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Monetary policy decision, 04.08.2022

The Executive Board of the National Bank of Moldova, at its meeting of 4 August 2022, adopted unanimously the following decision:

1. **To set the base rate applied to the main short-term monetary policy operations at 21.50% annually.**
2. **To set the interest rates:**

a. on overnight loans at 23.50% annually;
b. on overnight deposits at 19.50% annually.

3. **To increase the required reserves ratio from the financial means attracted in Moldovan lei and in non-convertible currency, as follows:**

a. starting with the period of application of required reserves in MDL: 16 August 2022 – 15 September 2022, from 34.0% to 37.0% of the calculation base;

b. starting with the period of application of required reserves in MDL: 16 September 2022 – 15 October 2022, from 37.0% to 40.0% of the calculation base.

4. **To increase the required reserves ratio from the financial means attracted in freely convertible currency, as follows:**

a. starting with the period of application of required reserves in freely convertible currency: 16 August 2022 – 15 September 2022, from 39.0% to 42.0% of the calculation base;

b. starting with the period of application of required reserves in freely convertible currency: 16 September 2022 – 15 October 2022, from 42.0% to 45.0% of the calculation base.

The Executive Board of the NBM approved the Inflation Report, August 2022, for publication.

The Executive Board's decision aims at tempering the rapid growth rates of consumer prices, mitigating the secondary effects of supply shocks, stimulating financial intermediation in the national currency and saving against consumption, stabilizing the trade balance, as well as anchoring inflationary expectations.

At the same time, the magnitude of monetary policy measures was calibrated to support the decrease in the consumer price index starting from the fourth quarter of 2022.

In this context, the adopted measures are very likely to complete the monetary policy tightening cycle, in the absence of major unanticipated pro-inflationary shocks in the immediate period ahead. Once the future projections outline substantiated premises to ease the monetary policy, the NBM will adopt the necessary measures to bring inflation back closer to the 5.0% target.

Development of inflation. The annual rate of inflation increased from 22.2% in March 2022 to 31.8% in June 2022. The acceleration in prices was driven by the increase in international and regional quotations for food products and energy resources, leading to the increase in the price of both goods and services on the domestic market. The adjustment of tariffs for network gas, heating and electricity, the increase in fuel prices, but also the upward dynamics of wages increased costs for economic operators, which gradually reflected in prices. The war in Ukraine has put additional pressure on prices for food, fuel and some components of core inflation. The depreciation of the Moldovan leu against the US dollar generated additional inflationary pressures on certain components of the CPI. Demand-side pressures have eased, with a negligible impact on food prices and core inflation components.

External environment. The situation of the world economy continues to worsen. The rise in international quotations, tightening of monetary policies, increase in production costs, raise in the number of COVID-19 cases and reintroduction of quarantine in China have tempered global economic activity. The aggressive increase in the interest rate range by the Federal Reserve System in June, along with the increase in risk premiums, contributed to the significant appreciation of the US dollar. The euro depreciated to parity with the US dollar in July due to interest rate differences and government bonds. The gas crisis in Europe deepened at the end of June, with the price reaching USD 1,900 per 1,000 m^3. International agri-food prices have decreased slightly in recent months due to higher harvest expectations in the Northern Hemisphere and improved grain conditions at some major producers.

Economic activity slowed down sharply at the beginning of the current year, with the annual pace in real terms of GDP being 1.1% in the first quarter of 2022. The moderation in economic activity was driven by lower domestic demand (due to lower real incomes of population and more restrictive conditions for credit), increase in uncertainty in the region and emergence of barriers to foreign trade due to the war in Ukraine. On the demand side, exports, public administration consumption and imports increased, investments decreased, and population consumption remained almost unchanged. On the supply side, trade and the financial sector evolved positively, while the agricultural, industrial and construction sectors contracted. Several indicators available for April-June 2022 outline conditions for reduced economic activity in the second quarter of 2022 as well.

Monetary conditions. Excessive liquidity in the banking sector amounted to MDL 4.6 billion, increasing by MDL 0.1 billion in the second quarter of 2022 compared to the previous quarter. The annual growth of monetary aggregates decreased in the second quarter of 2022 compared to the previous quarter, largely due to money in circulation and deposits in the national currency. Interest rates on credit balances in the national currency increased by 0.64 percentage points compared to the previous quarter, and those on deposits increased by 0.97 percentage points. Interest rates on loans and deposits in foreign currency have not changed essentially.

Consistent with the **forecast** are the external assumptions of the increase or maintenance of pro-inflationary pressures from international quotations, moderation of external demand, maintenance of parity between the euro and the US dollar, and the Russian ruble reflecting internal monetary operations with a non-functioning capital account.

Consumer prices will rise sharply in the coming period as well, given (1) the increase in external food and energy prices, (2) the war in Ukraine, (3) the need to adjust tariffs for the supply of natural gas and related services, (4) with their side-effects, (5) pension indexation and (6) salary increases.

The annual rate of inflation will peak in the current third quarter and decline thereafter, returning to the

range at the end of the forecast horizon, the second quarter of 2024. The annual rate of inflation components will increase until the end of the year, but will decrease thereafter, except that of food, which will already decrease from the fourth quarter of 2022. Aggregate demand will be negative throughout the forecast period due to the deterioration of external demand and financing of household consumption, but it will be stimulated by the persistently positive fiscal impulse and, to an insignificant extent, by monetary conditions.

The inflation forecast was increased until early next year and mostly lowered for the rest of the comparable period. By components, the forecast of food and fuel prices was raised, and that of core inflation - decreased; the regulated prices forecast was increased until the first half of 2023 and decreased thereafter.

The forecast is marked by increased uncertainty. Externally, sources such as tightening of monetary policies in major economies, moderation of demand in China and other large economies, energy crisis in Europe, war in Ukraine, limited supply of raw materials and worsening of agro-meteorological conditions in Europe are taking shape. Among the main domestic uncertainties are adjustment of tariffs, weather conditions, flow of refugees, disruptions in foreign trade, and increase in COVID-19 cases.

The NBM will continue to monitor the inflationary process, assessing the associated risks and uncertainties, and further decisions of the Executive Board will depend on the updated inflation outlook.

The next meeting of the Executive Board of the NBM on monetary policy will take place on 13 September 2022, according to the approved schedule.

Evolution of the NBM interest rates [1]

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