

Summary on the implementation of the monetary policy on results of 2007

1. Macro economical situation and global economic processes

National Bank held policy supporting protection of currency and financial stability, as well as realization of budget-investing policy within 2007. Wide range of economical processes within the country and abroad effected to the obligations fulfillment of monetary policy.

Macroeconomic situation. Development in leaps, beginning a few years ago continued in current year. Economical growth during 2007 was 25 %, as well as in oil sector 36.8%, and in non-oil sector 11.3%. Within the period, it was possible to achieve increase of industrial production for 24%, agricultural production 4%, investing in construction 14.9%, transport of goods 14.9%, and communication services 27%, goods turnover 15.3%, paid services 33.8%.

One of the important conditions for a country with market economy role of **private sector** in economy is being increased. During January-September of 2007 more than 80 % of GDP, as well as 77.4% of industrial production, agricultural production entirely, investing in solid capital 51.6%, transport of goods 67.9% fell to the share of non-governmental sector.

Inflation during the year of 2007 caused by such factors as traditional factors, communal sector held in the frame of structure reforms and several imported food products (sugar, wheat etc.), and rise of prices in world market.

Inflation rate in January-December of 2007 stand for 16.7% related to the same period of the previous year. Within the period rise in the prices of goods was 16.2%, nonfoods 10.5% and services 25.3%.

Recently, positive tendencies occurred in **foreign trade balance** of Azerbaijan continued gradually. Record in oil price in the world market and dynamic development in non-oil sector resulted in improvement of country foreign balance. Foreign trade turnover stand for 10461.3 million USD in January-November 2007. The share of export in total amount was 5461.6 USD and import 4999.7 USD.

Improvement in **social status of the population** was ongoing. So average monthly salary reached 214 AZN and its growth rate stood for 42%.

Inclinations in world financial and food markets. Processes in the economies of leading countries reflected financial market indicators.

Within the period, it has been occurred USD rate reduction related to main currencies of the world. Therefore, USD exchange rate decreased 11.7% relate to EURO, 7.3% relate to RUR, 8.4% relate to CHF, 3.4% relate to GBP, 4% relate to KZT, 19% relate to TRY, and 5.1% relate to JPY.

We have to mention that within the period it was decided to reduce Federal Stock System rate from 5.25% to 4.25%, and increase Europe Central Bank main interest rate from 3.5% to 4%.

Main **fund indexes** rate increased within the reporting period. Therefore, *Dow Johns index* reflecting average price of more than 30 large-scale financial

companies was 7.8%. *NASDAQ* index calculating in the basis of shares of 100 large-scale high-technology companies was 9.9%, *FTSE Euro top 100 index*, calculating in the basis of stock prices of 100 large-scale companies of Europe was 2.2%, average stock price of 100 large-scale companies sold at an German Fund Exchange auction- *DAX index* increased for 22.4%, but *Nikkei Index*, calculating in the basis of 225 large-scale companies stock prices auctioned in Tokyo Fund Exchange decreased by 10.4%.

The **average price of Brent oil** in the world market constituted 72.9 USD during the nine months of 2007, which was more than 31% (55.6 USD) that of the nine months of 2007.

Within the year **gold** continued increase in price. As well as, the price of gold unit stands for 606.9 USD in beginning of the year, but by the end of December, this figure increased by 38.4% (or 233.3 USD) and was 840.2 USD.

2. Monetary policy

Institutional development of monetary management. In relation with high economical growth, in circumstances of increase money demand within 2007, National Bank defined such goals as protection of currency stability, meet needs of the economy to money, as well as protection of stability in banking-financial system.

According to experience, the most important priority of the National Bank is to prevent negative influence of highly increased oil incomes to currency stock markets, financial system and to the national currency. Taking into consideration such point, within the period National Bank protected **manat's stability**, sterilizing surplus part of oil incomes in currency stock market, same as previous year.

Within the mentioned period nominal effective rate of manat characterized its average exchange, decreased in comparison with the main trade partner countries' currencies. As well as, 2.2% for general trade turnover, for import 1.9%, and export 2.3%, in September of 2007, relate to December 2006. Manat's real effective rate in September of 2007 (including oil sector) increased 5.1% for general trade turnover, 4% for import and 5.8% export, compared to December of 2006.

Within the mentioned period, nominal effective rate of manat characterized its average exchange, decreased in comparison with the main trade partner countries' currencies. As well as, 5.1% for general trade turnover, for import 4%, and export 5.8%, in December of 2007, relate to December 2006. Nominal effective exchange rate on non-oil sector within this period stood for 4.3% for general trade turnover, and 4.4% for export and import weighted.

Real effective rate of manat (including oil sector) increase by 6.8% by general trade turnover, import and export weighted in December 2007, compared to the same month of previous year. Change of nominal foreign exchange rates effected real effective exchange rate on general trade turnover by 52% and on 48%

on price hesitation (including oil sector). Change of the nominal foreign exchange rate has a reducing effect, but change of prices has an increasing effect.

