National Bank of Moldova

Translation

Inflation Report

no. 4, November 2015

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Note

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy, 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.

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List of acronyms

CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECB	European Central Bank
EU	European Union
EUR	European Single Currency
FCC	Freely convertible currency
FRS	Federal Reserve System
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPPI	Industrial Producer Price Index
MDL	Moldovan leu
NBM	National Bank of Moldova
NBR	National Bank of Romania
NBS	National Bureau of Statistics of the Republic of Moldova
NERA	National Energy Regulatory Agency
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purghasing Manager’s Index
SS	State Securities
USA	United States of America
USD	U.S. Dollar

Summary

Inflation development

In the third quarter of 2015, the annual inflation rate was 11.1 percent, by 3.1 percentage points more compared to the previous quarter. In September 2015, inflation accelerated to the value of 12.6 percent, exceeding for the seventh consecutive month the upper limit of the inflation target set in the Medium-term monetary policy strategy. This pronounced acceleration was mainly due to the increase in regulated prices up to 13.6 percent in September, as a result of the approval of new electricity and gas tariffs and the further increase in medicines prices, in the context of the national currency depreciation. Similar to the previous periods, the upward development of the CPI annual rate was generated by the increasing pressures from food prices and core inflation that accelerated in September up to 12.6 and 13.6 percent, respectively, as a result of the depreciation of the national currency at the end of the previous year and during this year. The contribution from fuel prices was slightly lower to that recorded in the second quarter of 2015. Annual inflation rate in the third quarter of 2015 was by 0.3 percentage points higher than it was anticipated in the projection of Inflation Report no. 3, 2015.

External environment

World economy is getting through a complex period, many indicators reflecting more precarious performances since 2009. The advanced economies remained relatively stable, while the major emerging economies, such as China, Brazil and the Russian Federation have recorded unsatisfactory performances. During the reporting period, the fluctuations of the China's stock exchange indexes have upset the financial markets and the economies of Brazil and the Russian Federation entered into recession. International prices of raw material continued to decrease amid reduced global demand, while the oil prices have seen an exacerbated volatility due to the unsustainability of positive factors and the persistence of those negative. The foreign exchange markets counterbalance has continued, given that the Federal Reserve System has maintained its cautious behaviour and has not increased the interest rates, the disinflationary pressures in euro area continued to persist, while the currencies of oil exporting countries have reproduced the oil prices development.

Economic developments

In the second quarter of 2015, GDP recorded an increase of 2.5 percent compared to the same period of the previous year, the economic activity dynamics being lower to that recorded at the beginning of this year. The GDP positive dynamics was mainly favoured by the depreciation of the national currency, which had an important incentive effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the second quarter of 2015, the volume of exports of goods and services was by 4.1 percent higher than that recorded in the same period of the previous year. At the same time, imports recorded a contraction of 4.4 percent. In the second quarter 2015, the demand from population was mediocre, household consumption increasing only by 0.2 percent in real terms. The dynamics of investments determined a substantial negative contribution in the second quarter of 2015. Gross fixed capital formation decreased by 1.5 percent, while the negative contribution from the component change in inventories was more accentuated. By categories of resources, the mitigation of the economic activity in the second quarter of 2015 was determined by the decrease in the positive contribution of "Financial intermediation and insurance" component recorded at the beginning of this year and the contribution from industry and trade. Similar to the previous periods, the industry continued to generate a significant contribution to the dynamics of the economic activity. In this regard, the extractive industry and manufacturing was by 4.4 percent higher during the reporting period compared to the second quarter of 2014. The other branches of the economy recorded positive developments, but their impact on GDP growth was more modest. In the second quarter of 2015, the situation on the labour market has slightly deteriorated compared to the situation recorded in the second quarter of 2014, but improved compared to the beginning of this year.

Monetary policy

In the third quarter of 2015, there were held three meetings of the Council of Administration of the National Bank on Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks, to which the economy of the Republic of Moldova could be subject and the inflation outlook in the short and medium term, NBM adopted two decisions by which the base rate was increased by 2.0 percentage points, from the level of 15.5 percent to 19.5 percent, and subsequently it was maintained at the level of 19.5 percent (meeting of August 26, 2015). The decisions to increase the base rate will gradually produce effects in the economy in the coming two-three quarters, being aimed at anchoring inflation expectations and maintaining the inflation close to the target of 5.0 percent over the medium-term, with a possible deviation of ± 1.5 percentage points. In order to sterilize the excess liquidity formed in the last months and improve the transmission mechanism of monetary policy decisions, the Council of Administration decided within the meetings of July 30 and August 26, 2015 to raise the required reserves ratio attracted in MDL and non-convertible currency from the level of 26.0 percent to 32.0 percent and from 32.0 percent to 35.0 percent of the base, respectively.

The growth rates of monetary indicators have decreased in 2015. Thus, in the third quarter of 2015, the dynamics of monetary aggregates was negative, the values recorded being below the growth level recorded in the previous years, the quarterly average in annual terms constituted minus 11.5 percent for M2 (by 0.2 percentage points lower than growth in the second quarter of 2015) and 1.1 percent for M3 (by 1.7 percentage points lower than the growth in previous quarter).

During reporting period, the average annual interest rate on loans in national currency increased by 0.48 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.08 percentage points compared to the previous quarter, registering values of 12.42 percent for those in national currency and 6.90 percent for those in foreign currency. The average interest rate on deposits in MDL accounted for 11.84 percent, increasing by 1.74 percentage points compared to the previous quarter, while the interest rate on placements in foreign currency constituted on average 2.56 percent, decreasing by 0.53 percentage points compared to the second quarter of 2015.

Medium-term inflation forecasting

According to the current projection, output gap will remain negative for the entire forecasting period. This will be negative, significantly below its potential level. An economic activity below its potential level will cause, on medium-term, increased disinflationary pressures from domestic demand.

According to the current projection, the annual growth rate of CPI will record a level of 9.7 percent in 2015 and 11.9 percent in

2016. Compared to the values registered in the Inflation Report no.3, 2015, the average annual values projected for 2015 are higher by 0.4 percentage points and those projected for 2016 by 0.3 percentage points, the same trend will be also maintained in the first two quarters of 2017. The reconfiguration of the annual inflation rate projection is mainly caused by the slightly higher dynamics of the core inflation, food prices and oil prices, these effects being balanced by the lower contribution of regulated prices this year and in 2016.

Chapter 1

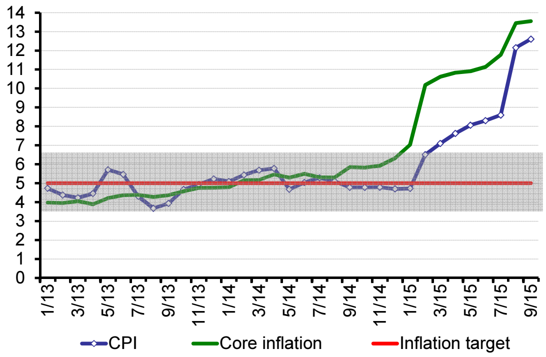
Inflation development

The annual inflation rate continued in the third quarter of 2015 the upward dynamics, accelerating to 12.6 percent in September 2015, being for the seventh consecutive month above the upper limit of the inflation target range stipulated in the Medium-term monetary policy strategy. Average annual inflation in the third quarter of 2015 was 11.1 percent, by 3.1 percentage points higher than in the second quarter of 2015. This increase was due to the depreciation of the national currency at the end of last year and during this year, which had a pronounced impact on food prices and core inflation, increasing to values of 12.6 percent and 13.6 percent in September 2015. The depreciation of the national currency has also left a significant mark on the regulated prices through the impact that it had on medicines and the main cause was the approval of new electricity and gas tariffs. Annual inflation rate in the third quarter of 2015 increased by 0.3 percentage points compared to the projection (10.8 percent) of Inflation Report no. 3, 2015, given the higher than expected depreciation of the national currency. In the third quarter of 2015, annual industrial producer price index increased to the level of 6.1 percent.

1.1 Consumer price index

In the third quarter of 2015, CPI inflation upward trend was accentuated from the beginning of the year, so that the annual growth rate of CPI has increased from 8.3 percent in June to 12.6 percent in September 2015. At the same time, the annual inflation rate over a period of seven months is outside the range of ± 1.5 percentage points from 5.0 percent target stipulated in the Medium-term monetary policy strategy. Average annual growth rate of CPI in the third quarter of 2015 amounted to 11.1 percent, by 3.1 percentage points higher than the previous quarter (Chart 1.1).

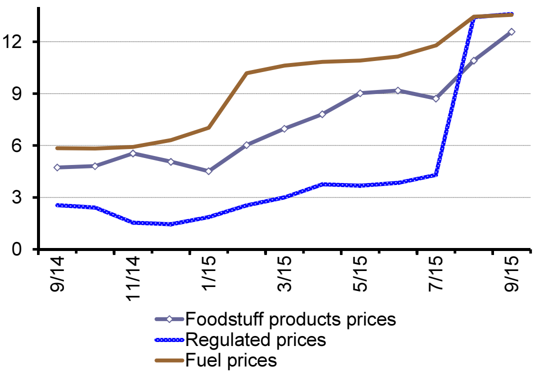
Chart 1.1: The annual rate of CPI and core inflation (%)



Source: NBS, NBM calculus

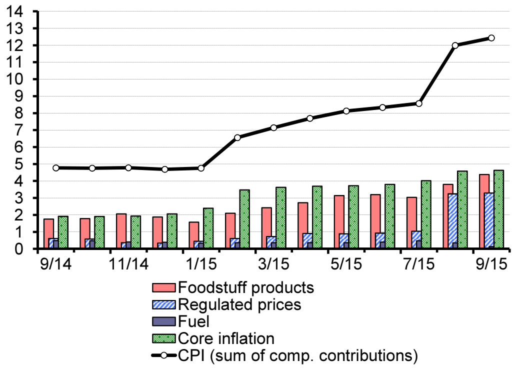
The annual core inflation rate continued to maintain a higher trajectory than that of total inflation. Core inflation has also

Chart 1.2: The annual rate of food, regulated and fuel prices (%)



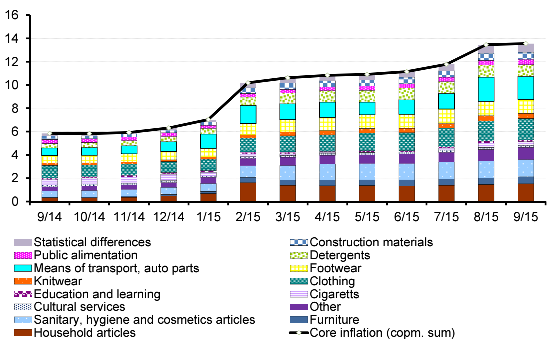
Source: NBS

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



Source: NBS,NBM calculus

Chart 1.4: The components contribution to the annual growth of core inflation (p.p.)



Source: NBS, NBM calculus

accentuated its upward trend during the third quarter, increasing from 11.1 percent in June to 13.6 percent in September. In the third quarter of 2015, the average rate of core inflation amounted to 12.9 percent, exceeding by 1.9 percentage points the level of the previous quarter amid the depreciation of the national currency against the U.S. dollar. As a result, the contribution from core inflation on the annual rate of CPI has increased by 0.7 percentage points, up to 4.4 percentage points.

The greatest impact on the annual growth rate of CPI was generated by the increased pressures from regulated prices. Their contribution to the CPI dynamics has increased from 0.9 percentage points to 2.5 percentage points, as a result of the approval in June of new electricity and gas tariffs, as well as higher medicine prices amid the depreciation of the exchange rate. The pronounced increase of the CPI annual rate was also supported by the intensification of the pressures from food prices, as a result of the depreciation of the national currency and dry weather conditions this year. Thus, their contribution to CPI increased from 3.0 percent in the second quarter to 3.7 percent in the third quarter of 2015. Factors that offset, to some extent, pro-inflationary influence of the national currency depreciation and the tariff increases are represented by the still modest domestic demand, rich harvest of agricultural products from the previous year, embargoes on certain categories of domestic products, and the downward trend of food prices internationally. The contribution from fuel prices constituted 0.3 percentage points, being slightly lower to that recorded in the second quarter of 2015 (Chart 1.3).

Within the components structure, the highest increases in September 2015 compared to September 2014 were recorded by non-food prices (12.9 percent), followed by food prices (12.6 percent) and services (11.4 percent).

Core inflation index

In the third quarter of 2015, the annual rate of core inflation continued its upward trend, increasing from 11.0 percent in the second quarter to 12.9 percent in the reporting period.

During the third quarter, core inflation was mainly fed by the increase in prices of the subcomponents "means of transport, auto parts", "clothing", "sanitary, hygiene and cosmetics articles", "household articles" etc. (Chart 1.4).

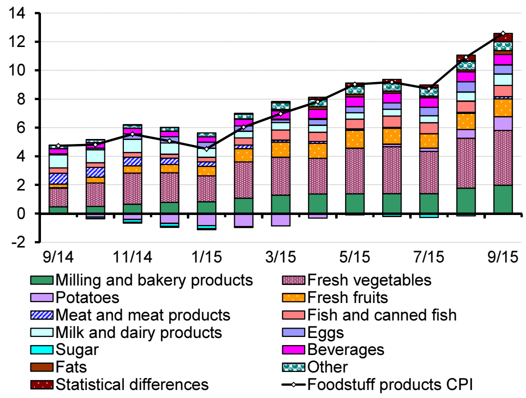
At the same time, in September 2015, the increase in prices of "detergents" (by 21.3 percent), "household articles"[1] (by 20.7 percent), "means of transport, auto parts" (by 19.7 percent), "sanitary, hygiene and cosmetics articles"[2] (by 18.0 percent) etc. has contributed to the annual inflation acceleration up to 13.6 percent.

The main factor contributing to the annual growth of prices for core inflation is not significantly different from previous periods. Thereby, the prices increases occurred mainly as a result of pressures from the depreciation of the national currency against the currencies of major trading partners of Moldova. The average exchange rate of the national currency against the U.S. dollar recorded in the third quarter of 2015 the value of MDL/USD 19.20, depreciating by 5.9 percent compared to the previous quarter, or by 36.6 percent compared to the same period of 2014. The impact of aggregate demand on core inflation is expected to be a modest one.

Food prices

In the third quarter of 2015, the annual growth rate of food prices recorded an average level of 10.7 percent, by 2.1 percentage points higher than the second quarter of 2015. This upward dynamics was caused mainly by higher contributions from groups "potatoes", "fresh vegetables", "milling and bakery products", "eggs" and "milk and dairy products" (Chart 1.5). The price increase of these products was mainly influenced by dry weather conditions of the summer 2015, which has significantly compromised the development of agricultural crops during this period. At the same time, the depreciation of MDL/USD exchange rate by 5.9 percent in the third quarter of 2015 compared to the second quarter of 2015 has also contributed to the accentuation of the inflationary pressures on food imported prices.

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



Source: NBS, NBM calculus

It should be mentioned that, for the ninth consecutive quarter, the annual growth rate of international food prices remained negative, thus, in the third quarter of 2015, it recorded a level of minus 20.1 percent.

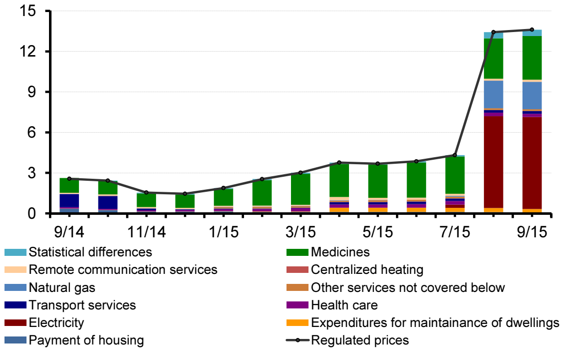
The increase of 12.6 percent in annual terms of food prices in September 2015 was mainly due to the increase in prices of "fresh fruits" (38.6 percent), "fresh vegetables" (37.8 percent), "potatoes" (28.4 percent), "milling and bakery products" (11.0 percent) and "fish and canned fish" (10.4 percent).

[1]This increase in the component "household articles" refers to: electric hotplates (by 36.0 percent), sewing machines (by 32.8 percent), other small electrical devices (by 31.5 percent) etc.

[2]This increase in the component "sanitary, hygiene and cosmetics articles" refers to: means for toilet (by 21.5 percent), other items for personal hygiene (by 20.0 percent), sanitary and hygiene items (by 19.9 percent) etc.

Regulated prices

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

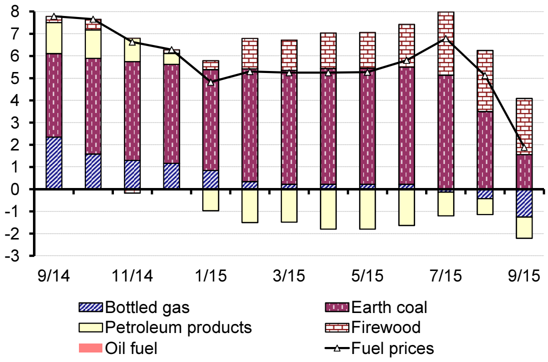


Source: NBS, NBM calculus

The annual rate of regulated prices recorded a pronounced acceleration in the third quarter, amounting to 10.5 percent in the last two months, thus by 6.7 percentage points higher than in the previous quarter. This increase occurred amid the significant increase in electricity and gas tariffs (34.5 percent and 15.4 percent in September 2015), after that the Council of Administration of the National Energy Regulatory Agency (NERA) has approved during its public meeting of July 18, 2015 the new regulated tariffs for electricity supply and distribution to end-customers by ÎCS „RED Union Fenosa” SA, ÎCS „Gas Natural Fenosa Furnizare Energie” SA, „RED Nord” SA and „RED Nord - Vest” SA. Similarly, the Council of Administration of NERA has accepted the increase in average final tariff of natural gas supplied by SA "Moldovagaz". The increase in medicine prices continued also to persist in the third quarter of 2015. As a result, their annual rate recorded in September 2015 a level of 18.5 percent. The depreciation trend of the national currency against the US dollar over the last year was the cause of the increase in medicine tariffs and prices. Negligible contributions to annual dynamics of prices for regulated services were generated by the dynamics of prices for remote communication services, healthcare services and transport services (Chart 1.6).

Fuel prices

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



Source: NBS, NBM calculus

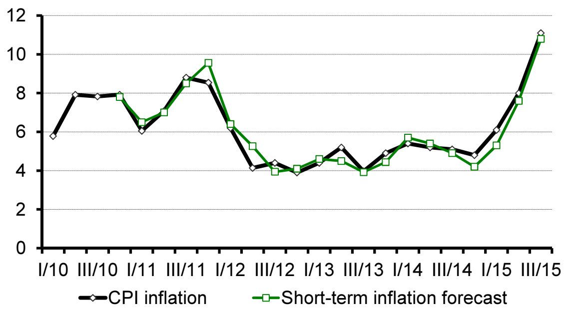
During the third quarter of 2015, the annual growth rate of fuel prices recorded a downward dynamics, decreasing from 6.9 percent in July to 1.9 percent in September. Thus, the average annual growth rate was 4.7 percent, by 0.8 percentage points lower than the second quarter of 2015 (Chart 1.7).

The formation of the annual growth rate of fuel prices during the third quarter of 2015 was driven mainly by rising prices of "earth coal" and "firewood". This was caused by the continuing military conflict in eastern Ukraine that affected negatively the coal mining. During the reporting period, the contribution of subcomponent "earth coal" in fuel prices formation constituted 3.4 percentage points, by 1.8 percentage points lower than the second quarter of 2015. In the third quarter of 2015, the contribution from "firewood" prices increased by 1.0 percentage points compared with the previous period, up to the amount of 2.7 percentage points.

During the reporting period, the contribution generated from fuel prices reached the amount of minus 0.9 percentage points to the annual rate formation of fuel prices, by 0.8 percentage points higher compared with the previous quarter. In should be mentioned that, starting with July 2015, the prices of the subcomponent "bottled gas" turned negative, thus, its contribution to annual rate formation constituted minus 0.6 percentage points, by 0.8 percentage points lower than the second quarter of 2015.

1.2 Comparing forecasts of the Inflation Report no.3, 2015 with the inflation developments in the third quarter of 2015

Chart 1.8: The evolution and forecast of CPI since the implementation of inflation targeting regime (%)



Source: NBM

The accentuated upward trend of the inflation in the third quarter of 2015 has determined a deviation of 0.3 percentage points from the anticipated values (10.8 percent) within the forecasting round of July. Given the higher than expected depreciation of the national currency during the reporting period, this deviation may be considered minor.

Within the inflation subcomponents, the most significant deviation from forecast was noted for the core inflation, being caused, as it was mentioned above, by a higher than expected depreciation of MDL against USD, given that this component includes imported subcomponents and, subsequently, highly sensitive to the exchange rate dynamics. Thus, core inflation in the third quarter of 2015 was 12.9 percent, by 1.3 percentage points higher to the value of 11.6 percent anticipated in the previous forecasting round. Fuel prices have also recorded a positive deviation (1.1 percentage points), but with an insignificant impact on the total deviation. Their annual rate was 4.6 percent in the third quarter of 2015 than the value anticipated of 3.5 percent.

