Inflation Report

no. 4, November 2012

Note

Statistical data were taken from the National Bureau of Statistics,

Ministry of Economy, Ministry of Finance,

Eurostat, International Monetary Fund,

National Energy Regulatory Agency,

State Hydrometeorological Service.

Likewise were selected certain statistical data provided by the international community and by the Central Banks of the neighboring states.

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

Contents

List of acronyms

ANRE   National Agency for Energy Regulation

CHIBOR   Average interest rate at which the contributors banks are available to lend funds in MDL to other banks, on the interbank monetary market

CIS   Commonwealth of Independent States

CPI   Consumer Price Index

EUR   Common European Currency

FAO   Food and Agriculture Organization of the United Nations

FCC   Freely convertible currency

GDP   Gross Domestic Product

IMF   International Monetary Fund

IPPI   Industrial Producer Price Index

MDL   Moldovan leu

NBC   Certificates issued by the National Bank of Moldova

NBM   National Bank of Moldova

NBS   National Bureau of Statistics of the Republic of Moldova

OPEC   Organization of the Petroleum Exporting Countries

REPO   Sale and Repurchase Agreement

RUB   Russian ruble

SS   State Securities

USA   United States of America

USD   US Dollar

Summary

Inflation

The annual inflation rate constituted 4.4 percent in the third quarter of 2012, reversing its downward trend started at the end of the previous year. The upward trend of inflation was determined by the gradual increase of pressure from food prices caused by adverse weather conditions in the region this year. The contribution from regulated prices remained at the level of the previous quarter in the absence of certain tariff adjustments during the reporting period. Contribution from core inflation was lower than the previous quarter due to a weakening domestic demand. The average annual rate of inflation during the aforementioned period was higher than anticipated in the July round of forecasting. This deviation was due to the changes in anticipated oil prices and the increase over the expectation of food prices. The annual rate of core inflation continued its downward trend started at the end of the previous year and fell to a value of 3.6 percent in September 2012. In the third quarter of 2012, the annual rate of industrial production price index was 5.0 percent, decreasing by 0.8 percentage points as compared to the previous quarter, while construction price index continued its upward trend started in 2010 and amounted to 11.3 percent in the respective period.

External environment

The world economy remains in a precarious state, with an uncertain future. The effects of economic stimuli, adopted by advanced economies, are late in coming, affecting the international trade, and respectively the emerging economies and developing countries. The macroeconomic indicators continue to denote a reduction in global economic activity, through a decreased rate of industrial production, manufacturing orders and respectively, through a decreased rate of international trade. At the same time, the severe drought this year in the USA, Europe and the Russian Federation affected the harvest, which was reflected in the increase of global food prices. In addition, the international oil prices remain relatively high due to the geopolitical tensions in the Middle East, which is still an impediment to global economic growth.

Economic developments

In the second quarter of 2012, the GDP recorded an increase of only 0.6 percent compared to the same period of the previous year. The insignificant increase in GDP shows the continuing trend of slowing economic activity reported in the second half of 2011. For the first time after the 2009 crisis, the household consumption recorded a decrease (0.4 percent), due to the slowdown in the disposable income growth of the population.

The annual rate of gross capital formation increased by 8.8 percent, solely due to the positive evolution of changes in inventories, the gross fixed capital formation decreasing in real terms. In the second quarter of 2012, the final consumption of general government increased as compared to the previous year. Following the slowdown in the domestic demand, the imports increased by 3.9 percent compared to the second quarter of 2011. The low performance of the European economy determined the exports to grow only by 5.6 percent.

The positive GDP growth was mainly due to the increase in gross value added in industry and commerce, while agricultural production declined during the reporting period. In the second quarter of 2012, the reduction of the unemployment rate up to 4.5 percent shows an improvement in the labor market situation of the Republic of Moldova after the crisis of 2009. These positive signals are overshadowed by the decline of the working population by 4.7 percent in the reporting period, determined by both the decrease of the number of unemployed and that of employed people.

Monetary policy

During the third quarter of 2012, the NBM adopted three decisions to maintain the monetary policy interest rate at the level of 4.5 percent annually. The major argument of those decisions was the strengthening disinflationary trend in the Republic of Moldova.

At the same time, to ensure the adequate monetary conditions to maintain the price stability, the NBM continued to firmly manage the liquidity excess through sterilization operations on the monetary market.

During the third quarter of 2012, the NBM intervened in the foreign exchange market as a buyer of foreign currency in the context of its monetary policy promoted and to ensure the consolidation of foreign exchange reserves. During the analyzed period, the volume of NBM transactions carried out on the domestic foreign exchange market against MDL was USD 222.1 million.

From the beginning of 2012, the monetary indicators recorded a pronounced growth. Thus, in the third quarter of 2012, the growth rate of monetary aggregates has increased, the quarterly average in annual terms constituting 17.8 percent for M2 and 14.2 percent for M3, by 6.1 percentage points and 5.5 percentage points more as compared to the previous quarter.

The average interest rates applied by banks recorded a stable development in the third quarter of 2012, recording insignificant increases or decreases. At the end of September 2012, the average interest rate on credits granted in national currency recorded a new historical minimum level of 12.58 percent and those in foreign currency – 7.78 percent. In turn, the term deposits in national currency recorded higher values as compared to the previous quarter and lower values for those in foreign currency.

Medium-term inflation forecasting

According to the current round of forecasting, the annual inflation rate will constitute 4.1 percent at the end of 2012. Almost during the entire forecasting period, the values are projected onto a trajectory placed within the variation range of $\pm$ 1.5 percentage points from the 5.0 percent target, except the third quarter of 2013, when these will exceed the variation range. It should be mentioned that the price increase will be determined by the supply-side shocks, while the demand-side disinflationary pressures will be persistent throughout the forecasting period.

However, according to the current round of forecasting, the dynamics of output gap is expected to be negative throughout the forecast horizon, with a slight recovery tendency by the end of 2013 – beginning of 2014. Despite the recovery tendency, the economic activity below its potential, especially in the coming quarters, maintains the disinflationary pressures from demand, following the decrease in external demand and the adverse weather conditions this year.

Chapter 1

Inflation development

The annual inflation rate constituted 4.4 percent in the third quarter of 2012, by 0.3 percentage points higher than the previous quarter. The CPI's upward trend was mainly determined by the gradual increase of pressure from food prices caused by adverse weather conditions in the region this year. At the same time, the contribution from regulated prices remained at the level of the previous quarter in the absence of certain tariff adjustments during the reporting period. The contribution from core inflation was lower than the previous quarter due to weakening domestic demand. At the same time, the actual value of inflation in the third quarter of 2012 was higher than anticipated in the July round of forecasting due to changes in oil prices and the increase over the expectations of food prices. In the third quarter of 2012, the annual rate of industrial production price index was of 5.0 percent, decreasing by 0.8 percentage points as compared to the previous quarter, while construction price index continued its upward trend started in 2010 and amounted to 11.3 percent in the respective period.

1.1   Consumer price index

Chart 1.1: The annual rate of CPI and core inflation (%)
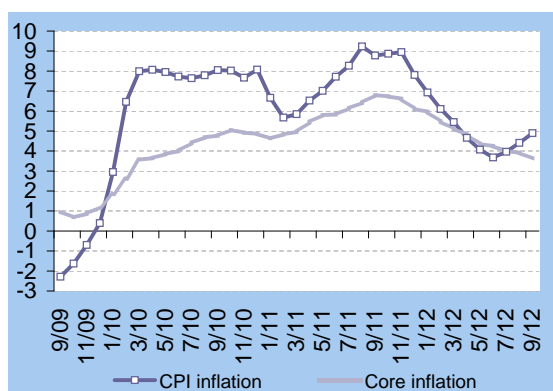
Source: NBS, NBM calculus

In the third quarter 2012 the annual rate of CPI inflation has reversed the downward trend observed in the first half of this year, increasing from 3.7 percent in June to 4.9 percent in September 2012 (Chart 1.1).

The average annual rate of inflation during the aforementioned period was higher than anticipated in the July round of forecasting. This deviation was due to the uncertainty in estimating the impact of drought on food prices, but also the changing trend in world oil prices compared to that observed in July 2012. Within the components structure, in September 2012, the highest increase compared to September 2011 was recorded in prices of services (6.3 percent), followed by foodstuff products (5.1 percent) and non-foodstuff products (3.5 percent).

On the other hand, in the third quarter of 2012, the annual core inflation rate continued its downward trend started at the end of the previous year and fell to a value of 3.6 percent in September 2012. Thus, after a period of 3 months (second quarter of 2012), the overall annual inflation rate is again higher than the core inflation rate, determined by the food prices pressure.

During the reporting period, due to adverse weather conditions this year, the contribution from food prices has increased considerably, so that in September they held a share (of 1.8 percentage points) in the formation of annual inflation rate similar to that of regulated prices. However, the regulated prices continued in the third quarter of 2012 to exert the greatest contribution to the annual inflation rate formation (1.8 percentage points), following the previous year's increases in prices for gas, electricity and heating supply and the increases in electricity tariffs in May 2012.

The core inflation had a contribution of 1.1 percentage points, decreasing as compared to the previous quarter due to weakening domestic demand. The fuel prices had the lowest contribution (0.3 percentage points), despite recent increases in fuel prices. Their contribution has decreased compared to the previous quarter due to a favorable effect of the base period.
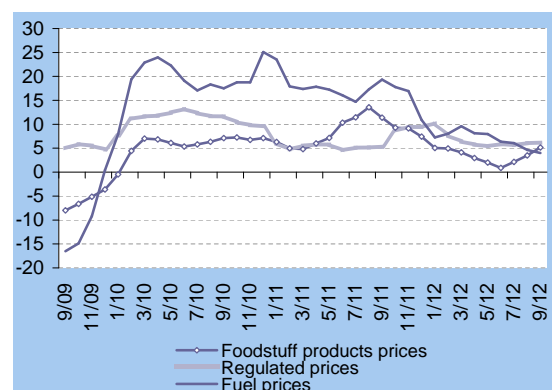
Core inflation index

As mentioned above, the annual core inflation rate recorded a downward trend in the third quarter of 2012, decreasing from 4.3 percent in June to 3.6 percent in September, a development associated with the trend of slowing demand observed during the current year.

The increase in prices of goods and services related to core inflation in September 2012 compared to September 2011 was determined mainly by price increases in clothing, footwear and cigarettes by 4.6, 3.9 and by 17.4 percent, respectively. Significant contributions, but of a lower intensity, were determined by the increases of 3.3, 2.5, 8.7 and 4.0 percent of the prices of the components "public alimentation", "construction materials", "education and training" and "knitwear" (Chart 1.4).

These price increases were a result of changes in the excise duty on tobacco products at the beginning of this year, the side effects from increases in tariffs for utilities, fuel and food prices, as well as a result of an increasing demand from population in the previous year, driven by higher disposable income. Since the fourth quarter of 2011, domestic demand pressures were mitigated by the lower growth rate of population's disposable income in real terms, which resulted in a reducing annual inflation rate in the last 12 months.

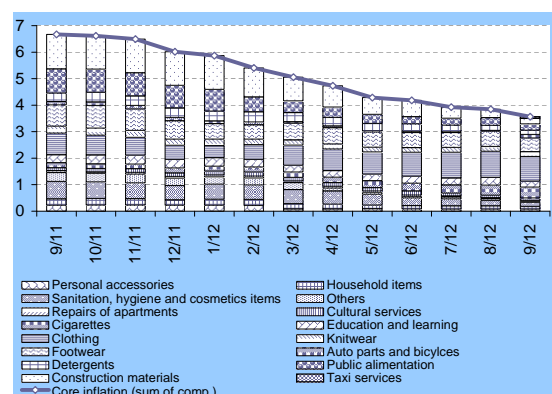Chart 1.2: Annual rate of inflation subcomponents (%)

Source: NBS, NBM calculus

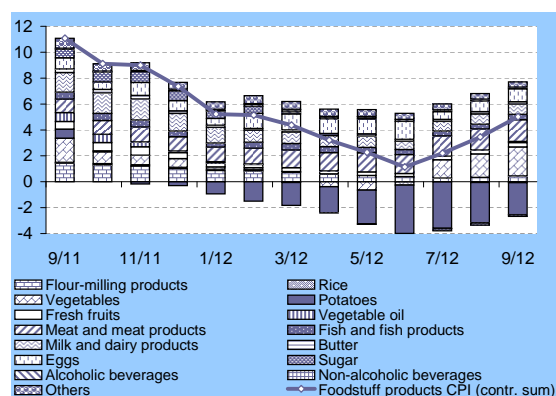Chart 1.3: The evolution of annual inflation and subcomponents' contribution (p.p.)
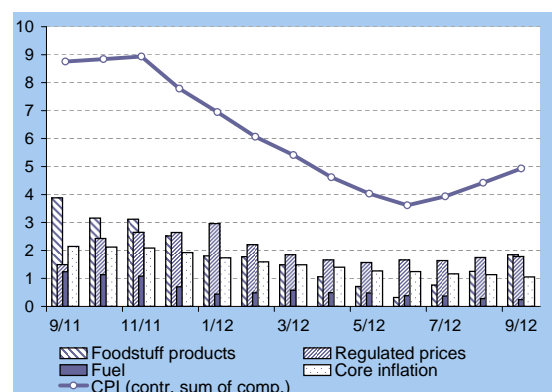
Source: NBS, NBM calculus

Chart 1.4: Components' contribution to the annual growth rate of core inflation (p.p.)

Source: NBS, NBM calculus

Food prices

Chart 1.5: Components' contribution to the annual growth rate of food prices (p.p.)

Source: NBS, NBM calculus

In the third quarter of 2012, the annual rate of food price inflation recorded a change of direction in the development, increasing in annual terms by 5.1 percent in September 2012, which is higher by 4.2 percentage points than in June 2012. At the same time, the average annual rate was by 1.6 percentage points higher in the third quarter of 2012 (3.6 percent) than in the second quarter of 2012. It should be mentioned that this trend is observed on the international markets, too. Thus, in the third quarter of 2012, the average annual rate of food prices was minus 6.6 percent, by 5.1 percentage points above the rate recorded in the previous quarter. At the same time, the increase in annual terms of food prices in September 2012 was driven mainly by higher prices of "eggs" (65.1 percent), "vegetables" (28.4 percent), "meat and meat products" (8.7 percent), "milk and dairy products" (6.6 percent) and "fish and fish products" (5.9 percent) (Chart 1.5). Abnormal hot weather this summer and the lack of rainfall have significantly decreased soil moisture reserves, thus contributing to a significant drought in the summer of 2012. Considering the affected area, this year's drought is classified as catastrophic drought. Thus, the increase in prices of the above-mentioned products was mainly influenced by adverse weather conditions. The reason for higher prices for meat and meat products lies in price increase for raw materials, following the reduction in domestic supply due to domestic production orientation towards foreign markets.

The restrictions imposed in August 2012 on pork imports from Ukraine (due to an outbreak of African Swine Fever[1]) have also contributed to setting the stage for higher prices of meat and meat products. Higher prices for milk and dairy products were determined by reduced milk production in all categories of households during January-September 2012 (by 3.8 percent lower than the previous year). The prices for the above-mentioned products have been influenced by the impact of indirect effects, but also by the second round effects from the gas price increase (made in October 2011) and electricity (made in May 2012), which have affected the production costs. A key factor that helped to reduce the annual rate of food prices is the reduction of the price of potatoes by 49.7 percent in September 2012, due to an oversupply of the product in autumn 2011. At the same time, the drought in the summer of 2012 contributed to a significant reduction of the production of potatoes in 2012, which reduced the negative impact of this subcomponent on food price inflation (Chart 1.5).

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[1]http://epresa.md/stirile-zilei/republica-moldova-este-amenintata-de-ciuma-africana-la-porci

Box no. 1

Annual and monthly inflation rate. Prices seasonality

This box includes the advantages and disadvantages of using the annual and monthly inflation rate in the analysis and forecast of CPI. It also includes the prices seasonality in the Republic of Moldova.

The National Bank of Moldova sets the inflation target through the annual variation of the Consumer Price Index. By the calculation (formula 1), this indicator cumulates the monthly inflation rates for the last 12 months and, thus, its trajectory is determined by both the current evolutions and by the last year's evolutions, also called the base period effect.

$$\pi_t = \frac{P_t - P_{t-12}}{P_{t-12}} * 100 \text{ , where} \tag{1}$$

π_t - annual inflation, P_t - prices level in the current period,

P_{t-12} - prices level 12 months ago.

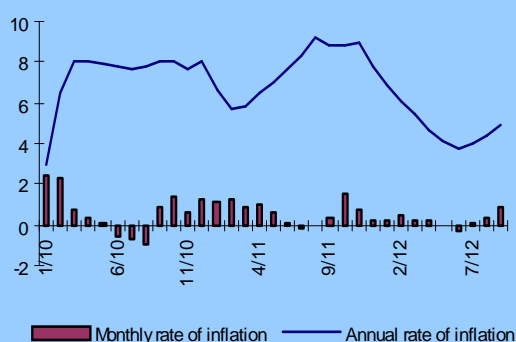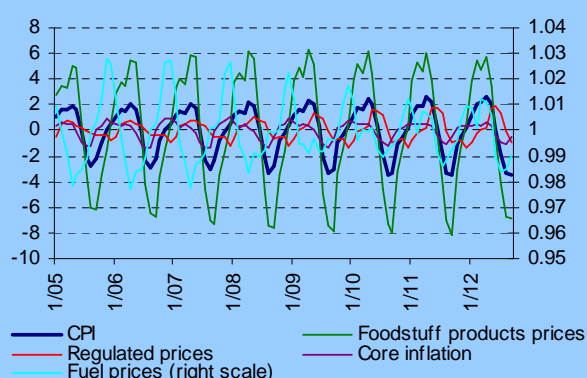**Chart no. 1. Consumer Price Index, %**   **Chart no. 2. Estimated seasonal factors**


This can be seen especially in the downward trend of the annual inflation in the first half of the year, which was due to a higher level of inflation in the base period (early 2011) due to increases in utility tariffs and less due to price trends this year (Chart no.1). Thus, the respective measure could create an incomplete image in reflecting the inflationary pressures in due time relevant to the monetary policy existing at the moment.

However, the annual inflation measure advantage is that, by comparison with the index of the current period with that of 12 months ago, it excludes price changes which repeat in similar periods during the year, such as, for example, large sales during the winter holiday season or lower prices for fruit and vegetables in hot weather periods, a phenomenon known as seasonality. Unlike the annual inflation measure, the measure of monthly CPI inflation and its subcomponents presented by the NBS is affected by the seasonal effect. Thus, an evaluation of short-term inflation trends requires, first of all, an estimation of seasonal effects on prices. This can be done by adjusting the CPI basket subcomponents before their weighting in the overall inflation or by seasonally adjusting the overall inflation series.

The prices in the Republic of Moldova have a pronounced seasonal behavior, determined mainly by the food prices. Thus, the seasonal factor for food prices is the most volatile and reaches its maximum value in April and minimum value in September. In other words, food prices, unless other shocks, reach the highest value in spring and the lowest in late summer and autumn, due to the agricultural calendar in the Republic of Moldova (Chart no.2). In conditions where seasonal effect is less pronounced in the rest of subcomponents, the overall inflation seasonality is determined mostly, as mentioned above, by that of food prices.

Chart no. 3. The impact of seasonality on prices, %
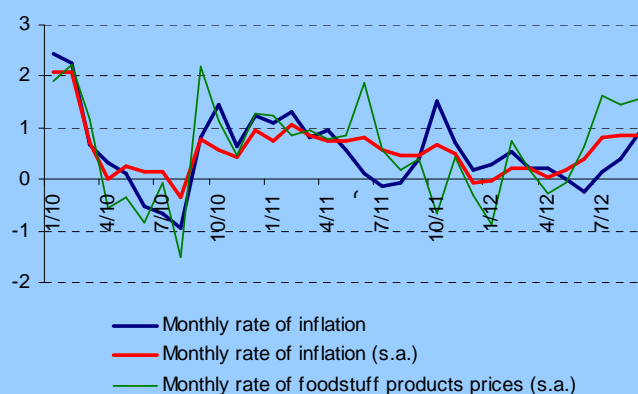
The exclusion of the estimated seasonal effect from the gross monthly inflation series shows a less volatile price increase. At the same time, it should be mentioned its significant influence in the summer. Thus, the increase of prices in the summer, without a negative seasonal impact, was actually more pronounced and was driven by inflationary pressures from food prices (Chart no.3). Thus, if not treated properly, the monthly inflation measure may present a distorted image of inflationary pressures in the economy. Therefore, for the analysis and forecast of the CPI and its subcomponents, the NBM uses the monthly time series adjusted to the seasonal effect.

