National
Bank of Moldova

Inflation Report

No. 2, May 2020

National Bank of Moldova
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ISBN 978-9975-3357-9-9
ISBN 978-9975-3088-6-1

Note

The Inflation Report no. 2, 2020 was examined and approved by the Executive Board of the National Bank of Moldova in the meeting of May 11, 2020.

The report was elaborated based on the latest macroeconomic information from the internal and external environment.

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy and Infrastructure, Ministry of Finance,

Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

State Hydrometeorological Service.

Likewise were selected certain statistical data provided by the international community and by the Central Banks of the neighboring states.

The calculation of the statistical data was carried out by the National Bank of Moldova.

Contents

List of acronyms

CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CPI	Consumer Price Index
ECB	European Central Bank
FCC	Freely convertible currency
Fed	Federal Reserve System
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
MDL	Moldovan leu
NBC	Certificates issued by the National Bank of Moldova
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
REER	Real effective exchange rate of the national currency
RUB	Russian rouble
SS	State Securities
USA	United States of America
USD	U.S. Dollar

Summary

In the first quarter of 2020, the annual inflation rate started a downward trajectory, decreasing from 7.5% in December 2019 to 5.9% in March 2020, due to the decrease in contributions from core inflation and food prices. The downward dynamics of core inflation were determined by the effect of the high base period from the beginning of 2019 and the disinflationary pressures from aggregate demand. A significant impact was also exerted by the atypical hot weather recorded between October 2019 and March 2020, which caused the delay and decrease in intensity of the seasonal effect associated with food and fuel prices. The last ones were influenced, in March 2020, by the decrease of oil prices on the international market. According to estimates, the domestic demand has had a disinflationary impact on both core inflation and food prices. The depreciation of the national currency at the end of the first quarter of 2020 has mitigated the aforementioned disinflationary pressures. In February 2020, the annual inflation rate returned to the range of 5.0% ± 1.5 percentage points stipulated in the medium-term monetary policy strategy. The average annual rate of CPI in the first quarter of 2020 was 6.4%, being 0.7 percentage points lower than in the previous quarter. Over the next period, the annual CPI rate will continue the downward trend, largely due to disinflationary pressures associated with domestic demand in the context of the impact of COVID-19, as well as due to declining prices for petroleum products on the international market.

The first quarter of 2020 proved to be unfavorable for the world economy due to the COVID-19 pandemic. Several *important economies*, such as the USA, China, Italy, Spain, France, etc. were significantly affected by the cessation of economic activity, especially in the field of services. Stock market indices reached minimum levels, reflecting uncertainties in the *global financial market* and investors' flight to reserve assets. In particular, *US dollar* appreciated considerably, due to the fact that it holds the position of the safest currency among the liquid reserve assets. Most authorities have announced *extraordinary monetary and fiscal stimulus programs*, and international organizations have opened special lending programs for the economies affected by COVID-19. At the same time, at the OPEC+ meeting on March 5-6, 2020, Saudi Arabia and the Russian Federation did not agree on the extension of the agreement to limit *oil* production, which led to a real price war that degenerated into a reduction in oil prices by more than 60% since the beginning of this year. The fall in world demand and oil prices has led to a fall in the prices of other *raw materials* and a significant depreciation of the *currencies of emerging economies* and, in particular, of those dependent on oil exports.

At the end of 2019, economic growth was marginal and significantly lower than expected in the previous round of forecasting, which already predicted a slowdown in the GDP growth. Thus, the GDP growth rate was 0.2%, being 4.1 percentage points lower than in the third quarter of 2019. At the same time, the seasonally adjusted series reflects a 1.2% contraction in GDP compared to the third quarter of 2019. The sharp slowdown in economic growth was expected to be due to significantly more modest evolution of domestic demand, both consumption and investment. At the same time, a more modest impact was exerted by the dynamics of exports against the background of low performance in the agricultural sector. Constructions, which played an important role in economic growth in previous periods, had a marginal impact towards the end of the previous year. Regarding the estimation of economic activity for the beginning of the current year, the external trade indicators for the first two months of the year outline preconditions for a negative contribution from it to the GDP dynamics in the first quarter of 2020. At the same time, the operational indicators on industrial production for the first two months of this year outline preconditions for a positive contribution from this sector to economic growth. A positive dynamic during this period was also recorded in the transport sector. Positive signals on economic activity were transmitted by the evolution of internal trade. Agricultural production similarly registered a positive dynamics in January-March 2020. Despite these indicators, the annual dynamics of economic activity will be very modest with a pronounced risk of entering negative territory in the first quarter of 2020, mainly, as a result of the negative impact of foreign trade, as well as the anticipated development for March 2020 in the context of measures to prevent the spread of COVID-19. With regard to labour market developments, its main indicators continued the negative dynamics at the end of the previous year. The number of economically active population and employed population decreased compared to the fourth quarter of 2018. At the same time, the unemployment rate in the fourth quarter of 2019 was higher than in the same period of 2018. In the context of the COVID-19 pandemic and its impact on economic activity, in the next period the employed population will decrease, and the unemployment rate will be more pronounced.

In the first quarter of 2020, the annual dynamics of revenues of the national public budget registered a moderation of the growth rate, being 6.2% higher than in the same period of 2019. The expenditures of the national public budget increased by 6.4% compared to the same period of 2019. At the same time, on the state securities market, during the first quarter of 2020, interest rates decreased by all types of maturities.

In the first quarter of 2020, excessive liquidity amounted to 6.7 billion MDL, increasing compared to the previous quarter by 0.67 billion MDL.

Monetary aggregates in the first quarter of 2020 had a positive dynamics in annual terms, largely due to the change in sight deposits in both national currency and foreign currency.

The Executive Board of the National Bank of Moldova, at the meeting on March 4, 2020, decided to reduce the base rate applied to the main monetary policy operations by 1.0 percentage point, to 4.5% annually, and at the extraordinary meeting of March 20, 2020 by 1.25 percentage points, up to 3.25% annually.

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

Since the previous forecast round, the international macroeconomic situation has changed radically, which has led to a significant revision of *external assumptions*. The deepest crisis of the world economy in the last century is anticipated for 2020, after which the world economy is expected to recover in 2021, but not able to reach the pre-crisis level.

The annual inflation rate starting with the first quarter of the forecast will decrease continuously until the end of the current year (minimum level 3.5% in the fourth quarter of 2020 and the first quarter of 2021). Subsequently, it will increase slightly in the second quarter of 2021 (maximum level 4.6%), after which it will decrease again, but will not fall below the lower limit of the interval. Throughout the forecast horizon, inflation will remain within the inflation target range and will oscillate at the bottom of it.

Core inflation will decline significantly this year, after which it will increase until the end of the forecast horizon. The annual growth rate of *food prices* although declining considerably in the first quarter of the forecast, will remain at a relatively high level until the second quarter of 2021, then declining towards the end of the forecast horizon. The annual rate of *regulated prices* will be relatively low over the whole horizon. It will decrease until the third quarter of 2021, after which it will stabilize towards the end of the forecast horizon. *Fuel* prices will decline significantly in 2020 and early next year and a relatively steady increase thereafter.

Aggregate demand will be disinflationary for the entire forecast horizon, with a significant decrease in the third quarter of 2020, largely associated with measures to prevent the spread of COVID-19, and a slow return towards the end of the forecast horizon.

Actual *monetary conditions* will be restrictive of aggregate demand over the entire forecast period.

The current *inflation* forecast is significantly lower for the first two quarters of the forecast and higher starting with the fourth quarter of 2020 for four consecutive quarters, then lower for the end of the comparable period. *Core inflation* was revised downwards for the entire comparable period. The annual rate of *food* prices was revised upwards for the whole comparable period, except for the first quarter of the forecast. The current forecast of *regulated prices* is lower for the whole comparable period, except for the first four quarters of the forecast when they register insignificant deviations. The forecast for the annual rate of *fuel* prices was revised downwards for the first four quarters of the forecast and upwards for the rest of the comparable period.

Chapter 1

Inflation development

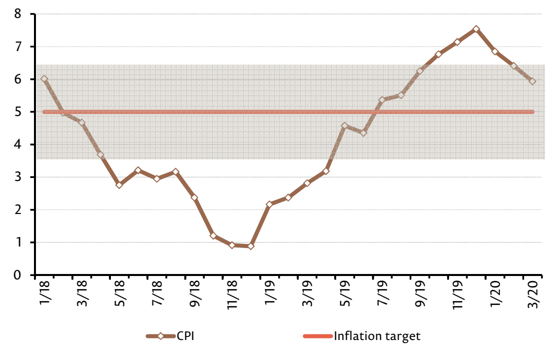
1.1 Consumer Price Index

In the first quarter of 2020, the annual inflation rate started a downward trajectory, due to the decline in positive contributions from core inflation and food prices. Since February 2020, the annual rate of CPI has been in the range of the inflation target.

The annual inflation rate showed a downward trend at the beginning of 2020, following the upward trend of the previous year. In February 2020, it re-entered the range of 5.0% ± 1.5 percentage points stipulated in the Medium-term monetary policy strategy. Thus, the annual inflation rate decreased from 7.5% in December 2019 to 5.9% in March 2020 (Chart 1.1).The average annual rate of the CPI in the reference quarter was 6.4%, with 0.7 percentage points lower than in the previous quarter.

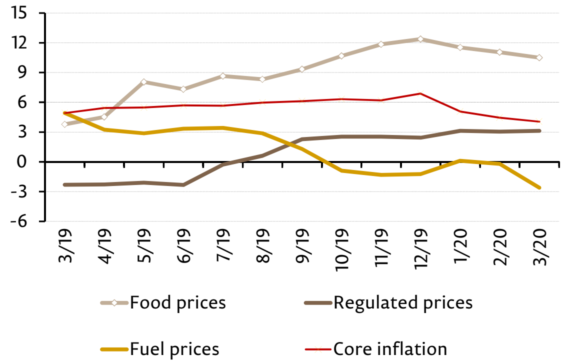
The downward trajectory of the first quarter of 2020 was mainly determined by the decrease in the positive contribution from core inflation, due to the effect of a high base period at the beginning of 2019 associated with cigarette prices. A significant role was played by the atypical warm weather from October 2019 to March 2020, which caused the delay and decrease in intensity of the positive seasonal effect on food and fuel prices. The latter were influenced by the fall in oil prices in the international market in March. According to estimates, domestic demand has had a disinflationary impact on both core inflation and food prices. The sharp depreciation of the national currency towards the end of the first quarter of 2020 has further reduced these pressures. Over the next period, the annual rate of CPI will continue to decline, largely due to disinflationary pressures associated with domestic demand in the context of the COVID-19 pandemic, as well as declining prices for petroleum products on the international market.

Chart 1.1: The annual rate of the CPI (%)



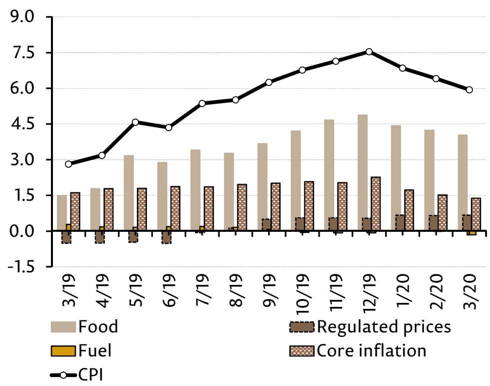
Source: NBS, NBM

Chart 1.2: The annual rate of the main subcomponents of the CPI (%)



Source: NBS

Chart 1.3: The evolution of the annual inflation (%) and subcomponents contribution (p.p.)



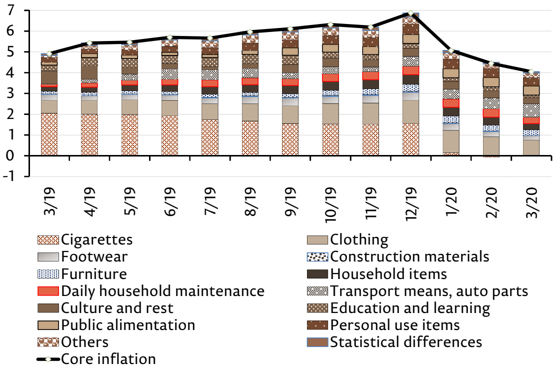
Source: NBS, NBM calculus

Core inflation

In the first quarter of 2020, the annual core inflation rate showed a sharp downward trajectory, mainly due to the effect of the high base period since the beginning of 2019 and disinflationary pressures from aggregate demand.

The annual core inflation rate decreased from 6.9% in December 2019 to 4.0% in March 2020 (Chart 1.4). The average core inflation rate was 4.5%, with 1.9 percentage points lower than in the previous quarter, mainly due to the effect of a high base period

Chart 1.4: The subcomponents contribution (p.p.) to the annual rate of core inflation (%)



Source: NBS, NBM calculus

from the beginning of 2019 related to the introduction of the concept of "minimum retail price for cigarettes". But this provision on the minimum selling price of cigarettes has been changed in fiscal policy for 2020, which has resulted in a significant decrease in the annual core inflation rate in January 2020.

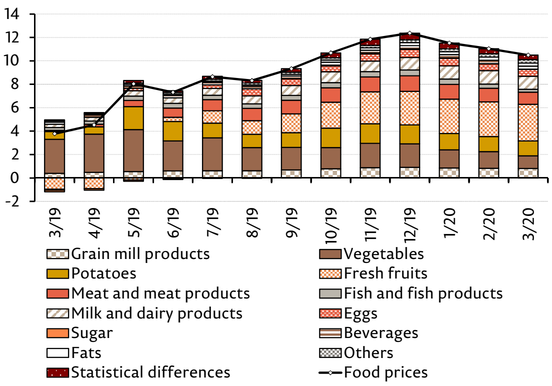
According to estimates, domestic demand had a disinflationary impact on core inflation in the reference period in the context of moderating the increase in disposable income of the population, but also the restrictive measures adopted in March to stop the spread of COVID-19. Therefore, domestic demand supported the continuation of the downward trajectory in February and March 2020. In this way, the dynamics of some subcomponents such as clothing, footwear, household items, as well as some services lost intensity.

In the first quarter of 2020, the downward trend in core inflation was partially offset by the depreciation of the national currency, especially in the second half of March, in the context of the epidemiological situation in the country, which influenced the foreign exchange market and favored higher prices for certain subcomponents, such as prices for means of transport and car parts. In the next period, the annual core inflation rate will continue the downward trajectory, mainly due to the decrease in domestic demand in the context of the restrictive measures related to COVID-19.

Food prices

The annual rate of food prices outlined a downward trajectory at the beginning of this year, mainly due to atypical hot weather conditions between October 2019 and March 2020.

Chart 1.5: The components contribution (p.p.) to the annual rate of food prices (%)



Source: NBS, NBM calculus

In the first quarter of 2020, the annual rate of food prices recorded an average level of 11.0%, being 0.6 percentage points lower than in the fourth quarter of 2019. The contribution from food prices to the formation of the annual inflation rate decreased by 0.4 percentage points, constituting 4.2 percentage points. The evolution of the annual rate of food prices was largely due to the moderation of the growth rates of fresh vegetables, potatoes and processed goods[1] (Chart 1.5). The moderation of the growth rates of prices for processed goods can be considered a signal of the disappearance of inflationary pressures due to increased costs, but also of a disinflationary impact from domestic demand. At the same time, the decrease in the positive contributions from the "fresh vegetables" and "potatoes" groups was determined by the stabilization of prices for these product categories, against the background of atypically high temperatures for that period.

It is worth mentioning that on the international market food prices have followed a downward trajectory. In the first quarter of 2020, the annual rate of international food prices recorded an average level of 7.3%, being 1.8 percentage points lower than in the fourth quarter of 2019. As a result, international prices have exerted disinflationary pressures on food prices traded on the domestic market.

[1] Meat, egg, fish and fish products

Regulated prices

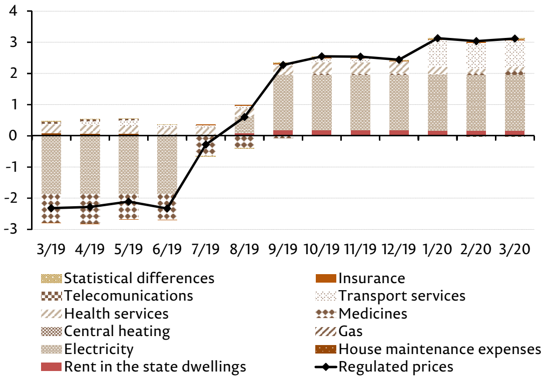
In the first month of this year, the annual rate of regulated prices continued the upward trend of the previous year, after which it outlined a relatively stable evolution.

The annual rate of regulated prices increased from 2.4% in December to 3.1% in January 2020, after which, by the end of the first quarter, it had a relatively stable dynamics, registering the value of 3.1% in March 2020. The increase in regulated prices in January 2020 was mainly determined by the increase in the tariff for intercity transport by 25.0%.

At the same time, at the beginning of this year, in the northern region of the country, there was a decrease in the central heating tariff for one of the local suppliers. At the same time, during the quarter there were some fluctuations in the prices of medicines, tariffs for railway and air transport. Also, at the beginning of the year, the tariffs for the compulsory car insurance services increased by 9.4%. However, the impact of these changes was minor on regulated prices.

In the first quarter of 2020, the annual rate of regulated prices continued to be significantly influenced by the adjustment of the electricity tariff in the summer of the previous year.

Chart 1.6: The components contribution (p.p.) to the annual rate of regulated prices (%)



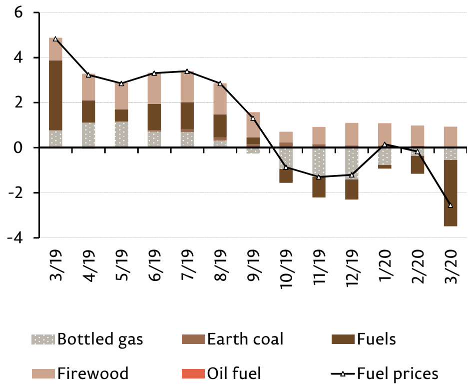
Source: NBS, NBM calculus

Fuel prices

Fuel prices had a downward trend in the first quarter of 2020, moving to the negative level between February and March.

Thus, the annual rate of fuel prices decreased from 0.1% in January 2020 to -2.6% in March 2020, due to lower fuel prices (Chart 1.7). At the same time, the average annual rate of fuel prices was -0.9%, still being 0.2 percentage points higher than in the fourth quarter of 2019. The downward trend in fuel prices in February and March was supported by the decline in international oil prices during this period. Thus, the price of Urals oil was about 48.4 US dollars / barrel, down 22.1% compared to the previous quarter. The impact of this dynamic was partially mitigated by the change in the share of excise duties on gasoline and diesel for 2020, but also by the depreciation of the national currency against the US dollar. At the same time, during the reference period, prices for "firewood" had a positive impact on the annual rate of fuel prices.

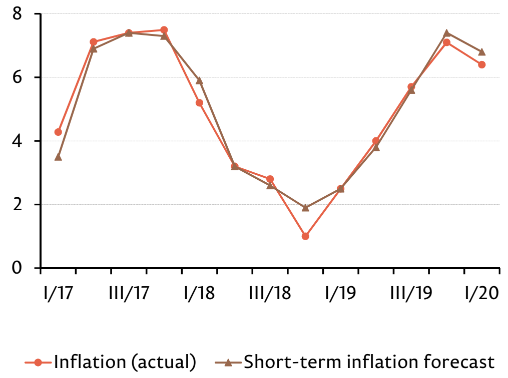
Chart 1.7: The components contribution (p.p.) to the annual rate of fuel prices (%)



Source: NBS, NBM calculus

1.2 Comparison of the forecast in the Inflation Report no. 1, 2020 with the evolution of inflation in the first quarter of 2020

Chart 1.8: The evolution and short-term forecast of CPI (%, yoy)



Source: NBS, NBM forecast

Table 1.1: The evolution and forecast of CPI and its components

	De facto Q I, 2020/ Q I, 2019 (%)	Forecast IR I, 2020 Q I, 2020/ Q I, 2019 (%)	Deviation (De facto-forecast) (p.p.)
CPI	**6.4**	**6.8**	**-0.4**
Core inflation	4.5	5.3	-0.8
Food prices	11.0	10.8	0.2
Regulated prices	3.1	3.2	-0.1
Oil prices	-0.9	2.1	-3.0

Source: NBS, NBM calculus
IR I, 2020 - Inflation Report no. 1, 2020

In the forecast round for January 2020, the beginning of a downward trend in the annual inflation rate was forecast, thus anticipating a level of about 6.4% in March and an average level of 6.8% for the first quarter of 2020[2]. Inflation data for January-March 2020 outline a lower trajectory than anticipated in the previous forecast round.

