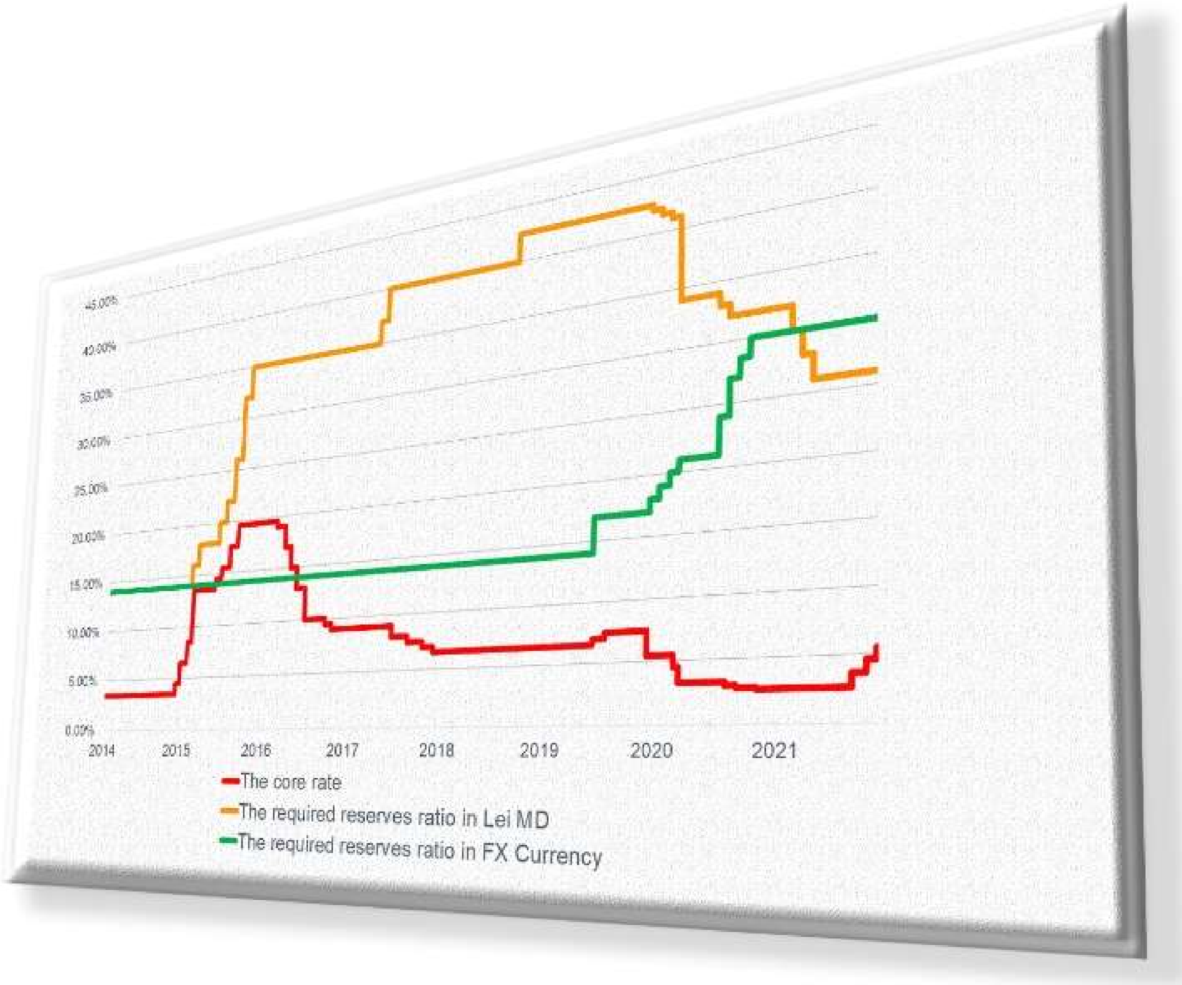
National Bank of Moldova

INFLATION REPORT



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Note

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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.

Inflation Report, February 2023 is a translation of *Raport asupra inflației, februarie 2023* in Romanian. In case of discrepancies, the version of the Report in the original language prevails.

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, February 2023 was discussed and approved at the meeting of the NBM Executive Board on February 7, 2023.

Contents

List of acronyms

ANRE	National Agency for Energy Regulation
CHIBOR	The reference rate calculated based on quotations of contributor banks to place funds in MDL with other banks
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CPS	Cuciurgan power station
ECB	European Central Bank
EU	European Union
EUR	Euro
FAO	Food and Agriculture Organization of the United Nations
FCC	Freely convertible currency
FRS	Federal Reserve System
GDP	Gross Domestic Product
GVA	Gross Value Added
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	Organization of the Petroleum Exporting Countries
OPEC+	The alliance between the Organization of the Petroleum Exporting Countries (OPEC) and a group of non-OPEC oil-producing countries
REER	Real effective exchange rate of the national currency
RUB	Russian ruble
SB	State budget
SS	State Securities
SSIB	State social insurance budget
STA	Single treasury account
USA	United States of America
USD	US Dollar

Summary

The upward trend in the annual inflation rate over the past two years reversed at the end of 2022. At the same time, in the fourth quarter of 2022, the annual inflation rate was marginally lower than anticipated in the Inflation Report, November 2022, declining from 34.6% in October 2022 to 30.2% in December 2022. As a result, similar to the previous period, in the fourth quarter of 2022, the annual inflation rate remained above the upper bound of the range of 5.0% ±1.5 percentage points. At the same time, the average annual inflation rate was 32.1% in the fourth quarter of 2022, 1.8 percentage points lower than in the third quarter of 2022 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 impact of previous increases of international and regional market prices of food and energy resources, which led to the increase of their prices on the internal market and the adjustment of tariffs for network gas, heat, and electricity. At the same time, the adjustment of tariffs, the increase of fuel prices, but also the upward dynamics of wages supported the increase of costs for economic operators, which was gradually reflected in prices. The impact of the above factors was amplified in the previous year by the escalation of the situation in Ukraine, which put additional pressure on food, fuel, and some core inflation subcomponents. Additional pressure on food prices was also exerted by the dry weather conditions in the summer of last year. According to estimates, the demand pressure observed in the second part of 2021 and the first part of 2022 weakened due to monetary policy measures and attenuated the influence of the above-mentioned factors in the second part of 2022. The exchange rate dynamics had an insignificant impact on inflation developments at the end of the previous year.

The last two months of 2022 recorded a reversal of the upward trend in the annual industrial price rate, outlining premises for a partial moderation of the pressure for price increases in some CPI subcomponents in the coming period. The tense situation in the region, the risks of its escalation, the reflection of cold-weather compensation granted to the population for tariff increases, the increased volatility of energy prices and the tariff adjustment mechanism preserve a high uncertainty around the short- and medium-term inflation forecast.

The year 2022 ended on a very negative note, with the IMF announcing at the turn of the year that a third of the world's economies are entering recession. Rising interest rates in most economies, intended to reduce pro-inflationary pressures, will weaken global consumer demand, and dampen the outlook for economic growth. The increase in COVID-19 cases in China and the delay in easing restrictions have fuelled investors' perception of low consumer demand and raw material stocks at very high levels in China. At the same time, high temperatures in Europe resulted in lower natural gas prices, as low gas consumption allows Europe's gas reserves to maintain satisfactory levels. The oil quotations fell after 5 December 2022, when the EU embargo on Russian oil came into force, but the uncertainties remain rather significant, causing oil prices to remain high. The gradual decline in commodity and food prices on the international market in correlation with the high base over the last 18 months have reduced overall pro-inflationary pressures, even if levels are well above historical averages. The regional economy is still affected by the war in Ukraine, while the perspectives are overshadowed by uncertainties and risks.

After stagnating in the first half of 2022, economic activity declined significantly in the third quarter of 2022. From July to September 2022, GDP contracted by 10.3% compared to the same period of 2021, which is below the dynamics anticipated in the Inflation Report, November 2022, due to considerably weaker internal demand caused mainly by falling real household incomes, tighter credit conditions and increased uncertainty in the region. At the same time, a negative impact was also caused by less favourable agrometeorological conditions, which resulted in a more modest agricultural output compared to the previous year. The seasonally adjusted series reflects an 8.4% decline in GDP compared to the second quarter of 2022. Overall, GDP decreased by 4.1% between January and September 2022 compared to the same period of the previous year. In this context, aggregate demand pressures on prices are estimated to have exerted a disinflationary impact during that period.

In terms of uses, both household consumption and gross fixed capital formation declined in the third quarter of 2022, generating, along with import dynamics, a negative impact on GDP development.

This was partly mitigated by export dynamics and the changes in inventories component. Export dynamics were mostly supported by re-export developments, while exports of domestic goods had a smaller impact. The increase of imports was mainly influenced by the "mineral products" component. By resource category, the decrease in GDP in the third quarter of 2022 was mainly determined by developments in most sectors of the economy. However, the most pronounced negative contributions were generated by the dynamics of agriculture, trade, industry, and real estate transactions. After positive developments in the first half of 2022, both the economically active and employed population experienced a noticeable slowdown in the third quarter of 2022. The unemployment rate increased marginally, and the underemployment rate showed a slightly decreasing dynamic compared to the second quarter of 2022. Several operational indicators available from October and November 2022 showed more modest dynamics compared to the first half of 2022, thus outlining preconditions for contracting economic activity in the fourth quarter of 2022.

In the fourth quarter of 2022, the national public budget revenue increased by 11.3% above the level recorded in the corresponding period of 2021. National public budget expenditure increased, being 29.0% above the level of the fourth quarter of 2021. At the same time, on the state securities market interest rates remained on the upward trend during the fourth quarter of 2022.

In the fourth quarter of 2022, the average excess liquidity amounted to MDL 5.3 billion, increasing from the previous quarter by MDL 1.7 billion.

Monetary aggregates in the fourth quarter of 2022 recorded stronger annual growth rates than in the previous quarter. At the same time, the main contribution to this development was largely determined by the change of deposits in national currency.

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 over the short and medium term, the Executive Board of the National Bank of Moldova, at the meeting held on 8 November 2022, decided to maintain the base rate applied to the main monetary policy operations at the level of 21.50% per annum. Thereafter, at the meeting held on 5 December 2022, it was decided to lower the base rate applied to the main monetary policy operations by 1.50 percentage points up to the level of 20.00% annually. At the same time, the Executive Board of the National Bank of Moldova decided to lower the reserve requirement ratio for two consecutive application periods. Thus, the reserve requirement ratio from the financial means attracted in MDL and in non-convertible foreign currency was reduced from 40.0% to 34.0% of the calculation base (by 3.0 percentage points for the application periods 16.12.2022 – 15.01.2023 and 16.01.2023 – 15.02.2023 respectively).

Average interest rates on the balance of loans in national currency increased compared to the previous quarter by 0.83 percentage points and on deposits – by 2.66 percentage points. Average interest rates on loans and deposits in foreign currency recorded minor increases.

In the current round of forecasting, external assumptions point to weak external demand, lower international price growth rates and continued risks and uncertainties in the region. As the IMF has warned, by 2023, a third of the world’s economies will be in recession. Rising interest rates and moderating global demand will reduce international price growth rates, but they will still be well above pre-pandemic averages. In the region, the economic situation will continue to be affected by the war in Ukraine and the energy crisis in Europe. Although abnormally high temperatures for the cold period of the year in Europe resulted in lower natural gas prices, the energy crisis in Europe is far from over and will have a significant impact on economic development in the coming years. Based on the trajectory of interest rate forecasts in the US and the Eurozone, we can expect an increase in EUR/USD parity, i.e., a depreciation of the US dollar and an appreciation of the European single currency. At the same time, world market prices for agri-food products are expected to decrease compared to their 2022 peaks.

The annual inflation rate will follow rapid downward trend over the current year and remain relatively stable thereafter until the end of the forecast period[1]. Inflation will return to the target range in the second quarter of 2024 and will preserve until the end of the forecast horizon. In terms of monthly inflation, there is a high probability that it will fall within the uncertainty range at the end of December 2023.

[1] Fourth quarter of 2024.

The annual rate of core inflation will decline rapidly over the current year, then increase slightly by the end of the forecast horizon[2]. The annual rate of *food prices* will follow a downward trend until the second quarter of 2024, thereafter, increasing slightly by 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 three consecutive quarters of the forecast, thereafter, increasing slightly to the end of the forecast horizon.

Aggregate demand will be negative this year and in the first half of next year due to deteriorating external demand and household consumption financing, as well as tightening monetary conditions. At the same time, the neutral fiscal impulse will maintain a negative aggregate demand in the first part of the forecast, followed by a positive impact in the second half of next year.

Real monetary conditions for aggregate demand will be insignificantly stimulative in the first quarter of 2023 and restrictive for the rest of the forecast period.

The current *inflation* forecast, compared to the previous inflation report[3], was revised downwards over the entire comparable period[4], except for the last quarter, where it appears slightly higher. The current forecast for the annual rate of increase in *core inflation* was revised downwards over the entire comparable period. The annual rate of *food prices* was insignificantly revised over the entire comparable period. The current forecast for the annual rate of *regulated prices* is revised mainly downwards over the entire comparable period. The annual *fuel price* rate forecast was lowered for the current year and increased for the rest of the comparable period.

[2] First quarter of 2023 – fourth quarter of 2024.

[3] Inflation Report, November 2022

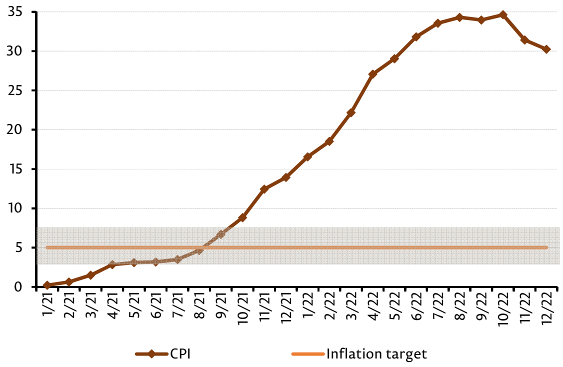
[4] First quarter of 2023 – third quarter of 2024.

Chapter 1

Inflation evolution

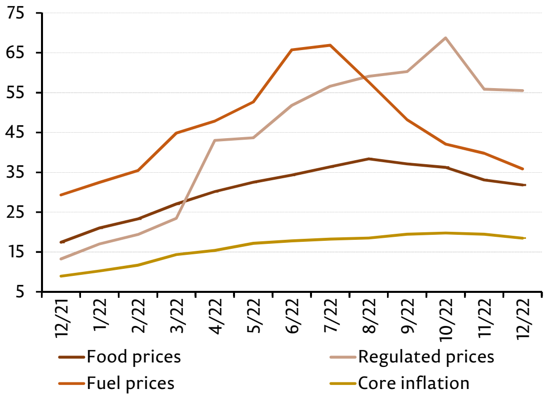
1.1 Consumer price index

Chart 1.1: Annual CPI rate (%)



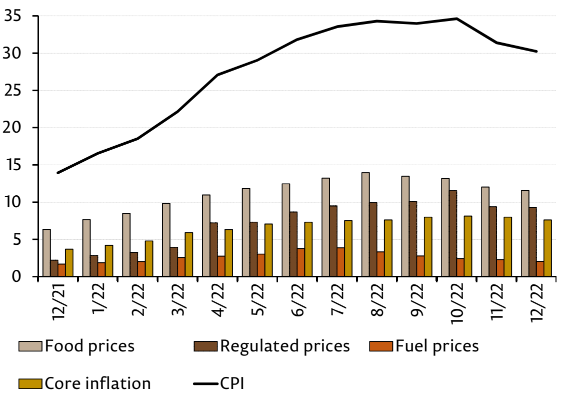
Source: NBS, NBM

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



Source: NBS

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



Source: NBS, NBM calculations

The upward trend in the annual inflation rate over the past two years reversed at the end of the year 2022. At the same time, in the fourth quarter of 2022 the annual inflation rate was marginally lower than anticipated in the Inflation Report, November 2022. Thus, the annual inflation rate decreased from 34.6% in October 2022 to 30.2% in December 2022. Consequently, like the previous period, in the fourth quarter of 2022, the annual inflation rate remained above the upper bound of the 5.0% range ±1.5 percentage points. At the same time, the average annual inflation rate was 32.1% in the fourth quarter of 2022, 1.8 percentage points lower than in the previous quarter.

This dynamic was supported by the effect of the previous year's base period. However, the present value of the annual rate of CPI is still high, reflecting the impact of past increases in international and regional market prices for food and energy resources, which led to increases in their prices on the domestic market and adjustments in tariffs for piped gas, heating and electricity. At the same time, the adjustment of tariffs, the increase in fuel prices, but also the upward dynamics of wages supported the increase in costs for economic operators which was gradually reflected in prices. The impact of the above factors was significantly amplified in the previous year by the escalation of the situation in Ukraine which generated additional pressures on food, fuel, and some core inflation subcomponents. Additional pressures on food prices were also exerted by the dry weather conditions of the previous summer. According to estimates, the demand pressures observed in the second part of the year 2021 and the first part of the year 2022 are expected to have lost their intensity due to monetary policy measures and to have contributed to moderating the influence of the above-mentioned factors in the second part of the year 2022. Exchange rate dynamics had an insignificant impact on inflation developments at the end of the previous year.

In the fourth quarter of 2022, the annual inflation rate was marginally lower than anticipated in the Inflation Report, November 2022. There were both positive and negative deviations in the inflation subcomponent forecast, but these were partly offsetting. These were mainly influenced by regional uncertainty that determined the prices of energy resources, as well as local uncertainty about compensation for the cold season. The tense situation in the region and the risks of its escalation, the way in which compensation to the population for tariff increases shall be reflected, the increased volatility of energy prices and the way in which tariffs shall be adjusted maintain uncertainty about the short and medium-term inflation outlook.

Core inflation

After the upward trend in previous periods, in the fourth quarter of 2022, the annual core inflation rate started a downward trend, recording a value of 18.5% in December or 1.5 percentage points lower than in October 2022.

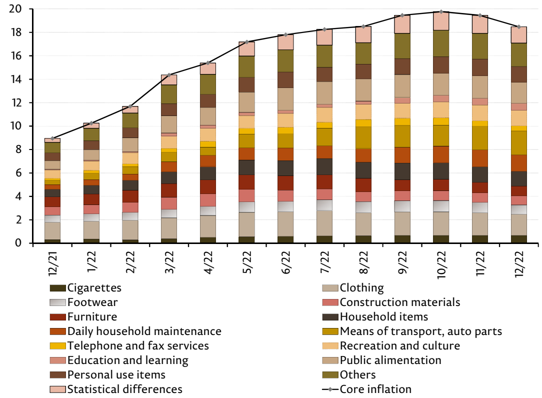
However, during the fourth quarter of 2022, inflationary pressures on the core inflation subcomponents continued to be driven mainly by second-round effects associated with tariff adjustments, rising commodity prices, and the consequences of the war in Ukraine.

Inflationary pressures related to aggregate demand, observed in 2021, are estimated to have lost their intensity. In this respect, although the wage fund in the third quarter of 2022 grew at around 15.5% and is expected to have a strong momentum in the fourth quarter of 2022, the effect of this development was significantly eroded by rising inflation. A similar situation is observed for two other important sources of consumption financing: remittances and social benefits, whose positive dynamics was insufficient to offset price increases and generate additional demand for goods and services. At the same time, new loans to individuals are showing negative dynamics in fourth quarter of 2022.

In December 2022, within the annual dynamics of core inflation (18.5%), more pronounced upward developments were recorded in the sub-components "means of transport, auto parts" (27.3%), "public alimentation" (25.9%), "construction materials" (25.8%), "education and learning" (23.4%), "furniture" (19.0%) and "daily household maintenance" (30.1%).

Within the structure, the most pronounced contributions to the annual rate of core inflation in the fourth quarter of 2022 continued to be driven mainly by price developments in the sub-components "means of transport", "public alimentation", "clothing", "personal use items", "daily household maintenance" and "recreation and culture" (Chart 1.4). Transport means exerted the highest pressures in the annual core inflation rate, a component directly linked to the influence of exchange rates, which was also affected by the increase in international and regional prices of vehicles and their components in the post-pandemic period. Prices of clothing continued to make large contributions, further supported by regional dynamics in textile prices, higher transport, and labour costs. In the public alimentation segment, there were significant increases in the context of rising energy prices, food prices and wage increases. These factors also put pressure on prices of international tourism packages as well as domestic tourism packages, which led to significant price increases in the recreation and culture segment. Although at a more modest pace, construction materials continued their positive momentum, the increase in prices on international and regional markets caused imported goods to increase in price. 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 furniture manufacturing continues to be affected by price dynamics for basic raw materials. Global trends in the timber market are also

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



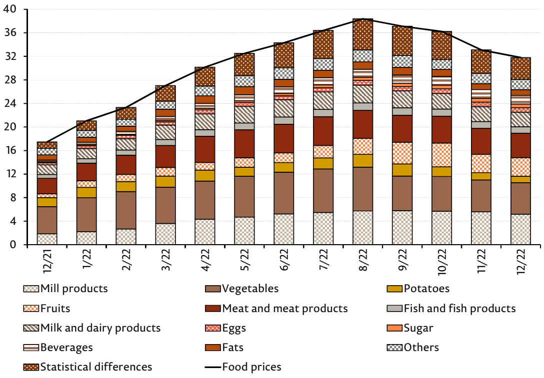
Source: NBS, NBM calculations

reflected on the market of the Republic of Moldova, which is largely dependent on imports from Ukraine, Belarus, and Russia.

The future trend in the prices of some important categories of goods included in the calculation of core inflation will be determined by the significant price adjustments made recently to gas and electricity. At the same time, their effect will be partly offset by modest aggregate demand; and their dynamics will, however, be further affected by uncertainty over the war in Ukraine.

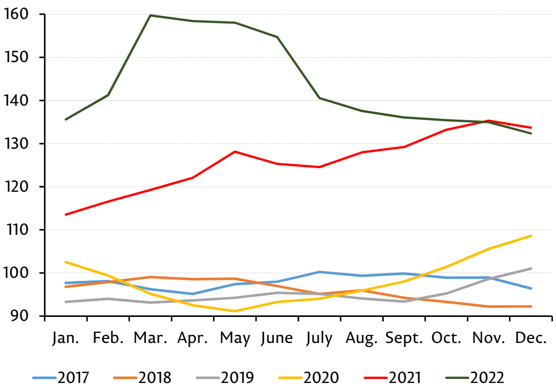
Food prices

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



Source: NBS, NBM calculations

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



Source: FAO, NBM calculations

In the fourth quarter of 2022, similar to previous periods, the groups "vegetables", "mill products", "meat and meat products", "fresh fruit", "milk and dairy products" and "beverages" contributed most to the annual rate of food prices (Chart 1.5). It should be noted that the significant contribution of these product categories to the annual food price rate generally reflects inflationary pressures accumulated in previous periods. Thus, the hydrological drought in the summer of 2022, the increase in transport costs, the increase in production costs (increase in gas and electricity prices), the depreciation of the MDL/USD exchange rate, the inflationary pressures exerted by food prices on the international market, overlapping with the pro-inflationary effects associated with the war in Ukraine, have created preconditions for a significant increase in food prices in 2022.

In the fourth quarter of 2022, the annual food price rate averaged 33.7%, 3.6 percentage points lower than in the previous quarter. At the same time, moderate demand in the second half of 2022 and actual food price data for the fourth quarter of 2022 reconfirm the assumption of moderating inflationary pressures, thus giving a reasonable expectation that food prices should ease in the coming periods. **As a result, against the background of the high base period, but also the absence of short-term inflationary pressures, the annual rate of food prices will decline rapidly.**

It should be noted that on the international market, the trend of moderation in the annual rate of food prices continues. Thus, in fourth quarter of 2022, the annual rate was 0.1% or 8.4 percentage points lower than in third quarter of 2022.

