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Monetary policy decision, 09.08.2023

The Executive Board of the National Bank of Moldova, at its meeting on 9 August 2023, adopted by unanimous vote the following decision:

1. **To maintain the base rate applied to the main short-term monetary policy operations at the current level of 6.00% annually.**
2. **To maintain the interest rates:**
   a) on overnight loans, at the current level of 8.00% annually;
   b) on overnight deposits, at the current level of 4.00% annually.
3. **To maintain the required reserve ratio from the financial means attracted in Moldovan lei and in non-convertible currency at the current level of 34.0% 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 Executive Board of the NBM approved for publication the Inflation Report, August 2023.

This decision is taken in the context of the continued propagation of the stimulus effects, which are influenced by the decisions of the NBM in the previous period. This decision is taken considering the delays in the transmission of these effects and aims to anchor inflationary expectations and ensure the required monetary conditions to both restore and maintain inflation at or near the target of 5.0 percent over the medium term.

The decision of the NBM is based on the confirmation of the latest forecast by the National Bank of Moldova, along with the new round of forecasts. According to this forecast, the annual inflation rate in the third quarter of 2023 will decrease to 9.2 percent, and in the fourth quarter of 2023, it will fall within the target range, where it will remain until the end of the forecast horizon (the second quarter of 2025). It worth noting that annual inflation is expected to enter the target range in October this year.

The timely adoption of restrictive monetary policy measures during 2022 led to a change in the inflation trend. Thus, after the peak reached in October 2022 (34.6 percent), the inflationary process was reversed, with inflation reaching 13.2 percent in June 2023.

The moderation of inflation and its forecast remain within the target range, coupled with excess liquidity and further declines in interest rates, offer a positive outlook for economic activity.

The National Bank of Moldova proactively adjusts conditions in the money, credit and foreign exchange markets, adapting its monetary policy configuration as needed to maintain inflation close to the 5.0 percent target in the medium term. This approach creates the necessary conditions for implementing a macroeconomic policy mix that fosters economic growth.

Under these circumstances, inflation is no longer a determining factor that could influence the

consumption and investment decisions of economic agents and households.

The National Bank of Moldova will continue to monitor the domestic and external macroeconomic situation, the risks associated with the evolution of inflation and, depending on this, will come up with new monetary policy measures necessary to keep inflation close to the target in the medium term.

Inflation developments. In the second quarter of 2023, the downward trend in the annual inflation rate, which started at the end of the previous year, persisted. Consequently, the annual inflation rate decreased from 22.0 percent in March 2023 to 13.2 percent in June 2023. At the same time, actual annual inflation in the second quarter of 2023 was 0.2 percentage points higher than expected, with the deviation mainly due to food prices as a result of higher-than-expected increases in fruit and potato prices as a consequence of weather conditions in the spring of this year.

The current CPR rate, exceeding the upper limit of the ± 1.5 percentage points range from the 5.0 percent target, reflects significant inflationary pressures from the previous year, including tariffs increases for regulated services, the impact of the War in Ukraine, and the drought of last summer. Additionally, inflationary pressures in the first part of this year were driven by colder spring weather in 2023 and an excise tax hike at the outset of the year. However, disinflationary demand since mid-2022 and the appreciation of the MDL since the beginning of this year have helped mitigate these pressures.

External environment. The world economy has been continuing its post-pandemic recovery, albeit at a slow and fragmented pace. The tightening of monetary policies in major economies has dampened global demand, leading to a depression in commodity prices. While inflation rates are approaching target levels, monetary authorities remain cautious about changing the monetary policy cycle.

Saudi Arabia and the Russian Federation have announced oil supply reductions. However, weak demand, particularly from China, and ample oil supply from non-OPEC countries have halted a significant rise in market prices. Natural gas prices in Europe have returned to pre-crisis levels, thanks to comfortable gas reserves for the upcoming cold season. International food prices have generally decreased, except for sugar and cereal prices. Sugar prices are influenced by concerns about Brazil's sugar cane harvest and the significant appreciation of the Brazilian real against the US dollar. Additionally, the non-extension of the agreement on grain exports through the Black Sea on July 17, 2023, has led to higher grain prices on international stock exchanges.

Economic activity experienced a sharp decline earlier this year, with the annual real GDP growth rate being negative 2.4 percent in the first quarter of 2023. This decline was primarily attributed to weak domestic demand resulting from reduced real household incomes, tighter credit conditions, rising energy prices, and increased uncertainty in the region. On the demand side, government consumption and investment saw increases, while household consumption, exports and imports declined. On the supply side, agriculture, industry, trade, and construction contracted, while sectors such as health and social care, real estate and information and communication experienced positive growth.

Monetary conditions. In the second quarter of 2023, the weighted average interest rates on new domestic currency loans and time deposits were lower than in the previous quarter due to consecutive rate cuts implemented as part of the main monetary policy operations, which began in December 2022.

The weighted average interest rate on MDL deposits recorded 7.29 percent for the entire second quarter of 2023, marking 4.47 percentage points decrease compared to the previous quarter. The weighted average interest rate on new loans extended in domestic currency during the second quarter of 2023, was 13.18

percent per annum, which is 1.11 percentage points lower than in the first quarter of 2023. In light of this developments, it is expected that interest rates on loans will continue to decrease.

Excess liquidity in the second quarter of 2023 amounted to MDL 14.4 billion, representing an increase of MDL 2.6 billion compared to the first quarter of 2023.

The current forecast is based on weaker external demand and a continued easing of inflationary pressures. While international energy and food prices have stabilised in recent months, there is a concern that supply shocks in the medium to long term could potentially help resume their upward trend.

Throughout the entire forecast horizon, aggregate demand is expected to remain below potential, primarily due to looser and declining real monetary conditions and the adverse effects of weakened external demand. Meanwhile, the positive fiscal impulse will provide some support to domestic demand, except in the last two forecast quarters.

The trends anticipated in previous rounds remain valid, and there has been a slight reduction in the inflation forecast over the comparable period.

The risks and uncertainties of the forecast are high, but the balance of risks remains disinflationary. In terms of external environment, potential supply shocks from the War in Ukraine, the timing of monetary policy easing both regionally and globally, and fluctuations in energy and other commodity prices are noteworthy factors. The main domestic uncertainties include energy supply and prices, tariff adjustments, refugee influxes, weather conditions and the outlook for agricultural production for the current and upcoming year.

Detailed information on recent analyses and the current forecast will be reflected in the Inflation Report, August 2023, which will be published on the NBM website on 14 August 2023.

The next meeting of the Executive Board of the NBM on monetary policy promotion will take place on 19 September 2023, according to the approved calendar.

Evolution of the NBM interest rates [1]

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