Regulated prices

Chart 1.6: Components' contribution to the annual growth of regulated prices (p.p.)
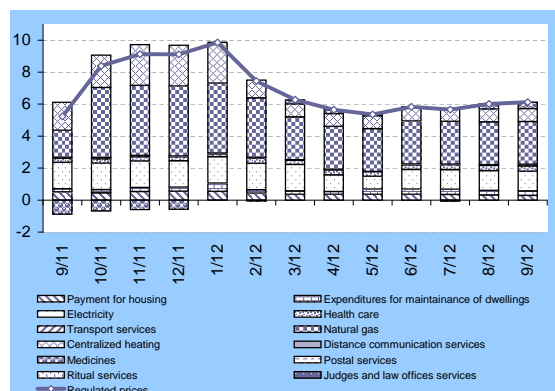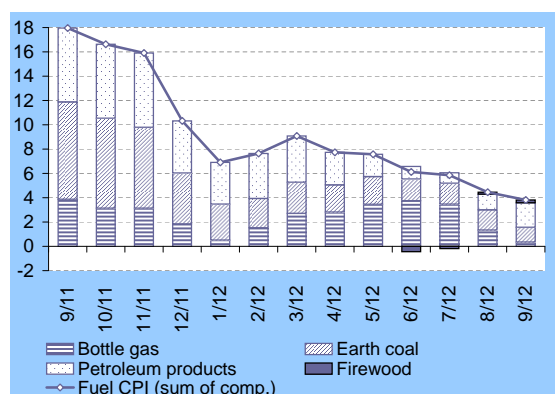

Source: NBS, NBM calculus

In the absence of significant tariff adjustments in the third quarter of 2012, the annual rate of regulated prices had a slightly upward trend, increasing from 5.9 percent in June 2012 to 6.2 percent in September 2012 (Chart 1.6).

Regulated prices increase in the third quarter of 2012, as compared to the same period of the previous year, reflects mainly the increases in gas and heating tariffs conducted in autumn 2011 and increases in electricity tariff in May 2012. Thus, the tariffs adopted during 2011 and 2012 led to higher prices for natural gas, heat and electricity supply in September, 2012 by 22.3, 12.3 and 7.3 percent, respectively.

At the same time, the approval of the new hot water tariff on February 1, 2012 determined the decrease of price for this component by 20.2 percent. These developments, together with rising prices of rental services, drinking water and sanitation by 4.6 and 12.5 percent, respectively, determined the public utilities as a whole in September to be higher by 11.5 percent as compared to the previous month. Prices for health services, railway and airway passengers transport increased by 5.6, 6.5 and 4.2 percent respectively, but the impact of these developments was less significant on the regulated prices dynamics.

Fuel prices

Chart 1.7: Components' contribution to the annual growth in fuel prices (p.p.)

Source: NBS, NBM calculus

In the third quarter of 2012, the annual rate of fuel prices continued the downward trend, decreasing from 6.4 percent in June 2012 to 4.0 percent in September 2012, largely due to a favorable base effect, as during that period the fuel prices increased. During the analyzed period, the oil prices continued to rise under the influence of the complex geopolitical situation in the Middle East and the reduction of the U.S. oil stocks.

Thus, in the third quarter of 2012, the Urals brand oil prices reached the level of USD 108.8 per barrel, increasing by 2.2 percent as compared to the previous quarter. At the same time, the national currency has depreciated by 4.2 percent against the U.S. dollar versus the previous quarter. This development created conditions for the increase of import prices of petroleum products on the domestic market.

Consequently, the prices of fuel and liquid gas increased in two rounds during the months of August and September. Within

the structure of fuel price increases, the price rises of combustible and earth coal by 5.2 and 3.0 percent, respectively, had the largest contributions to this dynamic in September 2012 compared to the same period of the previous year. The price increases of bottled gas (by 1.3 percent) and firewood (by 0.8 percent) had the lowest contributions (Chart 1.7).

1.2   Comparing forecasts of the Inflation Report no.3, 2012 with the inflation developments in the third quarter of 2012

The Table 1.1 shows the evolution of the annual rate of CPI in the third quarter of 2012 and the forecast published in the Inflation Report no.3, 2012. Thus, the effective value of 4.4 percent was by 0.5 percentage points higher than the value of 3.9 percent from the July forecast round.

The deviation from the food prices forecast contributed the most to this situation. Thus, these have increased by 1.1 percentage points above the value projected in July, mainly due to the uncertainty in estimating the impact of drought on local agricultural production. The fuel prices had the largest deviation from projected values. Their annual rate was by 2.8 percentage points higher than anticipated due to changes in world oil prices trend compared to that observed in July 2012.

The developments of the core inflation subcomponent and regulated prices were largely consistent with those projected in the Inflation Report no. 3, 2012. Thus, the core inflation deviation from the projected value was zero, while the deviation of the regulated prices developments was of only 0.2 percentage points.

Table 1.1: Evolution and forecast of CPI and its components

	De facto	Forecasted (IR no.3,2012)
	Q III, 2012/ Q III, 2011	Q III, 2012/ Q III, 2011
CPI	**4.4**	**3.9**
Core inflation	3.8	3.8
Foodstuff products	3.6	2.5
Regulated prices	6.0	6.2
Fuel	4.9	2.1

Source: NBS, NBM calculus

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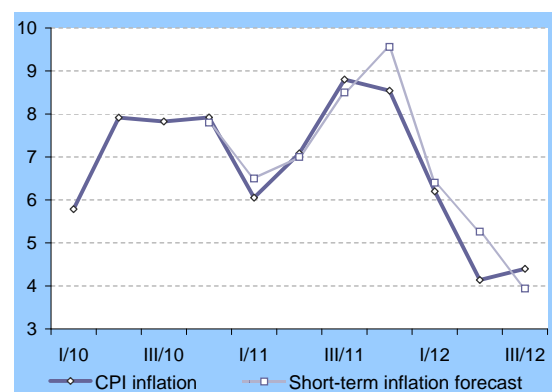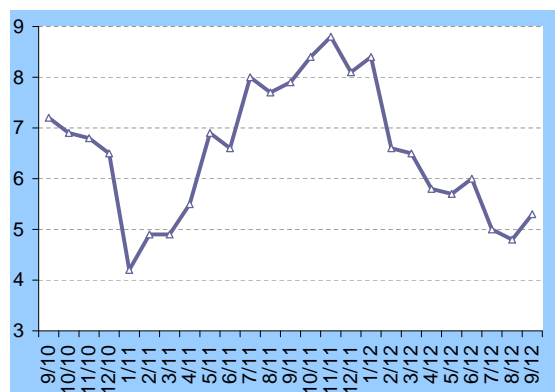

Source: NBM

1.3   Industrial production price index

In the third quarter of 2012, the annual rate of industrial production price index continued the downward trend begun in the first quarter of this year. Thus, in the third quarter 2012, the annual rate of industrial production price index constituted 5.0 percent, by 0.8 percentage points lower than the previous quarter. At the same time, the annual rate of industrial production price index recorded a slight acceleration in September 2012 (Chart 1.9).

Within the structure, the highest increases were recorded in prices of the energy industry, which increased by 9.9 percent compared to September 2011, while prices of the extractive industry and manufacturing recorded more modest increases of 5.7 and 4.4 percent, respectively.

Chart 1.9: The annual rate of IPPI (%)

Source: NBS

As compared to August 2012, the prices in industry increased by 0.4 percent. This development was influenced mainly by higher prices in extractive industry and manufacturing (by 0.3 percent and 0.4 percent, respectively). Thus, the most significant increases in manufacturing were recorded for the following activities: "chemical industry" (by 6.5 percent), "production of rubber and plastic" (by 2.6 percent), "production of other non-metallic mineral products" (by 2.1 percent), "production of leather, leather goods and leather footwear" (by 1.9 percent), "wood processing and wood products production" (by 1.3 percent), and "furniture production and other industrial activities" (by 1.3 percent).

1.4   Construction prices

Chart 1.10: Evolution of construction price index (%, compared to the same period of the previous year)
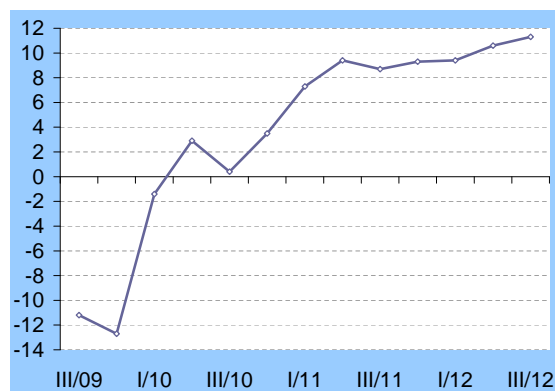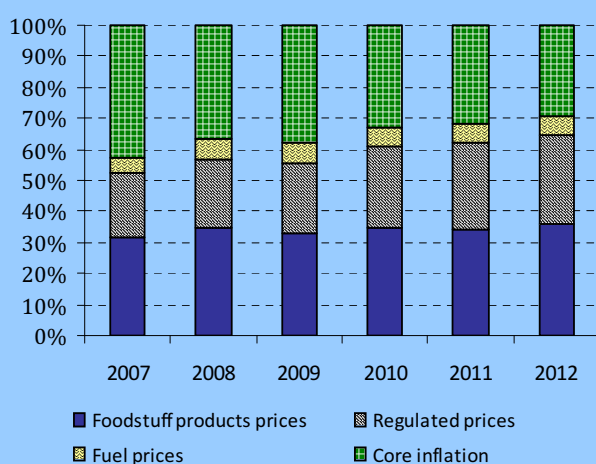

Source: NBS

In the third quarter of 2012, the annual growth rate in construction prices recorded the value of 11.3 percent, increasing by 0.7 percentage points as compared to the previous quarter, continuing the upward trend started in 2010. The acceleration of the annual growth rate of prices in construction is due to the revival of this sector after the crisis of 2009.

Within the structure of the national economy sectors, the largest price increases in the third quarter of 2012, as compared to the third quarter of 2011, were recorded in "telecommunications" (by 20.8 percent), "transport" (by 15.7 percent), "construction of social and cultural buildings" (by 12.8 percent), "commerce and public alimentation" (by 12.1 percent), "dwelling building" (by 10.8 percent) and in "agriculture" (by 10.8 percent).

Box no. 2

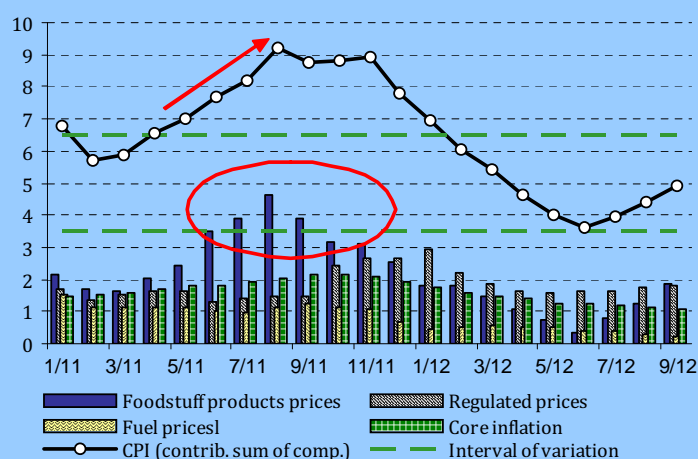### Consumer price index disaggregated by components: food and drink prices

Both in the international practice and in the Republic of Moldova, to allow a better understanding of the inflationary process, the CPI was disaggregated into four categories: regulated prices, fuel prices, core inflation and prices of food and drinks. The latter is one of the main categories, and this is confirmed by the Chart no.1 (the categories of goods included in the list of foodstuffs, alcoholic and soft drinks can be found on the official website of the National Bureau of Statistics in Annex no.1 to the Methodology for the calculation of the core inflation index).

Chart no. 1. **The evolution of CPI subcomponents' shares**

Legend:
- ■ Foodstuff products prices
- ▨ Fuel prices
- ▤ Regulated prices
- ⊞ Core inflation

Source: **NBS, NBM calculus**

Chart no. 2. **The evolution of annual inflation and subcomponents' contribution**

Legend:
- ■ Foodstuff products prices
- ▨ Fuel pricesl
- —o— CPI (contrib. sum of comp.)
- ▤ Regulated prices
- ⊞ Core inflation
- – – Interval of variation

Source: **NBS, NBM calculus**

The Chart no.2 shows that over the last two years the annual inflation left the variation range for a period of three quarters. At the same time, according to the information presented, it can be seen that this situation was generated by a pronounced influence of food prices during this period, due to the drought recorded in the summer of 2011. The impact of rising food prices on the overall inflation was also boosted by the large share of food in the CPI basket.

It should be noted that the monetary policy instruments cannot directly affect food prices because they are goods with an inelastic demand. Thus, as the share of these products will be larger, the ability of monetary policy to influence the overall inflation will decline.

The analysis of the table presenting the shares of foodstuff in total CPI for 2012 contributes to shaping the idea that the share of foodstuff in the CPI basket of the Republic of Moldova is impressive compared to other countries with similar regimes of monetary policy.

| Country	Share, %
Great Britain	11.2
CzechRepublic	15.0
New Zealand	18.8
Moldova	**35.9**
Romania	37.2

Considering the above, a special attention in the process of forecasting within the NBM is drawn to food prices forecast. Thus, for the most accurate forecasting, the NBM uses data from external sources such as Consensus Forecast, the FAO - Food and Agriculture Organization of the United Nations and other sources. At the same time, both the domestic and the Black Sea region weather conditions have a considerable influence on the evolution of food prices, which affect the regional prices.

Non-monetary factors such as unpredictable weather conditions over a long period, exacerbated by the uncertainty of natural disasters occurrence (droughts, floods, frosts, etc.), and other factors entail risks in the inflation targeting process of the National Bank of Moldova by a possible deviation of the actual inflation from the expected one.

Chapter 2

External environment

Chart 2.1: The annual rate of world price index (%)
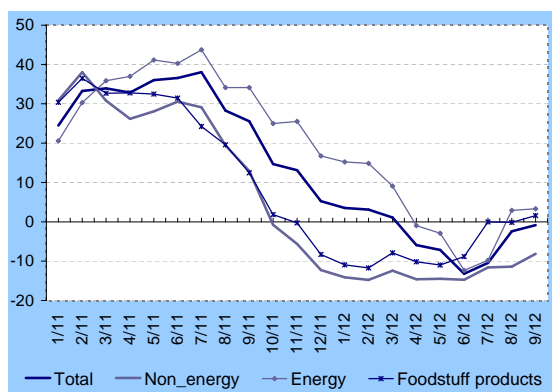
Source: IMF

The world economy remains in a precarious state, with an uncertain future. The effects of economic stimuli adopted by advanced economies are late in coming, affecting the international trade and, thus, the emerging and developing countries. The macroeconomic indicators continue to denote a reduction in global economic activity, through a decreased rate of industrial production, of manufacturing orders and respectively, through a decreased rate of international trade. At the same time, the severe drought this year in the USA, Europe and the Russian Federation affected the harvest which reflected in the increase of global food prices. In addition, the international oil prices remain relatively high due to the geopolitical tensions in the Middle East, which still represents an impediment to global economic growth.

According to the latest data, the International Monetary Fund lowered the growth forecast for the world economy by 0.2 percentage points for 2012 and by 0.3 percentage points for 2013. Thus, the world economy is expected to grow in 2012 on average by 3.3 percent and by 3.6 percent in 2013. Moreover, it is expected that the advanced economies will grow on average by 1.3 percent in 2012 and by 1.5 percent in 2013, given the weak U.S. economic growth and the economic recession of the euro area. The growth forecast for emerging economies has also been reduced to the level of 5.3 percent for 2012 and 5.6 percent for 2013, taking into account China's economic slowdown, which will have consequences for other countries, given its size and the catalyst role in the global development, and taking into account the worsening growth prospects in Eastern Europe as a result of the escalating euro zone crisis.

World prices rose during the third quarter of 2012, due to higher food prices. This was determined by a reduced agricultural yield as a result of unfavorable meteorological conditions in the United States, Europe and the Russian Federation. At the same time, the depreciation of the U.S. dollar, supply problems and the geopolitical tensions in the Middle East have pushed up the prices of petroleum products (Chart 2.1).

Since the second half of July 2012, the parity of the single European currency and the U.S. dollar has changed its path, swinging in favor of the single European currency. The European authorities' decision to resolve the sovereign debt crisis in peripheral euro zone economies, by initiating an unlimited bond-buying program by the European Central Bank and the German Constitutional Court decision on partial participation of the German Government to the European Stability Mechanism have contributed to the appreciation to the single European currency.

At the same time, the depreciation of the U.S. dollar and the appreciation of the single European currency were supported by poor macroeconomic statistics from the U.S.A. Thus, in September 2012, the single European currency has been traded against the U.S. dollar at an average rate of 1.29, which is the highest monthly average in the last five months (Chart 2.2).

Against the backdrop of high volatility of international currencies and especially the U.S. dollar depreciation against the European single currency in the second half of the third quarter of this year, the Russian ruble recorded an appreciation against the U.S. dollar, which was also supported by high oil prices. In addition, the Romanian leu has appreciated against the U.S. dollar during the third quarter of 2012, while the Ukrainian hryvnia remained stable - a result of the policy promoted by the Central Bank of Ukraine (Chart 2.3).

The labor market situation in the euro area continued to worsen, as a result of a decreased rate of economic activity. Thus, the Eurostat announced a new record of unemployment rate for July and August of 11.4 percent (seasonally adjusted). At the same time, according to the Russian Federal State Statistics Service, the unemployment rate in the Russian Federation decreased up to the level of 5.2 percent in august 2012 – the lowest level in the last years (Chart 2.4).

United States of America

The U.S. economy continues to expand at a relatively robust pace compared to other major developed economies. After a relatively strong growth of 2.4 percent in the first quarter of this year, in the second quarter of this year the U.S. economic growth was of only 2.1 percent, as compared to the same quarter of the previous year. The reduction of the U.S. real GDP growth in the second quarter of 2012 has primarily reflected the slowdown in the growth rate of private consumption, investment and government spending cuts.

Chart 2.2: Average monthly evolution of the USD/EUR exchange rate
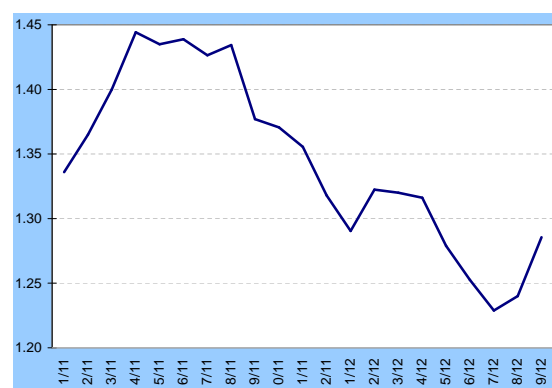
Source: European Central Bank

Chart 2.3: Monthly growth rate of the exchange rate of MDL, RON, RUB, UAH against USD

	7/12	8/12	9/12
MDL_USD	2.3	1.1	-0.7
RUB_USD	-1.2	-1.6	-1.4
UAH_USD	0.0	0.0	0.0
RON_USD	4.0	-1.6	-3.8
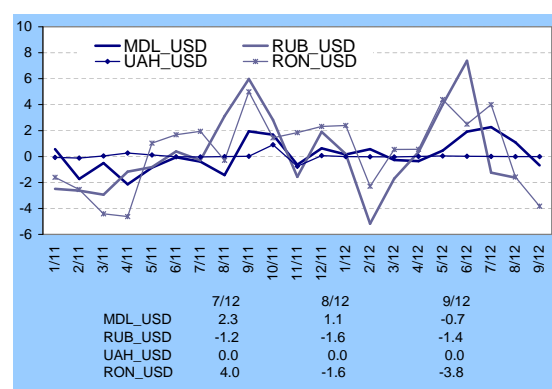
Source: National Bank of Moldova, National Bank of Romania, Central Bank of Russia, National Bank of Ukraine

Chart 2.4: Unemployment rate in the euro area and in neighbouring economies (%)
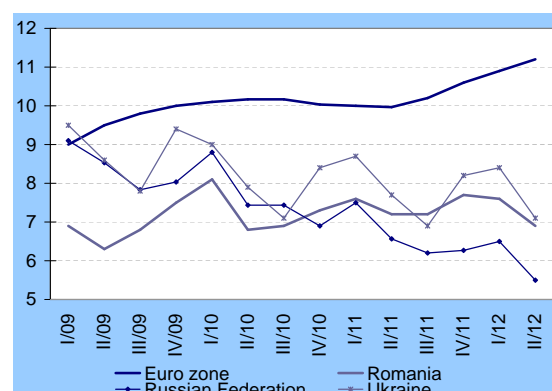
Source: Eurostat, Federal State Statistics Service of the Russian Federation, U.S. Bureau of Labor Statistics

The U.S. labor market in September 2012 experienced a significant improvement, the unemployment rate reducing from 8.1 percent in August to 7.8 percent in September. At the same time, the evolution of industrial production of the USA shows a continued slowdown in the growth rate, given the reduction of domestic consumption and international trade disruption. During the third quarter of this year, the U.S. consumer prices increased on average by 1.7 percent as compared to the same period of the previous year.

