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Inflation Report no. 4, 2022

The Governor of the National Bank of Moldova, Octavian Armașu presents the Inflation Report No. 4, November 2022

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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.

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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.

See also

Tags
Rata anuală a inflației [2]
core inflation [3]
External environment [4]
inflation forecast [5]
forecast [6]
forecasting inflation [7]