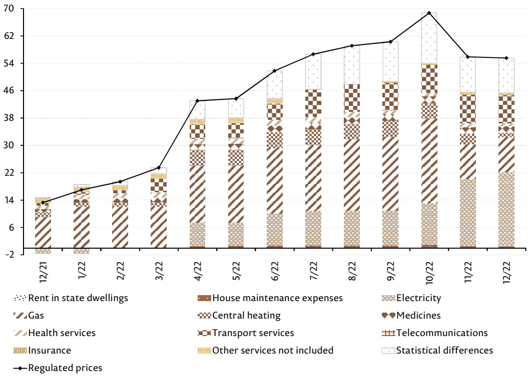
In the fourth quarter of 2022, the contribution of food prices to the annual inflation rate decreased by 1.3 percentage points and amounted to 12.3 percentage points.

Regulated prices

The upward path of the annual rate of regulated prices observed during 2022 peaked in October 2022, then followed a downward trend until the end of the year. This dynamic was driven, on the one hand, by the adjustment of some tariffs, but on the other hand, by the implementation of the compensation package for energy resources by the state which temporarily mitigated the effect of tariff increases.

With the beginning of the cold season, the state programme on compensation for energy resources in the period from November 2022 to March 2023 came into force. As a result, the contributions to the annual rate of regulated prices of some subcomponents affected by the recent growth in tariffs increased significantly (electricity) while others decreased (natural gas, heating, hot water) (Chart 1.7). Thus, the annual rate of regulated prices was 55.5% in December 2022, 4.8 percentage points lower than in September 2022. However, the average annual rate of regulated prices in the fourth quarter of 2022 amounted to 60.0%, 1.4 percentage points higher than in the third quarter of 2022.

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



Source: NBS, NBM calculation

In this respect, according to the decision of 23 September 2022, ANRE increased the natural gas tariff up to MDL 29.27/cubic metre (with VAT) from MDL 22.99/cubic metre (with VAT)[5], which resulted in a 27.3% increase in this subcomponent of the CPI in the month of October. Given the compensation provided by the government, natural gas prices in the CPI in November decreased by about 49.0%. At the same time, the tariff for the thermal agent delivered to consumers by S.A. "Termoelectrica" was set at MDL 2,854/Gcal (excluding VAT), compared to the previous tariff of MDL 2,169 /Gcal (excluding VAT), the amount of MDL 3,766/Gcal (excluding VAT) the tariff for S.A. "Comgaz-Plus" was adjusted from the previous tariff of MDL 2,718 /Gcal (excluding VAT), and that delivered to consumers by S.A. "CET-Nord" in the amount of MDL 3,052/Gcal (excluding VAT), compared to the previous tariff of MDL 2,115/Gcal (excluding VAT), with effect from 1 October 2022[6]. The respective adjustments for both heating and hot water were reported by the NBS during the fourth quarter of 2022, also considering the effect of compensation for these services. During the quarter under review, several adjustments were made to the electricity tariff. It increased from MDL 2.64/kWh (Premier Energy) and MDL 2.86/kWh (FFE Nord)[7]up to MDL 5.91/kWh and MDL 5.60/kWh, respectively[8]. On 8 December, ANRE lowered electricity tariffs. The main reason behind the decision was the new electricity procurement price of USD 73.5/MWh, following the signing on 3 December of the contract between SA Energocom and CPS. Thus, as of December 8, consumers in central and southern parts of the Republic of Moldova pay MDL 4.62/kWh, and in the north – MDL 4.65/kWh[9]. These adjustments were reflected by the NBS during the fourth quarter of 2022, also considering the effect of compensation for this service.

Towards the end of the year, in December 2022, the ceiling rates that could be applied by road transport operators decreased[10], which led to a drop in the prices of these services in the CPI by about 3.0%. At the same time, prices for air transport services increased up to 16.4% in December 2022. Over the reference

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

[6]Monitorul oficial No. 298-304 (8342-8348) of 30.09.2022, p. 67-69

[7]Monitorul oficial, No. 170-176 (8214-8220) of 10.06.2022, p. 99-100
Monitorul oficial No. 318-325 (8362-8369) of 14.10.2022, p. 116-117
Monitorul oficial No. 343-348 (8387-8392) of 04.11.2022, p. 114-115

[8]Monitorul oficial No. 385-391 (8429-8435) of 02.12.2022, p. 81-82

[9]https://anre.md/anre-a-aprobat-preturi-mai-mici-pentru-energia-electrica-furnizata-consumatorilor-3-589

[10]https://anta.gov.md/content/tarife-plafon

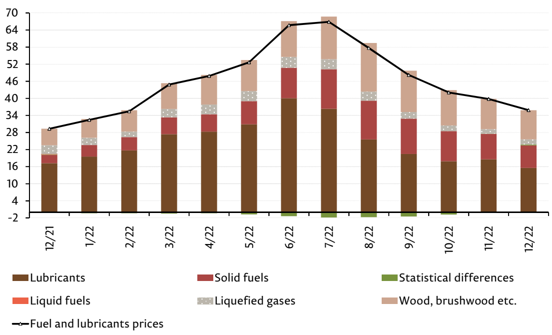
period, prices of pharmaceuticals continued to rise. In the last two months of 2022, prices for ritual services increased by 15.6% and 2.1%, respectively.

Regarding the assumptions for the next period, given that since November 2022 the NBS reflects the compensated tariffs for natural gas, central heating, hot water and electricity in April 2023, their full reflection with the end of the 2022-2023 heating season will create the conditions for a pronounced increase in regulated prices.

At the end of December, ANRE additionally adjusted electricity tariffs, decreasing them up to MDL 3.42/kWh for consumers connected to "Premier Energy" S.R.L. and MDL 3.84/kWh for those connected to "Furnizarea Energiei Electrice Nord" S.A., thus the CPI expects a decrease in electricity prices over the coming period.

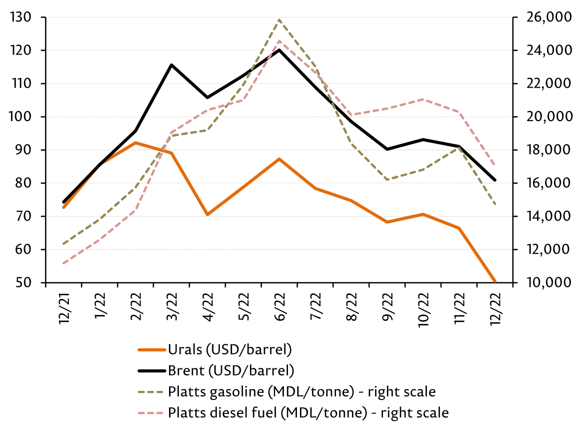
It should be noted that on 11 January 2023, ANRE approved the new water and sewage tariffs in Chisinau. According to the decision for the drinking water supply service, a tariff of MDL 11.12/cubic meter – for domestic consumers and MDL 13.29/cubic meter – for non-households was approved. New tariffs were also approved for sewerage services, at MDL 4.18/cubic metre – for domestic consumers and MDL 11.17 – for non-household consumers[11]. As of 1 January 2023, the citizens of municipality of Balti shall pay MDL 5 for a trolleybus ride in the context of increased prices for electricity[12]. At the same time, since the beginning of this year the price of the health insurance policy has increased from MDL 4,056 to MDL 12,636[13].

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



Source: NBS, NBM calculations

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



Source: ANRE, NBM calculation

Fuel and lubricants prices

The annual rate of fuel and lubricants prices declined in the fourth quarter of 2022 as oil prices decreased in the period October-December 2022. Thus, the annual rate of fuel and lubricants prices decreased from 48.2% in September 2022 to 35.9% in December 2022. The average annual rate of fuel and lubricants prices in the fourth quarter of 2022 was 39.2%, 18.4 percentage points lower than in the third quarter of 2022 (Chart 1.8). This development was mainly driven by lower lubricants prices, as a result of lower gasoline and diesel prices at PECO stations during the quarter. These decreases were determined by average Platts gasoline and diesel prices, which averaged around MDL 16,563.3 and MDL 19,461.8 per tonne in the reference quarter, decreasing by 13.8% and 7.7% respectively compared to the third quarter of 2022 (Chart 1.9). The decrease in the above-mentioned quotations were driven by the downward trend in the price of oil (Brent brand, decreasing by 11.0% compared to the previous quarter).

During the fourth quarter of 2022, significant but decreasing positive contributions to the annual rate of fuel and lubricants

[11] Monitorul oficial No. 3-4 (8509-8510), p. 91

[12] https://nordnews.md/votat-baltenii-vor-achita-5-lei-pentru-o-calatorie-cu-troleibuzul/

[13] https://gov.md/sites/default/files/document/attachments/subiect-28-nu-943-ms-2022.pdf

prices continued to be exerted by the prices of "solid fuels" and "wood, brushwood etc.", supported by the demand for these subcomponents, in the context of the increase in natural gas prices in the Republic of Moldova, but also of the increase in coal prices on the international market in 2022. Prices of "liquefied gases" showed a positive but minor impact.

1.2 Inflation developments and assessment of the short-term forecast in the Inflation Report, November 2022

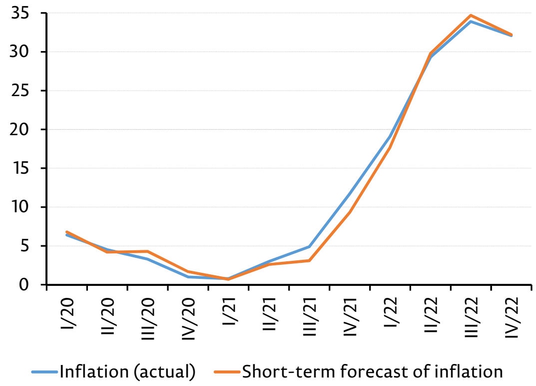
In the October 2022 forecast round, the annual CPI rate was expected to increase in October, followed by a moderation to an average of 32.2% in the fourth quarter of 2022[14].

Inflation data for the fourth quarter of 2022 outline a marginally lower trend than anticipated in the previous forecast (Inflation Report, November 2022).

In the fourth quarter of 2022, the annual inflation rate amounted to 32.1% and was only 0.1 percentage points lower than expected (Table 1.1). There were both positive and negative deviations in the inflation subcomponent forecast, but these were partly offsetting. In this respect, the annual rate of core inflation and fuel prices developed below expectations, with this deviation being mitigated by a better-than-expected dynamics of the annual rate of regulated prices and food prices. Thus, the annual rate of regulated prices was 2.3 percentage points higher than expected in the Inflation Report, November 2022, mainly because of a larger-than-expected adjustment in the November electricity tariff. At the same time, the annual rate of food prices was 0.5 percentage point higher than expected in the context of more volatile price developments, thus the possibility of more modest price dynamics early this year.

At the same time, negative deviations were recorded for the forecast of core inflation and fuel prices. Thus, the annual rate of core inflation in the fourth quarter of 2022 amounted to 19.2%, 0.9 percentage points lower than anticipated in the Inflation Report, November 2022, pointing to less pronounced pressures from tariff adjustments and food price increases on some subcomponents of core inflation. A similar situation prevails for the forecast of fuel prices, with the annual rate of fuel prices 4.0 percentage points lower than expected in the context of a lower trajectory of oil prices (the average price of Brent crude oil from October to December 2022 was USD 88.37/barrel vs. USD 95/barrel as estimated in the Inflation Report, November 2022).

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



Source: NBM

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

	De facto Q IV, 2022/ Q IV, 2021 (%)	Forecast IR, Nov. 2022 Q IV, 2022/ Q IV, 2021 (%)	Deviation (De facto-forecast) (p.p.)
CPI	**32.1**	**32.2**	**-0.1**
Core inflation	19.2	20.1	-0.9
Food prices	33.7	33.2	0.5
Regulated prices	60.0	57.7	2.3
Fuel prices	39.2	43.2	-4.0

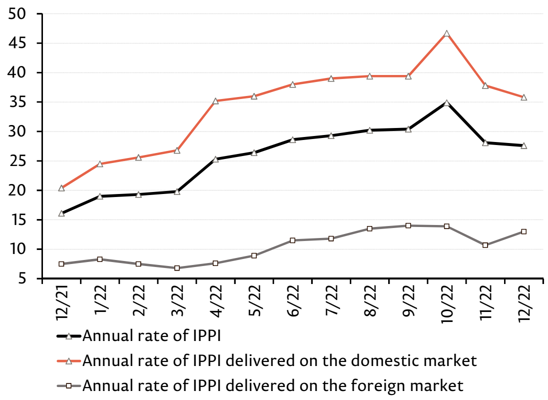
Source: NBS, NBM calculations

[14] In view of the higher volatility of the monthly values, but also 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 is similarly quarterly 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 shall be interpreted accordingly, also considering the assumptions/anticipations for the other months within the quarter.

Therefore, the deviation of the CPI subcomponent forecast was mainly influenced by regional uncertainty that dictated energy prices, as well as local uncertainty about how to reflect the compensation of the population for energy resources in the cold season. The tense situation in the region and the risks of its escalation maintain uncertainty regarding the short and medium-term inflation forecast.

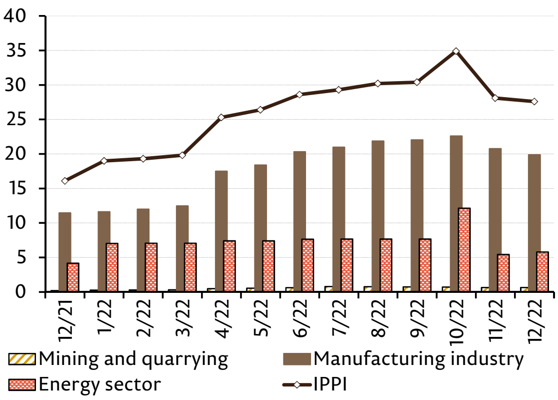
1.3 Industrial production prices

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

In the fourth quarter of 2022, the annual industrial price rate averaged 30.2% or 0.2 percentage points higher than in the third quarter of 2022. In terms of structure, the annual rate of prices of products delivered on the domestic market increased, while the annual rate of prices of products delivered on the foreign market followed a declining trend (Chart 1.11).

It should be noted that the last two months of 2022 marked a reversal of the upward trend in the annual rate of industry prices. Thus, the moderation of the annual price rate in the manufacturing industry and energy sectors determined the downward dynamics of the total index (Chart 1.12).

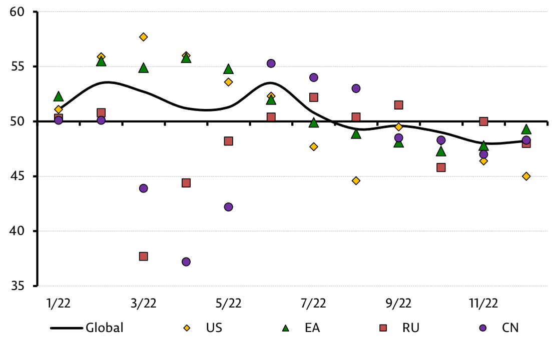
An analysis of the development of the annual industrial price rate by main branches indicates that the high rates recorded in recent months were supported by developments in the manufacturing industry and energy sectors (Chart 1.12). Prices in the energy sector increased significantly (about 2.2 times in the fourth quarter of 2022 compared to the same period of the previous year) in the context of the regional energy crisis. At the same time, because of the significant increase in energy resource and raw material prices, prices in the manufacturing industry followed. Thus, in the context of the significant increase in cost components, the annual rate of prices in the manufacturing industry in the fourth quarter of 2022 amounted to 23.0%. Prices in mining and quarrying increased by 32.3%, generating a contribution of 0.7 percentage points to industrial price dynamics.

Chapter 2

External environment

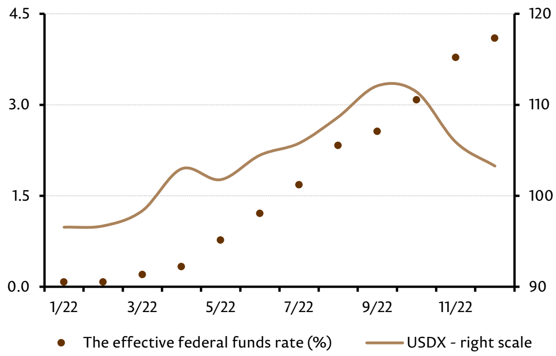
2.1 World economy, financial and commodities markets

Chart 2.1: PMI index development



Source: Markit

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



Source: FRS, Bloomberg

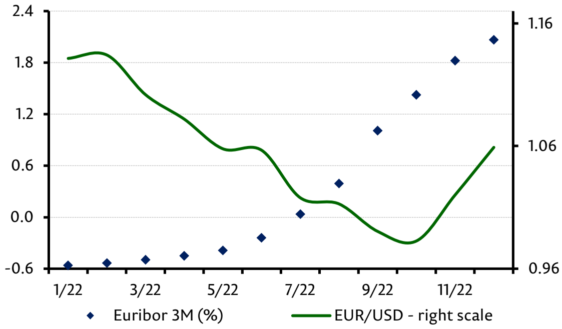
* DXY is an index calculated by the weighted geometric mean of the value of the US dollar against a basket of foreign currencies: euro – 57.6%, Japanese yen – 13.6%, pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%

The year 2022 ended on a negative note, with the IMF announcing at the turn of the year that a third of the world's economies are entering an economic recession. Higher interest rates in most economies, aimed at easing pro-inflationary pressures, will temper global consumer demand and attenuate growth prospects. The increase in COVID-19 cases in China and the delay in lifting restrictions fuelled investor perceptions of weak consumer demand and the maintenance of very high commodity stocks in China. At the same time, high temperatures in Europe caused natural gas prices to fall, while low gas consumption allows gas reserves in Europe to remain at satisfactory levels. Oil prices fell after 5 December 2022, when EU embargo on Russian oil came into force, but uncertainties remain quite high, causing oil prices to remain at high levels. The gradual decline in international commodity and food prices in line with the high base over the past 18 months has reduced overall pro-inflationary pressures, even if levels are well above historical averages. The regional economy remains affected by the war in Ukraine and the outlook is overshadowed by uncertainties and risks.

PMI index for the economies analysed (Chart 2.1) shows a strong economic decline, which will most likely be reflected in negative GDP growth. China's economy is affected by the high number of COVID-19 cases and Beijing's zero-case policy. The Russian Federation's economy is affected by the impact of economic sanctions imposed by the Western bloc, the euro area economy is facing the energy crisis, while the US economy is tempering under the burden of rising interest rates in the context of the tightening of monetary policy by the FRS.

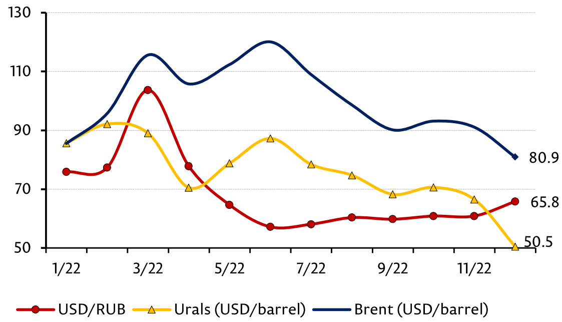
US dollar depreciated in the fourth quarter of 2022, after a strong appreciation in early 2022. Against the backdrop of economic data released in the last quarter of the previous year, the market started to expect the US Federal Reserve System to temper the rise in interest rates. Thus, on 14 December 2022, the FRS raised the interest rate range by 50 basis points (less than previous increases of 75 basis points) up to 4.25-4.50% (Chart 2.2). Note that Federal Reserve Chairman Jerome Powell warned that the fight against inflation is far from over and that key questions remain unanswered, including how much rates will eventually have to rise and for how long. In December 2022, the US unemployment rate fell by 0.1 percentage points to 3.5% and consumer prices fell by 0.3% compared to November 2022. Annual inflation fell to

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



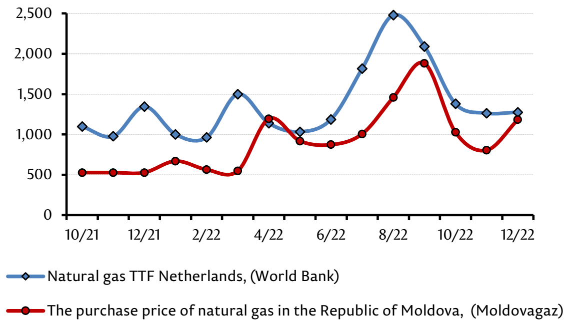
Source: ECB

Chart 2.4: Evolution of oil prices and the Russian ruble



Source: World Bank, Bank of Russia, Ministry of Finance of the Russian Federation

Chart 2.5: Evolution of European quotations and average purchase price of natural gas in the Republic of Moldova (USD/1,000 cubic meters)



Source: World Bank, Moldovagaz, NBM calculations

6.5% in December 2022 from a peak of 9.1% in June 2022, but remains well above the FRS's average target level of 2.0%. At the same time, the depreciation of the US dollar was also driven by the rise in riskier equities and currencies, while the Japanese yen strengthened amid reports that Japan will consider revising its anti-deflation programme.

The European Central Bank continued the tightening of monetary policy started in July 2022, steadily raising the benchmark interest rate to 2.5% at its last meeting in 2022. At the same time, both the European Central Bank's statements and market expectations indicate that there may be further significant interest rate hikes in the euro area. The annual rate of harmonised inflation in the euro area peaked at 10.6% in October 2022, after which it declined slightly to 9.2% in December 2022, due to the reflection in the statistical calculations of cold-season energy compensation granted by European governments. After trading below parity with the US dollar in September-October 2022 **single European currency** appreciated above parity with the US dollar towards the end of 2022, but apparently for technical reasons, such as the depreciation of the US dollar and sterling. Another factor contributing to the appreciation of the European single currency is the monetary cycle which implies a further increase in interest rates, while other major economies are most likely to follow a trend of no change or possibly a decrease in interest rates. Also, high temperatures in Europe and unexpectedly low energy prices have mitigated the complexity of Europe's energy crisis, which has favoured the European single currency (Chart 2.3).

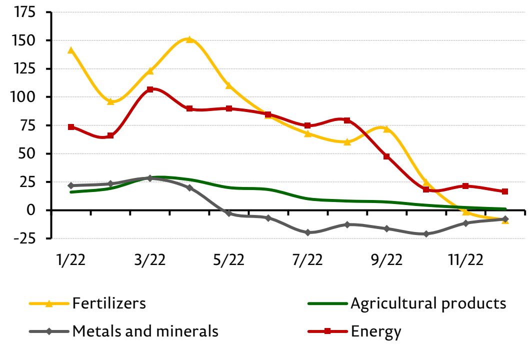
After several months of inertia **Russian ruble** depreciated in fourth quarter of 2022 to a level above USD 70/RUB, due to the discrepancy between the growth rates of export flows and the restoration of import supplies. Another factor was the decline in oil quotations, especially for Russian brands. According to Russia's Ministry of Finance, the average price of Russian branded oil **Urals** for December 2022 was USD 50.5/barrel (Chart 2.4). On 5 December 2022, EU sanctions on the import and transport of Russian oil came into force. At the same time, the European Union introduced a ninth package of restrictive measures, which will apply controls on exports to the Russian Federation of dual-use goods, a range of space technologies and products, and extend the prohibition on new investment in the Russian energy and mining sector. The EU also approved on 19 December 2022 a mechanism to cap the price of natural gas from around EUR 180/MWh (about USD 2,000/1,000 cubic meters) from 15 February 2023. The ceiling mechanism shall only be activated if the price of natural gas exceeds the price of liquefied natural gas (LNG) by more than EUR 35, to safeguard the European Union's gas supply.

The price of **Brent** brand oil fell slightly towards the end of the year, reaching a monthly average of USD 80.9/barrel in December 2022, the lowest average level since 2022 (Chart 2.4). Economic recession fears and the outbreak of COVID-19 cases in China have raised concerns about the global demand. World Bank President David Malpass and International Monetary Fund Managing Director Kristalina Georgieva both warned of a growing risk of global recession, saying inflation remains a problem. Also, both the OPEC, and the US Department of Energy have reduced their forecasts for global oil demand, as the explosion of COVID-19 cases in China raised new concerns about fuel consumption in the world's largest oil importer. Factors such as the entry into force of

EU bans on oil deliveries from Russia on 5 December 2022 and the lowering of the OPEC+ production target by 2 million barrels per day have also contributed to the rise in oil prices.

