

## **Situation on the summary of the monetary policy on the year 2002**

### ***1. Situation of the monetary policy***

The National Bank conducted the monetary policy related to the maintenance of the acceptable level of inflation, the stability of national currency rate, the currency reserves meeting international standards, strengthening of the national banking system and improvement of the money supply in the economy in 2002 and mostly achieved the targets.

The successes achieved on the economy of the country continued in the year 2002 as well. Attained macroeconomic stability became irreversible and even deeper. These all proves the effectiveness and properness of economical policy and its main component – the money-and-credit and exchange rate policy.

#### ***State of Macroeconomics***

At the result of purposeful economical and monetary policy the macroeconomic stability was retained in Azerbaijan during the year 2002.

The average inflation rate was at 2.8% in Azerbaijan in 2002. Researches carried out according to the inflation model show that the price change of the food products 92%, the price changes of the non-food products 8% influenced the price alteration.

The alteration of the prices is related 41.6% to the monetary factors, 33.3% to the non-monetary factors and 25.1% to the seasonal factors.

The **real amount of gross domestic product** as a main economical indicator has increased by 10.6%.

3.6% industrial and 6.4% agricultural growth rates were achieved.

The share of the private sector in the economy increases regularly which is an important condition to obtain the status of the country of the market economy. 73% of GDP, as well as 53.7% of industrial product, 98% of agricultural commodities, 81.6% of investment, 66.5% of communicational services, 56% of freight forwarding and 85.3% of passenger turnover were performed by non-government sector during the year.

The amount of the investment in the fundamental construction sphere as a main guarantee factor of the future economical development increased by 82.2% constituting 10.3 trillion manats, since 7.8 trillion manats (1.6 billion USD) or 75.5% of this was foreign investment.

The positive inclinations observed in foreign trade balance of the Azerbaijan during last years were improved. The foreign trade turnover rapidly increased as a bright result of successful oil strategy and reached 3.9 billion USD by the end of the year. The export was 2.1 billion USD and import was 1.8 billion USD. Finally the payment ability of the country became even greater and the positive balance of the foreign trade was more than 330 million USD.

The improvement of the population welfare proceeded. The income of the population during the year increased by 11.4% constituting 21169.9 billion manats and the expenses increased by 12.6% constituting 20965 billion manats compared to the previous year. The average salary went up to 315.2 thousand manats and its real growth was 17.4%. In its turn the increase of population's income was the guarantee factor of the real sector development, enhancing purchasing capacity.

#### ***The inclinations in the world economy***

The past period of 2002 was memorable due to start of some decelerations of the economical crisis begun in leading countries of the world in the year 2001.

After the traditional New Year improvement in the USA the stock indexes began to slowdown again at the beginning of the year. For the first time during the last year and half the growth of the industrial product was observed during the months of January – February. According to the summary on the first quarter of the year the GDP increased by 5.8%. The increase of the new employment places was fixed firstly since July, 2001. The raise of the wholesale trade also has indicated the increase of the busyness activity. The Consumer

Sentiment Index also began to rise. So the Federal Reserve System officially declared that the economical regress had been stopped and it would perform neutral monetary policy.

Under the pressure of the industrial producers of the USA and for the purpose of the export stimulation the FRS began to soften exchange policy. It should be noted that the increase of the government spendings played an important role in the increase of the economical indicators. But the production activity index began to drop again which displayed a stagnation in the industry in the third quarter. Index of the new orders also dropped below the critic level (50). Meanwhile the supposed apprehension of this crisis began to worry the analysts. FRS lowered the discount rate from 1.75% to 1.25% to revive the economical activity in November.