In the first quarter of 2020, the annual inflation rate stood at 0.4 percentage points below the level anticipated in the Inflation Report no. 1. (Table 1.1). The deviation was mainly determined by the forecast of core inflation and fuel prices. Thus, its annual rate was 0.8 percentage points lower than the value of 5.3% anticipated in the previous forecast round, mainly due to a significantly lower evolution of cigarette prices. This was determined by the adjustment of some provisions in the fiscal policy for 2020 (the minimum selling price of cigarettes). At the same time, a pronounced negative deviation was registered for fuel prices, as a result of lower than expected prices for petroleum products, but also for atypical weather conditions that did not generate the anticipated seasonal increases for coal and firewood prices. Thus, the price of oil (Urals) in the first quarter was about 48.4 USD / barrel, being about 25.3% lower than anticipated (64.7 USD / barrel) in the Inflation Report no. 1. Regulated prices registered a minor negative deviation (-0.1 percentage points). At the same time, these negative deviations were slightly mitigated by the minor positive deviation (0.2 percentage points) recorded by food prices. **Therefore, the negative deviation for the short-term inflation forecast was mainly due to: the exclusion of the minimum selling price of cigarettes from fiscal policy, the atypical weather conditions from the beginning of 2020 and the lower-than-expected decline in international oil prices.**

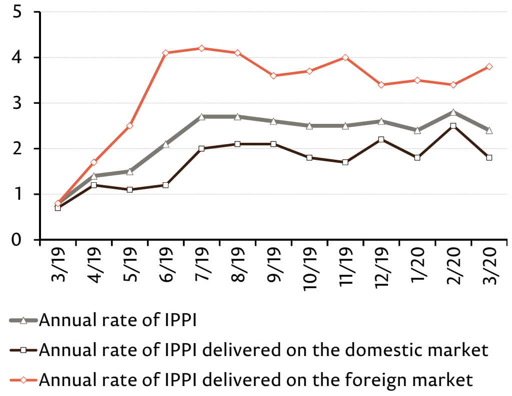
[2]Given the more pronounced volatility of monthly values, but also some possible measurement errors, which normally should not influence monetary policy decisions, the short-term inflation forecast is made on a quarterly basis. That value is an input to the medium-term inflation projection, which similarly has a quarterly frequency and underpins monetary policy decisions. At the same time, it is communicated in the Inflation Reports. However, the actual monthly CPI data, as published by the NBS during the quarter, are analyzed and compared with the short-term forecast for the whole quarter to assess whether the main anticipated assumptions are confirmed or whether there is a risk of pronounced deviations from the forecast. Therefore, the deviations between the actual data available for the months of the quarter and the short-term inflation forecast must be interpreted accordingly, taking into account the assumptions / forecasts for the remaining months of the quarter.

1.3 Industrial production prices

In the first quarter of 2020, the annual rate of prices in industry was 2.5%, similar to that of the previous quarter. At the same time, the annual rate of prices for products delivered on the domestic market recorded a slight increase, to an average level of 2.0%, and that of the prices of products delivered on the foreign market moderated by 0.1 percentage points up to an average level of 3.6% (Chart 1.9).

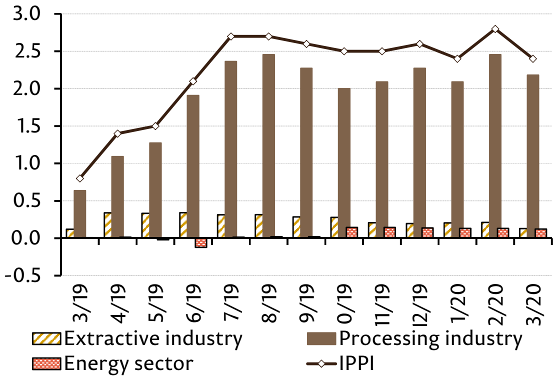
Analyzing the evolution of the annual rate of prices in industry by main branches, it is clear that, similar to previous periods, the major contribution to the formation of the annual rate is the manufacturing industry (Chart 1.10). Thus, the "food industry", "textiles" and "clothing" sectors contributed most to the formation of the annual price rate in the manufacturing industry. The increase in prices in the food industry was supported by the increase in prices for products from the groups "processing and preserving of fruit and vegetables", "manufacture of dairy products" and "manufacture of sugar". Similar to the previous quarter, the contribution from the energy sector and the extractive industry remained insignificant.

Chart 1.9: The annual rate of prices in industry (%)



Source: NBS

Chart 1.10: The annual rate of prices in industry (%) and the contribution of its components categorised by main branches (p.p.)



Source: NBS, NBM calculus

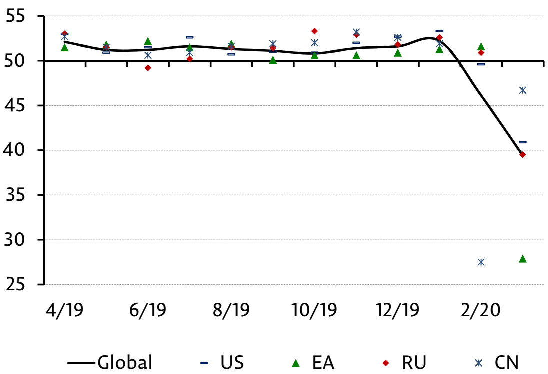
Chapter 2

External environment

The first quarter of 2020 proved to be unfavorable for the world economy due to the COVID-19 pandemic. Several important economies, such as the USA, China, Italy, Spain, France, etc. were significantly affected by the cessation of economic activity, especially in the field of services. Stock market indices reached minimum levels, reflecting uncertainties in the global financial market and investors' flight to reserve assets. In particular, the US dollar appreciated considerably, due to the fact that it holds the position of the safest currency among the liquid reserve assets. Most authorities have announced extraordinary monetary and fiscal stimulus programs, and international organizations have opened special lending programs for the economies affected by COVID-19. At the same time, at the OPEC+ meeting on March 5-6, 2020, Saudi Arabia and the Russian Federation did not agree on the extension of the agreement to limit oil production, which led to a real price war that degenerated into a reduction in oil prices by more than 60% since the beginning of this year. The fall in world demand and oil prices has led to a fall in the prices of other raw materials and the depreciation of the currencies of emerging economies, and especially those dependent on oil exports.

2.1 World economy, financial and commodity markets

Chart 2.1: The evolution of PMI composite indices



Source: Markit

The fall in the ***PMI indexes*** well below the reference value of 50 (interpreted as an economic downturn) reflects the depth of the crisis in which the world economy found itself because of COVID-19. If in February 2020 only for China a significantly reduced PMI index of 27.5 was reported, in March all analyzed PMI indexes registered essential reductions. Globally, the composite PMI index fell to 46.1 in February and to 39.4 in March. Analyzing the situation in the first two weeks of April, the indexes will most likely remain at the same low levels in April 2020, except for countries that ended the quarantine regime (Chart 2.1).

In the first quarter of 2020 ***the U.S. dollar*** appreciated considerably, the U.S. dollar index (DXY[3]) reaching on March 19,

[3]DXY is an index calculated by weighted geometric mean of the value of the U.S. dollar against a basket of foreign currencies: euro - 57.6%, Japanese yen - 13.6%, pound sterling - 11.9%, Canadian dollar - 9.1%, Swedish krona - 4.2%, Swiss franc - 3.6%.

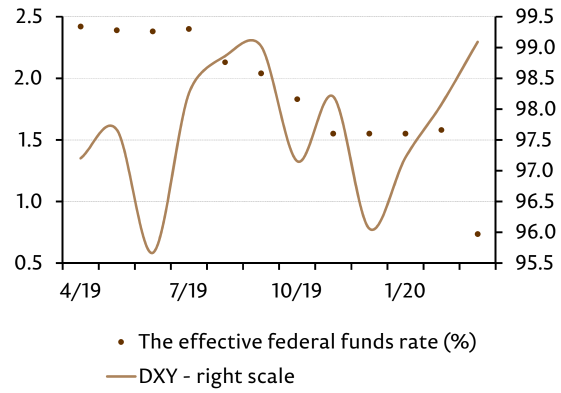
2020 the maximum value of 103,605 amid the high demand for liquidity. In a panic, investors closed all positions and resorted to the safest currency - the U.S. dollar, ignoring monetary easing and record rising of unemployment claims in the US. On March 4, 2020, the Fed convened an extraordinary meeting to reduce the base rate by 0.5 percentage points, a decision which not only did not increase confidence in the future, but, on the contrary, has caused concern, this being the most aggressive reduction in the base rate since the collapse of Lehman Brothers in 2008. On March 16, 2020, the U.S. dollar depreciated slightly, after Fed made another unexpected reduction in interest rates by 1.0 percentage points to 0-0.25% and promised to increase the balance by at least USD 700 billion (Chart 2.2). Also on March 23, 2020, Fed announced about unlimited acquisitions of U.S. Treasury bonds and mortgage-backed securities and the creation of new credit instruments to support companies and financial markets. In March 2020, the U.S. unemployment rate rose by 0.9 percentage points to 4.4%, this being the highest increase in the unemployment rate in a month since January 1975.

In the first quarter of 2020 ***the European single currency*** depreciated against the U.S. dollar by an average of 0.5% compared to the previous quarter. The key factor in the depreciation of the euro was the spread of COVID-19 throughout Europe, the closure of borders, the cessation of economic activity and the EU's problem on a common financial response to the COVID-19 pandemic. The ECB announced extraordinary monetary stimulus measures to support the economy, but the base rate remained at zero. Thus, reducing the interest rate gap between the US and the euro area was a key factor in consolidating the single currency in March 2020. The French and German governments also announced unprecedented measures to support the business affected by COVID-19. After several debates, on April 10, 2020, euro area finance ministers adopted a package of support measures that includes a special credit line for euro area countries through the European Stability Mechanism (ESM). This is a signal to investors that, thanks to the ESM, countries now have access to sufficient liquidity. The new stimulus package together with the previously announced monetary and fiscal support methods will lead to a faster recovery in the region than expected (Chart 2.3).

Russian ruble depreciated significantly in the first quarter of 2020 due to the worsening international climate and the sharp decline in oil prices by more than 60% since the beginning of this year. On a quarterly basis, the Russian ruble depreciated by an average of 4.3% compared to the fourth quarter of 2019. The most significant depreciation was recorded in March, when the Russian ruble depreciated by an average of 15.4% against the U.S. dollar (Chart 2.4). At the monetary policy meeting of March 20, 2020, the Central Bank of the Russian Federation maintained the base rate at 6.0%, contrary to market expectations of a reaction to the recent depreciation of the Russian ruble, but on April 24, 2020, the Bank of Russia acted by lowering the base rate from 6.0 to 5.5%.

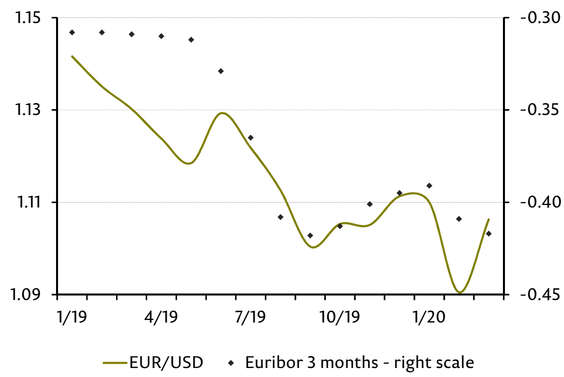
At the beginning of March 2020 ***oil quotations*** fell by an average of 60.0% due to the break-up of the OPEC+ alliance to limit oil production and the sale of oil by Saudi Arabia at significant discounts. Thus, in the first quarter of 2020, the Urals oil mark decreased by 22.1% compared to the fourth quarter of 2019, in March 2020 the monthly reduction was 46.2% (Chart 2.4). At the

Chart 2.2: Evolution of the U.S. Dollar Index (DXY) in the context of SRF monetary policy



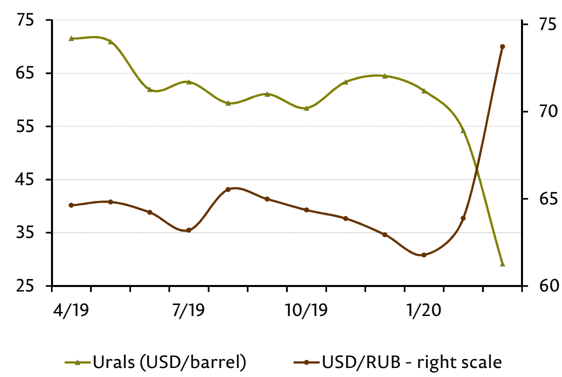
Source: SRF, Bloomberg

Chart 2.3: Evolution of EUR/USD (monthly average) and interest rates in the euro area



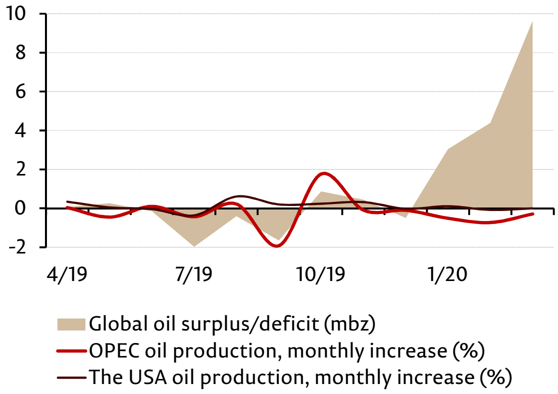
Source: ECB, Eurostat

Chart 2.4: Evolution of USD/RUB against Urals



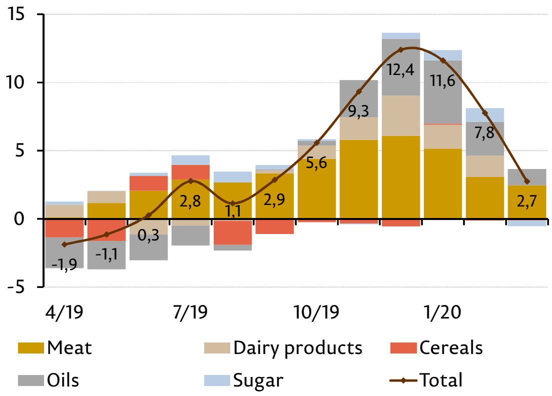
Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation

Chart 2.5: Oil production (mbz)



Source: US Energy Information Administration, NBM calculus

Chart 2.6: Annual growth rate of world food prices (FAO index) (%)



Source: FAO, NBM calculus

same time, the slowdown in exports due to COVID-19 led to a significant decrease in world oil demand (down 6.0% in March 2020 compared to February 2020). Thus, for March 2020, the U.S. Energy Information Administration reported an oil surplus of 9.6 million barrels per day (Chart 2.5). In the first weeks of April, the U.S. became involved in the situation created on the oil market, inviting the Russian Federation and Saudi Arabia to the negotiating table. After several days of negotiations under OPEC+ and the G20, on April 12, 2020, a consensus was reached to reduce oil production by an average of 23.0% between May and June 2020, which is approximately 9.7 million of barrels per day.

Although it has been anticipated that the annual growth rate of ***international food prices*** will decline in the first quarter of 2020, the values are above expectations. Like other international quotations, food prices have fallen significantly due to declining global demand as a result of the COVID-19 pandemic. At the same time, the logistics chain of trade has deteriorated due to border closures and a ban on the export of essential goods by some countries. Among the factors reducing international food prices, we mention the reduction of oil prices, the appreciation of the U.S. dollar and the policies to stimulate consumption. Thus, from the annual rate of 12.4% in December 2019, the FAO index decreased to an annual rate of 2.7% in March 2020 (Chart 2.6).

2.2 The evolution of important economies

In the fourth quarter of 2019, the gross domestic product of ***United States of America*** increased by 2.3% in annual terms, recording an average increase of 2.3% for 2019. In the first quarter of 2020, the industrial production in the U.S. it contracted on average in annual terms by 2.1%, of which in March by 5.5%. The unemployment rate in the U.S. rose in March 2020 by 0.9 percentage points to 4.4%, this being the highest increase in the unemployment rate for a month since January 1975. Consumer prices fell in March 2020 by 0.2% compared to the previous month and increased by 1.5% compared to March 2019.

In the fourth quarter of 2019, the gross domestic product in ***euro area*** increased by 0.1% compared to the previous quarter and by 1.0% (seasonally adjusted series) compared to the fourth quarter of 2018. Overall, in 2019, the euro area economy grew by an average of 1.2%. In the first two months of 2020, industrial production fell by 1.6% compared to the same period last year, of which in Germany it contracted by 2.4%, in France by 2.2% and in Italy by 1.5%. The latest published data show that in February 2020 the unemployment rate in the euro area fell to 7.3% from 7.4% in January 2020. If we analyze the PMI indexes since March 2020, we can deduce that the data on industrial production and the unemployment rate in the euro area in March will be much more negative. In March, the harmonized euro area consumer price index showed an annual inflation of 0.7%, well below the 2.0% target set by the ECB.

2.3 Evolution of economies in the neighboring countries and in the main trade partner countries

In the fourth quarter of 2019, the gross domestic product in ***Romania*** increased, in seasonally adjusted terms, by 1.5% compared to the third quarter of 2019, and compared to the similar period of the previous year, on the gross series it registered an increase of 4.3%. In January-February 2020, the industrial production decreased compared to the same period of the previous year by 2.6%. In March 2020, the consumer prices increased by 0.5% compared to the previous month and by 3.0% compared to the price level in March 2019. On March 23, 2020, the National Bank of Romania decreased the base rate from 2.5 to 2.0%.

In the fourth quarter of 2019, the gross domestic product in ***Ukraine*** recorded the lowest increase in 2019 of only 1.5% in annual terms. Overall, in 2019, the gross domestic product in Ukraine increased by 3.2%. In the first two months of 2020, the industrial production contracted by 3.1%, construction production by 0.6%, and agricultural production increased insignificantly by 0.1%. Inflation continued to moderate in March 2020, with consumer prices increasing by 0.8% compared to the previous month and by 2.3% compared to March 2019. At the same time, production prices in industry in Ukraine increased in March by 1.8% compared to the previous month, but were 4.2% lower than in March 2019.

In the fourth quarter of 2019, the economy of the ***Russian Federation*** grew by 2.1% compared to the same period of the previous year, accelerating compared to the growth recorded in the previous quarters of 2019. In March 2020, industrial production grew only by 0.3% compared to March 2019, and cumulatively in the first quarter of 2020 recorded an average annual rate of 1.5%. In March 2020, the annual inflation in Russia was 2.5%. The persistence of annual inflation values below the level targeted by the Bank of Russia determined the bank to maintain at the meeting of March 20, 2020 the base rate at 6.0%. At the same time, at the meeting on April 24, 2020, the Bank of Russia decided to act by reducing the base rate from 6.0 to 5.5%.

Chapter 3

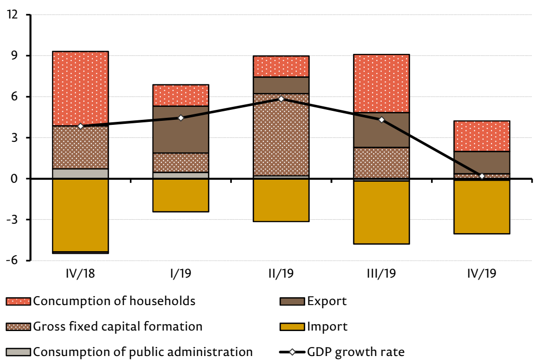
Economic developments

3.1 Demand

At the end of 2019, the economic growth was marginal, much lower than the anticipated value in the previous forecast round which already predicted a slowdown in GDP growth. In the fourth quarter of 2019, the GDP was only 0.2% higher than in the same period of 2018. At the same time, the seasonally adjusted series reflects a contraction of 1.2% of GDP compared to the third quarter of 2019. The pronounced slowdown in economic growth was expected to be driven by significantly more modest developments in domestic demand, both in terms of consumption and investment. At the same time, a non-essential impact was exerted by the dynamics of exports against the background of a negative performance in the agricultural sector. Constructions, which played an important role in economic growth in the previous periods, had a minor impact at the end of the previous year.

