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Inflation Report no. 2, 2016

Inflation Report no.2, May 2016 [1]

Summary

Inflation

In the first quarter of 2016, the annual inflation rate was 11.0 percent, by 2.4 percentage points less compared to the previous quarter. In March 2016, inflation decreased to the value of 9.4 percent. However, it continued to be above the upper limit of the inflation target set in the Medium-Term Strategy of Monetary Policy. The downward evolution of inflation was determined by the modest domestic demand, revision of natural gas tariffs, appreciation of the national currency against the U.S. dollar in February and March and the favourable meteorological conditions during the reporting period. At the same time, the downward trajectory was also supported by the trajectory of food and energy resources prices in the region. The annual inflation rate continued to maintain a higher trajectory than that of overall inflation. Core inflation has also had a downward trajectory during the first quarter of 2016, decreasing from 14.6 percent in December to 10.2 percent in March 2016. In March 2016, the annual rate of food and regulated prices slowed to 10.1 and 11.5 percent, respectively. In the first quarter of 2016, oil prices decreased on average by 3.8 percent compared to the same period of the previous year. In the first quarter of 2016, the actual annual inflation rate was lower to that anticipated within the forecasting round presented in the Inflation Report no.1, 2016.

External environment

In the first quarter of 2016, a number of macroeconomic indicators of international importance confirmed the new trends in the world economy. The global oil surplus continued to persist, being the main cause of low oil prices. The weak global demand determines the low quotations for raw materials, which affect the emerging economies dependent on raw material export. The gap between the development of advanced economies and that of emerging and developing economies is reflected in the antagonist monetary policies with direct repercussions on the evolution of foreign exchange rates and indirect repercussions on the evolution of consumer prices. In order to counteract the disinflationary pressures, the European Central Bank decreased the monetary policy rate from 0.05 to 0.0 percent as from 16 March 2016 and increased the asset purchase programme from EUR 60 to 80 billion monthly starting with April 2016. In the region, the growth rates of consumer price index recorded a decrease due to the stabilization and appreciation of local currencies and as a result of the annual base effect.

Internal economic developments

In the fourth quarter of 2015, GDP recorded a decrease of 3.3 percent compared to the same period of 2014, the dynamic of economic activity being slightly lower compared to the third quarter of 2015 and significantly lower to that recorded in the first quarter of 2015. The negative development of GDP was mainly determined by the decrease in domestic demand due to the decrease in real disposable income of households and the increase of the political and economic uncertainty, as well by a pronounced decrease of agricultural crop in 2015. Thus, in the fourth quarter of 2015, household consumption decreased by 3.5 percent, while the gross fixed capital formation recorded a decrease of 2.9 percent. Government consumption was by 1.9 percent higher to that recorded in the fourth quarter of 2014. In the fourth quarter of 2015, gross value added in agriculture was lower by 18.3 percent compared to the same period of 2014, as a result of dry weather conditions in the summer of 2015. The negative impact of the decrease in domestic demand and agriculture was slightly mitigated by the depreciation of the national currency, which had an incentive effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the fourth quarter of 2015, the volume of exports of goods and services was only by 0.5 percent lower compared to the same period of 2014, due to the embargoes on certain categories of goods from the Russian Federation and increased regional uncertainty. At the same time, imports recorded a contraction of 8.4 percent. Negative developments were recorded in trade, industry and construction. At the same time, the decline in GDP was mitigated by the positive contribution from the increase of the gross added value in financial and real estate sector.

Monetary policy

In the first quarter of 2016, there were held three meetings of the Executive Board of the National Bank on Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks to which the economy of the Republic of Moldova could be subject and the inflation outlook in the short and medium term, the NBM decided to decrease the base rate applied to main monetary policy operations by 0.5 percentage points, from the level of 19.5 percent (level set at the meeting of 26 August 2015) to 19.0 percent, at the meeting of 25 February 2016 and by 2.0 percentage points, from the level of 19.0 to 17.0 percent annually, at the meeting of 31 March 2016.

The beginning of 2016 was characterized by the slowdown in growth rates of monetary indicators. Thus, in the first quarter of 2016, the growth rate of monetary aggregates was negative, the quarterly average in annual terms constituted -2.7 percent for M2 (by 9.2 percentage points higher than in the fourth quarter of 2015) and -3.5 percent for M3 (by 0.8 percentage points lower than the previous quarter).

During the reporting period, the average annual interest rate on loans in national currency increased slightly by 0.40 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.16 percentage points compared to the fourth quarter of 2015, recording values of 13.68 percent in national currency and 6.65 percent in foreign currency. The average interest rate on deposits in MDL accounted for 15.11 percent, increasing by 1.41 percentage points compared to the previous quarter, while the interest rate on placements in foreign currency constituted on average 2.14 percent, decreasing by 0.14 percentage points compared to the fourth quarter of 2015.

Medium-term inflation forecast

According to the current round of forecasting, the output gap will continue to be negative. Compared to the previous round of forecasting, the aggregate demand estimated was revised upwardly. The evolution of the

economic activity mainly below its potential, on medium-term, will determine disinflationary pressures from domestic demand, although more moderate compared to the previous forecast.

According to the current projection, the annual average CPI inflation will record a downward trend until the end of 2016, being followed by a stabilization around the target. On average, this will reach the level of 7.0 percent in 2016 and 4.8 percent in 2017. According to the projection, the annual inflation rate will return to the inflation target range in the third quarter of 2016. The maximum level of 8.1 percent will be recorded in the second quarter of 2016 and the minimum level of 3.6 percent in the fourth quarter of 2016.

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