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Monetary Policy

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Inflation Report no. 4, 2012

Inflation Report no.4, November 2012 [1]

Summary

Inflation

The annual inflation rate constituted 4.4 percent in the third quarter of 2012, reversing its downward trend started at the end of the previous year. The upward trend of inflation was determined by the gradual increase of pressure from food prices caused by adverse weather conditions in the region this year. The contribution from regulated prices remained at the level of the previous quarter in the absence of certain tariff adjustments during the reporting period. Contribution from core inflation was lower than the previous quarter due to a weakening domestic demand. The average annual rate of inflation during the aforementioned period was higher than anticipated in the July round of forecasting. This deviation was due to the changes in anticipated oil prices and the increase over the expectation of food prices. The annual rate of core inflation continued its downward trend started at the end of the previous year and fell to a value of 3.6 percent in September 2012. In the third quarter of 2012, the annual rate of industrial production price index was 5.0 percent, decreasing by 0.8 percentage points as compared to the previous quarter, while construction price index continued its upward trend started in 2010 and amounted to 11.3 percent in the respective period.

External environment

The world economy remains in a precarious state, with an uncertain future. The effects of economic stimuli, adopted by advanced economies, are late in coming, affecting the international trade, and respectively the emerging economies and developing countries. The macroeconomic indicators continue to denote a reduction in global economic activity, through a decreased rate of industrial production, manufacturing orders and respectively, through a decreased rate of international trade. At the same time, the severe drought this year in the USA, Europe and the Russian Federation affected the harvest, which was reflected in the increase of global food prices. In addition, the international oil prices remain relatively high due to the geopolitical tensions in the Middle East, which is still an impediment to global economic growth.

Economic developments

In the second quarter of 2012, the GDP recorded an increase of only 0.6 percent compared to the same period of the previous year. The insignificant increase in GDP shows the continuing trend of slowing economic activity reported in the second half of 2011. For the first time after the 2009 crisis, the household

consumption recorded a decrease (0.4 percent), due to the slowdown in the disposable income growth of the population.

The annual rate of gross capital formation increased by 8.8 percent, solely due to the positive evolution of changes in inventories, the gross fixed capital formation decreasing in real terms. In the second quarter of 2012, the final consumption of general government increased as compared to the previous year. Following the slowdown in the domestic demand, the imports increased by 3.9 percent compared to the second quarter of 2011. The low performance of the European economy determined the exports to grow only by 5.6 percent.

The positive GDP growth was mainly due to the increase in gross value added in industry and commerce, while agricultural production declined during the reporting period. In the second quarter of 2012, the reduction of the unemployment rate up to 4.5 percent shows an improvement in the labor market situation of the Republic of Moldova after the crisis of 2009. These positive signals are overshadowed by the decline of the working population by 4.7 percent in the reporting period, determined by both the decrease of the number of unemployed and that of employed people.

Monetary policy

During the third quarter of 2012, the NBM adopted three decisions to maintain the monetary policy interest rate at the level of 4.5 percent annually. The major argument of those decisions was the strengthening disinflationary trend in the Republic of Moldova.

At the same time, to ensure the adequate monetary conditions to maintain the price stability, the NBM continued to firmly manage the liquidity excess through sterilization operations on the monetary market.

During the third quarter of 2012, the NBM intervened in the foreign exchange market as a buyer of foreign currency in the context of its monetary policy promoted and to ensure the consolidation of foreign exchange reserves. During the analyzed period, the volume of NBM transactions carried out on the domestic foreign exchange market against MDL was USD 222.1 million.

From the beginning of 2012, the monetary indicators recorded a pronounced growth. Thus, in the third quarter of 2012, the growth rate of monetary aggregates has increased, the quarterly average in annual terms constituting 17.8 percent for M2 and 14.2 percent for M3, by 6.1 percentage points and 5.5 percentage points more as compared to the previous quarter.

The average interest rates applied by banks recorded a stable development in the third quarter of 2012, recording insignificant increases or decreases. At the end of September 2012, the average interest rate on credits granted in national currency recorded a new historical minimum level of 12.58 percent and those in foreign currency – 7.78 percent. In turn, the term deposits in national currency recorded higher values as compared to the previous quarter and lower values for those in foreign currency.

Medium-term inflation forecasting

According to the current round of forecasting, the annual inflation rate will constitute 4.1 percent at the end of 2012. Almost during the entire forecasting period, the values are projected onto a trajectory placed within the variation range of ± 1.5 percentage points from the 5.0 percent target, except the third quarter of 2013, when these will exceed the variation range. It should be mentioned that the price increase will be

determined by the supply-side shocks, while the demand-side disinflationary pressures will be persistent throughout the forecasting period.

However, according to the current round of forecasting, the dynamics of output gap is expected to be negative throughout the forecast horizon, with a slight recovery tendency by the end of 2013 – beginning of 2014. Despite the recovery tendency, the economic activity below its potential, especially in the coming quarters, maintains the disinflationary pressures from demand, following the decrease in external demand and the adverse weather conditions this year.

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