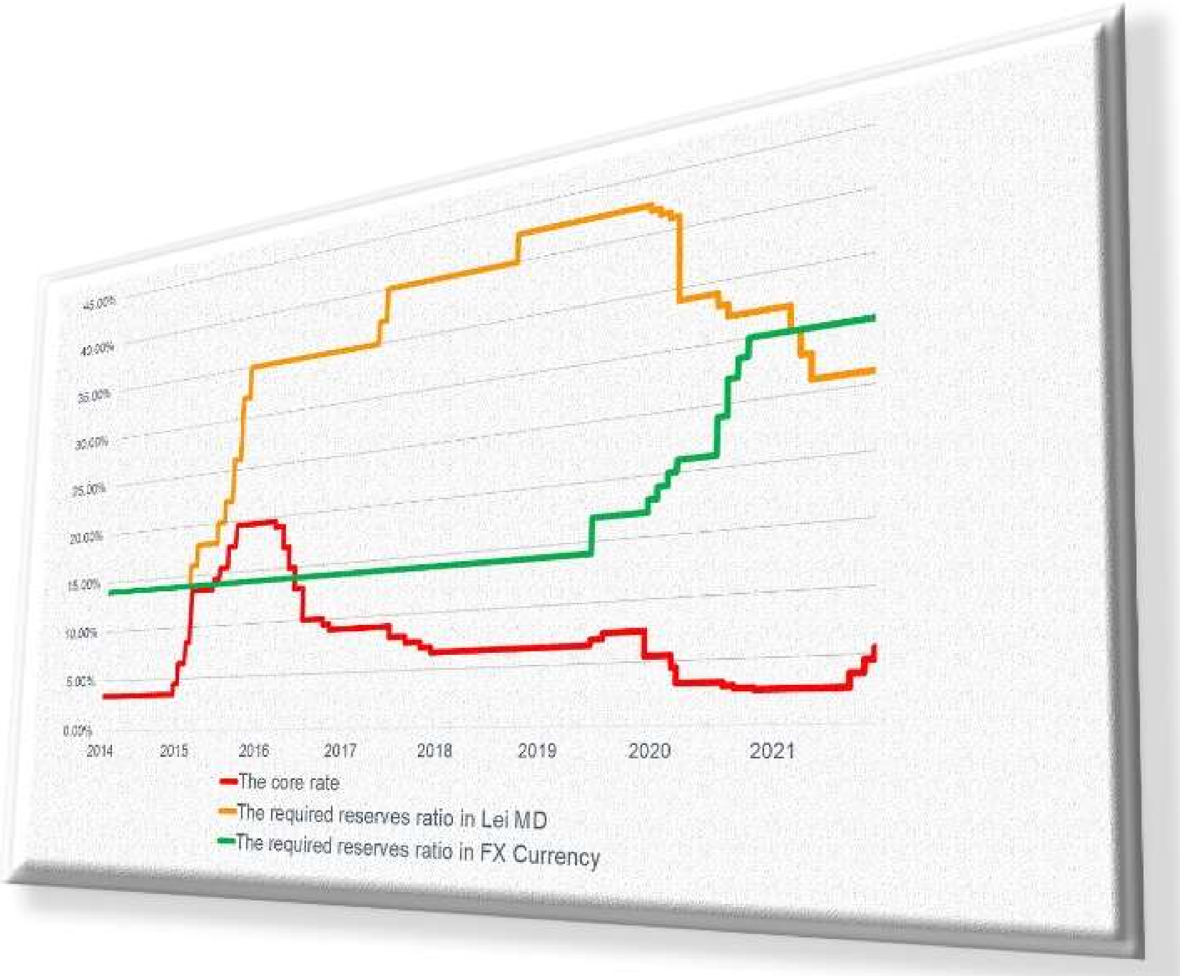
National Bank of Moldova

INFLATION REPORT



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Note

Statistical data were taken from the National Bureau of Statistics,

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Eurostat, International Monetary Fund,

National Agency for Energy Regulation,

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.

Pursuant to the provisions of art. 4 para. (1) of Law no. 548/1995 on the National Bank of Moldova (republished in the Monitorul Oficial 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, November 2022 was discussed and approved at the meeting of the NBM Executive Board on November 8, 2022.

Contents

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
ECF	Extended Credit Facility
EFF	Extended Fund Facility
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
IMF	International Monetary Fund
LB	Local budgets
MDL	Moldovan leu
MHIF	Mandatory health insurance fund
NBC	Certificates issued by the National Bank of Moldova
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
OPEC+	OPEC cooperation with oil producers outside OPEC in an attempt to reduce production and increase the price of oil
PMI	Purghasing Manager’s Index
REER	Real effective exchange rate of the national currency
SB	State budget
SDR	Special drawing rights
SS	State Securities
SSIB	State social insurance budget
USD	US Dollar

Summary

In the third quarter of 2022, the annual inflation rate continued the upward trend of previous periods and was slightly lower than anticipated in the Inflation Report, August 2022. It increased from 31.8% in June 2022 to 34.0% in September 2022. As a result, similar to the previous period, the annual inflation rate remained above the upper bound of the 5.0% range ±1.5 percentage points in the reference quarter. At the same time, the average annual inflation rate was 33.9%, 4.6 percentage points higher than in the previous quarter.

This dynamic was underpinned by the increase in international and regional energy prices, which led to higher domestic energy prices and adjustments in gas, heat, and electricity tariffs, as well as the drought this year, which put pressure on food prices. At the same time, the adjustment of tariffs, the increase in food and fuel prices, as well as the upward trend in wages, supported the increase in costs for economic operators, which was gradually reflected in prices. The impact of the above factors was significantly amplified during the current year by the escalation of the situation in Ukraine, which generated additional pressures on food, fuel, and some core inflation subcomponents. At the same time, for some CPI subcomponents, additional inflationary pressures were driven by the dynamics of the MDL/USD exchange rate. According to recent estimates, the demand-side pressures observed in the previous year have lost their intensity and had a negligible impact on prices of the core inflation subcomponents and food prices.

The upward path of the annual IPPI rate continued in the third quarter of 2022, setting the stage for higher prices of some CPI subcomponents in the period ahead. At the same time, given the modest harvest in the current year compared to the previous year, the increase in international and regional energy prices, amplified by the escalating situation in Ukraine, the recent adjustment in electricity, gas and heat tariffs, the increase in food, energy and other CPI goods and services prices will continue in the coming period. At the same time, the increase in domestic costs, the secondary effects of tariff increases, pension indexation, wage increases will generate additional pressures on the CPI on the domestic market in the coming period. The tense situation in the region and the risks of its escalation, as well as the way in which compensation for tariff increases will be reflected in the cold period of the year, keep the inflation forecast highly uncertain.

The world economy is in a precarious and uncertain situation. More and more indicators point to a significant slowdown in the world economy. Commodity prices, and in particular energy prices, remain at very high levels for an extended period, eroding savings, investment and consumer purchasing power. At the same time, the tightening of monetary policies to ease inflationary pressures creates additional conditions for dampening demand and consumption. The likelihood of the sovereign debt crisis spilling over into financial markets remains high. Borrowing and lending over the last 2-3 years at low rates to compensate for the decline in economic activity, against the current backdrop of galloping inflation, will lead to old debt being serviced at much higher interest rates, at which new loans are taken out. The global supply of energy resources reflects geopolitical decisions at the expense of economic balance. For example, OPEC+ has decided to reduce the cumulative supply of oil by 2 million barrels per day in order not to allow oil prices to fall. Gas prices in Europe continue to be well above recent highs, due to a halt in gas supplies from Russia in response to EU economic sanctions. Currently, the European single currency is trading below parity with the US dollar due to the energy crisis in Europe, but also due to large differences in ECB and FRS interest rates in correlation with high levels of annual inflation in the economies concerned.

GDP has sharply moderated in the first half of this year after the upward trend of the previous year, recording minor growth at the beginning of the year and entering negative territory in the second quarter of 2022. The moderation in economic activity was underpinned by weaker domestic demand mainly due to falling real household incomes and tighter credit conditions, as well as increased uncertainty in the region. A negative impact was also caused by less favourable agrometeorological conditions, which resulted in a more modest agricultural output compared to the previous year. Thus, after a minor increase at the beginning of the current year, GDP decreased by 0.9% in the second quarter of 2022

compared to the same period in 2021, with this dynamic being similar to that anticipated in the Inflation Report, August 2022. At the same time, the seasonally adjusted series reflects a 1.3% decline in GDP compared to first quarter 2022. Overall, in the first half of 2022 GDP remained at the level of the similar period last year. In this context, aggregate demand pressures on prices are estimated to have weakened compared to previous periods.

Positive contributions to GDP dynamics were driven by growth in exports and general government consumption. However, their positive impact was eroded by declining household consumption, investment, and rising imports. On the supply side, more pronounced increases were recorded in trade, financial, medical, and social assistance sectors. The agricultural, industrial and construction sectors continued the negative dynamics of the beginning of the year. In the first half of this year, both the number of economically active population and the number of employed population were on the rise, which increased in the second quarter of 2022. The unemployment rate as well as the underemployment rate showed a slightly downward dynamic compared to the first quarter of 2022. Several operational indicators available for July-August 2022 showed more modest dynamics compared to the first half of this year, thus outlining preconditions for contracting economic activity in the third quarter of 2022.

In the third quarter of 2022, national public budget revenues increased, being 24.7% above the level recorded in the same period of 2021. The structure of national government budget revenue over the last two quarters has changed fundamentally. Thus, the growth rate of taxes and duties collected during the third quarter continued the downward trend that started in March-April this year. This decline has been offset by a higher growth rate of grants collected during the third quarter of 2022.

National public budget expenditures increased to 23.2% above the level recorded in the third quarter of 2021. At the same time, on the market for allocated state securities, interest rates remained on an upward trend during the third quarter of 2022.

In the third quarter of 2022, excess liquidity amounted to MDL 4.3 billion, decreasing by MDL 0.3 billion compared to the previous quarter.

Monetary aggregates in the third quarter of 2022 recorded more moderate annual growth rates compared to the previous quarter. At the same time, the main contribution to this development was largely determined by the change in the volume of money in circulation.

Two meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions were held during the reporting quarter. Following the assessment of the balance of internal and external risks and the inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova, at its meeting on 4 August 2022, decided to increase the base rate applied to the main monetary policy operations by 3.0 percentage points to 21.50% per year.

At the same time, the decisions to increase the reserve requirements adopted by the Executive Board at the monetary policy meetings of 3 June 2022 and 4 August 2022 indicated the application periods between 16 July 2022 and 15 October 2022. Thus, the required reserve ratio of funds attracted in MDL and non-convertible foreign currency was increased from 32.0% to 40.0% and the required reserve ratio of funds attracted in freely convertible currency (FCC) – from 36.0% to 45.0%. Subsequently, at the meeting on 13 September 2022, it was decided to maintain the base rate applied to the main monetary policy operations at the level of 21.50% per year.

These decisions were aimed at moderating the alert growth rates of consumer prices, mitigating the second-round effects of supply shocks, stimulating financial intermediation in domestic currency, and saving at the expense of consumption, balancing the trade balance and anchoring inflationary expectations.

Average interest rates on outstanding loans in national currency increased by 1.95 percentage points and on deposits by 2.58 percentage points compared to the previous quarter. Average interest rates on foreign currency loans and deposits showed minor changes.

Uncertainties and risks related to external developments are very high and affect the short and medium-term outlook. The armed conflict in the region and the related economic crisis form an unfavourable conjuncture between weak external demand and very high import prices. International financial conditions have undergone structural changes in recent months, with the single European currency trading below parity with the US dollar, pound sterling depreciating to unprecedented rate and the US dollar appreciating to record levels. Commodity prices will continue to oscillate between a moderating global economy and tight supply caused by rising geopolitical risks.

Starting from the fourth quarter of this year, the *annual inflation rate* will follow a downward trend until the end of the forecast horizon[1]. The inflation rate will continue to be above the upper limit of the range and will return to the range from the second quarter of 2024. The annual rate of core inflation will peak in the first quarter of the forecast period, and from next year onwards, it will reorient its path and decline continuously for the rest of the forecast period[2]. The annual rate of *food prices* will follow a downward trend until the end of the forecast horizon. The annual rate of *regulated* prices will decline significantly for the whole forecast period. The annual rate of *fuel* prices will continue to decline significantly in the first four consecutive quarters of the forecast, after which it will remain relatively stable until the end of the forecast horizon.

The *aggregate demand* will be negative throughout the forecast period due to deteriorating external demand and household consumption financing, but also to tighter monetary conditions. The tax impulse as well as the partial indexation of wages and pensions will mitigate the decline in aggregate demand.

Real monetary conditions will be restrictive for aggregate demand throughout the forecast horizon.

The current *inflation* forecast, compared to the previous inflation report[3], has been revised downwards for the first two consecutive quarters and for the last quarter of the comparable period[4] and upwards for the rest of the period. The current forecast for the annual rate of *core inflation* has been increased for the first four consecutive quarters and decreased from the fourth quarter of 2023 to the end of the comparable period. The annual rate of food prices has been revised downwards over the entire comparable period. The current forecast for the annual rate of *regulated prices* is revised downwards through the first quarter of 2023 and upwards for the next four consecutive quarters. The annual *fuel* price rate forecast has been increased over the entire comparable period.

The Executive Board of the National Bank of Moldova, at its meeting on 8 November 2022, adopted by unanimous vote to maintain the base rate applied to the main short-term monetary policy operations at the level of 21.50% per year and to maintain the interest rates on overnight loans and deposits at the level of 23.50% and 19.50% per year, respectively. The decision was taken against the background of the pass-through of the effects of previous monetary policy measures and is aimed at slowing down consumer prices by mitigating the second-round effects of supply shocks, further supporting financial intermediation in domestic currency, and saving at the expense of consumption, balancing the trade balance and anchoring inflationary expectations.

In the context of the presence of major risks and uncertainties, when the balance of risks tilts towards disinflationary ones, the NBM will promote a stimulative monetary policy, which will ensure that inflation is restored and maintained close to the target.

At the same time, the projection of the inflation rate in the current Report could be decelerating due to the materialisation of risks such as: a more pronounced moderation of the global economic crisis accompanied by a fall in global demand and a deepening of the sovereign debt crisis of some countries on the back of a supply shortfall, a more subdued aggregate demand generated by the maintenance of high tariffs in the context of a less pronounced tax impulse and a lower increase in disposable income of the population.

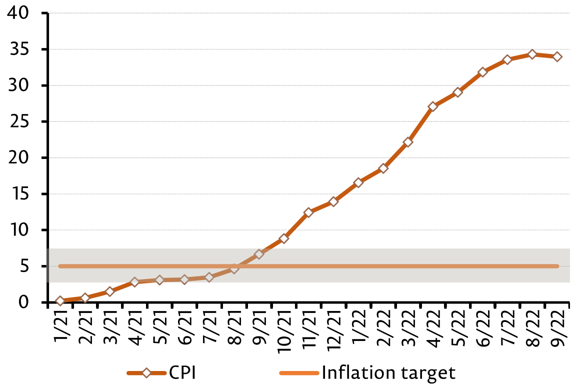
[1] Third quarter of 2024.
[2] Fourth quarter of 2022 – third quarter of 2024.
[3] Inflation Report, August 2022.
[4] Fourth quarter of 2022 – second quarter of 2024.

Chapter 1

Inflation evolution

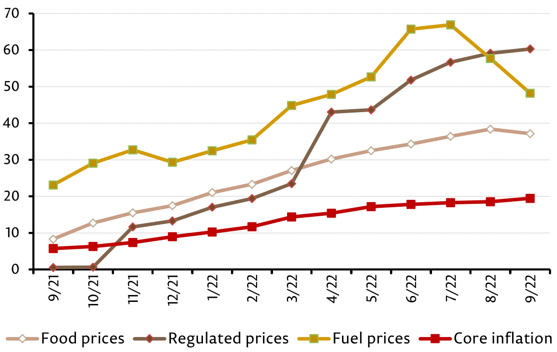
1.1 Consumer price index

Chart 1.1: Annual CPI rate (%)



Source: NBS, NBM

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



Source: NBS

In the third quarter of 2022, the annual inflation rate continued the upward trend of previous periods. However, it was slightly lower than anticipated in the Inflation Report of August 2022. It increased from 31.8% in June 2022 to 34.0% in September 2022. As a result, similar to the previous period, in the third quarter of 2022, the annual inflation rate remained above the upper limit of the range of 5.0% ±1.5 percentage points. At the same time, the average annual inflation rate was 33.9% in the third quarter of 2022, being 4.6 percentage points higher than in the previous quarter.

This dynamic was underpinned by rising international and regional prices for energy resources, which led to higher domestic energy prices and adjustments in tariffs for network gas, heat and electricity, as well as by this year's hydrological drought, which put pressure on food prices. At the same time, the adjustment of tariffs, the increase in food and fuel prices, as well as the upward trend in wages, have supported the increase in costs for economic agents, which has gradually been reflected in prices. The impact of the above factors was significantly amplified during the current year by the escalation of the situation in Ukraine, which generated additional pressures on food, fuel and some core inflation subcomponents. At the same time, for some subcomponents of the CPI, additional inflationary pressures were driven by the dynamics of the MDL/USD exchange rate.

According to recent estimates, the demand-side pressures observed in the previous year have lost their intensity and had a negligible impact on the prices of core inflation subcomponents and food prices this year.

In the third quarter of 2022, the average annual inflation rate was lower than anticipated in the forecast (Inflation Report, August 2022), mainly as a result of a lower trajectory of oil prices on the international market, but also due to a delay in some anticipated tariff adjustments.

Given the modest harvest of the current year, the increase in international and regional energy prices, amplified by the escalating situation in Ukraine, the recent adjustment in electricity, gas and heat tariffs will continue to increase the price for food, energy and other goods and services in the CPI in the coming period. At the same time, the increase in domestic costs, side effects from tariff increases, pension indexation, wage

increases will generate additional pressures on the CPI in the domestic market in the coming period.

At the same time, the tense situation in the region and the risks of its escalation, as well as the way in which the cold-weather compensation granted to the population for tariff increases will be reflected, maintain the pronounced uncertainty regarding the inflation forecast.

Core inflation

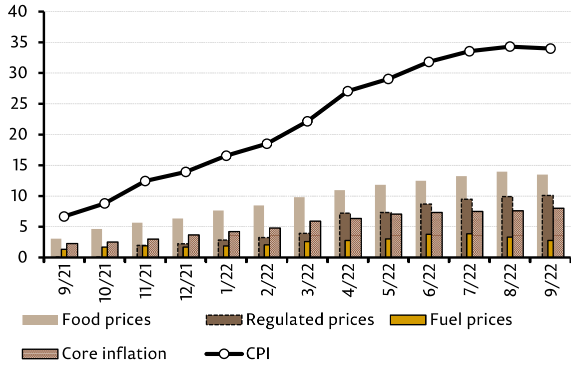
In the third quarter of 2022, the core inflation continued the upward trend started at the beginning of the previous year, averaging 18.7%, or 1.9 percentage points higher than in the previous quarter.

During the third quarter, inflationary pressures on the subcomponents of core inflation continued to be driven mainly by second-round effects associated with tariff adjustments, rising commodity prices and the consequences of the military conflict in Ukraine.

Inflationary pressures related to aggregate demand, observed in 2021, are estimated to have lost their intensity. In this regard, although the wage fund in the second quarter grew at a rate of about 15.2% and is expected to show similar dynamics in the third quarter of 2022, the effect of this development was significantly eroded by rising inflation. A similar situation can also be observed for two other important sources of consumption financing, remittances and social benefits, whose positive dynamics were insufficient to offset price increases and generate additional demand for goods and services. At the same time, in the third quarter of 2022, there was a negative dynamics in new loans to individuals, as a result of monetary policy measures.

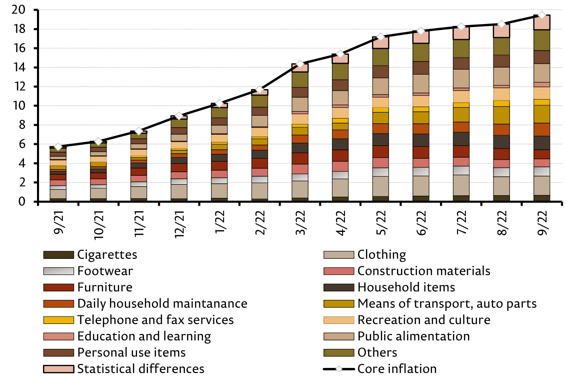
In terms of structure, the increase in the annual core inflation rate was mainly driven by price increases in the sub-components "means of transport", "public alimentation", "personal items", "daily household maintenance" and "recreation and culture" (Chart 1.4). Pressures from the "construction materials" and "furniture" subcomponents, while still significant, were lower compared to the second quarter of 2022. Clothing prices continued to make the largest contribution to the annual core inflation rate, further supported by regional dynamics in textile prices, higher transport and labour costs. On the education and training segment, there were considerable increases in fees for higher education, pre-school education (nurseries and kindergartens) and private tuition in primary education in the context of rising energy prices, food prices and wage increases. Price pressures on international tourism packages, coupled with increases in licence fees, TV and radio subscription prices, have led to significant price increases in the leisure and culture segment. Although at a more modest pace, construction materials continued their positive dynamics. The increase in their prices on international and regional markets led to higher prices for goods imported into the country. At the same time, rising gas and electricity prices and higher wages contributed to the increase in the cost of domestically produced goods. Price formation for

Chart 1.3: Annual inflation evolution (%) and contribution of subcomponents (percentage points)



Source: NBS, NBM calculations

Chart 1.4: Contribution of subcomponents (percentage points) to annual core inflation dynamics (%)



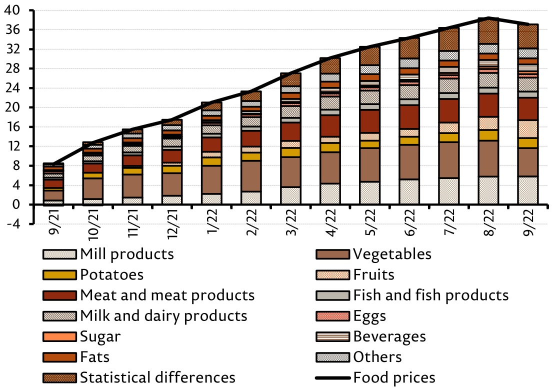
Source: NBS, NBM calculations

furniture manufacturing continues to be affected by price dynamics for basic raw materials. Global timber market trends are also reflected on the market of the Republic of Moldova, which is largely dependent on imports from Ukraine, Belarus and Russia, as well as on the redirection to other countries' markets dictated by the war situation in Ukraine.

In September 2022, within the annual dynamics of core inflation (19.5%), all commodity groups recorded increases, the most pronounced being recorded in the sub-components "construction materials" (28.7%), "furniture" (21.3%), "food" (28.2%), "daily household maintenance" (28.9%), "means of transport, auto parts" (24.5%).

The further trend in prices of some important categories of goods included in the calculation of core inflation will be affected by the significant tariff adjustments made recently to gas and electricity. On the other hand, their effect will be partly offset by modest aggregate demand. At the same time, price dynamics will continue to be affected by uncertainty related to the war in Ukraine. However, the depletion of stocks of raw materials, either of final goods imported from this country or transiting it before reaching the Republic of Moldova (from Belarus, Russia, Poland, etc.), requires finding new suppliers of products, negotiating new contracts, additional prices for logistics, transport, etc., which leads to an increasing dynamic of these prices.

Chart 1.5: Contribution of components (percentage points) to annual food prices dynamics (%)



Source: NBS, NBM calculations

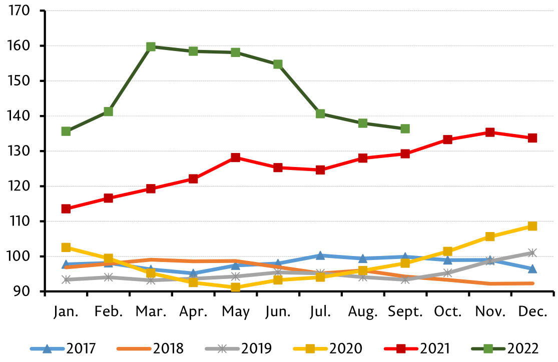
Food prices

In the third quarter of 2022, the annual rate of food prices averaged 37.3%, 5.0 percentage points higher than in the previous quarter. The acceleration in the annual rate of food prices during the period under review was underpinned by the intensification of inflationary pressures from all product groups, with the exception of prices for the fat group. It should be noted that, similarly to previous periods, the groups "vegetables", "mill products", "meat and meat products", "fresh fruit", "milk and dairy products" and "potatoes" contributed most to the annual rate of food prices (Chart 1.5). The sharp increase in food prices was influenced by:

- The occurrence of a hydrological drought in the summer of the current year which significantly affected the agricultural harvest, thus the price level remained high;
- Increase in transport costs (fuel, increase in charges levied by transport companies, damage to shipping routes in the context of the war in Ukraine), both at national and regional level, which implicitly contributes to the increase in final prices;
- Increases in the price of network gas and electricity over the last few months have generated additional inflationary cost pressures (second-round effects);
- Against the background of a high annual inflation rate at the end of 2021 and a continuation of the upward trend in the first months of 2022, economic operators have indexed/will index the wage fund in the immediate future. Increases in payroll expenditure have generated/will generate additional pressures on price growth (second round effects);

- The depreciation of the MDL/USD exchange rate by about 2.6% in the third quarter of 2022 compared to the second quarter of 2022 generated inflationary pressures through the import price channel;
- Inflationary pressures from international food prices have been relatively high, but their impact is steadily decreasing. Thus, in the third quarter of 2022, the annual rate of food prices on the international market averaged 8.7%, 16.8 percentage points lower than in the second quarter of 2022 (Chart 1.6);
- The war in Ukraine generated inflationary pressures pronounced in several aspects: 1) Logistically – many products were imported via the border of Moldova with Ukraine and the Odessa seaport, thus the use of alternative routes increased transport costs; 2) Substitution of Ukrainian products (which were abundant on the Moldovan market and were the most affordable by price/quality in the region) with similar products, but from another (more expensive) country of origin.

Chart 1.6: Evolution of the international food price index, FAO index



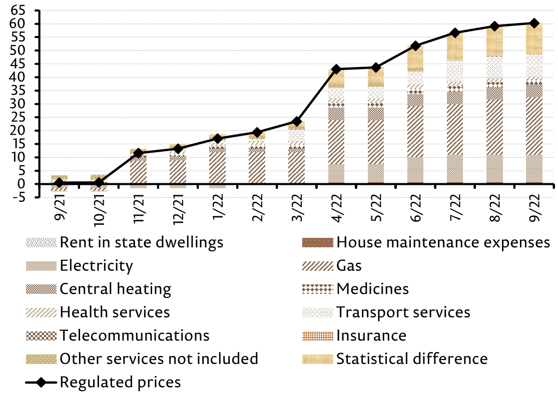
Source: NBS, NBM calculations

In the third quarter of 2022, the contribution of food prices to the annual inflation rate increased by 1.8 percentage points to 13.6 percentage points.

