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Inflation Report no. 3, 2024

Guvernatoarea BNM, Anca Dragu prezintă Raportul asupra inflației nr. 3, 2024

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Summary

Inflation

From April to May 2024, the annual inflation rate continued its downward trend, temporarily leaving the range of ±1.5 percentage points from the 5.0% target in May and returning within it in June. In the second quarter of 2024, the annual inflation rate was lower than the value anticipated in the Inflation Report, May 2024. The annual inflation rate decreased from 3.9% in March 2024 to 3.3% in May 2024, thus falling below the lower limit of the inflation target variation range. This can also be attributed to the specific features of the transmission mechanism of monetary policy actions, the delayed implementation of certain budgetary expenditures, but also to the delay in the adjustment of some regulated tariffs. Subsequently, in June 2024, the annual CPI rate increased to 3.8%, thus returning to the above-mentioned range. At the same time, the average annual inflation rate amounted to 3.5% in the second quarter of 2024, about 0.8 percentage points lower than in the previous quarter. The downward trajectory of the annual inflation rate in the second

quarter of 2024 was supported by subdued domestic demand, which exerted disinflationary pressures on prices. Disinflationary pressures continued to be driven by the trajectory of international food prices, but also by the domestic agricultural and industrial output prices, as well as by the reduction of some tariffs. In these conditions, inflationary pressures on the annual CPI inflation rate, during the reference period, were mainly supported by some adverse sectoral developments.

Recently, the downward trend in the annual rate of industrial prices has continued, thus paving the way for a moderation of their price pressures on some CPI subcomponents in the period ahead. In addition, domestic demand will continue to exert a disinflationary impact in the coming period, although this will be tempered by some tariff adjustments. The manner in which tariffs are adjusted, as well as the tense situation in the region and the risks of its escalation, keep the inflation outlook highly uncertain.

External environment

In its latest report[1] the IMF cautioned that the varied dynamics of economic activity, since the beginning of this year, have somewhat narrowed the output gap between economies, as cyclical factors diminish, and activity becomes better aligned with its potential. The persistence of high service prices is delaying progress towards disinflation, which complicates the normalization of monetary policy. Inflationary risks remain elevated, increasing the prospect of higher interest rates for longer periods amid escalating trade tensions, political and geopolitical uncertainties. Global activity and world trade strengthened at the beginning of the year, with trade being boosted by strong exports from Asia, particularly in the technology sector. In the United States of America, after a sustained period of strong performance, a sharper-than-expected slowdown in growth reflected moderating consumption and a negative contribution from net trade. In contrast, Europe saw some sectoral economic recoveries, notably an improvement in services activity. In China, the revival of domestic consumption in the first quarter was supported by what seemed to be a temporary pick-up in exports, which has belatedly regained its connection with last year's global demand growth.

International prices have shown low volatility in recent months and remain at relatively high levels. At the same time, the dissipation of the base year effect is reversing the upward trend in international quotations. In the region, the harvest could be jeopardized by poor agrometeorological conditions of this year, which have damaged some agricultural crops. In June 2024, the ECB reduced the monetary policy rate in an attempt to stimulate economic activity and in anticipation of a decrease in the annual inflation to the 2.0% target. At the same time, electoral changes in the European Union and expectations regarding the outcome of the November 2024 presidential elections in the USA determine the current trajectory of the EUR/USD exchange rate. Another factor driving fluctuations is the anticipation of the start of interest rate cuts by the FRS. It should be noted that the Russian ruble has appreciated recently due to new sanctions related to foreign exchange transactions and measures taken by the Russian authorities to stabilize the domestic market.

Economy

In the first quarter of 2024, the annual GDP dynamics returned to positive territory after the slight decline in the last quarter of the previous year. Thus, in the first quarter of 2024, GDP increased by 1.9% compared to the same period of 2023. This dynamics was insignificantly higher than that anticipated in the Inflation Report, May 2024. This development of economic activity was supported by the previous year's rich harvest in the agricultural sector, which had a positive impact on some branches at the beginning of this year, as

well as by a positive impact from industry. Positive developments in the information and communication, accommodation and food services sectors are also worth mentioning. However, domestic demand continued to be modest, a fact signaled by subdued developments in household consumption and investment amid increased uncertainty in the region and despite the rise in household incomes. Less optimistic signals regarding economic activity are also confirmed by the negative trends in transportation, real estate transactions, but also by a decline in net taxes on products. At the same time, the seasonally adjusted series reflects a 2.5% GDP growth compared to the fourth quarter of 2023.

It should be noted that the NBS revised the annual rates for the previous periods. Thus, the values of -0.9% and 0.2% for the first and fourth quarters of 2023 have been revised to -0.4% and -0.2%, respectively. The revision of the rates did not change annual GDP growth in 2023 (0.7% compared to 2022). In this context, similar to the previous year, during this period the aggregate demand pressures on prices exerted a disinflationary impact.

Monetary policy

In the second quarter of 2024, excess liquidity amounted to MDL 10.0 billion, down by MDL 2.4 billion compared to the previous quarter.

In the second quarter of 2024, the M3 monetary aggregate recorded an annual growth rate of 15.7%. The main contribution was provided by the balance of deposits in the national currency.

