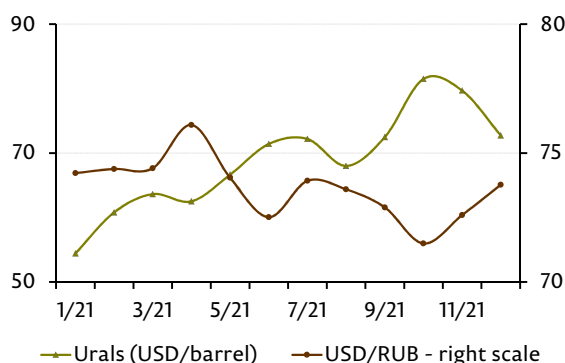
* DXY is an index calculated by the weighted geometric mean of the value of the US dollar against a basket of foreign currencies: euro – 57.6%, Japanese yen – 13.6%, pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%

Chart 2.3: Evolution of EUR/USD (monthly average) and interest rates in the euro area



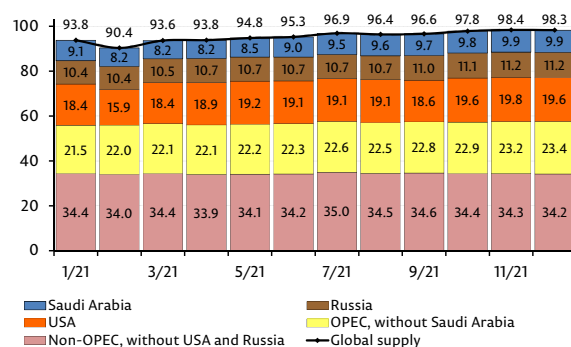
Source: ECB, Eurostat

Chart 2.4: The evolution of USD/RUB under the Urals price development



Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation

Chart 2.5: World oil supply (millions of barrels per day)



Source: US Energy Information Administration

rising production costs, while advanced economies still benefit from fiscal and monetary incentives and reserved stocks at much lower prices.

The US dollar appreciated as a whole in the last months of 2021, after Federal Reserve Chairman Jerome Powell said the risk of inflation had risen and agreed that it was time to stop describing inflation as temporary. He noted that it is advisable to consider completing the reduction in asset purchases a few months earlier than expected, as inflation appears to be stronger than expected. Thus, the average forecast of FRS anticipates three increases in the interest rate range in 2022 and the accelerated completion of asset redemptions. At the same time, some experts see the risk of even four FRS interest rate hikes in 2022, after official statistics announced an annual increase in US consumer prices of 7.0% in December 2021 (Chart 2.2).

The single European currency depreciated on average quarterly by 3.0% against the US dollar in the fourth quarter of 2021. Annual inflation in the euro area reached 5.0% in December 2021, but amid concerns about Europe's COVID-19 outbreaks, Governor Christine Lagarde went on to say that ECB will not rush to raise rates. This has caused confusion among investors, especially as forecasts show that inflation in the euro area will not reach the target of 2.0% per year on average in 2022 either. It should be noted that other countries outside the European bloc, such as the United Kingdom, Norway, Iceland have resorted in recent months to tightening monetary conditions. Also, Eastern European countries, such as Romania, Poland, Hungary, the Czech Republic, have raised interest rates in response to increased pro-inflationary pressures (Chart 2.3). It should be noted that at its meeting on February 3, 2022, the ECB announced that it would phase out its asset acquisition program from March 2022, and the market anticipates that by the end of this year the ECB will start raising interest rates.

In the fourth quarter of 2021, **Russian ruble** depreciated as a whole against the US dollar due to worsening geopolitical tensions, declining oil prices and the global strengthening of the US currency. At the same time, the Russian ruble was supported by rising European gas prices, hopes for a high-level dialogue between Russia and the USA and Russia and NATO in January 2022, and further tightening of monetary conditions by the Bank of Russia. During 2021, the Bank of Russia increased the cumulative base rate 7 times from 4.25 to 8.5% (Chart 2.4).

Oil prices had increased volatility in the last months of 2021, but overall increased by 10.0% compared to the previous quarter and by 75.6% compared to the fourth quarter of 2020 (Chart 2.4). The OPEC+ Alliance has continued its plan to increase oil production by only 400,000 barrels per day each month (Chart 2.5), even as global demand has continued to grow and far exceed its oil supply (Chart 2.6). As energy prices rise sharply and create strong pro-inflationary pressures, US President Joe Biden has called for OPEC to increase oil production to reduce the current global deficit. As OPEC continued its plans and ignored the US request, it was decided that more countries would sell off their oil reserves. However, this action has had a limited and short-term effect, as the oil capacity released from reserves is not sufficient to meet growing global demand. Another factor that caused the volatility of oil prices was the appearance of the Omicron variant. Initially, the

market reacted negatively to the news of a new, rapidly spreading SARS-CoV-2 strain, but later concerns about the impact of the Omicron variant on global fuel demand diminished, leading to rising oil prices. Discussions on Iran's nuclear program have also stalled, delaying the "return" of Iranian oil. In early 2022, oil prices rose, fueled by supply worries amid escalating social unrest in Kazakhstan, Libya's power outages, cold weather in North America and escalating geopolitical tensions in the Middle East.

International prices have continued to rise due to limited supply, rising energy costs, persistently high transport and logistics costs, and uncertainties about the evolution of the world economy. Overall, in the fourth quarter of 2021, world prices calculated by the IMF index increased by 12.0% compared to the third quarter of 2021 and by 60.3% compared to the fourth quarter of 2020. The food index rose by 1.1% from the previous quarter and by 23.2% from the same quarter in 2020. The metal index fell by 11.9% from the previous quarter, but was up by 15.5% from the same quarter in 2020. The largest increase continues to be in the energy resources index, which increased by 26.5% compared to the previous quarter and 2.3 times compared to the fourth quarter of 2020 (Chart 2.6).

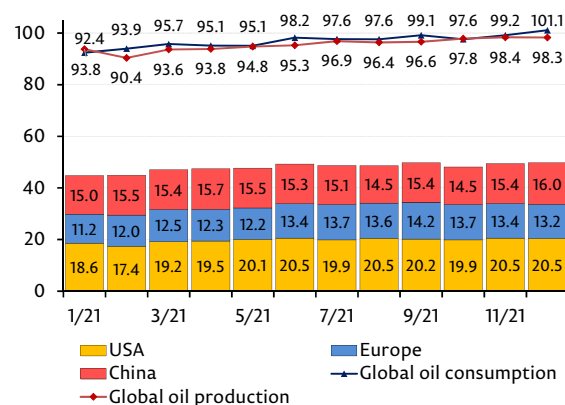
International food quotes continued to rise, increasing by an average of 5.3% in the fourth quarter of 2021 compared to the previous quarter and by 27.3% compared to the fourth quarter of 2020. With the exception of meat quotations, which fell by 1.6% on a quarterly basis, all groups recorded increases (in oils by 11.8%, cereals by 7.6%, dairy products by 7.0%, and 1.3% sugar). On an annual basis, quotations increased significantly – for oils by 52.4%, sugar by 37.1%, cereals by 22.1%, meat by 19.5% and dairy products by 17.7%. Among the factors with a direct impact on international food quotations were increased demand, poor harvest and unfavorable expectations for some crops, and among those with an indirect impact were rising costs for energy resources, mineral fertilizers and financing costs (Chart 2.8).

2.2 The evolution of important economies

In the third quarter of 2021, the gross domestic product of **United States** increased by 0.5% (in seasonally adjusted terms) compared to the previous quarter and by 4.9% compared to the level of the same period of the previous year. In 2021, industrial production in the US increased by an average of 5.6% compared to 2020. In December 2021, the unemployment rate in the US fell by 0.3 percentage points to 3.9%. Annual inflation in the US accelerated to 7.0% in December 2021, exceeding the 2.0% target level for 10 consecutive months.

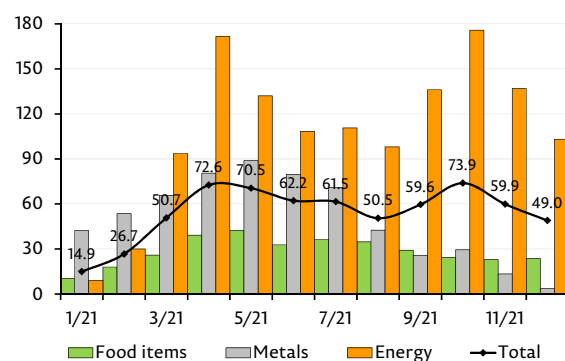
The acceleration of economic activity in the third quarter of 2021 led to a 2.2% increase in gross domestic product in the **euro area** (in seasonally adjusted terms) compared to the second quarter of 2021 and to a 3.9% increase compared to the third quarter of 2020. In the first 11 months of 2021, industrial production in the euro area increased by 8.4% compared to the same period last year, of which in Germany by 4.6%, France by 6.6% and Italy by 11.9%. The latest published data show that in November 2021,

Chart 2.6: World oil consumption (millions of barrels per day)



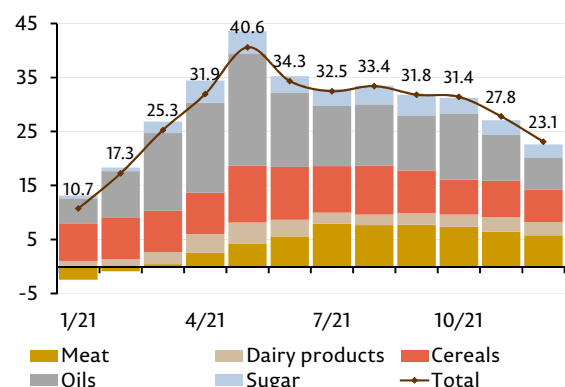
Source: US Energy Information Administration

Chart 2.7: Annual growth rate of world prices (IMF indices) (%)



Source: IMF, NBM calculations

Chart 2.8: Annual growth rate of world food prices (FAO index) (%)



Source: FAO, NBM calculations

the unemployment rate in the euro area fell to 7.2%, and the harmonized index of consumer prices in December 2021 increased by 0.4% compared to the previous month and by 5.0% compared to December 2020. Keeping annual inflation above the 2.0% target set by the ECB in the context of the energy crisis leads market participants to continue to wait for the gradual cessation of the monetary stimulus related to COVID-19.

2.3 Evolution of neighboring economies and main trading partners

In the third quarter of 2021, the gross domestic product of **Romania** increased by 0.4% (in seasonally adjusted terms) compared to the previous quarter, and compared to the same period of the previous year, the gross series increased of 7.4%. In the period of January-November 2021, industrial production increased compared to the same period of the previous year by 7.5% on the gross series. In December 2021, consumer prices rose by 0.7% from the previous month's price level and by 8.2% from the December 2020 price level. As the annual inflation level exceeded the 1.5-3.5% corridor targeted by NBR, the monetary policy rate was increased from January 1, 2022, from 1.75 to 2.0%.

In the third quarter of 2021, the economy of the **Russian Federation** contracted by 0.5% (in seasonally adjusted terms) compared to the previous quarter and increased by 4.3% compared to the same period last year. Cumulatively, in January-November 2021, industrial production in the Russian Federation increased by 5.2%. Annual inflation was above the target set by the Bank of Russia in November 2020, and in December 2021 reached a significantly high level of 8.4%. Thus, the Bank of Russia continued to tighten monetary policy, raising the base rate in December by 100 basis points to the current level of 8.5%.

In the third quarter of 2021, the gross domestic product of **Ukraine** increased by 1.4% (in seasonally adjusted terms) compared to the second quarter of 2021 and by 2.4% in annual terms. In the first 11 months of 2021, industrial production increased by 1.3%, construction output by 0.3% and agriculture by 16.7%. Inflation continued to accelerate in December 2021, with consumer prices rising in Ukraine by 0.6% from the previous month and by 10.0% from December 2020. Against the background of increasing pro-inflationary pressures, the National Bank of Ukraine increased the base rate 5 times in 2021 to the level of 9.0% and at the beginning of 2022 followed an increase of 1.0 percentage points to the current level of 10.0%.

Chapter 3

Economic developments

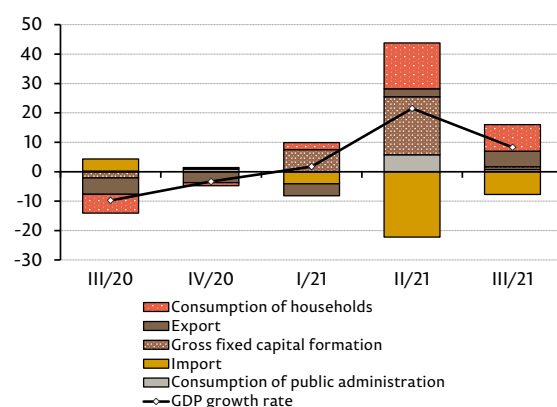
3.1 Demand

After the sharp acceleration of April-June 2021, economic activity continued the positive dynamics, but at a more modest pace. The positive evolution was supported, mainly, by the domestic demand from the population and the positive economic dynamics in the region. Thus, in the third quarter of 2021, GDP was 8.3% higher than in the same period of 2020, the dynamics being lower than expected in the Inflation Report no.4, 2021. At the same time, the seasonally adjusted series reflects a 3.3% decrease in GDP compared to the second quarter of 2021. In this context, the effect of aggregate demand on prices was estimated to be less pronounced than expected. The positive dynamics of GDP were mainly due to the increase in household consumption and exports. However, a significant part of the domestic demand led to an increase in imports, which attenuated the domestic economic dynamics. On the supply side, more positive developments were recorded in agriculture, trade and industry.

In the third quarter of 2021, GDP increased by 8.3% compared to the same period last year. In the period of January-September 2021 compared to the similar period of 2020, the GDP increased by 10.3%. Among the factors that supported the respective dynamics in 2021 can be mentioned the decrease of interest rates, which supported the increase of credit, the depreciation of the exchange rate, the increase of budgetary expenditures, the increase of the salary fund and the economic recovery in the region, as well as the effect of a reduced base period in 2020 due to restrictions on COVID-19. Although the positive dynamics of economic activity in the third quarter of 2021 was anticipated in the previous forecast round (Inflation Report no.4, 2021), it was lower than the forecast values. However, GDP data show that the level of economic activity up to the pandemic has been exceeded. In this context, the effect of aggregate demand on prices, although positive, is lower than expected in the third quarter of 2021.

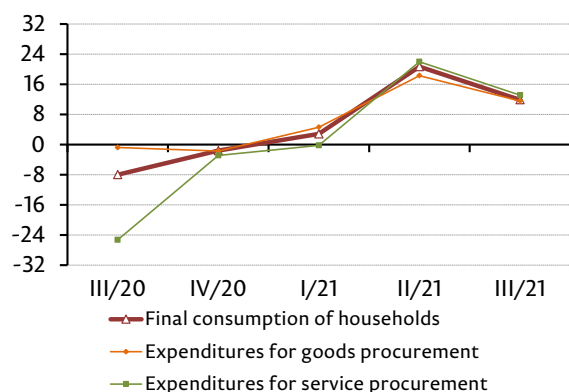
In terms of uses (Chart 3.1), economic growth in the third quarter of 2021 was mainly due to higher consumption of the population and exports. However, after the pronounced evolution in the second quarter of 2021, the annual dynamics of household consumption of the population moderated to 11.9%. Similar to the previous period, the positive evolution of consumption was supported by the increase of the disposable income of the population, but also by the relaxation of the credit conditions from the previous periods.

Chart 3.1: The contribution of demand components to GDP growth (percentage points)



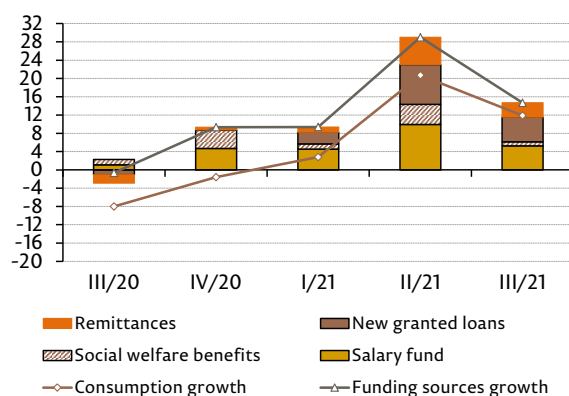
Source: NBS, NBM calculations

Chart 3.2: Evolution in real terms of the final consumption of households (% , compared to the previous year)



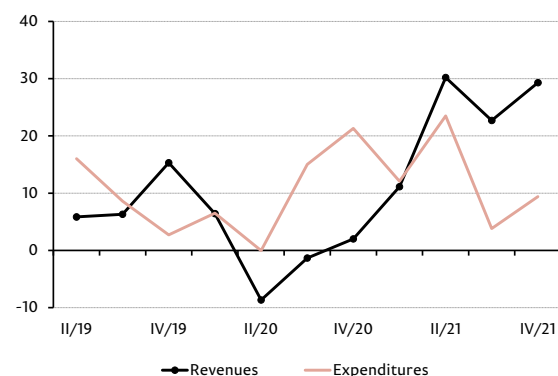
Source: NBS

Chart 3.3: Evolution of disposable income of the population (% , compared to the previous year) and contributions of the subcomponents (percentage points)



Source: BNS

Chart 3.4: Dynamics of public revenues and expenditures (% , compared to the previous year)



Source: Ministry of Finance

After the sharp acceleration (32.1%) in the second quarter of 2021, between July and September 2021, public administration consumption increased by only 2.8%. Investments, in the third quarter of 2021, generated a positive impact (0.6 percentage points), but significantly more modest compared to the first half of 2021. Their positive dynamics were influenced by the contribution from the stock change subcomponent (3.5 percentage points), while the gross fixed capital formation decreased by 7.9% and generated a negative impact of -2.4 percentage points. The dynamics of exports of goods and services, as a result of the economic growth of the main trading partners, but also of a rich harvest in 2021, accelerated to 25.1% in real terms compared to the third quarter of 2020. The increase in domestic demand was accompanied by an increase in imports, which were 17.8% higher than in the same period of the previous year, a significantly more modest annual rate than in April-June 2021 (52.0%).

Consumer demand of the population

The annual consumption rate of households registered a less pronounced increase in the third quarter of 2021.

Thus, the annual rate of final consumption of households registered a level of 11.9%, being 8.8 percentage points lower than in the second quarter of 2021. The positive dynamics of household consumption were supported by the increase in spending on the purchase of goods by 11.6% and spending on the purchase of services by 13.1% compared to the same period last year (Chart 3.2).

Similar to the previous period, the positive evolution of consumption was supported by the increase of the disposable income of the population, but also by the relaxation of the credit conditions from the previous periods. Thus, the main sources of financing the consumption of the population signaled a positive dynamic in the third quarter of 2021 (Chart 3.3). In this way, the salary fund increased by about 17.0%, the annual rate being more temperate compared to the acceleration of 25.0% from April-June 2021. At the same time, the monetary policy measures of 2020 have led to a decrease in credit rates and an increase in lending volumes, which has favored domestic consumption. At the same time, remittances and social security reflected a positive growth rate during that period. On the other hand, outlining the preconditions for new restrictions, as well as more cautious expectations regarding the further evolution of the economy in the context of the increase in the number of COVID-19 cases in the third quarter of 2021 can be considered an impediment in the consumption dynamics of households during the reference period.

Public sector

According to the data provided by the Ministry of Finance, in the fourth quarter of 2021, the revenues of the national public budget were accumulated in the amount of 23.3 billion lei, 29.3% more than the revenues accumulated in the same period of 2020 (Chart 3.4). The majority of budget revenues were accrued from taxes and fees, which accounted for 59.2%. Compulsory insurance contributions and premiums accounted for 25.9%, and the share of grants and other revenues accounted for 9.2% and 5.8% of total budget revenues, respectively.

