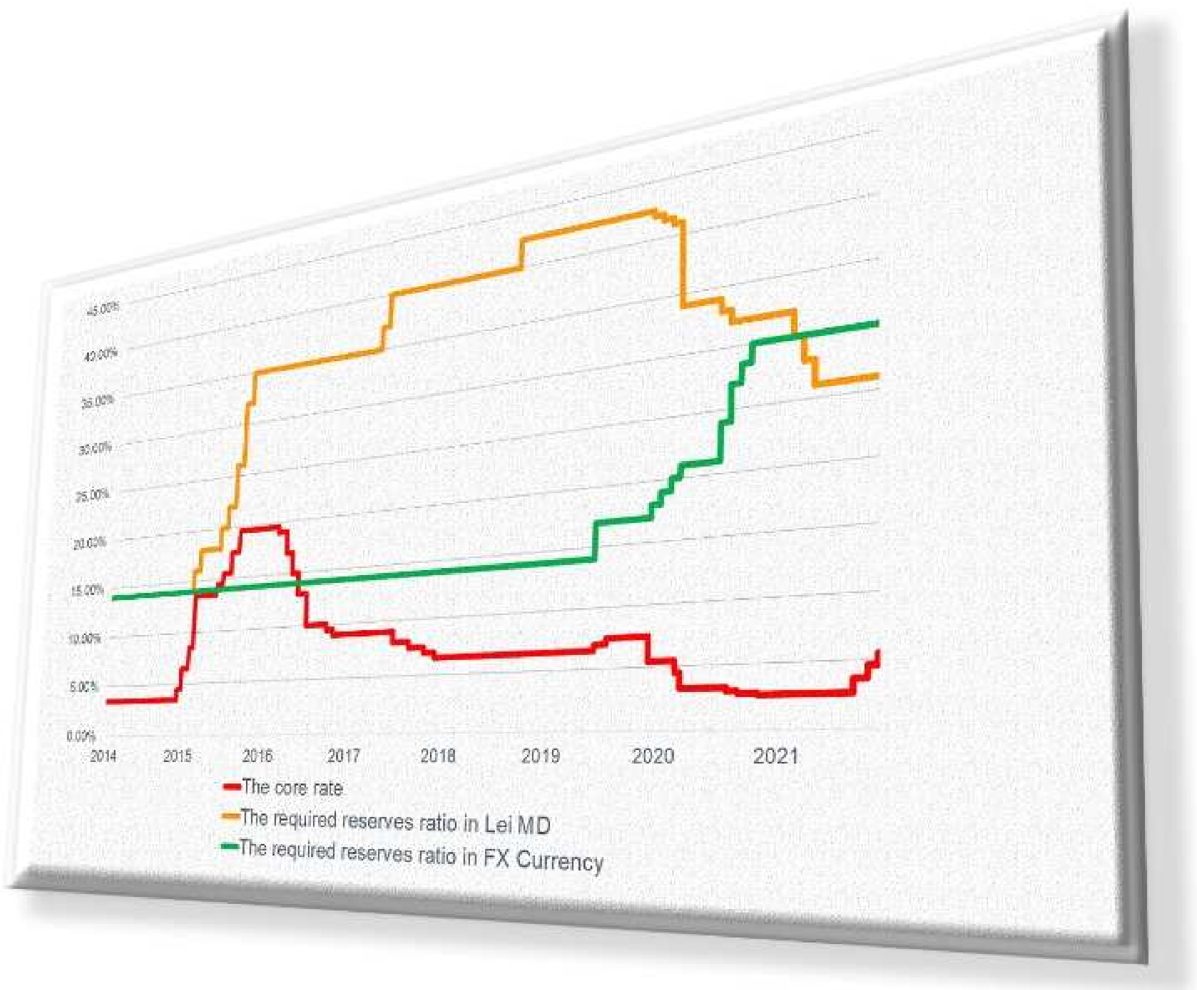
National
Bank of
Moldova

INFLATION REPORT



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National Bank of Moldova
1 Grigore Vieru Avenue
MD-2005, Chișinău
Tel.: (373 22) 822 606
Fax: (373 22) 220 591

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Note

The report was elaborated based on the latest macroeconomic information from the internal and external environment.

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy, Ministry of Finance,

Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

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.

Pursuant to the provisions of art. 4 para. (1) of Law no. 548/1995 on the National Bank of Moldova (republished in the Official Gazette 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, August 2022 was discussed and approved at the meeting of the NBM Executive Board on August 4, 2022.

Contents

List of acronyms

ANRE	National Agency for Energy Regulation
CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECB	European Central Bank
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EU	European Union
EUR	Single European Currency
FAO	Food and Agriculture Organization of the United Nations
FCC	Freely convertible currency
FRS	Federal Reserve System
GDP	Gross Domestic Product
IDA	International Development Association
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
NBR	National Bank of Romania
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+	OPEC cooperation with oil producers outside OPEC in an attempt to reduce production and increase the price of oil
PMI	Purghasing Manager’s Index
REER	Real effective exchange rate of the national currency
RUB	Russian ruble
SB	State budget
SDR	Special drawing rights
SHS	State Hydrometeorological Service

SS	State Securities
SSIB	State social insurance budget
UAH	Ukrainian hryvnia
USD	US Dollar

Summary

In the second quarter of 2022, the annual inflation rate continued the upward trend of the previous year. However, it was slightly below the value anticipated in the Inflation Report of May 2022. It increased from 22.2% in March 2022 to 31.8% in June 2022. As a result, similar to the previous period, in the first quarter of 2022, the annual inflation rate remained above the upper limit of 5.0% range ±1.5 percentage points. At the same time, the average annual inflation rate accounted for 29.3% in the second quarter of 2022, being by 10.2 percentage points higher than in the previous quarter. This dynamic was supported by the increase in international and regional market prices for food and energy resources, which led to an increase in their prices on the domestic market and an adjustment in tariffs for network gas, thermal energy, and electricity. At the same time, the adjustment of tariffs, the increase in fuel prices, but also the upward dynamics of monthly income supported the increase in costs for economic operator, which was gradually reflected in prices. The impact of the above-mentioned factors was significantly amplified in the first half of the current year by the escalation of the situation in Ukraine, which generated additional pressures on food, fuel, and some core inflation subcomponents. At the same time, for some CPI subcomponents, additional inflationary pressures were driven by the dynamics of the MDL/USD foreign exchange rate. According to recent estimates, the demand-side pressures observed in previous periods have lost their intensity and had a negligible impact on prices of the core inflation subcomponents and food prices. The upward trend of the annual IPPI rate continued in the second quarter of 2022, setting the stage for higher prices of some CPI subcomponents in the coming period.

At the same time, considering the increase in international and regional food and energy prices, amplified by the escalation of the armed conflict in Ukraine, the requests of suppliers to adjust gas and thermal energy tariffs, the increase in prices of food, energy resources, and other goods and services within the IPC will continue in the coming year. At the same time, the increase in domestic costs, the side effects of tariff increases, the indexation of pensions, the increase in wages will generate additional pressures on the CPI in the domestic market in the coming period. The sharp increase in natural gas prices on foreign markets will exert additional pressure on the adjustment of the network gas tariff, which will be followed by an increase in the tariff for related services, which will further support the increase in inflation. Similar to previous periods, further CPI dynamics remain marked by the uncertainty of the timing and magnitude of some tariff adjustment in the context of the considerable increase in energy prices on the regional market, as well as the impact of weather conditions on domestic food prices.

The situation in the world economy continues to worsen, with the level of complexity of the problems being very high. World market prices continued to increase, which amplified pro-inflationary pressures. The tightening of monetary policies to counter pro-inflationary pressures, along with the increase in production costs, is having a major impact on economic activity. In addition, the increase in the number of COVID-19 cases worldwide and the re-introduction of restrictions and quarantine in China led to the moderation of global economic activity. In June, the FRS significantly increased the range of interest rates by 0.75 percentage points, which, together with the increase in risk premia contributed to the significant appreciation of the US dollar. In this context, the ECB raised interest rates by 0.5 percentage points at its monetary policy meeting on 21 July 2022, the first rate increase since 2011. In the context of the difference between interest rates and government bonds, the single European currency depreciated in July close to parity with the US dollar. The natural gas crisis in Europe worsened at the end of June due to the shutdown of the Nord Stream 1 pipeline for scheduled maintenance work and the risk of Gazprom not resuming gas deliveries. Thus, the TTF Netherlands quotation increased to USD 1,900/1,000 cubic meters. The FAO index eased slightly in recent months amid expectations of a good harvest in the northern hemisphere and improved cereal crop conditions at some major producers.

GDP dynamics have moderated at the beginning of the current year after the upward trend of the previous year. The moderation of economic activity was supported by more modest domestic demand, mainly because of the decrease in real incomes of the population and tighter credit conditions, as well as increased uncertainty in the region and the emergence of barriers to foreign trade due to the escalation of the conflict in Ukraine. However, although modest, the annual GDP rate continued to be positive due

to the impact of export developments and government consumption. As a result, GDP in the first quarter of 2022 was 1.1 percentage points higher than in the same period of 2021, but the dynamics were lower than anticipated in the Inflation Report, May 2022. At the same time, the seasonally adjusted series reflects a decrease of 6.4% in GDP compared to the fourth quarter of 2021. Positive contributions to GDP dynamics were driven by the increase in exports and government consumption. Household consumption recorded a minor dynamic. At the same time, their positive impact was eroded by lower investment and higher imports. On the supply side, more pronounced positive developments were recorded in trade and the financial sector. The agricultural, industrial and construction sectors contracted at the beginning of this year compared to the same period of the previous year. After the modest dynamics at the end of the previous year, both the economically active and the employed population experienced a positive development at the beginning of this year. Unemployment as well as underemployment rates recorded a slightly upward trend. Several operational indicators available for April-June 2022 period outlined a more modest dynamic compared to the beginning of the current year, thus outlining preconditions for a modest economic activity in the second quarter of 2022.

In the second quarter of 2022, the revenues of the national public budget increased by 18.6% above the level recorded in the similar period of 2021. The expenses of the national public budget increased, being 13.1% above the level recorded in second quarter 2021.

At the same time, in the state securities market, allocated during the second quarter of 2022, interest rates maintained their upward trend.

In the second quarter of 2022, excess liquidity amounted to MDL 4.6 billion, increasing by MDL 0.1 billion compared to the previous quarter.

Monetary aggregates, in the second quarter of 2022, recorded more moderate annual growth rates compared to the previous quarter. At the same time, the main contribution to this development was largely driven by the change in the volume of currency in circulation and deposits in the national currency.

Average interest rates on outstanding amounts of loans in the national currency increased by 0.64 percentage points and on deposits by 0.97 percentage points compared to the previous quarter. Average interest rates on loans and deposits in foreign currency showed minor changes.

Two meetings of the Executive Board of the National Bank of Moldova regarding monetary policy decisions were held during the second quarter of 2022. 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 decided successfully increase the base rate applied to the main monetary policy operations by 3.00 percentage points each at the meetings of 5 May and 3 June, up to the level of 18.50% annually.

At the same time, the Executive Board of the National Bank of Moldova, during the ordinary meeting of 4 August 2022 adopted by unanimous vote an increase in the base rate applied to the main short-term monetary policy operations by 3.00 percentage points, to 21.50% annually. At the same time, the required reserve ratio of the funds attracted in MDL and non-convertible foreign currency was increased by 3.0 percentage points each in two consecutive periods of application 16 August – 15 September 2022 and 16 September – 15 October 2022, respectively, from 34.0% to 40.0% of the calculation basis. The norm of required reserves from funds drawn in freely convertible currency assets was increased by the same magnitude and in similar periods, from 39.0% to 45.0% of the calculation base.

This decision is aimed at tempering the rapid growth rates of consumer prices, mitigating the side effects of supply shocks, stimulating financial intermediation in domestic currency, and saving at the expense of consumption, balancing the trade balance, and anchoring inflationary expectations.

The current forecast in the Inflation Report of August 2022 includes appropriate monetary policy measures, the magnitude of which being calibrated to support the decline in the consumer price index from the fourth quarter of 2022 thereafter.

In this context, there is a high probability that the measures adopted can complete the monetary policy tightening cycle in the absence of major unanticipated pro-inflationary shocks in the immediate period term. Once future projections outline a well-founded basis for monetary policy easing, the NBM will take the necessary measures to bring inflation back closer to the 5.0% target.

The world economy is at a turning point, with macroeconomic indicators fluctuating without any concrete trend, which increases the uncertainty of forecasts. On the one hand, the world economy is affected by the tightening of monetary policies in major economies and the moderation of demand in China and other large economies. On the other hand, risks related to the armed conflict in Ukraine, limited supply of raw materials and poor agrometeorological conditions in Europe facilitate the persistence of high quotations for raw materials. Thus, in the current round of forecast, the assumption regarding the pro-inflationary growth/maintenance related to quotations on the international market remains valid, but external demand is expected to be more subdued. Also, based on the latest developments, it is anticipated that the European currency will oscillate in the vicinity of parity with the US dollar, and the Russian ruble is expected to reflect domestic monetary operations in the absence of the functioning of the capital account.

In the third quarter of the current year, the *annual inflation rate* will reach its highest level and from the next quarter onwards it will follow a downward trend towards the end of the forecast horizon. The inflation rate will be above the upper end of the range throughout the forecast period and in the last quarter will return to the range. The annual rate of *core inflation* will increase during the first two quarters of the forecast period and will reverse its path starting next year onwards and decline for the rest of the forecast period[1]. The annual rate of *food prices* will peak in the first quarter of the forecast period and will start to decline from the next quarter onwards. The annual rate of *regulated prices* will increase until the end of the current year, and starting with the first quarter of 2023, it will decrease significantly towards the end of the forecast period. The annual rate of *fuel prices* will increase in the first two consecutive quarters of the forecast and starting from 2023 it will decrease significantly towards the end of the forecast horizon.

Aggregate demand will be negative over the entire forecast period due to deterioration in external demand and household consumption financing. Fiscal stimulus and, to a lesser extent, monetary conditions will mitigate the decline in aggregate demand.

Real monetary conditions will be mildly supportive of aggregate demand over much of the forecast horizon.

The current *inflation* forecast relative to that in the previous Inflation Report[2] has been revised upwards through the first quarter of 2023 and downwards for the rest of the comparable period[3], except for the first quarter of 2024. The current forecast for the annual rate of *core inflation* has been lowered over the entire comparable period, except for the first quarter of 2024. The annual rate of *food prices* was revised upwards over the entire comparable period. The current forecast of the annual rate of *regulated prices* has been revised upwards until the second quarter of 2023 and downward towards the end of the comparable period. The forecast for the annual rate of *fuel prices* has been increased over the entire comparable period.

[1] Third quarter 2022 – second quarter 2024.
[2] Inflation Report, May 2022.
[3] Third quarter 2022 – first quarter 2024.

Chapter 1

Inflation development

1.1 Consumer price index

In the second quarter of 2022, the annual inflation rate continued the upward trend of the previous year but was slightly lower than anticipated in the Inflation Report, May 2022. Thus, it increased from 22.2% in March 2022 to 31.8% in June 2022. As a result, similar to the previous period, in the second quarter of 2022, the annual inflation rate remained above the upper limit of the range of 5.0% ±1.5 percentage points. The average annual inflation rate was 29.3%, 10.2 percentage points higher than in the previous quarter.

This dynamic was underpinned by rising international and regional market prices for food and energy resources, which led to higher domestic prices for food and energy resources and adjustments in the prices of network gas, heat, 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 agents, which was gradually reflected in prices. The impact of the above factors was significantly amplified in the first half of this year by the escalation of the situation in Ukraine, which generated additional pressures on food, fuel, and some core inflation subcomponents. At the same time, for some subcomponents of the CPI, additional inflationary pressures were driven by the dynamics of the MDL/USD exchange rate.

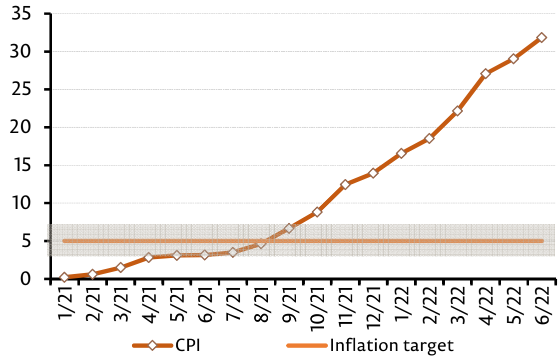
According to recent estimates, the demand-side pressures observed in previous periods have lost their intensity and have had a negligible impact on the prices of core inflation subcomponents and food prices.

The delay of some of the tariff adjustments included in Inflation Report, May 2022 forecast and their expected proportionate second-round effects, the tense situation in the region and the risks of its escalation, as well as the dry conditions in the current summer maintain the pronounced uncertainty about the medium-term inflation forecast and preconditions for an upward path of inflation.

In this respect, given the increase in international and regional food and energy prices, amplified by the escalating situation in Ukraine, as well as the requests of suppliers to adjust gas and heat tariffs, will increase further the prices for food, energy resources and other goods and services in the CPI in the coming period.

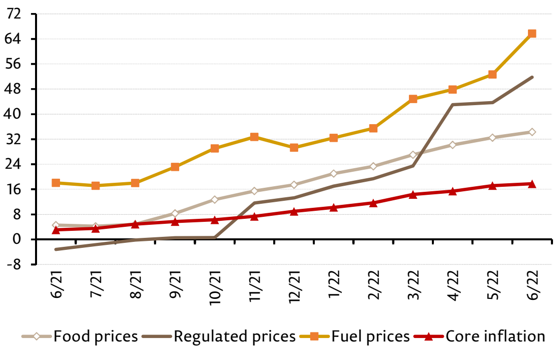
There will also be additional pressures on the CPI in the domestic market in the coming period from higher

Chart 1.1: Annual CPI rate (%)



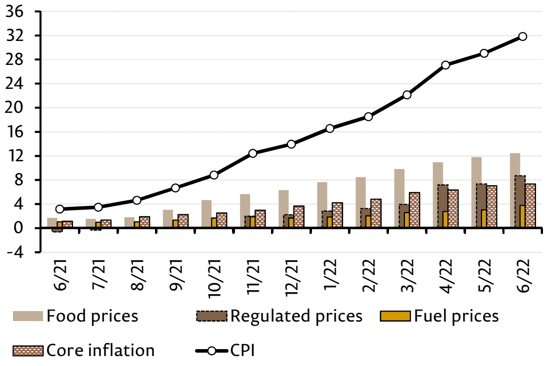
Source: NBS, NBM

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



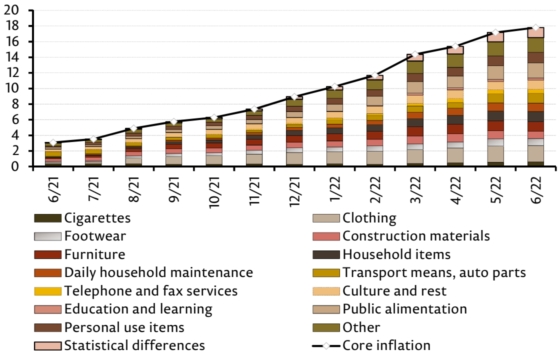
Source: NBS

Chart 1.3: Annual inflation developments (%) and subcomponent contributions (percentage points)



Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

domestic costs, side effects from tariff increases, pension indexation, wage increases. The pronounced increase in natural gas prices on external markets will put additional pressure on the adjustment of tariffs for network gas, which will be followed by an increase in the tariff for related services, which will further support the increase in inflation.

Core inflation

In the second quarter of 2022, the annual core inflation rate continued the upward trend started at the beginning of the previous year, averaging 16.8% or 4.7 percentage points higher than in the previous quarter. At the same time, it accelerated in June 2022 to 17.8%. Upward dynamics were recorded for all groups of goods, with the most significant increases recorded for the subcomponents "construction materials" (32.8%), "furniture" (28.9%), "public alimentation" (27.8%) and "daily household maintenance" (22.6%). In structure (Chart 1.4), the upward trend in core inflation in the second quarter of 2022 was mainly driven by the increase in prices of "public alimentation", "clothing", "household items", "personal use items", "daily household maintenance", "means of transport, auto parts", "culture and rest", "construction materials".

Core inflation continued to face pressures from costs. These, similar to the previous period, were largely driven by the upward trend in international and regional commodity and energy prices, which led to higher prices for imported goods. At the same time, rising food prices as well as adjustments in some tariffs supported the increases in some services prices within the core inflation. The military conflict in Ukraine has enhanced inflationary pressures that had emerged in previous periods, contributing to further increases in prices of some subcomponents of core inflation, such as construction materials, furniture, household goods, etc. Additional pressures on some subcomponents of core inflation were driven by the depreciation of the exchange rate against the USD. These were, however, mitigated by an appreciation against the European currency.

The wage fund at the beginning of this year continued the positive dynamics of the previous year. At the same time, social payments recorded a pronounced increase in the first half of this year. However, these developments were eroded by the considerable increase in prices and, as a result, their impact on domestic demand was insignificant compared to previous periods. At the same time, remittances contracted at the beginning of this year and new loans granted to individuals in the second quarter of 2022 showed a downward trend. Thus, according to recent estimates, the demand pressures observed in previous periods have lost their intensity and have had a negligible impact on subcomponent prices of the core inflation.

The further trend in the development of some core inflation subcomponents (mainly goods in the segments of building materials, furniture, household goods, personal goods, etc.) will be affected by the development and extent of the military conflict in Ukraine. The depletion of stocks of raw materials, either of final goods imported from this country or transiting through it to the Republic of Moldova (from Belarus, Russia, Poland, etc.), requires finding new suppliers of products, negotiating new contracts, additional prices for logistics, transport, etc., which will lead to an upward dynamic of the related prices.

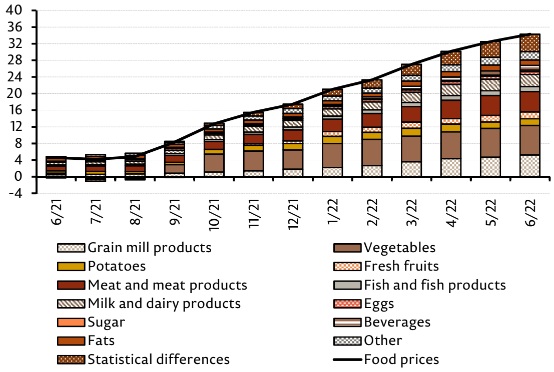
Food prices

During the second quarter of 2022, the annual rate of food prices continued the upward trajectory started in September 2021. Thus, during the second quarter of 2022 it increased by 7.3 percentage points, reaching 34.3% in June 2022 (Chart 1.5). The acceleration in the annual rate of food prices was supported by increasing inflationary pressures from all product groups except for potato prices. The pronounced increase in food prices was driven by:

- Pronounced pressures exerted by food prices on the international market which, after the considerable increase in 2021 and in the first 6 months of 2022, remain at high levels (Chart 1.6);
- Pronounced increase in the price of network gas and electricity in the first half of 2022, leading to significant inflationary pressures for a wide range of products (second-round effects);
- Pronounced increase in diesel prices (by 79.3%) in the first 6 months of 2022, driving up transport costs;
- Depreciation of the MDL/USD exchange rate in the second quarter of 2022 compared to the first quarter of 2022 by 4.1% also contributed to the increase in food prices;
- In the context of a high annual inflation rate at the end of 2021, and the continuation of the upward trend in the first months of 2022, economic operator indexed/will index the wage fund in the immediate future. Increases in payroll expenditure have generated/will generate additional upward price pressures (second round effects);
- The war in Ukraine has generated pronounced inflationary pressures in several respects: 1) Psychological – the population of the Republic of Moldova began to buy products for fear of shortages, which led economic operators to substantially increase prices; 2) Logistic – the import of many products was carried out through the border of the Republic of Moldova with Ukraine and the Odessa seaport, thus the use of alternative routes increased transport costs; 3) Substitution of Ukrainian products (which were abundant on the market of the Republic of Moldova and were the most accessible in terms of price/quality in the region) with similar products, but from another country of origin (more expensive); 4) Increase in the number of consumers on the territory of the Republic of Moldova (about 80 thousand refugees).