European natural gas quotations, also fell in the fourth quarter of 2022 from their August 2022 peak amid indications that Europe will be able to survive this winter due to ample supplies, an influx of LNG[15] and measures taken by the European Union to limit the consequences of the energy crisis. At the end of October 2022, European natural gas storage was on average 94% full, of which 100% in Belgium, 99% in France and 99% in Germany, according to GIE[16]. Subsequently, abnormally high temperatures for the winter months have increased expectations that Europe will easily get through the cold season and that by April 2023 natural gas stocks would be at a sufficient level to be able to be filled until the next cold season. LNG supplies also remain sufficient, but sensitive to weather changes, as LNG ships wait off the European coast in the hope of falling temperatures and rising gas costs. For the month of December 2022, the World Bank has reported an average price of USD 1,275.3/ 1,000 cubic meters for **TTF Netherlands** (Chart 2.5). By mid-January 2023, the TTF Netherlands had already reached USD 574 on the stock market/1,000 cubic meters (minimum price as of September 2021). International quotations for other raw materials fell significantly during the period under review, allowing for negative annual growth rates. Thus, according to the World Bank, in December 2022 compared to December 2021 **fertiliser price index** decreased by 8.9% and **metals and minerals price index** by 7.8%. At the same time, **energy price index** increased by 16.4% and **price index of agricultural products** increased, but insignificantly by 1.0%. Although most commodity prices remain above the averages of recent years, annual pressures on producer and consumer price formation are expected to follow a negative trend (Chart 2.6).

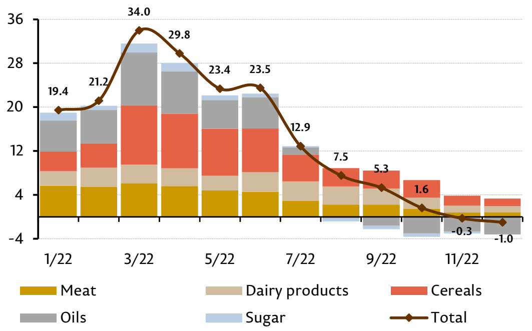
Chart 2.6: World price indexes (%)



Source: World Bank, NBM calculations

The annual growth rate of **world food prices** calculated by the FAO was negative in November and December 2022, after more than 2 years of significant positive increases. Thus, overall, international food prices declined on an annual basis by an average of 0.3 and 1.0% in November and December 2022 (Chart 2.7). Oil quotations decreased the most as the harvest and large supply of palm, rapeseed, and sunflower oil outstripped low import demand. Wheat and maize export prices fell recently as ongoing harvests in the southern hemisphere boosted supplies and competition among exporters remained strong. The decrease in the meat price index in December 2022 was driven by lower world prices of bovine and poultry meats, partly counterbalanced by higher pig and ovine meat prices. The December 2022 increase in international sugar price quotations was mostly related to concerns over the impact of adverse weather conditions on crop yields in India, the world's second largest sugar producer, and sugarcane crushing delays in Thailand and Australia. In December 2022, international dairy prices rose, mainly reflecting robust global import demand and somewhat tighter export availabilities amid high internal retail, especially in Western Europe.

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



Source: FAO, NBM calculations

[15] Liquefied natural gas

[16] Gas Infrastructure Europe

2.2 Developments in major economies

In the third quarter of 2022, the GDP of **the United States of America** increased by 0.8% compared to the previous quarter and by 1.9% compared to the same period last year (in seasonally adjusted terms). In January-November 2022, US industrial production rose 4.3% and the unemployment rate fell to 3.5% in December 2022. Consumer prices continued to rise, but the annual pace of inflation moderated to 6.5% in December 2022.

In the third quarter of 2022, economic activity in the **euro area** grew at a positive quarterly pace of 0.3%. Compared to the same quarter in 2021, the euro area economy grew by 2.3% (in seasonally adjusted terms). In the first 11 months of 2022, industrial production in the euro area grew insignificantly by 0.9% in annual terms, of which in Germany it declined by 0.2%, in France it stagnated and in Italy it grew by 0.5%. The euro area unemployment rate remained at a low of 6.5% in recent months, while consumer prices continued to rise, with annual harmonised inflation rising by 9.2% in December. It is somewhat premature to justify the slight moderation in euro area inflation by the effects of the European Central Bank's tightening of monetary policy, but rather the statistical reflection of cold-season energy compensation by European governments.

2.3 Developments in neighbouring economies and main trading partners

In the third quarter of 2022, the GDP of **Romania** increased by 1.3% (in seasonally adjusted terms) compared to the previous quarter and by 4.0% on a gross basis compared to the same period last year. In January-November 2022, industrial production contracted compared to the same period last year by 1.6% in the seasonally adjusted series and by 1.1% in the gross series. In December 2022, consumer prices increased by 0.4% from the previous month and by 16.4% from December 2021. As the annual inflation rate remains above the target corridor of 1.5-3.5% for an extended period, the NBR raised its policy rate repeatedly by 25 basis points at the beginning of January 2023 to a cumulative level of 7.0%.

In the third quarter of 2022 **Russian Federation** economy grew by 0.9% (in seasonally adjusted terms) compared to the previous quarter and contracted by 3.7% compared to the same period last year. In January-November 2022 industrial production in the Russian Federation fell on an annual basis by only 0.1%. Against the backdrop of falling internal demand and the unprecedented appreciation of the Russian ruble, consumer prices in the Russian Federation continued to decline. In December 2022, consumer prices increased by 0.8% compared to the previous month and by 11.9% compared to December 2021.

In the third quarter of 2022, due to the war, the GDP of **Ukraine** fell dramatically, by 30.8% in annual terms. Forecasts for Ukraine's economy are very bleak as the war continues, with industrial infrastructure and shipping badly affected. From the little data published by the Statistical Service of Ukraine, we can mention that in January-November 2022 the export of goods amounted to USD 40,671.2 million or 66.4% compared to January-November 2021, and the import amounted to USD 49,194.9 million or 75.8% compared to January-November 2021. Consumer prices continued to rise, with monthly inflation of 0.7% in December 2022 and consumer prices up 26.6% compared to December 2021.

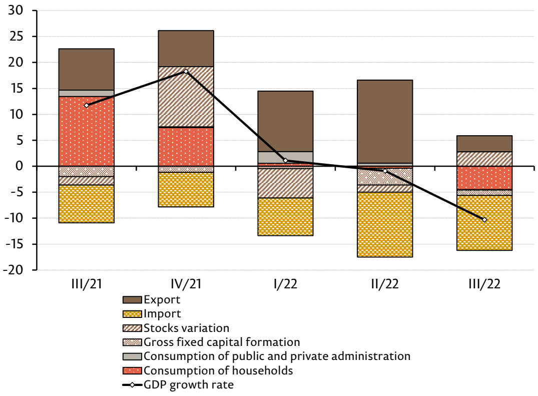
Chapter 3

Economic developments

3.1 Demand

After stagnating in the first half of 2022, economic activity declined significantly in the third quarter of 2022. As a result, GDP contracted by 10.3% in July-September 2022 compared to the same period of 2021, lower than anticipated in the Inflation Report, November 2022, due to notably weaker internal demand caused mainly by lower real household incomes, tightened credit conditions and increased uncertainty in the region. At the same time, a negative impact was also caused by less favourable agrometeorological conditions, which resulted in a lower agricultural output compared to the previous year. The seasonally adjusted series reflects an 8.4% decrease in GDP compared to second quarter of 2022. Overall, GDP decreased by 4.1% in January-September 2022 compared to the same period of the last year. In this context, aggregate demand pressures on prices are estimated to have exerted a disinflationary impact over the period.

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



Source: NBS, NBM calculations

In the third quarter of 2022, GDP declined by 10.3% compared to the same period of last year, after stagnating in the first half of 2022. Among the factors that led to the moderation of economic activity during the previous year and especially in the third quarter of 2022, one can mention the decline in real incomes of the population in the context of accelerating inflation, the rise in interest rates that slowed lending, the increased uncertainty in the region as a result of the escalation of the war in Ukraine, the real appreciation of the national currency against the currencies of the countries – main trading partners and, as a result, the decline in the competitiveness of domestic products. At the same time, in the third quarter of 2022, the GDP contraction was also driven by modest developments in construction, industry, a lower performance of the agricultural sector compared to the third quarter of 2021 in the context of dry weather conditions in summer 2022. The contraction in economic activity was anticipated in the previous round of forecasting (Inflation Report, November 2022), however, the downturn was stronger than expected. Overall, demand pressures on prices are estimated to have exerted a disinflationary impact over the reference period.

In terms of uses (Chart 3.1), in the third quarter of 2022, after a relatively stable development in the first half of the year, household consumption contracted by 5.7 compared to third quarter of 2021. The fall in consumption was underpinned by a decline in household disposable income in real terms against the backdrop of accelerating inflation and tighter credit conditions. Gross capital formation during the reference period had a positive impact on GDP dynamics. Overall, this impact was driven by the contribution of the change in inventories subcomponent (2.8 percentage points), which offset the negative impact (-1.0 percentage points) of gross fixed capital formation (GFCF). The latter, due to heightened uncertainty in the region but also to tighter credit conditions, declined by 4.4% compared to the third quarter of 2021. After the pronounced dynamics in the first half of this year, general government consumption increased insignificantly by 0.1% in July-September 2022.

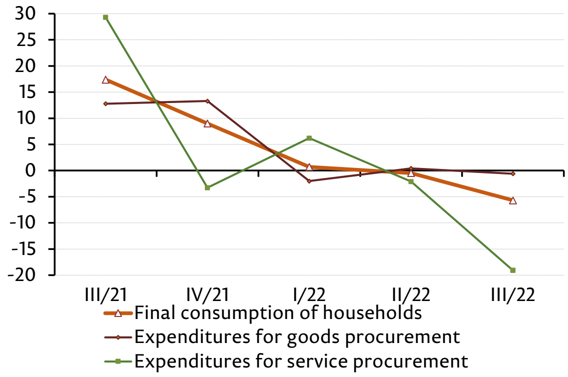
Exports, in real terms, increased by 10.7% and generated a positive impact of 3.1 percentage points. Exports in US dollars by commodity groups increased mainly due to the "mineral products" component. A smaller impact was also generated by the "vehicles, optical and sound recording or reproducing apparatus" component, while the "food, animal products, beverages and fats" component contracted in the context of this year's low harvest. At the same time, the increase in exports was mainly driven by higher export volumes to CIS (Ukraine), but also to some extent to EU. At the same time, export dynamics were mostly supported by the development of re-exports, while exports of domestic goods had a smaller impact. A considerable negative impact (-10.6 percentage points) on GDP growth in the third quarter of 2022 was caused by a 20.8% increase in imports. An analysis of imports, in US dollars, by commodity group showed that the increase was mainly due to the "mineral products" component, but also due to the sub-components "vehicles, optical appliances and food products". Imports from the EU and the "Rest of the World" contributed mostly to the development, while imports from the CIS had an insignificant contribution.

Household demand for consumption

Annual negative trend in household consumption increased in the third quarter of 2022. As a result, the annual rate of household final consumption was -5.7%, 5.2 percentage points lower than in the second quarter of 2022. The respective dynamics of household consumption was driven by a 19.1% decrease in expenditure on the purchase of services. At the same time, expenditure on purchases of goods decreased by 0.6% compared to the same period last year (Chart 3.2).

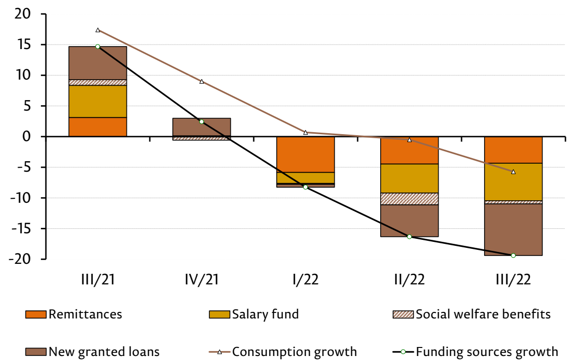
The contraction in consumption was underpinned by a fall in real disposable household income against the background of accelerating inflation and tighter credit conditions (Chart 3.3). In this respect, the payroll fund, social payments, and remittances increased during the reference period in nominal terms. Adjusted for the annual inflation rate, which continued its ascending trend in the third quarter of 2022, they have, however, followed a descending path, creating the conditions for a decreasing trend in household consumption. For example, the salary fund increased by about 15.5%. However, as the average annual inflation rate accelerated to 33.9% in the third quarter of 2022, the salary fund in real terms is estimated to have contracted by around 13.8%. A similar effect can be observed in other sources of consumption financing, such as social benefits or remittances. At the same time, the increase in credit rates resulted in lower volumes of lending in national currency by individuals, which tempered internal consumption. Thus, new

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



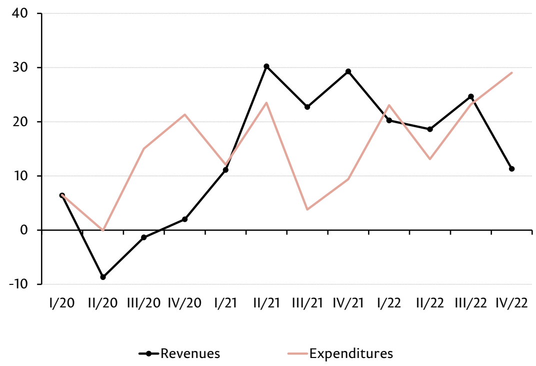
Source: NBS

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



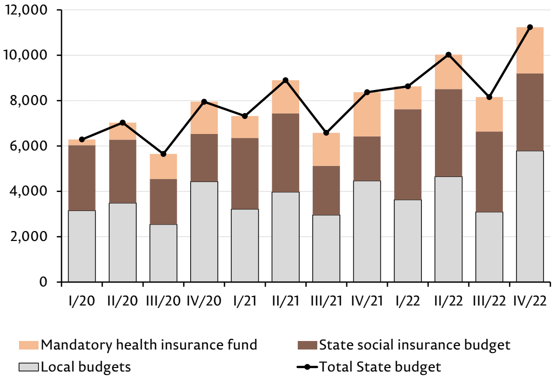
Source: NBS, NBM calculations

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



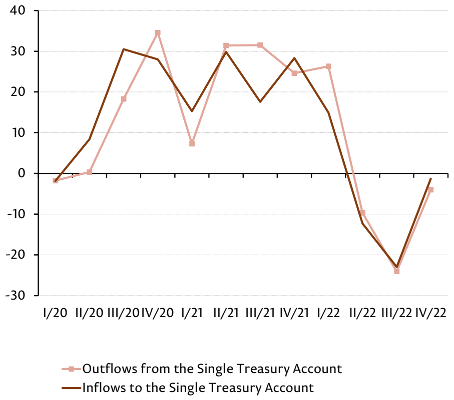
Source: Ministry of Finance

Chart 3.5: Evolution of budget transfers (MDL million)



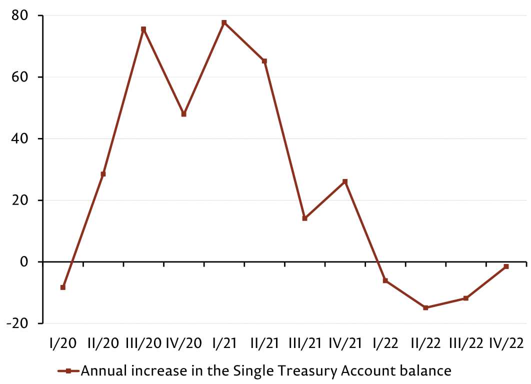
Source: Ministry of Finance

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

loans provided to individuals recorded a significant contraction (-56.7%) in the third quarter of 2022, generating the largest negative impact on the dynamics of consumption financing sources.

Public sector

According to data provided by the Ministry of Finance, during the fourth quarter of 2022, the national public budget revenues amounted to MDL 25.9 billion, 11.3% more than the revenues for the same period of 2021 (Chart 3.4). A major part of the budget revenue came from taxes and fees, which accounted for 59.7%. Compulsory state social insurance contributions and compulsory health insurance premiums accounted for 26.9%, and the share of grants and other revenues was 8.5% and 5.0% of total budget revenues, respectively.

National public budget expenditure in the fourth quarter of 2022 amounted to MDL 32.9 billion, an increase of 29.0% compared to the same period of 2021. Of the total expenditure, the largest share was allocated to social protection (33.9%), to education – 16.6%, and to health protection – 12.1%.

Note that in the fourth 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 11.2 billion, an increase of 34.1% compared to the same period of 2021 (Chart 3.5). The bulk of transfers went to local budgets, about 51.5% of total transfers, followed by transfers to SSIB, about 30.3%, with MHIF receiving 18.2% funding.

In this context, in the fourth quarter of 2022, the execution of the national public budget resulted in a deficit of MDL 6.3 billion, compared to MDL 2.2 billion of the same period of 2021. The balances of the national public budget as of 31 December 2022 amounted to MDL 6.5 billion.

In the fourth quarter of 2022, the single treasury account (STA) recorded negative annual rates of payments and receipts (Chart 3.6). As a result of inflows and outflows, as of 31 December 2022, the STA balance amounted to around MDL 6.6 billion, recording an annual decrease of 1.5% (Chart 3.7). At the same time, at the end of the fourth quarter of 2022, the balance of the Government's foreign currency deposit account with the National Bank of Moldova amounted to about MDL 2.3 billion, compared to MDL 7.7 billion as of 31 December 2021.

State debt

As of 31 December 2022, the balance of state debt of the Republic of Moldova amounted to about MDL 94.7 billion in relation to GDP[17] it reached 33.8% (Chart 3.9). In annual terms, state debt recorded a nominal increase of 21.7% (Chart 3.8), due to the increase in external state debt recalculated in national currency (with a positive contribution of 20.2 percentage points) and internal state debt (with a positive contribution of 1.5 percentage points). State debt, as at 31 December 2022, amounted to 63.6% external government debt and 36.4% internal government debt.

[17] GDP estimated by NBM.

At 31 December 2022, the external state debt balance totalled USD 3,140.6 million, higher than at 31 December 2021 by around USD 634.5 million or 25.3%. Recalculated in national currency, the external state debt balance amounted to about MDL 60.2 billion (21.5% of GDP[17]) (Chart 3.9).

As of 31 December 2022, the national state debt amounted to around MDL 34.5 billion (12.3% of GDP[17]) (Chart 3.9), 3.6% higher than as of 31 December 2021 (Chart 3.8). Domestic debt included state securities issued in the primary market (58.5%), state securities issued for the execution of state guarantees (35.0% of the total amount) and converted securities (6.5%).

Primary market of state securities (SS)

During the fourth quarter of 2022, the Ministry of Finance issued state securities for a total amount of MDL 7,736.5 million, 15.0% less than the volume of the initial offering. It should be noted that the primary market for state securities shows an increase 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, the average effective interest rates on 91-day, 182-day and 364-day Treasury bills increased by 3.2 percentage points, 0.7 percentage points, and 0.3 percentage points, respectively, compared to the previous quarter. Average effective interest rates on 2-year state bonds decreased compared to the third quarter of 2022 by 1.3 percentage points, while those on 3-year increased by 0.9 percentage points. For state bonds with a maturity of 5 and 7 years, no auctions were organised during the quarter. Thus, it should be noted that banks continue to invest in short-term securities, remaining more reluctant to invest in long-term bonds, especially with a maturity of 2 and 3 years (Chart 3.11).

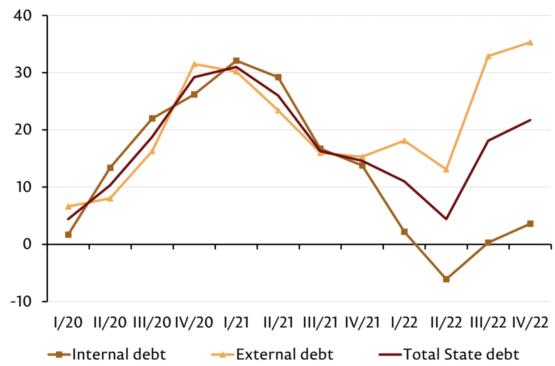
The structure of the portfolio of SS put into circulation during the reference period shows that the most demanded state securities were those with 182-day maturity, which accounted 49.2% of total transactions, followed by 364-day Treasury bills, whose share was 40.6%. Treasury bills of 91 days had a share of 8.2%. The share of 2-year state bonds was 1.6% and that of 3-year state bonds was 0.3% (Chart 3.12).

Investment demand

In the third quarter of 2022, the investment component accounted for a positive contribution of 1.8 percentage points to the dynamics of economic activity. However, within the structure, this impact was driven by the contribution from the "changes in inventories" subcomponent (2.8 percentage points), which offset the negative impact (-1.0 percentage points) of gross fixed capital formation. The latter, in the context of increased uncertainty in the region but also tighter credit conditions, recorded a decrease of 4.4% compared to third quarter of 2021. It should be noted that gross fixed capital formation has now recorded negative rates for five consecutive quarters, mainly amid contracting construction-oriented investment.

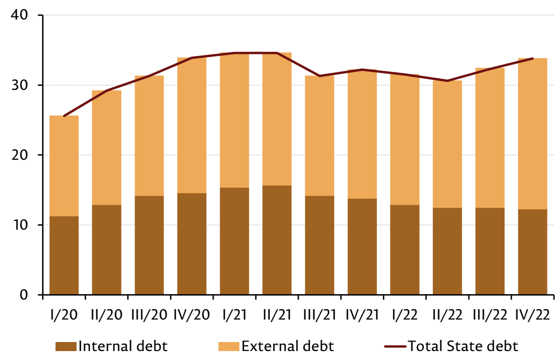
The negative dynamics of gross fixed capital formation was mainly determined by the dynamics of construction-oriented investments, which decreased by 8.2%, while the "machinery and equipment"

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



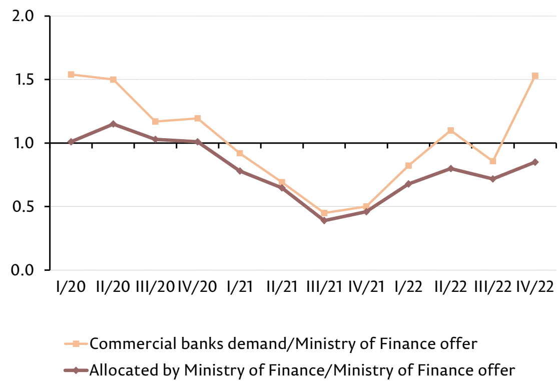
Source: Ministry of Finance

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



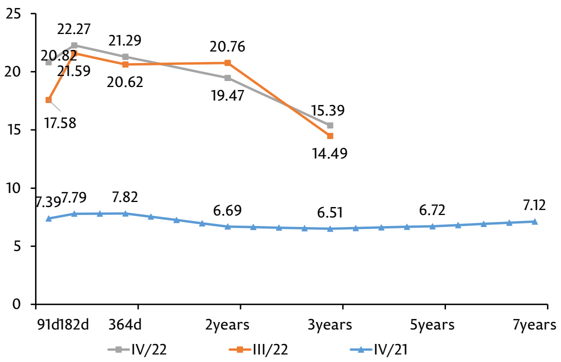
Source: Ministry of Finance

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



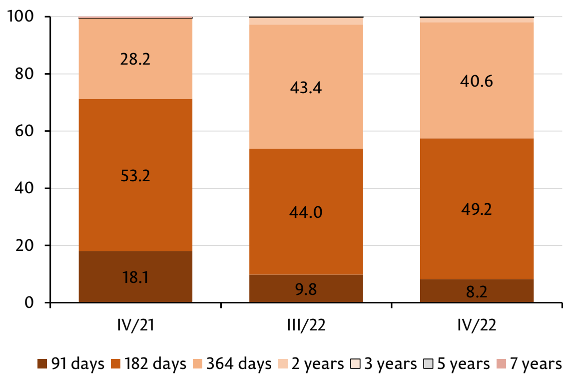
Source: NBM

Chart 3.11: SS yield curve (%)



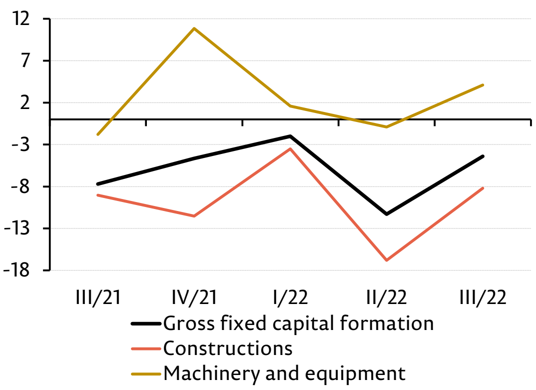
Source: NBM

Chart 3.12: Structure of SS allocated to the primary market (%)



Source: NBM

Chart 3.13: Annual investment dynamics (%)



Source: NBS

component increased by 4.1% compared to the same period of 2021 (Chart 3.13).