The real effective exchange rate on the gross trade turnover of the non-oil sector increased by 5.4 %, whereas the export influenced rate increased by 5.9% and the import influenced rate by 2.7% in September, 2007.

Effective exchange rate indexes are more expedient for estimation of competition ability within long-term period. From this point, it will be advisable to draw attention to the dynamics of effective exchange rate indexes from December 2000.

The real effective exchange rate on the gross trade turnover of the oil sector decreased by 4.9%, whereas the export influenced rate decreased by 3.4% and the import influenced rate by 6.8% during December 2007. The real effective exchange rate on non-oil sector depreciated. Excluding, oil sector real effective exchange rate depreciation was 10.9% relate to gross trade turnover, 8.6% import influenced rate, 22.2% export influenced rate.

Within the long-term period, depreciation in the amount of real effective exchange rate is related with increase of inflation rate in main trade partner countries relate to Azerbaijan. Therefore, within the long-term period (2000-2007) manat's real effective exchange rate cheapened, and this fact proofs that conditions for of foreign trade with main trade partners are suitable.

Scope of the currency reserves under the disposal of the National Bank increased by 2 times or 2048 million USD as compared to the beginning of year (1967,3 million USD) and constituted 4015.3 million USD by the end of the nine months of 2007.

Within the passed period of 2007, in the condition of high acceleration of economic growth, increase of **money demand** was ongoing. By the end of December broad money supply (M2) increased by 4405 AZN million. From the beginning of the year money supply indicator monetization coefficient of non-oil economy reached 13.2 %.

It has been observed approach of indicators characterized money-creating ability of banking system. As well as money, multiplier increased by 2.2% and reached 1.37 compared to the same period of the previous year. Speedy development of banking infrastructure in our country and especially implementation of advanced payment systems, enlargement of electron interbank operations, expansion of plastic card circulation, installation of Pos terminals serve as additional stimuli for increase of money-creating ability of banking system. Specific weight of cash money, in broad money supply, stood for 61.6% during last year.

High macroeconomical dynamics and rapid development of the banking system actualized highlighting of thr development of the **financial stability**. Monetary and exchange rate policy of the National Bank directed to rate stability, rendered assistance for defense of financial stability in our country. With the purpose of strengthening of financial stability, the National Bank conducted determined measures for systematic capitalization, improvement of administrative management systems.

Consequently, within 2007 increasing money supply in our economy changed into house holding and corporate sector and these means rapidly transformed to

investments in non-oil sector. Quality of bank assets increased, banks have had adequate capital for risks, capacity for fulfillment of clients demands in time and entirely.

Monetary policy tools. *In the aim of achieving defined the NBA used such tools as open market operations, interest rates, as well as obligatory reserve norms.*

NBA continued to use its short-term notes for sterilization of money stock having inflation potential. Within reporting period the NBA has held 52 auctions on localization of notes. Emission's total figure constituted for 2650 million AZN and sum of placed notes constituted for 1920 million AZN. (72.5% of total emission volume) Within reporting period middle sized profit of the NBA on short-term notes depreciated. So that, in the first

auction held in starting period, middle-sized profit rate stood for 12.33%, but in the last auction constituted for 10,56%.

Volume of circulated market on notes was 167.7 million AZN, or 2.1 times more compared with the same period of 2006. Volume of REPO operations within the reporting period stood for 2440,8 million AZN, for ensuring banks` liquid funds, fulfillment of obligations execution upon correspondent banks in time.

The total volume of operations on non-REPO (daily) stood for 37,5 million. AZN, within the reporting period. Taking into consideration definitely development of the economy, in the aim of conducting more severe monetary policy, the NBA double increased refinancing rate, the main indicator of the percentage corridor from 9,5% to 13%.

The other parameters of the percentage corridor of non-REPO rate defined as 19% and REPO rate 5% and have not been changed from April 2, 2007.

3. Financial markets

Credit investments. The volume of loaning by the end of September 2007 increased by 97.4% compared to the same period of the previous year and its specific weight in GDP (upon non-oil sector GDP) has been increased by 46% and constituted for 4323.1 AZN million.

Volume of new credits stood for 6709.3 AZN million in 2007, and this figure is 2 times more than last year. Sum of new credits within last year considerably exceeded the amount of credit payments. As a result, of this fact net increase of loaning was 2301.9 AZN million and therefore remnant sum of loaning increased by 4664.6 AZN million by 01.01.2008, against 2362.7 AZN million by 01.01.2007.

The share of credits by banks was 97.6%, and credits by non-bank organisations 2.4% by the end of analyzing period. Within last year, credit investment by banks was 98%, by non-banks 71.6%.

