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Monetary Policy

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# Monetary policy decision, 15.02.2022

**The Executive Board of the National Bank of Moldova, at its meeting of 15 February 2022, adopted by unanimous vote the following decision:**

1. **to increase the core rate applied to major short-term monetary policy operations by 2.00 percentage points from 8.50 percent to 10.50 percent annually.**
2. **to increase the interest rates:**
   **a) on overnight loans by 2.00 percentage points, from 10.50 percent to the level of 12.50 percent annually;**
   **b) on overnight deposits by 2.00 percentage points, from 6.50 percent to the level of 8.50 percent annually.**
3. **to maintain the required reserves ratio from the attracted funds in freely convertible currency at the current level of 30.0 percent of the calculation base.**

Recent information reflects the accelerating prices of raw materials, food, energy resources by overlapping with disruptions in production and supply chains, thus affecting the global economic conditions. In this context, global inflation is rising, implicitly exceeding central bank targets. Against the backdrop of high inflation levels, with the upward adjustment of forecasts for the coming years as a benchmark, central banks in Central and Eastern Europe are promoting restrictive monetary policy conduct, resorting directly to increasing the monetary policy rates in February this year. The vulnerability of domestic prices to external environment developments in terms of import prices is impressive, which along with domestic factors led to further annual inflation increase in January 2022.

Thus, the annual inflation rate registered 16.6 percent in January 2022, being by 2.6 percentage points higher than in December 2021. This development was due to the contribution of food prices (7.6 percentage points), core inflation (4.2 percentage points), regulated prices (2.9 percentage points) and fuel prices (1.9 percentage points).

In detail, the upward inflation trend was supported by the increase in international and regional prices for food and energy resources, which led to an increase in their prices on the domestic market and the adjustment of tariffs for mains gas and heating. Likewise, the adjustment of tariffs, the increase in fuel prices, but also the upward dynamics of wages supported the increase in costs for economic agents, which was gradually reflected in prices. At the same time, demand pressures associated with an increase in household disposable income and lending have supported the increase in prices of the subcomponents of core inflation, but also in food prices. It should be noted that, thanks to the Government's compensation granted to the population for the cold period of the year, the disposable income of the population was not significantly affected, while maintaining pressure on demand.

The operational indicators for October-November 2021, provided by the NBS outline prospects for a positive dynamics of economic activity in the fourth quarter of 2021 similar to that of the third quarter of 2021.

Industrial production increased by 8.2 percent in October-November 2021 compared to the respective period of 2020. During this period, transport of goods recorded an increase of 31.2 percent compared to the same period of 2020. At the same time, the turnover of enterprises with the main activity of wholesale trade increased by 14.3 percent. Global agricultural production increased by 116.0 percent in the fourth quarter of 2021.

Economic conditions have fostered improvements in the labor market situation for the second consecutive quarter. Thus, in the third quarter of 2021, the economically active and employed population registered a positive dynamic of 1.6 percent and, respectively, 2.6 percent annually. At the same time, the economy wage fund moderated its positive growth rate, increasing by 17.0 percent in real terms and the average number of employees increased by 2.9 percent compared to the third quarter of 2020.

In the fourth quarter of 2021, the new loans fueled the demand, generating strong pressures on the inflationary process, with their volume in national currency increasing by 45.1 percent annually. It should be noted that in January 2022, compared to the same period of the previous year, new loans in national currency increased by 55.3 percent, warning of the need to maintain the restrictive nature of monetary policy in order to mitigate the pressures associated with the credit lending process on the further rise in consumer prices.

The current inflation forecast, drawn up based on the available flow of information, has been revised upwardly for the comparable period (quarter I 2022 - quarter III 2023) compared to October 2021. In this sense, the annual inflation rate will register a pronounced upward trajectory until the third quarter of 2022, after which it will decelerate, returning in the range of the target in the second quarter of 2023.

Inflation will continue to be affected by both demand and supply shocks.

Aggregate demand, supported by the positive fiscal momentum and the revival of external demand, will record positive values increasing in the first quarter of 2022, subsequently decreasing continuously and maintaining the pro-inflationary character over the forecast horizon (quarter I 2022 - quarter IV 2023).

**The forecast adjustment is based on pro-inflationary factors, such as imported inflation, rising international food prices, energy and oil resources, positive domestic demand, a possible increase in electricity tariffs during the first and second quarters of 2022, and excise duty adjustment, along with the low annual base effect.**

Among the factors with a negative impact that will influence inflation in the downward phase are: aggregate demand steadily decreasing until the end of the forecast horizon, the downward trend in projected external prices for oil and gas, the improvement of the situation on the regional and global energy market expected in the next year, the slight decline in the annual rate of international food prices in the first half of the next year, the high annual base effect.

*It should be noted that the current medium-term forecast has been prepared based on the information available and, in the event of additional factors or risks materializing, its trajectory will be revised accordingly.*

We note that the annual inflation rate for January 2021 was 0.8 percentage points above the level anticipated in the Inflation Report No. 1, 2022. This deviation was mainly determined by the earlier adjustment of gas tariff, but also by higher cost pressures on food prices, as well as oil price dynamics. Thus, the risk of a higher-than-expected inflation trajectory in the Inflation Report no.1, 2022 is taking shape in the next period, given the positive deviation recorded for the first month of the forecast, as well as

more than expected price developments and possible second-round effects of the tariffs' adjustment.

Thus, following the analysis and findings made during the meeting, taking as a reference the medium-term inflation forecast, the NBM Executive Board decided to increase by 2.0 percentage points the core rate and rates on standing facilities. At the same time, it should be mentioned that item no. 3 of the NBM Executive Board Decision no. 2 of 13.01.2022 will enter into force on 16 February 2022, providing for the increase of the required reserves ratio attracted in Moldovan lei and in non-convertible currency starting with the period of application of the required reserves in MDL: 16 February 2022 – 15 March 2022 by 2.0 percentage points, being established at the level of 28.0 percent of the calculation base.

*The decision seeks to mitigate persistent inflationary pressures on the inflation process, creating preconditions for bringing inflation back within the range of the medium-term target range, including by anchoring inflation expectations and mitigating the side effects of increasing regulated tariffs.*

*It should be noted that this monetary policy decision is aimed at moderating the growth of credit at the expense of increasing associated costs, stimulating savings at the expense of immediate consumption and reducing the pressure on the depreciation of the national currency due to the increasing current account and trade balance deficit, along with mitigating the dollarization effect of deposits.*

*Thus, through this decision, the NBM strengthens its anti-inflationary position and, gradually adjusting its monetary policy instruments, carefully monitors the reaction of real and monetary sector indicators to decision-making impulses.*

*At the same time, the NBM reiterates that it will carefully monitor the evolution of inflation components and factors likely to affect its dynamics, as well as the risks and uncertainties associated with the short- and medium-term forecast. At the same time, the NBM mentions that, to achieve its fundamental objective of ensuring and maintaining price stability, the NBM reserves its legal right to intervene at the appropriate time by adjusting monetary policy instruments.*

The next meeting of the NBM Executive Board on monetary policy will take place on 15 March 2022, according to the approved schedule.

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