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Inflation Report no. 1, 2023

The Governor of the National Bank of Moldova, Octavian Armașu presents the Inflation Report No. 1, Fwbruary 2023

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Summary

The upward trend in the annual inflation rate over the past two years reversed at the end of 2022. At the same time, in the fourth quarter of 2022, the annual inflation rate was marginally lower than anticipated in the Inflation Report, November 2022, declining from 34.6% in October 2022 to 30.2% in December 2022. As a result, similar to the previous period, in the fourth quarter of 2022, the annual inflation rate remained above the upper bound of the range of 5.0% ±1.5 percentage points. At the same time, the average annual inflation rate was 32.1% in the fourth quarter of 2022, 1.8 percentage points lower than in the third quarter of 2022 due to the effect of the base period of the previous year. However, the still high current value of the annual CPI rate reflects the impact of previous increases of international and regional market prices of food and energy resources, which led to the increase of their prices on the internal market and the adjustment of tariffs for network gas, heat, and electricity. At the same time, the adjustment of tariffs, the increase of fuel prices, but also the upward dynamics of wages supported the increase of costs for economic operators, which was gradually reflected in prices. The impact of the above factors was amplified in the previous year by the

escalation of the situation in Ukraine, which put additional pressure on food, fuel, and some core inflation subcomponents. Additional pressure on food prices was also exerted by the dry weather conditions in the summer of last year. According to estimates, the demand pressure observed in the second part of 2021 and the first part of 2022 weakened due to monetary policy measures and attenuated the influence of the above-mentioned factors in the second part of 2022. The exchange rate dynamics had an insignificant impact on inflation developments at the end of the previous year.

The last two months of 2022 recorded a reversal of the upward trend in the annual industrial price rate, outlining premises for a partial moderation of the pressure for price increases in some CPI subcomponents in the coming period. The tense situation in the region, the risks of its escalation, the reflection of cold-weather compensation granted to the population for tariff increases, the increased volatility of energy prices and the tariff adjustment mechanism preserve a high uncertainty around the short- and medium-term inflation forecast.

The year 2022 ended on a very negative note, with the IMF announcing at the turn of the year that a third of the world's economies are entering recession. Rising interest rates in most economies, intended to reduce pro-inflationary pressures, will weaken global consumer demand, and dampen the outlook for economic growth. The increase in COVID-19 cases in China and the delay in easing restrictions have fuelled investors' perception of low consumer demand and raw material stocks at very high levels in China. At the same time, high temperatures in Europe resulted in lower natural gas prices, as low gas consumption allows Europe's gas reserves to maintain satisfactory levels. The oil quotations fell after 5 December 2022, when the EU embargo on Russian oil came into force, but the uncertainties remain rather significant, causing oil prices to remain high. The gradual decline in commodity and food prices on the international market in correlation with the high base over the last 18 months have reduced overall pro-inflationary pressures, even if levels are well above historical averages. The regional economy is still affected by the war in Ukraine, while the perspectives are overshadowed by uncertainties and risks.

After stagnating in the first half of 2022, economic activity declined significantly in the third quarter of 2022. From July to September 2022, GDP contracted by 10.3% compared to the same period of 2021, which is below the dynamics anticipated in the Inflation Report, November 2022, due to considerably weaker internal demand caused mainly by falling real household incomes, tighter credit conditions and increased uncertainty in the region. At the same time, a negative impact was also caused by less favourable agrometeorological conditions, which resulted in a more modest agricultural output compared to the previous year. The seasonally adjusted series reflects an 8.4% decline in GDP compared to the second quarter of 2022. Overall, GDP decreased by 4.1% between January and September 2022 compared to the same period of the previous year. In this context, aggregate demand pressures on prices are estimated to have exerted a disinflationary impact during that period.

In terms of uses, both household consumption and gross fixed capital formation declined in the third quarter of 2022, generating, along with import dynamics, a negative impact on GDP development. This was partly mitigated by export dynamics and the changes in inventories component. Export dynamics were mostly supported by re-export developments, while exports of domestic goods had a smaller impact. The increase of imports was mainly influenced by the "mineral products" component. By resource category, the decrease in GDP in the third quarter of 2022 was mainly determined by developments in most sectors of the economy. However, the most pronounced negative contributions were generated by the dynamics of agriculture, trade, industry, and real estate transactions. After positive developments in the first half of 2022, both the economically active and employed population experienced a noticeable slowdown in the third quarter of 2022. The unemployment rate increased marginally, and the underemployment rate showed a

slightly decreasing dynamic compared to the second quarter of 2022. Several operational indicators available from October and November 2022 showed more modest dynamics compared to the first half of 2022, thus outlining preconditions for contracting economic activity in the fourth quarter of 2022.

