National
Bank of Moldova

Inflation Report

No. 4, October 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.

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List of acronyms

ANRE	National Agency for Energy Regulation
CPI	Consumer Price Index
ECB	European Central Bank
EUR	European Single Currency
FCC	Freely convertible currency
Fed	Federal Reserve System
GDP	Gross Domestic Product
IDA	International Development Association
IPI	Industrial Production 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
OPEC	Organization of the Petroleum Exporting Countries
REER	Real effective exchange rate of the national currency
RUB	Russian ruble
SS	State Securities
USD	U.S. Dollar

Summary

Inflation development

In the third quarter of 2016, the annual inflation rate was 4.5 percent, by 3.4 percentage points less compared to the previous quarter. In September 2016, inflation decreased to the level of 3.0 percent. Thus, after being, in August 2016, within the range of ± 1.5 percentage points from the 5.0 percent target, as set in the Medium-term monetary policy strategy, the annual inflation was below the lower limit of this range at the end of the third quarter. The decrease in annual inflation rate during the reporting period was mainly due to the modest domestic demand, the effect of a high base period associated with the national currency depreciation of the previous year and the gradual dissipation of the impact of the electricity tariffs increase in July 2015. The annual core inflation rate was higher than the overall inflation rate. The core inflation also had a downward trajectory during the third quarter of 2016, decreasing from 9.3 percent in June to 6.7 percent in September 2016. In September 2016, the annual rate of food prices fell to 4.6 percent, while prices of regulated services and fuels decreased by 2.0 and, respectively, by 1.8 percent compared to September 2015. In the third quarter of 2016, the actual average value of inflation was slightly lower than the value anticipated in the projection of Inflation Report no.3, 2016.

External environment

The second semester of 2016 started with the stabilisation of macroeconomic trends at international level. The passive volatility of main international economic indicators shows the lack of new prominent macroeconomic risks and uncertainties. At the same time, the global economic situation remains precarious and the economic growth is below the average for the last years. In the absence of external risks and/or incentives, most of economies refocused towards promoting internal policies to stimulate the economic growth. The slight upward trend of the euro area inflation represents a first sign of efficiency of the European Central Bank's quantitative easing monetary policy. However, the uncertainties relating to Brexit and the risks to the euro area financial system are two premises for maintaining the ECB quantitative easing programme for a long period. The Russian Federation's economy has stabilised, unless new external risks have emerged. At the same time, OPEC member countries succeeded at the end of September to reach a consensus on reducing the oil production, which caused the oil prices strengthening, accounting for about USD 50 per barrel.

Economic developments

In the second quarter of 2016, GDP recorded an increase of 1.8 percent compared to the same period of 2015, the annual economic activity dynamics being higher than at the beginning of this year. However, the economic growth was modest in the first half of the year, being below its potential level. In the second quarter of 2016, the GDP positive evolution was due to the domestic demand and exports positive contribution. Thus, in the second quarter of 2016, the household consumption increased by 2.2 percent. However, the household consumption dynamics was insignificant. At the same time, the positive contribution of investments to GDP dynamics was determined by the favourable impact of the component change in inventories, given that the gross fixed capital formation recorded a decrease of 9.4 percent compared to the same period of the previous year. These developments show the decrease of household disposable income in real terms and the increased uncertainty on further development of the economy, persisting in the environment of the economic agents and households. In the second quarter of 2016, the final consumption of public administration decreased by 0.8 percent compared to the same period of last year. In the second quarter of 2016, after contracting at the beginning of the year, the exports and the subcomponents of domestic demand supported the GDP growth, which increased by 3.0 percent compared to the same period of last year, due to a better harvest during the reporting period. The economic activity dynamics was significantly offset in the second quarter of 2016 by the increase of imports by 4.3 percent compared to the second quarter of 2015. By categories of resources, almost all main sectors of the national economy recorded positive developments, except for constructions and public sector.

Monetary policy

During the third quarter of 2016, there were held four meetings of the Executive Board of the National Bank of Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks to which the economy of the Republic of Moldova could be subject and the inflation outlook in the short and medium-term, the NBM Executive Board decided at the meeting of 4 July 2016 to decrease the base rate applied on main monetary policy operations by 3.0 percentage points, from the level of 13.0 percent (set at the meeting of 26 May 2016) to 10.0 percent annually. Thereafter, at the meetings of 8 August 2016 and 25 August 2016, it was decided to maintain the base rate applied on main monetary policy operations at the level of 10.0 percent annually, while at the meeting of 29 September 2019, the base rate was decreased by 0.5 percentage points, up to 9.5 percent annually.

In the third quarter of 2016, the monetary aggregates dynamics was positive, the quarterly average in annual terms constituted 11.9 percent for M2 (by 7.1 percentage points higher than in the

second quarter of 2016) and 4.7 percent for M3 (by 3.8 percentage points higher than the previous quarter).

Following the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, the average interest rates on deposits continued its downward trend and consequently, the average rates on credits granted by banking system recorded a tempered decline.

During the reporting period, compared to the second quarter of 2016, the annual average interest rates related to the balance of credits recorded a decrease of 0.71 percentage points on credits in national currency and of 0.26 percentage points on credits in foreign currency, recording the levels of 12.89 and 6.16 percent, respectively. The average interest rate on deposits in MDL was 10.98 percent during the third quarter of 2016, decreasing by 3.95 percentage points compared to the previous quarter. The interest rate of placements in foreign currency constituted on average 2.08 percent, lower by 0.03 percentage points than in the second quarter of 2016.

Medium-term inflation forecasting

The current round of forecasting anticipates that the *output gap* will continue to be negative for the entire forecasting period and will reach the minimum level in the first quarter of 2017, after which, it will record a slow recovery by the end of the forecasting period, continuing to be negative. Therefore, the economic activity below its potential, on medium-term, will determine increased disinflationary pressures from the aggregate demand.

The *annual inflation rate* will have an upward trajectory in the first part of the forecasting period and a downward trajectory in the second part. The annual inflation rate, for the first two quarters of forecast, will be below the lower limit of the inflation target range.

Thereafter, it will return and maintain within the target range by the second quarter of 2018. After being below the lower limit of the target range in the fourth quarter of 2016, the inflation will accelerate and record a maximum level in the fourth quarter of 2017. Subsequently, the inflation will fall by the end of the forecasting period and will be below the range, recording the level of 3.2 percent. The average annual inflation rate will record the level of 6.3 percent in 2016 and the level of 4.6 percent in 2017.

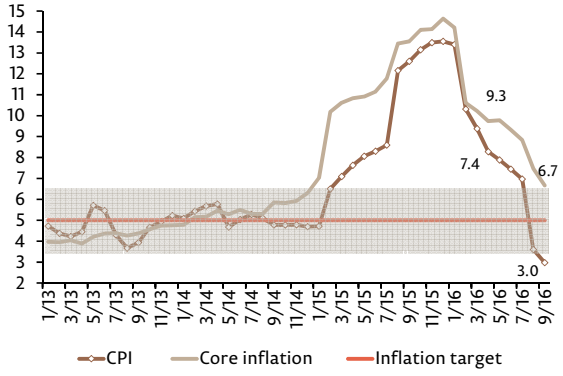
Chapter 1

Inflation development

The annual inflation rate continued the downward dynamics since the beginning of this year, decreasing to the level of 3.0 percent in September 2016. As a result, it was by 0.5 percentage points below the lower limit of the inflation target set in the Medium-term monetary policy strategy. In the third quarter of 2016, the annual average rate was 4.5 percent, managing to fall within the aforementioned range. The decrease in annual inflation rate was mainly due to the modest domestic demand, the high effect of a base period associated with the national currency depreciation of the previous year and the gradual dissipation of the impact of the electricity tariffs increase in July 2015. The annual rate of core inflation recorded a similar development. In the third quarter of 2016, the actual annual inflation rate was slightly lower to that anticipated within the forecasting round presented in the Inflation Report no.3, 2016.

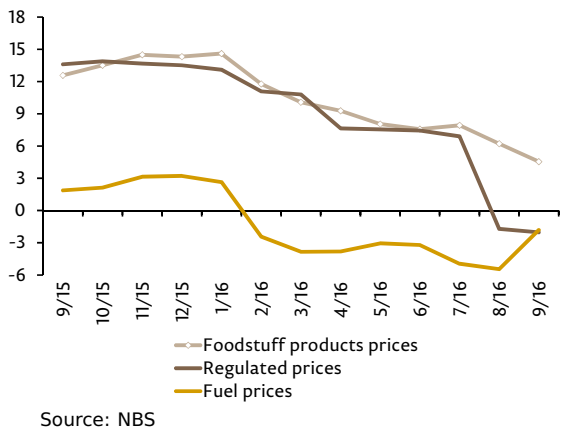
1.1 Consumer price index

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

In the third quarter of 2016, the annual CPI inflation rate continued the downward trajectory since the beginning of this year, thus decreasing from 7.4 percent in June 2016 to 3.0 percent in September 2016 (Chart 1.1). Thus, after being within the range of ± 1.5 percentage points from the 5.0 percent target, as set in the Medium-term monetary policy strategy, recording in August the level of 3.6 percent, the annual inflation was at the end of the third quarter below the lower limit of this range. The annual average CPI rate in the third quarter of 2016 was 4.5 percent, by 3.4 percentage points lower than the previous quarter.

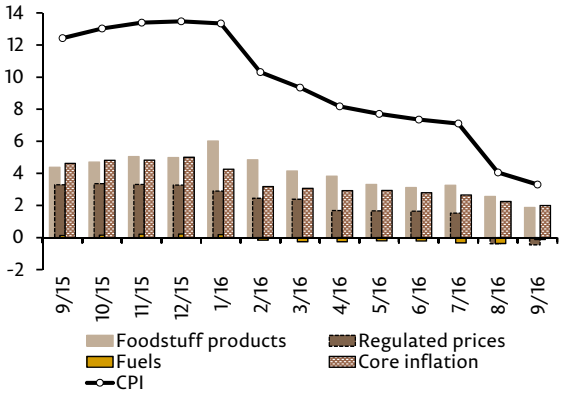
The annual rate of core inflation continued to maintain a higher trajectory than that of overall inflation. The core inflation also had a downward trajectory during the third quarter of 2016, decreasing from 9.3 percent in June to 6.7 percent in September 2016. In the third quarter of 2016, the average rate of core inflation was 7.7 percent, by 1.9 percentage points lower than the previous quarter, due to the modest domestic demand and the effect of a high base period during the same period of last year. As a result, the contribution from core inflation to the annual rate of CPI decreased by 0.6 percentage points, reaching the level of 2.3 percentage points.

The downward trajectory of the annual CPI inflation rate was determined mainly by the gradual dissipation of the pressures from the prices of regulated services. Thus, their contribution decreased by 1.4 percentage points, to 0.2 percentage points in

the third quarter of 2016, as a result of phasing-out of the impact from the electricity tariffs increase in July 2015. The slowdown of annual inflation rate was also supported by food prices, due to a better harvest compared to previous year and by the lack of pressures from the exchange rate. Their contribution to the CPI dynamics decreased from 3.4 percentage points to 2.6 percentage points. The contribution of fuel prices was -0.3 percentage points, being slightly lower than previous quarter, in the context of low oil prices, exchange rate stability and of certain additional regulations in this sector (Chart 1.3).

Within the components' structure, food prices and non-food prices recorded in September 2016 increases of about 4.6 percent each compared to September 2015. Service prices recorded a contraction of 0.8 percent.

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



Source: NBS, NBM calculus

Core inflation

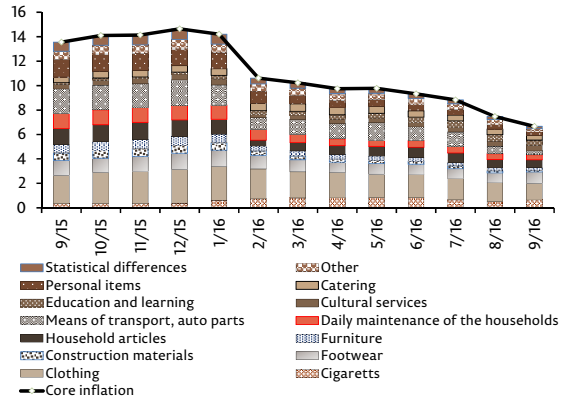
The annual rate of core inflation continued its downward trend since the beginning of this year, decreasing from 9.6 percent in the second quarter of 2016 to 7.7 percent in the third quarter of 2016.

The aggregate demand below its potential and the national currency stability against U.S. dollar have supported the disinflationary nature of this indicator. In this regard, the average exchange rate of national currency against U.S. dollar recorded insignificant fluctuations in the third quarter of 2016 compared to previous quarter, maintaining the level of MDL/USD 19.8.

During the reporting quarter, the annual core inflation was mainly determined by the increase in prices of subcomponents "clothing", "footwear", "means of transport, auto parts", "household articles" etc.

At the same time, in September 2016, the increase in prices of "cigarettes" (by 15.4 percent), "footwear" (by 11.2 percent), "education and training" (by 9.5 percent), "clothing" (by 7.5 percent) etc. has contributed to the annual core inflation formation up to 6.7 percent (by 2.6 percentage points lower than in June 2016).

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



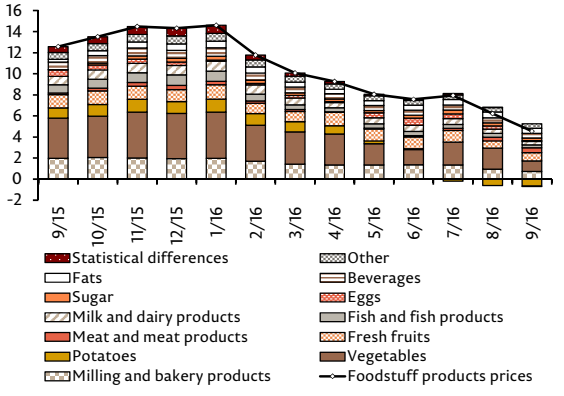
Source: NBS, NBM calculus

Food prices

In the third quarter of 2016, the annual rate of food prices recorded an average level of 6.2 percent, by 2.1 percentage points lower than the second quarter of 2016.

The downward dynamics of annual rate was caused mainly by low contributions from groups "fresh vegetables", "potatoes", "milling and bakery products", "eggs" and "fresh fruits" (Chart 1.5). The decrease in contributions from the aforementioned groups was determined mainly by the record of a good agricultural year with a very high harvest compared to previous year. The lack of inflationary pressures related to the exchange rate channel was also noted in the third quarter of 2016.

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



Source: NBS, NBM calculus

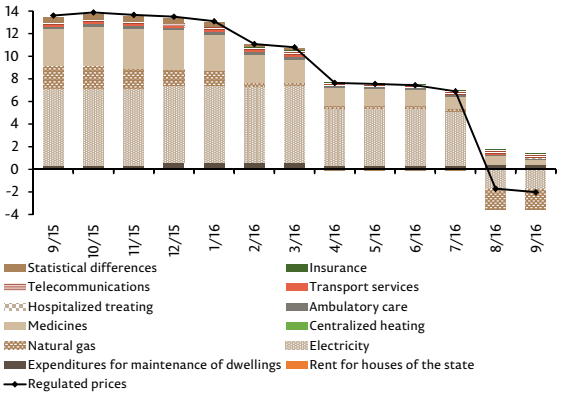
It should be mentioned that the pronounced slowdown in annual rate of food prices was also determined by the lack of inflationary pressures from the aggregate demand, which still remains modest.

In the third quarter of 2016, the annual rate of food prices turned positive and reached the medium level of 5.4 percent, after being negative for a period of three years on international market.

The increase of 4.6 percent in annual terms of food prices in September 2016 was mainly due to the increase in prices of "fresh fruits" (14.6 percent), "sugar" (12.6 percent), "fats" (8.0 percent), "fresh vegetables" (5.1 percent) and "milling and bakery products" (4.1 percent).

Regulated prices

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

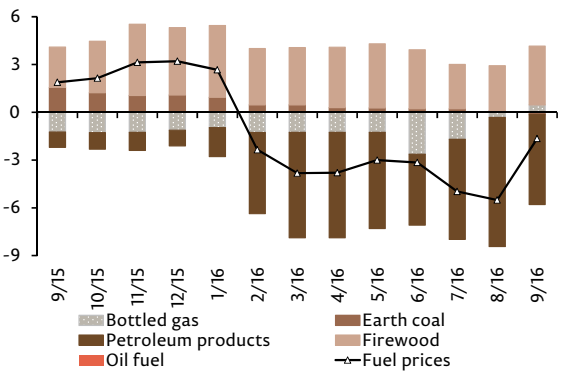


Source: NBS, NBM calculus

The annual rate of regulated prices recorded a pronounced downward trend in the third quarter of 2016, amounting to 1.1 percent, by 6.5 percentage points lower than the previous quarter. This was mainly due to the phasing-out of the impact from the electricity and gas tariffs increase in summer of last year (Chart 1.6). As a result of the subsequent downward revisions in these tariffs, these two subcomponents of the regulated prices have generated negative contributions in the last two months of the third quarter (by about 1.8 percentage points). At the same time, the decrease in annual rate of regulated prices was due to the decrease of the positive contribution from medicine prices, as a result of the legislative amendments on pharmaceutical activity made in spring of this year[1] in order to reduce the medicine prices for final consumer. Therefore, in September 2016, the annual rate of medicine prices recorded the level of 2.4 percent, by 5.2 percentage points lower compared to June 2016. During the reporting period, a positive contribution on regulated prices evolution was also exerted by the telecommunication services, due to the increase in internet services tariffs of S.A. „Moldtelecom" by about 4.8 percent as from 1 July 2016. However, the impact of this increase on annual dynamics of regulated services prices was less pronounced in comparison with the subcomponents mentioned previously.

Fuel prices

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



Source: NBS, NBM calculus

In the third quarter of 2016, the annual average rate of fuel prices was -4.1 percent, by 0.7 percentage points lower than in the second quarter of 2016 (Chart 1.7).