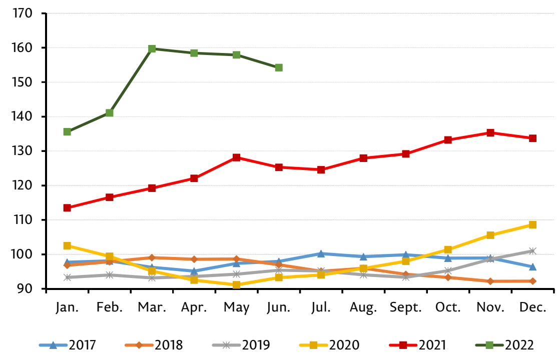
On the international market, the annual rate of food prices continues to record high growth rates, thus generating strong

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



Source: NBS, NBM calculations

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



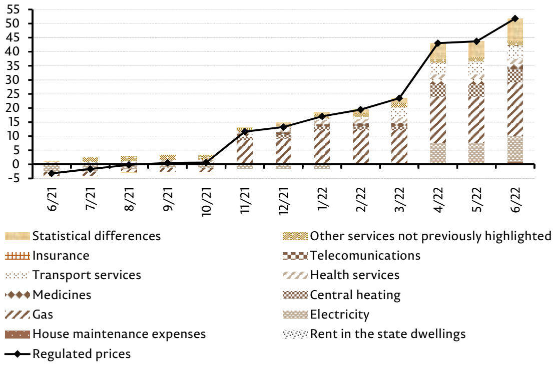
Source: NBS, NBM calculations

inflationary pressures on the domestic market as well. In the second quarter of 2022, the annual rate averaged 25.3%, 0.4 percentage points higher than in the first quarter of 2022.

In the second quarter of 2022, the contribution of food prices to the annual inflation rate increased by 3.0 percentage points to 11.7 percentage points.

Regulated prices

Chart 1.7: Contribution of components (percentage points) to the annual dynamics of regulated prices (%)



Source: NBS, NBM calculations

The upward trajectory of regulated prices intensified in the second quarter of 2022, in the context of the further adjustment of some service tariffs, as well as the full reflection of adjusted tariffs still at the end of last year. Thus, the annual rate of regulated prices amounted to 51.8% in June 2022, 28.3 percentage points higher than in March 2022. At the same time, the average annual rate of regulated prices in the second quarter of 2022 amounted to 46.2%, 26.2 percentage points higher than in the first quarter of 2022.

This dynamic was largely supported by tariff adjustments made earlier (November 2021, January 2022), in the context of the end of the compensation period for new gas, central heating and heat tariffs[4] at the end of the 2021-2022 cold season on April 1. Thus, in April 2022, the NBS reflected the remaining impact of the tariff adjustment from the end of the previous year and the beginning of the current year on the corresponding subcomponents of the CPI (natural gas – 41.6%, central heating – 59.8% and heat – 62.9%).

At the same time, a significant impact on regulated prices was determined by the adjustment of the electricity tariff from 1 April 2022. Thus, ANRE examined and approved the new tariffs for electricity supplied by I.C.S. "Premier Energy" S.R.L. in the amount of 2.17 MDL/kWh, which is 0.66 MDL/kWh or 43.7% more than the previous prices, and for that supplied by S.A. "Furnizarea Energiei Electrice Nord" in the amount of 2.51 MDL/kWh for final consumers, which is 0.47 MDL/kWh or 22.9% more than previous prices[5]. As a result, in the CPI, at the country level, the electricity tariff increased by 34.9% in April 2022.

Subsequently, in May-June, natural gas and electricity tariffs were increased further. Thus, the adjustment of the gas tariff is based on ANRE's decision of 31 May 2022[6]. According to it, from 1 June 2022, the tariff for network gas delivered to domestic consumers will be MDL 18.62 (VAT included), which is 22.66% higher than the previously established tariff.

At the same time, on 8 June 2022[7], the electricity tariff was also revised. Currently, it is 2.86 MDL/kWh for SA "FEE-Nord" (14.0% higher than the previous one) and 2.64 MDL/kWh (21.6% higher

[4] https://www.anre.md/anre-a-ajustat-preturile-reglementate-la-gazele-naturale-energia-termica-si-energia-electrica-produsa-de-centralele-electrice-de-termoficare-3-394

[5] https://www.anre.md/anre-a-ajustat-tarifele-si-preturile-pentru-energia-electrica-3-423

[6] https://www.anre.md/anre-a-ajustat-preturile-reglementate-la-gazele-naturale-3-470

[7] https://www.anre.md/anre-a-ajustat-tarifele-si-preturile-pentru-energia-electrica-3-480

than the previous one) for consumers connected to the Î.C.S. "Premier Energy", the increase reflected by the NBS, weighted at the country level, being 13.1% in June 2022.

At the same time, in June 2021, there were approved the new tariffs for the supply/provision of public water supply, sewerage and wastewater treatment services by S.A. "Apa-Canal Cahul" – the public service of drinking water supply – for domestic consumers in the amount of 13.98 MDL/cubic meter (compared to the previous 13.87 MDL/cubic meter) and the public service of sewerage and wastewater treatment – for domestic consumers in the amount of 8.18 MDL/cubic meter (compared to the previous 5.96 MDL/cubic meter)[8]. As a result, at the country level, prices for the service in the CPI increased by 0.5%.

Also, in the second quarter of 2022, the increases for public transport trips, carried out in different regions of the country were fully reflected[9] [10], especially from Balti municipality[11], as well as the reflection of increases in intercity travel fares was continued, and these, according to the methodology in force[12], during the state of emergency, are strictly linked to the evolution of fuel prices.

At the same time, there was an impact during the quarter due to the increase in healthcare tariffs and medicine prices. Also, the sub-component "Other services not previously reported" generated a noticeable impact, due to price increases for ritual services, lawyers and judges' services, as well as a sharp increase (of 22.6%) in postal services. These were approved by the Decision of the Government No 31 of 22 April 2022[13], following the revision of the list of services concerned, including domestic postal deliveries; international postal deliveries and ordinary international parcel post services.

In the coming period, regulated prices will continue their upward trend. As the decision on new electricity tariffs came into force in mid-June, part of this increase will be reflected in July 2022. At the same time, on 14 July, ANRE published the draft decision[14], according to which the natural gas tariff will be 22.25 MDL/cubic metre (VAT included). This increase also requires the adjustment of the tariff in the near future for related services (central heating and hot water). In addition, new tariffs for public transport in Chisinau municipality will be reflected in July, which are already in force. Also, in July the new tariff for the collection, transport, and storage of waste in Chisinau municipality[15] and Comrat city[16] will

[8] https://anre.md/anre-a-aprobat-mai-multe-hotarari-privind-activitatea-unor-operatori-din-sectorul-gazelor-naturale-si-domeniul-serviciului-public-de-alimentare-cu-apa-si-de-canalizare-3-454

[9] https://expresul.md/2022/03/5-lei-noul-tarif-pentru-o-calatorie-prin-oras-cu-transportul-public-depasit-de-timp-ce-zic-autoritatile/

[10] https://stiri.md/article/social/calatoria-cu-transportul-public-in-soroca-s-a-//scumpit-pana-la-5-lei

[11] https://esp.md/ru/sobytiya/2022/03/18/v-belcah-povysili-tarify-na-proezd-v-//trolleybusah-i-avtobusah

[12] https://cancelaria.gov.md/sites/default/files/dispozitia_cse_nr.9_10.03.2022.pdf

[13] https://monitorul.fisc.md/editorial/noile-tarife-pentru-serviciile-postale-aprobate.html

[14] https://www.anre.md/consultari-publice-3-27

[15] https://realitatea.md/noi-scumpiri-au-fost-ajustate-tarifele-pentru-colectarea-transportarea-si-depozitarea-deseurilor-din-chisinau/

[16] https://grt.md/news/2022/07/01/%D0%B2-%D0%BA%D0%BE%D0%BC%D1%80%D0%B0%D1%82%D0%B5-%D0%B2%D1%8B%D1%80%D0%BE%D1%81-%D1%82%D0%B0%D1%80%D0%B8%D1%84-%D0%BD%D0%B0-%D0%B2%D1%8B%D0%B2%D0%BE%D0%B7-%D0%BC%D1%83%D1%81%D0%BE%D1%80%D0%B0/

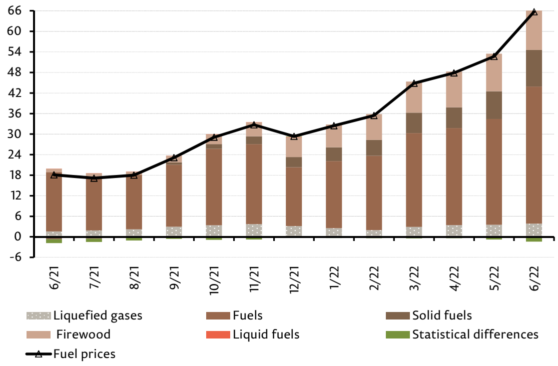
be reflected. Decisions to this effect have already been voted and signed. Substantial price increases in natural gas, electricity; wage costs in the last period, as well as the current water and sewage tariff level create the conditions for adjusting the respective tariff, especially in Chisinau municipality, Balti municipality and Comrat city. It should be noted that the requests in this regard are placed on the official page of ANRE for Comrat, Soroca, Ungheni, Orhei. There is still a risk of high medicine prices in the context of the conflict in Ukraine, due to which access roads are longer and more expensive, and there is a risk of reorientation of medicine imports, which imposes higher costs and prices. At the same time, rising domestic production costs in the pharmaceutical industry, but also in countries exporting medicines, are creating upward pressure on medicine prices for end consumers.

Fuel prices

The annual rate of fuel prices became even more pronounced in the second quarter of 2022, in the context of rising oil prices and the April-June 2022 military conflict in the region. Thus, the annual rate of fuel prices increased from 44.8% in March 2022 to 65.7% in June 2022 under the influence of the increase in "fuel" . The average annual rate of fuel prices in the second quarter of 2022 was 55.4%, 17.8 percentage points higher than in the first quarter of 2022 (Chart 1.8). This development was mainly driven by the increase in "fuel" prices, because of higher petrol and diesel prices by petrol and diesel stations during the quarter. These increases were directed by the average Platts quotations for petrol and diesel, which averaged around 22,316.7 MDL/tonne and 21,993.3 MDL/tonne in the reference quarter, respectively, increasing by 38.3 and 43.4% compared to the first quarter of 2022 (Chart 1.9). The increase in the above-mentioned quotations was linked to the upward dynamics of the price of Brent brand oil (increasing by 13.9% compared to the previous quarter), while the price of Urals brand oil decreased by about 11.3%, in the context of the sanctions imposed on the Russian Federation during the period. At the same time, in addition to the increase in oil prices, additional pressures on fuel prices during this period were exerted by the conflict in the region.

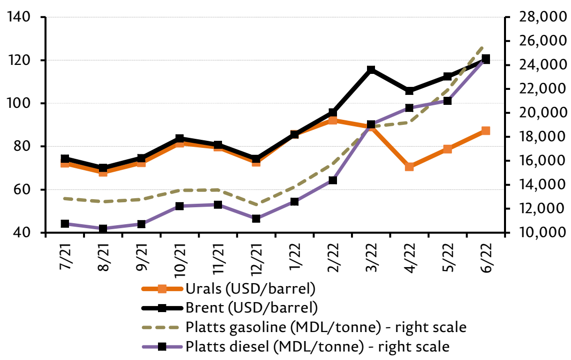
During the second quarter of 2022, "liquefied gas" prices had a positive impact on the annual rate of fuel prices. At the same time, prices of solid fuels and of wood, etc. increased during the period, due to higher demand for these subcomponents in the context of the increase in natural gas prices in the Republic of Moldova, but also due to the considerable increase in coal prices on the international market in the recent period.

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



Source: NBS, NBM calculations

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



Source: ANRE, NBM calculations

1.2 Inflation evolution and short-term forecast assessment from the Inflation Report, May 2022

In the April 2022 forecast round, the annual inflation rate was expected to accelerate markedly to an average of 29.8% in the second quarter of 2022[17] Inflation data for the second quarter of 2022 outline a slightly lower path than anticipated in the previous forecast round (Inflation Report, May 2022), mainly in the context of the postponement of the adjustment of some tariffs included in the forecast.

In the second quarter of 2022, the annual inflation rate was 29.3%, 0.5 percentage points lower than forecast (Chart 1.10, Table 1.1). This deviation was mainly driven by the forecast of regulated prices, but also by core inflation. This negative deviation was mitigated by the positive deviation for the fuel price forecast.

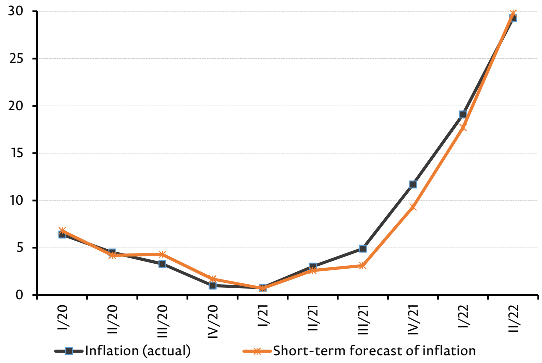
In this regard, the annual rate of regulated prices was 46.2%, 3.9 percentage points lower than the figure forecast in the Inflation Report, May 2022, which was mainly due to the failure or delay in adjusting some tariffs included in the forecast (gas, heating, hot water, water supply and sewerage, urban transport included in the forecast for May 2022). Some of these tariffs have been adjusted and reflected in June 2022 and others are to be adjusted in the following period. As mentioned above, a negative deviation was also recorded for the core inflation forecast. Its annual rate in the second quarter of 2022 was 16.8% and 1.4 percentage points lower than anticipated in the May 2022 Inflation Report, which can be partly attributed to some delay in the pass-through of second-round effects to the extent anticipated from food price increases and tariff adjustments. The annual rate of food prices increased by only 0.4 percentage point above the anticipated level for the second quarter of 2022. At the same time, the annual rate of fuel prices was 55.4% in the second quarter of 2022 and was 10.8 percentage points higher than anticipated in the Inflation Report, May 2022. This is mainly due to a more pronounced increase in oil prices during the period. Thus, the average price of Brent oil in the second quarter of 2022 was 112.7 USD/barrel vs. 100.6 USD/barrel anticipated for the second quarter of 2022. At the same time, the average exchange rate was MDL/USD 18.8 vs. MDL/USD 18.6 anticipated in the Inflation Report, May 2022.

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

	De facto Q II, 2022/ Q II, 2021 (%)	Forecast IR, May 2022 Q II, 2022/ Q II, 2021 (%)	Deviation (De facto- forecast) (p.p.)
CPI	**29.3**	**29.8**	**-0.5**
Core inflation	16.8	18.2	-1.4
Food prices	32.3	31.9	0.4
Regulated prices	46.2	50.1	-3.9
Fuel prices	55.4	44.6	10.8

Source: NBS, NBM calculations

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



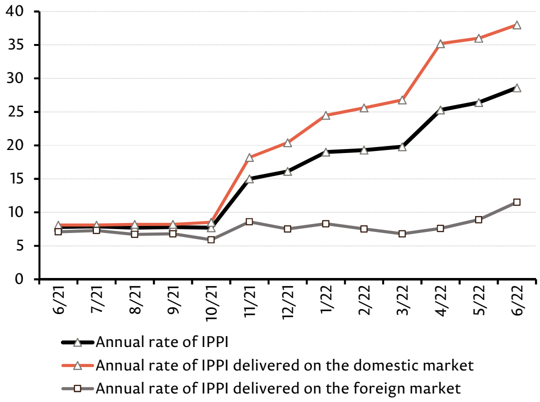
Source: NBM

[17]In view of the higher volatility of the monthly values and some possible measurement errors, which should not normally influence monetary policy decisions, the short-term inflation forecast is conducted on a quarterly basis. This value is an input to the medium-term inflation projection, which similarly has a quarterly frequency and underpins monetary policy decisions. At the same time, it is communicated 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 should be interpreted accordingly, taking into account also the assumptions/anticipations for the remaining months within the quarter.

The delay of some tariff adjustments included in the Inflation Report, May 2022 forecast and their associated expected proportionate second-round effects, the tense situation in the region and the risks of its escalation, as well as the dry conditions in the current summer keep the medium-term inflation forecast highly uncertain and preconditions for an upward path of inflation.

1.3 Industrial production prices

Chart 1.11: Annual industrial price rate (%)

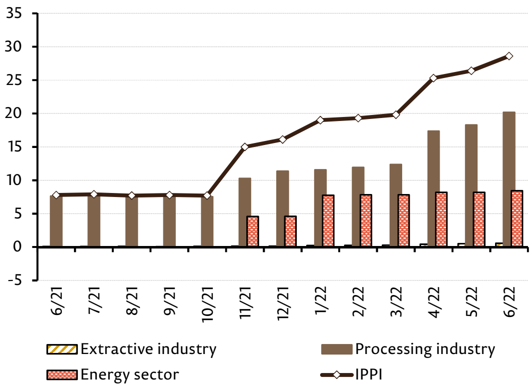


Source: NBS

In the second quarter of 2022, the annual industrial price rate averaged 26.8% or 7.4 percentage points higher than in the first quarter of 2022. In structure, the annual rate of prices of products delivered on the domestic market had a pronounced upward trajectory, while that of prices of products delivered on the external market recorded a marginal increase (Chart 1.11).

Analysing the evolution of the annual price rate in industry by main branches, we can note that its pronounced upward dynamics was driven by developments in the manufacturing and energy sectors (Chart 1.12). Prices in the energy sector increased significantly (by about 2.1 times compared to the same period last year) against the background of the global energy crisis. At the same time, because of the considerable increase in energy and raw material prices, prices in the manufacturing industry have also risen against the background of a significant increase in the prices of cost price components. Thus, the annual rate of prices in the manufacturing industry increased by 7.4 percentage points up to 20.5% in the second quarter of 2022. The upward trend in the annual price rate in manufacturing industry was mostly driven by price increases in the "food industry", in the production of "other non-metallic mineral products"[18] and "electrical equipment". Prices in the extractive industry increased by 26.8%, generating a contribution of 0.5 percentage points to industrial price dynamics.

Chart 1.12: Annual industrial price rate (%) and its components' contribution by main industry (percentage points)



Source: NBS, NBM calculations

[18]Glass articles, clay materials, cement, limestone, plaster; articles of cement, limestone, plaster.

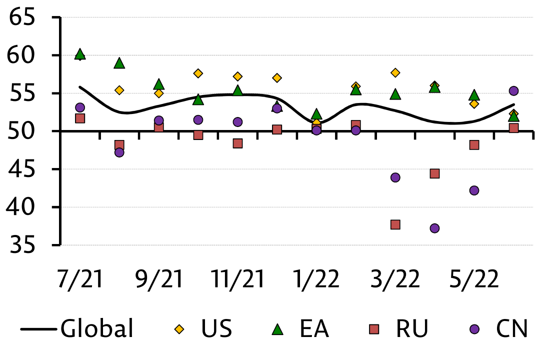
Chapter 2

External environment

2.1 World economy, financial and commodity markets

The situation in the global economy continues to worsen, with the level of complexity of the problems being very high. International market prices have continued to increase, adding to proinflationary pressures. The tightening of monetary policies to counter pro-inflationary pressures, together with rising production costs, is having a major impact on economic activity. Also, the increase in the number of COVID-19 cases worldwide and the reintroduction of restrictions, quarantines in China have led to a dampening of global economic activity. In June, the FRS significantly increased the interest rate range by 0.75 percentage points, which, like the increase in risk premia, contributed to the significant appreciation of the USD. In the same context, the ECB increased interest rates by 0.5 percentage points at its monetary policy meeting on July 21, 2022, the first rate hike since 2011. Against the background of the spread between interest rates and state securities, the European single currency depreciated in July close to parity with the USD. The gas crisis in Europe worsened at the end of June due to the closure of the Nord Stream 1 pipeline for scheduled maintenance work and the risk of Gazprom not resuming gas deliveries. As a result, the TTF Netherlands quotation increased to USD 1,900/1,000 cubic metres. The FAO index has declined slightly in recent months amid expectations of a good harvest in the northern hemisphere and improved grain crop conditions at some major producers.

Chart 2.1: Evolution of PMI indices

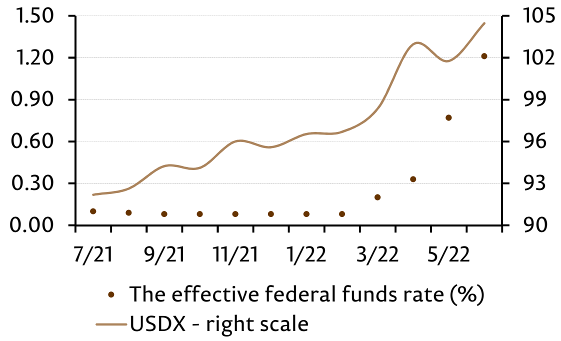


Source: Markit

PMI indexes show that economic activity has moderated significantly in the second quarter of 2022 in the US and the euro area. The notions of crisis, recession and stagflation are increasingly used in information resources, indicating that market participants are very concerned and cautious in their decisions. At the same time, economic activity in the Russian Federation has recovered on the basis of increased revenues from the export of energy and mineral resources. At the same time, the extreme fluctuations of the Russian rouble over the last few months represent a substantial problem for the Russian authorities and economy. China's economy has also recovered after the relief of the COVID-19 pandemic-related restrictions imposed in April 2022 (Chart 2.1).

The USD index reached its highest level in 20 years. The appreciation of the US dollar has been driven by the worsening gas crisis in Europe and political uncertainty fuelling fears of recession and prompting investors to seek a safe haven currency. The FRS also increased the range of interest rates in May by 0.5

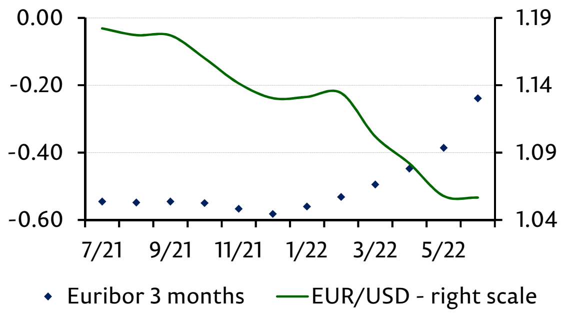
Chart 2.2: Evolution of the USD index (DXY)* in the context of FRS monetary policy



Source: FRS, Bloomberg

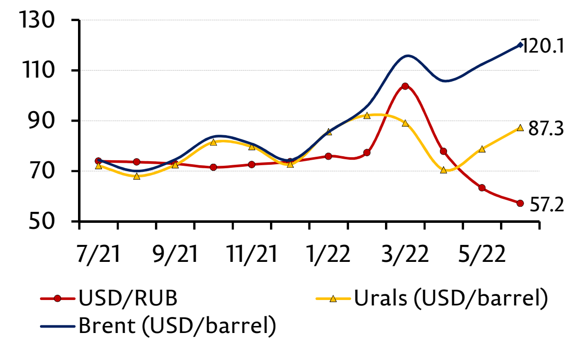
* DXY is an index calculated by the weighted geometric mean of the value of the US dollar against a basket of foreign currencies: euro – 57.6%, Japanese yen – 13.6%, pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%

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



Source: ECB

Chart 2.4: Evolution of USD/RUB and the Urals and Brent oil quotations



Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation, World Bank

percentage points and in June by 0.75 percentage points to a cumulative level of 1.5-1.75%. US Federal Reserve Chairman Jerome Powell has announced that he will increase interest rates and that it is even possible to raise rates above the neutral level in order to stop the increasing inflation that threatens the fundamentals of the economy. In June 2022, annual inflation in the US reached 9.1% (Chart 2.2).

The euro has fallen since the start of 2022 by about 13.0% to a new two-decade low against the US dollar, as concerns about rising energy prices and potential deficits are severe concerns about the eurozone economy. Europe's gas crisis deepened at the end of June due to the closure of the Nord Stream 1 pipeline for scheduled maintenance work and the risk of Gazprom not resuming gas deliveries. Also in early July 2022, oil and gas production in Norway was halted due to a workers' strike. The TTF Netherlands quotation rose to USD 1,900/1,000 cubic metres in early July 2022. Another reason for the depreciation of the single European currency is the difference between interest rates and government bonds. The ECB increased its interest rate by 0.5 percentage points at its monetary policy meeting on July 21, 2022, the first rate increase since 2011. In June 2022, annual harmonised inflation in the euro area was 8.6% (Chart 2.3).

