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Inflation Report no. 3, 2020

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Summary

In the second quarter of 2020, the annual inflation rate continued its downward trajectory from the beginning of the current year, decreasing from 5.9 percent in March to 4.3 percent in June and thus remaining in the range of 5.0 percent ± 1.5 percentage points stipulated in the medium-term Monetary Policy Strategy of the National Bank of Moldova. This development was supported by the decline in positive contributions from food prices, fuel prices and core inflation. The downward dynamics of food prices was determined by the effect of a high base period in April and May 2019 associated with potato prices. The decrease in fuel prices was generated by the decrease in oil prices on the international market. Negative expectations, but also restrictions on stopping the spread of COVID-19 have led to a disinflationary impact from domestic demand, associated with the appreciation of the national currency, have supported the decline in the annual rate of core inflation. Regulated prices outlined a relatively stable dynamic during the reporting period. Towards the end of the second quarter of 2020, in the context of the preconditions for increasing prices for bakery products, but also for unfavorable agro-meteorological conditions for some agricultural crops, certain inflationary pressures from food prices were outlined, which could manifest themselves in the next period. At the same time, they will be mitigated by the disinflationary pressures associated with domestic demand that will continue in the next period in the context of the impact of COVID-19. At the same time, the subsequent dynamics of the CPI remain marked by the preconditions for lower tariffs and the uncertainty of the timing and magnitude of their adjustment.

In the second quarter of 2020, the world economy experienced the deepest recession of the last century. In April, the world economy virtually stopped under the conditions of quarantine related to COVID-199, and only since the second half of May some countries eased the restrictions imposed by the pandemic, and certain sectors of the economy have resumed their activity. The most affected was the services sector, in particular the tourism, air passenger transport and other related activities. This led that the IMF further reduce its forecast for the evolution of the world economy this year, anticipating a contraction of 4.9 percent worldwide, of which 8.0 percent in advanced economies and 3.0 percent in emerging economies. In 2021, the IMF anticipates a substantial economic growth, but not enough to reach pre-pandemic levels. Currently, the biggest challenge for the world economy is to create a vaccine against COVID-19, which would help return to normalcy.

The US dollar gradually depreciated with the lifting of bans imposed in the context of the pandemic in several economies, further registration of a large number of COVID-19 infections in the US and the uncertainties related to the US presidential elections. Another factor that disrupted the foreign exchange market was the escalation of tensions between the US and China.

The single European currency appreciated after the ECB increased its Pandemic Emergency Purchase Programme (PEPP) package by EUR 600 billion to a total of EUR 1,350 billion at its meeting on 4 June 2020. At the same time, discussions within the European Commission on the EUR 750 billion emergency package have boosted investor confidence regarding the fiscal consolidation of the euro area.

At the same time, in April, both the countries participating in the OPEC + agreement and the US and other oil-producing countries decided to limit oil production by 9.7 million barrels per day until June 2020, in order to eliminate the excessive surplus following the sharp decline in world demand. This agreement was extended, by the same quota, by OPEC + at the June regular summit for another month, and for August it was decided to limit oil production by 7.7 million barrels per day, due to the gradual recovery of world demand. These concerted actions by oil producers allowed oil prices to rise above USD 40 / barrel.

At the beginning of 2020, economic growth was modest, but higher than at the end of the previous year. At the same time, it was higher than expected in the forecast round for April 2020. Thus, in the first quarter of 2020, the GDP was 0.9 percent higher than in the same period of 2019. At the same time, the seasonally adjusted series reflects a 0.5 percent increase in GDP compared to the fourth quarter of 2019. The evolution of GDP was due to a pronounced impact generated by investment dynamics, which was offset by the negative contribution from domestic consumption and net exports. The negative dynamics of household consumption exerted disinflationary pressures at the beginning of this year, a fact reflected by the modest values of core inflation. The acceleration of the investment component was reflected in the significant growth of the construction sector. The other sectors of the economy showed a more modest dynamic. In the second quarter of 2020, mostly, in the context of measures to stop the spread of COVID-19 and its impact on the economic activity, the GDP will register a negative dynamic, a fact reflected by most of the economic indicators published for the period April-May 2020. Thus, the indicators on industrial production, transport, domestic and foreign trade decreased sharply in the second quarter of 2020 compared to the same period of the previous year. At the beginning of this year, the main indicators on the labour force continued the negative dynamics observed in the previous year. In this regard, the economically active population and the employed population decreased compared to the first quarter of 2019.

In the second quarter of 2020, the revenues of the national public budget decreased, being by 8.7 percent below the level recorded in the similar period of 2019. The expenditures of the national public budget also decreased, being lower by 0.1 percent compared to the second quarter of 2019. At the same time, interest rates in the government securities market decreased on all types of maturities during the second quarter of 2020. In the second quarter of 2020, the excessive liquidity amounted to MDL 6.1 billion, decreasing compared to the previous quarter by MDL 0.58 billion.

The monetary aggregates in the second quarter of 2020 registered a positive dynamic in annual terms. At the same time, the main contribution to this development was largely determined by the change in the volume of sight deposits both in the national currency and in foreign currency.

The Executive Board of the National Bank of Moldova, at its meetings of 11 May 2020 and 11 June 2020, decided to maintain the base rate applied to the main monetary policy operations at the level of 3.25 percent per year (level set at the meeting of March 20, 2020).

Average interest rates on the balance of loans and deposits in national currency continued their downward trend. Average interest rates on loans and deposits in foreign currency registered minor changes.

In the current forecast round, the external environment assumptions imply a low external demand, a gradual increase in commodity quotations and the depreciation of the US dollar. Compared to the previous

forecast round, the expectations on foreign demand and the foreign exchange market continue to be disinflationary, but the forecast values for commodity quotations show pro-inflationary signals.

The annual inflation rate will be relatively stable throughout the forecast period. Being in the lower half of the variation range, it will reach the target only in the middle of 2022.

Core inflation will be relatively stable until the end of next year, after which it will increase towards the end of the forecast horizon. The annual growth rate of food prices will accelerate until the first quarter of next year. Starting with the second half of 2021, it will have a downward trend towards the end of the forecast horizon. The annual rate of regulated prices will decrease until the first quarter of next year, after which it will have an insignificant upward trend. The annual rate of fuel prices will increase until the third quarter of 2021, stabilizing later.

Aggregate demand will generate disinflationary pressures until the third quarter of 2021, mainly due to the measures imposed by the authorities to prevent a pandemic crisis and reduce budget expenditures compared to anticipated levels, subsequently registering positive values towards the end of the forecast horizon.

Real monetary conditions will have a restrictive effect on aggregate demand over the entire forecast period.

The current inflation forecast is higher practically over the entire forecast horizon, except for the third and fourth quarters of 2021. The core inflation has been revised upwards over the entire forecast horizon, except for the fourth quarter of 2021. The annual rate of food prices has been revised upwards over the entire forecast period. The current forecast of regulated prices is lower until the third quarter of 2021 and will register similar values towards the end of the forecast period. The forecast for the annual rate of fuel prices has been revised insignificantly downwards over the entire forecast period, except for the first quarter of 2022.

The forecast made is dominated by major risks the materialization of which can influence the evolution of inflation in the medium term. The risks associated with it are both disinflationary and proinflationary. At the same time, it is worth drawing attention to disinflationary risks such as the uncertainty about the timing and magnitude of the adjustment of tariffs for regulated services, and the appreciation of the national currency observed recently. Coupled, the risks mentioned above may prevail over the others and move the inflation trajectory below the forecast level.

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