



National
Bank of Moldova



Inflation Report

No. 4, NOVEMBER 2021

*National Bank of Moldova
1 Grigore Vieru Avenue
MD-2005, Chişinău
Tel.: (373 22) 822 606
Fax: (373 22) 220 591*

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Note

The report was elaborated based on the latest macroeconomic information from the internal and external environment.

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy, Ministry of Finance,

Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

State Hydrometeorological Service.

Likewise were selected certain statistical data provided by the international community and by the Central Banks of the neighboring states.

The calculation of the statistical data was carried out by the National Bank of Moldova.

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Pursuant to the provisions of art. 4 para. (1) of Law no. 548/1995 on the National Bank of Moldova (republished in the Official Gazette of the Republic of Moldova, 2015, no. 297-300, art. 544, with subsequent amendments) the fundamental objective of the National Bank of Moldova is to ensure and maintain price stability.

This objective is achieved in the light of the monetary policy framework associated with the direct inflation targeting regime. The quantitative target is to maintain inflation, measured by the consumer price index at 5.0% per year with a possible deviation of ± 1.5 percentage points.

*National Bank of Moldova appreciates the role of transparency and predictability of monetary policy in strengthening institutional credibility and ensuring inflation target. In this context, the **Inflation Report** is the main communication tool, which reflects the latest analyzes of the situation in the internal and external environment, the evolution of the inflation process and economic activity, along with aspects related to the conduct of monetary policy.*

At the same time, the Report incorporates the inflation forecast for the eight-quarter horizon, as well as the risks and uncertainties associated with this projection.

Summaries of the minutes of the meetings of the NBM Executive Board on the promotion of monetary policy are part of the Report, which are published six months after the decision in accordance with the NBM's medium-term monetary policy strategy (approved by the Decision of the Executive Board of the National Bank of Moldova no. 303 of December 27, 2012).

According to art. 69 para. (2) the Inflation Report shall be submitted to Parliament and the Government within 45 days of the end of the quarter.

The Inflation Report no. 4, November 2021 was discussed and approved at the meeting of the NBM Executive Board on October 29, 2021.

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List of acronyms

ANRE	National Agency for Energy Regulation
ASP	Public Services Agency
CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CPI	Consumer Price Index
ECB	European Central Bank
EUR	Single European Currency
FAO	Food and Agriculture Organization of the United Nations
FCC	Freely convertible currency
FRS	Federal Reserve System
GDP	Gross Domestic Product
HoReCa	Hotel, Restaurant and Catering
IMF	International Monetary Fund
LB	Local budgets
MDL	Moldovan leu
MHIF	Mandatory health insurance fund
NBC	Certificates issued by the National Bank of Moldova
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
OPEC	Organization of the Petroleum Exporting Countries
OPEC+	OPEC cooperation with oil producers outside OPEC in an attempt to reduce production and increase the price of oil
PMI	Purchasing Manager's Index
REER	Real effective exchange rate of the national currency
RUB	Russian ruble
SB	State budget
SDR	Special drawing rights
SS	State Securities
SSIB	State social insurance budget
TTF	Title Transfer Facility
USA	United States of America
USD	US Dollar
WTI	West Texas Intermediate

Summary

In the third quarter of 2021, the annual inflation rate continued, at a faster pace than expected (Inflation Report no. 3, 2021), the upward trajectory started in the first part of the current year. Thus, it increased from 3.2% in June 2021 to 6.7% in September 2021. As a result, it was above the upper limit of 5.0% ± 1.5 percentage points. At the same time, the average annual inflation rate in the third quarter of 2021 was 4.9%, 1.9 percentage points higher than in the previous quarter. During the reference period, inflationary pressures were determined by the increased impact of demand in the context of increasing disposable income of the population. At the same time, the acceleration of price growth during this period was also determined by the increase in prices for food, oil and other raw materials on the international market, which was partially reflected in the increase in prices of these products on the local market. A certain impact was determined by the adjustment of tariffs related to regulated prices. Inflationary pressures associated with the above-mentioned factors have been partially mitigated by the dynamics of the exchange rate, as well as by a good harvest this year, which has supported the fall in fruit and vegetable prices on the local market. In the next period, the upward trajectory of the annual CPI rate will continue, both as a result of demand pressures and in the context of cost pressures. In this sense, the dynamics of prices in the industry outlined a pronounced upward trajectory in the first 9 months of this year. At the same time, the subsequent dynamics of the CPI remains marked by the uncertainty of the timing and magnitude of some tariff adjustments in the context of the sharp rise in energy prices in the regional market, but also by the impact of weather conditions on domestic food prices.

In recent months, the world economy has continued to recover combined with the significant increase in commodity and food prices. If at the beginning of the year the increase in pro-inflationary pressures was seen as a temporary effect, currently most monetary authorities and even the IMF in the new report warned of their intensification and the need for measures to counteract the negative effects. In October, the price of Brent brand oil exceeded 85 USD/barrel, after OPEC+ continued to carry out the initial increase plan by only 400 thousand barrels per day each month, which does not cover world demand. The gas crisis in Europe has led to several times an increase in spot prices for natural gas, causing a real collapse in the energy sector. By correlation, most metal and coal quotations also rose sharply. Against the background of low supply and significantly higher production costs, there is a reduction in production activity in China and other emerging economies. Several economic experts warn that the gap between growth in advanced and emerging economies is at an all-time low.

At the same time, while in the first part of the year, most emerging economies began to reduce the stimulus and subsequently tighten monetary conditions, today the advanced economies have adopted a similar behavior. The Federal Reserve System (FRS) informed that the reduction of the monetary stimulus will most likely be announced at the November meeting, and the financial market anticipated that at the end of 2022 – beginning of 2023 the FRS interest rate range will be increased. The international financial market now expects the European Central Bank and the Bank of Japan to announce similar monetary policy measures in the near future.

As for the pandemic crisis, currently, in Southeast Europe, but also in other parts of the globe, there is a wave four, which has caused new restrictions and reduced economic activity.

The dynamics of economic activity accelerated considerably in the second quarter of 2021 after the modest evolution at the beginning of this year, in the context of significant growth in domestic demand, positive economic dynamics in the region, but also the effect of the reduced base period of the previous year due to COVID-19 restrictions. Thus, in the second quarter of 2021 GDP was 21.5% higher than the level of the same period of 2020, the respective dynamics being much higher than anticipated in the Inflation Report no. 3, 2021. At the same time, the evolution of the reference period determined the recovery and even the exceeding of the level of economic activity until the pandemic. At the same time, the seasonally adjusted series reflects a 7.0% increase in GDP compared to the first quarter of 2021. Thus, according to estimates, the effect of aggregate demand on prices was positive. The positive dynamics of GDP was mainly determined by the increase in investment

and consumption of the population. Net exports generated a significant negative impact. On the supply side, positive developments were recorded in all sectors of the economy, with the exception of agriculture. The pronounced growth of economic activity was partially reflected in the dynamics of labor market indicators. Thus, in the second quarter of 2021, both the economically active and the employed population registered an increase compared to the similar period of the previous year. At the same time, the unemployment rate, as well as the underemployment rate registered a downward dynamics. Most of the available operational indicators from July and August 2021 continued to show positive developments, but of a lower intensity compared to those of the second quarter of 2021, thus outlining prospects for a pronounced positive dynamics of GDP in the third quarter of 2021, but of a lower magnitude.

In the third quarter of 2021, the revenues of the national public budget recorded increases, being 22.7% above the level recorded in the similar period of 2020. Expenditures of the national public budget increased, being 3.8% above the level recorded in July-September of 2020. At the same time, on the allotted state securities market, during the third quarter of 2021, interest rates registered minor increases.

In the third quarter of 2021, excessive liquidity amounted to 4.3 billion lei, decreasing compared to the previous quarter by 1.2 billion lei.

Monetary aggregates in the third quarter of 2021 registered a positive dynamic in annual terms. 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.

During the third quarter of 2021, two meetings of the Executive Committee of the National Bank of Moldova on monetary policy decisions took place. 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, at its meetings of July 30, 2021 and September 3, 2021, decided to increase the base rate applied to major monetary policy operations by 1.0 percentage point each. Thus, the base rate rose from 2.65% annually to 4.65% annually.

The average interest rates on the balance on loans in national currency decreased by 0.23 percentage points compared to the previous quarter, and on deposits decreased by 0.11 percentage points. Average interest rates on loans and foreign currency deposits also continued their downward trend.

Taking into account the recent evolution of international quotations, the external hypotheses from the forecast round related to the Inflation Report no. 4, 2021 are significantly pro-inflationary. Compared to the previous forecast round, all external variables were increased in the direction of a stronger external economic growth, the increase of external prices above the levels targeted by the monetary authorities, the US dollar and the more appreciated Russian ruble, as well as the considerable increase in international quotations on energy resources and food.

The annual inflation rate will increase rapidly until the third quarter of 2022, then decline rapidly until the end of the forecast horizon¹. Starting with the first quarter of the forecast, the annual inflation rate will be above the upper limit of the variation interval and will return in the interval only in the second quarter of 2023.

The annual rate of *core inflation* will have an upward trend until the first half of next year, after which it will decrease rapidly towards the end of the forecast period². The annual pace of *food prices* will increase significantly by the third quarter of 2022, but, starting with the end of 2022, will decrease significantly by the end of the forecast period. The annual rate of *regulated prices* will increase sharply until the end of next year, after which it will remain at a high level. The annual rate of *fuel prices* will increase in the first quarter of the forecast horizon, but, starting in 2022, it will decrease considerably for the rest of the forecast period.

Aggregate demand will increase positively and will show a strong pro-inflationary character in the first quarter of the forecast, after which it will decrease continuously, but it will be pro-inflationary and in the first half of next year, later it will become disinflationary. This trajectory will be largely supported by a

¹Quarter III 2023.

²Quarter IV 2021 – quarter III 2023.

Summary

positive fiscal momentum in the current year, the revival of external demand and the current economic recovery, but will be mitigated by restrictive monetary conditions.

Actual monetary conditions will be restrictive over the entire forecast period, with a negative impact on aggregate demand.

The current *inflation forecast*, compared to the previous inflation report, has been revised significantly upwards over the entire comparable period³. The current forecast for the annual rate of *core inflation* has increased over the entire comparable period, except for the last quarter. The annual rate of *food prices* was revised upwards for the comparable period. The current forecast of the annual rate of *regulated prices* has been revised significantly upwards for the comparable period. The forecast for the annual rate of *fuel prices* was increased for the entire comparable period, except for the last quarter.

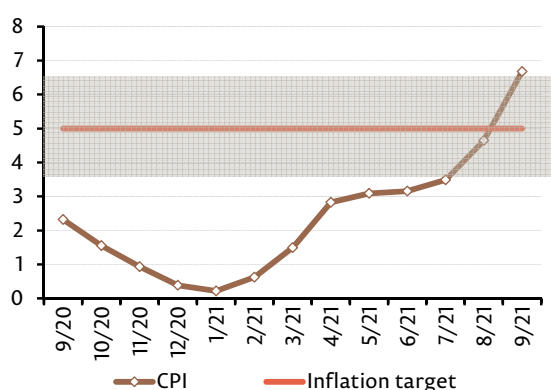
³Quarter IV 2021 – quarter II 2023.

Chapter 1

Inflation development

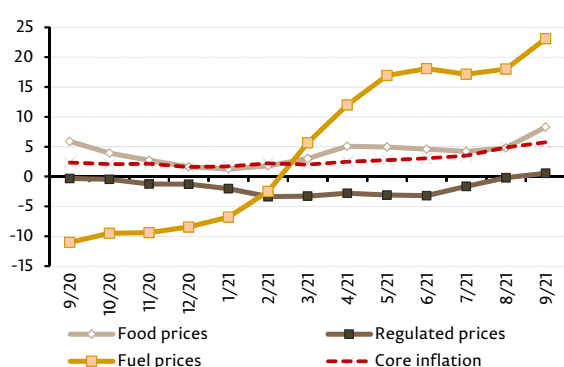
1.1 Consumer price index

Chart 1.1: The annual rate of the CPI (%)



Source: NBS, NBM

Chart 1.2: The annual rate of the main subcomponents of the CPI (%)



Source: NBS

In the third quarter of 2021, the annual inflation rate continued, at a faster pace than expected (Inflation Report no. 3, 2021), the upward trajectory started in the first half of this year, mainly, due to the intensification of demand pressures, supported by the increase in disposable income, but also as a result of rising prices for food, oil and other raw materials on the international market, which led to increased costs on some subcomponents of the CPI. In September 2021, the annual inflation rate exceeded the upper limit of the inflation target range. Between July and September 2021, the annual inflation rate continued, however, at a more pronounced pace, with the upward trend observed in the first half of the year. Thus, it increased from 3.2% in June 2021 to 6.7% in September 2021. As a result, it was above the upper limit of 5.0% \pm 1.5 percentage points. At the same time, the average annual inflation rate in the third quarter of 2021 was 4.9%, 1.9 percentage points higher than in the previous quarter. The acceleration of prices in the above-mentioned period was determined by the increase in prices for food, oil and other raw materials on the international market, which was partially reflected in the increase in prices of these products on the local market. At the same time, rising inflation has been supported by shaping demand pressures in the context of increasing disposable income. A certain impact was determined by the adjustment of tariffs related to regulated prices. Inflationary pressures associated with the above-mentioned factors were partially mitigated by the dynamics of the exchange rate, as well as by the good harvest this year, which supported the decrease in fruit and vegetable prices on the local market.

In the next period, the upward trajectory of the annual rate of CPI will continue, mainly in the context of the persistence of demand pressures, but also of the increase in food and energy prices on the regional market. At the same time, the subsequent dynamics of the CPI remains marked by the uncertainty of the timing and magnitude of some tariff adjustments in the context of the sharp rise in energy prices in the regional market, but also by the impact of weather conditions on domestic food prices.

Core inflation

In the third quarter of 2021, core inflation continued the upward trajectory started at the beginning of the current year, registering an average level of 4.7% or 1.9 percentage points higher than in the previous quarter.

The inflationary path was marked mainly by the increase in prices for "clothing", "construction materials", "means of transport, car parts", "recreation and culture". Also on the furniture segment we can see a significant increase in prices (Chart 1.4). Thus, in September 2021, in the annual dynamics of core inflation (5.7%) upward developments were recorded by all groups of goods, the most significant being recorded in "building materials" (19.5%), "furniture" (13.1%), "recreation and culture" (8.4%).

On the side of the fundamental factors, influences from the recovery of the final consumption of the population were highlighted. The positive dynamics of the salary fund for both the real and the budgetary sector, associated with the rapid rise in lending, especially of individuals, granting new loans for consumption and real estate, generated a positive impact on aggregate demand, leading to pressure inflationary components of core inflation.

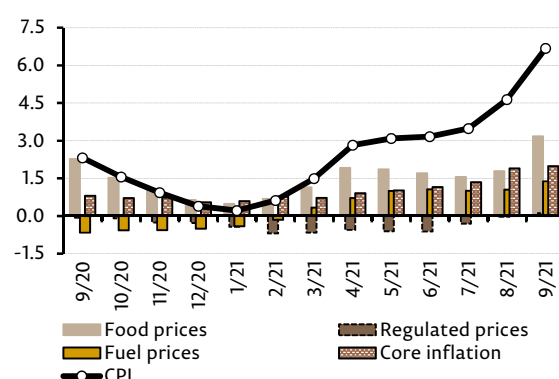
At the same time, core inflation continued to receive persistent cost pressures. Clothing and footwear have become significantly more expensive. The increase in raw material prices on international markets has led to higher prices for goods produced or imported into our country. At the same time, the persistent shortage of containers around the world has increased the cost of supplying goods from China. The significant increase in prices for construction materials recorded in recent months reflects the avalanche of their price increases internationally, with the recovery of savings amid the easing of restrictive measures related to COVID-19.

The means of transport show an increased volatility towards the exchange rate dynamics. Much of the positions monitored in this category of NBS depend on the MDL/USD and MDL/EUR quotes. Thus, the appreciation of the national currency, especially against the single European currency (by 2.2%), mitigated the inflationary course of their annual rate.

In order to comply with the legal norms regarding the security measures, the accommodation capacity of the tourist units remained limited, the price of the packages of domestic and international tourist services increasing considerably. In addition, inflationary pressures specific to the management of the health crisis (costs of sanitary materials, disinfectants, etc.), felt more acutely in the areas of activity most exposed to direct human contact (referring to the services included in core inflation, is about cultural and recreational services, the sector HoReCa).

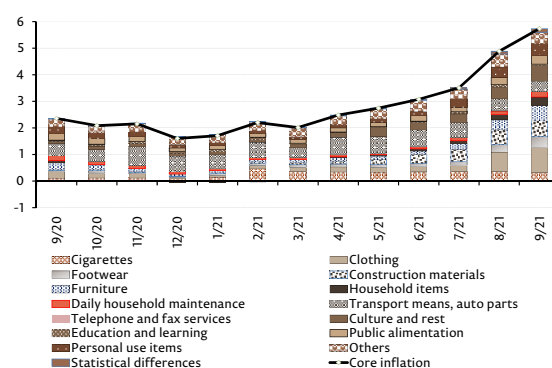
The price for the manufacture of furniture continues to be affected by the explosion of prices for the basic raw material. Global trends in the timber market are also reflected in the Moldovan market, which is largely dependent on imports from Ukraine, Belarus and Russia.

Chart 1.3: The evolution of the annual inflation (%) and subcomponents contribution (percentage points)



Source: NBS, NBM calculation

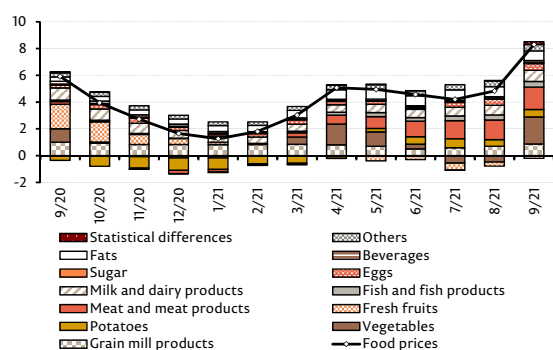
Chart 1.4: The contribution of subcomponents (percentage points) to the annual dynamics of core inflation (%)



Source: NBS, NBM calculations

Food prices

Chart 1.5: The contribution of components (percentage points) to the annual dynamics of food prices (%)



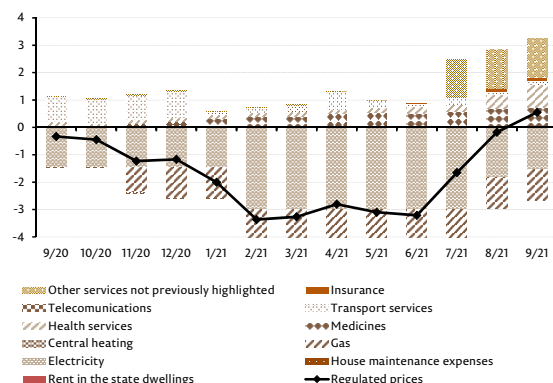
Source: NBS, NBM calculations

During the third quarter of 2021 there was an acceleration of the annual rate of food prices. Thus, it stood at a level of 8.3% in September 2021 or 3.7 percentage points higher than in June 2021. It should be mentioned that, during the summer months, the annual rate of food prices registered a relatively stable trajectory, determined by the rich agricultural harvest of the current year, and with the substitution of some local products with the imported ones, we witnessed a pronounced correction of prices and as a result, a significant acceleration of the annual rate of food prices. In the structure, the record of an upward trajectory of the annual rate of food prices in the third quarter of 2021 was largely determined by the acceleration of price growth rates in the groups "vegetables", "potatoes", "meat and meat products", "grain mill products" and "eggs" (Chart 1.5). Thus, the sharp rise in international food prices, energy prices by overlapping with a revival of aggregate demand at local/regional level creates major inflationary pressures on food prices traded on the local market (pressures fed both costs as well as demand).

In the international market, the annual rate of food prices continues to record high growth rates, thus generating pronounced inflationary pressures on the domestic market as well. In the third quarter of 2021, their annual rate recorded an average level of 33.1%, being 2.5 percentage points lower than in the second quarter of 2021 and about 25.3 percentage points higher than the level at the end of 2020.

In the third quarter of 2021, the contribution of food prices to the formation of the annual inflation rate increased by 0.3 percentage points to 2.1 percentage points.

Chart 1.6: The contribution of components (percentage points) to the annual dynamics of regulated prices (%)



Source: NBS, NBM calculations

Regulated prices

The annual rate of prices for regulated goods and services showed an upward trend in the third quarter of 2021, after a relatively stable period. Thus, the annual rate of regulated prices was 0.6% in September 2021, being 3.8 percentage points higher than in June 2021. At the same time, the average annual rate of regulated prices in the third quarter of 2021 was -0.4%, being 2.6 percentage points higher than in the second quarter of 2021. That dynamic was mainly determined by the increase of administrative fees (the subcomponent of other services not highlighted above) by 196.6%. This increase was determined by the increase by ASP of the tax for the registration of the marital status, the completion of the identity card and the passport.

At the same time, there was a significant impact during the quarter due to the increase in tariffs for medical services and prices for medicines. Also, between July and September 2021, there were increases in fares for air passenger transport services, ritual services, transport insurance and accommodation services provided by other units.

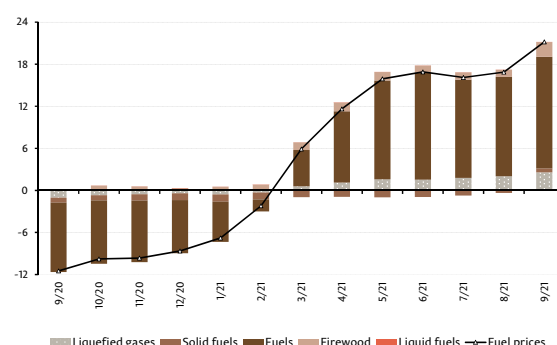
Within the annual rate of regulated prices a significant negative impact in the third quarter of 2021 continued to be exerted by the adjustment of the electricity tariff of January 26, 2021⁴ and grid gas from October 28, 2020⁵.

Fuel prices

The annual rate of fuel and petrol prices became more pronounced in the third quarter of 2021, in the context of rising oil prices and in the period July-September 2021. Thus, the annual rate of prices for fuels and petrol increased from 18.1% in June 2021 to 23.1% in September 2021 under the influence of rising prices for "fuels" and "liquefied gases". The average annual rate of fuel and fuel prices in the third quarter of 2021 was 19.4%, 3.8 percentage points higher than in the second quarter of 2021 (Chart 1.7). This development was mainly due to the increase in "fuel" prices as a result of the increase in petrol and diesel prices made by the CEEC stations during that quarter, supported by the increase in international oil prices in the third quarter of 2021 (by 6.0%). It should be noted that, on June 14, 2021, during the public meeting, ANRE approved the Methodology for calculating and applying prices to petroleum products (in force since July 1, 2021)⁶. That methodology sets out: how to calculate the maximum retail prices of petroleum products; the method of determining the maximum wholesale prices of petroleum products; the method of establishing by ANRE the margin on the marketing of petroleum products; how licensees apply retail and wholesale prices for petroleum products. At the same time, on September 1, 2021, a round of consultations was organized and the Decision on amending some provisions of the Decision of the Board of Directors of ANRE no. 254 of 14.06.2021⁷. As a result, as in previous years, wholesale prices become free, as do liquefied gas retail prices. At the same time, ANRE will publish daily only the maximum retail prices of the main petroleum products of standard type – COR 95 petrol and diesel, without the trade name.

