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Monetary policy decision, 20.06.2023

The Executive Board of the National Bank of Moldova, at its meeting on 20 June 2023, adopted by a majority vote the following decision:

1. **The base rate for the main short-term monetary policy operations is hereby set at 6.00 percent annually.**
2. **Interest rates are set:**
   (a) for overnight loans, at the level of 8.00 percent annually,
   (b) for overnight deposits, at the level of 4.00 percent annually.
3. **The required reserve ratio of funds attracted in MDL and non-convertible foreign currency is maintained at the current level of 34.0 percent of the reserve base.**
4. **The required reserve ratio of funds attracted in freely convertible currency is maintained at the current level of 45.0 percent of the reserve base.**

This decision continues the series of stimulus measures adopted by the NBM in the last period and aims to create the monetary conditions necessary to bring inflation back within the range of ± 1.5 percentage points of the inflation target of 5.0 percent and to maintain it within this range over the medium term.

This decision is conditional on the confirmation of the assumptions and conclusions considered in the April 2023 forecast and the downward trend in the annual inflation rate, under the impact of pronounced disinflationary pressures from domestic and external demand.

The decision of the NBM is aimed at supporting the balancing of the national economy by creating monetary conditions to boost lending in the context of decreasing related costs, stimulating consumption, thus contributing to boost aggregate demand.

Thus, the new macroeconomic information available after the completion of the previous forecast round confirms the validity of the inflation forecast developed and presented in the Inflation Report, May 2023.

Inflation developments. The annual inflation rate in May 2023 continued its downward trend, recording a value of 16.3 % which is 0.6 percentage points higher than expected. The deviation of actual inflation from the forecast is mainly driven by the positive impact of regulated prices and food prices, which increased by 46.1 % and 14.0 %, respectively, in annual terms, 2.3 and 0.9 percentage points higher than anticipated in the Inflation Report, May 2023.

The dynamics of regulated prices resulted from the increase in air passenger transport prices for international flights and the reflection of the partial effect of the electricity tariff adjustment in April 2023, food prices resulted from the more pronounced evolution of volatile prices. The gradual dissipation of second-round effects associated with gas and electricity tariffs in previous periods, together with the persistence of disinflationary aggregate demand and exchange rate appreciation have dampened pressures

from core inflation.

Core inflation and fuel prices in May 2023 were 0.1 and 0.6 percentage points lower than expected and amounted to 10.5 % and -3.4 % respectively per year. Fuel prices were supported by the lower-than-expected trend in oil prices and a more appreciated exchange rate.

Although annual inflation in the period April-May 2023 was marginally higher than forecast, the earlier-than-anticipated decrease in the natural gas prices, together with the more modest dynamics of oil prices, point to a similar trend in the annual inflation rate for the second quarter of 2023 as projected in the Inflation Report, May 2023.

External environment. Global economic conditions remain under further pressure from subdued demand, along with the looming risks and uncertainties associated with the war in Ukraine. From the perspective of moderate global demand, there is a decrease in international quotations for oil, food, and raw materials. Against this background, global inflation is moderating, however, remaining well above pre-pandemic levels.

Economic activity. The economy of the Republic of Moldova continued to record negative growth rates in the first quarter of 2023, but of a more subdued magnitude compared to the last two quarters of the previous year. Thus, gross domestic product contracted by 2.4 % in real terms in the first quarter of 2023 compared to the same period of the previous year, generating disinflationary pressures from aggregate demand in that period.

The evolution of the growth rate of economic activity was supported by the dynamics of household consumption, which reversed its downward trend, recording a decline of 2.6 % on the back of the reduction in real terms of the disposable income of the population and the still restrictive credit conditions. Gross fixed capital formation (-0.4 %), together with net exports of goods and services, had a negative impact on GDP development. At the same time, the contraction in economic activity was driven by negative developments recorded in industry, trade, and construction. Gross value added in agriculture decreased by 4.0 % in the first quarter of 2023.

From the perspective of consumption financing sources, it should be noted that the payroll fund in real terms decreased by about 3.9 % in the first quarter of 2023 compared to the same period last year. On the other hand, money transfers in March 2023 maintained the positive dynamics of the first two months of the current year, recording 15.3 %.

Monetary conditions. The gradual stimulative conduct of monetary policy through the interest rate channel adopted since the end of last year, together with the money market environment, has conditioned the reduction in interest rates on new loans granted and new deposits attracted in domestic currency during the period February-May 2023.

Thus, the weighted average interest rate on new loans granted in MDL decreased by 0.27 percentage points in May this year, reaching the level of 13.36 % per annum, while the interest rate on new term deposits attracted in MDL recorded the level of 8.36 % per annum, being by 0.19 percentage points lower than in April 2023. The evolution of rates favoured the dynamics of the volume of new loans granted in MDL, which increased by 9.3 % in May compared to the previous month.

Risks and uncertainties. Identifying and assessing the risks of deviation from the inflation forecast developed in April 2023, the more appreciated exchange rate trend, the lower forecast for domestic demand, as well as more subdued import prices for natural gas and oil on the international market are highlighted. In this context, the evolution of the medium-term inflation forecast has been estimated to be slightly lower over the forecast horizon. At the same time, the expectation of a slightly higher forecast for international food prices from the year 2024 onwards mitigated the slightly negative deviation.

The tense situation in the region and potential escalations, the volatility of regional energy prices, the way tariffs for utilities (natural gas, heating, and electricity) are adjusted maintain uncertainty about the inflation outlook in the short and medium term. Also, relevant remains the uncertainty about agricultural production in the current and next year.

The NBM will continue to carefully monitor the domestic and external macroeconomic situation, risks, and uncertainties to inflation developments in the short and medium term, and further monetary policy decisions aimed at ensuring and maintaining price stability will depend on the updated inflation outlook.

The next meeting of the Executive Board of the NBM on monetary policy promotion will take place on 9 August 2023, according to the approved schedule [1].

Evolution of the NBM interest rates [2]

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