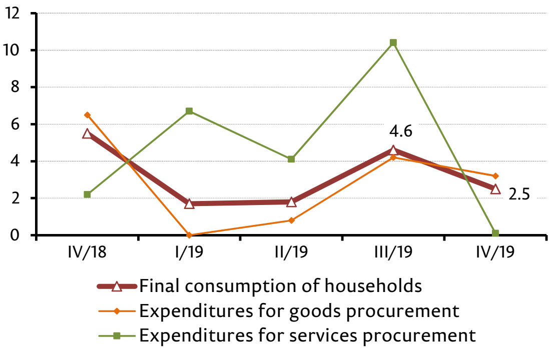
From the perspective of uses (Chart 3.1), positive contributions to GDP dynamics were made by household consumption and gross capital formation. However, their value was significantly lower than in the previous period. After the pronounced evolution in the third quarter of 2019, the consumption of households registered an annual increase of only 2.5% towards the end of the previous year in the context of moderating the growth of disposable income of the population. Investments, as mentioned above, exerted a positive contribution of 0.7 percentage points, much more modest than in previous periods. In this way, the gross fixed capital formation increased by only 3.3% compared to the similar period of 2018. At the same time, the change in stocks had a negative contribution of 0.3 percentage points. Similar to the previous periods, the final consumption of the public administration generated a marginal impact on the GDP dynamics, registering a contraction of 0.3%. Exports, in the conditions of a modest external demand, but also of a negative evolution in the agricultural sector, registered an increase of only 5.1% compared to the fourth quarter of 2018. The modest increase in household consumption as well as investment has led to a slowdown in import growth. Thus, the import of goods and services in the fourth quarter of 2019 increased by 7.0% compared to the corresponding period of the previous year, thus generating a negative contribution of 3.9 percentage points to GDP dynamics.

Chart 3.1: The contribution of demand components to GDP growth (p.p.)



Source: NBS, NBM calculus

Chart 3.2: Evolution in real terms of the final consumption of households' (%, yoy)



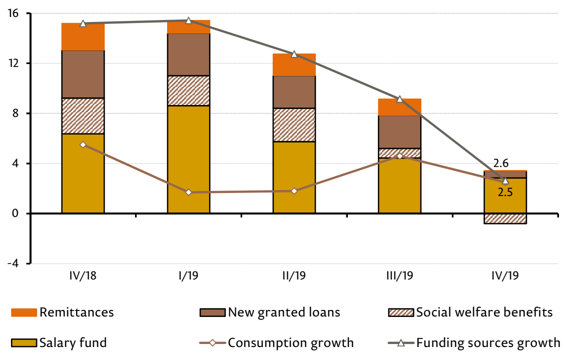
Source: NBS

Household consumer demand

The annual rate of household consumption registered a more modest increase in the fourth quarter of 2019. The annual rate of household final consumption registered a level of 2.5%, being 2.1 percentage points lower than in the third quarter of 2019, as a result of the increase in expenditures for the purchase of goods by 3.2%. Expenditure on procurement of services increased slightly (0.1% compared to the same period of the previous year) (Chart 3.2).

The growth rate of the main sources of financing household consumption moderated at the end of the previous year, but remained positive (Chart 3.3). This dynamic was mainly determined by the decrease of the positive effect of the annual evolution of the wage-fund and of the new loans granted to individuals. At the same time, a more modest evolution at the end of the previous year is also attested for remittances. The contribution from the dynamics of social payments became a negative one in the fourth quarter of 2019.

Chart 3.3: Evolution of personal disposable income (%, yoy) and subcomponents' contribution (p.p.)

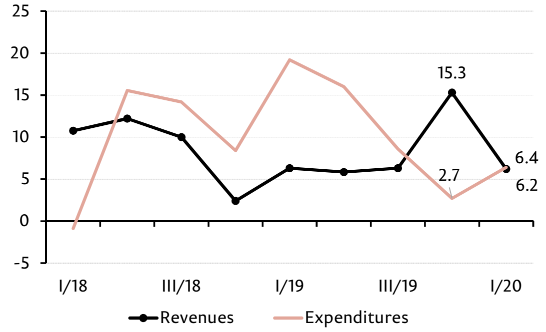


Source: NBS, NBM calculus

Public sector

According to the data provided by the Ministry of Finance, in the first quarter of 2020, the revenues of the national public budget were accumulated in the amount of 15.0 billion MDL, by 6.2% more than the same period of 2019 (Chart 3.4). The major part of the budget revenues was accumulated from the account of taxes and fees, which had a share of 64.6%. Compulsory insurance contributions and premiums accounted for 31.0%, and the share of other revenues and grants accounted for 4.0% and 0.4% of total budget revenues, respectively.

Chart 3.4: The dynamics of public revenues and expenditures, (%, yoy)

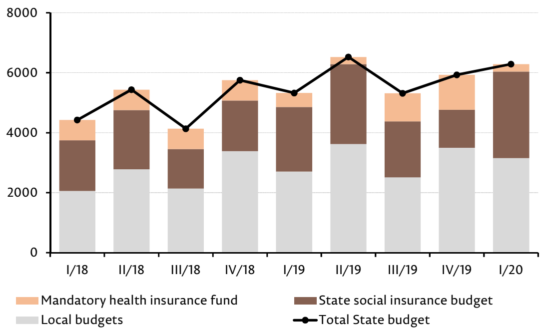


Source: Ministry of Finance

The expenditures of the national public budget, in the first quarter of 2020, totaled 15.4 billion MDL, registering an increase of 6.4% compared to the similar period of 2019. Of the total expenditures, the largest share was the expenditures for social protection (41.8%), for education there were allocated 19.5%, and for health care – 11.9%.

It should be mentioned that during this period from the state budget (SB) was transferred to the state social insurance budget (SSIB), in the Mandatory Health Insurance Fund (MHIF) and in the local budgets (LB) the amount of 6.29 billion MDL (up 18.1% compared to the same period in 2019 (Chart 3.5). The majority of state budget transfers went to local budgets, about 50.1% of the total, followed by transfers to SSIB about 45.9%, the MHIF benefiting from a more modest funding of 4.0%.

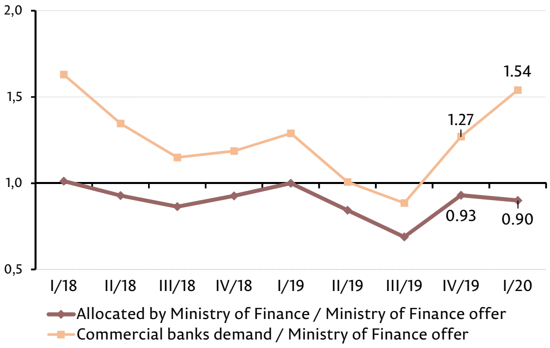
Chart 3.5: The evolution of budget transfers (lei million)



Source: Ministry of Finance

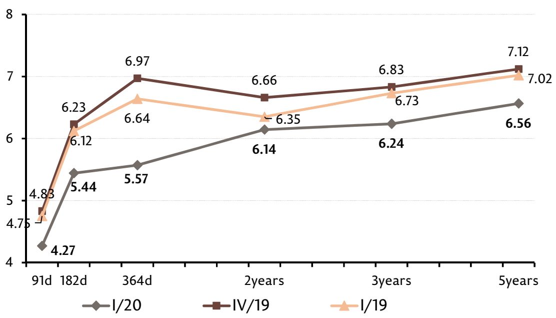
In January-March 2020, the execution of the national public budget resulted in a deficit of 0.39 billion MDL, compared to 0.35 billion MDL in the same period of 2019. The balances of the national public budget accounts as of February 29, 2020 were 5.36 billion MDL.

Chart 3.6: The demand and supply ratio on the primary market of state securities



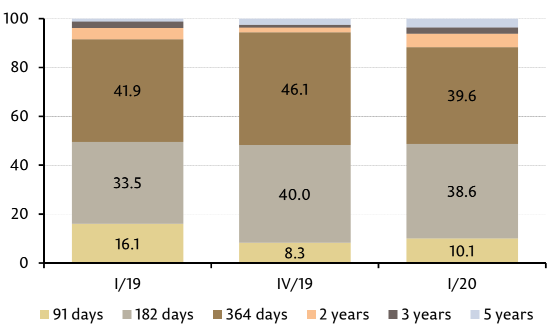
Source: NBM

Chart 3.7: SS yield curve (%)



Source: NBM

Chart 3.8: Structure of SS allocated on the primary market (%)



Source: NBM

Government debt

As of March 31, 2020, the government debt balance of the Republic of Moldova totaled 54.1 billion MDL, if we relate to GDP, it amounted to 25.7%[4]. In annual terms, the government debt increased by 4.4%, due to the increase of the external government debt recalculated in the national currency (with a positive contribution of 3.6 percentage points) and the internal government debt (with a positive contribution of 0.8 percentage points). The government debt, at the end of March 2020, consisted of 55.9% external government debt and 44.1% internal government debt.

At the end of March 2020, the balance of the external government debt amounted to USD 1,665.8 million, lower than on January 1, 2020 by USD 38.5 million or 2.2%. Recalculated in national currency, the balance of the external government debt amounted to 30.3 billion MDL (14.4% of GDP[4]).

As of March 31, 2020, the internal government debt amounted to 23.8 billion MDL (11.3% of GDP[4]), higher than that of January 1, 2020 by 3.0%. The increase in the internal government debt was determined by state securities (SS) issued on the primary market, whose volume increased by 8.3% compared to the beginning of 2020. As a result of these developments, at the end of March 2020, the internal debt was composed of SS issued for the execution of government guarantees (53.9% of the total), SS issued on the primary market (37.5%) and converted SS (8.6%).

Primary market of state securities (SS)

During the first quarter of 2020, the Ministry of Finance put into circulation government securities totaling 2,770.5 million MDL, 9.9% less than the volume of the initial offer, and the ratio between demand and supply on the SS primary market constituted 1.54, the volume of demand on the primary market registering 4,750.4 million MDL (Chart 3.6).

During the reporting period, the average effective interest rates on treasury bills maturing in 91 days, 182 days and 364 days decreased by 0.6 percentage points, 0.8 percentage points and 1.4 percentage points respectively, compared to the level recorded in the previous quarter. The average effective interest rate on government bonds with a maturity of 2 years decreased by 0.5 percentage points, and the average effective interest rates on government bonds with a maturity of 3 and 5 years decreased by 0.6 percentage points, each (Chart 3.7).

The structure of the SS portfolio put into circulation during the reference period shows that the most popular SS were those with a maturity of 364 days, which accounted for 39.6% of total transactions, followed by 182-day treasury bills, whose share was 38.6%, and the share of 91-day treasury bills was 10.1%. It should be noted that the shares of government bonds maturing in 2 years, 3 years and 5 years accounted for 5.6%, 2.6% and 3.5%, respectively (Chart 3.8).

[4]GDP estimated by the NBM.

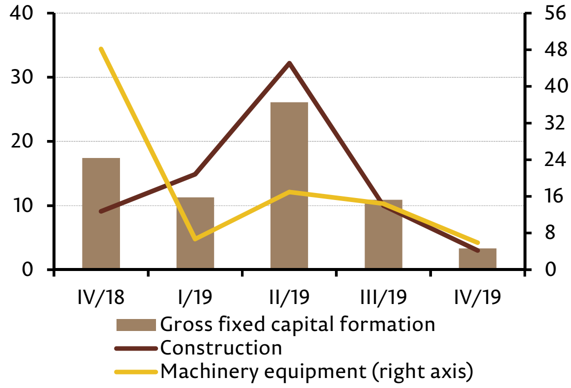
Investment demand

After the pronounced evolution in the first part of the year, the investment dynamics moderated towards the end of the previous year. In the fourth quarter of 2019, the investment component generated a positive impact on economic activity, thus contributing by 0.4 percentage points to GDP growth, but this being significantly lower than in the first part of 2019. This evolution was determined by the increase of gross fixed capital formation by 3.3%, which generated a contribution of 0.7 percentage points to GDP growth. At the same time, in the fourth quarter of 2019 a decrease in stocks was noticed, which contributed to the moderation of the annual growth rate of GDP by 0.3 percentage points. It should be noted that the moderation of the annual rate of gross fixed capital formation was determined by the dynamics of investments oriented in both "construction" and "machinery", which recorded annual growth rates of 3.0 and 5.9%, respectively (Chart 3.9).

At the same time, according to the operative data presented by the NBS, in the fourth quarter of 2019, the annual growth rate of investments in tangible fixed assets[5] constituted 0.8%. In the structure, positive contributions to the formation of the annual rate of investments in tangible fixed assets went to the groups "engineering constructions" and "residential buildings". At the same time, targeted investments in the other categories were declining (Chart 3.10).

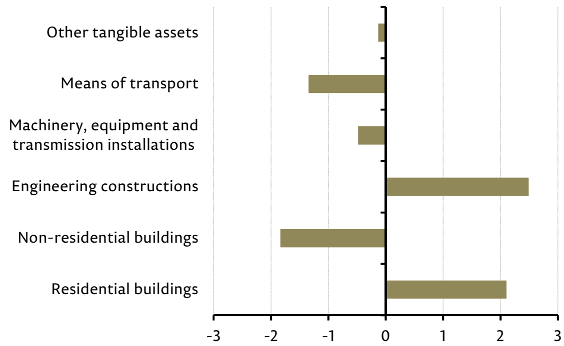
From the perspective of the financing sources of the investment process, the moderation of the growth rate of investments in fixed assets for the second consecutive quarter was mainly determined by the significantly lower contribution from investments from own funds. If in the first half of the year the investments from the own funds of the population had an essential contribution to the annual dynamics of investments, in the third and fourth quarters there was attested a pronounced moderation of their growth rates (Chart 3.11). At the same time, after a period of five quarters in which the sources from the state budget contributed positively to the dynamics of investments, in the second half of 2019 they recorded negative growth rates. It should be noted that, similar to the previous periods, own funds remain the main source of financing investments in fixed assets (57.0% in the fourth quarter of 2019).

Chart 3.9: The annual dynamics of investments



Source: NBS

Chart 3.10: Components' contribution to increase of investment in tangible assets in the fourth quarter of 2019 (p.p.)



Source: NBS, NBM calculus

Net foreign demand[6]

The annual dynamics of exports registered a moderation in the fourth quarter of 2019. Operational data for the first two months of 2020 show a contraction of exports, while imports increased at the beginning of this year. Thus, in the first two months of 2020, the annual export rate stood at minus 2.3% or 3.2 percentage points lower than in the fourth quarter of 2019. At the same time, the annual rate of imports in the same period increased to the level of 4.0% or 4.8 percentage points higher than the level in the fourth quarter of 2019.

[5]As of January 1, 2017, the statistical questionnaire 2-INV "On investments" was modified to adjust the statistical instrumentation (notions and definitions used, methods of calculation and presentation of indicators) with the provisions of the new National Accounting Standards, which entered into force compulsorily from January 1, 2015.

[6]There were used quarterly data on the evolution of the foreign trade of the Republic of Moldova, expressed in thousands of US dollars.

The moderation of the annual export rate over the last two quarters was determined by the evolution of exports to countries classified as the "Rest of the World"[7]. At the same time, the exports to EU countries offset a part of the negative effect generated by the trade with other partners (Chart 3.12).

The moderation of the annual export rate in the first quarter of 2020 was mainly due to the evolution of exports of "vehicles, optical and sound recording or reproducing apparatus" and "chemical and wood processing products"[8] (Chart 3.13). The dynamics of the "textiles and clothing" and "food, animal, beverages and fats" groups contributed to the increase in exports.

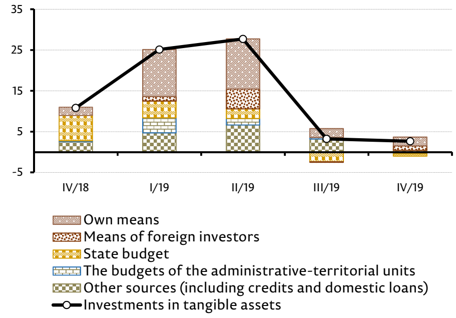
Analyzing the evolution of exports by origin of products, it can be seen that the decrease in the annual rate of exports in the first quarter of 2020 was generated by the dynamics of re-exports (Chart 3.14). At the same time, the exports of domestic goods generated a positive contribution to the dynamics of total exports.

It should be noted that the moderation of the annual rate of imports in the second half of 2019 was determined by the sharp contraction of imports from CIS countries. At the same time, in the first two months of 2020 there is a change in the structure of imports by main categories of countries, compared to the situation at the end of 2019. Thus, the increase in imports from EU countries is shaping up, and those from CIS countries are registering much more modest declining rates. As a result, in the first quarter of 2020, the annual rate of imports stood at 4.0% or 4.8 percentage points higher than the level in the fourth quarter of 2019 (Chart 3.15).

By groups of goods (Chart 3.16), the increase in the annual rate of imports in the first quarter of 2020 was influenced by the increase in imports of "food, animal products, beverages and fats", "chemical and wood processing products" and "articles of metal, stone or ceramic". Similar to the situation at the end of 2019, in the first quarter of 2020 the imports of mineral products decreased.

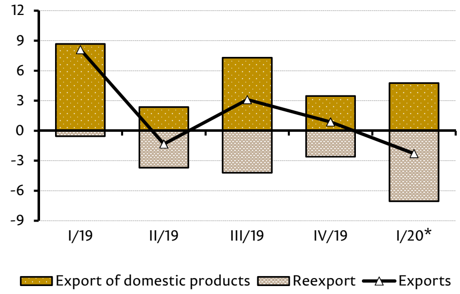
[7] Turkey has the largest share in this group.
[8] Major contribution determined by pharmaceuticals.

Chart 3.11: Annual dynamics of investments by financing sources (%, real terms)



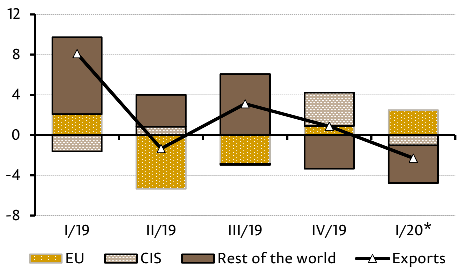
Source: NBS, NBM calculus

Chart 3.14: Evolution of exports annual rate (%) and contribution by origin (p.p.)



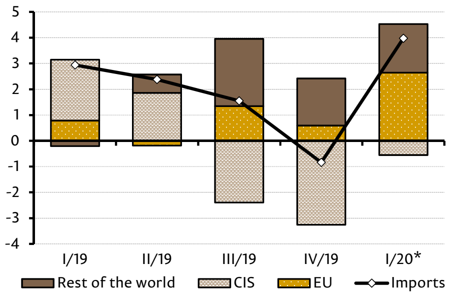
Source: NBS, NBM calculus
*Jan.-Feb.

Chart 3.12: Evolution of exports annual rate (%) and contribution by categories of countries (p.p.)



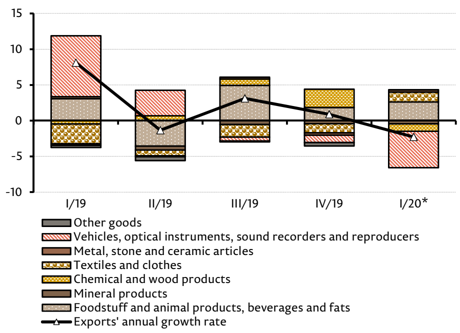
Source: NBS, NBM calculus
*Jan.-Feb.

Chart 3.15: Evolution of imports annual rate (%) and contribution by categories of countries (p.p.)



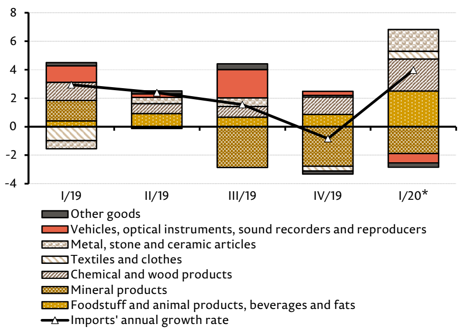
Source: NBS, NBM calculus
*Jan.-Feb.