Euro area

According to Eurostat data, after the stagnation recorded in the first quarter of 2012, the economy of the euro area declined by 0.2 percent in the second quarter of 2012, as compared to the previous quarter (seasonally adjusted) and by 0.4 percent compared to the same period last year. The largest reductions of the volume of activity were recorded in Greece, Portugal (-3.3 percent), Italy (-2.6 percent), Cyprus (-2.3 percent), Spain (-1.3 percent). In addition to challenging economies, decreases in the rate of economic activity, on an annual basis, were recorded in Slovenia (-2.2 percent), Hungary (-1.1 percent), Czech Republic (-1.0 percent), the United Kingdom, the Netherlands and Ireland (by -0.5 percent each). The German economy grew by only 1.0 percent and France by only 0.3 percent in the second quarter of 2012, compared with the second quarter of 2011.

The latest Eurostat data show a continuing decline in industrial production, construction activity, and in the wholesale and retail trade volume, etc. The unemployment rate continued to rise, recording a record level in August of 11.4 percent. The Euro area inflation is rising, recording a level of 2.6 percent in September 2012, as compared with September 2011 (for comparison - the annual inflation rate in July was 2.4 percent, in August - 2.6 percent).

The main factor that contributed to higher prices in the third quarter of 2012 constituted the increase in energy prices, caused by the increase in oil prices on international markets and by higher local prices for gasoline. For example, the price index for energy products in the euro area in September 2012 was by 9.1 percent higher than the same period of the previous year. The relatively high inflation prompted the European Central Bank to keep monetary policy rate at 0.75 percent, an action that also highlighted the fragility of the euro area economy.

Box no.3

Monetary policy - macroeconomic stabilization instrument

The monetary policy rate (base rate in the Republic of Moldova) is one of the instruments of the monetary policy through which the monetary authority of a country affects the national economy in line with the targets in place. The monetary policy rate is used to influence the demand for money. When the monetary authority lowers the monetary policy rate, it stimulates the banks' interest for refinancing, so that they require more loans, which are used for lending to the economy. Conversely, by increasing the base rate, the central bank "marks up" its credit, discouraging the practice of refinancing and reducing the potential of banks to lend to the economy.

If price stability is the primary objective of the monetary authorities, the monetary policy rate is an indirect instrument of influence on medium and long term inflation. For example, increasing the monetary policy rate determines the financial institutions to increase the interest rates, which inhibits investment and consumption in favor of savings. Thus, the aggregate demand decreases and, given the aggregate supply rigidity to monetary policy, in the short run, it creates "excess supply", resulting in decreasing prices and, respectively, in a lower inflation. The reduction of rate is an alternative to stimulate economic activities in periods when aggregate demand is below its potential level and to eliminate the disinflationary pressures. From the CIS countries, in the recent years, Armenia (2006), Georgia (2009) and the Republic of Moldova (2010) have passed, explicitly or implicitly, to the inflation-targeting regime. Other CIS countries, such as the Russian Federation, Ukraine, Kazakhstan, Belarus are in the process of transition to inflation-targeting regime. Price-targeting is also promoted by the monetary authorities of the Czech Republic (1997), Poland (1999), Hungary (2001), Turkey (2002), Romania (2005), etc.

In some countries, the monetary policy is oriented towards the exchange rate stability. The monetary policy rate change, in that case, is used to avoid destabilization in the exchange rate from the target as a result of pressures arising through uncovered interest parity. Typically, the monetary policy decisions are strongly correlated with the monetary policy decisions of the economy whose currency serves as reference currency. Therefore, this implies a reduced independence of the monetary policy. This type of regime is found mainly in Asian countries (Hong Kong, Singapore, Sri Lanka, etc.) - which is explained by their orientation towards exports, however, such policies are still present in some CIS countries, Bulgaria etc.

At the same time, the monetary policy rate of the main economic players represents a global indicator that reflects the global economic tendency. The monetary policy decisions related to the base rate of the Federal Reserves System of the USA, Central European Bank, People's Bank of China, and of the Bank of England are of material importance for the financial markets, their modifications leading to significant changes in global financial operations. For example, the reduction of the monetary policy rate at the beginning of July by the European Central Bank and People's Bank of China have convinced the international stock exchanges of the imminent regress of the global economy, which determined the significant decrease of oil and raw material prices.

In 2012, as a result of the euro area crisis and disruption of world trade, but also of reduced pro-inflationary tensions, several countries have decided to lower the monetary policy rate in order to support national economic activities and to prevent a possible economic recession. However, considering the time intervals in which the impulse spreads after lowering the policy rate, the anticipation of the disinflationary phenomenon and preventive decisions taking led to obtaining successful results for some monetary authorities. Since January 2012, for 3 consecutive months, the National Bank of Moldova decreased the monetary policy rate by 1.0, 2.0 and 2.0 percentage points respectively, up to the level of 4.5 percent. For a more detailed analysis and comparison, Table no.1 describes some of the monetary policy decisions of neighboring countries and of some important economies:

Table no.1. Monetary policy decisions taken in 2012 neighboring countries and of some important economies

Country	Monetary policy	Inflation targeted in 2012	Inflation in the month prior to the monetary policy decision		Date of changing the monetary policy rate	Monetary policy rate	
			annual	monthly		Unchanged	Changed
Armenia	Inflation-targeting	4% ± 1.5 pp	Since September 6, 2011 - 8.0%				
Georgia	Inflation-targeting	6.0%	2.0	0.5	January, 18 2012	6.75	6.5
			-2.2	-0.2	April 25, 2012	6.5	6.25
			-2.1	0.0	May 23, 2012	6.25	6.0
			-3.3	-0.9	June 20, 2012	6.0	5.75
Republic of Moldova	Inflation-targeting	5% ± 1.5 pp	7.8	0.2	January 6, 2012	9.5	8.5
			6.9	0.3	February 3, 2012	8.5	6.5
			6.1	0.5	March 2, 2012	6.5	4.5
Russian Federation	Price stability – transition to inflation-targeting regime	5.0 - 6.0%	5.9	0.1	September 14, 2012	8.0	8.25
Romania	Inflation-targeting	3.0% ± 1.0 pp	3.1	0.2	January 6, 2012	6.0	5.75
			2.7	0.4	February 3, 2012	5.75	5.5
			2.6	0.6	March 30, 2012	5.5	5.25
USA	Maximum employment, stable prices, and moderate long-term interest rates	2.0%	Since December 16, 2008 interest rates fall within the range of 0.0 - 0.25%				
Euro area	Inflation-targeting	2.0%	2.3	-0.1	July 11, 2012	1.00	0.75
China	Currency stability and ensuring economic growth	-	3.0	-0.3	June 7, 2012	6.56	6.31
			2.2	-0.5	July 5, 2012	6.31	6.00

Romania

In the second quarter of this year, Romania's economy grew by 1.1 percent compared to the same period last year. Significant increases were recorded in construction, information and communication activities, real estate, industry and trade. Workload reductions occurred primarily in publicly funded sectors and agriculture. The developments in agriculture were determined by the unfavorable meteorological conditions this year. Domestic demand grew by 1.3 percent compared to the same quarter of 2011, mainly due to significant increase in gross fixed capital formation by 15.5 percent. Total final consumption rose by 1.3 percent as a result of the increase in final consumption expenditure of households (+2.1 percent). Final consumption expenditure of general government fell by 2.4 percent. Net export development had a negative effect on GDP, due to the increasing volume of imports of goods and services (+0.2 percent) and the decline in exports (-0.5 percent).

In the third quarter of this year, the Romanian economy continued to be affected by the economic crisis in the euro area, being reflected in reduced exports against the backdrop of falling consumption in the euro area and the appreciation of the Romanian leu against the single European currency. Consumer prices have increased significantly in the recent months due to the relatively high prices of foodstuff products for this time of year, caused by lower yield, which can be explained by unfavorable meteorological conditions this year. International financial sector vulnerabilities continue to be a danger, given that most of the banks are controlled by foreign credit institutions and given the dependence on external financing.

Russian Federation

The Russian Federation has managed to sustain the economic growth, albeit at a slightly lower pace than expected. According to the Federal Statistics Service information, in the second quarter of 2012 the Russian economy grew by 4.0 percent, as compared with the second quarter of 2011. As compared to the first quarter of 2012, the economy grew by 0.1 percent (seasonally adjusted)[2]. As in the first quarter of 2012, the economic activities, which contributed the most to the economic growth, were financial activities, real estate and trade.

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[2]According to the Russian Federal State Statistics Service

The unfavorable meteorological conditions in the current agricultural season led to a growth in agriculture of only 3.5 percent compared to the same quarter of 2011. The growth in constructions remained at the first quarter level, recording an increase of 4.2 percent compared to the same quarter of the previous year. Simultaneously, the exports recorded a reduction of 1.4 percent, while imports increased by 2.9 percent compared to the same period last year.

In the third quarter of 2012, the Russian economy has been subject to economic and world trade regress, increased volatility in oil prices and one to the deepest drought in recent years. The Russian Federation joined the World Trade Organization in August 2012, which means major changes for foreign trade. The unemployment rate decreased, the Federal State Statistics Service reporting an unemployment rate of 5.2 percent in August 2012, which is the lowest level for the last years. At the same time, during the second quarter of this year, prices increased significantly due to higher utility tariffs and high food prices. This prompted the Central Bank of Russia to increase the monetary policy rate by 0.25 percentage points, up to the level of 8.25 percent in September 2012. The annual inflation in the Russian Federation was of 6.6 percent in September 2012, the highest annual inflation rate since the beginning of 2012.

Ukraine

According to the State Statistics Committee of Ukraine, the Ukrainian economy grew by 3.0 percent in the second quarter of 2012, compared to the same quarter of the previous year and by 1.9 percent (seasonally adjusted)[3] compared with the previous quarter. The economic growth was generated by the 11.4 percent growth in agriculture as compared to the same period last year, which can be explained by a rich crop this year, by the increases recorded in wholesale and retail trade by 6.9 percent and by increases recorded in transport and communications sector by 3.8 percent as compared to the previous year, most likely favored by the large number of tourists who participated in the European Football Championship, held in June and July in some cities of Ukraine. On the other hand, under the influence of the decline of the world economy in the second quarter of 2012, the Ukraine's industrial production declined by 0.3 percent, while exports declined by 6.8 percent compared to the same quarter of the previous year.

However, in the third quarter of 2012, the Ukraine's economy seemed to be affected, to a greater extent, by the regress in

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[3]According to the data of the State Statistics Committee of Ukraine

the euro area and by the economic slowdown of the Russian Federation, given that most of exports from Ukraine are directed to these regions.

At the same time, the drought in July and August most likely will lead to a poor harvest, which will adversely affect the growth rate in the agricultural sector. The sovereign debt continues to be quite high, which endangers the economic stability of Ukraine. The stable level of Ukrainian hryvnia against the U.S. dollar is another factor that negatively affected the exports, given that the U.S. dollar and the single European currency have recorded an extremely volatile evolution during the third quarter of 2012. In addition, high interest rates continue to affect the lending, which further leads to reduced economic activity.

Oil and natural gas prices

Chart 2.5: Evolution of natural gas (USD/1000m^3) and oil prices (USD per barrel)
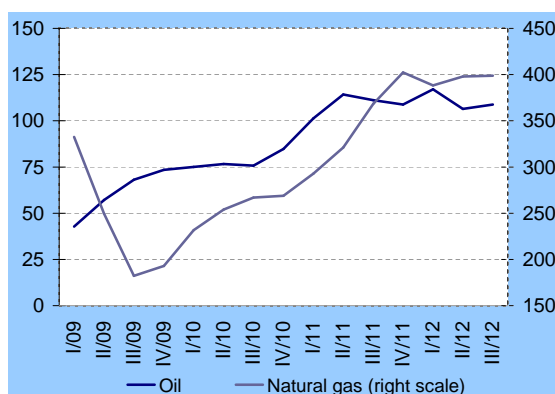
Source: ANRE, NBM calculus, Bloomberg

In the third quarter of 2012, oil price on the world market recorded a growing trend since mid-July, peaking in August with the level of USD 116.93 per barrel[4]. Thus, the average price for Urals brand oil in the third quarter of 2012 amounted to USD 108.8 per barrel, increasing by 2.2 percent as compared to the previous quarter (Chart 2.5). The reference basket of the Organization of Petroleum Exporting Countries (OPEC) equaled to USD 106.6 per barrel in the third quarter of 2012, decreasing by 0.1 percent compared with the previous quarter.

In the analyzed period, oil prices continued to rise under the influence of complex geopolitical situation in the Middle East, oil supply reduction from North Sea and oil stocks reduction in the U.S.A. The risk of a conflict escalation between the West and Iran because of its nuclear program, within which the European Union imposed an embargo on Iranian oil as of July 1, 2012, represents the main reason for the rapid increase in oil prices. At the same time, the worsening of the geopolitical situation occurred after a series of attacks between Syria and Turkey and a series of explosions in Iraq.

In August, after three months of decline, the price of oil has reversed the trend, increasing by 10.0 percent compared with July. The support factors of this increase were: reduced oil production by OPEC countries - in order to remove excess oil on the world market, increased oil imports by China, the Atlantic hurricane season - which created oil supply problems. The expectations of economic stimulus programs by central banks of the major economies of the world constituted another significant impact on oil market during the respective period.

[4]Bloomberg European Urals Northwest Europe Crude Oil Spot Price

Chapter 3

Economic developments

3.1   Demand and supply

The insignificant increase in GDP in the second quarter of 2012 shows the continuing trend of slowing economic activity reported in the second half of the previous year. For the first time since the crisis, private consumption declined in annual terms. The increase in gross capital formation was due solely to the evolution of the changes in inventories, gross fixed capital formation decreased as compared to the same period last year. The evolution of imports and exports was modest. The positive GDP growth was mainly due to the increase in gross value added in industry and commerce, while agricultural production declined during the reporting period.

Data on agricultural production in early 2012, freight transport, foreign trade, domestic trade of goods and services for July and August outline a greater likelihood for recording a contraction in economic activity in the third quarter of 2012. Thus, agricultural production fell by 21.6 percent in the first nine months of the year. The annual rate of imports fluctuated around zero, while that of exports dropped significantly negative in July and August. Internal trade in goods and services recorded a modest growth during these months, compared to the same months of the previous year. The industrial production, after a minor increase in July, showed a pronounced decline in August.

Demand

Gross Domestic Product

Gross domestic product in the first half of this year grew by only 0.8 percent compared to the same period last year, which shows a clear trend of slowing economic activity, given that in the first half of 2011 the economic growth was of 7.5 percent. At the same time, economic activity slowdown continued in the second quarter, so that GDP grew by only 0.6 percent,

Chart 3.1: Contribution of demand compo-
nents to GDP growth (p.p.)

Source: NBS, NBM calculus

Chart 3.2: Components' contribution (p.p.)
to the households' final consumption growth
(%)
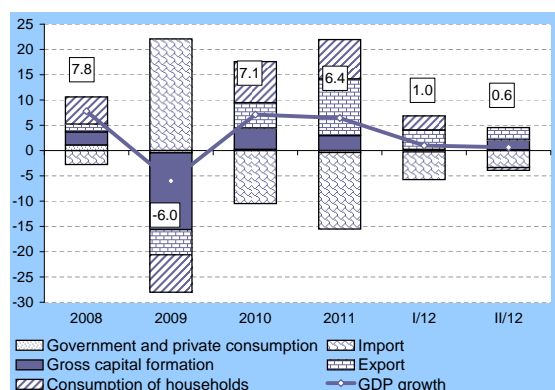
Source: NBS, NBM calculus

while the economic growth at the beginning of the current year was of 1.0 percent. Among the main factors that led to this development may be mentioned the modest performance of the European economy, which resulted in a lower growth rate of exports in 2011, and by the slowdown in remittances which, along with a more modest evolution of wages and lending to population, resulted in a small change in disposable income, which contributed to the slowdown in domestic demand.

In terms of uses (Chart 3.1), data from the second quarter of 2012 show significant changes in economic development compared to the situation at the beginning of this year. In this way, for the first time in the period after the crisis of 2009, household consumption registered a reduction (minus 0.4 percent) primarily due to the slowdown in the household disposable income.

The household consumption decrease resulted also in a more modest evolution of imports compared to the beginning of the year. Thus, these increased only by 3.9 percent compared to the second quarter of 2011. Negative contributions from import and household consumption were offset by the positive evolution of exports, investment and government consumption. Export growth (5.6 percent) was slightly more modest than in the first quarter of 2012 and significantly lower than in 2011, due to low performance of the European economy, remaining positive only due to the economic development in CIS countries. Gross capital formation grew by 8.8 percent, but given that the gross fixed capital formation fell by 0.9 percent, this dynamics was due solely to the evolution of changes in inventories. Government consumption in the second quarter of 2012 increased by 0.6 percent compared to the same period of the previous year.

Household consumer demand
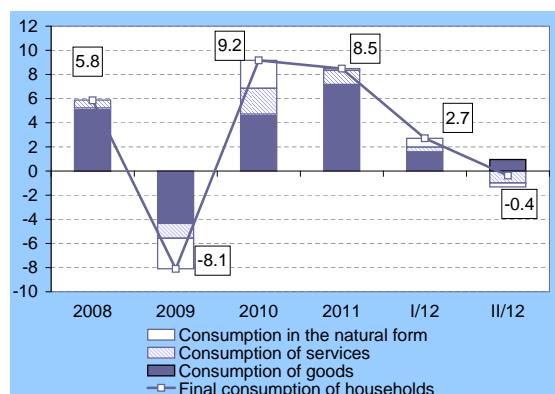
In the second quarter of 2012, the annual rate of household consumption continued the downward trend observed in the current year. Further, in the reference period it became negative. In this way, household consumption decreased by 0.4 percent in the second quarter of 2012 compared to the same period last year, due to a slower growth rate of funding sources.

The expenditure related to the procurement of goods for final consumption, which increased by 1.9 percent in the reporting period, had the largest contribution to the household consumption growth as compared to the second quarter of 2011 and contributed to offset, to some extent, the negative contribution of the other components. The negative dynamics of household consumption was determined mainly by the development of the expenditure related to the procurement of services. These fell by 3.5 percent compared to the same period last year.

At the same time, the decrease in final consumption of goods and services in kind (by 2.7 percent) had a negative contribution, but of a smaller intensity, to the final consumption growth. This evolution may be explained, in part, by a more modest development of global agricultural production. Thus, during January-June 2012, this indicator has decreased by 2.1 percent as compared to the same period last year.

As mentioned previously, the evolution of main funding sources of consumption slowed down, recording a value of 3.2 percent in real terms[5] compared with the same period of the previous year. The main funding sources of consumption in the analyzed period remains to be the total cost of labor (wage bill), which grew by 2.5 percent in real terms compared to the second quarter of 2011 and resulted in a positive contribution to the funding sources dynamic (1.1 percentage points). However it is still much more modest compared with that of 2011.

The remittances recorded an annual rate of growth of 6.0 percent in the second quarter of 2012, and their contribution was slightly lower than in the previous periods, due to the negative effects of the euro area sovereign debt crisis. Although the development of new granted loans continued to produce a positive contribution to the funding sources of consumption growth, their contribution (0.8 percentage points) was significantly lower than in the previous periods. Payments related to social insurance recorded a negative evolution, decreasing by 3.9 percent in real terms, leading to a negative contribution to the financing sources growth (0.7 percentage points).

Government consumption demand

Public sector

Budget execution

According to the data of the Ministry of Finance, during January - September 2012, the national public budget has accrued revenues in the amount of 23940.7 million lei or by 12.7 percent more than the same period last year. Consumption-based economy is also reflected in the main source of revenues collected by the state, the taxes on goods and services recording the highest contribution of 41.7 percent in total revenues. These, in turn, were formed mainly from VAT - 76.3 percent and excise duties - 20.4 percent. During the analyzed period, the excise duties increased by 16.9 percent annually and value added taxes increased by 2.5 percent annually.

