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Inflation Report no. 1, 2025

Petru Rotaru, First Deputy Governor of the NBM, presents the Inflation Report No. 1, 2025

Inflation Report no. 1, 2025 [1]

Prezentation [2] (available in Romanian)

Summary

Inflation

In the fourth quarter of 2024, the annual inflation rate continued the upward trajectory that has started in the middle of the previous year. As a result, the annual inflation rate increased from 5.2% in September 2024 to 7.0% in December 2024, exceeding, at the end of the previous year, the upper limit of the inflation target variation range, which was caused by the dynamics of regulated prices in the context of the adjustment of the network gas tariff. Excluding this impact, the annual inflation rate stood at approximately 6.2% in December 2024, slightly lower than projected in the Inflation Report, November 2024. Meanwhile, the average annual inflation rate was 5.9% in the fourth quarter of 2024, by about 0.9 percentage points higher than in the previous quarter.

The upward trajectory of the annual inflation rate in recent months has been driven by some adverse sectoral developments, including the adjustment of the network gas tariff and the dry conditions in the previous summer. Aggregate demand is estimated to have continued to exert a disinflationary impact on prices during the reference period. Inflation dynamics in December 2024 and the adjustment of the heat and electricity tariffs at the beginning of this year will push the annual inflation rate above the upper limit of the inflation target variation range, at least in the first part of this year. In the period ahead, domestic demand is expected to continue to exert a disinflationary impact. The manner in which tariffs are adjusted, as well as the tense situation in the region and the risk of its escalation, keeps the inflation outlook highly uncertain.

External environment

The year 2024 ended full of uncertainties and on negative trends of fragmentation in the global economy. The election of Donald Trump to a new term as the US President has further heightened the risks related to the deterioration of international trade, given that numerous economic sanctions and trade tariffs had already been imposed in recent years. European economies continue to grow on the brink due to the consequences of the 2022 energy crisis, which significantly damaged the industrial sector, as well as the internal disagreements over fiscal policies and public debt sustainability. Although there are some signs of improvement in China's real estate sector, the demand in the largest Asian economy remains weak compared to the pre-pandemic levels. Oil prices were relatively stable in the last months of 2024, but have risen sharply since January 2025, following the introduction of new economic sanctions on tankers carrying Russian oil products. Additionally, European natural gas prices have risen significantly, as very low temperatures led to a rapid decline in reserves and from January 1, 2025, Ukraine no longer transports natural gas from Russia to Europe via the last remaining pipeline. International food prices have also started to rise from their lows reached in early 2024, driven by increasing consumer demand and higher transportation and logistics costs. Another important phenomenon during the period under review has been the significant appreciation of the US dollar, which is creating inflationary pressures in emerging, and especially import-dependent countries. The fading of disinflationary pressures and the rise of inflationary ones point to a shift in global monetary cycles and create expectations that interest rates will stop falling and even start to rise.

Economy

After the positive developments in the first half of the year, the annual GDP dynamics entered negative territory in the third quarter of 2024. As a result, in the third quarter of 2024, GDP contracted by 1.9% compared to the same period in 2023. These dynamics were lower than anticipated in the Inflation Report, November 2024, primarily due to the negative impact of net external demand. Domestic demand, both from households, in the context of rising real income growth, and from businesses, partly offset this effect. At the same time, it is worth mentioning the negative impact on GDP dynamics from the agricultural sector, due to the dry conditions in the previous summer, as well as from trade and real estate transactions. This was partly mitigated by developments in construction, the financial sector and the information and communications sector. According to estimates, the domestic demand has remained moderate, as indicated by the still below than expected growth in household consumption, thus exerting a disinflationary impact during this period. At the same time, the seasonally adjusted series reflects a 3.1% decline in GDP compared to the second quarter of 2024. Overall, between January and September 2024, GDP increased by 0.6% compared to the same period in the previous year.

Monetary policy

In the fourth quarter of 2024, excess liquidity amounted to MDL 8.4 billion, decreasing by MDL 934.8 million from the previous quarter.

The M3 monetary aggregate in the fourth quarter of 2024 grew at an annual rate of 15.7%. The main contribution came from the balance of deposits in the national currency.

During the fourth quarter of 2024, the Executive Board of the National Bank of Moldova held two meetings on monetary policy decisions. Following the assessment of the balance of domestic and external risks and the inflation outlook in the short- and medium-term, the Executive Board of the National Bank of Moldova decided, at its meetings on November 5 and December 5, 2024, to maintain the base rate at 3.60% annually (level set on May 7, 2024). At the same time, the standing facility and repo rates were also maintained. The required reserve ratio of funds attracted in MDL and non-convertible foreign currency was reduced by 4.0 percentage points from 29.0% to 25.0% of the calculation basis, while the required reserve ratio of funds attracted in freely convertible foreign currency – by 5.0 percentage points from 39.0% to 34.0% of the calculation basis.

Also, at the monetary policy meeting on December 5, 2024, the Executive Board of the National Bank of Moldova unanimously voted to decrease the required reserve ratio for funds attracted in MDL and non-convertible foreign currency, as well as for funds attracted in freely convertible currency, starting with the period of application of required reserves from January 16, 2025 to February 15, 2025, lowering them to 22.0% and 31.0%, respectively, of the calculation basis.