Chart 3.13: Evolution of exports annual rate (%) and components' contribution by groups of goods (p.p.)



Source: NBS, NBM calculus
*Jan.-Feb.

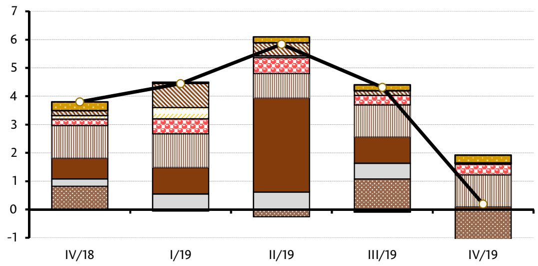
Chart 3.16: Evolution of imports annual rate (%) and components' contribution by groups of goods (p.p.)



Source: NBS, NBM calculus
*Jan.-Feb.

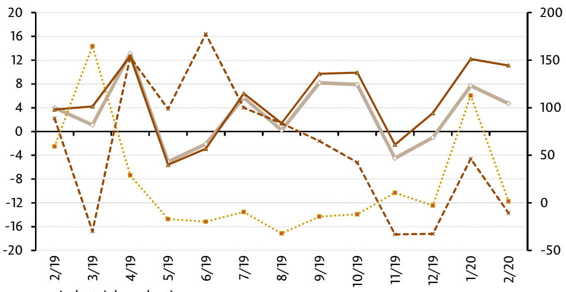
3.2 Production

Chart 3.17: The contribution of economic sectors to GDP growth (p.p.)



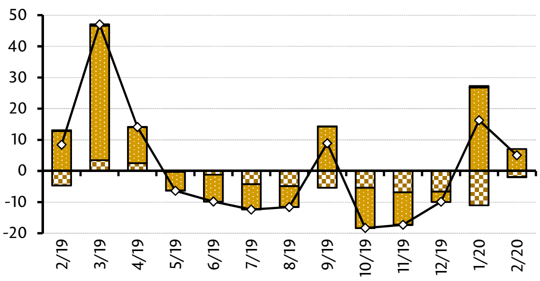
Source: NBS, NBM calculus

Chart 3.18: Evolution in real terms of industry (%, yoy)



Source: NBS

Chart 3.19: Evolution of goods transport (%, yoy)



Source: NBS

By categories of resources, the marginal GDP growth in the fourth quarter of 2019 was largely supported by the positive contribution from the evolution of the trade, transport and warehousing sector. In the fourth quarter of 2019, its gross value added increased by 5.5%, generating a contribution of 1.2 percentage points to GDP growth. At the same time, the gross value added of the "information and communications" component increased by 8.3%, thus exerting an impact of 0.4 percentage points on economic growth. A noticeable positive contribution (0.3 percentage points) had a 2.0% increase in the net tax subcomponent per product. After a pronounced impact in previous periods, at the end of 2019 the value added related to the construction sector increased by only 1.7%, generating a marginal contribution (0.1 percentage points) to the GDP dynamics. The value added related to the financial activities and insurance sector increased by 1.5%, and that related to the real estate sector – by 0.4%. These developments, however, generated a negligible impact on GDP dynamics in the reference period, being offset by the contraction of 10.9% of gross value added in agriculture, forestry and fisheries, which had a negative contribution of 1.6 percentage points.

Operational indicators on industrial production for the first two months of this year outline preconditions for a positive contribution from this sector to economic growth. During January-February 2020, the annual growth rate of industrial production recorded an average level of 6.2%, being 5.4 percentage points higher than in the fourth quarter of 2019 (Chart 3.18). That dynamic was determined by the increase in the annual growth rate of the manufacturing industry (from 3.6% in the fourth quarter of 2019 to 11.7% in the first two months of the first quarter of 2020). At the same time, the annual growth rate of production volume in the extractive industry, during January-February 2020, increased by 58.6 percentage points compared to the fourth quarter of 2019, up to the level of 57.2%. At the same time, the annual rate in the "production and supply of electricity and heat, gas, hot water and air conditioning" sector was -9.2% in the first two months of the first quarter of 2020 being higher than in the fourth quarter of 2019.

A positive trend in the first two months of the first quarter of 2020 was also recorded in the transport sector (Chart 3.19). Rail, road, river and air transport enterprises transported 9.7% more goods compared to the similar period of 2019, as a result of the annual increase in the volume of goods transported by river and road by 35.7 and 24.0%, respectively. At the same time, the volume of goods transported by air decreased by 31.3% compared to the same period of the previous year, and that transported by rail – by 15.9%.

Positive signals on economic activity in the first two months of the first quarter of 2020 are reflected in the dynamics of internal trade. The turnover of enterprises with main retail activity increased on average by 17.9%, being 7.0 percentage points higher than in the previous quarter (Chart

3.20). At the same time, the turnover of the enterprises with main activity of market services provided to the population registered, during January-February 2020, an increase of 7.5%, but being by 3.2 percentage points lower than in the fourth quarter of 2019.

In the first two months of the 2020 quarter, the turnover of enterprises with the main activity of wholesale recorded an average increase of 5.5%[9] (Chart 3.21). At the same time, the turnover of the enterprises with main activity of market services provided to the enterprises increased by 0.3%, being by 6.6 percentage points higher than the annual rate of the previous quarter.

In the first quarter of 2020, the global agricultural production increased by 2.4% compared to the same quarter of the previous year. as a result of the increase in the volume of production in the livestock sector by 2.6%, which accounted for about 99% of total volume of agricultural production (Chart 3.22). The increase in the volume of production in the livestock sector[10] in the first quarter of 2020 compared to the similar quarter of the previous year was determined by the increase in production of "cattle and birds (live mass)" by 10.1%. At the same time, the production of "milk" and "eggs" contracted by 15.0 and 2.7%, respectively.

It should be noted that, despite the positive dynamics of the indicators of internal trade, industrial production, freight transport in the first two months of the year and agricultural production in January-March 2020, the annual dynamics of economic activity will be very modest with a pronounced risk of entering negative territory in the first quarter of 2020, mainly due to the negative impact of external trade and the expected negative development for March 2020 in the context of measures to stop the spread of COVID-19.

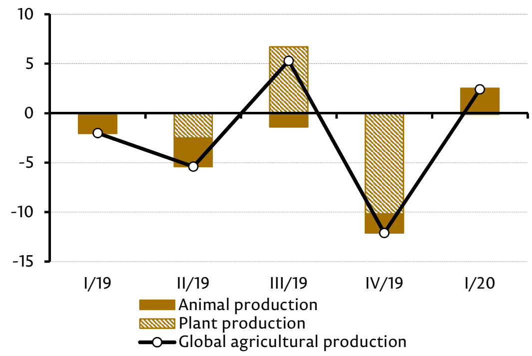
Chart 3.20: The evolution of domestic trade in real terms (%, yoy)

Source: NBS

Chart 3.21: The evolution of wholesale trade (deflated by annual CPI) (%, yoy)

Source: NBS

Chart 3.22: Annual rate of global agricultural production (%) and sectoral contribution (p.p.)



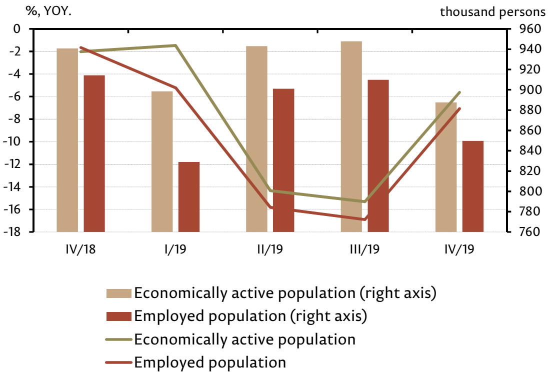
Source: NBS, NBM calculus

[9]Deflated with the annual rate of the CPI.
[10]Comparable prices.

3.3 Labour market

Labour force

Chart 3.23: Economically active population and employed population (%)



Source: NBS, NBM calculus

Chart 3.24: Evolution of the unemployment and employment rate (%)

Source: NBS, NBM calculus

Labour market indicators continued the negative dynamics at the end of the previous year. The number of economically active population and employed population decreased compared to the fourth quarter of 2018. At the same time, the unemployment rate in the fourth quarter of 2019 was higher than the similar period of 2018. In the context of the COVID-19 pandemic and its impact on the activity economic, in the next period the number of employed population will decrease, and the unemployment rate will be more pronounced.

In the fourth quarter of 2019, the economically active population amounted to 887.7 thousand people, being 5.6% less than the similar period of 2018. At the same time, the employed population was 849.7 thousand people, being 7.1% less than in the fourth quarter of 2018 (Chart 3.23). It should be noted that the negative dynamics of these indicators continued throughout the previous year. The number of unemployed in the reference period increased to 38.1 thousand people or 11.6 thousand people more than in the fourth quarter of 2018. As a result, the unemployment rate in the fourth quarter of 2019 was 4.3%, being 1.5 percentage points higher than at the end of 2018 (Chart 3.24). In 2019, in the research methodology "Labour Force Survey (LFS)"[11] some changes were made, among which we mention the use of the number of the population with habitual residence, recalculated based on the results of the 2014 Population and Housing Census. Another important change is that the employed population includes only those who carry out activities to produce goods or provide services for payment or profit[12]. At the same time, the indicators active, inactive population, employed population, unemployment rate, etc. were recalculated according to the new methodology for the last three years, which allowed the examination and interpretation of the dynamics of the above-mentioned indicators.

According to data provided by NEA[13], in the fourth quarter of 2019, the number of dismissed persons decreased by 41.8% compared to the same period of the previous year, and the number of identified vacancies reduced by 4.4%. Given the socio-economic situation affected by the COVID-19 pandemic, associated with the return of a large number of citizens from abroad, but also the negative impact on domestic economic activity of measures to stop the spread of coronavirus, in the next period the number of employed population will decrease, and the unemployment rate will be more pronounced.

[11] Methodology of household labour force survey, approved by the Order of the National Bureau of Statistics no. 53 of September 20, 2019.
[12] http://statistica.gov.md/newsview.php?l=en&idc=168&id=6468&parent=0
[13] National Employment Agency

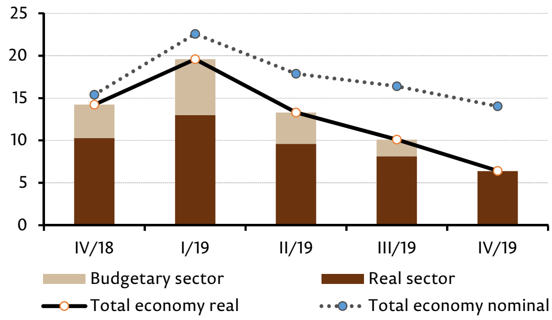
Wage fund

In the fourth quarter of 2019, the annual rate of the wage-fund per economy continued the downward trend that began in the second quarter of 2019, but it remains significant. Information on the evolution of earnings in the fourth quarter of 2019 reveals that the wage-fund per economy increased by 14.0%, and in real terms, deflated with the CPI, it increased by 6.4% compared to the same period of the previous year, largely due to the positive contribution from the dynamics of the real sector remuneration fund (Chart 3.25).

In the fourth quarter of 2019, the number of employees in the economy was higher than in the corresponding period of 2018, following the developments in the real sector of the economy. The average number of employees in the national economy was 2.0% higher than in October-December 2018 (Chart 3.26).

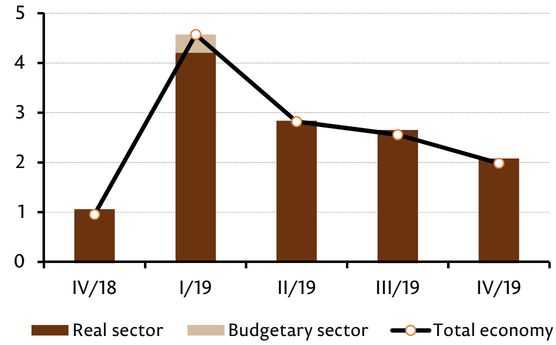
In the fourth quarter of 2019, the annual rate of labour productivity estimated at the level of the industrial sector remained in the positive level, constituting 0.9%. At the same time, the annual dynamics of the average real wage in the industrial sector increased to 3.8%. **In this context, the annual growth rate of the unit labour cost in industry increased by about 3.4 percentage points up to 2.9%** (Chart 3.27).

Chart 3.25: The wage fund in the economy (%, yoy) and the contributions of the economy sectors (p.p.)



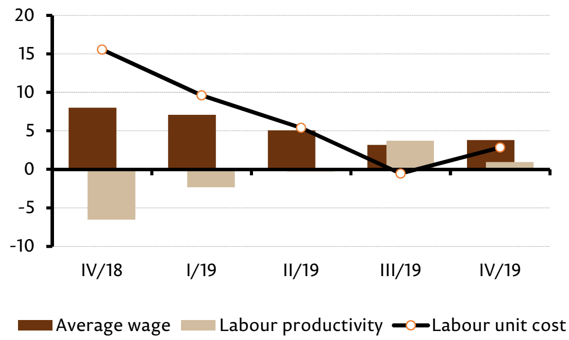
Source: NBS, NBM calculus

Chart 3.26: The average numbers of employees in the economy (%, yoy) and the contributions of the economy sectors (p.p.)



Source: NBS, NBM calculus

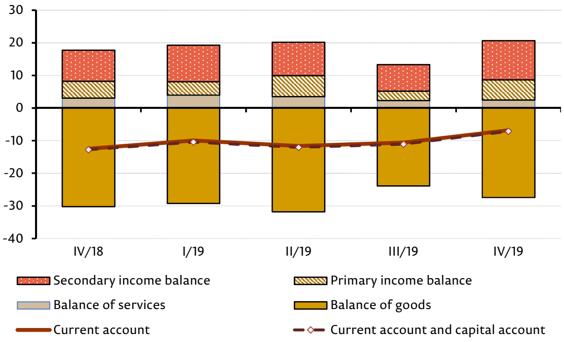
Chart 3.27: Average real wage and labour productivity in industry (%, yoy)



Source: NBS, NBM calculus

3.4 External sector

Chart 3.28: Current account share in GDP (%)



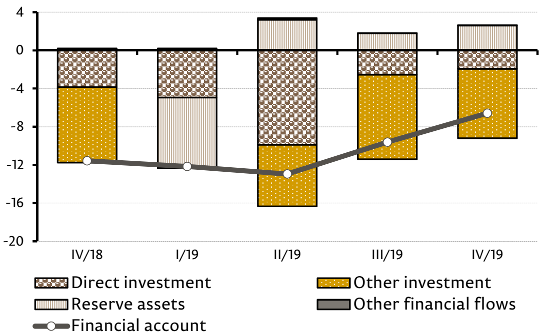
Source: NBM

In the fourth quarter of 2019, the current account deficit of the balance of payments decreased by 3.8 percentage points compared to the previous quarter, following the increase of shares of the components with positive contribution, constituting 6.8% as a share in GDP (Chart 3.28). During this period, the share of "services balance", "secondary income balance" and "primary income balance" increased. At the same time, the component with a negative contribution increased – the "balance of goods".

Financial Account

Similar to the previous quarter, in the fourth quarter of 2019, a moderation of net capital inflows was reported. The financial account, as a share in GDP, constituted 6.6% or by 3.0 percentage points decreasing compared to the third quarter of 2019. It should be noted that the decrease in net capital inflows was determined by all subcomponents (Chart 3.29). Direct investments flow, as a share in GDP, recorded a level of 1.9%, being 0.7 percentage points lower than in the previous quarter, as a result of the decrease of foreign participations in the share capital of enterprises from the Republic of Moldova, but also of the reinvested profit. At the same time, the component of other investments decreased to 7.3% or by 1.6 percentage points, mainly due to the net decrease in assets in the form of cash and deposits. In the fourth quarter of 2019, the NBM's reserve assets were growing.

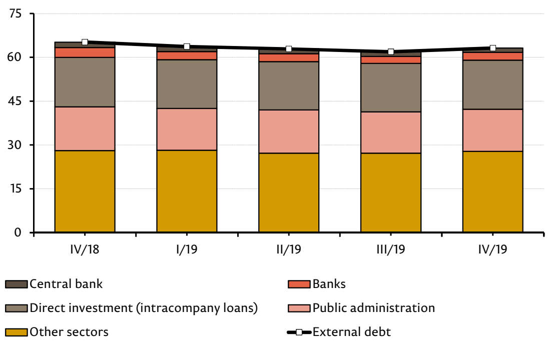
Chart 3.29: Financial account share in GDP (%)



Source: NBM
Note: (-) – net capital inflows, (+) – net capital outflows

The share of external debt in GDP was 63.2%, being 1.2 percentage points higher than in the third quarter of 2019 (Chart 3.30). No significant changes were recorded in the structure of external debt, so similar to previous periods, the major share in total external debt is held by economic agents[14] by 30.4%, direct investments account for 16.8% and the government sector[15] – 15.9%.

Chart 3.30: Share of external debt in GDP (%)



Source: NBM

[14] Cumulative debt of "Banks" and "Other sectors".
[15] Cumulative debt of "Public administration" and "Central bank".

Chapter 4

Monetary policy

4.1 Monetary policy instruments

Interest rate policy

In the context of confirming the disinflationary trend and in order to further strengthen the level of liquidity in the banking sector, and of supporting the business environment amid recent developments in the global and national economies, the National Bank decreased in two consecutive steps (1.0 and 1.25 percentage points each) the monetary policy rate in March, after being maintained at the same level during January and February.

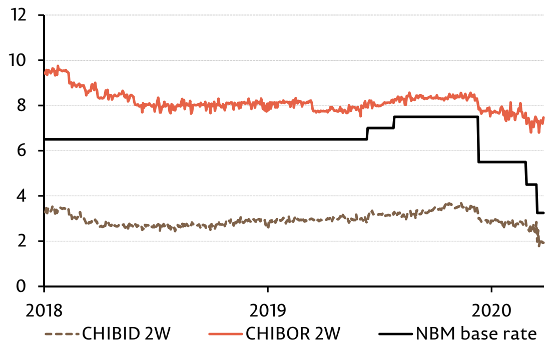
The yield curve CHIBOR 2W followed a slightly downward trajectory during the first quarter of 2020, recording a sharper decline in early March due to the change in the base rate. Thus, the CHIBOR 2W quotation at the end of March was 7.47%, lower by 0.32 percentage points the one recorded on the last day of the previous quarter (Chart 4.1).

The consistent demand from investors for government securities with a maturity of 91 days led to a change in the direction of evolution of the rates related to them. Over the whole period, the average of these rates was 4.20% (-0.55 percentage points compared to the fourth quarter of 2019) (Chart 4.2).

The quarterly average of the yield of sale-purchase operations on the secondary market of government securities amounted to 5.62%, being lower than in the previous quarter (-0.78 percentage points), under the conditions of increasing the weighted average term to maturity from 253 days to 272 days.

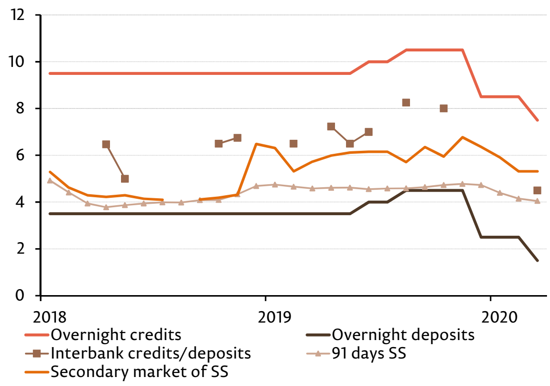
The weighted average interest rate on the interbank money market stood at 4.50% annually.

