National
Bank of Moldova

Inflation Report

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National Bank of Moldova
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Note

Statistical data were taken from the National Bureau of Statistics,

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Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

State Hydrometeorological Service.

Likewise were selected certain statistical data provided by the international community and by the Central Banks of the neighboring states.

The calculation of the statistical data was carried out by the National Bank of Moldova.

Contents

List of acronyms

CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECB	European Central Bank
EUR	European Single Currency
Fed	Federal Reserve System
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
IPPI	Industrial Producer Price Index
MDL	Moldovan leu
NBC	Certificates issued by the National Bank of Moldova
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
REER	Real effective exchange rate of the national currency
RUB	Russian rouble
SS	State Securities
USD	U.S. Dollar

Summary

The annual inflation rate will pass downwards the variation interval in current year, but will return to the target level in the first semester of 2019. Core inflation will continue to decrease throughout the current year, after which, in the second half of the next year, it will return close to 5.0% level. The growth rate of food prices will drop significantly over this year, however, the trend is expected to reverse in the coming year. The same downward trend will be recorded for regulated prices, which are expected to fall in the current year to about -4.0%. The annual growth rate of fuel prices will have a downward trajectory, which will be followed by a slight increase at the beginning of the forecast horizon.

Aggregate demand will maintain a disinflationary trend over the next two years, largely due to existing monetary conditions, the economic cycle, as well as internal and external factors. The accumulated appreciation of the actual real exchange rate will continue exerting pressures on the competitiveness of domestic products with a corresponding impact on the trade balance. At the same time, through another channel, the appreciation will largely offset this effect, by lowering the costs of imported components, decelerating the CPI and by generating pressures that will enhance productivity.

The real monetary conditions index denotes a restrictive character throughout the forecasting period. At the same time, disinflationary pressures of the current year, which are to be followed by pro-inflationary pressures of the coming year, suggest that a marginal relaxation of monetary policy is not opportune. In the short term, the seasonally adjusted currency supply will determine the exchange rate evolution.

In line with the Budget Law for 2018, the fiscal policy will have a stimulating character throughout this year, and the slowing down of fiscal impulse for the next year.

Global macroeconomic activity records positive trends, however, is associated with many risks and uncertainties. The escalation of diplomatic and geopolitical conflicts have determined an increased volatility of the main macroeconomic indicators. The protectionist measures, promoted by the US President Donald Trump, as well as the threats of countermeasures to be taken by the US trading partners, gave rise to apprehensions that a large-scale trade war may commence, that will develop along the US-China axis. The worsening of diplomatic relations between London and Moscow and the new US sanctions imposed on 6 April 2018 against Russian billionaires hit the Russian ruble and the Russian stock market. International oil prices have increased following the output cuts, which exceeded the levels agreed by the OPEC+ members, but also following the escalation of the geopolitical conflict in Syria. At the same time, there are the first scattered signs of the slowing down of global economy's growth rate, which may be a negative factor for global economic growth, given the rise in commodity quotations and the intensification of risks.

The latest inflation forecast remains quite close to the initially projected values, although they were slightly revised downwards for the current year. The core inflation was revised downwards throughout the forecasting period following the aggregate demand's revision. The forecast for the growth rate of food prices was revised upwards being mainly driven by the upward revision of the forecast for international food prices. The forecast for the growth rate of regulated prices was revised downwards for the current year and upwards for the next year. The forecast for the growth rate of fuel prices has been slightly revised due to rising oil prices as well as the strengthening of the exchange rate of domestic currency.

In the first quarter of 2018, the CPI annual rate recorded a downward trend, which was mainly driven by the dynamics of regulated prices, being also supported by the trend towards appreciation of domestic currency. Thus, annual inflation decreased from 7.3% in December 2017 to 4.7% in March 2018. According to estimates, domestic demand has continued to exert a negligible impact on inflation through the beginning of this year. Strong pressures, generated by food prices last year, are gradually losing intensity. At the same time, the adjustment of excise duties and the rise in international oil prices, as well as their impact over local fuel prices, were mitigated by the exchange rate dynamics. Since January, the CPI annual rate has been within the inflation target range set in the Medium-term

monetary policy strategy. Similarly to the preceding periods, the annual inflation rate remained within the inflation target limits set in the Inflation Consultation Mechanism under the IMF Memorandum. The CPI annual rate recorded lower values than were projected in the previous forecasting round due to a lower-than-expected gas supply tariff set for 2018 and a stronger exchange rate. In the second quarter of 2018, the CPI annual rate is expected to record a sharper decline, being largely driven by such factors as the anticipation of a lower electricity tariff, the appreciation of domestic currency, a still modest domestic demand, and the slowdown of the growth rate of food prices compared to the same period of the previous year. Industrial prices have recorded a downward trajectory in the first three months of 2018, thus outlining the first signs of a future decline in some of the CPI subcomponents.

In the fourth quarter of 2017, the annual growth rate of economic activity accelerated compared to the first half of 2017, being driven by both the growth of aggregate demand and the agricultural performance. Thus, in the fourth quarter of 2017, GDP grew by 6.4% compared to the same period of 2016. The contribution generated by household consumption marked a significant increase compared to previous quarters, recording the annual growth rate of 5.8%. The public administration consumption recorded slightly negative dynamics. In the fourth quarter of 2017, a positive, though smaller than in the previous quarter, contribution to the dynamics of economic activity was generated by the investment component. As a result, gross fixed capital formation increased by 5.9%. Besides, a strong positive contribution to GDP growth was generated by exports. Thus, in the fourth quarter of 2017, exports recorded values 12.4% higher than in the same period of the previous year. However, an important part of positive contribution generated by the above-mentioned components was offset by the increase in imports by 8.0%. This development was driven by the increase in domestic demand, as well as by the appreciation of domestic currency against the US dollar. By resources categories, GDP growth, in the fourth quarter of 2017, was mainly driven by a positive contribution from agriculture and net product taxes. Positive, yet smaller, contributions were generated by the increase in gross value added of trade, industry and transport and storage. Agricultural performance has determined the increase in the employment rate in the national economy. Most economic indicators of the first quarter of 2018 outline preconditions for a strong economic growth in the reporting period and a slowdown of economic activity in the second half of the year.

In the first quarter of 2018, the annual growth rate of public budget expenditures recorded a notable downward trend, decreasing by 0.9% compared to the same quarter of 2017. This trajectory could create negative pressures on domestic demand in the coming months. At the same time, these pressures may be mitigated by positive developments in public budget revenues.

It should be noted that at the end of the first quarter of 2018, for the first time in the history of the Republic of Moldova, the Ministry of Finance issued government bonds with five-year maturity. This financial tool will be used regularly, starting with the second quarter of this year. Increasing the yield curve is an important step in consolidating the state securities market and the capital market of the Republic of Moldova. Developing the capital market is essential for any economy in order to enlarge access to financing for all economic agents. At the same time, the market conjuncture allowed to continue lowering interest rates on the state securities placed on the market, which decreased, during the first quarter of 2018, for all types of maturities.

In the first quarter of 2018, the volume of excess liquidity continued to rise, recording a record level of 9.6 billion lei. This growth was largely driven by a steady decline in the loan portfolio of the banking system (although new loans recorded an increase) against the background of a moderate loan demand, the tightening of prudential requirements following the recent financial crisis, the monetary issues as a result of the NBM’s interventions on foreign exchange market, as well as the migration of lending activity outside the banking system. In such conditions, banks preferred to invest in low-risk instruments, such as SS and NBC.

In the first quarter of 2018, monetary aggregates recorded positive and faster dynamics compared to the previous quarter. At the same time, this evolution was largely determined by the increase in sight deposits, which were placed both in domestic and foreign currency.

Following the trend set by the base rate applied to main monetary policy operations of the National Bank of Moldova and as a result of the liquidity surplus recorded in the banking system, the average interest rates of licensed banks continued their downward trend.

Chapter 1

Forecast

1.1 Internal environment

Inflation

In 2018, the annual inflation rate will have a downward trend, but will return close to the inflation target in the second half of 2019 (Chart 1.1).

All CPI components will contribute to the inflation's decline during this year, the main contribution, however, being generated by regulated prices, food prices and the core inflation against a background of a weak aggregate demand (Chart 1.2).

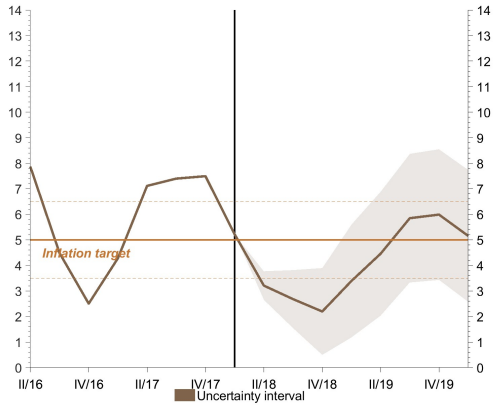
At the same time, the fuel prices will slightly offset disinflationary pressures. Besides, the asymmetric price elasticity[1] to the exchange rate fluctuations will help mitigate disinflation. Therefore, the prices will show certain resistance to decline despite the accumulated and anticipated appreciation of the domestic currency (short-term). The high base of the previous year, the moderate aggregate demand, the appreciation of the domestic currency, and, not least of all, the phase of the political cycle will be the main factors to produce disinflationary effects during this year. In 2019, a slight fluctuation of the domestic currency's exchange rate, the anticipated adjustment of a number of tariffs, the scheduled increase in excise duties, and the adjustment of the commercial margins of economic agents will be the key factors to determine the inflation's positioning within the variation interval starting with the second quarter of 2019 and through the end of forecast horizon.

From its current level within the variation interval, inflation will gradually fall to the minimum level of 2.2%, on average, in the fourth quarter of 2018. Subsequently, its trajectory will reverse and inflation will return within the interval limits in the first semester of 2019. Thus, inflation will record 3.3% and 4.9%, on average, during the current and next year, respectively.

The core inflation will have a steady downward trend throughout this year, will reverse its trend afterwards and will revert to a position close to 5.0% level in the second half of the next year. Thus, on the one hand, in 2018,

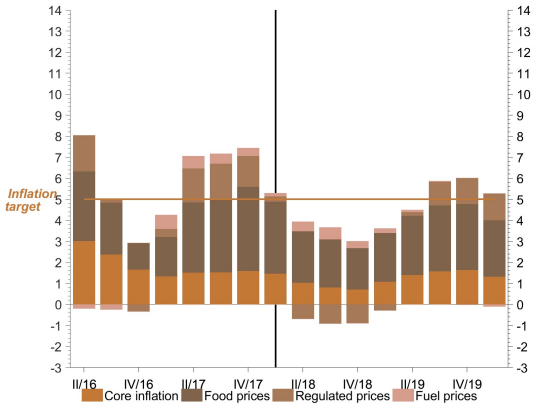
[1]The asymmetry of price elasticity to the exchange rate fluctuations, at least in terms of the Moldovan economy, means that the effect of appreciation on prices is lower, in absolute values, than that of depreciation, which can be mainly explained by the imperfect structure of markets. That is, in case of monopolies, oligopolies etc., the vendors take advantage of their positions and are reluctant to lower prices, even if their costs decrease.

Chart 1.1: CPI with the uncertainty interval (%, f.a.p.)



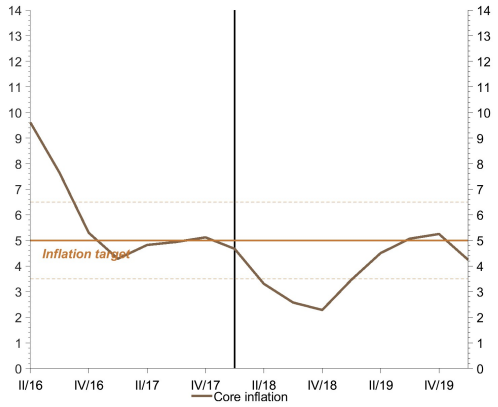
Source: NBS, NBM calculus

Chart 1.2: The CPI decomposition (%, p.p., f.a.p.)



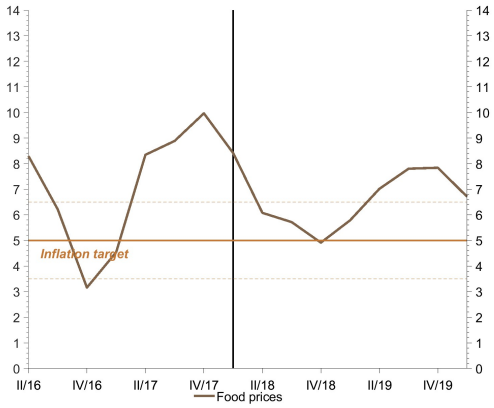
Source: NBS, NBM calculus

Chart 1.3: The core inflation (%, f.a.p.)



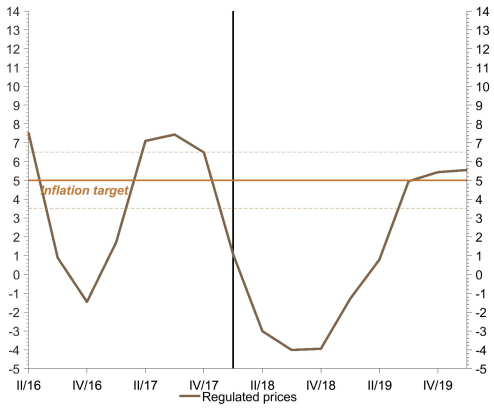
Source: NBS, NBM calculus

Chart 1.4: The food prices (%, f.a.p.)



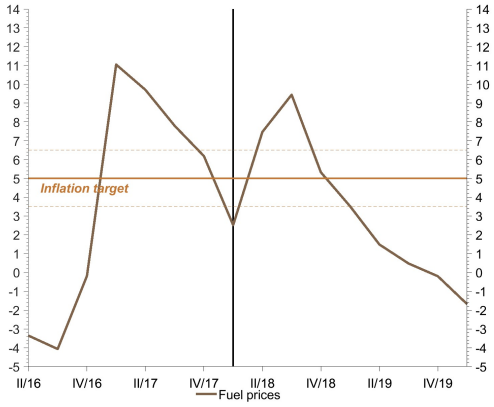
Source: NBS, NBM calculus

Chart 1.5: The regulated prices (%, f.a.p.)



Source: NBS, NBM calculus

Chart 1.6: The fuel prices (%, f.a.p.)



Source: NBS, NBM calculus

the annual inflation rate will fall below the target level being driven by (1) the moderate aggregate demand, (2) the high base effect of the previous year, (3) the domestic currency's appreciation, and (4) the anti-inflationary efforts made by authorities. On the other hand, inflation will return to a position close to 5.0% level in the next year.

The growth, in annual terms, of these prices will be caused by (1) the correction of the exchange rate of the domestic currency during the next year, (2) the increase of excise duties on some products, but also by (3) the correction of commercial margins of economic agents (Chart 1.3).

The growth rate of food prices will slow down considerably over this year, with a potential to increase in the next year. The slowdown will be driven by (1) the slight appreciation of the domestic currency, (2) the disappearance of the unique effect produced by the atypical weather conditions recorded in April 2017, and (3) the reduced impact of the firstlings prices[2] in the spring of 2018. It is being assumed that in 2018 the impact of prices for strongly seasonal products will be lower than last year, as the level of charged prices will be close to the level of the entry market prices for seasonal products, which, currently, are quite high. The trend of the annual growth rate will reverse early next year.

The annual growth rate of regulated prices will be characterised by considerable volatility and is expected to fall to the level of around -4.0 percent over this year. The declining trajectory will be driven by (1) the high base effect of the previous year and (2) by the expected cuts in tariffs to be made in 2018, particularly, in electricity tariffs (Chart 1.5). At the same time, in 2019, the regulated prices will be adjusted in order to reduce financial deviations.

The annual growth rate of fuel prices will be characterised by a generally downward trajectory, although it is expected to record a slight acceleration at the beginning of the forecast horizon. The annual growth rate will increase sporadically at the beginning of the forecast horizon (up to the third quarter of 2018), largely reflecting the annual base effects as well as the recent increase in oil prices on international markets (Chart 1.6). However, the downward correction of oil prices will inevitably determine its declining trajectory. Thus, starting with the fourth quarter of 2018, the annual growth rate of fuel prices will continuously decrease through the end of the forecast horizon. At the same time, the evolution of the domestic currency's exchange rate and the increase of excise duties, projected for the next year, will slightly offset the impact of the fall in oil prices.

Demand

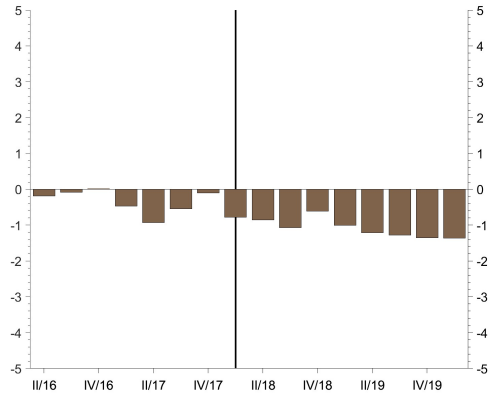
Largely due to the existing monetary conditions, aggregate demand will maintain a disinflationary trend over the next two years against the background of the evolution of the domestic currency's exchange rate as well as of other economic factors (Chart 1.7).

[2]The first agricultural produce or animal offspring of a season.

The prospects for economic activity in 2018 are determined by the performance of the agricultural sector and, consequently, by the field-related activities, by the implementation of the provisions of the Budget Law for 2018 and by monetary conditions.

At the same time, some factors will act to boost aggregate demand, but not to the extent as to make it pro-inflationary. In 2018, the consumption of the population and of the public administration is expected to increase and thus to fuel the growth of imports. At the same time, exports are to record higher growth rates than those of imports (agriculture 4.0%, major investments in free economic zones will contribute to higher exports). This year, unlike the previous year, the evolution of gross capital formation will be fuelled by increasing investments in public sector. Therefore, the fiscal impulse is anticipated to be positive and to be increasing through the end of this year, when the GDP deviation will get close to zero. Starting with the next year, however, once with the decrease of fiscal impulse, the deviation will steadily move down. The real interest rate will decrease as well, although to a lesser extent, and, predominantly, towards the end of this year. Foreign demand, yet moderate, will record the positive contribution to aggregate demand throughout the forecast horizon.

Chart 1.7: The GDP deviation (%)

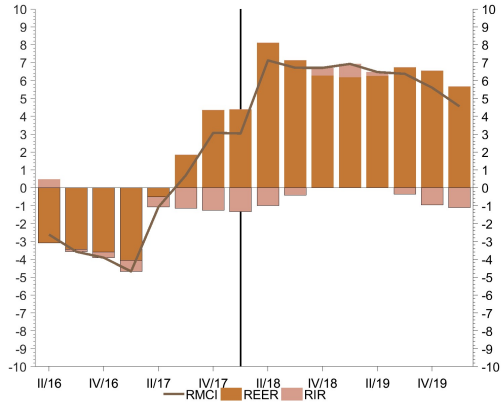


Source: NBM calculus

Monetary policy

The real monetary conditions index (RMCI) denotes a restrictive character over the entire forecasting period (Chart 1.8). A significant contribution in this respect will be generated by the real effective exchange rate. Its significant deviation from the equilibrium level will be recorded throughout the forecasting period. The real interest rate will only marginally determine the developments in monetary conditions. Its insignificant impact will be determined, first of all, by the low level of indebtedness of the economy, especially through the banking channel. Deviations of the real interest rate will continue to ease the restrictive impact of monetary conditions over the entire forecast horizon, with the exception of three consecutive quarters starting with the fourth quarter of 2018, when it will slightly fuel restrictive monetary conditions. This development will be determined by the expected decrease of inflation, but also by a slight increase in the base rate at the end of this year and early next year.