Consumption of goods and services continue to be supported by imported products, the taxes collected from these exceeded by
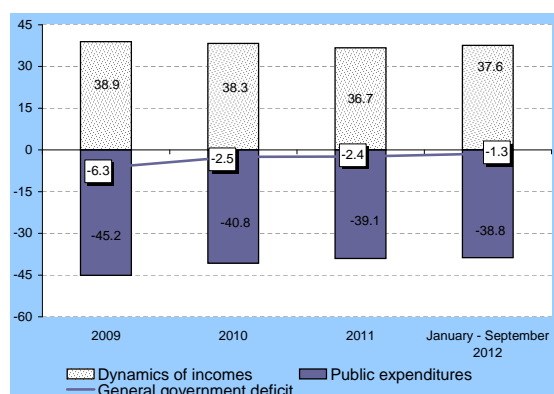
Chart 3.3: Contribution of funding sources (p.p.) to the growth of real household consumption (%)
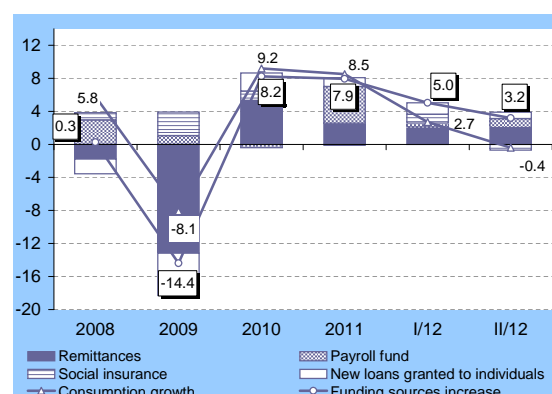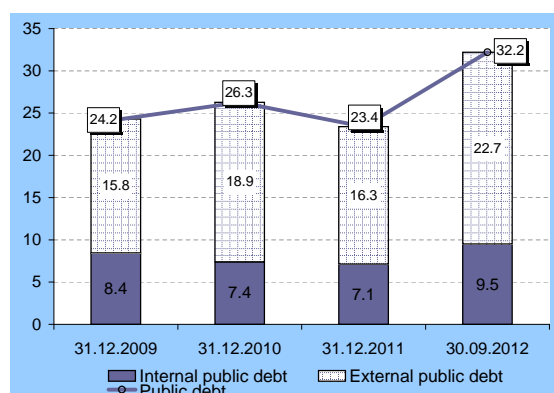

Source: NBS, NBM calculus

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[5]In 2000 year prices

2.5 times the taxes collected from domestic goods and services. At the same time, mandatory social insurance contributions (21.5 percent), income taxes (11.8 percent) and mandatory health insurance premiums (5.5 percent) contributed to the accumulation of revenues with significant shares. Income taxes increased considerably in the reference period - by 68.9 percent as compared to the same period of 2011, increasing particularly due to the accumulation of business activity taxes (BAT).

During the first 9 months of 2012, the national public budget expenditures constituted 24748.4 million lei, increasing by 9.3 percent as compared to the same period of 2011. Within the structure, the major part of public spending was directed to carry out social - cultural programs. Thus, social insurance and social assistance received 35.0 percent, education - 21.4 percent and health care - 12.3 percent of total expenditure. Other expenses were directed to the national economy - 12.1 percent, national defense, justice, constitutional jurisdiction, public order and national security - 6.6 percent, state services with general purpose – 4.3 percent, etc.

Chart 3.4: The evolution of the general government as a share of GDP (%)

Source: Ministry of Finance, NBM calculus

General government deficit amounted to 807.7 million lei, decreasing by 600.2 million lei or by 42.6 percent compared to 2011. For the reporting period, general government deficit, as a share of GDP[6], was 1.3 percent, thus, the executive managing to maintain this indicator at reasonable values preset in the State Budget Law for 2012 (Chart 3.4).

State debt

Chart 3.5: State debt as a share of GDP (%)

Source: Ministry of Finance, NBM calculus

On September 30, 2012 the state debt of the Republic of Moldova constituted 20529.0 million lei, increasing by 1302.5 million lei or by 6.8 percent more as compared to the beginning of the year. The state debt was made up of external state debt - 70.5 percent and domestic state debt - 29.5 percent. The balance of external debt increased by USD 26.6 million compared to the situation of January 1, 2012 and constituted USD 1169.1 million. The external public debt expressed in MDL increased by 8.2 percent compared with the beginning of the year and constituted 14479.2 million lei on September 30, 2012.

The domestic state debt, compared with the situation earlier this year, increased by 3.6 percent (or by MDL 208.0 million more), representing 6049.9 million lei. The domestic state debt is comprised of state securities issued on the primary market in the amount of MDL 3533.8 million, converted state securities – MDL 2213.4 million, and state securities to ensure financial stability issued in the amount of 302.7 million lei.

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[6]GPD data for 2012 are projected by the Ministry of Economy

In the first 9 months of this year, for state debt servicing, there were used funds in the amount of MDL 525.6 million, from which 74.7 percent being designed for servicing domestic state debt and 25.3 percent from the resources for servicing the external state debt.

As of September 30, 2012, as a share of GDP, the debt stock was 32.2 percent, from which 9.5 percent – domestic state debt and 22.7 percent – external state debt (Chart 3.5).

Investment demand

In the second quarter of 2012, the annual rate of gross capital formation increased by 8.8 percent, solely due to the positive evolution of changes in inventories. The gross capital formation decreased by 0.9 percent compared to the second quarter of 2011. The negative growth rate of gross fixed capital formation was due mostly to the negative evolution of the "capital invest-ments" component, which has the largest share in the structure of this indicator. Thus, it fell by 8.0 percent as a result of the decline in investment in residential buildings, equipment and machinery.

The downward trend of gross fixed capital formation was also supported by the decreases recorded in the following compo-nents: „purchase of books for libraries" and „expenditures for geological prospecting works". Positive contributions to gross fixed capital formation were generated by the developments in the following components: „fixed capital value growth in cattle", "expenditure for fixed assets repair" and "expenditure for the development and procurement of programs and databases" (Chart 3.6).

Net external demand

External sector

In the second quarter of 2012, the adjusted data of the current account[7] reflects a significant decrease in the deficit of this account, which was only 8.1 percent as a share of GDP (Chart 3.7). The deficit evolution was influenced by the decrease in deficit trade balance as a share of GDP, which registered 37.3 percent, by 0.5 percentage points less than in the previous period and by 3.7 percentage points less than in 2011.

Chart 3.6: Gross fixed capital formation (%, versus the same period of the previous year)

Source: NBS, NBM calculus

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[7]For the analysis of the current account, the standard terminology ac-cording 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 those included in the *Trade Balance*, grouped in the category *Other transfers and other income*
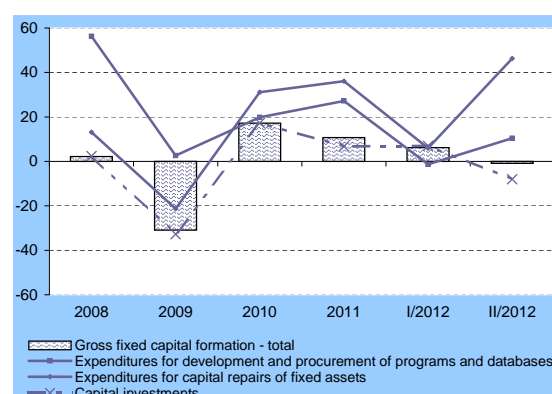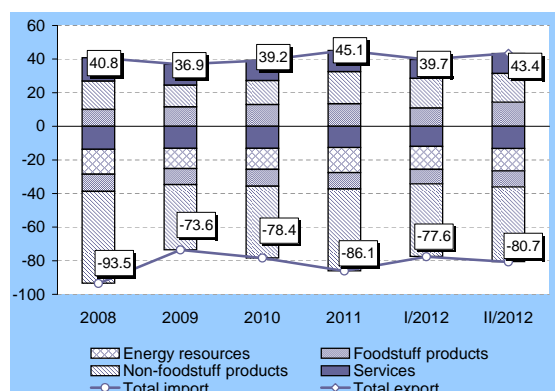
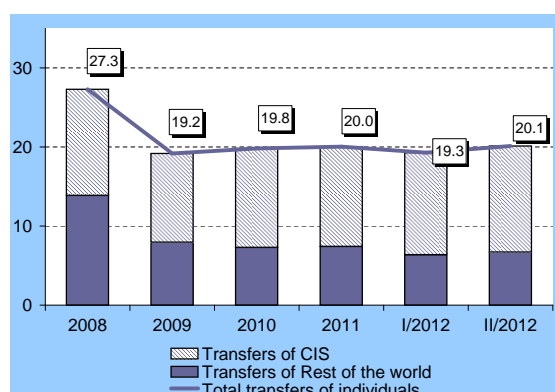Chart 3.7: Current account share in GDP (%)
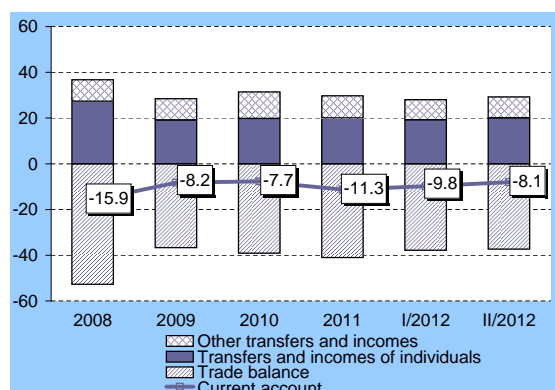
Source: NBM

Chart 3.8: The share of exports and imports in GDP (%)

Source: NBM

Chart 3.9: Share of transfers in GDP (%)

Source: NBM

Along with the positive trade balance evolution, the current account deficit was also reduced due to the increase in GDP of the shares of the components with positive influence, thus the transfers and other income increased by 0.4 percentage points and the transfers and individuals' income by 0.8 percentage points compared with the first three months of this year.

In the analyzed period, both imports and exports of goods and services rose as a share of GDP. Thus, the exports increased by 3.7 percentage points as compared to the first quarter of 2012, amounting to 43.4 percent in GDP (Chart 3.8). Compared to first quarter of 2012, the exports of goods and services increased at the expense of agri-food products and services, which accounted for 14.3 percent and 11.9 percent respectively in GDP. Agri-food products exports to GDP increased by 3.4 percentage points and services reported a slight increase of 0.7 percentage points. Non-foodstuff products accounted for 17.2 percent in GDP, decreasing by 0.5 percentage points compared to the first quarter of 2012. Exports structure shows a relatively uniform distribution of the major constituent components, the exports market being dominated by non-foodstuff products exports by 39.5 percent, agri-food products – by 33.0 percent and services - by 27.5 percent. Foreign aggregate demand has favored the exports of alcoholic beverages, machinery and various equipment, edible fruits and nuts, apparel and clothing accessories, etc.

The imports totaled 80.7 percent in GDP, or by 3.1 percentage points more than in the first quarter of 2012. Most components of imports have changed their trend, thus increasing as a share of GDP, except energy which fell by 0.3 percentage points, covering 13.3 percent of the gross domestic product.

Imports of goods and services rose by 1.2 percentage points each, representing 44.6 and 13.2 percent of GDP. Imported agri-food products constituted 9.6 percent of the GDP or by 1.0 percentage points more than in the first quarter of 2012. Thus, non-foodstuff products represented 55.3 percent of imports, energy - 16.5 percent, services - 16.3 percent, and agri-food products - 11.9 percent.

From imports, the domestic demand was mainly supplied by fossil fuels and petroleum products, machinery and equipment as well as various ground vehicles, etc.

According to the NBS, 61.4 percent of foreign trade operations are conducted with trading partners from Romania, Russian Federation, Ukraine, Italy, Germany and Turkey.

The individuals' transfers in the second quarter of 2012 were placed at a higher level than their average over the past three years (Chart 3.9).
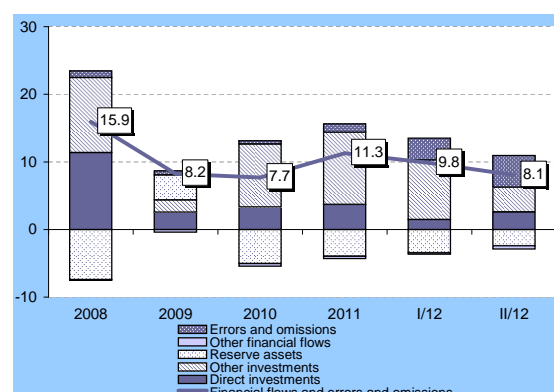
As a share of GDP, the individuals' transfers represented 20.1 percent, exceeding by 0.8 percentage points the rate recorded in the period of January to March 2012. This increase was determined by the transfers received from the CIS countries (+0.5 percentage points) as well as those from countries classified as the *Rest of the world*[8] (+0.3 percentage points). The transfers from CIS countries to GDP amounted to 13.4 percent in the reporting period and the transfers from the *Rest of the world* accounted for 6.7 percent. Thus, the CIS countries continue to hold the major source of origin of remittances - 66.7 percent and the *Rest of the World* contributed by 33.3 percent.

The share of financial flows in GDP constituted 8.1 percent, by 1.7 percentage points lower as compared to the previous quarter (Chart 3.10). This slowdown of the movement of financial flows was mainly due to the significant reduction of inflows of loans in the national economy and due to the increase in foreign assets of commercial banks as currency and deposits.

In the second quarter of 2012, direct investment in GDP constituted 2.6 percent, increasing by 1.1 percentage points as compared to the first quarter of 2012. Direct investment flows in the analyzed period were oriented mainly towards the share capital of companies, constituting 2.8 percent of GDP (Chart 3.11). The share in GDP of the income reinvested by non-residents has diminished significantly the contribution, reaching the value of 0.6 percent, by 0.7 percentage points less as compared to 2011, but by 0.4 percentage points more as compared to the first quarter of 2012. This was determined by the economic slowdown, leading to lower profitability of foreign-owned enterprises.

During April - June 2012, the component "other investments" had the most significant share of GDP (3.6 percent) in the total financial flows, decreasing by 5.2 percentage points as compared to the previous quarter (Chart 3.12). The commercial loans had the greatest contribution in the component "other investments", with a share of 5.0 percent in GDP and the net loans had a more modest share of 4.1 percent of GDP. The volume of net commercial loans increased by 4.1 percentage points compared to the previous quarter, at the expense of loans granted by non-residents to local economic agents and at the expense of commercial loans reimbursed by foreign partners of the residents. The subcomponent "currency and net deposits" as a share of GDP decreased significantly by 3.3 percentage points compared to the first quarter of 2012, mainly due to higher deposits abroad of local commercial banks.

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[8]It is referred to the transfers received from all countries except CIS member countries

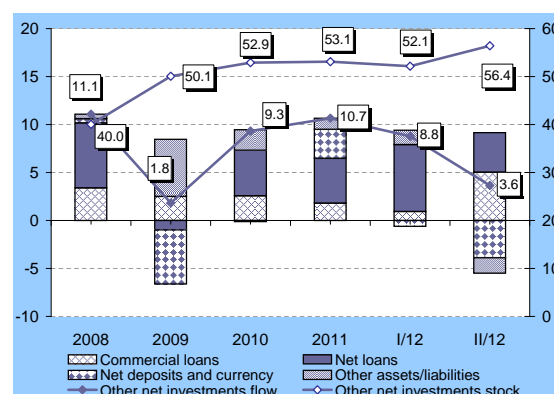Chart 3.10: Share in GDP of the movement of financial flows (%)

Source: NBM

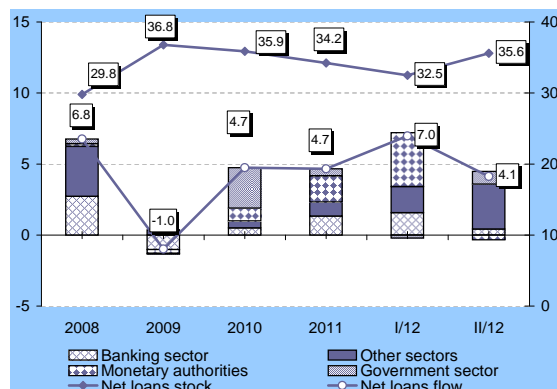Chart 3.11: Foreign direct investment's share in GDP (%)
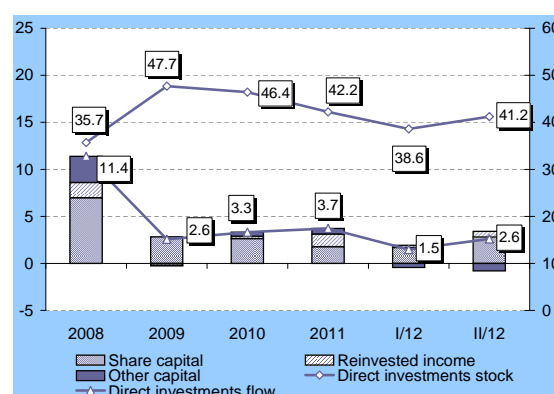
Source: NBM

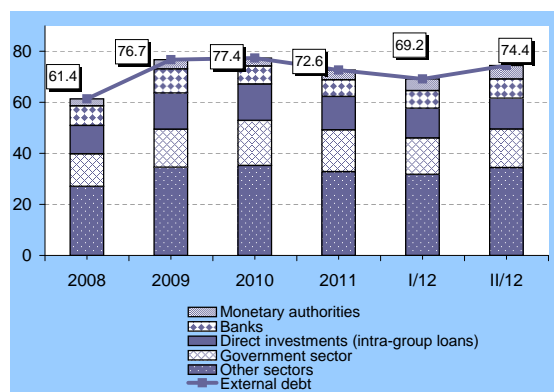Chart 3.12: Share of other net investments in GDP (%)

Source: NBM
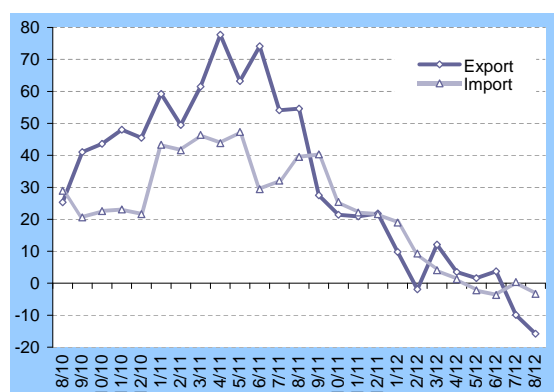
Chart 3.13: Share of loans in GDP (%)

Source: NBM

Chart 3.14: The share of external debt in GDP (%)

Source: NBM

Chart 3.15: Developments in real terms of foreign trade (%, versus the same period of the previous year)

Source: NBS

The share of net loans in GDP decreased by 2.9 percentage points compared to the previous period (Chart 3.13). The reason behind this decrease constituted the lower amount of banking sector loans and the reimbursements of the monetary authorities to the IMF. The share of loans of resident economic agents was the highest in this period, constituting 3.2 percent in GDP, increasing significantly as compared to the previous period. The monetary authorities have made repayments, thereby recording a negative contribution (-0.4 percent as a share of GDP). The stock of loans constituted 35.6 percent of GDP, by 3.1 percentage points higher than the previous quarter.

The share of external debt in GDP increased at the end of the second quarter of 2012 in most of the institutional sectors (Chart 3.14). The share of foreign debt of the Republic of Moldova constituted 74.4 percent of GDP, by 5.2 percentage points lower as compared to the end of the first quarter of 2012.

The economic agents hold the major share in total external debt of 46.5 percent, followed by the government sector and direct investment with a share 20.2 and 16.0 percent respectively. Within the structure of external debt, by short-term commitment types, the trade credits (50.5 percent), other commitments (mainly debts for energy resources) (21.5 percent) and arrears (16.4 percent) have the largest shares.

Foreign trade

During the second quarter of 2012, the annual growth rate of exports and imports fluctuated around zero. However, in the first two months of the third quarter of 2012, the imports recorded similar rates as in the previous quarter, but the exports dropped significantly on a negative track. Thus, in August 2012, the annual growth rate of exports was minus 15.8 percent, by 12.5 percentage points below that of imports (Chart 3.15).

It should be mentioned that the exports of goods decreased by 0.1 percent during January-August 2012, compared to the same period last year, due to the decrease of exports of goods for EU countries by 6.1 percent. At the same time, the exports oriented towards CIS and other countries increased by 7.2 and 1.3 percent respectively. The main factors influencing the foreign demand for domestic products in the respective period are the slowdown of the economic activities in the euro area in the context of the deteriorating problem of sovereign debt crises, which have disrupted the activity of some member countries. An important factor that influenced the decrease of exports of goods to the EU is the European single currency depreciation versus the U.S. dollar (by 9.1 percent in January-August 2012 compared to the same period last year).

