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# Inflation Report no. 1, 2024

The Governor of the National Bank of Moldova, Anca Dragu presents the Inflation Report no. 1, 2024

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## SUMMARY

### Inflation

During 2023, the annual inflation rate continued the downward trend since the end of 2022, and in the last quarter it entered in the range of the inflation target. At the same time, in the fourth quarter of 2023, the annual inflation rate was lower than anticipated in the Inflation Report, November 2023. Thus, the annual inflation rate declined from 8.6% in September 2023 to 4.2% in December 2023. In October 2023, after a period of about two years, the annual inflation rate re-entered the range of ±1.5 percentage points from the 5.0% target and remained within it until the end of the year. At the same time, the average annual inflation rate amounted to 5.3% in the fourth quarter of 2023, by 4.4 percentage points lower than in the previous quarter. The downward trajectory of inflation during the previous year and its placement within ±1.5 percentage points of the 5.0% target in the fourth quarter of 2023 is largely the result of the restrictive monetary policy measures of the NBM initiated in the summer of 2021 and continued consistently until the end of 2022. These have succeeded in dampening the excessive aggregate demand in the post-pandemic period, which, together with other sectoral shocks, exerted pronounced inflationary pressures in that period. Subsequently, given the peculiarities of the transmission mechanism of the effects of monetary policy actions on the domestic economy, in the second half of 2022 and during 2023, as estimated, demand moderated and contributed, together with the decline in energy and food prices at the regional level, to the downward trajectory of the annual CPI rate. At the same time, this effect was also intensified by the exchange rate dynamics during 2023. At the same time, in November and December 2023 a temporary disinflationary impact was determined by the compensation of energy resources in the cold period of the year.

The downward trend in the annual rate of industrial production prices has continued, setting the stage for a moderation of their pressures on the prices of some CPI subcomponents in the period ahead. In addition, domestic demand will continue to exert a disinflationary impact, which will be mitigated by the adjustment of tariffs on some services and increases in excise duties on some CPI goods. The way in which tariffs are adjusted, as well as the tense situation in the region and the risks of its escalation, maintain a high degree of uncertainty regarding the inflation forecast, which is also intensified by the procedure for reflecting the compensation granted to the population during the cold period of the year.

In January 2024, the annual inflation rate remained within ±1.5 percentage points of the inflation target of 5.0%, constituting 4.6%, by 0.4 percentage points higher than in December 2023. By subcomponents, the annual core inflation rate increased by 0.5 percentage points to 6.4%. The annual rate of prices of regulated goods and services amounted to 2.2%, by 2.1 percentage points higher than in December 2023. The annual rate of food and fuel prices decreased by 0.4 and 0.9 percentage points, respectively, to 4.2% and -2.3%, respectively.

## External environment

At the beginning of 2024, the world economy can be characterized by a certain stability overshadowed by many uncertainties and gloomy forecasts. Globally we have two major ongoing armed conflicts, the war in Ukraine and the conflict in Palestine. On top of these, attacks by Houthi rebels in Yemen on merchant ships in the Red Sea and counterattacks by the USA and allies have disrupted shipping through the Suez Canal, forcing traders to take a detour route around Africa, thus increasing logistics and transportation costs. Although inflation rates have come down towards the levels targeted by monetary authorities, they are in no hurry to cut interest rates because of persistent risks and uncertainties. These risks are related to the transportation costs, especially shipping, energy prices, the impact of El Niño on some agricultural crops and foreign exchange and financial risks. Economic growth continues to be weak under the burden of still high interest rates and structural shifts in global trade in recent years.

