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Inflation Report no. 4, 2023

The Governor of the National Bank of Moldova, Octavian Armașu presents the Inflation Report no. 4, 2023

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SUMMARY

The restrictive monetary policy stance configured in a timely manner during 2022 conditioned the recording of a downward trend in the annual inflation rate starting with the end of the previous year, continuing in the first nine months of the current year. In the third quarter of 2023, it was higher than anticipated in the Inflation Report, August 2023. The annual inflation rate declined from 13.2% in June 2023 to 8.6% in September 2023. As a result, similar to the previous period, in the third quarter of 2023, the annual inflation rate remained above the upper limit of the range of ±1.5 percentage points from the 5.0% target, with a return to the range in October this year. Therewith, the average annual inflation rate was 9.7%, 6.1 percentage points lower than in the second quarter of 2023, due to the effect of the base period of the previous year. However, the still high current value of the annual CPI rate reflects the effect of the previous year's pronounced inflationary pressures associated mainly with tariff adjustments and their side effects, the consequences of the war in Ukraine, as well as dry weather conditions in the previous summer, and the effect of the cooler weather in spring this year. At the same time, additional inflationary pressures in the first part of this year were exerted by the adjustment of excise duties. Modest demand is estimated to have had disinflationary pressures in the second part of 2022 and in the first nine months of this year, helping to temper the influence of the above-mentioned factors. At the same time, the dynamics of the exchange rate generated a disinflationary impact on the evolution of inflation during this year.

The downward trend in the annual rate of industrial prices has continued in the recent period, thus setting the stage for a

moderation of their pressure on the prices of some CPI subcomponents in the upcoming period. On top of that, the downward trajectory of the annual CPI rate will continue, mainly in the context of the effect of the high base period, still modest domestic demand, and some recent tariff adjustments. The way tariffs are adjusted, as well as the tense situation in the region and the risks of its escalation, maintain the pronounced uncertainty related to the short- to medium-term inflation forecast. This could also be accentuated by the way of reflecting the compensation to be granted to the population during the cold period of the year.

Recent international events have had a major impact on the outlook of the world economy. The economic recovery has been dampened by rising interest rates, supply controls on some commodities and food products and intensifying geopolitical conflicts. At the last monetary policy meeting, the FRS kept the interest rate range at 5.25-5.5%, anticipating the approaching end of the policy tightening period. Similarly, the ECB, at its last monetary policy meeting, raised interest rates by another 25 basis points to 4.5%, as annual inflation was 4.3% in September 2023, far from the ECB's target of 2.0%. Saudi Arabia and the Russian Federation have announced further cuts in oil supply, which has pushed oil prices to record highs this year. At the same time, the food market was shaken by the decision of India, the world's largest rice exporter, to impose a ban on the export of white rice to stabilise rising domestic prices. On 7 October 2023, following the Hamas attack on Israel, tensions in the Middle East increased, creating additional risks to the energy market. Gas prices in Europe have risen due to fears of supply disruption from the international market, such as pipeline damage in Finland, reduced exports from Israel to Egypt and strikes by gas workers in Australia. The Russian ruble has depreciated over 100 against the USD, prompting the Russian authorities to partially reintroduce capital controls. The Turkish lira also continued to depreciate, which again caused consumer prices to soar.

In the second quarter of 2023, the decline in national economic activity moderated slightly compared to the beginning of this year, with GDP contracting by 2.2% compared to the same period of 2022, after an annual rate of 2.4% recorded in the first quarter. This was higher than anticipated in the Inflation Report, August 2023. The evolution of economic activity was supported by still modest domestic demand signalled by lower consumption and investment, mainly as a result of declining real household incomes and still tight credit conditions, as well as increased uncertainty in the region. This impact was partly mitigated by the favourable outcome in the agricultural sector and the performance in the information and communication sector. At the same time, positive contributions were driven by evolutions in education, health, and social services. The seasonally adjusted series reflects a 0.5% decline in GDP compared to the first quarter of 2023. Overall, in the first half of 2023, GDP decreased by 2.3% compared to 2022. In this context, similar to the previous year, aggregate demand is estimated to have exerted disinflationary pressures on prices. In terms of uses, in the second quarter of 2023, household consumption accentuated its decline since the beginning of this year. At the same time, government final consumption declined. Investment, in the reference period, generated a negative impact on GDP dynamics caused by the gross fixed capital formation subcomponent. Net exports had a positive impact on GDP dynamics in the second quarter of 2023, in the context of a sharp decline in imports. By resource category, the decline in GDP was mainly driven by a contraction in GVA in trade[1], industry and construction. Their impact was partly mitigated by evolutions in agriculture, the information and communication sector, the accommodation and food services sector. At the same time, positive contributions came from evolutions in education, health, and social services. The positive dynamics of the economically active and employed population observed at the beginning of this year continued in the second quarter of 2023, but at a more modest pace.

In the third quarter of 2023, the national public budget revenue increased, being by 12.3% above the level recorded in the same period of 2022. National public budget expenditure increased, being by 24.8% above the level recorded in the third quarter of 2022. At the same time, in the state securities market allocated during the third quarter of 2023, interest rates maintained the downward trend.

