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Inflation Report no. 2, 2023

The Governor of the National Bank of Romania, Octavian Armașu presents the Inflation Report No. 2, 2023

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Summary

The downward trend in the annual inflation rate, which began at the end of the previous year, continued during the first months of this year. However, in the first quarter of 2023, the annual inflation rate exceeded the expectations outlined in the Inflation Report, February 2023. Consequently, the annual inflation rate dropped from 30.2% in December 2022 to 22.0% in March 2023. As a result, similar to the previous quarter, the annual inflation rate remained above the upper limit of the 5.0% ±1.5 percentage points range in the first quarter of 2023. Additionally, the average annual inflation rate for the same period was 25.1%, which is 7.0 percentage points lower than the previous quarter. This change was primarily driven by the base period effect from the previous year. Despite this decrease, the annual CPI rate remained high due to lingering inflationary pressures from the prior year, primarily stemming from tariff adjustments, second-round tariff effects, the consequences of the war in Ukraine, and dry weather conditions from the previous summer. Furthermore, the recent excise tax adjustment added to the inflationary pressures at the beginning of this year. It is estimated that the modest demand in the latter half of 2022 and early this year helped counteract the influence of these factors. Additionally, exchange rate fluctuations had a disinflationary impact on

early-year inflation developments. The annual industrial price rate continued to decrease during the first months of this year, which is expected to ease the pressure on the prices of certain CPI subcomponents in the upcoming period. The downward trend in the annual CPI rate is anticipated to persist, driven by modest domestic demand, declining electricity tariffs, and the influence of the high base period from the previous year. The tense regional situation and the risks of its escalation, the increased energy price volatility, and the adjustments to tariffs maintain the significant uncertainty related to the short and medium-term inflation forecasts.

At the start of 2023, global economic activity showed accelerated growth. The initial concerns of an escalating energy crisis in the European Union during the 2022-2023 winter season did not materialize, thanks to relatively high temperatures and conservation efforts that significantly reduced natural gas consumption in Europe. As of early April 2023, European Union storage capacity reached 55.7%, the highest level since April 2011, according to Gas Infrastructure Europe, an industry organization. Oil prices displayed minimal volatility compared to 2022, stabilizing due to signals of potential crises in some US and Swiss banks and unmet expectations of rapid demand growth in China. Additionally, in early April 2023, OPEC+ decided to cut an additional 1.66 million barrels per day (mb/d) of oil production, totalling 3.66 mb/d, which pushed oil prices above USD 85/barrel. Prices of fertilizers, metals, and agri-food products continued to decline, driven by low demand and sufficient supply, as well as the influence of a high base from the previous year. According to the FAO, the international food price index fell by 20.5% on an annual basis in March. The reduction in inflationary pressures resulted in unchanged or lower interest rates in emerging economies, with advanced economies also experiencing significantly reduced interest rate increases. In March 2023, the Federal Reserve System increased its interest rate range by 0.25 percentage points to 4.75-5.0%, while the European Central Bank raised its rates by 0.5 percentage points to 3.5%. The regional economy continued to grapple with the impact of the ongoing war in Ukraine, as well as the devastating earthquake that struck Turkey on February 6, 2023.

After a stagnant first half of 2022, the economy saw a sharp decline in the latter part of the year. GDP contracted by 10.6% in the fourth quarter of 2022 compared to the same period in 2021, following a 10.3% decline in the third quarter of 2022. This decline exceeded the expectations outlined in the Inflation Report, February 2023. It resulted from reduced domestic demand, primarily due to falling real incomes, tighter credit conditions, and increased regional uncertainty. Additionally, adverse agro-meteorological conditions in the previous summer led to modest agricultural output. However, the seasonally adjusted series showed a 2.9% increase in GDP compared to the third quarter of 2022. Overall, GDP for 2022 decreased by 5.9% compared to 2021, with aggregate demand exerting disinflationary pressures during this period, according to estimates.

