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Inflation Report no. 1, 2020

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Summary

In the fourth quarter of 2019, the annual inflation rate continued its upward trajectory since the beginning of 2019, increasing from 6.3% in September 2019 to 7.5% in December 2019. This evolution was favored by some positive contributions from food and regulated prices, as well as, pressures from aggregate demand. The upward dynamics of food prices was mainly determined by the less favorable weather conditions in the summer of 2019 for certain crops, but also by the increase in production costs of processed foods. The annual rate of regulated prices continued its positive dynamics as a result of the increase of electricity tariff in the second half of August. To a lesser extent, the increasing trend in the annual CPI rate was influenced by the core inflation. The rise in core inflation, as well as, food prices was supported by aggregate demand pressures. These, according to estimates, were, however, declining compared to previous periods. The appreciation trend of the national currency has eased from the pressures mentioned above. At the same time, the unusual hot weather recorded in October-December 2019 caused the delay and decrease in intensity of the positive seasonal effect associated with food and fuel prices. Starting with October 2019, the annual CPI rate was above the upper limit of the inflation target range. The average annual inflation rate in the fourth quarter of 2019 was lower than expected. In the next period, the annual CPI rate will start a downward trend, largely due to the effect of a high base period in the previous year. Following the upward

trend in the first half of the year, in the fourth quarter of 2019 the annual rate of prices in industry registered a slightly downward trajectory, thus outlining premises for reducing the annual growth rate of some subcomponents of the CPI in the following periods.

The year 2019 ended on a slightly positive note, the main indicators of international importance improving insignificantly, even if the risks remained at a very high level. In the foreground, in the fourth quarter of 2019, the negotiations between the US and China were highlighted, which resulted in the signing of a preventive trade agreement on 15 January 2020. After the victory of the British Conservative Party in the parliamentary elections of 12 December 2019, Brexit has become a certainty, already working on procedural issues. OPEC+ decided at its regular meeting on December 5-6, 2019 to further reduce oil production by another 0,5 million barrels per day, to support oil prices affected by declining global demand. Oil prices were also favored by the enhancement of geopolitical tensions in Libya and Iran, with the Brent price reaching USD 70 per barrel in early 2020. Food prices also significantly increased in the second half of 2019, the main influencing factors were supply issues, poor agro-meteorological conditions and rising oil prices. Another factor that favored the increase in quotations for raw materials and food at the end of 2019 was the significant depreciation of the US dollar, due to the enhancement of political risks in the US before the 2020 presidential elections, the announcement of the need to introduce new trade taxes and maintaining the federal funds rate in the range of 1.50 - 1.75%, following the Fed meeting on December 11, 2019. In the region, the end of 2019 was characterized by the appreciation of the Russian ruble favored by the fiscal period, the increase in oil prices and the demand for risky assets.

The positive dynamics of economic activity continued in the third quarter of 2019. However, its growth rate, as expected, was more modest compared to the first half of this year. Thus, the GDP growth rate registered the value of 4.3%, being by 1.5 percentage points lower than in the second quarter of 2019 and marginally lower than anticipated in the previous round of forecasts. At the same time, the seasonally adjusted series reflects a 1.1% increase in GDP, compared to the second quarter of 2019. The positive evolution of GDP was mainly due to an acceleration in household consumption, which was also reflected in the increasing added value in the commercial sector. At the same time, a more pronounced impact was exerted by the dynamics of exports, which were supported by the performance in the agricultural sector. Investments continued to have a significant impact on economic growth, but somewhat more modestly than in the previous period. Their positive evolution led to an increase in gross value added in the construction sector in the third quarter of 2019. At the same time, during the reference period, the dynamics of agriculture had a major impact on GDP growth. Regarding the estimation of economic activity at the end of 2019, the available operational indicators reflect premises for moderating GDP growth in the fourth quarter of 2019. The operational indicators on industrial production for October-November 2019 outline preconditions for a positive but more modest contribution in the fourth quarter of 2019. At the same time, in the first two months of the quarter there was a contraction of the volume of transported goods. At the same time, the internal trade continued to register a positive dynamic during the fourth quarter of 2019. Regarding the developments in the labour market, in 2019, in the research methodology "Labor Force Survey" there were made some changes that complicate the interpretation of data and namely the delimitation of information on the business cycle.

In the fourth quarter of 2019, the annual dynamics of the revenues of the national public budget registered an upward trajectory, increasing by 15.3% compared to the similar period of 2018. The expenditures of the national public budget also had positive evolutions, increasing with 2.7% compared to the similar period of 2018. At the same time, on the allotted government securities market, during the fourth quarter of 2019, interest rates registered minor increases on all types of maturities.

In the fourth quarter of 2019, the excessive liquidity amounted to 6.0 billion MDL, increasing compared to the previous quarter by 0.64 billion MDL.

The monetary aggregates in the fourth quarter of 2019 followed a positive dynamic in annual terms. At the same time, the main contribution to this evolution was largely determined by the change in the volume of money in circulation and sight deposits in both MDL and foreign currency.

At the meeting of December 11, 2019, the Executive Board of the National Bank of Moldova decided to reduce the base rate applied to the main monetary policy operations by 2.0 percentage points, to 5.5% annually.

The average interest rates accepted by licensed banks for loans continued their decreasing trend. Average interest rates on the balance of deposits in both national currency and foreign currency increased slightly.

After several quarters in which external factors of a disinflationary nature predominated, in the current forecast round the external environment reflects a symbiosis between an external demand that continues to be relatively low and the increase of international oil and food prices. At the same time, the international foreign exchange market will continue to show low volatility. Several uncertainties have been clarified towards the end of 2020 (Brexit, US-China trade agreement), but the intensity of geopolitical risks has increased with implicit repercussions on international prices.

The annual inflation rate starting with the first quarter of forecast (maximum level 6.8% in the first quarter of 2020) will decrease continuously until the beginning of 2021 (minimum level 3.0% in the first quarter of 2021). Starting with the second quarter of 2020, it will return to the interval and will remain within it for two consecutive quarters. Starting with the fourth quarter of 2020, it will leave the corridor for three consecutive quarters, after which it will increase slightly and return to the lower level of the corridor towards the end of the forecast horizon. The core inflation will decline insignificantly this year and early next year, but will remain relatively stable towards the end of the forecast horizon. The annual growth rate of food prices will decrease significantly until the beginning of next year, after which, by the end of the forecast horizon, it will increase insignificantly. The annual rate of regulated prices will be relatively low over the entire horizon. It will increase slightly in the first half of this year, after which it will decrease until the first quarter of 2021. Subsequently, it will increase towards the end of the forecast horizon. Fuel prices will register insignificant increases in 2020 and a slight decrease next year, except for the last quarter.

The aggregate demand, although declining, it will be pro-inflationary during the first three consecutive quarters of the current year and disinflationary from the fourth quarter of this year until the end of the forecast horizon.

The real monetary conditions will be restrictive on the aggregate demand over the entire forecast period.

The current inflation forecast is lower for the entire comparable period[1], but maintains the path of the previous trajectory. The core inflation was revised downwards for the entire forecast period, except for the second and third quarters of 2021. The annual rate of food prices was revised downwards for the entire comparable period. The current forecast of regulated prices is lower for the whole comparable period, except for the fourth quarter of 2020. The forecast of the annual rate of fuel prices has been revised upwards for the current year, and downwards for the rest of the comparable period.

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https://www.bnm.md/ro/node/60753

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