Regulated prices

The increasing trajectory of regulated prices was maintained in the third quarter of 2022, in the context of the full reflection of the increased tariffs from the previous quarter, as well as the further adjustment of other tariffs and services. Thus, the annual rate of regulated prices was 60.3% in September 2022, 8.5 percentage points higher than in June 2022. At the same time, the average annual rate of regulated prices in the third quarter of 2022 was 58.7%, 12.5 percentage points higher than in the second quarter of 2022.

Chart 1.7: Evolution of regulated prices (%) and contribution of subcomponents (percentage points)



Source: NBS, NBM calculations

This dynamic was partly supported by the full reflection of the adjustment of electricity tariffs in mid-June[5], the increase in natural gas tariffs in August[6], as well as the entry into force on 1 July of the new tariffs for public transport in the Chisinau municipality[7] (Chart 1.7).

Thus, on 8 June 2022, it was revised and calculated the electricity tariff for the I.C.S. "Premier Energy" in the amount of 264 bani/kWh (21.6% higher than the previous one) and 286 bani/kWh for consumers connected to the SA "FEE-Nord" (14.0% higher than the previous one).

At the same time, in July 2022, the adjustments of tariffs for public transport in the Chisinau municipality, which led to an increase of this subcomponent in the CPI by about 70.0%. Thus, the fare for

[5] Monitorul Oficial No. 170-176 (8214-8220) of 10.06.2022, p. 98
[6] Monitorul Oficial No. 257-263 (8301-8307) of 12.08.2022, p. 173
[7] https://www.chisinau.md/libview.php?l=ro&idc=403&id=38857&t=/Presa/Comunicate-de-presa/De-astazi-a-intrat-in-vigoare-tariful-unic\-de-calatorie-cu-transportul-public-in-municipiul-Chiinau

trolleybus trips increased from MDL 2 to MDL 6, and for bus and minibus trips from MDL 3 to MDL 6. Public transport season tickets have also been increased.

New tariffs have also been approved for the collection, transport, and disposal of waste in the Chisinau municipality and the south of the country. In Chisinau, the decision was signed on 21 June, following a request from the Regie "Autosalubritate". According to it, the monthly fee for an individual per block will be MDL 17.50 (from MDL 9.25)[8]. In Cahul municipality a number of communal services, including garbage disposal, have been increased to MDL 23.00 per person[9]. As a result, at the country level the prices for this service increased by 45.7%.

Also in August in Soroca municipality the water tariff for domestic consumers was adjusted[10] in the amount of MDL 15.39/cubic meter instead of MDL 15.26/cubic meter and increased the tariff for sanitation services in Comrat municipality from MDL 10 to MDL 15 per person[11].

At the same time, according to the ANRE decision of 4 August, the tariff for natural gas for domestic consumers was adjusted to MDL 22.99/cubic metre (with VAT), from MDL 18.62/cubic metre (with VAT). Thus, the tariff increase was about 15.2%.

Similar to previous periods, prices for intercity trips subcomponent showed an increasing trend. These, according to the methodology in force[12], are strictly linked to the evolution of fuel prices during the state of emergency. At the same time, pharmaceutical prices continued to rise during the reference period.

Legal and accounting services, especially in Chisinau municipality increased by about 36.5%. At the same time, in September, the basic premium for compulsory RCA insurance was significantly increased, a decision in this regard was taken by the National Commission for Financial Markets (NCFM)[13], but this had a minor impact on the CPI. On the other hand, since 1 August 2022[14] prices for a number of services provided by the Public Services Agency (PSA) were reduced. The price for the issuance of passports issued within 20 working days was reduced by MDL 200 – from MDL 850 to MDL 650.

In the coming period, the upward trend in regulated prices will continue. Thus, on 23 September 2022, ANRE approved the new regulated prices for the supply of natural gas by Moldovagaz. The current tariff is MDL 27,103/1,000 cubic meters (MDL 29,271/1,000 cubic meters VAT included), about 27.3% higher than the previous one[15]. At the same time, on 28 September 2022, ANRE adjusted the tariffs for heat energy supplied to

[8] https://www.moldpres.md/news/2022/06/21/22004649

[9] https://noi.md/md/sudul-moldovei/au-fost-ajustate-tarifele-la-serviciile-comunale-in-cahul

[10] Monitorul Oficial No. 257-263 (8301-8307) of 12.08.2022, p. 174

[11] https://comrat.md/4298-reshenie-municipalnogo-soveta-komrat-6-1-ot-01072022g-ob-utverzhdenii-tarifov-na-uslugi-po-vyvozu-bytovyh-othodovmusoramp-zhkhdoc.html

[12] https://cancelaria.gov.md/sites/default/files/dispozitia_cse_nr.9_10.03.2022.pdf

[13] Monitorul Oficial No. 274-277 (8318-8321) of 02.09.2022, p. 49

[14] https://gov.md/en/content/moldovan-cabinet-approves-cutting-tariffs-issuing-passports-identity-papers

[15] Monitorul Oficial No. 298-304 (8342-8348) of 30.09.2022, p. 67

consumers by S.A. "CET-Nord" and S.A. "Termoelectrica" (in force since 1 October). Thus, the tariff for thermal energy delivered to consumers by S.A. "CET-Nord" was set at MDL 3,052/Gcal (excluding VAT), an increase of MDL 937/Gcal or 44.3% compared to the current tariff, and the tariff for thermal energy delivered to consumers by S.A. "Termoelectrica" was set at MDL 2,854 lei/Gcal (excluding VAT), by MDL 685 or 31.6% higher compared to the current tariff[16]. At the same time, following the examination of the applications submitted by the licensees ("Premier Energy" and "FFE Nord"), ANRE adjusted the electricity tariffs. Thus, the tariff for "Premier Energy" consumers, valid from 14 October is MDL 3.15/kWh, which is 50 bani higher than the previous one, and for "FFE Nord" consumers is MDL 3.21/kWh, 40 bani higher than the previous one[17]. Thus, the increase in the countrywide weighted electricity tariff is about 15.3%. It should be noted that, given the impossibility of procuring the necessary electricity from Ukraine, since 14 October the Republic of Moldova has been importing part of the necessary volume from Romania. At the same time, in the context of the reduction in the volume of gas supplied to the main electricity supplier, alternative suppliers must be identified, which creates the preconditions for a higher electricity tariff for end consumers in the coming period.

Therefore, there is currently a great deal of uncertainty about the volume of electricity purchased and the tariff in future periods for consumers. Uncertainty about the dynamics of regulated prices is also amplified by the way in which the compensation granted to the population for energy resources during the cold period of the year will be reflected.

Substantial increases in electricity prices, wage costs in the last period, and the level of the current water and sewerage tariff create the conditions for adjusting the respective tariff in several regions in the country.

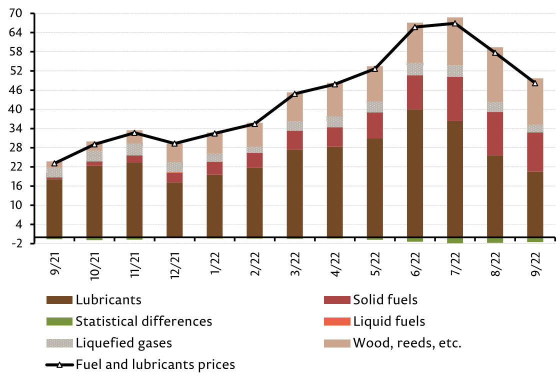
Further adjustment of tariffs for regulated services will lead to additional inflationary pressures (second-round effects) on core inflation and food prices.

At the same time, inflationary pressures related to the adjustment of tariffs for regulated services could be dampened in the coming periods by more negative aggregate demand.

Fuel and lubricants prices

The annual rate of fuel and lubricants prices has moderated during the third quarter of 2022, in the context of lower oil prices during July-September 2022. Thus, the annual rate of fuel and lubricants prices declined from 65.7% in June 2022 to 48.2% in September 2022 (Chart 1.8). This evolution was predominantly driven by the decrease in "lubricants" prices, as a result of lower gasoline and diesel prices by petrol and diesel stations in the quarter. These decreases were influenced by the Platts average gasoline and diesel quotations, which averaged around MDL 19,211.4 and MDL 21,091.4/tonne in the reference quarter, decreasing by 13.9 and 4.1% compared to

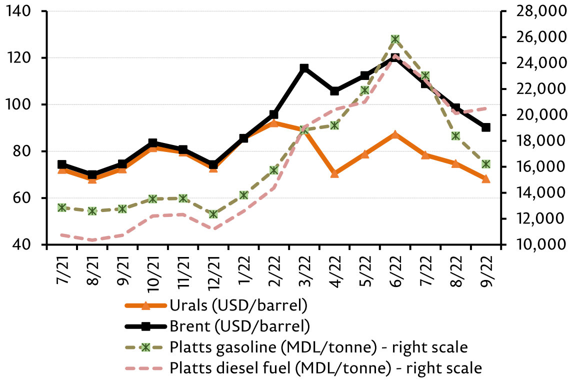
Chart 1.8: Contribution of components (percentage points) to the annual increase in fuel and lubricants prices (%)



Source: NBS, NBM calculations

[16] Monitorul Oficial No. 298-304 (8342-8348) of 30.09.2022, p. 68
[17] Monitorul Oficial No. 318-325 (8362-8369) of 14.10.2022 p. 116-117

Chart 1.9: Evolution of average Platts quotations (MDL/tonne) and Urals and Brent oil prices



Source: ANRE, NBM calculations

the second quarter of 2022 (Chart 1.9). The decrease in the above-mentioned quotations was driven by the downward trend in oil prices. In this respect, Brent brand oil decreased by 12.0% compared to the previous quarter. At the same time, in the context of the sanctions imposed on the Russian Federation, the difference between the price of Brent and Urals oil was maintained during the third quarter of 2022, with the price of the latter decreasing by about 6.4% compared to the previous quarter.

On the other hand, the average annual rate of fuel and lubricants prices in the third quarter of 2022 was 57.6% higher than in the second quarter of 2022. During the third quarter of 2022, "liquefied gas" prices exerted a minor positive impact on the annual rate of fuel and lubricants prices. At the same time, prices of "solid fuels" and "wood, reeds, etc." increased over the period, as a result of higher demand for these subcomponents in the context of the increase in natural gas prices in the Republic of Moldova, but also of the considerable increase in coal prices on the international market in the recent period.

1.2 Inflation evolution and short-term forecast assessment from the Inflation Report, August 2022

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

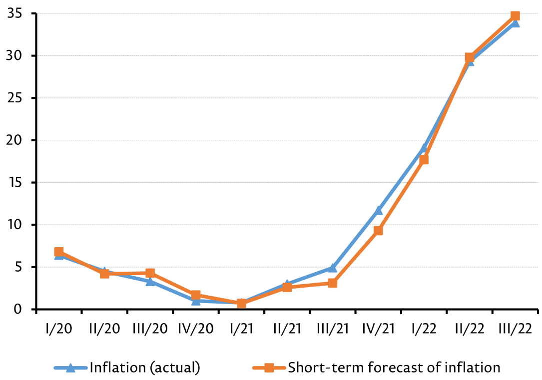
	De facto	Forecast IR, Aug. 2022	Deviation
	Q III, 2022/ Q III, 2021 (%)	Q III, 2022/ Q III, 2021 (%)	(De facto-forecast) (p.p.)
CPI	**33.9**	**34.7**	**-0.8**
Core inflation	18.7	18.2	0.5
Food prices	37.3	37.0	0.3
Regulated prices	58.7	63.2	-4.5
Fuel prices	57.6	68.8	-11.2

Source: NBS, NBM calculations

In the July 2022 forecast round, the annual inflation rate was expected to accelerate to an average of 34.7% in the third quarter of 2022[18]. Inflation data for July-September 2022 show a lower trend than anticipated in the previous forecast round (Inflation Report, August 2022).

In the third quarter of 2022, the average annual inflation rate was 33.9% and 0.8 percentage points lower than projected in the forecast (Chart 1.10). There were both positive and negative deviations in the forecast inflation subcomponents, which partially offset each other (Table 1.1).

Chart 1.10: Annual rate of main CPI subcomponents (%)



Source: NBM

In this regard, the annual rate of core inflation in the third quarter of 2022 was 18.7%, 0.5 percentage points higher than anticipated in the Inflation Report, August 2022, signalling stronger pressures from past tariff adjustments and food price increases on some subcomponents of core inflation. A similar picture emerges for the food price forecast, with the annual rate of food prices being 0.3 percentage points higher than expected, mainly in the context of the dry conditions during the summer of this year, which put pressure on fruit and vegetable prices. At the same time, the

[18] In view of the higher volatility of the monthly values and some possible measurement errors, which should not normally influence monetary policy decisions, the short-term inflation forecast is made on a quarterly basis. This value is an input to the medium-term inflation projection, which similarly has a quarterly frequency and underpins monetary policy decisions. At the same time, it is reported in the Inflation Reports. However, the actual monthly CPI data, as published by the NBS during the quarter, are analysed and compared with the short-term forecast for the whole quarter to assess whether the main anticipated assumptions are confirmed or whether there is a risk of pronounced deviations from the forecast. Therefore, deviations between the actual data available for the months within the quarter and the short-term inflation forecast should be interpreted accordingly, taking into account also the assumptions/anticipations for the remaining months within the quarter.

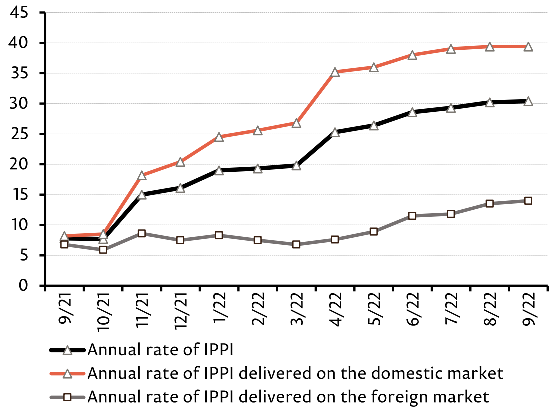
above-mentioned deviations were offset by lower-than-expected dynamics of regulated and fuel prices. Thus, the annual rate of regulated prices was 4.5 percentage points lower than anticipated in the Inflation Report, August 2022 in the context of a delay in some tariff adjustments forecast for the period (district heating, hot water supply, network gas). The annual rate of fuel and lubricants prices was 11.2 percentage points lower than anticipated in the context of a lower trajectory of oil prices in the period (USD 99.2/barrel in the third quarter of 2022 vs. USD 106.8/barrel anticipated for the third quarter of 2022).

1.3 Industrial production prices

In the third quarter of 2022, the annual industrial price rate averaged 30.0%, or 3.2 percentage points higher than in the second quarter of 2022. In structure, both the annual rate of prices of products delivered on the domestic market and the annual rate of prices of products delivered on the foreign market showed an upward trend (Chart 1.11).

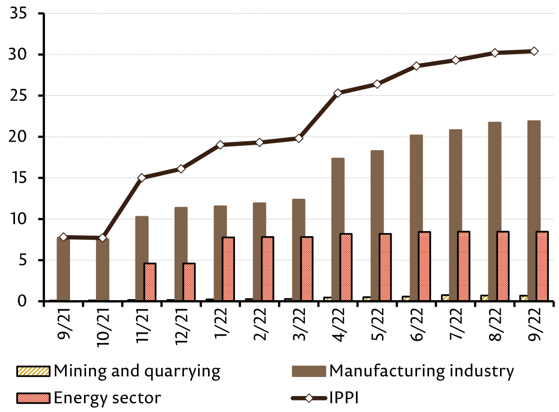
An analysis of the annual industrial price rate by main branches shows that the high rates recorded in recent months have been supported by developments in the manufacturing and energy sectors (Chart 1.12). Prices in the energy sector increased significantly (by about 2.2 times in the third quarter of 2022 compared with the same period of the previous year) against the background of the global energy crisis. Totally, as a result of the substantial increase in energy and raw material prices, prices in the manufacturing industry also reacted against the background of a significant increase in cost components. Thus, the annual rate of prices in manufacturing industry increased by 3.1 percentage points to an average level of 23.6% in the third quarter of 2022. The upward trend in the annual rate of prices in manufacturing industry was mostly driven by price increases in the "food industry" and in the production of "other non-metallic mineral products"[19]. Prices in mining and quarrying increased by 37.5%, generating a contribution of 0.7 percentage points to industrial price dynamics.

Chart 1.11: Annual industrial price rate (%)



Source: NBS

Chart 1.12: Annual industrial price rate (%) and its components contribution classified by main branches (percentage points)



Source: NBS, NBM calculations

[19]Glassware, clay materials, cement, lime, plaster; articles of cement, lime, plaster.

Chapter 2

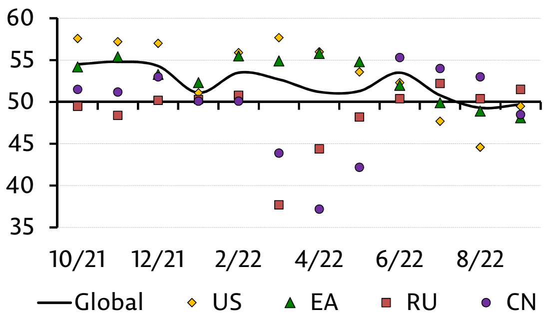
External environment

2.1 World economy, financial and commodities markets

The world economy is in a very precarious and uncertain situation. More and more indicators point to a significant slowdown in the world economy. Commodity prices, and in particular energy prices, remain at very high levels for a prolonged period, eroding savings, investment and consumer purchasing power. At the same time, the tightening of monetary policies to ease inflationary pressures creates additional conditions for dampening demand and consumption. Global energy supply reflects geopolitical decisions at the expense of balance. For example, OPEC+ has decided to reduce the cumulative supply of oil by 2 million barrels per day in order not to allow oil prices to fall. Gas prices in Europe continue to be well above recent highs, due to a halt in gas supplies from Russia in response to European Union economic sanctions. Currently, the European single currency is trading below parity with the US dollar due to the energy crisis in Europe, but also due to large differences in interest rates ECB and FRS in relation to high levels of annual inflation in the economies concerned.

Sovereign debt crisis and contagion in financial markets. After a radical transformation in the rhetoric of the major central banks regarding the transitory nature of the inflationary process and the restrictive monetary policy measures of central banks that were forced to ensure its fundamental objective of price stability, the benchmark for financing costs changed. Thus, loans and credits taken out in the last 2-3 years at low rates to compensate for the decline in economic activity, against the current background of galloping inflation, will lead to old debts being serviced at much higher interest rates, at which new loans are also taken out. In this context, the debt-to-GDP ratios of some countries can be mentioned: Greece (189% of GDP), Italy (152% of GDP), Portugal (127% of GDP), Spain (117.7% of GDP), France (114% of GDP), Belgium (107.9% of GDP), Cyprus (104.9% of GDP).

Chart 2.1: Evolution of PMI indices



Source: Markit

The PMI indices fell below the 50 benchmark, reflecting an economic contraction globally, but also in most of the economies analysed. The PMI data for the US and the euro area show that these economies have experienced negative economic growth since July 2022. In September 2022, economic activity in China also slowed significantly after new outbreaks of COVID-19 and new lockdowns were instituted. An exception is Russia's economy, for which the PMI index reflects a slight progress in economic activity that can be explained by the increase in domestic production (Chart 2.1).

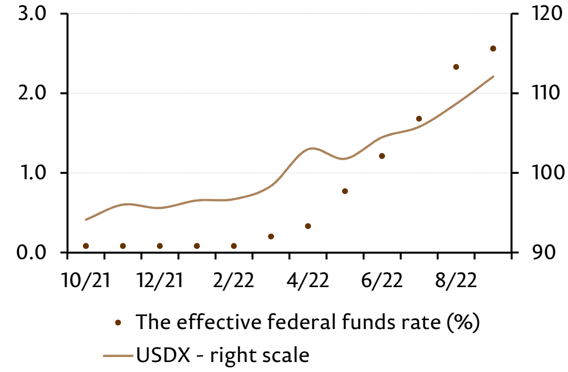
The US dollar has continued to appreciate, largely due to two factors: rising Federal Reserve System interest rates and rising global risks that increase the attractiveness of the US dollar as a reserve asset. At the same time, other major currencies depreciated significantly, which again contributed to the appreciation of the US dollar. For example, **the pound sterling** hit a record low against the US dollar at the end of September 2022, as investors worried about announcements of tax cuts and massive aid to pay bills in a country already in recession. This triggered an unprecedented sell-off in long-term UK government bonds, prompting the Bank of England to step in and stabilise the market. Also, there was a change in the UK Minister of Finance and a reversal of fiscal policy is expected to achieve economic and financial stability (Chart 2.2).

Single European currency has fallen below parity with the US dollar since the second half of August 2022. In July 2022, the European Central Bank began raising interest rates to counter pro-inflationary pressures, raising the base rate by 0.5 and 0.75 percentage points in July and September 2022 respectively. However, the ECB's monetary policy has not narrowed the significant differences between ECB and FRS interest rates in relation to the high levels of annual inflation in the economies concerned. The latest data for September 2022 reflect annual harmonised inflation of 10.0% in the euro area in line with an ECB base rate of 1.25%. For comparison, in the US the annual inflation rate for September 2022 was 8.2% corresponding to an interest rate range of 3.0-3.25%. Another factor contributing to the depreciation of the European single currency is the energy crisis in Europe and the slowdown in production and consumption due to energy shortages and high production costs (Chart 2.3).

The European quotation for **natural gas TTF Netherlands** reached a historical monthly average of USD 2,478.2/1,000 cubic meters in August 2022, with a daily high for the period of USD 3,540.24/1,000 cubic meters[20] (Chart 2.4). The dispute between Germany and Russia over a Nord Stream pipeline turbine, which was stuck in transit after being repaired in Canada, escalated in August 2022 and Moscow reduced gas deliveries to minimum capacity, citing technical problems. At the same time, at the end of September 2022, several nodes of the Nord Stream 1 and Nord Stream 2 gas pipelines in the Baltic Sea suffered unprecedented damage, dashing any hopes of resuming gas exports from Russia. But October is already seeing a significant drop in European gas prices, thanks to reports that gas storage in Europe is 92.0% full, which is above the average of recent years.

Prices for energy resources remain at very high levels for a long time, eroding savings, investment and consumer purchasing power. **Brent brand oil prices** has declined to an average of USD 90.2/barrel in September 2022, down about 25% from the average peak reached in June this year (Chart 2.4). The decrease in oil prices in recent months reflects pressure from expectations of lower global demand and a more appreciated US dollar. At the same time, amid decreasing domestic demand, China is considering stepping up its exports of oil products, which could add enough fuel to world markets to alleviate a shortage that has

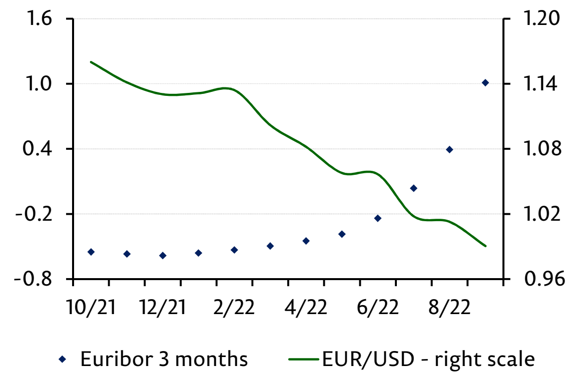
Chart 2.2: Evolution of the USD index (DXY)* in the context of FRS monetary policy



Source: FRS, Bloomberg

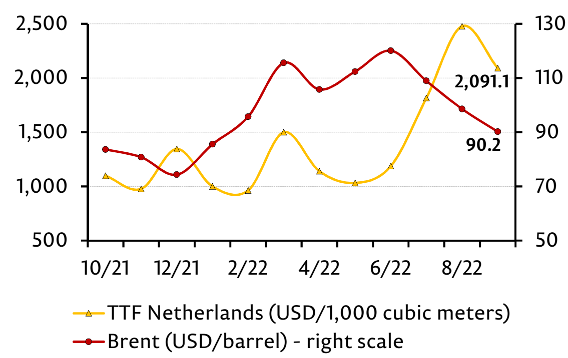
* DXY is an index calculated by the weighted geometric mean of the value of the US dollar against a basket of foreign currencies: euro – 57.6%, Japanese yen – 13.6%, pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%

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



Source: ECB

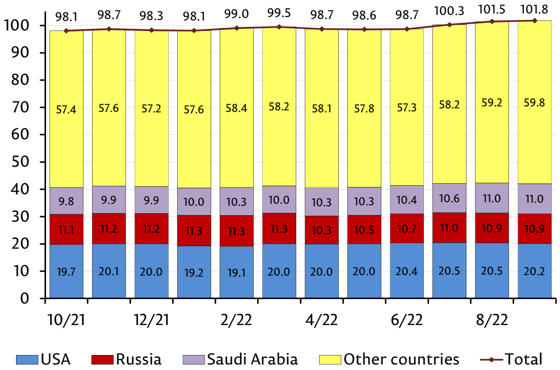
Chart 2.4: Evolution of energy quotes



Source: World Bank, NBM calculations

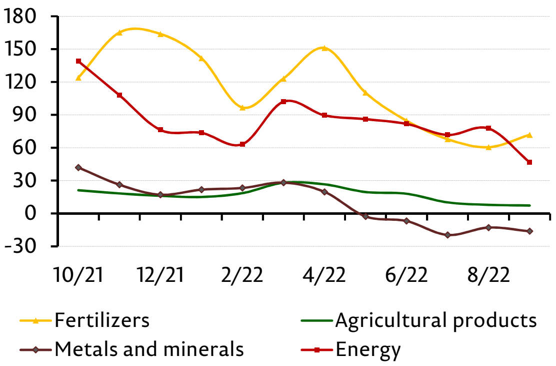
[20]The value refers to the August 2022 high reached on 26.08.2022. At the same time, the daily record level of USD 3,800/1,000 cubic meters was recorded on 07.03.2022.

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



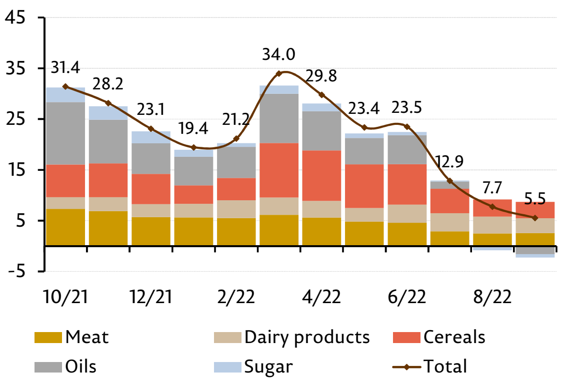
Source: US Energy Information Administration

Chart 2.6: World annual prices growth rates (World Bank indices) (%)



Source: World Bank, NBM calculations

Chart 2.7: Annual growth rate of world food prices (FAO index) (%)



Source: FAO, NBM calculations

worsened since the outbreak of the Russian-Ukrainian military conflict.

