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# Inflation Report no. 2, 2022

*The Governor of the National Bank of Moldova, Octavian Armașu presents the Inflation Report No. 2, May 2022*

— Inflation Report no. 2, May 2022 [1]

## Summary

In the first quarter of 2022, the annual inflation rate continued the upward trend started in 2021 at a faster pace than expected (Inflation Report no. 1, 2022). Thus, it increased from 13.9% in December 2021 to 22.2% in March 2022. As a result, in the first quarter of 2022, like in the previous period, it was above the upper limit of the range of 5.0% ± 1.5 percentage points. At the same time, the average annual inflation rate in the fourth quarter of 2021 was 19.1%, being 7.4 percentage points higher than in the previous quarter. The acceleration of prices in the above-mentioned period was determined by the increase of prices for food and energy resources on the international and regional market, which led to the increase of their prices on the domestic market and the adjustment of tariffs for network gas and heat. At the same time, the adjustment of tariffs, the increase of fuel prices, but also the upward dynamics of salaries supported the increase of costs for economic operators, which was gradually reflected in prices. Also, the rise in inflation was supported by persistent demand pressures in the context of rising disposable income and lending, which led to higher prices for the subcomponents of core inflation, but also for food prices. The impact of the above factors was

significantly amplified in late February and during March by the escalating situation in Ukraine, which put additional pressure on food, and fuel prices, and some core inflation subcomponents. Inflationary pressures associated with the above-mentioned factors have also been exacerbated by the side effects of the increase in regulated tariffs and the adjustment of excise duties at the beginning of this year.

Over the next period, the upward trend of the annual CPI rate will continue in the context of rising food and other commodity prices on the regional market. A major impact on the CPI is to be established by the full reflection of tariff adjustments by the NBS in the first half of 2022. Increased tariffs for gas, heat, and electricity, further increase in gas import prices, and possible increases in other tariffs will lead to upward price pressures on several sub-components of the CPI. At the end of 2021, major deviations accumulated in several categories of prices regulated by both the central and local public administration. Over the last 5-10 years, these services have been directly or indirectly subsidized by local budgets, and some service providers have accumulated significant negative deviations due to non-adjustment of tariffs to costs. It should be noted that these inflationary pressures may materialize in the future and will contribute to the development of inflation both through the direct effect and through side effects on other goods and services. Like in previous periods, the subsequent dynamics of the CPI remain marked by the current uncertainty and magnitude of some tariff adjustments in the context of the sharp rise in energy prices on the regional market, but also by the impact of weather conditions on domestic food prices.

The world economy was shaken, in the first months of 2022, by the armed conflict in Ukraine, which disrupted the post-pandemic recovery and significantly increased the already existing pro-inflationary pressures. The strong volatility of the main macroeconomic indicators was generated by the increase in quotations for energy resources, agri-food products, metals, and fertilizers, but also by the depreciation of the single European currency and the unprecedented devaluation of the Russian ruble. The economic activity in Ukraine declined sharply, and traditional transport routes in the region were paralyzed by military action. This increased the risk of supply shortages, which contributed to rising pro-inflationary pressures. The economies of Moldova, Romania and Poland have been under increasing pressure on public spending to help Ukrainian refugees. The eurozone economy faces the risk of stagflation, after annual inflation rose to 7.5% in March 2022, and economic activity has moderated significantly following the unprecedented rise in energy prices. The economic activity in China declined sharply in March 2022 after rising COVID-19 infections forced the reintroduction of restrictions, including quarantine. The unprecedented rise in quotations for agri-food products has prompted the UN to warn of the risk of famine in poor countries.

The economic activity accelerated sharply at the end of the previous year. This development was mainly supported by domestic demand from households in the context of increasing disposable income, a favourable environment with still relatively low interest rates, a rich harvest in 2021, but also by the positive economic activity in the region. Thus, in the fourth quarter of 2021, GDP was 18.9% higher than in the same period of 2020, the respective dynamics being significantly higher than anticipated in the Inflation Report no. 1, 2022. At the same time, the seasonally adjusted series reflects a 6.0% increase in GDP compared to the third quarter of 2021. In 2021, GDP increased by 13.9% compared to 2020. GDP developments in the fourth quarter of 2021 were determined, mainly, by the increase of investments, increase of the households' consumption, but also by the dynamics of exports. A significant part of the domestic demand, however, led to an increase in imports, which attenuated the domestic economic dynamics. On the supply side, more pronounced positive developments were recorded in agriculture, construction, and transport. At the end of the previous year, the labour force indicators showed a more modest dynamics in annual terms compared to previous periods. Thus, in the fourth quarter of 2021, the number of economically active population contracted, while the employed population registered a minor increase compared to the similar period of

2020. The unemployment rate as well as the underemployment rate recorded a downward dynamic. Most of the operational indicators available from January and February 2021 continued to show positive developments, thus outlining preconditions for a positive dynamic of GDP at the beginning of this year.

