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Monetary Policy Report 1, 2010

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Summary

The External Environment

Following two years since the outbreak of the economic and financial crisis the severe recession that has eroded business performances worldwide is gradually making space for re-launching in major developing markets as well as in some of the advanced economies. Shrinking of global economy during the last quarter of 2008 and the first quarter of 2009 was replaced by positive growth in Q2 and Q3 of 2009. Due to measures taken by the governments of the United States, Europe, Japan and China aimed at granting support to banks and other financial institutions it became possible to prevent their meltdown. As a result the latter reported profits for Q2 and Q3 of 2009.

Although there are signs of worldwide economic stabilization, including improvement in the stock market as well as in regaining consumers' trust at the background of lower interest rates, still, the medium term perspective remains uncertain as there are still major risks endangering the global economic and financial stability.

Macroeconomic background

The economic development of Moldova's key commercial counterparts was marked by further aggravation of global financial and economic crisis which, in its turn, has lead to deterioration in domestic conditions caused by a decrease of the size of remittances as well as by the slumping domestic demand to locally manufactured products. Thus, in the third quarter of 2009 as compared to the same period of the previous year the gross internal product decreased by 7.7 percent in real term.

The labor market in 2009 was marked by the tendency toward shrinking due to the fact that a permanently growing number of companies renounced on their personnel recruitment plans while reducing the number of hired employees. According to the data made available by the National Bureau of Statistics the unemployment rate amounted to 5.7 percent beating by 3.6 percentage points the number registered for the same period of the previous year.

Although the crisis persists producing a notable impact onto the labor market, the average monthly wage paid to some employees of the national economy during January-November 2009 showed an ascending pattern increasing by 8.5 percent in nominal terms.

Development of the Inflationary Process

The annual inflation rate in December 2009 measured using the consumer price index amounted to 0.4 percent as compared to 7.3 percent reported for December 2008. This development occurred at the background of a descending trend that has started in June 2008 and continued through the summer of 2009.

Brake down by the components shows that the larger growth (by 2.5 percent) was marked by prices on non-foods followed by prices on services furnished to households (by 2.2 percent) while prices on food grade products showed a decrease of minus 3.8 percent.

The core inflation registered a descendent development beginning with April 2008 (11.2 percent) amounting to 2.1 percent in October 2009 and showing slight alteration in December 2009 (2.9 percent). December growth of core inflation was determined by devaluation of the national currency against foreign currencies.

Macroeconomic Projection of Medium-Term Inflation

The medium term macroeconomic projection (2 years) was prepared based on the external economic conditions, actual standing of the economic cycle in the Republic of Moldova while bearing on the following assumptions:

- continuity of the monetary policies promoted by the National Bank of Moldova while pursuing its fundamental scope, i.e "ensuring and maintaining price stability" and achieving the inflation objective (measured against consumer price index published monthly by the National Bureau of Statistics (NBS)) at the level of 5.0 percent in 2010 with possible deviation of ±1.0 percentage points while for 2011-12 maintaining the inflation rate close to the average single digit range;
- maintaining slightly restrictive fiscal policy so as to allow for a decrease of budget deficit by 2.0 percentage points – from 9.0 to 7.0 percent of GDP due to increase of revenues as a result of growing indirect tax collection as well as by growing amount of grants. At the same time, overall expenditures will be reduced by about 1.0 percentage points. The assumptions in regard to fiscal policy are based integrally on the 2010 State Budget Law;
- increasing excise duties and VAT and impact of this measure onto the inflation;
- bearing in mind when making projection were such factors as increase of energy tariffs for end consumers as of the beginning of 2010 approved by the National Agency for Energy Regulation as well as eventual changes of such in medium term perspective.

Pursuant to our projection the annual CPI inflation rate will reach 6.1 percent in March 2010 followed by a ascending trend up to 7.7 percent in August-September while towards the end of the year it will register the value of 6.5 percent. Exceeding the stated range of inflation will bear only temporary and non-persistent nature based on certain objective factors, including such as: temporary shock registered at the beginning of this year as a result of increasing tariffs on natural gas, electricity and municipal heating by the National Agency for Energy Regulation. At the same time, this shock is partially determined by the increase of excise and VAT rates on certain products.

Reversing the inflation trend and bringing it back to 5.0 percent ±1.0 percentage points has a rather high level of probability. With a probability of over 50.0 percent the inflation rate at the end of 2010 will be within the stated range. In 2010 the inflation will be captured totally within the stated range with a probability of over 90.0 percent while gradually decreasing to reach 4.6 percent in December.

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