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Monetary Policy

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June 25, 2015. Press release of the National Bank of Moldova

Within the meeting of June 25, 2015, the Council of Administration of the NBM adopted the following decisions by unanimous vote:

1. to increase the base rate applied on main short-term monetary policy operations by 1.0 percentage points, from the level of 14.5 to 15.5 percent annually;

2. To increase the interest rates:

- on overnight loans by 1.0 percentage points, from 17.5 to 18.5 percent annually;

- on overnight deposits by 1.0 percentage points, from 11.5 to 12.5 percent annually;

3. To increase the required reserves ratio from financial means in MDL and non-convertible currency by 4.0 percentage points and set at the level of 26.0 percent of the base starting with the maintenance period of August 8, 2015 – September 7, 2015 of the required reserves in MDL;

4. To maintain the required reserves ratio from financial means attracted in freely convertible currency at the level of 14.0 percent of the base.

The annual inflation rate in May 2015 was 8.1 percent, increasing by 0.5 percentage points compared to the previous month, mainly due to the contribution from core inflation and food prices of 3.7 and 3.1 percentage points, respectively.

In May 2015, the annual rate of core inflation[1] was 10.9 percent, increasing by 0.1 percentage points compared to April 2015.

The economic growth in the Republic of Moldova recorded pronounced pace at the beginning of this year, so that in the first quarter of 2015, gross domestic product increased by 4.8 percent compared to the same period of last year. Following the elimination of the seasonal factor influence, this indicator recorded in the reporting period an increase of 0.7 percent compared to the end of the previous year. The positive dynamics of GDP was favoured to a pronounced extent by the depreciation of the national currency, which, on the one hand, had a significant simulative effect on the increase of 6.3 percent in exports of domestic products and on the other hand, helped to mitigate the increase in imports to the level of 1.1 percent. At the same time, investments have generated a significant impact on GDP growth, the gross fixed capital formation being by 7.8 percent higher than at the beginning of the previous year. As compared with the second half of 2014, household consumption recorded a more modest evolution, increasing by only 0.7 percent. By categories of resources, GDP growth was mostly supported by developments in the financial, industrial and trade sector. The contribution of agriculture, construction and transport to GDP growth was a more modest one, although they recorded in the first quarter of 2015 a positive development.

According to the information published by the NBS, in January-April 2015, exports and imports decreased

by 16.7 and 21.4 percent, respectively, while the industrial production increased by 6.5 percent than in January-April 2014.

In January-May 2015, the transport of goods recorded a decrease of 0.6 percent compared to the same period of last year. In April 2015, the annual average real wage growth was 4.9 percent, by 1.7 percentage points lower than in the first quarter of 2015. The money transfers to individuals through the banks of the Republic of Moldova decreased by 28.7 percent in January – May 2015 and by 33.6 percent in May compared to the same periods of 2014.

At the end of May 2015, the balance of loans granted to the economy decreased by 5.2 percent compared to the end of May 2014, while the balance of deposits increased by 4.1 percent.

In May 2015, the average interest rates on loans and deposits in national currency recorded upward trend. Thus, the average interest rate on loans portfolio in national currency was 11.99 percent, increasing by 0.22 percentage points compared to the previous month. The average interest rate for deposits in MDL recorded the level of 10.14 percent, increasing by 0.53 percentage points.

The monetary policy continues to be affected by the complexity of risk balance, with a gradual accentuation of the inflationary risks. The weak economic activity in the euro area countries and the recession in the Russian Federation – the major trading partners of the Republic of Moldova, maintain the risks of lower household and domestic exporters' income on short-term through the external trade channel and remittances, which may further influence the inflation dynamics. The intensification of geopolitical tension in the region may generate additional inflationary pressures.

The depreciation of the national currency from the beginning of this year accentuates the inflationary pressures in the next periods, which determine CPI to leave temporarily the upper limit of the range of variation of ± 1.5 percentage points from the 5.0 percent target, through the prices of imported goods and regulated services tariffs, and subsequently through the second round effects. It is anticipated that inflation will accelerate in the coming quarters, including due to the low base of the previous year.

In this context, the Council of Administration of the NBM decided by unanimous vote within its meeting of June 25, 2015 to increase the monetary policy interest rate by 1.0 percentage points, from the level of 14.5 to 15.5 percent annually.

At the same time, in order to sterilize the liquidity excess recorded during the last months and to improve the transmission mechanism of the monetary policy decisions, the Council of Administration of the NBM decided to increase the required reserves ratio from financial means attracted in MDL and non-convertible currency for the maintenance period of August 8, 2015 – September 7, 2015 of the required reserves in MDL – by 4.0 percentage points up to the value of 26.0 percent of the base. At the same time, the required reserves ratio from financial means attracted in freely convertible currency maintained the current level of 14.0 percent of the base.

It should be mentioned that, on June 22, 2015, the banks liquidity excess was about MDL 1845.0 million, including the liquidity excess in placements, such as: NBM Certificates – MDL 1176.0 million, overnight deposits with NBM – MDL 149.0 million and the liquidity excess in LORO accounts – MDL 520.0 million. Following the increase in required reserve ratio by 4.0 percentage points, the liquidity excess will decrease by about MDL 751.0 million. It is anticipated that the banks liquidity excess will continue to increase in the coming months, maintaining the banks' lending capacity at a comfortable level.

The decisions of the Council of Administration of the NBM of June 25, 2015 aim at anchoring inflation

expectations in the context of reducing and maintaining the inflation close to the target of 5.0 percent in the medium-term, with a possible deviation of ± 1.5 percentage points.

In order to support the proper functioning of the interbank money market, the NBM will continue to manage firmly the liquidity excess through sterilization operations, according to the announced schedule.

National Bank will continue to offer banks liquidity, according to the schedule announced for 2015, through term REPO operations of 14 days, at a fixed rate equal to the base rate of the National Bank plus a margin of 0.25 percentage points.

NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.

The next meeting of the Council of Administration of the NBM on monetary policy will take place on July 30, 2015, according to the announced schedule.

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[1] *Core inflation is calculated by the NBS, excluding prices that are outside the influence of monetary policy promoted by the NBM, such as food and beverages, fuel, products and services with regulated prices. Data prepared and published since January 2012 have been calculated by the NBS, based on the amendment of Annex no.2 of "Methodology for the calculation of core inflation index", approved by joint order of the National Bank of Moldova and National Bureau of Statistics N8-07-01203/6 of 19 January 19 2012 (the amendment refers to the inclusion of prices for remote communication services and medicines in regulated prices).*

Evolution of theNBM interest rates [1]

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