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05.12.2022

Monetary policy decision, 05.12.2022

The Executive Board of the National Bank of Moldova, at its meeting of 5 December 2022, adopted the following decision:

1. To establish the base rate applied to the main short-term monetary policy operations at 20.00% annually.
2. To establish the interest rates:
a) on overnight loans at 22.00% annually;
b) on overnight deposits at 18.00% annually.

3. To decrease the required reserves ratio from financial means attracted in Moldovan lei and in non-convertible currency, as follows:
a) starting with the period of application of the required reserves in Moldovan lei 16 December 2022 – 15 January 2023, from 40.0% to 37.0% of the calculation base;
b) starting with the period of application of the required reserves in Moldovan lei 16 January 2023 – 15 February 2023, from 37.0% to 34% of the calculation base.

4. To maintain the required reserve ratio from financial means attracted in freely convertible currency at the current level of 45.0% of the calculation base.

The Decision of the NBM to resume monetary policy relaxation measures is conditioned by confirming the accuracy of the latest forecast of the National Bank of Moldova and the related disinflationary trend. Recent

information mainly reveals the main hypothesis, conclusions and assumptions associated with the Inflation Report, published in November 2022. The slowdown in annual inflation confirms and validates the correctness and appropriateness of the restrictive character of monetary policy measures previously adopted.

That decision was adopted in the context of the reverse perspective of the annual inflation trend after the maximum value in the fourth quarter 2022 and the shape of certain sharp disinflationary pressures on the part of aggregate demand against the negative output gap during the forecast horizon.

Although risks and uncertainties regarding inflation are persistent and directly related to how the events associated with the military conflict in Ukraine will unfold, including its implications on the global and domestic macroeconomic situation, the NBM by its decision comes to support a comprehensive perspective on the economic activity, configuring certain preconditions on the monetary, credit and foreign exchange markets necessary for the revival of domestic aggregate demand, which, within the limits of the transmission mechanism, will be spread through several channels, including the lending one.

The decision to reduce the required reserve requirement from funds attracted in Moldovan lei and in non-convertible currency by 6.0 percentage points will lead to additional liquidity on the money market of about MDL 3.2 billion, contributing to the increase of lending resources to the real and public sector.

In this context, the Republic of Moldova joins the first countries in the world to start easing monetary policy. This is due to the fact that the inflationary process, compared to other countries in the region, started to be operational earlier, and restrictive monetary policy measures had the expected impact of tempering inflation.

Thus, the NBM aims to anchor inflationary expectations, to bring back and maintain inflation within the variation range of ± 1.5 percentage points from the medium-term inflation target of 5.0 percent.

Evolution of inflation. The annual inflation rate in October 2022 was 34.6 percent, increasing by 0.6 percentage points compared to September. This was lower by 0.4 percentage points compared to the value forecast in the Inflation Report of November 2022, mainly due to the delayed reflection of the thermal energy tariff. That deviation is caused by the negative deviation of all inflation components, except for food prices. The upward evolution of food prices in October 2022 was determined by the hydrological drought in the summer of the current year, which affected the agricultural harvest, by overlapping with the pressures linked to costs amid the increase in tariffs for electricity and network gas delivered to economic operators, as well as fuel prices.

A larger-than-anticipated electricity tariff adjustment and a positive deviation in food prices outline the risk of a slightly higher inflation trajectory than anticipated for the fourth quarter of 2022 but will not have a significant influence on medium-term inflation developments.

Economic activity. The national economy is facing both cost and demand pressures. Amid high prices for electricity, natural gas and food products, there is a weakening of the growth rates of disposable income of the population, trade margins and investments of economic operators, which therefore reduce household consumption and gross capital formation, thus outlining definite signals for the further decrease of the economic activity.

Operational statistical data for August-September 2022, published by the National Bureau of Statistics after the forecast round in October, show prospects for the continued decrease of the economic activity in

comparable terms in the third quarter of 2022, as well. Industrial production increased in August by 2.4 percent and contracted by 13.4 percent in September. In July-September 2022, agricultural production decreased by -22.2 percent compared to the similar period of 2021, and investments in fixed assets by -11.5 percent.

At the same time, the annual rate of exports and imports expressed in US dollars increased in September of the current year by 8.0 percent and 25.8 percent, respectively. Money transfers expressed in US dollars from outside the country to individuals increased in September 2022 by 10.0 percent and in October by 15.8 percent. It should be noted that imports, exports, and transfers decreased in real terms.

Monetary conditions adjusted by the restrictive monetary policy promoted, remain favourable both in October and in the first three weeks of November to support population saving. The weighted average interest rate on term deposits in the first three weeks of November 2022 was 13.37 percent annually, increasing by 0.87 percentage points compared to October. The volume of new term deposits attracted in the national currency in the first three weeks of November registered an annual increase of 89.5 percent.

As concerns the lending activity, it also weighed down consumption in the first three weeks of November 2022, maintaining disinflationary pressures on the evolution of the consumer price index. Thus, the volume of new loans granted in the national currency decreased by 16.9 percent compared to the first three weeks of November last year under the impact of a weighted average interest rate of 14.21 percent annually, decreasing by 0.10 percentage points compared to October of the current year.

At the same time, the dollarization of loans increased to 34.6 percent, and that of deposits decreased to 39.2 percent.

Source of risks and uncertainties at the national, regional, and global level regarding the stability of consumer prices in the short and medium term is mainly associated with the tense situation in the region and potential escalations. Amid this background, recent developments in the external environment indicate a worsening of global economic conditions. Thus, the updated external assumptions show a negative external demand for next year, the adjustment of the inflation forecast in the euro area in an upward direction, and here is added the hypothesis regarding the increase in interest rates in compliance with the messages of the European Central Bank to mitigate the inflationary process.

At the same time, the forecasts regarding the evolution of international prices for 2022 have not changed significantly, while for 2023 they have decreased in accordance with the developments of the last weeks.

The risks and uncertainties associated with the latest forecast arise from the import prices of energy resources and food products. On the other hand, the compensation programs to be granted to the population for the cold period of the year involve uncertainties regarding the medium-term inflation forecast. Additionally, the 2023 Budget Law and the associated revenue and expenditure policy imply more pro-inflationary pressures, including through the positive fiscal impulse from the perspective of stimulating aggregate demand.

Under these conditions, the NBM reiterates the need for coordination and interaction of monetary and fiscal policy measures in order to maximize their effects on the real economy and inflation.

The NBM will continue to carefully monitor the internal and external macroeconomic situation, the risks and uncertainties associated with the evolution of inflation in the short and medium term and, at the appropriate time, will intervene by adjusting monetary policy instruments in order to achieve the fundamental objective of ensuring and maintaining price stability .

The next meeting of the Executive Board of the NBM regarding the promotion of monetary policy will take place on 7 February 2023, according to the approved schedule.

Evolution of the NBM interest rates [1]

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