National
Bank of Moldova

Inflation Report

No. 3, August 2016

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.

The calculation of the statistical data was carried out by the National Bank of Moldova.

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List of acronyms

CHIBOR	Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECB	European Central Bank
EUR	European Single Currency
FCC	Freely convertible currency
Fed	Federal Reserve System
GDP	Gross Domestic Product
IPI	Industrial Production Index
IPPI	Industrial Producer Price Index
MDL	Moldovan leu
NBM	National Bank of Moldova
NBS	National Bureau of Statistics of the Republic of Moldova
NEER	Nominal effective exchange rate of the national currency
NERA	National Energy Regulatory Agency
REER	Real effective exchange rate of the national currency
SS	State Securities
USD	U.S. Dollar

Summary

Inflation development

In the second quarter of 2016, the annual inflation rate was 7.9 percent, by 3.1 percentage points less compared to the previous quarter. In June 2016, inflation decreased to 7.4 percent. However, it continued to be above the upper limit of the inflation target set in the Medium-term monetary policy strategy. The downward trend was due to modest domestic demand, electricity tariff revision, increased supply of fruits and vegetables this year, and the national currency appreciation. The annual rate of core inflation continued to maintain a higher trajectory than that of overall inflation. Core inflation has also recorded a downward trajectory throughout the second quarter of 2016, decreasing from 10.2 percent in March to 9.3 percent in June. In June 2016, the annual growth rate of food and regulated prices slowed to 7.6 and 7.4 percent, respectively. In the second quarter of 2016, oil prices decreased on average by 3.4 percent compared to the same period of the previous year. The average actual value of inflation for the second quarter of 2016 was only by 0.2 percentage points lower than the anticipated 8.1 percent in the forecasting round of Inflation Report no. 2, 2016.

External environment

In the second quarter of 2016, there were several events with significant impact on global economic development. An extraordinary meeting of OPEC with other big oil producers has held on April 17, 2016, where the discussions on reducing global oil production were unsuccessful. On June 23, 2016, the UK held a referendum on its EU membership, where 51.9 percent of participants voted in favour of leaving the EU. It should be also mentioned the resumption of bilateral relations between Turkey and the Russian Federation in late June and the recent coup in Turkey, which caused economic instability of the country. These events have generated significant market volatility, increasing risks to global economic development.

Economic developments

In the first quarter of 2016, GDP grew by 0.8 percent compared to the same period of 2015, the annual growth rate of economic activity was higher than in the second half of last year. However, economic growth was modest, so hovering below its potential. Positive trends in GDP was due to domestic demand, while exports generated a very negative impact on GDP growth. Thus,

in the first quarter of 2016, household consumption grew by 2.3 percent. However, household consumption development is minor. At the same time, the positive contribution of investment to GDP was only due to the positive impact from changes in inventories, while gross fixed capital formation recorded a contraction of 3.6 percent compared to the same period of the previous year. These developments reflect a decrease in real terms of personal disposable income and a still increased uncertainty from economic agents and population on the future development of the economy. Final consumption of public administration in the first quarter of 2016 was down by 0.4 percent compared to the same period of 2015. After having an insignificant influence on GDP growth in the second half of the previous year, exports recorded a contraction of 5.6 percent compared with the first quarter of 2015, largely due to the consequences of modest agricultural production in this period. Imports grew by 1.8 percent in the reporting period. By resources, the GDP development was driven mainly by the increase in gross added value in all sectors of economy, except the "constructions" and "other services".

Monetary policy

In the second quarter of 2016, the Executive Board of the National Bank of Moldova held two meetings 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, the Executive Board of the NBM decided to decrease the base rate applied to main monetary policy operations by 2.0 percentage points within each meeting. Thus, at its meeting of April 28, 2016, the base rate was lowered from 17.0 (a level set at the meeting of March 31, 2016) to 15.0 percent annually, at the meeting of May 26, 2016 from 15.0 to 13.0 percent annually.

In the second quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 4.8 percent for M2 (by 7.5 percentage points higher than in the first quarter of 2016) and 0.9 percent for M3 (by 4.4 percentage points higher than the previous quarter).

Reflecting the downward trend of the base rate applied on the main monetary policy operations of the National Bank of Moldova, the average interest rates on outstanding deposits have reversed the upward trend, as a result of which the average interest rates on credits granted by the banking system also recorded a slight decline.

During the reporting period, as compared to the first quarter of 2016, the average annual interest rates on the balance of credits decreased by 0.08 percentage points on those in national currency and by 0.18 percentage points on those in foreign currency, recording values to the level of 13.60 percent and 6.42 percent, respectively. The average annual interest rate on deposits in MDL was 14.93 percent, by 0.18 percentage points less compared to the previous quarter. The interest rate on deposits in foreign currency amounted to 2.11 percent on average, by 0.03 percentage points lower compared to the first quarter of 2016.

Medium-term inflation forecasting

The current round of forecasts anticipates a continuation of the negative dynamics of the output gap for the entire forecasting horizon. It will recover slowly, but will continue to be negative, turning positive only towards the end of the forecasting horizon. Compared to the previous round of forecasting, the estimated aggregate demand was reconfigured. The evolution of the economic activity mainly below its potential, on medium-term, will determine disinflationary pressures from domestic demand, although more moderate compared to the previous forecast.

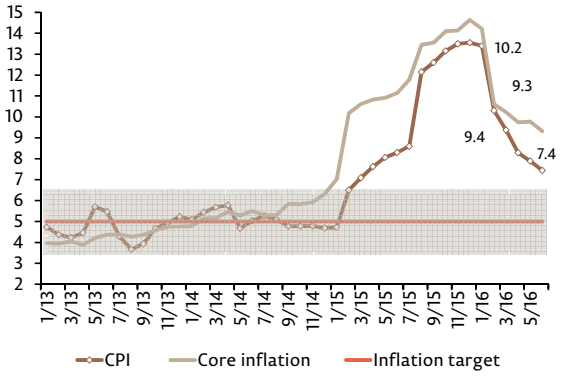
According to the current projection, the annual average CPI inflation will record a downward trend until the end of 2016, being followed by a stabilization around the target. On average, this will reach the level of 6.7 percent in 2016 and 4.4 percent in 2017. According to the projection, the annual inflation rate will return to the inflation target range in the third quarter of 2016. The maximum level of 6.0 percent will be recorded in the second quarter of 2018 and the minimum level of 3.5 percent in the fourth quarter of 2016.

Chapter 1

Inflation development

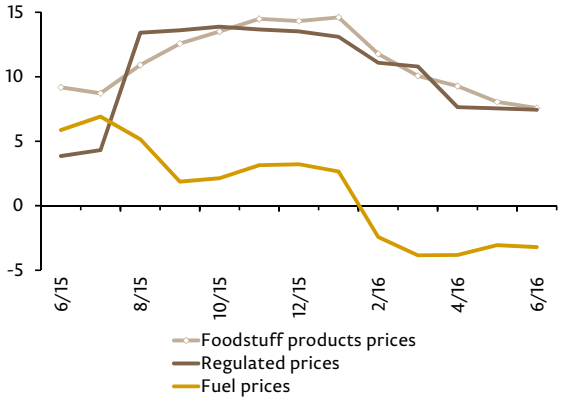
The annual inflation rate continued the downward dynamics since the beginning of this year, decreasing to the value of 7.4 percent in June 2016. However, it was above the upper limit of the inflation target set in the Medium-term monetary policy strategy. Average annual inflation rate in the second quarter of 2016 was 7.9 percent and was lower than in the first quarter of 2016. Its decrease was mainly determined by the modest domestic demand, revision of electricity tariff, high supply of fruits and vegetables of this year and national currency appreciation. The annual rate of core inflation recorded a similar development. In the second quarter of 2016, the actual annual inflation rate was slightly lower to that anticipated within the forecasting round presented in the Inflation Report no.2, 2016.

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



Source: NBS, NBM calculus

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



Source: NBS

1.1 Consumer price index

In the second quarter of 2016, the annual CPI inflation rate continued the downward trajectory since the beginning of this year, so that this decreased from 9.4 percent in March 2016 to 7.4 percent in June 2016 (Chart 1.1). However, the annual inflation continued to be outside the range of ±1.5 percentage points from 5.0 percent target set in the Medium-term monetary policy strategy. Annual average CPI rate in the second quarter of 2016 was 7.9 percent, by 3.1 percentage points lower than in the previous quarter.

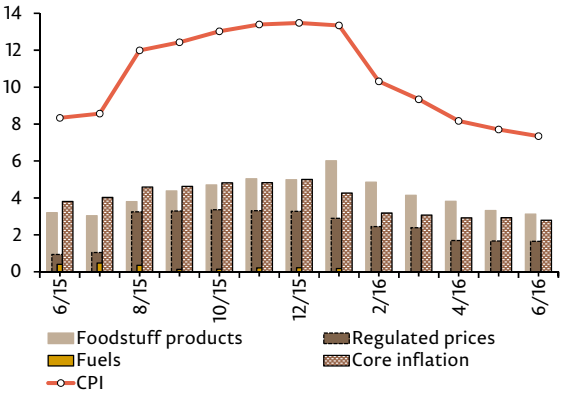
The annual rate of core inflation continued to maintain a higher trajectory than that of overall inflation. Core inflation has also had a downward trajectory during the second quarter of 2016, decreasing from 10.2 percent in March to 9.3 percent in June 2016. In the second quarter of 2016, the average rate of core inflation was 9.6 percent, by 2.1 percentage points lower than in the previous quarter, due to the modest internal demand and the appreciation of the national currency against the U.S. dollar compared to the beginning of this year. As a result, the contribution from core inflation to CPI annual rate decreased by 0.6 percentage points, up to 2.9 percentage points.

The downward trajectory of the annual CPI inflation rate was determined mainly by the low pressures from food prices. Thus, their contribution decreased by 1.6 percentage points, to 3.4 percentage points in the second quarter of 2016. The slowdown in annual inflation rate was also supported by regulated prices, as a result of the downward revision in electricity tariffs and some changes in legislation on medicinal products. Their contribution

to the CPI dynamics decreased from 2.6 percentage points to 1.7 percentage points. Although decreasing, the high values of annual inflation rate reflect largely the impact of the national currency depreciation during the last year and the increase in tariff for electricity since summer of last year. The factors that offset, to some extent, the inflationary influence of the national currency depreciation and the tariff increases are the modest domestic demand, embargoes on certain categories of domestic products, and the downward trend of food prices at international level. The contribution from fuel prices was -0.2 percentage points, being slightly lower to that of the previous quarter (Chart 1.3).

Within the components structure, the highest increases in June 2016 compared to June 2015 were recorded by food prices and services (each 7.6 percent), followed by non-food prices (6.9 percent).

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



Source: NBS, NBM calculus

Core inflation

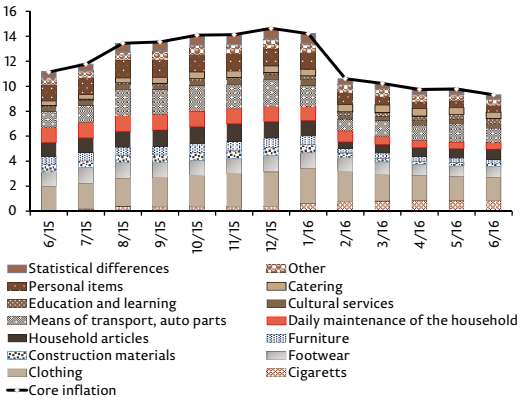
In the first quarter of 2016, the annual rate of core inflation continued its downward trend, decreasing from 11.7 percent in the first quarter of 2016 to 9.6 percent in the second quarter of 2016.

The aggregate demand lower than its potential value, as well the slight appreciation trend of Moldovan leu against the U.S. dollar, recorded in the second quarter of 2016 compared to the beginning of 2016, were the factors that determined the downward dynamics of this indicator. In this regard, the official average exchange rate of the national currency against the U.S. dollar recorded in the second quarter of 2016 the value of MDL/USD 19.8, appreciating by 1.4 percent compared to the first quarter of 2016.

During the reporting quarter, the annual core inflation was mainly determined by the increase in prices of subcomponents "clothing", "means of transport, auto parts", "footwear", "cigarettes" etc. (Chart 1.4).

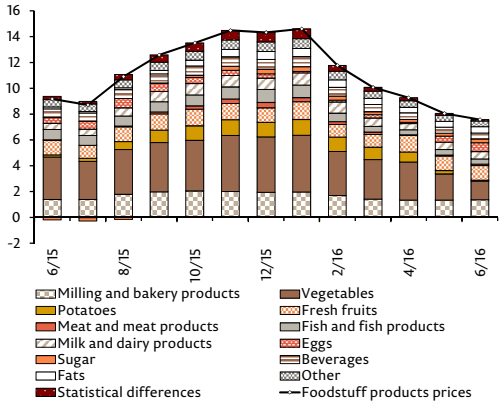
At the same time, in June 2016, the increase in prices of "cigarettes" (by 26.2 percent), "household articles" (by 11.4 percent), "means of transport, auto parts" (by 10.8 percent), "education and training" (by 10.7 percent) etc. has contributed to the annual inflation formation up to 9.3 percent (by 0.9 percentage points lower than in March 2016).

Chart 1.4: The subcomponents contribution (p.p.) to the annual rate of core inflation (%)



Source: NBS, NBM calculus

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



Source: NBS, NBM calculus

Food prices

In the second quarter of 2016, the annual rate of food prices recorded an average level of 8.3 percent, by 3.8 percentage points lower than in the first quarter of 2016. This downward dynamics was caused mainly by low contributions from groups "fresh vegetables", "potatoes", "milling and bakery products", "fish and fish products" and "milk and dairy products" (Chart 1.5). The pronounced decrease of the contribution from the groups "fresh vegetables" and "potatoes" was influenced mainly by the registration of some favourable meteorological conditions for a good crop year and the existence of a rich supply of these

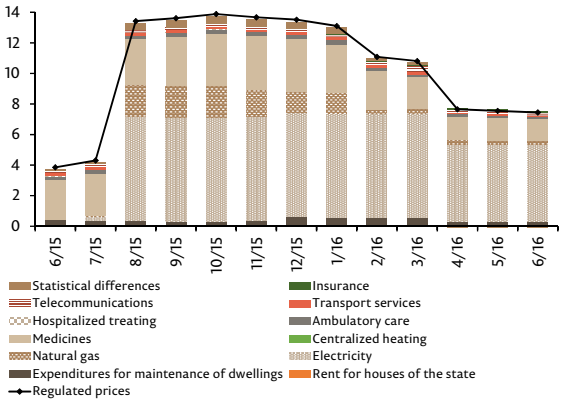
products on the market. At the same time, the MDL/USD exchange rate maintained the appreciation trend in the second quarter of 2016 compared to the first quarter of 2016, contributing to the neutralisation of the inflationary pressures recorded during the previous periods. The slowdown in annual rate of food prices was also influenced by the base effect.

On international market, the annual growth rate of food prices was negative, similar to 2015. Thus, in the second quarter of 2016, it recorded an average level of -5.5 percent.

The increase of food prices in June 2016 by 7.6 percent in annual terms was mainly determined by the increase in prices of "eggs" (32.8 percent), "fresh fruits" (19.5 percent), “milling and bakery products" (7.6 percent), "fresh vegetables" (6.8 percent) and “milk and dairy products” (4.7 percent).

Regulated prices

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



Source: NBS, NBM calculus

The annual rate of regulated prices recorded a downward trend in the second quarter of 2016, amounting to 7.5 percent, by 4.1 percentage points lower than in the previous quarter. This dynamic was mainly caused by the decrease in electricity prices by 9.9 percent in April, under the Decision of March 12, 2016 of the Council of Administration of NERA that updated the tariffs in force for electricity supply and distribution. Thus, pursuant this decision, starting with April 1, 2016, the electricity tariffs for household customers decreased by up to 11.0 percent, based on the distribution network to which they are connected. It should be mentioned that the last increase in electricity tariffs was operated by NERA in July 2015, so that these continued in the second quarter of 2016 to produce effects on annual rate of regulated services prices.

At the same time, the decrease in annual rate of regulated prices was also due to the evolution of medicine prices. In this regard, after more than three years, regulated prices recorded for the first time in April 2016, a decrease of 1.7 percent. This is a consequence of the legislative amendments relating to pharmaceutical activity adopted by the Parliament of the Republic of Moldova [1]. However, even after the aforementioned changes, the medicine prices continued to record a positive evolution in May and June 2016, but the contribution of this subcomponent to annual rate of regulated prices decreased compared to the previous quarter. At the same time, the positive contributions from the house maintenance expenditure and transport services over the regulated prices evolution have decreased in the second quarter of 2016 (Chart 1.6).

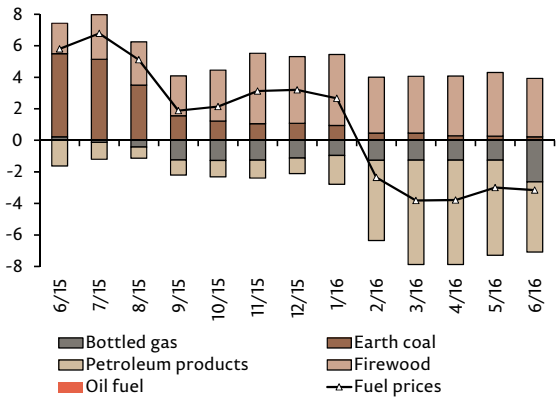
Fuel prices

The annual average rate of fuel prices, in the second quarter of 2016, was -3.4 percent, by 2.2 percentage points lower than in the first quarter of 2016 (Chart 1.7).

[1] According to new provisions, beginning with April 1, 2016, the pharmacies apply a mark up for sale of medicines, which is in line with the price included in the National medicine price catalogue. These changes in law were made in order to reduce the medicine price for final consumer.

The negative dynamics of oil prices was mainly influenced by the impact of fuel prices in the second quarter of 2016. Thus, the negative contribution generated by them reached a level of -5.7 percentage points, by 1.2 percentage points higher compared to the first quarter of 2016. However, it slowed down by the end of the second quarter, as a result of the increase in petrol and diesel prices in May and June, due to the petrol price increase and also to high excise duties. In this regard, the petrol prices on international market increased in the second quarter of 2016 by 36.5 percent compared to the beginning of this year. At the same time, it should be mentioned that starting with May 2016, NERA adopted a new methodology of formation and application of prices for oil products (in force since May 13, 2016). Accordingly, NERA establishes every 14 calendar days, on Tuesdays, a price ceiling [2] for retail trade of petrol and diesel, which cannot be exceeded by the market operators. Similar to the previous quarter, a negative contribution to annual rate formation of fuel prices was also exerted by the dynamics of bottled gas prices. Thus, in the second quarter of 2016, the contribution of this subcomponent to annual rate formation was -1.7 percentage points, by 0.6 percentage points lower compared to the previous quarter.

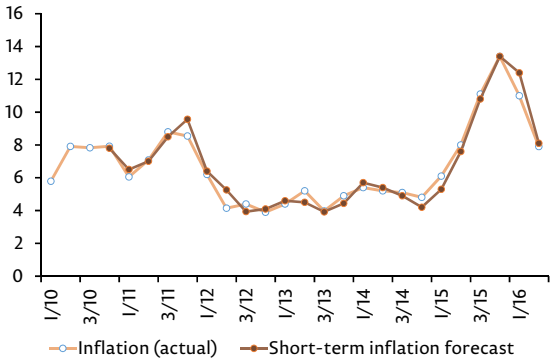
Chart 1.7: The components contributions to the annual growth of fuel prices (p.p.)



Source: NBS, NBM calculus

On the other hand, the negative dynamics of the aforementioned subcomponents was offset by the positive evolution in annual terms of the "firewood" component. During the reporting period, the contribution generated by the subcomponent "firewood" reached 3.8 percentage points to the annual rate formation of fuel prices, by 0.1 percentage points lower compared with the first quarter of 2016. At the same time, the contribution from "earth coal" subcomponent decreased by 0.4 percentage points compared with the previous period, reaching the level of 0.3 percentage points.

