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Monetary policy decision, 08.11.2022

The Executive Board of the National Bank of Moldova, at its meeting of 8 November 2022, adopted unanimously the following decision:

1. To maintain the base rate applied to the main short-term monetary policy operations at 21.5% annually.

2. To maintain the interest rates:
a) on overnight loans at 23.5% annually;
b) on overnight deposits at 19.5% annually.

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

Today's decision was adopted in the conditions of the transmission of the effects of the previous monetary policy measures and aims to slow down consumer prices, by mitigating the secondary effects of supply shocks, further supporting financial intermediation in the national currency, and saving in favor of consumption, balancing the trade balance, as well as by anchoring inflationary expectations.

According to previous forecasts and the current one, annual inflation in the fourth quarter of 2022 will reach its maximum level and change its trajectory, decreasing for the entire forecast period. Considering the change in the inflation trend, the conduct of the monetary policy will require careful adjustment to national and world realities, in order to create appropriate conditions to achieve the fundamental objective of the NBM.

Assuming major risks and uncertainties, when the balance of risks tilts in the direction of disinflationary ones, the NBM will promote a stimulating monetary policy, which will ensure the return and maintenance of inflation close to the target.

Development of inflation. The annual inflation rate rose to 34.0% in September 2022, or 2.2 percentage points compared to June 2022. The increase in international quotations for energy resources, the hydrological drought, with effects on domestic prices for food products, the adjustment of tariffs and, therefore, the increase in costs are among the factors of this increase. The depreciation of MDL against the US dollar generated additional pressure. The war in Ukraine significantly increased the impact of the above factors. Last year's constant demand pressures have eased and had a minor impact on core inflation and food prices.

The external environment. The world economy has slowed sharply in the context of increased uncertainties. The war and the ongoing economic crisis are causing demand to fall and prices to rise at the same time. High quotations, during an extended period, for raw materials, especially for energy resources, reduce savings, investments, and the purchasing power of the population. Tightening the monetary policies aimed to bring inflation back to the level of the established targets causes the aggregate demand to slow down. OPEC + decision to reduce the cumulative supply by 2 million barrels per day, in order to stop the drop in the price of oil, explains how the supply of energy resources reflects the priority of geopolitical

interests at the expense of the economic balance in this period. The price of gas in Europe goes far beyond the maximum of recent years, due to the gas supply shutdown from Russia. The appreciation of the US dollar against the background of the depreciation of the euro and the pound sterling, all at record levels, represents the international financial markets differently, from the structural point of view. The euro remains below parity against the US dollar because of the energy crisis in Europe and substantial differences between monetary policy rates.

Economic activity slowed down in the first part of the current year, with the annual rate of real GDP decreasing by 0.9% in the second quarter of 2022. The slowdown in economic activity was driven by reduced domestic demand, increased uncertainty in the region and the small harvest against the backdrop of unfavorable agrometeorological conditions. On the demand side, exports, government consumption and imports increased, while investment and household consumption decreased. On the supply side, the trade, financial, medical and social assistance sectors evolved positively, while the agricultural, industrial and construction sectors decreased. Several indicators available for the July-August 2022 period outline conditions for reduced economic activity in the third quarter of 2022 as well.

Monetary conditions. Excessive liquidity in the banking sector amounted to MDL 4.3 billion, decreasing by MDL 0.3 billion in the third quarter of 2022 compared to the previous quarter. The annual growth of monetary aggregates decreased in the third quarter of 2022 compared to the previous quarter, largely due to money in circulation. Interest rates on balance of loans in the domestic currency increased by 1.95 percentage points compared to the previous quarter, and those on deposits increased by 2.58 percentage points. Interest rates on loans and deposits in foreign currency have not changed essentially.

Forecast. The tempering of the world economy and the tight supply, caused by the increase in geopolitical risks, will influence the prices of raw materials.

Consumer prices will continue to rise, at least, because of the decline of this year's harvest, rising external energy prices, the war in Ukraine, the adjustment of tariffs for natural gas and related services (with their side effects), indexation of pensions and salary increase.

The annual inflation rate will decrease until the end of the forecast horizon and will return to the variation range in the second quarter of 2024. This dynamic will be determined by all components of inflation. Aggregate demand will be negative over the entire forecast period due to deterioration in external demand and financing of household consumption, but also due to tight monetary conditions, but will be boosted by positive fiscal stimulus.

The trends anticipated in previous rounds remain broadly valid. The inflation forecast decreased for the first two forecast quarters and raised mostly for the rest of the comparable period. By components, the forecast of food and fuel prices was reduced, and that of core inflation and at regulated prices – increased.

The risks and uncertainties of the forecast are high. From the external environment, sources such as the reduced supply and high quotations of energy resources and other raw materials, the war in Ukraine, the decrease in world demand are emerging. The probability of a state debt crisis with transmission to financial markets remains high. The current rampant inflation will increase both the interest rates to finance the public deficits and the interest rates to service the debts which greatly increased in order to stop the economic downturn caused by the COVID-19 pandemic. The provision of the necessary energy resources and their price, the adjustment of tariffs, the flow of refugees, and meteorological conditions are among the main domestic uncertainties.

The next meeting of the Executive Board of the NBM on monetary policy will take place on 5 December 2022, according to the approved schedule.

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