During the third quarter of 2021, prices for "liquefied gases" and "wood, brushwood, etc." have had a positive impact on the annual rate of fuel and fuel prices. **Over the next period, fuel and fuel prices will continue to rise, largely to reflect the pressures exerted by previous oil price dynamics.**

Chart 1.7: The contribution of components (percentage points) to the annual increase in fuel prices (%)



Source: NBS, NBM calculations

⁴<http://www.anre.md/anre-a-aprobat-micsorarea-preturilor-pentru-energie-electrica-3-214>

⁵<http://www.anre.md/anre-a-aprobat-preturile-reglementate-pentru-furnizarea-gazelor-naturale-de-catre-sa-moldovagaz-in-contextul-obligatiei-de-serviciu-public-3-190>

⁶<https://www.anre.md/anre-a-aprobat-metodologia-de-calcul-si-aplicare-a-preturilor-la-produsele-petroliere-3-273>

⁷<https://www.anre.md/noi-modificari-la-procedura-de-stabilire-a-preturilor-la-produsele-petroliere-3-309>

1.2 Inflation evolution and short-term forecast assessment from the Inflation Report no. 3, 2021

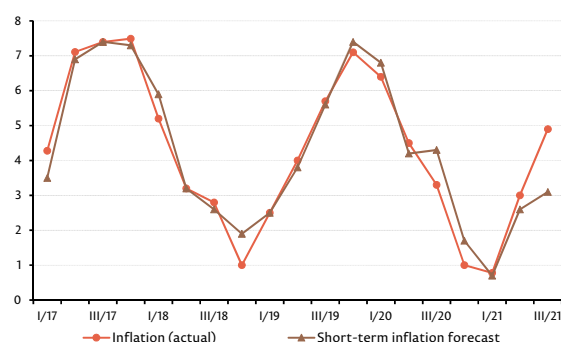
Table 1.1: The evolution and forecast of CPI and its components

	De facto	Forecast	Deviation
	Q III, 2021/ Q III, 2020 (%)	IR 3, 2021* Q III, 2021/ Q III, 2020 (%)	(De facto- forecast) (p.p.)
CPI	4.93	3.10	1.83
Core inflation	4.71	4.00	0.71
Food prices	5.77	2.30	3.47
Regulated prices	-0.42	-2.30	1.88
Fuel prices	19.41	19.80	-0.39

Source: NBS, NBM calculations

*IR 3, 2021 – Inflation Report no. 3, 2021

Chart 1.8: Evolution and short-term forecast of the CPI (% , compared to the previous year)



Source: NBS, NBM forecast

In the forecast round for July 2021, the continuation of the upward trajectory of the annual inflation rate and the registration of an average value of 3.1% in the third quarter of 2021 was anticipated⁸. Inflation data for the period July-September 2021 outline a higher trajectory than anticipated in the previous round of forecasts.

In the third quarter of 2021, the annual inflation rate was 1.8 percentage points above the forecast level (Table 1.1). That deviation was mainly determined by the food price forecast. Thus, their annual rate was 3.5 percentage points higher than the anticipated value for the third quarter of 2021 in the previous round of forecasts. This deviation may be associated with growing demand from sustained demand driven by rising disposable income as well as higher-than-expected growth in international food prices⁹. In this way, the price index for international food products increased by about 2.2% in July-September 2021 compared to the previous quarter, and one of the hypotheses considered in preparing the forecast in the Inflation Report no. 3, 2021 was its decrease by about 3% in the third quarter of 2021 compared to the second quarter of 2021. Therefore, the actual data show a change in the trend of international food prices and more pronounced pro-inflationary pressures for domestic food prices. At the same time, the fall in prices for locally produced fruit and vegetables anticipated as a result of favorable conditions this year was less significant than projected. At the same time, a positive deviation was registered for the forecast of regulated prices. Thus, their annual rate was 1.9 percentage points higher than expected for the third quarter of 2021. The deviation was due to the unforeseen increase in administrative fees (marriage registration, passport and identity card) in July, the increase in transport insurance tariffs from August 2021 and the tariffs for medical services during the reference period. There was also a positive deviation for the core inflation forecast in the context of more pronounced inflationary pressures due to both rising costs and demand as disposable income and credit increased. In this sense, the data published after the forecast round related to the Inflation Report no. 3, 2021 of the NBS on earnings shows an increase of about 25% of the remuneration fund in the second quarter of 2021 compared to the similar period of the previous

⁸Given the higher volatility of monthly values, but also some possible measurement errors, which normally should not influence monetary policy decisions, the short-term inflation forecast is made on a quarterly basis. This value is an input of the medium-term inflation projection, which similarly has a quarterly frequency and is the basis for monetary policy decisions. At the same time, this is communicated in the inflation reports. However, the actual monthly CPI data, as published by the NBS during the quarter, are analyzed and compared with the short-term forecast for the whole quarter to assess whether the main anticipated assumptions are confirmed or whether there is a risk of pronounced deviations from the forecast. Therefore, deviations between the actual data available for the months of the quarter and the short-term forecast of inflation must be interpreted accordingly, taking into account the assumptions / expectations for the remaining months of the quarter.

⁹FAO index, <http://www.fao.org/worldfoodsituation/foodpricesindex/en/>

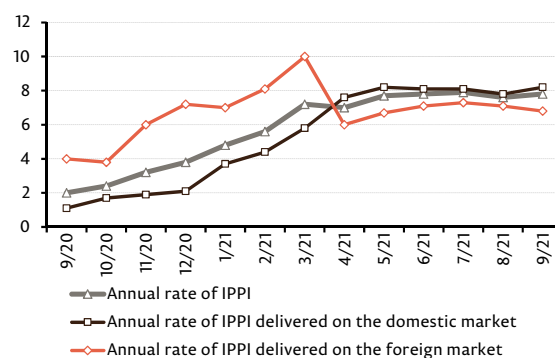
year. In this context, the annual rate of core inflation was 0.7 percentage points higher than the 4.0% expected for the reference period. The above-mentioned positive deviations were marginally offset by a negative deviation for the fuel price forecast. Their annual rate in the third quarter of 2021 was 0.4 percentage points lower than expected, a deviation supported by a lower exchange rate than expected (18.10 MDL/USD anticipated in the Inflation Report no. 3, 2021 compared to 17.80 MDL/USD in the third quarter of 2021) and a lower level of oil prices in the reference period than anticipated (73.4 USD/barrel anticipated in Inflation Report no. 3, 2021 compared to 70.88 USD/barrel in the third quarter of 2021). At the same time, the forecast and the actual dynamics of fuel prices were marked by the uncertainty related to the new methodology for setting fuel prices.

1.3 Industrial production prices

In the third quarter of 2021, the annual rate of prices in industry recorded an average level of 7.8% or 0.3 percentage points higher than in the second quarter of 2021. In terms of structure, the annual rate of prices for products delivered on the external market had an upward trajectory, and that of prices for products delivered on the domestic market recorded a relatively stable level (Chart 1.9).

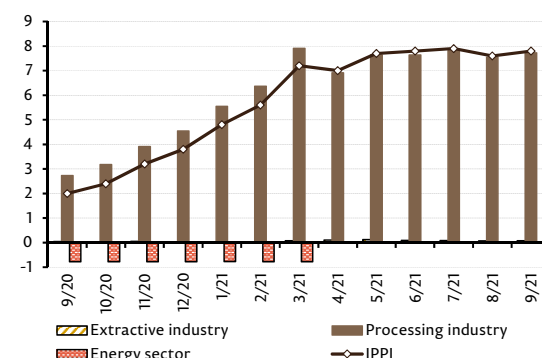
Analyzing the evolution of the annual rate of prices in industry by main branches, it is clear that, similar to previous periods, the major contribution to the formation of the annual rate is made by the manufacturing industry (Chart 1.10). Thus, the annual rate of prices in the manufacturing industry increased by 0.4 percentage points to the level of 8.5% in the third quarter of 2021. The upward trend in the annual rate of prices in the manufacturing industry was largely due to rising prices in "textile production", "beverage manufacturing", "rubber and plastics" production, and in some classified as "others". It should be noted that, after a period of five consecutive quarters in which prices in the food industry have been constantly rising, in the third quarter of 2021 there is a slowdown in the annual growth rate, against the background of declining inflationary pressures from the sectors "manufacture of vegetable and animal oils and fats" and "processing and preservation of fruit and vegetables". At the same time, prices in the extractive industry increased by 4.0%, generating a contribution of 0.1 percentage points to the dynamics of prices in the industry. In the third quarter of 2021 the annual rate of prices in the energy sector recorded an average level of -0.2%, generating a tiny contribution to the dynamics of the annual rate of prices in industry.

Chart 1.9: Annual rate of prices in industry (%)



Source: NBS

Chart 1.10: Annual rate of prices in industry (%) and the contribution of its components classified by main branches (percentage points)



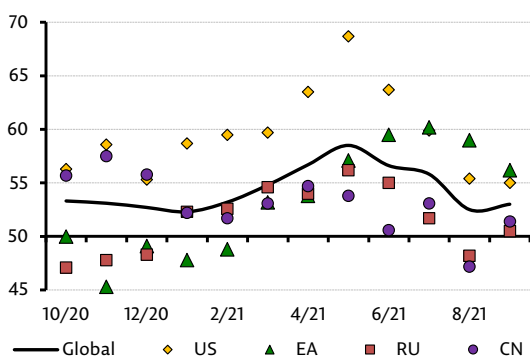
Source: NBS, NBM calculations

Chapter 2

External environment

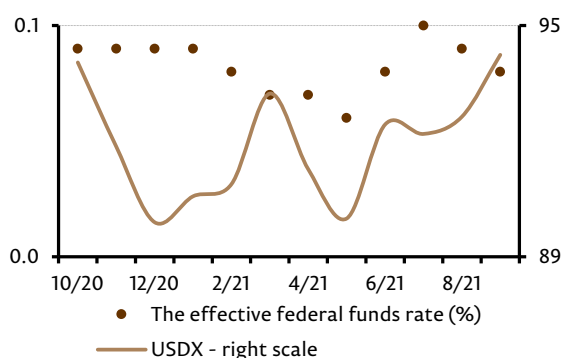
2.1 World economy, financial and commodity markets

Chart 2.1: Evolution of PMI indices



Source: Markit

Chart 2.2: Evolution of the USD index (DXY)* in the context of FRS monetary policy



Source: FRS, Bloomberg

* DXY is an index calculated by the weighted geometric mean of the value of the US dollar against a basket of foreign currencies: euro – 57.6%, Japanese yen – 13.6%, pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%

In recent months the world economy has continued the economic recovery combined with the significant increase in the quotations of raw materials and food. If at the beginning of the year the increase in pro-inflationary pressures was seen as a temporary effect, currently most monetary authorities and even the IMF in the new report warned of their intensification and the need for measures to counteract the negative effects. In October, Brent brand oil exceeded 85 USD/barrel after OPEC+ agreed to follow the initial plan to increase production by only 400,000 barrels per day each month, which does not cover global demand. The natural gas crisis in Europe has led to several times an increase in spot prices for natural gas, causing a real collapse in the energy sector. By correlation, most quotations for metals and coal have also skyrocketed. Against the background of low supply and high production costs, in China and other emerging economies there is a reduction in production activity. Several economic experts warn that the gap between growth in advanced and emerging economies is at an all-time low.

At the same time, if in the first part of the year most emerging economies began to reduce the stimulus and, later, the tightening of monetary conditions, now the advanced economies have adopted a similar behavior. The Federal Reserve announced that the reduction in the monetary stimulus will most likely be announced at the November meeting, and the financial market anticipated that at the end of 2022 – the beginning of 2023, the interest rate range will be increased. The international financial market now expects the European Central Bank and the Bank of Japan to announce similar monetary policy measures in the near future.

As for the pandemic crisis, currently, in Southeast Europe, but also in other parts of the globe, the fourth wave started, which has caused new restrictions and reduced economic activity.

The PMI indices have decreased significantly compared to the beginning of the year, but at the composite level they remain above 50, which indicates the continuation of economic growth. At the same time, there is a significant decrease in the production sector in emerging economies due to the energy crisis, the low supply of raw materials and the increase in production costs. For example, since June 2021, the PMI index in the production sector in Russia has been below 50, and since August 2021 similarly in China.

Recently, more and more economic experts are warning that the gap between growth in advanced and emerging economies is at the lowest level ever recorded (Chart 2.1).

Thus, for the current year, the IMF¹⁰ anticipates that the world economy will grow by an average of 5.9% and 4.9% in 2022. Advanced economies will grow significantly by 5.2% in 2021 and by 4.5% in 2022. At the same time, emerging and developing economies will advance by 6.4% this year and by 5.1% in 2022.

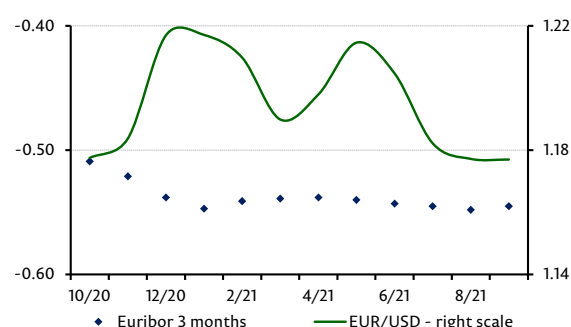
The USD index rose to an average of 94.24 in September 2021. The appreciation of the **US dollar** is due to the intention of the Federal Reserve System to reduce monetary stimulus amid rising energy prices and pro-inflationary pressures as a whole. The annual inflation level in the US in September 2021 was 5.4%, for the 7th consecutive month outside the average target of 2.0%. Another factor in the appreciation of the US dollar was the increase in the risk premium due to the fourth wave of the COVID-19 pandemic. At the same time, weak US employment reports have periodically led to a depreciation of the US dollar. US consumer sentiment has recently fallen to its lowest level in a decade, with Americans making uncertain forecasts on everything from personal finance to inflation and employment (Chart 2.2).

In the third quarter of 2021, the average parity of **EUR/USD** was 1.1788, down by 2.2% (against the US dollar) compared to the previous quarter. As mentioned in the previous paragraph, the US dollar has appreciated in recent weeks. Unlike major central banks, including the Fed and the Bank of England, the European Central Bank has given little indication that it is ready to reduce its bond-buying program soon. The level of annual inflation in the euro area in September 2021 was 3.4%. This reduces the attractiveness of the euro, which had one of the weakest performances of the main currencies in the last period (Chart 2.3).

In the third quarter of 2021, **the Russian ruble** traded at an average of 73.5 against the US dollar, representing an average quarterly appreciation of 1.0%. The appreciation of the Russian ruble since September 2021 is largely due to rising oil and gas prices. The spot price of gas in Europe has reached an all-time high (USD 1,000 per 1,000 m³), causing a collapse in the global energy sector. At the same time, the Bank of Russia continued to tighten monetary policy, increasing the base rate in July, September and October 2021 by 100, 25 and 75 basis points, respectively, to the current level of 7.5%. Against the backdrop of rising annual inflation to 7.4% in September 2021, the Bank of Russia will continue to tighten monetary policy (Chart 2.4).

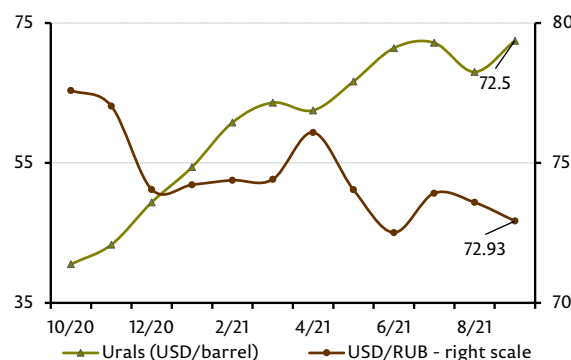
Starting with July 2021, **oil prices** had a mixed evolution, decreasing significantly in August, after which, starting with September, they increased rapidly (Chart 2.4). The decline in oil prices in August 2021 was caused by concern about the rapid spread of the COVID-19 delta variant worldwide. Also, data on production activity in July 2021 in China indicated that at the beginning of the third quarter the country's economy slowed down. At that time, China was facing one of the worst outbreaks of COVID-19 since the beginning of the pandemic, in particular, for the first time in a few months, restrictions were introduced in Beijing, and road traffic fell by 30%. The chart 2.6 shows that in

Chart 2.3: Evolution of EUR/USD (monthly average) and interest rates in the euro area



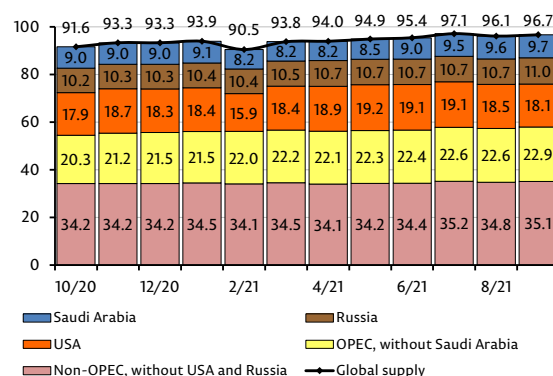
Source: ECB, Eurostat

Chart 2.4: The evolution of USD/RUB under the Urals price development



Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation

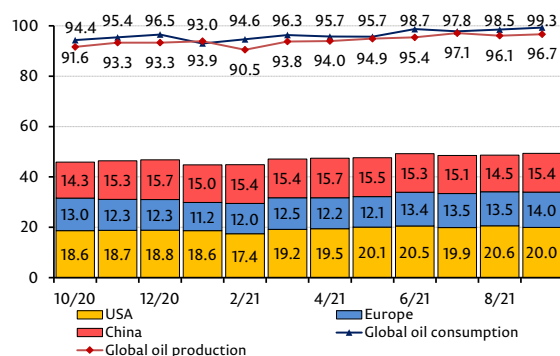
Chart 2.5: World oil supply (millions of barrels per day)



Source: US Energy Information Administration

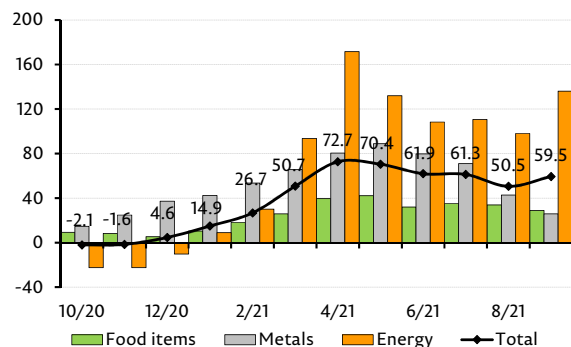
¹⁰IMF World Economic Outlook October 2021

Chart 2.6: World oil consumption (millions of barrels per day)



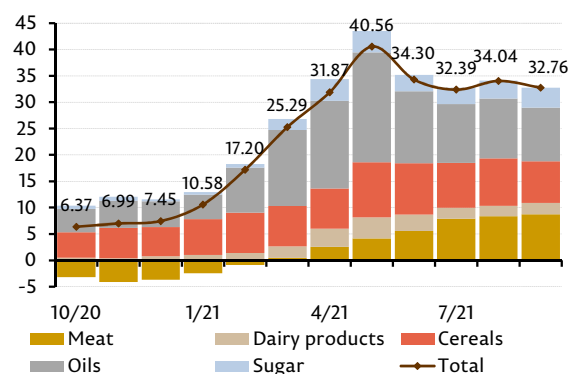
Source: US Energy Information Administration

Chart 2.7: Annual growth rate of world prices (IMF indices) (%)



Source: IMF, NBM calculations

Chart 2.8: Annual growth rate of world food prices (FAO index) (%)



Source: FAO, NBM calculations

August 2021 the demand for oil in China decreased significantly. Since September 2021, the pronounced dynamics of oil have been determined by China's success in the fight against the new wave of COVID-19 (the chart shows that the demand for oil has increased), the rise in Goldman Sachs forecasts (the bank predicts that the price of Brent oil will reach 80 USD/barrel in the fourth quarter), as well as the tropical storm in the Gulf of Mexico. WTI futures contracts rose sharply after Hurricane Ida hit the shores of Louisiana, causing power outages in the US.

In September 2021, the White House called on OPEC and its allies to increase oil production in a bid to counter rising gasoline prices amid fears that rising inflation could undermine the economic recovery after COVID-19. The White House said the group's July agreement to increase production by 400,000 barrels per day monthly from August to 2022 is not enough at a critical time in the global recovery (Chart 2.5). However, the participants in the OPEC+ agreement agreed to follow the established gradual growth plan, the alliance considering that the oil deficit will remain until the end of this year (Chart 2.6), and in 2022 it will turn into an excess supply.

IMF data on **commodity quotations** show that they have continued to grow on a monthly basis, even though the pressure has eased on an annual basis. At the same time, in September, the global commodity index increased by 5.4% in monthly terms and by 59.5% in annual terms (Chart 2.7). Prices for energy resources increased the most, by 136.1% in annual terms, of which the oil index rose by 78.1%, the natural gas index by 354.9% and the coal index by 218.4%. The quotation for Dutch TTF gas increased in September 2021 in monthly terms by 44.2% and annual terms by 471.4%. Base metal prices have fallen in monthly terms since August by 10.7 and 9.8%, respectively, amid the emergence and exacerbation of new outbreaks related to the fourth wave of the COVID-19 pandemic and the decline in production activity. But in annual terms, the base metals index remains by 25.8% higher in September 2021. Even though at the beginning of summer 2021, **food quotes** started to decrease, decreasing from the pressure of the annual growth rates, starting with August 2021, contrary to expectations, the trend was reversed. In September 2021, all product groups included in the **FAO index** increased in both monthly and annual terms (Chart 2.8). The reversal of the trend in the middle of the agricultural season was due to increased demand in terms of limited supply, expectations of a poor harvest in the southern hemisphere and rising prices for energy resources which boosted production and transportation costs.

2.2 The evolution of important economies

In the second quarter of 2021, the gross domestic product of **the United States** increased by 1.6% (in seasonally adjusted terms) compared to the previous quarter and by 12.2% compared to the level of the same period of the previous year. In the first 9 months of 2021, the US industrial production increased by an average of 6.1% compared to the same period in 2020. In September 2021, the unemployment rate in the US fell by 0.4 percentage points to 4.8%. Annual inflation in the US accelerated to 5.4% in September

2021, being for 7 consecutive months above the target level of 2.0%.

The acceleration of economic activity in the second quarter of 2021 led to gross domestic product in the **euro area** increase by 2.2% (in seasonally adjusted terms) compared to the first quarter of 2021 and by 14.3% compared to the second quarter of 2020. In the first 8 months of 2021, industrial production in the euro area increased by 10.5% compared to the same period last year, of which in Germany by 6.8%, France by 9.3% and Italy by 15.1%. The latest published data show that in August 2021 the unemployment rate in the euro area fell to 7.5%, and the harmonized index of consumer prices in September 2021 increased by 0.5% over the previous month and by 3.4% compared to September 2020. The fact that annual inflation remains above the 2.0% target set by the ECB in the context of the energy crisis leads market participants to expect a gradual cessation of the monetary stimulus related to COVID-19.

2.3 Evolution of neighboring economies and main trading partners

In the second quarter of 2021, the gross domestic product of **Romania** increased by 1.8% (in seasonally adjusted terms) compared to the previous quarter, and compared to the similar period of the previous year, on the gross series, it increased by 13.0%. In January-August 2021, industrial production increased compared to the same period of the previous year by 12.7%, on the gross series. In September 2021, consumer prices increased by 0.8% compared to the previous month's price level and by 6.3% compared to the September 2020 price level. As the level of annual inflation exceeded the corridor of 1.5-3.5% targeted by the NBR, on October 6, 2021 the monetary policy rate was increased from 1.25 to 1.5%.

During the reference period, the economy of **the Russian Federation** increased by 3.6% (in seasonally adjusted terms) compared to the previous quarter and by 10.5% compared to the same period of the previous year. Cumulatively, in January-August 2021, industrial production in the Russian Federation increased by 4.5%. Annual inflation was above the level set by the Bank of Russia in November 2020, and in September 2021 reached a significantly high level of 7.4%. Thus, the Bank of Russia continued to tighten monetary policy, increasing the base rate in July, September and October 2021 by 100, 25 and 75 basis points, respectively, to the current level of 7.5%.

Over the same period, the gross domestic product of **Ukraine** increased by 0.8% (in seasonally adjusted terms) compared to the first quarter of 2021 and by 5.4% in annual terms. In the first 8 months of 2021, industrial production increased by 1.7%, production in construction by 1.8% and agriculture by 8.4%. Inflation continued to accelerate in September 2021, with consumer prices rising in Ukraine by 1.2% compared to the previous month and by 11.0% compared to September 2020. Amid rising pro-inflationary pressures, the National Bank of Ukraine increased its base rate 4 times this year, from 6.0 to the current level of 8.5%.