The expenditures of the national public budget, in the fourth quarter of 2021, totaled 25.5 billion lei, registering an increase of 9.4% compared to the similar period of 2020. Of the total expenditures, the largest share was spent on social protection (31.4%), education – 16.2%, and health care were allocated 15.2%.

It should be noted that, in the fourth quarter of 2021, transfers from the state budget (SB) were made to the state social insurance budget (SSIB), the mandatory health insurance fund (MHIF) and local budgets (LB), amounting to 8.4 billion lei (up 5.2% compared to the same period in 2020) (Chart 3.5). Most of the transfers went to local budgets, about 53.4% of all transfers, followed by transfers to SSIB, about 23.4%, with MHIF receiving more modest funding of 23.2%.

In this context, in the fourth quarter of 2021, the execution of the national public budget resulted in a deficit of 2.2 billion lei. In the similar period of 2020, the execution of the national public budget resulted in a deficit of 5.3 billion lei. The balances of the accounts of the national public budget as of December 31, 2021 amounted to 11.9 billion lei.

Evolution of the Single Treasury Account

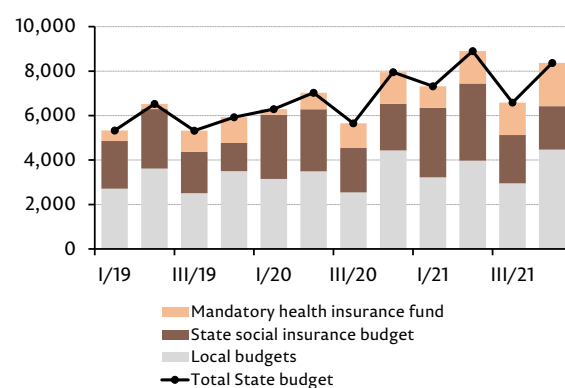
The dynamics of the single treasury account (STA) in the fourth quarter of 2021 was characterized by a slowdown in the pace of payments compared to the previous quarter and compared to the fourth quarter of 2020 (Chart 3.6). As a result of the evolution of inflows and outflows, the balance of the STA amounted to about 6.7 billion lei as of December 31, 2021 and recorded an annual increase of 26.1% (Chart 3.7).

It should be noted that at the end of the fourth quarter of 2021, the balance of the Government's foreign currency deposit account with the National Bank of Moldova increased and was equivalent to about 7.7 billion lei or 69.8% higher than at the end of 2020.

State debt

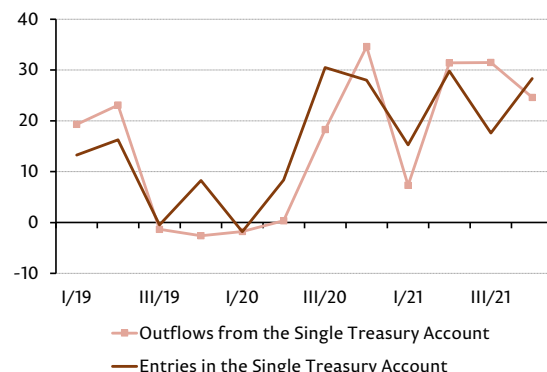
As of December 31, 2021, the balance of the state debt of the Republic of Moldova totaled about 77.8 billion lei, compared to GDP¹⁸ this amounted to 33.5% (Chart 3.9). In annual terms, the state debt registered a nominal increase of 14.6% (Chart 3.8), as a result of the increase in the external state debt recalculated in the national currency (with a positive contribution of 8.7 percentage points) and domestic state debt (with a positive contribution of 5.9 percentage points). The state debt, as of December 31, 2021,

Chart 3.5: Evolution of budget transfers (millions of lei)



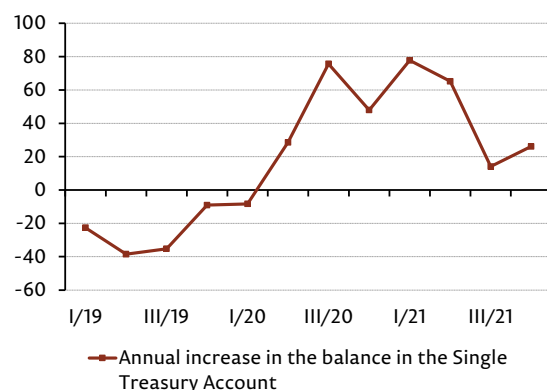
Source: Ministry of Finance
Oct.-Nov.

Chart 3.6: Evolution of the single treasury account flows (% compared to the previous year)



Source: NBM

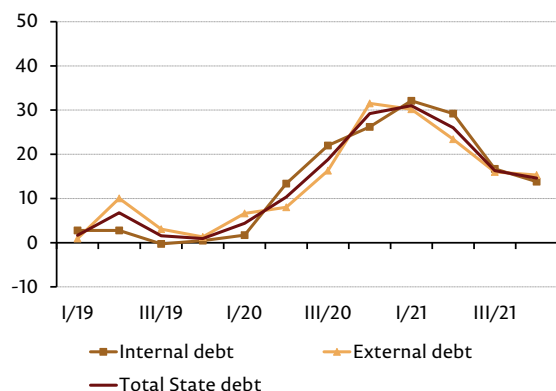
Chart 3.7: Evolution of the balance of the single treasury account (% compared to the previous year)



Source: NBM

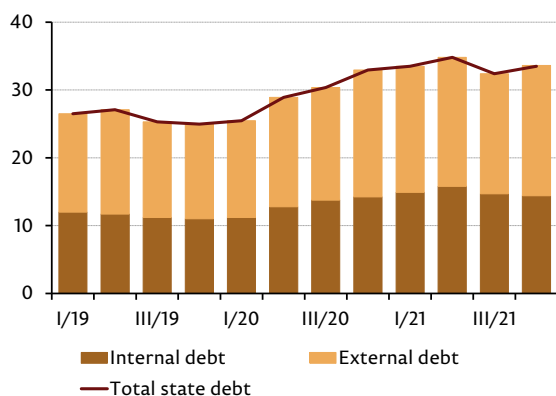
¹⁸GDP estimated by the NBM.

Chart 3.8: Evolution of the state debt growth rate (% compared to the previous year)



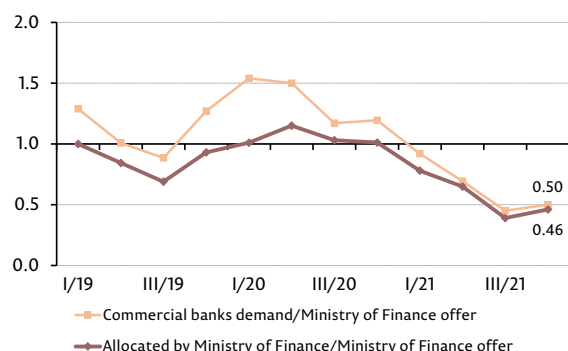
Source: Ministry of Finance

Chart 3.9: Share of state debt in GDP (% end of quarter)



Source: Ministry of Finance

Chart 3.10: Relationship between supply and demand in the primary market of government securities



Source: NBM

consisted of 57.2% external state debt and 42.8% internal state debt.

As of December 31, 2021, the foreign government debt balance amounted to USD 2,506.1 million, higher than on December 31, 2020 by approximately USD 264.7 million or 11.8%. Recalculated in domestic currency, the balance of external government debt amounted to about 44.5 billion lei (19.2% of GDP¹⁸) (Chart 3.9).

As of December 31, 2021, the domestic state debt amounted to 33.3 billion lei (14.4% of GDP¹⁸) (Chart 3.9), higher than in the similar period 2020 with 13.8% (Chart 3.8). The increase in domestic state debt was driven by state securities (SS) issued on the primary market, whose volume increased by 29.0% compared to the end of 2020. As a result of these developments, as of December 31, 2021, the domestic debt consisted of SS issued on the primary market (56.4%), SS issued for the execution of state guarantees (37.1% of the total) and converted SS (6.5%).

Primary market of state securities (SS)

During the fourth quarter of 2021, the Ministry of Finance put into circulation state securities totaling 5,680.3 million lei, 54.0% less than the volume of the initial offer. It should be noted that the volume of the offer of the Ministry of Finance increased 2.4 times compared to the offer in the fourth quarter of 2020. Banks' demand was 49.9% lower than the offer of the Ministry of Finance, amounting to 6,186.9 million lei (Chart 3.10).

Over the reporting period, average effective interest rates on 91 days, 182 days and 364 days treasury bills increased from the previous quarter by 3.9 percentage points, 2.5 percentage points, and 2.1 percentage points, respectively. The average effective interest rate on government bonds with a maturity of 2 years and 3 years increased compared to the third quarter of 2021 by 1.1 percentage points and 0.6 percentage points, respectively. The average effective interest rates on government bonds with a maturity of 5 years and 7 years increased by 0.5 percentage points each compared to the level recorded in the previous quarter (Chart 3.11).

The structure of the SS portfolio put into circulation during the reference period shows that the most requested SS were those with a maturity of 182 days, which accounted for 53.2% of total transactions, followed by 364 days treasury bills, whose share was 28.2%, while the share of 91 days treasury bills was 18.1%. It should be noted that the shares in government bonds with a maturity of 2 years and 7 years accounted for 0.1% and 0.4%, respectively. The share of government bonds with a maturity of 3 years and 5 years was insignificant (Chart 3.12).

Investment demand

In the third quarter of 2021, the investment component generated a modest positive contribution of 0.6 percentage points to the dynamics of economic activity. This development was caused by the increase in stocks, which generated a contribution of 3.5 percentage points to GDP growth. At the same time, there was a decrease in gross fixed capital formation (-7.9%), which contributed to a decrease in the annual GDP rate by 2.4 percentage points. It should be noted that the

reduction in the annual rate of gross fixed capital formation was largely due to the dynamics of investments in "construction" which contracted by 13.7% (Chart 3.13). At the same time, the 9.2% increase in the "machinery and equipment" subcomponent generated a positive contribution to the dynamics of gross fixed capital formation.

According to the operative data presented by the NBS, in the third quarter of 2021, the annual growth rate of investments in tangible fixed assets¹⁹ decreased by 2.5%. Thus, the decrease in investments in "means of transport", "non-residential buildings" and "engineering constructions" determined the negative dynamics of investments in tangible fixed assets (Chart 3.14).

From the perspective of sources of financing investments in fixed assets, the negative dynamics of -2.0% in the third quarter of 2021 was mainly determined by the dynamics of the group "other sources (including loans and domestic loans)" and "state budget" (Chart 3.15). As in previous periods, own funds remain the main source of financing investments in fixed assets (about 62.9% in the third quarter of 2021), recording a positive momentum in the reference period.

Net foreign demand²⁰

In the second half of 2021, a continuation of the revival of the international trade of the Republic of Moldova is outlined. Thus, during the analyzed period, the annual rate of imports and that of exports register sharp growth rates. It should be noted that the positive dynamics of imports was determined by the revival of domestic consumption, but also by the sharp increase in prices for energy resources internationally. At the same time, the positive developments in the agricultural sector have significantly contributed to the positive dynamics of exports.

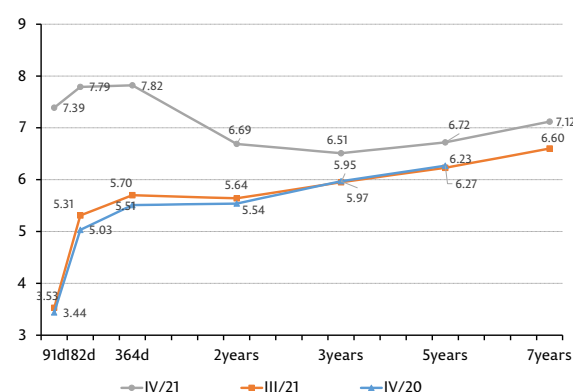
The annual export rate in the third quarter of 2021 was 36.1% or 5.5 percentage points higher than in the second quarter of 2021. At the same time, the data for the first two months of the fourth quarter of 2021 show a continuation of the upward trend in the annual rate of exports. The acceleration of the annual export rate in the second half of 2021 was mainly due to the evolution of exports to CIS countries and those classified as "rest of the world". At the same time, exports to EU countries increased, but the impact on the total dynamics of exports decreased compared to the second quarter of 2021 (Chart 3.16).

The record of a rich agricultural harvest in 2021 contributed to the sharp increase in the export of agricultural products in the second half of 2021 (Chart 3.17). At the same time, data for the second half of 2021 show a slowdown, compared to the second quarter of 2021, of exports of "vehicles, optical and sound recording or reproducing", "textiles and clothing" and "mineral products".

¹⁹As of January 1, 2017, the 2-INV statistical questionnaire "On investments" was modified to adjust the statistical tools (notions and definitions used, methods of calculation and presentation of indicators) with the provisions of the new National Accounting Standards, which entered into force on January 1, 2015.

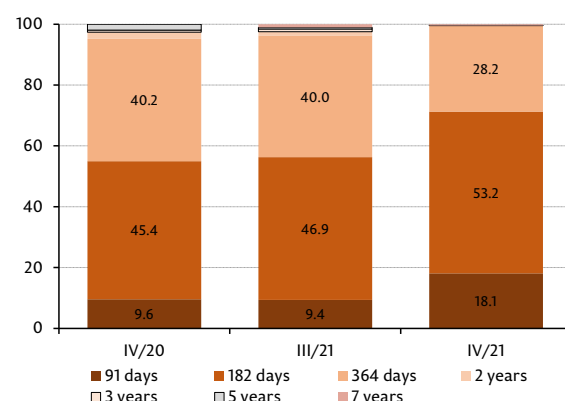
²⁰Quarterly data on the evolution of the foreign trade of the Republic of Moldova, expressed in thousands of US dollars, were used.

Chart 3.11: SS yield curve (%)



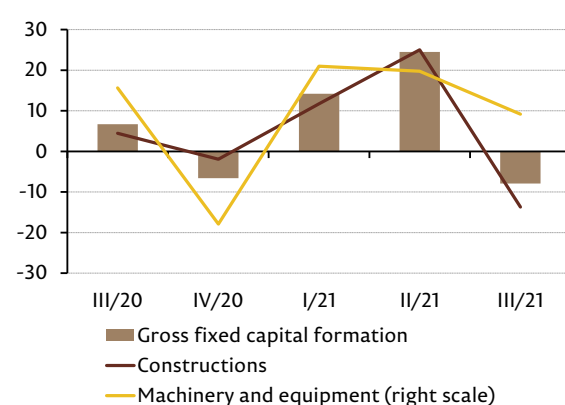
Source: NBM

Chart 3.12: SS structure allocated to the primary market



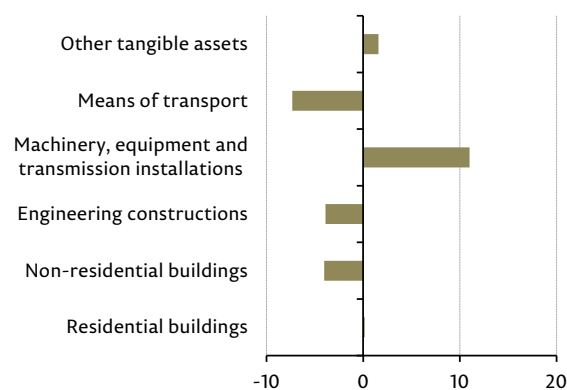
Source: NBM

Chart 3.13: Annual dynamics of investment (%)



Source: NBS

Chart 3.14: The contribution of the components to the increase of investments in tangible assets in the third quarter of 2021 (percentage points)



Source: NBS, NBM calculations

Analyzing the evolution of exports by origin of products, it can be seen that the acceleration of the annual rate of exports in the third and fourth quarters of 2021 was mainly determined by the evolution of exports of domestic products. At the same time, the re-export in the analyzed period generates positive contributions to the dynamics of the total export, but clearly lower than those determined by the export of domestic products (Chart 3.18).

In the third quarter of 2021, the annual rate of imports was 25.6% or 41.2 percentage points lower than in the second quarter of 2021. The slowdown in the annual rate of imports in the third quarter is essentially a correction to the levels characteristic of the economy of the Republic of Moldova, after the very high level in the second quarter of 2021, determined by the effect of the favorable base in 2020²¹. At the same time, the data for the first two months of the fourth quarter of 2021 show an acceleration of the annual rate of imports to the level of about 32.5%. The recording of positive rates of the annual rate of imports in the analyzed period was determined by their evolution from all categories of countries (Chart 3.19).

By groups of goods (Chart 3.20), the increase in the annual rate of imports in the first two months of the fourth quarter of 2021 was mainly due to the increase in imports of "mineral products"²². At the same time, in the fourth quarter of 2021 the data for the other product categories present a practical picture similar to that of the third quarter of 2021.

²¹ Significant contraction of imports amid economic and social constraints imposed by authorities worldwide on the backdrop of the COVID-19 pandemic.

²² The sharp increase in the import of mineral products mainly reflects the significant increase in the marketing price of energy resources.

Chart 3.15: The annual investment dynamics by funding sources (% , in real terms)

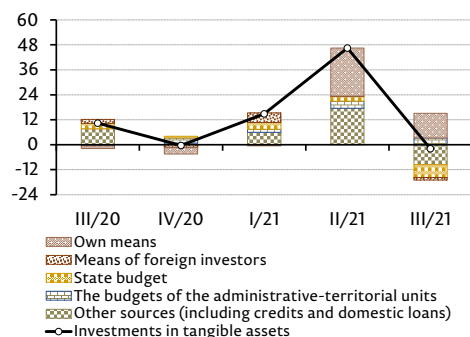


Chart 3.18: Evolution of exports annual rate (%) and contribution by origin (p.p.)