In early October 2022, OPEC+ decided to cut oil production by 2 million barrels per day – the highest since the start of the pandemic. The actual supply cut will probably be about half of the reported figure, as most of the countries in the agreement were already producing below the previous target level. OPEC+ cuts could also be associated with potential further supply cuts from Russia as a result of EU sanctions coming into force in December 2022. US Administration energy intelligence data reflects a slight decline in oil production in Russia in recent months, somewhat offset by increased oil production in the US and Saudi Arabia. At the same time, the average daily global oil surplus in September 2022 was 2 million barrels, a trend that has persisted in recent months (Chart 2.5).

International commodity prices remain at very high levels, but annual growth rates are down slightly from the base of the previous year. Chart 2.6 shows that although **energy resource prices and fertilizer prices** are 46.7 and 71.8% higher, respectively, than a year earlier, metals prices are down 16.2% (September 2022). **Commodity metal prices** are reacting most rapidly to the slowdown in economic activity. At the same time, fertiliser and energy resource quotations in recent months reflect a geopolitical conjuncture rather than an economic balance between supply and demand.

International food prices, represented by the FAO index, reflect a gradual decline to previous year's levels, but somewhat above recent years' averages. In September 2022, the FAO index fell (for the sixth consecutive months) by 1.1% from the previous month, but was 5.5% higher than in September 2021. From the chart 2.7, it can be seen that since August 2022, oil and sugar prices have fallen below the previous year's levels, thus contributing negatively to the increase in the FAO index. International palm oil prices fell for the sixth consecutive months, largely due to high stocks, which coincided with the seasonal increase in production in Southeast Asia. For sunflower oil, international prices fell to a 14-months low due to increased export supplies from the Black Sea region amid reduced import demand. The decrease in sugar prices was mainly linked to good production prospects in Brazil, the world's largest sugar exporter, and lower ethanol prices which led to greater use of sugar cane to produce sugar. International wheat prices rose 2.2% in September (compared to August 2022), supported by increased uncertainty about the continuation of the Black Sea grain export initiative, concerns about poor agrometeorological conditions in Argentina and the United States, as well as a rapid rate of exports from the European Union. In September 2022, international prices of all dairy products fell moderately, largely reflecting the impact of the depreciation of the euro against the US dollar. At the same time, limited demand for medium-term deliveries due to fears of market uncertainties stemming from reduced milk production, high energy costs and labour shortages, particularly in Europe, together with the gloomy growth outlook for the global economy, also influenced international dairy price quotations.

2.2 Evolution of important economies

In the second quarter of 2022, the gross domestic product of the **United States** contracted 0.1% (in seasonally adjusted terms) compared with the previous quarter and increased 1.8% from the level of the same period a year earlier. Since, US GDP has recorded negative growth two consecutive quarters, according to economic theory, it can be argued that the US economy has entered a recession. In the January-September 2022 period, industrial production in the US increased by 4.7% and the unemployment rate fell to 3.5% in September 2022. Consumption prices continued to rise, but the annual rate of inflation moderated to 8.2% in September 2022. As monetary policy is expected to continue to tighten to counter inflationary pressures, there is a risk of further contraction in the US economy.

In the second quarter of 2022, economic activity in the **euro area** grew at a positive quarterly rate of 0.8%, and compared with the same quarter in 2021, the euro area economy grew by 4.1% (in seasonally adjusted terms). At the same time, the PMI indices reflect that the euro area economy most likely recorded a negative rate in the third quarter of 2022 due to the energy crisis, the drought affecting agricultural regions and the social and economic consequences of the war in Ukraine. In the first 8 months of 2022, industrial production in the euro area grew insignificantly by 0.1% in annual terms, of which Germany saw a decline of 0.6%, France saw an insignificant increase of 0.1% and Italy grew by 1.5%. The euro area unemployment rate has remained at a low level of 6.6% in recent months, while consumption prices have continued to increase, with harmonised annual inflation reaching 9.9% in September, including 11.8% for food, alcohol and tobacco, 40.7% for energy resources, 5.5% for non-energy industrial goods and 4.3% for services.

2.3 Evolution of neighboring economies and main trading partners

In the second quarter of 2022, the gross domestic product of **Romania** grew by 2.1% (in seasonally adjusted terms) compared to the previous quarter, and compared to the same period of the previous year, on a gross basis, it recorded robust growth of 5.3%. In the January-August 2022 period, industrial production contracted compared to the similar period of the previous year by 2.0% in the seasonally adjusted series and by 1.2% in the gross series. In September 2022, consumption prices increased by 1.3% compared with the price level in the previous month and by 15.9% compared with the price level in September 2021. Since the annual inflation rate has exceeded the target corridor of 1.5-3.5% since the beginning of 2022, the NBR has increased the monetary policy rate 7 times to a cumulative level of 6.25%.

In the second quarter of 2022, the economy of the **Russian Federation** contracted by 2.0% (in seasonally adjusted terms) compared with the previous quarter and by 4.1% compared with the same period a year earlier. In January-August 2022, industrial production in the Russian Federation increased on an annual basis by 0.9%. Amid falling domestic demand and the unprecedented appreciation of the russian ruble, consumer prices in the Russian Federation continued to decline. In September 2022, consumer prices increased by 0.1% from the previous month and by 13.7% from September 2021. After the Bank of Russia raised the base rate on February 28, 2022 from 9.5% to 20.0%, several cuts followed to a cumulative level of 7.5%.

In the second quarter of 2022, due to the outbreak of armed conflict, gross domestic product of **Ukraine** fell dramatically by 19.1% (in seasonally adjusted terms) compared to the first quarter of 2022 and by 37.2% in annual terms. Forecasts for Ukraine's economy are very bleak as the conflict continues, with industrial infrastructure and shipping badly affected. From the little data published by the State Statistics Service of Ukraine, we can mention that in January-August 2022, Ukraine's exports of goods decreased by 30.8% compared to the same period of 2021, and imports decreased by 21.4%. Consumer prices continued to rise, with monthly inflation of 1.9% in September, and consumption prices increased by 24.6% compared to September 2021.

Chapter 3

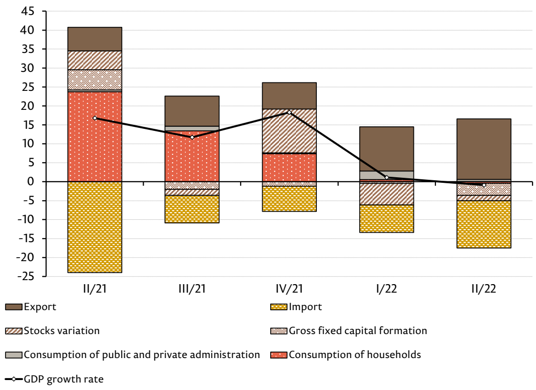
Economic developments

3.1 Demand

The GDP dynamic slowed down significantly in the first part of this year after the upward trend of the previous year, registering a minor increase at the beginning of the year and then entering negative territory in the second quarter of 2022. The slowdown in economic activity was underpinned by more subdued domestic demand, mainly because of falling real household incomes and tighter credit conditions, as well as increased uncertainty in the region. At the same time, less favourable agrometeorological conditions also had a negative impact, resulting in a more modest agricultural output compared to the previous year. After minor growth earlier this year, GDP contracted by 0.9% in the second quarter of 2022 compared to the same period in 2021, with the dynamics similar to that anticipated in the Inflation Report, August 2022. At the same time, the seasonally adjusted series reflects a 1.3% decline in GDP compared to the first quarter of 2022. Overall, in the first half of 2022 GDP remained at the level of the similar period last year. In this context, according to the estimates, aggregate demand pressures on prices are estimated to have weakened compared to previous periods.

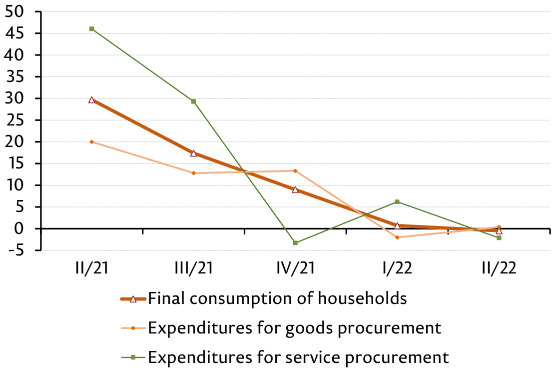
In the second quarter of 2022, GDP contracted by 0.9% compared to the same period of the previous year, following a 1.1% increase at the beginning of the year. Among factors that determined the slowdown in the economic activity in the first half of this year can be mentioned the decrease in real household income amid accelerating inflation, rising interest rates, which slowed lending, increased uncertainty in the region as a result of the escalation of the conflict in Ukraine. At the same time, in the second quarter of 2022, the contraction in GDP was also driven by more modest developments in construction, industry, a lower performance of the agricultural sector compared to the second quarter of 2021 in the context of drier conditions. At the same time, the increase in external demand as a result of the economic recovery in the EU and other trading partners since the beginning of the year, the previous year's rich agricultural harvest, part of which was also harvested in the first part of this year, and the increase in budget expenditure mitigated the negative impact of the above-mentioned factors on GDP dynamics. These dynamics of economic activity were anticipated in the previous round of forecasting (Inflation Report, August 2022) and are broadly in line with the forecast. In this context, according to the estimates, aggregate demand pressures on prices have weakened compared to previous periods.

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



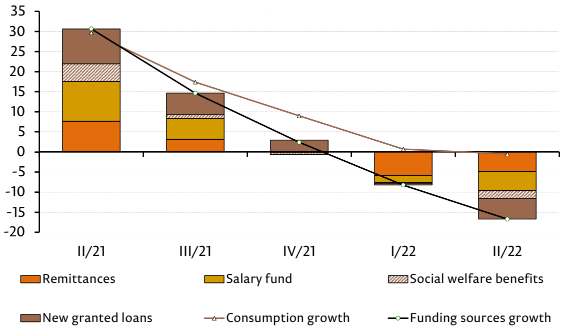
Source: NBS, NBM calculations

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



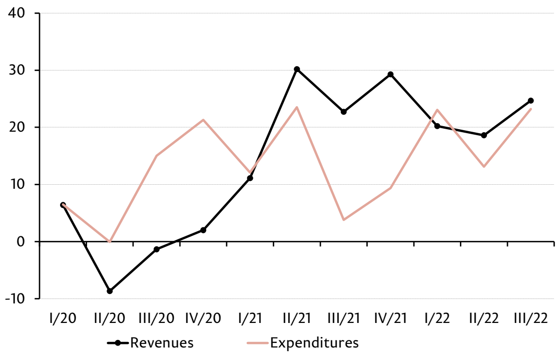
Source: NBS

Chart 3.3: Development in the population's disposable income (%, compared to the previous year) and subcomponent contributions (percentage points)



Source: NBS, NBM calculations

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



Source: Ministry of Finance

From the perspective of uses (Chart 3.1), in the second quarter of 2022, after the pronounced moderation at the beginning of the year, the annual dynamics of household consumption entered negative territory and contracted by 0.5% compared to the second quarter of 2021. Investment in the period under review generated a pronounced negative impact (-4.7 percentage points) on GDP dynamics in the context of increased uncertainty in the region, but also of tighter credit conditions. Structurally, this impact was mainly driven by the negative dynamics of gross fixed capital formation. This registered a contraction of 11.3% compared to the second quarter of 2021. At the same time, a negative contribution was determined by the subcomponent of the change in inventories, which amounted to about -1.4 percentage points, which can be attributed to the decrease in agricultural production inventories due to their export. After the pronounced dynamics in January-March 2022, public administration consumption recorded a more modest increase of 1.5% in the second quarter of 2022. A considerable positive impact on GDP dynamics was exerted by export developments. These, with the economic recovery of some trading partners, but also due to the effects of a rich harvest in the previous year, continued the dynamics observed in previous periods and increased by 53.9% in real terms compared to the second quarter of 2021. Imports increased by 20.0% compared to the same period of the previous year, a more pronounced annual rate than at the beginning of this year.

Household demand for consumption

The annual dynamics of household consumption entered negative territory in the second quarter of 2022 after the modest development in the first part of the year. As a result, the annual rate of household final consumption recorded a level of -0.5%, 1.2 percentage points lower than in the first quarter of 2022, due to a 2.1% reduction in expenditure on the purchase of services. At the same time, expenditure on purchases of goods increased by 0.4% compared with the same period of the previous year (Chart 3.2).

The modest consumption growth was supported by a fall in real disposable income of the population against the background of accelerating inflation and tighter credit conditions. As a result, in the second quarter of 2022, the wage fund increased by about 15.2%. However, given that the average annual inflation rate accelerated to 29.3% in the second quarter of 2022, the salary fund in real terms is estimated to have contracted by about 10.9%, with a significant negative impact on the disposable income of the population. A similar effect can be found for other sources of consumption financing such as social benefits or remittances (Chart 3.3). At the same time, the increase in lending rates has led to a contraction in the volume of domestic currency lending to individuals, which has contributed to a dampening of domestic demand. In this respect, new loans to individuals contracted significantly (-30.4%) in the second quarter of 2022, generating the most pronounced negative impact on the dynamics of potential consumption financing sources.

Public sector

According to the data provided by the Ministry of Finance, during the third quarter of 2022, the national public budget revenues were accumulated in the amount of MDL 23.9 billion, by 24.7%

more than the revenues accumulated in the same period of 2021 (Chart 3.4). A major part of budget revenues was accrued from taxes and fees, which had a share of 61.5%. Compulsory state social insurance contributions and compulsory health insurance premiums accounted for 25.4%, and the share of grants and other revenues accounted for 8.8 and 4.3% of total budget revenues, respectively.

National public budget expenditures (NPB) in the third quarter of 2022 totalled MDL 22.4 billion, an increase of 23.2% compared to the same period of 2021. Out of the total expenditure, the highest share was allocated to social protection (39.4%), 14.6% were allocated to health care, and 11.6% were allocated to education.

It should be noted that in the third quarter of 2022, 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), in the amount of MDL 8.2 billion (an increase of 23.9% compared to the same period of 2021) (Chart 3.5). The major share of transfers went to SSIB, about 43.4% of total transfers, followed by transfers to local budgets about 37.9%, with MHIF receiving 18.7% of funding.

In this context, in the third quarter of 2022, the execution of the national public budget resulted in a proficit of MDL 1.5 billion. In the same period of 2021, the execution of the national public budget resulted in a proficit of MDL 1.0 billion. The balances of the national public budget accounts as of 30 September 2022 amounted to MDL 15.6 billion.

In the third quarter of 2022, the Treasury Single Account (TSA) was characterized by negative annual rates of payments and receipts into the account (Chart 3.6). As a result of inflows and outflows, as of 30 September 2022, the TSA balance amounted to approximately MDL 7.1 billion, recording an annual decrease of 11.8% (Chart 3.7). It should be noted that, at the end of the third quarter of 2022, the balance of the Government's foreign currency deposit account with the National Bank of Moldova amounted to the equivalent of about MDL 10.1 billion, higher than at the end of 2021 by 31.7%.

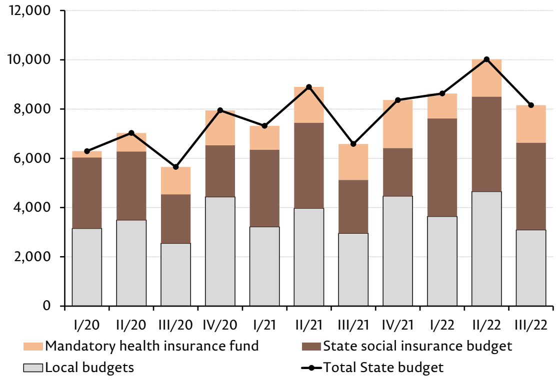
State debt

As of 30 September 2022, the balance of the state debt of the Republic of Moldova totalled about MDL 85.5 billion, and in relation to GDP[21] it amounted to 32.0% (Chart 3.9). In annual terms, state debt recorded a nominal increase of 18.1% (Chart 3.8), due to the increase in external state debt recalculated in national currency (with a positive contribution of 18.0 percentage points). The domestic state debt made a minor contribution of 0.1 percentage points. State debt, as of 30 September 2022, consisted of 61.4% of external state debt and 38.6% of domestic state debt.

As of 30 September 2022, the balance of external state debt amounted to USD 2,687.1 million, higher than as of 30 September 2021 by about USD 448.6 million or 20.0%. Recalculated in national currency, the external state debt balance amounted to about MDL 52.5 billion (19.7% in GDP[21]) (Chart 3.9).

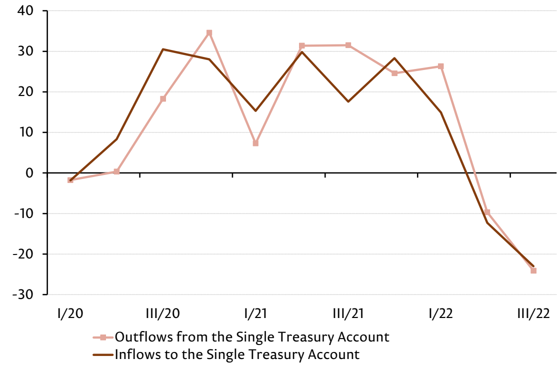
[21] GDP estimated by the NBM

Chart 3.5: Evolution of budget transfers (MDL million)



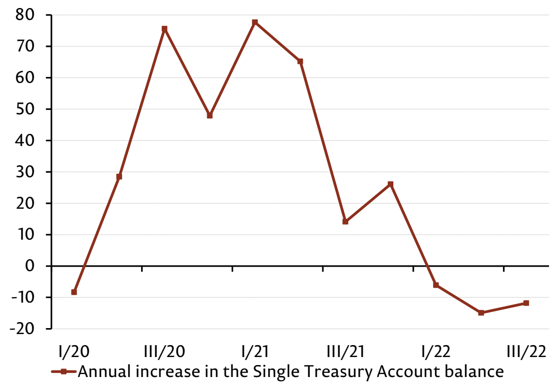
Source: Ministry of Finance

Chart 3.6: Evolution of Treasury Single Account flows (% compared to the previous year)



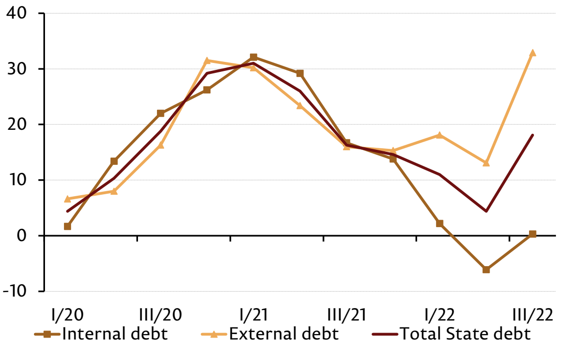
Source: NBM

Chart 3.7: Evolution of Treasury Single Account balance (% compared to the previous year)



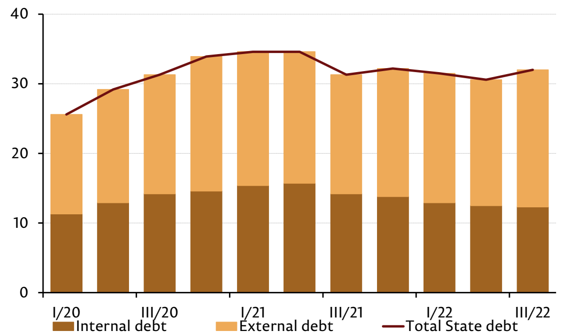
Source: NBM

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



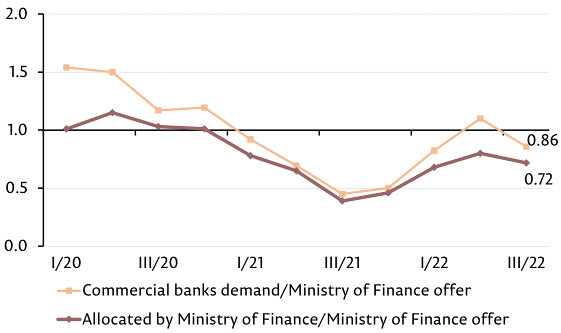
Source: Ministry of Finance

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



Source: Ministry of Finance

Chart 3.10: Demand/supply ratio on the primary market of state securities



Source: NBM

As of 30 September 2022, the domestic state debt amounted to about MDL 33.0 billion (12.3% of GDP[21]) (Chart 3.9) and was essentially unchanged from that of 30 September 2021 (Chart 3.8). Domestic debt was made up of SS issued in the primary market (55.6%), SS issued to enforce state guarantees (37.5% of the total) and converted SS (6.9%).

Primary market of state securities (SS)

During the third quarter of 2022, the Ministry of Finance put into circulation state securities for a total amount of MDL 6,034.0 million, 28.3% less than the volume of the initial offer. It should be noted that on the primary market of state securities there is a decrease both in demand from licensed banks and in the volume offered for placement by the Ministry of Finance (Chart 3.10).

During the reporting period, average effective interest rates on 91-day, 182-day and 364-day treasury bills increased from the level recorded in the previous quarter by 1.0 percentage point, 4.0 percentage points, and 2.8 percentage points, respectively. Average effective interest rates on 2-year and 3-year state bonds increased from the second quarter of 2022 by 2.3 percentage points and 0.8 percentage points, respectively. With regard to state bonds with a 5-year and 7-year maturity, it should be noted that there were no applications from licensed banks during the quarter. Thus, we see that banks continue to invest in short-term securities, being more reluctant to invest in long-term bonds, especially with maturities of 5 and 7 years (Chart 3.11).

The structure of the portfolio of SS put into circulation during the reference period shows that the most demanded SS were those with a maturity of 182 days, which accounted for 44.0% of total transactions, followed by 364-day treasury bills, whose share was 43.4%, and the share of 91-day treasury bills was 9.8%. It should be noted that the share of 2-year state securities was 2.6%, while the share of 3-year state securities was insignificant (Chart 3.12).

Investment demand

In the second quarter of 2022, the investment component generated a negative contribution of 4.7 percentage points to the dynamics of economic activity, mainly due to the impact generated by gross fixed capital formation (-3.2 percentage points), but also to the negative impact (-1.4 percentage points) caused by the subcomponent change in inventories. It should be noted that the decrease in inventories during this period could be associated with the export of agricultural food products in the context of the rich agricultural harvest in 2021. In the second half of 2021, at the harvest stage of agricultural products, significant stocks were accumulated and during the following quarters this excess of agricultural food products was exported, thus the impact of the change in stocks was also negative.

It should be noted that gross fixed capital formation for the fourth consecutive quarter shows negative growth rates, mainly against the background of contracting construction-oriented investment. The dynamics of investment in construction could be driven by a decline in demand from the population, against the background of a significant increase in prices of construction materials, but also by deteriorating credit conditions. As a result, gross fixed capital formation contracted by 11.3% in the second quarter of 2022 compared with the same period of the previous year.

The negative dynamics of gross fixed capital formation was largely driven by the dynamics of "construction" oriented investment, which decreased by 16.8%. Also, the "machinery and equipment" component decreased by 0.9% compared to the same period of 2021 (Chart 3.13).

According to the operational data presented by the NBS, investment in fixed assets decreased by 18.5% in the second quarter of 2022. Intangible fixed assets decreased by 9.8%, while tangible investment decreased by 18.6%. The dynamics of the latter were driven by negative developments in the sub-components "engineering construction" (-44.8%), "non-residential buildings" (-22.8%), "residential buildings" (-11.3%), "means of transport" (-6.6%). Investment in machinery, equipment and installations increased by 2.2%.

From the perspective of sources of financing investments in fixed assets, the negative dynamics of 18.5% was mainly determined by the dynamics of the group "other sources" (-37.5%) and "own resources" (8.9%) (Chart 3.15). At the same time, investment financed from "foreign investors’ funds" contracted by 33.0%. Investments financed from the state budget and local authority budgets contracted by 11.4 and 20.2% respectively in the second quarter of 2022.

Net foreign demand[22]

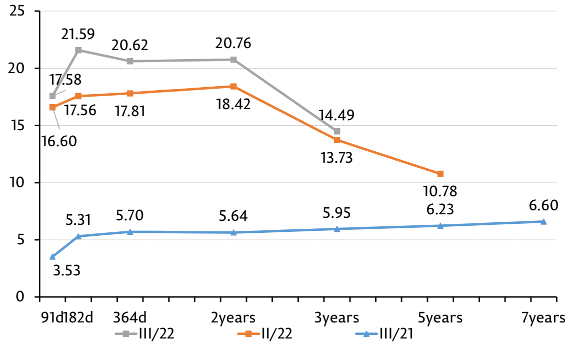
Data for the second quarter of 2022 and the first two months of the third quarter of 2022 show some major changes in the structure of Moldova’s foreign trade. Thus, in the context of the war in Ukraine, the emergence of the phenomenon of re-export of mineral products is highlighted, as well as an increase in imports of agri-food products that are processed on the territory of the Republic of Moldova (at the first stage) or re-exported. It should be noted that, amid the modest agricultural harvest in the current year, in the third quarter of 2022, the first signs of a contraction in the export of agricultural food products (cereals) can be noted. At the same time, the import dynamics is dominated by the import of mineral products, as a result of the pronounced increase in the prices of these categories of products in the context of the global energy crisis.

The annual export rate in the second quarter of 2022 recorded a level of 89.8% or 34.6 percentage points higher than in the first quarter of 2022. At the same time, data for the first two months of the third quarter of 2022 show a reversal of the upward trend in the annual export rate because of a moderation in exports to EU countries and those classified as Rest of the World. At the same time, exports to CIS countries also moderated, but with a lower amplitude (Chart 3.16).

The annual export rate in the first two months of the third quarter of 2022 recorded a level of 40.0%, or 49.8 percentage points lower

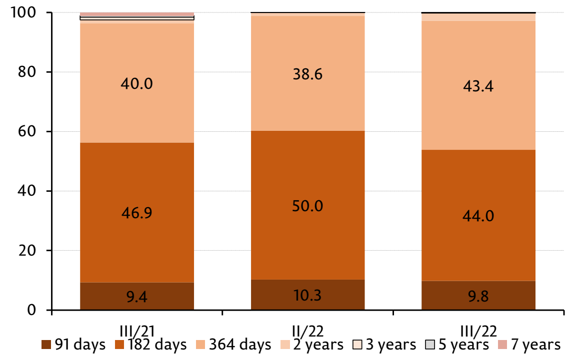
[22] Quarterly data on the evolution of the foreign trade of the Republic of Moldova, expressed in thousands of US dollars, were used.