Table 1.1: Evolution and forecast of CPI and its components

	De facto	Forecast IR 3, 2015	Deviation
	Q III, 2015/ Q III, 2014	Q III, 2015/ Q III, 2014	
CPI	**11.1**	**10.8**	**0.3**
Core inflation	12.9	11.6	1.3
Food products	10.7	11.2	-0.5
Regulated prices	10.4	10.5	-0.1
Fuel	4.6	3.5	1.1

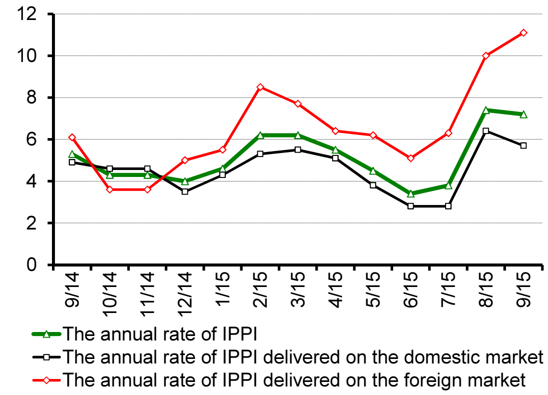
Source: NBS, NBM calculus

Positive deviations mentioned above have been partially counterbalanced by a negative deviation of 0.5 percentage points of food prices from the value anticipated of 11.2 percent. However, taking into account that, as it was anticipated, there was adopted in July the increase in electricity and gas tariffs, the prices of regulated products and services recorded a negligible negative deviation (0.1 percentage points).

1.3 Industrial production prices

Following the deceleration of the annual rate of industrial production price index in the second quarter of 2015, in the third

Chart 1.9: IPPI annual rate (%)



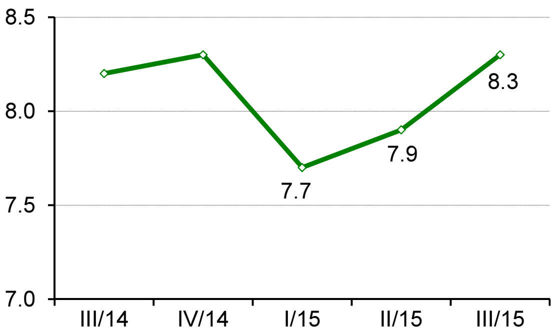
Source: NBS

quarter it reversed its trend, recording an annual rate of 6.1 percent, or by 1.7 percentage points higher than in the second quarter of 2015 (Chart 1.9). This was influenced by the dynamics of prices of products delivered both on foreign and domestic market. In this regard, the annual rate of price index of industrial production delivered on the domestic market in the analyzed quarter was 5.0 percent, by 1.1 percentage points higher than in the second quarter of 2015 and the annual growth rate of price of production delivered on the foreign market increased by 3.2 percentage points and reached the level of 9.1 percent.

In September 2015, the annual rate of industrial production price index (IPPI) was 7.2 percent. Within the structure, the largest increases in annual terms were recorded by prices of manufacturing and extractive industry, which accounted for 8.2 and 3.7 percent, respectively. At the same time, prices of energy sector increased by 0.2 percent compared to September 2014.

1.4 Construction prices

Chart 1.10: The evolution of construction prices index (%, compared to the same period of the previous year)



Source: NBS

In the third quarter of 2015, the annual rate of construction prices was 8.3 percent, increasing by 0.4 percentage points from the second quarter of 2015 (Chart 1.10).

Within the structure of the national economy, the following sectors have recorded the largest increases compared to the same period of the previous year: "building construction" (11.3 percent), "telecommunications" (9.7 percent), "trade and catering" (7.9 percent) and "agriculture" (7.7 percent).

Technical box no.1

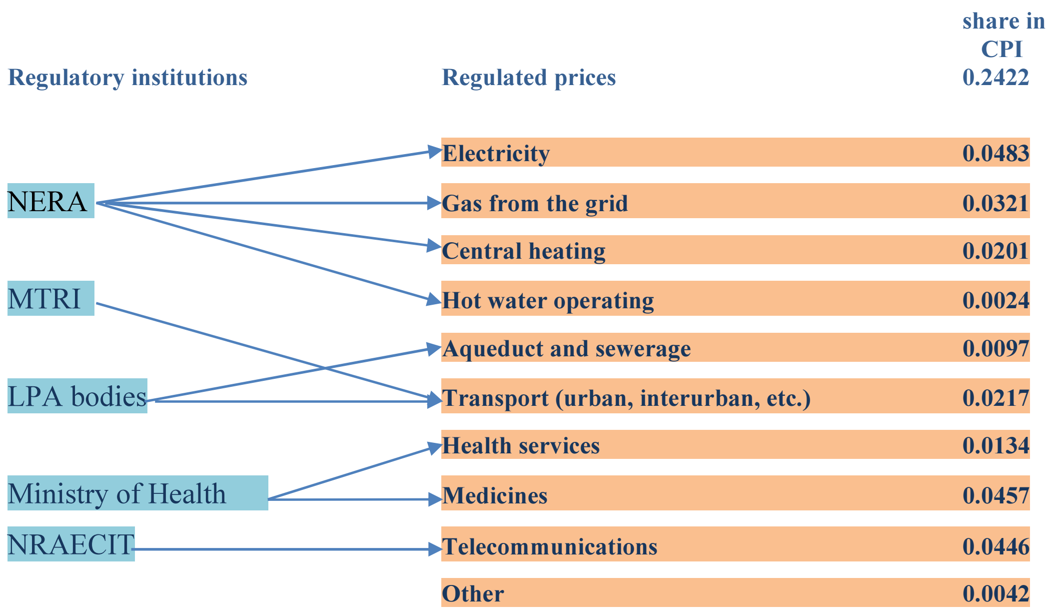
The institutions responsible for the regulated prices adjustment

The NBM mission to ensure and maintain the price stability is often hindered by the fact that a large part of prices of goods and services in the CPI are not determined by the market rules, in particular by the interaction of supply and demand for thereof, which in turn may be influenced by the NBM monetary policy instruments.

According to the Methodology of the calculation of core inflation index, adopted at the end of 2009, the prices of goods and services established by the authorities of the central or local public administration have been named regulated prices. The share of the subcomponents of regulated prices in the CPI structure was significant over time, constituting 24.2 percent in 2015. According to the Republic of Moldova legislation, the prices of regulated goods and services are approved by different regulatory institutions. Therefore, in spite of any pressures determined by objective factors, such as the increase in prices of raw materials, import prices, wear and operational expenses, the prices of these components are amended only if they are approved by the respective institutions. In the event the necessary amendments are postponed or economically unjustified for political or social reasons, there may be accumulated financial deviations for suppliers, which will further require a more pronounced tariffs adjustment that will probably generate impediments in implementing the monetary policy by the NBM.

The main components, their share in the regulated prices, as well as the main regulatory institutions responsible for the tariffs adjustment are given in the figure below.

Figure no.1 **Regulatory institutions and the regulated prices components in the CPI**



Source: NBM, NBS

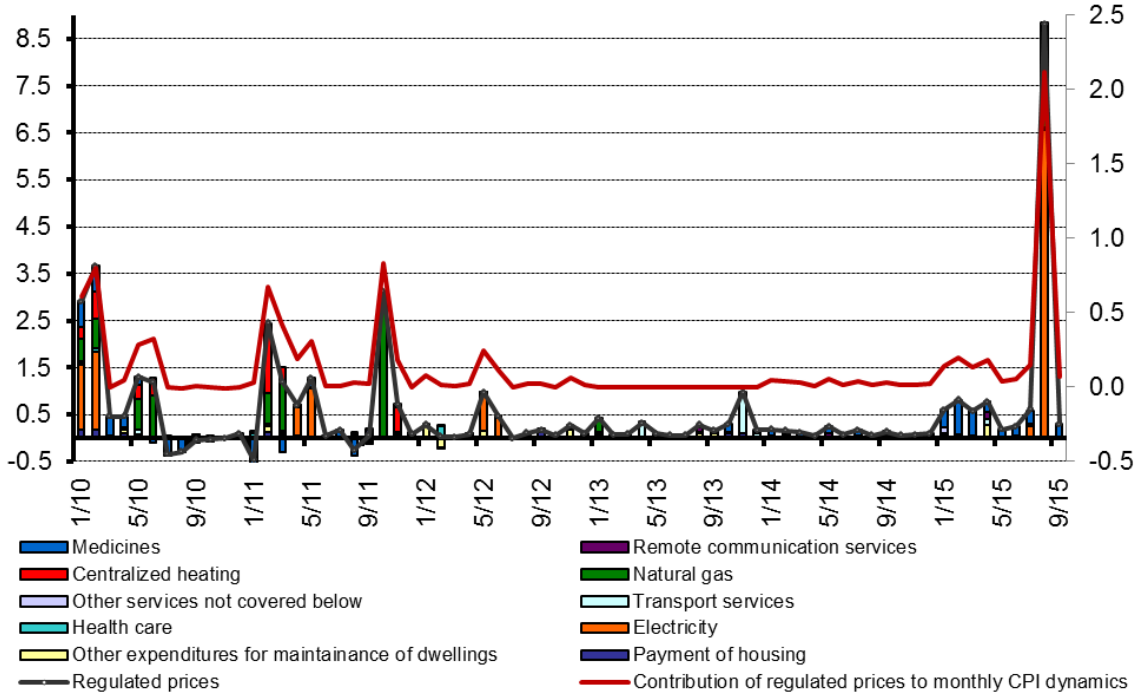
The prices of more than 40.0 percent of the subcomponents mentioned in the figure above are regulated by the National Energy Regulatory Agency (NERA) (figure no.1). Thus, NERA regulates the gas tariff based on the existing methodologies and reasoned requests of the energy resources suppliers. The requested tariff depends on several factors such as gas import prices, exchange rate, operational expenses, previous financial deviations etc. At the same time, NERA also approves the electricity tariffs, taking into consideration such factors as energy import and production prices, operational expenses, exchange rate etc. Tariffs for central heating and heat water operating are also regulated by NERA. The tariffs adjustment by NERA for the gas, central heating and electricity has caused the largest impact on the regulated prices and, ultimately, on the CPI monthly rate in 2010, 2011 and 2012 (Chart 1). Their impact was more pronounced in 2015. Thus, following the increase in tariff for electricity and gas by about 35.0 and 15.0 percent, respectively, the regulated prices increased by 8.8 percent in August 2015, generating a significant contribution to CPI.

Ministry of Transport and Road Infrastructure (MTRI) approves the tariff for interurban transport. Initially, MTRI increased in autumn 2011, at the transporters request, the tariff for interurban transport (26.3 percent) and the further tariff increase was also made at the transporters request.

At the same time, the tariff for urban transport is regulated by the local public administration (LPA). During the reporting period, the tariff for public transport in Chișinău has not been amended, despite of the transporters pressures. However, this was changed in some regions by the local councils, i.e. in Bălți (April 2013), Orhei, Comrat (November 2013). At the same time, the authorities of the local public administration are responsible for the tariffs for the public provision of water supply and sewerage services.

The tariff for telecommunication services is regulated by the National Regulatory Agency for Electronic Communications and Information Technology (NRAECIT). In 2010-2015, this has not recorded major fluctuations.

Chart 1 **The subcomponents contribution to the monthly dynamics of regulated prices and CPI monthly dynamics (the scale from the right side), %**



Source: NBM, NBS

Referring to the medicines prices, the Regulation on the formation of prices for medicines and other pharmaceutical and parapharmaceutical products provides the price formation by applying to the producer purchase price a markup of up to 40.0 percent. At the same time, the medicines price catalogue stipulates the maximum price of the imported medicines. The Medicines Agency issues import authorisations only for the products registered in the medicines price catalogue and only if their customs prices do not exceed the price registered in the catalogue. The producer medicines price approved in MDL may be revised by the Ministry of Health at the applicant's request or on its own initiative if there was registered an appreciation of 3.0 percent and more of the national currency against the price currency included in the national price catalogue. The chart above indicates that the medicines prices have recorded relatively minor fluctuations by the end of 2014. However, in the context of the national currency depreciation, the impact of this subcomponent is much more pronounced this year. At the same time, the Ministry of Health is the institution responsible for verifying the tariffs for health services applied by the healthcare institutions.

In the light of the above, it should be noted that the process of maintaining the inflation close to the target, necessary for a sustainable development of the economy, is hindered, to some extent, by the existence of about a quarter of the components in the CPI structure, the prices of which are not established by the market rules, but are regulated by certain institutions, as well as by the procrastination of the necessary tariffs adjustment in line with objective pressures accumulated. Thus, although the NBM has the mandate and the necessary instruments to maintain the price stability, indirectly, there are other institutions involved in this process, which may compromise the bank's objectives on short and medium term.

Chapter 2

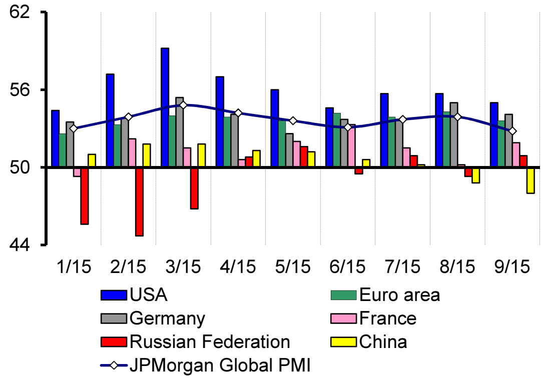
External environment

World economy is getting through a complex period, many indicators reflecting more precarious performances since 2009. The advanced economies remained relatively stable, while the major emerging economies, such as China, Brazil and the Russian Federation have recorded unsatisfactory performances. During the reporting period, the fluctuations of the China's stock exchange indexes have upset the financial markets and the economies of Brazil and the Russian Federation entered into recession. International prices of raw material continued to decrease amid reduced global demand, while the oil prices have seen an exacerbated volatility due to the unsustainability of positive factors and the persistence of those negative. The foreign exchange markets counterbalance has continued, given that the Federal Reserve System (FRS) has maintained its cautious behaviour and has not increased the interest rates, the deflationary pressures in euro area continued to persist, while the currencies of oil exporting countries have reproduced the oil prices development.

In its report World Economic Outlook of October 2015, International Monetary Fund revised downwardly its forecast on the global economic increase of 0.2 percentage points. Thus, it is expected that the global economy will increase by 3.1 percent in 2015 and by 3.6 percent in 2016. Advanced economies will increase on average by 2.0 percent in 2015 compared to 2.1 percent in the previous report and by 2.2 percent in 2016 compared to 2.4 percent in the previous report. The emerging economies will increase by 4.0 percent in 2015 and by 4.5 percent in 2016. The emerging economies have been significantly revised. For example, the economy of the Russian Federation will decrease in 2015 and in 2016 by 3.8 percent and 0.6 percent, respectively, by 0.4 and 0.8 percentage points, respectively, more than in the previous forecast. The economies of the Community of Independent States will decrease on average by 2.7 percent in 2015 and will increase by 0.5 percent in 2016.

The PMI index is in decrease, reflecting the weak global demand and precarious development of the important economies. The

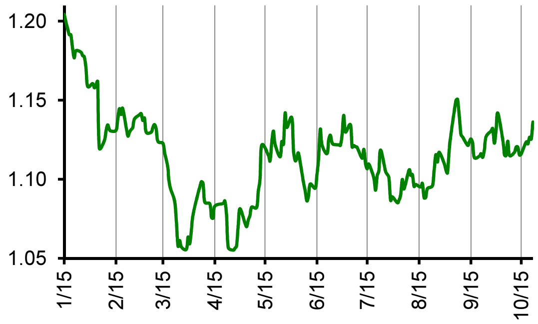
Chart 2.1: The evolution of PMI indexes*



Source: Markit

*Composite Purchasing Manager's Index

Chart 2.2: Daily evolution of the USD/EUR in 2015



Source: ECB

Table 2.1: Monthly average of the currencies in the region (%), appreciation (-)/depreciation (+)

EUR				USD		
Jul.	Aug.	Sep.		Jul.	Aug.	Sep.
- 1.9	1.3	0.7	USD	x	x	x
2.7	15.3	3.6	RUB	4.7	14.2	2.5
0.4	0.0	2.2	UAH	2.5	-1.0	1.1
-0.7	-0.3	0.0	RON	1.3	-1.5	-0.9
0.9	1.5	4.2	MDL	2.9	0.1	3.4

Source: ECB, NBM, NBR, Central Bank of the Russian Federation, National Bank of Ukraine, NBM calculus

global composite PMI index constituted 53.7 in July, 53.9 in August and 52.8 in September. China and the Russian Federation recorded the worst performances, the composite PMI index for the respective economies being periodically below the reference value. The economy of the USA and euro area remained relatively stable and according to Markit the composite PMI index recorded in September the value of 55.0 and 53.6, respectively. In the light of the same PMI index, the evolution of Germany's economy is relatively robust, while the economy of France tends to recover gradually (Chart 2.1).

During the reporting period USD/EUR ratio has evolved contrary to expectations, the European single currency has appreciated on average by 0.6 percent. The major movement was recorded at the beginning of September, where FRS maintained the precarious behaviour of monetary policy and postponed again the interest rate increase. In August, the unemployment rate in USA decreased to 5.1 percent, but the inflation low level and possible shocks related to the China economic development have determined the FRS to maintain the interest rates close to zero. On the other hand, the annual inflation in euro area was minus 0.1 percent in September, after being positive for several consecutive months (Chart 2.2). Compared to the Japanese yen, the U.S. dollar has not recorded significant changes, appreciating on average by 0.7 percent in the third quarter of 2015. During the analysing period, the U.S. dollar has also appreciated against the Swiss franc by 2.4 percent, but depreciated by 1.0 percent against the pound sterling. At the same time, the Chinese yen has adjusted against the U.S. dollar, depreciating on quarterly average by 1.6 percent (only in August by 2.1 percent). Turkish lira depreciated on quarterly average by 6.8 percent against the U.S. dollar.

Russian ruble continued to decline, amid lower oil prices, depreciating in August on average by 14.2 percent against the U.S. dollar and on average by 19.7 percent in the third quarter of 2015. Both Ukrainian hryvnia and Romanian leu had a slow development. Ukrainian hryvnia depreciated in the third quarter of 2015 on average by 0.3 percent against the US dollar and by 1.0 percent against the EUR. Romanian leu appreciated during the reporting period by 0.9 percent against the U.S. dollar and by 0.4 percent against the EUR. For comparison, during the reporting period, the Moldovan leu depreciated on average by 5.9 percent against the U.S. dollar and by 6.6 percent against the EUR (Table 2.1).

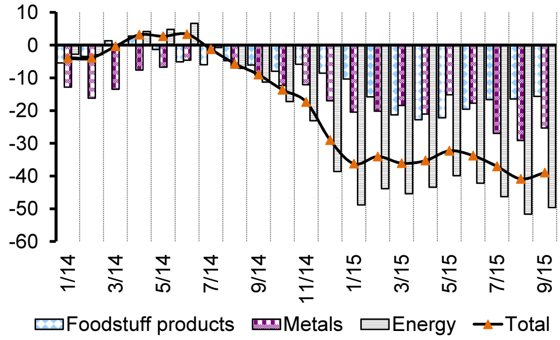
International raw material prices continued to decrease amid weak global demand. Thus, in the third quarter of 2015, international raw materials prices decreased on average by 12.6 percent compared to the previous quarter and by 38.9 percent compared with the third quarter of 2014. International food prices decreased on average by 2.3 percent compared to the previous quarter and by 16.3 percent compared with the third quarter of 2014. International metal prices decreased in the analysed period on average by 10.7 percent compared to the previous quarter and by 27.2 percent compared with the third quarter of 2014. Energy resources prices decreased the most in the analysed period on average by 17.4 percent compared to the previous quarter and by 49.1 percent compared with the third quarter of 2014 (Chart 2.3).

In the third quarter of 2015, international oil prices have seen an exacerbated volatility. During the reported period, the price of Urals brand oil decreased on quarterly average by 19.8 percent, accounting for USD 49.3 per barrel. The deterioration of core indicators, as well as the excessive supply, caused by increasing OPEC production, significant oil reserves in USA and the FRS indetermination regarding the interest rates have contributed to the decrease in oil prices. In the third quarter of 2015, global oil surplus constituted on average 1.8 million barrels per day, of which the most was recorded in August - of 2.4 million barrels per day. In the second half of September, oil prices have slightly increased, due to the OPEC increase in oil demand forecast in 2016 and the oil production decrease in the United States of America. However, the negative long-term factors continue to prevail, determining the most competent organisations to decrease the oil price forecasts for the coming years (Chart 2.4).

Against the backdrop of an ultra stimulative monetary policy, the labour market in the euro area continued to improve, the unemployment rate decreasing to 11.0 percent in July 2015, maintaining the same level as in August 2015. In Italy, the unemployment rate has also recorded a downward trend, decreasing to 11.9 percent in August 2015. In Romania, the unemployment rate has maintained for the sixth consecutive month at the level of 6.8 percent. In the Russian Federation, the unemployment rate represented 5.3 percent in July and August. In Ukraine, in the second quarter of 2015, the average unemployment rate was 8.8 percent (Chart 2.5).

