

Inflation report 2018/3 (Monetary Policy Program Q3, 2018, Status report on Implementation of the Monetary Policy Program Q2, 2018)

2018-08-27

Executive summary

In the second quarter of 2018 inflation slowed down to a certain extent, driven by the fall in prices of seasonal products. However, under current monetary policy, the 12-month inflation rate is expected to increase over the second half of the year, remaining within the confidence band; in the forecast horizon it will stabilize around the 4% target.

Positive developments in the macroeconomic environment carrying on in the short run will largely facilitate the fulfilment of the 12-month inflation target, owing to the effect of persisting expansionary monetary policy and relatively high economic activity, although domestic demand and inflation in the external sector weakened to some extent. The inflation environment remained low in the past period of the year and the 12-month inflation mostly fluctuated within the lower part of the confidence band. The core inflation and short-term inflation expectations have reduced as well, influenced by the change in the supply in some product markets. It is estimated that inflation expectations will also increase and stabilize around the target, as inflation recovers. In view of the actual and predictable macroeconomic developments, in particular, the need to strengthen the domestic demand recovery, the Board of the Central Bank decided to keep the refinancing rate unchanged, leaving the monetary policy direction expansionary.

In the light of predicted macroeconomic developments, the Central Bank estimates that maintaining the monetary environment expansionary in the upcoming period will be needed, while considering that it will gradually eliminate in the medium run.

High economic activity was persisting over the first half of 2018, mainly due to strong growth of investments in the private sector. The estimation is that these trends will continue over the short term, on the basis of which the Central Bank has revised the year's economic growth forecast upside. In the mid-term perspective, the growth will approach its long-term equilibrium.

According to the baseline scenario, mid-term economic growth trends will largely depend

on the economy's fundamentals, investment activity and an increase of production capacities in 2017-2018, the pace of Government-led structural reforms, and the anticipated potential of economic growth in partner countries.

Risks to inflation and economic growth in the short run and medium run are dual-sided and estimated to be balanced (see subsection 2.2.4 "Main assumptions and risks").

If the event risks deviate from the prediction, the Central Bank will react by adjusting its monetary conditions accordingly.

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