Chart 3.11: SS yield curve (%)



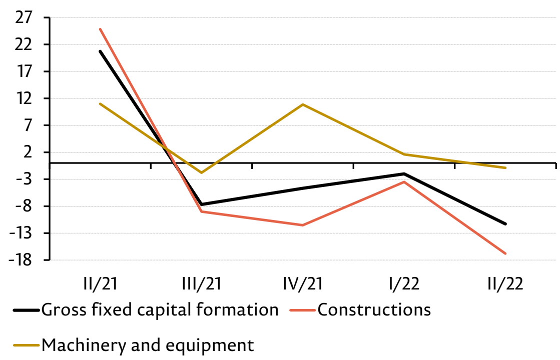
Source: NBM

Chart 3.12: Structure of SS allocated to the primary market



Source: NBM

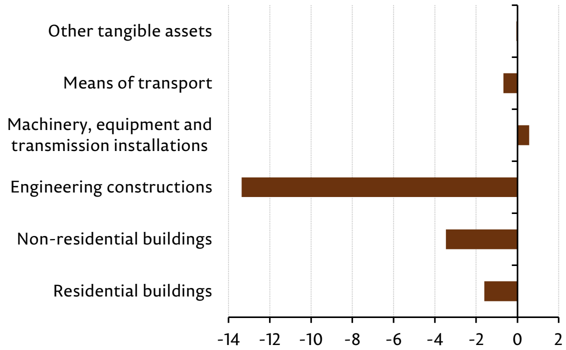
Chart 3.13: Annual investment dynamics (%)



Source: NBS

than in the second quarter of 2022. The downward dynamic of the annual export rate was influenced by the pronounced tempering of agricultural food products exports as a result of a modest agricultural harvest in 2022, which directly influenced the country's export capacity (Chart 3.17). At the same time, for the second consecutive quarter, there was a significant increase in the export of "mineral products", a phenomenon that was conditioned by a shortage of gasoline and diesel on the Ukrainian market against the background of the war in the neighbouring country.

Chart 3.14: Contribution of components to the increase in investments in tangible assets in the second quarter of 2022 (percentage points)



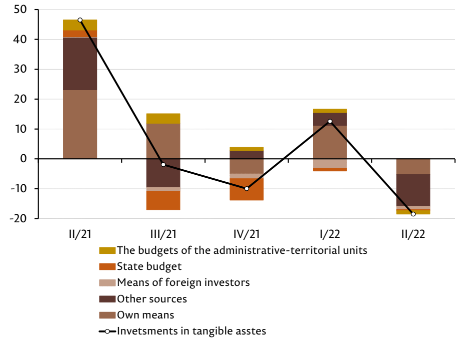
Source: NBS, NBM calculations

While analysing the evolution of exports by origin of products, it can be seen that the moderation of the annual rate of exports in the third quarter of 2022 was driven by the evolution of exports of domestic products (Chart 3.18).

In the second quarter of 2022, the annual import rate was 34.6%, being marginally higher than in the first quarter of this year. At the same time, data for the first two months of the third quarter of 2022 show a similar trend to that of the second quarter of 2022. The positive annual rate of imports in 2022 was determined by the evolution of imports from all country categories (Chart 3.18).

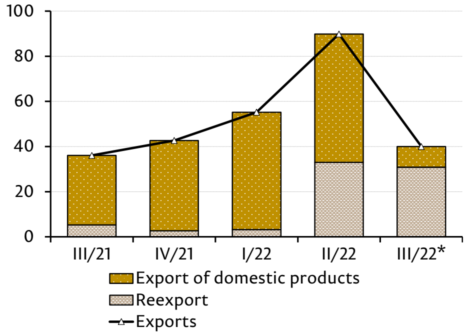
By commodity group (Chart 3.19), the increase in the annual rate of imports in the first two months of the third quarter of 2022 was influenced by increases in imports of "mineral products", "vehicles, optical and sound recording or reproducing devices" and "food, animal products, beverages and fats" (Chart 3.20)

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



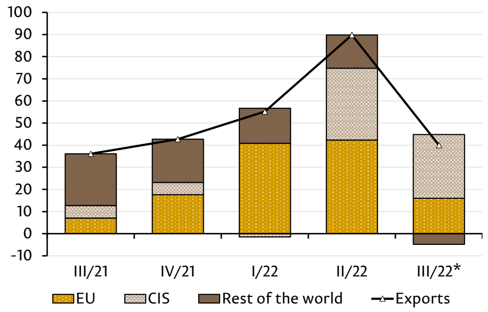
Source: NBS, NBM calculations

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



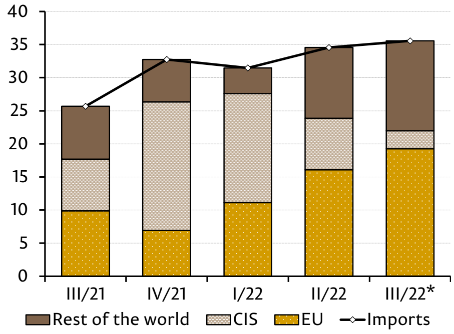
Source: NBS, NBM calculations
*Jul.-Aug.

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



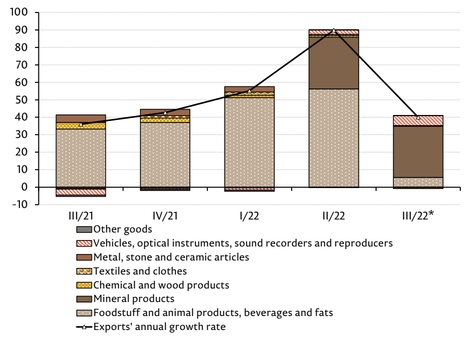
Source: NBS, NBM calculations
*Jul.-Aug.

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



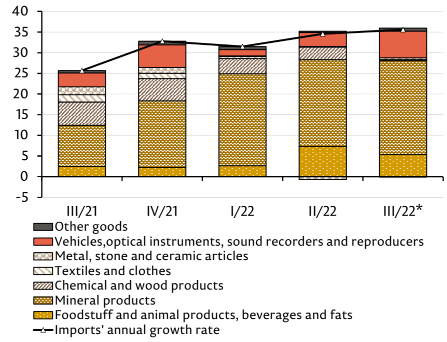
Source: NBS, NBM calculations
*Jul.-Aug.

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



Source: NBS, NBM calculations
*Jul.-Aug.

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

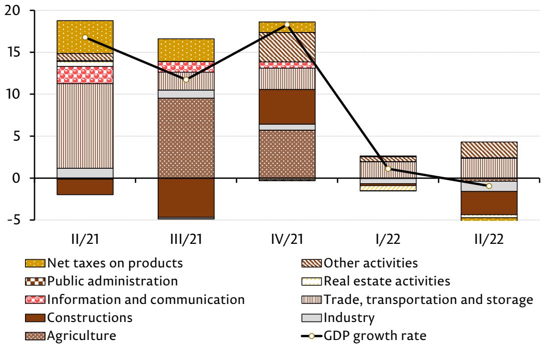


Source: NBS, NBM calculations
*Jul.-Aug.

3.2 Production

By resource category, the decrease in GDP in the second quarter of 2022 was mainly determined by developments in construction (-2.8 percentage points) (Chart 3.21).

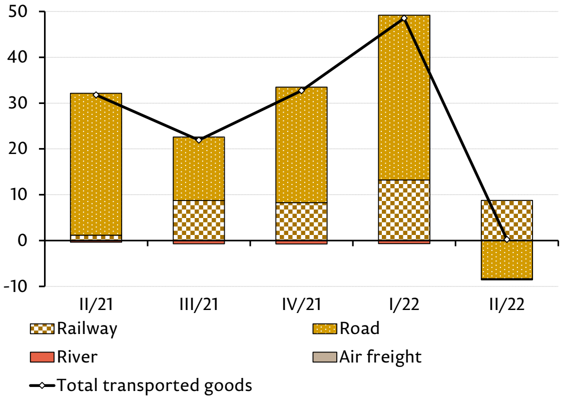
Chart 3.21: Contribution of supply components to GDP growth (percentage points)



Source: NBS, NBM calculations

Thus, the gross value added in this sector contracted by 28.1% compared to the same period of the previous year, as this branch was negatively affected by both the significant increase in construction material prices and the tightening of credit conditions and the decline in real disposable income of the population. These factors, together with the uncertainty in the region, would also have led to a 4.9% decline in real estate transactions, which had an impact of -0.4 percentage points on GDP dynamics. At the same time, a significant negative impact (-1.1 percentage points) was caused by the decline in value added in industry. The energy industry contracted by 27.3%, processing industry by 6.5%, while mining and quarrying decreased by only 0.5% compared to the second quarter of 2021. In the context of less favourable agrometeorological conditions of this year, the agricultural sector contracted by 6.0% and had a negative impact of -0.3 percentage points on GDP dynamics during the reference period. This dynamic was supported by decreases in crop and livestock production of 7.54 and 7.4%, respectively. Net taxes on products decreased by 3.8%, generating a contribution of -0.6 percentage points to GDP dynamics.

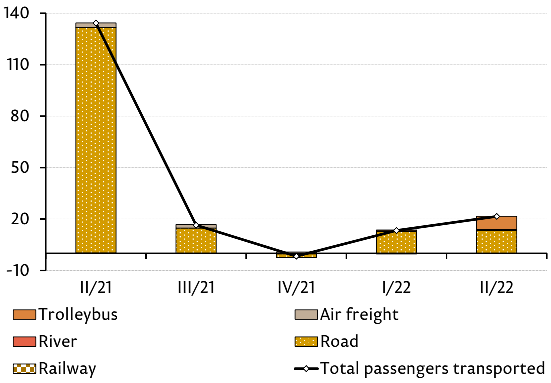
Chart 3.22: Evolution of freight transport (%, compared to the previous year)



Source: NBS

On the other hand, the negative contributions mentioned above were mitigated by developments in the "trade" sector[23]. and the subcomponent other activities. Thus, the gross value added of the trade subcomponent increased by 14.3%, generating a positive impact of 2.2 percentage points on GDP dynamics. In this regard, turnover in enterprises providing services to enterprises increased in nominal terms by 35.4% compared to April-June 2021 (Chart 3.26), and turnover in enterprises specializing in wholesale trade increased by 47.7% compared to the second quarter of 2021. A more modest development is seen in retail trade, so that turnover at enterprises specializing in retail trade amounted to about -2.1% (in comparable prices) in April-June 2022 (Chart 3.25), while turnover at enterprises providing services to the population decelerated to 6.8%. A positive contribution was driven by an increase in gross value added in transport and storage of 5.1% compared to the second quarter of 2021. Freight transport increased by only 0.3% in April-June 2022 compared to the same period of the previous year, while the number of passengers transported increased by 21.6% (Charts 3.22 and 3.23). Within the other activities subcomponent, the financial and insurance activities sector increased by 11.5% and generated an impact of 0.4 percentage points on GDP growth, while the health and social work sector increased by 21.8% and thus contributed 0.9 percentage points to GDP growth.

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



Source: NBS

[23]Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles

Freight and passenger transport

The annual freight volume rate in the second quarter of 2022 was 0.3%, being by 48.3 percentage points lower than in the first quarter of 2022 (Chart 3.22). This development was mainly driven by the increase in annual terms of the volume of goods transported by rail by 64.9% compared to the similar period of the previous year. At the same time, the volume of goods transported by road and inland waterways decreased by 9.8 and 14.9% respectively. At the same time, the volume of goods transported by air decreased by 38.7% compared to the same period of the previous year.

Positive results were recorded in the passenger transport sector in the second quarter of 2022. Thus, the number of passengers carried was 21.6%, higher by 8.3 percentage points than in the first quarter of 2022 (Chart 3.23). This development was determined by the increase in annual terms in the number of passengers carried by road and trolleybus by 13.6 and 25.2%, respectively, while the number of passengers carried by domestic air and sea increased by 48.1 and 32.2%, respectively. On the other hand, the number of passengers carried by rail decreased by 6.8% compared to the same period last year.

Industrial production

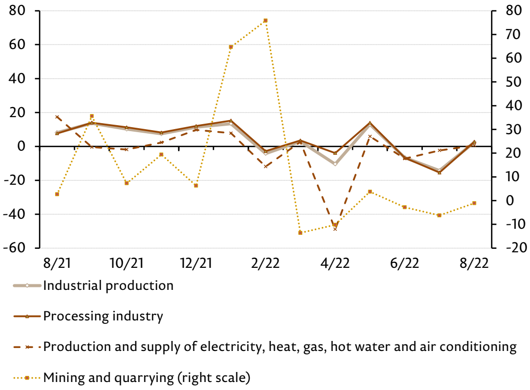
In the first two months of the third quarter of 2022, the annual rate of industrial production volume averaged -6.0%, 4.6 percentage points lower than in the second quarter of 2022 (Chart 3.24). This dynamic was determined by the slowdown in the annual growth rate of manufacturing industry (from 1.1% in the second quarter of 2022 to -6.4% in the first two months of the third quarter of 2022). At the same time, mining and quarrying, during July-August 2022, decreased (from -3.1% in the second quarter of 2022 to -3.7% in the first two months of the third quarter of 2022). At the same time, the annual rate of the volume of production in the sector "production and supply of electricity, heat, gas, hot water and air conditioning" increased by 15.8 percentage points compared to the second quarter of 2022 to -0.9%.

Domestic trade

In the first two months of the third quarter of 2022, turnover in enterprises with retail trade as their main activity decreased by an average of 5.1%, this annual rate being 3.8 percentage points lower than in the previous quarter (Chart 3.25). At the same time, the turnover of enterprises with the main activity of market services provided to households increased by 9.3% in July-August 2022, which was 2.4 percentage points higher than in the second quarter of 2022.

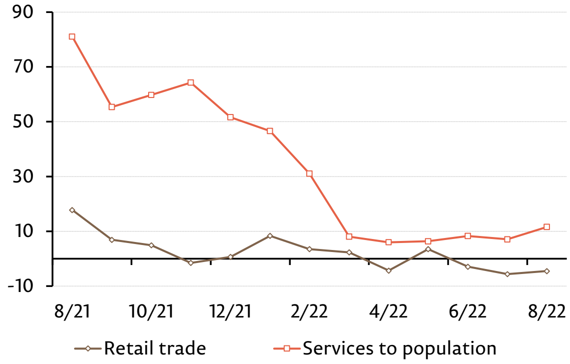
In July-August 2022, the turnover of enterprises with wholesale trade as their main activity decreased by 13.5%[24], being 27.7 percentage points lower than in the second quarter of 2022 (Chart 3.26). At the same time, the turnover of enterprises with the main activity of market services provided to enterprises registered a decrease of 4.2% during the reference period, being 8.9 percentage points lower compared with the previous quarter.

Chart 3.24: Industry evolution in real terms (%, compared to the previous year)



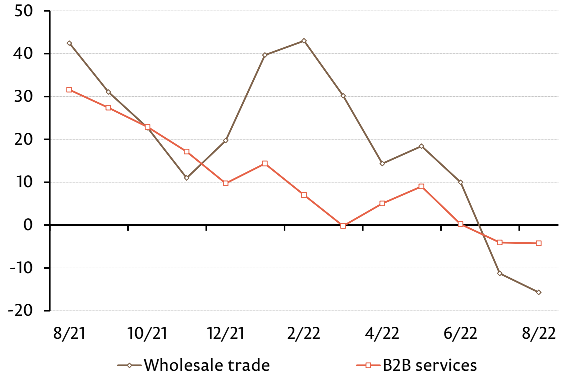
Source: NBS

Chart 3.25: Internal trade evolution in real terms (%, compared to the previous year)



Source: NBS, NBM calculations

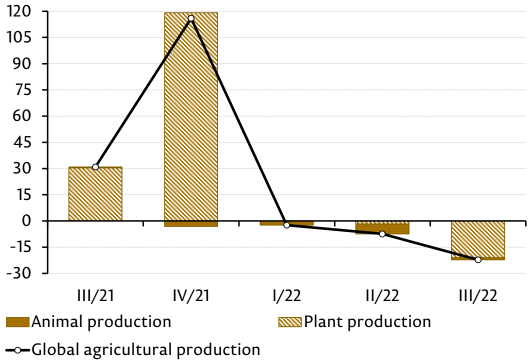
Chart 3.26: Evolution of wholesale trade (deflated at annual CPI rate) (%, compared to previous year)



Source: NBS, NBM calculations

[24]Deflated by annual CPI rate.

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



Source: NBS, NBM calculations

Agricultural production

In the third quarter of 2022, the overall agricultural production decreased by 22.2% compared to the level in the same quarter of the previous year (Chart 3.27), due to decreases of crop and livestock production by 24.2 and 6.5%, respectively. The pronounced decrease in crop production was determined by dry weather conditions in the summer of 2022, which reduced the average harvest per hectare for most agricultural crops. At the same time, the contraction in the volume of output in the livestock sector[25] in the third quarter of 2022 was determined by lower production of milk, cattle and poultry (in live weight) and eggs.

[25] Comparable prices.

3.3 Labour market

Labour force

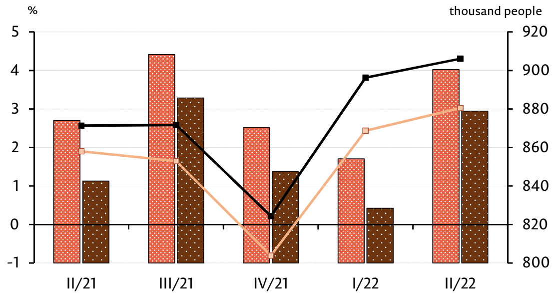
In the first half of this year, both the number of the economically active population and the number of the employed population were increasing, which increased in the second quarter of 2022. The unemployment rate as well as the underemployment rate recorded a slight decrease compared to the first quarter of 2022.

In April-June 2022, the labour force totalled 900.4 thousand persons, increasing by 3.0% compared to the second quarter of 2021. At the same time, the employed population amounted to 878.9 thousand persons, 4.3% higher than in the same period of 2021 (Chart 3.28).

By sub-components, the growth of the employed population in the second quarter of 2022 is observed in almost all economic sectors, with the exception of construction and social services (Chart 3.30).

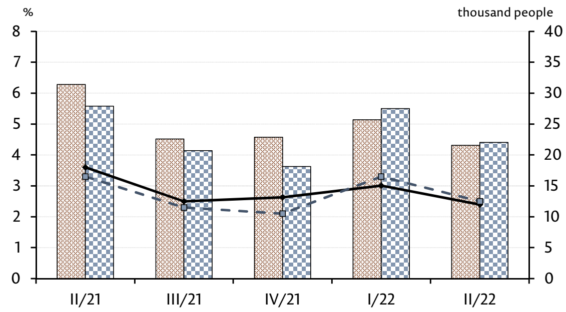
In the second quarter of 2022, the number of unemployed was 21.6 thousand people or 4.1 thousand people lower than in the first quarter of 2022, and the unemployment rate was 2.4%, 0.6 percentage points lower than in the first quarter of 2022 (Chart 3.29). At the same time, the number of unemployed and the unemployment rate were lower (by 9.8 thousand and 1.2 percentage points, respectively) than the values recorded in the same period of 2021. Similar trends are also observed for the underemployed population. Thus, in the second quarter of 2022, the underemployed population decreased to 22.0 thousand persons from 27.5 thousand persons in January-March 2022, and the underemployment rate was 2.5% or 0.8 percentage points lower than in the first quarter of 2022.

Chart 3.28: Economically active population and employed population



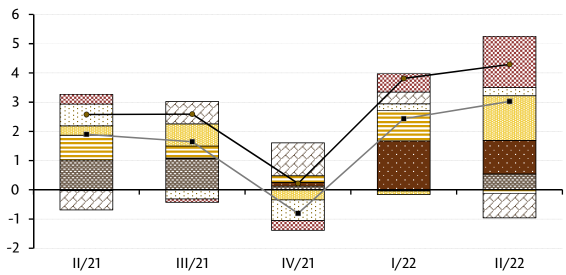
Source: NBS, NBM calculations

Chart 3.29: Evolution of the unemployed and underemployed population



Source: NBS, NBM calculations

Chart 3.30: Contribution of sectors to the dynamics of the employed population (percentage points)



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

Salary fund

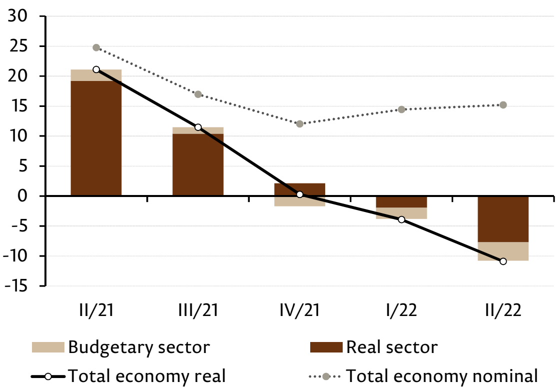
In the second quarter of 2022, the wage fund on the economy continued the pronounced positive dynamics observed in previous periods. It recorded an increase of 15.2% in nominal terms. This dynamic was mainly supported by developments in the trade, information and communication and industry sectors, which contributed 2.8 percentage points, 2.7 percentage points and, correspondingly, 2.4 percentage points to the dynamics of the respective indicator. At the same time, significant contributions, but of a smaller magnitude, were determined by the dynamics of the payroll fund for employees in the public administration (1.3 percentage points), education (1.1 percentage points) and transport (1.0 percentage points) sectors.

However, in real terms, deflated by the CPI, the salary fund for the economy decreased by 10.9% compared with the same period last year. The respective dynamics of the compensation fund in real terms were driven by developments in both the budget and real sectors of the economy (Chart 3.31).

In the second quarter of 2022, the annual change in the average number of employees in the national economy moderated slightly to 0.4%. The dynamics of the number of employees in the real sector contributed 0.7 percentage points, while the dynamics of the number of employees in the budget sector contributed -0.3 percentage points (Chart 3.32).

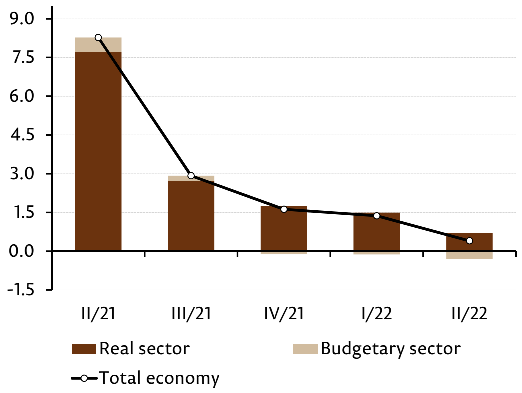
The distribution by sector of the economy reveals more pronounced increases in the average number of employees, mainly in the fields of information and communications (4.3%), transport and storage (4.1%), real estate transactions (3.8%), health and social assistance (2.8%). On the other hand, the number of employees contracted in agriculture (-4.0%), construction (-9.5%), industry (-1.1%), wholesale and retail trade (-4.0%), education (-1.0%) and public administration (-1.5%) (Chart 3.33).

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



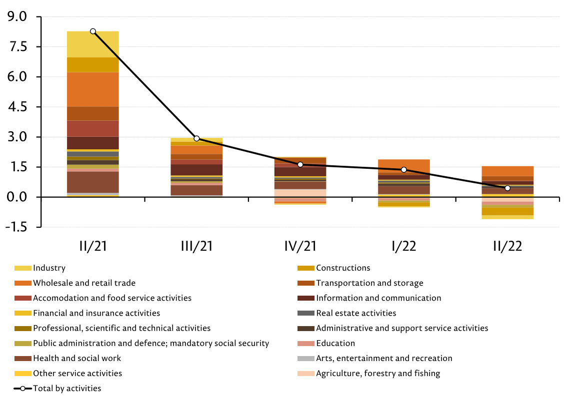
Source: NBS, NBM calculations

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 previous year)



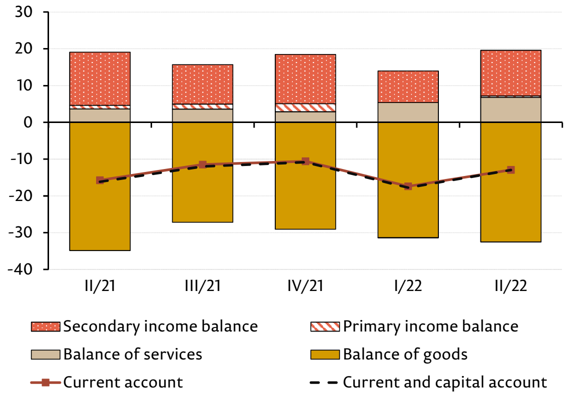
Source: NBS, NBM calculations

3.4 External sector

Current account

In the second quarter of 2022, the current account deficit of the balance of payments decreased by 4.5 percentage points compared to the previous quarter to 12.9% as a share of GDP (Chart 3.34). The decrease in the balance of payments deficit was the result of an increase in all components with a positive contribution: "secondary income balance", "primary income balance" and " balance of services ". At the same time, the component with a negative contribution – "balance of goods" – increased in the second quarter of 2022.

Chart 3.34: Share of current account in GDP (%)

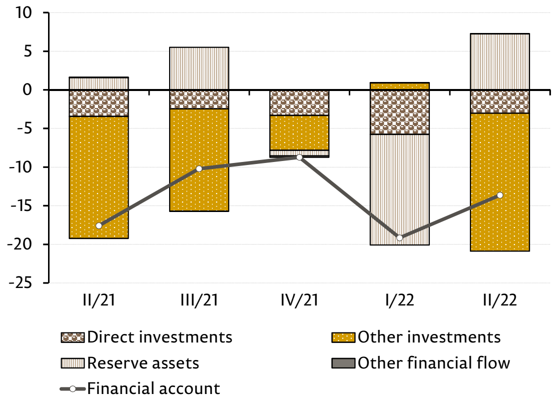


Source: NBM

Financial account

In the second quarter of 2022, the financial account as a share of GDP was 13.6% or 5.5 percentage points lower than in the first quarter of 2022. Thus, lower net capital inflows (as a ratio to GDP) were driven by the change in the direct investment and reserve asset components (Chart 3.35). Thus, net direct investment inflows as a share of GDP were 3.0%, being 2.7 percentage points lower than in the first quarter of 2022. The net decrease in financial assets under "direct investments" mainly reflects the decrease in assets in the form of "debt instruments". At the same time, there was a net accumulation of reserve assets (7.2% as a share of GDP) in the second quarter of 2022, resulting in a decrease in net capital inflows. It should be noted that in the second quarter of 2022 the "other investments" component recorded an upward trend, thus contributing to the significant increase in net inflows of financial assets[26].

