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Monetary Policy

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16.08.2013

Inflation Report no. 3, 2013

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Summary

Inflation development

The annual inflation rate was 5.2 percent in the second quarter of 2013, by 0.8 percentage points higher than the previous quarter. Its upward trend was due to the contribution from food prices as a result of the changes made by the NBS in the procedure for reflecting the prices of the agricultural production from the new harvest. However, the price increase was supported to some extent by the depreciation of the national currency against the currencies of major trading partners. On the other hand, domestic demand, which is still modest, exerted a deflationary effect on prices in the reporting period. The annual rate of core inflation was 4.2 percent in the second quarter of 2013, by 0.2 percentage points higher than the previous quarter. Both the annual inflation rate and the annual core inflation rate continued to be in the range of 5.0 percent ± 1.5 percentage points, according to the Medium-term monetary policy strategy. Evolution of the annual inflation rate in the second quarter 2013 was higher (by 0.7 percentage points) in the projection of its expected value (4.5 percent) of the Inflation Report no. 2, 2013.

External environment

The global economy is progressing very slowly, but to mitigate the gaps of the recent years it clearly needs a longer period. Macroeconomic statistics are antithetical, so the development picture of some economies is much distorted and the economic policies are geared only toward solving only the problems of some segments of the economy. Demand is falling, so raw materials prices are relatively low. However, the advancement of the global economy will be further supported by the U.S. and Chinese economies, but to a lesser extent than previously anticipated.

Economic developments

After the economic activity contracted last year, the GDP has increased by 3.5 percent in the first quarter of 2013. The increase in annual growth rate of exports (9.4 percent) and that of final consumption of households (3.7 percent) remain the main components that contributed to the revival of economic activity in the first quarter of 2013. General government final consumption has decreased by 1.5 percent. Gross fixed capital formation increased by 6.6 percent. Slight revival in domestic demand contributed to the acceleration of the growth of imports of goods and services, so it was 4.0 percent in the first quarter of 2013. Gross value added of agriculture and industry increased by 2.3 and 2.2 percent, respectively.

Gross value added of services recorded an increase of 2.8 percent. At the same time, the net taxes on products in the first quarter of 2013 increased by 6.6 percent compared with the same period last year. In the first quarter of 2013, the number of employees grew by 0.6 percent. However, the unemployment rate was 8.1 percent, by 0.9 percentage points higher than the same period last year.

Monetary policy

In the second quarter of 2013, within three consecutive meetings on monetary policy, the members of the Council of Administration of the NBM have reviewed the balance of risks for future inflation prospects in the short and medium term. Thus, within the meeting of April 25, 2013 the Council of Administration of the NBM adopted the decision to reduce the interest rate by 1.0 percentage points, from the level of 4.5 to 3.5 percent annually, while within the two subsequent meetings the Council decided to keep the base rate at 3.5 percent annually.

In the second quarter of 2013, the NBM intervened in the domestic foreign exchange market as a buyer of foreign currency in the context of its monetary policy promoted and to strengthen its foreign exchange reserves. The volume of NBM transactions carried out during the analyzed period on the interbank foreign exchange market against MDL was USD 25.65 million. In the second quarter of 2013, the growth rate of monetary aggregates remained high, the quarterly average in annual terms of M2 constituted 26.1 percent (up by 0.5 percentage points from growth recorded in the previous quarter) and the quarterly average in annual terms of M3 accounted for 21.9 percent (down by 0.2 percentage points from growth recorded in the first quarter of 2013).

Average interest rates charged by licensed banks during the second quarter of 2013 had a stable trend of diminishing. In late June 2013, the average interest rate on new loans in national currency recorded the level of 12.03 percent and in foreign currency - 7.59 percent. In turn, the yields on term bank placements recorded lower values than in the previous quarter both those in national currency - 6.79 percent and foreign currency - 4.36 percent.

Medium-term inflation forecasting

In the period May to July 2013, most global organizations in economics have revised their forecasts for the global economy development. Thus, estimates of GDP and CPI in the euro area and the Russian Federation were reduced, which represent the reducing factors for inflation in the current round of inflation forecasting. At the same time, the intensification of tensions in the Middle East has led to the increase of oil prices forecast. International markets are waiting for the agriculture results and the confirmation of positive outlook will likely further contribute to lower international prices for food. Volatility of the currencies of international circulation, in particular the EUR and RUB, in the coming quarters will be subject to the monetary policies of the economies concerned, but also the evolution of macroeconomic statistics. According to the current projection, the annual inflation rate will fall within the range of ± 1.5 percentage points from the inflation target of 5.0 percent annually, close to its lower limit, registering insignificant deviations from the forecast in the Inflation Report no.2, 2013.

Overall, the current round of forecasting anticipates a positive quarterly dynamics of output gap for the entire forecasting period. The recovery pace is accelerated and places the economic activity over its potential level, the domestic demand exerting pro-inflationary pressures to offset the disinflationary

pressures from external demand and supply.

Output gap will record positive values as a result of much more incentive character of real monetary conditions in comparable terms with the Inflation Report no.2, 2013. The evolution of real monetary conditions will be determined both by maintaining the incentive character through the real interest rate channel and by increasing incentive impact through real effective exchange rate channel.

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