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Inflation Report no. 2, 2012

Inflation Report no.2, May 2012 [1]

Summary

Inflation

In the first quarter of 2012, the annual inflation rate measured by CPI constituted 6.2 percent and continued its downward trend started at the end of the previous year. This value of the annual inflation rate registered in the first quarter of 2012 was due to several factors, the main of them being: increases in utility rates and side effects they caused on other components, increases in world oil derivatives prices and increases in excise duties on petroleum products, maintenance of population's demand following the increased disposable income in the previous year and increased external demand for some local products, especially in the first half of 2011. At the same time, the aforementioned pro-inflationary pressures were partially attenuated by the development of the national currency against the currencies of the main trading partners and the excessive supply of some crops in the region at the end of the previous year. The deviation between the actual value and expected inflation in the Inflation Report no.1 (RI no.1, 2012) was minor. The annual core inflation rate, similarly, recorded a downward dynamic during the reference period, decreasing from 6.1 percent in December 2011 up to 5.1 percent in March 2012. The annual rate of prices in construction was relatively stable during the reporting period and amounted to 9.4 percent. In March 2012, the annual rate of industrial producer price index was 6.5 percent, decreasing by 0.1 percentage points compared to the previous month.

The economic growth continued in 2011, but was more moderate than in 2010, thus the gross domestic product during the reporting period increased by 6.4 percent. Due to increased external demand and augmented disposable income, especially in the first half of the year, the exports and household consumption were the determinant factors of the GDP growth. The contribution of exports was significantly higher than that of consumption. The imports growth decreased a significant positive contribution generated by the rest of the components. The economic growth was supported by the positive developments in all sectors.

Data on foreign and domestic trade, industrial and agricultural production, and on transport of goods for the first quarter of 2012, outline a high probability to register an insignificant economic growth or even a decline during this period. In the fourth quarter of 2011, the NBS data on unemployment and the number of redundancies presented by the NEA show an improvement in the labor market as compared to the same period of 2010. The annual rate of real wages in the economy in the first two months of 2012 was higher than in fourth quarter of 2011.

Monetary policy

The mitigation of price increases and possible widening of disinflation have determined the NBM to loosen its monetary policy. Thus, in the first quarter of 2012, the National Bank of Moldova reduced consecutively the monetary policy interest rate by 2.0 percentage points, within the meetings of the Council of Administration of the NBM of January 26, 2012 and February 23, 2012. In this regard, the base rate applied to the main monetary policy operations in the short term was changed gradually from 8.5 percent to 4.5 percent, the value recorded representing a historical minimum.

At the same time, to ensure appropriate monetary conditions for price stability, the National Bank continued to firmly manage the liquidity surplus through sterilization operations in the money market.

During the first quarter of 2012, the National Bank of Moldova promoted a flexible foreign exchange policy. As the situation on the domestic foreign exchange market was balanced, the intervention of the NBM was not necessary.

After substantial increase of monetary indicators in 2010, due to economic restoration in the aftermath of crisis, the growth rates have slowed down in 2011 and recorded a sharper downward dynamic in 2012. In the first quarter of 2012, the growth rate of monetary aggregates decreased, the quarterly average value constituted 13.1 percent for M2 and 9.2 percent for M3.

The average interest rates charged by banks during the first three months of 2012 had a stable trend, most of the indicators recording insignificant increases or decreases. At the end of March 2012, the average interest rate on new loans in national currency was 14.05 percent and the rate on new loans in foreign currency was 9.36 percent. In turn, the yields on bank time placements recorded higher values than those recorded in the previous quarter in foreign currency and lower for those in national currency

Medium-term inflation forecast

In the first months of 2012, the global economic prospects have strengthened gradually. Major advanced economies have had a poor recovery, while in most of emerging and developing economies, the economic activity remained robust. However, recent improvements are very fragile and downside risks remain high.

The unlocking of the Greek sovereign debt crisis convinced the international markets about the possibility of recovery of the euro area economy and thus, the risk of a drop in global demand was reduced. At the same time, overall economic development prospects of the euro area in 2012 have not changed, but a deepening of the differentiation between developed and peripheral economies of the euro zone is expected. The U.S. economy has made significant progress, combining cutting unemployment and inflationary pressures.

The analyzed period was marked by significant growth in oil prices, which are supported by political tensions on the nuclear situation in Iran and Greece’s sovereign debt crisis unlock. Also, the deterioration of agro-meteorological conditions in the main agricultural areas contributed to the worsening of the outlook for this year’s harvest.

According to the projection of the baseline scenario, the annual inflation rate will reach the level of 4.9 percent at the end of 2012, and at the end of the next year – the level of 4.4 percent. The projected trajectory is similar to that published in February 2012, so that according to the baseline scenario, both in 2012 and in 2013, the inflation will be within the target corridor.

As a result of worsening outlook of external environment, the projection of domestic aggregate demand has been revised. Thus, the GDP deviation is expected to register negative values in the forecasting period. This shows the intensification of disinflationary pressures. Therefore, the monetary policy will follow a stimulating behavior by counterbalancing the effects on inflation arising from the possible reduction in aggregate demand.

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