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Inflation Report no. 3, 2022

The Governor of the National Bank, Octavian Armașu presents the Inflation Report No. 3, August 2022

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Summary

In the second quarter of 2022, the annual inflation rate continued the upward trend of the previous year. However, it was slightly below the value anticipated in the Inflation Report of May 2022. It increased from 22.2% in March 2022 to 31.8% in June 2022. As a result, similar to the previous period, in the first quarter of 2022, the annual inflation rate remained above the upper limit of 5.0% range ±1.5 percentage points. At the same time, the average annual inflation rate accounted for 29.3% in the second quarter of 2022, being by 10.2 percentage points higher than in the previous quarter. This dynamic was supported by the increase in international and regional market prices for food and energy resources, which led to an increase in their prices on the domestic market and an adjustment in tariffs for network gas, thermal energy, and electricity. At the same time, the adjustment of tariffs, the increase in fuel prices, but also the upward dynamics of monthly income supported the increase in costs for economic operator, which was gradually reflected in prices. The impact of the above-mentioned factors was significantly amplified in the first half of the current year by the escalation of the situation in Ukraine, which generated additional pressures on food, fuel, and some core inflation subcomponents. At the same time, for some CPI subcomponents, additional inflationary

pressures were driven by the dynamics of the MDL/USD foreign exchange rate. According to recent estimates, the demand-side pressures observed in previous periods have lost their intensity and had a negligible impact on prices of the core inflation subcomponents and food prices. The upward trend of the annual IPPI rate continued in the second quarter of 2022, setting the stage for higher prices of some CPI subcomponents in the coming period.

At the same time, considering the increase in international and regional food and energy prices, amplified by the escalation of the armed conflict in Ukraine, the requests of suppliers to adjust gas and thermal energy tariffs, the increase in prices of food, energy resources, and other goods and services within the IPC will continue in the coming year. At the same time, the increase in domestic costs, the side effects of tariff increases, the indexation of pensions, the increase in wages will generate additional pressures on the CPI in the domestic market in the coming period. The sharp increase in natural gas prices on foreign markets will exert additional pressure on the adjustment of the network gas tariff, which will be followed by an increase in the tariff for related services, which will further support the increase in inflation. Similar to previous periods, further CPI dynamics remain marked by the uncertainty of the timing and magnitude of some tariff adjustment in the context of the considerable increase in energy prices on the regional market, as well as the impact of weather conditions on domestic food prices.
The situation in the world economy continues to worsen, with the level of complexity of the problems being very high. World market prices continued to increase, which amplified pro-inflationary pressures. The tightening of monetary policies to counter pro-inflationary pressures, along with the increase in production costs, is having a major impact on economic activity. In addition, the increase in the number of COVID-19 cases worldwide and the re-introduction of restrictions and quarantine in China led to the moderation of global economic activity. In June, the FRS significantly increased the range of interest rates by 0.75 percentage points, which, together with the increase in risk premia contributed to the significant appreciation of the US dollar. In this context, the ECB raised interest rates by 0.5 percentage points at its monetary policy meeting on 21 July 2022, the first rate increase since 2011. In the context of the difference between interest rates and government bonds, the single European currency depreciated in July close to parity with the US dollar. The natural gas crisis in Europe worsened at the end of June due to the shutdown of the Nord Stream 1 pipeline for scheduled maintenance work and the risk of Gazprom not resuming gas deliveries. Thus, the TTF Netherlands quotation increased to USD 1,900/1,000 cubic meters. The FAO index eased slightly in recent months amid expectations of a good harvest in the northern hemisphere and improved cereal crop conditions at some major producers.

GDP dynamics have moderated at the beginning of the current year after the upward trend of the previous year. The moderation of economic activity was supported by more modest domestic demand, mainly because of the decrease in real incomes of the population and tighter credit conditions, as well as increased uncertainty in the region and the emergence of barriers to foreign trade due to the escalation of the conflict in Ukraine. However, although modest, the annual GDP rate continued to be positive due to the impact of export developments and government consumption. As a result, GDP in the first quarter of 2022 was 1.1 percentage points higher than in the same period of 2021, but the dynamics were lower than anticipated in the Inflation Report, May 2022. At the same time, the seasonally adjusted series reflects a decrease of 6.4% in GDP compared to the fourth quarter of 2021. Positive contributions to GDP dynamics were driven by the increase in exports and government consumption. Household consumption recorded a minor dynamic. At the same time, their positive impact was eroded by lower investment and higher imports. On the supply side, more pronounced positive developments were recorded in trade and the financial sector. The agricultural, industrial and construction sectors contracted at the beginning of this year compared to the same period of the previous year. After the modest dynamics at the end of the previous year, both the

economically active and the employed population experienced a positive development at the beginning of this year. Unemployment as well as underemployment rates recorded a slightly upward trend. Several operational indicators available for April-June 2022 period outlined a more modest dynamic compared to the beginning of the current year, thus outlining preconditions for a modest economic activity in the second quarter of 2022.

In the second quarter of 2022, the revenues of the national public budget increased by 18.6% above the level recorded in the similar period of 2021. The expenses of the national public budget increased, being 13.1% above the level recorded in second quarter 2021.