In the fourth quarter of 2022, the national public budget revenue increased by 11.3% above the level recorded in the corresponding period of 2021. National public budget expenditure increased, being 29.0% above the level of the fourth quarter of 2021. At the same time, on the state securities market interest rates remained on the upward trend during the fourth quarter of 2022.

In the fourth quarter of 2022, the average excess liquidity amounted to MDL 5.3 billion, increasing from the previous quarter by MDL 1.7 billion.

Monetary aggregates in the fourth quarter of 2022 recorded stronger annual growth rates than in the previous quarter. At the same time, the main contribution to this development was largely determined by the change of deposits in national currency.

Two meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions were held during the reporting quarter. Following the assessment of the balance of internal and external risks and the inflation outlook over the short and medium term, the Executive Board of the National Bank of Moldova, at the meeting held on 8 November 2022, decided to maintain the base rate applied to the main monetary policy operations at the level of 21.50% per annum. Thereafter, at the meeting held on 5 December 2022, it was decided to lower the base rate applied to the main monetary policy operations by 1.50 percentage points up to the level of 20.00% annually. At the same time, the Executive Board of the National Bank of Moldova decided to lower the reserve requirement ratio for two consecutive application periods. Thus, the reserve requirement ratio from the financial means attracted in MDL and in non-convertible foreign currency was reduced from 40.0% to 34.0% of the calculation base (by 3.0 percentage points for the application periods 16.12.2022 – 15.01.2023 and 16.01.2023 – 15.02.2023 respectively).

Average interest rates on the balance of loans in national currency increased compared to the previous quarter by 0.83 percentage points and on deposits – by 2.66 percentage points. Average interest rates on loans and deposits in foreign currency recorded minor increases.

In the current round of forecasting, external assumptions point to weak external demand, lower international price growth rates and continued risks and uncertainties in the region. As the IMF has warned, by 2023, a third of the world's economies will be in recession. Rising interest rates and moderating global demand will reduce international price growth rates, but they will still be well above pre-pandemic averages. In the region, the economic situation will continue to be affected by the war in Ukraine and the energy crisis in Europe. Although abnormally high temperatures for the cold period of the year in Europe resulted in lower natural gas prices, the energy crisis in Europe is far from over and will have a significant impact on economic development in the coming years. Based on the trajectory of interest rate forecasts in the US and the Eurozone, we can expect an increase in EUR/USD parity, i.e., a depreciation of the US dollar and an appreciation of the European single currency. At the same time, world market prices for agri-food products are expected to decrease compared to their 2022 peaks.

The annual inflation rate will follow rapid downward trend over the current year and remain relatively stable thereafter until the end of the forecast period[1]. Inflation will return to the target range in the second quarter of 2024 and will preserve until the end of the forecast horizon. In terms of monthly inflation, there is a high probability that it will fall within the uncertainty range at the end of December 2023.

The annual rate of core inflation will decline rapidly over the current year, then increase slightly by the end of the forecast horizon[2]. The annual rate of food prices will follow a downward trend until the second quarter of 2024, thereafter, increasing slightly by the end of the forecast horizon. The annual rate of regulated prices will decline significantly for the whole forecast period. The annual rate of fuel prices will continue to decline significantly in the first three consecutive quarters of the forecast, thereafter, increasing slightly to the end of the forecast horizon.

Aggregate demand will be negative this year and in the first half of next year due to deteriorating external demand and household consumption financing, as well as tightening monetary conditions. At the same time, the neutral fiscal impulse will maintain a negative aggregate demand in the first part of the forecast, followed by a positive impact in the second half of next year.

Real monetary conditions for aggregate demand will be insignificantly stimulative in the first quarter of 2023 and restrictive for the rest of the forecast period.

The current inflation forecast, compared to the previous inflation report[3], was revised downwards over the entire comparable period[4], except for the last quarter, where it appears slightly higher. The current forecast for the annual rate of increase in core inflation was revised downwards over the entire comparable period. The annual rate of food prices was insignificantly revised over the entire comparable period. The current forecast for the annual rate of regulated prices is revised mainly downwards over the entire comparable period. The annual fuel price rate forecast was lowered for the current year and increased for the rest of the comparable period.

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1. Fourth quarter of 2024.
2. First quarter of 2023 – fourth quarter of 2024.
3. Inflation Report, November 2022
4. First quarter of 2023 – third quarter of 2024.

See also

Tags
Rata anuală a inflației [2]
core inflation [3]
External environment [4]
inflation forecast [5]
forecast [6]
forecasting inflation [7]

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