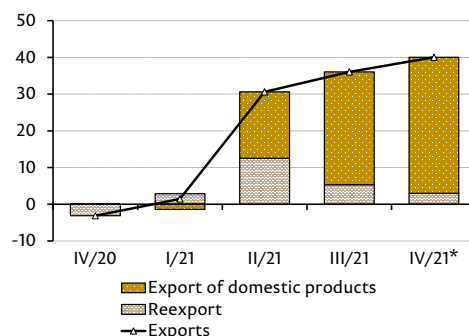


Chart 3.16: Evolution of exports annual rate (%) and contribution by categories of countries (percentage points)

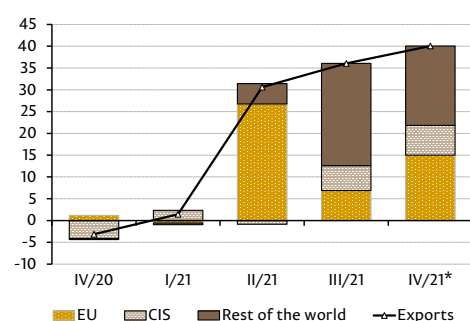


Chart 3.19: Evolution of imports annual rate (%) and contribution by categories of countries (percentage points)

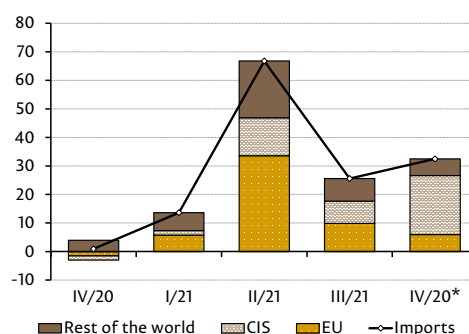


Chart 3.17: Evolution of exports annual rate (%) and components' contribution by groups of goods (percentage points)

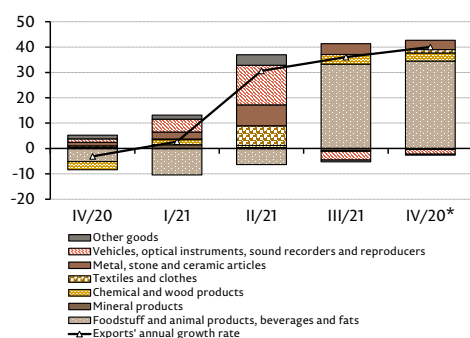
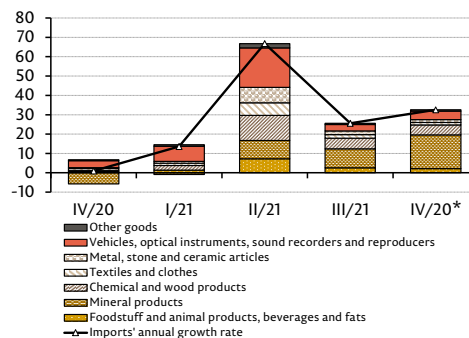


Chart 3.20: Evolution of imports annual rate (%) and components' contribution by groups of goods (percentage points)



3.2 Production

Chart 3.21: Contribution of sectors of the economy to GDP growth (percentage points)

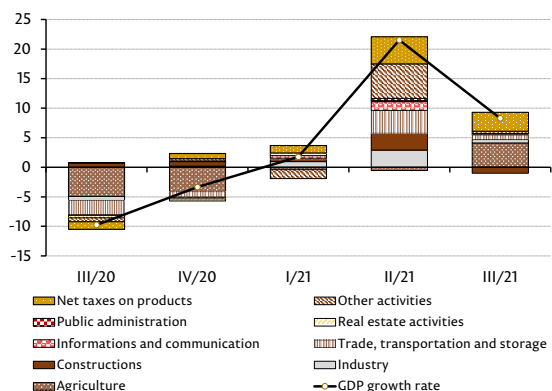


Chart 3.22: Real evolution of industry in terms (% , compared to the previous year)

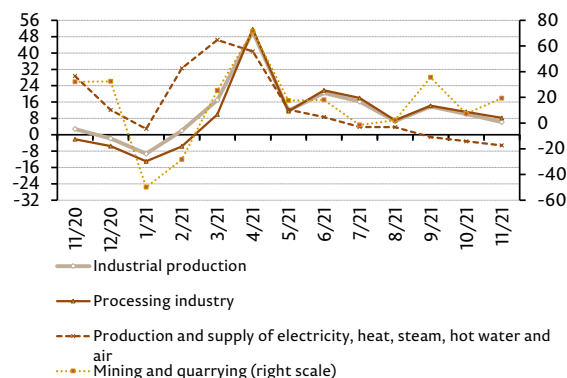
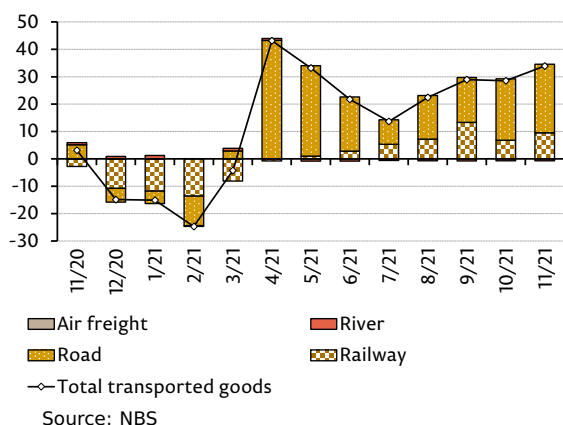


Chart 3.23: Evolution of freight transport (% compared to the previous year)



By categories of resources, the growth of GDP in the third quarter of 2021 was mainly due to developments in **agriculture, trade and industry**. Thus, the gross value added in the agricultural sector, in the context of relatively favorable agro-meteorological conditions in 2021 which supported a rich harvest, increased by 28.6%, generating a positive impact of 3.9 percentage points on GDP dynamics. That dynamic was mainly determined by the increase in crop production. Gross value added for subcomponent **"trade, transport and storage"**²³ increased by 3.5%, generating a positive impact of 0.8 percentage points on GDP dynamics. The monthly operating indicators showed a still positive trend for freight transport, which increased by about 27.5% in July-September 2021 compared to the same period of the previous year (Chart 3.22). The number of passengers carried registered a more modest annual dynamics after the sharp return in the second quarter of 2021 (Chart 3.23). The dynamics of internal trade continue to increase significantly. Thus, the average annual growth rate of the turnover of the enterprises specialized in retail trade was about 10.6% between July and September 2021, and that of the turnover of the enterprises providing services to the population decelerated up to 76.6% (Chart 3.24). Turnover for enterprises providing business services increased by 37.2% compared to the period July-September 2020, and turnover for enterprises specializing in wholesale trade increased by 36.7% compared to the third quarter of 2020 (Chart 3.25). Gross value added related to the industrial sector increased by 4.4% and thus determined a positive impact of 0.6 percentage points on GDP dynamics. In this context, the manufacturing and extractive industries showed a positive dynamic, while the energy industry contracted during the period of July-September 2021 compared to the similar period of the previous year (Chart 3.22). The financial and insurance business sector increased by 6.0% and had an impact of 0.2 percentage points on GDP growth. The information and communications sector rose by 3.4% and contributed with 0.1 percentage points to GDP growth. Real estate transactions grew more modestly (by 0.9% and an impact of 0.1 percentage points). Net taxes on products increased by 28.5%, generating a contribution of 3.3 percentage points to GDP dynamics. The positive impact of the subcomponents mentioned above has been mitigated by the dynamics of the construction sector. Thus, contrary to the trends of previous periods, the gross value added related to the construction sector contracted by 9.1%, generating a negative contribution of 1.0 percentage points.

Most of the operational indicators available in October and November 2021 continued to show strong but, overall, lower intensities than in the third quarter of 2021, outlining prospects for a positive GDP growth in the fourth quarter of 2021, similar to that of the third quarter of 2021.

In the first two months of the fourth quarter of 2021, the annual growth rate of the volume of industrial production

²³Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles; transport and storage; accommodation and catering activities.

recorded an average level of 8.2%, still by 4.1 percentage points lower than in the third quarter of 2021 (Chart 3.22). This dynamic was determined by the moderation of the annual growth rate of the manufacturing industry (from 13.1% in the third quarter of 2021 to 9.7% in the first two months of the fourth quarter of 2021). At the same time, the annual growth rate of production in the sector "production and supply of electricity and heat, gas, hot water and air conditioning", in October-November 2021, decreased by 6.3 percentage points compared to the third quarter of 2021, down to -4.2%. At the same time, the extractive industry experienced increases (from 12.1% in the third quarter of 2021 to 13.4% in the first two months of the fourth quarter of 2021).

Positive results for the first two months of the fourth quarter of 2021 were recorded in the freight transport sector. Thus, the average annual rate of volume of transported goods registered a level of 31.2%, being 9.5 percentage points higher than in the third quarter of 2021 (Chart 3.23). At the same time, between January and November 2021, the railway, road, river and air transport companies transported 17.8% more goods compared to the similar period of 2020. This development was determined by the increase in annual terms of the volume of goods transported by road and rail by 19.5% and 12.8%, respectively. At the same time, the volume of goods transported by air increased by 6.3%, while the volume of goods transported by river decreased by 22.7% compared to the same period last year.

Negative results were recorded in the passenger transport sector in the first two months of the fourth quarter of 2021. Thus, the average annual rate of passengers transported was -2.0%, being 18.9 percentage points lower than in the third quarter of 2021 (Chart 3.24). At the same time, in January-November 2021, 10.6% more passengers were using public transport compared to the similar period of 2020. This development was determined by the increase in annual terms of the number of passengers transported by air and road by 2.2 times and 10.3%, respectively. At the same time, the number of passengers transported by river decreased by 18.5% compared to the same period of the previous year, and rail passenger transport decreased by 15.9%.

Positive signals on economic activity in the first two months of the fourth quarter of 2021 are recorded in internal trade. Thus, during the reference period, the turnover of the enterprises with main activity of retail trade registered an increase of 1.6%, being however by 8.9 percentage points lower than in the previous quarter (Chart 3.25). At the same time, the turnover of the enterprises with main activity of market services provided to the population registered, between October and November 2021, an increase of 60.9%, being however by 15.9 percentage points lower than in the third quarter of 2021.

Between October and November 2021, the turnover of enterprises with main wholesale activity increased by 14.3%²⁴, being 16.1 percentage points lower than in the third quarter of 2021 (Chart 3.26). At the same time, the turnover of the enterprises with main activity of market services provided to

Chart 3.24: Evolution of passenger transport (% , compared to the previous year)

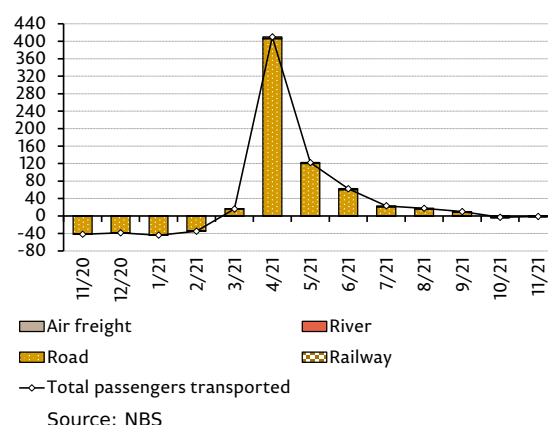


Chart 3.25: Evolution in real terms of internal trade (% , compared to the previous year)

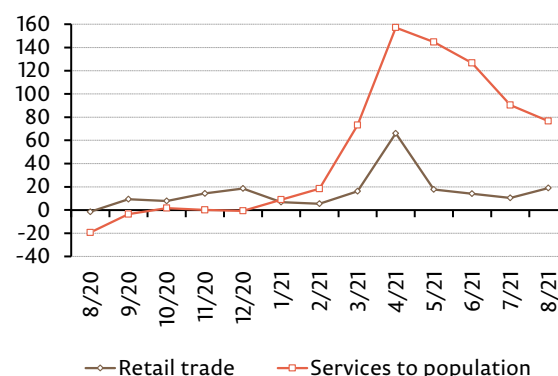
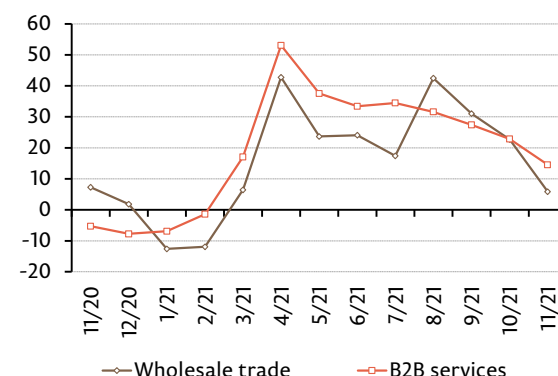
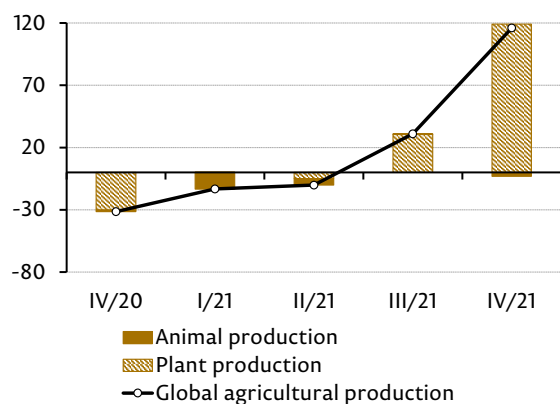


Chart 3.26: Evolution of wholesale trade (deflated at annual CPI rate) (% over previous year)



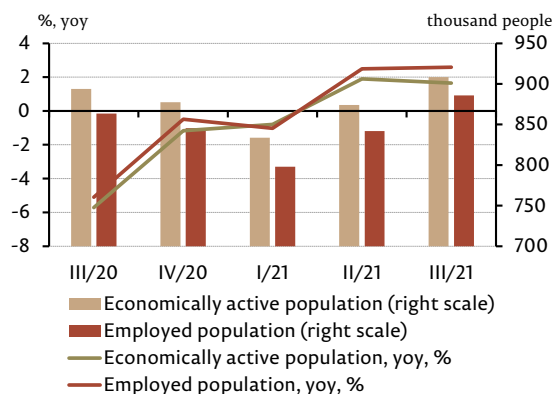
²⁴Deflated at the annual CPI rate.

Chart 3.27: Annual rate of overall agricultural production (%) and contribution by sector (percentage points)



Source: NBS

Chart 3.28: Economically active population and employed population



Source: NBS, NBM calculations

the enterprises registered, in the reference period, an increase of 18.7%, being by 12.5 percentage points lower than the annual rate of the previous quarter.

In the fourth quarter of 2021, global agricultural production increased by 116.0% compared to the fourth quarter of 2020, due to the increase in crop production of about 2.5 times. Livestock production decreased by 17.0% (Chart 3.27).

In 2021, global agricultural production increased by 49.9% compared to 2020. This dynamic was supported by the positive developments in the vegetable sector (75.5%), at the same time, the livestock sector contracted (-7.0%). Thus, the largest increases in production volumes were recorded for wheat crops (2.7 times), grain corn (3.0 times), rapeseed (95.3%), sunflower (92.9%), sugar beet (50.1%) and fruits, nuts and berries (28.7%). At the same time, the contraction of the volume of production in the livestock sector was determined by the decrease in production related to all types of products (meat, milk and eggs).

3.3 Labour market

Labour force

After the negative dynamics of over two years, already two consecutive quarters, both the economically active and the employed population registered an increase compared to the similar period of the previous year, evolution supported by the gradual recovery of economic activity combined with the partial relaxation of COVID-19 restrictions, but also by some favorable conditions for the agricultural sector. At the same time, the unemployment rate as well as the underemployment rate registered a downward dynamics.

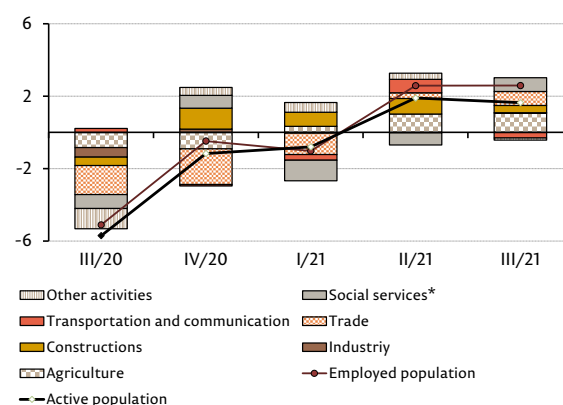
Between July and September 2021, the workforce and the employed population increased compared to the third quarter of 2020. Thus, in the third quarter of 2021, the economically active population was 908.3 thousand people, 1.6% more than the similar period of 2020. At the same time, the employed population was 885.7 thousand people, 2.6% more than in the third quarter of 2020 (Chart 3.28).

By subcomponents, the growth of the employed population in the third quarter of 2021 is attested in construction, agriculture, trade²⁵ and social services²⁶. Thus, the population employed in construction and agriculture increased by 4.7%. The pronounced positive evolution of the construction population continues since the end of 2020. The population employed in the agricultural sector has increased due to the favorable agro-meteorological conditions this year, which have supported a rich harvest.

The population employed in trade increased by 4.3%, and in the industrial sector remained practically at the level of the previous year. On the other hand, negative developments in the third quarter of 2021 were recorded in the transport and communications sector, as well as in the subcomponent "other activities" (Chart 3.29).

In the third quarter of 2021, the number of unemployed was 22.6 thousand people or 8.8 thousand people lower than in the second quarter of 2021, and the unemployment rate was 2.5%, being 1.1 percentage points lower than in the second quarter of 2021 (Chart 3.30). At the same time, the number of unemployed and the unemployment rate were lower (by 7.6 thousand people and 0.9 percentage points, respectively) than in the same period of the previous year. Similar trends are evident for the underemployed population. Thus, in the third quarter of 2021, the underemployed population decreased to 20.7 thousand people, from 27.9 thousand people in April-June 2021, and the underemployment rate was 2.3% or 1.0 percentage points lower than in the second quarter of 2021.

Chart 3.29: Contribution of sectors to the dynamics of the employed population (percentage points)



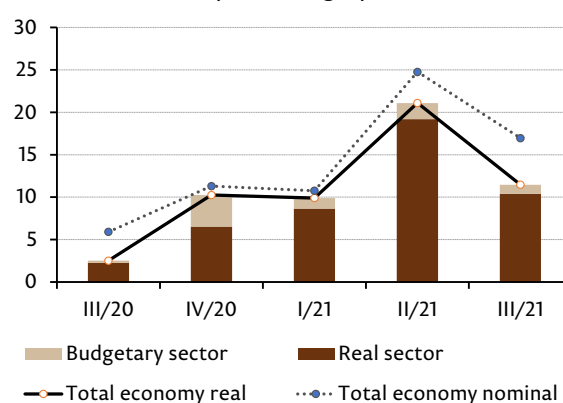
Source: NBS, NBM calculations
*Public administration, education, health and social assistance

Chart 3.30: Evolution of the unemployed and the underemployed population



Source: NBS, NBM calculations

Chart 3.31: Salary fund in the economy (% compared to the previous year) and sector contributions (percentage points)

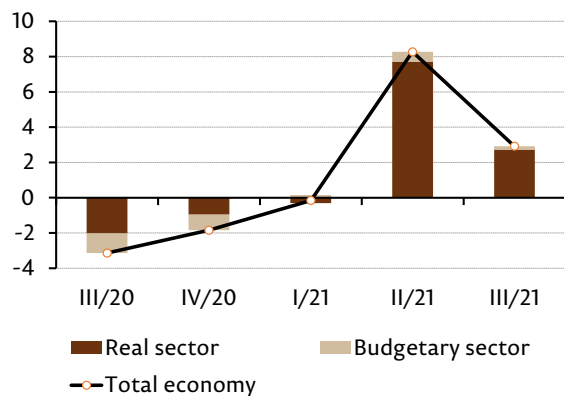


Source: NBS, NBM calculations

²⁵Wholesale and retail trade; accommodation and catering activities.

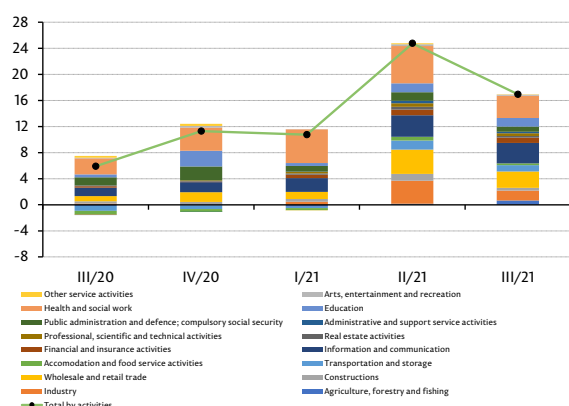
²⁶Public administration, education, health and social assistance.

Chart 3.32: Average number of employees in the economy (% , compared to the previous year) and sector contributions (percentage points)



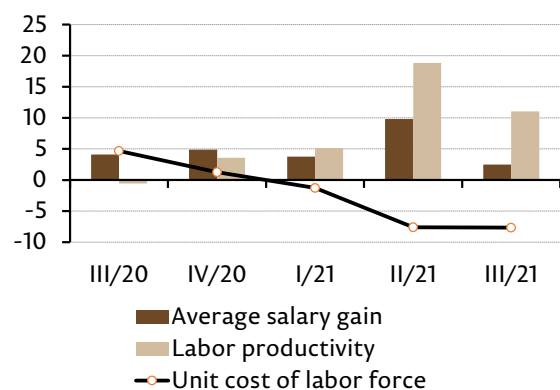
Source: NBS, NBM calculations

Chart 3.33: The contribution of the sectors of the economy to the dynamics of the number of employees (% , compared to the previous year)



Source: NBS, NBM calculations

Chart 3.34: Real average salary and labor productivity in industry (% , compared to the previous year)



Source: NBS, NBM calculations

Salary fund

In the third quarter of 2021, the annual dynamics of the economy's salary fund moderated its positive growth rate. Thus, the salary fund increased by 17.0%, and in real terms, deflated by CPI, by 11.5% compared to the same period last year. This evolution was due to the positive, albeit more modest, contribution, both from the dynamics of the remuneration fund in the real sector (predominantly) and from the budgetary sector (Chart 3.31).