Despite the descent in the exchange rate of euro from 0.9 USD to 0.8 USD, as well as the increase of the unemployment level, the other indicators of the economical activity displayed the development in Europe in the beginning of the year. For example, the index of the economical activity in the services sector went up to the top level during the last 13 months. The strengthening of the inclinations of the economical growth in Europe in the end of the year, as well as the policy of the FRS of the USA oriented to make dollar cheaper, increased the exchange rate of euro. As a result the exchange rate of euro to USD rose up to the parity level. It should be noted that the appreciation of euro appeared sooner than expected by the analysts. But the production activity index, as well as the index on the services sector began to drop during the third quarter. It is mostly related to the negative tendencies in Germany possessing the most enormous economy in Euro region. The Central Bank of Europe lowered the discount rate from 3.25% to 2.75% taking into account these processes, as well as the decision of the FRS of the USA.

The economical indicators in Japan display the continuation of the economical crisis. The situation of the banks has become worse, the assurance for the deposits was eliminated by the government and the orders for the machinery and equipment dropped down to the level of 1987. In addition, the ratings of the leading insurance companies decreased in Japan. But the improvement of the variety of economical indicators was already observed in Japan by the end of the second quarter of the year. So, according to the summary of the second quarter of 2002, 0.6% growth of GDP and 5.7% growth of the export were fixed. The economical indicators began to deteriorate again at the end of the third quarter. Main stock index dropped to 19-year minimum in September 4 in Japan.

Despite some upward inclinations of the principal stock indexes in the second quarter they started to fall down from the beginning of the third quarter.

The demand for the government loans rose significantly as the shares went down. This allowed the profitability of the government loans to drop.

In spite of the influence of information that the oil reserves of America had increased and the demand had decreased during the period, the price of oil in the world market was characterized as appreciating. The price of oil for a barrel already exceeded 25 USD since March. It already reached 30 USD by the end of September.

The raise in price of gold in the world market was fixed as well. Experts explain this as the result of joining companies - gold producers. Meanwhile 10 biggest corporations of gold producers maintain 40% of the world gold production.

## *2. Dynamics of the money-and-credit indicators*

According to the main directions of the monetary policy, the aims on the inflation rate and the exchange value of manat relative to the convertible foreign currencies were achieved due to the chasing of the amounts of the monetary program parameters.

The monetary base of manat increased by 11.5% constituting 1874 billion manats by January 1, 2003.

The **broad monetary aggregate (M-2)** increased by 15.7% constituting 2032.1 billion manats.

The monetary multiplier characterizing the ability of banking system to create money went up by 3.8%. The reconstruction of the banking system, the development of the banking infrastructure, and especially improvement of the payment system resulted in the positive dynamics of this indicator.

Though the amount of the non-cash increased by 26.8%, the amount of the cash increased only by 13.6% and this resulted in the decrease of the cash in the money supply by 1.6%.

The level of the dollarisation decreased during the report period as well. The share of the savings and deposits with foreign currency in the total savings and broad money supply decreased.

The real amount of the credit investment in the banks increased up to 15% in the year 2002.

The amount of the short-term credits increased by 5.2% and the amount of the long-term credits increased by 10.5% in the year 2002.

86.9% of credits were accrued by banks and 13.1% of these were accrued by other credit organisations.

The percentage of credits had been slightly decreased. So the average percentage of the short-term credits with manat decreased from 19.7% in the beginning of the year to 18.17% by the end of the year and average percentage of the long-term credits with manat decreased from 19.5% to 19.15%. This was related to the radical banking reforms resulted in the expansion of their base of the resources increasing the interest of the customers towards the banks. This was also related to the actions performed by The National Bank to improve money supply in the economy. It is beyond doubt that the reduction of the discount rate for the centralized credits had influenced the dynamics of the credit percentage.

During the period the savings were one of the main sources of the credits as well. The savings of the natural persons increased by 31.1% constituting 767.3 billion USD. The private banks share 41.5% of the savings in the banks.

During the year the amount of the Short-Term State Loans decreased by 26.5% or 50.6 billion manats constituting 140 billion manats (7.5% of monetary base) by January 1, 2003. The average profitness of STSL fell down to the 12.57% by the end of the year from 15.94% in the beginning of the year.

### *3. Improvement of the monetary management*

**The institutional improvement of the monetary management.** For the successful fulfillment of the duties of the monetary policy the institutional improvement of the monetary management should also be considered.