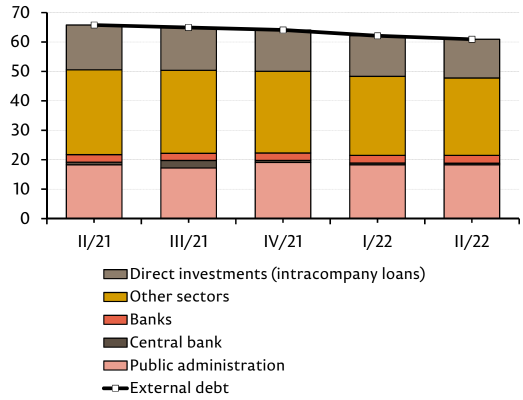
Chart 3.35: Share of financial account in GDP (%)



Source: NBM
Note: (-) – net capital inflows, (+) – net capital outflows

The share of external debt in GDP in the second quarter of 2022 was 60.9%, 1.2 percentage points lower than in the first quarter of 2022 (Chart 3.36). There were no major changes in the structure of external debt, thus, similarly to previous periods, the major share of total external debt is held by economic agents[27] with 29.0%, government sector[28] accounted for 18.8% and direct investments for 13.2%.

Chart 3.36: Share of external debt in GDP (%)



Source: NBM

[26] In the second quarter of 2022 the components cash and deposits, loans and trade credits and advances contributed to the significant increase in net financial inflows as part of the "other investments" component.
[27] Cumulative debt of "Banks" and "Other sectors".
[28] Cumulative debt of "Public Administration" and "Central Bank".

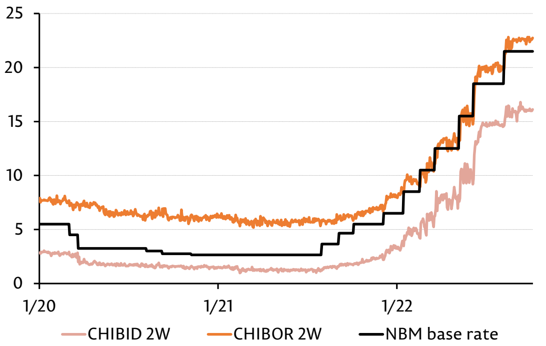
Chapter 4

Monetary policy

4.1 Monetary policy instruments

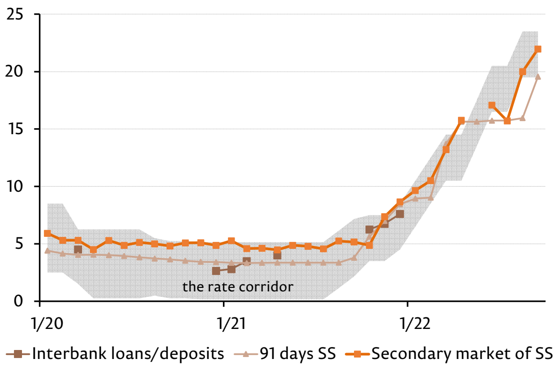
Evolution of money market interest rates

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

In August, NBM increased the monetary policy interest rate by a further 3.00 percentage points (the tenth consecutive increase), subsequently keeping it at 21.50% per year. The NBM's decision to further increase the monetary policy interest rate in August was mainly motivated by the continued upward drift of the forecasted annual inflation rate. In September, the NBM interrupted the series of successive increases in the monetary policy interest rate, keeping it at 21.50% per year.

The quotations of CHIBOR 2W continued to rise in the third quarter, but at a more modest rate, being above the policy rate for most of the period. Thus, the quotation CHIBOR 2W rate at the end of September was higher (+2.58 percentage points) than on the last day of the previous quarter, representing 22.73% (Chart 4.1).

The trajectory of interest rates on state securities with 91-day maturity reflected both the signal sent by the Ministry of Finance not to increase rates in the previous quarter and the continued high investors' interest in this type of investment, in a context in which interest rates continued to fall until the end of July and the volume of issuance was significantly higher than announced. The increase in the base rate in early August triggered a surge (by more than 3.0 percentage points) in an auction, despite the almost complete rejection of investors' bids by the Ministry of Finance. Thus, the value recorded in the last month of the quarter of 19.56% was 3.83 percentage points higher than that recorded at the end of the second quarter of 2022 (Chart 4.2).

In the secondary segment of the state securities market, the interest rates on transactions carried out developed somewhat similarly to the rates on the primary market. The quarterly average stood at 19.20%, higher than in the previous quarter (+2.91 percentage points), as the weighted average maturity increased from 149 days to 200 days.

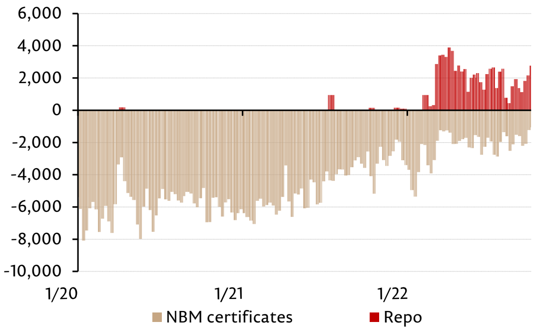
Money market operations

Sales of NBM certificates (NBC)

The evolution of the quantitative parameters of monetary absorption operations was roughly similar to that of the second quarter of 2022. Both the volume drained (MDL 13,205.5 million) and the average quarterly balance (MDL 1,973.3 million) were slightly higher than the values recorded in the previous quarter (MDL 12,933.4 million and MDL 1,965.5 million, respectively).

The NBM conducted NBC placement auctions with weekly frequency, 14-day maturity and with the announcement of the maximum interest rate equivalent to the base rate of the NBM. The bids submitted by banks in the auctions were fully allocated (Chart 4.3).

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



Source: NBM

Repo operations

The volume of liquidity delivered through repo operations decreased, as reflected in the evolution of the average quarterly balance of repo transactions, which decreased by MDL 567.1 million compared to the second quarter of 2022 and amounted to MDL 2,333.9 million in the period under review.

Repo operations for the disbursement of liquidity were conducted weekly for 14 days at a fixed interest rate (base rate plus a margin of 0.25 percentage points) through the no-ceiling tender procedure.

Standing facilities

During the third quarter of 2022, banks used both permanent facilities offered by the NBM.

The total volume of overnight deposits amounted to MDL 24,387.0 million, slightly below the level of the previous quarter. The average daily balance of MDL 346.4 million was about 1.3 times lower than in the previous quarter. The amounts placed by banks ranged from a minimum of MDL 10.0 million to a maximum of MDL 2,000.0 million.

The total amount of overnight loans granted to banks by the NBM in the third quarter of 2022 amounted to MDL 2,372.0 million, a decrease of 1.5 times compared to the previous period. The average daily balance recorded MDL 41.0 million.

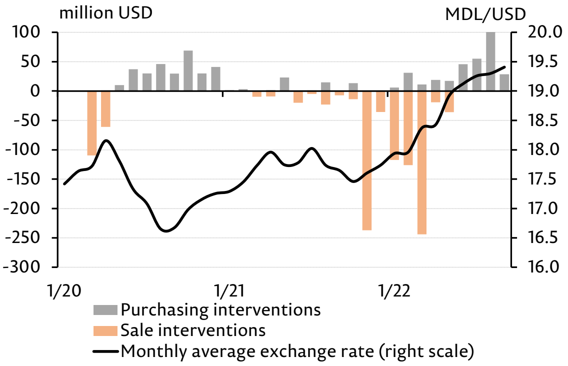
On 4 August 2022, along with the increase in the monetary policy rate, the interest rates on the standing facilities granted by the NBM were also increased by 3.0 percentage points, to 19.5% for overnight deposits and 23.5% for overnight loans, and these values were maintained until the end of the quarter.

Required reserves

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

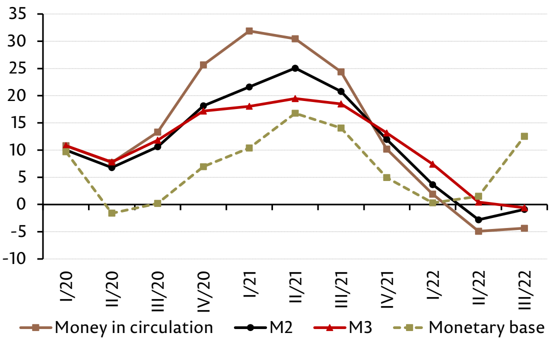
At the monetary policy meetings of 3 June 2022 and 4 August 2022, the Executive Board of the NBM decided to increase the required reserves ratio for 3 consecutive implementation periods. Thus, the required reserve ratio of funds attracted in MDL and non-convertible foreign currency was increased from 32.0% to 40.0% (by 2.0 percentage points in the application period 16.07.2022 – 15.08.2022 and by 3.0 percentage points in the application periods 16.08.2022 – 15.10.2022). The required reserve ratio in freely convertible currency (FCC) has been increased by 3.0 percentage points, from 36.0% to 45.0%.

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



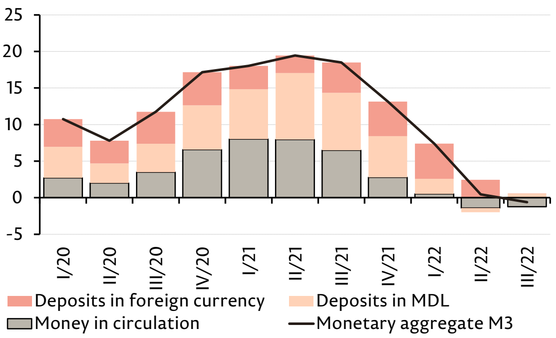
Source: NBM

Chart 4.5: Modification of monetary aggregates (%, annual growth)



Source: NBM

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



Source: NBM

Respectively, during the application period 16.09.2022 - 15.10.2022, required reserves in MDL amounted to MDL 20,429.3 million, which is MDL 5,376.9 million (+35.7%) higher than those maintained during the period 16.06.2022 – 15.07.2022.

As regards required reserves from the resources attracted in the FCC, during the application period 16.09.2022 – 15.10.2022, they totalled USD 242.9 million and EUR 618.6 million. Compared with the period 16.06.2022 – 15.07.2022, required reserves in US dollars increased by 29.4% and those in euro by 30.1%.

Interbank money market

In the third quarter of 2022, no transactions were recorded in the interbank credit/deposit market.

Interventions on the domestic foreign exchange market

The NBM intervened on the domestic foreign exchange market in July-September 2022 through foreign exchange purchases.

During the period under review, the volume of transactions of the National Bank of Moldova carried out on the interbank foreign exchange market against Moldovan lei, on the date of the currency, amounted to USD 193.08 million, including purchase transactions in the amount of USD 192.30 million, as well as foreign exchange conversions with World Bank institutions (International Bank for Reconstruction and Development and International Development Association) in the amount of USD 0.78 million (Chart 4.4).

4.2 Dynamics of monetary indicators

In the third quarter of 2022, the dynamics of the annual growth rate of monetary aggregates recorded a downward trend, with the M2 monetary aggregate recording a decrease of 0.9% per year (by 1.9 percentage points higher than in the second quarter of 2022) and a decrease of 0.6% per year for M3 (by 1.1 percentage points less than in the previous quarter). The monetary base during the third quarter of 2022 saw an acceleration in the annual growth rate to 12.5% per year (Chart 4.5).

Money supply

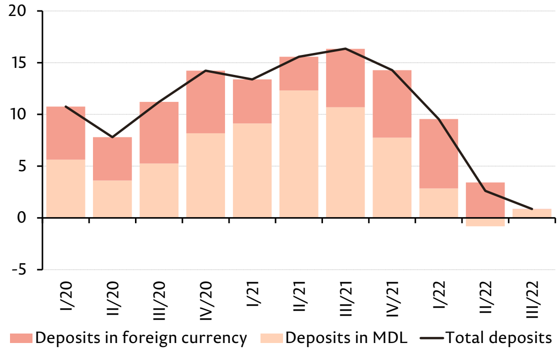
The evolution of the M3 monetary aggregate compared to the previous quarter was driven by the negative contribution from money in circulation, together with the positive contribution from deposits in domestic currency and the neutral contribution from deposits in foreign currency, which provided the M3 monetary aggregate with an annual decrease of 0.6% (Chart 4.6).

The positive evolution of deposits in domestic currency of 1.4% per year (Chart 4.8) was caused by an increase in term deposits of individuals and legal entities, while the growth rate of sight deposits of individuals slowed down compared with the previous quarter.

Foreign currency deposits in the third quarter of 2022 recorded a minor positive annual growth rate of 0.1% per year, 8.5 percentage points below the level recorded in the previous quarter, as a result of the decrease in term deposits of individuals (Chart 4.11). At the same time, sight deposits in foreign currency recorded more moderate increases compared with the previous quarter, amounting to 13.9% on an annual basis (Chart 4.13).

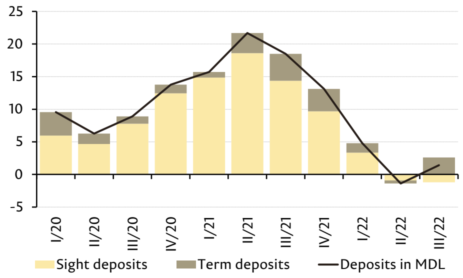
The growth rate of money in circulation at the end of the third quarter of 2022 increased by 2.0 percentage points compared to the end of the previous quarter, amounting to -2.7% annually. The average quarterly contribution of money in circulation to M3 growth increased by 0.2 percentage point compared with the level recorded in the second quarter of 2022 (Chart 4.6). The dynamics of money in circulation were driven by both the inflow of cash receipts and the outflow of cash disbursements at commercial banks. Out of the total inflows, the largest share was accounted for by inflows from the sale of consumer goods and inflows on current and deposit accounts of individuals. The main components of cash withdrawals from commercial banks were withdrawals for the purchase of foreign currency from individuals and withdrawals from ATMs and POS terminals.

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



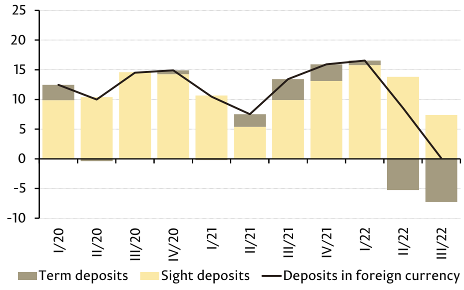
Source: NBM

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



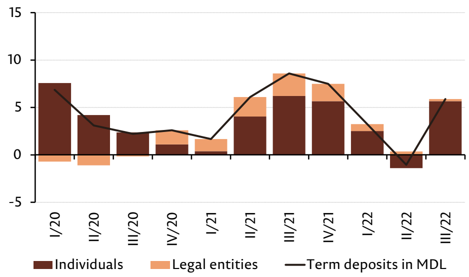
Source: NBM

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



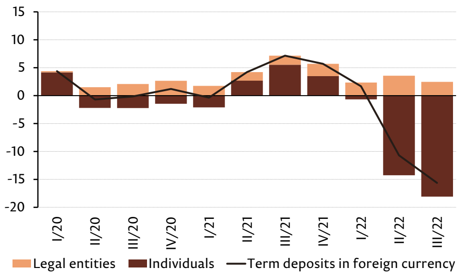
Source: NBM

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



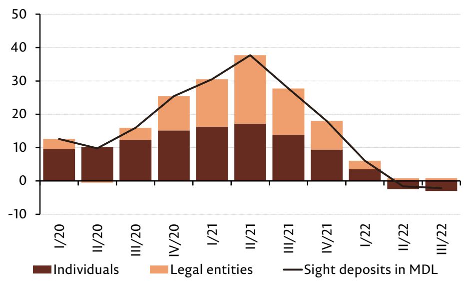
Source: NBM

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



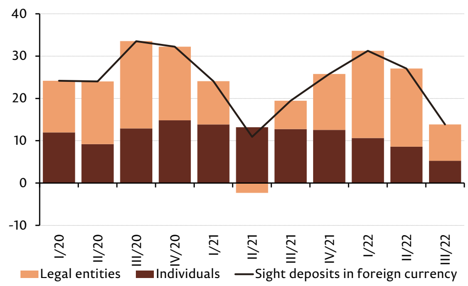
Source: NBM

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)

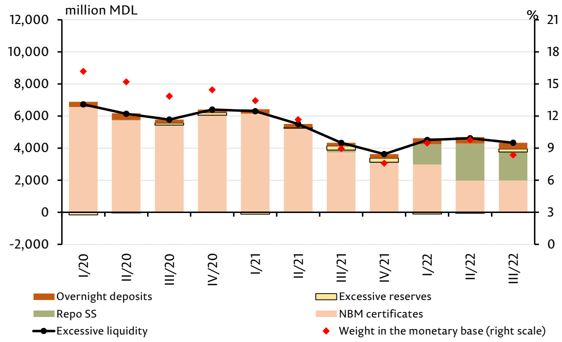


Source: NBM

Excessive liquidity

During the third quarter of 2022, the average excess liquidity in the banking system decreased by MDL 284.6 million. It should be noted that, compared to the third quarter of 2021, the volume of excess liquidity remained practically at the same level, recording an average value of MDL 4.34 billion (Chart 4.14).

Chart 4.14: The excessive liquidity



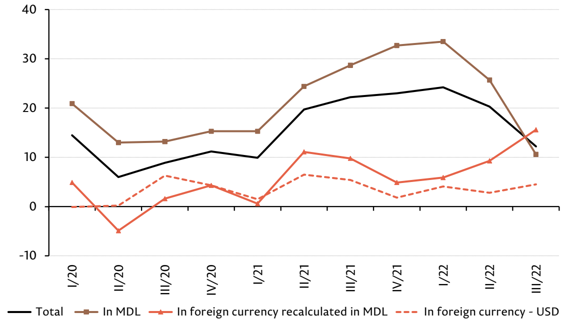
Source: NBM

Loan market

Evolution of the balance of loans granted by licensed banks[29]

At the end of the third quarter of 2022, the total balance of loans granted by licensed banks recorded a positive annual growth (Chart 4.15) and amounted to MDL 58,187.2 million, higher than at the end of the third quarter of 2021 by 12.2%. The annual dynamics continued to decrease as lending activity in MDL decreased (Chart 4.18). The share of the balance of loans granted in domestic currency decreased to 68.3% of the total balance of loans, down from 70.4% at the end of the second quarter of 2022 (Chart 4.16).

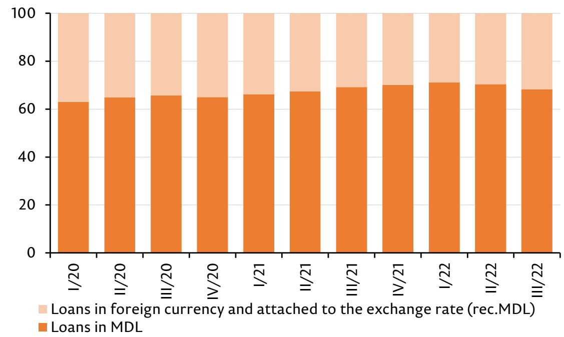
Chart 4.15: Evolution of the loan balance (%, annual growth)



Source: NBM

As of 30 September 2022, the balance of loans granted in domestic currency by licensed banks grew at an annual rate of 10.6%; 2.7 times lower than at the end of the third quarter of 2021. In turn, the balance of loans in MDL granted to individuals recorded an annual increase of 12.3%, up from 36.2% on 30 September 2021. The share of balance of loans in domestic currency granted to individuals amounted to 61.9% out of total MDL loans.

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



Source: NBM

At the end of the reporting quarter, in the structure of the total portfolio of loans granted by licensed banks, the largest share, similar to previous quarters, went to loans granted to individuals (43.5%), followed by the share of loans granted to legal entities in the trade field (21.0%) (Chart 4.17).

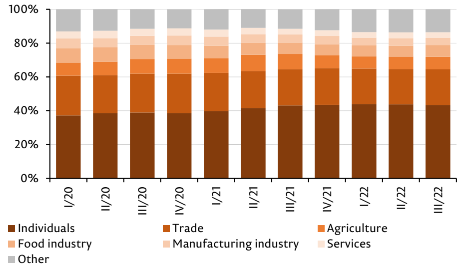
Evolution of new loans granted by licensed banks

In the third quarter of 2022, the annual dynamics of the total volume of new loans granted by licensed banks entered a negative range and amounted to -11.6% (Chart 4.18). This evolution was influenced by the significant reduction in loans granted in domestic currency, as a result of the increase in interest rates. The volume of new loans granted in MDL by licensed banks recorded an annual decrease of 34.3%. The share of loans granted in domestic currency decreased to 53.6% from 72.0% in the third quarter of 2021.

Amid the monetary policy decisions in 2022, in the third quarter, the volume of term deposits attracted in MDL by licensed banks was higher than the volume of loans granted in MDL, thus the expected effect of stimulating saving at the expense of consumption was evident (Chart 4.19).

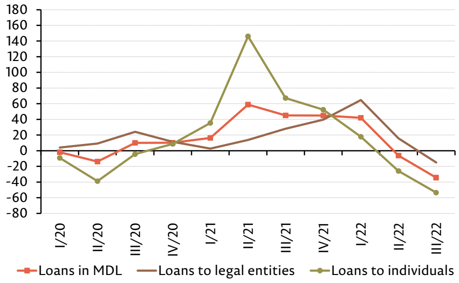
[29] The data analysis was carried out based on the ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks by October 11, 2022.

Chart 4.17: Loan balance structure (% in total)



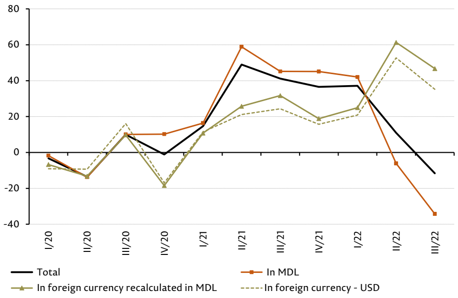
Source: NBM

Chart 4.20: Evolution of new loans granted in MDL (%, annual growth)



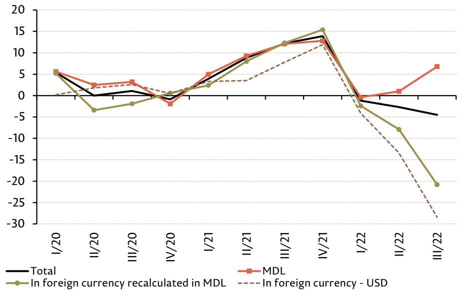
Source: NBM

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



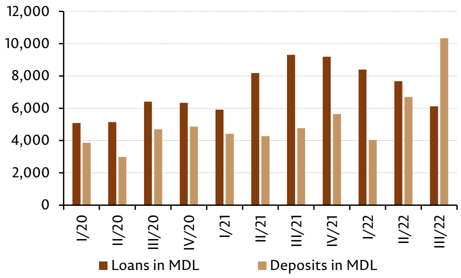
Source: NBM

Chart 4.21: Deposit balance dynamics (%, annual growth)



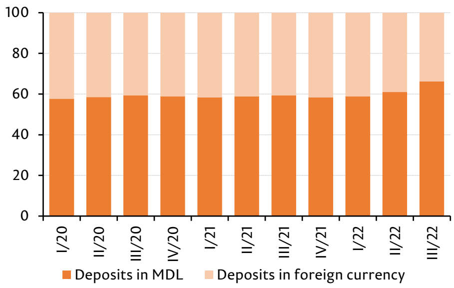
Source: NBM

Chart 4.19: Evolution of the volumes of term loans/deposits in MDL (million MDL)



Source: NBM

Chart 4.22: Evolution of the share of term deposits by subcomponents in the total balance (%)

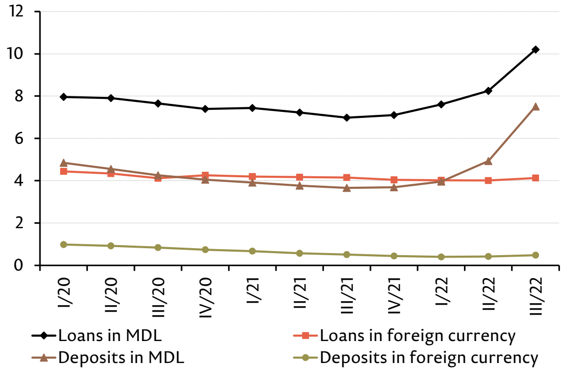


Source: NBM

From the perspective of the subjects who received loans in MDL, the annual growth rate of loans granted to legal entities accounted for -14.9% (Chart 4.20). The volume of loans in MDL granted to individuals decreased by 2.2 times compared to the same period in 2021. Similar to the previous quarters, the largest share in total MDL loans granted to individuals was consumer loans (66.7%) followed by real estate loans (19.5%).

In the context of rising interest rates on loans in domestic currency, demand increased for foreign currency loans, a segment with relatively stable interest rates. Thus, during the third quarter of 2022, foreign currency and currency-linked loans granted to legal entities grew at an annual rate of 42.9%. The volume of foreign currency loans granted to individuals increased by 5 times.

Chart 4.23: Average interest rates on balance of loans and deposits (%)

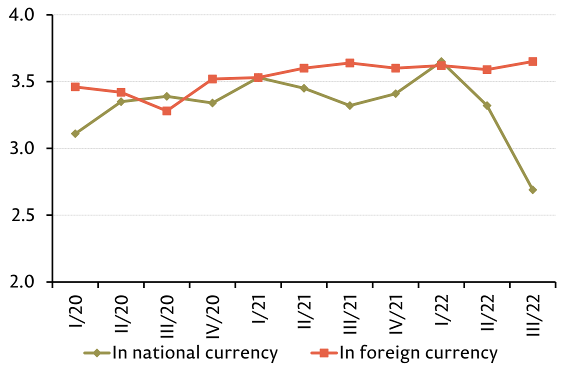


Source: NBM

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

At the end of the third quarter of 2022, the total balance of term deposits attracted by licensed banks recorded an annual decrease of 4.5%, as a result of the decrease in the balance of term deposits attracted in foreign currency from individuals (Chart 4.21). At the same time, the annual dynamics of term deposits attracted in domestic currency constituted 6.8%, reflecting an increase in the volume of new deposits at higher interest rates (Chart 4.21, Chart 4.25).

Chart 4.24: The evolution of the banking margin on loan and deposit balances (percentage points)



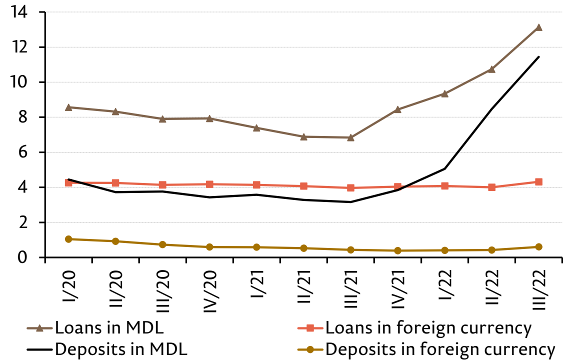
Source: NBM

The major component in the total balance of term deposits attracted by licensed banks was the balance of deposits in MDL (Chart 4.22). At the end of the third quarter of 2022, the share of the balance of term deposits attracted in domestic currency increased to 66.2% of the total balance of term deposits, higher than at the end of the third quarter of 2021 by 6.9 percentage points. It should be noted that at the end of the reporting quarter, the share of term deposits attracted in MDL from individuals amounted to 88.5%.