In the second quarter of 2022, the **Russian ruble** appreciated by about 70.0% from its March 2022 peak. The excessive strengthening of the Russian ruble is driven by foreign trade operations and the lack of capital transactions. Since energy resource quotations are at peak levels, foreign exchange earnings from exports are much higher than demand from Russian importers. Sanctions, disruption of supply chains, redirection of trade flows, reduced consumer demand and many other factors have had a negative impact on the Russian ruble. The Bank of Russia has lost its ability to regulate the exchange rate directly – by buying or selling currency – due to the seizure of foreign exchange reserves, and indirect methods, such as interest rates, restrictions on capital movements and compulsory sale of earnings, have a time lag for action. Thus, the Bank of Russia has gradually lowered the monetary policy rate to 8.0%. Russia's Ministry of Finance has also removed the limit on export-oriented companies to convert foreign exchange earnings. Until May 2022, Russian companies had to sell 80.0% of their foreign exchange earnings, later this requirement was relaxed to 50.0%. Another measure, to temper the excessive appreciation of the Russian ruble, were the announcements of the Ministry of Finance in early July 2022 of its intention to replenish reserves in the currencies of "friendly" countries, relax controls on exporters' foreign exchange operations, and approve Eurobond issuers to buy back Russian ruble bonds (Chart 2.4).

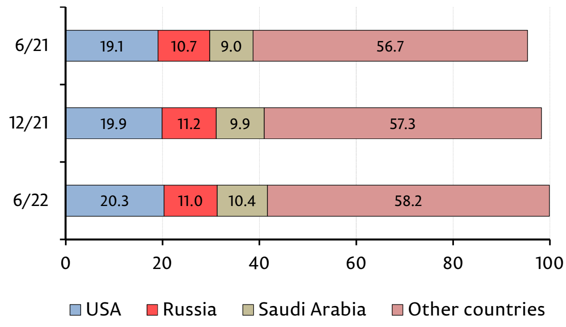
Oil prices have risen significantly in recent months, with the June 2022 average for Brent crude oil averaging 120.1 USD/barrel, up 6.9% from the previous month and up 64.3% from June 2021. At the same time, in the second quarter of 2022, Urals brand oil traded at an average discount of 33.9 USD/barrel to Brent brand oil. In April 2022, oil quotations fell due to the outbreak of COVID-19 cases in China, which undermined hopes of increased oil demand from China. At the same time, concerns about further interest rate hikes, underpinned by US inflation data, have affected forecasts for oil demand developments. Starting in May 2022, the main factor driving up oil prices has been the European Union's ban on maritime imports of oil and oil products from Russia, which will lead to a long-term deficit in the fuel market. Oil prices also rose amid an expected pick-up in demand from China as the world's second largest economy eased tough COVID-19-related restrictions imposed in April 2022. In early July 2022, a Russian court ruled to suspend for 30 days the operation of a Caspian Pipeline Consortium (CPC) owned marine terminal, through which more than 30 million barrels of predominantly Kazakh oil are exported monthly. This is another blow to the European oil market, which has lost large volumes of deliveries due to the unrest in Libya and is facing a sharp reduction in deliveries from other countries (Chart 2.4).

The Organization of Petroleum Exporting Countries (OPEC) and its partners, collectively known as OPEC+, decided to increase production in July and August by 648 thousand barrels per day or 50.0% more than previously planned. However, many member countries have little room to increase production, including Russia, which faces Western sanctions. Total OPEC production, including all 13 cartel members, rose by 280 thousand barrels per day in June to 33.8 million barrels per day. At the same time, oil production in the US and other non-OPEC countries increased, and oil production in the Russian Federation in June 2022 was 11.0 million barrels per day, 0.3 million barrels per day more than in June 2021, but 0.2 million barrels per day less than at the end of 2021. In recent months there has been a moderation in global oil consumption, with the market in oversupply for the 4th consecutive month (Chart 2.5) and (Chart 2.6).

World Bank data show that most **resource prices** on the world market have remained at high levels but, with the exception of the energy resources group, have fallen slightly from their March-April 2022 highs. Thus, in June 2022, the energy resources price index increased by 82.3% compared to June 2021, of which the oil resources price index increased by 62.7%, coal (South Africa) by 2.5 times and European gas by 3.3 times. The fertilizer price index increased in June 2022 by 1.8 times compared to June 2021, the metals and minerals price index decreased by 6.9%, and the agricultural products price index increased by 18.0%. Metal prices are falling against the backdrop of the imposition of quarantine measures in major cities in China and fears of dampening global demand following rising interest rates. Agricultural commodity prices, while higher than a year earlier, are down slightly from their March-April 2022 highs. This is due to slightly lower fertiliser and cereal costs, amid forecasts of a satisfactory harvest in Russia, the US, Canada, Brazil and Argentina (Chart 2.7).

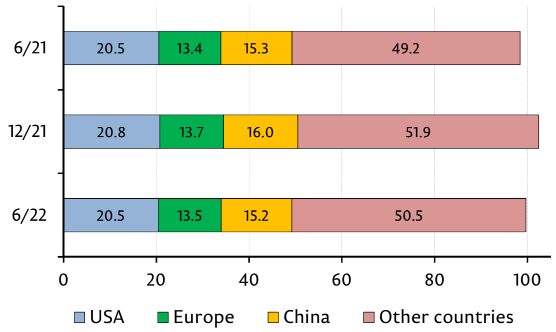
The FAO Food Price Index decreased insignificantly from its peak in March 2022, falling 2.3% in June 2022 compared to May 2022, but 23.1% higher than in the same period last year. The decline reflects lower grain prices, driven by the seasonal availability of new crops in the northern hemisphere, following improved agrometeorological conditions in some major producers, such as Canada and the Russian Federation. Seasonal availabilities in Argentina and Brazil, where corn harvests have increased significantly, and improved agrometeorological conditions in the US have also led to lower corn prices. International market prices for palm oil declined as the seasonal increase in production in the main producing countries coincided with prospects for increased export deliveries from Indonesia on the back of high domestic stocks. The slowdown in global economic growth affected international demand for sugar, and

Chart 2.5: World oil production (millions of barrels per day)



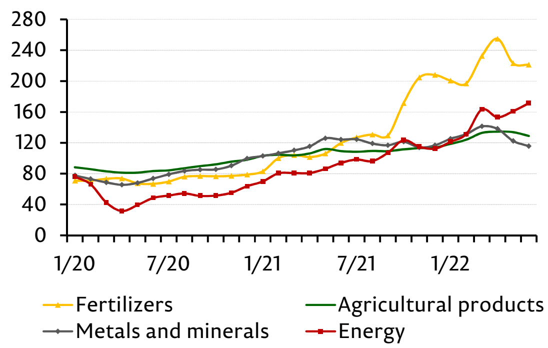
Source: US Energy Information Administration

Chart 2.6: World oil consumption (millions of barrels per day)



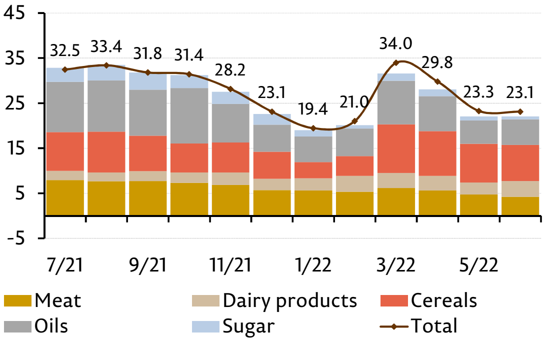
Source: US Energy Information Administration

Chart 2.7: World prices indices (%)



Source: World Bank

Chart 2.8: Annual growth rate of world food prices (FAO index) (%)



Source: FAO, NBM calculations

rising global supplies continued to put downward pressure on sugar prices. The weakening of the Brazilian real against the US dollar and lower ethanol prices in Brazil prompted producers to step up sugar production, contributing to higher supplies and lower world market sugar prices. Dairy quotations increased, supported by increasing import demand for deliveries amid market concerns about the availability of supply at the end of the year, as the early summer heatwave in Europe further affected already low milk production. At the same time, world prices for all types of meat have increased, due to reduced supply affected by the war in Ukraine and avian influenza outbreaks in the northern hemisphere (Chart 2.8).

2.2 Evolution of important economies

In the first quarter of 2022, US gross domestic product contracted 0.4% (in seasonally adjusted terms) compared with the previous quarter and increased 3.5% compared to the level of the similar period of the previous year. Over the January-May 2022 period, industrial production in the US increased by 5.7% and the unemployment rate remained at a level of 3.6% as of March 2022. Consumer prices have continued to soar, with June 2022 seeing a 40-year high inflation rate of 9.1%. With further monetary policy tightening expected to counter inflationary pressures, there is a risk of further contraction in the US economy.

Economic activity in the **euro area** grew by 0.6% in the first quarter of 2022, and compared with the same quarter in 2021, the euro area economy grew by 5.4% (in seasonally adjusted terms). At the same time, the PMI's show that the euro area economy slowed significantly in the second quarter of 2022 due to the energy crisis in Europe, the drought affecting agricultural regions and the social and economic consequences of the war in Ukraine. Data on industrial production reveal that in the first five months of 2022, industrial production in the euro area declined by 0.3% in annual terms, of which Germany saw a decline of 1.4%, France registered stagnation and Italy increased by 2.3%. Unemployment continued to decline to 6.6% in May 2022, while consumer prices continued to increase, with harmonised annual inflation reaching 8.6% in June, of which food, alcohol and tobacco rose by 8.9%, energy resources by 41.9%, non-energy industrial goods by 4.3% and services by 3.4%.

2.3 Evolution of neighboring economies and main trading partners

In the first quarter of 2022, the gross domestic product of **Romania** grew by 5.1% (in seasonally adjusted terms) compared to the previous quarter, and compared to the same period last year, on a gross basis, it recorded a robust growth of 6.4%. In January-May 2022, industrial production contracted from the same period a year earlier by 2.3% in the seasonally adjusted series and by 0.8% in the gross series. In June 2022, consumer prices increased by 0.8% from the previous month's price level and by

15.1% from the June 2021 price level. As the annual inflation level has exceeded the target corridor of 1.5-3.5% since the beginning of 2022, the NBR has increased the monetary policy rate 5 times to a cumulative level of 4.75%.

In the quarter under review, the **Russian Federation** economy increased by 0.5% (in seasonally adjusted terms) compared to the previous quarter and by 3.5% compared to the same period in 2021. PMI data show a significant decline in economic activity in March-May 2022 due to sanctions imposed and the withdrawal of foreign investors from the Russian Federation market, and some recovery in June 2022 on the back of rising revenues from energy resource exports. In January-May 2022, industrial production in the Russian Federation contracted on an annual basis by 1.7%. On the back of falling domestic demand and the unprecedented appreciation of the Russian ruble, consumer prices in the Russian Federation have started to decrease. In June, consumer prices were 0.4% lower than in May 2022, but 15.9% higher than in June 2021. After the Bank of Russia increased the base rate on February 28, 2022 from 9.5% to 20.0%, more reductions followed to a cumulative level of 8.0%.

In the first quarter of 2022, due to the armed conflict, the gross domestic product of **Ukraine** decreased dramatically, by 15.1% (in seasonally adjusted terms) compared to the fourth quarter of 2021 and by 19.3% in annual terms. Forecasts for Ukraine's economy are very gloomy as the conflict continues and industrial infrastructure and shipping have been severely damaged. Also, a lot of land has been left unprocessed due to land mining, which will diminish agricultural production this year. From the little data published by the Statistical Service of Ukraine we can mention that in January-May 2022, Ukraine's export of goods totaled USD 19.5 billion, which is 79.6% compared to January-May 2021. Imports to Ukraine in the mentioned period amounted to USD 20.4 billion or 80.1% compared to the previous year. Consumer prices continued to increase, registering in June a monthly inflation of 3.1% and compared to June 2021, consumer prices increased by 21.5%. On June 3, 2022, the National Bank of Ukraine increased the base rate from 10.0% to 25.0%, and on July 21, 2022, it depreciated the official hryvnia exchange rate by 25.0% to 36.5686 UAH/USD.

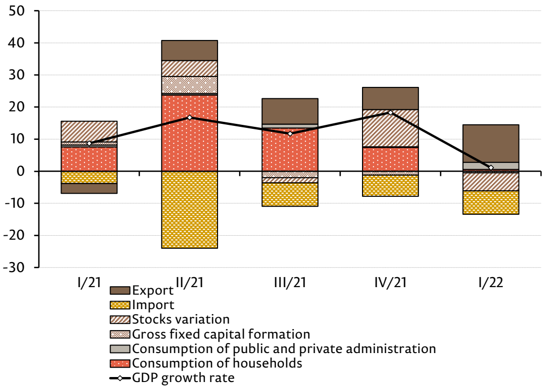
Chapter 3

Economic developments

3.1 Demand

Dynamics of GDP have sharply tempered at the beginning of this year after the upward trajectory of the previous year. The slowdown in economic activity was underpinned by more subdued domestic demand, mainly due to lower real household incomes and tighter credit conditions. However, although modest, the annual rate of GDP remained positive due to the impact of export developments and government consumption. As a result, in the first quarter of 2022 the GDP was 1.1% higher than in the same period of 2021, with this dynamic lower than anticipated in the Inflation Report, May 2022. At the same time, the seasonally adjusted series reflects a 6.4% decline in GDP compared to the fourth quarter of 2021. In this context, the effect of aggregate demand on prices is estimated to have been less pronounced than anticipated in the Inflation Report, May 2022.

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



Source: NBS, NBM calculations

In the first quarter of 2022, GDP increased by only 1.1% compared to the same period of the previous year, following an 18.3% increase at the end of the previous year. Factors that have dampened economic activity from the beginning of this year include falling real household incomes amid accelerating inflation, rising interest rates that have slowed lending, increased uncertainty in the region, and the emergence of barriers to foreign trade because of the escalating conflict in Ukraine. At the same time, rising external demand, following the recovery of the EU economy and other trading partners since the beginning of the year, as well as increased budgetary expenditure, had a positive impact on GDP dynamics. Although the moderation in economic activity in the first quarter of 2022 was anticipated in the previous forecast round (Inflation Report, May 2022), it was more pronounced than projected values. Thus, at the beginning of this year, the effect of aggregate demand on prices was estimated to have been more modest than anticipated.

In terms of uses (Chart 3.1), the moderation in economic activity in the first quarter of 2022 was mainly driven by household consumption dynamics. After the pronounced development in 2021, the annual dynamics of household consumption moderated to 0.7%, because of the decrease in household disposable income in real terms on the back of accelerating inflation, but also of more restrictive credit conditions. Investment in the reference period had a significant negative impact (-6.1 percentage points) on GDP dynamics in the context of increased uncertainty in the region and tighter credit conditions. After modest dynamics at the end of 2021, general government consumption grew by 13.6% in January-March 2022. A significant positive impact on GDP dynamics was exerted by export developments.

These, with the economic recovery of some trading partners and the effects of a rich harvest in the previous year, continued the pronounced dynamics observed in previous periods, increasing by 36.9% in real terms compared to the first quarter of 2021. Imports increased by 11.4 percentage points compared to the same period of the previous year, however, at a significantly more modest annual growth rate than in 2021.

Consumer demand of the population

The slowdown in the annual dynamics of household consumption continued at the beginning of this year. As a result, the annual pace of household final consumption was 0.7% lower than in the fourth quarter of 2021, decreasing by 8.3%. The modest but still positive dynamics of household consumption was supported by a 6.2% increase in expenditure on the purchase of services, while expenditure on the purchase of goods decreased by 2.0% compared with the same period of the previous year (Chart 3.2).

The slowdown in household consumption was driven by a real decrease in the main sources of financing household consumption during the reference period (Chart 3.3). In this respect, remittances registered a significant contraction (-9.4%) at the beginning of the current year, generating the largest negative impact on the dynamics of consumption financing sources. The wage fund, social payments and new loans to the population increased in nominal terms in the first quarter of 2022. Adjusted to the annual inflation rate, which continued its upward trend over the period, followed a downward path, creating conditions for modest developments in household consumption. However, in the second part of the first quarter of 2022, household consumption was supported by a significant number of refugees in the context of the military conflict in Ukraine.

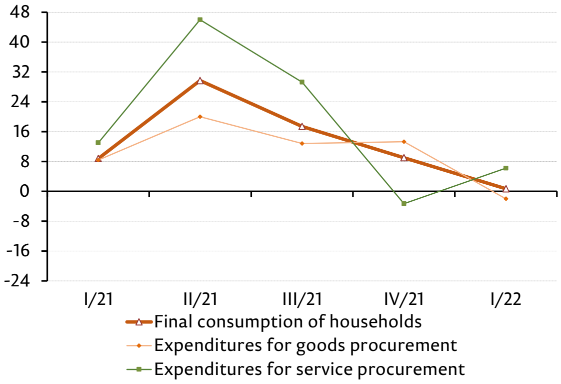
Public sector

According to the data provided by the Ministry of Finance, during the second quarter of 2022, the national public budget revenues were accumulated in the amount of MDL 21,6 billion, 18.6%more than the revenues accumulated in the same period of 2021 (Chart 3.4). The major part of budget revenues was accrued from taxes and fees, which had a share of 63.8%. Contributions and compulsory insurance premiums accounted for 29.2%, and the share of other revenues and grants accounted for 6.3% and 0.7%, respectively, of total budget revenues.

National public budget expenditures in the second quarter of 2022 amounted to MDL 23,8 billion, an increase of 13.1% compared to the same period of 2021. Of the total expenditure, the largest share was allocated to social protection (39.4%), 18.1% to education and 13.6% to health care.

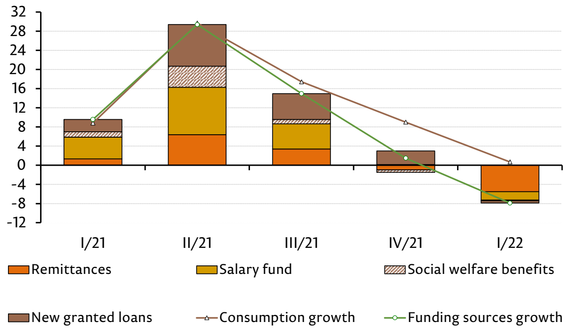
It should be noted that, in the reporting quarter, transfers from the state budget (SB) were granted to the state social insurance budget (SSIB), the mandatory health insurance fund (MHIF) and local budgets (LB) amounting to MDL 10,0 billion (an increase of

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



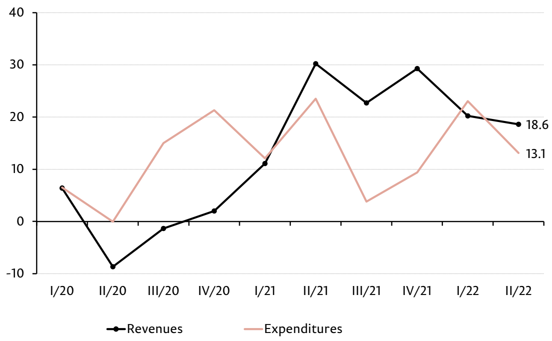
Source: NBS

Chart 3.3: Development in real terms of possible sources of financing of household consumption (%, compared of the previous year) and subcomponent contributions (percentage points)



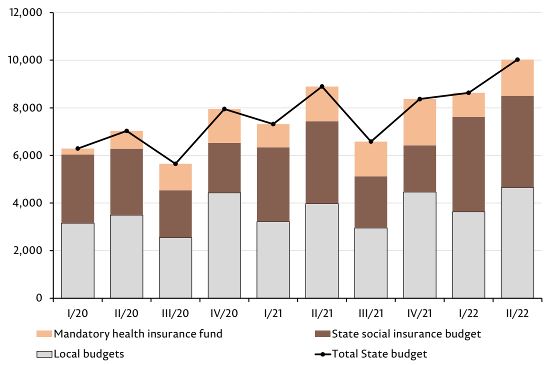
Source: NBS, NBM calculations

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



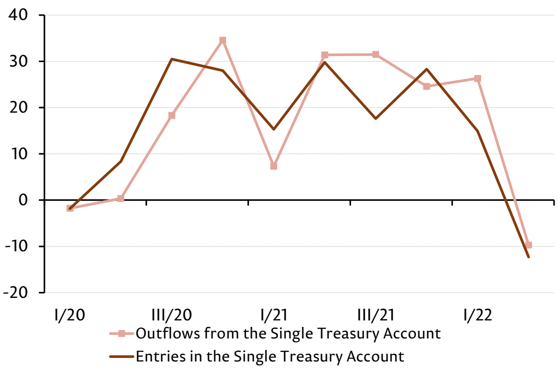
Source: Ministry of Finance

Chart 3.5: Evolution of budget transfers (MDL million)



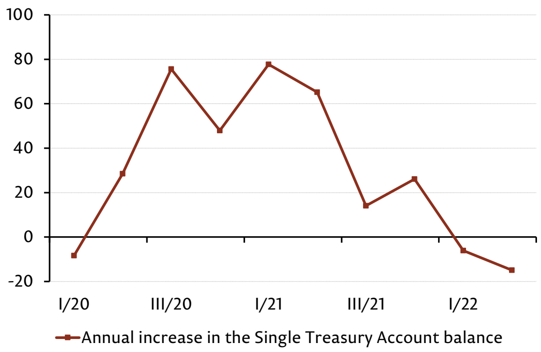
Source: Ministry of Finance

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

12.7% compared to the same period of 2021) (Chart 3.5). The major share of transfers from the state budget went to local budgets, about 46.4% of total transfers, followed by transfers to SSIB, about 38.5%, with MHIF receiving 15.1%.

In this context, in the second quarter of 2022, the execution of the national public budget resulted in a deficit of MDL 2.2 billion, compared to MDL 2.9 billion in the same period of 2021. The balances of the national public budget accounts as of 30 June 2022 amounted to MDL 10.7 billion.

In the second quarter of 2022, the Treasury Single Account (TSA) was characterized by negative annual rates of payments and receipts into the account (Chart 3.6). As a result of inflows and outflows, as of 30 June 2022, the TSA balance amounted to around MDL 6.7 billion, recording an annual decrease of 14.9% (Chart 3.7). It should be noted that, at the end of the second quarter of 2022, the balance of the Government's foreign currency deposit account with the National Bank of Moldova amounted to the equivalent of about MDL 5.5 billion, higher than at the end of the first quarter of 2022 by 8.8%, but lower than as of 31 December 2021 by 28.2%.

State debt

As of 30 June 2022, the balance of state debt of the Republic of Moldova amounted to about MDL 78.9 billion, reported to GDP[19] it was 30.6% (Chart 3.9). In annual terms, government debt recorded a nominal increase of 4.4% (Chart 3.8), due to the increase in external state debt recalculated in national currency (with a positive contribution of 7.1 percentage points). Domestic state debt had a negative contribution of 2.8 percentage points. State debt, as of 30 June 2022, consisted of 59.2% of external state debt and 40.8% of domestic state debt.

On 30 June 2022, the external state debt balance totalled USD 2,440.8 million, higher than on 30 June 2021 by about USD 145.1 million or 6.3%. Recalculated in national currency, the external state debt balance amounted to around MDL 46.7 billion (18.1% in GDP[19]) (Chart 3.9).

As of 30 June 2022, the domestic state debt amounted to about MDL 32.2 billion (12.5% of GDP[19]) (Chart 3.9), lower than on 30 June 2021 by 6.1% (Chart 3.8). The decrease in domestic state debt was driven by state securities (SS) issued in the primary market, the volume of which decreased by 10.3% compared to 30 June 2021. Following these developments, at the end of the first quarter of 2022, domestic debt consisted of SS issued in the primary market (54.6%), SS issued for the execution of state guarantees (38.4% of the total) and converted SS (7.0%).

Primary market of state securities (SS)

During the second quarter of 2022, the Ministry of Finance put into circulation state securities for a total amount of MDL 7,114.1 million, 19.6% less than the volume of the initial offering.

It should be noted that on the primary market of state securities there has been an increase in demand from licensed banks, thus, after a period of five consecutive quarters, the demand of licensed

[19]GDP estimated by the NBM.

banks has exceeded the supply of the Ministry of Finance, the ratio between them being 1.1%. This is also due to the adjustment of the supply of the Ministry of Finance, which decreased compared to the previous year (Chart 3.10).

