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Inflation Report no. 2, 2024

The Governor of the National Bank of Moldova, Anca Dragu presents the Inflation Report no. 2, 2024

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SUMMARY

Inflation

The restrictive conduct of monetary policy promoted during 2021-2022 has conditioned the return, in October 2023, and the maintenance of inflation within the variation range of ±1.5 percentage points from the medium-term target of 5.0%. Thus, in the first three months of this year, the annual inflation rate continued the downward trend that started at the end of 2022. At the same time, in the first quarter of 2024, the annual inflation rate was marginally lower than it was anticipated in the Inflation Report, February 2024. The annual inflation rate declined from 4.2% in December 2023 to 3.9% in March 2024. It increased to 4.6% in the first month of this year, after which it resumed the trend observed during the previous year. As a result, similar to the fourth quarter of 2023, the annual inflation rate was within the variation range of ±1.5 percentage points from the medium-term target of 5.0%. At the same time, the average annual inflation rate amounted to 4.3% in the first quarter of 2024, by about 1.1 percentage points lower than in the previous quarter. The downward trajectory of inflation at the beginning of this year and its maintenance within the variation range of ±1.5 percentage points from the medium-term target of 5.0% in the first quarter of 2024 was supported by a modest domestic demand, which exerted disinflationary pressures on prices, amid mediocre real disposable income growth of the population and uncertainty in the region. Disinflationary pressures continued to be driven by the trajectory of food prices on the international market, but also by the effects of the previous year's rich harvest. A certain impact was generated by the decrease in some utility tariffs in the first part of the year, as well as by the effects of compensations granted to the population for energy resources during the cold period of the year. At the same time, inflationary pressures in the first three months of this year were driven by the adjustment of fiscal policy and by some adverse sectoral shocks.

In the recent period, the downward trend in the annual rate of industrial prices has continued, thus paving the way for a moderation of their pressures on the prices of some subcomponents of the CPI in the period ahead. In addition, domestic demand will continue to exert a disinflationary impact, which will be mitigated by the effect of the end of the period of tariff compensation for the population. The way tariffs are adjusted, the tense situation in the region and the risks of its escalation keep the inflation forecast highly uncertain.

External environment

The beginning of 2024 in the world economy was characterized by heightened geopolitical tensions and persistent inflationary pressures. Oil prices rose substantially in the early months of 2024 due to OPEC+ controls on production volumes, the avoidance of Red Sea navigation by oil tankers, and heightened tensions in the Middle East. Inflationary pressures have proved more persistent, in particular core inflation pressures, reducing financial markets' expectations of a rapid decline in interest rates. For example, in the USA in March 2024, the annual inflation rose to 3.5%, which shifted expectations of the first FRS interest rate cut from June to November 2024. Food prices on the international market have reversed the downward trend and are on a slight upward trend. Natural gas prices have also periodically risen due to increased purchases in Asia, which has contributed to a decrease in supply for Europe. Gas stocks in Europe, however, remain at peak levels after a mild winter season and falling industrial gas consumption. Economic growth continues to be globally dispersed. For example, statistical data shows that the US economy is in good shape, which will allow the FRS to maintain high rates for a while longer. In Europe, the economic growth is weak after the constant crises of recent years. In the region, the economic growth continues to be disrupted by the aftermath of the war in Ukraine.

Economy

In the fourth quarter of 2023, the GDP recorded an insignificant annual increase, which was only 0.2% higher than in the same period of the previous year. The modest dynamics of the economic activity was mainly supported by the rich harvest in the agricultural sector in 2023, which created conditions for increased exports of agricultural products. At the same time, some developments in the communications, social services, accommodation and food services sectors should also be mentioned. However, domestic demand is weak, signaled by a non-essential increase in household consumption and investments, in the context of a mediocre real income growth and increased uncertainty in the region. Less optimistic signals regarding the economic activity are also confirmed by the negative dynamics of industry, construction, trade and transportation. At the same time, the seasonally adjusted series reflects a zero GDP dynamics compared to the third quarter of 2023. The National Bureau of Statistics revised the annual rates for the previous periods. Thus, the values of -2.4%, -2.2%, and 2.6% for the first, second, and third quarters have been revised upward to -0.9%, -0.3%, and 3.3%, respectively. As a result, the GDP increased by 0.7% in 2023 compared to 2022. In this context, similar to the previous year, aggregate demand pressures on prices exerted a disinflationary impact.

Monetary policy

In the first quarter of 2024, excess liquidity amounted to MDL 12.3 billion, up by MDL 2.8 billion compared to the previous quarter.

The M3 monetary aggregate, in the first quarter of 2024, grew at an annual rate of 17.9%. The main contribution is provided by the balance of deposits in national currency.

During the first quarter of 2024, two meetings of the Executive Board of the National Bank of Moldova were held on monetary policy decisions. Following the assessment of the internal and external balance of risks and the inflation outlook in the short- and medium-term, the Executive Board of the National Bank of Moldova, at its meetings on February 6, 2024 and March 21, 2024, decided to lower the base rate applied to the main monetary policy operations by 0.50 percentage points consecutively, up to the level of 3.75% annually.