Chart 4.1: The average monthly reference rates on the interbank market and the base rate of the NBM (%)



Source: NBM

Chart 4.2: The monthly evolution of the interest rate corridor (%)



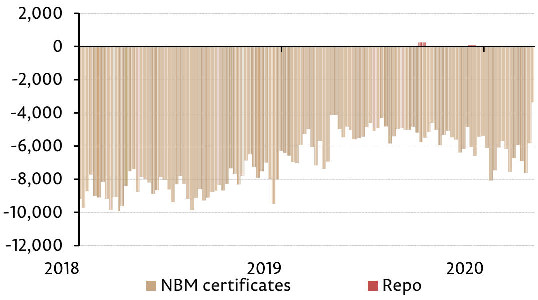
Source: NBM

Money market operations

Sales of NBM certificates (NBC)

The NBM conducted weekly placement auctions of NBC, with a maturity of 14 days and with the announcement of the maximum interest rate equivalent to the base rate of the NBM. For the whole of the first quarter of 2020, the weighted average rate of liquidity absorption operations amounted to 5.19% annually.

Chart 4.3: Evolution of the daily balance of sterilization operations (million MDL)



Source: NBM

The stock of placements NBC varied during the quarter between the minimum value of 3,369.8 million MDL and the maximum value of 8,087.6 million MDL. The average quarterly balance of NBC amounted to 6,471.6 million MDL (+955.6 million MDL compared to the fourth quarter of 2019) (Chart 4.3).

Repo operations

Repo operations on payment of liquidities were carried out weekly for 14 days at a fixed interest rate (base rate plus a margin of 0.25 percentage points) through the tender procedure without a ceiling, according to the calendar of monetary policy operations for 2020. The balance of repo operations recorded at the end of the management quarter was zero.

Standing facilities

The regime of operation of permanent facilities (deposits and overnight loans) established by the NBM allowed banks to efficiently manage their own liquidity and gave the NBM more flexibility in conducting monetary policy, helping to reduce the volatility of short-term money market interest rates.

In the first quarter of 2020, the National Bank reduced the interest rates on overnight loans and deposits in two stages (March 4 and 20) to 6.25% and 0.25% annually, respectively, in total by 2.25 percentage points.

During the analyzed period, the banks mainly used the overnight deposit facility, the overnight credit facility, in the amount of 45.0 million MDL, being requested only by a bank, at the end of the periods of application of required reserves, to supply the short-term liquidity demand.

The total volume of overnight deposits placed with the NBM in the reference quarter amounted to 19,823.5 million MDL, which indicates an average daily balance of 331.5 million MDL, higher than in the previous quarter by 31.6%.

The weighted average rate on overnight deposits placed/ overnight loans granted was 2.28% and 7.50%, respectively.

Required reserves

Required reserves mechanism continued to exercise the functions of monetary control and liquidity management in the banking system.

During the first quarter of 2020, required reserves norms were gradually adjusted towards balancing them. Thus, the required reserves norms from funds attracted in Moldovan lei and in non-convertible currency was decreased from 42.5% to 41.0% of the calculation base, and that for funds attracted in FCC was increased from 17.0% to 20.0%. Also, towards the end of the quarter, in order to mitigate the effects of the COVID-19 pandemic on the economy, the required reserves norm from funds attracted in Moldovan lei and in non-convertible currency was reduced by another 7.0 percentage points, and the required reserves norm from funds attracted in FCC was increased by 1.0 percentage point, these measures having the period of application April 16 - May 15.

Between March 16 and April 15, 2020, the required reserves in MDL amounted to 16,065 million MDL, a volume higher by 33.9 million MDL (+0.2%) than those maintained between December 16, 2019 - January 15, 2020. During the same period, required reserves in FCC amounted to USD 84.5 million and EUR 206.2 million, an increase of 15.1% and 23.2%, respectively, compared to December 16, 2019 - January 15, 2020.

In the first quarter of 2020, several changes came into force in the field of regulation of required reserves to make the regime of setting up and maintaining required reserves by banks more flexible. In this respect, during the application period, part of the required reserves in FCC (5% of the calculation basis) can be maintained by banks in the average amount.

Interbank monetary market

The excess liquidity pursued in the banking system continued to keep passive the interbank credit/ deposit market. The volume of transactions in the first quarter of 2020 amounted to 15.0 million MDL, the average interest rate - 4.50%, the term of transactions being overnight.

Government deposits placed at the National Bank of Moldova

As of March 31, 2020, the balance of deposits placed by the Ministry of Finance at the National Bank amounted to 177.7 million MDL, all of which were intended to maintain the state's liquidity reserve. The weighted average rate on deposits in the balance amounted to 6.42%, the weighted average term - 1274 days.

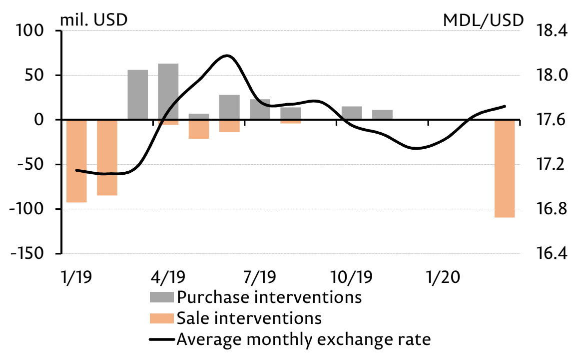
Interventions on the domestic foreign exchange market

The NBM intervened on the domestic foreign exchange market between January and March 2020, mainly through foreign exchange sales.

During the analyzed period, the volume of transactions of the National Bank of Moldova performed on the interbank foreign exchange market against Moldovan lei, at the date of the currency, amounted to 109.87 million US dollars, including sales transactions amounting to 109.55 million US dollars, currency conversions with the International Development Association in the amount of 0.28 million US dollars and cash purchase transactions in the amount of 0.04 million US dollars (equivalent to 0.04 million euros).

At the same time, during the reporting period, the NBM conducted purchase swap transactions amounting to USD 5.50 million (equivalent of 5.0 million euros) (Chart 4.4).

Chart 4.4: Evolution of the official MDL/USD exchange rate and the volume of daily transactions of the NBM, first quarter of 2020 (million US dollars)

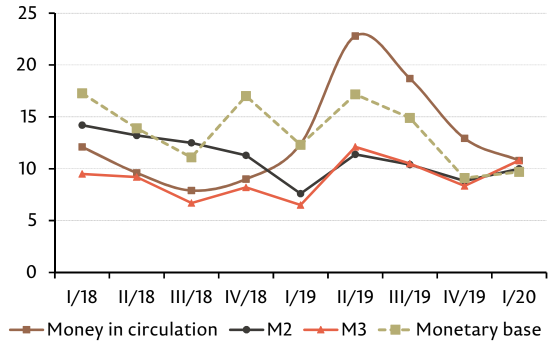


Source: NBM

4.2 Dynamics of monetary indicators

In the first quarter of 2020, the dynamics of monetary aggregates was positive, the quarterly average in annual terms being 10.0% for M2 (by 1.2 percentage points above the level of the fourth quarter of 2019) and 10.8% for M3 (by 2,4 percentage points more compared to the previous quarter). The monetary base registered, compared to the previous quarter, a quarterly average of 9.7% in annual terms (Chart 4.5).

Chart 4.5: Changing monetary aggregates (%, annual growth)

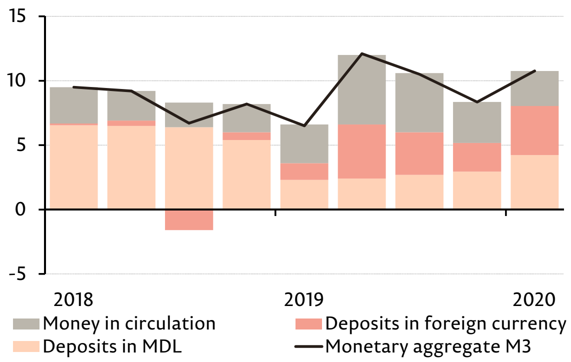


Source: NBM

Money supply

During the first quarter of 2020, money supply in a broad sense recorded an average annual increase of 10.8%, due to the increase, with a major contribution, of deposits in national currency and foreign currency deposits, as well as the contribution from money in circulation was declining (Chart 4.6).

Chart 4.6: Dynamics of the M3 monetary aggregate (contribution of the components in annual growth, %)

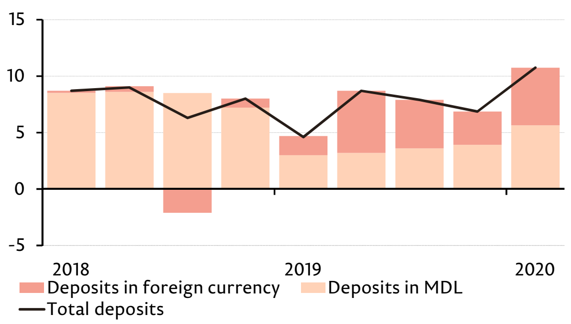


Source: NBM

The evolution of deposits in national currency (Chart 4.8) was determined by the increase in the second consecutive quarter of term deposits, predominantly of individuals, and sight deposits, as a result of the increase in the volume of sight deposits attracted from individuals (Chart 4.10).

The component of foreign currency deposits registered a faster evolution than in the previous quarter as a result of a faster growth of the volume of sight and term deposits (Chart 4.11). It should be noted that, after a long period of decreases in annual terms, there is a revival of foreign currency term deposits of legal entities, their average annual increase in the first quarter of 2020 being 2.7% (Chart 4.12).

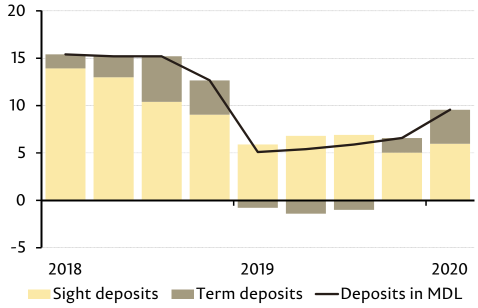
Chart 4.7: Dynamics of the total balance of deposits (contribution of the components in annual growth, %)



Source: NBM

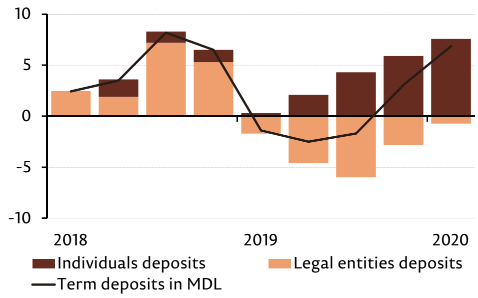
The growth rate of money in circulation in the first quarter of 2020 decreased by 2.1 percentage points compared to the end of the previous quarter, and the average quarterly contribution of money in circulation to M3 growth decreased by 0.5 percentage points compared to the level recorded in the fourth quarter of 2019. The dynamics of money in circulation was determined by the lower cash flow compared to the flow releases from the cash offices of commercial banks. Of the total receipts, the largest share was the receipts from the sale of consumer goods and the receipts on the current and deposit accounts of individuals. Regarding the releases from the cash offices of commercial banks, the main components were: the releases for the purchase of foreign currency from individuals and the releases of cash from current and deposit accounts.

Chart 4.8: Annual growth rates of the balance of deposits in national currency (%) and the contribution of components (p.p.)



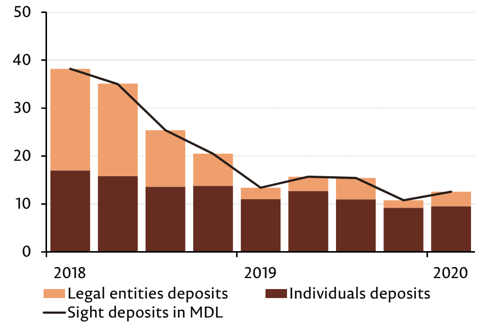
Source: NBM

Chart 4.9: Annual growth rates of term deposits balance in national currency (%) and the contribution of components (p.p.)



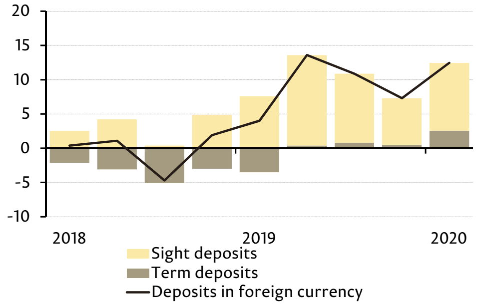
Source: NBM

Chart 4.10: Annual growth rates of sight deposits balance in national currency (%) and the contribution of components (p.p.)



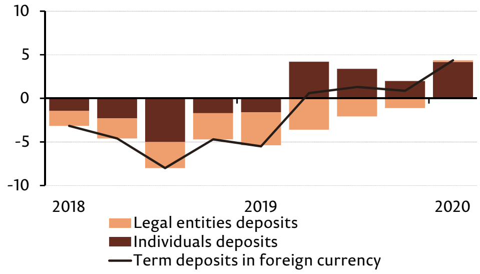
Source: NBM

Chart 4.11: Annual growth rates of the balance of deposits in foreign currency (%) and the contribution of components (p.p.)



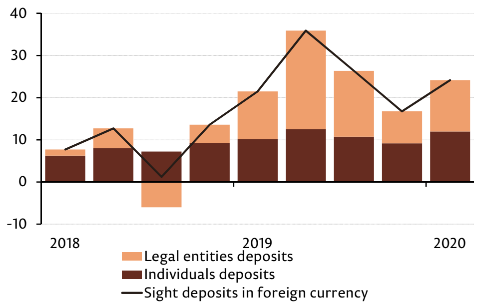
Source: NBM

Chart 4.12: Annual growth rates of term deposits balance in foreign currency (%) and the contribution of components (p.p.)



Source: NBM

Chart 4.13: Annual growth rates of the sight deposits balance in foreign currency (%) and the contribution of components (p.p.)

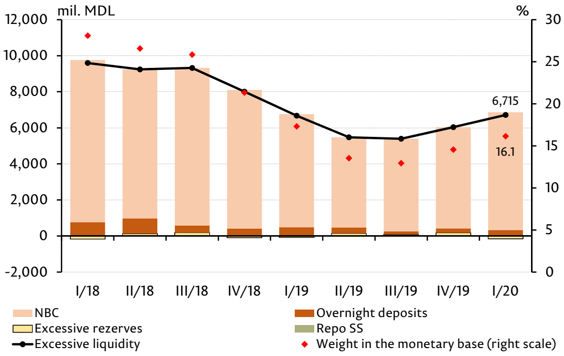


Source: NBM

Excess liquidity

During the first quarter of 2020, excessive liquidity in the banking system increased by 675.0 million MDL. It should be mentioned that compared to the first quarter of 2019, the volume of excessive liquidity remained practically at the same level, registering the average value of 6.7 billion MDL (Chart 4.14).

Chart 4.14: Excessive liquidity (millions MDL)



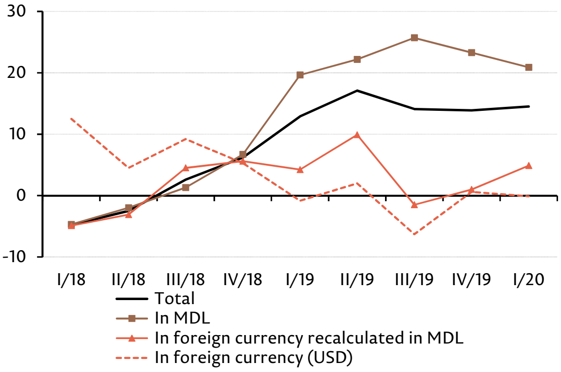
Source: NBM

Credit market

Evolution of the balance of loans granted by licensed banks[16]

At the end of the first quarter of 2020, the total balance of loans granted by licensed banks recorded a positive annual increase (Chart 4.15). The total balance of loans amounted to 41,174.1 million MDL, higher than at the end of the first quarter of 2019 by 14.5%, due to the increase of the balance of loans granted in the national currency, with a positive contribution of 12.5 percentage points. The share of the balance of loans granted in the national currency constituted 63.0% of the total balance of loans.

Chart 4.15: Evolution of the loan balance (%, annual increase)



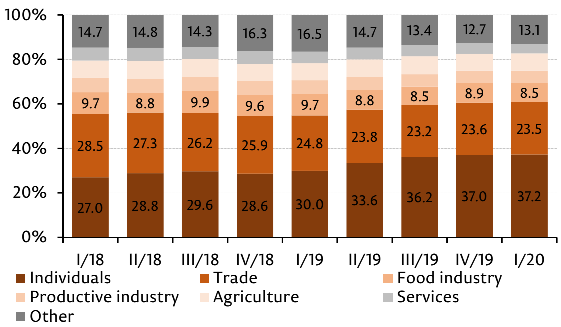
Source: NBM

At the end of the first quarter of 2020, the balance of loans granted in the national currency registered an annual growth rate of 20.9%, due to the increase in the balance of loans granted to both individuals, with a positive contribution of 17.5 percentage points, and the balance of loans granted to legal entities, with a positive contribution of 3.4 percentage points. In turn, the balance of loans in MDL granted to individuals registered an annual increase of 33.7%, the share of these loans constituted 57.3% of the balance of loans in MDL.

At the end of the first quarter of 2020, the balance of foreign currency loans recalculated in the national currency, compared to the end of the first quarter of 2019, increased by 4.9%.

During the analyzed period, in the structure of the loan portfolio granted by the licensed banks, the highest share, analogous to the previous quarters, went to loans granted to individuals (37.2%), followed by the share of loans granted in the field of trade (23.5%) (Chart 4.16).

Chart 4.16: Loan balance structure (% in total)



Source: NBM

Evolution of new credits granted by licensed banks

During the first quarter of 2020, the total volume of new loans granted in MDL was lower than in the first quarter of 2019 by 1.8% (Chart 4.17). This development was influenced by the reduction of the volume of new loans granted in MDL to individuals by 9.0%. It should be mentioned that, during the years 2017-2019, the quarterly volume of new loans granted in MDL registered only positive annual increases. The volume of loans granted in foreign currency recalculated in MDL registered a decrease of 6.8%, generated by the decrease in the volume of loans granted to legal entities.

[16] Data analysis was performed on the basis of ORD 01.06 reports "Interest rates on the balance of loans and deposits" submitted by licensed banks until April 13, 2020.

The market of term deposits accepted by licensed banks (balance of deposits[17])

At the end of the first quarter of 2020, the annual rate of increase in the balance of term deposits attracted by licensed banks increased by 5.4%, due to the increase in the balance of deposits in the national currency by 5.6% and the balance of foreign currency deposits recalculated in national currency by 5.2% (Chart 4.18). The balance of deposits in MDL increased due to the increase of deposits attracted from individuals, the share of these deposits being 89.1%.

Interest rates[18]

Evolution of the base rate

During the first quarter of 2020, there took place three meetings of the Executive Committee of the National Bank of Moldova on monetary policy decisions. Following the assessment of the balance of internal and external risks and the short- and medium-term inflation outlook, the Executive Board of the National Bank of Moldova, at the meeting of January 29, 2020, decided to maintain the base rate applied to the main monetary policy operations at 5.5% annually (level set at the meeting of December 11, 2019). Subsequently, at the meeting of March 4, 2020, it decided to reduce the base rate applied to the main monetary policy operations by 1.0 percentage point, to 4.5% per year, and at the extraordinary meeting of March 20, 2020 by 1.25 percentage points, up to 3.25% annually. These decisions aimed at fostering a monetary climate capable of reviving lending and saving activity, further adapting the domestic economic environment to the volatility and uncertainty of the external macroeconomic situation, with the aim of anchoring inflationary expectations, restoring and maintaining the inflation rate close to the target of 5.0% in the medium term, with a possible deviation of ± 1.5 percentage points.

Evolution of the interest rate related to the loan balance

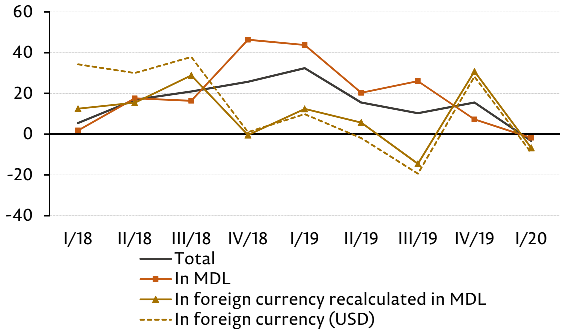
Between January and March 2020, the weighted average interest rate on the balance of loans granted in MDL by licensed banks amounted to 7.96% annually (-0.43 percentage points compared to the first quarter of 2019) (Chart 4.19). This dynamic was determined by the decrease of the rates on the balance of loans granted to both legal entities and individuals.

