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Monetary Policy

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Inflation Report no. 4, 2016

Inflation Report no.4, October 2016 [1]

Summary

Inflation

In the third quarter of 2016, the annual inflation rate was 4.5 percent, by 3.4 percentage points less compared to the previous quarter. In September 2016, inflation decreased to the level of 3.0 percent. Thus, after being, in August 2016, within the range of ± 1.5 percentage points from the 5.0 percent target, as set in the Medium-Term Strategy of Monetary Policy, the annual inflation was below the lower limit of this range at the end of the third quarter. The decrease in annual inflation rate during the reporting period was mainly due to the modest domestic demand, the high effect of a base period associated with the national currency depreciation of the previous year and the gradual dissipation of the impact of the electricity tariffs increase in July 2015. The annual inflation rate was higher than the overall inflation rate. Core inflation also had a downward trajectory during the third quarter of 2016, decreasing from 9.3 percent in June to 6.7 percent in September 2016. In September 2016, annual rate of food prices fell to 4.6 percent, while prices of regulated services and fuels decreased by 2.0 and, respectively, by 1.8 percent compared to September 2015. In the third quarter of 2016, the actual average value of inflation was slightly lower than the value anticipated in the projection of Inflation Report no.3, 2016.

External environment

The second quarter of 2016 started with the stabilisation of macroeconomic trends at international level. The passive volatility of main international economic indicators shows the lack of new prominent macroeconomic risks and uncertainties. At the same time, the global economic situation is precarious and the economic growth is below the average for the last years. In the absence of external risks and/or incentives, most of economies refocused towards promoting internal policies to stimulate the economic growth. The slight upward trend of the euro area inflation represents a first sign of efficiency of the European Central Bank's quantitative easing monetary policy. However, the uncertainties relating to Brexit and the risks to the euro area financial system are two premises for maintaining the ECB quantitative easing programme for a long period. The Russian Federation’s economy has stabilised, unless new external risks have emerged. At the same time, OPEC member countries succeeded at the end of September to reach a consensus on reducing the oil production, which caused the oil prices rise, accounting for about USD 50 per barrel.

Economic developments

In the second quarter of 2016, GDP recorded an increase of 1.8 percent compared to the same period of 2015, the economic activity dynamics being higher than at the beginning of this year. However, the economic growth was modest in the first half of the year, being below its potential level. In the second quarter of 2016, the GDP positive evolution was due to the domestic demand and exports positive contribution. Thus, in the second quarter of 2016, household consumption increased by 2.2 percent. However, the household consumption growth was insignificant. At the same time, the positive contribution of investments to GDP dynamics was determined by the favourable impact of the component change in inventories, given that the gross fixed capital recorded a decrease of 9.4 percent compared to the same period of the previous year. These developments show the decrease of household disposal income in real terms and the increased uncertainty on further development of the economy, persisting in the environment of the economic agents and households. In the second quarter of 2016, the final consumption of public administration decreased by 0.8 percent compared to the same period of last year. In the second quarter of 2016, after contracting at the beginning of the year, the exports and the subcomponents of domestic demand supported the GDP growth, which increased by 3.0 percent compared to the same period of last year, due to the rich harvest during the reporting period. The economic activity dynamics was significantly offset in the second quarter of 2016 by the increase of imports by 4.3 percent compared to the second quarter of 2015. By categories of resources, almost all main sectors of the national economy recorded positive developments, except for constructions and public sector.

Monetary policy

In the third quarter of 2016, there were held four 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 the inflation outlook in the short and medium term, the NBM Executive Board decided at the meeting of 4July 2016 to decrease the base rate applied on main monetary policy operations by 3.0 percentage points, from the level of 13.0 percent (set at the meeting of 26 May 2016) to 10.0 percent annually. Thereafter, at the meetings of 8 August 2016 and 25 August 2016, it was decided to maintain the base rate applied on main monetary policy operations at the level of 10.0 percent annually, while at the meeting of 29 September 2019, the base rate was decreased by 0.5 percentage points, up to 9.5 percent annually.

In the third quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 11.9 percent for M2 (by 7.1 percentage points higher than in the second quarter of 2016) and 4.7 percent for M3 (by 3.8 percentage points higher than the previous quarter).

Following the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, the average interest rates on deposits continued its downward trend and consequently, the average rates on credits granted by banking system recorded a tempered decline.

During the reporting period, compared to the first quarter of 2016, the annual average interest rates related to the balance of credits recorded a decrease of 0.71 percentage points on credits in national currency and of 0.26 percentage points on credits in foreign currency, recording the levels of 12.89 and 6.16 percent, respectively. The average interest rate on deposits in MDL was 10.98 percent during the third quarter of 2016, decreasing by 3.95 percentage points compared to the previous quarter. The interest rate of placements in

foreign currency constituted on average 2.08 percent, lower by 0.03 percentage points than in the second quarter of 2016.

Medium-term inflation forecasting

The current round of forecasting anticipates that the output gap will continue to be negative for the entire forecasting period and will reach the minimum level in the first quarter of 2017, after which, it will record a slow recovery by the end of the forecasting period, continuing to be negative. Therefore, the economic activity below its potential, on medium-term, will determine increased disinflationary pressures from the domestic demand.

The annual inflation rate will have an upward trajectory in the first part of the forecasting period and a downward trajectory in the second part. The inflation annual rate, for the first two quarters of forecast, will be below the lower limit of the inflation target range.

Thereafter, it will return and maintain within the target range by the second quarter of 2018. After being below the lower limit of the target range in the fourth quarter of 2016, inflation will accelerate and record a maximum level in the fourth quarter of 2017. Subsequently, inflation will fall by the end of the forecasting period and will be below the range, recording the level of 3.2 percent. Inflation annual average rate will record the level of 6.3 percent in 2016 and the level of 4.6 percent in 2017.

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