During the reporting period, the average effective interest rates of treasury bills with a maturity of 91-day, 182-day, and 364-day increased from the level recorded in the previous quarter by 4.9 percentage points, 5.8 percentage points, and 5.6 percentage points, respectively. Average effective interest rates of the state securities with a maturity of 2-year, 3-year and 5-year increased from the first quarter of 2022 by 7.2 percentage points, 0.5 percentage points and 1.1 percentage points, respectively. Regarding state securities with a 7-year maturity, it should be noted that there were no applications from licensed banks during the quarter. Thus, we see that banks continue to invest in short-term securities, being more reluctant to invest in long-term securities, especially with a maturity of 5 and 7 years (Chart 3.11).

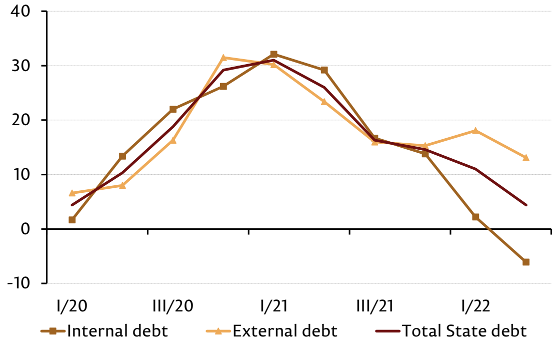
The structure of the portfolio of securities in circulation during the reference period shows that the most requested SS were those with a maturity of 182 days, which accounted for 50.0% of total transactions, followed by 364-day treasury bills, which accounted for 38.6%, and 91-day treasury bills, which accounted for 10.3%. It should be noted that the share of 2-year state securities was 1.2%, while the shares of 3-year and 5-year state securities were insignificant (Chart 3.12).

Investment demand

In the first quarter of 2022, the investment component generated a negative contribution of 6.1 percentage points to the dynamics of economic activity (Chart 3.13). This development was mainly driven by the inventory change subcomponent (-5.6 percentage points), but also by the negative impact (-0.5 percentage points) of gross fixed capital formation. It should be noted that the decrease in inventories during this period can be associated with the massive export of agri-food products due to the rich agricultural harvest in 2021. Thus, in the second half of 2021, at the stage of harvesting agricultural products, significant stocks have been accumulated, and in the following quarters the excess[20] of agricultural food products is exported, thus, the change in stocks becomes negative. It should be noted that gross fixed capital formation for the third consecutive quarter shows negative growth rates, mainly against the backdrop of contracting construction-oriented investment. The dynamics of investment in construction could be driven by a decline in demand from the population, due to the significant increase in prices of construction materials. As a result, gross fixed capital formation contracted by 2.0% in the first quarter of 2022 compared to the same period of the previous year. The negative dynamics of gross fixed capital formation was largely driven by the dynamics of "construction" oriented investment, which decreased by 3.5%. On the other hand, the "machinery and equipment" component increased by 1.6% compared to the same period of 2021 (Chart 3.13).

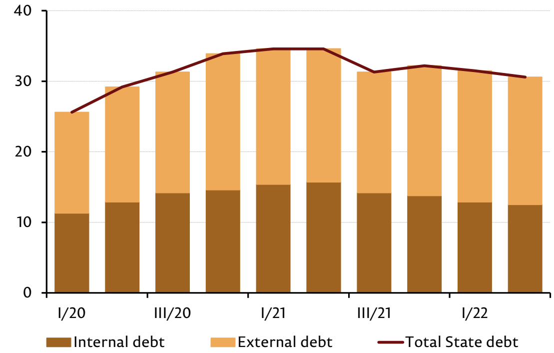
[20]Which exceeds the domestic requirement to ensure the food security of the country.

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



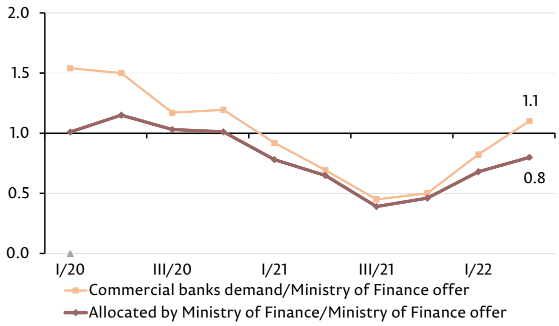
Source: Ministry of Finance

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



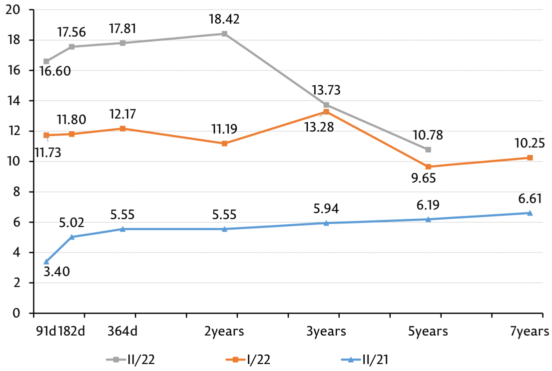
Source: Ministry of Finance

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



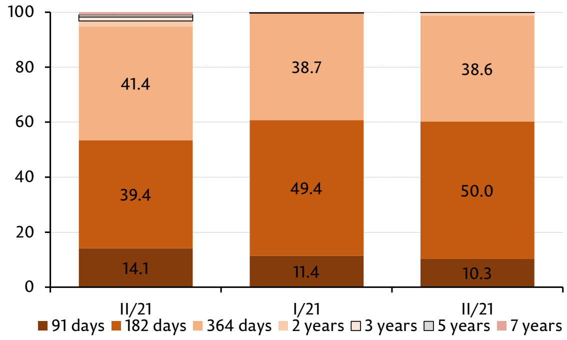
Source: NBM

Chart 3.11: SS yield curve (%)



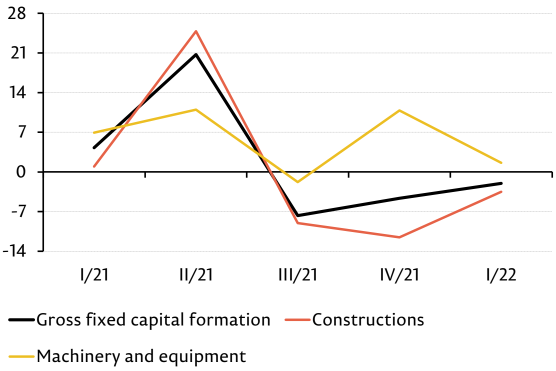
Source: NBM

Chart 3.12: Structure of SS allocated to the primary market



Source: NBM

Chart 3.13: Annual investment dynamics (%)



Source: NBS

According to the operational data presented by the NBS, in the first quarter of 2022 investments in fixed assets[21] increased by 12.6%. Intangible fixed assets increased by 10.8%, while tangible fixed assets increased by 12.7% as a result of the positive dynamics of the sub-components "engineering constructions" (51.2%), "non-residential buildings" (18.7%), "residential buildings" (11.1%) "machinery, equipment" (2.7%). Investment in means of transport decreased by 5.1% compared to the first quarter of 2021.

From the perspective of sources of financing of investment in fixed assets, the positive dynamics of 12.6% was mainly driven by "own assets" and "other sources" (Chart 3.15). Similar to previous periods, own resources remain the main source of financing fixed asset investments (about 66.3% in the first quarter of 2022). Positive contributions were also determined by investments financed from the TAU budgets. Investments financed from foreign investors' funds decreased in the first quarter of 2022.

Net foreign demand[22]

Data for the first five months of 2022 outlines a further revival of the international trade of the Republic of Moldova. Thus, during the period under review, the annual rate of imports and exports recorded pronounced growth rates. It should be noted that the positive dynamics of imports was driven by the increase in domestic consumption, but also because of the considerable increase in international energy prices. At the same time, developments in the agricultural sector were a key contributor to the positive export dynamics. It should be noted that, against the background of the war in Ukraine, the first two months of the second quarter of 2022 witnessed the emergence, on a massive scale, of the phenomenon of re-export of mineral products, as well as an increase in imports of agricultural products that are processed on the territory of the Republic of Moldova (at the first stage) or re-exported.

The annual export rate in the first quarter of 2022 recorded a level of 55.2% or 12.5 percentage points higher than in the fourth quarter of 2021. At the same time, data for the first two months of the second quarter of 2022 show a continuation of the upward trend in the annual export rate. The acceleration of the annual export rate in the first months of 2022 was mainly driven by the development of exports to the EU and CIS countries. At the same time, the dynamics of exports to countries classified as "rest of the world" were positive, but the impact on total export developments was decreasing (Chart 3.16).

The annual export rate in the first two months of the second quarter of 2022 recorded a level of 93.5% or 38.3 percentage points higher than in the first quarter of 2022. The record of a rich agricultural harvest in 2021 contributed to an increase in agri-food exports in the second half of 2021, a phenomenon that continued

[21] Since 1 January 2017 the statistical questionnaire 2-INV "On investments" has been amended in order to adjust the statistical tools (concepts and definitions used, methods of calculation and presentation of indicators) with the provisions of the new National Accounting Standards, which came into force on 1 January 2015.

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

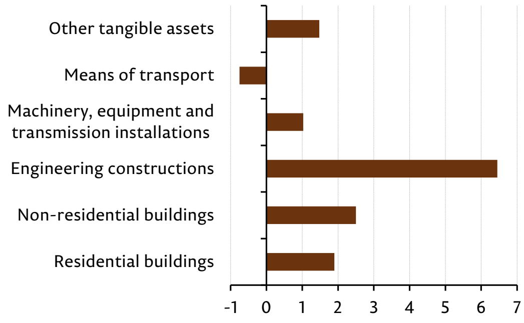
in the first half of 2022 (Chart 3.17). Thus, exports of agricultural food products in the first two months of the second quarter of 2022 contributed 61.8 percentage points to the annual export rate. At the same time, during the period under review, there was a significant increase in the export of "mineral products" in the context of a shortage of gasoline and diesel on the Ukrainian market due to the war.

Analysing the export evolution by origin of products, we can notice that the acceleration of the annual export rate in the last period was driven by the evolution of both the export of domestic products and re-exports (Chart 3.18).

In the first quarter of 2022, the annual import rate was 31.4% or 1.3 percentage points lower than at the end of 2021. At the same time, data for the first two months of the second quarter of 2022 show a slight acceleration in the annual import rate to about 37.1%. The positive pace of the annual rate of imports in 2022 was driven by developments in imports from all country categories (Chart 3.18).

By group of goods (Chart 3.19), the increase in the annual rate of imports in the first two months of the second quarter of 2022 was mainly influenced by the increase in imports of "mineral products"[23], "food, animal products, beverages and fats" and "products of the chemical and woodworking industries". At the same time, in the second quarter of 2022, the data for the other product categories show a broadly similar picture to that of the first quarter of 2022.

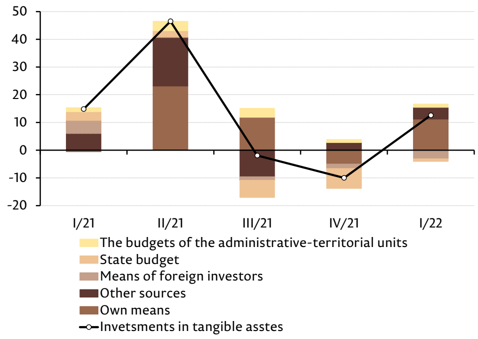
Chart 3.14: Contribution of components to the increase in investments in tangible assets in the first quarter of 2022 (percentage points)



Source: NBS, NBM calculations

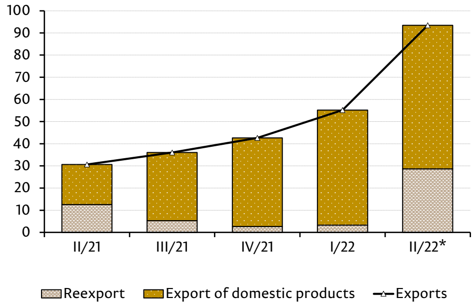
[23]The pronounced increase in imports of mineral products mainly reflects the significant increase in the price of trading energy resources, but also the re-export of fuels to Ukraine.

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



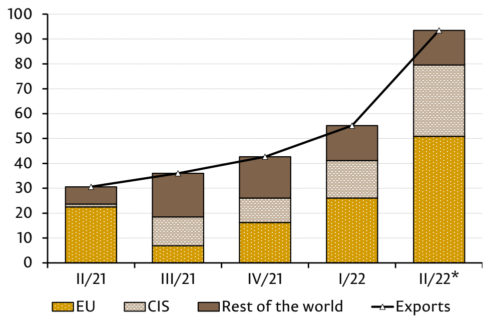
Source: NBS, NBM calculations

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



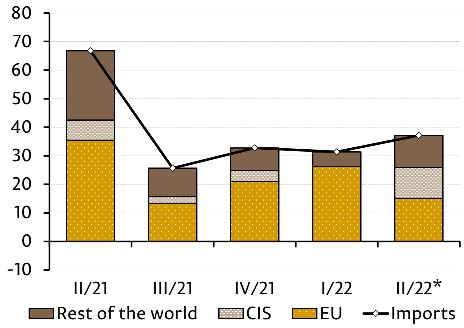
Source: NBS, NBM calculations
*Apr.-May

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



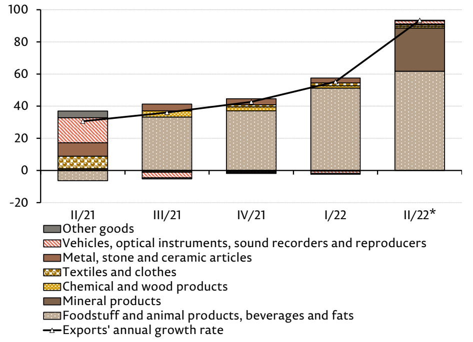
Source: NBS, NBM calculations
*Apr.-May

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



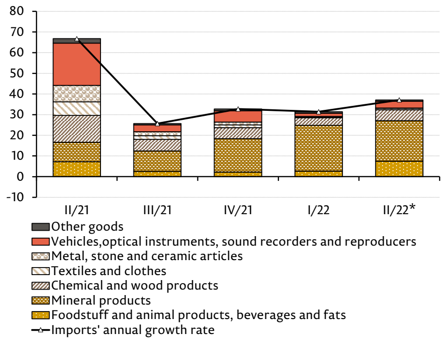
Source: NBS, NBM calculations
*Apr.-May

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



Source: NBS, NBM calculations
*Apr.-May

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



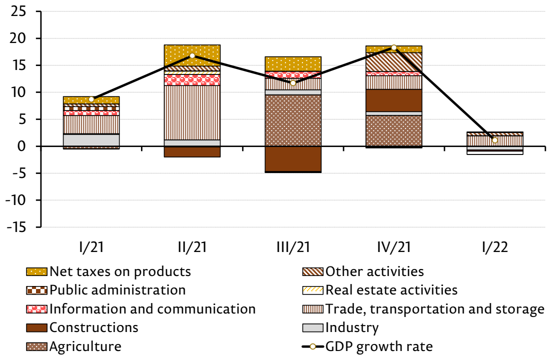
Source: NBS, NBM calculations
*Apr.-May

3.2 Production

By resource category, GDP growth in the first quarter of 2022 was mainly driven by developments in trade (Chart 3.21). In this respect, the gross value added in the subcomponent "trade"[24] increased by 12.7%, generating a positive impact of 1.7 percentage points on GDP dynamics.

A positive contribution was driven by an increase in gross value added in transport and storage of 1.9% compared to the first quarter of 2021. The financial and insurance activities sector increased by 12.4% and generated a contribution of 0.4 percentage points to GDP growth. The information and communication sector increased by 0.5% compared to the first quarter of 2021. Net taxes on products increased by 0.7%, generating a contribution of 0.1 percentage points to GDP dynamics. At the same time, gross value added in the agricultural sector decreased by 2.1%, generating a negative impact of 0.1 percentage points on GDP dynamics. Gross value added in the manufacturing sector generated a negative impact of 0.5 percentage points on GDP dynamics. Within this sector, the energy and manufacturing industries generated a negative impact, while mining and quarrying generated a neutral impact in early 2022. Gross value added in construction decreased by 3.5%, generating an impact of -0.3 percentage points on GDP growth. Real estate transactions decreased by 6.7% and had an impact of -0.6 percentage points on GDP growth.

Chart 3.21: Contribution of economic sectors to GDP growth (percentage points)

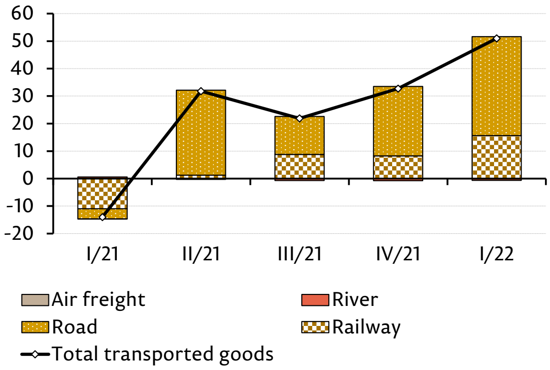


Source: NBS, NBM calculations

Freight and passenger transport

In the first quarter of 2022, the annual freight volume rate was 51.0%, 18.2 percentage points higher than in the fourth quarter of 2021 (Chart 3.22). This development was driven by the annual increase in the volume of goods transported by road and rail by 44.5 and 89.1%, respectively. At the same time, the volume of goods transported by inland waterway decreased by 43.6% and the volume of goods transported by air decreased by 11.5% compared to the same period of the previous year.

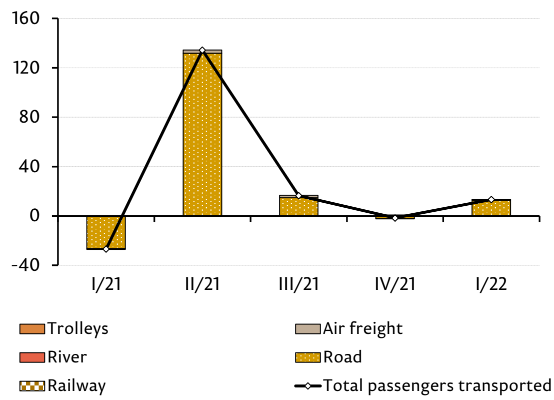
Chart 3.22: Evolution of freight transport (%, compared to the previous year)



Source: NBS

In the first quarter of 2022, the annual rate of passengers transported registered a level of 13.3%, 14.9 percentage points higher than in the fourth quarter of 2021 (Chart 3.23). This development was driven by annual increases in the number of passengers transported by air, trolleybus and road of 28.0, 13.6 and 13.2%, respectively. At the same time, the number of passengers transported by waterway decreased by 54.1% compared to the same period last year, and the number of passengers transported by rail – by 9.7%.

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



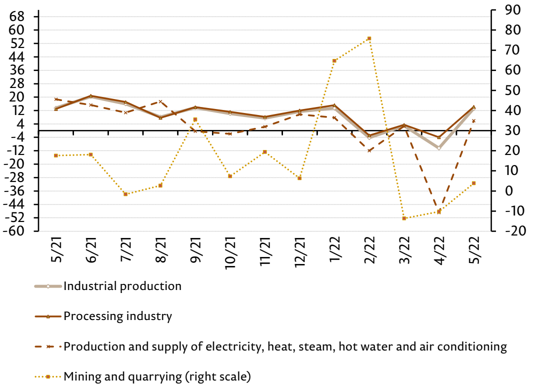
Source: NBS

Industrial production

In the first two months of the second quarter of 2022, the annual growth rate of the volume of industrial production averaged 1.4%, but was 2.6 percentage points lower than in the first quarter of

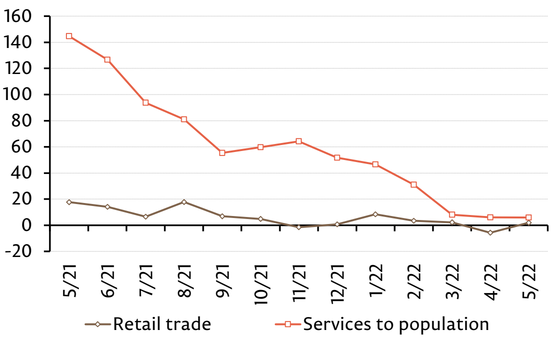
[24]Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles

Chart 3.24: Real evolution of industry (%, compared to the previous year)



Source: NBS

Chart 3.25: Real evolution of internal trade (%, 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

2022 (Chart 3.24). This dynamic was driven by a moderation in the annual growth rate of the manufacturing industry (from 5.3% in the first quarter of 2022 to 5.2% in the first two months of the second quarter of 2022).

At the same time, the annual rate of production volume in the sector "production and supply of electricity and heat, gas, hot water and air conditioning" in April-May 2022 decreased by 21.0 percentage points compared to the first quarter of 2022 to -21.5%. At the same time, mining and quarrying decreased (from 42.3% in the first quarter of 2022 to -3.2% in the first two months of the second quarter of 2022).

Domestic trade

In the first two months of the second quarter of 2022, turnover at enterprises with retail trade as their main activity decreased by an average of 1.9% in annual terms, 6.6 percentage points lower than in the previous quarter (Chart 3.25). At the same time, turnover in enterprises whose main activity is market services provided to households increased by 6.0% between April and May 2022, although this annual rate was 22.6 percentage points lower than in the first quarter of 2022.

Turnover at enterprises engaged primarily in wholesale trade increased by 14.9%[25] between April and May 2022, although this annual rate was 22.7 percentage points lower than in the first quarter of 2022 (Chart 3.26). At the same time, turnover in enterprises whose main activity is market services provided to companies increased by 6.5% during the reference period, this annual rate being 0.6% lower than in the previous quarter.

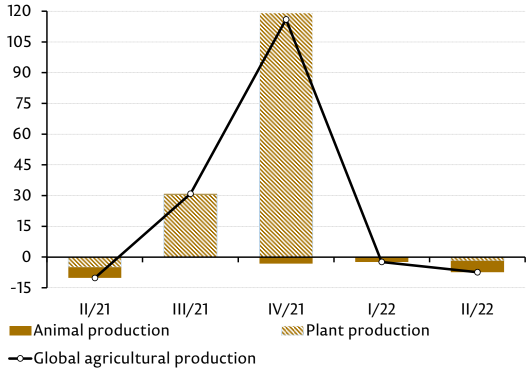
[25] Deflated by the annual rate of the CPI.

Agricultural production

In the second quarter of 2022, global agricultural production decreased by 7.4% compared to the level in the same quarter of the previous year (Chart 3.27). This dynamic was supported by decreases in crop and livestock production of 7.5 and 7.4%, respectively. The decrease in crop production was driven by dry weather conditions during the period under review, which deteriorated the average harvest per hectare.

The contraction in the volume of production in the livestock sector[26] in the second quarter of 2022 was driven by decreases in the production of milk and "cattle and poultry (live weight)". At the same time, eggs production was higher than in the similar quarter of the previous year.

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



Source: NBS, NBM calculations

[26]Comparable prices

3.3 Labour market

Labour force

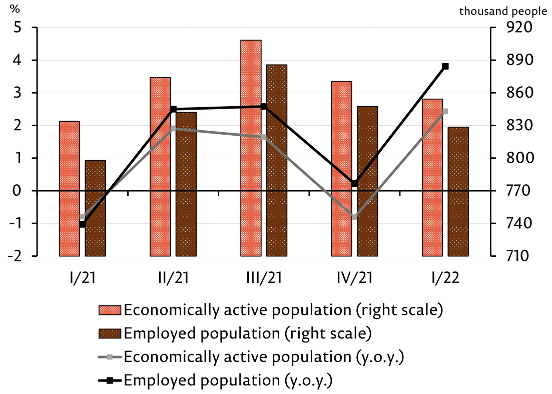
After the modest dynamics at the end of the previous year, both the economically active population and the employed population experienced positive dynamics at the beginning of this year. The unemployment rate as well as the underemployment rate showed a slightly upward dynamic compared to the fourth quarter of 2021.

In January-March 2022, the labour force totalled 854.2 thousand persons, growing by 2.4% compared to the first quarter of 2021. At the same time, the employed population amounted to 828.5 thousand persons, 3.8% higher than in the same period of 2021 (Chart 3.28).

By subcomponent, the increase in the number of employed population in the first quarter of 2022 was witnessed in almost all economic sectors. Industry, construction and the sub-component "other activities" contributed most significantly in this respect (Chart 3.30).