Interest rates[31]

Evolution of the base rate

Chart 4.25: Average interest rates on new volume of loans and deposits (%)



Source: NBM

During the third quarter of 2022, two meetings of the Executive Board of the National Bank of Moldova were held on monetary policy decisions. Following the assessment of the balance of internal and external risks and the inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova, at its meeting on 4 August 2022, decided to increase the base rate applied to the main monetary policy operations by 3.0 percentage points up to 21.50% annually. Subsequently, at its meeting on 13 September 2022, it decided to maintain the base rate on the main monetary policy operations at 21.50% per year.

[30]The data analysis was based on ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks by October 11, 2022 and does not include demand deposits.

[31]The analysis of rates was based on ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks by October 11, 2022 and does not include rates on demand deposits.

These gradual monetary policy-tightening measures were adopted with the aim of mitigating inflationary pressures stemming from the effects of rising global prices, production and distribution costs of energy resources and food. The aim of these decisions was to anchor inflation expectations and to bring inflation back to and maintain the inflation rate close to the 5.0% target 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 July-September 2022, the weighted average interest rate on the balance of loans granted in MDL by licensed banks amounted to 10.20% per year, higher than in the third quarter of 2021 by 3.22 percentage points and by 1.95 percentage points in the second quarter of 2022, influenced by the significant increase in the weighted average interest rate on the balance of loans granted in MDL to both legal entities and individuals (Chart 4.23).

For the entire third quarter of 2022, the weighted average interest rate on the balance of loans in foreign currency was 4.13% per year, 0.12 percentage points higher than in the second quarter of 2022.

Evolution of the interest rate related to the balance of deposits

In the third quarter of 2022, interest rates in the domestic currency segment continued their upward trend. Thus, the weighted average interest rate related to the balance of deposits in domestic currency amounted to 7.51% per year and increased compared to the third quarter of 2021 by 3.85 percentage points (Chart 4.23). The weighted average interest rate related to the balance of term deposits attracted in foreign currency amounted to 0.48% per year and did not change substantially compared to the third quarter of 2021.

Evolution of banking margin

In the third quarter of 2022, the banking margin (calculated as the difference between the weighted average interest rates on loan balances and the weighted average interest rates on deposit balances) decreased in the domestic currency segment as a result of increases in interest rates on term deposits attracted one step higher than interest rates on granted loans (Chart 4.24).

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

As a result of the evolution of the money-foreign exchange market indicators, also influenced by monetary policy decisions, in the third quarter of 2022, the weighted average interest rates on new term deposits and new loans granted in national currency increased further and reached their highest values in the last 6 years. For the whole of the third quarter of 2022, the weighted average interest rate on deposits in MDL continued to increase and amounted to 11.44% per year, higher than in the third quarter of 2021 by 8.28 percentage points and in the second quarter of 2022 by 2.96 percentage points (Chart 4.25), under the impact of the significant increase in interest rates on term deposits attracted from individuals. The weighted average interest rate on term deposits attracted in domestic currency from individuals increased by 9.52 percentage points compared to the third quarter of 2021 to 13.11%. Tight money market conditions continue to require increases in interest rates on term deposits attracted in domestic currency by licensed banks, thus stimulating the savings of the population.

The weighted average interest rate on new loans granted in national currency in the third quarter of 2022 was 13.13 percentage points per annum, 6.29 percentage points higher than in the third quarter of 2021 and 2.39 percentage points higher than in the second quarter of 2022. These developments led to a reduction in the volume of new loans granted (Chart 4.20).

Evolution of the nominal and real effective exchange rate

In the third quarter of 2022, both according to the quarterly average exchange rate and its end-of-quarter values, the Moldovan leu depreciated against the US dollar (by 2.6 and 2.3% respectively) and appreciated against the euro (by 3.0 and 5.6% respectively) (Chart 4.26).

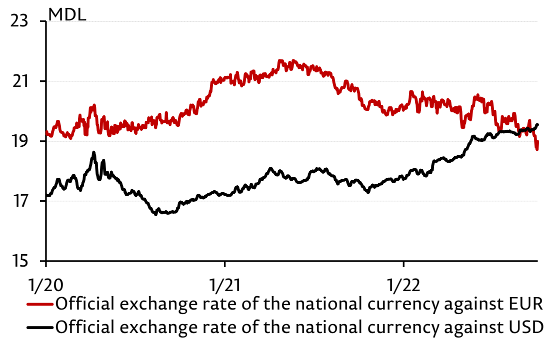
During the reference period, most of the currencies of the main trading partners of the Republic of Moldova included in the basket REER, with the exception of two currencies, depreciated in average values against the US dollar. In particular, the Ukrainian hryvnia depreciated by 18.0%, the Turkish lira – by 13.9%, the Hungarian forint – by 10.7%, the Polish zloty – by 7.9%, the pound sterling – by 6.7%, the euro and the Bulgarian leva – by 5.7% each. The Russian rouble appreciated by 9.2% and the Belarusian rubble by 5.6% (Chart 4.27).

Under these conditions, in real terms, the Moldovan leu appreciated by 4.1% against the basket of currencies of Moldova's main trading partners (the average of the third quarter of 2022 compared to the average of the second quarter of 2022). The biggest contributions to the appreciation of the REER were made by Ukraine (1.4 percentage points) and Romania (1.2 percentage points) (Chart 4.29).

During the reference period, foreign exchange supply and demand factors evolved in a manner typical for the third quarter of the year, so that a surplus of foreign exchange was formed on the local market, which allowed the NBM to recover part of the foreign exchange reserves sold to balance the foreign exchange market in the first quarter of the year.

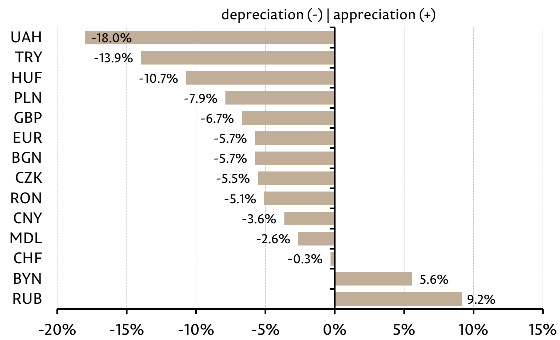
The net supply of foreign exchange from individuals, amounting to USD 864.9 million, increased compared to the third quarter of 2021 (+21.4%), as well as compared to the previous quarter (+46.2%). The robust growth rate in transfers from abroad to individuals continued to be an important factor in the positive dynamics of the net supply. Thus, foreign exchange transfers from abroad in favour of individuals increased by 20.8% over the third quarter of 2021 (+10.4% over the previous quarter). Also, in the quarter under review, the higher foreign exchange supply was also driven by the de-dollarization trend of deposits, as well as individuals' foreign currency cash savings, as the euro/US dollar exchange rate fell below parity and the NBM continued to tighten the monetary policy stance through monetary policy rates and the required reserve ratio.

Chart 4.26: Fluctuations in the official exchange rate of the Moldovan leu against the US dollar and the euro



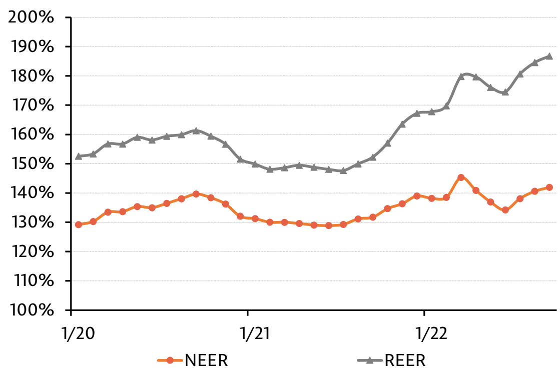
Source: NBM

Chart 4.27: The evolution of the main trading partners currencies against the US dollar (average exchange rate Q3 2022/ Q2 2022, %)



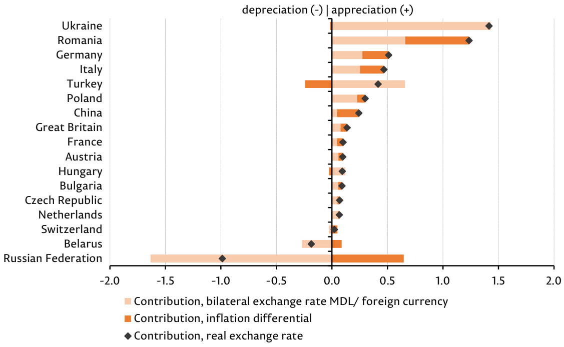
Source: NBM

Chart 4.28: Dynamics of the nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated on the basis of the share of main trading partners (Dec.2000-100%)



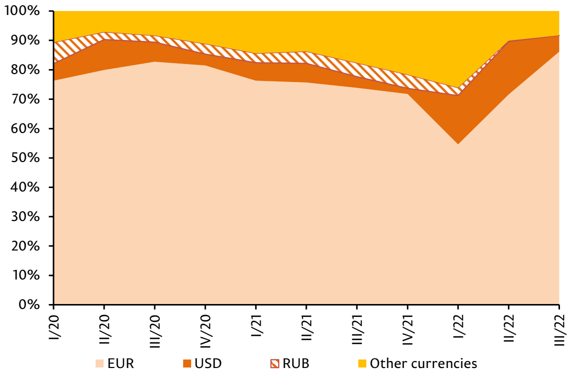
Source: NBM

Chart 4.29: Contribution of the main trading partners of the Republic of Moldova to the change in the real effective exchange rate in the third quarter of 2022



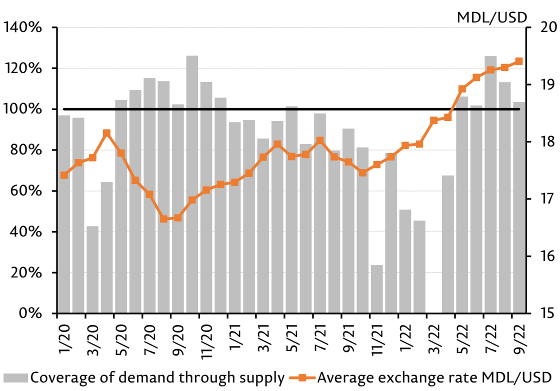
Source: NBM

Chart 4.30: 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 4.31: Net sales coverage through the net supply and dynamics of the official exchange rate



Source: NBM

In the structure of the net supply of foreign currency from individuals, the single European currency continued to account for the largest share (86.2%[32]) (Chart 4.30).

The net demand for foreign currency from economic agents also increased, but in relatively smaller proportions compared with the net supply of foreign exchange from individuals. In the third quarter of 2022, it amounted to USD 767.0 million, declining by 4.3% in annual terms and exceeding the level recorded in the previous quarter by 20.6%, as the trade balance deteriorated by a similar proportion, by 19.5%[33].

Under these circumstances, the coverage of net demand for foreign exchange from economic agents by net supply of foreign exchange from individuals increased to 112.8% in the third quarter of 2022 compared to 93.0% in the previous quarter and 88.9% in the third quarter of 2021, creating the premises for NBM interventions for net foreign exchange purchases in the amount of USD 192.3 million.

Throughout the quarter under review, the exchange rate of the Moldovan leu against the US dollar was on a slow depreciation path, with short-lived reversals of the trend being observed in some periods, particularly in the first half of August and mid-September. These brief episodes of appreciation largely coincided with periods of increased supply of foreign exchange by individuals.

At the same time, since the second half of August, for the first time in 20 years, a dollar has become more expensive than a euro. This development was caused by the worsening of the macroeconomic situation in the euro area, given the threats to Europe's energy security in the context of Russia's war in Ukraine, including unexplained gas leaks from the two Russian pipelines (Nord Stream1 and Nord Stream2), the shrinking economies of France and Germany (two of the largest economies in the EU) and in this respect a slower monetary policy response to inflationary pressures, unlike other major central banks in the world, notably the FRS. After almost a decade of the European Central Bank (ECB) keeping interest rates in negative territory, on 21 July 2022 it took the first decision to raise the three of ECB representative interest rates (by 50.0 basis points each). The next monetary policy meeting of 8 September 2022, also ended with a decision to increase policy rates by a further 75.0 basis points.

Thus, during the third quarter, the euro depreciated against the US dollar by 7.7 percentage points compared to the end of the previous quarter. In this regard, at the end of September, the official exchange rate of the Moldovan leu against the euro recorded its lowest level since 2019.

At the end of September 2022, the balance of official reserve assets amounted to USD 4,227.5 million (Chart 4.32), up by USD 611.2 million (+16.9%) compared to the end of June. Official reserve assets increased mainly on the back of inflows related to external financing, an increase in funds in banks' foreign currency required reserve accounts and net foreign exchange purchases.

[32] Weight calculated by applying a constant rate.
[33] Based on data available at the time of reporting (July-August 2022).

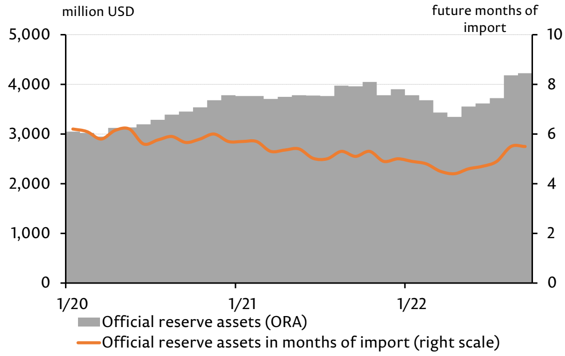
As regards inflows related to external financing, the largest disbursements were recorded as budgetary support, mostly in the form of loans, amounting to USD 351.0 million, disbursed by:

- World Bank institutions – USD 154.1 million, of which USD 143.4 million (equivalent to EUR 142.10 million) under the Development Policy Operation on Emergency Response, Resilience and Competitiveness of Moldova;
- European Commission on behalf of the EU – USD 127.08 million (equivalent to EUR 125.0 million), of which:
  - the second grant tranche of USD 76.28 million (equivalent to EUR 75.0 million) to support the vulnerable population affected by increased energy prices and to alleviate the economic pressure associated with the influx of refugees from Ukraine;
  - the first loan and grant instalments of USD 50.80 million (equivalent to EUR 50.0 million) under the new macro-financial assistance programme;
- IMF – USD 26.64 million (equivalent to SDR 20.6 million) as the third loan tranche under the Extended Credit and Financing Facilities (ECF/EFF);
- Government of the Republic of Poland – USD 20.04 million (equivalent to EUR 20.0 million) for refugee crisis management;
- French Development Agency – USD 15.29 million (equivalent to EUR 15.0 million);
- European Investment Bank – USD 7.92 million (equivalent to EUR 7.93 million) for the Moldova rail infrastructure development project.

At the same time, several loans and grants were received by the Ministry of Finance of the Republic of Moldova from external partners for investment projects in the total amount of USD 23.0 million.

According to the situation at the end of the third quarter of 2022, official reserve assets continued to ensure a sufficient level of coverage of imports of goods and services (5.5 months of future imports[34]).

Chart 4.32: Evolution of official reserve assets expressed in months of import of goods and services (MBP6)



Source: NBM – based on updated actual and forecast data

[34]Calculated based on the IMF forecast of imports of goods and services.

Chapter 5

Forecast

5.1 External assumptions

The uncertainties and risks related to the evolution of the external environment are very high and affect short- and medium-term forecasts. The armed conflict in the region and the related economic crisis form an unfavourable conjuncture between weak external demand and very high import prices. International financial conditions have undergone structural changes in recent months, with the single European currency trading below parity with the US dollar, pound sterling depreciating at an unprecedented rate and the US dollar appreciating to record levels. Commodity prices will continue to oscillate between the slowdown of the world economy and a tight supply caused by increasing geopolitical risks. The table 5.1 shows the values of the main external assumptions accepted in the round of forecast related to the Inflation Report, November 2022, with their subsequent description.

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

	2022	2023
Economic growth in the euro area, %	3.0	0.0
Economic growth in the Russian Federation, %	-5.1	-2.9
Average annual inflation in the euro area, %	8.3	5.8
Average annual inflation in the Russian Federation, %	14.0	6.8
EUR/USD	1.04	1.01
USD/RUB	68.9	73.5
Urals brand oil prices (USD/barrel)	101.5	87.7
International food prices growth, %	15.4	-2.3

Source: Consensus Economics, Bloomberg, NBM calculations

If we analyse the statistical indicators of the third quarter of 2022, we can affirm that the economy of the eurozone has entered recession due to the worsening of the energy crisis, the unprecedented increase in production costs and the tempering of consumption. Cumulatively with the results from the economic activity in the first semester of 2022, it is forecasted that on average the gross domestic product in the euro area will register an increase of 3.0% in 2022 and will stagnate in 2023. Compared to the previous forecast round, the external assumption regarding the gross domestic product in the euro area was significantly reduced by 0.3 and 1.4 percentage points for 2022 and 2023, respectively. At the same time, in correlation with the increase in inflation in the euro area up to 9.9% in September 2022, the external assumption regarding the average growth of consumer prices in the euro area has been increased from 7.6 to 8.3% for 2022. As the rhythm of monetary policy tightening by the ECB presents a substantial gap with the growth rate of domestic inflation in the euro area and the level of interest rates in other comparable economies, it is anticipated that even in 2023 the ECB will not reach the medium-term harmonized inflation target of 2.0%. In 2023, the average annual inflation in the euro area will be 5.8% compared to 3.6% assumed in the previous forecast round.

The economy of the Russian Federation has recovered more quickly from the primary shocks of economic sanctions imposed by the international community by replacing imported products and services with domestic ones. High-energy prices and the identification of new markets have also contributed to the increase in export earnings. Thus, in the current round of forecasting, the Russian economy is expected to shrink by an average of 5.1% in 2022, compared to 8.4% assumed in the previous round of forecasting. At the same time, uncertainties related to 2023 are relatively high, with the Russian Federation's economy expected to contract by 2.9% compared to 2.2% assumed in the previous forecast round. Thanks to prompt actions by the Bank of Russia to counter the consequences of economic sanctions on consumer prices, decreasing domestic demand and energy market independence and related costs, annual inflation in the Russian Federation decreased to 13.7% in September 2022, which resulted in a lower forecast value. In the current round of forecasting, average annual inflation in the Russian Federation is expected to be 14.0% compared to 15.8% in 2022 and 6.8% compared to 10.2% in 2023.

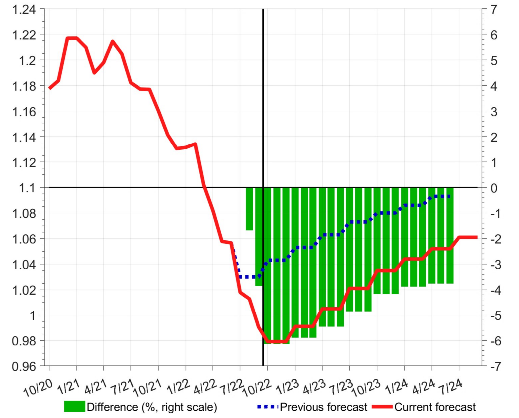
Since the second half of August 2022, the European currency has been trading below parity with the US dollar due to the worsening energy crisis in Europe, but also due to the significant differences between ECB and FRS interest rates. This has led to a decrease in the average forecasted EUR/USD parity in the current forecast round from 1.07 to 1.04 for 2022 and from 1.07 to 1.01 for 2023. The non-essential appreciation in 2023 of the single European currency is based on long-term EUR/USD inertia, but also on expectations of a further increase in interest rates by the European Central Bank to a level needed to bring inflation back towards the target corridor (Chart 5.1).

In the current forecast round, the Russian rubble is expected to trade against the US dollar at an average level of 68.9 in 2022 and 73.5 in 2023, decreasing by 2.4 and 2.9% respectively compared to the previous forecast round. In the current year, the Russian rouble has been the currency with the most extreme fluctuations, depreciating to 177.3 USD/RUB in March 2022 and appreciating to 50.0 USD/RUB at the end of June 2022. The recent appreciation of the Russian rouble reflects the domestic monetary operations in the absence of capital account functioning and is a rather serious and persistent problem for the Russian authorities.

In the last few weeks, there has been less volatility in oil prices, which means less uncertainty in the related forecast. For 2022, the average forecast Brent oil price is expected to be USD 101.5/barrel, a decrease of 3.2% from the previous round's forecast. At the same time, the average forecast price of the Brent oil quotation for 2023 is USD 87.7/barrel, a decrease of 4.2% compared to the previous forecast. The backward trajectory of Brent oil futures reveals that oil market participants expect oil prices to fall in the short to medium term, which could be explained by the prospects of further declining global demand. It should be noted that geopolitical risks and the likelihood of supply shocks are significant, which could contribute to the periodic increase in oil prices (Chart 5.2).

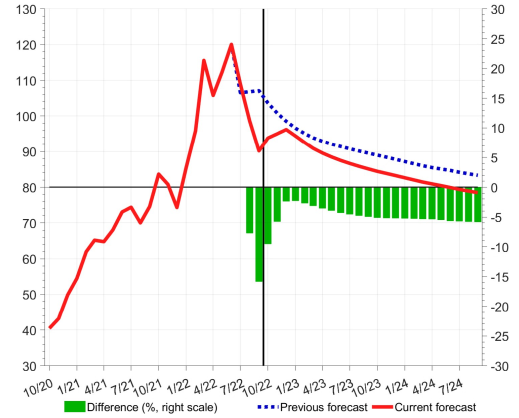
Recent developments in international food quotations also reflect a downward trajectory in the short to medium term driven by the seasonal harvest in the northern hemisphere, rising inventories and the high base in the previous year. Thus, after an average increase of 15.4% in the current year, international food quotations are expected to fall by a cumulative 2.3% next year. In the short to medium term, risks are expected for wheat quotations due to uncertainties related to shipping in the Black Sea and rising production costs, in particular for energy and fertilisers,

Chart 5.1: EUR/USD exchange rate assumption



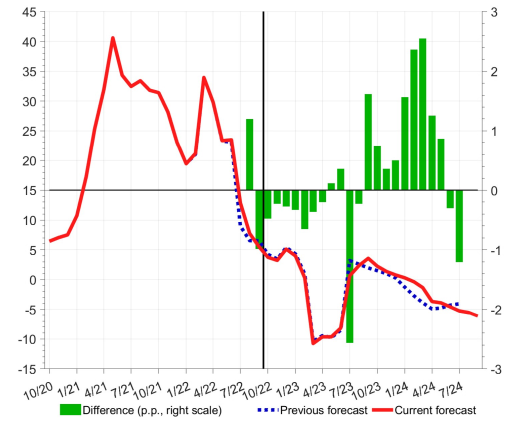
Source: ECB, Consensus Economics, NBM calculations

Chart 5.2: Brent international oil price assumption (USD/barrel)



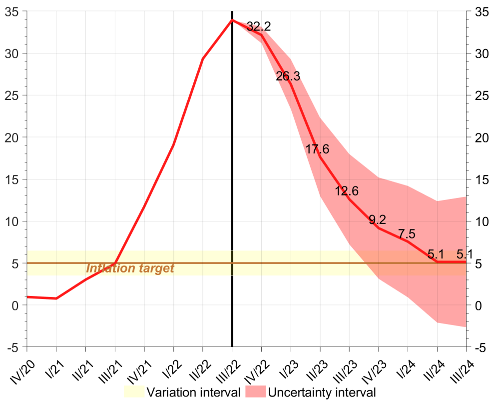
Source: Bloomberg, NBM calculations

Chart 5.3: International food price assumption (%)



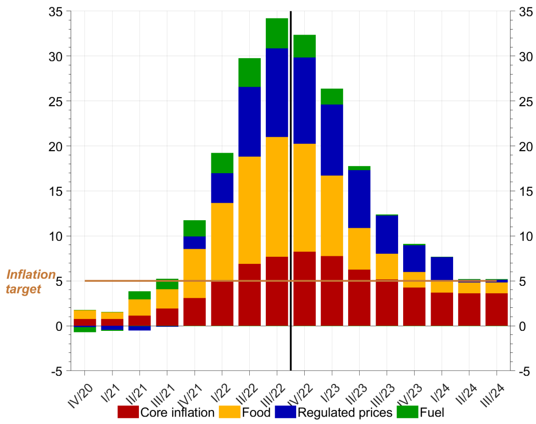
Source: FAO, Bloomberg, NBM calculations which could contribute significantly to the increase in agricultural quotations next year (Chart 5.3).

Chart 5.4: CPI with uncertainty interval (%, compared to previous year)



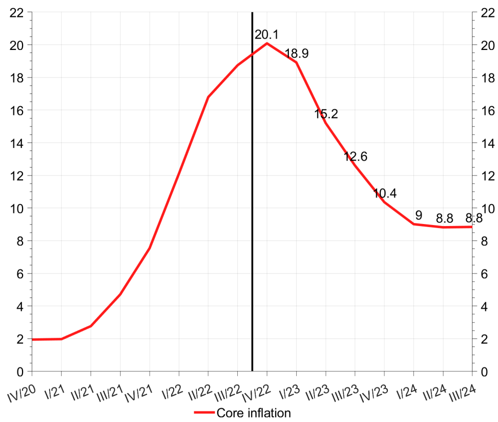
Source: NBS, NBM calculations

Chart 5.5: CPI breakdown (%, percentage points, compared to previous year)



Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

5.2 The internal environment

Inflation

Starting in the fourth quarter of this year, the annual inflation rate will follow a downward trend until the end of the forecast horizon[35]. The inflation rate will continue to be above the upper limit of the range and will return to the range starting in the second quarter of 2024 (Chart 5.4).

The high rates of increase in the annual inflation rate will be due to the positive impact of all CPI components, with a significant contribution from food prices, regulated prices and core inflation, less from fuel prices (Chart 5.5).

The presence of factors such as (1) negative aggregate demand over the entire forecast horizon, (2) the high base from the previous year, (3) the decline in imported inflation, (4) the continued downward trend in international oil prices, (5) the predominantly declining pace of food prices on the international market, and (6) the negative impact of highly seasonal products prices in the second and third quarters of 2023 will determine the continued decline in the annual inflation rate for the entire forecast horizon.

