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Inflation Report no. 2, 2019

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Summary

The annual rate of inflation shall increase by the end of the current year, and afterwards, diminish by the end of forecast horizon. During the first two quarters of the forecast horizon, inflation will stay in the range of inflation target. The last quarter of the current year will register an increase of inflation above the superior limit of the range. In the third quarter of 2020, the inflation rate will return in the range. The core inflation shall increase until the second half of the next year and diminish by the end of the forecast horizon. The annual growth rate of food prices will increase significantly until the end of the current year and afterwards, decrease by the end of the forecast horizon. The annual rate of regulated prices shall increase sharply in the second half of the current year and decrease in the same manner in the third quarter of 2020. Subsequently, the rate will keep a relatively low value by the end of the forecast horizon. The annual rate of oil prices will be relatively stable with insignificant fluctuations.

The aggregate demand shall be pro-inflationary, although diminishing, during the first two consecutive quarters and disinflationary – for the rest of the forecast period.

2019 started with mixed signals for the global economy. In this context, the growth rate of the economic activity at global level will diminish, while the external demand will show positive indicators and stay slightly pro-inflationary.

The oil price increased by more than 30 percent from the beginning of 2019, following the prolongation of the OPEC+ agreement on limiting the oil production and intensification of tensions from Venezuela and Libya. At the same time, the signs of moderating the growth of advanced economies determined the Federal Reserve System and the European Central Bank to postpone the rise in interest rates. The industrial production in Germany was affected significantly by the introduction of new standards for carbon emissions. Moreover, the Brexit planned for 29 March 2019 did not take place following the failure to vote the Agreement by the UK's Parliament. Other important factors which had an impact on the situation were: the discussions in the US Congress regarding the new economic sanctions against the Russian Federation, the significant depreciation of Turkish lira and the presidential elections in Ukraine.

Compared with the previous forecast, the current forecast of inflation is superior in the entire forecast horizon, except the second quarter of 2019. The core inflation was revised upwards in the entire forecast horizon and remained the same in the second quarter of 2019. The annual rate of food prices was revised downward until the first quarter of 2020 and upward – for the rest of forecast period. The current forecast of regulated prices is superior until the first half of the next year and inferior – for the rest of forecast period. The forecast of the annual growth rate of oil prices was revised downward until the end of the current year and upward – for the rest of forecast horizon, except the fourth quarter of 2020.

After the downward trajectory in the last year, at the beginning of the current year, the annual rate of inflation recorded an upward trend, increasing from 0.9 percent in December 2018 to 2.8 percent in March 2019, mainly as a consequence of tax policy adjustments, pressures from food prices, and a low level of the base period for the regulated prices. However, the annual rate of the CPI continued to remain below the range of inflation target. The first quarter of 2019 was marked by the start of an upward trajectory for the core inflation, caused by the effects of the budgetary and fiscal policy for the current year, as well as by pressures from the aggregate demand. In the first quarter of 2019, the core inflation registered superior values than the annual CPI rate. The annual rate of food prices showed an upward trajectory at the beginning of the current year, determined mostly by the rise in the prices of fresh vegetables. In the reference quarter, the annual rate of regulated prices continued its negative dynamics. However, it had an upward trajectory caused by the disappearance from the annual value of the negative impact caused by the drop in tariffs of network gas at the beginning of the previous year. The trajectory of domestic fuel prices continued its downward trend in the first months of 2019, as well. The annual average rate of inflation in the first quarter of 2019 was similar to the anticipated one, which confirms the main hypotheses and conclusions related to the forecast round of January 2019.

In the fourth quarter of 2018, the economic growth was more significant than that from the previous quarter, in compliance with the expectations of the previous forecast round. Therefore, the GDP growth rate registered 3.9 percent, that is 0.5 percentage points more than in the third quarter of 2018. At the same time, the seasonally adjusted series show an increase of the GDP by 1.1 percent, compared to the third quarter of 2018. Similarly to the previous quarter, the economic growth was determined mainly by an investment activity associated to some programs launched at central level. In the reference period, the role of private consumption became more visible. Although the trend was supported by a rise in imports, it did not cause significant pressures on the prices of the domestic market, which partially explains the downward trajectory of the annual inflation rate at the end of 2018. In the context of a relatively modest evolution of the agricultural production in the first half of 2018, after a more visible evolution in the last two years, the

exports have generated a negative impact on the dynamics of economic activity in the second half of 2018. Following the negative evolution of exports in the fourth quarter of 2018, the operative data for January and February 2019 shows signals of rise in their volume in the first quarter of 2019. At the same time, the volume of imports registered a more modest dynamics in the first months of the current year. By categories of resources, the rise in GDP in the fourth quarter of 2018 was mainly caused by the positive contribution of the dynamics in retail and wholesale trade, agriculture and constructions. The indicators of the period January – February 2018 outline pre-conditions for the continuation of the economic growth in the first quarter of 2019. Following the significant increase in the second and third quarter of 2018, the economically active and the employed population registered a minor negative dynamics. In addition, the number of unemployed from the fourth quarter of 2018 was lower than that from the previous period of the last year.

In January – March 2019, the annual dynamics of the national public budget revenues registered a downward trajectory, which increased by 6.3 percent compared to the similar period of 2018. The expenditures of the national public budget increased by 19.1 percent compared to the same period in 2018. At the same time, the market conditions maintained the increasing trend of interest rates of allotted state securities, which increased for all types of maturities during the first quarter of 2019.

The monetary aggregate in the first quarter of 2019 had a positive dynamics in annual terms, determined mainly by the modification of the volume of sight deposit, both in domestic and foreign currency. The excess liquidity registered an amount of MDL 6.7 billion, which represents a decrease of MDL 1.3 billion, compared to the previous quarter.

Based on the trend of the base rate applied for the main operations of monetary policy of the National Bank of Moldova, and on the surplus of liquidity registered in the banking system, the average interest rates accepted by licensed banks for loans continued their downward trend. The average interest rates of the balance of deposits, both in domestic and foreign currency, remained almost the same as in the previous quarter.

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