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# Monetary Policy Report No. 4, 2010

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## Summary

In the first quarter of 2010, the world economy continued its recovery process. According to the International Monetary Fund estimates (IMF), in the first and second quarters of the year, the world economy grew at an annual rate of 4.7 and 4.9 percent respectively. Based on data from the first quarter of this year, the annual growth rate of world economy is expected to be 4.8 percent in 2010.

The recovery process remains to be uneven, each region registering its growth rate. While in the advanced economies, the recovery process will further depend on the public debt, high unemployment, maintenance of difficult conditions in terms of credit, and volatility in foreign exchange markets, the outlook for emerging countries is considerably better. However, the advanced economies would grow by 2.7 percent, while for the emerging and developing economies the new forecast indicates an advance of 7.1 percent.

However, the most recent macroeconomic indicators, published during July – September 2010, suggest a decrease in the global economic activity rate, offering a possible further deceleration in global growth during the second quarter of 2010. In the most developed economies, the recovery is tempered by unfavorable conditions in the labor market, mortgage decline, and difficulties in financing fiscal deficits. The growth in emerging economies remained generally robust, but the short-term indicators suggest a slowdown of economic growth.

In the upcoming period, the inflationary pressures remain low, mainly in the developed economies. The inflation in the advanced countries will reach 1.4 percent in 2010 and in emerging countries will reach 6.2 percent.

### Dynamics of the inflationary process

In the third quarter of 2010, the annual rate of inflation measured by the CPI showed a slight upward trend, increasing from 7.6 percent in July to 8.0 percent in September, while the annual core inflation rate experienced a declining growth in the reference period (from 5.1 percent in July to 4.8 percent in September 2010). The significant difference between the rate of CPI inflation and core inflation rate shows the significant contribution of the non-monetary factors in prices increase in Moldova.

To the annual inflation rate formation in September 2010, the most had contributed the regulated prices as a result of changes in tariffs for gas, electricity and heating, conducted in January and May. At the same time, a major contribution has been exerted by food prices, as a result of weather deviations from the norm during

the year and food price fluctuations on the world market. The oil prices fluctuations in the world market have determined the increase in fuel prices. The increase in core inflation was mainly influenced by the developments in the foreign exchange market in the first quarter of this year, by the increases in indirect taxes from the beginning of the year, and by the second-round effects resulting from higher prices of services with regulated prices.

## Macroeconomic situation

In the first half of this year, it is recorded a pronounced recovery of the Moldovan economy, after the severe decline during 2009, following the global economic crisis. Thus, the gross domestic product in the first semester of 2010 rose by 5.6 percent compared to the same period last year. Household consumption and gross capital formation have been the engines of the economic growth in the second quarter of 2010. The export growth had a modest contribution to the positive evolution of GDP in this period. The significant increase in imports in the second quarter of 2010 had a considerable impediment to the GDP growth in Moldova, a significant portion of domestic demand being directed towards goods and services from outside, to the detriment of those produced by the branches of national economy. The entry of the economy in the recovery phase is confirmed by positive developments in all sectors, and after a long period of decline, in the construction sector.

Operational data on consumption of goods and services, industrial production and transport of goods for July, August, and September, and the information on foreign trade for July and August outline the prerequisites for continuing recovery in economic activity in the third quarter of 2010.

In the second quarter of 2010, it is recorded a deterioration in the labor market situation in Moldova, so that the unemployment rate on country-level exceeded by 0.9 percentage points the value recorded in the previous year due to reduced flexibility of the labor market in Moldova.

## Macroeconomic and inflation forecast on medium term

According to the NBM estimates, the level of GDP exceeded the minimum level of recession and starting with the end of 2009 has had an upward trend, which was visible in the first two quarters of this year. However, the level of the economic activity is still below its potential, which created disinflationary pressures that are still persistent.

Compared with the Monetary Policy Report no.3, 2010, the economic growth will be higher by about 1.6 percentage points for this year and by 0.1 percentage points higher for the next year. Thus, the GDP growth in 2010 will be 5.0 percent and 3.4 percent in 2011. Therefore, as in the previous forecast, potentially reaching the level of economic activity will be outside the horizon of two years.

The annual rate of CPI inflation at the end of 2010 will record the level of 7.8 percent, which is 0.4 percentage points less than the amount previously projected. The reduction of the forecasted inflation rate for 2010 is due to inflationary pressures, which were lower than previously projected.

The inflationary pressures in 2011 will have a nature and intensity similar to those of 2010. Towards the end of the forecast period (2012), the annual inflation rate will reach close to a long-term sustainable level of 5.0 percent. The core inflation at the end of this year will reach 4.0 percent. During 2011, it will drop to 2.1 percent, which will accelerate to a level of approx. 4.0 percent at the end of 2012.

The risks relating to external environment evolution are generated by signs of recovery in the world economy, which could transpose into price fluctuations on oil and natural gas. The food products have recorded a considerable growth pace in the recent years. All these external factors could therefore cause disruptions in the evolution of inflation.

## Monetary policy decision

Analyzing the medium-term inflation projections, the Council of administration of the NBM decided in the meeting of October 28, 2010 to maintain the base rate at 7.0 percent. The base rate remained unchanged throughout the second and third quarter of 2010.

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