The salary fund for the medical system continued to make the largest contribution to the positive dynamics of the salary fund, in the context of supporting and appreciating the effort of the medical staff in the fight against the COVID-19 pandemic. At the same time, the salary fund in the information and communications sector, trade had a significant positive contribution to the dynamics of the analyzed indicator.

In the third quarter of 2021, the annual dynamics of the average number of employees in the national economy registered a more modest positive evolution, being 2.9% above the level of July-September 2020. The number of employees in the real sector increased by 3.7% and that in the budget sector by 0.8% (Chart 3.32). The evolution reflects, to a large extent, the manifestation of a basic effect associated with the employment of a significant number of employees in technical unemployment a year ago, during the onset of the pandemic.

Distribution by sectors of the economy reveals more pronounced increases in the average number of employees, mainly in information and communications (15.2%), health (4.9%), trade (2.6%) (Chart 3.33).

In the third quarter of 2021, the estimated annual labor productivity rate in the industrial sector increased to 11.0%. At the same time, the annual dynamics of the average real wage in the industrial sector slowed down to 2.5%. In this context, the annual rate of unit labor costs in industry fell to -7.7% (Chart 3.34).

3.4 External sector

Current Account

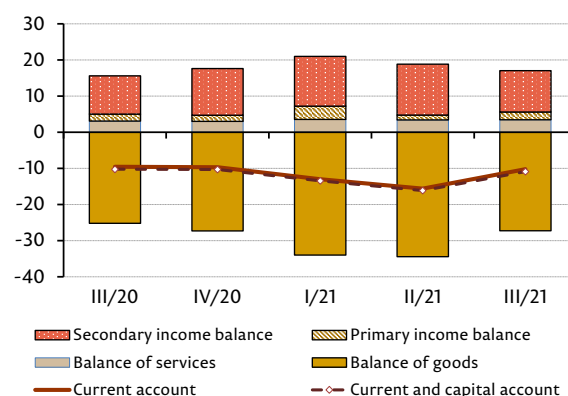
In the third quarter of 2021, the current account deficit of the balance of payments decreased by 5.4 percentage points compared to the previous quarter, accounting for 10.2% as a share of GDP (Chart 3.35). The decrease in the balance of payments deficit was due to a decrease in the negative contribution component "balance of goods". At the same time, the components with a positive contribution: the "services balance" and the "primary income balance" increased, while the "secondary income balance" decreased during the reference period.

Financial Account

In the third quarter of 2021, the financial account, as a share of GDP, recorded a level of 9.4% or 6.3 percentage points down compared to the second quarter of 2021. Thus, the recording of lower net capital inflows (relative to GDP) was determined by the change recorded in the components "other investments" and "reserve assets" (Chart 3.36). The net flow of other investments, as a share in GDP, recorded a level of 12.8%, being 2.4 percentage points lower than in the second quarter of 2021. The net weighting of financial assets under "other investments" mainly reflects the decrease in assets in the form of "loans", "cash and deposits" and "trade credits and advances". At the same time, in the third quarter of 2021 there is an increase in reserve assets (5.5% as a share of GDP), and as a result there was a decrease in net capital inflows. The flow of direct investments in the third quarter of 2021 recorded a level of 2.1% as a share in GDP, being similar to that of the previous quarter.

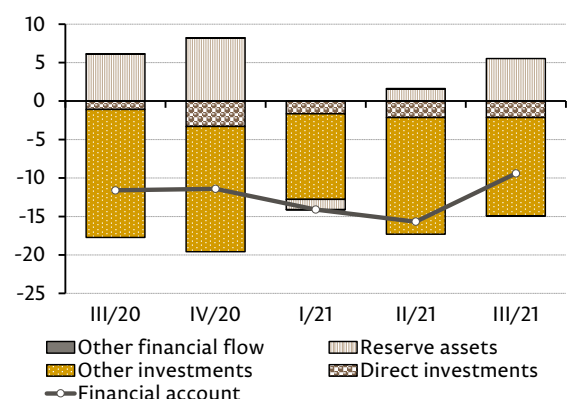
The share of external debt in GDP in the third quarter of 2021 was 66.1%, being similar to that of the second quarter of 2021 (Chart 3.37). No significant changes were recorded in the structure of external debt, so, as in previous periods, the largest share of total external debt is held by economic agents²⁷ 31.8%, after which the government sector²⁸ accounted for 19.8% and direct investment 14.5%.

Chart 3.35: Share of current account in GDP (%)



Source: NBM

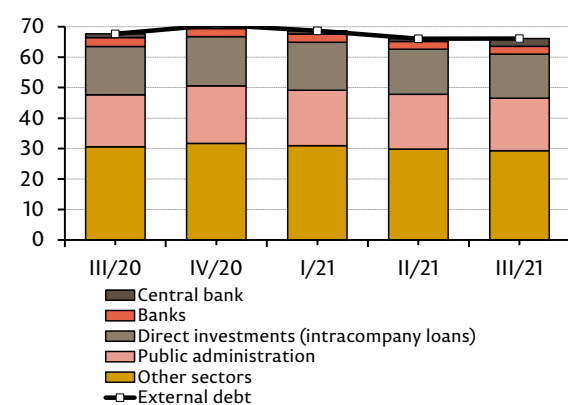
Chart 3.36: Share of financial account in GDP (%)



Source: NBM

Note: (-) - net capital inflows, (+) - net capital outflows

Chart 3.37: Share of external debt to GDP (%)



Source: NBM

²⁷Cumulative debt of "Banks" and "Other sectors".

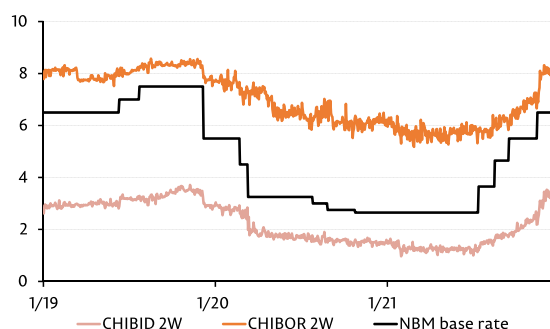
²⁸Cumulative debt of "Public Administration" and "Central bank".

Chapter 4

Monetary policy

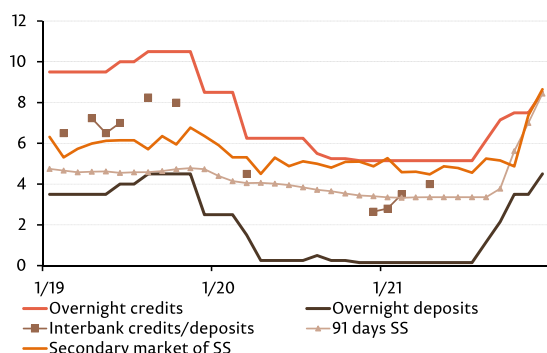
4.1 Monetary policy instruments

Chart 4.1: The average monthly reference rates on the interbank market and the base rate of the NBM (%)



Source: NBM

Chart 4.2: The monthly evolution of the interest rate corridor (%)



Source: NBM

Interest rate policy

To alleviate the inflationary pressures generated by the acceleration of aggregate domestic demand, fueled by rising consumption, and to ease the second-round effects of supply shocks, against the background of rising prices on the international market and imported inflation, the NBM decided to increase the monetary policy rate in two steps up to 6.50% during the fourth quarter of 2021.

Between October and November, the yield curve CHIBOR 2W followed the slow upward trend started in the previous quarter. The rise in quotations accelerated temporarily in early December, receiving with intensity the increase in the base rate during this period, and continued to fluctuate close to the upper limit of the interest rate corridor until the end of the year. As a result of these developments, the CHIBOR 2W quotation at the end of December was significantly higher (+1.91 percentage points) than the one recorded on the last day of the previous quarter, amounting to 8.19% (Chart 4.1).

The impact of the increases in the monetary policy rate of the NBM, amplified by the issuance of a volume of state securities with a maturity of 91 days clearly higher than in the previous quarter, propelled their interest rate to the upper limit of the interest rate corridor. Thus, the value of 8.44% recorded in the last month of the quarter was by 4.66 percentage points higher than at the end of the third quarter of 2021 (Chart 4.2).

On the secondary market of state securities, the interest rates related to the transactions performed had a similar evolution to the primary market. Their quarterly average was 7.64%, higher than in the previous quarter (+2.68 percentage points), given that the weighted average term until maturity decreased from 246 to 175 days.

Money market operations

Sales of NBM certificates (NBC)

The NBM conducted weekly NBC placement tenders, with a maturity of 14 days and with the announcement of the maximum

interest rate equivalent to the base rate of the NBM. For the whole of the fourth quarter of 2021, the weighted average rate of liquidity absorption operations amounted to 5.77% annually.

The daily stock of NBC investments decreased significantly during the quarter, varying between the minimum value of 1,821.2 million lei and the maximum value of 5,179.1 million lei, a situation also reflected in the value recorded by the average quarterly balance amounting to 3,054.8 million lei (-667.4 million lei compared to the third quarter of 2021) (Chart 4.3).

Repo operations

Repo liquidity repurchase operations were carried out weekly, for a period of 14 days at a fixed interest rate (base rate plus a margin of 0.25 percentage points), through the no-limit auction procedure, in accordance with the calendar of monetary policy operations for the year 2021. The volume of liquidity delivered was 410.0 million lei. The balance of repo operations recorded at the end of the reference quarter was zero.

Standing facilities

During the fourth quarter of 2021, the NBM increased interest rates on the main monetary policy instruments in two stages, at the same time narrowing the rate corridor.

In October 2021, the rate on overnight deposits was increased by 1.35 percentage points up to the level of 3.50%, and on overnight loans by 0.35 percentage points to 7.50%, thus decreasing the rate corridor by 0.5 percentage points from +/- 2.5% to +/- 2.0%, while maintaining its symmetry.

In December 2021, interest rates were increased by a further 1.0 percentage points, reaching 4.50% for overnight deposits and 8.50% for overnight loans by the end of 2021.

During the fourth quarter of 2021, the banks used both the overnight deposit facility and the overnight credit facility.

The total volume of overnight investments amounted to 17,061.0 million lei, which indicates an average daily balance of 276.9 million lei, about 1.7 times higher than in the previous quarter. The amounts placed by banks varied between the minimum of 20.0 million lei and the maximum of 1,200.0 million lei.

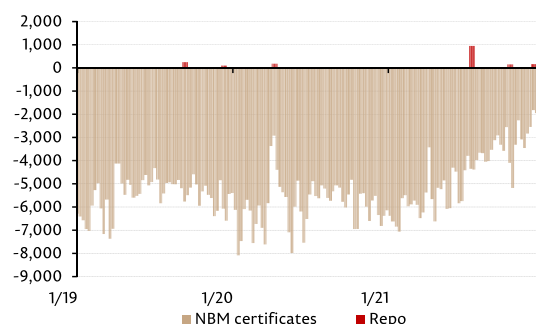
The total amount of overnight loans granted to banks by the NBM for the whole of the fourth quarter of 2021 amounted to 190.0 million lei, the average daily balance being about 2.9 million lei.

Required reserves

The reserve requirement mechanism continued to exercise the functions of monetary control and liquidity management in the banking system.

During the fourth quarter of 2021, the reserve requirements for funds attracted in Moldovan lei and freely convertible currency (FCC) were maintained at the level of 26.0% and 30.0%, respectively.

Chart 4.3: Evolution of the daily balance of sterilization operations (million lei)



Source: NBM

During the application period December 16, 2021 – January 15, 2022, the required reserves in MDL amounted to 12,514.6 million lei, a volume higher by 135.1 million lei (+1.1%) compared to the period September 16 – October 15, 2021.

Regarding the required reserves from the means attracted in FCC, in the application period December 16, 2021 – January 15, 2022, those totaled 144.5 million US dollars and 404.2 million euros. Compared to September 16 – October 15, 2021, required reserves in USD increased by 0.5% and reserves in euros increased by 6.7%.

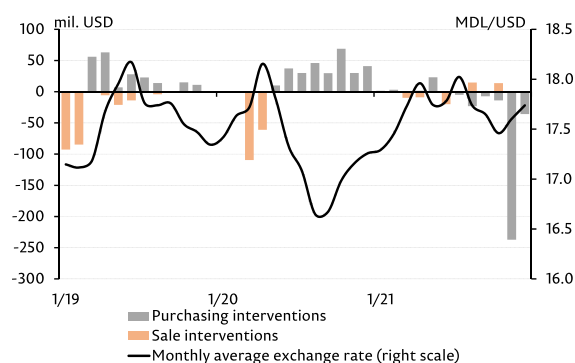
Interbank money market

The liquidity deficit observed in some banks during the fourth quarter of 2021, mainly at the end of the application periods of required reserve, has led to the revival of the interbank market. The total volume of interbank transactions amounted to 300.0 million lei, with a weighted average rate of 6.80%, and the term being overnight.

Interventions on the domestic foreign exchange market

The NBM intervened on the domestic foreign exchange market between October and December 2021, mainly through sales of foreign currency.

Chart 4.4: Evolution of the official MDL/USD exchange rate and the volume of daily transactions of the NBM, fourth quarter of 2021

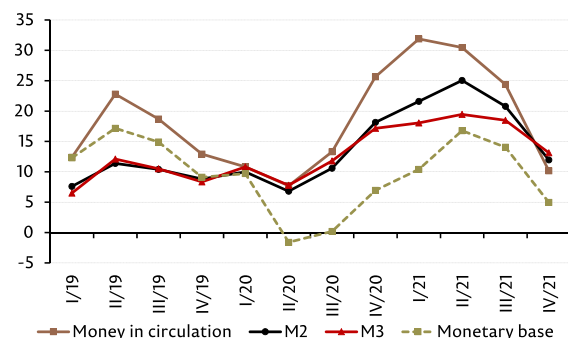


Source: NBM

During the analyzed period, the volume of transactions of the NBM performed on the interbank foreign exchange market against Moldovan lei, at the date of the currency, amounted to USD 301.00 million, including sales transactions amounting to USD 286.93 million, purchase transactions in the amount of USD 13.00 million, as well as currency conversions with the institutions of the World Bank (International Bank for Reconstruction and Development and the International Development Association) in the amount of USD 1.07 million.

At the same time, during the reference period, the NBM carried out purchase swap transactions in amount of USD 36.46 million (of which USD 28.46 million, the equivalent of EUR 25.00 million) (Chart 4.4).

Chart 4.5: Changing monetary aggregates (% annual growth)



Source: NBM

4.2 Dynamics of monetary indicators

In the fourth quarter of 2021, the dynamics of monetary aggregates was positive, but much more tempered, the quarterly average in annual terms being 12.0% for the monetary aggregate M2 (by 8.8 percentage points below the level of the third quarter of 2021) and 13.1% for M3 (by 5.3 percentage points less compared to the increase in the previous quarter). The monetary base increased compared to the fourth quarter of 2020, with the quarterly average in annual terms being 5.0% (Chart 4.5).

Money supply

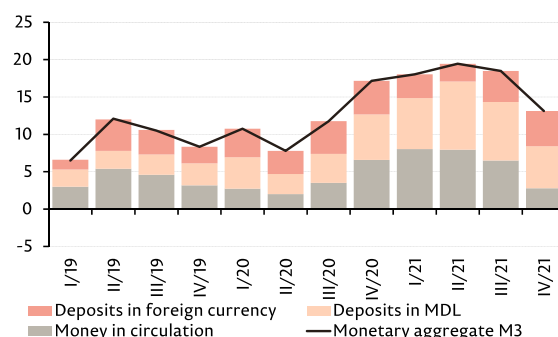
The slowing growth rate of the M3 monetary aggregate, compared to the previous quarter, resulted from the decrease in the growth rate of deposits in national currency and money in circulation, which moderated the sharper growth of foreign currency deposits (Chart 4.6).

The decrease in the growth rate of deposits in national currency (Chart 4.8) was mainly determined by a more modest increase, compared to the previous quarter, of demand and term deposits of both individuals and legal entities.

The component of foreign currency deposits increased by 2.5 percentage points above the level recorded in the previous quarter, as a result of the faster growth of demand deposits of legal entities (Chart 4.10). At the same time, term foreign currency deposits registered lower increases compared to the previous quarter, due to the decrease in the growth rate of term deposits of individuals (Chart 4.9).

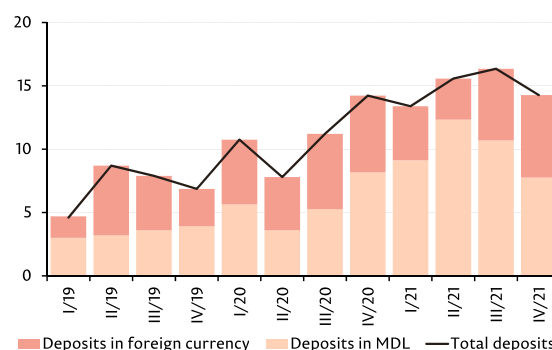
The growth rate of money in circulation at the end of the fourth quarter of 2021 decreased by 14.5 percentage points compared to the end of the previous quarter, amounting to 6.3%. The average quarterly contribution of money in circulation to M3 growth decreased by 3.7 percentage points compared to the level recorded in the third quarter of 2021 (Chart 4.6). The dynamics of money in circulation was determined by the faster growth of the cash flow of receipts compared to the cash flow of releases in the vaults of commercial banks. Of the total receipts, the largest share was the receipts from the sale of consumer goods and receipts on the current accounts and deposit accounts of individuals. At the same time, regarding the releases from the vaults of commercial banks, the main components were releases for the purchase of foreign currency from individuals and releases of cash from ATMs and POS-terminals.