According to operational data provided by the NBS, investment in fixed assets decreased by 11.5% in the third quarter of 2022. Intangible fixed assets increased by 6.8% and tangible fixed assets decreased by 11.9%. The dynamics of the latter were driven by the negative contribution of the sub-components "engineering construction" (5.7 percentage points), "machinery, equipment and installations" (2.9 percentage points), "residential buildings" (3.9 percentage points) and "other tangible fixed assets" (1.4 percentage points). Developments in investment in "non-residential buildings" generated a positive impact of 0.9 percentage points and in "means of transport" – of 1.0 percentage point in third quarter of 2022 (Chart 3.14). The modest dynamics of construction investment were influenced by lower demand amid significantly higher building material prices and tighter credit conditions.

From the perspective of the sources of financing of investments in fixed assets for the third quarter of 2022, the negative dynamics of 11.5% was determined by the evolution of the following sub-components: "own funds" accounted for -6.9 percentage points, the ATU budgets for -2.2 percentage points, state budget funds for -1.1 percentage points and foreign investors' funds for -0.9 percentage points. The only component that generated a positive impact was "other sources" (0.7 percentage points) (Chart 3.15).

Net foreign demand[18]

In 2022, mineral imports and re-exports were noted within the structure of Moldova's foreign trade in the context of the war in Ukraine. It should be mentioned that, against the background of a poor agricultural harvest in 2022, the second half of the year recorded a marked contraction in the export of agri-food products (cereals). At the same time, low demand led to a moderation in the annual rate of imports in the second half of 2022.

The annual export rate in the third quarter of 2022 recorded a level of 27.8% or 62.2 percentage points lower than in the second quarter of 2022. At the same time, the data for the first two months of the fourth quarter of 2022 points to a continuation of the downward trend in the annual export rate, thus positioning the annual rate in the negative range. The considerable decrease in the annual export rate in the second half of 2022 was driven by the significant dampening of exports to EU countries and those classified as "Rest of the World". At the same time, exports to the CIS accounted for a strong positive contribution to the total export dynamics, mainly driven by the re-export of mineral products to Ukraine (Chart 3.16).

The annual export rate in the first two months of the fourth quarter of 2022 recorded a level of -1.2% or 29.0 percentage points lower than in the third quarter of 2022. The declining dynamics of the annual export rate were influenced by the significant drop in agri-food exports as a result of a low agricultural harvest in 2022, which had a direct impact on the country's export capacity (Chart

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

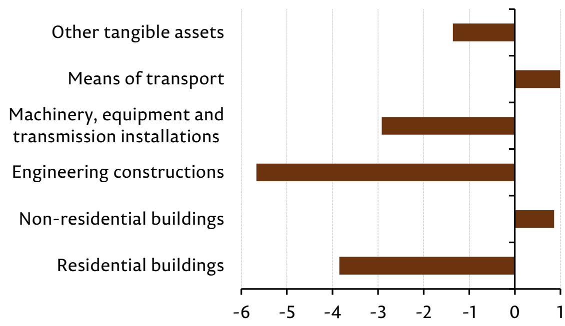
3.17). At the same time, for the third consecutive quarter, there was a significant increase in exports of mineral products, which resulted from a shortage of gasoline and diesel on the war-affected Ukrainian market.

Analysing the evolution of exports by origin of products, the decrease in the annual rate of exports in the fourth quarter of 2022 was driven by the increase in exports of domestic products (Chart 3.18).

In the third quarter of 2022 the annual import rate was 31.9%, insignificantly lower than in the second quarter of 2022. At the same time, data for the first two months of the fourth quarter of 2022 reveals a more pronounced moderating trend in the annual import rate. The structure of imports from the CIS in the fourth quarter of 2022, unlike previous quarters, shows a decline. At the same time, imports from the EU increased, while those from countries classified as "Rest of the World" – followed a downward trend (Chart 3.18).

By commodity group (Chart 3.19), the decrease in the annual rate of imports in the first two months of the fourth quarter of 2022 was influenced by the import dynamics of "mineral products[19]", "food, animal products, beverages and fats" and "vehicles, optical and sound recording or reproducing apparatus" (Chart 3.20).

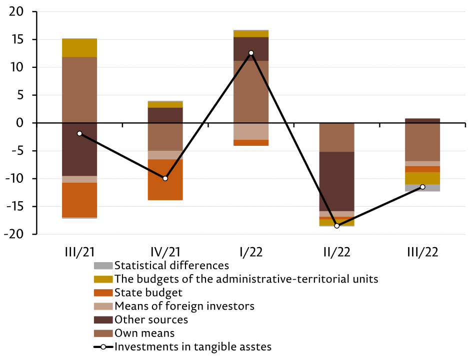
Chart 3.14: Contribution of investment components in tangible fixed assets in the third quarter of 2022 (percentage points)



Source: NBS, NBM calculations

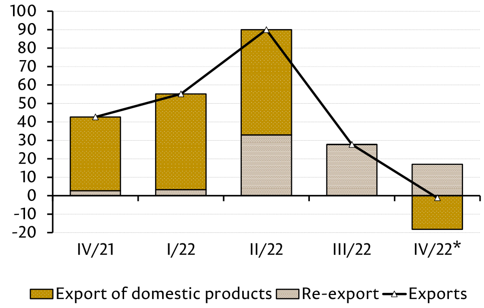
[19]The marked increase in imports of mineral products mainly reflects the significant increase in the trading price of energy resources, but also the re-export of fuels towards Ukraine.

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



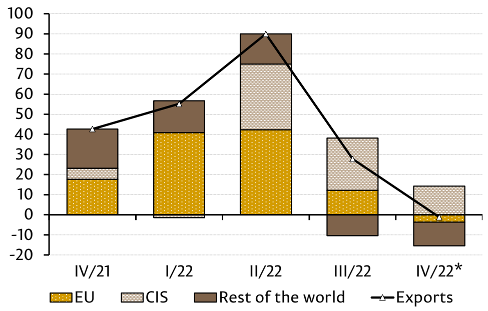
Source: NBS, NBM calculations

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



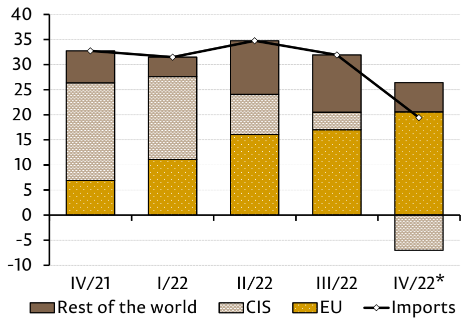
Source: NBS, NBM calculations
*Oct.-Nov.

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



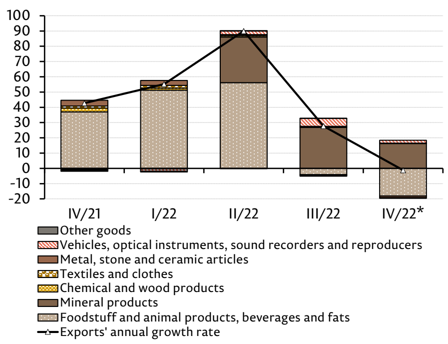
Source: NBS, NBM calculations
*Oct.-Nov.

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



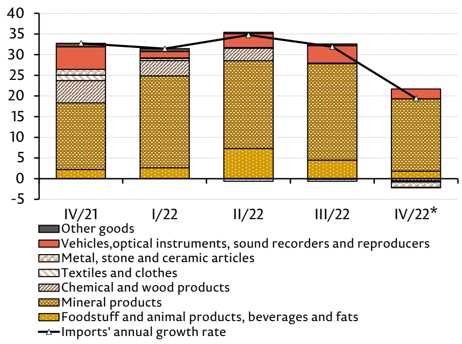
Source: NBS, NBM calculations
*Oct.-Nov.

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



Source: NBS, NBM calculations
*Oct.-Nov.

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



Source: NBS, NBM calculations
*Oct.-Nov.

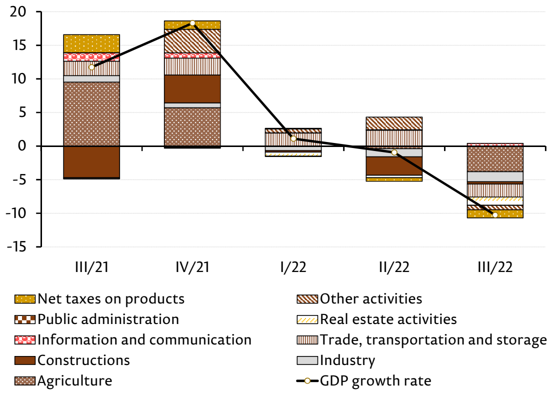
3.2 Production

By resource category, the decline in GDP in the third quarter of 2022 was mainly driven by developments in most sectors of the economy. However, the largest negative contributions were caused by dynamics in agriculture, trade, industry and real estate transactions (Chart 3.21). Thus, the agricultural sector contracted by 21.4% and had a negative impact of -3.5 percentage points on GDP dynamics in the reference period.

That dynamic was underpinned by decreases in crop and livestock production of 24.2% and 6.5% respectively. A significant decrease in crop production was driven 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 production in the livestock sector[20] in the third quarter of 2022 was driven by a decrease in the production of "milk", "cattle and poultry (live weight)" and "eggs". At the same time, the gross value added related to the sub-component of trade[21] decreased by 12.1%, generating a negative impact of 1.9 percentage points on GDP dynamics. In this context, the turnover of enterprises specialised in retail trade amounted to around -4.6% in the period July-September 2022. Meanwhile, the turnover of enterprises providing services to the population increased by 9.6%. The annual rate of turnover at enterprises providing services to businesses decreased in nominal terms to 27.1% in the period July-September 2022, while turnover at enterprises operating in wholesale trade decreased in nominal terms to 9.6%. A negative contribution of -0.2 percentage points was driven by the decrease in GVA transport and storage by 3.7% compared to the third quarter of 2021. Freight transport decreased by 4.5% in the period July-September 2022 compared to the same period last year, while passenger numbers increased by 24.0%. At the same time a significant negative impact (-1.5 percentage points) was caused by the decrease in value added in industry. Therein, the energy industry contracted by 7.6%, the manufacturing industry – by 13.4%, and the mining and quarrying industry – by 33.3% compared to third quarter of 2021. The value added of the "real estate transactions" sector contracted by 20.3% and had an impact of -1.2 percentage points on GDP dynamics. At the same time, the "construction" sector continued its decline of previous periods, contracting by 4.7% compared to the third quarter of 2021, as these sectors were affected both by the significant increase in prices of construction materials, the tightening of credit conditions and the decrease in the real disposable income of the population, as well as the uncertainty in the region. Net taxes on products decreased by 8.7%, generating a contribution of -1.2 percentage points to GDP dynamics.

At the same time, the above-mentioned negative contributions were partially mitigated by developments in the financial and insurance activities sector and in the information and

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



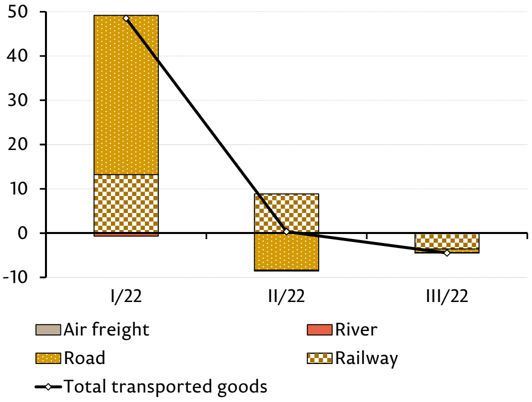
Source: NBS, NBM calculations

[20] Comparable prices.

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

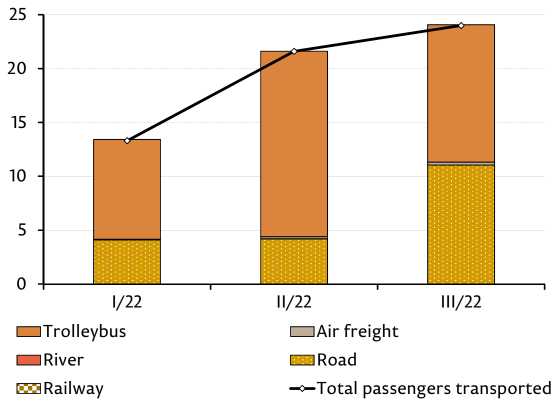
communication sector, which increased by 18.0% and 8.7%, respectively, and generated contributions of 0.4 percentage points to GDP dynamics. At the same time, GVA in the accommodation and food service sector increased by 13.3% but generated an impact of only 0.1 percentage points on GDP dynamics.

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



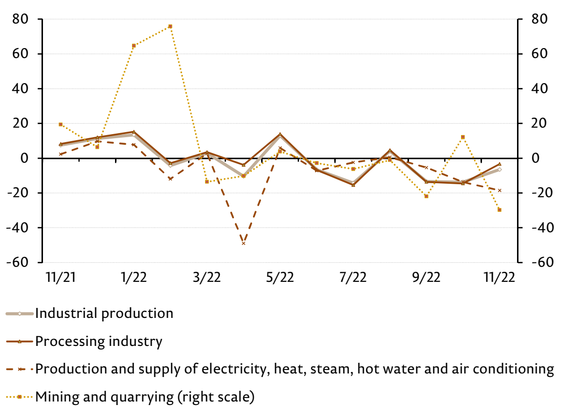
Source: NBS

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



Source: NBS

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



Source: NBS

Freight and passenger transport

The annual freight volume rate in the third quarter of 2022 was -4.5%, 4.8 percentage points lower than in the second quarter of 2022 (Charts 3.22). This development was driven by the 18.7% annual decrease in the volume of goods transported by rail compared to the same period last year. At the same time, the volume of goods transported by inland waterways and road decreased by 11.2% and 1.0% respectively. Similarly, the volume of goods transported by air decreased by 11.5% compared to the corresponding period of the previous year.

Positive results were recorded in the passenger transport sector in the third quarter of 2022. Thus, the growth rate in passenger numbers recorded a level of 24.0%, 2.4 percentage points higher than in the second quarter of 2022 (Chart 3.23). This development was driven by year-on-year increases in the number of passengers transported by road and trolleybus of 37.2% and 18.4% respectively. The number of passengers carried by air increased by 38.9%. At the same time, the number of passengers transported by inland waterway and rail decreased by 47.7% and 17.2% respectively compared to the same period of last year.

Industrial production

In the first two months of the fourth quarter of 2022, the annual growth rate of the volume of industrial production averaged -10.1%, 2.2 percentage points lower than in the third quarter of 2022 (Chart 3.24). This dynamic was driven by the slowdown in the annual growth rate of manufacturing (from -8.1% in the third quarter of 2022 to -8.9% in the first two months of the fourth quarter of 2022). At the same time, the sector "production and supply of electricity and heat, gas, hot water and air conditioning" decreased in October-November 2022 (from -2.4% in the third quarter of 2022 to -16.1% in the first two months of the fourth quarter of 2022). Similarly, the annual pace of production volume in the extractive industry increased by 0.9 percentage points compared to the third quarter of 2022 reaching the level of -8.8%.

Domestic trade

In the first two months of the fourth quarter of 2022, the turnover of enterprises with retail trade as their main activity decreased on average by 2.6%, however, this dynamic was 2.3 percentage points higher than in the previous quarter (Chart 3.25). At the same time, the turnover of enterprises whose main activity concerns market services provided to the population increased by 1.6% in the period October-November 2022, although this dynamic is 8.0 percentage points lower than in the third quarter of 2022.

In the period October-November 2022, the turnover of enterprises engaged mainly in wholesale trade decreased by 23.4%[22], which is 5.2 percentage points lower than in the third quarter of 2022 (Chart 3.26). At the same time, the turnover of enterprises whose main activity concerns market services provided to businesses decreased by 8.3%, which is 3.3 percentage points lower than the annual rate of the previous quarter.

Agricultural production

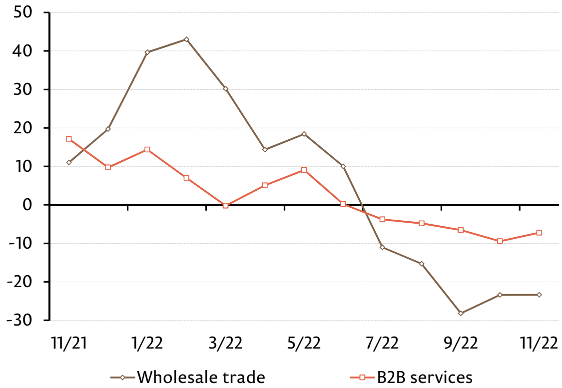
In the fourth quarter of 2022, total agricultural production decreased by 44.7% compared to the level of the fourth quarter of 2021. This dynamic was driven by a 50.1% decline in crop production. At the same time, the 11.4% increase in livestock production marginally offset the decline in the crop sector (Chart 3.27).

In 2022 as compared to 2021, total agricultural production decreased in comparable prices by 29.8%. This dynamic was underpinned by negative developments in the crop (-36.8%) and livestock (-2.6%) sectors. Thus, the largest decreases in production volumes were recorded for grain maize (-74.8%), sugar beet (-49.6%), wheat (-45.6%), sunflower (-35.3%) and fruits, nuts, and berries (-26.1%). At the same time, the contraction in the volume of production in the livestock sector was driven by a decrease in milk and meat production.

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

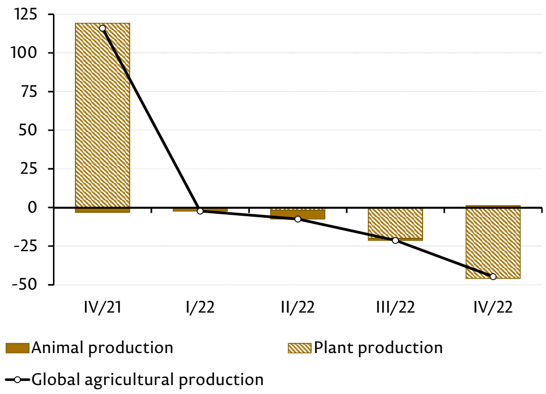
Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

[22] Deflated by annual CPI rate.

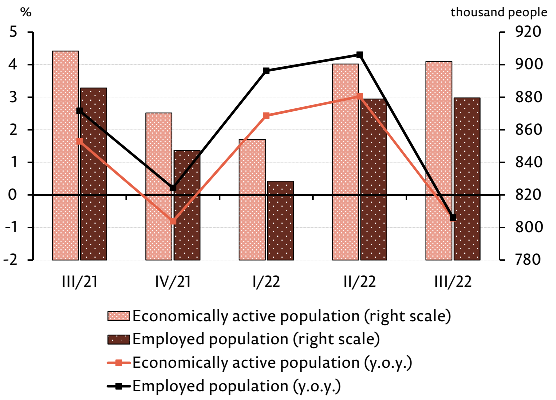
3.3 Labour market

Labour force

Following the positive development in the first half of 2022, both the economically active and employed population experienced a significant slowdown in the third quarter of 2022. The unemployment rate increased marginally and the underemployment rate[23]showed a slightly downward trend compared to the second quarter of 2022.

In the period July-September 2022, the labour force amounted to 901.8 thousand people, which is 0.7% lower than in the third quarter of 2021. At the same time, the employed population amounted to 879.5 thousand people, which is also 0.7% lower compared to the same period of 2021 (Chart 3.28).

Chart 3.28: Economically active population and employed population



Source: NBS, NBM calculations

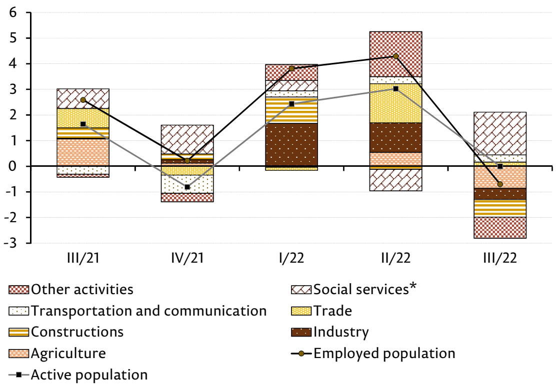
By sub-component, the decrease of the employed population in the third quarter of 2022 was recorded in agriculture (-3.7%), industry (-3.2%), construction (-7.8%), "other" sub-component (-9.6%). Positive developments were recorded in trade sector (0.9%), transport and communications domain (4.2%) and social services (7.9%) (Chart 3.30).

In the third quarter of 2022, the number of unemployed people amounted to 22.3 thousand, or 0.7 thousand people more than in the second quarter of 2022, the unemployment rate was 2.5%, by 0.1 percentage points higher than in the second quarter of 2022 (Chart 3.29). On the other hand, the number of underemployed populations has decreased. Thus, in the third quarter of 2022, it was down to 19.0 thousand people as against 22.0 thousand people in April-June 2022, while the underemployment rate amounted to 2.2%, 0.3 percentage points lower than in the second quarter of 2022.

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

[23]Underemployed people: employed people whose actual hours worked in total during the reference period were less than 40 hours per week, who wanted and were available to work overtime. The underemployment rate is calculated as follows: $\mathit{Underemployment\ rate} = \frac{\mathit{Employed\ population}}{\mathit{Underemployed\ population}} * 100\%$

Salary fund

In the third quarter of 2022, the economy wage fund continued the strong positive dynamics recorded in previous periods. However, in real terms, the decline of this indicator was more significant.

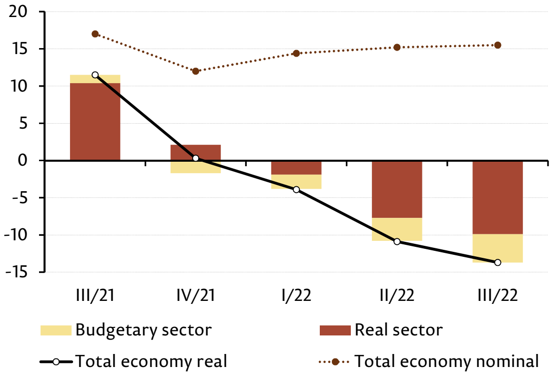
The economy wage fund in the third quarter of 2022 recorded an increase of 15.5% in nominal terms, mainly due to the developments of the wage fund in the industrial sector, the information and communication sector, and the trade sector, respectively contributing 2.7 percentage points, 2.7 percentage points and 2.6 percentage points to the dynamics of this indicator. At the same time, significant but smaller contributions were determined by the dynamics of the wage fund for employees in education (1.4 percentage points), transport (1.4 percentage points) and public administration (1.0 percentage points).

However, in real terms, deflated by CPI, the economy wage fund decreased by 13.7% as compared to the same period of the previous year, as a result of developments in both the budgetary and real sectors of the economy (Chart 3.31).

In the third quarter of 2022, the annual growth of the average number of employees in the national economy slightly decreased to -0.4%. The number of employees in the real sector declined by 0.2%, with a contribution of -0.1 percentage points, while the number of employees in the budgetary sector contracted by 1.2%, with a contribution of -0.3 percentage points (Chart 3.32).