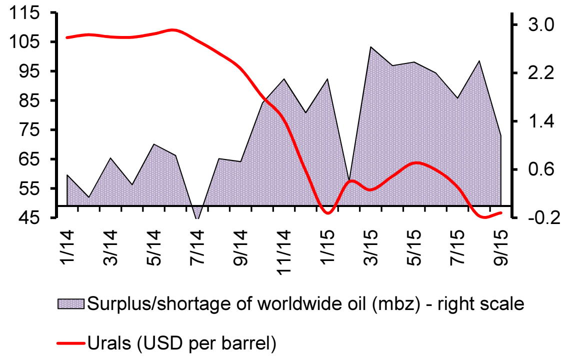
Economy of USA continues gradually to extend. In the second quarter of 2015, the GDP average growth in USA was 1.0 percent compared to the previous quarter of 2015 and 2.7 percent compared to the same period of 2014. The industrial production increased in annual terms by 2.1 percent in January-August 2015, of which by 0.9 percent in August. Labour market has shown positive performances, the unemployment rate decreased in August 2015 to 5.1 percent, maintaining the same level next month. At the same time, inflation continued to be low, which is explained by decrease in oil prices and other prices, but this may be a sign of consumer demand mitigation (Table 2.2).

Chart 2.3: The annual growth rate of world price indexes (%)



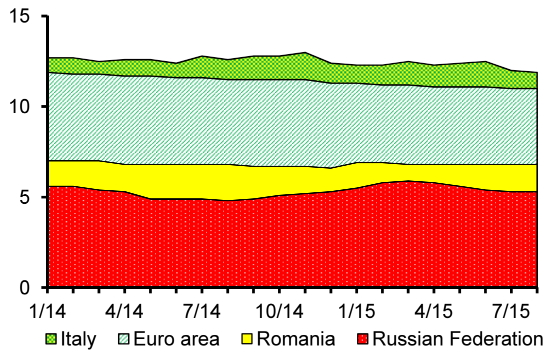
Source: IMF, NBM calculus

Chart 2.4: The evolutions on the world oil market



Source: Ministry of Economy of the Russian Federation, the U.S. Energy Information Administration

Chart 2.5: The unemployment rate in the euro area, Italy, Romania and Russian Federation (%)



Source: Eurostat, Russian Federal Statistics Service

Table 2.2: The evolution of GDP and CPI in the selected economies (%)

		GDP	IPPI	CPI
	QII,15/ QI,15 (based on seasonally adjusted series)	QII,15/ QII,14 (based on gross series)	Jan.- Aug. 15/ Jan.- Aug. 14	Sep.15/ Sep.14
USA	1.0	2.7*	2.1	0.0
Euro area	0.4	1.5	1.4	-0.1
Germany	0.4	1.6	1.4	0.0
France	0.0	1.1	1.0	0.0
Italy	0.3	0.9	0.5	0.2
Romania	0.1	3.4	2.9	-1.7
China	1.8	7.0	6.3	1.6
Russian Federation	-2.0	-4.6	-3.2	15.7
Ukraine	-2.5	-14.6	-18.0	51.9

Source: Eurostat, related national bureaus of statistics
*based on seasonally adjusted series

Euro area economy continues its slowly recovery, gross domestic product increased in the second quarter of 2015 by 0.4 percent compared to the previous quarter and by 1.5 percent compared to the second quarter of 2014. In the first quarter of 2015, gross domestic product increased by 0.5 percent compared to the previous quarter and by 1.2 percent compared to the first quarter of 2014 (GDP turned positive in the second estimate). At the same time, most macroeconomic indicators in euro area are satisfactorily evolving, so that in August 2015 the industrial production increase in annual terms by 0.9 percent and the unemployment rate maintained the level of 11.0 percent. Deflationary pressures continued to persist, in particular when the oil prices are decreasing again. Thus, consumer prices have slightly increased in September, by 0.2 percent compared to the previous month and decreased by 0.1 percent compared to September 2014 (Table 2.2).

In the context of regional conjuncture, the economy of Romania recorded a slowdown in the second quarter of 2015, gross domestic product increased only by 0.1 percent per seasonally adjusted series compared to the previous quarter and by 3.4 percent per gross series compared to the second quarter of 2014 (by 3.8 percent per seasonally adjusted series). The decrease in domestic and external demand determined the annual growth rate of industrial production to increase only by 6.0 percent in August 2015, recording an growth of 2.9 percent since the beginning of the year. In Romania, consumer prices increased in September by 0.3 percent than in the previous month and decreased by 1.7 percent than in September 2014, against the background of the intensification of disinflationary pressures and seasonal decrease in food prices (Table 2.2).

The crisis in the Russian Federation continued to deepen, data for the second quarter of 2015 has indicated a decrease in gross domestic product by 4.6 percent in annual terms and overall, the economy of the Russian Federation decreased in January-August 2015 on average by 3.8 percent. Most of the Russian economic indicators have shown negative evolutions or at best chaotic evolutions. For example, in January-August 2015, the industrial production decreased in annual terms by 3.2 percent, of which, in August 2015, the industrial production decreased by 4.3 percent compared to the same period of the previous year. Maintaining the unemployment rate at the level of 5.3 percent in August 2015 seems rather a seasonal effect, concealing the economic crisis. At the same time, annual inflation accelerated in September up to 15.7 percent and consumer prices increased in monthly terms by 0.6 percent in September. Russian ruble has seen an increased volatility during the reporting period, amid the fluctuations of oil prices and the interventions of the Central Bank of the Russian Federation (Table 2.2).

In Ukraine, GDP in the second quarter of 2015 decreased by 14.6 percent compared to the same period last year. Industrial production decreased in August by 5.8 percent in annual terms and on average by 18.0 percent in the first eight months of 2015. Since early 2015, exports decreased on average by 34.8 percent and imports by 37.8 percent. At the same time, following the drought in the region, agricultural production decreased in the first eight months of the current year on average by 5.8 percent. In September, consumer prices increased in monthly terms by 2.3 percent and in annual terms by 51.9 percent (Table 2.2).

Chapter 3

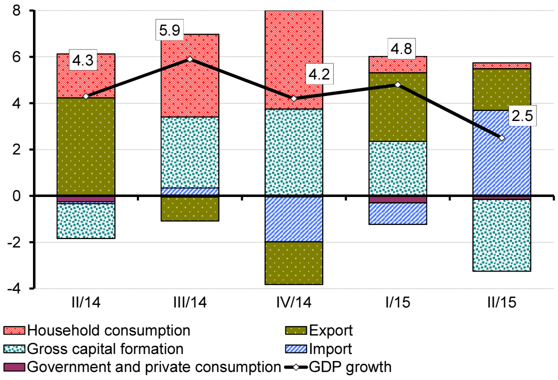
Economic developments

3.1 Demand and output

According to data on GDP, economic growth rate started to decelerate in the second quarter of 2015. In this regard, GDP increased only by 2.5 percent compared to the level recorded in the second quarter of 2014. However, there are significant changes compared to the beginning of this year in terms of determinants of this evolution. Seasonally adjusted series show a slight increase of only 0.2 percent of GDP compared with the first quarter of 2015.

Demand

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



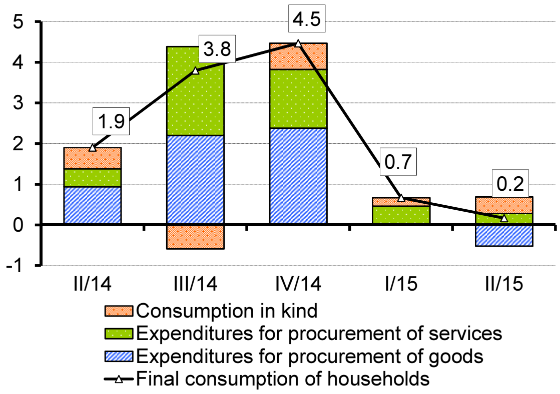
Source: NBS, NBM calculus

In the light of uses (Chart 3.1), the GDP positive dynamics was mainly favoured by the depreciation of the national currency, which had an important incentive effect on exports of domestic products on the one hand, but led to slowdown in imports on the other hand. Thus, in the second quarter of 2015, the volume of exports of goods and services was by 4.1 percent higher than that recorded in the same period of the previous year. The increase in exports was seen in particular towards the countries as Romania, Great Britain, France, the Netherlands, and Belarus. Export towards the Russian Federation and Ukraine continued to decrease significantly amid the economic crisis in the region, the military conflict in eastern Ukraine and as a result of embargoes from the Russian Federation. At the same time, imports recorded a decrease of 4.4 percent, generating a major positive contribution to GDP growth formation. In the second quarter of 2015, household consumption recorded a modest dynamics, increasing only by 0.2 percent compared to the same period of last year, thus determining a negligible contribution to GDP dynamics. In the second quarter of 2015, investments recorded a pronounced negative evolution, which have eroded a significant part of the positive contribution resulted from the net export dynamics. Thus, gross fixed capital formation decreased by 1.5 percent, while the negative contribution from the component change in inventories was more accentuated. The modest consumption dynamics and the significant decrease in investments show the mitigation in the household real income growth and the deterioration of expectations regarding the economic activity. Similar to the previous periods, general government consumption recorded a negative evolution, decreasing by 0.4 percent.

Household consumer demand

In the second quarter of 2015, the annual growth rate of household consumption continued its downward trend recorded in the previous quarter, reaching a level of 0.2 percent or by 0.5 percentage points lower than the first quarter of 2015. It should be mentioned that the slowdown in the annual growth rate of final consumption of households was driven mainly by the reduction of the expenses for the procurement of goods and the mitigation of those for the services (Chart 3.2). As a result, the contribution from the expenses for the procurement of goods decreased by 0.6 percentage points, while that of services - by 0.1 percentage points compared with the first quarter of 2015. During this period, consumption in kind increased by 3.4 percent compared to the previous quarter, generating a contribution of 0.2 percentage points to annual rate formation.

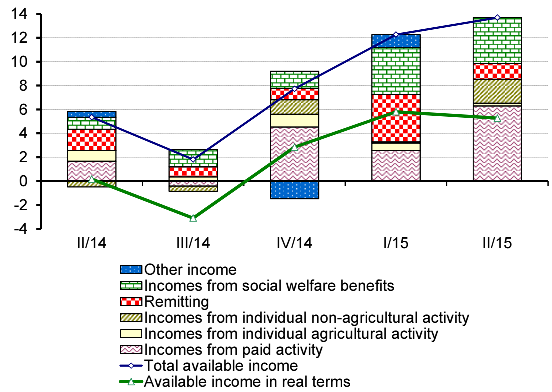
Chart 3.2: Components contribution (p.p.) to the final consumption of households' growth (%)



Source: NBS, NBM calculus

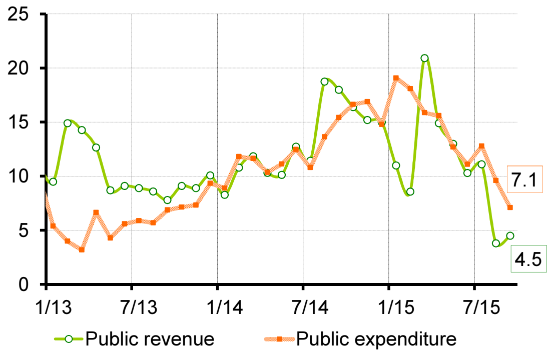
However, the annual growth rate of household disposable income continued the upward trend, recording a level of 13.7 percent or by 1.4 percentage points higher than the level in the first quarter of 2015 (Chart 3.3). This dynamics of annual rate was due especially to higher volume from employed activity and social benefits, which have generated contributions of 6.3 and 3.8 percentage points to the annual rate formation. At the same time, the contribution of remittances has been positive (1.3 percentage points), but decreasing compared to the first quarter of 2015. Income from individual non-agricultural and agricultural activity generated a joint contribution of 2.2 percentage points to the annual rate formation. However, during the reporting period, annual growth rate of personal disposal income in real terms recorded a level of 5.3 percent, by 0.5 percentage points lower to that of the previous quarter.

Chart 3.3: Evolution of personal disposable income (%, versus the same period of the previous year) and subcomponents contribution (p.p.)



Source: NBS

Chart 3.4: Dynamics of public revenue and expenditure (%, annual growth)



Source: Ministry of Finance

Public sector

Execution of national public budget

According to data provided by the Ministry of Finance, government revenues amounted to MDL 31822.5 million in January-September 2015, exceeding by 4.5 percent the revenues collected in the same period of 2014 (Chart 3.4). The revenues collected in the first nine months of 2015 were by MDL 494.6 million lower than targets set for the reporting period, covering 98.5 percent thereof.

The major part of budget revenues has accrued on the account of tax-related revenues, which accounted for a share of 86.7 percent of total revenues, increasing by 6.1 percent compared to the same period of 2014. At the same time, the non-related tax revenues were 5.6 percent of total revenues, by 74.5 percent higher than the level recorded in the same period of 2014. It should be also mentioned that the share of tax-related revenues in the structure of the national public budget revenues increased by 1.3 percentage points compared to the previous year.

Revenues administered by the State Tax Service accounted for 57.8 percent of total national public budget revenues and 36.1 percent of revenues administered by the Customs Service. The revenue collection level set for the reporting period was carried out by the tax authorities at the level of 102.6 percent (by MDL 465.5 million more than the established amount) and by customs - at the level of 94.4 percent (by MDL 676.3 million less than the set for the reporting period). Compared to the respective period of 2014, revenue collection administered by the State Tax Service increased to MDL 937.0 million or by 5.4 percent, and revenue collection administrated by the Customs Service - by MDL 275.0 million or by 2.5 percent.

National public budget expenditures during January – September 2015 totalled MDL 32687.1 million, recording an increase of 7.1 percent compared to the same period of 2014. The evolution of public expenditure has contributed to their execution in the proportion of 83.2 percent compared to the initially planned expenditures. Of the total expenditures, the social-cultural programs (70.4 percent) held the largest share, national economy held 11.8 percent, public order and national security - 6.1 percent of expenditures, other areas enjoying a modest funding.

National public budget execution resulted in a deficit in the amount of MDL 864.6 million in the analysed period. During the same period of 2014, national public budget execution resulted in a deficit in the amount of MDL 79.6 million. As of September 30, 2015, the general government accounts balances increased by MDL

523.0 million compared to January 1, 2015, accounting for MDL 3774.1 million.

Government debt

As of September 30, 2015, the balance of the debt of the Republic of Moldova was MDL 33538.7 million and consisted of external state debt (80.0 percent) and domestic government debt (20.0 percent). Compared to September 2014, the government debt increased by MDL 7556.5 million or by 29.1 percent, due to the increase of external debt (with a contribution of +30.3 percentage points) and internal debt (with a negative contribution of 1.2 percentage points).

During the reporting period, the balance of external debt was USD 1334.0 million, increasing by USD 27.9 million compared with the beginning of the year, due to achieving positive value of net foreign financing of USD 73.3 million and negative fluctuations of the USD exchange rate against other foreign currencies of USD 45.4 million.

As of September 30, 2015, the internal government debt amounted to MDL 6714.2 million, by 4.4 percent or MDL 311.2 million lower than the level of September 2014. Internal debt was composed of SS issued on the primary market (68.9 percent), SS converted (30.7 percent) and SS for financial stability (0.4 percent).

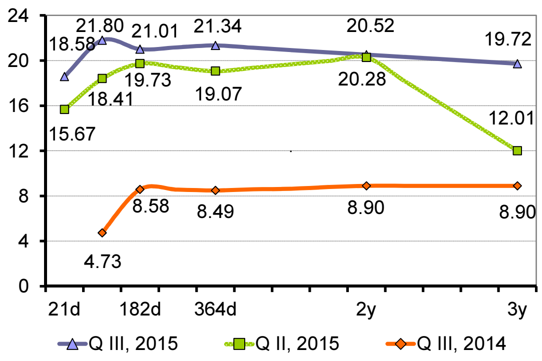
For the internal debt service since the beginning of the year, there were used funds in the amount of MDL 482.0 million or 92.2 percent of the funds provided for this period.

SS yield curve

In the third quarter of 2015, the volume of SS traded in the primary market amounted to MDL 1744.5 million, by 27.9 percent less than in the second quarter of 2015. The volume of SS released into circulation during the reporting period was by 46.6 percent lower than the volume initially announced by the Ministry of Finance. The ratio between the demand from participants and supply from the issuing authority was 0.6 in the third quarter of 2015.

The auctions of treasury bills of 21 days have been resumed in May this year, being traded, in the third quarter, at an average effective rate of 18.58 percent annually, increasing by 2.91 percentage points compared to the second quarter. The average effective interest rate on treasury bills with a maturity of 91 days was 21.80 percent, being over the average level of interest rate from the previous quarter by 3.39 percentage points. Treasury bills of 182 days were placed at an average effective rate of 21.01 percent, by 1.28 percentage points over the level recorded in the second

Chart 3.5: SS yield curve (%)



Source: NBM

quarter of 2015, and those with a maturity of 364 days - 21.34 percent, by 2.27 percentage points more than in the previous quarter (Chart 3.5). It should be mentioned that the nominal rate of treasury bills of 364 days was higher than that of treasury bills of 91 days, while at the calculation of the effective interest rate, the rate of treasury bills of 91 days was higher, due to the shorter maturity and the possibility to reinvest the obtained interest rate.

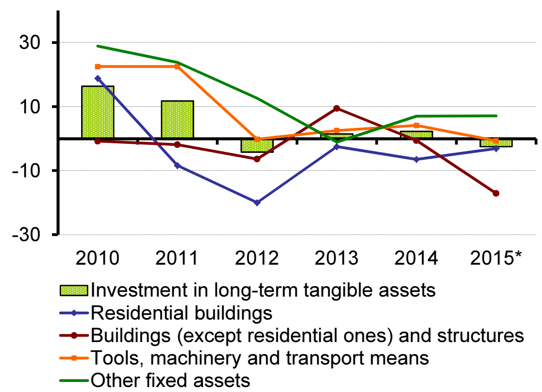
Government bonds with a maturity of 2 years were traded at an average effective rate of 20.52 percent, by 0.24 percentage points more compared to the previous quarter. Government bonds with a maturity of 3 years were placed at average effective rate of 19.72 percent, by 7.71 percentage points more compared to the second quarter of 2015. It should be mentioned that the Ministry of Finance has announced the cessation, on undefined term, of the placement of state securities in primary market with a maturity of 3 years, beginning with the second decade of August 2015.

The treasury bills with a maturity of 91 days held the largest share in the volume of SS in circulation during the reporting period, accounting for 34.98 percent of total transactions, followed by treasury bills of 364 days, with a share a 33.63 percent, the share of treasury bills of 182 days has reached the level of 28.04 percent and that of treasury bills with a maturity of 21 days - 3.23 percent. The volume of state securities with a maturity of 2 and 3 years was insignificant, accounting for 0.12 percent of total transactions.

Investment demand

In the second quarter of 2015, gross capital formation recorded a negative evolution, being marked both by the decrease in gross fixed capital formation and significant decrease in contribution from the component change in inventories.

Chart 3.6: Investment in long-term tangible assets, by type of fixed assets (%, versus the same period of the previous year)



Source: NBS

*Jan.-Jun.

Thus, gross fixed capital formation decreased in real terms by 1.5 percent compared to the same period of 2014. This was supported by the decrease in expenses for purchases of machinery and equipment (by 6.0 percent) and a slight increase of those for constructions (by 0.7 percent).

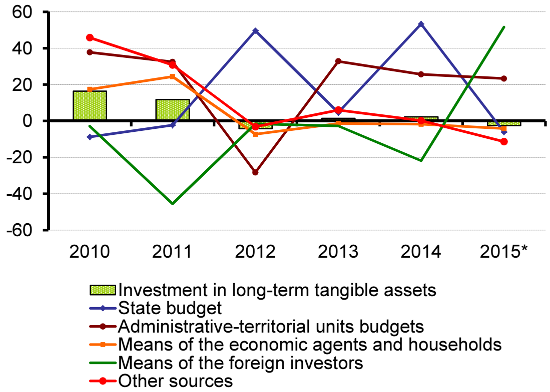
According to the information provided by the NBS, the volume of investments in long-term tangible assets registered a decrease of 2.5 percent annually in the first half of 2015 (Chart 3.6).

Depending on the types of fixed assets, all subcomponents have been adjusted, excluding investments in other fixed assets. Thus, annual growth rate of investments in non-resident buildings recorded a decrease of 17.1 percent, while the investments in residential buildings and those in tools, machinery and transport means decreased by 3.1 and 0.7 percent, respectively.

In terms of funding sources to achieve the investment process (Chart 3.7), the development of subcomponents recorded a non-homogeneous dynamics. Thus, the most important sources of investment financing (with a share of 89.1 percent) recorded a decline: expenditure at the expense of the funds of economic agents and households - minus 4.2 percent, other sources - minus 11.4 percent, while expenditure at the expense of the state budget decreased by 6.1 percent.

At the same time, annual growth rate of foreign investors funds and the budgets of administrative-territorial units, which contributed to investments in long-term tangible assets, increased by 51.6 and 23.3 percent, respectively.