In the reporting quarter, excess liquidity amounted to MDL 10.0 billion, decreasing by MDL 4.3 billion from the previous quarter.

The M3 monetary aggregate recorded growth rates similar to the previous quarter, of 20.3% per annum. The main contribution came from the balance of deposits in national currency.

Average interest rates on outstanding loans in national currency decreased compared to the previous quarter by 1.08 percentage points and on deposits – by 2.17 percentage points. Average interest rates on foreign currency loans and deposits remained on an upward trend.

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 meetings on 9 August 2023 and 19 September 2023, decided to maintain the base rate applied to the main monetary policy operations at the level of 6.00% per annum.

At the same time, the Executive Board of the National Bank of Moldova adopted by unanimous vote at the ordinary monetary policy meeting of 7 November 2023 to decrease the base rate applied to the main short-term monetary policy operations by 1.25 percentage points, setting a level of 4.75% per annum. By the same magnitude, the rates on overnight loans and deposits were lowered to 6.75 and 2.75% per annum, respectively. At the same time, the required reserves ratio attracted in MDL and non-convertible currency decreased by 1.0 percentage point up to 33.0% of the calculation base. While the required reserves ratio attracted in freely convertible currency decreased by 2.0 percentage points up to 43.0% of the calculation base.

At the meeting it was also decided to make changes to the remuneration rate of required reserves in US dollars and euro.

This decision was taken in the context of the gradual adjustment of monetary policy to ensure that credit is stimulated and domestic aggregate demand is supported by encouraging consumption and investment, balancing the national economy and anchoring inflation expectations, with the aim of keeping inflation within the target range over the medium term.

At the same time, the decision of the NBM was conditioned by the current forecast, which certainly confirms the previously predicted disinflationary trends.

The current round of forecasting is complicated because of the multitude of uncertainties and risks to the global economy. Increasing geopolitical tensions, with possible implications on energy quotations on the international market, would undermine fragile growth in global demand. At the same time, although monetary authorities have raised interest rates in recent months, inflation in most economies is well above the target levels. Economic growth in the euro area is expected to be weak over the forecast horizon due to the impact of the energy crisis on industrial activity. Therewith, amid rising risk premia and interest rate differentials, the USD will continue to appreciate significantly against other international currencies. In the case of the Russian ruble, the monetary authorities are expected to continue to apply domestic measures on capital outflows in order to stabilise the exchange rate. Food prices on the international market will continue to decrease slightly from last year's highs, after which they will stabilise in 2024.

During the first three consecutive quarters of the forecast, the annual inflation rate will be on a downward trend, then it will increase until the end of 2024 and will decrease insignificantly for the rest of the forecast horizon. In the fourth quarter of 2023, the annual inflation rate will fall below the upper limit of the range and remain within the range until the end of the forecast period. The annual rate of core inflation will decrease in the first half of the forecast horizon, then increase in the second half. The annual pace of food prices will follow a relatively steady trend until the end of next year, after which it will decrease for the rest of the forecast period. The annual rate of regulated prices will decrease significantly in the first half of 2024, reaching negative values, after which it will quickly return towards small positive and stable level. The annual pace of fuel prices will increase slightly in the current quarter and the first half of next year, then decline in the second half of next year and increase insignificantly towards the end of the forecast period.

Negative aggregate demand over the forecast horizon will be driven largely by tight real monetary conditions, negative fiscal momentum and, to a lesser extent, the negative impact of external demand.

Real monetary conditions will be restrictive on aggregate demand until the first half of next year and stimulative for the rest of the forecast horizon.

The current inflation forecast, compared to that in the previous inflation report, has been revised insignificantly upwards to the first quarter of 2024 and downwards for the rest of the comparable period, except for the second quarter of 2024, where it is similar. The annual rate of core inflation has been revised downwards over the whole comparable period. The current forecast of the annual rate of food prices has been raised over the whole comparable period, except for the fourth quarter of 2023, where it is lower, and the third quarter of 2024, where it is similar. The annual pace of regulated prices is revised upwards until the third quarter of 2024 and slightly downwards towards the end of the comparable period. The forecast annual rate of fuel prices has been increased up to the first quarter of 2024 and decreased towards the end of the comparable period.

The evolution of the annual inflation rate for October 2023, published by the NBS on 10 November 2023, validates the current forecast and confirms the NBM's forecast of tempering the inflationary process with its return to the target range. Thus, annual inflation in October this year recorded the level of 6.3%, positioning itself within the range of variation of ±1.5 percentage points from the inflation target of 5.0%.

The moderation of inflation and its forecast within the target range against the backdrop of excess liquidity and further declines in interest rates outlines a prospect for boosting and encouraging a recovery in economic activity.

The National Bank of Moldova, using the monetary policy instruments under its management, adjusts in advance the conditions on the money, credit and foreign exchange markets, assuming the necessary configuration of the monetary policy, thus aiming to maintain inflation close to the target of 5.0% in the medium term and creating all the preconditions for implementing a mix of macroeconomic policies associated with supporting economic growth.

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1. Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles.

See also

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