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# Inflation Report no. 4, 2017

Inflation Report no.4, November 2017 [1]

# Summary

## Inflation

In the third quarter of 2017, the average annual inflation rate was 7.4 percent, being by 0.3 percentage points higher than in the previous quarter. Compared to the significant increase in the first half of this year, during the third quarter of 2017, the annual inflation rate dynamics was less pronounced. Thus, it maintained at the level of 7.3 percent in July and August, then, it increased to 7.6 percent in September. As a result, during the third quarter of 2017, the annual inflation rate continued to be above the inflation target set in the medium-term Monetary Policy Strategy. Maintenance of an upward trajectory of annual CPI inflation rate was mainly driven by food products' prices accumulated pressures as a result of less favorable agriculture-meteorological conditions for local fruit and vegetables this year. At the same time, the high inflation figures were also sustained by the impact of tariffs' increases on some regulated services, especially at the beginning of this year. The basic inflation experienced a relatively stable dynamic, maintaining close to the inflation target. The trend of appreciation of the national currency, during the reference period, has mitigated the influence of pro-inflationary factors mentioned above. According to estimates, the domestic demand has had a negligible impact on inflation over the reference period. Deviation between the effective annual inflation rate in the third quarter of 2017 and the anticipated value within the forecasting round

pertaining to the Inflation Report no. 3, 2017 was a null one.

## External environment

Global economic activity continues to recover, fact that contributes to the intensification of pro-inflationary external pressures. Most statistical indicators indicate the sustainable growth of the Euro Zone economy and the recovery of the Russian Federation economy after the previous years' crisis. In the third quarter of 2017, the international currency market was marked by the slight appreciation of both the USA dollar and of the single European currency, and the regional currency market of stabilization and then by the slight appreciation of the Russian Ruble amid the rise of prices for oil. The price of oil has increased significantly in recent months as a result of global oil production decline, of precarious weather conditions in the USA, and of intensification of geopolitical conflicts in oil extracting regions. Economic revival and increased global growth has also contributed to increasing international quotations for raw materials, including for food products. Against the background of recovery both of the world economy and of the regional economy, the amount and intensity of risks, as well as the uncertainties related to external environment have diversified.

## Economic developments

The annual dynamics of economic activity, in the second quarter of 2017, was slightly lower than at the beginning of this year, mainly, as a result of the dissipation of positive effects generated by the previous year's harvest, which fueled the increase in exports in the previous periods. Thus, in the second quarter of 2017, GDP grew by 2.5 percent compared to the same period of 2016. The domestic demand contribution became more pronounced than in the previous years. Thus, the annual rate of gross formation of fixed capital accelerated up to 6.3 percent, by 3.0 percentage points above the level of the beginning of the current year. Similar to the previous periods, the contribution of the component to the change in stocks at GDP dynamics continued to be a pronounced positive one, attaining the level of 2.7 percentage points. In the second quarter of 2017, final consumption of households experienced an annual dynamic of 3.8 percent. Final consumption of public administration recorded a negligible evolution during the reference period, decreasing by 0.1 percent compared to the second quarter of 2016. At the same time, the positive impact of external demand declined considerably compared to previous periods. In this way, exports of goods and services increased by only 7.3 percent compared to the second quarter of 2016. Though to a lesser extent than at the beginning of the year, the economic activity was substantially tempered by the evolution of imports. Thus, they were by 11.1 percent higher than those in the second quarter of 2016. By categories of resources, GDP growth was largely determined by the positive contribution of 1.6 percentage points generated by the increase of net taxes on the product. Positive developments with noticeable impact on GDP dynamics were recorded in trade, transport and storage and construction. The industrial sector experienced a stagnation in the second quarter of 2017, while the added value related to agriculture decreased by 6.9%.

## Monetary policy

During the third quarter of 2017, three meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions were held. As a result of the assessment of the balance of internal and external risks and of the short and medium term inflation expectations, the Executive Board of the National Bank of Moldova decided at its meeting from 26 July 2017 to maintain the base rate applied to the main monetary policy operations at the level of 8.0 percent annually. Subsequently, at the meetings of 28 August 2017, it

was decided to reduce the base rate applied to the main monetary policy operations by 0.5 percentage points, from 8.0 percent (level set at the meeting on 28 June 2017) to 7.5 percent per year. At its meeting on September 27, 2017, the Executive Board of the National Bank of Moldova decided to maintain the base rate applied to the main monetary policy operations at 7.5 percent per year.

Following the downward trend of the base rate applied to main monetary policy operations of the National Bank of Moldova, the quarterly average interest rates on the national currency deposit balance accepted by the licensed banks continued their downward trend, and as a result, they recorded a decline and quarterly average rates on loans granted by licensed banks. In the reference period, compared to the second quarter of 2017, the quarterly average interest rates on the balance of credits granted by licensed banks decreased by 0.46 percentage points on loans in national currency and by 0.19 percentage points on foreign currency loans, registering values of 10.18% per year and 5.21% per year, respectively. The average quarterly interest rate on the balance of deposits in MDL accepted by licensed banks constituted 6.15% per year, down by 0.42 percentage points compared to the previous quarter. The average quarterly interest rate on the foreign currency deposits amounted to 1.65 percent annually, lower compared to that from the second quarter of 2017 by 0.21 percentage points.

## Medium-term inflation forecasting

According to the current forecasting round, the GDP deviation will register a sluggish recovery for the entire forecasting period. However, it will remain in the negative zone, near the “0” value, for the entire forecasting period. Therefore, placing economic activity below its equilibrium level will cause disinflationary pressures on behalf of aggregate demand.

The real monetary conditions will have a restrictive impact on demand. The actual effective exchange rate will feed a restrictive nature of monetary conditions throughout the whole forecast horizon. At the same time, the real interest rate will be stimulating for the entire forecast horizon, with the exception of three consecutive quarters, starting in the fourth quarter of 2018, when it will feed a restrictive nature of monetary conditions.

The annual inflation rate, starting with the fourth quarter of 2017, will decline rapidly and will return, beginning with the first quarter of 2018, within the interval for two consecutive quarters. As of the third quarter of 2018, for three consecutive quarters, the annual inflation rate will place below the lower limit of the range, after which, as of the second quarter of 2019, it will return within the interval and will place in the proximity of inflation target at the end of the forecast horizon. The maximum value of 7.3 percent will be recorded in the fourth quarter of 2017, and the minimum value of 2.6 percent - in the fourth quarter of 2018. Compared to the values recorded in the Inflation Report no. 3, 2017, the projected annual average annual inflation rates are similar for the current year and are below by 0.4 percentage points for the year 2018.

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