At the same time, imports of foreign products in the period of January-August 2012 rose by 2.3 percent compared to the same period last year.

The coverage ratio of imports by exports in January - August 2012 was 41.5 percent, unlike January- August 2011 when the recorded value constituted 42.4 percent.

Domestic trade

During January - August 2012, the turnover volume of enterprises with the retail trade as the main activity recorded an increase of 1.3 percent as compared to the same period of the previous year, but a more modest increase than the one recorded in the fourth quarter of 2011 (15.5 percent).

During January-August 2012, the trade in services recorded an increase of 4.6 percent, compared to the same period of the previous year, however, in the first two months of the third quarter of 2012 showed significantly lower rates compared with the previous quarter. In August 2012, the annual growth rate of the turnover of the retail trade was 1.2 percent, decreasing by 21.9 percentage points as compared to the end of 2011 and the annual growth rate of the turnover of the services rendered to population was 3.2 percent (Chart 3.16).

Chart 3.16: Developments of domestic trading (%, versus the same period of the previous year)
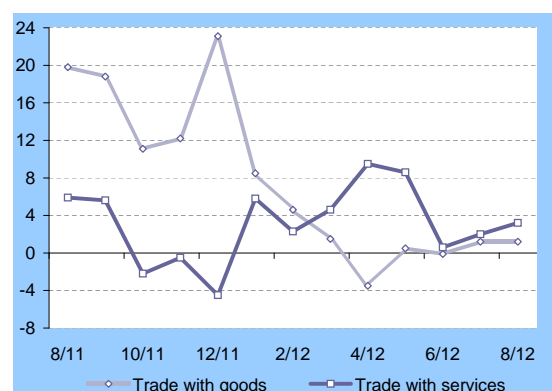
Source: NBS

Supply

By categories of resources (Chart 3.17), the attenuation of the annual GDP growth rate in the second quarter of 2012 was determined mainly by the negative contributions equally from the agriculture, which decreased by 7.5 percent as compared to the same period last year, following the adverse weather conditions early this year. Growth of industry and trade has generated the most significant positive contributions to GDP growth in the reporting period. In this way, industry gross value added increased by 4.3 percent due to manufacturing and mining development, which offset the negative dynamics of the energy industry. Gross value added in wholesale and retail trade grew by 3.7 percent. Construction sector has registered impressive growth in the current year, while in the second quarter of 2012 a modest one (0.9 percent), so its contribution became insignificant. Gross value added in transport and communications grew by 1.2 percent compared to the second quarter of 2011.

A positive contribution to GDP in the reference period was determined by the increase of 1.3 percent in the taxes on products collected in the national public budget.

Chart 3.17: Economic sectors contribution (p.p.) to GDP growth
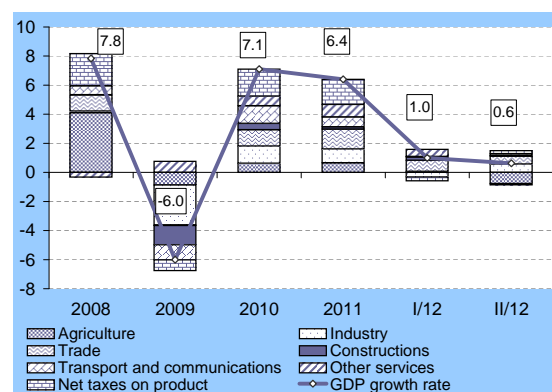
Source: NBS, NBM calculus

Chart 3.18: Evolution of industrial production in real terms (%, versus the same period of the previous year)

Source: NBS

Chart 3.19: The volume of transported goods (%, versus the same period of the previous year)
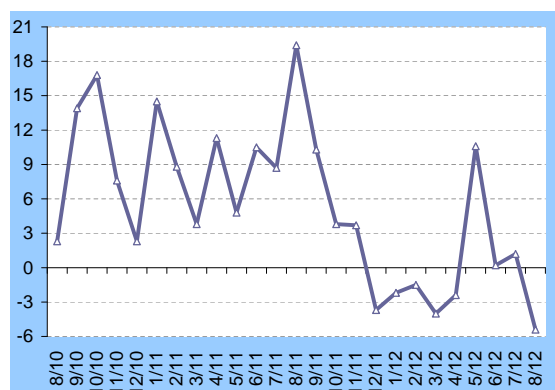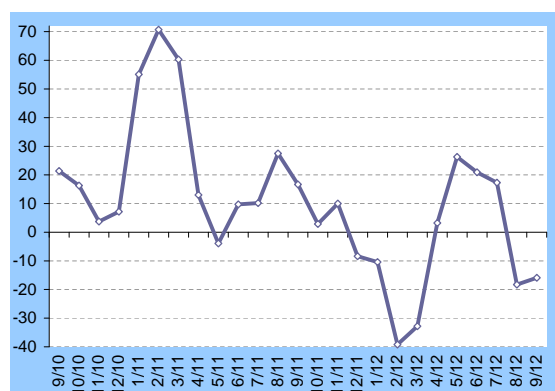

Source: NBS

Industrial production

During January - August 2012, the industrial production volume in all forms of property has decreased in real terms by 0.4 percent compared to the same period last year. It should be mentioned that in August 2012, the volume of industrial production decreased by 5.4 percent, compared to August 2011 (Chart 3.18). The decrease of industrial production volume, compared with January – August 2011, was determined by the reduced production of the energy sector by 3.8 percent and manufacturing by 0.1 percent. At the same time, in the extractive industry was recorded an increase in the volume of industrial production by 7.1 percent.

It should be mentioned that in manufacturing the most significant decreases were recorded in the following industrial activities: "production of tobacco products" (by 23.0 percent), "production of apparel" (by 19.7 percent), "metallurgy" (by 17.6 percent), "manufacture of machinery and equipment" (by 17.2 percent), "paper and cardboard production" (by 16.6 percent) and „manufacture of leather, leather goods and footwear" (by 10.3 percent).

Goods transport

During January - September 2012, the enterprises of railway road, inland and air transportation carried goods by 4.2 percent less than during the same period of the previous year. This decrease was recorded as a result of lower volume of goods transported by railway by 12.7 percent in the reporting period, mainly due to the reduction of transported volume of "cereal and bakery products".

At the same time, after a period of four consecutive months with positive annual growth rates in the volume of goods transported, there was recorded a two month period of pronounced decreases. Thus, the volume of goods transported decreased by 15.9 percent in September 2012 as compared to the same month of the previous year (Chart 3.19). This development was driven mainly by decreased volume of goods transported by all means of transport.

Agricultural production

During January – September 2012, the agricultural production in all categories of households decreased by 21.6 percent as compared to the same period of the previous year. Thus, this development was driven by lower vegetable production (by 33.1 percent). At the same time, the volume of livestock production reordered a slight decrease of 0.3 percent.

In January- September 2012, the decrease of the livestock pro-
duction volume occurred as a result of decreased production
of "milk" (by 3.8 percent) and "eggs" (by 11.2 percent). At the
same time, the decrease of the cereals crop had a significant
negative influence on the physical volume of agricultural pro-
duction. Thus, the harvest of wheat and barley decreased by
42.0 and 44.0 percent respectively during January-September
2012, compared to the same period last year.

3.2   Labour market

*In the second quarter of 2012, the reduction of the unemployment
rate shows an improvement in the labor market situation in the
Republic of Moldova after the crisis of 2009. These positive signals
are overshadowed by the decline of the working population in the
reference period, determined by the reduction in the number of
unemployed and that of employed population. Real gross wage
in the economy has accelerated its annual growth rate from 4.2
percent in the second quarter of 2012 to 5.7 percent in August
2012, a trend found in most economic sectors. As regarding the
budgetary sector, the difference in rate (of 5.4 percentage points)
can be largely attributed to the increase in wages in public admin-
istration and education. The evolution of the real sector (annual
rate acceleration of 0.8 percentage points, up to 4.2 percent) was
determined by higher wages in transport and communications,
health care and social assistance and industry.*

Workforce

In the second quarter of 2012, the reduction of unemployed rate
up to 4.5 percent, as compared to 6.2 percent recorded during
the same period last year, outlines, on one hand, a tendency
to improve the situation on the labor market as a result of
economic recovery after the crisis of 2009.

Chart 3.20: Dynamics of the unemployment
rate (%)

This is also confirmed by the seasonally adjusted unemployment
rate, which recorded a downward trend since the second half
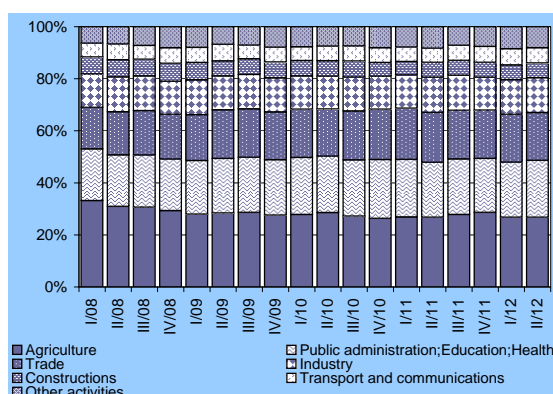of 2010 (Chart 3.20).

On the other hand, however, the reduction of employment by
3.0 percent, along with the reduction of unemployment, caused
a reduction in the workforce by 4.7 percent as compared to
the second quarter of 2011, and presents less positive signals.
The reduction of employment was due to developments in
trade, constructions, industry, agriculture and other activities.

Source: NBS, NBM calculus

In the second quarter of 2012, the number of people dismissed decreased by 5.0 percent as compared to the average of the second quarter of 2011, and the number of vacancies according to the NAE[9] increased by 27.2 percent as compared to April – June 2011.

Chart 3.21: Distribution of employed persons by economic sector (s.a.)

Source: NBS, NBM calculus

By the distribution on the activities of the national economy, the largest concentration of population employed (seasonally adjusted) is registered in agriculture. Its share was 26.8 percent in the second quarter of 2012, recording the same value as in the first quarter of 2012 (Chart 3.21). The share of persons employed in "public administration, education, health, and social assistance" constituted 21.9 percent, increasing by 0.7 percentage points compared with the previous quarter.

The share of persons employed in "other activities" and "transport and communications" decreased by 0.4 and 0.3 percentage points respectively as compared to the first quarter of 2012. The lowest concentration of employed persons was found in the construction sector, whose share has remained unchanged from the previous quarter.

Wages

In August 2012, the average wage of a worker in the national economy increased by 10.4 percent compared to the same period last year. Both in the budgetary sphere and the real sector of the economy were recorded average salary increases of 15.7 and 8.8 percent, respectively, as compared to August 2011.

Chart 3.22: Real average wage* (%, versus the same period last year)
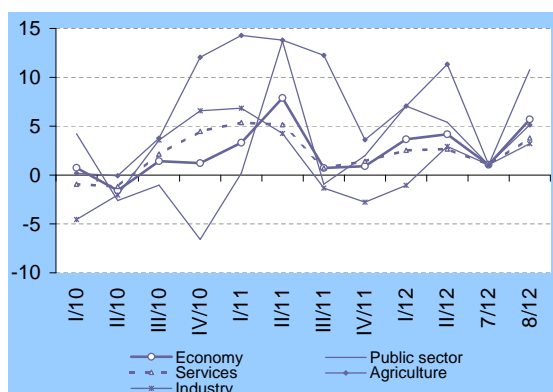
Source: NBS, NBM calculus
*deflated by CPI

In August 2012, the annual growth rate of the real average wage in the economy constituted 5.7 percent (Chart 3.22). This increase was supported mainly by the favorable development of the budgetary sector, as well as by the modest contribution of the real sector. The annual growth rate of real average wage in the public sector recorded an increase of 10.8 percent, by 9.7 percentage points higher than the previous month and by 5.4 percentage points more compared to the second quarter of 2012. This was due mainly to the increase of wages in public administration and education. In August 2012, the annual growth of average real wage in the agricultural sector accounted for 5.1 percent, the average of July and August being much lower than in the second quarter of 2012.

In the services sector, the annual growth of the average real wage has registered a rise of up to 3.8 percent, driven by the positive contributions from transport and communications, trade, health and social assistance and less from the constructions.

[9]The National Agency for Employment of the Republic of Moldova

In the industrial sector, the annual change in real average wages rose to 3.2 percent in the reporting period, by 0.3 percentage points lower than the second quarter of 2012 (Chart 3.23). In August 2012, the annual growth of the average real wage in manufacturing constituted 1.8 percent, as compared to the same month of the previous year, being much lower than during April - June 2012, which was conditioned by the reduction of wages in certain sectors such as: tobacco production, production of leather, leather articles and footwear, publishing, printing and reproduction of information materials, machinery and electrical apparatus manufacturing, and production of other products form non-metallic minerals.

The growth rate of the average real wage in the energy industry continued the upward trend started in the second quarter of 2012, reaching the level of 7.8 percent in annual terms. This growth was supported by higher production and distribution of electricity, gas and hot water supply. At the same time, the increase in annual terms of the production volume of extractive industry for the past four months on average led to accelerating the wages growth rate in this sector from minus 1.0 percent in the second quarter of 2012 to 3.6 percent (the average of July and August 2012). During July - August 2012, labor productivity fell below zero, recording an annual rate of minus 0.4 percent, which was determined by a deceleration in the annual growth rate of the industry in July and August of this year.

Chart 3.23: Real average wage in industry (%, versus the same period last year)
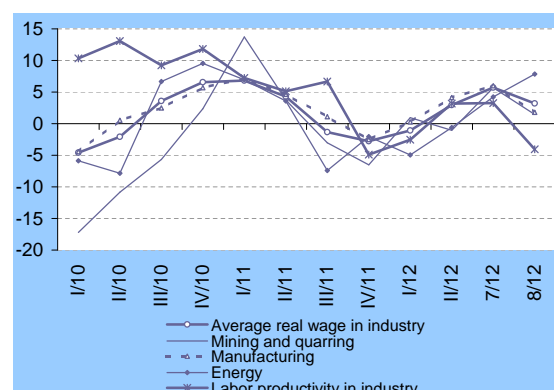
Source: NBS, NBM calculus

Chapter 4

Monetary Policy

4.1 Monetary Policy Instruments

Interest rate policy

Chart 4.1: Average monthly reference rate in the interbank market and the base rate of the NBM (%)
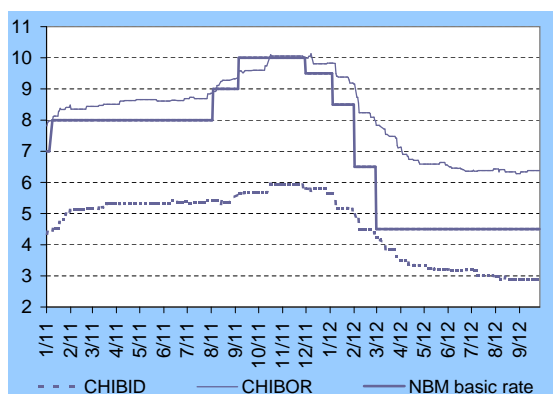
Source: NBM

Chart 4.2: Monthly evolution of the interest rate corridor (%)
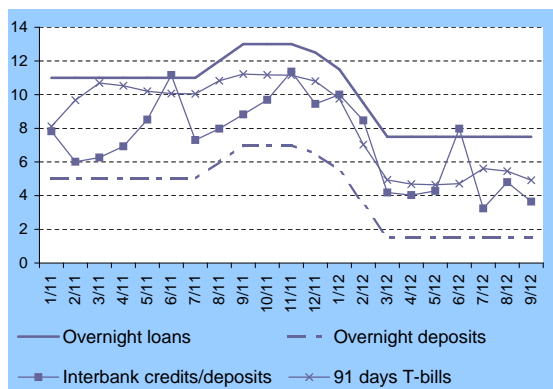
Source: NBM

During the third quarter of 2012, the NBM adopted three decisions to maintain the monetary policy interest rate at the level of 4.5 percent annually. The major argument of those decisions was the strengthening of the disinflation trend in the Republic of Moldova.

The CHIBOR 2W interbank reference rate remained generally stable throughout the third quarter of 2012, sporadically recording changes in both directions. Following these evolutions, the CHIBOR 2W interest rate recorded at the end of the reporting quarter was marginally higher than that recorded in the last day of the previous quarter, representing 6.38 percent.

At the beginning of the quarter, the average interest rate on state securities (SS) of 91 days registered an increase, but a short-lived one, of 5.61 percent, following at the end of July a downward trend and evolving in the proximity of the monetary policy rate at the end of the quarter, constituting 4.92 percent.

The average interest rate on the interbank credits/deposits market, although remained within the interest rate corridor of the NBM, recorded divergent trends: in July, the average rate on interbank credits/deposits (3.24 percent) decreased significantly from the level recorded at the end of the previous quarter (7.98 percent), while in August recorded an increase of 4.8 percent and returned to the level of 3.65 percent in September 2012.

Open Market Operations

NBM Certificates (NBC) selling operations

During the third quarter of 2012, the excess liquidity in the banking system remained high and was drained exclusively by NBM certificates sale. The operations have been carried out according to the schedule published on the official website of the NBM, two weekly auctions, the NBC having a maturity of 14 days.

The NBM carried out 26 auctions with the announcement of the maximum interest rate equivalent to the NBM base rate. The participants' requests were fully accepted.

Following that the interest rates asked in the requests were equal to the maximum rate announced at the auctions, the NBC were sold at an interest rate equivalent to the NBM base rate, which was maintained at the level of 4.5 percent throughout the quarter.

The daily stock of the NBC placements at the end of the reference quarter and their monthly average constituted 4014.6 million lei and 3931.7 million lei respectively, increasing by 553.0 million lei and 385.7 million lei respectively, as compared to the second quarter of 2012. This increase was determined by the NBM interventions on the domestic foreign exchange market, by purchasing currency in the second half of the reporting quarter.

State securities REPO-buying operations

According to the schedule published on the official website, the NBM announced weekly state securities Repo-buying operations with a 28 days term and with the fixed rate of 4.75 percent (the base rate plus a margin of 0.25 percentage points). Requests from banks have not been recorded.

Lending activity

As of September 30, 2012 the credit indebtedness of the licensed banks to the National Bank of Moldova constituted 314.1 million lei, being represented by the loans granted to banks in 2009 for the protection of the integrity of the banking system – MDL 302.7 million and for the construction of housing cooperatives – MDL 11.4 million.

During the third quarter of 2012, the amount of reimbursed loans constituted MDL 24.1 million, including loans granted to banks for the protection of the integrity of the banking system – MDL 23.3 million and loans granted for the construction of housing cooperatives – MDL 0.8 million.

Compared with the previous quarter, the balance of loans granted to banks decreased by 7.1 percent, from MDL 338.2 million to MDL 314.1 million.

Standing Facilities

The operating regime of standing facilities (overnight deposits and credits), established by the NBM, allowed banks to manage efficiently their liquidity and offered the NBM more flexibility in implementing the monetary policy.

Similarly to the previous quarter, the banks continued in the third quarter of 2012 to resort to overnight deposits facility, while the overnight credit facility was not requested. The deposited amounts ranged between MDL 1.0 million and MDL 500.0 million. The total volume of overnight deposits constituted MDL 17025.0 million, which indicates a daily average balance of MDL 264.8 million, increasing by MDL 79.4 million or by 42.8 percent as compared to the previous quarter.

The interest rate on the overnight deposit facility maintained at the level of 1.5 percent annually throughout the third quarter of 2012 and the interest rate on the overnight credit facility at the level of 7.5 percent annually.

Required Reserves

In the third quarter of 2012, along with the open market operations, the required reserves mechanism continued to exercise the monetary control function and to manage the liquidity in the banking system. The required reserves ratio was maintained at the level of 14.0 percent of the base throughout the quarter.

The required reserves in MDL during the attracted means tracking period of August 8 – September 7, 2012 maintained by banks during September 8, 2011 – October 7, 2012 constituted 2740.2 million lei, increasing by 6.9 percent compared to the tracking period of May 8 – June 7, 2012 maintained by banks during June 8 – July 7, 2012.

Required reserves in FCC constituted USD 72.2 million, increasing by 13.9 percent as compared to the situation as at June 30, 2012 and EUR 93.2 million, by 0.3 percent less as compared to the previous period.

