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Annual Report 2011

Annual Report, 2011 [1]

Summary

The year 2011 was marked by numerous events in the economic, social, political sphere, as well as by natural disasters that changed the world economic climate. Dramatic increases in food and oil prices, high unemployment, high inflation rates, and fiscal consolidation have caused disturbances in the economic activities and created pressure on the consumers' budgets. Also, in the last quarters of 2011 were recorded signals on the worsening global economy, the main focus being the sovereign debt problem in developed economies, manifested mainly in the euro area countries.

Asian countries were hit by the weakening global demand, primarily Japan, strongly affected by the earthquake in March 2011. Emerging economies have recorded a relatively high growth rate, but it was offset by the tightening of the monetary policy, and by adverse effects caused by propagation of international financial instability.

World prices rose significantly during 2011, their evolution being positively influenced by the economic boom in China and other Asian countries, by the energy prices increase due to political tensions in the Middle East and North Africa, by the disturbance in international products circuit following the earthquake in March 2011 in Japan. For these reasons, during the year, many central banks have tightened their monetary policy, contributing to the reduction of inflationary pressures. Moreover, some countries faced additional inflationary pressures generated by the depreciation of the national currencies.

The Moldovan economy recorded a 6.4 percent growth during 2011 as compared to the previous year, mainly due to the economic recovery of the main trade partners. This fact determined the upward evolution of exports, which increased by 28.6 percent, generating this way the maximum positive contribution to the GDP growth. At the same time, household consumption rose by 8.5 percent, mainly due to the increase of its financing sources during the period, with a significant positive impact on GDP growth. The gross capital formation increase had a positive contribution, but of a lower extend, while government final consumption registered a negative evolution during the reference period. The increased domestic demand contributed to the imports growth by 19.3 percent. In 2011, positive developments were recorded in all sectors. Similar to the previous year, the increase in gross value added of services-related branches had the largest contribution to the GDP growth. The industry recorded a growth rate below the level recorded in 2010, and constructions, despite the positive developments of the last two years, have not yet reached the level recorded before the economic crisis.

At the end of 2011, the annual inflation rate constituted 7.8 percent, while the annual core inflation recorded

a value of 6.1 percent in December 2011. Consequently, the difference between the CPI and the core inflation rate was of 1.7 percentage points, thus further outlining the significant influence of the non-monetary factors on inflation process in the Republic of Moldova. The prices for regulated services (2.7 percentage points) contributed the most to the annual inflation formation in December 2011, because of increases of tariffs for gas, electricity, and heating in the spring and fall of 2011. Food prices contributed by 2.5 percentage points to the annual inflation rate growth due to the propagation of the second round effects as a result of increases in fuel prices and gas and electricity tariffs at the beginning of 2011. At the same time, the higher prices for food products were driven by adverse weather conditions for specific crops and the increase in prices on foreign markets. The goods and services related to core inflation had a major contribution (1.9 percentage points), caused by second-round effects, due to higher prices for regulated services, fuel and food, as well as by the increasing demand from population in the first half of 2011. Fluctuations in oil prices on world market, exacerbated by the tensions in the Middle East and North Africa in early 2011, with liquefied gas deficit in the third quarter of 2011, determined the increase of fuel prices, which have contributed to the annual inflation growth by 0.7 percentage points.

Quantifying the macroeconomic situation, trends and projections of macroeconomic indicators in the medium term, the inflation outlook in short and medium term, with possible uncertainties and challenges during the reference period, as well as to anchor inflationary pressures, the National Bank of Moldova has promoted a prudent monetary policy during 2011.

The NBM's response to increased inflationary pressures in the period of January - November 2011 was to progressively increase the tightening of the interest rate policy, initiated in January 2011. Thus, the NBM operated three upward adjustments of the monetary policy rate, its level was increased from 7.0 to 10.0 percent. At the same time, the mitigation of price increases by the end of 2011 and the high degree of uncertainty in the global economy have prompted the central bank to loosen the monetary policy, initiating in November 2011 a prudent trend of reduction of monetary policy interest rate by performing two subsequent reductions, with an amplitude of 0.5 percentage points and 1.0 percentage points respectively (the latter being applied from January 6, 2012).

