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Monetary Policy

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01.02.2017

Inflation Report no. 1, 2017

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Summary

Inflation

In the fourth quarter of 2016, the annual inflation rate was 2.5 percent, by 2.0 percentage points less compared to the previous quarter. In December 2016, inflation decreased to the level of 2.4 percent. Thus, after being within the range of ± 1.5 percentage points from the 5.0 percent target in August 2016, as set in the Medium-Term Strategy of Monetary Policy, annual inflation was below the lower limit of this range at the end of the fourth quarter of 2016. The decrease in annual inflation rate during the reporting period was mainly due to the modest domestic demand, rich harvest in agricultural sector, high effect of a base period associated with the national currency depreciation in 2015 and the dissipation of the impact of the electricity tariffs increase in July 2015. The annual inflation rate continued to maintain a higher trajectory than that of overall inflation. Core inflation also had a downward trajectory during the fourth quarter of 2016, decreasing from 6.7 percent in September to 4.5 percent in December 2016. In December 2016, annual rate of food prices fell to 2.8 percent, while prices of regulated services decreased by 1.1 percent compared to December 2015. Annual rate of fuel prices continued the upward trend of the previous quarter, accounting for 1.6 percent in December 2016. The actual average value of inflation was in the fourth quarter of 2016 marginally higher than the value anticipated in the projection of Inflation Report no.4, 2016.

External environment

Last quarter of 2016 was marked by significant events, fixing milestones on further development of world economy. As of 30 November, OPEC member countries signed the agreement concerning the decrease in oil production volume, including the quota distribution by country. The agreement's impact on the oil market was also deepened by the decision of the Russian Federation and ten other non-OPEC countries, which agreed to cut the oil production. Other significant event was the decision of the Federal Reserve System of 15 December 2016 to increase the interest rates by 0.25 percentage points, to the level of 0.5-0.75 percent. This decision caused a sound appreciation of the US dollar with effects over the financial and raw materials markets. Another phenomenon noted by the end of 2016 was the significant increase in raw materials prices generated by the global demand revival, which offset the disinflationary pressures that persisted in certain economies during the last two years. Overall, the global economy forecasts for 2017-2018 are higher than those of 2016.

Economic developments

In the third quarter of 2016, GDP recorded an increase of 6.3 percent compared to the same period of 2015, the annual dynamics of the economic activity being higher than in the first half of 2016. The positive evolution of GDP 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 16.4 percent in the third quarter of 2016. At the same time, household consumption increased by 4.9 percent mainly due to the increase in consumption of goods and services in kind by 15.8 percent. Investments contributed positively to GDP dynamics due exclusively to the component change in inventories, given that the gross fixed capital recorded a decrease of 1.1 percent compared to the same period of 2015. The final consumption of public administration decreased by 0.8 percent in the third quarter of 2016. In the third quarter of 2016, the economic activity dynamics was significantly offset by the increase of imports by 7.4 percent compared to the third quarter of 2015. The pronounced dynamics of the agricultural sector has also generated positive developments in related sectors. Thus, in the third quarter of 2016, wholesale and retail trade increased by 6.8 percent, manufacturing - by 1.6 percent, transport and storage - by 3.3 percent. In the third quarter of 2016, the number of employed people decreased by 0.5 percent compared to the third quarter of 2015. However, the unemployment rate accounted for 2.9 percent, being lower than in the same period of 2015.

Monetary policy

In the fourth 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 Executive Board decided at the meeting of 27 October 2016 to decrease the base rate applied on main monetary policy operations by 0.5 percentage points, from the level of 9.5 percent (set at the meeting of 29 September 2016) to 9.0 percent annually. Thereafter, at the meetings of 24 November 2016 and 29 December 2016, there were adopted decisions to maintain the base rate applied on main monetary policy operations at the level of 9.0 percent annually.

In the fourth quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 17.9 percent for M2 (by 6.0 percentage points higher than in the fourth quarter of 2016) and 9.3 percent for M3 (by 4.7 percentage points higher than the previous quarter).

Following the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, 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 first quarter of 2016, the annual average interest rates related to the balance of credits recorded a decrease of 0.79 percentage points on credits in national currency and of 0.31 percentage points on credits in foreign currency, recording the levels of 12.10 and 5.85 percent, respectively. The average interest rate on deposits in MDL was 8.97 percent during the fourth quarter of 2016, decreasing by 2.01 percentage points compared to the previous quarter. The interest rate of placements in foreign currency constituted on average 2.21 percent, higher by 0.13 percentage points than in the third quarter of 2016.

Medium-term inflation forecasting

The current round of forecasting anticipates that the output gap will continue to be negative for the entire forecasting period. The output gap will register a slow recovery, continuing to be negative and will be close to zero by the end of the forecasting period. Therefore, the placement of the economic activity below its potential level, on medium-term, will cause disinflationary pressures from the aggregate demand. 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.

According to the current projection, the annual average CPI inflation rate will record an upward trend until the third quarter of 2017, after which it will decrease and hover close to the target. The inflation annual rate will fall within the inflation target range for the entire forecasting horizon. This will record the minimum level of 3.5 percent in the first quarter of 2017, while the maximum level of 6.0 percent in the third quarter of 2017. Compared to the previous forecast, the average annual values of the annual inflation are higher by 0.6 percentage points for 2017 and by 1.1 percentage points for 2018.

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