Chart 4.6: Dynamics of the M3 monetary aggregate (% comp. contrib. in annual growth)



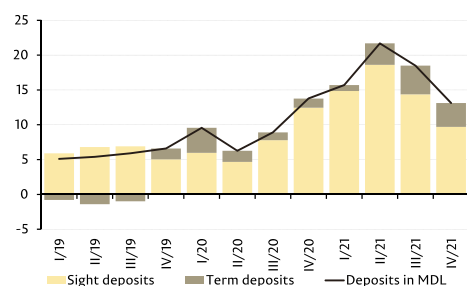
Source: NBM

Chart 4.7: Dynamics of the total balance of deposits (% comp. contrib. in annual growth)



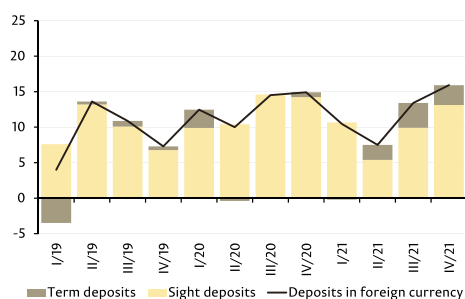
Source: NBM

Chart 4.8: Dynamics of the balance of deposits in MDL (% comp. contrib. in annual growth)



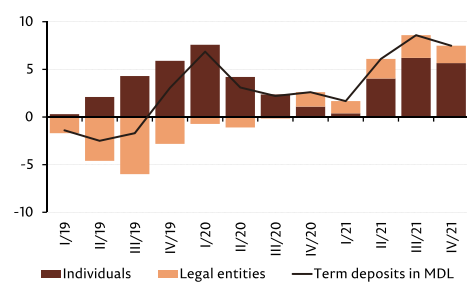
Source: NBM

Chart 4.11: Dynamics of the balance of deposits in foreign currency (% comp. contrib. in annual growth)



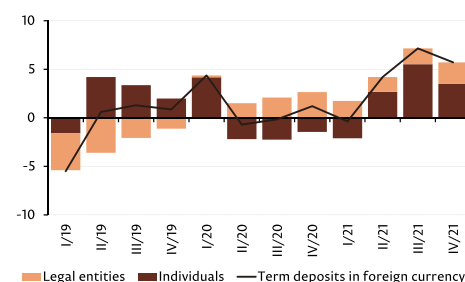
Source: NBM

Chart 4.9: Dynamics of the term deposits balance in MDL (% comp. contrib. in annual growth)



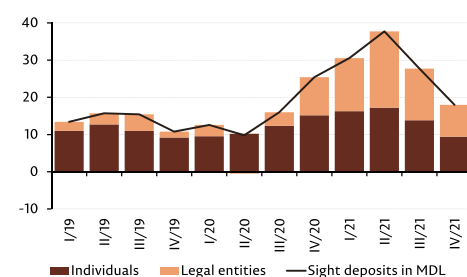
Source: NBM

Chart 4.12: Dynamics of the term deposits balance in foreign currency (% comp. contrib. in annual growth)



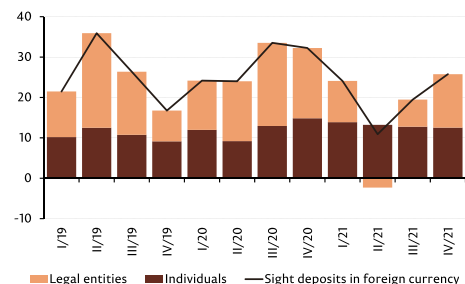
Source: NBM

Chart 4.10: Dynamics of the sight deposits balance in MDL (% comp. contrib. in annual growth)



Source: NBM

Chart 4.13: Dynamics of the sight deposits balance in foreign currency (% comp. contrib. in annual growth)



Source: NBM

Excessive liquidity

During the fourth quarter of 2021, excessive liquidity in the banking system decreased by 703.0 million lei. It should be mentioned that compared to the fourth quarter of 2020, the volume of excessive liquidity also decreased on average by 64.0 million lei, registering the average value of 3.6 billion lei (Chart 4.14).

Credit market

Evolution of the balance of loans granted by licensed banks²⁹

At the end of the fourth quarter of 2021, the total balance of loans granted by licensed banks recorded a positive annual increase (Chart 4.15) and amounted to 54,551.5 million lei, higher than at the end of the fourth quarter of 2020 by 23.0%, with a positive contribution from the balance of loans granted in national currency of 21.2 percentage points. The share of the balance of loans granted in the domestic currency increased to 70.1% of the total balance of loans, which led to a decrease in the degree of dollarization by 5.1 percentage points compared to the end of the fourth quarter of 2020, as a result of the more significant increase of loans in MDL during 2021 (Chart 4.16).

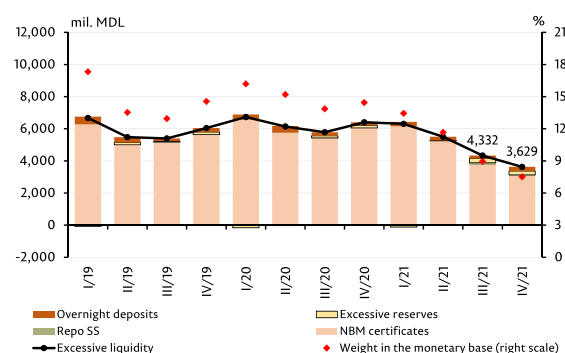
On December 31, 2021, the balance of loans granted in domestic currency by licensed banks registered an annual growth rate of 32.7%, with the contribution from the increase in the balance of loans granted to individuals of 23.2 percentage points, and from loans granted to legal entities of 9.5 percentage points. In turn, the balance of credits in MDL granted to individuals registered an annual increase of 40.3%, and the share of these credits constituted 60.8% of the balance of credits in MDL.

At the end of the reporting quarter, in the structure of the total portfolio of loans granted by licensed banks, the largest share, as in the previous quarters, went to loans granted to individuals (43.5%, higher than on December 31, 2020 by 5.0 percentage points), followed by the share of trade loans (21.7%) (Chart 4.17).

Evolution of new credits granted by licensed banks

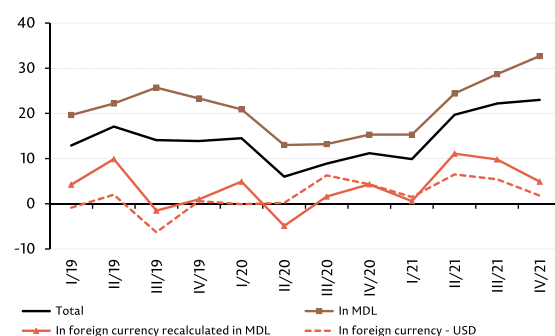
In the fourth quarter of 2021, the total volume of new loans granted by licensed banks was 36.5% higher than in the fourth quarter of 2020 (Chart 4.18). This increase was influenced by the positive evolution of loans granted both in national currency and in foreign currency, recalculated in MDL. The volume of new loans in national currency granted by licensed banks increased by 45.1% annually, similar to the third quarter of 2021. The share of loans in national currency accounted for 71.6% of total loans granted in the fourth quarter of 2021 by licensed banks.

Chart 4.14: The excessive liquidity



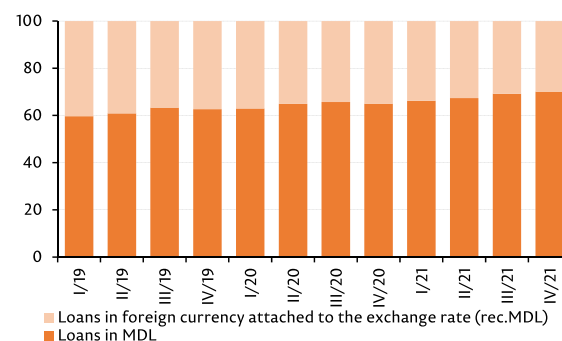
Source: NBM

Chart 4.15: Evolution of the loan balance (% annual increase)



Source: NBM

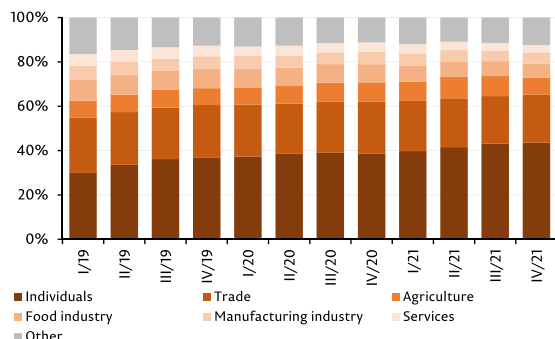
Chart 4.16: Evolution of the loans weights on subcomponents in the total balance (%)



Source: NBM

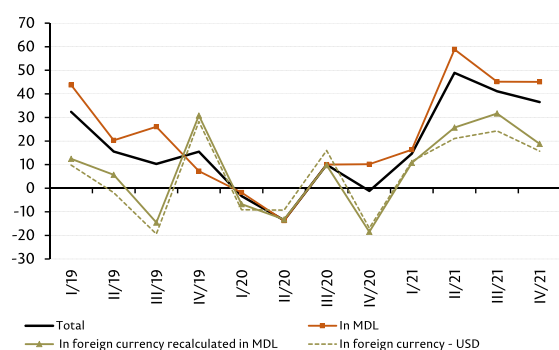
²⁹The data analysis was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" submitted by licensed banks until January 12, 2022.

Chart 4.17: Loan balance structure (% in total)



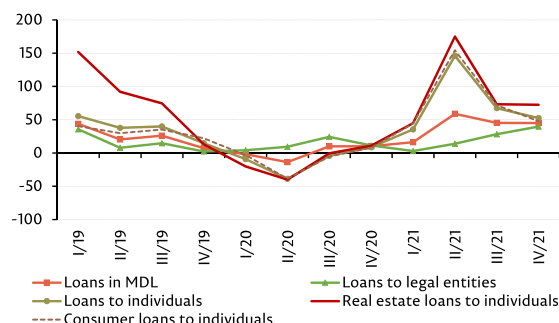
Source: NBM

Chart 4.18: Evolution of new granted loans (% annual growth)



Source: NBM

Chart 4.19: Evolution of new loans granted in MDL (% annual growth)



Source: NBM

The annual variation in loans granted to individuals in the fourth quarter of 2021 was 52.4% (Chart 4.19). In the fourth quarter of 2021, the loans in MDL granted to individuals for real estate registered the same annual growth rate as in the previous quarter, namely 72.4%. At the same time, in the fourth quarter of 2021, the annual growth rate of consumer loans in national currency granted to individuals decreased to 47.7%, compared to the third quarter of 2021, but was about 6 times higher than in the fourth quarter of 2020.

As in the previous quarters, the largest share in the total loans in MDL granted to individuals was held by consumer loans (56.6%), followed by loans for real estate, which share amounted to 35.4%.

Market of term deposits accepted by licensed banks (balance of deposits)³⁰

At the end of the fourth quarter of 2021, the total balance of term deposits attracted by licensed banks registered an annual increase of 13.9%, as a result of the increase in the balance of term deposits in both lei and foreign currency (Chart 4.20). The annual dynamics of term deposits attracted in domestic currency constituted 12.8%.

The major component in the total balance of term deposits attracted by licensed banks was the balance of deposits in MDL (Chart 4.21). At the end of the fourth quarter of 2021, the share of the balance of term deposits attracted in the domestic currency accounted for 58.3% of the total balance of term deposits, lower than in the fourth quarter of 2020 by 0.6 percentage points. Respectively, the dynamics of the degree of dollarization of the balance of term deposits recorded a slight increase (Chart 4.21). It should be noted that, at the end of the reporting quarter, term deposits attracted in MDL from individuals held a share of 86.2% of the total balance of deposits in MDL.

Interest rates³¹

Evolution of the base rate

During the fourth quarter of 2021, three meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions took place. Following the assessment of the balance of internal and external risks and short- and medium-term inflation prospects, the Executive Board of the National Bank of Moldova, at its meetings of October 05, 2021 decided to increase the base rate applied to major operations of monetary policy by 0.85 percentage points to 5.50% annually, at its meeting of October 29, 2021 – decided to maintain the base rate, and at its meeting of December 03, 2021 – decided to increase the base rate applied to major operations of monetary policy by 1.0 percentage point to 6.50% annually.

³⁰The data analysis was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" submitted by licensed banks until January 12, 2022 and does not include demand deposits.

³¹The analysis of the rates was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" presented by the licensed banks until January 12, 2022 and does not include the rates on demand deposits.

These measures to gradually tighten monetary policy were adopted to mitigate the inflationary pressures generated by the second-round effects of global price growth, costs of energy resources production and distribution and food costs. At the same time, the NBM considered the pressures from domestic aggregate demand supported by the increase of the population's income (salary fund, social assistance, remittances etc.) and the increase in the volume of consumer and mortgage loans. These decisions aimed at anchoring inflationary expectations, restoring and keeping inflation close to the target of 5.0% over the medium term, with a possible deviation of ± 1.5 percentage points.

Evolution of the interest rate on the balance of loans

For the period October-December 2021, the weighted average interest rate on the balance of loans granted in MDL by licensed banks was 7.10% annually, lower than in the fourth quarter of 2020 by 0.29 percentage points (Chart 4.22). Compared to the third quarter of 2021, the weighted average interest rate on the balance of loans granted in MDL increased by 0.12 percentage points, being determined by the increase in the weighted average interest rate on the balance of loans granted in MDL to both individuals and legal entities.

For the entire fourth quarter of 2021, the weighted average interest rate on the balance of foreign currency loans was 4.04% annually, by 0.22 percentage points lower than in the fourth quarter of 2020 and by 0.11 percentage points lower than in the third quarter of 2021.

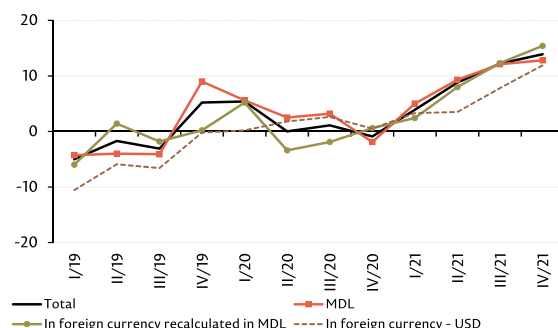
Evolution of the interest rate related to the balance of deposits

In the fourth quarter of 2021, the weighted average interest rate on the balance of deposits in national currency was 3.69% annually and decreased compared to the fourth quarter of 2020 by 0.36 percentage points, but did not change significantly compared to the third quarter of 2021 (Chart 4.22). The weighted average interest rate on the balance of term deposits attracted in foreign currency decreased by 0.30 percentage points compared to the end of the fourth quarter of 2020, amounting to 0.44% annually.

Evolution of banking margin

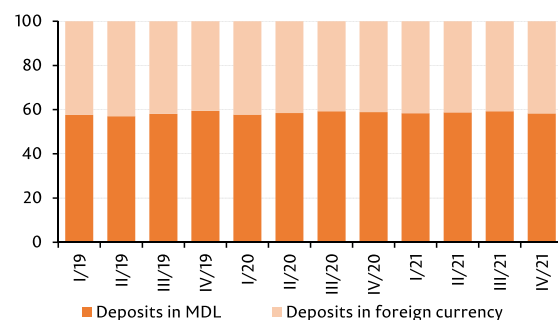
In the fourth quarter of 2021, bank margins (calculated as the difference between the weighted average interest rates on loan balances and the weighted average interest rates on deposit balances) increased on the national currency segment and decreased on the foreign currency subcomponent, compared to the third quarter of 2021 (Chart 4.23).

Chart 4.20: Deposit balance dynamics (% annual growth)



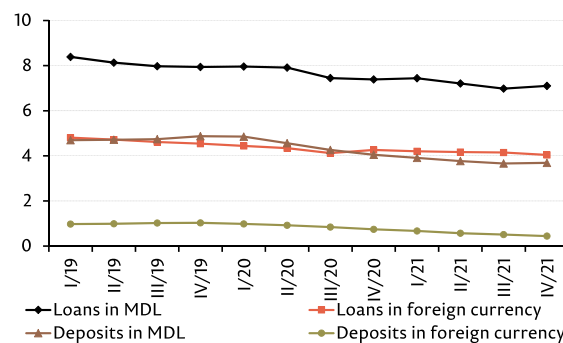
Source: NBM

Chart 4.21: Evolution of the share of term deposits on subcomponents in the total balance (%)



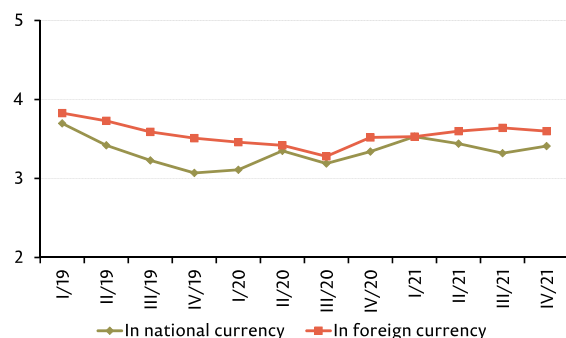
Source: NBM

Chart 4.22: Average interest rates on balance of loans and deposits (%)



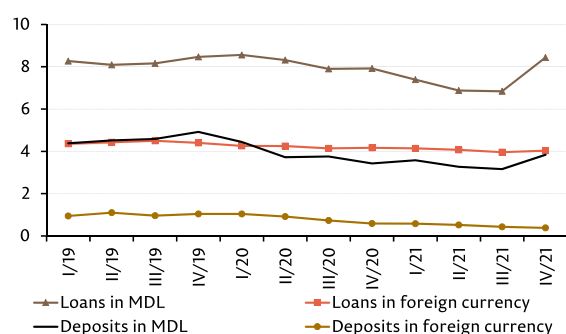
Source: NBM

Chart 4.23: The evolution of the banking margin on loan and deposit balances (percentage points)



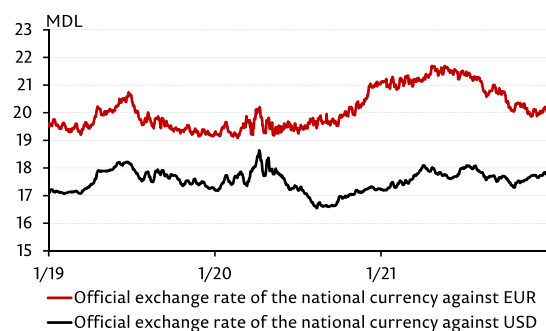
Source: NBM

Chart 4.24: Average interest rates on new volume of loans and deposits (%)



Source: NBM

Chart 4.25: Fluctuations in the official exchange rate of the Moldovan leu against the US dollar and the euro



Source: NBM

Evolution of interest rates on new loans and deposits granted/attracted by licensed banks

As a result of the situation on the money-foreign exchange market, in the fourth quarter of 2021, the weighted average interest rates on new term deposits attracted and new loans granted in the national currency increased (Chart 4.24). For the whole of the fourth quarter of 2021, the weighted average interest rate on deposits in MDL was 3.84% annually, by 0.41 percentage points higher than in the fourth quarter of 2020 and by 0.68 percentage points higher than in the third quarter of 2021. The weighted average interest rate on new loans granted in national currency in the fourth quarter of 2021 was 8.44% annually, by 0.52 percentage points higher than in the fourth quarter of 2020 and by 1.60 percentage points higher than in the third quarter of 2021. The evolution of the weighted average interest rate on new loans granted in MDL was marked by the significant increases of the interest rates on the loans granted to individuals.

Evolution of the nominal and real effective exchange rate

According to the values at the end of the fourth quarter of 2021, the official nominal exchange rate of the domestic currency depreciated by 0.5% against the US dollar and appreciated by 2.4% against the euro compared to the levels recorded at the end of the previous quarter (Chart 4.25).

On average values, the exchange rate of the Moldovan leu appreciated by 1.1% against the US dollar and by 4.1% against the euro, compared to the averages of the previous quarter.

In the fourth quarter of 2021, most of the currencies of the countries – main trading partners of the Republic of Moldova included in the REER basket depreciated, in average values, against the US dollar. In particular, the Turkish lira depreciated by 25.9%, the Hungarian forint – by 6.1%, the Polish zloty – by 4.3%, the Romanian leu – by 3.5%, the euro and Bulgarian leva – by 3.1% etc. On the other hand, the Russian ruble appreciated against the US dollar by 1.2%, the Chinese yuan renminbi and the Belarussian ruble – by 1.1%, and the Ukrainian hryvnia – by 0.8% (Chart 4.26).

Under these conditions, in real terms, the Moldovan leu appreciated by 8.4% against the currency basket of the countries – main trading partners of the Republic of Moldova (average of the fourth quarter of 2021 compared to the average of the third quarter of 2021). The highest contributions to the REER appreciation were made by Romania (2.3 percentage points), Turkey (1.4 percentage points) and Germany (0.9 percentage points) (Chart 4.28).

In the reference quarter, the shortage of foreign currency increased, given that, in annual terms, the net demand from legal entities continued to advance at a fast pace, while the net supply by individuals decreased significantly.

The net supply of foreign currency by individuals amounted to 423.2 million dollars, a decrease both in annual terms (-39.1%) and in relation to the previous quarter (-40.6%). Individuals reduced their foreign exchange supply in the reference quarter, preferring to increase their savings in foreign currency, a trend

confirmed by the increasing dollarization of their deposits. One of the factors that contributed to the saving of the foreign currency by individuals was the depreciation of the euro against MDL, due to the depreciation of the European currency against the US dollar on international markets. As for the dynamics of transfers from abroad in favor of individuals, according to data for the first two months of the quarter, they increased slightly by 1.2% compared to the same period last year.