However, (1) cumulative increases in the prices of energy resources and agri-food products on the international market, (2) recent and anticipated adjustments through the end of this year and into the second quarter of next year to a number of tariffs, (3) the high pace of cumulative and rising imported inflation in the first quarter of the forecast for core inflation, (4) the mild upward trend in international food prices in the first three consecutive quarters, (5) excise duties adjustment, and (6) second-round effects from the tariff adjustment will drive the high rates and dampen the decline in the annual inflation rate.

The annual inflation rate for the forecast period will peak at 32.2% in the fourth quarter of 2022 and fall to a low of 5.1% in the second and third quarters of 2024.

Average annual inflation will be 28.8% and 16.0% in the current year and next year, respectively.

The annual rate of core inflation will peak in the first quarter of the forecast period and, starting next year, will refocus its path, declining continuously for the remainder of the forecast period[36] (Chart 5.6).

The upward trajectory in the fourth quarter of this year will be driven by the rising pace of imported inflation. However, (1) the moderation in imported inflation from the first quarter of next

[35] Third quarter of 2024
[36] Fourth quarter of 2022 - third quarter of 2024

year, (2) disinflationary domestic demand over the entire forecast period, and (3) the high base this year will be factors that will dampen the annual rate of core inflation. Second-round effects from the tariff adjustment that will further drive the increase in production costs and the excise duty adjustment from early 2023 and 2024 will dampen the decline in the annual rate.

Average annual core inflation will be 17.0% and 14.1% in 2022 and 2023, respectively.

The annual food price rate will follow a downward trend until the end of the forecast horizon (Chart 5.7).

The downward trend of the annual food price rate will be influenced by (1) the negative aggregate demand, (2) the subsequent downward trend in the annual rate of food prices on the international market, (3) the high base, (4) the negative impact of highly seasonal products prices in the second and third quarters of 2023. The impact of strongly seasonal products in the second and third quarters of 2024, the slight upward trend in international market food prices in the first three consecutive quarters, the second-round effects from the tariff adjustment, which will further increase production costs, and the excise duties adjustment in early 2023 and 2024, will mitigate the decline in the annual rhythm.

The average annual rate of food prices will constitute 31.7% and 12.0% in 2022 and 2023 respectively.

The annual rate of regulated prices will decline significantly for the entire forecast period (Chart 5.8).

The annual rhythm will be driven by recent and anticipated adjustments through the end of this year and into the second quarter of the next year to a number of tariffs. Cost increases, particularly for energy and salaries, on the one hand, and, on the other hand, non-adjustment or insufficient adjustment of tariffs for those services over long periods, sometimes years, are the main factors behind the high rates of regulated prices.

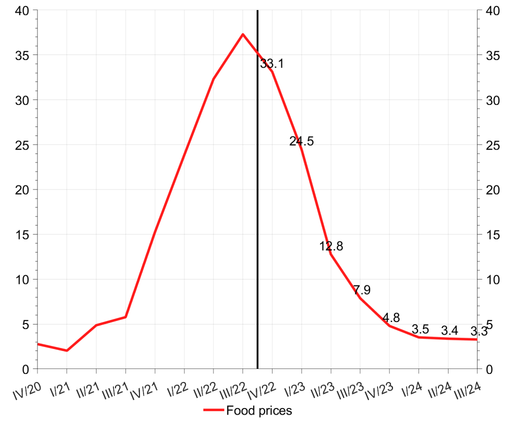
The decrease in the annual rhythm of regulated prices for the whole forecast period will be due to the anticipated moderate decrease in external energy prices, but also to the effect of the high annual base.

The annual rhythm of regulated prices will peak in October 2022, then decline significantly, but increase towards the end of this year, and then decline continuously until the end of the forecast horizon.

The increase in the annual rate will be driven by recent and anticipated adjustments, as well as the statistical reflection of compensation for gas and heat consumption granted to the population (at the beginning and end of the cold season).

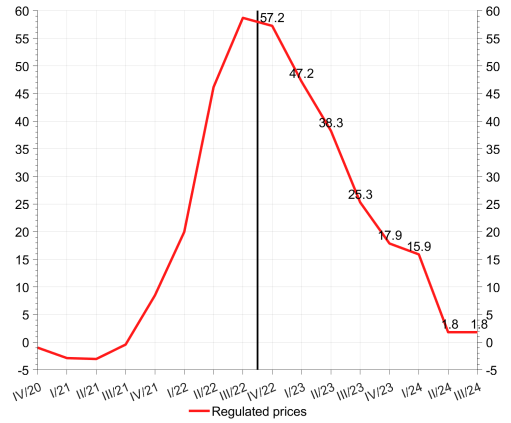
According to the assumptions, in the fourth quarter of 2022, the scenario to be published includes several tariff adjustments, namely in October for network gas, district heating and hot water supply. Also, in October-November there will be a reflection of the electricity tariff adjustment made in mid-October. The decisions have already been taken by ANRE and published in the Monitorul

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



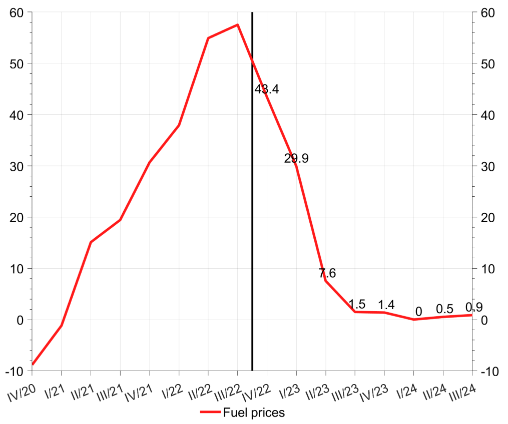
Source: NBS, NBM calculations

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



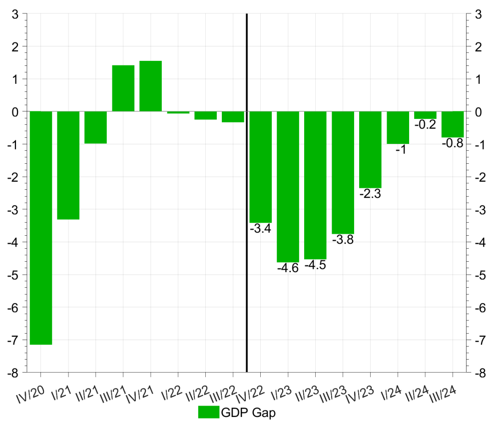
Source: NBS, NBM calculations

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



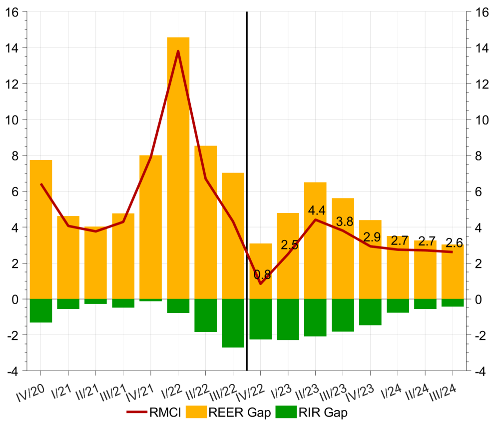
Source: NBS, NBM calculations

Chart 5.10: GDP deviation (%)



Source: NBM calculations

Chart 5.11: Real monetary conditions index and decomposition



Source: NBM calculations

Oficial. The current situation on the energy market, both external and internal, creates the conditions for an additional increase in the electricity tariff in December 2022. Due to the fact that the period of energy compensation offered by the state starts in November, this will be reflected by the NBS through considerable decreases in the components concerned, namely natural gas, central heating, and hot water. There are also prerequisites for increases in fares for intercity and interdistrict trips during the quarter.

Substantial price increases in natural gas, electricity, fuel, wage costs in the recent period, as well as the current level of aqueduct and sewerage tariffs, create premises for adjusting this tariff, especially in large municipalities.

With the end of the compensation period, the NBS will reflect the full increase in tariffs from October 2022, which will lead to an increase in the natural gas and heat price index.

The upward trend in prices for medicines and the "other" component in future periods is less pronounced than in the fourth quarter of 2022 and is maintained for the entire forecast horizon.

The average annual rate of regulated prices will be 45.9% and 30.7% in 2022 and 2023, respectively.

The annual rate of fuel prices will continue to decline significantly in the first four consecutive forecast quarters, after which it will be relatively stable until the end of the forecast horizon (Chart 5.9).

The continuation of the strong downward trend in fuel prices is driven by (1) the continued decline in international oil prices over the entire forecast horizon, (2) disinflationary domestic demand, and (3) the effect of the current year's high annual base. The excise duties adjustment in early 2023 and 2024 will mitigate the reduction in the annual rate.

The average annual rate of fuel prices will be 48.5% and 9.0% in 2022 and 2023, respectively.

Demand

Aggregate demand will be negative throughout the forecast period due to deteriorating external demand and household consumption financing, as well as tighter monetary conditions. The fiscal impulse will dampen the decline in aggregate demand (Chart 5.10).

Deteriorating external demand, (2) the decline in real terms in the sources of financing for household consumption and (3) slightly tightening real monetary conditions will be the main factors driving down aggregate demand. The slightly positive fiscal impulse will dampen the decline in aggregate demand.

The deviation of the real effective exchange rate will continue to exert a restrictive character on aggregate demand. At the same time, the real interest rate will boost domestic demand over the whole forecast horizon. External demand from both eastern and western economic partners will have a negative impact on domestic demand.

Monetary policy

Real monetary conditions will be restrictive for aggregate demand throughout the forecast horizon (Chart 5.11). Monetary policy via the real effective exchange rate will be restrictive; via the real interest rate, it will be stimulative over the entire forecast horizon.

The real depreciation of the national currency has reduced the deviation of the real effective exchange rate from its equilibrium level, thus diminishing the restrictive effects on aggregate demand in the first quarter of the forecast, while the accumulated appreciation of the Moldovan leu will maintain the accumulated imbalance of the real effective exchange rate, which will continue to exert restrictive effects on aggregate demand.

5.3 Comparison of forecasts

The current inflation forecast, relative to that in the previous inflation report[37], has been revised downward for the first two consecutive quarters and for the last quarter of the comparable period[38] and upward for the rest of the period (Chart 5.12).

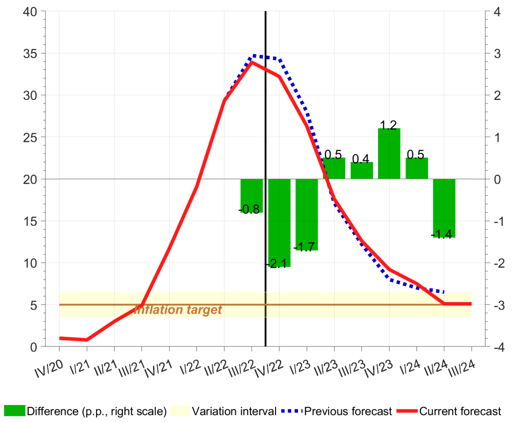
The downward trend in the annual inflation rate forecast is driven by a decline in the forecast for food prices, fuel prices, and regulated prices for the first two quarters and core inflation from the fourth quarter of 2023 to the end of the comparable period. The sharp increase in the forecast for regulated prices from the second quarter of 2023 onwards and for core inflation for the first four consecutive quarters will cause the current inflation forecast to be revised upwards (Chart 5.13).

The lower projection of the annual inflation rate forecast is driven by (1) a lower trend of imported inflation over the entire comparable period except for the last two quarters, (2) lower-than-expected actual inflation for the previous quarter, (3) a declining near-term forecast, (4) a lower forecast for international oil prices, (5) and for natural gas import prices for the first two quarters, and (6) a more moderate expected path for the exchange rate. However, (1) an expectation of less tight aggregate demand except for the first quarter of the forecast, (2) a higher path of international food prices starting in the second quarter of 2023, (3) a higher path of inflation for some trading partners, and (4) the expectation of a higher forecast for the import price of natural gas from the second quarter of 2023 through the end of the comparable period dampened the downward revision to the current forecast.

The average annual inflation rate has been decreased by 0.7 percentage points for 2022 and increased by 0.3 percentage points for 2023.

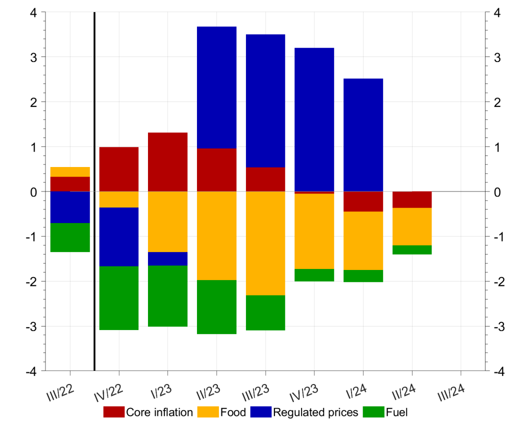
The current forecast of the annual rate of core inflation was increased for the first four consecutive quarters and

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



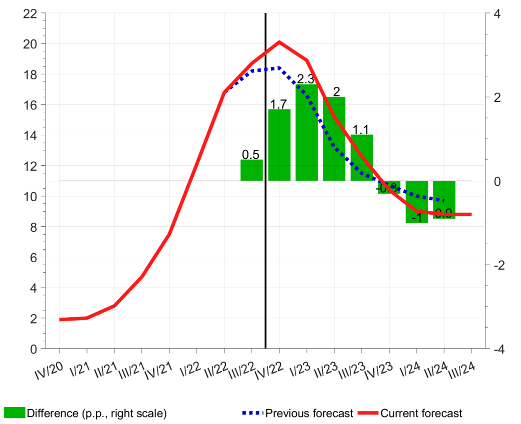
Source: NBS, NBM calculations

Chart 5.13: Decomposition of the forecast difference (percentage points)



Source: NBM calculations

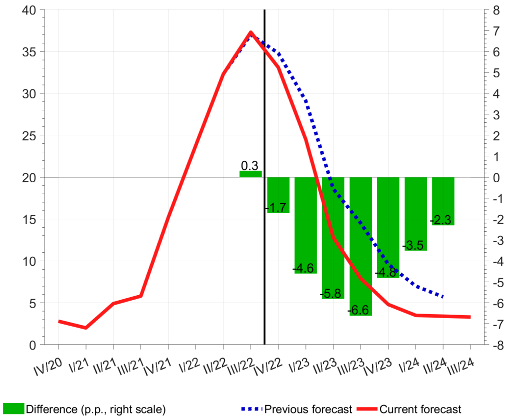
Chart 5.14: Core inflation (%, compared to previous year, percentage points)



Source: NBS, NBM calculations

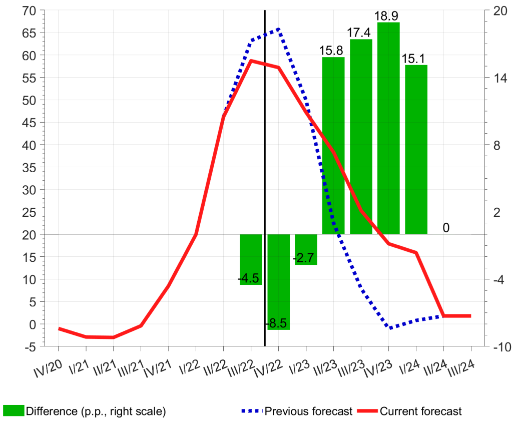
[37] Inflation report, August 2022
[38] Fourth quarter of 2022 – second quarter of 2024

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



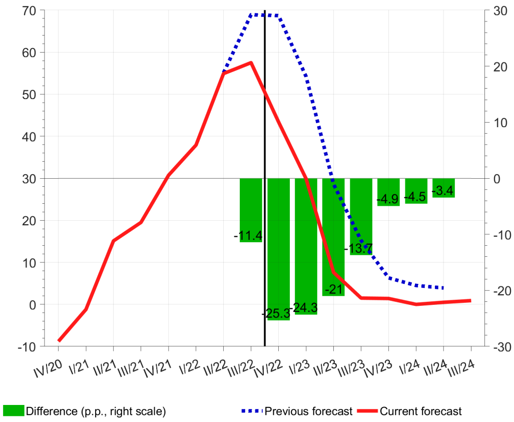
Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

decreased from the fourth quarter of 2023 to the end of the comparable period (Chart 5.14).

The higher projection of the current forecast relative to the previous forecast is driven by (1) higher actual inflation than anticipated in the previous quarter, (2) a rising near-term forecast, (3) the anticipation of less restrictive aggregate demand except for the first quarter of the forecast, and (4) a higher inflation path at some trading partners. Lower rates of (1) imported inflation and (2) a more appreciated expected exchange rate dampened the upward revision to the current forecast.

The forecast average core inflation rate has been raised by 0.6 percentage points for 2022 and by 1.2 percentage points for 2023.

The annual rate of food prices has been revised down over the whole comparable period (Chart 5.15).

The lower rhythm of food prices is driven by (1) a declining short-term forecast, (2) a more moderate anticipated exchange rate movement, (3) a lower forecast for imported inflation, except for the last two consecutive quarters of the comparable period. The anticipation of less tight domestic demand, (2) a slightly higher trajectory of food prices on the international market, except for the first two quarters, are the factors that mitigated the downward revision of the food price forecast.

The average food rate forecast has been lowered by 0.4 percentage points for 2022 and by 5.4 percentage points for 2023.

The current annual regulated prices rate forecast is revised downwards until the first quarter of 2023 and upwards for the next four consecutive quarters (Chart 5.16).

Its lower projection in the first two quarters is driven by (1) lower-than-expected inflation in the third quarter of 2022, (2) a lower forecast of international oil prices, (3) and of natural gas import prices for the first two quarters. The higher trajectory of the natural gas import price from the second quarter of 2023 to the end of the comparable period has led to the anticipation of additional tariff adjustments in the first half of next year and, therefore, to an upward revision of the current forecast of regulated prices from the second quarter of 2023 for four consecutive quarters.

The forecast average regulated prices rate has been lowered by 3.3 percentage points for 2022 and raised by 13.8 percentage points for 2023.

The annual fuel prices rate forecast has been lowered over the whole comparable period (Chart 5.17).

The lower forecast for the annual rate of fuel prices is conditional on (1) lower-than-expected actual inflation in the previous quarter, (2) a lower forecast for international oil prices, and (3) a more moderate expected movement in the exchange rate. The anticipation of less tight domestic demand dampened the downward revision to the fuel price forecast.

The forecast average fuel price rate was lowered by 9.9 percentage points for 2022 and by 14.5 percentage points for 2023.

5.4 Risks and uncertainties

External sector

- **Regional economic and geopolitical crisis.** The armed conflict in Ukraine and the economic crisis in the region continue to pose enormous risks to the development of economic activity in the region, social security, trade stabilisation and price formation under market equilibrium (uncertainty).
- **Sovereign debt crisis and contagion in financial markets.** Following a radical transformation in the rhetoric of the major central banks regarding the transitory nature of the inflationary process and the restrictive monetary policy measures of central banks that were forced to ensure their fundamental objective of price stability, the yardsticks for financing costs changed. Thus, loans and credits taken out in the last 2-3 years at low rates to compensate for the decline in economic activity, against the current background of galloping inflation, will lead to old debts being serviced at much higher interest rates at which new loans are taken out (disinflationary, uncertainty).
- **Persistence of high energy resource prices.** Although international energy quotes have fallen from the highs reached in spring this year, they remain well above the averages of recent years. In addition, the case for lower prices is not sufficiently clear-cut compared to the risk of a steep increase in the event of supply shocks. OPEC+'s recent decision to cut oil supply by 2 million barrels per day reflects successful cooperation among producers to support oil prices. At the same time, in December 2022 the EU embargo on imports of oil and oil products from the Russian Federation comes into force, which could significantly limit regional supply and contribute to higher oil product prices. Natural gas prices in Europe have experienced significant volatility over the past year, overreacting to shocks, which erodes the stability of the long-term trend outlook (pro-inflationary).
- **Deficient external supply.** Deficient external supply of energy resources will disrupt the history of import price creation under well-defined long-term contracts. Thus, in order to cover possible shortfalls, there is a risk of purchases being made on tight terms and at high prices. Transposing these possible events into the costs of calculating regulated tariffs for the population could significantly deviate upwards the projected path of inflation (pro-inflationary).
- **Continued appreciation of the US dollar.** As the Federal Reserve System is expected to continue tightening monetary policy and risks to the global economy persist, the US dollar will remain strongly appreciated. The Moldovan leu will be subject to considerable depreciation pressures and this will contribute to higher import costs and higher domestic prices (pro-inflationary).

- **Global demand decrease.** From recent statistical data it can be deduced that the downturn in manufacturing activity in major economies seems to be just beginning. It remains uncertain how long this period will last, what bottom levels will be reached and when the economic recovery will follow (disinflationary).

Real sector

- **Uncertainty about the way the NBS reflects compensation.** In the framework of the preparation of the medium-term inflation forecast, the impact on the CPI of the compensation granted to the population in the cold period of the year for the increase in energy resource tariffs was estimated on the basis of some provisions of the Regulation on the assignment of energy vulnerability categories and the way of establishing and paying compensation for the payment of energy bills. However, should the NBS use other primary data, assumptions or information on actual claims from the population for compensation to quantify this impact, the CPI, i.e. regulated prices, could have a different trajectory (uncertainty).
- **Uncertainty about the supply of the required volume of electricity, import price and electricity tariff.** The limitation of gas volumes delivered by Gazprom creates impediments to Moldova’s electricity supply from the Cuciurgan thermal power plant. This, together with the interruption of electricity supply from Ukraine, increases the risk to the supply of electricity to the national economy and to domestic consumers. Under these conditions, the electricity needs would have to be imported from the European market or partly produced on the domestic market. Possible power cuts would have a negative effect on economic activity. At the same time, the identification of alternative electricity suppliers in emergency conditions will lead to an increase in the average electricity purchase price, which will ultimately lead to an adjustment of tariffs for household consumers. Thus, the lack of medium-term contracts on electricity purchase volumes and prices creates uncertainty about the future evolution of the electricity tariff (uncertainty, pro-inflationary).
- **Uncertainties about the timing and magnitude of the adjustment of tariffs for regulated services.** The medium-term inflation forecast is based on a trajectory of prices for regulated services that corresponds to certain assumptions about international and regional energy prices and other indicators relevant to the sector. However, given that tariffs for some regulated services have a considerable economic impact on the population, the timing of their adjustment may 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 tariff adjustments cannot be estimated with sufficient confidence. At the same time, in the context of the increase in international and regional energy resource prices over the last few quarters, as well as the insufficient volume of electricity supplied and the need to identify alternative suppliers, for the medium forecast horizon, there are

preconditions for significant tariff adjustments to some sub-components of regulated prices (uncertainty, pro-inflationary).

- **Military conflict in Ukraine.** Events associated with the military conflict in the neighbouring country outline additional risks for the prices of some domestically traded goods. Thus, the substitution of Ukrainian products (which were abundant on the Moldovan market and more affordable in the region) by similar products from another country of origin (more expensive) leads to pronounced price adjustments. Logistically, economic agents are forced to use alternative routes (avoiding the territory of Ukraine) to export/import products, as well as to identify new suppliers, which in some cases contributes to higher transport costs (pro-inflationary).

- **Decreasing number of consumers located on the territory of the Republic of Moldova.** The military conflict in Ukraine has led to a massive outflow of people from Ukraine. Part of the refugees are on the territory of the Republic of Moldova (about 70 thousand people), which contributes directly to the increase in consumption of the population. Their return to their country of origin or their departure to other regions would lead to lower demand on the domestic market (uncertainty, disinflation).

- **Vulnerability of domestic fruit and vegetable prices to weather conditions in the immediate future.** According to the experience of recent years, prices of domestic fruit and vegetables are largely affected by adverse weather conditions such as frosts, heavy rainfall, costs associated with harvesting, transport, storage, and marketing at domestic outlets. In the event of lower than normal temperatures or heavy rainfall/snowfall, this would result in higher than expected food prices in the coming months (pro-inflationary).

- **Uncertainties about agricultural production in 2023.** The 2023 harvest and domestic food prices, respectively, will mostly depend on agrometeorological conditions in autumn 2022 and 2023. Developments in the agricultural sector and hence the trend of food prices for 2023 and the first half of 2024 is marked by pronounced uncertainty (uncertainty).

Monetary and public sectors

- **Depreciation of the national currency.** Since the fourth quarter of 2021, the Moldovan leu has been facing depreciation pressures against the US dollar against the background of increasing demand for foreign currency from energy importers, and since February 2022 these pressures have been supported by negative expectations about the situation in Ukraine. With the onset of the warming period, demand for foreign exchange will remain high in the coming months, influenced by demand from importers of energy resources (amid rising international prices for oil products, natural gas, electricity). Thus, these factors will lead to a depreciation pressure on the national currency, which will influence the evolution of domestic prices (pro-inflationary).

- **Evolution of the NEER/REER effective exchange rate.** The nominal and real effective appreciation of the national currency is a stimulating factor on imports and has the potential to affect Moldova's net exports. Combined with the recent increase in international prices for goods and services, the trade deficit will continue to trend negatively, fuelling depreciation pressures on the Moldovan leu (pro-inflationary).

- **Appreciation against the EUR.** About 70% of the balance is traded or linked to the euro. The appreciation of the Moldovan leu of about 5.8% in annual terms further accentuates the problem mentioned above (uncertainty).

- **Financial stability.** If the regional situation worsens in connection with the conflict in Ukraine, the national economy may experience several consecutive years of recession. Deposits will decrease or have low dynamics (withdrawal of deposits, likelihood of national currency instability, complicated public finance situation, etc.), which may lead to a decrease in liquidity at banks and in the volume of lending to the national economy. In this way, contributing to a dampening of economic activity. In the circumstances described the solvency of many debtors of the domestic financial system will also be affected, which will deteriorate the financial stability of the country.

  The aggravation can also be attributed to the increase in interest rates on loans in the context of double-digit inflation, the decrease in real income due to the slowdown in economic activity and the increase in the financing costs of previously contracted loans (uncertainty).

- **State Budget 2023 and Tax and Customs Policy for 2023.** The postponement of the adoption and publication of the Draft Law on the State Budget for 2023 and Tax and Customs Policy for 2023 creates uncertainty in the estimation and analysis of future developments of fiscal measures and the public sector (uncertainty).

- **Salaries growth in the budget sector.** In the context of rising food and energy prices, the Government of the Republic of Moldova, in order to protect low-income employees in budgetary units, will annually review the guaranteed minimum amount of the salary in the budgetary sector (taking into account the minimum required amount of social insurance established in the country and depending on the economic situation and financial possibilities). Thus, in line with the Medium-Term Budgetary Framework 2023-2025, published at the end of September 2022, personnel expenditure for the period 2023-2025 will be 8.3% higher in nominal terms and is expected to increase from 7.9% of GDP in 2023 to 8.1% in 2025 (pro-inflationary).