In the first quarter of 2022, the number of unemployed was 25.7 thousand persons or by 2.8 thousand persons higher than in the fourth quarter of 2021, and the unemployment rate was 3.0% being by 0.4 percentage points higher than in the fourth quarter of 2021 (Chart 3.29). However, the number of unemployed and the unemployment rate were lower (by 10.1 thousand persons and 1.3 percentage points, respectively) than the values recorded in the same period of 2021. Similar trends were also observed for the underemployed population. Thus, in the first quarter of 2022, the underemployed population increased to 27.5 thousand persons from 18.1 thousand persons in October-December 2021, and the underemployment rate was 3.3% or 1.2 percentage points higher than in the fourth quarter of 2021.

Chart 3.28: Economically active population and employed population

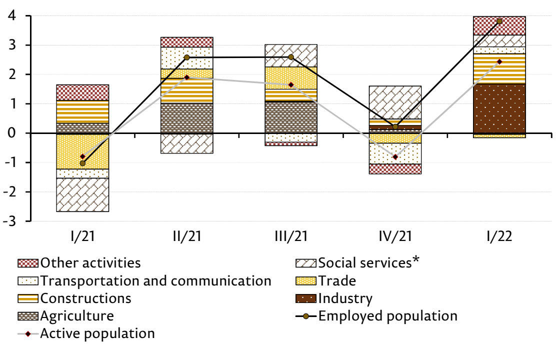


Source: NBS, NBM calculations

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

Salary fund

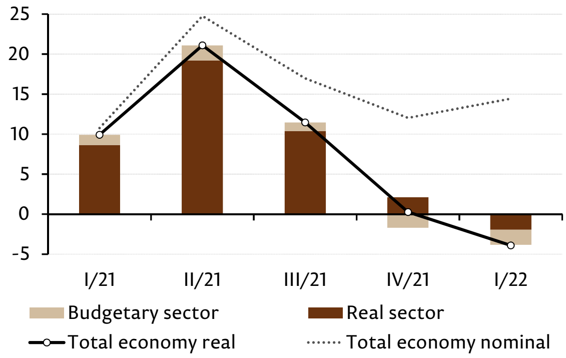
In the first quarter of 2022, the wage fund on the economy continued the pronounced positive dynamics observed in previous periods, recording an increase of 14.4% in nominal terms. The wage fund for employees in trade contributed most to the positive dynamics of the wage fund (3.1 percentage points), followed by the wage fund for employees in information and communication technologies (2.9 percentage points). The industrial sector payroll fund also made a significant positive contribution to the dynamics of the indicator analysed (2.0 percentage points).

However, in real terms, deflated by the CPI, the wage fund in the economy decreased by 3.9% compared with the same period of the previous year, as a result of developments in both the budget and real sectors (Chart 3.31)

In the first quarter of 2022, the annual change in the average number of employees in the national economy moderated slightly to 1.4%. The dynamics of the number of employees in the real sector contributed 1.5 percentage points, while the dynamics of the number of employees in the budget sector contributed -0.1 percentage points (Chart 3.32).

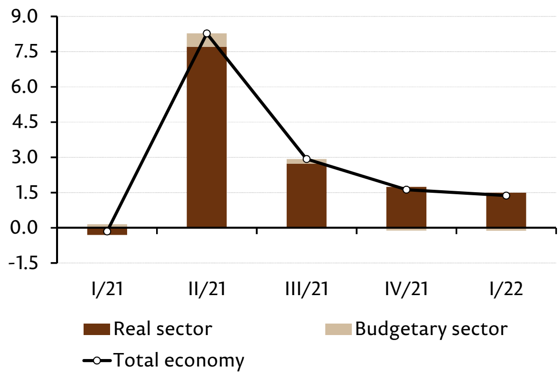
The distribution by sector of the economy shows more pronounced increases in the average number of employees, mainly in administrative and support service activities (6.9%), real estate activities (5.5%), information and communication (5.8%) and wholesale and retail trade (4.0%) (Chart 3.33).

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



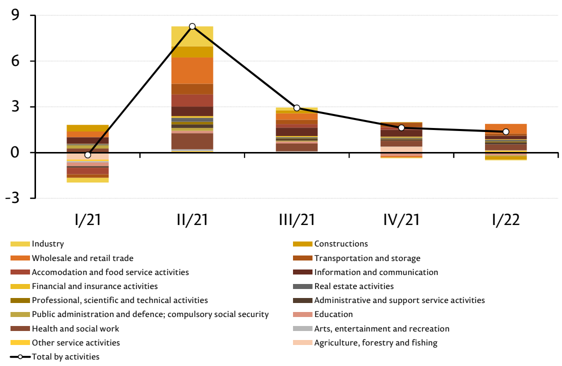
Source: NBS, NBM calculations

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)



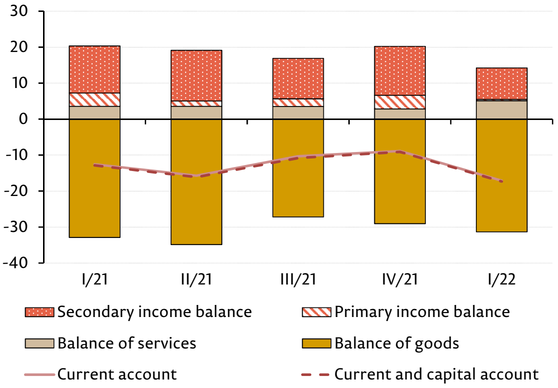
Source: NBS, NBM calculations

3.4 External sector

Current Account

In the first quarter of 2022, the current account deficit of the balance of payments increased by 8.2 percentage points compared to the previous quarter to 17.1% as a share of GDP (Chart 3.34). The increase in the balance of payments deficit was due to a decrease in the components with a positive contribution: the "secondary income balance" and the "primary income balance" decreased, while the "balance of services" increased during the reference period. At the same time, the negative contributing component – "balance of goods" – increased in the first quarter of 2022.

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

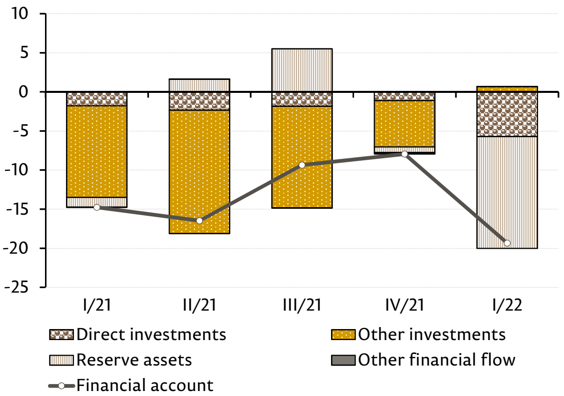


Source: NBM

Financial Account

In the first quarter of 2022, the financial account as a share of GDP was 19.3% or by 11.4 percentage points higher than in the fourth quarter of 2021. Thus, higher net capital inflows (as a ratio to GDP) were driven by the change recorded in the direct investment and reserve asset components (Chart 3.35). Thus, net direct investment inflows as a share of GDP recorded a level of 5.7%, 4.6 percentage points higher than in the fourth quarter of 2021. The net increase in financial assets under "direct investments" mainly reflects the increase in assets in the form of "reinvestment of profits". At the same time, in the first quarter of 2022, there was a marked decrease in reserve assets (14.3% as a share of GDP) and, as a result, an increase in net capital inflows. It should be noted that in the first quarter of 2022, the "other investments" component recorded a development less characteristic of this component, thus contributing to the decrease in net inflows of financial assets[27].

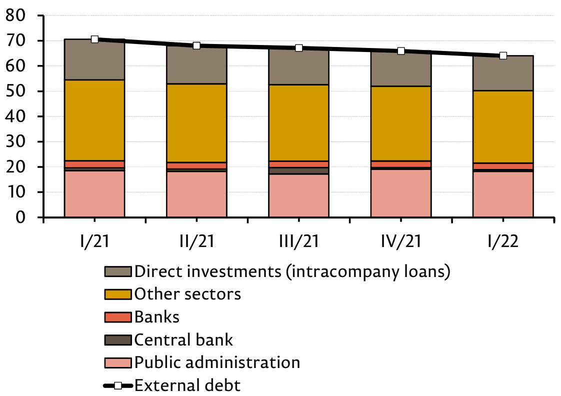
Chart 3.35: Share of financial account in GDP (%)



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

External debt as a share of GDP in the first quarter of 2022 was 64.0%, which was by 1.9 percentage points lower than in the fourth quarter of 2021 (Chart 3.36). In the structure of external debt there were no major changes, thus, similarly to previous periods, the major share in total external debt is held by economic agents[28] with 31.4%, the government sector[29] with 18.9%, and direct investments – 13.8%.

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



Source: NBM

[27] In the first quarter of 2022, net loans contracted and trade loans and advances recorded modest values compared to those of 2021.
[28] Cumulative debt of "Banks" and "Other sectors".
[29] Cumulative debt of "Public administration" and "Central bank".

Chapter 4

Monetary policy

4.1 Monetary policy instruments

Evolution of money market interest rates

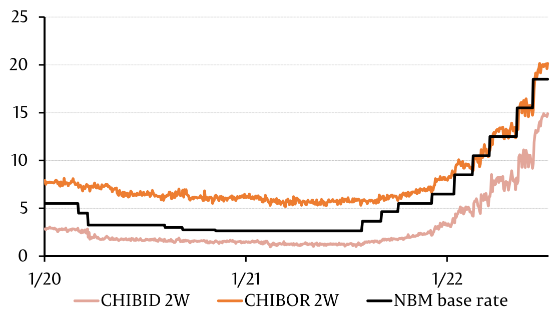
In the context of the accelerating pace of global and regional inflation, together with the upward revision of its forecasts for the coming quarters, as well as the tense situation in the region, the NBM maintained the tight monetary policy conduct, materialized by two successive increases of the NBM base rate by 3.00 percentage points, thus raising its level to 18.5%.

Under the impact of the restrictive policy stance that started in July 2021, CHIBOR 2W rates continued to increase in the April-June 2022 period, but at a faster pace, intensely receiving the increases in the base rate during this period. Thus, the CHIBOR 2W rate at the end of June was significantly higher (+6.87 percentage points) than on the last day of the previous quarter, at 20.15% (Chart 4.1).

Increased investor interest, together with the partial rejection by the Ministry of Finance of offers submitted at tenders for the placement of government securities with a maturity of 91 days, in an attempt to resist the increase in interest rates, mitigated the effect of the increases in the NBM monetary policy rate. Thus, the value recorded in the last month of the quarter of 15.73% was only 2.03 percentage points higher than that recorded at the end of the first quarter of 2022 (Chart 4.2).

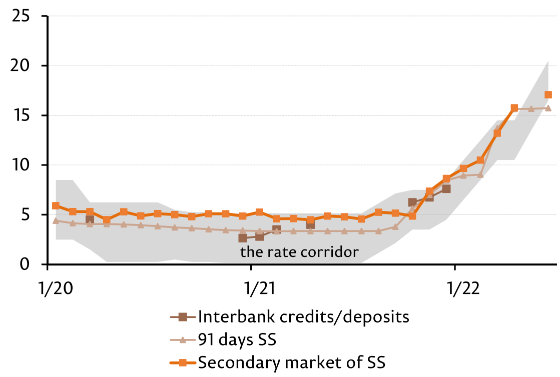
In the secondary segment of the state securities market, the interest rates on transactions performed were somewhat similar to those in the primary market, but their upward movement was more extensive. The quarterly average was 16.29%, higher than in the previous quarter (+5.42 percentage points), while the weighted average term to maturity decreased from 219 days to 149 days.

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



Source: NBM

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



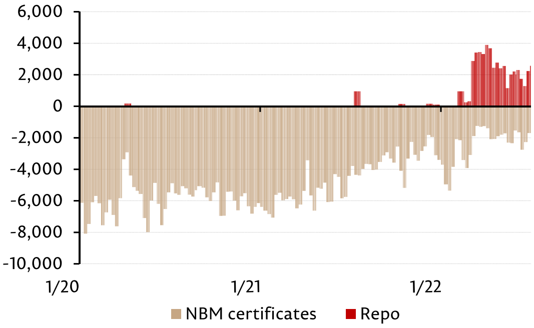
Source: NBM

Money market operations

Sales of NBM certificates (NBC)

The NBM's debtor position towards the banking system has narrowed significantly over the period under review, accompanied by a reduction in the volatility of the daily stock of NBC placements. Thus, the average quarterly balance decreased by MDL 979.0 million compared to the first quarter of 2022, amounting to MDL 1,965.5 million.

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



Source: NBM

The NBM conducted NBC placement tenders with weekly frequency, 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 evolution of the quantitative parameters of monetary injection operations was the inverse of that of the draining of the liquidity surplus. The volume of liquidity supplied increased, a situation reflected in the evolution of the average quarterly balance of repo operations, which increased from MDL 1,292.8 million in the first quarter of 2022 to MDL 2,333.9 million in the period under review.

Repo-liquidity repurchase operations were conducted weekly for 14 days at a fixed interest rate (base rate plus a margin of 0.25 percentage points) through the no-limit auction procedure.

Standing facilities

During the second quarter of 2022, banks used both standing facilities offered by the NBM.

The total volume of overnight deposits amounted to MDL 24,695.0 million, slightly exceeding that of the previous quarter. The average daily balance of MDL 464.7 million was about 1.3 times higher than in the previous quarter. The amounts placed by banks ranged from a low of MDL 10.0 million to a high of MDL 2,800.0 million.

The total amount of overnight loans granted to banks by the NBM for the whole of the second quarter of 2022 amounted to MDL 3,558.0 million, a significant decrease compared to the previous period. The average daily balance amounted to MDL 109.6 million.

Required reserves

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

In the second quarter of 2022, with the aim of moderating inflationary pressures and discouraging dollarization, reserve requirements were increased in two steps, from the funds attracted in Moldovan lei and non-convertible currency – by 2.0 percentage points to 32.0%, and from the funds attracted in freely convertible currency (FCC) – by 3.0 percentage points to 36.0%.

Thus, during the application period from June 16 to July 15, 2022, required reserves in MDL amounted to MDL 15,052.4 million, which is MDL 1,685.3 million (+12.6%) higher than those maintained from 16 March 2022 to 15 April 2022.

As regards required reserves from funds attracted in the FCC, during the application period 16 June – 15 July 2022, they amounted to USD 187.7 million and EUR 475.5 million. Compared to the period from 16 March 2022 to 15 April 2022, reserve requirements in US dollars increased by 22.8% and those in euros by 13.7%.

Interbank money market

There were no transactions on the interbank credit/deposit market in the second quarter of 2022.

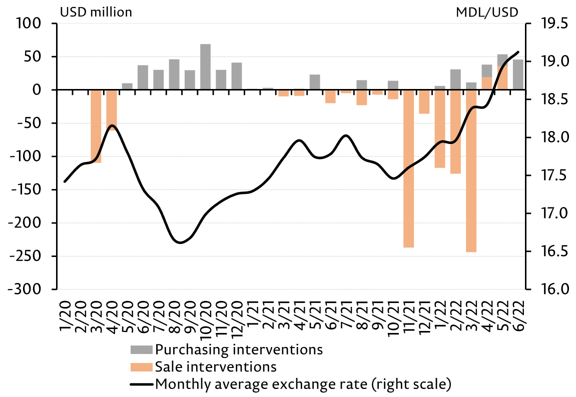
Interventions on the domestic foreign exchange market

The NBM intervened on the domestic foreign exchange market during April-June 2022, both through purchases and sales of foreign exchange.

During the period under review, the volume of transactions of the National Bank of Moldova carried out on the interbank foreign exchange market against Moldovan lei, on the date of the currency, amounted to USD 137.59 million, including purchase transactions in the amount of USD 82.05 million, sale transactions in the amount of USD 55.00 million, as well as foreign exchange conversions with World Bank institutions (International Bank for Reconstruction and Development and the International Development Association) in the amount of USD 0.54 million.

At the same time, during the reference period, the NBM carried out purchase swaps amounting to USD 7.80 million (Chart 4.4).

Chart 4.4: Evolution of the official MDL/USD exchange rate and the volume of daily transactions of the NBM, second quarter of 2022

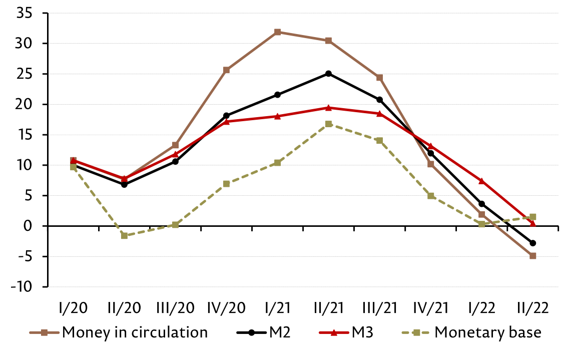


Source: NBM

4.2 Dynamics of monetary indicators

In the second quarter of 2022, the dynamics of monetary aggregates recorded a downward trend, thus the M2 monetary aggregate recorded a decrease of 2.8% (by 6.4 percentage points below the level of the first quarter of 2022) and an increase of 0.5% for M3 (by 6.9 percentage points less than the increase in the previous quarter). The monetary base increased compared to the second quarter of 2021, with the quarterly average in annual terms constituting 1.5% (Chart 4.5).

Chart 4.5: Changing monetary aggregates (%, annual growth)

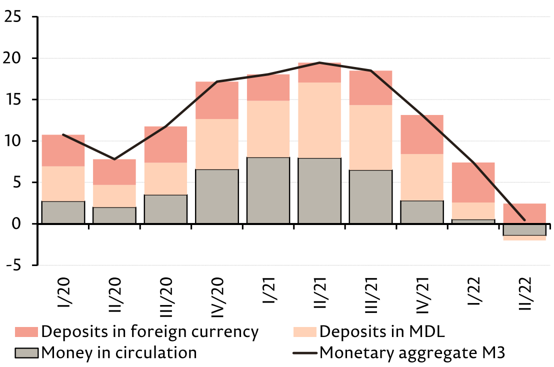


Source: NBM

Money supply

The evolution of the M3 monetary aggregate compared to the previous quarter was driven by the negative contribution from currency in circulation and deposits in national currency, while the positive contribution from foreign currency deposits provided the M3 monetary aggregate with an annual growth of 0.5% (Chart 4.6).

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



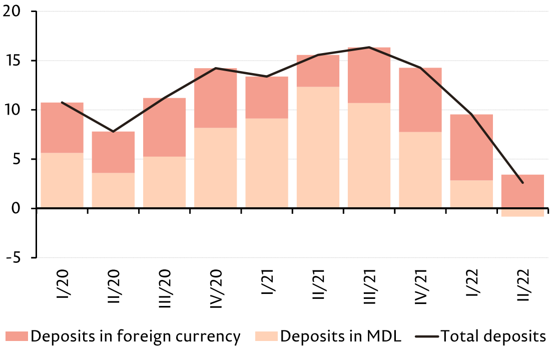
Source: NBM

The 1.4% decrease in national currency deposits (Chart 4.8) was due to a decrease in both term and sight deposits of individuals, while the growth rate of both term and sight deposits of corporations slowed compared to the previous quarter.

The growth of foreign currency deposits in the second quarter of 2022 was 8.6% annually, by 8.0 percentage points below the level recorded in the previous quarter as a result of 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 (Chart 4.13).

The growth rate of money in circulation at the end of the second quarter of 2022 decreased by 4.1 percentage points compared to the end of the previous quarter to -4.7%.

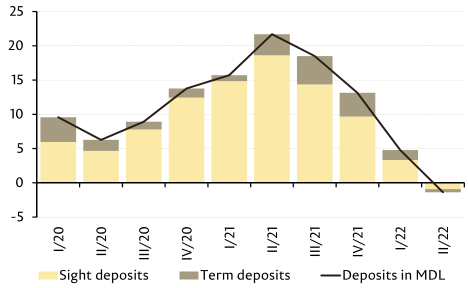
Chart 4.7: Dynamics of the total balance of deposits (%, comp. contrib. in annual growth)



Source: NBM

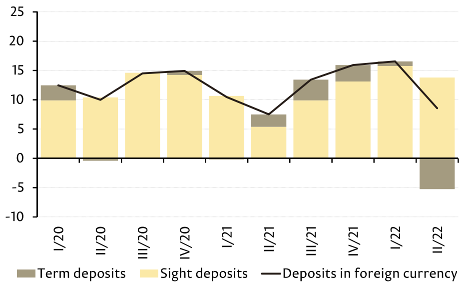
The average quarterly contribution of money in circulation to M3 growth decreased by 1.9 percentage points from the level recorded in the first quarter of 2022 (Chart 4.6). The dynamics of money in circulation were driven by both the inflow of cash receipts and the outflow of cash disbursements at the cash offices of commercial banks. Out of the total inflows, the largest share was accounted for by inflows from the sale of consumer goods and inflows on current and deposit accounts of individuals. At the same time, the main components of the releases from the cash offices of commercial banks were: releases for the purchase of foreign currency from individuals and cash releases from ATMs and POS-terminals.

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



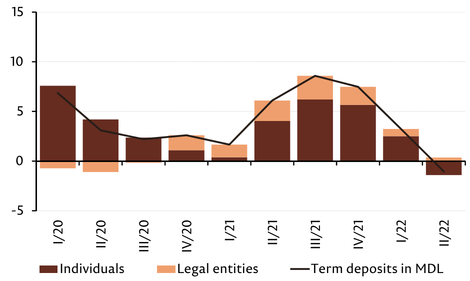
Source: NBM

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



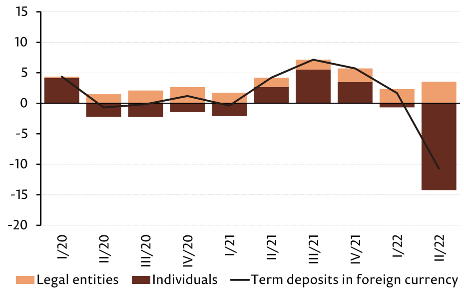
Source: NBM

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



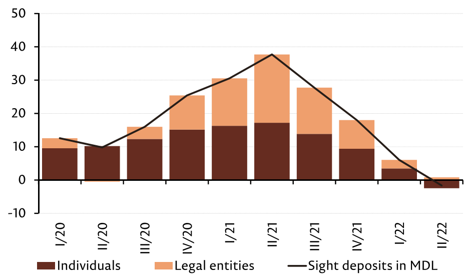
Source: NBM

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



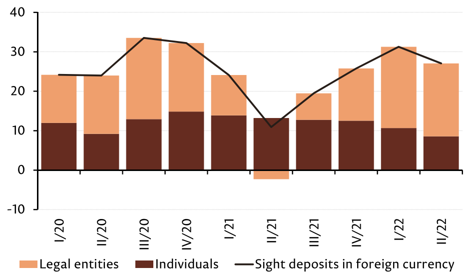
Source: NBM

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



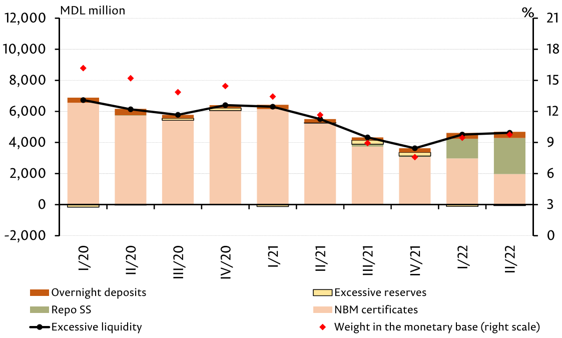
Source: NBM

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



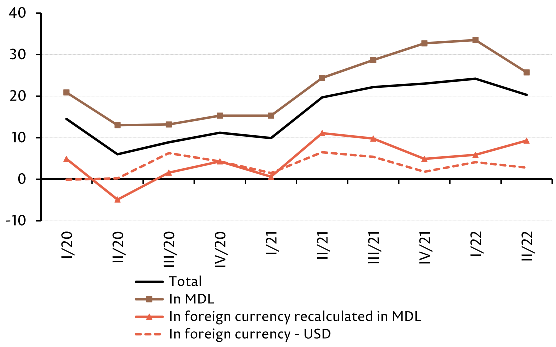
Source: NBM

Chart 4.14: The excessive liquidity



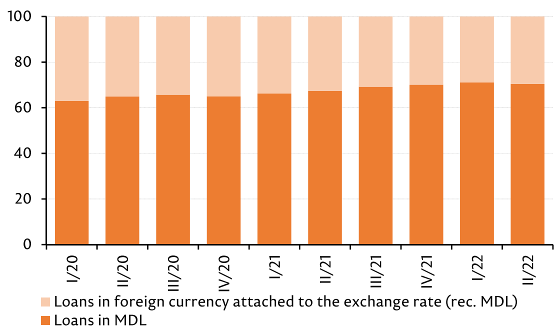
Source: NBM

Chart 4.15: Evolution of the loan balance (%, annual increase)



Source: NBM

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



Source: NBM

Excessive liquidity

During the second quarter of 2022, excess liquidity in the banking system increased by MDL 112.9 million. It should be noted that compared to the second quarter of 2021, the volume of excess liquidity decreased on average by MDL 882.9 million, recording an average value of MDL 4.62 billion (Chart 4.14).