Chart 3.7: Investment in long-term tangible assets, by type of funding resources (%, versus the same period of the previous year)

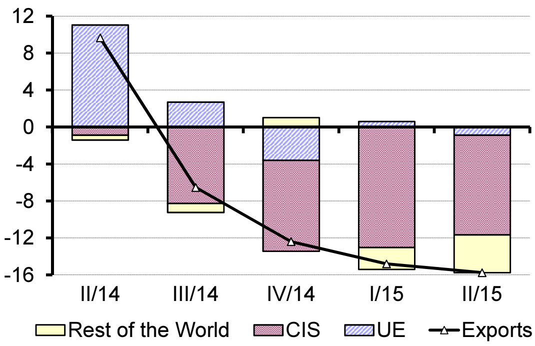


Source: NBS
*Jan.-Jun.

Net external demand[3]

In the second quarter of 2015, the annual growth rate of exports (expressed in USD) continued its downward trend since the third quarter of 2014, recording a level of minus 15.8 percent, or by 1.0 percentage points less compared to the first quarter of 2015. This development was mainly due to the reduction of exports to CIS countries and to those classified as "Rest of the World" (Chart 3.8). It should be mentioned that the exports to CIS countries recorded negative growth rates for the ninth consecutive quarter, mainly determined by the decrease in annual terms of the volume of exports to the Russian Federation. Exports to CIS countries and those classified as "Rest of the World" decreased by 32.6 and 38.1 percent, thus generating negative contributions of 10.8 and 4.1 percentage points, respectively. At the same time, exports to EU countries decreased by 1.5 percent.

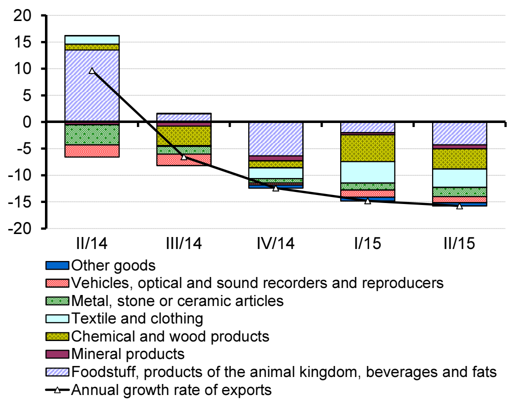
Chart 3.8: Evolution of exports annual rate (%) and contribution by categories of countries (p.p.)



Source: NBS, NBM calculus

The analysis of the exports by groups of goods reveals that the slowdown in annual growth rate of exports in the second quarter of 2015 compared to the first quarter of 2015 was mainly conditioned by the decrease in contribution from the group "foodstuff, products of the animal kingdom, beverages and fats" by 2.3 percentage points. At the same time, the decrease in exports of "foodstuff, products of animal kingdom, beverages and fats" (minus 4.3 percentage points), "chemical and wood products" (minus 3.8 percentage points), "textile and clothing" (minus 3.5 percentage points) and "articles of metal, stone or ceramics" (minus 1.7 percentage points) contributed significantly to the annual rate formation in the second quarter of 2015 (Chart 3.9).

Chart 3.9: Evolution of exports annual rate (%) and subcomponents contribution by groups of goods (p.p.)

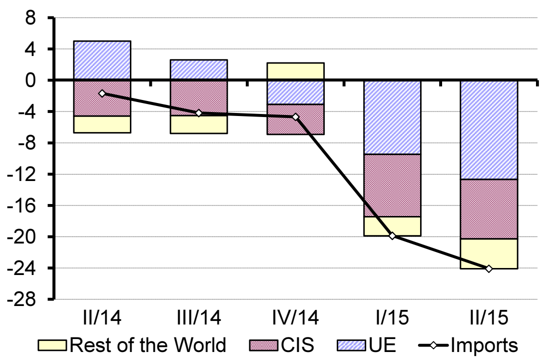


Source: NBS, NBM calculus

It should be mentioned that after a period of four quarters, the annual growth rate of imports was close to the level of minus 3.0 percent, decreasing significantly in the first two quarters of

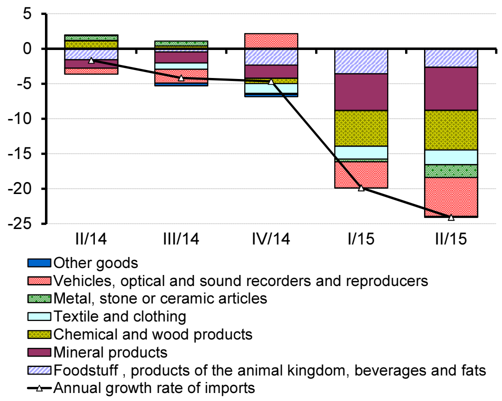
[3] It has been used quarterly data on the development of foreign trade of the Republic of Moldova, expressed in thousands of U.S. dollars.

Chart 3.10: Evolution of imports annual rate (%) and contribution by categories of countries (p.p.)



Source: NBS, NBM calculus

Chart 3.11: Evolution of imports annual rate (%) and subcomponents contribution by groups of goods (p.p.)



Source: NBS, NBM calculus

Chart 3.12: Evolution of foreign trade in real terms (%, versus the same period of the previous year)

Source: NBS

2015 to the level of minus 19.9 and 24.1 percent (Chart 3.10), due to the decrease in imports of goods from all the categories of countries. Thus, imports from CIS and EU countries decreased by 31.9 and 24.2 percent, contributing to the slowdown in the annual rate of imports by 7.6 and 12.7 percentage points, respectively. At the same time, imports classified as the "Rest of the World" decreased by 16.0 percent, generating a negative contribution of 3.8 percentage points to the formation of the annual growth rate of imports (Chart 3.10).

By groups of goods (Chart 3.11), the reduction in the annual growth rate of imports was mainly influenced by the negative evolution of imports of "mineral products", "chemical and wood products", "vehicles, optical and sound recorders and reproducers" and "foodstuff, products of the animal kingdom, beverages and fats", which have generated negative contributions of 6.2, 5.7, 5.6 and 2.6 percentage points, respectively.

Data on foreign trade of the Republic of Moldova for the first eight months of 2015 show a significant contraction thereof. Thus, the exports decreased during the reporting period by 17.2 percent in annual terms, while imports - by 23.0 percent. It should be mentioned that in the first eight months of 2015, the exports of domestic goods decreased by 14.3 percent, as opposed to re-exports which registered a higher decrease (minus 22.2 percent). During July-August 2015, the annual growth rate of exports reached the level of minus 23.6 percent and that of imports the level of minus 25.7 percent (Chart 3.12).

Coverage of imports by exports in January-August 2015 was 49.0 percent, as compared to the same period of 2014, when the recorded level was 45.6 percent.

Output

By categories of resources, the contribution from the component "other services" has also decreased significantly in the second quarter of 2015, mainly determined by the dynamics of the component "Financial intermediation and insurance[4]" that recorded an increase of 14.5 percent. Similar to previous periods, the industry continued to generate a significant contribution to the economic activity dynamics. In this regard, the manufacturing was by 4.9 percent higher during the reporting period compared to the second quarter of 2014. The energy industry had a more pronounced performance, exceeding by 11.4 percent level

[4]Within the structure, it includes the result of the activity of the National Bank of Moldova, commercial banks and insurance companies.

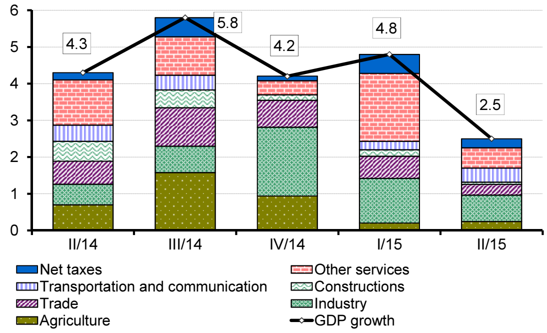
recorded in the same period last year. At the same time, the extractive industry decreased by 7.7 percent, generating an insignificant contribution to GDP dynamics. Although it grew by 2.7 percent, the contribution of agriculture to the dynamics of economic activity was modest in the second quarter of 2015. GDP growth was also supported by trade and transport, which recorded increases of 2.2 and 3.9 percent, respectively. The component "Information and communication" recorded an increase of 4.2 percent, while "constructions" were only by 1.1 percent higher than in the second quarter of 2014. The increase of net taxes on products constituted 1.5 percent in the second quarter of 2015.

In the first two months of the third quarter of 2015, the annual growth rate of industrial production recorded an average level of 2.2 percent, by 1.6 percentage points lower than in the second quarter of 2015 (Chart 3.14). This dynamics was determined by the slowdown in annual growth rate of all sub-components of the industry. Thus, the manufacturing (sub-component with the largest share) decreased from 4.7 percent in the second quarter of 2015 to 4.6 percent in the first two months of the third quarter of 2015. The slowdown in the annual growth rate of the production volume of "water distribution, sewerage, waste management and remediation activities" and extractive industry has also contributed downwardly to the annual rate by minus 2.4 and minus 9.2 percentage points, respectively, and recorded in the first two months of the third quarter of 2015 an average of minus 21.0 and minus 16.5 percent, respectively. At the same time, the annual growth rate of "production and supply of electricity, gas, hot water and air conditioning" has decreased from 9.7 percent in second quarter of 2015 to minus 6.1 percent in the first two months of the third quarter of 2015.

In the third quarter of 2015, the annual growth rate of transported goods decreased significantly, recording a level of minus 25.5 percent, by 15.6 percentage points less compared to the second quarter of 2015. It should be mentioned that this contraction of annual rate was driven mainly by the decrease in the volume of goods transported by road and rail (Chart 3.14). During January-September 2015, enterprises of rail, road, river and air transport have transported goods by 15.2 percent fewer compared to the same period of 2014. This development was due to the decrease in annual terms of the volume of goods transported by all means of transport.

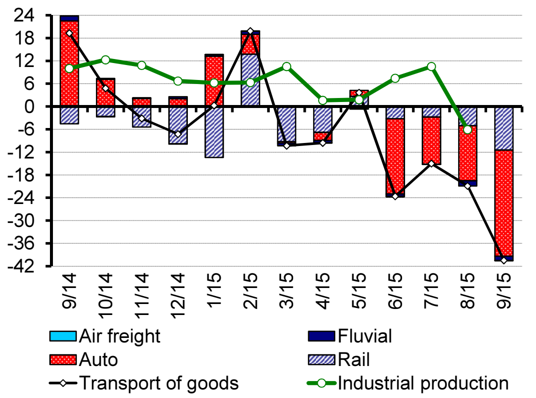
Data on internal trade in July-August 2015 reflect a slight revival of both the trade in goods and trade in services (Chart 3.15). During the reporting period, the annual growth rate of turnover of enterprises having as main activity retail trade decreased by 4.5 percent, by 2.1 percentage points higher compared to the second quarter of 2015. The annual growth rate of turnover of enterprises

Chart 3.13: Contribution of economic sectors to GDP growth (p.p.)



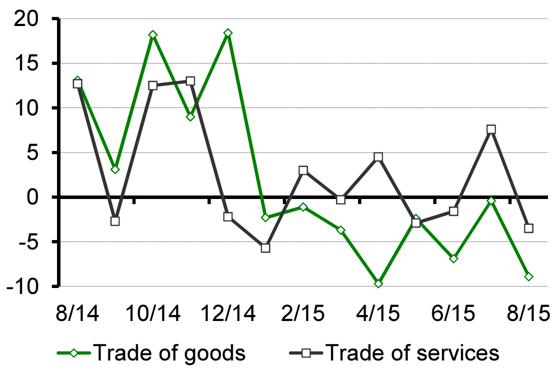
Source: NBS, NBM calculus

Chart 3.14: Evolution in real terms of industrial production and transported goods (%, versus the same month of the previous year)



Source: NBS

Chart 3.15: Evolution of domestic trade (%, versus the same period of the previous year)

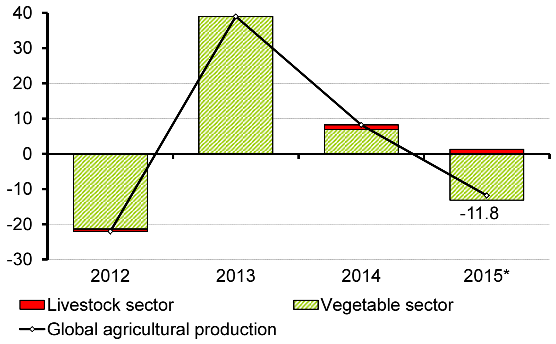


Source: NBS

having as main activity services rendering recorded in the first two months of the third quarter of 2015 an average increase of 2.1 percent, by 1.6 percentage points higher compared to the second quarter of 2015.

Agricultural output

Chart 3.16: Global agricultural production (%) and sectors contribution (p.p.)



Source: NBS
*Jan.-Sep.

In the first nine months of 2015, the volume of global agricultural production decreased by 11.8 percent compared to the same period of the last year (Chart 3.16), as a result of the decrease in volume of the plant production sector by 21.8 percent, generating a negative contribution of 13.1 percentage points to annual rate formation. The pronounced decrease in volume of the plant production sector was mainly influenced by the drought of summer 2015. At the same time, the volume of livestock sector recorded an increase of 3.3 percent, generating a contribution of 1.3 percentage points to annual rate formation.

It should be mentioned that, according to preliminary data, the decrease in volume of livestock sector was mainly determined by the decrease in average harvest per hectare of "soya" (minus 61.0 percent), "sugar beet" (minus 42.0 percent), "maize for grains" (minus 34.0 percent), "potatoes" (minus 31.0 percent), "sunflower" (minus 18.0 percent) and "autumn and spring wheat" (minus 17.0 percent).

3.2 Labour market

In the second quarter of 2015, the situation on the labour market has slightly deteriorated compared to the situation recorded in the second quarter of 2014, but improved compared to the beginning of this year. Both the employed population and active population are slightly over the values recorded in the same period of last year. However, the increase in active population was more pronounced than that of the employed population, thus the unemployment rate constituted 4.1 percent compared to 3.7 percent recorded in the second quarter of 2014. In the first two months of the third quarter of 2015, the annual growth rate of the wage bill in the economy continued its downward trend.

Workforce

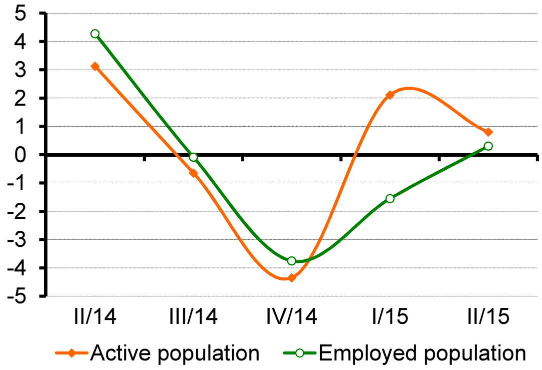
Data on labour market in the second quarter of 2015 show, on the one hand, a slightly deteriorated situation compared to that of the second quarter of 2014, but, on the other hand, a pronounced amelioration compared to the beginning of this year. Thus, the unemployment rate was 4.1 percent during the reporting period, or by 0.4 percentage points higher than the same quarter of last year (Chart 3.18). At the same time, the number of employed population in the second quarter of 2015 has marginally increased (by 0.3 percent) compared to the same period of last year, thus contributing to the increase in employment rate by 0.2 percentage points, up to the level of 43.0 percent. At the same time, the number of economically active population increased by 0.8 percent compared to the second quarter of 2014 (Chart 3.17).

In the second quarter of 2015, the number of people discouraged to find a desired job was about 10.000 persons, by 3.000 less compared to the same period of last year. At the same time, according to the NBS estimates, the number of persons who went abroad to work was 336.100 persons, by 7.800 less than in the second quarter of 2014.

According to data provided by the ANOFM[5], the number of people laid off fell by 23.9 percent in the second quarter of 2015, compared to the quarterly average in the second quarter of 2014, while the number of vacancies has declined by 4.5 percent compared to April-June 2014.

[5]The National Agency for Employment

Chart 3.17: Economically active population and employment (%, versus the same period of the previous year)

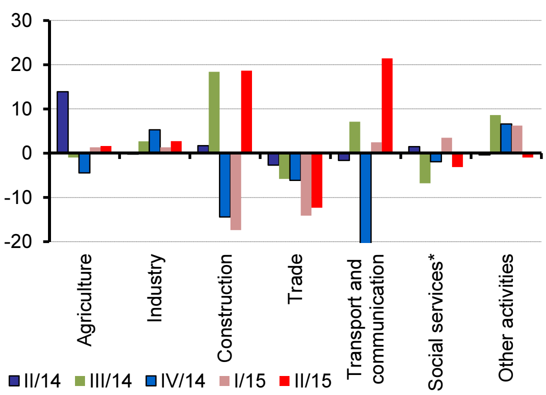


Source: NBS, NBM calculus

Chart 3.18: Evolution of the unemployment and employment rate (%)

Source: NBS, NBM calculus

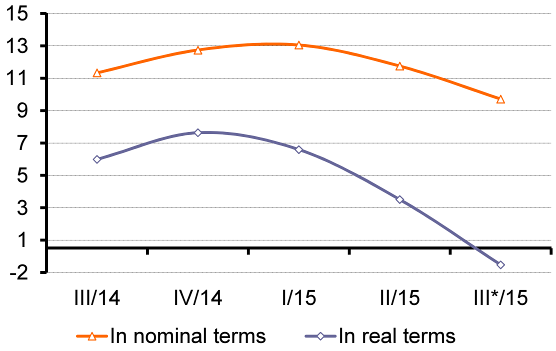
Chart 3.19: Employment by activities of national economy (%, versus the same period of the previous year)



Source: NBS, NBM calculus

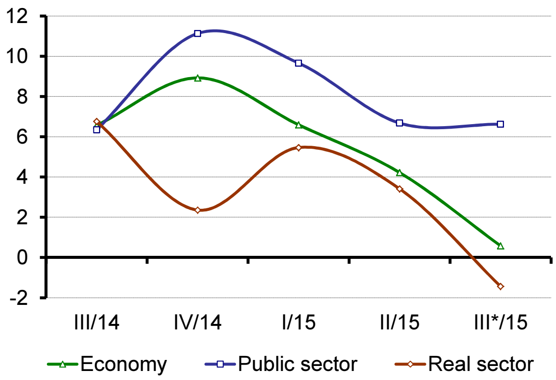
*excluding "other activities with collective, social and personal services"

Chart 3.20: Wage bill in the economy** (%, versus the same period of the previous year)



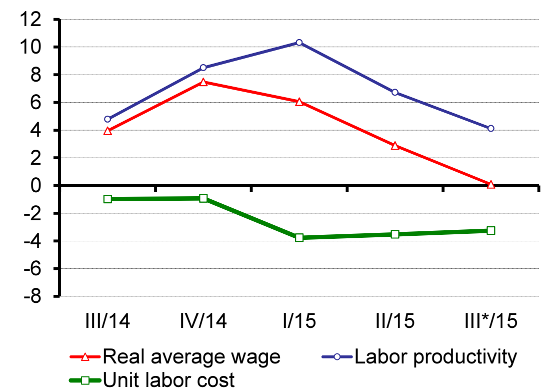
Source: NBS, NBM calculus
*Jul.-Aug.; **deflated by CPI

Chart 3.21: Average real wage**(%, versus the same period of the previous year)



Source: NBS, NBM calculus
*Jul.-Aug.; **deflated by CPI

Chart 3.22: Average real wage and productivity in industry** (%, versus the same period of the previous year)



Source: NBS, NBM calculus
*Jul.-Aug.; **deflated by CPI

The analysis of seasonally adjusted data on the unemployment and employment rate evolution reveals an amelioration of these indicators compared to the first quarter of 2015. Therefore, the unemployment rate decreased by 2.3 percentage points, to the level of 4.5 percent, while the employment rate increased by 0.4 percentage points, up to the level of 40.0 percent.

Within the distribution of the national economy, the largest concentration of employed population is registered in agriculture and the public administration sectors and in the second quarter of 2015, their share constituted 36.0 and 18.1 percent, respectively. It should be mentioned that in the second quarter of 2015, the number of employed persons increased in the "transport and communication" sector (21.4 percent) and in that of "constructions" (18.6 percent) compared to the second quarter of 2014. At the same time, the number of employed persons in the trade sector recorded a decrease in annual terms for seventh consecutive quarters. The decrease in number of employed persons in the trade sector accentuated during the last two quarters, thus in the second quarter of 2015, decreasing in annual terms by 12.3 percent (Chart 3.19).

Wages

In the first two months of the third quarter of 2015, the annual growth rate of the nominal wage bill in the economy continued its downward trend noted this year, constituting 9.2 percent. In real terms, deflated by CPI, the wage bill decreased by 1.0 percent compared to the same period of the previous year (Chart 3.20).

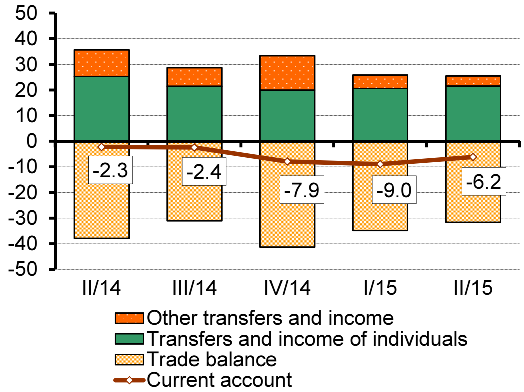
During the reporting period, the average wage in the national economy increased by 11.0 percent compared to the same period of the previous year. Both the budgetary sphere and the real sector of the economy registered an increase of the average wage by 17.6 and 8.8 percent, respectively, compared to the similar period of last year. During this period, the annual average real wage growth in the economy was 0.6 percent, lower by 3.6 percentage points compared to the second quarter of 2015 (Chart 3.21). This increase was driven by positive dynamics of real average wages in the public sector (6.6 percent) and by the negative dynamics in real sector (minus 1.4 percent).