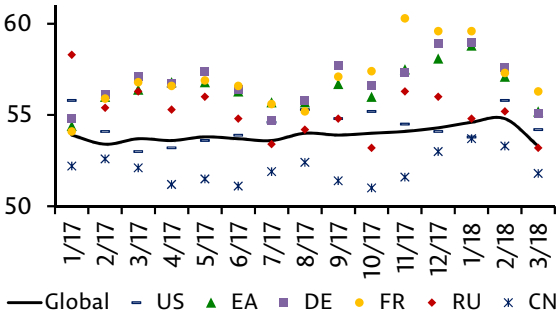
Chart 1.8: The real monetary conditions index and decomposition



Source: NBM calculus

1.2 External environment

Chart 1.9: The evolution of the composite PMI index

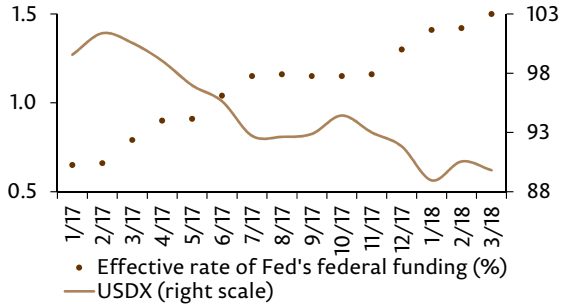


Source: Markit

Global economy

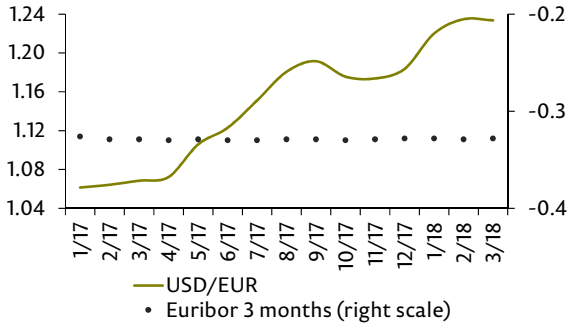
Early in 2018, global economy was marked by the escalation of diplomatic and geopolitical conflicts that contributed to the increased volatility of main macroeconomic indicators and to the accentuation of macroeconomic risks and uncertainties. The protectionist measures, promoted by the US President Donald Trump, as well as the threats coming from the US trading partners to take countermeasures took the foreground of the economic scene and gave rise to apprehensions that a large-scale trade war may commence, being centred along the US-China axis (see box no. 1). The worsening of diplomatic relations between London

Chart 1.10: US dollar index (USDX*) evolution in Fed monetary policy context



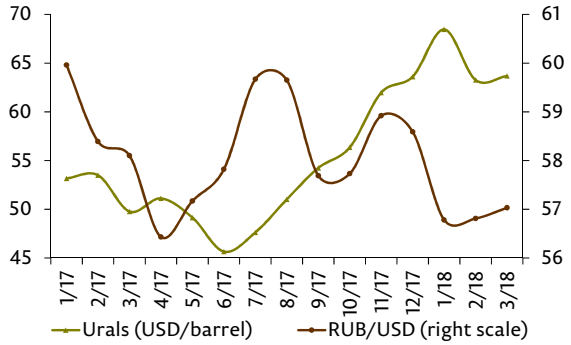
Source: Fed, Bloomberg
USDX is an index calculated using the weighted geometric mean of the US dollar value against a basket of foreign currencies: Euro – 57.6%, Japanese yen – 13.6%, Pound sterling – 11.9%, Canadian dollar – 9.1%, Swedish krona – 4.2%, Swiss franc – 3.6%.

Chart 1.11: The evolution of USD/EUR (monthly average) and interest rate in euro area



Source: ECB, Eurostat

Chart 1.12: The evolution of RUB/USD under the Urals price development



Source: ECB, Eurostat

and Moscow and the new US sanctions imposed on 6 April 2018 against Russian billionaires hit the Russian ruble and the Russian stock market. International oil prices have increased as a result of the overachievement of the OPEC+ plan targets, but also following the escalation of the geopolitical conflict in Syria. At the same time, there are the first signs of the slowing down of the global economy's growth rate, which may be a negative factor for global economic growth, given the rise in commodity prices and the intensification of risks.

The composite PMI index reflects contradicting trends in the global economy's development. In February 2018, the global composite PMI index reached its maximum in the last three years of 54.8. At the same time, already in March 2018, the index fell to 53.3, which is below the average level recorded in the last 12 months. Chart 1.9 shows that the evolution of the composite PMI indices across countries correlates with the evolution of the global index, a small gap being notable between the advanced and emerging economies. The analysis of historical data does not reveal any seasonal factors that could explain a significant slowing down starting with March 2018; however, in order to confirm the trend, it is necessary to monitor further developments.

The US dollar has had a varied evolution in the first months of this year, but, overall, its price remains below parity with other major currencies. At the end of January, the USD (USDX) index fell to its three-year low of 88.95, which was caused by a temporary suspension of the US Government's activity as the deadline for raising the domestic debt ceiling drew close. Subsequently, the US dollar slightly appreciated as a result of the resumption of the Government's activity, of the positive macroeconomic figures, and the anticipated effect of the Fed interest rate's increase. In March, the US dollar depreciated being driven by the US tensions with its trading partners as well as by the return of the investors' attention to the issue of the US budget deficit and current account deficit (Chart 1.10).

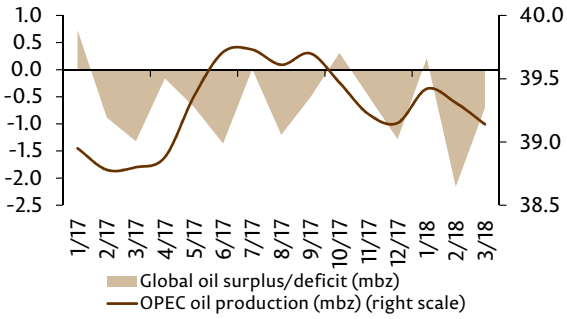
In the first quarter of 2018, the European single currency appreciated, on average, by 4.4% against the US dollar. Economic stability and political consensus have been the key factors driving the appreciation of the European single currency. On March 14, 2018, after several months of dialogue, Angela Merkel, a conservative, was elected for the fourth time as German Chancellor, having received 364 votes from the Bundestag Deputies. At the same time, as it was anticipated, the ECB, at its March 2018 meeting, decided to keep all rates unchanged, but, what is more important, gave up on its previously declared availability to increase the level of QE, should it be required. Apparently, the ECB now regards the reduction of incentives as inevitable, this fact changing the focus of the regulator's debates to the trajectory of the rate's increase. Another factor behind the appreciation of the European single currency against other international currencies is a stable positive balance of the current account in Eurozone. It should be noted that, in March 2018, the Eurozone's harmonised inflation recorded 1.0% on a monthly basis and 1.3% on an annual basis. Although the annual inflation rate remains below the ECB target, the acceleration of the monthly growth rate of consumer prices can be regarded as a positive signal to suggest that the ECB's objective will be attained soon (Chart 1.11).

In January 2018, *the Russian ruble* appreciated significantly (by 3.1%) following the increase in international oil prices, whereas, throughout the first quarter of 2018, it appreciated, on average, by 2.6% against the US dollar (Chart 1.12). In addition to the persistence of high oil prices and the increased investors' appetite for risk, that favoured currencies of large emerging economies, the Russian ruble was fuelled by a significant demand for bond loans coming from non-residents as well as a sharp growth of the current account surplus. The improved trade balance was determined by the rise in commodity prices. In addition, the Russian ruble appreciated in response to the expected decrease of the rate of the Central Bank of Russia. The Central Bank of Russia decreased the reference rate by 0.25 p.p. on February 12 and March 23, 2018, respectively, currently the reference rate recording 7.25%. At the same time, the new set of economic sanctions imposed by the US in April 2018 and the worsening of diplomatic relations between Moscow and London hit the Russian ruble and the Russian stock market, its official exchange rate depreciating from 57.6 RUB/USD up to 64.1 RUB/USD in the first half of April 2018.

Oil prices recorded an average value of 65.1 US dollar/barrel in the first quarter of 2018, up 7.4% compared to the previous quarter (Chart 1.12). International oil quotations have increased as a result of the overachievement of the OPEC+ plan, seasonal demand growth, and a steady decline in the US oil commercial reserves. Average OPEC oil production declined in March to 39.1 mb/day, whereas average oil production in the US rose in March to a peak of 17.0 mb/day. The gap between a rising oil production and declining oil commercial reserves in the US can be explained by a seasonal increase in domestic consumption and a significant increase in oil exports. However, through the OPEC+ efforts, an average deficit of 0.9 mb/day was recorded in the first quarter of 2018, of which a deficit of 2.2 mb/day was recorded in February 2018 (Chart 1.13). It should be mentioned that in April 2018 international oil quotations have increased significantly amid the intensification of the nuclear conflict between the US, Saudi Arabia and Iran, and the escalation of the conflict in Syria.

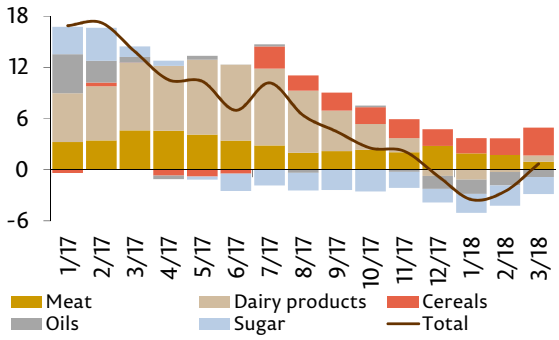
In the first quarter of 2018, *international food prices* have reversed their trend to an upward one. Although this development was mainly due to the base effect, there are preconditions for a rise in prices for certain crops as well as for the depreciation of the US dollar and the increase in international oil quotations. At the same time, the previously low prices for some crops, such as grain, boosted the trade, thus diminishing the producers' stocks. The seasonal factor is another factor that affects dairy prices during the global seasonal change. At the same time, sugar prices are declining against the background of a rich harvest, recorded in Brazil, and the depreciation of the Brazilian real, which boosts exports (Chart 1.14).

Chart 1.13: The global oil market



Source: U.S. Energy Information Administration

Chart 1.14: The annual growth rate of FAO index on food world prices (%)



Source: FAO, NBM calculus

Box no.1

The escalation of the trade war between United States of America and China

In March 2018, the trade relations on the international stage were market by an increasing number of statements and actions issued, characterised by the protectionist tone, which intensified the risks and uncertainties as well as created preconditions for the slowdown of global economy. The US President, whose electoral message focused on economic protectionism, was the one who initiated debates on the trade balances and how they affect the national economy. In January 2017, one of the first decisions adopted by Donald Trump was to withdraw from the Trans-Pacific Partnership[1] (Trade Agreement signed on 4 February 2016 between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the United States, but which was not ratified and did not come into force). Later, Donald Trump focused his efforts on the revision of the NAFTA Agreement (North American Free Trade Agreement between Canada, the United States and Mexico), the negotiations on which have not been completed yet. On March 8, 2018, the US President Donald Trump introduced import taxes of 25% and 10% for imports of steel and aluminium, respectively. Two weeks later, the taxes became applicable for all countries, excepting Canada and Mexico. The White House suspended the imposition of import taxes for Argentina, Australia, Brazil, Canada, Mexico, South Korea and the European Union until May 1, 2018. Most of the countries, affected by this decision, have informed the World Trade Organization that they denounce it and intend to take countermeasures. For example, the European Commission, which coordinates trade policy for 28 EU member states, declared that, in case the EU is not exempt from taxes, it shall consider imposing a 25% import tax for a range of US products, the annual imports of which to the European Union generate revenues equal to 2.8 billion euros (3.45 billion US dollars)[2].

On March 22, 2018, the US President Donald Trump ordered the minister of finance, within 60 days, to have new investment restrictions developed for Chinese companies, thus ensuring protection of American sensitive technologies, according to the classification of the US Government. Besides, the US President announced his intention to reduce trade deficit with China by 100 billion US dollars. In response, on March 23, 2018, China's Ministry of Commerce published a list of 128 US imported products, amounting to 3 billion US dollars and on which additional taxes could be imposed. Subsequently, an exchange of measures and countermeasures between the US and China followed (Table 1), being described by experts as trade war.

What is the definition of trade war? According to the dictionary[3], a trade war is the conflict between two or more nations regarding trade tariffs on each other. This type of conflict usually arises because the nations involved are trying to improve imports or exports for its own country. Trade wars have the potential of increasing the costs of certain imports if the nations involved refuse to reach a compromise.

The protectionist measures promoted by the US President Donald Trump and the threats of US trade partners to take countermeasures fall within this definition. The current escalation of the conflict raises fears that Trump has launched a large-scale trade war, having put the main focus on China.

There have been several trade wars throughout history, but, according to experts, none has ever emerged as a winner in these wars. A study conducted by the US International Trade Commission shows that, when President George W. Bush increased steel import tariffs in 2002, the US GDP fell by 30.4 million US dollars[4]. About 200 000 American employees lost their jobs, one quarter of which were employed in the metallurgical sector[5]. According to the Peterson World Economics Institute, the Bush's bills paid for each job saved in the industry amounted to about 400 000 US dollars[6]. Subsequently, the WTO declared the Bush's measures as illegal. Another example is the Hawley-Smoot Law, passed by the American Congress in 1930, which is often considered the cause of the Great Depression[7]. Under this law, the US authorities raised customs duties by an average of 20%. Initially, the initiative aimed to protect local farmers, however, later, it became more widespread, as other industries began lobbying for similar protection measures.

[1] https://en.wikipedia.org/wiki/Trans-Pacific_Partnership
[2] https://www.reuters.com/article/us-usa-trade-eu/eu-starts-retaliation-process-against-u-s-tariffs-idUSKCN1GS1RZ
[3] http://www.businessdictionary.com/definition/trade-war.html
[4] https://www.usitc.gov/mwg-internal/de5fs23hu73ds/progress?id=FWrQ267NDDg8Q3Sq9FTawbXWo5sZ6vR8E_nj7gmYdOI,
[5] http://www.tradepartnership.com/pdf_files/2002jobstudy.pdf
[6] https://piie.com/publications/pb/pb03-1.pdf
[7] https://en.wikipedia.org/wiki/Smoot%E2%80%93Hawley_Tariff_Act

When demand collapsed, countries tried to maintain their gold and currency reserves by devaluing currencies or by introducing higher trade barriers.

Table 1. **Measures and countermeasures applied in the US-China trade war**

8 March 2018	The US President Donald Trump introduced import taxes of 25% and 10% for imports of steel and aluminium, respectively. The taxes became applicable within 15 days for all countries, excepting Canada and Mexico. The White House suspended the imposition of import taxes for Argentina, Australia, Brazil, Canada, Mexico, South Korea and the European Union until May 1, 2018.
22 March 2018	The US President Donald Trump ordered the minister of finance, within 60 days, to have new investment restrictions developed for Chinese companies, thus ensuring protection of American sensitive technologies, according to the classification of the US Government.
23 March 2018	China's Ministry of Commerce published a list of 128 US products, the imports of which generate revenues amounting to 3 billion US dollars and for which additional customs duties could be imposed (applicable since April 2, 2018).
3 April 2018	Having accused Beijing of unfair practices, the US administration published a list of about 1,300 products, imported from China, which might be subject to additional customs duties. New customs duties were to be imposed on products imported for such industries as the aerospace, information and communications technology, robotics and machine tools.
4 April 2018	China decided to impose a 25% import tax on 106 types of products, such as: cars, including many types of SUV automobiles, chemicals, whiskey, cigarettes, soybeans, aircraft weighing less than 45 tonnes, and other goods imported from the USA. The taxes are to become applicable immediately after US authorities announce the imposition of import taxes published on April 3, 2018.
5 April 2018	The US President Donald Trump has announced that he ordered the US administration to consider imposing additional taxes on Chinese imports in the amount of 100 billion US dollars.
10 April 2018	China's President announced the country’s readiness to cut import taxes on cars and other goods, expand foreign investors' access to the Chinese market and strengthen intellectual property’s protection.

Currently, the escalation of the US-China trade war represents the greatest risk to the global economy’s growth. Economists warn that the world is on the verge of a trade war that will result in the application of countermeasures such as "eye for eye, and tooth for tooth".

The gravity of the problem is scaled up by the fact that the World Trade Organization may be powerless to solve the problem.

Risks and uncertainties associated with the US-China trade war:

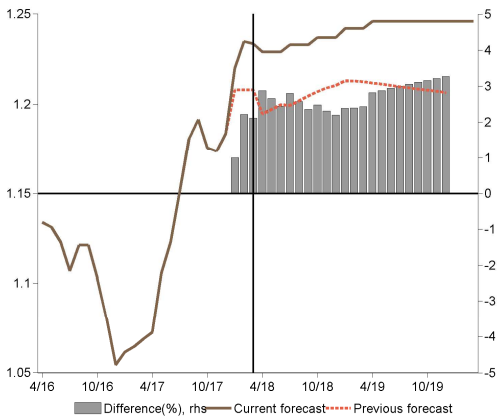
1. The disruption of international trade and investment processes.
2. The decline of economic growth potential of both economies, involved in the conflict, as well as of other partner economies.
3. The depreciation of currencies, in particular, of the US dollar and the Chinese yuan.
4. The shifting of investments to safer assets (such as gold, Swiss franc, etc.).
5. The strengthening of economic mercantilism based on the notion that a nation's power can be increased if exports exceed imports.

Table 1.1: The expected evolution of external variables (annual average)

	2018	2019
Economic growth in the euro area, %	2.4	1.9
Economic growth in the Russian Federation, %	1.8	1.7
Average annual inflation in the euro area, %	1.5	1.5
Average annual inflation in the Russian Federation, %	3.8	5.6
USD/EUR	1.23	1.25
RUB/USD	60.3	61.5
Urals brand oil prices (USD/barrel)	68.5	65.5
International food prices growth, %	-0.2	5.4

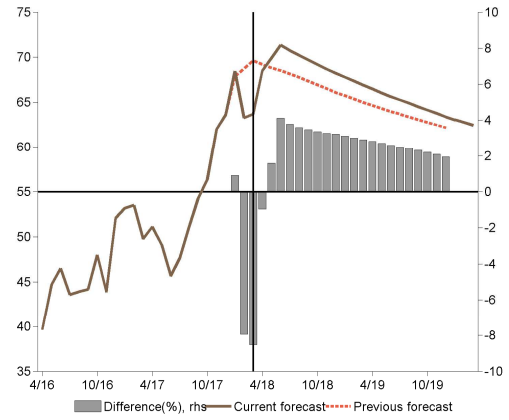
Source: Consensus Economics, Bloomberg, NBM calculus

Chart 1.15: The evolutionary scenario of the USD/EUR exchange rate



Source: ECB, Consensus Economics, NBM calculus

Chart 1.16: The evolutionary scenario of the Urals brand oil world prices (USD/barrel)



Source: Ministry of Economic Development of the Russian Federation, Bloomberg, NBM calculus

External assumptions

The external assumptions (Table 1.1) maintain a pro-inflationary character in the current forecasting round. Recent statistics shows that global economy is in the upward stage of the economic cycle, with global demand supporting the rise in international commodity prices. At the same time, the intensification of economic protectionism, diplomatic disputes and the escalation of geopolitical conflicts amplify the volatility of the main macroeconomic indicators of global reference, thus increasing the risks and uncertainties. Overall, it is expected that the Eurozone economy will continue to grow against the background of economic stability and political consensus. Also, the Russian economy will continue to recover, the negative effect of economic sanctions being offset by a significant rise in oil prices.

The European single currency will continue to appreciate and then will stabilise. The strong parity of the European single currency against the US dollar stems from the anticipation that the ECB will be able to normalise rapidly the monetary policy to the detriment of a gradual easement of the monetary policy implemented by the Fed. At the same time, the euro will be supported by a positive evolution of the Eurozone economy, marked by economic and political developments in Europe, and by the surplus of the current account. On the other hand, the US dollar parity will suffer because of the US-China trade war (Chart 1.15).

