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Monetary policy decision, 07.02.2023

The Executive Board of the National Bank of Moldova, at its meeting of 7 February 2023, adopted unanimously the following decision:

1. **to establish the base rate applied to the main short-term monetary policy operations at 17.00% annually.**
2. **to establish the interest rates:**
   a) on overnight loans at 19.00% annually;
   b) on overnight deposits at 15.00% annually.

The Executive Board of the NBM approved the Inflation Report of February 2023 for publication.

This decision is adopted from the perspective of ensuring the continuity of stimulus measures in the context of the monetary policy relaxation cycle started at the end of the previous year amid well-founded premises associated with the creation of a disinflationary macroeconomic framework.

The respective decision is conditioned by the confirmation of the veracity of the forecast of the National Bank of Moldova from October 2022 and the perspectives of decelerating annual inflation, under the impact of pronounced disinflationary pressures outlined on the external and internal demand, as well as of a neutral fiscal impulse, also confirmed by the current forecast.

According to the current forecast, the annual inflation rate will have a rapid downward trend during the current year, returning to the target variation range in the second quarter of 2024, where it will remain until the end of the forecast horizon.

The decision of the NBM is aimed at supporting the balancing of the national economy by creating the monetary conditions for boosting and accelerating domestic aggregate demand, as well as the revival of consumption, activating in this sense, the channels of the transmission mechanism, including the lending one.

The fourth quarter of 2022 resulted in the deepening of the global economic decline. Global economic conditions and their perspectives remain affected by the implications of the armed conflict in the region and the anti-inflationary conduct of central banks.

From the perspective of the tempering world demand, there is a decrease in the annual growth rates of international quotations associated with oil, food and raw material. Under the repercussion of the afore-mentioned, the global inflation slowdowns, remaining however at levels well above the pre-pandemic ones, conditioning the reluctance of some central banks in increasing monetary policy rates, while those that adopt restrictive decisions resort to a reduced magnitude of the interest rate.

Assuming the fact that the inflationary process in the Republic of Moldova occurred earlier, with rapid growth rates compared to other countries in the region, while the opportunity of the restrictive conduct of

the monetary policy resulted with its slowdown, our country joins the first countries in the world that have reversed its monetary policy trend with the expansionist one.

Therefore, the NBM aims to anchor the inflationary expectations, to return and maintain inflation within the variation range of ± 1,5 percentage points from the medium-term inflation target of 5.0 percent.

Development of inflation. Recent developments in annual inflation confirm the correctness and appropriateness of the restrictive nature of the previously adopted monetary policy measures. This, the annual inflation rate, in the fourth quarter of 2022, outlined a downward trend and recorded 30.2 percent in December 2022 compared to 34.6 percent in October 2022, as a result of the decrease in contributions from all subcomponents. In average terms, the inflation rate was 32.1 percent in the fourth quarter of 2022, being only 0.1 percentage points lower than the level anticipated in the Inflation Report of November 2022.

Inflationary pressures are also decreasing due to the decrease in industrial prices, the rate of which recorded a downward trend in the last two months of 2022.

Economic activity. In the third quarter of 2022, the national economy registered a pronounced decline, with certain prospects of stagnation in the following quarter, a fact reported by the operative indicators provided by the NBS for October-November 2022. GDP decreased, in the third quarter of 2022, by 10.3 percent compared to the similar period of 2021, being below the level anticipated in the previous forecast round, thus generating additional disinflationary pressures from the perspective of the deficit in the aggregate demand for the respective period.

This dynamic was supported by both demand and supply factors. Thus, there is a decrease of 5.7% in the annual growth rate of final consumption of households amid the decrease in the disposable income of the population and the restrictive lending conditions. Gross formation of fixed capital (-4.4 percent), along with the dynamics of imports, generated a negative impact on GDP evolution. At the same time, the contraction of economic activity was determined by the downward trend recorded in trade, industry and the agricultural sector, the latter amid of dry conditions in the summer of 2022.

Monetary conditions remain relevant to the saving process in the fourth quarter of 2022 as well, due to the gaps in the transmission of the restrictive conduct of the promoted monetary policy. The weighted average interest rate on term deposits accounted for 13.23% annually, increasing by 9.4 percentage points compared to the fourth quarter of 2021 and by 1.8 percentage points compared to the third quarter of 2022. The volume of new term deposits in domestic currency recorded an annual increase of 90.4% in the fourth quarter of 2022.

The lending activity also diminished consumption in the fourth quarter of 2022 from the perspective of its financing sources, with disinflationary implications on the dynamics of consumer prices. Thus, the volume of new loans granted in domestic currency decreased by 14.4% in annual terms under the incidence of a weighted average interest rate of 14.14% annually, increasing by 5.7 percentage points compared to the fourth quarter of 2021. At the same time, there is a slowdown in the annual rate of decrease in the volume of new loans granted in domestic currency by the licenced banks.

Forecast. Aggregate demand will generate disinflationary pressures during the current year and the first half of next year and inflationary pressures for the second half of next year. The deterioration of external demand and the sources of financing household consumption are the basis of the sharp decrease in aggregate demand. At the same time, the neutral fiscal stimulus will maintain a negative aggregate demand in the first part of the forecast, later, in the second half of next year, it will have a positive impact. Under

these circumstance, a stronger fiscal impulse is needed to stimulate economic activity during 2023.

At the same time, among the factors that will influence inflation in the deceleration phase (first quarter of 2023 – second quarter of 2024) there are: the high base from 2022, the recent adjustments of tariffs for electricity, the ongoing mitigation of imported inflation in the coming year, as well as the ongoing mitigation of oil prices on the international market. The acceleration of the inflationary process in the second half of 2024 will be determined by the accumulated increases in the prices of energy resources on the international market, the adjustment of excise duties at the beginning of 2023 and 2024, the recent and anticipated adjustments of tariffs in the current year and the effects of the second round associated with them.

The current forecast levels the annual average inflation at 13.7% and 5.5% in the current year and next year, respectively.

Events associated with the military conflict in Ukraine and eventual escalations maintain the persistent nature of risks and uncertainties regarding the short- and medium-term inflation outlook. In this context, the economic and geopolitical recession in the region, the worsening of world economic conditions and the tempering of world demand, the import prices for energy resources and food products should be emphasized. Uncertainties are looming regarding agricultural production of this year and next year, along with those associated with the timing and magnitude of the adjustment of tariffs for regulated services. Relevant are the uncertainties regarding the way compensations will be reflected by the National Bureau of Statistics with the eventual change in the regulated prices trend.

Additionally, the risk associated with external financing stimulates the increase of excessive liquidity in the banking system with repercussions on aggregate demand and on the dynamics of the exchange rate of the domestic currency likely to generate additional inflationary pressures.

It should be noted that the current medium-term forecast was developed based on the available information, taking into account the circumstances of the reflection of additional factors or the materialization of risks, therefore its trajectory will be revised accordingly.

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 stability of prices.

The next meeting of the Executive Board of the NBM regarding the promotion of monetary policy is scheduled for March 2023.

Evolution of the NBM interest rates [1]

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