At the same time, during the regular monetary policy meeting on May 7, 2024, the Executive Board of the National Bank of Moldova adopted by an unanimous vote the decrease of the base rate applied to the main short-term monetary policy operations by 0.15 percentage points, setting the level at 3.60% annually. Rates on overnight loans and deposits were lowered by the same magnitude, setting the levels at 5.60% and 1.60% annually, respectively. At the same time, the required reserves ratio of funds attracted in MDL and non-convertible foreign currency and that of funds attracted in freely convertible foreign currency for two consecutive periods of application of reserves was lowered to 29.0% and 39.0% of the calculation base, respectively.

This decision was taken in the context of a gradual adjustment of monetary policy in order to continue to stimulate lending and support domestic aggregate demand by encouraging consumption and investments, balancing the national economy and anchoring inflationary expectations, with the aim of keeping inflation within the variation range from the medium-term target.

In the first quarter of 2024, within the national currency segment, weighted average interest rates on new loans and on term deposits continued to decrease, also under the impact of the transmission mechanism of the consecutive base rate cuts applied to the main monetary policy operations. Thus, the weighted average rate on loans amounted to 9.66% and that on deposits to 3.91%, down by 4.63 and 7.85 percentage points, respectively, compared with the first quarter of 2023.

Average interest rates on the balance of loans in national currency recorded decreases compared to the previous quarter by 0.88 percentage points, down to the level of 9.69%, and on deposits – by 2.44 percentage points, down to the level of 4.80%. Average interest rates on loans and deposits in foreign currency had remained practically at the same levels.

Medium-term inflation projection

The current round of forecast anticipates that external demand will remain moderate compared to historical averages, and external inflation will continue to fall towards the levels targeted by the monetary authorities. Interest rates in the region and globally will fall, but not as rapidly as anticipated. The US dollar will continue to appreciate as a result of the continued high levels of FRS interest rates, the satisfactory performance of the US economy relative to other economies, but also the increased attractiveness of the US dollar amid heightened geopolitical tensions worldwide. The Russian ruble will continue to depreciate due to the rebalancing of purchasing power parity, but also increasing difficulties in circumventing economic sanctions and working with new outlet markets. Oil prices on the international market will remain at high levels due to geopolitical tensions, but also the extension of the OPEC+ agreement to limit oil production by 2.2 million barrels per day until June 2024, which could create a significant shortage of oil on the world market in the second half of 2024. Natural gas prices will continue to be susceptible to the smallest supply shocks, and food prices on the international market will increase moderately compared to the highs of previous years, due to ample supply in some segments.

In the current round of forecast, the inflation risks identified are associated with heightened tensions in the Middle East and possible temporary supply shocks on the food price formation on the international market. At the same time, situations such as the mutual destruction by drone strikes of energy production and processing capacities in the context of the war in Ukraine, the monetary policy of the FRS and the geopolitical configuration after the 2024 elections are also taken into account.

The annual inflation rate will continue to slightly decline in the first quarter of the forecast, then it will increase until the beginning of the next year, after which it will decrease insignificantly until the end of the forecast horizon[1], except in the fourth quarter of 2025, when it will increase only slightly. Over the forecast horizon[2], the annual inflation rate will oscillate close to the target of 5.0% and remain within the variation range. The annual core inflation rate will continue on an upward trajectory during the first two quarters of the forecast period, after which it will decline towards the end of the forecast period, except in the last quarter, when it will slightly increase. The annual rate of food prices will follow a relatively stable trend throughout the forecast period. The annual rate of regulated prices will continue to decline in the first quarter of the forecast, after which it will trend upward until the beginning of the next year, followed by a steady decline until the end of the forecast horizon, except in the fourth quarter of 2025, when it will increase insignificantly. The annual growth rate of fuel prices will continue its upward trend until the end of this year, after which it will decline towards the end of the forecast horizon.

The negative aggregate demand, over the entire forecast horizon, will be, largely, due to tight real monetary conditions and, to a lesser extent, the negative impact of external demand. The positive fiscal impulse over the same period will mitigate the downward revision of domestic demand.

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

The current inflation forecast, relative to that in the Inflation Report, February 2024, has been revised insignificantly upward for the comparable period[3], except for the second quarter of 2024, where it is similar, and the third quarter of 2025, where it is lower. The annual rate of core inflation has been revised upward throughout the comparable period, except for the last quarter. The current forecast for the annual rate of food prices has been increased over the entire comparable period, except for the second quarter of 2025, where it is lower. The annual rate of regulated prices is revised downward for the entire comparable period, except for the second and fourth quarters of 2025. The forecast for the annual rate of fuel prices has been increased until the second quarter of 2025 and decreased towards the end of the comparable period.

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1. First quarter of 2026

2. Second quarter of 2024 – first quarter of 2026

3. Second quarter of 2024 – fourth quarter of 2025

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Ссылки по теме:

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