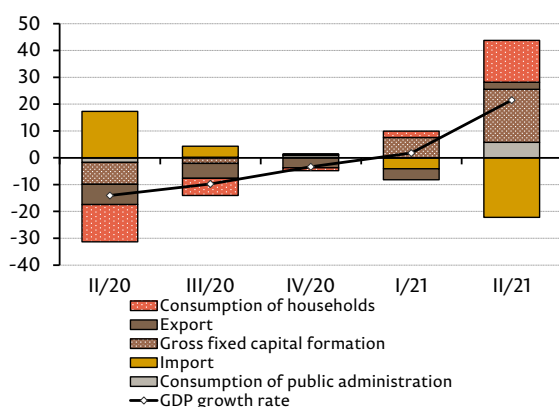
Chapter 3

Economic developments

3.1 Demand

The dynamics of economic activity accelerated considerably in the second quarter of 2021, after the modest evolution at the beginning of this year, in the context of significant growth in domestic demand, positive economic dynamics in the region, but also the effect of the reduced base period of the previous year due to COVID-19 restrictions. Thus, in the second quarter of 2021, GDP was 21.5% higher than in the similar period of 2020, the respective dynamics being significantly higher than anticipated in the Inflation Report no. 3, 2021. At the same time, the evolution in the reference period determined the recovery and even the exceeding of the level of economic activity until the pandemic. At the same time, the seasonally adjusted series reflects a 7.0% increase in GDP compared to the first quarter of 2021. Thus, according to estimates, the effect of aggregate demand on prices was positive. The positive dynamics of GDP was mainly determined by the acceleration of investments and the increase of the population's consumption. Net exports generated a significant negative impact. On the supply side, positive developments were recorded in all sectors of the economy, with the exception of agriculture.

Chart 3.1: The contribution of demand components to GDP growth (percentage points)



Source: NBS, NBM calculations

In the second quarter of 2021, GDP increased by 21.5% compared to the same period last year. Among the factors that supported the respective dynamics of GDP can be mentioned the decrease of interest rates, the increase of lending, the depreciation of the exchange rate, the increase of budgetary expenditures, the increase of the salary fund and the economic recovery in the region, as well as the effect of a reduced base period from the previous year due to COVID-19 restrictions. Although the recovery of economic activity was anticipated in the previous forecast round (Inflation Report no. 3, 2021), it was significantly above the forecast values. At the same time, GDP data show that the level of economic activity up to the pandemic has been exceeded. In this context, the effect of aggregate demand on prices was estimated to be positive in the second quarter of 2021.

From the perspective of uses (Chart 3.1), economic growth was mainly determined by the acceleration of the investment component and the consumption of the population. In this way, the gross capital formation generated a contribution of 19.7 percentage points to the GDP dynamics. Most of it (12.8 percentage points) was attributed to the "change in stocks"

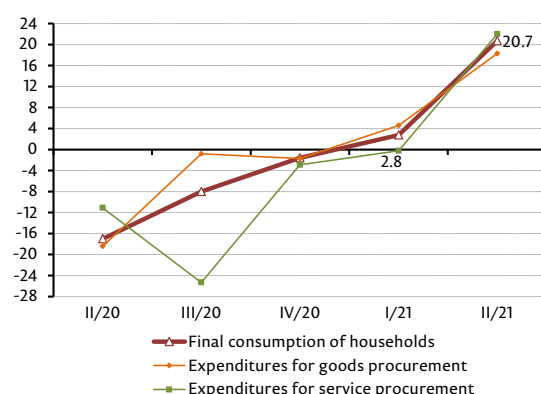
subcomponent, while gross fixed capital formation contributed 6.9 percentage points as a result of its increase of 24.5% compared to with the second quarter of 2020. Relatively low interest rates, but also more optimistic prospects in the second quarter due to the decrease in the number of COVID-19 cases determined the orientation of own funds towards investments in tangible fixed assets. After the relatively modest dynamics at the beginning of this year, in the second quarter of 2021 the consumption of households increased by 20.7% compared to the second quarter of 2020, in the context of increasing disposable income of the population, but also relaxing credit conditions in previous periods. In this way, in the second quarter of 2021 the salary fund continued the positive dynamics pronounced from the previous periods and accelerated to about 25.0%. At the same time, the monetary policy measures of the previous year led to a decrease in credit rates and an increase in lending volumes, which favored both domestic consumption and investment. The gradual relaxation of restrictions, as well as the more optimistic expectations regarding the further evolution of the economy in the context of the decrease in the number of COVID-19 cases in the second quarter of 2021 is another factor that generated the increase in household consumption. After the negative dynamics at the beginning of the year, the consumption of the public administration registered an increase beyond expectations, of 32.1%. Exports of goods and services, amid economic growth in the main trading partner countries, but also with a reduced base effect due to restrictions on COVID-19 in the region, increased by 10.7% in real terms compared to second quarter 2020. The increase in domestic demand was accompanied by an acceleration of imports, which were 52.0% higher than in the same period last year.

Consumer demand of the population

The annual consumption rate of households registered a sharp increase in the second quarter of 2021. Thus, the annual rate of final consumption of households recorded a level of 20.7%, being 17.9 percentage points higher than in the first quarter of 2021. The respective dynamics of population consumption was supported by the increase of expenditures for the purchase of goods by 18.3%. Expenditure on services increased by 22.0% compared to the same period of the previous year (Chart 3.2).

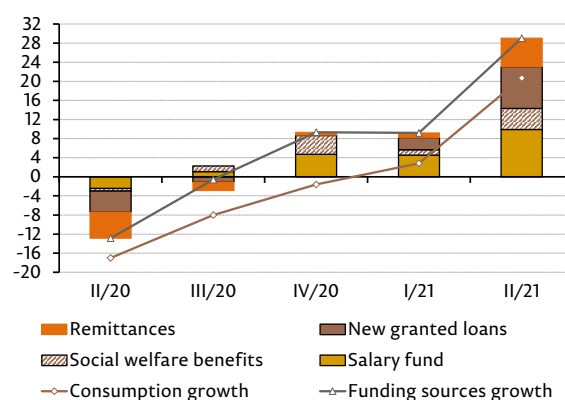
The increase in household consumption was supported by the acceleration of its disposable income. In this way, the possible main sources of financing the population's consumption have outlined a positive dynamic pronounced in the second quarter of 2021 (Chart 3.3). Thus, the salary fund and the new loans granted to the population recorded a pronounced upward dynamics in the first half of the current year, generating significant contributions to the dynamics of the indicator on the disposable income of the population. At the same time, a major positive impact was also determined by the dynamics of remittances and social payments. On the other hand, at the same time, the gradual easing of restrictions with the registration of a relatively small number of COVID-19 infections between April and June 2021 supported the positive dynamics of population consumption.

Chart 3.2: Evolution in real terms of the final consumption of households' (% , compared to the previous year)



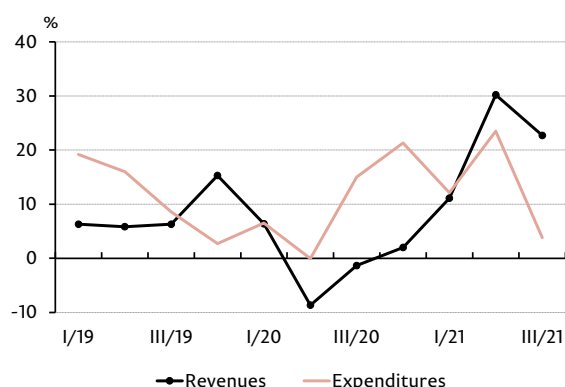
Source: NBS

Chart 3.3: Evolution of the disposable income of the population (% , compared to the previous year) and the contributions of the subcomponents (percentage points)



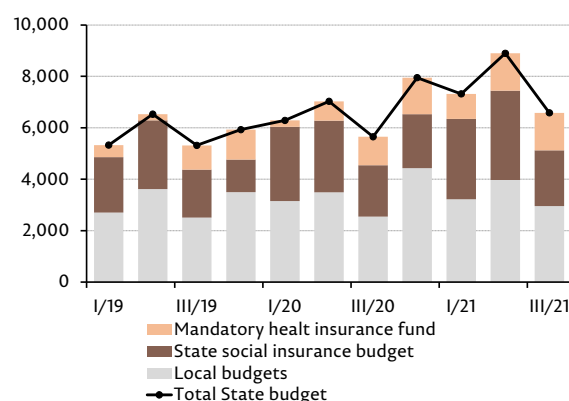
Source: NBS

Chart 3.4: Dynamics of public revenues and expenditures (% , compared to the previous year)



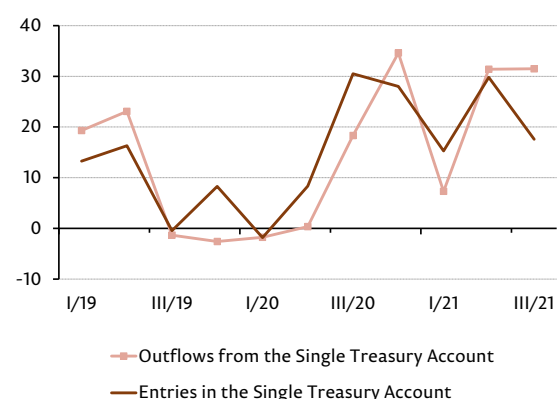
Source: Ministry of Finance

Chart 3.5: Evolution of budget transfers (million lei)



Source: Ministry of Finance

Chart 3.6: Evolution of Single Treasury Account flows (% , compared to the previous year)



Source: NBM

Public sector

According to the data provided by the Ministry of Finance, in the third quarter of 2021, the revenues of the national public budget were accumulated in the amount of 19.1 billion lei, 22.7% more than the revenues accumulated in the same period of 2020 (Chart 3.4). The majority of budget revenues were accrued from taxes and fees, which had a share of 67.9%. Compulsory insurance contributions and premiums accounted for 27.9%, and the share of other revenues and grants accounted for 4.0% and 0.2% of total budget revenues, respectively.

The expenditures of the national public budget, in the third quarter of 2021, totaled 18.1 billion lei, registering an increase of 3.8% compared to the similar period of 2020. Of the total expenditures, the largest share was spent on social protection (37.5%), 17.1% for health care, and 12.9% for education.

It should be noted that in the third quarter of 2021, transfers from the state budget (SB) were made to the state social insurance budget (SSIB), the mandatory health insurance fund (MHIF) and local budgets (LB), amounting to 6.6 billion lei (increasing by 16.5% compared to the same period of 2020 (Chart 3.5). The majority of transfers from the state budget were directed to local budgets, about 44.9% of total transfers, followed by transfers to SSIB, about 33.0%, MHIF benefiting from a more modest funding of 22.2%.

In this context, in the third quarter of 2021, the execution of the national public budget resulted in a surplus of 1.0 billion lei. In the similar period of 2020, the execution of the national public budget resulted in a deficit of 1.9 billion lei. The balances of the accounts of the national public budget as of September 30, 2021 amounted to 8.7 billion lei.

Evolution of the Single Treasury Account

The evolution of movements in the Single Treasury Account (STA), in the third quarter of 2021, was characterized by maintaining the pace of payments at the level of the previous quarter, but increasing compared to the third quarter of 2020 (Chart 3.6). As a result of the evolution of inflows and outflows, the balance of the STA amounted to about 8.0 billion lei on September 30, 2021 and recorded an annual increase of 14.1% (Chart 3.7).

It should be mentioned that, at the end of the third quarter of 2021, the balance of the Government's foreign currency deposit account with the National Bank of Moldova decreased and was equivalent to about 3.3 billion lei, 1.3 billion lei less than at the end of the previous quarter.

State debt

As of September 30, 2021, the balance of the state debt of the Republic of Moldova totaled 72.4 billion lei, compared to GDP¹¹ this amounted to 32.4% (Chart 3.9). In annual terms, government debt increased by 16.3% (Chart 3.8), due to the increase in external government debt recalculated in national currency (with a positive contribution of 8.8 percentage points) and of domestic government debt (with a positive contribution of 7.5 percentage points). The

¹¹GDP estimated by the NBM.

state debt, as of September 30, 2021, consisted of the external state debt in the proportion of 54.6% and the internal state debt in the proportion of 45.4%.

As of September 30, 2021, the balance of foreign government debt amounted to USD 2,238.5 million, higher than on September 30, 2020 by about USD 229.1 million or 11.4%. Recalculated in national currency, the balance of external state debt amounted to about 39.5 billion lei (17.7% of GDP¹¹) (Chart 3.9).

As of September 30, 2021, the domestic state debt amounted to 32.9 billion lei (14.7% of GDP¹¹) (Chart 3.9), higher than in the similar period of 2020 by 16.7% (Chart 3.8). The increase in domestic government debt was determined by state securities (SS) issued on the primary market, whose volume increased by 37.2% compared to the same period of 2020. As a result of these developments, at the end of September 2021, the domestic debt consisted of SS issued on the primary market (55.3%), SS issued for the execution of state guarantees (38.4% of the total) and converted SS (6.3%).

Primary market of state securities (SS)

During the third quarter of 2021, the Ministry of Finance put into circulation state securities with a total value of 5,260.1 million lei, 61.4% less than the volume of the initial offer. It should be noted that the volume of the offer of the Ministry of Finance increased 3.0 times compared to the offer in the third quarter of 2020. The demand of banks was 55.4% lower than the offer of the Ministry of Finance, amounting to 6,069.6 million lei (Chart 3.10).

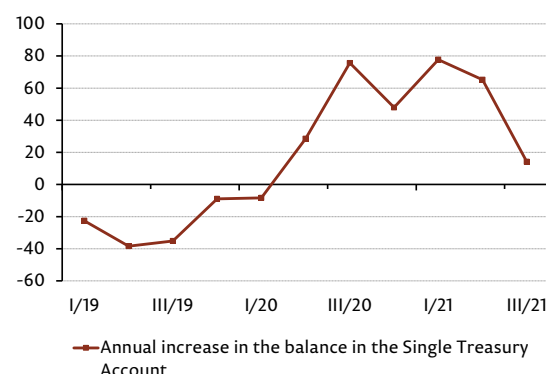
During the reporting period, the average effective interest rates on treasury bills maturing in 91 days, 182 days and 364 days increased compared to the level recorded in the previous quarter by 0.1 percentage points, 0.3 percentage points and 0.2 percentage points, respectively. The average effective interest rate on government bonds with a maturity of 2 years increased by 0.1 percentage points compared to the second quarter of 2021. The average effective interest rates on government bonds with maturities of 3 years, 5 years and 7 years remained at the level recorded in the previous quarter (Chart 3.11).

The structure of the SS portfolio put into circulation during the reference period identifies that the most popular SS were those with a maturity of 182 days, which accounted for 46.9% of total transactions, followed by 364-day treasury bills, which share was 40.0%, and the share of 91-day treasury bills was 9.4%. It should be noted that the shares in government bonds with a maturity of 2 years and 3 years accounted for 1.2% and 0.9%, respectively. The share of government bonds with a maturity of 5 years and 7 years was 0.5% and 1.1%, respectively (Chart 3.12).

Investment demand

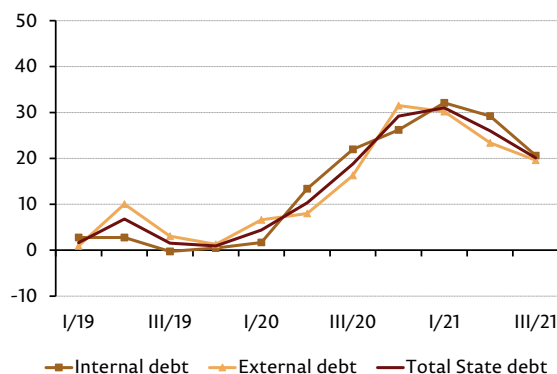
In the second quarter of 2021, the investment component generated a pronounced positive contribution to the dynamics of economic activity, thus contributing to GDP growth by 19.7 percentage points. The respective evolution was determined by the increase of the gross fixed capital formation by 24.5%, which generated a contribution of 6.9 percentage points to the GDP growth. It should be noted that the increase in the annual

Chart 3.7: Evolution of the balance of the single treasury account (% , compared to the previous year)



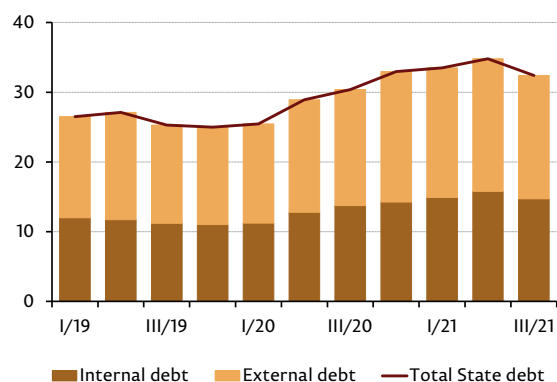
Source: NBM

Chart 3.8: Evolution of the growth rate of government debt (% , compared to the previous year)



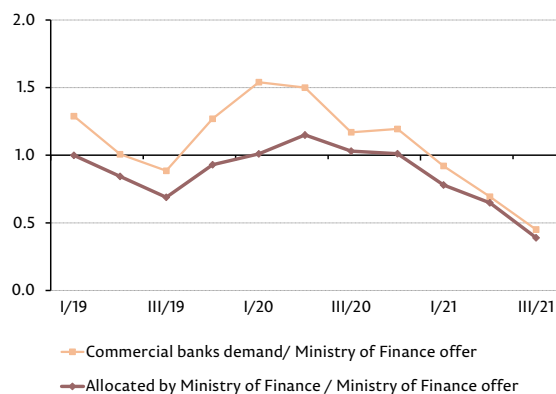
Source: Ministry of Finance

Chart 3.9: Share of government debt in GDP (% , end of quarter)



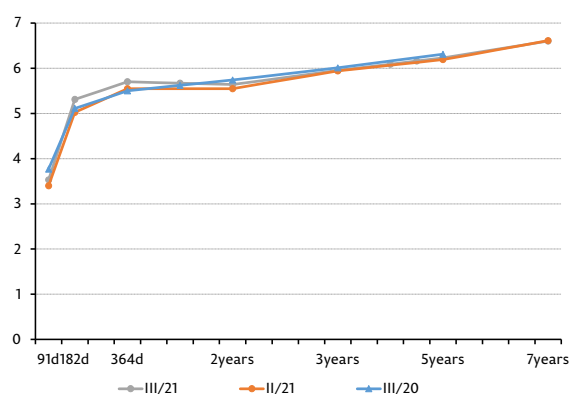
Source: Ministry of Finance

Chart 3.10: The ratio of supply and demand on the primary market of state securities



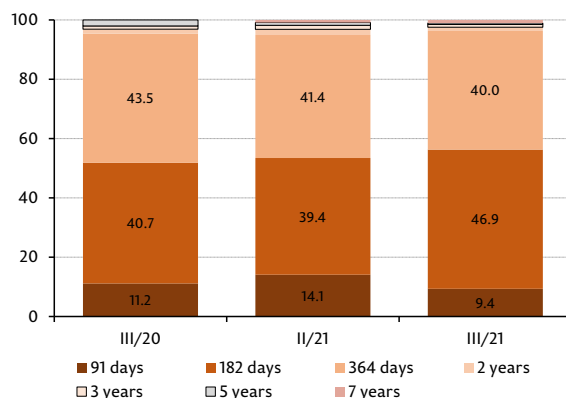
Source: NBM

Chart 3.11: SS yield curve (%)



Source: NBM

Chart 3.12: SS structure allocated to the primary market



Source: NBM

rate of gross fixed capital formation was determined by the dynamics of investments oriented in "constructions" and "machines and equipment", which increased by 25.0% and 19.8%, respectively (Chart 3.13). At the same time, the "inventory change" component generated a positive contribution of 12.8 percentage points to GDP dynamics.

According to the operative data presented by the NBS, in the second quarter of 2021, the annual growth rate of investments in tangible fixed assets ¹² increased by 27.3%. Thus, the increase in investments in "means of transport", "machinery, equipment, transmission facilities" and "non-residential buildings" mainly determined the positive dynamics of investments in property, plant and equipment (Chart 3.14).

In the second quarter of 2021 there was a sharp acceleration in the annual rate of sources of investment financing, which increased by 26.9% in the period under review. It should be noted that the acceleration of the annual rate of investment financing sources was mainly due to the dynamics of the "own funds" group (Chart 3.15). As in previous periods, own funds remain the main source of financing investments in fixed assets (about 68.0% in the second quarter of 2021).

Net foreign demand¹³

In the second and third quarters of 2021 a pronounced revival of the international trade of the Republic of Moldova was outlined. Thus, during the analyzed period, the annual rate of imports and exports registered accentuated growth rates. It should be noted that the positive dynamics of imports is determined by the revival of domestic consumption and that of exports, at least in the third quarter, by the positive developments in the agricultural sector and the manufacturing industry.

The annual rate of exports in the second quarter of 2021 recorded a level of 30.6% or 29.2 percentage points higher than in the first quarter of 2021. At the same time, the data for the first two months of the third quarter of 2021 show a continuation of the upward trend of the annual rate of exports. The acceleration of the annual export rate in the second quarter of 2021 was mainly due to the evolution of exports to EU countries. At the same time, in the third quarter of 2021 the acceleration of the annual rate was supported by the dynamics of exports to the CIS countries and those classified as "Rest of the world". At the same time, exports to EU countries increased, but the impact on the total dynamics of exports decreased compared to the second quarter of 2021 (Chart 3.16).

The sharp decline in the volume of agricultural production in 2020 has negatively affected the export of "food, animal feed, beverages and fats" both in late 2020 and in the first half of 2021. At the same time, the recording of a rich agricultural harvest in 2021 contributed to the intensification of the export of

¹²As of January 1, 2017, the statistical questionnaire 2-INV "On investments" was modified to adjust the statistical instruments (notions and definitions used, methods of calculation and presentation of indicators) with the provisions of the new National Accounting Standards, which entered into force on 1 January 2015.

¹³Quarterly data on the evolution of the foreign trade of the Republic of Moldova, expressed in thousands of US dollars, were used.

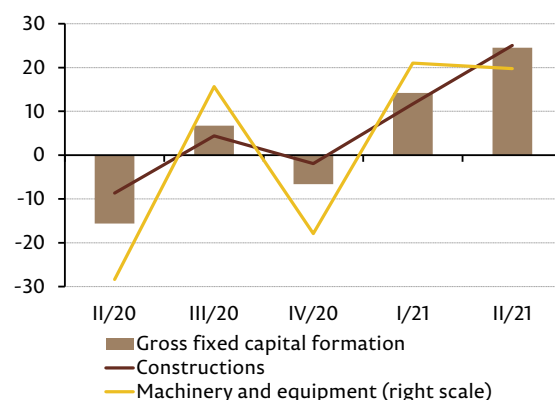
agro-food products in the third quarter of 2021 (Chart 3.17). It should be noted that the operating data for the first months of the third quarter of 2021 show a moderation, compared to the second quarter of 2021, of exports of "vehicles, optical and sound recording or reproducing equipment", "textiles and clothing" and "articles of metals, stones or ceramics".

Analyzing the evolution of exports by origin of products, it can be seen that the acceleration of the annual rate of exports in the second and third quarters of the current year was mainly determined by the evolution of exports of domestic products. At the same time, the re-export in the analyzed period generated positive contributions to the dynamics of total exports, but clearly lower than those determined by the export of domestic products (Chart 3.18).

In the second quarter of 2021, the annual rate of imports was 66.8% or 53.2 percentage points higher than in the first quarter of this year. The sharp acceleration in the annual import rate in the second quarter was also supported by the base effect¹⁴ favorable from the previous year. At the same time, the data for the first two months of the third quarter of 2021 show a moderation of the annual rate of imports to the level of about 22.2%. The recording of positive rates of the annual rate of imports in the analyzed period was determined by their evolution from all categories of countries (Chart 3.19).

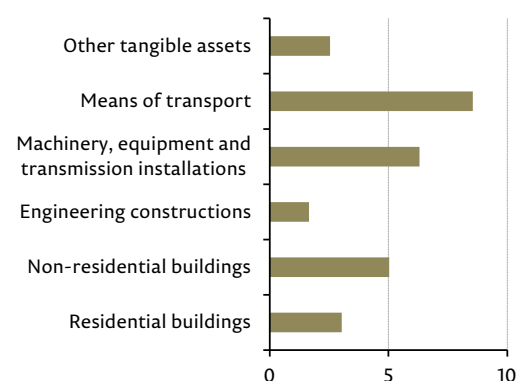
By groups of goods (Chart 3.20), the increase in the annual rate of imports in the first two months of the third quarter of 2021 was mainly due to the increase in imports of "mineral products" and "chemical and wood processing products". It should be noted that in the third quarter compared to the second quarter of this year there was a moderation in exports of "vehicles, optical and sound recording or reproducing apparatus", "articles of metal, stone or ceramic" and "textile materials and clothing".

