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# Inflation Report no. 2, 2017

Inflation Report no. 2, 4 May 2017 [1]

## Summary

### Inflation

In the first quarter of 2017, the annual inflation rate was 4.3 percent, by 1.8 percentage points more compared to the previous quarter. In March 2017, inflation increased up to the value of 5.1 percent. As a result, this fell within the target inflation range set in the Medium-Term Strategy of Monetary Policy. The increase of annual inflation rate during the reporting period was determined mainly by the increase in tariffs for healthcare services, the adjustment of excise duty for some categories of products, certain pressures from aggregate demand, increase of oil prices and by the effect of a low base period of 2016. The annual rate of core inflation also recorded a more pronounced upward trend, increasing up to 4.6 percent in March 2017. The annual rate of food prices increased from 2.8 percent in December to 5.0 percent in March 2017. Fuel prices increased from 1.6 percent in December to 12.5 percent in March 2017. At the end of the first quarter of 2017, regulated prices increased by 3.6 percent than the same period of the previous year. In the first quarter of 2017, the actual annual inflation rate was higher to that anticipated within the forecasting round presented in the Inflation Report no.1, 2017, due mainly to the unexpected increase in tariffs for healthcare services.

### External environment

The beginning of 2017 marked the world economy by a consolidated effort of the oil exporting countries to fulfil the plan of decreasing the oil production volume, which contributed to the international oil prices stabilization.  Another important event was the increase in interest rates of the Federal Reserve System from 0.5-0.75 to 0.75-1.0 percent, an event that created a new wave of volatility on foreign exchange market. At the same time, in the first months of 2017, most of countries published their summary statistics on the economic activity results of 2016, which determined the confirmation or, reversely, the modification of forecasts on the development of each economy and of the world economy as a whole. A relevant example in this regard is the increase in forecasted value of gross domestic products in the euro area for 2017, after that Eurostat announced that the euro area economy increased by 1.7 percent in 2016.

### Economic developments

In the fourth quarter of 2016, GDP recorded an increase of 6.5 percent compared to the same period of 2015. The annual dynamic of the economic activity in the second half of 2016 was significantly higher than in the first half of the year. The positive evolution of GDP in the fourth quarter of 2016 was due mainly to the agricultural sector dynamic, which created premises for the increase in export, as well the increase in household consumption and a positive evolution of the change in inventories. Thus, exports recorded an increase of 19.9 percent in the fourth quarter of 2016. At the same time, household consumption increased by 4.6 percent mainly due to the increase by 5.0 percent in consumption of goods and services in kind and also due to the increase in household income during the reporting period. Investments contributed positively to GDP dynamics due mainly to the component change in inventories, given that the gross fixed capital recorded an increase of 1.0 percent compared to the same period of 2015. The final consumption of public administration decreased by 0.3 percent in the fourth quarter of 2016. The economic activity dynamics was significantly offset by the increase of imports by 9.4 percent compared to the fourth quarter of 2015. The pronounced dynamics of the agricultural sector has also generated positive developments in related sectors. Thus, in the fourth quarter of 2016, wholesale and retail trade increased by 10.2 percent, manufacturing - by 5.3 percent, transport and storage - by 14.5 percent. During the reporting period, the number of employed people decreased by 1.9 percent compared to the fourth quarter of 2015. However, the unemployment rate accounted for 3.8 percent, being lower than in the same period of 2015.

## Monetary policy

In the first quarter of 2017, there were held three meetings of the Executive Board of the National Bank on Moldova on monetary policy decisions. Following the assessment of the balance of internal and external risks, to which the economy of the Republic of Moldova could be subject and inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova decided to maintain the base rate applied on main monetary policy operations at the level of 9.0 percentage points.

In the first quarter of 2017, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 19.6 percent for M2 (by 1.7 percentage points higher than in the fourth quarter of 2016) and 10.5 percent for M3 (by 1.1 percentage points higher than the previous quarter).

The average interest rates on deposits in national currency continued its downward trend and consequently, the average rates on credits granted by banking system recorded a tempered decline.

During the reporting period, compared to the fourth quarter of 2016, the annual average interest rates related to the balance of credits recorded a decrease of 0.78 percentage points on credits in national currency and of 0.27 percentage points on credits in foreign currency, recording the levels of 11.32 and 5.58 percent, respectively. The average interest rate on deposits in MDL was 7.59 percent during the first quarter of 2017, decreasing by 1.38 percentage points compared to the previous quarter. The interest rate of placements in foreign currency constituted on average 2.13 percent, lower by 0.08 percentage points than in the fourth quarter of 2016.

## Medium-term inflation forecasting

According to the current round of forecasting, the output gap will record positive values in the first four quarters of the forecasting horizon and negative values in the other next quarters. The placement of the economic activity above its potential level, on medium-term, will cause disinflationary pressures, while the

negative values of output gap during four quarters of the forecasting horizon will generate disinflationary pressures. Real monetary conditions will have a heterogeneous impact on the demand. Real effective exchange rate will manifest incentive effects in the third quarter of the forecasting period, after which it will produce restrictive monetary conditions for the rest of the forecasting horizon. Actual interest rate will be incentive for the entire forecasting horizon, except the last two forecasting quarters when it will be insignificant restrictive.

According to the current projection, the annual average CPI inflation rate will record an upward trend until the fourth quarter of 2017, after which it will decrease until the end of the forecasting horizon. Starting with the second quarter of 2017, annual inflation rate will be above the range of variation during four consecutive quarters. Thereafter, this will fall within the target inflation range by the end of the forecasting horizon. This will record the maximum level of 8.1 percent in the fourth quarter of 2017, while the minimum level of 4.1 percent in the fourth quarter of 2018. Compared to the previous forecast, the average annual values of the annual inflation are higher by 1.6 percentage points in 2017 and by 0.2 percentage points in 2018.

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