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Monetary Policy

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Inflation Report no. 1, 2015

Inflation Report no.1, February 2015 [1]

Summary

Inflation

In the fourth quarter of 2014, the average annual inflation rate was 4.8 percent, by 0.3 percentage points lower compared to the third quarter. Its downward trend was determined by the mitigation of pressures from food prices and regulated prices. The core inflation impact was higher than the previous quarter, it rose to 6.3 percent in December 2014 due to the depreciation of national currency. The contribution from fuel prices increased in the fourth quarter of 2014 due to the conflict in Eastern Ukraine that caused the decrease in coal supply on the market. Both the annual inflation rate and the core inflation rate were within the range of ± 1.5 percentage points from 5.0 percent target stipulated in the NBM Medium-term monetary policy strategy. The annual inflation rate in the fourth quarter of 2014 increased by 0.6 percentage points compared to the projection (4.2 percent) of Inflation Report no. 4, 2014.

External environment

The main conclusion of the study results of 2014 shows that the global growth was lower than initially expected and the prospects for the beginning of 2015 are overshadowed by uncertainties and risks. There have been distinct trends in the advanced economies: while the economies of United States of America and Great Britain have advanced due to the improvement of the labor markets and highly accommodative monetary policies, the recovery in the euro area and Japan was sprayed as a result of the persistent consequences of the financial crisis related to deflationary pressures. China is going through a period of economic mitigation carefully managed and the disappointing growths in other emerging economies and developing economies in 2014 reflected weak external demand and tightening domestic policies, political uncertainties and supply-side constraints. In the region, the situation of the major trading partners' economies is more precarious, as the crisis in the Russian Federation related to the depreciation of the Russian ruble and the consequences of Ukrainian conflict have a significantly contractor impact on the regional economic development.

Economic developments

In the third quarter of 2014, the dynamics of the economic activity was more pronounced compared to that of the first half of the year, so that GDP recorded an increase of 5.9 percent compared to the same period of last year. The economic activity acceleration in the third quarter of 2014 was mainly determined by the

domestic demand. The household consumption increased by 3.8 percent in the reporting period, while the gross fixed capital formation was by 11.5 percent higher than in the third quarter of 2013. During the reporting period, imports decreased by 0.5 percent, despite the increase in domestic demand. For the first time since the crisis in 2009, mainly due to the embargoes imposed by the Russian Federation for domestic products, exports recorded a negative annual growth, decreasing by 2.7 percent compared to the same period of 2013 and thus, decreasing the positive contribution generated by the domestic demand to GDP growth. However, the GDP annual dynamics in the first nine months of 2014 (4.7 percent) was significantly lower than 2013 (9.4 percent). This dynamics was determined by the major effect disappearance of the agricultural production growth in 2013. The evolution of unemployment and employment rate shows an improvement on the labour market of the Republic of Moldova in the third quarter of 2014 compared to the same period of 2013.

Monetary policy

In the fourth quarter of 2014, there were four meetings of the Council of Administration of the National Bank on monetary policy decisions. As a result of assessing the balance of internal and external risks, which could be faced by the Moldovan economy and inflation forecasts in the short and medium terms, there were issued two decisions to maintain the base rate at the level of 3.5 percent (level set at the meeting of April 25, 2013). Within the next two meetings held in December, there were issued two decisions to increase the base rate by 1.0 and 2.0 percentage points respectively, up to the level of 6.5 percent. During the reporting period, there was required a gradual tightening of monetary policy to combat the pro-inflationary pressures from regulated prices and the depreciation of the national currency. The decisions to increase the base rate will produce effects in the economy over the next 2-3 quarters, aimed at anchoring inflation expectations and maintain inflation close to the target of 5.0 percent in medium-term, with a possible deviation of ± 1.5 percentage points.

Growth rates of monetary indicators have decreased during 2014. Thus, in the fourth quarter of 2014, the growth rate of monetary aggregate fell below values recorded in 2011-2013, the quarterly average in annual terms of M2 constituted 0.7 percent (by 11.5 percentage points less than in the third quarter of 2014) and that of M3 accounted for 8.2 percent (by 8.0 percentage points less than in the third quarter of 2014).

During the fourth quarter of 2014, the average annual interest rate of credits balance granted to private sector decreased both in national currency (by 0. 27 percentage points) and foreign currency (by 0.16 percentage points) compared to the third quarter, accounting for 10.58 percent in national currency and for 7.24 percent in foreign currency. The average interest rate of deposits in MDL recorded a level of 7.61 percent in the fourth quarter of 2014, by 0.08 percentage points lower than in the third quarter. The interest rate of deposits in foreign currency amounted to an average of 4.46 percent in the reporting period, decreasing by 0.12 percentage points compared to the previous quarter.

Medium-term inflation forecasting

According to the current projection, the output gap for the fourth quarter of 2014 recorded an insignificant positive level, due to the persistent economic growth that was recorded in the first three quarters of 2014 and the simulative nature of the monetary policy. As from the first quarter of 2015, the output gap will turn negative and will record negative values throughout the entire forecasting period, reaching the minimum value in the first quarter of 2015.

According to the current projection, the annual inflation rate will record the level of 5.8 percent for 2015 and 6.1 percent in 2016. According to the current projection, the annual inflation rate will fall within the range of the inflation target for the entire forecasting period. Although inflation is projected to be tolerable, this will be mostly situated on the upper limit of the range of variation. The maximum value of 6.4 percent will be recorded in the first and second quarters of 2016.

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