Chart 3.13: Annual investment dynamics (%)



Source: NBS

Chart 3.14: The contribution of the components to the increase of investments in tangible fixed assets in the second quarter of 2021 (percentage points)



Source: NBS, NBM calculations

¹⁴Significant contracting of imports against the background of economic and social restrictions imposed by the authorities, worldwide, against the background of the COVID-19 pandemic.

Chart 3.15: The annual investment dynamics by funding sources (% , in real terms)

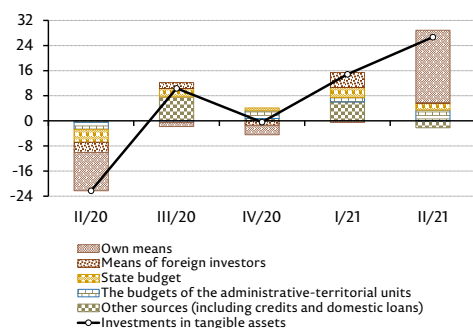


Chart 3.18: Evolution of exports annual rate (%) and contribution by origin (p.p.)

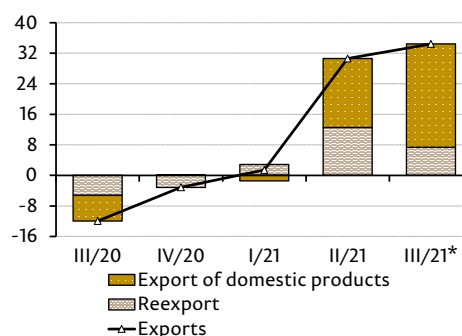


Chart 3.16: Evolution of exports annual rate (%) and contribution by categories of countries (percentage points)

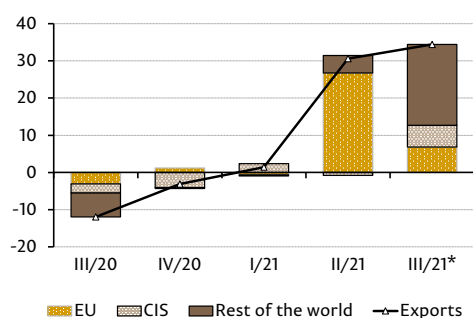


Chart 3.19: Evolution of imports annual rate (%) and contribution by categories of countries (percentage points)

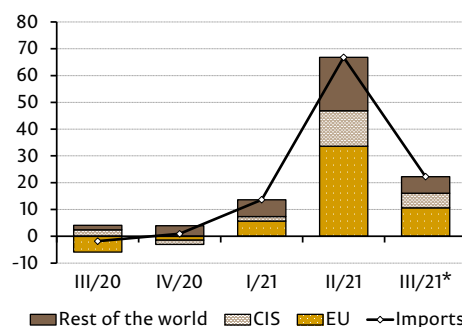


Chart 3.17: Evolution of exports annual rate (%) and components' contribution by groups of goods (percentage points)

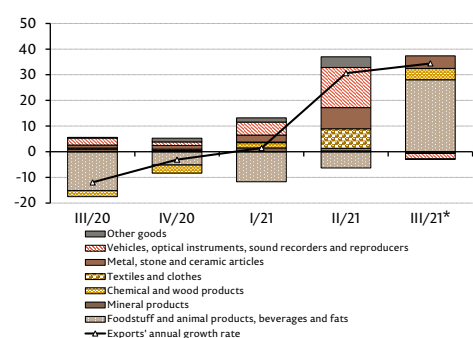
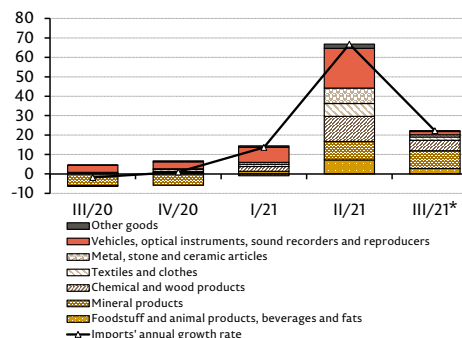


Chart 3.20: Evolution of imports annual rate (%) and components' contribution by groups of goods (percentage points)



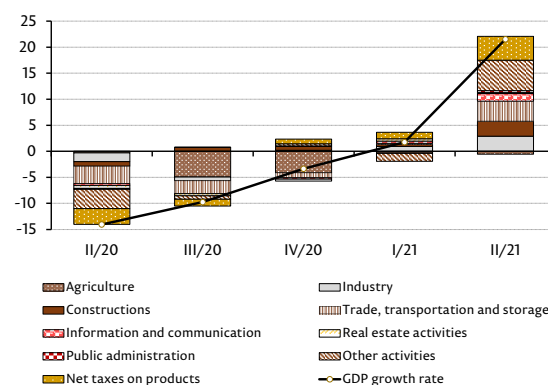
3.2 Production

By resource categories, GDP growth in the second quarter of 2021 was supported by the dynamics of all major sectors of the economy except agriculture. The gross value added of the industrial sector increased by 19.9% and thus determined a positive impact of 2.9 percentage points on the GDP dynamics. Gross value added for the construction sector accelerated to 22.0%, generating a positive contribution of 2.9 percentage points. After the negative developments in previous periods, the gross value added of the subcomponent **"trade, transport and storage"**¹⁵ increased by 23.0%, generating a positive impact of 4.2 percentage points on GDP dynamics. The information and communications sector increased by 29.1% and contributed 1.4 percentage points to GDP dynamics. The financial and insurance activities sector increased by 11.2%. Real estate transactions registered a more modest increase (2.2% and an impact of 0.2 percentage points). Net taxes on products increased by 38.3%, generating a contribution of 4.8 percentage points to GDP dynamics. An impressive positive contribution (4.7 percentage points) was generated by the "other activities" component. Within this, the subcomponent "health and social assistance" increased by 57.6%, and the gross value added related to the education sector increased by 45.2%. At the same time, the gross value added related to public administration and compulsory social insurance was 9.5% higher than in the second quarter of 2020. The positive impact of the above-mentioned subcomponents has been slightly mitigated by the dynamics of the agricultural sector. Gross value added in the agricultural sector, in the context of the negative evolution of the previous year in the vegetable sector, of lower-than-normal temperatures in the second quarter of 2021, and thus, the delay in the development of some agricultural crops, registered a decrease of 7.9%, generating a negative impact of 0.6 percentage points on the GDP dynamics. The respective dynamics was determined, both by the decrease of the animal and the vegetal production.

Most of the operational indicators available in July and August 2021 continued to show positive developments, but of a lower intensity compared to those of the second quarter of 2021, outlining prospects for a positive dynamics of GDP in the third quarter of 2021, but of lower magnitude.

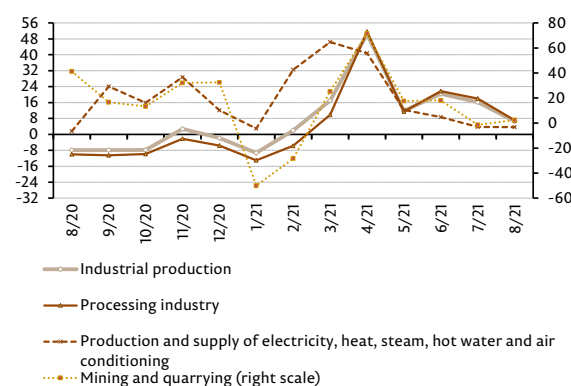
Thus, in the first two months of the third quarter of 2021, the annual rate of volume of industrial production recorded an average level of 11.4%, being however 16.2 percentage points lower than in the second quarter of 2021 (Chart 3.22). This dynamic was determined by the decrease in the annual growth rate of the manufacturing industry (from 28.3% in the second quarter of 2021 to 12.6% in the first two months of the third quarter of 2021). At the same time, the annual growth rate of production volume in the extractive industry, in July-August 2021, decreased by 35.3 percentage points compared to the second quarter of 2021, to the level of 0.4%. At the same time,

Chart 3.21: The contribution of economic sectors to GDP growth (percentage points)



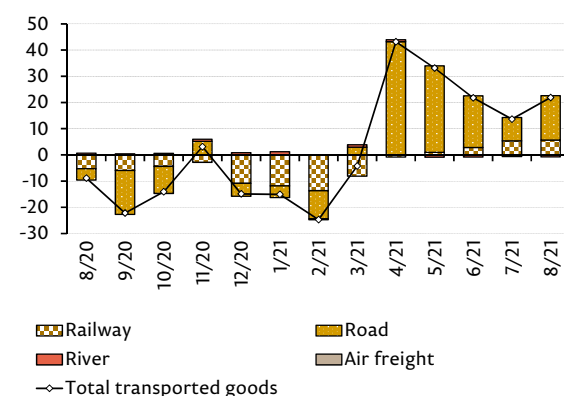
Source: NBS, NBM calculations

Chart 3.22: Evolution in real terms of industry (% , compared to the previous year)



Source: NBS

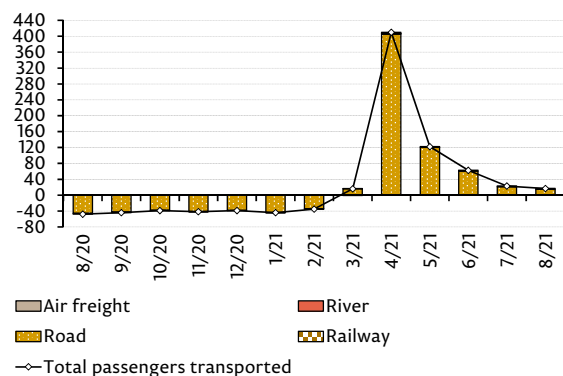
Chart 3.23: Evolution of freight transport (% , compared to the previous year)



Source: NBS

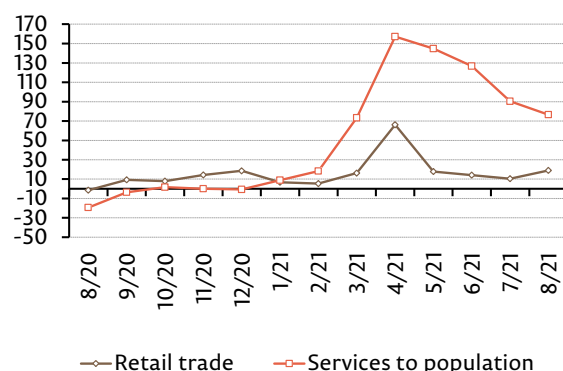
¹⁵ Wholesale and retail trade; maintenance and repair of motor vehicles and motorcycles; transport and storage; accommodation and catering activities.

Chart 3.24: Evolution of the transport of passengers (% , compared to the previous year)



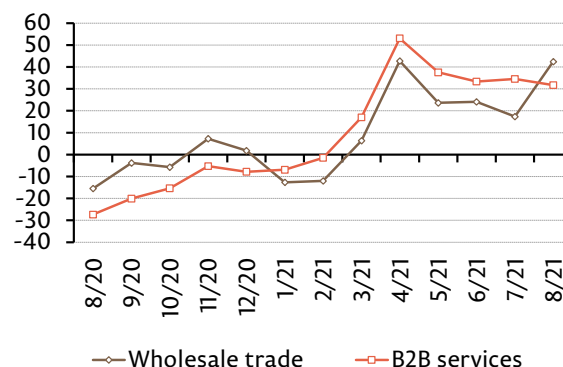
Source: NBS

Chart 3.25: The evolution of domestic trade in real terms (% , compared to the previous year)



Source: NBS

Chart 3.26: Evolution of wholesale trade (deflated by annual CPI) (% , compared to the previous year)



Source: NBS

the annual rate of "production and supply of electricity and heat, gas, hot water and air conditioning" decreased from 20.6% in the second quarter of 2021 to 3.8% in the first quarter in the first two months of the third quarter 2021.

Positive results for July and August 2021 were recorded in the freight transport sector. Thus, the average annual rate of volume of transported goods registered a level of 17.8%, being still 14.9 percentage points lower than in the second quarter of 2021 (Chart 3.23). At the same time, between January and August 2021, the railway, road, river and air transport companies transported 11.4% more goods compared to the similar period of 2020. This development was determined by the increase in annual terms of the volume of goods transported by road and air by 16.8% and 16.6%, respectively. At the same time, the volume of goods transported by rail and river decreased by 9.2% and 7.7%, respectively, compared to the same period of the previous year.

A moderation of the ascending evolution is also attested for the passenger transport in the third quarter of 2021. Thus, the average annual rate of passengers carried during July-August 2021 registered a level of 19.9%, being 178.3 percentage points lower than in the second quarter of 2021 (Chart 3.24). At the same time, in January-August 2021, 14.4% more passengers traveled by public transport compared to the similar period of 2020. This evolution was determined by the increase in annual terms of the number of passengers transported by air and road by 99.1% and 14.2%, respectively. At the same time, the number of passengers transported by rail decreased by 14.8% compared to the same period of the previous year, and river passenger transport decreased by 2.5%.

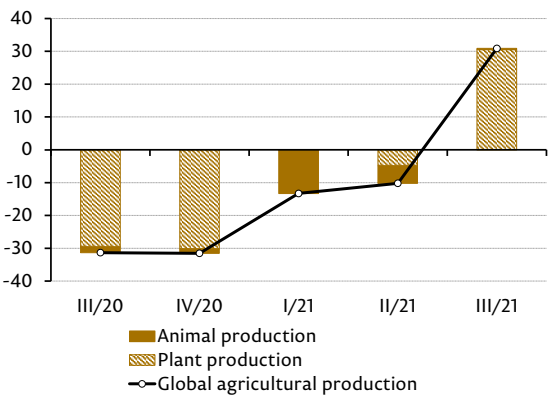
Positive signals on economic activity in the first two months of the third quarter of 2021 were recorded in internal trade. Thus, during the reference period, the turnover of the enterprises with main retail trade activity increased by 14.8%, being however by 17.9 percentage points lower than in the previous quarter (Chart 3.25). At the same time, the turnover of the enterprises with main activity of market services provided to the population registered, between July and August 2021, an increase of 83.5%, being by 59.3 percentage points lower than in the second quarter of 2021.

Between July and August 2021, the turnover of enterprises with main wholesale activity increased by 29.9%¹⁶, being 0.2 percentage points lower than in the second quarter of 2021 (Chart 3.26). At the same time, the turnover of the enterprises with main activity of market services provided to the enterprises registered, in the reference period, an increase of 33.2%, being by 8.1 percentage points lower than the annual rate of the previous quarter.

¹⁶Deflated by annual CPI rate.

In the third quarter of 2021, global agricultural production increased by 30.9% compared to the level of the same quarter of the previous year (Chart 3.27), as a result of the increase in plant and animal production by 38.1% and 2.1%, respectively. The increase in vegetable production was determined by the rich harvest of cereals and legumes (without corn), which is about 2.6 times higher than the previous year.

Chart 3.27: Annual global agricultural production rate (%) and contribution by sectors (percentage points)

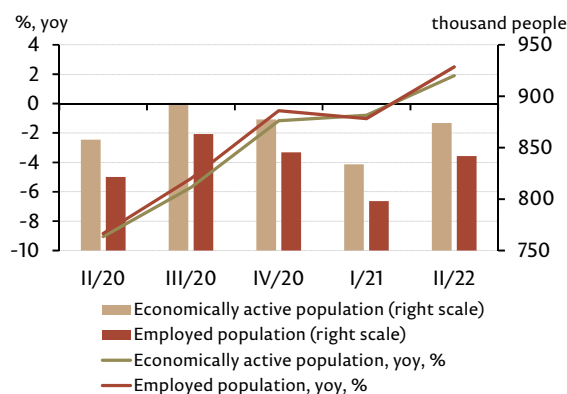


Source: NBS

3.3 Labour market

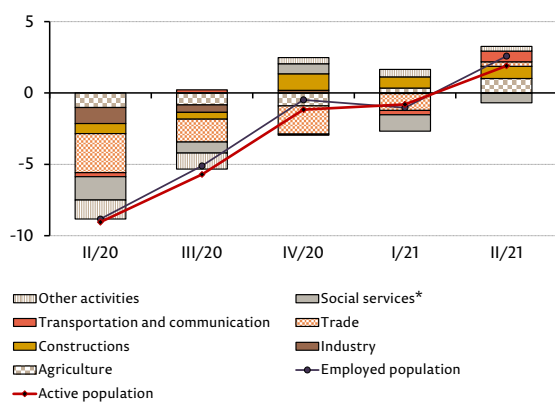
Labour force

Chart 3.28: Economically active population and employed population



Source: NBS, NBM calculations

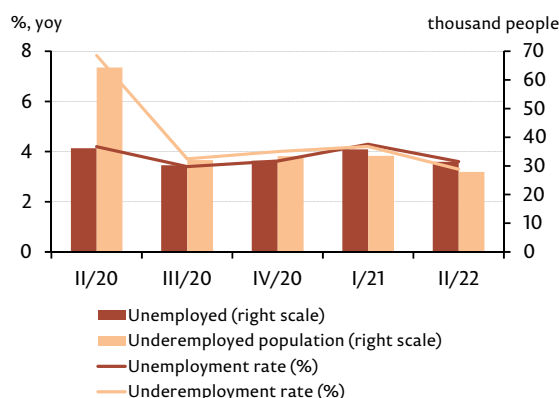
Chart 3.29: The contribution of the sectors to the dynamics of the employed population (percentage points)



Source: NBS, NBM calculations

* Public administration, education, health and social assistance

Chart 3.30: Evolution of the unemployed and the underemployed population



Source: NBS, NBM calculations

After the negative dynamics of over two years, in the second quarter of 2021, both the economically active and the employed population registered an increase compared to the similar period of the previous year, evolution supported by the gradual recovery of economic activity with partial relaxation of related restrictions COVID-19, but also some favorable conditions for the agricultural sector. At the same time, the unemployment rate, as well as the underemployment rate registered a downward dynamics.

In the period April-June 2021 after the continuous hiring of the previous periods, the labor force and the employed population registered an increase compared to the second quarter of 2020. Thus, in the second quarter of 2021, the economically active population was 874 thousand people, being 1.9% higher than in the same period of 2020. At the same time, the employed population was 842 thousand people, being 2.5% higher than in the second quarter of 2020 (Chart 3.28).

By subcomponents, the growth of the employed population in the second quarter of 2021 is attested in construction, agriculture, the transport and communications sector and in trade¹⁷. In this way, the population employed in construction increased by 12.1%. Its pronounced positive evolution continues from the second half of the previous year. The population employed in agriculture increased by 4.4% due to the favorable prospects for this sector this year. The population employed in trade and transport and communications increased by 1.9% and 10.4%, respectively, compared to the second quarter of 2021. At the same time, the population employed in the "other activities" subcomponent increased by 4.2%. On the other hand, negative developments in the second quarter of 2021 continued to be recorded in industry and the sub-component "public administration and social services"¹⁸. Thus, the population employed in the first subcomponent decreased by 0.2%, and the one in the second subcomponent by 2.8% compared to the same period of the previous year (Chart 3.29).

In the second quarter of 2021, the number of unemployed was 31.4 thousand people or 4.4 thousand people lower than in the first quarter of 2021, and the unemployment rate was 3.6%, 0.7 percentage points lower than in the first quarter of 2021 (Chart 3.30). At the same time, the number of unemployed and the unemployment rate were lower (by 4.8 thousand people and by 0.6 percentage points, respectively) than the values recorded in the similar period of the previous year. Similar trends are attested for the underemployed population. Thus, in the second quarter of 2021, the underemployed population decreased to 27.9 thousand people, from 33.5 thousand people in January-March 2021, and the underemployment rate was 3.3% or 0.9 percentage points lower than in the first quarter of 2021.

¹⁷ Wholesale and retail trade; Accommodation and public catering activities.

¹⁸ Public administration, education, health and social assistance.

Salary fund

The situation on the labor market improved between April and June 2021. The wage fund on the economy registered a well-defined positive annual dynamics. It increased by 24.8%, and in real terms, deflated by CPI, by 21.1% compared to the same period of last year. This evolution was made against the background of the positive contribution both from the dynamics of the remuneration fund in the real sector (mainly) and from the budgetary sector (Chart 3.31).

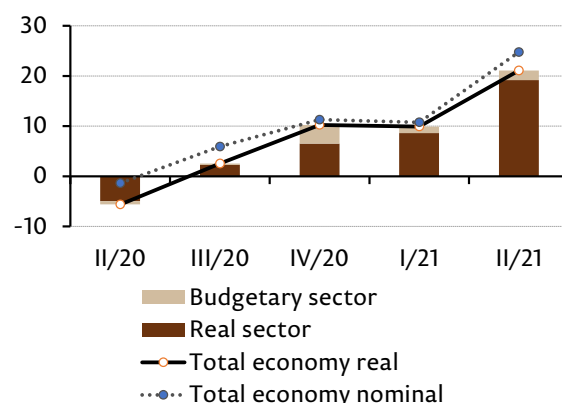
The salary fund for the medical system continued to make the largest contribution to the positive dynamics of the salary fund, in the context of supporting and appreciating the effort of the medical staff in the fight against the COVID-19 pandemic. At the same time, the salary fund in trade and industry recorded significant increases as a result of the increase in both the average number of employees and the average nominal salary in the nominated sectors.

On the fundamental factors side, the relaunch of economic activities has boosted the growth of the wage fund, although some restrictions related to the COVID-19 pandemic are still valid, and some uncertainties persist regarding the evolution of the epidemiological situation.

In the second quarter of 2021, the annual dynamics of the average number of employees in the national economy registered a jump, moving to the positive level, being 8.3% above the level of April-June 2020. The number of employees in the real sector increased by 10.7% and that in the budget sector by 2.0% (Chart 3.32). The evolution largely reflects the manifestation of a basic effect associated with the employment of a significant number of employees in technical unemployment a year ago, when the pandemic broke out.

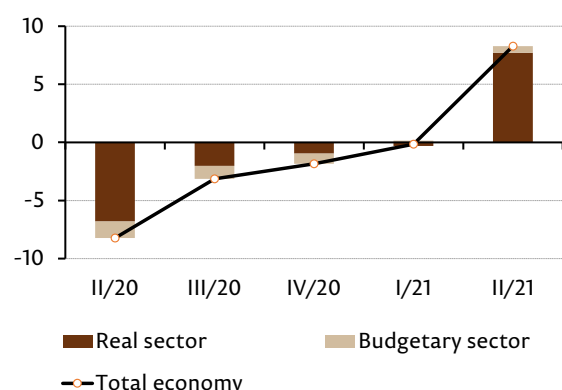
The distribution by sectors of the economy reveals more pronounced increases in the average number of employees, mainly in trade (11.0%), industry (7.3%), health (10.3%), accommodation and public catering (83.7%) (Chart 3.33).

