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Inflation Report no. 4, 2013

Inflation Report no.4, November 2013 [1]

Summary

Inflation development

In the third quarter of 2013, the annual inflation rate reached the level of 4.0 percent, by 1.2 percentage points lower than in the previous quarter. This decrease was mainly due to reduced inflationary pressures from food prices as a result of a rich harvest of fruits and vegetables this summer. Core inflation recorded a modest annual growth of 4.3 percent during the reporting period, given the moderate domestic demand. The depreciation of the national currency has mitigated some of the disinflationary effects generated by the evolution of food prices and favored the slight increase of core inflation. Both the annual inflation rate and the annual core inflation rate have further fallen within the range of ± 1.5 percentage points from the 5.0 percent target set in the Medium-term monetary policy strategy of the National Bank of Moldova. The annual inflation rate in the third quarter of 2013 was only by 0.1 percentage points above its anticipated value in the projection (3.9 percent) published in the Inflation Report no. 3, 2013.

External environment

After a lull in the financial markets, the autumn has brought attention to several issues which strongly influenced the global economy. Thus, the last few weeks have been rich in events that influenced the evolution of the main macroeconomic indicators. Among the most important centers of financial distress there should be mentioned the Syrian conflict worsening, which resulted in a significant increase in oil prices and the delay in terminating the monetary stimulus program of the Federal Reserve System (Fed) in conjunction with the deepening problems of U.S. public debt, which constituted the basis for the significant depreciation of the U.S. dollar, while the opposite was expected. Also, special attention was paid to monetary policy, especially in emerging economies, given that several currencies have depreciated significantly against the background of massive capital outflows. It should be mentioned that inflation in most economies was relatively low as a result of lower demand and lower food prices. However, the euro area is gradually coming out of recession, which underlies the optimism in the financial markets.

Economic developments

After a growth of 3.5 percent in the first quarter of this year, the economic growth became more pronounced in the second quarter of 2013, GDP increasing by 6.1 percent over the same period of the previous year. The positive dynamics was driven by the domestic demand, the external demand having less influence. Thus, the final consumption of households has increased by 7.8 percent, the gross fixed capital formation - by 3.0 percent, and the exports grew only by 1.2 percent. Government final consumption has decreased by 0.4 percent. Specifically for the Republic of Moldova’s economy, the domestic demand growth has resulted in increased imports, which were higher by 6.7 percent in the second quarter of 2013. Industry generated a considerable contribution to the GDP growth, while agriculture recorded a slight increase of 3.8

percent during the reporting period. Gross value added of services recorded an increase of 4.3 percent. Net taxes on products increased by 6.7 percent in the second quarter of 2013 compared to the same period of the previous year. In the second quarter of 2013, both employment and unemployment increased. As a result, the unemployment rate grew to 4.7 percent and the economically active population increased by 1.7 percent compared to the second quarter of 2012.

Monetary policy

In the third quarter of 2013 there have been three meetings of the Council of Administration of the National Bank of Moldova for monetary policy decisions, within which the updated balance of risks for future inflation prospects in the short and medium term has been reviewed. Thus, there have been taken three decisions to keep the base rate at the level of 3.5 percent annually, a level set within the meeting of April 25, 2013. During the reporting period, the NBM promoted an expansionary monetary policy and its efforts were oriented towards combating disinflationary pressures and achieving the objective of keeping inflation within the range of ± 1.5 percentage points from the 5.0 percent target. The average annual inflation rate was 4.0 percent in the third quarter of 2013.

In the context of the promoted monetary policy and the consolidation of foreign exchange reserves, the NBM intervened in the third quarter of 2013 as a buyer of foreign currency. During this period, the volume of NBM transactions carried out on the interbank foreign exchange market against MDL was USD 248.8 million.

In the third quarter of 2013, the growth rate of monetary aggregates remained high, the quarterly average in annual terms of M2 constituted 25.7 percent, down by 0.4 percentage points from growth recorded in the previous quarter, and the quarterly average in annual terms of M3 accounted for 21.9 percent, which is similar to the growth recorded in the second quarter of 2013. Average interest rates charged by licensed banks in the third quarter of 2013 had a stable downward trend. In late September 2013, the average interest rate on new loans in national currency recorded a new historical minimum level of 11.79 percent and the new loans in foreign currency - 7.07 percent. In turn, the return on term deposits in national currency recorded lower values than in the previous quarter – 6.62 percent and the deposits in foreign currency stood at the level of June 2013 of 4.36 percent.

Medium-term inflation forecasting

Current projection places the annual CPI inflation rate at the average level of 4.5 percent for the year 2013, by 0.2 percentage points higher than anticipated in the Inflation Report no.3, 2013. For 2014, the average annual inflation rate is forecasted to reach the level of 4.7 percent, by 0.9 percentage points more compared to the previous report. According to the current projection, the annual inflation rate will fall within the range of ± 1.5 percentage points from the inflation target of 5.0 percent annually throughout the 24 months forecasting period. External assumptions of current forecasting round are based on the most recent data and the recorded developments are superior compared to the previous report. Thus, the forecasts for raw material and energy resources prices recorded increases compared to the forecasts assumed in the projection published in the Inflation Report no.3, 2013. The GDP gap will record positive values for the entire forecasting period, thus placing the economic activity above its potential level, exerting pro-inflationary pressures from domestic demand. Positive quarterly GDP gap for the forecasting period is largely due to the incentive nature of real monetary conditions versus the Inflation Report no. 3, 2013. The evolution of real monetary conditions will be determined both by the incentive nature though the real interest rate channel and by the incentive effect of the real effective exchange rate channel.

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