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



Source: NBM

1.2 Comparing forecasts of the Inflation Report no.2, 2016 with the inflation development in the second quarter of 2016

In the second quarter of 2016, data on CPI reflects mainly the key assumptions and conclusions regarding the inflation short-term forecast for the reporting period, presented in the Inflation Report no.2, 2016. Thus, the actual average value was in the second quarter of 2016 by 0.2 percentage points lower than the value anticipated of 8.1 percent (Table 1.1).

Table 1.1: The evolution and forecast of CPI and its components

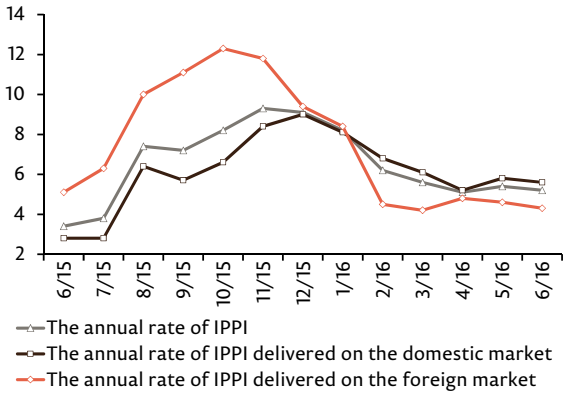
	De facto	Forecast IR 2, 2016	Deviation
	Q II, 2016/ Q II, 2015	Q II, 2016/ Q II, 2015	De facto-forecast
CPI	**7.9**	**8.1**	**-0.2**
Core inflation	9.6	9.7	-0.1
Food	8.3	8.6	-0.3
Regulated prices	7.5	7.8	-0.3
Fuels	-3.4	-3.6	0.2

Source: NBS, NBM calculus

The main subcomponents of CPI inflation have not recorded deviations of a pronounced magnitude. However, the forecast deviation of food prices (-0.3 percentage points) generated mainly the highest impact on the aforementioned negative deviation, as a result of a rich supply of domestic fruits and vegetables this year. Although recording a similar value with that of food prices, the deviation recorded for regulated prices forecast (-0.3 percentage points) had a lower negative impact, having regard to

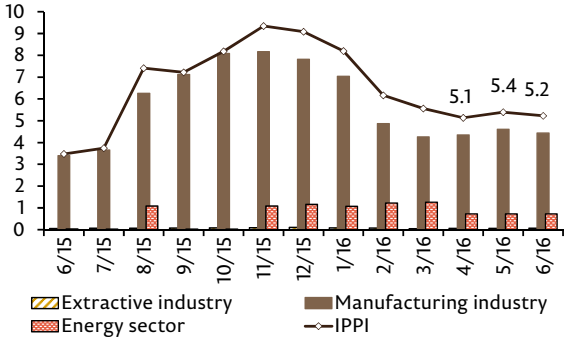
[2] Price ceiling consists of the following components: Platts average quotations for petrol; transaction costs for import operations, including the costs of transport and insurance; the rate of excise duty and of value added tax (VAT), applied in accordance with the Tax Code of the Republic of Moldova, and the specific trade margin, which includes the expenditure amount and oil companies' profit.

Chart 1.9: The IPPI annual rate (%)



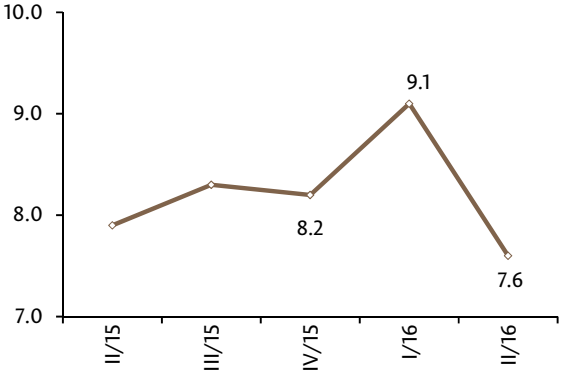
Source: NBS

Chart 1.10: The IPPI annual rate (%) and the contribution of its components categorised by main branches (p.p.)



Source: NBS, NBM calculus

Chart 1.11: The evolution of construction prices index (%, compared to the same period of the previous year)



Source: NBS

the share of this subcomponent to CPI structure. Core inflation has also recorded a negligible negative deviation (-0.1 percentage points). On the other hand, only fuel prices recorded a positive deviation (0.2 percentage points) from the anticipated value, as a result of a higher oil prices than expected.

1.3 Industrial output prices

In the second quarter of 2016, the annual growth rate of prices in industry recorded an average level of 5.2 percent, by 1.5 percentage points lower compared to the first quarter of 2016. The downward dynamics of the IPPI annual rate in the analysed period was influenced by the dynamics of prices of the products delivered both on domestic and foreign market (Chart 1.9). Thus, in the second quarter of 2016, the annual rate of IPPI delivered on domestic and foreign market decreased by 1.5 and 1.1 percentage points, respectively, compared to the level recorded in the previous quarter.

The dynamic of annual rate of prices in industry is determined mainly by the evolution of prices in manufacturing (Chart 1.10). In the second quarter of 2016, the prices in manufacturing industry contributed on average by 4.5 percentage points to the IPPI annual rate formation, or by 0.9 percentage points less than in the first quarter of 2016. At the same time, the contribution from energy sector prices decreased during the reporting period.

The decrease of the contribution from energy sector by 0.5 percentage points in the second quarter of 2016 was determined by the decrease in electricity tariffs since April 1, 2016. Contribution from extractive industry prices maintained the level of the previous quarter.

1.4 Construction prices

In the second quarter of 2016, the annual rate of construction prices was 7.6 percent, by 1.5 percentage points lower compared to the first quarter of 2016 (Chart 1.11).

Within the structure of the national economy, in the second quarter of 2016, the following sectors have recorded the largest increases compared to the same period of the previous year: "building construction" (11.9 percent), "agriculture" (6.9 percent), "other constructions" (6.7 percent), "construction of social and cultural objects" (6.1 percent), "telecommunications" (5.9 percent) and "manufacturing" (5.8 percent).

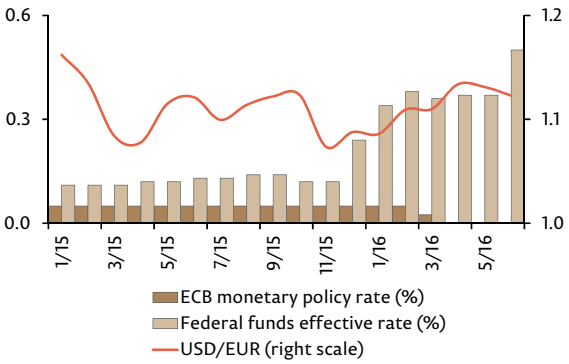
Chapter 2

External environment

Many events with significant impact on the world economy development have occurred in the second quarter of 2016. OPEC held an unordinary meeting on April 17, together with other major oil producers, where the discussions on decreasing the global oil production failed. On June 23, Great Britain held a referendum on whether to leave or remain in the European Union and 51.9 percent of votes were cast to leave the EU. It should be also mentioned the renewal of bilateral relations between Turkey and Russian Federation at the end of June and the recent coup d'état in Turkey that caused the country's economic instability. These events generated significant volatility on the market, increasing the risks over the world economy development.

During the reporting period, the USD/EUR parity decreased gradually, the European single currency depreciating due to the ECB quantitative easing programme, as well as a result of the Brexit and exacerbation of issues in the euro area banking sector. The U.S. dollar appreciation was possible thanks to the positive statistics on USA labour market, which enhanced the investors' expectations on faster increase of interest rates by the Fed. Another factor of the U.S. dollar appreciation is the stable recovery of the USA economy amid the more severe slowdown in emerging economies and of other advanced economies. Thus, after a U.S. dollar depreciation of 2.2 percent in April, this appreciated against EUR by 0.2 percent in May and by 0.7 percent in June (Chart 2.1).

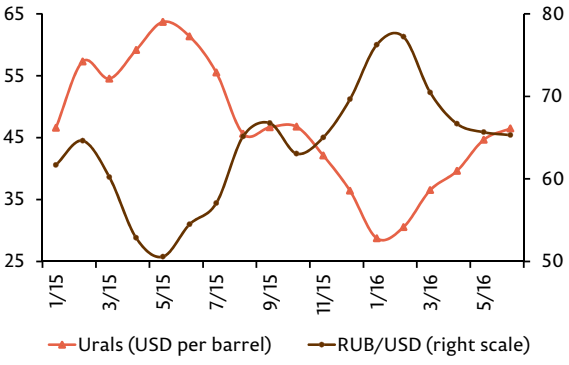
Chart 2.1: The evolution of USD/EUR parity (monthly average) in the context of the monetary policy promoted by ECB and Fed



Source: ECB, Fed

Foreign exchange market in the region was marked by the appreciation of the Russian ruble and the stabilization of the Ukrainian hryvnia. The main cause of Russian ruble appreciation was the gradual increase of oil price and the decrease of risks related to oil market, as a result of the decrease in gap between the oil demand and supply. On a quarter-average basis, the Russian ruble appreciated in the second quarter of 2016 by 11.7 percent against the U.S. dollar and by 9.7 percent against the EUR compared to the first quarter of 2016. During the same period, the Ukrainian hryvnia appreciated by 1.6 percent against the U.S. dollar and depreciated by 0.9 percent against the EUR. Romanian leu appreciated by 2.3 percent against the U.S. dollar and depreciated by 0.1 percent against the euro. For comparison, during the reporting period, the Moldovan leu appreciated by 1.4 percent against the U.S. dollar and depreciated by 1.0 percent against the EUR (Chart 2.2).

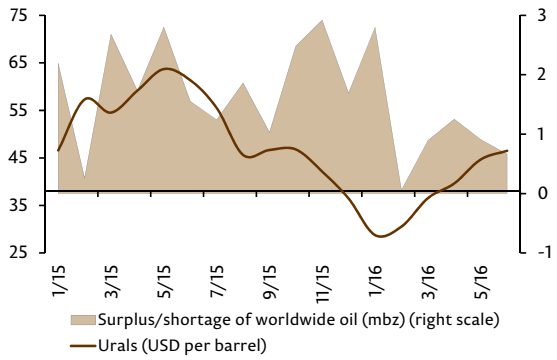
Chart 2.2: The evolution of RUB/USD (monthly average) under the influence of the oil price developments



Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation

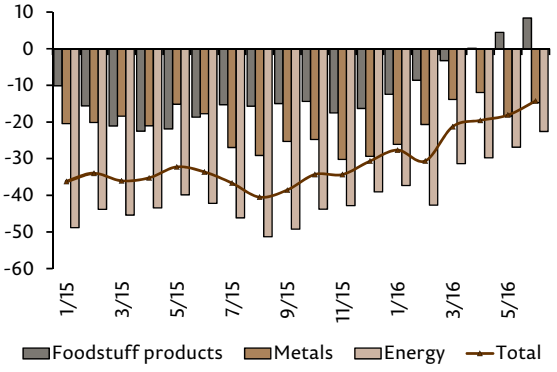
In the second quarter of 2016, oil prices continued to increase, accounting currently for about USD 50 per barrel. The quarter average price of Urals brand oil was USD 43.6 per barrel, increasing by 36.5 percent compared to the previous quarter. The oil demand growth rate higher than the oil supply growth rate was the main

Chart 2.3: The developments on the world oil market



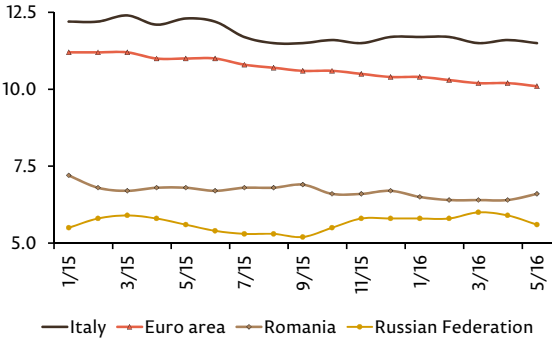
Source: Ministry of Economic Development of the Russian Federation, U.S. Energy Information Administration

Chart 2.4: The annual growth rate of world prices indexes (%)



Source: IMF, NBM calculus

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



Source: Eurostat, Federal State Statistics Service of the Russian Federation

factor of oil prices increase, contrary to the expectations related to the failure of Doha negotiations. At the same time, there were fires in some Canada's oil extraction zones, the Kuwait oil workers' strike and the potential for a similar oil workers' strike in Norway. Another factor of oil price volatility was the evolution of the USA oil reserves and the reaction of financial markets towards Brexit. The increase in number of the USA working wells and the increase in volume of oil production in Saudi Arabia and Nigeria have also determined the decrease in oil prices by the end of the analysed period (Chart 2.3).

The U.S. dollar appreciation in last months and trade imbalances determined the selective registration of constant monthly increases in international prices for raw materials. Respectively, the annual growth rates of international prices for raw materials recorded insignificant increases lower than the values from previous quarters. Thus, according to the IMF data, in the second quarter of 2016, international raw materials prices increased on average by 17.2 percent compared to the previous quarter and decreased by 17.3 percent compared with the second quarter of 2015. International food prices increased by 9.5 percent compared to the previous quarter and by 4.3 percent compared to the second quarter of 2015. International metal prices increased by 5.1 percent compared to the previous quarter but have been by 15.1 percent less compared to the same quarter of the previous year. Energy resources prices increased by 28.5 percent compared to the previous quarter and deceased by 26.4 percent than the second quarter of 2015 (Chart 2.4).

The labour market continued to improve in the countries chosen by Moldovan migrants for working purposes. Thus, the unemployment rate in euro area decreased in May to 10.1 percent. In the European Union, the unemployment rate was 8.6 percent in May, it was 11.5 percent in Italy and 6.6 percent in Romania. In the Russian Federation, the unemployment rate decreased gradually during April and May, reaching the last value of 5.6 percent (Chart 2.5).

In the first quarter of 2016, the GDP of the USA grew by 0.3 percent compared to the fourth quarter of 2015 and by 2.1 percent compared to the first quarter of 2015. The actual increase reflected positive contributions from "personal consumption expenditure", "residential fixed investment" and "local and state expenditure", which have been partially offset by the negative contributions from "non-residential fixed investment", "exports" and "federal government expenditure". Imports have increased, contributing to the GDP decrease. Industrial output decreased in January-May 2016 by 1.5 percent in annual terms, while the unemployment increased in May up to 4.9 percent, after recording during the previous month a minimum level in recent years of 4.7 percent. Consumer prices increased in June 2016 by 0.3 percent compared to the previous month and by 1.0 percent compared to June 2015 (Table 2.1).

The GDP of the euro area increased in the first quarter of 2016 by 0.6 percent compared to the previous quarter per seasonally adjusted series and by 1.6 percent compared to the first quarter of 2015 per seasonally non-adjusted series. Industrial output increased in January-May 2016 by 1.5 percent, of which by 1.0 percent in Germany, by 0.8 percent in France and by 1.2 percent in Italy.The unemployment level continued to decrease, recording in May 2016 an unemployment rate in the euro area of 10.1 percent,

by 0.1 percentage points less compared to the previous month. The annual inflation in the euro area was 0.1 percent in June 2016 (Table 2.1).

The GDP of Romania increased in the first quarter of 2016 by 1.5 percent in real terms compared to the fourth quarter of 2015 per seasonally adjusted series and compared to the same quarter of 2015, GDP recorded an increase of 4.3 percent per gross series and of 4.1 percent per seasonally adjusted series. In the first five months of this year, industrial output of Romania increased by 1.4 percent on an annual basis.Consumer prices continued to decrease due to the VAT reduction from 24.0 to 20.0 percent, thus, monthly average inflation was in May -0.2 percent and on an annual basis,consumer prices decreased by 0.7 percent (Table 2.1).

In January-May 2016, the economy of the Russian Federation decreased on average by 1.0 percent. During the same period, industrial output increased by 0.1 percent, construction activity decerased by 4.6 percent and retail trade by 5.7 percent. The unemployment rate decreased to 5.6 percent in May 2016 from 5.9 percent recorded during the previous month. Consumer prices increased in June on average by 0.4 percent compared to the previous month. At the same time, annual inflation was 7.5 percent in June, increasing by 0.2 percentage points compared to the previous month. Given that the utilities tariffs increased since July 1, 2016 on average by 4.0 percent, of which in Moscow on average by 7.5 percent and the minimum wage increased by 21.0 percent from RUB 6204 to 7500, most likely, inflation will continue to be prominent in the next months (Table 2.1).

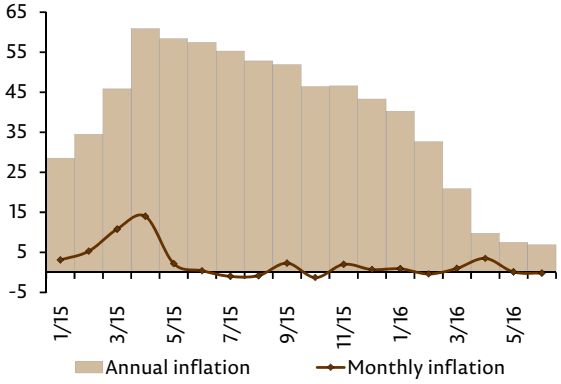
In the first quarter of 2016, the economy of Ukraine decreased by 0.7 percent compared to the previous quarter and increased by 0.1 percent compared with the first quarter of 2015. In January-May 2016, on an annual basis, industrial output increased by 3.1 percent, construction production increased by 9.3 percent, while agricultural output decreased by 1.3 percent caused by the drought of this agricultural year. At the same time, on an annual basis, exports decreased in the first five months of this year by 13.9 percent and imports by 6.6 percent. In June 2016, consumer prices decreased by 0.2 percent in monthly terms and increased by 6.9 percent in annual terms. The slowdown in prices growth is due to the annual base effect used in calculations and the stabilization of the Ukrainian hryvnia (Table 2.1).

Table 2.1: The evolution of GDP, CPI and IPI in the selected economies (%)

	GDP QI,16/ QIV,15 (s.a.)	GDP QI,16/ QI,15	IPI Jan-May16/ Jan-May15	CPI Jun16/ Jun15
USA	0.3	2.1*	-1.5*	1.0
Euro area	0.6	1.6	1.5*	0.1
Germany	0.7	1.3	1.0*	0.3
France	0.6	1.4	0.8*	0.1
Italy	0.3	0.8	1.2*	-0.3
Romania	1.5	4.3	1.4	-0.7
Russian Federation	-1.7	-1.2	0.1	7.5
Ukraine	-0.7	0.1	3.1	6.9

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

Chart 2.6: The evolution of consumer prices in Ukraine (%)



Source: State Statistics Service of Ukraine

Chapter 3

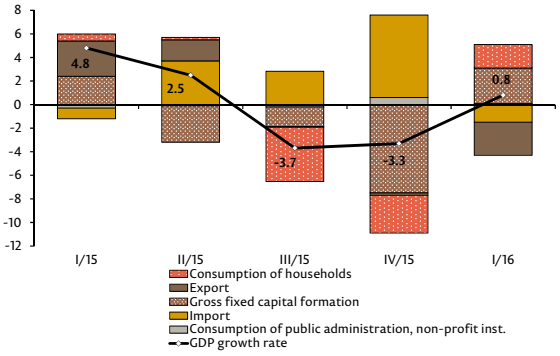
Economic developments

3.1 Demand and production

In the first quarter of 2016, the GDP annual dynamics turned positive, following the negative developments recorded in the second half of the previous year. However, the economic growth was modest, GDP was only by 0.8 percent higher than at the beginning of 2015, below its potential level. The positive evolution of GDP was due to domestic demand, while exports generated a negative impact on GDP dynamics. At the same time, gross value added related to services had in the reporting period higher influence on economic growth than that related to goods. Seasonally adjusted series show an increase of 1.7 percent of GDP compared with the fourth quarter of 2015.

