

Status report on implementation of the monetary policy program 2009 (inflation report)

2010-02-23

(2009/4) SUMMARY

The main macroeconomic developments in the fourth quarter of 2009 were high inflationary environment and faster recovering global economy and domestic economies. Faster than expected increase of prices of raw materials and some food products in global markets, revived economy and strictly expansionary monetary and fiscal policy implementation during the year have resulted in notable acceleration of the rate of inflation in the fourth quarter, having persisted within the target until November. In December, however, the 12-month inflation indicator increased sharply to 6.5 percent, outstripping the target by nearly 1 pp, which was due to more prominent seasonal growth of agricultural products in December. Note that under the above developments the annual average inflation in 2009 has been just 3.4 percent. Inflation in the fourth quarter was 3.7 percent largely due to 5.8 percent increase in food products (alcohol and tobacco included) (with 3.1 pp contribution to inflation). This in turn has been determined by seasonal price increase in the following items: 'Fruit', by 35.9 percent (with 0.9 pp contribution to inflation) and 'Vegetable and Potato', by 44.2 percent (with 2.1 pp contribution to inflation). The price increase in item 'Vegetable and Potato' was totally driven by price increases in 4 products: tomato, cucumber, green pepper and eggplant (with 4.2 pp contribution to inflation). Prices of non-food products and service fees have increased by 3.0 percent and 0.7 percent, respectively, with a total 0.7 pp contribution to the quarter's inflation. The impact of inflationary pressures was reflected in the behavior of core inflation, too. Interestingly though, core inflation in the fourth quarter was merely 1.7 percent¹, while the 12-month core inflation has increased by 1.5 pp against the previous quarter's indicator and made up 5.25 percent.

Economic slowdown, driven by global economic crisis, reached its peak in the second quarter of 2009 (21.8 percent y-o-y) but trended downward in the next quarters, reflecting gradual improvement of the macroeconomic conditions thanks to stimulatory fiscal and monetary policy measures. As a result, as expected, the fourth quarter saw somewhat lesser economic decline of 5.3 percent y-o-y under which circumstance the decline in the period January-December has been up to 14.4 percent y-o-y. And, save for construction branch where the slowdown decelerated, the rest of branches of the economy reported growth over the quarter. Industry reported growth of value added nearly by 1.4 percent y-

o-y (7.6 percent y-o-y decline in January-December); agriculture reported 2.1 percent growth y-o-y (0.1 percent y-o-y decline in January-December); and

services reported 0.7 percent growth y-o-y (0.7 percent y-o-y growth in January-December, as well).

Due to rigidities existing in the labor market, in the fourth quarter nominal wages in the economy have slightly grown driven by the rise of wages in both budget-supported organizations and firms in the private sector. The growth rate of wages has decelerated in comparison with that of recorded over the first three quarters of the year. The unemployment rate has also responded to the economic slowdown with a certain time-lag. As a result, the labor productivity kept on declining in the fourth quarter though

at a slower rate. These developments have resulted to increase of unit labor costs, thus creating an estimated 0.9 percent inflationary pressures in the consumer market, according to the Central Bank.

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Expansionary monetary policy brought about high dram excess liquidity in the banking sector, which in turn has contributed to interest rate cuts in secondary markets of repo operations and government securities. The aforementioned developments have steered the fulfillment of the inflation target and the monetary policy directions during the quarter. On the whole, in the fourth quarter the Central Bank continued implementing monetary policy based on prudent combination of tasks to stimulate economic activity and ensure price stability. Despite the expectations of higher inflation in the forecast horizon, given still high declining rates of GDP, CBA refrained from interest rate lifts based on necessity to contribute to the acceleration of economic recovery. This policy helped to somewhat improve macroeconomic situation, reflecting some positive shifts in real sector.

