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Monetary Policy

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Press release of the National Bank of Moldova, 4 July 2016

Within the meeting of the 4 July 2016, the Executive Board of the National Bank of Moldova adopted the following decision by unanimous vote:

1. to decrease the base rate applied on main short-term monetary policy operations by 3.0 percentage points from 13.0 to 10.0 percent annually;

2. to decrease the interest rates:
- on overnight loans by 3.0 percentage points from 16.0 to 13.0 percent annually;
- on overnight deposits by 3.0 percentage points from 10.0 to 7.0 percent annually;

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

4. to maintain the required reserves ratio from financial means attracted in MDL and non-convertible currency at the current level 35.0 percent of the base;

The analysis of recent statistics shows the appearance the downward trend of the annual inflation rate for the fifth consecutive month, although it is still above the upper limit of the range of ± 1.5 percentage points from the 5.0 percent target.

The annual rate of inflation was 7.9 percent in May 2016, decreasing by 0.4 percentage points compared to the previous month.

The deceleration of the annual inflation rate in May is in line with the latest forecast of the NBM (published in May 2016) and validates the correctness of monetary policy decisions taken in 2015.

The annual rate of core inflation[1] was 9.8 percent in May 2016, increasing by 0.1 percentage points compared to the previous month.

In the first quarter of 2016, economic activity recorded an increase of 0.8 percent compared to the same period of 2015. In terms of uses, this dynamics is driven by increased household final consumption and gross capital formation, generating a contribution of 2.0 percentage points and 3.0 percentage points respectively. By resources, the positive evolution of GDP was driven mainly by the increase in gross value added in all sectors, except the "constructions" and "other services". Thus, the increase in production volume was recorded in "agriculture" by 5.1 percent, "trade" by 3.5 percent, "transport and communications" by 2.8 percent and in "industry" by 1.1 percent.

The dynamics of macroeconomic indicators in the first month of the second quarter of 2016 shows positive signals relating to the revival of the economic activity during the reporting period. In April 2016, exports increased by 18.0 percent and imports by 21.4 percent compared to the same period of the previous year. At the same time, industrial output recorded an increase of 10.0 percent. The turnover for the retail trade increased by 0.4 percent and the volume of trade in services by 2.1 percent in April 2016 compared to same

period of the previous year.

In terms of consumer demand, the annual average real wage growth in the economy in April 2016 was 0.2 percent, by 1.5 percentage points more than in March 2016. Money transfers to individuals through the banks of the Republic of Moldova fell by 7.5 percent in January-May and by 10.8 percent in May in nominal terms, compared with the same period of 2015.

Lending and saving processes in May 2016 have evolved differently. The volume of new loans during the reporting period decreased by 14.6 percent and new attracted deposits increased by 55.5 percent compared to the same period last year. The total balance of loans at the end of May decreased by 10.3 percent, while the total balance of deposits increased by 0.7 percent compared to the same period of the previous year.

The average rate of new loans granted in national currency decreased by 0.44 percentage points compared to April 2016, accounting for 15.23 percent. The rate on new deposits attracted in MDL decreased by 1.37 percentage points, up to the level of 12.48 percent in May 2016.

The monetary policy continues to be affected by the complexity of risk balance and uncertainties associated with the development of internal and external environment. External risks associated disinflationary pressures are marked by weak economic activity in the euro area countries and the ongoing recession in the Russian Federation - the main external trade partners of the Republic of Moldova. The external risks are propagated through the channel of remittances in favour of population and external trade, leading to lower foreign currency income of population and domestic exporters in the short-term with implications for the future dynamics of inflation. Potential risks to inflation stemming from major fluctuations in financial markets that might affect the oil market. The main internal risks are associated with the delay in tariff adjustment. At the same time, the existing weather conditions favour an increase compared to the previous year, agricultural production, which will adversely affect the growth of food prices over 2-3 consecutive quarters and will cause further decline in consumer inflation. **Thus, analysing the balance of risks, there is an increased prevalence of disinflationary risks and it is anticipated a process of rapid reduction in the annual rate of price growth, also due to the high base of comparison in 2015.**

Assessing the short and medium term perspectives of inflation, within the meeting held on 04 July 2016, the members of the Executive Board of the NBM decided by unanimous vote to decrease the policy rate by 3.0 percentage points from 13.0 to 10.0 percent annually.

This decision is aimed at anchoring inflation expectations in the context of restoring and maintaining the inflation rate close to the target of 5.0 percent over the medium-term, with a possible deviation of ± 1.5 percentage points. Gradual calibration of monetary policy stance, backed by expectations about the reduction of inflation, seeks to ensure real monetary conditions appropriate for stimulating lending and savings and boosting domestic demand, combined with adapting further domestic economic environment to volatilities and uncertainties of the external environment.

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 2016, through REPO operations with the term of 14 days, at a fixed rate equal to the base rate of the National Bank plus a margin of 0.25 points percentage.

NBM will further monitor and anticipate the domestic and international economic environment developments, including the potential impact of the vote for Brexit, 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 Executive Board of the NBM on monetary policy will take place on 28 July 2016, 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 from January 2012 are calculated by the NBS according to the modification 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 2012 (the modification refers to the inclusion of prices for remote communication services and medicines in regulated prices).

Evolution of the NBM interest rates [1]

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