The negative dynamics of fuel prices during the reporting period was mainly influenced by the dynamics of petroleum products prices. Thus, the negative contribution generated by them reached

[1] According to new provisions, starting with 1 April 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. The medicines from the pharmacies' stocks have also been subject to revaluation in order to apply a mark-up in accordance with the new provisions. However, the Medicines and Medical Devices Agency ensures the logistics-related activity in identifying the producer's prices excluded from the National medicine price catalogue in order to apply the aforementioned provisions.

the level of -6.7 percentage points to the annual rate formation of fuel prices, by 1.0 percentage points lower compared with the second quarter of 2016. This pronounced negative impact may be associated with a lower oil price by about 10.9 percent compared to the same period of last year. It should be mentioned that starting with May, ANRE adopted a new methodology of formation and application of prices for oil products (in force since 13 May 2016). Accordingly, ANRE 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. As a result, the fuel price became more sensitive to the energy resources prices oscillations regionally. Similar to the previous quarter, a negative contribution to annual rate formation of fuel prices was also exerted by the bottled gas prices. However, this is less pronounced in comparison with fuels prices. Thus, in the third quarter of 2016, the contribution of the bottled gas prices to annual rate formation was -0.5 percentage points, by 1.2 percentage points more compared to the previous quarter.

At the same time, the negative dynamics of the aforementioned subcomponents have been mitigated by the positive evolution of firewood prices, which contributed with 3.1 percentage points to the annual rate formation of fuel prices, decreasing by 0.7 percentage points compared to the second quarter of 2016. At the same time, the contribution from "earth coal" subcomponent decreased by 0.2 percentage points compared with the previous period, reaching the level of 0.1 percentage points.

1.2 Comparing forecasts of the Inflation Report no.3, 2016 with the inflation development in the third quarter of 2016

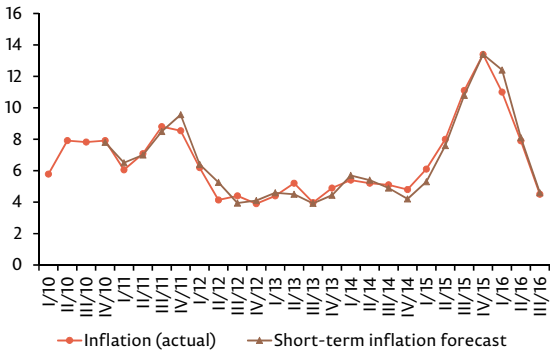
In the third quarter of 2016, data on CPI reflects mainly the key assumptions and conclusions regarding the inflation short-term forecast for the reporting period, presented in the Inflation Report no.3, 2016. Thus, the actual average value, in the third quarter of 2016, was lower only by 0.1 percentage points than the value anticipated of 4.6 percent.

The main subcomponents of CPI inflation have not recorded significant deviations compared to the forecast scenario projected. The deviations have been mainly generated by the deviation of the forecast for regulated prices. Thus, these deviations recorded the level of 1.1 percent in the third quarter of 2016, by 0.6 percentage points lower than it was anticipated, due to the delayed adoption of the new tariffs for heat energy.

Thus, this was not reflected in September, but it will produce a positive impact anticipated in the fourth quarter of 2016. Fuel prices have also recorded a slight negative deviation (0.2 percentage points), in the context of a more appreciated exchange rate than it was anticipated.

[2]The 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, 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 1.8: The evolution and forecast of CPI since the implementation of inflation targeting regime (%)



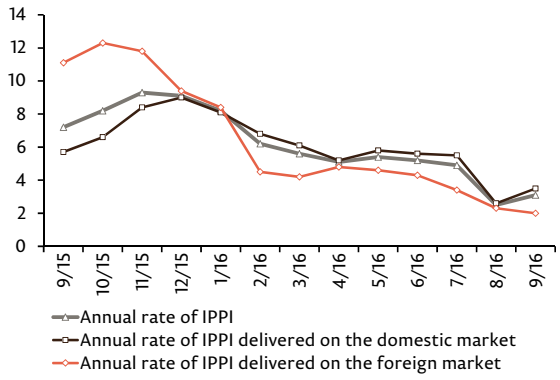
Source: NBM

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

	De facto	Forecast IR 3, 2016	Deviation
	Q III, 2016/ Q III, 2015	Q III, 2016/ Q III, 2015	De facto-forecast
CPI	**4.5**	**4.6**	**-0.1**
Core inflation	7.7	7.7	0.0
Food	6.2	5.9	0.3
Regulated prices	1.1	1.7	-0.6
Fuels	-4.1	-3.9	-0.2

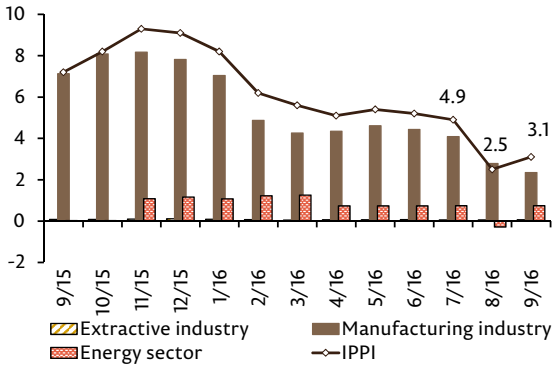
Source: NBS, NBM calculus

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

However, its impact is negligible. The negative deviation of the aforementioned subcomponents was partially offset by the positive deviation (0.3 percentage points) recorded by the forecast for food prices (5.9 percent in the forecast scenario). The deviation of core inflation was null (Table 1.1).

1.3 Industrial output prices

In the third quarter of 2016, the annual rate of prices in industry recorded an average level of 3.5 percent, by 1.7 percentage points lower compared to the second quarter of 2016. The downward evolution of the IPPI annual rate was influenced by the dynamics of prices of the products delivered both on domestic and foreign market (Chart 1.9). Thus, in the third quarter of 2016, the annual rate of IPPI delivered on domestic and foreign market decreased by 1.7 and 2.0 percentage points compared to the previous quarter.

The evolution of annual rate of prices in industry shows that its dynamics was determined mainly by the evolution of prices in manufacturing (Chart 1.10). In the third quarter of 2016, the prices in manufacturing industry contributed on average with 3.1 percentage points to the IPPI annual rate formation, by 1.4 percentage points less than in the second quarter of 2016. At the same time, it should be noted that the decrease in contribution from energy sector prices by 0.3 percentage points was determined by the base effect. The contribution from extractive industry prices maintained the level of the previous quarter.

Chapter 2

External environment

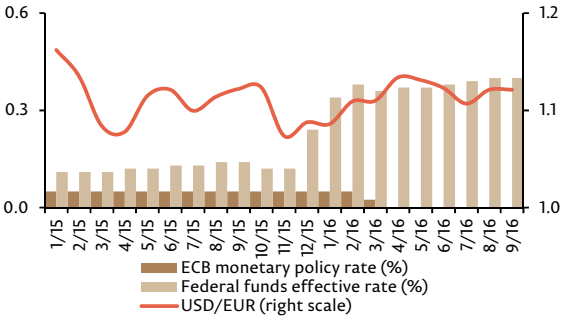
2.1 World economy, financial and raw materials markets

The second semester of 2016 started with the stabilisation of the macroeconomic trends at international level. The passive volatility of main international economic indicators shows the lack of new prominent macroeconomic risks and uncertainties. At the same time, the global economic situation remains precarious and the economic growth is below the average for the last years. In the absence of external risks and/or incentives, most of economies refocused towards promoting internal policies to stimulate the economic growth. The slight upward trend of the inflation in the euro area represents a first sign of efficiency of the European Central Bank's monetary policy of quantitative easing. However, the uncertainties relating to Brexit and risks posed to the euro area financial system are two premises for maintaining the ECB quantitative easing programme over a long period. The Russian Federation economy has stabilised, unless new external risks have emerged. At the same time, OPEC member countries succeeded at the end of September to reach a consensus on reducing the oil production, which caused the oil prices strengthening, accounting for about USD 50 per barrel.

The antagonistic monetary policies of the advanced economies continued to lead the trajectory of major international currencies. Thus, in the third quarter of 2016, the U.S. dollar appreciated against EUR by 1.1 percent compared to previous quarter, by 0.5 percent against Swiss franc and by 2.1 percent against Chinese yuan. At the same time, U.S. dollar depreciated against Japanese yen on quarterly average by 5.3 percent during the reporting period. Amid the Brexit uncertainties, Pound Sterling reached the lowest level after 1985, depreciating in the reporting period on average by 9.2 percent against the U.S. dollar and by 8.0 percent against the European single currency (Chart 2.1).

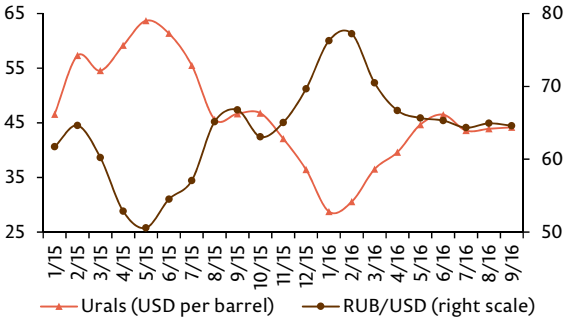
The oil price strengthening and the lack of new external risks to the Russian Federation's economy contributed to the stabilisation of the Russian rouble. Thus, in the third quarter of 2016, the Russian rouble appreciated on average by 1.9 percent against the U.S. dollar and by 3.0 percent against the European single currency compared to previous quarter. During the same period, the Ukrainian hryvnia appreciated by 0.7 percent against the European single currency and depreciated by 0.5 percent against the U.S. dollar. The Romanian leu appreciated on average by 0.7 percent against the European single currency and depreciated on average by 0.4 percent against the U.S. dollar.

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



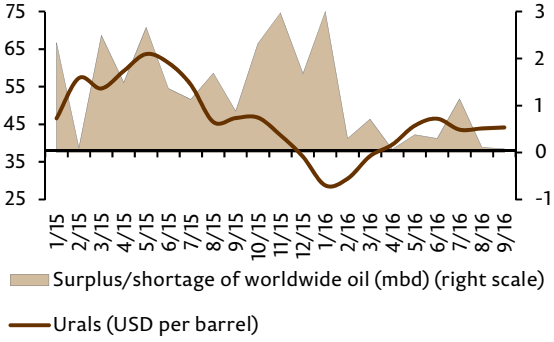
Source: ECB, Fed

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



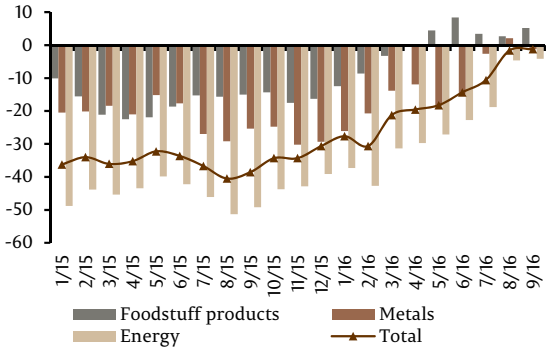
Source: Central Bank of the Russian Federation, Ministry of Economic Development of the Russian Federation

Chart 2.3: The developments on the world oil market



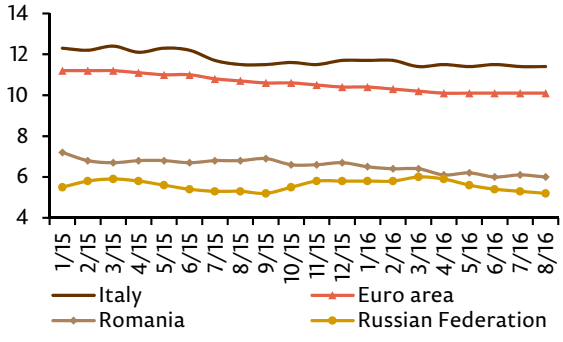
Source: Ministry of Economic Development of the Russian Federation, U.S. Energy Information Administration

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

For comparison, in the third quarter of 2016, on a quarterly average, Moldovan leu appreciated by 1.1 percent against the European single currency and remained stable against the U.S. dollar (Chart 2.2).

In the third quarter of 2016, *Urals average oil price* was USD 43.9 per barrel, increasing by 0.7 percent compared to previous quarter, by 10.9 percent below the average level of the similar period of the last year. The oil price rise and its further strengthening to the value of about USD 50 per barrel is the result of the consensus reached by the OPEC member countries at the end of September. Thus, the OPEC production volume will be reduced to 32.5 million of barrels per day, while the quotas per country will be determined at the OPEC's next meeting on November 2016. At the same time, data of the U.S. Energy Information Administration shows that in August and September 2016 the global oil surplus decreased to 0.1 million of barrels per day, a minimum level compared to last two years (Chart 2.3).

After more than two years of decline, the *international raw materials prices* started to record selectively constant monthly increases, as a result of the increase in consumption of the advanced economies amid the incentive monetary policies, the trade imbalances recorded in last period and forecasts for poor harvest in certain agricultural cultures. Thus, the annual growth rates of international raw materials prices recorded smaller and smaller increases. According to the IMF data, in the third quarter of 2016, the international raw materials prices increased on average by 1.2 percent compared to the previous quarter and decreased on average by 4.7 percent compared with the third quarter of 2015. The international food prices decreased by 2.2 percent compared to the previous quarter and increased by 3.8 percent compared to the third quarter of 2015. The international metal prices increased by 4.5 percent compared to previous quarter and by 0.6 percent less compared to the same quarter of the previous year. The energy resources prices increased by 1.9 percent compared to the previous quarter and decreased by 9.7 percent compared to the third quarter of 2015 (Chart 2.4).

The positive trends on the *labour markets* of the countries chosen by Moldovan migrants for working purposes have been maintained during the analysed period. Thus, the unemployment rate in euro area was 10.1 percent for five consecutive months. However, the unemployment rate decreased in Italy up to 11.4 percent (August 2016), while in Romania - up to 6.0 percent (August 2016). The unemployment rate in the Russian Federation recorded a downward trend (up to 5.2 percent in August 2016), determined by the stabilization of the Russian economy and the seasonal effect characterised by the unemployment decrease amid the intensive economic activities during the warm period of the year. It should be mentioned that the decrease of unemployment rate in the Russian Federation is a phenomenon opposite to the economic crisis situation, a fact explained by the experts through job losses for migrants who work on an informal basis and are not included in the population statistical study (Chart 2.5).

2.2 Economic development of USA and euro area

In the second quarter of 2016, the GDP of the *USA* grew by 0.4 percent compared to previous quarter and by 1.3 percent compared to the same period of last year. The low prices of energy resources had a negative effect over the USA industry in January-August 2016, industrial output decreasing on average by 1.2 percent (Table 2.1). The unemployment rate increased in September 2016 by 0.1 percentage points, up to the level of 5.0 percent. The U.S. consumer prices increased by 0.3 percent compared to previous month, while the annual inflation level reached the level of 1.5 percent. As a result of the increase in external risks and the fragile recovery of the U.S. economy, Fed continued to maintain the interest rates within a range of 0.25-0.5 percent.

The GDP of the *euro area* increased in the second quarter of 2016 by 0.3 percent compared to the previous quarter and by 1.6 percent (seasonally adjusted series) compared to the second quarter of 2015. The industrial output increased in January-August 2016 by 1.1 percent, which increased by 0.8 percent in Germany, 0.6 percent in France and by 1.2 percent in Italy. The unemployment rate in the euro area remained stable for five consecutive months, recording the level of 10.1 percent. The annual inflation in euro area increased up to 0.4 percent in September 2016, as a result of the consumption increase and the gradual increase in energy resources prices (Table 2.1).

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

	GDP QII,16/ QI,16 (s.a.)	GDP QII,16/ QII,15	IPI Jan.-Aug.16/ Jan.-Aug.15	CPI Sep.16/ Sep.15
USA	0.4	1.3*	-1.2*	1.5
Euro area	0.3	1.6*	1.1*	0.4
Germany	0.4	1.7*	0.8*	0.7
France	0.0	1.4*	0.6*	0.2
Italy	0.0	0.8*	1.2*	0.2
Romania	1.5	6.0	1.1*	-0.6
Russian Federation	0.0	-0.6	0.4	6.4
Ukraine	0.6	1.3	2.0	7.9

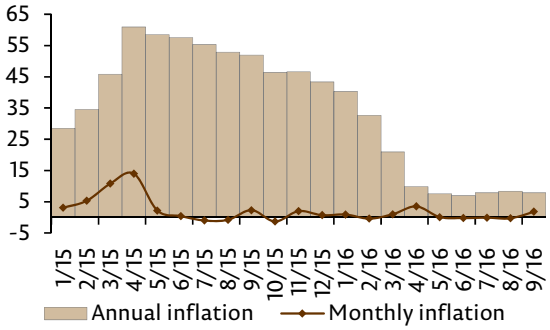
Source: Eurostat, national bureaus of statistics concerned
*based on seasonally adjusted series

2.3 Economic development of the major trading partners countries

The GDP of *Romania* increased in the second quarter of 2016 by 1.5 percent in real terms compared to the first quarter of 2016 and compared to the same quarter of 2015, it recorded an increase of 6.0 percent per gross series and of 5.9 percent per seasonally adjusted series. In the first eight months of 2016, industrial output in Romania increased on an annual basis by 1.1 percent per seasonally adjusted series, a significant low pace compared to previous years. The decrease of the deflationary pressures impact led to the inflation level increase. Thus, consumer prices decreased on average by 0.1 percent compared to the previous month and by 0.6 percent than in September 2015 (Table 2.1).

In the first eight months of 2016, the *Russian Federation's* economy decreased on average by 0.7 percent and in the second quarter of 2016, GDP recorded a decrease of 0.6 percent compared to the second quarter of 2015. In January-August 2016, industrial output increased by 0.4 percent, while construction activity decreased by 4.6 percent and retail trade by 5.7 percent. The unemployment rate decreased by 0.1 percentage points in August 2016, reaching the level of 5.2 percent. In September 2016, inflation continued the downward trend, recording the lowest level of 6.4 percent as from February 2014 compared to previous year.

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



Source: State Statistics Service of Ukraine

As of 16 September 2016, Central Bank of the Russian Federation decreased the base rate by 0.5 percentage points, up to the level of 10.0 percent, demonstrating once again a prudent approach to inflation, which seriously affected the household consumption last year (Table 2.1).

In the second quarter of 2016, the economy of *Ukraine* increased by 0.6 percent compared to the previous quarter and by 1.3 percent compared with the second quarter of 2015. In January-August 2016, on an annual basis, industrial output in Ukraine increased by 2.0 percent, construction production by 11.9 percent and agricultural output by 0.1 percent. At the same time, on an annual basis, exports decreased in the first eight months of this year by 9.0 percent and imports by 0.9 percent. In September 2016, consumer prices increased by 1.8 percent in monthly terms and by 7.9 percent in annual terms (Chart 2.6).