In 2018, international oil prices will continue to grow, a correction of prices following to take place in 2019. Recently, factors contributing to the oil price rise have intensified: the over-achievement of the OPEC+ oil reduction plan; a temporary decrease of the US oil commercial reserves; the escalation of the geopolitical conflict in Syria. At the same time, starting with the second half of 2018, oil prices will undergo a correction determined by the upcoming completion of the OPEC+ agreement and by the risk of oil surplus being created on the global market. In addition, oil production in the US is currently on the rise; therefore, in case of export restrictions being imposed, there is danger of a significant increase of oil trade reserves. Another factor is the US' intention to withdraw from the nuclear agreement with Iran, which may lead again to an exclusion of Iranian oil from international trade. The average projected value of Ural oil is 68.5 US dollar/barrel in 2018 and 65.5 US dollar /barrel in 2019 (Chart 1.16).

Over the next 8 quarters, international food prices will be characterised by increased volatility and record an overall increase. Starting with the second half of 2018, international food prices are expected to rise as a result of uncertainties surrounding the 2018 harvest to be collected in the northern hemisphere. Also, the base year effect will continue to contribute to the rising of international commodity prices. Thus, in 2018, international food prices are projected to drop by 0.2%, on average, after which, in 2019, they will rise, on average, by 5.4% (Chart 1.17).

1.3 Comparison of forecasts

The current inflation forecast's values remain close to the projected ones, although they were slightly revised downwards for the current year (Chart 1.18). The main contribution to the downward revision was generated, on the one hand, by core inflation and regulated prices. At the same time, the upward forecast revision of food and fuel prices offset the downward revision. The upward revision of inflation forecast for the next year was insignificant. It was determined by the updated assumptions on regulated prices, food and fuel prices, although the downward revision of the core inflation forecast partially mitigated their contributions (Chart 1.19).

The average annual inflation rate was revised downward by 0.4 p.p. for 2018 and upwards by 0.2 p.p. for 2019.

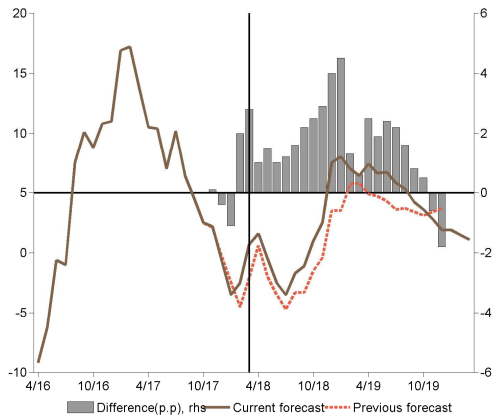
The core inflation was revised downward throughout the forecasting period. The main reason for the decrease was the aggregate demand's revision, caused, largely, by real monetary conditions, which proved to be more restrictive because of a stronger MDL/USD exchange rate. These effects were slightly mitigated by the revision of the price elasticity asymmetry to exchange rate fluctuations. Besides, the effective core inflation, which recorded in the first quarter of 2018 values lower than projected, determined further downward revision of the forecast trajectory.

The forecast of the core inflation rate was revised downward by 1.5 p.p. for 2018 and by 0.8 p.p. for 2019 (Chart 1.20).

The forecast of the food prices' growth rate was revised upwards being mainly driven by the upward revision of the forecast of international food prices. A higher level of international food prices, supported by the adjustment of the USD/MDL exchange rate in the second half of this year, will trigger a rise in imported inflation, mainly for five consecutive quarters, starting with the third quarter of 2018. Besides, the effective inflation of food prices, which recorded in the first quarter of 2018 values higher than projected, determined further upward revision of projected trajectory. At the same time, the growth rate of food prices in the first quarter of 2019 was revised upwards as a result of possible seasonal price increases.

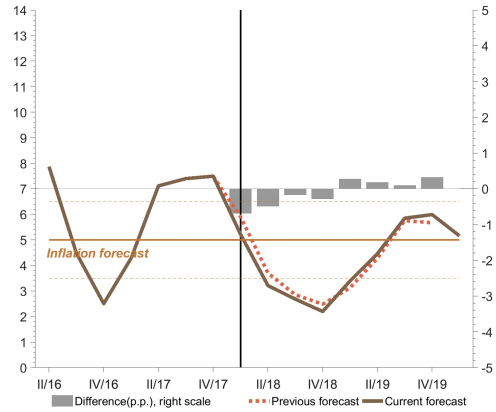
The forecast of the growth rate of regulated prices was revised downwards for the current year and upwards for the next year (Chart 1.22). The downward revision of forecast was largely determined by a 20.2% cut of tariffs for gas supply, carried out by the National Agency for Energy Regulation (ANRE) at the end of the first quarter of 2018; the tariffs' decrease was retroactively implemented starting with January 1, 2018. Previously, a 10.0% cut of gas supply tariffs was projected for the third quarter of 2018. At the same time, as a result of the appreciation of the domestic currency, drug prices were also revised downwards by 1.2 p.p. These developments were slightly tempered by the assumptions that energy prices will be decreased this year by about 3.5 p.p. Next year, the growth rate of regulated

Chart 1.17: The evolutionary scenario of food world prices annual growth (%)



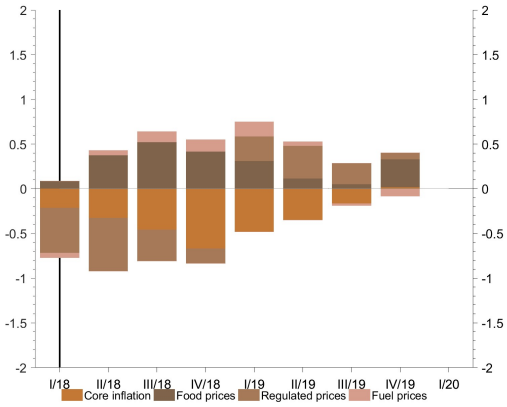
Source: FAO, Bloomberg, NBM calculus

Chart 1.18: CPI (%, f.a.p., p.p.)



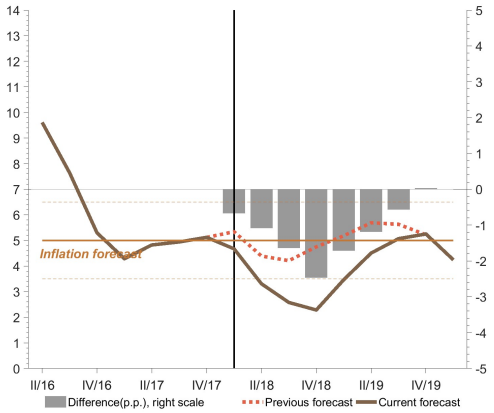
Source: NBS, NBM calculus

Chart 1.19: The difference decomposition between the forecasts (p.p.)



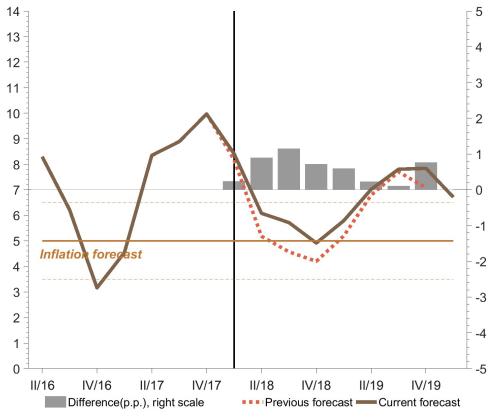
Source: NBM calculus

Chart 1.20: The core inflation (%, f.a.p., p.p.)



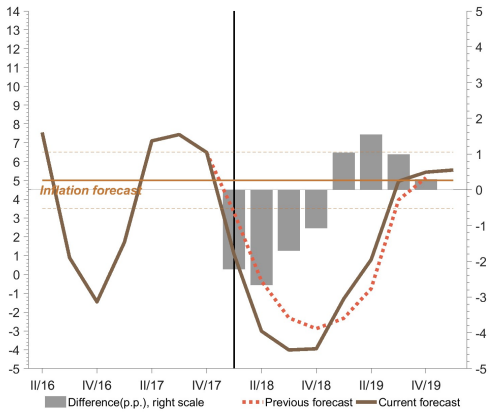
Source: NBS, NBM calculus

Chart 1.21: The food prices (%, f.a.p., p.p.)



Source: NBS, NBM calculus

Chart 1.22: The regulated prices (%, f.a.p., p.p.)



Source: NBS, NBM calculus

prices is expected to be slightly higher, provided that previous assumptions remain valid, the positive differences being due to the annual base effect.

Given the above, the forecast of regulated prices was revised downwards by 1.9 p.p. for 2018 and upwards by 1.0 p.p. for 2019.

The forecast of the growth rate of fuel prices has been slightly revised due to rising oil prices (Chart 1.23) as well as the strengthening of the exchange rate of the domestic currency. After an appreciation of the domestic currency in the first quarter of 2018 and a lower-than-expected oil price, recorded in the first quarter of 2018, fuel prices fell below the forecasted level. Consequently, the fuel price forecast was revised upwards by 0.9 p.p. for 2018 and by 0.3 p.p. for 2019.

1.4 Risks and uncertainties

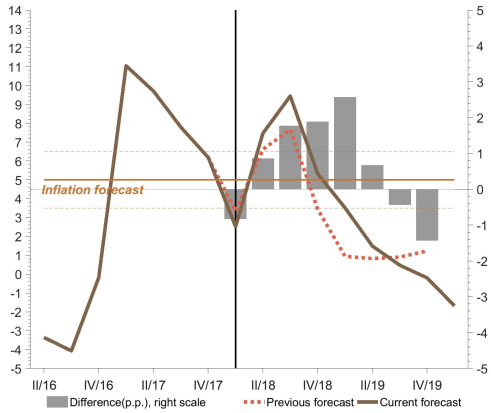
External sector

- **Escalation of geopolitical risks.** The recent escalation of the armed conflict in Syria and the US intention to withdraw from the nuclear agreement with Iran represent the main geopolitical risks with serious implications for global oil and commodity markets. Stock exchange markets have already recorded a strong increase in global oil quotations; should this trend persist, it will generate significant pressures on all commodity prices, food prices and production costs (pro-inflationary).
- **Rising international prices for oil and other commodity.** In mid-April 2018, the Brent crude oil price exceeded 75 US dollar/barrel. A significant increase in oil prices over a short period of time has intensified the risks associated with them. A key growth factor was the overachievement of the OPEC+ agreement providing the reduction of oil production by the end of 2018. At the same time, the escalation of geopolitical conflicts in the oil extracting and exporting regions has also fuelled the rise in oil prices. Another current factor is a constant oscillation of the US oil stocks and the contradictory signals recorded by field-related statistics that disrupt the existing trends. As oil quotations are used as a benchmark for other commodity prices, we may witness an explosion of pro-inflationary pressures in the coming months. It is only at the end of 2018, provided the period of the OPEC+ agreement is not further extended, there is a likelihood of a rise in oil supply and a decline in oil prices; the probability of this happening, however, keeps decreasing (pro-inflationary).
- **US-China trade tensions.** Currently, the escalation of the US-China trade war represents a major risk to the growth of global economy. The gravity of the problem is scaled up by the fact that the World Trade Organization may be powerless to solve the problem. Major implications of the trade war may include the disruption of the international trade and

of the investment process; the decline of economic growth potential of both economies, involved in the conflict, as well as of other partner economies; the depreciation of currencies, in particular, of the US dollar and the Chinese yuan; and the shifting of investments to safer assets (such as gold, Swiss franc etc.) (disinflationary).

- **Significant slowdown of global and regional economic activity.** The recent evolution of a number of indicators shows a significant slowing down of the growth rate of economic activity, most often this being explained as a seasonal effect noted in the northern hemisphere as a result of low temperatures recorded during the cold period of the year. However, there are reasons to believe that the recent economic moderation is correlated with the development of the economic cycle and that, as geopolitical risks intensify, global economy is entering a new stage of economic regress. Therefore, in the coming months, all macroeconomic developments have to be carefully monitored to quantify the impact of developing trends (disinflationary).

Chart 1.23: The fuel prices (%, f.a.p.)



Source: NBS, NBM calculus

Real sector

- **Uncertainties regarding the 2018 harvest.** The 2018 harvest and domestic food prices, respectively, will depend, largely, on the agrometeorological conditions of the current year. Whereas it is difficult to anticipate weather developments, this fact lends a high level of uncertainty to the 2018 forecast of food prices (uncertainty).
- **Price vulnerability to domestic agricultural products against the weather conditions in the near future.** Based on the recent years' experience, prices for domestic fruit and vegetables are, to a large extent, affected by adverse weather conditions such as frosts, droughts, abundant rainfalls, or by costs associated with harvesting, transportation, storage, and their marketing on local markets. Droughts or heavy rainfalls could cause rising of food prices above the projected values over the next few months (pro-inflationary).
- **Uncertainties regarding the timing and the scale of tariff adjustments for regulated services.** The medium-term inflation outlook is based on the assumption of the electricity tariff's cut in the second quarter of 2018 and a serious tariff increase for a range of services, to be implemented in 2019, as a result of the unprojected shifts in economic trends as well as certain financial deviations recorded in several domestic economy sectors. Since the level of tariffs on a range of regulated services has a considerable social impact, the timing of their adjustment can be determined based not only on economic factors but also on social or political objectives pursued by decision-makers. Therefore, the timing and the scale of tariffs' adjustment cannot be projected with a sufficient degree of confidence (uncertainty).
- **Potential decrease of drug prices.** Following the adoption of additional regulations and because of the domestic currency's appreciation over this year, drug prices fell significantly. In the event that the drug assortment,

included in the Drug Price Catalogue, changes or if the current exchange rate's dynamics remains unchanged, drug prices could decrease significantly (disinflationary).

- **Potential faster recovery of aggregate demand.** The medium-term inflation outlook is based on the assumption of a modest aggregate demand that has minor impact on prices. An eventual increase in economic activity could exert further inflationary pressures on core inflation and some food prices (pro-inflationary).

Monetary and public sectors

- **Excess liquidity in the banking sector.** Following monetary emissions in 2017-2018, as a result of the NBM's net interventions on foreign exchange market (foreign exchange purchases) totalling 542.4 million USD (approx. 9.64 billion MDL), the banking system accumulated excess liquidity in the amount of approx. 9.6 billion MDL. In the short term, the excess liquidity may have a positive impact on aggregate demand and foreign exchange rate, as well as create inflationary pressures (pro-inflationary).
- **Rise in foreign currency lending.** The annual growth rate of foreign currency lending has increased over the last period. The dollarisation of lending activity increases the risk of intensifying the pressures on the domestic currency exchange rate (pro-inflationary).
- **Poor domestic currency lending of the economy.** During 2017 and early 2018, the market of newly extended loans has recorded a downbeat annual growth. A slowdown of lending activity could lead to a decline in aggregate demand, which will generate additional disinflationary pressures (disinflationary).
- **External partners' funding.** Originally, it has been agreed that in 2018 the Republic of Moldova will receive financing under the EU macro-financial assistance programme in the total amount of EUR 100.0 million (EUR 60.0 million as a loan and EUR 40.0 million as a grant). Currently, there are uncertainties regarding the receipt of the first instalment of macro-financial assistance (disinflationary).

Chapter 2

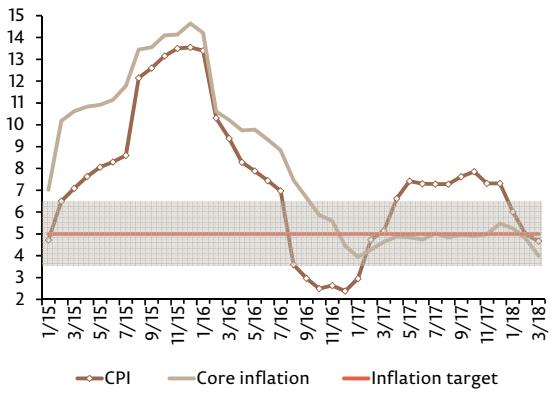
Inflation development

After a relatively stable evolution at the end of 2017, at the beginning of the current year, the annual inflation rate recorded a prominent downward trajectory, which was mainly determined by a gradual dissipation of the effects of tariff adjustments, implemented in the first half of the previous year, and the recalculation of inflation values following the decrease of the gas supply tariff. At the same time, the downward development was also supported by the trend towards appreciation of the domestic currency against the US dollar. On the one hand, aggregate demand continued to exert a minor impact on core inflation in the first quarter of 2018. On the other hand, the increase in international oil prices and the adjustment of excise duties have put pressure on fuel prices on the local market. However, their impact on the annual CPI rate was insignificant during the reference period. Since January, the CPI annual rate has been within the inflation target range set in the medium-term monetary policy strategy. The effective annual inflation rate, in the first quarter of 2018, recorded values below those projected in the forecasting round of the Inflation Report no. 1 as a result of the recalculation of inflation in March and a stronger-than-anticipated exchange rate. In the coming months, the inflation's downward trend will be maintained so that it will fall below the lower limit of the inflation target range as a result of the anticipated electricity tariff's adjustment and the persistence of the above-mentioned disinflationary factors.

2.1 Consumer Price Index

In the first quarter of 2018, the annual inflation rate recorded a prominent downward trajectory, having fallen from 7.3% in December 2017 to 4.7% in March 2018 (Chart 2.1). Starting January 2018, it recorded values within the range of 5.0% ± 1.5 p.p. stipulated in the medium-term monetary policy strategy. In the first quarter of 2018, the average CPI annual rate record to 5.2%, being lower by 2.3 p.p. than in the previous quarter. The inflation's downward trend, recorded at the beginning of this year, was largely determined by the dissipation of the impact of tariffs' adjustment for medical services, implemented in the first quarter of 2017, as well as the recalculation of inflation for the first two months of the year as a result of the reduction of gas supply tariffs for 2018. This trend is expected to continue in the coming months.

Chart 2.1: The annual rate of CPI and core inflation (%)

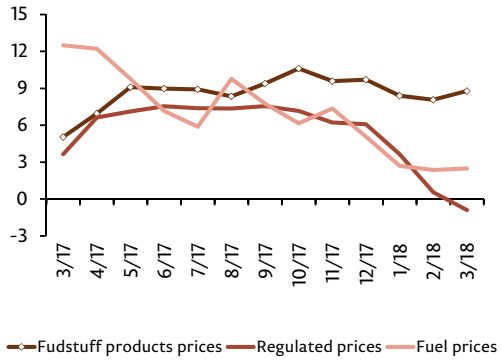


Source: NBS, NBM calculus

Core inflation

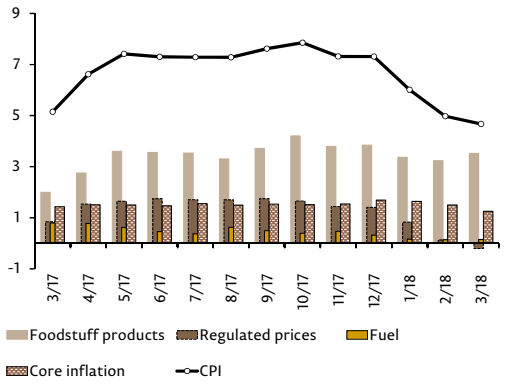
In the first quarter of 2018, core inflation recorded values significantly lower than total inflation, remaining close to the inflation target. It should be mentioned that this level of inflation, that excludes transient effects on the CPI and largely reflects the inflationary pressures associated with excess demand, has remained within the inflation target range for more than one year. However, in the first quarter of 2018, after a relatively stable evolution of previous months, it assumed a downward trajectory, having recorded 4.0% in March 2018. In the first quarter of 2018,

Chart 2.2: The annual rate of food, regulated and fuel prices (%)



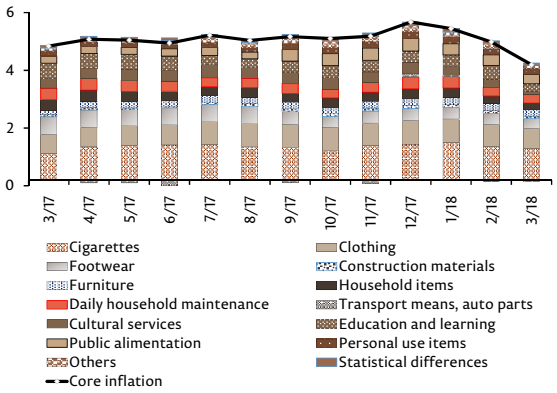
Source: NBS

Chart 2.3: The evolution of the annual inflation (%) and subcomponents contribution (p.p.)