For the whole of the first quarter of 2020, the weighted average interest rate related to the balance of foreign currency loans recalculated in MDL was 4.44% annually, lower than in the first quarter of 2019 by 0.37 percentage points (largely due to the decrease in the weighted average interest rate on the balance of foreign currency loans granted to legal entities, the share of these loans was 97.0%).

[17]Data analysis was performed based on ORD 01.06 reports "Interest rates on the balance of loans and deposits" presented by licensed banks until April 13, 2020 and does not include sight deposits.

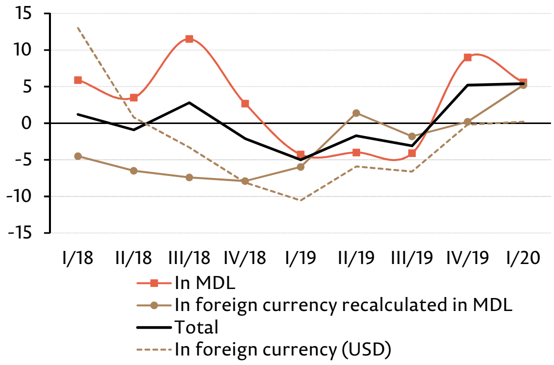
[18]The analysis of the rates was carried out based on ORD 01.06 reports "Interest rates related to the balance of loans and deposits" presented by the licensed banks until April 13, 2020 and does not include the rates on sight deposits.

Chart 4.17: Evolution of new loans granted (%, annual growth)



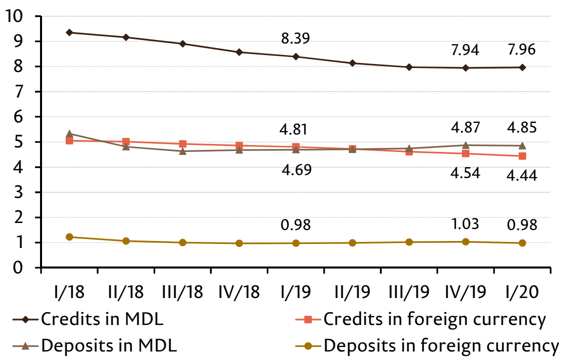
Source: NBM

Chart 4.18: Deposit balance dynamics (%, annual growth)



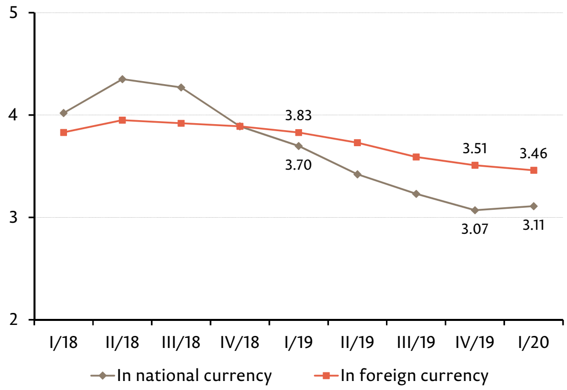
Source: NBM

Chart 4.19: Average interest rates on loan and deposit balances (%)



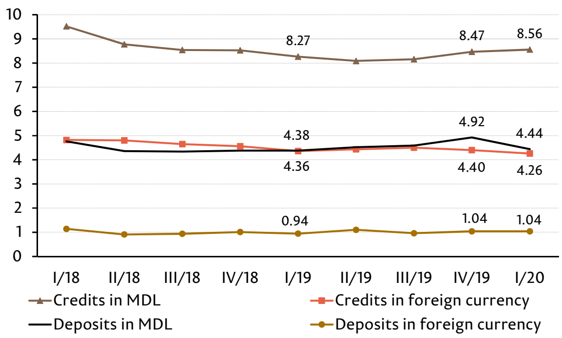
Source: NBM

Chart 4.20: The evolution of the bank margin on loan and deposit balances (p.p.)



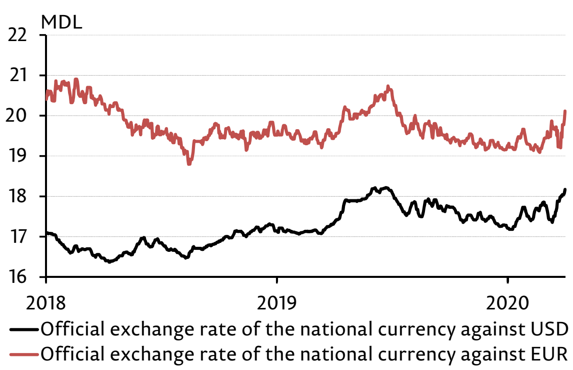
Source: NBM

Chart 4.21: Average interest rates on new volumes of loans and deposits (%)



Source: NBM

Chart 4.22: Fluctuations in the official exchange rate of the Moldovan leu against the US dollar and the euro



Source: NBM

Evolution of the interest rate related to the balance of deposits

The weighted average interest rate on the balance of deposits in the national currency in the first quarter of 2020 increased compared to the first quarter of 2019, and did not change significantly compared to the fourth quarter of 2019 (Chart 4.19). The weighted average interest rate related to the balance of term deposits in the national currency increased by 0.16 percentage points compared to the first quarter of 2019 (with a contribution from the rate increase of 0.15 percentage points).

Evolution of banking margin

In the first quarter of 2020, the bank margins (calculated as the difference between the weighted average interest rates on loan balances and the weighted average interest rates on deposit balances) decreased compared to the first quarter of 2019 and did not change significantly compared to the previous quarter (Chart 4.20).

Evolution of interest rates on loans granted and on deposits attracted by licensed banks

Reflecting monetary conditions, in the first quarter of 2020, the weighted average interest rate on new term deposits attracted in the national currency decreased compared to the previous quarter (Chart 4.21). The weighted average interest rate on MDL deposits was 4.44% annually or 0.48 percentage points less than in the fourth quarter of 2019 (the contribution from the rate increase was negative, of 0.52 percentage points). The weighted average interest rate on new loans granted by licensed banks increased compared to the fourth quarter of 2019 (due to the reweighting of amounts).

Evolution of the nominal and real effective exchange rate

During the first quarter of 2020, the official nominal exchange rate of the national currency depreciated by 5.6% against the US dollar, and against the euro - by 4.4% compared to the level recorded at the end of the previous quarter (Chart 4.22).

On average, the exchange rate of the Moldovan leu depreciated to a lesser extent - by 0.8% against the US dollar and by 0.4% against the euro, compared to the averages of the previous quarter.

In the first quarter, most currencies of the main trading partner countries of the Republic of Moldova included in the REER basket recorded significant depreciations against the US dollar: the Russian ruble - by 29.0%, the Belarusian ruble - by 23.6%, the Ukrainian hryvnia - by 17.8%, the Turkish lira - by 9.8%, the Hungarian forint - by 9.4% etc. During this period, only the Swiss franc appreciated against the US dollar (Chart 4.23).

Under these conditions, in real terms, the Moldovan leu appreciated by 2.5% against the currency basket of the main trading partners of the Republic of Moldova. Of these, Russia had higher contributions to the REER appreciation - by 1.6 percentage points and Ukraine - by 0.9 percentage points (Chart 4.24).

In the first quarter of 2020, a foreign exchange deficit formed on the local foreign exchange market, which deepened especially in the second half of March, the main cause being the disturbances caused to the national economy by the COVID-19 pandemic.

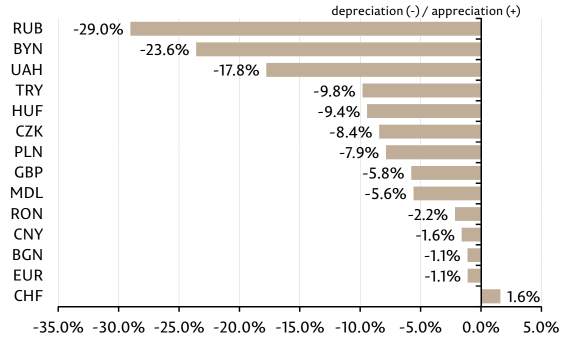
In the first quarter of 2020, the net supply of foreign currency from individuals amounted to 412.4 million US dollars, down 17.2% compared to the previous quarter, but by 12.2% above the level recorded in the first quarter of 2019. In January-February, the net supply of foreign currency from individuals registered robust annual increases, to some extent, due to the resurgence in recent months of transfers from abroad in favor of individuals. In the first two months of the year [19], they increased by 3.9% compared to the same period in 2019. In March, however, the net supply of foreign currency decreased by about a third compared to March 2019, due to the pandemic situation that affected the growth prospects of transfers from abroad and the consumption of the population. In the structure of the net supply of foreign currency from individuals, the single European currency continued to have a majority share (76.1%) (Chart 4.26).

At the same time, the net demand for foreign currency from economic agents increased both compared to the previous quarter (+14.2%) and compared to the first quarter of 2019 (+8.8%), to the level of 554,1 million US dollars. In contrast to this dynamic, an important component of the net demand for foreign currency, that of the local natural gas supplier, decreased by 22.6% compared to the first quarter of 2019, in the context of the reduction of both the price and the volume of gas imports taking into account the atypical seasonal weather conditions. Thus, the net sales of foreign exchange to economic agents remained at a high level amid a temporary tendency of them to convert their savings from MDL into foreign currency, observed in March, and generated by the uncertainties to which the business environment was exposed following the establishment of the state of emergency at national level in connection with the pandemic situation.

Under these conditions, the degree of coverage of the net demand for foreign currency by economic agents through the net supply of foreign currency from individuals was 74.4% in the first quarter of 2020 compared to 102.6% in the previous quarter and 72.2% in the first quarter of 2019. In January and February, the degree of coverage of demand by supply recorded values slightly below the equilibrium level - 96.9% and 95.7%, respectively. This dynamic was also reflected in the evolution of the official exchange rate, which was on a slightly upward trend in the first two months of the year. Periods with faster depreciation rates were associated with higher foreign exchange sales to energy importers, whose demand usually intensifies in the cold season. In some weeks, however, the increased net supply of foreign currency from individuals or some exporters in the manufacturing industry generated foreign exchange surpluses, causing a temporary reversal of the official exchange rate trend towards appreciation. Starting with the second decade of March, the effects of the COVID-19 pandemic began to be felt on the local foreign exchange market. Of particular note is the impact on net supply from individuals, which has shrunk to USD 96.8 million. Under these circumstances, the coverage of net demand by net foreign exchange supply fell to 42.7% in March (Chart 4.27). The imbalance between the supply and demand for currency also occurred, to some extent, amid the cessation of air travel since the second half of the month, which affected the ability of foreign exchange market operators to manage cash

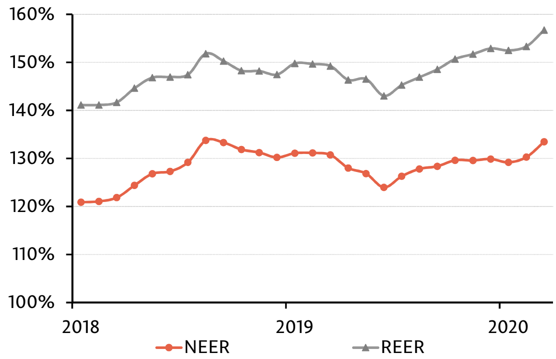
[19] At the time of report preparation, there were available data only for the first 2 months of the year.

Chart 4.23: The evolution of countries' currencies - main trading partners against the US dollar (31.03.2020/ 31.12.2019, %)



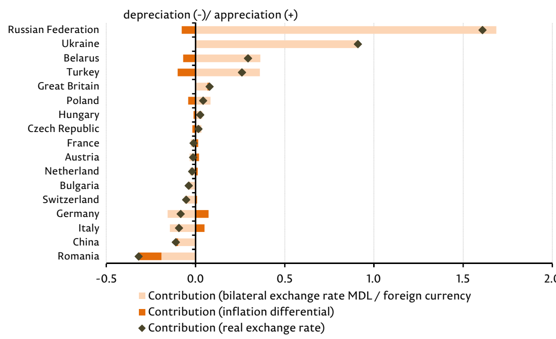
Source: NBM

Chart 4.24: Dynamics of the nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated on the basis of the share of countries - main trading partners (Dec.2000-100%)



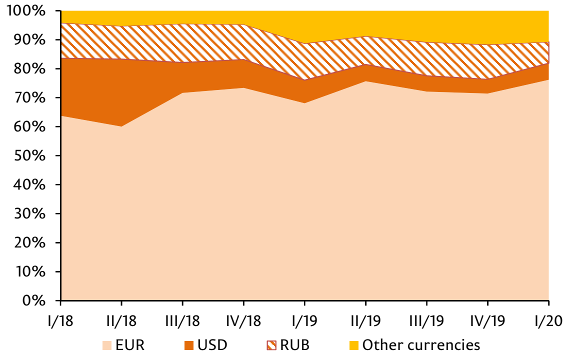
Source: NBM

Chart 4.25: Contribution of the countries - main trading partners of the Republic of Moldova to the change in the real effective exchange rate in the first quarter of 2020



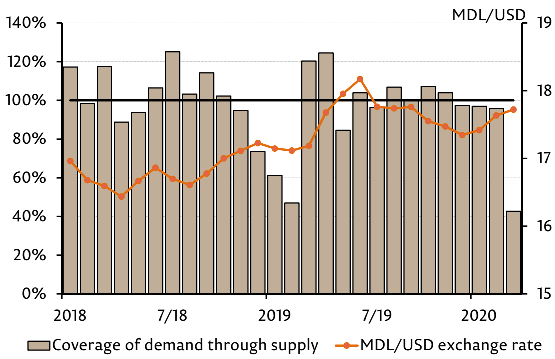
Source: NBM

Chart 4.26: The net supply of foreign currency from individuals disaggregated by major currencies (the currencies are recalculated in USD at the constant exchange rate)



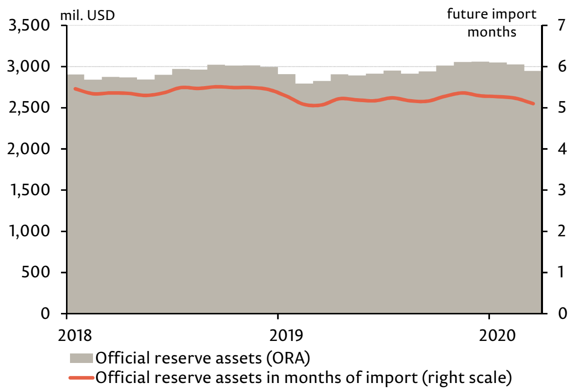
Source: NBM

Chart 4.27: Net sales coverage through the net supply and dynamics of the official exchange rate



Source: BNM

Chart 4.28: Evolution of official reserve assets expressed in months of import of goods and services (MBP6)



Source: NBM - based on updated actual and forecast data

in foreign currency. In these circumstances, NBM intervened by foreign exchange sales in the local market in the amount of 109.6 million US dollars [20].

The dynamics of the official exchange rate of the Moldovan leu against the euro was also influenced by the evolutions of the single European currency against the US dollar on international markets. In the first half of the quarter, the US dollar showed a strong appreciation trend, consolidating its position as a safe haven currency for investors in times of instability. From the second half of February until the end of the quarter, the EUR/USD exchange rate fluctuated significantly between USD 1.07 and USD 1.14 per 1 euro, reflecting the high volatility of international financial markets in connection with the spread of the COVID-19 pandemic in most states of the world.

During this period, the ECB's and Fed's efforts were focused on combating the negative effects of the pandemic on economic activity. Thus, Fed reduced the federal funds rate to 0-0.25%, and ECB adopted new quantitative easing measures to support the real sector of the economy. Under these conditions, from the beginning of the year until the end of the first quarter of 2020, the euro depreciated by 1.1% against the US dollar.

According to the situation at the end of the first quarter of 2020, the balance of official reserve assets amounted to USD 2,948.7 million (Chart 4.28), down by USD 110.9 million (-3.6%) compared to the end of 2019. NBM interventions for the sale of foreign currency and payments related to the service of external public debt were the main factors that determined the decrease of official reserve assets. At the same time, it was partially mitigated by higher inflows into the FCC required reserve accounts of licensed banks and disbursements within the external financing from development partners of the Republic of Moldova. In this regard, under the Program of the Republic of Moldova with IMF was disbursed the last tranche in the amount of the equivalent of 19.9 million US dollars, of which 11.8 million US dollars for budget support. From the World Bank institutions - IBRD and IDA - loans and grants amounting to USD 7.9 million were recorded, including loans for local road rehabilitation projects (USD 3.9 million) and improving competitiveness (USD 1.8 million).

According to the situation at the end of the first quarter of 2020, official reserve assets continued to provide a sufficient level of coverage for imports of goods and services (5.1 months of future imports [21]).

[20]Volume calculated at the currency date

[21]Calculated on the basis of the latest available forecast of import of goods and services for 2020, MBP6 methodology

Chapter 5

Forecast

5.1 External Hypotheses

Since the previous forecast round, the macroeconomic situation at international level has changed radically, leading to a significant revision of forecasts. For 2020, the deepest crisis of the last century is anticipated, after which in 2021 the recovery of the world economy is expected, but not able to reach the pre-crisis level. In the table no.5.1 there are presented the main anticipations regarding the evolution of external variables, with the detailed description below.

According to the Consensus Forecast[22], the euro area expects a decline in the gross domestic product by an average of 5.7% in 2020, followed by a significant increase of 5.4% in 2021. Compared to the previous forecast round, the forecast values for euro area economic growth decreased by 6.7 percentage points in 2020 and increased by 4.2 percentage points for 2021. The economies of Italy, Spain and France will be the hardest hit by the crisis. At the same time, the forecast for average annual inflation in the euro area has declined as a result of the reduction in global international prices, especially in oil, but also in the decline in domestic consumption. For 2020, consumer prices in the euro area are expected to increase by an average of 0.4%, and in 2021 by 1.3%. At the same time, monetary conditions will continue to be deeply stimulating in the euro area, following the ECB's announcement of a number of appropriate measures.

According to the Consensus Forecast, the economy of the Russian Federation will grow by 1.0% in 2020 and by 1.8% in 2021. At the same time, the consumer prices will increase by an average of 2.7% in 2020 and by 3.4% in 2021. The economy of the Russian Federation is subject to two major shocks: the COVID-19 pandemic and the significant reduction in oil prices. Compared to the European Union and the U.S., the epidemiological situation in the Russian Federation worsened towards the end of April 2020. At the same time, the agreement between OPEC and the G20 of April 10, 2020 on reducing 9.7 million barrels per day of oil production was not sufficient to improve the situation on the oil market in the absence of oil storage space. It is not excluded that in the May report in the forecasts on the economy of the Russian Federation to be incorporated the latest events and respectively to reduce the anticipated values.

The average of EUR/USD currency parity will be 1.10 in 2020 and 1.13 in 2021, which is a more appreciable U.S. dollar compared

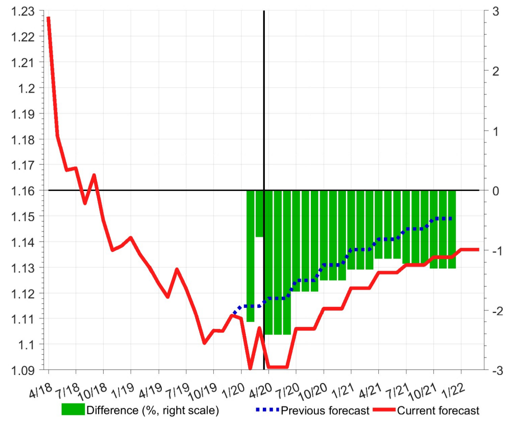
[22]Foreign Exchange Consensus Forecast, April 6, 2020.