Technical box

The possible effects of Brexit for the global economy

A referendum on the Great Britain status in the European Union took place in the United Kingdom of Great Britain on 23 June 2016, which resulted in the vote of 51.9 percent of people to leave the European Union. The referendum caused the fall of stock indices, the withdrawal of capital from the Great Britain by foreign investors and the significant depreciation of Pound Sterling, which reached the lowest level after 1985. Thereafter, the forecasts for the development of economy of the United Kingdom, European Union and euro area, respectively, have decreased. The survey carried out by Bloomberg show that the accumulated losses related to Brexit for the euro area economic growth will be about of 0.6 percentage points for the period 2016-2018 (USD 66 billion)[1]. In this context, the probability that the ECB quantitative easing programme will be extended is very high, which will generate again the depreciation of the European single currency.

The uncertainties relating to Brexit are very high, given that the Great Britain officials are slow in submitting the request for leaving the European Union. Given the lull registered in financial markets, the speculations on deadlines, the negotiations and the possibility of repeating the referendum determine the investors to be precarious. In this context, the possible adverse effects of the Brexit for global economy and the risks and uncertainties related to national economy are listed below:

1. Moderation in economic growth of the United Kingdom, the European Union and euro area.
2. Extension of the ECB quantitative easing programme and as a result, the depreciation of the European single currency.
3. The U.S. dollar appreciation compared to other international currencies in circulation, which could determine the Federal Reserve System to postpone the increase in interest rates in order to adjust the international competitiveness.
4. Slowdown in emerging economies growth due to the decrease in global demand and related uncertainties.
5. Decrease in volume of remittances from the Great Britain to emerging economies.
6. Decrease in price of oil and other raw materials.
7. Increase in price of gold, alternative affect for foreign exchange fluctuations.
8. The stock indices decrease.

The Brexit effects have an indirect and slightly pronounced character for the economy of the Republic of Moldova. The moderation in economic growth of the Great Britain and the decrease in number of migrants for the purpose of employment could determine the decrease in volume of remittances in the emerging economies, including the Republic of Moldova. Given that the foreign exchange markets are interconnected, the most viable channel of the Brexit consequences for the economy of the Republic of Moldova is the foreign exchange channel. Thus, the close monitoring of the fluctuations on the international markets is the optimal solution to anticipate the volatilities and the adjustment to the international macroeconomic environment.

[1] http://www.bloomberg.com/news/articles/2016-07-03/brexit-means-draghi-s-ecb-seen-as-euro-area-rescuer-once-again

Chapter 3

Economic developments

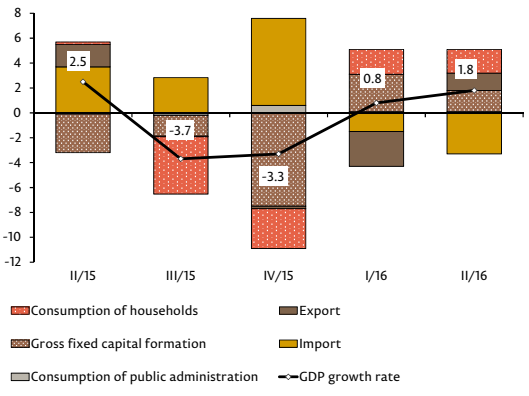
3.1 Demand and production

According to the information published by the NBS, in the second quarter of 2016, the annual rate of GDP continued its upward trajectory since the beginning of this year, recording a level of 1.8 percent. In comparison with the beginning of this year, the positive dynamics of the economic activity was due to domestic and external demand during the reporting period. However, all main sectors of the national economy recorded positive developments, except for constructions and public sector. The GDP quarterly rate was 0.6 percent per seasonally adjusted series, or by 1.1 percentage points lower than in the first quarter of 2016. In spite of the GDP positive evolution, the dynamics of economic activity continued to be modest in the first half of this year (1.3 percent compared to January-June 2015), being below its potential and exerting thus disinflationary pressures.

Demand

In terms of uses (Chart 3.1), the positive annual GDP rate was determined mainly by the domestic demand. Thus, the final household consumption increased by 2.2 percent, generating a contribution of 1.9 percentage points to annual rate formation of GDP. However, the household consumption growth continued to be insignificant, being similar to the beginning of the year. At the same time, the positive contribution of investments to GDP dynamics was determined by the favourable impact of the component change in inventories, given that the gross fixed capital formation recorded a decrease of 9.4 percent compared to the same period of the previous year, the negative value being more pronounced than in the first quarter of 2016. In the second quarter of 2016, the final consumption of public administration decreased by 0.8 percent and had a negligible influence to GDP dynamics. These developments show the decrease of household disposable income in real terms and the increased uncertainty on further development of the economy, persisting in the environment of the economic agents and households. In the second quarter of 2016, after contracting at the beginning of the year, the exports and the components of domestic demand supported the GDP growth, which increased by 3.0 percent compared to the second quarter of 2015, due to a better harvest during the reporting period. The economic activity dynamics was significantly offset in the second quarter of 2016 by the increase of imports by 4.3 percent compared to the second quarter of 2015.

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

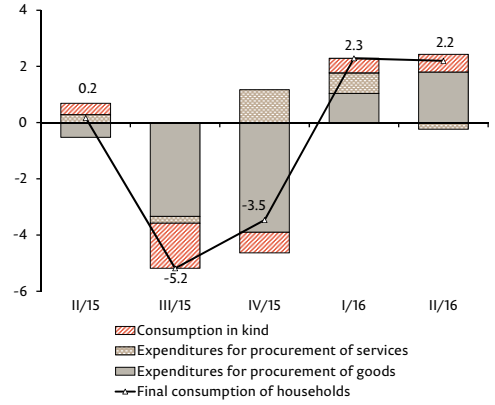


Source: NBS, NBM calculus

Household consumer demand

In the second quarter of 2016, the annual growth rate of final household consumption recorded a level of 2.2 percent, by 0.1 percentage points less than the previous quarter. This dynamics of household consumption was determined by the increase in expenditure for the procurement of goods and consumption in kind, while the expenditure for the procurement of services have decreased. The expenditure for the procurement of goods increased by 2.6 percent, contributing to annual growth rate formation of final household consumption by 1.8 percentage points (Chart 3.2). The consumption in kind recorded a positive annual dynamic, increasing by 5.1 percent, due to favourable conditions for agricultural production during the reporting period, contributing thus with 0.6 percentage points to annual rate formation. At the same time, the expenditure for the procurement of services decreased by 0.9 percent compared to the second quarter of 2015, generating a negative contribution of 0.2 percentage points.

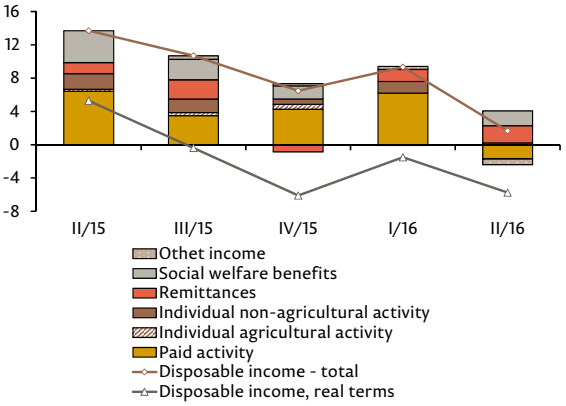
Chart 3.2: Components' contribution (p.p.) to the final consumption of households' growth (%)



Source: NBS, NBM calculus

The modest increase in household consumption was determined by the decrease in real terms of the household disposable income and by still high uncertainty on the further development of the economy. Thus, in the second quarter of 2016, the annual growth rate of household disposable income recorded a level of 1.7 percent or by 7.7 percentage points lower than in the first quarter of 2016 (Chart 3.3). The positive dynamics of disposable income compared to the second quarter of 2015 was supported mainly by the remittances, social benefits and personal non-agricultural activity, which generated contributions of 2.1, 1.8 and, respectively, 0.2 percentage points to annual rate formation. It should be mentioned that the contribution of social benefits increased by 1.9 percentage points than the previous quarter, while the contributions from employed activity decreased by 7.9 percentage points. Thus, income generated by the employed activity component had a negative contribution of 1.7 percentage points to annual rate formation and the component "other income" a negative contribution of 0.7 percentage points. The contribution from the personal agricultural activity remained unchanged compared to the first quarter of 2016. The annual growth rate of household disposable income in real terms recorded a level of -5.8 percent, by 4.2 percentage points lower than the first quarter of 2016.

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



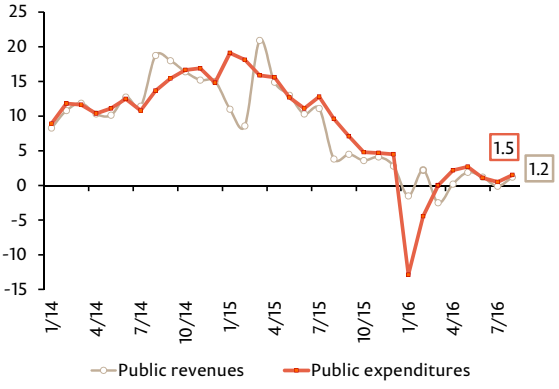
Source: NBS, NBM calculus

Public sector

Execution of national public budget

According to data provided by the Ministry of Finance, the government revenues amounted to MDL 28354.7 million in the first eight 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 64.7 percent (MDL 18334.0 million). The contributions and compulsory insurance premiums accounted for 29.8 percent (MDL 8461.8 million), while the share of other income and grants accounted for 4.7 percent (MDL 1322.7 million) and 0.8 percent, respectively, (MDL 236.2 million) of total budget revenue.

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



Source: Ministry of Finance

The revenues administered by the State Tax Service accounted for 25.7 percent of total national public budget revenue and 38.2 percent - revenues administered by the Customs Service.

In the first eight months of 2016, the national public budget expenditures totalled MDL 29619.5 million, recording an increase of 1.5 percent compared to the same period of 2015. The social protection expenditure held the largest share (38.3 percent) of the total expenditures, education held 18.1 percent and health protection 12.2 percent. The state services of general interest and services in the economy held the share of 10.7 percent and 8.3 percent, respectively, while the public order and national security held 7.6 percent of expenditures, other areas enjoying a more modest funding.

In the reporting period, the execution of the national public budget resulted in a deficit in the amount of MDL 1264.8 million compared to MDL 1160.9 million in the same period of 2015. As of 31 August 2016, the general government accounts balances increased by MDL 1799.5 million compared to 01 January 2016, accounting for MDL 4981.9 million.

Government debt

As of 31 August 2016, the government debt balance of the Republic of Moldova was MDL 37380.3 million and consisted of external state debt in the proportion of 77.0 percent and domestic government debt 23.0 percent. Compared to August 2015, the government debt increased by MDL 4430.4 million or by 13.4 percent, due to the increase of external debt (with a positive contribution of 9.2 percentage points) and internal government debt (with a positive contribution of 4.2 percentage points).

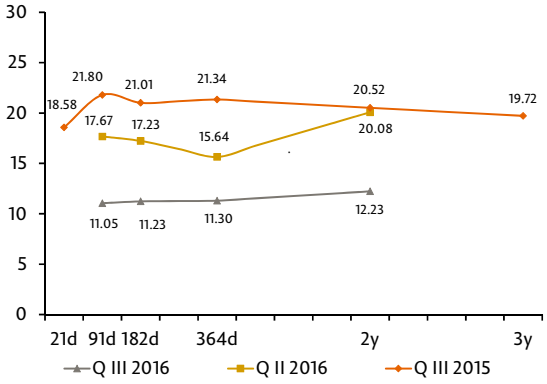
During January-August 2016, the balance of external government debt increased by about MDL 2480.6 million or by about 9.4 percent, accounting at the end of the reporting period for MDL 28764.4 million. At the same time, the balance of external government debt in foreign currency amounted to USD 1454.9 million, recording an increase of USD 117.88 million or 8.82 percent compared to the beginning of the year. During the first eight months of 2016, net external funding reached a positive value, accounting for about USD 87.27 million. At the same time, the U.S. dollar exchange rate fluctuation against other currencies reached positive values and accounted for USD 30.61 million. During January-August 2016, the external government debt service used financial means in the amount of MDL 177.1 million.

As of 31 August 2016, internal government debt accounted for MDL 8615.9 million, higher than in August 2015 by about 19.3 percent or by MDL 1391.0 million. During January-August 2016, the balance of internal government debt increased by MDL 1390.5 million, due to the SS issuance increase on primary market of about 26.9 percent. Therefore, at the end of August 2016, internal debt constituted of SS issued on primary market (76.1 percent) and SS converted (23.9 percent).

SS yield curve

In the third quarter of 2016, the volume of SS traded on the primary market amounted to MDL 2419.2 million, by 23.7 percent less than the previous quarter. The volume of SS released into circulation

Chart 3.5: SS yield curve (%)



Source: NBM

during the reporting period was by 5.7 percent lower 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 1.83 in the third quarter of 2016.

The average effective interest rate on treasury bills with a maturity of 91 days was 11.05 percent, being by 6.6 percentage points below the average level of interest rate in the previous quarter. Treasury bills of 182 days were placed at an average effective rate of 11.23 percent, by 6.0 percentage points less than the second quarter of 2016, and those with a maturity of 364 days - 11.30 percent, by 4.3 percentage points less than in 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 12.23 percent, decreasing by 7.8 percentage points than the previous quarter. 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 40.2 percent of total transactions, followed by treasury bills of 182 days, with a share a 32.1 percent, while the share of treasury bills of 91 days held the share of 26.2 percent. The volume of government bonds with a maturity of 2 years was insignificant, accounting for 1.5 percent of total transactions.

Investment demand

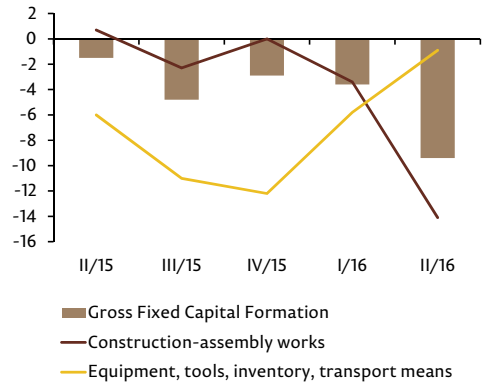
In the second quarter of 2016, gross capital formation recorded a positive evolution, as an effect of the increase in change in inventories, while the annual rate of gross fixed capital formation decreased compared to the previous period (from -3.6 percent to -9.4 percent) (Chart 3.6). The main factor was the accentuated decrease of investment in constructions (-14.1 percent), while investments for the procurement of machinery and equipment have offset the negative growth rate (to -0.9 percent).

According to the NBS operative data, investments in long-term tangible assets recorded during this period a significant decrease of 19.7 percent in annual terms, generated mainly by the high uncertainty on the further development of the economy.

By types of fixed assets, all subcomponents contributed negatively (Chart 3.7) to the investments dynamics, mainly the investments in equipment, machinery and means of transport, which recorded a decrease of 16.2 percent annually. At the same time, the building construction sector has not improved. Non-residential sector recorded a decrease in investment volume of 19.0 percent, while residential sector offset the negative growth rate to -1.3 percent. 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 3.8).

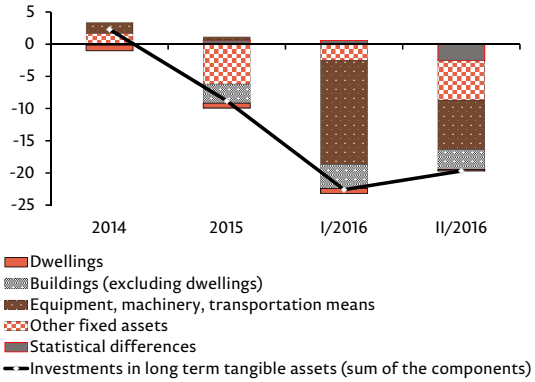
The decrease in foreign investors' funds by 68.8 percent had the highest negative impact on the investments dynamics. The most important financing sources of the investments are the economic agents' and households' own funds (with a share of 74.6 percent), which remained unchanged.

Chart 3.6: The annual dynamics of investment (%)



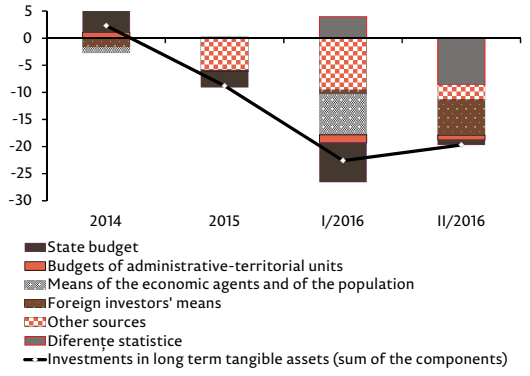
Source: NBS

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



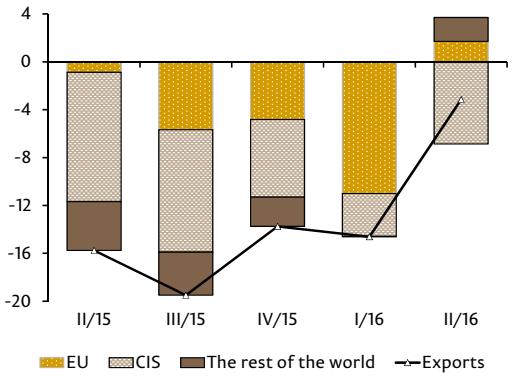
Source: NBS

Chart 3.8: Contribution of funding sources (p.p.) to the annual dynamics of investment in long-term tangible assets (%)



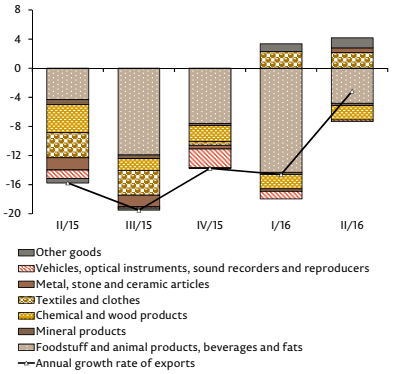
Source: NBS

Chart 3.9: Evolution of exports annual rate (%) and contribution by categories of countries (p.p.)



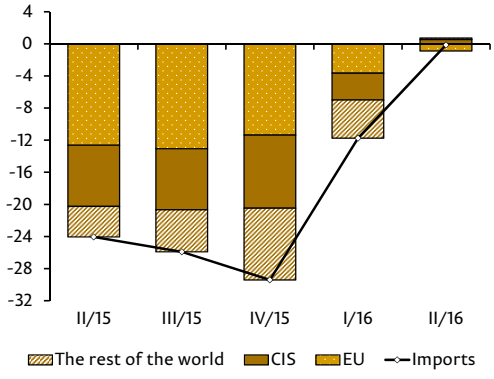
Source: NBS, NBM calculus

Chart 3.10: Evolution of exports annual rate (%) and subcomponents contribution by groups of goods (p.p.)