As a result of recently implemented economical reforms, role of private sector in our economy is increasing and this fact follows with increasing of private banks share in the structure of credit investing. Furthermore, share of private banks in credit investing upon the end of 2007 stood for 54.9%. Besides that,

amount of credits to private sector increased by 86.9% within last year and stood for 4007.5 AZN million by 01.01.2008 and its specific weight in credit investing stood for 85.9%.

Within the analyzed period, growth rate of credit investments upon all types of economic subjects to the economy was high.

Credit investments to non-profit juridical persons increased by 94% related to the same period of the previous year and its specific weight in total credit investment was 64.5%. During last year amount of credits harnessed to industry increased by 60% and stood for 308 AZN million and credits to trade and service increased by 84.4% and stood for 1193.9 AZN million, credits to agriculture and processing increased by 44.1% and stood for 196.6 AZN million, credits to transport and communication sectors increased by 2.2 times and stood for 469.6 AZN million.

Credits for individuals increased by 2.1 times and stood for 1605.5 million AZN, 3.4% of this sum falls to the share of credits on *plastic card operations*. Rapidly growth of credits to individuals can be explained with rise of income level of the population, as well as increase of credit service varieties proposed by banks. Recently, starting mortgage loans mechanism served as additional stimulus for increase of credits to individuals.

Strengthening of manat rate related to other currencies and real results of denomination influences currency structure of loaning. In December of 2007, credits in foreign currencies increased by 81.4%, compared to the same period of last year. However, increase of credits in manat is 2.1 times. Consequently, specific weight of credits in national currency for total sum exceeded 4.1 percentage barrier %. Specific weight of credits in foreign currency constituted for 46.4% in January 1, 2007. 35.4% of short-term credits and 52.3% of long-term credits is in foreign currency.

In spite of increase of short-term credit investing by 43.5% on the end of December 2007, compared to the same period of the previous year, long-term credits increased by 2.5 times. As a result of this fact specific weight of long-term credits in the structure of credit investing increased by 13.2% within the period and stood for 64.9% in 01.01.2008.

Results of done measures in the direction of social-economic development have an effect on regional structure of credit investment. Enlargement of credit network on regions enlarges opportunities of economic subjects for getting credits in regions. Enlargement of credit organizations on regions, enlarges opportunity of economic subjects operating in regions. On the end of December 2007, 84.9% of credit investment falls to the share of Baku city and 15.1% to the share of other regions.

In December 2007, average interest rates upon credits with national currency increased by 0.47% related to the same month of the previous year and stood for 16.97% in 01.01.08. Average interest rates of credits with manat, on juridical persons increased by 0.24% related to the same period of the previous year and stood for 15.13%, on individuals this figure stood for 20.29 % increasing by 0.19%. Average interest rates on credits with foreign currencies were same as previous year and constituted for 16.26% decreasing by 0.91%. Within this period

average interest rates for juridical persons with foreign currencies decreased from 14.81% by 13.72% in December of the previous year, within the reporting period, interest rates for individuals decreased from 21.82% to 21.70%.

Deposit market. Volume of deposits and savings in 2007 increased by 58% and reached 3400 AZN million compared to the previous period of the year.

Increase of **individuals' deposits** was ongoing. As well as, deposits of individuals increased by 79.2% and constituted for 1468.4 AZN million. By the end of reporting period 65.4% of derived deposits falls to the share of private banks.

We have to note that besides resident individuals, number of deposit investments by **non-resident individuals** is increasing rapidly. However, by the end of September deposits of non-resident individuals increased by 2.6 times compared to the same period of the previous year.

Analysis of the structure of deposits upon currencies validates increase of confidence of economic subjects to manat. So that, in comparison with the same period of previous year, house holdings' deposits in foreign currency increased by 39.2%, however **deposits with manat** increased by 2.7 times. This factor improves structure of money supply and creates suitable conditions for strengthening of the role of manat in economic circulation.

Interbank money market. During reporting period agreements signed in manat and USD, in Organized Interbank Credit Markets. Total volume of agreements in manat stood for 35,8 AZN million. Average interest rate on signed agreements stood for 15,1%. Within the mentioned period total volume of agreements signed in USD stood for 25,8 USD million and average interest rate was 13,1%. Interval of credits was 3-450 days.

During January-September of 2007, total volume of interbank repository operations with securities of our government according to "bank-bank" scheme stood for 253,8 AZN million. Average income on interbank repository operations was 8,1%. Interval of operations was 1-7 days.

State short term securities market. The Ministry of Finance conducted 48 auctions on replacement of state short-term securities, during 2007. Volume of announced issues was 269 AZN million, and volume of replaced issues was 167 AZN million. Average income in first auction was 10,02% and in last auction this figure constituted for 10,49%. Volume of recurrent market on securities stood for 30,7 AZN million.

Consequently, within 2007 monetary policy conducted by the National Bank, have an positive influence on provision of money demands of our economy, protection of rate and financial stability.