Credit market

Evolution of the balance of loans granted by licensed banks[30]

At the end of the second quarter of 2022, the total balance of loans granted by licensed banks recorded a positive annual growth (Chart 4.15) and amounted to MDL 58,411.8 million, higher than at the end of the second quarter of 2021 by 20.3% and with a positive contribution from the balance of loans granted in national currency of 17.3 percentage points. The share of the balance of loans granted in national currency accounted for 70.4% of the total balance of loans (Chart 4.16).

As of June 30, 2022, the balance of loans granted in national currency by licensed banks recorded an annual growth rate of 25.7%, with the contribution from the increase in the balance of loans granted to individuals of 16.3 percentage points and from loans granted to legal entities of 9.4 percentage points. In turn, the balance of loans in MDL granted to individuals recorded an annual increase of 27.1%, and their share accounted for 60.7% of the balance of loans in MDL.

At the end of the reporting quarter, the largest share in the structure of the total portfolio of loans granted by licensed banks, analogous to the previous quarters, went to loans granted to individuals (43.8%), followed by the share of loans granted to legal entities in the trade sphere (21.0%) (Chart 4.17).

Evolution of new credits granted by licensed banks

In the second quarter of 2022, the total volume of new loans granted by licensed banks was by 10.9% higher than in the second quarter of 2021 (Chart 4.18). The annual increase was influenced only by the positive development of loans granted in foreign currency and linked to the foreign exchange rate, recalculated in MDL. The volume of new loans granted in national currency by licensed banks recorded an annual decrease of 6.1%, due to the increase in interest rates. The share of loans granted in domestic currency decreased to 63.2% from 73.8% in the first quarter of 2022. From the perspective of MDL borrowers, the annual growth rate of loans to legal entities represented 15.9%. The annual dynamics of loans in MDL granted to individuals recorded a decrease of 25.9% (Chart 4.19).

In the second quarter of 2022, compared to the same quarter of the previous year, the volume of loans granted in MDL to individuals for real estate decreased by 36.9%, and those for consumption purposes by 28.0% (Chart 4.19). Analogous to the previous quarters, the largest share of total MDL loans to individuals was consumer loans (60.5%), followed by loans for real estate (25.8%).

[30]The data analysis was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" submitted by licensed banks until 12 July 2022.

In the context of increasing interest rates on loans in national currency, there was an increase in demand for foreign currency loans, a segment with relatively stable interest rates. Thus, during the second quarter of 2022, loans in foreign currency to legal entities and linked to the exchange rate recorded an annual growth rate of 59.7%, and those to individuals of 123.8%.

Market of term deposits accepted by licensed banks (balance of deposits)[31]

At the end of the second quarter of 2022, the total balance of term deposits attracted by licensed banks recorded an annual decrease of 2.7%, due to the decrease in the balance of term deposits attracted in foreign currency, under the influence of the reduction in the dynamics of term deposits attracted from individuals (Chart 4.20). At the same time, the annual dynamics of term deposits attracted in national currency increased by 1.0%, reflecting the effect of higher interest rates (Chart 4.20).

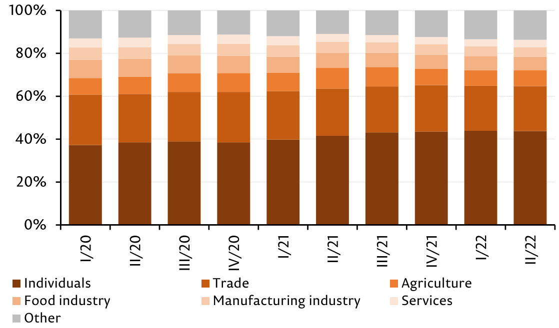
The major component in the total balance of term deposits attracted by licensed banks was the balance of deposits in MDL (Chart 4.21). At the end of the second quarter of 2022, the share of the balance of term deposits attracted in national currency was 61.0% of the total balance of term deposits, higher than at the end of the second quarter of 2021 by 2.2 percentage points. It should be noted that at the end of the reporting quarter, the share of term deposits attracted in MDL from individuals amounted to 87.4%, similar to the situation as of 30 June 2021.

Interest rates[32]

Evolution of the base rate

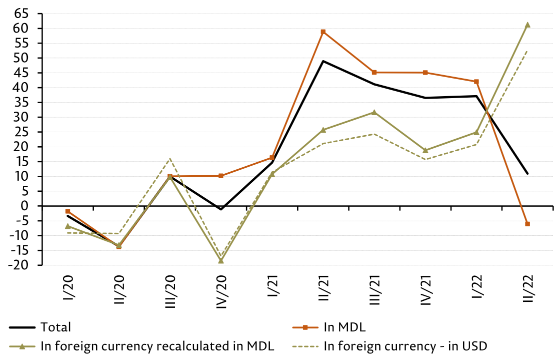
Two meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions were held during the second quarter of 2022. Following the assessment of the balance of internal and external risks and the inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova decided to successively increase the base rate applied to the main monetary policy operations by 3.00 percentage points at the meetings of 5 May 2022 and 3 June 2022, up to the level of 18.50% annually. These gradual monetary policy tightening measures were adopted with the aim of mitigating inflationary pressures stemming from the effects of rising global prices, energy and food production and distribution costs. The aim of these decisions was to anchor inflationary expectations, bring back and maintain the inflation rate close to the 5.0% target over the medium term, with a possible deviation of ±1.5 percentage points.

Chart 4.17: Loan balance structure (% in total)



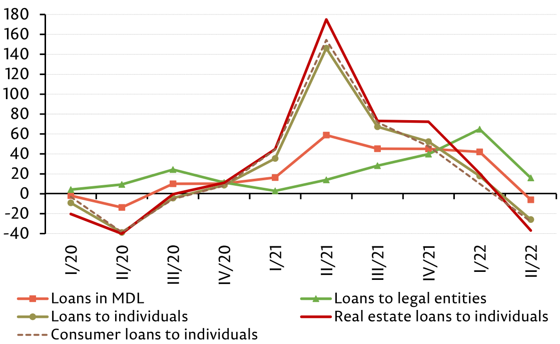
Source: NBM

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



Source: NBM

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

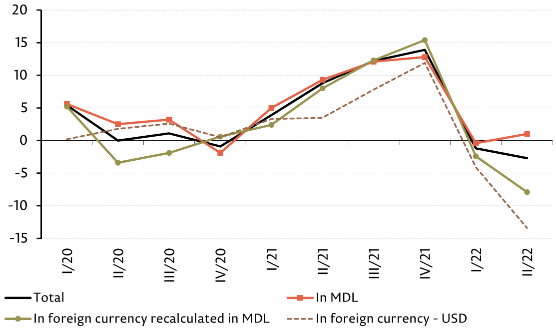


Source: NBM

[31] The data analysis was based on ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks up to 12 July 2022 and does not include demand deposits.

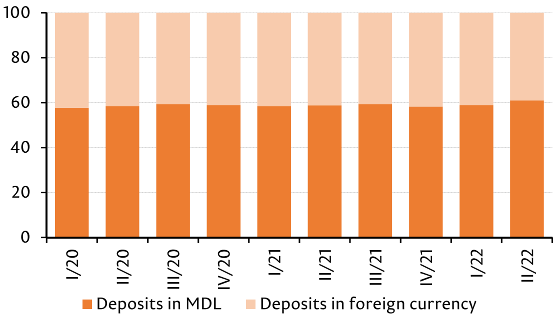
[32] The analysis of rates was carried out on the basis of the ORD 01.06 "Interest rates on loan and deposit balances" reports submitted by licensed banks up to 12 July 2022 and does not include rates on demand deposits.

Chart 4.20: Deposit balance dynamics (%, annual growth)



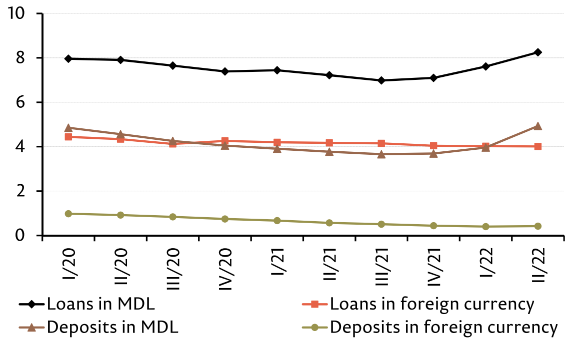
Source: NBM

Chart 4.21: Evolution of the share of term deposits on subcomponents in the total balance (%)



Source: NBM

Chart 4.22: Average interest rates on balance of loans and deposits (%)



Source: NBM

Evolution of the interest rate on the balance of loans

For the period April-June 2022, the weighted average interest rate on the balance of loans granted in MDL by licensed banks amounted to 8.25% annually, higher than in the second quarter of 2021 by 1.03 percentage points, and higher than in the first quarter of 2022 by 0.64 percentage points under the influence of the increase in the weighted average interest rate on the balance of loans granted in MDL to both legal entities and individuals (Chart 4.22).

For the whole of the second quarter of 2022, the weighted average interest rate on the balance of foreign currency loans was 4.01% annually, lower than in the second quarter of 2021 by 0.16 percentage points and did not change significantly compared to the first quarter of 2022.

Evolution of the interest rate related to the balance of deposits

In the second quarter of 2022, interest rates in the domestic currency segment continued their upward trend. Thus, the weighted average interest rate on the balance of deposits in national currency amounted to 4.93% annually and increased compared to the second quarter of 2021 by 1.16 percentage points (Chart 4.22). The weighted average interest rate on the balance of term deposits attracted in foreign currency remained essentially unchanged at 0.42% annually.

Evolution of banking margin

In the second quarter of 2022, the bank margin (calculated as the difference between the weighted average interest rate on loan balances and the weighted average interest rates on deposit balances) decreased in the domestic currency segment (Chart 4.23).

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

As a result of the evolution of monetary and foreign exchange market indicators, the weighted average interest rates on new term deposits attracted and new loans granted in domestic currency continued to increase in the second quarter of 2022 (Chart 4.24). For the whole of the second quarter of 2022, the weighted average interest rate on deposits in MDL recorded a relatively higher increase and amounted to 8.47% annually, higher than in the second quarter of 2021 by 5.20 percentage points and in the first quarter of 2022 by 3.42 percentage points. The weighted average interest rate on term deposits attracted in national currency from individuals increased by 6.30 percentage points compared to the second quarter of 2021 and amounted to 10.02% annually.

The weighted average interest rate on new loans in domestic currency in the second quarter of 2022 was 10.74% annually, by 3.86 percentage points higher than in the second quarter of 2021 and by 1.40 percentage points higher than in the first quarter of 2022.

Evolution of the nominal and real effective exchange rate

According to the official exchange rates at the end of the second quarter of 2022, the national currency depreciated against the US dollar by 4.4% and appreciated against the EUR by 1.4% (Chart 4.25).

On average, the Moldovan leu's exchange rate fluctuations were lower, depreciating by 4.0% against the US dollar and appreciating by 1.1% against the EUR compared to the previous quarter's averages.

During the period under review, most of the currencies of the Republic of Moldova's main trading partners included in the basket REER, with the exception of the Russian ruble, depreciated on average against the US dollar. In particular, the Turkish lira depreciated – by 12.9%, the Hungarian forint – by 11.1%, the pound sterling – by 6.6%, the Polish zloty – by 5.8%, the euro and the Bulgarian leva – by 5.2%, the Romanian leu and the Czech koruna – by 5.1%, etc. The Russian ruble appreciated by 22.6% (Chart 4.26).

Under these conditions, in real terms, the Moldovan leu depreciated by 2.9% against the basket of currencies of the Republic of Moldova's main trading partners (average of the second quarter of 2022 against the average of the first quarter of 2022). Only the Russian Federation and Ukraine contributed to the depreciation of the REER, by -7.4 and -0.5 percentage points, respectively (Chart 4.28).

In the second quarter, the situation on the local currency market improved compared to the first quarter, which was characterized by the worsening geopolitical situation at the country's borders and high import prices for energy resources, especially natural gas.

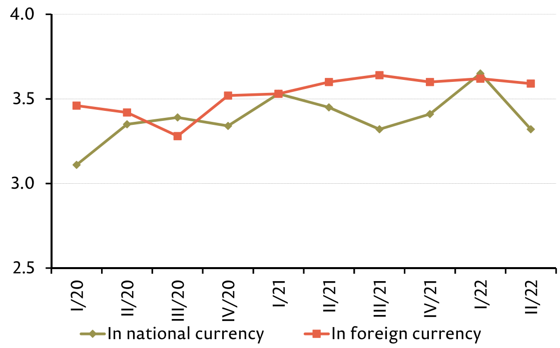
The net supply of foreign exchange from individuals, at USD 591.5 million, increased 2.8 times from the previous quarter, but declined from the second quarter of 2021 (-14.6%). It recovered compared to the previous quarter due to the normalization of the situation on the foreign exchange market, given that, with the successful overcoming of the agiotage period the sales of foreign exchange to individuals and the reflux of foreign exchange from their accounts at local banks to foreign banks tempered. The increase in foreign exchange transfers from abroad to individuals by 27.3% over the previous quarter (+3.7% over the second quarter of 2021) was an additional factor of foreign exchange supply.

In the structure of the net supply of foreign exchange from individuals, the single European currency continued to account for the largest share (71.6%[33]) (Chart 4.29).

Although it had a negative development both compared to the previous quarter and to the second quarter of 2021 (-9.4% and -15.9%, respectively), the net demand for foreign exchange from economic operators remained at a high level – USD 635.9 million. Its decrease compared to the previous quarter was due to the reduction in demand for foreign currency from the local natural gas supplier with the end of the heating season, as well as the trend of economic operators to migrate their funds from accounts in national currency to those in foreign currency.

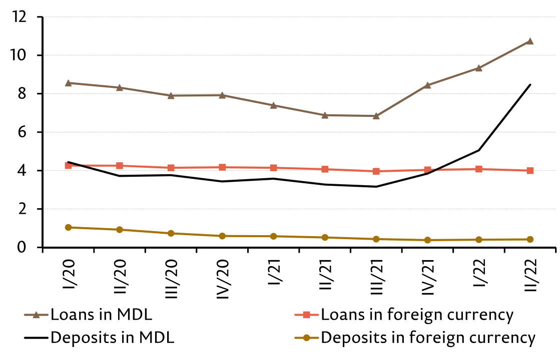
[33]Weight calculated by applying a constant rate.

Chart 4.23: The evolution of the banking margin on loan and deposit balances (percentage points)



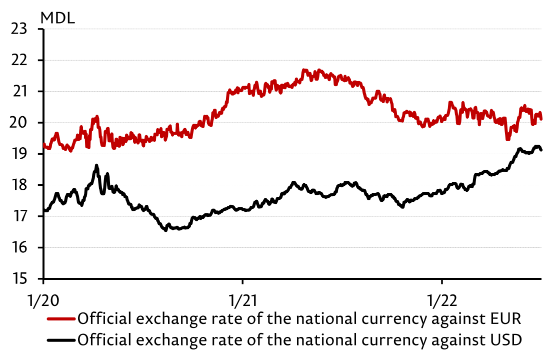
Source: NBM

Chart 4.24: Average interest rates on new volume of loans and deposits (%)



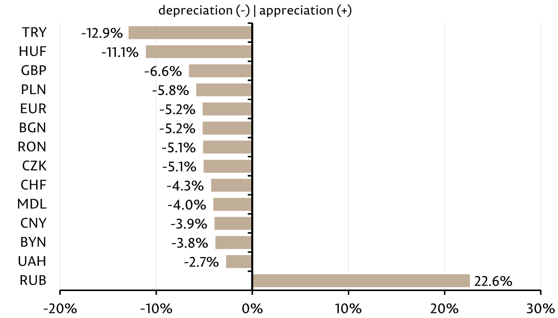
Source: NBM

Chart 4.25: Fluctuations in the official exchange rate of the Moldovan leu against the US dollar and the euro



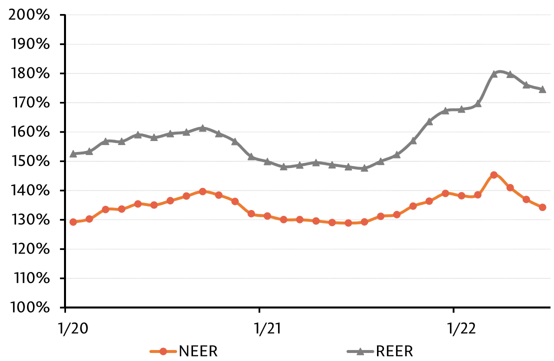
Source: NBM

Chart 4.26: The evolution of countries' currencies – main trading partners against the US dollar (average exchange rate Q2 2022/ Q1 2022, %)



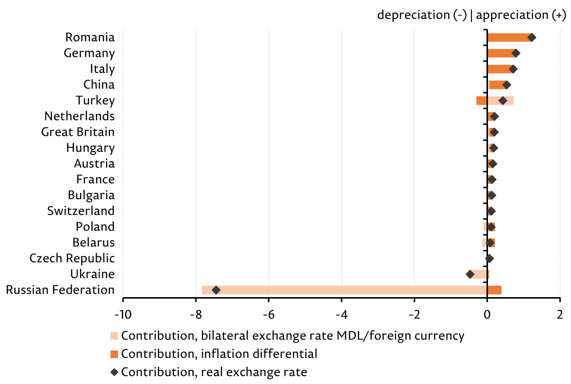
Source: NBM

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 countries – main trading partners (Dec.2000-100%)



Source: NBM

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



Source: NBM

Under these circumstances, the coverage of net demand for foreign exchange from economic agents by net supply of foreign exchange from individuals increased to 93.0% in the second quarter of 2022 compared to 31.1% in the previous quarter and 91.7% in the second quarter of 2021, creating the premises for NBM's interventions for net foreign exchange procurement in the amount of USD 27.1 million.

Viewed in dynamic terms, the Moldovan leu's exchange rate against the US dollar started the quarter under depreciation pressure, amid increased demand from energy importers and uncertainties caused by the invasion of the Russian Federation of Ukraine. The domestic currency market became more balanced in the last decade of May, with the Moldovan leu stabilising at the level of previous periods.

The appreciation of the Moldovan leu against the euro was due to the continued depreciation of the single European currency against the US dollar on international markets in the reporting quarter. This dynamic of the euro is due to the firmer monetary policy tightening measures taken by the FRS compared to the ECB, at a time when the EU economy is exposed to major economic risks in the context of the war in Ukraine, dependence on imports of Russian energy resources and potential natural gas shortages from the Russian Federation.

Thus, during the second quarter, the euro/dollar exchange rate reached two-year lows, with the single European currency depreciating against the US dollar by 5.5% compared to the end of the previous quarter.

At the end of June 2022, the balance of official reserve assets stood at USD 3,616.4 million (Chart 4.31), up by USD 184.0 million (+5.4%) compared to the end of March. Official reserve assets increased mainly based on inflows related to external financing, the increase in funds in banks' required foreign currency reserve accounts and net foreign exchange purchases.

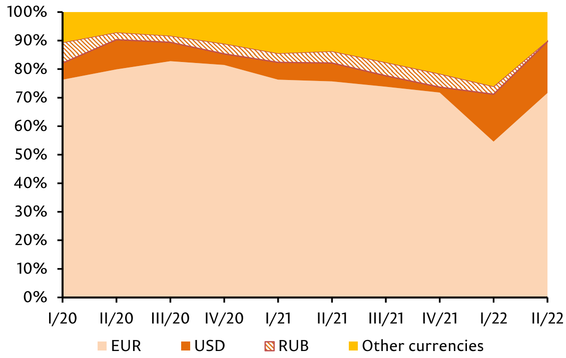
In terms of external financing inflows, the largest disbursements were recorded from the IMF in the form of loans ECF (64.8 million SDR) and EFF (43.4 million SDR) as budget support (equivalent to USD 144.0 million). There were also inflows in the form of donations for refugees amounting to the equivalent of USD 5.1 million from several individuals and institutions.

The World Bank, mainly through IDA, disbursed a budget support credit of USD 8.7 million under the health development programme and USD 9.2 million to finance the following projects: land registration and evaluation, rehabilitation of local roads, modernisation of government services, etc. The European Commission also disbursed USD 3.6 million, including a grant under the project for sustainable development of public transport in Chisinau municipality (USD 1.5 million).

The European Investment Bank continued to finance the Livada Moldovei project, disbursing loans of USD 7.9 million. At the same time, several grants were received from external partners for road modernisation projects in localities of the Republic of Moldova for a total amount of USD 1.4 million and others for USD 1.5 million from public institutions of Romania, Hungary, etc.

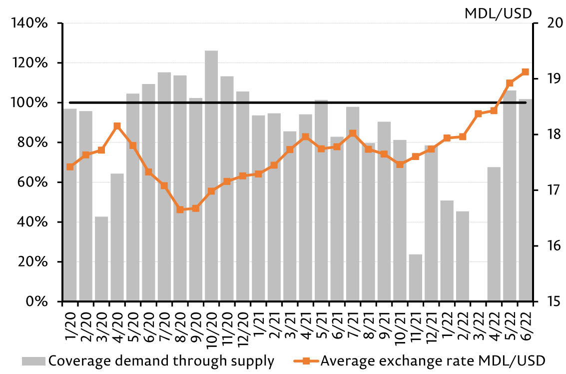
According to the situation at the end of the second quarter of 2022, official reserve assets continued to provide sufficient coverage for imports of goods and services (5.1 months of future imports[34]).

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)



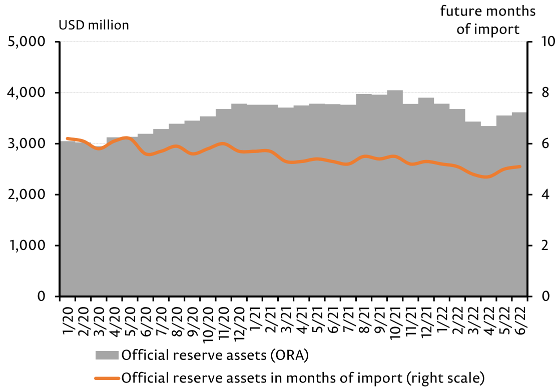
Source: NBM

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

[34] Calculated based on a preliminary forecast of import of goods and services.

Chapter 5

Forecast

5.1 External hypotheses

The world economy is in a turning point, with macroeconomic indicators fluctuating without any concrete trends, which increases the uncertainty of forecasts. On the one hand, the global economy is affected by the tightening of monetary policies in major economies and the dampening of demand in China and other large economies. On the other hand, risks related to the armed conflict in Ukraine, limited supply of raw materials and poor agrometeorological conditions in Europe are facilitating persistently high commodity prices. Thus, the pro-inflationary growth/maintenance assumption for international quotations remains valid in the current forecast round, but external demand is expected to be more subdued. Also, based on the latest developments, the European currency is expected to hover close to parity with the USD and the Russian rouble is expected to reflect domestic monetary operations in the absence of capital account functioning. In table 5.1 the values of the main external assumptions accepted in the forecast round of the Inflation Report, August 2022, are reflected, with their subsequent description.