Source: NBS, NBM calculus

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



Source: NBS, NBM calculus

Net external demand[3]

In the second quarter of 2016, the annual growth rate of exports (expressed in U.S. dollars) recorded a level of -3.1 percent or by 11.5 percentage points higher compared to the first quarter of 2016. This development was mainly determined by the exports revival to the EU countries and to the countries classified as "Rest of the World", which increased in annual terms by 2.6 and 25.5 percent, generating positive contributions of 1.7 and 2.0 percentage points, respectively (Chart 3.9). At the same time, the exports to CIS countries decreased by 25.9 percent and generated a negative contribution of 6.9 percentage points in the reporting period. It should be mentioned that the exports to CIS countries recorded negative growth rates for the thirteenth consecutive quarter, mainly due to the decrease in annual terms of the volume of exports to the Russian Federation.

Analysing the exports by category of goods (Chart 3.10), it should be noted that the group "foodstuff, products of the animal kingdom, beverages and fats" recorded negative contributions (-4.8 percentage points), due to the decrease in annual terms of the export of such products by 10.4 percent. The decrease in exports of agricultural products was determined by the decrease of agricultural sector in 2015. At the same time, the decrease in exports of "chemical and wood products" by 18.7 percent has also influenced the decrease in volume of exports, generating thus negative contributions of 2.0 percentage points. Similar to the previous quarter, the positive contribution generated by the group "textile and clothing" was determined by the increase of 14.2 percent in the volume of these exported goods. The positive development of "textile and clothing" exports was also supported by the increase in the first six months of 2016 in the volume of industrial output in the sectors "manufacture of textile products" (34.8 percent), "manufacture of clothing articles" (24.0 percent) and "manufacture of footwear, tanning or working hides" (16.8 percent) compared to the same period of last year.

In the first half of 2016, imports reinvigorated compared to 2015, when the annual growth rate of imports recorded the level of -20.0 percent. In the second quarter of 2016, the annual rate of imports was -0.1 percent, increasing by 29.3 percentage points compared to the end of 2015 and by 11.6 percentage points than the previous quarter. The revival of imports was supported by the development of imports by category of countries (Chart 3.11). Thus, imports from CIS countries and countries classified as "Rest of the World" increased by 2.6 and 0.7 percent, contributing to the increase in annual rate of imports by 0.6 and 0.2 percentage points, respectively. At the same time, imports from EU decreased by 1.7 percent, generating a negative contribution of 0.9 percentage points to the formation of the annual growth rate of imports (Chart 3.11).

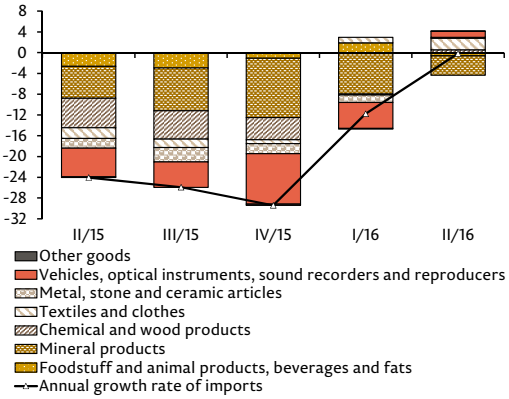
By category of goods (Chart 3.12), the decrease in annual rate of imports was influenced by the evolution of the imports of "mineral products" and "foodstuff, products of the animal kingdom, beverages and fats", which generated negative contributions of 3.7 and 0.6 percentage points, respectively. At the same time, the groups "textile materials and clothing" and "vehicles,

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

optical and sound recorders and reproducers" have generated positive contributions. It should be mentioned that the demand for "textile materials and clothing" was generated by these branches manufacturing.

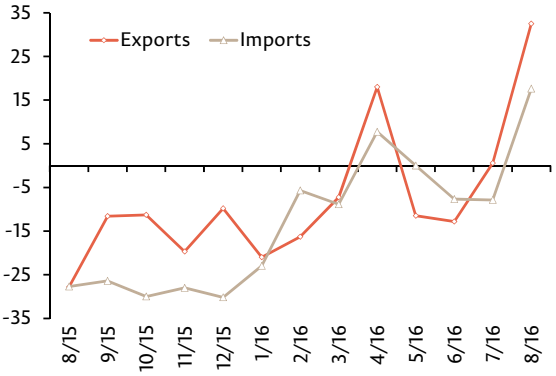
The operative data on foreign trade of the Republic of Moldova for the first two months of the third quarter of 2016 show the first sign of its revival (Chart 3.13). The annual growth rate of imports in July-August 2016 recorded the level of 4.9 percent, by 5.0 percentage points higher than in the second quarter of 2016. At the same time, the annual rate of exports recorded a level of 16.5 percent, by 19.6 percentage points higher compared to the second quarter of 2016.

Chart 3.12: Evolution of imports annual rate (%) and subcomponents contribution by groups of goods (p.p.)



Source: NBS, NBM calculus

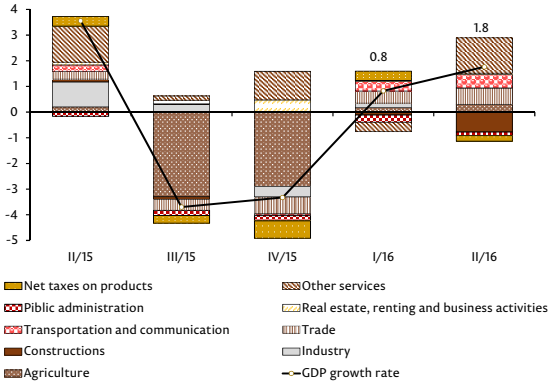
Chart 3.13: The evolution in real terms of foreign trade (%)



Source: NBS

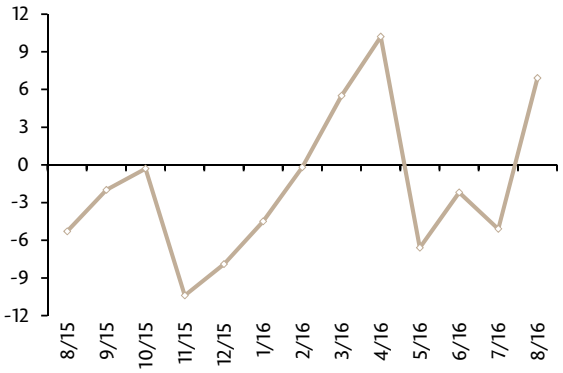
Production

Chart 3.14: The contribution of economic sectors to GDP growth (p.p.)



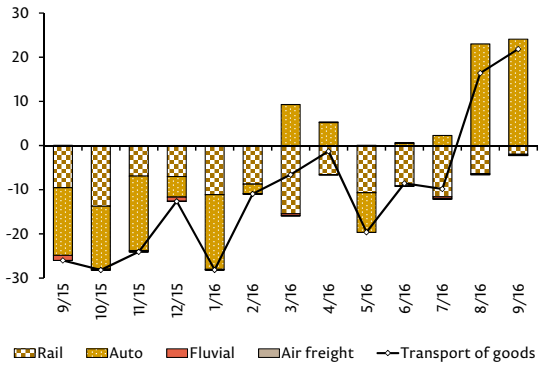
Source: NBS

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



Source: NBS

Chart 3.16: Evolution of goods transport (%, versus the same month of the previous year)



Source: NBS

By category of resources, the positive evolution of GDP was determined by the increase of gross added value in all main economy sectors, except for the subcomponent "construction" and "public administration", which recorded decreases of 14.5 and 1.0 percent, respectively (Chart 3.14). Thus, the gross added value recorded increases in "agriculture" (4.1 percent), "trade" (4.1 percent), "transport and storage" (3.1 percent), "information and communications" (7.0 percent) and "industry" (0.6 percent). However, the component "other activities" exerted the highest positive impact, as a result of the contribution of the subcomponent "financial intermediation service indirectly measured" of 1.7 percentage points. "Net taxes on products" component decreased by 1.3 percent compared to the same period of 2015.

In the first two months of the third quarter of 2016, the annual growth rate of industrial production recorded an average level of 0.9 percent, by 0.4 percentage points higher than the second quarter of 2016 (Chart 3.15). This dynamic was mainly determined by increase in 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" by 13.0 and 5.4 percentage points, respectively, reaching in the first two months of the third quarter of 2016 an average level of -11.2 and -4.4 percent, respectively. At the same time, the slowdown in annual growth rate of the manufacturing production volume (sector with the largest share) also contributed to the annual rate decrease, reaching the level of 2.1 percent in the first two months of the third quarter of 2016, by 1.4 percentage points lower than the second quarter of 2016.

In the third quarter of 2016, the annual rate of the transported goods volume recorded an average level of 9.5 percent, by 19.3 percentage points higher compared to the second quarter of 2016. It should be mentioned that this pronounced increase of the annual rate was determined mainly by the increase in volume of goods transported by road (Chart 3.16). At the same time, in January-September 2016, the enterprises of rail, road, river and air transport have transported goods by 3.5 percent less than in the same period of 2015. This evolution was determined by the decrease in annual terms of the volume of goods transported by rail (-27.2 percent), air (-20.8 percent) and river (-13.3 percent). At the same time, the transport of goods by road increased in annual terms by 8.4 percent.

Data on internal trade for July-August 2016 show an increase of the trade in goods, while the trade in services decreased (Chart 3.17). Thus, the turnover of the enterprises having retail trade as main activity recorded an average growth rate of 4.6 percent, by 1.7 percentage points higher compared to the second quarter of 2016. At the same time, the turnover of the enterprises having services rendering as main activity recorded in the first two months of the third quarter of 2016 an average decrease of 4.4 percent, by 0.4 percentage points lower compared to the previous quarter.

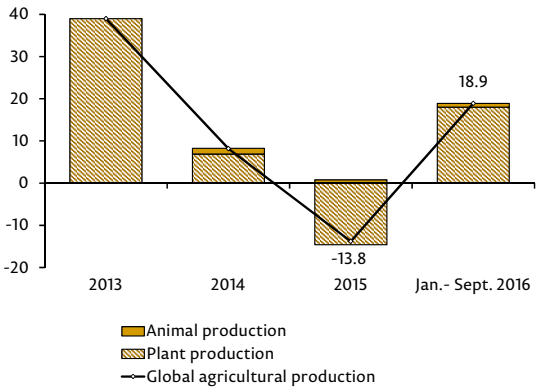
Agricultural production

In the first nine months of 2016, the volume of global agricultural production increased by 18.9 percent compared to the same period of the previous year (Chart 3.18). This development was determined mainly by the increase in volume of the plant production by 28.4 percent, contributing thus to the increase in the volume of global agricultural production by 18.0 percentage points. According to preliminary data, the positive dynamics of plant production was supported by the increase in harvest of "wheat", "barley" and "grain legumes" by 36.0, 39.0 and 44.0 percent, respectively. At the same time, the volume of livestock production increased by 2.1 percent during the reporting period.

Chart 3.17: Evolution of domestic trade (%, versus the same month of the previous year)

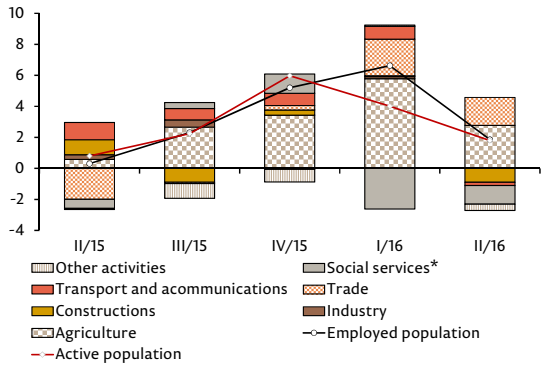
Source: NBS

Chart 3.18: Global agricultural production (%, versus the same period of the previous year)



Source: NBS

Chart 3.19: Annual growth rate of active and employed population (%) and its formation by national economy sectors (p.p.)

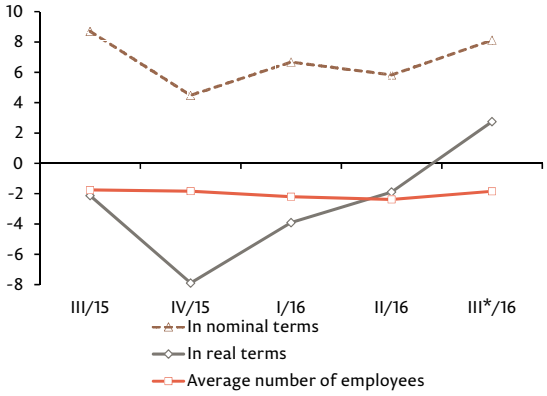


Source: NBS, NBM calculus
*Public administration, education, health and social care

Chart 3.20: Evolution of the unemployment and employment rate (%)

Source: NBS, NBM calculus

Chart 3.21: Wage bill in economy and average number of employees (%, versus the same period of the previous year)



Source: NBS, NBM calculus
*July-August

3.2 Labour market

In the second quarter of 2016, both the employed population and active population increased compared to the same period of last year. However, they were more modest compared to the beginning of this year. At the same time, the unemployment rate was slightly lower in the reporting period compared to the second quarter of 2015.

Workforce

In the second quarter of 2016, the annual growth rate of employed population decreased by 4.8 percentage points compared with the first quarter of 2016, representing 1.9 percent. At the same time, referring to the domestic economy structure, the increase in number of employed population was determined by the increase of its number in "agriculture" and "trade", while the rest of sectors recorded negative evolutions (Chart 3.19). The number of economically active population increased by 1.8 percent compared to the second quarter of 2015.

The unemployment rate at the country level was 4.0 percent (Chart 3.20). At the same time, the unemployment rate adjusted seasonally recorded a level of 4.7 percent, being slightly higher than at the beginning of 2016. The seasonally adjusted employment rate was 41.2 percent, by 0.5 percentage points lower than the previous quarter.

According to data provided by the ANOFM[4], the number of people laid off increased in April-June 2016 by 50.5 percent compared to the same period of last year, while the number of vacancies increased by 7.6 percent.

Wages

In the first two months of the third quarter of 2016, the annual growth rate of the wage bill recorded an average level of 8.1 percent, by 2.3 percentage points higher than the previous quarter. At the same time, deflated by CPI, the wage bill recorded the level of 2.8 percent, leaving the negative territory after recording negative growth rates over a period of four consecutive quarters. It should be mentioned that the annual growth rate of the average number of employees at the level of the national economy recorded negative paces during a period of ten consecutive quarters, thus recording in the first two months of the third quarter of 2016 the level of -1.8 percent (Chart 3.21).

In the first two months of the third quarter of 2016, the average wage in the national economy increased by 10.2 percent compared to the same period of last year. Both the budgetary sector and the real sector of the economy registered an increase of the

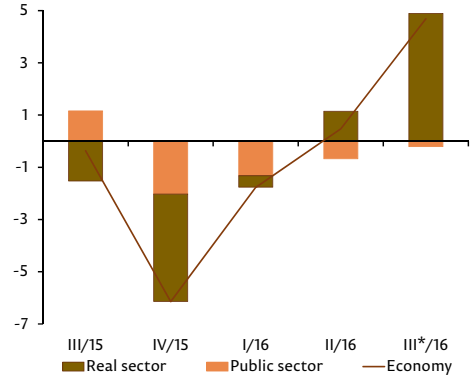
[4]National Agency for Employment.

average wage by 4.2 and 12.4 percent, respectively, compared the similar period of 2015. It should be mentioned that for the fourth consecutive quarter, the annual growth rate of the average wage in real sector exceeded more the rate recorded in budgetary sector, contributing thus to the occurrence of a more pronounced gap between the wages paid in real and budgetary sector.

In this period, the annual growth rate of real average wage in the economy was 4.7 percent, by 4.2 percentage points higher compared to the second quarter of 2016 (Chart 3.22). This increase in annual rate was determined by the positive dynamics of wages in real sector (6.8 percent), contributing positively with 4.9 percentage points to the general evolution of the real average wage in the economy. This increase was supported mainly by the increase of wages in the following sectors of the economy: "wholesale and retail trade", "financial and insurance activities", "real estate transactions" and "constructions". At the same time, the evolution of average wage in the budgetary sector contributed to the slowdown in annual growth rate of real average wage per economy by 0.2 percentage points.

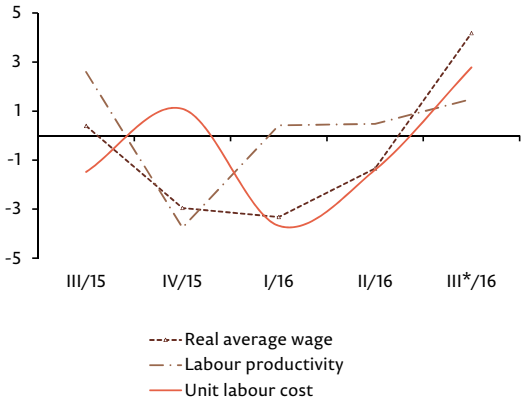
The labour productivity in industry was 1.5 percent, increasing by 1.0 percentage points than the second quarter of 2016. At the same time, the annual growth rate of real average wage in the industry was 4.2 percent, by 5.5 percentage points higher compared to the previous quarter (Chart 3.23). In this regard, the annual rate of the labour unit cost in industry increased by 4.2 percentage points, up to the level of 2.9 percent.