At the same time, in the state securities market, allocated during the second quarter of 2022, interest rates maintained their upward trend.

In the second quarter of 2022, excess liquidity amounted to MDL 4.6 billion, increasing by MDL 0.1 billion compared to the previous quarter.

Monetary aggregates, in the second quarter of 2022, recorded more moderate annual growth rates compared to the previous quarter. At the same time, the main contribution to this development was largely driven by the change in the volume of currency in circulation and deposits in the national currency.

Average interest rates on outstanding amounts of loans in the national currency increased by 0.64 percentage points and on deposits by 0.97 percentage points compared to the previous quarter. Average interest rates on loans and deposits in foreign currency showed minor changes.

Two meetings of the Executive Board of the National Bank of Moldova regarding monetary policy decisions were held during the second quarter of 2022. Following the assessment of the balance of internal and external risks and the inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova decided successfully increase the base rate applied to the main monetary policy operations by 3.00 percentage points each at the meetings of 5 May and 3 June, up to the level of 18.50% annually.

At the same time, the Executive Board of the National Bank of Moldova, during the ordinary meeting of 4 August 2022 adopted by unanimous vote an increase in the base rate applied to the main short-term monetary policy operations by 3.00 percentage points, to 21.50% annually. At the same time, the required reserve ratio of the funds attracted in MDL and non-convertible foreign currency was increased by 3.0 percentage points each in two consecutive periods of application 16 August – 15 September 2022 and 16 September – 15 October 2022, respectively, from 34.0% to 40.0% of the calculation basis. The norm of required reserves from funds drawn in freely convertible currency assets was increased by the same magnitude and in similar periods, from 39.0% to 45.0% of the calculation base.

This decision is aimed at tempering the rapid growth rates of consumer prices, mitigating the side effects of supply shocks, stimulating financial intermediation in domestic currency, and saving at the expense of consumption, balancing the trade balance, and anchoring inflationary expectations.

The current forecast in the Inflation Report of August 2022 includes appropriate monetary policy measures, the magnitude of which being calibrated to support the decline in the consumer price index from the fourth quarter of 2022 thereafter.

In this context, there is a high probability that the measures adopted can complete the monetary policy tightening cycle in the absence of major unanticipated pro-inflationary shocks in the immediate period

term. Once future projections outline a well-founded basis for monetary policy easing, the NBM will take the necessary measures to bring inflation back closer to the 5.0% target.

The world economy is at a turning point, with macroeconomic indicators fluctuating without any concrete trend, which increases the uncertainty of forecasts. On the one hand, the world economy is affected by the tightening of monetary policies in major economies and the moderation of demand in China and other large economies. On the other hand, risks related to the armed conflict in Ukraine, limited supply of raw materials and poor agrometeorological conditions in Europe facilitate the persistence of high quotations for raw materials. Thus, in the current round of forecast, the assumption regarding the pro-inflationary growth/maintenance related to quotations on the international market remains valid, but external demand is expected to be more subdued. Also, based on the latest developments, it is anticipated that the European currency will oscillate in the vicinity of parity with the US dollar, and the Russian ruble is expected to reflect domestic monetary operations in the absence of the functioning of the capital account.

In the third quarter of the current year, the annual inflation rate will reach its highest level and from the next quarter onwards it will follow a downward trend towards the end of the forecast horizon. The inflation rate will be above the upper end of the range throughout the forecast period and in the last quarter will return to the range. The annual rate of core inflation will increase during the first two quarters of the forecast period and will reverse its path starting next year onwards and decline for the rest of the forecast period[1]. The annual rate of food prices will peak in the first quarter of the forecast period and will start to decline from the next quarter onwards. The annual rate of regulated prices will increase until the end of the current year, and starting with the first quarter of 2023, it will decrease significantly towards the end of the forecast period. The annual rate of fuel prices will increase in the first two consecutive quarters of the forecast and starting from 2023 it will decrease significantly towards the end of the forecast horizon.

Aggregate demand will be negative over the entire forecast period due to deterioration in external demand and household consumption financing. Fiscal stimulus and, to a lesser extent, monetary conditions will mitigate the decline in aggregate demand.

Real monetary conditions will be mildly supportive of aggregate demand over much of the forecast horizon.

The current inflation forecast relative to that in the previous Inflation Report[2] has been revised upwards through the first quarter of 2023 and downwards for the rest of the comparable period[3], except for the first quarter of 2024. The current forecast for the annual rate of core inflation has been lowered over the entire comparable period, except for the first quarter of 2024. The annual rate of food prices was revised upwards over the entire comparable period. The current forecast of the annual rate of regulated prices has been revised upwards until the second quarter of 2023 and downward towards the end of the comparable period. The forecast for the annual rate of fuel prices has been increased over the entire comparable period.

1. Third quarter 2022 – second quarter 2024.
2. Inflation Report, May 2022.
3. Third quarter 2022 – first quarter 2024.

See also

Tags
Rata anuală a inflației [2]
core inflation [3]

External environment [4]

inflation forecast [5]

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