In the structure of the net supply of foreign currency from individuals, the majority share continued to belong to the single European currency (71.8%) (Chart 4.29).

The net demand for foreign currency from economic operators increased by 28.4% compared to the last quarter of the previous year, up to USD 782.9 million, as the overall trade balance deteriorated and, in particular, amid a significant increase in import prices for natural gas and petroleum products. Also, as in the case of individuals, the trend of dollarization of deposits of legal entities continued.

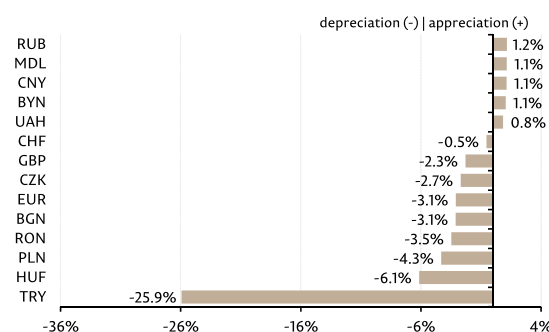
The coverage of the net demand for foreign currency by economic operators through the net supply of foreign currency from individuals decreased to 54.1% in the fourth quarter of 2021 compared to 88.9% in the previous quarter and 113.9% in the fourth quarter of 2020. Under these conditions, the NBM intervened through net foreign exchange sales on the local foreign exchange market in the amount of USD 273.9 million³².

Under these conditions, after a brief appreciation in the first half of October amid a temporary foreign currency surplus, the exchange rate of the Moldovan leu against the US dollar had a depreciation trend that lasted, with few exceptions, until the end of the quarter. A faster pace of depreciation was observed in November when, in addition to the increased demand from energy importers, the net supply from individuals decreased significantly. Thus, the coverage of demand by foreign currency supply in November fell to a minimum level (23.7%) in the last 6 years, leading the NBM to intervene promptly through foreign exchange sales on the local foreign exchange market in order not to admit an excessive volatility of the exchange rate. In December, there was an improvement in the foreign exchange deficit, in some short periods there were even appreciations, amid the increased supply from individuals specific to the days before holidays.

The dynamics of the official exchange rate of the Moldovan leu against the euro was also influenced by the evolutions of the single European currency against the US dollar on international markets. The reference quarter saw the depreciation of the single European currency against the US dollar in the first three weeks of November, with relatively minor fluctuations in the rest of the period.

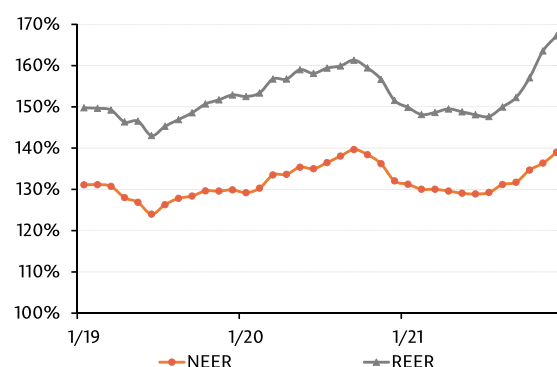
The rise in consumer prices in the USA in October above economists' expectations, combined with positive sales dynamics in the retail segment, fueled investors' expectations of an earlier tightening of monetary policy by FRS. These developments have determined the euro/dollar exchange rate to reach in November a minimum level of the last 16 months.

Chart 4.26: The evolution of countries' currencies – main trading partners against the US dollar (average exchange rate Q4 2021/ Q3 2021, %)



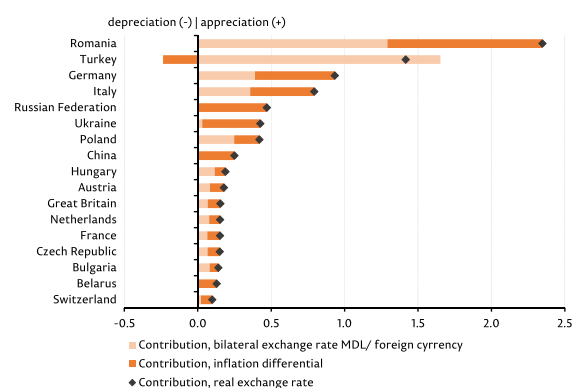
Source: NBM

Chart 4.27: Dynamics of the nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated on the basis of the share of countries – main trading partners (Dec.2000-100%)



Source: NBM

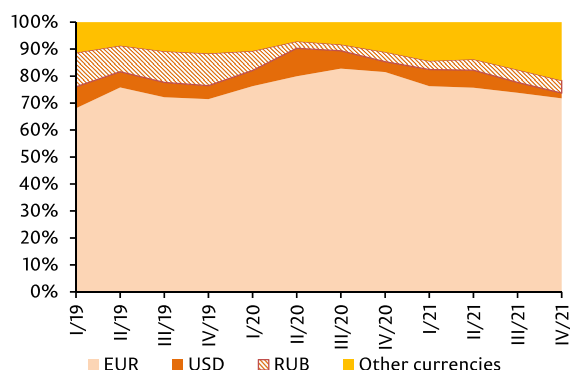
Chart 4.28: Contribution of the countries – main trading partners of the Republic of Moldova to the change in the real effective exchange rate in the fourth quarter of 2021



Source: NBM

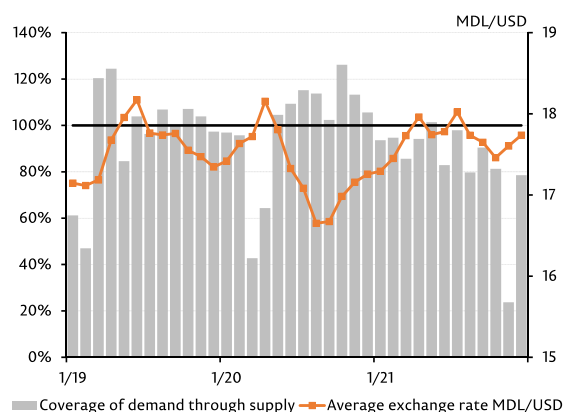
³²Volume calculated at the currency date.

Chart 4.29: The net supply of foreign currency from individuals disaggregated by major currencies (the currencies are recalculated in USD at the average constant exchange rate)



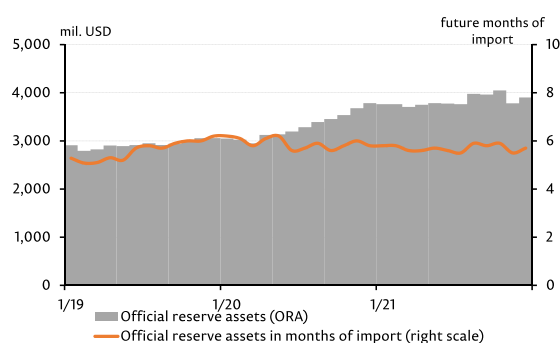
Source: NBM

Chart 4.30: Net sales coverage through the net supply and dynamics of the official exchange rate



Source: NBM

Chart 4.31: Evolution of official reserve assets expressed in months of import of goods and services (MBP6)



Source: NBM – based on updated actual and forecast data

At the same time, ECB, amid a high degree of uncertainty generated by the new wave of the pandemic, has signaled that it will not tighten the monetary policy in the near future.

Thus, during the fourth quarter, compared to the end of the previous one, the US dollar appreciated by 3.0% against the single European currency.

At the end of the fourth quarter of 2021, the balance of official reserve assets amounted to USD 3,901.9 million (Chart 4.31), down by USD 59.9 million (-1.5%) compared to the end of September. This decrease was mainly due to foreign exchange sales and payments related to the external public debt service and payments from investment project accounts.

The impact of these factors has been partially mitigated by external financing inflows. The largest disbursements were in the form of loans and grants from the European Union for budget support under the macro-financial assistance program, for mitigation of the energy crisis impact, under COVID-19 resilience project and support for police reform, in the total amount of 146.1 million euros (equivalent to USD 167.4 million). Under the new IMF-supported economic and financial reform program, the first tranche of budget support was disbursed through the Extended Credit Facility and Extended Fund Facility in amount of USD 79.8 million. The European Investment Bank also provided a loan of 11.5 million euros (equivalent to USD 12.9 million) under the "Fruit Garden of Moldova" project, and the World Bank disbursed loans totaling USD 11.2 million in several projects, including the local road rehabilitation project (USD 7.9 million).

According to the situation at the end of 2021, official reserve assets continued to provide a sufficient level of coverage of imports of goods and services (5.7 months of future imports³³).

³³Calculated based on a preliminary forecast of import of goods and services.

Chapter 5

Forecast

5.1 External hypotheses

Recent developments indicate the persistence of external pro-inflationary pressures. Oil quotations are moving to USD 90/barrel, and some experts anticipate that USD 100/barrel for Brent oil will be reached soon. European gas quotations remain very high, and recent events have shown the fragility of the energy system to supply shocks. The poor harvest of certain crops and the increase in logistics, transport, energy, and financing costs will continue to contribute to the increase of quotations for food products on the international market in 2022, which will gradually moderate towards 2023. To counter pro-inflationary pressures, it is expected that emerging economies will continue, and advanced ones will begin, to tighten monetary conditions. Table no. 5.1 contains the values of the main external hypotheses admitted within the forecast round related to the Inflation Report no. 1, 2022, with their subsequent description.

Preliminary data show that in 2021 the euro area economy grew by an average of 5.1%, registering a significant percentage of the vaccinated population and the postponement of monetary tightening by the ECB. At the same time, the continued imposition of social and economic restrictions in response to the new Omicron variant has led to a reduction in the forecast for the growth of gross domestic product in 2022 from 4.4 to 4.0%. For 2023, the euro area economy is expected to grow by an average of 2.5%. At the same time, the average inflation in the euro area reached a much higher level in 2021 than anticipated (2.6% compared to 2.3%). The persistence of pro-inflationary pressures, especially in the context of the energy crisis and the delay in the ECB's response, has led to an increase in the harmonized inflation forecast for the euro area for 2022 from 2.0% to 3.1%. In 2023, the inflation in the euro area is expected to return to the ECB's target of 2.0% and will even fall slightly to an annual average of 1.6%.

Increasing quotations for energy resources on the international market is a positive factor in the evolution of the Russian Federation's economy, but geopolitical tensions and the risk of introducing new economic sanctions will temper the economic potential. After an estimated economic growth of 4.2% in 2021, it is anticipated in the current forecast round that, in 2022, the economic growth in the Russian Federation will be 2.6% compared to 2.8% previously forecast. For 2023, the Russian Federation's economy is expected to advance by an average of 2.3%.

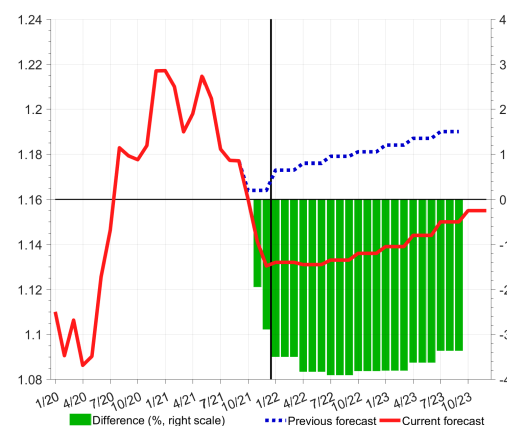
The moderation of economic growth over the entire forecast horizon is also generated by the decline in production activity and

Table 5.1: Expected evolution of external variables (annual average)

	2022	2023
Economic growth		
in the euro area, %	4.0	2.5
Economic growth		
in the Russian Federation, %	2.6	2.3
Average annual inflation		
in the euro area, %	3.1	1.6
Average annual inflation		
in the Russian Federation, %	6.7	4.6
EUR/USD	1.13	1.15
USD/RUB	72.4	72.5
Urals brand oil prices		
(USD/barrel)	77.0	71.3
International food prices		
growth, %	5.2	-1.9

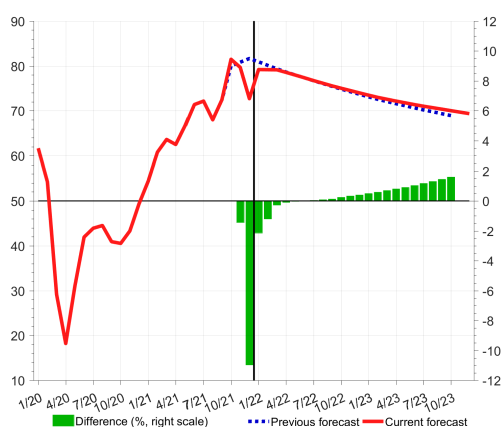
Source: Consensus Economics, Bloomberg, NBM calculations

Chart 5.1: The evolutionary scenario of the EUR/USD exchange rate



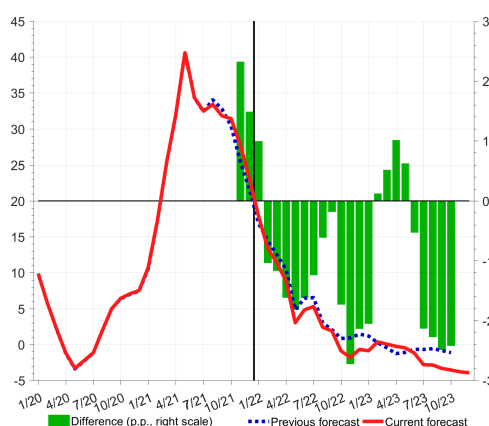
Source: ECB, Consensus Economics, NBM calculations

Chart 5.2: The evolutionary scenario of the Urals brand oil world prices (USD/barrel)



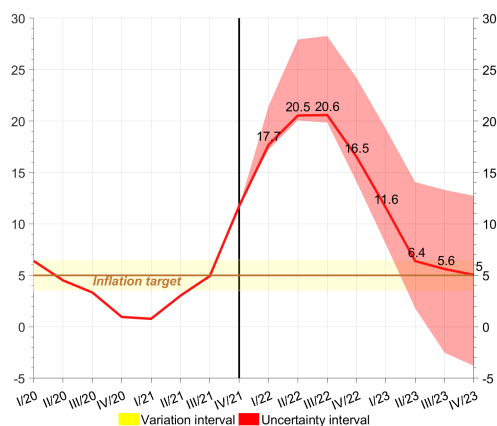
Source: Ministry of Economic Development of the Russian Federation, Bloomberg, NBM calculations

Chart 5.3: International price assumption for food (%)



Source: FAO, Bloomberg, NBM calculations

Chart 5.4: CPI with uncertainty range (% compared to the previous year)



Source: NBS, NBM calculations

the tightening of monetary policy amid pro-inflationary pressures. As consumer prices continue to rise in the Russian Federation, the current forecast round predicts that the average annual inflation in 2022 will be 6.7% compared to 4.5%, after which it will temper towards the Bank of Russia's target recording an average of 4.6% in 2023.

The appreciation of the US dollar in the last months of 2021 led to a change in the EUR/USD parity forecast from 1.18 to 1.13 (-4.0%) for 2022. For 2023, an average EUR/USD parity of 1.15 is expected. FRS's announced intention to close the asset repurchase program earlier and begin raising interest rates in 2022 is a key factor in the appreciation of the US dollar. At the same time, the depreciation of the single European currency is caused by the delay in the ECB's reaction to inflation of 5.0% in December 2021, which is well above the 2.0% target (Chart 5.1).

The Russian ruble depreciated significantly in the last months of 2021, this trend being maintained in forecasts, as well. For 2022, the current forecast round anticipates an average USD/RUB exchange rate of 72.4, and for 2023 – an almost similar value of 72.5. Even if the Russian ruble is favored by high prices for energy resources, the Ministry of Finance of the Russian Federation, under the budgetary rule, buys foreign currency from the market after a barrel of oil has exceeded 45 USD, which moderates the appreciation of the Russian ruble correlated with the increase in oil quotations. At the same time, a significant risk for the forecast is the geopolitical tensions and possible new economic sanctions imposed by the USA.

The recent increase in oil quotations above 90 USD/barrel has led to an average price for Urals oil of USD 77.0/barrel in 2022 and USD 71.3/barrel in 2023 anticipated in the current forecast round. The significantly high oil prices for the first period of the forecast horizon will be supported by the crisis in the energy sector, rising global energy prices and global oil deficit as OPEC+ capacity is limited to fully meet existing demand (Chart 5.2).

In 2021, food prices on the international market increased by an average of 28.1%. The reversal of the trend from upward to downward in the evolution of food quotations on the international market in the last months of 2021 led to a decrease in the forecast of food prices on the global market from 6.4 to 5.2% for 2022. For 2023, global food prices are expected to decline gradually, with an average annual increase of -1.9%. The main upward factors in the variable of food prices on the international market for the first forecast period are limited supply, the unfavorable forecast for the harvest in the southern hemisphere and increase in production and transport costs related to energy and human resources. For the second period of the forecast horizon, the downward factors will be the decline in global demand amid counter-cyclical policies to moderate consumption and the hope of a richer harvest (Chart 5.3).

5.2 Internal environment

Inflation

The annual inflation rate will increase until the third quarter of 2022, after which it will decrease rapidly until the end of the forecast horizon³⁴. Starting with the first forecast quarter, the annual inflation rate will continue to be above the upper limit of the variation range and will return in the interval only in the second quarter of the next year (Chart 5.4).

The increase in the annual inflation rate is driven by all its components, mainly food prices, regulated prices except for the last three quarters of the forecast, core inflation, and less by fuel prices. In the last three quarters of the forecast, regulated prices will contribute negatively to the annual inflation rate (Chart 5.5).

The positive impact of factors such as (1) imported inflation, (2) rising prices for energy resources on the international market, (3) positive domestic demand over the forecast horizon, as a result of the Government granting aid to the population during the cold period of the year, supported also by an increase in wages and credit, (4) side effects from a sharp rise in prices for fuel and gas in the network, (5) a possible increase in electricity tariffs during the first and second quarters of 2022, (6) the accumulated increase in the oil price on the international market, (7) the effect of the low annual base, (8) the adjustment of excise duties, (9) the increase in prices for wood and coal due to the increase in prices for natural gas and coal on the international market, (10) the effect of the prices of highly seasonal products next year, but also (11) the effect of the low annual base, will determine the increase of the annual inflation rate.

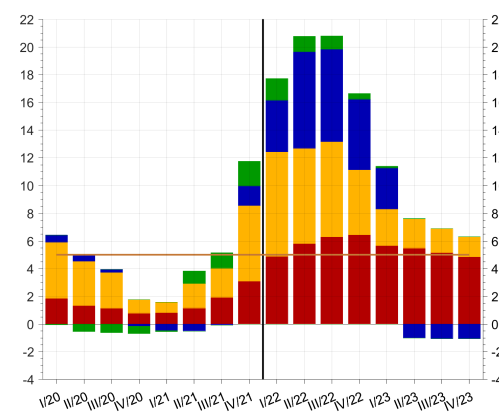
The downward trend in projected external oil and gas prices, (2) the anticipated improvement in the regional and global energy market next year, (3) the aggregate demand continuously declining to the forecast horizon, (4) the high base of this year, (5) the slight decrease in the anticipated food prices on the international market, but also (6) the effect of the prices of highly seasonal products in the current year, will be the factors with negative impact leading to the reduction of the annual inflation rate.

The annual inflation rate will register a maximum value of 20.6% in the third quarter of 2022, and a minimum value of 5.0% in the fourth quarter of 2023.

The average annual inflation will be 18.8% and 7.1% this year and next year, respectively.