Chart 3.22: Real contributions of economy sectors (p.p.) to earnings growth (%, versus the same period of the previous year)



Source: NBS, NBM calculus
*July-August

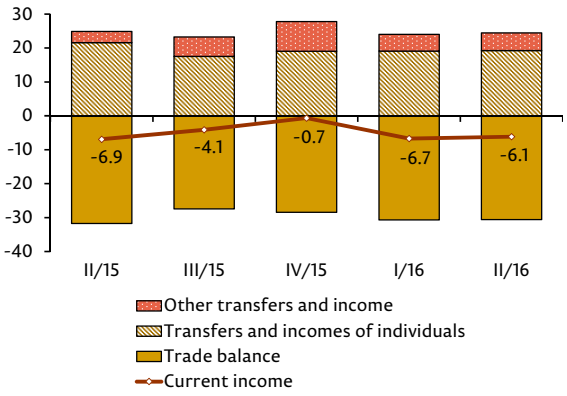
Chart 3.23: Average real wage and productivity in industry (%, versus the same period of the previous year)



Source: NBS, NBM calculus
*July-August

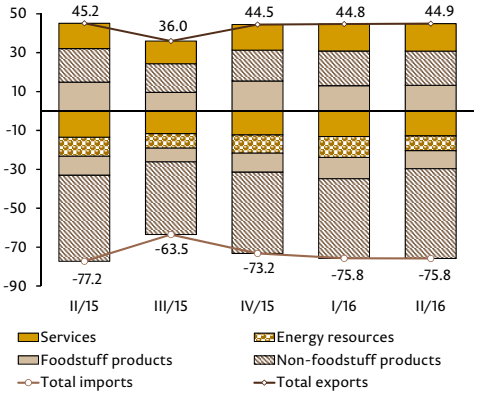
3.3 External sector

Chart 3.24: Current account share in GDP (%)



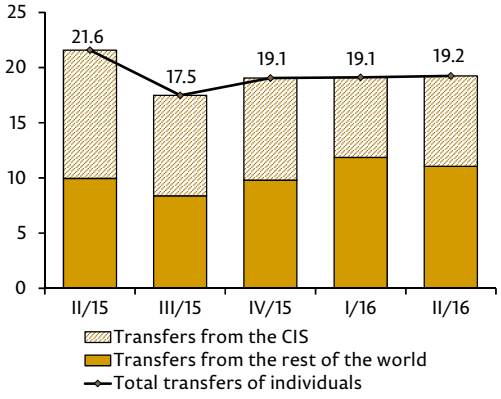
Source: NBM

Chart 3.25: Share of exports and imports in GDP (%)



Source: NBM

Chart 3.26: Share of transfers in GDP (%)



Source: NBM

In the second quarter of 2016, current account deficit[5] of the balance of payments decreased, representing 6.1 percent as share to GDP, by 0.6 percentage points lower than the previous quarter (Chart 3.24). The decrease in the balance of payments deficit was generated by the increase in share of the components to GDP with positive contribution - transfers and income of individuals and other transfers and income. These components increased as a share of GDP by 0.1 and 0.4 percentage points compared to the first quarter of 2016, respectively. The trade balance deficit decreased as a share of GDP by 0.1 percentage points than the first quarter of 2016, reaching a level of 30.6 percent. This development was driven, on the one hand, by the increase of the share of exports to GDP by 0.2 percentage points, while on the other hand, by the decrease of the share of imports by 0.1 percentage points.

During the reporting period, the export of goods and services increased as a share of GDP up to the level of 44.9 percent (Chart 3.25). This development was driven by the increase of the share of agri-food products exports by 0.2 percentage points, up to the level of 13.2 percent in GDP, the share of exports of services increased by 0.2 percentage points, up to the level of 14.1 percent in GDP, while that of exports of non-food products decreased by 0.3 percentage points (17.6 percent in GDP). Within the exports structure, the non-food products prevailed and accounted for 39.1 percent, services constituted 31.5 percent, while agri-food products - 29.4 percent.

In the second quarter of 2016, the share of imports of goods and services in GDP maintained the previous quarter level of 75.8 percent. It should be mentioned that all components: energy resources, agri-food products and services to GDP recorded higher values compared to the first quarter of 2016. Thus, energy resources, agri-food products and services increased by 3.2, 1.7 and 0.3 percentage points, respectively. As a share of GDP, these components represented 9.9, 12.3 and 17.0 percent, respectively. At the same time, the share of non-food products decreased by 5.2 percentage points compared with the first quarter of 2016, representing 60.9 percent. Within the structure of imports, the share of non-food products constituted 60.9 percent, services - 17.0 percent, agri-food products - 12.3 percent and energy resources - 9.9 percent.

During the reporting period, the exports reflected in the trade balance covered the imports to a greater proportion (59.2 percent) compared with the first quarter of 2016 (59.1 percent). At the same time, according to the NBS data for the second quarter of 2016, the trading partners such as Romania, Russian Federation, Ukraine, Germany, Italy, Turkey and Belarus have owned 54.1 percent of total commercial transactions carried out within export-import operations with goods and services.

[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, grouped in the category Other transfers and other income.

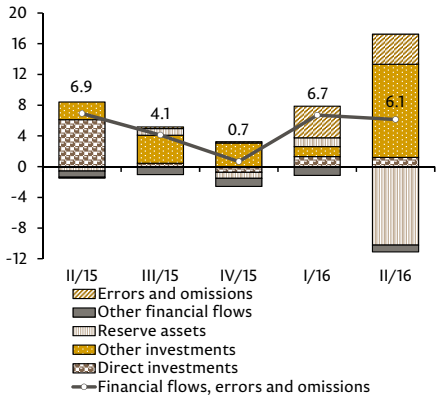
In the second quarter of 2016, the share of transfers and income of individuals working abroad recorded a minor increase of 0.1 percentage points as a share in GDP compared to the previous quarter, thus reaching the level of 19.2 percent (Chart 3.26). The upward trend of transfers was driven by the increase of transfers from the CIS countries. The funds transferred from the CIS countries as a share of GDP was 8.2 percent, by 0.9 percentage points more compared to the first quarter of 2016, while the funds transferred from countries classified as the "Rest of the World"[6] held a share of 11.0 percent in GDP, by 0.8 percentage points less than in the previous quarter. According to geographical distribution, the transfers from countries classified as "Rest of the World" accounted for 57.4 percent and from CIS countries - 42.6 percent during the reporting period.

The financial flows reinvigorated in the second quarter of 2016, while their net volume to GDP decreased by 0.6 percentage points compared to the first quarter of 2016, reaching the level of 6.1 percent (Chart 3.27). The recovery of financial flows was determined by the development of "other investment" and "reserve assets". It should be mentioned that the positive contribution of the component "other investment" was supported mainly by the financial inflows recorded under the item "foreign currency and deposits". At the same time, the interventions on the Republic of Moldova foreign exchange market (negative contribution from the component "reserve assets") influenced the decrease of financial inflows on the market.

During the reporting period, direct investments to GDP recorded a similar development as in the first quarter of 2016, recording the level of 1.2 percent or by 0.1 percentage points lower than in the first quarter of 2016. Similar to the previous quarter, direct investments in "share capital" and "reinvested income" contributed to the increase of the direct investments flow, while the component "other capital" - to the decrease thereof (Chart 3.28)

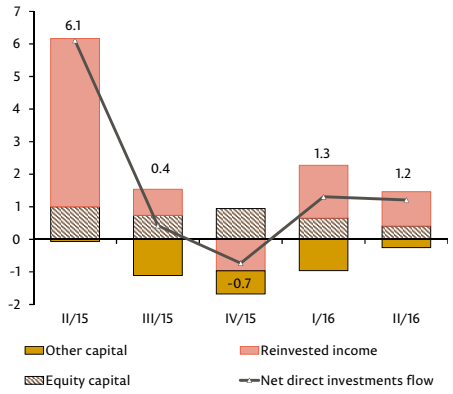
In the second quarter of 2016, the share of external debt in GDP recorded the level of 97.0 percent, by 0.3 percentage points higher than the previous quarter (Chart 3.29). It should be mentioned that "government sector" (0.2 percentage points) and "other sectors" (0.5 percentage points) contributed to the increase of external debt as a share to GDP compared to the first quarter of 2016. At the same time, these developments have not influenced significantly the structure of external debt. Thus, similarly to the previous periods, the economic agents hold the largest share of 54.5 percent in total external debt, followed by government sector with a share of 25.8 percent and direct investment - 16.7 percent.

Chart 3.27: Share of financial flows in GDP (%)



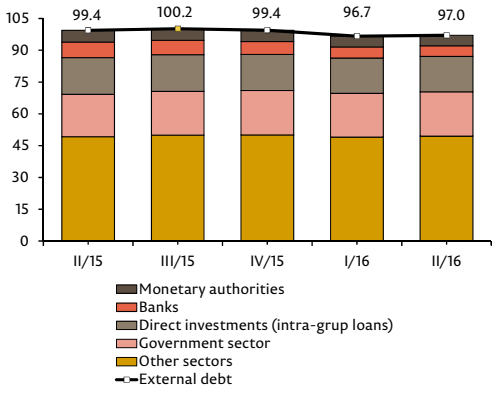
Source: NBM

Chart 3.28: Share of direct investments in GDP (%)



Source: NBM

Chart 3.29: Share of external debt in GDP (%)



Source: NBM

[6]Transfers received from all world countries, excluding the CIS countries.

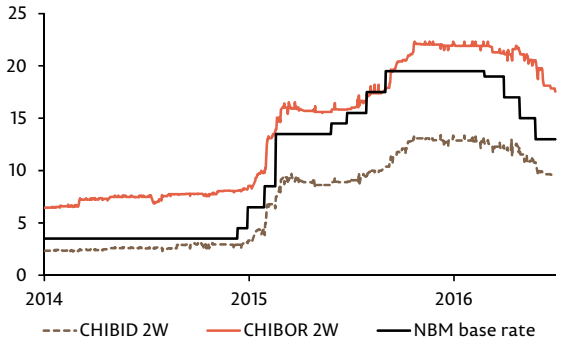
Chapter 4

Monetary Policy

4.1 Monetary Policy Instruments

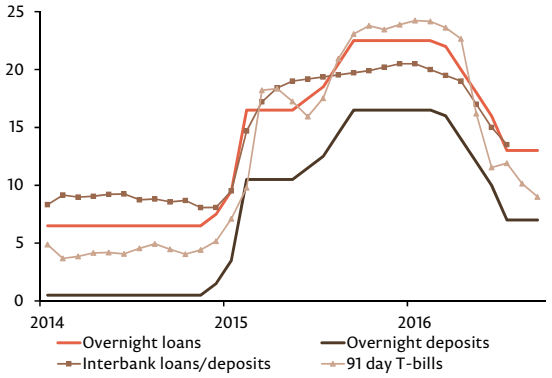
Interest rate policy

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

The unfavourable evolution of the macroeconomic indicators and implicitly the further mitigation perspective of inflationary pressures for the monetary policy on relevant horizon represented the basis of the monetary policy decisions adopted by the NBM during the third quarter of 2016. During this period, the downward trend of monetary policy interest rate has strengthened and the NBM decreased its level by 3.0 percentage points at the beginning of the quarter and by 0.5 percentage points at the end of the quarter, up to 9.5 percent annually.

CHIBOR 2W yield curve continued its downward trend, including the decreases in the monetary policy interest rate. CHIBOR 2W registered at the end of September was lower compared to the last day of the previous period (-2.94 percentage points), representing 14.62 percent, which is above the upper limit of the policy rate corridor established by the NBM (Chart 4.1).

The monthly interest rate on state securities (SS) of 91 days recorded a gradual upward adjustment in July, in the forthcoming period this initiated a more moderate downward trend, which maintained until the end of the quarter. The average interest rate on SS of 91 days in the last month of the quarter decreased compared to June by 2.54 percentage points, representing 9.00 percent annually. The interbank monetary market rates have also decreased, the monthly average rate recording in July the level of 13.52 percent annually (-1.48 percentage points compared to June 2016) (Chart 4.2).

Open market operations

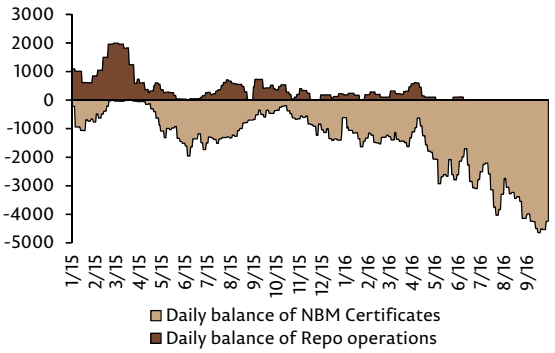
During the third quarter of 2016, the NBM liquidity management manner was in line with the operating conditions of the financial market. The NBM net debtor position to the banking system has straightened as a result of the bids submitted by the participants and accepted entirely by the NBM within the auctions of NBM Certificates placement, evolution associated with the systematic absence of the bids within repo auctions during the third quarter of 2016 (Chart 4.3).

NBM Certificates-selling operations

The NBM carried out 27 auctions with the term of 14 days with the announcement of the maximum interest rate equivalent to the NBM base rate, the banks bids being fully awarded. During the third quarter of 2016, the weighted average rate of liquidity-absorbing operations constituted 10.13 percent annually.

The balance of NBM Certificates at the end of the reporting quarter and their monthly average represented MDL 4227.4 million and MDL 3597.0 million respectively, increasing by MDL 1446.1 million and MDL 1485.0 million respectively, compared to the second quarter of 2016.

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



Source: NBM

Repo operations

NBM carried out repo operations with the term of 14 days at fixed rate (the base rate plus a margin of 0.25 percentage points) through auction procedure without ceiling and full allocation. The balance of repo operations recorded at the end of the reporting quarter was null.

Lending activity

As of 30 September 2016, the credit indebtedness of the licensed banks to National Bank of Moldova constituted MDL 13344.5 million, represented by emergency outstanding loans in the amount of MDL 13344.0 million and loans granted in 1996-2002 for crediting the construction of housing cooperatives in the amount of MDL 0.5 million.

During the third 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 85.4 million. Thus, at the beginning of 2016, the amount of outstanding emergency loans decreased by MDL 345.2 million.

Standing facilities

In the third quarter of 2016, the banks used daily overnight deposit facility, the overnight credit facility was not requested on the grounds of the liquidity excess in the banking system.

The total volume of overnight deposits with the NBM amounted to MDL 46626.0 million, representing a daily average of MDL 699.4 million, by about 30.1 percent higher compared to the previous quarter.

Concomitantly with the base rate, the interest rates on the NBM standing facilities decreased twice during the third quarter of 2016 by 3.0 percentage points in July and by 0.5 percentage points in September. Thus, at the end of the third quarter of 2016, the interest rate of overnight deposit facility was 6.5 percent annually and the overnight credit facility was 12.5 percent annually.

Required reserves

In the third quarter of 2016, required reserves mechanism continued to exercise the function of monetary control and liquidity management in the banking system.

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.

The required reserves in MDL maintained by banks in 08 September - 07 October 2016 amounted to MDL 9931.3 million, higher than the previous quarter (08 June 2016 - 07 July 2016) by MDL 707.4 million (7.7 percent). The increase of required reserves in MDL was determined by the increase of financial means attracted in MDL by banks.

Required reserves in FCC maintained by banks with the NBM constituted USD 62.1 million and EUR 100.8 million as of 30 September 2016. Compared to 30 June 2016, the required reserves in USD decreased by 2.4 percent, while those in EUR increased by 1.3 percent.

Interbank money market

The volume of transactions on interbank money market amounted to MDL 87.3 million, interbank credit/deposit transactions accounting for 95.1 percent.

In the third quarter of 2016, interbank credit/deposits market recorded a significant number of transactions. As the debtor in respect of interbank transactions was one bank, which satisfied its liquidity need on short-term, in order to comply with the requirements of the mandatory reserves regime in July 2016.

Thus, interbank (overnight) credit/deposit with minimum market maturity recorded in July totalled to MDL 83.0 million, the interest rate accounting to 13.52 percent annually, which decreased by 4.08 percentage points compared to previous quarter.

Secondary market of state securities

In the third quarter of 2016, the participants in the secondary market of state securities performed transactions in a volume of MDL 4.3 million, decreasing by MDL 7.3 million compared to the previous period.

The bank - client transactions prevailed in total transactions recorded, constituting 60.5 percent of total transactions.

The average quarterly yield for the selling-buying operations on the secondary market of state securities equalled to 10.78 percent, decreasing by 7.46 percentage points compared to the previous quarter, given the increase of the weighted average term of maturity from 180 days up to 229 days.

Intervention on the domestic foreign exchange market

NBM intervened in the domestic foreign exchange market in July-September 2016, as a purchaser of foreign currency, carrying out purchases from commercial banks.

During the reporting period, the volume of NBM transactions carried out on the interbank foreign exchange market against MDL

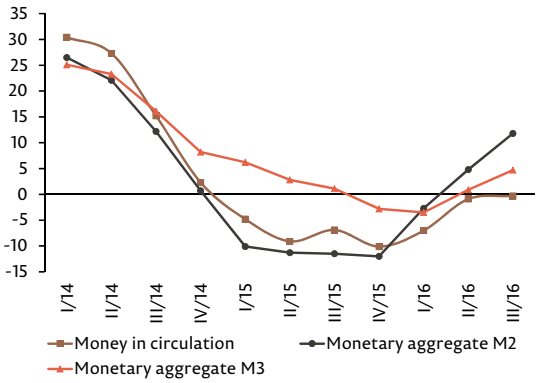
was USD 233.38 million[7], of which the purchasing transactions in the amount of USD 231.7 million and the currency conversions in the form of purchases with the World Bank institutions (International Bank for Reconstruction and Development and International Development Association) in the amount of USD 1.68 million.

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

4.2 Dynamics of monetary indicators

In the third quarter of 2016, the growth rate of monetary aggregates was positive, the quarterly average in annual terms constituted 11.9 percent for M2 (by 7.1 percentage points higher than in the second quarter of 2016) and 4.7 percent for M3 (by 3.8 percentage points higher than the previous quarter) (Chart 4.4).

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

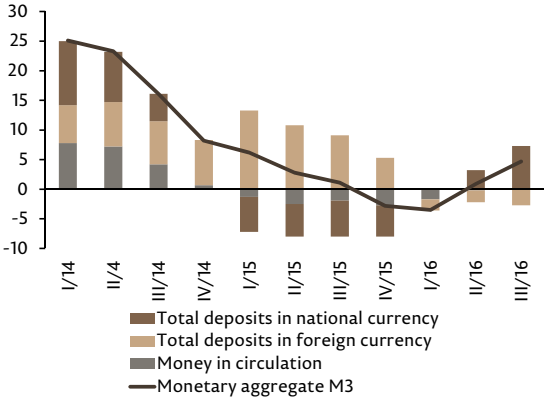


Source: NBM

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 third quarter of 2016, broad money supply recorded an annual average increase of 4.7 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. Thus, the average increase of 4.7 percent of money supply M3 was due to the increase in balance of deposits in MDL (7.3 percentage points), decrease of money in circulation (-0.1 percentage points), decrease in balance of deposits in foreign currency (-2.6 percentage points) (Chart 4.5).