For the attracted means tracking period of August 8 - September 7, 2012, the attracted means with a term of more than 2 years, for which a 0.0 (zero) percent required reserves ratio has been applied, constituted: MDL 1807.8 million, USD 278.6 million and EUR 119.5 million, increasing as compared to the previous quarter by 10.1 percent for the funds attracted in MDL, by 5.7 percent for the funds attracted in USD and by 9.6 percent for the funds attracted in EUR.

The required reserves both in MDL and FCC recorded a dynamic similar to that of funds attracted in the respective currencies.

Interbank monetary market

In the third quarter of 2012, the total volume of transactions carried out on the interbank market decreased significantly as compared to the previous quarter – by 2.7 times, totaling MDL 326.9 million. The interbank credits/deposits held the largest the in total transactions – 96.9 percent.

Interbank Market for Loans/Deposits

The volume of interbank loans/deposits constituted MDL 316.8 million in the third quarter of 2012, decreasing by MDL 448.5 million or by 2.4 times as compared to the second quarter of 2012.

The average interest rate on interbank loans/deposits in the reporting quarter ranged between 3.24 percent annually to 4.80 percent annually, thus recording the lowest rate in 2012 (3.24 percent annually in July). The average quarterly interest rate constituted 3.78 percent annually.

The average term of interbank credits/deposits decreased to 13 days as compared to the previous quarter.

The reduction of both the average weighted term and of the interest rate in the reporting quarter reflects the increased share of transactions with maturities up to one month, which reached the level of 92.0 percent of the total.

Secondary market of state securities

The quarterly value of the transactions carried out in the secondary market of state securities decreased to the value of MDL 10.1 million as compared to the second quarter, most of transactions have been carried out between banks.

The average yield for SS traded on the interbank secondary market increased by 0.37 percentage points from the previous

quarter and equaled 5.35 percent, in the context of the increase of the average weighted term to maturity from 59 days to 109 days.

Intervention on the Domestic Foreign Exchange Market

During the third quarter of 2012, the NBM intervened in the foreign exchange market as a buyer of foreign currency in the context of the monetary policy promoted by the NBM and to ensure the consolidation of foreign exchange reserves.
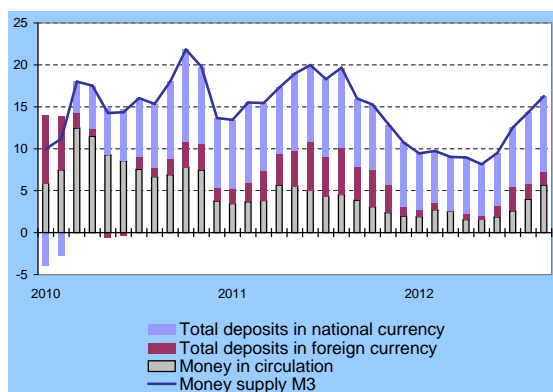
During the analyzed period, the volume of NBM transactions carried out on the domestic foreign exchange market against MDL was USD 222.1 million.

Chart 4.3: Monetary aggregates development (%, annual growth)

Source: NBM

4.2 Dynamics of monetary indicators

From the beginning of 2012, the monetary indicators recorded a pronounced growth.

Thus, in the third quarter of 2012, the growth rate of monetary aggregates has increased, the quarterly average in annual terms constituting 17.8 percent for M2 and 14.2 percent for M3, by 6.1 percentage points and 5.5 percentage points more as compared to the previous quarter (Charter 4.3).

Money supply

Chart 4.4: Dynamics of monetary aggregate M3 (%, components contribution to the annual growth)

Source: NBM

The analysis of monetary aggregates indicates that medium term inflation growth prospects, associated with money supply, remain moderate, mainly due to the increase of money in circulation. During the third quarter of 2012, the money supply registered a more pronounced growth compared to the previous quarters of 2012.

The deposits in national currency had the main contribution to this growth (over 55.0 percent), followed by the contribution of money in circulation (by about 35.0 percent). It should be mentioned that the money in circulation was the main engine of growth of the monetary aggregate M3 during the analyzed period, whose contribution in M3 is increasing for the fifth month, in a row, while the contribution of deposits in national currency during that period fell (Chart 4.4).

The structure of money supply M3 has not recorded any significant changes as compared to the end of the previous quarter, the

share of deposits in MDL and of money in circulation increasing by 1.0 percentage points each at the expense of the decrease of the share of deposits in foreign currency.

The dynamics of deposits recorded an upward trend throughout the third quarter of 2012, increasing by 4.0 percentage points, reaching at the end of September 2012 an annual growth of 14.1 percent, which is the maximum growth in 2012 (since the beginning of the year the evolution of deposits has been stable under the level of 10.0 percent). This development was influenced by the more pronounced growth of deposits in national currency, which exceeded at the end of September 2012 the growth rate of 21.2 percent annually, while the recovery of this growth occurred at the expense of deposits in foreign currency, which recorded at the end of the quarter an annual growth of 5.1 percent (Chart 4.5).

The term deposits constituted the main factor of growth of deposits in national currency in the third quarter of 2012, which contributed with 80.0 percent to this growth. It should be mentioned that the term deposits were influenced by the deposits attracted from individuals, with an average contribution of 79.0 percent (Chart 4.6). The deposits structure did not undergo significant changes, the share of deposits in MDL increased by 2.0 percentage points, accounting for 59.3 percent of the total deposits.

Credit market

The lending process has been influenced by the slowdown in the economic activity in the first half of this year. In the third quarter of 2012, the new credits granted to economy decreased by 6.6 percent as compared to the previous year growth of 23.2 percent. The volume of granted credits constituted MDL 6669.1 million or by 0.5 percent less as compared to the previous quarter (Charter 4.7).

The negative dynamics of the lending process was mainly influenced by the credits in foreign currency (by 9.7 percent less), the credits in national currency decreasing by 4.4 percent as compared to the previous year.

The credits granted in MDL constituted MDL 2972.7 million and were mainly granted to legal entities, their share in total credits totaled 74.7 percent.

During July – September 2012, the credits granted to legal entities recorded the lowest level this year, by 11.6 percent

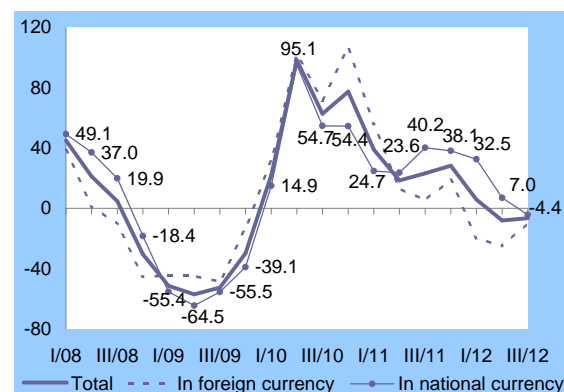Chart 4.5: Deposits development (%, annual growth)
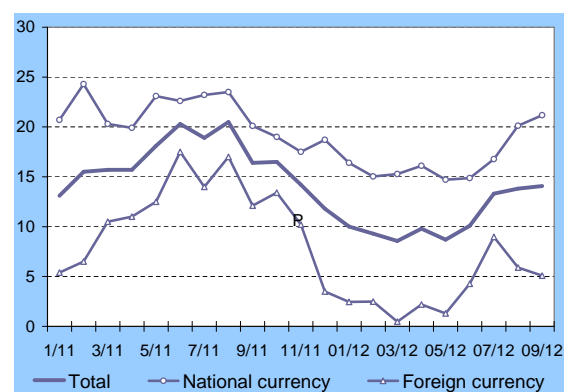
Source: NBM

Chart 4.6: Dynamics of term deposits in MDL (%, components contribution to the annual growth)
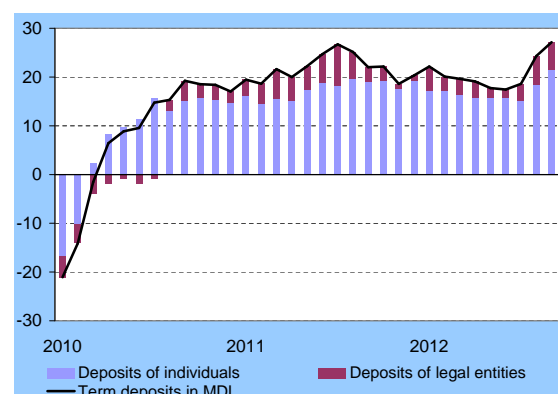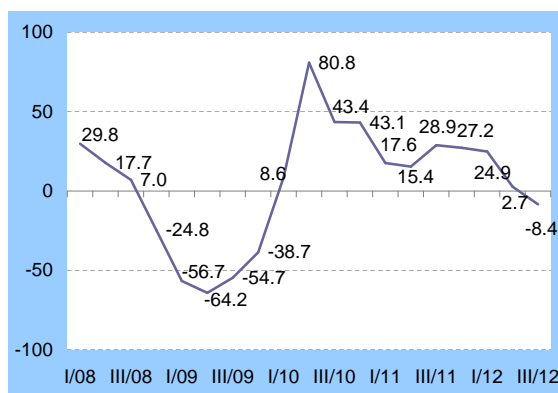

Source: NBM

Chart 4.7: Quarterly evolution of new granted loans (%, annual growth)

Source: NBM

Chart 4.8: Quarterly evolution of new granted loans in MDL (%, annual growth in real terms)

Source: NBM

Chart 4.9: Quarterly evolution of new attracted deposits (%, annual growth)

Source: NBM

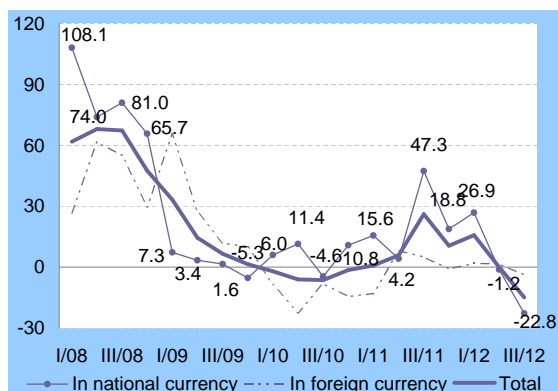Chart 4.10: Quarterly evolution of new attracted deposits in MDL (%, annual growth in real terms)

Source: NBM

less as compared to the third quarter of 2011. The volume of credits in MDL granted to individuals increased by 25.8 percent annually, recording the highest level in the past 4 years (MDL 1009.0 million). The value of credits granted in foreign currency constituted MDL 2687.5 million, less as compared to the third quarter of 2011, at the expense of credits granted to legal entities (by 9.7 percent less). Although the volume credits granted to individuals decreased by 10.8 percent, their insignificant share of 2.0 percent in total has not contributed to the pronunciation of the negative dynamics. In the third quarter of 2012, the value of credits granted to legal entities in foreign currency reached the lowest level this year.

During the reporting period, the dynamic of new credits granted in national currency recorded negative values in real terms, their decrease constituting 8.4 percent as compared to 2011 (Chart 4.8).

Deposits market

Starting with the first three months of this year, the deposits recorded a downward quarterly evolution, their volume decreasing in the third quarter of 2012 as compared to the same period last year. The new deposits attracted during the reporting period decreased by 14.9 percent annually, constituting MDL 9641.9 million (Chart 4.9).

The reduction of deposits volume was determined mainly by the low level of deposits in national currency as compared to 2011 (by 22.8 percent less), up to the level of MDL 5100.9 million. The structure of deposits in MDL consists of individuals' deposits – 53.9 percent and legal entities deposits – 46.1 percent. Both categories of clients had the tendency to decrease their term deposits in the last quarters. Thus, the individuals' deposits decreased in the reporting period by 23.1 percent annually and those of legal entities by 22.5 percent annually.
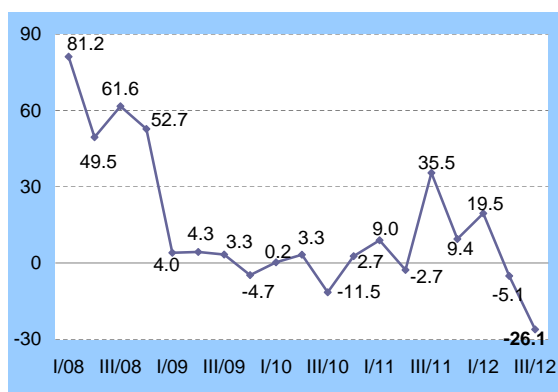
Deposits attracted in foreign currency decreased by 3.8 percent annually, constituting MDL 4541.0 million, mitigating the reduction of deposits in national currency. The deposits in foreign currency were attracted from individuals (63.6 percent) and legal entities (36.4 percent). The deposits of legal entities started to increase since the fourth quarter of 2011, increasing significantly in the third quarter of 2012 by 3.4 times in annual terms. The deposits of individuals recorded a downward trend, decreasing by 33.5 percent annually in the reporting period.

In real terms, for the second consecutive quarter, the annual growth rate of deposits in national currency is negative. Thus,

in the third quarter of 2012, the deposits decreased by 26.1 percent as compared to the same period of the previous year (Chart 4.10).

Interest rates and monetary policy transmission mechanism

In the third quarter of 2012, the monetary policy of the National Bank of Moldova was conducted through the base rate mechanism, which was maintained at a low level. During July – September 2012, the Council of Administration of the NBM decided within its meetings on monetary policy to maintain the base rate applied to the main monetary policy operations in the short term at the level of 4.5 percent annually.

The decision to keep the rate unchanged was taken in the context of medium-term examination of developments in the country's macroeconomic indicators.

Following the monetary policy decisions and the current economic environment, the average interest rate on new granted credits had a downward tend throughout the third quarter of 2012.

Thus, the average interest rate on credits granted in national currency decreased by 1.1 percentage points as compared to the second quarter of 2012, falling to the level of 12.58 percent in September 2012. This level is a new historical minimum and was determined by the decrease of interest rates on credits granted to legal entities, whose average reached the level of 11.83 percent (Chart 4.11).

The average interest rate on deposits in national currency recorded a volatile evolution in the third quarter of 2012, the highest level of 7.94 percent being recorded at the end of the analyzed period, exceeding by 0.35 percentage points the level recorded in June 2012. This evolution was similar to the dynamic of the average interest rate on deposits granted to individuals, which increased to 9.70 percent at the end of the third quarter of 2012.

After individuals' deposits attracted in national currency recorded an increase of 58.5 percent in the second quarter of 2012, during July – September 2012, this indicator recorded again low shares in total deposits. Thus, the share of these deposits has decreased by 4.6 percentage points in the third quarter of 2012, as compared to the previous quarter, constituting 53.9 percent (Chart 4.12).

Chart 4.11: Average interest rates in MDL (%)

New loans — New attracted term deposits — NBM basic rate
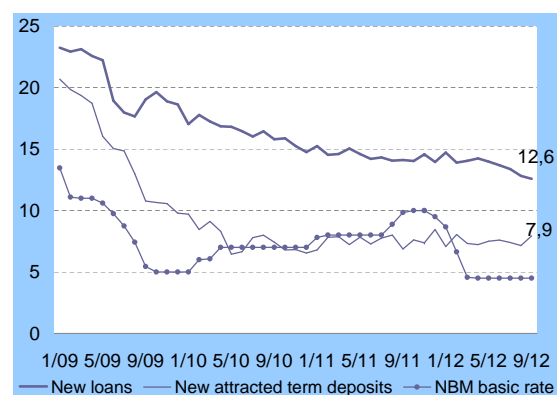
Source: NBM

Chart 4.12: Dynamics of the share of new deposits attracted in MDL from individuals (%)
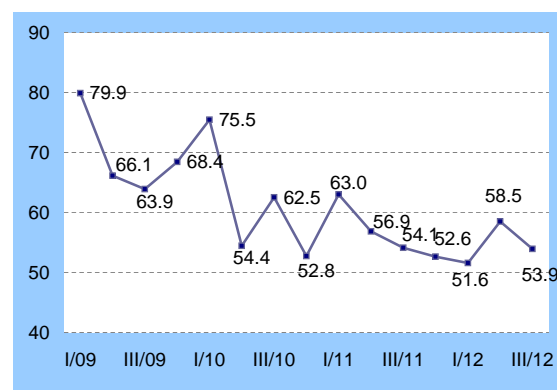
Source: NBM

During the reporting period, the annual inflation rate fell within the limits set in the Monetary Policy Strategy of the National Bank of Moldova for 2010-2012, so that the NBM had the flexibility to further support the monetary policy measures for the economic growth. Through the mechanism of lending the banking system with cheap money, the NBM is seeking to gradually decrease the interest rates on credits granted to real sector, which will contribute later to the economic productivity.

In the third quarter of 2012, the National Bank of Moldova monitored the money market liquidity by conducting in the second half of the quarter sterilization operations to manage the excess liquidity.

Chart 4.13: Evolution of banking margin (p.p.)

Banking margin on operations in national currency
Banking margin on operations in foreign currency
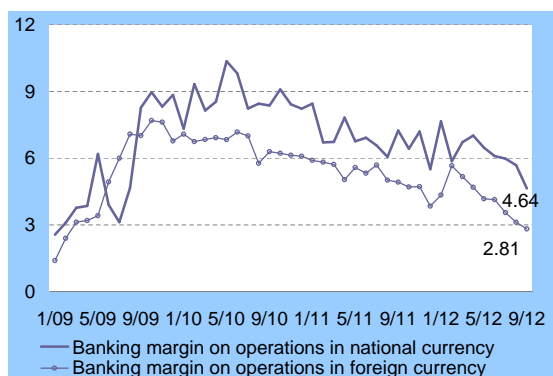
Source: NBM

The banking margin (the difference between the average rates on loans and deposits) related to the operations in national currency decreased by 1.46 percentage points in the third quarter of 2012, constituting 4.64 percentage points in September 2012 (Chart 4.13). This decrease occurred at the expense of the quarterly evolution of the interest rate on credits, which decreased by 1.10 percentage point, being also determined by the increase of the interest rate on deposits by 0.35 percentage points.

The banking margin on foreign exchange operations gradually decreased, constituting 2.81 percentage points at the end of the third quarter of 2012, by 1.32 percentage points less compared to June 2012. The banking margin was mainly influenced by the upward trend of the interest rates on deposits in foreign currency, which contributed by 1.18 percentage points to the decrease of the margin. The interest rate on credits has also contributed by 0.14 percentage points to the decrease of the margin.

The downward trend of the banking margin reflects a reorientation of banks towards other profitable banking activities and towards reducing the perception of the lending process as the only source to increase the income. In this way, the base of a performing banking system oriented towards economic needs of the society and not only towards personal profit started to consolidate.

At the same time, to successfully achieve the macroeconomic objectives set at the country-level, the monetary policy decisions need to be supported by a prudent fiscal policy and by the successful implementation of structural reforms.

Foreign exchange market (the nominal exchange rate and real effective rate)

During the third quarter of 2012, the *official nominal exchange rate of the national currency against the U.S. dollar* depreciated by 1.0 percent, and against the single European currency by 4.6 percent compared to the end of the second quarter of 2012 (Chart 4.14).

The *average official nominal exchange rate of the national currency against the U.S. dollar* recorded in the third quarter of 2012 depreciated by 4.3 percent and against the single European currency by 1.5 percent compared to the average official nominal exchange rate of the national currency recorded during the previous quarter.

The *real effective exchange rate of the national currency*[10] , calculated under the weight of the major trading partners and the average exchange rates, has recorded a depreciation of 4.5 percent as compared to June 2012 (Chart 4.15).

The real effective exchange rate depreciation was determined mainly by the significant appreciation of the U.S. dollar against the currencies of the main external trading partners with significant share in Moldova's foreign trade (including the significant appreciation of Polish zloty - by 6.0 percent, Hungarian forint - by 5.5 percent, Russian ruble – by 3.9 percent, Euro – by 2.2 percent, and Romanian leu – by 1.5 percent).

The following countries had the most significant contribution to the depreciation of the real effective exchange rate: Russia – by 1.42 percentage points, Romania – by 0.92 percentage points, Germany – by 0.32 percentage points and Italy – by 0.30 percentage points (Chart 4.16).

A series of factors, such as the fluctuations in the volume of liquidity in foreign currency generated by corresponding variations of foreign currency inflow and outflow, the evolution of foreign currencies on the foreign markets and the NBM interventions on the domestic foreign exchange market, have influenced the trajectory of the foreign exchange rate of the national currency against the U.S. dollar throughout the third quarter of 2012.