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

	2022	2023
Economic growth in the euro area, %	2.7	1.4
Economic growth in the Russian Federation, %	-8.4	-2.2
Average annual inflation in the euro area, %	7.6	3.6
Average annual inflation in the Russian Federation, %	15.8	10.2
EUR/USD	1.07	1.07
USD/RUB	70.6	75.7
Urals brand oil prices (USD/barrel)	104.9	91.5
International food prices growth, %	15.1	-2.2

Source: Consensus Economics, Bloomberg, NBM calculations

In the scenario of the current forecast round, **the euro area economy** is projected to grow at a much more moderate pace, with GDP growth of 2.7 and 1.4% in 2022 and 2023 respectively. Compared to the previous round of forecasting, the euro area GDP assumption has been significantly lowered by 0.1 and 0.9 percentage points for 2022 and 2023 respectively. The basis of the new forecasts is the start of the monetary policy tightening cycle by the ECB from July 2022 and the worsening of the energy crisis following the increase in European gas prices and concerns about the insufficient level of natural gas deliveries by Gazprom needed for both production and heat supply to EU consumers in the cold season. At the same time, **further increases in the level of harmonised inflation** to 8.6% in June 2022 have led to an increase in the forecast level of average annual inflation in the euro area from 6.5 to 7.6% for 2022 and from 2.4 to 3.6% for 2023.

In the first months after the imposition of economic sanctions by the international community, the economy of the Russian Federation achieved a noticeable resilience based on the increase in international market prices for energy resources and other important raw materials. Thus, even though the volume of exports of energy resources and raw materials decreased compared to the previous year, the Russian Federation received significantly more than in the previous year. The Russian Federation has refocused on the Asian market, succeeding in exporting oil to China and India, and is negotiating with South Africa and Brazil on exports of oil resources and chemical fertilisers for agriculture. Thus, the forecast for **gross domestic product of the Russian Federation** has been increased for 2022, with the current round of forecasts anticipating a contraction of 8.4% compared to 9.9% in April 2022. At the same time, a contraction of 2.2% is expected for 2023 compared to 0.2% for 2023, explained by the delayed transfer of economic sanctions from 2022 to 2023. Currently, at the international level, discussions continue on new economic sanctions for the Russian Federation. At the same time, lower domestic demand based on risk anticipation and lower imports have led to a moderation in inflation. In the current round of forecasting, **average annual inflation in the Russian Federation** is expected to be 15.8% (-2.0 percentage points) in 2022 and 10.2% (-2.5 percentage points) in 2023. As pro-inflationary pressures have subsided, the Bank of Russia has lowered the base rate to 8.0%.

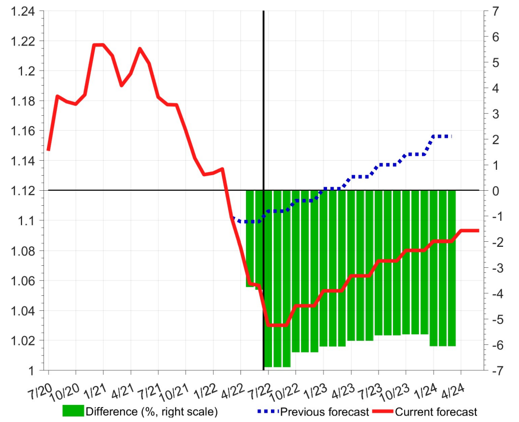
In recent weeks the pair **EUR/USD** has reached close to parity, reflecting a significantly appreciated US dollar and the depreciation of the single European currency. The situation is explained by the difference in spreads between interest rates and government bonds of the US and euro area economies. At the same time, the US dollar benefits from its status as a liquid reserve asset in times of rising global risks, while the European single currency is affected by the gloomy outlook for the energy crisis and its related effects. For the current forecast round, an average USD/EUR level of 1.07 is projected for both 2022 and 2023. Compared to the previous forecast round this represents a decrease of 3.6 and 5.5% respectively (Chart 5.1).

In the current forecast round, **Russian ruble** is expected to trade against the US dollar at an average level of 70.6 in 2022 and 75.7 in 2023, a decrease of 23.6 and 22.7%, respectively, compared with the previous forecast round. In the current year, the Russian ruble has been the currency with the most extreme fluctuations, depreciating to 177.3 USD/RUB in March 2022 and appreciating to 50.0 USD/RUB at the end of June 2022. The recent appreciation of the Russian rouble reflects the domestic monetary operations in the absence of capital account functioning and is a rather serious and persistent problem for the Russian authorities.

In the current round of forecasting, the average Brent oil price forecast was increased from 98.4 to 104.9 USD/barrel (+6.6%) for 2022 and from 91.3 to 91.5 USD/barrel (+0.2%) for 2023. The increase reflects the rise in oil prices in recent months to an average level of 120.1 USD/barrel in June 2022 due to discussions and, subsequently, the adoption of the embargo on oil products from the Russian Federation by the European Union. At the same time, US attempts to persuade Saudi Arabia to increase oil production have failed and negotiations with Iran on its nuclear programme have been suspended. It was only in July 2022 that oil prices fell to around 100 USD/barrel for Brent due to fears of a slowdown in global economic activity. The risks associated with the evolution of oil prices are relatively high and complex, and momentary shocks can cause significant swings (Chart 5.2).

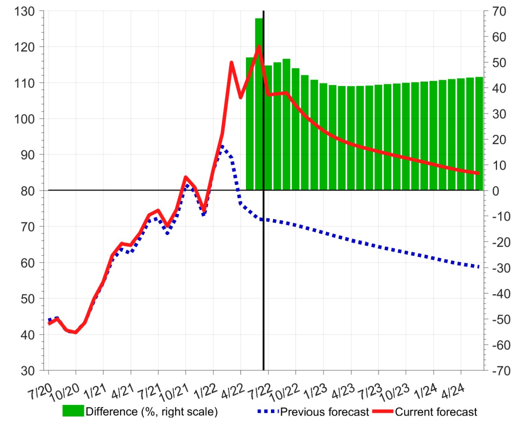
In recent months, the FAO agricultural commodity index has declined slightly, reflecting the fall in cereal and vegetable oil prices from the highs reached in March-April 2022. Thus, in the current round of forecasting, international food prices are

Chart 5.1: Exchange rate assumption EUR/USD



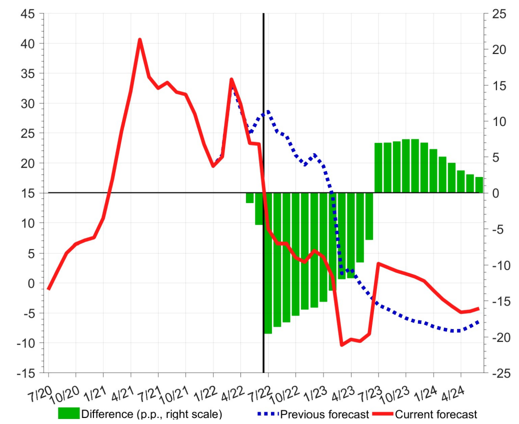
Source: ECB, Consensus Economics, NBM calculations

Chart 5.2: Brent international oil price assumption (USD/barrel)



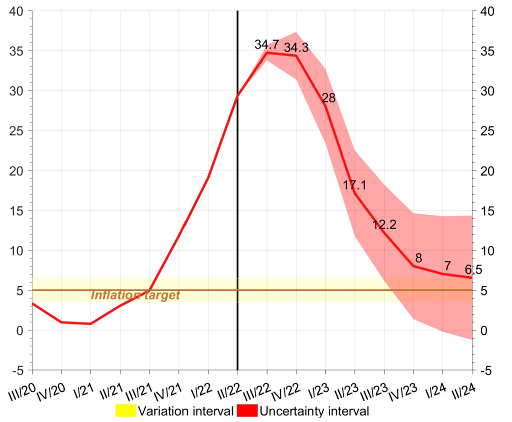
Source: Bloomberg, NBM calculations

Chart 5.3: International food price assumption (%)



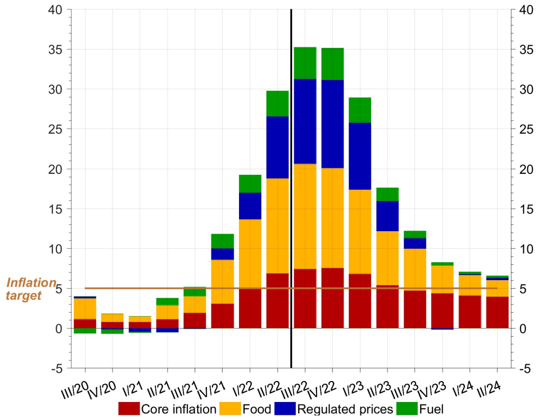
Source: FAO, Bloomberg, NBM calculations

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



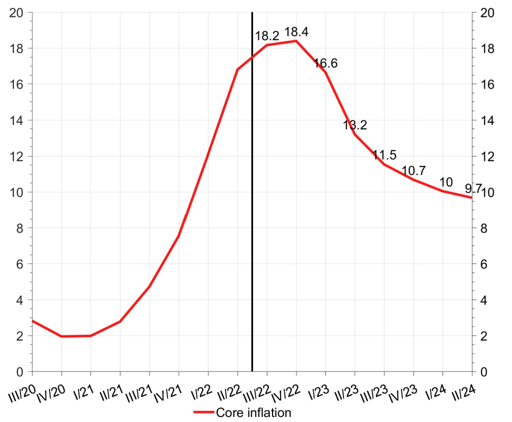
Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

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



Source: NBS, NBM calculations

expected to increase by an average of 15.1% in the current year and decrease by an average of 2.2% in 2023. Compared with the previous forecast round, the estimates for international food price growth have been lowered by 9.5 and 2.1 percentage points respectively. While international food prices will gradually decline over the coming quarters due to reduced consumer demand, they will remain well above recent years' averages, which will undermine the purchasing power of low-income people (Chart 5.3).

5.2 The internal environment

Inflation

In the third quarter of this year, the annual inflation rate will reach its highest level, and from the following quarter onwards it will follow a downward trend towards the end of the forecast horizon[35]. The inflation rate will be above the upper limit of the range during the forecast period and in the last quarter will return to the range (Chart 5.4).

The high annual inflation rates will be due to the positive impact of all CPI components, with a significant contribution on the part of food prices, regulated food prices and core inflation and less on the part of fuel prices (Chart 5.5).

The positive impact of factors such as (1) cumulative increases in international prices for energy resources and agri-food products, (2) recent and anticipated adjustments through the end of the year to a number of tariffs, (3) excise duties adjustments, (4) the high pace of cumulative imported inflation, especially in the first quarters of the forecast, (5) the drought this year, and (6) second-round effects from tariff adjustments will drive the high annual inflation rates early in the forecast horizon. However, the presence of factors such as (1) lower imported inflation, (2) negative domestic demand over the entire forecast horizon, (3) the downward trend in international oil prices, and (4) declining rates of food prices, (5) the negative impact of highly seasonal commodity prices in the second and third quarters of 2023, and (6) the high base in the current year will lower the annual rate from the fourth quarter of 2022 thereafter.

The annual inflation rate will record a high of 34.7% in the third quarter of 2022 and a low of 6.5% in the second quarter of 2024.

Average annual inflation will be 29.5% and 15.7% in the current year and next year, respectively.

The annual rate of core inflation will increase during the first two forecast quarters and, starting the next year, will redirect its path and decline for the rest of the forecast period[36] (Chart 5.6).

The upward trajectory from the beginning of the forecast period will be driven by the high pace of imported inflation for the first quarter

[35] Second quarter 2024.
[36] Third quarter 2022 – second quarter 2024.

of the forecast period. However, (1) the moderation in imported inflation from the fourth quarter of this year, (2) disinflationary domestic demand throughout the forecast period, and (3) the high base this year will be factors that will dampen the pace of annual core inflation. The excise tax adjustment in early 2023 and 2024 will dampen the annual rate decline.

Average annual core inflation will be 16.4% and 12.9% in 2022 and 2023, respectively.

The annual food price rate will peak in the first quarter of the forecast and begin a downward trend from the following quarter (Chart 5.7).

The cumulative increase in international food prices, (2) this year's drought, and (3) second-round effects from the tariff adjustment will be the factors driving the annual pace peak in the third quarter of this year. The downward phase will be influenced by (1) the subsequent downward trend in the annual pace of international market food prices, (2) negative aggregate demand, (3) the high base, and (4) the negative impact of highly seasonal commodity prices in the second and third quarters of 2023. The impact of strongly seasonal products in the second and third quarters of 2024 and the excise duties adjustment in early 2023 and 2024 will mitigate the annual rate decline.

The average annual rate of food prices will be 32.1% and 17.4% in 2022 and 2023, respectively.

The annual rate of regulated prices will increase by the end of this year and then decline significantly towards the end of the forecast period from the first quarter of 2023 (Chart 5.8).

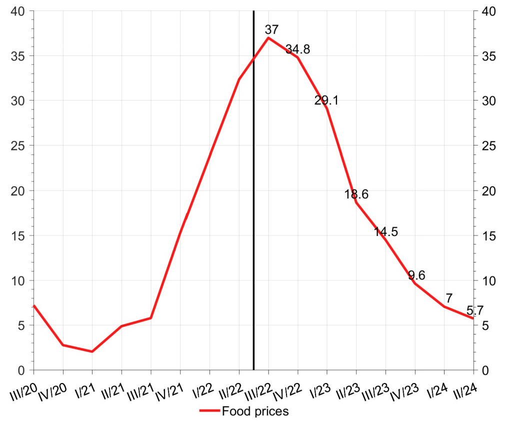
The increase in the annual pace will be driven by recent and anticipated year-end adjustments to a number of tariffs. Cost increases, particularly from energy and payroll costs, on the one hand, and non-adjustment or insufficient adjustment of tariffs for those services over long periods, sometimes years, on the other hand, are the main drivers of the increase in the pace of regulated prices. The further decline in the annual pace will be due to the anticipated moderate decline in external energy prices, but also to the effect of the high annual base.

According to the assumptions, in the third quarter of 2022, the scenario to be published includes several tariff adjustments, namely in August for network gas (19.5%), district heating (21.3%) and hot water supply (21.6%). The increases mentioned are associated with the latest draft decision of ANRE on natural gas tariffs as well as the estimated impact on related services.

At the same time, there are prerequisites for an additional increase in the gas tariff in September (30.0%), in the context of the projected import price of natural gas for the next period, which will also affect the tariffs for district heating and hot water supply by an estimated 18.0% in September 2022.

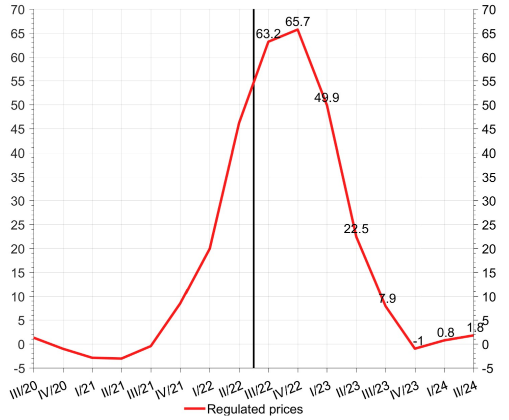
Also, in July the NBS will reflect the rest of the increase from the electricity tariff adjustment that came into effect in mid-June. Similarly, there will be a reflection of the already current tariff for

Chart 5.7: Food prices (%, compared to the previous year)



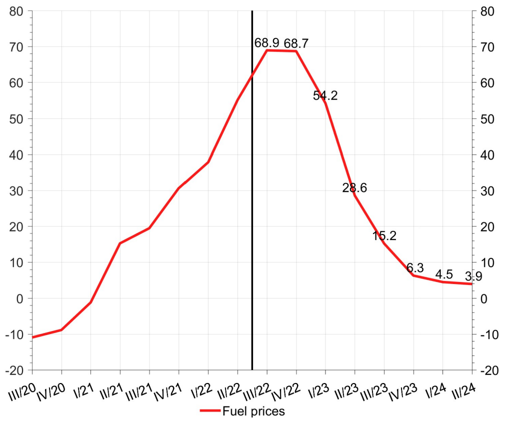
Source: NBS, NBM calculations

Chart 5.8: Regulated prices (%, compared to the previous year)



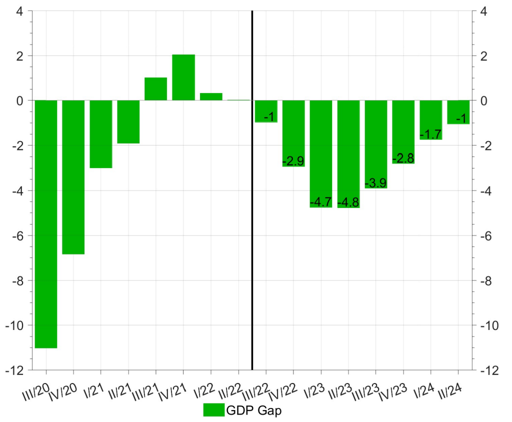
Source: NBS, NBM calculations

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



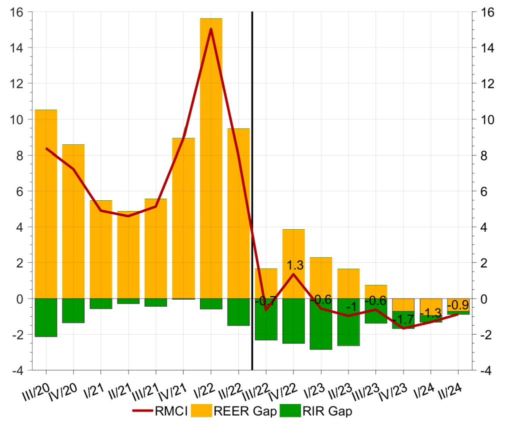
Source: NBS, NBM calculations

Chart 5.10: GDP deviation (%)



Source: NBM calculations

Chart 5.11: Real monetary conditions index and decomposition



Source: NBM calculations

public transport in Chisinau municipality (70.0% increase in July 2022).

Also, in July will be reflected the new tariff for the collection, transport, and storage of waste (about 41.7%) in Chisinau and Comrat. Decisions in this regard have already been voted and signed. The upward trend in prices for medicines and the "other" component from previous periods is maintained for the whole forecast horizon.

The average annual rate of regulated prices will be 49.2% and 16.9% in 2022 and 2023, respectively.

The annual rate of fuel prices will increase in the first two consecutive quarters of the forecast, and from 2023 onwards it will decrease significantly towards the end of the forecast horizon (Chart 5.9).

The initial increase is mainly driven by (1) the cumulative increase in international oil market prices, but also by (2) the increase in the price of fuel substitutes for natural gas in anticipation of higher prices or disruption of gas supply in the next cold season. The downward trend from the first quarter of 2023 onwards is driven by (1) the expectation of lower international oil market prices over the entire forecast horizon, (2) disinflationary domestic demand and (3) the effect of the high annual base. The excise duties adjustment in early 2023 and 2024 will mitigate the reduction in the annual rate.

The average annual rate of fuel prices will be 58.4% and 23.5% in 2022 and 2023, respectively.

Demand

Aggregate demand will be negative throughout the forecast period due to deteriorating external demand and household consumption financing. Tax stimulus and, to a lesser extent, monetary conditions will dampen the decline in aggregate demand (Chart 5.10).

Deteriorating external demand and a real decline in the sources of household consumption financing will be the main factors driving down aggregate demand. Positive fiscal momentum and mildly stimulative effects of real monetary conditions will dampen the decline in aggregate demand. The deviation of the real effective exchange rate will be decreasing, but will still show a restrictive character on aggregate demand until the third quarter of 2023. On the other hand, the real interest rate will boost domestic demand over the whole forecast horizon. External demand from both eastern and western economic partners will have a negative impact on domestic demand.

The NBS's revision of the time series for gross domestic product in constant prices and the publication of much more moderate economic activity than anticipated for the first quarter of this year led, in some places more pronounced, to a revision of the deviation of aggregate demand for the historical period.

Monetary policy

Real monetary conditions will be mildly stimulative for aggregate demand over much of the forecast horizon (Chart 5.11). Monetary policy via the real effective exchange rate will be restrictive until the third quarter of 2023 and stimulative for the rest of the forecast period; via the real interest rate, it will be stimulative over the entire forecast horizon.

The real depreciation of the domestic currency has reduced the deviation of the real effective exchange rate from its equilibrium level, thus diminishing the restrictive effects on aggregate demand. Starting with the first quarter of 2023, the deviation of the real exchange rate is expected to narrow systematically and become stimulative from the fourth quarter of 2023 onwards.

5.3 Comparison of forecasts

The current inflation forecast, relative to that in the previous inflation report[37], has been revised upwards up to the first quarter of 2023 and downwards for the rest of the comparable period[38], except for the first quarter of 2024 (Chart 5.12).

The upward trend in the annual inflation rate forecast is driven by the pronounced upward revision in the forecast for regulated prices, fuel prices, and food prices. The downward shift in the forecast for core inflation as well as in the forecast for regulated prices will lead to a downward revision of the current inflation rate forecast (Chart 5.13).

The higher projection of the annual inflation rate forecast is driven by (1) a higher path of imported inflation during the first quarters of the comparable period, (2) worsening agrometeorological conditions in the current year, (3) a higher forecast for energy resource prices on the international market. However, (1) tighter domestic demand, (2) anticipation of lower food prices on the international market, and (3) lower impact of strongly seasonal products in the second and third quarters of 2023 led to a downward revision of the current forecast.

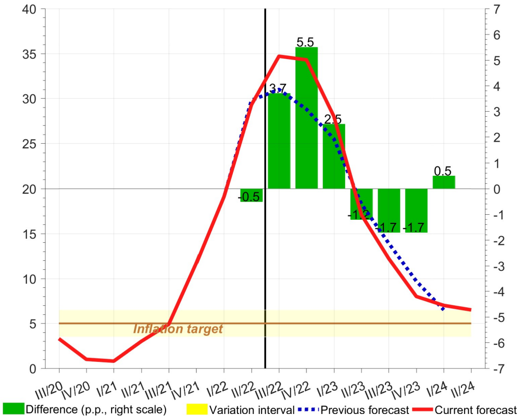
The average annual inflation rate has been increased by 2.2 percentage points for 2022 and decreased by 0.8 percentage points for 2023.

The current forecast for the annual pace of core inflation has been lowered over the entire comparable period, with the exception of the first quarter of 2024 (Chart 5.14).

The lower projection of the current forecast relative to the previous forecast was driven by (1) lower actual inflation than anticipated in the previous quarter, (2) tighter aggregate demand, (3) a more appreciated exchange rate against the euro, and (4) lower imported inflation starting in the fourth quarter of 2023. The higher

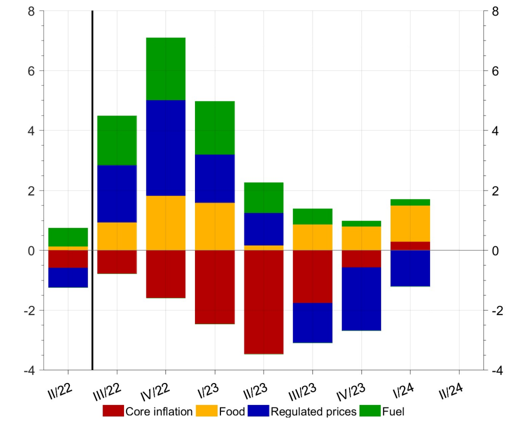
[37] Inflation report, May 2022.
[38] Third quarter of 2022 – first quarter of 2024.