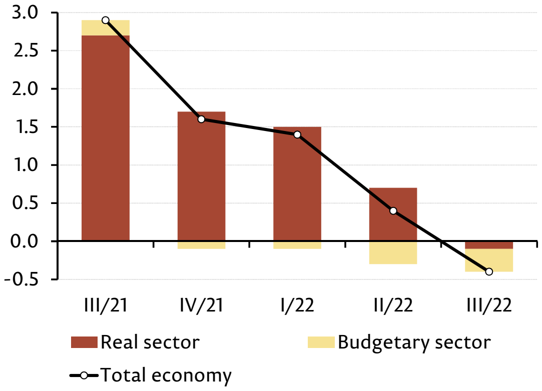
The distribution by sector of the economy shows increases in the average number of employees mainly in the following sectors: administrative and support services (5.5%), information and communication (4.8%), transport and storage (3.4%), real estate (2.6%), health and social work (2.1%) and wholesale and retail trade (1.9%). On the other hand, there was a decrease in the number of employees in agriculture (-8.5%), construction (-7.5%), food services (-3.3%), public administration (-2.1%) and education (-1.4%) (Chart 3.33).

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



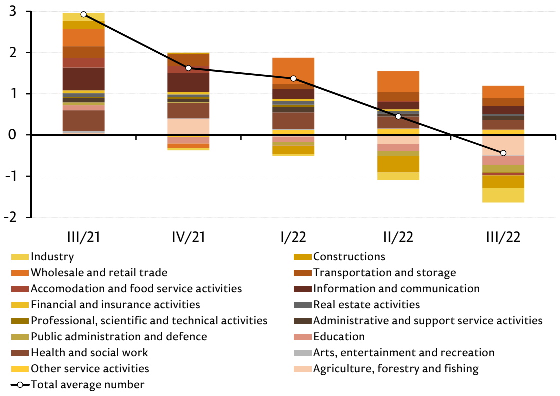
Source: NBS, NBM calculations

Chart 3.32: Average number of employees in the economy (%, compared to the previous year) and sector contributions (percentage points)



Source: NBS, NBM calculations

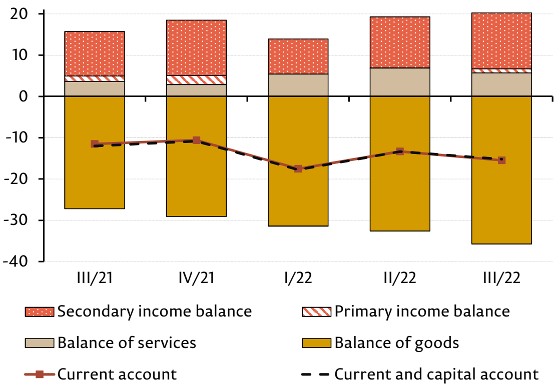
Chart 3.33: The contribution of the sectors of the economy to the dynamics of the number of employees (%, compared to previous year)



Source: NBS, NBM calculations

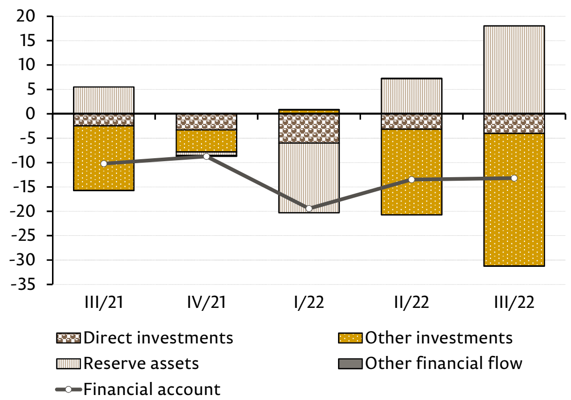
3.4 External sector

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



Source: NBM

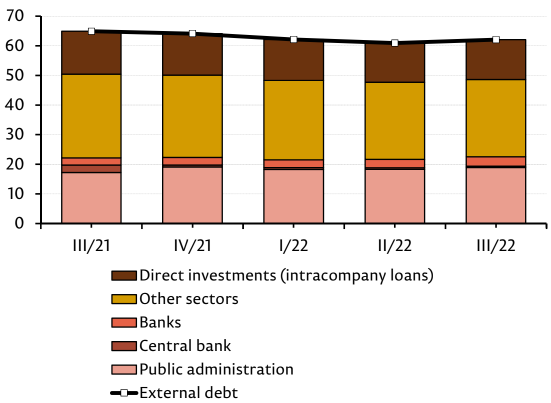
Chart 3.35: Share of financial account in GDP (%)



Source: NBM

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

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



Source: NBM

Current account

In the third quarter of 2022, the current account deficit of the balance of payments increased by 2.2 percentage points compared to the previous quarter, reaching 15.5% as a ratio to GDP (Chart 3.34). The increase in the balance of payments deficit was generated by an increase in the negative contribution component – the "balance of goods". At the same time, the components with a positive contribution: "secondary income balance" and "primary income balance" increased, while the "services balance" decreased during the reference period.

Financial account

In the third quarter of 2022, the financial account as a ratio to GDP registered a level of 13.2%, which is almost the same level as in the second quarter of 2022. At the same time, there were more significant changes in the structure of financial flows, but the overall picture compared to the previous quarter did not change significantly (Chart 3.35). Thus, in the third quarter of 2022, the "other investments" component recorded a substantial growth, thus contributing to the significant increase in net inflows of financial assets[24]. It should be noted that the net flow of direct investment, as a ratio to GDP, recorded a level of 4.0%, 0.9 percentage points higher than in the second quarter of 2022. In the third quarter of 2022, there was a net accumulation of reserve assets (18.0% as a ratio to GDP) resulting in a decrease in net capital inflows.

After a period of six consecutive quarters where the external debt-to-GDP ratio was on a downward trend, in the third quarter of 2022 it turned around, recording a level of 62.1% or 1.2 percentage points higher than in the second 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[25] with 29.3%, the government sector[26] is 19.4% and direct investments – 13.4%.

[24] In the third quarter of 2022 the components "cash and deposits" and "trade credits and advances" contributed to the significant increase in net financial inflows as part of "Other investments" component.

[25] Cumulative debt of "Banks" and "Other sectors".

[26] Cumulative debt of "Public Administration" and "Central bank".

Chapter 4

Monetary policy

4.1 Monetary policy instruments

Developments in money market interest rates

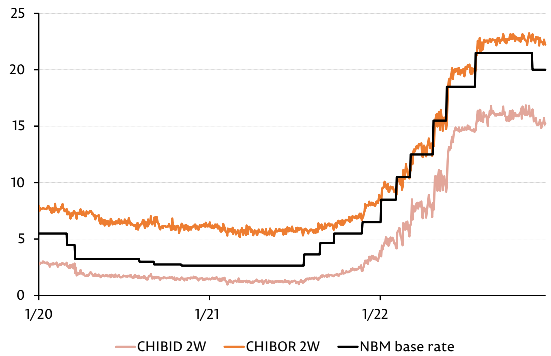
The monetary policy interest rate was maintained at 21.50% per annum at the November 2022 monetary policy meeting and subsequently lowered to 20.00% annually. The NBM decision to resume monetary policy easing was conditioned by the prospect of a reversal of the annual inflation trajectory after the peak in the fourth quarter of 2022 and the emergence of pronounced disinflationary pressures from aggregate demand.

The CHIBOR 2W yield curve remained relatively stable in October and November, oscillating in the upper part of the interest rate corridor. In the second half of December, the CHIBOR yield curve returned to a downward path under the impact of the decline in the base rate, but its amplitude was modest. Thus, the CHIBOR 2W rate at the end of December was 0.50 percentage points lower than on the last day of the previous quarter, standing at 22.23% (Chart 4.1).

The trajectory of interest rates on state securities with a 91-day maturity was slightly downward in the October-November period, amid strong investor bidding for this type of investment and a net issuance volume higher than announced. Following this, in anticipation of a resumption of monetary policy easing, the Ministry of Finance partially rejected investor bids for 91-day securities, causing interest rates to decline by more than 1 percentage point during the month of December. The value recorded in the last month of the fourth quarter amounted to 18.43% (-1.13 percentage points compared to the end of the third quarter of 2022) (Chart 4.2).

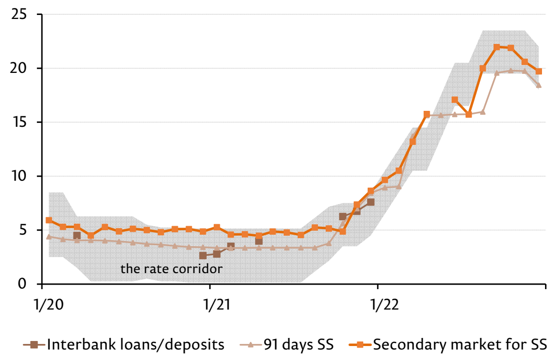
In the secondary segment of the state securities market, interest rates on transactions carried out developed somewhat similarly to rates in the primary market. Average monthly interest rates followed a downward trend, the value recorded in the last month of the fourth quarter amounted to 19.72% (-2.25 percentage points compared to the end of the third quarter of 2022), also associated with a significant decrease in the average maturity of transactions (about 100 days).

Chart 4.1: Average monthly reference rates on the interbank market and the base rate of the NBM (%)



Source: NBM

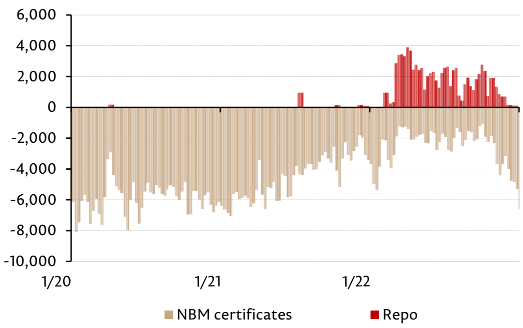
Chart 4.2: Monthly evolution of the interest rate corridor (%)



Source: NBM

Money market operations

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



Source: NBM

Sales of NBM certificates (NBC)

The daily stock of NBC placements increased significantly during the fourth quarter, recording a minimum value of MDL 1,057.9 million at the beginning of the reporting period and a maximum value of MDL 6,598.6 million at the end of the period, a situation also reflected on the value of the average quarterly balance, which amounted to MDL 3,423.6 million (MDL +1,450.3 million compared to the third quarter of 2022).

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

Repo operations

The positive sign of banks' net liquidity position in October and the subsequent consolidation of its relatively high values resulted in a marked reduction in banks' demand for liquidity in the last two months of the fourth quarter, implying a significant decrease in the number of participants and the volume of bids submitted in repo auctions. The average quarterly balance of repo operations decreased from MDL 2,333.9 million in the third quarter of 2022 to MDL 961.3 million in the period under review. Since there were no bids at the last two auctions, the repo balance at the end of the fourth quarter was zero.

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 fourth quarter of 2022 banks drew on both standing facilities offered by NBM.

The total volume of overnight deposits amounted to MDL 37,905.5 million, 55% higher than in the previous quarter. The average daily balance of MDL 548.1 million was about 1.6 times higher than in the previous quarter. The amounts placed by banks ranged from a minimum of MDL 10.0 million to a maximum of MDL 4,640.0 million.

The total amount of overnight loans granted to banks by NBM in the fourth quarter of 2022 amounted to MDL 1,001.0 million, a decrease of 2.4 times compared to the previous period. The average daily balance of overnight loans recorded MDL 32.6 million.

In December 2022, after several increases in the monetary policy rate corridor, the NBM reversed the upward trend in interest rates, lowering all rates by 1.5 percentage points. As a result, interest rates on NBM's standing facilities at the end of 2022 amounted to 18.00% for overnight deposits and 20.00% for overnight loans.

Required reserves

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

Against the background of disinflationary pressures, the NBM has initiated measures associated with stimulative monetary policy to inject additional liquidity into the money market. Thus, at the monetary policy meeting of 5 December 2022, the NBM Executive Board decided to decrease the required reserve ratio for two consecutive implementation periods. Thus, the reserve requirement ratio of funds attracted in MDL and non-convertible foreign currency was reduced from 40.0% to 34.0% (by 3.0 percentage points in the application period 16.12.2022-15.01.2023 and by 3.0 percentage points in the application period 16.01.2023-15.02.2023). The required reserve ratio of funds attracted in freely convertible currency (FCC) remained unchanged throughout the reporting quarter – 45.0%.

Thus, during the application period 16.12.2022-15.01.2023, required reserves in MDL amounted to 20,153.6 million lei, which is MDL 275.7 million (-1.3%) less than those maintained during the period 16.09.2022-15.10.2022.

Regarding the required reserves from the funds attracted in the FCC, during the application period 16.12.2022-15.01.2023 they amounted to USD 254.1 million and EUR 605.9 million. Compared with the period 16.09.2022-15.10.2022, required reserves in US dollars increased by 4.6% and those in Euro decreased by 2.1%.

Interbank money market

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

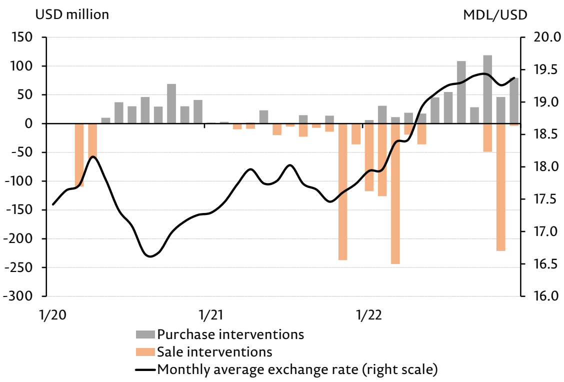
Interventions in the domestic foreign exchange market

NBM intervened in the domestic foreign exchange market in the period October-December 2022 through foreign exchange purchases and sales.

During the period under review, the volume of transactions of the National Bank of Moldova carried out on the interbank foreign exchange market against MDL, on the date of the currency, amounted to USD 520.09 million, including purchase transactions in the amount of USD 244.20 million and sale transactions in the amount of USD 274.18 million (of which USD 192.18 million equivalent to EUR 184.50 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 1.71 million.

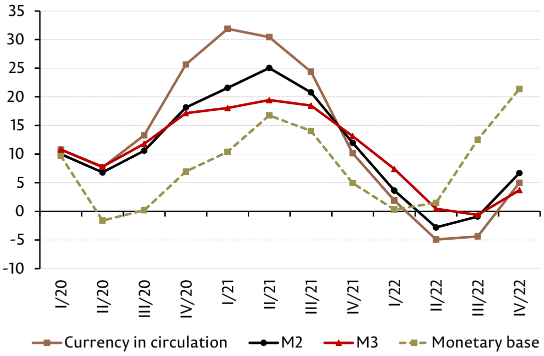
At the same time, during the reporting period, NBM carried out swap transactions amounting to USD 121.88 million (equivalent to EUR 120.0 million) (Chart 4.4).

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



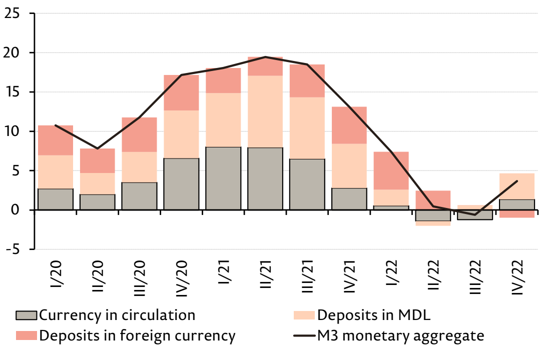
Source: NBM

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



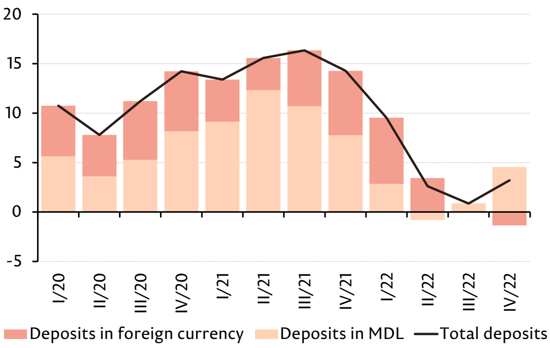
Source: NBM

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



Source: NBM

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



Source: NBM

4.2 Dynamics of monetary indicators

In the fourth quarter of 2022, the annual growth rate of monetary aggregates recorded an upward trend, with the M2 monetary aggregate recording an increase of 6.7% per annum (by 7.6 percentage points higher than in the third quarter of 2022), and M3 – an increase of 3.7% per year (4.3 percentage points higher than in the previous quarter). The monetary base during the fourth quarter of 2022 recorded a strong annual growth rate, amounting to 21.4% annually (Chart 4.5).

Money supply

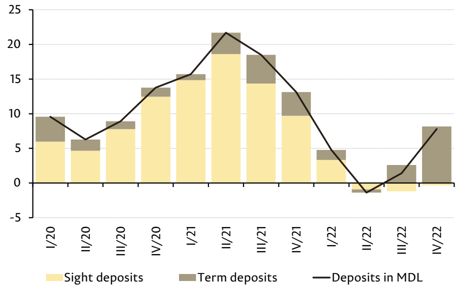
The evolution of the M3 monetary aggregate compared to the previous quarter was driven by the positive contribution from money in circulation, deposits in national currency and the negative contribution from foreign currency deposits, which provided the M3 monetary aggregate with an annual growth of 3.7% (Chart 4.6).

The increase in the balance of deposits in national currency by 7.8% annually (Chart 4.8) was generated by the growth of term deposits of individuals and legal entities and, at the same time, by the negative pace, compared to the previous quarter, of sight deposits of individuals.

Foreign currency deposits in the fourth quarter of 2022 decreased by 3.3% annually, 3.4 percentage points below the level recorded in the previous quarter, due to the decrease in term deposits of individuals (Chart 4.11). At the same time, sight deposits in foreign currency recorded more moderate increases compared to the previous quarter, amounting to 2.9% per annum (Chart 4.13).

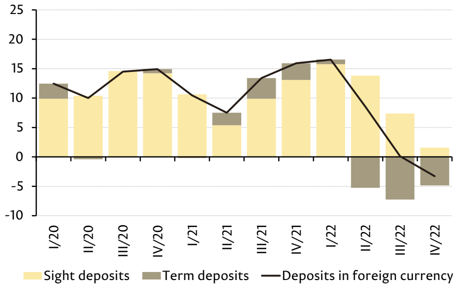
The growth rate of currency in circulation at the end of the fourth quarter of 2022 increased by 11.2 percentage points compared to the end of the previous quarter, amounting to 8.5% annually. The average quarterly contribution of currency in circulation to M3 growth increased by 2.6 percentage points from the level recorded in the third quarter of 2022 (Chart 4.6). The dynamics of currency in circulation were determined by both the inflow of cash receipts and the outflow of cash disbursements at commercial banks. Of the total cash inflows, the largest share was accounted for by inflows from the sale of consumer goods and inflows from the replenishment of individuals' current and deposit accounts. The main components of withdrawals from commercial banks were withdrawals for the purchase of foreign currency from individuals and withdrawals from ATMs and POS terminals.

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



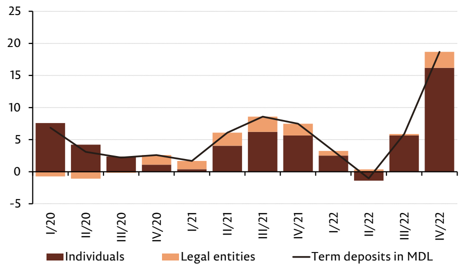
Source: NBM

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



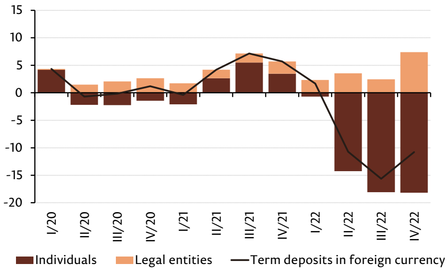
Source: NBM

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



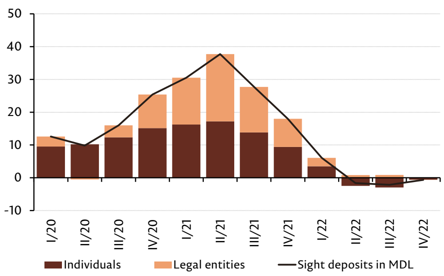
Source: NBM

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



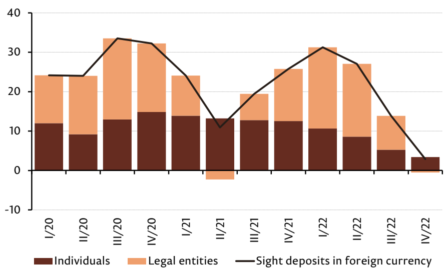
Source: NBM

Chart 4.10: Dynamics of sight deposits balance in MDL (%, comp. contrib. in annual growth)



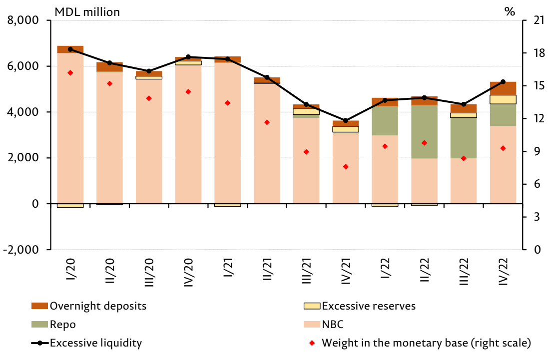
Source: NBM

Chart 4.13: Dynamics of sight deposits balance in foreign currency (%, comp. contrib. in annual growth)



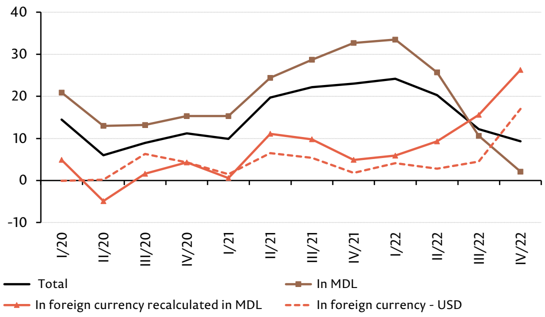
Source: NBM

Chart 4.14: Excessive liquidity



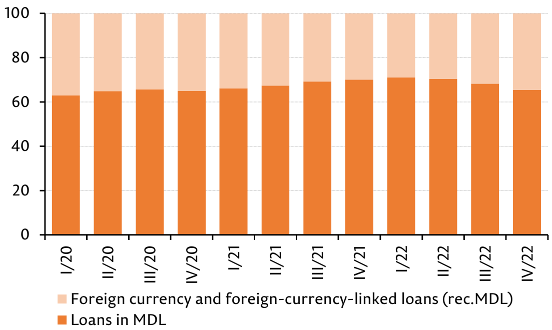
Source: NBM

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



Source: NBM

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



Source: NBM

Excessive liquidity

During the fourth quarter of 2022, the average excess liquidity in the banking system increased by MDL 978.1 million. It should be noted that compared to the fourth quarter of 2021 the volume of excess liquidity increased by MDL 1.69 billion, recording an average value of MDL 5.32 billion (Chart 4.14).

Loan market

Evolution of the balance of loans granted by licensed banks[27]

At the end of 2022, the total balance of loans granted by licensed banks recorded a positive annual growth (Chart 4.15) and amounted to MDL 59.6 billion, 9.3% higher than at the end of 2022, and 23.0% higher than at the end of 2021.

The annual dynamics had a downward trend as lending activity in MDL decreased (Chart 4.18). The share of the balance of loans granted in national currency decreased to 65.5% of the total balance of loans, compared to 70.1% at the end of the fourth quarter of 2021 (Chart 4.16). As of 31 December 2022, the growth rate of the balance of loans granted in national currency by licensed banks decreased to 2.1% per annum (Chart 4.15). The downward trend was largely influenced by the decrease in the balance of loans in MDL granted to individuals (1.8% annually), while the volume of new loans granted in MDL decreased (Chart 4.19). The share of the balance of loans in national currency granted to individuals was 60.7% of total loans in MDL.