In the third quarter of 2012, there was recorded an excess of liquidity in foreign currency on the domestic foreign exchange market. This excess was generated by both the increase in the net foreign currency supply from individuals by 29.9 percent as

[10]calculated compared to December 2000

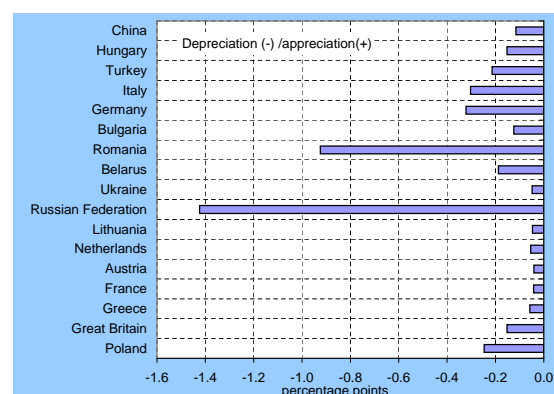Chart 4.14: Fluctuations of the official exchange rate of the MDL
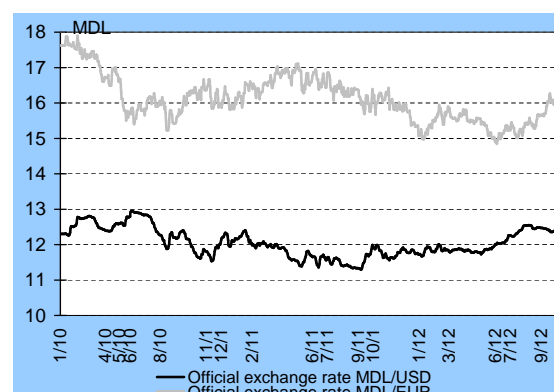
Source: NBM

Chart 4.15: Dynamics of nominal effective exchange rate (NEER) and real exchange rate (REER) of MDL, calculated based on the main trade partners weights
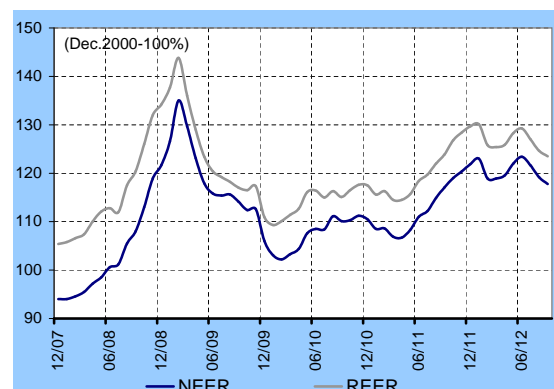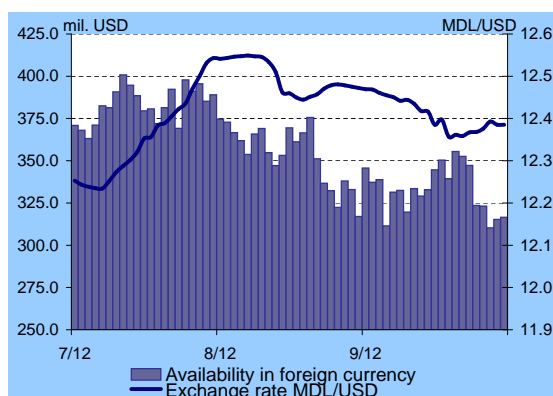

Source: NBM

Chart 4.16: Contribution of Moldova's major trade partners to the real effective exchange rate modification in Q3, 2012

Source: NBM

compared to the previous quarter, which reached a new maximum level of USD 840.3 million and by the reduced demand of foreign currency from the economic agents, which decreased by 1.4 percent, constituting USD 629.2 million.

Chart 4.17: Dynamics of the availability in foreign currency and the official foreign exchange rate during the Q3, 2012

Source: NBM

At the same time, the increase of the balance of individuals' deposit accounts by USD 38.5 million or by 4.6 percent as compared to the second quarter of 2012 contributed to the increase of the volume of liquidity in foreign currency on the domestic foreign exchange market.

In the context of these evolutions, during the third quarter of 2012, the NBM absorbed the excess liquidity in foreign currency by purchasing USD 220.9 million. These purchases aimed at achieving the fundamental objective of the monetary policy promoted by the NBM and at the consolidation of foreign exchange reserves (Chart 4.17).

As regarding the evolution of the monthly official exchange rate of the MDL against USD, during July, both the average exchange rate and that recorded at the end of the month depreciated by 2.3 percent. The upward trend of the exchange rate of the national currency against the USD was influenced by the NBM purchases of foreign currency in the amount of USD 31.5 million in order to achieve the aforementioned objective. Thus, the NBM intervened on the domestic foreign exchange market in the context of a net foreign exchange supply from individuals in the amount of USD 253.0 million, which supplied, in excessive proportions, the net sales of foreign currency to legal entities (USD 217.4 million).

At the same time, in July was recorded a positive net flow of credits and investments in the amount of USD 27.2 million, which contributed to the increase of the volume of liquidity in foreign currency.

The balance of availability in foreign currency of the licensed banks recorded a level of USD 389.0 million, increasing by USD 15.1 million or by 4.0 percent as compared to the end of the previous month. Thus, the share of the availability in foreign currency in total balance of net balance sheet assets constituted 22.1 percent, the licensed banks being able to ensure the continuity of their activities.

In August 2012, the net supply of foreign currency from individuals reached a new maximum level of USD 315.0 million, exceeding by 39.5 percent the net sales of foreign currency to legal entities, which totaled USD 225.8 million. In this context, the NBM intervened on the domestic foreign exchange market by purchasing USD 115.9 million.

Thus, the average official exchange rate of the national currency against the USD recorded in August 2012 depreciated by 1.1 percent as compared to that recorded in the previous month. At the same time, the average official exchange rate of the national currency against the USD recorded at the end of the month appreciated by 0.6 percent.

The balance of the availability in foreign currency of the licensed banks at the end of August recorded the level of USD 317.1 million, decreasing by USD 71.9 million, as compared to the end of the previous month, mainly at the expense of sales of foreign currency to the NBM and the reimbursements related to the external debt. The share of the availability in foreign currency constituted 18.4 percent in the total balance of net balance sheet assets in foreign currency, the licensed banks having a comfortable level of liquidity.

As regarding the evolution of the official exchange rate of the MDL against USD, during September, both the average exchange rate and that recorded at the end of the month appreciated by 0.7 percent. This appreciation of the national currency occurred in the context of a net supply of foreign currency from individuals in the amount of USD 272.3 million, which provided a coverage of 146.4 percent for the low supply of foreign currency from economic agents (USD 186.0 million). Thus, as compared to August 2012, the net sales of foreign currency to legal entities decreased by USD 39.8 million or by 17.6 percent.

At the same time, the net inflows related to external credits and investments amounted to USD 23.4 million[11] during September 2012. In this context, the NBM intervened on the domestic foreign exchange market by purchasing currency in the amount of USD 73.5 million.

The balance of the availability in foreign currency of the licensed banks at the end of September 2012 remained almost the same as compared to that recorded at the end of August 2012. Thus, the balance of availability in foreign currency totaled USD 316.6 million, constituting 18.0 percent in total balance of net balance sheet assets in foreign currency of the licensed banks.

At the end of the third quarter of 2012, the foreign exchange reserves of the State constituted USD 2326.8 million, by 13.0 percent more as compared to the end of the previous quarter and covering 3.9[12] months of imports (Chart 4.19).

Chart 4.18: Coverage rate of net sales by the net supply and the dynamics of the official exchange rate
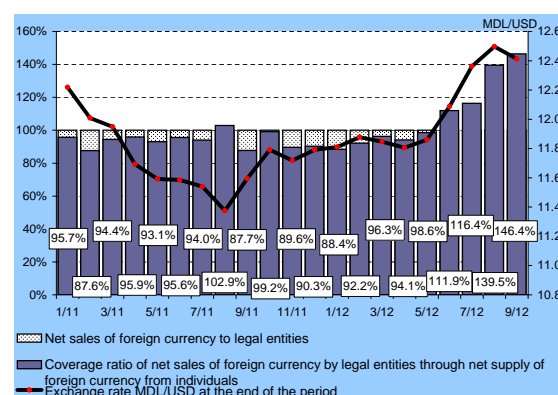
Source: NBM

Chart 4.19: Evolution of foreign exchange reserves expressed in months of goods and services imports
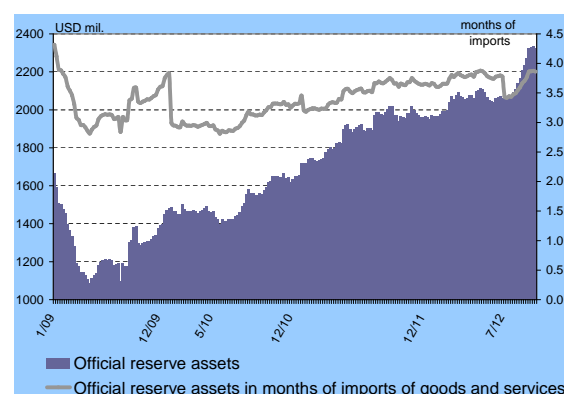
Source: NBM

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[11]preliminary data

[12]calculated on the basis of forecasts relating to the import of goods and services for 2013

The increase of foreign exchange reserves was due mainly to the purchases of USD 220.9 million made by the NBM on the domestic foreign exchange market and to the receipt by the Ministry of Finance from the European Commission of the second tranche of EUR 12.03 million (USD 14.8 million) for further implementation of Water Sector Policy Support Program.

Chapter 5

Medium-term inflation forecasting

5.1 External assumptions of the forecast

According to the new report of the International Monetary Fund, the global economy may slip into a recession, recording an economic downfall in developed countries and a severe economic slowdown in emerging and developing countries. The global GDP growth forecast for 2012 and 2013 has been revised downward by 0.2 and 0.3 percentage points respectively, as compared to the forecast made in July 2012. Thus, the world economy is expected to record a growth of 3.3 percent in 2012 and 3.6 percent in 2013.

Overall, the European economy forecast remains in general dominated by the disintermediation process, which is present simultaneously in the public, private and financial sectors. The recent European authorities' actions to solve the sovereign debt crisis have mitigated the high volatilities in the international markets, generated by the economic downfall deepening perspective in the eurozone.

Thus, as compared to the Inflation report no.3, 2012, the GDP growth forecast of the eurozone for 2012 remained unchanged (minus 0.5 percent) as compared to the previous year. However, the current problems consequences will have a great influence on the eurozone economic recovery in 2013.

Thus, in the current round of forecasting, the GDP of the eurozone is expected to grow by 0.2 percent in 2013, as compared to the 0.5 percent growth forecast[13] published in the Inflation Report no.3, 2012 (Chart 5.1).

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[13]Forecasts for external variables (GDP and CPI of the euro area, GDP and CPI of the Russian Federation, the exchange rate of USD / EUR and RUB / USD) are based on Consensus Forecasts of 9 July 2012 and Futures prices (Brent and main foodstuff products) of 8 October 2012.
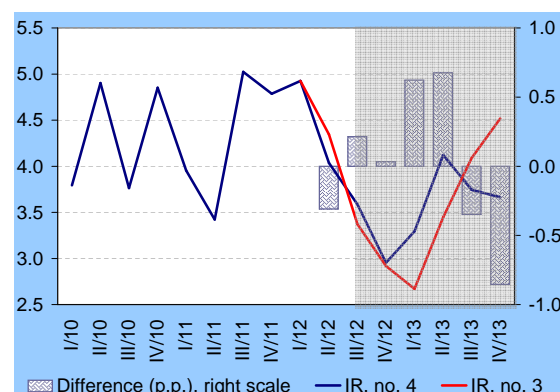
Chart 5.1: Annual rate of GDP in the euro zone (%)
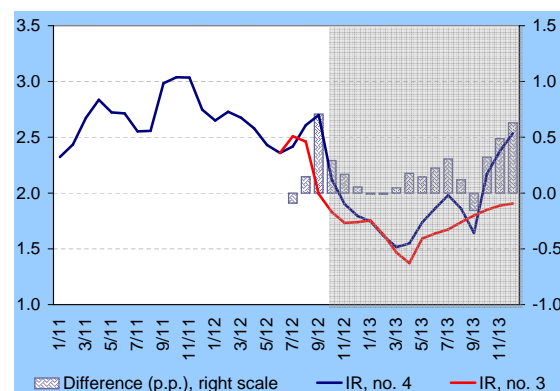
Source: Eurostat, Consensus Forecasts
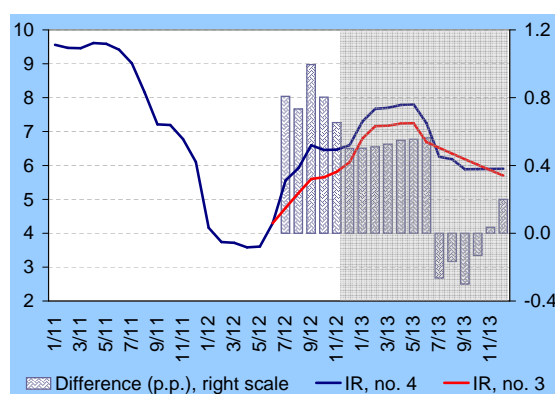
Chart 5.2: Annual rate of CPI in the euro zone (%)
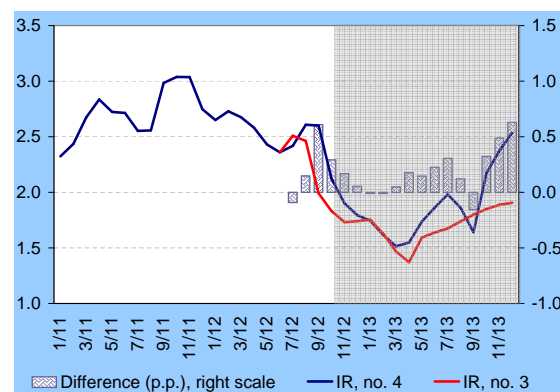
Source: Eurostat, Consensus Forecasts

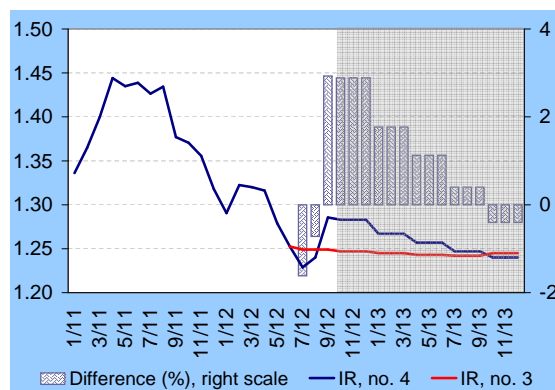Chart 5.3: Annual rate of GDP in the Russian Federation (%)

Source: Federal State Statisitcs Service of Russia, Consensus Forecast

Chart 5.4: Annual rate of CPI in the Russian Federation (%)
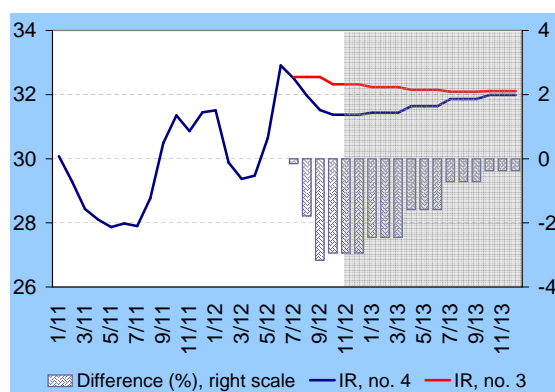

Source: Federal State Statisitcs Service of the Russian Federation, Consensus Forecast

Chart 5.5: The USD/EUR exchange rate

Source: Eurostat, Consensus Forecasts

Chart 5.6: The RUB/USD exchange rate

Source: Central Bank of the Russian Federation, Consensus Forecasts

Following the eurozone inflation rate increase in the third quarter of 2012, determined by the energy and food prices increase, the forecast of eurozone inflation rate for 2012 and 2013 has been revised upward by 0.1 and 0.2 percentage points respectively, as compared to the forecast published in the Inflation Report no.3, 2012. Thus, the current round of forecasting shows an average price increase of 2.4 percent in the eurozone in 2012 and an average of 1.9 percent in 2013, as compared to the previous year (Chart 5.2).

The worsening international macroeconomic environment has also affected the Russian Federation. Thus, the Russian GDP is expected to increase by 3.8 percent in 2012 and by 3.7 percent in 2013 as compared to the previous year. Although the annual estimates of Russian economic growth has not changed significantly as compared to the previous forecasting round, in the first half of the next year it is expected a lower growth and at the end of the next year it is expected an acceleration of the economic activities growth rate. In the next quarters, the Russian economy will record a weak development in agriculture and industrial production, as well as a high volatility of oil and energy resources prices (Chart 5.3).

Following the acceleration of the Russian inflation rate during July – September 2012, as a result of higher tariffs of utilities and food prices, the forecast of Russian annual inflation rate for the current round of forecasting has been revised upward to 5.1 percent for 2012 and to 6.8 percent for 2013. For comparison, in the forecasting round from the Inflation Report no.3, 2012 was projected an inflation rate growth of 4.7 percent for 2012 and 6.6 percent for 2013 (Chart 5.4).

The European Central Bank decision to launch the unlimited bond-buying program for the eurozone member states and the Constitutional Court decision on the partial participation of the German Government in the European Stability Mechanism, which purpose was to resolve the sovereign debt crisis in the peripheral economies of the eurozone, led to increased European stock indexes and to a significant appreciation of the single European currency.

Thus, in the current round of forecasting, the average EUR/USD exchange rate for 2012 is 1.28 compared to 1.27 projected in the Inflation Report no.3, 2012 (Chart 5.5).

Following the USD depreciation against other currencies of international circulation and the gradual increase of oil prices starting with July 2012, it is expected that the average RUB/USD exchange rate will constitute 31.2 for 2012 and 31.7 for 2013.

For comparison, in the forecasting round from the Inflation Report no.3, 2012 it was projected an average RUB/USD exchange rate of 31.5 for 2012 and 32.1 for 2013 (Chart 5.6).

It is anticipated that over the next quarters of this year and in 2013, the Urals brand oil prices will fall within the range from USD 103.0 to 111.2 per barrel[14].

The forecast of development of oil prices has been revised upwards, after the international oil prices have increased significantly in the third quarter of 2012.

Overall, it is expected that in 2012, the average oil price will be about USD 110.7 per barrel, compared to USD 105.8 per barrel, as was estimated in the Inflation Report no.3, 2012 (Chart 5.7).

However, in the next months, the oil price may be very volatile, due to the amplified tensions in the Middle East or if the world economy will record significant contractions.

In the context of maintaining the conditions of the contract valid at the moment on the price of import of the natural gas from the Russian Federation, we anticipate that in 2012 the average import price of natural gas will be approximately USD 396.0 per $1000m^3$ and USD 389.7 per $1000m^3$ in 2013, which represents an increase of 1.7 and 10.5 percent respectively, compared to the average forecast within the previous round of forecast (Chart 5.8).

Compared with the assumptions of the Inflation Report no.3, 2012, the forecast on the reduction of international food prices in 2012 compared with 2011 was revised downwards. Thus, it is expected that global food prices will decline by 5.7 percent in 2012 compared to the 4.1 percent forecast published in the Inflation Report no.3, 2012 (Chart 5.9).

