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Inflation Report no. 2, 2020

– ation Report no.2, May 2020 [1]

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.

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