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February 17, 2015. Press release of the National Bank of Moldova

Within the extraordinary meeting of February 17, 2015, 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 5.0 percentage points, from 8.5 to 13.5 percent annually;**
2. **to increase the interest rates:**

- **on overnight loans by 5.0 percentage points, from 11.5 to 16.5 percent annually;**
- **on overnight deposits by 5.0 percentage points, from 5.5 to 10.5 percent annually;**

3. **the rates mentioned in paragraphs 1 and 2 shall enter into force on February 18, 2015.**

The annual inflation rate in January 2015 was 4.7 percent, being maintained at the previous month level, mainly due to the contribution of food prices and core inflation by 1.6 and 2.4 percentage points, respectively. Since February 2012, the annual inflation rate is maintained within the range of variation of ± 1.5 percentage points from the target of 5.0 percent.

In January 2015, the annual core inflationCore inflation is calculated by the NBS, excluding prices that are outside the influence of monetary policy promoted by the NBM, such as food and beverages, fuel, products and services with regulated prices. Data prepared and published since January 2012 have been calculated by the NBS, based on the amendment of Annex no.2 of "Methodology for the calculation of core inflation index", approved by joint order of the National Bank of Moldova and National Bureau of Statistics N8-07-01203/6 of 19 January 19 2012 (the amendment refers to the inclusion of prices for remote communication services and medicines in regulated prices). was 7.0 percent, increasing by 0.7 percentage points compared to December 2014.

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 months, the Moldovan leu has depreciated more significantly against the Euro and U.S. dollar, due to the significant gap between the demand and supply of foreign currency. This was driven by the decrease in the supply of foreign currency caused by the embargoes imposed by the Russian Federation for Moldovan products and the decrease in foreign currency transfers to individuals. 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", "Banca Socială" and "Unibank". These conditions resulted in the formation of negative expectations and perceptions on further evolution of the MDL exchange rate and inflation.

According to the information published by the National Bureau of Statistics (NBS), in December 2014, both exports and imports recorded negative developments. The exports decreased by 11.5 and imports by 9.0 percent. At the same time, in December 2014, money transfers to individuals through banks of the Republic of Moldova recorded a decrease of 30.8 compared to December 2013.

Average interest rates charged by banks on loans and deposits in national currency recorded a divergent development.

Thus, in January 2015, the average annual interest rate on the loan portfolio in national currency has decreased by 0.3 percentage points compared to December 2014, representing 10.67 percent. The average interest rate for deposits in national currency increased by 0.08 percentage points compared to the previous month, recording a level of 7.62 percent. This slight increase of the rate on deposits in national currency is insufficient to stimulate savings in MDL.

The monetary policy continues to be affected by the complexity of risk balance, with pro-inflationary risks emphasizing. The increasing probability of a recession in the economies of the euro area countries and the Russian Federation - the main trading partners of the Republic of Moldova, induces risks of lower foreign exchange income of households and domestic exporters on short-term through foreign trade channel and remittances, which may influence the dynamics of the exchange rate of the national currency and subsequently the inflation development. The escalation of geopolitical tension in the region could lead to additional inflationary pressures.

Therefore, the increasing depreciation tendency of the national currency from the beginning of this year shows the imminence of some pronounced inflationary pressures for next periods, which will determine CPI to leave temporarily the upper limit of the range of variation of ± 1.5 percentage points from the 5.0 percent target, through the prices of imported goods and utilities tariffs, and subsequently through increasing pro-inflationary expectations.

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 extraordinary meeting of February 17, 2015 to increase the monetary policy interest rate by 5.0 percentage points from 8.5 to 13.5 percent annually.

The decision to increase the base rate will gradually produce effects in the economy over the next 2-3 quarters by raising interest rates on loans and deposits in national currency, aimed at anchoring inflation expectations and maintain inflation close to the target of 5.0 percent in 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.

The National Bank will continue to offer banks liquidity, according to the schedule announced for 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, foreign exchange market indicators 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 February 26, 2015, according to the announced schedule.

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