## Economy

In the third quarter of 2023, the annual GDP dynamics returned to the positive territory after the decline in the second half of 2022 and the first half of 2023. As a result, the GDP increased by 2.6% compared to the same period of 2022. This dynamic was marginally higher than that anticipated in the Inflation Report, November 2023. Developments in economic activity were mainly supported by the rich harvest in the agricultural sector, which created conditions for both higher exports and lower imports of agri-food products. There were also some positive developments in the financial sector, communications, social services, construction and real estate transactions. However, domestic demand continued to be modest, signaled by a decrease in the consumption of population and investment, amid weak real income growth and heightened uncertainty in the region. Less optimistic signals regarding the economic activity are also confirmed by negative dynamics in industry, trade and transportation, as well as a reduction in the net taxes on products. At the same time, the seasonally adjusted series reflects a 0.8% decline in GDP compared to the second quarter of 2023. Overall, in the first nine months of 2023, the GDP decreased by 0.4% compared to 2022. Against this backdrop, similar to the previous periods, as projected, the aggregate demand pressures on prices had exerted a disinflationary impact.

In the fourth quarter of 2023 as well, the GDP is expected to continue its positive dynamics on the basis of a rich harvest in the agricultural sector, an increase in exports overlapping with a subdued domestic demand affected by uncertainties in the region. Thus, according to the operational data published by the NBS for November 2023, exports and retail trade increased in nominal terms by 6.7% and 2.3%, respectively. Imports, industrial production, wholesale trade decreased by 14.7%, 6.1% and 3.5%, respectively. In terms of consumption financing sources, transfers to individuals declined by 12.8% annually.

In the fourth quarter of 2023, the national public budget revenue increased by 9.6% above the level recorded in the same period of 2022. National public budget expenditure increased by 8.7% above the level recorded in the fourth quarter of 2022. At the same time, on the market of state securities allocated during the fourth quarter of 2023, interest rates maintained their downward trend.

## Monetary policy

In the fourth quarter of 2023, the average excess liquidity amounted to MDL 9.4 billion, decreasing by MDL 0.6 billion compared to the previous quarter. In January 2024, excess liquidity averaged MDL 12.7 billion.

The M3 monetary aggregate in the fourth quarter of 2023 recorded an annual growth rate of 18.3% annually. The main contribution is provided by the deposits balance in national currency.

During the fourth quarter of 2023, two meetings of the Executive Board of the National Bank of Moldova were held on monetary policy decisions. Following the assessment of the balance of internal and external risks and the inflation outlook in the short- and medium-term, the Executive Board of the National Bank of Moldova, at its meeting on November 7, 2023, decided to lower the base rate applied to the main monetary policy operations by 1.25 percentage points to 4.75%, and subsequently, at its meeting on December 14, 2023, maintained this level.

At the same time, during the ordinary monetary policy meeting on February 6, 2024, the Executive Board of the National Bank of Moldova adopted unanimously the decrease of the base rate applied to the main short-term monetary policy operations by 0.50 percentage points, setting the level at 4.25%. Rates on overnight loans and deposits were lowered by the same magnitude, to 6.25% and 2.25%, respectively. At the same time, the required reserve ratio of funds attracted in MDL and non-convertible currency was maintained at the level of 33.0% of the calculation base. Meanwhile, the required reserve ratio from funds attracted in freely convertible foreign currency was maintained at the level of 43.0% of the calculation base.

This decision was taken in the context of a gradual adjustment of monetary policy so as to continue to stimulate credit and support domestic aggregate demand by encouraging consumption and investment, balancing the national economy and anchoring inflationary expectations, with the aim of keeping inflation within the variation range of the target over the medium-term.

Interest rates on new loans and deposits in national currency continued to decline in the fourth quarter of 2023, including as a result of cumulative monetary policy stimulative measures. Thus, the weighted average rate on loans amounted to 10.50% and that on deposits to 4.23%, decreasing by 3.64 and 9.0 percentage points, respectively, compared to the fourth quarter of 2022.

A similar downward trend was followed by the interest rates on the balances of loans and deposits in national currency. In this regard, the weighted average interest rate on the balance of loans in MDL decreased by 0.46 percentage points and amounted to 10.57% in the fourth quarter of 2023 compared to the fourth quarter of 2022. The weighted average interest rate on the balance of term deposits in MDL amounted to 7.24% annually, lower by 2.93 percentage points. Average interest rates on loans and deposits in foreign currency have maintained on an upward trend.