Chart 3.31: Wage fund in the economy (% compared to the previous year) and sectoral contributions (percentage points)



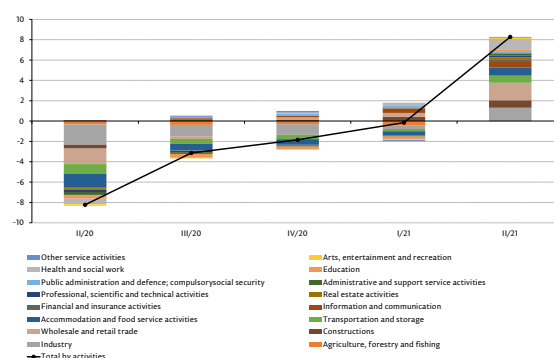
Source: NBS, NBM calculations

Chart 3.32: Average number of employees in the economy (% compared to the previous year) and sectoral contributions (percentage points)



Source: NBS, NBM calculations

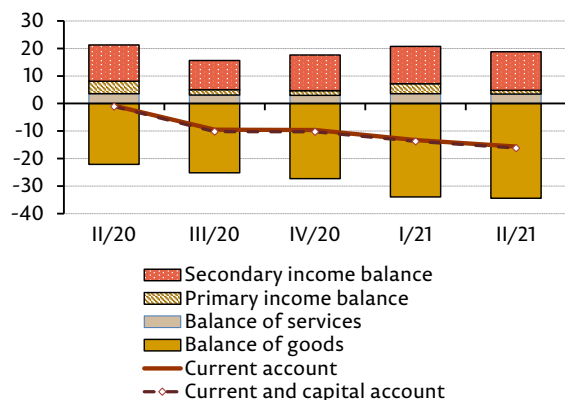
Chart 3.33: The contribution of the economy sectors to the dynamics of the number of employees (% compared to the previous year)



Source: NBS, NBM calculations

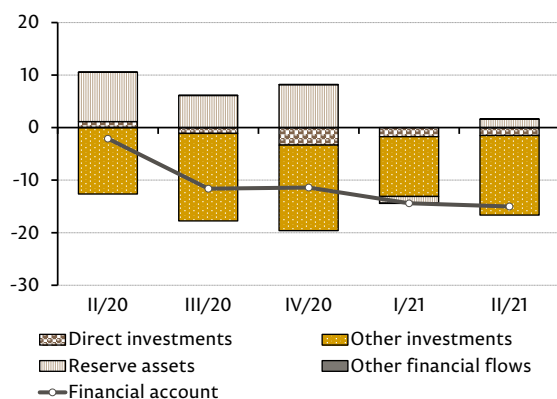
3.4 External sector

Chart 3.34: Current account share in GDP (%)



Source: NBM

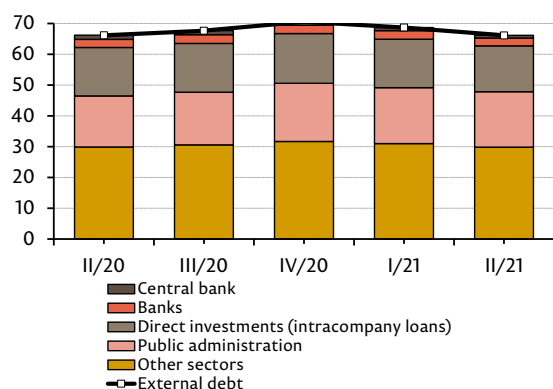
Chart 3.35: Financial account share in GDP (%)



Source: NBM

Note: (-) - net capital inflows, (+) - net capital outflows

Chart 3.36: Share of external debt in GDP (%)



Source: NBM

Current Account

In the second quarter of 2021, the current account deficit of the balance of payments increased by 2.4 percentage points compared to the previous quarter, amounting to 15.7% as a share of GDP (Chart 3.34). The increase in the balance of payments deficit was due to the increase in the negative contribution component "balance of goods". At the same time, the components with a positive contribution: the "balance of services" and the "primary income balance" decreased, while the "secondary income balance" increased during the reference period.

Financial Account

In the second quarter of 2021, the financial account, as a share of GDP, recorded a level of 15.0% or 0.6 percentage points increase compared to the first quarter of 2021. Thus, the recording of higher net capital inflows (as a ratio to GDP) was determined by the change recorded in the "other investments" component (Chart 3.35). Thus, the net flow of other investments, as a share in GDP, recorded a level of 15.1%, being 3.8 percentage points higher than in the first quarter of 2021. The net increase in financial assets under "other investments" mainly reflects the increase in assets in the form of "trade and advances" and "cash and deposits". The flow of direct investments in the second quarter of 2021 recorded a level of 1.5% as a share of GDP or 0.2 percentage points lower than in the previous quarter. At the same time, during the reference period, there was a slight increase in reserve assets (1.6% as a share of GDP), and as a result there was a decrease in net capital inflows.

The share of external debt in GDP in the second quarter of 2021 decreased by 2.5 percentage points to 66.1% (Chart 3.36). No significant changes were recorded in the structure of external debt, so, as in previous periods, the largest share of total external debt is held by economic agents¹⁹ by 32.4% to the government sector²⁰ is 18.9% and direct investment – 14.9%.

¹⁹Cumulative debt of "Banks" and "Other sectors".

²⁰The cumulative debt of the "General Administration" and the "Central Bank"

Chapter 4

Monetary policy

4.1 Monetary policy instruments

Interest rate policy

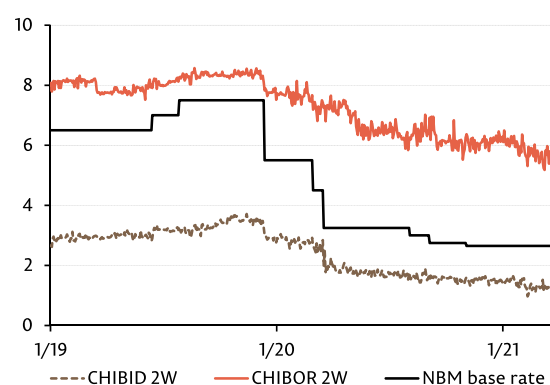
To alleviate the inflationary pressures generated by the acceleration of aggregate domestic demand, fueled by rising consumption, and to ease the second-round effects of supply shocks, against the background of rising international prices and imported inflation, NBM decided to increase the monetary policy rate in two consecutive steps of 1 percentage point each up to 4.65%.

The yield curve CHIBOR 2W remained relatively stable in July and August, fluctuating at the top of the interest rate corridor. At the beginning of September, the yield curve CHIBOR re-entered an upward trajectory under the impact of increases in the base rate, but the amplitude of growth was modest. Thus, the CHIBOR 2W quotation at the end of September was by 0.31 percentage points higher than the one recorded on the last day of the previous quarter, amounting to 6.28% (Chart 4.1).

The partial rejection by the Ministry of Finance of the bids submitted in the tenders for the placement of state securities with a maturity of 91 days, in an attempt to oppose the increase of interest rates, determined its maintenance at 3.36%, followed by a sharp increase (+0.42 percentage points) in the last month of the quarter (Chart 4.2).

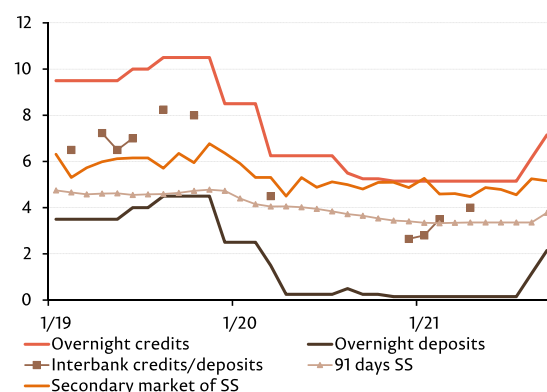
The quarterly average of the yield related to the sale-purchase operations on the secondary market of state securities amounted to 4.96%, being higher than in the previous quarter (+0.26 percentage points), in circumstances when the weighted average term until maturity decreased from 252 to 246 days.

Chart 4.1: The average monthly reference rates on the interbank market and the base rate of the NBM (%)



Source: NBM

Chart 4.2: The monthly evolution of the interest rate corridor (%)



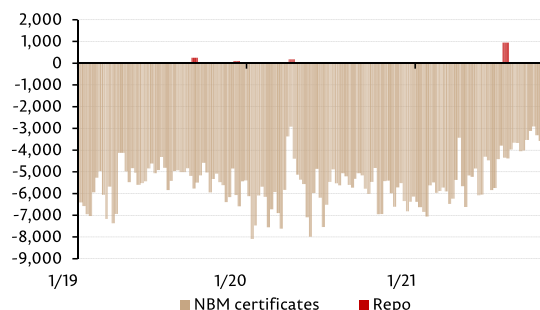
Source: NBM

Money market operations

Sales of NBM certificates (NBC)

The NBM conducted weekly NBC placement tenders, with a maturity of 14 days and with the announcement of the maximum interest rate equivalent to the base rate of the NBM. For the whole of the third quarter of 2021, the weighted average rate of liquidity absorption operations amounted to 3.44% annually.

Chart 4.3: Evolution of the daily balance of sterilization operations (million lei)



Source: NBM

The daily stock of NBC investments decreased significantly during the quarter, varying between the minimum value of 2,910.8 million lei and the maximum value of 4,383.2 million lei, a situation also reflected in the value recorded by the average quarterly balance amounting to 3,722.2 million lei (-1,509.2 million lei compared to the second quarter of 2021) (Chart 4.3).

Repo operations

Repo liquidity repurchase operations were carried out weekly, for a period of 14 days at a fixed interest rate (base rate plus a margin of 0.25 percentage points), through the no-limit auction procedure, in accordance with the calendar of monetary policy operations for the year 2021. The volume of liquidity delivered was 951.0 million lei. The balance of repo operations recorded at the end of the management quarter was zero.

Standing facilities

During the third quarter of 2021, the banks used both the overnight deposit facility and the overnight credit facility.

The total volume of overnight investments amounted to 11,975.4 million lei, which indicates an average daily balance of 163.6 million lei, lower than in the previous quarter by about 15.4%. The amounts placed varied between the minimum of 30 million lei and the maximum of 900 million lei.

The total amount of overnight loans granted to banks by the NBM for the whole of the third quarter of 2021 amounted to 1,241.0 million lei, the average daily balance being about 13.5 million lei.

Required reserves

The reserve requirement mechanism continued to exercise the functions of monetary control and liquidity management in the banking system.

During the third quarter of 2021, the reserve requirements for funds attracted in Moldovan lei and freely convertible currency (FCC) were maintained at the level of 26.0% and 30.0%, respectively.

During the application period September 16 – October 15, 2021, the required reserves in MDL amounted to 12,379.5 million lei, a volume higher by 321.4 million lei (+2.7%) compared to the period June 16 – July 15, 2021.

Regarding the required reserves from the means attracted in FCC, in the application period September 16 – October 15, 2021, those totaled 143.8 million US dollars and 378.7 million euro. Compared to June 16 – July 15, 2021, required reserves in US dollars increased by 4.6% and reserves in euro increased by 12.8%.

Interbank money market

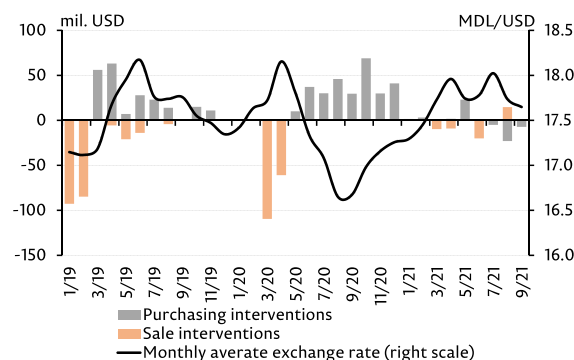
In the third quarter of 2021, due to the persistence of the excess liquidity in the banking system, no transactions were registered on the interbank credit/deposit market.

Interventions on the domestic foreign exchange market

NBM intervened on the domestic foreign exchange market between July and September 2021, both through purchases and sales of foreign currency.

During the analyzed period, the volume of transactions of the National Bank of Moldova performed on the interbank foreign exchange market against Moldovan lei, at the date of the currency, amounted to 51.10 million US dollars, including sales transactions amounting to 35.15 million US dollars, purchase transactions in the amount of 14.80 million US dollars, as well as currency conversions with the institutions of the World Bank (International Bank for Reconstruction and Development and the International Development Association) in the amount of 1.15 million US dollars (Chart 4.4).

Chart 4.4: Evolution of the official MDL/USD exchange rate and the volume of daily transactions of the NBM, third quarter of 2021

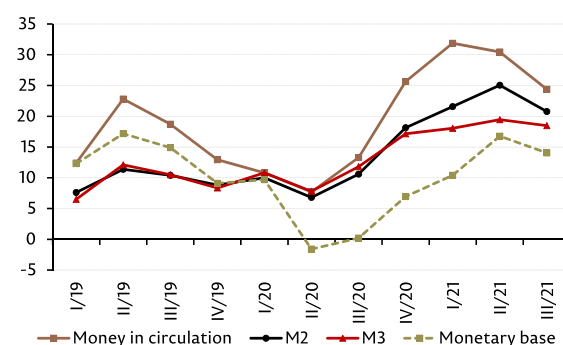


Source: NBM

4.2 Dynamics of monetary indicators

In the third quarter of 2021, the dynamics of monetary aggregates was positive, but more tempered, the quarterly average in annual terms being 20.8% for the monetary aggregate M2 (by 4.3 percentage points below the level of the second quarter of 2021) and 18.5% for M3 (1.0 percentage points less compared to the increase in the previous quarter). The monetary base increased compared to the third quarter of 2020, with the quarterly average in annual terms being 14.0% (Chart 4.5).

Chart 4.5: Changing monetary aggregates (% annual growth)



Source: NBM

Money supply

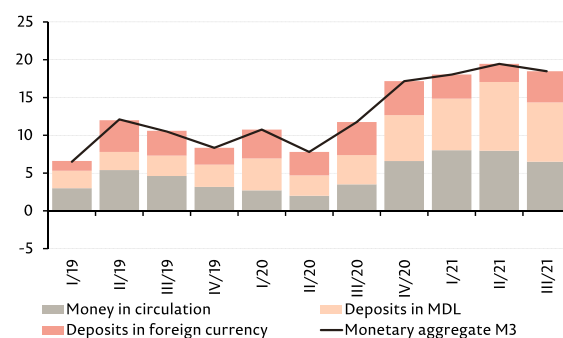
The slowing growth rate of the M3 monetary aggregate, compared to the previous quarter, resulted from the decrease in the growth rate of deposits in national currency and money in circulation, being offset at the same time by a sharper growth of foreign currency deposits (Chart 4.6).

The decrease in the growth rate of deposits in national currency (Chart 4.8) was mainly determined by a more modest increase, compared to the previous quarter, of demand deposits of both individuals and legal entities (Chart 4.10). Term deposits in national currency continued the upward trend (Chart 4.9).

The component of foreign currency deposits increased by 5.9 percentage points above the level recorded in the previous quarter as a result of a faster growth of both demand and term deposits (Chart 4.11). At the same time, there is a return to the positive level of foreign currency demand deposits of legal entities (Chart 4.12).

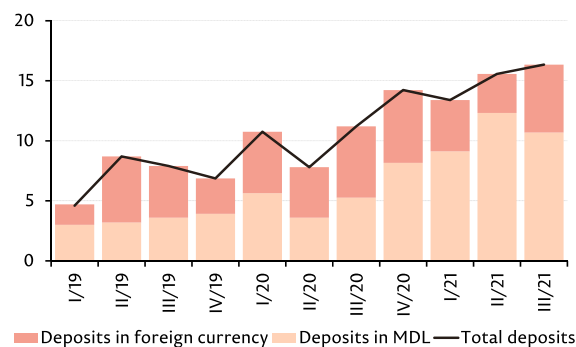
The growth rate of money in circulation at the end of the third quarter of 2021 decreased by 8.7 percentage points compared to the end of the previous quarter, amounting to 20.8%. The average quarterly contribution of money in circulation to M3 growth decreased by 1.4 percentage points compared to the level recorded in the second quarter of 2021 (Chart 4.6).

Chart 4.6: Dynamics of the M3 monetary aggregate (% comp. contrib. in annual growth)



Source: NBM

Chart 4.7: Dynamics of the total balance of deposits (% comp. contrib. in annual growth)

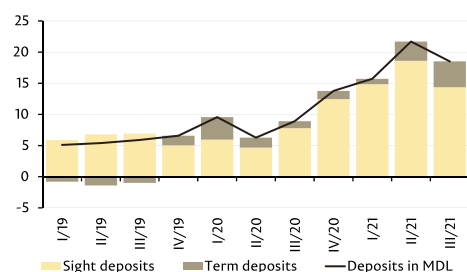


Source: NBM

The dynamics of money in circulation was determined by the faster growth of the cash flow of receipts compared to the cash flow of releases in the vaults of commercial banks. Of the total receipts, the largest share was the receipts from the sale of consumer goods and receipts on the current accounts and deposit accounts of individuals.

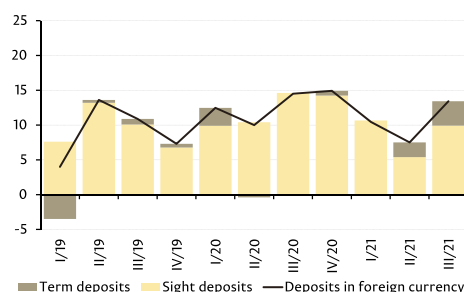
At the same time, regarding the releases from the vaults of commercial banks, the main components were releases for the purchase of foreign currency from individuals and releases of cash from ATMs and POS-terminals.

Chart 4.8: Dynamics of the balance of deposits in MDL (% comp. contrib. in annual growth)



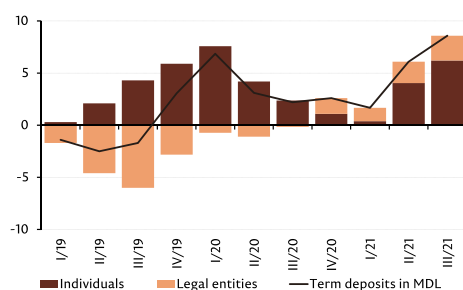
Source: NBM

Chart 4.11: Dynamics of the balance of deposits in foreign currency (% comp. contrib. in annual growth)



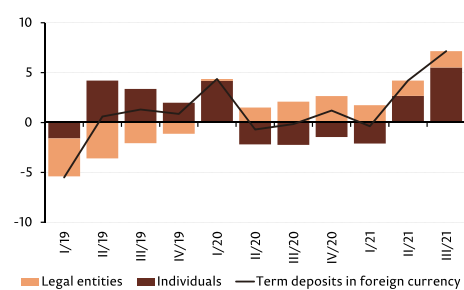
Source: NBM

Chart 4.9: Dynamics of the term deposits balance in MDL (% comp. contrib. in annual growth)



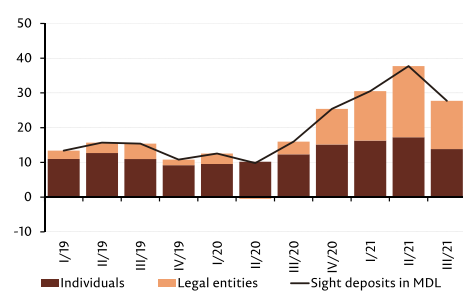
Source: NBM

Chart 4.12: Dynamics of the term deposits balance in foreign currency (% comp. contrib. in annual growth)



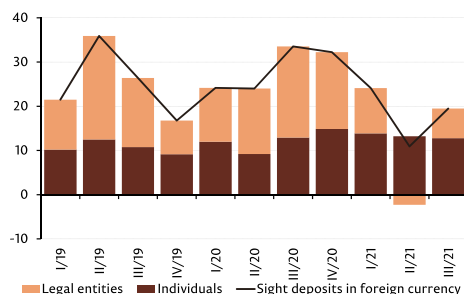
Source: NBM

Chart 4.10: Dynamics of the sight deposits balance in MDL (% comp. contrib. in annual growth)



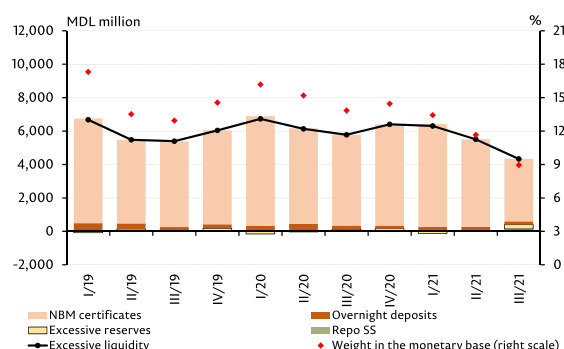
Source: NBM

Chart 4.13: Dynamics of the sight deposits balance in foreign currency (% comp. contrib. in annual growth)



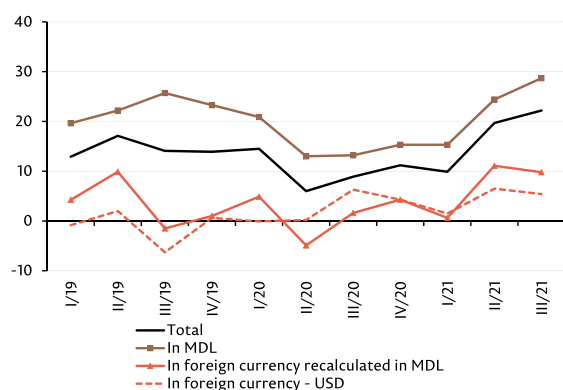
Source: NBM

Chart 4.14: The excessive liquidity



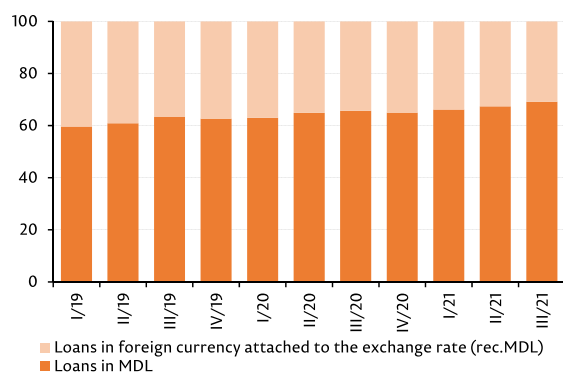
Source: NBM

Chart 4.15: Evolution of the loan balance (% annual increase)



Source: NBM

Chart 4.16: Evolution of the loans weights on subcomponents in the total balance (%)



Source: NBM

Excessive liquidity

During the third quarter of 2021, excessive liquidity in the banking system decreased by 1.17 billion lei. It should be mentioned that compared to the third quarter of 2020, the volume of excessive liquidity also decreased on average by 1.45 million lei (-25.0% annually), registering the average value of 4.3 billion lei (Chart 4.14).

Credit market

Evolution of the balance of loans granted by licensed banks²¹

At the end of the third quarter of 2021, the total balance of loans granted by licensed banks recorded a positive annual increase (Chart 4.15) and amounted to 51,878.7 million lei, higher than at the end of the third quarter of 2020 by 22.2% (with a positive contribution from the balance of loans granted in national currency of 18.9 percentage points). The share of the balance of loans granted in the domestic currency increased up to 69.2% of the total balance of loans, which led to a decrease in the degree of dollarization by 3.5 percentage points compared to the end of the third quarter of 2020 (Chart 4.16).

On September 30, 2021, the balance of loans granted in domestic currency by licensed banks registered an annual growth rate of 28.7%, with the contribution from the increase in the balance of loans to individuals of 20.8 percentage points, and from loans granted to legal entities of 7.9 percentage points. In turn, the balance of credits in MDL granted to individuals registered an annual increase of 36.2%, and the share of these credits constituted 61.0% of the balance of credits in MDL.

As at the end of the reporting quarter, in the structure of the total loan portfolio granted by the licensed banks, the highest share, went, as in the previous quarters, to loans granted to individuals (43.1%, which is by 1.6 percentage points higher than on June 30, 2021), followed by the share of loans granted in trade (21.4%) (Chart 4.17).

Evolution of new credits granted by licensed banks

In the third quarter of 2021, the total volume of new loans granted by licensed banks was by 41.1% higher than in the third quarter of 2020 (Chart 4.18). This increase was influenced by the positive evolution of loans granted both in domestic currency and in foreign currency, recalculated in MDL. The volume of new loans granted in the domestic currency by licensed banks registered an annual increase of 45.2%. The share of loans granted in the domestic currency accounted for 72.0% of total loans granted in the third quarter of 2021 by licensed banks.

The annual dynamics of loans granted to individuals in the third quarter of 2021 constituted 67.3%. As in the previous quarters, the largest share in these loans was held by consumer loans (62.2%), followed by loans for real estate, which share increased up to 32.5%, due to the declining trend in nominal interest rates and the Government's "First Home" Program.

²¹The data analysis was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" submitted by licensed banks until October 12, 2021.

Market of term deposits accepted by licensed banks (balance of deposits)²²

At the end of the third quarter of 2021, the total balance of term deposits attracted by licensed banks registered an annual increase of 12.2%, as a result of the increase in the balance of term deposits in both lei and foreign currency (Chart 4.19).

The major component, in the total balance of term deposits attracted by licensed banks, was the balance of deposits in MDL (Chart 4.20). At the end of the third quarter of 2021, the share of the balance of term deposits attracted in the domestic currency accounted for 59.3% of the total balance of term deposits, as in the third quarter of 2020. Respectively, the dynamics of the degree of dollarization of the balance of term deposits was relatively stable (Chart 4.20). It should be noted that, at the end of the reporting quarter, term deposits attracted in MDL from individuals held a share of 86.4% of the total balance of deposits in MDL.