Demand

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



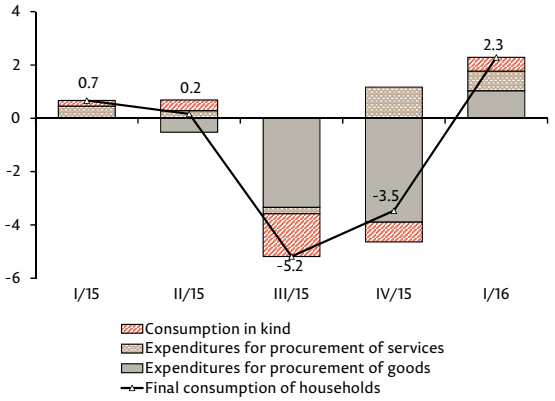
Source: NBS, NBM calculus

In the light of uses (Chart 3.1), the positive evolution of GDP in the first quarter of 2016 was due exclusively to domestic demand, both household consumption and investment generated positive contributions to the economy activity dynamics. However, the household consumption growth was minor. In the first quarter of 2016, it increased only by 2.3 percent, generating a contribution of 2.0 percentage points to annual rate formation of GDP. At the same time, the contribution from investments to GDP dynamics was determined by the positive impact of the component change in inventories, given that the gross fixed capital recorded a decrease of 3.6 percent compared to the same period of the previous year. These developments reflect the decrease in real terms of household disposable income and the high uncertainty from economic agents and population towards the economy further development. In the first quarter of 2016, final consumption of public administration decreased insignificantly (-0.4 percent) and had a negligible influence to GDP dynamics. At the same time, net external demand had a negative impact on economic activity in the first quarter of 2016. Exports, after having a negligible influence to GDP dynamics in the second half of the previous year, recorded a decrease of 5.6 percent compared to the first quarter of 2015, generating a significant negative impact, mainly due to the consequences of a modest agricultural production during the previous year. The economic activity dynamics was significantly offset at the beginning of the year by the increase in imports by 1.8 percent compared to the first quarter of 2015.

Household consumer demand

In the first quarter of 2016, the annual growth rate of household consumption turned positive, after two consecutive quarters when it recorded negative values. Thus, in the reporting period, the annual rate of final household consumption recorded a significant increase up to the level of 2.3 percent or by 5.8 percentage points higher than the previous quarter. Household consumption dynamics was determined by the increase in all main components. In this regard, in the first quarter of 2016, the expenditure for the procurement of goods increased by 2.2 percent, contributing to annual growth rate formation of final household consumption by 1.0 percentage points (Chart 3.2). The expenditure for the procurement of services was by 2.4 percent higher than the first quarter of 2015, contributing by 0.7 percentage points to final consumption dynamics. At the same time, consumption in kind increased by 4.4 percent compared to the beginning of the previous year, generating a positive contribution of 0.5 percentage points.

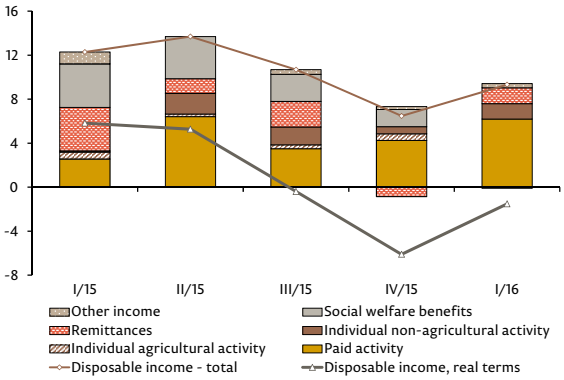
Chart 3.2: Components' contribution (p.p.) to the final consumption of households' growth (%)



Source: NBS, NBM calculus

In the first quarter of 2016, annual rate of household disposable income recorded a level of 9.3 percent, or by 2.8 personal disposable income higher than the fourth quarter of 2015, ending the downward trajectory of this indicator observed in the second half of the previous year (Chart 3.3). This dynamics of annual rate was due mainly to income from the subcomponents "employed activity", "remittances" and "personal non-agricultural activities", which have generated contributions of 6.2, 1.4 and, respectively, 1.4 percentage points to the annual rate formation. It should be mentioned that the contribution of "remittances" increased by 2.3 percentage points than the previous quarter and the contributions from "employed activity" and "personal non-agricultural activities" increased by 1.9 and 0.8 percentage points, respectively. The income of subcomponent "other income" generated a contribution of 0.4 percentage points to annual rate formation, while the income from "personal agricultural activities" remained unchanged. In the first quarter of 2016, annual growth rate of household disposal income in real terms recorded a level of -1.5 percent, by 4.6 percentage points higher than the fourth quarter of 2015.

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



Source: NBS, NBM calculus

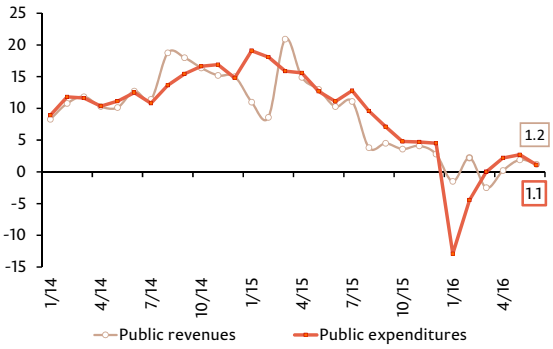
Public sector

Execution of national public budget

According to data provided by the Ministry of Finance, government revenues amounted to MDL 21031.3 million in the first six months of 2016, exceeding by 1.2 percent the revenues collected in the same period of 2015 (Chart 3.4). The major part of budget revenues has accrued on the account of tax-related revenues, which accounted for a share of 64.2 percent (MDL 13504.9 million). The compulsory insurance contributions and premiums accounted for 29.8 percent (MDL 6262.0 million), while the share of other income and grants accounted for 4.9 percent (MDL 1041.2 million) and 1.1 percent, respectively, (MDL 223.2 million) of total budget revenue.

Revenues administered by the State Tax Service accounted for 27.0 percent of total national public budget revenue and 37.2 percent – revenues administered by the Customs Service.

Chart 3.4: The dynamics of public revenues and expenditures (%, annual growth)



Source: Ministry of Finance

In the first six months of 2016, national public budget expenditures totalled MDL 21709.4 million, recording an increase of 1.1 percent compared to the same period of 2015. The social protection expenditure held the largest share (39.2 percent) of the total expenditures, education held 19.0 percent and health protection 11.7 percent. The state services of general interest and services in the economy held the share of 10.7 percent and 7.6 percent, respectively, while the public order and national security held 7.4 percent of expenditures, other areas enjoying a more modest funding.

In the first semester of 2016, national public budget execution resulted in a deficit in the amount of MDL 678.1 million. During the same period of 2015, national public budget execution resulted in a deficit of MDL 673.4 million. As of June 30, 2016, the general government accounts balances increased by MDL 676.7 million compared to January 1, 2016, accounting for MDL 3859.1 million.

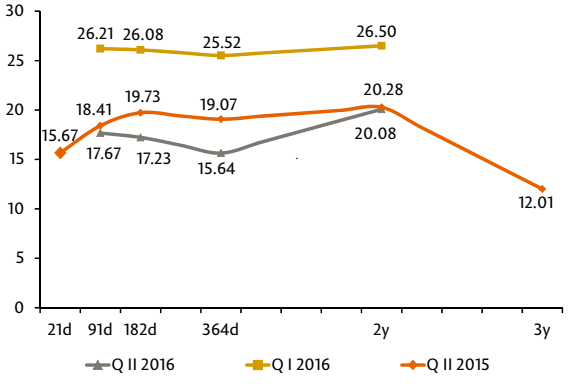
Government debt

As of June 30, 2016, the government debt balance of the Republic of Moldova was MDL 35596.4 million and consisted of external state debt in the proportion of 76.0 percent and domestic government debt – 24.0 percent. Compared to June 2015, the government debt increased by MDL 4371.6 million or by 14.0 percent, due to the increase of external debt (with a positive contribution of 9.4 percentage points) and internal government debt (with a positive contribution of 4.6 percentage points).

During January-June 2016, the balance of external government debt increased by about MDL 782.2 million or by about 3.0 percent, accounting at the end of June for MDL 27066.0 million. At the same time, the balance of external government debt in foreign currency amounted to USD 1362.2 million, recording an increase of USD 25.15 million or 1.88 percent compared to the beginning of the year. During the first six months of 2016, net external borrowing reached a positive value, accounting for about USD 6.30 million. At the same time, the U.S. dollar exchange rate fluctuation against other currencies reached positive values and accounted for USD 18.85 million. During the reporting period, external government debt service used financial means in the amount of MDL 133.84 million.

As of June 30, 2016, internal government debt accounted for MDL 8530.4 million, higher than in June 2015 by about 20.3 percent or by MDL 1439.7 million. During January-June 2016, the balance of internal government debt increased by MDL 1305.0 million, due to the increase of SS issuance on primary market of about 25.3 percent. Therefore, at the end of June 2016, internal debt constituted of SS issued on primary market (75.8 percent) and SS converted (24.2 percent).

Chart 3.5: SS yield curve (%)



Source: NBM

SS yield curve

In the second quarter of 2016, the volume of SS traded on the primary market amounted to MDL 3172.6 million, by 9.1 percent less than the previous quarter. The volume of SS released into circulation during the reporting period was by 2.2 percent higher than the volume initially announced by the Ministry of Finance. The ratio between the demand from participants in auctions and

supply from the issuing authority was 1.81 in the second quarter of 2016.

The average effective interest rate on treasury bills with a maturity of 91 days was 17.67 percent, the average interest rate being below the previous quarter by 8.5 percentage points. Treasury bills of 182 days were placed at an average effective rate of 17.23 percent, by 8.9 percentage points less than the first quarter of 2016, and those with a maturity of 364 days – 15.64 percent, by 9.9 percentage points less than the previous quarter (Chart 3.5). It should be mentioned that starting with December 2015, the auctions of treasury bills of 21 days were not conducted.

Government bonds with a maturity of 2 years were traded at an average effective rate of 20.08 percent, decreasing by 6.4 percentage points than the previous quarter. It should be mentioned that the Ministry of Finance has announced the cessation, on undefined term, of the placement of government bonds on primary market with a maturity of 3 years, starting with the second decade of August 2015.

The treasury bills with a maturity of 364 days held the largest share in the volume of SS in circulation during the reporting period, accounting for 39.1 percent of total transactions, followed by treasury bills of 182 days, with a share a 31.4 percent, while the share of treasury bills of 91 days was of 28.5 percent. The volume of government bonds with a maturity of 2 years was insignificant, accounting for 1.0 percent of total transactions.

Investment demand

In the first quarter of 2016, gross capital formation recorded a positive evolution, mainly as a result of the impact of the component change in inventories, while the gross fixed capital formation decreased by 3.6 percent compared to the first quarter of 2015. The decrease in gross fixed capital formation was determined by the dynamics of the components "construction" (-3.4 percent) and "machinery and equipment" (-5.8 percent).

Investment in long-term tangible assets recorded during this period a significant decrease (22.6 percent in annual terms).

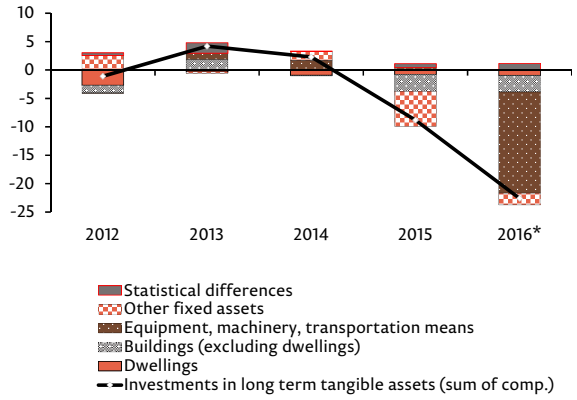
By types of fixed assets, all subcomponents contributed negatively (Chart 3.6), the most pronounced impact was generated by the component investments in tools, machines and means of transport, which recorded a decrease of 33.4 percent compared to the beginning of the previous year.

In terms of funding sources to achieve the investment process, the development of all subcomponents had a negative impact on the dynamics of investment in long-term tangible assets (Chart 3.7).

The state budget funding sources recorded the drastic decrease of 81.0 percent, being influenced by the delay of the state budget adoption for 2016.

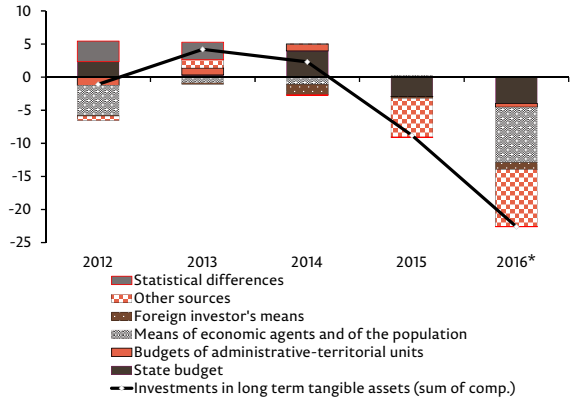
In the first quarter of 2016, the most important sources of investment financing are the economic agents' and households' own funds (79.0 percent), the value of which recorded a decrease of 12.0 percent compared to the first quarter of 2015, under the impact of the high financing costs and the diminution of real disposable income.

Chart 3.6: Contribution of fixed assets type (p.p.) to the annual dynamics of investment in long-term tangible assets (%)



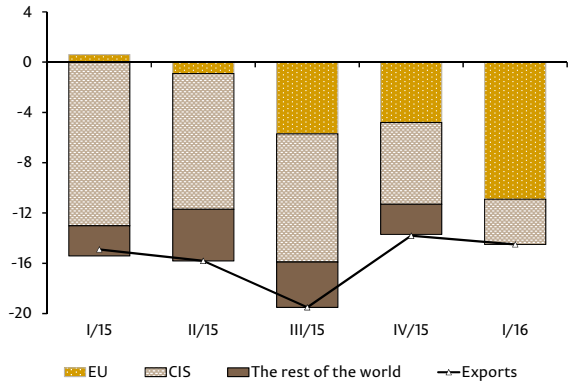
Source: NBS
*Q1

Chart 3.7: Contribution of funding sources (p.p.) to the annual dynamics of investment in long-term tangible assets (%)



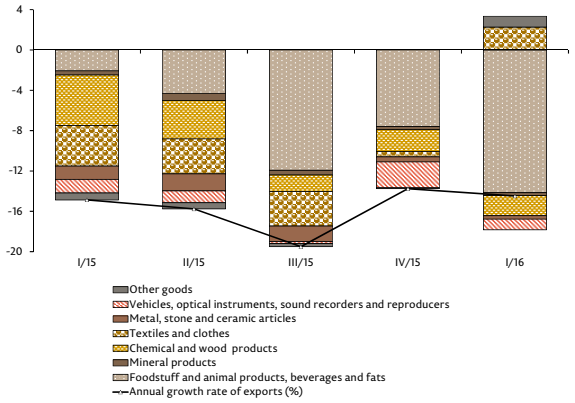
Source: NBS
*Q1

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



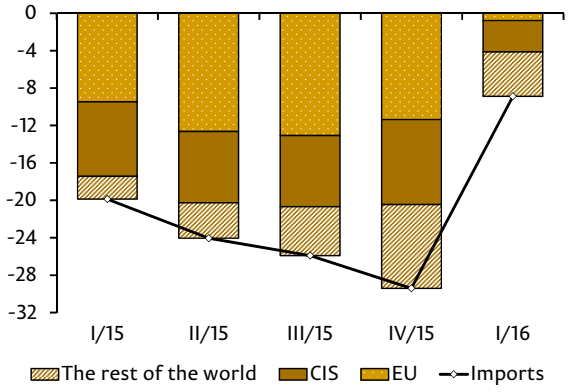
Source: NBS, NBM calculus

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



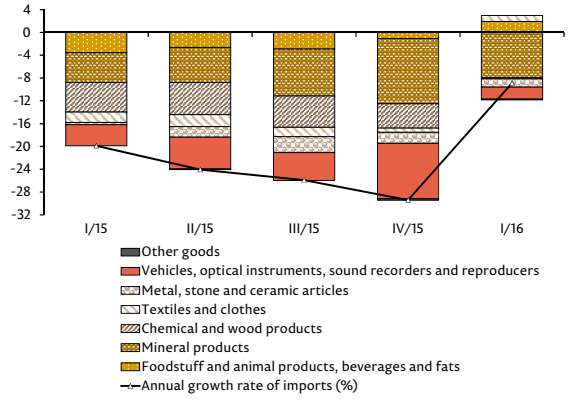
Source: NBS, NBM calculus

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

Net external demand[3]

In the first quarter of 2016, the annual growth rate of exports (expressed in U.S. dollars) recorded a level of -14.5 percent or by 0.7 percentage points lower compared to the fourth quarter of 2015. This development was determined mainly by more pronounced decrease of exports to EU, which decreased in the first quarter of 2016 by 15.4 percent in annual terms, generating a negative contribution of 10.9 percentage points or by 6.0 percentage points lower than the fourth quarter of 2015 (Chart 3.8). At the same time, exports to CIS countries decreased by 17.4 percent and generated a contribution of 3.6 percentage points. It should be mentioned that the exports to CIS countries recorded negative growth rates for the twelfth consecutive quarter, mainly due to the decrease in annual terms of the volume of exports to the Russian Federation. Exports to the countries classified as "Rest of the world" decreased only by 0.4 percent, generating a null contribution to annual rate formation.

By category of goods (Chart 3.9), it should be mentioned the significant decrease in exports of "foodstuff, products of the animal kingdom, beverages and fats" of 28.2 percent, generating the most negative contribution (-14.2 percentage points) to the annual growth rate formation of exports. The pronounced decrease in exports of agricultural products was determined by the pronounced decrease of agricultural sector in 2015. At the same time, the decrease in exports of "chemical and wood products", "vehicles, optical and sound recorders and reproducers" by 21.6 and 6.3 percent has also influenced the decrease in volume of exports, thus generating negative contributions of 2.0 and 1.0 percentage points, respectively. At the same time, the positive contribution from the group "textile and clothing" (Chart 3.9) was determined by the increase of 16.5 percent in volume of exported goods related to this group. It should be mentioned that the positive development of textile and clothing exports was also supported by the increase in the first three months of 2016 in the volume of industrial output in the sectors "manufacture of textile products" (23.4 percent), "manufacture of clothing articles" (35.5 percent) and "manufacture of footwear, tanning or working hides" (7.9 percent).

If during 2015, annual growth rate of imports was below the level -20.0 percent then in the first quarter of 2016, imports recorded a less pronounced decrease compared to the developments of previous year. In the first quarter of 2016, the annual rate of imports was -8.9 percent, by 20.5 percentage points more compared to the end of 2015. In the first quarter of 2016, the increase in annual rate of imports was supported by the slowdown of decreasing import rates of goods from all groups of countries (Chart 3.10). Thus, imports from CIS and countries classified as "Rest of the world" decreased only by 11.6 and 17.5 percent, contributing to the slowdown in annual rate of imports by 3.4 and 4.7 percentage points, respectively. At the same time, imports from EU decreased by 1.8 percent, generating a negative contribution of 0.8 percentage points to the formation of the annual growth rate of imports (Chart 3.10).

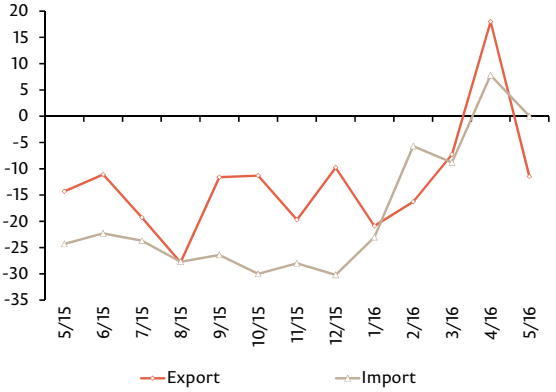
By groups of goods (Chart 3.11), the decrease in imports was mainly influenced by the negative evolution of components

[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.

"mineral products", "vehicles, optical and sound recorders and reproducers" and "articles of metal, stone or ceramics", which have generated negative contributions of 8.0, 2.1 and 1.4 percentage points, respectively. At the same time, the group "foodstuff, products of the animal kingdom, beverages and fats" and "textiles and clothing" generated positive contributions in the first quarter of 2016. It should be mentioned that the demand for food products was determined by the lack of a sufficient supply of these products on the market due to the agricultural sector contraction in 2015, while the demand for "textiles and clothing" was generated by the manufacturing relating to these branches and by the further reexport of these products.