During July-August 2015, the annual average real wage growth in industry was 0.1 percent, by 2.8 percentage points lower compared to the second quarter of 2015. The annual rate of labour productivity in industry decreased to the amount of 4.1 percent (Chart 3.22). As a result, the annual unit cost of labour in industry constituted the value of minus 3.3 percent in the reference period.

3.3 External sector

In the second quarter of 2015, the current account deficit[6] of the balance of payments decreased compared to the same period of the previous year, accounting for 6.2 percent as a share of GDP, or by 2.8 percentage points less compared to the previous quarter (Chart 3.23). This decrease occurred due to lower share in GDP of the component with negative contribution - the trade balance. The trade balance deficit in the second quarter of 2015 declined as a share of GDP by 3.2 percentage points from the previous quarter, reaching a level of 31.6 percent. This development was driven, on the one hand, by the decrease of the share of imports to GDP by 7.5 percentage points, while on the other hand, by the decrease of the share of exports by 4.3 percentage points.

Chart 3.23: Current account share in GDP (%)

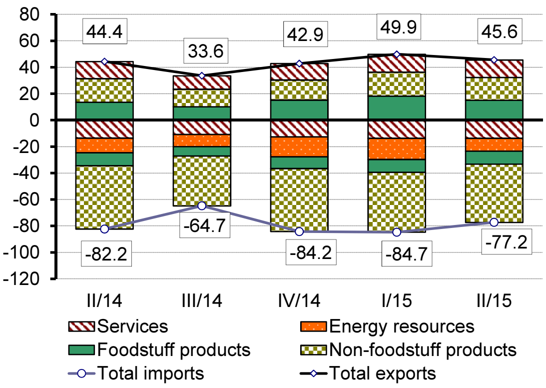


Source: NBM

At the same time, the components with positive contribution, transfers and income of individuals recorded an increase of 1.0 percentage points compared to the previous quarter, while other transfers and income decreased by 1.4 percentage points as share in GDP.

During the reporting period, the export of goods and services decreased as a share of GDP to the level of 45.6 percent (Chart 3.24). This evolution was driven by the decrease of the share of food products exports by 3.3 percentage points, to the level of 15.0 percent of GDP, the share of exports of non-food products decreased by 0.7 percentage points, to the level of 17.4 percent of GDP, while that of exports of services - by 0.3 percentage points (13.2 percent of GDP). Within the exports structure, the non-food products prevailed and accounted for 34.9 percent, food products constituted 30.2 percent, while services - 26.4 percent.

Chart 3.24: Share of exports and imports in GDP (%)



Source: NBM

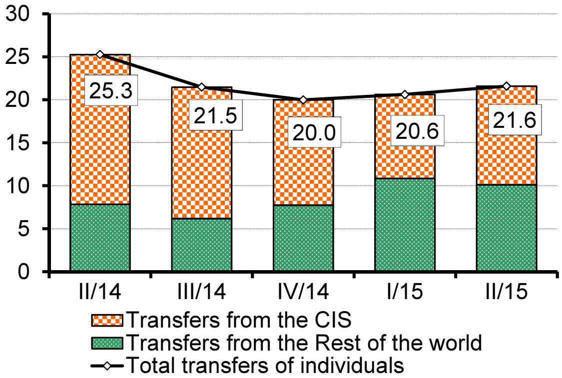
In the second quarter of 2015, the share of imports of goods and services as a share in GDP reached the level of 77.2 percent. It should be mentioned that, energy resources and non-food products to GDP recorded lower values than in the previous quarter, while the food products increased. At the same time, services recorded the level of the first quarter of 2015. Thus, energy resources and non-food products decreased by 6.3 and 1.2 percentage points, respectively. As a share of GDP, these components were 9.7 and 44.1 percent, respectively. At the same time, the share of the food products increased by 0.1 percentage points compared with the

[6]For the analysis of the current account, the standard terminology according to IMF has not been used. The category Total transfers of individuals includes the compensation for work and remittances (current account items), the remaining items, except those included in the Trade Balance, grouped in the category Other transfers and other income.

previous quarter, representing 9.8 percent as share in GDP. In the structure of imports, the share of non-food products constituted 52.1 percent, services - 16.1 percent, energy resources and food products - 11.5 percent each, respectively.

During the reporting period, the exports reflected in the trade balance covered the imports to the same proportion (59.0 percent) compared with the first quarter of 2015 (58.9 percent). According to the NBS data for the second quarter of 2015, the trading partners of the Republic of Moldova, such as Romania, Russian Federation, Ukraine, Germany, Italy, Turkey and Belarus have owned 54.8 percent of total commercial transactions of export-import operations with goods and services.

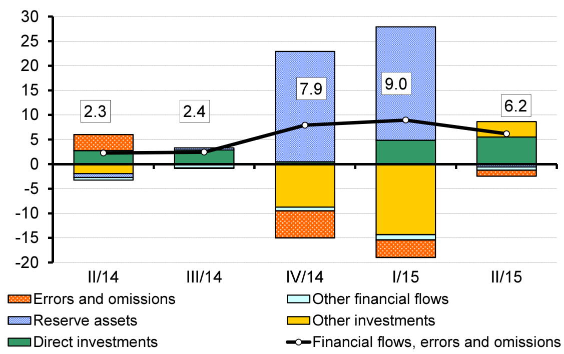
Chart 3.25: Share of transfers in GDP (%)



Source: NBM

In the second quarter of 2015, the share of transfers and personal income of individuals working abroad increased as a share in GDP by 1.0 percentage points compared to the previous quarter, thus reaching the level of 21.6 percent (Chart 3.25). The upward trend was driven by increased transfers from CIS countries. Thus, in the second quarter of 2015, the share of funds transferred from the CIS countries in GDP was 11.5 percent or by 1.7 percentage points more compared to the first quarter of 2015, while the funds transferred from countries classified as the "Rest of the World"[7] held a share of 10.1 percent in GDP or by 0.7 percentage points less than in the previous quarter. According to geographical distribution, transfers from countries classified as "Rest of the World" accounted for 46.8 percent and 53.2 percent were received from CIS countries during the reporting period.

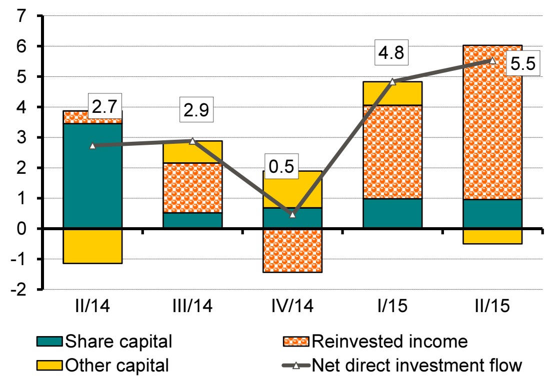
Chart 3.26: Share of financial flows in GDP (%)



Source: NBM

In the second quarter of 2015, the share of financial flows in GDP was 6.2 percent or by 2.8 percentage points less compared to the first quarter of 2015. It should be mentioned that the financial flows mitigated significantly in the second quarter of 2015, after a half year period when they recorded significant movements (Chart 3.26). Thus, during the reporting period the negative contribution from other investments has ended, which indicates a halt in the massive capital outflows. This contributed to the stabilization of the financial flow movements and stopped the necessity of the central bank to intervene in the market in order to cover the liquidity needs. Therefore, the share of reserve assets flow in GDP in the second quarter of 2015 was only minus 0.6 percent compared to the level of 23.1 percent recorded in the first quarter of 2015.

Chart 3.27: Share of direct investments in GDP (%)



Source: NBM

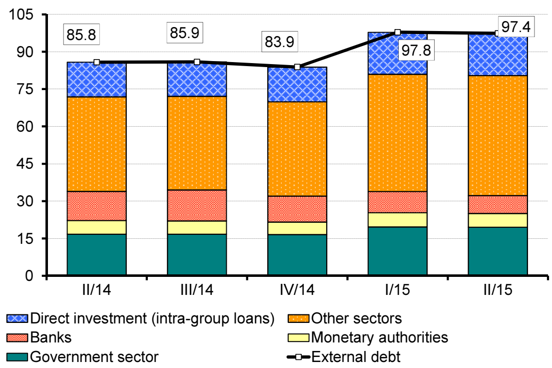
At the same time, in the second quarter of 2015, direct investment share in GDP increased by about 0.7 percentage points, to the level of 5.5 percent compared to the first quarter of 2015, which also contributed to the increase in net cash flow in the economy. It

[7] It refers to transfers received from all countries, except the CIS member countries.

should be mentioned that the increase in direct investments flow in the second quarter of 2015, similarly to the previous quarter, was mainly due to the increase of reinvested income. Thus, its share in GDP was 5.1 percent, or by 2.0 percentage points higher than the previous quarter (Chart 3.27). At the same time, financial flows related to "share capital" generated a similar contribution with that of the previous quarter (1.0 percent), while those related to "other capital" were negative (minus 0.5 percent).

The share of external debt in GDP in the second quarter of 2015 reached a level of 97.4 percent, similarly to that of the previous quarter, by 13.5 percentage points higher than the level at the end of the previous year (Chart 3.28). It should be mentioned that the increase of share of the external debt to GDP compared to the end of 2014 was driven by the increase in external debt of all sectors, except "Banks", which decreased as a share of GDP by 3.3 percentage points. At the same time, these changes have not influenced significantly the structure of external debt. Similarly to the previous periods, the economic agents hold the largest share of 55.4 percent in total external debt, followed by government sector with a share of 25.1 percent and direct investment - 16.9 percent.

Chart 3.28: Share of external debt in GDP (%)



Source: NBM

Chapter 4

Monetary Policy

4.1 Monetary Policy Instruments

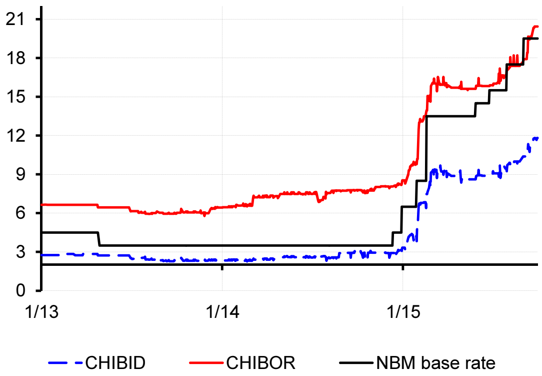
Interest rate policy

The imminence of some pronounced inflationary pressures in subsequent periods imposed the need to continue to increase the base rate. Thus, the NBM carried out two successive increases of the policy rate (by 2.0 percentage points each), its level reaching 19.50 percent.

CHIBOR 2W yield curve has initiated in early July an upward trend, incorporating the effects of further increases of monetary policy interest rate. CHIBOR 2W quotation registered at the end of September was slightly higher compared to the last day of the previous period (+4.54 percentage points), representing 20.43 percent, which is above the monetary policy rate.

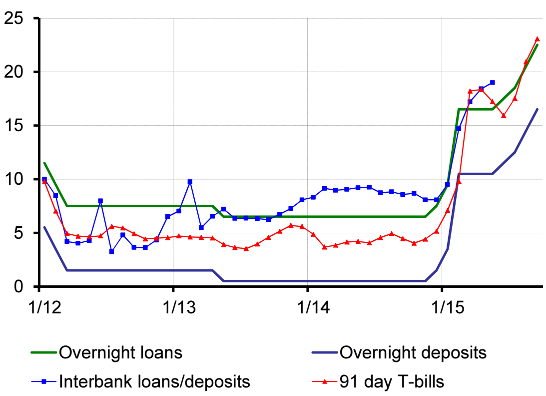
The monthly average interest rate on state securities (SS) of 91 days has reversed its trend from the beginning of the second quarter of 2015, increasing gradually in coming quarter to the level of 23.57 percent, under the impact of the NBM base rate increase and under the conditions of a modest supply from investors for this type of placements.

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



Source: NBM

Chart 4.2: Monthly evolution of interest rates corridor (%)



Source: NBM

Open market operations

NBM Certificates-selling operations (NBM Certificates)

During the third quarter of 2015, the excess liquidity in the banking system was absorbed by the NBM Certificates selling operations with a maturity of 14 days.

The NBM carried out 25 auctions with the announcement of the maximum interest rate equivalent to the NBM base rate, the banks bids being fully awarded.

Following that the interest rates asked in the bids were equal to the maximum rate announced at the auctions, the NBM Certificates were sold at an interest rate equivalent to the NBM base rate. Overall in the third quarter of 2015, the weighted average rate of sterilization operations constituted 16.77 percent annually.

Gradual reduction of the liquidity excess was reflected in the evolution of the volumes of NBM Certificates issuance operations. Thus, the stock of NBM Certificates at the end of the reporting quarter decreased significantly compared to that recorded at the end of the previous quarter (from MDL 1502.2 million to MDL 366.3 million).

State securities (SS) Repo-buying operations

Liquidity needs of the banking system were met through Repo operations with the term of 14 days at fixed rate (the base rate plus a margin of 0.25 percentage points), carried out through tender procedure without ceiling and full allocation. The volume of liquidity injected (MDL 2857.0 million) has been twice than that of the previous quarter. At the end of the reporting period, the balance of Repo operations recorded MDL 390.0 million (MDL +133.0 million compared to the second quarter of 2015).

Lending activity

As of September 30, 2015, the credit indebtedness of the licensed banks to the National Bank of Moldova constituted MDL 14125.9 million, being represented by emergency loans - MDL 14101.7 million, loans granted in 2009 for the protection of the integrity of the banking system – MDL 23.3 million and loans granted in 1992-2002 for crediting the construction of housing cooperatives – MDL 0.9 million.

Compared to the end of the previous quarter, the balance of loans granted to banks increased by 15.6 percent, following the granting of emergency loans in the reporting period in the amount of MDL 1930.0 million.

The amount of loans repaid during the third quarter of 2015 amounted to MDL 26.8 million, including loans granted for the protection of the integrity of the banking system - MDL 23.3 million and loans for crediting the housing construction cooperatives - MDL 3.5 million.

Standing facilities

In the third quarter of 2015, standing facilities regime (overnight deposits and credits) set by the NBM allowed banks to manage their liquidity efficiently and with more flexibility.

National Bank of Moldova increased twice the interest rates on the NBM monetary policy instruments by 2.0 percentage points during the reporting quarter. Thus, the interest rate on the deposit facility evolved from 12.5 percent annually at the beginning of the quarter to 16.5 percent annually at the end of the quarter, and the overnight credit facility from 18.5 percent annually to 22.5 percent annually.

During the reporting period, banks used daily the overnight deposit facility, credit facility being solicited only in September by a restrained number of banks, in insignificant amounts, in order to satisfy the short-term liquidity demand.

The total amount of overnight deposits with the NBM amounted to MDL 33078.7 million in the reporting period, representing a daily average of MDL 521.1 million, by about 19.2 percent less compared to the previous quarter.

During this period, banks have also recoursed to overnight credits, the amount of credits constituted MDL 150.0 million, while the average balance was MDL 1.63 million.

Required reserves

In the third quarter of 2015, along with open market operations, required reserves mechanism continued to exercise the monetary control function and the liquidity management function in the banking system.

During the analysed period, simultaneously with the base rate, the Council of Administration of the NBM decided to increase the required reserves ratio attracted in MDL and non-convertible currency.

Thus, the required reserves ratio was changed as follows:

- for the maintenance period of required reserves July 8, 2015 - August 7, 2015, the required reserves ratio was increased by 2.0 percentage points and established at the level of 22.0 percent of the base;
- for the maintenance period of required reserves August 8, 2015 - September 7, 2015, the required reserves ratio was increased by 4.0 percentage points and established at the level of 26.0 percent of the base;
- for the maintenance period of required reserves September 8, 2015 - October 7, 2015, the required reserves ratio was increased by 6.0 percentage points and established at the level of 32.0 percent of the base.

Within the meeting held on August 26, 2015 the Executive Board decided to increase the required reserves ratio from financial means attracted in MDL and non-convertible currency by 3.0 percentage points, to 35.0 percent of the base, starting with the maintenance period of the required reserves of October 8, 2015 - November 7, 2015.

The required reserves ratio from financial means attracted in freely convertible currency was maintained in the third quarter of 2015 at the level of 14.0 percent of the base.

The required reserves in MDL maintained by banks during September 8, - October 7, 2015 amounted to MDL 6975.5 million, higher than those maintained at the end of the previous quarter (June 8, - July 7, 2015) by MDL 2846.3 million, or by 68.9 percent.

The increase in required reserves in MDL was due to the significant increase of the required reserves ratio and the increase of the financial means attracted by banks with more than MDL 1 billion.

Required reserves in FCC maintained by banks with the NBM constituted USD 64.3 million and EUR 106.1 million as of September 30, 2015. Compared to June 30, 2015, the required reserves in USD decreased by 3.6 percent, while those in EUR increased by 0.3 percent.

Interbank money market

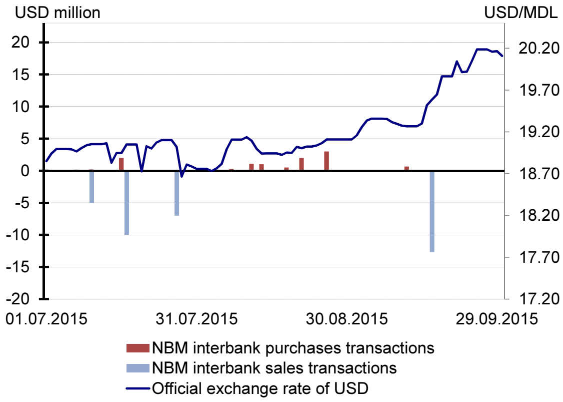
In the third quarter of 2015 only the transactions with securities on the secondary market were recorded in the interbank market, accounting for MDL 2.0 million. No transaction was recorded in the interbank credits/deposits market.

Secondary market of state securities

The quarterly turnover of the secondary market of state securities amounted to MDL 24.2 million, increasing by MDL 0.4 million compared to the previous period. Bank-client transactions were 80.0 percent of total transactions.

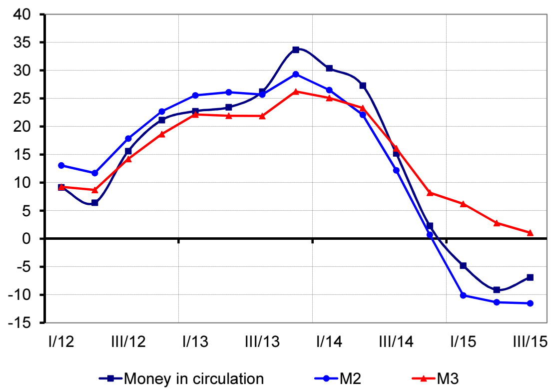
Average quarterly return for the selling-buying operations on the secondary market of state securities equalled to 20.28 percent, increasing by 3.32 percentage points compared to the previous quarter, given the decrease of the weighted average term of maturity from 163 days up to 116 days.

Chart 4.3: Evolution of the official exchange rate USD/MDL and the NBM daily transactions volume (in the QIII, 2015)



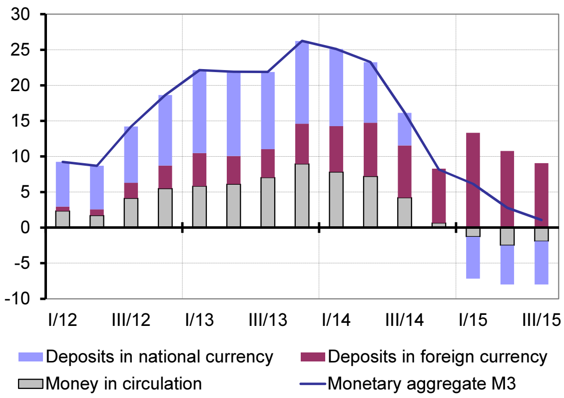
Source: NBM

Chart 4.4: Dynamics of monetary aggregates (%, annual growth)



Source: NBM

Chart 4.5: Dynamics of monetary aggregate M3 (%, components contribution to the annual growth)



Source: NBM

Intervention on the domestic foreign exchange market

NBM intervened on the domestic foreign exchange market in July-September 2015, mainly as a seller of foreign currency, in order to mitigate excessive fluctuations of the exchange rate of the national currency against the U.S. dollar.

The volume of NBM transactions carried out during the reporting quarter on the interbank foreign exchange market against MDL was USD 45.89 million[8], including purchase transactions amounting to USD 9.70 million and selling transactions amounting to USD 34.70 million, as well as currency conversions with the World Bank institutions in the amount of USD 1.49 million.

4.2 Dynamics of monetary indicators

The growth rates of monetary indicators have decreased during 2015. Thus, in the third quarter of 2015, the growth rate of monetary aggregates was negative, the values recorded being below the growth level recorded in the previous years, the quarterly average in annual terms constituted minus 11.5 percent for M2 (by 0.2 percentage points lower than growth in the second quarter of 2015) and 1.1 percent for M3 (by 1.7 percentage points lower than in the previous quarter) (Chart 4.4).