Table 5.1: Expected evolution of external variables (annual average)

	2020	2021
Economic growth in the euro area, %	-5.7	5.4
Economic growth in the Russian Federation, %	1.0	1.8
Average annual inflation in the euro area, %	0.4	1.3
Average annual inflation in the Russian Federation, %	2.7	3.4
EUR/USD	1.10	1.13
USD/RUB	72.9	70.8
Urals brand oil prices (USD/barrel)	38.0	39.3
International food prices growth, %	-1.9	4.3

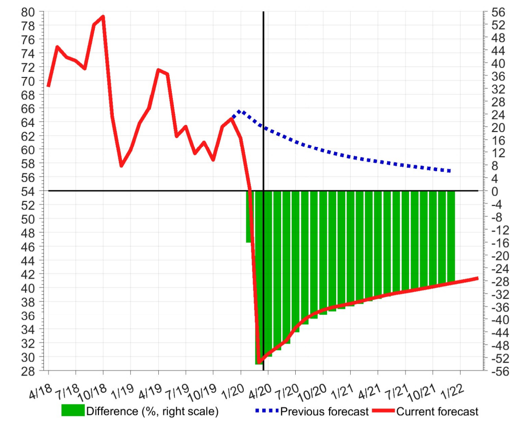
Source: Consensus Economics, Bloomberg, NBM calculus

Chart 5.1: The evolutionary scenario of the EUR/USD exchange rate



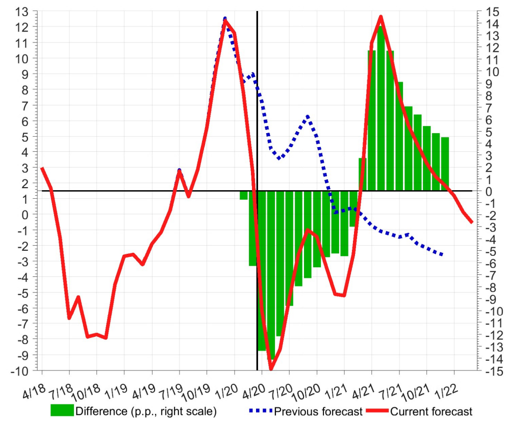
Source: ECB, Consensus Economics, NBM calculus

Chart 5.2: The evolutionary scenario of the Urals brand oil world prices (USD/barrel)



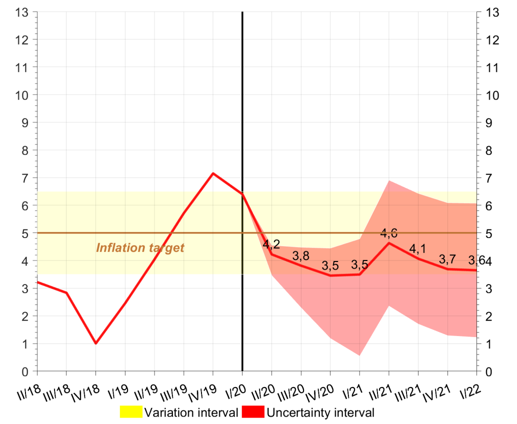
Source: Ministry of Economic Development of the Russian Federation, Bloomberg, NBM calculus

Chart 5.3: International price assumption for food (%)



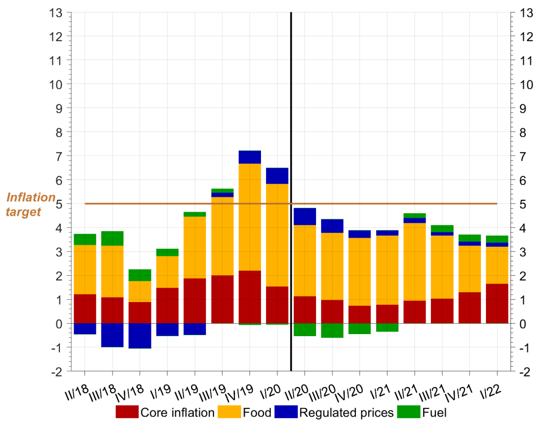
Source: FAO, Bloomberg, NBM calculus

Chart 5.4: CPI with uncertainty range (%, fap)



Source: NBS, NBM calculus

Chart 5.5: Decomposition of CPI (%, percentage points, compared to the previous year.)



Source: NBS, NBM calculus

to the previous forecast round. As explained in Chapter 2 of this Inflation Report, the U.S. dollar is currently appreciating, benefiting as a liquid reserve asset preferred by investors in times of panic. At the same time, both the SRF and the ECB have announced in recent months several monetary stimulus measures, which after the end of the crisis will be more reflected in the EUR/USD parity (Chart 5.1).

After a long period of appreciation, starting with March 2020, the Russian ruble reversed the trend, depreciating significantly due to the reduction of oil prices. In the current forecast round, it is anticipated that the USD/RUB parity will be 72.9 in 2020 and 70.8 in 2021. Compared to the forecast round related to the Report on inflation No1/2020, the USD/RUB forecast was increased by 15.3% for 2020 and 9.8% for 2021. In addition to the precarious situation on the world oil market, the Russian ruble is at a disadvantage as an emerging currency avoided by the investors in times of crisis.

The most significant change in external assumptions is the forecast on the evolution of the oil price (Urals quotation). In the current forecast round, an average oil price of 38.0 USD/barrel is expected in 2020 and 39.3 USD/barrel in 2021. Compared to the previous forecast round, the forecast values decreased by 38.5 and 32.0%, respectively. The factors that led to this significant reduction in the oil price forecast are described in Chapter 2 of the report (Chart 5.2).

As global demand has declined, the trajectory of the international food price forecast has changed significantly. Thus, in the current forecast round, international food prices are expected to fall by an average of 1.9% in 2020 compared to the 5.4% increase anticipated in the previous forecast round. For 2021, an increase of 4.3% in international food prices is already expected, compared to the reduction of 1.2% anticipated in the previous forecast round (Chart 5.3).

5.2 Internal environment

Inflation

The annual inflation rate starting with the first quarter of the forecast will decrease continuously until the end of the current year (minimum level 3.5% in the fourth quarter of 2020 and the first quarter of 2021). Subsequently, it will increase slightly in the second quarter of 2021 (maximum level 4.6%), after which it will decrease again, but will not fall below the lower limit of the interval. Throughout the forecast horizon[23], the inflation will remain within the inflation target range and will oscillate at the bottom of it (Chart 5.4) (see subchapter 5.4).

The decrease in inflation this year will be due to all components, especially food in the first quarter of the forecast, but which will subsequently maintain a stable contribution. For the next year, the decrease in inflation will be due to food, except for the second quarter of 2021. For the next year, fuel prices and regulated prices

[23] second quarter of 2020 - first quarter of 2022.

will contribute insignificantly, and core inflation will reverse its trend and contribute to rising inflation by the end of the forecast horizon[24] (Chart 5.5).

The significantly disinflationary aggregate demand associated with measures to prevent the spread of COVID-19, the considerable decrease in expectations of international food prices and international oil prices in the first quarter of forecast and the high base in 2019 will be the main factors that will reduce inflation this year and will place it at a relatively low level over the next year.

At the same time, this decrease will be tempered by adverse weather conditions, the anticipated increase in international food and oil prices, the adjustment of the national currency, the planned increases in excise duties, as well as the pro-inflationary effect of highly seasonal products.

The annual inflation rate will decrease significantly in the first quarter of the forecast, but slower - until the end of this year, when it will be placed at the lower end of the range for two consecutive quarters. Subsequently, it will increase slightly in the second quarter of 2021, when it will register the maximum level of 4.6 percent, after which it will decrease again, but will remain within the inflation target range until the end of the forecast horizon.

The average annual inflation will be 4.4% and 4.0% this year and next year, respectively.

Core inflation will decrease significantly in the current year, after which it will increase until the end of the forecast horizon (Chart 5.6).

The main factors that will contribute to the decrease in core inflation are (1) the aggregate disinflationary demand associated with the measures to prevent the spread of COVID-19, (2) the decrease in imported inflation, largely due to the substantial depreciation of main trading partners' currencies and (3) high base from the previous year.

The subsequent increase in core inflation will be determined by (1) the upward trajectory of imported inflation, mainly in the second half of the forecast horizon, (2) the exchange rate adjustment and (3) the planned excise adjustments.

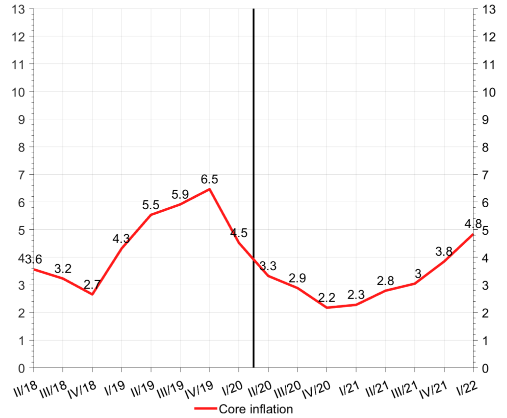
The average annual rate of core inflation will be 3.2% and 3.0% in 2020 and 2021 respectively.

The annual growth rate of food prices, although declining significantly in the first quarter of the forecast, will remain relatively high until the second quarter of 2021, then declining towards the end of the forecast horizon (Chart 5.7).

The high pace of food prices until the second quarter of 2021, as well as the moderation of the decline towards the end of the forecast horizon will be determined by the (1) adverse weather conditions, (2) adjustment of the national currency, (3) rapid early

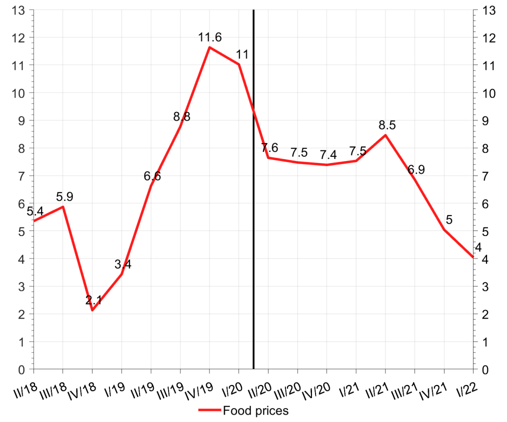
[24]first quarter of 2022.

Chart 5.6: Basic inflation (%, yoy)



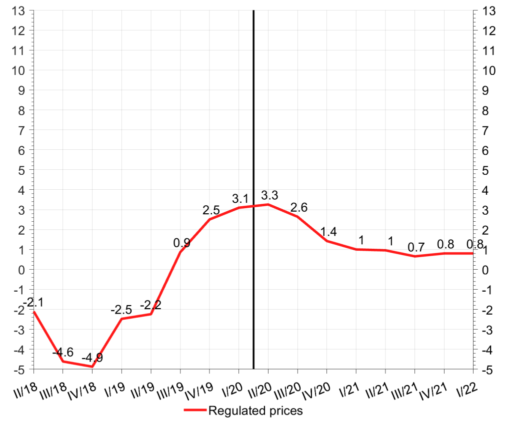
Source: NBS, NBM calculus

Chart 5.7: Food prices (%, yoy)



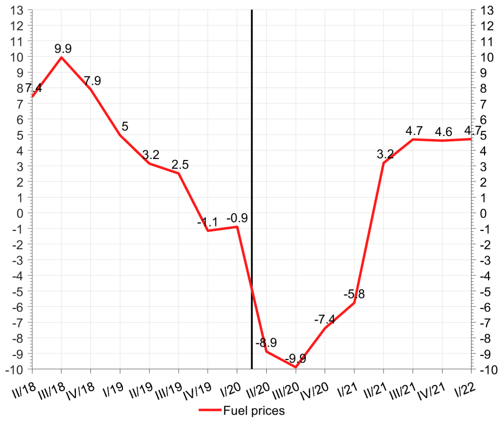
Source: NBS, NBM calculus

Chart 5.8: Regulated prices (%,yoy)



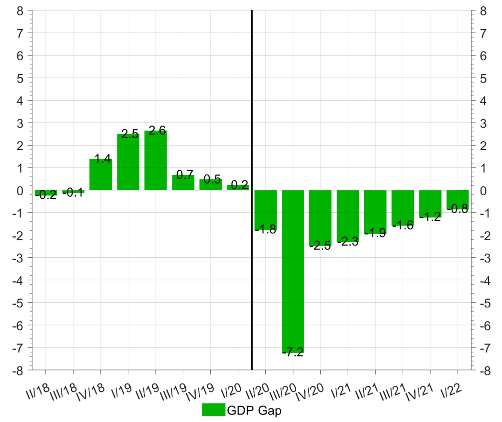
Source: NBS, NBM calculus

Chart 5.9: Fuel prices (%, compared to the previous year.)



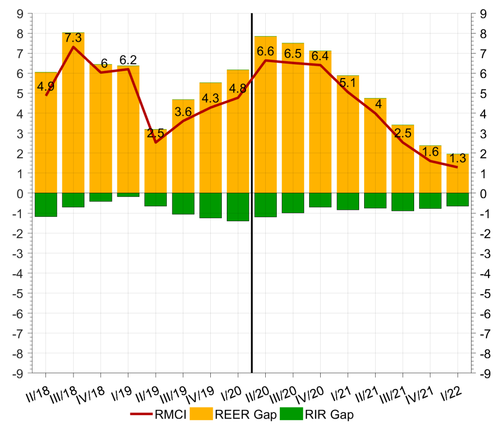
Source: NBS, NBM calculus

Chart 5.10: GDP deviation (%)



Source: NBM calculus

Chart 5.11: The index of the real monetary conditions and decomposition



Source: NBM calculus

recovery of international food prices, (4) the planned increases in excise duties and (5) the effect of highly seasonal products.

At the same time, in the downward direction, the pace will largely be influenced by the (1) negative domestic demand, (2) the significant decrease in anticipated international food prices in the first quarter of the forecast, but also by (3) the significantly high base last year.

The average annual rate of food prices will be 8.4% and 6.9% in 2020 and 2021 respectively.

The annual rate of regulated prices will be relatively low over the whole horizon. It will decrease until the third quarter of 2021, after which it will stabilize towards the end of the forecast horizon (Chart 5.8).

The annual rate of regulated prices will register insignificant values on the whole horizon.

According to the assumptions, in the fourth quarter of this year, the forecast includes a decrease in tariffs for gas in the network. At the same time, the forecast includes a trend of increasing prices for drugs and regulated subcomponents with a minor share during the years 2020-2021.

The average annual rate of regulated prices will be 2.6% and 0.9% in 2020 and 2021 respectively.

Fuel prices will decline significantly in 2020 and early next year and increase relatively steadily thereafter (Chart 5.9).

That dynamic will be conditioned by the opposite effects of the significant decline in international oil prices in the first quarter of the forecast, the accumulated real appreciation, and negative domestic demand on the one hand, and the anticipation of a lower exchange rate, the predominantly positive trend of forecast oil prices, base effect and planned increases in excise duties, on the other hand.

The average annual rate of fuel prices will be minus 6.8% and 1.5% in 2020 and 2021 respectively.

Demand

The aggregate demand will be disinflationary for the entire forecast horizon, with a significant decrease in the third quarter of 2020, largely associated with measures to prevent the spread of COVID-19, and a slow return towards the end of the forecast horizon (Chart 5.10).

In addition to the effects of measures to prevent the spread of COVID-19, the GDP deviation will also diminish under the influence of restrictive monetary conditions. The real effective exchange rate will have strong restrictive effects on aggregate demand, which will be slightly moderated by the real interest rate. At the same time, the fiscal impulse in the first part of this year will mitigate the decline in aggregate demand.

The GDP deviation was revised as a result of the publication of the real GDP rate for the fourth quarter of 2019 (0.2% compared to the previous year), of the measures to prevent the spread of COVID-19, but also of the revision of the fiscal impulse. The change in the budgetary-fiscal policy for 2020, which involves a decrease in budget revenues by 3.0% and an increase in budget expenditures by 18.1%, allowed the estimation of a stimulus fiscal impulse in the first part of this year. Subsequently, it will become restrictive on the aggregate demand.

Monetary policy

Real monetary conditions will be restrictive of aggregate demand over the entire forecast period.

A substantial contribution in this respect will go to the real effective exchange rate. The significant deviation of the real effective exchange rate from its trend will decrease continuously until the end of the forecast horizon.

At the same time, the monetary policy position through the interest rate will be stimulating throughout the forecast horizon. The deviation of the real interest rate will have stimulating effects, moderating the restrictive effects of the deviation of the real exchange rate (Chart 5.11).

5.3 Comparison of forecasts

The current inflation forecast is significantly lower for the first two quarters of the forecast and higher starting with the fourth quarter of 2020 for four consecutive quarters, then lower for the end of the compared period [25] (Chart 5.12).

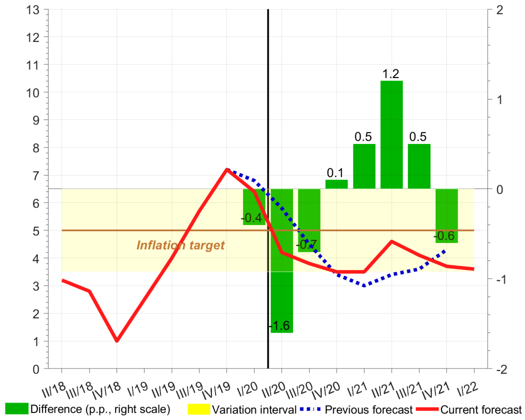
In the current conditions, mainly marked by the measures to prevent the spread of COVID-19, the considerable decrease in the international price of oil and adverse weather conditions, the forecasts of most CPI components have been significantly reconfigured, but in opposite directions, thus, for the most part, counterbalancing themselves.

Compared to the previous inflation report, the core inflation forecast for the whole compared period, the growth rates of regulated prices for the last three quarters and those for fuels for the first four consecutive quarters, decreased. Increasing revisions were made for the forecast of food prices for the whole compared period, except for the first quarter of the forecast, and of fuel prices for the last three consecutive quarters of the compared period (Chart 5.13).

The forecast of the average annual inflation rate was decreased by 0.7 percentage points for the year 2020 and increased by 0.4 percentage points for the year 2021.

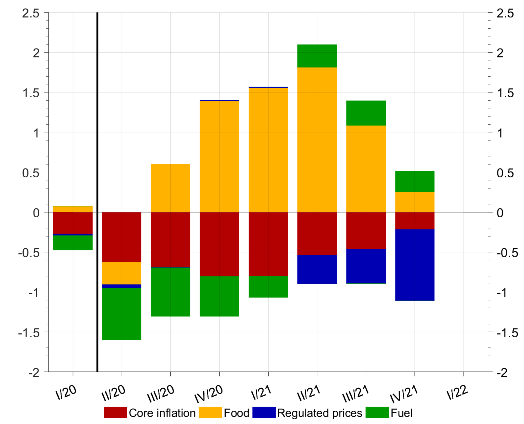
The core inflation was revised downwards for the entire comparable period (Chart 5.14).

Chart 5.12: CPI (%, compared to the previous year, percentage points)



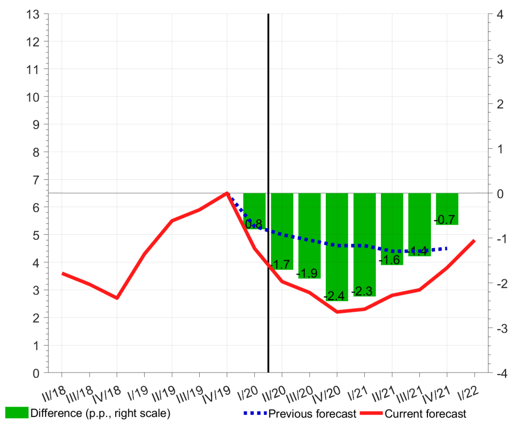
Source: NBS, NBM calculus

Chart 5.13: Decomposition of the difference between forecasts (percentage points)



Source: NBM calculus

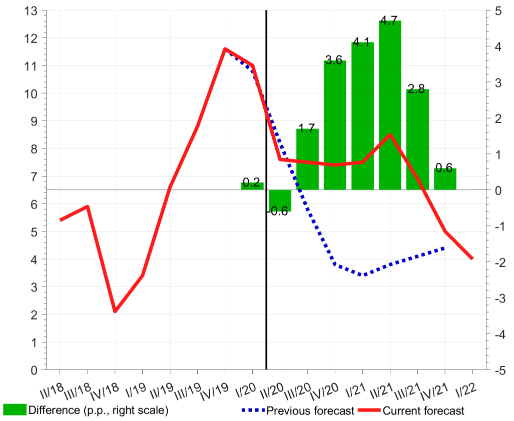
Chart 5.14: Core inflation (%, compared to the previous year, percentage points)



Source: NBS, NBM calculus

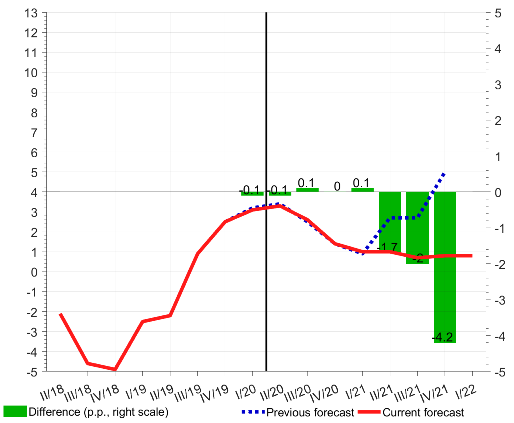
[25] second quarter of 2020 - fourth quarter of 2021.