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



Source: NBM

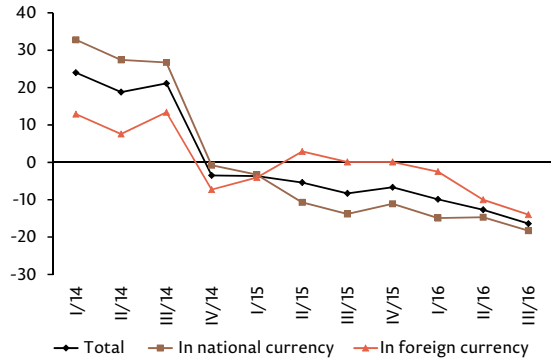
At the same time, the structure of money supply M3 recorded changes as compared to the second quarter of 2016. The quarterly average share of deposits in national currency increased by 1.3 percentage points compared to the previous quarter and equalled to 40.8 percent. The share of deposits in foreign currency decreased by 1.8 percentage points, amounting to 35.1 percent, while the share of money in circulation increased by 0.5 percentage points, reaching the level of 24.2 percent as quarterly average.

The balance of deposits in national currency increased in annual terms on average by 12.1 percentage points compared to the previous quarter, the average growth rate recording the value of 20.7 percent during the reporting period. Deposits in foreign currency have evolved in the opposite direction, recording an average decrease of 6.5 percent annually, by 1.3 percentage points less compared to the previous quarter. The growth rate of the total balance of deposits increased during this period on average by 4.9 percentage points compared to the second quarter of 2016, recording an annual average growth rate of 6.4 percent.

[7] Including the foreign currency purchases from the banks under the liquidation process in the amount of USD 0.25 million (of which USD 0.22 million are the equivalent of EUR 0.20 million).

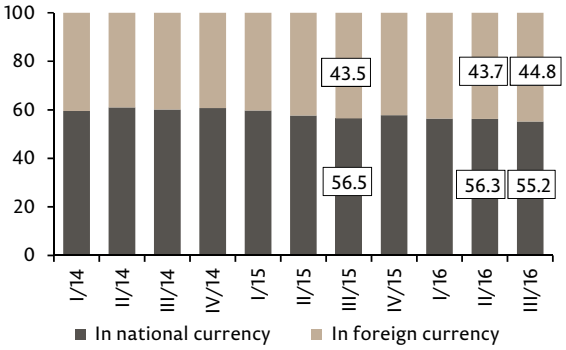
Lending market

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



Source: NBM

Chart 4.7: The shares of loans balance (%)



Source: NBM

In July-September 2016, the balance of credits recorded a downward trend, falling at the end of the quarter to the value of MDL 35540.8 million, decreasing by 16.4 percent compared to the end of September 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 accounted to 55.2 percent (-1.1 percentage points than the previous quarter), while those granted in foreign currency - 44.8 percent (Chart 4.7).

At the end of September 2016, the balance of loans in MDL extended by licensed banks from the Republic of Moldova amounted to MDL 19625.3 million, decreasing by 18.3 percent compared to the end of September 2015.

During the third quarter of 2016, the development of loans balance in MDL was generated by the decrease in volume of loans granted to legal entities of 24.7 percent, accounting for MDL 12678.8 million (with a share of 64.6 percent of the total loans in MDL), and by the decrease in volume of loans granted to individuals of 3.2 percent annually, accounting for MDL 6946.5 million (with a share of 35.4 percent of total loans in MDL).

The balance of credits in foreign currency at the end of the third quarter of 2016 recorded a decrease in annual terms of 14.0 percent compared to the end of the third quarter of 2015, recording the level of MDL 15915.5 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 15598.5 million on 30 September 2016 and by 14.2 percent lower compared to the end of the third quarter of 2015. Loans in foreign currency granted to individuals recorded at the end of the third quarter of 2016 a more tempered negative annual growth rate of -2.7 percent.

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 29.9 percent for the loans granted in national currency and by 21.5 percent for loans in foreign currency. The share of credits targeted to this sector was 22.7 percent in national currency (-3.8 percentage points than in September 2015) and 37.6 percent in foreign currency (-3.6 percentage points than in September 2015).

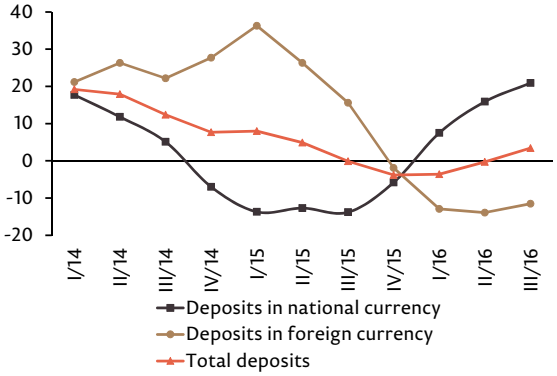
Deposit market

During the third quarter of 2016, the annual total balance of deposits attracted by the banking system in annual terms increased up to positive values. Thus, the total balance of deposits accounted at the end of September 2016 for MDL

32491.2 million, recording an annual growth rate of 3.4 percent, compared to the decrease of 0.1 percent in September 2015.

The positive dynamics of the balance of deposits was influenced by the upward trend only of the component in national currency compared to the same period of the previous year. The annual growth rate of deposits in national currency decreased to 20.9 percent annually, compared to the decrease of 13.8 percent annually in September 2015. In turn, the annual growth rate of deposits in foreign currency recorded a decline of 11.5 percent annually, compared to the increase of 15.6 percent in September 2015 (Chart 4.8).

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



Source: NBM

The balance of deposits in national currency increased up to MDL 17438.7 million. During third quarter of 2016, the upward trend of deposits in MDL was determined by the evolution of placements attracted from individuals, the share of which increased up to MDL 15592.8 million (89.4 percent of total portfolio of deposits in national currency). Deposits attracted in MDL from legal entities recorded an annual growth rate of 4.7 percent, their share in the last 12 months decreased by 1.6 percentage points, reaching the level of 10.6 percent of total deposit portfolio.

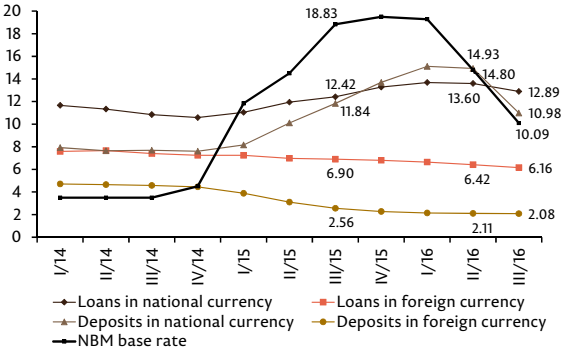
The annual dynamics of deposits in foreign currency recorded a decline of 11.5 percent, reaching the level of MDL 15052.5 million. This decrease occurred on the account of deposits attracted from legal entities (with a share of 13.8 percent of total deposits in foreign currency) and from individuals (86.2 percent of total deposits attracted in foreign currency). At the end of the third quarter of 2016, the deposits attracted from legal entities recorded an annual decrease of 4.2 percent, accounting for MDL 2080.5 million, while those attracted from individuals decreased by 12.6 percent, amounting to MDL 12972.0 million.

Interest rates

Base rate

In the third quarter of 2016, there were held four meetings of the Executive Board of the National Bank on Moldova on monetary policy decisions. Following the assessment of internal and external balance of risks to which the economy of the Republic of Moldova could be subject and the inflation outlook in the short and medium term, the NBM Executive Board decided at the meeting of 4 July 2016 to decrease the base rate applied on main monetary policy operations by 3.0 percentage points, from the level of 13.0 percent (set at the meeting of 26 May 2016) to 10.0 percent annually. Thereafter, at the meetings of 8 August 2016 and 25 August 2016, it was decided to maintain the base rate applied on main monetary policy operations at the level of 10.0 percent annually, while at the meeting of 29 September 2016, the base rate was decreased by 0.5 percentage points, up to 9.5 percent annually. 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

Chart 4.9: The average interest rates (%)



Source: NBM

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.

Interest rate of credits

During the third quarter of 2016, the average interest rates on credits balance granted by licensed banks continued the downward trend and their average amounted to 12.89 percent for the credits in national currency (-0.71 percentage points compared to the second quarter of 2016) and 6.16 percent for the credits in foreign currency (-0.26 percentage points compared to the second quarter of 2016). This evolution shows the continuing effect 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 during 2016. At the same time, the annual average interest rate on loans balance in national currency increased by 0.47 percentage points, while the average annual interest rate on loans balance in foreign currency decreased by 0.74 percentage points compared to the third quarter of 2015 (Chart 4.9).

The decrease in average interest rate on the credit balance in national currency was caused by the decrease in average rate on credits granted both to legal entities and individuals. The average quarterly rate on loans granted to legal entities decreased by 0.76 percentage points compared to the second quarter and constituted 12.44 percent. The annual average interest rate for loans in MDL granted to individuals reached in the third quarter of 2016 the level of 13.75 percent, decreasing by 0.64 percentage points compared to the previous quarter.

During the third 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 0.26 percentage points, up to the level of 6.12 percent annually) and the interest rates of loans granted to individuals (by 0.29 percentage points, up to the level of 7.87 percent annually).

Interest rate of deposits

Following the downward trend of base rate applied on main monetary policy operations of the National Bank of Moldova, the average interest rates on deposits balance continued their downward trend.

The average interest rate of deposits in MDL amounted to 10.98 percent in the third quarter of 2016, lower by 3.95 percentage points than the previous quarter and by 0.86 percentage points than the third 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 7.93 percent (-2.29 percentage points than the previous quarter), while from individuals up to 11.35 percent (-4.09 percentage points than the previous quarter).

The interest rate of deposits in foreign currency amounted to an average of 2.08 percent during the reporting period, decreasing by 0.03 percentage points than the previous quarter and by 0.48 percentage points than the third quarter of 2015. The quarterly

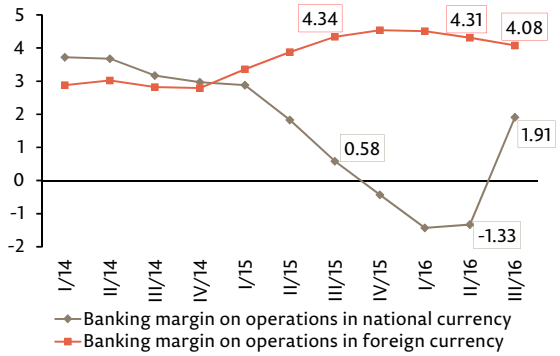
decrease was influenced by the decrease of the average interest rates for deposits attracted from individuals by 0.04 percentage points, up to 2.09 percent annually. The average rate on deposits in foreign currency from legal entities increased by 0.07 percentage points and amounted to 2.02 percent annually. 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 0.54 percentage points and 0.47 percentage points, respectively.

Banking margin

The banking margin (the difference between the average interest rates on loans and deposits) for the operations in national currency recorded a positive level in the third quarter of 2016, amounting to 1.91 percentage points, by 3.24 percentage points more compared to the previous quarter (Chart 4.10). This development was due to the downward trend of the rates on deposits attracted by the banking system.

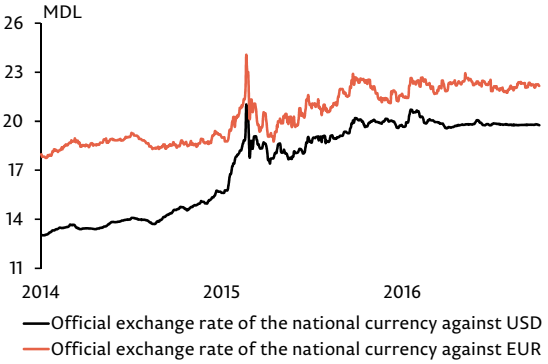
Evolution of banking margin for operations in foreign currency recorded a downward trend, constituting 4.08 percent, by 0.23 percentage points less compared to the second quarter of 2016, mainly driven by a more pronounced reduction during the reporting period of the interest rate on loans granted in foreign currency.

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



Source: NBM

Chart 4.11: The fluctuations of the official exchange rate of MDL against USD and EUR



Source: NBM

Nominal exchange rate and real effective rate

During the third quarter of 2016, the official exchange rate of national currency appreciated slightly against the USD, decreasing at the end of the period by 0.6 percent, while against EUR the evolution was inversed, increasing by 0.6 percent (Chart 4.11).

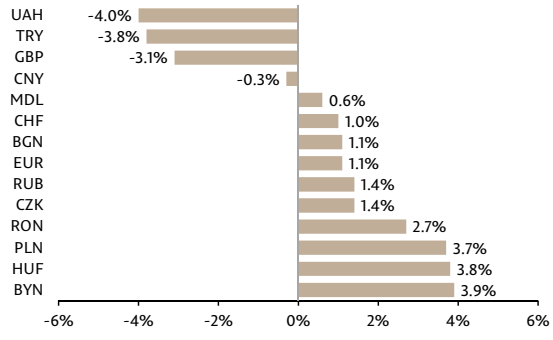
The average official exchange rate of national currency against USD maintained the level of the previous quarter in the third quarter of 2016, while against the EUR this appreciated by 1.1 percent.

In the third quarter of 2016, the real effective exchange rate of the national currency (REER) depreciated by 0.3 percent (Chart 4.13), the trading partners contributed mainly to this dynamics: Russia - by 0.4 percentage points and Romania by 0.3 percentage points (Chart 4.14). At the same time, the depreciation of Moldovan leu in real terms offset mainly by its appreciation against Ukrainian hryvnia and Pound Sterling.

Net supply of foreign currency from individuals had a positive dynamic, although it was not so robust as in the first two quarters of this year and increased by 5.2 percent compared to the previous quarter.

Overall, the premises that determined the evolution in foreign currency demand and supply from population maintained the configuration of previous quarter. The volume of transfers from abroad in favour of individuals[8] increased by 6.7 percent, while in August these reinvigorated compared to the same period of the previous year. In these circumstances, net supply reached in

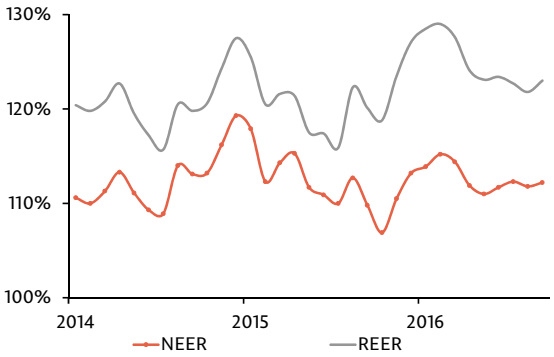
Chart 4.12: The evolution of currencies in the region and currencies of the major trading partners of the Republic of Moldova against the U.S. dollar (30.09.2016), 30.06.2016=100%



Source: NBM

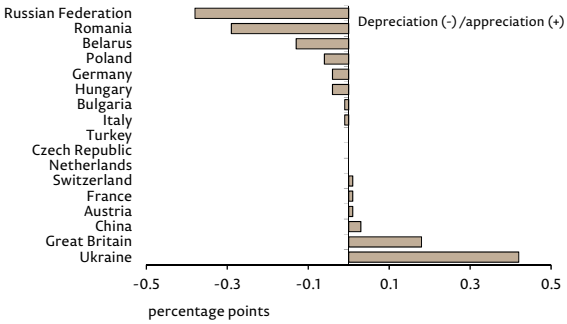
[8] According to data available for the first two months of the quarter.

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%)



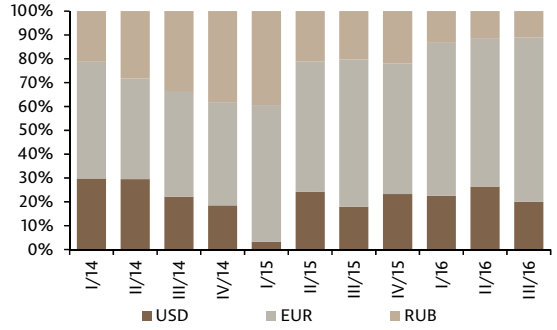
Source: NBM

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



Source: NBM

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

August values unrecorded in last two years, accounting for USD 217.4 million.

However, the supply of foreign currency continued to be further driven by the withdrawals from current accounts and deposit accounts in foreign currency of individuals, in the equivalent of USD 11.1 million[9], due to the constant positive trend of population deposits in national currency.

In this context, the net foreign currency supply from individuals amounted to USD 563.9 million in the third quarter 2016 compared to the value of USD 535.8 million recorded the previous quarter and the value of USD 508.9 million in the third quarter of 2015. The supply increase was supported mainly by the transactions in EUR, net purchases in this currency increasing by the equivalent of USD 52.0 million (by 15.7 percent) and gross purchases by USD 88.6 million (by 19.9 percent). At the same time, net purchases in Russian rouble recorded an insignificant increase - of USD 2.6 million (by 4.2 percent), while those in USD decreased by USD 26.3 million (by 19.6 percent).

Net sales in foreign currency to economic agents increased in the third quarter of 2016, after recording negative evolution in the second quarter. However, the net sales increased insignificantly by 1.9 percent than the previous quarter, reaching the net level of USD 388.2 million. Although the sale operations of foreign currency to economic agents increased (15.7 percent), the advance has been fully counterbalanced by the increase in foreign currency purchases from the economic agents, which continued to increase in relative terms (26.7 percent than the second quarter).

Foreign currency purchases from legal entities increased mainly on the account of foreign currency supply from the exporters of agricultural products, in particular of cereal and oilseed products.

Overall, with regard to the external trade, the imports of goods recorded a decrease (of 2.6 percent), followed by a slight increase of exports (of 0.7 percent) than the previous quarter[8].

Based on these evolutions, net foreign currency supply from individuals exceeded the net demand of foreign currency from economic agents by USD 175.7 million, while the coverage of net demand by net supply amounted to 145.3 percent in the third quarter of 2016 compared with 140.6 percent in the previous quarter and 95.4 percent in the third quarter of 2015 (Chart 4.16).

In this context, in order to satisfy the foreign exchange reserves and to avoid an excessive appreciation in national currency, the NBM intervened on the market through the purchasing operations, in the amount of USD 231.4 million[10], thus absorbing entirely the foreign exchange excess. At the same time, the relatively uniform distribution of the interventions during the reporting period, in line with the volume of currency accumulated in the market, have created a favourable ground to ensure a relatively stable exchange rate of the national currency against the USD during the third quarter of 2016, recording at the end of this quarter a slight increase compared to the previous quarter. Respectively, as of

[9] At a constant exchange rate of 31 December 2015.

[10] Additionally, there were carried out foreign currency purchasing operations in the amount of USD 0.25 million (including the equivalent of EUR 0.20 million) from the banks under the liquidation process since 2015.