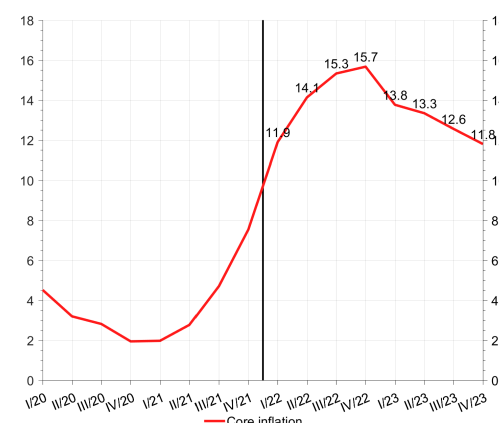
The annual rate of core inflation will have an upward trend during the current year, subsequently decreasing continuously until the end of the forecast period³⁵ (Chart 5.6).

Chart 5.5: Decomposition of CPI (% , percentage points, compared to the previous year)



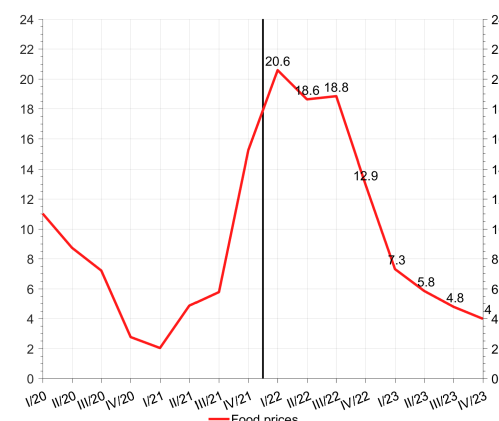
Source: NBS, NBM calculations

Chart 5.6: Core inflation (% , compared to the previous year)



Source: NBS, NBM calculations

Chart 5.7: Food prices (% , compared to the previous year)

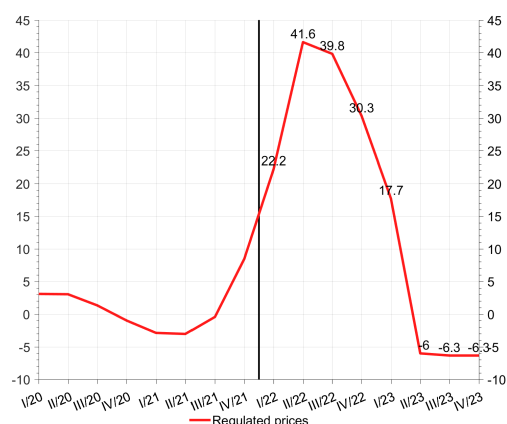


Source: NBS, NBM calculations

³⁴Quarter IV of 2023.

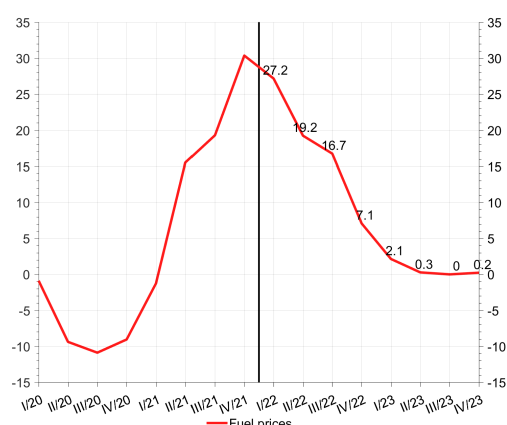
³⁵Quarter I of 2022 – quarter IV of 2023.

Chart 5.8: Regulated prices (% , compared to the previous year)



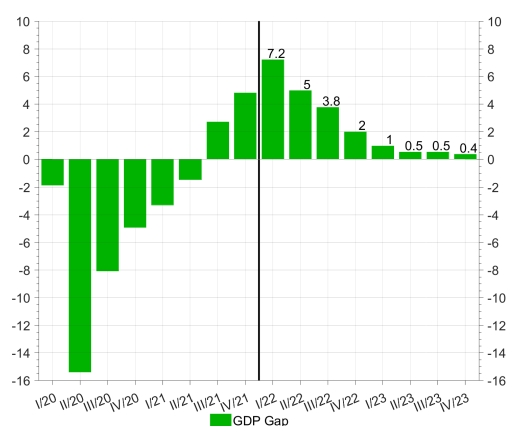
Source: NBS, NBM calculations

Chart 5.9: Fuel prices (% , compared to the previous year)



Source: NBS, NBM calculations

Chart 5.10: GDP deviation (%)



Source: NBM calculations

The accelerated increase in the annual rate of core inflation will be driven by (1) imported inflation, (2) aggregate demand with significant pro-inflationary effects for the current year, albeit declining by the end of the forecast horizon, supported by higher wages and credit, (3) side effects as a result of the sharp increase in prices for fuel and gas in the network, which will further lead to an increase in transportation and production costs, (4) a possible increase in the electricity tariff, during the first and second quarter of 2022.

The change in the core inflation trend starting in the first quarter of 2023 will be caused by (1) the current year's high base and (2) the declining aggregate demand. The adjustment of excise duties from the beginning of 2023 will moderate the downward trend in the annual rate of core inflation.

The average annual rate of core inflation will be 14.3% and 12.8% in 2022 and 2023, respectively.

The annual rate of food prices will continue to rise significantly in the first quarter of 2022 as well, and then it will decrease considerably until the end of the forecast period (Chart 5.7).

The high annual rate of food prices will be determined by (1) the increase in imported inflation, (2) the side effects of the sharp rise in prices for fuel and gas in the network, which will further increase transport and production costs, (3) positive domestic demand over the forecast horizon, (4) the effect of the prices of highly seasonal products next year, (5) the adjustment of excise duties, but also (6) the effect of the low annual base.

On the other hand, its downward trend will be due to (1) the slight decrease in anticipated food prices on the international market, (2) the effect of the high annual base, (3) the aggregate demand continuously declining to the forecast horizon, but also (4) the effect of the prices of highly seasonal products in the current year.

The average annual rate of food prices will be 17.7% and 5.5% in 2022 and 2023, respectively.

The annual rate of regulated prices will continue to increase sharply until the second quarter of this year, after which it will decrease rapidly. From the second quarter of the next year until the end of the forecast horizon, it will record negative values (Chart 5.8).

The accelerated increase in the annual rate of regulated prices will be largely due to the increase in energy prices on the international market, especially the import price of natural gas, which has showed a significant accumulated increase and is expected to decrease relatively slowly over the entire forecast period, creating premises for the increase in tariffs for gas in the network and energy-intensive services. Also, the accumulated increase in the price of oil on the international market creates significant pressures to increase tariffs for transport services.

The downward trend in projected external oil and gas prices, as well as the effect of the high annual base, will moderate the annual rate of regulated prices. The anticipated improvement on the regional and global energy market next year will lead to a

substantial correction in prices, offering the possibility to reduce tariffs for gas in the network and energy-intensive services in the second quarter of 2023. Thus, from that moment, the annual rate will register negative values until the end of the forecast period.

The average annual rate of regulated prices will be 33.4% and -0.9% in 2022 and 2023, respectively.

The annual rate of fuel prices will decrease considerably over the entire forecast period (Chart 5.9).

The decrease in annual rate of fuel prices will be due to (1) the effect of the high annual base, (2) the downward trend in anticipated oil prices on the international market during the forecast period, except for the first quarter. On the other hand, the annual slowdown will be offset by (1) the accumulated increase and increase in the first quarter of the forecast of oil prices on the international market, (2) the stimulating aggregate demand, (3) the increase in wood and coal prices due to the increase in the prices of natural gas and coal on the international market, but also (4) the adjustments of the excise duties at the beginning of the current and next year.

The average annual rate of fuel prices will be 17.1% and 0.6% in 2022 and 2023, respectively.

Demand

The aggregate demand will record growing positive values in the first quarter of the forecast as well, after which it will decline continuously, but it will be pro-inflationary over the entire forecast horizon. This trajectory will be largely supported by a positive fiscal impulse, a revival of external demand and stimulating interest rates, although overall monetary conditions will be restrictive (Chart 5.10).

The GDP deviation will increase as a result of positive contributions from (1) the fiscal impulse, (2) accumulated increases in wages and credit, (3) positive external demand from the euro area over the entire forecast period and from the Russian Federation for the first two quarters of the forecast. The negative deviation of the real effective exchange rate over the entire forecast horizon will show restrictive effects on aggregate demand, which will be slightly tempered by the real interest rate.

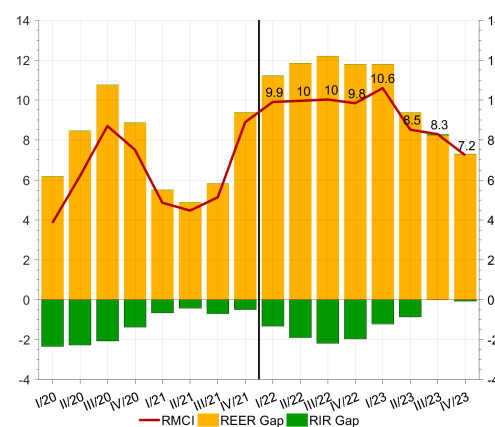
Monetary policy

The real monetary conditions will be restrictive over the entire forecast period, with a negative impact on aggregate demand (Chart 5.11).

The monetary policy through the real effective exchange rate will be restrictive over the entire forecast horizon. Through the real interest rate, the monetary policy will be stimulating throughout the forecast period.

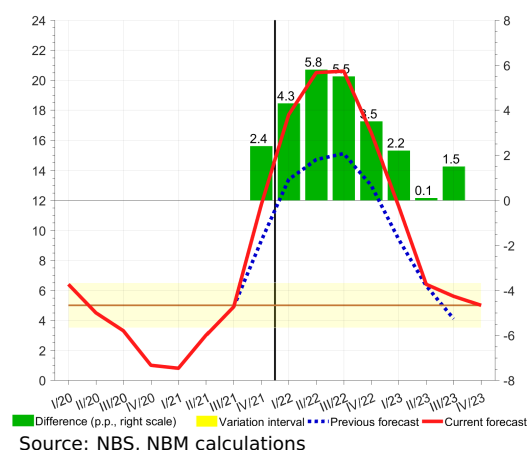
The accumulated appreciation of the Moldovan leu and the effective and subsequent increase in inflation will increase the accumulated imbalance in the real effective exchange rate, which will continue to have restrictive effects on aggregate demand. In the first half of 2023, it is anticipated that the deviation of the real exchange rate will decrease but will remain restrictive.

Chart 5.11: The index of the real monetary conditions and decomposition



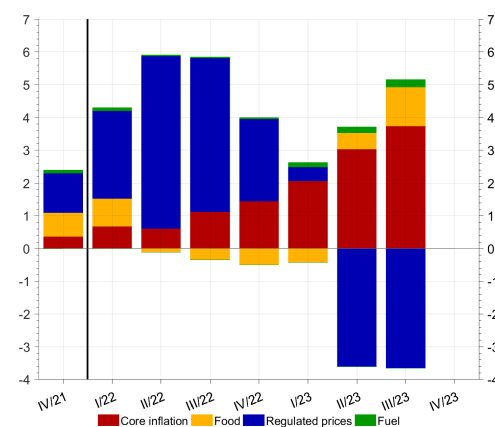
Source: NBM calculations

Chart 5.12: CPI (% , compared to the previous year, percentage points)



Source: NBS, NBM calculations

Chart 5.13: Decomposition of the difference between forecasts (percentage points)



Source: NBM calculations

5.3 Comparison of forecasts

Chart 5.14: Core inflation (% , compared to the previous year, percentage points)

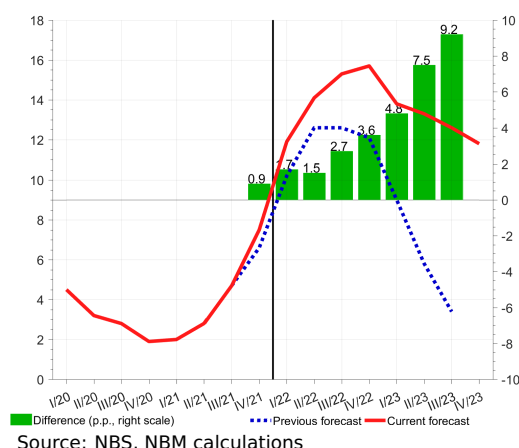


Chart 5.15: Food prices (% , compared to the previous year, percentage points)

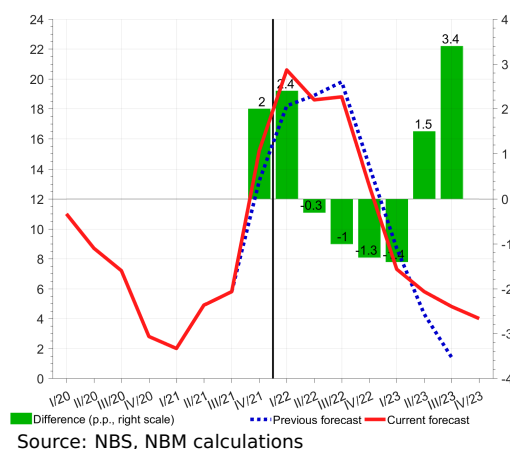
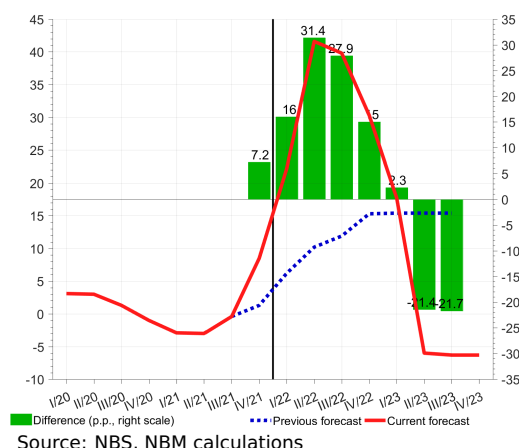


Chart 5.16: Regulated prices (% , compared to the previous year, percentage points)



The current inflation forecast, compared to the previous inflation report, has been revised significantly upwards over the entire comparable period³⁶ (Chart 5.12).

The higher projection of the annual inflation rate forecast is largely due to significant upward revisions in the forecast of regulated prices for the first 5 consecutive quarters of the comparable period, core inflation, food prices in the first quarter of 2022 and the last two quarters of the comparable period and, to a lesser extent, the fuel price forecast.

The significantly lower projection of regulated prices in the second and third quarter of 2023 and a less pronounced one for food prices, starting in the second quarter of 2022, for four consecutive quarters, have attenuated the upward revision of the current forecast (Chart 5.13). The higher annual inflation rate is due to (1) the adjustment of tariffs for natural gas and heating in the first quarter of 2022, (2) the more significant anticipated increase in some tariffs in the second quarter of 2022, (3) the increase in the tariff for interurban transport in the first quarter of 2022, (4) higher imported inflation, (5) higher actual inflation, (6) significantly higher trend in aggregate demand, (7) side effects from the significant adjustment of regulated tariffs at the beginning of this year, but also of the higher level of oil prices on the international market from the third quarter of 2022 until the end of the comparable period. The anticipation of a decrease in the tariffs for electricity, gas in the network and other energy-intensive services (central heating, hot water, etc.), compared to the previous forecast, (2) a lower forecast of food prices on the international market, (3) a lower level of oil prices on the international market for the effective period and in the first two quarters of the forecast, (4) a lower anticipated adjustment of excise duties, and (5) a lower effect of the prices of highly seasonal products in the current year, have attenuated the upward revision of the annual inflation rate forecast.

The average annual inflation rate was increased by 4.8 percentage points for 2022 and by 1.5 percentage points for 2023.

The current forecast for the annual rate of core inflation was increased significantly over the entire comparable period (Chart 5.14).

The higher projection of core inflation is determined by (1) higher imported inflation, (2) a significantly higher trend in aggregate demand, (3) side effects from the significant adjustment of regulated tariffs at the beginning of this year, and (4) higher-than-expected actual inflation in the previous quarter.

The forecast of the average core inflation was increased by 2.4 percentage points for 2022 and by 7.9 percentage points for 2023.

The annual rate of food prices was reconfigured, revised upwards for the first quarter of 2022 and the last two

³⁶Quarter I of 2022 – Quarter III of 2023.

quarters of the comparable period. The annual rate of food prices was revised downwards starting with the second quarter of 2022 for four consecutive quarters (Chart 5.15).

The higher projection of food prices is determined by (1) higher-than-expected actual inflation in the previous quarter, (2) a significantly higher trend in aggregate demand, but also by (3) side effects from significant adjustments to regulated tariffs. A lower forecast of food prices on the international market, and (2) a lower effect of the prices of highly seasonal products in the current year, have attenuated the upward revision and even led to downward revision, for four consecutive quarters starting with the second quarter of 2022.

The forecast for the annual rate of food prices is the same for this year and increased by 2.1 percentage points for 2023.

The current forecast of the annual rate of regulated prices was revised significantly upwards for the comparable period, except for the last two quarters (Chart 5.16).

The annual rate of regulated prices will be significantly higher as a result of (1) the adjustment of tariffs for natural gas and heating in the first quarter of 2022, (2) higher anticipated increase in some tariffs in the second quarter of 2022, (3) increase in tariffs for interurban transport in the first quarter of 2022, compared to the previous forecast. At the same time, in the current forecast, for the second quarter of 2023, a decrease in the tariffs for electricity, gas in the network and other energy-intensive services (central heating, hot water, etc.) was anticipated, compared to the previous forecast, which determined a lower annual rate of regulated prices in the last two consecutive quarters at the end of the comparable period.

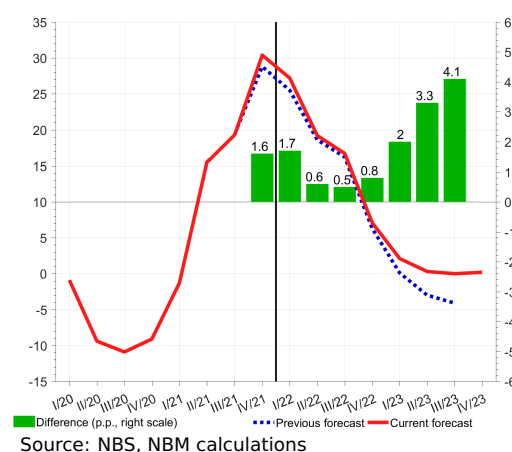
The forecast of the annual rate of regulated prices was increased by 22.5 percentage points for 2022 and decreased by 16.3 percentage points for 2023.

The forecast for the annual rate of fuel prices was increased for the entire comparable period (Chart 5.17).

The higher projection of the annual rate of fuel prices is determined by (1) a higher aggregate demand than the previous one, (2) a higher level of oil prices on the international market from the third quarter of 2022 until the end of the comparable period and (3) higher-than-expected actual inflation in the previous quarter. The lower level of international oil prices for the effective period and in the first two quarters of the forecast, but also (2) the lower anticipated adjustment of excise duties, have attenuated the upward revision of the forecast annual rate of fuel prices.

The fuel price forecast was increased by 0.8 percentage points for 2022 and by 3.2 percentage points for 2023.