The components of monetary policy operational framework, specific for the strategy to reduce inflation, have been extensively applied in 2011. The 2011 situation, characterized by liquidity excess in the money market and inflationary pressures increase has driven the National Bank of Moldova to act as a net debtor in relation to the banking system.

In order to increase the effectiveness of money market liquidity management, the NBM increased, starting from January 2011, the maturity on NBM certificates from one to two weeks.

In 2011, the average weighted rate of sterilization operations amounted to 8.54 percent annually compared to 6.74 percent recorded in the previous year.

In order to counter the inflationary pressures and to improve the monetary policy decisions' transmission mechanism of the National Bank, in the context of an underdeveloped capital market and abundant liquidity in the banking system, the required reserves ratio was increased twice in 2011 by 3.0 percentage points each time, reaching the level of 14.0 percent at the end of 2011 from the funds attracted in MDL, non-convertible currency, and freely convertible currency.

In 2011, the required reserves mechanism continued to exercise the functions of monetary control and banking system liquidity management. During the required reserves regime undergone significant changes in terms of increasing the tracking periods of attracted funds and required reserves maintenance periods,

rising the required reserves ratio, and applying the 0% required reserves ratio of attracted funds included in the calculation base, with a maturity greater than two years.

Since January 2011, according to the Decision of the Council of Administration of the National Bank of Moldova no.227 of 18 October 2010, the licensed banks have passed to a monthly tracking period of attracted funds and required reserves maintenance. Extending the term of required reserves maintenance for a period of a month contributed to the improvement of the operational framework of the National Bank of Moldova and to a uniform distribution of liquidity within the banking system during the required reserves maintenance period.

The firm management of liquidity in the banking system was aimed at ensuring the proper functioning of the money market, maintaining a balance between the price stability and the national economic recovery.

Thus, the long-term liquidity in the banking system constituted 0.7 percent on December 31, 2011, while the current liquidity – 33.2 percent. All of the banks except B.C. „Universalbank" S.A. have complied with both indicators. It should be mentioned that by the Decision no.272 of November 25, 2011 on B.C. "Universalbank" S.A. was established special administration.

A prerequisite of the implementation of inflation targeting regime is to maintain a flexible exchange rate. Thus, the NBM limited the interventions on the foreign exchange market to the amounts needed, without resisting to the long-term trend of the exchange rate of MDL.

During 2011, foreign exchange reserves rose by 14.4 percent, up to USD 1965.3 million as of December 31, 2011, covering 3.6 months of imports.

In 2011, the NBM intervened in foreign exchange market mainly as a buyer of foreign currency, the interventions being made to mitigate the volatility in the exchange rate of national currency against the U.S. dollar and providing liquidity to the foreign exchange market.

It should be mentioned that, according to the Regulation on Risk Weighted Capital Adequacy, since December 31, 2011 the minimum amount of capital was established at the sum of 150.0 million lei. On December 31, 2011 all banks' Tier I capital corresponded to the minimum set amount, excepting B.C. "Universalbank" S.A. The average risk weighted capital adequacy (ratio of total regulatory capital to risk-weighted assets) is maintained at a high level - 30.4 percent (the minimum level in the Republic of Moldova is 12.0 percent), indicating a high degree of safety of banks determined by the existence of a potential of making risky operations without affecting the capital.

The share of non-performing loans (substandard, doubtful, and compromised) in total loans constituted 10.7 percent at December 31, 2011, or by 2.6 percentage points less compared to the end of 2010.

The National Bank of Moldova reiterates that it will further promote a prudent monetary policy, monitoring and anticipating domestic macroeconomic and international environment, such that, by using monetary policy instruments, to ensure price stability over the medium term and long term economic growth.

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