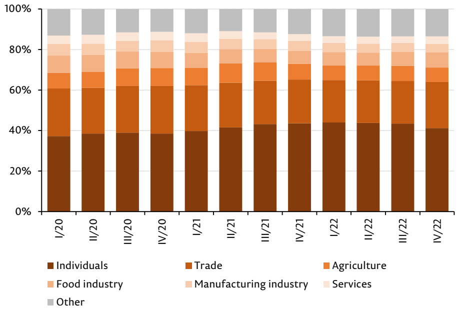
At the end of the fourth quarter of 2022, in the structure of the total portfolio of loans granted by licensed banks, the largest share, similarly to previous quarters, went to loans granted to individuals (41.2%), decreasing compared to previous quarters, followed by the share of loans granted to legal entities in the trade sector (22.8%), increasing compared to previous periods (Chart 4.17).

Evolution of new loans granted by licensed banks

In the fourth quarter of 2022, the annual dynamics of the total volume of new loans granted by licensed banks slowed down and amounted to -1.1%, compared to -11.6% in the third quarter of 2022, (Chart 4.18), due to the moderate decrease of the component in MDL (the share of which amounted to 62.0%, compared to 53.6% in the third quarter of 2022). The volume of new loans granted in MDL increased compared to the third quarter of 2022, amid the rise in the volume of loans granted to legal entities (Chart 4.19). The share of loans granted to legal entities increased in the fourth quarter of 2022 to 75.9% of total loans granted in national currency. At the same time, similar to the previous quarter, the volume of loans in MDL granted to individuals decreased by about 2 times compared to the same period of 2021.

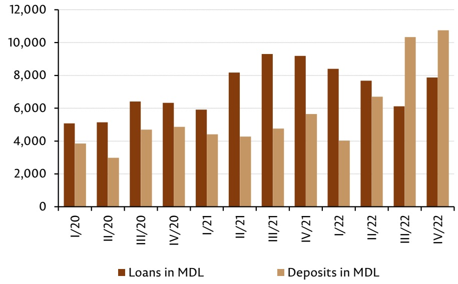
[27] The data analysis was carried out on the basis of the ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks by 11 January 2023.

Chart 4.17: Loan balance structure (% in total)



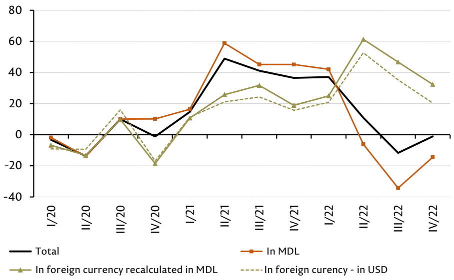
Source: NBM

Chart 4.20: Evolution of the volumes of term loans/deposits in MDL (million MDL)



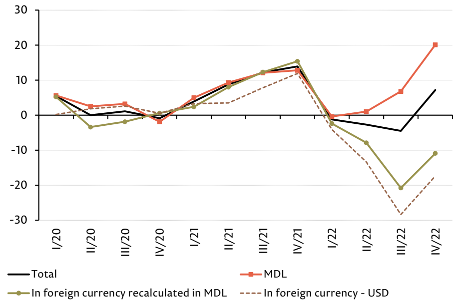
Source: NBM

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



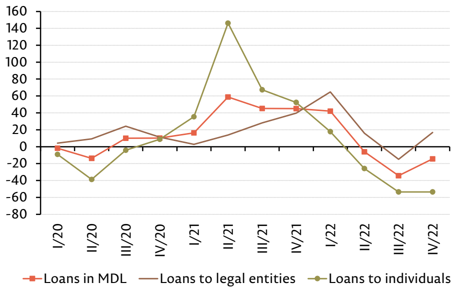
Source: NBM

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



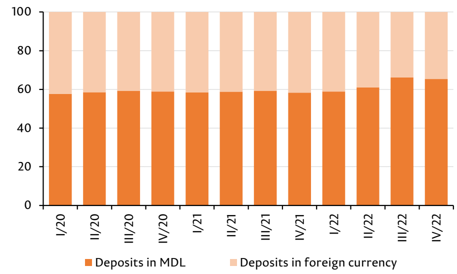
Source: NBM

Chart 4.19: Evolution of new loans granted in MDL (%, annual growth)



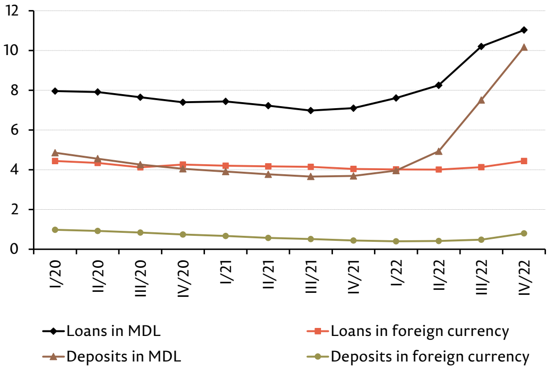
Source: NBM

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



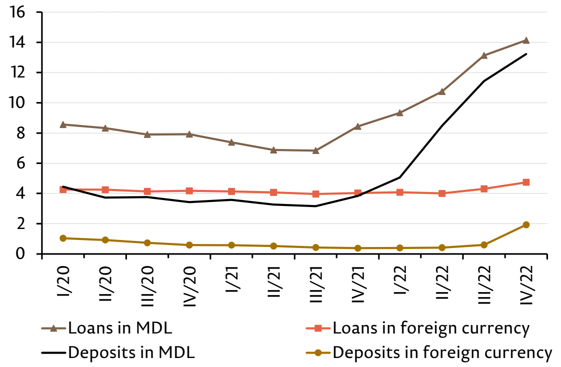
Source: NBM

Chart 4.23: Average interest rates on loan and deposit balances (%)



Source: NBM

Chart 4.24: Average interest rates on new loan and deposit volumes (%)



Source: NBM

In the context of continued high interest rates on national currency loans, demand for foreign currency loans increased, a segment with relatively stable interest rates. Thus, during the fourth quarter of 2022, foreign currency, and foreign currency-linked loans, recalculated in domestic currency, recorded an annual growth rate of 32.3% (Chart 4.18).

In the fourth quarter, in the domestic currency segment, the volume of loans granted by licensed banks was lower than the volume of term deposits attracted (Chart 4.20).

Market of term deposits accepted by licensed banks (balance of deposits)[28]

At the end of the reporting quarter, the total balance of term deposits attracted by licensed banks recorded an annual growth of 7.2%, as a result of the increase in the MDL component (Chart 4.21), associated with positive annual rates of deposits placed by both individuals and legal persons. Both sectors contributed to this development against the background of the upward trend in interest rates (Chart 4.23). The MDL component accounted for 65.3% of the total balance of term deposits attracted by licensed banks, compared to 58.3% at the end of the fourth quarter of 2021 (Chart 4.22). In contrast, the annual change in the balance of foreign currency deposits decreased by 10.9%, due to reductions in deposits placed by individuals.

Interest rates[29]

Evolution of the base rate

During the fourth 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 8 November 2022, decided to maintain the base rate applied to the main monetary policy operations at the level of 21.50% per annum. Following this, at its meeting on 5 December 2022, it was decided to lower the base rate on the main monetary policy operations by 1.50 percentage points to 20.00% annually. These measures were adopted in the context of the prospect of a reversal of the annual inflation path from its peak in the fourth quarter of 2022 and the emergence of pronounced disinflationary pressures from aggregate demand amid a negative GDP deviation over the forecast horizon. The aim of the decisions was to anchor inflation expectations and to return and maintain inflation close to the 5.0% target over the medium term, with a possible deviation of ±1.5 percentage points.

[28]The data analysis was based on ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks up to 11 January 2023 and does not include sight deposits.

[29]The analysis of rates was based on ORD 01.06 "Interest rates on balances of loans and deposits" reports submitted by licensed banks up to 11 January 2023 and does not include rates on sight deposits.

Evolution of interest rate on balance of loans

For the period October-December 2022, the weighted average interest rate on the balance of loans granted in MDL by licensed banks amounted to 11.03% per annum, higher than in the fourth quarter of 2021 by 3.93 percentage points and by 0.83 percentage points than in the third 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 fourth quarter of 2022, the weighted average interest rate on the balance of loans in foreign currency was 4.44% per year, 0.40 percentage points higher than in the fourth quarter of 2021.

Evolution of the interest rate related to the balance of deposits

In the fourth quarter of 2022, weighted average interest rates on the domestic currency segment increased (+6.48 percentage points compared to the fourth quarter of 2021). Thus, the weighted average interest rate on the balance of term deposits in national currency amounted to 10.17% annually (Chart 4.23). The weighted average interest rate on the balance of term deposits in foreign currency amounted to 0.80% per annum, 0.36 percentage points higher than in the fourth quarter of 2021.

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

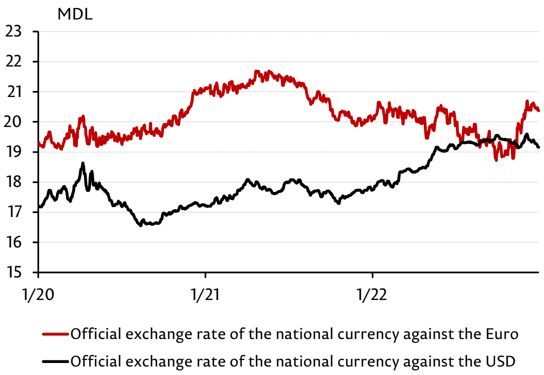
Weighted average interest rates on new term deposits and new loans in national currency increased their upward trend. In the fourth quarter of 2022 as a whole, the weighted average interest rate on deposits in MDL continued to grow and amounted to 13.23% per annum, 9.40 percentage points higher than in the fourth quarter of 2021 and 1.80 percentage points higher than in the third quarter of 2022 (Chart 4.24). The weighted average interest rate on term deposits attracted in national currency from individuals increased by 10.71 percentage points compared to the fourth quarter of 2021 and amounted to 15.15%. The weighted average interest rate on term deposits attracted from legal entities also increased to 8.50% per annum, compared to 2.65% annually in the fourth quarter of 2021.

The weighted average interest rate on new loans granted in national currency amounted to 14.14% per annum in the reporting quarter, 5.70 percentage points higher than in the fourth quarter of 2021.

Evolution of the nominal and real effective exchange rate

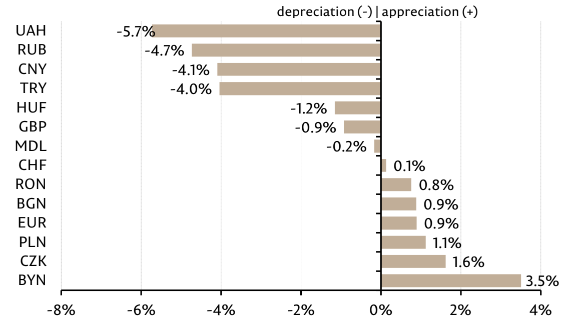
According to the values at the end of the fourth quarter of 2022, the official nominal exchange rate of the national currency appreciated by 2.0% against the US dollar, while it depreciated against the Euro by 7.3% compared to the levels recorded at the end of the previous quarter. On average, the Moldovan leu depreciated against both the US dollar and the Euro – by 0.2% and 1.1%, respectively, compared to the previous quarter's averages (Chart 4.25).

Chart 4.25: Fluctuations of the official exchange rate of the Moldovan Leu against the US dollar and the Euro



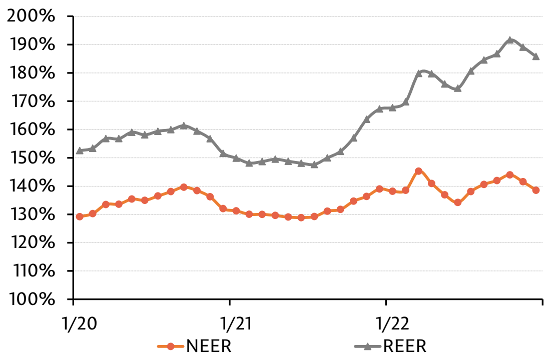
Source: NBM

Chart 4.26: The evolution of the main trading partners currencies against the US dollar, average exchange rate fourth quarter of 2022/ third quarter of 2022 (%)



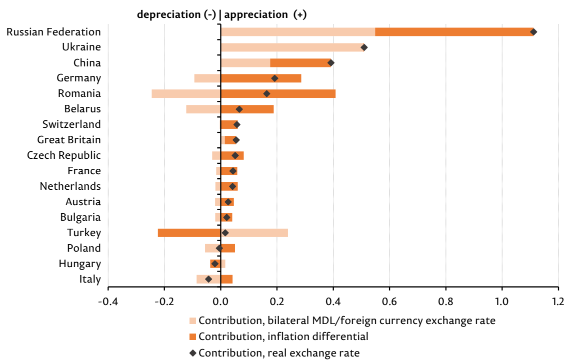
Source: NBM

Chart 4.27: 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 4.28: Contribution of the main trading partners of the Republic of Moldova to the change in the real effective exchange rate in the fourth quarter of 2022



Source: NBM

In terms of the evolution of the main trading partners' currencies, the Ukrainian hryvnia lost more than 5.0% of its value against the US dollar in the fourth quarter amid uncertainties related to the escalation of the war between Ukraine and Russia. The Russian ruble (4.7%), the Chinese yuan renminbi (4.1%), and the Turkish lira (4.0%) depreciated more moderately compared to the end of the previous quarter. At the same time, most Central and Eastern European currencies, along with the Euro, strengthened their positions against the US dollar (Chart 4.26).

Under these conditions, in real terms, the Moldovan leu appreciated by 2.6% against the basket of currencies of the main trading partners of the Republic of Moldova (average of the fourth quarter of 2022 compared to the average of the third quarter of 2022). The Russian Federation (1.1 percentage points) and Ukraine (0.5 percentage points) made the largest contributions to the appreciation of the REER (Chart 4.28).

The local foreign exchange market developed atypically for the fourth quarter, with a foreign exchange surplus in October and December, while a foreign exchange shortage was recorded only in November amid developments in the energy market. In this respect, the official exchange rate of the Moldovan leu against the US dollar, although it followed a sinuous, showed an overall upward trend, with a relatively short depreciation phase.

The net supply of foreign exchange from individuals, amounting to USD 795.4 million, decreased slightly compared to the previous quarter (-8.0%) and practically doubled in annual terms (+87.9%). In terms of supply by source, transfers from abroad to individuals decreased by 5.1% and increased by 14.1% respectively compared to the same period. The continued preference of individuals for savings in national currency, as a result of the NBM's disinflationary policy through high monetary policy rates, also contributed to the relatively high net supply of foreign exchange in the fourth quarter of 2022. In this regard, the dollarization of deposits of individuals decreased by 3.4 percentage points from the end of the previous quarter.

In the structure of the net supply of foreign currency from individuals, the single European currency continued to account for the largest share (92.8%[30]) (Chart 4.29).

Net demand for foreign currency by economic agents, reached a new all-time high of USD 913.0 million in the period under review, with more than half of it in November (USD 467.1 million). Compared to the previous quarter, net demand for foreign currency by economic agents increased by 18.6% and exceeded the level recorded in the fourth quarter of 2021 by 16.6%, while the trade balance in goods worsened by 3.3% and 42.7% respectively[31]. In the total net demand for the foreign currency, that from importers of energy resources amounted to about 84.0%, driven by higher import prices, the need to ensure the country's energy security by building up natural gas reserves, but also by the decrease in demand for foreign currency from other types of importers, together with the reduction in public consumption and investment activity by economic operators. In the fourth quarter of 2022, an

[30]Share calculated by applying a constant rate

[31]Based on data available at the time of reporting (October-November 2022)

additional factor increasing demand for foreign currency was the increase in dividend payments to foreign investors.

On the side of supply of foreign currency from economic operators, in the fourth quarter, there were highlighted purchases of foreign currency from representatives of international organizations for managing the flow of refugees from Ukraine, the energy crisis and for the implementation of various development projects in the country, as well as from exporters of agricultural products and retail operators founded by foreign investors.

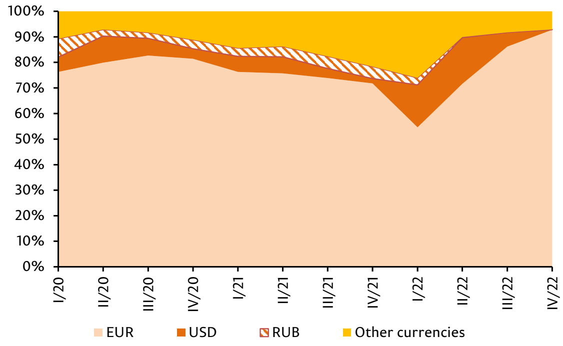
Under these circumstances, the coverage of net demand for foreign exchange from economic operators by net supply of foreign exchange from individuals amounted to 87.1% in the period under review (Chart 4.30), compared to 112.4% in the previous quarter and 54.1% in the fourth quarter of 2021. Thus, setting the stage for NBM interventions of net sale of foreign exchange in the amount of USD 30.0 million.

As regards the MDL/USD exchange rate dynamics during the period under review, it followed an appreciation trend in the first half of the quarter amid a foreign exchange surplus. This was the result of a substantial supply of foreign currency from both individuals and economic operators, on the one hand, and a moderate demand for foreign currency from importers of energy resources, on the other, in view of the unusually high temperatures for this period, which led to the postponement of the start of the heating season. With its commencement and the temporary reorientation of electricity purchases from European markets at higher prices, starting from the second half of November 2022, the Moldovan leu depreciated against the US dollar until the beginning of December 2022. Subsequently, the exchange rate trend reversed amid an oversupply of foreign currency characteristic of the winter holiday period, but also due to the resumption of purchases of electricity at a lower price from traditional sources.

The dynamics of the official exchange rate of the Moldovan leu against the Euro was also influenced by the evolution of the single European currency against the US dollar on international markets. During the period under review, the European currency against the US dollar followed an upward trend, exiting below parity in the third quarter of 2022. Although the FRS has reacted faster and more firmly than the European Central Bank on rates in the tightening monetary policy framework in order to bring inflation close to target, US unemployment and wage indicators remain volatile, creating uncertainty about the pace of inflation. Regarding the euro area, despite the fact that the inflation rate has moderated, due to lower energy tariffs as a result of unusually high temperatures in the winter months of 2022-2023, with Europe thus reaching the limit of its natural gas storage capacity, the ECB announced at its December meeting a further rate increase in the near future.

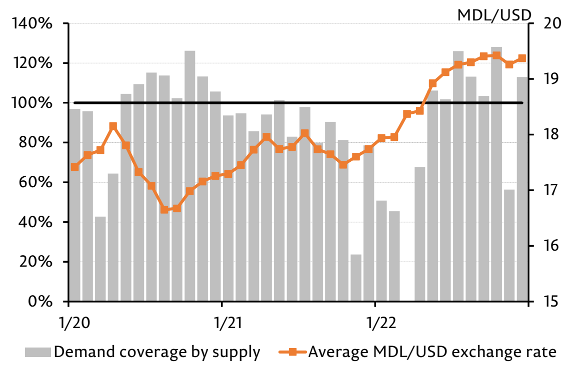
Thus, by the end of the fourth quarter of 2022, compared to the end of the previous quarter, the Euro appreciated by 9.5% against the US dollar.

Chart 4.29: The net supply of foreign currency from individuals disaggregated by major currencies (the currencies are recalculated in USD at the average constant exchange rate)



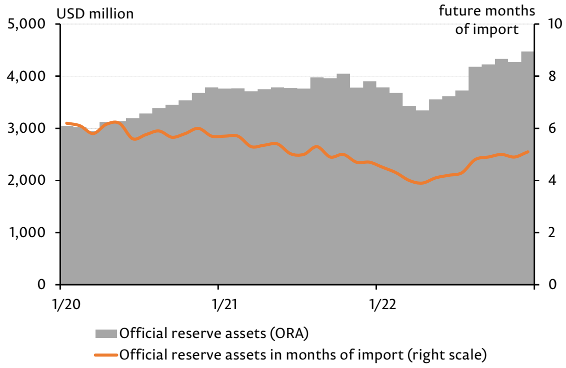
Source: NBM

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



Source: NBM

Chart 4.31: Evolution of official reserve assets expressed in months of import of goods and services (MBP6)



Source: NBM – based on updated actual and forecast data

At the end of December 2022, the balance of official reserve assets amounted to USD 4,474.2 million (Chart 4.31), an increase of USD 246.6 million (+5.8%) compared to the end of September. This increase was mainly due to inflows from external financing. The largest outflows were mainly in the form of grants as budget support. These grants were disbursed by the International Bank for Reconstruction and Development (USD 43.8 million) under the project "Moldova, Emergency Preparedness, Resilience and Competitiveness. Development Policy Operation", by the Government of Germany to ensure energy security for vulnerable population groups (USD 41.9 million, equivalent to EUR 40.3 million) and by the Government of Romania (USD 10.3 million, equivalent to EUR 10.5 million). The French Development Agency provided a loan of EUR 60.0 million (USD 63.9 million) for the modernisation of the energy and railway system.

At the same time, external development partners provided several loans and grants totalling USD 47.3 million to finance investment projects.

According to the situation at the end of the fourth quarter of 2022, official reserve assets continued to ensure a sufficient level of coverage of imports of goods and services (5.1 months of future imports[32]).

[32] Calculated on the basis of the Ministry of Economy’s forecast of imports of goods.

Chapter 5

Forecast

5.1 External assumptions

In the current round of forecasting, external assumptions point to weak external demand, lower international price growth rates and continued risks and uncertainties in the region. As the IMF, has warned, by 2023, one third of the world's economies will be in recession. Rising interest rates and moderating global demand will temper international price growth rates, but they will still be well above pre-pandemic averages. In the region, the economic situation will continue to be affected by the war in Ukraine and the energy crisis in Europe. Although abnormally high temperatures for the cold season in Europe have led to a drop in natural gas prices, Europe's energy crisis is far from over and will have a significant impact on economic developments in the coming years. Based on the trajectory of interest rate forecasts in the US and the euro area, we can expect an increase in EUR/USD parity, i.e., a depreciation of the US dollar and an appreciation of the European single currency. At the same time, prices of agri-food products on the international market are expected to decrease compared to their peaks in 2022. The table 5.1 outlines the values of the main external assumptions accepted in the forecast round for the Inflation Report, February 2023, with a further description.

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

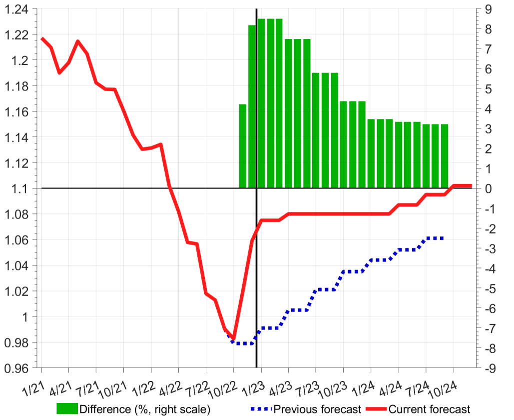
	2023	2024
Economic growth in the euro area (%)	0.0	1.2
Economic growth in the Russian Federation (%)	-2.9	1.3
Average annual inflation in the euro area (%)	5.9	2.4
Average annual inflation in the Russian Federation (%)	6.2	5.5
EUR/USD	1.08	1.09
USD/RUB	71.6	78.0
Urals brand oil prices (USD/barrel)	79.4	76.4
International food prices growth (%)	-7.2	-0.3

Source: Consensus Economics, Bloomberg, NBM calculations

According to the current round forecast, the **euro area economy** will stagnate in 2023, after which it will recover and grow by an average of 1.2% in 2024. Economic stagnation in 2023 in the euro area will be caused by a moderation in consumer demand because of rising interest rates and lower output volumes amid rising energy resource costs. At the same time, investment in energy infrastructure will contribute to euro area economic growth in the medium to long term. **Harmonised inflation in the euro area** will be around 5.9% in 2023 and then 2.4% in 2024, close to the ECB target.