Data on foreign trade of the Republic of Moldova for the first two months of the second quarter of 2016 show some significant changes in its dynamics. Thus, the annual growth rate of imports in April-May 2016 recorded the level of 3.9 percent, by 16.4 percentage points higher than the first quarter of 2016. At the same time, the annual growth rate of exports recorded the level of 3.3 percent or by 18.1 percentage points higher than the first quarter of 2016 (Chart 3.12). It should be mentioned that in the first five months of 2016, the exports of domestic goods decreased by 14.0 percent in annual terms and reexports increased by 5.5 percent, even that in 2015 the exports of domestic goods and reexports recorded negative growth rates compared to 2014.

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



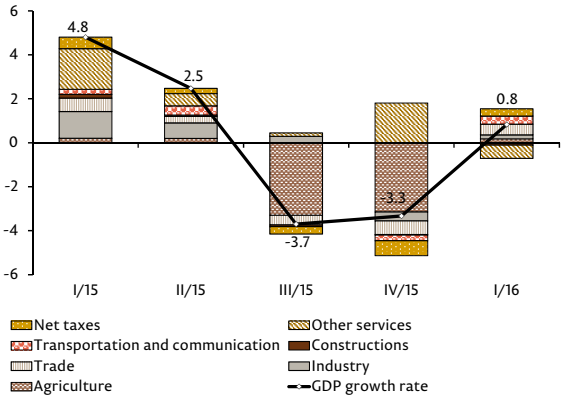
Source: NBS

Production

By categories of resources, the positive dynamics of GDP was determined by the increase of gross added value in all main economy sectors, except for that of the subcomponent "construction" and "other services" (Chart 3.13). Thus, the gross added value recorded increases in "agriculture" (5.1 percent), "trade" (3.5 percent), "transport and communication" (2.8 percent) and "industry" (1.1 percent). "Net taxes on products" component increased by 2.2 percent compared to the same period of 2015. It should be mentioned that the decrease of "other services" was generated mainly by the decrease of "financial and insurance activities" by 22.4 percent, which was determined by the unfavourable base effect (foreign exchange transactions in the first quarter of 2015, which contributed to the increase in annual terms of "Financial intermediation and insurance" by 36.9 percent in the first quarter of 2015).

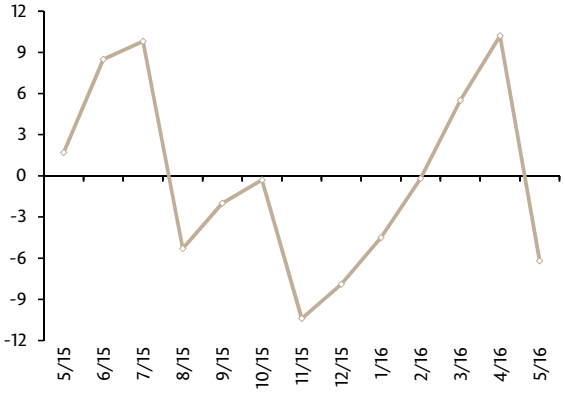
In the first two months of the second quarter of 2016, the annual growth rate of industrial production recorded an average level of 2.0 percent, by 1.7 percentage points higher than the first quarter of 2016 (Chart 3.14). This dynamic was driven mainly by the acceleration of the annual growth rate of the manufacturing (subcomponent with the largest share) from 1.5 percent in the first quarter of 2016 to 6.1 percent in the first two months of the second quarter of 2016. At the same time, the volume of production in the extractive industry and of the sector "production and supply of electricity and heating energy, gas, hot water and air conditioning" has decreased by -13.3 and -8.3 percentage points, respectively, reaching in the first two months of the second quarter of 2016 an average level of -26.7 and -12.8 percent, respectively.

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



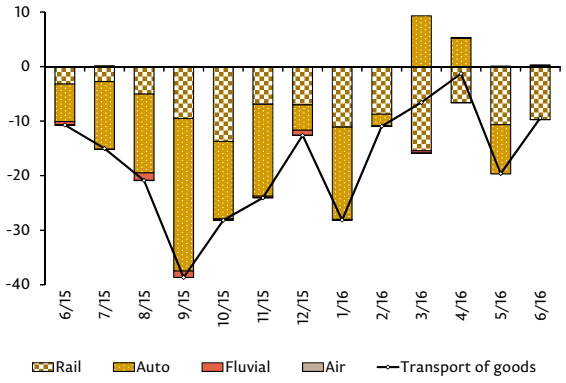
Source: NBS

Chart 3.14: Evolution in real terms of industry (%, versus the same month of the previous year)



Source: NBS

Chart 3.15: Evolution in real terms of goods transport (%, versus the same month of the previous year)

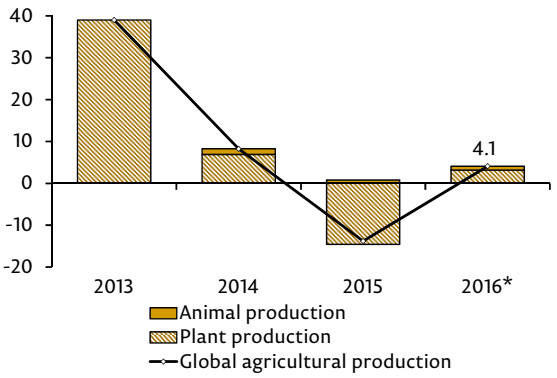


Source: NBS

Chart 3.16: Evolution of domestic trade (%, versus the same month of the previous year)

Source: NBS

Chart 3.17: Global agricultural production (%, versus the same period of the previous year)



Source: NBS
*Semester I

In the second quarter of 2016, the volume of transported goods recorded a more modest decrease in annual terms than at the beginning of this year, so their annual average rate constituted -10.1 percent during the reporting period, by 5.1 percentage points higher than the first quarter of 2015. This dynamic was determined mainly by lower negative contributions both from the annual dynamics of volume of goods transported by road and that transported by rail (Chart 3.15). At the same time, in January-June 2016, transport enterprises have transported goods by 12.0 percent less compared to the same period of 2015. 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 for April-May 2016 show a slight increase of the trade in goods, while the trade in services decreased (Chart 3.16). Thus, the turnover of the enterprises having retail trade as main activity recorded an average growth rate of 2.2 percent, by 6.3 percentage points higher compared to the first quarter of 2016. The turnover of the enterprises having services rendering as main activity recorded in the first two months of the second quarter of 2016 an average decrease of 2.5 percent, by 3.5 percentage points lower compared to the previous quarter.

Agricultural production

In the first half of 2016, the volume of global agricultural production increased by 4.1 percent compared to the same period of the previous year (Chart 3.17). This development was determined mainly by the increase in volume of vegetable sector by 21.5 percent, while as a result of a low share in this period, the impact on global agricultural production was modest (3.2 percentage points). At the same time, the volume of livestock production increased by 1.1 percent during the reporting period. The positive dynamics of the livestock sector was supported by the increase in "eggs" production by 13.3 percent. At the same time, the production of "milk" and "cattle and poultry" recorded during this period a decrease of 0.1 and 0.3 percent, respectively.

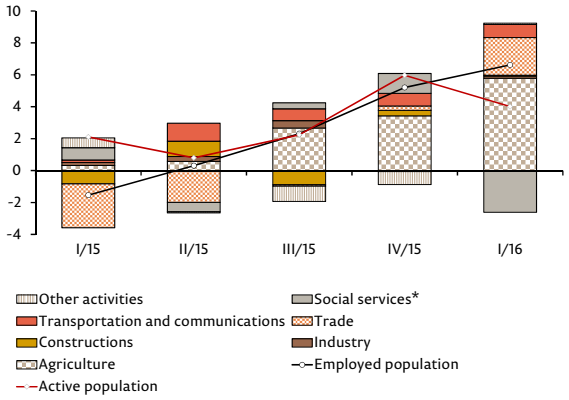
3.2 Labour market

In the first quarter of 2016, both the number of employed population and the number of economically active population increased compared to the same period of last year. At the same time, the unemployment rate decreased during the reporting period compared to the first quarter of 2015.

Workforce

In the first quarter of 2016, the number of economically active population increased by 4.0 percent than the same period of the previous year. At the same time, the annual growth rate of the number of employed population increased at the beginning of 2016 by 1.4 percentage points compared to the fourth quarter of 2015, reaching the level of 6.6 percent. Within the structure, according to the national economy's sectors, the increase in number of employed population was determined by the increase of the number of employed population in "agriculture", "trade" and "transport and communications" (Chart 3.18). At the same time, the number of the population employed in social services recorded a decrease, thus contributing to the slowdown in annual growth rate of employed population.

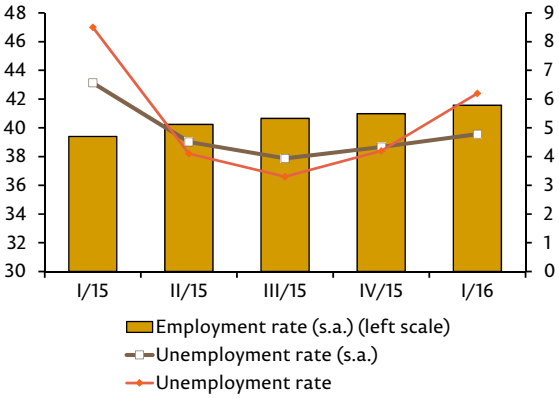
Chart 3.18: Annual growth rate of active and employed population (%) and its formation by national economy sectors (p.p.)



Source: NBS, NBM calculus
*Public administration, education, health and social care

Data on unemployment rate show a slight improvement of the labour market in the first quarter of 2016. Thus, the unemployed rate decreased from 8.5 percent in the first quarter of 2015 to 6.2 percent in the first quarter of 2016 (Chart 3.19). At the same time, the seasonally adjusted unemployment rate remained the same as the previous quarter, reaching the level of 4.8 percent. It should be mentioned that the seasonally adjusted employment rate recorded a positive tendency after a period of a year and a half. Thus, in the first quarter of 2016, it recorded the level of 41.6 percent or by 0.6 percentage points higher than the previous quarter (Chart 3.19).

Chart 3.19: Evolution of the unemployment and employment rate (%)

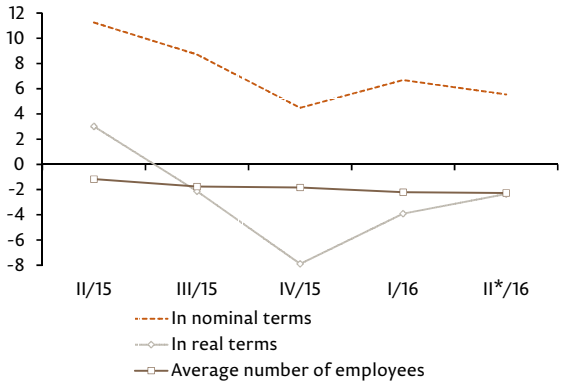


Source: NBS, NBM calculus

According to data provided by the ANOFM[4], the number of people laid off increased in first six months of 2016 by 57.3 percent compared to the same period of last year, while the number of vacancies increased by 11.0 percent.

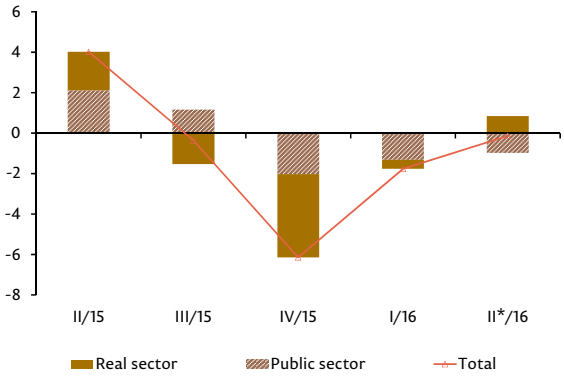
[4]National Agency for Employment.

Chart 3.20: Wage bill in economy and average number of employees (%, versus the same period of the previous year)



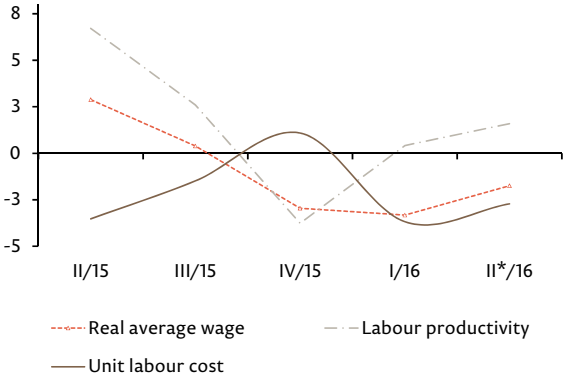
Source: NBS, NBM calculus
*April-May

Chart 3.21: Real contributions of economy sectors (p.p.) to earnings growth (%, versus the same period of the previous year)



Source: NBS, NBM calculus
*April-May

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



Source: NBS, NBM calculus
*April-May

Wages

In the first two months of the second quarter of 2016, wage bill in the economy increased by 5.5 percent compared to April-May 2015. In real terms, deflated by CPI, the wage bill decreased by 2.4 percent compared to the same period of last period. At the same time, the average number of employees at the level of national economy continued the downward trend, decreasing by 2.3 percent compared to the same period of last year (Chart 3.20).

During the reporting period, the average wage in the national economy increased by 8.0 percent compared to the same period of the previous year. Both the budgetary sector and the real sector of the economy registered an increase of the average wage by 4.6 and 9.3 percent, respectively, compared to the similar period of 2015. During this period, the annual average real wage growth in the economy was -0.1 percent, higher by 1.7 percentage points compared to the first quarter of 2016 (Chart 3.21). This dynamic was driven by the negative development of the average wage, in real terms, in budgetary sector (-3.2 percent), which has been offset practically by the positive dynamics of the real sector (1.1 percent).

The labour productivity in industry amounted to 1.6 percent, increasing by 1.2 percentage points than the first quarter of 2016. At the same time, the annual dynamics of the average real wage in industry was -1.7 percent, higher by 1.6 percentage points compared to the first quarter of 2016 (Chart 3.22). In this regard, the annual growth rate of the labour unit cost in industry increased by about 1.0 percentage points, remaining still negative and reaching the level of -2.7 percent.

3.3 External sector

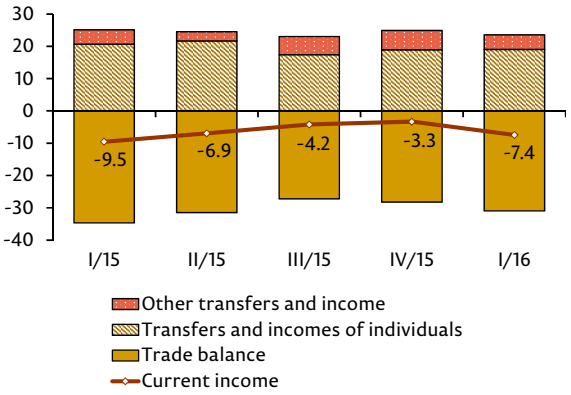
In the first quarter of 2016, the current account deficit[5] of the balance of payments increased, representing 7.4 percent as share to GDP, by 4.1 percentage points higher than the previous quarter (Chart 3.23). The increase in balance of payments deficit was caused by the increase in negative balance of the trade balance as a share to GDP. At the same time, the components with positive contribution, the transfers and income of individuals and other transfers and income recorded both increases and decreases. Thus, the component Other transfers and income decreased by 1.5 percentage points than the previous quarter, while the transfers and income of individuals increased by 0.1 percentage points as a share of GDP. In the first quarter of 2016, the trade balance deficit increased as a share of GDP by 2.7 percentage points than the previous quarter, reaching a level of 31.0 percent. This development was driven, on the one hand, by the increase of the share of imports to GDP by 3.0 percentage points, while on the other hand, by the increase of the share of exports by 0.2 percentage points.

During the reporting period, the export of goods and services increased as a share of GDP to the level of 44.9 percent (Chart 3.24). This development was driven by the increase of the share of non-food products exports by 2.0 percentage points, to the level of 17.9 percent in GDP, the share of exports of services increased by 0.6 percentage points, to the level of 14.0 percent in GDP, while the share of exports of agri-food products decreased by 2.4 percentage points (13.1 percent in GDP). Within the export structure, the non-food products prevailed and accounted for 39.8 percent, services constituted 31.1 percent, while agri-food products – 29.1 percent.

In the first quarter of 2016, the share of imports of goods and services as a share of GDP increased by 3.0 percentage points compared to the fourth quarter of 2015, reaching a level of 76.1 percent. It should be mentioned that all components: energy resources, agri-food products and services to GDP recorded higher values compared to the previous quarter. Thus, energy resources, services and agri-food products increased by 1.3, 1.2 and 0.9 percentage points, respectively. As a share of GDP, these components represented 10.7, 13.4 and 10.7 percent, respectively. At the same time, the share of non-food products decreased by 0.4 percentage points compared with the fourth quarter of 2015, representing 41.3 percent. Within the structure of imports, the share of non-food products constituted 54.3 percent, services – 17.6 percent, agri-food products and energy resources – by 14.1 percent, respectively.

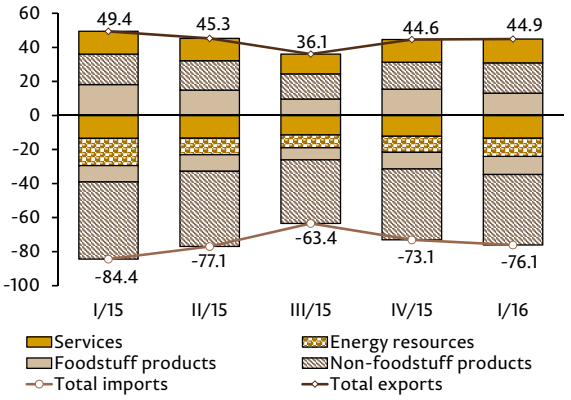
During the reporting period, exports reflected in the trade balance covered to a lesser extent the respective imports (58.9 percent) compared with the fourth quarter of 2015 (61.0 percent). At the same time, according to the NBS data for the first quarter of 2016,

Chart 3.23: Current account share in GDP (%)



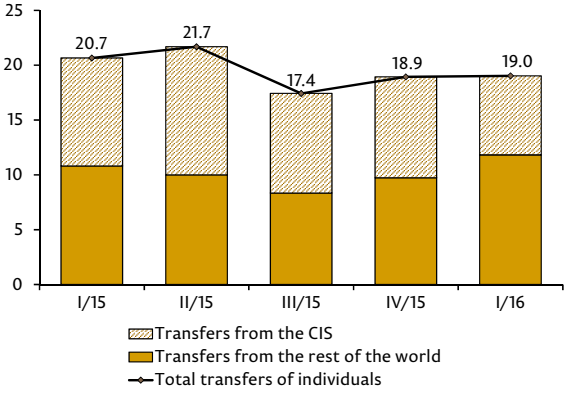
Source: NBM

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



Source: NBM

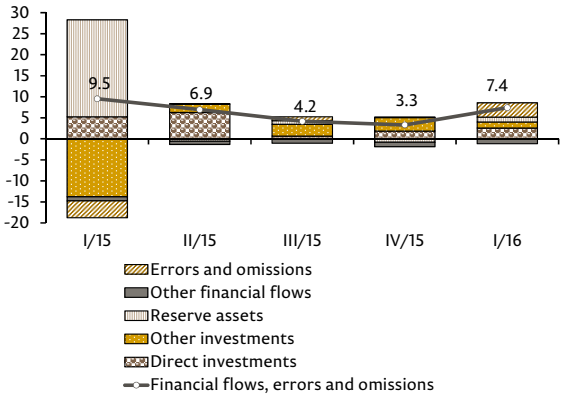
Chart 3.25: Share of transfers in GDP (%)



Source: NBM

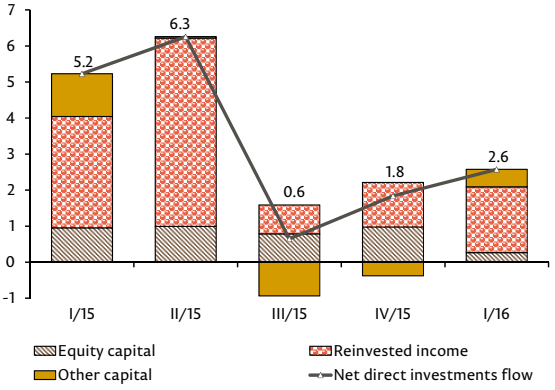
[5]For the analysis of the current account, the standard terminology according to IMF has not been used. The category Total transfers of individuals includes the compensation for work and remittances (current account items), the remaining items, except for those included in the trade balance, have been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

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



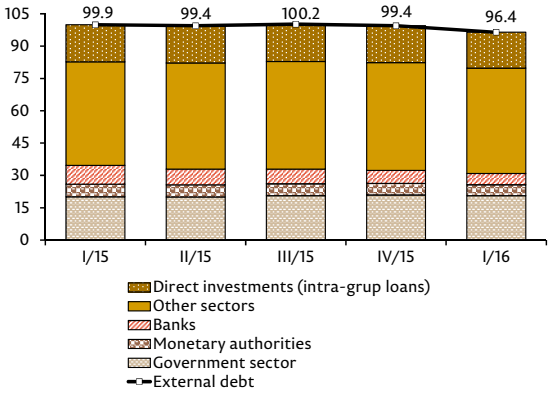
Source: NBM

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



Source: NBM

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



Source: NBM

the trading partners of the Republic of Moldova, such as Romania, Russian Federation, Ukraine, Germany, Italy, Turkey and Belarus have owned 53.4 percent of total commercial transactions carried out within export-import operations with goods and services.

