11.05.2023

Monetary policy decision, 11.05.2023

The Executive Board of the National Bank of Moldova (NBM), at its meeting of 11 May 2023, adopted the following decision by a majority vote:

1. **To establish the base rate applied to the main short-term monetary policy operations at 10.00% annually.**
2. **To establish the interest rates:**
   a) on overnight loans at 12.00% annually;
   b) on overnight deposits at 8.00% 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 ration from financial means attracted in freely convertible currency at the current level of 45.0% of the calculation base.**

Recent macroeconomic data largely confirm the validity of previous NBM forecasts.

The monetary policy restrictive measures timely adopted during 2022 led to a change in the inflation trend. Thus, after the peak reached in October 2022 (34.6%), the inflationary process has been continuously moderating, with inflation reaching 18.1% in April 2023.

The current decision continues the set of stimulative monetary policy measures adopted since the end of the last year.

The NBM manages the inflationary process by aiming to moderate the decline in inflation by stimulating aggregate demand, including by encouraging consumption, balancing the national economy and anchoring inflationary expectations.

The NBM will continue to monitor the inflation process, assessing the associated risks and uncertainties, and further decisions of the Executive Board will depend on the updated inflation outlook.

Development of inflation. The annual inflation rate decreased from 30.2% in December to 22.0% in March 2023. Actual inflation in the first quarter of 2023 was 0.9 percentage points higher than forecast. The deviation of actual inflation from the forecast was mainly due to regulated prices, as a result of the NBS reflecting compensation to consumers for natural gas, heat and electricity.

According to data published today by the NBS, the annual inflation rate in April 2023 was 18.1%, lower than expected by the NBM. By components, food prices increased by 16.4% annually, non-food goods – by 10.6%, and household services - by 33.2%.

Tariff hikes with their side effects, the war in Ukraine, last summer's drought and the excise tax hike earlier this year are keeping inflation well above target. However, disinflationary demand from mid-2022 onwards and the appreciation of the MDL since the beginning of this year continue to mitigate the pressures from the above factors.

External environment. The world economy grew faster in early 2023 than anticipated. Europe's energy crisis did not worsen this winter, contrary to expectations, as natural gas consumption fell sharply due to high temperatures and savings, while storage capacity was filled to its highest levels in 12 years. Oil prices were less volatile than last year largely due to signs of distress at some US and Swiss banks and below-expected demand growth in China. However, OPEC's decision in early April to cut supply by a further 1.66 million barrels a day has pushed oil prices above US dollars 85 a barrel. Other commodity prices fell further, due to low demand and satisfactory supply, as well as a high base from last year. The war in Ukraine and the earthquake in Turkey continue to affect the regional economy.

Amid moderating pro-inflationary pressures, some emerging economies have started to loosen monetary policy, while advanced economies have raised interest rates by a smaller magnitude.

Economic activity declined sharply in the second half of 2022, with the annual rate of real GDP at -10.6% in the fourth quarter of 2022. In 2022, GDP declined by 5.9 percent compared to 2021. The moderation in economic activity was driven by lower domestic demand (due to lower real household incomes and tighter credit conditions), increased uncertainty in the region, and lower harvests (because of adverse agrometeorological conditions). On the demand side, government consumption, exports and imports increased, while investment and household consumption decreased. On the supply side, agriculture, industry, trade, transport and the social sector declined the most.

Monetary conditions. Excess liquidity in the banking sector was MDL 11.7 billion, increasing by MDL 6.4 billion in the first quarter of 2023 compared to the previous quarter. The annual growth of monetary aggregates increased in the first quarter of 2023 compared to the previous quarter, largely due to deposits in MDL. In the first quarter of 2023, weighted average interest rates on new loans in national currency continued to rise, while they declined on term deposits compared to the previous quarter. For the whole of the first quarter of 2023, the weighted average interest rate on deposits in MDL was 11.48% per annum, lower than in the fourth quarter of 2022 by 1.75 percentage points. The weighted average interest rate on new loans in local currency in the first quarter of 2023 was 14.30% per annum, 0.16 percentage points higher than in the fourth quarter of 2022.

The current forecast is based on a better external economic context, but below potential and with many risks and uncertainties. Monetary tightening in advanced economies and still low demand in China overshadow the outlook for the global economy. International prices are falling, due to risk-off and lower consumption versus high supply in several segments. The forecast for the euro area economy has improved.

The growth rate in consumer prices will slow in the coming period, at least, due to low domestic demand, lower electricity tariffs, the effect of last year's high base, and slower food price growth due to expectations of a positive agricultural year. At the same time, a decline in natural gas and related utilities tariffs at the end of the third quarter of 2023 is anticipated, which, together with their side effect, will have a disinflationary impact.

The annual inflation rate will decrease by the end of the forecast horizon and return to the range in the fourth quarter of 2023. This dynamic will largely be driven by all components of inflation. Aggregate demand will be negative until early next year due to deterioration in household consumption financing, weak external demand, and less restrictive monetary conditions, but will be stimulated by a small positive fiscal stimulus.

Trends anticipated in previous rounds remain valid. The inflation forecast has been lowered for the whole comparable period largely due to all components.

Forecast risks and uncertainties are high, but the balance of risks remains disinflationary. From the external environment, sources such as trade with Turkey, the war in Ukraine, the moment of relaxation of monetary policies in the region and worldwide, quotations of energy resources and other raw materials are emerging. The supply of energy resources and their price, the adjustment of tariffs, the flow of refugees, weather conditions and the future agricultural harvest are among the main domestic uncertainties.

The Inflation Report, May 2023 will contain detailed information and will be published on the official website of the NBM on 15 May 2023.

The next meeting of the Executive Board of the NBM regarding monetary policy promotion will take place on 20 June 2023, according to the approved schedule.

Evolution of the NBM interest rates [1]

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