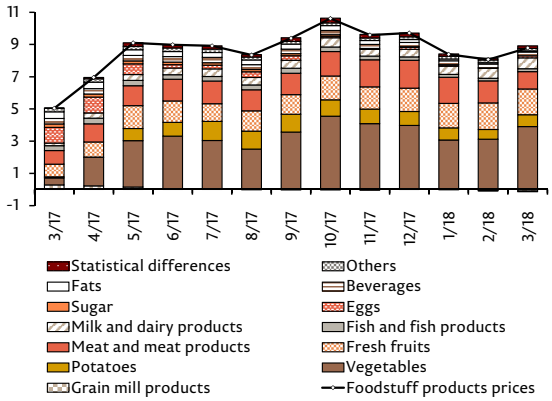
Source: NBS, NBM calculus

Chart 2.4: The subcomponents contribution (p.p.) to the annual rate of core inflation (%)



Source: NBS, NBM calculus

Chart 2.5: The components contribution (p.p.) to the annual rate of food prices (%)



Source: NBS, NBM calculus

the average rate of core inflation record to 4.7%, thus being lower by 0.4 p.p. than in the previous quarter. Consequently, the contribution of core inflation to the annual CPI rate has diminished over the reference period and recorded 1.5 p.p. (Chart 2.3). According to estimates, aggregate demand exerted a negligible impact on core inflation, thus supporting its downward trajectory. At the same time, the downward evolution of core inflation was driven by the trend towards appreciation of the domestic currency that favoured price stagnation for most of its subcomponents as well as the fall in prices for some subcomponents, such as “machinery” and “tourism abroad”, given that many of these categories, monitored by the National Bureau of Statistics (NBS), depend on the USD / MDL exchange rate. At the same time, the adjustment of excise duties on cigarettes exerted pressures on core inflation during the first quarter of 2018. As a result, their prices in March recorded levels 22.4% higher, year-on-year, thus generating a significant contribution to core inflation over the reference period (Chart 2.4).

Food prices

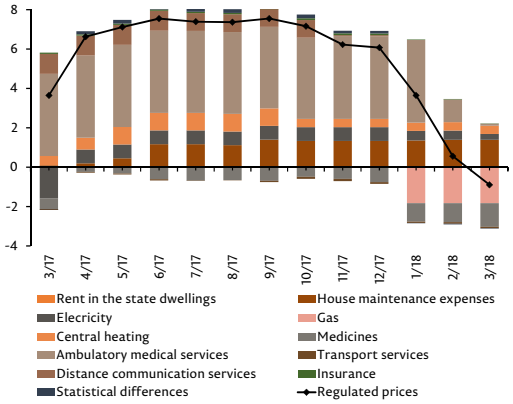
The high annual growth rate of food prices, maintained in the first quarter of 2018, was largely determined by pressures accumulated in earlier periods, generated by less favourable agrometeorological conditions, which were periodically recorded in Moldova during 2017, but also following several sectoral shocks that affected prices for meat and a range of imported products. It should be mentioned that, during the first quarter of 2018, disinflationary factors prevailed in the economy. Thus, a steady trend towards appreciation of the domestic currency exchange rate, along with a rich supply of fresh vegetables, created preconditions for the slowing down of the annual growth rate of food prices. At the same time, the prices for "meat, meat products and canned meat" stopped generating inflationary pressures during this period. Thus, in the first quarter of 2018, the annual rate of food prices recorded average level of 8.4%, having dropped by 1.6 p.p. compared to the fourth quarter of 2017. As a result, the contribution of food prices to the annual inflation rate decreased by 0.5 p.p, recording 3.4 p.p. in the first quarter of 2018.

Regulated prices

The downward trajectory of the CPI annual rate, recorded early this year, was mainly driven by the decrease of pressures generated by regulated prices. Thus, during the first quarter of 2018, there was a prominent decrease in their annual growth rate. In March 2018, the annual growth rate of regulated prices recorded -0.9%, having dropped by 7.0 p.p. compared to the end of the fourth quarter of 2017. This development was mainly driven by the lowering of the gas supply tariff and the exclusion from the annual growth rate’s calculation of the impact produced by the increase in healthcare tariffs, which was implemented at the beginning of 2017 (Chart 2.6). On 16 March 2018, the Administration Board of the ANRE approved the 20.2% reduction of the gas supply tariff set for 2018. Consequently, the NBS recalculated inflation

indices[3]for January and February 2018. It should be noted that a significant decrease in the gas supply tariff was supported by the appreciation of the Moldovan lei against the US dollar as well as by the lowering of the gas import price. At the same time, the slowing down of the growth rate of regulated prices was also determined by the fall in drug prices as well as the electricity tariff's cut implemented in certain regions of the country. In this context, a steady trend towards appreciation of the domestic currency exchange rate, maintained in the first three months of 2018, generated additional disinflationary pressures on drug prices. At the same time, the merger of the "RED Nord" and "RED Nord West" joint stock companies permitted the users of the RED Nord West services to benefit from a reduction in electricity tariff. It should be noted that, as the difference between the applied electricity tariffs was insignificant, the tariff's reduction exerted a minor impact over regulated prices. However, a cut in electricity tariff for all household consumers is expected to be implemented in the second quarter of 2018, which will help maintaining the downward trend of the annual CPI rate.

Chart 2.6: The components contribution (p.p.) to the annual rate of regulated prices (%)

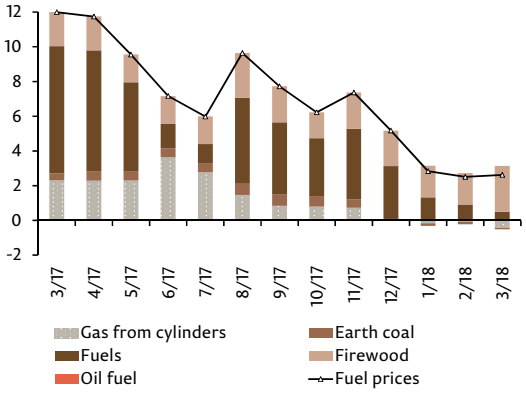


Source: NBS, NBM calculus

Fuel prices

Pressures exerted by fuel prices on inflation continued to decline in the first quarter of 2018. Thus, the annual growth rate of fuel prices recorded a downward trend, having decreased from 5.1% in December 2017 to 2.5% in March 2018. The average rate of fuel prices recorded 2.5%, having dropped by 3.7 p.p. compared to the fourth quarter of 2017 (Chart 2.7)). This growth rate development, recorded during the first quarter of 2018, was supported by the decrease in contribution from such subcomponents as "fuels", "cylinder gas" and "coal" and by the appreciation of the domestic currency against the US dollar (-3.6% compared to the fourth quarter of 2017), which has mitigated the impact of higher excise duties imposed on petroleum products and rising international energy prices. At the same time, the contribution generated by prices for "firewood" subcomponent recorded a slight increase over the previous quarter, being driven by lower temperatures recorded during the reference period.

Chart 2.7: The components contributions (p.p.) to the annual growth of fuel prices (%)



Source: NBS, NBM calculus

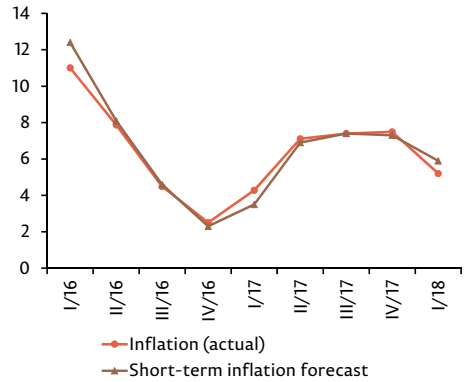
[3]http://bnm.md/ro/content/traiectoria-ratei-anuale-inflatiei-fost-modificata

Table 2.1: The evolution and forecast of CPI and its components (%)

	De facto (%)	Forecast IR 1, 2018	Deviation (p. p.)
	Q I, 2018/ Q I, 2017	Q I, 2018/ Q I, 2017	De facto-BS
CPI	**5.2**	**5.9**	**-0.7**
Core inflation	4.7	5.3	-0.6
Food	8.4	8.2	0.2
Regulated prices	1.1	3.3	-2.2
Fuels	2.5	3.4	-0.9

Source: NBS, NBM calculus

Chart 2.8: The evolution and short-term forecast of CPI (%)



Source: NBS, NBM forecast

2.2 Evolution of inflation in the first quarter of 2018 compared to the inflation forecast of the Inflation Report no.1, 2018

CPI data, recorded in the first quarter of 2018, reflect a lower level of inflation [4](0.7 p.p.) than was projected (5.9% in baseline scenario) (Tabelul 2.1). The negative deviation was mainly driven by the decrease of the gas supply tariff, which was approved in March although was not initially forecasted for that period, the lower tariff being set for the whole of 2018, and a subsequent NBS recalculation of the inflation level for the first two months of the year. Thus, in the first quarter of 2018, average regulated prices recorded 1.1%, being 2.2 p.p. lower than was anticipated in the previous forecasting round. These developments resulted in an unanticipated negative impact of 0.4 p.p. on inflation in the first quarter of 2018. At the same time, the negative deviation was also determined by a lower-than-anticipated dynamics of core inflation. Thus, in the first quarter of 2018, its annual growth rate reached values 0.6% lower than anticipated due to recording a stronger exchange rate than was projected in the previous forecasting round. This factor combined with lower oil prices (65.1 USD/barrel against 68.7 USD/barrel, down 5.2%) has generated a negative deviation of 0.9 p.p. from the fuel price forecast. The negative impact, generated by the aforementioned subcomponents, was slightly mitigated by a positive deviation (of 0.2 p.p.) from the food price forecast. Thus, in the first quarter of 2018, the average annual growth rate of food prices recorded 8.4%, having risen by 0.2 p.p. above the anticipated level because of lower temperatures recorded in March.

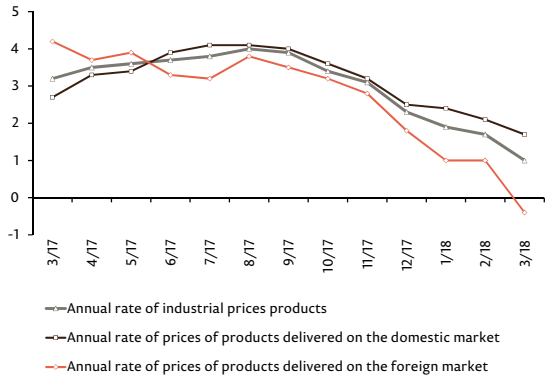
[4]Given a more prominent volatility of monthly values as well as potential measurement errors that, normally, should not influence monetary policy decisions, the short-term inflation forecast is performed on quarterly basis. The resulting value reflects the medium-term inflation projection, which is also determined on quarterly basis and serves as the basis for monetary policy decisions. At the same time, it is reflected in Inflation Reports. However, the actual monthly CPI data, published by the NBS during the reference quarter, are analyzed and compared with the short-term forecast for the whole quarter, to assess whether the main assumptions are confirmed or whether there is a risk of serious deviations from the forecast. Therefore, the deviations between the actual data available for each month of the quarter and the short-term inflation forecast should be interpreted accordingly, by taking into account the assumptions/anticipations related to the remaining months of the quarter.

2.3 Industrial output prices

During the first quarter of 2018, the annual Industrial Production Price Index (IPPI) recorded a prominent downward trajectory reaching a level of 1.5%, thus having dropped 1.4 p.p. compared to the fourth quarter of 2017. A downward trend of the annual IPPIwas driven by the price dynamics of goods delivered both on the internal and external market (Chart 2.9).

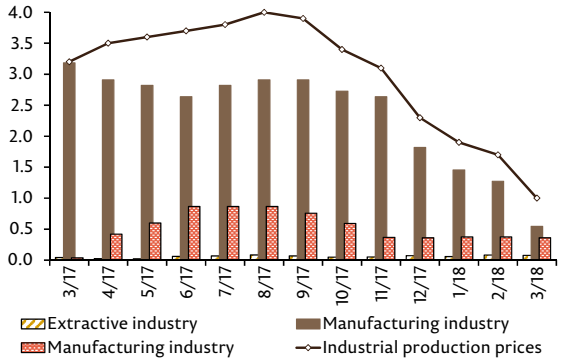
The analysis of the annual IPPI evolution, by main sectors, suggests that its significant decline was determined by price developments in the manufacturing sector (Chart 2.10). The decline in the annual growth rate of manufacturing prices was driven by the fading of inflationary pressures generated by food and beverage industries. This price dynamics can be associated with a rich crop of agricultural products recorded in the second half of 2017. At the same time, prices in the energy sector and mining industry generated a negligible impact on developments recorded in industrial production prices.

Chart 2.9: The industrial production prices annual rate (%)



Source: NBS

Chart 2.10: The industrial production prices annual rate (%) and the contribution of its components categorised by main branches (p.p.)



Source: NBS, NBM calculus

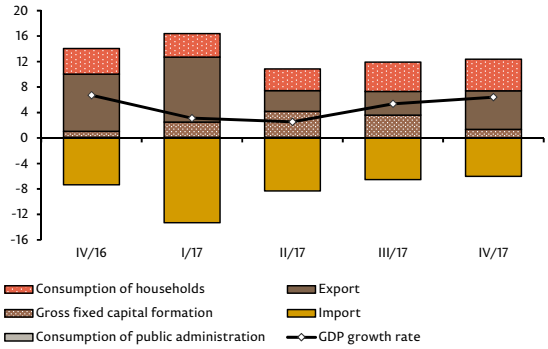
Chapter 3

Economic developments

3.1 Demand

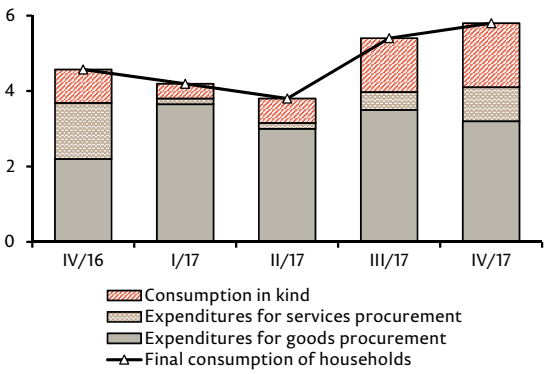
The upward dynamics of economic activity continued in the fourth quarter of 2017, as was anticipated in the previous forecasting round. During the reference period, GDP grew by 6.4% compared to the same period of 2016, having recorded a growth rate 1.0 p.p. higher than in the third quarter of 2017. A prominent positive evolution of economic activity, recorded in the fourth quarter of 2017, was driven, like in the previous quarter, by both the growth of aggregate demand and a strong agricultural performance. At the same time, the seasonally adjusted series reflects the GDP increase of 1.3% compared to the third quarter of 2017. Despite the economic growth, aggregate demand, in accordance with estimates, continued to exert a negligible impact on inflation over the reference period.

Chart 3.1: The contribution of demand components to GDP growth (p.p.)



Source: NBS, NBM calculus

Chart 3.2: Components' contribution (p.p.) to the final consumption of households' growth (%)



Source: NBS, NBM calculus

From the perspective of the usage of goods and services (Chart 3.1), a positive annual GDP rate, recorded in the fourth quarter of 2017, was driven by both domestic and external demand. Thus, on the one hand, the annual growth rate of final household consumption amounted to 5.8% against the background of the increase in the disposable income of the population. On the other hand, the final consumption of public administration recorded a marginal decrease (0.1%) compared to the fourth quarter of 2016. A positive, though smaller than in the previous quarter, contribution to the dynamics of economic activity was generated by the investment component. Gross fixed capital formation increased by 5.9%, generating a contribution of 1.4 p.p. to GDP dynamics. Stock change component brought minor contribution to the GDP's growth (-0.1 p.p.). A strong positive contribution to the GDP's growth was generated by the evolution of exports. Thus, in the fourth quarter of 2017, exports recorded values 12.4% higher than in the similar period of 2016. However, a significant part of the positive contribution generated by the above-mentioned components was offset by the growth of imports by 8.0%, thus generating a negative contribution of 6.0 p.p. This development was supported by the increase in domestic demand as well as by the trend towards appreciation of the domestic currency against the US dollar.

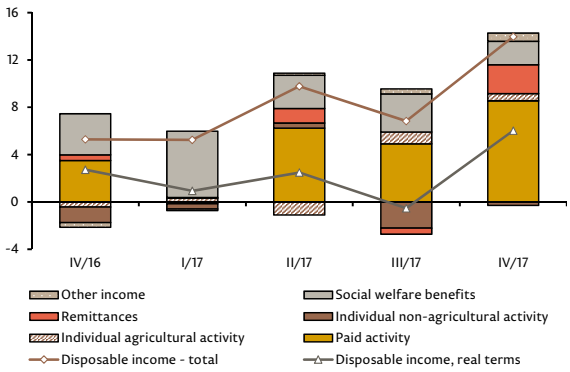
Household consumer demand

In the last quarter of 2017, private consumption maintained its positive dynamics recorded in the previous periods. In this way, the annual growth rate of final household consumption recorded 5.8%, being 0.4 p.p. higher than in the third quarter of 2017. The respective dynamics of household consumption was driven by the increase in expenditures on consumer goods by 5.0%, but also by the increase in consumption of in-kind goods and services by 9.7%. At the same time, the expenditures on services recorded a

slower positive dynamics, compared to other components, having increased by 3.6% (Chart 3.2).

The annual positive dynamics of household consumption was supported by the evolution of the disposable income of the population. Thus, after a slight decline, recorded in the third quarter, in the fourth quarter of 2017, the annual growth rate of disposable income of the population increased significantly, recorded 14%, by 7.1 p.p. higher compared to the third quarter 2017 (Chart 3.3). This development was mainly driven by revenues received by population in the form of salary and remittances. Positive, yet smaller, contributions were generated by such components as "incomes obtained from individual agricultural activity", "other incomes" and social benefits. At the same time, incomes obtained from non-agricultural individual activity contributed negatively to the annual dynamics of the disposable income of the population. After a slightly negative dynamics of the previous quarter, in the fourth quarter of 2017, the annual growth rate of the disposable income of the population, in real terms, recorded 6.0%, having increased by 6.6 p.p. compared to the third quarter of 2017.

Chart 3.3: Evolution of personal disposable income (%, versus the same period of the previous year) and subcomponents' contribution (p.p.)



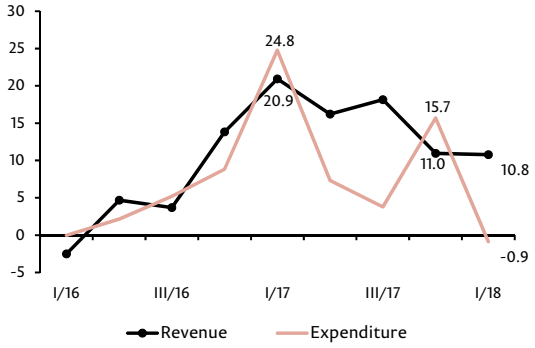
Source: NBS, NBM calculus

Public sector

Execution of the national public budget

According to the data provided by the Ministry of Finance, in the first quarter of 2018, the national public budget revenues amounted to 13.3 billion lei (34.6% of GDP[5]), having increased by 10.8% compared to the first quarter of 2017 (Chart 3.4). The major part of budget revenues was accrued from taxes and fees, accounting for 65.8% of total revenues. Social insurance contributions and compulsory insurance premiums accounted for 29.6%, whereas the share of other revenues and grants recorded 4.1% and 0.5%, respectively, of total budget revenues.