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



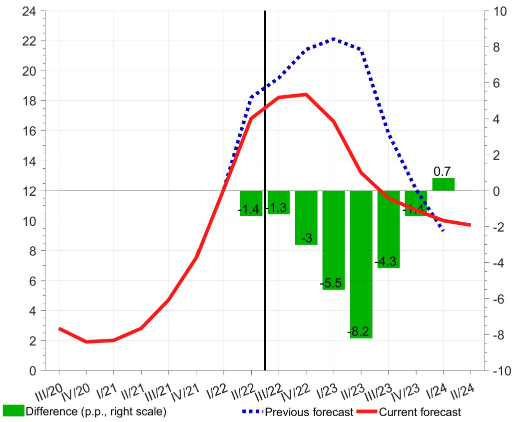
Source: NBS, NBM calculations

Chart 5.13: Decomposition of forecast difference (percentage points)



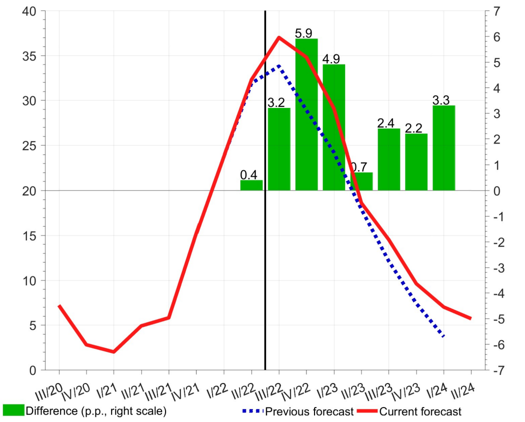
Source: NBM calculations

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



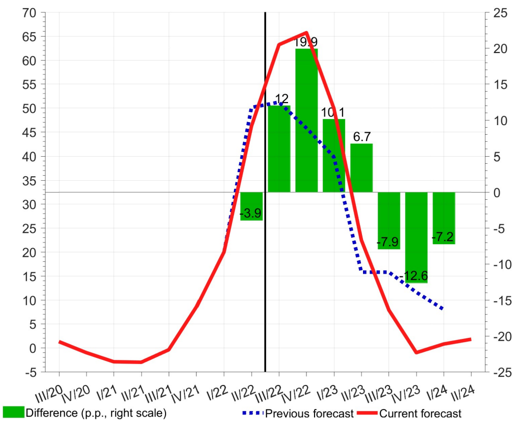
Source: NBS, NBM calculations

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



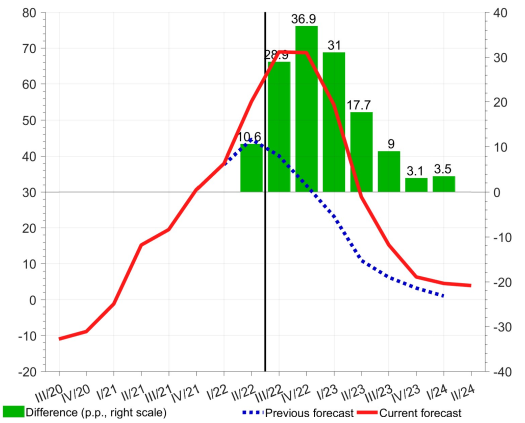
Source: NBS, NBM calculations

Chart 5.16: Regulated prices (%, compared to the previous year, percentage points)



Source: NBS, NBM calculations

Chart 5.17: Fuel prices (%, compared to previous year)



Source: NBS, NBM calculations

rates of imported inflation up to the second quarter of 2023 have tempered the downward revision to the current forecast.

The forecast for the average core inflation rate has been lowered by 1.5 percentage points for 2022 and by 4.7 percentage points for 2023.

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

The increase in the current forecast relative to the previous forecast was driven by (1) higher actual inflation than anticipated in the previous quarter, (2) worsening agrometeorological conditions in the current year, and (3) the higher forecast for imported inflation beginning in the second quarter of 2023. Anticipation of tighter domestic demand, (2) a lower trajectory of food prices in the international market, and (3) a lower impact of strongly seasonal products in the second and third quarters of 2023 are the factors that mitigated the upward revision of the food price forecast.

The average food rate forecast was raised by 2.4 percentage points each for 2022 and 2023.

The current forecast of the annual regulated price rate is revised upward through the second quarter of 2023 and downward toward the end of the comparable period (Chart 5.16).

The upward trajectory of natural gas import prices over the entire comparable period and of international market oil prices up to the first quarter of 2023 has led to the anticipation of additional rate adjustments in the second half of the current year and therefore to an upward revision of the current forecast of regulated prices.

The average fuel price rate forecast was increased by 7.3 percentage points for 2022 and decreased by 2.7 percentage points for 2023.

The annual fuel price rate forecast has been increased over the entire comparable period (Chart 5.17).

The higher forecast for the annual pace of fuel prices is conditional on (1) higher-than-expected actual inflation in the previous quarter, (2) a higher forecast for international oil prices through the first quarter of 2023, and (3) higher import prices for natural gas over the entire comparable period, as well as (4) upward revisions to the dynamics of fuel-natural gas substitutes in anticipation of higher prices or disruptions to gas supplies in the next cold season.

The average fuel price rate forecast was increased by 20.1 percentage points for 2022 and 13.1 percentage points for 2023.

5.4 Risks and uncertainties

External sector

- **The global economic downturn.** Tightening monetary policies in major economies, the energy crisis and the armed conflict in Ukraine are the main reasons for expectations of a moderation in global economic activity. The Federal Reserve System has increased the interest rate range to 1.5-1.75% since the beginning of this year, and rates are expected to be raised further to counter the high level of inflation in the U.S. (9.1% in June 2022). At its meeting on 21 July 2022, the ECB raised its base rate by 0.5 percentage points for the first time since 2011. As annual inflation in the euro area reached 8.6% in June 2022, the ECB is expected to continue its monetary policy tightening cycle. At the same time, most inflation-targeting economies have raised interest rates in recent months to cope with strong pro-inflationary pressures. Rising rates temper consumer demand and the volume of investment, i.e. it leads to a significant dampening of gross domestic product. Lately there has been increasing talk of a possible economic recession, but it will take some more time and statistical data to clearly outline the new stage the world economy is going through (disinflationary).

- **Energy crisis in Europe.** In July 2022, the price of natural gas listed as TTF Netherlands rose to 1,900 USD/1,000 cubic metres after the Nord Stream 1 pipeline was shut down for 10 days for scheduled maintenance and some rumours said Russia would not resume gas deliveries at the end of those 10 days. However, on 21 July 2022, gas deliveries were resumed, even though the risk of them being stopped due to the need for repairs to a turbine remains. This caused the TTF Netherlands quotation to fall to 1,600 USD/1,000cubic metres. Even so, this price is far too high compared to historical averages, affecting production costs and consumer spending. Another major risk is that natural gas supplies are far too low and stocks needed for the heating season may not be replenished by winter. The EU has announced a plan to cut energy consumption by 15%, while maintaining the risk of disruptions to electricity and heat supplies during the cold season. Deficits and high natural gas prices could cause a significant contraction in Germany's industrial sector (proinflationary).

- **Regional crisis related to the armed conflict in Ukraine.** The continuing armed conflict in Ukraine is increasingly affecting the regional economy. The destruction of industrial capacities and maritime transport possibilities will lead to a massive configuration of the economic potential of Ukraine and the region as a whole. At the same time, the migration of refugees has led to increased government spending in the host countries at a time of great economic instability and significant price increases (uncertainty). Events associated with the military conflict 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 were abundant on the Republic of Moldova's market and more affordable in the region) by similar products from another country of origin (more expensive) leads to pronounced price adjustments. From a logistical point of view, economic agents are forced to use alternative routes (avoiding the territory of Ukraine) to export/import products, which contributes to higher transport costs (proinflationary).

- **Distorted trends of international quotes for raw materials.** After most commodity prices peaked in March-April 2022, they have been very distorted, making it difficult to get a global trend. Some quotations, e.g. metals, have fallen sharply to 2020 levels, others, e.g. fertilisers, cereals, vegetable oils, have moderated slightly and others have continued to rise, such as energy quotations. Daily energy and industrial raw material quotations oscillate between supply shortages and the tempering of the world economy, diametrically opposed factors of influence, which confuses the market and does not form the common trend that would facilitate the analysis and forecasting process. It is most likely that this transitional period will end in the coming months and that clear trends will emerge in the evolution of international quotes for raw materials (uncertainty).

Real sector

- **Vulnerability of domestic fruit and vegetable prices to weather conditions in the immediate future.** According to the experience of recent years, prices of domestic fruit and vegetables are to a large extent affected by adverse weather conditions such as dry weather. According to data from the SHS in the summer of 2022, a hydrological drought is expected, so the prices of domestic fruit and vegetables could also experience a higher trajectory than assumed in the forecast. This would result in higher than forecasted increases in food prices in the coming months (proinflationary).
- **Uncertainties about agricultural production in 2023.** The harvest in 2023 and domestic food prices, respectively, will depend mostly on agro-meteorological conditions in the autumn of 2022 and in 2023. Developments in the agricultural sector and hence the trajectory of food prices for 2023 and the first half of 2024 is marked by pronounced uncertainty (uncertainty).
- **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 that corresponds to certain assumptions about 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 involved. Therefore, the timing and magnitude of tariff adjustments cannot be estimated with sufficient confidence. At the same time, in the context of the

increase in international and regional energy resource prices over the last few quarters, for the medium forecast horizon, pre-conditions for significant tariff adjustments to some sub-components of regulated prices are emerging (uncertainty, proinflationary).

- **Decreasing number of consumers on the territory of the Republic of Moldova.** The military conflict in Ukraine has led to a massive outflow of people from Ukraine. A part of them is on the territory of the Republic of Moldova (about 70-80 thousand people), which directly contributes to the increase in consumption of the population. Their return to their country of origin or their departure to other regions would lead to lower demand on the domestic market (uncertainty, disinflationary).

- **Excluding the possibility of using traditional transport routes for petroleum products** from countries such as Russia, Belarus, Ukraine, which causes all fuel imports to be redirected towards the western border. This factor implies for some oil companies importing from the region both a change in supply chains and the identification of new suppliers in exchange for existing ones. At the same time, international stock exchange quotations for oil products have also soared in recent months, creating uncertainty for domestic energy prices (uncertainty, proinflationary).

- **The increase in the number of COVID-19 cases and the impact on the domestic economy.** With an increasing number of new COVID-19 infections, uncertainty about the evolution of the virus and possible restrictive measures is becoming more pronounced than in recent months. In the event of new and prolonged restrictive measures, domestic demand is expected to be more subdued than anticipated and the impact on inflation is expected to be disinflationary (uncertainty, disinflationary).

Monetary and public sectors

- **External financing.** In 2022, external financial assistance in the form of foreign credit and grant inflows is expected to increase considerably, which will allow faster implementation of reforms in the national economy and create additional incentives for inflation. At the same time, in the wake of the war in Ukraine and the huge influx of refugees, external partners are providing humanitarian aid and grants to finance the costs of organising and arranging refugees' accommodation and transit on the territory of the Republic of Moldova. 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 (proinflationary).

- **Budgetary sector wage increase.** In the context of increasing food and energy prices, the Government of the Republic of Moldova is examining the possibility of increasing wages in the public sector (proinflationary).

- **Compensation of gas, heat and electricity tariffs.** In the context of the current energy crisis and the increase in gas, heat and electricity prices and tariffs, the Government is examining the possibility of compensating some vulnerable consumers for these costs. By offering these compensations, the state will apply a concrete form of social protection, well targeted to vulnerable consumers, for poverty reduction. Additional financial means from the state budget will be needed for the implementation of the draft law (proinflationary).

- **Rectification of the State Budget for 2022.** Taking into account the energy crisis, the war in Ukraine, the intensification of the COVID-19 pandemic and the rise in prices, the Government announced about the development of the draft law on amending the Law on the State Budget for 2022. Currently, the draft law has not been published and the main proposals for amendments concerning the expenditure and revenue side of the budget are unknown (uncertainty).

Chapter 6

Monetary policy decisions

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 03.12.2021
on monetary policy

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, Mr. Ion Sturzu – Deputy Governor, Mr. Constantin Schendra – Deputy Governor
Rapporteur: Mr. Radu Cuhal - Director of the Monetary Policy Department
Guests: Mr. Natan Garstea – Advisor to the Governor, Mr. Daniel Savin - Director of the Financial Markets Department, Ms. Diana Avtudov - Deputy Director of the Banking Supervision Department, Mr. Eugeniu Aftene - Director of the Reporting and Statistics Department, Ms. Rusu Valentina - Head of the General Legal Assistance Division, Legal Department, Mr. Andrei Rotaru – Director of the Applied and Economic Research Department, Ms. Alina Boboc - Head of the Communication and Financial Education Division

Mr. Radu Cuhal presented to the Executive Board of the NBM the Report on the assessment of the risk of deviation from the inflation forecast, prepared on the basis of data and information from the external and interanal environment that have emerged after October 2021 forecast round. At the same time, the trends of the main macroeconomic indicators were addressed, along with the risks and uncertainties that would compromise the inflation forecast in the short and medium term.

The discussions of the Executive Board members started with the analysis and assessment of the macroeconomic information available after drafting the October forecast round, highlighting that the main assumptions and conclusions reflected in the Inflation Report no.4, 2021 were broadly confirmed. At the same time, the EB members noted that the updated information signals the outline of the risk of forecast deviation in the context of external and domestic factors.

Assessing the external macroeconomic situation, EB members noted that the global economy is facing a pronounced acceleration of quotations for raw materials, food, energy resources, along with high production and transport costs, continued supply chain disruptions. From this perspective, it was pointed out that we are witnessing an intensification of the inflationary process in many economies, implicitly with the overshooting of central banks' targets and an upward adjustment of forecasts for next year.

With reference to the dynamics of the domestic inflationary process, EB members warned about its vulnerability to developments in the external environment, stressing that the acceleration of inflation in the recent period is mainly due to supply shocks from the perspective of rising international and regional prices for food, energy resources and other raw materials with repercussions on import prices. It has been noted that inflation pressures are also partly on the demand side in the context of rising disposable income and credit growth, which have supported increases in the prices of the subcomponents of core inflation as well as food prices.

In this context, it was found that amid intensifying inflationary pressures, in October 2021, the annual inflation rate moved higher than expected by 0.4 percentage points to 8.8%. The EB members stressed that this deviation was due to the positive deviation of all inflation components except core inflation. At the same time, it was noted that the largest deviation (3.3 percentage points) from the forecast was recorded in fuel prices, which was caused by the more pronounced increase in oil prices on the international market, along with the uncertainty associated with the import price and the gas tariff, which supported the sharp increase in coal and wood prices.

EB members noted that the higher than expected level of inflation in October this year, as well as the adjustment in gas and heat tariffs in November 2021, imply that the risk of an upward deviation in the near-term inflation forecast persists. At the same time, the risk of a markedly higher inflation trajectory also for 2022 has been highlighted in the context of higher than expected increases in regulated prices.

The EB members then commented on developments in the national economy, noting that the macroeconomic indicators for August-September 2021, published by the NBS after the October forecast round, confirm positive dynamics, but of a more subdued magnitude than anticipated. Thus, the annual rate of exports and imports in September increased by 38.9% and 31.7%, respectively. Industrial production increased by 6.6% in August and by 13.7% in September. In July-September 2021, agricultural production recorded a growth rate of 30.9% compared to the same period of 2020. At the same time, it was noted that transfers of money from abroad to individuals in September 2021 decreased by -2.9%.

In the discussions associated with the loan and savings process, the EB members stressed that new loans in national currency maintained the growth trend and in October 2021 they were close to historical peaks, with their volume increasing by 51.9% in annual terms. At the same time, it was emphasized that under the restrictive decision-making character started in July this year, the weighted average interest rates on new loans granted and new deposits attracted in national currency recorded increases in October 2021. Thus, the weighted average rate on loans and deposits amounted to 7.92% and 3.38% per annum, respectively, recording a jump of 1.08 percentage points and 0.19 percentage points, respectively, compared to September.

It was noted that, due to the increase in tariffs and chained price increases, the growth rates of disposable income of the population and consumption respectively are expected to slow down, directly affecting economic activity. At the same time, it was warned that the domestic economic conditions will be affected by the possible contraction of remittances associated with the increase in living costs at international level and the limitation of the saving capacities of our compatriots working abroad, together with the attenuation of global demand and the weather conditions.

Following the assessment of the quantified risk to the inflation forecast deviation published in the Inflation Report no.4, 2021, EB members highlighted the persistence of an upward deviation for the first half of the forecast horizon (fourth quarter 2021 to third quarter 2022) and downward deviation for the second half of the forecast horizon (fourth quarter 2022 to third quarter 2023).

The Executive Board of the NBM therefore decided to increase the base rate and the standing facility rates by 1.00 percentage point each, while maintaining the reserve requirement norms for MDL and non-convertible foreign exchange assets and for freely convertible foreign exchange assets at current levels.

It was justified that this monetary policy decision was taken in the context of maintaining the gradual adjustment of monetary policy against the background of persistent inflationary pressures on the evolution of the consumer price index in the short and medium term. At the same time, the decision is aimed at moderating the second-round effects of the supply shock associated with international price increases and imported inflation.

At the end of the meeting, it was highlighted the need to monitor with caution the domestic and external macroeconomic situation, risks and uncertainties associated with the evolution of inflation in the short and medium term, noting that, at the appropriate time, the National Bank will intervene by adjusting monetary policy instruments in order to achieve the fundamental objective of ensuring and maintaining price stability.

The Executive Board of the NBM adopted the following decision:

1. **To increase the base rate applied to the main short-term monetary policy operations by 1.00 percentage points, from 5.50% to 6.50% annually.**

2. **To increase interest rates:**

   a) **on overnight loans by 1.00 percentage points, from 7.50% to 8.50% annually;**

   b) **on overnight deposits by 1.00 percentage points, from 3.50% to 4.50% annually.**

3. **To maintain the required reserve ratio from the financial means attracted in Moldovan lei and in non-convertible foreign currency at the current level of 26.0% of the calculation base.**
4. **To maintain the required reserve ratio from the financial means attracted in freely convertible foreign currency assets at the current level of 30.0% of the calculation base.**

Voting results

PRO – 3 AGAINST – 1 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 13.01.2022
on monetary policy

Meeting chaired by: Mr. Octavian Armașu, Governor – Chairman of the Executive Board
The following were present: members of the Executive Board, Ms. Tatiana Ivanicichina – Deputy Governor, Mr. Constantin Schendra – Deputy Governor
Rapporteur: Mr. Radu Cuhal – Director of Monetary Policy Department
Guests: Mr. Natan Garstea – Advisor to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Ms. Diana Avtudov – Deputy Director of the Banking Supervision Department, Mr. Eugeniu Aftene – Director of the Reporting and Statistics Department, Ms. Rusu Valentina – Head of the General Legal Assistance Division, Legal Department, Mr. Andrei Rotaru – Director of the Applied and Economic Research Department, Ms. Alina Boboc – Head of the Communication and Financial Education Division

At the opening of the meeting, the members of the Executive Board highlighted that the convening of the extraordinary monetary policy meeting resulted from the need to shape monetary policy in such a way as to alleviate persistent inflationary pressures. In this context, they also referred to the acceleration in headline inflation and the upwardly revised inflation forecasts of central banks for the coming quarters.

Mr Radu Cuhal presented the Executive Board with the report on the assessment of the risk of deviation of the inflation forecast, based on the analysis of the latest statistical data and information from the external and domestic environment that have emerged in the recent period. The outlook for the main macroeconomic indicators and the risks and uncertainties surrounding inflation were also mentioned.

Assessing the external macroeconomic situation, EB members stressed that global economic conditions remain affected by high commodity prices, mainly for natural gas, oil, food, overlapping with high production and transport costs.

Discussing the evolution of domestic inflation, EB members noted that the acceleration of inflation in the recent period is due to the vulnerability of the domestic inflationary process to developments in the external environment, mainly supply shocks from the perspective of rising prices on the international and regional markets for food, energy resources and other raw materials with repercussions on import prices. At the same time, demand-side pressures on inflation are also emerging in the context of rising disposable income and increased consumer credit, which have supported increases in the prices of the subcomponents of core inflation as well as food prices.

Analyzing the statistical data provided by the National Bureau of Statistics, the EB members found that the annual inflation rate in December 2021 was 13.9%, the annual value for the fourth quarter of 2021 was 2.4 percentage points higher than expected.

The Executive Board noted that this deviation was due to the positive deviation of all inflation components. It was pointed out that regulated prices were 7.1 percentage points higher than expected in the context of the increase in the tariff for network gas and hot water preparation. The deviation of 2.5 percentage points in fuel prices was due to higher than expected increases in coal, wood prices, amid uncertainty in the price and tariff of network gas. At the same time, it was noted that amid pronounced volatility and the upward trend in international food prices, the annual rate of domestic food inflation was 2.0 percentage points higher than expected. Referring to the annual core inflation rate, it was specified that it was 0.9 percentage points higher than expected at 6.6%, as a result of unanticipated increases in mobile phone tariffs and cost increases.

EB members then turned to the statistical information associated with economic growth, pointing out that it showed a positive effect of aggregate demand on prices, but of a smaller magnitude than anticipated. It was noted that in the third quarter of 2021, GDP moderated and recorded a lower than expected dynamic, increasing by 8.3% compared to the same period of 2020. It was noted that from the perspective of uses, the positive dynamics of GDP was driven by the increase in household consumption and exports. In this regard, it was noted that household consumption was influenced by factors similar to the previous period, such as the increase in disposable income of the population and the easing of credit conditions, its rate moderated to 11.9% compared to the third quarter of 2020. Exports increased by 25.1% in real terms due to the economic growth of the main trading partners and the rich harvest in 2021, and imports - by 17.8% conditioned by the increase in domestic demand. It was stressed that on the supply side, positive contributions were generated by agriculture, trade and industry.

Discussions also focused on operational indicators for October-November 2021. It was noted that the annual rate of exports and imports in October 2021 increased by 41.3% and 30.9%, respectively. Industrial production increased by 13.8% in September and by 11.0% in October 2021. In October 2021, freight transport recorded a growth rate of 31.0% compared to the same period in 2020. It was also noted that remittances from abroad to individuals in November 2021 increased by 5.5%.

During the discussion on economic growth prospects, EB members warned that against the background of tariff increases, the growth of disposable income and household consumption will moderate, which contributed to the downward revision of the trajectory of the GDP deviation in the medium term.

Discussing the loan and savings process, EB members highlighted that new loans granted in national currency maintained the growth trend in December 2021, close to historical peaks, with their volume increasing by 46.7% in annual terms. At the same time, it was highlighted that, under the restrictive decision-making character started in July 2021, the weighted average interest rates on new loans granted and new deposits attracted in national currency recorded increases in December 2021. Thus, the weighted average rate on loans and deposits was 8.85% and 4.13% per annum, respectively, recording an increase of 0.30 percentage points and 0.21 percentage points, respectively, compared to November.

Assessing the downside risks to the inflation forecast, EB members found that consumer prices in 2022 are more pro-inflationary than anticipated in the last forecast round. The impact of the sharp rise in international and regional food and energy prices on import prices was mentioned, generating additional inflationary pressures. In particular, attention was drawn to the pronounced impact on the over-acceleration of regulated prices generated by the adjustment of tariffs in November 2021 and the first half of 2022, with reference also to secondary effects on other subcomponents of the consumer price index.

Under these circumstances, the Executive Board of the NBM considered it necessary to continue the gradual tightening of monetary policy in order to alleviate persistent pro-inflationary pressures. Thus, the meeting decided to increase the base rate and the rates on standing facilities by 2.0 percentage points each, while increasing the reserve requirement rule for funds attracted in MDL and non-convertible foreign currency by 2.0 percentage points for the period of application of the reserve requirement in Moldovan lei from February 16, 2022 to March 15, 2022.

It was justified that this monetary policy decision aimed towards moderating the growth rates of consumer credit, which currently has a strong pro-inflationary impact and, at the same time, puts pressure on the current account deficit of the balance of payments, trade balance and exchange rate.

The EB members also highlighted that this decision was aimed at anchoring inflationary expectations and stimulating savings at the expense of immediate consumption.

At the end of the meeting, it was stressed the need for cautious monitoring of the domestic and external macroeconomic situation, risks and uncertainties associated with the evolution of inflation in the short and medium term, noting that, at the appropriate time, the National Bank will intervene by adjusting monetary policy instruments in order to achieve the fundamental objective of ensuring and maintaining price stability.

The Executive Board of the NBM adopted the following decision:

1. **To increase the base rate applied to the main short-term monetary policy operations by 2.00 percentage points, from 6.50% to 8.50% annually.**

2. **To increase interest rates:**
   a) **on overnight loans by 2.00 percentage points, from 8.50% to 10.50% annually;**
   b) **on overnight deposits by 2.00 percentage points, from 4.50% to 6.50% annually.**

3. **To increase the required reserve ratio from the financial means attracted in Moldovan lei and in non-convertible foreign currency from the period of application of the required reserves in Moldovan lei from February 16, 2022 to March 15, 2022 – by 2.0 percentage points and is set at 28.0% of the calculation base.**

4. **To maintain the required reserve ratio from the financial means attracted in freely convertible foreign currency assets at the current level of 30.0% of the calculation base.**

Voting results

PRO – 3	AGAINST – 0	ABSTAINED – 0

Chairman of the Executive Board	**Secretary of the Executive Board**
Octavian ARMAȘU	**Sergiu SURDU**

List of Figures

List of Tables