Money supply

The analysis of monetary aggregates in the medium term indicates that inflationary pressures associated with money supply do not exist at the moment. During the third quarter of 2015, broad money supply has averaged an annual increase of 1.1 percent, due to the significant increase of deposits in foreign currency, while other components of the monetary aggregate M3 deceased in annual terms. Thus, the average increase of 1.1 percent included 9.1 percentage points - the result of the increase in the balance of deposits in foreign currency, minus 1.9 percentage points - the effect of the decrease in money in circulation, and the balance of deposits in national currency decreased the growth rate of M3 by 6.1 percentage points (Chart 4.5).

At the same time, the structure of money supply M3 recorded changes as compared to the second quarter of 2015. The share of

[8]Including interventions in the form of currency purchase to Banca de Economii S.A. and BC "BANCA SOCIALĂ" S.A. in the amount of USD 9.70 million (of which USD 4.00 million are purchases on the account of required reserves).

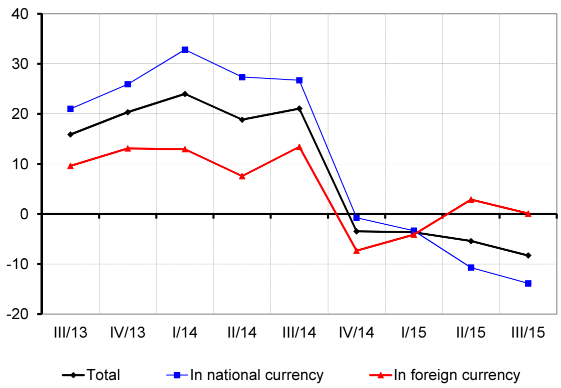
deposits in foreign currency increased by 0.1 percentage points compared to the previous quarter, accounting for 39.3 percent. The quarterly average share of deposits in national currency decreased by 1.3 percentage points and equalled to 35.4 percent. At the same time, the share of money in circulation increased by 1.3 percentage points, reaching the value of 25.4 percent as quarterly average.

The balance of deposits in national currency decreased in annual terms on average by 1.8 percentage points in the third quarter of 2015 compared to the previous quarter, the average growth rate recording negative value of minus 14.6 percent during the reporting period. Deposits in foreign currency have evolved in the opposite direction, recording an average increase of 29.6 percent annually, by 6.9 percentage points less compared to the previous quarter. The growth rate of the total balance of deposits during this period decreased on average by 3.1 percentage points compared to the second quarter of 2015, recording a quarterly average rate of 4.1 percent annually.

Lending market

In January-September 2015, the balance of credits registered a downward trend, reaching MDL 42518.8 million at the end of the quarter, decreasing by approximately 8.3 percent compared to the end of September 2014 (Chart 4.6).

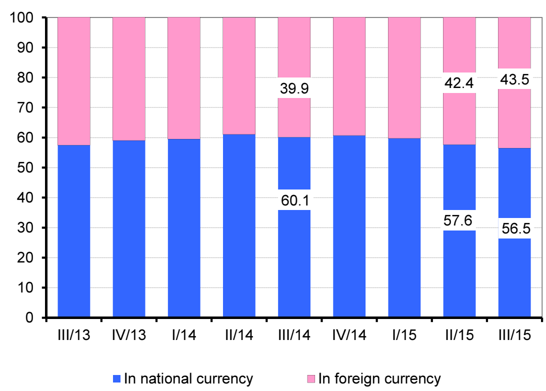
Chart 4.6: Balance of loans evolution (%, annual growth)



Source: NBM

In terms of currency structure, the negative dynamics of loans balance was mostly due to the decrease of loans balance in national currency, which held a share of 56.5 percent of the total loans portfolio (Chart 4.7). At the end of September 2015, the balance of loans in MDL granted by licensed banks from the Republic of Moldova amounted to MDL 24019.2 million, decreasing by 13.8 percent compared to the end of September 2014.

Chart 4.7: Shares of loans (%)



Source: NBM

During the third quarter of 2015, the evolution of loan balance in MDL was generated by the decrease of loan balance granted to legal entities by 19.0 percent, accounting for MDL 16840.8 million (with a share of 70.1 percent of the total loans in MDL), and by the increase of the loans granted to individuals – by 1.3 percent annually, accounting for MDL 7178.5 million (with a share of 29.9 percent of total loans in MDL).

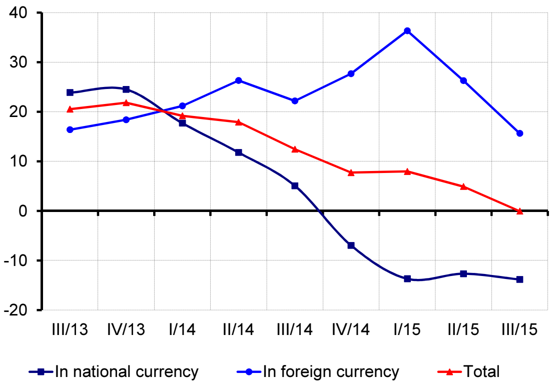
The evolution of credits in foreign currency during the third quarter of 2015 recorded an increase in annual terms of 0.1 percent compared to the end of the third quarter of 2014, standing at the end of September 2015 to the level of MDL 18499.6 million.

The trend of loans in foreign currency was driven largely by the evolution of loans granted to legal entities, which, on September 30, 2015, constituted MDL 18173.8 million, and decreased by 0.3 percent from the level recorded at the end of the third quarter of 2014. Loans in foreign currency granted to individuals showed a positive growth rate of 32.0 percent compared to September 2014, but held a reduced share of only 1.8 percent (MDL 325.7 million) in total loan portfolio in foreign currency.

In the structure of loan portfolio by sectors, the most significant changes in the third quarter of 2015 have been registered in the trade sector, which had a reduction in annual terms of 36.0 percent for loans granted in national currency and of 17.7 percent for loans granted in foreign currency. At the end of the reporting quarter, the share of loans targeted to this sector was 26.4 percent for loans in national currency and 41.2 percent for loans in foreign currency, as a result, their shares decreased, during the last twelve months, both in national currency and in foreign currency by 9.2 and 8.9 percentage points, respectively.

Deposit market

Chart 4.8: Balance of deposits evolution (%, annual growth)



Source: NBM

At the end of the third quarter of 2015, the balance of deposits recorded a negative growth rate of minus 0.1 percent annually, by 5.0 percentage points below the annual increase recorded at the end of the previous quarter. At the end of September 2015, their balance amounted to MDL 31435.5 million. The negative dynamics of balance of deposits compared to the previous quarter was due to a moderation of growth rate of the component in foreign currency by 10.6 percentage points, up to 15.6 percent annually, being supported by the national currency component, which recorded a decrease of 1.2 percentage points, up to minus 13.8 percent annually (Chart 4.8).

The trend of deposits in national currency was determined by the developments of placements attracted from the population, which held a share of 87.7 percent of the total deposits portfolio in national currency. At the end of the third quarter of 2015, the balance of deposits in national currency was MDL 12655.6 million, decreasing by 11.9 percent compared to the end of September 2014. Deposits attracted in MDL from legal entities recorded an annual negative growth of 25.5 percent, their share during the last 12 months decreased by 1.9 percentage points, reaching the level of 12.2 percent of total deposit portfolio.

The annual growth rate of deposits in foreign currency stood at 15.6 percent (decreasing by 10.6 percentage points compared to the end of the previous quarter), representing the balance of MDL

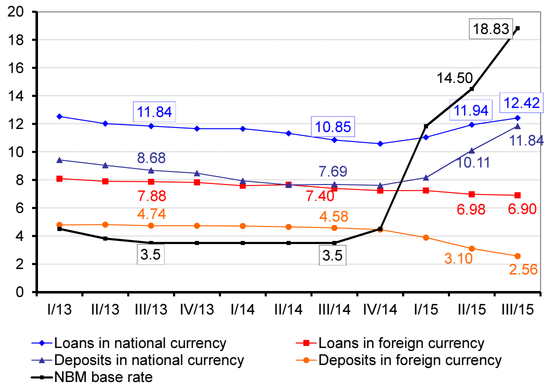
17010.2 million. At the same time, this increase occurred on the account of deposits attracted from individuals (with a share of 87.2 percent of total deposits in foreign currency), which totalled MDL 14835.1 million at the end of the third quarter of 2015 (with an annual growth rate of 15.7 percent). At the same time, deposits attracted from legal entities (12.8 percent of total deposits in foreign currency) increased by 14.7 percent compared to the end of the third quarter of 2014.

Interest rates and monetary policy transmission mechanism

Base rate

In the third quarter of 2015, there were held three meetings of the Council of Administration of the National Bank of Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks, to which the economy of the Republic of Moldova could be subjected and the inflation outlook in the short and medium term, NBM adopted two decisions by which the base rate was increased by 2.0 percentage points respectively, from the level of 15.5 percent to 19.5 percent, and subsequently it was maintained at the level of 19.5 percent. In the reporting period, it was necessary to gradually tighten the monetary policy, in order to combat inflationary pressures from regulated prices and national currency depreciation. The decisions to increase the base rate will gradually produce effects in the economy in the coming two-three quarters, being aimed at anchoring inflation expectations and maintaining the inflation close to the target of 5.0 percent over the medium-term, with a possible deviation of ± 1.5 percentage points.

Chart 4.9: Average interest rates of loans and deposits portfolios (%)



Source: NBM

Interest rate of credits

During the third quarter of 2015, the average annual interest rate on loans in national currency increased by 0.48 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.08 percentage points compared to the previous quarter. As compared to the third quarter of 2014, the rates recorded similar trends, those in national currency increased by 1.57 percentage points (12.42 percent) and those in foreign currency decreased by 0.49 percentage points (6.90 percent) (Chart 4.9).

Significant variations in interest rates on credits in national currency were registered by loans granted to legal entities, which increased by 0.46 percentage points compared to the second quarter of 2015 and during the last 12 months - by 1.76

percentage points, up to 12.24 percent. The average annual interest rate for loans in national currency granted to individuals in the third quarter of 2015 reached the level of 12.85 percent, increasing over the previous quarter by 0.52 percentage points, and compared to the third quarter of 2014 - by 0.91 percentage points.

During the third quarter of 2015, the average interest rate of loans in foreign currency decreased by 0.08 percentage points compared to the previous quarter and by 0.49 percentage points compared to the third quarter of 2014, reaching the level of 6.90 percent. The cost of credits in foreign currency granted to legal entities had a downward evolution, reaching the level of 6.89 percent in the third quarter of 2015. The average interest rate of loans in foreign currency granted to individuals was by 0.14 percentage points below the level recorded in the previous quarter, representing 7.64 percent, decreasing by 1.12 percentage points during the last 12 months.

Interest rate of deposits

In July-September 2015, interest rates for deposits had different tendencies for the resources attracted in national currency and for those in foreign currency.

The average interest rate for deposits in national currency during the third quarter was 11.84 percent, by 1.74 percentage points higher than in the previous quarter and by 4.16 percentage points higher than the rate in the third quarter of 2014 (Chart 4.9). The increase of the average interest rate of placements in MDL was mostly determined by the increase of the average interest rate on deposits in MDL attracted from individuals (by 1.85 percentage points compared to the previous quarter). At the same time, the average interest rate for deposits attracted from legal entities increased by 0.94 percentage points compared to the previous quarter, registering a value of 9.79 percent.

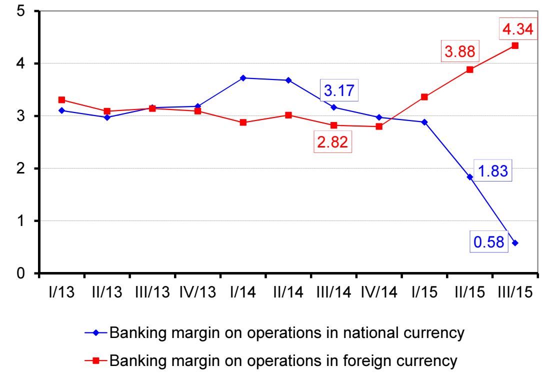
The interest rate of deposits in foreign currency amounted to an average of 2.56 percent during the reporting period, decreasing by 0.53 percentage points compared to the previous quarter and by 2.01 percentage points compared to the level recorded in the third quarter of 2014. It was influenced by the average interest rate for placements attracted from individuals, which decreased by 0.55 percentage points and reached the level of 2.56 percent in the reporting period. At the same time, the average interest rate for deposits of legal entities (2.56 percent) decreased by 0.44 percentage points during the last three months. During the last 12 months, the interest rates calculated for the deposits in foreign currency recorded further decreases both for the deposits of individuals and legal entities, by 2.06 percentage points and 1.68 percentage points, respectively.

Banking margin

The banking margin (the difference between the average interest rates on loans and credits) related to the operations in national currency recorded a downward trend in the third quarter of 2015, reaching a level of 0.58 percentage points, by 1.26 percentage points less compared to the second quarter of 2015 (Graficul 4.10). During the third quarter of 2015, the cost of deposits attracted in national currency had a considerable impact on banking margin, which changed significantly compared to the cost of loans granted.

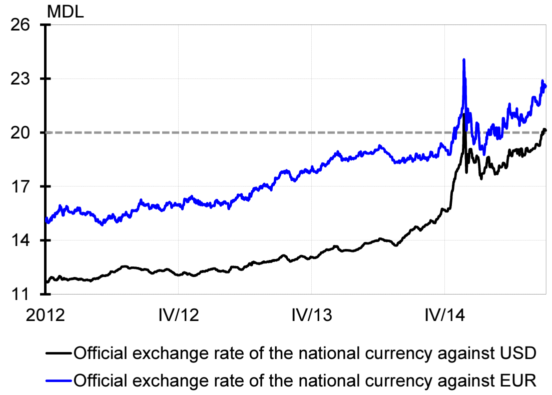
Evolution of banking margin for operations in foreign currency recorded an upward trend, constituting 4.34 percent, by 0.46 percentage points more compared to the previous quarter, mainly driven by a more pronounced reduction in the interest rate on deposits in foreign currency during the reporting period.

Chart 4.10: Banking margin evolution (p.p.)



Source: NBM

Chart 4.11: Fluctuations of the official exchange rate of MDL



Source: NBM

Nominal exchange rate and real effective rate

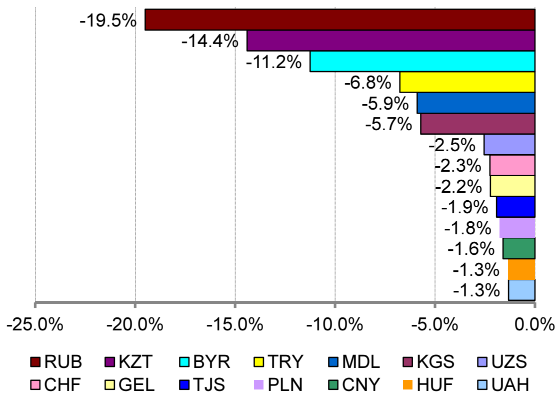
During the third quarter of 2015, the official nominal exchange rate of the national currency increased by 7.5 percent against the U.S. dollar and against the European single currency the increase was 8.6 percent compared to the end of the second quarter of 2015 (Chart 4.11).

The official average exchange rate of the national currency in the third quarter of 2015 compared with that recorded in the previous quarter shows a lower depreciation of the national currency against the U.S. dollar of 5.9 percent and against the European single currency of 6.5 percent.

At the same time, the currencies of major trading partners with notable shares in external trade of the Republic of Moldova recorded more significant depreciations against the U.S. dollar compared to that of the Moldovan leu (Chart 4.12). Thus, Russian ruble depreciated by 19.5 percent, Belarusian ruble - by 11.2 percent and Turkish lira - by 6.8 percent.

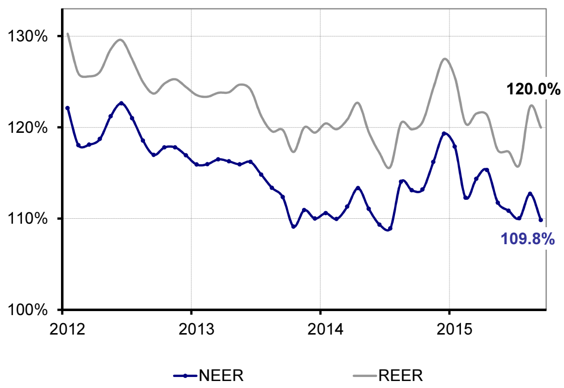
Against the background of these evolutions, the real effective exchange rate of the national currency (REER) recorded an upward trend, appreciating by 2.2 percent. Thus, Russia, Turkey and Belarus contributed by 2.99 percentage points, 0.45 percentage points and 0.38 percentage points, respectively, to the REER appreciation (Chart 4.14).

Chart 4.12: Evolution of other currencies against USD (QI, 2015=100)



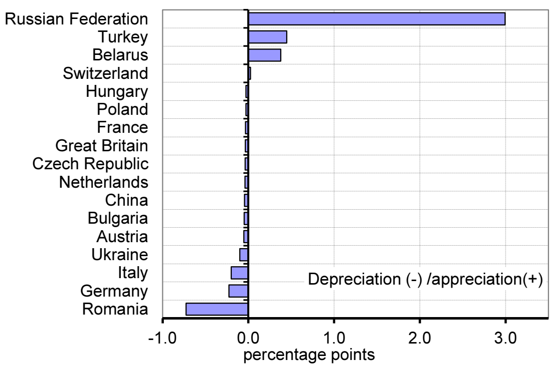
Source: NBM

Chart 4.13: Dynamics of nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated based on the main trade partners weights (Dec.2000-100%)



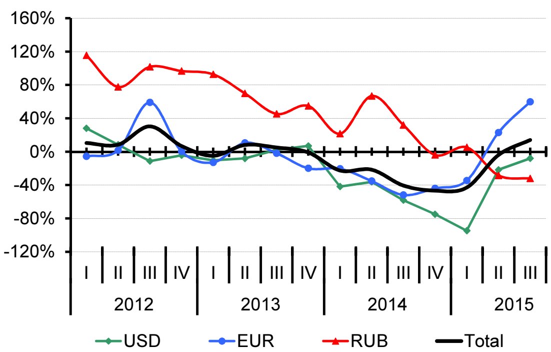
Source: NBM

Chart 4.14: Contribution of the main trade partners of the Republic of Moldova to the real effective exchange rate modification in QIII, 2015



Source: NBM

Chart 4.15: Growth rate of net supply of foreign currency from individuals, by currencies, compared to the same period of the previous year



Source: NBM

In the third quarter of 2015, the depreciation of the exchange rate of Moldovan leu was due to the low coverage of net demand of foreign currency through the net supply of foreign currency, net outflows of external loans and investments, the NBM interventions to supply the shortage of foreign currency, the fluctuations of main currencies on foreign markets.

Compared to the previous quarter, in the third quarter of 2015, both the net demand of foreign currency from legal entities and net supply of foreign currency from individuals have increased. Net foreign currency sales to legal entities amounted to USD 535.1 million, increasing by 19.6 percent amid the increased demand of foreign currency from importers of energy resources and from some mobile phone companies for the distribution of dividends in favour of their founders.

Net supply of foreign currency from individuals (USD 508.7 million) increased less - by 7.4 percent, mainly due to the higher net supply of EUR from individuals compared both to the previous quarter (by 26.5 percent) and to the third quarter of 2014 (by 59.9 percent) and to some extent, to the withdrawals of funds (USD 67.5 million), in particular in EUR, made by individuals from their deposit accounts.

The volume of supply of Russian rubles increased insignificantly compared to the second quarter of 2015 (by 6.6 percent) and decreased compared to the third quarter of 2014 (by 32.1 percent). The supply in U.S. dollars decreased compared to the previous quarter (by 17.6 percent) and compared to the same period of last year (by 8.0 percent).

Coverage rate of demand by supply was 95.1 percent, under the conditions of a modest increase in net supply of foreign currency from individuals compared to the net demand from the economic agents.

As regarding the monthly dynamics of the exchange rate of Moldovan leu against the U.S. dollar, the average exchange rate in July 2015 and that recorded at the end of the month increased by 2.9 percent and 0.3 percent, respectively, compared to the previous month. In July 2015, the depreciation of Moldovan leu occurred under the conditions of a net supply gap of foreign currency from individuals, which satisfied only 88.8 percent the needs of foreign currency of the economic agents. At the same time, the repayments of external loans and investments continued to exceed the newly contracted loans and attracted investments, generating a negative net flow of USD (-15.3) million.

In July 2015, NBM satisfied the shortage of foreign currency on the local foreign exchange market by selling USD 22.0 million.

The evolution of Moldovan leu against EUR recorded in average a lower depreciation - of 0.9 percent and at the end of the month recorded an appreciation - of 1.1 percent, as a result of the depreciation of EUR against USD and other major currencies on external markets. This depreciation occurred amid the uncertainties related to the Greece's decision - State in economic deadlock and on the brink of default, to accept the austerity measures imposed by the external creditors in order to benefit from the emergency package or to reject this programme and to leave the euro area.