Chart 3.4: The dynamics of public revenues and expenditures

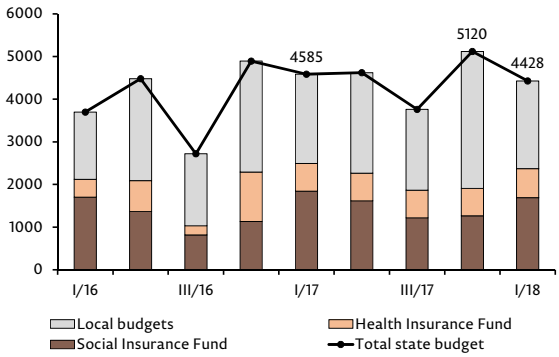


Source: Ministry of Finance

The national public budget expenditure, in the first quarter of 2018, totalled 12.2 billion lei (31.6% of GDP[5]), recording a 0.9% decrease compared to the same quarter of 2017. Of total expenditures, the largest share was accounted by expenditures on social protection (40.7%), 18.9% being allocated for education and 12.8% – for health care.

It should be mentioned that 4.4 billion lei (by 3.4% less, compared to the first quarter of 2017) were transferred in the first quarter of 2018 from the State public budget to State Social Insurance Budget (SSIB), the Mandatory Health Insurance Fund (MHIF) and to local budgets (LBs) (Chart 3.5). The largest share of budget allocations was channelled to local budgets, around 46.4% of total budget transfers, followed by the allocations made to the SSIB, around 38.2%, the MHIF having received smaller financing accounting for 15.4% of total allocations.

Chart 3.5: The evolution of budget transfers

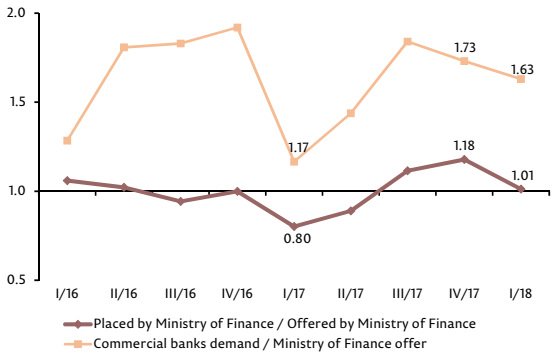


Source: Ministry of Finance

In this context, during the first quarter of 2018, the execution of the national public budget resulted in a surplus of 1.1 billion lei. In the first quarter of 2017, the budget execution resulted in a deficit of 0.27 billion lei. As of March 31, 2018, the national ublic budget balance increased by 733.4 million lei, as compared to January 1, 2018, and totalled 7.5 billion lei.

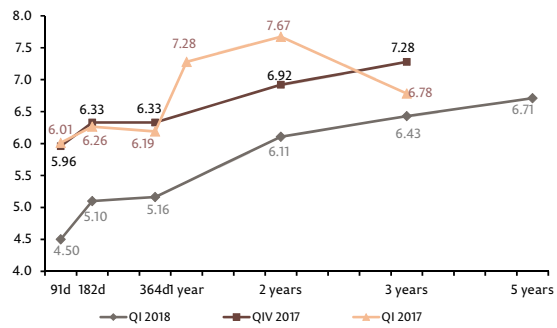
[5]GDP according to the NBM's estimation.

Chart 3.6: The demand and supply ratio on the primary market of state securities



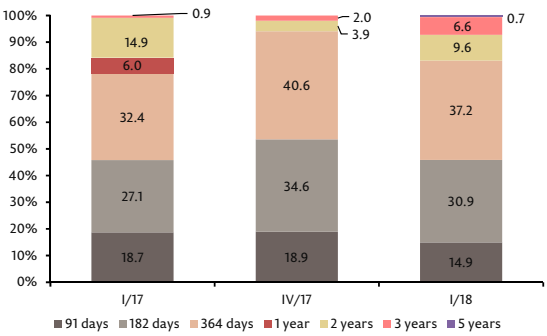
Source: NBM

Chart 3.7: SS yield curve (%)



Source: NBM

Chart 3.8: Structure of SS allocated on the primary market (%)



Source: NBM

State debt

As of March 31, 2018, the balance of state debt of the Republic of Moldova totalled 50.9 billion lei (33.2% of GDP[5]), having decreased, year-on-year, by 1.4% on account of debt reduction (with a negative contribution of 3.4 p.p.), being partly offset by the domestic State debt (with a positive contribution of 2.0 p.p.). State debt, at the end of the first quarter of 2018, consisted of 55.2% foreign debt and 44.8% domestic debt.

At the end of the first quarter of 2018, the external debt balance amounted to 1707.8 million US dollars, having increased by 7.1 million US dollars or about 0.4%, compared to the beginning of the year. Recalculated in domestic currency, the balance of external debt amounted to 28.1 billion lei (18.3% of GDP[5]). During 2018, net external funding reached a negative value of around -35.0 million US dollars. At the same time, the exchange rate fluctuations of the US dollar against other currencies recorded positive values and totalled 42.1 million US dollars.

As of March 31, 2018, domestic debt totalled 22.8 billion lei (14.9% of GDP[5]), having increased by 4.7%, year-on-year. This evolution of domestic debt was driven by government securities issued on the primary market, the volume of which has increased by 17.0% over the last 12 months. As a result of these developments, at the end of the first quarter of 2018, domestic debt consisted of government securities issued for the execution of State guarantees (58.2% of total debt), government securities issued on the primary market (32.7%) and government convertible securities (9.0%).

Primary market of state securities (SS)

During the first quarter of 2018, the Ministry of Finance issued state securities totalling 2707.2 million lei, having exceeded the initial offer by 1.2% as a result of the excess liquidity in the primary market of state securities. The demand-supply ratio on the SS primary market recorded 1.63, the volume of demand on the primary market amounting to 4358.6 million lei (Chart 3.6).

The market conjuncture allowed the Ministry of Finance to continue lowering interest rates on the SS placed on the market, which decreased, during the reporting period, for all maturities; thus, interest rates on Treasury bills recorded a decline of 1.2-1.4 p.p., whereas interest rates on government bonds with maturity of two and three years – a decline of 0.8-0.9 p.p. (Chart 3.7). It should be mentioned that in March 2018 government bonds with five-year maturity were issued for the first time and were traded at an average effective rate of 6.71%. The Ministry of Finance intends to use this financial tool on a regular basis starting with the second quarter of this year.

The structure of the SS portfolio, traded during the reference period, shows that SS with 364-day maturity recorded highest demand, accounting for 37.2% of total transactions; these were followed by the 182-day Treasury bills, holding a share of 30.9%, and the 91-day Treasury bills accounting for 14.9% of total transactions. It should be mentioned that the share of government bonds with 2-year, 3-year and 5-year maturity recorded 9.6%, 6.6% and 0.7%, respectively (Chart 3.8).

Investment demand

In the fourth quarter of 2017, investment component continued to generate positive, though slightly lower than in the previous quarter, contribution to GDP dynamics. The decline in the growth rate of investments was driven by stock change component, which generated a negative contribution in the fourth quarter of 2017 as opposed to the third quarter of 2017. At the same time, the annual rate of gross fixed capital formation recorded a level of 5.9%, or by 0.4 p.p. higher than in the third quarter of 2017. The upward trajectory was mainly driven by the increase in the annual rate of investment in "machinery and equipment" by 2.0 p.p., thus rising to 8.6%. At the same time, the annual rate of investment in "construction" has only marginally increased reaching 5.0% (Chart 3.9).

At the same time, according to operating statistics published by the NBS, in the fourth quarter of 2017, the annual growth rate of investments in tangible fixed assets[6] recorded a level of -0.4%. If analysed by components, positive contributions to the dynamics of investments in fixed assets were generated by such components as "machinery, equipment, transmission facilities" and "engineering constructions" (Chart 3.10). These developments were largely offset by the decline of investments in building construction.

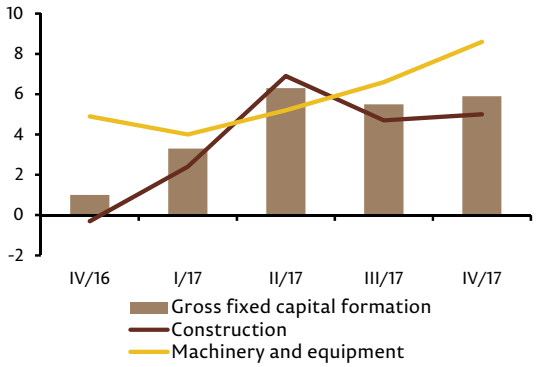
From the perspective of the sources of investment financing, such sources as "the national public budget" and "other sources of financing" recorded a positive evolution, whereas capital formation through "foreign investments" and "personal savings" recorded a negative dynamics (Chart 3.12).

Net foreign demand[7]

The statistical data on the evolution of foreign trade of the Republic of Moldova reflect its continued recovery in the first quarter of 2018. Thus, in the first two months of the first quarter of 2018, the annual export rate recorded 38.0% or a level 11.6 p.p. higher than in the fourth quarter of 2017. Similarly to the second quarter of the previous year, the rise in the annual export rate in the first quarter of 2018 was driven by the increased demand coming from the EU. At the same time, the growth of exports to the CIS countries was less prominent, though still positive (Chart 3.13).

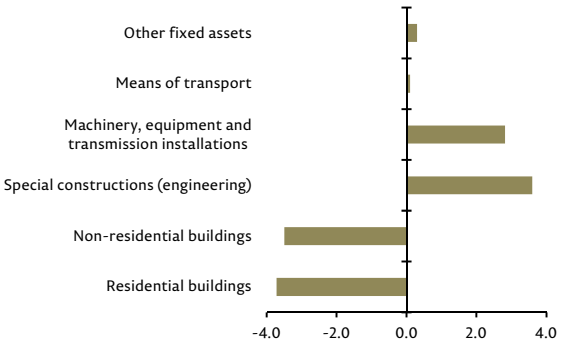
The analysis of exports by category of goods (Chart 3.14) demonstrates that a significant rise in the annual export rate in the fourth quarter of 2017 was determined by the increase in exports of agricultural products. Thus, a good agricultural harvest in 2017, coupled with an increased EU demand for these products, created the necessary preconditions for the revival of exports in the fourth quarter of 2017. Similarly to the third quarter of 2017, in the fourth quarter, an important contribution was generated by the category of "vehicles, optical devices and sound recording or reproducing devices" due to favourable developments in their manufacturing sectors (especially free economic areas). At the

Chart 3.9: The annual dynamics of investments



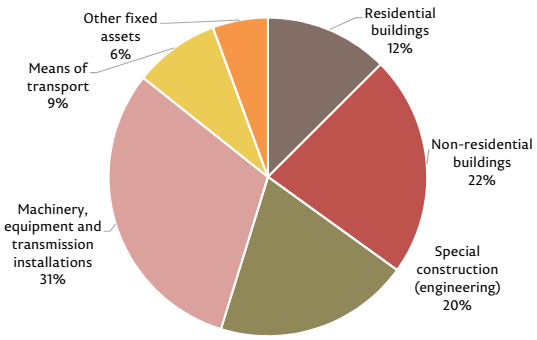
Source: NBS

Chart 3.10: Components' contribution to increase of investment in tangible assets in the fourth quarter of 2017 (p.p.)



Source: NBS, NBM calculus

Chart 3.11: Structure of investments by tangible assets types (%)



Source: NBS, NBM calculus

[6]Starting January 1, 2017 the statistical questionnaire 2-INV "Investments" was amended in order to align statistical instruments (applicable concepts and definitions, methods of the calculation and presentation of indicators) with the provisions of the new National Accounting Standards, which entered into force as mandatory on January 1, 2015.

[7]The data presented in this section are quarterly data reflecting the evolution of the Moldovan foreign trade, expressed in thousands of US dollars.

same time, operating statistics for the first two months of the first quarter of 2018 show almost similar situation, although the annual export rate of agricultural products increased compared to the fourth quarter of 2017.

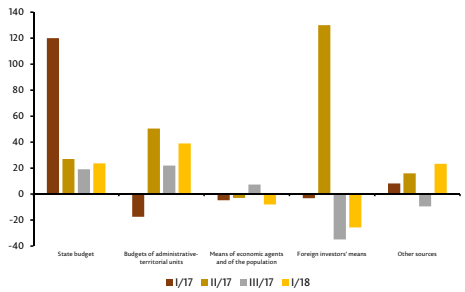
It should be mentioned that an increased volatility of the annual export rate over the last months was determined by the evolution of exports of domestic goods, as opposed to re-exports, the latter having generated a positive, yet significantly lower, contribution than exports (Chart 3.15).

In the fourth quarter of 2017, the annual import rate of consumer goods recorded 23.8% or a level 1.3 p.p. higher than in the third quarter of 2017. At the same time, operating statistical data for the first two months of the first quarter of 2018 reflect a steady upward trend of the annual import rate. It should be noted that, according to operating statistics, in the first quarter of 2018, the annual export rate exceeded that of imports, thus creating preconditions for the rise of net external demand.

Robust import growth rates, recorded over the last reference period, were supported by the evolution of imports, mainly from the EU countries and those classified as "rest of the world" (Chart 3.16). At the same time, imports from the CIS countries recorded a positive evolution, however, their impact on total imports was less significant.

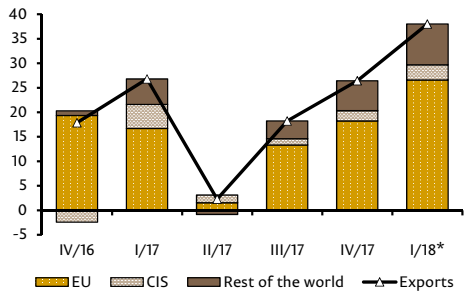
The analysis of imports by groups of consumer goods (Chart 3.17) demonstrates that the increase in the annual import rate in the fourth quarter of 2017 was mainly driven by the evolution of imports of "vehicles, optical devices and sound recording or reproducing devices", which generated a positive contribution of 7.7 p.p., "products of chemical and wood processing industries" (3.9 p.p.), "articles of metals, stones or ceramics" (3.4 p.p.) and "mineral products" (3.3 p.p.). It should be noted that the significant growth rate of imports, recorded during the last years, was determined by the revival of personal consumption, as a result of the increase in the disposable income of the population and the appreciation of domestic currency.

Chart 3.12: Annual dynamics of investments by financing sources (%, f.a.p.)



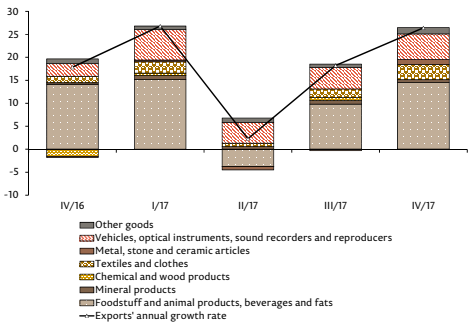
Source: NBS, NBM calculus

Chart 3.13: Evolution of exports annual rate (%) and contribution by categories of countries (p.p.)



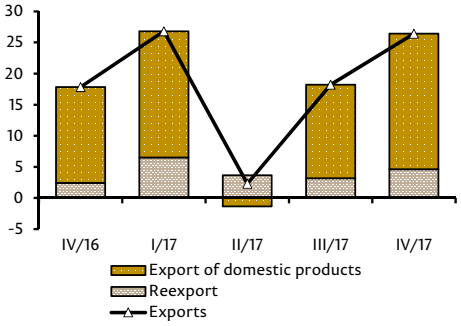
Source: NBS, NBM calculus
* Jan.-Feb.

Chart 3.14: Evolution of exports annual rate (%) and components' contribution by groups of goods (p.p.)



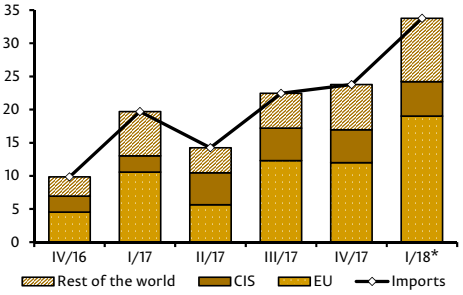
Source: NBS, NBM calculus

Chart 3.15: Evolution of exports annual rate (%) and contribution by origin (p.p.)



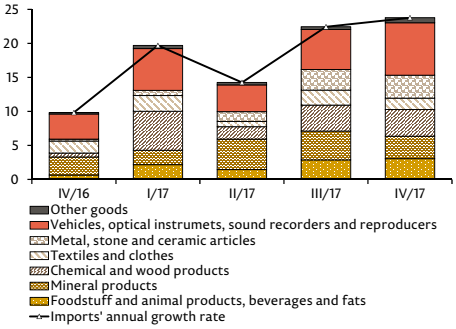
Source: NBS, NBM calculus

Chart 3.16: Evolution of imports annual rate (%) and contribution by categories of countries (p.p.)



Source: NBS, NBM calculus
* Jan.-Feb.

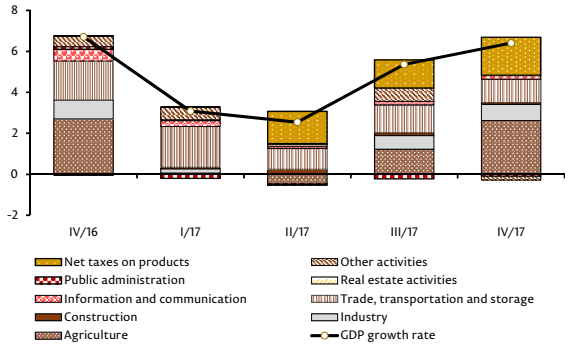
Chart 3.17: Evolution of imports annual rate (%) and components' contribution by groups of goods (p.p.)



Source: NBS, NBM calculus

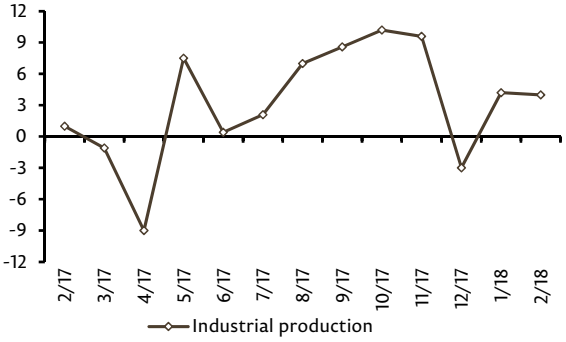
3.2 Production

Chart 3.18: The contribution of economic sectors to GDP growth (p.p.)



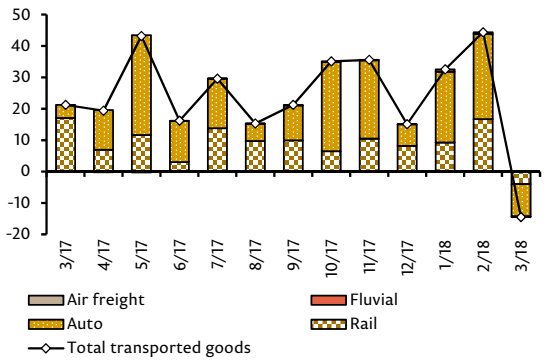
Source: NBS, NBM calculus

Chart 3.19: Evolution in real terms of industry (%, versus the same month of the previous year)



Source: NBS

Chart 3.20: Evolution of goods transport (%, versus the same month of the previous year)



Source: NBS

By resource categories, in the fourth quarter of 2017, GDP growth was mainly driven by a positive contribution of agriculture and net product taxes. In this way, the gross value added of agriculture increased by 18.5%, year-on-year, whereas, net product taxes, in the fourth quarter of 2017, increased by 13.3%, generating a contribution of 1.8 p.p. to GDP dynamics. Positive, yet smaller, contributions were generated by the increase in gross value added of such sectors as trade (by 5.2%), industrial production (by 5.1%) and transport and storage (by 6.6%) (Chart 3.18). At the same time, gross value added of construction industry and information and communications sector increased by 4.3% and 3.1%, respectively, compared to the fourth quarter of 2016.

Operating statistics for the first two months of 2018 outlines preconditions for further economic growth in the first quarter of 2018. Thus, after a sharp decline at the end of 2017, in the first two months of the first quarter of 2018, the annual growth rate of industrial production output averaged 4.1%, being still 1.5 p.p. lower than in the fourth quarter of 2017 (Chart 3.19). This evolution was driven by the acceleration of the annual growth rate of the manufacturing industry (from 8.1% in the fourth quarter of 2017 to 11.3% in the first two months of the first quarter of 2018) and of the extractive industry (from -1.3% in the fourth quarter 2017 to 40.7% in the first two months of the first quarter of 2018). At the same time, the annual growth rate of production output in the sector of "production and supply of electricity, heating, gas, hot water and air conditioning", recorded in January-February 2018, fell to -11.2%, having decreased by 3.1 p.p. compared to the fourth quarter of 2017.