In the first quarter of 2016, the share of transfers and income of individuals working abroad recorded a minor increase (of 0.1 percentage points) as a share of GDP compared to the previous quarter, thus reaching the level of 19.0 percent (Chart 3.25). The upward evolution of transfers was determined by the increase of transfers from the countries classified as the "Rest of the world"[6]. Thus, in the first quarter of 2016, the share of funds transferred from the countries classified as the "Rest of the world" was 11.8 percent in GDP, by 2.1 percentage points more than the fourth quarter of 2015, while the funds transferred from CIS countries accounted for 7.2 percent in GDP, by 2.0 percentage points less than the previous quarter. According to geographical distribution, the transfers from countries classified as "Rest of the World" accounted for 62.2 percent and from CIS countries – 37.8 percent during the reporting period.

In the first quarter of 2016, the share of financial flows in GDP was 7.4 percent or by 4.1 percentage points more compared to the fourth quarter of 2015. The revival of the financial flows movement was supported by the evolution of the components "direct investment", "reserve assets" and "errors and omissions", after recording a constant slowdown for three consecutive quarters. At the same time, the component "other investment" influenced the decrease of financial inflows (Chart 3.26).

It should be mentioned that a slight revival of the direct investment share in GDP was recorded in the first quarter of 2016, after the pronounced slowdown in the third quarter of 2015. Thus, it represented 2.6 percent or by 2.0 percentage points higher than the third quarter of 2015 or by 0.8 percentage points higher compared with the fourth quarter of 2015. This revival was supported by the increase in volume of direct investments in "other capital" and "reinvested income" (Chart 3.27). At the same time, the direct investments in equity capital as a share of GDP decreased in the first quarter of 2016. It represented 0.3 percent, by 0.7 percentage points lower compared to the previous quarter.

In the first quarter of 2016, the share of external debt in GDP recorded the level of 96.4 percent, by 3.0 percentage points lower than the previous quarter (Chart 3.28). It should be mentioned that the decrease of external debt as a share of GDP was determined by the decrease in external debt of all sectors compared to the end of 2015. However, these modifications did not contribute to significant change in the external debt structure. Thus, similarly to the previous periods, the economic agents held the largest share of 54.1 percent in total external debt, followed by government sector with a share of 25.7 percent and direct investment – 16.6 percent.

[6] It is referred to the transfers from all the countries of the world, except for the CIS member countries.

Chapter 4

Monetary Policy

4.1 Monetary Policy Instruments

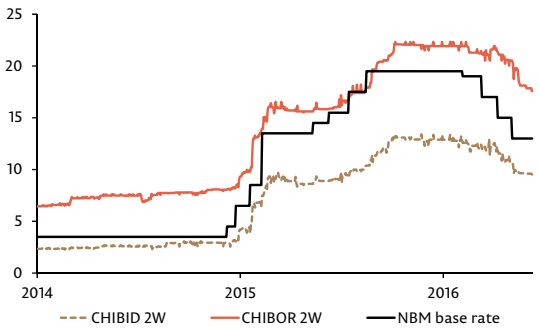
Interest rate policy

The monetary policy decisions adopted by the NBM during the second quarter of 2016 were based on the economic activity expected during the next eight quarters and the further mitigation perspective of inflationary pressures for the monetary policy on relevant horizon. Thus, during this period, the downward trend of monetary policy interest rate has strengthened and the NBM decreased successively (in April and May) its level by 2.0 percentage points, up to 13.0 percent annually.

CHIBOR 2W yield curve recorded a more accentuated decline compared to the previous quarter, reacting actively to the successive decreases of the monetary policy interest rate. Although, their levels continued to be higher compared to the level of the monetary policy rate. Thus, the CHIBOR 2W quotation recorded at the end of month was lower compared to the last day of the previous quarter (-3.62 percentage points), representing 17.56 percent, which is above the upper limit of the NBM policy rate corridor (Chart 4.1).

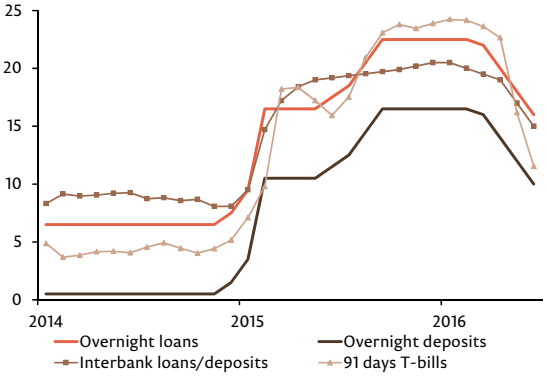
The monthly interest rate on state securities (SS) of 91 days continued to accentuate its downward trend under the combined influence both of the base rate decrease operated by the NBM and the gradual amplification of investors' supply for this type of placements. The sharpest decline was recorded in May, after that its decreasing rate has lost from its intensity. The average value of interest rate on SS of 91 days in the last month of the quarter decreased compared to March by 12.08 percentage points, representing 11.54 percent annually. The interbank monetary market yields have also decreased, the monthly average rate recording 15.00 percent annually in June (-5.50 percentage points compared to January) (Chart 4.2).

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



Source: NBM

Chart 4.2: The monthly evolution of interest rates corridor (%)

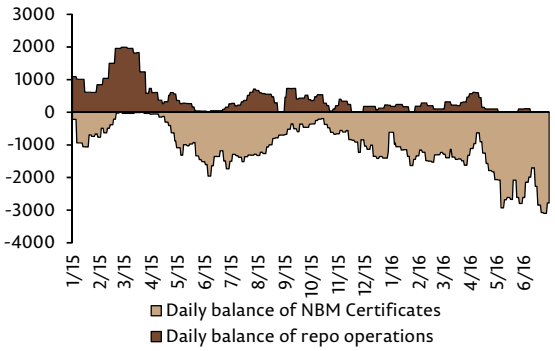


Source: NBM

Open market operations

During the second quarter of 2016, the NBM liquidity management manner continued to be in line with the concrete operating conditions of the financial market. The net debtor position of the central bank to the banking system has strengthened throughout the quarter, the NBM monetary policy operations were intended mainly to reduce the excess liquidity

Chart 4.3: The daily balance of money market operations (MDL, million)



Source: NBM

that has been achieved primarily through the NBM Certificates issuance operations. Liquidity needs of banks were met through repo operations (Chart 4.3).

NBM Certificates-selling operations

The NBM carried out 26 auctions within 14 days with the announcement of the maximum interest rate equivalent to the NBM base rate, the banks bids being fully awarded. Overall, in the second quarter of 2016, the weighted average rate of sterilization operations constituted 14.75 percent annually.

The balance of NBM Certificates at the end of the reporting quarter and their quarterly average amounted to MDL 2781.3 million and MDL 2111.9 million respectively, recording a higher level by MDL 1459.7 million and MDL 800.0 million respectively, compared to the first quarter of 2016.

Repo operations

The 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. At the end of the reporting period, the balance of repo operations was null compared to the level of MDL 565.0 million recorded at the end of the first quarter of 2016.

Lending activity

As of June 30, 2016, the credit indebtedness of the licensed banks to National Bank of Moldova constituted MDL 13430.0 million, represented by emergency outstanding loans in the amount of MDL 13429.4 million and loans granted in 1996-2002 for crediting the construction of housing cooperatives in the amount of MDL 0.6 million.

During the second quarter of 2016, the banks under the liquidation process Banca de Economii S.A., BC "BANCA SOCIALĂ" S.A. and B.C. "UNIBANK" S.A. have partially reimbursed the emergency loans granted by the National Bank, amounting to MDL 137.8 million. Thus, at the beginning of 2016, the amount of outstanding emergency loans decreased by MDL 259.8 million.

Standing facilities

During the second quarter of 2016, the banks used daily the overnight deposit facility, the credit facility being requested only in May and June by a restrained number of banks to satisfy the liquidity demand for short-term.

The total volume of overnight deposits with the NBM amounted in the analysed quarter to MDL 36057.0 million, representing a daily average of MDL 537.4 million, by about 42.3 percent higher compared to the previous quarter.

The amount of overnight credits granted during this period was MDL 71.4 million, the daily average balance being of MDL 2.1 million.

It should be mentioned that concomitantly with the base rate, the interest rates on the NBM standing facilities decreased twice during the second quarter of 2016 by about 2.0 percentage points, in April and May 2016. Thus, at the end of the second quarter of 2016, the interest rate of overnight deposit facility was 10.0 percent annually and the overnight credit facility was 16.0 percent annually.

Required reserves

In the second quarter of 2016, along with open market operations, the required reserves mechanism continued to exercise the monetary control and liquidity management function in the banking system.

During this quarter, the ratio of required reserves attracted in MDL and non-convertible currency was maintained at the level of 35.0 percent of the base, while the ratio of required reserves attracted in freely convertible currency at the level of 14.0 percent of the base.

Required reserves in MDL maintained by banks in June, 08- July 07, 2016 amounted to MDL 9223.9 million, higher to those maintained the previous quarter (March 08- April 07, 2016) by MDL 735.2 million (about 8.7 percent). The increase of required reserves in MDL was determined by the increase of financial means attracted by banks.

Required reserves in FCC maintained by banks with the NBM constituted USD 63.6 million and EUR 99.5 million as of June 30, 2016. Compared to March 31, 2016, the required reserves both in USD and EUR decreased by 3.9 percent and 1.7 percent, respectively. The decrease of required reserves in FCC was determined by the deposits migration process from foreign currency to Moldovan leu.

Interbank money market

In the second quarter of 2016, the volume of transactions on interbank money market amounted to MDL 137.3 million, credit/deposit transactions accounting for 92.5 percent.

In the second quarter of 2016, the interbank market of credits/deposits continued to be passive. Although, the volume of transactions increased compared to the previous quarter, it remained insignificant, while the number of participants- limited.

Thus, overnight deposit transactions have been recorded on interbank market of credits/deposits in April and June, the total volume accounting for MDL 127.0 million.

The interest average rate pursued in the reporting quarter the trend of monetary policy rates, recording decreasing values, from 19.0 percent annually in April to 15.0 percent annually in June 2016.

Thus, the weighted average interest rate decreased compared to the previous quarter by 2.9 percentage points, accounting for 17.60 percent annually.

Secondary market of state securities

The quarterly turnover of the secondary market of state securities amounted to MDL 11.6 million, increasing by MDL 4.5 million compared to the previous period.

The bank-client transactions prevailed in total transactions recorded, constituting 73.3 percent of total transactions.

Average quarterly return for the selling-buying operations on the secondary market of state securities equalled to 18.24 percent, decreasing by 6.46 percentage points compared to the previous quarter, the weighted average term of maturity recording the same level.

Intervention on the domestic foreign exchange market

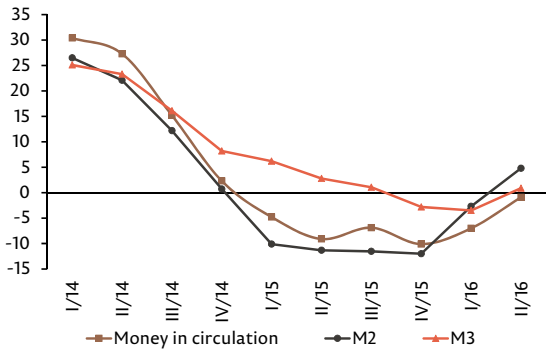
NBM intervened in the domestic foreign exchange market in April-June 2016, as a purchaser of foreign currency.

During the reporting period, the volume of NBM transactions carried out on the interbank foreign exchange market against MDL, at currency date, was USD 177.0 million[7], of which the purchasing transactions from local banks in the amount of USD 176.24 million and currency conversions with the World Bank institutions (International Bank for Reconstruction and Development and International Development Association) in the amount of USD 0.76 million.

It should be mentioned that the NBM has not carried out swap operations during the reporting period.

4.2 Dynamics of monetary indicators

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



Source: NBM

In the second quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 4.8 percent for M2 (by 7.5 percentage points higher than in the first quarter of 2016) and 0.9 percent for M3 (by 4.4 percentage points higher than the previous quarter) (Chart 4.4).

Money supply

The analysis of monetary aggregates in the medium term shows that inflationary pressures associated with money supply do not exist at the moment. During the second quarter of 2016, the broad money supply recorded an annual average increase of 0.9 percent, due to the increase of deposits in MDL and slowdown in downward trend of money in circulation, concomitantly with the negative influence of the decrease of deposits in foreign currency.

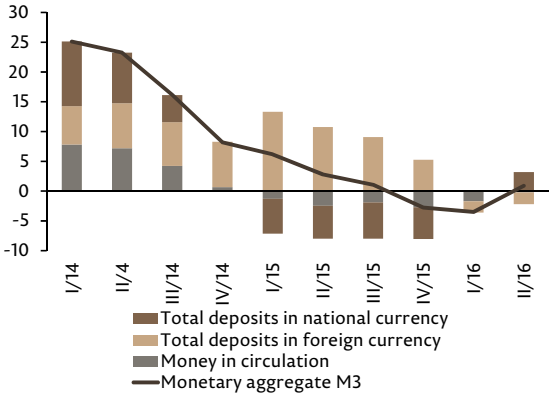
[7] Including the purchases of foreign currency from the banks under liquidation process in the amount of USD 1.49 million (of which USD 0.94 million represent the equivalent of EUR 0.83 million).

Thus, the average increase of 0.9 percent included the result of the increase of 3.2 percentage points in the balance of deposits in MDL, the effect of the decrease in money in circulation of minus 0.2 percentage points, while the balance of deposits in foreign currency decreased the growth rate of M3 by 2.0 percentage points (Chart 4.5).

At the same time, the structure of money supply M3 recorded changes as compared to the first quarter of 2016. The quarterly average share of deposits in national currency increased by 2.0 percentage points compared to the previous quarter and equalled to 39.5 percent. The share of deposits in foreign currency decreased by 2.4 percentage points, amounting to 36.8 percent, while the share of money in circulation increased by 0.5 percentage points, reaching the value of 23.7 percent as quarterly average.

The balance of deposits in national currency decreased in annual terms on average by 8.5 percentage points in the second quarter of 2016 compared to the previous quarter, the average growth rate recording the value of 8.6 percent during the reporting period. Deposits in foreign currency have evolved in the opposite direction, recording an average decrease of 5.2 percent annually, by 0.6 percentage points less compared to the previous quarter. The growth rate of the total balance of deposits increased during this period on average by 3.9 percentage points compared to the first quarter of 2016, recording an annual average growth rate of 1.5 percent.

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



Source: NBM

Lending market

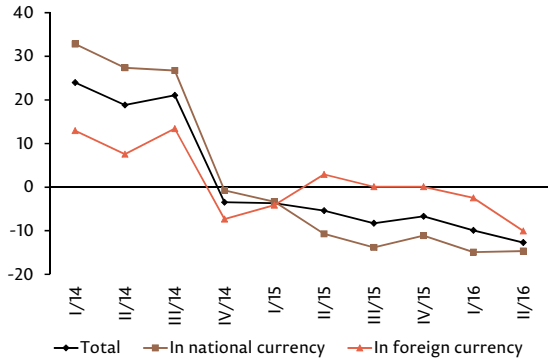
In April-June 2016, the balance of credits recorded a downward trend, falling at the end of the quarter to the value of MDL 36343.5 million, decreasing by 12.7 percent compared to the end of June 2015 (Chart 4.6).

In terms of currency structure, the annual negative dynamics of loans balance was mostly due to the decrease of loans both in national currency and foreign currency. In total loan portfolio, the loans granted in national currency held a share of 56.3 percent, while those granted in foreign currency held the share of 43.7 percent (Chart 4.7).

At the end of June 2016, the balance of loans in MDL granted by licensed banks from the Republic of Moldova amounted to MDL 20468.9 million, decreasing by 14.7 percent compared to the end of June 2015.

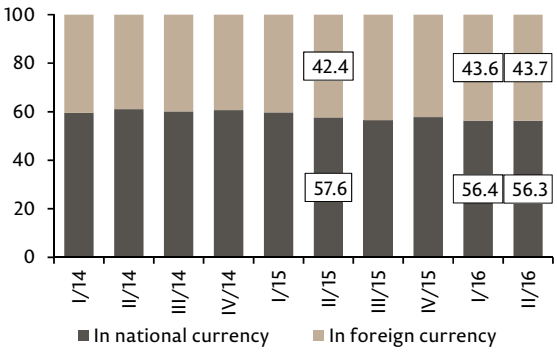
During the second quarter of 2016, the development of loans balance in MDL was generated by the decrease in volume of loans granted to legal entities of 18.6 percent, accounting for MDL 13633.3 million (with a share of 66.6 percent of the total loans in MDL), and by the decrease in volume of loans granted to individuals of 5.7 percent annually, accounting for MDL 6835.7 million (with a share of 33.4 percent of total loans in MDL).

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



Source: NBM

Chart 4.7: The shares of loans balance (%)



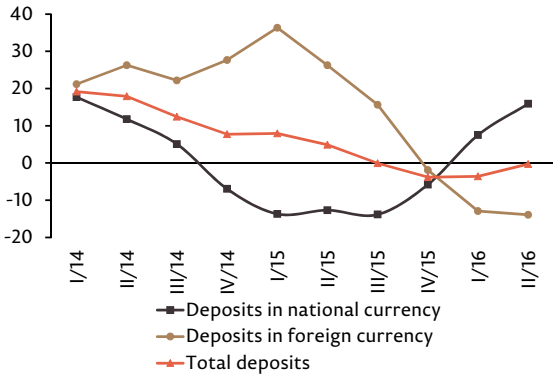
Source: NBM

The evolution of credits in foreign currency recorded during the second quarter of 2016 a decrease in annual terms of 10.0 percent compared to the end of the second quarter of 2015, reaching the level of MDL 15874.6 million. The downward trend of loans in foreign currency, recalculated in MDL, was driven largely by the development of loans granted to legal entities (with a share of 98.0 percent of total loans in foreign currency), which constituted MDL 15564.0 million on June 30, 2016 and by 10.2 percent lower compared to the end of the second quarter of 2015. The decrease pace of loans in foreign currency granted to individuals was more moderate by 1.5 percent compared to the end of June 2015.

The trade sector held the largest share in the structure of loan portfolio by sectors. At the end of the reporting quarter, this sector recorded an annual decrease of 24.7 percent for the loans granted in national currency and by 17.1 percent for loans in foreign currency. The share of credits targeted to this sector was 23.2 percent in national currency (-3.1 percentage points than in June 2015) and 37.6 percent in foreign currency (-3.2 percentage points than in June 2015).