## Medium-term inflation projection

The current round of forecasting assumes that external demand will be weak relative to historical averages and that external inflation will trend towards the levels targeted by monetary authorities. Interest rates in the region and globally will decrease, but not as rapidly as previously anticipated. The US dollar will follow a slightly depreciating trend due to the low interest rates, renewed talks on raising the debt ceiling and the reduced attractiveness of the US dollar. The Russian ruble will fluctuate in the range of USD/RUB 90-100 according to the new foreign exchange reality, which is also the level desired/forecasted by the Russian authorities. Oil prices will be affected by the falling consumer demand in China and Europe as well as by the tensions in the Middle East. Natural gas prices will be stable and food prices on the international market will increase moderately compared to the previous years' peaks.

The annual inflation rate will have a relatively stable trend for the entire forecast period[1]. Inflation will slightly oscillate close to the 5.0% target and will remain within the variation range over the forecast horizon. The minimum value will be recorded in the second quarter of 2024 and in the second and third quarters of 2025, and the maximum value in the first quarter of 2025. The annual rate of core inflation will increase only slightly in the first half of this year, after which it will slightly decline until the end of the forecast horizon[2], except in the last quarter of the forecast, when it will slightly increase. The annual rate of food prices will trend slightly downward for the early part of the forecast horizon, after which it will trend relatively steady until the end of the forecast period. The annual rate of regulated prices will decline in the first half of the current year, then will rapidly increase until the first quarter of 2025, then will decline in the following quarter and remain stable through the end of the forecast horizon. The annual rate of fuel prices is projected to slightly increase, at modest rates, until the end of the forecast horizon, with the exception of the third quarter of 2024.

Aggregate demand will be negative for the entire forecast period due to deteriorating external demand and modest financing of household consumption, as well as tightening monetary conditions. The rich agricultural harvest in the previous year and the positive fiscal impulse starting in the second quarter of 2025 for two consecutive quarters will mitigate the decline in aggregate demand.

Real monetary conditions are likely to be restrictive, albeit diminishing, on aggregate demand over the entire forecast period.

Current inflation forecast, compared to that in the previous inflation report[3], has been revised downward insignificantly in the first quarter of 2024 and upward for the remainder of the comparable period[4]. The current forecast of the annual rate of core inflation has been revised significantly upward over the entire comparable period. The annual growth rate of food prices has been revised downward over the entire comparable period. The current forecast of the annual rate of regulated prices is revised significantly upwards over the entire comparable period, except for the first quarter of 2024. The forecast for the annual rate of fuel prices has been lowered for the entire comparable period.

Risks and uncertainties associated with the current forecast remain high. The identified proinflationary risks from the external environment are the tensions in the Middle East, the prolonged blockage of access to transportation across the Red Sea, the war in Ukraine, rising consumer prices in Türkiye and the Russian Federation, and possible temporary supply shocks to international food price formation. Currently, a disinflationary risk is the continued sharp moderation in the rate of economic activity in the eurozone. Uncertainties relate to the transition period from tighter monetary conditions to lower interest rates in the region and globally and the geopolitical configuration after the 2024 electoral elections. Among the main domestic uncertainties are the timing and magnitude of the adjustment of tariffs for regulated services, changes in the CPI basket weights, the way the energy compensations to the population during the cold period of the year is reflected in the statistics, external financing, refugee inflows, weather conditions and the upcoming harvest.

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1. First quarter of 2024 – fourth quarter of 2025
2. Fourth quarter of 2025
3. Inflation Report, November 2023
4. First quarter of 2024 – third quarter of 2025

See also

Tags
Rata anuală a inflației [2]
core inflation [3]
External environment [4]
inflation forecast [5]
forecast [6]
forecasting inflation [7]

**Related links:**

[1] http://www.bnm.md/files/Inflation_Report_February_2024_ISBN.pdf [2] http://www.bnm.md/en/search?hashtags[0]=Rata anuală a inflației [3] http://www.bnm.md/en/search?hashtags[0]=core inflation [4] http://www.bnm.md/en/search?hashtags[0]=External environment [5] http://www.bnm.md/en/search?hashtags[0]=inflation forecast [6] http://www.bnm.md/en/search?hashtags[0]=forecast [7] http://www.bnm.md/en/search?hashtags[0]=forecasting inflation