In the first two months of the year, positive developments were also recorded in transport sector. Thus, freight shipping in January and February 2018 recorded volumes higher by 32.5% and 44.5%, respectively, year-on-year; however, in March the freight shipping decreased by 14.5% (Chart 3.20). Nonetheless, in the first quarter of 2018, the railway, road, river and air transport companies carried by 13.6% more freight compared to the same period of 2017. This development was driven by the increase in the volume of freight shipped by road (13.7%), rail (12.9%), air (1.8-fold) and by river (1.7-fold).

Retail trade. Some positive developments were recorded in trade in early 2018. Thus, during January-February 2018, the turnover of retail trade companies recorded an average increase (in comparable prices) of 6.5%, by 12.4 p.p. higher than in the previous quarter (Chart 3.21). At the same time, the turnover of the B2C companies, during the same period, recorded an average increase of 8.1%, having grown by 9.2 p.p. compared to the fourth quarter of 2017.

Wholesale trade. In the first two months of the first quarter of 2018, the turnover of the main wholesale companies recorded an average growth of 7.7%[8], which was 3.5 p.p. lower than in

[8]Deflated by annual CPI rate.

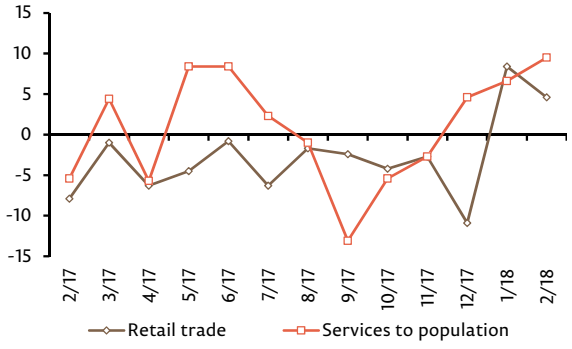
the fourth quarter of 2017 (Chart 3.22). At the same time, the turnover of B2B companies, during the reference period, recorded an average decrease of 2.1%, being by 5.6 p.p. lower than the annual growth rate recorded in the previous quarter.

Agricultural production

In the first three months of 2018, the volume of global agricultural production increased by 1.0% compared to the same period of the previous year. It should be noted that the growth was determined by a positive evolution of the livestock sector.

The increase of the livestock production output was driven by the evolution of production of "cattle and poultry" (2.0%) and "milk" (0.7%). At the same time, the decrease in the production of "eggs" by 1.1% has offset some of the positive effects generated by the increase in milk and meat production.

Chart 3.21: The evolution of wholesale trade in current prices (%, versus the same month of the previous year)

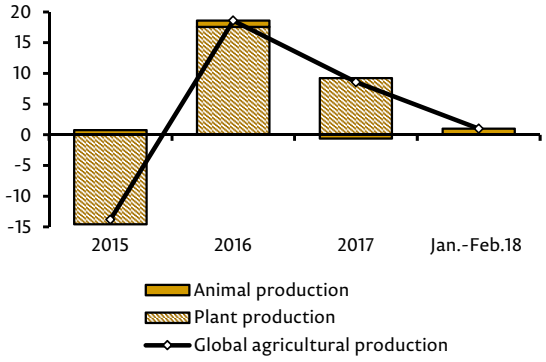


Source: NBS

Chart 3.22: The evolution of internal trade in real terms (%, versus the same month of the previous year)

Source: NBS

Chart 3.23: Global agricultural production (%, versus the previous year)



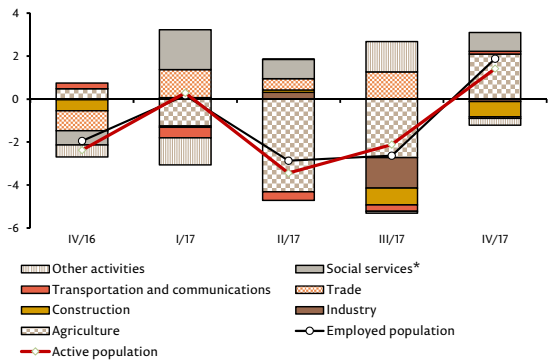
Source: NBS, NBM calculus

3.3 Labour market

Positive evolution in agricultural sector has favoured positive labour market developments in October-December 2017 by increasing employment and slightly reducing the unemployment rate. The annual growth rate of salary earnings has increased, mainly as a result of its growth in such economic sectors as manufacturing, trade, information and communications. The unit labour cost in the industrial sector has increased due to a more notable increase in salary earnings versus labour productivity.

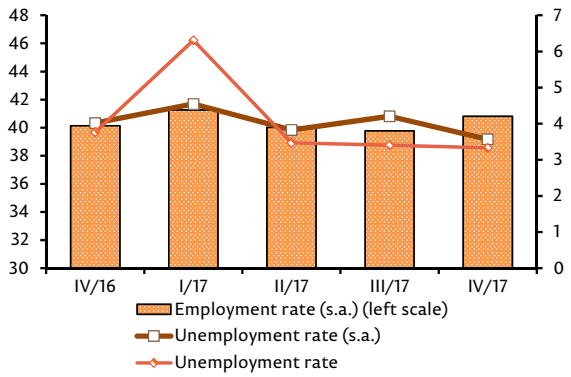
Labour force

Chart 3.24: Annual growth rate of employed population (%) and its formation by national economy sectors (p.p.)



Source: NBS, NBM calculus
*Public administration, education, health and social care

Chart 3.25: Evolution of the unemployment and employment rate (%)



Source: NBS, NBM calculus

In the fourth quarter of 2017, both economically active population and employed population recorded positive evolution compared to the same period of 2016, increasing by 1.4% and 1.9%, respectively (Chart 3.24). Given the structure of the national economy, the annual dynamics of employed population was determined, mainly, by its increase in the agricultural sector by 7.1%. At the same time, the construction sector recorded the most notable decrease of employed population (14.6%) compared to the fourth quarter of 2016.

The unemployment rate, according to ILO[9] methodology, recorded 3.3% in the reference period, being 0.4 p.p. lower than at the end of 2016. The seasonally adjusted unemployment rate dropped to 3.6%, recording a level 0.6 p.p. lower than in the third quarter of 2017. The seasonally adjusted employment rate recorded value of 40.8%, having increased by 1.0 p.p. compared to the third quarter of 2017 (Chart 3.25). According to the data provided by ANOFM[10], in the 12 months of 2017, the number of redundancies decreased by 34.9% compared to 2016, whereas the number of job vacancies increased by 21.6%.

Payroll fund

In the fourth quarter of 2017, the payroll fund increased by 14.9%, whereas, in real terms, deflated by CPI, it rose by 6.9%, year-on-year, as a result of positive contributions generated by the payroll fund of the real sector and by the budget sector (Chart 3.26).

The average number of employees in the national economy recorded a level 2.2% higher than in October-December 2016, thus maintaining a positive growth trend of the number of engaged employees for three consecutive quarters. However, these positive developments were solely driven by the dynamics of the average number of employees in the real sector, which contributed by 2.7 p.p. to the evolution of the total number of employees. At the same time, the budget sector continued to exert a negative impact on the evolution of this indicator in the fourth quarter of 2017 (Chart 3.27).

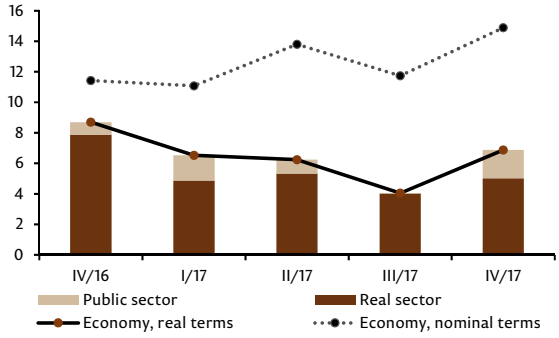
In the reference period, the average salary of an employee in the national economy increased by 12.4% compared to the similar

[9] International Labour Office.
[10] The National Employment Agency of Moldova.

period of 2016. The average salary increased both in the budget and real sectors of the economy, year-on-year, by 18.0% and 10.3%, respectively. The annual average real wage in the economy recorded 4.6%, having risen 1.2 p.p., compared to the third quarter of 2017. This increase was driven by wage dynamics recorded in the budget sector (9.8%) and real sector (2.6%).

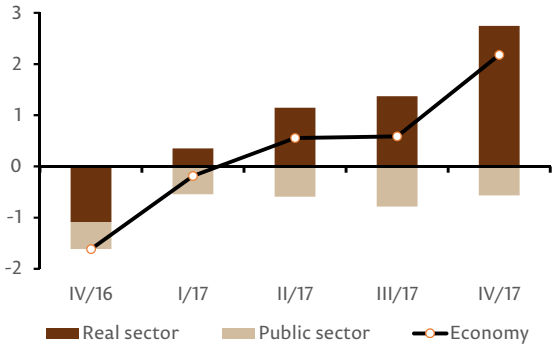
In the fourth quarter of 2017, the annual labour productivity, estimated for the whole economy, recorded 4.4%, whereas in the industrial sector it fell to a negative level of -2.6%, thus having dropped 3.8 and 6.6 p.p., respectively, compared to the third quarter of 2017. At the same time, the annual growth rate of the average real wage, estimated for the whole economy, amounted to 4.6%, whereas in the industrial sector it fell to a level of 2.8%. In this context, the annual growth rate of the unit labour cost for the whole economy increased by around 4.6 p.p., reaching a level close to zero, whereas in industrial sector it recorded 5.5%, having increased by 6.2 p.p. (Chart 3.28).

Chart 3.26: The payroll fund in the economy in nominal and real terms (%, compared to the same period of the previous year) and the real contributions of the economy sectors to them (p.p)



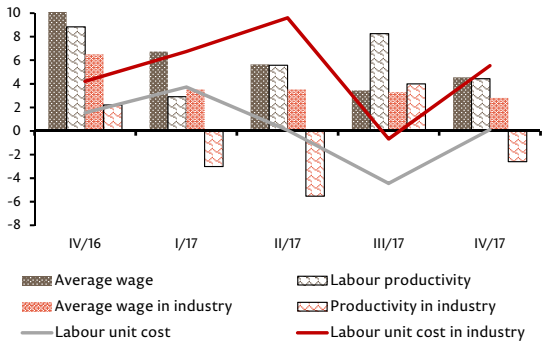
Source: NBS, NBM calculus

Chart 3.27: The average number of employees (%, compared to the same period of the previous year) and the real contributions of the economy sectors to them (p.p.)



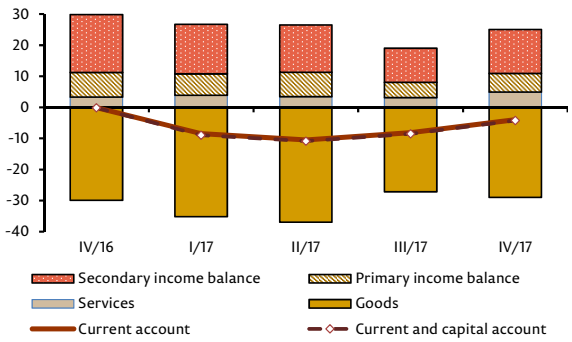
Source: NBS, NBM calculus

Chart 3.28: Average real wage and labor productivity in economy and industry (%, compared to the same period of the previous year)



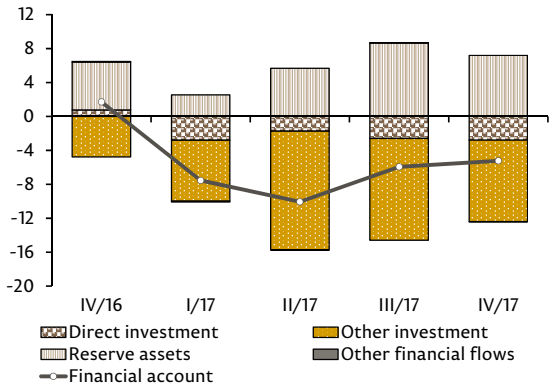
Source: NBS, NBM calculus

Chart 3.29: Current account share in GDP (%)



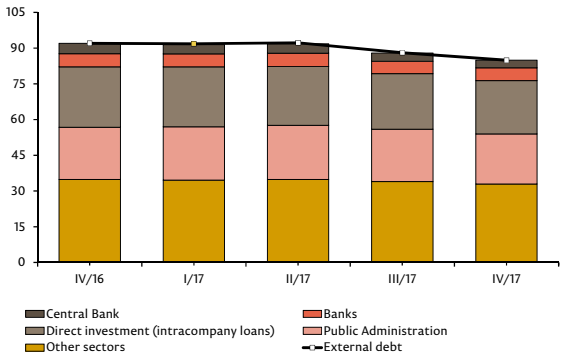
Source: NBM

Chart 3.30: Financial account share in GDP (%)



Source: NBM
Note: (-) – net capital inflows, (+) – net capital outflows

Chart 3.31: Share of external debt in GDP (%)



Source: NBM

3.4 External sector of the economy

In the fourth quarter of 2017, the current account deficit of the balance of payments reduced by 4.2 p.p. compared to the previous quarter, accounting for 3.9% as a share of GDP (Chart 3.29). The balance of payments deficit diminished as a result of the increase in the positive contribution of the "balance of secondary incomes", "balance of primary incomes" and "balance on services". At the same time, the negative share of component "balance on goods" increased insignificantly.

In the fourth quarter of 2017, a slight decrease in net capital inflows was reported; thus, the financial account, as a share of GDP, registered 5.2% level or by 0.7 p.p. lower than in the third quarter of 2017. It should be mentioned that the NBM's interventions on foreign exchange market contributed to the decline of net capital inflows. Thus, reserve assets, as a share of GDP, increased by 7.2%. Similar to the previous quarter, the "other investment" component generated the largest contribution to the increase in capital inflows (Chart 3.31). This increase was supported primarily by developments recorded in the "commercial loans and advances" and "currency and deposits" components.

In the fourth quarter of 2017, the share of external debt in GDP amounted to 84.9%, having decreased by 3.1 p.p. compared to the third quarter 2017 (Chart 3.31). It should be noted that no changes were recorded in the external debt structure; thus, similar to previous periods, the major share of 38.3% in the total external debt is held by economic agents[11], being followed by the government sector[12] and direct investments, accounting for 24.2% and 22.4%, respectively.

[11] The cumulative debt of "Banks" and "Other sectors".
[12] The cumulative debt of "Public administration" and "Central bank" components.

Chapter 4

Monetary Policy

4.1 Monetary policy instruments

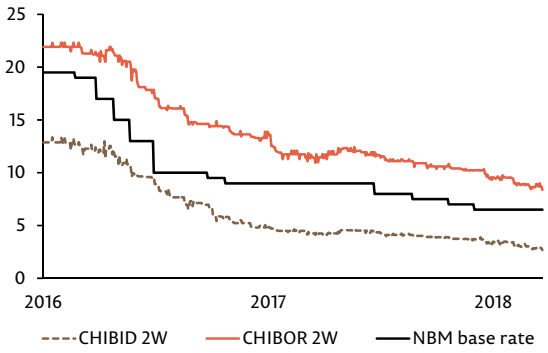
Interest rate policy

A constant placement of economic activity below the equilibrium level and the persistence of disinflationary pressures during the reporting period, in the context of a delayed effect of monetary policy decisions on inflation, have warranted the decision to maintain the base rate of the NBM in the first quarter of 2018 at the level of 6.5% per year.

In the first quarter of 2018, interbank quotations continued to decline, however, at a more prominent rate than in the previous quarter. The level of Chisinau Interbank Bid Rate (CHIBOR) 2W, recorded at the end of the quarter, decreased by 1.14 p.p. compared to the previous quarter, dropping to the level of 8.31% (Chart 4.1).

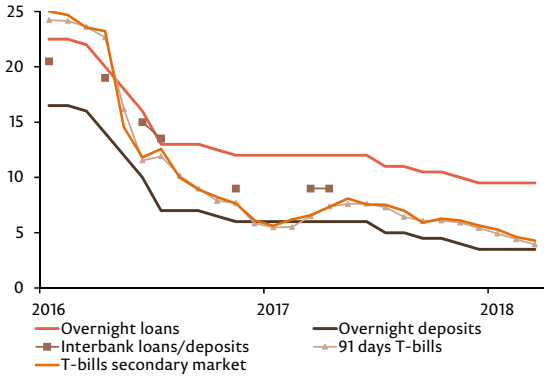
Interest rates on state securities (SS) with 91-days maturity continued their downward trend (Chart 4.2), though at a faster pace compared to the previous quarter. The average interest rate on 91-days SS in the last month of the quarter recorded 3.94%, annually (-1.48 p.p. compared to the value recorded in the last month of the previous quarter).

Chart 4.1: The average monthly reference rates on interbank market and the NBM base rate (%)



Source: NBM

Chart 4.2: The monthly evolution of interest rates corridor (%)



Source: NBM

Monetary market operations

During the first quarter of 2018, excess liquidity continued to be absorbed through the NBM's certificate auctions (The National Bank's Certificates – NBC).

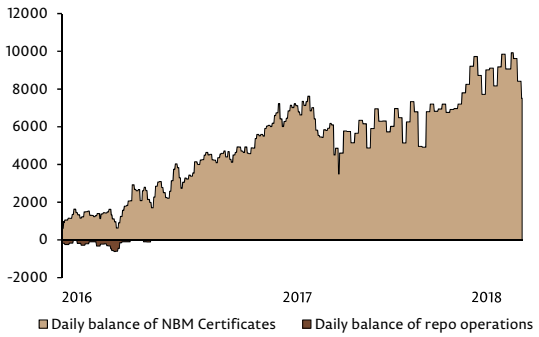
The NBM's certificate auctions (NBC)

The NBM conducted weekly NBC auctions, setting the maximum interest rate equivalent to the NBM's base rate. In the first quarter of 2018, the weighted average rate of liquidity-absorbing operations recorded 6.5%, annually.

The volume of the NBC stock varied throughout the quarter, ranging from the minimum amount of 7,506.5 million lei to the maximum amount of 9,926.2 million lei, depending on the NBM's consistent foreign exchange purchases carried out during the reference period. The average monthly balance of the NBC

amounted to 8,985.4 million lei (+2,041.4 million lei compared to the fourth quarter of 2017) (Chart 4.3).

Chart 4.3: The daily balance of money market operations (MDL, million)



Source: NBM

Lending activity

As of March 31, 2018, the loan exposure of banks to the National Bank of Moldova amounted to 0.08 million lei, being entirely accounted for by loans extended to banks in 1992-2002 for lending to housing cooperatives. Compared to the previous quarter, the balance of loans extended to banks decreased by 0.05 million lei. The assessment of loan portfolio, carried out in March 2018, identified no write-downs for loan losses.

Standing facilities

The conditions of accessing its standing facilities (overnight deposits and credits), established by the NBM, allowed banks to manage their own liquidity efficiently and enhanced the NBM's flexibility in pursuing its monetary policy.

During the first quarter of 2018, interest rates on standing facilities of the NBM were maintained at the same level, recording 3.5% per annum for overnight deposits and of 9.5% per annum for overnight credits.

During the first quarter of 2018, banks accessed overnight deposit facility on a daily basis, the loan facility being requested only once, in March, by a bank that had to meet a short-term demand for liquidity.

The total volume of overnight deposits placed at the NBM during the reference quarter amounted to 47,329.4 million lei, having thus recorded a daily average balance of 759.3 million lei, by 19.7% lower than in the previous quarter. The amount of overnight deposits placed by individual banks ranged between a minimum of 5.0 million lei and a maximum of 1,000.0 million lei.

The volume of overnight loans extended during the reporting period amounted to 340.0 million lei.

Required reserves

In the first quarter of 2018, the required reserve mechanism continued to ensure monetary control and liquidity management in the banking system.

