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Monetary Policy

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05.11.2015

Inflation Report no. 4, 2015

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Summary

Inflation development

In the third quarter of 2015, the annual inflation rate was 11.1 percent, by 3.1 percentage points more compared to the previous quarter. In September 2015, inflation accelerated to the value of 12.6 percent, exceeding for the seventh consecutive month the upper limit of the inflation target set in the Medium-Term Strategy of Monetary Policy. This pronounced acceleration was mainly due to the increase in regulated prices up to 13.6 percent in September, as a result of the approval of new electricity and gas tariffs and the further increase in medicines prices, in the context of the national currency depreciation. Similar to the previous periods, the upward development of the CPI annual rate was generated by the increasing pressures from food prices and core inflation that accelerated in September up to 12.6 and 13.6 percent, respectively, as a result of the depreciation of the national currency at the end of the previous year and during this year. The contribution from fuel prices was slightly lower to that recorded in the second quarter of 2015. Annual inflation rate in the third quarter of 2015 was by 0.3 percentage points higher than it was anticipated in the projection of Inflation Report no. 3, 2015.

External environment

World economy is getting through a complex period, many indicators reflecting more precarious performances since 2009. The advanced economies remained relatively stable, while the major emerging economies, such as China, Brazil and the Russian Federation have recorded unsatisfactory performances. During the reporting period, the fluctuations of the China's stock exchange indexes have upset the financial markets and the economies of Brazil and the Russian Federation entered into recession. International prices of raw material continued to decrease amid reduced global demand, while the oil prices have seen an exacerbated volatility due to the unsustainability of positive factors and the persistence of those negative. The foreign exchange markets counterbalance has continued, given that the Federal Reserve System has maintained its cautious behaviour and has not increased the interest rates, the disinflationary pressures in Euro area continued to persist, while the currencies of oil exporting countries have reproduced the oil prices development.

Economic developments

In the second quarter of 2015, GDP recorded an increase of 2.5 percent compared to the same period of the previous year, the economic activity dynamics being lower to that recorded at the beginning of this year.

The GDP positive dynamics was mainly favoured by the depreciation of the national currency, which had an important incentive effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the second quarter of 2015, the volume of exports of goods and services was by 4.1 percent higher than that recorded in the same period of the previous year. At the same time, imports recorded a contraction of 4.4 percent. In the second quarter 2015, the demand from population was mediocre, household consumption increasing only by 0.2 percent in real terms. The dynamics of investments determined a substantial negative contribution in the second quarter of 2015. Gross fixed capital formation decreased by 1.5 percent, while the negative contribution from the component change in inventories was more accentuated. By categories of resources, the mitigation of the economic activity in the second quarter of 2015 was determined by the decrease in the positive contribution of "Financial intermediation and insurance" component recorded at the beginning of this year and the contribution from industry and trade. Similar to the previous periods, the industry continued to generate a significant contribution to the dynamics of the economic activity. In this regard, the extractive industry and manufacturing was by 4.4 percent higher during the reporting period compared to the second quarter of 2014. The other branches of the economy recorded positive developments, but their impact on GDP growth was more modest. In the second quarter of 2015, the situation on the labour market has slightly deteriorated compared to the situation recorded in the second quarter of 2014, but improved compared to the beginning of this year.

Monetary policy

In the third quarter of 2015, there were held three meetings of the Council of Administration 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, NBM adopted two decisions by which the base rate was increased by 2.0 percentage points, from the level of 15.5 percent to 19.5 percent, and subsequently it was maintained at the level of 19.5 percent (meeting of 26 August 2015). The decisions to increase the base rate will gradually produce effects in the economy in the coming two-three quarters, being aimed at anchoring inflation expectations and maintaining the inflation close to the target of 5.0 percent over the medium-term, with a possible deviation of ± 1.5 percentage points. In order to sterilize the excess liquidity formed in the last months and improve the transmission mechanism of monetary policy decisions, the Council of Administration decided within the meetings of 30 July and 26 August 2015 to raise the required reserves ratio attracted in MDL and non-convertible currency from the level of 26.0 percent to 32.0 percent and from 32.0 percent to 35.0 percent of the base, respectively.

The growth rates of monetary indicators have decreased in 2015. Thus, in the third quarter of 2015, the growth rate of monetary aggregates was negative, the values recorded being below the growth level recorded in the previous years, the quarterly average in annual terms constituted minus 11.5 percent for M2 (by 0.2 percentage points lower than growth in the second quarter of 2015) and 1.1 percent for M3 (by 1.7 percentage points lower than the previous quarter).

During reporting period, the average annual interest rate on loans in national currency increased by 0.48 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.08 percentage points from the previous quarter, registering values of 12.42 percent for those in national currency and 6.90 percent for those in foreign currency. The average interest rate on deposits in MDL accounted for 11.84 percent, increasing by 1.74 percentage points compared to the previous quarter, while the interest rate on placements in foreign currency constituted on average 2.56 percent, decreasing by 0.53 percentage points compared to the second quarter of 2015.

Medium-term inflation forecasting

According to the current projection, output gap will remain negative for the entire forecasting period. This will be negative, significantly below its potential level. An economic activity below its potential level in the long-term will cause, on medium-term, increased disinflationary pressures from domestic demand.

According to the current projection, the annual growth rate of CPI will record a level of 9.7 percent in 2015 and 11.9 percent in 2016. Compared to the values registered in the Inflation Report no.3, 2015, the average annual values projected for 2015 are higher by 0.4 percentage points and those projected for 2016 by 0.3 percentage points, the same trend will be also maintained in the first two quarters of 2017. The reconfiguration of the annual inflation rate projection is mainly caused by the slightly higher dynamics of the *core inflation*, *food prices* and *oil prices*, these effects being balanced by the lower contribution of *regulated prices* this year and in 2016.

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