During the second 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 balance of internal and external risks and the inflation outlook in the short- and medium-term, the Executive Board of the National Bank of Moldova, at its meeting on May 7, 2024, decided to reduce the base rate applied to the main monetary policy operations by 0.15 percentage points, setting the level at 3.60% annually. The rates on overnight loans and deposits were lowered by the same magnitude, setting their levels at 5.60% and 1.60% annually, respectively.

At the same time, the required reserve ratio of the funds attracted in MDL and non-convertible foreign currency and that of the funds attracted in freely convertible foreign currency for two consecutive periods of reserve application was lowered to 29.0% and 39.0% of the calculation base, respectively. Subsequently, at the meeting on June 20, 2024, it was decided to maintain the base rate at the level of 3.60% annually.

Also, during the regular monetary policy meeting on August 6, 2024, the Executive Board of the National Bank of Moldova decided, by an unanimous vote, to maintain the base rate at the level of 3.60% annually, respectively, the rates on standing facilities were maintained. The required reserve ratio of funds attracted in MDL and non-convertible foreign currency and that of funds attracted in freely convertible foreign currency, remained unchanged at 29.0% and 39.0% of the calculation base, respectively.

This decision was taken in the context of the continued spillovers effects from previous monetary policy decisions, given the lags in their transmission. At the same time, the decision was influenced by the actual monetary conditions prevailing in the deposit, credit and foreign exchange markets, which indicated a favorable situation for ensuring that inflation remained within the variation range of ±1.5 percentage points of the 5.0% medium-term target. The cumulative monetary policy stimulus measures, both the consecutive reduction of the base rate and the decrease of the required reserve ratio, will increase excess liquidity in the banking system by the end of this year. The current and projected volume of liquidity will allow banks to lend to economic agents and households, as well as to invest in state securities.

In the second quarter of 2024, on the national currency segment, the weighted average interest rates on new loans and on term deposits continued their downward trend under the impact of the cumulative monetary policy stimulus measures. Thus, the weighted average rate on loans amounted to 9.08% and that on deposits – 3.24%, decreasing by 4.1 and 4.05 percentage points, respectively, compared to the second quarter of 2023.

The average interest rates on the balance of loans in national currency decreased compared to the previous quarter by 0.35 percentage points, reaching 9.34% and on deposits by 0.79 percentage points to 4.01%. The average interest rates on loans and deposits in foreign currency decreased by 0.16 percentage points, reaching 6.61% and 2.04%, respectively.

Medium-term inflation projection

In the current forecasting round, the assumptions regarding the external environment reflect an uncertain situation with weak economic growth trends. As inflation in advanced economies has fallen to the levels targeted by their monetary authorities, monetary easing is expected to either begin or continue. At the same time, inflation has bottomed out in many emerging economies and given the intensification of inflationary pressures, a gradual shift in the monetary cycle is expected. Exchange rates will continue to be influenced by the differential between interest rates, geopolitical tensions and the outcome of the US presidential elections in November 2024. International oil and natural gas prices will remain at relatively high levels, but they will exhibit low volatility. Prices of metals and other agroindustrial raw materials will be affected by global demand, especially demand from China. Food prices will follow a slight upward trend due to the jeopardization of some harvests caused by adverse agrometeorological conditions of this year.

The annual inflation rate will have a relatively stable trend for the whole forecast period[2]. Inflation will fluctuate slightly near the target of 5.0% and remain within the variation range throughout the forecast horizon. The maximum value will be recorded in the first quarter of 2025 and the minimum value in the second quarter of 2026. The annual growth rate of core inflation will continue to increase slightly in the first forecast quarter, after which it will decline until the third quarter of 2025 and then increase gradually towards the end of the forecast horizon[3]. The annual rate of food prices will have a slight upward trend until the third quarter of 2025, after which it will show a downward trend until the end of the forecast period. The annual rate of regulated prices will increase rapidly until the first quarter of 2025, after which it will decline over the next three consecutive quarters, and then remain stable until the end of the forecast horizon. The annual rate of fuel prices will have a relatively stable trend at low levels throughout the forecast period.

Aggregate demand will be negative for the entire forecast period due to dry conditions in the summer of 2024, the cumulative real appreciation of the national currency, and relatively weak external demand this year and early next year. The low real interest rate, the positive fiscal impulse, the rich agricultural harvest of fruits and vegetables in the second quarter of 2024, and the recovering external demand, which is expected to turn positive from the second quarter of 2025 until the end of the forecast horizon, will reduce the aggregate demand deficit.

Real monetary conditions, in general, will have a restrictive, albeit decreasing, effect on aggregate demand for the entire forecast period.

The current forecast of inflation, compared to the one in the Inflation Report, May 2024 has been revised downward for the second half of this year and upward from the second quarter of 2025 until the end of the comparable period[4]. The current forecast for the annual rate of core inflation has been revised downward in the second half of this year and the first half of next year, and then upward until the end of the comparable

period. The annual rate of food prices has been revised upward, predominantly, for the entire comparable period. The current forecast of the annual rate of regulated prices is revised upward for the entire comparable period, except for the third quarter of 2024 and the fourth quarter of 2025. The forecast for the annual rate of fuel prices was significantly lowered in the second half of this year and the first half of next year, being subsequently revised upward until the end of the comparable period.

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1. IMF, World Economic Outlook Update July 2024

2. Third quarter of 2024 – second quarter of 2026

3. Second quarter of 2026

4. Third quarter of 2024 – first quarter of 2026

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Метки
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