Throughout the quarter, the ratio of required reserves held in Moldovan lei and non-convertible currencies was maintained at the level of 40% of the calculation base, whereas the ratio of required reserves held in freely convertible currencies remained at the level of 14% of the calculation base.

The banks' required reserves, held in MDL between March 16, 2018 – April 15, 2018, amounted to 13,767.2 million lei, having increased by 1,128.6 million lei (8.9%) compared to the end of the previous quarter (December 8, 2017 – January 7, 2018).

As of March 31, 2018, the banks' required reserves held in FCC at the National Bank of Moldova totalled 64.8 million US dollars and 128.2 million euro. Compared to December 31, 2017, the amount of required reserves held in the euro increased by 8.2% as

opposed to US dollars, the amount of which decreased in similar proportion.

Interbank money market

In the first quarter of 2018, no transactions were concluded on interbank loan/deposit markets due to persistent liquidity surplus recorded in the banking system.

Government deposits placed with the National Bank of Moldova

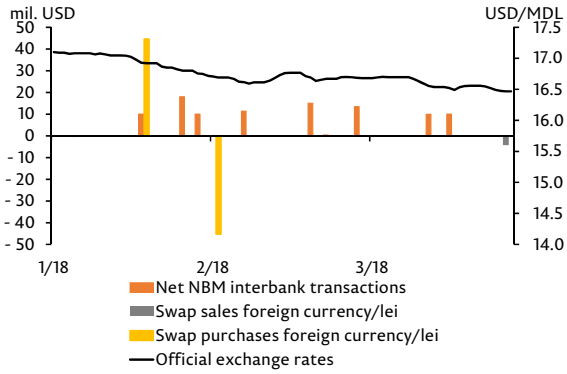
As of March 31, 2018, the balance of deposits placed by the Ministry of Finance at the National Bank of Moldova amounted to 526.9 million lei, out of which 498.9 million were intended for maintaining the state's liquidity reserve. The weighted average rate on deposit balance was 7.1%, annually, and the weighted average term to maturity recorded 775 days. During January-March 2018, the NBM intervened on the domestic foreign exchange market mainly as a buyer of foreign currency (Chart 4.4).

Interventions on the domestic foreign exchange market

During the reference period, net volume of purchase transactions, concluded by the NBM in Moldovan lei on interbank foreign exchange market, amounted to 97.82 million US dollars, at value date (of which 23.34 million US dollars as equivalent of 19.0 million euro), including currency conversions carried out through the World Bank's institutions (the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), in the amount of 0.76 million US dollars.

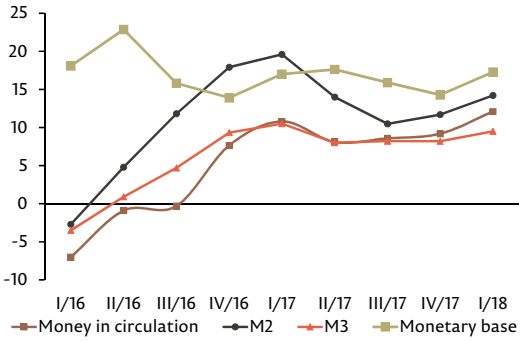
Besides, the NBM performed swap purchases amounting to 44.54 million US dollars (the equivalent of 36.39 million euros) and swap sales amounting to 4.00 million US dollars.

Chart 4.4: Evolution of official exchange rates and the volume of NBM daily transactions, I quarter 2018



Source: NBM

Chart 4.5: The dynamics of monetary aggregates (%, annual growth)



Source: NBM

4.2 Evolution of monetary indicators

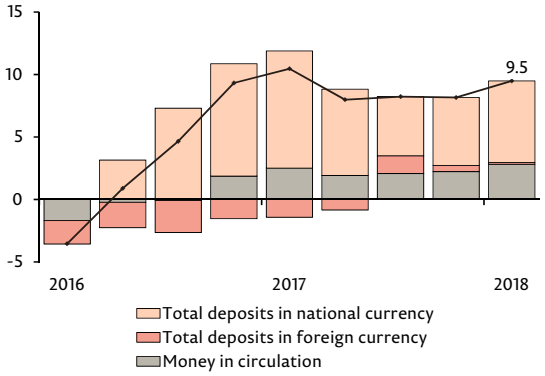
In the first quarter of 2018, monetary aggregates recorded positive developments, the quarterly average growth rate, in annual terms, amounting to 14.2% for M2 (increasing 2.5 p.p. compared to the fourth quarter of 2017) and 9.5% for M3 (rising 1.3 p.p. compared to the previous quarter). The monetary base recorded a higher growth rate than in the previous quarter, its quarterly average having reached, in annual terms, 17.3% (Chart 4.5).

Money supply

During the first quarter of 2018, broad money supply recorded an average annual growth of 9.5%, being driven by the increase in all its subcomponents. Thus, the growth of M3 was determined by the major contribution generated by domestic currency deposits, being followed by the contribution of money in circulation and a minor contribution of foreign currency deposits (Chart 4.6).

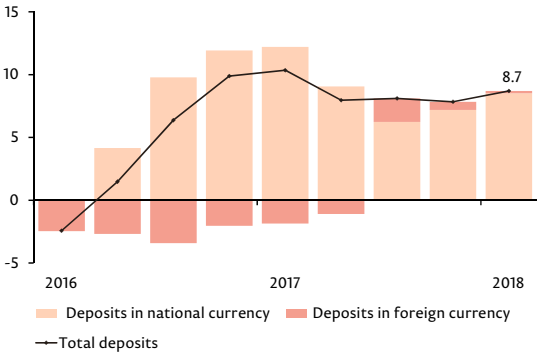
A positive evolution of the domestic currency deposit component, recorded in the reference quarter (Chart 4.7), was almost entirely

Chart 4.6: The dynamics of monetary aggregate M3 (%, components contribution to the annual growth)



Source: NBM

Chart 4.7: The dynamics of balance of deposits (%, components contribution to the annual growth)



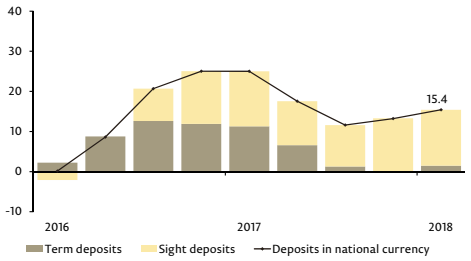
Source: NBM

determined by the modifications in sight deposits, the contribution of which has kept increasing for seven consecutive quarters (Chart 4.8). In terms of the medium-term stability of financial sector, such development is less preferred as opposed to an increasing demand for term deposits. At the same time, in the first quarter of 2018, the contribution of term deposits has returned to positive values, accounting for 1.5% of the total increase in domestic currency deposits (Chart 4.10). During the reporting period, corporate deposits accounted for the largest share of total sight deposits; at the same time, the contribution from individuals deposits has recorded a considerable increase, compared to the previous quarter (Chart 4.12).

During the last three quarters, the foreign currency deposit component generates a minor positive contribution and has been recording a downward trend (Chart 4.9). In the first quarter of 2018, developments in foreign currency deposits were entirely accounted for by the evolution of retail sight deposits placed in foreign currency (Chart 4.13). The subcomponents of foreign currency sight deposits continued the same trend, recorded eight quarters ago, generating null or minor negative contributions to the evolution of foreign currency deposits (Chart 4.11).

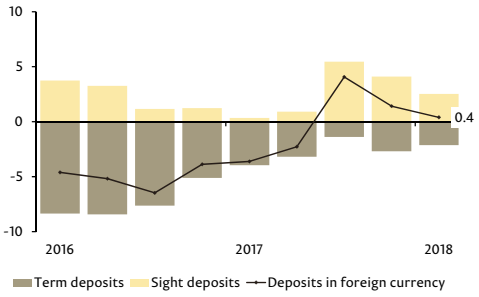
Money in circulation, in its turn, decreased by 3.1% compared to the previous quarter; at the same time, the contribution of money in circulation to M3 growth has increased by 0.6 p.p. compared to the fourth quarter of 2017. The increase in Money in circulation was determined by lower volumes of cash received, as opposed to cash released, by licensed banks. Of total receipts, the largest share was held by proceeds obtained from the sale of consumer goods as well as by cash credited to current and deposit accounts of individuals. At the same time, in terms of funds released by licensed banks, the largest share was held by cash released to purchase foreign currency from individuals and in the form of cash withdrawn through ATMs and POS terminals.

Chart 4.8: The dynamics of balance of deposits in national currency (components contribution to the annual growth, %)



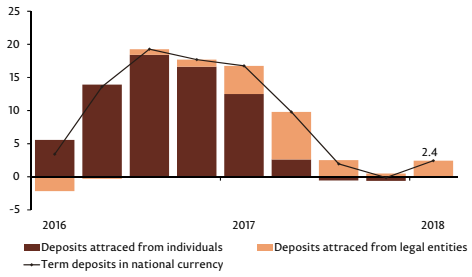
Source: NBM

Chart 4.9: The dynamics of balance of deposits in foreign currency (components contribution to the annual growth, %)



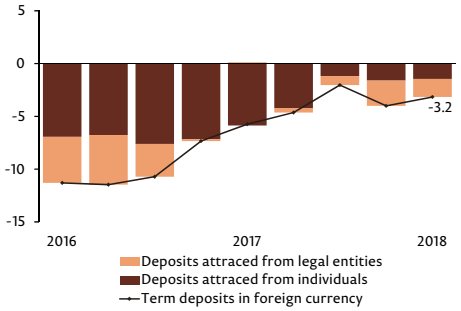
Source: NBM

Chart 4.10: The dynamics of term deposits balance in national currency (components contribution to the annual growth, %)



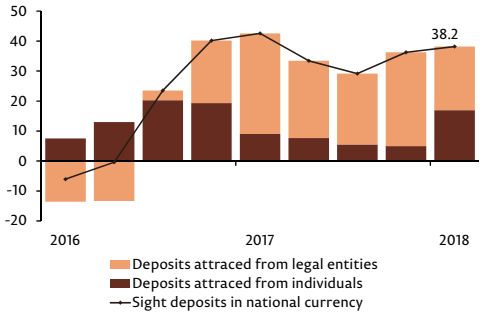
Source: NBM

Chart 4.11: The dynamics of term deposits balance in foreign currency (components contribution to the annual growth, %)



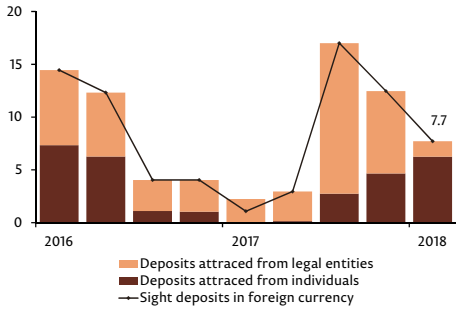
Source: NBM

Chart 4.12: The dynamics of sight deposits balance in national currency (components contribution to the annual growth, %)



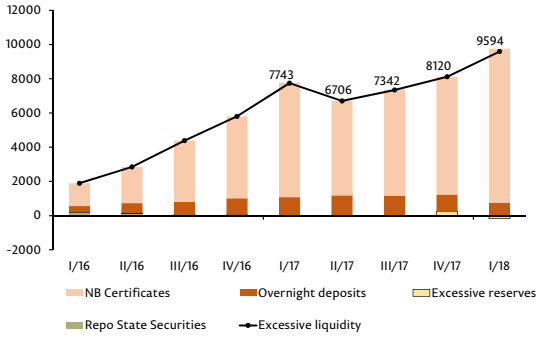
Source: NBM

Chart 4.13: The dynamics of sight deposits balance in foreign currency (components contribution to the annual growth, %)



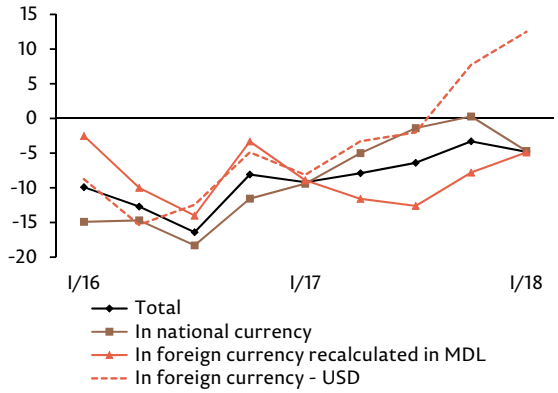
Source: NBM

Chart 4.14: Excess liquidity



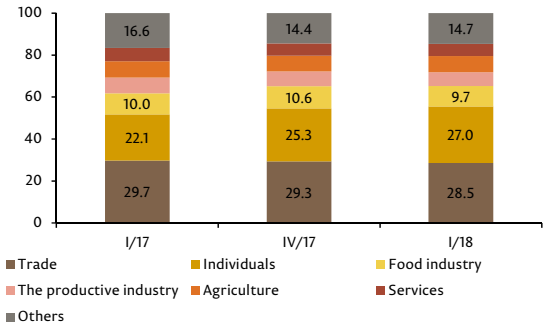
Source: NBM

Chart 4.15: The evolution of loans balance (%, annual growth)



Source: NBM

Chart 4.16: The structure of loans balance (%, in total)



Source: NBM

Excess liquidity

Excess liquidity in the banking system creates a potential risk of financial instability in the national economy. In the context of a weak loan demand from legal entities as well as unfavourable economic conditions (the share of non-performing loans recording 16.2% in March 2018), banks will grow increasingly reluctant to accept high level of risk associated with lending operations, hence redirecting their demand towards operations ensuring a low level of risk and sufficient profitability, such as placements in SS and NBC, thus contributing to the increase of excess liquidity.

During the first quarter of 2018, the volume of excess liquidity in the banking system increased, on average, by 1.5 billion lei (+18.1%), recording an average of 9.6 billion lei (Chart 4.14); however, at the end of the first quarter of 2018, excess liquidity has already reached 9.8 billion lei.

Loans market

Developments in the balance of loans extended by licensed banks[13]

In the first quarter of 2018, the total balance of loans extended by licensed banks recorded a downward trend, totalling, at the end of the reference period, 31,858.6 million lei, thus having decreased by 4.8% compared to the end of the first quarter of 2017. The downward development was driven by the decrease of both its components: the balance of loans in both domestic and foreign currency (recalculated in domestic currency) (Chart 4.15). At the end of the first quarter of 2018, the balance of loans, extended in domestic currency, recorded a negative annual growth rate of 4.7%.

During the first quarter of 2018, the annual evolution of the balance of loans in domestic currency extended by licensed banks was driven by the decrease in the balance of corporate loans, being partly offset by the balance of retail loans, which recorded increases.

At the end of the first quarter of 2018, the annual growth rate of foreign currency loans extended by licensed banks, recalculated in domestic currency, recorded a decrease of 4.9%, which was also driven by the annual variation in corporate loans (holding a share of 97.8% of total foreign currency loans). The downward trend of foreign currency loans, recalculated in Moldovan lei, was largely determined by the appreciation of the domestic currency against the main reference currencies.

If analysed by business sector, the largest share (28.5%) in the portfolio of loans extended by licensed banks, in the first quarter of 2018, was held by trade sector, followed by retail loans (27.0%), the share of which has recorded a significant growth of 4.9 p.p. over the last 12 months, compared to other sectors. Besides, loans were extended to food industry (about 9.7%) and agriculture (about 7.7%). The shares held by loan balances of other business sectors did not record any significant modifications (Chart 4.16).

[13]Data analysis was performed based on the ORD 01.06 reports "Interest rates on loan and deposit balance", submitted by licensed banks prior to April 12, 2018.

Developments of new loans extended by licensed banks

In the first quarter of 2018, licensed banks of the Republic of Moldova extended new loans in a volume by 5.4% higher, year-on-year (Chart 4.17). Like in the previous quarter, the highest increases were recorded in loans extended to the non-banking financial sector, food industry and trade.

Of total new loans extended by licensed banks during the reference period, domestic currency loans accounted for the highest share of 63.7%. The evolution of the new domestic currency loans extended in the first quarter of 2018 was determined by the annual growth rate of retail loan sector, which increased by 22.5%.

Term deposits placed at licensed banks[14]

At the end of the first quarter of 2018, the annual growth rate of term deposit balances of licensed banks recorded positive value of 1.2%, being driven by the upward trend of its domestic currency component (Chart 4.18).

The annual upward trend of deposits in Moldovan lei, recorded at the end of the first quarter of 2018, was determined by the evolution of corporate deposits. At the same time, the negative annual growth rate of foreign currency deposits, recalculated in domestic currency, was determined by the evolution of both components, yet mainly by the developments in the balance of corporate deposits driven by the appreciation of the domestic currency against main reference currencies.

Interest rates[15]

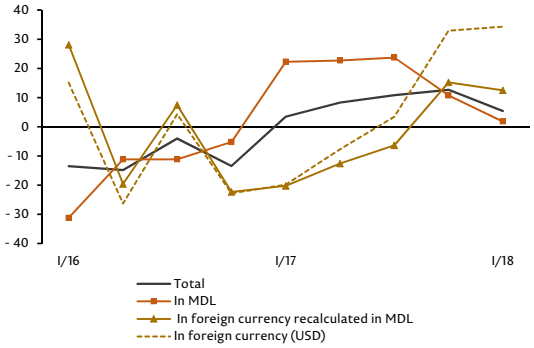
Evolution of base rate

During the first quarter of 2018, the Executive Board of the National Bank of Moldova has held two meetings on monetary policy decisions. Following the internal and external risk balance assessment and the short- and medium-term inflation forecast, the Executive Board of the National Bank of Moldova decided, at its meetings held on January 30, 2018 and March 1, 2018, to maintain the base rate applied to main monetary policy operations at the level of 6.5% annually (the level set at the meeting of December 5, 2017). These decisions aimed at fostering a monetary climate, which would revitalise lending and saving activities, at further adjustment of the domestic economic environment to the volatility and uncertainty associated with the external macroeconomic situation; the ultimate objectives included the anchoring of inflation expectations, the bringing and maintaining of the inflation rate close to the target of 5.0% in the medium term, allowing for deviation of ± 1.5 p.p.

Evolution of loan interest rate

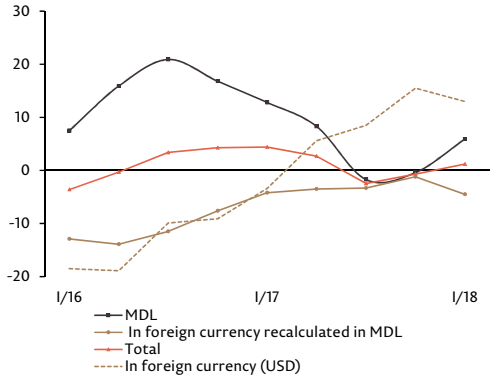
During January-March 2018, the quarterly average interest rates on the balance of loans extended by licensed banks continued a

Chart 4.17: Developments of new loans (%, annual growth)



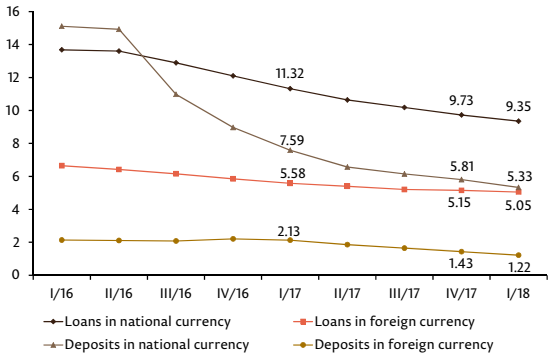
Source: NBM

Chart 4.18: The evolution of deposits balance (%, annual growth)



Source: NBM

Chart 4.19: The average rates of loans and deposits balance (%)



Source: NBM

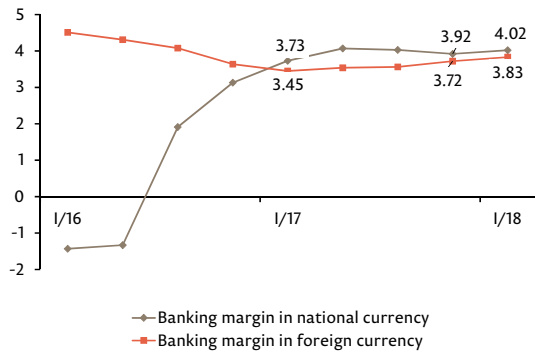
[14]The data analysis was performed based on the reports ORD 01.06 "Interest rates on the loan and deposit balance" submitted by licensed banks by April 12, 2018

[15]The data analysis was performed based on the reports ORD 01.06 "Interest rates on the loan and deposit balance" submitted by licensed banks by April 12, 2018 and does not include information on sight deposits rates.

downward trend, their average recording 9.35% per annum for loans in domestic currency (-0.38 p.p. compared to the fourth quarter of 2017 and -1.97 p.p. compared to the first quarter of 2017). This decline was largely determined by the fall in interest rates applied on retail loans. The above developments reflected the effect of the relaxation of the monetary policy, promoted by the National Bank of Moldova over the last nine quarters, and the existence of excess liquidity in the banking system.