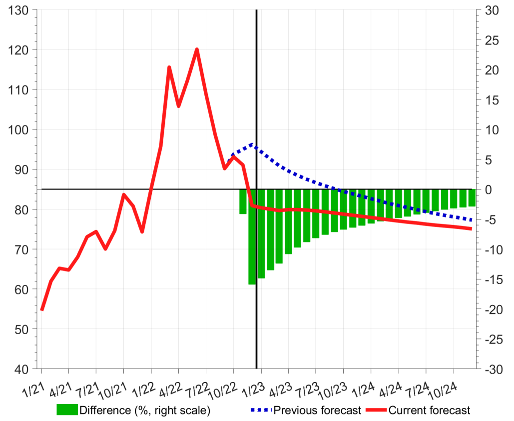
After an economic regression of about 3.5% in 2022, the **Russian Federation's economy** is expected to continue to decline by 2.9% in 2023, followed by a possible slight growth of 1.3% in 2024. The Russian Federation's economy will continue to be affected by the consequences of economic sanctions, declining revenues from raw material exports and increased budget spending on the military at the expense of structural investment in the economy. At the same time, the increase in domestic consumption in correlation with the decrease in imports will support domestic production. Consumer prices in the Russian Federation will moderate and inflation will tend towards the Bank of Russia's target level towards the end of the forecast horizon. Thus, in the current forecast

Chart 5.1: EUR/USD exchange rate assumption



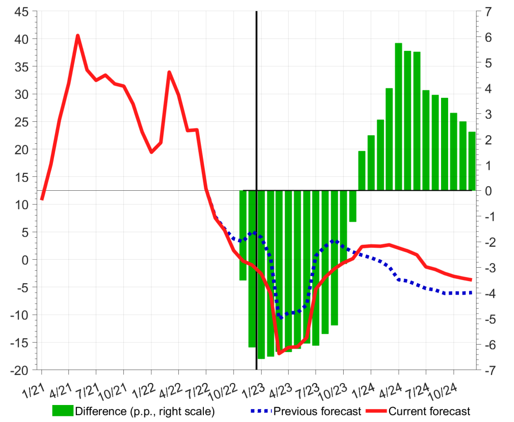
Source: ECB, Consensus Economics, NBM calculations

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

period, **average annual inflation in the Russian Federation** will be 6.2% in 2023 and 5.5% in 2024.

Parity **EUR/USD** will increase over the forecast horizon. Thus, the depreciation of the US dollar will reflect the moderation in the pace of monetary policy tightening by the FRS and lower global risk premium. The European single currency will appreciate because of further interest rate increases by the ECB and a more favourable outlook for economic developments due to lower energy prices and efforts to overcome the energy crisis in Europe. In the current forecast round, the average annual EUR/USD parity is expected to be 1.08 in 2023 and 1.09 in 2024 (Chart 5.1).

It is expected that the **Russian ruble** will continue its depreciation trend and will average 71.6 USD /RUB in 2023 and 78.0 USD/RUB in 2024. The depreciation will be caused by the consequences of the economic sanctions on Russia and, in particular, by the decrease in the supply of foreign currency from exporters in correlation with the increase in demand for foreign currency amid the recovery of imports. At the same time, as of 13 January 2023, the Bank of Russia has resumed foreign currency buying and selling transactions on the domestic foreign exchange market as part of the implementation of the budget regulation mechanism by the Ministry of Finance of Russia. The transactions will be carried out in the foreign exchange section of the Moscow Stock Exchange in Chinese yuan.

Current forecasts reflect relatively stable levels for oil prices. For **Brent** an average level of 79.4 USD/barrel is expected in 2023 and 76.4 USD/barrel in 2024. This situation does not reflect a lack of influencing factors on the world oil market, but rather a counterbalancing of uncertainties and risks on both the demand and supply side of the global oil market. Slowing growth in the world economy will lead to lower consumer demand. Also, if China abandons its "zero-COVID" policy, there will be no sudden increase in oil imports as existing stocks are in surplus. At the same time, oil supply will continue to be determined by OPEC+, the USA plans to buy oil to supplement state reserves and the consequences of the economic sanctions on the import of oil and oil products imposed by the West on the Russian Federation (Chart 5.2).

International food prices will decrease on average by 7.2% in 2023 and by 0.3% in 2024. The decline in international market prices for agri-food products is expected to reflect a return to pre-war trends in Ukraine and a consumption of the peaks reached amid significantly increased uncertainty. At the same time, a satisfactory harvest is expected for most crops, albeit at increased prices due to high production, storage, and processing costs, especially for energy and fertiliser resources. In Europe, there is a risk that the 2023 harvest, especially the autumn crops, will be partly affected by the abnormally high temperatures this winter and the intensity of winds which may dehydrate arable areas (Chart 5.3).

5.2 The internal environment

Inflation

The annual inflation rate will continue on a rapid downward trend during the current year and remain relatively stable thereafter until the end of the forecast period[33]. Inflation will return to the target range in the second quarter of 2024 and remain there until the end of the forecast horizon (Chart 5.4). In terms of monthly inflation there is a high probability that it will be within the range of uncertainty at the end of December 2023.

High annual inflation rates will be driven by positive impacts from regulated prices, food prices, core inflation and, to a lesser extent, fuel prices (Chart 5.5).

The presence of factors such as (1) disinflationary domestic demand in the current year and first half of next year, (2) high base in 2022, (3) recent electricity tariff adjustments, (4) continued tempering of imported inflation next year, (5) continued decline in international oil prices over the forecast horizon, (6) moderate anticipated decrease in external energy prices, (7) negative impact of highly seasonal commodity prices in the second and the third quarters of 2023 will cause the annual inflation rate to decline.

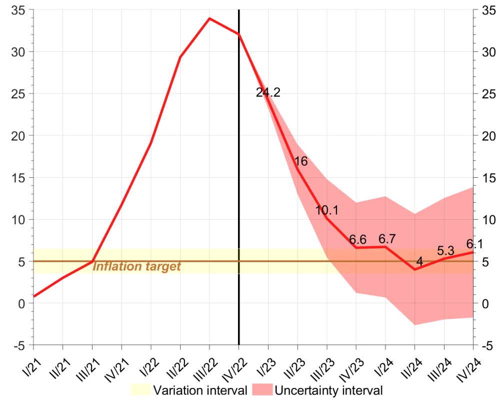
At the same time, (1) cumulative increases in international energy resource prices, (2) recent and anticipated current year adjustments to a number of tariffs, (3) excise tax adjustments in early 2023 and 2024, (4) second round effects from tariff adjustments that will further increase production expenditures, (5) slight upward trend in international food prices for four consecutive quarters, starting in the second quarter of 2023, (6) slight depreciation trend of the domestic currency, (7) inflationary domestic demand in the second half of 2024, (8) the impact of strong seasonal products in the second and third quarters of 2024 will attenuate the downward annual pace and contribute to its acceleration during 2024.

The annual inflation rate for the forecast period will peak at 24.2% in the first quarter of 2023 and will reach a low of 4.0% in the second quarter of 2024.

Average annual inflation will be 13.7% and 5.5% this year and next year respectively.

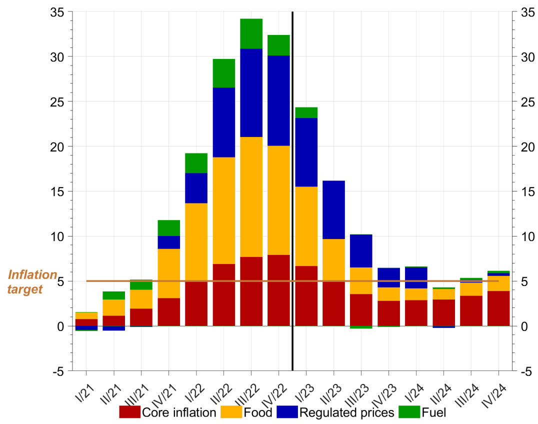
The annual rate of core inflation will decline rapidly during the current year and then increase slightly by the end of the forecast horizon[34] (Chart 5.6).

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



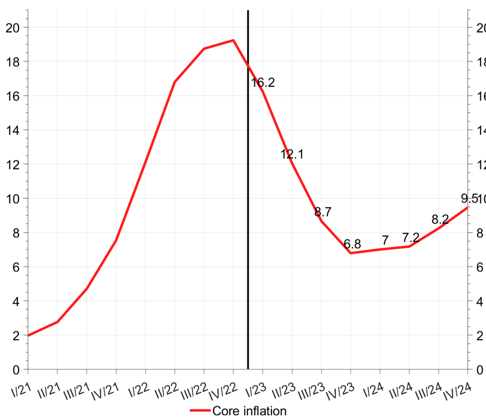
Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

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

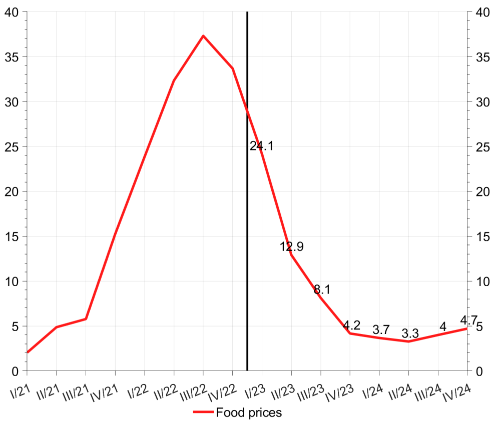


Source: NBS, NBM calculations

[33] Fourth quarter of 2024.

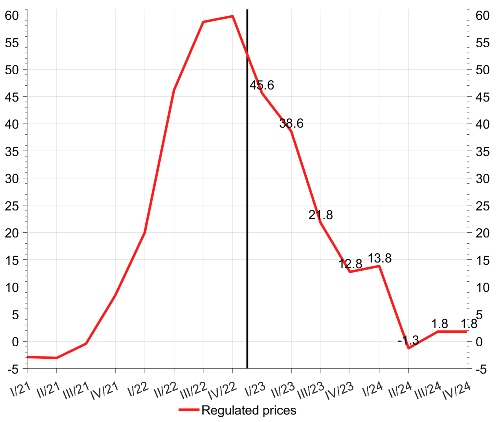
[34] First quarter of 2023 – fourth quarter of 2024.

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

The downward trend in core inflation will be driven by (1) disinflationary internal demand in the current year and the first half of next year, (2) the high base in the previous year, and (3) continued moderation in imported inflation from the second quarter of 2023 onwards. At the same time, (1) inflationary domestic demand in the second half of 2024, (2) the mild depreciation trend of the national currency, (3) the excise tax adjustment in early 2023 and 2024, and (4) the second-round effects from the tariff adjustment, which will further generate growth in production expenditures, will dampen the downward annual pace and help accelerate it during the year 2024.

Average annual core inflation will amount to 10.8% and 8.0% in 2023 and 2024, respectively.

The annual rate of food prices will follow a downward trend until the second quarter of 2024, thereafter increasing slightly until the end of the forecast horizon (Chart 5.7).

The downward trend in the annual food price rate will be influenced by (1) the negative aggregate demand in the current year and the first half of next year, (2) the negative pace of import inflation for the first three consecutive quarters of the current year and the second half of next year, (3) the high base, (4) the negative impact of highly seasonal product prices in the second and third quarters of 2023. Second-round effects from the tariff adjustment, which will further increase production expenditures, (2) positive aggregate demand in the second half of 2024, (3) the mild upward trend in international food prices for four consecutive quarters starting in the second quarter of 2023, (4) the excise tax adjustment in early 2023 and 2024, and (5) the impact of strongly seasonal products in the second and third quarters of 2024 will moderate the slowdown in the annual pace and contribute to the mild increase in the second half of 2024.

The average annual rate of food prices will account for 11.8% and 3.9% in 2023 and 2024, respectively.

The annual pace of regulated prices will decrease significantly for the whole forecast period (Chart 5.8).

The annual pace will be determined by recent and anticipated adjustments in the first half of this year to several tariffs. Cost increases, particularly for energy and payroll, on the one hand, and non-adjustment or insufficient adjustment of tariffs for those services over long periods, in some cases years, are the main factors driving high rates of increase in regulated prices.

The decrease in the annual pace 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 medium-term inflation forecast includes several tariff adjustments that will mainly take place in the first part of this year. Thus, January will reflect the decrease in the electricity tariff approved at the end of December. At the same time, in January-February 2023 the increase in the water and sewage tariff in Chisinau will be reflected. The scenario also assumes water and sewerage tariff adjustments in other regions of the country in the first quarter of 2023, following previous requests from suppliers. In the context of a different pricing mechanism for medicines in 2023, the forecast includes more pronounced increases for medicines in the first half of this year, after which they will moderate.

Intercity and inter-regional fares, as assumed, will be relatively stable. At the same time, the forecast also includes the reflection in January 2023 of the increase in urban transport fares in the municipality of Balti. Also, since the beginning of this year, the health insurance policy has increased by about three times. According to the forecast, its effect on regulated prices will be reflected in two stages, in January and April of 2023.

With the end of the cold-weather energy resource cost compensation period, the NBS will reflect the full increase in approved tariffs at the end of 2022, resulting in strong increases for natural gas and heat prices within the CPI in April 2023. At the same time, the downward trend in regional natural gas prices creates preconditions for covering financial deviations from previous periods as well as for reducing the current tariff. This has supported the inclusion of a decrease in the natural gas and heat tariff in the middle of this year. The rest of the subcomponents (other), within the regulated prices, show moderate and relatively stable price dynamics.

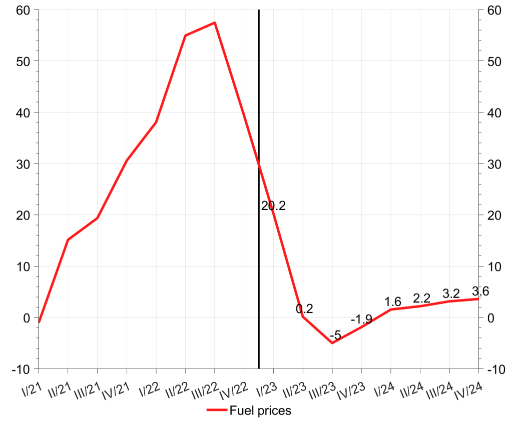
The average annual rate of regulated prices will be 28.0% and 3.7% in 2023 and 2024 respectively.

The annual rate of fuel prices will continue to decline significantly in the first three consecutive forecast quarters, after which it will increase slightly 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 this year and the first half of next year and (3) the effect of the high annual base. The excise tax adjustment in early 2023 and 2024 and (2) positive aggregate demand in the second half of 2024 will moderate the decline in the annual rate and contribute to its slight increase next year.

The average annual rate of fuel prices will be 2.5% and 2.6% in 2023 and 2024 respectively.

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

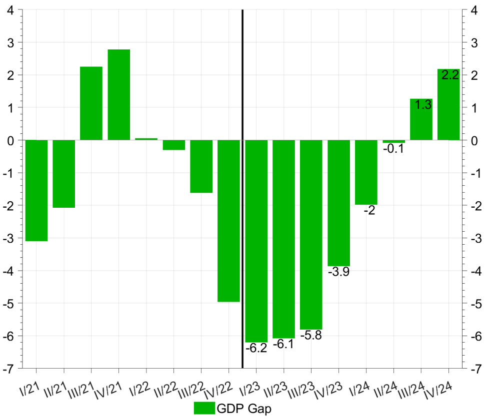


Source: NBS, NBM calculations

Demand

Aggregate demand will be negative during this year and the first half of next year due to deteriorating external demand and household consumption financing, as well as tightening monetary conditions. The neutral fiscal impulse will maintain a negative aggregate demand in the first part of the forecast, followed by a positive impact in the second half of next year (Chart 5.10).

Chart 5.10: GDP deviation (%)



Source: NBM calculations

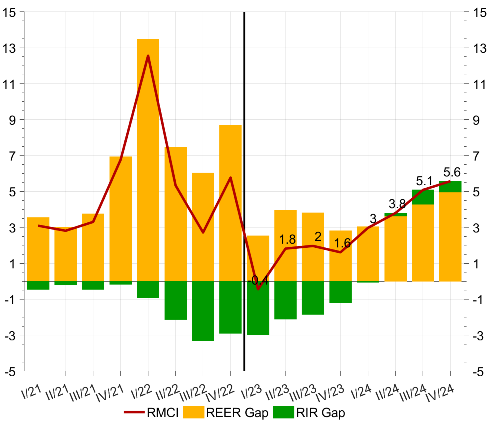
Deteriorating external demand, (2) a decline in real terms in the sources of financing for household consumption, and (3) slightly tightening real monetary conditions will be the main factors driving down aggregate demand.

Positive fiscal impulse, recovering albeit negative external demand and favourable agrometeorological conditions during the current year will mitigate the decline in aggregate demand and lead to positive aggregate demand in the second half of next year.

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 during the current year and early next year, after which it will be restrictive until the end of the forecast horizon. External demand from both eastern and western economic partners will mainly have a negative impact on domestic demand.

Monetary policy

Chart 5.11: Real monetary conditions index and decomposition



Source: NBM calculations

Real monetary conditions for aggregate demand will be insignificantly stimulative in the first quarter of 2023 and restrictive for the rest of the forecast period (Chart 5.11). Monetary policy via the real effective exchange rate will be restrictive; via the real interest rate it will be stimulative during the current year and in the first quarter of 2024, after which it will be restrictive until the end of the forecast horizon.

The real depreciation of the domestic currency has significantly reduced the deviation of the real effective exchange rate from its steady-state level, thereby easing the restrictive effects on aggregate demand in the first quarter of the forecast. The accumulated appreciation and high inflation relative to that of trading partners will maintain the imbalance in the real effective exchange rate, which will continue to exert restrictive effects on aggregate demand.

5.3 Comparison of forecasts

The current inflation forecast compared to the previous inflation report[35], has been revised downwards for the whole comparable period[36], except for the last quarter, where it is slightly higher (Chart 5.12).

The downward trend in the annual inflation rate forecast is driven by a decline for the whole comparable period in the forecast for core inflation, regulated prices except for the second quarter of 2023, fuel prices for the first four consecutive quarters and food prices in the first and fourth quarter 2023 and the second quarter 2024. The increase in the forecast for food prices in the second and third quarter of 2023 and the first and third quarter of 2024, regulated prices in the second quarter of 2023, and fuel prices in the first quarter of 2024 and to the end of the comparable period will revise the current forecast upwards (Chart 5.13).

The lower projection of the annual inflation rate forecast is driven by (1) the expectation of tighter aggregate demand, except for the last two quarters of the comparable period, (2) a significantly lower forecast of international oil prices and the import price of natural gas, (3) lower actual inflation than anticipated for the previous quarter, (4) a significantly declining short-term forecast, (5) a lower path of import inflation in the first three quarters of the comparable period and in the second quarter of 2024.

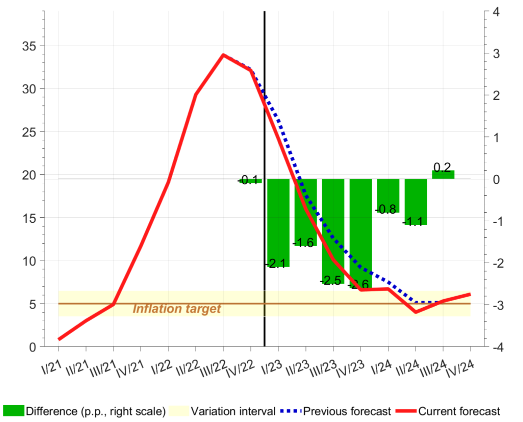
At the same time, (1) a larger adjustment in excise tax, (2) the expectation of higher aggregate demand in the second and third quarter of 2024, (3) a higher path of import inflation in the fourth quarter of 2023 and the first and third quarter of 2024, (4) but also the expectation of tariff increases in the second quarter of 2023 will mitigate the downward revision of the current forecast.

The average annual inflation rate has been decreased by 2.3 percentage points for 2023 and by 0.2 percentage points for 2024.

The current annual core inflation forecast has been revised downwards over the whole comparable period (Chart 5.14).

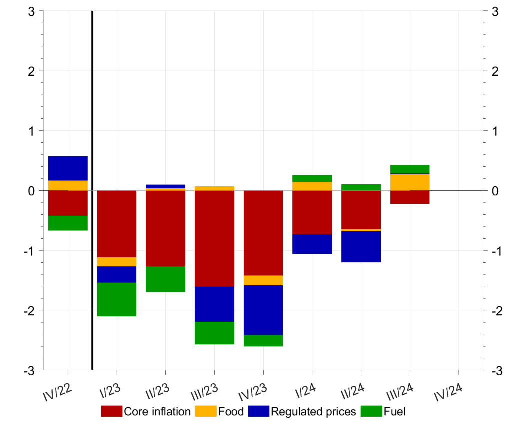
The lower projection of the current forecast relative to the previous one is driven by (1) lower actual inflation than anticipated in the previous quarter, (2) a significantly declining near-term forecast, (3) the expectation of tighter aggregate demand, except for the last two quarters of the comparable period, and (4) a lower path of imported inflation from the second half of the current year to the end of the comparable period. Higher rates of (1) imported inflation in the first half of the current year, (2) a larger excise adjustment, and (3) the anticipation of higher aggregate demand in the second and third quarter of 2024 have dampened the downward revision to the current forecast.

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



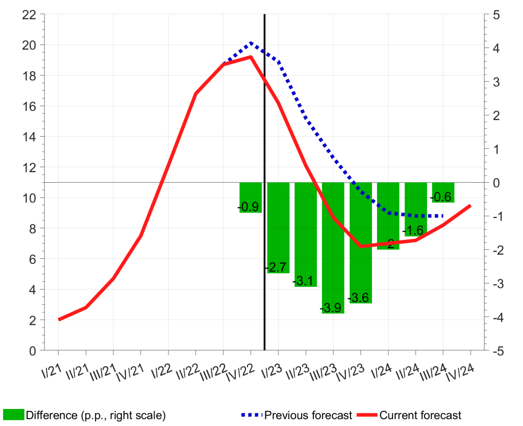
Source: NBS, NBM calculations

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



Source: NBM calculations

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

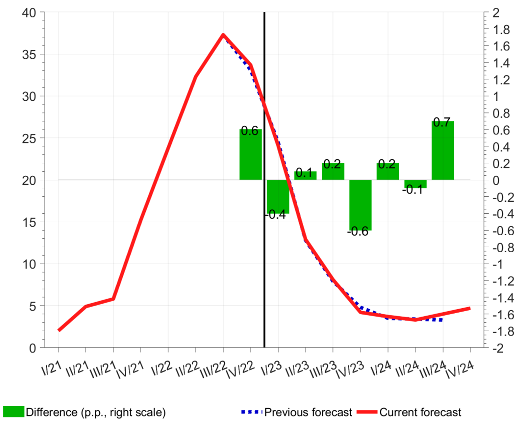


Source: NBS, NBM calculations

[35] Inflation Report, November 2022

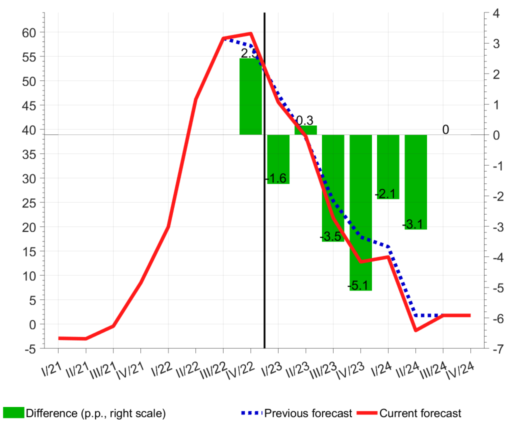
[36] First quarter of 2023 – third quarter of 2024.

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



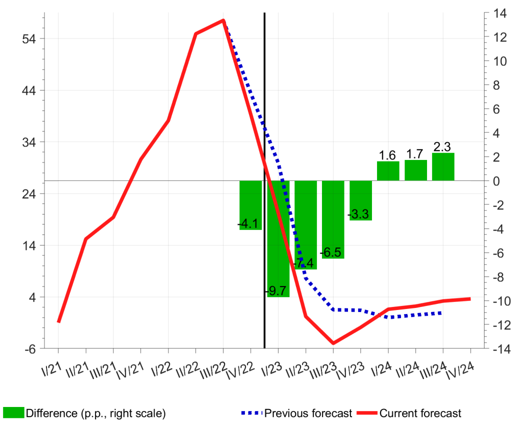
Source: NBS, NBM calculations

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

The forecast average core inflation rate was reduced by 3.3 percentage points for 2023 and by 0.8 percentage points for 2024.