30 September 2016, the MDL/USD exchange rate was 19.7566 compared to MDL/USD 19.8698 on 30 June 2016.

Referring to the national currency exchange rate against the European single currency, its evolution during the reporting period was not uniform as that of USD, recording overall a depreciation than the exchange rate recorded at the end of the previous quarter. The factors that generated the formation of a different trajectory of the EUR exchange rate were the result of the Great Britain referendum and evolution of the USA and EU economies and the monetary policy decisions approved by the respective central banks. Thus, the EUR position was strongly affected by the result of the Great Britain referendum on 23 June 2016, the effect of vote in favour of leaving the EU determined the appearance on long-term of a negative feeling and uncertainty on financial markets. In this context, in July 2016, the European single currency recorded a lower level than in June, decreasing on average by 1.4 percent and by 0.5 percent compared to the level recorded at the end of month. The referendum effect over the EU has been revised positively in August and the slowdown incurred previously by EUR has been offset, while the European single currency has been also supported by certain statistical data on the USA and EU economies. Thereafter, EUR/MDL exchange rate exceeded in August the level recorded the previous month and increased at the end of month by 1.8 percent than at the end of July, while EUR increased in August on average by 1.1 percent than the previous month. In the last month of the reporting quarter, the European single currency regressed slightly as a consequence of the aforementioned referendum. At the same time, the monetary policy decisions foreseen for September have not changed the policies of the European Central Bank and the Federal Reserve System and were not such as to determine the trend of the EUR exchange rate.

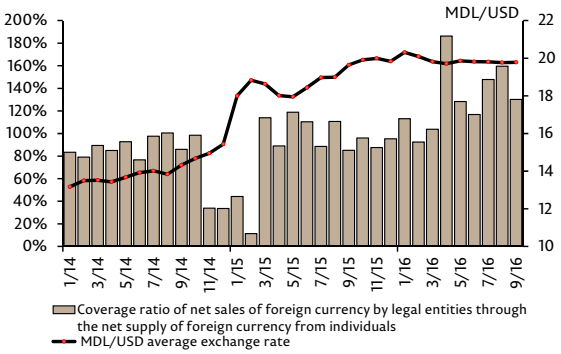
The EUR exchange rate decreased at the end of September by 0.7 percent than at the end of August, while the average exchange rate increased by 0.1 percent compared to the same month. Overall, Moldovan leu depreciated against the European single currency by 0.6 percent during the third quarter of 2016, from MDL/EUR 22.0325 on 30 June 2016 to MDL/EUR 22.1611 on 30 September 2016.

The official reserve assets increased by USD 272.1 million (14.5 percent) compared to the end of the second quarter of 2016, up to USD 2146.7 million (Chart 4.17), mainly due to the foreign currency purchasing interventions carried out by the BNM.

Referring to the external financial assistance, it should be noted the financial means offered by the Romanian Government to support the state budget in the amount of USD 68.0 million (equivalent of EUR 60.0 million) as first tranche of the loan in the amount of EUR 150.0 million.

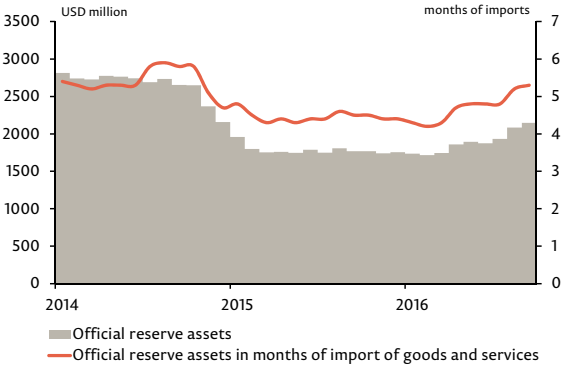
At the same time, the European Investment Bank offered financial means in the amount of USD 16.3 million (equivalent of EUR 14.4 million) as a loan to support the Road Sector Program; World Bank institutions (IBRD and IDA) offered financial means in the amount of USD 12.2 million, a part of which was a loan for the state budget support (USD 7.0 million), loan for Improving Efficiency SACET project (USD 3.4 million) and loans to support the Competitiveness enhancement project II (USD 1.0 million); the Council of Europe

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



Source: NBM

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



Source: NBM

Development Bank (CEB) offered USD 1.6 million (equivalent of EUR 1.5 million) as a grant to support the Social Housing Construction Project II etc.

As of the end of the third quarter of 2016, the official reserve assets continued to ensure a sufficient level of coverage of the imports of goods and services (5.3 months of import[11]).

[11] Calculated on the basis of forecasts for the import of goods and services in 2017.

Chapter 5

Medium-term inflation forecasting

5.1 External environment assumptions

Traditionally, the trajectories of macroeconomic variables are predefined by the end of the year, so the forecasted values for 2016 show a high level of veracity. At the same time, the lull in the foreign currency markets, the gradual increase of global demand and the tempered increase of raw materials prices outline the first trajectories of global economy development in 2017. Therefore, following more consecutive rounds of forecasting reflecting the disinflationary pressures of the external environment, the assumptions for external environment development in the current round of forecasting (Table 5.1) points out inflationary pressures.

The satisfactory results in the first nine months of this year regarding the euro area economic development have determined the increase in the *euro area* GDP by 0.1 percentage points, up to the level of 1.6 percent according to the current round of forecasting. At the same time, the forecast for the GDP average growth rate by 1.3 percent in the euro area has been maintained for 2017. The precautions with regard to the euro area economic development in 2017 are driven by the negotiations on the United Kingdom leaving the European Union. Another risk to the euro area economic development is the persistence of issues in the financial sector (Chart 5.1).

The oil price stability and the lack of new external risks determined the increase in forecast for the GDP growth in the *Russian Federation* this year. Thus, the current round of forecasting anticipates that the Russian economy will decrease by 0.6 percent in 2016 compared to 0.9 percent recorded in the previous round of forecasting. It is anticipated that the Russian Federation GDP will increase in 2017 on average by 1.2 percent, the more relevant challenges being the domestic consumption and traditionally, the oil prices evolution (Chart 5.2).

Inflationary conditions in the *euro area* changed insignificantly in the last months, given that the forecast for the average annual inflation rate in 2016 has slightly decreased from 0.3 to 0.2 percent according to the current round of forecasting. It is anticipated that the euro area consumption prices will increase in 2017 on average by 1.3 percent amid the increase in households' consumption and the increase in prices of international raw materials and energy resources (Chart 5.3).

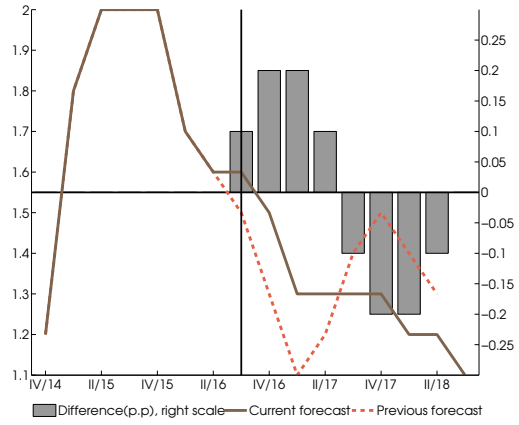
The slowdown in inflationary pressures continued in the *Russian Federation* under the conditions of the decrease in economic

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

	2016	2017
Economic growth in the euro area, %	1.6	1.3
Economic growth in the Russian Federation, %	-0.6	1.2
Annual inflation in the euro area, %	0.2	1.3
Annual inflation in the Russian Federation, %	7.2	5.8
USD/EUR	1.11	1.09
RUB/USD	67.0	63.5
Urals brand oil prices (USD/barrel)	42.5	53.7
International food prices growth, %	-2.6	16.7

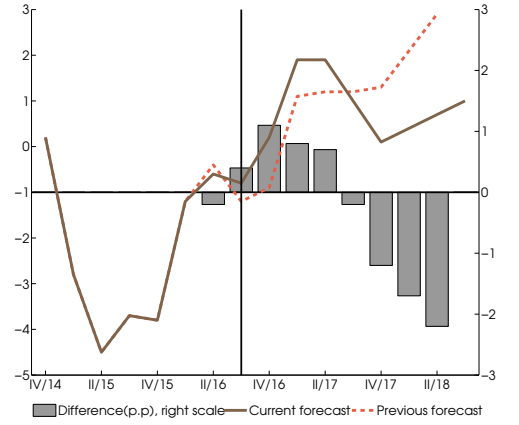
Source: Consensus Economics, futures quotations and NBM calculus

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



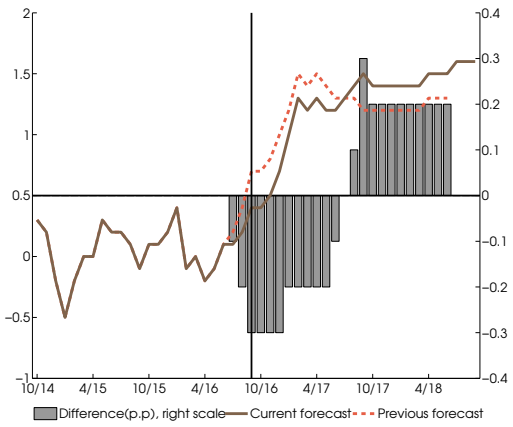
Source: Eurostat, Consensus Economics and NBM calculus

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



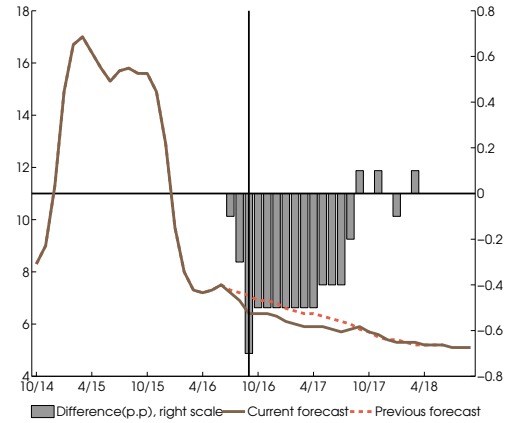
Source: Russian Federal State Statistics Service, Consensus Economics and NBM calculus

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



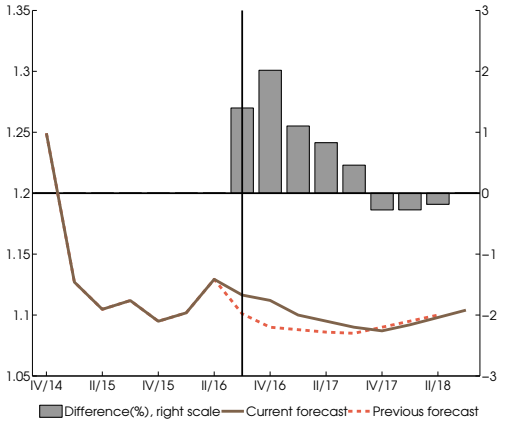
Source: Eurostat, Consensus Economics and NBM calculus

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



Source: Russian Federal State Statistics Service, Consensus Economics and NBM calculus

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



Source: ECB, Consensus Economics and NBM calculus

activity and the persistence of low consumption level. Thus, the current round of forecasting anticipates that the consumption prices will increase in the Russian Federation on average by 7.2 percent in 2016 and by 5.8 percent in 2017, or by 0.2 and respectively, 0.3 percentage points less compared to the previous round of forecasting (Chart 5.4).

The European single currency continued its consistent stable trend, which determined to maintain in 2016 the USD/EUR parity at an annual average level of 1.11 for the third consecutive round of forecasting. For 2017 it is anticipated that the annual average parity for the currencies concerned will be USD/EUR 1.09 - a similar level with that of the previous round of forecasting. It should be mentioned that the main factors of these currencies evolution in the next eight quarters are represented by the antagonism of the FRS and ECB monetary policies, the USA elections results and the further policies and negotiations on the United Kingdom leaving the European Union (Chart 5.5).

In the third quarter of 2016, the *Russian rouble* had a relatively passive volatility amid the high oil prices. Thus, the current round of forecasting anticipates the level of RUB/USD of 67.0 for 2016 and RUB/USD 63.5 for 2017. Compared to the current round of forecasting, the new anticipations for the Russian rouble evolution have not significantly changed (Chart 5.6).

At the end of September 2016, in Algeria the OPEC member countries decided to reduce the oil production level and to determine the quotas per country during the next meeting in November 2016. This fact caused the oil prices rise, amounting to about USD 50 per barrel. Thus, the current round of forecasting anticipates that the annual average value of Urals oil price will be USD 42.5 per barrel in 2016 and USD 53.7 per barrel in 2017 (Chart 5.7).

The increase in international food prices was driven by the unfavourable agro-meteorological conditions that affected the harvest in the principal agricultural regions caused the increased demand in advanced economies and led to the disappearance of stocks of some agricultural products. Thus, the current round of forecasting anticipates that *international food prices* will decrease on average by 2.6 percent in 2016 compared to the level of 3.6 percent recorded in the previous round of forecasting. Thus, it is anticipated that in 2017 the international food prices will increase on average by 16.7 percent compared to the level of 4.0 percent recorded in the previous round of forecasting (Chart 5.8).

5.2 Assumptions for regulated prices

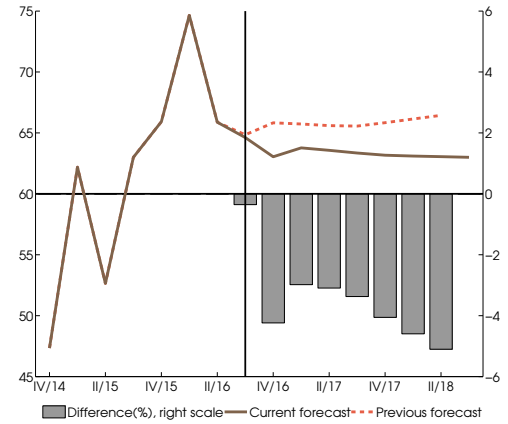
According to the current round of forecasting, the tariffs evolution throughout the inflation forecasting horizon provides for adjustment of the electricity tariffs by 12.1 percent at the beginning of 2017 and by 12.1 percent at the beginning of 2018 to cover the financial deviations of the previous periods. In this regard, on 4 October 2016, entered into force the ANRE decision to establish a mechanism for the recovery of the tariffs deviations from the regulated tariffs recorded by electricity providers and by

other electricity distribution system operators. This fact supposes that the mechanism for the recovery of tariffs deviations recorded in 2012-2015 has been established. According to the mechanism for the recovery of tariffs deviations set by ANRE, these will be recovered in four years during the period 1 January 2017 - 31 December 2020 for all electricity providers and electricity distribution system operators[12] .

At the same time, it is anticipated that the water and sanitation tariffs will increase in the second quarter of 2017 by 10.4 percent in the context of increasing electricity tariffs.

Taking into consideration the ANRE decision of September to increase by 8.2 percent the heat energy tariffs for consumers from Chișinău, the effect of this decision was also included in the forecast, which was estimated to be of about 7.0 percent and will be reflected in the fourth quarter of 2016 by the NBS.

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



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

5.3 Medium-term inflation forecasting

Aggregate demand

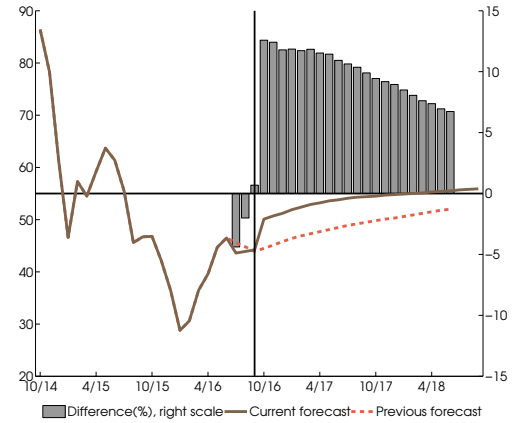
The current round of forecasting anticipates that the *output gap* will continue to be negative for the entire forecasting period and will reach the minimum level in the first quarter of 2017, after which, it will recover slowly, continuing to be negative until the end of the forecasting period. Therefore, the placement of the economic activity below its potential level on medium-term will cause increased disinflationary pressures from the aggregate demand (Chart 5.9).

The *external demand* from both the euro area and the *Russian Federation* will cause a negative output gap. The economic activity of the Russian Federation will maintain its restrictive character over the internal economic activity mainly in the first half of the forecasting horizon. It is anticipated that the *euro area* economic activity will be below its potential for the entire forecasting period, maintaining thus the restrictive impact on the internal economic activity.

The negative level of the aggregate demand will be also generated by the *increasing regulated prices*. These will exert restrictive effects over the households' consumption.

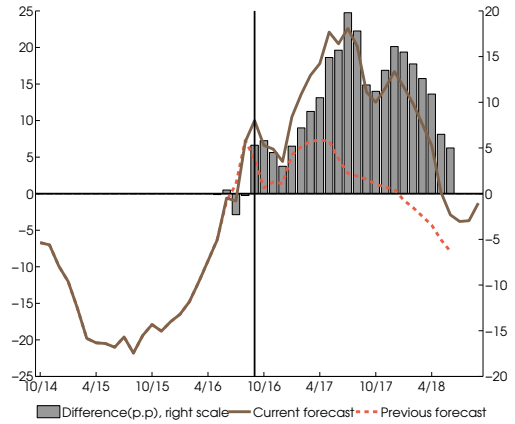
Real monetary conditions will have a heterogeneous impact on the demand. *Real effective exchange rate* will exert insignificant effects, being close to its equilibrium level. *Real interest rate* will be restrictive in the first forecasting part. Thereafter, this will have an incentive character by the end of the forecasting horizon.