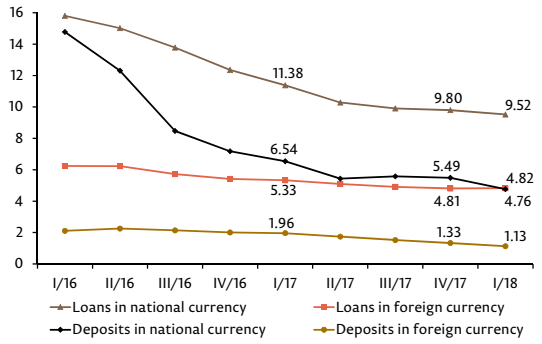
During the first quarter of 2018, the cost of the interest rates paid on the balance of loans extended in foreign currency had similar evolutions to the one paid on the balance of loans in domestic currency, although it recorded a less significant decline, the weighted average rate recording 5.05% per year. Also, the decrease was partly driven by the excess of foreign currency recorded on the market in the reporting period.

Chart 4.20: The evolution of banking margin (p.p.)



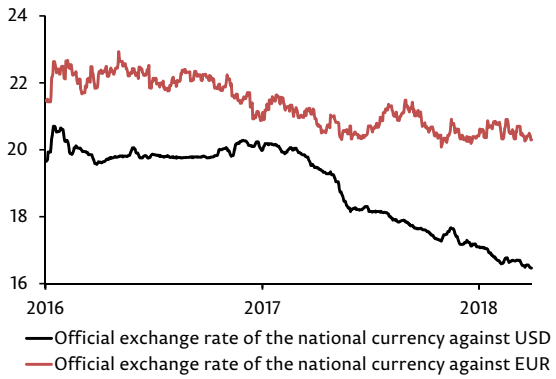
Source: NBM

Chart 4.21: Developments in interest rates on new loans and deposits



Source: NBM

Chart 4.22: The fluctuations of the official exchange rate of MDL against USD and EUR



Source: NBM

During the first quarter of 2018, the cost of the interest rates paid on the balance of loans extended in foreign currency had similar evolutions to the one paid on the balance of loans in domestic currency, although it recorded a less significant decline, the weighted average rate recording 5.05% per year. Also, the decrease was partly driven by the excess of foreign currency recorded on the market in the reporting period.

Evolution of deposit interest rate

The quarterly average interest rates, paid on deposit balance of licensed banks, kept declining following the downward trend set by the base rate applied by the National Bank of Moldova to main monetary policy operations.

Thus, the average interest rate on the balance of deposits placed in Moldovan lei, in the first quarter of 2018, recorded 5.33% annually, having decreased by 0.48 p.p. compared to the previous quarter and by 2.26 p.p. compared to the first quarter of 2017 (Chart 4.19). The evolution of the quarterly average interest rate on the balance of deposits in Moldovan lei was mainly driven by the decrease in average interest rates applied on the balance of domestic currency deposits placed by corporate clients.

The quarterly average interest rate applied on the balance of foreign currency deposits recorded a new historical minimum of 1.22% annually in the reference period, having fallen by 0.21 p.p. compared to the previous quarter. The quarterly decrease was driven by the fall in average interest rates applied on balances of both the retail and corporate deposits.

Evolution of banking margins

In the first quarter of 2018, the quarterly banking margin (calculated as the difference between average interest rates applied on the loan balance and average interest rates applied on the deposit balance) on the balance of operations concluded in Moldovan lei increased by 0.10 p.p. compared to the previous quarter, recording 4.02%. The quarterly banking margin on the foreign currency balance recorded a similar trend and amounted to 3.83%, having increased by 0.11 p.p. (Chart 4.20).

Evolution of interest rates applied to new loans and deposits

As a result of the monetary policy promoted by the National Bank of Moldova and the excess liquidity recorded in the banking system, average weighted interest rates applied on new loans and new term deposits continued to decline during the first quarter of 2018 (Chart 4.21). Compared to the previous quarter, the average weighted rate applied on domestic currency loans, extended by licensed banks, dropped to 9.52% annually (-0.28 p.p.), whereas

the average weighted rate applied on domestic currency deposits decreased by 0.73 p.p., recording a level of 4.76% per year. These developments were driven by declines in interest rates applied on loans extended to legal entities and individuals from various business sectors, as well as by the decrease in interest rates applied on deposits placed by both individual and corporate clients. In the forex segment, average weighted deposit rates recorded the same downward trend, whereas average weighted rates on loans did not record any major changes.

Developments in nominal and real effective exchange rates

During the first quarter of 2018, the official nominal exchange rate of domestic currency appreciated by 3.7% against the US dollar, while, against the euro, it recorded a smaller appreciation of 0.6% compared to the previous quarter (Chart 4.22).

On average, in the reporting quarter, the Moldovan lei appreciated by 3.6% against the US dollar, whereas against the euro it depreciated by 0.5% compared to the last quarter of the previous year.

In the first quarter of 2018, the evolution of the exchange rate of domestic currency against the US dollar was in line with the trend followed by most currencies of the main trading partner countries. Thus, at the end of the quarter, compared to the end of 2017, the following currencies appreciated against the US dollar: the Ukrainian hryvnia – by 5.5%, the euro – by 3.1%, the Romanian leu – by 3.0%, the pound sterling – by 4.5% the Czech crown – by 3.9%, the Chinese renminbi yuan – by 3.8%, etc. (Chart 4.23).

In real terms, in the first quarter of 2018, the Moldovan lei depreciated by 0.9% (Chart 4.24), such evolution being mainly driven by the developments recorded in the inflation differential between the Republic of Moldova and the main trading partner countries. Significant contributions to the depreciation of the REER were generated by Ukraine – 0.4 p.p. and Romania – 0.3 p.p. (Chart 4.25).

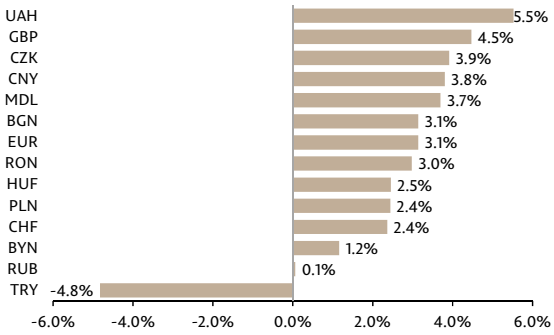
Similarly to previous periods, in the first quarter of 2018, the forex market has kept recording excess foreign currency, which continued to exert pressures towards appreciation over the Moldovan lei, thus determining the NBM's intervention on the market.

In this context, net foreign exchange supply from individuals exceeded by 10.9% net foreign exchange demand from economic agents, compared to the level of coverage recorded in the previous quarter (124.1%) and in the first quarter of 2017 (100.1%). Under these circumstances, the NBM purchased 97.7 million US dollars from local banks.

In the first quarter of 2018, transfers from abroad in favour of individuals decreased by 15.2%[16], compared to the previous quarter, being driven downwards by seasonal factors. However, a strong annual growth rate was maintained, individuals having

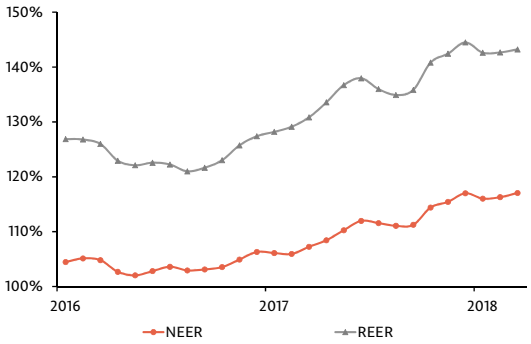
[16] According to the available data for the first two months of 2018, when the report was drawn up.

Chart 4.23: The evolution of currencies of the major trading partners of the Republic of Moldova against the US dollar, 31.03.2018/31.12.2017, %



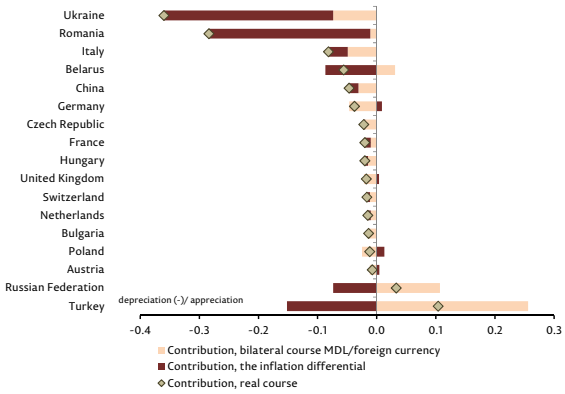
Source: NBM

Chart 4.24: The dynamics of nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated based on the major trading partners weights (Dec.2000-100%)



Source: NBM

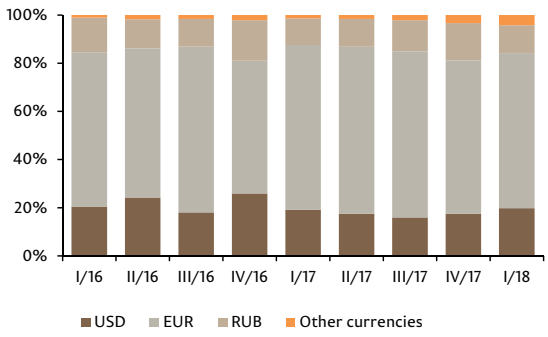
Chart 4.25: The contribution of the major trading partners of the Republic of Moldova to the real effective exchange rate modification in the first quarter of 2018



Source: NBM

received through transfers by 22.1%[17] more foreign currency in the reference period, compared to the same period of the previous year.

Chart 4.26: The foreign currency structure of net foreign currency supply from individuals (foreign currencies are recalculated in USD at constant exchange rate)

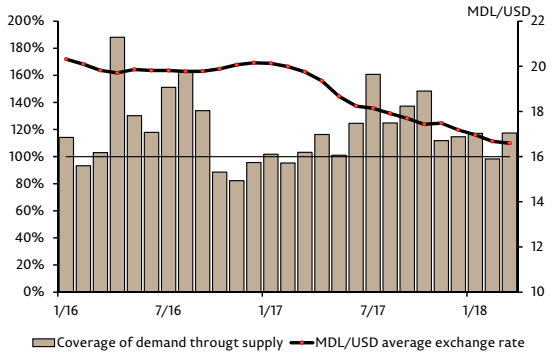


Source: NBM

At the same time, net foreign exchange supply from individuals grew both compared to the fourth quarter of 2017 (+4.0%) and year-on-year (+14.4%), amounting to 451.6 million US dollars. Compared to the fourth quarter of 2017, the highest increase was recorded in the net supply of US dollars, which grew by 14.2%, being followed by the increase in the euro supply by 2.1%, whereas the net supply of Russian rubles declined by 24.5%. Consequently, the US dollar share has increased in the structure of net foreign exchange supply from individuals (Chart 4.26).

At the same time, in the reference quarter, the foreign exchange surplus decreased due to a higher demand for foreign currency generated by economic agents (407.2 million US dollars), which grew by 16.3% compared to the fourth quarter of 2017 and by 3.2% compared to the first quarter of 2017. As a rule, a higher demand for foreign currency comes from energy importers during the cold periods of the year; thus, during the reference period, demand has increased by 4.3% compared to the previous quarter. Besides, a more consistent demand for foreign currency was recorded from the importers of pharmaceuticals, the telecom sector companies, etc.

Chart 4.27: The coverage rate of net demand by the net supply and the dynamics of the official exchange rate

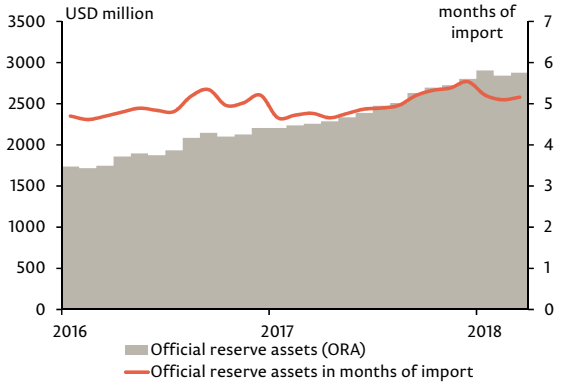


Source: NBM

Looking from the perspective of monthly dynamics recorded in January, the domestic currency's exchange rate assumed a rapid appreciation trend, which was driven by the surplus of foreign currency accumulated by banks in the last days of 2017; besides, the trend was supported by a steady and strong net supply of foreign currency generated by individuals. At the end of January, the Moldovan lei appreciated against the US dollar by 2.2% compared to the end of the previous month.

This trend continued through the first week of February, being followed by a period of depreciation due to a higher foreign exchange demand generated by energy importers, pharmaceutical companies and telecoms companies. However, in the second half of February, once the foreign exchange demand synchronised with supply, the dynamics of the exchange rate of Moldovan lei against the US dollar stabilised, the USD/MDL exchange rate having remained virtually unchanged, according to statistical data collected at the end of the month.

Chart 4.28: The evolution of official reserve assets expressed in months of import



Source: NBM

At the beginning of March, a rather modest foreign exchange demand, generated by economic agents, once again determined the appreciation of the Moldovan lei against the US dollar, this trend persisting through the end of the quarter, with few exceptions. Thus, in March, when net foreign exchange supply from individuals recorded 117.5% (Chart 4.27), thus surpassing net foreign exchange demand from corporate clients, the domestic currency appreciated by 1.4% against the US dollar, according to statistical data collected at the end of the month.

In the first quarter of 2018, the dynamics of the depreciation of the Moldovan lei against the European single currency, in average values, was driven by the evolution of the euro on foreign markets.

[17] The evolution was calculated by excluding the differences generated by the exchange rate's fluctuations.

The euro strengthened its position against the US dollar (+4.2%), returning to its level which was last recorded in 2015. On the one hand, this evolution was driven by the increased confidence of market participants in the Eurozone's economic performance; on the other hand, the appreciation of the euro occurred amid the disputes developing between the US and its main trading partners, as well as the scepticism of the market shown towards the sustainability of expansionist tax reforms, approved by the US Senate at the end of the last year.

At the end of the first quarter of 2018, the balance of official reserve assets amounted to 2,875.2 million US dollars (Chart 4.28)[18], having increased by 71.9 million US dollars (+2.6%), mainly following the NBM's interventions on the local market in the form of foreign exchange purchases.

At the same time, in the first quarter of 2018, the International Development Association extended loans totalling 2.3 million US dollars (0.9 million US dollars being destined for budget support), whereas IFAD continued to finance the "Inclusive Rural Economic and Climate Resilience Programme" (IFAD VI) through the disbursement of grants and loans in total amount of 1.7 million US dollars.

According to the data as of the end of the first quarter of 2018, the amount of official reserve assets recorded a sufficient level to cover imports of goods and services (5.2 months of imports[19]).

[18] Based on actual and updated forecast data.

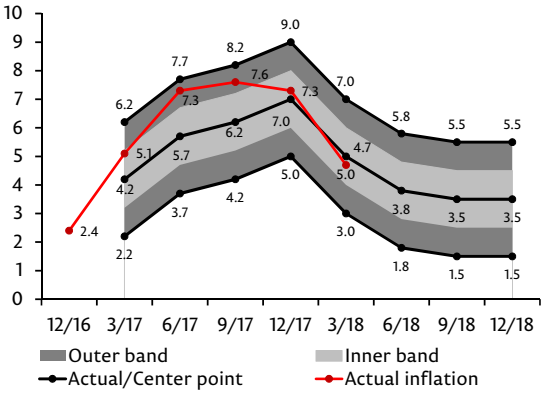
[19] Calculated based on the latest available forecast (March 2018) on imports of goods and services for 2018.

Chapter 5

Implementation of the provisions of the Memorandum on Economic and Financial Policies

5.1 Consumer price index

Chart 5.1: The inflation tolerance limits related to inflation consultation mechanism (%)



Source: NBM, IMF

In the first quarter of 2018, the annual CPI rate recorded a level situated within the tolerance band's limits (Chart 5.1) set forth in the inflation clause of the IMF programme. Thus, in March, the inflation rate recorded a level 0.3 p.p. below the centre point and within the inner band limits stipulated in the Inflation Consultation Mechanism.

Monetary policy commitments include a set of quarterly inflation targets (according to CPI data published by the National Bureau of Statistics of the Republic of Moldova) set within the limits of tolerance bands. The inner band limits are set within ± 1.0 p.p. from the centre point, whereas outer band limits – within ± 2.0 p.p. from the centre point. In case of any deviations recorded from the established tolerance band limits, consultations with IMF experts or the IMF Executive Board's members will be required, focusing on: (i) the assessment of the pursued monetary policy and the degree of compliance with the conditions set forth in the IMF-supported program; (ii) causes of deviations recorded from the established parameters, taking into account compensatory factors and proposed remedial actions.

Table 5.1: The tolerance limits of annual inflation rate (%)

	Outer band	Inner band	Actual/ Center point	Inner band (limit)	Outer band (limit)
2016					
31 Dec.	-	-	2.4	-	-
2017					
31 Mar.	6.2	5.2	5.1	3.2	2.2
30 Jun.	7.7	6.7	7.3	4.7	3.7
30 Sep.	8.2	7.2	7.6	5.2	4.2
31 Dec.	9.0	8.0	7.3	6.0	5.0
2018					
31 Mar.	7.0	6.0	4.7	4.0	3.0
30 Jun.	5.8	4.8	3.8	2.8	1.8
30 Sep.	5.5	4.5	3.5	2.5	1.5
31 Dec.	5.5	4.5	3.5	2.5	1.5

Source: NBM, IMF

In cases when annual inflation rate exceeds inner band limits set for the end of each quarter, the NBM will initiate consultations with IMF experts to determine causes of the deviation and to receive suggestions on policy actions to be taken. In cases when annual inflation rate exceeds outer band limits set for the end of each quarter, the management will consult with members of the IMF Executive Board to determine causes of the deviation and to receive suggestions on policy actions to be taken before applying for additional funding.

In the first half of 2017, the annual inflation rate recorded an upward trajectory, after which it had a relatively stable evolution in the second half of the year. Later, in the first quarter of 2018, the annual CPI rate assumed a downward trend. Thus, in 2017 and early 2018, the annual inflation rate recorded a level situated within the outer limits of the tolerance band, set out in the inflation clause of the IMF-supported program (Table 5.1).

5.2 The NBM's net international reserves

One of the quantitative performance criteria, based on which the IMF-supported program is assessed, is the threshold of the NBM's net international reserves (Table 5.2).

As of March 31, 2018, the stock of the NBM's net international reserves (at the program rate) amounted to 2517.8 million US dollars, having exceeded the quantitative target of 2368 million US dollars set for March 2018 in the IMF program.

Table 5.2: The NBM's net international reserves stock (USD, million)

	NBM net international reserve's threshold, set in the program agreed with the IMF	Stock of NBM's net international reserves (at the program course)
2016		
Dec.	1833.0	1894.2
2017		
Mar.	1818.0	1953.0
Jun.	1843.0	2053.5
Sep.	1962.0	2292.6
Dec.	2131.0	2463.3
2018		
Mar.	2368.0	2517.8

Source: NBM, IMF

List of Figures

List of Tables