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

The revision to the food price growth rate forecast is driven downward by (1) a declining short-term forecast, (2) an expectation of predominantly tighter aggregate demand, and (3) a lower forecast for imported inflation this year.

At the same time, (1) higher actual inflation than anticipated in the previous quarter, (2) higher imported inflation next year, (3) a larger excise tax adjustment, and (4) the expectation of higher aggregate demand in the second and third quarter of 2024 contributed negatively to the revision of the current forecast.

The average food rate forecast has been lowered by 0.2 percentage points for 2023 and raised by 0.6 percentage points for 2024.

The current forecast of the annual rate of regulated prices is revised, for the most part, downwards over the whole comparable period (Chart 5.16).

Lower forecasts for oil prices on international markets and the import price of natural gas have led to the expectation of lower tariffs during the current year and, therefore, to a downward revision of the forecast rate of increase in regulated prices. Higher-than-expected inflation in the fourth quarter of 2022, but also the anticipation of tariff increases in the second quarter of 2023 has dampened the downward revision of the current forecast.

The forecast average regulated price rate has been lowered by 2.7 percentage points for 2023 and by 1.3 percentage points for 2024.

The annual fuel price rate forecast has been lowered for the current year and increased for the rest of the comparable period (Chart 5.17).

The lower forecast for the annual rate of fuel prices is influenced by (1) lower actual inflation than anticipated for the previous quarter, (2) the expectation of a predominantly tighter aggregate demand and (3) a significantly lower forecast for international oil prices. At the same time, (1) a higher anticipated adjustment in excise taxes and (2) higher aggregate demand in the second and third quarter of 2024 revised the current forecast upwards.

The forecast average fuel price rate was lowered by 6.5 percentage points for 2023 and increased by 2.0 percentage points for 2024.

5.4 Risks and uncertainties

External sector

- **Regional economic and geopolitical crisis.** The war 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 conditions (uncertainty).
- **Tempering global demand.** Recently, the IMF warned that a third of the world's economies will be in recession by 2023. This will lead to lower global demand and restructuring of consumer markets, and will probably result in some price declines, but only to the extent that production costs allow (disinflationary).
- **Increased uncertainties about energy prices.** Energy prices have fallen significantly in recent times, but the uncertainties associated with the underlying factors have increased. Oil prices are oscillating between reduced supply of 2 million barrels per day by OPEC+ and EU sanctions on the import of oil and oil derivatives from Russia and the tempering of global demand, particularly in China. Natural gas prices in Europe have fallen significantly to USD 574/1,000 cubic metres on 16 January 2023, due to the very high temperatures for the cold season of the year, which limits natural gas consumption. Electricity prices in Europe are also falling as strong winds have contributed to a significant amount of wind power. While oil prices are more stable, natural gas and electricity prices are unpredictable and probably short-lived. Thus, in the coming months uncertainties will increase, but the volatility of the indicators will probably be quite low (uncertainty).
- **Damage to agriculture caused by high cold season temperatures in Europe.** According to experts in the field, temperatures this winter season in Europe are abnormally high, which could seriously affect this year's agricultural harvest in Europe. High temperatures could cause early vegetation of autumn and fruit crops, and lack of snow and strong winds could severely dehydrate arable areas (pro-inflationary).
- **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 the central banks, which tended to ensure their fundamental objective of price stability, the standards for financing costs changed. Thus, loans and credits contracted 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 servicing old debts at much higher interest rates (uncertainty).

Real sector

- **Uncertainties about the timing and magnitude of adjustment of tariffs for regulated services.** The medium-term inflation forecast is based on a trajectory of prices for regulated services corresponding to certain assumptions on 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 concerned. Therefore, the timing and magnitude of tariff adjustments cannot be estimated with a sufficient degree of confidence (uncertainty).
- **Decrease in regional natural gas prices and possible domestic tariff adjustment.** The decrease in natural gas prices at the end of last year and the beginning of this year would create the preconditions for a decrease in the gas grid and heat tariffs. However, given that there are still gas reserves procured at a higher price, as well as tariff deviations accumulated in previous periods, the tariff decrease may take longer (uncertainty, disinflationary).
- **Uncertainties about the supply of the required volume of electricity, import price and electricity tariff.** The insufficient volume of electricity supplied and the need to identify alternative suppliers for the medium forecast horizon means increased uncertainty for electricity tariffs. 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).
- **War in Ukraine.** The war-related events in the neighbouring country pose additional risks to the prices of some goods traded on the domestic market. Thus, the substitution of Ukrainian products (which are found in abundance on the Moldovan market, being the most accessible by price in the region) with similar products, but from another country of origin (more expensive), causes pronounced price adjustments. From a logistical point of view, economic operators are forced to use alternative routes (avoiding the territory of Ukraine) to export/import products, as well as to identify new suppliers in exchange for existing ones, which will contribute in some cases to higher transport costs (pro-inflationary).
- **Decrease in the number of consumers on the territory of the Republic of Moldova.** The war in Ukraine has led to a massive outflow of people from Ukraine. Some of the refugees are on the territory of the Republic of Moldova, which contributes directly to the increase in population consumption. Their return to the country of origin or their departure to other regions would lead to lower demand on the domestic market (uncertainty, disinflationary).

- **Vulnerability of domestic fruit and vegetable prices to weather conditions in the immediate future.** According to the experience of recent years, the prices of domestic fruit and vegetables are to a large extent affected by adverse weather conditions such as frosts, heavy rainfall, the costs associated with harvesting, transport, storage, and their commercialisation in sales points in the country. In case 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 and 2024.** The harvest in the next two years, i.e., food prices on the internal market, will depend, for the most part, on the agrometeorological conditions during that period. Therefore, developments in the agricultural sector and hence the trajectory of food prices for the years 2023 and 2024 is marked by pronounced uncertainty (uncertainty).

- **Uncertainties about the dynamics of medicine prices.** From 2023 a new mechanism for the formation of final prices for medicines will be implemented. This will allow drug manufacturers to increase prices by up to 15.0% per year, depending on the rate of inflation in the previous year. The authorities also want to change the price formation mechanism for medicine registration[37]. Whereas previously the authorities accepted producers offering the lowest price, now the price will be set considering four and more reference countries (uncertainty, pro-inflationary).

Monetary and public sectors

- **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 may affect Moldova's net exports. Combined with the recent increase in prices of goods and services on the international market, the trade balance deficit will continue to be negative, fuelling depreciation pressures on the Moldovan leu (pro-inflationary).

- **Financial stability.** If the regional situation deteriorates in connection with the war in Ukraine, the national economy could experience several consecutive years of recession. The volume of deposits will decrease or have low dynamics (withdrawal of deposits, probability of national currency instability, difficult public finance situation etc.), which may lead to reduced liquidity in banks and reduced lending to the national economy, thus contributing to the slowdown in economic activity. Under these circumstances, the solvency of many debtors of the domestic financial system will also worsen, which will deteriorate the financial stability of the country.

  The situation could also be aggravated by higher interest rates on loans, with inflation in double digits, and lower real incomes due to a slowdown in economic activity and higher financing costs for previously contracted loans (uncertainty).

[37] https://gov.md/sites/default/files/document/attachments/subiect-05-nu-522-ms-2022_0.pdf

- **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 and electricity, the Government has developed a mechanism to compensate 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).

- **Estimation of budget revenue.** In the case of revenue overestimation, practice calls for tighter fiscal management measures and/or recourse to expenditure cuts (expenditure freezes). In the case of revenue underestimation, recourse can be had to budget expenditure increases (while preserving or reducing the deficit), another approach would be to promote a counter-cyclical policy, which would mean saving excess receipts for use in future budgets without recourse to borrowing (uncertainty).

- **Estimation of budgetary expenditure.** The budget expenditure forecast is based on the estimated expenditure for the maintenance of obligations already undertaken, social, wage and investment policies currently being developed, as well as proposals for new policies that are or will be implemented. In the case of overestimation of expenditures, there is a mechanism for correcting budgetary expenditures, during this period only priority expenditures are financed, which are also specified in the law (servicing the state debt, salaries, pensions, social allowances etc.). In the case of underestimation of expenditures, they can be revised upwards, without allowing the deficit to be exceeded (uncertainty).

- **Sustainability of public finances.** High inflation, the probability 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 in the government securities, thus affecting the sustainability of public finances and the capacity 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.

  Against the backdrop of the energy crisis and inflationary developments, there is a major risk for local public administrations (LPAs) of insufficient budget allocations to cover the rising costs of thermal energy services, commensurate with the lack of resources in these budgets. As a result, there is a risk that arrears will be created in this expenditure item and that, in order to cover them, LPAs will have to resort to support from the state budget, in particular for delegated competences, or will have to stop the activity of some budgetary institutions (social assistance centres, cultural activities etc.), thus encountering difficulties in the execution of the national public budget in the coming periods (uncertainty).

- **External financing.** The European Commission proposed on 24 January 2023 to increase the ongoing macro-financial assistance to the Republic of Moldova by up to EUR 145 million (EUR 45 million – grant, EUR 100 million – loan), bringing the total amount of support to EUR 295 million. For 2023, the Government of the Republic of Moldova expects external financial assistance in the form of loans and grants to increase considerably, which will allow for faster implementation of reforms in the national economy and create additional inflationary incentives. 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 (pro-inflationary).

Chapter 6

Monetary policy decisions

Summary
of the meeting of the Executive Board of the National Bank of Moldova of June 3, 2022
on monetary policy promotion

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 Șchendra – Deputy Governor, Mr. Arcadie Albul – Deputy Governor
Rapporteur: Mr. Radu Cuhal – Director of the Monetary Policy Department
Guests: Mr. Natan Garștea – Advisor to the Governor, Mr. Octavian Teaca – Deputy Director, Monetary Policy Department, Head of Macroeconomic Analysis and Forecasting Department, Mr. Daniel Savin – Director of the Financial Markets Department, Mrs. Valentina Rusu – Head of General Legal Assistance Division, Legal Department, Mrs. Alina Boboc – Head of Communication and Financial Education Division

The meeting of the Executive Board of the NBM on monetary policy started with the presentation of the Report on the assessment of the risk of deviation from the inflation forecast by Mr. Radu Cuhal. It was pointed out that the report was prepared based on data and events available in the external and domestic environment after the April forecast round. At the same time, the trends of the main macroeconomic indicators were specified, identifying the risks that could affect the inflation forecast in the short and medium term.

EB members assessed and analysed the information on macroeconomic developments available since the April forecast and found confirmation of some of the assumptions and conclusions included in the Inflation Report, May 2022. At the same time, EB members noted that the updated information points to the persistence of downside risks to the inflation forecast.

Analysing the external environment, EB members stressed that regional and global economic conditions remain affected by the tense situation caused by the war in Ukraine with associated risks and uncertainties. Global inflation was referred to, noting that the driving factors behind its acceleration are the continued rise in international commodity, food and energy prices and disruptions in the supply, production, and transport chains.

In this regard, the conduct of anti-inflationary monetary policy promoted by central banks was discussed as a response to upward revisions of inflation forecasts for the coming quarters. Attention was drawn to the regional and international context, which unbalances the domestic macroeconomic environment and puts pressure on inflation dynamics through the import channel. In this context, the increased dependence of the Republic of Moldova on quotations and developments on international markets was highlighted, noting the pronounced vulnerability of our country to price shocks in comparison with other countries.

In the discussions related to the evolution of domestic inflation, EB members noted that the annual inflation rate accelerated from 22.2% in March to 27.1% in April this year. Assessing the determinants of these developments, it was noted that in addition to the import component of the inflationary process, an important factor that has amplified inflation is the delay in adjusting regulated tariffs. EB members remarked that the negative deviation of 0.3 percentage points of actual inflation from the April 2022 forecast, together with the delay of some tariff adjustments and the expected side effects, implies the likelihood of downward deviation of the inflation forecast in the second quarter of 2022. At the same time, EB members expressed concern about the tense situation in the region and the risks of its escalation, pointing out that these keep the medium-term inflation forecast highly uncertain.

In estimating the inflation outlook, it was stressed that the factors determining inflation dynamics continue to be import prices for energy resources and food. It was mentioned that the latter will possibly replace goods from Ukraine, and that these pro-inflationary effects will activate supply factors through production costs.

During the discussions related to the national economic activity, the EB members noted that the operational statistical data published by the NBS after the April forecast round points to positive economic growth in the current first quarter, but markedly weaker than in the previous quarter.

Analysing the economic outlook, EB members agreed that the medium-term path of GDP depends on the course of the war in Ukraine and the risks and uncertainties associated with it. In this respect, the factors that could affect household consumption were identified. On the one hand, a pro-inflationary impact from refugee demand and, on the other hand, a disinflationary impact from the perspective of the attenuation of consumption financing sources linked to the contraction of remittances have been observed. Emphasis was placed on the persistence of the trend towards product substitution and restructuring of sectors of the economy against the background of disruptions in supply chains and foreign trade logistics. At the same time, it was pointed out that the rising cost of mineral fertilisers and energy resources is forcing farmers to bear high costs, which is a precondition for lower agricultural activity this year and the maintenance of high food prices.

Following this, EB members commented on monetary conditions, noting that, adjusted by the restrictive nature of the monetary policy promoted, they remain favourable to support saving, the attractiveness of deposits and, at the same time, the dampening of population consumption, as well as consumer credit which heats up the economy and fuels pro-inflationary pressures.

Following the analysis of the statistical data on the money market, it was noted that interest rates on new loans granted in national currency have increased and lending pace have slowed down, thus easing pressures on the inflationary process. At the same time, despite an upward trend in rates on new deposits attracted in the national currency, the reluctance of depositors was highlighted amid uncertainties related to developments of the war in the neighbouring country. However, weekly data show an upward trend in the volume of new deposits attracted in Moldovan lei, after a decrease in March this year.

EB members expressed concern about global, regional, and national risks and uncertainties, pointing to their amplification amid the repercussions of the war in Ukraine, noting the uncertain outlook for economic conditions in the context of these events.

Guided by the analysis and assessment of the available macroeconomic information, after the April forecast round, the EB members found that there is a risk that the medium-term inflation forecast remains on the upside for the whole forecast horizon, except for the second quarter of this year.

External assumptions associated with lower global economic activity and higher oil and international food prices compared to the Inflation Report, May 2022 expectations underpinned the estimate of the downside risk. In addition, it was pointed out that domestic risks related to possible actions by the authorities to support the population and economic agents in the coming periods, as well as the adjustment of regulated tariffs, will also have a pro-inflationary influence.

Thus, following the analyses and conclusions of the meeting, the Executive Board of the National Bank of Moldova noted that the risks and uncertainties related to consumer price stability are major, which requires maintaining the restrictive nature of monetary policy. Thus, the EB unanimously decided to increase the base rate and the standing facility rates by 3.0 percentage points.

At the same time, the Executive Board of the National Bank of Moldova increased the reserve requirement ratio on funds attracted in MDL and non-convertible foreign currency and on funds attracted in freely convertible foreign currency by 4.0 percentage points and 6.0 percentage points respectively for the next two consecutive reserve maintenance periods.

During the meeting, the appropriateness of monetary policy measures was justified from the perspective of mitigating the second-round effects of external price shocks, balancing aggregate demand, stimulating saving at the expense of immediate consumption, and reducing pressures on the depreciation of the national currency because of the increase of the current account deficit and capital outflows.

At the same time, the EB members underlined that the monetary policy promoted by the NBM creates monetary conditions that are expected to mitigate the alert growth rates of consumer prices and the side effects of supply shocks. Thus, the NBM aims to anchor inflation expectations and bring inflation back within ±1.5 percentage points of the 5.0% medium-term inflation target.

By the end of the meeting, it was stressed that further decisions of the Executive Board will depend on the dynamics and medium-term outlook for inflation, monitoring and assessing risks in the internal and external environment. At the same time, it was reiterated that monetary and fiscal measures should be coordinated and interact to maximise their effects on the real economy and inflation.

Decision adopted unanimously by the Executive Board of the National Bank of Moldova:

1. **The base rate applied to the main short-term monetary policy operations shall be set at 18.50% annually.**
2. **Interest rates are set:**
   a) **on overnight loans at 20.50% annually;**
   b) **on overnight deposits, at 16.50% annually.**
3. **The required reserve ratio from the financial means attracted in Moldovan lei and in non-convertible currency shall be increased as follows:**
   a) **with effect from the reserve maintenance period in Moldovan lei commencing on June 16, 2022 to July 15, 2022, from 30.0% up to 32.0% of the calculation base;**
   b) **with effect from the reserve maintenance period in Moldovan lei commencing on July 16, 2022 to August 15, 2022, from 32.0% up to 34.0% of the calculation base.**
4. **The required reserve ratio from the financial means attracted in freely convertible foreign currency assets shall be increased as follows:**
   a) **with effect from the reserve maintenance period in freely convertible foreign currency commencing on June 16, 2022 to July 15, 2022, from 33.0% up to 36.0% of the calculation base;**
   b) **with effect from the reserve maintenance period in freely convertible foreign currency commencing on July 16, 2022 to August 15, 2022, from 36.0% up to 39.0% of the calculation base.**

Voting results of EB members

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 August 4, 2022
on monetary policy promotion

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

At the beginning of the Executive Board meeting on monetary policy promotion, Mr. Radu Cuhal introduced the new round of the medium-term forecast, reflecting recent macroeconomic developments as well as risks and uncertainties identified when the Inflation Report August 2022 was prepared.

The Executive Board noted that the global economic situation continues to worsen and is exposed to increased uncertainties.

With regard to the evolution of the domestic inflationary process, EB members noted that the annual inflation rate increased from 22.2% in March 2022 to 31.8% in June 2022. The price growth was driven by the increase of international and regional quotations for food and energy resources, resulting in higher prices on the internal market for both goods and services. The adjustment of gas, heat and electricity tariffs, the increase in fuel prices and wage growth have increased costs for economic agents, which have gradually been reflected in prices. The war in Ukraine has put additional pressure on the prices of food, fuel, and some components of core inflation. The depreciation of the Moldovan Leu against the US dollar generated additional inflationary pressures on some components of the CPI. EB members noted that demand pressures have decreased, insignificantly affecting food prices and core inflation components.

Analysing the external environment, EB members agreed that the situation of the world economy continues to worsen. Rising international prices, tighter monetary policies, higher production costs, an increase in the number of COVID-19 cases and the reintroduction of quarantine in China have dampened global economic activity. An aggressive increase in the Federal Reserve System's interest rate range in June, along with rising risk premiums, contributed to the significant appreciation of the US dollar. The Euro depreciated in July to parity with the US dollar due to interest rate differentials and government bonds. Europe's gas crisis worsened at the end of June, with the price reaching USD 1,900 per 1,000 m^3. International agri-food prices have decreased slightly in recent months, because of rising expectations for the northern hemisphere harvest and improving grain conditions at some major producers.

In discussions associated with national economic activity, the Executive Board determined that it slowed significantly earlier this year, with the annual real GDP growth rate at 1.1% in first quarter of 2022. The slowdown in economic activity was driven by weaker domestic demand (as a result of declining real household incomes and tighter credit conditions), increased uncertainty in the region, and the emergence of barriers to foreign trade because of the war in Ukraine. On the demand side, exports, government consumption and imports increased, investment declined, and household consumption remained almost unchanged. On the supply side, trade and the financial sector developed positively, while the agricultural, industrial and construction sectors contracted. Several indicators available for April-June 2022 outline conditions of reduced economic activity in the second quarter of 2022.

Following this, the attention of EB members was directed towards monetary conditions. It was pointed out that excess liquidity in the banking sector amounted to MDL 4.6 billion, increasing by MDL 0.1 billion in the second quarter of 2022 compared to the previous quarter. The annual growth of monetary aggregates decreased in the second quarter of 2022 compared to the previous quarter, primarily on account of money in circulation and currency deposits. Interest rates on outstanding loans in national currency increased by 0.64 percentage points compared with the previous quarter, while interest rates on deposits increased by 0.97 percentage points. Interest rates on foreign currency loans and deposits remained unchanged.

Following the meeting, EB members referred to the current inflation forecast. External assumptions of increasing or maintaining pro-inflationary pressures from international quotes, moderating external demand, maintaining the Euro parity against the US dollar were found to be appropriate for the current forecast, and the Russian ruble reflecting domestic monetary operations in the absence of capital account functioning.

Consumer prices are also expected to increase rapidly in the upcoming period, given the increase in external prices for food and energy, the war in Ukraine, the need to adjust tariffs for natural gas supply and related services and their spill-over effects, pension indexation and wage growth.

EB members expect the annual inflation rate to peak in the current third quarter and decline thereafter, returning to the range at the end of the forecast horizon in the second quarter of 2024. The annual rate of the inflation components will increase until the end of the year but will decline thereafter, except for food, which will decline from the fourth quarter of 2022. Aggregate demand will be negative throughout the forecast period due to deteriorating external demand and household consumption financing but will be boosted by persistent positive fiscal impulse and, to a minor extent, by monetary conditions.

The inflation forecast has been increased until early next year and largely lowered for the rest of the comparable period. By component, the forecast for food and fuel prices has been raised and core inflation – lowered; for regulated prices – increased until the first half of 2023 and lowered thereafter.

EB members noted the increased uncertainty that characterises the current forecast. Externally, sources such as tightening monetary policies in major economies, moderating demand in China and other large economies, the energy crisis in Europe, the war in Ukraine, limited supply of raw materials and worsening agrometeorological conditions in Europe are emerging. Key internal uncertainties include tariff adjustments, weather conditions, refugee flows, external trade disruptions, the increasing number of COVID-19 cases.

EB members estimated that the risks to inflation developments remain pro-inflationary. As a result, the Executive Board of the National Bank of Moldova decided to increase the base rate and the standing facility rates by 3.0 percentage points. In addition, the required reserve ratio of funds attracted in Moldovan lei and non-convertible foreign currency and the required reserve ratio of funds attracted in freely convertible foreign currency were increased by 6.0 percentage points.

EB members stressed that today's decision was taken with a view to moderating the alarming rates of growth in consumer prices, mitigating the side effects of supply shocks, stimulating financial intermediation in domestic currency, and saving over consumption, equilibrating the trade balance, and anchoring inflationary expectations.

At the same time, it was noted that the magnitude of monetary policy measures was calibrated to support the decline in the consumer price index from the fourth quarter of 2022 onwards.

By the end of the meeting, the high probability that the adopted measures can complete the tightening cycle of monetary policy was stressed, provided that no major unanticipated pro-inflationary shocks are expected in the immediate future. Once future projections provide a solid basis for monetary policy easing, the NBM will take the necessary measures to bring inflation back to its 5.0% target.

Decision adopted by the Executive Board of the National Bank of Moldova:

1. **The base rate applied to the main short-term monetary policy operations shall be set at 21.50% annually.**

2. **Interest rates are set:**
   a) **on overnight loans at 23.50% annually;**
   b) **on overnight deposits, at 19.50% annually.**

3. **The required reserve ratio from the financial means attracted in Moldovan lei and non-convertible currency shall be increased as follows:**
   a) **with effect from the reserve maintenance period in MDL commencing on August 16, 2022 to September 15, 2022, from 34.0% up to 37.0% of the calculation base;**

b) **with effect from the reserve maintenance period in Moldovan lei commencing on September 16, 2022 to October 15, 2022, from 37.0% up to 40.0% of the calculation base.**

4. **The required reserve ratio from the financial means attracted in freely convertible foreign currency assets shall be increased as follows:**

   a) **with effect from the reserve maintenance period in freely convertible foreign currency commencing on August 16, 2022 to September 15, 2022, from 39.0% up to 42.0% of the calculation base;**

   b) **with effect from the reserve maintenance period in freely convertible foreign currency commencing on September 16, 2022 to October 15, 2022, from 42.0% up to 45.0% of the calculation base.**

The Executive Board of the National Bank of Moldova approved for publication the Inflation Report, August 2022.

Voting results of EB members

PRO – 5 AGAINST – 0

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

Octavian ARMAȘU **Sergiu SURDU**

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