These measures have been adopted with a view to lowering borrowing costs, stimulating aggregate demand, including by encouraging consumption, balancing the national economy and anchoring inflation expectations.

At the beginning of this year, the need arose to convene an unscheduled meeting and, respectively, to adjust the monetary policy in such a way as to mitigate the pressures on the inflationary process in the context of the recently approved tariff increases in December 2024 and January 2025. In this regard, the gradual tightening cycle of monetary policy was resumed and on January 10, 2025, the Executive Board of the National Bank of Moldova unanimously voted to increase the base rate to 5.60% annually. At the same time, interest rates on overnight loans and deposits were increased to 7.60 and 3.60%, respectively. The interest rate on repo operations was set at 5.85% annually.

At the meeting on February 5, 2025, the Executive Board of the National Bank of Moldova adopted by an unanimous vote the increase of the base rate applied to the main short-term monetary policy operations by 0.90 percentage points to 6.50% annually. The rates on overnight loans and deposits were accordingly raised to 8.50 and 4.50% annually. The interest rate on repo operations also increased to 6.75% annually.

With these decisions, the NBM aimed to mitigate the second-round effects on inflation caused by the change in regulated tariffs and to anchor inflation expectations in order to bring the annual rate of the consumer price index back within the variation range of ±1.5 percentage points of the 5.0% medium-term inflation target within a reasonable timeframe.

In the fourth quarter of 2024, in the domestic currency segment, the weighted average interest rates on new loans and term deposits continued their downward trend under the impact of the cumulative monetary policy stimulus measures. Thus, the weighted average interest rate on loans amounted to 8.26% and that on deposits was 3.16%, down by 2.24 and 1.07 percentage points, respectively, compared to the fourth quarter of 2023.

The average interest rates on the balance of loans in the national currency decreased by 2.01 percentage points compared to the fourth quarter of 2023, reaching 8.56%, while those on term deposits – by 3.88 percentage points to 3.36%.

Medium-term inflation projection

In the current round of forecasts, risks and uncertainties prevail in the external environment. Donald Trump's new term as the US President entails the return of trade tariffs and increased restrictions on international trade. Global markets are awaiting a resolution to the war in Ukraine, which would change the economic climate in the region. In the context of the ceasefire between Israel and the Gaza Strip, any escalation could again contribute to higher oil prices. The European Union economies are on a downward trend, have not yet recovered from the energy crisis, and are already facing threats of increased trade tariffs from the USA. There is growing talk of the end of stimulative monetary cycles and the emergence of inflationary pressures that will prompt monetary authorities to raise interest rates. Oil prices will be influenced by Trump's policy of purchasing oil to replenish strategic reserves, as well as by Russia's ability to circumvent new sanctions on oil tankers. Natural gas prices in Europe will continue to be affected by this winter's deviation from normal temperatures and countries' ability to replenish storage until the next cold season. International food prices have ended their downward trend and will continue rising at a normal pace, as supply and demand for agricultural products appear fairly balanced.

The annual inflation rate will follow an upward trend in the first quarter of this year, after which it will decline steadily until the third quarter of 2026 and increase slightly at the end of the forecast horizon[1]. In the first quarter of 2025, the inflation rate will exceed the upper limit of the inflation target variation range but is expected to return within the range in the fourth quarter of 2025, remaining there until the end of the forecast horizon. The maximum value will be recorded in the first quarter of this year, while the minimum value in the third quarter of 2026. The annual core inflation rate will have a slight downward trend in the first three quarters of the current year, thereafter remaining relatively stable until the end of the forecast horizon. The annual rate of food prices will trend upwards in the first half of this year, after which it will decline continuously until the end of the forecast horizon. The annual rate of regulated prices will increase sharply in the first quarter of 2025, then decline continuously until the first quarter of 2026, after which it will follow a relatively stable path until the end of the forecast horizon. The annual rate of fuel prices will follow a predominantly upward trend during the current year, after which it will decline and register negative values in the first three quarters of next year.

Aggregate demand will be negative for the entire forecast period[2] due to dry conditions in the summer of 2024, negative external demand for the entire forecast period, and real overvaluation. The low real interest rate, slightly positive fiscal impulse and recovering external demand will narrow the aggregate demand deficit.

Real monetary conditions will generally be restrictive on aggregate demand throughout the forecast period.

The current inflation forecast has been revised upward, compared to the Inflation Report, November 2024, for the entire comparable period[3]. The current forecast for the annual core inflation rate has been revised downward for the entire comparable period. The annual growth rate of food prices has been revised upward for the entire comparable period. The current forecast for the annual rate of regulated prices has been significantly revised upward for the entire comparable period. The forecast for the annual rate of fuel prices has been revised upward for the current year and then downward until the end of the comparable period.

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1. Fourth quarter of 2026

2. First quarter of 2025 – fourth quarter of 2026

3. First quarter of 2025 – third quarter of 2026.

See also

Tags
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inflation forecast [4]
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