Deposit market

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



Source: NBM

During the second quarter of 2016, the total balance of deposits attracted by banking system in annual terms slowed down its downward trend. Thus, the total balance of deposits accounted at the end of June 2016 for MDL 32127.9 million, recording an annual growth rate of -0.3 percent, compared to 4.9 percent in June 2015.

The negative dynamics of the balance of deposits was only influenced by the downward trend of the component in foreign currency compared to the same period of the previous year. The annual growth rate of deposits in foreign currency decreased to -13.9 percent annually, compared to the growth rate of 26.3 percent annually in June 2015. In turn, the annual growth rate of deposits in national currency recorded an increase of 15.9 percent annually, increasing by 28.6 percentage points compared to the second quarter of 2015 (Chart 4.8).

The balance of deposits in national currency increased up to MDL 17041.6 million. During the second quarter of 2016, the upward trend of deposits in MDL was determined by the evolution of placements attracted from individuals, the balance of which increased up to MDL 15348.6 (90.1 percent of total portfolio of deposits in national currency). Deposits attracted in MDL from legal entities recorded a negative annual growth rate of 0.3 percent, their share in the last 12 months decreased by 1.6 percentage points, reaching the level of 9.9 percent of total deposit portfolio.

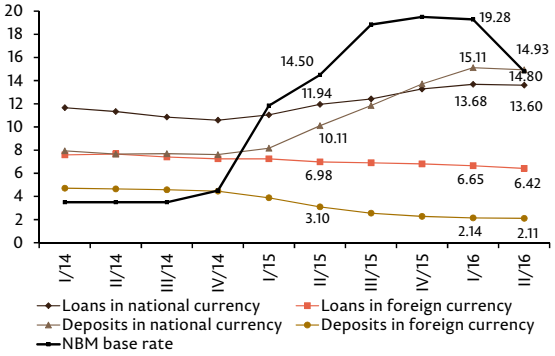
The annual dynamics of deposits in foreign currency recorded a decline of 13.9 percent, reaching the level of MDL 15086.3 million. This decrease occurred on the account of deposits attracted from legal entities (with a share of 12.8 percent of total deposits in foreign currency) and from individuals (87.2 percent of total deposits attracted in foreign currency). At the end of the second quarter of 2016, the deposits attracted from legal entities recorded an annual decrease of 28.8 percent, accounting for MDL 1930.5 million, while those attracted from individuals decreased by 11.1 percent, amounting to MDL 13155.8 million.

Interest rates

Base rate

In the second quarter of 2016, there were held two meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions. Following the assessment of the balance of internal and external risks, to which the economy of the Republic of Moldova could be subject and inflation outlook in the short and medium term, the Executive Board of the National Bank of Moldova decided at each meeting to decrease the base rate applied on main monetary policy operations by 2.0 percentage points. Thus, at the meeting of April 28, 2016, the base rate was decreased from 17.0 percent (level set at the meeting of March 31, 2016) to 15.0 percent annually and at the meeting of May 26, 2016, from 15.0 to 13.0 percent annually (Chart 4.9). These decisions, as a result of the inflation return to downward trend and the gradual normalisation of the monetary policy conduct, supported by the expectations related to the fast decrease of inflation rate, aimed to promote a monetary climate able to leverage the lending and savings, along with further adaptation of domestic economic environment to the volatility and uncertainty related to external macroeconomic situation, with the aim to anchor the inflation expectations, decrease and keep inflation close to the target of 5.0 percent on medium term, with a possible deviation of ± 1.5 percentage points.

Chart 4.9: The average interest rates (%)



Source: NBM

Interest rate of credits

During the second quarter of 2016, the average interest rates on balance of credits granted by licenced banks ceased their upward trend and their average amounted to 13.60 percent for the credits in national currency (-0.08 percentage points compared to the first quarter of 2016) and 6.42 percent for the credits in foreign currency (-0.23 percentage points compared to the first quarter of 2016). This change shows the start of the transmission mechanism effect of the consecutive base rate decreases applied on main monetary policy operations, approved by the Executive Board of the National Bank of Moldova. At the same time, the annual average interest rate on balance of loans in national currency increased by 1.66 percentage points, while the average annual interest rate on loans in foreign currency decreased by 0.56 percentage points from the second quarter of 2015 (Chart 4.9).

The decrease of the average interest rate on balance of loans in national currency was caused by the decrease of the average interest rate on loans granted to legal entities, which decreased by 0.21 percentage points compared to the first quarter and recorded the level of 13.20 percent. The annual average interest rate for loans in MDL granted to individuals reached in the second quarter of 2016 the level of 14.39 percent, increasing by 0.14 percentage points compared to the previous quarter.

During the second quarter of 2016, the cost of loans in foreign currency decreased due to the downward development both of the interest rates on loans granted to legal entities (by 0.24 percentage points, up to the level of 6.38 percent annually) and the interest

rates of loans granted to individuals (by 0.13 percentage points, up to the level of 8.16 percent annually).

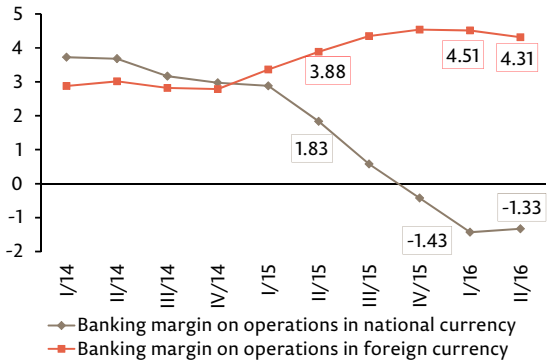
Interest rate of deposits

Given the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, the average interest rates on balance of deposits ceased its upward trend.

The average interest rate of deposits in MDL amounted to 14.93 percent, lower by 0.18 percentage points than the previous quarter and higher by 4.82 percentage points than the second quarter of 2015 (Chart 4.9). The evolution of the average interest rates for placements in MDL was influenced by the decrease of the average interest rates for deposits from legal entities up to the level of 10.22 percent (-1.04 percentage points than the previous quarter), while from individuals up to 15.44 percent (-0.09 percentage points than the previous quarter).

The interest rate of deposits in foreign currency amounted to an average of 2.11 percent during the reporting period, decreasing by 0.03 percentage points compared to the previous quarter and by 0.99 percentage points compared to the second quarter of 2015. The quarterly decrease was influenced by the decrease of the average interest rates for deposits attracted from legal entities by 0.18 percentage points, up to 1.95 percent annually. The average interest rate on deposits in foreign currency from individuals maintained the average level of the previous quarter. During the last 12 months, the interests calculated for the deposits in foreign currency recorded decreases both for the deposits from individuals and legal entities, by 0.79 percentage points and 1.0 percentage points, respectively.

Chart 4.10: The evolution of banking margin (p.p.)



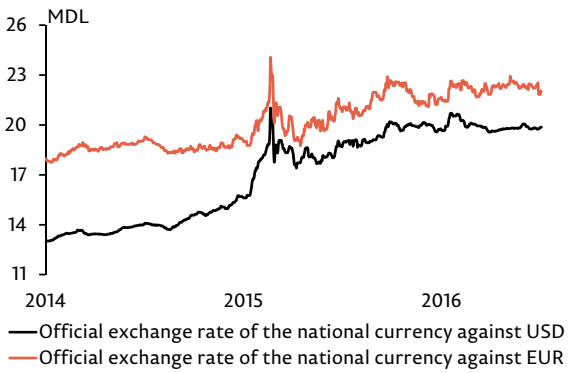
Source: NBM

Banking margin

The banking margin (the difference between the average interest rates on loans and deposits) related to the operations in national currency recorded a slight upward trend in the second quarter of 2016, reaching a level of -1.33 percentage points, by 0.1 percentage points more compared to the previous quarter (Chart 4.10). During the second quarter of 2016, the cost of deposits attracted in national currency had a considerable impact on bank margin in national currency, which exceeded significantly the cost of loans granted, reflecting the increased needs for resources in national currency of the banking system.

Evolution of banking margin for operations in foreign currency recorded a downward trend, constituting 4.31 percent, by 0.2 percentage points less compared to the first quarter of 2016, mainly driven by a more pronounced reduction during the reporting period of the interest rate on deposits in foreign currency.

Chart 4.11: The fluctuations of the official exchange rate of MDL



Source: NBM

Nominal exchange rate and real effective rate

In the second quarter of 2016, the official nominal exchange rate of national currency recorded a downward trend against USD, increasing by 1.2 percent at the end of the quarter, while against EUR recorded an opposite evolution, decreasing by 0.9 percent compared to the end of the previous quarter (Chart 4.11).

The average official exchange rate of national currency against USD recorded in the second quarter of 2016 an appreciation of 1.4 percent, while against EUR recorded a depreciation of 1.0 percent compared to the levels of these indicators in the first quarter of 2016.

The real effective exchange rate of the national currency (REER) depreciated by 3.3 percent in the second quarter of 2016. The majority of trading partners of the Republic of Moldova contributed to the REER depreciation (except for China and Poland), while the most significant contributions were made by Russia - 1.64 percentage points, Ukraine - 1.09 percentage points, Belarus - 0.22 percentage points etc. (Chart 4.14).

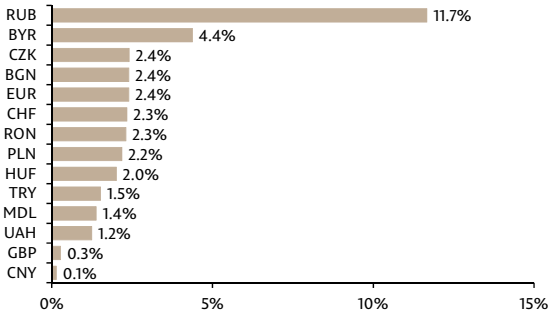
In the second quarter of 2016, under the conditions of a net oversupply of foreign currency from individuals against the net foreign currency needs of the economic agents, NBM intervened in purchasing the oversupply of foreign currency in order to strengthen the official reserve assets and to decrease the effect of the significant exchange rate appreciation.

During the second quarter of 2016, the net supply of foreign currency from individuals continued to increase up to USD 535.8 million or by 29.2 percent compared to the previous quarter. Net supply, disaggregated by currencies, increased in all three major currencies. Thus, the net supply of U.S. dollar recorded the highest increase (of 46.0 percent), followed by the net supply of EUR (of 24.0 percent) and Russian ruble (of 19.3 percent). In addition to the seasonal developments specific to this period (such as the intensification of money transfers from abroad in favour of individuals compared to the first months of the year), the currency supply increase from individuals was also determined by the conversions made by them at the expense of financial means kept in the form of savings. In this regard, the balances of current accounts and deposit accounts of individuals decreased during the second quarter of 2016 by USD 14.3 million[8].

Referring to the net currency sales to legal entities, its volume decreased to USD 381.0 million in the second quarter of 2016 (by 6.1 percent compared to the first quarter of 2016), due to the currency supply increase at a faster pace from economic agents compared to currency demand generated by them. Respectively, amid the increase in revenue from the export of goods and services[9], the currency supply from legal entities increased by about 35.0 percent than the first quarter of 2016 compared to a more modest increase of currency sales made by domestic banks to economic agents (by 13.0 percent). It should be mentioned that the currency demand from the importators of energy resources decreased by 33.6 percent or by USD 66.1 million than the first quarter of 2016.

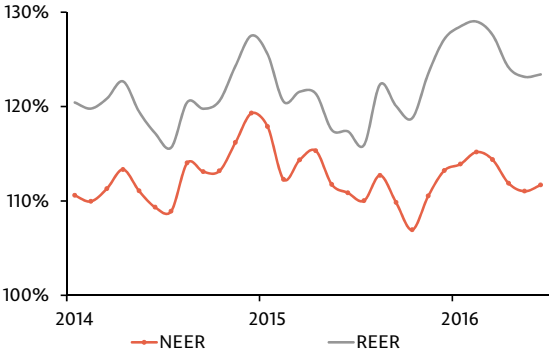
In these circumstances, an oversupply of foreign currency of USD 154.9 million occurred on domestic foreign exchange market and the coverage of net demand by net supply represented 140.6 percent (compared to 102.2 percent in the first quarter of 2016 and 106.0 percent in the second quarter of 2015 (Chart 4.16).

Chart 4.12: The evolution of currencies in the region and currencies of the major trading partners of the Republic of Moldova against the U.S. dollar (Q II 2016), Q I 2016=100%



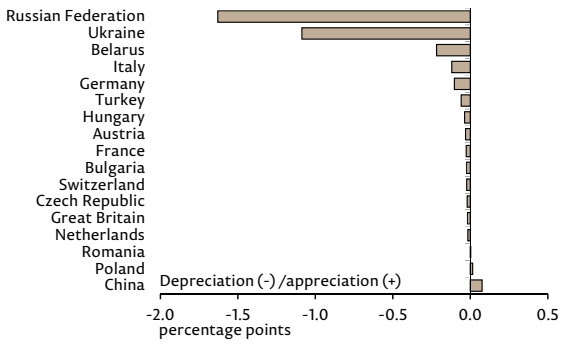
Source: NBM

Chart 4.13: The dynamics of nominal effective exchange rate (NEER) and real effective exchange rate (REER) of MDL calculated based on the major trading partners weights (Dec.2000=100%)



Source: NBM

Chart 4.14: The contribution of the major trading partners of the Republic of Moldova to the real effective exchange rate modification in the second quarter of 2016

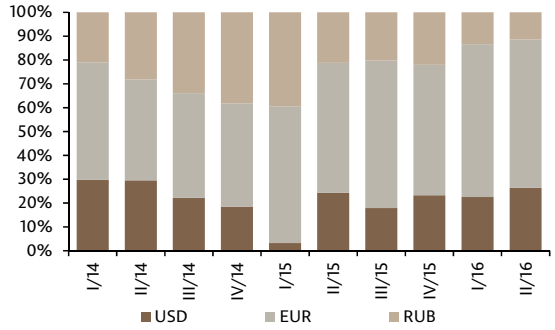


Source: NBM

[8]At constant exchange rate.

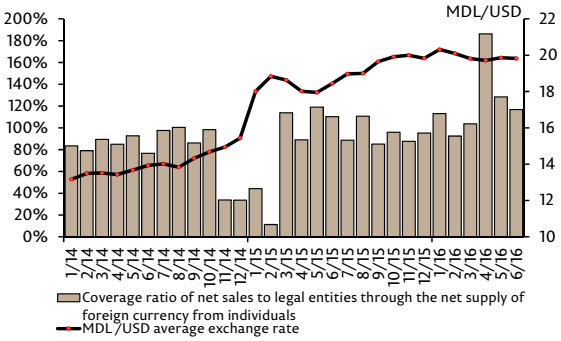
[9]By 20.0 percent compared to April-May 2015 and by 44.2 percent compared to the first two months of the first quarter of 2016.

Chart 4.15: The foreign currency structure of net foreign currency supply (foreign currencies are recalculated in USD at an average constant exchange rate)



Source: NBM

Chart 4.16: The coverage rate of net sales by the net supply and the dynamics of the official exchange rate



Source: NBM

These developments have created the necessary conditions to the NBM to make purchasing interventions of USD 176.3 million[10].

As regarding the monthly developments recorded on domestic foreign exchange market and relating to Moldovan leu exchange rate dynamics, it was found that in April 2016 (Easter holiday period), net currency supply from individuals reached high levels - of USD 202.2 million (maximum level starting with August 2014), while net currency demand from economic agents recorded a modest level (USD 108.6 million), mainly due to the intensification of currency supply from exporters of agricultural products. In these circumstances, a currency oversupply of USD 93.7 million occurred on domestic foreign exchange market and the NBM intervened by purchasing USD 108.1 million. Amid these developments, in April 2016, the Moldovan leu exchange rate recorded a moderate depreciation trend and increased at the end of the month by 0.7 percent against USD, while in average values it appreciated by 0.6 percent compared to the exchange rate recorded in March.

In May 2016, the national currency depreciated against USD, both in average values - by 0.8 percent and as per end of month - 1.2 percent compared to the levels of these indicators of the previous month. More accentuated trends of depreciation were recorded in the second half of May, when the foreign currency demand from economic agents increased temporary, in particular from electricity suppliers. In general terms, the currency oversupply recorded a lower level in May 2016 - of USD 38.1 million, which, similarly to April, was entirely absorbed by the NBM (USD 47.5 million) for monetary policy purposes.

In the first half of June 2016, the national currency exchange rate against USD reversed its trajectory towards appreciation, stabilising in the second half of the month. Respectively, both the average exchange rate of Moldovan leu against U.S. dollar and the exchange rate at the end of month recorded an appreciation of 0.2 percent and 0.7 percent, respectively, compared to these indicators registered in May 2016. The Moldovan leu appreciated due to the coverage of net currency demand from legal entities (USD 138.1 million) by the net currency supply from individuals (USD 161.3 million), which exceeded the unit value (116.8 percent).

The NBM carried out lower purchasing interventions during this month - USD 20.7 million based on the decrease in currency oversupply on domestic foreign exchange market up to USD 23.1 million.

In April 2016, the exchange rate of national currency depreciated stronger against EUR, both in average values (by 1.6 percent) and as per end of April - by 0.9 percent, as a result of appreciation of the European single currency against U.S. dollar on external markets. The EUR appreciation was determined by more prudent declarations of the Federal Open Market Committee (FOMC) regarding the increase of the refinancing rate in 2016, which mitigated the USD global demand. The European single currency also continued to appreciate against USD at the beginning of May, based on some positive data related to the economic growth in euro area (published for the first quarter of 2016).

[10] Of which USD 2.1 million – interventions made with Banca de Economii S.A., BC "BANCA SOCIALĂ" S.A. and B.C. "UNIBANK" S.A. that are under liquidation process since October 2015.

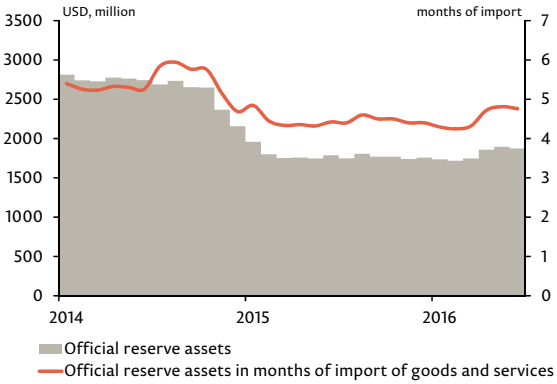
However, since the second half of May and until the end of the quarter, EUR was exposed to some pressures of depreciation amid the Brexit referendum scheduled for June 23, 2016 (which resulted in the UK citizens' vote to leave the EU). Thus, Moldovan leu appreciated against EUR until the end of the second quarter of 2016 by 1.8 percent compared to the end of April.

Official reserve assets

Referring to official reserve assets, at the end of the second quarter of 2016, their level increased by USD 128.3 million or by 7.3 percent compared to the end of the first quarter of 2016, up to USD 1874.6 million (Chart 4.17), mainly due to the foreign currency purchasing interventions carried out by the NBM. As regarding the external financial assistance, there were recorded reduced disbursements from external donors during the second quarter of 2016. Thus, the World Bank institutions IBRD and IDA offered financial means in the amount of USD 2.0 million, of which loans within the Competitiveness enhancement project II (USD 1.0 million) and loans for state budget support (USD 0.8 million). The International Fund for Agricultural Development offered financial means in the amount of USD 1.1 million within the Inclusive Rural Economic and Climate Resilience Programme and Rural Financial Services Programme, while the Austrian Development Agency offered grants within more investment projects in the amount of USD 1.1 million (equivalent of EUR 1.0 million) etc.

As at the end of the second quarter of 2016, the official reserve assets continued to ensure a sufficient level of coverage of the imports of goods and services (4.8 months of import[11]).

Chart 4.17: The evolution of official reserve assets expressed in months of import of goods and services



Source: NBM

[11]Calculated based on the import of goods and services forecast for 2016.