Although the meteorological conditions were unfavorable during the last two quarters of 2012, the international food prices increase was mitigated by the Russian Federation announcement of not imposing an embargo on the export of cereals, which made the international markets to calm down and contributed to the decrease of anticipated cereal prices.
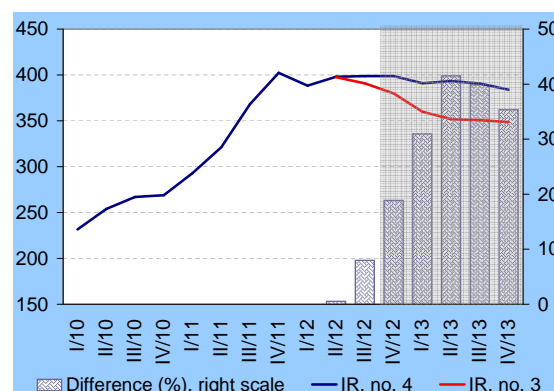
However, the pressures on international food prices will be significant in 2013, when it is expected an average growth of 6.7 percent compared to 2012, as a result to higher prices for meat and cereals.
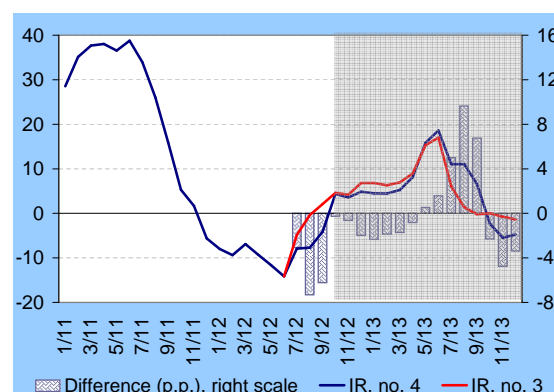
Chart 5.7: Urals brand oil prices (USD per barrel)
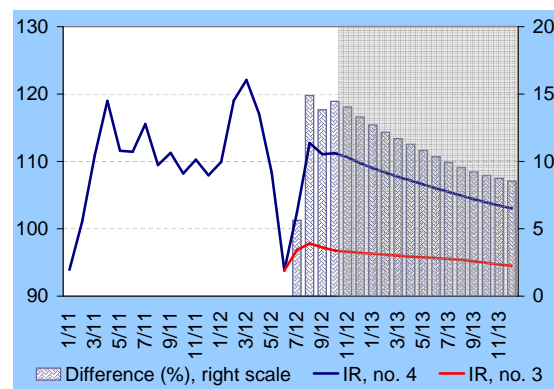
Source: Bloomberg

Chart 5.8: Natural gas price (USD/$1000m^3$)

Source: ANRE, NBM calculus

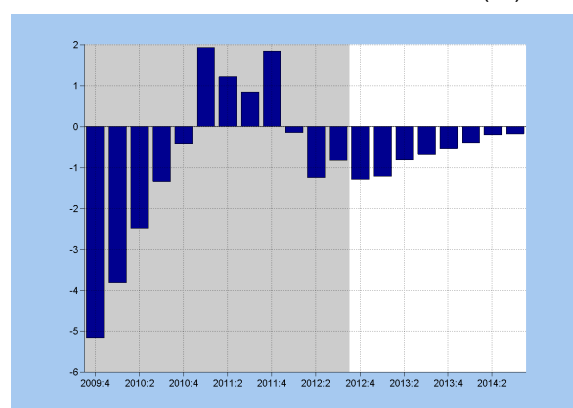Chart 5.9: The annual rate of global food price index (%)

Source: FAO, Bloomberg

5.2   Baseline scenario

Aggregate demand

Chart 5.10: GDP deviation forecast (%)

Source: NBS, NBM calculus

According to the current round of forecasting, the quarterly dynamics of the output gap is expected to be negative throughout the forecast horizon, with a slight recovery tendency by the end of 2013 – beginning of 2014. However, despite the recovery tendency, the economic activity below its potential, especially in the coming quarters, maintains the disinflationary pressures from demand, following the decrease in external demand and the adverse weather conditions this year.

At the same time, as compared to the previous round of forecasting, the output gap is less negative for the forecast range. The real monetary conditions, which became less restrictive, have also contributed to the stabilization of the national economy. This was mainly due to the depreciation of the nominal effective exchange rate that determined also a real depreciation[15]. At the same time, the negative output gap of the real interest rate had a stimulating effect on the aggregate demand[16].

Taking into account the above-mentioned, the countercyclical character of the monetary policy will be further maintained. This is determined by the need to stabilize the aggregate demand, which will directly create prerequisites for the mitigation of the disinflationary pressures. In this context, the annual inflation rate will fall within the inflation range. At the same time, the National Bank of Moldova will maintain a cautious monetary policy aimed at strengthening the convergence of the inflation rate to the target set for medium term.

Inflation

According to the projection from the current forecasting round, the annual inflation rate will reach the level of 4.1 percent at the end of 2012. The upwards revision of the forecast by 0.2 percentage points, as compared to that published in the Inflation Report no.3, 2012, was due to the evolution of international oil prices over the expectations, as well as the increasing impact of the adverse weather conditions on domestic food prices.

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[14]NBM calculus

[15]See the Box no.2 from the Inflation Report no.3, 2012

[16]See the Box no.4 from the inflation Report no.4, 2012

Almost during the entire forecasting period, the values are projected onto a trajectory placed within the variation range of ± 1.5 percentage points from the 5.0 percent target, except the third quarter of 2013, when these will exceed the variation range.

It should be mentioned that the price increase will be determined by the supply-side shocks, while the demand-side disinflationary pressures will be persistent throughout the forecasting period. This also explains the reserved attitude of the monetary policy regarding a possible reaction. The moderate economic growth will further determine the lack of inflationary pressures from aggregate demand, thus, the inflationary pressures will come from supply-side throughout the forecasting period.

The food price increase on the international markets and the unfavorable weather conditions this year will determine the increase of the annual food price inflation. It should also be mentioned that the evolution of the food prices will generate the main contributions to the CPI evolution, the most significant annual growth rate is expected to be recorded in the second quarter of 2013, after which it will follow a downward trend.

The evolution of core inflation will be stable, but below the medium-term objective. The modest growth of prices included in core inflation will be first of all due to a reduced aggregate demand caused by an economic activity below its potential. The goods and services with regulated prices will have a significant contribution, which will enhance by the end of the forecasting period.

Chart 5.11: The CPI annual rate forecast (%, annually)
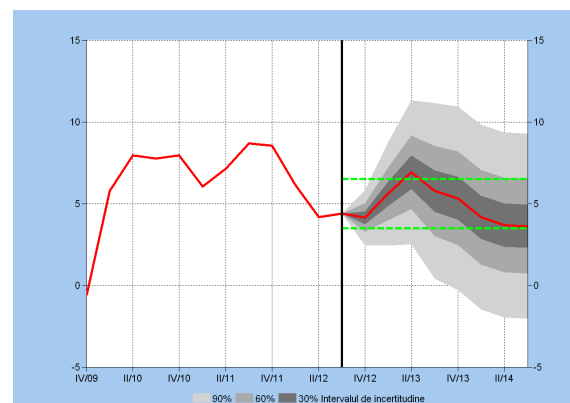
Source: NBS, NBM calculus

Chart 5.12: Decomposition of the total CPI's annual rate forecast (%, annually)

Source: NBS, NBM calculus

Risks and uncertainties

In the last months, the world economy risks have increased significantly. The main cause is the sovereign debt crisis faced by the peripheral eurozone countries, despite of all the measures taken by the authorities to improve the situation. At the same time, Eastern European countries are recording a pronounced slowdown in their economies, due to the propagations of shocks from the eurozone, which will affect the national economy's direction. Thus, the national economy may record in the coming months a more pronounced stagnation, given the possible decrease of exports from the Republic of Moldova to European countries and to those from the region, as the consumption may reduce in the respective countries.
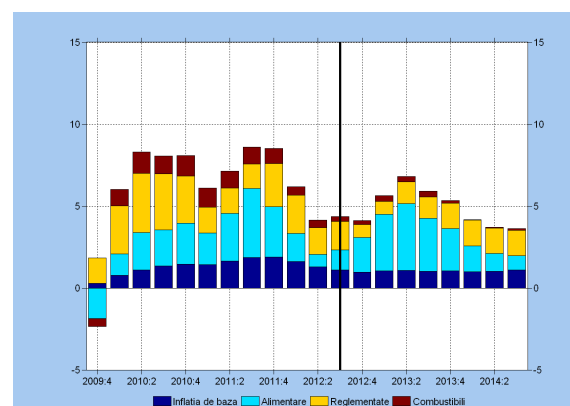
As a consequence, certain sectors of the economy may also be affected, which will influence the industrial production volume.

Another risk related to the economic downfall is the reduction of the investments and external financing, which will again contribute to the mitigation of the economic growth rate.

On the other hand, taking into account the reduced dependence of the national banking system on the international banking system, the external financial vulnerabilities will have a minor impact on the evolution of the financial system of the Republic of Moldova. Thus, the financial intermediation may be insignificantly affected by an eventual worsening of the financial system of the eurozone.

At the same time, domestic pro-inflationary pressures may be significantly affected by the oil prices growth – given the energy dependence of the Republic of Moldova, by the food prices growth – especially in 2013, as a consequence of the reduced harvest in the previous year generated by the unfavorable meteorological conditions in the United States of America, Europe and Russian Federation, by the consumption prices growth in the trading partner economies, which may cause pro-inflationary shocks through the foreign trade channel.

The evolution of international oil prices will be under the incidence of the tensions in the Middle East. The depreciation of the USD and the eventual economic stimuli applied by the central banks of the main world economies will have a stimulating effect on oil prices. Also, the oil stock variation will influence the international oil demand and supply.

However, the significant increase of import price of natural gas purchased from the Russian Federation represents an extremely high risk. The main causes that determine the high probability of this increase are the recent negotiations at high level between the Republic of Moldova and the Russian Federation. There weren't taken any final decisions yet, but the high risk of increase of import price of natural gas from the Russian Federation is still persistent, given that Romania and Ukraine pay a higher price than that presently paid by the Republic of Moldova.

Box no. 4

Real interest rate

The interest rate is one of the main monetary policy instruments through which the National Bank of Moldova influences the evolution of prices. The economic situation may be presented more objectively through the use of real indicators. In this context, it should be mentioned that the real interest rate is a very important indicator for the promotion of the monetary policy, which accurately describes the monetary policy promoted in a certain period. The monetary policy may be of three types: expansionary, neutral and restrictive.

The real interest rate is approximately the nominal interest rate minus the inflation rate. For example, if the nominal interest rate is of 5.0 percent and the inflation rate is of 4.0 percent, then the real interest rate is of 1.0 percent.

The relationship between real and nominal interest rates and the inflation rate is presented in the *Fisher equation*. Expressed as the linear approximation, it can be presented as follows:

$$i = r + \pi^e \qquad\qquad (1)$$

where,

i – nominal interest rate;
r – real interest rate;
π^e – expected inflation rate.

Thus, the formula for calculating the real interest rate can be rewritten as follows:

$$r = i - \pi^e \qquad\qquad (2)$$

The nominal interest rate may have only positive values, but the real interest rate may have both positive and negative values. The real interest rate indicates a negative value when the inflation rate exceeds the nominal interest rate.

At the end of 2011 (Chart no.1), the average quarterly nominal rate of monetary policy was around 10.0 percent, while the real interest rate was close to 3.0 percent. According to the chart shown below, the monetary policy during the last quarter of 2011 was insignificantly restrictive, while in the first quarter of 2012 the monetary policy had expansionary features, following the decisions to decrease the monetary policy rate.

Chart no. 1. **Real interest rate and nominal interest rate**

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Appendix A

Statistical tables

Table A.1: Average monetary policy rates (%)

	Ukraine	Russian Federation	Romania	Hungary	Belarus	Poland	Kazakhstan	Moldova	Turkey	Armenia	Georgia*
2011											
Jan.	7.8	7.8	6.3	5.8	10.5	6.3	7.0	7.8	5.3	7.3	7.5
Feb.	7.8	7.8	6.3	6.0	10.5	6.3	7.0	8.0	5.3	7.6	8.0
Mar.	7.8	8.0	6.3	6.0	11.3	6.3	7.4	8.0	5.3	8.2	8.0
Apr.	7.8	8.0	6.3	6.0	12.4	6.5	7.5	8.0	5.3	8.4	8.0
May	7.8	8.2	6.3	6.0	13.4	6.8	7.5	8.0	5.3	8.5	8.0
Jun.	7.8	8.3	6.3	6.0	16.6	7.0	7.5	8.0	5.3	8.5	8.0
Jul.	7.8	8.3	6.3	6.0	19.2	7.0	7.5	8.0	5.3	8.5	7.9
Aug.	7.8	8.3	6.3	6.0	21.0	7.0	7.5	8.9	6.8	8.5	7.6
Sep.	7.8	8.3	6.3	6.0	28.7	7.0	7.5	9.8	7.0	8.1	7.5
Oct.	7.8	8.3	6.3	6.0	32.9	7.0	7.5	10.0	7.6	8.0	7.5
Nov.	7.8	8.3	6.0	6.0	38.3	7.0	7.5	10.0	8.8	8.0	7.2
Dec.	7.8	8.2	6.0	6.7	43.2	7.0	7.5	9.5	8.8	8.0	6.9
2012											
Jan.	7.8	8.0	5.8	7.0	45.0	7.0	7.5	8.7	8.8	8.0	6.6
Feb.	7.8	8.0	5.5	7.0	44.0	7.0	7.2	6.6	8.6	8.0	6.5
Mar.	7.7	8.0	5.5	7.0	38.0	7.0	7.0	4.6	8.3	8.0	6.5
Apr.	7.5	8.0	5.3	7.0	36.0	7.0	6.5	4.5	8.3	8.0	6.5
May	7.5	8.0	5.3	7.0	35.0	7.3	6.5	4.5	8.3	8.0	6.2
Jun.	7.5	8.0	5.3	7.0	34.0	7.3	6.1	4.5	8.3	8.0	6.0
Jul.	7.5	8.0	5.3	7.0	31.5	7.3	6.0	4.5	8.3	8.0	5.8
Aug.	7.5	8.0	5.3	7.0	30.7	7.3	5.6	4.5	8.3	8.0	5.8
Sep.	7.5	8.1	5.3	6.8	30.2	7.3	5.5	4.5	8.3	8.0	5.8

* At the end of the period
Source: Official websites of the central banks of the respective countries

Table A.2: Required reserve rates of countries in the region (%)

	Ukraine	Russian Federation	Romania	Hungary	Belarus	Poland	Kazakhstan	Moldova	Turkey	Armenia	Georgia*
2011											
Jan.	0.0	2.5	15.0	2.0	3.0	3.5	1.5	8.0	7.6	n/a	10.5
Feb.	0.0	3.3	15.0	2.0	3.0	3.5	1.5	10.3	8.9	n/a	15.3
Mar.	0.0	4.0	15.0	2.0	4.5	3.5	1.5	11.0	9.0	n/a	16.0
Apr.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	11.0	13.0	n/a	15.5
May	0.0	4.8	15.0	2.0	4.5	3.5	1.5	11.0	13.0	n/a	16.0
Jun.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	11.0	13.0	n/a	15.6
Jul.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	13.3	13.0	n/a	15.9
Aug.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	14.0	13.0	n/a	15.1
Sep.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	14.0	13.0	n/a	13.5
Oct.	0.0	4.8	15.0	2.0	4.5	3.5	1.5	14.0	13.0	n/a	14.0
Nov.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	14.0
Dec.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	12.7
2012											
Jan.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	14.1
Feb.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	14.1
Mar.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	13.7
Apr.	0.0	4.8	15.0	2.0	3.8	3.5	1.5	14.0	11.0	n/a	13.9
May	0.0	4.8	15.0	2.0	5.0	3.5	1.5	14.0	11.0	n/a	12.8
Jun.	0.0	4.8	15.0	2.0	5.0	3.5	1.5	14.0	11.0	n/a	13.9
Jul.	0.0	4.8	15.0	2.0	5.0	3.5	1.5	14.0	11.0	n/a	12.8
Aug.	0.0	4.8	15.0	2.0	5.0	3.5	1.5	14.0	11.0	n/a	13.6
Sep.	0.0	4.8	15.0	2.0	6.0	3.5	1.5	14.0	11.0	n/a	n/a

* At the end of the period
Source: Official websites of the central banks of the respective countries

Table A.3: Annual consumer price index (%)

	Ukraine	Russian Federation	Romania	Hungary	Belarus	Poland	Kazakhstan	Moldova	Turkey	Armenia	Georgia*
2011											
Jan.	8.2	9.6	7.0	4.0	10.6	4.0	8.1	6.7	4.9	10.6	12.3
Feb.	7.2	9.5	7.6	4.1	13.0	4.0	8.8	5.7	4.2	12.4	13.7
Mar.	7.7	9.5	8.0	4.5	13.9	4.4	8.6	5.8	4.0	11.5	13.9
Apr.	9.4	9.6	8.3	4.7	18.1	4.5	8.4	6.5	4.3	8.9	13.5
May	11.0	9.6	8.4	3.9	32.6	4.8	8.3	7.0	7.2	9.0	14.3
Jun.	11.9	9.4	7.9	3.5	43.8	4.0	8.4	7.7	6.2	8.5	10.0
Jul.	10.6	9.0	4.9	3.1	48.4	3.9	8.8	8.3	6.3	6.3	8.5
Aug.	8.9	8.2	4.3	3.6	60.7	4.3	9.0	9.2	6.7	4.8	7.2
Sep.	5.9	7.2	3.5	3.6	79.6	3.9	8.7	8.8	6.2	6.2	4.6
Oct.	5.4	7.2	3.5	3.9	92.3	4.0	8.0	8.9	7.7	5.7	2.3
Nov.	5.2	6.8	3.4	4.3	106.0	4.6	7.8	8.9	9.5	4.8	1.9
Dec.	4.6	6.1	3.1	4.1	108.7	4.6	7.4	7.8	10.5	4.7	2.0
2012											
Jan.	3.7	4.2	2.7	5.5	109.7	4.1	5.9	6.9	10.6	4.8	0.5
Feb.	3.0	3.7	2.6	5.9	107.4	4.4	4.7	6.1	10.4	3.0	-2.1
Mar.	1.9	3.7	2.4	5.5	106.5	4.0	4.6	5.4	10.4	2.2	-2.2
Apr.	0.6	3.6	1.8	5.7	101.1	4.1	4.8	4.7	11.1	1.9	-2.1
May	-0.5	3.6	1.8	5.3	80.5	3.6	5.0	4.1	8.3	0.5	-3.3
Jun.	-1.2	4.3	2.0	5.6	69.2	4.3	4.9	3.7	8.9	0.7	-0.2
Jul.	-0.1	5.6	3.0	5.8	65.7	4.1	4.7	4.0	9.1	2.3	0.6
Aug.	0.0	5.9	3.9	6.0	55.6	3.8	4.7	4.4	8.9	2.5	-0.4
Sep.	0.0	6.6	5.3	6.6	38.8	3.8	5.0	4.9	9.2	2.5	-0.1

* At the end of the period
Source: Official websites of the central banks of the respective countries

Table A.4: Monetary policy real rates (%)

	Ukraine	Russian Federation	Romania	Hungary	Belarus	Poland	Kazakhstan	Moldova	Turkey	Armenia	Georgia*
2011											
Jan.	-0.4	-1.7	-0.7	1.7	-0.1	2.2	-1.0	1.0	0.3	-3.0	-4.2
Feb.	0.5	-1.6	-1.3	1.8	-2.2	2.1	-1.7	2.2	1.0	-4.3	-5.1
Mar.	0.0	-1.4	-1.6	1.4	-2.3	1.8	-1.1	2.1	1.2	-3.0	-5.2
Apr.	-1.5	-1.5	-1.9	1.2	-4.9	1.9	-0.8	1.4	0.9	-0.4	-4.8
May	-2.9	-1.2	-2.0	2.0	-14.5	1.9	-0.7	0.9	-1.8	-0.5	-5.5
Jun.	-3.7	-1.1	-1.6	2.4	-18.9	2.9	-0.8	0.3	-0.9	0.0	-1.8
Jul.	-2.6	-0.7	1.3	2.8	-19.7	3.0	-1.2	-0.2	-1.0	2.1	-0.6
Aug.	-1.0	0.1	1.9	2.3	-24.7	2.6	-1.4	-0.3	0.1	3.5	0.4
Sep.	1.7	1.0	2.7	2.3	-28.3	3.0	-1.1	1.0	0.8	1.8	2.8
Oct.	2.2	1.0	2.6	2.0	-30.9	2.9	-0.5	1.0	0.0	2.2	5.0
Nov.	2.4	1.4	2.5	1.6	-32.9	2.3	-0.3	1.0	-0.7	3.1	5.2
Dec.	3.1	1.9	2.8	2.5	-31.4	2.3	0.1	1.6	-1.5	3.2	4.8
2012											
Jan.	3.9	3.6	3.0	1.4	-30.9	2.8	1.5	1.6	-1.7	3.1	6.1
Feb.	4.6	4.1	2.9	1.0	-30.6	2.5	2.4	0.5	-1.7	4.9	8.8
Mar.	5.7	4.1	3.0	1.4	-33.2	2.9	2.3	-0.8	-2.0	5.7	8.9
Apr.	6.9	4.3	3.4	1.2	-32.4	2.8	1.6	-0.2	-2.6	6.0	8.7
May	8.1	4.2	3.4	1.6	-25.2	3.5	1.4	0.4	0.0	7.5	9.8
Jun.	8.8	3.6	3.1	1.3	-20.8	2.8	1.1	0.8	-0.6	7.2	6.2
Jul.	7.6	2.3	2.2	1.1	-20.6	3.0	1.2	0.5	-0.8	5.6	5.1
Aug.	7.5	2.0	1.3	0.9	-16.0	3.3	0.8	0.1	-0.6	5.4	6.2
Sep.	7.5	1.4	-0.1	0.1	-6.2	3.3	0.5	-0.4	-0.9	5.4	5.9

 * At the end of the period
Source: Official websites of the central banks of the respective countries