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Inflation Report no. 3, 2016

Inflation Report no. 3, August 2016 [1]

Summary

Inflation

In the second quarter of 2016, the annual inflation rate was 7.9 percent, by 3.1 percentage points less compared to the previous quarter. In June 2016, inflation decreased to the level of 7.4 percent. However, it continued to be above the upper limit of the inflation target set in the Medium-Term Strategy of Monetary Policy. Its downward trend was determined by the modest domestic demand, revision of electricity tariff, high supply of fruits and vegetables of this year and national currency appreciation. 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 second quarter of 2016, decreasing from 10.2 percent in March to 9.3 percent in June 2016. In June 2016, the annual rate of food and regulated prices slowed to 7.6 and 7.4 percent, respectively. In the second quarter of 2016, oil prices decreased on average by 3.4 percent compared to the same period of the previous year. The actual average value of inflation decreased in the second quarter of 2016 by 0.2 percentage points than the value anticipated of 8.1 percent in the projection of Inflation Report no.2, 2016.

External environment

Many events with significant impact on the world economy development have occurred in the second quarter of 2016. OPEC held an unordinary meeting on 17 April together with other major oil producers, where the discussions on decreasing the global oil production have failed. On 23 June, Great Britain held a referendum on whether to leave or remain in the European Union and 51.9 percent of votes were cast to leave the EU. It should be also mentioned the renewal of bilateral relations between Turkey and Russian Federation at the end of June and the recent coup d'état in Turkey that caused the country's economic instability. These events generated significant volatility on the market, increasing the risks over the world economy development.

Internal economic developments

In the first quarter of 2016, GDP recorded an increase of 0.8 percent compared to the same period of 2015, the annual dynamics of economic activity being higher to that recorded in the second half of the previous year. However, the economic growth was modest, below its potential level. The positive evolution of GDP was determined by the domestic demand, while exports generated a negative impact on GDP dynamics. Thus, in

the first quarter of 2016, household consumption increased by 2.3 percent. However, the evolution of household consumption was minor. At the same time, the positive contribution of investments to GDP dynamics was determined by the positive impact of the component change in inventories, given that the gross fixed capital recorded a decrease of 3.6 percent compared to the same period of the previous year. These developments reflect the decrease in real terms of household disposable income and the high uncertainty from economic agents and population toward the economy further development. In the first quarter of 2016, the final consumption of public administration decreased by 0.4 percent compared to the same period of 2015. Exports, after having a negligible influence to GDP dynamics in the second half of the previous year, recorded a decrease of 5.6 percent compared to the first quarter of 2015, mainly due to the consequences of a modest agricultural production during the reporting period. Imports recorded an increase of 1.8 percent during the reporting period. By category of resources, the positive dynamics of GDP was determined by the increase of gross value added in all main economy branches, except for "construction" and of the subcomponent "other services".

Monetary policy

In the second quarter of 2016, there were held two meetings of the Executive Board of the National Bank of 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 at each meeting to decrease the base rate applied on main monetary policy operations by 2.0 percentage points. Thus, at the meeting of 28 April 2016, the base rate was decreased from 17.0 percent (level set at the meeting of 31 March 2016) to 15.0 percent annually and at the meeting of 26 May 2016, from 15.0 to 13.0 percent annually.

In the second quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 4.8 percent for M2 (by 7.5 percentage points higher than in the first quarter of 2016) and 0.9 percent for M3 (by 4.4 percentage points higher than the previous quarter).

Reflecting the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, the average interest rates on deposits ceased its upward trend and consequently, the average rates on credits granted by banking system recorded a decline.
During the reporting period, compared to the first quarter of 2016, the annual average interest rates related to the balance of credits recorded a decrease of 0.08 percentage points on credits in national currency and of 0.18 percentage points on credits in foreign currency, recording the levels of 13.60 percent and 6.42 percent, respectively. The average interest rate on deposits in MDL was 14.93 percent, decreasing by 0.18 percentage points compared to the previous quarter. The interest rate on placements in foreign currency constituted on average 2.11 percent, decreasing by 0.03 percentage points than in the first quarter of 2016.

Medium-term inflation forecast

The current round of forecasts predicts a further negative dynamics of output gap for the entire forecast period. It will slightly recover, but remaining negative and will reach positive values only to the end of forecasting horizon. Compared to the previous round of forecasting, the estimated aggregate demand has been reconfigured. 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 rate will record a downward trend until the end of 2016, being followed by a stabilization around the target. On average, inflation will reach the level of 6.7 percent this year and 4.4 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 6.0 percent will be recorded in the second quarter of 2018 and the minimum level of 3.5 percent in the fourth quarter of 2016.

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