Interest rates²³

Evolution of the base rate

During the third quarter of 2021, two meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions took place. Following the assessment of the balance of internal and external risks and short- and medium-term inflation prospects, the Executive Board of the National Bank of Moldova, at its meetings of July 30, 2021 and September 03, 2021, decided to increase the base rate applied to major operations of monetary policy by 1.0 percentage points. Thus, the base rate rose from 2.65% to 4.65% annually. These measures to gradually tighten monetary policy were adopted to mitigate the inflationary pressures generated by the second-round effects of global price growth, costs of energy resources and food production and distribution. At the same time, the NBM considered the pressures from domestic aggregate demand supported by the increase of the population's income (salary fund, social assistance, remittances etc.) and the increase in the volume of consumer and mortgage loans. These decisions aimed at anchoring inflationary expectations, restoring, and keeping inflation close to the target of 5.0% over the medium term, with a possible deviation of ± 1.5 percentage points.

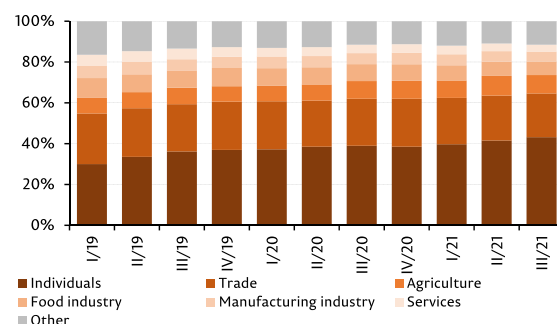
Evolution of the interest rate on the balance of loans

For the period July-September 2021, the weighted average interest rate on the balance of loans granted in MDL by licensed banks was 6.98% annually, lower than in the third quarter of 2020 by 0.47 percentage points (Chart 4.21). This dynamic was determined by the annual decrease of the weighted average interest rate on the balance of loans granted in MDL to individuals by 0.90 percentage points. Compared to the second quarter of 2021, the weighted average interest rate on the balance of loans granted in MDL decreased by 0.23 percentage points.

²²The data analysis was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" submitted by licensed banks until October 12, 2021 and does not include demand deposits.

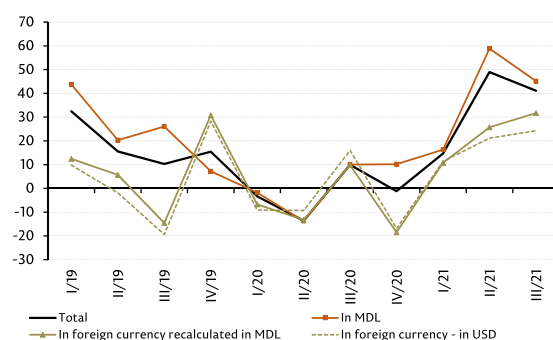
²³The analysis of the rates was performed based on the reports ORD 01.06 "Interest rates related to the balance of loans and deposits" presented by the licensed banks until October 12, 2021 and does not include the rates on demand deposits.

Chart 4.17: Loan balance structure (% in total)



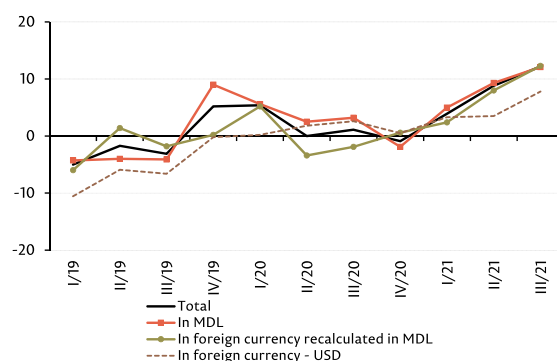
Source: NBM

Chart 4.18: Evolution of new granted loans (% annual growth)



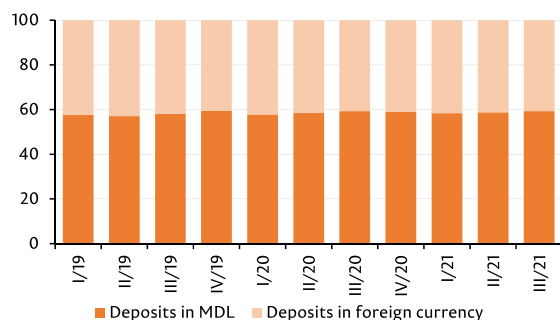
Source: NBM

Chart 4.19: Deposit balance dynamics (% annual growth)



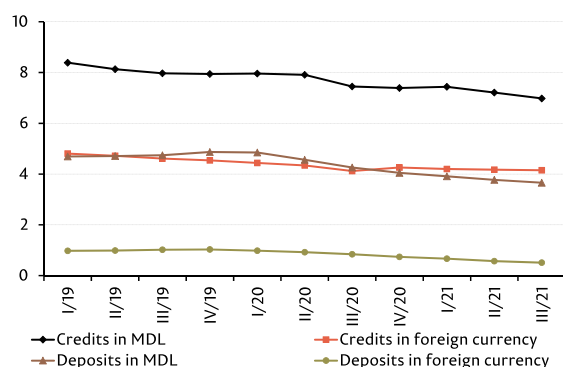
Source: NBM

Chart 4.20: Evolution of the share of term deposits on subcomponents in the total balance (%)



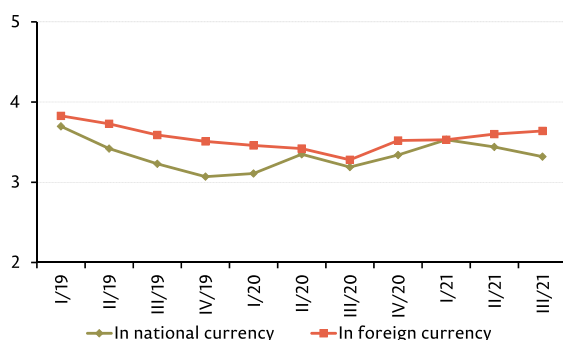
Source: NBM

Chart 4.21: Average interest rates on balance of loans and deposits (%)



Source: NBM

Chart 4.22: The evolution of the banking margin on loan and deposit balances (percentage points)



Source: NBM

For the whole of the third quarter of 2021, the weighted average interest rate on the balance of foreign currency loans was 4.15% annually and did not change significantly compared to the third quarter of 2020.

Evolution of the interest rate related to the balance of deposits

At the end of the third quarter of 2021, the weighted average interest rate on the balance of deposits in national currency was 3.66% annually and decreased compared to the third quarter of 2020 by 0.60 percentage points and 0.11 percentage points compared to the second quarter of 2021 (Chart 4.21). The weighted average interest rate on the balance of term deposits attracted in foreign currency decreased by 0.33 percentage points compared to the end of the third quarter of 2020, amounting to 0.51% annually.

Evolution of banking margin

In the third quarter of 2021, bank margins (calculated as the difference between the weighted average interest rates on loan balances and the weighted average interest rates on deposit balances) both on the national currency segment and foreign currency subcomponent increased compared to the third quarter of 2020 (Chart 4.22).

Evolution of interest rates on new loans and deposits granted/ attracted by licensed banks

As a result of the monetary policy decisions in 2020-2021 and the situation on the money-foreign exchange market, in the third quarter of 2021, the weighted average interest rate on new term deposits attracted in the national currency decreased (Chart 4.23). For the whole of the third quarter of 2021, the weighted average interest rate on deposits in MDL was 3.16% annually, by 0.60 percentage points lower than in the third quarter of 2020 and by 0.11 percentage points lower than in the second quarter of 2021 (likewise the evolution of rates on the balance of term deposits in MDL). The weighted average interest rate on new loans granted in national currency in the third quarter of 2021 was 6.84% per year, lower than in the third quarter of 2020 by 1.06 percentage points.

Evolution of the nominal and real effective exchange rate

According to the values at the end of the third quarter of 2021, the official nominal exchange rate of the national currency appreciated by 1.7% against the US dollar and by 3.8% against the euro compared to their levels recorded at the end of the previous quarter (Chart 4.24).

On average, the exchange rate of the Moldovan leu appreciated to a lesser extent, by 0.1% against the US dollar and by 2.2% against the euro, compared to the averages of the previous quarter.

In the third quarter, most of the currencies of the countries – main trading partners of the Republic of Moldova included in the REER basket depreciated, in average values, against the US dollar. In particular, the Polish zloty depreciated by 2.8%, the Romanian leu – by 2.3%, the euro and Bulgarian leva – by 2.1%, the Turkish lira – 1.9%, and the Hungarian forint – by 1.8% etc. At the same time, the Ukrainian hryvnia appreciated against the US dollar – by 2.5%, the Belarussian ruble – by 1.4%, and the Russian ruble – by 1.1% (Chart 4.25).

Under these conditions, in real terms, the Moldovan leu appreciated by 0.8% against the currency basket of the countries – main trading partners of the Republic of Moldova (average of the third quarter of 2021 compared to the average of the second quarter of 2021). The highest contributions to the REER appreciation were made by Romania (0.5 percentage points), and Italy and Germany (0.2 percentage points each) (Chart 4.27).

In the reference period, the demand and supply factors on the local intrabank foreign exchange market evolved more atypically for the third quarter of the year, resulting in a shortage of currency. The net demand from legal entities continued its upward trend in annual terms for the fifth consecutive quarter, while the net supply of foreign currency by individuals narrowed slightly.

The net supply of foreign currency by individuals amounted to 713.0 million dollars, decreasing in annual terms by 4.5%, as transfers from abroad in favor of individuals decreased to a similar extent, according to data for the first two months of the quarter. Also, in the reference quarter, there was a more pronounced increase in foreign currency deposits of individuals, which potentially contributed to the decrease in their supply. Compared to the previous quarter, the supply from individuals increased slightly, by 2.8%.

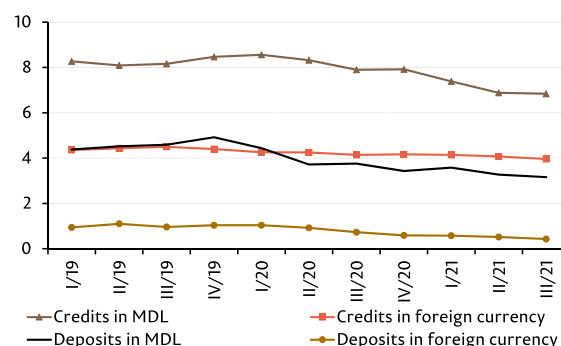
In the structure of the net supply of foreign currency from individuals, the majority share continued to belong to the single European currency (73.8%) (Chart 4.28).

At the same time, the net demand for foreign currency from economic operators continued to advance sharply, increasing by 17.5% in annual terms and by 6.2% compared to the previous quarter, up to the level of 802.5 million US dollars. The widening trade deficit resulted in a general increase in net demand from several categories of importers, including importers of energy resources, cars, machinery, equipment, construction materials, and consumer goods. Another factor with a potential impact on demand from economic operators, as in the case of individuals, was the slight increase in the dollarization of deposits of legal entities, especially in the second half of the quarter.

The coverage of the net demand for foreign currency by economic operators through the net supply of foreign currency from individuals amounted to 88.9% in the third quarter of 2021 compared to 91.7% in the previous quarter and 109.4% in the third quarter of 2020. Under these conditions, the NBM intervened through net foreign exchange sales on the local foreign exchange market in the amount of 20.4 million US dollars²⁴.

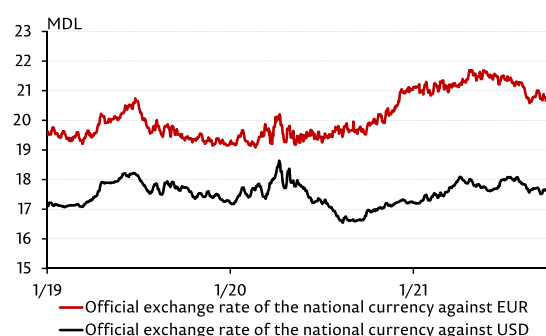
²⁴Volume calculated at the currency date.

Chart 4.23: Average interest rates on new volume of loans and deposits (%)



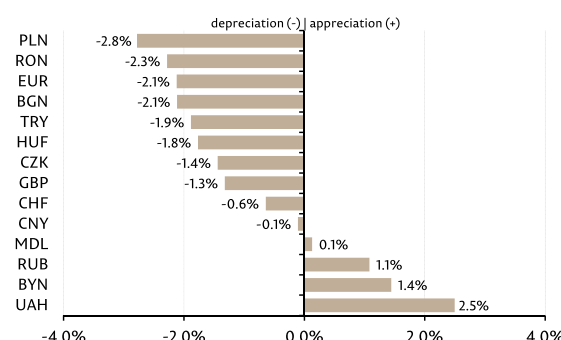
Source: NBM

Chart 4.24: Fluctuations in the official exchange rate of the Moldovan leu against the US dollar and the euro



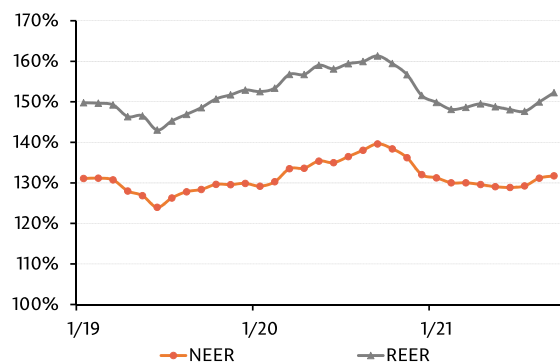
Source: NBM

Chart 4.25: The evolution of countries' currencies – main trading partners against the US dollar (average exchange rate Q3 2021/ Q2 2021, %)



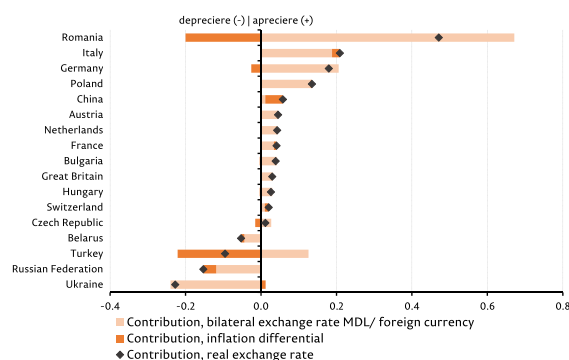
Source: NBM

Chart 4.26: Dynamics of the nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated on the basis of the share of countries – main trading partners (Dec.2000=100%)



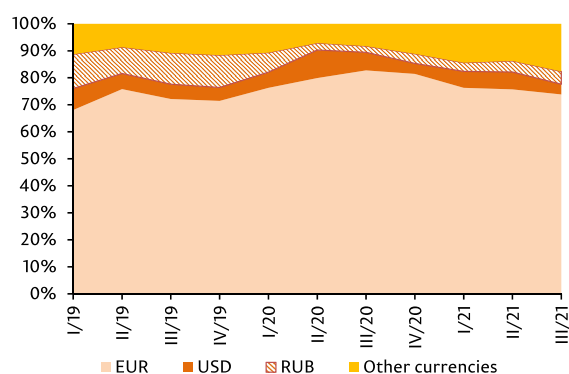
Source: NBM

Chart 4.27: Contribution of the countries – main trading partners of the Republic of Moldova to the change in the real effective exchange rate in the third quarter of 2021



Source: NBM

Chart 4.28: The net supply of foreign currency from individuals disaggregated by major currencies (the currencies are recalculated in USD at the average constant exchange rate)



Source: NBM

In the dynamics of the exchange rate of the Moldovan leu against the US dollar, during the quarter, there was a temporary trend of appreciation in the last week of July and the first two weeks of August, the rest of the periods being characterized by relatively minor fluctuations. During the mentioned period, the increased net supply from individuals, but also from some exporters of agricultural products temporarily outpaced the demand for foreign currency. The factors on the demand side, mentioned above, stood out especially in the last three weeks of the quarter, creating premises for the modest depreciation of the leu against the dollar during this period.

The dynamics of the official exchange rate of the Moldovan leu against the euro was also influenced by the evolutions of the single European currency against the US dollar on international markets. In July-September, the EUR/USD exchange rate moved in a relatively narrow range, with a general trend of appreciation of the dollar, in the context of mixed signals from the FRS on tightening monetary policy. Investors' expectations of a faster adjustment in monetary policy in the USA, which led to a strengthening of the dollar at the beginning of the quarter, proved premature, with FRS announcing the start of a decrease in asset purchases later this year, but not an earlier increase in Federal Reserve ratio. These decisions contributed to a short-term upward correction in the EUR/USD exchange rate at the end of July – beginning of August.

ECB, also driven by rising inflation above target levels, announced, in September, its decision to move the pandemic emergency procurement program to a more moderate pace. In this context, after a brief depreciation, in early September, in the context of worse-than-expected data on the US labor sector, the dollar resumed its appreciation trend against the euro until the end of the quarter.

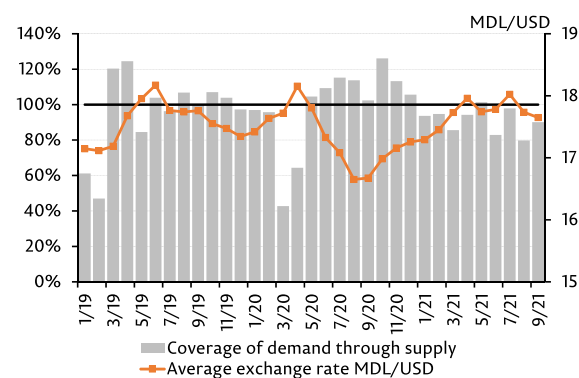
Thus, during the third quarter, compared to the end of the previous one, the US dollar appreciated by 2.1% against the single European currency.

At the end of the third quarter of 2021, the balance of official reserve assets amounted to 3,961.8 million US dollars (Chart 4.30), with 187.4 million US dollars (+5.0%) more compared to the end of June. This increase was mainly due to the allocation of SDRs by IMF in the amount of SDR 165.3 million (equivalent to 234.5 million US dollars).

There were also disbursements related to external financing, including loans from the European Bank for Reconstruction and Development and the European Investment Bank, under the project on Energy efficiency and thermal insulation of public and residential buildings in Chisinau, in the amount of 5.8 million euros (equivalent to 6.9 million US dollars). Also, the World Bank and its institutions disbursed loans totaling 7.7 million US dollars, including projects on modernization of tax administration and government services, emergency response to COVID-19, education reform etc. Another factor that contributed to the increase in official reserve assets was the increase of funds in the required reserve accounts in freely convertible currency of licensed banks.

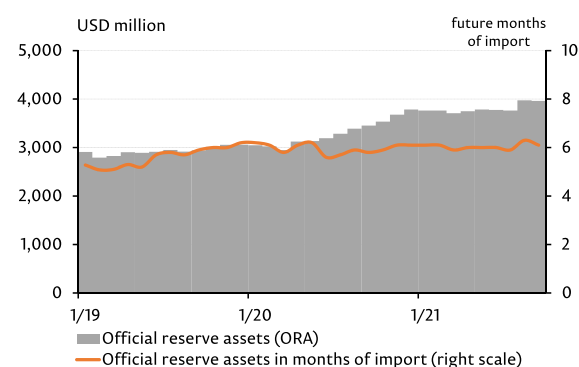
According to the situation at the end of the third quarter of 2021, official reserve assets continued to provide a sufficient level of coverage of imports of goods and services (6.1 months of future imports²⁵).

Chart 4.29: Net sales coverage through the net supply and dynamics of the official exchange rate



Source: NBM

Chart 4.30: Evolution of official reserve assets expressed in months of import of goods and services (MBP6)



Source: NBM – based on updated actual and forecast data

²⁵Calculated based on a preliminary forecast of import of goods and services.

Chapter 5

Forecast

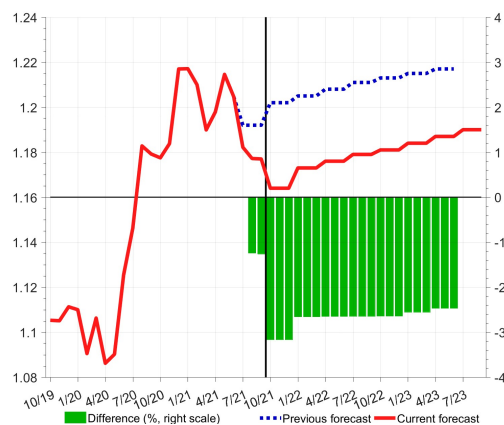
5.1 External hypotheses

Table 5.1: Expected evolution of external variables (annual average)

	2021	2022
Economic growth in the euro area, %	5.1	4.4
Economic growth in the Russian Federation, %	4.0	2.8
Average annual inflation in the euro area, %	2.3	2.0
Average annual inflation in the Russian Federation, %	6.2	4.5
EUR/USD	1.19	1.18
USD/RUB	73.5	71.4
Urals brand oil prices (USD/barrel)	69.5	77.1
International food prices growth, %	27.8	6.5

Source: Consensus Economics, Bloomberg, NBM calculations

Chart 5.1: The evolutionary scenario of the EUR/USD exchange rate



Source: ECB, Consensus Economics, NBM calculations

Considering the recent evolution of international quotations, the external hypotheses from the forecast round related to the Inflation Report no. 4, 2021 are significantly pro-inflationary. Compared to the previous forecast round, all external variables have been increased towards a stronger external economic growth, increase of external prices above the levels targeted by the monetary authorities, a more appreciated US dollar and Russian ruble, as well as a considerable increase of international quotations for energy resources and food. Thus, the table no. 5.1 states the values of the main external hypotheses admitted within the forecast round related to the Inflation Report no. 4, 2021, with their subsequent description.

The acceleration of economic growth in the first half of 2021 in the euro area and achievement of a significant percentage of vaccinated population have led to an increase in the forecast for the growth of gross domestic product in the current year from 4.6 to 5.1% (+0.5 percentage points). The euro area economy is expected to grow by an average of 4.4% in 2022, benefiting from continued fiscal and monetary stimulus. At the same time, the increasing pro-inflationary pressures, especially in the context of the energy crisis, have led to an increase in the forecast of the level of harmonized inflation in the euro area from 1.9 to 2.3% (+0.4 percentage points) for 2021 and from 1.4 to 2.0% (+0.6 percentage points) for 2022.

The increase in international quotations for energy resources is a positive factor in the evolution of the economy of the Russian Federation. Therefore, in the current forecast round, the projected economic growth in the Russian Federation has been increased from 3.3 to 4.0% (+0.7 percentage points) for 2021. For 2022, it is expected that the economy of the Russian Federation will advance on average by 2.8% (+0.1 percentage points). The slowing economic growth in 2022 will be determined by the decrease of production activity and tightening of monetary policy amid pro-inflationary pressures. As consumer prices have continued to rise in the Russian Federation, the current forecast round anticipates that the average annual inflation in 2021 will be 6.2% (+0.3 percentage points), after which it will decrease towards the target set by the Bank of Russia, reaching an average of 4.5% in 2022.

The recent appreciation of the US dollar has led to a change in the EUR/USD parity forecast in the current forecast round from 1.20 to 1.19 (-0.8%) for 2021 and from 1.21 to 1.18 (-2.5%) for 2022. At the same time, the uncertainties related to the EUR/USD variable are significant given that the European Central Bank is also likely to reduce the monetary stimulus program in the short or medium term (Chart 5.1).

The forecast for the evolution of the Russian ruble in the current year did not change significantly due to the cumulative values for 9 months of the current year, when the Russian ruble depreciated. Its recent appreciation will be reflected more in the average for 2022. At the same time, based on the budgetary rule, the Ministry of Finance of the Russian Federation buys foreign currency from the market after a barrel of oil exceeds 45 USD, which moderates the appreciation of the Russian ruble correlated with the increase in oil quotations. Thus, in the current forecast round, it is anticipated that the Russian ruble will record, against the US dollar, an average of 73.5 (+0.1%) in 2021 and 71.4 (+0.4%) in 2022.