Chapter 5

Medium-term inflation forecasting

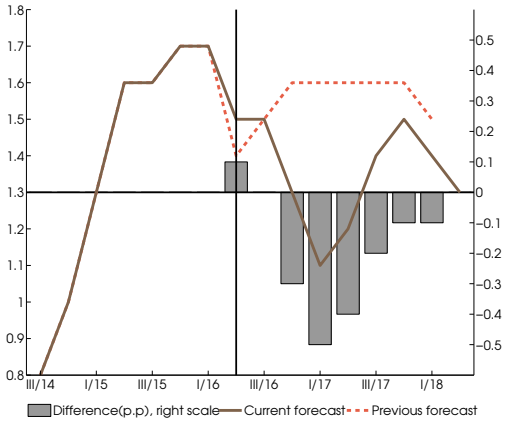
5.1 External assumptions of the forecast

Table 5.1: The expected evolution of external variables (annual average)

	2016	2017
Economic growth in the euro area (%)	1.5	1.3
Economic growth in the Russian Federation (%)	-0.9	1.2
Annual inflation in the euro area (%)	0.3	1.3
Annual inflation in the Russian Federation (%)	7.4	6.1
USD/EUR	1.11	1.09
RUB/USD	67.8	65.7
Urals brand oil prices (USD/barrel)	41.4	48.6
International food prices growth (%)	-3.9	4.0

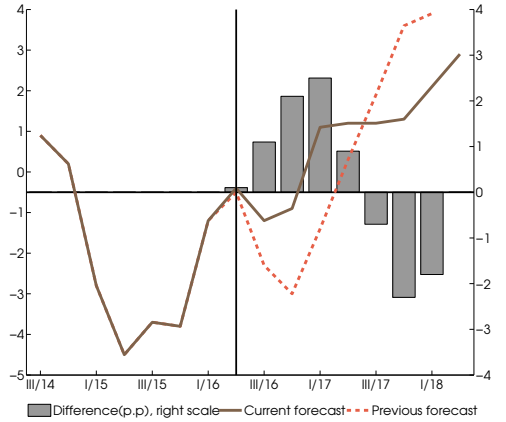
Source: NBM assumptions based on Consensus Economics data and futures quotations

Chart 5.1: The evolutionary scenario of GDP annual growth rate in the euro area (%)



Source: Eurostat, NBM assumptions based on Consensus Economics data

Chart 5.2: The evolutionary scenario of GDP annual growth rate in the Russian Federation (%)



Source: Russian Federal State Statistics Service, NBM assumptions based on Consensus Economics data

In the second quarter of 2016, there were several events of global significance that have defined the trajectory of external variables related to the medium-term inflation forecast. As some significant shocks caused insignificant volatility, external variables projection for 2016 has not essentially changed compared with the previous round of forecasts. However, there were projected more risks for 2017, which are also reflected in new values of external variables. According to the current round of forecasting, the assumptions regarding the evolution of the external environment (Table 5.1) continues to reflect mainly disinflationary pressures.

Thanks to the quantitative easing programme by the European Central Bank, in the first months of this year, the euro area economy recorded a steady recovery. At the same time, risks related to the UK referendum outcome seemed insignificant, which further fuel hopes on euro area economic growth this year. De facto, the referendum results denote the beginning of a new era for the European Union or the euro area and the UK. The negotiations for the separation will begin in the near future, which will jeopardize the economic boom of recent months in both economies. Another factor that tips negatively the balance in euro area is the financial risks related to non-performing bank loans. Thus, the new round of forecasting for 2016 maintains the level of 1.5 percent for the economic growth of the euro area. In 2017, it is anticipated a slowdown in the economic activity in the euro area, the gross domestic product will increase by an average of 1.3 percent, by 0.3 percentage points less than in the previous round of forecasting (Chart 5.1).

Stabilizing oil prices and reducing the risk of their further reduction led the most specialized organizations to revise upwardly the forecasts on the evolution of the Russian economy. Thus, the current round of forecasting anticipates a 0.9 percent decrease of Russian GDP in 2016 and a 1.2 percent increase in 2017. For comparison, the previous round of forecasting anticipated a decrease of 1.5 percent for 2016 and an increase of 1.1 percent for 2017.

It should be mentioned that the bilateral relations between the Russian Federation and Turkey were resumed at the end of June 2016, including economic ones, but mutual sanctions between the Russian Federation and the European Union are still maintained (Chart 5.2).

Inflationary conditions in the euro area have not changed significantly in recent months. As a result, the current round of forecasting maintains the average annual inflation for 2016 at the level of 0.3 percent. For 2017, it is anticipated that consumer prices in the euro area will increase on average by 1.3 percent, by 0.1 percentage points less than in the previous round of forecasting. It should be mentioned that inflationary pressures in the euro area generated by rising oil prices are balanced by disinflationary pressures, due to reduced economic activity and weak consumer demand (Chart 5.3).

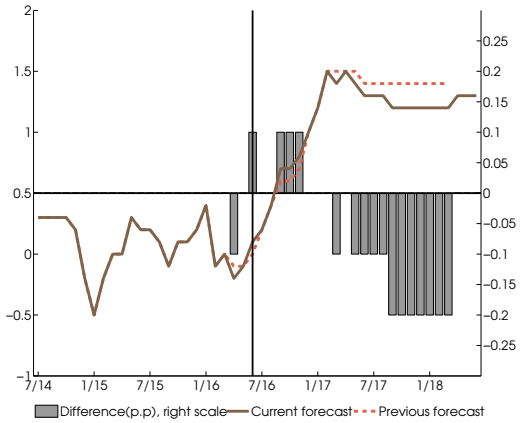
In the Russian Federation, the inflationary pressures are also cooling, due to the appreciation of the Russian ruble, the stagnation of economic activity and reducing macroeconomic risks. Thus, the new round of forecasting anticipates an increase in consumer prices in the Russian Federation on average by 7.4 percent in 2016 and by 6.1 percent in 2017, by 0.7 and 1.0 percentage points less than in the previous round of forecasting (Chart 5.4).

In recent weeks, the European single currency recorded a consistent stability, which determined that in the current round of forecasting, the annual average parity of 1.11 USD/EUR to be maintained for 2016. Given the quantification of the risk that UK might leave the EU and the impact on both economies, it is anticipated that the average annual parity of USD/EUR for 2017 will be 1.09, compared to 1.10 anticipated in the second round of forecasting (Chart 5.5).

In the second quarter of 2016, the Russian ruble appreciated on average by 11.7 percent against the U.S. dollar, which causes the current round of forecasting to project a value of 67.8 RUB/USD for 2016, compared to 71.2 RUB/USD in the previous round of forecasting. Assuming further stability in oil price and Russian ruble, it is anticipated that the Russian ruble will record an annual average of 65.7 RUB/USD in 2017 (Chart 5.6).

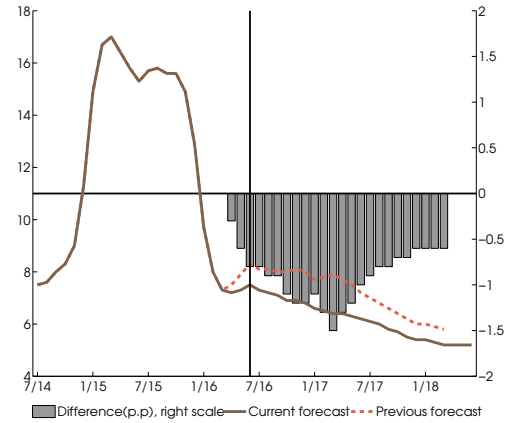
In the second quarter of 2016, the oil price grew on average by 36.5 percent, due to a faster increase in oil demand than in its supply. According to the current round of forecasting, the average price of Urals brand oil will reach the value of 41.4 USD/barrel in 2016 and 48.6 USD/barrel in 2017 (Chart 5.7). International food prices will decrease on average by 3.9 percent in 2016 and will increase on average by 4.0 percent in 2017 (Chart 5.8).

Chart 5.3: The evolutionary scenario of annual inflation in the euro area (%)



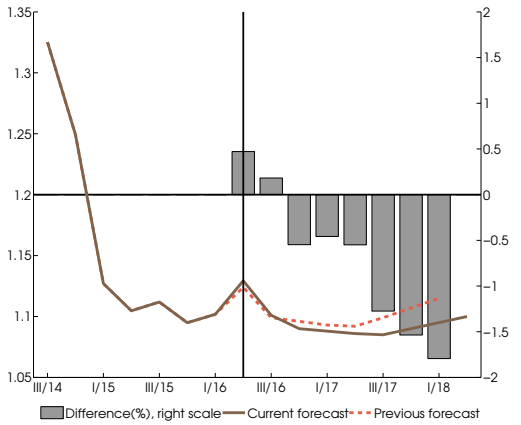
Source: Eurostat, NBM assumptions based on Consensus Economics data

Chart 5.4: The evolutionary scenario of annual inflation in the Russian Federation (%)



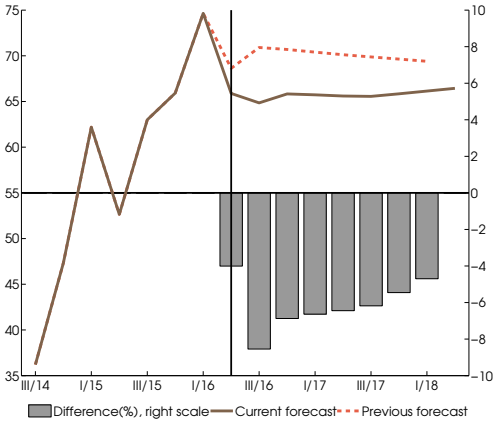
Source: Russian Federal State Statistics Service, NBM assumptions based on Consensus Economics data

Chart 5.5: The evolutionary scenario of the USD/EUR exchange rate



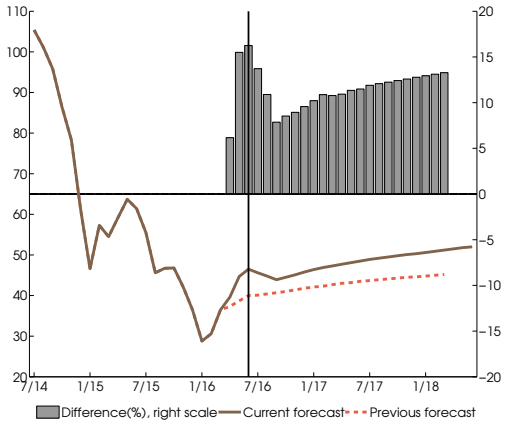
Source: ECB, NBM assumptions based on Consensus Economics data

Chart 5.6: The evolutionary scenario of the RUB/USD exchange rate



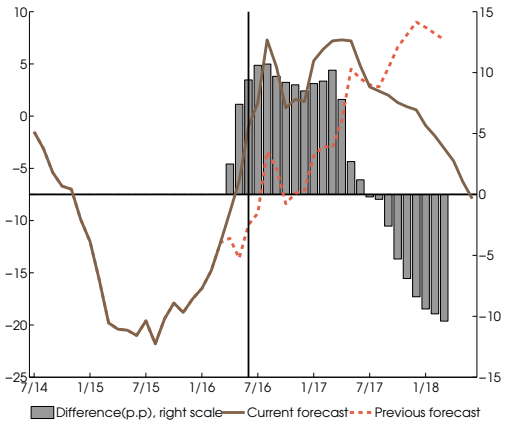
Source: Central Bank of the Russian Federation, NBM assumptions based on Consensus Economics data

Chart 5.7: The evolutionary scenario of the Urals brand oil prices (USD/barrel)



Source: Ministry of Economic Development of the Russian Federation, NBM assumptions based on futures quotations

Chart 5.8: The evolutionary scenario of the annual growth rate of world food prices (%)



Source: FAO, NBM assumptions based on futures quotations

Assumptions on regulated prices

The evolution of tariffs in the inflation forecasting horizon provides for an adjustment in electricity tariff by 10.7 percent at the beginning of 2017 and by 4.0 percent at the beginning of 2018 to cover the financial deviations recorded in the previous periods.

At the same time, this provides for an increase of 10.0 percent in centralised heating tariff in the third quarter of 2016.

According to the estimations, the increase in Internet tariff operated by S.A. Moldtelecom in July 2016 will generate an impact of 0.5 percentage points on the component "telecommunications" of the regulated prices.

According to the projection, medicines prices will continue to generate positive contributions to the dynamics of regulated prices until the end of the current year, as a result of pressures accumulated from the foreign exchange evolution in the last year. Subsequently, these pressures are expected to lose from intensity.

The assumptions about possible increases in tariffs were included in the medium-term inflation projection. Given that the 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.

5.2 Medium-term inflation forecasting

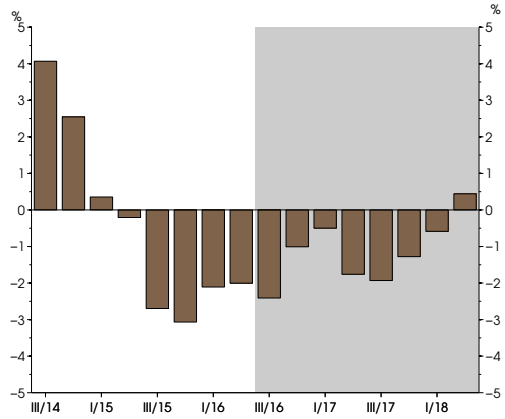
Aggregate demand

The current round of forecasts anticipates a continuation of the negative dynamics of the output gap for the entire forecasting horizon. It will recover slowly, but will continue to be negative, turning positive only towards the end of the forecasting horizon. Compared to the previous round of forecasting, the estimated aggregate demand was reconfigured. The evolution of the economic activity mainly below its potential, on medium-term, will determine disinflationary pressures from domestic demand, although more moderate compared to the previous forecast.

External demand will continue to record negative values throughout the forecast horizon and therefore will have a restrictive impact on domestic economic activity. Aggregate demand deficit will be also determined by the significant reduction of consumption financing sources. A negative contribution will be caused by lower remittances, following the low growth or even declines in economic activity in major source countries.

The recovery of agricultural production levels after last year's drought is a reason that will offset the negative effects of the external environment on domestic aggregate demand. The revision implied updating the historical GDP data and the reconfiguration of real monetary conditions influence. The real effective exchange rate will deviate significantly from its trend, producing a stimulating impact on the economy. The real interest rate will decrease rapidly, exerting stimulating influence.

Chart 5.9: The output gap forecast (%)



Source: NBS, NBM calculus

Inflation

According to the current projection, the annual average CPI inflation will record a downward trend until the end of 2016, being followed by a stabilization around the target. On average, this will reach the level of 6.7 percent in 2016 and 4.4 percent in 2017. According to the projection, the annual inflation rate will return to the inflation target range in the third quarter of 2016. The maximum level of 6.0 percent will be recorded in the second quarter of 2018 and the minimum level of 3.5 percent in the fourth quarter of 2016.

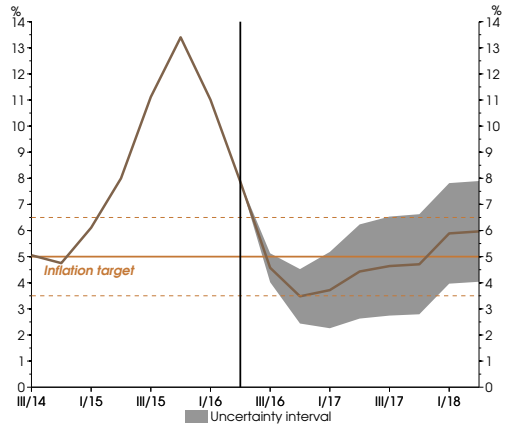
Core inflation contribution to the annual inflation rate will record a relatively constant trend until the end of the year. Thus, the average annual core inflation will reach 9.0 percent this year and 6.9 percent next year. Compared with the values recorded in the previous report, the average values of annual core inflation are similar for 2016 and higher by 0.6 percentage points for 2017.

Food prices contribution to the annual inflation rate will record a slight downward trend until the end of the first quarter of 2017, subsequently increasing slowly until the end of forecasting horizon. The maximum value of the annual rate of food prices will be recorded in the third quarter of 2016, representing 5.9 percent.

Inflation contribution to *fuel* for the current year will be negative, but for the rest of the forecasting horizon it will grow towards positive. Beginning with the first quarter of 2017, both the annual rate and the contribution of inflation to fuel will register positive values. The annual rate increase since the first quarter of 2017 will be possible, primarily as a result of growth, although moderate, but permanent of international oil prices.

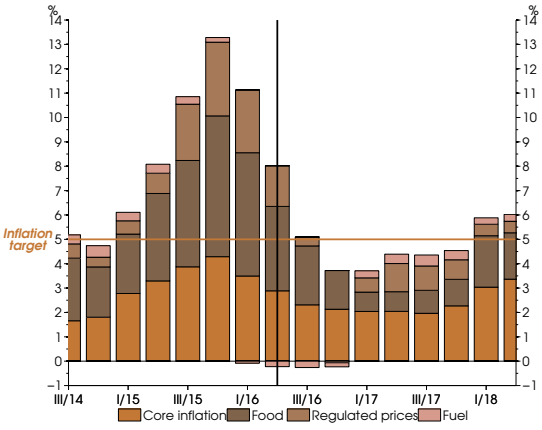
Regulated prices in the current round of forecasting will decelerate rapidly during the year, followed by a moderate acceleration in the first half of next year and a slight decrease in the annual rate by the end of the forecasting horizon.

Chart 5.10: The annual rate of total CPI forecast (%)



Source: NBS, NBM calculus

Chart 5.11: The CPI decomposition (p.p.)

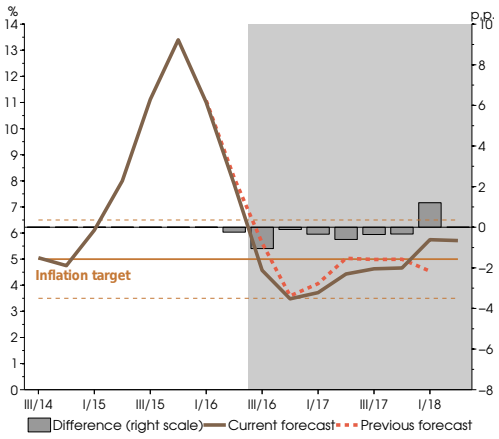


Source: NBS, NBM calculus

Comparison of current and previous forecasts

The projection of the *annual inflation rate*, according to the current round of forecasting, was reduced mainly throughout the forecasting horizon. During this year, the annual inflation rate will decrease on average by about 0.3 percentage points from the previous projection.

Chart 5.12: The annual rate of total CPI



Source: NBS, NBM calculus

In 2017, the annual inflation rate will decrease on average by about 0.4 percentage points compared to the projection in the Inflation Report no. 2, 2016.

This year, core inflation will record dynamics similar to those reflected in the previous report on inflation. Compared to the previous round of forecasting, core inflation will register greater dynamics. It is determined largely by a higher imported inflation compared with the previous report. In 2017, the annual inflation rate will increase on average by about 0.6 percentage points compared to the projection in the Inflation Report no. 2, 2016. The average annual values projected for the core inflation for this year are similar.

Compared to the previous scenario, *food prices* inflation will record a more pronounced downward trend, falling below the range of variation in the first quarter of 2017. Since the second quarter of 2017, the dynamics of inflation in food prices will record a slightly upward trend, largely due to international food prices. During this year, the annual inflation rate in food prices will decrease on average by about 0.7 percentage points from the previous projection. In 2017, the annual inflation rate of food prices will decrease on average by about 2.1 percentage points compared to the projection in the Inflation Report no. 2, 2016.

This year, the annual inflation rate in *regulated prices* will be lower by about 0.1 percentage points compared to projection included in the Inflation Report no.2, 2016. For 2017, the annual inflation rate in regulated prices will be on average by about 0.8 percentage points higher than previously projected.

Compared with the values recorded in the previous report, the average values of annual inflation of *fuel* are projected by 0.8 percentage points lower for 2016 and by 0.7 percentage points for 2017.

Risks and uncertainties

External environment

The results of the UK referendum of June 23, 2016 represent a great impetus to modify significantly the macroeconomic environment worldwide. After a strong post-referendum reaction of the financial markets where the turning items of indices of global importance have been set, the new associated uncertainties and risks generated some lull in global markets, market participants still waiting for new incentives.