Chart 5.17: Fuel prices (% , compared to the previous year, percentage points)



5.4 Risks and uncertainties

External sector

- **Further increase in oil quotations on the international market.** Currently, the quotation for Brent oil tends to be around USD 90/barrel, with experts anticipating that it is very likely that in a few months it will exceed USD 100/barrel. Although OPEC+ approves monthly the increase in oil production by 400,000 barrels of oil per day, in fact, the increase is much smaller. The limitation of OPEC+ countries in increasing oil production is explained by the lack of investment in the energy sector in recent years, the delay in negotiations on a new nuclear deal with Iran and the maintenance of individual oil reserves at maximum levels in favor of the consumption of barrels supplied recently at a much higher price. At the same time, oil consumption is growing rapidly, with the world economy already having a high degree of adaptation to the pandemic crisis (pro-inflationary).
- **The persistence of record levels in European gas quotations.** Europe's energy crisis continues after Gazprom refused to reserve transport capacities through Poland, and approval of the Nord Stream 2 gas pipeline was postponed until mid-2022. Thus, in mid-December, European gas prices rose to around USD 2,000 /1,000 m³. Later, it became known that demand in Asia had fallen and several US shale gas vessels had been re-directed to European ports, so that natural gas prices fell again to around USD 1,000 /1,000 m³. This situation has revealed the vulnerability of the European energy system, with risks persisting in the short and medium term (pro-inflationary).
- **Persistence of high food prices on the international market.** Although the effect of last year's base will diminish the value of annual increases in international food prices, these will continue to rise and then decline at a very slow pace. Among direct factors affecting the food quotations on the international market are increased demand, poor harvest in some regions and unfavorable expectations for some crops, and indirect ones include rising costs for energy resources, mineral fertilizers, and financing costs (pro-inflationary).
- **Declining production activity in emerging economies and fragmented growth worldwide.** The energy crisis, tightening monetary conditions, outbreaks of COVID-19, rising production costs and logistical and transport issues are the main causes of declining production activity, especially in emerging economies. Given that major changes are not expected in the near future, there is a risk of a sharp decline in global production. At the same time, most economies evolve very differently, depending on access to raw material resources, fiscal and monetary incentives, human resources and, last but not least, the COVID-19 factor (disinflationary).
- **Geopolitical and foreign currency risks in the region.** The degeneration of the Russian-Ukrainian conflict could

create major problems in the regional economy in terms of currency developments, flows of goods and services, and capital, as well as the huge social impact. Both the Russian ruble and the Ukrainian hryvnia have already depreciated significantly, and the likelihood of introducing new economic sanctions on Russia increases the risks to the Russian economy. In another respect, the currency crisis in Turkey has a major impact on consumer prices in the Republic of Moldova in terms of imports of fruits, vegetables, and textiles (pro-inflationary).

Real sector

- **Uncertainties about the volume of agricultural production in 2022 and 2023.** The harvest of 2022 and 2023, respectively, the prices for food products on the domestic market will depend, to a large extent, on the agro-meteorological conditions of the current year and next year. Developments in the agricultural sector and, therefore, the trajectory of food prices for the next two years is marked by a strong uncertainty (uncertainty).
- **Vulnerability of prices for local fruits and vegetables to weather conditions in the near future.** According to the experience of recent years, the prices for local fruits and vegetables are largely affected by adverse weather conditions such as dry weather, heavy rainfall, etc., the costs associated with harvesting, transporting, storage, but also their sale at outlets in the country. In the event of significantly different temperatures than normal or heavy rainfall, this would result in a more-than-forecasted increase in food prices over the coming months (pro-inflationary).
- **Uncertainties about the timing and magnitude of the tariff adjustment for regulated services.** The medium-term forecast of inflation is based on a trajectory of prices for regulated services that corresponds to certain assumptions about the prices of energy resources at international and regional level, as well as about other indicators relevant to the respective sector. However, given that tariffs for some regulated services have a considerable economic impact on the population, the timing of their adjustment can be based not only on economic factors but also on the pursuit of social or political objectives by the decision makers involved. Therefore, the timing and magnitude of the tariff adjustments cannot be estimated with a sufficient degree of confidence. At the same time, in the context of the increase in prices for energy resources internationally and regionally, during the last quarters, for the average forecast horizon, certain preconditions for significant adjustments of tariffs in some subcomponents of regulated prices are outlined (uncertainty, pro-inflationary).
- **Side effects due to tariff adjustment and rising fuel prices.** In addition to the direct impact on the CPI, the adjustment of the natural gas tariff, the increase in fuel prices in the last period, but also possible additional tariff adjustments in the next period, will cause a significant increase in costs for economic operators, that will have to increase prices for many goods and services in the CPI structure (pro-inflationary).

- **Duration, intensity of the COVID-19 pandemic and impact on the domestic economy.** The state of uncertainty regarding the evolution of the virus, emergence of new related variants and associated restrictive measures, depending, particularly, on the coverage and effectiveness of the vaccination, remains valid. If additional restrictive measures are further applied for a longer period, the domestic demand will be more modest than anticipated and the impact on inflation will be disinflationary (disinflationary).

Monetary and public sectors

- **External financing.** The flow of external credit and grants is expected to increase considerably, which will allow the Government to implement reforms in the national economy more quickly and will create additional incentives on aggregate demand and inflation (pro-inflationary).
- **A possible increase in excessive liquidity in the banking sector.** As a result of the monetary issue during 2021, following the interventions of the NBM on the domestic foreign exchange market and the anticipated external financial assistance in future periods, in addition, the continuous increase of excessive liquidity in the banking system will be stimulated. Consequently, this surplus will have a positive impact, in the short term, on aggregate demand, and on the exchange rate of the national currency, and may generate additional inflationary pressures (pro-inflationary).
- **Balances in the single treasury account.** During 2021, the Ministry of Finance accumulated balances of financial means in the single treasury account. It is very likely that the Government of the Republic of Moldova will spend the excessive financial means accumulated in the STA in the first half of 2022 to provide compensation in the context of increasing tariffs on energy resources and to index pensions in April 2022 (pro-inflationary).

Chapter 6

Monetary policy decisions

Summary of the meeting of the Executive Board of the National Bank of Moldova of 08.06.2021 on monetary policy promotion

Meeting chaired by: Mr. Octavian Armaşu, Governor – Chairman of the Executive Board

The following were present: members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mr. Ion Sturzu – Deputy Governor, Mr. Aureliu Cincilei – Deputy Governor

Rapporteur: Mr. Radu Cuhai – Director of the Monetary Policy Department

Guests: Mr. Daniel Savin – Director of Financial Markets Department, Mr. Serghei Bucur – Deputy Director of Department – Head of Foreign Exchange Operations Division, Mr. Constantin Şchendra – Director of Banking Supervision Department, Ms. Alina Boboc – Head of Communication and Press Service

The meeting of the Executive Board of the NBM began with the presentation of the Report on the assessment of the risk of deviating from the inflation forecast by Mr. Radu Cuhai. It was noted that the Report had been prepared based on the information and events in the external and internal environment that emerged after the forecast round in April 2021. At the same time, the trends in key macroeconomic indicators, and risks to the short- and medium-term inflation forecast, were specified.

The discussions of the members of the Executive Board began with the analysis and assessment of the macroeconomic information available after the April forecast, emphasizing that, in general, the main assumptions and conclusions reflected in the Inflation Report no. 2, 2021 confirmed. At the same time, they noted the persistence of the risk of an upward deviation of the inflation forecast for the second quarter of 2021, taking as a benchmark the higher level than expected of inflation in April 2021.

In this context, they referred to the dynamics of the inflationary process, noting that the annual inflation rate in April 2021 continued the anticipated upward trajectory, but with a higher magnitude than the forecast (2.3%), registering 2.8%. It was noted that the deviation of the actual inflation from the forecast is mainly due to the positive impact of the core inflation and food prices, which increased by 2.5% and 5.1%, respectively, in annual terms, being by 0.1 and 1.1 percentage points above the levels anticipated in the Inflation Report no.2, 2021. Also, it was found that the level of regulated prices (-2.8%) registered in April 2021 was higher than the forecast (-3.1%), and fuel prices (12.0%) had a slightly lower (by 0.2 percentage points) dynamics than expected.

The EB members spoke on domestic economic conditions, stressing that the February-March 2021 operational data, published by the NBS after the forecast round in April, reveal signs of a slight recovery of the national economy.

In this regard, it was noted that after a negative dynamic in January-February 2021, exports, wholesale trade, and business services, accelerated in March to 36.6%, 8.0%, and 18.5%, respectively. It was found that in March 2021, imports increased by 25.9%, industry by 17.1%, turnover in enterprises specialized in the sale of goods to the population – by 14.1%, and those specialized in provision of services to the population – by 73.2%. At the same time, it was mentioned that freight transport (-5.7%) continued to register a negative dynamic in March, but of a more attenuated intensity, and agricultural production decreased by 13.3% in the first quarter of 2021 compared to the same period in 2020.

Referring to the dynamics of money transfers from abroad to individuals, it was noted that their annual rate continued a strong positive dynamic in the first quarter of 2021, registering the level of 53.6% in March 2021.

At the same time, the EB members emphasized that demand remains disinflationary and fragile despite optimistic operational data in the real and monetary sector, associated with the partial recovery of aggregate demand under insufficient fiscal impulse for a stronger economic recovery.

Discussions also focused on assessing liquidity in the banking sector, noting that the volume of excessive liquidity varies between 4.6-5.5 billion lei, and emphasizing that it is a stimulating level for honoring current payments and granting loans to the real sector of the national economy

Analyzing the situation on the credit and deposit market, the EB members pointed out that the monetary policy incentive measures previously adopted through the interest rate and liquidity channels have determined the reduction of the weighted average interest rate on new loans in national currency during the period: January 2021 – first two weeks of May 2021, from 7.68% to 6.88% annually. At the same time, it was found that the weighted average interest rate on new term deposits attracted in Moldovan lei was 3.11% in the first two weeks of May 2021.

While identifying and assessing the risks of deviation of the inflation forecast made in April 2021, the EB members noted a stronger impact of costs and variation in seasonal fluctuations for the short-term inflation forecast. At the same time, it was noted that, in the medium term, the risks to the inflation forecast are marked by a higher dynamics of oil prices, with prospects of partial compensation from domestic food prices in the context of more favorable conditions for agricultural production.

From the perspective of the external assumptions, the EB members pointed out that these are still associated with the uneven recovery of the world economy and the amplification of inflationary pressures against the background of increasing production costs.

Following the assessment of the quantified risk of deviation of the inflation forecast published in the Inflation Report no.2, 2021, the EB members pointed out the persistence of an upward deviation for the short-term inflation forecast (second quarter of 2021). At the same time, it was mentioned that for the second semester of the current year, inflation remains at the level forecast in the Inflation Report no.2, 2021.

In the ensuing discussions, the EB members noted that the inflation trajectory forecast for 2022 is more likely to be revised upwards against the background of imported inflation due to rising expectations associated with prices for oil, raw materials, energy resources and food on international markets, along with their side effects. At the same time, in this context, it was emphasized that the above-mentioned factors will not have the capacity to raise the inflation trajectory above the upper limit of the target variation range under the conditions of an anticipated fiscal impulse.

Following the analyses and findings made during the meeting, the Executive Board of the NBM decided to maintain the base rate, rates related to standing facilities and ratios of required reserves from the means attracted in Moldovan lei and non-convertible currency, as well as of freely convertible currency, at the current levels.

This decision is justified as coming against the background of the incentive measures previously adopted, associated with an encouraging monetary policy on account of the minimum required reserves in the national currency. At the same time, it was mentioned that the current monetary conditions are conducive to the support of domestic demand, credit and economic activity as a whole.

At the end of the meeting, the EB members stressed the need for continuous monitoring of the internal and external macroeconomic situation, and that the NBM, without prejudice to its fundamental objective of ensuring price stability, will come up, in due course, with measures to maintain the sufficient liquidity of the licensed banks, in support of a viable and stable banking system.

The Executive Board of the NBM unanimously adopted the following decision:

- 1. The base rate applied to the main short-term monetary policy operations is maintained at the current level of 2.65% annually.**
- 2. Interest rates are maintained:**
 - a) on overnight loans at the current level of 5.15% annually;**
 - b) on overnight deposits at the current level of 0.15% annually.**

3. The required reserve ratio for the means attracted in Moldovan lei and in non-convertible currency is maintained at the current level of 26.0% of the calculation base.

4. The required reserve ratio for the means attracted in freely convertible currency is maintained at the current level of 30.0% of the calculation base.

Voting results

PRO – 4

AGAINST – 0

ABSTAINED – 0

Chairman of the Executive Board

Octavian ARMAȘU

Secretary of the Executive Board

Sergiu SURDU

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 30.07.2021
on monetary policy promotion

Meeting chaired by: Mr. Octavian Armașu, Governor – Chairman of the Executive Board

The following were present: members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mr. Ion Sturzu – Deputy Governor

Rapporteur: Mr. Radu Cuhai – Director of Monetary Policy Department

Guests: Mr. Natan Garștea, Ms. Natalia Sîrbu – Advisers to the Governor, Mr. Serghei Bucur – Deputy Director of Department – Head of Foreign Exchange Operations Division, Mr. Constantin Șchendra – Director of Banking Supervision Department, Mr. Eugeniu Aftene – Head of Reporting Management and Development Division, Reporting and Statistics Department, Mr. Andrei Rotaru – Director of the Economic and Applied Research Department, Ms. Alina Boboc – Head of Communication and Press Service

Mr. Radu Cuhai presented to the Executive Board of the NBM a detailed analysis of the macroeconomic developments in the internal and external environment, as well as the new round of medium-term forecast, with the associated risks and uncertainties.

Thus, the EB members indicated a positive deviation of the actual value of the inflation level for the second quarter of 2021 compared to the inflation forecast for that period. This was due to the intensification of inflationary pressures in the second quarter of 2021, and the annual inflation rate continued its upward trajectory, registering the average level of 3.0% (0.4 percentage points above the level anticipated in the previous forecast round). This deviation is mainly explained by the deviation of the food price forecast in the context of the increase in costs associated with the modest harvest of the previous year, the higher increase in prices for core inflation components, especially imported construction materials, and prices for oil, raw materials, and food. These inflationary pressures have only been partially mitigated by the still disinflationary impact of GDP deviation and the slowdown in regulated price growth.

While assessing the country's economic situation, the EB members noted the gradual return of economic activity to the level before the COVID-19 pandemic. It was mentioned that in the first quarter of 2021, the economy of the Republic of Moldova recorded a partial recovery of the economic activity before the pandemic, entering positive territory. Thus, in the first quarter of 2021, the gross domestic product increased by 1.8% in real terms compared to the same period of the previous year. This dynamic was mainly caused by the acceleration of the investment component – gross capital formation generated a contribution of 7.6 percentage points to the GDP dynamics. Household consumption increased by 2.8% against a background of positive dynamics of its sources of financing. It should be noted that the increase in disposable income of the population is due to significant contributions from the salary fund and new loans to the population. The latter have evolved in the context of declining credit rates as a result of monetary policy measures taken during the previous year. The annual rate of exports in the first quarter of 2021 was 1.4%, and that of imports was 13.6%. Sectors of the national economy, such as industry, construction, real estate transactions, communications, supported economic growth in the first quarter of 2021. At the same time, the gross value added in the agricultural sector decreased by 13.9%, generating a negative impact of 0.5 percentage points on GDP dynamics as a result of the sharp decline in agriculture in the previous year.

The EB members stressed that operational data for April-May 2021 confirm the economic recovery. Thus, compared to January-May 2019, there is an increase in industrial production (+4.4%), turnover in enterprises with main activities related to retail trade (+24.3%) and turnover in services provided to the population (+40.6%), as well as in the import of goods and services (+13.3%).

The credit market reflects the monetary policy decisions previously taken, registering in the second quarter of 2021 an increase, in annual terms, of 58.9% in new loans granted in national currency with a weighted average interest rate of 6.88% per year, down by 1.44 percentage points compared to the second quarter of 2020 and by 0.51 percentage points compared to the previous quarter.

Discussions related to the inflation forecast focused on the idea that the current forecast was developed based on the available information flow associated with the analysis and forecast cycle. The forecast was revised upwards for the entire forecast period (third quarter of 2021 – second quarter of 2023), largely due to upward revisions of the core inflation forecast and food prices, but less due to regulated and fuel prices. This adjustment was determined by the following factors: the higher actual inflation compared to the forecasts for the previous quarter, the stronger trend of the recovery of aggregate domestic and external demand, the higher trajectory of external inflation, the higher forecast of international food and oil prices.

Thus, compared to the previous forecast, in which supply shocks were shown as the main pro-inflationary factors in the medium term, starting with the end of the second quarter of 2021, inflationary pressures are already sharply amplified by the increase in aggregate demand.

The Executive Board members noted that the updated forecast had indicated the risk of inflation exceeding the upper limit of the target variation range in the strong pro-inflationary context of the external environment determined by the faster-than-expected recovery of the world economy and Moldova's main foreign trade partners, along with the persistence of high prices for oil, raw materials, and food. At the same time, supply pressures are fueled by aggregate domestic demand from the perspective of the recovering consumption by the population in the context of accelerating salary fund, volume of new loans granted, and money transfers in favor of individuals.

It was noted that annual inflation will increase by more than 4.0 percentage points by the third quarter of 2022, from a minimum value of 3.1% in the third quarter of 2021. Subsequently, it will gradually decrease, so that towards the end of the forecast horizon, the annual inflation will be positioned within the variation range. From the perspective of inflationary pressures associated with aggregate demand, it will be fully recovered in the third quarter of 2021, but will be close to a disinflationary level due to counterbalancing of the positive fiscal impact of this year, persistence of external demand and recovery of agriculture this year, as well as more restrictive monetary conditions.

The Executive Board members emphasized that the inflationary process will be persistent and not temporary. The scenario described is based on the hypothesis of a slightly positive fiscal impulse, but close to zero from an inflationary point of view for the years 2022-2023. The return to the target variation range at the end of the inflation forecast horizon is conditional on a multitude of factors. At the same time, the current medium-term forecast has been prepared based on relatively limited information, and, if new pro-inflationary or disinflationary factors arise, the inflation trajectory will be revised accordingly.

While analyzing and quantifying the risk balance, the EB members noted the prevalence of pro-inflationary risks. These include rising international prices for raw materials, food, and oil, the vulnerability of domestic fruit and vegetable prices to weather conditions in the near future, and external financing with its implications for aggregate demand and inflation. At the same time, the risks and uncertainties associated with the current forecast arise as a result of the COVID-19 pandemic, possible restrictions and their impact on the economic situation both externally and internally.

In these circumstances, the EB members indicated the need for proper synchronization of macroeconomic policies, in particular fiscal and monetary policies, in the near future.

The analysis and findings made during the meeting determined the Executive Board of the NBM to adopt the decision to increase by 1.0 percentage points the base rate, the rates related to standing facilities, and to maintain the ratios of required reserves from the means attracted in Moldovan lei and in non-convertible foreign currency, as well as of freely convertible currency, at current levels.

The decision was taken in view of the sharp increase in inflationary pressures associated with the new forecast round. Taking as a benchmark the period necessary for the transmission of monetary policy decisions to the real economy, the National Bank outlines the timeliness of this decision, consolidating the position of the NBM in ensuring its fundamental objective.

During the meeting, the Executive Board of the NBM reviewed and approved the Inflation Report no.3, 2021. The document contains recent analyses of the internal and external situation associated with the inflationary process, economic activity, and the conduct of monetary policy. It also includes a new inflation forecast for the next eight quarters, with associated risks and uncertainties.

At the end of the meeting, the EB members stressed the need for careful monitoring of the internal and external macroeconomic situation, the risks and uncertainties associated with the evolution of inflation in the short and medium term, and that the NBM will continue to intervene in due course by adjusting monetary policy instruments to achieve the fundamental objective of ensuring and maintaining price stability.

The Executive Board of the NBM unanimously adopted the following decision:

- 1. The base rate applied to the main short-term monetary policy operations is increased by 1.0 percentage points, from 2.65% to 3.65% annually.**
- 2. Interest rates are increased:**
 - a) on overnight loans by 1.0 percentage points, from 5.15% to 6.15% annually;**
 - b) on overnight deposits by 1.0 percentage points, from 0.15% to 1.15 % annually.**
- 3. The required reserve ratio for the means attracted in Moldovan lei and in non-convertible currency is maintained at the current level of 26.0% of the calculation base.**
- 4. The required reserve ratio for the means attracted in freely convertible currency is maintained at the current level of 30.0% of the calculation base.**

The Executive Board of the NBM approved for publication the Inflation Report no.3, August 2021.

Voting results

PRO – 3

AGAINST – 0

ABSTAINED – 0

Chairman of the Executive Board

Secretary of the Executive Board

Octavian ARMAȘU

Sergiu SURDU

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