Much was done to form a perfect research base - one of the most important elements of the monetary management mechanism. Especially complex actions performed to establish the monetary development models. As a result, a modern econometric apparatus of the macroeconomic researchs had been created and a wide implementation of the mathematical-economical methods maintained. The equilibrium models of the inflation and money market have been created and began to be used in the practical implementation of the monetary policy. It allowed to create the long-term economical forecasts by the use of the established models.

The system was created to monitor and analyze the processes in the international markets, as well as the inclination of growth in the world economy under the conditions of globalisation of the world economy. This establishes a favorable condition for the study of the influence channels of the world economy to the national economy, as well as macroeconomic aspects of the republics' integration to the global economy.

Variety of researches has been performed to create the modeled criterions and variants for the choice of the appropriate tools of the monetary regulation corresponding to the economical situation according to the inclinations of the development of the financial markets. Moreover, the base of the information processing and processing the forecasts of the short- and

long-term monetary indicators were created and brought to the world standards in the monetary research and forecast sphere.

The important actions were performed for the establishment of the complete information database to guarantee an effective monetary management. The statistical database on processes in the economy of the world, as well as the CIS region and the country was enriched. Works within the frame of the project of the Automated Bank Statistical Accounts Systems completed. Besides, several documents as the procedure rules, methodical fundamentals were prepared within the boundaries of the creation of the normative-methodological base for the collection, processing and transmitting of the statistical information.

**The tools of the monetary policy.** The National Bank has regulated the money market by participating at the credit auctions, securities and money market, as well as by the obligatory reserve norms during the report period as well.

The National Bank performed the refinance of the commercial banks on the ground of auctions upon the centralized credits as well.

By the decision of the Management Committee of the National Bank the discount rate of the centralized credits was lowered from 10% to 7% since September 16, 2002, with the aim of the implementation of the 5<sup>th</sup> item of the decree of the President of the Azerbaijan Republic number 783 “About additional measures in the sphere of the governmental protection on the development of the **proprietary** in the Azerbaijan Republic” dated September 10, 2002.

**The obligatory reserve norms both for manat as well as currency were 10% during 2002. The implementation of practice to join obligatory reserve norms with correspondent accounts began. The National Bank decided to drop to the zero level the obligatory reserve norms upon long-term deposits of banks from the January 1, 2003.**

**The actions for the realization of the strategy to set the open market operations as a main means of monetary policy also proceeded during 2002. The participation of the National Bank in the market of the STSL (short-term state loans) aimed to regulate the short-term liquidity in the banking system. The National Bank performed the REPO and the reverse REPO operations depending on the liquidity of the banking system.**

#### *4. Currency market and monetary policy*

**Exchange rate policy.** The alteration of the exchange rate of the national currency at the regime of floating rates proceeded during the year 2002 as well. During the period the exchange rate of manat against USD changed by 2.5% or 118 manats and to the end of the year 1USD was equal to 4893 manats.

Though as an indicator of the international competition ability of the Azerbaijan economy the monthly average nominal exchange rate of manat against USD in December 2002 decreased by 2.5% in comparison to December 2001, its real change index was only 2.1%. This shows the improvement of the international competition ability of the Azerbaijan during the year 2002.

**Situation of the currency market.** The gross amount of the internal currency market increased by 484.6 million USD or 24.5% constituting 2.5 billion USD in the year 2002.

The National Bank maintained balance in the currency market by the regulation of the demand and supply, and had the influence on exchange rate of manat. During the report period the sales of the National Bank were 375.6 million USD, purchases were 440.3 million USD in the internal currency market. The National Bank’s exact interference to the currency market was amounted to 64.7 million USD (2.6%) and was purchase oriented.

**Currency reserves.** Though approximately 110 million USD were paid for foreign liabilities and for the financing of Baku-Tbilisi-Ceyhan project during the report period, the amount of the official currency reserves retained as forecasted and was 681.7 million USD by the end of the report period. It means the relative growth at the amount of 80 million USD.