Most forecasts for the global economy have been divided into ante and post-referendum forecasts, the significance of errors being justified. Thus, the new round of forecasting related to the Inflation Report no. 3, 2016 considered the following risks and uncertainties regarding the developments in the external environment with repercussions on the national economy, especially in the area of monetary policy:

- **Risks of subsequent events that will determine the USD/EUR evolution.** The events with influence on the evolution of the USD/EUR in the coming months are numerous. First, it should be mentioned the UK exit from the EU, which will continue to generate a major impact on the evolution of the European single currency and the pound sterling. In addition, Brexit increased the likelihood of ramping up the quantitative easing program by the ECB, which would create depreciation pressures on the euro. Periodically, it is possible that problems in the financial sector of the euro area and the unsatisfactory statistics to generate depreciation of the euro too. At the same time, more and more experts believe that after Brexit, the Federal Reserve will delay increasing interest rates, as a precautionary measure to increase risks to the global economy and maintain international competitiveness. Thus, it would be most prudent to follow carefully all movements in the foreign exchange markets, so that short-term shocks are anticipated as adequately as possible.

- **Adjustment of the EU economy after Brexit and the increase in issues related to NPL in the banking sector of the euro area.** Recently, more and more forecasting organisations revise downwardly the projections on the euro area economic growth. It is expected a period of two years with deadlines and negotiations between the European Union and the United Kingdom, which will reduce the resilience of both economies. Another risk is associated with the increasing problems related to NPL in the banking sector. The most precarious situation is recorded in Italy's banking sector, where NPL portfolio amounts to EUR 360 billion.

- **Ambiguous risks on oil price developments.** In recent months, oil prices have gradually increased, currently settling at around 50 USD/barrel. The main reduction factor in the last two years - oil surplus - continues to maintain, however, several technical and natural accidents that occurred periodically decreased the daily volume of oil production. Thus, according to OPEC, in the second quarter of 2016, oil demand grew faster than supply, which diminished the imbalance in the market. Despite the positivism on the oil market, it is to mention that the increase in global demand is quite uncertain in light of recent events, such as Brexit, deepening problems in the financial sector of the euro area and financial risks associated with China's economy, which could again generate reduction in oil prices.

- **Continuation of decadence of emerging economies.** The greatest risk is associated with the financial and fiscal sector of China, given the amount of NPL in the banking sector. Two other large emerging economies, the Russian Federation and Brazil, are in crisis, and many other emerging economies are in a precarious situation, due to the reorientation of investment capital to the advanced economies and the persistence of low raw material prices. The Turkish lira volatility affected the currencies of many other emerging economies, which has been caused by the recent attempt of a military coup in Turkey.

- **Heightened uncertainties regarding the evolution of international prices for raw materials and food products.** In recent months, the international prices of raw materials and food began selectively to record steady monthly increases, generated by the recovery of advanced economies, rising oil prices, the appreciation of the U.S. dollar and the stabilization of international trade. However, the severe slowdown in emerging economies growth, which resulted in a decline in global demand, is a risk to further increases in raw material prices. Also, this year's harvest in the northern hemisphere appears to be relatively satisfactory, which will lead to lower prices for certain crops. Another factor of uncertainty in raw material prices is generated by strong volatility in the foreign exchange markets, especially the U. S. dollar.
- **Precarious macroeconomic situation in the region.** Russian economy continues to evolve negatively, even though this year it is expected a decline in GDP, lower than the previous year, and a slight recovery in 2017. Stabilization of oil prices is the main factor of Russian ruble stability, but previous deficiencies maintain the recessional effects. Ukraine's economy shows first signs of recovery, statistics reflecting slight increases, but consecutive. However, it should not be ignored the importance of the base year in the calculation of statistics. After three years of recession and stagnation, the monthly increases are far from a full recovery of the Ukrainian economy. Romania's economy continues to be one of the most stable in the EU and in the region, even though a slowdown in the pace of growth in industry and exports is recorded.
- **Heightened uncertainties regarding the outcome of US elections.** The economic policy of the largest economies in the next 4 years will depend on the outcome of the November 2016 US elections. Investors are particularly interested in the evolution of the monetary policy of the Federal Reserve System and the intentions to increase the interest rates, which will directly determine the parity of the U. S. dollar against other international currencies.

Real sector

- **Uncertainties relating to the 2016 harvest.** Given the high vulnerability of agricultural production to weather conditions, agri-meteorological conditions for crops this year were basically satisfactory. Nevertheless, the uncertainty about the 2016 harvest and the uncertainty about the dynamics of prices of domestic food products, although lower than projected in the previous round of forecast, still persists. Meanwhile, the harvest of the next year and, respectively, food prices on the domestic market will depend to the greatest extent on the agri-meteorological conditions in the autumn and in the first half of the next year. However, this information cannot be anticipated, so that food prices forecast for 2017 implies a higher degree of uncertainty.
- **The trajectory of the MDL/USD exchange rate.** Some of CPI subcomponents, such as goods imported or those with prices quoted in foreign currency have increased sensitivity to exchange rate dynamics, so that any appreciation or

depreciation of the national currency results in an immediate change in their variation. Since the dynamics of the exchange rate had increased volatility in recent periods, which has been fuelled both by objective and subjective factors (which cannot be anticipated), the inflation medium-term projection is characterized by significant uncertainty generated by exchange rate developments.

- **Postponement of tariff increases in the context of social and political tensions and uncertainties.** Social and political tensions in the current year may postpone the adjustments in tariffs of regulated services undertaken in the forecast, which will lead to a lower inflation than anticipated.
- **Keeping energy prices in the region** will create prerequisites for the downward revision of tariffs for some regulated services, but under financial deviations accumulated by suppliers in prior periods and under contractual terms of the acquisition, the decrease of these tariffs remains uncertain. Consequently, the uncertainty related to the adjustment of regulated prices is significantly superior to previous rounds of forecast.
- **Approval of new methodologies for the formation and application of prices of petroleum products.** The methodology establishes a direct correlation between the prices of petrol and diesel fuel on domestic market and regional stock prices developments for petroleum products. At the same time, it sets specific commercial margin which capped the amount of costs and profits of oil companies. Therefore, this methodology, given current oil prices, could reduce prices for fuel and liquefied gas in the CPI.

Monetary and public sector

- **Increasing internal state debt.** As a result of the liquidation of Banca de Economii S.A., BC "BANCA SOCIALĂ" S.A. and B.C. "UNIBANK" S.A., there has emerged the risk that internal state debt will rise by 159.0 percent and will reach a value of MDL 21.84 billion and total state debt will rise to MDL 48.97 billion.
- **Negative banking margin.** Higher interest rates on outstanding deposits against credits in national currency generated a negative banking margin in the second quarter of 2016, which subject banks to capital risk in the long run.

Box no. 1

Annualisation of data

The annualisation of data is a process of transformation of monthly/quarterly growths or for certain periods, into annual growths. In other words, it is a hypothetical growth based on the information available from the beginning of the year, taking into account that similar growths will be recorded until the end of year, thus obtaining an annualised growth. **The annualisation process may be applied for a series of monthly or quarterly data only on condition that no seasonal factor exists or after its exclusion.**

The annualisation formula for monthly data is the following:

$$g_m = \left[\left(\frac{X_m}{X_{m-1}} \right)^{12} - 1 \right] * 100,$$

where X_m and X_{m-1} is the absolute value of the economic variable in m month (current) and m-1 (previous), while g_m is the annualised growth. As for the quarterly data series, the figure 12 is replaced by 4.

The annualisation process of data provides a simplistic way of comparing the performance of current monthly or quarterly economic indicators, with their modification in the previous year (e.g.: GDP in EU increased by 1.6 percent in 2015, while the annualised GDP for the first quarter of 2016 increased by 2.2 percent. This acceleration of annualised rate compared to the annual rate outlines some positive prerequisites for the acceleration of the annual growth rate of GDP in 2016 compared to that recorded in 2015).

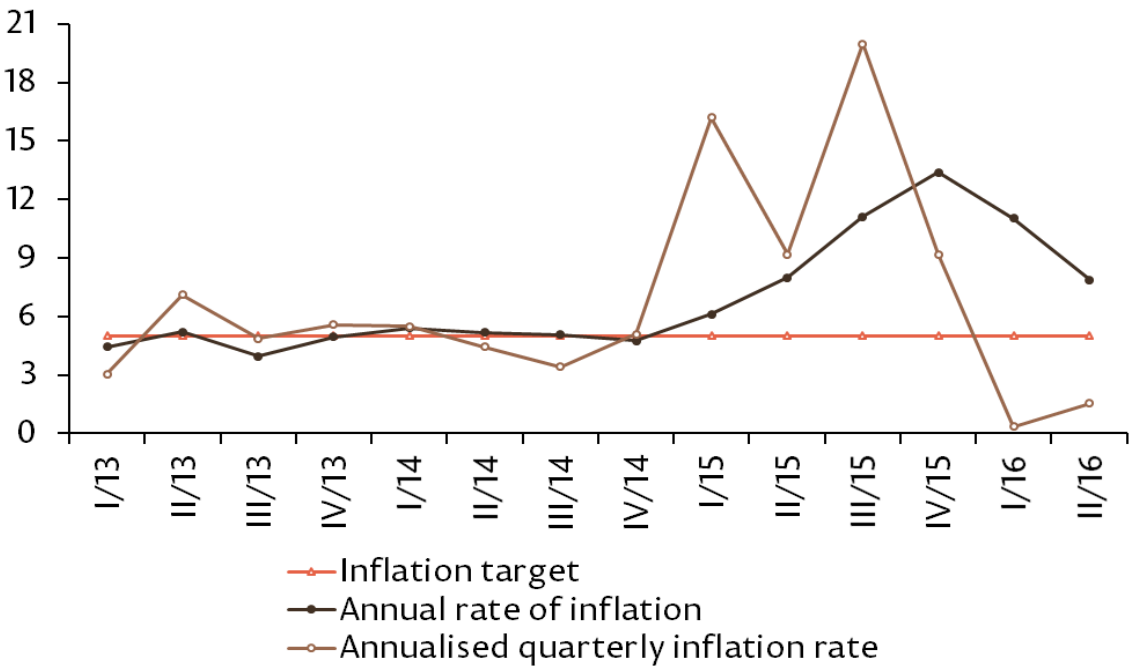
An example of where data annualisation may be applied is presented below.

This example is based on actual data of inflation development in the Republic of Moldova. Thus, this example illustrates one of the most simplistic but effective ways of identifying the appearance/disappearance of inflationary/disinflationary pressures in the economy. The seasonally adjusted monthly inflation rate, annual inflation rate and inflation target were used to create this example. It should be mentioned that the monthly rate is volatile, so to obtain qualitative information, it is better to use quarterly series. Thus, monthly series were aggregated to obtain quarterly series.

Chart no.1 shows the evolution of annual inflation rate and the annualised quarterly inflation rate for the period that includes the quarters I/2013 - II/2016. The explanations on how to interpret the information provided by this chart are presented below.

If we look at the period 2013 - 2014, we can see that the annualised quarterly inflation rate is in the proximity of the 5.0 percent target, which suggests that the inflationary process in the economy is normal and falls within the Medium-Term Monetary Policy Strategy of the National Bank of Moldova. At the same time, if we analyse the annual inflation rate for this period, we can see that it is also close to the target of 5.0 percent, a situation similar to the annualized inflation rate.

Chart no.1 **The annual rate of inflation and the annualised quarterly inflation rate (%)**



Source: NBS, NBM calculus

A pronounced acceleration of the annualised quarterly inflation rate can be seen in 2015, signalling the emergence of significant inflationary pressures, starting with the first quarter of 2015, despite the fact that the annual rate of inflation was positioned at the 6.1 percent, level which falls within the Medium-Term Monetary Policy Strategy of the NBM. In conclusion, we can state that the annual inflation rate in 2015 accelerated from 4.8 percent in the fourth quarter of 2014 to 13.4 percent in the fourth quarter of 2015.

It should be mentioned that in the first two quarters of 2016, the annualised quarterly inflation rate was well below the inflation target level. In this context, it should be also noted the disappearance of inflationary pressures in the first half of 2016, and the appearance of risk that at the end of 2016, the annual inflation rate could reach the lower bound of the inflation-target corridor. **Thus, the annualised inflation rate in the second quarter of 2016 would suggest that if in the second half of 2016 the inflation rate will increase similar to the pace recorded in the second quarter of 2016, it may reach the proximity of 1.5 percent level by the end of year.** At the same time, the pronounced slowdown speed in the annual inflation rate in the first half of 2016 once again reconfirms the hypothesis about the lack of inflationary pressures in the given period.

It should be mentioned that the annualised quarterly inflation rate is a more qualitative indicator, unlike the annual inflation rate, when referring to inflationary pressure, because it contains only current information, unlike the annual rate that includes information for last 12 months, information from the past.

Chapter 6

Monetary policy decisions

Minutes of the monetary policy meeting of the Executive Board of the National Bank of Moldova of 26.11.2015

The meeting was chaired by Mr. Dorin Drăguțanu, Governor - Chairman of the Executive Board of the National Bank of Moldova.
There were present: members of the Executive Board – Mr. Marin Moloșag, First Deputy Governor - Deputy Chairman of the Executive Board, 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, Adviser to the Governor, Mrs. Lucia Hadârcă, Director of Banking Operations Department, Mr. Matei Dohotaru, Director of Banking 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 Executive Board have assessed the impact of monetary policy measures previously implemented. The 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 Executive Board assessed the defining aspects to inflation in the medium-term, with the persistence of inflationary risks. The external risks to inflation remain significant, given the weak economic activity of the euro area countries and the recession faced by the Russian Federation - the main external trade partners of the Republic of Moldova. The external risks are propagated through the remittances channel in favour of population and the external trade, leading to lower foreign currency income of population and domestic exporters on the short term. This may subsequently influence inflation. The escalation of geopolitical tension in the region could cause additional inflationary pressures. The situation in the domestic banking system and the incentive fiscal policy, with the prevalence of social element in the structure of public expenditures contribute to the relatively high level of consumption, which influences the dynamics of consumer prices as from the end of the previous year. The risks to inflation associated mainly with the depreciation of the national currency since the beginning of this year, which will subsequently determine the CPI in the future periods, through the prices of imported goods and tariffs of regulated services, higher excise duty on some categories of goods and later by second-round effects to leave temporarily the upper limit of the variation range of ± 1.5 percentage point from the inflation target of 5.0 percent. Inflationary pressures are expected to be persistent in the following quarters, including due to unfavourable agri-meteorological conditions of this year and the low base of comparison in the previous year.
In order to anchor inflation expectations and bring inflation back to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided to maintain the main indicator for monetary policy - the base rate at the level of 19.5 percent annually. At the same time, this decision of the Executive Board of the NBM is reasoned by the fact that the monetary policy measures adopted by the NBM since the beginning of the current year until now are still to act through different transmission channels in the national economy, including by influencing the interest rates on loans and deposits in national currency, so that exerting further effects on the inflation development. The Executive Board will further monitor 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 Executive Board 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 19.5 percent annually;
2. to maintain the interest rates:
• on overnight loans at the current level of 22.5 percent annually;
• on overnight deposits at the current level of 16.5 percent annually.

Voting results

FOR – 4 AGAINST – 0 ABSTAIN – 0

Chairman of the Executive Board

Dorin DRĂGUȚANU

Secretary of the Executive Board

Sergiu SURDU

Minutes of the monetary policy meeting of the Executive Board of the National Bank of Moldova of 30.12.2015

The meeting was chaired by Mr. Dorin Drăguțanu, Governor - Chairman of the Executive Board of the National Bank of Moldova.
There were present: members of the Executive Board - Mr. Marin Moloșag, First Deputy Governor - Deputy Chairman of the Executive Board, 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, Adviser to the Governor, Mrs. Lucia Hadârcă, Director of Banking Operations Department, Mr. Matei Dohotaru, Director of Banking 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 Executive Board have assessed the impact of monetary policy measures previously implemented. The 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 Executive Board assessed the defining aspects to inflation in the medium-term, with the persistence of inflationary risks. The external risks to inflation remain significant, given the weak economic activity of the euro area countries and the deepening recession faced by the Russian Federation - the main external trade partners of the Republic of Moldova. The external risks are propagated through the channel of remittances in favour of population and external trade, leading to lower foreign currency income of population and domestic exporters on the short-term with implications for the future development of inflation. The escalation of geopolitical tension in the region could cause additional inflationary pressures. The risks to inflation associated mainly with the depreciation of the national currency since the beginning of this year, which will subsequently determine the CPI in the future periods, through the prices of imported goods and tariffs of regulated services, higher excise duty on some categories of goods and later by second-round effects to maintain temporarily above the upper limit of the variation range of ± 1.5 percentage point from the inflation target of 5.0 percent. The inflationary pressures are expected to be persistent in the following quarters, including due to unfavourable agri-meteorological conditions in 2015 and the low base of comparison in the previous year.
In order to anchor inflation expectations and bring inflation back to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided to maintain the main indicator for monetary policy - the base rate at the level of 19.5 percent annually. At the same time, this decision is reasoned by the fact that the monetary policy measures adopted by the NBM in 2015 continue to propagate in the national economy, including by influencing the interest rates on loans and deposits in MDL, expecting to reduce the inflation in 2016. NBM will further monitor 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 Executive Board 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 19.5 percent annually;
2. to maintain the interest rates:
• on overnight loans at the current level of 22.5 percent annually;
• on overnight deposits at the current level of 16.5 percent annually.

Voting results

FOR – 4 AGAINST – 0 ABSTAIN – 0

Chairman of the Executive Board **Secretary of the Executive Board**

Dorin DRĂGUȚANU **Sergiu SURDU**

Minutes of the monetary policy meeting of the Executive Board of the National Bank of Moldova of 28.01.2016

The meeting was chaired by Mr. Dorin Drăguțanu, Governor - Chairman of the Executive Board of the National Bank of Moldova.
There were present: members of the Executive Board - Mr. Marin Moloșag, First Deputy Governor - Deputy Chairman of the Executive Board, Mr. Ion Sturzu - Deputy Governor, Mr. Aureliu Cincilei - Deputy Governor.
Reporter: Mr. Radu Cuhal, Director of Monetary Policy and Research Department.
Invitees: Mr. Andrei Rotaru, Adviser to the Governor, Mrs. Lucia Hadârcă, Director of Banking Operations Department, Mr. Matei Dohotaru, Director of Banking 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 Executive Board have assessed the impact of monetary policy measures previously implemented. The 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 Executive Board assessed the defining aspects to inflation in the medium-term. The external risks to inflation remain significant, given the weak economic activity of the euro area countries and the recession faced by the Russian Federation - the main external trade partners of the Republic of Moldova. The external risks are propagated through the channel of remittances in favour of population and external trade, leading to lower foreign currency income of population and domestic exporters on the short-term with implications for the future development of inflation. At the same time, the main internal risks are associated with the postponement of fiscal policy approval in 2016 in the light of the fiscal policy behaviour.
In order to anchor inflation expectations and bring inflation back to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided to maintain the main indicator for monetary policy - the base rate at the level of 19.5 percent annually. This decision is reasoned by the fact that the monetary policy measures adopted by the NBM in 2015 are adequate and continue to propagate in the national economy, including by influencing the interest rates on loans and deposits in national currency, expecting to reduce the inflation in 2016.
The dynamics of the output gap remains negative in the next eight quarters. An economic activity below its potential level will cause in the long-term increased disinflationary pressures from domestic demand. According to the new round of forecasting, the annual average rate of inflation for 2016 and 2017 will reach the level of 10.1 percent and 6.6 percent, respectively, while returning back within the limits of the variation range of the target in the third quarter of 2017. The Executive Board of the NBM will analyse the statistics that will be published in the next period and the perspectives on inflation to determine the appropriate moment to start to ease the monetary policy in 2016.
The Executive Board of the NBM will further monitor 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 Executive Board 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 19.5 percent annually;
2. to maintain the interest rates:
• on overnight loans at the current level of 22.5 percent annually;
• on overnight deposits at the current level of 16.5 percent annually.

Voting results

FOR – 4 AGAINST – 0 ABSTAIN – 0

Chairman of the Executive Board **Secretary of the Executive Board**

Dorin DRĂGUȚANU **Sergiu SURDU**

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