In August 2015, the exchange rate of the national currency against the U.S. dollar recorded at the end of the month increased by 1.9 percent, while the average exchange rate remained relatively unchanged compared to July 2015, under the conditions of a coverage rate of the net demand of foreign currency by the net supply of foreign currency, which exceeded the unit value (110.5 percent).

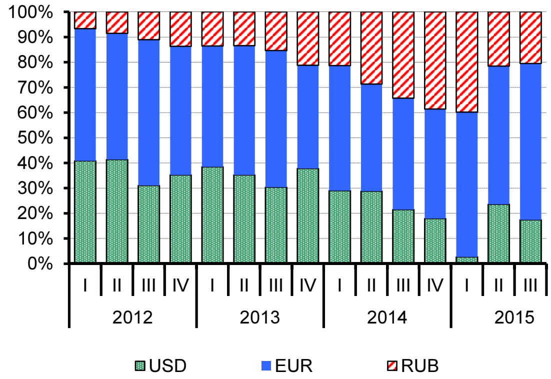
As regards the evolution of Moldovan leu, in the first 10 days of August 2015, its exchange rate against the U.S. dollar showed a trend of sharp increase, of 2.0 percent, caused by the higher demand of foreign currency from local gas supplier. In August 2015, this economic agent purchased more foreign currency (USD 38.0 million) compared to the previous months of this year.

At the same time, the net transfers in foreign currency in favour of individuals recorded in August 2015 a decrease of 47.3 percent, representing one of the largest decreases of recent years. This reduction was also generated by the depreciation of the Russian ruble on foreign markets, due to slump in oil prices in the third quarter of 2015.

As regards the exchange rate of MDL against EUR, the average exchange rate increased by 1.5 percent, while that recorded at the end of the month – by 6.8 percent. In August 2015, the European single currency has strengthened its position on foreign markets against the U.S. dollar amid the enhancing investor sentiment about the EUR potential as a currency of refuge (under the conditions of some positive expectations regarding the evolution of EU macroeconomic indicators and the Greece's decision to comply with the programme of measures imposed by external creditors to reduce the public debt at sustainable levels).

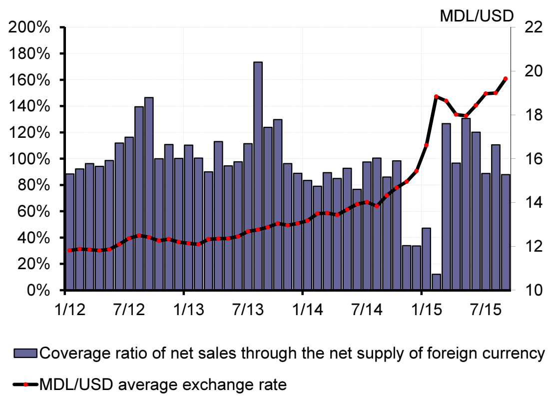
In September 2015, the exchange rate of the national currency against the U.S. dollar continued the upward trend, caused by lower coverage of net demand of foreign currency by net supply of foreign currency to 87.9 percent, due to the increased demand of foreign currency from importers of energy resources, in particular from electricity suppliers. As compared to the levels recorded

Chart 4.16: Currency structure of the net foreign currency supply (currencies are recalculated in USD at an average constant exchange rate)



Source: NBM

Chart 4.17: Coverage rate of net sales by the net supply and the dynamics of the official exchange rate of MDL

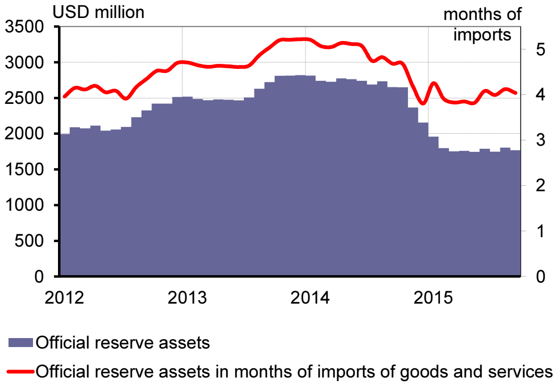


Source: NBM

in August 2015, the exchange rate of MDL recorded at the end of September and the average exchange rate depreciated by 5.2 percent and 3.4 percent, respectively. In September 2015, NBM intervened on the foreign exchange market by selling USD 12.7 million.

At the same time, the national currency recorded a more significant depreciation against the European single currency - of 4.2 percent, according to the average exchange rate recorded in September 2015. This evolution was mainly generated by the dynamics on foreign markets of the European single currency against U.S. dollar, recorded in the second half of the month. Thus, EUR recorded an appreciation basing on the decision of the Federal Open Market Committee (FOMC) to maintain the monetary policy rate at the same level in the conditions in which, according to FOMC, the global economic and financial evolutions become more concerning, taking into consideration the slowdown of the economic growth in emerging markets, especially that of China.

Chart 4.18: Evolution of official reserve assets expressed in months of import of goods and services



Source: NBM

Official reserve assets

At the end of the third quarter of 2015, the official reserve assets decreased compared to the end of the previous quarter by USD 18.9 million (1.1 percent), to USD 1769.4 million (Chart 4.18). The reduction of official reserve assets occurred as a result of the depreciation against the U.S. dollar of the currencies components of foreign exchange reserves, the payments related to external debt service of the Republic of Moldova, as well as a result of the net sale interventions made by the NBM to mitigate the excessive fluctuations in exchange rates.

Chapter 5

Medium-term inflation forecasting

5.1 External assumptions of the forecast

The analysis of the external environment, but also the forecasts of international organizations determine the new round of forecasting to take into account the following assumptions (Table 5.1).

The economy of euro area is relatively stable and the sovereign debt crisis has been gradually overcome. At present, the issues related to Greece and deflationary pressures remain the most significant concerns for the economic growth sustainability in the euro area. The expected effects of the quantitative easing programme of the European Central Bank, which suppose the purchase of assets in the amount of EUR 1.2 trillion, are visible through the prices increase for all groups of goods excluding the prices of energy resources, given the reduction in global oil prices. Thus, according to the current round of forecasting, the average annual projections for harmonized prices increase in the euro area decreased from 0.2 to 0.1 percent for 2015 and from 1.3 to 1.1 percent for 2016. The forecast for GDP growth in the euro area maintained the level of 1.5 percent for 2015 and decreased from 1.8 to 1.7 percent for 2016, due to the intensification of external risks (Chart 5.1).

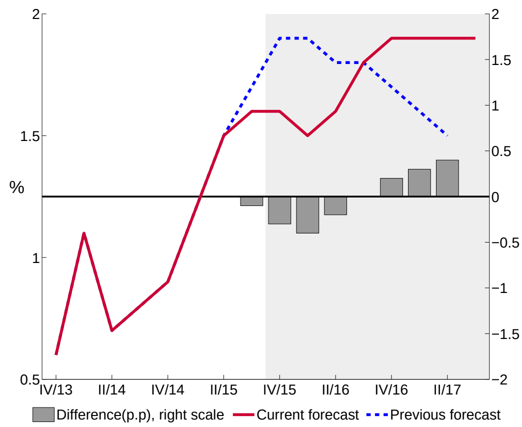
The decrease in global oil prices and the deterioration of the statistics regarding the real sector of the Russian economy in the last months determined most of relevant organisations to revise downwardly the forecasts for economic growth in the Russian Federation in the coming quarters. Based on forecasts of international organizations and Russian economic authorities, the current round of forecasting anticipates a contraction of the gross domestic product in the Russian Federation in 2015 by 3.8 percent from 3.5 percent forecast in the previous round and will stagnate in 2016 from the 0.5 percent increase anticipated in the previous round of forecasting (Chart 5.2). At the same time, the

Table 5.1: Expected evolution of external variables

	annual average values 2015	2016
Economic growth in the euro area, %	1.5	1.7
Economic growth in the Russian Federation, %	-3.8	0.0
Inflation in the euro area, %	0.1	1.1
Inflation in the Russian Federation, %	15.5	7.6
USD/EUR	1.11	1.08
RUB/USD	60.8	67.7
Urals brand oil prices (USD/barrel)	53.2	53.2
International food prices, %	-18.2	2.2

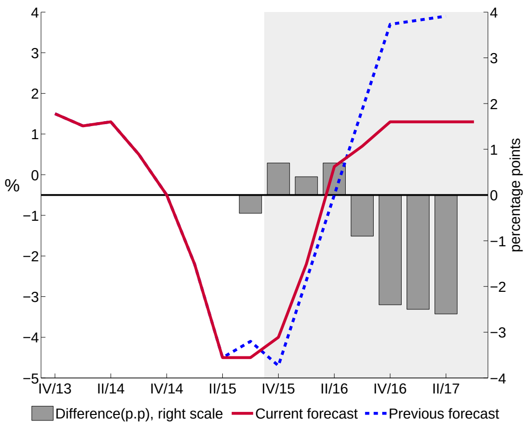
Source: NBM assumptions based on data of Consensus Economics and futures quotes

Chart 5.1: Annual growth rate of GDP in the euro area



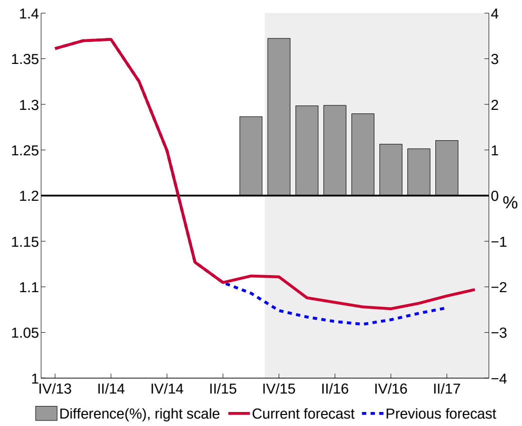
Source: Eurostat, Consensus Forecasts, NBM calculus

Chart 5.2: Annual growth rate of GDP in the Russian Federation



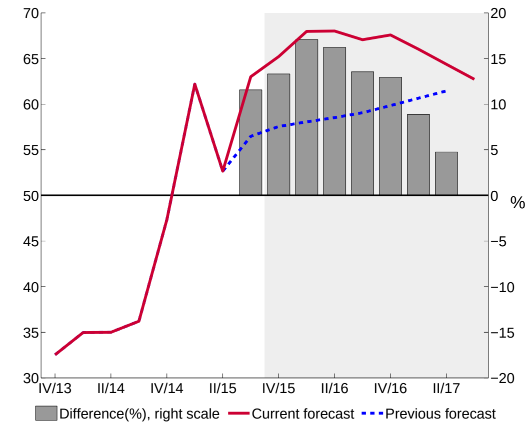
Source: Federal Service for State Statistics, Consensus Forecasts, NBM calculus

Chart 5.3: Exchange rate of USD/EUR



Source: ECB, Consensus Forecasts, NBM calculus

Chart 5.4: Exchange rate of RUB/USD



Source: Central Bank of the Russian Federation, Consensus Forecasts, NBM calculus

acceleration in the pace of consumer prices growth in recent months amid the depreciation of the Russian ruble, determined the average annual inflation in the Russian Federation to increase, according to the current round of forecasting, anticipating an annual average inflation rate in 2015 of about 15.5 percent and in 2016 of 7.6 percent.

The evolution of the USD/EUR parity in the third quarter of 2015, namely a more appreciated EUR than anticipated, determines the evolution of this parity to be increased from 1.10 to 1.11 for 2015 and from 1.06 to 1.08 for 2016 in the current round of forecasting (Chart 5.3). The projection is based on the presumption of FRS reluctance to increase the interest rates in the near future, but when it will happen, the USD/EUR parity will decrease at least for short periods of time. However, the projections on the USD/EUR 1:1 parity appear implausible since the beginning of this year. With the end of the ECB's program at the end of 2016, the EUR is expected to appreciate gradually.

The decrease in oil prices in the third quarter of 2015 determined the Russian ruble to depreciate on average by 19.7 percent compared to the previous quarter. Thus, the current round of forecasting anticipates a more depreciated level of the Russian ruble compared to the previous round of forecasting. In 2015, the average Russian rouble will trade at 60.8 against the U.S. dollar versus 57.5 forecast projected in the previous round. For 2016, it is anticipated that RUB/USD will be traded on average at 67.7 versus 61.7 (Chart 5.4).

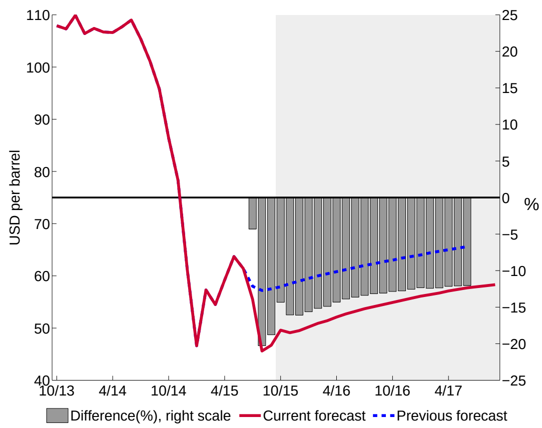
The oversupply of oil worldwide pressed the oil prices, which decreased significantly during the third quarter of 2015. Although, under the influence of some factors, the oil price recorded periodically an upward trend, which proved to be unsustainable. Therefore, most of relevant organisations revised downwardly the forecast for oil price. Thus, this round of forecasting anticipates that in 2015 the average oil price will account for USD 53.2 per barrel. In 2016, it is expected the gradual recovery of oil prices, which will register on average the same value of the current year, of USD 53.2 per barrel (Chart 5.5).

The agricultural harvest in the region in this year was below the level of recent years due to dry weather conditions. At the same time, dry weather conditions are also recorded in autumn of 2015 not only in the region, but in the entire North hemisphere. Thus, following the decrease in this year in international food prices of about 18.2 percent, it is anticipated that in 2016 the international food prices will increase on average by 2.2 percent (Chart 5.6).

5.2 Assumptions on regulated prices

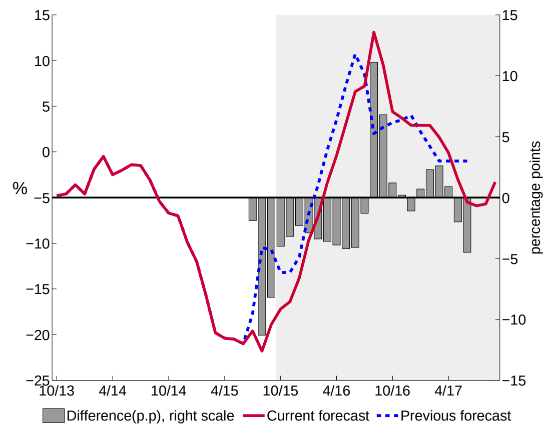
The Council of Administration of NERA[9] examined at the public meeting of July 2015 the suppliers' request to increase the tariffs for electricity and natural gas supplied to consumers. Following that meeting, the electricity tariff was increased on average by 35.0 percent and the tariffs for natural gas by 15.0 percent for households. Suppliers have presented several reasons to justify the increases. However, the main reason lies in the national currency depreciation against the U.S. dollar. However, given the society protests, as well as the invocation of a reduced transparency of tariffs formation, NERA decided, at the beginning of September 2015, to suspend the new tariffs for a period of two months in order to carry out the audit of these enterprises. The suspension of the increase in tariffs for electricity and gas approved in July 2015 will generate additional pressures for suppliers. At the same time, the approved tariffs are significantly lower than that requested by the suppliers and given that the risk of a further depreciation of the national currency still persists, there are anticipated further increases for these services in coming years. The increase in tariffs for electricity and natural gas, associated with national currency depreciation up to now, will determine the tariff adjustment related to other utilities, such as centralised heating, water supply, urban and interurban transport. The tariffs increases already made and some assumptions about possible increases in tariffs were included in the medium-term inflation projection. At the same time, given that those decisions are grounded not only in economic terms but also in terms of social impact, the time of adopting new tariffs and their value are characterized by a significant degree of uncertainty, which will be a pronounced risk that could cause a deviation for medium-term inflation forecast.

Chart 5.5: Urals brand oil prices



Source: NBM calculus

Chart 5.6: The annual growth rate of world food price index



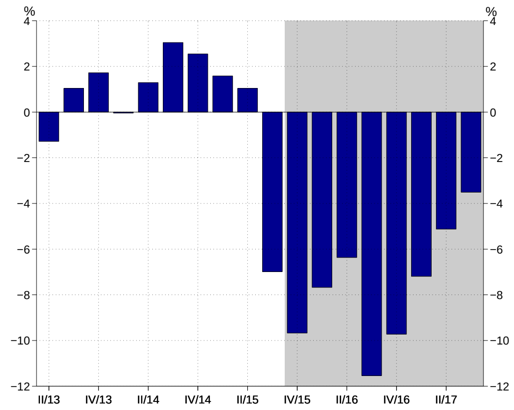
Source: FAO, NBM calculus

[9] The National Energy Regulatory Agency

5.3 Medium-term inflation forecasting

Aggregate demand

Chart 5.7: GDP deviation forecast (%)



Source: NBS, NBM calculus

The current round of forecasts predicts a further negative dynamics of output gap for the entire forecast period. This will be negative, significantly below its potential level. An economic activity below its potential level will cause, on medium-term, increased disinflationary pressures from domestic demand.

According to the data published by the National Bureau of Statistics, the economic activity recorded in the second quarter of 2015 an increase of 2.5 percent and output gap being revised upwardly compared to the previous report forecast. The output gap will remain significantly negative, due to the drought of this year and the *decrease in volume of agricultural production.*

The contribution of the *external demand* from both the euro area and the Russian Federation determined the output gap to be negative. External demand from both the euro area and the Russian Federation, compared with the previous report forecast will continue to record negative values on the entire forecasting period and therefore will maintain its restrictive impact on the domestic economic activity. The negative level of aggregate demand will be also generated by the *decrease of consumption financing sources*. A negative contribution is caused by *lower remittances* as a result of insignificant economic activity growth in major source countries.

The output gap decrease will be mitigated by the influence of incentive monetary policy for the entire forecasting period. The incentive impact of real monetary conditions will be determined primarily by the real effective exchange rate. In the first three quarters of forecast, real interest rate will contribute to the decrease of aggregate demand, which will have a slightly incentive character till the end of the forecasting horizon.

Inflation

According to the current projection, the annual growth rate projection of CPI will record a level of 9.7 percent in 2015 and 11.9 percent in 2016. According to the projection, the annual inflation rate will return to the inflation target range in the third quarter of 2017. The maximum value will be recorded in the fourth quarter of 2015 and the first quarter of 2016, representing 13.4 percent.

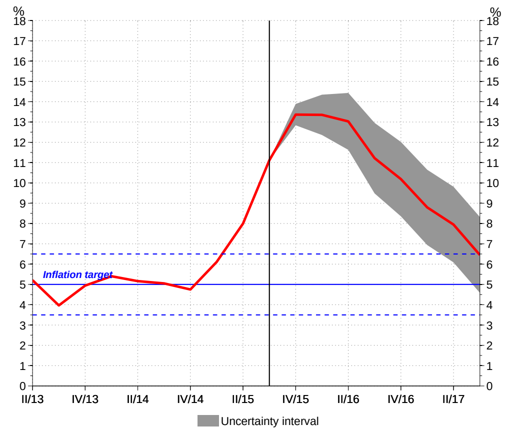
The contribution from *core inflation* to annual inflation rate will record a reconfiguration. It will increase till the fourth quarter of 2015 and will further record a downward trend till the end of the forecasting horizon. As compared to the previous report, the increase of core inflation contribution in the fourth quarter of 2015 is mainly caused by higher dynamics of imported inflation. Thus, according to the current round of forecasting, the average annual rate of *core inflation* will reach the level of 11.9 percent in 2015 and of 9.9 percent in 2016. Compared to the values registered in the previous report, the average annual values of core inflation are higher by 1.2 percentage points for 2015 and by 2.1 percentage points for 2016. An insignificant higher evolution will be also recorded in the first two quarters of 2017.

Food prices will accelerate till the third quarter of 2016 and then it will register an accentuated downward trend till the end of the forecasting horizon. As compared to the previous report, food prices inflation will reach a higher level during this year and 2016, mainly due to the drought recorded this year, which will determine the major decrease in production volume of agricultural sector.

The evolution of *regulated prices* will be lower during 2015 and 2016 compared to the projection published in the Inflation Report no. 3, 2015, maintaining at the same time their increased contribution to CPI. During the first three quarters of 2017, regulated prices will record a more significant contribution.

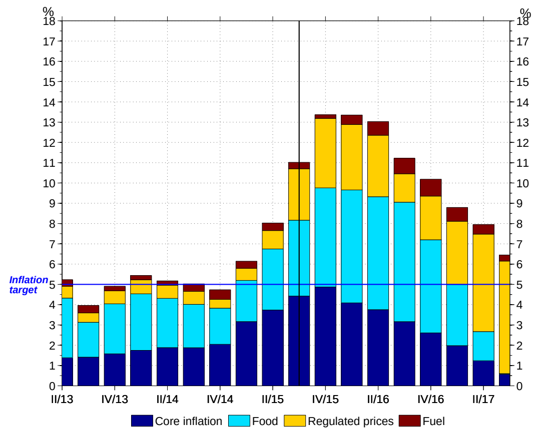
Fuels contribution to the annual inflation rate will increase slightly till the fourth quarter of 2016, after which it will record a significant decrease. The higher insignificant fuel evolution is due to the higher effective data recorded in the third quarter of 2015. This difference decreased gradually as a result of the lower evolution of oil and imported gas prices.