In the first quarter of 2022, the revenues of the national public budget increased by 20.2% above the level recorded in the same period of 2021. Expenditures of the national public budget increased by 23.1% above the level recorded in the first quarter of 2021.

At the same time, interest rates remained on the upward trend on the market of state securities allocated during the first quarter of 2022.

In the first quarter of 2022, excessive liquidity amounted to 4.5 billion lei, increasing compared to the previous quarter by 0.9 billion lei.

The monetary aggregates recorded, in the first quarter of 2022, faster annual growth rates than in the previous quarter. At the same time, the main contribution to this development was largely determined by the change in the volume of deposits in national currency and money in circulation.

The average interest rates on the balance of loans in national currency increased by 0.51 percentage points compared to the previous quarter and on deposits in national currency by 0.27 percentage points. Average interest rates on foreign currency loans and deposits continued their downward trend.

During the first quarter of 2022, the Executive Board of the National Bank of Moldova held three meetings on monetary policy decisions. Following the assessment of the balance of internal and external risks and the short- and medium-term inflation outlook, the Executive Board of the National Bank of Moldova decided, at its meetings of 13 January, 15 February, and 15 March (with effect from 16 March 2022) to operate 2.00 percentage points successive increases in the base rate applied to the main monetary policy operations up to the level of 12.50% annually.

At the same time, at its ordinary meeting on 5 May 2022, the Executive Board of the National Bank of Moldova continued the tightening measures and adopted, by unanimous vote, the decision to increase the base rate applied to the main short-term monetary policy operations by 3.00 percentage points, setting its level at 15.50% annually. Concurrently, for the application period: 16 May 2022 – 15 June 2022, the required reserves ratio from the financial means attracted in Moldovan lei and in non-convertible currency was increased from 28.0% to 30.0% of the calculation base, while the required reserves ratio from the financial means attracted in freely convertible currency was increased from 30.0% to 33.0% of the calculation base. It should be noted that the current forecast contained in this Report includes the taken measures.

The effects of the armed conflict in Ukraine have completely changed the outlook for the post-pandemic recovery of the world economy and economic activity in the region. Thus, in the coming quarters, a reduced external demand is anticipated amid the geopolitical, economic, and humanitarian crisis in the region. External pro-inflationary pressures are on the rise as quotations for energy resources, agri-food products, and other commodities have reached record or significantly high levels. The financial markets will adjust to the gradual tightening of the monetary policy of the Federal Reserve System. In the hope of balancing oil demand and supply, a slight stabilization of oil prices is expected, but levels will remain relatively high compared to the averages of recent years. The increase in quotations for food on the international market will be considerable, which will increase spending on basic needs of the population at the expense of spending on secondary needs. The amplitude of the current factors generates a high degree of uncertainty regarding the future developments of the external hypotheses.

The annual inflation rate will increase until the third quarter of this year, after which it will follow a downward trend towards the end of the forecast horizon. In the second quarter of 2022, the inflation rate will continue to be above the upper limit of the variation range and will return into the range only in the last quarter of the forecast. The annual rate of core inflation will have an upward trend until the first quarter of 2023, then it will decline towards the end of the forecast period. The annual rate of food prices will continue to rise until the third quarter of 2022 and, starting with the end of 2022, will decrease significantly for the rest of the forecast period. The annual rate of regulated prices will increase in the first two quarters of the forecast and, starting with the fourth quarter of 2022, will decrease significantly, towards the end of the forecast period. The annual rate of fuel prices will also increase in the first quarter of the forecast and, starting with the second half of 2022, will decrease considerably for the rest of the horizon.

The aggregate demand will be positive during the first two consecutive quarters of the forecast horizon, after which it will show disinflationary pressures. The positive fiscal momentum across the forecast horizon will easily offset the restrictive effects of real monetary conditions and external demand.

Real monetary conditions will be restrictive until the third quarter of 2023 and slightly stimulating for the rest of the forecast horizon.

The current inflation forecast, as well as its components, compared to the previous Inflation Report, has been revised upwards over the entire comparable period.

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