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December 11, 2014. Press release of the National Bank of Moldova

Within the meeting of December 11, 2014, the Council of Administration of the NBM adopted the following decisions by unanimous vote:

1. **to increase the base rate applied on main short-term monetary policy operations by 1.0 percentage points, from the level of 3.5 to 4.5 percent annually;**
2. **to increase the interest rates:**
 - **on overnight loans by 1.0 percentage points, from the level of 6.5 to 7.5 percent annually;**
 - **on overnight deposits by 1.0 percentage points, from the level of 0.5 to 1.5 percent annually;**
3. **the rates mentioned in paragraphs 1 and 2 shall enter into force on 12 December 2014;**
4. **to maintain the required reserves ratio from financial means attracted in MDL and foreign currency at the current level of 14.0 percent of the base.**

Data on inflation rate for November 2014 shows important premises for a positive deviation compared to the inflation forecast for the fourth quarter of 2014. Thus, the annual inflation rate in October and November reached the level of 4.8 percent, by 0.6 percentage points higher compared to the expected value published in the Inflation Report no.4, 2014, due to the higher than expected increase in food prices and core inflation as a result of the depreciation of the national currency against the U.S. dollar and Euro.

This evolution of inflation and the decision to increase the interest rates on the main instruments of monetary policy are based on the following aspects.

During the last three months of this year, the Moldovan leu has depreciated more significantly against the Euro and U.S. dollar, due to lower net supply of foreign currency on the domestic market and the psychological factors that have an important influence on the foreign exchange market situation. Nervousness on the foreign exchange market was fuelled to some extent by the decision of the National Bank of Moldova to establish special administration over "Banca de Economii" and "Banca Socială". These conditions resulted in the formation of negative expectations and perceptions on further evolution of the MDL exchange rate and inflation.

The monetary policy continues to be affected by the complexity of risk balance, with a gradual accentuation of the pro-inflationary risks. The probability of a recession in the economies of the euro area countries and the Russian Federation – the major trading partners of the Republic of Moldova, leads to risks of lower household and domestic exporters income on short-term through the external trade channel and remittances that may further influence the dynamics of the national currency exchange rate and, subsequently, the inflation dynamics. In October 2014, the annual rate of money transfers from abroad made by individuals through the banks of the Republic of Moldova decreased by 9.0 percent compared to the previous year and the exports of goods in January – September 2014 recorded a negative annual rate of (minus) 0.2 percent. The intensification of geopolitical tension in the region may generate additional inflationary pressures.

In the context of national currency depreciation, more significant than the value used in 2012 for setting the tariffs for regulated services, there is a high risk that these will be revised upwardly in 2015, which could result in increasing inflation expectations. There exists the risk of inflation acceleration next year, along with the propagation of second-round effects of these adjustments.

The accentuation of the pro-inflationary risks requires a preventive response from the monetary policy. A gradual tightening of monetary policy is required to combat the pro-inflationary pressures from regulated prices and the depreciation of the national currency.

In these circumstances, the Council of Administration of the NBM decided by unanimous vote within its meeting of December 11, 2014 to increase the monetary policy interest rate by 1.0 percentage points from the level of 3.5 to 4.5 percent annually. It was also decided to maintain the required reserves ratio in MDL and in foreign currency at the current level of 14.0 percent of the base.

This decision aims at anchoring inflation expectations in the context of maintaining the inflation close to the target of 5.0 percent in the medium-term, with a possible deviation of ± 1.5 percentage points.

In order to support the proper functioning of the interbank money market, the NBM will continue to manage firmly the liquidity excess through sterilization operations, according to the announced schedule.

National Bank will continue to offer banks liquidity, according to the schedule announced for the years 2014-2015, through term REPO operations of 28 days, at a fixed rate equal to the base rate of the National Bank plus a margin of 0.25 points percentage.

NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances and changing foreign trade conditions, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.

The next meeting of the Council of Administration of the NBM on monetary policy will take place on December 29, 2014, according to the announced schedule.

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