The recent increase in oil quotations above 85 USD/barrel has led to an increase in the value forecasted for the current year for the evolution of Urals brand oil from 67.9 to 69.5 USD/barrel (+2.4%) and from 67.8 to 77.1 USD/barrel (+13.7%) for 2022. The significantly high oil prices will be supported by the crisis in the energy sector, and rising global energy prices and global oil deficit, with OPEC+ being in no hurry to fully cover the existing demand (Chart 5.2).

The reversal of the trend from downward to upward in the evolution of international food quotations in August 2021 led to an increase in the forecasted growth of the FAO index calculated based on futures quotations for the main product groups. Thus, in the current forecast round, it is anticipated that international food prices will increase by an average of 27.8% (+3.7 percentage points) in 2021 and by 6.5% (+3.0 percentage points) in 2022. The main determinants of the evolution of international food prices are limited supply, unfavorable forecast for the harvest in the southern hemisphere and increase in production and transport costs related to energy and human resources (Chart 5.3).

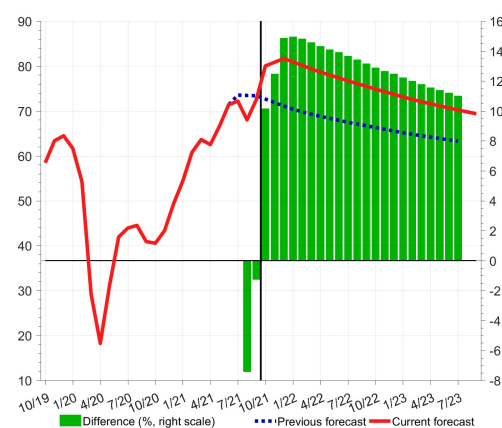
5.2 Internal environment

Inflation

The annual inflation rate will increase rapidly until the third quarter of 2022, subsequently decreasing at a fast pace towards the end of the forecast horizon²⁶. Starting with the first forecast quarter, the annual inflation rate will exceed the upper limit and will return in the interval only in the second quarter of 2023 (Chart 5.4).

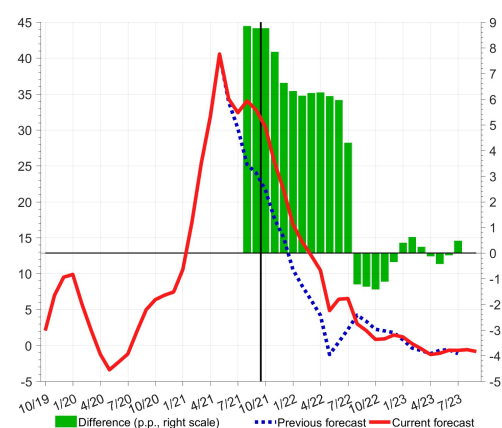
The upward trend in the annual inflation rate is due to all its components, mainly, food prices and core inflation, and less to regulated prices and fuel prices (Chart 5.5).

Chart 5.2: The evolutionary scenario of the Urals brand oil world prices (USD/barrel)



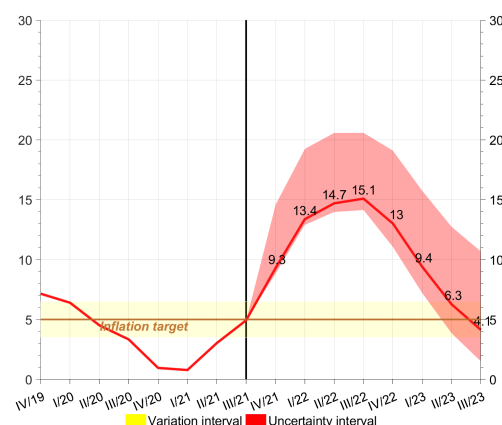
Source: Ministry of Economic Development of the Russian Federation, Bloomberg, NBM calculations

Chart 5.3: International price assumption for food (%)



Source: FAO, Bloomberg, NBM calculations

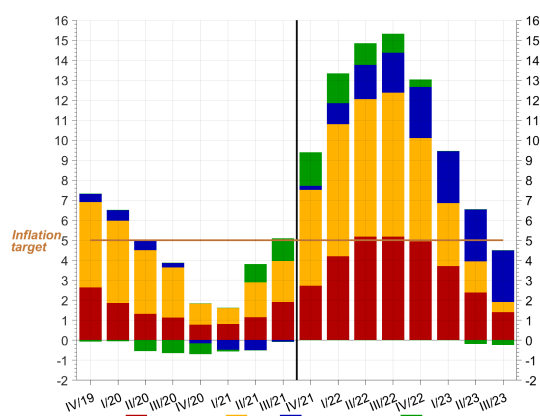
Chart 5.4: CPI with uncertainty range (% , compared to the previous year)



Source: NBS, NBM calculations

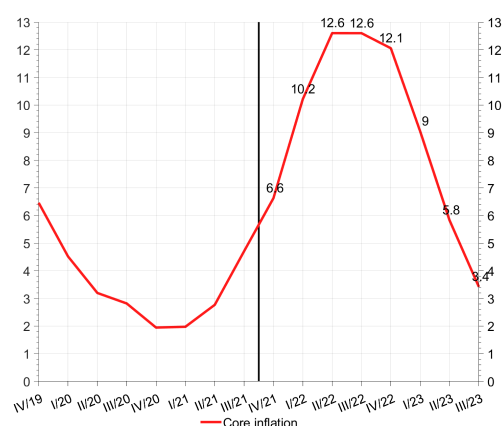
²⁶Quarter III 2023.

Chart 5.5: Decomposition of CPI (% , percentage points, compared to the previous year)



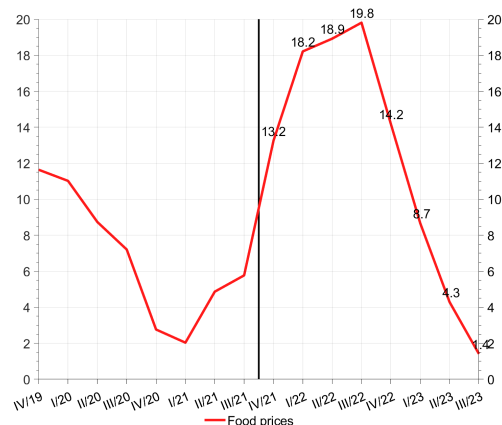
Source: NBS, NBM calculations

Chart 5.6: Core inflation (% , compared to the previous year)



Source: NBS, NBM calculations

Chart 5.7: Food prices (% , compared to the previous year)



Source: NBS, NBM calculations

The positive impact of factors, such as (1) aggregate demand with significant pro-inflationary effects in the current year, and more moderate, but equally pro-inflationary, in the first half of next year, (2) increase in food prices on the regional market, (3) increase in prices for natural gas in the current semester, (4) anticipated increase in some tariffs, (5) increase in international oil prices in the first quarter of the forecast, (6) adjustment of excise duties, (7) effects of highly seasonal products, but also (8) effect of the low annual base, will determine the increase of the annual inflation rate until the third quarter of 2022.

In the downward phase, (1) the negative aggregate demand from the second half of next year until the end of the forecast horizon, (2) decline in imported inflation, (3) continuing downward trend in international oil prices from the next year until the end of the forecast horizon, (4) effect of the high annual base, (5) slight decrease in the annual rate of international food prices in the first half of 2023, will be the factors with negative impact leading to the reduction of the annual inflation rate.

The annual inflation rate will register a maximum value of 15.1% in the third quarter of 2022 and a minimum value of 4.1% in the third quarter of 2023.

The average annual inflation will be 4.5% and 14.0% this year and next year, respectively.

The annual rate of core inflation will have an upward trend until the first half of next year, then declining rapidly towards the end of the forecast period²⁷ (Chart 5.6).

The accelerated growth of the annual rate of core inflation will be driven by (1) the relatively high rate of imported inflation over the entire forecast period, (2) second-round effects of recent increases in commodity prices and transport costs, (3) aggregate demand with significantly pro-inflationary effects in the current year, and more moderate, but equally pro-inflationary, in the first half of next year. The negative aggregate demand (1) from the second half of next year until the end of the forecast horizon, (2) a slight early appreciation of the national currency in the third quarter of 2022, (3) the high base in the second half of this year, and over the next year, will be the factors that will change the trend of core inflation starting with the fourth quarter of 2022, which will decrease rapidly towards the end of the forecast horizon. The adjustment of excise duties from the beginning of 2023 will moderate the downward trend in the annual rate of core inflation.

The average annual rate of core inflation will be 4.0% and 11.9% in 2021 and 2022, respectively.

The annual rate of food prices will increase significantly by the third quarter of 2022 and, from the end of 2022, it will decrease substantially for the rest of the forecast period (Chart 5.7).

The upward trend in the annual rate of food prices will be conditioned by (1) the increase in international food prices in the

²⁷Quarter IV 2021 – quarter III 2023.

current year and in the first half of next year, (2) positive domestic demand in the current year and the first half of next year, (3) effect of the prices of highly seasonal products and (4) adjustment of excise duties from the beginning of next year. On the other hand, its downward trend will be due to (1) the decrease in imported inflation over the next year, (2) effect of the high annual base, (3) decrease in aggregate demand and (4) stabilization of international food prices from the beginning next year. The effect of the prices of highly seasonal products and adjustment of excise duties at the beginning of 2023 will mitigate the decrease of the annual rate of food prices.

The average annual rate of food prices will be 6.5% and 17.7% in 2021 and 2022, respectively.

The annual rate of regulated prices will increase sharply until the end of next year, after which it will remain at a high level (Chart 5.8).

The increase in the annual rate of regulated prices will be largely due to the increase in commodity prices, in particular, the significant increase, in the current quarter, of the import price for gas, and the relatively slow decrease over the whole forecast period, which will lead to significant increases in prices (1) for grid gas and energy-intensive services (2) for medicines, (3) for other regulated prices with a minor weight over the entire forecast period, and (4) to the effect of the low annual base.

The average annual rate of regulated prices will be -1.3% and 10.9% in 2021 and 2022, respectively.

The annual rate of fuel prices will increase in the first quarter of the forecast horizon and, starting in 2022, will decrease considerably for the rest of the forecast period (Chart 5.9).

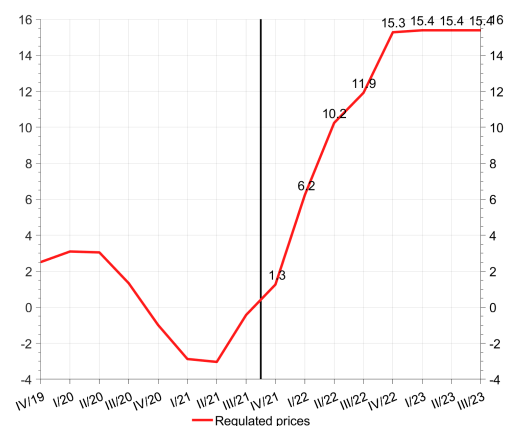
The high annual rate will be determined by (1) the cumulative increase in international oil prices in the first quarter of the forecast and (2) stimulating aggregate demand. The subsequent decline in the annual rate of fuel prices will be due (1) to the effect of the high annual base, (2) continuing downward trends in international oil prices from next year to the end of the forecast horizon, and (3) aggregate demand decreasing from the middle of next year. Adjustments of excise duties from the beginning of 2022 and 2023 will alleviate the decline in the annual rate.

The average annual rate of fuel prices will be 15.2% and 16.3% in 2021 and 2022, respectively.

Demand

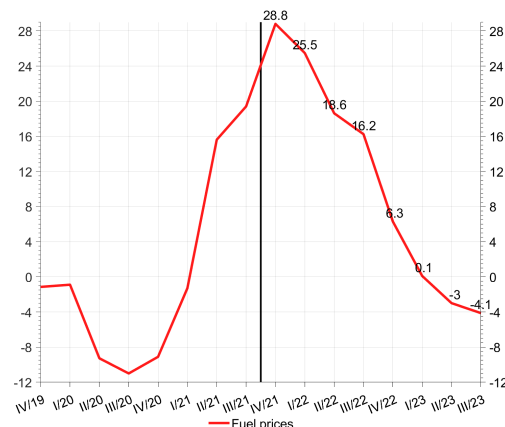
The aggregate demand will have increasing positive values and a strong pro-inflationary character in the first quarter of the forecast, after which it will decrease continuously, but will be pro-inflationary in the first half of next year, later becoming disinflationary. This trajectory will be largely supported by a positive fiscal impulse in the current year, the revival of external demand and current economic recovery, but it will be mitigated by restrictive monetary conditions (Chart 5.10).

Chart 5.8: Regulated prices (% , compared to the previous year)



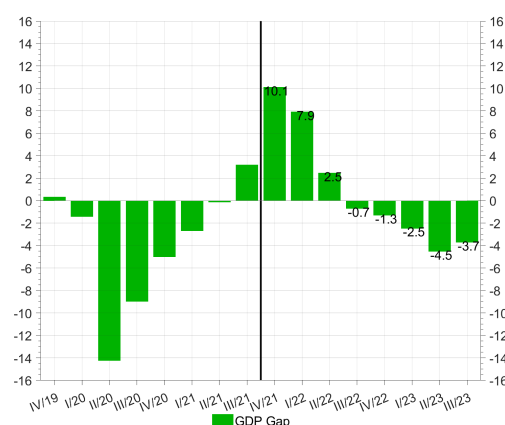
Source: NBS, NBM calculations

Chart 5.9: Fuel prices (% , compared to the previous year)



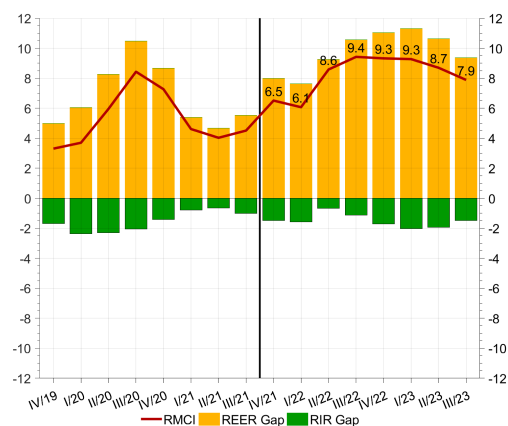
Source: NBS, NBM calculations

Chart 5.10: GDP deviation (%)



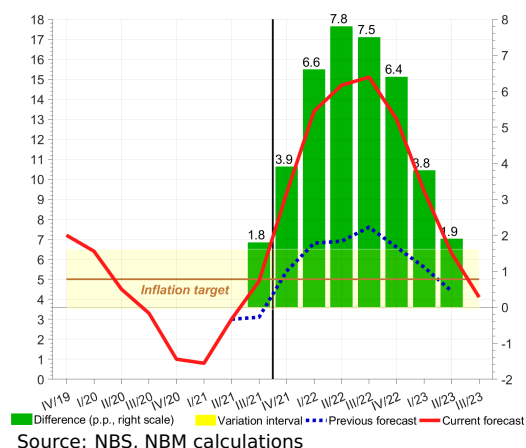
Source: NBM calculations

Chart 5.11: The index of the real monetary conditions and decomposition



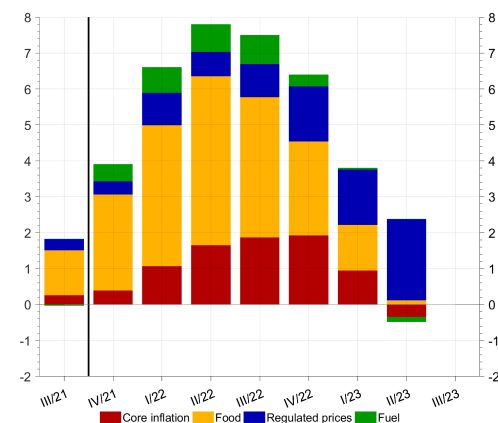
Source: NBM calculations

Chart 5.12: CPI (% , compared to the previous year, percentage points)



Source: NBS, NBM calculations

Chart 5.13: Decomposition of the difference between forecasts (percentage points)



Source: NBM calculations

The GDP deviation was revised in the context of the publication of the real GDP rate for the second quarter of 2021 (21.5% compared to the previous year). The GDP deviation will increase in the first quarter of the forecast, after which it will continuously decrease under the influence of the decrease of the external aggregate demand, monetary conditions and diminishing influence of the fiscal impulse. The negative deviation of the real effective exchange rate over the entire forecast horizon will show restrictive effects on aggregate demand, which will be slightly tempered by the real interest rate.

Monetary policy

Real monetary conditions will be restrictive over the entire forecast period, with a negative impact on aggregate demand (Chart 5.11). Monetary policy through the real effective exchange rate will be restrictive over the entire forecast horizon. Through the real interest rate, monetary policy will be stimulating throughout the forecast period.

The slight nominal appreciation of the Moldovan leu in the second half of this year and the effective and subsequent rise in inflation will increase the accumulated imbalance in the real effective exchange rate, which will continue to have restrictive effects on aggregate demand. In the first half of 2023, it is anticipated that the deviation of the real exchange rate will be restrictive but decreasing.

5.3 Comparison of forecasts

The current inflation forecast, compared to the previous inflation report, has been revised upwards over the entire comparable period²⁸ (Chart 5.12).

The upper projection of the annual inflation rate forecast is largely due to significant upward revisions in the forecast of food prices, core inflation, regulated prices and, to a lesser extent, fuel prices. The lower projection of core inflation and fuel prices in the last quarter of the comparable period dampened the upward revision of the current forecast (Chart 5.13).

The average annual inflation rate was increased by 1.4 percentage points for 2021 and by 7.0 percentage points for 2022.

The current forecast for the annual core inflation rate has been increased over the entire comparable period, except for the last quarter (Graficul 5.14).

The upper projection of core inflation is determined by (1) a significantly higher trend in aggregate demand in the current year and in the first half of next year, (2) higher-than-expected actual inflation for the previous quarter, (3) a higher trajectory of import prices starting next year. On the other hand, (1) a lower trajectory of import prices in the current quarter and (2) a lower aggregate demand starting with the fourth quarter of 2022 dampened the

²⁸Quarter IV 2021 – quarter II 2023.

upward revision of the annual core inflation forecast and a lower projection in the last quarter of the comparable period.

The forecast of the average core inflation rate was increased by 0.4 percentage points for 2021 and by 4.1 percentage points for 2022.

The annual rate of food prices was revised upwards significantly for the comparable period (Chart 5.15).

The upper projection of food prices is determined by (1) higher-than-expected actual inflation for the previous quarter, (2) a higher forecast of international food prices, (3) a significantly higher trend in aggregate demand in the current year and in the first half of next year. The appreciation of the exchange rate in the third quarter of the current year attenuated the upward revision of the annual food rate forecast.

The forecast of the annual rate of food prices was increased by 2.7 percentage points for 2021 and by 10.5 percentage points for 2022.

The current forecast of the annual rate of regulated prices has been revised significantly upwards for the comparable period (Chart 5.16).

The annual rate of regulated prices will be significantly higher as a result of the multiplication of the actual level, but also of the anticipated one, of the import price of natural gas. Respectively, in the current forecast, a higher increase in the tariff for grid gas and other services with a high energy component (central heating, hot water, etc.) was anticipated, compared to the previous forecast²⁹.

The forecast of regulated prices was increased by 1.0 percentage points for 2021 and by 6.1 percentage points for 2022.

The forecast for the annual rate of fuel prices was increased for the entire comparable period, except for the last quarter (Chart 5.17).

The upper projection of the annual rate of fuel prices is determined by (1) a higher forecast of international oil prices, (2) a higher aggregate demand, compared to the previous one, in the current year and the first half of next year. The higher-than-expected exchange rate in the third quarter of this year and a lower aggregate demand from the fourth quarter of 2022 dampened the upward revision of the forecast of annual rate of fuel prices and a lower projection in the last quarter of the comparable period.

The fuel price forecast was increased by 1.9 percentage points for 2021 and by 11.2 percentage points for 2022.

Chart 5.14: Core inflation (% , compared to the previous year, percentage points)

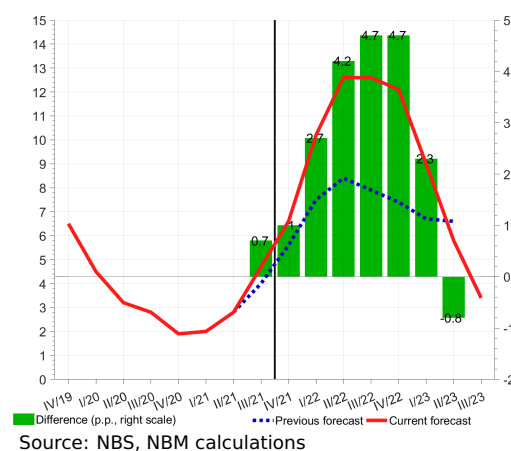


Chart 5.15: Food prices (% , compared to the previous year, percentage points)

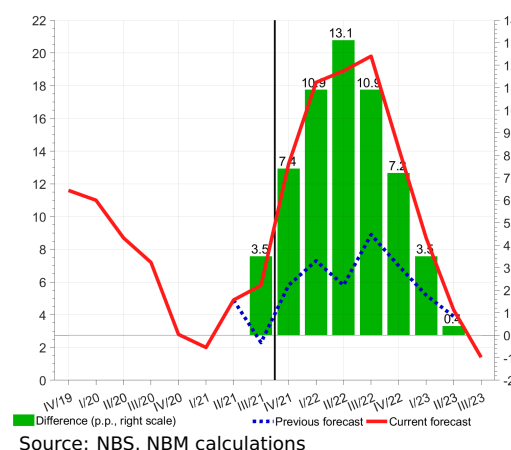
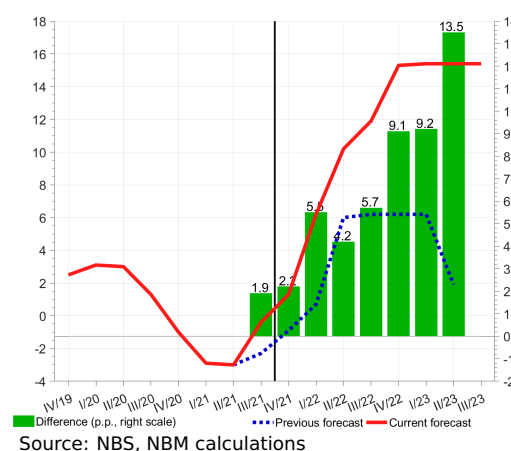


Chart 5.16: Regulated prices (% , compared to the previous year, percentage points)

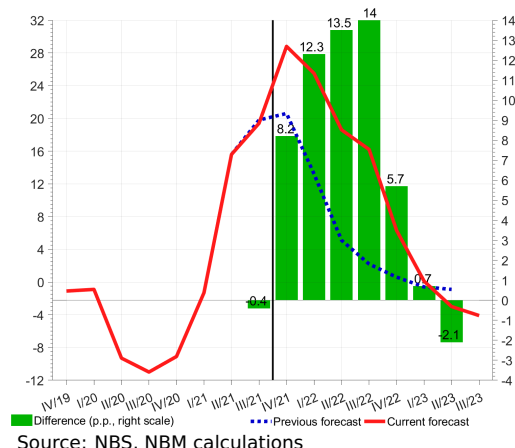


²⁹Inflation Report no.3, 2021

5.4 Risks and uncertainties

External sector

Chart 5.17: Fuel prices (% , compared to the previous year, percentage points)



- Increasing international prices for energy resources.** Recently, the price of Brent oil has exceeded 85 USD/barrel, which is the highest level in the last 3 years, and experts anticipate that the risk is quite high of it exceeding 100 USD/barrel in a few months. At the same time, the energy crisis in Europe, as well as worldwide, made quotations for natural gas and coal increase several times. Given the limited supply and logistical and transport disruptions, quotations for energy resources will continue to increase. At the same time, even if the USA asked OPEC+ to increase the oil production more than the planned 400 thousand barrels per day monthly, this did not happen, thus further increasing oil quotations. Raising prices on energy resources is a huge challenge given that the risks are twofold. In the first round, what one already may notice is the rise in prices for energy resources, such as natural gas, petrol and diesel. The second round will see an increase in prices for most products given that energy resources are an important component of production and transportation costs (pro-inflationary).
- Increasing international food prices.** Even if at the beginning of summer of 2021, the international quotations for food products started to decrease, diminishing the pressure of the annual growth rates, starting with August 2021, the trend reversed, contrary to expectations. In September 2021, all product groups included in the FAO index increased in both monthly and annual terms. The reversal of the trend in the middle of the agricultural season was due to increased demand given a limited supply, expectations of a poor harvest in the southern hemisphere and rising prices for energy resources, which increased production and transportation costs. At the same time, in the conditions of the end of the agricultural season in the northern hemisphere and unfavorable predictions regarding the harvest in the southern hemisphere, no premises can be seen for a reduction of the imminent increase of the international quotations for food (pro-inflationary).
- Declining production activity in emerging economies and fragmented growth worldwide.** The energy crisis, COVID-19 outbreaks, rising production costs, and logistics and transport problems, are the main causes of declining production activity, especially in emerging economies. Given that no major changes are expected soon, there is a risk of even more drastic decline in global production. At the same time, most economies are evolving very differently, depending on access to raw material resources, fiscal and monetary incentives, human resources and, last but not least, the COVID-19 factor (disinflationary).

