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Monetary Policy

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04.02.2016

Inflation Report no. 1, 2016

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Summary

Inflation

In the fourth quarter of 2015, the annual inflation rate was 13.4 percent, by 2.3 percentage points more compared to the previous quarter. In December 2015, inflation accelerated up to 13.6 percent, remaining above the upper limit of the range of ± 1.5 percentage points from 5.0 percent target. The upward development of inflation was due to the depreciation of the national currency at the end of 2014 and during 2015, which had a significant impact on food prices and core inflation, these increasing to 14.3 percent and 14.6 percent in December 2015. The depreciation of the national currency has also affected significantly the regulated prices through the impact that it had on medicines, which was the main cause invoked for the approval in the summer of 2015 of new electricity and gas tariffs. The contribution from fuel prices was slightly lower to that recorded in the third quarter of 2015. The development of the annual inflation rate in the fourth quarter of 2015 was consistent with the main assumptions of the forecasting round presented in the Inflation Report no.4, published in November 2015, which determined the registration of a null deviation compared to the anticipated value of inflation for the reporting period.

External environment

The last months of 2015 were marked by the deepening decline of world economy, fuelled by the precarious situation in the emerging economies. The consequences of the slowdown in the China's economy are reflected in the indexes of the China Stock Exchange with its implicit effects on the entire world financial system. The economic crisis in the Russian Federation intensifies and the prospects are gloomy in the conditions of a continuing decrease of oil prices. For the first time in several years, the advances economies have ended positively the year. For example, the Federal Reserve System increased the interest rates as a sign of overcoming the consequences of the economic crisis of 2008-2009. This decision has contributed more to the appreciation of the US dollar, thus creating a higher pressure on the decrease of international quotations for raw materials and the depreciation of currencies of the emerging economies.

Internal economic developments

In the third quarter of 2015, GDP recorded a decrease of 3.7 percent compared to the same period of 2014, the economic activity dynamics being significantly lower to that recorded at the beginning of 2015. The negative developments of GDP was mainly determined by the decrease of the domestic demand in the

context of stagnation of the personal disposable income and the increase of the political and economic uncertainty, as well by a pronounced decrease of agricultural crop in 2015. Thus, in the third quarter of 2015, household consumption decreased by 5.2 percent, while the gross fixed capital formation recorded a decrease of 4.8 percent. Government consumption was by 1.6 percent lower to that recorded in the third quarter of 2014. In the third quarter of 2015, gross value added in agriculture was lower by 17.4 percent compared to the same period of 2014, as a result of dry weather conditions in the summer of 2015. The negative impact of the decrease in domestic demand and agriculture was slightly mitigated by the depreciation of the national currency, which had an incentive effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the third quarter of 2015, the volume of exports of goods and services was only by 0.2 percent lower compared to the same period of 2014, while the imports recorded a decrease of 4.4 percent, due to the embargoes on certain categories of goods from the Russian Federation and an increased regional uncertainty. At the same time, the decline in GDP was also mitigated by the positive contribution from the components "Financial intermediation and insurance" and "Extractive industry; manufacturing", which recorded increases of 17.8 and 3.6 percent, respectively. Information and communications sector recorded an increase of 0.9 percent, while constructions a decrease of 1.8 percent.

Monetary policy

In the fourth quarter of 2015, there were held three meetings of the Executive Board of the National Bank on Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks, to which the economy of the Republic of Moldova could be subject and inflation outlook in the short and medium term, there were issued three decisions to maintain the base rate applied on main short-term monetary policy operations at the level of 19.5 percent annually and the required reserves ratio attracted in MDL and non-convertible currency at the level of 35.0 percent of the base (level established at the meeting of 26 August 2015).

The growth rates of monetary indicators decreased in 2015. Thus, in the fourth quarter of 2015, the growth rate of monetary aggregates was negative, the values recorded being below the growth level recorded in the previous years, the quarterly average in annual terms constituted -12.0 percent for M2 (by 0.5 percentage points lower than growth in the third quarter of 2015) and -2.8 percent for M3 (by 3.9 percentage points lower than the increase in the third quarter of 2015).

During reporting period, the average annual interest rate on loans in national currency increased by 0.86 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.09 percentage points compared to the third quarter of 2015, recording values of 13.28 percent in national currency and 6.81 percent in foreign currency. The average interest rate on deposits in MDL accounted for 13.70 percent, increasing by 1.86 percentage points compared to the third quarter of 2015, while the interest rate on placements in foreign currency constituted on average 2.28 percent, decreasing by 0.28 percentage points compared to the third quarter of 2015.

Medium-term inflation forecast

According to the current projection, output gap will continue to record a negative dynamics for the entire forecasting period. This will try to recover slowly, but will remain negative, significantly below its potential. An economic activity below its potential level in the long-term will cause increased

disinflationary pressures from domestic demand. NBM revised downwardly the inflation forecast for 2016 - 2017.

According to the current projection, the annual rate of CPI will record a level of 10.1 percent in 2016 and 6.6 percent in 2017. The average annual inflation rate projected for 2016 is by 1.8 percentage points lower compared to that published in November 2015. According to the projection, the annual inflation rate will return to the inflation target range in the third quarter of 2017. The maximum value will be recorded in the first quarter of 2016, representing 12.4 percent. The reconfiguration of the annual inflation rate projection for 2016 is mainly caused by lower contributions form regulated prices, fuel prices and food prices, these effects being balanced by slightly higher contribution of core inflation. The reconfiguration for 2017 is generated by higher contributions of core inflation and food prices.

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