- **Indexing pensions.** According to Article 13 of the Law on the Public Pension System, indexation takes place on 1 April and the indexation coefficient is the inflation rate at the end of the previous year, expressed as the increase in consumer prices in December of that year compared to the same month of the previous year. According to recent forecasts, inflation at the end of 2022 will amount to about 30.0% annually, so indexing pensions in April 2023 on the basis of existing legislation will be a difficult task for the national public budget.

Thus, it is likely that by the end of the first quarter of 2023 the mechanism of indexation of pensions will be changed by returning to indexation twice a year, or another approach will be implemented (in the last four years Article 13 of the Law on the Public Pension System No. 156-XIV of 14.10.1998 has been amended six times).

The impact of these changes will be stimulative for the inflation growth rate during 2023-2024 (pro-inflationary).

- **Compensation of gas, heat, and electricity tariffs.** In the context of the current energy crisis and the increase in prices and tariffs for gas, heat, electricity, the Government has developed the mechanism for compensating these expenses to vulnerable consumer categories. By granting these compensations, the state will apply a concrete form of social protection, aimed at vulnerable consumers, against poverty. The implementation of the compensation mechanism will require additional financial means from the state budget in the amount of approximately MDL 5.7 billion (granted between December 2022 and April 2023) (pro-inflationary).

- **Sustainability of public finances.** High inflation, the likelihood of financial, social and political instability against the backdrop of recession in the national economy and the volatility of the Moldovan leu subject to depreciation pressures will reduce the attractiveness of investments in the national economy and state securities, thus affecting the sustainability of public finances and the ability of the Ministry of Finance to fund national public budget expenditures. At the same time, maintaining the current system of indexation of pensions, state wages and social expenditure further fuels inflationary pressures and increases the need to finance budgetary expenditure, eroding the stability of public finances. In the absence of sufficient sources of external financing of budgetary expenditure, the Ministry of Finance will find it difficult to attract the necessary resources, thus facing major difficulties in the execution of the national public budget in the coming periods (uncertainty).

- **External financing.** For 2023, the Government of the Republic of Moldova, according to the Medium-Term Budgetary Framework 2023-2025, expects that external financial assistance manifested in the flow of foreign credits and grants will increase considerably, which will allow faster implementation of reforms in the national economy and create additional incentives on inflation. Estimates point to a medium-term decline in the financing of the state budget balance from external sources, due to a reduction in budget support flows. Thus, it is planned to allocate external sources mainly for the implementation of capital investment projects. External financing will stimulate the continued growth of excess liquidity in the banking system, which will have a positive impact on aggregate demand, the exchange rate of the national currency and generate additional inflationary pressures (uncertainty).

Chapter 6

Monetary policy decisions

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 15.02.2022
on monetary policy

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, Mrs. Tatiana Ivanicichina – Deputy Governor, Mr. Constantin Schendra – Deputy Governor
Rapporteur: Mr. Radu Cuhal - Director of the Monetary Policy Department
Guests: Mr. Natan Garstea, Mrs. Natalia Sirbu – Advisors to the Governor, Mr. Daniel Savin – Director of Financial Markets Department, Mrs. Alina Boboc – Head of Communication and Financial Education Division

After the opening of the meeting of the Executive Board on monetary policy promotion, the floor was given to Mr. Radu Cuhal, who presented the comprehensive analysis of recent phenomena and developments in the external and domestic environment, trends and prospects of the main macroeconomic indicators included in the Inflation Report no.1, February 2022. It also presented the new inflation forecast for the next eight quarters, together with the associated risks and uncertainties.

Analysing the external macroeconomic situation, the members of the EB noted that global economic conditions continue to be affected by the high levels of commodity, food, and energy prices overlapping with disruptions in the production and supply chains. At the same time, it was warned that global inflation is intensifying, with most countries facing an unprecedented wave of inflation. In this regard, reference was made to the central banks of Central and Eastern Europe which, having recorded high levels of inflation, implicitly exceeding their targets, guided also by the upward adjustment of forecasts for the coming periods, have resorted directly to raising monetary policy rates in February this year, promoting a restrictive monetary policy stance.

The discussion then focused on the economic situation in the country, noting that the vulnerability of domestic prices to developments in the external environment through the prism of import prices is considerable, which together with domestic factors have led to a further increase in annual inflation in January 2022.

Analyzing the statistical data provided by the National Bureau of Statistics, the members of the Executive Board noted that the annual inflation rate in January 2022 registered 16.6%, 2.6 percentage points higher than in December 2021. In this regard, they referred to the contributions of subcomponents to the respective inflation development, pointing out that the most significant contribution was generated from food prices (7.6 percentage points), followed by the impact of the core inflation (4.2 percentage points), regulated prices (2.9 percentage points) and fuel prices (1.9 percentage points).

Discussions associated with the pro-inflationary factors behind the increasing trend in inflation referred to external shocks, such as rising international and regional market prices for food and energy resources, which led to their higher prices on the domestic market, and adjustments in gas and heat tariffs. At the same time, it was noted that the adjustment of tariffs, the increase in fuel prices, as well as the upward dynamics of wages supported the increase in costs for economic operators, which was gradually reflected in prices. On the other hand, the discussion also focused on demand factors, pointing out that demand pressures associated with rising disposable income and credit continued to support the increase in prices of the subcomponents of core inflation, as well as food prices. In this context, it was noted that disposable household income did not change substantially as a result of the

Government's compensation of the population for the cold period of the year, maintaining further demand pressures.

At the meeting, the members of the EB also discussed the domestic economic conditions, noting that the operational indicators for October-November 2021 provided by the NBS outline prospects of recording a positive dynamics of economic activity also in the fourth quarter of 2021, similar to that of the third quarter of 2021. In this regard, reference was made to the dynamics of industrial production, freight transport, turnover of enterprises with the main activity of wholesale trade, noting a growth rate of 8.2%, 31.2% and 14.3%, respectively, in October-November 2021, compared to the same period of 2020. It was noted that the overall agricultural production in the fourth quarter of 2021 increased by 116.0%.

In discussions associated with labour market developments, it was noted that thanks to economic conditions the situation on the labour market improved for the second consecutive quarter. In this regard, the EB members referred to the economically active and employed population, which in the third quarter of 2021, recorded a positive dynamic of 1.6% and 2.6% in annual terms, respectively. At the same time, the salary fund in the economy moderated its positive growth rate, increasing by 17.0% in real terms, while the average number of employees increased by 2.9% compared to the third quarter of 2020.

Assessing the lending process in the economy, the members of EB found that in the fourth quarter of 2021, the volume of new loans granted in national currency increased by 45.1% in annual terms, noting that credit is an important source of demand supply, generating pronounced inflation pressures during the period. It was pointed out that the trend of boosting demand at the expense of loans continued in January 2022, noting that new loans granted in national currency increased by 55.3% compared to the same period last year. During the discussions, it was pointed out that this phenomenon of intensive lending signals the need to maintain the restrictive nature of monetary policy in order to mitigate the pressures associated with the lending process on the further growth of consumer prices.

During the discussions that followed, the members of the EB referred to the current inflation forecast, noting that the forecast, being based on available information flow, has been revised upwards for the comparable period (first quarter 2022 to third quarter 2023) compared to October 2021. With reference to the pforcasted trend of the annual inflation rate, it was noted that it will accelerate markedly until the third quarter of 2022, after which it will decelerate, returning to the target range in the second quarter of 2023.

The EB members said that inflation would continue to be assessed under the impact of both demand and supply shocks.

The EB members found that the positive fiscal impulse and the revival of external demand will support aggregate demand, which will record positive growth in the first quarter of 2022, declining steadily thereafter, but pointing to persistent pro-inflationary pressures over the forecast horizon (first quarter 2022 to fourth quarter 2023).

With regard to the factors underlying the forecast adjustment, the members of the EB mainly referred to the incidence of pro-inflationary factors, such as imported inflation, rising international market prices for food, energy resources and oil, positive domestic demand, a possible increase in the electricity tariff during the first and second quarters of 2022, the adjustment of excise taxes, along with the effect of the low annual base.

It was also pointed out that in the downward phase the inflation will be influenced by the continuously declining aggregate demand until the end of the forecast horizon, the downward trend in projected external oil and natural gas prices, the anticipated improvement in the regional and global energy market situation next year, the slight decline in the annual pace of international food prices in the first half of next year, the effect of the high annual base.

It has been repeatedly emphasized that the current medium-term forecast has been prepared on the basis of available information and in the circumstances of the manifestation of additional factors or the materialization of risks, its trajectory will be revised accordingly.

In this context, the EB members expressed concern about the evolution of the annual inflation rate for January 2021, which was 0.8 percentage points higher than expected in the Inflation Report no.1, 2022. This deviation was considered to have been mainly driven by the earlier adjustment of the network gas tariff, but also by more pronounced cost pressures on food prices as wel as the dynamics of oil prices. In this context, taking into account the positive deviation recorded for the first month of the forecast, as well as the better-than-expected evolution of oil prices and possible second-round effects from the tariff adjustment, the members of the EB mentioned the emerging risks of a higher-than-expected inflation path in the Inflation Report no. 1, 2022.

As a result, following the analysis and findings of the meeting, taking as a benchmark the medium-term inflation forecast, the Executive Board of the NBM decided to increase the base rate and the standing facility rates by 2.0 percentage points. At the same time, the meeting noted that on 16 February p. 3 of the DEB of the NBM No. 2 of 13.01.2022 on the increase of the required reserves rate from the funds attracted in MDL and in non-convertible foreign currency, starting with the period of application of the required reserves in MDL from February 16, 2022 to March 15, 2022 – by 2.0 percentage points, being set at 28.0% of the calculation base.

It was argued that this decision aims at mitigating persistent inflationary pressures on inflation, creating preconditions for bringing inflation back within the range of the medium-term target, including by anchoring inflationary expectations and mitigating the side effects related to the increase in regulated tariffs.

It was also noted that the justification for the decision was to moderate the pace of credit growth on account of the associated cost increases, to stimulate saving at the expense of immediate consumption, and to ease pressures on the depreciation of the domestic currency due to the widening current account and trade deficits, together with mitigating the dollarisation effect on deposits.

The EB members stressed that with this decision, the NBM reinforces its anti-inflationary stance and, by gradually adjusting monetary policy instruments, cautiously monitors the reaction of real and monetary sector indicators to decision impulses.

At the end of the meeting, it was stressed that the NBM will monitor with caution the evolution of inflation components and factors likely to affect its dynamics, as well as risks and uncertainties associated with the short and medium-term forecast. At the same time, the EB members noted that, in order to achieve the fundamental objective of ensuring and maintaining price stability, the NBM reserves the legal right to intervene at the appropriate time by adjusting monetary policy instruments.

The Executive Board of the NBM adopted the following decision:

1. **To increase the base rate applied to the main short-term monetary policy operations by 2.00 percentage points, from 8.50% to 10.50% annually.**

2. **To increase the interest rates:**
   a) **on overnight loans by 2.00 percentage points, from 10.50% to 12.50% annually;**
   b) **on overnight deposits by 2.00 percentage points, from 6.50% to 8.50% annually.**

3. **To maintain the required reserve ratio from the financial means attracted in freely convertible foreign currency assets at the current level of 30.0% of the calculation base.**

Voting results

PRO – 4 AGAINST – 0 ABSTAINED – 0

Chairman of the Executive Board **Secretary of the Executive Board**

Octavian ARMAȘU **Sergiu SURDU**

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 15.03.2022
on monetary policy

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, Mrs. Tatiana Ivanicichina – Deputy Governor, Mr. Constantin Schendra – Deputy Governor, Mr. Arcadie Albul – Deputy Governor
Rapporteur: Mr. Radu Cuhal – Director of Monetary Policy Department
Guests: Mr. Natan Garstea – Advisor to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mrs. Rusu Valentina – Head of the General Legal Assistance Division, Legal Department, Mrs. Alina Boboc – Head of the Communication and Financial Education Division

Mr. Radu Cuhal presented to the Executive Board of the NBM the Report on the assessment of the risk of deviation from the inflation forecast, prepared on the basis of data and events in the external and domestic environment that emerged after the January forecast round. The developments and prospects of the main macroeconomic indicators were addressed, together with the risks and uncertainties likely to jeopardize the inflation forecast in the short and medium term.

Assessing and analysing the available macroeconomic information, the members of the Executive Board found that the assumptions and conclusions reflected in the Inflation Report no1, 2022 were broadly confirmed. At the same time, the members of the EB noted that the updated information signalled the outline of the risk of forcast deviation in the context of external and domestic factors.

Discussing the external environment, EB members stressed that regional and global economic conditions are deteriorating amid tense developments in the region, with severe repercussions on the evolution of headline inflation, which is already at a high level. In this context, attention was drawn to the excessive rise in international market prices for energy, food and metals, taking into account disruptions in the production and supply chains. Increased volatility on international stock exchanges and financial markets was noted. A special place was given to discussions on the refugee wave in Ukraine and the associated humanitarian crisis, together with its implications for domestic economic conditions.

EB members noted that the tensions in the region imply major uncertainties and risks, likely to adjust inflation forecasts upwards. At the same time, it was noted that from the perspective of moderating inflationary pressures, the central banks of the reserve currencies, as well as those of Central and Eastern Europe, are signalling or continuing the process of tightening monetary policy.

It was stressed that in the context of the latest events in the region, price shocks are inevitable for any economy, but more vulnerable are countries that depend on quotations and developments on international markets in terms of import prices, which includes the Republic of Moldova.

With reference to the evolution of the domestic inflation process, the EB members noted that the annual inflation rate in February 2022 evolved as expected, being 1.9 percentage points higher than in January 2022 and registering the expected level of 18.5%. At the same time, significant deviations between the actual and forecast values of the inflation subcomponents emerged, which, although they have been compensatorily adjusted, imply major risks to the evolution of the consumer price index for the coming periods. In this context, core inflation (11.7%) and regulated prices (19.4%) were found to have developed below expectations (11.9 and 25.9%, respectively), while food prices (23.3%) and fuel prices (35.4%) showed better-than-expected dynamics (21.0 and 27.5%, respectively).

During the discussions associated with national economic activity, EB members noted that the macroeconomic indicators for November-December 2021, published by the NBS after the forecast round in January this year, record positive dynamics above expectations and thus outline signs of higher economic growth in the fourth quarter of 2021 than anticipated. In this regard, they referred to exports and imports, noting that in December 2021 they increased by 48.9% and 32.9%, respectively, while noting that industrial production increased by 11.4%, freight transport – by 38.9%. It was noted, however, that the most significant contribution to GDP dynamics for the fourth quarter comes from agricultural production, which in the fourth quarter of 2021 increased by 116.0% compared to the fourth quarter of 2020. At the same time, it was noted that remittances from abroad to individuals in December 2021 decreased by 7.1%, after an increase of 5.5% in November 2021.

Assessing the economic outlook, EB members agreed that the medium-term GDP development trajectory is affected by risks and uncertainties associated with the situation in the region, mainly determined by the duration, magnitude of the war and possible escalations. In this respect, the impact on the growth of population consumption on refugees was identified, on the one hand, and on the other hand, the contraction of remittances both from the CIS area amid tensions in the region and from other countries in the context of rising international living costs and the limitation of the saving capacities of our compatriots working abroad was noted, stressing the dampening effect on the sources of financing consumption.

The EB members then commented on the evolution of lending activity in the economy, noting that it continues to generate pro-inflationary impulses, recording high growth rates in February (+49.7%), although the annual growth rate of loans granted in national currency has moderated slightly. At the same time, it was stressed that under the restrictive policy stance started in July 2021, weighted average interest rates on new loans and new deposits attracted in domestic currency continued their upward trend also in February 2022. Thus, the weighted average rate on loans and deposits amounted to 9.22% and 4.97% per annum, respectively, recording an increase of 0.13 percentage points and 0.11 percentage points, respectively, compared to January this year.

During the follow-up discussions, EB members expressed concern about the current situation and the associated implications and challenges for the macroeconomic environment, noting that we are witnessing increased global, regional and national risks and uncertainties arising from the conflict in the region, and that the outlook for economic conditions in the context of these events is precarious. It was stressed that the implications of these events are conditioning an unprecedented conjuncture in the Republic of Moldova and the national economy is subject to structural changes.

Following the assessment of the quantified risk of inflation forecast deviation published in Inflation Report no.1, 2022, EB members noted that the risk of a pronounced positive deviation persists for both short-term inflation forecast (first quarter 2022) and medium-term inflation forecast. The rationale for this was provided by the positive deviation in the first two months of the forecast for food and fuel prices, the escalating situation in the region which has led to a marked acceleration in oil and natural gas prices, possible distortions in supply chains and higher demand.

As a result of the analyses and findings of the meeting, taking as a reference the assessment of the risk of deviation from the inflation forecast, the Executive Board of the NBM unanimously decided to increase the base rate and the standing facility rates by 2.0 percentage points.

At the meeting, it was noted that this decision is appropriate in the context of the radical change in the external and domestic environment and the need to maintain the gradual adjustment of monetary policy against the background of persistent inflationary pressures on the evolution of the consumer price index in the short and medium term.

It was justified that this decision is aimed at easing inflationary pressures, anchoring inflationary expectations, protecting deposits and savings of the population.

The EB members also stressed that the decision is aimed at mitigating the effects associated with the crisis in the region from the perspective of reducing pressures on the depreciation of the national currency as a result of the increase in the current account deficit and the trade balance and is aimed at reducing capital inflows.

At the end of the meeting, it was stressed the need to monitor with caution the evolution of inflation components and factors likely to affect its dynamics, as well as risks and uncertainties associated with the short and medium-term forecast. At the same time, it was reiterated that, in order to achieve the fundamental objective of ensuring and maintaining price stability, the NBM as monetary authority reserves the legal right to intervene at the appropriate time by adjusting monetary policy instruments.

At the same time, the EB members warned about the need for prudent monitoring of the situation in the banking system of the Republic of Moldova, reiterating that it remains stable and viable, and the sufficiency of foreign exchange reserves gives the NBM the ability to react in the event of a crisis in order to ensure financial stability. In this context, he stressed the cautious monitoring of liquidity levels in the banking sector, assuring that the NBM will intervene if necessary by injecting sufficient liquidity into the market.

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

1. **To increase the base rate applied to the main short-term monetary policy operations by 2.00 percentage points, from 10.50% to 12.50% annually.**

2. **To increase the interest rates:**

   a) **on overnight loans by 2.00 percentage points, from 12.50% to 14.50% annually;**

   b) **on overnight deposits by 2.00 percentage points, from 8.50% to 10.50% annually.**

3. **To maintain the required reserve ratio from the financial means attracted in freely convertible foreign currency assets at the current level of 30.0% of the calculation base.**

Voting results

PRO – 5 AGAINST – 0 ABSTAINED – 0

Chairman of the Executive Board **Secretary of the Executive Board**

Octavian ARMAȘU **Sergiu SURDU**

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 5.05.2022
on monetary policy

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, Mrs. Tatiana Ivanicichina – Deputy Governor, Mr. Constantin Schendra – Deputy Governor, Mr. Arcadie Albul – Deputy Governor
Rapporteur: Mr. Radu Cuhal – Director of Monetary Policy Department
Guests: Mr. Natan Garstea – Advisor to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mrs. Rusu Valentina – Head of the General Legal Assistance Division, Legal Department, Mrs. Alina Boboc – Head of the Communication and Financial Education Division

At the beginning of the Executive Board meeting on monetary policy promotion, Mr. Radu Cuhal presented in detail the internal and external macroeconomic developments, mainly the inflationary process, economic activity and monetary policy conduct. The new round of medium-term forecasts was also presented, reflecting the risks and uncertainties identified when the Inflation Report, May 2022 was prepared.

The Executive Board noted that the Russian military aggression against Ukraine has increased uncertainty about future global macroeconomic developments and significantly deteriorated economic sentiment. Inflation continued to rise in many economies, reaching the highest levels in decades. The main factors still contributing to rising prices remain high commodity prices, protracted disruptions in global and regional supply chains and in international transport, which have been triggered by the pandemic crisis and amplified by the war in Ukraine.

It has been noted that due to the economic effects of Russian aggression, external inflation forecasts have been revised significantly upwards. Against the background of such rising inflation, many central banks in advanced economies as well as in Central and Eastern Europe have tightened monetary policy, notably by raising interest rates, despite the risk of stagflation (the coexistence of high inflation and economic stagnation), and the rhetoric of transitory inflationary pressures has been abandoned.

EB members noted that the impact on prices is inevitable for every economy, but countries heavily dependent on international markets through import prices, such as the Republic of Moldova, are more vulnerable to external shocks.

With regard to the evolution of the domestic inflation process, EB members noted that the average annual inflation rate in the first quarter of 2022 continued to rise at a faster rate than anticipated, being 7.4 percentage points higher than in the fourth quarter of 2021 and reaching 19.1%. The acceleration in prices was driven by rising international and regional quotations for food and energy resources, which led to higher domestic prices for them and adjustments in tariffs for mains gas and heat. There were significant deviations between actual and forecast inflation subcomponents, which, although partially offsetting, point to prominent risks to the continuation of positive inflation dynamics in the period ahead. In addition, the war in the region is expected to affect foreign trade, and the domestic market will see substitution of cheaper CIS products by more expensive ones.

The EB members also agreed that the entry into force of the new electricity tariffs from 1 April 2022 will have a significant direct impact and will have secondary effects on all goods and services. Moreover, it was estimated that there are prerequisites for a much more pronounced increase in electricity prices in the context of the war in the region and the increase in international natural gas prices, which will also lead to a significant adjustment of the gas tariff in the network. Similarly, the possibility of adjusting tariffs for public transport services in the Chisinau municipality was evaluated. At the same time, it was noted that the evolution of inflation will also be determined by the multitude of tariffs not adjusted in time, which were subsidized directly or indirectly.

During the discussions associated with the national economic activity, the Executive Board determined that in the fourth quarter of 2021, GDP was 18.9% higher than in the same period of 2020. This development was mainly supported by domestic demand from the population in the context of increasing disposable income, a favorable environment with still relatively low interest rates, a rich harvest in 2021, as well as positive economic activity in the region. At the same time, the EB members reviewed the statistical data for the first quarter of 2022, which show an increase in economic activity similar to that of the fourth quarter of 2021. Thus, it was found that in January-February 2022, in annual terms, industrial production increased by 4.5%, imports – by 40.1%, exports – by

56.8%. Wholesale trade[39] increased by 41.0%, and retail trade[40] – by 5.9%.

Discussions on labour market developments revealed that in the fourth quarter of 2021, the annual growth rate of the wage fund in the economy was 12.0% in nominal terms, and that of the average number of employees – 1.6%, the economically active population decreased by 0.8%, and the unemployment rate was 2.6%.

Assessing the outlook for economic conditions, EB members agreed that the evolution of GDP in the medium term will be affected by the persistence of risks and uncertainties related to the situation in the region, determined by the duration and extent of the war, with imminent implications for the Republic of Moldova. It was noted that accurate estimation and analysis of the multitude of factors is complicated in the context of their increased volatility.

The attention of EB members was then turned to monetary conditions. It was pointed out that they had become slightly restrictive, albeit insufficiently so, both in terms of rates and liquidity, following the string of anti-inflationary measures that began in July 2021, and that their implementation remains appropriate in the near future. Thus, it was found that in the first quarter of 2022, the weighted average lending rate was 9.34% and the deposit rate – 5.05%, increasing by 0.9 and 1.21 percentage points, respectively, compared to the fourth quarter of 2021. On the other hand, there are still considerable inflationary pressures from lending, against the backdrop of a decline in deposits in the banking system: in the first quarter of 2022, in annual terms, new loans granted in domestic currency increased by 37.1%, while new deposits attracted declined by 8.6%.

During the following discussions, EB members referred to the current inflation forecast. It was revised upwards for the whole comparable period (second quarter 2022 to fourth quarter 2023) compared to the previous forecast round. It was noted that the annual inflation rate will increase until the third quarter of this year, when it will peak, after which it will follow a downward trend towards the end of the forecast horizon.

EB revealed that the high inflation growth rates in the Republic of Moldova are influenced by the lack of its own energy resources, but also by the higher share of food and energy resources in the CPI than in many other countries. It was stressed that high and persistent inflation negatively affects the prospects for economic development and growth, and erodes the purchasing power of the population.

EB members assessed that the risks to inflation developments remain pro-inflationary, driven in particular by the sharp rise in food and other commodity prices, the war in the region that has conditioned the sharp acceleration in oil and gas prices, along with actual and potential disruptions to supply chains. Similarly, additional inflationary pressures on all components of inflation were expected to be generated by the second-round effects of tariff increases.

As a result, the Executive Board of the NBM unanimously decided to increase the base rate and the standing facility rates by 3.0 percentage points. In addition, the required reserve ratio on MDL and non-convertible foreign currency assets and the required reserve ratio on freely convertible foreign currency assets were increased by 2.0 and 3.0 percentage points respectively.

EB members stressed that today's decision was taken with the aim of easing persistent inflationary pressures and protecting the savings of the population, anchoring inflationary expectations, stimulating saving at the expense of consumption, and easing pressures on the depreciation of the national currency as a result of the widening current account deficit and capital inflows.

At the same time, the increase in reserve requirements in MDL and in freely convertible currency will contribute to higher deposit interest rates and lower new lending, thus reducing pressures from aggregate demand. In addition, the expected effect of today's decision is to encourage intermediation in the domestic currency and to maintain official reserve assets at an adequate level, thus ensuring financial stability.

At the end of the meeting it was reiterated the need for the NBM to monitor with caution the inflationary process, including the associated factors, risks and uncertainties, with a view to adjusting monetary policy instruments at the appropriate time, in order to meet the fundamental objective of ensuring and maintaining price stability. In addition, it was stressed that in the coming period, the NBM will closely monitor the level of liquidity in the banking sector and, if necessary, sterilise excess liquidity permanently.

[39] Turnover of enterprises with the main activity of wholesale trade
[40] Turnover of enterprises with the main activity of retail trade

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

1. **To establish the base rate applied to the main short-term monetary policy operations at the level of 15.50%.**

2. **To establish the interest rates:**
   a) **on overnight loans, at the level of 17.50%;**
   b) **on overnight deposits, at the level of 13.50%.**

3. **To increase the required reserve ratio from the financial means attracted in Moldovan lei and in non-convertible foreign currency, starting with the period of application of the reserve requirement in Moldovan lei from May 16, 2022 to June 15, 2022 from 28.0% to 30.0% of the calculation base.**

4. **To increase the required reserve ratio from the financial means attracted in freely convertible foreign currency assets, starting with the period of application of the reserve requirement in Moldovan lei from May 16, 2022 to June 15, 2022 from 30.0% to 33.0% of the calculation base.**

The Executive Board of the NBM approved for publication the Inflation Report, May 2022.

Voting results

PRO – 5 AGAINST – 0 ABSTAINED – 0

Chairman of the Executive Board **Secretary of the Executive Board**

Octavian ARMAȘU **Sergiu SURDU**

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