Chart 5.15: Food prices (%, yoy, p.p.)



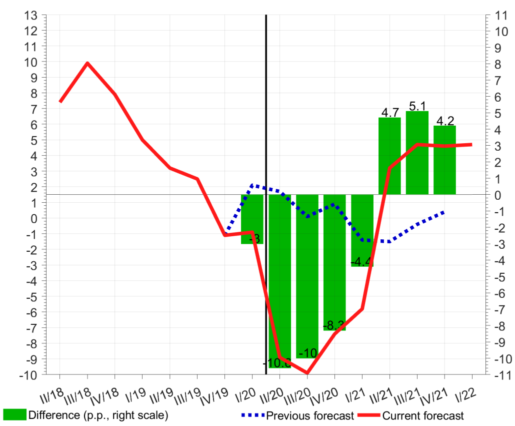
Source: NBS, NBM calculations

Chart 5.16: Regulated prices (%, yoy, p.p.)



Source: NBS, NBM calculations

Chart 5.17: Fuel prices (%, yoy)



Source: NBS, NBM calculations

Its lower projection is due to the (1) lower-than-expected inflation for the previous quarter, (2) strong aggregate disinflationary demand associated with measures to prevent the spread of COVID-19, and (3) lower imported inflation in the first four consecutive quarters of forecast.

These effects are slightly mitigated by an exchange rate adjustment over the entire period, leading to higher imported inflation from the second quarter of 2021 until the end of the comparable period.

The forecast of the average rate of core inflation was decreased by 1.7 percentage points for the year 2020 and with 1.5 percentage points for the year 2021.

The annual growth rate of food prices has been revised upwards for the whole compared period, except for the first quarter of the forecast (Chart 5.15).

The higher rate of food prices is determined by (1) adverse weather conditions and (2) a more depreciated level of the national currency.

At the same time, these effects were mitigated by (1) a significantly lower aggregate demand, (2) a lower evolution of international food prices and (3) a more temperate effect of strongly seasonal products in the spring of 2021.

The forecast of the average annual rate of food prices was increased by 1.3 percentage points for the year 2020 and with 3.0 percentage points for the year 2021.

The current forecast of regulated prices is lower for the whole compared period, except for the first four quarters of the forecast when they register insignificant deviations (Chart 5.16).

The decrease in regulated prices is largely due to the lack of anticipated increases in tariffs for gas in the network, central heating and aqueduct and sewerage in the second quarter of 2021 previously assumed. At the same time, these effects were moderated by the assumption of an increase in the upward trend in drug prices for the second and third quarters of 2020.

The forecast of the average annual rate of regulated prices is similar for the current year and decreasing by 1.9 percentage points for the year 2021.

The annual fuel price forecast was revised downwards for the first four quarters of the forecast and upwards for the rest of the compared period (Chart 5.17).

The lower projection of fuel prices is largely due to a significantly lower oil price. At the same time, the decrease was mitigated by a more depreciated exchange rate trajectory.

The forecast of the average annual rate of fuel prices was reduced by 8.0 percentage points for the year 2020 and increased by 2.2 percentage points for the year 2021.

5.4 Risks and uncertainties

External sector

- **Increased uncertainty about the magnitude of the COVID-19 crisis and the subsequent economic recovery.** Current forecasts are deduced from the current state of the world economy and COVID-19. Because it is not known when the COVID-19 pandemic will end and when the world economy will begin to recover, there is a fairly large range of uncertainty in the variation of projected values (uncertainty).
- **Increased uncertainties about the oil market and the evolution of oil prices.** In early April 2020, OPEC and the G20 met online to discuss the situation on the oil market, the drastic reduction in oil prices and the decline in global demand caused by COVID-19. It has been decided that the producing countries, starting with May 2020, will reduce by an average of 23.0% the oil production, which is equivalent to about 9.7 million barrels per day. However, after about a week, the enthusiasm of market participants was shattered by information about the lack of extracted oil storage space and the selling of WTI futures contract at a negative price for May 2020. The complexity of the challenges of the oil industry and oil exporting countries shows the difficulty of accuracy in anticipating the evolution of oil prices (uncertainty).
- **Risk of U.S. dollar depreciation after the end of the COVID-19 panic.** Currently, the U.S. dollar has appreciated significantly due to the panic caused by COVID-19 and the flight of investors from risky assets, preferring the U.S. dollar as a reserve asset. However, the stimulus measures recently announced by the Federal Reserve System in the context of COVID-19 far outweigh the incentive effect of other central banks. Therefore, after the end of the crisis caused by COVID-19 and the start of the recovery of the world economy, there is a risk that the US dollar will depreciate amid differences in the degree of monetary stimulus (disinflationary).
- **Risk of rising international food prices.** International food prices have fallen faster than expected following the decline in global demand caused by COVID-19. However, more and more information is being reported on the problems facing the agricultural and livestock sectors in some countries. For example, in the US, the domestic supply of meat has decreased significantly, and the Russian Federation has announced that it will ban the export of grain until July 1, 2020. The quarantine regime in some countries has also affected the transport supply chain. Therefore, it is worth mentioning the risk of falling supply even more than reducing demand, which will contribute to the creation of deficits in some segments and respectively to the increase of prices for certain foods (proinflationary).

Real sector

- **The risk of a modest harvest in 2020 and the uncertainties about agricultural production in 2021.** The harvest in 2020 and 2021, and food prices on the domestic market will depend, to a large extent, on the agrometeorological conditions of the current year and next year. At the same time, the agrometeorological conditions in recent months have been atypical, with temperatures above the norm of previous years and with a deficit of precipitation in certain periods. The impact of these conditions on the 2020 harvest is difficult to estimate. The information presented by the State Hydrometeorological Service outlines certain risks for a modest harvest in 2020. Developments in the agricultural sector and, therefore, the trajectory of food prices for 2020 show a pro-inflationary risk, and for 2021 the trajectory of food prices is marked by a pronounced uncertainty (proinflationary, uncertainty).

- **Vulnerability of local fruit and vegetable prices to weather conditions in the near future.** According to the experience of recent years, the prices of local fruits and vegetables are largely affected by adverse weather conditions such as frost, drought, heavy rainfall, the costs associated with harvesting, transportation, storage, but also their selling in the points of sale in the country. In the event of lower temperatures or dry conditions, this would result in an increase in food prices over the coming months (proinflationary).

- **Uncertainties about the timing and magnitude of the tariff adjustment for regulated services.** The medium-term forecast of inflation is based on a trajectory of prices for regulated services that corresponds to certain assumptions about the prices of energy resources internationally and regionally, as well as on other indicators relevant to that sector. However, given that tariffs for some regulated services have a considerable economic impact on the population, the timing of their adjustment can be based not only on economic factors, but also on the pursuit of social or political objectives by the decision makers involved. Therefore, the timing and magnitude of tariff adjustments cannot be estimated with a sufficient degree of confidence (uncertainty).

- **Duration, intensity of the COVID-19 pandemic and the impact on the domestic economy.** To stop the spread of the COVID-19 pandemic, a series of restrictive measures have been put in place since the second half of March that have a negative impact on domestic economic activity. The longer these measures last, the more the income of the population and its demand for goods and services will be affected. If restrictive measures continue beyond the period initially announced, domestic demand will be more modest than anticipated and the impact on inflation will be disinflationary (disinflationary).

Monetary and public sectors

- **Excessive liquidity in the banking sector.** As a result of the monetary issue during the period 2018-2019, following the interventions of the NBM on the foreign exchange market, in the banking system there accumulated excessive liquidity in the volume of about MDL 6.7 billion. This surplus can create a positive short-term impact on aggregate demand, the exchange rate and can generate inflationary pressures (proinflationary).
- **Granting of the loan from Russia.** The governments of Russia and the Republic of Moldova have agreed on the granting of a loan of euro 200 million for the Republic of Moldova which will be directed for infrastructure projects. The first tranche was to arrive in the second quarter of 2020, but the draft law on granting a state financial loan to the Government of the Republic of Moldova was challenged in the Constitutional Court. Subsequently, the Loan Agreement was declared unconstitutional by the Court, and the loan is likely to be renegotiated with the Government of Russia (uncertainty).
- **COVID-19.** The COVID-19 pandemic is spreading globally, prompting central authorities to take additional security measures. These measures require additional budgetary resources. At the same time, the pandemic will also affect the economic activity, which will negatively influence the collection of taxes and will create difficulties in maintaining the budget deficit within the forecasted limits (uncertainty).

In the context of the assessment of the main risks and uncertainties stated above, it should be mentioned that the medium-term inflation forecast in the Report on inflation No 2/2020 is mainly affected by disinflationary risks. This justifies an uneven range of forecast uncertainty in the current forecast round.

Chapter 6

Monetary policy decisions

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 11.09.2019
on monetary policy

The meeting was chaired by: Mr. Octavian Armasu, Governor – Chairman of the Executive Board.
The following were present: the members of the Executive Board – Mrs. Cristina Harea – Deputy Governor, Mr. Aureliu Cincilei – Deputy Governor, Mr. Ion Sturzu – Deputy Governor.
Rapporteur: Mr. Octavian Teaca – Head of the Macroeconomic Analysis and Forecasting Division, Deputy Director of the Monetary Policy Department.

Mr. Octavian Teaca presented the risk assessment associated with the deviation of the inflation forecast published in the Inflation Report no. 3, 2019 based on the available macroeconomic information related to the internal and external environment.

Discussions began with issues related to the evolution of inflation depending on the quantitative objective of monetary policy, the factors influencing the inflationary process and the risks that could compromise the NBM forecast. Executive Board (EB) members pointed out that annual inflation in August 2019 evolved according to the forecasts and amounted to 5.5%, remaining for the fourth consecutive month in the range of target variation.

When discussing the events outlined after the forecast round associated with the elaboration of the Inflation Report no.3, it was observed that there persists the risk of a slightly higher inflation trajectory than anticipated for the third quarter of 2019 and at the same level for the fourth quarter of 2019. The EB members considered that this could be mainly due to the materialization of the risk associated with the adjustment of prices for regulated goods and services, as a result of the recent increase in electricity prices delivered to household consumers.

At the same time, the EB members commented on the risk of a deviation in the medium-term downward inflation forecast from the first quarter of 2020, citing lower international food and oil prices and slower external demand than the forecast presented in the Inflation Report no.3.

At the same time, at the meeting, the Executive Board analyzed the evolution of the external macroeconomic environment, noting that the forecasts for external demand have diminished. The members of the Board noted that the forecast for GDP in the euro area remained unchanged, namely that economic growth continued to be insignificant, referring to the recent decline in industrial production in Germany and the slowdown in the world economy.

Particular attention was also paid to domestic demand, noting that it will generate disinflationary pressures from the first quarter of 2020, mainly due to the slowdown in remittances and the wage-fund.

Consequently, the EB found the validity of the medium-term forecast published in August of this year, pointing out that inflation will increase in the third and fourth quarters of 2019 and will record a downward trend from the first quarter of 2020.

Analyzing the prospects of macroeconomic indicators of internal and external nature, the EB of NBM pointed out that the main risks associated with the inflation forecast (published in August this year) are outlined by the uncertainty about the timing and magnitude of adjustment of regulated tariffs for services compared to the assumptions taken into account in the previous forecast, as well as on a more disinflationary external macroeconomic environment, emphasizing that they will influence the evolution of inflation over the entire forecast horizon. At the same time, the EB members highlighted the fiscal uncertainties related to the State Budget Law for next year.

In this context, the members of the NBM Executive Board discussed and analyzed the opportunity to potentially diminish the value of monetary policy instruments in the coming periods, in order to create monetary conditions capable of keeping inflation in the range of ± 1.5 percentage points from the inflation target of 5.0% in the medium term.

At the same time, the EB noted that the effect of the monetary policy measures adopted in June and July is set to spread, taking as a benchmark the time needed to transmit the impetus to the real economy.

At the end of the meeting, the EB members reiterated the need to continuously monitor and anticipate internal and external macroeconomic developments, the risks and uncertainties to the evolution of inflation in the short and medium term, as well as those that could jeopardize the NBM forecast, noting that, as appropriate, will react by appropriately applying monetary policy instruments to ensure and maintain price stability.

Thus, the Executive Board of the NBM unanimously adopted the following decision:

1. The base rate applied to the main short-term monetary policy operations shall be maintained at the current level of 7.5% per annum.
2. Interest rates shall be maintained:
- on overnight loans at the current level of 10.5% annually;
- on overnight deposits at the current level of 4.5% annually.
3. The norm of required reserves from funds attracted in Moldovan lei and in non-convertible currency is maintained at the current level of 42.5% of the calculation base.
4. The norm of required reserves from the means attracted in freely convertible currency is maintained at the current level of 17.0% of the calculation base.

Voting results

PRO – 4 AGAINST – 0 ABSTAINED – 0

President of the Executive Board **Secretary of the Executive Board**

Octavian ARMASU **Sergiu SURDU**

Summary
of the meeting of the Executive Board of the National Bank of Moldova of 30.10.2019
on monetary policy

The meeting was chaired by: Mr. Octavian Armasu, Governor – Chairman of the Executive Board.
The following were present: the members of the Executive Board – Mr. Vladimir Munteanu, First Deputy Governor – Deputy Chairman of the Executive Board, Mrs. Cristina Harea – Deputy Governor, Mr. Ion Sturzu – Deputy Governor.
Rapporteur: Mr. Radu Cuhal – Director of the Monetary Policy Department.
Guests: Mr. Victor Colta, Ms. Natalia Sirbu, Mr. Natan Garstea – advisers to the Governor, Mr. Daniel Savin – Director of the Financial Markets Department, Mr. Constantin Schendra – Director of the Banking Supervision Department, Ms. Viorica Bejan – Director of Legal Department, Mr. Eugeniu Aftene – Head of the Management and Development of the Reporting Process Division, Reporting and Statistics Department, Mr. Andrei Rotaru – Director of the Economic and Applied Research Department, Ms. Alina Boboc – Head of the Communication and Press Service.

The Executive Board (EB) meeting started with the presentation of Mr. Radu Cuhal on the analysis of the latest available macroeconomic information, the main trends related to the internal and external environment. At the same time, the new forecast round was presented, as well as the risks and uncertainties associated with inflation for the next eight quarters.

The discussions of the members of the Executive Board focused on the evolutionary tendencies of the inflationary process according to the quantitative objective of the monetary policy, with reference to the determinant components of inflation, as well as to the factors influencing the inflationary trend. EB members noted that the annual inflation rate evolved as expected in the third quarter of 2019, continuing the upward trend since the beginning of this year. Thus, it increased from 4.4% in June 2019 to 6.3% in September 2019.

EB members ruled on economic growth in the second quarter of 2019, which recorded a level of 5.8%, being 1.4 percentage points higher than in the first quarter of 2019. According to the opinions expressed by the members of the board, there persists premises for moderating the economic growth in the second half of 2019, according to the available information associated with the operational statistical indicators. In this respect, reference was made to industrial production, turnover of wholesale and retail undertakings as well as service providers, which increased, while the transport of goods and the volume of exported goods recorded negative developments along with the persistence of some premises and for the reduction of agricultural production. This will lead to positive economic growth, but more modest compared to the first half of 2019.

The EB members noted that, after a long period in which aggregate demand was mainly determined by consumer demand, starting with the second quarter of 2019 the role of the investment component increased considerably. Thus, gross fixed capital formation in the second quarter of 2019 increased by 26.1% compared to the same period of the previous year.

In this context, special attention was paid to lending, emphasizing that the volume of new loans granted in the national currency during the third quarter of 2019 amounted to 5.8 billion MDL and recorded an annual increase of 26.1%. It was mentioned that both individuals and legal entities had similar percentages, these being 50% of the total volume of loans granted. Thus, legal entities contracted loans, mainly for trade - 23.7%, agriculture - 6.8%, non-banking financial environment - 5.5%, while individuals used consumer loans - 30.5% and real estate - 15.0%.

Discussions continued to address the assumptions taken into account in the preparation of the current forecast, highlighting pro-inflationary pressures from aggregate demand for the current year and disinflationary from the first quarter of 2020 until the end of the forecast horizon. EB members noted that starting next year, the persistence of disinflationary risks in addition to those associated with weak aggregate domestic demand, such as lower international prices for oil, food and raw materials, slowing the pace of growth of the world economy, along with the high base of 2019 will contribute to the moderation of the inflationary process during the forecast horizon.

In this context, reference was made to the evolution of inflation in the next eight quarters in line with the new forecast round, according to which the annual inflation rate will be above the upper limit of the target range in the first two consecutive forecast quarters, recording a maximum level of 8.0% in the fourth quarter of 2019. Subsequently, in the first quarter of 2020, the disinflationary cycle will begin, so that in the third quarter of 2020 the annual inflation rate will return in the interval and will remain within it until the end of the forecast horizon. It was mentioned that the average annual inflation will register the level of 5.0% and 5.9% in 2019 and 2020, respectively. EB members also commented on the comparison of the current forecast with the previous one of the average annual inflation rate, finding that it is similar for 2019 and decreased by 0.8 percentage points for the year 2020.

At the same time, there were discussed the increased uncertainties regarding the medium-term inflation perspective generated by the finalization and approval of fiscal policy and the postponement of the adoption and publication of the Budget Law for 2020. They are joined by the prospects of external financing, as well as the potential adjustment of regulated prices.

In these circumstances, the EB of the NBM decided to keep the applied rate to the main short-term monetary policy operations at the current level of 7.5% per year.

In adopting this decision, the EB members focused on the assessment of recent macroeconomic analyzes associated with the internal and external environment, the assumptions taken into account in developing the new forecast round, as well as on trends in domestic economic activity. The main arguments underlying the decision are the fact that aggregate demand, increased unit labour costs, the seasonal effect specific to the period will be some of the factors that will stimulate the increase of the annual inflation rate until the end of this year. The situation will reverse from the first quarter of 2020, when inflation will decelerate under the impact of declining aggregate demand due to the attenuation of consumer and external demand due to the moderation of world economic activity, the relative stagnation of growth rates in international prices for food and raw materials.

Following the debates on the new forecast round, the assessments and findings made at the meeting, the EB members noted that, in the context of a disinflationary trend from next year, the NBM will promote a stimulus of monetary policy in the coming period, in order to creating monetary conditions associated with ensuring and maintaining inflation in the range of ± 1.5 percentage points from the inflation target of 5.0% in the medium term.

At the same time, during the meeting, the NBM Executive Board approved the Inflation Report no. 4, which will be published on November 6 and will contain the latest available data on inflation, economic activity, monetary policy promotion, as well as risks and uncertainties associated with the new forecast round.

At the end of the meeting, the EB members reiterated the need for continuous monitoring and anticipation of internal and external macroeconomic developments, the risks and uncertainties associated with inflation development, so that, by the timely application of monetary policy instruments, it ensures that price stability is maintained in the medium term.

Thus, the Executive Board of the NBM unanimously adopted the following decision:

1. The base rate applied to the main short-term monetary policy operations shall be maintained at the current level of 7.5% per annum.
2. Interest rates shall be maintained:
- on overnight loans at the current level of 10.5% annually;
- on overnight deposits at the current level of 4.5% annually.
3. The norm of required reserves from funds attracted in Moldovan lei and in non-convertible currency is maintained at the current level of 42.5% of the calculation base.
4. The norm of required reserves from the means attracted in freely convertible currency is maintained at the current level of 17.0% of the calculation base.

Voting results

PRO – 4	AGAINST – 0	ABSTAINED – 0

President of the Executive Board | **Secretary of the Executive Board**

Octavian ARMASU | **Sergiu SURDU**

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