- **Appreciation of the single European currency.** In recent weeks, the US dollar has been favored by the announcement of the Federal Reserve System to start reducing the asset purchase program to temper pro-inflationary pressures. Currently, the tightening of monetary policy is common to both emerging and advanced economies. Given that the European Central Bank has not come up with an official announcement to reduce the asset purchase program, despite inflation exceeding the target level of 2.0%, the single European currency was disadvantaged compared to other currencies of international circulation. But there are anticipations that the ECB could announce some changes soon in the context of the reduction of the monetary stimulus program, which will lead to an appreciation of the single European currency and, actually, a change in the EUR/USD exchange rate (uncertainty).

Real sector

- **Uncertainties about agricultural production in 2022.** The harvest of 2022, respectively, the prices for food products on the domestic market will depend, to a large extent, on the agro-meteorological conditions of the current year and next year. If the estimates for this year's harvest are optimistic in the context of favorable conditions so far, developments in the agricultural sector and, therefore, the trajectory of food prices for next year, are marked by a pronounced uncertainty (uncertainty).
- **Vulnerability of prices for local fruits and vegetables to weather conditions in the near future.** According to the experience of recent years, the prices of local fruits and vegetables are largely affected by adverse weather conditions such as dry weather, heavy rainfall, etc., the costs associated with harvesting, transporting, storage, but also their sale at outlets in the country. In the event of significantly different temperatures than normal or heavy rainfall, this would result in a more-than-forecasted increase in food prices over the coming months (pro-inflationary).
- **Uncertainties about the timing and magnitude of the tariff adjustment for regulated services.** The medium-term forecast of inflation is based on a trajectory of prices for regulated services that corresponds to certain assumptions about the prices of energy resources at international and regional level, as well as about other indicators relevant to the respective sector. However, given that tariffs for some regulated services have a considerable economic impact on the population, the timing of their adjustment can be based not only on economic factors but also on the pursuit of social or political objectives by the decision makers involved. Therefore, the timing and magnitude of the tariff adjustments cannot be estimated with a sufficient degree of confidence. At the same time, in the context of the increase in prices for energy resources internationally and regionally, particularly for natural gas, during the last quarters, for the average forecast horizon, certain preconditions for adjusting tariffs in some subcomponents of regulated prices are outlined (uncertainty, pro-inflationary).

- **Duration, intensity of the COVID-19 pandemic and impact on the domestic economy.** The state of uncertainty regarding the evolution of the virus, emergence of new related variants and associated restrictive measures, depending, particularly, on the coverage and effectiveness of the vaccination, remains valid. If additional restrictive measures are further applied for a longer period, the domestic demand will be more modest than anticipated and the impact on inflation will be disinflationary (disinflationary).

Monetary and public sectors

- **External financing.** The flow of external credit and grants is expected to increase considerably, which will allow the Government to implement reforms in the national economy more quickly and will create additional incentives on aggregate demand and inflation (pro-inflationary).
- **A possible increase in excessive liquidity in the banking sector.** As a result of the monetary issue during the period 2020-2021, following the interventions of the NBM on the domestic foreign exchange market and the anticipated external financial assistance in future periods, in addition, the continuous increase of excessive liquidity in the banking system will be stimulated. Consequently, this surplus will have a positive impact, in the short term, on aggregate demand, and on the exchange rate of the national currency, and may generate additional inflationary pressures (pro-inflationary).
- **State budget and fiscal and customs policy for 2022.** The postponement of the adoption and publication of the Law on the state budget for 2022 and the fiscal and customs policy for 2022 creates uncertainty in estimating and analyzing future developments in the public sector (uncertainty).

Chapter 6

Monetary policy decisions

Summary of the meeting of the Executive Board of the National Bank of Moldova of 05.03.2021 on monetary policy

Meeting chaired by: Mr. Octavian Armaşu, Governor – Chairman of the Executive Board

The following were present: members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mr. Ion Sturzu – Deputy Governor, Mr. Aureliu Cincilei – Deputy Governor

Rapporteur: Mr. Radu Cuhai – Director of the Monetary Policy Department

Guests: Mr. Natan Garştea, Ms. Natalia Sîrbu – Advisers to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mr. Constantin Şchendra – Director of the Banking Supervision Department, Mr. Ion Veveriţă – Director of the Reporting and Statistics Department, Mr. Andrei Rotaru – Director of the Economic and Applied Research Department, Ms. Alina Boboc – Head of the Communication and Press Service

Mr. Radu Cuhai presented to the NBM Executive Board the Report on the assessment of the risk of deviating from the inflation forecast, prepared on the basis of information and events in the external and internal environment that emerged after the forecast round in January 2021. At the same time, the trends in key macroeconomic indicators, and risks to the short- and medium-term inflation forecast, were specified.

The discussions of the members of the Executive Board began with the analysis and assessment of the macroeconomic information available after the January forecast, emphasizing that, in general, the main assumptions and conclusions reflected in the Inflation Report no. 1, 2021 were confirmed. At the same time, they noted the persistence of the risk of a downward deviation of the inflation forecast for the first quarter of 2021, taking as a benchmark the actual inflation values for January this year, along with the validity of the new electricity tariffs starting with February.

In this context, they referred to the dynamics of the inflationary process, noting that the annual inflation rate in January 2021 continued the downward trajectory, but with a lower magnitude than expected (0.4%), registering 0.2%. It was noted that the deviation of the actual inflation from the forecast is mainly due to the negative impact of the core inflation and food prices, which increased by 1.7% and 1.3%, respectively, in annual terms, being by 0.3 and 0.1 percentage points lower than expected in the Inflation Report no.1, 2021. Also, it was found that the level of regulated prices registered in January 2021 was practically identical to the forecast, and fuel prices had a slightly higher evolution than expected.

During the discussions on the developments of the inflationary process, EB members pointed out that, in January 2021, the National Bureau of Statistics changed the weights associated with the CPI basket-related components and subcomponents. It was mentioned that the share of core inflation increased by 7.0 percentage points, up to 41.1%, to the detriment of the share of prices for the other subcomponents. The share of food prices decreased by 2.1 percentage points, to 36.3%, and the share of prices for regulated services decreased by 4.7 percentage points, to 16.8%, while the share of fuel prices was 5.8%, by 0.2 percentage points lower than in the previous year.

EB members spoke on developments in the national economy sectors, noting that despite the slow recovery in aggregate demand, economic conditions remain affected by the impact of the pandemic, as confirmed by some operational indicators available after the January 2021 forecast round.

In this regard, it was noted that after a slightly positive evolution in November 2020, freight transport,

industrial production, and trade in services registered, in December 2020, negative annual growth rates of -14.9%, -1.8% and -0.7%, respectively. At the same time, there was an increase in trade in goods and imports in December 2020, with exports reaching the level of the same month of 2019. It was stressed that the national economy is affected by negative developments in the agricultural sector, mainly due to adverse weather conditions, which conditioned the decrease of agricultural production by about 31.5% in October – December 2020 compared to the similar period of 2019. Referring to the dynamics of remittances from abroad to individuals, it was stated that their annual rate, in the fourth quarter of 2020, continued to show a strong positive dynamic, reaching the level of 36.9% in December 2020.

EB members established that the stimulating conduct of the previously adopted monetary policy through the interest rate and liquidity channel, together with the money market situation, conditioned the decrease of the weighted average interest rate on new loans granted in national currency, in December 2020 – first two weeks of February 2021, from 7.85% to 7.29% annually. It was found that the weighted average interest rate on new term deposits attracted in Moldovan lei was 3.32% in the first two weeks of February this year.

While identifying and assessing the risks of deviation of the inflation forecast made in January 2021, EB members referred to the risk associated with an earlier and more pronounced reduction in the electricity tariff. At the same time, the risks of a pro-inflationary nature were highlighted, such as the increase in international prices for food and energy resources and the faster recovery of global economic activity. It was noted that immediately after the drawing up of the forecast round in January 2021, most central banks revised their economic activity forecast upwards.

Following the assessment of the quantified risk of deviation of the inflation forecast published in the Inflation Report no. 1, 2021, EB members pointed out the persistence of a negative deviation for the short-term inflation forecast (quarters I, II 2021). At the same time, they referred to the existence of the risk of a higher inflation trajectory starting with the fourth quarter of the current year until the end of the forecast horizon, except for the fourth quarter of 2022, when it will register similar values.

In the discussions that followed, EB members noted that recent information suggests an increased degree of uncertainty about the implications of the pandemic on the domestic economy and its mitigation measures with repercussions on inflation. It was emphasized that the use of internal sources to finance the national public budget while limiting access to external ones could lead to an insufficient fiscal impulse for faster economic recovery and mitigation of the consequences of the pandemic.

Following the analyses and findings made during the meeting, the NBM Executive Board decided to maintain the base rate, rates related to standing facilities and ratio of required reserves in freely convertible currency at current levels, and, respectively, to reduce the ratio of required reserves in Moldovan lei and non-convertible currency by 2.0 percentage points to the level of 30.0% of the calculation base.

It was noted that the decision aims to create monetary conditions that would contribute to the return of inflation in the range of ± 1.5 percentage points from the medium-term inflation target of 5.0%. The decision was justified as coming against the background of the stimulating measures of monetary policy adopted in the second half of the previous year.

At the same time, EB members emphasized that this decision aims to maintain sufficient adequate liquidities to support the recovery of economic activity, in particular, to maintain an upward trend in lending to the real economy and to reduce the cost of bank loans, as well as to support the need to finance budget expenditures in the context of increasing political uncertainty and diminishing certainty about external financial assistance. It was pointed out that this decision corresponds to the strategic aim of balancing the conditions of financial intermediation in national currency and in foreign currency.

At the end of the meeting, EB members reiterated the need for continuous monitoring of the internal and external macroeconomic situation, stressing that the NBM, without prejudice to its fundamental objective of ensuring price stability, will come up, in due course, with measures to maintain the sufficient liquidity of the licensed banks, in support of a viable and stable banking system.

The Executive Board of the NBM adopted the following decision by majority of votes:

- 1. The base rate applied to the main short-term monetary policy operations is maintained at the current level of 2.65% annually.**
- 2. Interest rates are maintained:**
 - a) on overnight loans at the current level of 5.15% annually;**
 - b) on overnight deposits at the current level of 0.15% annually.**
- 3. The required reserve ratio for the means attracted in Moldovan lei and in non-convertible currency is diminished, beginning with the period of application of required reserves in Moldovan lei: March 16, 2021 – April 15, 2021, by 2.0 percentage points, and is set at 30.0% of the calculation base.**
- 4. The required reserve ratio for the means attracted in freely convertible currency is maintained at the current level of 30.0% of the calculation base.**

Voting results

PRO – 3

AGAINST – 1

ABSTAINED – 0

Chairman of the Executive Board

Secretary of the Executive Board

Octavian ARMAȘU

Sergiu SURDU

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 05.04.2021
on monetary policy

Meeting chaired by: Mr. Octavian Armașu, Governor – Chairman of the Executive Board

The following were present: members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mr. Ion Sturzu – Deputy Governor

Rapporteur: Mr. Radu Cuhai – Director of the Monetary Policy Department

Guests: Mr. Natan Garștea, Ms. Natalia Sîrbu – Advisers to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mr. Constantin Șchendra – Director of the Banking Supervision Department, Mr. Ion Veveriță – Director of the Reporting and Statistics Department, Mr. Andrei Rotaru – Director of the Economic and Applied Research Department, Ms. Alina Boboc – Head of the Communication and Press Service

The members of the NBM Executive Board underlined that the extraordinary monetary policy meeting was determined by the analysis of the current situation, the evaluation of the trends of the main macroeconomic indicators and, mainly, by the evolution of excessive liquidity in the banking system.

Following the information presented by Mr. Radu Cuhai, EB members found that the decrease by 2.0 percentage points of the ratio of required reserves in Moldovan lei and in non-convertible currency from last month contributed to the increase of liquidity up to 7.1 billion lei on March 16 this year, which subsequently decreased continuously and reached the level of 3.4 billion lei on the day of the meeting. In the discussions on the reasons having determined the decrease of the liquidities, the payment of taxes to the state by economic operators was mainly highlighted.

In the discussions that followed, the members of the Board referred to the evolution of the inflationary process, finding that the annual inflation rate in February 2021 was 0.6%, being by 0.4 percentage points higher than in January 2021. It was pointed out that core inflation (0.8 percentage points) and food prices (0.7 percentage points) generated the largest contributions to the annual inflation rate, while regulated prices (-0.7 percentage points) and fuel prices (-0.1 percentage points) had a negative impact.

EB members spoke on the domestic economy, stressing that under the impact of internal and external pandemic restrictions, along with unfavorable conditions for the agricultural sector, it continued to show negative growth rates in the fourth quarter of 2020, but with a lower magnitude compared to the second and third quarters of 2020. In this respect, they referred to the gross domestic product, which contracted by 3.3%, in real terms, in the fourth quarter of 2020 compared to the same period of the previous year, and by 7.0% in 2020 compared to 2019.

Following the analyses, findings and assessments made during the meeting, the NBM Executive Board decided to maintain the base rate, rates related to standing facilities and ratio of required reserves in freely convertible currency at current levels, and, respectively, to reduce the ratio of required reserves in Moldovan lei and in non-convertible currency by 2.0 percentage points to the level of 28.0% of the calculation base.

It was noted that the decision comes against the background of continued stimulating monetary policy measures to mitigate the impact of the pandemic, and strengthens the NBM's position in supporting economic recovery, boosting aggregate demand and a viable and stable banking system.

At the same time, EB members stressed that by this decision the NBM supports the upward trend of lending activity, ensuring sufficient adequate liquidity for this purpose, while reducing lending costs in support of the business environment. They also referred to the appropriateness of this decision in the light of avoiding the "crowding out" effect as the demand for funding from the Ministry of Finance increases.

At the same time, the members of the Board expressed the opinion that the decision was aimed at increasing the efficiency of the transmission of monetary impulses in the real sector of the economy and balancing the conditions of financial intermediation in the national currency.

Referring also to the dynamics of inflation in the coming periods, depending on the quantitative objective of monetary policy and the projected CPI trend in the January 2021 round, EB members noted that the monetary policy measure would create preconditions for an earlier return of inflation to the range of ± 1.5 percentage points from the 5.0% target, being appropriate to the expectations regarding the evolution of inflation, whose annual growth rate will be below the lower limit of the variation range. In this regard, the members of the Board stressed that conditions would emerge for reduction of the risks related to the inflation's evolution beyond expectations in 2022.

At the end of the meeting, EB members reiterated the need for continuous monitoring of the internal and external macroeconomic situation, stressing that the NBM, without prejudice to its fundamental objective of ensuring price stability, will come up, in due course, with measures to maintain the sufficient liquidity of the licensed banks.

The Executive Board of the NBM unanimously adopted the following decision:

- 1. The base rate applied to the main short-term monetary policy operations is maintained at the current level of 2.65% annually.**
- 2. Interest rates are maintained:**
 - a) on overnight loans at the current level of 5.15% annually;**
 - b) on overnight deposits at the current level of 0.15% annually.**
- 3. The required reserve ratio for the means attracted in Moldovan lei and in non-convertible currency is diminished, beginning with the period of application of required reserves in Moldovan lei: April 16, 2021 – May 15, 2021, by 2.0 percentage points, and is set at 28.0% of the calculation base.**
- 4. The required reserve ratio for the means attracted in freely convertible currency is maintained at the current level of 30.0% of the calculation base.**

Voting results

PRO – 3

AGAINST – 0

ABSTAINED – 0

Chairman of the Executive Board

Octavian ARMAȘU

Secretary of the Executive Board

Sergiu SURDU

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 30.04.2021
on monetary policy

Meeting chaired by: Mr. Octavian Armașu Governor – Chairman of the Executive Board

The following were present: members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mr. Aureliu Cincilei – Deputy Governor

Rapporteur: Mr. Radu Cuhăl – Director of the Monetary Policy Department

Guests: Mr. Natan Garștea, Ms. Natalia Sîrbu – Advisers to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mr. Constantin Șchendra – Director of the Banking Supervision Department, Mr. Ion Veveriță – Director of the Reporting and Statistics Department, Mr. Andrei Rotaru – Director of the Economic and Applied Research Department, Ms. Alina Boboc – Head of the Communication and Press Service

The meeting of the NBM Executive Board began with a presentation by Mr. Radu Cuhăl on the analyses of the latest available information from the external and internal environment, trends and perspectives of the main macroeconomic indicators, which were reflected in the Inflation Report no. 2, May 2021. At the same time, the external hypotheses, assumptions associated with the new forecast round, as well as the risks and uncertainties related to the inflation process for the next eight quarters, were presented.

Assessing the external macroeconomic situation, EB members noted that recent information reflects the improvement in global economic conditions in the first quarter of 2021. It was pointed out that against the background of the economic recovery, quotations on international markets for oil, food and raw materials had upward trends. At the same time, it was found that most economies were experiencing inflationary pressures due to rising production, storage, and transportation costs.

In discussions related to the domestic macroeconomic environment, EB members referred to the evolution of the inflationary process, noting that in the first quarter of 2021, the annual inflation rate marked the beginning of an upward trajectory and recorded 1.5% in March 2021 compared to 0.2% in January this year, remaining below the range of ± 1.5 percentage points from the inflation target of 5.0%. At the same time, it was noted that the average annual rate, in quarterly terms, continued the downward dynamics of previous periods, amounting to 0.8% compared to 1.0% in the fourth quarter of 2020. In discussions on the reasons that determined the evolution of inflation in the first quarter of 2021, EB members referred to supply-side factors, such as rising oil prices, adjustment of excise duties, cost pressures, along with the disinflationary impact of domestic demand and electricity tariffs.

Subsequently, the discussion focused on the local economic activity, noting that the gross domestic product will further remain in the negative area in the first quarter of 2021, based on the operational data for January-February 2021 provided by the National Bureau of Statistics. It was found that a negative impact is outlined by net external demand, as exports decreased by 8.4% and imports increased by 6.8% in the first two months of 2021 compared to the similar period of the previous year. At the same time, EB members pointed out that negative results are witnessed in the freight (-19.8%) and passenger (-39.5%) transport sectors, while the turnover in retail sales and services provided to the population increased by 5.9% and 12.6%, respectively. It was emphasized that industrial production had a slight recovery in February (2.4% in annual terms). They also referred to agricultural production, noting a decrease of 13.3% in the first quarter of 2021 compared to the same quarter of the previous year.

Analyzing developments on the labor market, EB members noted that it was still conditioned by the impact of COVID-19 restrictions and contraction of economic activity. They also referred to the negative dynamics of the economically active and employed population, finding, for the fourth quarter of 2020, a contraction of 1.2% and 0.5%, respectively, in annual terms.

EB members commented on the sources of financing the consumption of the population, emphasizing that the salary fund outlines premises for reviving consumption, increasing by 11.3% compared to the fourth quarter of 2019.

In this regard, it was mentioned that the new loans granted in the national currency enhanced their advance, with their volume increasing by 16.3% in annual terms. It was found that the weighted average interest rate on new loans in national currency amounted to 7.39% annually in the first quarter of 2021, decreasing by 1.17 percentage

points compared to the first quarter of 2020 and by 0.53 percentage points compared to the previous quarter.

The hypotheses and assumptions considered in developing of the new forecast round were further discussed. In this context, it was revealed that the gradual recovery of the world economy and main foreign trade partners of the Republic of Moldova, appreciation of the US dollar, depreciation of the single European currency and Russian ruble, and increases in oil and food prices, underlie the forecasts related to the developments in the external environment, with implications for the domestic situation by influencing domestic demand and price dynamics.

Referring to the new forecast round, it was pointed out that this denotes the maintenance of inflation trends reflected in the previous forecast of January 2021. At the same time, it was noted that the current projection of the annual inflation rate was revised upwards for the second quarter of 2021 – first quarter of 2022, and downwards for the second quarter – fourth quarter 2022, reaching the inflation target in the first quarter of 2023.

It was emphasized that the annual inflation will be below the lower limit of the target variation range until the third quarter of 2021, after which it will return to the range and will remain at the lower level until the end of the forecast horizon. At the same time, it was highlighted that the average annual inflation will register the level of 2.5% and 4.4% in 2021 and 2022, respectively.

From the information associated with the GDP deviation forecast, EB members noted that the aggregate demand, which is negative but in partial recovery, will continue to generate disinflationary pressures over the forecast horizon (second quarter of 2021 – first quarter of 2023). Regarding the domestic aggregate demand rallying, it was mentioned that the generators in this regard will be the recovery of external demand, improvement of monetary conditions and recovery in agriculture in the current year.

In the discussions on the risks and uncertainties associated with the current forecast, the subsequent evolution of the pandemic and its impact on the economic situation both externally and internally were highlighted. Potential pro-inflationary risks referred to the further increase in production costs amid accelerated commodity quotations, transport, and storage costs. EB members noted that the current forecast round implies persistent uncertainties about the timing and magnitude of tariff adjustment for regulated services, agricultural production in 2021 and 2022, and the external financing of the budget deficit.

Following the analyses, findings and assessments made during the meeting, the NBM Executive Board decided to maintain the base rate, rates related to standing facilities and ratio of required reserves in freely convertible currency at current levels, and, respectively, to reduce the ratio of required reserves in Moldovan lei and in non-convertible currency by 2.0 percentage points to the level of 26.0% of the calculation base.

It was noted that by this decision, the conduct of monetary policy maintains the direction of mitigating and counteracting the negative effects of the pandemic on the national economy, strengthening the position of the NBM in support of economic recovery.

At the same time, EB members emphasized that the decision aims to ensure a sufficient level of liquidity to support the revitalization of the lending process in the context of lower related costs, thus helping to boost aggregate demand.

EB members referred to the appropriateness of this decision, including from the perspective of stimulating financial intermediation in the national currency, thus contributing to strengthening the efficiency of the transmission of monetary impulses in the real sector of the economy.

During the meeting, the NBM EB analyzed and approved the Inflation Report no. 2, May 2021 – a document containing a detailed analysis of macroeconomic developments in the internal and external environment, mainly associated with the inflationary process, economic activity, and monetary policy conduct. It also includes the new medium-term forecast, reflecting the associated risks and uncertainties.

At the end of the meeting, EB members reiterated the need for continuous monitoring of the internal and external macroeconomic situation, stressing that the NBM, without prejudice to its fundamental objective of ensuring price stability, will come up, in due course, with measures to maintain the sufficient liquidity of the licensed banks.

The Executive Board of the NBM unanimously adopted the following decision:

- 1. The base rate applied to the main short-term monetary policy operations is maintained at the current level of 2.65% annually.**
- 2. Interest rates are maintained:**
 - a) on overnight loans at the current level of 5.15% annually;**
 - b) on overnight deposits at the current level of 0.15% annually.**
- 3. The required reserve ratio for the means attracted in Moldovan lei and in non-convertible currency is diminished, beginning with the period of application of required reserves in Moldovan lei: May 16, 2021 – June 15, 2021, by 2.0 percentage points, and is set at 26.0% of the calculation base.**
- 4. The required reserve ratio for the means attracted in freely convertible currency is maintained at the current level of 30.0% of the calculation base.**

The Executive Board of the NBM approved the Inflation Report no. 2, May 2021 for publication.

Voting results

PRO – 3

AGAINST – 0

ABSTAINED – 0

Chairman of the Executive Board

Secretary of the Executive Board

Octavian ARMAȘU

Sergiu SURDU

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