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Inflation Report no. 1, 2019

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Summary

The annual rate of inflation shall increase by the end of the current year, afterwards the trajectory will reverse and inflation will decrease by the end of the forecast horizon. In the first quarter of the forecast horizon, it will stay under the range of target variation, however, at the end of 2019 and beginning of 2020, it will increase below the range. In the second quarter of 2020, the annual rate of inflation will return in the range. The core inflation will accelerate by the end of the current year but diminish by the end of the forecast horizon. The annual growth rate of food prices will increase by the end of the current year and decrease during the next year. The annual growth rate of regulated prices will increase, except for the fourth quarter of 2020. The annual growth rate of domestic fuel prices will register a downward trajectory by the end of 2019, then will increase insignificantly at the beginning of 2020 and keep a relatively constant trajectory by the end of the forecast horizon.

The aggregate demand will be pro-inflationary during the first three consecutive quarters and disinflationary for the rest of the forecast period.

Internationally, the end of 2018 and beginning of 2019 plunged in events which generated significant volatility on the financial markets. The price of oil reduced considerably following the rise in oil production by OPEC. This determined OPEC+ to decide in the meeting of 6 December 2018, that starting with 1 January 2019, the production of oil will be reduced by 1.2 million barrels per day compared to the level of October 2018. The international quotes of raw materials were still affected by the trade war between USA and Russia, even if these two countries decided to freeze the import duties until 31 March 2019. The evolution of the US dollar continued to be defined by the monetary policy of the Federal Reserve System, but it depreciated in December based on the FRS signs of intention to moderate the rates of monetary policy tightening in 2019, the collapse of US stock market, as well as the partial shutdown of the American government. The economic evolution of the EU was affected by the following factors: the risk of a no-deal Brexit; the tensions between Italy and the EU on the budget deficit which exceeds the EU regulations and the prolonged protests of "yellow jackets" in France. Since 1 January 2019, the VAT increased in the Russian Federation from 18 to 20%, which contributed to the accentuation of inflationary pressures.

Compared to the previous forecast published in the Report on inflation no 4 of 2018, the current forecast of inflation is insignificantly inferior on the entire forecast horizon, except for the last quarter of 2019 and the first quarter of 2020, where the forecast is similar and respectively, superior. The core inflation was revised

downwards up to the beginning of 2020 and upwards until the end of the forecast horizon. The growth rate of food products was revised upwards for the entire forecast horizon, except for the first quarter of 2019. The current forecast of regulated prices will be insignificantly higher in the first half of the current year and lower for the rest of the forecast horizon. The forecast of the growth rate of domestic fuel prices was revised downwards until the third quarter of 2019 and upwards by the end of the forecast horizon.

In the context of a modest aggregate demand, a rich harvest of certain agricultural crops and appreciation in real terms of the domestic currency against the foreign currency of some trading partner countries, the annual rate of CPI continued its downward trajectory from the beginning of the year, diminishing from 2.4% in September 2018 to 0.9% in December 2018, placing itself under the range of inflation target. Within the CPI subcomponents, the downward trajectory of core inflation continued, being sustained by the appreciation in real terms of the domestic currency against the foreign currencies of some trading partner countries, by the effect of the high base period at the end of 2017, and also by the absence of significant inflation pressures from the aggregate demand. In the fourth quarter of 2018, the core inflation registered values slightly higher than the annual rate of the CPI. The downwards trajectory of the annual rate of food prices during the fourth quarter of 2018 was caused mainly by the decrease in prices of fresh fruits, meat, meat products and by the moderation of growth rates of prices of fresh vegetables. In the fourth quarter of 2018, the annual rate of regulated prices continued to be negative, following the impact caused by some tariff adjustments made in 2018, as well as the persistence of decrease in prices for drugs. The acceleration of the increase in domestic fuel prices until July 2018 was followed by a downward evolution until the end of 2018. The annual rate of inflation registered a low rate compared to the rate anticipated for the fourth quarter of 2018 of the previous forecast round. In the following period, the annual rate of inflation will register an upward trend, following the slight increase of pressures from the aggregate demand, and also from the effects of fiscal policy. In the fourth quarter of 2018, the annual rate of prices in industry continued its downward trajectory from the previous periods.

In the third quarter of 2018, the economic growth got moderated. The GDP growth rate recorded a value of 3.4%, which is 1.8 percentage points less than in the previous quarter. At the same time, the seasonally adjusted series shows a rise of 1.2% in the GDP, compared to the second quarter of 2018. The economic growth, which was mainly supported by the agricultural production and the rise in exports in the last 2 years, was replaced by a growth caused mainly by the investment activity associated to some programs launched at central levels. However, the dynamics in the consumption of population became more modest and subsequently, the demand pressures on prices were insignificant in the reference period, which was confirmed by a modest evolution of inflation. In the third quarter of 2018, the investment component was the main element which contributed to the economic growth. Following the modest evolution of exports in the third quarter of 2018, the operative data of October and November shows contracting signs in the fourth quarter of 2018. At the same time, the volume of imports continued to show a positive dynamics in the second half of the year but more modest than at the beginning of 2018. In terms of resource categories, the growth of GDP in the third quarter of 2018 was caused mainly by the positive contribution of the evolution of constructions. The operative indicators for the period October – November 2018 outlined preconditions to continue the economic growth in the fourth quarter of 2018, as well. Similarly to the previous quarter, in the third quarter of 2018, the economically active population and the employed population recorded a significant growth, mainly due to the developments in the agricultural sector. At the same time, the number of unemployed was lower than in the similar period of the previous year.

In September – December 2018, the annual dynamics of the national public budget revenues registered an increasing downward trajectory of 2.4% compared to the similar period of 2017. The expenditures of the national public budget also registered positive evolutions with rises of 8.4% compared to the similar period

of 2017. In addition, the market conditions maintained the increasing trend of interest rates of allocated state securities, which increased insignificantly in the fourth quarter of 2018 for all types of maturities.

In the fourth quarter of 2018, the excess liquidity totalled MDL 8.0 million, which represents a decrease of MDL 1.3 billion compared to the previous quarter. This volume of excess liquidity was mainly generated by money emissions, following the interventions of the NBM on the foreign exchange market in the previous periods.

The monetary aggregates in the fourth quarter of 2018 recorded a stable positive dynamics compared to the previous quarter. At the same time, the main contribution to this evolution was brought by the modification of sight deposits, both in domestic and foreign currency.

Following the trend of the base rate applied to the main operations of monetary policy of the National Bank of Moldova and the surplus of liquidity registered in the banking system, the average interest rates accepted by the licensed banks for loans and deposits continued their downward trend.

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