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Inflation Report no. 4, 2011

Inflation Report no.4, November 2011 [1]

Summary

Inflation developments

The annual rate of inflation measured by CPI was 8.8 percent in the third quarter of 2011, continuing the upward trend started in February 2011. However, the actual amount of inflation corresponds largely to the amount projected in the Inflation Report no. 3, August 2011. The annual rate of core inflation has also seen a dynamic trend in the reporting period, recording a level of 4.4 percent in September 2011, being less pronounced than the overall inflation.

Among the main factors that favored the CPI growth in the third quarter, compared to the previous year, may be mentioned the increases in utilities tariffs and the side effects caused by them on other components, adverse weather conditions for some crops, worldwide increase in prices for food and oil derivatives, increasing demand of the population from disposable income, increasing external demand to some local products. At the same time, the aforementioned pro-inflationary pressures have been partially mitigated by the developments of the national currency against the currencies of the major trading partners.

In the third quarter of 2011, the prices of industrial production and construction prices have registered an upward trend, which will create pressure to increase prices of some components of the CPI in the following periods.

The gross domestic product increased by 6.8 percent during the second quarter of 2011 as compared with the second quarter of 2010. The economic growth continued in the second quarter of 2011, but was more moderate than in the first three months of this year, in accordance with the projection indicated in the Inflation Report no. 3, August 2011. External demand was the determining factor in GDP growth and the quality of the economic growth is higher than in previous periods.

The unemployment rate reduction to 6.2 percent shows, on one hand, an improvement in the labor market situation in the second quarter of 2011. On the other hand, there is a decrease in the number of employed. In August 2011, the nominal average wage of a worker in the national economy has grown by 8.5 percent against the same period last year. However, the annual average real wage in the economy in August recorded a negative dynamic economy driven by the developments recorded in all sectors, except agriculture. Since the first quarter of 2010, consequently, the growth rate of labor productivity gets ahead the real average wage in the industry.

Monetary policy

In order to anchor the inflation expectations in conjunction with counteraction of possible second round effects of adverse shocks, the National Bank of Moldova has maintained during the third quarter of 2011 the prudent conduct of monetary policy. However, the NBM continued to manage firmly the liquidity excess existing in 2011 on the monetary market through sterilization operations.

The National Bank of Moldova has intervened in the foreign exchange market during July - September 2011 as a buyer of foreign currency in order to mitigate the excessive exchange rate fluctuations of the national currency against the U.S. dollar.

During the analyzed period, the volume of transactions conducted by the National Bank of Moldova on domestic foreign exchange market against MDL constituted the equivalent of USD 22.62 million.

Monetary indicators have recorded a modest growth in the third quarter of 2011 compared with the previous quarter, the quarterly average in annual terms constituting 19.7 percent for M2 and 17.9 percent - for M3.

The persistence of a high level of liquidity in the banking system, which slows the transmission of monetary policy decisions, determined the downward position of the interest rates charged by banks on new loans and new deposits attracted in national currency during the third quarter of 2011.

Anticipating the inflationary pressures, the National Bank of Moldova has consequently increased by 1.0 percentage points the interest rates on its instruments of monetary regulation during the third quarter of 2011, so that the base rate was increased up to 10.0 percent and interest rates on overnight deposit and credit facilities up to 7.0 and 13.0 percent, respectively.

Medium-term inflation forecasting

The world economy continues to recover, but with smaller rates, due to the intensification and spread of sovereign debt crisis among developed economies, which has an impact on international financial market trends and causes rapid deterioration of the indicators in developed economies.

While policy makers in developed countries are trying to support the economic growth rate, large emerging economies try to avoid overheating them. Over the past few months some of the major developing economies have sought to reduce high rates of inflation by tightening the monetary policy. However, lower growth in developed economies is reflected in lower exports. All these have contributed to the stagnation of macroeconomic balance in the world, leading to a downward revision of forecasts for global economic development.

The main risks that could significantly change the global economy in the near future are related to the issues facing the public finances and banking systems in developed economies, the lack of policies to redress the economic crisis and volatility of commodity markets.

Deviation of real GDP in early 2011 showed positive values being over the potential level of economic activity. Compared to the projection of the Inflation Report no. 3, August 2011, where the output gap was positive throughout the forecasting period, the output gap in the current round of forecasting has a more pronounced downward trend, so, towards the end of the forecast (third quarter 2013), it will record slightly negative values.

Current projection, from the baseline scenario, places the annual inflation rate at the level of 9.6 percent at

the end of the year, while at the end of the next year - at the level of 6.5 percent. Compared with Inflation Report no. 3, August 2011 the inflation rate at the end of this year is projected at a 1.1 percentage point higher, while at the end of 2012 - at a lower level by 0.9 percentage points. The main cause of negative gap for 2012, between the current projection and from the previous report, represents slightly lower levels of global food prices, natural gas and of the fuel. These developments would be the result of reduced economic activity worldwide.

Global economic developments in the coming quarters will be marked by high risks and uncertainties caused by the major sovereign debt crisis.

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