From a usage perspective, household consumption continued to decline in the fourth quarter of 2022, driven by reduced real disposable income, amid rising prices and tighter credit conditions. In contrast, final government consumption increased towards the end of 2022. Gross capital formation had a negative impact on GDP dynamics. Both exports and imports showed an upward trend at the close of 2022. By commodity groups, exports in USD terms increased primarily due to mineral products, driven by re-export developments, while exports of domestic commodities had a negative impact. Import growth, as in previous periods, was primarily due to mineral products. In terms of resource categories, the decline in GDP in the fourth quarter of 2022 was driven by most sectors of the economy, with agriculture, industry, trade, transport, and the social sector contributing the most to the negative dynamics. Despite the downward trend in the third quarter of 2022, both the economically active and employed populations increased in the fourth quarter of 2022. However, the unemployment rate also increased significantly, while the underemployment rate showed a slight upward trend.

In the first quarter of 2023, national public budget revenue increased by 19.4% compared to the same period in 2022, while national public budget expenditure grew by 21.9% over the first quarter of 2022. During this period, interest rates in the state securities market continued their downward trend.

In the first quarter of 2023, excess liquidity amounted to MDL 11.7 billion, up by MDL 6.4 billion from the previous quarter.

Monetary aggregates in the first quarter of 2023 recorded higher annual growth rates compared to the previous quarter, primarily driven by deposits in domestic currency.

Throughout the first quarter of 2023, the Executive Board of the National Bank of Moldova convened for two meetings to make monetary policy decisions. Following an assessment of domestic and external risks and the short to medium-term inflation outlook, the Executive Board decided, in consecutive meetings held on February 7, 2023, and March 20, 2023, to reduce the base rate applied to the main monetary policy operations by 3.0 percentage points, lowering it to 14.0% per annum.

Average interest rates on outstanding loans in national currency increased by 0.85 percentage points compared to the previous quarter, while deposit interest rates rose by 1.83 percentage points. Average interest rates on loans and deposits in foreign currency also continued the upward trend.

The current round of forecasts is based on a more favourable international economic context compared to previous rounds, but it still falls below its potential and is fraught with numerous risks and uncertainties. The outlook for the global economy is clouded by the rising interest rates in advanced economies and the relatively slow recovery in Chinese demand. International prices are easing compared to the previous year's highs due to risk dispersion and low consumption relative to potential supply in many segments. In contrast to previous forecast rounds, where the energy crisis in Europe painted a very gloomy picture, especially at the regional level, the current forecast round offers a more optimistic outlook for growth in the euro area economy. It's worth mentioning that the regional economy is still affected by the war in Ukraine.

The annual inflation rate will continue its rapid downward trend during the current year and then remain relatively stable until the end of the forecast period[1]. Inflation will return to the target range in the fourth quarter of 2023 and remain within that range until the end of the forecast horizon. The annual rate of core inflation will decline rapidly during the current year, then increase in the following year, and eventually decline slightly at the end of the forecast horizon[2]. The annual rate of food prices will follow a downward trend until the first quarter of 2024, stabilizing thereafter. The annual pace of regulated prices will essentially decline throughout the entire forecast period. The annual rate of fuel prices will continue to decline significantly in the first two consecutive quarters of the forecast, after which it will increase slightly until the second quarter of 2024, stabilizing thereafter.

Aggregate demand will be negative during this year and the first quarter of next year due to the deterioration in household consumption financing, negative external demand, lower agricultural production in the last year, and tight monetary conditions. The fiscal impulse will mitigate the decline in aggregate demand and lead to a positive aggregate demand starting from the second quarter of next year.

Real monetary conditions for aggregate demand will remain significantly tight throughout the entire forecast period.

The current inflation forecast, compared to that in the previous Inflation Report[3], has been revised downward for the entire comparable period[4]. The current forecast for the annual rate of core inflation has

been revised downward for the end of this year and the fourth quarter of next year but upward for the first three quarters of next year. The annual pace of food prices has been insignificantly revised downward over the entire comparable period. The current forecast for the annual rate of regulated prices is revised downward, except for the first two consecutive quarters and the last quarter of the comparable period. The annual fuel price rate forecast has been lowered over the entire comparable period, except for the second quarter of 2024.

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1. First quarter of 2025;
2. Second quarter of 2023 – first quarter of 2025;
3. Inflation Report, February 2023;
4. Second quarter of 2023 – fourth quarter of 2024.

See also

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