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Inflation Report no. 2, 2011

Inflation Report no.2, May 2011 [1]

Summary

Inflation

The annual rate of inflation measured by the CPI showed a downward trend, decreasing from 8.1 percent in December 2010 to 5.8 percent in March 2011, which is consistent with the Medium-term strategy for monetary policy. At the same time, it corresponds to the amount projected in the Inflation Report no.1, February 2011 (IR no. 1, 2011), recording a slight deviation in terms of increased uncertainty, as a result of the existing pressures on the world oil market, and of the current increases in tariffs of regulated services.

The annual rate of core inflationDecomposition of CPI inflation in these components is made based on the internal methodology of the NBM. Components of CPI inflation are: (1) core inflation (2) food prices (3) regulated prices (4) fuel prices. constituted 2.8 percent in March 2011, making the difference between it and total inflation to be 3.0 percentage points, thus further outlining the nonmonetary factors influence on the inflation process in Moldova. The regulated prices had contributed the most to the annual inflation rate formation in March 2011, as a result of increases in tariffs for services with regulated prices (gas, electricity and heating) made in May 2010 and February 2011. At the same time, the food prices had a major contribution, as a result of food prices fluctuations in world market, as well as the increases in transportation costs. Fluctuations in oil prices on the world market, enhanced by the tensions in North Africa and the Middle East, have led to increased fuel prices, which have contributed to the fuel prices growth. The second round effects, caused by fuel and food price increases generated inflationary pressures on goods and services prices related to core inflation.

The gross domestic product increased by 6.9 percent in real terms in 2010 as compared to the previous year. Taking into account that in 2009 the GDP constituted 6.0 percent, it shows that the Moldova’s economy reached the level before the economic crisis. Domestic demand was the key factor in GDP growth. However, a significant part of domestic demand is oriented towards goods from outside, as a result of a lower competitiveness of domestic products, which constitutes a major impediment to the economic recovery in Moldova. External demand has played a significant role in the positive evolution of GDP over the period. Data on foreign trade, industrial and agricultural production, transport of goods for the first months of this year outlines the prerequisites for registering a significant increase in GDP in the first quarter of 2011.

In the fourth quarter of 2010, the labor market situation in Moldova showed deterioration in compared to the forth quarter of 2009. The unemployment rate in the forth quarter of 2010 increased to 7.5 percent. This situation shows a labor market delay of the process of creating new jobs in Moldova’s economy, despite the positive signals of economic recovery in 2010. The real average salary in the economy constituted 1.2 percent in the forth quarter of 2010 as compared to same period last year.

Monetary policy

National Bank of Moldova develops and implements the monetary and foreign exchange policy to ensure and maintain price stability. During 2011-2012, the NBM will guide the inflation within the mid-single digit interval.

Quantifying the inflation outlook in the short and medium term, with eventual uncertainties and challenges during the reported period, as well as to anticipate the inflationary pressures, the National Bank of Moldova has promoted a prudent monetary policy during the first quarter of 2011.

Also, NBM continued to manage the liquidity excess through sterilization operations on the monetary market. The National Bank of Moldova intervened in the domestic foreign exchange market with an insignificant volume during January to March 2011, as a seller of foreign exchange.

Monetary indicators increased in the first quarter of 2011 with a lower annual rate compared to the third and forth quarter of 2010, decreasing significantly towards the end of March, which is reflecting the positive impact of monetary policy pursued during 2009-2010.

In the current conditions in the banking system, after the base rate increase by 1.0 percentage points and the required reserves ratio increase by 3.0 percentage points during the first quarter of 2011, the interest rates charged by banks on new attracted deposits and loans granted to individuals and legal entities have slightly increased.

In order to anticipate the inflationary pressures and to maintain the inflation within the planned limits, on January 27, 2011 the Council of Administration of the National Bank of Moldova decided to increase the ratio of required reserves consisting of attracted funds in MDL, soft currencies, and freely convertible currencies by 3.0 percentage points, setting it in the amount of 11.0 percent starting with the tracking period of attracted funds 8 February - 7 March 2011.

Medium-term inflation forecasting

The world economy is continuing the process of recovery. Macroeconomic indicators published during this period show the development of manufacturing and construction sector, thus confirming a positive beginning of the year for the world economy. On the other hand, some macroeconomic indicators draw attention to the sustainability and pace of global economic recovery. Also, the disasters from Japan have determined the macroeconomic indicators to deteriorate, through the unprecedented damage and enhanced nuclear risk. Although the international analysts do not talk about a new recession for the world economy, it is mentioned that some risks have reacently intensified.

he beginning of 2011 was characterized by rapid and signifi- cant increase in food and oil prices, which caused disruptions to economic activities with intensive energy consumption and has led to pressure on consumer’s budgets. Food prices increases and oil prices fluctuations represent a threat to the global pace of development and the most negative effects will be felt in emerging economies, which have been the engine of the global economic recovery. Unemployment problem remains acute in 2011, which determined most developed economies to implement measures to enhance the labor market, which should contribute to economic growth of countries, even if the global economic conditions remain to be unstable. During the forecast period, the real output gap will be in the negative range, showing disinflationary effects. The likelihood of inflationary pressures from an aggregate demand is low. Although the level of real interest rates will challenging contribute to the economic activity, however, the real effective exchange rate will eclipse the effect of the latter, so that the overall monetary conditions will help in the sense to diminish the inflationary pressures.

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