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Inflation Report no. 3, 2015

Inflation Report no.3, August 2015 [1]

Summary

Inflation development

In the second quarter of 2015, the annual inflation rate was 8.0 percent, by 1.9 percentage points more comapred to the previous quarter. In June 2015, inflation accelerated to the value of 8.3 percent, exceeding for the fourth consecutive month the upper limit of the inflation target set in the Medium-Term Strategy of Monetary Policy. Its upward trend was due, in most part, to the increase of pressures from food prices and core inflation, which increased in June to 9.2 and 11.1 percent, respectively, in the context of national currency depreciation at the end of the previous year and early this year. Similarly, foreign currency fluctuations resulted in an increase of regulated prices up to 3.9 percent in June 2015. However, their contribution was significantly lower than the components referred to in the annual inflation rate formation. The contribution from fuel prices was similar to that recorded in the first quarter of 2015. Annual inflation rate in the second quarter of 2015 was by 0.4 percentage points higher than it was anticipated in the Inflation Report no. 2, 2015.

External environment

There have emerged recently several economic problems on the international arena with global impact, which contributed to the distortion of macroeconomic environment. Among the most important events to be mentioned is Greece's entry into default to the IMF and the subsequent consultations with donors, signing of the agreements that will lead to lifting the ban on the import of oil from Iran and significant oscillations of Chinese stock market indices. At the same time, the region remains in economic crisis, despite that the forecasts were revised positively. Economic sanctions imposed by EU to Russian Federation have been extended, and together with the risk of diminishing oil prices rise in the coming quarters prerequisites for deepening economic crisis in the Russian Federation. International prices of raw materials remain low, thus exacerbating the fragility of international trade. On the other hand, labour markets show slight improvement, which is reflected in the gradual reduction in unemployment. The IMF has diminished recently the forecasts for economic growth this year, the world economy being excepted to accelerate next year.

Economic developments

In the first quarter of 2015, GDP grew by 4.8 percent, the dynamics of economic activity is slightly higher

compared with the previous quarter. The depreciation of the national currency had an important stimulative effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the first quarter of 2015, the volume of exports of goods and services was by 6.3 percent higher than that recorded in the same period of the previous year. At the same time, imports grew by only 1.1 percent. Demand from the public earlier this year was modest, household consumption increasing by only 0.7 percent in real terms. The evolution of investments had a significant contribution, slightly decreasing compared to the second half of the previous year, gross fixed capital formation in the reporting period being by 7.8 percent higher than at the beginning of the previous year. By categories of resources, GDP growth in the first quarter 2015 was mainly supported by the dynamics of the component "Financial intermediation and insurance", which registered an increase of 36.9 percent. Similar to previous periods, the industry still had a significant contribution to the economic activity dynamics. In this regard, the extractive industry and manufacturing was by 9.1 percent higher during the reporting period compared to the first quarter of 2014. The other branches of the economy recorded positive developments, but their impact on GDP growth was more modest. In the first quarter of 2015, the unemployment rate was 8.5 percent, increasing by 3.4 percentage points compared to the same period of the previous year.

Monetary policy

In the second quarter of 2015, there were held three meetings of the Council of Administration 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, it was decided to maintain the base rate at the level of 13.5 percent (level set at the extraordinary meeting of 17 February 2015), subsequently issuing two other decisions to increase the base rate by 1.0 percentage points from 13.5 percent to 15.5 percent. In these circumstances, it was necessary to gradually tighten the monetary policy, in order to combat inflationary pressures from regulated prices and national currency depreciation. These decisions to increase the base rate will gradually produce effects in the economy in the coming quarters, aimed at anchoring inflation expectations, bringing and keeping inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points.

Characteristics of the required reserves mechanism have been changed following the decision of the Council of Administration of 30 April 2015, by increasing the required reserves attracted in MDL and non-convertible currency from 18.0 to 20.0 percent of the base, starting with the maintenance period of the required reserves of 8 June 2015 - 7 July 2015. The required reserves ratio from financial means attracted in freely convertible currency was maintained at the current level 14.0 percent of the base.

During 2015, the developments of monetary indicators have further recorded a negative growth trend. Thus, in the second quarter of 2015, the growth rate of monetary aggregates fell further below the values recorded in the years 2013 and 2014, the quarterly average in annual terms constituted minus 11.3 percent for M2 (by 1.2 percentage points lower than growth in the first quarter of 2015) and 2.8 percent for M3 (by 3.4 percentage points less than the previous quarter).

During the second quarter of 2015, the average annual interest rate on loans in national currency increased by 0.83 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.22 percentage points from the previous quarter, registering values of 11.87 percent in national currency and 7.03 percent in foreign currency. The average interest rate for deposits in national currency during the reporting quarter was 9.82 percent, by 1.66 percentage points higher in the previous quarter and by 2.17

percentage points higher than the rate in the second quarter of 2014. The interest rate of deposits in foreign currency amounted to an average of 3.16 percent during the reporting period, decreasing by 0.73 percentage points compared to the previous quarter and by 1.49 percentage points compared to the level recorded in the second quarter of 2014.

Medium-term inflation forecasting

According to the current projection, the output gap will still have a negative dynamics throughout the forecast period, the minimum will be recorded in the first quarter of 2016. The aggregate demand will recover slowly starting with the second quarter of next year, reaming still negative and significantly below its potential. An economic activity below its potential level in the long-term will cause increased disinflationary pressures from domestic demand.

According to the current projection, the annual rate of CPI will record this year the level of 9.3 percent and 11.6 percent in 2016. The annual inflation rate will return to the inflation target range in the second quarter of 2017, the last quarter of forecast. The maximum value will be recorded in the second quarter of 2016, representing 13.0 percent. High dynamics of core inflation, food prices, regulated prices and fuel prices for the entire forecast period determines a higher than expected evolution of the inflation forecast compared with the previous report.

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