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Monetary Policy

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Inflation Report no. 2, 2015

Inflation Report no.2, May 2015 [1]

Summary

Inflation development

In the first quarter of 2015, the annual rate of inflation was 6.1 percent, by 1.3 percentage points higher than the previous quarter. This development was mainly determined by increasing pressures from core inflation, which increased to 10.6 percent in March, due to the depreciation of the national currency at the end of the previous year and at the beginning of this year. Higher contributions from food prices and regulated services contributed to a lesser extent. The contribution from oil prices was similar to that of the fourth quarter of 2014. In March 2015, the annual inflation rate increased up to 7.1 percent and for the first time after a period of three years, it exceeded the upper limit of the range of variation of ±1.5 percentage points from 5.0 percent target stipulated in the Medium-term monetary policy strategy. In the first quarter of 2015, the annual inflation rate increased by 0.8 percentage points compared to the projection (5.3 percent) of the Inflation report no.1, 2015.

External environment

The fragility of the global economy accentuated in the first months of 2015. On the one hand, it allowed the completion of the trajectories of some macroeconomic indicators, and on the other hand, it amplified the concerns on the development of the global economy as a whole. The slowdown in the growth rate of the emerging countries was considered until recently as a transitory factor and in recent weeks, the statistics indicate a long recovery period. Economy of the United States of America continues to evolve stably and it is expected to accelerate in the second half of 2015, which explains to some extent the FRS reticence on increasing interest rates after the end of the QE3 program. Economy in the euro area shows a slight recovery, supported by increasing domestic demand, better export opportunities and improving financing conditions. In the region, the situation has stabilized, but it may not cancel the forecasts about two years of economic crisis in the Russian Federation. The initiation of the quantitative easing program by the European Central Bank and the gradual increase in oil prices due to participants' reaction to positive factors of the moment are among the most important events during the reporting period.

Economic developments

In the fourth quarter of 2014, GDP recorded an increase of 4.2 percent, being lower compared to that of the previous quarter but significantly higher than expected compared to the first half of 2014. The slowdown in

the economic growth rate in the fourth quarter of 2014 was driven, on the one hand, by more accentuated exports contraction (by 4.0 percent) in the context of the embargoes imposed in the second half of the previous year by the Russian Federation for the domestic products and the increase in imports by 2.3 percent during the reporting period. On the other hand, the domestic demand accelerated in the reporting period, thus, the household consumption increased in the fourth quarter of 2014 by 4.5 percent, while the gross fixed capital formation was by 12.1 percent higher than in the fourth quarter of 2013. Overall, in 2014 the GDP growth rate was significantly lower than that from 2013, mainly due to a more modest contribution from agricultural production and an unfavourable external climate. However, although modest, the positive development of the economic activity in 2014 was favoured to some extent by the depreciation trend of the national currency against the currency of the countries – major trading partners of the Republic of Moldova, a good agricultural output and the first facilities offered by the EU for the domestic products exports, which offset to some extent the embargoes imposed by the Russian Federation.

Monetary policy

In the first quarter of 2015, there were four meetings of the Council of Administration of the National Bank on monetary policy decisions. As a result of assessing the balance of internal and external risks, which may be faced by the Moldovan economy and inflation forecasts in the short and medium terms, there were issued two decisions to increase the base rate by 2.0 and 5.0 percentage points, respectively, from the level of 6.5 percent to 13.5 percent, followed by two decisions to maintain the base rate at the level of 13.5 percent (level set at the extraordinary meeting of February 17, 2015). During the reporting period, there was required the gradual tightening of the monetary policy in order to combat the inflationary pressures from regulated prices and the depreciation of the national currency. The decisions on the base rate increase will gradually produce effects in the economy during the next two-three quarters, aim at anchoring inflation expectations and maintaining the inflation close to the target of 5.0 percent in the short term, with a possible deviation of ± 1.5 percentage points. At the same time, in order to sterilize the liquidity excess recorded during the last months of 2014 and to improve the transmission mechanism of the monetary policy decisions, the Council of Administration of the NBM decided within its meeting of January 29, 2015 to increase the required reserves ratio from financial means attracted in MDL and non-convertible currency from the level of 14.0 to 18.0 percent of the base.

During 2014, there was recorded a decrease in the growth rates of monetary indicators. Thus, in the first quarter of 2015, the growth rate of monetary aggregates fell further below the values recorded in 2011 and 2012, the quarterly average in annual terms of M2 constituted minus 10.1 percent (by 10.8 percentage points lower than in the fourth quarter of 2014) and that of M3 was 6.2 percent (by 2.0 percentage points less than in the last quarter of the previous year).

During the first quarter of 2015, the average annual interest rate of credits increased both in national currency (by 0.46 percentage points) and in foreign currency (by 0.01 percentage points) compared to the previous quarter, reaching the level of 11.04 percent in national currency and of 7.25 percent in foreign currency. The average interest rate of deposits in MDL recorded a level of 8.16 percent, by 0.55 percentage points higher than the level recorded in the previous quarter. The interest rate of deposits in foreign currency amounted to an average of 3.88 percent in the first quarter of 2015, decreasing by 0.57 percentage points compared to the level of the previous quarter.

Medium-term inflation forecasting

According to the current round of forecasting, the output gap will record a negative dynamics throughout the entire forecasting period, the minimum value will be recorded in the first quarter of 2016. As from the second quarter of next year, the aggregate demand will record a slow recovery but the values will be below theirs potential level throughout the entire forecasting period.

According to the current projection, the annual growth rate of CPI will reach the level of 8.1 percent in 2015 and of 6.4 percent in 2016. The annual inflation rate will leave the range of inflation target for the fourth consecutive quarters, starting with the second quarter of this year. The maximum value will be recorded in the third quarter of 2015, reaching the level of 9.8 percent. In the second quarter of 2016, the annual inflation rate will return within the range of inflation target.

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