Chart 5.8: The CPI annual rate forecast (%, annual)



Source: NBS, NBM calculus

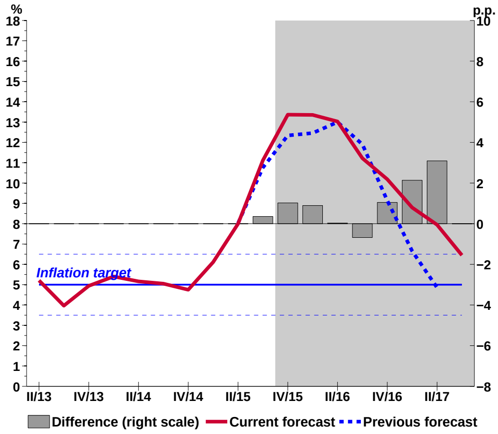
Chart 5.9: CPI decomposition (p.p.)



Source: NBS, NBM calculus

Comparison of current and previous forecasts

Chart 5.10: The annual CPI rate (%, annual)



Source: NBS, NBM calculus

According to the current round of forecasting, the projected trajectory of the annual inflation rate was insignificantly revised upwardly for the entire forecasting horizon. Compared to the values registered in the Inflation Report no.3, 2015, the average annual values projected for 2015 are higher by 0.4 percentage points and those projected for 2016 by 0.3 percentage points, the same trend will be recorded in the first two quarters of 2017.

Slightly high dynamics of *core inflation, food* and *fuels* prices for the entire forecast period determines a higher than expected evolution of the inflation forecast compared with the previous forecast.

The upward evolutions of *core inflation* and *food prices* are mainly determined by the negative situation from agricultural sector, due to the drought of this year, being also conditioned by a slight depreciation of the national currency in the third quarter of 2015. A higher contribution to the annual inflation rate will be recorded by both the core inflation and food prices.

The evolution of *regulated prices* will be lower in 2015 and in 2016 and higher in the first quarters of 2017 compared to the evolution recorded in the scenario published in the Inflation Report no. 3, 2015.

Risks and uncertainties

According to the recent external, macroeconomic, financial, fiscal and social evolutions, the risks and uncertainties adjustment represents a challenge, a difficult task. The external environment presents, on the one hand, disinflationary risks, while on the other hand, the internal environment risks are pronounced pro-inflationary. Counterbalancing these factors will determine the further evolution of the national economy. The difficulty is that the dispersion of the factors influence direction reduces fewer effects with positive character for the national economy. Therefore, it is required a more careful risks and uncertainties monitoring and the determination, in the light of the further evolution, of the most appropriate scenarios for the national economy.

External sector

The distribution of external growth risks remained negative. The structural slowdown in emerging economies and, mainly, the transition of China's economy, force to rebalance the financial markets. The decrease in international prices of raw materials disadvantages the export-dependent economies and determines the adjustment of the currencies' parity against the U.S. dollar. Disinflationary risks in the advanced economies generated the initiation of the most drastic QE programmes, which also have repercussions on foreign exchange markets. In the region, the deferment of structural reforms relating to the consequences of Ukrainian geopolitic conflict caused a crisis of proportions.

The risks and uncertainties with the most significant impact for the national economy in the coming eight quarters, which complete the forecasting round related to the Inflation Report no.4 of 2015, will be described below:

- **The unpredictability of the USD/EUR parity evolution.** The USD/EUR evolution has shaken during 2015 the global economic environment. The momentum generated in March 2015 by the start by the ECB of the QE programme has determined the USD/EUR decrease to 1.04 and subsequently, USD/EUR recorded a slightly upward trend, contrary to the most forecasts of a further depreciation of the European single currency. Another factor, taken into consideration by the experts in forecasting, was the anticipation of the interest rates increase by the FRS in autumn 2015, which might generate the appreciation of the U.S. dollar. However, the FRS continued the monetary policy status quo, accentuating the external risks for the U.S. economy. Thus, the USD/EUR parity shows a significant increase in the last weeks. It is sure that the QE programme of the ECB will continue till September 2016. It becomes more uncertain when the FRS will increase the interest rates and the reaction of the USD/EUR parity thereof constitutes a short-term risk.

- **Regional crisis.** The military conflict in eastern Ukraine creates impediments for the economic growth in the region. However, the region becomes less attractive in terms of investments, discouraging the capital inflows. At the same time, the tense situation in eastern Ukraine has a direct effect on the coal prices increases and, as a result, on the inflation in the Republic of Moldova. Statistical data for the last quarters show a profound economic crisis in Ukraine, recession in the Russian Federation and a significant slowdown of economic activity in Romania. This is already reflected in the decrease of external trade with the major trading partners and the reduction of remittances.

According to the international forecasts, a recovery in the regional economic situation will be recorded, most likely, beginning with the second quarter of 2016.

- **Reduction of oil prices.** Oil prices decreased significantly in the last weeks and the competent organisations have not delayed to revise their forecasts. It is certain that the oil prices will decrease in the coming quarters, but the period and extent remain unknown. Beyond the fact that oil surplus was maintained more than one year, the recent negative fluctuations of the China's stock exchange show negative signals relating to the trajectory of the world economy, which will determine the decrease in global demand. At the same time, the appreciation of U.S. dollar favours lower prices for raw materials. There is also the premise that oil supply from Iran will fully recover till the end of the year, which will further increase the oil supply.

  At the same time, the significant decrease in oil prices over the last year has challenged the Russian economy. According to many forecasts, this trend is expected to continue. The depreciation of the Russian ruble associated with lower oil prices will generate additional pressures for the depreciation of the national currency, although this phenomenon, at first view, will create conditions to decrease the fuels on domestic market, on medium and long term. However, the Russia's military involvement in Syria and a possible worsening of the situation in Middle East could change the oil prices trends on the international market.

- **Destabilisation of regional foreign exchange market.** Although the foreign exchange market in the region has slightly stabilised in recent weeks, with few exceptions, it is too early to assess this as an improvement in the economic and financial situation of the region. Forecasts for economic growth are negative, certain sectors of the economies are in critical condition. However, in recent weeks, monetary policies were aimed at stabilization of financial systems and the mitigation of the general price level growth at the expense of economic stimulation.

- **Reduction to a lesser extent or even increase of food prices in the region versus worldwide level.** Most forecasts of food prices developments worldwide indicate their decrease in 2015 and in 2016, due to high cereals harvest in 2014, and surpluses of dairy products due to reduced imports of milk by two large and important markets - China and the Russian Federation. However, prospects for the 2015 harvest in the northern hemisphere are poor, especially in the region where autumn was dry. At the same time, in the region, the prices, including food prices, will increase amid the depreciation of national currencies.

Real sector

- **Modest harvest in 2015 and uncertainties regarding the harvest in 2016.** In 2015, the harvest for some agricultural crops is much lower than that of the previous year, which will exert an additional pressure on food prices. At the same time, the drought of September 2015 was partially mitigated by the rains of October 2015. However, given the higher vulnerability of the agricultural production against the meteorological conditions, the uncertainty about the 2016 harvest continues to persist. In addition to direct effect on food prices, the decrease in exports of these products will contribute to the contraction of foreign currency inflows and to additional pressures on the national currency.

- **Higher than expected depreciation of the national currency.** The decrease of the foreign currency supply on the market, due to the contraction of exports, remittances, as well as the blocking of some transfers from international institutions, associated with the increased demand of foreign currency from the economic agents and individuals, due to an increased uncertainty on the market, could contribute to a more pronounced depreciation of the Moldovan leu against the U.S. dollar. Consequently, there will be adjusted the prices of related goods and services traded on the market of the Republic of Moldova.

- **More pronounced adjustment in tariffs for regulated services.** The suspension of the increase in tariffs for electricity and gas approved in July 2015 will generate additional pressures for suppliers. These, associated with a pronounced depreciation of the national currency, will determine significant price adjustments for regulated services.

- **The escalation of internal political and social tensions.** The recent events on political scene of the country triggered by the protests in the capital generate tensions and divergences within the governing coalition. These phenomena delay the signing of the agreement with the IMF, as well as the financial assistance from other development partners, which influence the exchange rate evolution and feed the inflationary pressures.

- **The European migrants' crisis.** Mass exodus of migrants from the conflict-affected countries during 2015 will considerably strain the labour market in the European Union, where hundreds of thousands of Moldovan migrants work. This could generate in 2016 a lower foreign currency inflow in the form of remittances and additional pressures on the national currency.

Public and monetary sector

- **Given the liquidation of the Banca de Economii S.A., B.C. ”BANCA SOCIALĂ” S.A. and B.C. „UNIBANK” S.A.,** there is a risk that the amount of emergency loans granted to these three banks, according the Government Decision, to be transferred to the internal state debt account, which will increase by about 3.0 times and will reach the value of MDL 21.4 billion, and the share of total state debt to GDP will increase to 39.5 percent (actually 27.6 percent). Consequently, enormous pressures will arise on the state debt services, which will aggravate the situation of the National public budget for the coming years.

- **Fiscal policy in 2015 and 2016.** The increases in exercise duties, as well as the sub-evaluation of their impact for some categories of goods in inflation forecast, constitute a risk for the medium-term inflation projection.

Chapter 6

Monetary policy decisions

Minutes of the monetary policy meeting of the Council of Administration of the National Bank of Moldova of 17.02.2015

The meeting was chaired by Mr. Dorin Drăguţanu, Governor - Chairman of the Council of Administration of the National Bank of Moldova.

There were present: members of the Council of Administration – Mr. Marin Moloşag, First Deputy Governor - Deputy Chairman of the Council of Administration, Mrs. Emma Tăbîrţă, Deputy Governor, Mr. Aureliu Cincilei - Deputy Governor, Mr. Ion Sturzu - Deputy Governor.

Reporter: Mr. Radu Cuhal, Director of Monetary Policy and Research Department.

Invitees: Mrs. Natalia Sîrbu, Director of Legal Department.

Mr. Radu Cuhal presented the current macroeconomic situation, including the evolution of monetary, foreign exchange, credit and deposit markets, the changes in external macroeconomic environment, analysis of current inflation and the influential factors on inflationary process. The members of the Council of Administration have assessed the impact of monetary policy measures previously implemented. Assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to comply with the inflation target.

The members of the Council of Administration assessed the defining aspects to inflation in the medium-term, with an emphasis on inflationary risk. The higher likelihood of a recession in the economies of the euro area countries and the Russian Federation - the main trading partners of the Republic of Moldova, induced risks of lower income in foreign currency of the population and domestic exporters in short-term through external trade channel and remittances of the population, which could further impact the dynamics of the national currency exchange rate and subsequently inflation development. The escalation of geopolitical tension in the region could cause additional inflationary pressures. Consequently, the accentuation of the depreciation trend of the national currency since the beginning of this year shows the imminence of some inflationary pressures pronounced in the future periods, which will firstly determine, through the prices of imported goods and tariffs of utilities services and later by increasing the inflation expectations, the CPI to leave temporarily the upper limit of the variation range of ± 1.5 percentage points from the inflation target of 5.0 percent.

In order to combat the inflationary pressures from regulated prices and the depreciation of the national currency, as well as to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Council of Administration decided to increase the main indicator for monetary policy - the base rate by 5.0 percentage points from 8.5 to 13.5 percent annually. NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.

As a result, the Council of Administration of the National Bank of Moldova adopted the following decision:

1. to increase the base rate applied on main short-term monetary policy operations by 5.0 percentage points from 8.5 to 13.5 percent annually;

2. to increase the interest rates:

• on overnight loans by 5.0 percentage points from 11.5 to 16.5 percent annually;

• on overnight deposits by 5.0 percentage points from 5.5 to 10.5 percent annually;

3. the rates mentioned in items 1 and 2 shall entry into force on February 18, 2015.

Voting results

FOR – 5 AGAINST – 0 ABSTAIN – 0

Chairman of the Council of Administration
Dorin DRĂGUȚANU

Secretary of the Council of Administration
Sergiu SURDU

Minutes of the monetary policy meeting of the Council of Administration of the National Bank of Moldova of 26.02.2015

The meeting was chaired by Mr. Dorin Drăguţanu, Governor - Chairman of the Council of Administration of the National Bank of Moldova.

There were present: members of the Council of Administration - Mr. Marin Moloşag, First Deputy Governor - Deputy Chairman of the Council of Administration, Mrs. Emma Tăbîrţă, Deputy Governor, Mr. Aureliu Cincilei - Deputy Governor, Mr. Ion Sturzu - Deputy Governor.

Reporter: Mr. Octavian Teaca, Head of Macroeconomic Analysis and Forecasts Division, Monetary Policy and Research Department.

Invitees: Mr. Andrei Rotaru, Advisor to the Governor, Mrs. Lucia Hadârcă, Director of Foreign Exchange Operations and External Relations Department, Mrs. Silvia Lizanciuc, Head of Monetary Instruments and Forecasts Division, Market Operations Department, Mr. Vladimir Ţurcanu, Director of Banking Regulation and Supervision Department, Mr. Andrei Velicev, Head of Legal Advice and Litigation Division.

Mr. Octavian Teaca presented the current macroeconomic situation, including the evolution of monetary, foreign exchange, credit and deposit markets, the changes in external macroeconomic environment, analysis of current inflation and the influential factors on inflationary process. The members of the Council of Administration have assessed the impact of monetary policy measures previously implemented. Assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to comply with the inflation target.

The Council of Administration assessed the defining aspects to inflation in the medium-term, with an emphasis on inflationary risk. The higher likelihood of a recession in the economies of the euro area countries and the Russian Federation - the main trading partners of the Republic of Moldova, induced risks of lower income in foreign currency of the population and domestic exporters in short-term through external trade channel and remittances of the population, which could further impact the dynamics of the national currency exchange rate and subsequently inflation development. The escalation of geopolitical tension in the region could cause additional inflationary pressures. Consequently, the accentuation of the depreciation trend of the national currency since the beginning of this year shows the imminence of some inflationary pressures pronounced in the future periods, which will firstly determine, through the prices of imported goods and tariffs of utilities services and later by increasing the inflation expectations, the CPI to leave temporarily the upper limit of the variation range of ± 1.5 percentage points from the inflation target of 5.0 percent.

In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Council of Administration decided to maintain the main indicator for monetary policy - the base rate at the level of 13.5 percent annually. NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, domestic banking system, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.

As a result, the Council of Administration of the National Bank of Moldova adopted the following decision:

1. to maintain the base rate applied on main short-term monetary policy operations at the current level of 13.5 percent annually;

2. to maintain the interest rates:

• on overnight loans at the current level of 16.5 percent annually;

• on overnight deposits at the current level of 10.5 percent annually.

Voting results

FOR – 5 AGAINST – 0 ABSTAIN – 0

Chairman of the Council of Administration	**Secretary of the Council of Administration**
Dorin DRĂGUȚANU	**Sergiu SURDU**

Minutes of the monetary policy meeting of the Council of Administration of the National Bank of Moldova of 26.03.2015

The meeting was chaired by Mr. Dorin Drăguţanu, Governor - Chairman of the Council of Administration of the National Bank of Moldova.
There were present: members of the Council of Administration - Mr. Marin Moloşag, First Deputy Governor - Deputy Chairman of the Council of Administration, Mr. Aureliu Cincilei - Deputy Governor, Mr. Ion Sturzu - Deputy Governor.
Reporter: Mr. Radu Cuhal, Director of Monetary Policy and Research Department
Invitees: Mr. Andrei Rotaru, Advisor to the Governor, Mrs. Lucia Hadârcă, Director of Foreign Exchange Operations and External Relations Department, Mrs. Silvia Lizanciuc, Head of Monetary Instruments and Forecasts Division, Market Operations Department, Mr. Vladimir Ţurcanu, Director of Banking Regulation and Supervision Department, Mr. Andrei Velicev, Head of Legal Advice and Litigation Division.
Mr. Radu Cuhal presented the current macroeconomic situation, including the evolution of monetary, foreign exchange, credit and deposit markets, the changes in external macroeconomic environment, analysis of current inflation and the influential factors on inflationary process. The members of the Council of Administration have assessed the impact of monetary policy measures previously implemented. Assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to comply with the inflation target.
The Council of Administration assessed the defining aspects to inflation in the medium-term, with an emphasis on inflationary risk. Weak economic activity in the euro area countries and the recession in the Russian Federation - the main trading partners of the Republic of Moldova, induced risks of lower income in foreign currency of the population and domestic exporters in short-term through external trade channel and remittances of the population, which could further impact the dynamics of the national currency exchange rate and subsequently inflation development. The escalation of geopolitical tension in the region could cause additional inflationary pressures. The depreciation of the national currency since the beginning of this year will accentuate the inflationary pressures, which will firstly determine, through the prices of imported goods and tariffs of regulated services and later through second-round effects, the CPI to leave temporarily the upper limit of the variation range of ± 1.5 percentage points from the inflation target of 5.0 percent.
In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Council of Administration decided to maintain the main indicator for monetary policy - the base rate at the level of 13.5 percent annually. At the same time, the NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, domestic banking system, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.
As a result, the Council of Administration of the National Bank of Moldova adopted the following decision:
1. to maintain the base rate applied on main short-term monetary policy operations at the current level of 13.5 percent annually;
2. to maintain the interest rates:
• on overnight loans at the current level of 16.5 percent annually;
• on overnight deposits at the current level of 10.5 percent annually.

Voting results

FOR – 4 AGAINST – 0 ABSTAIN – 0

Chairman of the Council of Administration **Secretary of the Council of Administration**

Dorin DRĂGUȚANU **Sergiu SURDU**

Minutes of the monetary policy meeting of the Council of Administration of the National Bank of Moldova of 30.04.2015

The meeting was chaired by Mr. Dorin Drăguţanu, Governor - Chairman of the Council of Administration of the National Bank of Moldova.
There were present: members of the Council of Administration - Mr. Marin Moloşag, First Deputy Governor - Deputy Chairman of the Council of Administration, Mr. Ion Sturzu, Deputy Governor.
Reporter: Mr. Radu Cuhal, Director of Monetary Policy and Research Department.
Invitees: Mr. Andrei Rotaru, Advisor to the Governor, Mrs. Lucia Hadârcă, Director of Foreign Exchange Operations and External Relations Department, Mrs. Silvia Lizanciuc, Head of Monetary Instruments and Forecasts Division, Market Operations Department, Mr. Matei Dohotaru, Deputy Director of Banking Regulation and Supervision Department, Mrs. Natalia Sîrbu, Director of Legal Department.
Mr. Radu Cuhal presented the current macroeconomic situation, including the evolution of monetary, foreign exchange, credit and deposit markets, the changes in external macroeconomic environment, analysis of current inflation and the influential factors on inflationary process. The members of the Council of Administration have assessed the impact of monetary policy measures previously implemented. Assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to comply with the inflation target.
The Council of Administration assessed the defining aspects of inflation in the medium-term, with an emphasis on inflationary risk. Weak economic activity in the euro area countries and the recession of the Russian Federation - the main trading partners of the Republic of Moldova induced the risk of lowering of foreign currency income of households and domestic exporters in short-term, through foreign trade and remittances channel. This may influence the dynamics of the national currency exchange rate against foreign currencies and subsequently inflation development. The escalation of geopolitical tension in the region could cause additional inflationary pressures. The depreciation of the national currency since the beginning of this year has increased the inflationary pressures, which subsequently determine in the future periods, through the prices of imported goods and tariffs of regulated services and later by second-round effects, the CPI to leave temporarily the upper limit of the variation range of ± 1.5 percentage points from the inflation target of 5.0 percent.
In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Council of Administration decided to maintain the main indicator for monetary policy - the base rate at the level of 13.5 percent annually. In order to sterilize excess liquidity accumulated in recent months and improve the transmission mechanism of monetary policy decisions, the Council of Administration took the decision to increase the required reserves ratio attracted in MDL and non-convertible currency for the maintenance period of required reserves in MDL June 8, 2015 - July 7, 2015 - by 2.0 percentage points up to the value of 20.0 percent of the base. At the same time, the required reserves ratio from financial means attracted in freely convertible currency was maintained at the current level 14.0 percent of the base. NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, so that by the flexibility of operational framework specific for the inflation targeting strategy to ensure price stability in the medium term.
As a result, the Council of Administration of the National Bank of Moldova adopted the following decision:
1. to maintain the base rate applied on main short-term monetary policy operations at the current level of 13.5 percent annually;
2. to maintain the interest rates:
• on overnight loans at the current level of 16.5 percent annually;
• on overnight deposits at the current level of 10.5 percent annually;
3. to increase the required reserves ratio from financial means attracted in MDL and non-convertible currency by 2.0 percentage points, reaching the level of 20.0 percent of the base as from beginning of the maintenance period of required reserves in MDL June 8, 2015 - July 7, 2015;
4. to maintain the required reserves ratio from financial means attracted in freely convertible currency at the current level 14.0 percent of the base.

Voting results

FOR – 3 AGAINST – 0 ABSTAIN – 0

Chairman of the Council of Administration	Secretary of the Council of Administration
Dorin DRĂGUȚANU	**Sergiu SURDU**

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