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



Source: Ministry of Economic Development of the Russian Federation, futures quotations and NBM calculus

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



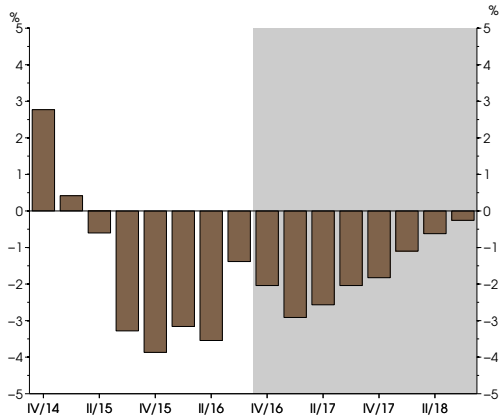
Source: FAO, futures quotations and NBM calculus

Inflation

The *annual inflation rate* will record an upward trajectory in the first part of the forecasting period and a downward trajectory in the

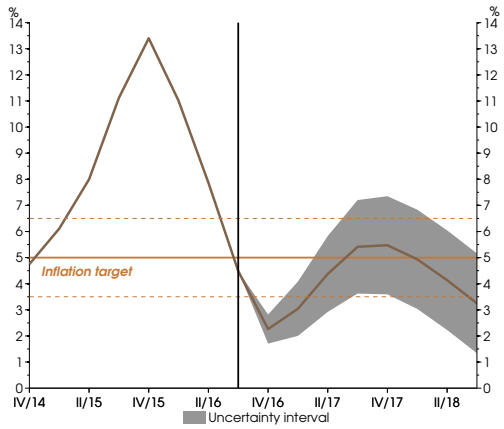
[12] http://anre.md/ro/content/fost-publicat%C4%83-hot%C4%83r%C3%A2rea-anre-privind-mecanismul-de-recuperare-devierilor-tarifare-%C3%AEn

Chart 5.9: The output gap forecast (%)



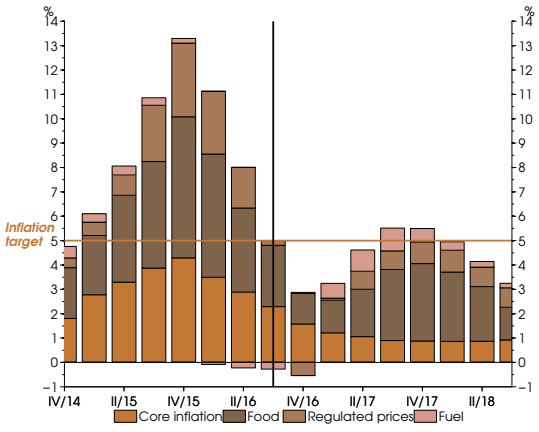
Source: NBS, NBM calculus

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

second part. The annual inflation rate, for the first two quarters of forecast, will be below the lower limit of the inflation target range. Thereafter, it will return and maintain within the target range until the second quarter of 2018. After being below the lower limit of the target range in the fourth quarter of 2016, inflation will increase and record a maximum level in the fourth quarter of 2017. Thereafter, inflation will fall by the end of the forecasting period and will be below the target range, recording the level of 3.2 percent (Chart 5.10).

The annual average inflation rate will record the level of 6.3 percent this year and 4.6 percent next year, respectively.

The annual rate of *core inflation* will fall in the target range only in the first three quarters, under the persistence of disinflationary pressures from the aggregate demand. Since the third quarter of 2017 and until the end of the forecasting horizon the core inflation will be below the lower limit of the target range. The contribution of core inflation to annual inflation rate will record a relatively stable trend, excluding the first quarter of forecasting horizon (a more increased contribution) (Chart 5.11).

The annual rate of *food prices* will increase constantly until the fourth quarter of 2017. Thereafter, the trend will be reversed and the rate will decrease until the end of the forecasting horizon. The anticipation of high food prices is conditioned by the significant increase in the international food prices forecast (Chart 5.8).

The annual rate of *regulated prices* will increase significantly until the end of the second quarter of 2017, after which it will stabilise in the target range, although close to the lower limit. The determinants of this evolution are mentioned above (5.2. Assumptions for regulated prices). It should be noted that the rate will be negative only in the fourth quarter of 2016, while for the rest of the forecasting horizon this will record positive values.

Fuel prices will significantly accelerate until the third quarter of 2017. The annual rate increase will be generated by the recent increase of international oil prices. Thereafter, the annual rate will decrease significantly until the end of the forecasting horizon, as a result of the slow increase in oil price and base effect consumption.

Comparison of current and previous forecasts

The trajectory of the *annual inflation rate* in the current forecast has been essentially reconfigured. On the one hand, this will increase significantly in the first half of the forecasting horizon, on the other hand, it will reverse its trend in the second half, decreasing until the third quarter of 2018. Compared to the previous forecast, the annual average inflation rate will be lower by 0.4 percentage points in 2016 and higher by 0.2 percentage points in 2017. For the first two quarters of 2018, the rate will be lower on average by 0.7 percentage points (Chart 5.12).

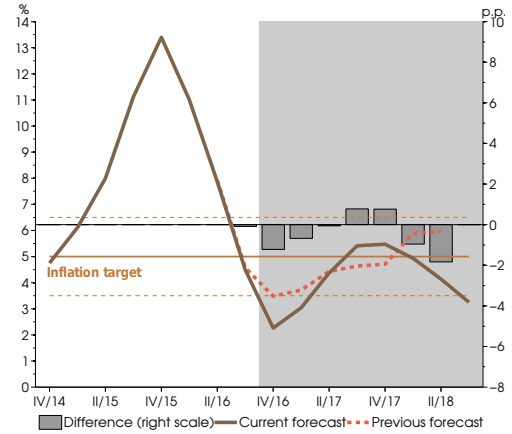
Core inflation will be lower for the entire forecasting period compared to the reference report. This revision is due, on the one hand, to a lower short-term forecast and on the other hand, to the downward re-estimation of the aggregate demand both for the historical and forecasting period.

The annual rate of *food prices* will be significantly higher for the entire forecasting period, except for the first and last quarter. The downward revision of the rate in the first quarter is due to the anticipation of the short-term food prices moderate increase, as a result of an increased agricultural production of 2016. For the rest of the forecasting period, the high evolution is determined by the significant increase of international food prices compared to the reference scenario.

The annual rate of *regulated prices* decreased in the first half of the forecasting horizon and increased in the second half. The decrease in the first period was generated by the actual increase in central heating tariff, which is lower by 3.0 percentage points to that previously anticipated. The increase in the second period is determined by higher electricity tariffs. The tariffs will increase by 1.4 and 8.1 percentage points in the first quarter of 2017 and first quarter of 2018 compared to the reference report.

The annual rate of *fuel prices* will be significantly higher until the first quarter of 2018 and insignificantly lower in the last two quarters of the forecasting horizon. The oil price increase, both in present and future period, is the main source of this difference, compared to the previous report.

Chart 5.12: The annual rate of total CPI



Source: NBM

Risks and uncertainties

External environment

The lull in the financial and raw materials markets during the last months and the global demand stabilization decreased the number and intensity of external risks. Currently, the intensification of the internal economic incentives represents the challenge for each economy. However, the international macroeconomic conditions are not negligible. The performance of events shall be carefully monitored to anticipate the unusual shocks. Thus, the inflation projection is exposed to following risks and uncertainties from external environment:

- **Intensification of the ECB quantitative easing programme and higher depreciation of the European single currency.** The initiation of the negotiations on the United Kingdom leaving the European Union, the deepening of problems in the euro area financial banking sector and the persistence of sovereign debts may create additional risks to the euro area economic growth. This could determine the European Central Bank to intensify the quantitative easing programme, which will have a depreciative impact on the European single currency evolution.
- **Higher volatility of oil price.** International oil price converges in last weeks towards the level of USD 50 per barrel and the forecasts of all international organisations operate close to this value. As a result of the oil demand and supply stabilisation, the short-term shocks could generate a higher volatility of international oil prices, which could also have short-term effects on internal prices for petroleum derivatives.

- **Increase in international raw materials prices.** The international raw materials prices recorded last months a manifest upward trend. Food prices have been affected by the low harvest caused by the agro-meteorological conditions in the principal agricultural regions and the increasing global demand and the stocks' depletion over the last years. The increase in raw materials and energy resources prices is also driven by the global demand recovery, the stability of foreign exchange markets, the lack of new important external risks and the recovery of the emerging economies producing raw materials.
- **Destabilization of regional macroeconomic situation.** A relative stability was attested in the region and the economies recovered from economic crisis in the last quarters. Thus, the lowest destabilisation of the macroeconomic situation in the region could determine the deviations of forecasted values.

Real sector

- **Uncertainties regarding the harvest in 2017.** The agro-meteorological conditions have been satisfactory for agricultural crops during 2016, despite the drought in the third quarter, which mainly affected certain categories of vegetables. Thereafter, it is anticipated that the agricultural production in 2016 will be significantly higher than the previous year, a fact that exerted overall disinflationary pressures on food prices this year and which will last early next year. At the same time, the harvest in 2017 and respectively, the food prices on domestic market will depend mainly on the agro-meteorological conditions in autumn this year and in the first half of next year. Thus, this information may not be anticipated if a high uncertainty level is assigned to the forecast for food prices in 2017. So, taking into consideration the high vulnerability of agricultural production to the meteorological conditions, the uncertainty regarding the harvest in 2017 and the dynamic of internal food prices, although to a lesser extent than in the previous forecasting round, still persists.
- **Impact of the changes in excise duties related to fiscal policy in 2017.** Fiscal policy project for 2017 provides for a significant increase in excise duties for certain categories of goods included in the CPI structure and their establishment for a period of 3 years to increase the fiscal collections and to ensure a predictability of the fiscal policy and legislation. This could generate the increase in prices of certain subcomponents of CPI, on which excise duties are applied. Thus, fiscal policy project for 2017 provides for a significant increase in excise duties for oil products and cigarettes in compliance with the Directives of the European Union under the Moldova-EU Association Agreement.
- **Republic of Moldova - Turkey Free Trade Agreement.** RM-Turkey Free Trade Agreement, which aims to promote mutual trade, will enter into force in November 2016. In total, the Republic of Moldova and Turkey will reduce by 99.5 and 100 percent, respectively, the taxes with commercial value. Thereafter, the prices of some categories of products will be adjusted downwardly, thus CPI could record a lower trajectory than it was anticipated.

- **Postponement of tariff increases in the context of social and political tensions and uncertainties.** Social and political tensions at the beginning of this year could lead to the postponement of adjusting some tariffs for regulated services assumed in the forecast, which will result in a lower inflation trajectory than it was anticipated.
- **Reinclusion of liquefied gas price into the methodology of formation and application of prices for oil products adopted in the first half of 2016.** The methodology establishes a direct correlation between the petrol and diesel prices on domestic market, on the one hand, and the regional price quotations of petroleum products, on the other hand. At the same time, it establishes a specific trade margin, which sets a ceiling of expenditure and oil companies' profit. Although, liquefied gas prices were initially stipulated in the methodology above-mentioned, subsequently these have been excluded, which led to a significant increase thereof. However, there is a likelihood of reinclusion of the liquefied gas prices into the aforementioned document, which will determine its decrease.
- **Abolishment of custom duty on import of some products from Ukraine.** In spring this year, the Republic of Moldova introduced temporarily custom duties on import of milk and dairy products, meat and cement from Ukraine and set the prices for the import of these products. The Decision approved by the Government provides for the application of custom duties in the trade regime with the CIS countries until 31 December 2016. Thereafter, the prices for aforementioned products could decrease in 2017 along with the term expiration date set out in this decision.

Monetary and public sector

- **Excessive liquidities in the banking sector.** The banking system accumulated excessive liquidities in the amount of MDL 5.1 billion, as a result of the monetary issuance in 2016, of the NBM net interventions in foreign exchange market (currency purchases) in the amount of USD 419.3 million (about MDL 8.3 billion). These may have a positive impact on aggregate demand, exchange rate, determining thus the increase in inflationary pressures.
- **Weak lending.** The lending market records very pessimistic evolutions during 2016. The low lending to legal entities is caused by the economic and political instability in the Republic of Moldova and in the region, or by the inacceptable lending conditions and high risks. Their worsening could cause additional disinflationary pressures.
- **Worsening of public finances.** During the first eight months of 2016, national public budget revenue recorded weak evolutions. This could influence negatively the budget expenditure and SS rates (attracting higher volumes of liquidities by the Ministry of Finance could increase the rates). Partially and temporarily, this risk will be reduced by the disbursement of the first tranche within the *Agreement on reimbursable financial assistance between Romania and the Republic of Moldova*. However, the issue on the income

accumulation in the national public budget remains very acute. A possible worsening of situation could generate disinflationary pressures by the decrease in aggregate demand.

- **Foreign exchange trajectory.** Certain consumption prices, such of the goods imported or in foreign currency, are very sensitive to the exchange rate dynamic. Taking into consideration the higher historical volatility of the exchange rate, which has been driven both by the objective and subjective factors (which may not be anticipated), inflation projection has a significant uncertainty.

Chapter 6

Monetary policy decisions

Minutes of the Executive Board of the National Bank of Moldova of 25.02.2016 on monetary policy

The meeting was chaired by Mr. Dorin Drăguțanu, Governor - Chairman of the Executive Board.
There were present: members of the Executive Board - Mr. Marin Moloşag, First Deputy Governor - Deputy Chairman of the Executive Board, Mr. Ion Sturzu, Deputy Governor.
Reporter: Mr. Octavian Teaca, Head of Macroeconomic Analysis and Forecasts Division, Monetary Policy and Research Department.
Invitees: Mr. Andrei Rotaru, Adviser to the Governor, Mrs. Lucia Hadârcă, Director of Banking Operations Department, Mr. Ruslan Grate, Deputy Director of Banking Supervision Department, Head of On-site Supervision and AML Division, Mrs. Natalia Sîrbu, Director of Legal Department.
Mr. Octavian Teaca presented the current macroeconomic situation, including the evolution of monetary, foreign exchange, credit and deposit markets, the changes in external macroeconomic environment, analysis of current inflation and the influential factors on inflationary process. The members of the Executive Board have assessed the impact of monetary policy measures, highlighting the correctness of monetary policy decisions in 2015. The assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to bring inflation back in the target.
The members of the Executive Board assessed the defining aspects to inflation in the medium-term. The external risks to inflation remained 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 in the short-term, which reflects the future dynamics of inflation. Potential internal risks to inflation arise from postponing the approval of fiscal policy for 2016 and the uncertainties regarding the fiscal policy conduct. On the other hand, the evolution of prices of the energy resources and food products on international markets offset the inflationary pressures. Thus, analysing the balance of risks, the annual rate of price growth is projected to gradually reduce, also due to the high base of comparison in 2015.
In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided by unanimous vote to decrease the monetary policy interest rate by 0.5 percentage points, from 19.5 to 19.0 percent annually. The gradual normalisation of monetary policy conduct, supported by the expectations on inflation rate decrease, aims to promote a monetary climate able to foster the lending and savings, along with further adaptation of domestic economic environment to the volatility and uncertainty related to external macroeconomic situation. The Executive Board reiterated that the NBM will further monitor and anticipate the domestic and international economic environment developments, including household consumption dynamics, remittances, foreign exchange market indicators and changing foreign trade conditions, so that by the flexibility of operational framework specific for the inflation targeting strategy to act effectively and decisively in order to ensure and maintain the price stability in the medium-term.

As a result, the Executive Board of the National Bank of Moldova adopted the following decision:
1. to decrease the base rate applied on main short-term monetary policy operations by 0.5 percentage points, from 19.5 to 19.0 percent annually;
2. to decrease the interest rates:
• on overnight loans by 0.5 percentage points, from 22.5 to 22.0 percent annually;
• on overnight deposits by 0.5 percentage points, from 16.5 to 16.0 percent annually.

Voting results

FOR – 3 AGAINST – 0 ABSTAIN – 0

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

Dorin DRĂGUȚANU **Sergiu SURDU**

Minutes of the Executive Board of the National Bank of Moldova of 31.03.2016 on monetary policy

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 Moloşag, 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, highlighting the correctness of monetary policy decisions in 2015. The assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to bring inflation back in the target.
The members of the Executive Board assessed the defining aspects to inflation in the medium-term. The external risks to inflation remained 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 in the short-term, which reflects the future dynamics of inflation. The potential internal risks to inflation arise from postponing the approval of fiscal policy for 2016 and the uncertainties regarding the fiscal policy conduct. Thus, analysing the balance of risks, the annual rate of price growth is projected to gradually reduce, also due to the high base of comparison in 2015.
In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided by unanimous vote to decrease the monetary policy interest rate by 2.0 percentage points, from 19.0 to 17.0 percent annually. The gradual normalisation of monetary policy stance, backed by expectations on the faster reduction of inflation, aims to promote a climate of monetary 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. The Executive Board reiterated that the NBM will further monitor and anticipate the domestic and international economic environment developments, 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 decrease the base rate applied on main short-term monetary policy operations by 2.0 percentage points, from 19.0 to 17.0 percent annually;
2. to decrease the interest rates:
• on overnight loans by 2.0 percentage points, from 22.0 to 20.0 percent annually;
• on overnight deposits by 2.0 percentage points, from 16.0 to 14.0 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 Executive Board of the National Bank of Moldova of 28.04.2016 on monetary policy

The meeting was chaired by Mr. Sergiu Cioclea, Governor - Chairman of the Executive Board of the National Bank of Moldova.
There were present: members 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. Marin Moloșag, 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, highlighting the correctness of monetary policy decisions in 2015. The assumptions and scenarios of the new round of medium-term forecasting were discussed, including monetary policy measures to be adopted in order to bring inflation back in the target.
The members of the Executive Board assessed the defining aspects to inflation in the medium-term. The external risks to inflation remained significant, disinflationary, 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 in the short-term, which reflects the future dynamics of inflation. The potential internal risks to inflation arise from the volatility of international prices for raw materials and the uncertainties regarding the oil prices. Thus, analysing the balance of risks, the annual rate of price growth is projected to gradually reduce, also due to the high base of comparison in 2015.
In order to anchor inflation expectations and maintain inflation close to the target of 5.0 percent over the medium-term, with a possible deviation of ± 1.5 percentage points, the Executive Board decided by unanimous vote to decrease the monetary policy interest rate by 2.0 percentage points, from 17.0 to 15.0 percent annually. The gradual calibration of monetary policy conduct, supported by the expectations on inflation rate decrease, aims to promote a monetary climate able to foster the lending and savings, along with further adaptation of domestic economic environment to the volatility and uncertainty related to external macroeconomic situation.
At the same time, the Executive Board of the NBM approved the Inflation Report no.2, 2016, which will be presented at a press conference on 05 May 2016. With the focus on the dynamics of output gap, which will remain negative during the next eight quarters, it was mentioned that the evolution of the economic activity below its potential will determine disinflationary pressures from domestic demand, although more modest compared to the previous forecast. According to the new round of forecasting, the annual average inflation rate will reach in 2016 and 2017 the level of 7.0 percent and 4.8 percent respectively, with the return within the range of variation in the third quarter of 2016.
The Executive Board reiterated that the NBM will further monitor and anticipate the domestic and international economic environment developments, 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 decrease the base rate applied on main short-term monetary policy operations by 2.0 percentage points, from 17.0 to 15.0 percent annually;
2. to decrease the interest rates:
• on overnight loans by 2.0 percentage points, from 20.0 to 18.0 percent annually;
• on overnight deposits by 2.0 percentage points, from 14.0 to 12.0 percent annually.

Voting results

FOR – 3 AGAINST – 0 ABSTAIN – 0

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

Sergiu CIOCLEA **Sergiu SURDU**

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